

Challenges in the transition from China-Made to China-Innovation

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ABSTRACT

The introduction and appearance of Chinese brands in the international market is an emerging issue for Chinese firms. This paper highlights the challenges encountered by Chinese firms while moving towards original brand manufacturing (OBMs from original equipment manufacturers (OEMs). The study identifies that branding dilemma, the performance of Chinese firms in domestic markets, lack of government support, need of global distribution channel and marketing, technology backwardness and need for strong R&D activities are some important factors that are impeding the successful switching of Chinese OEMs to OBMs. The OEMs can convert these challenges into opportunities by effectively coping with them. The study also presents some recommendations to deal with the problems.

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Introduction

Asia has become the hub of the manufacturing in the world during last 25 years and as a result alleviated poverty. Several Asian firms have grown into successful original equipment manufacturers (OEMs); manufacturing goods for international brands. A key example is China. After the opening up and reforms in China there was a significant development in last thirty years of development which makes the China the world's manufacturing center of many products, and broadly considered as the "factory of the world." Chinese corporations largely depend on the world's multinational companies possessing the technology, innovative design competencies, brands, and sales channels to execute OEM production that brings low-end processing mode and low-profit margins [1].

The cheap labor advantage of China is fading due to the domestic economic development and the progress of Southeast Asia and other emerging countries, which makes challenging to depend on the OEM production mode. The increasing production costs in China have made the manufacturing business model less profitable, presenting lesser margins and a decline in productivity. Since with China's progress, most of their major firms are investing in research and development (R&D) and innovation having wish to expand their own branded products that require a premium and higher margins [2].

So far there are very few successful examples switching from manufacturer to brand owner in mainland China including Taiwan Haier, Giant, ASUS, Galanz, Acer, HTC, Johnson, Maxxis, Depo, and Merida [3]. Chinese manufacturing companies that cogitate to enter into international markets come across many challenges including competing with experienced incumbents that have a well-built understanding of the brand and advanced marketing skills. In developing markets like China, the firms that desire to set up successful brands in the US, Europe, and Japan should vigilantly think about the difficulties ahead and the

persistent dedication needed to overpower them. Developing and maintaining brands in developed markets is an expensive, complex and uncertain enterprise [4].

The research question of the study is that what are the different challenges that OEM companies face in the way of moving towards OBM? The study derives the motivation from the thoughts that OEM firms have become less profitable due to China's aging problem cheap labor shortages, increasing production costs and switching off their customer base to other developed economies so, the need for adopting an alternate strategy arises. Chyr [5] argued that investigate the challenges faces by OEM companies moving towards OBM is under researched area. Also, the literature reveals that most of the articles and books published in recent years have focused on how international trade has contributed to the economic growth of China, about MNCs strategies regarding market entry. However, less attention has been paid to firms' international expansion strategies and challenges affecting their development [6].

Rest of the paper as follows section 2 discuss the literature review, section 3 will provide recommendations and concludes the study.

Review of Literature

The review of the literature highlights the significance of OEM strategy associated with OEM transition towards brands. It then looks at the threats of not adopting the shifting policy and, afterward, the issues related to switching from OEM to OBM. For a firm that has not a brand image and perhaps rooted in a country with the bad reputation in the world, it would be hard to market to internationally [7]. OEM branding is one approach that evades these difficulties [5]. It decreases the marketing costs radically and product associated legally with the client's brand name.

Grunsven and Smakman [8] studied the OEM strategies of the garment industry in Singapore in the 1980s and 1990. They observed and evaluated the successful

internationalization of 47 OEM firms through different strategies as well as pathways and found that a few OEM firms had both the production as well as marketing departments of their brands, while OEM (supplying goods to other brands) was their core business. On the other hand, research suggests that few a successful transition of few OEM firms to original design manufacturing (ODM) while also working as OEM [7].

Amongst the restrictions in switching from OEM to OBM, Yeung [9] reported the three corporate strategies of leading Asian firms including a strategic partnership with other firms, targeting some segments according to specialization, and ownership of global brands. Likewise, Child and Rodrigues [10] experienced the same strategies in China with a case study of Haier internationalization through partnerships, acquiring of foreign brands, innovative technology, and market position.

In comparison to the advantages of OEM, Lee and Kim [11] studied the shift of Korean OEM into China due to low costs and found that failed not compete with Chinese OEM producers due to their cost efficiency. Another risk is that OEMs have low margins as these firms rely on customers' orders and rates if the customer finds another OEM company that done their order in small cost then they will switch to that firm [7].

The literature appears to offer less exposure to the obstacles in the transition from OEM to OBM [1, 3, 7, 12-14]. The associated costs in this transition from OEM to OBM should not be undervalued. For instance, the probable supplementary costs; both financial and time of shaping a brand in a foreign country, in comparison to just contract manufacturing, are expected to include "R&D, product development, name search and registration, international market selection, market entry mode selection and implementation, marketing channel selection and management, marketing communications and marketing planning" [7]. In addition to this, a lot of other factors are essential for success.

Wreden [15] stated that several Asian firms shifting from OEM to OBM have to build an understanding of branding and to consider it as an investment instead of just a cost. He recommends that they are likely to associate branding with advertising instead of the "ability to develop emotional and experiential relationships with customers." The options facing a firm that desires an OBM approach are whether to implement a single or multi-brand strategy and whether to sustain an OEM strategy as well, the opinions for each policy have been widely recognized [7]. Zhang [12] proposed corresponding OEM and OBM strategy is a significant and effective strategic choice for various manufacturing firms through a profit-maximization model.

A major lead of multiple-brand strategy is that it provides more revenues as there are from various market segments [3]. Maintaining an OEM strategy also means more opportunity given that the OEM and OBM options target different segments. It is very risky for a firm to have a business model with both OEM as well as OBM that might "stuck in the middle" according to Porter [16], as on the one hand firm needs to be cost efficient to compete for OEM, whilst OBM puts extra costs due to differentiation from others.

The transition from OEM to OBM also requires commitment and sense of change from top managements and employees. Acer (the Taiwanese laptop company) built the sense of change and determined to the emphasis on R&D,

target marketing and it outsources its manufacturing to other OEM firms [17]. Another firm, Asus adopted a changed method by transferring its OEM segment to its wholly owned subsidiary. However, other companies from Taiwan such as Arima, Clevo, Elite, and Twin head preserve to house OBM and OEM business in the same company [17].

Switching to branding requires OEMs to transform their business model as it entails a significant amount of investment in R&D and marketing and an extended lead time to attain competence beyond manufacturing technology [5, 18, 19]. It has been specified by the evidence that OEMs often have to keep their OEM business going on to back up their long-standing investment into activities related to OBM [20]. Thus, even though switching to OBM look like to be the best path in GVC framework, in fact, this transfer model might be too uncertain for some Chinese OEMs to take up [21]. Some large OEMs like Foxconn and TSMC (Taiwan Semiconductor Manufacturing Company) have agreed on to declare their customers that they will not go beyond the line for branding [21].

Provisionally, in spite of risks, the plan of adopting branding by Chinese OEMs is encouraged by China's local governments. In return to declining demand of mature markets in current years, the Chinese government has implemented a range of expansionary fiscal policies to motivate firms to venture back to domestic markets; specifically, it has exclusively actuated local OMEs to set up own brand identification and compete on the world frontier at home [22, 23]. In China [24] five-year economic plan, the government emphasizes the significance of encouraging local OEMs to set up own brands, while the exploitation of international markets, to help shift the country up the (Global value chain) GVCs [25].

Through government's dynamic supports, domestic markets have turned out to be a well-suited policy for Chinese OEMs to shift to the most value-added OBM phase, specifically when there is low capacity for expanding exports to developed countries in the upcoming period. For Chinese global startup OEMs, carrying out own brand approach to compete domestically is becoming a conventional trend [23, 26]. Provided the significance of branding might be different across industries, Chin, et al. [21] recently studied the global startup OEMs embedded in buyer-driven commodity value chains. Such type of value chains point out to industries where the GVC direct firms with strong brand names command decentralized production networks in a variety of exporting countries, such as electronics, home decoration, and apparel industries (e.g., Sony, IKEA and Nike) [27].

Since mentioned before, a shift from OEM to OBM is risky. Aside from discouraging the original customer-supplier relation, OEM firms need to involve themselves in marketing and R&D and produce for their inventories instead for order when getting on OBM [14, 20, 27]. They have to attain an inventive mode with a definite amount of investment rather than engaging in a competency game as contract manufacturer [1]. As a result, the decisive knowledge obtained through internationalization might turn out to be even more important. But transforming from OEM to OBM is very challenging and dynamic process [5].

Key challenges in transition from OEM to OBM

Many Chinese firms who desire to move towards adopting own brand strategy face various challenges. I have emphasized following major challenges including branding dilemma, performance in domestic markets, Global

distribution channel and marketing, technology backwardness and investment in R&D and innovation presented in Figure 1.

The transition from OEM to OBM is a reformulation of the business field that results in increased uncertainty. Firms that are switching to OBM strategy and desire to be successful must cope with branding dilemma, an issue that arises when OEM firm during switching engages in dual-track business [3]. When OEM firms choose to adopt own brand strategy the conflict of interest arises with their MNC customers. As it sounds threatening for MNC clients that an OEM firm is going to reveal their business secrets to the potential competitors or cross subsidize its own brand with the profits earned through its contract manufacturing set-ups and consequently challenging the prices of MNCs' products [28]. The transforming firms cannot escape from the allegation that they are biting the hands that feed them [3].

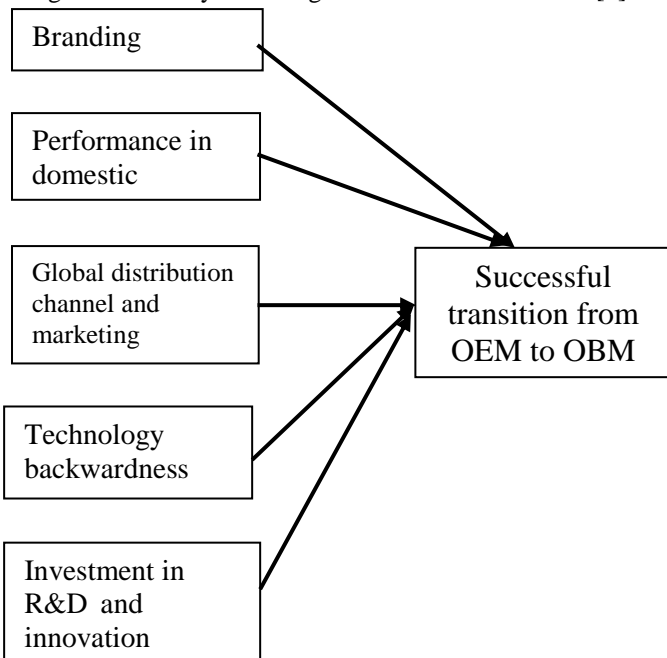


Figure 1: Key challenges from OEM to OBM

Switching to OBM renders various new opportunities, however, the risk taking business should line up their policies to deal with the obstacles with the aim to be benefited from the new paths of success [29]. The commercial leaders should practice replenishment strategies to tackle the changing environment [30, 31]. It is not necessary that all firms encounter branding dilemma it depends on the entrepreneurial setting and the approaches the transforming firms take up [3]. Some firms deal with this dilemma by keeping their OEM and OBM businesses separate. Some carry on their business successfully through developing a concerted relation with their MNC clients.

Success at home is often a precondition to funding the R&D and innovation needed to go through mature markets [2]. McGowan, et al. [32] claimed that expansion in the domestic OBM is more and significantly profitable as compared to OEM and they documented that firms long term future lay in an expansion of OBM in the international market. Cardoza, et al. [6] state that after the global financial crisis of 2008-2009 the pressure of sales growth placed the Chinese firms in the situation to find opportunities in their huge domestic markets. While these firms have to face difficulties when they moved from foreign markets that were well regulated to their home markets in spite of the fact that they have acquired valuable knowledge through

internationalization because the legal protection was weak in China [6].

To practice OBM, one of the biggest challenges is the global distribution channel and marketing for most OEM firms, which have been accustomed to the production and R&D with decades of practicing OEM/ODM [19]. For OBM firms to be successful, the availability and accessibility of products and service to customers are imperative. Distribution channels make up the "place" in the 4 p's of the marketing mix (along with product, price, and promotion). How to best deliver your goods to their intended destination can change drastically across international markets. Understanding what factors influence global logistics and choosing the most reliable channel can be one of the most critical challenges faced by the global marketer. Supply and distribution chain management decisions pose large organizational and financial risks to any company.

One challenge for Chinese OEM companies is having the patience to be consistent in strategy and long term vision. They like to go fast and want to see the results tomorrow [18]. Creating a brand and get it recognized globally requires a long term commitment and smart management of visionary leaders of the company. With a moderating force of strategic leadership, which not only enhances the organization's long-term viability, but at the same time also maintains the firm's short-term financial stability, such capital and capabilities are able to lead a firm to transform from OEM to OBM, as shown in variant cases of Taiwanese global brands [19, 33].

Global competition makes OEM industry's unfavorable characteristic, such as weak value-added capacity, low-level technology, significantly weak brand competitive disadvantages, more significant [1]. Therefore, OEM is urgently needed to upgrade to the higher level of the value chain. Research scholars have drawn the enterprise upgrade path from OEM to ODM and then to OBM with cases and related theories [13, 34]. In this process, the technological innovation is one of the core elements of the upgrade. If enterprises have a valuable, scarce, inimitable and irreplaceable resource, they will have access to potential sustainable competitive advantage [35]. Following the route of technological innovation to acquire the proprietary technology for competitive advantage, then to accomplish the upgrade to ODM model, is an important way for OEM enterprises to achieve transition towards high-tech and branded model [1].

OBM is also about innovation and continuously doing new things to cater the demands of target customers [18]. Innovation is not just for products but also services, processes, and business models. The long term investment is needed to do marketing research for forecasting the needs and wants of customers, producing new and innovative products and adaptation of latest technology [2, 3, 7].

The internet changes many companies and consumers on what we need, how we work and how we think. New business models like Facebook, Google, Groupons, etc., come every day [33]. OEM that transforming towards OBM needs to build innovative culture and capabilities to sustain its success in the future. It is not just an R&D department but also training, process, incentives, policies to recruit, develop and retain innovative talents. Zhiying and Xiaofeng [1] suggest that constructing industry-education-research cluster and independent R&D essential for successful OBM transformation.

Besides the market-level barriers, there are also cultural obstacles that affect the ability of new Asian marketers to effectively build up their own brands abroad. Most of the manufacturing companies have their origin in trading, particularly family-owned firms. The trading mentality is likely to emphasize on high turnover and low margins, with a stronger commitment to sales and distribution instead of branding and positioning [2].

Conclusions and Recommendations

OEM model has several benefits regarding technology, quality enhancement, entering into foreign market, large sales volume with limited expenditure. But the risks associated with OEM strategy are also present. On the other hand, the OBM advantages appear to be a natural growth on the way to OBM. However, numerous factors contribute towards the OEM-OBM choice for any specific firm that has mentioned above. Certainly, OBM is a difficult business model. The commitment to invest in the brand over the long term is crucial for success.

Chinese firms can raise their brands in the domestic market particularly due to low brand development expertise and less financial resources. On being successful, it can promote its brands to other emerging markets that are particularly more open to new brands. I highly suggest that OEM firms must follow four paths recommended by Zhiying and Xiaofeng [1] for progression towards ODM; absorbing technology spillover, adverse OEM, constructing industry-education-research cluster, and independent R&D To be successful, adequate employee training, appropriate resource allocation, and a persistent long-term brand strategy are essential. Firms that are committed to improving quality innovate product design and service and invest time to ensure the brand would be certainly successful. The manufacturing business now does not have high margins than before. Several Chinese firms are generating their own brands in order to reinvent themselves. A strong commitment to innovation and consistent delivery of customer value across all geographies and a clear brand strategy can lead to successful shifting from OEM to a valuable brand in China.

In general, Hong Kong manufacturers engaged in OEM, OBM or ODM should consider growing product safety concerns, increasing competition, and growing environmental realization. They need to improve the overall quality of their products and services by moving the whole value chain upward. In addition to these, enhancing product safety and reliability, improving warehousing and logistics, presenting better designs and features, using environmentally friendly materials, and strengthening marketing and distribution are also important to consider when shifting upward. However, manufacturers must balance the higher costs needed to increase the added value. For this, they should make use of production and information technology to improve their effectiveness in manufacturing and other value-added activities, while containing escalations in costs.

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