INTERNATIONAL MARKETING: EMERGING MARKETS

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VOLUME 21

INTERNATIONAL MARKETING: EMERGING MARKETS

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INTERNATIONAL MARKETING AND EMERGING MARKETS: AN INTRODUCTION TO THE AIM VOLUME 21

The global financial and economic crises have accelerated the rise of emerging markets in the global economy. In fact, the BRICs (i.e., Brazil, Russia, India, and China) have become the engine of global economic growth in the past two years when the developed economies were struggling to regain their growth. China became the largest exporter in the world in 2009 and has just overtaken Japan in mid-2010 to become the second largest economy in the world. India has made huge stride in attracting MNCs' investment and is poised to become the main destination of business process outsourcing. Brazil has regained its confidence as the largest economy in South America and as a major economy in the world. After struggling in the face of oil price collapse in 2008, Russia is back on track with robust growth, thanks to the rebound of oil price. Even outside the BRICs, many developing economies are doing very well. For example, Turkey, Vietnam, Indonesia, Thailand, Argentina, and several African countries have seen their growth rates surpassing 5% per year for several years. There seems to be a fast shift of global economic power to the developing world, especially to the BRICs.

The shift of global economic power to the emerging markets has presented a number of fundamental challenges to managers of multinational corporations (MNCs), as well as to the academic researchers in international marketing. With the fast emergence of the middle-market segments across the emerging markets, the traditional competitive advantages of MNCs may not offer them much when it comes to serving the fast expanding middle-market segments' demand in the emerging markets. MNCs' traditional competitive advantages include the state-of-the-art technology, the highest product quality, the latest product design features, the dominant global brand names, and premium prices for their products and services. Such skills and capabilities allowed the MNCs to enter and dominate the upper market segments across the developing world in past few decades. Indeed, MNCs are still enjoying the premium upper market segments in the developing world today.

Yet, the traditional competitive advantages of MNCs may not be readily applicable to serving the middle-market segments' need in the emerging markets. Owing to their fast rising but still modest disposable income, middle-market consumers are increasing demanding high-quality products and services at affordable prices. They cannot afford to buy products or services that are of highest quality and that have leading-edge product features and designs. But they do want the products and services that are of much better quality than those offered to lower market segments by local firms. Unless MNCs can figure out a way to revamp their business model to bring down the costs substantially while maintaining product quality, they risk losing out in the competition to serve the middle market segments in the emerging markets. In some industries, some local competitors already seized the opportunity to become successful in serving the middle market segments in Brazil, India, and China. This has created a major challenge to MNCs when they seek new growth opportunities.

The explosive growth of the middle-market segments across the emerging markets is not an opportunity that MNCs can simply ignore. If and when this trends continues in the emerging markets, the middle-market segments will become the largest market in the world both in number of consumers and perhaps in total purchasing power in the next decade or two. If it fails to figure out quickly how to revamp its business model to meet the middle-market segments' demand and preferences, a world-class MNC today may become a minor player in the global market in the future. No responsible managers of MNCs can afford to let this happen. Yet, the tasks of figuring out a new business model that is suitable to serving the middle-market segments are by no means easy. There simply is not much knowledge of how to do it. MNCs managers are used to emphasize the leading technology, highest quality, dominant global brands, and premium prices. After all, that is what they did well to advance to the current management positions. To undo what they have been trained for and made successful is simply not natural for MNC managers. To meet the challenge, MNC managers badly need better knowledge about the emerging market consumers and businesses.

To academic researchers in international marketing, understanding consumers, and businesses in the emerging markets is equally challenging. Owing to the significant differences in cultures, political and legal environments, and economic environments, existing theories about firm's internationalization, branding building in the global market, and strategies for conquering the markets are simply not readily applicable to explain the consumer and business behaviors in the emerging markets. For example, when firms from emerging markets enter the global markets, they face well-entrenched MNCs in almost all major industries that have better technology, higher product quality, dominant brands, and greater financial resources. The gradual learning approach to internationalization that is theorized in the current literature can hardly explain the internationalization of emerging market firms. Similarly, building a global brand based on leading technology and product quality and heavy investment in marketing may not be a feasible strategy for emerging market firms to adopt or follow.

Thus, new theories and new research must be developed in order to understand and explain the middle-market segment consumers' behaviors and emerging market firms' strategy. This is a tremendous opportunity for international marketing researchers to make ground-breaking contributions to the literature. There are so many emerging issues in the emerging markets that need to be researched and that need new theories to explain. For example, the following issues are intriguing to many international marketing researchers: How do consumers in middle-market segments behave? What are they unique preferences? How do they respond to various marketing stimuli? How do firms' from emerging markets enter the global markets? How can they develop their global brands in the case of entrenched global brands of MNCs? What determines the export performance of firms from the developing world? How does retailing sector evolve in India, China, and Brazil?

Responding to the urgent needs of the management and the academics to understand the emerging market consumers and businesses, we have developed this special volume of *Advances in International Marketing* (AIM) to tackle some of the issues identified above. The papers published in this volume are contributed by a large number of academics from around the world. Initially, the Consortium for International Marketing Research (CIMaR) and the University of International Business and Economics (UIBE)'s Business School organized a joint conference in Beijing in late 2009 that was focused specifically on the international marketing in emerging markets and by firms from emerging markets. Dozens of papers were submitted to the conference and went through a rigorous review process. From the submissions, 15 papers were selected and went through a revision process. The 12 successful chapters are now selected for publication in this special volume of AIM.

The 12 chapters in this volume focus on a wide variety of issues about the emerging market consumers and businesses from a wide selection of countries/regions such as China, India, Brazil, Malaysia, Hong Kong, and Africa. Collectively, they shed significant new insight into the consumer and business behaviors in the emerging markets and laid a solid foundation for further theory development about the important issues in international marketing in emerging markets. We are very excited about the publication of these chapters. We believe that readers will be well informed by them and that they will spur a lot of exciting future research on issues that are so important to both MNCs and firms from emerging markets.

Shaoming Zou
Huifen Fu
Editors

AWAKENING DRAGONS: AN EXPLORATION OF THE INTERNATIONALISATION OF CHINESE SMES FROM THE ELECTRONICS SECTOR

Sharon Loane and Jim Bell

ABSTRACT

As part of their growth strategy, many firms choose to expand internationally. Such expansion is an especially important decision for small- and medium-sized enterprises (SMEs). These SMEs are vital to China's economy and have grown in importance since the reform and opening-up, measured in terms of size, number, financial status, or profitability. In addition, the Chinese electronics sector plays an important role in the economy. This inquiry explores the internationalisation behaviour of 50 Chinese electronics SMEs. The findings are presented and implications drawn for future research, along with those for policy makers and practitioners.

Keywords: Internationalisation; Chinese electronics industry; small and medium enterprises (SMEs).

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INTRODUCTION

Recent literature on international new ventures (INVs) and 'born global' firms has recognised the inherent complexity of operating in an increasingly global business environment and points to factors that facilitate rapid internationalisation. Most notable are the emergence of new communication and process technologies, increased trade liberalisation, regional economic integration, and the growth of international networks (Knight & Cavusgil, 1996; Knight, 2000; Petersen, Pedersen, & Sharma, 2001). As the face of the world changes, firms both large and small must also face change in their business environment, and many choose to expand their geographic scope from domestic to foreign markets. Traditionally, small- and medium-sized enterprises (SMEs) restricted their activities to the region of their location, or stayed within their national boundaries (Pleitner, 1997). Today many are active in one or two world regions and are therefore international or regional players. International expansion is an especially important decision for SMEs, which traditionally have a small financial base, a domestic focus, and a limited geographic scope (Barringer & Greening, 1998).

SMEs make substantial contributions to national economies (Poon & Swatman, 1999) and are estimated to account for 80% of global economic growth (Jutla, Bodorik, & Dhaliqal, 2002). SMEs have been playing a progressively more important role in international business since the beginning of the past decade (Bell, 1995; Oviatt & McDougall, 1994). By the late 1990s, about a quarter of SMEs around the world derived a major portion of their revenues from foreign countries (Oviatt & Mc Dougall, 1997).

Since China's economic reform and accession to the World Trade Organisation, nowhere is change among firms, particularly SMEs, more apparent. China's integration with the global economy has contributed to sustained growth in international trade. Both its exports and imports have grown faster than world trade for more than 20 years. As China's trade with the rest of the world has deepened, its composition and geographical pattern have also shifted. Its overall share of exports to industrial economies has increased and become more diversified (Rumbaugh & Blancher, 2004). Where 15 years ago China was primarily an exporter of low-tech products such as apparel, toys and footwear, today it has become the world's largest exporter of electronics (OECD, 2005). The country's electronics production grew at a remarkable rate of 24.8% between 1992 and 2005. As a result, its share of world electronics production has risen from 1.9% in 1992 to 18.4% in 2005. With a value of production of US$260.1 billion, it has surpassed that of the European Union and Japan, lagging just behind the electronics production value of the United States (Van Assche & Gangnes, 2007). China's emerging system of capitalism has its own special institutional and cultural characteristics (Boisot & Child, 1996; Child & Tse, 2001), which raises the possibility that an examination of Chinese internationalisation may indicate the need for some extension of existing theory (Child & Rodrigues, 2005).

This inquiry explores the internationalisation of 50 electronics SMEs drawn from five sectors: audio/visual electronics, medical electronics, small household appliances and white goods, automotive electronics and measurement meter electronics. The following sections present a synthesis of the literature, the research focus and the methodological approach. Finally, the findings are presented and discussed.

SYNTHESIS OF THE LITERATURE

Internationalisation Stimuli

The recent literature on INVs and 'born global' firms, while recognising the inherent complexity of operating in an increasingly global business environment, points to factors that facilitate rapid internationalisation. Most notable are the emergence of new communication and process technologies, increased trade liberalisation, regional economic integration and the growth of international networks (Knight & Cavusgil, 1996; Knight, 2000; Petersen et al., 2001).

The pivotal role of key decision-makers within firms has also been widely recognised in the extant export behaviour and firm internationalisation literature (Reid, 1983; Miesenbock, 1988; Aaby & Slater, 1989; Leonidou & Katiskeas, 1996; Zou & Stan, 1998). Indeed, there is widespread agreement that subjective characteristics (such as attitudes, perceptions and personality) and objective characteristics (such as knowledge, experience and networks) influence decision-makers' views of the risks involved in entering new export markets.

Whereas entrepreneurs are influential change agents with regard to internationalisation, and actually make the decision to go international, there are also several factors involved. Katsikeas and Piercy (1993) categorized motives into several broad areas: decision-maker characteristics, firm-specific factors, environmental factors, firm characteristics and ongoing export motives. Crick and Chaudhry (1997) distinguished between internal and external stimuli to classify factors into two categories: internal change agent and external change agent. They suggested that the internal change agent – either the entrepreneur (owner/manager) or the senior management team – is the most important factor, because of having the final say as to whether or not the company will commit to international activity. Katsikeas and Piercy (1993) have provided a useful classification of internal firm-specific factors found in previous studies to motivate firms to export: differential firm strengths (Cavusgil & Nevin, 1981; Cavusgil, Bilkey, & Tesar, 1979; Wiedersheim-Paul, Olson, & Welch, 1978); accumulated unsold inventory (Johnston & Czinkota, 1982; Sullivan & Bauerschmidt, 1988); economies resulting from additional orders (Kaynak & Kothari, 1984; Sullivan & Bauerschmidt, 1988) and available production capacity (Diamantopoulos, Schlegelmilch, & Allpress, 1990; Johnston & Czinkota, 1982; Wiedersheim-Paul et al., 1978).

With regard to 'external change agents', Simmonds and Smith (1968) suggest that it is important whether or not the first order was unsolicited. However, Simpson and Kujawa (1974) claim that although an unsolicited order may be significant, it alone is not sufficient for export initiation, and they suggest that other factors also affect exporting behaviour. For example, Wiedersheim-Paul et al. (1978) state that some other factors can have a positive effect on export behaviour, such as receipt of fortuitous orders and the effect of government including chambers of commerce, industrial associations, banks, government agencies and other firms. Johanson and Vahlne (1977) also identified the economic climate and trading conditions in the domestic market, internal market size and the location and proximity of the firm to export markets as important.

Exporting stimuli can also be classified according to their proactive/reactive nature (Johnston & Czinkota, 1982; Piercy, 1981). Proactive stimuli are the 'pull factors' that compel firms to exploit their unique internal competences (Leonidou, 1995); reactive stimuli are 'push factors' that explain the firm's export engagement as a response to external environmental pressures (Johnston & Czinkota, 1982). Boisot (2004, p. 6) argues that Chinese firms may be different in conflicting with extant internationalisation theories, stating that 'many Chinese firms will not be moving abroad to exploit a competitive advantage that was developed in the domestic market, but to avoid a number of competitive disadvantages incurred by operating exclusively in the domestic market'. Indeed, a range of disadvantageous domestic conditions exist that offset and limit the opportunities normally offered by a large domestic market (Boisot, 2004: Child & Rodrigues, 2005). These include regional protectionism, limited access to capital that prevents investment in plants of optimal scale, lack of developed intellectual property rights that limits access to state-of-the-art technologies, under-provision of training and education that limits access to skilled human resources, poor local infrastructure that increases transport costs and regional markets that are fragmented by provincial and municipal protectionism. Moreover, electronics and white goods SMEs face strong competition from many leading international brands. Such competition combined with overcapacity has driven down profit margins. Therefore, it may be the case for Chinese SMEs working in the electronics sector that manufacturing for foreign markets becomes more attractive.

SME Internationalisation

Internationalisation has been depicted as a gradual and incremental process, which assumes a time span. Owing to rapid globalisation, the time span has shrunk significantly. Thus, SMEs often become 'instant internationals' (Oviatt & McDougall, 1997). Following a significant breakthrough, entrepreneurs often develop a global focus from the beginning to obtain first mover advantages and to exploit new processes or new technologies immediately (Bell, McNaughton, & Young, 2001). Oviatt and Mc Dougall (1997) explain that INVs must internationalise from their inception or shortly thereafter in order to survive, as they face high start-up costs, a small domestic market and short product life cycles. Furthermore, international competition, particularly in knowledge-intensive industries, is so high that new companies internationalise instantly or do so shortly after establishment, typically within two to five years (Oviatt & McDougall, 1994; Bell et al., 2001).

Market selection does not always depend on geography; instead, many companies operate in very specialised 'niches' where the home market is too small. The ability to serve niche markets is often due to a major innovation in terms of either a product or a process (Bell, McNaughton, Young, & Crick, 2003). The firm gains a competitive advantage that enables it to offer value-added products (McKinsey & Co. 1993). It has even been observed that some SMEs, especially knowledge-intensive firms, ignore the home market completely and go on lead markets immediately after establishment or go on the home market and international markets at the same time (Bell, 1995). Bell (1995) further observes that SMEs would enter international markets by following their domestic clients, rather than considering the psychic proximity of the market.

In fast-changing environments such as that experienced by Chinese SMEs, the 'learning advantages of newness', or how quickly firms learn to adapt, can often play a pivotal role, in comparison to a firm having acquired prior knowledge (McDougall, Shane, & Oviatt, 1994; Autio, Sapienza, & Almeida, 2000). Indeed, in older firms, routines and practices may be well established, resulting in high levels of organisational inertia (Hannan & Freeman, 1988). Quick learning in international environments can eventually lead to faster firm growth (Autio et al., 2000), suggesting that high-technology SMEs that internationalise at a young age can achieve higher growth rates than those that internationalise later (Lu, 2002).

Barriers to Internationalisation

As Rhee (2002, p. 51) points out, 'The generalisation about the internationalisation patterns derived from the literature on SMEs may be inappropriate when applied to new ventures'. Therefore, it is important to understand the barriers perceived by SMEs under internationalisation, particularly as such barriers can exist at any stage in the process. As Morgan (1997) comments, barriers to exporting are treated in the literature as attitudinal, structural, operational and related constraints that hinder or prohibit a firm's ability to initiate, expand or sustain export operations (Leonidou, 1995). Export barriers can be encountered by the firm at any stage of internationalisation, from pre-export and other initial stages to extensive levels of international involvement (Bilkey & Tesar, 1977; Cavusgil & Nevin, 1981; Czinkota, 1982; Thomas & Araujo, 1985). Although firms at differing stages of development may face similar export challenges, the exact nature of the barriers encountered tends to differ between each stage (Bilkey, 1978; Czinkota & Ricks, 1981; Ford & Leonidou, 1991; Pavord & Bogart, 1975). For example, gathering market intelligence and processing export documentation are more problematic for early-stage exporters. Conversely, more established exporters may face greater challenges controlling distribution channels or establishing alternate market entry modes (Bell, 1994).

Numerous studies have investigated the barriers to internationalisation for exporters in general (e.g. Leonidou, 1995; Campbell, 1996; Katsikeas & Morgan, 1994; Morgan, 1997). However, much less attention has been paid to the perception of barriers to internationalisation by smaller, more entrepreneurial firms. It may be presupposed that, due to their inherent resource constraints, smaller firms may be more severely affected by potential export/internationalisation barriers than their larger counterparts. In addition, small Internet-enabled firms undergoing rapid internationalisation in particular may suffer from many of the internationalisation barriers consecutively, identified in the most recent studies on small entrepreneurial firms. Considering the importance of rapidly internationalising SMEs to national economies such as China and the limited knowledge of internationalisation barriers to INVs, as Shaw and Darroch (2003, p. 5) comment, 'this is a notable gap in the literature'. In general, the five main barriers to internationalisation for small exporters are limited financial resources, the high costs of selling abroad, lack of government assistance/incentives to export, limited access to capital, and limited knowledge of foreign market opportunities (Shaw & Darroch, 2003; Buckley, 1989; Coviello & McAuley, 1999; Ward, 1993; Burpitt & Rondinelli, 2000).

It is important to note that, as Bell (1994) states, exporters are far from a homogeneous group. Therefore, it is not realistic for critics of the export literature to expect that inquiries conducted among a diverse range of firms within various industries across different countries should reach identical conclusions regarding the nature of export problems. Finally, although methodological inconsistencies have undoubtedly contributed to diverse findings in past research, the problems of the individual, Internet-enabled small firm are likely to be influenced by the unique circumstances pertaining to that firm. Thus, internal resources and constraints, industry or sector-specific conditions, prior export experience and domestic and target market conditions will all contribute to the precise nature and intensity of export problems (Bell, 1994).

Entry Modes

Whereas the previous section dealt with the barriers facing INVs in international activity, this section gives an overview of the entry modes available to such firms in foreign markets. An entry mode is an institutional arrangement a firm uses to market its product in a foreign market in the initial years (Root, 1994). The selection of an appropriate entry mode in a foreign market has a significant and far-reaching impact on a firm's performance and development (Terpstra & Sarathy, 1994). SMEs deciding to enter and service international markets face a plethora of choices, each with varying degrees of cost, risk and control. The simplest form of entry strategy is exporting from the home country using either a direct method, such as an agent, or an indirect method, such as counter-trade. More complex forms including truly global operations located in the foreign market may involve strategic alliances, joint ventures or wholly owned foreign subsidiaries. Each of these may be differentiated according to three characteristics of the modes identified in previous research (Maignan & Lukas, 1997; Woodcock, Beamish, & Makino, 1994).

The various entry modes available to an SME display wide differences in terms of resource commitment, the degree of control and the degree of risk involved. Resource commitments are the dedicated assets that are unavailable for other uses without incurring costs. Resources may be intangible in nature, such as management skills, or tangible, such as machinery. The degree of resource commitment varies widely with the entry mode, from virtually none with indirect exporting, to minimal training costs in licensing, to extensive investments in wholly owned subsidiaries (Osland, Taylor, & Zou, 2001). Therefore, selecting the most appropriate entry mode is a long-term strategic decision of the utmost importance for a small, rapidly internationalising firm (Agarwal & Ramaswami, 1992). Recent developments in the study of small-firm internationalisation indicate that entry modes are viewed more as firm-specific ways of doing business rather than just methods to access international markets (Bell, Crick, & Young, 1998; Jones, 1999, 2001). Indeed, some small firms combine entry modes in early internationalisation even though they struggle with limited resources (Jones, 2001).

A resource-based perspective can also be used to explain the way in which smaller firms carry out export activities. Owing to the lack of a broad resource base, small firms may be able to compensate through the focused use of a narrow but critical set of skills (Wolff & Pett, 2000). Entrepreneurs (and firms) can acquire strategically relevant information for internationalisation by pursuing cooperative activities and using other external information sources over time (Katsikeas, 1994), such as networks. For some SMEs, export activities are generally based on unsolicited orders (Moen, 2002). Furthermore, as Buckley (1989) argued, some smaller firms may be 'pushed' into exporting due to a small or declining domestic market, increased competition from a dominant large competitor, the entry of a large number of firms offering similar products or services in the domestic market, or a combination of these factors (Moen, 1999).

Market Selection

Another of the key decisions in the internationalisation of a firm is the selection of the 'right' country markets (Andersen & Strandskov, 1998). The international market selection literature confirms the importance of using market size and level of economic development for identifying potential opportunities (Cavusgil, 1984; Young, Hamill, Wheeler, & Davies, 1989; Papadopoulos & Jansen, 1994; Daniels & Radebaugh, 1998).

Sakarya, Eckman, and Hyllegard (2007) propose four criteria for selecting markets: long-term market potential, cultural distance, competitive strength of the industry and customer receptiveness. Furthermore, some studies integrate product-specific market size and growth, availability and cost of production factors, level of economic development (Russow & Okoroafo, 1996), country environmental factors, psychic distance, market-based factors, competition, information and market knowledge (Whitelock & Jobber, 2004) as sets of criteria for market selection.

Market selection is constrained by two interrelated key concepts: psychic distance and experiential learning (Johanson & Vahlne, 1977; Kogut & Singh, 1988; Fina & Rugman, 1996). Consequently, SMEs tend to select foreign markets that exhibit similar economic, cultural and political systems. It is assumed that the firm could make a rational choice based on cost information and analysis. Thus, the need for market intelligence is crucial when selecting foreign markets. Indeed, the network approach to internationalisation views the information gleaned from firm interactions as guiding the market selection process (Cunningham, 1986). The nature of the market opportunity, the firm's resources and the managerial philosophy affect internationalisation and market selection may result from an evaluation of factors such as market attractiveness, psychic distance, accessibility and informal barriers (Root, 1987; Turnbull & Ellwood, 1986). Because SMEs lack resources and experience, they may not have the capability to gain enough information or process it correctly. Lindqvist (1997) suggests that they rely heavily on networks at the initial stages of expansion into foreign markets. Such networks facilitate internationalisation through collaboration with internal and external network partners. Some small firms enter foreign markets as subcontractors. According to Westhead, Wright, and Ucbasaran (2002), many subcontracting exporting firms do not actively select their foreign markets; rather, the decision is made by the partner firm, 'pulling' them into international markets.

According to Coveillo and Munro (1997), a firm's first international decision is often made through networks to a psychically close market, but later market choices are less influenced by networks or distance. Indeed, Czinkota and Ursic (1987) and Hamill and Gregory (1997) suggest that in market selection, networks combined with new communication technology will reduce psychic distance. Nevertheless, good network relationships still make an important contribution to reducing export barriers, including geographical distance and cultural factors. This is particularly true in high-tech SMES that operate in narrow niches, as technological competency is somewhat independent of cultural differences. However, this may create new barriers as technology levels differ between countries.

METHODOLOGY

This inquiry considers 'rapid internationalisers' as 'those firms that exhibit an innate propensity to engage in a meaningful level of international business activity at or near inception with the intent of achieving strategic competitive advantage' (Oviatt & McDougall, 1994). It adopts the definition put forward by Shrader, McDougall, & Oviatt (2000) that includes firms with an export ratio of at least 25% within six years of formation.

The definition of an SME in China is quite complex and can include relatively large firms, at least by Western standards. The definition used for regulatory purposes (and thus for the collection of statistics on SME exports) in China depends on the industry category and is defined in terms of employees, sales, and assets. For example, an industrial SME is defined as having up to 2,000 employees, while a small business has fewer than 300, leaving a medium-sized business with between 301 and 2,000 employees. However, for this inquiry the criteria used in sample selection was that participating firms should have fewer than 1,000 employees. Independent firms, rather than subsidiaries, were also selected to preclude any influence of a parent company on international decision making. In addition, firms were required to have established websites with both English and Chinese versions.

A multi-stage, multi-method approach was adopted (Loane, Bell, & McNaughton, 2006), with an emphasis on qualitative perspectives. This choice reflects the trend away from survey methodologies and towards more qualitative and/or mixed methods in recent small-firm internationalisation inquiry (Coviello & McAuley, 1999; Coviello & Jones, 2004; Marschan-Piekkari & Welch, 2004). In the first of five stages, a judgmental sample of 500 Chinese firms (100 firms for each of the five electronic industry sectors) was constructed from secondary sources, such as the Chinese Industry Annual Report, export directories, market reports on the electronics industry and government statistics. Of these firms, 157 met the sample selection criteria. In stage 2, Internet searches were used to gather information on the focal firms. By the end of stage 2, approximately half of the information required for this inquiry was gathered.

In the third stage, after further research using information from their 'Home Page', 70 firms were screened out due to a lack of information on their internationalisation activity. In the fourth stage, each of the remaining firms was asked to complete an internationalisation template that was e-mailed to them, after permission was sought by telephone. The respondents corroborated the information already gathered, and addressed specific highlighted information gaps, thus improving the quality and reliability of

Table 1. Sample Filters and Process.

Electronics Sector	Step 1: Online Screen	Step 2: Screen by Criterions	Step 3: Website Screen	Step 4: E-Mail Survey	Step 5: In-Depth Telephone Interviews
Small household appliances and white goods	100	32	15	9	3
Medical electronics	100	28	14	8	2
Measurement meter electronics	100	35	16	9	2
Automotive electronics	100	26	13	8	2
Audio and visual electronics	100	36	12	7	3
$N=$	500	157	70	41	12

the information and statistics already obtained. This approach was also beneficial in gathering additional statistical information on the SMEs' international activity (Loane & Bell, 2006). A total of 41 completed replies were received (Table 1), resulting in a 60% response rate. In the final stage, 12 in-depth telephone interviews were undertaken with key decision makers, typically the CEO (Table 1). The responses allowed descriptive statistics to be raised, and the data gathered were analysed using thematic content analysis. The findings are presented in the following section.

FINDINGS

Table 2 presents a profile of the responding firms. The results of this inquiry indicate that half of the respondents were in Guangdong province in the southeast coastal area of China, an area regarded as one of China's economic powerhouses. Most notably, it is where almost all the audio/visual electronics firms are located. Furthermore, with regard to the medical electronics companies, it should be noted that apart from the 30% based in Guangdong and 10% in neighbouring Fujian, the remaining 60% are located in the coastal developed areas of China (30% in Beijing, 10% in Shanghai, 10% in Zhejiang and 10% in Jiangsu). This geographical division is not surprising, as the coastal developed area is an ideal location for exporting firms, and its population, compared with Western China, is more highly educated.

Table 2. Profile of Responding Firms by Electronics Sector.

	Small Household Appliance and White Goods	Medical Electronics	Measurement Meter Electronics	Audio and Visual Electronics	Automotive Electronics	Overall
Location	$n=10$	$n=10$	$n=10$	$n=10$	$n=10$	$n=50$
Beijing	–	30.0%	–	–	–	6.0%
ChongQing	–	–	10.0%	–	10.0%	4.0%
Fujian	10.0%	10.0%	10.0%	–	–	6.0%
GuangDong	50.0%	30.0%	30.0%	90.0%	50.0%	50.0%
Jiangsu	10.0%	10.0%	–	10.0%	–	6.0%
Jiangxi	–	–	–	–	10.0%	2.0%
Shandong	–	–	10.0%	–	–	2.0%
Shanghai	10.0%	10.0%	20.0%	–	–	8.0%
Zhejiang	20.0%	10.0%	20.0%	–	30.0%	16.0%
Ownership						
Privately owned	80.0%	30.0%	80.0%	100.0%	90.0%	76.0%
State owned	–	30.0%	10.0%	–	10.0%	10.0%
Other(joint stock, joint venture)	20.0%	40.0%	10.0%	–	–	14.0%
Firm age	$n=10$	$n=10$	$n=10$	$n=10$	$n=9$	$n=49$
0–6 years	10.0%	10.0%	30.0%	30.0%	44.4%	24.5%
7–10 years	20.0%	30.0%	10.0%	50.0%	44.4%	30.6%
11–15 years	30.0%	30.0%	30.0%	10.0%	11.1%	22.4%
15+ years	40.0%	30.0%	30.0%	10.0%	–	22.4%
Firm size (no. of staff)						
0–150	–	30.0%	30.0%	30.0%	70.0%	32.0%
151–300	20.0%	10.0%	50.0%	50.0%	–	26.0%
301–500	40.0%	60.0%	20.0%	20.0%	20.0%	32.0%
>501	40.0%	–	–	–	10.0%	10.0%

Three-quarters of the investigated firms are privately owned. Indeed, private ownership dominates all sectors except medical electronics. This is not surprising; traditionally, most medical equipment manufacturers were state founded, though there is now evidence of other forms of ownership (30% are privately owned, 30% are state-owned and 40% are joint ventures or joint stockholders). As anticipated, the firms are relatively young (the mean age is 11.5 years old), with more than half (55.1%) being under 11 years old. It should be noted that the average age of audio/visual electronics firms is 8.7 years and the mean age of automotive electronics firms is 5.9 years. The firms are also small in size, using employee numbers as a measure. The preponderance of them employs fewer than 500 people. However, it is important to note that this differs by sector, as the firms engaged in the household appliance and white goods sector tended to be larger, with 40% employing more than 500.

Given the focus of this inquiry, it is not surprising that the firms investigated for this study are active in international markets. Indeed, approximately two-thirds (65%) had exported to foreign markets within six years of their inception, making them rapid internationalisers. This was especially so for those in audio/visual (90%) and automotive (88.9%) electronics. However, it is interesting to note that among these case firms, 22% of the white goods and domestic appliance electronics firms internationalised after 10 years. Again, not surprisingly, given the inclusion criteria, the firms have relatively high export ratios, signalling a high dependence on international activity. In fact, almost 40% of them have export ratios of 51–80%.

Decision Makers' Educational Background

The educational backgrounds of decision makers play an important role in SME internationalisation. Some authors posit that long-term international success depends on firms having an international orientation or global strategic presence (GSP) (Barkema & Vermeulen, 1998; Barlett & Ghosal, 1989; Barney, 2002). Key decision makers are widely regarded as the 'drivers' and the single most important factor in achieving this international orientation (Aaby & Slater, 1989; Cavusgil, 1984; Chetty & Hamilton, 1993; Miesenbock, 1988; Reid, 1983; Zou & Stan, 1998). Indeed, it is argued that they are responsible for influencing both the firm's strategic orientation (Miles & Snow, 1978) and the patterns and pace of internationalisation, showing a correlation that the higher the technological level of the product, the higher the educational level of the key decision makers. Table 3 shows that 63% of all the decision makers in this inquiry were well educated ('high education' refers to a third-level degree). Moreover, 12% of the respondents had studied abroad (Table 3). Thus, all the decision markers in this inquiry are highly educated, with the educational levels of the medical electronics firms being highest. Interestingly, it should be noted that 10% of those considered as highly educated achieved doctoral degrees in the United States.

Table 3. Product Properties.

	Small Household Appliance and White Goods ($n=10$)	Medical Electronics ($n=10$)	Measurement Meter Electronics ($n=10$)	Audio and Visual Electronics ($n=10$)	Automotive Electronics ($n=10$)	Overall ($n=50$)
Product technological level						
Low	60.0%	40.0%	60.0%	30.0%	10.0%	40.0%
Medium	40.0%	30.0%	–	50.0%	40.0%	32.0%
High	–	30.0%	40.0%	20.0%	50.0%	28.0%
Brand recognition (domestic)						
Low	60.0%	0.0%	60.0%	40.0%	90.0%	50.0%
Medium	10.0%	40.0%	0.0%	60.0%	10.0%	24.0%
High	30.0%	60.0%	40.0%	0.0%	0.0%	26.0%
Brand recognition (external)						
Low	80.0%	70.0%	100.0%	80.0%	100.0%	86.0%
Medium	20.0%	30.0%	–	20.0%	–	14.0%
High	–	–	–	–	–	–
Competitive advantages						
Price	100.0%	50.0%	100.0%	80.0%	70.0%	80.0%
Quality	40.0%	50.0%	30.0%	20.0%	10.0%	30.0%
Technology	20.0%	30.0%	40.0%	30.0%	40.0%	32.0%
Service	–	20.0%	–	30.0%	–	10.0%

Motives and Triggers to Internationalisation

Internationalisation motives varied among the investigated Chinese electronics SMEs. Each of the firms reported at least four motives for their internationalisation. Therefore, when trying to understand the patterns hidden behind these descriptions, the methodology adopted was that of calculating the proportion of firms who chose the listed motive from among all of the responding SMEs. The bulk of the firms (60%) were motivated by profit, followed by brand building as the motivating factor (42%), particularly for those engaged in automotive electronics (50%). The third major motivator was government support (24%); this is unusual, as government support will often facilitate internationalisation in the West but rarely actually drives it. Other important motives included: management adaptation (18%), domestic competition (13%), company expansion (7%) and product uniqueness (2%). In particular, 10% of the automotive electronics SMEs indicated that their product uniqueness gave rise to opportunities to expand into foreign markets.

Market Spread and Market Entry Mode

Advanced country imports from China have risen over the past two decades, with particularly sharp increases since the early 1990s in Japan, the United States, and the European Union (Rumbaugh & Blancher, 2004). In addition, China's role in Asian regional trade has become increasingly important. The investigated case firms in this inquiry provide evidence for these trends. Indeed, almost all the case firms displayed evidence of wide market spread coupled with rapid internationalisation, serving a total of 217 international markets. From Fig. 1, it is apparent that these Chinese electronics firms are targeting certain regions, including Asia (60%), Europe (56%) and the United States (46%). For example, 70% of the Chinese measurement meter SMEs internationalise to Asian countries such as Bangladesh, Pakistan and Kirghizia. This may be explained by China's geographic proximity to Asian countries, which may help decrease the barriers to learning about and understanding the new foreign environment (Sakarya et al., 2007). In addition, this phenomenon may be explained in part by the fact that these markets may lag behind the markets for the technology these firms offer (Fig. 1). However, it must be noted that there are some interesting differences by sector. For example, for the medical electronics firms, Africa was the second most popular region (60%), with South Africa, Nigeria and Egypt being the most popular countries on that continent.

Internationalisation activities and the consequent drain on already scarce resources in a small firm increase both risk levels and uncertainty. Therefore, the choice of the 'correct' or appropriate mode of internationalisation or market entry is strategically important. Without exception, the case firms were using a low-cost market entry mode, direct exporting. However, there was some evidence of more involved entry modes among a minority of the larger firms, as they had established sales offices in lead markets.

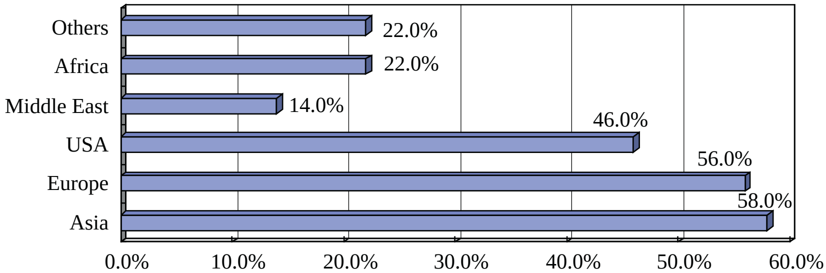

Fig. 1. Markets Served by Case Firms. *Note:* Multiple responses by case firms.

Export Growth Rates

China's increasing integration with the global economy has contributed to sustained growth in international trade. Both its exports and imports have grown faster than world trade for more than 20 years (IMF, 2004). This trend continues into the present, with exports of electronic and information products at about $202 billion from January to May 2008, up 24.1% year-on-year (*China Daily*, 2008). The export growth rate for the investigated SMEs is extraordinarily high, as almost three-quarters of them (across the sectors) reported export growth between 11% and 50% year-on-year. In addition, a small minority (7%) of the firms grew their exports in excess of 80% year-on-year.

Technology, Brand and Competitive Advantage

In an attempt to explain the high export growth levels presented above, the SMEs' representatives were asked to respond to a series of questions on their perceived technology levels, brand recognition and sources of competitive advantage with regard to internationalisation. A number of recent studies have used trade data to show that China has become more sophisticated than one would expect, given its level of development (Van Assche & Gangnes, 2007). Rodrik (2006) and Hausmann, Hwang, and Rodrik (2007) have come up with a methodology to assess a country's position on the technology ladder by analyzing the composition of its export bundle. Findings indicated that the bundle of goods (including electronics) that China exports are similar in sophistication to exports of countries with income levels three times higher. Rodrik (2006) concluded, 'China has somehow managed to latch on to advanced, high-productivity products that one would not normally expect a poor, labour-abundant country to produce, let alone export'.

With regard to the case firms (Table 4), 60% of the product offerings may be considered as either medium or high value-added technology, leaving 40% to be considered as low value-added technology offerings. However, this is not consistent across the electronic sectors. For example, about two-thirds (60%) of the medical electronics are medium or high-tech. Three-quarters of the audio/visual electronics (70%) and, interestingly, almost all (90%) of the automotive electronics fall into these categories. The small household appliance electronic products are relatively lower

Table 4. Benefits of Internationalisation.

	Small Household Appliance and White Goods	Medical Electronics	Measurement Meter Electronics	Audio and Visual Electronics	Automotive Electronics	Overall
Influence to domestic market	$n=5$	$n=6$	$n=4$	$n=9$	$n=9$	$n=33$
Brand	60.0%	66.7%	25.0%	44.4%	33.3%	45.4%
Sales	–	33.3%	25.0%	55.6%	66.7%	42.4%
Brand and sales	40.0%	–	50.0%	–	–	12.1%
Change in company	$n=9$	$n=9$	$n=6$	$n=5$	$n=8$	$n=37$
Product quality	33.3%	66.7%	66.7%	40.0%	50.0%	51.4%
Management	33.3%	33.3%	16.7%	60.0%	50.0%	37.8%
Technology	0.00%	–	66.7%	40.0%	50.0%	27.0%
Others	33.3%	–	16.7%	0.00%	0.00%	10.8%

Note: Others – from indirect export to direct export, staff education level, company size.

technologically than the other four sectors, which may help to explain their ‘slower’ internationalisation.

The inquiry next explored the SMEs’ market status at home and abroad. Generally speaking, brand recognition abroad is much lower than in the domestic market for all five Chinese electronics industries. The preponderance of firms (86%) have low brand recognition in foreign markets, compared to only 50% in the domestic market. A total of 26% of the firms (30% for small household appliances; 60% for medical electronics; 40% for measurement meter electronics) have high brand recognition in the domestic market, but it bottoms to zero in their foreign market. This means that Chinese electronics SMEs still have a long way to go in terms of brand building.

Finally, the SMEs were asked to state their perceived main source of competitive advantage. Across all five sectors, the firms considered price as most important (Table 3). This was not surprising, since the Chinese electronics sector retains a competitive advantage for a variety of reasons, including lower production costs. However, it is important to note the differences by sector, as some medical electronics firms (20%) and audio/visual electronics firms (30%) indicated superior service as one source of their competitive advantage. In addition, there is a growing recognition that both the technology offering (30%) and quality (30%) are important.

Internationalisation Benefits and Barriers

International activity has the potential to bring about positive changes for SMEs (Lu & Beamish, 2002), as evidenced by these Chinese electronics SMEs (Table 4). Some firms indicated a 'halo effect' in the domestic market as a result of internationalisation, most likely because electronics for export from China have to meet stringent product specifications. However, more than half of the firms indicated no effects in the domestic market from international sales. Not surprisingly, almost half of the SMEs (42%) reported increased sales, with the small household appliances and white goods being the exception. The major benefit reported by these firms was increased brand recognition, which was important to approximately half of them.

In investigating how internationalisation changed the firm's organisational structure, responses typically fell into three categories: product quality, company management and technology improvements. It would appear that the most important change, reported by half of the firms, was improvements in product quality as a result of their international activities. This was often because the electronics had to meet specific requirements in the export markets, like those required by the EU with regard to electronics manufacture and assembly.

However, change was not confined to the firms' offerings. They also reported changes in their organisations as a result of internationalisation. For example, they adopted new management systems. Moreover, 33.3% of the small household appliance SMEs changed from indirect to direct exporting (they employed export agents at the beginning of internationalisation).

Initial Export Barriers

The literature suggests that SME managers' perceived barriers to exporting are responsible for a reluctance to commit to international activities (Ali & Swiercz, 1991; Bilkey, 1978; Kaynak & Kothari, 1984; Rabino, 1980; Simpson & Kujawa, 1974). Among such barriers are a perceived lack of cultural familiarity, operational and administrative complexity, lack of staff and managerial time, perceptions of a large domestic market and the need for product adaption. It is also well recognised that insufficient access to capital and local corruption saps Chinese SMEs' dynamism (Story & The China Advisory Council, 2010). The interviews revealed a number of interesting perspectives on export barriers among these rapidly internationalising Chinese electronics SMEs at inception, which are presented here.

Table 5. Export Barriers.

	Small Household Appliance and White Goods	Medical Electronics	Measurement Meter Electronics	Audio and Visual Electronics	Automotive Electronics
Export problems at initial	$n=7$	$n=8$	$n=10$	$n=10$	$n=8$
Brand recognition	28.6%	25.0%	–	–	–
Trade barrier	28.6%	25.0%	10.0%	30.0%	25.0%
Lack knowledge of target market	42.8%	–	–	10.0%	12.5%
Lack knowledge of risk aversion	57.1%	–	–	–	–
Technical innovation	28.6%	–	30.0%	20.0%	37.5%
Different consumers and standards	–	50.0%	–	–	–
Start-up cost	–	–	80.0%	50.0%	25.0%
Management adaptation	–	–	50.0%	10.0%	12.5%
Current export problems	$n=8$	$n=8$	$n=10$	$n=10$	$n=8$
Currency fluctuation	50.0%	62.5%	50.0%	20.0%	12.5%
Increasing cost	25.0%	–	–	20.0%	25.0%
Government policy	37.5%	–	–	–	–
Price transparency	12.5%	–	–	–	–
Technical innovation	12.5%	–	–	–	–
Different consumers and standard	25.0%	37.5%	80.0%	30.0%	25.0%
Securing payment	–	50.0%	50.0%	10.0%	37.5%
Brand recognition	–	–	–	20.0%	12.5%
Servicing foreign market	–	–	–	10.0%	
Trade barrier	–	–	–	20.0%	
Patent problem	–	–	–	10.0%	12.5%

It should come as no surprise that the highest single barrier cited at inception was a lack of start-up finance (Table 5). The costs associated with start-up were considered prohibitive, with 35% of the firms experiencing difficulty in this area. This was followed by difficulties with technology and innovation (23%), as well as those presented by trade barriers (23%).

There were some differences across the five sectors, as the main export problem for small household appliance and white goods SMEs is a lack of knowledge about target markets (43%) and managerial perceptual barriers (57%). The situation is somewhat different for medical electronics, as half of these firms (50%) encountered differing consumer product standards. Although differing standards are without doubt problematic, these firms did not report any other barriers at inception, possibly because product technology levels are comparatively high in medical electronics. Start-up costs present the most severe initial problem for meter measurement electronics (80%), audio/visual electronics (50%) and automotive electronics (25%). Interestingly, no firm reported having any difficulty with permission to export or with any form of corruption.

Ongoing Export Barriers

The nature and severity of export barriers changes with increased exposure to international activity. Obviously, greater exposure and multiple markets increase risks and therefore the degree to which operational export barriers may affect a firm. For example, 39% of the case firms experienced difficulty with currency issues. Undoubtedly, the appreciation of the RMB has had an impact on Chinese exports, as product costs are indirectly raised. The problem of different consumer standards (41%), followed by securing payment (30%) were also ongoing export problems. Moreover, there are sector-specific differences with regard to such export problems, inasmuch as 38% of the small household appliance and white goods SMEs encounter problems with government policy. For example, the recent decrease of the export tax refund rate in China has caused difficulties. Price transparency (13%) means foreign customers are more aware of the product price than before, so the export profit margin is rather limited. As may be seen in Table 5, the audio/visual electronics (10%) and the automotive sectors (13%) have problems with product patents.

Sources of Assistance and Their Efficacy

Inevitably, as highlighted above, SMEs can encounter problems during internationalisation and may need to avail themselves of assistance programmes. For these investigated firms, the top three sources of assistance were local banks (24%), CCPIT, CEIF and trade unions (30%) and trade exhibitions and shows (33%). These sources help Chinese electronics SMEs keep abreast of market trends, increase sales volume, elevate their brand reputation, and engender some form of financial stability. Notwithstanding, the Chinese electronics firms actually get little help from government export development programmes.

The Future of Internationalisation for Chinese Electronic SMEs

Finally, this inquiry explored the firms' future plans in terms of anticipated target markets, entry modes and brand-building activities. Of the 50 firms interviewed, 22 of them (44% – six small household appliance and white goods, three medical electronics, three measurement meter electronics, six audio/visual electronics and four automotive electronics firms) indicated that they anticipated future international expansion. The remaining firms did not report any future plans to increase their market spread. Interestingly, with regard to their target markets, the firms indicated that they anticipated chasing further market share in existing international markets as opposed to new foreign market entry. This was broken down as follows: USA (45%), Europe (36%) and Asia (32%) (Table 6).

However, 14 of the firms noted that they hope to open offices in the future in their overseas markets. Surprisingly, one company aimed to use a wholly owned subsidiary as the potential market entry mode. This company already has a good brand reputation in China and has already opened a European office. Branding, then, is important for company expansion, especially for the international electronics markets. Although low brand recognition is a general problem for Chinese companies in international markets, this inquiry revealed that 15 companies (68%) have their brand-building plan

Table 6. Future International Expansion Plans.

Sample Size (Overall)		$n = 22$
Target markets	USA	10 (45.4%)
	Europe	8 (36.4%)
	Asia	7 (31.8%)
	Others	3 (13.6%)
Entry mode	Export	14 (63.6%)
	Subsidiary	1 (4.5%)
Brand building	Own brand	15 (68.2%)
	OEM	3 (13.6%)

drawn up and are already operationalising such plans. Only three of the interviewed companies will continue to depend on OEM.

DISCUSSION

The inquiry presented here contributes to the existing literature in several ways. First, more than half of the investigated firms began to internationalise within six years of their inception. Approximately 22% of small appliances and white goods SMEs exported in 0–6 years, and 22% of these firms exported to their first market in just over 10 years after foundation. The small appliances and white goods industry export growth rate is 25%. In contrast, nine out of ten firms from the automotive electronics sector internationalised within three years of their foundation, with a 52% export growth rate. Therefore, although the electronics firms may be termed rapid internationalisers, there are differences by sector, with the automotive sector appearing to internationalise extremely rapidly. Because China has entered into the WTO, the conditions now exist for 'born global' internationalisation with associated high speed export growth rates, often before having established a solid domestic market.

With regard to entry modes, it is apparent that SMEs predominantly choose 'direct exporting' and may not consider alternative modes of foreign market entry. The reason may be that SMEs with limited information and narrower managerial expertise bases may not actively consider alternative modes of foreign market entry. Therefore, direct export as a strategy is easier and safer to implement, providing quick and flexible access to a foreign market. Low-cost market entry modes, such as exporting, are important for Chinese electronics SMEs. However, it must be borne in mind that in China it may well be difficult for SMEs to access the requisite finance to fund more involved market entry modes at present.

This inquiry confirms that organisations in general prefer to enter markets that rank high in attractiveness and low in market risk and where they can enjoy a competitive advantage. This is of much more concern to some firms than geographic distance. According to the findings, these firms currently export to countries and regions including the United States, Australia, South Africa, Europe, Asia, Middle East, Bangladesh, Pakistan, Kirghizia, Cuba, Russia and India. SMEs always suffer from a lack of resources and experience, and Asia has become the top main export target for these firms (58%). More than half the investigated firms go there for the geographic advantage and low cultural distance; however, it must be recognised that

Asian countries may be lead markets for some products, and that there are less trade barriers within the ASEAN region.

Notwithstanding, Africa is the second main internationalisation market for Chinese medical electronics, with 60% of the firms active there. Emerging markets (EMs) are among the world's fastest expanding markets, fuelling explosive growth in global trade (Garten, 1996). Africa as an EM was chosen by 22% of the investigated firms. The choice or ability to respond to opportunities in an EM can determine international growth and success (Alexander & Myers, 2000; Arnold & Quelch, 1998; Dawson, 2001). EMs offer potential product development and international sourcing opportunities to the Chinese firms (Liu & McGoldrick, 1996). Interestingly, some sampled firms chose Bangladesh, Australia, Pakistan, Kirghizia, Cuba and Russia as main export countries, where they likely operate in narrow market niches, reducing the psychic distance and forcing them to seek partners worldwide.

The top three initial barriers for the five electronics sectors are start-up costs (34.8%), technical innovation (23.3%), and trade barriers (23.3%). That is, 58% of the firms' initial problems centre around start-up costs (this figure includes technical innovation problems and lack of finance for R&D), and 18% for documentation problems (including barriers). These figures support the finding by Tesar and Tarelton (1982) that initiating issues involve export documentation and start-up costs. These start-up costs are almost crippling for some Chinese SMEs, as the immature capital markets are unused to lending to the private sector. SMEs still lack access to the resources lavished on larger state-owned firms, according to investment statistics. During the first three quarters of 2001, private sector investment was US$ 30.7 billion, up 7.9% year-on-year, while public sector investment was US$ 191.7 billion, up 18.2%. Widespread wariness by both borrowers and lenders of the higher risks accompanying private projects is a key cause of the slower growth in private sector investment. However, the most remarkable aspect of China's SMEs is their rapid growth despite their inability to tap the official financial system. Two factors predict even faster development in the near future. First is their suitability for the post-WTO accession economy; SMEs in China will continue to thrive as more responsive partners of foreign companies rather than large state firms. Second, they will have the opportunity to move into market segments once dominated by state firms.

Currency fluctuations are also problematic, as these SMEs rely heavily on export activity (41%). Indeed, as the yuan moves against major international currencies, Chinese electronics firms, particularly those with low value-added technology offerings, may lose some of their price competitiveness in the international arena. In addition, these SMEs face differing specification and administrative barriers with regard to exporting, since they may not have the human resources or management capability to deal with these adequately. However, this is a double-edged sword, as such factors may pull up the SMEs' capabilities and improve product/service quality, enhancing long-term competitiveness.

Undoubtedly, price provides the basis for competitive advantage with regard to SMEs' internationalisation in all the five sectors. Both small household appliances and white goods and measurement-meter electronics are totally reliant on price as their competitive advantage. This provides a complement to the existing literature on the competitive advantage approach developed by Porter (1985). Having a low-cost position yields the firm above-average returns in its industry despite the presence of strong competitive forces. For these firms, a low-cost position protects them to a degree against rivalry from competitors, because lower costs mean that they can still earn returns after their competitors have competed away their profits through rivalry (Porter, 1980). Cheap labour, land and government incentive policies are reasons for Chinese enterprises to maintain the price advantage. However, Chinese SMEs need to learn the lessons from others who were in a similar situation some years ago, as price competitiveness is now under threat in the face of higher world commodity prices, increasingly skilled labour will demand higher wages, and so on.

IMPLICATIONS AND FUTURE RESEARCH

With regard to government support, it must be noted that these firms consider government agencies as providing limited human, managerial, financial and information support. Policy makers should focus their efforts on building platforms for enterprise start-up and incubation, integrating SMEs' financing mechanisms, enhancing their information technology capabilities, strengthening their management guidance programs and building an environment conducive to their development. The Chinese government clearly has the economic strength to financially support SME programmes. The People's Bank of China announced that China's foreign exchange reserve reached US$1.066 trillion at the end of 2006, according to the Ministry of Commerce of the People's Republic of China (January 16, 2007). The Chinese financial market does not function well; it is extremely limited and has restrictions or difficulties surrounding access for SMEs' finance.

Many of the investigated SMEs were generally weak in brand competitiveness and had relatively low technology levels. Indeed, some firms enter international markets as 'OEMs'; hence, the majority of brands in China today are no more than well-known names, lacking the key attributes of a real brand (Ying, 2006). Creating distinctive brands is an effective way to avoid homogenisation of competition; it also gives the company a sustainable competitive advantage that improves its image and cultivates consumer loyalty. Furthermore, although the SMEs' production expanded quickly, they mainly focused on the low-technology market where growth was limited. With the diminishment of the traditional comparative advantage in cheap labour, on which China relied heavily in the past, companies should develop deep niche strategies to retain market share. Because high-tech industries operate in narrow market niches with high technology levels, this might reduce the psychic distance since technological competency is somewhat independent of cultural differences (Moen, Gavlen, & Endresen, 2003). Improving technology has become an important way to enhance competitiveness; thus, it is vital for SMEs to focus on brand strategy and enhance technology offerings.

Much of the literature on SME internationalisation has emanated from advanced economies in the West. Because China's market-oriented economy started late, research literature about SMEs is scarce, although a body of literature is beginning to emerge. This suggests a pressing need for research inquiry to explore and uncover the salient facts with regard to Chinese SMEs undergoing rapid internationalisation, with so little currently known. Because this inquiry investigated only fifty firms, research on a larger scale is recommended, as are longitudinal studies.

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INNOVATION PLATFORMS FOR EMERGING CONSUMERS: SPINNING THE WHEEL OF RETAILING IN LATIN AMERICA

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ABSTRACT

This exploratory study identifies key pillars on which innovative business models rely in the Latin American retail landscape. First, using qualitative research methods, we delve into the minds of Latin America's emerging consumers to uncover their needs and paradigms. In a region where retail innovation has traditionally been targeted at high-income consumers, we find a new breed of retailers that cater to the large mass of emerging consumers. Second, we explore the avenues of innovation retailers have followed to serve this impoverished segment and find that retailers' efforts to innovate have resulted in at least three original retail formats: one centered on providing access to durable goods, another centered on offering a wide assortment of goods and a convenient location, and the last one centered on incorporating design and quality. Based on the wheel of

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retailing theory, we show how these new formats are changing the structure of the retail industry in the region.

Keywords: Innovation; emerging consumers; retailing; Latin America.

The overall function of retail institutions is to ''serve as a system, or facility, for moving merchandise and some services from producers to consumers'' (May, 1989, p. 356). Beginning with McNair (1958), scholars have attempted to understand and, to some extent, predict the evolution of different retail formats. Retail innovation, whether radical or incremental, has been observed mainly in developed countries, where production and distribution systems are firmly established and where consumer trends can be expected to show increasing degrees of sophistication. Empirical observations have fueled the expectation that new formats will stem only from the most advanced retail systems (Cundiff, 1965).

Retail innovation in emerging economies is a topic that has received a relatively small but increasingly expanding share of attention, first as a scenario for the implementation of foreign formats (Goldman, 1981) and later as a potential source of new formats (Prahalad, 2004). Prahalad (2004) has highlighted the efforts of both multinational and local companies to serve the needs of emerging consumers in innovative ways. He concluded that the fragmentation of society in emerging countries, where masses of poor consumers offer a sharp contrast to a few segments of affluent ones, might provide innovative retailers with challenges as well as opportunities.

Our study aims to establish whether and how innovation has translated into effective, sustainable business for Latin American retailers. More specifically, our efforts focus on: understanding particular traits of emerging consumers in Latin America; mapping the most common avenues followed in retail innovation to serve emerging consumers, with an emphasis on format dimensions; identifying the key pillars on which retail business models rely and understanding drivers of innovation success; and establishing whether and how the overall structure of the retail industry has changed in Latin America upon the inception of innovative formats. Our structural approach is based on the well-known wheel of retailing theory.

In order to address these issues, we first delve into that wheel with a special focus on empirical studies. We later set the stage for our research by examining early developments in the Latin American wheel of retailing and by observing the retailing scenario from the point of view of emerging consumers. We present a series of needs and paradigms held by emerging consumers that appear to have triggered a new wave of retail innovation in the region.

Our findings suggest that retail innovation is thriving in Latin America, and that retailers' efforts to innovate have proven fruitful in more than one direction. We have identified three distinctly new retail formats that build on different attributes of the retail experience in such diverse realms as food and beverages, technology, and home decor. Our findings also suggest that these formats have altered the structure of the retail industry in the region. Because they address a consumer segment that has traditionally remained uncared for, they have shaped a completely new area of the retail landscape while contributing to the social integration of many. Given this redefinition of the retail landscape, we draw inferences about the mobility of high- and low-end retail formats to serve consumers of different socioeconomic segments than are currently served. We conclude with a discussion on the transferability of Latin American retail innovation to other emerging and developed economies.

THE WHEEL OF RETAILING REVISITED

Developed by Malcom P. McNair in 1958, the wheel of retailing stands among the most widely discussed hypotheses in retailing literature. It offers one possible explanation for the dynamics of institutional evolution in retailing: that this evolution is contingent on the recurring introduction of innovative retail formats. The business models adopted by successive entrants to the retail landscape are believed to undergo similar evolutionary paths.

The theory proposes that new retail formats tend to enter the market as low-status, low-margin, and low-price options. This focus on the low end is evidenced in such dimensions of the business model as store location, premises, equipment, processes, and services. Because they opt for a "no frills" approach, new formats can often be ridiculed, scorned, or condemned as illegitimate. However, as time goes by they become institutionalized in a particular way. By upgrading one or more dimensions of their business model they evolve into high-status, high-margin, and high-price businesses. This move to the high end is thought to contribute to profitability and to simultaneously create a vulnerability vis-à-vis upcoming formats at the low end (McNair, 1958).

A variety of factors are believed to fuel the turning of the wheel. In connection with retail innovation in emerging economies, the following tentative explanations seem especially relevant (Hollander, 1960):

(a) *A shift in retail personalities* – New retail formats are often established by aggressive, cost-conscious entrepreneurs who have "no interest in unprofitable frills." The entrepreneurs relax their focus on costs as their business grows and trading-up mechanisms ensue. The same may occur to their successors. This shift in management philosophy leads to movement along the wheel.
(b) *Imperfect competition* – Retailers tend to avoid price competition for fear of retaliation by competitors. Service improvements, rather than price cuts, should prove a more effective and less imitable source of differentiation in the marketplace. More service leads to higher margins, and these lead to movement along the wheel.
(c) *Secular (or socioeconomic development) trends* – Improvements in the population's standard of living may foster movement along the wheel. As consumers' budgets increase, so does the degree of sophistication of the retail experiences they require. Retailers thus gain opportunities for trading up. Conversely, as long as the distribution of wealth across socioeconomic segments remains uneven, low-end segments should continue to be attractive for new, innovative retailers.

Regardless of which factor would prove more conducive to movement along the wheel, the initial expectation that the wheel would always revolve in the same way has not proven accurate in practice. Evidence disproving the theory includes retail formats entering the market at the high end and either remaining there or migrating to the low end. This has awakened a heated debate in the retailing literature as to the validity and reliability of the wheel of retailing theory. Scholars have attempted to examine the theory by looking at the evolution of different retail formats in a variety of industries and geographical settings (Hollander, 1960; Goldman, 1975). They have attempted to complement it (Izraeli, 1973; Kaynak, 1979), to compare it with other theories (Brown, 1987), to condemn it (D'Amico, 1983; Savitt, 1984), and to defend it (Sheth, Gardner & Garrett, 1988; Brown, 1990). Consensus seems to hold that the wheel hypothesis applies to a series of retail formats (e.g., supermarkets, department stores, and discount stores) but not to all (e.g., vending machines, boutiques, and high-ticket shopping malls).

Izraeli's (1973) contribution in particular seems valuable in the context of our investigation. Three wheels of retailing, instead of one, are proposed in his model: the first represents innovators entering the market at the low end of the cost-margin continuum; the second represents innovators entering at the high end; and the third wheel represents the established institutions in the middle. Izraeli argued that retailers in these three wheels came to influence each other so that, in time, all of them tended to migrate to the middle, albeit sustaining certain high- or low-end attributes that allow for differentiation.

RESEARCH CONTEXT: EXPLORING THE RETAIL MAP WITH THE WHEEL OF RETAILING

The wheel of retailing theory has provided an interesting tool for mapping the evolution of retail formats in developed economies (Dreesmann, 1968; May, 1989; Savitt, 1989). In recent years, market trends stressing individualization and fragmentation have created significant complexity in retailing, leading to a reduction in customer satisfaction and taking a toll on retailers' profits. Sources of radical innovations, however, have proven hard to come by. In recent years, retailers in developed markets have limited themselves largely to deploying incremental innovations that brought improvements to day-to-day operations (Liebmann, Foscht, & Angerer, 2003) but little substantial change to systems, structures, or business models. Although the advancement of e-tailing may provide new sources of inspiration (Amit & Zott, 2002), the challenge of innovation is still present for bricks-and-mortar formats.

Explorations of the retail map in emerging regions such as Asia, Latin America, and Africa have been less comprehensive. Studies have focused mainly on the diffusion of the U.S. or European formats (Goldman, 1981), following the premise that innovation could take place only in highly developed systems and that a successful adoption of such innovations was directly related to the adopting country's degree of economic development (Cundiff, 1965). Emerging economies show much room for improvement in this respect. Although low-income consumers represent a modest segment in developed economies, they dominate the scene in emerging ones. Emerging countries show staggering differences in the relative size of mid- to low-income segments and in the shape of the socioeconomic pyramid vis-à-vis developed countries, as shown conceptually in Fig. 1. In Latin America, in particular, emerging consumers represent 50–60 percent of the population, but they hold only 10–20 percent of the total purchasing power. Comparatively, high-income consumers represent 10–20 percent of the population, but they concentrate over 50 percent of the total purchasing power (D'Andrea, 2003). These differences create a discontinuity between affluent and nonaffluent segments, fragmenting the market. Such a scenario poses a severe challenge for retailers, since serving a particular socioeconomic segment may require radically different capabilities than

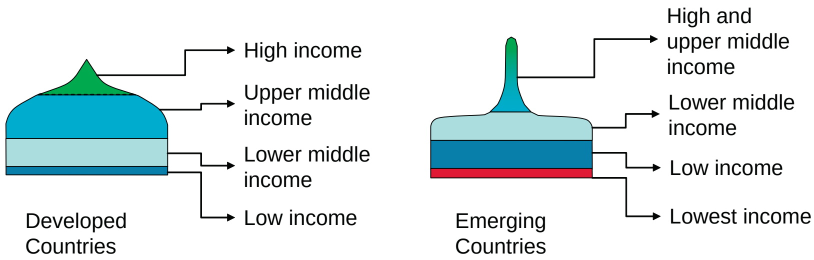

Fig. 1. A Conceptual View of Socioeconomic Pyramids in Developed and Emerging Markets.

serving another. Arguably, retailers in emerging markets may not enjoy as much flexibility to serve a wide array of consumer segments as their counterparts in developed markets. This lower level of flexibility is rooted in barriers that preempt retail formats from migrating significantly between segments and competing with each other.

Initial evidence of a Latin American wheel of retailing can be traced to the 1970s and 1980s with the introduction of foreign formats such as the supermarket and the hypermarket. The adoption of these formats at the low end was intended to improve the retailing system and to reduce the costs of food distribution, thereby increasing consumers' real incomes. This higher level of spending by emerging consumers was expected to "initiate a multiplier effect resulting in expanded production, rising levels of wage payments, and a general economic takeoff" (Goldman, 1981, p. 7). In other words, the movement along the wheel of retailing for these novel formats in Latin America was expected to conform to McNair's prediction, migrating hand-in-hand with social and economic development from the low end to the high end.

However, a different result ensued. Supermarkets and hypermarkets found favor with mid- to high-income consumers in Latin America. The value proposition of these formats was centered on the provision of high-quality products and services at high prices. Other dimensions of their business model such as location in the outskirts of big cities (which would, for example, require a car) and services (e.g., home delivery and extended opening hours) put pressure on costs and margins. By the turn of the millennium, supermarkets, and hypermarkets had become favorites among high-income consumers but received little business from low-income consumers (D'Andrea, Stengel, & Goebel-Krstelj, 2004; D'Andrea, Lopez-Aleman, & Stengel, 2006).

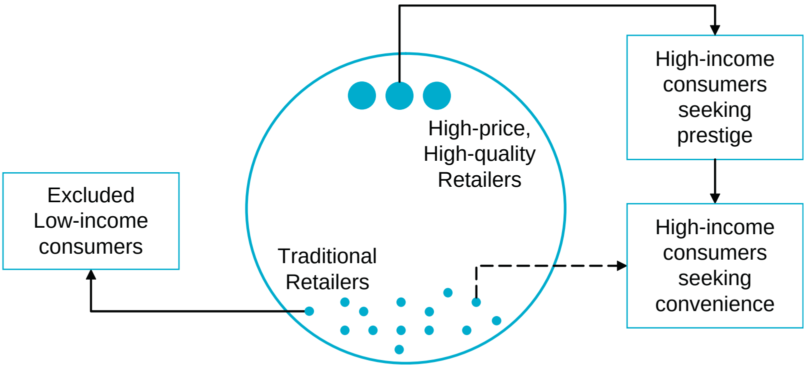

Fig. 2. Early Developments of the Wheel of Retailing in Latin America.

It is our intuition that these developments have contributed to the polarization, over time, of retail formats across socioeconomic segments in Latin America. Emerging consumers remained attached to traditional retailers characterized by small, independent convenience stores that have operated in the region for decades without significant doses of technological or process innovation. These stores became default providers of basic household goods to low-income consumers – mainly, food, and hygiene products – by developing certain attributes these consumers deemed valuable. Among them, emotional proximity to the patrons/owners, a feeling of community, and flexible price–payment arrangements were the most salient. Not surprisingly, these stores have enjoyed anywhere between 45 and 61 percent market share in Latin America, depending on the country (D'Andrea et al., 2004). Still, emerging consumers remained excluded from the market for high-ticket, high-technology durable goods, which came to represent missed opportunities to improve their quality of life. These early developments of the wheel of retailing in Latin America are presented in Fig. 2. The following sections explore how retail innovation in Latin America has created opportunities for excluded segments and, consequently, how the structure of the industry has changed.

METHODOLOGY

A qualitative research study was carried out following a pragmatic approach. Both emerging consumers and innovative retailers were studied in depth. We worked under the premise that innovation is a new idea that stems from a recombination of old ideas, a scheme that challenges the present order, a formula, or a unique approach that is *perceived as new by the individuals involved* (Zaltman, Duncan, & Holbek, 1973; emphasis added). Consumers' perceptions vis-à-vis retailers would therefore play a relevant role in our sample selection.

Initially, more than 200 interviews with consumers at store intercepts were conducted to gather insights on innovation and on potential cases. Subsequently, 14 focus groups with 14 participating consumers each were carried out in Argentina, Brazil, Chile, Colombia, and Mexico. Discussions revolved around the identification of the most innovative retailers in each geographical market. Participants were instructed to consider only providers of common goods (i.e., food/non-food; grocery; home appliances/furniture/home improvement; drug/mass drug; apparel; and personal/beauty care) as well as the benefits they perceived each retailer offered. Focus groups were complemented by approximately 30 interviews with store managers, performed to gather insights on consumers' perspectives on innovation and on key factors in purchasing decisions. We also relied on insights from an expert panel consisting of 15 leading retail executives, five academics with relevant knowledge of retailing, and more than 20 retail field managers and sales managers from consumer goods companies in Argentina, Brazil, Chile, Colombia, Peru, Venezuela, and Mexico.

A preliminary list of 43 retailers emerged. Retailers were screened according to predefined criteria: cases had to be "made in Latin America," explicitly target emerging consumers, have achieved a relevant scale, possess a track record of several years, and project themselves as profitable, growing businesses. Retailers who did not meet all criteria were removed from the list. The final list contained seven retailers: Casas Bahia, Elektra, CMR/Falabella, Locatel, Magazine Luiza, Casa & Ideas, and Surtifruver. Table 1 shows the companies' profiles.

We conducted semi-structured interviews with key executives to understand how these retailers conceptualized innovation and engineered sustainable solutions to deliver that innovation. From this point onwards, a multiple-case approach was used to unearth the fundamentals of successful business models. This methodology permitted a "replication" logic (Yin, 1984) in which the cases were used as experiments to confirm or disconfirm emerging conceptual insights. Research was complemented by public information on selected retailers. From the data collected throughout the entire process, a set of paradigms and needs held by emerging consumers in Latin America was identified. The foundations of innovative retail

Table 1. Company Profiles.

Retailer	Origin	Profile
Casas Bahia	Brazil	Founded in 1956 Brazil's leading household goods retailer. Ranks #138 in Deloitte & Touche's 2007 study "Global Powers of Retailing" Specializes in consumer electronics and furniture *Trademark*: Customer-centric approach: "Total dedication to you" *Number and location of stores*: 560 in 10 states of Southern and Central Brazil *Sales*: USD 4.8 billion (2005–2006 fiscal year) *Employees*: 55,000
Elektra	Mexico	Founded in 1950 Part of Grupo Elektra, one of Mexico's most renowned financial and commercial groups Specializes in consumer electronics, furniture, décor, small vehicles Has recently expanded geographically to Argentina, Brazil, Peru, and Honduras *Trademark*: Company values include "learning, trust, passion, family, and freedom" *Number and location of stores*: close to 800 across Mexico *Sales*: USD 3.5 billion (2007 fiscal year for the entire Grupo Elektra) *Employees*: NA
CMR/ Falabella	Chile	Founded in 1889 Chile's leading department store. Ranks #218 in Deloitte & Touche's 2007 study "Global Powers of Retailing" Specializes in consumer electronics, furniture, décor, apparel Is the biggest card issuer in Chile, with more than three million active cards Has recently expanded geographically to Argentina, Colombia, and Peru *Trademark*: Customer-centric approach: "With you for life" *Number and location of stores*: 33 across Chile *Sales*: USD 2.9 billion (2007 fiscal year) *Employees*: 12,000
Locatel	Venezuela	Founded in 1979 Venezuela's first health-centered supermarket Specializes in over-the-counter and prescription drugs and health related services (medical equipment rental, vaccination, clinical lab, optical lab, nutrition services, self-help books, basic food items, and pet food) *Trademark*: Customer-centric approach: "Not only there in sickness, but also to help maintain health" *Number and location of stores*: 45 across Venezuela, with emphasis in Caracas *Sales*: NA *Employees*: NA
Magazine Luiza	Brazil	Founded in 1957 The third-largest retailer in Brazil Recognized in 2003 as the best company to work for in Brazil by The Great Place to Work Institute Specializes in consumer electronics, furniture, beauty & health products

Table 1. (*Continued*)

Retailer	Origin	Profile
		Trademark: People come first. "Values such as transparency, honesty, respect and courtesy underlie all decisions" *Number and location of stores*: about 350 (among them, 50 virtual stores) across 7 states in Southern Brazil and, more recently, the city of Sao Paulo *Sales*: USD 1.26 billion (expected for 2008 fiscal year) *Employees*: 10,000

Retail Format	Retailer	Origin	Profile
3. Affordable Design, Quality, and Assortment	*Casa & Ideas*	Chile	Founded in 1993 Specializes in small décor items and furniture Has recently expanded geographically to Peru *Trademark*: "We believe in democratizing design. Through design, people can achieve well-being, express and renew their identity, create happier environments, and generate daily spaces of creativity" *Number and location of stores*: 26 across Chile *Sales*: NA *Employees*: 1,200, among them 40 designers
	Surtifruver	Colombia	Founded in 1983 Specializes in fresh produce: fruits, vegetables, meats, dairy products, bread, and flowers *Trademark*: "We base our operations on values such as respect, honesty, loyalty, and authencity" *Number and location of stores*: 7 in Colombia's major cities such as Bogotá and Cali *Sales*: USD 12 million (fiscal year 2004) *Employees*: 1,000 direct and 8,000 indirect (network of independent farmers/ suppliers)

Notes: NA, not available.
Sources: Booz Allen Hamilton and published company data. All data refer to 2008 unless stated otherwise.

formats to serve emerging consumers have arisen from the identification of these paradigms and needs.

ANALYSIS AND RESULTS

Consumers' Paradigms as a New Source of Innovation

Social fragmentation and the subsequent arrangements seen in the Latin American retail industry have contributed to the formation of strong paradigms among emerging consumers. These paradigms appear to be rooted in the perception that purchasing decisions involve some form of trade-off vis-à-vis the usual dimensions of a retail experience: products, services, design, quality, assortment, and location. Our study has revealed that emerging consumers have preconceived notions of how to address these trade-offs, notions that seem to arise from negative past experiences as well as from hidden frustrations and desires.

Paradigm No. 1: Access to durable goods requires a long-term sacrifice. Emerging consumers in Latin America spend 50–75 percent of their disposable income on household purchases (D'Andrea, Ring, Lopez-Aleman, & Stengel, 2006). Their ability to generate savings is thus limited, as are their chances to acquire high-ticket items such as cars, quality furniture, and useful household appliances (e.g., freezers, TVs, and computers). Budgetary constraints are further exacerbated by the relative absence of credit options. Few emerging consumers possess bank accounts; still, "bankable" individuals face difficulties obtaining loans because they lack adequate credit histories, proof of income, or collateral. Moreover, should customers fail to comply with interest payments, financial institutions offer little or no room for debt restructuring. Members of our discussion groups have indicated that, in order to purchase durable goods, they must often resort to saving over long periods of time and paying in installments that contain substantial interest rates. Many lack the discipline of making such a sacrifice and opt to devote their meager disposable incomes to the purchase of simple consumption goods.

Paradigm No. 2: Better service and assistance must be more expensive. Our study identified service as a highly valued attribute for emerging consumers in Latin America. However, positive service experiences are rare. Consumers tend to find sales assistants sophisticated, snobbish, cold, and out of touch with the real needs of low-income families. The absence of proper guidance and assistantship leads emerging consumers to believe that proper service will come only at a higher price. Some show surprise and even skepticism when stores offer complimentary services such as free installation of household appliances.

Paradigm No. 3: Small shops carry a limited assortment of products. Emerging consumers believe that store area determines the degree of product assortment. This does not seem to pose an inconvenience for consumption goods, but it certainly does for durable goods. The presumption that small stores carry narrow product lines leads customers to suppose that they will have to visit many stores before making "the right purchasing decision." Research and the perception of making "a good deal" are paramount in the purchase of high-ticket items. Commuting to a larger store, generally located in the outskirts of big cities, requires more time and more expensive transportation than does visiting a small store nearby. Emerging consumers sometimes find themselves waiting for months before they can organize a visit to a large store.

Paradigm No. 4: Better quality must be more expensive. Emerging consumers in Latin America believe that superior quality commands a premium price. Quality is associated with intermediate or leading brands, as well as with noble raw materials and fashionable design. Following this paradigm, consumers tend to favor low-end stores, where they settle for unattractive, poor-quality items that sell at prices they can afford. Emerging consumers reach the point of not even comparing prices of equivalent merchandise at stores that offer better quality and where cost may be quite competitive.

Paradigm No. 5: Design stores sell expensive products. Emerging consumers take for granted that a modern, fashionable shopping environment also carries a premium price. There is a perceived relationship between the attractiveness of the shopping environment and the goods sold in that environment. A trendy store should therefore offer trendy products, which will be costly.

The paradigms detailed above could also be characterized as impossible equations in the minds of emerging consumers in Latin America. Our study suggests that these equations have served as the basis for an evolution in the regional wheel of retailing. The apparition of innovative retail formats fostered by local entrepreneurs has brought answers to the aspirations of emerging consumers, helping them improve their living standards and their sense of personal dignity. These retailers appear to defy the low-price, low-quality dynamic proposed by the wheel of retailing, offering customers high-quality goods and services at affordable prices. Access to high-ticket, durable goods such as electronics, furniture, and apparel provides once excluded low-income consumers a way to integrate themselves into society.

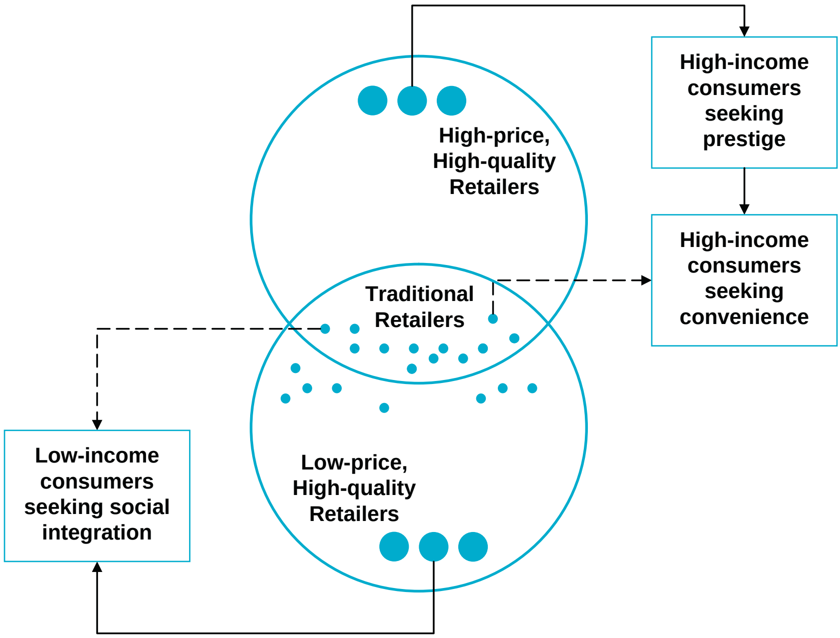

Fig. 3. Our Understanding of the Evolution of the Wheel of Retailing in Latin America.

The presence of new retail formats for the poor has generated structural changes in the Latin American wheel of retailing by giving rise to a second wheel altogether at the low end. Our understanding of this scenario is represented in Fig. 3. The overlap between the wheels includes the traditional retailers who may sometimes serve convenience-oriented high-income consumers. Preference for this kind of retailer is not a question of trust or friendship, as is the case with emerging consumers, but of location and expediency. Purchases are performed ad hoc.

Three Innovative Retail Formats for Emerging Consumers in Latin America

Liebmann et al. (2003) have recently commented on the lack of novel business models in retailing and warned that "radical innovations are needed to provide growth and profits." At the same time, they acknowledged that most innovation by retailers takes the form of small, incremental steps toward efficiency and refinement of existing business models. Unsystematic handling of the innovation process will lead, in their minds, to a "lack of consideration for customers' requests and needs." In this same vein, Gagnon, Kleinberger, and Morrison (2005) have called for customer-centric innovations in retail formats that may deliver "the total experience." A customer-centric philosophy should be embedded throughout the retailer's organization. According to their study, the quality of customer-employee interactions and key elements of the in-store experience rank among the most important drivers of customer satisfaction.

In line with these findings, innovative retailers in Latin America rely on two engagement levers: emotional proximity and value-delivered. These levers constitute key elements through which the retailers have managed to overcome consumer paradigms in the region. The first lever, emotional proximity, is delivered through three mutually reinforcing mechanisms shared in similar measure by most retailers:

(a) Respect for the customer – Assistants interact with customers demonstrating care, dignity, and friendliness throughout the purchasing process. Assistants perform the key task of educating customers and helping them match their desire to consume to their financial capabilities.
(b) Inspiring founders and leaders – Almost all successful retail chains for emerging consumers started as humble, small-scale projects by low-income entrepreneurs. The active presence of founders who rose from poverty and understand customers' needs from their own personal experience provides inspiration and meaning to the purchasing process.
(c) Deep knowledge of the customer through ties to the community – Assistants often belong to mid- to low-income segments themselves, which gives them a special perspective on customers' dispositions and emotional needs as well as the opportunity to establish peer-to-peer relationships with them. This degree of embeddedness in the low-income community generates credibility and positive word of mouth for retailers.

The second lever, value-delivered, is in direct relationship to customer needs and wishes. This study yielded a particular "Needs Ladder" for emerging consumers in the region, depicted in Fig. 4. The needs ladder begins with the threshold of access to goods and services that were previously beyond emerging consumers' reach. Access is granted via affordable prices, the provision of credit, and value-added services. The fulfillment of a step in the ladder should eventually lead to the manifestation of a superior step as a need or desire toward a more fulfilling shopping experience and a better

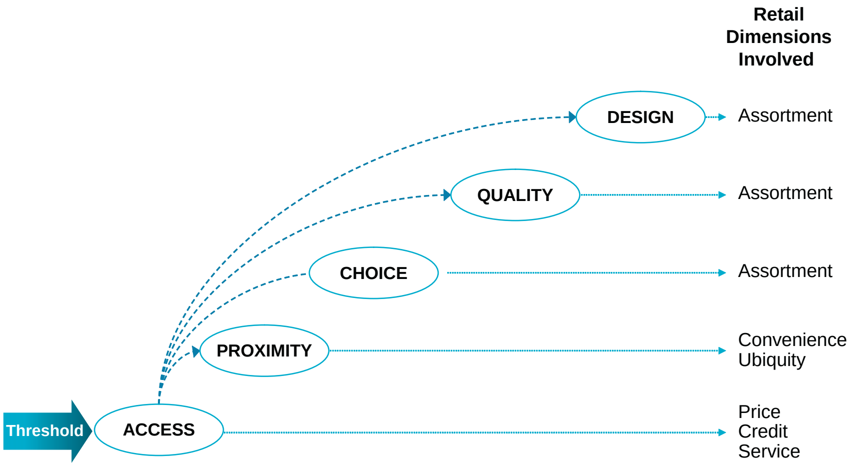

Fig. 4. The Needs Ladder of Emerging Consumers in Latin America.

quality of life. Although there is yet no empirical evidence of the order in which these needs emerge, the insights we have gathered during the course of our study leads us to believe that, after the initial threshold, the ladder evolves as follows. Emerging consumers appear to move from access to proximity – the desire to count on a variety of retail outlets in the vicinity of their homes, their place of work, or high-traffic areas such as train and bus stations. This step highlights the dimensions of convenience and ubiquity of shopping outlets in contrast to size, which often requires stores to be located in faraway areas and forces customers to commute. The steps of choice, quality, and design seem to be more complex. All of them lead to the provision of an adequate assortment of goods, a dimension to which emerging customers are particularly drawn and which remains mostly unfulfilled. Assortment shortens the purchasing process by presenting consumers with an adequate range of goods to choose from, at any one time. This gives customers the perception that they have researched and compared a satisfactory number of alternatives, and contributes to their overall satisfaction.

Retailers operate the engagement lever of value-delivered in different ways, according to the preeminence of each step of the needs ladder in their chosen retail format. Finding common denominators in value-delivered among the innovative retailers in our sample, we have identified three distinct retail formats to serve emerging consumers in Latin America: (1) focus on access, (2) focus on choice, and (3) focus on design. Before we analyze each format more closely, it seems important to stress that retailers positioned in one format group may present elements characteristic of other formats. However, format groups have emerged from establishing links among those elements that appeared most salient and more distinctive of each retailer.

Format No. 1: Product or service access – from resignation to fulfillment. Retailers belonging to this group have innovated by fulfilling previously unmet aspirations of emerging consumers. The value proposition of these retailers creates the necessary conditions for emerging consumers to be able to afford durable goods to which they traditionally have had limited access. In so doing, retailers have activated the threshold of access on the needs ladder. The business models they have deployed directly challenge consumer paradigms 1 and 2. Retailers include Casas Bahia, Brazil's leading household goods retailer; Elektra, the retail arm of a large conglomerate in Mexico; and CMR/Falabella, Chile's leading retailer. Our study indicates that their business models seem to rest on the following pillars:

Unconventional credit processing and risk management systems. Retailers focus on speed and flexibility in their credit and risk management practices. An average of 70 percent of goods is sold on credit. An emotional connection is fostered in which most customers feel a sense of gratitude toward retailers for recognizing them as full-fledged consumers. No collateral or proof of income is required to get credit; repayment capabilities are evaluated unconventionally. Retailers have invested heavily in centralized credit systems, where customer credit histories are stored and monitored. Employees are encouraged to generate quality credit sales: variable compensation is based on sales to customers who honor their commitments. At Casas Bahia, customer behavior as recorded by the credit system is a leading determinant of further access to credit. Assistants play a key role in determining customers' creditworthiness and may, in some cases, overrule the system to make exceptions. Before granting loans, Elektra sends credit investigators on visits to applicants' homes to perform a socioeconomic study. Neighbors are often consulted as to the customer's trustworthiness, and income is estimated at the family, not personal, level. Customers choose the amount they are willing and able to pay on a weekly basis, and the number of payments is later determined.

In-house development of key capabilities. Retailers tend not to outsource many components of their value chains; instead, in-house development of capabilities seems to prevail. At Casas Bahia, delivery and installation are done by a proprietary fleet. Customer care activities reach customers' homes and neighborhoods, sending feedback to the retailer's databases. Financing is also done in-house; Casas Bahia, unlike close Brazilian competitors, does not transfer credit risk to other finance institutions nor does it enforce payment via third-party collectors. This generates close ties with customers, who remain motivated to honor their commitments. CMR/Falabella has created a credit card to serve emerging consumers and has obtained a lower provisions/outstanding loans ratio than most commercial banks. Elektra provides financing through its own Banco Azteca, which maintains outlets within Elektra stores and provides a range of complementary services of frequent use by emerging consumers, such as personal loans, and money transfers.

Personalized attention. Retailers provide services that help build engaging relationships with customers. At Casas Bahia, assistants walk customers step-by-step through the purchasing process and educate them as to their possibilities, balancing product needs and wishes with repayment options. Elektra has its own university to train employees, coupled with a strong coaching process. Most retailers require customers to visit the store regularly to make payments. Assistants are thus enabled to interact frequently with customers, generate loyalty, and eventually cross-sell new products.

Top-tier brands. Retailers offer leading brands, especially for consumer electronics. Casas Bahia, Elektra, and Falabella carry brands such as Sony, Toshiba, Panasonic, and Philips. Retailers implicitly acknowledge that low-income consumers have the same brand aspirations as more affluent consumers. In the presence of limited budgets, brands appear to act as quality warrantors that give emerging consumers the feeling of having made a good purchasing decision. Low-income consumers are more at risk in their purchases than affluent consumers since they cannot afford to buy a second product if they are dissatisfied with the first (D'Andrea et al., 2006).

Management by numbers. Retailers monitor business on a real-time basis. At Casas Bahia, key performance indicators include total unit sales, total revenues, total financed value, average down payment, average interest paid, average payment period, and cross-selling levels. Analysis may be performed at store, region, city, product category, individual product line, or SKU level. An internal audit team also performs in-store verifications of inventory, cleanliness, and advertising. Elektra monitors contributions per customer and sales and contributions per store, product, and day.

Format No. 2: Assortment and location – access to choice. Retailers belonging to this group have innovated by offering a broad assortment of goods in relatively small stores located at premium sites. In so doing, they cater to the proximity and choice dimensions of the needs ladder and directly challenge paradigm 3. Examples include Locatel, a health services provider in Venezuela, and Magazine Luiza, a retailer operating in small cities throughout Brazil. Their business models seem to build upon the following premises:

Everything under the same roof. Retailers working under this format are aggregators. They offer a wide array of products around a specific consumer need. In so doing, they become a one-stop-shop for the fulfillment of that need and a top-of-mind reference point for related products. Locatel, which started as a medical equipment rental store, extended its product range to cover pharmaceuticals, vaccinations, clinical lab and nutrition services, self-help books, basic food items, and pet food. Locatel has gone beyond the restrictive model of "aid in sickness" to encompass the concept of "aid for health maintenance." Magazine Luiza has turned to a virtual solution. Fifty of the company's 350 stores contain nothing but PC terminals where consumers can log in to browse the store's merchandise. Magazine Luiza thus provides access to a megastore's assortment of basic home appliances and furniture without having to maintain high inventory levels.

Location, location, location. Retailers make a point of establishing branches in high-traffic locations or in areas where the presence of a store will make an impact. Locatel's stores operate 24 h a day and are located mainly within shopping malls. In other high-traffic areas, the company offers free parking. Following its virtual model, Magazine Luiza managed to grow by steering clear of Brazil's biggest cities, where its competitors are already firmly entrenched. The company has established itself in rural areas and smaller urban settings where big retailers have little incentive to go.

Self service for the basics – personalized attention for complex purchases. Locatel knows that customers do not regard the stores as high-frequency shopping outlets; rather, they go to the store with a clear idea of the items they require. Locatel employees offer assistance geared toward fulfilling customers' needs quickly and efficiently. Personalized attention is highlighted during medical exams. In contrast, Magazine Luiza's electronic interface features a virtual salesperson called Tia Luiza who welcomes customers and guides them through the purchasing experience. Sales representatives are available to train customers on how to use the computers. They also take part in activities to enhance customer loyalty and to encourage cross-selling.

Affordable price. Retailers offer variety at competitive prices and creative financing conditions, enabled by nontraditional credit processes. Locatel has established a customer relationship program where families can register for less than one U.S. dollar. Registration enables customers to obtain a 30 percent discount on all pharmaceutical products and to access the remaining array of health-related services. The majority of Magazine Luiza's sales occur in installments with affordable credit conditions. The company's average monthly interest rate is three times lower than credit card rates, the cost of which most small-town Brazilians cannot afford. In a country where almost half the population does not have a checking account, Magazine Luiza also provides customers with services such as personal loans and insurance policies, which would otherwise remain out of their reach.

Format No. 3: Affordable design, quality and assortment – from functional to emotional. Retailers belonging to this group have innovated by creating models in which mid- to low-income consumers can buy well-designed, stylish, high-quality products at reasonable prices. "Specialty" retail environments allow retailers to convert purchasing decisions that were formerly based on functionality to decisions based on emotional drive. These retailers cater to the *quality* and *design* dimensions of the needs ladder and directly challenge paradigms 4 and 5. Examples include Casa & Ideas, one of Chile's foremost decor stores, and Surtifruver, a food retailer in Colombia. Business model features comprise:

Great assortment – democratization of choice. Retailers seem to have identified a profitable niche in the specialty store business, offering a broad assortment of high-quality products at affordable prices. The approach contrasts with that of supermarkets, where, at the same price level, product assortment is narrower and economies of scale in purchasing dominate. Casa & Ideas sees design as a value that should be accessible to all people. The company introduces about six collections a year. Short production runs per product give emerging consumers a feeling of exclusiveness and broad access to choice. Store ambiance is paramount, combining cleanliness, fashion, and bright colors. Surtifruver, conversely, seeks to democratize access to a balanced diet and good health. The company sells a wide variety of edible products, already cleaned and packaged, at prices 5 percent lower on average than supermarkets. To give emerging consumers a sense of quality and sophistication, shelves are arranged neatly with few, continuously restocked items.

Alliances for the development of key capabilities. Positioned as product specialists, these retailers tend to develop critical components of their value chains in collaboration with key players. Casa & Ideas employs a team of 40 designers who conceive original products integrating aesthetics, functionality, and wellness. Manufacturing is outsourced to cost-competitive factories in Asia and shipped to Chile. Casa & Ideas also maintains a technology-laden warehouse and distribution center. Surtifruver holds long-term agreements with food vendors. Personnel regularly visit plantations and factories, providing technical assistance and arranging for logistics services.

Personalized attention. Retailers provide in-store services that help build loyalty among customers. The goal is to provide the same level of service available at more upscale department stores, at supermarket prices. At Casa & Ideas, assistants act as specialists advising customers on style and assortment. At Surtifruver, 60 percent of store employees are solely dedicated in providing sales assistance and arranging goods on shelves.

DISCUSSION AND CONCLUSIONS

This study has drawn on the literature on the wheel of retailing to explore the issue of retail innovation in Latin America and its consequences over industry structure. Latin America is a region where retail formats imported from developed markets have traditionally prevailed over indigenous ones. It is also a region where a mass of emerging consumers has remained largely underserved vis-à-vis a few segments of affluent consumers. Considering this scenario, we have endeavored to establish whether effective, sustainable business has been possible for innovative retailers throughout the region. Our findings suggest that retail innovation is thriving in Latin America. We have identified three innovative formats that are gaining force by serving emerging consumers.

Several conditions make this wave of innovation especially interesting: (a) the appearance of successful retail formats for the poor is a region-wide phenomenon, not an occurrence exclusive to a specific country; (b) these formats have proven viable for a variety of products such as home electronics, home decor, and groceries; (c) these formats have been designed and implemented by indigenous retailers who are deeply ingrained in their respective communities, not by large international retail chains.

We have established a correspondence between consumers' unfulfilled needs and prevailing paradigms and the specific dimensions of the retail experience upon which each of these formats rely. Specifically, new formats focus on providing access to durable goods, assortment and choice, and attractive design and quality – dimensions usually reserved for more sophisticated retail experiences than emerging consumers could traditionally afford.

We have further traced how the inception of these innovative formats has altered the overall structure of the retail industry in Latin America by creating a retail space – a completely new wheel of retailing – that did not previously exist. These two wheels, each containing consumers positioned at the top or at the bottom of a fragmented society, overlap only slightly. Indeed, the socioeconomic characteristics of the consumers that populate each retail space are so dissimilar that retailers are forced to develop target-specific capabilities, business models, and organizational identities. Such specific configurations determine that, once positioned within a wheel, retailers find a positive barrier to mobility toward the other wheel. Imported retail formats have tended to enter at the high end. Innovative indigenous formats have sprouted at the low end. Still, Izraeli's (1973) expectation that formats would eventually migrate and meet at the middle has not materialized. For high-end retailers, a move toward the middle or the low end would signify investing in commercial and operational capabilities they now lack. Because these new capabilities are distant from current ones, any effort to develop them would lead to a disruption in retailers' business models. It is our conjecture that a certain degree of ambidexterity (O'Reilly & Tushman, 2004) will need to be incorporated by any high-end retailer willing to serve emerging consumers. The costs associated with sustaining an ambidextrous model may be enough of a deterrent to the mobility of high-end retailers. Conversely, innovative indigenous retailers have seemed to remain at the low end, disproving Hollander's (1960) and Izraeli's (1973) arguments for movement toward the middle and the high end. There have been no significant shifts in retail personalities among those retailers that have entered the second-generation tenure. At Casas Bahia, to name an example, the founder's sons have not abandoned the combination of austerity in operations and generosity in customer service that were originally considered central to the company's value proposition. The imperfect competition conjecture appears not to apply either, since affordability and convenience instead of low price (or possible price wars) seem to be the key to retailers' success. Finally, the effects of secular trends remain to be seen. On the one hand, recent financial crises in Latin America have fragmented society even more; poverty in some countries such as Argentina is not only structurally ingrained but also the result of receding purchasing power by once mid-income consumers. On the other hand, the significant number of individuals who have risen from poverty in fast-growing countries such as Chile, Mexico, Brazil, and recently Peru points to increasing demand for more sophisticated retail experiences (Economist, 2007).

Considering that the organizational identities of innovative retailers in Latin America are closely tied to their consumers' identities, we expect retailers to stay true to their high-quality, affordable price scheme in the long term. We foresee, however, a scenario in which low-end retailers could begin serving affluent consumers. This scenario would involve low-end retailers acting as attractive options for affluent consumers focused on functional rather than emotional aspects of the retail experience, and only for certain types of goods. This possibility would not require low-end retailers to develop radically different capabilities, but would demand, for example, locating a store in a high-traffic area close to an upscale neighborhood and improving aesthetic dimensions such as layout and decor.

Our study has been eminently empirical and exploratory. Its very nature determines several limitations. First, we have worked in depth with a reduced number of retailers. Although we gathered an extensive list of preliminary candidates from consumers' suggestions, many were eliminated for not meeting our selection criteria of firm size, proven track record, originality of retail format, and endogeneity to the Latin American context. Many retailers suggested by consumers who viewed them as innovative had, in fact, imported their retail formats from abroad. This was true, for example, of most health-related retailers, who adapted the foreign concept of drugstore to their local environments. Our selection criteria were strict yet necessary to make sure that our study yielded relevant information on endogenous innovation in Latin American retailing. The seven retailers in our final sample allowed us a deep understanding of the fundamentals that underlie their chosen formats. The resulting information was rich enough to enable us to clearly recognize coincidences that led to the identification of different format groups.

Second, because we wished to appreciate innovation from the consumer's point of view, we relied heavily on consumer suggestions to build our preliminary list of retailers. This initial wave of suggestions may have been biased by consumers' experiences and depth of knowledge of retailers in their home countries. In order to double-check and make sure that most (if not all) relevant cases were considered in our study, consumer suggestions were complemented by others from a wide array of industry experts. It is possible that relevant cases may have escaped our attention; still, we trust that our selection process was thorough.

Third, our study has yielded no quantitative data that may allow us to compare or rate retailers within the same or among different format groups. Consequently, at no point were we able to establish whether one format is superior to another, or whether one retailer is more sophisticated than another within the same format group. We could also not establish links to performance, in the sense that we could not prescribe what an ideal format or business model within a format would consist of.

Finally, our findings shed light on successful cases of retail innovation in Latin America but do not suggest that the same formats may exist (or come to be successfully deployed) in other regions of the world. With the information uncovered so far, we venture to say that certain foundations of retail innovation seen in Latin America may have implementation potential in other emerging regions and, to some extent, in developed countries, especially in relation to consumer segments that still find it difficult to gain access to credit (e.g., immigrants, minorities, and youngsters). Success will depend on how these foundations fit together with consumers' needs, practices, and aspirations in each geography.

It has been our intention to contribute to the body of knowledge of retail innovation in emerging markets and to motivate other scholars to expand research in Latin America and other regions. Future studies should analyze the phenomenon of retail innovation in greater detail. In particular, a study attempting to match the complexity of retail formats with the degree of economic development of the countries in which these formats prevail would add great value to our understanding of the forces that underlie the process of retail innovation in each region.

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FUELLING INDIA'S RETAIL BOOM – WHAT SHOULD BE THE RIGHT POLICY?

Arpita Mukherjee

ABSTRACT

The retail sector is one of the fastest growing sectors in India. Increase in per capita income, growing urbanization, and economic reforms are some key factors that have propelled its growth. The growing Indian market has attracted many foreign retailers and Indian corporates to invest in this sector. However, this is one of the few sectors in which there is a restriction on foreign direct investment. The sector is politically sensitive, and the Indian government is trying to formulate an appropriate policy regime.

In this context, based on a primary survey, this chapter tries to analyze what should be the right policy regime that will help to sustain the growth of retail in India. The chapter shows that due to the quasi-federal nature of governance, the retail sector is regulated by a large number of ministries/departments at the centre state and local level, which leads to multiple regulations and the requirement of multiple clearances. The laws relating to this sector are outdated and their definitions and enforcement varies across different states of India. Lack of supporting infrastructure, high real estate costs and low purchasing power of consumers are some other barriers. To sustain the growth of this sector, there is an urgent need for regulatory, fiscal, and other reforms. Precisely, the clearances process

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needs to be streamlined and outdated regulations should be amended. To encourage investment in the supply chain and inflow of technical know-how and skills the government should allow FDI in multibrand retail. However, since retail is a sensitive sector, India cannot take an international commitment on liberalization of retail before streamlining the domestic policy regime.

Keywords: Retail; India; government policy; foreign direct investment (FDI).

Retailing, the largest private industry in India and the second largest employer after agriculture, has witnessed significant transformation since 1995. Traditionally, the Indian retail sector was characterized by the presence of a large number of small family-owned mom-and-pop stores. With the liberalization of the economy in the 1990s, modern retail formats began to develop, and Indian business houses and manufacturers started investing in this sector, which enjoyed double-digit growth in the past 15 years. Burgeoning business opportunities and the large market have attracted foreign retailers. Despite restrictions on foreign direct investment (FDI), foreign players have entered the market through different routes such as wholesale cash-and-carry, local manufacturing, test marketing, single brand retailing, and franchising. For three consecutive years (2005–2007), the country ranked topmost among 30 emerging markets for foreign retailers (Kearney, 2004–2009).[1] Some Indian retailers are also venturing into foreign markets. With growth in modern formats, traditional retailers are quickly changing their business models, implementing new technologies and modern accounting practices to face competition. In fact, in the past 10 years, with growing GDP and increased income levels, India is enjoying a retail boom. Moreover, the sector has spurred booms in other sectors, such as real estate, logistics and supply chain management, entertainment, and food processing.

Despite these developments, the share of modern retailing in India is one of the lowest in the world. In 2006, it was only 4 percent, compared to 20 percent in China, 36 percent in Brazil, 40 percent in Thailand, 55 percent in Malaysia, and over 80 percent in developed countries such as the United States, the United Kingdom, and Germany (Planning Commission, 2008). Most of these developing countries, including China, have liberalized the sector since the 1990s, with a rate of modernization much higher than India's. This is because of India's various barriers to setting up retail operations in the country. FDI is not allowed in multibrand retailing. The sector is politically sensitive and, of late, even domestic organized (corporate) retailers are facing protests in a few states due to the fear of job losses in the unorganized (mom-and-pop) sector. The government is struggling to come up with an appropriate policy regime that will enable the sector to modernize without having any adverse impact on employment and traditional sectors. Owing to the quasi-federal nature of governance, retail is regulated by different departments/ministries of the central and state governments and local/municipal bodies that complicate the regulatory regime and force businesses to face a multilevel and varied policy environment. India is under significant pressure in the ongoing Doha Round of multilateral negotiations in the WTO and in its negotiations in bilateral/regional agreements to open up this sector for FDI.

This chapter attempts to answer the question: What should be the right policy regime to sustain the retail boom? The layout of the chapter is as follows: Section "Indian Retail Scenario" provides a broad overview of the retail scenario in India, highlighting the recent trends and developments. It also discusses the factors contributing to the retail revolution and how changes in that sector are affecting other sectors. Section "The Current Policy Regime" analyzes the current policy regime. Section "Issues and Concerns" examines the barriers faced by retailing, and Section "What should be the Right Policy?" suggests reforms that are needed for the growth and modernization of the sector and for improving its productivity, efficiency, and global competitiveness.

The research is based on both primary and secondary data analysis. The primary survey covered 391 respondents, including large (domestic and foreign) retailers, mom-and-pop stores, retail associations, ministries and/or departments (central/state/local), retail experts, real estate developers, supply chain managers, and consumers. The first set of interviews was conducted in 2005[2] in eight Indian cities or regions (Chennai, Kolkata, Bangalore, Ahmedadad, Mumbai, Hyderabad, Jaipur, and the National Capital Region consisting of Delhi, Gurgaon, and Noida), and a selected sample of 50 respondents was again interviewed in May–July 2008.

INDIAN RETAIL SCENARIO

According to Central Statistical Organization estimates, the retail sector accounted for 11–12 percent of Indian GDP in 2008–2009. With more than 15 million retail outlets, India has the highest retail density in the world. However, only 4 percent of these are larger than 500 square feet. About 96 percent of the sector constitutes small mom-and-pop stores that survive on cheap labour (often family members), resulting in a high incidence of disguised unemployment/underemployment. The share of this sector in total employment is only 7 percent, compared to around 10 percent in developed countries (Mukherjee & Patel, 2005). In 2004–2005, employment in retail trade was 29–95 million, while that in wholesale trade was 4.6 million.[3] Because the sector is highly fragmented and traditional retailers do not often have formal accounting practices, it is difficult to obtain reliable data. The government does not collect data on a regular basis. Most estimates are provided by private consulting organizations and they vary widely.

On the basis of private consumption expenditure data of the Central Statistical Organization, National Account Statistics, and industry information, the retail sector was estimated to be Rs 14,574 billion (US$322 billion) in 2006–2007 and grew at a compound annual rate of 11 percent during 2003–2007 (Table 1). Modern retailing grew at a much higher rate, around 20 percent. Segment-wise, food and groceries constitute the bulk of retailing, followed by clothing and footwear. While the share of food and groceries has fallen (from over 66 percent in 2003–2004 to around 60 percent in 2006–2007), the share of clothing and footwear shows an upward trend (from 7.3 percent in 2003–2004 to over 9 percent in 2006–2007). The share of modern retailers is less than 1 percent in the food and grocery segment, and until recently they were concentrated in a few segments such as clothing and footwear, furniture, and sporting goods. Since food and groceries constitute around 43 percent of final consumption expenditures, modern retailers foresee a huge potential in this sector and are now trying to enter it.

Most studies have estimated that the Indian economy would grow at the rate of 8–10 percent in the next five years, with modern retailing growing at the rate of 40–50 percent. However, its economic growth has slowed, down to about 7 percent for 2009. Moreover, since 2007 some corporate retailers are facing protests/backlashes in a few states such as Uttar Pradesh, Orissa, and West Bengal and have had to withdraw or slow their pace of growth. Taking this into account, the growth of modern retailing will likely be at the rate of 30 percent, and its share in total retailing is likely to be around 15 percent by 2012.[4]

Modern retailing initially started in the south of India, spreading from large metro cities to Tier 2 and Tier 3 cities. Various store and non-store formats have developed, including supermarkets, hypermarkets, discount stores, specialty stores, direct selling, Internet selling, and telemarketing. Corporate retailers are experimenting with new formats such as pushcarts. In 2001 India did not have a single hypermarket; that number is expected to be 1,200 by 2011 (India Retail Report, 2007). Within non-store formats,

Table 1. Indian Retail Industry: Size and Share of Different Sub-Sectors.

	2003–2004	2004–2005	2005–2006	2006–2007	CAGR 2004–2007 (%)	Share of the Sub-Sector in Total in 2006–2007 (%)	2003–2004	2004–2005	2005–2006	2006–2007	CAGR 2004–2007 (%)	Share of Organized Retail in Total Retail by Sub-Sector (%) 2006–2007
Total retail (Rs bn)							Modern formats/corporate retail (Rs bn)					
Food and grocery	7,028	7,064	7,418	8,680	7.3	59.6	39	44	50	61	16.5	0.7
Beverages	212	309	373	518	34.7	3.6	11	12	13	16	14.7	3.1
Clothing and footwear	777	993	1,036	1,356	20.4	9.3	168	189	212	251	14.3	18.5
Furniture, furnishing, appliances and services	512	656	746	986	24.4	6.8	67	75	85	101	14.8	10.2
Noninstitutional healthcare	950	872	1,022	1,159	6.9	8.0	14	16	19	24	20.0	2.1
Sports goods, entertainment, equipment, and books	212	272	308	395	23.0	2.7	25	33	44	63	37.0	16.0
Personal care	371	433	465	617	18.5	4.2	11	15	22	33	46.9	5.4
Jewelry, watches, etc	530	610	655	863	17.7	5.9	18	24	33	49	40.5	4.6
Total	10,591	11,308	12,023	14,574	11.2	100.0	350	408	479	598	19.5	4.1

Source: Compiled by authors from Technopak Advisors Private Limited data.

Internet retailing is growing at a fast pace, which is likely to increase further with the penetration of credit cards. The concept of brands has developed and more and more manufacturers are branding their products. Retailers are developing their own brands, which generally have lower prices and higher profit margins. Some corporations have established a pan-India presence. For instance, from its one store in 1997, The Future Group was expected to have 1,000 stores in over 115 cities covering around 10 million square feet of retail space by the end of financial year 2008. From retailing, the company has diversified into other areas such as consumer financing.

Given that the urban market is getting saturated and the rural sector accounts from nearly 55 percent of the retail market, modern retailers are venturing into the rural markets focusing on specific requirements of that population. For instance, Hariyali Bazaars set up by DCM Sriram for agri-products provide retail banking, credit, insurance, and other financial services. Choupal Saagars, the rural hypermarket set up by ITC in states like Madhya Pradesh and Maharashtra, provides a platform for farmers to sell their products and buy products for personal and farm consumption. Companies like ITC and Adanifresh plan to have large investments in the supply chain linking farmers to retailers.

Franchising has been the most preferred mode of entry for foreign brands due to its relatively low investment requirements. Foreign players such as Lacoste, Mango, and Marks & Spencer entered India through this route. Benetton has a manufacturing unit in India. Companies such as Oriflame and Amway entered through the test marketing route. In this route, the Foreign Investment Promotion Board (FIPB), the nodal agency to clear foreign investment, allows foreign companies to test-market products for a two-year period, after which they are required to set up manufacturing units. German-based Metro Cash & Carry GmbH entered as a wholesale cash-and-carry operator. Many foreign retailers are entering into joint venture/partnership agreements with Indian companies. These partnerships are mutually beneficial, since foreign players acquire local market knowledge while the Indian companies get global best management practices and technological know-how. Wal-Mart signed a 50:50 joint venture with Indian telecom giant Bharti in which Wal-Mart will provide back-end support to the Indian company and open wholesale cash-and-carry outlets. The joint venture plans to roll out the first cash-and-carry outlet in 2009 and have 15 outlets by 2015. The TATA Group signed a joint venture with Woolworth's for a new subsidiary "Infinity Retail," which plans to open sixty multibrand consumer durable outlet "Croma" stores in 2009. Shopper's Stop has tied up with Mothercare, the global brand for infants and children. Since FDI is allowed in single-brand retailing, luxury brands such as Louis Vuitton, Damro, and

Lladro have come in through this route. Many foreign retailers prefer shop-in-shop arrangements with leading Indian department chains rather than entering through the single-market FDI route.

Retail infrastructure is growing at a fast pace. In 1999, India had three shopping malls measuring less than one million square feet each; by 2006, there were 137 shopping malls measuring 28 million sq ft. By the end of 2008, it was estimated there were 479 shopping malls with a capacity of 126 million sq ft (ICICI Property Services-Technopak, 2007). The logistics market for modern retailing is expected to grow at the rate of 16 percent, reaching US$120–130 million by 2010. A study conducted by industry association Federation of Indian Chambers of Commerce and Industry (FICCI) found that in 2006 India's total warehousing capacity was 81 million tons. An additional capacity of 35 million tons (at a cost of US$1.88 million) would be required by 2012 to support the growth of the retail sector. This provides immense opportunities for companies in logistics and supply chain management. The growth of modern retailing and shopping malls has boosted the development of multiplexes in the entertainment industry, while the use of IT in this sector has increased. The retail sector share in the total revenue of the IT/BPO sector rose from 4 percent in 2001–2002 to 7.6 percent by financial year 2006.[5]

Modern retailing has benefited the agriculture sector and small manufacturers. Technical know-how and best agricultural practices are percolating down to the farmers from the domestic and foreign players. For instance, lettuce used to be grown in India only during the winter. But when McDonald's came to the country, it brought international technical know-how with which Trikaya Farms in Telegaon, Maharashtra, is now able to grow the crop year-round. Trikaya Agriculture Private Ltd. is now exporting these high-value products to other international markets. The supply chains in India are highly fragmented, inefficient, and marked by the presence of a large number of intermediaries. Because of this, farmers get a lower price for their products while consumers have to pay more.[6] By setting up the supply chains, direct sourcing, and reducing intermediaries, modern retailers are helping farmers get a better price. Large retailers are also training farmers and small manufacturers in branding and packaging their products. For instance, tamarind is grown in the Tumkur region of Karnataka. By sourcing its product from farmers in this region and branding it as *Tumkur Tamarind*, RPG Group's FoodWorld have helped to build the farmers' brand equity. Large manufacturers, on the other hand, are losing their bargaining power and facing tough competition from the private labels of modern retailers. Owing to bulk sourcing, retailers now determine the terms and conditions that were previously determined by the manufacturers. To compete, many manufactures are establishing their own retail outlets.

The Indian economy is growing and so are both traditional and modern retailers. Thus, there is no clear evidence of job loss in the traditional sector due to the advent of modern retailing.[7] One estimate shows that modern retailing would generate over 2.5 million jobs by 2010 through backward and forward linkages (India Retail Report, 2007). Emergence of modern formats has improved quality of employment, increased salaries, and created jobs in ancillary sectors such as the food processing industry and logistics support services. However, there will likely be some job loss due to consolidation and reduction in intermediaries. There has been a sudden spurt in demand for retail-related skills in India. Modern retailers are facing skill shortages and are taking measures such as partnerships/tie-ups with management institutes, in-house training facilities, and so on to develop talents.

Various demand and supply side factors have led to this retail boom. Since the 1990s there has been an increase in income levels and consumer spending. India has a young population (more than 65 percent below the age of 35 years), which has a strong bias toward spending. The growth of services, especially knowledge-based services such as IT and BPO, provide employment to young Indians who are more brand-conscious. The penetration of credit cards, easier bank credits/personal loans, demographic changes such as nuclear families replacing joint families, and dual income with more and more women in the workforce are key drivers of modern formats. The proliferation of brands after the liberalization of the 1990s and the entry of foreign manufacturers have created the need for more retail space in order to provide consumers with a wide range of choice. With globalization, consumers are now more aware of international shopping experiences and are showing a preference for better shopping ambience and access to multiple products under one roof.

THE CURRENT POLICY REGIME

The retail sector is regulated by different departments of the central government, state governments, and local/municipal bodies. At the centre, the Ministry of Consumer Affairs/Food and Public Distribution regulates internal trade, while FDI falls under the purview of the Department of Industrial Promotion and Policy (DIPP) in the Ministry of Commerce and Industry. Taxation issues come under the Ministry of Finance. Other ministries regulate specific sub-sectors of retailing such as the Ministry of

Agriculture, the Ministry of Food Processing Industry, and the Ministry of Textiles. Zoning regulations and trade licenses are under the egis of municipal/local bodies while state governments regulate the establishment of retail outlets, shop open times, interstate movement of goods, agriculture,[8] and so on. The multiplicity of regulatory bodies has resulted in a large number of laws and regulations. The number of regulations and extent of restrictions varies from state to state and their impact depends on the type of retail formats and the commodities traded. On average, a corporate retailer in the food and grocery segment needs around 40–45 licenses, clearances, registration certificates, and so on for every outlet, each from different departments/ministries/agencies to set up operations.[9] The agriculture sector itself is regulated by around 20 different laws.

India started liberalizing in the early 1990s and retail is now among the few sectors that still has FDI restrictions. This sector is unique because prior to 1997 there was no specific regulation restricting the entry of foreign players. In 1997, when the rest of the economy was being liberalized, a ban on FDI was imposed in this sector due to the fear of job losses in the traditional sector and the threat of FDI outflows. Although foreign players were allowed in wholesale cash-and-carry and franchising,[10] the first major step toward liberalization was in 2006.

In the past, government approval was required for wholesale cash-and-carry trading and for FDI above 51 percent in export trading. In 2006, FDI up to 100 percent was allowed through the automatic route for cash-and-carry wholesale trading and export trading.[11] In the same year, the government also allowed 51 percent FDI in "single-brand retailing" subject to FIPB approval and to the conditions that (a) only single brand products would be sold (i.e., retailing of multibrand goods would not be allowed even if produced by the same manufacturer), (b) products should be sold under the same brand internationally, (c) single-brand product-retailing would cover only products branded during manufacturing, and (d) any addition to product categories to be sold under "single brand" would require fresh approval from the government.

Even before 2006, FDI up to 100 percent, with FIPB approval, was allowed for the trading of items sourced from the small-scale sector, test marketing, the trading of items for the social sector, the trading of high-tech, medical, and diagnostic items, and domestic sourcing of products for exports subject to the provisions of the Export Import (EXIM) Policy. Domestic trading of joint venture products is permitted at the wholesale level for such trading companies that wish to market manufacturers' products on behalf of their joint ventures, in which they have equity participation in India. FDI up to 100 percent is permitted for e-commerce activities. However, these companies are only allowed to do business-to-business (B2B) e-commerce and not in retail trading.

In 2005, FDI in real estate was allowed to facilitate the growth of the retail infrastructure, resulting in a significant inflow of investment. In May 2008 the sector was among the top five in terms of FDI inflows, accounting for 5.6 percent of the total. However, easing FDI in single-brand retailing did not lead to substantial FDI inflows. The approval of more than thirty proposals since 2006 had accounted for only 0.03 percent of total FDI inflows by May 2008 (US$19.38 million).[12] The government is encouraging FDI in back-end retail activities such as logistics management, cold chains, and warehousing and in allied sectors such as food processing. Tax concessions and other fiscal incentives are given for investment in these sectors.

FDI in multibrand retailing is prohibited, creating an entry barrier to retail giants such as Wal-Mart, Carrefour, and Tesco. However, they can and have entered the Indian market through other routes. The government wants to further liberalize the sector and is considering FDI in multibrand retailing in sporting goods, stationery, construction materials, and electronics, among others, on a case-by case basis. It also wants to remove the FDI cap in single-brand retailing subject to certain conditions, such as local sourcing. A recent survey by the United Nations Conference on Trade and Development (UNCTAD) of 300 international retailers found that more than a quarter of them have either opened or are planning to open their stores in India if the country relaxes the norms further. India is facing international pressure to further liberalize the retail sector. On the contrary, there is significant domestic protest against FDI in multibrand retailing, especially in the food and grocery segment.

The central government has been in the process of amending some outdated legislations to facilitate modern retailing. For instance, it proposed an amendment to the Agricultural Produce Marketing Committee (APMC) Act in 2003, which had been implemented by different state governments to establish market yards, or *mandis*, for agri-products and consolidate buyers and sellers in one place. It prohibited transactions outside regulated *mandis* and did not allow direct marketing or procurement from the farmers. Although it was enacted to protect farmers over the years, it had given rise to a large number of intermediaries and the farmers had no alternative but to sell their products in the *mandis*. Many states have already amended their legislation along the lines of the Model Act 2003 proposed by the central government. Two key provisions of the legislation are allowing retailers to buy directly from the farmers and allowing contract farming, under which a buyer can directly contract in advance to buy produce from the farmer.

To facilitate the interstate movement of goods and enable retailers to have a centralized procurement system, it has been proposed that central sales taxes should be phased out. In most states, value-added tax instead of sales tax was implemented as of April 1, 2005. The government's decision to introduce a Goods and Services Tax in the year 2011, to integrate all indirect taxes on goods and services at the central and state levels should be beneficial for the retail sector. To facilitate the use of land for retail purposes (shopping malls and so on), states such as Gujarat and Goa have repealed the Urban Land (Ceiling and Regulation) Act of 1976, which had a restrictive provision for the use of land for commercial purposes.

ISSUES AND CONCERNS

Both traditional and modern retailers are facing various barriers in India, but these are more acute for the latter. Because the livelihood of a large number of people is dependent on the retail sector, it is politically very sensitive. In the past, there was apprehension about the adverse impact of foreign retailers on domestic retailers if FDI was allowed in this sector. Now, with the entry of Indian business houses in retailing and their ambitious expansion plans, the debate has focused on big versus small, or whether corporate retailers would drive the traditional retailers out of business. Those against corporate retailers have the following arguments: modern retailing has marginalized traditional retailers in countries like Thailand; the corporate sector is financially strong and has higher bargaining power; it can source and sell products at a cheap rate and therefore can drive traditional retailers out of business; and corporate giants practice anti-competitive practices, including predatory pricing. Those in favor of modernization argue in the alternative: because the economy is growing, both traditional and modern retailers can grow simultaneously; modern retailers will bring in technical know-how and global best management practices; they will invest in the supply chain/retail infrastructure and allied sectors (food processing), create better quality jobs, increase government revenue due to transparent accounting practices, and offer consumers a wide range of choice. Both sides fail to understand that the impact of modernization on traditional retailers depends on various other factors, such as economic growth,[13] changes in consumer demand patterns, government policy, and so on. Modern and traditional retailers are not two distinct homogeneous groups. Some traditional retailers in India have higher turnovers/revenues than corporate retailers, which differ in their operating models, pricing, clients they cater to, and pace of expansion, among others. Each can have a different impact on the traditional sector. During the survey, it was found that corporate retailers who have a neighborhood store format tend to have an adverse affect on the traditional retailers when they start their operations. However, this tends to taper down with time. The adverse impact is not seen in the case of hypermarkets, because Indians tend to buy most of their daily requirements from neighborhood stores. The traditional retailers also have some advantages (such as allowing purchases on credit and the ability of consumers to order by telephone) over modern retailers.

The evolving regulatory regime together with the political sensitivity of the sector has created an uncertain operating environment. This is one of the few sectors in which even Indian business houses are facing political backlashes and protests. For instance, due to political pressure, the Uttar Pradesh state government had to shut down a retail chain dealing with fresh products. In 2005, Metro Cash and Carry GmbH was given a wholesale cash-and-carry license in the state of West Bengal that faced renewal problems in 2008 after the agriculture minister blocked it on the grounds that Metro is a foreign company. Such sporadic measures make it difficult to have long-term investment plans that are essential for setting up efficient supply chains. Also, many corporate retailers have slowed down their expansion plans due to backlashes and are not willing to reveal their future growth plans.

The retail sector is subject to a plethora of laws at the central, state, and local/municipal levels. There is no nodal ministry or any specific legislation for this sector even at the centre. Requirement of multiple clearance from different government ministries and departments affect efficient operations. Some laws relating to this sector, such as the Prevention of Food Adulteration Act (1954), are outdated and extremely restrictive in terms of permitted additives since they do not take technological changes into account. In many states, the Shop and Establishment Acts are more than half a century old. For instance, the Delhi Act was made in 1954, that of Mumbai in 1948. These laws have restrictive shop opening and closing times and require shops to be closed once a week. Although this was done with the intention of giving employees a day off, such laws are redundant for modern retailers who can use employees on a rotational basis. Some regulations that were important at the time of implementation have now lost significance. For instance, the purpose of the Essential Commodities Act of 1955 was to ensure easy availability of essential commodities to consumers and protect them from exploitation from unscrupulous traders. Using powers under this Act, various ministries/departments of the central government have issued control orders to regulate production, supply, distribution, prices, and more. Some notifications under this Act restrict movement of certain commodities (food grains, edible oils, sugar, etc.) from surplus to deficit states. It also regulates stocks. Although the number of products under this Act has been reduced overtime, it is still sometimes imposed in a sporadic manner, making it difficult for retailers to carry on pan-India operations. Trade in certain commodities, such as liquor, is highly regulated, with each state having its own policies related to production, distribution, and taxation.

Interstate differences in definition, enforcement, and incidence of taxes make it difficult to have a uniform pricing model across the country. This leads to infiltration of products from states with lower taxes to states with higher taxes, resulting in black marketing. Multipoint taxation makes it difficult to set up a centralized sourcing infrastructure, so retailers with chain stores often work in a hub-and-spoke model with a centralized merchandising office and source products locally from contract manufacturers, which does not allow economies of scale in sourcing. These are likely to be reduced in the future as the government makes the fiscal reforms discussed earlier. Moreover, differential taxation on raw materials, intermediaries, and final products also distorts trade. For instance, processed food is taxed at a high rate, which deters the purchase of such food and thereby affects investment in the food processing sector.

One of the major barriers retailers face is the lack of supporting infrastructure such as storage facilities, electricity supply, and transport and communication networks. In India's highly fragmented supply chain, around 35–40 percent of the fresh fruits and vegetables get wasted in the supply chain due to the lack of proper infrastructure.[14] It is estimated that in 2005–2006 the total logistics costs in India were close to 15 percent of the GDP, compared to 9 percent in the United States (Planning Commission, 2008). The transportation sector is dominated by a large number of players with one or two single-axle trucks. Road conditions are not suitable for multiaxle vehicles, so travel time is increased. Most warehouses have small capacities and poor deployment of handling, tracking, and monitoring technologies. The government-owned *mandis* do not have proper infrastructure and/or do not adhere to international quality standards. Because of this, many large retailers in India, unlike developed countries, have to invest in the logistics chains rather than outsourcing. Power failures are common and retailers have to invest in a captive power supply, which adds to costs. Shortage of electricity also imposes restrictions on shop opening times. Lack of supporting infrastructure such as approach roads, adequate parking facilities, and public transportation are major barriers to development of modern formats.

Real estate costs are very high in cities such as Delhi and Mumbai. This is because of restrictive zoning regulations that limit the availability of land for retail/commercial purposes, as well as high stamp duties. Laws relating to land conversions and rent control acts vary across states. While some states are in the process of amending the old Acts, laws in states like Delhi are very stringent. Non-availability of government land together with fragmented private holdings make it difficult for retailers to acquire large plots of land. The property market is not transparent. Lack of clear ownership/titles and high stamp duties result in grey markets for property. There is no proper urban planning, and illegal construction of shops not only aggravates parking, electricity, and other problems but also creates operational uncertainty. For instance, in 2007 the Delhi municipality sealed many shops that were illegally located in residential areas, then opened them up later with some size restrictions. Enforcement on such sporadic regulations has affected a number of retailers, especially smaller ones.

While large retailers have access to institutional and venture capitalist funding, and some are even listing in the stock exchanges, traditional retailers find it extremely difficult to access institutional funding. Banks are not keen to give loans without collateral, and many small players without it have to take loans from the unorganized sector at higher interest rates.

Low purchasing power among the majority of consumers as well as conservative shopping habits deters development of modern formats. A large section of Indian consumers prefer to buy fresh fruits and vegetables daily from their neighborhood stores. The number of brands available in India is much fewer than what is available globally. With fewer brands, Indian supermarkets/hypermarkets are not able to enjoy an advantage over small retailers because the latter are able to deliver all the brands desired by the consumers.

Labor productivity in India ranges from one-sixth to one-half of the US average (Mukherjee & Patel, 2005). Modern retailers are facing acute skill shortages. Labor laws are rigid and do not allow companies to lay off redundant workers or limit hours of work, and there are minimum wage requirements. These are applicable only for the corporate retailers. Modern retailers also face other barriers in India, such as low credit card penetration. Moreover, since the food processing industry is in its nascent stage, only 4 percent of the fruits and vegetables are processed compared to more than 30 percent in Thailand and 70 percent in Brazil.[15]

The government wants local sourcing, but many small manufacturers do not barcode their products or have proper packaging and labeling technologies. Quality standards also vary widely. Some large retailers such as Metro Cash and Carry GmbH are training small manufacturers in barcoding, branding, and packaging. Farm sizes are small and retailers have to enter into contracts with a large number of farmers for direct sourcing.

WHAT SHOULD BE THE RIGHT POLICY?

The discussions throughout this chapter show that the retail sector in India is evolving. Retailers, both traditional and modern, are facing various problems and the government is trying to come up with an appropriate policy regime that will ensure a smooth transition from traditional to modern retailing and improve the productivity, efficiency, and global competitiveness of this sector. Because of retailing's multilevel governance structure, regulatory, fiscal, and other reforms have to be initiated at different levels of government, and there is a need for coordination between and among different ministries and departments of the central, state, and local/municipal bodies. The fiscal reforms in terms of streamlining the interstate differences in taxes and converting India into a single market are a major step in this direction. However, there are problems associated with how to compensate the states and local bodies for the forgone revenue. Unless these are clearly defined, states and local bodies will not be willing or able to do fiscal restructuring toward a single market. The number of licenses and clearance requirements can be reduced through better coordination among different regulatory bodies. To avoid bureaucratic red tape and delays, the authorities can grant licenses/clearances to all outlets of a retail chain within their particular jurisdiction in one transaction, instead of the current requirement of processing the application for each outlet separately. There should be a nodal agency at the centre and state levels for monitoring this sector.

Outdated acts should be amended and multiple, mutually conflicting regulations should be replaced by a few regulations that are essential for the smooth functioning of retailing. Rather than controlling the distribution of food grains and prices, the government should act as a facilitator, encouraging private investment in the supply chain, warehousing, and wet markets. There is need for private investment in logistics services, but private players will not be willing to invest if there is no clearly specified revenue-earning models and regulatory certainty. Although many state governments have modified their APMC Acts, the case of Metro Cash and

Carry GmbH in West Bengal shows that state government departments are still granting licenses on an ad hoc basis. Once a private player is given a license, it should be allowed to operate smoothly. Proper implementation of the APMC Act will also allow contract farming and thereby encourage retailers to source directly from farmers. In such cases, farmers will get a better price for their products and will also get regulatory assurance against contract violations. The state governments also have to amend their land conversion acts and shop establishment regulations to facilitate modern formats. Local authorities/municipalities should identify land for development of retail outlets and incorporate shopping centers/retail mall space in their city/township planning.

With the development of modern formats, new regulations will have to be implemented. For instance, the Information Technology Act of 2000 does not adequately address the issues of online trading and protection for online customers. This needs to be modified. With new forms of retailing such as franchising and direct marketing, there is a need for new regulations. And there is an urgent need for defining and enforcing minimum quality standards in line with international standards. Although the Indian Competition Act (2002) is a global standard and takes into account concerns such as predatory pricing, it is not properly enforced. In countries like Australia, Competition Commission plays an important role against collusions and predatory pricing. In India, it can provide assurance that modern retailers will not resort to anti-competitive practices.

To encourage the inflow of foreign investment in the supply chain, technical know-how, and international best management practices, the government should come up with a clear policy of allowing FDI in multibrand retailing. Single-brand retailers have largely concentrated in luxury goods and catered to high-end consumers. They have not brought in the much-needed foreign investment in the supply chain. Multibrand retailers such as Tesco and Wal-Mart cater to all income groups across a wide range of products. Multibrand retailers, especially in the food and grocery segment, have strong backward linkages. They play a major role in streamlining the production process, developing the supply chain, investing in logistics, and bringing down prices. In fact, they earn profits by modernizing the supply chain and not through product exclusivity. In addition, the FDI restriction is not an entry barrier. Foreign investors are entering the country through different routes while India is losing out on foreign investment and technology. The opening up of multibrand retailing can be gradual, giving the domestic industry enough time to adjust. In the initial stage, FDI up to 49 percent can be allowed, which can then be raised to 100 percent in a three to five year time frame. Unless the operating environment is investor friendly, India will not be able to attract the requisite foreign investment.

The government can help the traditional sector to have a smooth transition and upgrade itself. Since this sector faces a financial crunch, government-owned banks and micro-credit institutions can have innovative packages for meeting its specific requirements. Some banks, such as Syndicate Bank, have already started micro-financing for the small retailers. Insurance schemes can be specially designed for small retailers. One of the biggest disadvantages of the mom-and-pop stores vis-à-vis large retailers is the high purchasing/procurement costs. The government can work with small retailers' associations to streamline the procurement process and encourage them to do bulk purchases through associations. Government can work closely with them in upgrading technology, providing manpower training, investing in infrastructure, and using IT.

The experience of India shows that with economic growth and rising income levels, both modern and traditional retailers can grow. Modernization of retailing is a natural process that will happen as the economy grows and develops. With its strong backward and forward linkages, the development of the retailing sector is crucial for the growth of other sectors such as food processing industry, and tourism. India also wants to develop as a sourcing hub, for which investment in the supply chain is crucial. Since China opened up its retail sector under the WTO, sourcing from there has increased many times over. Unlike China, it is difficult to implement reforms at a fast pace in a coalition democracy[16] such as India. It requires reaching a consensus not only among different departments of the government, but also among different political parties and between the government and the private sector. Unlike China, India cannot use its WTO commitments to speed up domestic reforms. This is because there is no guarantee that a multilateral commitment to liberalize will be honored at home because retail is politically sensitive. It is also difficult to roll back from WTO commitments. India, therefore, needs to unilaterally liberalize this sector before offering binding commitments in the WTO or in its bilateral/regional agreements. The country has indicated that it will be able to undertake commitments at the existing level of openness in the WTO, but it is under pressure from its trading partners to liberalize further. It is likely that in the near future India will initiate some key reforms in retailing, thereby facilitating modernization.

NOTES

1. In 2008, Vietnam replaced India as the topmost attractive destination.
2. For details of the survey see Mukherjee and Patel (2005).

3. National Sample Survey Organization's Employment and Unemployment survey.
4. Industry experts and policymakers pointed this out during the survey.
5. NASSCOM (2004, 2007, 2008).
6. Consumer price is almost 3.5 times the farm gate price.
7. For details see Mukherjee and Patel (2005) and Kumar, Patwari, and Ayush (2008).
8. Since under the Indian Constitution, agriculture is under the jurisdiction of the state governments.
9. For details see Planning Commission (2008).
10. In the case of franchising, FDI (unless otherwise prohibited) is allowed with the approval of the Central Bank (Reserve Bank of India).
11. Subject to the guidelines for FDI in trading issued by the Department of Industrial Policy and Promotion.
12. DIPP (2008), Fact Sheet on Foreign Direct Investment, from August 1991 to May 2008.
13. Countries such as Thailand liberalized during the Asian Crisis (economic slowdown) and due to the lack of demand traditional retailers were marginalized.
14. Mukherjee and Patel (2005) and the survey.
15. Mukherjee and Patel (2005) and Ministry of Food Processing Industry.
16. Coalition democracy is a democracy in which no party wins an absolute majority and the government is formed by a group of political parties.

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FASHION RETAILING IN CHINA: AN EXAMINATION OF ITS DEVELOPMENT AND ISSUES☆

Priscilla Y. L. Chan

ABSTRACT

China represents around 20% of the world's population, and her economy is still performing well under economic crisis. Historical events have shaped different parts of China with different economic developments and cultural encounters. The most prominent difference is between Hong Kong and the Mainland. This chapter would like to examine the development and issues of fashion retailing in China. For better understanding, this chapter starts with a brief discussion on apparel industry development and fashion culture in Hong Kong and the Mainland, follows by historical development and then presents systems of fashion retailing in both Hong Kong and the Mainland. Desktop research and exploratory research techniques were employed. Stores of international fashion luxury brands in Hong Kong, Shanghai and Beijing were visited. Comparison of branding issues,

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particularly for luxury market in Hong Kong and the Mainland are discussed, so are future directions of fashion retailing in these places.

Keywords: Luxury; fashion retailing; brand; Mainland China; Hong Kong.

INTRODUCTION

With a population of over 1.3 billion, China is the world's largest and most populous country. She represents around 20% of the world's population, as the world's population is around 6.6 billion, meaning 1 in every 5 persons is Chinese (Rosenberg, 2010). She is rich in history and cultural tradition. Historical events have shaped different parts of China with different economic developments and cultural encounters. These, inevitably, have resulted in different business practices and diversified consumer lifestyles and behaviour. The most prominent difference is between Hong Kong and the Mainland. Hong Kong, a previous British Colony, has developed into an international metropolitan city, a place where East meets West. She is more advanced in her economic development, and with many international citizens, a new hybrid international culture developed. In the Mainland, the majority of the population consists of local people. Mainland China is an emerging economy and is undergoing tremendous change, development and growth after 1978.

Fashion is indispensable in our daily lives. Everyone needs to wear clothes. The core items of fashion are apparel, extended to include also shoes, bags, eyeglasses and other accessories. Consumer behaviour in fashion is linked closely with economic development, and the living lifestyle of the consumers shapes the format and trends of the distribution and retailing of fashion.

Hong Kong, as a historical contact point of East meeting West, has developed into a fashion centre of design, sourcing, merchandising, wholesaling and retailing for the region. International fashion brands of different market segments and price points are available in Hong Kong (Ling & Taylor, 2001). Flagship stores of different famous international brands showcase their core values and provide unique brand shopping experiences. Hong Kong is a tax-free environment where luxury goods are over 20% lower than in the Mainland. A dynamic city, a place of 1,104.38 km^2 housing a population of over 7 million people (Information

Service Department, 2009) has shaped the fashion distribution and retailing system in Hong Kong. In 2009, Hong Kong had 205,000 millionaire households (increased 16%), with around 8.8% of the total households sharing over 70% of the wealth (Wong, 2010). Hong Kong ranks tenth in places with the most millionaire households. Shops are everywhere and the Tsim Sha Tsui district alone has over 600 stores. Fashion shopping is one of the main leisure activities of Hong Kong people. Large cozy shopping malls, central air-conditioning with selections of chain stores and specialty stores and amenities are the venues for this leisure activity. Products of different price levels are available, including extreme luxury products.

Mainland China has undergone tremendous changes in these 30 years: from a standard uniform to varieties of clothing, from a planned economy to a free one, and from a focus on manufacturing and wholesaling to one that includes retailing (Beijing Consultech, 1999; China Garment Industry Development Report, 2007–2008; Ma, 2007). Distributions of apparel have also changed from having the specialty wholesale market selling to both the wholesalers and individual consumers to having department stores selling varieties of items to individual consumers (MacPheron, 1998; Zhen, 2007). In addition to department stores, many shopping malls and specialty stores have developed, offering different choices for consumers (Hong Kong Trade Development Council, 2009). Mainland China has a population of 1,331.4 million on a land area of 9.6 million square kilometers. There are 22 provinces, 5 autonomous regions, 4 directly administered municipalities (Beijing, Tianjin, Shanghai, and Chongqing), and 2 highly autonomous special administrative regions (Hong Kong and Macau). In 2009, there were 670,000 millionaire households (an increase of 30.7%) in the Mainland sharing 50% of the country's wealth (Wong, 2010). Although China ranks third in the world of countries with millionaire households, there is a wide gap from the second and there is an uneven distribution of wealth a small group of entrepreneurs and investors has emerged in cities like Shanghai. These emerging wealthy groups act as the driving force for luxury markets.

This chapter has five broad sections. Section one briefly discusses the apparel industry development and fashion culture in both Hong Kong and the Mainland. Section two discusses the historical development of fashion retailing in Hong Kong and the Mainland. Section three discusses the fashion retailing and distribution systems in both Hong Kong and the Mainland today. Section four discusses and compares different branding issues, particularly luxury branding in Hong Kong and the Mainland. The last section discusses the future directions of fashion retailing and distribution in Hong Kong and Mainland China.

APPAREL INDUSTRY DEVELOPMENT AND FASHION CULTURE IN HONG KONG AND THE MAINLAND

Hong Kong was declared a free port on the 7 June 1841 by the Commander of the British Foreign Trade. Hong Kong people at that time were mostly boat dwellers, workers and farmers. Their clothes were simple and loose-fitting, with wide sleeves and a large front piece with an opening on one side, called 'large front clothes'. These clothes were made for practical purposes only (Ng, 1992a, p. 2).

The rich Chinese native businessmen wore Chinese robes and long gowns; whereas loose-fitting cheongsams were preferred by the ladies. They went to the tailors to make their clothes according to their body measurements. The Europeans and Americans who came to Hong Kong for the purpose of doing business asked tailors to hand-make clothes for them by imitating the latest fashion from Britain and France (Ng, 1992b, p. 34). There were only a few shops that sold fashionable ladies' wear and majority of the tailors did their business door-to-door by going directly to their customers' houses to do tailoring. At that time, the Chinese people were wearing traditional Chinese clothing, whereas the European and American in Hong Kong were wearing their westernised clothes.

The Revolution in 1911 had a great impact on local Chinese tradition, values and clothing customs (Szeto, 1992, p. 53). Women of the upper class started to liberate themselves from binding their breasts and feet, and they preferred up-to-date 'free style suits' with long or elbow-length sleeves and chin-high collars instead of loose-fitting robes (Ng, 1992a, p. 4). For men, the changes were not drastic. Some cut their pigtails as a revolt against the Qing Dynasty (Szeto, 1992, p. 30). The 'Zhongshan suit', named after the great Revolutionary Dr. Sun Yatsen, became the new type of men's wear. The rich Chinese gentlemen, people from the upper class such as the managers and directors of the Tung Wah Hospital, still dressed in Qing official regalia, which included the *bufu*, the robe with the rank badge, ceremonial hat with tassels, ornaments and feathers and a pair of boots, and some also wore necklaces with beads for formal meetings and ceremonies to enhance and demonstrate the family's reputation and that they were willing to pay for official titles (Szeto, 1992, p. 22). With the closer link to Mainland China and easier travel and communication, women from the upper class and wealthy families in Hong Kong were eager to emulate the fashions of Shanghai, the leading city in China in the early twentieth century. Well-dressed women would pay special visits to Shanghai, commissioning skilful tailors to create their fashionable wardrobes (Clark, 1999).

In 1919, the May Fourth Movement led to lots of new ideas and new culture. With a lot of overseas students returning to China, clothing became more westernised, particularly among the young and well-educated men as well as those from the upper-middle class of Hong Kong. Clothes-conscious women were tempted to take on a new western look. Modified cheongsams appeared in the 1920s, imported from Shanghai to Hong Kong. Since, at that time, women were supposed to stay indoors looking after household affairs and leaving most of the career opportunities for men, the men had a wider exposure to Western culture and so Hawaiian-style shirts and western-style suits began to be accepted for the first time by men in the Chinese society (Szeto, 1992, p. 31). In the 1930s, the Chinese Civil War led to soaring prices. No one worried about what to wear. Many families had their own sewing machines and most women knew needlework and made all the clothes for the family. Only the rich could afford to go to the tailors. At that time, the clothing industry died down.

The influx of entrepreneurs from Mainland China to Hong Kong during the Sino-Japanese War in 1939 set the path for Hong Kong's industrialisation. Following the Communist Liberation of China in 1949, the population of Hong Kong increased from 1.6 million to 2 million, providing lots of labour (Ng, 1992a, p. 6). A large group of Shanghai tailors with experience in manufacturing both Chinese and Western clothes immigrated to Hong Kong. They set up tailor shops or engaged in the textile and clothing industry (Szeto, 1992, p. 31). Most of their products were for export; however, with the growth in the textiles and apparel industry, many women also went to work and became financially independent. Shanghai had been a centre of fashion in the past, since many Shanghai people migrated to Hong Kong and their emphasis on fashion began to influence the Hong Kong people. The whole society began to pay more attention to clothes and fashion. An upsurge of interest in the ladies' long gown, *qipao or cheung-sam*, occurred again during that time. There are common expressions, like 'clothes maketh the man' and 'even Buddha needs gold clothes', that reflected the pre-occupation with fashion that the Hong Kong people showed in the 1950s (Ng, 1992a). Life was not easy in those days. Monthly wages remained under 200 dollars a month. A dollar could purchase only one catty of rice and a suit made by tailor cost 50 dollars. As a result, many second-hand clothing shops appeared.

The cheung-sam or *qipao*, which was originally developed from the attire of the Manchu women (Clark, 1999; Szeto, 1992, p. 55), started to be popular in the 1920s, whereas its golden period was from the 1940s to 1960s. During this period the number of tailors increased to as many as one thousand. However, this number started to decline from the 1960s because many young tailors went to work in the sample rooms of the garment factories. As a result, there were less than 250 tailors in the 1990s (Ng, 1992b, p. 22). The earliest style of cheung-sam was loosely fitted and ankle length, then descended to mid-calf or knee length. It may have long, medium sleeve lengths or cap sleeves and the collar may be as high as the ear level. The movie star Gu Lanjun took the lead in introducing side slits to the cheung-sam, which were gradually cut higher and higher (Wu, 1989). More women preferred to wear tight-fitted cheung-sams with slits on both sides of the hem to show the curvaceous body shape. The evolution of the cheung-sam kept abreast with the trends in Shanghai and later western details like laces and satin were added.

Men's suits from Hong Kong and Italy had a reputation for quality and international flavour. Western tailoring can be dated back to the 1920s when over 600 people were engaged in the production of tailored suits, which at the time were exclusively for the upper class (Ng, 1992c, p. 26). A tailored jacket with trousers could cost around 1 dollar and 50 cents, whereas a tea house bill cost a few cents and a rented bed cost 2 dollars or so. Suit tailors were popular in the 1940s. Wing On, Sincere and other major department stores established counters for tailored suits and tailor shops were all over the city (Chan, 1998; Chu & Yick 2004). The golden period of tailored men's suit was in the 1960s, with over 15,000 tailors (Ng, 1992c, p. 30). In the 1970s and 1980s, readymade suits became available in the market, and chain stores appeared. This caused a decreased in the number of traditional tailors, although they could still be found in the hotel malls.

Many dealers who had originally run ladies' fashion came back to Hong Kong and expanded their businesses after Hong Kong recovered from the Japanese occupation in the 1940s. In the 1950s, many fashion professionals who had originally engaged in the fashion business in Shanghai came to Hong Kong together with many famous tailoring masters. They established big fashion shops in Kowloon from Prince Edward Road to Tsim Sha Tsui. Each shop had its own workshop which employed several tens of skilled masters and shops in Tsim Sha Tsui also offered custom-made services to women and sold ready-made garments. These shops also attracted tourists because of their 'efficient services and excellent tailorship'. They also established many well-known fashion shops in the North Point, that the place was once called 'Little Shanghai' (Ng, 1992d).

In the 1960s, with the speedy development of the textile and clothing industry, women went to work in the factories and became more independent. With the influence of American culture and the completely westernised appearance of local movie stars like Chan Po-chu and Siu Fong-fong, Hong Kong people began to demand western clothes (Ng, 1992a).

Women's suits gradually took the place of the cheongsam and other Chinese style garments (Chan, 2001, p. 145). The ready-to-wear market emerged.

In the 1970s, with equal education opportunities for both genders, professional women began to make their appearance in Hong Kong society. They were more sensitive to fashion than men and eager to catch up with the world fashion trends. Denim from America appeared everywhere and Hong Kong people began to place less value on conservative way of dressing, they prefer mini skirts, bell-bottom pants and jeans (Szeto, 1992, p. 59; Chan, 2001, p. 145). Suits and ties were no longer essential and tailors were slowly replaced by clothing companies, boutiques and department stores. The post-1970s period in Hong Kong was an age of modernisation and diversified economic development. In addition, Hong Kong was rising as an important financial centre.

With this rapid development, the city was becoming an international metropolis, whereas its people's incomes increased considerably. Hong Kong stood fifth among countries with earnings in the mid-level in the early 1980s in the annual report 'World Development in 1980' published by the World Bank. In the mid-1980s, the 'yuppie' class emerged in the mid-1980s, they are young urban professionals who enjoyed high salaries (Ng, 1992a). They cared about style and taste, they went after famous brand names and high class fashions, and turned Hong Kong into one of the world's top fashion centres. Fang Brothers, originally a knitter, started to establish their own brands in 1985, such as Jessica, Episode, etc. (Fang, 1992). Manhattan Garments, originally a jeans manufacturer founded their fashion chain G2000 and U2 in 1979 (Tien, 1992). Peninsula Knitters established Belford brand in the United States (Tang, 1992). Wing Tai Garment established brands Pacific Coast Highway and Baxter in the United States and Campri, Lee Cooper and L'Ultima in Europe (Cheng, 1992) and Yangtzekiang Garment established a specialised shirt brand Doctor (Chan, 1992). In the 1990s, local brands like Toppy, Episode, Bossini, Giordano, etc. appeared, whereas Joyce Boutique, Swank Shop, Lane Crawford introduced different international brands from Europe and America to Hong Kong.

HISTORICAL DEVELOPMENT OF FASHION RETAILING IN HONG KONG AND THE MAINLAND

In this section, fashion retailing development in both Hong Kong and China are discussed briefly.

Hong Kong Fashion Retailing Development

Hong Kong is an East-meets-West, mixed-culture, metropolitan city. The success of Hong Kong's retailing is due to the high growth speed of Hong Kong's economy. During the Second World War, the Chinese government supported Korea against the United States, so the western countries had an embargo on China. The British Government did not allow Hong Kong to trade with Mainland China. This stopped the entre-pot trade and Hong Kong was pushed to establish a labour intensive industry in the 1950s and 1960s, with cheap local labour and imported raw or semi-finished products from abroad. This set the foundation of Hong Kong's multidimensional economic situation and internationalisation.

Along with this industry, Hong Kong's trading, financial, logistics, and transportation industries developed. In retailing, in addition to small individual stores, the department store developed as another common mode. For example, Sincere Company Limited opened in 1900. Then Wing On Department Store opened in 1907, followed by other department stores. The 1960s was the golden age for Chinese products companies (Chan, 1998; Chu & Yick, 2004). Chinese products had stable quality, were priced reasonably and offered a very good choice for the consumers, particularly for those with limited disposable incomes in the beginning of economic growth. In the 1970s, there were more than 130 Chinese products companies. The 1970s was also the golden age of the department store, with the number of these increasing from 32 to 82. In the 1970s, Hong Kong gradually developed from a manufacturing base to a more service-oriented one (Cheng & Fing, 2001). Hong Kong's economy entered into a high speed growth period, and the citizens' disposable incomes increased very quickly. With the increase in disposable income, consumers looked for quality products, brands, styles, and colours. European and American brand clothing, shoes and sportswear goods were welcomed by consumers in Hong Kong. Many foreign companies established their shops in Hong Kong and traditional department stores began to face new challenges.

Shopping malls also appeared in the 1960s and 1970s, established in different commercial buildings, or large residential estates. One of the remarkable opening is Ocean Terminal in 1966 that symbolised the beginning of 'malling' in Hong Kong and arrival of growing affluence (Lui, 2001, p. 33). Depending on the positioning, shopping malls introduce different level department stores, specialty stores into the shopping mall. Each shopping mall creates a very comfortable environment, grouping retail stores of different commodities together. A shopping mall also has coffee shops, restaurants, fast food stores, supermarket, and some have cinemas, amusement areas, ice-skating, etc. For example, Harbour City has 700 shops, with over 90 shops selling ladies' wear, 50 shops selling menswear, 45 shops selling casual and sportswear products, 30 shops selling children's wear and toys, 2 department stores and 2 supermarkets, 50 shops selling leather and shoes, 80 shops selling gift, jewellery, swatches; 25 shops selling art products, 16 shops selling electronic and audio-visual products, 19 shops selling household products, together with 2 cinemas, 50 restaurants, and 30 banks and other services (www.harbourcity.com.hk). Most of these shopping malls are operated by different large estate developers and they are everywhere, such as the Landmark was opened in 1980 in Central right above the MTR station in the central business district, the Cityplaza opened in 1984 in Taikoo Shing which is a massive new housing projects for middle class redeveloped from previous dockyard and Lok Fu Shopping Centre II in 1991 as an extension to the existing shopping centre of a redeveloped public housing estate (Lui, 2001, p. 39).

Before the financial crisis, Hong Kong enjoyed a high economic growth, residents' purchasing power was increasing, and with a yearly GDP growth rate of 16.5% and 1.3% unemployment rate in 1989 (Information Service Department, 1990). With booming economy and increasing salary, in 1987, Hong Kong residents spent 800 billion Hong Kong dollars. In 1988, the total retail sales went up to 1895 billion HK$, which was a growth of 21.3%. So the 1980s was the golden age for retail development. Parkin and Welcome, the two big supermarket stores, had severe price competitions to the extent with some products marked below wholesale prices that led to the closing of many traditional small and medium grocery shops and smaller supermarkets. In the 1980s, Japanese department stores had successfully filled the market gap (MacPheron, 1998). Although there were only 15 large Japanese department stores, they enjoyed 30% of the total sales as they found the market gap for the emerging middle class. The traditional department stores were either aiming only at the expensive market for the upper class or providing an inferior quality of the not-so-expensive items, so these Japanese department stores meet the demands of the rapidly increasing middle class, and the young people looking for new commodities, adding coffee shops, bars and little playgrounds within the department store and providing diversified shopping and relaxation venues.

With the severe competition, Hong Kong department stores became larger and larger, and developed into large Groups. For example, in 1984, there were 84 department stores owned by local people with 184 store venues. However, in 1988, there were only 48 department stores with 66 store venues with the floor space of each store increased from 8,000 to 20,000 ft^2. Their product lines had also increased, from selling products made solely in China and Hong Kong to selling items from different parts of the world. The management style also changed from the family business with family members holding all key positions to recruiting experts in the field (Access Asia, 2002). There were large differences in prices for different stores because of the differences in rent for different locations, the sources of products, etc.

The financial crisis in 1997, together with 911 in the United States in 2001, contributed to Hong Kong's change into a knowledge economy, network economy, advance technology, free port and service centre. The financial crisis also dealt a serious blow to the retail industry in Hong Kong. This was not only because of the weak consumption behaviour of the local economy, but also the weak surrounding economy, which caused a lot of companies to close down (www.hkrma.org). However, the people of Hong Kong are very flexible, hardworking, dynamic and adaptive. They are willing to take risks, move along with the changing economic and financial situations and seek different opportunities. For example, faced by the challenges from many specialty stores and specialty chain stores, especially for the younger generations, department stores have moved in two directions. One is to move towards specialising, e.g. Lane Crawford caters for the high-end up-market segment, selling international designer labels, accessories and other luxury-branded products. Another trend is to be more diversified and included supermarket, e.g. Yue Hwa Chinese Products.

Another blow to the Hong Kong retail business was the SARS epidemic in 2003. The outbreak of SARS in Hong Kong from March to June 2003 resulted in a sharp drop in the number of visitors from both Mainland China and overseas. The Hong Kong Government granted rental relief to some retail tenants in the Housing Authority, whereas some landlords reduced the rent. Retail situations started to improve slightly from June 2003 onward (www.hkrma.org). The Individual Visit Scheme was launched on 28 July 2003 to boost the economy of Hong Kong and Macau. This scheme allows travellers from Mainland China to visit Hong Kong and Macau on an individual basis for a short period of time (7 days each time). Before the scheme, Mainland residents could only travel to Hong Kong on a business visa, or in a group tour. In the initial stage, citizens of Beijing, Shanghai, and eight Guangdong provincial cities could apply for visas to visit Hong Kong individually. The scheme was extended to all 21 cities of Guangdong in July 2004 and then extended to other cities in the Mainland. The scheme brought an immediate surge in the number of Mainland visitors. In the short period from 28 July to 4 November 2003, more than 600,000 individuals in the Mainland applied for visas and 450,000 visas were issued. The number of visitors under the scheme reached two million in May 2004. There are nearly 4.3 million Mainland visitors visited Hong Kong in 2004 (Information Service Department, 2004). Many women joining the Individual Visit Scheme come to Hong Kong because they want to buy brand-name products, gold jewellery and cosmetics. This has also attracted more overseas visitors to come to Hong Kong. Visitors from Mainland China think it is safe to buy luxury items in Hong Kong and they can be sure that the products are genuine. The booming of the economy and the possibilities to make known their brands to Mainland visitors has attracted many luxury companies to establish their flagship stores in Hong Kong. Prime locations in prime shopping districts, prime street-level shops in Central, Tsim Sha Tsui and Causeway Bay, especially those with larger floor plates to accommodate flagship stores, were sought after by many international brands. These brands established their flagship stores in Hong Kong as Hong Kong is a very good window to show their products to visitors from Mainland China and overseas.

The economic crisis that started in the second half of 2008 also affected the retailing business in Hong Kong, so the Individual Visit Scheme has been extended to other provinces in Mainland China and has attracted different customers to shop in Hong Kong. There is a tendency towards bipolar demand, either very luxury products or very low-priced products for these visitors. Retailers are facing difficulties and need to have temporary rental relief (www.hkrma.org). The second half of 2009 showed a slight increase in sales. Mainland's implementation of measures to facilitate the visits of Shenzhen residents, the 'same day consumption visits', has contributed to an increase in the average per capita spending from HK$1,498 in 2008 to HK$1,700 in 2009. With the booming of the economy by the end of 2009, the number of millionaire households in Hong Kong had risen by 16% (Wong, 2010), and tourists are still one of the major fashion retailing consumer groups in Hong Kong.

Mainland Fashion Retailing Development

Before 1980, the Chinese economy was a highly centralised planned economy. Since 1950s, the circulation of all goods from production to sales was controlled by the Government and each month, people were allocated a certain fixed number of goods through the shops (Zhen, 2007; Li, 2009).

During this period, retailing was completely under the government's control and was administered as an allocation tool. The State Planning Commission (SPC) made a plan quota for each product and then the factory produced the product. Products circulated from factories to National Distribution Centers to Provincial Warehouse Stations to Local Stores to Consumers. Stores sold items at the prices set by the State Bureau of Commodity Price (SBCP) and the whole transportation process was undertaken by the state-owned transportation companies (Zhen, 2007, p. 68). This did not involve any marketing efforts and there was no concept of retail format. They were actually just outlets for distribution and could not keep any profits which had to be handed to the government. By 1978, there were about one million retail stores as allocation outlets and there are always shortages of commodities. There are state-owned stores and collectively owned stores. The former dominated the urban areas while the latter monopolised the rural areas. Privately owned stores were not allowed, and neither were traditional free markets at that time.

From 1980, China began an economic reform, increasing the autonomy of the State-owned Enterprises (SOEs), and a dual-track price policy was introduced. Under this policy, the planned prices and planned quotas for delivery were maintained as before. Enterprises were allowed to sell output in excess of their quotas with negotiated prices in markets, to plan their output accordingly after fulfilling the plan quotas, and had the right to retain some of the profit they made (Zhen, 2007, p. 71). Many private enterprises emerged during this period, particularly in Southern China. China fashion retailing in the 1980s was dominated mainly by the wholesale market. Garments produced by the factories were sold to individual wholesalers or agent wholesalers to be sold to the fashion retailers in the wholesale market and then to the final consumers. Garment manufacturers could only select and manage good wholesalers to distribute their products for them. Private enterprises were market-oriented and they drove the development of the real market. When specialised markets appeared during the 1980s, they mainly specialised by different product categories, such as 'suit specialist', 'blouse specialist', 'trousers specialist', 'ladies' wear specialist', 'sportswear specialist', etc. Each store sold a particular product category. However, the situation changed in the mid-1990s. The markets become brand specialty stores, like 'Shan Shan Specialty Store', 'Li Ning Specialty Store', etc. This was a change catering for the demands of the consumers (Access Asia, 2002).

China decided to open up retailing in 11 selected cities as a trial in 1992. One example was a joint-venture between Japan-based Yaohan and Shanghai Number One Department Store (Li, 2009). In 1993, price controls were largely eliminated, the economic situation was better, and retail joint-ventures became popular (Zhen 2007, p. 75). In the beginning of the 1990s with a period of economic development, medium and large department stores and shopping malls appeared. They were close to the consumers and located in very strategic locations, so many of them developed to be popular among consumers. Since they were at the front line facing the consumers directly, many distributors and manufacturers supplied garments to these stores directly and established specialty corners.

During the mid-1990s, fashion manufacturers were not only selling their products to wholesalers and retailers, at the same time some of them also established their own specialty stores and managed their own distributions (Cheng & Kierzkowski, 2001). Some established subsidiary offices in different places and then these subsidiary offices arranged and distributed products to different specialty stores. This often required a long time to supply and react to market demands. Another way was for manufacturers to supply products directly to the specialty stores, with no subsidiary office. The head office would have direct control and understanding of the sales and marketing situations of the different specialty stores and would be able to react directly. However, there was limited space for stock keeping, so it would take a longer period of time to have replenishment.

Some manufacturers found that establishing their own specialty stores did not increase distribution efficiency but increased costs and so reduced profits. As a result, during the late 1990s, the manufacturers delegated the distribution tasks to large representative agents, so these agents helped distribute the products to the retailers and then to the final consumers (Cheng & Kierzkowski, 2001). Franchising is a popular distribution method for manufacturers. This method can enhance the expansion of their markets without having a lot of monetary investments, and it can also prevent large distributing agents controlling the manufacturers. In 1997 and 1998, many retailers were forced out of business. The economic reform caused many workers to be laid off, and future uncertainty made people reduce their consumption. Foreign hypermarkets such as Carrefour, entered China in December 1995 and Wal-Mart in August 1996. These chain stores operated with low-price strategies, which made them popular quickly (Beijing Consultech, 1999). The China government also promoted chain store operations in 1994 with low interest bank loans, tax reductions and discount rents, so chain-operated Chinese department stores and other chain stores developed very quickly and tripled in numbers in 1998. On 25 June 1999 all provincial capitals were opened to foreign retailers and, in December 2001, China joined the WTO (Zhen, 2007, p. 83). The expansion of foreign retailers in the Chinese market has been accelerated and Chinese retailers try their best to acquire as much market share as possible. The traditional department store was once the first priority for consumers because of the different varieties of products offered, prestigious and high quality. However, with economic development and new forms of retailing formats appearing, department stores have slowly been losing their popularity. In reaction to the trends and demand of consumers, some department stores developed into shopping malls, adding restaurants, different entertainment facilities, cinema, art museums, etc. (Li, 2009). Local clothing stores evolved from selling single clothing items into brands selling mix-and-match collections with themes. Many local brands are developing and are facing severe competitions with foreign brands which are more familiar and experienced in marketing and retailing fashions. The retailing market is continuously changing and evolving.

With the economic growth of Mainland China, many international companies have established offices in different parts of the Mainland, in particular those first tier cities like Beijing, Shanghai, etc. (Access Asia, 2002). With the possibilities for the people in the Mainland to travel abroad freely, and the increase in the living standard and salary, people are knowledgeable and demand overseas brands. Many of them demand luxury products. Further encouraged by the Olympic Games in Beijing in 2008, and the World-Expo in Shanghai in 2010, many shopping malls were developed and international brands established their stores, boutique flagship stores in the Mainland. With the constant economic growth in China, even during a crisis, there has been over 30% increase in the number of millionaire households in 2009 (Wong, 2010), and many luxury brands are continuing establishing new stores in different part of China. Many Hong Kong land developers have also expanded their businesses in Mainland China and built new shopping complex in different parts of China.

GENERAL FASHION RETAILING SITUATION IN HONG KONG AND THE MAINLAND

General Fashion Retailing in Hong Kong

Hong Kong is a fashion paradise, with international brands from different parts of the world and in different price brackets. Many international brands have opened flagship stores in Hong Kong to showcase their collections and concepts. Hong Kong's retail market is mainly in commodities, particularly imported goods. Hong Kong has a very strong local retail market, with highly international characteristics. Products available in the markets are from over 160 countries or regions in the world.

Hong Kong is both an exporter and importer. It is located in a very good strategic geographical location, attracting people not only from different parts of Mainland China, but also from South East Asia. Data from Information Service Department (2009) showed that we had 29.59 million tourist arrivals (over 60% from the Mainland) in 2009 and with 7 million local residents, these contributed to a very busy, strong and successful local market. Imported commodities, together with locally produced products, make a very strong wholesale and retail market in Hong Kong. Hong Kong is a shopper's paradise, a tax free and free trade economy. It also has very good transportation systems. In addition, Hong Kong allows parallels to be sold here. The retail market is the second largest industry, with a total of 57,000 establishments employing over 236,000 people.

Shopping is one of the major leisure activities for Hong Kong people. One is able to find shopping facilities and venues everywhere in Hong Kong. Retail establishments include shopping centres, department stores, chain stores, specialty stores, supermarkets and convenience stores. Air-conditioned multi-functional shopping malls, which usually have indoor car parks, bus termini or MTR stations, are commonly found in Hong Kong (Wong & Chan, 2008). Even if the weather is hot or raining, people can spend the whole day inside the shopping mall, where they have a choice of different types of restaurants and fast food, can go to the cinema to watch a movie, have their hair done, have a cup of tea after shopping for a while, etc. All activities are 'weather-proof', meaning they are not affected by the thunder storms, or heavy rain outside. In Hong Kong, it is possible to see new retailing concepts, e.g. in Elements, a large shopping mall link to the Kowloon Airport Express Station, and terminal for buses to Shenzhen Airport, you are able to find self-contained two-storey boutiques of individual fashion houses. Although all these boutiques are within the shopping mall, when you enter the boutique of an individual fashion house from one floor, inside the store, it has its own stairs to go to another floor of the same fashion house. This is just like moving a whole street of two-storey fashion houses inside the shopping mall. In addition, a new fashion retail concept called dual-branding has been introduced to Hong Kong. An example of this is the store Y' Mandarina Duck that sells two lines, original Mandarina Duck and Y's Mandarina (a co-brand line with Yohji Yamamoto and Mandarina Duck) together under one roof. In fact, this company opened its Hong Kong shop in Hong Kong before its New York one (Chan, 2008).

Shopping Malls in Hong Kong

There are shopping malls in different parts of Hong Kong. Every MTR station has at least one shopping mall. Each large residential estate also has at least one. Shopping Malls in Hong Kong have different characteristics and positioning, targeting different customers, and many of them are linked with hotels. For example, the *IFC Mall* (www.ifc.com.hk), the shopping mall of the International Financial Centre, focuses more on local residents and the international population working in the financial centre, those middle to upper class consumers who like a leisure environment with ample space to go shopping. This shopping mall is linked with the Four Seasons Hotel, and the flagship Lane Crawford houses inside this mall also have interior designs by famous artists, cozy cafés and also luxury personal styling rooms for the customers to enjoy professional personal styling services. The *Landmark*, the *Charter House, Prince's Building, Time Square, World Trade Centre, the Lee Gardens, Island Beverley, Pacific Place,* the *Peninsula Hotel Shopping Arcade, Harbour City (Ocean Terminal), 1 Peking Road*, *the Sun Arcade, Elements, Park Lane Shopper's Boulevard, Beverly Centre, Langham Place,* and *Festival Walk* are for both local residents and tourists (Wong & Chan, 2008).

The *Peninsula Hotel* has been creating the legend of luxury since 1928. Many customers have a relaxing afternoon tea in the coffee lounge before starting the journey of shopping at the many international luxury labels in its arcade (www.peninsula.com). *1 Peking Road* in Tsim Sha Tsui is a place that houses many flagship stores of international luxury fashion labels, such as Dior, Dior Homme, Fendi, Miu Miu, Cartier and Ermengildo Zegna (www.onepeking.com.hk). *Harbour City* is a huge shopping complex in Tsim Sha Tsui. It is part of a series of office blocks and hotels. It has four parts: Marco Polo Hong Kong Hotel, Ocean Terminal, Ocean Centre and the Gateway. It is along the Canton Road, stretching from the Star Ferry to the China Hong Kong Terminal, and houses department store Lane Crawford, supermarkets, stores with different price brackets and different types of merchandise. It houses the boutique store of Louis Vuitton Maison, Salvatore Ferragamo, Shiatzy Chen, Versace, Burberry, etc. (www.harbourcity.com.hk).

Element has over 1 million square feet of retail space. The whole shopping mall was built based on the traditional five elements of nature: water, earth, fire, wood and metal, by architectural firm Benoy, best known for Bluewater in the United Kingdom. Each zone (element) features a different mix of retailers as well as artwork and interactive installations reflecting the theme. There are also 700,000 ft^2 rooftop gardens, a 700-seat cinema and an ice rink. This shopping mall also links with a large residential estate (www.elementshk.com).

MegaBox is a large shopping mall in Eastern Kowloon and the largest block plaza in Hong Kong. As the name implies, its positioning is 'mega'. It has the largest book store in Hong Kong, the only ice-skating rink that meets international standards, an IMAX film display system and a mega store of household items (www.megabox.com.hk).

The *APM Shopping Mall* is located in Kwun Tong, a district that was previously an industrial district with factories, now turning into a commercial and residential area. It is a seven-storey arcade with restaurants, clothing stores, cosmetics shops and a cineplex. It is also linked with a bus terminus and parking facilities. Its name 'APM' implies that visitors are welcome both day and night. Catering for the habits of the community it serves, some shops close at 12 midnight, restaurants close at 2 a.m. and there are stores that operate for 24 h. It is positioned to attract the 15–35 age group and is a 'vertical mall': the escalator takes the visitors to the upper storey of the mall, from where they make their way downward. Catering for young families with new-born babies, washrooms for both genders have sitting places for the baby inside the cabinets to facilitate the father or mother with the baby (www.apm-millenniumcity.com).

New Town Plaza in Shatin is one of the early large shopping mall for residents of the New Territories. It was renovated recently to cater for the changing styles of the population. It is one of the most dynamic shopping centres, close to the City Hall, MTR station, bus terminus, etc. In addition to all the features of shopping malls with restaurants, fashion stores, department stores, cinema, household stores, Hi-tech stores, etc., it has a music fountain with water that dances to the changing rhythms of the music and a Snoopy Land for children (www.newtownplaza.com.hk).

Festival Walk is located at Kowloon Tong, the MTR station that links the MTR line and the East Rail line together. With this strategic location, consumers from different parts of Hong Kong Island, Kowloon Peninsula and the New Territories come to this mall. This shopping mall offers over one million square feet of sky-lit shopping space. It houses many large names in the fashion industry, a unique fusion of flagship stores and boutiques, selling luxury items, street fashion, home accessories, cosmetics and books. Restaurants, ice skating, cinema, bus terminus, and stations for coaches to the Mainland are also available (www.festivalwalk.com.hk).

Island Beverley at Causeway Bay features many local designers and imported Japanese and European clothing. *Rise Shopping Arcade* and *Beverly Centre* are shopping malls for fashionable youngsters.

Department Stores in Hong Kong

Sincere Company and Wing On Department Stores still have their chain department stores in Hong Kong selling international collections. In addition, Lane Crawford, Harvey Nichols and Seibu are selling to the high-end upper-market segment with designer labels collections. Sogo, Apita, Jusco and Yata are Japanese department stores with supermarkets and selling lifestyle products. Yue-wah Chinese Products is a chain department store that originally sold only products produced in China, but that now also includes a small portion of merchandise from other countries.

Flagship Stores

Hong Kong is a very good 'window' for promoting brands to consumers in the region, including greater China, and South East Asia. International fashion brands like Agnès b, Burberry, Celine, Chanel, Chloé, Christian Dior, Coach, Dolce & Gabbana, DSquared2, eYe Junya Watanabe Comme Des Garcons, Fendi, Giorgio Armani, Gucci, Hermès, Loewe, Louis Vuitton, Marc by Marc Jacobs, Moschino, Nike Sportswear, Prada, Ralph Lauren, Salvatore Ferragamo, Valentino, Yves Saint Laurent, etc. have opened flagship stores in Hong Kong. All these flagship stores are concentrated mainly in Central, Admiralty, Causeway Bay, Tsim Sha Tsui and Kowloon Tong. Many of them are located inside large shopping malls.

Chain Stores

Many Hong Kong fashion entrepreneurs and manufacturers have expanded their businesses by developing retail chain stores, e.g. Anteprima, Bauhaus, Bossini, Colour 18, D'urban, Episode, EQ:IQ, F.C.K. (Fashion Community Kitterick), G2000, Giordano, I.T, i.t, Jessica, JeansWest, Joyce, Kingkow, Laosmiddle, mademoiselle, Moiselle, Shanghai Tang, Si Boutique, Si Sport, Swank Shop, www.izzue.com, etc. and many of them have developed into international chain companies with stores not only in Hong Kong, but different parts of the world.

Street Markets and Others

Hong Kong also has street markets, wholesale markets and outlets as an additional choice for consumers.

General Fashion Retailing in Mainland China

In this vast land with its economic developments, new hotels and shopping malls are continuously being built and new fashion brands are entering into the market. The retailing system is facing tremendous changes and these changes are continuing at high speeds. In general, the regional shopping mall is the main trend (with the largest sales turnover), and the large department store shopping mall is the main fashion distribution channel. In the city, the brand specialty store is the second largest fashion distribution channel after the shopping mall (Access Asia, 2002; Ma, 2007; Hong Kong Trade Development Council, 2009). In the rural area, the wholesale market is still popular. People can go to the wholesale market to buy clothing items, this being particular attractive to those with lower income levels. Another change is the move away from stores with a single product category.

Shopping in Shanghai is mainly 'Four streets and four cities' plus other shopping areas such as the Bund (www.travelchinaguide.com; Hong Kong Trade Development Council, 2009). Nanjing Road (including East Nanjing Road and West Nanjing Road) the first commercial street, houses products of different price levels. These include the Jiuguang City Plaza, housing Tiffany & Co and Omega, Plaza 66 with Louis Vuitton, Dior, and Prada; Huaihai Road featuring luxury brands like Gucci, Ferragamo, Hugo Boss, Kenzo, Bally and shopping malls and department stores such as Printemps, Parkson, Shanghai Time Squares, etc.; North Sichuan Road offers non-expensive merchandise for the ordinary people and Middle Tibet Road for food and tourism. Four cities are Yuyuan Shopping City, specialising in Chinese goods and local craft; Xujiahui Shopping City with large stores with different price levels; New Shanghai Shopping City located in Pudong and surrounded by retail outlets and Jiali Sleepless City facing the railway station. Many flagship stores of international brands are located in the Bund, such as Giorgio Armani at Three on the Bund, Dolce & Gabbana at six Bund and Cartier, Patek Philippe, Ermengildo Zegna and Boucheron at Bund 18. Prada has opened another boutique at the IFC Shanghai Mall and Ralph Lauren purple label/collection has launched at the Peninsula Hotel in Shanghai. Shanghai is still developing and there are many new shopping malls under constructions.

In Beijing, the two main shopping areas are Wangfujing Dajie, which is a 700 years old business street with a variety of shops and brands of different price levels; and Xidan Commercial Street with food and clothing stores (www.travelchinaguide.com). This has Xidan Department Store, Xidan Shopping Centre and Chung You Shopping Centre, with counters for Dior, Channel, Gucci, etc. Shopping malls like the Place, Shin Kong Palace, the Malls at Oriental Plaza and the China World Mall at the China World Trade Center house many luxury brands like Tiffany, Louis Vuitton, Salvatore Ferragamo, Chloe, Hermes, Loewe, Alfred Dunhill, Christian Dior, Max Mara, Prada, Fendi, etc.

The different retailing formats available in Mainland China (Access Asia, 2002; Beijing Consultech, 1999; Cheng & Kierzkowski, 2001; Hong Kong Trade Development Council, 1994, 2009) are:

Brand Specialty Stores

The fashion brand specialty store is one of the popular modes, they can be located inside the mall or as individual store at street-level. Basically, these stores are either directly established or run by manufacturers or through the form of franchising. The majority of the large manufacturers invests in large shopping malls and opens the specialty stores to conduct their retailing business. Some large international brands run their own stores because can protect their brand values and it is easier to control. However, the franchising mode is also a very popular fashion retailing mode for in China.

Brand Special Corners

This refers to special corners or counters inside large department stores or supermarkets. The majority of fashion brands use this mode because it is easy to promote brand awareness, facilitates product displays and increases sales volume, particularly when opened corners or counters in different large department stores or shopping malls. Brand special corners can have consistent image, price level, product style and display to create consistent desired positioning in the minds of the consumers, thereby increase their sales.

Individual Retail Stores

This is the most common format, in which an entrepreneur buys products from the wholesale market and then sells them in their store. This type of store has greater flexibility and freedom. The entrepreneurs can have special ‘characteristics’ or positioning to attract consumers, such as a store selling only printed T-shirts.

Department Stores/Shopping Mall (Specialty Stores + Brand Corners)

With the establishment of electronic specialty stores and home decor specialty stores, many electronic companies have moved out from the department stores, leaving fashions and shoes as the traditional products in department stores. Many of the large department stores are now operated inside large shopping malls with open styles of separate corners or counters for each individual brand. It is common to have some brands having both counters inside the department store and specialty stores in the same shopping mall. This enables the brand awareness to be aroused among the consumers and also to serve different types of consumers. Some consumers enjoy shopping inside a department store as they can easily enjoy the VIP and other promotions offered by the department store by shopping different brands of products together. Other consumers like the atmosphere and intangible satisfaction offered by the brand specialty stores. There are different levels of both department stores and shopping malls catering for different consumer groups. Usually they have strict controls over the way their tenants can do promotion, business format and interior design.

Clothing Commercial City (Specialty Store and Individual Retail Shops)

This type of city provides only the space for companies to set up their stores, with less restrictions, and simple estate management. Tenants are free to arrange their interior designs and business formats, hence these cities may give an impression of untidiness. At present, the clothing commercial cities in Guangzhou are operated with specialised themes. For example, the Trend Frontline specialises in stores selling all types of trendy items, winning the hearts of the trendy young people. Tung Chung Sportswear City specialises in active sportswear and attracts the attentions of sports lovers.

Large Supermarkets (Specialty Stores and Counters)

With the booming development of large supermarket or mega stores, clothing items have also appeared in these stores. Usually these stores will have a brand of supermarket/mega store on the first floor inside the store, usually with a lower price level to attract price sensitive consumers, and some corners of medium to low priced casual wear brands aimed at increasing brand awareness and influence.

Wholesale Markets and Outlets in the Mainland (Specialty Stores and Individual Stores)

We can separate China's clothing wholesale markets into three geographical categories, namely *regional*, targeting local regions such as Huangzhou Sijiqing clothing wholesale market, and Beijing clothing wholesale market; *national*, such as Han Jin Street of Wuhan and Wu Ai Market of Shenyang; and *international*, the clothing market for international trade such as Guangzhou and Fumen. The product categories can be separated into collective, mixed and separated. In the collective clothing wholesale market, menswear, ladies' wear, children's wear, jeans wear and infant wear can be seen. For the mixed wholesale market, we can find not only clothing items, but also other items like household items, furniture, etc. For separate or specialised provisions, we have the jeans wear wholesale market, ladies' wear wholesale market, fur wholesale market, etc. Many consumers go to the wholesale markets as they also sell to individuals, particularly in the second or third tier cities. On the outskirts of Shanghai a large outlet mall is available.

COMPARISON OF LUXURY BRANDING IN HONG KONG AND THE MAINLAND

Luxury Branding in Hong Kong

Hong Kong is a metropolitan international city. With a long history of contacts with different parts of the world, it is an important financial and fashion centre. It is a city with mixed cultures, people can easily appreciate other cultures and many people have multi-language skills. Foreigners find Hong Kong easy to adapt to and to live in. International cuisine and international brands of different images, and segments are available in Hong Kong. Many international companies establish regional offices in Hong Kong because of its strategic geographical location and concentration of the industry and long-term establishment.

Hong Kong is not a place where there is a huge demand for haute couture design, as in Paris and Los Angeles; however Hong Kong's economy has developed one of the most affluent consumer societies in the world, so local consumers have demands for luxury products and have opportunities for haute couture design. Many visitors come to Hong Kong because of the low import and sales taxes and large collections to choose from. In addition, many brands make use of Hong Kong as a doorway to the Mainland. Hong Kong is located in a very strategic position that enables it to serve as a window not only to consumers from the Mainland, but also to visitors from other parts of South East Asia.

Hong Kong is a place for ready-to-wear markets. Consumers in Hong Kong are more knowledgeable and mature, with a long history of exposure to the rest of the world. When visitors come to Hong Kong, they also discover the brands available here and how Hong Kong people wear fashion. Many international fashion brands have established their flagship stores in Hong Kong to showcase their brand concepts and full collections. This has particularly been the case after the Individual Travel Scheme of the Chinese Government allowing Mainland citizens free travel to visit Hong Kong and Macau. Many luxury brands have selected Hong Kong to be the first place to establish their large flagship stores for the Greater China region, such as Giorgio Armani and Ermenegildo Zegna. They have bold logos and brand images and have created full-brand experiences for the consumers. The flagship store of Giorgio Armani in Hong Kong is located at the Charter House, Central houses Giorgio Armani, Emporio Armani, Armani Jeans, Armani Casa (home collection), Armani Libri (bookshop), Armani Flori (flower shop), Giorgio Armani cosmetics, Armani/Bar HK (bar), Armani Dolci (sweet shop), Emporio Armani Accessories, etc. providing the total Armani empire experience. For Ermenegildo Zegna, the flagship store in 1 Peking Road, Kowloon, houses Ermenegildo Zegna, couture line, made-to-measure services, Zegna Sport, Z Zegna, etc.

In Hong Kong, brands are offered to knowledgeable local and international consumers and there is no need to translate these brand names for local people. Brands keep their original names, original styles and interior decoration. The brand experiences inside the flagship store are similar to those in Europe. When you walk into the Charter House, Central, Hong Kong, where flagship stores of the Giorgio Armani empire are located, you will be able to experience the Boutique Giorgio Armani store similar to that in Via Montenapoleone 2, Milan Italy; and the experience of Emporio Armani, Armani Jeans, Armani Casa, Armani Libri, Armani Flori, similar to that in Via Manzoni 31, Milan Italy. The interior decorations, colours, etc. are projecting the same message and images as those in Milan. When you enter the Louis Vuitton flagship Maison in Canton Road, Kowloon, you will have a shopping experience similar to that in the Louis Vuitton flagship Maison in avenue des Champ-Elysees in Paris, France. The Maison in Hong Kong held an art exhibition, Hiroyuki Masuyama's lightbox photographs: let a thousand flowers bloom from June 11 to September 2010. In the introduction leaflet of the exhibition, it was quoted: "In February 1957 Mao Zedong initiated the 'Hundred Flowers Movement' as a campaign designed to promote free and open discussion of the problems facing China at that time. The idea was to have intellectuals discuss the country's problems in order to promote new forms of art and new cultural institutions ... Mao's comments have been translated in the West as 'let a thousand flowers bloom' and have come to describe any process of encouraging many ideas from many sources ... The artist's lightbox photographs contain tens of thousands of flowers in full bloom. He photographs flowers in his environment and digitally combines images into a single image. He compresses 365 days and all four seasons into one memorable image." This is a very good example of how the company targeted customers in Hong Kong and Mainland visitors. Even in the description of an art piece, they can still link with thinking relevant to the Chinese.

Luxury Branding in Mainland China

Branding in Mainland China is different from that in Hong Kong. Mainland China has an area of 9.6 million square kilometers and a population of 1.3 billion, the world's third or fourth largest country by area. There are different provinces, autonomous regions and sub-cultures. There are several important points one has to think about if planning to enter the market of Mainland China. *What should be the brand name used?* The majority of the people in China do not speak foreign languages, so should we keep our original brand name only? Or we should have a Chinese version of our brand name? We would like consumers not only to know our brand, but also to remember our brand and buy from it. It is important that our potential customers are able to tell others the brands they like. So an easily pronounced and remembered name is definitely an advantage. The company then needs to think whether it should have a direct translation of the brand name. If so, care should be taken to check the meaning of the translated name and the sound resemblance of the name. Or the company can think of a Chinese brand name that spells out the main characteristics of the brand or just a nice name without any special meaning. For Chanel in China, the interior design, store display, etc. are the same as that in Hong Kong and in France; however, Chanel has a translated Chinese brand name (香奈兒), and they have one of the model wearing a pullover with the knitted Chinese brand name in front.

How to make people know your brand? It is important that people know your brand, and understand your brand identity and positioning. Though seldom seen in Hong Kong, it is very common in Mainland China that there is a board inside each brand store, explaining the brand's story to the consumers. The location you select to open your store is important. You need to design your store carefully, have leaflets or magazines describing your brand concepts and positioning to target customers, and you may even have your catalogues and DVDs of your fashion show placed inside your store for consumers to take. This is particularly the practice of luxury international designer labels, they place their catalogues or booklets showing their collections and brand images inside the store for consumers to pick up. Hermes has a Chinese version of their magazines (Le Monde d'Hermes) and distributed them inside their stores. This magazine illustrates the brand concept of horse saddle, and builds stories with the latest product collections (Editions Hermes, 2010). In addition, also have screens inside their stores showing their catwalk shows for consumers to know the styles and items they offer. Celebrity endorsement is very important in Mainland China, with familiar Chinese celebrities selected carefully to endorse a brand or be a brand's spoke-person to enable people in China know your brand. Sponsoring different events, organise road shows, and collaborate with different universities facilitates the spreading of knowledge of your brand to the people in China.

What will be the Influences of Chinese Culture?

Chinese written language is composed of pictures, Chinese people are trained to recognise and remember pictures. As a result, a brand logo, monogram and other symbolic motifs are important. Simple, easily recognised and remembered, transferable and if possible, showing the personality of your brand are key considerations. This is an important aspect that can be employed to make Chinese people remember a brand. Chanel has a display model wearing a pullover knitted with the Chinese name (香奈兒) of the brand to facilitate remember in their Shanghai Peninsula Hotel store as seen in July 2010. Chinese people have different cultural specific values: 'face', 'one of us (zijiren)', 'family', 'respect', 'humility', 'competence' and 'success' and retailers have to take these into consideration. For example, Ermenegildo Zegna has specially arranged Chinese decorative motifs in the interior design of their flagship store in Shanghai for their made-to-measure section to have a closer link with the customers (Chan, 2007; www.zegna.com). Chinese people have their own styles and lifestyles; strictly speaking different cities have their own characteristics, so it is important to observe the real life situation. The retailing format and promotional methods appropriate for other countries may not be appropriate in China, so retailers should not just transfer previous successful models directly into China. Ralph Lauren has introduced their luxury purple line to Shanghai April 2010 together with the luxury watch line. They open the store in the Peninsula Hotel in Shanghai. Though they are projecting the same image and American lifestyle of Mr. Ralph Lauren by decorating the stores as corners of the home and with American songs, when they explain the brand concept and the newly introduced luxury watch line to their potential customers (Chan, 2010), they emphasise on the 'competence' aspect. They mentioned that Mr. Ralph Lauren loves watches, he pay special attention to the watches. When he talked with his friend, Johann Rupert (owner of Richemont), they shared the same passions for attention to details and quality. They decided cooperate together and developed the watches collections with Ralph Lauren's signature sensibilities of luxury, glamour, exceptional finishes and intricate details, with mechanical movements of Swiss Made excellence from Richemont. The sales manager in the store clearly explained the authoritative and competence aspects of the watches collections.

What will be the Collections for China Market?

China is a huge market with different living standards and market segments. People are experiencing as well as experimenting during their shopping trips. Some international brands found their original lines to be too expensive for Chinese people to afford, so they developed special lines to cater for the China market. For example, Ermenegildo Zegna's Z Zegna line was welcomed with enthusiasm in China. Zegna also trained their sales teams to share the benefits and specialties of each product with their customers and to encourage their customers to try other lines and appreciate products from their more expensive lines (Chan, 2007). Consumers need to understand and appreciate the factors that make price and product differences in the Z Zegna line, Zegna Sport line, Ermenegildo Zegna line, couture line and made-to-measure line. The front line sales forces are the right people to inform and facilitate consumers to experience and adopt. China is a relatively high power distance and masculine society, hence menswear is a huge market for international brands. Men are also more brand loyal than ladies. Louis Vuitton has especially developed a lantern collection for celebrating the Lantern Festival in China. In addition, recently, Louis Vuitton has specially developed a Louis Vuitton mahjong set for Chinese people. Prada has a Prada-Milano-Shangahi bag for the opening of their Shanghai stores, such as in the IFC Shanghai Mall in 2010, in addition to their original Prada-Milano bag.

Mainland China is a huge and diversified market with over 1.3 billion people in 9.6 million square meters. There has been an increase in their standard of living and purchasing power. China has a high power distance society, in which men traditionally have more power and earn more income (Hofstede, 2001). The luxury market is one of the major markets in emerging China. An analysis of a successful case in China can show some insights for other companies about their retailing strategies in Mainland China. Ermemegildo Zegna is a successful case that will be discussed here.

CASE STUDY: ERMENEGILDO ZEGNA (INFORMATION EXTRACTED FROM WWW.ZEGNA.COM)

The Ermenegildo Zegna Group is the world leader in fine men's clothing. It has a yearly output of 2 million metres of fabric, 350,000 sleeve units, over 1 million sportswear items and 1.5 million accessories. It employs more than 5000 staff world-wide and has achieved a turnover of 601 million Euros in 2003, 85% of which has been derived from clothing and accessories and 15% from textiles. Over 86% of all sales are exported. The Group is still a 'family business' and is managed by the fourth generation of the family: Ermenegildo and Paolo, as Ceo, Anna, Benedetta, Laura and Renata Zegna.

The Ermenegildo Zegna group was founded in 1910 in Trivero, a small town in the Biella Alps, by Ermenegildo Zegna. The young entrepreneur create high-quality fabrics for men's clothing and his strategy was focused on the selection of the best raw materials from their markets of origin, innovation in product and in the production process and promotion of the brand. The founder's sons, Angelo Zegna, President of the Group and Aldo Zegna, who passed away in 2000, took over the management of the company from their father in the 1960s. They lead the company into the ready-to-wear market with a line of men's clothing aimed at the top end of the market, followed gradually by knitwear, accessories and sportswear. The growth in production led the Group to seek direct outlets in foreign markets, resulting in the opening of commercial branches in France, Germany, Great Britain, Spain, Turkey, Mexico, the United States, Japan and recently also in China, Hong Kong, Korea, Singapore, Taiwan and Australia and the creation of production units controlled by the Group in Spain and Switzerland.

In the 1980s, the Group's process of vertical integration was completed with the opening of the first single-brand boutiques in Paris in 1980 and Milan in 1985. The Group has its own wool mills producing excellent wool suit fabrics and suit producing factories in Switzerland, Turkey and China. Before running its own retail operations in Hong Kong and Mainland China, the group has manufacturing partners in Mainland China for its menswear clothing line. When it determined to enter into the retail business, it first entered its retail lines through agent/licensing in Hong Kong. It is after the market mature that the Group entered the retail operation in Hong Kong and the Mainland on its own, with fully owned stores. The Group is the first luxury brand for men that had a fully owned store in China as early as 1991, in Beijing. At the end of the 1990s, comprehensive vertical integration, skewed diversifications, brand extension and licensing were implemented. The Group developed into a global luxury brand with product ranges from clothing to accessories. In the year 2003 the Group had 392 monobrand points of sale in the world (Ermenegildo Zegna and Zegna Sport), of which 142 are fully owned.

In 2003, the Group already had over 25 points of sales in Mainland China. In March 2003, the Group acquired control of 50% of SharMoon, the Wenzhou company previously owned by the Chen family, which was producing high-quality men's suits and jackets for the Chinese market. With the acquisition of SharMoon, the Group then had further access to the retail network of ShaMoon in addition to production facilities. Collections offered by the Group are Ermenegildo Zegna, Ermenegildo Zegna Su Misura, Zegna Sport, Z Zegna and Agnona.

Ermenegildo Zegna label has three lines. *Couture* is the pinnacle of the Ermengildo Zegna tailoring offering, characterised by handmade rich luxurious details and exclusive fabrics. *Sartoria* redefines the classical Italian style, with traditional tailoring and contemporary elegance. *Upper Casual* is the sophisticated and chic leisurewear expression of Ermenegildo Zegna.

Ermenegildo Zegna Su Misura is Ermenegildo Zegna's exclusive made-to-measure service is provided to customers to produce tailor-made suits, leather garments, jackets, pants, coats, shirts and ties in a few weeks. *Zegna Sport* is centred on design and performance, offering a collection of innovative technical products that are sophisticated and highly functional. *Z Zegna* is designed for a modern man who is looking for an eclectic masculine and fresh style. *Agnona* is the womenswear line.

Retailing strategies used by the Group are niche marketing, good-quality products, being present, catering for the needs of customers and educating consumers. The Group has a good vision, and entered very early to the emerging BRIC markets. With the first store established in the Peninsula Hotel Beijing in 1991, the stores in the early stages were more for the purposes of advertising and educating consumers than for profit making. In the emerging markets, people needed to learn through experiences of overseas products and the different levels of quality. Zegna has a special team to train the sales force so that they have good product knowledge and understand how to share their knowledge with their consumers (Chan, 2007). They understand that the consumers may enter into the store and have a look first. Some of them may not have the knowledge of what constitute a good suit. The sales people will explain to the consumers how to select an appropriate suit. They may turn some of the consumers into their customers. After people have bought their products, they will gain confidence. When customers return to the store, the sales people will introduce to them to other clothing or other price range products. With the economic development, people are earning more money, their customers will move upward and buy more expensive, better quality items.

Zegna has different points of sales in China. The major points of sales in Mainland China are Beijing, Changchun, Dalian, Guangzhou, Qingdao, Shanghai, Shenyang, and Shenzhen. In 2003, the Group already had over 25 points of sales in the Mainland. In 2005, there were 50 stores. Understanding the importance of having Boutique or Flagship stores in big cities offering a fuller range of products to consumers, the Group opened its largest flagship store in 1 Peking Road, Hong Kong in March 2003. This store has an area of 4000 square feet and houses the Couture, Sartorial lines, sportswear line, accessories and made-to-measure services. Made-to-measure services and Couture line are only available in some selected stores. Then the Group opened the 3000 ft^2 boutique in IFC Mall in Central Hong Kong in November 2003 and then a 3500 ft^2 boutique in Alexandra House in Central Hong Kong in February 2004. All these three stores have Couture, Sartorial, made-to-measure and in-house tailoring services.

The Group opened a boutique in Plaza 66 in Shanghai in April 2004, another 144 m^2 boutique at Chengdu Renhe Department Store in March 2004 and then a new flagship 500 m^2 store at the Oriental Plaza Beijing in October 2004. This store houses the couture and sartorial lines of Ermenegildo Zegna, Z Zegna, Zegna Sport, accessories and made-to-measure services. In April 2005, the Group opened their largest flagship store in Asia at the Bund 18, Shanghai. This flagship store is with an area of 600 m^2 and has special ‘Chinese elements’ in the interior decoration. There are three floors and it houses the Couture, Sartorial, Z Zegna, Zegna Sport, accessories and made-to-measure collections. In May 2005, the Group opened a boutique of 280 m^2 in Shenzhen that houses the Couture, Sartorial, Z Zegna and Zegna Sport lines only. In March 2007, the Group opened a new boutique of 338 m^2 in Seibu Shopping Mall in Shenyang, the capital city of North-eastern China’s Liaoning Province. This is the third Ermenegildo Zegna boutique in Shenyang, with one in the Shenyang New World Department Store and another one in the Shenyang Chartered Department Store. It was the first and largest flagship store in North-eastern China. In October 2007, a new 115 m^2 Zegna leather corner was opened in the Grand Gateway Plaza in Shanghai. This is the second one of exclusive leather corner, following the one located at the Shanghai Hong Qiao Friendship Shopping Centre. In October 2007, a new boutique of 184 m^2 of young fashionable Z Zegna was launched in the Times Square Maison Mode Department Store Shanghai. All ranges of Z Zegna products are available in this boutique. This is the first national boutique for Z Zegna. In October 2009, the Global Concept Store of the Group for Greater China was opened in Hong Kong, at 1 Peking Road. This is a partnership with the Architect Peter Marino showing the new Global Luxury concept of the Group.

In 2009, the total sales for the Ermenegildo Zegna were 797 Million Euros and China became the most important market of the group (around 40% of the sales). The business in China increased by 29% and now there are 10 more stores open in Greater China. Experiences of this successful company in China have shown that their retail entry strategies are opening stores in different important cities, and then opening flagship stores in municipal cities like Shanghai and Beijing. They entered the market with niche brands, such as the Ermenegildo Zegna brand, before introducing the young fashionable line Z Zegna. They show their new Global Luxury concepts in Hong Kong first, then later in Shanghai (to be opened during the summer of 2010).

Source: www.zegna.com

FUTURE DIRECTIONS OF FASHION RETAILING IN HONG KONG AND MAINLAND CHINA

Hong Kong is a global centre for world trade, finance, business and telecommunication with a strategic location in the Mainland China. She is currently the world's eleventh largest trading entity and operated one of the world's busiest container ports in terms of container throughput, as well as one of the world's busiest airports in terms of number of international passengers and volume of air cargo handled and she is also the world's fifteenth largest banking centre in terms of gross external positions of banks, and the sixth largest foreign exchange trading centre (Information Service Department, 2009). She has a business-friendly environment with the rule of law, free trade and free flow of information, a simple tax system with low tax rates, open and fair competition, a well-established and comprehensive financial network, a superb transport and communications infrastructure, sophisticated support services, and efficient and innovative entrepreneurs complemented by well-educated workforce. Hong Kong was named by the US Heritage Foundation as the freest economy in the world for the fourteenth year. Hong Kong's per capita GDP has an average annual growth rate of 3% in real terms. At US$30,900, Hong Kong's per capita GDP was one of the highest in Asia in 2008 (Information Service Department, 2008).

With the open-door policy and economic reform in the Mainland, Hong Kong not only has an enormous production hinterland and market outlet at her back, there are also different business opportunities for a wide range of service providers. The Mainland has been Hong Kong's largest trading partner, accounting for 48% of Hong Kong's total trade values in 2008. Reciprocally, Hong Kong was the fourth largest trading partner with the Mainland (8% of total trade value in 2008), following the European Union, United States, and Japan.

Hong Kong is also a principal gateway to and from the Mainland for business and tourism. The number of trips made by foreign visitors to the Mainland through Hong Kong rose by a cumulative 90% in the past 10 years, or at an average growth rate of 6.6%, reaching 4.4 million trips in 2007 (Information Service Department, 2008). Correspondingly, the number of trips made by Mainland residents to, or through, Hong Kong rose by almost six times, at an average annual growth rate of 21%, amounting to 15.5 million trips in 2007. With the co-hosting of the Beijing Olympic and Paralympic Games, Hong Kong's tourism industry has a strong 8.9% growth in visitor arrivals in the first half of 2008, compared to the same period in the previous year. There was a slowing in September with the global financial crisis. Hong Kong received 29.5 million visitors by year's end, a 4.7% increase over 2007. The Mainland continued to be the largest source of visitors. A total of 16.9 million Mainlanders visited Hong Kong in 2008, a jump of 8.9% over 2007. Even under global economic downturn, there are 17.96 million Mainland visitors came to Hong Kong in 2009 and visitors from India increase 4.6% and from Russia increased 15.7% (Information Service Department, 2009).

Hong Kong continues to be the largest external investor in the Mainland. According to Mainland statistics, the cumulative value of Hong Kong's realised direct investment in the Mainland reached US$348 billion (around 41% of the total inward direct investment) at the end of 2008. Likewise, the Mainland is Hong Kong's largest source of foreign direct investment, amounting to a total of US$479 billion (around 35% of the total external direct investment) by the end of 2007. Mainland companies also maintain a strong presence in Hong Kong. In mid-2008, there were 223 and 499 Mainland companies that had established regional headquarters or offices and local offices respectively in Hong Kong. All these have reflected Hong Kong's position as the regional service hub (Information Service Department, 2008).

Hong Kong is also a major funding centre for Mainland enterprises. A total of 465 Mainland enterprises were listed on Hong Kong's stock market by the end of 2008. Among them, 28 were listed in 2008, raising equity capital of HK$294.1 billion. This shows Hong Kong's position as a major fund-raising centre in the region. In addition, Hong Kong is the first venue outside the Mainland to engage in the issuance of RMB bonds, which reflects the Mainland's recognition of Hong Kong as its premier international financial centre. At the end of 2008, a total of 39 licensed banks were engaged in renminbi (RMB) services business and outstanding renminbi deposits reached RMB56.1 billion.

The economic cooperation and integration with the Mainland has been fostered through the Closer Economic Partnership Arrangement (CEPA) and the Pan-Pearl River Delta Regional Cooperation Framework Agreement. Hong Kong is a famous international trade and financial centre with a fully open market and free trade. The Individual Visit Scheme, introduced by the Mainland authorities to allow residents in the Mainland to visit Hong Kong in a personal capacity, has been well received. In 2007, more than 8.59 million Mainlanders visited Hong Kong under the scheme, which now covers 49 cities, including all cities in Guangdong province, Beijing, Shanghai, Chongqing, Tianjian, Chengdu, Jinan, Dalian, Shenyang, Changsha, Nanchang, Nanning, Kunming, Guiyang, Haikou, Shijiazhuang, Zhengzhou, Changchun, Hefei, Wuhan and nine cities in Fijian, Jiangsu and Zhejiang provinces. In addition, new measures were introduced in 2007 for Russian and Vietnamese business visitors to apply for multiple-journey visas and a fast-track visa service was introduced to facilitate side trips to Hong Kong for Russian tour groups visiting the Mainland. All these will help to promote tourism in Hong Kong, which inevitably will enhance the fashion retailing in Hong Kong (Information Service Department, 2008).

Fashion brands from all over the world and in different market segments and styles can be found in Hong Kong. Flagship stores of different fashion houses have opened in Hong Kong to showcase their collections. Consumers from different parts of the Mainland, as well as from South East Asia, all come to Hong Kong because of the low tax, lower prices, better service and full collections of the product, as well as the strategic location and concentration of brands. Hong Kong will continue to be the fashion retail and wholesale centre for the region, the windows for consumers in the region to understand the latest fashion and to buy and select from a full collections. The fashion retail industry will continue to prosper. With the severe competition, shopping mall and companies will continue providing different services and establish their own characteristics to attract consumers. Image and positioning of brands and shopping malls are important. With the financial crisis, it is forecast that the fashion industry will be polarised further. On the one hand, there will be more demand from the mass market for lower priced good value items. On the other hand, there will also be consumers who are willing to pay a higher amount of money to buy really good quality and rarity items.

With the differences in prices of the luxury products, tax free environment, good services, full collections to select from and excellent shopping experiences, Hong Kong fashion retailing will continue to enjoy the business generated by tourists from abroad and the Mainland.

Although there is financial turmoil in the world, Mainland China is still a place for further development and investment. It is expected that they are having a growth rate of at least 9%. Many urban dwellers in China regard shopping as a leisure activity, and this trend will continue as visiting fashion stores is a habitual choice for most shoppers. Guaranteed quality, reasonable price and the availability of a wide variety of colour are the major attractions for shoppers visiting clothing shops. Suitable sizes, good cutting and reasonable price are the prime factors for the selection of clothes. Discount offers, internet and outdoor advertisements, and free gifts are effective promotion tools. Labour Day, National Day and Chinese New Year will continue to be the major festivals with higher spending in fashion and clothing.

The trend for future fashion retailing will also be polarised in the Mainland. On the one hand, traditional department stores have to change the retailing format with the arrival of characterised shopping mall department store complexes as well as large supermarkets, maybe towards chained department conglomerate (like Wang Fu Jin renovated into shopping mall with departmental store and supermarket) with different branches in major cities in the Mainland (China Garment Industry Development Report, 2007–2008, p. 43). Many Hong Kong land developers have investments in the Mainland and have established many shopping malls, each with its own characteristics and positioning. They are also introducing their style of management and lifestyle into the Mainland. On the other hand, stores are also more specialised; there are those specialising in selling products for only a particular market segment, like only sports shoes, bags, jeanswear, ties, etc.

The Mainland is the place of opportunities and growth, people are optimistic and they are willing to explore and keep up with the western lifestyles. Many Chinese people are demanding high-quality international brands. It is forecast that more and more shopping malls with character and style will be developed. More and more international brands will enter China, particular in the cities, and then develop into other areas. There will also be more and more local well-designed brands developed. Although there are e-commerce and virtual shopping means available; these are usually not popular in fashion retailing as trying on fashions, touching and feeling the fabrics are usually preferred shopping experiences. Shopping is also a key leisure activity for many families. With the continuous economic development, residents in the Mainland are willing to spend money and try new items. Luxury markets will continue growing and marketers have to cater for the needs of the younger generations. Young consumers have high purchasing powers and disposable income, young fashionable chic lines should be introduced.

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ADVERTISING APPEALS STRATEGY: MODERATING EFFECT ON THE RELATIONSHIP BETWEEN INNOVATION AND CUSTOMER EQUITY DRIVERS IN CHINA

Hao Zhang, Eunju Ko and Charles R. Taylor

ABSTRACT

This study focuses on the relationship between innovation and customer equity drivers and the moderating effect of advertising appeals on this relationship. First, the authors divided innovation into incremental innovation and radical innovation, and explained the influences of each type of innovation on drivers of customer equity based on literature review. Second, the authors tested the conceptual model using structural equation modeling find out the effects of innovation. Third, the authors also tested the effect of advertising appeal using moderating regression. The results indicate that both incremental innovation and radical innovation can positively influence value equity, relationship equity, and brand equity. Functional advertising appeal is more useful than emotional advertising appeal for radical innovation. On the contrary, emotional

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advertising appeal is more useful than functional advertising appeal for incremental innovation.

Keywords: Radical innovation; incremental innovation; customer equity drivers; advertising appeal.

INTRODUCTION

As a result of the rapid advances being made in science and technology, innovation has become a key concept in the past decades of years. Even in the most stable environments, innovation is a potential means of increasing stagnant returns, perhaps at the expense of less innovative firms. Many executives hold an unwavering belief in innovation as a strategic imperative, counting on innovation to spur growth and yield positive financial returns (Sorescu & Spanjol, 2008). Management research confirms that innovative firms – those that are able to use innovation to improve their processes or to differentiate their products and services – outperform their competitors, measured in terms of market share, profitability, growth, or market capitalization (Tidd, Bessant, & Pavitt, 2001).

The capacity of innovation to create new or expanded streams of income for a firm has been long recognized. Srinivasan, Pauwels, Silva-Risso, and Hanssens (2009) found that new product introduction (product innovation) has positive postlaunch effect on stock return, as well as that the stock return benefits of pioneering (new-to-the-market) innovations are seven times larger than those of innovations that are merely new the company. Nevertheless, innovation not only can positively influence organizations' financial result but also can increase organizations' nonfinancial performance (Sriram, Balachander, & Kalwani, 2007). There are merely researches that focus on the relationship between innovation and customer, except that some researches find that innovation can increase customer value (Nasution & Mavondo, 2008) and how customers adopt innovation products (Rogers, 1995).

In the past few years, marketing managers at leading companies have begun to organize their marketing efforts around customers rather than product lines (Rust, Lemon, & Zeithaml, 2004). How to manage customer assets more effectively? One of the most important ways is customer equity management (CEM). The customer equity paradigm recognizes customers as the primary source of both current and future cash-flows (Villanueva, 2003). In this framework, the firm is interested in maximizing the net present value of both current and future pools of customers, which is considered a proxy for the value of firm (Gupta & Lehmann, 2003; Villanueva, 2003).

The concept of customer equity brings together customer value management, brand management, and relationship/retention management (Vogel, Evanschitzky, & Ramaseshan, 2008). Rust, Zeithaml, and Lemon (2000) first attempted to link marketing inputs to customers' reaction. But only marketing input cannot fully explain corporate development. Drucker (1973) cites innovation and marketing as the two factors crucial to long-term corporate health. Most major consumer goods companies spend heavily on innovation – as much as 5 percent of sales. Truly innovative products create value for consumers, extend the category, generate higher margins, and strengthen the brand (Boston Consulting Group, 2000). Simply speaking, product innovation has relationships with each driver of customer equity. Thus, it is also necessary to find out the relationship between innovation and the drivers of customer equity.

In many models, advertising is represented as an instrument that increases either the intensity of demand or the amount they are willing to pay for a specific product. But for innovative products, advertising is one of the most important ways that customers can get knowledge and awareness about the new products. Especially in the initial period, firms should advertise heavily, informing all innovators early about the existence of the new products (Horsky & Simon, 1983). Advertising can increase the adoption rate when firms diffuse their new products. Advertising support for innovations, especially pioneering innovations, can enhance cash flows for the company (Srinivasan et al., 2009). Not only the direct effects, advertising can also build brand awareness and reduce consumers' perceived risk (Dowling & Staelin, 1994). Consumers can be much easier to understand and accept the new products. Thus, it is necessary to find out whether advertising can play a moderator on the relationship between innovation and each driver of customer equity.

LITERATURE REVIEW

Innovation and Innovation Types

An innovation is the adoption of a change that is new to an organization and to the relevant environment (Knight, 1967). It is an idea, practice, or material artifact perceived to be new by the relevant unit of adoption

(Dewar & Dutton, 1986; Zaltman, Duncan, & Holbek, 1973). Innovation can also be defined as the combined activities leading to new, marketable products and services and/or new production and delivery system (Burgelman, Maidique, & Wheelwright, 2001 Burgelman et al., 2001). It is the generation and/or acceptance of ideas, process, products, or services that the relevant adopting unit perceives as new (Garcia & Calatone, 2002; Zhou, Yim, & Tse, 2005). After all, change is the soul of innovation.

Innovation management performance is measured by financial and nonfinancial measures (Hertenstein & Platt, 1997). The financial measures are the company turnover and the product development costs. For example, innovation is a profitable investment because the return on investment is less than 3 years, with an average period of 15 months (Potter et al., 1991; Walsh, 1996). New product introductions can have a positive impact on the market value and profitability of firms (Blundell, Griffith, & Reenen, 1999; Geroski, Machin, & Van Reene, 1993), and that the more innovative these products are, the greater their financial value is (Sorescu, Chandy, & Prabhu, 2003). Srinivasan et al. (2009) find that new product introductions have positive postlaunch effects on stock returns and that the stock return benefits of pioneering innovations are seven times larger than those of innovation that are merely new to the company.

The nonfinancial measures of innovation performance are customer satisfaction, creativity, and brand attitudes. New brands and new industries are created by technological innovations, while competitors' brands, old technologies, and industries are destroyed (Gehani, 2001, p. 37). Sriram et al. (2007) find that product innovations have a positive effect on brand equity and can explain a significant proportion of its variation. Gehani (2001) proposes that high brand equity and reputational capital of an organization could be enhanced by product innovations. To sustain high brand equity and institutional renown, these product innovations need to be complemented with a high quality promise, alignment with process innovations, and building of a firewall of protective intellectual property. Titan's innovation cases proved that innovation can be an enhancer of brand personality and can improve brand reputation (Bhat & Bowonder, 2001).

Although most of the researches indicate that innovation can increase company competitive advantages and improve firm performance, the effects of different type of innovation are different. Palmer and Brookes (2002) found incremental innovation improved performance, although Baker and Sinkula (1999) cautioned that incremental changes translate into only short-term competitive advantages. Other researchers have found that innovation rate (Cefis & Ciccarelli, 2005) and more novel or radical product innovations increase company performance (Marsili & Slater, 2005). Chaney, Devinney, and Winer (1991) find that the original new products have a greater financial value than updates of existing products, and Kleinschmidt and Cooper (1991) find that highly innovative products surpass moderately innovative products in terms of their success rate and return on investment. But most industries and managers do not prepare proactively for such disruptive shifts caused by rivals' radical innovations (Christensen, 1997; Christensen & Bower, 1996).

CUSTOMER EQUITY DRIVERS

The value a customer brings to the firm is not limited to the profit from each transaction, but is the total profit he/she may provide over the duration of his/her relationship with the firm (Kumar & George, 2007). Thus, customers can be seen as the intangible assets that firm should wisely acquire, maintain, and maximize like other financial assets (Blattberg, Getz, & Thomas, 2001). But in the current competitive marketing environment, not only present customers' behavior but also their future behavior is a key strategic asset that must be monitored and nurtured by firms to maximize long-term performance (Vogel et al., 2008). Recently, customer equity has been seen to be the most determinant of the long-term value of the firm (Lemon, Rust, & Zeithaml, 2001). The customer equity paradigm recognizes customers as the primary source of both current and future cash-flow (Villanueva & Hanssens, 2007).

Since introduced to marketing academia by Blattberg and Deighton (1996), CE has been studied in various ways. Conceptual models have been suggested (e.g., Pferifer & Carraway, 2000), and empirical analyses based on purchase history data have been also implemented (e.g., Reinartz & Kumar, 2000). While some researchers analyze only an existing customer pool (e.g., Wang & Splegel, 1994), others consider expected customers as well (e.g., Gupta, Lehmann, & Stuart, 2004).

For understanding how to grow and manage customer equity and how to create significant competitive advantage, Lemon et al. (2001) concluded three drivers of customer equity – value equity, brand equity, and relationship equity (also known as retention equity). Firms need to recognize which of these three equities is most important for key customers and then focus on improving them. Although other researchers also developed other drivers that significantly influence customer equity [e.g., Gupta et al. (2006) identified customer acquisition, customer retention, and customer expansion are the key drivers; Bruhn, Georgi, and Hadwich (2006) Bruhn et al. (2006) developed that company structure, company systems and company culture are the drivers of CEM dimensions (analytical CEM, strategic CEM, and operational CEM)], Rust, Lemon and Zeithaml (RLZ) model is the best way to understand customers' reaction.

Value equity is defined as the customer's objective assessment of the utility of a brand, based on perceptions of what is given up for which is received. Brand equity, which is a customer's subjective and intangible assessment of the brand over and above its value, is built through image and meaning. Financially, the model includes relationship equity, which expresses the tendency of customers to stay in the relationship with the brand, beyond objective and subjective assessments of the brand. The three drivers are expected to influence the customers' brand-switching behavior, as displayed in Markov switching matrix. This matrix is the basis for the calculation of an individual customer's lifetime value. In line with Blattberg and Deighton (1996), the individual customer lifetime values are summed up to form the company's customer equity (Vogel et al., 2008).

Advertising Appeal Strategy

Advertising is attempting to influence the buying behavior of your customers or clients by providing a persuasive selling message about your products and/or services. In international markets, advertising is a constant concern for global marketers and scholars. Over the years, advertising has been given various definitions by different scholars. Lee and O'Connor (2003) defined advertising as the action of calling something to the attention of the public especially by paid announcement. This definition is clearly saying that advertising is about the public attention drawn by paid announcement. Advertising strategy plays an essential role throughout the purchasing decision process. In studies of advertising practice, various strategies used by advertisers were identified and several typologies were developed (Putte & Dhondt, 2005). For example, Li, Li, and Zhao (2009) Li et al. (2009) defined three Internet advertising strategies: creative strategy, media placement strategy, and budget strategy. But in the present research, advertising message strategy is a term used to convey nature of the advertising appeal. Advertising appeal aims to influence the way consumers view themselves and how buying certain products can prove to be beneficial for them. The message is conveyed through advertising appeals and tries to influence consumers' purchasing decision.

In advertising message strategy, emotional/rational framework has been studied extensively in the marketing and advertising literature (e.g., Albers-Miller & Stafford, 1999; Li et al., 2009). Rational appeals stimulate the audience's sense of self-relevance by showing the benefits of a product, such as the message about quality, price, or features (Mueller, 1991). In contrast, emotional appeals are grounded in the emotional, experiential side of consumption. They seek to make the consumer feel good about the product, by creating a likeable or friendly brand (Albers-Miller & Stafford, 1999). Different research shows different result about the effects of advertising appeals. Coulson (1989) finds that rational appeals result in higher purchase intention than do mood commercials. But Page, Thorson, and Heide (1990) find that emotional advertisings may be more effective and memorable than rational advertising. However, there have been some concerns shared by researchers that emotional and rational appeals are not mutually exclusive (Calder & Gruder, 1989), which means emotional appeal ad may have rational appeal components while rational appeal ads can have emotional appeal component respectively. But still, there is no research about the effects of rational appeal component and emotional appeal components in fashion industry, thus, this research is going to find out how these two types of advertising strategy's effects when fashion industry introduces their innovations.

But for introduction about innovations, it is not enough for rational advertising to only deliver the message about the quality, price, or features to consumers. The function of innovation must be delivered to consumers. Thus, the rational advertising is not appropriate for introducing innovations. The present research categories advertising message strategy into two types: functional advertising and emotional advertising. Functional advertising use rational appeals to demonstrate an innovation's attributes and features in an objective manner and thus correspond to the central route persuasion process (Lee & O'Connor, 2003). Emotional ads (such as humor, slice-of-life, fear, or guilt appeals) express the subjective and symbolic benefits of the product, thus incorporating the peripheral route.

Hypotheses Design

Customer value has become an increasing concern to consumers and marketers (Patterson & Spreng, 1997). According to Slater and Narver (2000) customer value is created "when the benefit to customer associated with products/services exceeds the cost of the offer to the customer." Value is the keystone of the customer's relationship with the firm. If the firm's innovative products and services do not meet the customer's needs and expectations, the best innovation will be insufficient.

Wind (2005) suggests that innovation is a strategy to create, deliver, sustain, and continuously enhance value. In online shopping industry, Birgelen, Ghijsen, and Semejin (2005) find that web innovation can increase customers' added-value through customer satisfaction. In service industry, innovation is considered a core competency for creating services that offer superior value to the customers (Kandampully, 2002). Nasution and Mavondo (2008) also found that product innovation positively influence customer value. In the present study, there are two types of innovation – radical innovation and incremental innovation. Both of them can be hypothesized to increase consumers' value. But Sorescu et al. (2003) mentioned that radical innovations are valued significantly more than other innovations for the firms that have capabilities to introduce them. Because radical innovation can provide substantially greater benefits from consumers, thus, the hypotheses can be concluded as follow:

H1. Radical innovation (a) and incremental innovation (b) can increase customers' value equity, but (c) compared to incremental innovation, radical innovation can increase more customers' value equity.

Enhancing the stickiness of relationship is a way to glue the customers to the firm, because great brand equity and value equity may not be enough to hold the customer (Lemon *et al.*, 2001). Relationship equity involves the elements that link a customer to a brand or a company (Rust et al., 2000). It happens when buyers compare the outcome or rewards against other experiences, including internal and external comparisons. The high perceived relationship equity means that customers will believe that they are well treated and handled with particular care.

Product innovation is generally conceptualized as a five-stage new product development (NPD) process – ideation, concept development, product design, product testing, and product introduction (e.g., Ulrich & Eppinger, 2000). At each stage of NPD, consumers more and more engage into the whole process, because firms have always sought to hear the "voice of the customer." Product innovation for/with customers has three key benefits: (a) the direction of communication, (b) the intensity and richness of the interaction, (c) the size and scope of the audience (Sawhney, Verona, & Prandelli, 2005). Co-creating value in innovation process is the new trend in customer relationship management (Maklan, Knox, & Ryals, 2008). Therefore, for the two types of innovation, we can predict that:

H2. Radical innovation (a) and incremental innovation (b) can increase customers' relationship equity, but (c) compared to incremental innovation, radical innovation can increase more customers' relationship equity.

Brand equity has been an important concept in business practice as well as in academic research because marketers can gain a competitive advantage through successful brands such as opportunity for successful extensions, resilience against competitors' promotion pressure, and so on (Lasser, Mittal, & Sharma, 1995). Aaker (1991) defined brand equity as a set of brand assets and liabilities linked to brand, its name, and symbol that add to or subtract from the value provided by a product or service to a firm and/or to the firm and/or that firm's customers.

Product innovation is defined as the process of identifying innovative unmet customer wants and embedding new technologies in unique new product features (Johne, 1999). To gain brand equity, some enterprises have focused their attention on the market and customer end of their primary value-adding chain. When firms have the capability to link product innovation to market orientation, they can gain brand equity (Gehani, 2001). The innovative products have to be continuously updated and re-innovated to sustain owners' market leadership. Sriram et al. (2007) empirical results indicate that the product innovations can have a significant, positive effect on brand equity if they are meaningful to consumers. Bhat and Bowonder (2001) also use a case study – Titan – to prove innovation is an enhancer of brand personality, which is one of the elements of brand equity (Pappu, Quester, & Cooksey, 2005 Pappu et al., 2005). Therefore, since there are two types of innovation, we hypothesize that:

H3. Radical innovation (a) and incremental innovation (b) can increase customers' brand equity, but (c) compared to incremental innovation, radical innovation can increase more customers' brand equity.

Because advertising has direct effect on consumers' knowledge, consumers' knowledge can moderate the relationship between innovation effects and performance (Marinova, 2004). Chandy and Tellis (2000) found that advertising and promotional budgets can sustain the innovation and increase the adoption rate of the new product. And Srinivasan et al. (2009) also found that advertising support for new-to-the company innovations and pioneering innovations increases the stock market returns of these innovations. Thus, we propose that both the types of advertising strategy may have influence on the relationship between innovation and each driver of customer equity.

When a company introduces a highly innovative product (radical innovation) to market, functional ads can educate consumers with product knowledge and provide better information about innovations. Beard and Easingwood (1996) propose that market education is a tactic that takes the most generic approach to attacking the market and is most appropriate when market is unaware of existence of the technology, especially for radically new technology. Thus, functional advertising can help radical innovation create superior product differentiation, because the information being signaled can extend to the innovation's value that shopper can expect by choosing an advertised products. But when firms introduce an incrementally new products, consumers may not pay enough attention on functional appeals (e.g., information about technical details or sophisticated product features). Under those conditions, emotional ads that evoke consumers' positive feelings about the product through peripheral routes may be a more effective approach (Lee & O'Connor, 2003). The hypotheses are concluded as follows:

H4. (a) For radical innovation, functional advertising can play more important role to increase customers' value equity. But (b) for incremental innovation, emotional advertising can play more important role to increase customer value equity.

H5. (a) For radical innovation, functional advertising can play more important role to increase customers' relationship equity. But (b) for incremental innovation, emotional advertising can play more important role to increase customer relationship equity.

H6. (a) For radical innovation, functional advertising can play more important role to increase customers' brand equity. But (b) for incremental innovation, emotional advertising can play more important role to increase customer brand equity.

RESEARCH METHOD

Measurements

Innovation

Two types of fashion innovation are used in the present research. *Radical innovation* is defined as fundamental changes that represent revolutionary changes in technology and design. These innovation incorporate technology or design is clear and risking departure from state of current knowledge and have a high degree of new knowledge or idea (Dewar & Dutton, 1986; Ettlie, Bridge, & Okeefe, 1984; Song & Thieme, 2009). *Incremental innovation* involves refining, improving, and exploiting an existing technical trajectory (Gatignon, Tushman, Smith, & Anderson, 2002).

Prior researches develop radicalness scale to assess radical/incremental innovation. Dewar and Dutton (1986) developed three-point scale indicating whether each innovation (1) had no new knowledge contained in the machine or process, (2) represented an improvement over existing technology, (3) represented a major technological advance. Gatignon et al. (2002) expanded this radicalness scale to five items, which increased two items focusing on the breakthrough and irresistibility. Following the prior researches, we use five items to test the innovation's radicalness. Using these items, we can test our proposed sample whether they match the innovation type or not.

Value Equity

Value equity was measured by eight items to understand the customers' evaluations of functional and cognitive value associated with the innovation products. Vogel et al. (2008) asked the respondents to rate perceived value in general. Following their research and the research from Nasution and Mavondo (2008), and Rust et al. (2004), the items that were part of the scale included price, product quality, service quality, convenience, reputation for quality, value for money and prestige.

Brand Equity

We measure brand equity, which focuses on the overall perception of brand image, with six items, suing the scale Verhoef (2003) and Vogel et al. (2008) introduced. Brand image–based brand equity is also widely used in other researches such as Rust et al. (2004) and Ko et al. (2009). It includes total brand image, attractiveness, famousness, and the brand activities.

Relationship Equity

Relationship equity refers to a choice made by consumers when they patronize a business based on the connection they feel to a brand or company. We adapted the relationship equity measure from the relationship marketing and customer equity research of Raimondo, Miceli, and Costabile (2008) and Rust et al. (2004). The measure consists of seven items that assess the trust, service quality, and the preferred treatment when consumers visit the store.

Advertising Appeal Type

Following Lee and O'Connor (2003) Lee and O'Connor (2003) research, advertising were divided into functional advertising and emotional advertising. Functional advertising is measured by four items including emphasized the technology superiority, detail product attributes, functional appeals, and its advanced technology. Emotional advertising is measured by two items which include positive feelings and persuasion from the advertising.

Data Collection and Sampling

For achieving the research objective, young consumers are our target sample. Because as young consumers, they play a important part in the market place as they exert enormous influence over the allocation of spending power across a growing number of product categories (Gregan-Paxton & Roedder, 1995; Hogg, Bruce, & Hill, 1998). Young consumers also have the highest awareness about innovation and brand. Thus, the subjects in this study were a convenience sample of college students and newly working employees in fashion industry because college students and newly working employees in fashion industry have the highest awareness about fashion trend and innovations. To test the proposed hypotheses, the sampling units are consumers who have sports shoes shopping experiences and fashion clothing shopping experiences. The sample size for a proposed design is determined by the desired precision, power, confidence level, and effect size.

The Chinese sample included 150 college and graduate students and 59 fashion industry employees from Beijing the capital of China. Data were collected during July 2009, and out of 235 questionnaires obtained, 209 were used. All respondents were given a self-administered questionnaire that was completed within 15–20 minutes. All participants were native to their respective countries. The original questionnaire was in English; thus, a two-way language barrier complicated the comparison of respondents in China. To verify concurrent interpretation of the instrument across two cultures, back translation techniques were used for item comparisons.

Section 8 of the questionnaire requested demographic information from the respondents. Demographic information included age, gender, college major, residence, and household income. This section uses a table of frequency distributions for measured consumers' demographic information (Table 1).

Among 209 Chinese respondents, there were 68 respondents (32.5%) of less than 20 years, 125 (59.8%) respondents from 20 to 25 years, and 16

Table 1. Demographic Analysis Results.

Contents	Categories	China (209)	
		Frequency	Percentage (%)
Age	Under 20	68	32.5
	20–25	125	59.8
	More than 25	16	7.7
Gender	Male	108	51.7
	Female	101	48.3
Major	Human Ecology	10	4.8
	Business	133	63.6
	Literature	9	4.3
	Industry	35	16.7
	Mathematics	8	3.8
	Others	14	6.7
Residence	Big city	196	93.8
	Middle city	13	6.2
	Rural area	0	0
Household income	Very low	35	16.7
	Low	118	56.4
	Middle	24	11.5
	High	24	11.5
	Very high	8	3.8

(7.7%) of them were more than 25 years. There were 108 males (51.7%) and 101 females (48.3%). Most of the respondents' majors were from business (63.6%) and industry (16.7%). Their monthly household incomes were mostly distributed in low (56.4%), very low (16.7%), and middle (16.7%). But there are still 32 respondents' household incomes distributed at high and very high level, which is partly because of the development of Chinese economy.

DATA ANALYSIS AND RESULTS

Validity and Reliability Test

The two-step procedure that was used by Zhou et al. (2005) was used to refine measures and assess their construct validity. First, we ran exploratory factor analyses for each set of focal constructs (i.e., innovation, value equity, relationship equity, brand equity, and loyalty intention), which resulted in factor solutions as theoretically expected. Second, we ran confirmatory factor analyses for the whole set of constructs. After we dropped some items that possessed either low factor loadings or cross-loadings, the confirmatory model fit the data satisfactory (Table 2). The convergent factor validity of the construct was assessed by estimating the confirmatory measurement model. Each questionnaire item loaded only on its latent construct. We allowed the latent constructs to be correlated, whereas we constrained the measurement items and their error items to be uncorrelated.

Chinese fashion clothing's incremental innovation model provides a satisfactory fit to the data, which resulted in χ^2 (67) = 149.67, which is statistically significant ($p < .001$). The fit indices are as follows: normed fit index (NFI) = .88; incremental fit index (IFI) = .92; comparative fit index

Table 2. Validity and Reliability Test for Measurement Items.

Construct	Items	Standardized Factor Loading		Cronbach's α	
		I	R	I	R
Innovation	Highly innovative, replacing an inferior alternative	.61	.73	.68	.78
	Not similar to competitors' products	.62	.69		
	Breakthrough innovation	.70	.81		
C-I:AVE = .42, HSV = .24; C-R: AVE = .56, HSV = .27					
Value equity	Deliver product of the highest quality	.58	.61	.71	.66
	Consider to be "top quality product"	.73	.72		
	Purchasing this innovation is prestigious	.71	.64		
C-I:AVE = .46, HSV = .30; C-R: AVE = .43, HSV = .26					
Relationship equity	Multiple purchase experiences on this brand	.75	.74	.84	.83
	Always visit this bran's store	.87	0.82		
	The employees are kind to me	.79	.81		
C-I:AVE = .65, HSV = .58; C-R: AVE = .63, HSV = .69					
Brand equity	Strong brand	.73	.87	.78	.77
	Attractive brand	.88	.76		
	Well known as famous brand in the world	.61	.59		
C-I:AVE = .56, HSV = .24; C-R: AVE = .56, HSV = .22					

China incremental: χ^2 = 149.67, df = 67, NFI = .88, IFI = .92, CFI = .92, GFI = .91, RMSEA = .08
China radical: χ^2 = 146.37, df = 67, NFI = .91, IFI = .96, CFI = .96, GFI = .93, RMSEA = .05

I, incremental innovation; R, radical innovation.

(CFI) = .92; goodness-of-fit index (GFI) = .91; and root mean square error of approximation (RMSEA) = .04, indicating the unidimensionality of the measures. Chinese fashion clothing's radical innovation model provides a satisfactory fit to the data, which resulted in χ^2 (67) = 146.37, which is statistically significant ($p < .001$). The fit indices are as follows: NFI = .91; IFI = .96; CFI = .96; GFI = .93; and RMSEA = .05, indicating the unidimensionality of the measures. Furthermore, all factor loadings were highly significant ($p < .01$). Thus the measures of Chinese sports shoes demonstrate adequate convergent validity.

Following Dabholkar and Bagozzi (2002), discriminant validity was assessed by comparing fit between separate unidimensional and two-dimensional CFA models for each pair of constructs. All items for both constructs were forced to load on a single factor in the unidimensional model. In the two-dimensional model, items were allowed to load only on their respective factor. Discriminant validity was assessed with a χ^2 difference test between these two models. The values of the chi-square statistic in these difference tests are statistically significant for each pairwise comparison, indicating good discriminant validity (Song & Thieme, 2009). Second, following Fornell and Larker (1981) and Zhou et al. (2005) procedure, we calculated the shared variance between all possible pairs of constructs to determine whether they were lower than the average variance extracted for the individual constructs. The results show that for each construct, the average variance extracted was much higher than its highest shared variance with other constructs, providing additional support for the discriminant validity.

Cronbach's α was used for testing the reliability of measures. On the basis of the benchmark built by Bagozzi and Yi (1988), Cronbach's α over .60 indicates high construct reliability. In the present research, all the values of Cronbach's α are over .60, which demonstrate adequate construct reliability for Chinese fashion clothing data.

We ran confirmatory factor analyses in the same way for the advertising appeal constructs (Table 3). Chinese fashion clothing's incremental innovation advertising model provides a satisfactory fit to the data, which resulted in χ^2 (8) = 36.71, which is statistically significant ($p < .001$). The fit indices are as follows: NFI = .89; IFI = .91; CFI = .91; GFI = .94; and RMSEA = .09. Chinese fashion clothing's radical innovation advertising model provides a satisfactory fit to the data, which resulted in χ^2 (8) = 26.82, which is statistically significant ($p < .001$). The fit indices are as follows: NFI = .92; IFI = .94; CFI = .94; GFI = .96; and RMSEA = .08. Furthermore, all factor loadings were highly significant ($p < .01$).

Table 3. Confirmatory Factor Analysis for Advertising Appeal Strategy.

Construct	Items	Standardized Factor Loading		Cronbach's α	
		I	R	I	R
Functional advertising	Provided detailed information about product	.61	.74	.71	.77
	Emphasized the firm's technological competence	.65	.71		
	Try to persuade customers by functional appeals	.75	.73		
C-I:AVE = .45, HSV = .22; C-R: AVE = .53, HSV = .31					
Emotional advertising	Evokes customers' positive feelings	.65	.55	.75	.72
	Persuade customers that after using, feel better	.71	.79		
	Persuade customers by creating mood or situation	.78	.72		
C-I:AVE = .51, HSV = .21; C-R: AVE = .48, HSV = .18					
China incremental: $\chi^2 = 36.71$, df = 8, NFI = .89, IFI = .91, CFI = .91, GFI = .94, RMSEA = .09					
China radical: $\chi^2 = 26.82$, df = 8, NFI = .92, IFI = .94, CFI = .94, GFI = .96, RMSEA = .08					

C, China; I, incremental innovation; R, radical innovation.

Hypotheses Test

To test the hypotheses H1–H3, we first employed structural equation modeling with the maximum likelihood estimation method using the model without moderator. We followed Anderson and Gerbing's (1988) two-step approach in structural equation modeling, for which the estimation of a confirmatory measurement model must precede the simultaneous estimation of the measurement and structural sub-models. On the basis of our confirmative factor analysis results, we test the model with standardized coefficients and other fit statistics. To assess the differential effects, we report standardized coefficients as path coefficients (Table 4).

First, we examine the overall model fit. For Chinese sports shoes' incremental innovation data, the chi-square statistic ($\chi^2 = 118.06$, df = 81) is at significant level ($p < .001$). The fit indices are as follows: NFI = .90, IFI = .95, CFI = .95, GFI = .92, RMSEA = .06. For Chinese sports shoes' radical innovation data, the chi-square statistic ($\chi^2 = 104.37$, df = 81) is at

Table 4. Standard Coefficients and *T*-Value for Each Path – Fashion Data.

No	Hypotheses	Standard Coefficients		*T*-Value	
		I	R	I	R
1	Innovation → value equity	.55	.31	5.09**	3.37**
2	Innovation → relationship equity	.59	.82	5.11**	6.57**
3	Innovation → brand equity	.55	.61	5.15**	5.58**

I, incremental innovation; R, radical innovation.
Note: $\Delta\chi^2 = 32.08$.
$^{*}p < .05$; $^{**}p < .01$.

significant level ($p < .001$). The fit indices are as follows: NFI = .90, IFI = .97, CFI = .97, GFI = .94, RMSEA = .04. On the basis of Hair, Black, Babin, Anderson, and Tatham (1998) cutoff criteria, while the Tucker Lewis Index (TLI) index is below accepted standards, it is concluded that overall, the models fit the data reasonably well.

Second, H1(a), H2(a), and H3(a) examine the impact of radical innovation on value equity, relationship equity, and brand equity. The estimation results show that all paths are significant at the .05 level. Radical innovation has positive effect on value equity ($\gamma = .31$, t = 3.37), relationship equity ($\gamma = .2$, t = 6.57) and brand equity ($\gamma = .61$, t = 5.58), in support of H1(a), H2(a), and H3(a). H1(b), H2(b), and H3(b) examine the impact of incremental innovation on value equity, relationship equity, and brand equity. The estimation results show that all paths is significant at the .05 level. Radical innovation has positive effect on value equity ($\gamma = .55$, t = 5.09), relationship equity ($\gamma = .59$, t = 5.11) and brand equity ($\gamma = .55$, t = 5.15), in support of H1(b), H2(b), and H3(b).

Third, for comparing the differences between radical and incremental innovations, we first use multigroup analysis to see whether there is significant difference between two types of innovation using χ^2 change ($\Delta\chi^2$). Then, we compare to the coefficients of both types of innovations. There are significant differences between the effects of radical and incremental innovations ($\Delta\chi^2 = 32.08$, $p < .01$). We can see that radical innovation's effects on relationship equity ($\gamma_{\mathrm{rad}} = .82 > \gamma_{\mathrm{inc}} = .59$) and brand equity ($\gamma_{\mathrm{rad}} = .61 > \gamma_{\mathrm{inc}} = .55$) are higher than incremental innovation's effect. Thus, H2(c) and H3(c) are all supported.

Forth, the moderator test is conducted in moderating regression approach. We follow the steps: we enter the main effects, and then the interaction effects.

To examine the incremental effect of including the interaction between innovation and drivers of equity, we examined the change in *R*-square (ΔR^2), which indicates the value of including additional of interactions in particular (Aiken & West, 1991).

Functional appeal has moderating effect on the relationship between incremental innovation and value equity ($b = .56$, $p < .01$) and the relationship between incremental innovation and brand equity ($b = .76$, $p < .01$). But emotional appeal only has moderating effect on the relationship between incremental innovation and brand equity ($b = .73$, $p < .001$). Comparing the coefficients of functional and emotional advertising appeal, functional appeal plays more important role on increasing radical innovation's effects on value equity and brand equity. Neither functional appeal nor emotional appeal can increase radical innovation's effects on relationship equity (Table 5). Thus, H4(a) and H6(a) are supported.

Functional appeal has moderating effect on the relationship between incremental innovation and value equity ($b = .38$, $p < .05$) and the relationship between incremental innovation and brand equity ($b = .43$, $p < .001$). But emotional appeal has moderating effect on the relationship between incremental innovation and value equity ($b = .43$, $p < .05$), the relationship

Table 5. Moderating Regression for Advertising Appeal – China Radical Data.

Independent Variable	Value Equity		Relationship Equity		Brand Equity	
	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
Functional appeals						
Innovation	.53	.14	.30***	.40**	.37***	−.16
Functional		−.12		.44**		−.19
Innovation* function		.56**		−.38		.76**
F-value	47.02	34.67	14.59	10.66	32.49	19.79
Adjusted R^2	.30	.33	.11	.12	.18	.22
ΔR^2		.03**		.01		.04**
Emotional appeals						
Innovation	.53***	.31	.30***	.14	.37***	−.23
Emotional		.22		.19		.07
Innovation* emotion		.16		.08		.73***
F-value	58.74	39.07	16.23	10.78	61.01	27.38
Adjusted R^2	.36	.36	.12	.12	.37	.41
ΔR^2		.00		.00		.04***

*$p < .05$; **$p < .01$; **$p < .001$.

Table 6. Moderating Regression for Advertising Appeal – China Incremental Data.

Independent Variable	Value Equity		Relationship Equity		Brand Equity	
	Model 1	Model 2	Model 1	Model 2	Model 1	Model 2
Functional appeals						
Innovation	.30***	−.02	.37***	.24*	.34**	.01
Functional		−.13		−.20		−.07
Innovation* function		.38*		−.10		.43*
F-value	27.68	20.27	25.75	17.21	27.22	21.82
Adjusted R^2	.20	.22	.18	.19	.21	.23
ΔR^2		.02*		.01		.02*
Emotional appeals						
Innovation	.30***	−.03	.37***	−.66	.34***	−.05
Emotional		−.11		.02		−.15
Innovation* emotion		.43*		1.08**		.51*
F-value	31.84	23.23	32.66	16.78	27.22	40.28
Adjusted R^2	.23	.26	.13	.18	.34	.36
ΔR^2		.03*		.05*		.02*

*$p<.05$; **$p<.01$; ***$p<.001$.

between incremental innovation and relationship equity ($b=1.08$, $p<.05$) and the relationship between incremental innovation and brand equity ($b=.51$, $p<.001$). Comparing the coefficients of functional and emotional advertising appeal, emotional appeal plays more important role on increasing incremental innovation's effects on value equity, relationship equity, and brand equity (Table 6). Thus, H4(b), H5(b), and H6(b) are supported.

DISCUSSION AND IMPLICATIONS

Conclusion

We divided fashion innovation into two types, which are radical innovation and incremental innovation. For Chinese fashion consumers, radical innovation and incremental innovation can positively influence value equity, relationship equity and brand equity. Comparing the effects of these between two types of innovations, we found that radical innovation effect is more important than incremental innovation except for value equity. Thus, partly matching with Marsili and Slater's (2005) theory about radical innovation, our findings show that for fashion consumers radical innovation can show better effects to create better relationship with customers and increase more brand equity. As a less innovative country, Chinese consumers can be more attracted by radical innovative products.

Functional advertising appeal is more important for radical innovation increasing value equity and brand equity. But emotional advertising appeal is more important for incremental innovation increasing value equity, relationship equity, and brand equity. With the limited knowledge about radical innovations, functional advertising can educate Chinese consumers about the new technology, material, or design and finally help them to understand the innovations. But when Chinese young consumers are pursuing new fashion trends and good reputation brands, emotional appeals can exactly help incremental innovations to match consumers brand and design-related goals. Thus, emotional appeals are more important for incremental innovations.

Implications and Limitations

Our analysis reveals the reliable estimates of innovation's effect can be obtained from customer-level data, which firms can use to predict the future innovation performance. Only measuring innovation performance from sales data is not sufficient. The effects of launching innovative products are not only for sale, but also for increasing the firm's brand equity and customer relationship equity. Firms employing customer surveys to monitor product innovation can use the approach we present herein to monitor innovation increased equity (value equity, relationship equity, and brand equity) that are derived from customer attitudinal data. Multiple measures of innovation performance based on different data sources (product sales data and customers' attitudinal data) can offer reinforcing and unique insights into an innovation's competitive market position.

The typology for dividing innovation in fashion industry can especially help fashion firms easily divide their innovation into two types. For fashion firms, our results reinforce this belief: Although technology-based innovation is important, fashion design–based innovation cannot be ignored. For fashion firms, design-based innovation is most desirable when consumers have fashion consciousness. Although not all the consumers are highly fashion conscious, consumers with normal or even low fashion consciousness can still be influenced by new-designed products. Thus, our criteria for dividing innovations in fashion industry can really help fashion firms manage their innovations.

When a market becomes highly competitive, it is increasingly difficult for firms to differentiate themselves from their competitors (Gatignon & Xuereb, 1997). Thus, firms cannot stop developing radical innovations to earn competitive advantages. For Chinese fashion clothing consumers, both radical innovation and incremental innovation are important. Each season's fashion show is one of the most important ways to increase customer value equity, relationship equity, and brand equity. But for Chinese consumers, radical innovation seems like a little bit more important than incremental innovation.

To help customers adopt innovations, advertising is one of the most important ways to promote products. When customers get knowledge from advertising about the innovation, they will think about whether the innovation is meaningful to them or not. If the new products are meaningful to them, innovation can have significant and positive effect (Sriram et al., 2007). In view of management concerns about the productivity of advertising expenditures, it is important to pay attention to the entire advertising appeal strategy in an integrated way to understand the impact on customer. But the focusing point should be different based on different culture and innovation type.

For young consumers, consumers knowledge of a product may be limited, making their ability to process information from ads low and their motivation relatively high (Chandy, Tellis, Macinnis, & Thaivanich, 2001). Thus, introduction about the new features of the products can help Chinese to understand the innovation. Brand- and design-related goals are the purchasing reasons for Chinese. The creative use of emotional appeals seems worthy of further consideration.

As an initial effort to address a complicated phenomenon, this study is subject to several limitations. First, fashion clothing industry is limited by the cross-sectional nature. As Chandy and Tellis (1998) note, it may take a long time for breakthrough innovation to demonstrate its effects on performance fully. A longitudinal study is warranted to examine this issue further. In addition, this study focuses mainly on the link between innovation and each driver of customer equity. Additional research should expand our model by considering other important factors that can influence each driver of customer equity, such as hedonic or utility attitudes. And we encourage further research to develop a more systematic measure of different types of innovations. Moreover, our empirical findings are based on data from China. Most of fashion innovation happened in Western countries. This may limit the implications of our findings.

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THE IMPACT OF BRAND CREDIBILITY AND BRAND PERSONALITY ON PURCHASE INTENTION: AN EMPIRICAL STUDY IN CHINA☆

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ABSTRACT

This study aims to investigate the relationships among corporate-brand credibility, product-brand personality, and purchase intention, specifically in China's auto industry. A large-scale survey was conducted in four major Chinese Mainland cities: Beijing, Shanghai, Guangzhou, and Chengdu. A total of 800 questionnaires were distributed for the study. Ultimately, 477 usable cases were collected for a 60 percent response rate. Results reveal that corporate-brand credibility and product-brand personality have direct positive effects on purchase intention. Furthermore, corporate-brand credibility acts as a positive moderator in the relationship between product-brand personality and purchase intention. This chapter offers new theoretical insights into the influential factors affecting consumers' purchase intentions by testing the moderating effect

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of corporate-brand credibility in the relationship between product-brand personality and purchase intention. It further provides useful suggestions to companies on brand credibility and personality issues.

Keywords: Brand credibility; brand personality; purchase intention; China.

INTRODUCTION

In general, brands can be classified into corporate and product brands. Compared to product brands, corporate branding has gained less attention. However, Keller (2003) points out that a corporate brand generates an overall judgment preceding a product brand that provides an evaluation immediately before a specific purchase situation. This indicates the significance of researching corporate brands. Compared to product brands, corporate brands represent an indirect force affecting consumer decision making (Keller & Richey, 2006). This study focuses on both corporate branding and product branding issues.

The credibility of a corporate brand is a key factor in determining a firm's success (Fombrun, 1996; Goldsmith, Lafferty, & Newell, 2000) and is an important component of corporate reputation, relating to the perceived representation of a corporation's past and future activities (Fombrun, 1996). Goldsmith et al. (2000) explicitly define corporate credibility as "the degree to which consumers, investors and other constituents believe in the company's trustworthiness and expertise." Consistent with prior work on corporate credibility (e.g., Keller, 2003), corporate-brand credibility refers to the extent to which consumers believe that a corporate brand can deliver its claimed benefits to satisfy their needs and wants.

Few studies have examined the effect of credibility brought by a corporate brand, rather than the whole corporation (e.g., Lafferty, Goldsmith, & Newell, 2002). But corporate branding has been receiving growing attention recently, particularly in light of the current global financial crisis. This chapter addresses this important gap by studying the direct influence of corporate-brand credibility on purchase intention. Corporate-brand credibility consists of three components: expertise, trustworthiness, and likeableness (Keller, 2003; McGuire, 1958; Ohanian, 1990). On the basis of prior literature on corporate credibility, it can be inferred that the greater the corporate-brand credibility, the higher the purchase intention (e.g., Goldsmith et al., 2000).

Another concept receiving growing attention in the marketing domain is brand personality, which is defined as the human characteristics associated with a specific brand (Aaker, 1997; Govers & Schoormans, 2005). Research emphasis is primarily predicated on the symbolic benefits a brand can bring to consumers (Keller, 1993). Product-brand personality is often determined by user imagery, that is, the characteristics of consumers who use the product brand. Through consumption of a product brand, an individual can enhance his/her actual or ideal self (Keller & Richey, 2006). For example, when talking about Lexus vehicles, people would associate such human characteristics as fashionable, high-status, and attractive with this product brand. Consistent with prior brand personality research (Biel, 1993; McCraken, 1986; Sirgy, 1982; Sirgy, Grewal, & Mangleburg, 2000), it is assumed that product-brand personality can influence purchase intention toward the brand. A positive and strong product-brand personality may thus incur higher purchase intention (e.g., Wang & Yang, 2008).

However, there remains a gap in the extant research as to whether corporate-brand credibility influences the strength of the relationship between product-brand personality and purchase intention. This study aims to investigate whether consumers would also consider corporate-brand credibility when influenced by product-brand personality, specifically in the Chinese Mainland's auto industry.

Thus, the objectives of this study are threefold: first, to examine the impact of corporate-brand credibility on purchase intention; second, to explore the influence of product-brand personality on purchase intention; and third, to investigate the moderating effect of corporate-brand credibility in the relationship between product-brand personality and purchase intention.

CONCEPTUAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

Corporate-Brand Credibility

Source credibility can be defined as the degree to which the receiver believes the source has relevant knowledge and/or expertise and thus trusts the information offered by the source (Ohanian, 1990). Source credibility originally indicated endorser credibility in an advertisement (e.g., Aronson, Turner, & Carlsmith, 1963) and has been considered an important factor influencing purchase intentions and attitudes toward advertising (e.g., Lutz, MacKenzie, & Belch, 1983). This concept can be operationalized into three dimensions: expertise, trustworthiness, and attractivenss (Ohanian, 1990).

Source can also refer to a specific product/company brand. A recent research trend has shown that corporate credibility plays a key role in affecting consumer purchase intentions (e.g., Lafferty et al., 2002). Prior research has examined corporate credibility primarily from three perspectives: advertiser credibility (MacKenzie & Lutz, 1989), advertiser reputation (Goldberg & Hartwick, 1990), and an important factor influencing corporate reputation (Fombrun, 1996). Corporate credibility refers to the extent to which consumers and other stakeholders believe in the company's trustworthiness, expertise, and likeableness, contributing to the corporation's whole image (Fombrun, 1996). Corporate brands represent common product/brand associations, benefits, values, attitudes, relationships, and corporate credibility. Corporate-brand credibility focuses only on consumers' belief in a firm's brand, rather than in other aspects such as a specific product or after-sales services; it is part of corporate credibility.

Regarding the three elements of corporate-brand credibility, expertise refers to the degree to which a corporate brand is supported by professionals possessing relevant knowledge and skills; trustworthiness means the degree to which a corporate brand is thought to be an honest source of products, services, and other information; and likeableness is defined as the degree to which a corporate brand is valued by consumers in terms of sympathetic behavior, perseverance, smartness, and other personality-related characteristics (e.g., Keller, 2003). Although the three elements are related to each other, they measure distinct aspects of the corporate-brand credibility construct. The expertise dimension relates to a corporate brand's competencies; the trustworthiness facet measures consumers' attitude toward a corporate brand; and the likeableness dimension is related to a corporate brand's appearance and/or emotional attachment (Maathuis, Rodenburg, & Sikkel, 2004).

Consumers believe a corporate brand's trustworthiness, expertise, and likeableness can be used to evaluate the firm's products and services, thus influencing their purchase intention (e.g., Fombrun, 1996). The credibility of a corporate brand is vital to the success of its branding strategy. Low levels or a complete lack of credibility can make consumers doubt the company's ability to produce quality products and services and thus be less likely to buy them (Goldsmith et al., 2000). In contrast, strong and positive corporate-brand credibility would enhance brand image and thus brand equity, resulting in higher purchase intentions. Consequently, consistent with Winters (1988) and Davis (1994), both of whom find that perceived credibility of a corporation is positively related to sales, we hypothesize that:

H1. The more favorable the perceived corporate brand's credibility is, the more likely the purchase intention toward a brand is.

Product-Brand Personality

Brand personality is defined as the human characteristics associated with a specific brand (e.g., Aaker, 1997; Diamantopoulos, Smith, & Grime, 2005; Govers & Schoormans, 2005). Aaker (1997) regards brand personality as different from human personality in that human personality characteristics are comprehended via behavior, attitudes, and beliefs, whereas brand personality should be considered through contacts that consumers have with the brand. Sweeney and Brandon (2006, p. 645) view brand personality as those human traits that "correspond to the interpersonal domain of human personality and are relevant to describing the brand as a relationship partner." As pointed out by Keller (1993), brand personality possesses symbolic values over and beyond its utilitarian functions. Consumers can achieve more positive self-esteem through associating brands with human personalities when consuming their selected brands.

Aaker (1997) has developed a five-dimensional scale to measure product-brand personality: sincerity (inclusive of down-to-earth, honest, wholesome, and cheerful), excitement (daring, spirited, imaginative, and up-to-date), competence (reliable, intelligent, and successful), sophistication (upper-class and charming), and ruggedness (outdoorsy and tough). A strong and positive brand personality can lead to favorable product evaluations, resulting in higher purchase intentions (e.g., Fennis, Pruyn, & Maasland, 2005; Freling & Forbes, 2005; Wang & Yang, 2008). Specifically, Fennis et al. (2005) have found that product-brand personality can influence consumers' self-perceptions in terms of agreeableness, extroversion, conscientiousness, and intellect. Freling and Forbes (2005) observe that consumers are inclined to have more congruent, unique, and strong brand associations when exposed to a product-brand's positive personalities. Wang and Yang (2008) also find that product-brand personality tends to be positively related to consumers' product evaluations. Therefore, we hypothesize that:

H2. Product-brand personality tends to be positively related to purchase intention.

Corporate-Brand Credibility's Moderating Effect

An individual engaging in a purchase would first consider the personality characteristics associated with a specific product brand instead of the corporate brand. However, if a new product is provided to the individual, who has limited knowledge about the new product, then s/he would certainly turn to corporate-brand credibility as a cue for evaluating quality (Dodds, Monroe, & Grewal, 1991). That is, although it is suggested that product-brand personality exerts a direct positive influence on purchase intention, the relative importance of product-brand personality on purchase intention may also depend on its corporate-brand credibility (Czellar, 2003; Roth & Romeo, 1992).

From prior literature in this regard (e.g., Davis, 1994; Fombrun, 1996; Lafferty & Goldsmith, 1999), it can be inferred that when a product brand can be distinctively differentiated from other brands on personality characteristics, and its corporate-brand credibility is perceived as positive, consumers would be more reassured about their product-brand personality perceptions and thus be more strongly affected by product-brand personality with regard to purchase intention. However, when a product-brand's personality is perceived as positive while its corporate-brand credibility is negative, the connection between product-brand personality and corporate-brand personality would become 'loose'; even worse, the product-brand personality may not significantly influence purchase intention under such circumstances. Hence, product-brand personality may have less of an impact in terms of purchase intention.

Therefore, it is suggested that positive corporate-brand credibility could enhance the influence of product-brand personality on purchase intention, whereas a negative corporate-brand credibility image may weaken the effect of product-brand personality on purchase intention, indicating the moderating role of corporate-brand credibility. Thus, we hypothesize that:

H3. Corporate-brand credibility tends to act as a moderating variable in the relationship between product-brand personality and purchase intention.

Subjective Product Knowledge as a Control Variable

Consumer knowledge held in memory can significantly influence consumer decision making (Alba & Chattopadhyay, 1985). Product knowledge is defined as consumers' memories and/or understanding relevant to the product (Brucks, 1985) and can be classified into three categories: experience-based knowledge, subjective knowledge, and objective knowledge. Experience-based knowledge refers to one's experience in buying and/or using a product (Marks & Olson, 1981), which can influence behavior only if it produces differences in one's memories. Therefore, the impact of experience-based product knowledge, to a large extent, depends on individual habits. Subjective product knowledge refers to how much knowledge consumers perceive about a product they have. Their purchase decision making is primarily dependent on their subjective product perception rather than on objective product knowledge, which refers to the product knowledge actually stored in their memory (Park & Lessig, 1981). Therefore, we focus only on subjective product knowledge in this study and include it as a control variable.

RESEARCH METHODOLOGY

Questionnaire and Measures

The questionnaire for this study was composed of two parts. The first part measured the four factors (corporate-brand credibility, product-brand personality, subjective product knowledge, and purchase intention); the second part recorded the demographic information of the respondents. The questionnaire was originally in English; it was then translated and back-translated into Chinese until acceptable translation accuracy was achieved.

Product-brand personality was measured using Aaker's (1997) scale (Cronbach's alpha = .93): sincerity (down-to-earth, honest, wholesome, cheerful), excitement (spirited and up-to-date), competence (reliable, successful, intelligent), sophistication (upper-class and charming), and ruggedness (outdoorsy and tough). The scale endpoints were "absolutely disagree" (1) and "absolutely agree" (7). Corporate-brand credibility was measured by adapting the scales from Ohanian (1990). Four items, such as "I trust the corporation" and "The corporation makes truthful claims," measured how trustworthy consumers perceive the company to be. Another four items, such as "The corporation is skilled in what they do" and "The corporation has great expertise," evaluated how much expertise a company possesses. Likeableness was measured by three items, including "The corporate-brand is very attractive," "I like the corporate brand very much," and "The corporate-brand is classy." Thus, a total of eleven items, with anchors ranging from "absolutely disagree" (1) to "absolutely agree" (7) and a Cronbach's alpha reliability coefficient of .89, were used for measurement. Since familiarity with products has been identified as a significant embodiment of subjective product knowledge (Alba & Hutchinson, 1987), we measured subjective product knowledge by using a seven-point semantic differential scale to correspond with the sentence "Please circle one of the numbers below to describe your familiarity with cars," with the anchors being "not at all familiar" and "extremely familiar" (Brucks, 1985). A seven-point Likert item with 1 meaning "absolutely impossible" and 7 "absolutely possible" was employed to measure purchase intention (e.g., Dodds et al., 1991).

Pilot Study

A pilot study was conducted to assess the content validity of the measurement scales contained in the questionnaire. Content validity can be evaluated by experts who decide whether the test represents all the content of a particular construct (Judd, Smith, & Kidder, 1991). After evaluation by four academics and five local professionals in this field, some items were reworded based on their feedback.

Subsequently, the questionnaire was administered to 50 local consumers recruited through a local newspaper advertisement, who were asked to answer, review, and critique the questionnaire. After completion, they were reimbursed with RMB50. All 50 questionnaires were useful; the questionnaire was then revised and finalized based on the feedback received.

Reliability and Validity

The reliability of constructs used was tested using Cronbach's coefficient alpha, which ranged from .89 to .93, much larger than the standard of .7 (Churchill, 1979; Nunnally, 1978). Since all measures were based on prior relevant literature and were often used or adapted in research (e.g., Lin & Chen, 2006), evidence of content validity was provided.

To test validity issues, measures (product-brand personality, corporate-brand credibility, subjective product knowledge, and purchase intention) were subjected to a confirmatory factor analysis (CFA) through AMOS 5.0. CFA allows for a validity assessment of the measures used. The fit indices [χ^2/df = 1.80, $p = .000$, goodness-of-fit index (GFI) = .93, adjusted goodness-of-fit index (AGFI) = .91, confirmatory fit index (CFI) = .95, normed fit index (NFI) = .94, root mean squared error of approximation (RMSEA) = .04] suggested a good fit for the measurement model. All items loaded significantly [critical ratio (CR) > 1.96] on their corresponding constructs. Therefore, evidence of trait validity was provided for the dependent measures (Anderson & Gerbing 1988).

Data Collection and Sample

The survey was conducted in four large, prominent Chinese Mainland cities – Beijing, Shanghai, Guangzhou, and Chengdu – all of which enjoy a higher income per capita and have a better living standard than other cities on the Chinese Mainland. This means there are more current and potential automobile users in these cities, offering a more solid statistical foundation. Survey brands incorporated two sets: company brands [including FAW Volkswagen, Shanghai General Motors, Guangzhou Honda, Tianjin Toyota, Dongfeng Nissan, FAW Mazda, Beijing Hyundai Motor Company (BHMC), Dongfeng Citroen, Changan Ford, Shanghai Volkswagen, and Dongfeng Peugeot, which constitute the major auto company brands in China] and corresponding product brands (including Passat, Bora, Santana 3000, Excelle, Vios, Bluebird, Sunny, Sonata, Elantra, Familiar, Corolla, Mazda 6, Elysee, Accord, and Peugeot 307). A well-trained interviewer asked each respondent to answer all questions contained in the questionnaire, and each respondent received RMB100 as nominal compensation upon completion of the task.

Respondents were recruited by a large research agency on the Chinese Mainland. A total of 800 questionnaires were distributed, and 477 usable cases with a response rate of 59.6 percent were collected. There were 225 female (47.2%) and 252 male respondents (52.8%). Their ages were mainly over 30 years old (69.8%), most had junior college diplomas or higher (66.0%), and their careers fell primarily into two categories: business and education. Most of them had a personal monthly income of more than RMB5,000 (45.8%) and a monthly household income of more than RMB8,000 (53.4%).

ANALYSIS AND RESULTS

Hierarchical regression analysis was employed to test hypotheses, after controlling for gender, age, education level, personal/household monthly income, career/industry, and product knowledge. Gender, education, and industry were dummied in the regression analysis. The averages of scale items of each construct were used as inputs in the regression analysis. A total of four regression models were developed, as presented in Table 1.

H1 had predicted that corporate-brand credibility would exert a positive influence on purchase intention. Based on models 1 and 2, the R square change was 10 percent and was statistically significant at the $p<.001$ level; the standardized regression coefficient was significantly and positively related to corporate-brand credibility (.37). Thus, the data supported H1.

H2 had predicted that product-brand personality was positive related to purchase intention. According to models 2 and 3, the R square change was 4.0 percent and was statistically significant at the $p<.001$ level; a positive

Table 1. Hierarchical Regression Analysis Results.

Explanatory Variables	Model 1	Model 2	Model 3	Model 4
Gender[a]	✓[b]	✓	✓	✓
Age	✓	✓	✓	✓
Education level[a]	✓	✓	✓	✓
Career[a]	✓	✓	✓	✓
Personal monthly income	✓	✓	✓	✓
Household monthly income	✓	✓	✓	✓
Subjective product knowledge	✓	✓	✓	✓
Corporate-brand credibility		✓	✓	✓
		(.37)[c,*]	(.26)[c,*]	(.23)[c,*]
		(.46)[d,*]	(.31)[d,*]	(.29)[d,*]
Product-brand personality			✓	✓
			(.19)[c,*]	(.15)[c,*]
			(.25)[d,*]	(.21)[d,*]
Corporate-brand credibility × Product-brand personality				✓
				(.34)[c,*]
				(.47)[d,*]
Constant	2.58	2.99	3.14	3.61
F	9.24	10.11	9.93	12.74
	($p<.001$)	($p<.001$)	($p<.001$)	($p<.001$)
R^2	.15	.25	.29	.33
R^2 change	.15	.10	.04	.04
Adj-R^2	.13	.22	.26	.30
Overall model p value	.000	.000	.000	.000

[a]Represents that the variable was dummied before data analysis.
[b]Means the corresponding explanatory variable is included in the model.
[c]Standardized regression coefficient.
[d]Unstandardized regression coefficient.
*$p<.05$.

standardized regression coefficient was related to product-brand personality (.19), showing that it had a significantly positive impact on purchase intention. Therefore, H2 was also supported.

H3 had predicted a significant positive corporate-brand credibility and product-brand personality interaction. According to model 4, the *R* square change for the interaction was 4.0 percent, which was statistically significant at the $p < .001$ level, and the standardized regression coefficient was 0.34, indicating that the interaction had a significantly positive impact on purchase intention, as illustrated by Fig. 1. Hence, corporate-brand credibility acts as a positive moderator between product-brand personality and purchase intention. Companies with strong and positive corporate-brand credibility could obtain higher purchase intentions with positive product-brand personality, whereas the positive effect of brand personality on purchase intention becomes smaller but is still positive when credibility decreases. Thus, H3 was strongly supported.

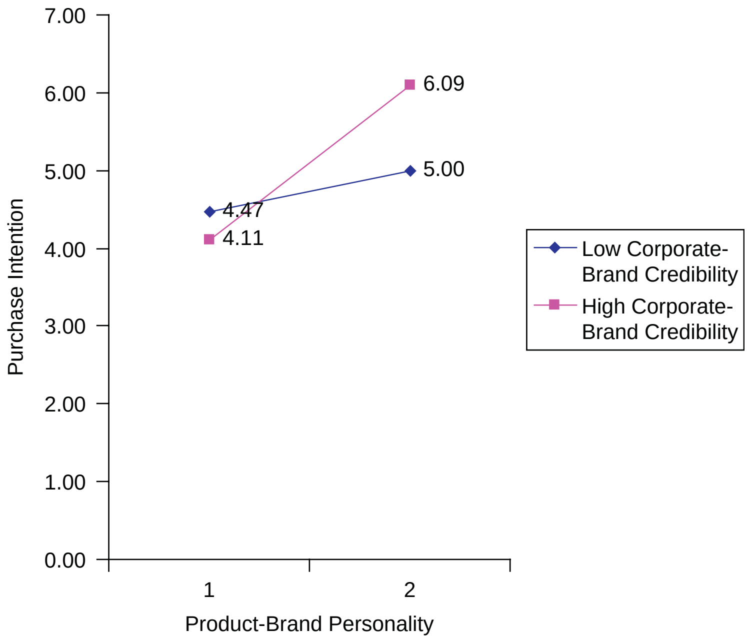

Fig. 1. Corporate-Brand Credibility by Product-Brand Personality Interaction on Purchase Intention.

DISCUSSION

The purpose of this study was to investigate the relationships between corporate-brand credibility, product-brand personality, and purchase intention, focusing on China's auto industry. It was suggested that corporate-brand personality has both main and interaction effects on purchase intention. Results revealed that both corporate-brand credibility and product-brand personality exert significant positive main influences on purchase intention, whereas corporate-brand credibility was found to be a positive moderator in the relationship between product-brand personality and purchase intention. Relatively few studies have been conducted on the interaction effect of corporate-brand credibility and product-brand personality in non-US settings. China is an emerging economy; therefore, with successful replications, our findings may be generalizable to other emerging countries or regions.

Corporate-brand credibility forms a specific part of the overall company image (Goldsmith et al., 2000). On the basis of Keller (2003), corporate brand is located at the highest level of the brand hierarchy. Corporate brands encompass a much wider range of associations than product brands in that they can evoke linkages to common products, their shared attributes or benefits, and corporate credibility (Keller, 2003). These associations are important in influencing consumers' purchase intentions.

Corporate-brand credibility was found to positively influence purchase intention: the more credible a corporate brand, the higher consumers' purchase intention toward it. As described by one of our respondents: "When I engage in a car purchase, I always turn to those product brands associated with credible corporate brands." This research finding is also in line with prior research results on corporate credibility. For instance, Davis (1994) and Maathuis et al. (2004) have found that corporate credibility can have a positive effect on all three outcome variables. More recently, Lafferty and Goldsmith (1999) and Goldsmith et al. (2000) observed that corporate credibility can directly affect purchase intention.

Consistent with prior literature on brand personality, product-brand personality is also positively related to purchase intention: the more positive the product-brand personality, the higher the purchase intention toward the brand. Wang and Yang (2008) also found that brand personality tends to exert a significant impact on purchase intention. One of our respondents noted that she wanted to be associated with a positive image that included fashion, high status, and prestige when driving a car. For example, German cars enjoy a worldwide reputation for personality-related aspects such as modernity and status, which may positively influence purchase intention.

Corporate-brand credibility was also found to be a positive moderator between product-brand personality and purchase intention. On the basis of Fig. 1, the direction of the relationships is not moderated by corporate-brand credibility, but the effects are more pronounced for companies with more positive corporate-brand credibility than for those with less. As described by one of our respondents, "Of course, product brand is the most important thing to me, but I also emphasize corporate brand; a strong corporate brand can give me a lot of confidence." Indeed, corporate-brand credibility is regarded as a guarantee for delivering high quality (Keller & Richey, 2006). A good product-brand personality with weak corporate-brand credibility would exert a less significant impact on purchase intention; in contrast, if the product-brand personality is positive while the corporate-brand is strong, then the effect of product-brand personality on purchase intention is stronger.

China has experienced rapid economic growth since its open-door policy began in 1978. However, brands and products originating from China have been considered cheap, low-quality, and lacking in credibility by foreign consumers. Even among the few globally successful Chinese brands, some are mistakenly regarded as being from Western countries instead of from China. For instance, Haier, a global home-appliance manufacturer, is thought to be German, simply because Germany was its first foreign entry market through exporting. In addition, although India mainly lags behind China's fast-growing economy, Indian textile products have a better brand credibility than the Chinese products that are flooding markets across the world (http://www.siliconindia.com). Since corporate-brand credibility is found to significantly influence purchase intention, it is urgent for Chinese companies to establish and maintain positive corporate-brand credibility on the basis of product quality and, more important, on intangible assets such as product-brand personality to enhance overall brand image and prestige.

Managerial Implications

Companies in China may benefit from the findings of this study. First, corporate-brand credibility exerts a significant influence on consumers' purchase intentions, and the effect of product-brand personality on purchase intention would be stronger for firms with higher corporate-brand credibility than for those that are less credible. Hence, it is desirable for a firm to develop the extent to which consumers believe it can design and deliver satisfying products/services. A possible way is to launch a corporate brand campaign, by means of which a firm can build corporate-brand awareness and create favorable attitudes and publicity (Keller, 2003). Another branding strategy is to employ brand line campaigns that refer to the whole range of products linked to a brand line. By presenting consumers with different uses and/or benefits of the multiple products under a brand line name, companies can enhance brand awareness, clarify brand meaning, and offer other applications (Keller, 2003). In addition, cause marketing may also prove beneficial in enhancing corporate-brand image and establishing corporate-brand credibility.

Second, product-brand personality characteristics can positively influence purchase intention. Thus, it is also important to design a competitive branding strategy and communicate the strong brand personality characteristics through effective advertising and/or by using Internet tools such as chat rooms or Web pages in order to promote products/services. Using celebrity endorsers is helpful for establishing desirable brand personality associations. For instance, Gillette is well known for employing celebrities such as David Beckham in order to build a strong image of modernity and fashion. However, one thing deserving attention is that, in choosing celebrity endorsers, a firm needs to avoid using those with low credibility and those who endorse too many products, making consumers think of them as opportunistic and/or insincere.

Limitations and Future Research

Limitations of this study directing future research need to be noted. Product involvement, which may influence purchase decisions, was not included as a control variable. Although an automobile purchase in itself is a high-involvement situation, various extents of product involvement may exist, resulting in different brand attitudes. In particular, some respondents who already own a branded car may be highly involved with the car brand in use, which might bias the sample. Hence, further research should also examine the effect of product involvement without biasing the sample. It is also possible that respondents might have felt reluctant to evaluate the full range of brand and company stimuli, which may have negatively affected our survey quality. In addition, both independent and dependent variables were measured with a single data source, probably resulting in common method bias.

We did not include self-image perception and word-of-mouth in this study. Different self-image congruence perceptions with product-brand personality can result in different purchase intentions. In addition, word-of-mouth may also affect consumers' purchase decision-making processes. Hence, self-image congruence and word-of-mouth should be examined by further research. In addition, it is possible that not only the effect of brand personality on purchase intention depends on brand credibility, but also the effect of brand credibility on purchase intention depends on brand personality (an idea we owe in large part to one of the anonymous reviewers). Therefore, it is desirable to consider both effects in future research.

Finally, an automobile purchase in itself is an act involving various other sociological and/or psychological factors such as peer pressure, social status admiration, and personality-related variables. Price and experience are also important factors. Future research is encouraged to examine more relevant factors in this regard.

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HALLMARKS IN THE DEVELOPMENT OF MARKETING: CHINESE MANAGERS' MARKET ORIENTATION AND ABILITY TO DELIVER SERVICE QUALITY

Dennis A. Pitta and Darlene B. Smith

ABSTRACT

This chapter presents the results of two empirical studies aimed at assessing the nature of two hallmarks of marketing development: market orientation and the ability to deliver service quality. Both studies used Chinese managers as subjects. The first investigated the nature and scope of marketing orientation the managers perceive in their firms and found that Chinese managers recognize the importance of market orientation and its relation to firm success and performance. The findings demonstrate a well-developed sense of market orientation.

The second study assessed managers' perceptions of their ability to deliver service quality using the SERVQUAL model. Managers in the sample perceive that reliability is the most important dimension for customers, followed by responsiveness and assurance. Formal standards exist for these dimensions and managers are quite optimistic about the ability of their firms to meet these performance standards. The original

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antecedents presented in the SERVQUAL model do not precisely fit the Chinese market. The factor analysis showed a strong orientation toward operating systems and processes.

Keywords: Market orientation; service quality; Chinese marketing.

INTRODUCTION

China enjoys one of the strongest economies in Asia and ranks high in terms of overall global competitiveness. Over the past 20 years, it has seen major improvements in its GNI, prospered from over 260 percent growth in its GDP, maintained a positive trade surplus, and enjoyed declining unemployment and inflation rates compared to other Asian countries. One of the drivers of this prosperity is the country's return to a free market economy.

With the development of the Chinese market, domestic enterprises have learned from global organizations, and Chinese managers have developed a level of sophistication. As the global economy matures, increased competition has led to the globalization of business techniques. Two indicators of mature management are a sense of the market, or market orientation, and a greater ability to go beyond making products – the ability to deliver service quality. One is a perspective that, when operationalized, yields a higher chance of success; the other is a skill set that has been found to determine the ability of firms to satisfy customers, gain repeat business, and succeed against competitors. This chapter reports the results of two separate studies: one assessing market orientation and the second assessing managers' perceptions of their ability to deliver service quality. Both take place in a Chinese setting.

MARKET ORIENTATION – THE FIRST STUDY

One of the hallmarks of a successful free-market economy is the market orientation of local industries (Jaworski & Kohli, 1993; Kohli & Jaworski, 1990; Day, 1990; Narver & Slater, 1990, 1998). The past several decade have seen a renewed academic and practitioner interest in the market orientation construct. This situation is logical, since it stems directly from the marketing concept, which forms the foundation of effective marketing practice.

The marketing concept has been described as a marketing management philosophy that guides what is thought to be best practice. However, a market orientation takes time to develop and environmental factors such as competitive intensity, governmental regulations, and other external uncertainties can moderate the level of market orientation.

Very little market orientation research has focused on Asia and even less on China. One study (Qu & Ennew, 2005) examined the early effects of market orientation and the moderating role of the environment. A second focused on China's transitional economy but did not offer benchmarks for comparison (Qu & Ennew, 2005); instead, it provided valuable insight into the effect of government and ownership on market orientation. No other published market orientation research to date has focused on China's growing economy.

Background Literature and Research Hypotheses

A decade ago, one criticism leveled at the market orientation construct was that despite its acknowledged importance, market orientation did not have a clear meaning or "a rich tradition of theory development, and a related body of empirical findings" (Kohli & Jaworski, 1990). There were numerous definitions and little empirically based theory. Moreover, there was little concern for the environmental factors that affect the proper orientation for a particular business. Over time, the construct has enjoyed continued refinement.

One of those refinements has focused on developing valid measures of market orientation. The first, attributed to Narver and Slater (1990), is one of the most comprehensive measures and has several positive features. For example, it adopts a focused view of markets by emphasizing customers and competitors as well as other environmental elements such as technology and regulation. Although it is firmly grounded in the marketing concept, it tends to concentrate on external factors. In contrast, work by Kohli, Jaworski, and Kumar (1993) recognizes the activities in which firms engage to succeed. These involve the speed with which market intelligence is generated and disseminated within the firm, and which activities it uses to exploit that intelligence. This use of intelligence is typified by a firm's level of responsiveness. Kohli, Jaworski, and Kumar (1993) designed the market orientation measure (MARKOR), which assesses the degree to which an SBU (1) engages in multidepartment market intelligence generation activities, (2) disseminates this intelligence vertically and horizontally through both formal and informal channels, and (3) develops and implements marketing programs on the basis of the intelligence generated.

Together, both approaches seem to capture the essence of market orientation. Underscoring the importance of both approaches to the construct, market orientation has been defined as a business culture that has two major elements. First, it places the highest priority on the profitable creation and maintenance of superior value for customers while considering the interests of other stakeholders. Second, it provides directions for the organizational generation and dissemination of and responsiveness to market information (Langerak, 2003). The concept of market orientation has an inherent logic that is well recognized. Moreover, the literature indicates that a company's market orientation is directly related to organizational performance (Langerak, 2003; Slater & Narver, 2000). Using either construct view, it appears that firms with a higher marketing orientation perform better than those with a lower marketing orientation. The measures of performance comprise metrics like profitability, sales growth, customer satisfaction, and successful introduction of new products. The underlying explanation may be that a market-oriented organizational culture produces a sustainable competitive advantage and thus superior long-run organizational performance (Hunt & Morgan, 1995).

The current research attempts to find answers to several questions, none of which have been researched in a Chinese context. The four research questions are:

- Is there a difference between market orientation and external focus?
- What is the link, if any, between market orientation and business performance?
- Does degree of market orientation vary by type and size of organization?
- Does managerial level moderate respondent perceptions of market orientation?

The research questions lead directly to the study's hypotheses.

Business Performance

Although marketing academics and practitioners have debated for more than three decades that business performance is affected by market orientation, the study by Narver and Slater (1990) was the first systematic empirical evidence of the effect of a market orientation on business profitability. Following that, a number of studies, conducted mainly in the context of developed countries, have supported the positive relationship between market orientation and business performance (Ruekert, 1992;

Deshpande, Farley, & Webster, 1993; Jaworski & Kohli, 1993; Slater & Narver 1994; Selnes, Jawoerksi, & Kohli, 1996; Pulendran, Speed, & Widing, 2000). However, although the strength of the market orientation–performance relationship appears to be fairly strong, the robustness of the relationship across different environments is not clear. Several researchers have proposed that environmental factors might moderate the relationship (Han, Kim, & Srivastava, 1998; Kumar, Subramanian, & Yauger, 1998). In recent years, findings from developing economies have been more mixed (Bhuian, 1998; Ngai & Ellis, 1998; Hooley et al., 2003; Subramanian & Gopalakrishna, 2001; Liu, Luo, & Shi, 2003), which have led some researchers to question the simple transferability of findings from developed countries (Ngai & Ellis, 1998). Owing to the importance of China in Asia and its robust business environment, we expect to find a positive relationship between a firm's market orientation and its performance. Thus, we postulate the following hypothesis:

> **H1.** The degree of market orientation is positively linked with business performance.

External Orientation

As aforementioned, two distinct scales have emerged to measure market orientation. Kohli et al. (1993) focus on the activities of the firm (i.e., intelligence generation, intelligence dissemination, and responsiveness) and advance the use of the MARKOR scale. Narver and Slater (1990) adopt an external focus of market orientation. External focus is measured by a customer and competitive orientation. This study seeks to assess the reliability between the two approaches and therefore postulates the following:

> **H2.** Externally oriented organizational cultures lead to higher levels of performance and internally oriented (bureaucratic and consensual) cultures lead to lower levels of performance.

Organizational Scope

One argument for differing levels of market orientation in an economy is the influence of multinational firms that succeed in the global marketplace by developing a market-oriented business strategy. Multinationals operate in most countries and have developed keen environmental sensing capabilities and become adept at responding to local needs. Although firms in domestic industries may emulate some of the multinationals' marketing practice, it is expected that they will lag behind them. The least progressive marketing firms may be in industries whose horizon is limited to local markets, with their traditions and concentrated focus. National firms usually possess a broader perspective, at least as broad as the national market. Broader perspectives should sensitize firms to the need to monitor their markets. This gives rise to the following hypothesis:

H3. International firms have a higher degree of market orientation than do local, domestic firms.

Industry Type

Products and services vary on many dimensions, not just their tangibility. On the whole, products, since they are tangible, communicate their want-satisfying benefits more completely than services whose intangibility may make their benefits less apparent. Although it may be argued that service firms are under a greater burden to learn what customers want and need, service development is inherently more difficult than product development. Many researchers have suggested that the inherent nature of service organizations requires a strong market orientation (Kara, Spillan, & DeShields, 2005). The intangibility of services and the maturity of service offerings have made developing a marketing orientation essential for service firms to develop a sustainable competitive advantage (Czepiel, 1990; Perrien & Ricard, 1995). Thus we postulate the following:

H4. Market orientation is greater in service industries than in manufacturing industries.

Economic Sector

Under China's Communist Party, private ownership of the means of production was sharply curtailed. After the revolution, state-owned and province-owned businesses predominated. The situation led to economic stagnation but widespread employment. Together with government control of prices, the situation was stabilized. The business climate was, at best, unexciting and, because of government control, bureaucratic. Typical bureaucratic organizations tend to stunt creativity and look inward rather than outward. Government organizations tend to avoid risks and, if they value improvements, concentrate on improving efficiency. They tend not to have competitors and they may not value satisfying customers. When Deng Xiao Ping served as General Secretary of the Communist Party, he relaxed private ownership restrictions and declared, "To be rich is glorious." That statement started a flood of foreign investment and some privatization that transformed the Chinese economy. The changes have themselves been revolutionary. Instead of the slow evolutionary dynamics that are present in the West, China underwent dramatic and sudden changes. The process has been described as the Big Bang in reference to the sweeping changes in regulations, investment climate, and wealth. One question that arises is how quickly China's managers could assimilate business practices common across the globe. An under-researched area focuses on the nature and scope of market orientation implementation in China.

As China's political control of the economy shifts to allow more private ownership, there could be shifts in firms' market orientation. Private ownership is often more entrepreneurial and more attuned to the elements that spell success; thus, we should expect differences in market orientation. Our hypothesis is as follows:

H5. Market orientation is greater in private industry than in government or quasi-government firms.

Size of Organization

Organizational research identifies the differences inherent in firms of different sizes. Therefore, we also test for differences in company size. Although several studies have investigated the market orientation of small businesses (Pelham, 1999, 1997), they have been limited to developed economies and have used small manufacturing firms. Thus, on the basis of previous research, we have some mixed expectations about the relationship. For example, we expect that larger companies tend to be higher on market orientation than smaller companies. The effect is often a resource-based result. Usually, larger companies have more resources like human resources, a professional marketing staff, and more access to market research than smaller firms. They may also have the necessary infrastructure such as formalized marketing departments and corporate communication specialists to pursue a market orientation. However, smaller firms may be more entrepreneurial and, despite having fewer resources, may be more active in pursuing opportunities. On balance, the resource argument seems the more powerful. Therefore we postulate the following:

H6. Large firms are more market oriented than small firms.

Managerial Level

Organizational research also identifies the differences among managers in a company. Organizational level is a determinant of job responsibilities, job focus, and manager orientation. Lower-level managers usually have responsibilities focused within the company that may include monitoring internal processes or supervising employees working in the firm. One exception is the sales force manager, whose duties involve supervising salespeople who deal with customers. Often those duties focus on increasing individual performance rather than that of the sales team. Thus, the intelligence generation and dissemination activities may be limited. Moreover, responsiveness may be outside the manager's responsibilities. In contrast, higher-level managers are usually concerned with managing a large part of the company. Working with several departments or groups increases their need to coordinate. In many cases, coordination takes the form of managing intelligence and responding to opportunities and threats. Therefore:

H7. Higher-level managers perceive greater market orientation than do lower-level managers.

METHODOLOGY

The purpose of this study is to gain an understanding of the level of market orientation in Chinese firms. In addition, the study aims to verify the relationship between market orientation and firm performance in an Asian context. The study employed a survey, administered in person to practicing managers. A 48-item questionnaire plus some descriptive questions were used to obtain data.

The Sample

The first stage in the study was to select a sample of Chinese managers. The sample was drawn from managers enrolled in their second year of an MBA program in Beijing. All respondents were fully employed in a managerial position within their organizations. A total of 51 subjects were included. Table 1 provides a general description of the sample.

Subjects in the sample represented the lower and mid levels of executives, and tended to be newer in the organization. In addition, they were overwhelmingly employed in the private sector. All three of these characteristics are what one might expect from managers in MBA programs. Most worked for domestic organizations in large companies, as well as for manufacturing companies.

Table 1. Sample Profile.

	China
Position in organization	
Entry level	23
Mid level	22
Senior level	6
Years at organization	
1–2 Years	10
3–8 Years	36
9–14 Years	1
15–20 Years	2
20+ Years	0
Ownership	
Private sector	45
Public sector	7
Scope of operations	
Domestic	33
International	11
Global	9
Type of organization	
Manufacturing	33
Service	19
Size of organization	
Small	12
Medium	8
Large	20

Questionnaire Development

The questionnaire was created in English to be administered to English-speaking managers, and was constructed using a combination of the MARKOR scale of Kohli et al. (1993) and the external orientation scale of Narver and Slater (1990). It included 29 items designed to assess the 5 different components of market and external orientation: customer orientation (items 1–6), competitor orientation (items 7–9), intelligence generation (items 10–15), intelligence dissemination (items 16–20), and responsiveness (items 20–29). The responses to each item were measured on a seven-point Likert scale ranging from ''Strongly disagree'' (1) to ''Strongly agree'' (7). In addition, descriptive measures and measures of perceived firm performance were taken. Questions used in the questionnaire can be found in Appendix A.

Scale Validity and Reliability

Factor analysis using principal components analysis and varimax rotation confirmed scale development and yielded five different factors. Twenty-five of the 29 items loaded on 5 factors explaining 64 percent of the total variance. The factors were labeled 'intelligence generation' (factor 1), 'competitor orientation' (factor 2), 'customer orientation' (factor 3), 'intelligence dissemination' (factor 4), and responsiveness (factor 5). The dimensions are consistent with both the Kohli and Jaworski (1990) and Narver and Slater (1990) frameworks.

To assess the reliability of the scales, Cronbach's alpha was calculated for the overall measure of market orientation (MO), the overall measure of external orientation (EO), and each of their respective sub-scales. Scores for each of the three dimensions of market orientation (i.e., intelligence generation, intelligence dissemination, and responsiveness) were combined to yield a market orientation measure. Scores for customer orientation and competitor orientation were combined to yield a measure of external orientation. The results of the analysis for the sample are provided in Table 2. The alpha scores for both the MO and EO scales were well above the benchmark level of 0.70 suggested by Nunnally (1994) and thus judged to have sufficient reliability.

DATA ANALYSIS

Data analysis was structured around the four research questions: market orientation effect on business performance, differentiation between marketing orientation and external orientation, the variability of market orientation across size and type of firm, and the affect of managerial level of perceptions of market orientation. The six hypotheses are embedded within these five areas.

Market Orientation and Business Performance

The first research question focused on the link between market orientation and business performance. The questionnaire contained nine separate items that assessed the respondent's perception of his or her firm's performance. The first two items ("Overall performance of my company for the past 12 months" and "Overall performance relative to major competitors") assessed

Table 2. Construct Reliability and Scores.

Scale Item (Cronbach's alpha)	Overall Sample
Market orientation	.908
Intelligence generation	.766
Intelligence dissemination	.732
Responsiveness	.865
External orientation	.877
Customer orientation	.887
Competitor orientation	.793

overall performance. The last seven items (market share growth; sales volume; profitability; achieving customer satisfaction; retaining current customers; attracting new customers; and building a positive image) assessed individual performance criteria relative to major competitors. Response to each item was measured on a seven-point Likert scale ranging from 'far below competitors' (1) to 'far above competitors' (7). Similarly, the overall scores and the seven criteria were averaged to yield a second performance measure.

The first hypothesis postulated that the degree of market orientation is positively linked with business performance. To test this, we conducted separate regression analyses using the different measures of business performance as the dependent variables, with market orientation and its subscales as the predicting variables. The results are reported in Table 3.

The market orientation/performance relationship is significant in the sample. Market orientation drives overall business performance, profitability, customer satisfaction, retention, and acquisition. It was not found to be significant in driving market share growth. The results provide mixed but strong support for H1.

External Orientation as a Driver of Business Performance

The second hypothesis postulated that externally oriented organizational cultures lead to higher levels of performance and internally oriented (bureaucratic and consensual) cultures lead to lower levels of performance. To test this hypothesis, performance and each of its components was entered as the dependent variable and the external orientation measure was entered as the independent variable. Separate regressions were run for

Table 3. Effect of Market Orientation on Business Performance Independent Variable – Market Orientation.

Dependent Variables	China Sample
Overall performance	$F = 16.84$, $p = .000$
Market share growth	$F = 2.57$, $p = .115$
Sales volume	$F = 2.35$, $p = .132$
Profit	$F = 4.53$, $p = .038$
Customer satisfaction	$F = 33.69$, $p = .000$
Customer retention	$F = 8.98$, $p = .004$
Customer acquisition	$F = 3.95$, $p = .052$
Image	$F = 13.91$, $p = .000$

Table 4. Effect of External Orientation on Business Performance Independent Variable – External Orientation.

Dependent Variables	China Sample
Overall performance	$F = 28.46$, $p = .000$
Market share growth	$F = 8.11$, $p = .006$
Sales volume	$F = 4.00$, $p = .051$
Profit	$F = 9.75$, $p = .003$
Customer satisfaction	$F = 29.07$, $p = .000$
Customer retention	$F = 16.05$, $p = .000$
Customer acquisition	$F = 6.36$, $p = .015$
Image	$F = 9.64$, $p = .003$

each measure of performance. The results are shown in Table 4. The relationship between external orientation and business performance is significant across all components of performance, thus providing strong support for H2.

Variability of Market Orientation by Firm Type and Size

The third major area of research inquiry was the degree to which market orientation varies by organization type and size. Specifically, the third hypothesis postulates that international firms have a higher degree of market orientation than do local, domestic firms. To test this hypothesis, we conducted a regression analysis using market orientation as the dependent variable and firm scope (global, international, or domestic) as the predicting dummy variable. The mixed results are provided in Table 5. The sample does not show a significant relationship between market orientation and organizational scope.

The fourth hypothesis concerned the relationship between market orientation and the service versus manufacturing classification of the firm (H4: "Market orientation is greater in service industries than in manufacturing industries"). To test this hypothesis, individual responses to the specific industry question (question 10) were recoded to reflect the nature of the industry. Thus, manufacturing was clearly a manufacturing industry and transportation was coded as a service industry. A regression analysis was performed with market orientation as the dependent variable and industry type entered as a dummy independent variable. The results, shown in Table 5, are not statistically significant; thus, this hypothesis was not supported.

H5 attempted to assess the relationship of government or private ownership on market orientation. ("Market orientation is greater in private industry than in the government/public sector.") The instrument question dealing with the ownership of the subject's organization used eight response categories. Each category was assessed and categorized as mainly in either the government or private sector, and each response was recoded into government or private and used as a dummy variable in a regression analysis. Marketing orientation was the dependent variable. The regression results are shown in Table 5. Significant results are shown. The results support the hypothesis.

The sixth hypothesis, concerning the relationship between firm size and level of market orientation, states, "Large firms are more market oriented than small firms." For the question about the size of the respondent's organization, the data were recoded into three categories: small, medium, and large. In order to use the data as dummy variables, a second category was created to accommodate the third value, large. To test this hypothesis,

Table 5. Summary of Regression Findings.

Independent Variable	Dependent Variable	China Sample
H3: Organizational scope	Market orientation	$F = 1.23$, $p = .274$
H4: Industry type (service versus mfg)	Market orientation	$F = .015$, $p = .748$
H5: Economic sector (private versus government)	Market orientation	$F = 6.99$, $p = .011$
H6: Organization size	Market orientation	$F = .049$, $p = .826$
H7: Managerial level	Market orientation	$F = .508$, $p = .479$

market orientation was entered as the dependent variable and each of the two size dummy variables entered as independent variables. The results were not statistically significant and the hypothesis was not supported.

The seventh and the last hypothesis deals with managers and their level in their organizations: "Higher-level managers perceive greater market orientation than do lower level managers." The question offered 10 different response levels ranging from entry- to top-level manager. Once again, market orientation was entered as a dependent variable while managerial level was entered as the dependent variable. The results, shown in Table 5, were not significant and the hypothesis was not supported.

DISCUSSION AND IMPLICATIONS

The results of this study demonstrate that market orientation is a valid construct. Both the Kohli and Jaworski MARKOR scale and Narver and Slater's external orientation scale produced similar results. Each scale was deemed to be a reliable measure of market orientation in Chinese firms and lends credence to the universal applicability of market orientation.

Given China's overall global competitiveness and its robust economy, it is not surprising that its levels of market orientation are strong, whether measured by the MARKOR MO scale or the EO scale. Chinese firms also scored high on overall business performance. Furthermore, a Chinese firm's overall business performance was found to be significantly related to its market orientation, especially with regard to markets and customer satisfaction. These finding are supported in the literature and were expected.

The present study also yields several insights regarding the specific hypotheses related to the variability of market orientation by firm type and size. As expected, the level of market orientation is greater in the private sector than in the public/government sector. The profit motive in private industry is a strong driver of business success and hence market orientation. Interestingly, market orientation is also greater for service-driven companies than for manufacturing firms. It did not differ significantly whether the firm was primarily a domestic player or international in its scope of operations.

An important finding pertains to the measurement of the two constructs of market orientation. Most researchers have conceptualized this construct as being multidimensional. However, researchers have not always agreed on exactly what the dimensions share. One piece of evidence confirming this controversy is the difference in the dimensions of market orientation developed by Kohli and Jaworski (1990) and Narver and Slater (1990). The dimensions for market orientation found in this study suggest that market orientation includes aspects of each.

Limitations

Although interpreting the significant of the results, it is important to keep in mind some of the study limitations. The sample size is a limiting factor. The Chinese sample represented only 51 managers and thus limits the extent to which the findings can be generalized to the Chinese market. Second, it would be beneficial to use both objective and subjective measures of performance. Unfortunately, while objective measures of financial performance can be obtained in some cases, it may not be possible to obtain objective measures of other performance dimensions, such as customer satisfaction, market share growth, and quality assessment.

CONCLUSION

Notwithstanding these limitations, we believe that the preliminary findings provide important insights into Chinese business practices. This analysis shows that Chinese firms have a strong market orientation. They recognize the importance of being kept informed of environmental trends, competitor activities, and the evolving needs of their customers. They disseminate information among their staff and respond to opportunities to provide better products and quality services to their customers. Although the relationship between market orientation and business performance may be complex, this study provides some empirical evidence that better performance will be achieved by the market-oriented organization. Market orientation may be one explanation why China is a strong global competitor.

SERVICE QUALITY – THE SECOND STUDY

Introduction

The second study attempted to assess Chinese managers' perceptions of their ability to deliver service quality. Over the years, many researchers have proposed and evaluated alternative service quality models and instruments for measuring service quality. Among these models, SERVQUAL (Parasuraman, Zeithaml, & Berry, 1986, 1988, 1991) is the most prominent. It is widely used and is regarded as applicable to a number of industries, including retail settings (Wakefield & Blodgett, 1999), professional services (Freeman & Dart, 1993), health care (Lunby & England, 2000; Lam, 1997), tourism (Tribe & Snaith, 1998), student services (Engelland, Workman, & Singh, 2000), business schools (Pariseau & McDaniel, 1997), and information systems (Kettinger & Lee, 1994). However, SERVQUAL has been subject to certain criticisms, including vagueness in the definition of expectations, its applicability in some industries (Teas, 1993), the need for expectation measurement (Cronin & Taylor, 1992, 1994), and its dimensionality (Carman, 1990). The applicability of SERVQUAL across different cultures has not been extensively evaluated. Most of the extant research has been conducted in developed countries, even though services are among the fastest growing sectors in emerging countries.

Previous studies of service quality using the SERVQUAL model in China are scarce. Several studies have focused on measuring the quality of Internet services in China, using a variation of the e-SERVQUAL model. Siu and Mou (2005) adapted the dimensions found in the e-SERVQUAL model (Zeithaml, Parasuraman, & Malhotra, 2000, 2002) to measure service quality in Internet banking in Hong Kong. Findings suggested that only one of the four original dimensions identified by Zeithaml (1996) remained the same. Horn, Feinberg, and Salvendy (2005) investigated the composition of customer relationship management in e-business by examining the possible elements that determine difference aspects of the relationship between customers and e-businesses. A survey constructed from SERVQUAL and SITEQUAL – an instrument developed by Yoo and Donthu (2001) to measure the perceived quality of Internet shopping – yielded results indicating that the combinations of these attributes significantly predicted customer attitude.

Studies focusing exclusively on the SERVQUAL model have primarily been limited in understanding the customer's perceptions of service quality and have not examined the provider side of the model, which measures the antecedents of the actual delivery of service quality. Wang, Low, and Hui (2003) measured the antecedents of service quality and product quality and their influences on bank reputation in China. Their findings agreed with most of the previous research findings in the field of service quality, but they did not find any significant support on the impact of reliability and empathy on overall service quality in China's retail banking industry. Assurance and responsiveness were the two most important drivers of overall service quality.

Zhao, Changhong, and Hui (2002) undertook an empirical assessment and application of SERVQUAL in a China department store, using both external customers and internal employees. Their findings did not support the five dimensions of service quality as measured in the SERVQUAL instrument and the authors concluded that further research was necessary to understand service quality in the retail industry of China. Tsang and Qu (2000), using the SERVQUAL model, assessed the perceptions of service quality in China's hotel industry, from the perspective of both international tourists and hotel managers. Their study was also limited to measure the gap between customers' expectations of service quality and perceptions of organizational performance and contrasting the customers' perceptions with employee perceptions. The results showed that tourists' perceptions of service quality were consistently lower than their expectations, whereas managers overestimated the service delivery compared to tourists' perceptions of actual service quality. No analysis was undertaken to access managers' perceptions of their ability to delivery quality service.

The purpose of this study is to assess the perceptions of service quality across a variety of industries, from the perspective of managers rather than customers. The specific objectives are to access the current perceptions held by Chinese managers with respect to their ability to deliver quality service and to examine the generalizability of the SERVQUAL model in measuring these antecedents of service quality. In the following sections, we review the SERVQUAL model and describe the data collection and analysis procedures used. Subsequently, we present the results of our statistical analysis and discuss the theoretical and managerial implications of the results. We conclude by summarizing the major contributions of the chapter, identifying limitations, and suggesting directions for future research.

REVIEW OF THE SERVQUAL MODEL

Much of the recent research on service quality has been carried out within the framework of the service quality (SERVQUAL) model developed from the extensive research of Parasuraman et al. (1986, 1988, 1991). The literature defines service quality as the difference between customers' expectations of service quality and their perceptions of an organization's performance. The ability to deliver service quality is dependent on the magnitude and direction of the following 4 dimensions and their 16 underlying antecedents.

Understanding Customer Expectations

Knowing what customers expect is a critical step in delivering quality service. Senior managers have the authority and responsibility for setting service priorities and for designing and developing service quality standards. Thus, if they do not fully understand what customers expect, they might trigger a chain a bad decisions resulting in poor perceived service quality. Zeithaml et al. (2002) have determined that customer expectations of service quality are based on five dimensions: *Tangibility* (ability to perform the promised service dependably and accurately); *Responsiveness* (willingness to help customers and provide prompt service); *Assurance* (employees' knowledge and courtesy and their ability to inspire trust and confidence); *Empathy* (caring, individualized attention given to customers), and *Tangibles* (appearance of physical facilities, equipment, personnel, and written materials). Parasuraman et al. (1985, 1988, 1992) identify three antecedents to understanding customer perceptions:

- Marketing research orientation.
- Adequate upward communication between customers, contact employees, and managers.
- Minimum levels of management between top management and those responsible for dealing with and serving customers.

Research Questions

In general, how do managers perceive the importance of the above five dimensions to Chinese customers? Is there significant variation in respondents' perceptions across different types of Chinese firms?

Aligning Service Delivery with Service Standards

Once managers of service businesses accurately understand what customers expect, they must use this knowledge to set service standards and goals for the organization. The antecedents to effective alignment of service delivery to service standards include:

- Management's commitment to service quality.
- Formal processes for setting service quality goals.
- Standardization of service behaviors and actions.
- Perception of the feasibility of meeting standards.

Research Questions
To what extent do explicit service performance standards exist in Chinese organizations? Are they formal or informal? Does their existence vary by type of organization? Do Chinese managers perceive that they have the ability to meet these performance standards, if they exist at all?

Delivering and Performing Service

Even when guidelines exist for performing services well and treating customers correctly, high-quality service performance is not a certainty. Standards must be backed by appropriate resources (people, systems, and technology) and employees must be trained, motivated, measured, and compensated on the basis of performance along those standards. The ability of the employees to meet service quality specifications is based on the following antecedents:

- Effective teamwork
- Employee-job fit
- Employee-technology fit
- Perceived control (i.e., empowered employees)
- Supervisory control systems
- Lack of role conflict
- Absence of role ambiguity

Research Questions
How important are these factors in driving service quality in Chinese organizations? To what extent do they contribute to service delivery in China?

Matching Performance to Promises

Promises made by a company through its media advertising, sales force, and other communications may potentially raise customer expectations that serve as the standard against which customers assess service quality. Broken promises can occur for many reasons, including:

- Poor horizontal communications (i.e., inadequate coordination between operations and marketing).
- Propensity to overpromise in advertising or personal selling.

Research Question
How important are these factors in driving service quality in Chinese organizations?

METHODOLOGY

To examine the above research questions and examine the 16 antecedents to delivering quality service, self-administered questionnaires were distributed to the students enrolled in the operations management course in the Beijing International MBA program at Peking University during spring 2005. A structured questionnaire was designed to measure their perception of service quality in their respective organizations. The items incorporated into the seven-part questionnaire were derived from the original SERVQUAL instrument.

The first part of the questionnaire sought to obtain a baseline understanding of the importance of each of the five dimensions of service quality (i.e., tangibility, reliability, responsiveness, assurance, and empathy). Using a constant sum scale, respondents were asked to allocate 100 points among the 5 dimensions according to how important each dimension was to their firm's customers. The second and third sections explored the respondent's perception of the existence of performance standards related to these five dimensions and ability of employees to meet these standards in their respective organizations. All responses were scored on a seven-point Likert scale, with a separate category to indicate the complete absence of a performance standard in each category. Fourth and fifth sections focused on the ability of employees to actually deliver quality service. Specifically, fourth section measured respondents' opinions of the internal actions and support for service quality in their organizations. In fifth section, respondents evaluated the ability of employees in their organizations to deliver quality service. Both parts used a seven-point Likert scale ranging from 1 (strongly disagree) to 7 (strongly agree). Some of these items are worded negatively, which is accordance to scale development.

The final portions of the survey examined firm performance and collected classification data. Sixth section incorporated the respondents' assessment of the performance of their respective firms on dimensions of sales, market share growth, profitability customer satisfaction, and customer retention. A seven-point Likert scale ranging from 1 (performance far below competitors) to 7 (performance far above competitors) was used. The last section of the survey solicited demographic information from the respondents, including managerial position, work experience, type of organization, and so on.

DATA ANALYSIS

Descriptive analysis was used to present a profile of the respondents. One-way ANOVAs were conducted to compare the perception means of groups with different demographic variables. Factor analysis was used to reduce insignificant variables and to test the applicability of the SERVQUAL model. Finally, multiple regression analysis was used to gain an understanding of the relationship between the antecedents of service delivery and perceived organizational performance and customer satisfaction.

Profile of Respondents

A total of 91 individuals were included in this study. Each respondent was enrolled in a part-time English-language MBA program in Beijing in the spring 2005. Five of the surveys were not usable due to incomplete information, thus yielding a usable sample of 86 surveys. Table 6 profiles the respondents. The majority (61.8 percent) classified themselves as mid-level managers, with an average of 5.3 years of experience. Two-thirds worked in a global (multinational) corporation, with only 15 percent being employed by domestic Chinese firms.

The largest number of subjects worked for global companies while the split between regional and Chinese companies was smaller and approximately even. Twice as many subjects worked for large companies than medium-sized companies. The smallest number worked in small companies. Participants were employed in organizations reflecting varied types of ownership. Eight different categories of ownership were identified in the survey, including an "other" choice to increase accuracy of response. The responses were recoded into three categories: state-owned, foreign-owned, and privately held. Organizations classified as "state-owned" represented state-owned, collective-owned, and state-stock enterprises. There is a roughly an even split among manufacturing, service, and a blend of both manufacturing and service employers represented in the sample. Overall the sample seems to include a balanced number of subjects.

Managers' Perceptions of the Determinants of Service Quality

Table 7 presents managers' perceptions of what is important to customers, the existence of service quality standards in their respective organizations,

Table 6. Profile of Respondents.

Type of Organization	Percent
Managerial position	
Entry level	20.2
Mid level	61.8
Senior level	14.6
Experience	
1–3 Years	34.2
4–9 Years	51.7
10+ Years	12.3
Type of organization	
Chinese	14.6
Global	66.3
Regional	19.1
Size of organization	
Small	15.7
Medium	28.1
Large	56.2
Ownership	
State-owned	11.2
Foreign-owned	76.4
Privately owned	9.0
Orientation	
Service	36.0
Hybrid	37.1
Manufacturing	23.6

Table 7. Service Quality Perceptions.

	What's Important to Customers		Existence of Standards		Ability to Meet Standards	
	Sample Mean	Standard Deviation	Sample Mean	Standard Deviation	Sample Mean	Standard Deviation
Tangible	16.90	10.61	5.03	1.64	5.39	1.35
Reliability	31.92	13.09	5.63	1.51	5.45	1.18
Responsive	18.72	7.60	4.79	3.58	5.54	1.29
Assurance	17.67	7.10	5.27	2.68	5.56	1.04
Empathy	14.67	7.46	5.03	1.64	5.17	1.32

and the ability of customer contact personnel in the organization to meet those standards. Sample means and standard deviations indicated that managers perceive reliability as most important to customers, with a score almost double the next highest factor, responsiveness. The other factors – assurance, tangibility and empathy – are grouped together with little relative difference in importance. One-way ANOVAs were used to test the differences in perceived importance between groups in terms of the demographic characteristics of the sample. Overall, the findings showed no significant differences in terms of firm ownership, managerial position, managerial experience, type of organization, firm size, or firm orientation (service/manufacturing). Individual one-way analysis showed that of the 30 individual relationships, only 2 were significantly different. There was no discernible pattern to the significant relationships.

Respondents were also asked to indicate whether or not standards existed for each of the five service dimensions and, if so, to indicate on a seven-point scale the extent to which the standard was informal (1) or more formal (7). Parasuraman et al. (1988) indicates that one of the key antecedents to delivering service quality is the existence of formal standards. All respondents indicated the existence of service standards. Data indicate that, on average, firms operating in China had formal service specifications, particularly with the most important standard: reliability. One-way ANOVAs were used to test the differences in the existence of standards between groups in terms of the demographic characteristics of the sample. Overall, the findings showed no significant differences in terms of firm ownership, managerial position, managerial experience, type of firm, size, or orientation. Individual one-way analysis showed that of the 30 individual relationships, only 3 were significantly different. Again, there was no discernible pattern to the significant relationships.

Respondents also evaluated the ability of employees in their respective organizations to meet the established performance standards, using a seven-point Likert scale from 1 (not at all) to 7 (all the time). Once again, respondents indicated a relatively high level of ability to meet standards, with means ranging from 5 to 6. One-way ANOVAs were used to test the differences in the ability to meet standards between groups in terms of the demographic characteristics of the sample. Overall, the findings showed no significant differences in terms of ownership, managerial position, managerial experience, type of firm, size, or orientation. Individual one-way analysis showed that of the 30 individual relationships, only 4 were significantly different but with no discernible pattern.

Factor Analysis

The literature review identified 16 antecedents to delivering service quality, all of which are captured in the SERVQUAL instrument. To test the reliability of SERVQUAL, we performed confirmatory factor analysis (CFA) on the set of statements in the questionnaire measuring these antecedents. A Kaiser-Meyer-Olkin (KMO) measure of sample adequacy was calculated to determine sample size adequacy. The KMO value equaled 0.758, indicating acceptable sample adequacy. Principal-component analysis with varimax rotation was conducted, with eigenvalues greater than one. A factor loading of 0.5 was used as a cut-off point to eliminate variables with low correlation from each factor and a reliability test was applied to examine the internal consistency of each factor separately. Reliability analysis was conducted on each of the extracted factors. Cronbach's alpha scores are listed in the bottom row of Tables 8 and 9 and range from acceptable alpha levels on multi-item factors to lower levels on factors with fewer items.

Antecedents to Understanding Expectations and Aligning Delivery

The first factor analysis was on the seven antecedents linked to understanding customer expectations and aligning service delivery with service standards. The SERVQUAL instrument contained 20 items reflecting these seven potential antecedents. Our factor analysis did not match the seven-factor structure as described by Parasuraman et al. (1988). The initial analysis extracted six factors, but three items with loadings less than 0.5 were eliminated. An additional factor analysis was performed on the remaining items, producing four factors that explained 67.1 percent of the variance. In addition, factor scores were saved as variables for use in later regression analysis.

The factors and their factor loadings for each questionnaire item appear in Table 8. The left-hand column of the table lists the items in correspondence with the original antecedents conceptualized in the SERVQUAL model. To save space, questionnaire items are listed by terms that captured their essence. The four extracted factors seem to represent Internal Processes (i.e., data collection mechanisms, goal setting, task standardization, and appropriate systems in place), Intensity of Communication (reflecting frequency of communication), Internal Communications (between management and customer contact personnel), and Sales Orientation. Thus, while only four factors were extracted, they captured the essence of the original seven antecedents.

Table 8. Factor Analysis of Internal Interactions and Support.

SERVQUAL Factor/ Questionnaire Item	Extracted Factors – Highest Factor Loadings			
	Internal Processes	Intensity of Communication	Internal Communication	Sales Orientation
Marketing research orientation				
Data on customer needs	.726			
Rarely use research	[a]	[a]	[a]	[a]
Collect information	.681			
Interactions w/customers		.701		
Communication				
Communicate frequency			.648	
Suggestions		.644		
Interactions			.543	
Memos	[a]	[a]	[a]	[a]
Levels of contact		.641		
Management's commitment to service				
Resources		.655		
Rewards	[a]	[a]	[a]	[a]
Sales orientation				.600
Goal setting				
Formal process	.732			
Sets specific goals	.765			
Task standardization				
Use of automation	.706			
Operating procedures	.695			
Perception of feasibility				
Capabilities in place	.609			
Service is unprofitable				.729
Appropriate systems	.667			
Eigenvalue	*5.29*	*2.73*	*1.55*	*1.17*
Percentage of explained variance	*33.09*	*17.04*	*9.71*	*7.31*
Chronbach's alpha	*.885*	*.738*	*.763*	*.056*

[a]Item removed for low-factor loading.

Antecedents to Matching Service to Standards and Performances to Promises

The SERVQUAL instrument also contained 30 items pertaining to the 9 potential antecedents of the employee's ability to deliver to the specified performance standards and the organization's ability to match performance

Table 9. Factor Analysis of Antecedents of Customer Contact Personnel's Ability to Deliver Quality Service.

SERVQUAL Factor/ Questionnaire Item	Extracted Factors – Highest Factor Loadings								
	Team Work	Role Clarity	Empowerment	Job Support	Negative Job Elements	Perceived Control	Honors Promises	Competition	Alignment
Teamwork									
Part of a team	.579								
Team effort	a	a	a	a	a	a	a	a	a
Sense of responsibility	.826								
Cooperation	.900								
Important team member	.658								
Employee job fit									
Comfortable in job	.593								
Qualified people in job	a	a	a	a	a	a	a	a	a
Technology job fit									
Necessary tools/equipment	.511		.483						
Perceived control									
Little control						.855			
Freedom			.710						
Lack of control					−.574				
Frustration on the job						.635			
Supervisory control system									
Appraisal linked to service				.715					
Pay not linked to service	a	a	a	a	a	a	a	a	a
Rewards for service		.578							

Role conflict									
Extensive paperwork					.835				
Sales emphasis					.745				
Match to customer									.837
Same ideas		.780							
Role ambiguity									
Knowledge		.622							
Understanding	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Timely changes			.688						
Lack of training				.808					
Ambiguity in evaluation	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Horizontal communication									
Consultation							.836		
Lack of knowledge-adv				.527					
Interact w/operations	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]	[a]
Consistent policies		.754							
Overpromise									
Intense pressure								.556	
Competitors exaggerate								.907	
Eigenvalue	*5.83*	*2.29*	*1.97*	*1.63*	*1.32*	*1.27*	*1.18*	*1.11*	*1.05*
Percentage of explained variance	*24.3*	*9.53*	*8.21*	*6.79*	*5.49*	*5.29*	*4.92*	*4.63*	*4.37*
Chronbach's alpha	*.882*	*.443*	*.478*	*.606*	*.197*	*.495*	*NA*	*.388*	*NA*

[a]Item removed for low factor loading.

to promises made to the customer. Factor analysis of these 30 items did not match the 9 factors identified in the SERVQUAL model. The initial analysis extracted 11 factors, but 7 items were removed because of low-factor loadings. An additional factor analysis was performed on the remaining items, resulting in 9 factors explaining 73.5 percent of the variance.

Table 9 identifies the nine factors and compares them to the original SERVQUAL antecedents. The nine factors represented some similarities to the SERVQUAL antecedents but some differences as well. Two of the original constructs were reflected in the factor analysis: teamwork and "overpromising." Teamwork captured four of the original five construct items in addition to two additional items: comfort and necessary tools & equipment. The "overpromise" construct was identical to the original construct. The remaining seven extracted factors seem to represent Role Clarity (RC), Empowerment (EP), Internal Job Support (IJS), Negative Job Elements (NJE), Perceived Control (PC), Honoring Promises (HP), Perception of Competition (COMP), and Alignment (AL).

Regression Analysis on Performance and Satisfaction

CFA revealed the factor loadings of the underlying antecedents on the extracted factors. From these loadings, surrogate variables were created to aid in the interpretation of further analysis in terms of the original variables. Table 10 reports the results of the multiple regression model with the 13 extracted service quality antecedents as the independent variables, whereas relative overall company performance and customer satisfaction were treated as dependent variables. Both regression analyses were significant overall. In terms of the relationship between the 13 extracted antecedents to service delivery and relative overall performance to competitors, the adjusted $R^2 = 0.439$ was statistically significant. Two dimensions, role clarity of employees and internal processes, were also statistically significant and accounted for 17.7 percent ($R^2 = 0.177$) of the variance. In addition, role clarity had the greater influence on perceived overall performance. Three dimensions accounted for 22.4 percent of the variation in perceived customer satisfaction: teamwork, role clarity, and internal processes. The strongest relationship was with Internal Processes. Three additional factors – empowerment, negative job factors, and honoring promises – were marginally significant.

Table 10. Relationship between Antecedents and Performance and Satisfaction.

Extracted Variables	Perceived Performance		Perceived Levels of Customer Satisfaction	
	Significance of *t*-Test	Beta	Significance of *t*-Test	Beta
Teamwork	.147	.148	.023	.213
Role clarity	.017	.305	.017	.315
Empowerment	.360	.094	.072	.169
Job support	.700	.052	.808	.030
Negative job elements	.472	.082	.086	.180
Perceived control	.294	.113	.229	.118
Honors promises	.301	.106	.060	.176
Competition	.328	.100	.551	.055
Alignment	.409	.084	.654	.041
Internal processes	.033	.266	.009	.298
Intensity of communications	.552	.076	.635	.055
Internal communication	.519	.077	.454	.081
Sales orientation	.777	.033	.766	.032

CONCLUSION

SERVQUAL has undoubtedly made a major impact on the business and academic communities. Although this study shows that the data collected do not fully support the dimensions as proposed by Parasuraman et al. (1988), the model is useful as a foundation for discussion of and determination of areas for improvement in a firm's service quality.

From a practical aspect, the study attempted neither to test existing theory nor to develop new research instruments. It simply tried to present the findings of assessing the perceptions of service quality from the perspective of mid-level Chinese managers. Managers perceived that reliability is the most important dimension for customers, followed by responsiveness and assurance. Formal standards exist for these dimensions and managers are quite optimistic about the ability of their firms to meet these performance standards. The fact that the majority of respondents worked for multinational corporations and large companies might explain this finding. The original antecedents presented in the SERVQUAL model do not precisely fit the Chinese market. The factor analysis showed a strong orientation toward operating systems and processes and less so on the internal resources and rewards associated with delivering service quality. Likewise, there was a strong emphasis on factors related to performance: effective teamwork and having the tools to do it.

As China enters the WTO, companies there will have to improve the quality of their services significantly in order to enable themselves to compete successfully in the global marketplace. It is therefore very important for them to know how customers evaluate service quality and what managers can do to measure and improve it.

Limitations and Future Research

The results of this study are subject to four major limitations that tend to be typical in exploratory studies. First, the data were gathered from MBA students in Beijing. Although this is valuable in an international context, it also limits its generalizability. A broader sample of managers located throughout the country would provide a more representative estimation of service delivery in China. Second, the survey did not focus on any one industry or company but instead represented a macroperspective of service quality in China. An important extension of this research would be to measure customer perceptions and expectations of service quality and to conduct a gap analysis between employee and customer perceptions. Third, since self-reporting techniques were used, respondent bias may exist. The survey was in English, and although English is the "official" language of the MBA program and is widely spoken in the business marketplace, there is a chance that some respondents may have misunderstood some terminology. Although the survey administrators did not receive any feedback from the participants that this was an obstacle, the negative wording in some of the questions may have caused problems in the reliability and practical interpretation of the data collected and therefore also of the results obtained. It is our recommendation that negative wording would be best avoided in future use of this instrument in China. Fourth, we used scales that have not been previously tested in the Chinese culture.

Future study of the SERVQUAL model in China is warranted. Despite the need for additional research, the current study does provide critical information and a foundation that academics and practitioners can use in evaluating service quality in China and in adapting questionnaires that suit and provide accurate reflections of the local environment.

Overall Conclusions

The two studies presented here illustrate that the Chinese managers in the samples have a significant market orientation and clearly understand the relationship of market orientation to firm success. Some of the problems reported with Chinese business just after the People's Republic opened its investment doors to outsiders have disappeared, such as lack of emphasis on customer needs and product quality. Similarly, the lack of competitors and the complacency that the earlier domestic market focus may have fostered also have disappeared. Finally, the two studies provide some empirical evidence that Chinese marketing practice has reached a significant level of development.

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EXAMINING THE DETERMINANTS OF INTERFUNCTIONAL COORDINATION AND EXPORT PERFORMANCE: AN INVESTIGATION OF BRAZILIAN EXPORTERS

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ABSTRACT

Although interfunctional coordination plays a key role in the performance of the firm, the literature has largely ignored it compared to the other two market orientation components: customer orientation and competitor orientation. The question of whether our current knowledge can be generalized to firms from the developing world has also been neglected since most studies have been conducted in developed countries. To address these issues, a model was developed here to empirically examine the relationship between interfunctional coordination and export performance as well as to identify the key determinants of both constructs. A sample of 201 senior managers of export firms in Brazil was used to test the hypotheses. The results suggest that the legal regulations and technical requirements, competitive intensity, and technological orientation of the

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product are positively related to interfunctional coordination. Contrary to expectations, the results also confirm that the difference in the stage of the product life cycle is negatively related to interfunctional coordination. In turn, interfunctional coordination has a positive effect on firms' export performance.

Keywords: Export performance; interfunctional coordination; market orientation; Brazil.

INTRODUCTION

The onward march of globalization highlights the need to understand organizational behavior and performance in export markets. Previous studies have devoted much attention to this issue, resulting in the identification of the key determinants of export performance. Since the seminal works by Kohli and Jaworski (1990) and Narver and Slater (1990), numerous studies have shown that market orientation is a key player in firm performance (e.g., Han, Kim, & Srivastava, 1998; Jaworski & Kohli, 1993). In the case of export operations, research into the effect of firms' market orientation is still in an early stage of development (Cadogan, Diamantopoulos, & Siguaw, 2002; Racela, Chaikittisilpa, & Thoumrungroje, 2007). Conceptually, however, there is no reason why this relationship should not hold up in an exporting context. Thus, recent studies have been concerned with investigating the link between market orientation and export performance (e.g., Rose & Shoham, 2002; Thirkell & Dau, 1998).

While a consensus seems to hold about the positive impact of market orientation on export performance (Sousa, Martinez-Lopez, & Coelho, 2008), there are still questions about its robustness (Shoham, Rose, & Kropp, 2005). Moreover, the literature offers different views about the role of the different components of market orientation (Zhou, Brown, Dev, & Agarwal, 2007). Most studies appear to have focused on customer orientation and competitor orientation (Armstrong & Collopy, 1996; Deshpandé, Farley, & Webster, 1993; Zhou et al., 2007), while the role of interfunctional coordination has been largely ignored. Narver and Slater (1990), however, single out interfunctional coordination as a key element of market orientation and indicate that it is equally important as customer and competitor orientation. In fact, it has been suggested that interfunctional coordination is key to achieving the main goal of marketing: the creation of superior customer value (Jüttner, Christopher, & Baker, 2007), and thereby performance.

Another challenge in the current literature is that, despite the growing interest in how market orientation shapes export performance, most studies have been conducted in developed countries, particularly in the United States and Western Europe. Given the differences between developed and developing economies, the generalization of prior research to firms in a developing country may be inappropriate (Aulakh, Kotabe, & Teegen, 2000). A major gap in the literature is, therefore, to establish whether our current knowledge can be successfully generalized to firms in other countries, especially from the developing world. South America is one particular region in which little systematic research on the export behavior of firms has been undertaken. Brazil was selected here as a research setting because not only is it the largest and most populous country in South America, it is also one of the four emerging countries – besides Russia, India, and China – in a group called BRIC, considered to be the biggest and fastest-growing economies from the developing world.

Thus, the objectives of this chapter are threefold: (1) to investigate the importance of the interfunctional coordination concept in an export context of a developing economy, Brazil; (2) to examine the key determinants of interfunctional coordination; and (3) to assess the effect of interfunctional coordination on the export performance of firms. The next section presents the conceptual background to the research, along with the development of specific research hypotheses. Following the description of the research methodology and its results, the chapter discusses the implications of the results and concludes with a mention of the study's limitations and suggestions for further research.

CONCEPTUAL FRAMEWORK AND RESEARCH HYPOTHESES

Theoretical Background

Market orientation is a central component of modern marketing concepts. Recently, growing numbers of studies have examined its impact on company performance (e.g., Han et al., 1998; Jaworski & Kohli, 1993). According to Narver and Slater (1990), the creation of superior value to the customer demands an organization-wide commitment for continuous information about markets and competitors as well as coordination of different departments in the firm. The result of this commitment is the integration of the firm and its focus on the markets, which creates superior firm performance. However, as suggested by Kirca, Jayachandran, and Bearden (2005), market orientation is still an area in need of further research, especially in international contexts. Despite some attempts to integrate the market orientation construct into international marketing, most conceptual and empirical studies have been in the context of domestic marketing. Conceptually, however, there is no reason why marketing orientation should not play a key role in international marketing. In fact, Rose and Shoham (2002) suggest that it provides a theoretical framework for explaining export performance.

Although definitions of the term vary, those by Kohli and Jaworski (1990) and Narver and Slater (1990) represent the leading research streams in the literature. According to Kohli and Jaworski (1990), market orientation consists of three organization-wide activities: market intelligence generation, the dissemination of this intelligence across departments in the firm, and responsiveness to it. Fleshing out this framework, Narver and Slater (1990, p. 21) define market orientation as "the organization culture that most effectively and efficiently creates the necessary behaviors for the creation of superior value for buyers and, thus, continuous superior performance for the business." Narver and Slater complement the Kohli and Jaworski framework by proposing that market orientation consists of customer orientation, competitor orientation, and interfunctional coordination, which complement the activities of market information acquisition and dissemination and the coordinated creation of customer value. Of the two sets of authors, Narver and Slater have explicitly examined the relationship between market orientation and firm performance. Their definition is used in this study.

The next step is to decide whether to use all three of the marketing orientation components proposed by Narver and Slater (1990) or a single component. This study focuses on the single component *interfunctional coordination* for three reasons. Firstly, the results of a factor analysis of MKTOR suggest that market orientation is multidimensional (e.g., Han et al., 1998); thus, researchers have examined the links among individual components of market orientation and performance (e.g., Perry & Shao, 2005). Secondly, prior studies indicate that each component has a different impact on the performance of the firm (e.g., Zhou et al., 2007). Thirdly, although interfunctional coordination is acknowledged to play a key role in the creation of superior customer value and performance (Jüttner et al., 2007), it has been largely ignored in the literature compared to the other two components. According to Hunt and Morgan (1995), less attention has been paid to interfunctional coordination due to its internal implementation focus. On the basis of the earlier discussion, the present study proposes to examine the determinants of interfunctional coordination and the effect on the export performance of the firm.

Development of Hypotheses

Narver and Slater (1990) suggest that interfunctional coordination is based on customer and competitor information and comprises the business's coordinated efforts, typically involving more than the marketing department, to create superior value for the buyers. Customer needs may change in so many ways that all departments have the obligation and responsibility to be involved in the customer relationship (Flint & Mentzer, 2000). Interfunctional coordination allows members of different departments to communicate and work together to achieve common goals, thereby enhancing their problem-solving capabilities and responsiveness to customers.

Differences in legal regulations and technical requirements across markets influence the degree of a firm's interfunctional coordination. Uncertainty arises when a firm attempts to export to countries not deemed similar to the home country (Erramilli & Rao, 1993) in terms of legal regulations and technical requirements, since the difficulty of interpreting the information correctly increases substantially (Boyacigiller, 1990). When these conditions exist, there is a greater need for effective interaction and collaboration between the departments to ensure that product and/or service specifications meet the requirements necessary in the export market. Thus, the differences in legal regulations and technical requirements should have a positive influence on the degree of interfunctional coordination that exists in the firm. Consequently, the following hypothesis is put forward:

H1. The greater the differences in legal regulations and technical requirements between the home and foreign country, the higher the degree of interfunctional coordination in the firm.

Interfunctional coordination appears to be more important in intensely competitive markets and less important in markets with low competition. This is consistent with the argument forwarded by Jaworski and Kohli (1993) that in the absence of competition a firm may perform well, even if it is not very market-oriented, because customers are "stuck" with the firm's products and services. However, in more competitive markets, firms that are not market-oriented are likely to perform worse as customers switch to more market-oriented competitors (Cadogan, Cui, & Li, 2003). Intense competition in the export market increases the need to actively monitor and respond to environment changes. It is particularly important to ensure that the firm engages in adequate promotion, delivers on time, and properly maintains service (Terpstra, 1987). Thus, firms operating in export markets under conditions of high competitive intensity are more likely to emphasize the need for more communication and collaboration between their departments in order to enhance the firms' responsiveness and capability of meeting customer needs. On the basis of the above, it is expected that:

H2. The greater the level of competitive intensity in the export market, the higher the degree of interfunctional coordination in the firm.

Interfunctional coordination appears to be emphasized more likely when the firm offers technology-intensive products. The rationale is that marketing a product with a high degree of technological complexity in a foreign market creates a greater need for in-depth information regarding that market in terms of end-user needs and competitor marketing practices (Bradley, 2002). Moreover, when the product is technologically complex, the manufacturer must engage in more training and technical support activities in order to be able to market and service the product properly in the export market (Cavusgil & Zou, 1994; McGuinness & Little, 1981). Thus, technology-intensive products lead to interfunctional dependencies, thereby increasing the need for greater interaction and collaboration among departments. In light of these arguments, the third hypothesis states:

H3. The greater the level of technological orientation of the product, the higher the degree of interfunctional coordination in the firm.

The stage of the product life cycle (PLC) is a fundamental variable affecting business strategy (Theodosiou & Katsikeas, 2001). The PLC consists of four stages: introduction, growth, maturity, and decline. Owing to possible dissimilarities in economic and market development levels among countries, a specific product can be in different PLC stages in different countries (Hollensen, 2004). As a result, firms may need to modify their strategies to take into account different local market conditions. Developing new strategies for the foreign market should increase the need for interaction and collaboration among departments so as to ensure that the product fits the market requirements. Therefore, the following is hypothesized:

H4. The greater the degree of difference in the stage of the PLC between the home and foreign country, the higher the degree of interfunctional coordination in the firm.

While some studies have examined the influence of market orientation (e.g., Rose & Shoham, 2002) or customer and competitor orientation (e.g., Zhou et al., 2007) on export performance, the literature has largely ignored the influence of the interfunctional coordination concept. Nevertheless, interfunctional coordination should be positively related to export performance. It is based on customer and competitor information and comprises the business's coordinated efforts to create superior value for the buyers (Narver & Slater, 1990), thus enhancing the firm's responsiveness and capability of meeting customer needs and placing it in a better position to succeed in the foreign market. Thus, it is proposed that:

H5. Interfunctional coordination is positively related to export performance.

In summary, the study proposes that interfunctional coordination is influenced positively by the differences in legal regulations and technical requirements, degree of competitive intensity, level of technological orientation of the product, and difference in the stage of the PLC. The export performance of the firm, in turn, is affected positively by interfunctional coordination. An overview of the conceptual framework is presented in Fig. 1.

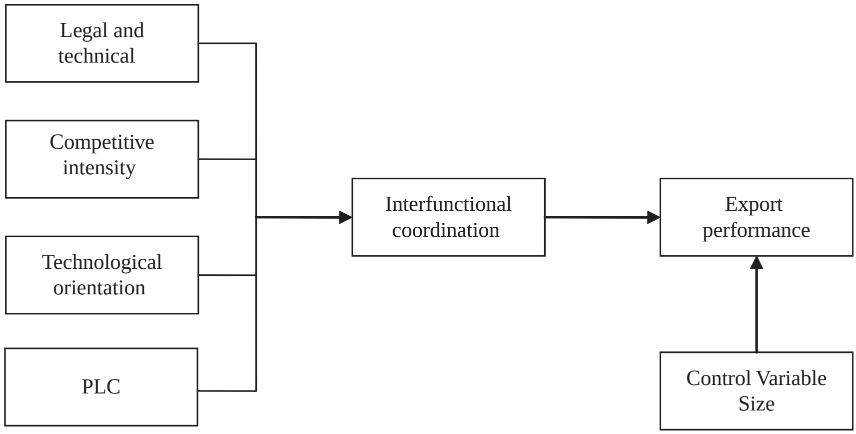

Fig. 1. Conceptual Model.

METHODOLOGY

Sample and Data Collection Procedure

This study was conducted using a sample of exporting firms based in Rio Grande do Sul, a large Brazilian state. We used a multi-industry sample to increase observed variance and to strengthen the generalizability of the results (Morgan, Kaleka, & Katsikeas, 2004). A sample of 1,000 exporting firms was randomly generated from databases provided by trade associations.

The structured questionnaire used was originally written in English and translated into Portuguese by a bilingual expert. Academic experts familiar with the topic under investigation assessed the content validity of the items. As suggested by Churchill (1979), the measures were then refined through interviews with people capable of understanding the nature of the concept being measured, such as managers involved in export operations. On the basis of the feedback of a pre-test sample of eight managers, the survey was revised and the questionnaire was back-translated into English and checked for consistency with the original translated version to enhance "translation equivalence" (Craig & Douglas, 2005; Van de Vijver & Leung, 1997). Questionnaires were sent with a postage-paid business reply envelope to the managers of 1,000 Brazilian export firms, followed by a reminder letter with a reply envelope. The effective response rate was 20.1 percent (201 usable questionnaires). This result constitutes a fairly high response rate, considering that the average top management survey response rates are in the range of 15–20 percent (Menon, Bharadwaj, & Howell, 1996), and is considerably higher than other studies conducted in countries with a developing economy (e.g., Zou, Andrus, & Norvell, 1997).

To explore the issue of nonresponse bias, we tested for differences between early and late respondents (Armstrong & Overton, 1977). As recommended by Weiss and Heide (1993), early responses were defined as the first 75 percent of returned questionnaires. The last 25 percent were considered late responses and representative of firms that did not respond to the survey. Using a *t*-test, early and late respondents were compared on all the variables and no significant differences were found; this suggests that nonresponse bias was not an issue. Moreover, since anonymity was guaranteed, bias associated with those who did not wish to respond for confidentiality reasons was also reduced (Bialaszewski & Giallourakis, 1985).

Particular attention was paid to the identification and selection of the most appropriate person in each firm to participate in the study. Because of involvement and direct responsibility in decision-making, a senior manager was considered to be a major force behind the initiation, development, sustenance, and success of a firm's foreign activities. To ensure the reliability of the data, the respondents selected were senior managers with responsibility for foreign operations. In addition, to make sure that the most appropriate person would receive the questionnaire, each firm was contacted by phone to identify that person as well as to create a more cooperative atmosphere. The approach suggested by Huber and Power (1985) of using a single key informant was also adopted, with a view to minimizing the potential for systematic and random sources of error.

Measures

The items used to operationalize each construct were developed on the basis of existing literature (see Appendix). *Export performance* is an important area of research and its measurement has been discussed and debated in previous studies (Katsikeas, Leonidou, & Morgan, 2000; Sousa, 2004). Benefiting from this discussion, we operationalized export performance with five items used frequently in previous studies to measure export performance (e.g., Cicic, Patterson, & Shoham, 2002; Lages & Lages, 2004; Prasad, Ramamurthy, & Naidu, 2001; Sousa & Bradley, 2008): export sales volume, export intensity, export market share, overall satisfaction, and meeting expectations. We measured these items on a five-point scale ranging from 1 (very unsatisfied) to 5 (very satisfied).

Interfunctional coordination was measured using the Narver and Slater (1990) scale. In relation to *competitive intensity*, we adopted the scale developed by Morgan et al. (2004). Following Johnson and Arunthanes (1995), a single item was employed to assess the extent to which the product is in the same *PLC stage* in the home and foreign market. The two items used to measure the *legal and technical environment* were based on the study by Theodosiou and Katsikeas (2001). Following Sousa and Bradley (2009), *technology orientation of the product* was assessed by asking respondents to indicate the degree of technology orientation of the product on a five-point scale ranging from 'not technology intensive' to 'highly technology intensive'. Finally, because previous research suggests that firm size affects export performance (Sousa & Bradley, 2008), we included firm size as a control variable in our framework.

ANALYSIS AND RESULTS

Reliability and Validity

Content validity was established through the literature review and by consulting experienced researchers and managers. On the basis of these procedures, it was concluded that the measures had content validity. Discriminant and convergent validity and scale reliability were assessed by confirmatory factor analysis in line with the paradigm advocated by Gerbing and Anderson (1988). The results obtained from the estimation of the CFA model indicate that the overall chi-square for this model was 526.488 ($p < .001$) with 123 degrees of freedom (df). Three measures of fit were examined: the comparative fit index (CFI = .952), Tucker-Lewis fit index (TLI = .933), and the incremental fit index (IFI = .952). The results of the CFA model also show that the items employed to measure the constructs were both valid and reliable. More specifically, convergent validity was evidenced by the large and significant standardized loadings ($t > 1.96$, $p < .05$) of the items on the respective constructs. Discriminant validity, on the contrary, was assessed by observing the construct intercorrelations. These were significantly different from 1, and the shared variance between any two constructs (i.e., the square of their intercorrelation) was less than the average variance explained in the items by the construct (Fornell & Larcker, 1981). As far as reliability was concerned, all constructs exceeded the recommended minimum level for composite reliability and variance extracted. We concluded, therefore, that for all constructs the indicators were sufficient and adequate in terms of how the measurement model was specified.

Testing of Hypotheses

Because of the complexity of the model and the need to test the relationships between the constructs simultaneously, structural equations were used by applying the maximum likelihood (ML) method (Amos version 4.0). The overall chi-square for the model was significant (chi-square = 539.448, df = 140, $p < .001$). We therefore examined the structural diagnostics for relative global fit suggested by Bollen (1989). As with the CFA model, the other measures of fit were: CFI = .952, TLI = .936, and IFI = .953. Given that all the fit indices were inside conventional cut-off values, the model was deemed acceptable (Browne & Cudeck, 1993; Vandenberg & Lance, 2000). The relationships proposed in the model were examined next.

Consistent with H1, the results indicate that the greater the differences in legal regulations and technical requirements between the home and foreign country, the higher the degree of interfunctional coordination in the firm (path coefficient = .290; $p < .01$). Similarly, as predicted by H2, the degree of competitive intensity has a positive effect on the level of interfunctional coordination (.214; $p < .01$). Supportive findings for H3 (.142; $p < .10$) indicated that the greater the level of product technology orientation, the higher the degree of interfunctional coordination. Contrary to expectations for H4, our findings suggested that the greater the degree of similarity in the stage of PLC between the home and foreign country, the higher the degree of interfunctional coordination (.304; $p < .01$). Finally, in relation to H5, the results supported our contention that the higher the degree of interfunctional coordination in the firm, the better the firm will perform in the foreign market (.166; $p < .05$). In sum, the findings indicate that all five hypotheses tested significantly, and that four were supported while H4 was not. In relation to the control variable, firm size had no significant effect on the firm's export performance.

DISCUSSION AND IMPLICATIONS

These results indicate that interfunctional coordination has a strong and positive effect on a firm's export performance, thus highlighting the crucial role of this marketing orientation construct component in developing successful export activities. Although not addressing interfunctional coordination specifically and solely, this finding is consistent with those studies that argue that market-oriented firms should be in a better position to recognize and respond to market opportunities, thereby increasing their export performance (e.g., Rose & Shoham, 2002).

As expected, the differences in legal regulations and technical requirements between markets have a positive influence on the degree of interfunctional coordination that exists in a firm. As differences increase between markets, there is a greater need for effective interaction and collaboration between the departments to ensure that the product specifications meet the requirements of the export market. The results also suggest that intense competition in the export market increases the importance of interfunctional coordination in the firm. In a competitive export market, firms are under intense competitive pressure, which emphasizes the need for more communication and collaboration among their departments to enhance the firm's responsiveness and capability of meeting customer needs, thereby gaining competitive superiority over rivals. Finally, interfunctional coordination appears to be more necessary when the product is highly complex technologically. This is consistent with the view that technology-intensive products lead to interfunctional dependencies whereby the firm must engage in more training and technical support activities in order to be able to market and service the product properly in the export market (Cavusgil & Zou, 1994; McGuinness & Little, 1981).

The relationship between similarity of the stage of the PLC and interfunctional coordination was positive, which contradicts H4. This finding suggests that the greater the degree of difference in the PLC stage between the home and foreign countries, the lower the degree of interfunctional coordination in the firm. A possible explanation for this unexpected relationship could be related to Brazil's level of development. Since Brazilian firms tend to export to more developed nations (particularly the United States and the European Union), when their products enter these markets they may be at a more advanced stage of the PLC (e.g., decline stage) compared to Brazil. As a product matures, its specifications and production process stabilize (Levy, 1995), as do customer preferences. Moreover, in the decline stage there is less incentive to monitor customers and competitors (Wong & Ellis, 2007). Consequently, the need to engage in interfunctional coordination in this case could be less apparent. Nevertheless, this is an issue that warrants further empirical research.

Managerial Implications

In addition to providing useful insights to the international marketing literature, our research has implications for exporters. Specifically, the results show that interfunctional coordination has a positive impact on export performance. This finding reinforces the assumption that firms should emphasize their ability to coordinate internal activities with the market. Moreover, internal conditions should be developed in order to gear up the firms' efforts. As such, firms may be advised to generate internal conditions to allow different departments to engage in joining activities, obtain accurate information, disseminate the information, and respond to market changes.

Our study further indicates that interfunctional coordination is affected by legal and technical regulations, level of competition, product technological orientation, and PLC stage. Considering the impact of legal and technical regulations on a firm's interfunctional coordination, managers need to analyze the foreign market carefully to delineate the degree of coordination needed between the different internal departments. In this context, developing an effective marketing information system serving all departments that broadcasts relevant information about the foreign market may help bridge the distance between the legal regulations and technical requirements of the environment and internal decisions. Because the level of product technology orientation has a positive influence on interfunctional coordination, we can conclude that if a firm offers technology-intensive products, the different internal departments should develop dependent dynamics, working articulately. Training and technical support activities are important and should be fostered in high-tech product firms to overcome problems in the export process.

The positive relationship between level of competitive intensity and interfunctional coordination shows that to survive in a highly competitive market, firms need to achieve a high degree of interfunctional coordination between their different departments. This is also consistent with the argument of Kohli and Jaworski (1990) that firms involved in fierce competition scenarios must develop well-structured market-oriented strategies to pursue higher performance. Finally, the results on the relationship between the stage of the PLC and interfunctional coordination were contrary to expectation. Advising managers to decrease their degree of interfunctional coordination in case of differences in PLC stage between the home and foreign country is counterintuitive. More research is needed to verify this result before definite conclusions and recommendations can be drawn.

Limitations and Directions for Further Research

As with any study, this one has some limitations that point to directions for further research. In this case, it is possible that the questionnaire used may have created a common method variance that inflated construct interrelationships. This is most threatening when the respondents are aware of the conceptual framework of interest. Respondents were not told the specific purpose of the study, however, and all construct items were separated and mixed so that no respondent should have been able to detect which items were associated with which factors (Jap, 2001). In addition, two statistical tests were conducted to determine the extent of possible method variance in the data. The Harman one-factor test (Podsakoff & Organ, 1986) demonstrated that the risk of common method variance was unlikely to be significant in this case because the exploratory factor analysis results showed that a single general factor did not account for most of the variance. To confirm these results, additional analyses were performed to test for common method variance following the procedure recommended by Podsakoff, MacKenzie, Lee, and Podsakoff (2003). In this approach, we re-estimated the model with all the indicator variables loading on a general method factor and the resulting model fit was unacceptable.

Another possible limitation of the study is that only firms based in Brazil were surveyed, which means that caution may have to be exercised in generalizing the present findings too broadly. Replication studies in other countries would be necessary to test the external validity of our model. Nevertheless, generalizations of these findings may be applicable to those many other countries that are in a similar stage of development and that experience structural characteristics and export contingencies comparable to those in Brazil. The use of a cross-sectional research design could also be criticized because of its limitation in capturing the dynamic aspects of the constructs incorporated in the model. Thus, the use of longitudinal research designs would provide a greater understanding of the dynamics of these relationships. Additional research is also encouraged to test the contributions of other orientations to firm export performance. Finally, it is hoped that this study will contribute toward a better understanding of this issue and stimulate others to investigate this topic further.

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APPENDIX. MEASURES

Export performance.

Export sales volume
Export intensity
Export market share
Overall satisfaction
Degree of meeting expectations

Interfunctional coordination.

Regularly visit customers
Free communication of customer information
Internal business functions integrated to serve customer needs
Understand how employees can create customer value
Sharing of resources among business units

Competitive intensity.

Competition in our export market is cut-throat
There are many promotion wars in our export market
Price competition is a hallmark of our export market
One hears of a new competitive move almost every day

Product life cycle stage.

Extent to which the product is in the same PLC stage in the home and foreign market

Legal and technical environment.

Legal regulations
Technical requirements

Technology orientation of the product.

Degree of technology orientation of the product

Size of the firm.

Number of employees

DIFFERENCES BETWEEN HIGH- AND LOW-PERFORMING EXPORTING FIRMS IN A DEVELOPING COUNTRY

Khutula Sibanda, Ronel Erwee and Eric Ng

ABSTRACT

This study identifies key variables that contribute most to the discrimination between firms with high export performance levels and those with low export performance levels. Data were collected through a structured multi-item questionnaire involving a randomly selected sample of 105 exporting firms. Discriminant analysis was used to identify the key discriminating variables. Exporters with high-performance levels differed significantly from those with low levels. Strategy implementation, experience in international business and training, economic factors, size of the firm, cultural factors, strategic orientation, education, *and* political/legal factors, *listed in order of importance, were identified as key discriminators between the two types of firms.*

Keywords: International marketing; marketing strategy; export performance; Zimbabwe.

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INTRODUCTION

Despite the significance of exports as a source of foreign currency, many exporters lack an understanding of export practices. Therefore, an exploratory research project involving a survey of 105 exporters in Zimbabwe is presented here to identify whether there are significant differences between high- and low-performing export firms. Comparisons are made in terms of the following factors: the organizational profile, the respondents' profile, the product-market export venture (e.g., type of product exported, industry, and major export market), economic climate, cultural environment, degree of commitment, political/legal climate, and export experience and training. In the sections below, the variables that could distinguish between the high- and low-performing firms are discussed. Prior research on factors affecting export performance is noted in each section of the literature review, with the results of the discriminant analysis provided in the results sections.

LITERATURE REVIEW

There is no established definition of export performance, or any agreement on establishing acceptable performance levels. This has led to the use of various ad hoc measurement dimensions (Diamantopoulos, 1998). A review of existing literature (e.g., Katsikeas, Leonidas, Leonidou, & Morgan, 2000; Lages & Jap, 2002; Morgan, Kaleka, & Katsikeas, 2004; Ogunmokun & Wong, 2004; Sousa, 2004) on measuring export performance shows conceptualization and methodological limitations hindering theory development and application in this area. Albaum, Strandskov, and Duerr (1998) define export performance in terms of sales growth and intensity. However, this definition has the limitation that it does not take into account other dimensions of export performance.

Current literature reveals that most studies (e.g., Cavusgil & Zou, 1994; Dhanaraj & Beamish, 2003; Naidu & Prasad, 1994; Styles & Ambler, 2000) conducted on export performance were primarily in developed countries such as the United States, Canada, and Australia, while limited studies have occurred in less-developed countries – the key focus of this paper. Other studies have also investigated several different aspects of export performance, such as performance measurements (e.g., Morgan et al., 2004; Styles & Ambler, 2000; Prasad, Ramamurthy, & Naidu, 2001; Shoham, Evangelista, & Albaum, 2002), financial impact (Akehurst & Akyol, 2003;

Cavusgil & Zou, 1994; Morgan et al., 2004; Ogunmokun & Wong, 2004), strategic considerations/implications (e.g., Aulakh, Kotabe, & Teegen, 2000; Julian, 2003; Lages & Lages, 2004; Styles, 1998), and performance satisfaction (e.g., Diamantopoulos, 1999; Katsikeas, Piercy, & Ioannidis, 1996; Lages & Jap, 2002; Lages & Lages, 2004).

Although several studies (e.g., Cavusgil & Zou, 1994; Julian, 2003; Katsikeas et al., 1996) have been conducted on the factors that affect export performance, very few have been carried out to investigate this phenomenon in Africa, particularly in Zimbabwe. Based on the literature, a preliminary framework (Fig. 1) has been developed and derived from these previous studies on the different influencing factors. Thus, while there is no single unique classification system for these influencing factors, they can generally be classified as: (a) organizational profile, (b) environmental, (c) managerial, and (d) product-related (e.g., Barney, 1991; Cavusgil & Zou, 1994; Chetty & Hamilton, 1993; Das, 1994; Leonidou, Katsikeas, & Piercy, 1998).

The literature suggests that export performance is closely linked to organizational profile, such as size, age, and ownership. Thus, the firm's capabilities and constraints can influence its choice of marketing strategy and the ability to execute it, which can help promote export performance (Sinkula, 1986). Some studies (Bodur & Cavusgil, 1985; Reid, 1989; Tookey, 1964)

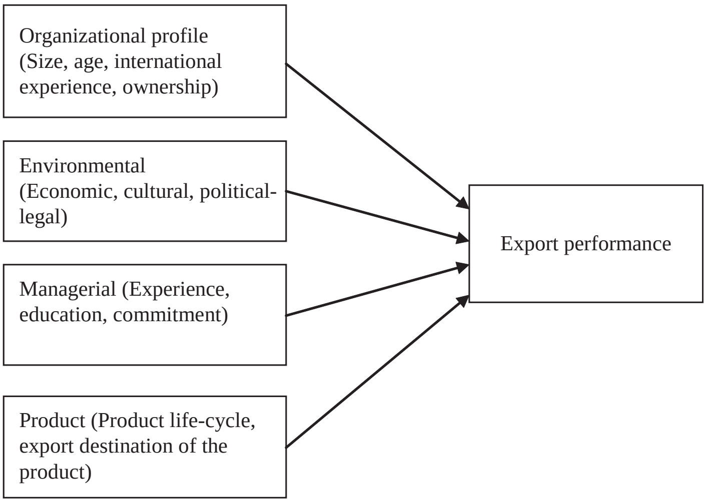

Fig. 1. A Preliminary Framework of Factors that Influence Export Performance. *Source:* Adapted from Cavusgil and Zou (1994) and Das (1994).

have found the *size of the firm* to be associated with export performance. In general, larger firms tend to use more marketing research and generate more export market intelligence than smaller ones (Cavusgil, 1984). However, some studies revealed that the relationship between export performance and size is not necessarily positive. In the case of German firms, Wagner (1995) found that the positive relationship between size and export intensity is valid only up to a point. Several other studies have found that the same relationship is not constantly increasing but assumes an inverted U-shape. This means that the impact of size on export performance is positive only for a first (and generally small) range of size variables, after which the relationship becomes negative or insignificant. The relationship between size and exporting, or between size and export success, is significant only within certain ranges (Sinkula, 1986). A study conducted by Cadogan, Diamantopoulos, and Siguaw (1999) in the United States and the United Kingdom found that size did not have a significant impact on export success. Furthermore, Lefebvre and Lefebvre (2001) also suggested that size may be relevant during the first stages of internationalization but not afterward. What matters is not the absolute but the relative size of the firm. Some smaller firms may well be important players in their own niche markets, whereas other small and medium-sized enterprises (SMEs) find that they are unable to compete with their larger rivals occupying dominant market positions. This is one of the reasons presented by Das (1994) to explain higher export intensity for small firms among Indian exporters.

Previous researchers (e.g., Cooper & Kleinschmidt, 1985; Calof, 1994; Becchetti & Rossi, 2000) have linked export performance to the *age of the firm*, as this variable is generally used as a proxy to indicate the amount of learning a firm has acquired over time that can affect the level of export performance. Older firms perform better compared to younger firms in the export market, according to Sibanda (2008). However, when firms get older, the exports–age–profile relationship flattens out to where it reaches a maximum and starts to fall. This probably explains why some old firms perform badly compared to new ones. In addition, Soderbom (2004) suggested that when firms are in their infancy, the likelihood of export success increases relatively rapidly with age, so that these young companies can achieve better international success if they are able to be more innovative and flexible than older companies.

Ownership of the firm has been regarded as another factor that can affect export performance. Various studies (e.g., Dijk, 2002; Johnson, Cullen, Sakano, & Bronson, 2001) have revealed that ownership has either a direct or an indirect impact by increasing the capacity of the firm to design an appropriate marketing strategy. Multinational enterprises are generally expected to achieve a higher performance level because they enjoy certain benefits not available to locally owned firms. These may include: (1) access to superior production technology, capital, management, and marketing competence (Beamish, 1993; Beamish & Delios, 1997); (2) the ability to produce efficiently and possess sophisticated international marketing networks that facilitate distribution (Beamish, 1993; Wilmore, 1992); (3) benefits of being part of a multibranch organization, with economies of scale and resource sharing (Dijk, 2002), and (4) sharing economic and political risks (Johnson et al., 2001). Multinationals tend to perform better than local firms as foreign-owned firms export larger proportions of their output than those that are domestically owned (Gunning & Mumbengegwi, 1995; Sibanda, 2008).

Environmental factors such as economic, cultural, and political-legal climates are regarded as having an impact on export performance. Evidence has shown that *economic environment factors* such as market attractiveness and good infrastructure are closely linked (Ssemogerere & Kasekende, 1994). It is suggested that firms that fail to identify economic factors/obstacles may result in using inappropriate export strategies (Sibanda, 2008). Lages and Montgomery (2004) also suggest that performance improves when there are higher rather than lower levels of competition in the export market. Intense competitive pressures can lead firms to boost their marketing orientation by designing innovative export marketing strategies that result in better performance in the medium to long term. This improvement in export performance may be attributed to the intense competition that enhances a firm's understanding of the nature and source of the competition, which facilitates self-assessments and re-orientation of strategies that are necessary in achieving better export performance outcomes (Ogunmokun & Ng, 2004).

Evidence has shown that links exist between the *cultural environment* and export performance (Baldauf, Cravens, & Wagner, 2000; Bello, Chelariu, & Zhang, 2003; Guan & Ma, 2003; Nes, Solberga, & Silkoset, 2007; Sibanda, 2008). Companies facing cultural obstacles are likely to improve their export performance through the adaptation of export strategies, while those not encountering any obstacles may use inappropriate strategies leading to poor performance (Ogunmokun & Ng, 2004). Other studies (e.g., Bilkey, 1985; Lado, Martinez-Ros, & Valenzuela, 2004; Madsen, 1989) have shown that in order to export successfully, firms should choose countries at a small psychic distance rather than those that are too distant and exotic. This implies the need to select markets in which the firm understands factors such as language, values, beliefs, and business norms. Research has also suggested that the level of export performance is related to how organizations address the issue of cultural factors in their marketing strategies (e.g., Bilkey & Tesar, 1977; Dow, 2000; Johanson & Vahlne, 1977; Ogunmokun & Ng, 2004; Shoham & Albaum, 1995).

Political-legal environment has been regarded as having an impact on export performance due to differing national and local legislations between home and host countries (Lages & Montgomery, 2003; Raven, McMucullough, & Tansuhaj, 1994). Evidence by Tremeche and Tremeche (2003) notes that Japanese firms exporting to the Arab market encountered heavy legal and administrative procedures, tariff and nontariff barriers, internal unrest, and a multiplicity of technical/legal requirements in the market, all of which greatly affected the overall export performance of the firms. Other studies (e.g., Humphrey, 1998; Ogunmokun & Ng, 2004) also showed that firms that were aware of the relevant political-legal issues (such as difficulties in converting/transferring foreign currencies and capital, investment licensing controls, and corrupt rent-seeking behavior) in the host country generally performed well since they had designed appropriate strategies in anticipation of overcoming these challenges.

Managerial commitment is an important determinant of export performance, according to some studies (Axinn, Noordewier, & Sinkula, 1996; Castaldi, Sengupta, & Silverman, 2001). With commitment, uncertainty is reduced and marketing strategy can be implemented effectively (Julian, 2003; Sibanda, 2008). This finding is consistent with Cavusgil and Zou (1994), who observed that a high level of management commitment allows a firm to aggressively go after export market opportunities and pursue effective exporting strategies, thereby improving performance. The commitment positively influences performance as it makes managers believe in themselves as well as the export venture. Moreover, managers in highly performing export sales organizations are more committed, motivated, and team-oriented than those in less effective export sales units (Katsikeas et al., 2000).

The level of *experience and training* of management in international business constitutes a source of sustainable competitive advantage, which also has a positive impact on export performance (Cadogan et al., 1999; Douglas & Craig, 1983; Lages & Montgomery, 2003). Some studies (e.g., Axinn, 1988; Koh, 1991; Lu & Beamish, 2001; Sibanda, 2008) indicate that managers who have substantial international business experience tend to have a better understanding of foreign markets, making them more likely to lead their firms to higher export performance levels. Furthermore, experience allows firms to establish good overseas contacts, including agents, distributors, and networks, thereby increasing the customer base and leading to increased sales (Aaby & Slater, 1989; CTA, 1994; Sibanda, 2008). Appropriate training enables firms to gain adequate understanding in export procedures and documentations and thus avoid costly mistakes, becoming knowledgeable on export environment opportunities, threats, and such legal requirements as health, safety, and product labeling (CTA, 1994; Loueter, Ouwerkerk, & Bakker, 1991; Sibanda, 2008).

The *product life cycle* in local and export markets is related to export performance, wherein firms with mature products are more likely to attain higher levels than firms with products in the introductory stage (Sibanda, 2008). Previous studies on export performance (e.g., Bilkey & Tesar, 1977; Cavusgil, 1980; Czinkota, 1982) have also revealed that firms generally perform poorly during the formative stages of internationalization compared to later stages. This can be explained by the lack of adequate financial and human resources to facilitate production and marketing during the formative stages, restricting the extent to which firms can improve export performance (Cavusgil & Noar, 1987; Czinkota & Ronkainen, 1990).

Finally, the *export destination of the product* has also been regarded as an export performance factor. Costs and communication difficulties tend to increase with geographic distance (Dow, 2000), so it would be expected that a shorter distance between home and host country markets would reduce costs and increase overall profitability. However, Wagner (1995) explained that the more distant the market is geographically, the greater the level of planning required by exporters to achieve success.

METHOD

This study set out to analyze factors that discriminate between Zimbabwean firms with low export performance and those with high export performance. The methods used in the study are explained earlier.

Sample

The unit of analysis used in the study was a single export venture, or one that exports a single product or service to a single foreign market. The study targeted export managers, marketing managers, or managing directors within the firm with knowledge of the company's export practices (Sibanda, 2008). The Export Directory of Zimbabwe published by ZimTrade Export is the country's best sampling frame corresponding to the target population. ZimTrade, a National Trade Promotion Board established in 1992 to promote exports, is mandated to collect data on exports and make updates to the Zimbabwe Export Directory. All exporters are registered under this directory. The database showed a list of 1,500 exporters. The specific probability sample used for this study was a systematic sampling process (Zikmund, 2000) that involved choosing a sample by selecting a random starting point and then picking every nth element in succession from the sample frame – an approach that had been used in similar studies (Ogunmokun & Ng, 2004; Ogunmokun & Wong, 2004). From the list of firms, the initial target was to obtain a response rate of around 40 percent that would ensure that a statistically significant confidence interval and precision.

Table 1 contains information about firm size, export experience, and ownership. It indicates that the distribution was skewed toward small firms, with a fair representation of both young and older firms in the sample. All the firms had at least five years of exporting experience. Zimbabweans owned 53 percent of them, while joint Zimbabwean/foreign-owned firms made up 19 percent of the total and foreign-owned firms 22 percent. The distribution suggests a declining level of foreign investors coming into Zimbabwe over the past three years, largely due to the unstable macroeconomic environment characterized by hyperinflation of over 1,600 percent in February 2007 and an average economic decline of more than 5 percent per annum since the year 2000.

Table 2 shows the *respondents' profile* regarding position held in the company, level of education, and number of years worked for the firm. The majority of the respondents were export managers (45 percent), followed by directors (29 percent) and export officers (19 percent), respectively. Other respondents (8 percent) could not be classified into any of the three groups. The distribution above was highly skewed toward respondents with in-depth knowledge of the firm's export activities. Most possessed higher standards of formal education, with the majority (58 percent) having less than 5 years work experience.

Table 3 demonstrates the characteristics of the sample in terms of *export markets*, *nature of the product exported*, *the local and foreign life cycle*, and the *sector to which the organization belongs*. The Southern Africa Development Community (SADC) is the biggest regional export market for Zimbabwe, representing 27 percent of the firms in the sample; this was

Table 1. Organizational Profile.

Number of Employees	Frequency	Frequency Percent
Fewer than 100 employees	65	61.9
At least 100 employees	40	38.1
Total	105	100
Age of the firm		
Less than 20 years	46	43.8
At least 20 years	59	56.2
Total	105	100
Number of years exporting		
Less than 10 years	59	56.2
At least 10 years	46	43.8
Total	105	100
Ownership		
Zimbabwean citizen-owned	56	53.3
Foreign-owned	23	21.9
Joint Zimbabwean/foreign-owned	20	19
Foreign-owned subsidiary	6	5.8
Total	105	100

Table 2. Respondent Profile.

Profile	Variable Description	Frequency	Frequency Percent
Description of position level	Director level	30	28.6
	Export manager level	47	44.8
	Export officer level	20	19.0
	Others	8	7.6
	Total	105	100
Level of education	Primary education	1	1
	Secondary education	9	8.6
	Apprenticeship/trade qualification	10	9.5
	Diploma	35	33.3
	University degree or higher	50	47.6
	Total	105	100
Number of years with the company	Less than 5 years	61	58.1
	At least 5 years	44	41.9
	Total	105	100

Table 3. Export Markets and Nature of Product.

Export Market	Frequency	Frequency Percent
Southern Africa Development Community (SOUTH AFRICAN DEVELOPMENT CORPORATION)	28	26.7
South Africa	25	23.8
Europe	18	17.1
Germany	11	10.5
United Kingdom	11	10.5
Other	7	6.6
Asia	5	4.8
Total	105	100
Nature of product		
Industrial good	38	36.2
Consumer durable	35	32.4
Consumer nondurable	24	23.8
Service	7	6.6
Other (specify)	1	1
Total	105	100

followed by South Africa (24 percent), the European Union (17 percent), the United Kingdom (11 percent), Germany (11 percent), Asia (5 percent), and others (7 percent). Zimbabwean exports have been mostly to the EU and the SADC region. Within SADC, South Africa accounted for almost 50 percent. In the EU, the United Kingdom and Germany were the biggest markets. Significant exports were made to the United States and Japan. Most of the *products* exported (56 percent) were durable and nondurable consumer goods. Industrial goods represented 36 percent of the firms in the sample, while services accounted for 7 percent of the total (Table 3). This is a reflection of the trend in developing countries, which are net importers of industrial goods.

In terms of the *product life cycle*, 39 percent of the firms had products at the growth stage in the local market, followed by those at the maturity stage (34 percent) and those at the introductory stage (26 percent). One firm had a product in the decline stage (Sibanda, 2008). However, in the export market the majority of firms (45 percent) had products at the introductory stage, followed by those at the growth (27 percent) and maturity (25 percent) stages. The majority of the respondents were from the manufacturing *sector* (47 percent), followed by agriculture and forestry (13 percent), mining and quarrying (11 percent), and finance and insurance (5 percent). When combined, agriculture, forestry, and manufacturing constituted 71 percent of the total firms in the sample.

Questionnaires

The variables used to differentiate low performers against high performers were based on an interval scale (Sibanda, 2008). Data on actual sales figures, profits, and income levels were based on a ratio scale. Under the rating scale technique, categorical scales ranging from "yes" to "no" were used as responses. Under the ranking scale, respondents were asked to place responses in order of importance, using a 5-point Likert scale on attitude ranging from "very negative" to "very positive." This required respondents to indicate how strongly they agreed or disagreed with a statement (Sibanda, 2008). Most of the variables were measured using multiple-item measures. The questionnaire comprised five key sections, which included organizational and respondent profiles as well as the product-market export venture, the export marketing strategy adaptation, and the export environment. The following factors were used to explain level of performance; economic, cultural, political, and legal environments, and mandatory requirements by host country. Other factors included the strategic orientation of the firm, top management commitment to the export venture, and experience and education levels of top management.

The design of the questionnaire was made with the intention of using the multidimensional approach taken by Ogunmokun and Wong (2004). Twenty questions were used to assess the export environment. The variables used for the economic section were per capita GNP, availability of natural resources, climatic conditions, topography, media availability, availability of distribution channels, and competition. The cultural section included cultural differences, material culture, language differences, aesthetics, education and literacy, religious attitudes, and values and social organizations. The political section included questions on political interference, legal environment, import/export laws, and mandatory requirements (Sibanda, 2008). The strategy orientation, commitment, and experience/training items and measurement scales comprised the next 10 questions. The strategic orientation question tested the probability that a non-Zimbabwean would be a CEO and that being a national was not important in selecting individuals for managerial positions. The commitment section included questions about substantial amounts of resources, degree of long-term planning, amount of strategy implementation, relevance of organizational design, and top management commitment. The management experience and training section included level of management's overseas experience, knowledge of foreign culture, training in international business, and management flexibility (Sibanda, 2008).

Process

A pre-test was made in line with recommendations from experts in research methodology who advised on the need for initial data collection instruments on a smaller but similar group of subjects comparable to the main survey (Lages & Montgomery, 2004; Ogunmokun & Ng, 2004; Philip & Wickramasekera, 1995; Zikmund, 2000). The pre-test involved mailing the questionnaire to a representative sample of 16 firms, along with a pre-paid self-addressed envelope that generated a 93 percent return rate.

Each construct had at least a standard reliability alpha of 0.60, which ensured reliability (Sibanda, 2008). The final questionnaire was mailed to all the firms in the sample or sent via e-mail. A short introductory letter that clarified the purpose of the study, how the company was selected, estimated time to complete the questionnaire, and assurances of confidentiality accompanied the questionnaire. Of the total 125 questionnaires returned, 20 were discarded because they were not fully completed, leaving 105 for a response rate of 21 percent.

Data Analysis

For grouping purposes, a dummy score was defined and given a value of 1 if the rank by the respondent was either 1 or 2, and 2 otherwise. The collapsed scores of 1 and 2 were summed up and the following was observed. The maximum possible total score for each firm was 40. The minimum possible total score was 20 and the sample mean and standard deviation were 28.2 and 6, respectively. All the firms that scored below the sample mean of 28.2 were re-coded as 1 and classified into the low export strategy adaptation group, whereas those scoring above the mean were classified into the high export strategy adaptation group (Ogunmokun, Hopper, & McClymont, 2005; Ogunmokun & Wong, 2004; Sibanda, 2008). Regarding export performance, firms performing highly in more than four of the key export indicator variables were categorized as high performers, whereas those with high performance in four or fewer of the variables were categorized as low performers. Cross-tabulation and χ^2 techniques were used to compare the two groups of organizations (low versus high-performing) and then test whether the differences between the groups were statistically significant (Sibanda, 2008; Zikmund, 2000).

The study used discriminant analysis to identify variables differentiating the two types of firms. A stepwise discriminant analysis was carried out using Statistical Package for the Social Sciences (SPSS) to identify the best discriminating variables among the groups. The approach began by entering the variable with the lowest Wilks' lambda (λ) in the model. In the process, the variable that contributed least to the discriminatory power was eliminated from the model. Only the variables that contributed most were maintained. The procedure was ended when all variables met the criterion to stay and no others could be entered. Hence, only a function containing an optimal set of independent variables was produced. The set of variables included were related to firm characteristics, economic variables, cultural variables, political and legal variables, commitment, experience, and education.

RESULTS AND DISCUSSION

The study examined 36 variables in order to assess their ability to discriminate between firms that recorded low export performance and those that recorded high export performance. The following 8 variables were identified as the main discriminators: strategy implementation (25 percent), experience in international business and training (18 percent), economic infrastructure (19 percent), firm size (17 percent), cultural differences and material culture (11 percent), strategic orientation (6 percent), level of education (2 percent), and political interference (1 percent). Table 4 shows the standardized and unstandardized coefficients of the main discriminator variables for the firms with low levels of adaptation against those with high levels of adaptation.

The results showed that *strategy implementation* was the most important variable that discriminated low- from high-performing export firms. Out of a total of 71 low export performers, 55 of them did not implement their strategies. In contrast, of the 34 firms that performed well, 27 of them implemented their strategies. This result shows that strategy implementation is a key factor separating the two groups of firms.

The second most important variable identified was *experience and training*, which showed the existence of two distinct groups of firms in

Table 4. Relative Importance of the Performance-Discriminating Variables.

Variable No.	Variable Description	Standardized Coefficient	Unstandardized Coefficient	Differences in Group Means ($X\hat{j}1-X\hat{j}2$)	Importance Values ($I\hat{j}$)	Relative Import Value ($R\hat{j}$) (percent)
V1	Size	0.571	0.341	2.12	0.723	17.29
V5	Level of education	−0.325	−0.331	0.3	0.099	2.37
V9	Natural resources	−0.556	−0.307	0.73	0.224	5.36
V12	Media	0.919	0.582	0.95	0.553	13.22
V15	Cultural differences	−0.501	−0.288	0.94	0.271	6.47
V16	Material culture	−0.449	−0.287	0.72	0.207	4.94
V23	Political interference	−0.423	−0.291	0.17	0.049	1.18
V27	Strategic orientation	0.395	0.270	1	0.270	6.46
V30	Strategy implementation	0.762	0.586	1.79	1.049	25.09
V35	International business	0.583	0.449	1.64	0.736	17.61
Total				181		100%

Source: Survey data
Wilks' lambda = 0.401
Canonical correlation = 0.774
Eigenvalue = 1.496
Correctly classified = 93.3 percent
$\chi^2 = 89.659$ d$f = 10$
$p = 0.000$

$^{**}p \leq 0.01$ (very high significant difference at 99 percent confidence).

Zimbabwe: the experienced good performers and the less-experienced poor performers. The results show that Zimbabwean companies that want to perform well in the export market should promote relevant training programs aimed at improving competence within the company.

Economic infrastructure was the third most important discriminating variable. The results showed better performance by firms that had encountered economic infrastructure obstacles in their endeavors to standardize strategies. Consistent with this result, previous research by Ssemogerere and Kasekende (1994) found that successful firms differed from the poor performers in that they tended to identify economic-related problems in the export market and address them.

The *size* of the firm was the fourth most important performance discriminating variable. This result means that firms that performed well tended to be larger than those that did not. Sterlacchini (1999) and Philip and Wickramasekera, 1995 also emphasized the size of the firm as a factor differentiating firm performance. It is apparent from the results that small firms in Zimbabwe have been subject to discriminatory practices by financial institutions in the past, which have favored large firms at the expense of small ones.

Cultural differences were identified as the fifth most important variable. This result means that firms that performed well strongly agreed that they faced obstacles of cultural differences in their endeavors to standardize strategies. The success appears to emanate from the fact that managers of high-performing firms encountering cultural problems are better prepared to deal with them than those from low-performing firms (Buzzel, 1968; Ogunmokun & Ng, 2004). However, because some of these companies managed to address these difficulties, only 4 percent actually performed poorly due to cultural differences (noted in Sibanda, 2008), as most adapted their strategies accordingly. In this study, most of the firms that faced cultural problems adapted their marketing strategies in line with the culture of the host country. These findings show that Zimbabwean companies wanting to succeed in export markets should be prepared to adapt strategies to meet the cultural needs of the host country.

The *strategic orientation* of the company was the sixth most important performance discriminating factor. Organizations that performed well were those that were export-oriented in their strategy. Consistent with this finding, Ogunmokun and Ng (2004) found that a manager willing to turn his or her interest toward the outside world is likely to be successful in the export business. The source of this success appears to be driven by the ability to meet the unique needs of individual buyers or groups of buyers in the foreign markets (Albaum et al., 1998). Other studies have also shown a positive relationship between success and adaptation of strategy to the needs of the host countries (Kotler, Leong, & Tan, 1996). The result shows that Zimbabwean firms likely to perform well in the export markets are those that agree that nationality is not important in selecting individuals for managerial posts; hence, they look for the best managers regardless of nationality.

Level of education was the seventh most important variable in the study. Organizations that performed well had more educated managers than those without. To succeed in the export market, firms should employ managers with the right level of education who can make informed decisions. Education raises focus and vision while imparting the ability to interpret export market information (Burton & Schegelmilch, 1987). Leonidou et al. (1998) and Brouthers and Brouthers (2001) also suggest that better-educated managers are more likely to succeed in the export market because of their enhanced knowledge, while managers of poor-performing firms have been found to have less education and to be therefore less knowledgeable about export markets.

Political interference was the eighth and final variable that discriminated low from high export performances. Better-performing firms strongly agreed that they encountered legal obstacles in their endeavors to standardize their strategies. This result compares well with Ogunmokun and Ng (2004), who observed that legal environmental obstacles were cited more frequently by managers of high-performing firms than by those of low performers. Tremeche and Tremeche (2003) also observed that a company faced with political challenges in the export market may overcome these challenges by strengthening relationships with local distributors, thereby reducing the perceived political risks. Under this study, most Zimbabwean firms that faced problems of a political and legal nature went on to adapt their marketing strategies, which appears to have helped them perform well.

CONCLUSIONS

Theoretical Implications and Contribution to Knowledge

The purpose of this study was to explore whether there are significant differences between firms with low levels of export performance and those with high levels of export performance. The eight major discriminators of such performance were strategy implementation, experience in international business and training, economic infrastructure, firm size, cultural differences and material culture, strategic orientation, level of education, and political interference. The results are useful in advancing the conceptual framework linking export performance to strategy adaptation. It also provides a starting point for designing appropriate public export advisory services and formulating strategies to improve export performance by management.

Practical Implications and Recommendations for Management and Public Policy

The study results provide some guidance for Zimbabwean exporting organizations in their efforts to achieve and sustain high-performing export ventures. To improve performance, it is important for management to consider the following recommendations: (a) encourage exporters to be committed toward export strategy implementation and allocating adequate human and financial resources toward the implementation of agreed strategies; (b) exporters should design appropriate business training programs relevant to export activities to include issues related to foreign languages, opportunities and threats of foreign markets, foreign market networking, and general export marketing strategies of product design, pricing, promotion, and distribution; and (c) exporters need to identify any economic obstacles that may make it difficult to use standardized marketing strategies.

Countries differ with regard to economic infrastructure facilities like energy and power supply, telephone lines and transmitting facilities for mobile telephones, roads, railways, airports, climatic conditions, and so on. When such differences exist between Zimbabwe and the export destination, it might be necessary to adapt production and marketing strategies in line with the available infrastructure.

Limitations of the Study and Future Research

The data used for this study were collected from a single source within the sample organizations (i.e., top export managers). Although care was taken to identify the right person within each firm, biased value judgments could not be ruled out during the process of completing the questionnaire, as respondents could be tempted to give desired and not actual responses (Zikmund, 2000). The data were also collected at a single point in time for use with a cross-sectional design; hence, it was not possible to explore issues of causality. The sample size ($N = 105$) can be considered small; thus, it is recommended that the subject matter be explored further with a much larger sample to permit generalization of the results.

Another limitation for this study is that it was carried out during a period of macroeconomic instability in Zimbabwe. Most companies were severely affected by the unstable environment that was characterized by high inflation of around 2,200 percent in March 2007 – the highest in the world. The challenges faced by companies also included high interest rates and depressed local demand. Such factors can partly contribute to poor export performance. In order to isolate the distortions associated with the timing of the study, future researchers could consider using longitudinal and time-based series analysis.

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PREDICTING AND EXPLAINING COMPLAINT INTENTION AND BEHAVIOUR OF MALAYSIAN CONSUMERS: AN APPLICATION OF THE PLANNED BEHAVIOUR THEORY

Wenjie Zhao and Md. Nor Othman

ABSTRACT

This report investigates attitude towards complaining, societal benefits and probability of complaint success, with emphasis on complaint intentions and actions, in applying the theory of planned behaviour to complaint behaviour in Malaysia. On the basis of a sample of 834 respondents at the National Consumer Complaint Centre, the Tribunal for Consumer Claims Malaysia, and three shopping malls, the research findings suggest that complainers with a more positive attitude towards those three factors have a stronger tendency to make a complaint. However, consumers with positive perceptions of societal benefits and a higher probability of success are less likely to take action for seeking redress. Moreover, the influence of attitude, benefits, and probability of success on complaint actions is mediated by intention.

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When consumers are dissatisfied with a purchase, they often contact the retailer or manufacturer from whom they bought the product to complain and seek redress for the problem. Few consumers actually complain directly to the firm, however, and the firm may be unaware of consumer complaint actions (CAs) (Day, Grabicke, Schaetzle, & Staubach, 1981; Stephens & Gwinner, 1998). As Liu and McClure (2001) suggest, attracting new customers is obviously necessary, but its value is much higher than retaining consumers. Davidow and Dacin (1997) argue that consumers' negative word of mouth is potentially much worse than simply exiting or boycotting a firm because it influences many more people. Fornell and Wernerfelt (1987) suggest that the best approach for an organisation is to encourage dissatisfied customers to make a complaint. As the study by Liu and McClure (2001) found, those who complain will be more loyal than those who do not. If consumers express their displeasure and are unable to obtain satisfaction from a firm, they may turn for help to various consumer complaint agencies. Once they use this external source to register complaints about a product or service, the organisation at fault can realise their dissatisfaction and have the opportunity to eliminate future similar problems (Oliver, 1987; Kowalski, 1996). Therefore, a third party can be a viable next step for consumers to gain satisfaction (Singh, 1988).

An empirical study by Singh (1988) classifies consumer complaint behaviour into three response groups: voice action, private action, and third-party action. Responses directed towards objects that are external to the consumer's social circle and directly involved in the dissatisfying exchange (e.g., seeking redress from the seller) can be defined as voice actions. Private actions involve objects not external to the consumer's social circle and not directly involved in the dissatisfying experience (e.g., word-of-mouth or exit), whereas responses to objects that are external to the consumer and not directly involved in the dissatisfying transaction can be regarded as third-party actions (e.g., reporting to a consumer agency). Third-party complaint agencies can be divided into two distinct camps: legal entities and arbitrators/mediators. The legal entities include small claims courts, states' attorney generals, and civil action suits involving an attorney (Best & Andreason, 1977; Singh, 1988, 1989). Arbitrators/mediators include arbitration or mediation offices and services such as the Banking Mediation Bureau (BMB), the Insurance Mediator Bureau (IMB), consumer associations and local chambers of commerce.

Registering complaints with third-party agencies is important in adjusting the marketplace and, ultimately, benefiting the customer (Singh, 1989). Consumers are less likely to engage in complaining behaviour using a third party as such complaint handling mechanisms are troublesome (Singh & Pandya, 1991). However, Liu & McClure (2001) suggest that consumers may feel more comfortable with the third-party complaining process because the agency can mediate the conflict between the consumer and the business at fault. Consumer complaints can encourage firms to improve the quality of their goods or services (Richins, 1982; Davidow & Dacin, 1997; Phau & Sari, 2004). The question is: What factors are likely to elicit complaints from discontented consumers?

To examine these concerns, this chapter mainly explores the initial steps in consumers' decisions to seek redress from firms or through third parties such as consumer complaint agencies and courts. Based on previous studies, this report provides a model for seeking redress using the theory of planned behaviour (TPB) to show how attitudinal variables influence the ultimate decision to complain to a firm, a third-party agency, or a court through the intention variable. The purpose is to investigate the motivation for seeking redress from firms and the third-party complaint process, especially from a consumer perspective.

THEORY OF PLANNED BEHAVIOUR

Human actions are controlled by intentions, but not all intentions can carry out the relevant actions (Ajzen, 1985). In fact, intentions can change over time based on the individual's provisional nature. Intention can affect human actions, and the relationship between intention and action can be seen as the goals and plans that guide behaviour (Ajzen, 1985). Consumer complaint responses as an intermediate goal-directed behaviour may be problematic, because performance impediments may exist due to the consumer's effort to perform complaint responses (Singh & Wilkes, 1996; Bagozzi & Warshaw, 1990). Therefore, a consumer's complaint intention (CI) can be expected to predict his complaint behaviour based on action control.

In exploring human social behaviour, TPB is used to explain various behaviours and behavioural intentions that are not under a person's volitional control (Ajzen, 1991, 2001; Bamberg, Ajzen & Schmidt, 2003). TPB extends the Theory of Reasoned Action (TRA) by adding perceived behavioural control (PBC) as a third determinant (Fishbein & Ajzen, 1975; Ajzen & Fishbein, 1980; Hrubes, Ajzen, & Daigle, 2001). According to

Ajzen and Driver (1992), TPB demonstrates that when volitional control is more problematic, the addition of PBC significantly improves the prediction of intentions as well as the prediction of behavioural achievement. Internal and external factors in real life might constrain someone to perform the intended behaviours. For example, the degree of successfully achieving that particular behaviour will depend not only on the person's desire or intention but also on non-motivational factors such as the requirement of opportunities and resources, including time, money, skill and the cooperation of others (Ajzen & Driver, 1992; Armitage & Conner, 2001). Alcalay and Bell (2000) and Cherry (2006) suggest that TPB provides a better framework than TRA in understanding people's actions and explaining certain specific behaviours.

A structural model of the TPB is introduced by Ajzen (1991). In this model, attitude towards behaviour, subjective norms and PBC are the determinants of behavioural intention, and behavioural intention is influence on actually behaviour. *Attitude towards behaviour* refers to the individual's positive or negative evaluation of behaving that way; it is produced by behavioural beliefs about the likely consequences. *Subjective norms* are defined as the perceived social pressures to perform or not to perform a specific behaviour, as determined by normative beliefs about the normative expectations of others (Hrubes et al., 2001). *PBC* can be used to predict the probability of a successful behavioural attempt when the extent of resources and opportunity become realistic (Ajzen, 1985). Generally, the more favourable the attitude towards the behaviour and subjective norm, the more likely the individual intends to perform that behaviour and the stronger the individual's intention to do so (Ajzen & Driver, 1992; Miesen, 2003). Finally, PBC may have both direct and indirect effects on behaviour in the TPB model (Ajzen, 1991). The indirect effect is mediated by intention, while the direct effect links PBC with behavioural achievement.

Many studies have applied TPB in various content domains such as smoking cessation (Norman, Conner, & Bell, 1999), hormone replacement therapy (Quine Rubin, 1997), alcohol abuse (Morrison, Gillmore, Simpson, & Wells, 1996), low-fat food consumption (Paisley & Sparks, 1998), moral values (Ajzen & Driver, 1992), literary reading (Miesen, 2003), ethnic judgments (Cherry, 2006), unethical behaviour (Chang, 1998), hunting (Hrubes et al., 2001), exercise behaviour (Biddle & Nigg, 2000) and so on. As suggested by East (1996, 2000), complaining (or seeking redress) can be seen as planned behaviour. But in applying TPB in examining consumers seeking redress, results generally have not been supportive due to the scenario method used in measuring consumer complaint behaviour. Cheng, Lam, and Hsu (2005) suggested that the variables in TPB can be used as mediating variables to influence the relation between past behaviour and CI.

In line with the previous research, this study attempts to apply the TPB model through the survey method in the consumer complaint behaviour domain. The research intention is to carry out a parallel study to contrast TPB among three different ethnicity groups in Kuala Lumpur: Malays, Chinese and Indians.

DEVELOPMENT OF HYPOTHESES

In the proposed research model, this study treats each factor in the TPB model as a separate concept that can influence consumers' CIs and actions (see Fig. 1). As suggested by Ajzen and Fishbein (1980), the mediating role of behavioural intention can best be illustrated with respect to the attainment of outcomes. Thus, the effects of attitude on behaviour and other factors are mediated by intention. Some studies have suggested that consumer CI is an outcome of the consumer's attitude perspectives, rather than complaint behaviour, because intention is much better predicted and explained by attitude than behaviour (Kim, Kim, Im, & Shin, 2003; Singh, 1988). This purpose here is to examine whether the past findings about consumer complaint behaviour will be applicable in a Malaysian setting: attitude towards complaining (ATC), in terms of the individual's norms; societal benefits (SB) or the social good stemming from the complaint; and PBC, or the individual's perception of the probability of success in making the complaint.

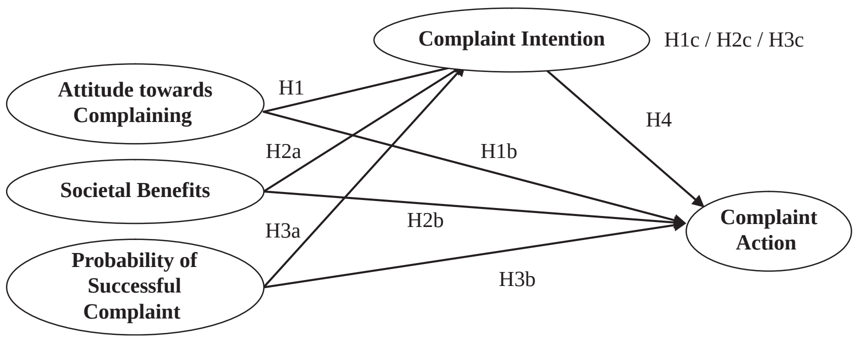

Fig. 1. The Proposed Model.

Attitude towards Complaining

Attitude towards behaviour, a core factor in TPB, concerns the individual's positive or negative evaluation of performing the behaviour (Ajzen, 1985). The conception of ATC, as defined by Singh (1989), is 'an individual's stable evaluations regarding the "goodness" or "badness" of complaining per se, irrespective of the specifics of the dissatisfaction episode' (p. 335). Singh (1990) uses this attitude to explain the individual norms for complaining to sellers/providers.

Before making complaints to a firm or a third party, many consumers are concerned about whether such behaviour is appropriate or not; some feel they do not like to be seen or to see themselves as complainers or troublemakers. This inhibits them from releasing their dissatisfaction about problematic products or services (Richins, 1982). However, some consumers have a distinctly opposite point of view – they feel they should complain because airing one's discontent with products or services is one's moral obligation. Phau and Sari (2004) suggest that people are likely to complain if they believe it is appropriate, whereas others may hesitate if they perceive others' negative reactions to such behaviour. Thus, attitudes towards complaining influence consumers' intention to air grievances and engage in complaint behaviour (Richins, 1982; Keng, Richmond, & Han, 1995; Singh, 1990; Lau & Ng, 2001).

Predicting Complaint Intention

Singh (1989, 1990) found that ATC is positively significant to the CI and plays an important role in understanding that intention. Complainers likely consider complaining an 'appropriate' behaviour. But Singh and Wilkes (1996) found that consumers with a more positive attitude towards it will have a higher voice and third-party complaint intentions (THCIs); there is no influence on private CIs. Kim et al. (2003) found that consumers in Korea with a more favourable ATC are more likely to express their CI to the firm compared to consumers who are reluctant to seek redress for their discontent. On the basis of the above literature, the following hypothesis is proposed:

Hypothesis 1a. Consumers having a more favourable ATC will be more likely to have CI.

Predicting Complaint Actions

Richins (1982) found that attitudes towards complaining have a strongly negative relationship with actual CAs. In studying Indonesian consumers, Phau and Sari (2004) used a *t*-test to investigate the differences in ATC between complainers and non-complainers and found a negative relationship between that attitude and actual complaints among Indonesian complainers. This result indicates that Indonesians may tend to believe that making complaints is not proper vis-a-vis their moral obligation and that it embarrasses them. Oh (2003) suggested that ATC influenced complaints among library users who were dissatisfied with a library service; however, he found that such an attitude had a non-significant relationship with third-party CAs. To capture the associations of ATC and CA for Malaysian consumers in the current study, the next hypothesis is stated as follows:

> **Hypothesis 1b.** Consumers having a more positive ATC will be less likely to engage in a CA.

Complaint Intention as the Mediating Variable between Attitude towards Complaining and Complaint Action

Ajzen (1985, 1991) suggested that the relationship between attitude towards behaviour and specific action is mediated by intention. In setting out to prove this mediation relationship in consumer complaint behaviour, the next hypothesis is suggested as follows:

> **Hypothesis 1c.** CI will mediate the relationship between ATC and CA.

Societal Benefits

Subjective norms, another key factor in TPB, are determined by normative beliefs, or beliefs about the normative expectations of others (Hrubes et al., 2001). Some researchers have used the socially related components factor in their model instead of subjective norms such as social support or negativity. Singh (1990) suggests that SB are the good that can come to society from an action such as complaining, and are related to individual beliefs about such good results. Richins (1982) proposes that registering complaints has both societal and personal benefits. If enough consumers are quick to complain about a particular product or service with which they feel discontented, the inferior product or service can eventually be removed from the marketplace or improved. However, other consumers may agree that complaints will not result in such a removal of inferior products/services from the marketplace. Thus, the perception of SB from a consumer's complaining influences the consumer's intention towards making complaints and engaging in actual complaint behaviour (Richins, 1982).

Predicting Complaint Intention

Ajzen (1985, 1991) has suggested that subjective norms should have a positive effect on behavioural intentions. In complaint behaviour, Singh (1990) found that SB are insignificant for a CI, meaning that individual beliefs about such benefits of complaining do not influence the CI. However, Richins (1982) found that consumers who believe that complaining is beneficial for society are more likely to make complaints. On the basis of this previous research, the next hypothesis is stated as follows:

Hypothesis 2a. Consumers who perceive more SB will be more likely to have a high complaint intention.

Predicting Complaint Actions

Richins (1982) found that SB are negatively significant to third-party complaining. In other words, consumers who believe that making a complaint is beneficial for society are less likely to take a third-party CA because they disagree that complaining can eventually improve or remove a faulty product from the marketplace. The related hypothesis can be proposed as follows:

Hypothesis 2b. Consumers who perceive more SB will be less likely to take CA.

Complaint Intention as the Mediating Variable between Societal Benefits and Complaint Actions

Ajzen (1985, 1991) suggests that intention mediates the relationship between subjective norms and behaviour. For proving this relationship in consumer complaint behaviour, the next hypothesis is suggested as follows:

Hypothesis 2c. Complaint intention will mediate the relationship between SB and CA.

Probability of Successful Complaints

Generally, the degree of success in performing a certain behaviour will depend not only on one's intention but also on non-motivational factors of requisite opportunities and resources, such as time, money, cooperation of others, and so on (Ajzen & Driver, 1992). Ajzen (1985) suggests that when the extent of resources and opportunity becomes realistic, PBC can be used to predict the probability of a successful behavioural attempt. In complaint behaviour, consumers' dissatisfaction occurs because of inconsistency between expectation and performance. Before making a purchase, consumers may investigate or search for information about the product or service. Once dissatisfaction occurs, they will have more confidence from enough information or resources to make a complaint to the company or third-party agencies (Busseri, Lefcourt, & Kerton, 1998). Kim et al. (2003) suggest that the probability of a successful complaint is the consumer's perceived likelihood of getting a reward from the firm, such as a refund, exchange or apology. Studies by Singh (1989) and Kim et al. (2003) have examined the probability of successful complaints (PSCs) empirically and the effect on complaint behaviour.

Predicting Complaint Intention

Kim et al. (2003) found that the probability of a successful complaint can increase the intention to complain. It can be said that if consumers believe their complaints will be accepted by a firm, they are more likely to express their discontent to the firm. If they believe the firm has no interest in their complaining, they may think the complaints will be meaningless and will prefer to keep silent and simply never shop there again. Singh (1989) found that the probability of a successful complaint has a positive significant effect on the intent to complain to a third party and plays a central role in understanding CI. Therefore, the association between the probability of a successful complaint and CI can be stated as follows:

> **Hypothesis 3a.** Consumers who perceive a high probability of a successful complaint will be more likely to have a complaint intention.

Predicting Complaint Actions

Oh (2003) found that the likelihood of success of dissatisfied library users' complaints significantly affected negative word-of-mouth. Ursic (1985) found the only direct empirical evidence between the probability of a successful complaint and a consumer's decision to take court action. Thus, it could be said that if consumers feel that success in court is probable, they are more likely to take action than consumers who do not feel that way. However, Singh (1989) argues that dissatisfied consumers who do not complain perceive that the chances of satisfying outcomes are meagre even if they were to complain. On the basis of the limited previous studies, the next hypothesis can be stated as follows:

Hypothesis 3b. Consumers who perceive a high PSC will be less likely to take CAs.

Complaint Intention as the Mediating Variable between Probability of Successful Complaint and Complaint Action

Ajzen (1985, 1991) suggests that the probability of a successful behavioural attempt is hypothesised to influence the target behaviour through effects mediated by behavioural intention. Therefore, the next hypothesis is stated as follows:

Hypothesis 3c. Complaint intention will mediate the relationship between the probability of a successful complaint and the CA.

Complaint Intention and Action

In both the TRA and the TPB models, the intention construct is considered the mediator between the beliefs and the behaviour. Godin and Kok (1996) define intention as 'the expressed motivation to perform some behaviour or achieve some goal' (p. 94). Ajzen (1991) suggests that intention can be referred to the amount of effort a person exerts to engage in actual behaviour. Ajzen and Driver (1992) argue that intention can be assumed to 'capture the motivational factors that influence behaviour; it is indicative of how hard people are willing to try, of how much of an effort they are planning to exert, in order to perform the behaviour' (p. 208). Hence, the more an individual intends to carry out an action, the more likely he or she will be to do so. Ajzen (2001) suggests that intention plays 'an important role in guiding human action' and can 'perform a goal-directed behaviour' in a specific context (p. 47).

In the attempt to evaluate intention in complaint behaviour, Richins (1982), Singh (1990) and Kim et al. (2003) have noted that complaint behaviour cannot be predicted by attitude and perception factors, but CI is much better at predicting the outcome of consumers' attitudinal perspectives. This is more consistent with both TRA and TPB. Hence, TPB can be applied in consumer complaint behaviour.

Ajzen and Driver (1992) discuss the strong intentions of individuals to engage in behaviour or to achieve their behavioural goals. Hrubes et al.

(2001) found that intention contributes significantly and gives a positive prediction of hunting behaviour. Singh (1988) found that consumers with private and THCIs are actually more engaged in private and third-party actions. Richins (1982) also suggests that a propensity to complain is significantly related to actual behaviour. Therefore, the stronger consumers' intentions are to engage in CAs, the more successfully those actions can be predicted. The proposition between CI and CAs is shown as the final hypothesis:

> **Hypothesis 4.** Consumers with a higher intention of seeking redress for complaining are more likely to take action on their complaints.

STUDY METHODS

The data in this research were collected through a survey involving self-administered questionnaires. The population and sample comprised Malaysian citizens residing in Kuala Lumpur, Peninsular Malaysia. Owing to the structural equation modelling (SEM) technique, a large sample was required. As Hair, Black, Babin, Anderson, and Tatham (2006) have found, the minimum target sample size is at least 5 times as many observations as the number of variables to be analysed, and a more acceptable sample size would have 10 observations per variable. To provide an adequate level of confidence, the present research used 700 as the target sample size. To capture such a sample, 1,200 respondents were intercepted and asked to participate in the study. For the shopping mall surveys, two research enumerators were used at each mall to distribute 167 questionnaires during two weekends (Saturday and Sunday). In the survey distribution, 350 questionnaires were given during February–April 2007 to consumers who had contacted the National Consumer Complaint Centre and the Tribunal for Consumer Claims regarding their dissatisfaction. Of the 1,200 questionnaires distributed, 946 were returned, for a response rate of 78.8 percent. A total of 834 survey questionnaires were found to be usable for the study.

The constructs and variables used in the questionnaire were derived from previous research based on the literature review. The questionnaires were produced in three languages: English, Chinese, and Malay. The final research questionnaire consisted of three parts. The first measured attitudes from the consumers' perspective to test three hypotheses related to ATC and SB based on the measurement of Singh (1990). A seven-point Likert scale was used in this section, rating from 1 = strongly disagree to 7 = strongly agree.

The second section of the questionnaire, based on Kim et al. (2003), addressed the respondent's perception of the probability of a successful complaint and the actions the respondent intended to take according to the list adapted from Singh (1989). A seven-point Likert scale measured these two constructs (1 = very unlikely to 7 = very likely). The last section measured the CAs consumers had taken (yes/no) by using the Guttman scale.

As discussed by Garver and Mentzer (1999), SEM is a powerful technique that combines the measurement model (confirmatory factor analysis or CFA) and the structural model (path analysis) into a simultaneous statistical test (Hair et al., 2006). In this report, AMOS 5.0 was used as the main statistical analysis tool to purify the measurement items and test the hypothesis relationship.

MAIN FINDINGS

AMOS was used to reduce the items that were not fit for the measurement model from the exploratory and confirmatory factor analyses. Measurement validity and theoretical relationships were also tested in this research.

Confirmatory Factor Analysis

SEM is a statistical tool to explain the relationships among multiple variables and examine the structure of interrelationships expressed in a series of equations, similar to a series of multiple regression equations (Hair et al., 2006). Anderson and Gerbing (1988) suggest the use of a two-step procedure comprising a CFA and SEM to test the hypotheses. Hair et al. (2006) note that the measurement model provides a basis for assessing the validity of the structural theory, testing the model fit and construct validity of the proposed measurement model in the CFA once a satisfactory measurement model is obtained. The second step is to test the structural theory in the path analysis.

CFA provides a confirmatory test of measurement theory for the constructs and explains how measured variables logically and systematically represent constructs involved in a theoretical model (Hair et al., 2006). The primary approaches for measurement item purification for the test include multiple CFA iterations with the maximum likelihood estimation (MLE) method that iteratively improves parameter estimates to minimise a specified fit function and ensure that stable MLE solutions are as small as 100–150 of the sample size (Hair et al., 2006). According to the path estimates, standardised residuals and modification indices, some of the items were deleted from the model CFA to improve the model fit indices. The fit for this final model in the calibration sample was excellent, with GFI = 0.943, AGFI = 0.926, TLI = 0.935, CFI = 0.946, RMSEA = 0.049 and CMIN/DF = 2.989.

Reliability and Validity Assessment

Once the hypothesised model was 'purified', the refined measurement model was used to test the construct validity and reliability through CFA. Hair et al. (2006) believe that assessing the construct validity of a proposed measurement theory is one of the advantages of CFA. It describes the extent to which a set of measured items actually reflect the theoretical latent construct. Construct validity can be formed by unidimensionality, reliability, convergent validity and discriminant validity.

Unidimensionality

Unidimensionality refers to the measured and latent variables whereby the critical ratio of regression weight are all statistically significant (CR > 1.96; at $\alpha \leq 0.05$). In the current study, the standardised parameter estimates were also higher than 0.70, and the signs of parameter estimation were all in the same direction to measure specific latent variables. The overall model fit indices were in excellent positions. The standardised regression weights were all higher than 0.5. As shown in Table 1, the evidence suggests that the construct is unidimensional in this study.

Reliability

On the basis of the formula of construct reliability (CR) (Garver & Mentzer, 1999) and variance extracted (VE) (Hair et al., 2006), the result of VE and CR were calculated. The CR on all constructs was greater than 0.70. The output of VE was reported from 0.43 to 0.82, with only the VE on ATC lower than the cutoff point of 0.50. A VE measure below 0.50 indicates that variance is larger due to measurement error. Fornell and Larcker (1981) estimate that measures of consumer personality traits have poor VE and suggest that each national sample should be considered separately. In the current study, attitude towards complaint refers to the individual's norms about complaining and can be described as a personal trait (Richins, 1982). Thus, this result proved to support the reliability of this study.

Table 1. Standardised Regression Weight, CR on Measurement Model (Final).

Indicator		Latent	Standardised Regression Weights	Parameter Estimate	Standard Error (S.E.)	Critical Ratio (C.R.)	p-Value
ATC5	←	ATC	0.507	1			
ATC2	←	ATC	0.657	1.251	0.114	10.992	0.000***
ATC3	←	ATC	0.767	1.469	0.137	10.75	0.000***
SB1	←	SB	0.709	0.987	0.055	17.992	0.000***
SB3	←	SB	0.742	1			
SB2	←	SB	0.837	1.079	0.057	18.923	0.000***
PSC3	←	PSC	0.913	1			
PSC2	←	PSC	0.967	1.057	0.023	46.38	0.000***
PSC1	←	PSC	0.832	0.924	0.027	34.744	0.000***
CI4	←	PCI	0.513	0.694	0.061	11.364	0.000***
CI6	←	PCI	0.816	1			
CI5	←	PCI	0.64	0.751	0.062	12.116	0.000***
CI9	←	THCI	0.845	1			
CI8	←	THCI	0.692	0.821	0.044	18.745	0.000***
CI10	←	THCI	0.718	0.827	0.044	18.638	0.000***
CI1	←	VCI	0.563	0.783	0.072	10.827	0.000***
CI3	←	VCI	0.708	1			
CI2	←	VCI	0.647	0.91	0.077	11.844	0.000***
CA5	←	CA	0.569	1			
CA4	←	CA	0.965	1.843	0.125	14.802	0.000***
CA3	←	CA	0.657	1.068	0.071	15.08	0.000***

***$p < 0.01$.

Convergent Validity

Steenkamp & van Trijp (1991) and Hair et al. (2006) found that convergent validity assesses the overall fit of the measurement model: the magnitude, direction, and statistical significance of the estimated parameters between latent variables and their indicators. In this study, overall fit was all within the acceptable index. The magnitudes of the standardised parameter estimations were higher than 0.50, and the directions to measure specific latent variables were all the same. The estimated parameters were all statistically significant between the latent and measured variables (Table 1). Thus, the results proved convergent validity in this study.

Discriminant Validity

With regard to testing discriminant validity, a pair-wise comparison (Long, 1983; Hair et al., 2006) was used in this study. The correlation of a pair of constructs was fixed to equal 1.0 as a constrained model was free to vary as an unconstrained model. In comparing the two models, the chi-square difference was tested to check whether the models were statistically significant for confirming discriminant validity. All χ^2 differences were significant at the $p < 0.01$ level, and the fit indexes for unconstrained models were all better than the constrained models. This indicates that the results were strongly supported by the discriminant validity criterion.

On the basis of the above tests, the results established the construct validity for this study. Once an acceptable measurement model is available, the structural model evaluation may begin.

Hypothesis Testing

To establish congruence with the hypotheses in the proposed model, ATC, SB and PSC were treated as the exogenous variables. The endogenous variable was CA. CI, which included private complaint intention (PCI), voice complaint intention (VCI) and THCI, was the mediating variable. The terms 'exogenous variables' and 'endogenous variables' are synonymous with independent variables and dependent variables, respectively.

If a model fits the data adequately, the *p*-value is evaluated to test the research hypotheses. To assess the overall fit of the model in this study, χ^2, χ^2/df, GFI, AGFI, TLI, CFI, RMSEA were computed. The results (shown in Table 4) demonstrate that the model was in the good fit index, the value of GFI, AGFI, TLI, CFI were all higher than the cutoff point 0.90, RMSEA was lower than 0.08, and χ^2/df was less than 3, higher than 1 (Hair et al., 2006; Kline, 1998). For the sake of clarity, the path diagram and results are shown in Fig. 2 and Table 2.

Overall, the model indicated acceptable fit with the observed data. When the squared multiple correlations were examined, 25 percent of the variance associated with CI was accounted for by its three predictors: ATC, SB and PSC. Accordingly, it was determined that 32 percent of the variation in CA was accounted for by its four predictors, including CI.

Testing the Hypotheses on the Complaint Intention

In this report, a path diagram examined the relationships between ATC, SB, PSC and CI. Table 3 examines the relationship between the independent variables and the CI.

Hypothesis 1a (Table 3) on the effect of ATC on CI was supported ($P = 0.000$, $\beta = 0.292$). Thus, if consumers believed that complaining was

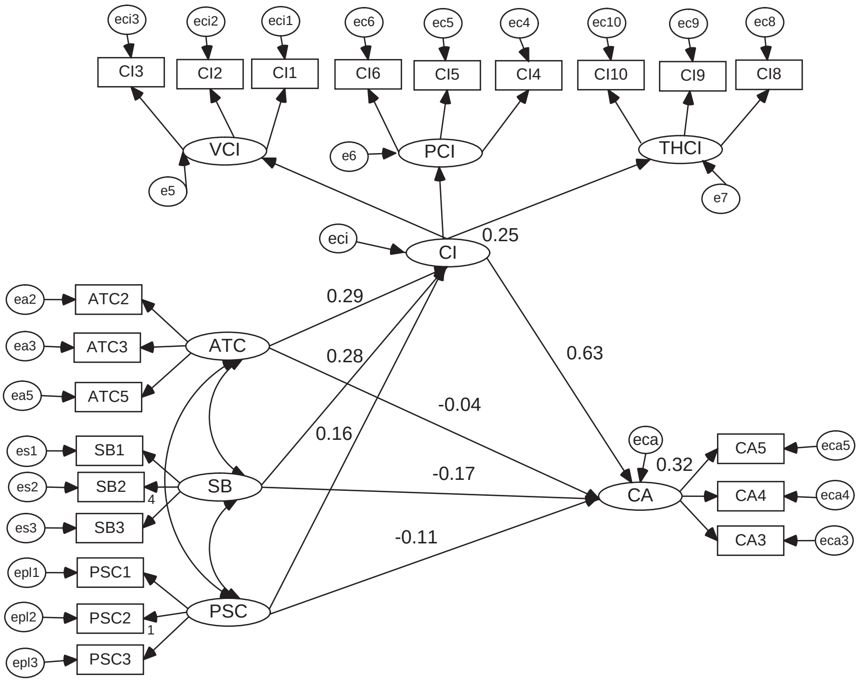

Fig. 2. Structural Equation Modelling on Complaint Behaviour.

Table 2. Model Fit Index on the Structure Model.

Fit Indices	GFI	AGFI	TLI	CFI	RMSEA	χ^2/df	χ^2
	0.943	0.926	0.935	0.946	0.049	2.989	526.093

Table 3. Hypothesis Testing on Complaint Intention.

Hypotheses				β	S.E.	C.R.	P	Support
H1a	CI	←	ATC	0.292	0.046	4.446	0.000***	Yes
H2a	CI	←	SB	0.278	0.04	4.569	0.000***	Yes
H3a	CI	←	PSC	0.159	0.02	3.18	0.001**	Yes

β: standardised regression weight; S.E.: standardised error; C.R.: critical ratio.
***$p<0.001$; **$p< 0.05$.

their duty and responsibility, and they would feel good if they complained about frustration, they would be more likely to make complaints when they were dissatisfied with products or services. This result is consistent with the research by Phau and Sari (2004) on Indonesian complainants.

The results also supported Hypothesis 2a (Table 3) on SB ($p = 0.000$, $\beta = 0.278$), indicating that if consumers believe that complaining about dissatisfied products or services is their responsibility, and making complaints could improve the quality of the products or services in the long run, they would likely intend to complain. This result is consistent with Phau and Sari (2004), Singh (1989) and Kim et al. (2003).

Referring to Hypothesis 3a, the results (again, see Table 3) show that the PSCs significantly influences the CI ($p = 0.000$; $\beta = 0.159$). This result indicates that if consumers have a high probability of success with a complaint, they are more likely to intend to complain. This result is consistent with Singh (1989) and Kim et al. (2003).

In the TPB model, Ajzen (1991) suggests that the more favourable the attitude and subjective norm with respect to behaviour, and the greater the perceived probability of a successful behavioural attempt, the stronger the person's intention to perform the behaviour under consideration. In the present study, the results explain the consistency with TPB, particularly in complaint behaviour. On the contrary, the ATC plays a more important role than the SB and probability of a successful complaint.

Testing the Hypotheses on the Complaint Action

To test the CA hypotheses, ATC, SB and PSC were treated as the independent variables, while CA was used as the dependent variable.

Hypothesis 1b (Table 4) on the influence of ATC on CAs was not supported ($p = 0.422$, $\beta = -0.041$). This indicates that such an attitude would not affect a consumer's CA.

Table 4. Hypothesis Test on Complaint Action.

Hypotheses				β	S.E.	C.R.	P	Support
H1b	CA	←	ATC	−0.041	0.017	−0.803	0.422	No
H2b	CA	←	SB	−0.165	0.015	−3.417	0.000***	Yes
H3b	CA	←	PSC	−0.106	0.007	−2.712	0.007**	Yes
H4	CA	←	CI	0.634	0.047	6.323	0.000***	Yes

β: standardised regression weight; S.E.: standardised error; C.R.: critical ratio.
$^{***}p < 0.001$; $^{**}p < 0.01$.

For Hypothesis 2b (Table 4), SB showed a negative influence on CA ($p = 0.000$, $\beta = -0.165$), which is consistent with the findings of Richins (1982). This can be explained in that Malaysian consumers who believe making a complaint is beneficial for society are less likely to take action against the firm or through a third party because they disagree that making a complaint can eventually improve or remove the faulty product from the marketplace (Richins, 1982).

In testing Hypothesis 3b (Table 4), the probability of a successful complaint shows a negative relationship with the CA towards a third party or a business ($p = 0.007$, $\beta = -0.106$). Thus, apparently consumers still dislike taking CA against firms or through third parties even though they perceive the probability of success with the complaint as high. An explanation is that Malaysian consumers perceive that the chances of satisfying outcomes are poor even if they do complain. This result is consistent with Singh (1989).

Regarding the relationship between intention and action, the results support Hypothesis 4 ($p = 0.000$; $\beta = 0.634$). Once complainers have a strong intention to seek redress, they will definitely take action to get further satisfaction on their problematic products or services from a third party or the business itself. These results confirm the TPB model of Ajzen (1985, 1991) and are consistent with the study by Singh (1988) for CIs and actions.

In TPB, behaviour intention is a central factor in capturing the motivational factors that influence behaviour. Ajzen (1991) suggests that the stronger the intention to engage in the behaviour, the more likely it will be performed. The support of Hypothesis 4 proves Ajzen's (1991) theory. In consumer complaint behaviour, consumers with the intention to make a complaint are shown as more likely to perform that action because standardised regression weight on the CI is higher than the other factors. Ajzen proposes that individuals differ in the relative weight on attitudes and subjective norms, and the weight of the predictor also varies across behaviour. In the current study, SB also played a more important role in TPB (standardised regression weight = 0.165) than the PSC (standardised regression weight = 0.106). Ajzen (1991) argues that the probability of a successful behavioural attempt and behaviour intention directly predict a person's behaviour. The results of this study show that the probability of a successful complaint has a direct effect, although the relationship has a negative influence on the CA. This confirms that TPB can be used in complaint behaviour. However, this study also found a direct effect between SB and CA, a result inconsistent with Ajzen (1991) but consistent with the consumer complaint study of Richins (1982).

Testing Hypotheses on Mediating Effect

The mediating effect is created when a third variable/construct intervenes between two other related constructs, which explains how or why each predictor variable influences the criterion. On the basis of Baron and Kenny (1986), the effects of the factors on the behaviour are mediated by various transformation processes internal to the whole model, which are important in the mediation effect. Ajzen (1985, 1991) has suggested that the mediating role of intention can best be illustrated with respect to the attainment of outcomes. In this research, CI was used as the mediator variable on the complaint behaviour to explain how or why each predictor variable influences the complaint behaviour, such as how or why ATC, SB, and PSC influenced the CA through intention.

For mediation effects, Hair et al. (2006) suggest that the indirect effect of the variable is higher than 0.08. If the *p*-value of independent variable/mediating variable, mediating variable/dependent variable, and independent variable/dependent variable are significant, partial mediating will be proved; if the *p*-values of the independent variable/mediating variable and mediating variable/dependent variable are significant, full mediating will be proved. Table 5 shows the hypotheses on the mediation effect in this study. In line with Hair et al. (2006), the results of the current study supported the hypotheses on the mediation effects.

Regarding Hypothesis 1c, the findings in Table 5 show that the indirect effect of ATC on the CAs was 0.185, which is higher than 0.08, and the *p*-value for ATC and CI, CI and CA, and ATC and CA were all significant. Thus, CI fully mediated the relationship between attitude and action. Following the same procedure, the indirect effect of SB is 0.176 (>0.08) in Table 5, and the *p*-value of SB and CA (direct effect) was significant, indicating that the CI proved the partial mediation on the relationship between SB and CA. Hypothesis 2c was also supported. For Hypothesis 3c, the indirect effect was 0.101 (>0.08), showing the mediation effect. On the

Table 5. Direct and Indirect Effect on the Mediation Variable.

Construct	Direct Effect	Indirect Effect	Total Effect	Hypothesis Supported	Type of Mediation
H1c: ATC→CA	−0.041	0.185	0.145	Yes	Full mediation
H2c: SB→CA	−0.165	0.176	0.011	Yes	Partial mediation
H3c: PSC→CA	−0.106	0.101	−0.005	Yes	Partial mediation

basis of the *p*-value of the direct effect, this study found that CI partially mediated the relationship between PSC and CA, again supporting Hypothesis 3c.

As mentioned earlier, this empirical study has attempted to prove CI as mediating complaint behaviour. The results have shown that the relationship among ATC, SB, PSC and CA is mediated by the CI. These findings indicate that TPB can be applied to consumer complaint behaviour.

DISCUSSION AND LIMITATIONS

Most previous studies on consumer complaint behaviour have focused on the two-group typology, which consists of complainers and non-complainers (Kim et al., 2003; Keng et al., 1995; Phau & Sari, 2004). However, these two categories are less likely to offer specific guidelines in improving complaint handling mechanisms (Singh, 1990). Only Ursic (1985) and Singh (1989) have paid more attention to the THCI. Therefore, this study offers a broader classification: consumers complaining to firms and third parties.

The research reported here has attempted to address some of the present gaps in the literature. In particular, it has applied the TPB to complaint behaviour as a conceptual framework in which diverse research findings can be integrated. The results show that the three major variables in the theory – ATC, SB and PSC – make substantial and significant contributions to the prediction of intention on complaint behaviour, with ATC being more important than SB and probability of complaint success in explaining intention. These findings confirm the results of Singh (1989), Phau and Sari (2004) and Kim et al. (2003). In predicting behaviour, Ajzen (1991) notes that the probability of successful attempt and intention can be used directly in predicting behavioural achievement. However, the data in this study show SB, PSC and CI as having a significant effect. Ajzen (1985) also notes that if a person believes that important referents think he or she should try to engage in a certain behaviour, subjective norms will independently perform that behaviour. Accordingly, it is easy to understand that SB have a direct effect on complaint behaviour in this study.

According to the conceptual framework of planned behaviour from Ajzen (1991), attitude, subjective norms and probability of successful behaviour attempts are hypothesised to influence the target behaviour through effects mediated by behavioural intention. The present study has found that the relationships between ATC, SB, PSC and the CA are all mediated by the CI.

This empirical finding confirms that CI is a mediator in affecting the relationships of ATC/CA, SB/CA and PSC/CA.

Certain limitations of this study should be noted. First, the findings are limited to a specific sample, namely, three shopping malls as well as the National Consumer Complaint Centre and the Tribunal for Consumer Claims in Kuala Lumpur, thereby minimising the generalisability of the results. Further studies are needed to examine the proposed framework in a broader range that might include other third-party complaint agencies such as the Consumers Association and the Tribunal for Consumer Claims in other states.

Second, people from different ethnicity groups may have different attitudes towards complaining. This research studied an ethnicity-based sample of people in the Malaysian population distribution of 50:30:20 (Malays:Chinese:Indians), comprising 395 Malay respondents, 313 Chinese, and 126 Indian respondents. Because the Indian group was so much smaller, this sample size is not an adequate estimation to predict each of the three groups of complainers through various firms, the National Consumer Complaint Centre and the Tribunal for Consumer Claims Malaysia. Thus, future studies should use multi-group analysis with SEM to predict the attitudinal differences on complaint behaviour based on ethnicity.

Finally, the respondents for this study were selected based on complaints to companies, the National Consumer Complaint Centre and the Tribunal for Consumer Claims Malaysia. These three groups of complainers were examined together but their influences were not tested separately. Thus, future studies should consider investigating how various factors may influence different types of CAs differently.

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A COMPARATIVE STUDY OF LOCATION CHOICE FOR OVERSEAS R&D INVESTMENT OF TNCS: AN EMPIRICAL STUDY OF THE UNITED STATES AND JAPAN BASED ON PANEL DATA

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ABSTRACT

Through comparative analysis, this study attempts to uncover the differences and similarities among transnational company (TNC) investments in various host countries. After empirically analyzing the panel data collected from the US and Japanese TNCs' foreign R&D investments, it looks into the influences of the host countries' economies, technologies, and institutional factors on absorbing TNCs' foreign R&D investment from different countries. The host countries' market size and potential are still the main influencing factors in making the choice. The US TNCs focus mainly on host countries' scientific and technological capabilities and potentials, whereas those of Japan are concentrated more on the scientific and technological capabilities and personnel, so as

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to improve R&D. Moreover, the US TNCs show more attention to host countries' intellectual property protection than do those from Japan.

Keywords: TNCs; overseas R&D investment; comparative study; location choice.

Since the implementation of China's reform and opening up policy in 1978, the country has attracted a significant amount of foreign direct investment. In the early 1980s, with insufficient funds and foreign exchange, China was a typical "double-gap" developing country. To solve this fund gap problem, it began to make a series of preferential policies to encourage foreign companies to invest in the country. One such policy was the "two-year exemption and three-year reduction" of income tax, which cut the tax burden on foreign companies to about half that of domestic companies. As a result of such stimulation policies, China has attracted the world's largest amount of foreign investment after the United States, greatly promoting its economic development. Since 1994, China's current account and capital account have realized a surplus every year, and the country has accumulated the world's largest foreign exchange reserves, which exceeded \$1.2 trillion by the end of March 2007. Meanwhile, with an average annual GDP growth rate of 9.6 percent during the past 27 years and a high propensity toward saving, China has a relative surplus in funds.

Now the situation has changed, and the policies made under the "double-gap" period no longer meet the current needs of economic development. Therefore, China needs to adjust and reposition these policies correspondingly. This issue has now become one of attracting high-quality FDI. The main purpose, mission, method, key industries, and regional structure of the utilization of foreign capital will be changed during China's "Eleventh Five-Year Plan" to focus on the introduction of advanced technology, management experience, and high-quality personnel rather than covering the fund and foreign exchange gap.

R&D activities, the source of scientific and technological innovation systems, are one engine of companies' innovation from the perspective of a host country. The development of R&D plays an important role in the economic development of a country or region. The overseas R&D activities of transnational companies (TNCs) could bring a host country not only advanced science and technology but also advanced management experience and scientific and technological talents, which may help it enhance its own technology and innovation capabilities.

This purpose of this chapter is to discuss the similarities and differences among various investment countries' location choice by comparing the overseas R&D investment of the United States and Japan. It is hoped that the discussion of the findings can help develop suggestions for the Chinese government in foreign investment policy making.

LITERATURE REVIEW AND HYPOTHESES

TNCs' R&D Investment and Host Country's Economic Factors

TNCs' overseas development process generally begins with exports, followed by the establishment of overseas production bases, and finally R&D activities. The TNCs have to adapt the products and production processes to some extent to accommodate consumers' preference differences and production technology limitations in the host countries. Therefore, the initial purpose of TNCs' overseas R&D institutions is to support their local production and sales.

Dalton and Serapio (1999) found that the investment motivations for the US R&D abroad and for foreign R&D in the United States are strikingly similar. They range from helping the parent company meet host country customer needs and monitor technological developments, to allowing the firms to take advantage of specialized skills in the host country. The United States and foreign companies primarily conduct applied research abroad.

After analyzing 21 Swedish multinational companies located in 20 countries, Hakanson (1992) found that overseas R&D investment was positively correlated with the number of overseas employees and the volume of overseas acquisitions. The number of Swedish companies' overseas employees positively correlated with local market capacity, and high market capacity encourages locally supportive R&D. Hakanson and Nobel (1993) further studied the 20 largest multinational companies in Switzerland that had set up 150 R&D branches abroad and showed that the main function of R&D branches is to provide technical support to the subsidiaries and adapt the company's main products or production processes to better satisfy the regional markets. Pearce (1999), using material from surveys of multinational enterprise (MNE) production subsidiaries and laboratories operating in the United Kingdom, discerned vital changes in the roles of such R&D facilities. From the primarily tactical and technologically dependent role of adapting established group products for the local market, these labs now take more committed positions in support of their group's strategic competitiveness. This can entail a much more profound involvement in original product development, or inputs into programs of pre-competitive (basic or applied) research to support the longer-term evolution of the MNE group's core technology. Fors (1997) analyzed the data of 149 Swedish MNEs' R&D activities in OECD countries from 1978 to 1990 and found that the most significant motivation of overseas R&D was to achieve local production and adapt to the local special technology. Zejan (1990) found that a subsidiary's R&D intensity is positively correlated with its parent company. Using a TOBIT model, he set out to explain the Swedish multinationals' overseas R&D density and found that the characteristics of the host country, such as market capacity and rate of capital return, had a significant impact on the overseas subsidiary's R&D investment input.

Empirical findings for the US TNCs suggest that they prefer to locate their R&D activities in countries that are able to offer them larger markets, technological resources, and infrastructure, among other things. Host market-oriented affiliates are more likely to have R&D units than the export-oriented ones, especially in developing countries (Kumar, 1996). Odagiri and Yasuda (1996) investigated the determinants of Japanese firms' overseas R&D investments and have indicated that support for local marketing is an important motivation. In addition, support for local manufacturing appears to be important as well, especially in Asia, while access to advanced technological knowledge and R&D resources appears to be an important motivation in the United States and Europe.

Chinese scholars hold very similar views. Mao Yun-shi (2001) maintains that the purpose of MNCs' overseas technology development is either to adapt to local market needs and changes and realize local development, production, and marketing, or to localize the parent company's products to satisfy local consumers' psychological needs and habits. Wei Hou-kai (2004) argues that the most important motivation of MNCs' foreign R&D investment is to enter overseas markets.

Based on the above analyses, the following hypotheses have been developed:

H1a. The greater the capacity of the host country market, the more it will attract market-oriented R&D investment for TNCs to increase the propensity to develop localized products.

H1b. The higher the host country's per capita income, consumer purchasing power, willingness to buy, and market potential, the more market-oriented R&D investment it will attract.

TNCs' R&D Investment and Host Country's Technology Factors

Faced with the emergence of knowledge-based economies and increasingly intense competition in the global market, TNCs are gradually focusing on technology R&D to enhance their competitiveness. Not only do they capitalize on their internal technology around the world to maximize their benefits, but they emphasize continuous technology development to maintain their long-term development and competitiveness. Resources to develop include technical personnel and environmental conditions such as technical infrastructure, laws, and policies necessary to ensure the smooth implementation of R&D activities. With increasingly tough international competition, highly qualified technology talents are badly needed. But the talent training cycle is rather long and the amount and quality of talent is vulnerable to many factors. As a result, a shortage of R&D talents is a common challenge for many countries (particularly some European countries). To overcome this problem, TNCs recruit local personnel in overseas R&D branches to enrich corporate R&D staff resources. Some small developed countries locate their R&D institutions in other countries for the small size of the domestic market and the lack of personnel in the specific field. Whether the host country has scarce technological resources or not has become more and more an important factor in attracting TNCs' R&D investment.

OECD (1998) reported that overseas scientific and technological human resources are the main influencing factor for Japanese TNCs' R&D investment abroad. By establishing local R&D institutions, TNCs can recruit high-level local scientists and engineers and provide an opportunity for those in both the home country and locally to communicate with each other. As a result, home country R&D personnel can be exposed to new ideas, products, and technology and cooperate with the local R&D laboratories. Granstrand, Lakanson, and Sjolande (1993) notes that not only in technology-intensive sectors such as chemical, electronic, and mechanical engineering but even in some machinery sectors, TNCs have established R&D institutions to take full advantage of foreign R&D technology, which implies that utilization of local technological personnel is also an important motive for TNCs' overseas R&D activities.

Technology tracing is one part of R&D activities. Since technology can be attached to products, production equipment, personnel, and other such factors, technology spillovers will occur naturally with the sale of production equipment and products as well as the rotation of scientific and technological personnel. In a survey of the US TNCs, Mansfield (1994) discovered that approximately 60 percent of patents had been imitated by competitors inside 4 years. TNCs establish R&D institutions in technologically advanced foreign countries or competitors' home countries as a foothold and information window to correctly judge the trend of forefront technology development, to understand the dynamics of competitors, to accelerate the pace of new technology development, and to make it convenient for the MNCs to assess the value of the advanced foreign technology and then to purchase it. Olk and Young (1997) analyzed the data from 184 member organizations of the US-based R&D consortia and noted that performance and the conditions of knowledge-related involvement, network ties, learning, and alternatives are related to the decision to stay or leave. Kuemmerle (1999) examined the determinants of FDI in the R&D laboratories of 32 TNCs in the pharmaceutical and electronics industries. The chapter applies a dichotomous set of motives for FDI. Results from an econometric analysis of 136 laboratory investments show that relative market size and strength of a country's science base determine whether FDI in research and development is carried out in order to exploit existing firm-specific advantages, or to build up new ones. This shows that another main purpose of TNCs' overseas R&D investment is to achieve scientific and technological spillover.

Wang (2004) analyzed MNCs' R&D institutions in the United States and points out that the main purposes of overseas R&D investment are to access advanced technology, to seek R&D resources as well as good environments, to occupy the overseas markets, to establish a global R&D network, to realize the systematic investment of TNCs, and to develop a global operation strategy.

Based on the above analysis, the following hypotheses are developed:

H2a. The higher the host country's technological level and spillover, the more technology tracing-oriented R&D investment will be attracted.

H2b. The higher the host country's investment in technical institutions and the technical products' potential to be transferred into productivity, the more technology tracing-oriented and resource acquisition-oriented R&D investment will be attracted.

H2c. The more the host country's technical personnel and the more abundant its technological human resources, the more resource acquisition-oriented R&D investment will be attracted.

H2d. The higher the input-output ratio of the host country's technical personnel, the more resource acquisition-oriented R&D investment will be attracted.

TNCs' R&D Investment and Host Country's Institutional Systems

Institutional factors of a host country have a significant impact on MNCs' overseas investment. The possible economic losses of FDI to be derived from institutional factor changes mainly include nationalization risks, policy and legal risks, and income transfer risks. A market economy is basically a legal institution; whether it has a sound political/legal system or not is an important indicator of a legal society. A sound system provides foreign investors with overall legal protection, which will undoubtedly increase a host country's regional advantage. The stability of the host government, the level of economic freedom, and the protection of private property has a great impact on the choice of overseas investors. One of the business goals of managers is to avoid risks. Therefore, political stability and relatively relaxed investment restrictions of a host country will promote the attraction of foreign investments to some extent. Some studies have found that the location choice of TNCs' overseas R&D investment has increasingly paid attention to a host country's political system (Dalton & Serapio, 1995).

There have been two different views of the influence of intellectual property protection (IPP) on attracting overseas R&D. One is that TNCs' R&D institutions are the main source of their core competitiveness, and TNCs generally prefer to invest in countries where intellectual property is well protected in order to prevent knowledge spillover and violation of company benefits (Mansfield, 1994). The second view is that TNCs' overseas R&D institutions are generally clustered in high-tech areas in the hope of achieving knowledge spillover and follow up or imitate other companies' leading technology. Driven by this motive, TNCs hope that the host country's IPP system has some loopholes in order to get more benefits on the other side (Kumar, 1996).

Thus, the institutional system plays an important role in all investment activities, indicating that the host country's institutional environment influences R&D investment with various purposes. Based on the above analysis, the following hypotheses are developed:

H3a. The higher the political stability of the host country, the more overseas R&D investment will be attracted.

H3b. The higher the economic freedom of the host country and the fewer restrictions to FDI, the more overseas R&D investment will be attracted.

H3c. The higher the level of intellectual property protection of the host country, the more overseas R&D investment will be attracted.

TNCs' R&D Investment and Host Country's Geography-Culture

Geographic proximity benefits the direct control of a TNC's management activities, especially those in R&D. With R&D activities requiring cross-institutional participation and a great deal of investment, geographic proximity can provide a TNC with the convenience of communicating, managing, and coordinating with the subsidies. Hakanson (1992) indicates that besides the market factor, the greater the distance between host and home countries, the less the TNCs' R&D investment. The similarity to a host country's language, culture, and living environment as well as its proximity reduce overseas personnel's living and management costs. Moreover, employees tend to work in regions similar to their home country's environment.

Others point out that environmental and cultural differences between host and home countries result in various consumers' preferences between the two countries. And the main purpose of a TNCs' overseas R&D is to adapt its products to satisfy local market needs. Therefore, the greater the differences between the two countries, the more the R&D investment will be attracted.

Based on the above analysis, the following hypotheses are developed:

H4a. The closer the geographic distance between the home and the host country, TNC will invest more geography-culture-oriented R&D investment.

H4b. The more similar the cultural atmosphere between the home and the host country, TNC will invest more geography-culture-oriented R&D investment.

SAMPLE SOURCE AND CHARACTERISTICS

The United States and Japan were chosen as the sample sources for this comparative study. The data from UNCTAD's *World Investment Report 2005* showed that the US ranks first in R&D investment, with $194.4 billion, accounting for 43.54 percent of the world's total R&D investment. Japan ranked second with $92.3 billion, accounting for 22.88 percent. Together, the two countries claim two-thirds of the world's total R&D investment. Thus, they are representative of this study in terms of total R&D volume.

On the contrary, the US companies started investing in overseas R&D early in the 1980s. In the 1990s, the pace of that investment accelerated so that by 2002 overseas R&D investment accounted for 13.3 percent of the total R&D investment. Meanwhile, Japanese companies started their overseas R&D investment relatively later, mainly through technology licensing transfer. They began to invest on a large scale in 1995; by 2002 their overseas R&D investment accounted for 4 percent of the total. The two countries are at different stages of overseas R&D investment: the United States at a mature stage, Japan in initial development.

We selected the data period for the US overseas R&D investment from 1994 to 2002, as published by the US Bureau of Economic Analysis; the data for Japan's overseas R&D investment was 1995 and 1998–2003, as published by *Japan Statistical Yearbook 2006*. Overseas high-tech investment volume was adapted as Japan's overseas R&D investment measure, for there were no direct data from the source.

As Table 1 indicates, Europe, as a major region, accounts for 68 percent of the total US overseas R&D investment volume, among which Germany, the United Kingdom, and France rank as the top three. American TNCs' R&D investment in Asia has grown rapidly in recent years, especially in Southeast Asian countries, where economies have developed rapidly and technology capability has improved a great deal. Japan is far ahead of other Asian countries in terms of the US R&D investment and has attracted more than half of it, followed by Singapore and China. In North America, due to geographical and cultural proximity, Canada and Mexico have attracted relatively large amounts of the US R&D investment. Overall, developed countries are still the main host countries for the US TNCs' overseas R&D investment.

For Japan, the United States is the main host country for overseas R&D investment, accounting for 57 percent of total volume – far more than any other country's volume. In contrast, Japan's direct investment in the US accounts for only 23 percent of its total international direct investment. This phenomenon could explain that there are significant difference between overseas R&D investment and other kinds of FDI.

Fig. 1 indicates the trend of the US TNCs' overseas R&D investment from 1994 to 2002. The host countries are classified into developed and developing countries by level of development in order to observe if there are

Table 1. Regional Location of the United States and Japanese Holding Subsidiaries' Overseas R&D Investment.

		United States				Japan		
		Number of Country	Investment Volume (mil. Dollars)	Percent		Number of Countries	Investment Volume (mil. Dollars)	Percent
Location region	Europe	15	95,292	0.68	Europe	6	9,041	0.15
	Leading countries	Germany	28,327	0.20	Leading countries	United Kingdom	4,473	0.07
		United Kingdom	27,627	0.20		France	1,414	0.02
		France	12,375	0.09		Germany	1,251	0.02
	Asia and Oceania	9	23,680	0.17	Asia and Oceania	8	16,583	0.28
	Leading countries	Japan	11,893	0.09	Leading counties	China	4,290	0.07
		Singapore	2,774	0.02		Thailand	3,841	0.06
		China	2,153	0.02		Korea	2,840	0.05
	North America and Caribbean	2	17,281	0.12	North America and Caribbean	1	34,344	0.57
	Leading counties	Canada	15,529	0.11	Leading counties	U.S.	34,344	0.57
		Mexico	1,752	0.01				
	South America	3	3,052	0.02	South America	–	–	–
Level of a country's development	Developed counties	20	128,429	0.92	Developed counties	8	128,429	0.61
	Developing counties	9	10,876	0.08	Developing counties	7	16,583	0.39
	Total	29	139,305	1	Total	15	59,968	1

Note: (1) Investment volume of the US refers to the summated amount of R&D investment from 1994 to 2002 published by the US Bureau of Economic Analysis, whereas investment volume of Japan refers to the summated amount of R&D investment in 1992 and during the period of 1998–2003 published by Japan Statistical Yearbook 2006. (2) The countries which are included in Europe are Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, United Kingdom, Norway, and Switzerland. The countries which are included in Asia and Oceania are Australia, New Zealand, Israel, Japan, China, India, the Philippines, South Korea, Singapore, Thailand, and Malaysia. The countries which are included in North America and the Caribbean region are the United States, Canada, and Mexico. The countries which are included in South America are Brazil, Colombia, and Venezuela.

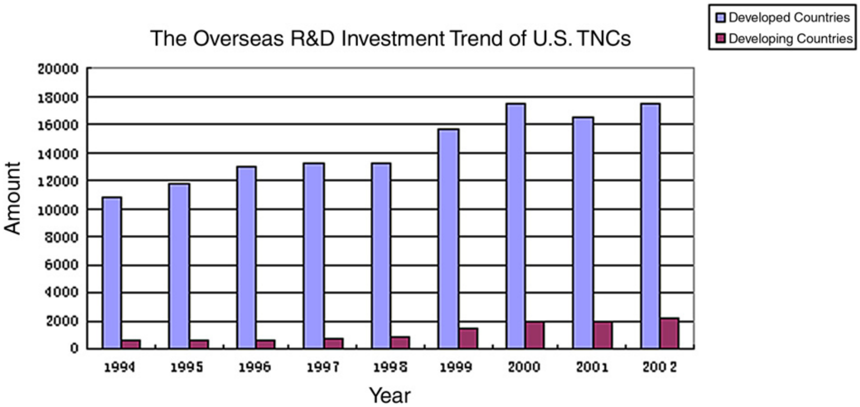

Fig. 1. MNCs' Overseas R&D Investment Trends. Purple: Developed Countries and Red: Developing Countries.

differences regarding overseas R&D investment attraction. With the globalization of the world economy, the US TNCs' R&D investments have increased in both categories, but still focus on developed countries.

MODEL AND EXPLANATION OF VARIABLES

Based on the reviewed literature, the following model has been developed for this study:

$$\begin{aligned}\ln(Y_{it}) = \alpha &+ \beta\beta_1 \ln(\mathrm{GDP}_{it-1}) + \beta_2 \ln(\mathrm{GDPP}_{it-1}) \\ &+ \beta_3 \ln(HTE_{it-1}) + \beta_4\left(\frac{RD}{GDP_{it-1}}\right) + \beta_5 \ln(SCI_{it-1}) \\ &+ \beta_6 \ln(\mathrm{QUA}_{it-1}) + \beta_7 \mathrm{CCR}_{it-1} + \beta_8 \mathrm{FREE}_{it-1} + \beta_9 \mathrm{IPP}_{it-1} \\ &+ \beta_{10} CD_{it-1} + \beta_{11} GD_{it-1} + \mu_{it}\end{aligned}$$

where Y_{it} is the R&D investment volume in each host country for each investing country (i.e. the United States and Japan), and i and t represent different countries and periods, respectively; α_{i} refers to individual effect; and μ_{it} refers to disturbance. Taking the lag-effect of the various factors into account, we have adopted the prior period value of various influencing factors.

When $Y > 0$, the model that uses ln (Y) as a dependent variable is closer to the CLM assumption than the model that uses the level-value of Y as a dependent variable. The conditional distribution of a strictly positive variable often has heteroscedasticity or skewedness, which could be mitigated through the use of the log function to the variables. In addition, the use of the log function would normally narrow the range of variables, which makes the estimated value less sensitive to the abnormal (or extreme) observation of the dependent or independent variable. Therefore, the log functions are used for the variables of Y, GDP, GDPP, HTE, SCI and QUA.

Dependent and Independent Variables

In this model, the dependent variable is the overseas R&D investment volume of the investing country (the United States or Japan). The US R&D investment data from 1994 to 2002 are from the US Bureau of Economic Analysis report, whereas Japan's R&D investment in 1992 and 1998–2003 are from the *Japan Statistical Yearbook 2006*. Based on the developed hypotheses, we selected the host countries' economic, scientific/technical, and institutional environments as independent variables.

Economic environment. GDP and GDPP were used to represent the economic environment of the host country. The historical values of GDP reflect the total economic amount of the host country. With the higher volume of the host country's GDP and the larger volume of the country's total economic activity, it is easier for the host country to attract more overseas R&D investment. As a result, we supposed GDP has a positive influence on overseas R&D investment. GDPP means a country's per capita GDP, which can be used to infer a country or region's per capita consumption level. The higher the value of GDPP, the stronger the purchasing power of the host country's consumers, which drives TNCs to invest more R&D funds to meet local market demand. These data were collected from the *International Statistical Yearbook* 1994 to 2005.

Technical environment. HTE, RD/GDP, SCI, and QUA are used to represent the technical environment of the host country. HTE is the host country's high-tech product exports, reflecting its scientific and technological strengths. TNCs require certain levels of scientific and technological support from the local country when they take on R&D activities. As a result, they tend to locate their R&D institutions in the countries or regions that have high scientific and technological strength to guarantee the smooth progress of scientific research activities in the host country. RD/GDP represents the ratio of the host country's R&D investment to GDP, reflecting that country's perception of technology development and investment intensity. The higher the value, the higher the proportion of the R&D investment in the host country's GDP. We assumed that RD/GDP would have a positive impact on the attraction of TNCs' R&D investment. SCI is the number of the host country's scientists per million people, which reflects the abundance level of the host country's scientific and technical human resources – the major participants in R&D activities. Therefore, areas with abundant resources in this area will facilitate the TNCs establishing overseas R&D labs. Finally, as an index, QUA was developed to reflect the quality of the scientific and technological personnel's output. This index is calculated by dividing the total number of patents by the total number of scientific and technological personnel and further dividing by the total amount of personnel wages. The smaller the value, the lower the input costs of scientific research. This index was expected to have a negative impact on the attraction of the TNCs' R&D investment. These data were collected from the *International Statistical Yearbook* 1994 to 2005 and the World Development Index 1998 to 2005.

Institutional environment. CCR, FREE, and IPP are used to represent the technical environment of the host country. CCR (Country Credit Risk) refers to the credit index of the host country, which reflects the extent of the host country's investment risk. The range of this index score varies from 0 to 100; the higher the score, the better the country's credit and the lower the risk. Data since 1996 were collected from the annual country investment risk data published by *Institutional Investor* magazine. Based on the analysis of each host country's data, we found a stable trend due to the stable political systems in these countries at that stage. As a result, the missing data can be approximately obtained based on the country's trend. FREE refers to economic freedom. Countries with higher degrees of economic freedom have fewer obstacles not only for their economic activities but also for foreign economic activities (including international direct investment). Data were collected from the index published annually by the Heritage Foundation to measure the degree of economic freedom around the world. The index has been transformed into a new score by 6 minus the index, making a score of 5 represent the highest degree of freedom and a score of 1 the lowest. It is expected that the country with the higher degree of freedom will attract more R&D investment, which means the impact of this index on the R&D investment is positive. IPP represents the level of protection the host country affords to intellectual property rights. Obtained from the US Trade Representative's annual Special 301 Report (2004, 2005), this index has a range score that varies from 0 to 5; the higher the score, the better the country protects intellectual property rights.

Control variable. Because the geography-cultural environment could not easily be changed, it is treated as a control variable. CD and GD are used to represent this environment of the host country. CD (Culture Distance) refers to cultural differences. Based on Hofstede's cultural dimensions, the following equation was used to calculate the value of CD:

$$\mathrm{CD}_j = \sum_{i=1}^{4} \frac{\{(I_{ij} - I_{iu})^2 / V_i\}}{4}$$

where CD_j refers to the cultural difference between the jth country and the investment country; I_{ij} refers to the index of the ith cultural variable of the jth country's; V_i refers to the ith cultural variables' variance; and u represents the investment country. GD refers to the geographical distance between the host and home country. We assumed that if the host country is a neighbor to the home country, GD = 0; if both countries are in the same continent, GD = 1; if both are not in the same continent, GD = 2. We assumed that the greater the GD, the less TNCs' investment would be attracted to that country.

Table 2 summarizes the above hypotheses and the related variables, whereas Table 3 shows the variables' descriptive characteristics.

DISCUSSION

First, to understand the factors influencing TNCs' overseas R&D location choice, regression analyses were implemented for the sample of the United States and Japan, respectively. Then the host countries were classified into developed and developing countries based on the different level of the development of each, and regression analyses were implemented, respectively, to observe how different levels of development influence the TNCs' overseas R&D investment. In addition, because of relatively high correlation effects between some variables, a sub-variable estimation method was used to avoid the multicollinearity problems.

Factors Influencing the Overseas R&D Location Choice: The United States

Table 4 indicates the regression results of the total US sample. GDP and GDPP were significant at the 1 percent level. The regression coefficients were 0.9037 and 0.8096, respectively, which means that a 1 percent increase in the host country's GDP will increase 0.90 percent of the host country's

Table 2. Summary of the Hypotheses and Related Variables.

	Variable Index	Expected Influence
Hypothesis 1a	GDP	+
Hypothesis 1b	GDPP	+
Hypothesis 2a	HTE	+
Hypothesis 2b	RD/GDP	+
Hypothesis 2c	SCI	+
Hypothesis 2d	QUA	−
Hypothesis 3a	CCR	+
Hypothesis 3b	FREE	+
Hypothesis 3c	IPP	+
Hypothesis 4a	CD	+
Hypothesis 4b	GD	−

Table 3. Descriptive Characteristics of the Variables.

	Mean	Standard Error
LN(GDP)	8.01	1.12
LN(GDPP)	9.34	1.20
LN(HTE)	9.17	1.73
RD/GDP	1.66	1.05
LN(SCI)	7.35	1.36
LN(QUA)	1.07	0.25
CCR	72.36	18.46
FREE	3.49	0.60
IPP	4.3	0.87
CD	1.61	2.01
GD	0.13	0.25

overseas R&D investment, while a 1 percent increase in the host country's GDPP will increase 0.81 percent. That is to say, the TNCs' overseas R&D investments tend to flow into the countries with high economic volume. As a result, H1a and H1b have been verified, indicating that adapting to the host country's market needs is one of the major motives of TNCs' overseas R&D investment if the host country has enough market capacity and consumption potential (Mariani, 2002).

Four indicators reflecting the host country's scientific and technological factors were significant, with the HTE, RD/GDP, and SCI at a 1 percent significant level and QUA at a 10 percent significant level. Capitalizing on the host country's scientific and technological human resources has been

Table 4. Regression Results of the Host Country's Environment to Overseas R&D Investment (Total, US).

	Economic Factor	Technological Factor		Institutional Factor		
LN(GDP)	0.9037***			1.0950***	1.0676***	0.8559***
	(6.42)			(8.13)	(8.11)	(5.98)
LN(GDPP)	0.8096***					
	(5.09)					
LN(HTE)		0.2843***	0.3116***			
		(2.54)	(2.51)			
RD/GDP		0.5060***				
		(3.84)				
LN(SCI)			1.008***			
			(5.03)			
LN(QUA)		−2.0202**	−1.5016*			
		(−2.20)	(−1.65)			
CCR						0.0441***
						(5.80)
IPP				−0.0171	−0.0090	−0.0472
				(−0.22)	(−0.12)	(−0.63)
FREE					1.2094***	
					(5.74)	
CD	−0.0123	Dropped	Dropped	−0.0084	−0.0329	−0.0030
	(−0.12)			(−0.08)	(−0.34)	(−0.03)
GD	0.9698	Dropped	Dropped	0.7724	0.9033	1.1096
	(1.23)			(1.00)	(1.17)	(1.33)
Constant term	−9.7993***	1.8387*	−5.0533***	−5.0712***	−7.5809***	−4.89994***
	(−5.73)	(1.81)	(−2.83)	(−3.94)	(−5.48)	(−3.92)
In subgroup R^2	0.1767	0.1037	0.1409	0.1264	0.1899	0.2118
Total R^2	0.6330	0.2719	0.2479	0.6332	0.6584	0.6060
Hausman test value	9.55	13.56	21.57	4.80	0.66	1.34
Model	RE	FE	FE	RE	RE	RE
Value of F test		8.83***	17.28***			
Wald chi(2)	101.85***			87.82***	111.70***	106.98***
N	261	261	261	261	261	261
Group	29	29	29	29	29	29

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%, and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

popular in TNCs' overseas R&D investment. Its abundant reserves and high-quality personnel attract TNC investment. As Table 4 illustrates, a 1 percent increase in the host country's scientific and technological personnel will increase about 1 percent of the overseas R&D investment, whereas a 1 percent decrease in the host country's scientific output cost will increase about 1.5 percent of the overseas R&D investment. Therefore, the host country's technological level and R&D input significantly influence TNC R&D investment, and H2a, H2b, H2c, and H2d were verified.

CCR, which reflects the host country's investment risk, and FREE, which reflects economic freedom, were significant at a 1 percent level. The regression coefficients were 0.0441 and 1.2094, respectively. The host country's institutional factors have great influence on TNCs' R&D investment, especially economic freedom, where a 1 percent increase will mean a 1.21 percent in the investment. Therefore, H3a and H3b were supported. IPP tested as not significant, thus failing to verify H3c; this is consistent with the Kumar (1996) and Mansfield (1994) findings. It should be noted that although the protection of intellectual property has no significant influence on overseas R&D attraction, strengthening it reflects the host government's respect for the knowledge and will finally boost overseas investment confidence.

CD and GD, which reflected the geography-cultural factors, did not pass the significance test. As we expected, these factors influence the R&D investment in the opposite directions, which counteract with each other. So the total impact of the results appears to have no fixed rules.

Differential Analysis of the Developed and Developing Host Countries' Environment: From the Investing Country's Perspective (United States)

We classified the host countries into developed and developing countries according to level of development. We then regressed the two categories, respectively, to find the differences. Tables 5 and 6 indicate these regression results.

First, we observed how the economic factors of the developed and developing countries differently influence overseas R&D investment. GDP and GDPP tested significant at 1 percent level in both categories, which illustrates that the host country's total economic volume – its market capacity – has a positive impact on the investment. One of the main functions of overseas R&D activities is to adapt products to satisfy the host country's market demand.

Table 5. Regression Results of the Host Country's Environment to Overseas R&D Investment (Developed Host Country, United States).

	Economic Factor	Technological Factor		Institutional Factor
LN(GDP)	0.4283***			0.4467***
	(2.74)			(3.13)
LN(GDPP)	1.6680***			
	(4.15)			
LN(HTE)			0.2083**	
			(1.66)	
RD/GDP		0.2737***	0.3859***	
		(2.72)	(3.89)	
LN(SCI)		0.1941	0.1036	
		(1.00)	(0.52)	
LN(QUA)		−9.2642***		
		(3.88)		
CCR				0.0339***
				(3.73)
IPP				−0.1053*
				(−1.79)
FREE				0.6671**
				(2.47)
CD	0.1156	Dropped	Dropped	0.0747
	(0.94)			(0.59)
GD	1.8732	Dropped	Dropped	1.6174
	(1.51)			(1.26)
Constant term	−15.4784***	4.3928	1.9168	1.001
	(−4.04)	(2.90)	(0.92)	(0.59)
In subgroup R^2	0.1323	0.1767	0.1131	0.2492
Total R^2	0.5396	0.5739	0.5438	0.5467
Hausman test value	7.30	26.13	27.48	1.37
Model	RE	FE	FE	RE
Value of F test		11.23***	6.68***	
Wald chi(2)	46.60***			71.16***
N	180	180	180	180
Group	20	20	20	20

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%, and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

Table 6. Regression Results of the Host Country's Environment to the Overseas R&D Investment (Developing Host Country, USA).

	Economic Factor	Technological Factor		Institutional Factor
LN(GDP)	1.2929***			1.2234***
	(4.42)			(3.97)
LN(GDPP)	0.9363***			
	(3.33)			
LN(HTE)		0.2643**	0.1760**	
		(1.30)	(0.92)	
RD/GDP		3.2351***		
		(3.99)		
LN(SCI)			2.2304***	
			(5.40)	
LN(QUA)		−1.5720	−0.8915	
		(−1.18)	(−0.67)	
CCR				0.0683***
				(3.19)
IPP				0.4018***
				(2.60)
FREE				0.5785**
				(2.19)
CD	0.1802	Dropped	Dropped	0.1532
	(0.57)			(0.32)
GD	−0.5612	Dropped	Dropped	0.7709
	(−0.40)			(0.40)
Constant term	−14.6687***	−1.0562	−10.7104***	−5.6969
	(−3.18)	(−0.59)	(−3.94)	(−1.36)
In subgroup R^2	0.2957	0.2211	0.3264	0.2250
Total R^2	0.5010	0.1646	0.2584	0.2866
Hausman test value	5.28	8.36	13.39	2.21
Model	RE	FE	FE	RE
Value of F test		12.21***	11.14***	
Wald chi(2)	34.27***			17.45***
N	81	81	81	81
Group	9	9	9	9

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%, and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

Second, scientific and technological factors influences were compared. Four indicators reflecting these factors were verified as significant at the 1 percent level in both categories, illustrating that the host country's technological situation plays an important role in overseas R&D investment. Specifically, developed countries' QUA indicator was -9.2642 (absolute value is higher than that of developing countries) and -1.5720 (developing countries' RD/GDP and SCI indicators are higher than those of developed countries). It can be explained that one of the main purposes of a TNC's overseas R&D location choice is to obtain knowledge spillover and trace the advanced technologies in developed countries and to benefit from the low-cost scientific and technological personnel in developing countries. Therefore, TNCs focus on the host country's scientific and technological personnel quality and level of national science and technology in developed countries as well as the number of such personnel and amount of such inputs in developing countries.

Finally, as far as the institutional factor is concerned, the coefficients of the two country categories were basically the same. The country credit risk indicator (CCR) and economic freedom indicator (FREE) had a significant effect on R&D investment. An open economic system is favorable for such investment. There are different views on the impact of IPP for TNCs' overseas R&D affiliates establishment. As Tables 5 and 6 indicate, the protection of intellectual property rights in developed countries had a negatively correlated 10 percent significant level, compared to 5 percent in for developing countries. How does one explain this phenomenon? When the US TNCs establish their R&D institutions in developed countries, they pursue advanced science and technology through technology spillover to enhance their strength in that area. This requires relatively loose knowledge protection. And when they invest in developing countries, they focus on the adaptation of the products as well as the establishment of new ones and a new technology research base. Moreover, the level of TNCs' technology is at the maturity stage, so they try to prevent the disclosure of technology. But as IPP in developing countries is relatively poor, the US multinationals generally require developing countries to improve that protection.

Factors influencing the Overseas R&D Location Choice: Japan

Table 7 shows the regression results of Japan's total sample. GDP and GDPP (host country's economic volume) were significant at 1 and 5 percent levels, respectively. Once again, a primary overseas R&D investment – adapting products to the host country market – was verified. TNCs' overseas R&D investment was proven to be market-oriented.

Among the technological factors, abundance of the host country's scientific and technological human resources and the input–output ratio of the personnel capability tested significant, whereas the RD/GDP indicator reflecting input did not. Finally, CCR and FREE were significant at a 1 percent level, meaning the coefficient of the protection of intellectual property rights indicator was negative, failing the test of significance.

Differential Analysis of the Developed and Developing Host Countries' Environment: From the Investing Country's Perspective (Japan)

Classifying the host countries into developed and developing countries by level of development, we regressed the two categories respectively to find the differences (Tables 7–9). The explanations are summarized in the following section.

SUMMARY OF THE COMPARATIVE ANALYSIS

Differential Influence of the Developed and Developing Host Country on Overseas R&D Investment

The economic factor representing the host country market environment influences TNCs' overseas R&D investment in the same direction in the two types of countries significantly. Wherever the TNCs invest, they have the consistent main purpose to occupy the market.

Technological factors' influence on R&D investment in the two types of countries is not the same in some aspects. HTE significantly influences investment in the same direction in both types of countries. The R&D function requires high levels of the host country's scientific and technological strength, regardless of whether it is product adaptation or technology tracking. When investing overseas, Japanese TNCs are sensitive to the abundance of the scientific and technological human resources in developed countries and low personnel costs in developing countries. This phenomenon implies that overseas R&D investment of Japanese TNCs is in the initial stage. They are mainly engaged in new technology development and science and technology tracking in the developed countries and product improvement in the developing countries.

Table 7. Regression Results of the Host country's Environment to Overseas R&D Investment (Total, Japan).

	Economic Factor	Technological Factor		Institutional Factor		
LN(GDP)	0.8558***			0.9248***	0.7873***	0.9552***
	(5.56)			(6.06)	(5.09)	(6.68)
LN(GDPP)	0.4387**					
	(2.35)					
LN(THE)		0.3710***	0.3059***			
		(3.35)	(2.73)			
RD/GDP		−0.3964				
		(−0.22)				
LN(SCI)			0.2462**			
			(2.40)			
LN(QUA)		−0.0269***	−0.0228**			
		(−3.02)	(−2.46)			
CCR					0.0326***	
					(2.91)	
IPP					−0.1335	−0.0634
					(−1.39)	(−0.70)
FREE						0.7845***
						(3.74)
CD	−0.1047	−0.0772	−0.0342	−0.1048	−0.1054	−0.1253
	(−1.01)	(−0.87)	(−0.35)	(−0.99)	(−1.04)	(−1.31)
GD	−1.4468***	−0.5314	−0.7360**	−1.2329***	−0.9582**	−1.2547***
	(−4.60)	(−2.64)	(−3.14)	(−4.38)	(−2.46)	(−4.96)
Constant term	−3.7278**	2.4919*	1.2593	−1.4820	−1.1217	1.5647
	(−1.93)	(1.86)	(0.81)	(−1.01)	(−0.76)	(1.08)
In subgroup R^2	0.2442	0.0269	0.0737	0.2279	0.2722	0.2886
Total R^2	0.6204	0.7100	0.36392	0.6127	0.5943	0.6819
Hausman test value	3.93	9.96	5.17	2.16	0.12	3.43
Model	RE	RE	RE	RE	RE	RE
Value of F test						
Wald chi(2)	46.04***	33.84***	32.52***	43.17***	50.78***	59.22**
N	105	105	105	105	105	105
Group	15	15	15	15	15	15

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%,and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

Table 8. Regression Results of the Host Country's Environment to Overseas R&D Investment (Developed Host Country, Japan).

	Economic Factor	Technological Factor		Institutional Factor		
LN(GDP)	1.0839***			1.0196***	1.0380***	1.1683***
	(4.04)			(4.43)	(9.59)	(13.26)
LN(GDPP)	0.5422***					
	(0.77)					
LN(HTE)		1.1325***	1.4840***			
		(4.26)	(5.53)			
RD/GDP		−0.2156				
		(−0.81)				
LN(SCI)			1.2132***			
			(2.46)			
LN(QUA)		−0.0077				
		(−0.46)				
CCR				0.0747***	0.0543***	
				(4.00)	(2.95)	
IPP						0.2270
						(1.04)
FREE					1.1187***	1.8138***
					(2.96)	(1.27)
CD	−0.1272	−0.0029	−0.0093	−0.0625	−0.1113**	−0.0861
	(−0.96)	(−0.05)	(−0.09)	(−0.51)	(−2.28)	(−0.30)
GD	−0.7493	−2.5208***	−1.4530**	−1.1021	−0.8298***	−1.3826
	(−0.99)	(−3.48)	(−2.40)	(−1.58)	(−2.81)	(−0.88)
Constant term	−8.0161	−1.4692	−7.8872*	−8.6746***	−4.5644	8.6137**
	(−1.15)	(−0.74)	(−1.67)	(−2.63)	(−2.33)	(2.04)
In subgroup R^2	0.1554	0.0068	0.0597	0.3659	0.3326	0.1361
Total R^2	0.8006	0.8466	0.7201	0.8440	0.8902	0.9022
Hausman test value	0.11	8.70	6.31	0.88	0.21	0.01
Model	RE	RE	RE	RE	RE	RE
Value of F test						
Wald chi(2)	26.11***	215.33**	26.38***	48.76***	190.1***	248.47***
N	56	56	56	56	56	56
Group	8	8	8	8	8	8

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%, and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

Table 9. Regression Results of the Host Country's Environment to Overseas R&D Investment (Developing Host Country, Japan).

	Economic Factor	Technological Factor		Institutional Factor			
LN(GDP)	0.7629***				0.8658***	0.7189***	1.0278***
	(3.31)				(3.68)	(2.54)	(4.74)
LN(GDPP)	0.5802***			0.6323***			
	(2.58)			(2.63)			
LN(HTE)		0.5112**	0.4124***				
		(3.77)	(2.87)				
RD/GDP		−0.0874					
		(−0.43)					
LN(SCI)			0.2584				
			(1.13)				
LN(QUA)		−2.4118**	−2.3850**				
		(−2.56)	(−2.58)				
CCR						0.0226*	
						(1.65)	
IPP				−0.2524**			
				(−2.44)			
FREE							0.9008**
							(3.67)
CD	0.0096	Dropped	Dropped	0.1369	0.0155	−0.0180	−0.1036
	(0.04)			(0.55)	(0.06)	(−0.08)	(−0.52)
Constant term	−4.8910*	1.2911	0.0987	0.4994	−2.3487	5.4994***	1.0263
	(−1.61)	(0.98)	(0.05)	(0.16)	(−0.89)	(2.59)	(0.54)
In subgroup R^2	0.3793	0.3516	0.3690	0.3176	0.3642	0.3368	0.4401
Total R^2	0.2912	0.0080	0.0030	0.0940	0.1590	0.2177	0.3807
Hausman test value	8.81	14.57	17.94	4.37	5.54	0.07	0.93
Model	RE	FE	FE	RE	RE	RE	RE
Value of F test							
Wald chi(2)	21.11***	7.05***	7.60***	15.67***	18***	10.77***	29.51***
N	49	49	49		49	49	49
Group	7	7	7		7	7	7

Note: (1) Statistical software stata8.0 is used to obtain the results. (2) Numbers in the parentheses are T values with the fixed effect and Z values with the random effects. ***, **, * refer to 1%, 5%, and 10% significant level, respectively. (3) FE and RE represent the fixed effect model and the random effect model, respectively. A fixed effect model is chosen if the Hausman test is significant at 1% level.

With regard to the institutional factor, CCR and FREE have a significant influence on the TNCs' overseas R&D investment in both types of countries. IPP has no significant influence on investment in developed countries, but a negative influence in developing countries at the 1 percent level. That is, developing countries with lower levels of intellectual property protection appear to attract more Japanese R&D investment. The possible explanation for this result is that China holds a large share of Japanese R&D developing country investment with a score that is relatively low, based on Section 301 of the US Trade Act. After separating China's data, a negative coefficient is achieved, which is not significant. Japanese TNCs' overseas R&D investment is in the initial stage and the R&D activities in the developing countries are mainly product improvement, which results in a relatively low cost of technical disclosure.

Comparative Analysis of the US and Japan's Overseas R&D Investment

Table 10 compares the similarities and differences between the two countries' overseas investment location decisions. These are summarized as follows:

(1) Market factors, such as total volume of economy and market potential, are the main consideration for TNCs investing in overseas R&D activities. Therefore, market development-oriented R&D investment is still the focus, whatever the investing country is.
(2) Host country technology level influences overseas R&D investment significantly. Technology tracking-oriented R&D is one important investment motive for the TNCs.
(3) A host country's political stability and economic freedom play a protective role in attracting overseas R&D investment. For the host country, it could reduce TNCs' overseas investment risk to some extent. As a result, such corporations are inclined to establish R&D institutions in a stable country. If the host country provides a free economic environment and less government control on foreign investment, it will easily attract the investment. Therefore, regardless of investing country, institutional factors play a significant role in R&D investment.

The differences between the location decisions are summarized as follows:

(1) The host country's R&D potential has a significant influence on the US investment, both in developed and developing countries, at a 1 percent significance level, but none for the Japanese TNCs.
(2) The host country's bundance of scientific and technological human resources has a significant influence for the United States in developing countries at a 1 percent significance level, and a significant influence for Japan in developed countries at the same level.

Table 10. Summary of the Regression Results.

		United States			Japan		
		Total	Developed Country	Developing Country	Total	Developed Country	Developing Country
Economic factor	GDP	0.9037 ***	0.4283***	1.2929***	0.8558***	1.0839***	0.7629***
	GDPP	0.8096***	1.6680***	0.9363***	0.4387**	0.5422***	0.5802***
Technological factor	HTE	0.3116***	0.2083*	0.2643**	0.3710***	1.4840***	0.5112***
	RD/GDP	0.5060***	0.3859***	3.2351***	−0.3964	−0.2156	−0.0874
	SCI	1.0008***	0.1036	2.2304***	0.2462**	1.2132***	0.2584
	QUA	−2.0202**	−9.2642***	−1.572	−0.0228**	−0.0077	−2.4118**
Institutional factor	CCR	0.0441***	0.0339***	0.0683***	0.0326***	0.0747***	0.0226*
	FREE	1.2094***	0.6671**	0.5785**	0.7845***	1.8138***	0.9008**
	IPP	−0.0171	−0.1053*	0.4018**	−0.1335	0.2270	−0.2876

(3) The host country's high-quality, low-cost technical human resources significantly influence the US for developed countries at 1 percent significance, while for Japan the same holds in developing countries but at a 5 percent significance level.
(4) IPP has a significant negative influence for the United States in developed countries at 10 percent significance, compared to 5 percent in developing countries, but no significant influence for Japanese, as discussed earlier.

CONCLUSION AND IMPLICATIONS

Differences between TNCs' overseas R&D investments can be explained as a concurrent effect of the development level of enterprises, strategic objectives, and preferences. Such investment from relatively sophisticated investors, such as American companies, has entered a relatively complete multilevel stage. Besides market occupation, technology tracking and resource acquisition have gradually become the main purposes of these TNCs' overseas R&D activities. TNCs establish a global R&D system in countries with competitive advantages to implement their global development strategy. Some developing countries also participate in the new product and/or new technology development system. In this stage, TNCs invest abroad to capitalize on the advanced scientific and technological resources of a developed country (Kumar, 1996) and to use the low-cost scientific and technological resources of developing countries to reduce R&D costs (Cantwell, 1999). Because TNCs' overseas R&D activities in developed countries are technology tracking-oriented to some extent, they expect relatively loose intellectual property protection. On the other side, even though TNCs' overseas R&D activities in developing countries are oriented toward resource acquisition to some extent, they are basically market share-oriented. As a result, TNCs tend to prefer developing countries, with their better protection of intellectual property rights, to prevent technology spillover.

Investing countries in the initial stage of overseas R&D investment, such as Japan, lack enough experience with complete system. Therefore, their overseas R&D institutions are generally engaged in product improvement (Kumar, 2001). Although such institutions in developed countries have the purpose of technology tracking, most of their activities are focused on implementing market improvement. Therefore, they require a certain number of technical personnel, but seldom implement new technology and product development with R&D affiliates in developing countries. Because these are mainly market-oriented instead of new product and technology-oriented, they require relatively lax IPP.

MANAGERIAL IMPLICATIONS AND SUGGESTIONS

The following presents several managerial implications and suggestions for TNCs intending to invest R&D in China.

(1) Overseas R&D investment strategies vary with development stage, motivation, industry investment focus, preferences, and development level of the host countries. Therefore, governments should rethink a unified policy to all kinds of investment and design differentiated policies based on the investing companies' industry characteristics and country of origin.
(2) Chinese foreign investment and trade policies legislated in the early reform and opening-up period, with its "double-gap" circumstances, have played an important role in the country's economic development. Now conditions have changed a lot, so the policies should be adjusted and repositioned accordingly. With regard to encouraging industries

and technology, preferential policies toward foreign investment could still be offered as long as industry access and high-tech standards are set up. Governments could set up several sub-departments responsible for each investing country group classified by the investing countries' preferences and development level. By doing so, the investing countries might be satisfied with the diversified policies.

(3) TNCs' R&D investment volume and type are closely related to the host country's scientific and technological strength. If the host country has enough resources in this regard, it will attract more R&D input and innovative research. Therefore, the strengthening of enterprises' overall scientific and technological capacity will improve the quality of foreign investment.

(4) Companies purposely delay technical improvements in order to capitalize fully on current technology to maximize their profits. If there is not enough competition, companies lack the motives to invest in R&D, which curbs the host country's R&D vitality. Therefore, it is necessary to attract several high-level TNCs to participate in market competition in order to avoid a market monopoly.

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CROSS-CULTURAL COMMUNICATION: EAST VS. WEST

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ABSTRACT

Relying on data collected from in-depth interviews and participant observation, as well as secondary data, this chapter compares the cross-cultural communication processes between easterners and westerners in an Asian cultural context, namely, that of Taiwan, as well as the potential influences of Confucianism and the theory of "manners of different orders." Our data reveal that westerners tend to communicate with Taiwanese people in an outspoken and brusque way and to make few changes during the communication process. On the contrary, easterners are inclined to communicate with a gentler approach and make adjustments for the local culture. We also find that Confucianism and the theory of manners of different orders have strong influences on cross-cultural communication strategies and performance. This chapter provides evidence to support the arguments that the theory of manners of different orders may play an even more significant role than the individualism–collectivism paradigm in explaining the causes of better communicational performance in Taiwan and possibly mainland China.

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Implications, limitations, and suggestions for future research are provided based on these findings.

Keywords: Cross-cultural communication; Taiwan; Confucianism; manners of different orders; individualism-collectivism.

INTRODUCTION

Cultural diversity has changed the dynamics of the workplace and managers must interact frequently with international suppliers and customers (Smeltzer, 1996). Although a number of covert and complicated issues are involved in managing an encounter with another culture, one of the most conspicuous problems takes place in communication (Knotts & Thibodeaux, 1992). Furthermore, many companies are currently developing alliances across cultures that require specialized communication because these alliances often involve companies from a multiplicity of cultures (Smeltzer, 1996).

All these facts underline the importance of cross-cultural communication. Given the dramatic differences in their communication patterns (Hall, 1976; Hall & Hall, 1990; Kalliny, Cruthirds, & Minor, 2006; Vuckovic, 2008), people from different cultural backgrounds frequently encounter communication problems. Many scholars often employ the individualism–collectivism paradigm to investigate differences between eastern and western societies. Mainland China and Taiwan, labeled as collectivistic societies, are viewed as aiming at upholding social harmony mainly by giving priority to the goals of the ingroup over those of the individual. Furthermore, this broad classification has led to the general conclusion that collectivistic societies are inclined to utilize an implicit or indirect approach of communication whereas individualistic societies tend to employ an explicit or direct form of communication (Chang & Holt, 1991; Yum, 1988). Similar distinctions can be found between restricted and elaborated codes (Bernstein, 1971), as well as between high-context and low-context cultures (Hall, 1976).

It is doubtful that this individualism–collectivism paradigm can fully explain differences in cross-cultural communication (Chang & Holt, 1991). For example, Chang and Holt (1991) argue that it is not collectivism but manners of different orders (Fei, 1948) that determine Chinese styles of communication. Another issue that is not clear from the literature but essential for international marketers is the differences in cross-cultural communication processes between people from eastern and western societies. Given that communication is not only cultural context bound, but is also a social process (Gefen, Geri, & Paravastu, 2007), it is beneficial both in theory and in practice to examine the cross-cultural communication process. Furthermore, eastern society is rarely used as a cultural context to investigate how foreigners from both eastern and western societies interact with local people. To address these issues and to take a closer look at the way cross-cultural communication takes place, we have examined the communication processes of westerners (e.g., those from Germany, Ireland, and the United States) and easterners (e.g., those from Japan, Mongolia, and South Korea) when they interact with local people in Taiwan, as well as the potential influences of Confucianism and the theory of manners of different orders.

To summarize our contributions, we found that westerners tended to communicate with the Taiwanese in an outspoken and brusque way and made few changes during the communication process. On the contrary, easterners were inclined to communicate with a gentler approach and to make adjustments for the local culture. We also found that Confucianism and the theory of manners of different orders had a strong influence on cross-cultural communication strategies and performance. The argument was also supported that the theory of manners of different orders may play an even more significant role than the individualism–collectivism paradigm in explaining the causes of better communicational performance in Taiwan and possibly mainland China. Furthermore, although Taiwan is often labeled as a collectivistic society and a high-context culture with restricted codes, our findings support the argument that the Taiwanese, along with the Japanese and South Koreans, are quite capable of elaborating their verbal messages according to the social position of the target person.

The rest of this chapter is organized as follows. First, the relevant literature is reviewed, and this is followed by an introduction to the methodology used. We then analyze the data and discuss their theoretical and managerial implications. Limitations and suggestions for future research are also presented.

LITERATURE REVIEW

Communication is not only an exchange of words but also a social process. As such, it is imbued with a social meaning of inclusion, exclusion, and social hierarchy (Gefen, Geri, & Paravastu, 2007). Deaux (1984) and Deschamps (1982) also suggest that communication involves not only information but also a strong social message, which is interpreted or misinterpreted within the cultural context of the speaker and the listeners. Consequently, communication can only be understood within specific cultural contexts.

Culture and Communication

Hall (1976) describes societies as high- or low-context societies in terms of the importance of the communication message elements involved in providing meanings. In high-context cultures, very little information is involved in the coded message because most information is shared by the members of a society. In contrast, a mass of information can be embedded explicitly in the communication messages of low-context cultures. Hall and Hall (1990) describe the United States, Germany, and northern European countries as low-context cultures, and Korea, Japan, Taiwan, China, and southern European countries as high-context cultures. Gudykunst and Kim (1984) suggest that this paradigm is equivalent to Bernstein's (1971) conceptualization of restricted and elaborated codes when it comes to the notion of communication patterns.

A similar paradigm, individualism–collectivism, is also widely used to differentiate communication preferences of different cultural categories. For example, researchers often claim that people in collectivistic societies tend to adopt an implicit or indirect form of communication whereas those in individualistic societies are inclined to utilize an explicit or direct form of communication (Yum, 1988).

Although these broad categorizations are useful for making cross-cultural comparisons and generalizations, they may not provide much help when it comes to understanding the causes of communication patterns and offering specific guidelines for better communicational performance. Furthermore, these paradigms and their general conclusions have been challenged by scholars (Chang & Holt, 1991; Yau, 2006).

First, the individualism–collectivism paradigm may not be suitable for studying Chinese or Taiwanese people (Chang & Holt, 1991; Yau, 2006). The well-known influence of Confucian philosophy on Chinese society and its emphasis on maintaining a stable and harmonious society may give us an impression that Chinese people always sacrifice personal interests for the benefit of society. This impression would thus make it a collectivistic society as classified by Hofstede (1980, 1984) and others. However, the concept of collectivism does not exist among the Chinese (Yau, 2006), so that this paradigm may lose its content or face validity when it is used to investigate the communication patterns among them. Chang and Holt's

(1991) empirical study conducted in Taiwan also concludes that it is not collectivism, but manners of different orders that determined the functioning of interpersonal relations (*guanxi*) and communication patterns.

The theory of manners of different orders, proposed by Fei (1948), compares the evolution of one's interpersonal relationships to a stone cast into the water that creates ripples from the center moving outward. The innermost ripples signify those ripples closest to the social actor, with different levels of the ripple effect representing different degrees of obligation and intimacy. According to the theory of manners of different orders, the individual is the self-created center of an ever-augmenting set of relationship "circles"; this is quite different from the argument behind the "collectivistic-individualistic metaphor" (Chang & Holt, 1991). According to Fei's theory, a clear line can be drawn between ingroup and outgroup members. Ingroup members are those who focus on caring for each other and helping one another in times of need. On the other hand, outgroup members are those who focus on the rules of equity and overlook human feelings (Huang, 1987). It is important to note that these circles are penetrable depending on changes in the relationships between the communicators.

Chang and Holt's (1991) findings suggest that communicational performances depend on whether the communicator is a member of an ingroup or outgroup, ingroup members being allowed to take on deeper and freer conversation. A similar observation is made by Wen (1988):

> Chinese are very sensitive to kuan-hsi [*guanxi*]. Whether to tell truth, to support, or to help the other tends to depend upon whether one has kuan-hsi with the other. A common saying states, "When you meet a person, only speak 30%, do not tell all [that is] in your heart," referring to the depth of kuan-hsi. People with greater kuan-hsi are allowed to talk more intimately, and people with less kuan-hsi, on the other hand, can only talk about matters that are not serious, such as [using the language of] greetings. (p. 32)

Furthermore, the general tendency to classify a collective culture as employing a "restricted code," which is often viewed as cognitively underdeveloped, is also questioned. Chang and Holt (1991) suggest that it is possible that social positioning and message elaboration co-exist in accordance with the strategic nature of maintaining good *guanxi* with a communication perspective. The Chinese and the Taiwanese, from the functional view of communication, have actually elaborated sophisticated ways of communicating with people of different positions through a set of simple but effective vocabularies. The concern about social relationships acts as a guide for formulating the best verbal messages, and the social position one occupies does not restrain one's ability to construct the message. Contrary to the general perception, the restricted content of messages toward people in different positions is actually an elaborated code. The Chinese and the Taiwanese are quite capable of elaborating their verbal messages according to the social position of the target person. Being restricted by the scope of a social position means that it is actually more cognitively demanding to elaborate the message.

It is clear that the theory of manners of different orders, as well as Confucianism, is important for understanding Chinese and Taiwanese communication patterns. Ignorance of this theory and of Confucianism may cause serious communication problems between foreigners (whether easterners or westerners) and local people. Since the host cultural context chosen for this study is Taiwan, the following section will introduce certain styles of communication prevalent in Taiwan in greater detail.

Communication Styles in Taiwan

First, communication is used as a skill to establish *guanxi* with others. There are many methods of communication that can be helpful in the establishment of *guanxi*. One of them is to utilize verbal strategies to decide whether the target person shares some commonality with the communicator. Another approach is to initiate and maintain a smooth social intercourse through communication strategies, such as restraining one's anger and identifying the interests and preferences of the target person, to develop one's conversation accordingly (Chang & Holt, 1991; Hsieh, 2004).

Second, verbal skills that serve as a pragmatic goal are employed in dealing with pure instrumental relationships. The issue of communication strategies becomes vital only when one is ambitious or is interested in making use of a relationship as a social resource. However, because there are many kinds of relationships and many different ways of generating interpersonal dynamics, those who are not ambitious or do not consciously employ *guanxi* as a social resource will emphasize sincerity rather than verbal skills (Chang & Holt, 1991; Hsieh, 2004).

Finally, communication through an intermediary is normal and effective in Taiwan. While most studies suggest indirectness as the dominant eastern mode of communication, the Chinese and Taiwanese have generated their own ways of "going through intermediaries." There are two primary reasons for going through an intermediary: first, the target person finds it difficult to refuse such a request (normally from relatives or friends) and second, the risk of losing face is very much reduced because the initiator and the target person do not directly confront each other. In this way, Chinese and Taiwanese communication is much less burdened with impression management and direct confrontation. It is the relationship, under the protection of *guanxi*, that guides and mediates the communication content and strategy, and not the other way around. Given such a complex interplay between communication and relationship, it is clear that there are many ways of delivering one's message that go far beyond the dichotomy of direct and indirect modes of communication (Chang & Holt, 1991; Hsieh, 2002; Huang, 1987).

As suggested by Daniel (1984), ''communication is not a 'what' but a 'how to' – a method of telling people about the 'what' subjects'' (p. 32). Consequently, those foreigners who do not understand the communication patterns of local people and the cultural differences may encounter cross-communication problems. Given cross-cultural or cross-national differences and a lack of understanding of the communication patterns of Taiwan as previously described, it is to be expected that foreigners, especially westerners, will encounter communication difficulties. The following research questions are used as guidelines to assist in the collection of data.

How do people from eastern and western societies communicate with Taiwanese people?

How do Confucianism and the theory of manners of different orders influence the communication between foreigners and the Taiwanese?

METHODOLOGY

To respond to these research questions, we utilized an ethnographic and qualitative approach to the interview data that focused on the subjective interpretation of the view of foreigners (Burrell & Morgan, 1979). That is, we gathered the perceptions of the informants (Thomas, Locander, & Pollio, 1989) during the interviews. The primary purpose of this kind of qualitative research was to capture experiences as closely as possible to how the informants felt or perceived them. The in-depth interviews allowed the researcher to gain insights into the cross-cultural communication processes of foreigners. The interview questions were intended to elicit detailed and complete descriptions of specific experiences. Furthermore, in-depth interviews allowed researchers to revise wordings according to the background of the informant and the answers given during the interview (Bailey, 1994); this flexibility and interaction lowered the level of misunderstanding between the researcher and the informant. The personalized meanings, meaning-based categories, and symbolic patterns that constituted the individual's abstracted understanding of communication process could be expressed freely by the informants (Haytko, 2004; Thomas et al., 1989).

The analysis of the informants in this chapter is based on data collected during June and December of 2008 in Taiwan as part of a research program focusing on the learning and living experiences of overseas students. The primary questions asked during the interview focused on cultural comparisons, especially styles of communication, between the home and the host cultures, and the communication process between foreigners and Taiwanese.

There were 27 interviews in total, ranging in length from 75 minutes to 2 hours, with an average of 95 minutes. Thirteen females and 14 males aged between 20 and 39 participated in the study. Fourteen informants were from western societies with an average age of 31.21 years and 13 were from eastern societies with an average age of 24.15 years. The duration of their stay in Taiwan was from one to seven years. While those from western societies were fluent in English, most eastern informants had poor English. Most easterners were studying for a first degree whereas most westerners were in master's programs. The interview language was Chinese or English according to the preference of the informant. The profiles of the informants are summarized in Table 1. A keyword search technique was used to content analyze the audiotaped and transcribed interviews and journals.

Participant observations were also used when the author taught overseas students in the classroom and participated in a round-table discussion and a conference presentation regarding the learning behavior of overseas students and their experiences of living in Taiwan. The former activity allowed the author to observe the behaviors of overseas students in the classroom whereas the latter gave the author a taste of how university lecturers and administrators perceived them.

Documentation from sources that regularly explored the perspectives of foreigners on Taiwan and the Taiwanese, such as newspaper clippings from the *United Daily News* (one of the most popular newspapers in Taiwan), was collected. Physical artifacts, such as the mid-term exams and term projects of selected overseas students, and the comments made by lecturers about these artifacts were also analyzed to compare them with the data collected from the other sources. The triangulation of the data and of the research methods enhanced the reliability and validity of this project (Belk, Wallendorf, & Sherry, 1989).

FINDINGS

As predicted, those informants who did not understand the essence of Taiwanese cultural values, mainly Confucianism and manners of different

Table 1. Informant Profiles.

No.	Nationality	Sex/Age	Duration of Stay (years)	Degree	Interview Language
1	Singapore	M/23	2	Undergraduate	Chinese
2	Malaysia	F/24	5	Undergraduate	Chinese
3	Korea	F/26	4	Undergraduate	Chinese
4	Korea	M/23	4.5	Undergraduate	Chinese
5	Korea	F/24	4.5	Undergraduate	Chinese
6	Korea	F/26	1	Graduate	Chinese
7	Japan	M/23	5	Undergraduate	Chinese
8	Japan	M/22	4	Undergraduate	Chinese
9	Japan	M/24	4	Undergraduate	Chinese
10	Japan	M/21	1.5	Undergraduate	Chinese
11	Mongolia	F/24	4	Undergraduate	Chinese
12	Mongolia	F/24	4	Undergraduate	Chinese
13	Vietnam	F/30	4	Graduate	Chinese
14	St. Vincent	F/25	4	Undergraduate	English
15	Costa Rica	F/37	7	Graduate	English
16	Sweden	M/28	2.5	Graduate	English
17	Ireland	M/37	4	Graduate	English
18	Germany	F/36	2	Graduate	English
19	Germany	F/31	3	Graduate	English
20	Italy	F/39	2	Graduate	English
21	Czech	M/25	1	Graduate	English
22	Russia	M/26	2	Graduate	Chinese
23	USA	M/27	1.5	Graduate	Chinese & English
24	USA	M/35	4.5	Graduate	English
25	New Zealand	M/39	3	Graduate	English
26	Guatemala	F/20	4	Undergraduate	English
27	Holland	M/32	5	Graduate	Chinese

orders, usually had difficulties in communicating successfully with local people and only achieved a poor communicational performance. On the contrary, those informants whose communication strategies were close to these cultural values not only got along with local people better but also gained more benefits because of better interpersonal relationships.

Cross-Cultural Communication Processes

Almost all the informants encountered communication problems at the beginning. These problems came mainly from cultural differences and language barriers. It was quite easy for foreigners to communicate with local people according to their original styles, which were part of their home cultures. Those informants, mainly westerners, who insisted on an equal relationship between the styles of communication of their interlocutors and their own communication styles often encountered communication problems and had poorer communicational performance. The following typical example demonstrates that a lack of understanding of Taiwanese culture, such as Confucianism and manners of different orders, and of appropriate communication strategies in Taiwan leads to a disappointing communicational performance:

> People are encouraged to be silent and do not question the professors. I think it is a contradiction to higher education. The professor is supposed to encourage you to challenge him. If you do not know what he is talking about, then he should perhaps make fun of you or mock you. He will tell you to go home and study. Then you should go home and study and then you will question him again maybe you have a point. From what I saw in the classroom here, the local students are not really interested in doing that. Second, the professors would not like it because the professor is the professor. You may say that it is immature. At first, I am kind of bitter about it. "Oh! My God" this is what I am getting into for two years. Then I went home and spoke to my Dad. Then he said you should understand and said something very clever. "This country started to develop in the 1960s only and so you cannot really expect it to be that good and that fast." So I have to understand this is a kind of not Third World country, of course, but I mean developing country and not really up there maybe … Taiwanese people think that foreign people are good at complaining about Taiwan and we did not want to do that too much. We thought that it was not very constructive. I put together in a group maybe five people and we worked together some suggestions that they could make some improvement. Then we sent it to all the classmates [to see] if they would have any comments on it and they encouraged us to send it to the director of the program that we were in. And the director thought that it was very good that we were taking a part in improving our own education and he thought that it was a good model of how people should be involved as a citizen. And he took us to dinner and had been very nice to us. But the next semester, nothing happened and there were no changes … you need to be sincere and we feel that they are just insincere and just buy us dinner and then try to zip out somewhere, the backdoor. That gives me a very bad impression and after that I do not really try much. I realize that I am going to just finish the program and that will be it … there are some things that obviously I like more about my own culture. For example, the professors would not be chauvinists. He would be more humble and encourage you to take an active part in education and take it seriously. He would encourage you to call him by his first name, not professor this and professor that. It is more equal and encourages you to focus on more important things, like what you discuss in class but not paying respect to this and that because he is the professor. (M/28, Sweden)

A direct, outspoken, and brusque method of communication appeared to be the style adopted by most western informants, which, of course, was different from the Taiwanese pattern of communication. To make things worse, the philosophy behind most of the communication of the western informants was that everyone was equal and should have an equivalent communicating position, which again was contradictory to Confucianism.

Academics in eastern societies have different social positions from their counterparts in western societies because of the influence of Confucianism, which also led to different communication strategies being adopted by local students. One of the criticisms that almost all western informants had was that there was a lack of interaction between the local students and the lecturer. The directness of the style of communication of the western informants appeared not only during the interview, but also in the classroom, where a female student from Haiti took the author's "Consumer Behavior" course. Although her Chinese was not fluent, she expressed her questions regarding course lectures, mid-term exams, and term projects in an aggressive way. When she sometimes had problems expressing herself in Mandarin, she spoke in English. When she did not receive satisfactory responses in the classroom, she kept trying to obtain answers by e-mailing the author in English. According to her statements, this attitude of trying to uncover the truth no matter whom she was dealing with was formed in her family and was part of Haitian culture. This attitude was consistent with that of other international students from western societies.

This issue, interestingly, did not appear to be a problem for most eastern informants because they all perceived that the interaction between students and lecturers in Taiwan was more frequent and better than in their own countries. The following extract is a typical response from Korean informants:

> Because we pay very high regards to professors, we are very distant from them. Korean professors have high social status and are very different from us. Because of this, the communication between professors and students are rare, and of course, not as frequent as what we see in Taiwan. Another important thing to mention is that when we leave, we cannot say "bye-bye" to our professors, we have to bow. Tell you the truth – it is impossible for a Korean professor to interview students, like what we are doing now. (F/26U, South Korea)

Cultural differences definitely played a role here because many eastern countries are influenced by Confucianism. It appeared that the influence of Confucianism in Taiwan was less significant than in South Korea.

Another potential cause of poor communication was language barriers. Most western informants only took courses taught in English. Given that English was not the mother tongue of their Taiwanese classmates, a lack of language fluency may have hindered their participation in the classroom.

That most western informants can obtain their degrees by taking only courses taught in English may contribute to their lack of cultural understanding and of communication strategies. Although they survive well in the classroom, they normally do not communicate well with local people. Most western informants revealed that, because of the difficulty of learning Mandarin and the lack of a strong motivation to make Taiwanese friends, their best friends in Taiwan were also foreigners. Given that they had more in common in terms of their life situations and personal preferences, drinking had become a popular activity among these westerners, as articulated by the following from a Swedish informant: "We [westerners] have more in common in the situation of our lives. I would rather be friends with them than my own classmates, in general … we hang out together to drink. Drinking is very important to us foreigners. We drink a lot. That is what we do." In contrast to the preference of the westerners for drinking, one of the preferred leisure activities among the Taiwanese was karaoke TV singing. Differences in preferred leisure activities may have further decreased the opportunities of the western informants to learn better communication strategies from local people.

All these factors contributed to the ignorance about better communication strategies on the part of most westerners, strategies such as establishing *guanxi*, making use of verbal skills, and communicating through an intermediary. It was unfortunate that most western informants were reluctant to look for the causes of such miscommunication and poor communicational performance. Instead, they often relied on their home cultural values when making judgments. Given that more than 80% of these informants expressed a desire to work or continue working in Taiwan or other Asian countries after graduation, attitudes of this kind could have only negative effects.

Nevertheless, a few western informants who were more sensitive to cultural differences and adapted better in the communication process or were capable of learning from mistakes usually had a satisfactory communicational performance. The following extract is from a female informant who was from Costa Rica and had been working in Taiwan for several years:

> I was lucky and met very nice friends. I feel very good here … Anyway, now if I need some help from Taiwanese, they are the one[s] to help me. They are very good friends of mine. That is why I love this country so much because of the people … I have many Taiwanese friends actually. My best friend, she is just like my mother here and I have many Taiwanese sisters, too. I can mention many, like Cherry, Jacqueline, Claudia, Susan[n]a and many … I used to cook in my house and invite them for dinner. We go

> outside, mountain climbing or we go to restaurants and they even invite me to their weddings. We are very good friends. When I have time, we have coffee together and exchange languages. We go to bar sometimes and go to movies. (F/37, Costa Rica)

Another informant from Germany, who married a Taiwanese woman, expressed some surprise at the results of his directness during a group discussion:

> At the beginning, I was in one team. We had a group discussion. There were also other international students. The international students made a proposal for the teamwork. I said like 'this is a pretty stupid idea' or something like that. Then for the next hour in the meeting, nobody said anything in the meeting any more or at least none of the Taiwanese said anything any more. Because it seemed that everybody was afraid that they would also be criticized. Everybody was quiet all of a sudden. Maybe it was not the best idea. (M/36, Germany)

Fortunately, this German informant undertook some self-analysis and recognized the importance of making adjustments, stating:

> Probably I have to learn the way of dealing with each other which is different in my home country that you cannot criticize somebody so easily without offending this person. You have to be more open-minded. This is, of course, [what] I have to learn. You have to get used to the environment.

Otherwise, he might have had frequent conflicts with his Taiwanese wife and her relatives as well. This German informant's experience is similar to those appearing in the secondary data.

Contrary to most western informants, most easterners learned to change their communication strategies to establish better *guanxi* with local people and hence achieved much better communicational performances. The following two extracts from Singaporean and Japanese informants respectively give typical examples of the adaptations employed by eastern informants:

> Singaporeans are used to having a positive answer. However, Taiwanese don't usually give you a positive response … Singaporeans are more direct in their speech and express what they think. However, it is not the case in Taiwan … for example, when team work is required and there are many members that I am not acquainted with, it is hard to build good relationships with them in a short time and finish a good report. Taiwanese culture is similar to mainland Chinese culture in terms of the concept of ingroup/outgroup. If all the team members are strangers, then all of us are outgroup members. Under such circumstance, all the discussions are very superficial because team members show up primarily for the reason of giving each other "a face." It is very hard to get every member involved and have in-depth discussion. This was my painful experience when I was a team leader one year ago. I was a total loser because I could not persuade them that it was an important project that required every member's dedication. Fortunately, another student was willing to take over the leadership and got other members involved.

> He was able to do that because he had already known them very well … they talked like friends. They got along very well and had been out for fun quite often, me excluded. He led other members in terms of the way that Taiwanese friends treating each other and eventually we got the paper done … I would like to learn how this works … This painful experience tells me that, when giving an instruction to team members, I should not order them to do this and that. It is much better to use phrases like "could you please help me do this and that." A soft communication style is the only way that works. (M/23, Singapore)

> At first, I was afraid of articulating different opinions when discussing with other team members because it was my concern that they were professional and may look down my opinions. However, after observing what happened for a while, I [dared] to express what I thought, but in a soft approach. That is, I used questions, such as "how do you think about this idea?" to express my opinions. During the observation process, I often heard other members say something like "This is not good; you should do it my way, which is better." Such [a] hard [method] of expressions usually creates [an] uncomfortable atmosphere and leads to [un]satisfactory results. It has become clear to me that a soft approach is easier to reach agreements and maintain good relationships with them. (M/22, Japan)

Careful observation seems to work for these eastern informants, enabling them to learn the appropriate communication strategies. Being an ingroup member is definitely helpful for better communication, and a gentle communication style usually has a better chance of resulting in a good communicational performance.

The Influence of Confucianism

The greater the cultural differences, the higher is the possibility of miscommunication. Furthermore, recognizing cultural differences is one thing; being open-minded and trying one's best to adjust to them is quite another.

It is interesting to note that most western informants recognized the strong influence of Confucianism on the Taiwanese perception of interpersonal relationships and communication strategies. However, they did not agree that a clear hierarchical divide should exist between communicators. Unequal positions between academic staff and students and hence inequitable communication patterns were especially criticized by these informants. Some of them tried to overturn this cultural tradition, which has lasted for more than 2,500 years. Those who did not achieve a satisfactory communicational performance perhaps simply gave up trying and did not bother to find out what the real problems were, like the Swedish informant previously discussed. Some extreme cases on occasion even invited a rebuff from angry informants, as the following extract demonstrates:

> I did try to see Professor X many times but she is never in her office. I was accusing her and I think my accusation is truthful, correct and righteous. I was accusing her of mismanagement in the classroom. You cannot schedule a student to do an oral presentation when he [is] not there. By all indications, he was not going to be there next week because he has been sick. I have told the secretary of the program that I was sick. She has seen me coming [in] with a white face, looking very old and unhealthy. In this situation, in a rush time towards the end of the semester everybody was putting the paper in. They did not want to try and did not want to be bothered. It's me who complained. Taiwanese professors did not like students to complain, even if the complaints are justified and you are sick. I have somebody whispered to me that they just think that I am lazy or something. I went back to the doctor and get all the medical certificates. I waited outside the President's office, the top of the university. I waited out there and I introduced myself and explained to him about my troubles of the subject. The convener of the subject did nothing for me [except] saying she would try to settle it. It was like there was some conflict between the convener's suggestion by giving more time and that what the professors really wanted. I think that these professors are not modern. They are not democratically minded. These professors have gone to the American universities but they have not learnt anything how being open-minded and following things through a sequential or logical manner in term of westerners' thinking. The student is sick. There is obvious evidence to prove that he was sick. You basically have to give him more time. After that, the President did not bother to reply to my situation at all. I think he is the top man in the school that I can go to. You cannot go any higher than this. But he does not want to help. There is clearly some corruption through the university at the lower level and corruption at the top level. I am sure if I go to see the President of Oxford or Cambridge, waiting outside his office. There will be a following inquiry and a following inquiry will come out in my favor. There is no correspondence from the President of this university at all to me. Giv[en] half the chance, as a radio producer, one day I would probably do a story on that about education in Taiwan … possibly, given half of a chance, it is never been resolved in this university, I would probably do some small features and small documentary on my experience here. It may not be all about me because it sounds if I had some prejudice. I would interview other people who I know have been also dissatisfied. I would probably be [public] enemy number 1 to this university. I was only [public] enemy number 1 because nothing was done about my situation. (M/39, New Zealand)

These informants, frankly speaking, had a point. What they failed to do was to work out what really caused these problems and whether there were better communication strategies to solve these problems. Some of their behaviors, including their styles of communication, may have violated the rules of Taiwanese culture. At this point, a western way of thinking became a burden rather than a help in communicating with academic staff or administrators who were heavily influenced by Confucianism. As suggested by Singer (1987), the more one knows about one's own perceptions, identities, and communication style, the better inter-cultural communicator she or he will become.

According to Confucianism, it is possible to create a stable society only when the five basic relationships are maintained: (1) father–son (the relation of love); (2) emperor–subject (the relation of righteousness); (3) husband–wife (the relation of chaste conduct); (4) elder–younger (the relation of order); and (5) friend–friend (the relation of faithfulness) (Ken, 1982). It is possible that the above informant's approach to communication was too aggressive and against the social norms that a student should behave toward those with higher status in a manner defined by Confucianism. A lecturer during a seminar discussion and a high-ranking administrator during a comment session of a conference, both of whom were involved with programs taught in English and with overseas student affairs, complained about the inappropriate behavior of international students. This high-ranking administrator, who is also a lecturer, even asked overseas students to be more appreciative of the efforts of lecturers and the administrative staff in view of the fact that more than half of the international students in the university had scholarships from the university or Taiwanese government.

On the contrary, a few western informants did appear to be able to recognize the importance of communicating in a Taiwanese way before things got worse. The German and Costa Rican informants discussed previously are two examples. Another, Irish, informant made an interesting comparison of communication strategies between Irish and Taiwanese people:

> Irish people are more direct and definitely Irish people like to argue. It is number one entertainment. Argument about the issue is what you do at work and how you brainstorm and come up with new ideas. But here it is pretty good for people from Europe especially Ireland to always find [the local people] to be so diplomatic. If you said someone is wrong, you said 'it is a very new way to think of something, how about we do this?' You must be always so soft and never try to say negative things. (M/37, Ireland)

The following extract from an American informant also expresses the importance of an open mind and necessary adaptation to achieve a satisfactory communicational performance:

> It is again small stuff. There is no big stuff [deserving complaints]. In my opinion, you cannot really look at big stuff because I choose to be here, so it is not fair for me to comment on these things. It is my choice to be here. So if there are any problems, they are the problems with me and not with people that speak loud. It is my fault. My Chinese sucks. Anyway, anything I am saying should not be taken as problems … because I am a foreigner it is my job to laugh it off and to understand. It is not my job to criticize to say what is right or what is wrong. Why don't they understand me? It is my job to practice that part…yes [I have made my opinions heard], I am in the Student Council. But I

> cannot speak too aggressive. It is a cultural thing, too. Being American, sometimes we are a little bit aggressive. I learned that, which is good. I was aggressive before. Be soft and use the gentle approach, but it takes longer. It is okay as long as it is done. (M/35, US)

Although some western informants were starting to get into the spirit of Confucianism, it was the eastern informants who became experts in putting Confucian teaching into practice. Because Confucianism has such strong roots in Asian countries, informants from Japan, Mongolia, Malaysia, South Korea, and Vietnam all recognized the importance of *guanxi* and harmony. Consequently, they had fewer problems in following the basic relationships suggested by Confucianism. Furthermore, as pointed out by informants from Japan and South Korea, Taiwan had been more westernized than Japan or South Korea and had maintained the traditional adherence to Confucian teaching to a lesser degree. For instance, with regard to interpersonal communication, honorific language was used less when communicating with older people or people with a high social status in Taiwan than in Japan or South Korea. The following extracts from comments provided by two Korean informants were typical responses among Koreans that revealed how interpersonal communication based on the other's social status and age difference was an important factor to take into account:

> We cannot call those who are older than us by [their] names. As long as I am younger than they are, I have to call them older brothers or sisters. We have to use honorific language[s] and titles for [older people]. It is not only a custom but also something that I learn from some classes about Confucianism. We have very clear divide of hierarchy in terms of age differences. (F/24, South Korea)

> I am the president of [the] Korean student association and we h[e]ld a greeting party last week. To break the tradition, we invited exchange students to participate in addition to degree seeking students. Although we had a good time, an older brother revealed his disagreement after these exchange students left. He said that this was supposed to be an [degree seeking] undergraduate activity. The rest of us kept silent because he is the oldest among us. (F/26U, South Korea)

Although they do not have to pay so much attention to honorific language when communicating with their Taiwanese friends, Korean informants still do what Confucianism teaches them when encountering other Koreans in Taiwan.

A new graduate student from South Korea revealed how the hierarchical divide influenced the sources of assistance that she could get despite her desperate need for help. This is also related to face:

> It is the elder who are supposed to take care of the younger and not the other way around. Consequently, it is kind of embarrass[ing] for me to ask help from those Korean

> undergraduate students because I am older than they are. If I ask help from them, I may lose my "face." (F/26G, South Korea)

The Influence of Manners of Different Orders

The concept of collectivism is different from the theory of manners of different orders. A common understanding of collectivism is that individuals will sacrifice their own interests in favor of the goals of the ingroup and to maintain social harmony. According to this definition, classmates and group members in a classroom should be viewed as ingroup members. However, our data indicated that these ingroup members did not perform as they should have done according to predictions for a collectivistic society in the literature. A better explanation comes from the theory of manners of different orders. According to this theory, there are many ingroups, with one ingroup inside another. Strangers are outgroup members. Classmates are ingroup members located somewhat in the outer range. Those group members who have the same case study or term project score, resulting from their cooperation, are supposed to be members of an inner ingroup. However, if the members are strangers to each other, they may be classified as outer ingroup members. The experience of the Singaporean informant that we discussed previously demonstrated this point.

Given that the relationship "circles" are, according to the theory of manners of different orders, penetrable, those who improve their interpersonal relationships can move from an outer ingroup to an inner ingroup, which has a higher degree of obligation and intimacy. This is also what most eastern informants tried to do to get involved with the local Taiwanese people. Again, this finding is supported by our secondary data. The following extract from a Singaporean informant demonstrates how his communication strategies work:

> Actually, things are getting better. One reason is that my Mandarin is getting better. If they don't pay close attention … they probably will think that I am a local. In this way, I will be more close to ingroup members. If it happens that there are one or two members that I can get along with well, I can build good relationships with other members through these intermediaries … my impression is that I ought to change my perception of Taiwanese culture and the way of communication to accomplish something here … compared to the US culture, which is transparent and people say what they think, Taiwanese culture is quite different. You can tell from TV programs, politicians, students, and the environment [a]round you that Taiwanese culture is opaque. You just need to spend time and effort to figure out what they really mean and listen carefully. (M/23, Singapore)

Language definitely plays a significant role in influencing communicational performance and moving from outer ingroup toward inner ingroup. In contrast with most western informants, most eastern informants tried very hard to learn Mandarin. Most of them were like western informants in that they did not learn Mandarin until after they had arrived in Taiwan. Some eastern informants refused to have boyfriends or girlfriends from their own countries because this might have had a negative impact on their learning of Mandarin. Other eastern informants worked very hard to learn Mandarin and Taiwanese culture through having girl- or boyfriends, engaging in conversation with Taiwanese people, watching TV programs, and listening to the radio. It appears that making good friends was the most effective approach among these eastern informants to moving into an inner ingroup.

To enter an inner ingroup, all sorts of approaches were used. The following extracts from interviews with a Korean and a Japanese informant are typical examples that demonstrate which effective communication strategies were used:

> I have been language exchanging with a Taiwanese student from the journalism department since my freshman year, and she also introduces her good friends to me. Whenever the exams are coming, I write my good friends a note saying something like "go for it and wish you score high" and, of course, it is accompanied by chocolates. When they need help, I will also do what I can to help them. Additionally, I often chat with them and invite them to dinner and have fun. When I return from South Korea, I also bring some delicious cookies for them and they love them. I think these are the primary reasons that they are so willing to help me. (F/24, South Korea)
>
> Local Taiwanese did not exclude me because they were curious about Japanese. Another, and possibl[y] the most important, reason is that I have been part of them for a long time. I have been a member of the educational research club, of the chorus, of the badminton team, and of the cheer team. Given that we have been participating in same activities for a long time, local Taiwanese and I have many in commons and we have many topics to talk about. My best friends are all Taiwanese. We also go shopping together quite often. Since we have known each other very well, they, of course, will help me whenever I need it. This is also my suggestions for new comers that the more they participate in the department's activities, the better relationships you can build with and more help you can get from local people. Of course, I will also do something in return. For instance, when I come back from Japan, I will bring some snacks and traditional souvenirs for them as gifts. I also give them "all pass candy" to wish them good luck before the examination. (M/23, Japan)

By joining the same clubs or associations, or participating in activities of mutual interest with the Taiwanese, these informants quickly got to know them better and moved from an outer ingroup toward an inner ingroup. It appeared that when entering into an inner group, the importance of verbal skills diminished. Instead, sincerity and nonverbal symbols, such as the giving of special gifts or notes of encouragement before an examination, played a more significant role in maintaining and improving interpersonal relationships.

DISCUSSION AND SUGGESTIONS

Relying on the data collected from the in-depth interviews, as well as participant observation and secondary data, this chapter compares the cross-cultural communication processes between easterners and westerners in an Asian cultural context, namely, that of Taiwan, and the potential influence of Confucianism and the theory of manners of different orders on those communication processes. We found that westerners tended to communicate with Taiwanese people in an outspoken and brusque way and to make few changes during the communication process. On the contrary, easterners, whose cultural backgrounds were more similar to that of Taiwanese culture, were inclined to communicate with a gentler approach and would make adjustments for the local culture. We also found that Confucianism and the theory of manners of different orders had a strong influence on cross-cultural communication strategies and performance.

Given that communication is culturally bound, there is no universally appropriate communication strategy. Communication, as one of the most important elements of marketing, should also be customer or target oriented. Where cross-cultural communication is concerned, the host culture should always be taken into account. Our data revealed that the cross-cultural communicational performance of westerners, in general, was not as successful as that of easterners when the cultural context was Taiwan. Cultural distance definitely played a role here. A lack of cultural understanding and appropriate communication strategies may further explain the differences between westerners and easterners. Two important cultural values of Taiwan, namely Confucianism and manners of different orders, need to be understood before effective cross-cultural communication can take place between foreigners and local people.

The primary purpose of Confucianism is to create a harmonious society through establishing clear hierarchical divisions in which specific interpersonal relationships are defined. The concern for social relationships acts as a guide for formulating the best verbal messages. Under the protection of *guanxi*, it is the relationship that guides and mediates the communication content and strategy, and not the other way around (Chang & Holt, 1991; Hsieh, 2002; Huang, 1987). Honorific language and titles that are still widely used in Japan and South Korea indicate that the influence of Confucianism is strong in these countries too, and appropriate communication strategies should follow. In this way, people in societies that are influenced by Confucianism have actually developed sophisticated ways of communicating with people in different positions through a set of simple but effective vocabularies. In contrast with general perceptions of collectivistic societies, the restricted content of messages directed at people in different positions is actually an elaborated code (Chang & Holt, 1991). It appears that the Japanese, South Koreans, and Taiwanese are quite capable of elaborating their verbal messages according to the social position of the target person. Ignorance of the social position of the target person often leads to inappropriate communication content and strategies being employed by the initiator, which is the mistake that we often see from westerners when communicating with societies that are strongly influenced by Confucianism.

It is important to note that although most westerners criticize a lack of interaction between local students and academic staff, most easterners comment that the interaction between students and academics in Taiwan is more frequent and better than in their own countries. This result revealed that our conclusions on cross-cultural communication may be different when cultural contexts are changed. Consequently, being open-minded and objective is critical to making the correct judgment, especially for international marketers.

Given the importance of *guanxi* in the Greater China context (Hsieh, 2006), several important communication skills can be used to establish and enhance interpersonal relationships. One can employ verbal strategies to identify whether there is any commonality between the communicators. A gentle approach normally works better than a brusque one, as evidenced in our data. Smooth social intercourse is also important during the communication because harmony and face are essential to good interpersonal relationships (Hsieh, 2002; Huang, 1987); communication strategies such as restraining one's anger, identifying the target person's interests and preferences, and developing one's conversation accordingly can be helpful (Chang & Holt, 1991). Language as a basic tool for communicating and truly understanding a particular culture cannot, of course, be ignored. The data revealed that those who neglected the significance of language and related communication strategies often ended up with poor results.

Communication through an intermediary or mutual friend can also be effective in achieving one's goal; since the initiator and the target person do not confront each other, the risk of losing face if rejected is also reduced. This strategy is employed more often by easterners. Our data supported the argument that there are many ways of delivering one's message that go far beyond the dichotomy of direct and indirect modes of communication (Chang & Holt 1991; Hsieh, 2002; Huang, 1987).

Our data also suggested that the theory of manners of different orders worked better than the individualism–collectivism paradigm when it came to cross-cultural communication with Chinese or Taiwanese people. The data revealed that the conversation of the Taiwanese was only superficial when they encountered outgroup members or strangers. The more one penetrates the inner ingroups, the more value can one derive from the communication (Chang & Holt, 1991; Wen, 1988). After entering the innermost ingroup, not many verbal skills are required because members focus mainly on caring for each other and helping one another in times of need.

Limitations and Suggestions

The informants who were interviewed were overseas students whose motives for communication and communication processes may have been somewhat different from those of real-world employees. Nevertheless, almost all of these informants had experience of work before coming to study in Taiwan or worked in Taiwan while studying for their degree. Furthermore, it may not be feasible to gather information from such diverse nationalities in the workplace and to conduct in-depth interviews. Consequently, the benefit gained from interviewing this group of informants may have outweighed the shortcomings of the somewhat skewed samples.

We focused only on the perspective of foreigners. It would have been more conclusive if these perspectives could have been compared with those of local people. Our suggestion is that future research might explore the views of those local people that have contact with these foreigners. Such a comparison would reduce the potential bias introduced by the informants. Furthermore, given the similarity of cultures between mainland China and Taiwan, similar studies conducted in mainland China might improve our understanding of cross-cultural communication in theory and in practice.

It appears that the degree of influence of Confucianism on communication is different for Japan, South Korea, and Taiwan. To conclude that these countries have all been influenced by Confucianism and belong to collectivistic societies may be misleading. Future research might analyze the different levels of influence of Confucianism on communication in these countries and how these differences influence the marketing strategies of firms and consumer behavior.

CONCLUSION

There can be no doubt that many emotions are aroused if one moves to a culture that is different from one's own. However, from an international marketer's perspective, one should understand the essence of host cultures before making any concrete marketing decisions, and when encountering cross-cultural communication problems one should remain calm and work out the possible causes.

This chapter has presented some findings on the cross-cultural communication processes between westerners and easterners and has made some suggestions for improving communicational performance. International marketers, especially those from western societies, should benefit from these comments.

Theoretically, this chapter provides evidence to support the arguments that the theory of manners of different orders may play an even more significant role than the individualism–collectivism paradigm in explaining the causes of good communicational performance in Taiwan and possibly in mainland China. Furthermore, although Taiwan is often labeled as a collectivistic society and a high-context culture with restricted codes, our findings supported the argument that the Taiwanese, along with the Japanese and the South Koreans, are quite capable of elaborating their verbal messages according to the social position of the target person.

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