



**AgEcon** SEARCH  
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

*The World's Largest Open Access Agricultural & Applied Economics Digital Library*

**This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.**

**Help ensure our sustainability.**

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

[aesearch@umn.edu](mailto:aesearch@umn.edu)

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

**US READY-TO-EAT BREAKFAST CEREALS' EXPANSION IN CHINA**

**By**

**Fang Zhang**

**A PLAN B PAPER**

**Submitted to  
Michigan State University  
in partial fulfillment of the requirements  
for the degree of**

**MASTER OF SCIENCE**

**Department of Agricultural Economics**

**1999**

## **ABSTRACT**

### **US READY-TO-EAT BREAKFAST CEREALS' EXPANSION IN CHINA**

**By**

**Fang Zhang**

US ready-to-eat breakfast cereals entered the Chinese market in the mid-1990s. In the past years, this all-American food has been generating business losses. Such underperformance calls for prompt strategic modification by the cereal investors.

This study focuses on foreign entry strategy and product strategy, and characterizes a combination of literature review and case study. Literature review seeks appropriate theories and frameworks, and therefore renders a sound conceptual foundation for the later analysis. Case study proposes a generic entry/product strategy, critiques current company-specific strategies, and provides recommendations for future improvement.

Selected in the case study are three brand-name cereal manufacturers, including Kellogg, Quaker Oats, and General Mills, with Kellogg being the focus and the others serving as a comparison.

Copyright by  
Fang Zhang  
1999

**To my family**

## ACKNOWLEDGMENTS

I would like to thank my committee chairman Dr. H. Christopher Peterson, and committee member Dr. Judith M. Whipple, for their invaluable guidance and encouragement throughout the length of this research. Without their inspiration, this paper would never have gotten off the ground.

I would also like to thank Dr. Eric W. Crawford. His continuous encouragement, guidance, and help have made this research as well as my whole Master study a less hard one.

Acknowledgement also goes to Mr. Eduardo T. Cadiz Jr., General Manager of Kellogg China Limited, who took the time to be interviewed and responded with ample information and revealing insights.

Finally, I have the steadfast and patient support of a loving family: my husband Yunchang Qiu, my mother Meiyun Yang, my father Youyi Zhang, and my sister Ping Zhang. To them, I owe the greatest debt of all.

## TABLE OF CONTENTS

<b>LIST OF TABLES.....</b>	<b>X</b>
<b>LIST OF FIGURES.....</b>	<b>XI</b>
<b>CHAPTER 1</b>	
<i>INTRODUCTION.....</i>	<i>1</i>
<b>CHAPTER 2</b>	
<i>HISTORY, CURRENT CHALLENGES AND INTERNATIONALIZATION .....</i>	<i>3</i>
2. 1. History.....	3
2. 2. Current Challenges in the Domestic Market.....	6
2. 2. 1. Current Performances of the Major Cereal Companies.....	7
2. 2. 2. Reasons for the Sagging Domestic Sales .....	8
2. 2. 2. 1. Declining popularity in the saturated US market.....	9
2. 2. 2. 2. Private Labels and Bagged Cereals.....	9
2. 2. 2. 3. Non-Cereal Breakfast Alternatives .....	11
2. 3. Internationalization and The Emerging Market in China .....	12
2. 3. 1. Past Internationalization Activities .....	12
2. 3. 2. The Emerging Market in China .....	14
<b>CHAPTER 3</b>	
<i>FOREIGN ENTRY STRATEGY.....</i>	<i>18</i>
3. 1. Literature Review .....	18

3. 1. 1. Foreign Entry Modes and Mode Characteristics .....	18
3. 1. 2. Entry Modes by US Food Firms and Mode Determinants .....	23
3. 1. 3. A Unified Model of Entry Mode Choice.....	25
3. 2. Case Study.....	29
3. 2. 1. The Application of Driscoll's Model .....	29
3. 2. 1. 1. Firm Factors.....	29
3. 2. 1. 1. 1. Firm-specific Advantages .....	29
3. 2. 1. 1. 2. Experience.....	31
3. 2. 1. 1. 3. Strategy .....	32
3. 2. 1. 2. Environmental Factors – China.....	33
3. 2. 1. 2. 1. Political/Economic Conditions: Emerging Market Economy .....	33
3. 2. 1. 2. 2. Market Demand/Competition.....	35
3. 2. 1. 2. 3. Socio-Cultural Conditions: <i>Guanxi</i> .....	37
3. 2. 1. 3. Desired Mode Characteristics .....	39
3. 2. 1. 4. Moderators .....	42
3. 2. 1. 4. 1. Chinese Governmental Policies and Regulations.....	42
3. 2. 1. 4. 2. Firm Size.....	45
3. 2. 1. 4. 3. Corporate Policy.....	46
3. 2. 1. 5. Mode Chosen: a Preliminary Mode Decision.....	47
3. 2. 2. Specific Foreign Investment Options in China and Lessons Learned .....	48
3. 2. 2. 1. Specific Foreign Investment Options in China.....	49
3. 2. 2. 2. Lessons Learned.....	52
3. 2. 3. Generic Entry Strategy for RTE Cereals.....	56



3. 2. 4. Specific Company Entry Strategies .....	59
3. 2. 4. 1. Current Entry Strategies by US Cereal Companies in China .....	60
3. 2. 4. 2. Assessment of Selected Strategies .....	60
3. 2. 4. 3. Recommendations to Kellogg.....	65

**CHAPTER 4**

<i>PRODUCT STRATEGY</i> .....	68
4. 1. Literature Review .....	68
4. 1. 1. Product Policy.....	68
4. 1. 2. Product Standardization vs. Product Adaptation .....	69
4. 1. 3. Keegan’s Product-Communication Mix.....	72
4. 2. Case Study.....	74
4. 2. 1. Situation Introduction.....	75
4. 2. 2. A Quick Glance at Chinese Diet History .....	75
4. 2. 3. Chinese Consumers.....	77
4. 2. 3. 1. Purchasing Patterns .....	78
4. 2. 3. 2. Where do consumers shop for food?.....	79
4. 2. 3. 3. Children Power.....	82
4. 2. 3. 4. China’ s Milk Industry.....	82
4. 2. 4. Generic Product Strategy for RTE Cereals.....	84
4. 2. 4. 1. Lessons Learned.....	85
4. 2. 4. 2. Recommendations to US Cereals.....	88
4. 2. 5. Specific Company Product Strategies .....	94

4. 2. 5. 1. Current Product Strategies by the Three US Cereal Companies in China .....	94
4. 2. 5. 2. Assessment of These Varied Strategies .....	95
4. 2. 5. 3. Recommendations to Kellogg .....	97

**CHAPTER 5**

<i>CONCLUSIONS AND RECOMMENDATIONS</i> .....	99
5. 1. Summary of Specific Findings/Recommendations .....	99
5. 2. Critique of the Two Theoretical Frameworks .....	104
5. 2. 1. Driscoll’s Foreign Market Entry Mode Choice Framework .....	104
5. 2. 2. Keegan’s Product-Communication Mix .....	105
5. 3. Recommendations for Future Research .....	106
<b>BIBLIOGRAPHY</b> .....	<b>110</b>

## LIST OF TABLES

Table 1: Amazing Cereal Statistics (As of 1995) .....	5
Table 2: Characteristics of Export, Contractual, and Investment Entry Modes .....	22
Table 3: Examples of Cultural Dimensions.....	38
Table 4: Seven Tidal Changes in the Legal Treatment of FDI in China.....	43
Table 5: Preferential Tax Treatment to FIEs at Different Locations .....	44
Table 6: Investment Vehicles in China.....	50
Table 7: Mode Characteristics of Different Investment Options.....	51
Table 8: Keegan's Global Product-communications Mix Strategic Alternatives.....	73
Table 9: Importance of Attributes Influencing Food Purchase.....	80
Table 10: Global Entry-Product Matrix.....	102

**LIST OF FIGURES**

**Figure 1: Driscoll’s Foreign Market Entry Mode Choice Framework.....28**

**Figure 2: Generic Entry Mode Proposed for the Product Class.....57**

## Chapter 1

### INTRODUCTION

Facing a super-saturated market and severe competition in the domestic American market, US ready-to-eat (RTE) breakfast cereal firms have been expanding in offshore markets for long-term growth. Brand-name cereal producers – Kellogg, Quaker Oats, General Mills, and Post – are the major players in this internationalization. Their operations in Europe and Latin America have been performing well, and sales and profits from foreign affiliates represent an increasingly large part in the total corporate pie.

With its 22% of world population, fast growing consumer purchasing power, modernization of lifestyle, and attractive foreign investment policies, China has tremendous potential for the US cereal giants. As part of globalization efforts, some US cereal giants entered this emerging market in the mid-1990s. However, US RTE cereals have been confronted with a variety of challenges. Diet differences, milk problems, difficulty in raw materials procurement, intense competition from traditional breakfast foods, and inferior retailing and distribution systems are the major contributing factors. Today, this all-American food has been running at a loss in China.

Recognizing their underperformance at this early stage in China, US cereal firms have committed to China as a long-term market. This long-term approach may be logical, but problems of short-term performance indicate the need for strategy change and adaptation. It becomes useful then to study these cases, critique current strategies and provide some recommendations for cereal's future expansion in China's unique market.

In order to critique current RTE cereal strategies, it is important to have a sound conceptual foundation for this process. Therefore, this study incorporates concepts of foreign entry strategy and product strategy because these two strategies build the base of foreign ventures and are the core strategies in international business.

The objectives of this paper are two: (1) to study the entry and product theories relevant to a non-traditional product in a new cultural environment, and (2) to critique the relevant strategies of US RTE cereal companies in China based on these theories.

The methodology is a combination of literature review and case study. Through the literature review, appropriate theories and models are identified. In the case study, a generic strategy for the whole product class is proposed as a general guideline, and then current strategies by individual companies are critiqued, followed by relevant recommendations.

The companies selected in the case study are Kellogg, Quaker Oats and General Mills. Among them, Kellogg is the focus of the study, while Quaker Oats and General Mills mainly serve as comparisons. The reason for this approach is that Kellogg is the company most involved in the RTE cereal category and facing the most serious problems relative to the other two companies.

This study consists of five chapters. Chapter 2 briefly introduces US RTE cereals' evolution, current domestic challenges, and recent performance in the emerging Chinese market. Chapter 3 and Chapter 4 study entry strategy and product strategy respectively, through a structure of reviewing the literature, recommending generic strategies for the product class, and critiquing the current strategies by individual companies. Finally, Chapter 5 presents conclusions and recommendations.

## Chapter 2

### HISTORY, CURRENT CHALLENGES AND INTERNATIONALIZATION

In the past one hundred years, ready-to-eat breakfast cereal has successfully become a staple in the American diet and evolved into a \$9 billion industry in the United States. However, since the mid-1990s, RTE cereals have been facing sagging domestic demand and increasingly intense competition. Recognizing the maturity of the domestic US market, cereal companies use globalization as a critical strategy to offset declining domestic sales and achieve long-term growth. As part of global expansion, major cereal companies have entered China and have committed to it as a long-term market. However, these investors have been operating at a loss (Cadiz 1998, Quaker Oats Annual Reports 1997). Such underperformance indicates the necessity for the cereal companies to revise their business strategies and make proper market moves.

#### 2. 1. History

Breakfast cereals were first introduced in the early nineteenth century by "eccentric" health reformers, who devoted themselves to overcoming the horrible consequences of the then American diet (Bruce and Crawford 1995). It was a process stimulated by a synthesis of American religious beliefs, scientific research, and technological innovation.

Before the discovery of breakfast cereals, the young nation's appetite was enough to turn anyone's stomach (Root 1976). New Englanders breakfasted on "black tea and toast, scrambled eggs, fresh spring shad, wild pigeons, pig's feet, tow robins on toast,

oysters” (Bruce and Crawford 1995: 3). On the edges of the American frontier, the food was even worse – “a region where the principal articles of diet are *saleratus* and grease, to which a little flour and pork are added” (Makanowitshky 1972: 16). *Saleratus* was the nineteenth-century term for baking soda. As a result of this poor nutrition diet, combined with eating fast, the nineteenth-century America suffered from one gaseous, painful bellyache – dyspepsia, and the influence was nationwide.

It was in the fight with this national dyspepsia and the search for a healthy diet that the world’s first RTE cold breakfast cereal, Granula, was invented by Dr. James Caleb Jackson (Bruce and Crawford 1995). However, it was Dr. John Harvey Kellogg who turned Jackson's innovation into the crunch heard around the world. Claimed as an idea originated from a dream, a new flaked cereal with improved texture and flavor, Granose, came into being eight years after Granula's invention and was acknowledged as the first of the modern breakfast foods (Bruce and Crawford 1995).

Since then, the ready-to-eat breakfast cereals business thrived in the United States. In the last one hundred years, more than 1,000 cereal brands have been created in the United States alone. As the industry evolved so did the dominance of the big four cereal companies - Kellogg, General Mills, Post, and Quaker Oats. Battle Creek, the breakfast cereal boomtown, had been nationally regarded as “the world’s cereal bowl”, “the national healthy city” and “food town” (Bruce and Crawford 1995). By the end of the 1980s, RTE cereal had become the most popular breakfast in America, with a significant forty-nine percent of Americans starting each morning with a bowl of cold cereal (Table 1: Amazing Cereal Statistics). By the early 1990s, it had become a \$9 billion industry in the United States.



Table 1: Amazing Cereal Statistics (As of 1995)

- Americans buy 2.7 billion packages of breakfast cereals each year. If laid end to end, the empty cereal boxes from one year's consumption would stretch to the moon and back.
- In the last one hundred years, more than 1,000 cereal brands have been created in the United States alone.
- The cereal industry uses 816 million pounds of sugar per year, enough to coat each and every American with more than three pounds of sugar. The cereal with the highest amount of sugar per serving is Smacks, which is 53% sugar.
- Americans consume about ten pounds or 160 bowls of cereal per person per year. But America ranks only fourth in per capita cereal consumption. Ireland ranks first, England ranks second, and Australia rank third.
- Forty-nine percent of Americans start each morning with a bowl of cereal, thirty percent eat toast, twenty-eight percent eat eggs, twenty-eight percent have coffee, seventeen percent have hot cereal, and fewer than ten percent have pancakes, sausage, bagels, or French toast.
- Breakfast cereals are the third most popular product sold at supermarkets in terms of dollar sales. The five most popular products are: 1) carbonated beverages, 2) milk, 3) breakfast cereal, 4) cigarettes, and 5) fresh bread and rolls.

Source: adapted from Bruce and Crawford, 1995.

In the words of economist Paul Samuelson, the saga of cereal is “one of those fascinating business stories that illuminate our lifestyles, history and economy” (Bruce and Crawford 1995: xiii). Indeed, for Americans, cereal serves not only as a food, but also as a barometer of the trends in the dietary and popular culture. From All-Bran to Cap'n Crunch, from Babe Ruth to Tiger Woods, from Jack Armstrong to Super Mario

Brothers, the cereal aisle is a true reflection of American cultural psyche (Bruce and Crawford 1995).

Going through this history, two major reasons explain cereal's glory. One is the characteristic of the product. Born in a time of national dyspepsia, the RTE cereals met the demand for healthy diet and nutrition. Meanwhile, the convenience attribute is another appealing factor. Flavor has also been emphasized and continuously developed. Since the first invention, producers have made cereals more and more appetizing. The other reason leading to the success is the heavy use of advertising and promotion to communicate the value to the public. The cereal industry, known as an industry laying the foundation for modern advertising and thriving on the base of advertising (Bruce and Crawford 1995), employed anything that might be attractive to consumers, from cartoon characters, such as Tony the Tiger and the Cocoa Puff cuckoo bird, to celebrities, such as Jack Armstrong and Michael Jordan. The industry spent tremendous amounts on advertising. In 1995, cereal marketers invested more than \$0.9 billion on advertising and just about all of these dollars went to TV (Food and Beverage Marketing 1996). Only auto manufacturers spent more money on television advertising than the makers of breakfast cereals did. Almost all these marketing efforts targeted children (Food and Beverage Marketing 1996).

## 2. 2. Current Challenges in the Domestic Market

Since the mid-1990s, immense changes have been happening in the cereal industry. At the end of 1998, the cereal market had fallen to \$7.1 billion, a 25% decrease from early 1990s when the industry sales peaked at \$9 billion (Wall Street Journal 1998).

Meanwhile, the industry has seen its volume growth rate fall to 1% in the past 3-4 years, versus the 3% annual growth rate usually experienced (Milling and Baking News 1998).

#### 2. 2. 1. Current Performances of the Major Cereal Companies

Nowhere was the cereal competition felt more keenly than at Kellogg Company (Battle Creek, MI), the last big-time cereal maker that still relied on breakfast for the bulk of its business – deriving about 80% of its sales from cereal. In November 1998, Kellogg announced its share of the US market had eroded from 40 % a decade ago to 32 %. The full-year earnings for 1998 declined by about 20 percent (Detroit Free Press 1998).

Internal rumblings started in 1998 also added to the cereal maker's woes. Thomas Knowlton, an 18-year veteran with the company, resigned as President of Kellogg North America. A week prior, Donald Fritz resigned as President of Kellogg Europe (USA Today 1998). The company was streamlining employee ranks as about 2,000 of its white-collar workers in North America were undergoing evaluations to determine if their jobs were necessary (Detroit Free Press 1998). In early 1999, the board replaced Arnold G. Langbo with Carlos Gutierrez as the new CEO of Kellogg Company. This appointment has fueled speculation that the firm might be taken over by another firm in the near future (Chicago Tribune 1999).

The second largest US RTE cereal producer, General Mills (Golden Valley, MN), found itself in a similar situation. It had just over 31% of dollar sales in cereals for the 52 weeks ending 11/29/98, a nearly 10% decline from five years ago when its share was 34.1%. Its share of 27.1% in terms of volume slipped to 24.4% by 1997. The whole company, however, continued to grow because of the profits from non-cereal categories,

such as the yogurt line (Yoplait, Colombo, and Trix), snacks (especially Chex Mix, Pop Secret popcorn, and Bugles) and dessert mixes under the Betty Crocker name (General Mills Annual Reports 1998).

In contrast, the third largest player, General Foods/Post's market share has increased from 15.5% to 16.4% in terms of dollar sales over the past five years, and it reached the peak in 1996 of 20%, according to Information Resource Inc. (IRI). Post gained its ground mainly due to the 20% price rollback of Post and Nabisco, and the Easy Saver Coupon program (both started in 1996).

The Quaker Oats Co, the small fourth player in the industry, has watched its cereal volumes increase each quarter over the last two years, raising its market share in the cereal business by nearly 2 percentage points from 7 % to 8.9% in terms of dollar sales. Quaker's secret is that, over the last three years, it has been putting out a line of bagged cereals that are less expensive versions than the national brands and can be sold for about \$1 less than the boxed cereals (Business Week 1998). Quaker also benefited from health claims now allowed by FDA for whole oats and oat bran. Quaker's sales fell 4-5% per year in 1993-96, but rose 5-6% per year after FDA released the health claim for oatmeal in 1996 (Milling and Baking News 1998).

#### 2. 2. 2. Reasons for the Sagging Domestic Sales

Sales of breakfast cereal are being hurt by a general decline in popularity in a supersaturated US market, high prices for brand-name cereals, and rapidly growing sales of non-cereal breakfast alternatives. Each of these major trends will now be discussed.

### 2. 2. 2. 1. Declining popularity in the saturated US market

One primary reason for the sagging sales of cereal is quite simple - fewer people are bothering to eat breakfast. A survey of 1,000 adult men and women nationwide conducted by Market Facts Inc. for milk processors under the banner of "the Milk Mustache Campaign" reveals that breakfast is the meal most likely to receive short shrift from consumers. Only 37% of respondents said that they ate breakfast every day, while fully 53% of participants said that breakfast was the meal that they are most likely to skip. In addition, 55% stated that they spent less than 10 minutes eating their morning meals. Moreover, 60% of respondents tended to consume food other than cold breakfast cereal, whether indulging in a cholesterol-rich meal of bacon and eggs or limiting themselves to coffee and fruit juice only. The harried, time-pressed lifestyles of increasing numbers of Americans have had a distinctly negative effect on cereal category sales (Sale 1998).

Industry analysts have also been observing a general decline in the popularity of cold-served breakfast cereals. According to New York Times, over the last two years, children had cut their breakfast cereal demand by 3% and adults have cut their breakfast cereal consumption by 5% (New York Times 1998).

### 2. 2. 2. 2. Private Labels and Bagged Cereals

Stiff competition from low-priced private-label brands and bagged cereals is the main reason for lower profits confronting major brand-name RTE cereals.

The 1980s had in general been a good time for cereals. According to analyst Andrew Lazar of New York-based Lehman Brothers, the cereal makers enjoyed

“tremendous pricing leverage” which the industry heavy weights could use to cover their costs and drive up their earnings to outperform competitors. But the slow economy of the 1990s produced more value-conscious consumers who recoiled with sticker-shock in the cereal aisle. At the same time, consumers were not as brand loyal as they used to be, with loyalty dropping from 47% in 1990 to 42% in 1992 (Lookout Foods 1996).

According to Dr. Cotterill, 40 to 50 percent of the price of a name-brand cereal represented the cost of manufacturing, and the rest represented “advertising, promotion, and profits”. Added to wholesalers’ cost was a retail markup of 18% per package. In the late 1980s, sales of private-label cereals surged, as consumers lunged for knock-off Cheerios, Corn Flakes, and Cocoa Krispies. Noticing the trend, grocers placed their private label cereals next to the brand-name products, breaking three decades of industry-inspired shelf management, which grouped manufacturers’ products together on the aisle (Bruce and Crawford 1995). In 1998, store brands captured an 11% share (Plain Dealer 1998).

In addition to private-label brands, cheaper bagged cereals have also been poaching market share from brand cereals. In addition to Quaker Oats’ strategy of no-frills, bagged products, Malt-O-Meal, originally a regional player, put its products in bags and took hold nationally. In 1998, Malt-O-Meal held a 4% share of the market in units. Quaker’s CEO Robert S. Morrison said bagged cereal volume rose 73% in 1997 alone. The growth of bagged cereals has increased to account for 8% of all cereal packages sold in 1998 (Business Week 1998).

### 2. 2. 2. 3. Non-Cereal Breakfast Alternatives

Competition reared its head, too, in the form of grab-and-go foods like bagels, convenience cereal bars, muffins, and fast-food breakfasts. These products contribute to the decreasing market of RTE cereals in general.

According to the NPD Group, unlike RTE breakfast cereals, bagels have shown outstanding performance and have been purchased at least once by 46% of all consumers in the nation (Prepared Foods 1999). Pushing the category's growth are new bagel varieties, and those which are frozen, refrigerated and shelf-stable. Breakfast bars and yogurt are both trending upward along with packaged toaster pastries, which are "at an all-time high" (Dwyer 1999: 16). Flavored packaged muffins and English muffins have also seen better days. Ready-to-eat muffin consumption is the greatest in households with children aged 12-17 (Prepared Foods 1999).

At the foodservice level, fast-food breakfasts are a big threat for eroding the general breakfast food market. Fast food restaurants introduced commercial breakfast items in the mid-1980s. By 1998, the fast-food breakfast has expanded into a \$20 billion industry (Advertising Age 1999). Major players, such as McDonald's, Burger King, Starbucks and Dunkin' Donuts, have been making efforts to snare a great portion of the breakfast trade multi-billion dollar market. McDonald's, the dominant leader with some 12,500 locations, broadened distribution of its bagel sandwich in 1998. In the same year, Burger King launched Ciniminis, four small cinnamon buns that became a hit in the market. Starbucks is considering tweaking its new breakfast forays designed to bolster food offerings in its 1,600-plus coffee bars. On March 1<sup>st</sup> 1999, Dunkin' Donuts was also launching cinnamon buns at all of its 3,500 stores (Kramer 1999).

To offset soggy sales domestically, major brand cereal players have been resorting to new product development, health claims, and aggressive marketing and promotion. In 1999, cereal producers launched TV commercials targeting adults. Meanwhile, new organic cereals were introduced, such as General Mill's Sunrise. To overcome the product's lack of portability in an age of grab-and-go eating, Kellogg recently introduced Breakfast Mates, refrigerated all-in-one cereal kits, as a possible way of stimulating on-the-go demand. If Kellogg's entry works, we can expect to see a deluge of copycats in the coming year. Despite all these efforts, industry analysts expect that domestic sales will continue to decline (Value Line 1999).

## 2. 3. Internationalization and The Emerging Market in China

### 2. 3. 1. Past Internationalization Activities

To offset the weak domestic market and sustain long-term growth, US cereal giants have put more weight on developing globalization strategies. Various publications, such as Value Line and Milling and Baking News, have also pointed out that foreign markets would be one key to the US cereal industry's future growth, and predicted that the business would continue to grow faster abroad than at home.

As a matter of fact, globalization is nothing new to US cereal giants. All the major producers have gone international for decades, and their businesses cover all six continents. All underscore the importance of global markets for long-term growth (Kellogg Annual Reports 1998, General Mills Annual Reports 1997-1998, Quaker Oats Annual Reports 1994-1997).



Kellogg has realized the importance of globalization for a long time. As of 1997, Kellogg's products were manufactured in 19 countries on 6 continents and distributed in over 160 countries. In the same financial year, foreign operations represented 42% of the total sales, and 30% in terms of profits (Value Line 1999). Kellogg has successfully achieved and maintained a global market leadership position. On an annualized basis, Kellogg continues to hold strong regional volume share of the RTE cereal category (as of 1997): 44% in Europe, 43% in Asia-Pacific, and 60% in Latin America (Kellogg Annual Report 1998).

General Mills' international growth strategy began with a powerful network of joint ventures. Specifically for the cereal category, in January 1991, General Mills formed a strategic alliance with Nestle, and established Cereal Partners Worldwide (CPW) which manufactures and markets RTE cereals outside North America. CPW began operations in the United Kingdom, France, Spain and Portugal. Today, CPW competes in 70 markets worldwide and holds a strong, number 2 position with an 18% combined market share second only to Kellogg. It is also expanding into new markets, including several Eastern European countries. The company is targeting the goal of a 20% worldwide share by the year 2000 (General Mills Annual Report 1998).

Quaker Oats also made efforts to diversify its packaged food industry geographically. However, its international sales (including Quaker cereals, biscuits, chocolate beverage, and canned seafood) represented only about 13% of total sales as of 1997. Foreign operations focused on Latin America, where sales represented nearly 70% of total international food sales. The European cereal business represented approximately 25%. The remaining 5% of sales occurred in Asia, where Quaker continues to invest for

future growth. Compared with the other two cereal giants, Quaker Oats has invested much less in non-American markets in the RTE cereal category, although its hot cereals and ready-to-drink chocolate beverages became leading products in some countries.

There is strong evidence supporting continued global opportunities for US RTE cereals. As consumers throughout the world become more educated and knowledgeable about the healthy effects of a nutritional diet, they will increase consumption of grain-based foods in the 21<sup>st</sup> century. Research is consistently producing evidence supporting these products as part of a healthy diet, and this positive exposure will influence demand for food such as RTE cereals. In addition to this trend, global economic and technological development continues to create new foreign consumers and markets which are now capable of purchasing and demanding value-added food products. The market liberalization and open policies developing in many foreign countries make these markets more accessible to US investors (Reed and Ning 1996).

### 2. 3. 2. The Emerging Market in China

China, with its open-door policy, booming economy and tremendous population, has attracted many US multinationals since the 1980s, including Coca-Cola, Procter and Gamble, Bausch and Lomb, Johnson & Johnson, Gillette and GE, to name a few. Enchanted by the promise that it will be one of the world's most important economies by early next century, many multinationals are approaching China as a long term strategic market, and they are investing large sums of money to help build sustainable long-term positions. The chief executive officer of a major international company said, "with 22% of the world's population in China, we cannot afford not to be there" (Shapiro 1991: 87).

A late entrant, US cereal multinationals entered this emerging market since the mid-1990s. Current major players involved in breakfast cereals in China are Kellogg and Quaker Oats. Kellogg established its first plant in August 1995, mainly selling its Corn Flakes, Rice Flakes and Wheat Flakes. In 1997, Kellogg introduced its US top-selling Frosted Flakes' Tony the Tiger in China under the name of Tony's Flakes (Kellogg Annual Reports 1997-1998, Journal of Commerce 1997, New York Times 1995).

Quaker Oats entered China in 1994, by forming a joint venture with its Taiwanese partner and selling All-in-One cereal, a grain-based instant beverage and a pudding mix under the Mighty brand name. In 1995, Quaker invested \$1.7 billion in China to market its leading sports beverage Gatorade. In 1997, Quaker opened its first cereal plant under its own name, producing and marketing Quaker All-in-One cereal beverage and Quaker cereals (Quaker Oats Annual Reports 1994 - 1998).

General Mills also followed suit and announced the formation of Tong Want, a 50% Equity Joint Venture with Want Want Holdings Ltd. of Singapore in 1998. This venture had a goal of establishing a savory snacks business in China. Operations were expected to begin in calendar year 1999 (General Mills Annual Report 1998).

The long-term results of these ventures are not yet known. However, the short-term performance so far has not been favorable. Kellogg has been operating at a loss, and initiated a plant-wide restructuring in early 1998 (Cadiz 1998). Quaker is also operating at a loss, especially in its core Gatorade line. Its cereal plant established in 1997, however, doubled its sales in China from a very small base (Quaker Oats Annual Report 1998).

A combination of different factors explained this current underperformance. Diet differences, culture differences, underdeveloped legal and distribution systems, deep-rooted impact of the former planned economy, raw material procurement, and so on. All these factors will be elaborated in detail in the next two chapters.

Recognizing these problems, Quaker and Kellogg both emphasized that they did not expect to make money in China in the short term, but adopted a long-term strategy. Such a strategy is logical. However, the long-term argument should not be taken too far, and patience alone does not necessarily lead to long-term success. Underperformance in the short term is probably the best indicator that a company's current strategy or practices or both may be outdated or may not measure up over the long run. This is particularly the case for the turbulent Chinese market where sustainable long-term positions are necessarily built on a series of successful short-term moves (Yan 1998). Successful short-term performance can help build brand recognition, attract local talent, and secure support from the parent company, all of which lay the foundation for long-term growth. Therefore, when companies see no positive short-term results, it is crucial for them to revise the strategies promptly and make the right moves to keep away from a vicious cycle.

This paper focuses on studying the foreign entry strategies and product strategies of US cereal companies (Chapters 3 and 4). In the business literature, these two strategies are the core strategies in international business and international marketing. Empirically, wisely designed entry and product strategies are crucial to enable the cereal investors to overcome the complexity of the reality in the Chinese market.

Generally speaking, the complexity mainly stems from two aspects. First of all, today's China is evolving into a hybrid system of authoritarianism, democracy, socialism, and capitalism. The cultural differences and inferior infrastructure further magnify the system-related complexity. Therefore, a proper foreign entry strategy is imperative to minimize the potential risk and leverage firm-specific advantages. Secondly, eating US RTE cold cereals as breakfast is still exotic to most Chinese consumers. Besides the diet difference, US cereals also face milk problems and raw material problems. At the same time, the competition in the breakfast food market is fierce, from both the traditional Chinese breakfast and other modern breakfast products. As a result, a proper product strategy for US cereals turns out to be extremely important.

## Chapter 3

### FOREIGN ENTRY STRATEGY

This chapter contains a literature review and a case study related to the foreign entry strategy of US RTE cereal firms. Through the literature review, related theories on international marketing are analyzed to identify a model that will serve as an analysis tool for the case study. In the case study, the analysis begins with proposing a standard entry strategy for the product class, and then critiques entry strategies currently used by individual companies.

#### 3. 1. Literature Review

##### 3. 1. 1. Foreign Entry Modes and Mode Characteristics

Today, amid the strong globalization trend in the business world, forms of doing business abroad have become diverse. These forms have been categorized as a spectrum with pure exporting at one end, foreign direct investment at the other, and foreign agencies, foreign distributors, foreign licensing, franchising, management contracts, just to name a few, as intermediate points (Buckley and Brooke 1992, Meloan 1995). In the international marketing literature, three generic groups are widely accepted as the way to classify various entry modes. They are export, contractual arrangements, and investment modes (Driscoll 1995, Hill *et al.* 1990, Eramamilli and Rao 1993, Root 1987).

Export entry modes With export entry modes, a firm's products are manufactured in the domestic market or a third country, and then transferred either directly or indirectly to the host market. Direct exports usually involve the firm handling

documentation, physical delivery, pricing policies, and overseas sales affiliates. Indirect export modes, by contrast, generally involve the use of intermediaries, such as export houses or trading companies, to perform the above activities, often without the firm's involvement in the foreign sales of its products (Driscoll 1995).

Contractual entry modes include a variety of arrangements such as licensing, franchising, management contracts, turnkey contracts, and the like. This kind of arrangement generally takes place when firms possessing some sort of competitive advantage are unable to exploit this advantage because of resource constraints, for instance, but are able to transfer the advantage to another party. The arrangements are typically designed to transfer intermediate goods such as knowledge and/or skills between firms in different countries (Driscoll 1995).

Investment modes typically include some form of ownership by the firm of production facilities in the host market. These facilities range in nature from assembly to manufacturing plants, and necessitate sizeable equity investments by the firm in the host market. Because of direct involvement in local production, it is apparent that this type of entry modes involves a greater commitment of financial and managerial resources, and are, therefore, more risky and difficult to handle than the other entry modes introduced earlier. There are, however, "a number of compensating advantages to the investment modes, including greater parent company control, closer contact with the market, and deeper market penetration" (Young *et al.* 1989: 206).

Varying levels of control, dissemination risk, resource commitment, and flexibility are widely acknowledged as the key characteristics that differentiate the three

mode categories. These characteristics represent underlying constructs that influence mode choice (Hill *et al.* 1990, Driscoll 1995).

Control Different entry modes imply different levels of control over the foreign operation. Hill *et al.* defines control as authority over operational and strategic decision-making (1990). Control allows firms to safeguard supplies of essential inputs to the production process, ensure the quality of end products, and influence the logistical and marketing activities for the product in the target markets. It also enables firms to adapt products/services to changing market needs and respond to the competition efficiently.

Dissemination Risk Dissemination risk refers to the risk that firm-specific advantages in know-how will be expropriated by a contractual partner. Technological and marketing know-how constitutes the basis of the competitive advantage of many multinational companies (MNCs), which MNCs need to offset their disadvantages due to the lack of local knowledge in comparison to local operators. In order to reap as much quasi-rent as possible, MNCs must avoid the dissemination of these advantages and keep them firm-specific (Hill *et al.* 1990).

Resource Commitment Each entry mode also requires different resource commitments. Resource commitment is defined as “dedicated assets that cannot be re-deployed to alternative uses without cost (loss of value)” (Hill *et al.* 1990: 118-119). These assets may be tangible, such as a physical plant, or intangible, such as management know-how. By its very nature, most foreign operations involve some degree of investment in dedicated assets.



**Flexibility** Flexibility is the ability of a firm to change entry modes quickly and with minimal costs in the face of evolving circumstances (Anderson and Gatignon 1986). Being able to change entry modes quickly and efficiently can prevent firms from incurring considerable losses or facilitate substantial gains in responding to environmental changes. Efficient adaptation gives a firm a “first mover” advantage in specific markets. After his 1995 study of Canadian firms active in international markets, Driscoll added that flexibility was also related to “the ability of the firm to unilaterally make its own change decisions without having to negotiate change with a contractual partner” (Driscoll 1995: 20).

Table 2 compares the characteristics of different entry modes across the three generic types. It presents a combination of the mode characteristics proposed in the theoretical literature and those identified in Driscoll’s empirical study. Evidently, investment modes of entry are characterized by high levels of control and resource commitment because of the direct involvement in local production and marketing. Dissemination risk of investment modes is relative low because under this mode business operations are internalized. At the other end of the continuum of mode types, exporting arrangements have low levels of control, dissemination risk, and resource commitment, as well as a high level of flexibility. The reason is obvious, that under exporting, firms simply transport and sell products in the host country, which are manufactured in the home country or a third country. There is little technology transfer and no heavy resource investment in the host country. Whenever the foreign markets change against exporters, firms can withdraw their exporting business immediately with very low costs. As a tradeoff, firms under the exporting mode hold a low level of control. Finally,

sandwiched between the options of investment and exporting modes are contractual modes which are characterized by a median level of control and medium to high levels of dissemination risk and resource commitment. In contrast to the theoretical hypotheses, Driscoll's empirical study on the flexibility construct suggests that flexibility is highest for export modes and investment modes, and lowest for contractual entry arrangements. In the theoretical literature, however, the same construct is proposed as the lowest for investment modes and medium for contractual modes. To explain this difference, Driscoll added in another aspect to define flexibility, as mentioned earlier, that "it is conceivable that flexibility is related to the ability of the firm to unilaterally make its own change decisions without having to negotiate change with a contractual partner" (Driscoll 1995: 20).

Table 2: Characteristics of Export, Contractual, and Investment Entry Modes

Entry method	Control	Dissemination risk	Resource commitment	Flexibility
Investments	High	Low	High	Low <sup>a</sup> / High <sup>b</sup>
Contracts	Medium	Med. -- High	Med. -- High	Med. <sup>a</sup> / low <sup>b</sup>
Exports	Low	Low	Low	High

Note: <sup>a</sup> denotes the original mode characteristics proposed in the academic literature.  
<sup>b</sup> denotes the mode characteristics identified in Driscoll's empirical study in 1995.  
 In other cases, the academic hypotheses and Driscoll's study agreed with each other.

Source: a combination of Hill, *et al.*, 1990, pp. 120, and Driscoll, 1995, pp. 19.

All the characteristics are interrelated rather than isolated, and there are tradeoffs between them. To choose an entry mode, in essence, is to choose between the tradeoffs of different desired characteristics.

### 3. 1. 2. Entry Modes by US Food Firms and Mode Determinants

All three modes have been used as foreign market entry strategies by food processors in the United States. According to Henderson, Hirschberg and Voros (1993), foreign direct investment (FDI) and exporting strategies are prominently used by leading food-manufacturing firms. Measured in terms of the value of international sales for the world's leading firms, FDI is roughly four times more prevalent than exporting. Data from a worldwide sample of 118 multinational food processing firms by Handy and Henderson show that, in aggregate, foreign affiliate sales appear to be significantly and consistently greater than processed food exports.

Observations by Handy and MacDonald (1989) show some specific characteristics of US food manufacturers: (1) major US food manufactures do relatively little exporting in comparison to manufactures in other OECD countries, (2) US food manufacturers have extensive overseas interests through direct investment, and (3) food manufacturers' affiliates in foreign countries focus on local sales (Carter and Yilmaz 1998). As a matter of fact, food manufacturing has consistently ranked among the top industries that are characterized by FDI (Carter and Yilmaz 1998).

Because of the dominant usage of FDI by US food processors, most of the related literature on entry mode determinants focuses on FDI.

Previous studies have examined on the role of technology, product differentiation, product diversity, firm size/scale, and firm concentration in FDI. Technology superiority is often a prerequisite for FDI (Reed and Ning 1996). Firms with new and continually upgrading technologies and marketing skills often want to secure their overseas markets by internalization of the advantages through FDI, rather than risk diffusion through

licensing or exporting. In industries like grain milling where brand recognition loyalty is not strong, concentration and product differentiation are ways to increase a firm's market power, and this could be accomplished through direct investment abroad. Product diversity is particularly related to the firm's risk management (Reed and Ning 1996).

Connor (1983) categorizes the various factors affecting the FDI decision into three groups: (1) firm-specific advantages (e.g., patents, trademarks, consumer loyalty to brand, positive enterprise image, R&D resources yielding technological leadership, effective data gathering and information system, and special relationship with sources of financial capital); (2) industry specific advantages (e.g., stable or growing demand, open distribution systems, standard guarantees or warranties, industry quality grades recognized by purchasers, machines or other inputs available from other industries, market information for purchase, and special industry subsidies for exporting); and (3) location-specific advantages (e.g., climate, worker education levels, language facility, knowledge of business and general customs, the power or prestige of the government, and trade barriers designed to protect domestic commerce).

Beyond the theoretical studies cited above, other researchers (Hagen 1998, Vaughan *et al.* 1994) have conducted interviews with senior executives of food MNCs regarding their firms' international operations. These interviews provide practical insights into entry mode decisions. The most often stated reason for establishment of foreign affiliates was slow growth at home and greater growth opportunities overseas. Interviewees expressed a strong desire to maintain control over the following intangible assets: "reputation and quality of branded products, process technologies, commodity trading, customer service, and skills related to marketing and market development"

(Vaughan *et al.* 1994: 11). Critical assets may depend on the host region. While firms were taking such assets with them, they were also taking organizational reputation, not in the brand sense, but in the sense of having a successful track record in bringing products to market. Meanwhile, as the firm “positions itself as a global player to be dealt with, its importance goes up, making it easier to gain the cooperation of other firms” (Hagen 1998: 303). There was no clear consensus on the influence of diversification in contributing to foreign production. A common view was that too much diversification was distracting, while a range of products properly selected was helpful in entering a new market because, if the initial product failed, the firm would readily switch to other products in its stable (Hagen 1998). While production technology can be transferred, it must be readily adapted to the dictates of the market. The idea of selling those skills in a consulting capacity could not serve the growth objectives of the firm. Similarly, licensing agreements allow the firm to increase its brand equity but not its product development asset base. The latter appears to be fundamental to the food companies interviewed.

### 3. 1. 3. A Unified Model of Entry Mode Choice

As seen in the literature review, various bodies of theoretical literature have focused on binary decisions. For example, some studies examine why firms choose trade or FDI to go overseas (Reed and Ning 1996), others considered the choice between investment and contractual management, such as licensing and franchising (Henderson and Sheldon 1998). Because of the dominant use of FDI in processed foods, a number of research articles further focus on the consideration of FDI alone. As a result, much of the

existing literature on entry choice focuses in a piecemeal fashion on many seemingly unrelated factors (Hill *et al.* 1990), or tends to concentrate on only one characteristic, namely, control, rather than on a number of significant characteristics as shown in Table 2 (Driscoll 1995). And there is a need for a unified framework within which different factors can be placed and the relationships between them analyzed. Such a framework will allow MNCs' managers to combine a set of insightful analyses to better address the totality of the multidimensional and complex entry mode decision (Hill *et al.* 1990).

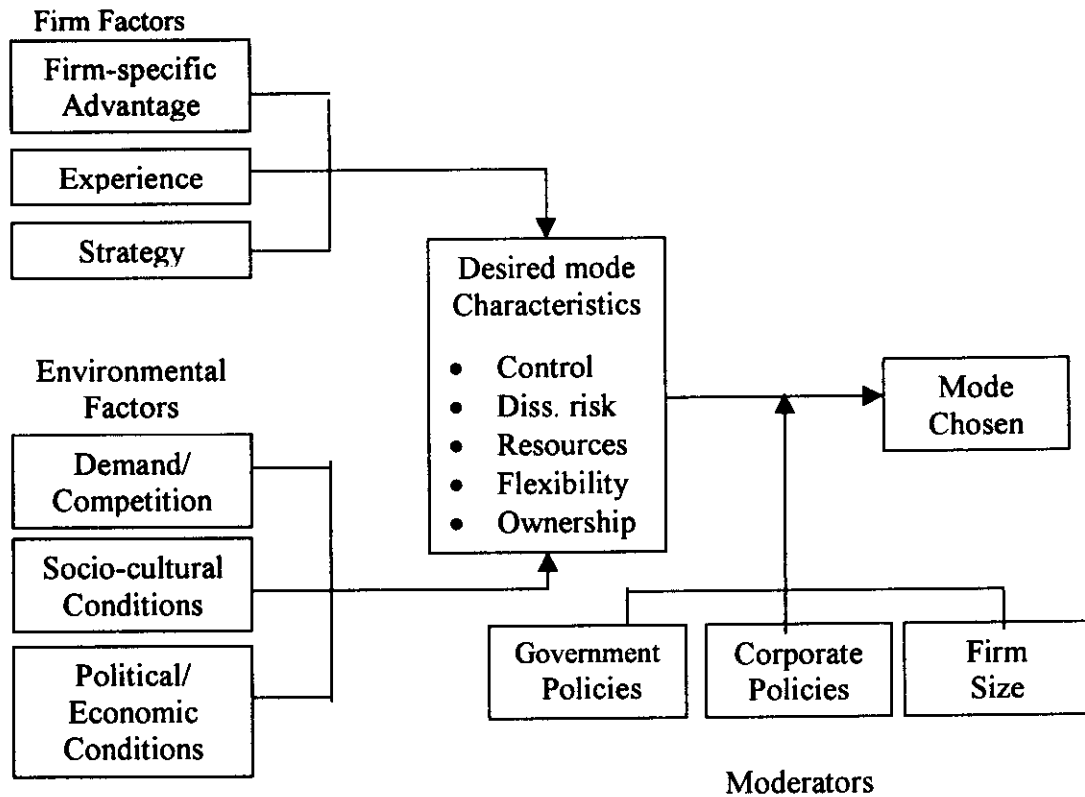
A previous attempt to provide such a framework was made by Anderson and Gatignon (1986) based on transaction cost analysis. The basic premise of transaction cost analysis is that the firm will internalize those activities that it is able to perform at lower cost, and will rely on the market for those activities where other providers have an advantage (Coase 1937). In their study, Anderson and Gatignon begin with the assumption that the market being entered has at least enough potential that the firm can recoup the overhead of a high-control entry mode. Under this assumption, the efficacy of an entry mode depends on four constructs: transaction-specific assets, external uncertainty, internal uncertainty and free-riding potential. These constructs, coupled with their corresponding propositions, should be positively associated with the entrant's degree of control, which then determines the long-term efficiency of entry modes. While promising, Hill *et al.* suggests that this transaction cost framework is flawed because transaction cost explanations of the entry mode choice focus on each entry decision in isolation, treating each as a self-contained decision, and therefore overlooking the role that global strategy and global competition play in determining the appropriate entry mode (Hill *et al.* 1990).

Hill *et al.* then develops an eclectic framework that integrates different explanations of influencing factors (1990). Three types of variables are included: (1) strategic variables (extent of national differences, extent of scale economies and global concentration), (2) environmental variables (country risk, location familiarity, demand conditions and volatility of competition), and (3) transaction variables (value of firm-specific know-how and tacit nature of know-how). The eclectic framework, however, has similar flaws as the transaction cost model. That is, they both have an implicit assumption that *actual* levels of different choice characteristics are equal to *desired* levels (Hill *et al.* 1990).

The extent to which such an assumption is valid is uncertain because there can be differences between the *actual* level of a characteristic employed by a firm (what the firm can do) and the *desired* level of that characteristic (what the firm would like to do) (Erramilli and Rao 1993, Klein 1989). Although firms have *desired* characteristics and thus *desired* entry modes, they may be unable to embrace these preferred modes because of a number of moderating factors, such as government intervention, firm size, and corporate policies, that prevent desired modes being achieved (Driscoll 1995). For example, when the host government places limits on foreign ownership so as to ensure some amount of local ownership of foreign assets, a firm wishing to use investment modes for a high level of control may be prevented from so doing. Several authors have advised that efficacy of mode choice models may be improved by conceptualizing a firm's *desired* level of different mode characteristic independent of *actual* levels (Erramilli and Rao 1993, Klein 1989). Heeding such advice, Driscoll (1995) developed an improved framework (Figure 1: Driscoll's Foreign Market Entry Mode Choice

Framework) that studies a number of alternative mode characteristics and identifies the impact of variables that moderate the relationship between *desired* and *actual* levels of different mode characteristics.

Figure 1: Driscoll's Foreign Market Entry Mode Choice Framework



Source: adapted from Driscoll, 1995, pp. 28.

Driscoll categorized the determinants of entry mode choice into situational influences and moderators. Situational influences affect a firm's desire for certain characteristics of mode choices. In the absence of moderating variables, a firm's *desired* mode is equal to its *actual* mode used in a given entry situation. Moderators are factors that can create a gap between *desired* and *actual* levels of various characteristics. When



moderators are present, these variables can prevent the firm from using its *desired* mode, compelling it to select an alternative mode of entry or to reconsider entirely its entry into a particular foreign market (Driscoll 1995).

It is worth noting that, in Driscoll's framework, ownership is also proposed as an underlying construct (mode characteristic) influencing entry mode choice. Even though it appears in the framework, this factor is omitted in this study because the efficacy of this construct is related to the *control* that ownership implies, and therefore examining the amount of *control* that ownership affords is more useful than studying *ownership* alone.

### 3. 2. Case Study

#### 3. 2. 1. The Application of Driscoll's Model

Guided by Driscoll's unified entry mode framework, this section studies influential factors determining the optimal entry mode for US RTE cereals in the emerging Chinese market. Considering that all the potential investors are the major players in the industry, the study on firm factors takes the perspective of the brand-name producers, namely, Kellogg, General Mills, and Quaker Oats. Each element of Driscoll's framework (Figure 2) will now be examined in turn as it relates to RTE cereals.

##### 3. 2. 1. 1. Firm Factors

###### 3. 2. 1. 1. 1. Firm-specific Advantages

In order to compete with indigenous firms, who possess knowledge of local customer's taste and the local legal, business and social systems, foreign investors must have some compensatory advantage (Driscoll 1995).

In the cereal case, all the studied major cereal players possess certain competitive advantages over the potential competitors in China. Specifically, the high quality cereals are distinguished by physical variations, brand name, and advertising. The attributes associated are generally recognized as high tech, health, nutrition, good flavor, and convenience. In terms of corporate resources and capacity, these US investors have strong R&D facilities, powerful brand assets (transferable not in a brand sense, but as a successful track record in bringing products to markets and being a global player), and superior marketing expertise backed by tremendous financial and human resources. These companies have made efforts in further product differentiation and innovation. They have also focused on supply chain management in order to ensure high quality raw materials, efficient distribution, and eventually competitive pricing.

In addition, for the whole product class, US RTE breakfast cereals are significantly different from the traditional breakfast foods in China, in terms of flavor, texture, appearance and ways of consumption. The exoticness can be a unique advantage if handled properly because it creates a natural product differentiation and therefore a clear product identity, attracts Chinese consumers longing for innovation, and facilitates the establishment of a strong market presence. As an example, McDonald's and Pizza Hut have been reaping the benefit of their product exoticness in the Chinese market. However, the exoticness might also be a big disadvantage if handled improperly. Such a lesson has been learned by Kraft. In the mid-1990s, Kraft introduced cheese to China, expecting a market hit. Despite years' efforts, the sale of cheese in China remained undesirably low because most Chinese consumers could not get used to the flavor.

### 3. 2. 1. 1. 2. Experience

Experience, in particular, the international experience of managers and thus of the firm, is another firm specific factor which influences mode choice (Benito and Grisprud 1992, Dunning 1991, Yu 1990). Buckley and Casson (1985) hypothesize that experience reduces the cost and uncertainty of serving a market and in turn increases the probability of firms committing resources to foreign markets.

For the cereal case, globalization is nothing new to the major players. All the companies studied in this paper have been actively involved in trading and foreign investments. Their foreign sales and profits show solid growth and represent an incremental proportion of the total corporate pie. Currently all these cereal manufacturers have successfully penetrated into Latin America, Europe, and Australia. In Asia, Kellogg has been the major investor involved in the RTE cereal line and holds an unrivaled market leader position. Japan was among the first markets where Kellogg expanded, and the company has achieved impressive market share in the Japanese breakfast food industry. In less developed Asian countries, such as Korea, Malaysia, and Singapore, Kellogg's expansion was also favorable (Kellogg Annual Report 1998). Comparatively, General Mills and Quaker Oats have been less active in Asia.

Considering their extensive globalization activities, it is reasonable to assume that these three firms have developed certain knowledge and experiences of dealing with different economic structures, governmental policies, culture issues, dietary habits, and other problems involved in international business management.

### 3. 2. 1. 1. 3. Strategy

The strategic goals and objectives of a firm also play important roles in determining what mode characteristics are desired and thus what entry mode a firm may wish to use when entering foreign markets (Driscoll 1995).

Facing the sagging domestic demand, major cereal producers have made international expansion a core strategy for long-term growth, along with product innovation, health claims, and intensive marketing programs. During past internationalization activities, these companies, more or less, expressed their preference for direct production and local marketing as long as the situation in the host country was appropriate. The reason is straightforward in that an investment presence allows on-the-spot controlled reactions to competitors' moves and enables firms to gauge precisely the market's needs.

The emerging Chinese market has drawn increased attention from the major cereal companies. Quaker Oats has selected China as the core market for its expansion in Asia/Pacific region (Robert 1998, Quaker Oats Annual Report 1996-1998). Kellogg considered China and India, the two most populous countries, as crucial markets for future expansion in Asia (New York Times 1995). General Mills has been expanding mainly in Latin America and Europe. As its major competitors, Kellogg and Quaker Oats, expanded into Asia, General Mills also followed suit, and China went onto its strategic agenda due to the enormous population, rapid economic growth and a trend of lifestyle westernization (General Mills Annual Report 1998).

Recognizing the strategic importance and the complexity of the Chinese market, all the companies committed to it as a long-term market, which therefore increased the likelihood of heavy resource commitment.

### 3. 2. 1. 2. Environmental Factors – China

#### 3. 2. 1. 2. 1. Political/Economic Conditions: Emerging Market Economy

China's open market reform and rapid economic growth have enticed a tremendous surge in market investment by multinational companies. China is second only to Japan as Asia's largest and fastest growing market for most products (Attaché Query Detail 1997). Real growth in GDP has average 9% per year since 1981 and hit over 10% in the last five years. According to some international business researchers, by the year 2000, China's consumer market will be larger than the United States or Western Europe (Luo 1998).

In many ways, China is taking steps toward a market economy. Massive migration from the countryside to urban areas, though often viewed as a threat to social stability, represents the inevitable workings of a market economy (Luo 1998). It indicates that jobs are no longer being allocated as strictly as in the past, and labor mobility has increased significantly.

At the same time, the influence of the governmental planning system has been substantially reduced. There is reduced relevance of "the plan" to actual economic performance. Consider the Eighth Five-Year Plan (1990-1995) as an example. Although the central government retained approval power over large-scale projects in critical industries, the grip on most sectors and levels of the economy as laid out in the plan had

virtually loosened. And there was very little connection between the plan set forth in 1990 and what actually happened.

The government also made efforts to engineer industrial growth by introducing market competition and fostering the expansion of collective enterprises (Luo 1998). As a result, Chinese business organizations have become less and less dependent on central authority and their autonomy and ability to determine how and with whom they will conduct business had grown. Bankruptcy and unemployment, unheard of in the past, have also increased in recent years and driven Chinese business organizations to compete for growth and avoid poor performance. Furthermore, China had recently emerged as a key participant in the international Merger and Acquisition field (Capener 1998). Along with the greater merger and acquisition opportunities, the 15<sup>th</sup> Communist Party Congress in September 1997 and the election of Zhu Rongji as Premier at the March 1998 national People's Congress "suggest a new openness and pragmatism, and a promise of even greater flexibility for foreign investment in China" (Capener 1998: 14).

Many foreign investors once cited currency convertibility in China as one of the biggest problems. Today, China is in a very strong position to increase the degree of currency convertibility. China already has current account convertibility (Luo 1998). Most importers have ready access to foreign exchange, unless they seek to purchase a restricted item. There is also fairly wide access to foreign exchange that supports foreign tourism and foreign-invested enterprises seeking to repatriate profits (Luo 1998).

Knowing these changes, it is expected that China's economy should expand to almost \$6 trillion, about 10 times its size in 1994, and become the world's largest economic center by the year 2020 (Attaché Query Detail 1997).

### 3. 2. 1. 2. 2. Market Demand/Competition

Given the changing political/economic conditions, Chinese purchasing power is on the rise. Meanwhile, the Chinese people are demanding more products that are better and cheaper, and they want them faster. Growth has not been uniform, however, with incomes for its 300 million urban residents growing much more rapidly than those for the remaining 900 million living in the countryside (Attaché Query Detail 1997).

Reliable and consistent income statistics are hard to come by in China due to the large amount of unreported black market trading. According to the Chinese Statistical Yearbook, the 125 million residents in major coastal cities are crossing the \$1,000 per capita annual income line and entering a phase of very high growth in demand (15% to 20% per year) for everything from blue jeans to electronic products, from motorcycles to processed foods. Unofficial sources present a more optimistic outlook. Some reports indicate that these 125 million persons have a purchasing power parity annual income of US\$10,000 to \$40,000. In addition, it is estimated that China's growing middle class could reach 445 – 580 million by the year 2005 (Attaché Query Detail 1997).

While there is no real consensus regarding the definition of the "Chinese Middle Class", demographic segments are becoming more pronounced. According to the survey reports from Shanghai Agricultural Trading Office, if a monthly household income of 2000RMB (approximately US\$ 241) is used as a dividing point (which according to the Shanghai survey accounts for about the upper 30% of households in Shanghai), China's middle class has the following characteristics: (1) married with one child, and (2) 36-45 years old.

China's consumer market has experienced spectacular growth and is still growing. In the leading cities, such as Shanghai, Beijing, and Guangzhou, which have the highest income levels in the country, the demand for brand name products is growing rapidly (Bates 1998).

Foreign processed foods have become popular in China because of perceived high quality and appealing appearance. Initially, people mainly purchased foreign foods as gifts or as a fad. Over time, with increased incomes and an expanding supply of foreign foods, more and more households purchase foreign foods for self-consumption and on a more frequent basis. The 1998 consumer study by advertising agency, Grey China, reveals that the westernization of the typical "grocery basket", including processed foods, is one of the strongest trends among Chinese consumers (Bates 1998).

Despite great potential, competition confronting US cereal breakfasts will be intense, coming from both traditional breakfast and other modern processed foods under either domestic or international names.

China has a long history of cuisine. In the traditional breakfast aisle, consumers have a broad selection from low-priced noodles, porridge, pastries, to high-priced Dim Sum with numerous flavors. With the spectacular development of a processed-food market (Bates 1998), food processors (domestic and international) have developed a variety of instant noodles and porridge, cereal beverages, biscuits, and the like. Battling for buyers, food firms are actively involved in product differentiation, new product development, promotion activities, and various marketing programs. Meanwhile, the rapidly increasing import market for consumer-ready food products is also generating greater levels of competition. Countries like New Zealand, Australia, and nearby



countries in Asia are the main competitors for US food producers (Attaché Query Detail 1997). All the competitor countries are increasing their levels of direct promotional activities such as in-store and hotel restaurant promotions and their trade service and exhibition activities.

The inferior distribution and retail system in China's fragmented, regional market spells another major problem. As a result, foreign investors should focus their attention not only on production, but also on many non-production issues such as distribution. As a recent US-China Business Council survey reveals, distribution-related problems are cited by foreign investors as one of the top difficulties facing their China operations. However, great progress has been made, characterized by continuously expanding distribution options, including local distributors, foreign distributors, representative offices, joint venture trading companies, and free trade zones (Baldinger 1998).

### 3. 2. 1. 2. 3. Socio-Cultural Conditions: *Guanxi*

Social-cultural conditions also affect the mode choice because socio-cultural dissimilarity between a firm's home country and its host country can create internal uncertainty for the firm (Driscoll 1995). Specifically, the dissimilarity leads to difficulties involved in transferring marketing skills, technology, and human resources (Davidson 1980). It also creates high information acquisition costs as firms strive to acquire information needed to bridge the cultural gap between home and host country (Erramilli and Rao 1993).

Social-cultural distance mainly stems from differences in business and industrial practices, languages, educational levels, and cultural characteristics – “the sum total of

knowledge, beliefs, art, morals, laws and customs, and any other capabilities and traits acquired by humans as a member of society” (Wertsch 1985: 2).

In the cereal case, it is apparent that US cereal investors in China will face socio-cultural conditions largely different from the United States, such as languages and educational levels. Work-related values also vary largely as a result of cultural dissimilarity between the two countries. In Hofstede’s famous study “Cultural Constraints in Management Theories” (1993), China and US were often found to display opposite characteristics in the five cultural dimensions – power distance, individualism, quantity of life, uncertainty avoidance and long-term orientation (Table 3).

Table 3: Examples of Cultural Dimensions

Country	Power Distance	Individualism*	Quantity of Life**	Uncertainty Avoidance	Long-term Orientation***
China	High	Low	Moderate	Moderate	High
France	High	High	Moderate	High	Low
Germany	Low	High	High	Moderate	Moderate
Hong Kong	High	Low	High	Low	High
Indonesia	High	Low	Moderate	Low	Low
Japan	Moderate	Moderate	High	Moderate	Moderate
Netherlands	Low	High	Low	Moderate	Moderate
Russia	High	Moderate	Low	High	Low
U.S.A.	Low	High	High	Low	Low
West Africa	High	Low	Moderate	Moderate	Low

\* A low score is synonymous with collectivism. \*\* A low score is synonymous with high quality of life.

\*\*\* A low score is synonymous with a short-term orientation.

Source: Adapted from Hofstede, 1993, pp. 91.

Among numerous cultural issues cited by foreign investors in China, the Chinese *Guanxi* is widely viewed as the most intricate and the most difficult issue to deal with.

Recognizing its critical importance in doing business in China, almost all the business books today about China spend chapters on exploring this topic alone.

The Chinese *Guanxi* refers to the concept of drawing on connections in order to secure favor in personal relations. As a result of the long influence of Confucianism, in China, power resides with people, rather than in laws or the system, and China's traditional political system is fundamentally a pattern of personal relationships. The current underdeveloped legal system is another reason for the prevalence of *Guanxi* used in business. In such an environment, the government cannot provide equal and fair protections to all the economic entities, and business clauses might form a useful agenda but obligations come from relationships. Here is a typical example. "McDonald's was evicted from a central Beijing building after two years despite having a 20-year contract – simply because the in-comer from Hong Kong had strong *Guanxi* with the government whereas McDonald's had not kept its own in good repair" (Luo 1998: 181).

Therefore, the extent of one's own personal *Guanxi* may determine the legality of what one does. "Using one's *Guanxi* to understand the informal systems beneath the law may also help one second-guess policy" (Brahm and Li 1996: 22). Unaware of the informal systems functioning beyond the statute, a foreign firm may find it working with only part of the system.

### 3. 2. 1. 3. Desired Mode Characteristics

As indicated in the preceding analysis, the tremendous popularity and impressive economic growth in China indicate too big an opportunity for US brand cereals to ignore. A successful expansion in this emerging market will not only ease the problems of

declining sales resulting from shrinking market share in the supersaturated domestic market, but also give great impetus to long-run growth.

Given the increasing demand for quality by Chinese consumers and intense competition from traditional foods, it is apparent that US cereals should rely on their firm-specific advantages to penetrate this emerging market and sustain long-term expansion. These advantages, including product quality, differentiation, brand name and marketing expertise, will make it possible for US cereal manufacturers to offset their deficit of knowledge of the local environment relative to local competitors and to ask for a price premium to cover costs and ensure desirable profits. Therefore, a high level of control should be preferred by the cereal investors. With a high level of control over operation and decision-making, investors can ensure the supply of high quality products and services and respond to the market changes promptly. In addition, a high level of control will also reduce the likeliness of conflicts with local partners holding a different culture and working style, and hence minimize dysfunctional management in ventures.

Meanwhile, dissemination risk becomes a sensitive issue because those advantages must remain firm specific so as to bring companies an edge in this competitive market. This requirement strengthens the need for a high level of control, as stated earlier because only by possessing a high level of control will the foreign investors be able to closely monitor and manage the flow of firm-specific advantages.

The third mode characteristic, resource commitment, is somewhat less critical than the constructs of control and dissemination risk. Although China has been controlled by communism and planned economy for a long time, the Chinese economy has been clearly heading toward a market economy and has been growing rapidly. The

political environment is generally viewed as stable and becoming increasingly open and flexible. Concerns stemming from socio-cultural differences can be offset to some degree by the US cereal firms' extensive international experiences, which the investors can leverage in the emerging Chinese market. Moreover, major cereal producers have committed to China as a strategic long-term market. Under such a strategy, heavy resource investment is very likely to be made.

The fourth mode characteristic, flexibility, seems ambiguous relative to the other three constructs because this concept can be defined from two aspects: (1) flexibility of withdrawing the investment (Anderson and Gatignon 1986), and (2) flexibility of decision making and strategic moves during the operation (Driscoll 1995). If understood in the first way, once the cereal firms commit heavy resource investment through FDI modes, the investors will have a low level of flexibility of withdrawing the investment because FDI modes entail large amount of sunk cost. However, if understood in the second way, FDI provides the investors an advantage of being on the spot and therefore enables them to make prompt strategic adjustments – a high level of flexibility. The increasingly flexible and open macro environment in China implies increasing flexibility allowed to foreign investors, as a result of the relaxation of central planned system and certain regulations (e.g. M&A), as well as the emerging market economy.

Besides the four mode characteristics proposed in Driscoll's model, for the cereal case, the *Guanxi* factor should be added as another important construct influencing the mode choice because *Guanxi* pervades almost all the aspects of Chinese society and has been functioning alongside the underdeveloped legal system. A good *Guanxi* with important governmental officials or certain business organizations is highly desired by

the newly arriving US cereal investors. The implication of this extra construct is that the US cereal investors should diligently seek proper strategic alliances or formal partnership in their entry strategies. Other cultures also have forces similar to Chinese *Guanxi*, perhaps *social capital* as suggested by Peterson *et al.* (1999) is a broader concept that should be added to Driscoll's mode characteristics.

All in all, when considering the entry mode choice, US cereal manufacturers would desire high control, good *Guanxi*, and low dissemination risk. Flexibility and resource commitment are less critical relative to the preceding three factors because of the investors' long-term commitment to the Chinese market, extensive international experiences and the continuously improving investment environment in China. Consequently, among the three generic entry modes, FDI stands out to be the desired mode choice against exporting and contractual arrangement.

#### 3. 2. 1. 4. Moderators

There are a number of factors that might prevent firms from embracing their preferred mode choices. Hereafter, three major moderators –government policies and regulations, firm size and corporate policy – will be studied.

##### 3. 2. 1. 4. 1. Chinese Governmental Policies and Regulations

Host government policies, such as intellectual property laws, labor, and trade and investment policies, may moderate the relationship between a firm's desired and actual level of mode characteristics. This section studies major government policies and regulations in China relevant to foreign business.

Since 1978, China has built a sound structural foundation for the legal system related to foreign operations in China. The Civil Code is the fundamental law and lays down the general principles for business transactions. Other general principles are enshrined in the Foreign Economic Contract Law in March 1985 and in the Law on Chinese-Foreign Equity Joint Ventures, the Law on Chinese-Foreign Cooperative Enterprise, the Law on Wholly Foreign Owned Enterprises, the Income Tax Law for Enterprises With Foreign Investment and Foreign Enterprises, the Patent Law, and so forth (Luo 1998). Table 4 described the tidal changes in the legal treatment of foreign investment in China from 1978 through today.

Table 4: Seven Tidal Changes in the Legal Treatment of FDI in China

1. Equity Joint Ventures: From *Controlling* to *regulating*;
2. Wholly foreign owned subsidiaries: From *regional experimentation* to *national promotion*;
3. Regional policies: From *coastlining* to *opening inland*;
4. Tax regime: From *initial favors* to *proliferating encouragement and rationalization*;
5. Foreign exchange management: From *relief qualification* to *greater accommodation*;
6. Technology transfer and intellectual property protection: From *rudimentary access* to *more sophisticated operations*;
7. Foreign bank and foreign trade operations: From *experiment and simple presence* to *operational expansions*.

Source: adapted from Luo, 1998, pp. 46.

The Chinese government highly values foreign business investment because these activities bring in advanced technology, foreign capital, and modern management skills, all of which are pivotal for China's economic development. As a consequence, the

Chinese government provides various preferential tax treatments to foreign investors. In general, all the foreign ventures with a contract extending for more than 10 years are not taxed for the first two profit-making years, and benefit from a 50% reduction in income tax for the following three years. Foreign ventures that reinvest their profits in China over five consecutive years can claim a refund of up to 40% of disbursed taxes (Wei 1994). In special locations such as SEZ (Special Economic Zone), ETDZ (Economic and Technological Development Zone), OCC (Open Coastal City), HNTIDZ (high and New Technology Industrial Development Zone), and the like, the tax is even much lower than the standard national rate of 30%, with additional exemptions (Table 5).

Table 5: Preferential Tax Treatment to FIEs at Different Locations

	General income tax rate	Exemptions
National Standard	30% + 3% local surcharge	2-yr tax holiday (no tax) & 3-yr 50% reduction
SEZ	15%	Tax holiday and 50% reduction Export Duties Exemption VAT Exemption Reduced 10% withholding tax
ETDZ	15%	Tax Holiday and 50% reduction Reduced 10% withholding tax
OCC	24% ; or 12% to export-oriented ventures; 15% to tech-advanced ventures	Tax holiday and 50% reduction Reduced 10% withholding tax
HNTIDZ	15%	Tax Holiday and 50% reduction

Source: created based on “Chinese Foreign Investment Laws and Policies”, Wei, 1994.



Intellectual property protection in China has undergone considerable development since the first joint ventures were established in the late 1970s. At that time there was virtually no intellectual property protection offered by law in China. In the intervening period, laws on trademarks in 1982, patents in 1984, and copyrights in 1990 have been passed, along with implementation regulations, while legislation on specific areas such as computer software protection has also been adopted.

Law enforcement in China has been weak for many decades as a result of the public's poor concept of law, conflicting traditions and working practices, and the low quality of legal professionals. In an effort to improve the legal environment, China gradually removed state administrative and financial controls over the legal profession. China also plans to train 100,000 more lawyers by the end of this decade. Moreover, some forty-one foreign law firms are being allowed to set up practice in China, with another hundred awaiting licenses (Steidlmeier 1995).

#### 3. 2. 1. 4. 2. Firm Size

Firm size is "an indicator of the firms' resource availability; increasing resource availability provides the basis for increased international involvement over time" (Driscoll 1995: 22). For instance, small firms desire a high level of control over international operations and wish to make heavy resource commitments to foreign markets; but because of their limited size and therefore limited resource, many times small firms resort to export entry mode, while giving up the desired investment mode.

In the cereal case, the study focuses on major brand name cereal producers, namely, Kellogg, Quaker Oats, and General Mill. All of these firms are industry giants in

their home country, as well as the leading RTE cereal marketers worldwide. In terms of total assets as of 1997, Kellogg held \$3,380.1 million, Quaker Oats \$2,697 million, and General Mills \$3,902.4 million. In its recent company financial strength rankings, Value Line (1999) ranked Kellogg A and General Mills B++, both of which were considered to be highly favorable rankings. Quaker' rank was relatively low at B, mainly due to the tremendous restructuring charges and losses on divestitures in 1997 (Quaker Oats Annual Reports 1997-1998). Despite the lower rank, Value Line analysts agreed that "Quaker closed 1998 on a strong note, and should gain strong growth in 1999" (Value Line 1999: 1494).

#### 3. 2. 1. 4. 3. Corporate Policy

Corporate policy can have a pivotal impact on the relationship between desired and actual levels of mode choices because in some cases firms may mandate the use of one entry mode over another. "It is not uncommon for firms to use one mode repeatedly in different entry situations, irrespective of whether this is situationally the optimal entry mode" (Driscoll 1995: 23).

As mentioned earlier, all the three firms studied show preference for investment modes in their global strategies. When dealing with specific investment modes, the three companies' corporate policies, though, varied from each other considerably. Kellogg has long been known for investing and building business by its own, either in Europe, Australia, or in some Asian countries, such as Malaysia and Singapore. Quaker and General Mills often did the contrary by resorting to alliances with strong partners when investing abroad. In terms of product lines, Kellogg was often found to bring its core

product - RTE breakfast cereals – to foreign markets. The other two companies, however, have diversified into snack, milling, beverage, and dairy categories, both at home and abroad. As a result, when investing overseas, the latter two companies do not consider that the core product line should necessarily be the RTE breakfast cereal.

### 3. 2. 1. 5. Mode Chosen: a Preliminary Mode Decision

Influenced by the above moderators, the desired levels of mode characteristics concluded earlier are moderated into the actual levels of mode characteristics, and therefore an actual mode choice.

The preferential policies offered by Chinese government to foreign business enable and virtually attract the US cereal firms to adopt investment modes. Meanwhile, the improving legal system helps to reduce the fear of investment risk, and hence, increase the likeliness of heavy resource commitment.

The large firm sizes of these investors further lower the concern for resource commitment. In addition, the investors can consider the strategy of starting with one plant so as to minimize the capital risk. Such a strategy has been conducted by many multinationals in China and has demonstrated impressive effectiveness. Nestle, for example, has captured half of the national instant coffee market by sourcing from just one plant in Dongguan, Guangdong Province. Philip Morris Co. claimed a 30% national market share for instant coffee and also had only one plant in Guangzhou (Bowles 1997).

The variation in corporate policies will lead to the differences only in specific FDI mode selection, but has no impact on the selection among the three generic entry modes.

As a consequence, among exporting, contractual arrangements and FDI, all the three companies still favor investment modes.

One threatening factor is the incomplete property rights law and weak law enforcement in current China. This factor, however, does not raise an opposite argument, but rather strengthens the earlier conclusion that high control, low dissemination risk and good *Guanxi* would be highly desired. The reason is apparent that in such an imperfect market as China, the most rational strategy to protect firm-specific know-how is to internalize operations and obtain a high level of control, which can be achieved through investment modes. Good *Guanxi* is emphasized because in the Chinese society, *Guanxi* functions as an important part of the total system (Brahm and Li 1996).

To sum up, the US cereal companies should and can chose investment modes to enter the emerging Chinese market. To minimize the resource commitment, these investors can consider the strategy of starting with one plant and then expanding when needed. As an additional mode characteristic – specifically for this case, good *Guanxi* plays a critical role in succeeding in China and therefore is highly desired. To realize this mode characteristic, the US cereal investors should make efforts to identify strong partnership or strategic alliances in their entry mode decision.

### 3. 2. 2. Specific Foreign Investment Options in China and Lessons Learned

The mode chosen in the preceding section, namely, investment modes, is too preliminary to give clear guidance for the US cereal investors because after the generic mode decision, the companies still face the choice among a spectrum of specific investment options legislated in China. Each of these FDI vehicles fulfills different needs

and features their own pros and cons, and in order to identify a proper and detailed entry strategy, the US cereal investors must understand fully the differences among these options. This section then provides an introduction to various FDI vehicles allowed in China. Following this are the experiences of Coke and Pepsi with these FDI modes. These experiences are presented in the form of lessons learned.

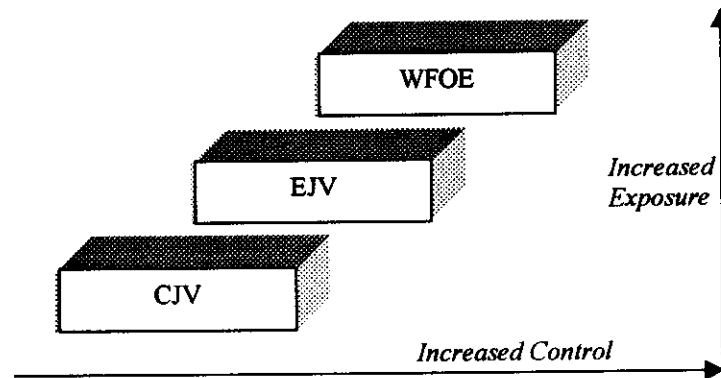
### 3. 2. 2. 1. Specific Foreign Investment Options in China

In general, foreign investors are free to choose from several investment modes: cooperative joint ventures (CJVs), Equity Joint Ventures (EJVs), and wholly foreign-owned enterprises (WFOEs). For a quick comparison, refer to Table 6.

Today, EJVs are the most favored investment vehicle, accounting for about 50% of the total amount of actual FDI in 1996 (Luo 1998). An EJV is a limited liability company with equity and management shared in negotiated proportions by foreign and Chinese partners. A WFOE is a foreign company using entirely its own capital, technology, and management while operating in China. The enterprise manages its operations independently and is responsible for all risks, gains, and losses. WFOEs represented about 30% of the total value of FDI in 1996 (Luo 1998). A CJV refers to a variety of arrangements and a loose association of partners that agree to pursue a joint undertaking (which may include a limited liability company). The Chinese and foreign partners cooperate in joint projects or other business activities according to the terms and conditions stipulated in the venture agreement. CJVs constituted about 20% of actual FDI in 1996 (Luo 1998).

Table 6: Investment Vehicles in China

“The Form of Investment is a Function of Balancing Management Control with Financial Exposure”



	CJV	EJV	WFOE
<b>STATUS</b>	<ul style="list-style-type: none"> <li>Partner structure</li> <li>May acquire status of legal entity if requirements are met and stated in contract</li> </ul>	<ul style="list-style-type: none"> <li>Corporate structure</li> <li>Status of legal entity</li> </ul>	<ul style="list-style-type: none"> <li>Corporate structure</li> <li>Status of legal entity</li> </ul>
<b>LIABILITY</b>	<ul style="list-style-type: none"> <li>Individual liability of parties may be limited by parties in their contract</li> </ul>	<ul style="list-style-type: none"> <li>Limited liability within limits of parties' capital</li> </ul>	<ul style="list-style-type: none"> <li>Liability limited to registered capital</li> </ul>
<b>MANAGEMENT</b>	<ul style="list-style-type: none"> <li>If registered as a legal entity board of directors must be established at the outset</li> <li>If not established as a legal entity, a joint management committee should be set up</li> </ul>	<ul style="list-style-type: none"> <li>Board of directors</li> <li>Regulated by articles of association</li> <li>Joint management and operation</li> </ul>	<ul style="list-style-type: none"> <li>Board of directors</li> <li>Regulated by articles of association</li> <li>Autonomy in operation and management</li> </ul>
<b>CAPITAL CONTRIBUTION</b>	<ul style="list-style-type: none"> <li>Law does not provide for capital contribution ratio between parties</li> <li>Foreign: usually equipment and technology</li> <li>Chinese: usually labor, land and cash</li> </ul>	<ul style="list-style-type: none"> <li>Specific minimum on foreign party's contribution: 25% of registered capital</li> <li>Foreign: usually equipment and technology</li> <li>Chinese: usually labor, land and cash</li> <li>Set time schedule for putting up contribution</li> </ul>	<ul style="list-style-type: none"> <li>Solely from foreign investors</li> </ul>
<b>RESTRICTIONS</b>	<ul style="list-style-type: none"> <li>Nil</li> </ul>	<ul style="list-style-type: none"> <li>Nil</li> </ul>	<ul style="list-style-type: none"> <li>Advanced technology</li> <li>Export oriented</li> </ul>
<b>PROFIT-SHARING</b>	<ul style="list-style-type: none"> <li>According to ratio specified in contracts</li> </ul>	<ul style="list-style-type: none"> <li>According to capital contribution ratio</li> </ul>	<ul style="list-style-type: none"> <li>No sharing, entirely for the foreign pocket</li> </ul>
<b>TERMINATION</b>	<ul style="list-style-type: none"> <li>According to the contract</li> </ul>	<ul style="list-style-type: none"> <li>Terms: generally 10-50 years</li> </ul>	<ul style="list-style-type: none"> <li>No perpetual succession</li> </ul>

Source: adapted from Brahm and Li, 1996, pp.17.

The four mode characteristics proposed in Driscoll's framework can also be applied to these specific investment vehicles (Table 7).

Table 7: Mode Characteristics of Different Investment Options

Investment Vehicles	Control	Dissemination risk	Resource commitment	Flexibility
WFOEs	High	Low	**	High
EJVs	*High-low	*Low – High	**	*High - Low
CJVs	Low	Med. - High	**	Med. - Low

Note: \* The levels of mode differences largely depend on the equity share.

\*\* The degree of resource commitment largely depends on the size of investment, stipulations of contract, and duration of ventures.

Source: created on the basis of the analysis.

In terms of control, WFOEs have the highest control over operation and management because foreign investors are the only decision-makers. In CJVs and EJVs, foreign investors have relatively lower control because power is distributed between partners. The degree of control in EJVs also differs under different equity ownership. In Majority EJVs, foreign partners have higher control than in equal or Minority EJVs. The dissemination risk shows a negative relationship with the control status: the higher control, the lower risk, and vice versa. The difference in resource commitment among these three vehicles is relatively ambiguous because it will largely depend on external factors, such as the size of investment, certain stipulations of contracts, and duration of the ventures. Defined in Driscoll's way, the degree of flexibility is the highest in WFOEs because with the absence of a contractual partner, foreign investors possess total control

over decision-making and operations. In Majority EJVs, foreign investors may also enjoy a high degree of flexibility because of the high level of control endowed by the majority ownership of venture equities. In equal or Minority EJVs and CJVs, foreign investors' strategic flexibility are greatly restricted due to the presence of a strong contractual partner.

### 3. 2. 2. 2. Lessons Learned

Recognizing the complexity of the Chinese market, recent arrivals like the US RTE cereal firms could find the experiences of other foreign investors in China a significant help in making their entry strategy decisions. This section thus presents some important lessons learned in the past by Coke and Pepsi. Consistent with the preceding analysis, the Coke and Pepsi cases reveal the critical importance of high control and good *Guanxi* in succeeding in China.

#### **Lesson 1: The Critical Importance of Management Control**

Experiences by various multinationals in China suggest that it is critical for foreign investors to have a high level of management control. A high level of control helps foreign investors to ensure quality and protect firm-specific advantages, as described by Driscoll in his academic study. As an empirical lesson of foreign investors in China, high control also helps to minimize potential dysfunctional management entailed by the dissimilar culture and business practices in China and therefore speed the process of operations. A high level of control by foreign investors is particularly important when the Chinese partners are inefficient and/or have divergent interests.



A close look at the operations of Coke and Pepsi in China reveals the critically important role played by control in successful expansion in China. Coca-Cola entered China in 1981, and Pepsi-Cola entered China with its Shenzhen plant only one year later. Today, however, sales of Coke are almost three times those of Pepsi. Coke has 23 bottling plants in China, nearly double the number that Pepsi has. What gave Coca-Cola its advantage? According to Rick Yan, Vice President in the Beijing Office of Bain & Company, "Coca-Cola's long-term success has involved taking as much control as possible of its joint ventures"(Yan 1998: 63). In the early 1980s, foreign investment in the Chinese beverage industry was highly restricted; Coca-Cola was forced to form partnerships with government bodies. However, in 1988, when regulation of bottling JVs was relaxed, the company moved quickly to acquire stakes from its partners to establish majority equity positions and to gain management control. Pepsi-Cola, in contrast, did not seek equity majority and management control until 1993. As a result, four of its bottling plants remain CJVs rather than EJVs. Because these ventures were based on cooperative contracts, they restricted the foreign party's level of management control and complicated the process of making investment decisions (Yan 1998).

## **Lesson 2: The Critical Importance of *Guanxi* and Proper Partnership**

As mentioned before, *Guanxi* is a delicate fiber woven into many aspects of China's society. The Chinese market cannot be tackled effectively today without paying due attention to the construction and maintenance of good *Guanxi*. For foreign investors, entry mode should be associated with *Guanxi*. A good local partner can spur the venture's market expansion and enhance its market power against rivals in the host

environment because of the operational synergy effect between a local partner's existing *Guanxi* network and a foreign venture's technological and organizational competencies. The *Guanxi* obtained via a current partner also helps to build larger networks in the future, and therefore drive consistent corporate success.

The case of Coca-Cola and Pepsi in China again serves as a good example exhibiting the importance of proper partnership/*Guanxi*. In the early-1990s, Coca-Cola shifted its entire partnering strategy as soon as the relevant regulations were loosened. It invited three partners into its new bottling JVs - Citic (China International Trust and Investment Corporation), Swire Pacific and Kerry Group. Citic is a state-owned investment conglomerate formed by the directive of the late Deng Xiaoping. It has arguably the most Western style management approach and the most astonishing *Guanxi*, or connections, in China. Swire Pacific is Coca-Cola's partner in Hong Kong. It is one of the leading trading companies there and enjoys a good relationship with the Chinese government. Kerry Group is owned by the Malaysian tycoon Rober Kuok, who holds significant investments in China and has top level access to Chinese leaders (Yan 1998). These partners served a number of the company's critical objectives, such as sharing the investment risk. Furthermore, the powerful connections also allowed Coca-Cola to leverage the political influence of its partners to get government approval for new bottling plants (Yan 1998).

Such a strong *Guanxi* network held by Coca-Cola is expected be even more useful in the future, when both Coca-Cola and Pepsi are trying to expand into smaller cities, where the volume potential in smaller cities will justify only one plant with sufficient scale to break even. The government has already announced that it will grant only one

license. With the powerful influence of its partners, as well as its own profitability and leadership, Coca-Cola is much more likely to win over Pepsi, and the resulting exclusive operation in the smaller cities will bring Coca-Cola even larger competitive advantage in the future.

Foreign investors have also increasingly realized that the importance of partnership is not only in gaining *Guanxi* and knowledge, but also in overcoming the inferior distribution system in the fragmented Chinese market. Therefore, it is not surprising that “supply chain management” has become one of the buzzwords of China business. Efficient distributor partners will effectively help foreign producers reduce costs, ensure product quality and on-time supply, and eventually drive up profits. A good distributor partner can also provide marketing support and relevant information. Furthermore, reduced excessive costs resulting from improved distribution enable producers to set -- and maintain -- competitive prices relative to competitors, especially the cheap domestic products. The forms of alliances can be formal or less formal. The potential partners can be chosen from either professional distributors or peer food producers with strong distribution networks, domestic or international. For example, Pepsi has initiated a production-for-distribution swap arrangement with Want Want, a market leader in China’s snack food. In this informal alliance, Want Want distributes Cheetos and other PepsiCo snack food brands in Beijing, Nanjing, Jiangsu Province, and Hunan Province where it has strong distribution network. In return, PepsiCo added Want Want’s Lonely God potato twists to its production lines at its joint-venture plant in Guangzhou (Market Asia Pacific 1998).

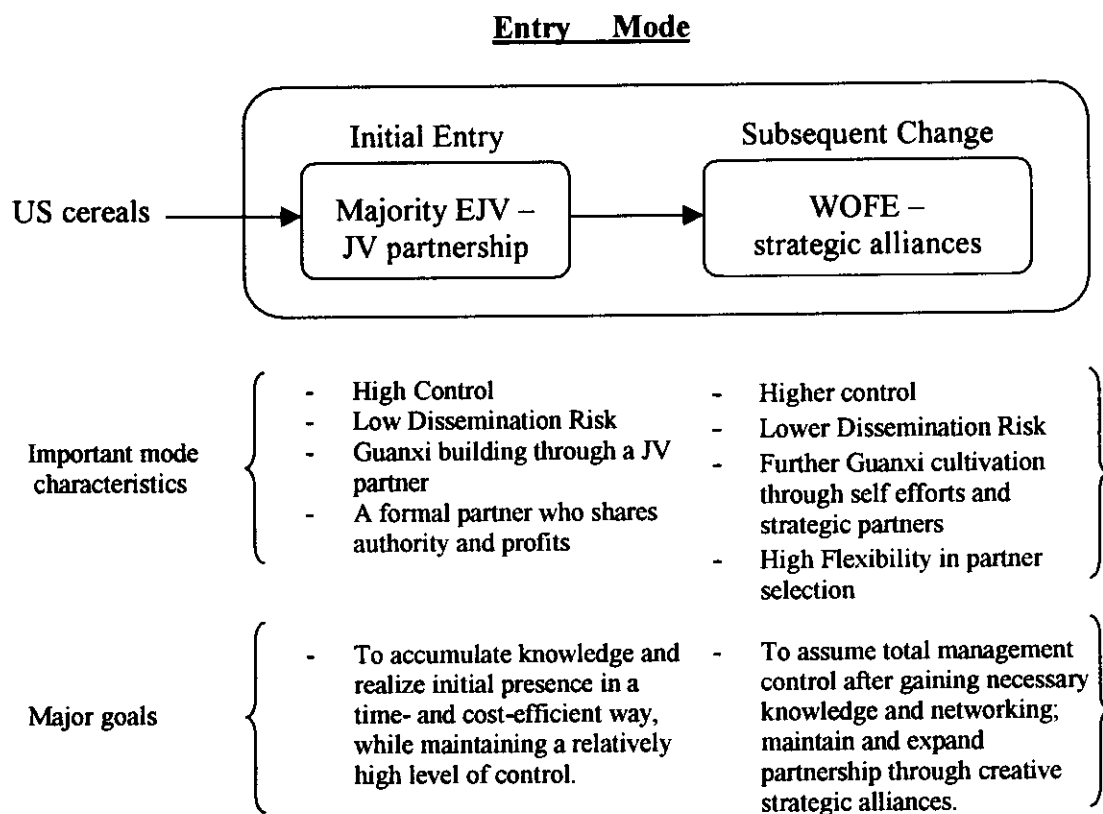
### 3. 2. 3. Generic Entry Strategy for RTE Cereals

Combining the analysis based on the application of Driscoll's model, specific investment options legislated in China and important lessons learned from Coke and Pepsi's past FDI experiences, a generic entry strategy for US RTE cereals –as a product class – can be proposed.

Recognizing the complexity of the Chinese market, the US cereal investors should focus on knowledge accumulation and the establishment of a strong market presence at the early entry stage. At the same time, the investors should seek as much management control as possible and reduce the dissemination risk to a minimum level. An optimal entry strategy is the one which best serves these fundamental objectives. Consequently, a WFOE or a Majority EJV will naturally stand out against a CJV, a Minority EJV, or an Equal EJV due to the high control and low dissemination risk associated (Table 7). The other critical factor, *Guanxi*, can be cultivated through appropriate partnerships or strategic alliances wisely chosen. Specifically, foreign EJV investors can immediately take advantage of their JV partners' existing *Guanxi* network. WFOE investors may also cultivate *Guanxi* but they must do it through strategic alliances with others not directly related to their ventures. This makes *Guanxi* more difficult to develop, especially for new entrants. In addition, in the early entry stage, the Majority EJV with a strong Chinese partner will provide greater opportunities to accumulate knowledge of local markets than a WFOE. The reason is that a strong formal JV partner is most likely to be the best teacher from whom foreign investors can closely learn knowledge and marketing expertise related to local markets.

In related literature, it has been suggested that the best way to enter China was through an EJV with a well-connected Chinese partner (Vanhonacker 1997). Because of relaxation in regulations, there has been increased interest in WFOEs. However, picking between a WFOE and an EJV is not necessarily an either-or decision. They can be used as a sequence to combine the advantages of both options while reducing the disadvantages (Luo 1998). This study adopts such a logic and recommends a strategy of a Majority EJV and a WFOE as a sequence (Figure 2) for the US cereal investors. The reason is that a dynamic strategy like this enables the investors to meet their needs at different stage, as elaborated below.

Figure 2: Generic Entry Mode Proposed for the Product Class



Under this strategy, US cereals realize initial entry by establishing a formal partnership with an appropriate organization (either domestic or international). The majority ownership of foreign investors is important because it allows US cereals to ensure high quality products and minimize the dissemination of technology and other firm-specific know-how transferred from its home country. Equally important is a formal venture partnership. In the unique Chinese market, an EJV partner is usually the best teacher and facilitator in that it shares with the “inexperienced” US investor the knowledge of local market, guides the investor into the complex *Guanxi* network and split some degrees of investment risk.

With the passage of time, cereal investors will familiarize themselves with the Chinese market and consumer behavior. They will also begin to know other potential partners, who are either more efficient than the original JV partner or are helpful to meet US investors’ emerging needs that may not be satisfied by the original partner. When conditions mature, US cereal producers can consider changing the entry strategy from an EJV to a WFOE in order to achieve even higher levels of control and flexibility. To realize such a strategic move, the investors can either (1) open a separate WFOE while maintaining the original EJV plant, or (2) simply transform the original EJV into a WFOE through purchasing the partner’s equities or collecting these equities according to the contract originally agreed and stipulated by both parties. In the latter scenario, the original formal partnership will come to an end because of the termination of the EJV. In case the original partnership is successful and is expected to be continuously useful, the US cereal producer can maintain the old partner through new forms of partnership, such as a less formal strategic alliance. In the new WFOE venture, the increased control –

100% – provides the US investors increased flexibility and lower dissemination risk. Meanwhile, the US cereal investor enjoys complete authority in developing different strategic alliances with a larger pool of potential partners involved in its various activities along the market chain.

At both stages, management control and partnership are always the critical issues. The way to obtain control is relatively straightforward, that is, equity ownership. Comparatively, how to choose a partner is much more complex because the selection criteria vary greatly depending on individual cereal firms' objectives, even though they are operating in the same product class. However, one fundamental principle should always be born in mind: a synergy of interests and mutual dedication to achieving similar goals must be ensured to facilitate the ventures' progress because a common understanding of mutual interests and goals lay the foundation of long-term cooperation.

#### 3. 2. 4. Specific Company Entry Strategies

As mentioned earlier, entry strategy is essentially a firm-specific strategy. The entry strategy recommended in the previous section is proposed from the product class perspective and mainly serves as a standard strategy to provide general guidance. This section moves on to analyze and critique the current entry strategies by individual companies operating in China. Kellogg is studied in more detail because it is the cereal company who has chosen to operate in China with its US RTE cereal product line. The entry strategies by Quaker Oats and General Mills are also mentioned and serve as a comparison. Unlike Kellogg, the latter two US cereal giants are not focusing on the product line of RTE breakfast cereals in their Chinese operations.

### 3. 2. 4. 1. Current Entry Strategies by US Cereal Companies in China

In August 1995, Kellogg established its first plant in Beiwei Industrial District, Guangzhou, Guangdong Province. The plant was formed as an Equity Joint Venture in which Kellogg holds 97% of the total equity and the Chinese partner only 3%. Kellogg contributed most of the capital, all the technology, machines and management, and captured almost absolute control over the venture operations. The Chinese partner, who was the Industrial District, contributed only land, buildings, and utilities by lease at special rates. It was virtually not involved in the plant operation and decision-making and was mainly responsible for taking care of the contacts and negotiation with the government. Kellogg has not opened another plant since.

Quaker Oats entered China in 1994, by forming a 50% Equity Joint Venture with its Taiwanese partner in Guangdong and selling All-in-One cereal (not under the name of Quaker), a grain-based instant beverage, and a pudding mix under the Mighty brand name. In 1997, it opened its first plant in China, producing and marketing Quaker All-in-One cereal beverage and Quaker cereals (Quaker Oats Annual Reports 1994 - 1997).

General Mills was a late entrant relative to its peers. In 1998, it announced the formation of Tong Want, a 50% Equity Joint Venture with Want Want Holdings Ltd. of Singapore. This venture pursued a savory snacks business in China. Operations were expected to begin in calendar 1999 (General Mills Annual Report 1998).

### 3. 2. 4. 2. Assessment of Selected Strategies

One common thing among the three companies was that they all selected the locations in the economic development districts at southern coastal cities where investors



can benefit from not only general preferential tax treatment and duty exemption, but also extra incentive regulations from the local government and special districts. In addition, consumers in these regions are affluent relative to many other regions in China and demonstrate an increased preference for foreign brand name processed foods.

In terms of control, Kellogg assumed the highest level of management control in its initial entry. As virtually the only decision-maker, Kellogg determined the strategies and goals of the plant and managed the whole process from procurement and inventory to production, distribution and marketing. All the products were goods manufactured and marketed in the home country and bore the Kellogg's name. Quaker Oats realized initial entry by an alliance with its Taiwanese partner. In this Equal EJV, management control was split between the two parties, and therefore Quaker Oats had much lower control than did Kellogg. RTE cereals were not introduced in the 1994 plant; rather Quaker was involved in the production and sales of the Taiwanese partner's cereal beverage product line. General Mills took a strategy similar to Quaker by establishing a 50% EJV with a successful Asian food producer in China. Again, in this 50% EJV, the management control is equally spread between General Mills and Want Want. The product line was also not the RTE cereal line from the US party, rather the plant pursued a snack business in which General Mills had little prior experience.

In terms of dissemination risk, Kellogg had little worry because of the absolute control over the operations. Quaker and General Mills had to share certain knowledge and experiences with their partners in the 50% EJV. However, they did not need to be as concerned about dissemination risk because the two companies were not directly introducing the product lines from their parent companies. Rather they were pursuing

product lines that they had little prior experience in and were supposed to learn from and develop with their partners.

In terms of operation flexibility, Kellogg enjoyed the highest level, while General Mills and Quaker a lower level. In an Equal EJV, any potential strategic changes and moves need the consensus of both parties. Given two greatly different cultures, variations in interests, goals and working styles, and EJV partner disagreements were highly likely. In contrast, Kellogg as the only decision-maker could reduce such conflicts and inflexibility to the minimum level.

In terms of *Guanxi*, the three companies also showed differences. The nominal partner of Kellogg was the Administration of the Industrial District, and was supposed to set up some networking with the government for the plant. The other benefit Kellogg enjoyed was the supply of land, building and utilities at special rates. However, this partner could not provide the expertise and knowledge of running a business in the Chinese food market, neither could it provide distribution support. In this aspect, Quaker and General Mills shared much similarity. Both entered China by forming an Equal EJV with successful Asian food firms who had been operating in China for a while. Considering their strong presence in China (or at least in regional markets), these partners possessed considerable networking with the government and in the industry. Therefore, Quaker and General Mills would be able to benefit from partners' strong *Guanxi* networks. Unlike Kellogg's partner, the latter two partners also possessed extensive market knowledge of the Chinese food market and strong distribution channels, which Quaker and General Mills could make use of. In addition, Quaker and General Mills

could also take advantage of their partners' successful image in China to build their own recognition in a time- and cost-efficient way.

All these entry strategies had pros and cons. In Kellogg's case, the US investor obtained a high degree of control and flexibility. The risk of disseminating the technology of US RTE was minimized. However, an obvious downside of this strategy is that Kellogg had to learn and grow by its own, in a market where a market economy is far from mature, distribution and retail systems are inferior, and eating RTE cereals as breakfast is still an exotic idea to most Chinese consumers. Quaker compromised the control issue in its mode selection by establishing an Equal EJV. In consequence, conflicts among management of both parties are likely. Such a tradeoff turned out to be worthwhile because Quaker could thus take advantage of its partner's product knowledge, specifically of the All-in-One cereal beverage. This product was initially introduced to the Chinese Mainland market by food firms from Taiwan, Hong Kong, and Singapore as a breakfast. It became a hit in the market and consumers believed that the product stood for nutrition and flavor. As was noted earlier, Quaker's new 1997 plant actually took this product as the core product line and sold it under Quaker's name. General Mills adopted a strategy similar to Quaker in the initial stage. The result is yet to be seen since the operation did not start until 1999. It is worth noting that the Chinese snack business is expanding rapidly, and that Want Want, the partner of General Mills, is a market leader in rice crackers and other snack goods in China, enjoys strong consumer loyalty, and has built powerful networking and distribution channels throughout the country.

Compared with the standard entry strategy suggested earlier for the whole product class, Quaker pursued the recommended strategy and demonstrated the same rationale, even though the 1997 plant was not directly transferred from the original 1994 factory. Kellogg employed a strategy that was essentially a WFOE with only a nominal partner who allowed Kellogg the total control. However, the partnership Kellogg formed did not meet the purpose of learning. General Mills' recent entry reflected the initial stage of the entry strategy, and its next step is yet to be seen.

The variation of the entry strategies by the three US cereal giants can be explained in two ways. First, the variation reflected the differences in the corporate policies of the companies. As mentioned earlier, these policies varied in choosing specific investment modes despite a common preference for FDI. Kellogg has long been known for investing and building business by its own and often sticks to its own brand name. As a consequence, the company seems to mandate the repeated use of this going-it-alone strategy. Comparatively, Quaker and General Mills often resorted to alliances with strong partners when investing abroad. Secondly, these strategies virtually served the different goals of the companies. Specifically, Kellogg entered China in order to penetrate the breakfast market, while Quaker and General Mills entered China in order to penetrate the broader food market and set the base for the future. The latter two companies did not consider it necessary to stay in the product line of RTE breakfast cereals. They were ready to learn new products, particularly those familiar and popular to the Chinese consumer, build their business on the base of these products, and then add their home products if appropriate. Quakers' past experience was a perfect example. General Mills' experience was too short to be entirely conclusive. As a side-note, the

business characteristics of these three companies partly explained the differences in goals. In Kellogg, the RTE breakfast cereals are still the bulk of its business. The other two companies, however, have already diversified into snack, milling, beverage, and dairy categories. As a result, when investing abroad, the latter two companies are likely as well as willing to consider options other than the breakfast market, and therefore more likely to find appropriate local partners.

### 3. 2. 4. 3. Recommendations to Kellogg

It is unnecessary, and actually impossible, to have these companies employ the same entry strategy when expanding into China. The standard strategy for the product class is proposed to provide general guidance. The assessment of the current strategies is not to tell which is right or wrong, but rather to help adjust these strategies and improve the future performance.

The entry mode by Kellogg earned the company high management control, high flexibility and low dissemination risk, and these constructs were mainly related to the process of production. However, to succeed in China, Kellogg should not only focus on production, but also pay keen attention to learning and adapting to the unique Chinese market, in that food is highly culturally sensitive and eating US RTE cereals as breakfast is still quite an exotic idea in China. As was analyzed earlier, the most effective and efficient way to achieve this objective is to obtain support from local partners with extensive knowledge and powerful networking in China.

In the aspect of partner search and selection, Kellogg did not perform as effectively as Quaker Oats and General Mills. So far, besides the nominal partner, the

Beiwei Industrial District, Kellogg has not built significant alliances with any other partners. Kellogg once had Baul (Australia) Corporation and YEO (Singapore) to supply quality milk for samples, but such alliances were relatively informal and temporary. After the launch of the products, Kellogg no longer provided or supported milk supplies with its cereal sales. Kellogg also contracted with IJOH, a Hong Kong transportation business, to distribute the cereals. All these partners did not commit to share their experiences and knowledge of the Chinese market with Kellogg, but rather simply sold their services.

Therefore, in the future, Kellogg should make efforts to seek and retain powerful partners. Since Kellogg committed to the RTE cereal category and there are virtually no other well-recognized brand names for this product in current China, potential partners are most likely to be found in non-manufacturing processes, such as distributors and food producers whose products have a high synergy with the sales of US RTE cereals – milk, for instance. A good strategic alliance with an efficient distributor would help Kellogg to adapt to the fragmented nature of the Chinese market, allow the company to set and retain competitive pricing of its products – currently sold at a prohibitive price of RMB 35-40 per 16oz box, and provide it prompt market information on consumer needs and changes. If an appropriate alliance is successfully established between Kellogg and a milk/dairy firm, the company is likely to solve the milk problem encountered in China – or at least in regional markets. This issue will be elaborated on in Chapter 4.

For the US RTE cereals, the problem lies not only in the fact that China is such a complex investing environment, but also in the fact that the product itself – RTE breakfast cereals – is so different from the traditional Chinese diet. In addition, the fact

that milk is not a Chinese staple further discourages many Chinese consumers from using US RTE cereals frequently. Therefore, besides the entry strategy, the US cereal investors must also pay due attention to the product strategy which will be studied in the next chapter.

## **Chapter 4**

### **PRODUCT STRATEGY**

Even the best entry mode strategy will not guarantee the success of foreign operations. Evidence exists that inadequate product planning is another major factor inhibiting growth and profitability in international business operations today. It is especially the case for US RTE cereal in China because of its exoticness as breakfast to most Chinese consumers. This chapter seeks to identify an appropriate product portfolio for the cereal investors in China. Following a similar structure as Chapter 3, this chapter will review the literature for appropriate theories and models, seek a standard product strategy for the product class, and finally critique the current product strategies by US cereal companies in China.

#### **4. 1. Literature Review**

##### **4. 1. 1. Product Policy**

Products commanding satisfactory market demand are the vital requirements of an effective strategy, taking precedence over all other components. And product policy is the cornerstone of the multinational marketing mix (Wind 1977 and 1982, Ronkainen 1993). The products or services a company chooses to sell to the selected target market constitute the basis for development of the company's world-wide marketing programs and determine the company's role in the world market, in relation to both customers and competitors. Decisions with regard to the nature, depth and breadth of the product line sold throughout the world and the importance attached to new product development



influence the global image of the company as well as its rate of growth and success in world markets. Product policy decisions reflect the company's positioning and segmentation strategies and hence are closely related to promotional, distribution and pricing decisions.

Most companies seek a product policy that optimizes company profits over the long term, or more precisely one that maximizes the present value of cash flows associated with business operations. Which strategy for international markets best achieves this goal? There is, unfortunately, no general answer to this question (Keegan 1981).

#### 4. 1. 2. Product Standardization vs. Product Adaptation

In the literature, the debate over global product strategy lies in a standardization-adaptation dilemma.

The proponents of standardization argue that the trends in international markets make it possible, even imperative, to provide the same types of goods and services in different overseas markets. The issue of standardization has been studied by marketing scholars since the mid-1960s. Buzzell (1968) provided one of the pioneering analyses of standardization and the variables that should be considered. Jeannet and Hennessey (1988) defined standardization as the amount of similarity companies want to achieve across many markets with respect to their marketing strategies and marketing mix. The most extreme form of standardization was best defined by Levitt (1983) as that views the entire world (or major regions) as a single entity and sells the same standardized product

in the same way everywhere. This can be achieved because “gone are accustomed differences in national or regional preferences” (Levitt 1983: 92).

The rationale for standardization is, at first glance, quite clear: no product research or development is required, manufacturing technology and quality control procedures have been established, and promotional material can quite often be used after language translation. Such a process enables the companies to achieve substantial economies of scale, and hence to enjoy significant cost savings and increasing margins. This is always the most powerful argument in favor of product standardization in the literature (Barker and Aydin 1994). Levitt (1983) also posits that the needs and interests of consumers are becoming homogeneous all over the world. If true, this trend will further strengthen standardization as the key product strategy for globalization.

Clark (1989) criticized that standardization was merely concerned with manufacturing and products (supply side) rather than consumers and brands (demand side). Douglas and Wind (1987) argued that production costs are often a minor component of total costs and, therefore, understanding the tastes and preferences of the consumers is far more important. Needless to say, at the very basic level of human needs, commonalities are far more prevalent. These basic needs can be satisfied by products that are similar at the core product level. What is of critical importance in order to penetrate, develop, and defend markets is to provide augmented products that not only meet these needs but create preference and brand loyalty in a given market segment. Without such penetration and brand loyalty, it is not possible to defend a segment against potential competitors without significant loss of one’s own market share and profitability (Barker and Aydin 1994).

When taking into account the characteristics of specific product categories, researchers acknowledge that the potential for standardization might be true for certain types of products such as industrial goods or consumer durables, but not for consumer non-durables (Stills and Hill 1984, Hill and James 1994, Barker and Aydin 1994). Boddewyn, Soehl, and Picard (1986) reported that while standardization of consumer durables in EC was up from 1973, industrialized goods manufacturers had standardized the most. However, even some of the industrial goods manufacturers were considering moving toward adaptation in the following five years. On the other hand, consumer non-durables, especially foods that are highly culturally sensitive, have been widely recognized as the most difficult category of products to standardize profitably and the most sensitive to environmental differences (Ward 1973, Hill and Still 1984, Barker and Aydin 1994, Hill and James 1994).

The reasons necessitating product adaptation stem from two aspects: structural and regulatory. Structurally, the differences in the tastes and perceptions of the consumers, different local usage characteristics, and infrastructure-related matters (distribution, raw materials, and the like) often impede standardization (Still and Hill, 1984, Barker and Aydine 1994). On the regulatory side, the host governmental regulations for health, safety, and other local standards also require the adaptation of the product. In short, customer preferences, usage, and local regulations as well as penetration and defensive marketing strategies necessitate modification and adaptation especially at the augmented product level (Barker and Aydin 1994). As one executive put it, a common product in even two countries in Europe would often be impossible (The New York Times 1985).

Product adaptation is usually multifaceted-modification. Changes can be made in terms of flavor, brand name, packaging, measurement units, labeling, contents, product features, and usage instructions. The study of Still and Hill (1984) on 55 firms with over 550 subsidiaries in LDC (less-developed countries) showed that only one out of ten packaged goods was sold without modification. On average 4.1 changes were made in terms of the above components. Food/drink products featured the most frequent adaptation among the four consumer goods categories. The information/message associated with products is an important part of the goods. As a result, the communication strategy in this sense should be an indispensable part of multinational product management.

#### 4. 1. 3. Keegan's Product-Communication Mix

To include the various possibilities and different combinations of product and communication strategies that may be employed in international markets in an overall-framework, reference can be made to Keegan (1969, 1995). The article in 1969 addressed issues of efficiency and creativity in product planning by offering a model for choosing strategy alternatives and a rationale for the alternatives. "It became a marketing classic because it addressed important issues in a timeless way" (Keegan 1995: 105).

Table 8 contains the model revised by the author in 1995.

Keegan (1995: 107) identified the three basic strategy alternatives as:

"(1) Extension: taking the home country product, communication, price, channel strategy or management practice and extending it to the target market without change.

“(2) Adaptation: taking the home-country product, communication, and so on, and adapting it to the conditions in the target market.

“(3) Creation: based on information from target markets, creating a new product designed to fill a need.”

Table 8: Keegan’s Global Product-communications Mix Strategic Alternatives

	Product function or need satisfied	Condition of product use	Ability to buy product	Product Strategy	Communications Strategy	Recommended Pricing strategy	Relative costs of adjustment*	Product examples
1	Same	Same	Yes	Extension	Extension	Extension	1	Fast food
2	Different	Same	Yes	Extension	Adaptation	Extension	2	Diamonds
3	Same	Different	Yes	Adaptation	Extension	Extension	3	Detergents, text-books, movies, software, and foods
4	Different	Different	Yes	Adaptation	Adaptation	Extension	4	Greeting cards
5	Same	Different	No	Invention	Create	Create	5	Handpowered washers
6	Same	Same	Limited Financial Resource	Extension	Extension	Create	6	Telephone digital switches

\*1=lowest to 6=highest

Source: adapted from Keegan, 1995, pp. 106.

In the matrix, six strategies are formulated: dual extension; product extension-communication adaptation; product adaptation-communications extension; dual adaptation; product invention, and dual extension with price invention. Each strategy has applications in reality (Keegan 1969, 1995). The last strategy was added in 1995. It works in cases where the lower income countries are not willing to accept a product that

is below current world-class, high-income country standards, despite their inability to buy. For example, China is rapidly expanding its telecommunications infrastructure by adding digital switch capacity. In spite of the availability of the former switch technology at affordable prices, China has a clear preference for the latest technology. Switch manufacturing companies seeking to penetrate the Chinese market have been challenged to offer creative financing packages and pricing strategies.

Evidenced by Keegan's Mix Matrix, the process of launching international product strategies is essentially an assessment of the match between product and foreign market. According to Keegan, "the product is defined in terms of the function or need it serves, and the market is defined in terms of the condition under which the product is used, including the preferences of potential customers and the ability to buy the products in question" (Keegan 1969: 62). In addition, as a moderator, costs of adaptation and manufacture should also be considered. Companies should take into account all these factors to find the most profitable international product strategy.

#### 4. 2. Case Study

Keegan's Mix Matrix, with its comprehensiveness and dynamism, provides an excellent guideline for the case study. The rationale of seeking the match between product and market has particularly important applications to our cereal case because US RTE cereals as breakfast are still exotic to Chinese consumers.

The case study methodology on product strategy is similar to that on entry strategy in Chapter 3. It begins with an introduction to Chinese traditional diet habits, Chinese consumers, food retailing, and the milk situation. Then, the analysis identifies a

proper product strategy for the product class as a general standard. Finally, a critique is made of current product strategies by individual companies.

#### 4. 2. 1. Situation Introduction

To Americans, a bowl of crunchy RTE cereals mixed in cold milk is one of the most normal breakfasts. People love the crunchy texture and sweet taste, and believe that it provides fiber and protein from cereals and milk. Cereal is available in all kinds of retail stores, and it is affordable. The condition of usage is convenient and quick, i.e., no cooking, no seasoning, and no waiting, just pour cereals from boxes into a bowl of milk. Milk is available throughout the country at reasonable prices. Milk freshness is readily maintained due to the highly developed distribution system for refrigerated products and wide usage of refrigerators in households. In the emerging Chinese market, the situation is largely different, as will now be described.

#### 4. 2. 2. A Quick Glance at Chinese Diet History

The history of Chinese nutrition is closely related to the history of agricultural production. It is known that two major changes took place in early times. From the fourth to the first centuries BC, the increase in population and the decrease in land available for pasturage caused the Chinese to limit greatly their meat intake, and to change from consumption of beef and mutton to that of pork and dog-meat. From this time on, cattle were used mainly for draught. Milk and milk products disappeared from the diet. A second important change took place between the third and sixth centuries AD when rice replaced wheat and pulses as the staple in the south. Wheat stayed dominant in

the North where the climate and weather provided favorable growing conditions for wheat. Vegetables and fish compensated for the reduced mineral, vitamin and protein content of the diet resulting from this change. In China, carbohydrates are the principal source of calories. Rice is the staple of over 70% of the people, particularly in the southern monsoonal provinces. Wheat and Kaoliang are the staple in the north. Maize is not popular, and is largely reserved for livestock feed (Huang, Rozelle, and Rosegrant 1997).

Chinese dietary traditions regarding health and nutrition are greatly influenced by the Chinese humoral beliefs, deriving both from Ayurvedic theories which entered China with Buddhism and from the Chinese theory of the Yin and the Yang, oppositeness and complementarity. Accordingly a complete and balanced diet was recognized as a combination of wet and dry food, served warm or hot (Whyte 1972). As the meal starting a day, breakfast was viewed as very important for health and energy. The typical breakfast consists of water rice/millet porridge, soup noodles, "dry food" such as steamed bread or Baozi, and a side dish of preserved (salted) vegetables to make up for salt lost during daily work. On the breakfast table of urban people, soybean juice is often found. Milk, a staple in American diet, was not a regular component of the diet, especially before 1980. There is not only a traditional distaste for, but also a physical intolerance of milk because a majority of Chinese people was unable to digest the lactose in animal milk, i.e., they had lactose intolerance (Whyte 1972). After 1980, with the help of the government and foreign investors, the Chinese dairy industry has seen significant increases in milk production and consumption. Currently, milk powder has become the most important way to consume milk in China, and people drink it by adding hot water.



Another high protein food, eggs, sometimes enters the breakfast table, depending on a household's income and product availability. Before 1980, when China was still in a strictly planned system, the national breakfast demand was restricted to rice-based porridge and noodles. The consumers' need was satisfied at the level of being fed.

Since the start of economic reforms in 1978, China has achieved rapid and sustained economic growth. Economic growth has resulted in a substantial increase in the standard of living, particularly in coastal urban areas, and the spectacular development of the processed food market (Luo 1998). More foods in more forms are accessible for people to enrich their breakfast table, such as bread, instant noodles and porridge, and coffee, to name a few. Although fundamental principles toward breakfast, such as the balance and the temperature, stay unchanged, some major changes for breakfast demand did occur with the change of social and economic forces. No longer viewing breakfast as mainly eating for energy, consumers have placed more emphasis on the nutrition and health implications of the meal's content, such as low-sodium and low-fat items. Furthermore, convenience has become an increasingly important attribute.

Despite all the changes, "the taste preferences of the Chinese are more localized than of Americans," said Rudy Lin, Ph.D., president of Newly Weds Foods Co., Ltd., in Beijing (Brandt 1997). For one thing, the Chinese are far less mobile than Americans are. In addition, fewer products are nationally distributed.

#### 4. 2. 3. Chinese Consumers

Understanding the consumer is the key to acceptance of foreign food products in China. For most foreign food producers, urban consumers are the ones to watch because

they lead the rural population in consumption patterns by about seven or eight years and they have much higher purchasing power (Market Asia Pacific 1995). For this reason, in this study, we will mainly study consumers in urban areas.

#### 4. 2. 3. 1. Purchasing Patterns

During the past two decades, Chinese consumer purchasing habits are shifting from buying commodity items in bulk to buying high-quality packaged brands in grocery stores and supermarkets (Bowles 1998). At the same time, consumers continue to be price-conscious because food still represents a large proportion of household expense. Furthermore, nationwide, prices in many food categories are falling in the face of oversupply, creating a unique advantage for consumers bargaining for a better deal.

Foreign foods have become popular in China because of high quality and appearance. In many cases, people purchase foreign foods as gifts or as a fad. Product origin is obviously an important criterion in many purchases. However, it is not always the case that “west is best.” According to the Grey ChinaBase Annual Consumer Study in six urban hubs of China in 1996 and 1998, most respondents rejected the notion that they were becoming westernized – only 18% described themselves as “westernized Chinese”, while 78 percent preferred the “modernized Chinese” label. There is a distinction between “modern” and “western” (Bates 1998). The concept of the “modern” Chinese consumer is about being a leader – having one's own opinion, being internationally aware and open minded, and take the best from both East and West. In contrast, to be “westernized” is to be seen as a follower who imitates or follows fashion or consumer trends, and is considered more superficial (Bates 1998).

The awareness of brand name has been increasing. However, brand loyalty varies largely from product to product. Brands of high-priced “status” goods, such as cars, stereos, and clothing, are believed to have attained widespread recognition and loyalty among China’s consumers. The development of food brands, especially national-level brands, has been relatively slower. Although some analysts asserted that Chinese are very brand-loyal in purchasing processed food (Brandt 1997), it is not always the case. Many consumers frequently try different brands, particularly when there are new product launches or promotion programs. In one sense, the Chinese market for branded food products is like any other, in that success hinges on providing the right product, at the right price and at the right place and time, rather than the name alone (Brandt 1997).

All in all, today’s Chinese consumers can choose from a growing array of domestic and foreign food products each time they go shopping. With increasing purchasing power and choices, consumers become more and more sophisticated. They want high quality, fair price, value, convenience, and flavor, and they want them all (Luo 1998). Table 9 showed the importance of attributes influencing food purchases in 1997 Shanghai. In the table, the most important factors focus on food sanitation and quality. Nutritional value, taste, prices, and value for the money were also cited as important factors. Although the table mainly represents the purchasing attitude of Shanghai residents, it does give a glimpse of the food purchase attitudes in the nation.

#### 4. 2. 3. 2. Where do consumers shop for food?

In China, the most popular grocery outlets today are still wet markets. Consumers shop daily in the wet market, which is usually within a 10-minute walk from home.

There they can buy rice, flour, fruit, vegetables and meat. Shopping with such frequency, Chinese consumers clearly exhibit a “buy little, buy often” mentality (Bowles 1998).

Table 9: Importance of Attributes Influencing Food Purchase

ATTRIBUTES	MEAN
Proof of food sanitation examination	4.92
High quality	4.91
High nutrition value	4.60
Having a taste family members like	4.57
Good price	4.46
Good value	4.37
Easy to prepare	4.06
Low fat	4.02
Brand name	3.77
Low cholesterol	3.71
Its suitability as a gift	3.56
Right package size	3.46
Attractive package design	3.26
Recommendation of others	3.16
Advertisement	3.08
Imported products	2.57

\*Means are computed using a five point scale where 5 = very important, and 1 = not at all important.

Source: adapted from “Attaché Query Detail”, 1997.

There have been many state-operated local retail food stores, which can be compared to small “mom and pop” stores. These grocery stores provide over-the-counter food sales to the general public. These stores carry packaged goods, produce, take-out food, and some have frozen food counters (Bowles 1998). They sell mostly domestic

products. Due to a reduction in state subsidies, these stores have been forced to compete on price and quality. In many cases, these old stores have attempted to meet the competition by joining forces with a foreign supermarket chain.

Western-style food stores, e.g., supermarkets, are capturing more and more market share from both wet market and grocery stores since 1996 (Bowles 1998). Supermarkets are upscale self-service stores with aisles and some cold storage facilities. They are principally found in Beijing, Shanghai, and Guangzhou. These stores were originally set up to serve expatriates, but the customer base has expanded to include the emerging middle- to high-income Chinese consumers. Domestically owned supermarkets are expanding and upgrading their existing facilities. Foreign supermarket chains from Hong Kong and Japan are entering what they see as high growth areas such as Shanghai and Guangzhou. The Japanese supermarket giant Yaohan plans to open 1,000 supermarkets in China by the year 2010, and the number of supermarkets in Shanghai alone is expected to rise to 1,000 by the year 2000 (Bowles 1998). A survey conducted in Shanghai reveals that about 11% of Shanghai consumers shop regularly for groceries in supermarkets. This group typically represents higher income households and younger people (Brandt 1997).

The above general food retail system also applies to the purchase of breakfast food. The locations for a meal vary in different circumstance. People can consume breakfast at home, at the stands in the wet market, and at hotels and restaurants.

#### 4. 2. 3. 3. Children Power

A Chinese family literally revolves around their children because the children will keep the family line going, which is crucial to Chinese culture. The One Child policy introduced decades ago leaves most urban households with only one child, and this makes the one child even more precious to the family. There is a vivid metaphor for such a phenomenon: “A family is analogous to the Solar system, and the one child is the Sun, while the parents and grandparents are all the planets, circling around the Sun.”

Research has shown that today Chinese children are a major influence on most household purchases. A study by Texas A&M University in 1996 found that 72% of the time Chinese children decided what foods would be bought, and parents were willing to do anything for their only child (Market Asia Pacific 1996).

In 1995, one study found that urban families spent about US\$240 a year on their one child (Market Asia Pacific 1995) – in contrast to the average national annual salary of US\$ 663 the same year (China Statistical Yearbook 1996), and they have been spending more on their one child. Currently there are about 315 million youngsters under age 15 in the country. With this tremendous spending, children-related products, such as toys, children’s food (especially dairy-based), and PCs, have experienced rapid growth in China (Market Asia Pacific 1995, Bates 1998).

#### 4. 2. 3. 4. China’ s Milk Industry

Milk is an essential good when consuming breakfast cereal in its traditional way; therefore, market research on breakfast cereals needs to take into account the dairy industry in China.

Historically, milk has never been a regular component of the diet, but a luxurious nutrient for infants, the sick, and senior officials, with very limited availability. Since 1980, with increases in purchasing power, health concern, and milk availability in the market, per capita milk consumption has quadrupled to about 6 kg in 1997 from 1.4 kg in 1980, but significantly lower than the nearly 300kg consumed per capita in the US. Furthermore, the growth rate varies between the rural and urban areas, mainly taking place in rich urban areas. It is worth mentioning that the way in which Chinese drink milk is very different from that of western countries. Due to the traditional belief, taste preference, and the physical reaction, Chinese are not used to consuming milk as a cold drink. They boil fresh milk or add boiling water to milk powder and serve it hot or warm.

In addition to diet, digestion, and cost reasons, the character of traditional milk production and distribution also contribute to the prudence in milk consumption. Until the very recent past, most fresh dairy products in China were delivered from a non-refrigerated vehicle to a non-refrigerated point of purchase. Typically this point of purchase was in the housing units of consumers. As a result, product was delivered within hours of production (in the very early morning hours), purchased by consumers immediately upon delivery to their housing unit, and consumed within hours of purchase. Under this system, milk is packaged in 240-ml soft/plastic packets ("baggies") that are purchased daily. This milk typically has a high bacteria count and less than satisfactory taste, certainly by western standards.

To boost national nutrition and reduce the infant mortality rate, the Chinese government intends to take practical steps to begin developing the dairy industry at a faster pace. Foreign dairy enterprises now investing in China have provided substantial

support. There are more than 60 dairy plants with foreign investment established as of 1998. Foreign investors have introduced China to advanced producing technology, refrigerated retail distribution system, safe packaging and scientific nutrient composition. Although the foreign branded milk is largely restricted to supermarkets in the main cities, and has a high premium price (generally RMB 2.5 –RMB3.00 per 240ml versus RMB 0.70 for domestic packaged milk of the same size), these high quality products through retail refrigerated merchandising have met with immediate consumer acceptance and success in the major cities. Annual consumption of dairy products, including milk powder and condensed milk, has increased an average of 10% every year over the past decade, while consumption of fresh milk surged 18% in each of the past two years as of 1998. In Beijing, for example, western-style milk and eggs are challenging the traditional soybean milk and noodles at the breakfast table (Market Asia Pacific 1998).

The government has long-term goals of 45 million tons of production and 25 kg of per capita consumption by the year 2030 (Market Asia Pacific 1998). But, even if these goals are reached, this is still below the mid-1980's level in developing countries, which was 36 kg per person. And the younger generation will surely be the main milk consumers.

#### 4. 2. 4. Generic Product Strategy for RTE Cereals

The Chinese situation study indicates that US RTE cereal faces a very different marketing problem from in home markets. The traditional preference for warm breakfast will destroy the crunchiness of RTE cereal. Milk's unpopularity and high price, as well as the fragmented regional market, is very likely to restrict RTE cereal to only a small



group of consumers, rather than the vast Chinese market. Distribution and retailing problems will entail tremendous amounts of extra working capital, which lead to high prices in a price-conscious market. Furthermore, “modernized” Chinese consumers will not buy simply for a foreign brand name, but ask for their perceived high quality, nutrition, flavor and value. At the same time, competition is intense from traditional breakfast and modern processed breakfast.

#### 4. 2. 4. 1. Lessons Learned

In such an environment, recent arrivals to the Chinese market such as US RTE cereals, should heed the experiences of foreign investors whose involvement with China began in the early stages of the country’s “Open Door” policy. These pioneers of foreign investment, who plunged a mere \$18. 5 billion in investment into China by 1989, paved the way for later investors to sink another \$204.3 billion into China in the 1990s (Luo 1998). The lessons of their success provide some important strategic guidance.

#### **Lesson 1: Start with products close to traditional preferences.**

Coke’s story is an excellent example. When Coke was first introduced in China, it was not well accepted by Chinese consumers. For one thing, Coke looked and tasted a bit like a Chinese herbal medicine. In addition, most of the soft drinks in China at the time were orange flavored and light colored. So from the beginning, Coca-Cola invested in Sprite and Fanta as well as in Coke; in the early 1980s, more Sprite than Coke was sold (Yan 1998). There are many reasons for Sprite’s popularity. Most Chinese women prefer Sprite to Coke, and many consumers mix Sprite with beer or red wine. As Coca-

Cola continued to invest in the Coke Brand, and as consumer acceptance improved in the 1990s, sales of Coke eventually exceeded those of Sprite. Today, the Coke-to-Sprite volume ratio is four to three (Yan 1998).

**Lesson 2: An appropriate product portfolio in a quick-paced market is critical; and, this portfolio is not necessarily a combination of global brands and products.**

Kraft entered China more than ten years ago with its product Tang. Subsequently, the company built three additional plants for producing coffee, dairy products, and gum. Despite this expansion, Kraft's market position in all product categories today is weak. Sales of Tang, for instance, declined 25% in the last five years, eroded by many emerging domestic orange-flavored carbonated drinks and fruit juices. Kraft's Maxwell House has always fought an upward battle against Nestle's Nescafe. As for the sales of dairy products, cheese is not part of the traditional Chinese diet. Kraft's competitors have gained market share by offering Chinese consumers products that are more suited to their tastes. Nestle behaves much more like a Chinese food company. In addition to offering global brands such as Nescafe, Nespray, Milo, Kit Kat, and Polo, Nestle has tailored several products to what the Chinese consumers want and need - instant noodles, seasonings for Chinese cuisine, mineral water, and a popular live-lactobacillus health drink. Nestle's experience is that consumer-goods companies must adapt to build a more attractive portfolio of product categories if they are to be successful in China (Yan 1998).

**Lesson 3: Product adaptation, under many circumstances, turned out to be necessary.**

For the most part, foreign-funded companies tend to specialize in lines in which the companies have prior product knowledge and experience. However, many manufactures have chosen to adapt their products to Chinese consumers' preferences. For example, United Biscuits developed and marketed (1) biscuits in sesame and spring onion flavor, (2) peanut, lemon, and mango wafers, and (3) lemon- and mango-flavored potato chips in China. The company did not sell these in the West. Asian manufacturers of instant noodles also adapted their product to China's regional tastes. Soy sauce-braised beef, shrimp, and black pepper beef are just some of the flavors marketed in China. Meanwhile, many other western companies have instituted more subtle changes. Cadbury Schweppes, for example, sweetens the chocolate in its China-bound products because Chinese consumers tend to dislike bitter chocolate (Bowles 1997).

**Lesson 4: Do not treat the Chinese market as one market. Find the appropriate market segment, penetrate that segment, and expand from the success of that segment if needed.**

A population of 1.2 billion in China is a major enticement to many foreign investors. However, such attraction is too naive. As indicated earlier, China is a fragmented, regional market as a result of wealth disparity among the consumers, localized preference and habits, and inferior distribution and retailing systems. Therefore, it would be rational for foreign investors to treat China as many markets, start with one appropriate market segment, and then expand into other segments when

possible. Moreover, for new arrivals whose products face intense existing competition, a clear market segment, and therefore a clear identity, backed by corresponding efforts, will speed the product recognition and capture increasing market share.

The experience of Ericsson is an excellent illustration. Before Ericsson entered the Chinese paging and cellular handset market, Motorola had a monopoly position due to its early entry. Noticing the demographic shift in the cellular handset market toward women, Ericsson brought in the model 377, which was somewhat smaller than competitors' offerings, to appeal to female consumers. Around this market-segment target, Ericsson used heavy advertisement. It launched a large advertising campaign with the most famous Chinese actresses, Gong Li and Maggie Cheung, to promote the lifestyle and feminine feature. After the hit, Ericsson then introduced a series of color phones to reinforce its position with trendy women. Impressively, by 1997 – less than three years after Ericsson first deployed its new marketing strategy – Ericsson had captured around 40% of the handset market in China (Yan 1998).

#### 4. 2. 4. 2. Recommendations to US Cereals

Considering the exoticness of US cereals as breakfast in China and its initial entry, the main marketing goal at this early stage should be to realize a presence, build brand name, and learn more about market and product. Due to the complexity of the Chinese market, short-term profits should not be emphasized, but rather a long-term market commitment.

Basically, US cereals face three options: (1) being sold as breakfast, like in America, Europe, and Latin America; (2) being sold as food other than breakfast, e.g.,

snacks, implying some significant changes from RTE cereals' original features; and (3) combining the first two options in some way.

#### 4. 2. 4. 2. 1. As Breakfast

If US cereal companies decide to stick to the breakfast function of RTE cereal, product modification will be necessary. There are four main reasons.

First of all, Chinese consumers prefer hot or warm breakfast. However, mixed in hot or warm milk, RTE cereals will lose their crunchiness, which is one of the advantageous features of the product in America. Meanwhile, if US cereals must be consumed with cold milk, the sales will be restricted greatly due to the unpopularity and high price of fresh milk. Therefore, either new conditions of usage, i.e., edible without milk or new product texture that maintains its crunchiness when mixed in hot milk, should be developed in order to solve the problem.

Secondly, better flavors should be developed to attract consumers' appetite in order to overcome the exoticness of RTE cereals as breakfast and the intense competition from tasty traditional breakfast foods. Even a normal breakfast stand in a wet market can provide over a dozen flavor choices with good taste and affordable prices. Dim Sum, a deluxe breakfast offered in restaurants, has hundreds of delicious varieties. Knowing such competition, US cereals must make efforts to introduce new and better flavors. In India, Kellogg introduced the Morning Mazza breakfast cereal in mango-elaichi, coconut-keasar, and rose flavors in 1998, which became hits (Business Line (India) 1998). Similar efforts should also be made in China.

Thirdly, raw material problems also call for adaptation. In China, the local corn variety does not meet the standard of cereal production. As a result, companies who produce Corn Flakes have to import quality corn from a third country, and as a result, cost is increased significantly. Moreover, China has a strict import quota over corn. If products can be adapted so as to be able to use local material, operating cost will be significantly reduced.

Finally, the modification of selling size is advisable. Current cereals are sold at RMB35-40 (about US\$4. 3), while the average annual household income in the three most affluent cities – Beijing, Shanghai, and Guangzhou – is only US \$1052 (Attaché Query Detail, 1997). Such a high price is not a result of companies' high profit margin, but rather most of the price is asked to cover high cost in manufacturing, distribution, advertising, and shelf fees. If cereals are sold in smaller sizes, a box of cereal will be more affordable to consumers. Such strategy is particularly useful in the early stage of product launch. For instance, Nabisco's Ritz crackers have been sold in a 4-ounce package for many years. Only after recognition and loyalty was built was the package size increased.

Besides some basic product modification, US cereals need to identify the appropriate market segment, rather than trying hard to expose everybody in China to the product. Three types of people in China are the most attractive potential consumers: children, yuppies, and expatriates. As argued before, children represent significant purchasing power in the Chinese market. US cereals, with high nutrition and snack-like flavor, can be very attractive to kids' tastes. At the same time, the convenience and hygiene attributes can attract parents who have little time to prepare breakfast and help

counter concern about the sanitary problems of a ready-to-eat breakfast from wet markets. To yuppies, the westernized lifestyle represented by US cereals, high value, convenience, and novelty/exoticness might be the main attractive factors. To expatriates living in China, especially those from North America and Europe, US RTE cereals are something they are familiar with.

Since it is still sold as breakfast, communication strategy will continue to emphasize the nutrition, flavor, and convenience, to name a few, as is done in the United States. Of course, modifications such as language need to be made.

Based on the preceding analysis, if RTE cereals are to pursue the option of being sold as breakfast, then Keegan's Mix Matrix Strategy 3 would appear to be the best choice. In other words, given (1) the same product function in Chinese markets as home markets, but (2) significant different conditions of use between the two markets, and (3) ability to pay among high-income parents, yuppies, and expatriates, the appropriate product strategy is Product Adaptation and Communication Extension.

#### 4. 2. 4. 2. 2. As Non-breakfast Food – Snack

In China, a sweet and crunchy cereal-product is often found to be a snack food. In southern China, there is a traditional snack called "Dong Mi Tang" made of crispy rice adhered together by sugar or honey, similar to Kellogg's Rice Kripie Treats, but harder and crispier. US cereals are sweet, crunchy, and they can be eaten with fingers. Even in America where US RTE cereals are widely recognized as breakfast, people are found to eat Shredded Wheat, Chex, Quaker Peanut Crunch as a snack food in times other than mornings.

The snack business in China is increasing much faster than the breakfast market. In the past, snack food meant peanuts or something crudely packaged and made of rice or bean paste. Recently, with increasing per capita income and an open marketplace, people are more and more interested in foreign snacks, and packaged savory snacks (excluding ethnic Chinese snacks) was a market worth almost RMB 590 million (US\$71.1 million) in mainland China in 1997 (Market Asia Pacific 1998). People are usually more accepting of exoticness in snack foods than in breakfast foods.

It is not rare for a regular food producer to expand into the snack business in China. In the mid-1990s, instant noodle producers started to launch the Spicy Crispy Noodle Snack. The way to consume normal instant noodles is to add boiling water and then serve the softened noodle in soup. Spicy Crispy Noodle Snack looked similar to the regular instant-noodle, but was crispier and could be eaten directly without boiling water. It immediately became a hit because of the novelty, flavor and low price. Today, almost all the major instant-noodle producers have a Spicy Crispy Noodle Snack product line under their brand names.

To develop a snack on the basis of RTE cereals means significant changes from the original features of cereal, the normal way of consumption, and conditions of usage. As for the communication strategy, it is obvious that the communication strategy for RTE cereals as breakfast in US cannot be extended to China, and must be modified to a snack product. Overall, this strategy is an application of Keegan's Mix Matrix Strategy 4 – Dual Adaptation.



#### 4. 2. 4. 2. 3. The Product Portfolio – Combine Keegan’s Strategies 3 and 4

A combined strategy of both breakfast and snack may be optimal for several reasons.

To sell as breakfast alone, the exotic RTE cereal consumed in cold milk is not likely to capture a strong presence and acceptance in a short time. This follows from the preceding analysis of the first option to sell RTE cereal as breakfast. However, cited market trends in concerns about health, the purchasing power of children, and evolving milk markets give hope for expanding RTE cereal sales over the long run. Therefore, developing better flavor and reducing price by cutting extra cost entailed in manufacturing and distribution today are likely to create some penetration into traditional breakfast markets.

Adding a snack line to this long-term strategy helps to increase the exposure of RTE cereal products. As analyzed earlier, China’s snack market is rapidly growing, and people are interested in foreign snacks and show high acceptance of novelty and exoticness (Market Asia Pacific 1998). The downside of adding an additional line is the increase in cost. Therefore, when developing appropriate snack products, US cereals should seek those having high synergy with current product lines, for example, cereal-based snacks sharing the same technology of popping and flaking. US cereals can bring their convenience cereal bars into China as both breakfast and snack. Such a change will entail little R&D cost. When seeking new snack products, US cereals can also consider some form of partnership with local food producers with strong brand name and experience in the Chinese market. In this way, cost can be split between two parties, and partner’ product knowledge can be learned.

As a two-meal product portfolio, it is not expected that either product line will necessarily succeed in a short period. Rather, this strategy is employed to spread market risks, increase the exposure of US cereals company names to Chinese consumers, speed brand name building, and facilitate the realization of a presence. With the passage of time, US cereals will learn more about this emerging market and then decide which product line to keep, which to expand, and what to be liquidated.

#### 4. 2. 5. Specific Company Product Strategies

Similar to entry strategy, product strategy is also essentially a firm-specific strategy. The product strategy recommended for the whole product class in the preceding section was mainly created for the purpose of serving as a standard that provides general guidance. In this section, we move on to analyze and critique the current product strategies by individual companies operating in China, and give relevant recommendations. Again, Kellogg will be studied more completely than Quaker Oats and General Mills.

##### 4. 2. 5. 1. Current Product Strategies by the Three US Cereal Companies in China

As mentioned earlier, Kellogg extended its US breakfast cereal line to China with little modification, including Corn Flakes, Rice Flakes and Wheat Flakes. In 1997, Kellogg introduced its US top-selling Frosted Flakes' Tony the Tiger in China under the name of Tony's Flakes (Kellogg Annual Reports 1997-1998, Journal of Commerce 1997). Despite various efforts, Kellogg China Limited has been running at a loss.

Quaker Oats started with an All-in-One cereal (not Quaker brand), a grain-based instant beverage and a pudding mix under the Might brand name, both of which it learned from its Taiwanese partner in its 1994 joint venture. Compared with the RTE breakfast cereals, these two products had been launched in China by food producers from Taiwan, Hong Kong and Singapore for several years and were much less exotic to Chinese consumers. Later, Quaker opened its own plant under Quaker's name. This new plant kept the All-in-One cereal beverage as one core line and sold it under Quaker's brand. Quaker also brought its Quaker cereals into China, notably hot cereals (Quaker Oats Annual Reports 1994 - 1998). In addition to cereals, Quaker Oats made major efforts to introduce its sports beverage, Gatorade. But plants for the two categories were separate entities.

General Mills found itself in a similar scenario as Quaker Oats. A late entrant, General Mills also selected to begin with a less exotic product, namely, a packaged savory snacks business in China. Although General Mills had little experience with this category before, it is expected that its partner Want Want, the market leader in rice crackers and many other snack categories in China, will be of great help in sharing the knowledge and experience needed for success.

#### 4. 2. 5. 2. Assessment of These Varied Strategies

These three companies showed large variations in product strategy. Kellogg stuck to its breakfast cereal line, and its effort was made mainly in product extension. The novelty of US RTE cereal as breakfast would draw some attention from consumers for the first trial. However, as expected, the unimpressive flavor, cold usage condition, high

price, and milk unpopularity prevented most consumers from becoming loyal consumers. Corn procurement stands out as a big cost problem and a threat for future expansions. The objective of brand-loyalty building and market presence realization was not accomplished. The plant has been running at a significant loss. In early 1998, a plant-wide restructuring was initiated, and the effects are yet to be seen. In addition, Kellogg did not target a clear market segment. Its advertisement of nutrition and healthfulness of US RTE cereals did not draw much attention (Cadiz 1998). Essentially, Kellogg attempted to pursue Keegan's Strategy 1 (Dual Extension) when a Strategy 3 was clearly called for.

Quaker adopted a similar strategy to the standard strategy suggested for the category. It started with breakfast products less exotic to Chinese people, i.e., All-in-all cereal beverage, and learned product knowledge from its Taiwanese partner. Years later, it started to sell the cereal beverage under its own name. Meanwhile, it brought in its Quaker cereals, notably hot cereals such as oats. Compared with cold crunchy RTE cereals, hot cereals fit better with Chinese consumers' need for a heated breakfast. It also took advantage of an increasing recognition of high nutrition contained in oats. Compared with Kellogg, Quaker encountered less direct diet conflicts.

Besides the cereal line, Quaker invested heavily in Gatorade, candy bars, and some snack foods. The marketing of these products did not have direct impacts on sales of cereals. However, with the Quaker brand name growing stronger, through whichever products, the general brand assets will provide benefits to any goods under Quaker's name.

General Mills' operation is too short to judge. However, it is obvious that it is doing something similar to Quaker, by selecting a less exotic food and finding an experienced local partner. With the rapid growth of the Chinese snack business, the savory snack is likely to be promising.

Analogous to the variation of entry strategies, the variation of product strategy can also be explained in part from the different goals of these companies. Kellogg devoted itself to the breakfast market. Quaker and General Mills entered China in order to penetrate the broader food market and set the base for the future. The latter two companies did not consider that they would necessarily be in the product line of RTE breakfast cereals. They were ready to learn new products (particularly those familiar and popular to the Chinese consumers), build their business on the base of these products, and then add their home products if appropriate. Quakers' past experience fully demonstrated such purposes. An important contributing factor to the variation of goals is again the business characteristics. In Kellogg, breakfast cereals are still the bulk of its business. The other two companies, however, have already diversified into snack, milling, beverage, and dairy categories. As a result, when investing abroad, the latter two companies are willing and able to consider options other than the breakfast market.

#### 4. 2. 5. 3. Recommendations to Kellogg

When seeking proper recommendations for Kellogg, the rationale of the proposed standard strategy, rather than the strategy itself, will be an important guideline. At the same time, it is important to take into account the firm-specific goals, which are not reflected in the standard strategy proposed for the whole product class.

To offset the losses resulting from cold RTE cereals' exoticness and to reduce the business risk, Kellogg should consider product diversification. Considering Kellogg's corporate policy in favor of doing business alone, a joint venture with a local partner to learn new products might not appeal to the company. To develop a totally new food, R&D and manufacturing cost can be prohibitive.

As a quick remedy, Kellogg can bring in its convenience food line such as Pop Tarts and Rice Krispie Treats. Adding these existing product lines will not entail significant cost. Meanwhile, the flavors of these products are not as exotic as RTE cereals as breakfast. They can be positioned as both breakfast and snack, as done in America.

For the breakfast line, Kellogg needs to make efforts to develop more localized flavors as it did in India. At the same time, to solve the corn problem, the answer will lie in a new way of producing Corn Flakes that can use local corn. To solve the associated milk restriction, Kellogg can consider developing new ways of consumption, for example using soybean milk as a substitute. The most severe problem is how to solve the dilemma of high temperature versus crunchiness.

Considering the fragmented regional nature of the Chinese market and the disparity among consumers, Kellogg should target clear market segment(s). This analysis suggests urban children, yuppie, and expatriates as the most important consumers, for the various reasons mentioned in the standard strategy recommendation.

## Chapter 5

### CONCLUSIONS AND RECOMMENDATIONS

As part of globalization efforts to offset sluggish domestic sales, major cereal companies entered the emerging Chinese market since the mid-1990s. However, this all-American food has been operating at a loss in this unique market owing to numerous intermingled problems. Such underperformance indicated the necessity for strategy modifications by the US cereal manufacturers.

To respond to this need for change, this study analyzed the cases of Kellogg, Quaker Oats, and General Mills, critiqued current strategies and provided relevant recommendations. The study further chose to focus on foreign entry strategy and product strategy because these two strategies are the frontier issues in international marketing and pinpoint the complexity of the Chinese market.

#### 5. 1. Summary of Specific Findings/Recommendations

For both entry and product strategies, the study proposed a generic strategy for the RTE cereal product class based on existing theoretical frameworks. These generic strategies revealed important principles for strategy formulation and served as a standard for the critique of specific company strategies.

The generic entry strategy was based on sequential entry through two phases of foreign direct investment. Dynamic in nature, this sequential strategy would allow the cereal investors to learn and adapt to the Chinese market in a time- and cost-efficient way and meet changing needs at different stages. Specifically, US RTE cereal firms should

earn their initial entry through a Majority Equity Joint Venture (EJV) with a strong local partner (domestic or international). With the help of a strong EJV partner, the cereal investors can speed the learning process and take advantage of the existing distribution channels and *Guanxi* network – a unique phenomenon in Chinese business. When conditions mature, US cereal investors can then transform the original EJV into a Wholly Foreign-Owned Enterprise (WFOE) so as to assume increased control and flexibility. At both stages, management control and *Guanxi* should be given the highest priority.

The generic product strategy recommended a breakfast-snack product portfolio. Such a portfolio strategy would help to modify the risk entailed by the exoticness of RTE cereals as breakfast, increase the exposure of company names to Chinese consumers, and accelerate the establishment of a market presence. In the breakfast line, product modification would be inevitable due to large diet differences. To diversify into the snack line implies significant changes from RTE cereals' original features. Despite the potential high start-up cost, this diversification is advisable because of the rapid growth of China's snack market and the fact that a majority of Chinese consumers associate the attributes of crunchiness and sweetness with snacks. This portfolio is not a once-and-for-all strategy. Over time, US cereals should consider diversifying into other promising categories or liquidating unprofitable product lines.

In the final analysis, entry and product strategies are both firm-specific. It is neither necessary nor realistic to expect different companies to adopt precisely the same strategies. Thus, it is not surprising that the cereal case found that the three firms, i.e., Kellogg, Quaker Oats, and General Mills, displayed some variation in their strategies when expanding into China. However, closeness of fit to the conceptually sound generic



strategies should result in better performance, which appears to have been true for these cases.

Compared with the generic entry strategy proposed for the product class, Quaker Oats and General Mills showed much similarity: both entered by forming an EJV with strong local partners. Over time, Quaker Oats started to build its own plant under Quaker's name. Kellogg, however, started with virtually a WFOE (a 97% EVJ) with a nominal local partner and had to learn and grow on its own. Diversion from the generic entry strategy appeared to have caused Kellogg's performance difficulties. Associated with its strategy was an obvious disadvantage of lacking powerful partners, and therefore the absence of facilitation in knowledge, *Guanxi*, and operations. Correspondingly, the study recommended that Kellogg make due efforts to cultivate strong strategic alliances in the future.

In the context of product strategy, similar divergence existed. Again, Quaker Oats and General Mills followed similar strategies by starting with less exotic food products that they learned from and developed together with their local partners. Their strategies thus paralleled the generic recommendations. On the contrary, Kellogg extended its US RTE breakfast cereals line with little modification. Again, diversion from the generic recommendation appeared to explain problems encountered. In order to achieve long-term expansion in China, Kellogg was advised to diversify into a snack line. Considering the probable smaller start-up cost, Kellogg could launch its US Pop Tarts and Rice Krispie Treats in China as a quick remedy.

Based on the preceding analysis, a Global Entry-Product Matrix can be constructed to visually illustrate how the interaction of entry and product strategies, would likely affect business performance in practice (Table 10).

Table 10: Global Entry-Product Matrix

		Product Strategy	
		* A=T (match)	A≠T (mismatch)
Entry Strategy	A≠T (mismatch)	<p>① Most Effective</p> <ul style="list-style-type: none"> <li>- <u>Supply side</u>: well-functioned management and operations</li> <li>- <u>Demand side</u>: excellent product recognition and high loyalty of consumers</li> <li>- <u>Profitability</u>: high, attributed to high revenue and efficient operations.</li> <li>- <u>Firm organization</u>: efficiency</li> </ul>	<p>③ Supply Effective</p> <ul style="list-style-type: none"> <li>- <u>Supply side</u>: well-functioned management and operations</li> <li>- <u>Demand side</u>: weak demand</li> <li>- <u>Profitability</u>: low, mostly attributed to efforts on cost saving in operations.</li> <li>- <u>Firm organization</u>: stability</li> </ul>
	* A=T (match)	<p>② Demand Effective</p> <ul style="list-style-type: none"> <li>- <u>Supply side</u>: weakness or even dysfunction in management and operations</li> <li>- <u>Demand side</u>: high product demand but may have problems such as out-of-stock or others stemming from supply</li> <li>- <u>Profitability</u>: varies from case to case; high – fair</li> <li>- <u>Firm organization</u>: conflicts</li> </ul>	<p>④ Least Effective</p> <ul style="list-style-type: none"> <li>- <u>Supply side</u>: weakness or even dysfunction in management and operations</li> <li>- <u>Demand side</u>: weak demand and low brand loyalty of consumers</li> <li>- <u>Profitability</u>: losses</li> <li>- <u>Firm organization</u>: instability</li> </ul>

\* A denotes actual strategy, while T denotes theoretically sound strategy.

Apparently, General Mills and Quaker Oats in the case study fell into the most effective cell while Kellogg exemplified the least effective situation. The variation in consequences reveals a major difference in the influences of the two strategies on business. That is, product strategy plays a key role in affecting the demand side, i.e., consumers/markets, while the consequence of entry strategy as an institutional arrangement is mostly cast on the supply side, i.e., firm organization. Consequently, this matrix can serve as a guideline of adjusting respective strategies. For a firm currently positioning in Cell 4 (Least Effective), the optimal move is always toward Cell 1 which results from a Dual Match. However, more often there are various restrictions of resources, and firms have to decide which to go for first between the two candidates. In such circumstances, giving priority to product strategy adjustment, namely, an initial move toward Cell 2, is encouraged because product strategy immediately acts upon the demand side which matters profoundly in today's consumer-dominated markets. In contrast, a sole entry strategy adjustment, i.e., a move from Cell 4 to Cell 3, is likely to be less effective in that even though active cost cutting on the supply side might push up profitability in the short term, in the long run it is not a way out because this strategic modification does not help solve the problem of poor demand and resultant weak revenues. These interaction effects between product and entry are reasonable hypotheses that need future testing.

In general, US cereal investors should realize the fact that the Chinese market is fragmented in nature, and therefore, should be approached as many markets rather than one market. Accordingly, US cereal investors should identify *the* appropriate market segment, penetrate *the* segment, and then expand on this base if needed and possible. In

this turbulent market, the cereal investors should also respond promptly and act flexibly rather than institutionalize one specific, fixed strategy. Finally, long-term commitment must be made due to the complications of doing business in the Chinese market.

## 5. 2. Critique of the Two Theoretical Frameworks

To underpin the analysis, this study incorporated concepts in foreign entry strategy and global product management. Two comprehensive frameworks were identified in the literature review and served as guidelines for forming the generic strategies and critiquing the company specific strategies.

### 5. 2. 1. Driscoll's Foreign Market Entry Mode Choice Framework

Driscoll's framework provided a comprehensive "consideration set" of entry mode choice. Applied in the RTE cereal case, this framework turned out to be an excellent fit and a highly effective tool to guide the analysis of various influencing factors, the appraisal of different mode characteristics, the exploration of important moderators and finally the selection of a situationally optimal entry mode. Although in its original version, the framework mainly considered the selection from the three generic entry modes, the same process and rationale were found also highly applicable to the selection from various specific investment modes.

In return, the case fully validated the framework. Three reasons explained the overall effectiveness of this model. First, this model considered a number of alternative mode characteristics and various entry modes, while previous models have tended to concentrate on one characteristic, namely, control, or concentrated on binary decisions or

even FDI alone. Secondly, it encompassed a variety of influencing factors and revealed the interrelationships of these factors. Finally, it conceptualized a firm's desired level of mode characteristics independent of actual levels (i.e. actual entry mode used), and identified a list of important moderating variables.

However, this framework is not all-inclusive. One limitation was that the model downplayed the importance of culture-related issues. Although it considered socio-cultural conditions as an important environmental factor, the potential cultural requirement for the entry mode was not reflected in the *mode characteristics*. Thus, when applied to a highly cultural context, the model might be found partly ineffective. In this case, for instance, Chinese *Guanxi*, or *social capital* suggested by Peterson *et al.* (1999), was recognized as a critical mode characteristic, but this construct was not adequately reflected in the model, and none of the proposed mode characteristics could adequately replace it. In this aspect, efforts should be made to expand the model in the future.

### 5. 2. 2. Keegan's Product-Communication Mix

Keegan's Product-Communication Mix identified six strategic alternatives available to international marketers, and more importantly, it disclosed the rationale for formulating international product strategy, namely, a Market-Product-Company analysis.

Following such a rationale, this case study analyzed the features of US RTE breakfast cereals, various factors in the Chinese market and company capabilities. The consequent recommendations coincided with two strategies proposed in the model. Actual product performance did appear to validate the recommendations.

Although validated by the case to some degree, this model was found too general to give detailed guidance because it was not built as a full consideration set, but rather a categorization of various strategy alternatives for selection from a *post hoc* perspective. Specifically, this model simplified influencing factors into three elements, i.e., product function or need satisfied, conditions of product use and consumers' ability to buy the product. These variables were not enough to cover all major dimensions of the product-market analysis especially when cultural differences were taken into account. Another limitation inherent was that the product examples for individual strategic alternatives were not robust. For instance, fast food was cited as the successful application of Dual Extension. However, it was not always the case. When McDonald's invested in some Asian countries, e.g., China, Hong Kong and Philippine, it made some important modifications to the standard menu and the original image as a fast, cheap and convenient service transformed into a luxurious place for gathering and entertaining (Watson 1997). Even in countries with less different diets like Italy and Norway, the menu also underwent certain adaptation to cater to local flavors. The cereal case also exhibits a slight divergence from the model in that the analysis argued for a mix of different strategies more useful than one separate option. Although Keegan's framework appears to be the best one available, additional work needs to be done to expand its power.

### 5. 3. Recommendations for Future Research

With an emphasis on entry strategy and product strategy, this paper analyzed the case of the US ready-to-eat breakfast cereals' expansion in China and rendered relevant recommendations for their future improvement. As a contribution to the international

marketing literature, this research highlighted the complexity of entering a new cultural environment with a non-traditional food. In general, the results are supportive of prior theoretical studies in international marketing. There are, however, several important differences and extensions in the current study. First, it narrowed the research focus to a single industry and a specific country setting, and therefore, allowed for a more in-depth examination of the contextual environment in which US food firms' entry occurred. Second, this study probed the choice from a spectrum of specific investment modes and validated the rationale of the generic mode choice proposed in the theoretical literature. Also, it provided more detailed guidance to US cereal investors in China. Third, when applying the conceptual frameworks to the cereal case, this study raised the cultural issues for these models' further expansion. Finally, it raised an issue of the interaction effects between product and entry strategies. Is one of these more important than the other when strategic change is needed? If so, then this knowledge would have important practical implications for making strategic modifications when resource restriction is a concern.

However, this study is still preliminary research on US agri-firms' entry into China. Clearly, in addition to entry and product strategies, many other issues associated with multinationals' foreign expansion, such as human resource management and logistic strategies, represent an important and challenging task for future research efforts in this area. Even within the scope of entry and product strategies, some questions remained about strategic alliances, organizational learning, pricing and packaging. In these aspects, more empirical studies need to be conducted in the future.

Secondly, it should be remembered that the present study focused on entry by a single industry in a specific country framework. The characteristics of the research settings must be considered when attempting to interpret these results in other entry contexts. Therefore, it is suggested that more empirical research on different industries be conducted, thereby testing the extent to which these findings are generalizable.

Thirdly, the present study revealed the need for developing a comprehensive consideration set for global product strategy. Current frameworks in the international marketing literature mainly provided a list of strategy alternatives for selection and are not enough to provide detailed guidance for the process of formulating product strategies. In the future, attention should be paid to identifying specific influencing factors and conceptualizing these factors into a unified framework.

Finally, more research work could be conducted in clarifying relationships among various corporate strategies, entry and product in this case, for instance. Findings in this respect will provide important insights of prioritizing strategic moves, which is sometimes crucial when firms are confronted with severe resource restrictions.



## **BIBLIOGRAPHY**

## Bibliography

- Anderson, E. and H. Gatignon, "Modes of Foreign Entry: A Transaction Cost Analysis and Propositions", *Journal of International Business Studies*, 17, Fall 1986, pp. 1-26.
- Attaché Query Detail*, Agriculture Trade Office Shanghai, 1997.
- Baldinger, Pamela, "Secrets of the Supply Chain", *The China Business Review*, September-October 1998, pp. 8-17.
- Barker, A. Tansu, and Aydin, Nizamettin, "Implications of Standardization in Global Market", *Globalization of Consumer Markets: Structures and Strategies*, edited by Hanssan, Salah S., *et al.*, International Business Press, 1994, pp. 283-302.
- Bates, Colin, "The Many China Markets", *The China Business Review*, September-October 1998, pp. 26-32.
- Bates, Colin, "The Many China Markets", *The China Business Review*, September-October, 1998, pp. 26-32.
- Benito, Gabriel R.G. and Cripsrud, Geir, "The Expansion of Foreign Direct Investments: Discrete Rational Location Choices or A Cultural Learning Process?", *Journal of International Business Studies*, Third Quarter, 1992, pp. 461-76.
- Bowles, Richard, "Food For Thought", *The China Business Review*, v24, n4, July 1997, pp. 8+.
- Bowles, Richard, "Food Retailing Takes Off", *The China Business Review*, September 1998, pp. 30-31
- Brahm, Lawrence, and Li, Daoran, *The Business Guide to China*, Reed Academic Publishing Asia, 1996.
- Brandt, Laura, "The China Challenge", *Food Formulating*, 1087-3120, September 1997, pp. 30+.
- Bruce, Scott, and Crawford, Bill, *Cerealizing America: the Unsweetened Story of American Breakfast Cereal*, Faber and Faber, Inc., 1995.
- Buckley, Peter J. and Casson, Mark C., *The Future of The Multinational Enterprise*, London: Macmillan, 1976.
- Buckley, Peter J., and Brooke, Michael Z., *International Business Studies: An Overview*, Three Cambridge Center, 1992, pp.318-321

- Business Line (India)*, "India: Kellogg Unveils Desi Cereal Varieties", July 12<sup>th</sup>, 1998.
- Business Week*, "Cereal-Box Killers Are On the Loose", October 12<sup>th</sup>, 1998, PP.72+.
- Buzzell, Robert, "Can You Standardize Multinational Marketing?", *Harvard Business Review*, November – December, 1968.
- Cadiz. Jr., Eduardo T., General Manager of Kellogg Great China, interviews, May 1998.
- Capener, Cole R., "M&A in China Comes of Age", *The China Business Review*, July-August 1998, pp. 14-21.
- Carter, Colin A. and Yilmaz, Alper, "Intra-industry Trade and Foreign Direct Investment in Processed Food as Alternatives to Trade Theory", *Global Markets for Processed Foods: Theoretical and Practical Issues*, edited by Pick, David H., et al., Westview Press, 1998, pp. 73-93.
- Chicago Tribune*, "Takeover Refueled As Kellogg Names New CEO", Jan. 6<sup>th</sup>, 1999, pp. 3.
- China Statistical Yearbook*, 1996.
- Clark H.F., "Consumer and Corporate Value in Global Marketing", *International Journal of Advertising*, 8(1), 1989, pp. 29-43.
- Connor, John M., "Determinants of Foreign Direct Investment by Food and Tobacco Manufacturers", *American Journal of Agricultural Economics*, 65(2), May 1983, pp. 395-404.
- Czinkota, Michael R., and Ronkainen, Ilkka A., *International Marketing*, 1993.
- Detroit Free Press*, "Kellogg to Fight Market-Share Loss with Cholesterol-Lowering Foods", Nov. 4<sup>th</sup>, 1998.
- Douglas, S. P. and Wind, Y. , "The Myth of Globalization", *Columbia Journal of World Business*, 22, Winter 1987, pp. 19-29.
- Driscoll, Angie, "Foreign Market Entry Methods: A Mode Choice Framework", *International Marketing Reader*, edited by Paliwod, Stanley J. and Ryans, John K., T.J. Press (Padstow) Ltd., Padstow, Cornwall, 1995, pp. 15-23.
- Dwyer, Steve, "Breakfast Choices Rise & Shine", *Prepared Foods*, February 1999, v168, n2, pp. 15-19.

- Eramili, M. Krishna, and Rao, C. P. , "Service Firms' International Entry Mode Choice: A Modified Transaction-cost Analysis Approach", *Journal of Marketing*, July 1993, pp.19-38.
- Food and Beverage Marketing*, "Kidding Around", v15, n9, September 1996, pp.23+.
- General Mills Annual Report*, 1998.
- Hagen, James M., "Foreign Production by US Food Processing Firms", *Global Markets for Processed Foods: theoretical and practical Issues*, edited by Pick Daniel H., et al., Westview Press, 1998, pp. 298-311.
- Henderson, Dennis R., Hirschberg, Joseph G., and Voros, Peter R., "Industrial Determinants of International Trade and Foreign Investment by Food and Beverage Manufacturing Firms", *Industrial Organization and Trade in the Food Industries*, edited by Sheldon, Ian M., et al., Westview Press, 1996, pp. 195-215.
- Henderson, Dennis R., Sheldon, Ian M., and Pick, Daniel H., "International Commerce in Processed Foods: Patterns and Curiosities", *Global markets for Processed Foods: theoretical and Practical Issues*, edited by Pick Daniel H., et al., Westview Press, 1998, pp. 7-32.
- Hill, Charles W. L., Hwang, Peter, Kim, W Chan, "An Eclectic Theory of the Choice of International Entry Mode", *Strategic Management Journal*, Vol. 11, 1990, pp. 117-128.
- Hill, John S., and James, William L., "Consumer Nondurable Products: Prospects for Global Advertising", *Globalization of Consumer Markets: Structures and Strategies*, edited by Hanssan, Salah S., et al., International Business Press, 1994, pp. 174-194.
- Hofstede, G. "Cultural Constrains in Management Theories", *Academy of Management Executive*, February 1993, pp. 91.
- Huang, Jikun, Rozelle, Scott, and Rosegrant, Market W., *China's Food Economy to the Twenty-first century: Supply, Demand, and Trade*, Food, Agriculture and Environment Discussion Paper 19, International Food Policy Research Institute, January 1997.
- Jeannet, J. P. and Hennessey, H. D. , *International Marketing Management*, 1988, Boston: Houghton Mifflin.
- Journal of Commerce*, "Tony the Tiger on way to Three Asian Nations", 1997, pp. 4A.
- Keegan, Warren J., "Multinational Product Planning: Strategic Alternatives", *Journal of Marketing*, January 1969, pp. 58-62.

- Keegan, Warren J. , "Multinational Marketing Management: Strategic Options", *Corporate Strategy and Product Innovation*, edited by Rothberg, Robert R., 1981, pp. 491-499.
- Keegan, Warren J., "Global Product Management: Strategic Alternatives", *International Marketing Reader*, 1995, pp. 105-109.
- Kellogg Annual Reports*, 1997-1998.
- Klein, Saul, "A Transaction Cost Explanation of Vertical Control in International Markets", *Journal of the Academy of Marketing Science*, v17, n3, 1989, pp.253-260.
- Kramer, Louise, "Dunkin' Donuts Seeks to Satisfy Breakfast Hunger With Buns", *Advertising Age*, v70, n9, March 1<sup>st</sup>, 1999, pp. 4.
- Levitt, Theodore, "The Globalization of Markets", *Harvard Business Review*, 61(May), 1983, pp. 92-103.
- Lookout Foods*, August 27<sup>th</sup>, 1996, pp. 152.
- Luo, Yadong, *International Investment Strategies in The People's Republic of China*, 1998.
- Makanowitsky, Barbara Norman, *Tales of the Table: A History of Western Cuisine*, Prentice-Hall, 1972.
- Market Asia Pacific*, "A Taste For Foreign Snacks in China and Hong Kong", v7, n7, July 1998, pp. 4.
- Market Asia Pacific*, "China's new Leisure time is controlled by Children", v5, n2, February 1996, pp.3+.
- Market Asia Pacific*, "New Chinese Generation Chooses Milk", v7, n10, October 1998, pp. 4+.
- Market Asia Pacific*, "Retailers Reap the Benefits of Chinese Consumer Spending", v4, n2, February 1995.
- Market Asia Pacific*, v4, n9, September 1995, pp. 3+.
- Meloan, Taylor W., "International and Global Marketing: And Overview", *International and Global Marketing: Concepts and Cases*, edited by Meloan, Taylor W., et al., Richard D. Irwin, Inc., 1995, pp. 3-14.
- Milling & Baking News*, "Bursting with nutrition: heart of the breakfast table", v77, n10, May 5<sup>th</sup>, 1998, pp. 26+.

- Milling and Baking News*, "Global Goodness", v77, n32, October 6<sup>th</sup>, 1998, pp. 28+.
- Money, John, *The Destroying Angel: Sex, Fitness and Food in the Legacy of Degeneration Theory, Graham Crackers, Kellogg's Corn Flakes and American Health History*, Prometheus Books, 1985.
- New York Times*, National Edition, "Is the Box Half-full or Half-Empty?", vCXLVIII, n51, 355, November 28<sup>th</sup>, 1998, pp. B1+.
- New York Times*, "Global Marketing Debated", Advertising Column, November 13<sup>th</sup>, 1985.
- Peterson, Christopher H. , Lindon Robison and Marcelo Siles, "The Social Capital Foundations of Trust in Global Agri-Food System Transactions", Michigan State University, Staff Paper No. 99-19, 1999.
- Plain Dealer*, "Kellogg, Cereal Firms Facing Crunch", November 27<sup>th</sup>, 1998, P3+.
- Quaker Oats Annual Report*, 1994-1998.
- Reed, Michael R., and Ning, Yulin, "Foreign Investment Strategies of US Multinational Food Firms", *Industrial Organization and Trade in the Food Industries*, edited by Ian M. Sheldon, *et al.*, Westview Press, 1996, pp. 183-196.
- Root, Michael, *Entry Strategies for International Markets*, D.C. Heath, 1987.
- Root, Waverly, and Richard De Rochemont, *Eating in America: A History*, William Morrow, 1976.
- Sales, Richard, "Box Top Bingo", *Promo*, vXI, n10, September 1998, pp.57+.
- Samuelson, Robert J., "The Great Cereal Wars", *Newsweek*, September 7, 1987.
- Shapiro, James E., Behrman, Jack N., Fischer, William A., and Powell, Simon G., *Direct Investment and Joint Ventures in China: A Handbook for Corporate Negotiators*, 1991, pp. 17.
- Steidlmeier, *Strategic Management of the China Venture*, 1995, Westport, Connecticut, Quorum Books.
- Stills, Richard R., and Hill, John S., "Adapting Consumer Products to Lesser-Developed Markets", *Journal of Business Research*, 12(1), 1984, pp. 51-62.
- Value Line*, February 1999.

- Vanhonacker, Weifried, "Entering China: An Unconventional Approach", *Harvard Business Review*, March – April 1997, pp. 130-140.
- Vaughan, Odett, Margaret Malanoski, Don West, and Charles Handy, 1994, "Firm Strategies for Accessing Foreign Markets and the Role of Government Policy", Working Paper 5/94, Agriculture Canada, Agri-food Policy Directorate, 1994.
- Wall Street Journal*, "Kellogg increases prices on majority of cereal brands", 3 Star, Eastern, vCCXXXII, n117, December 15<sup>th</sup>, 1998, pp. B23.
- Watson, James L., *Golden Arches East*, 1997, Stanford University Press.
- Wei, J, *Chinese Foreign Investment Laws and Policies*, Westport, Connecticut, Quorum Books, 1994.
- Whyte, R. O. , *Rural Nutrition in China*, Oxford University Press, 1972.
- Wind, Yoram J., "Research for Multinational Product Policy", *Multinational Product Management*, edited by Warren J. Keegan and Charles S. Mayer, pp. 165-183.
- Wind, Yoram J., *Product Policy: Concepts, Methods, and Strategy*, 1982.
- Yan, Rick, "Short-term Results: The Litmus Test for Success in China", *Harvard Business Review*, September-October 1998, pp. 61-75.
- Young, Stephen, James Hamill, Colin Wheeler, and J. Richard Davies, *International Market Entry and Development: Strategies and Management*, 1989, Hertfordshire: Harvester Wheatsheaf.