

The Chinese Service Industry as a Challenge for European SME: A Systematic Approach for Market Entry

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Abstract

Compared to industrial firms, the market share of foreign companies in the Chinese service industry is rather low. Especially western small and medium-sized service providing enterprises face different problems when they try to establish a business in China. Therefore an approach has been developed within a research project, which aims to support these companies in planning and successfully realising a service market entry in China. Methods are presented, which allow a systematic benchmark and selection of the target markets and a detailed definition and agreement of the cooperation between the Chinese and the western company.

Keywords:

Internationalisation, Service, China

1 INTRODUCTION

In the recent past, the service sector has grown rapidly. In many industrial countries, the service sector even accounts for a higher percentage in economic development than the traditional manufacturing sector. Like manufacturing companies before them, service providing firms are also experiencing the process of internationalisation by following their clients into a foreign market or seeking a new market in a foreign country.

With several reforms and the opening-up policy, China has utilised a large amount of foreign investments. However, the multinational corporations in China were mainly manufacturing companies. Until recently, China had failed to recognise the important role service can play in economic development. As a result, the service industry has remained relatively underdeveloped compared to other fields of industry.

The manufacturing sector will remain the main driver of economic growth in China for some time to come. However, the services sector is also now being touted as the country's next main engine of growth, as services will provide a solution to China's serious employment challenges, sustain economic growth and raise living standards. China's accession to the WTO in 2001, with its commitment to liberalise services, is expected to herald a new era in the country's services trade [1].

The huge potential of the Chinese service market attracts many multinational companies including German service providing firms. Although German manufacturing companies have obtained much experience in entering the Chinese market, this remains a relatively new topic for industrial service providers. Therefore, a procedure model that allows, especially small and medium-sized service providing enterprises, a successful entry into the Chinese service market is developed within a joint research project of research institutes and industrial partners. This paper focuses on two methods, which are essential elements of this procedure model.

2 THE CHINESE SERVICE MARKET: POTENTIALS AND RISKS

Internationalisation is traditionally viewed as a process through which a company moves from operation solely in its domestic market place to international markets [2]. Though internationalisation was typical for manufacturing companies in the past, the service sector has gained a great share of international trade and foreign investments. One reason for this ongoing development is the tendency towards combined offers of products and services in industrial product-service systems (IPS²) to fulfil customer needs. Following motivations for internationalisation of integrated solution providers have been suggested [3] [4] [5]:

1. **Client-following:** With the increasing globalisation of economic activity, service providing companies come under growing pressure to follow their multinational clients. Thus, client-following is a major demand-driven motivation for internationalisation.
2. **Market-seeking:** Based on supply-driven motivations, increasingly more service providing companies proactively seek new international markets. As a market of sufficient size may only be claimed through internationalisation, industrial service providers seek for a wider client base.

Furthermore, multilateral agreements such as the General Agreement on Trade in Services (GATS) and the EU Services Directive press towards internationalisation of services.

As the survey "Service within the mechanical engineering industry", conducted by the Fraunhofer Institute for Production Technology, indicates, the Asian market offers a high growth potential for the service industry. Within the Asian market, 70% of the respondents estimate China to be the market with the highest potential for growth of the service sector (Figure 1) [6]. This economic valuation is sustained by regarding the turnover distribution of the respondents. Asia is the second largest sales market of the questioned companies, but they generate only 10% of

their turnover in Asia by providing service. This is one of the lowest share compared to other markets, i.e. Germany with a service portion of 22% [6].

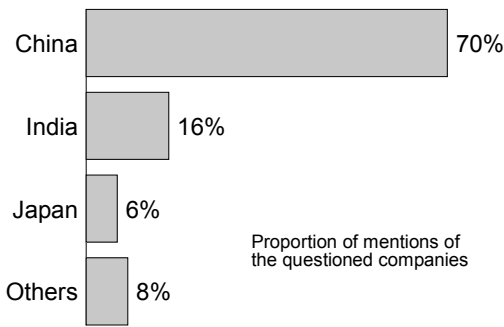


Figure 1: Potential for growth of service in Asia.

Additionally, the contribution of services to China's overall output is substantially lower than in many economies of comparative levels of income. In the context of world development experience, the services sector in China should account for a much greater proportion of the country's total output than it currently does [1].

Over the period from 1991 to 2002, the portion of the service sector increased for 1% to 34% of China's gross domestic product (GDP). In 2007 the proportion was around 39% [8]. Compared to Germany, with a portion of the service sector of nearly 70%, the portion of the service sector to China's GDP is still low [9].

China has acknowledged the importance of services. In its 11th Five-Year Plan (2006–2010), the Government announced further opening up and promotion of the development of the service sector in order to substantially expand its presence in the national economy.

In conclusion, China's service sector is seen as the next target for many multinational corporations as the opening of the sector offers enormous market opportunities [1] [7].

However, the study shows that internationalisation is a big challenge for German industrial companies, which want to offer integrated product-service systems in foreign markets. Up to 40% of the respondents do not know the requirements of their foreign clients and, therefore, up to 66% of the asked companies confirm that they do not offer tailored service products for their foreign target markets. As a result, up to 50% fail to fulfil the requirements of their foreign customers [6].

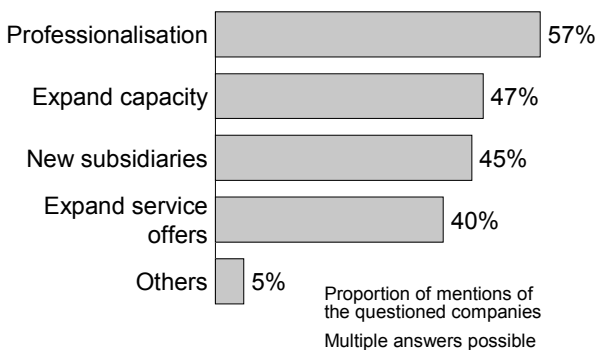


Figure 2: Next steps for expanding the international service business.

Many companies are already aware of this problem, when considering that 25% of the survey respondents are dissatisfied with their provided service quality in foreign markets. In consequence, 57% of the questioned firms are willing to professionalise their existing service offers while 47% want to increase their capacity, 45% intend to

establish new service subsidiaries and 40% think about expanding their offers in service (Figure 2) [6].

Service providing companies face different problems when they try to establish a business in foreign markets. In the conducted survey, the respondents refer to product piracy, employee qualifications, formalities and laws as well as cultural differences [6].

Especially when entering the Chinese market, these problems become noticeable and can mean substantial risks or cause loss in profitability. This is underlined by a survey, conducted by the European Union Chamber of Commerce in China and Roland Berger Strategy Consultants, which states that only 31% of the companies with a presence in China for less than 2 years are profitable in their China business. Furthermore, especially small and medium-sized enterprises seem to suffer from the mentioned problems, because the profitability rises with the number of employees (Figure 3). In summary, the study found that, the larger the enterprises and the longer they are present in China, the more profitable they tend to be [10].

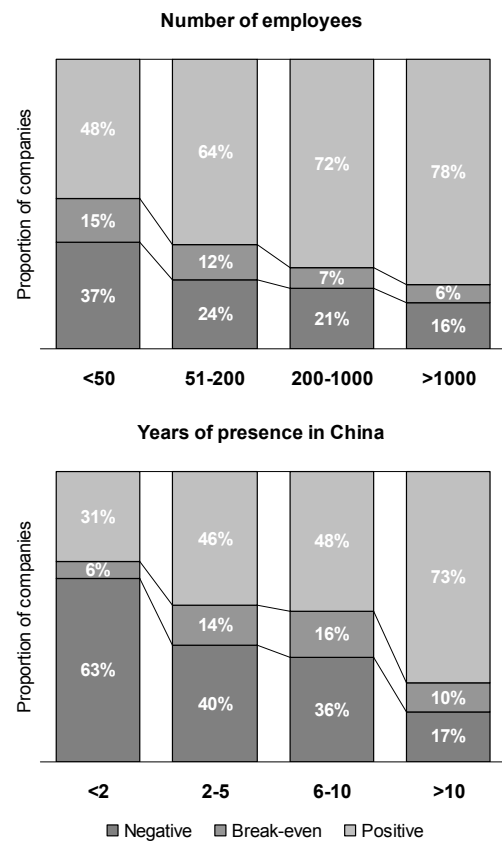


Figure 3: Profitability of service companies in China.

Regardless of the motivation for internationalisation, small and medium-sized enterprises seem to need a procedure model, which allows them to enter the Chinese service market successfully and to act profitable from the start.

In scientific literature, only research concerning company-internal success factors for internationalisation [11] or the effects of globalisation on small and medium-sized enterprises [12] can be found. Therefore an approach has been developed within a joint research project of research institutes and industrial partners, which aims to support western integrated solution suppliers as well as pure industrial service providers in planning and successfully realising a service market entry in China. The main focus of the approach is on the initial project phase, trying to avoid early failures and to ensure an efficient decision making at the project start. A second important aspect is

the arrangement of a cooperation with a local Chinese partner. Methods are presented which allow a systematic benchmark and selection of the target markets and a detailed definition and agreement of the cooperation between the Chinese and the western company.

3 METHODS

The procedure model, which is developed within the research project is structured in three phases.

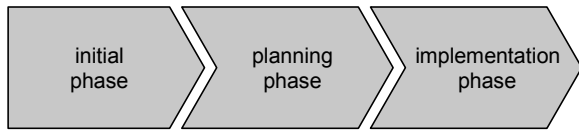


Figure 3: Three-phase procedure model.

Elements of the first phase are initial activities for preparing a possible China engagement and provide a basis for subsequent activities. For example, the analysis of target markets, an evaluation of market chances and risks, as well as the contacting of potential clients and business partners belong to this phase. The objective of the phase is to establish a solid information basis for decision making with regard to a China engagement. As an application-oriented tool for conducting a comprehensive market analysis, the scoring model, which is described in the next chapter, can be applied.

The detailed planning of the internationalisation process is accomplished within the second phase of the procedure model. For example, concepts for marketing, the offered services, the quality management and the organisational structure are developed. For establishing and ensuring a basis for a successful cooperation, the method Service-Blueprint was adapted within the research project and is described in a later chapter.

With regard to the intercultural cooperation and the establishing of a organisational culture, the objective of the third phase is to ensure a successful start of the new service business in China. The new insights gained in this phase are used for continuous improvements of the concepts in the second phase.

3.1 Scoring model

According to Applebaum, scoring models were the first approaches for a systematic evaluation of the worth of a company's location in comparison to other potential locations within a market area [13]. As scoring models have been used as a decision guidance for the choice of a location when opening a new subsidiary within a geographical region, this method has been adapted within the developed procedure model for the evaluation of potential target markets or rather target countries.

PRODUCT 1		CHINA		USA	
weight	criteria	rating	product	rating	product
20	customer structure	3	60	4	80
10	market growth	5	50	6	60
15	market volume	4	60	4	60
30	entry barriers	2	60	1	30
...
...
10	Infrastructure	3	30	2	20
Σ100			Σ 460		Σ 375

Figure 4: Example for scoring model evaluation.

Thus, the scoring model, as a classical tool for strategy planning, provides a basis for a methodical evaluation of options for actions within the process of

internationalisation. The objective of this method is to reach a better understanding of the interactions and players within different target markets. By identifying their own as well as the market potentials a company's strategic course can be determined. Therefore, economic, technical, psychological and social influencing factors are considered. These criteria are based upon quantitative and qualitative characteristics.

For a successful utilisation of the method, following steps have to be conducted accurately in a workshop:

1. **Choosing market alternatives:** At the beginning, the different markets, which come into consideration, have to be chosen.
2. **Choosing products:** It has to be defined, which service products should be sold in the target markets. Evaluations are conducted and documented in separate tables for each product. These tables embody separate evaluation columns for the specific target markets. Thus, a product-based evaluation of the target markets is conducted.
3. **Identifying the influencing factors:** Vitrally important for ensuring the success of the evaluation is the choice of the influencing factors, which should be chosen depending on the product. A fixed number of criteria is not prescribed. Within the scope of the research project a catalogue of influencing factors has been developed, which should provide assistance with finding the decisive influencing factors.
4. **Weighting of influencing factors:** Weighting factors, which indicate the relevance of each criterion with regard to the market attractiveness have to be defined. The sum of all weighting factors must be 100. The rating of the values is not trivial and requires a careful consideration.
5. **Evaluation:** Every single influencing factor for each product is now evaluated for the different target markets. The scale used for these evaluation factors can, i.e. reach from 1 (very bad) to 6 (very good), but also other increments are possible. The crucial point for a purposeful evaluation is a detailed discussion between the workshop participants about each evaluation rating. It is important to keep in mind that the highest rating for a criterion should not be given for the strongest characteristic value of a considered market, but for the optimal characteristic value. Therefore, it makes sense to define the optimal characteristic value of each influencing factor in the run-up to the evaluation.
6. **Documentation of reasons:** The reasons for specific evaluation ratings should be documented separately. Thus, the motivations become comprehensible for later reflections. Furthermore, it encourages discussions about the evaluation ratings and, with retrospective effect, about the influencing factors. Pros and cons should be documented for each criterion and target market. Additionally, the reasons for evaluating a market more positively compared to another should be recorded.
7. **Analysis and comparison:** After finishing the evaluation, the weighting factor of each influencing factor is multiplied with the corresponding evaluation value of each target market. After summing up the obtained values for each market, a conclusion about the market attractiveness can be reached by a comparison of the aggregated values.
8. **Deriving further decisions:** The utilisation of the scoring model facilitates a structured discussion about the market attractiveness and leads to a concerted understanding between the workshop participants.

When mapping out a market entry strategy, the identified strengths and weaknesses of each market should be taken into consideration.

When using the scoring model, the results of the market attractiveness for the different target markets can differ with respect to each product. In the end, the company's management has to decide about the target markets for an internationalisation process by balancing the reasons and calculating the involved risks.

Besides being an assistance for the decision process when choosing the target market for an internationalisation of service products, the scoring model also reveals, which competencies are to be strengthened or built-up for a successful start of the service business in the according target market.

3.2 Service-Blueprint

The Service-Blueprint facilitates a transparent visualisation of services with all detailed sub-processes and their classification into the two dimensions of customer proximity and time. This allows a systematic analysis of every single process step.

In standard Service-Blueprints the classification of process steps does not depend on the organisational unit that carries out a process step within the service company. Furthermore, division of work between strategic partners is not supported [14].

Prior to establishing a new subsidiary in a foreign target market, most companies cooperate with strategic partners in different forms. Within any form of cooperation it is important for the success of a service business to define which partner conducts which process steps to ensure an efficient and smooth workflow. Therefore, the standard Service-Blueprint was adapted within the research project to meet the demands of cooperation (Figure 5). It allows a clear and structured splitting of the process of service provisioning according to the cooperation partners. Thus, internal and external business interfaces can be well-defined and misunderstandings and delays due to ambiguous allocation of roles and responsibilities can be avoided by using the adapted Service-Blueprint.

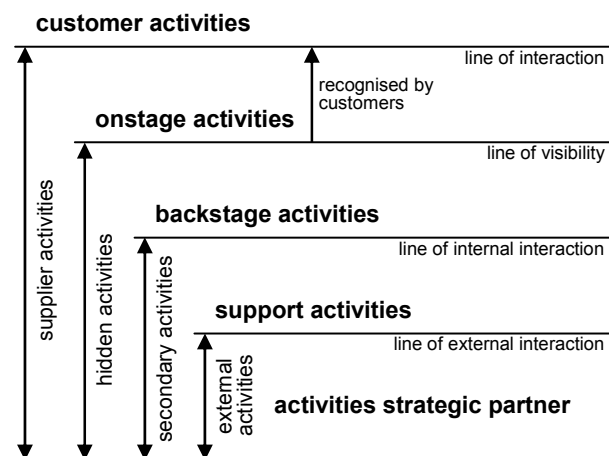


Figure 5: Adapted Service-Blueprint.

Just like in standard Service-Blueprints, the top layer of the adapted Service-Blueprint, with regard to the customer proximity, comprises the customer activities. These are the process steps within a service provisioning that are conducted by the customers themselves [15].

The layers below are used for the process steps, which are conducted by the service providing company or a strategic partner. The less the customer proximity of a process step, the lower the layer the process step is assigned to.

Below the layer of customer activities is the layer of onstage activities. All activities of the service providing company, which can be recognised by the customer, belong to this layer. To provide the customer with a single contact person, it is preferred that only the process steps, which are conducted by the service providing company should belong to this layer and not those of the strategic partner.

The layer of backstage activities is situated underneath the layer of onstage activities. As it can be gathered from the name, this layer comprises all process steps with a direct reference to the customer, but which can not be recognised by the customer himself. The dividing rule between the layers of onstage activities and backstage activities is the "line of visibility", because the activities below this line can not be experienced by the customer. By relocating the "line of visibility" to lower layers, the customer gets a deeper and more transparent insight into the service process. This can lead to an increased willingness to pay for the provided service and can therefore be vitally important for the success of the service business in China, because up to now the willingness to pay for services is rather low in Asia. However, it is important to deliberate about the activities which benefit the willingness to pay and should therefore be revealed to the customers and which do not do so and should therefore be remain hidden for the customers.

The layer of backstage activities is followed by the layer of support activities. The process steps which put customer information into customised service solutions belong to this layer. The separating line between the layers of backstage activities and support activities is called "line of internal interaction", because normally two different internal departments of a service provider interact at this line.

Up to the layer of support activities, the structure of the adapted Service-Blueprint corresponds to that of the standard version. The layers for preparation and facility activities, which lie below the layer of support activities in the standard Service-Blueprint, comprise the process steps which have no direct reference to the customer's order. Since the focus of the adapted Service-Blueprint is on the customer's order processing in cooperation with a strategic partner, both layers are omitted and substituted by the layer for the activities of the strategic partner. The dividing line between the layer of support activities and the layer of activities of the strategic partner is called "line of external interaction", because it presents the interface between the service providing company and a strategic partner.

Which activities are conducted by the strategic partner depends on the offered service and the form and intensity of the cooperation. Thus, these activities can be of the same value as the activities of the service providing company or provide only support for the process steps conducted by the service provider. Due to these different definitions of cooperation, it is also possible that the strategic partner has direct contact to the customer within specific activities, although its activities are assigned to the layer with the highest customer distance.

The decision, which process steps should or can be conducted by the strategic partner, can be supported by evaluating them on the basis of benefit as well as the general and the strategic importance. The benefit or the general importance of a process step is high, if the process step leads to an adding value or influences the service quality significantly. The strategic importance of a process step depends on the level of unique selling propositions. In addition, before outsourcing a process step it should be considered, that cooperation also hold disadvantages. It is necessary to take the risk of an

unintentional outflow of know-how or an opportunistic behaviour of the strategic partner.

Therefore, it is recommended to combine the process steps, which should be conducted by the strategic partner, to cooperation packages. In doing so, the following criteria for a cooperation package must be considered:

1. It has to be interesting for the strategic partner and must provide enough substance, as winning a partner for a cooperation package is only possible if conducting the package leads to generating profit.
2. The package should feature a clearly defined Input and Output to prevent additional costs due to increased coordination efforts.
3. The interfaces should be defined precisely and clearly, to facilitate the depiction of the contents and the demanded results of the package to the partner.

As in the standard Service-Blueprint, the adapted version provides no further classification of process steps within the dimension of time. All activities are documented in their logical and chronological order from the left to the right.

In conclusion, the adapted Service-Blueprint is not only a tool to picture the service process. It enables a systematic analysis and design of all activities within a service process. It is a tool, which describes the contact points between the customer and the service provider, the so called "Moments of Truth", on the one hand and the contact points between the service providing company and a strategic partner on the other hand.

4 SUMMARY

This paper describes the present situation of German service providing companies and their internationalisation efforts with special focus on the target market China. The attractiveness of the Chinese service market, due to its immense growth potential, is counter-balanced by several problems and risks especially small and medium-sized service providers have to face when trying to establish a business in China.

Subsequently, two selected methods of a procedure model, which were developed within a joint research project of research institutes and industrial partners, are presented. This procedure model aims to support both western integrated product-service suppliers as well as pure industrial service providers in planning and realizing a successful service market entry in China.

The scoring model, primarily used as a decision guidance for the choice of a location when opening a new subsidiary within a geographical region, has been adapted within the developed procedure model for the evaluation of potential target markets or rather target countries. It also reveals which competencies are to be strengthened or built-up for a successful start of the service business in the according target market.

Usually, the first step within the internationalisation process is to build up a cooperation with a strategic partner in the target market. Decisive for the success of a service business is to define which partner conducts which process steps to ensure an efficient and smooth workflow. Since the division of work between strategic partners is not supported in a standard Service-Blueprint, this method was adapted within the research project to meet the demands of cooperation.

The adapted methods have been successfully verified by the industrial partners of the research project, but continuous improvement and detailing is still subject to further research.

5 ACKNOWLEDGMENTS

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