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1. Introduction

1.1 Background

With a volume of nearly 102 billion euros, China is Germanys number-one partner in imports and with over 86 billion number-three partner in exports. In the turnover, this makes China being Germanys biggest trading partner outstanding the Netherlands and the US (Statistisches Bundesamt Deutschland, 2018). In 2017 with 5.3 Percent of all imports, Germany was China’s fourth biggest supplier of goods and services and with 3.1 Percent the fifth biggest customer country. Compared to 2016 this represents a 6.7 Percent growth in Germanys imports from China and a 13.4 Percent growth in German exports to China (German Trade and Invest Bundesministerium für Wirtschaft und Energie Deutschland, 2018). Those numbers emphasize the immense importance of the trade relationship between the two countries. To deepen this trade relationship even further, at the fifth Sino-German government consultations in Berlin in the middle of 2018, Li Keqiang and Angela Merkel signed more than 20 government and commercial agreements to ease trade and investment between the two countries (The Federal Chancellor Germany, 2018). The commercial pacts that have been settles between the two parties involve various sectors and are set to cover €20 billion (International Centre for Trade and sustainable Development, 2018).

With its huge market, a fast growing middle-class and a growing state spending on infrastructure, the Chinese market offers a wide range of opportunities to foreign companies, willing to invest in foreign markets. In the early 90s, when German investment in China grew by an eightfold within just seven years, Germany became one of Chinas most important investors outside Asia (Frey, 2018). In 2014, Germany was already Chinas second biggest investor outside Asia, just behind the US (PWC, 2015). From January to October 2018 Germany’s investment in China (as per the actual input of foreign capital) totaled 2.75 billion USD (Foreign Investment Department of the Ministry of Commerce China, 2018), while Chinese investment in Germany has reached a new all-time peal with an amount of 11.2 billion EUR in 2017 (Deutscher Bundestag, 2018). After the US (2.4 percent of the total FDI inflow) and the Netherlands (2.7 percent), Germany was the third biggest investor outside China with around 1.2 percent of Chinas total FDI inflow in 2017. Around 35% of Germanys net FDI outflows went to China, as much as to all North American countries. 16% of the investors invested for cost saving reasons, while 35% invested for market development and 49% for sales and customer services (Van der Putten, 2017).
More than 99% of all organizations in Germany are SMEs, generating more than half of the value added. Furthermore, they account for 58.5 percent of all workplaces and 82 percent of all company training places and are therefore considered as the success factor and motor of the German economy (Bundesministerium für Wirtschaft und Energie Deutschland, 2018). SMEs are believed to be the motor not only for technological innovation. Worldwide, there are around 2,700 “Hidden Champions” whereof half of them are German SMEs. Hidden Champions are world market leaders of niche products, mostly having high export shares (Schlepphorst et al., 2016). Over the past 15 years the German SMEs have received global attention from thought leaders in policy and business. In 2014 The Economist already stated:” Most countries want a Mittelstand like Germany’s. It’s not easy to copy” (Schlumpeter, 2018). As per definition of the German government, SMEs are organizations with up to 499 employees and a yearly revenue of less than 50 million EUR. As per definition of the European commission, organizations with up to 249 employees, a yearly maximum revenue of 50 million EUR and a balance sheet total of maximum 42 million EUR count as SMEs. This paper will use the definition of the German government to narrow the term of SMEs. As German SMEs are often international market leaders in certain niches, their internationalization contributes to the transfer of knowledge and innovation is therefore welcomed by many emerging markets. The productivity spillovers by FDI have become one of the most important benefits of FDI for policy makers. Literature increasingly researches the positive productivity spillovers of FDI and the positive effects on the host country (Tang, 2018). Considering these above mentioned characteristics of SMEs it is surprising, that less than 4% of German SMEs established an own production or distribution facility outside Germany or acquired an interest of more than 10% in an enterprise abroad (Abel-Koch, 2018). Compared to that, more than 52% large companies, with an annual turnover of more than EUR 500 million invested abroad in 2014 (Cf. Borger, 2016).

1.2 Purpose
This dissertation aims to find the critical success factors for German SMEs during their market entry to China. While China is attractive for foreign investors, mainly because of the big market, growing middle class, rising disposable income and immense industrial and technological parks, there are still many obstacles which are feared, especially by small- and middle-sized companies. The Ease of Doing Business Ranking 2018 placed China on rank 78 out of 190, which is a strong improvement compared to the 96th rank which China received in 2014 but a poor rank comparing China to other east Asian countries such as South Korea (Rank 4), Hong Kong (Rank 5) and Japan (Rank 34) (International Bank for Reconstruction and Development,
The World Bank, 2018). This index, which was developed by the World Bank, includes different parameter to define the ease of doing business in a country (The Economic Times). What makes China being a difficult market to entry for foreign companies are especially the regulations and bureaucracy. The market-entry process requires a large number of steps and can, depending on the industry and the entry vehicle, take up to six months. For a foreign company, not having expertise in the Chinese market and the Chinese market entry process, the entry without using professional consultancy seems to be nearly impossible (Geer, 2018). While the Chinese government is trying to simplify the process in order to attract more FDI, the risk still seems high compared to other jurisdictions.

In fact, over the years there have been several firms that failed to be successful in the Chinese market and therefore decided to offtake (Li, 2018; Witmer-Großner, 2018). While for big companies the financial loss is mostly immense but bearable, for SMEs this might result in a big financial crisis or even bankruptcy. The market-entry process is not only complicated but also expensive and is often a huge crucial for SMEs. For those reasons, lacking knowledge about the Chinese market and its market-entry barriers and procedures as well as not understanding the advantages and disadvantages in the market can cause a company to fail (Geer, 2016).

Regarding the importance of the German-Chinese trade relationship, the importance of SMEs not only for the German but also for the global market and the relatively complicated market-entry procedure to China for foreign companies lead to a personal interest in critical success factors for German SMEs during the market-entry to China.

1.3 Contribution to Theory

With the growing importance of SMEs in the world economy, there is also an increasing research in the special characteristics and internationalization processes of SMEs. McIvor (1997) noted that “The contribution of small and medium sized enterprises towards economic performance is now universally accepted as significant.” Nevertheless, research on SMEs is very little developed compared to this on large corporations and MNEs. While there is rich literature on the internationalization of organizations and their entry into emerging markets, such as China, this literature mostly concentrated on large companies, as these are still the driver of FDI outflow in developed economies (Cf. Borger, 2016). Authors of SME research emphasize, that the conducted research on SME and their internationalization is under-developed and there is more research required to explain the special characteristics of SMEs (Etemad, 2004; Stoian et al., 2018). Etemad (2004) said that SMEs in their internationalization
process have “for the most part, left alone to their own devices. There is a pronounced need for new theories shedding light on SMEs’ internationalization strategies and process”. “Stoian et. al points out that “Although micro multinationals represent a real-world phenomenon (Doh, 2015), we are yet to fully understand what enables their occurrence and subsequent proliferation.” (Stoian et al., 2018) Furthermore, it is little known about the continuing ability of firms to remain in the foreign markets and about the types of resources that determine their survival abroad (Keupp & Gassmann, 2009; Sapienza, Autio, George, & Zahra, 2006; Zahra, 2005). To fill this gap, this dissertation will specifically concentrate on the lack of literature in the field of the SME internationalization towards China. As mentioned before, China represent a special market that distinguishes significantly from other emerging markets and should therefore be separately researched. As especially the resource-based view of SMEs differentiates strongly from those of large companies, a special research will help manager of SMEs as well as consultants and government agencies to concentrate on the key success factors for those companies during the planning of a market entry to China. This study will be based on the evaluation of existing research and data to understand he variables that account for the entry- process of SMEs in China and will underline this findings with case study and to challenge or confirm models, theories and previous conducted research.

1.4 Delimitation
This thesis aims to find general valid information about critical success factors for German SMEs during their market entry to China. However, the internationalization and market-entry process will differ though different types of entities, the industry they operate in and other factors. This dissertation will therefore not concentrate on industry- or firm specific factors but rather on factors that will affect firms throughout several industries and firm structures. The thesis is further limited by the changing regulatory environment of the Chinese market. The thesis will concentrate on the current legal framework but cannot predict possible changes that will appear in the future and change the market-entry procedure for foreign companies in China.

1.5 Thesis Structure
The thesis will be divided into five parts: introduction, literature review, methodological design, result and a conclusion. The introduction part includes background information, the research purpose, contribution to theory, delimitation and the thesis structure. The literature review will give an overview over the existing literature connectable with the research topic and conclude the framework that this thesis will be working in. Furthermore, it will give definitions to the important terms used in the research field. The methodological design will describe the research
approach, research strategy as well as the used research method. In the results, the main findings of the research will be shown and a brief conclusion will be drawn. In the last chapter will draw the research results and the findings applicable by MNE manager, consultants and regulators.

2. Literature Review

This section aims to examine existing literature, models and theories on the research problem. Relevant information that are useful in answering the research question are to be identified and investigated. While there has not been specific research on the critical success factors for German SMEs during the market-entry process into the Chinese market, this literature review will review the certain areas such as internationalization of SMEs, market entry into emerging markets, market-entry modes in China etc.

2.1 Theoretical Framework

2.1.1 Internationalization Theory

2.1.1.1 The Internationalization Process Mode: The Uppsala Model

While there is a wide variety of internationalization theories, the Uppsala internationalization process model which first published in an international academic review by Johanson and Vahlne (1977; 1990) is still the dominant model even though it has been revised (Johanson and Vahlne 1992, 2002, 2006; Figueria-de-Lemos, Johanson and Vahlne 2010) and criticized (e.g. the special session at the 28th European International Business Academy 2002) several times. As the Uppsala Model was mainly based on empirical findings of internationalization processes or large Swedish Industrial firms, it is questionable if the model can be applied to SMEs as well. Blomstermo & Sharma (2003) agree on this question and declare the Uppsala Model as valid for firms of all sizes, while Internationalization Process Models such as Bilkey and Tesar (1977), Cavusgil (1980) and Reid (1981) are only applicable to SMEs.

Johanson and Vahlne aimed to develop a theoretical explanation for market seeking foreign expansions based on arguments previously developed. Some of these arguments covered the behavioral theory of the firm (Cyert and March, 1962; Aharoni, 1966; Carlson. 1966), the theory of the growth of the firm (Penrose, 1959) and the incremental decision-making process.
From the perspective of Johnson and Vahlne described the internationalization of firms as a process of experimental learning incremental commitment.

As you can see in Figure 1, the Uppsala Model consist of four stages, which aim to explain how learning- and opportunity affect and is affected by the environment of the firm. Thereby, the result from one process will be the input for the next step of the process, which will again be provide for the next one and so forth. This makes the model dynamic. In the old, as well as in the new model, there is a distinction between the state and change variables, that are each divided into two aspects. While the original model focused on a specific firm, its activities in the foreign market that that market’s level of uncertainty (Johanson and Vahlne, 1977), the new model also takes relationships and networks into account (Johanson and Vahlne, 2009).

**Figure 2 The Uppsala Internationalization Process Model**

One of the main assumptions of the old model was that “a lack of knowledge is an important obstacle to the development of international operations” (Johanson and Vahlne, 1977). General market and market-specific knowledge both contribute to the commitment decision and while general market knowledge can be taught, the market specific knowledge can only be learned through experience. The model furthermore explains, that firms gain knowledge (state) by learning and making decisions regarding the foreign market and operation, thus they increase commitment (change) and the more commitment they make (change), the more knowledge they
get (state). This is a closed cycle in which the output, in this case the change, constitutes the input, in this case the state, of the next.

Accordingly, a firm will internationalize by making small steps in the market commitment dimension as well as in the cultural and geographical dimension. But there are exceptions such as for firms with large resources. In this case consequences of commitments are small, and they can make larger internationalization steps. Another exception are stable and homogeneous market conditions. In this case market knowledge can be gained through other ways than experience.

This Model can give a great contribution to the research concerning the market entry of Western SMEs into the Chinese market when trying to find the appropriate time for an SME to move into the market. As proved by the Uppsala Model, knowledge and experience play an important role when planning to enter new markets. Firms individually must decide, based on their resources, experience knowledge and other factors when is an appropriate time to enter the Chinese market while gaining experience after entering the market.

2.1.1.2 The Eclectic Paradigm of Dunning
The Eclectic Paradigm was first introduced by Nobel Laurate Dunning in 1976 and counts as one of the leading explanations for the growth of multinational activities over the past three decades. With its broad appeal it can be adapted by several sectors and types of activities. According to the OLI paradigm, foreign owned activities are driven by three sets of advantages: Ownership, Location and Internationalization (OLI). The presence or absence of these OLI advantages encourages or discourages firms to get involved in foreign activities.

![ODI Model](image)

*Figure 3 ODI Model*
First of all, the company should have an Ownership advantage to overcome the liability of foreignness. These advantages suggest that some firms will have some specific competitive advantage in a certain market, such as internal know-how, degree of vertical integration, organizational synergies or valuable, rare, hard-to-imitate resources. The ownership can also be access to assets which will be capable of generating income or cost savings. Location Advantages arise from certain characteristics of the targeted country, that give the firm better conditions than those that they can find in the home country. In order to make FDI worthwhile for foreign firms, host countries must of offer compelling advantages such as low labor costs, cheap raw materials or special taxes and tariffs. If the company-specific advantages at the targeted location cannot be directly marketed through licensing or similar forms or cooperation, then companies must establish a local subsidiary or acquire a locally based company. In this case, Internationalization Advantages appeared. The Eclectic Paradigm by Dunning suggest, that all three benefits must be sufficiently present so that a firm decides for direct investment. If this is not the case, the company might choose other strategies for internationalization, such as Exports, Licensing, or cooperation within international corporate networks. (Dunning, 1979)

The results of the ODI model give great contribution to this research as they set a framework for the decision of a company whether to enter a new market or not. Companies lacking one of the advantages described by the ODI model might be more likely to fail in the entered market which is why ODI model should be considered before making a market entry decision.

**2.1.1.3 Network Theory of Internationalization**

The Network theory of Internationalization takes intra and interorganizational networks for a successful internationalization into consideration. Cook and Emerson (1978) define network as a junction of relationships. Especially SMEs often externalize their activities during their internationalization by depending heavily on establishing networks to select the market and the entry mode (Coviello and Munro, 1997). Coviello and Munro (1997) have also discussed that relationships and networks allow for a faster and more successful internationalization. Furthermore, they stated, that the form of internationalization as well as the degree to which a SME internationalize is influenced by the relationships in the network a company operates in. Firms can internationalize by building financial, technological and market relationships with other members of the networks and thereby slowly increase their activities across national borders.

In the modern business environment networks become more and more important and especially in complicated markets such as China, a missing network can lead to the failure of foreign
companies. Especially the establishment of inward connections and domestic relationships in internationalization become key factors for companies during their internationalization process which is why the Theory of Internationalization becomes one of the key theories in the framework of this study. (Ratajczak-Mrozek, 2017)

2.1.1.4 The Internationalization / Transaction Cost Theory
Buckley and Casson further developed the transaction cost approach by Coase (1937) as well as the market-hierarchy paradigm by Williamson (1975). According to this internationalization theory, firms can deal with international transactions externally, through exports or license agreement, in the market or through an in-house hierarchy (FDI). Transaction costs in the host market need to be compared with internal coordination costs that would arise when carried out in-house (Perlitz, 2004). As the transaction costs theory, the internationalization theory maintains that a firm performs business transactions outside the home market, whenever these costs are lower than the internal organization of these activities. Transaction costs can arise through several causes. Most of the market imperfections arise from government interventions in the home or the host country such as tariffs, restrictions on capital movements or from differences in income and profit taxation (Kutschker and Schmid, 2006). To overcome these market imperfections, companies need to consider the initiation, negotiation and conclusion of contracts (ex-ante costs) as well as supervision, putting through, and modification of contracts (ex-post costs) (Welge and Holtbrügge, 2003). Williamson (1975) states, that the height of transaction costs is generally determined by the Specificity, the danger of opportunistic behavior and declining costs rise with increasing specificity of performance, Uncertainty, the higher the uncertainty, the more difficult it is to include the complexity of possible future developments in contracts, Frequency, the more frequently equal transactions are carried out, the lower the average costs of a transaction due to learning effects.

2.1.1.5 FSA/CSA-Framework
Another important framework to consider when researching the success of SMEs during their market entry are the firms-specific advantages (FSAs) and the country-specific advantages (CSAs). While firm-specific advantages concern the strengths specific to a firm which can be the personal, certain technologies and/or equipment the country specific advantages concern the benefits of a certain country such as the competitive environment, the labor force, industrial clusters or natural resources. Furthermore, Porter’s diamond model can be used to investigate CSAs (Porter, 1990).
Hereby, the importance if relevance of these two advantages differ for different companies and industries. The FSA-CSA-Matrix implies, that if CSAs in the home country is high and FSAs of the company are low, then the comparative advantage of a country will, regardless of the specific characteristics of the company, lead to exports. On the other hand, if FSAs for the company are strong but CSAs are weak, then exploiting the company’s research regardless of the location will be the focus. FSAs and CSAs strongly influence the operation of companies across borders. To be successful in the new market, companies must combine their own FSAs with the country-specific CSAs (Rugman/Verbeke/Nguyen, 2011).

To find the CSAs and FSAs and use them in the right way can therefore be a critical success factor also for SMEs entering the Chinese market, which is why this theory is from high interest in this research.

2.1.1.6 Modes of Internationalization

According to Jaussaud and Schaeper (2006) the interaction and balance between the instrument of control for subsidiaries abroad are an important factor for the success of international operations. Their research concentrated on the specific case of Japanese and European subsidiaries in China, considering Joint Ventures (JVs) and Wholly Foreign Owned Enterprises (WFOEs). They assume, that if the subsidiary is a WOFE, the company should rather use essentially contractual control mechanism ex. in form of human resources sent from the head office than training and organizational mechanism to control the operations in their oversea subsidiary. Furthermore, the success of internationalization and market entry is influenced by four-micro processes that are: accelerators, export barriers, selectors of intra-stage foreign market development and foreign market outcomes. (Mtigwe, 2005). These should be considered and taken into a special account when looking for a successful market entry strategy. According to Fink and Kraus (2007) that the establishing trust-based cooperation relationships with foreign partners and cooperative arrangements will affect the success of the subsidiary positively. Ripolles, Blesa and Monferrer (2011) concluded, that firms choose relatively low-resource commitment entry modes to enter foreign markets and have significant impact on operations while firms which take higher risks by committing higher resources also increase their chances of getting quicker results. The international learning effort and experience of the certain company plays an important role in the decision on the resources the company commits into the new foreign market. The balance of the right resources invested seem therefore to be a critical factor for companies entering foreign markets. While some companies prefer to consolidate at their home country first, conducting export next and then making the step into the foreign market, others might be more aggressive, directly investing into the foreign market.
This thesis tries to close a gap, giving recommendations about which strategy is preferable for a successful market entry of a German SME in China.

2.1.1.7 Market choice

The incremental internationalization model (e.g., Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975) and related studies (e.g., Davidson, 1980; Welch & Lounstaren, 1988) argue, that companies should follow a sequential process, first selecting countries that are similar to their home country and later entering countries that are dissimilar. The incremental internationalization model further argues, that managers’ lack of knowledge about foreign markets and their related aversion to risk explain the firm’s selection of countries to expand to (Johanson and Vahlne, 1977,1990). A very important and related view is therefore the knowledge-based one. It argues, that knowledge explains the existence of a firm and its expansion across countries (Spender and Grant, 1996; Eisenhardt and Santos, 2002). Kogut and Zander (1993) explain, that a domestic firm goes abroad, when it has an advantage that is better transferred, used and protected abroad by using the firm than by using the market. In order to internationalize successful, companies need to develop three types of knowledge (Eriksson et al., 1997; Eriksson, Majkgard, & Sharma, 2000): (1) internationalization knowledge, which is knowledge about how to manage the increase in complexity and diversity associated with the overall foreign expansion; (2) foreign business knowledge, which concerns knowledge of clients, markets and competitors abroad; and (3) foreign institutional knowledge, or knowledge of government institutional frameworks, rules, norms and values prevalent in foreign countries. Companies are likely to first enter markets with close “psychic distance” (Stöttinger & Schlegenmilch, 1998), what can help them to elevate the risk of “foreignness” (Hymer, 1976) and gain experience and knowledge as a basis for entering other foreign markets (Johanson & Vahlne, 1977). Due to those arguments, literature suggest that most companies choose a sequential internationalization. However, companies that have developed certain knowledge in their home country that allows them to manage compacity, differences in competitive conditions and differences in institutional environments may choose non-sequential internationalization (Cuervo-Cazurra, 2010).

2.1.2 Large firms vs. SMEs

It is important to understand that SMEs distinguishes from large firms in many aspects and research applicable for large firms is often not transferable automatically to SMEs. There different definitions and methods to define SMEs and large firms, that can depend on the region, their governments and industries. SMEs and large firms differ not only in size but also in their HRM, Financial Management, Inventory Management, Performance Management, Operation
Management, Risk Management and many other management aspects. (Gleeson, 2018). It is often discussed, that whole large firms can resort to traditional theories of internationalization, the internationalization of SMEs cannot be generalized and a very individual strategy, motivated by different competitive needs and enabled by different strategic drivers must be employed (Etemad, 2004).

### 2.12.1 Characteristics of large firms vs. SMEs

Etemad (2004) states that “The SME’s relatively smaller resources greatly disadvantage them in the case of direct conflict with the larger firms”. Therefore, SMEs that want to operate abroad need to develop their own different, maybe even unique and dynamic, competencies ((Eisenhardt & Martin, 2000; Hamel & Prahalad, 1985. 1990; Mathew, 2003; Teece, Pisano, & Shuen. 1997) and develop equally distinctive competitive strategies (Fahy, 2002; Grant, 1991. 1996), that can help them to compete against MNEs and local embedded companies.

Small and medium firms often operate in narrow but well-defined market niches (McDougall & Oviatt, 1991; Oviatt & McDougall, 1995, 1997) and their strengths compared to big companies is often a higher value such as higher quality or lower prices (Dana, Etemad, & Wright, 2000, Etemad, Wright, & Dana, 2001). Small- and medium sized companies that could offer this kind of advantage, became globally competitive and have experienced a much higher rate of rapid internationalization (McDougall & Oviatt, 1991; Oviatt & McDougall, 1994, 1995, 1997).

Given those assumptions, the success of SMEs can be linked to game theoretic principles (Shubik, 1952, 1953, 1955; Von Neumann, 1954; Von Neumann & Morgenstern, 1947) as well as the competitive strategies that are resource-based (Barney, 1991, 1997; Grant, 1991, 1996; Nelson & Winter, 1977, 1982; Wernerfelt, 1984) and a SMEs’ distinctive core competencies and dynamic capabilities ((Hamel & Rahalad, 1985 & 1990). Internationalization strategies of SMEs are therefore very distinct and based on the sometimes very unique resources of the SME. SMEs must therefore develop their own and distinct competencies such as assets, dynamic (Eisenhardt & Martin, 2000; Mathew, 2003; Teece et al.. 1997) capabilities, core competencies (Hamel & Prahalad, 1985, 1990), knowledge (Nonaka & Takeuchi. 1995), collaborative advantage (GomesCasseres, 1996; Kanter, 1984; Yoshino & Rangan. 1995) or relationships to overcome entry, exit and competitive barriers.

Empirical research suggests that most of the large firms pay higher wages, are more effective, are more likely to survive, obtain more patents and rather operate international than small firms (Gibson and Stillman, 2009; Kim et al. (2009). Furthermore, Leung et al. (2008)
found out, that large Canadian firms in the manufacturing sector as well as in service and trading are more productive than small firms. The same results have been found for firms in France, Germany, Japan, the United Kingdom and the Unites States (Van Ark and Monnikhof, 1996). Small firms are also less likely to survive in the market than large firms are. Agarwal and Audretsch (2003) found out, that the growth in positively related to size and that firms that enter the market at a large size are more likely to survive than those that begin operations at a small size.

2.1.2.2 Internationalization of large firms vs. SMEs

While in the past, smaller companies rather stayed in their local or regional environment, thanks to the globalization which removed many barriers, more and more SMEs are internationalizing (Levitt, 1983). When going abroad, SME face the competition of multinational enterprises (MNEs) as well as global competitive and regionally dominant local firms. Therefore, they must the necessary and sufficient conditions to face this competitiveness (Fahy 2002; Grant, 1991; Mathew,2003) while at the same time they have to deal with limited resources (Bell, Murray, & Madden, 1991; Bonaccorsi, 1992; Etemad. 1999; McNaughton & Bell. 2000; Miesenbock. 1988). Little internationalization theories have acknowledged the difference between SMEs and MNEs and accordingly taken the special characteristics of SME into account (Etemad, 2004).

Regarding the market entry, researched have also found big differences between large firms and SMEs. Empirical studies show, that smaller-scale entry is more likely to fail during the entry than their larger counterparts. (Geroski, 1995; Sutton, 1995; Caves 1998). In fact, every study, except one (Harhoff and Stahl, 1995), have found a positive relationship between the firms’ size and the likelihood of survival. (Geroski (1995) stated, that “both firm size and age are correlated with the survival of entrants”. While Cave and Porter (1977) argues that through the occupation of niches, there is no need for small firms to growth in order to survive, according to Geroski, as small firms have a lower likelihood of survival and the likelihood of small firms to survive is directly related to growth, firm size is found to be negatively related to growth.

2.1.2.3 Characteristics of German SMEs

Germanys´ SMEs are envied by the whole world and are the backbone of Germanys strong economy. Germany has more global market leaders than any other nation in the world. Nearly half of the successful SMEs which are considered to be global market leaders are still owned by their founding families. Family business have certain advantages which are ex. that
“New customers are more likely to trust the owner than a manager who might not even be there anymore in a year’s time.”. Christoph Müller, a professor of business economics who specializes in small and medium-sized enterprises, or SMEs, at the HBM business school in St. Gallen, Switzerland, points out five characteristics that seem to make German SMEs being that successful. The first one is the effort to adapt to clients. Lots of German SMEs have realized, that you can not become a market leader if you offer the same product in different markets. Second, a lot of German SMEs open branches in foreign markets. Müller said that “Many global market leaders have recognized that exporting often isn’t enough”. Companies need a local base to “get the business”. Furthermore, companies need to acquire other companies in order to access markets or expand the portfolio to later be successful and competitive also in other markets. One of the main characteristics, that makes German SMEs successful is the occupation of a special niche. While other companies try to enlarge their business portfolio in order to become successful, German SMEs tend to choose a specialty and strive to become a world leader at it. The last point is developing new technologies. German SMEs often work together with one of Germany’s many research institutes. More than half of the German SMEs work continuously on innovations and they have five times as many patents as ordinary companies. 

Other factors that make German SMEs successful are ex. the Germanys strategic management of place (Standortpolitik) and the concentration on developing workers skills. Every state, region and city has a mandate with the responsibility to achieve and sustain economic property. Therefore, the certain locations implement incentives, regulations and policies that benefit the companies. Furthermore, they closely work together with state and federal levels to build on their strengths and support the local companies. This also related to the development of a skilled labor force. Companies work closely together with educational institutions. Nearly 50% of German high-school graduates in Germany start an apprenticeship and about 90% of the these are covered by SMEs (Dakers, 2017).

2.1.3 Institutional and country environments

2.1.3.1 Institutional environments China vs. Germany

Institutions are defined as regulatory structures, government agencies, laws and courts (Scott, 1987). Businesses will respond to their institutional environment to exploit and develop opportunities and to react to perceived threats (Andrews, 1987). Many research has be done on the influence of the institutional environment for business the close relationships between
environment, strategy and structure (Lawrence and Lorsch 1967; Thompson 1967; Venkatraman and Prescott 1990) and it is suggested, that changed in strategy and structure are directly related to changes in the market and the relevant environment (Chandler, 1962). A difference in the institutional environment and with that the treatment of new ventures differs especially between emerging and developing economies (Yamakawa et al., 2008). While it takes around 92 days to set up a business in China, it only takes around 18 days to do so in Germany (Djankov et al., 2002). Generally, there are significant differences in the institutional environments of China as an emerging and Germany as a developed economy. Companies transferring from one to the other market must be aware of these differences and adapt to the local environments.

According to the Ease of Doing Business report by the World Bank, Germany places rank 20 in 2018. The “business freedom” index for Germany is 89.6. The business freedom is well protected, and the regulatory framework can foster innovation and business formation (Heritage Foundation, 2011). In favor of the business freedom, the relatively low costs and a structures and friendly institutional framework, new ventures prefer establishing their businesses in developed economies such as Germany (Yamakawa et al., 2008). Developed economies in general also have a trade friendly environment and a strong institutional framework. According to the Heritage Foundation (2011), tariffs and other restrictions are well controlled and enforced by authorities. Germany, with a trade friendly environment index of 87.6, belong to one of the most friendly environment regarding foreign trade. On the other hand, Germany's complex safety standard can harden the entry of foreign companies and anti-dumping protection regulations are implemented to protect domestic firm against foreign competition (Department of Commerce, 2010). Furthermore, generally developed economies have strong formal institutional property rights and the governments guarantee the strict enforcement. There is very limited or no corruption and expropriation by the government is very unlikely. Germany has a “property right” index of 90, proving secure property rights (Heritage Foundation, 2011).

China counts as an emerging economy while Germany is considered as one of the most developed economies in the world. Based on its purchasing power, China today is the largest economy in the world (Morrison, 2015). However, firms that want to enter the Chinese market need take into account, that the market entry comes along with many challenges. The institutional environment in China has undergone significant changes within the last decades. Policies to further liberalize the market keep being implemented and more and more authorities have been given to lower-level government units, what also effect the business environment, as city governments can now formulate and implement policies also regarding business activities
However, there are still many institutional challenges such as the rule of law that is still in an early stage of development with a rather inconsistent enforcement. Furthermore, there is a need to develop a better environment for the protection and enforcement of intellectual property protection laws, regulations and procedures (Chen, 2007). Formal institutions, including the legal, regulatory and politic systems remain relatively weak, while informal institutions still play a significant and complimentary role in the behavior of firms (Chen and Chen, 2004; Luo 2000; Gao et al., 2010). The weaker institutions that firms face in China means that there are fewer formal constraints on business activities and although this provides more discretion for managers, it also creates more ambiguity. In countries with a weak rule of law, contracts are not a major value, which is why Chinese companies depend largely on relational norms for the governance of specific relationships (Zhou and Xu, 2012). To promote FDI in China a number of new laws have been implemented to protect property rights and amend current laws to comply with the World Trade Organization (WTO) obligations. Furthermore, the degree of marketization and the effectiveness of law enforcement have improved in many provinces, especially those that face high FDI (Fan et al., 2007, 2010; Zhou and Poppo, 2010). Even though China is one of the world biggest economies, according to the Ease of Doing Business Index published by the World Bank, China only placed rank 78 out of 190 in 2018. To improve market access, companies should cooperate with local governments or local cadres (Xin and Pearce 1996; Bai, Hsieh, and Song 2014). China, as one of many countries with a central planning background, remains a strong influence on capital allocation (Witt and Redding 2013). Furthermore, legal and cultural challenges often influence the performance of foreign companies in the Chinese market.

**2.1.3.2 Legal Challenges in China**

The most important legal challenges when entering the Chinese market is the entry mode choice. Different sectors and industries face different restrictions (Lehman Brown, 2015; PWC 2012) and investors have to consider the restrictions on their businesses based on the “Catalogue for Guiding Foreign Investment in Industries” (Invest in China, 2017). Based on this list, industries are classified as (1) encouraged, (2) permitted, (3) restricted, or (4) prohibited. Generally encouraged industries are those into new and/or advanced technology sectors, projects that will increase export/import, projects that conserve and protect the environment, projects that can increase the efficiency in which manpower is used etc. Prohibited industries, which are completely off limits to foreign investment are those, that can endanger state security, harm the public, pollute the environment, endanger human health, endanger the use of military resources or would use manufacturing techniques that are unique to China. Companies that
want to operate in restricted industries need the approval from higher level of governments and may be required to enter into a joint venture with a Chinese partner or other partnership with local shareholder in order to be able to enter the Chinese market. (Prange, 2016)

Furthermore, companies need to choose between different types of market entry. Depending on the government restrictions companies can “go alone” or enter the market with a Chinese partner. There are many different choices for companies entering the Chinese market, but the Representative Office (RO), Wholly Foreign-Owned Enterprise (WFOE) and the Joint Venture (JV) are the most common ones. Proceeding, companies have to make further choices regarding their market entry mode. A WFOE for example can be established as a service, trading or manufacturing WFOE. These entities have different restrictions and the choice is decisively for the framework a company if allowed to work in after the establishment. Changing the type of entity after the establishment is again connected to high costs and might cause a company to fail (Dezan Shira & Associates, 2018).

### 2.1.3.3 Cultural Challenges in China

Besides these legal challenges, cultural challenges arising for foreign firms in China often cause trouble during the market entry. Companies that want to be successful in the market need to adapt to local practices. In the literature guanxi is one of the most mentioned cultural aspect affecting business practices in China. Guanxi derived its meaning during the Confucianism, where lun was used instead but is used as the root of the guanxi the way it exists today (Kind, 1991). China is a very relationship-based society, and not only private but also business relationships are still influenced by this principle. According to Chen and Chen (2004) guanxi is “an informal, particularistic personal connection between two individuals who are bounded by an implicit psychological contract to follow the social norm of guanxi such as maintaining a long-term relationship, mutual commitment, loyalty, and obligation. A quality guanxi is also characterized by the mutual trust and feeling developed between the two parties though numerous interactions following self-disclosure, dynamic reciprocity, and long-term equity principles.” To understand the influence of guanxi in Chinese business practices, Vanhonacker (2004) commented “In the West, relationships grow out of deals… In China, deals grow out of relationships”. Companies establishing new businesses in China needs to understand this principle in order to be successful with Chinese partners.

Furthermore, another important principle to follow when doing business in China is mianzi. Mianzi, which is often translated as losing face, “refers to an individual’s value in the eyes of others, or the kind of prestige or reputation achieved through getting on in life though success
and ostentation” (Hu, 1944). Even though the concept of mianzi is less widely commented by non-Chinese media and research, a misunderstanding in the importance of face can have serious consequences for businesses and individuals. In order to have a successful business relationship, all partners need to make sure that all business partners need to retain face, as is a Chinese businessperson’s “most precious possessions” (Brunner and Wang, 1988).

Many Western companies assume that they can operate with the same business principles and practices they do in their home countries. Companies that do not prepare themselves and their employees for these cultural differences and challenges might be more likely to fail in the Chinese market.

2.2 Review of the previous literature

3. Methodological Design

3.1 Research Design
3.2 Quantitative vs. Qualitative Research
3.3 Case studies as a scientific method
3.4 Data collection
3.5 Verification and generalization of empirical data
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