

The China Strategies of Korea's Winning Companies

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- I The Changing Significance of the China Market for Korean Companies
- II Samsung's "Five-Percent Strategy" Based on Selection and Concentration, and Second Headquarters Structure
 - 1 Changes in Samsung's China Strategy
 - 2 The Samsung Group's New China Business Strategy
- III The LG Group's "Bipolar Strategy" and the LG Beijing Towers
 - 1 Changes in the LG Group's China Entry Strategy
 - 2 LG's Second-Phase China Entry Strategy
- IV SK Group: Business of the Chinese, by the Chinese, for the Chinese
 - 1 Learning from the Failure of Its Initial China Entry Strategy
 - 2 Thoroughgoing Localization Strategy to Create "Another SK"
- V Common Characteristics in the China Strategies of Winning Korean Companies

When Korean companies began to make their way into China, their principal aim was to secure low-cost manufacturing centers. However, Chinese companies became competitive much faster than anyone had predicted. They soon caught up with their Korean counterparts, forcing the Koreans to alter their strategies and start viewing China as a strategic market rather than a production base.

Under its new strategy of "selection and concentration," the Samsung Group is making great effort to differentiate itself from other companies by focusing on products and services targeted at those in the top five percent of the population in terms of annual income. The LG Group has adopted a "bipolar" strategy whereby it offers high value-added digital home appliances to the high-income cohorts in the coastal regions, and low-priced general household appliances to people with more moderate income levels living in the interior. The SK Group is actively pursuing localization and employing Chinese personnel, from the CEOs down to the ranks of ordinary employees, to run its business in China.

Case studies of these three groups highlight certain commonalities: their efforts to localize, their commitment and willingness to invest for the long term, and their determination to succeed at all costs. In other words, they have set high-level strategic goals and are displaying firm leadership in their long-term efforts to achieve them.

I The Changing Significance of the China Market for Korean Companies

Korean companies began to advance into China following the normalization of diplomatic relations between the two countries in August 1992. In particular, the signing of a trade agreement between China and Korea stimulated direct investment in China because it obviated the need for indirect trade through Hong Kong.

When Korean companies started entering China in the early 1990s, their main objective was to secure production centers where they could take advantage of China's lower production costs. At that time most Korean companies did not really see China as a viable market, and even those companies that had entered the country to take advantage of its domestic demand were somewhat skeptical of the China market. They indulged in a sort of "China fantasy" based on the dubious assumption that if every single Chinese bought just one unit of any low-quality, low-priced product that no longer had any value in Korea, they could sell 1.3 billion units.

Once into the 1990s, however, China's economy started growing at an astonishing pace. The improvement in the competitiveness of its manufacturing industry was particularly remarkable, and before long over 100 products manufactured in China had taken first place in global market share. According to the Samsung Economic Research Institute, China has already overtaken Korea in the area of low- to medium-priced consumer goods that use generic technologies, and within ten years will probably rank alongside Korea in information technology (IT), automobiles, shipbuilding, and iron and steel, all of which are currently areas of key competence for Korea.

As Korean companies saw Chinese companies steadily eroding their competitive advantages in products and technology, they were forced to review their strategies towards China. This was the main reason why they repositioned the China market. They could no longer treat it as a simple production base from which they could export products to Korea and third countries. Instead, they were obliged to recognize it as the second-largest market in the world, a market in which they faced competition from global companies with awesome strengths in product marketability and technology. As they came to share this awareness, Korean companies began to refine and optimize their strategies.

This paper analyzes the historical changes that have taken place in the China strategies of three leading Korean companies, the Samsung, LG, and SK groups, and examines their present strategies. In so doing, it seeks to provide useful hints for Japanese companies that are also aiming to enter the China market.

II Samsung's "Five-Percent Strategy" Based on Selection and Concentration, and Second Headquarters Structure

1 Changes in Samsung's China Strategy

Samsung's strategy to enter China can be divided into three stages. In the first half of the 1990s, it worked to secure production bases. In the second half, it sought to exploit the high-quality product segment. And following Samsung chairman Lee Kun-hee's visit to China at the end of 2001, it has moved to the third stage and now is working to make China a key strategic market for sales.

(1) Early 1990s: strategy to secure production bases

Under its initial China strategy, Samsung focused on taking advantage of China's low wages to mass-produce low- to medium-priced products that had lost their value in Korea. Most of these products were exported back to Korea or to third countries, and the remainder were sold in China. An analysis of the product lines manufactured by Samsung Electronics in China clearly reflects Samsung's initial policy.

In the first phase during the early 1990s, Samsung Electronics originally entered China in order to manufacture small color televisions, videocassette recorders (VCRs) and PC monitors in Tianjin. Later, it built a plant in Huizhou, Guangdong province, to manufacture audio equipment, and another in Suzhou to manufacture air conditioners and microwave ovens.

Samsung SDI built plants in Shenzhen, Shanghai, Tianjin, Dongguan (Guangdong province) and elsewhere to manufacture cathode ray tubes for PC monitors and televisions. During the early phase in the mid 1990s, products manufactured at these production bases comprised small CRTs for 14- to 15-inch monitors and 20-inch TVs. The products introduced into China at that time were less sophisticated than those in Korea, where 17-inch monitors and 29-inch televisions were typical.

In 1992, Samsung Electric established a plant to manufacture floppy disk drives, keyboards, speakers and other computer components in Dongguan. In 1993, it set up a production base for digital video components in Tianjin, manufacturing miniature electrical motors for mobile phones, drums for VCRs, tuners, and motors for CD-ROM drives. According to a Samsung Electric spokesman: "The main reason we entered China up to the mid 1990s was the need for plants to manufacture lower-priced products."

(2) Shift to high-quality products in the second half of the 1990s

Having originally concentrated on the production and sales of low- to medium-priced products, Samsung's

electronics affiliates gradually shifted their strategic focus towards higher quality products in the latter part of the 1990s. This was because they realized that low- to medium-priced products were not the key to success in the Chinese market. The essence of Samsung Electronics' China marketing strategy is "selection and concentration." Since it would be impossible to succeed throughout China in all product sectors, it decided to focus on the market for high value-added, currently popular, and technologically advanced products.

A good example of Samsung Electronics' success in high value-added products in China is the "Anycall" mobile terminal. In China, the Anycall is priced higher than the products of Finland's Nokia, the world's largest mobile phone manufacturer. Nevertheless, Samsung has introduced the latest models that justify the high price in order to compete, and as a result the Anycall is now seen as a symbol of status among China's young people.

The Anycall has demonstrated that high value-added items are more likely to succeed in China than low- to medium-priced items. It has also proved that Korean products are not cheap goods but very competitive, high quality items.

(3) Background to the third phase strategy switch, and the five-percent strategy

Following the success of the Anycall, Samsung initiated a complete review of its strategies for China up to that date. Abandoning its original, somewhat passive approach to the China market, it espoused a more proactive policy aimed at moving ahead of the competition. It also switched to a sales strategy that views China as a market for launching and selling high value-added products.

These moves were based on the realization that although it is possible to make short-term profits on low- to medium-priced products in China, this approach offers little in the longer term. Since the quality of products manufactured by Chinese companies is likely to improve rapidly, ordinary products will not be able to compete. Moreover, such products do not fare well against local products in terms of scale of production and cost competitiveness. In view of the fact that Changhong Electric and the Haier Group have the capacity to manufacture and sell 10 million and 4 million color televisions, respectively, while Galanz Enterprise can add 10 million more, Samsung could not possibly compete against local Chinese enterprises even if it was to build new mass-production facilities.

Samsung therefore decided to end its strategy of mass-producing low- to medium-priced products. Even though its production capacity would be relatively small, it changed track to concentrate on producing high-quality products for China's high-income strata.

Chairman Lee Kun-hee emphasized the importance of Samsung's China business as follows:

"Samsung's strategies for China are inextricably entwined with its strategies for its own survival, and so naturally the group's president is fully committed to the China market. China is an extremely important challenge for not just Korea, but also Samsung, and in a way this is our last chance. The next four to five years will be vitally important as we pursue our China strategy, and any sense of complacency or superiority about the market must be avoided at all costs. As China's rapid growth continues and consumers become more demanding, we must make utmost effort to ensure that each product keeps abreast of these developments."

As Samsung advances aggressively into the China market, it is not trying to compete through lower labor costs but to create high value-added products. It is not focusing on volume but on profitability. Says a source at Samsung: "One of the reasons Samsung has so far not actively moved into China is because it underestimated China's potential. We also feared that China's growth would eventually boomerang on us. However, we concluded that the loss caused by any further delay would outweigh the gains, which is why we switched to a proactive policy."

2 The Samsung Group's New China Business Strategy

In 1999, the Samsung Group posted its first surplus since entering the China market. In 2000, 23 of its local manufacturing companies in the PRC achieved a cumulative surplus.

Samsung then began to formulate a new strategy for doing business in China at the group level. This was partly spurred by the September 11, 2001 terrorist attacks in the United States, which highlighted how the Samsung Group's dependence on the US market left it vulnerable. In order to overcome uncertainties about the future of the US economy, Samsung rebuilt its global strategies around China. In the background, meanwhile, other factors combined to enhance the strategic importance of the China market, including China's accession to the World Trade Organization, the success of Beijing's Olympic bid and the Chinese government's "Great Western Region Development Project."

(1) Five-percent strategy based on selection and concentration

If any single word could summarize the Samsung Group's China business strategy, that word would be *differentiation*. As might be expected, this strategy focuses not on the 1.3 billion consumers who make up China's general population, but on the top five percent who constitute the high-income earners.

The members of this wealthy class live primarily in 10 major cities, including Beijing, Shanghai and Tianjin, and comprise some 65 million people whose purchasing power is equivalent to their rich counterparts in economically advanced nations. By concentrating on selling global-standard, high value-added products to this customer segment, Samsung should be able to avoid increasingly intense price competition with local Chinese companies. There is also the advantage that manufacturing and selling high-quality products helps strengthen Samsung's brand image.

Of course, product marketability is an essential prerequisite for this kind of high-quality brand strategy. The Anycall mobile terminal that was mentioned before is just one example. Cheil Industries Inc., a Samsung Group company that manufactures and sells men's suits in China, is using the "Galaxy" brand to penetrate the China market. Galaxy brand suits are on average 30 percent more expensive than competitive high-quality brands such as Dunhill and Boss, and sell at around 5,200 renminbi (rmb). This is 5.2 times the Chinese worker's average monthly wage of 1,000 rmb (1 rmb = approximately ¥15).

The same applies to PC monitors. In the mass electronics retailers of Beijing's Zhongkuancun, which is known as "China's answer to Silicon Valley," Samsung's "SyncMaster" LCD monitors sell for 3,800 rmb, far higher than the prices of competitive products, which average 2,800–3,000 rmb.

(2) Strategy underpinned by second headquarters organization

The Samsung Group is headquartered in Korea, but it decided to build a second headquarters in China in order to strengthen its operations there. Initially, it established its China headquarters with supervisory functions to cover its 21 manufacturing companies, including Samsung Electronics, Samsung SDI, and Samsung Corning. (As of January 2003, they employed 35,000 people, including 250 expatriates from Korea.) The decision was based on the belief that since local subsidiaries in China had their own personnel recruitment programs and carried out their own sales activities, the Samsung Group's brand power was not utilized to the fullest. The China headquarters, the group's second, controls the recruitment and deployment of personnel as well as sales channels in China. It has also been responsible for establishing Samsung's long-term vision for China, conducting market surveys covering all business fields, and drawing up marketing strategies. The goal is to consolidate the strategic planning functions that had formerly been delegated to individual companies in order to maximize the group's synergies.

As a result, the person in charge of the China headquarters has been promoted from the rank of president to that of deputy chairman, and is responsible for all

operations in China. This shows just how serious Samsung is about its China business.

III The LG Group's "Bipolar Strategy" and the LG Beijing Towers

1 Changes in the LG Group's China Entry Strategy

LG was slower off the mark than Samsung, entering China in 1993 with a view to reducing production costs. It began by establishing an audio equipment and CD-ROM production company in Huizhou, then set up LGESG in Changsha in August 1994 to manufacture cathode ray tubes, and LGETA in Tianjin in August 1995 to manufacture air conditioners and microwave ovens. Most of the products they manufactured were lower-priced, thin-profit-margin household electrical appliances aimed at the Chinese domestic market.

At the beginning of the 1990s, LG Electronics took advantage of its technological prowess and the marketability of its products, which were far superior to those of Chinese companies, and soon overtook local Chinese manufacturers, Sony, Matsushita Electric Industrial and other companies to take the top position in the Chinese domestic market in the area of TV exports. In the same way, it took the number-one spot in CD-ROM drives, number two in microwave ovens, number three in PC monitors, number five in washing machines and number six in air conditioners. As a result, it succeeded in popularizing the LG brand throughout China to the extent that sales placards for LG air conditioners were visible almost everywhere.

In the Chinese market for low-priced household electrical appliances, however, China's domestic manufacturers—LG's competitors—were able to improve their technological expertise and product marketability at a much faster pace than had been expected, and LG soon realized that there were limits to what it could do by simply expanding local production. In particular, the Haier Group, the world's largest manufacturer of air conditioners, refrigerators and washing machines, and the Legend Group, a world-class company that ranks fourth worldwide behind Sony, Matsushita and Philips in color television manufacturing capacity, had the advantage of an organizational culture that encouraged young employees to work energetically, as well as technological strengths and product marketability.

Inspired by China's rising competitiveness and the growth potential of its dynamic organizations, LG Group chairman Koo Bon-moo chaired a China Strategy Conference attended by some 30 top managers from its electronics and chemicals divisions in Shanghai in

October 2001. Following this conference, LG announced its second-phase China strategy.

2 LG's Second-Phase China Entry Strategy

(1) "Bipolarization" as a marketing strategy

The LG Group refers to its new strategy for China as a "bipolar strategy." The concept calls for a two-pronged marketing approach, offering high value-added digital home appliances to the high income earners living in the coastal areas, and low-priced household electrical appliances to general households living in the interior.

In terms of its product line-up, this strategy strives to avoid direct competition with Chinese companies in areas such as air conditioners and refrigerators, where price competition is fierce, while securing production bases for exports to third countries. At the same time, it seeks to open up the Chinese domestic market for digital home appliances such as plasma display panel (PDP) televisions, liquid crystal monitors, big-screen projection televisions, and DVD (digital video disc) players.

More recently, it has begun to take a more proactive approach to introducing high-priced products into the market with a view to establishing a high-quality brand image to replace the rather weak image it has had up to now. LG Electronics implemented a strategy of securing the top position in the digital display sector in the Chinese market. It set up a PDP production line in Shenyang which, together with its existing big-screen projection television line, began to mass-produce 60,000 high value-added television sets per year from May 2001. Moreover, it installed a dedicated line for TFT (thin film transistor) LCD monitors at its monitor production base in Nanjing and began to produce 15.1-inch and 18.1-inch monitors at the rate of 250,000 units per year.

Realizing that China would probably overtake the US to become the world's largest market for DVDs, LG became the first Korean company to set up DVD player production facilities with an annual capacity of 2 million units under its Shanghai manufacturing subsidiary, establishing a local production system capable of handling a line-up of 10 model types.

LG also created quite a stir when it set up a special task force of 21 university graduates of Han Chinese extraction to promote sales of PDP televisions. Following the strategy that "indigenous" marketing matching the needs of the Chinese people was the only way to sell high-priced products, the team sold more than 100 PDP televisions priced at over ¥1 million each. This demonstrates that sales activities targeted at the rapidly emerging ranks of the nouveau riche should yield good results.

(2) Enthusiastic commitment to business in China

Since LG Electronics established its local subsidiary in Huizhou in 1993, the LG Group's 12 subsidiaries have

come to manage some 34 local companies, including 22 manufacturers. In 1996, a China holding company was established with a view to enabling the mainstay LG Electronics to exercise greater responsibility in running its China operations.

This China holding company serves as the China headquarters of the LG Group and comprises 10 domestic companies employing 17,000 people. In 2002, it posted sales of US\$4 billion. Since then, it has announced plans to grow itself into the number-four household appliance brand in China with sales of US\$8 billion by 2005.

One symbol of the LG Group's enthusiasm for its China business is its plan to build the LG Beijing Towers. This construction project began in July 2001. Centrally located on Beijing's Chang'an Avenue close to Tiananmen Square, the complex will have two towers with 30 stories above ground and four stories below. When it is completed in 2005, it will occupy a site area of 13,021 square meters, stand 140.5 meters high, and have an aggregate floor area of 150,406 square meters. It is therefore comparable in size to the LG Twin Towers in Yoido-dong in Seoul, the home of the LG Group headquarters, and is an indisputable symbol of LG's enormous commitment to its business in China.

LG's plans call for all 12 group companies that have already entered the China market, including LG Chem, Ltd. and LG Electronics Inc., to move into this building, which will become the headquarters for promoting LG's localization strategy in China. Roh Yong-ak, vice chairman of the LG Electronics China holding company, is clear in stressing that this is the second phase of LG's China localization strategy: "The construction of our company headquarters does not symbolize LG's success as a foreign company in China. It symbolizes the fact that we are determined to become a 'Chinese company.'"

IV SK Group: Business of the Chinese, by the Chinese, for the Chinese

1 Learning from the Failure of Its Initial China Entry Strategy

SK was the first major Korean company to advance into China. Two years before China and Korea renewed diplomatic relations in 1990, SK established a joint videotape production plant in Fujian, China's first free economic zone. Like other companies moving from overseas into China, SK transferred its production base there in order to reduce manufacturing costs, and intended to export the plant's products to Korea and other countries. The factory was selected as the largest foreign company in Fujian and in the spring of 2000, and

SK's chairman Son Kil-seung was made an honorary citizen of Fuzhou.

Gaining confidence from the steady performance of the videotape production operation, SK joined a US\$1 billion project to build an oil refinery park in Shenzhen at the beginning of the 1990s. The plan was to build a refinery and produce and export petrochemical products. The project was important not only because of its size but also because it was strategically designed to enable both SK and the city of Shenzhen to become "winners."

SK's goal was to capitalize on the know-how and experience it had gained in the key industries that constitute its core businesses—energy, chemicals and telecommunications—to make a full-scale entry into the China market. Moreover, the project was expected to go smoothly because Hong Kong was attempting to abandon its role as a base for light manufacturing and switch to the development of heavy industries such as petroleum and chemicals. At that time, the Chinese central government was determined to protect its own industries, particularly heavy industries. As a result, the project was conditioned on the requirement that all production would be exported and there would be no participation in the domestic demand market.

This project took several years to come online. Furthermore, the Chinese government restricted investment by foreign companies in key national industries and instead adopted a national policy of developing state-owned enterprises (SOEs). Under pressure from this policy, SK decided at the end of 1996 to completely withdraw from the project without recovering the US\$2 million it had already committed.

In the process, SK learned two important lessons. First, China's curbs on the participation of foreign investors in SK's key business sectors of energy, chemicals, and telecommunications networks made it unrealistic for SK to pursue such a conventional business model in the PRC. Second, large-scale projects requiring huge capital investment incurred risks because of the slow response of the Chinese government and delays in recovering the capital; in the worst-case scenario, these risks could rebound to affect business back in Korea.

Having seen several years of effort come to nothing, SK was reluctant to get involved with Chinese projects for some time. After experiencing the economic crisis that hit Korea, however, SK started looking again for large markets that offered new growth potential and came to the conclusion that China was a promising option after all.

In October 1999, a seminar attended by SK Group CEOs came up with a plan that drew on the lessons taught by the Shenzhen project to create "another SK" in China. To ensure the effective development of business in China, SK created an organization comprising five teams: the Venture Team, the IT/Internet Team, the

Life Science Team, the PR Infrastructure Team, and the R&C (Research and Consulting) Team. Each of these teams conducted sustained experiments in order to uncover new potential.

In particular, the R&C Team, which reported directly to SK chairman Choi Tai-won and included some 60 Chinese MA and PhD holders, served as a think-tank and helped determine the strategic directions for the group's China business.

2 Thoroughgoing Localization Strategy to Create "Another SK"

The SK's localization strategy is so exhaustive it almost seems to go too far. It is apparent in activities ranging from the hiring and management of human resources and the establishment of a group image from a long-term perspective.

SK China has adopted the motto "Of the Chinese, by the Chinese, for the Chinese," and unlike other major Korean companies, delegates the management of its operations in China primarily to Chinese people.

To start with, the president and CEO of SK China is a Chinese national, Xie Cheng. Born in Sichuan, the 42-year-old Mr. Xie is a graduate of the Faculty of Process Physics and did his postgraduate work in radioelectronics at the prestigious Tsinghua University, before going to Purdue University in the United States to obtain a BA in physics and a Masters in electronics processing. He also worked as vice president of American-owned Intel China. For this reason, he has a reputation for his excellent understanding of Western-style capitalism as well as a broad knowledge of the IT industry.

When Mr. Xie was appointed CEO in July 2001, he immediately visited Seoul, where he met the president of the SK Group. Having absorbed the SK corporate culture, Mr. Xie confidently avers that: "Capitalist management methods are still fragile in China, but if we reinforce them through fusion with SK's management model, I'm convinced we will be able to create a successful company."

SK also hired new employees, not just the CEO, through local public recruitment. When it made its first public recruitment announcements in 2001, some 1,500 people applied. The company selected a total of nine people, including one PhD and four with Masters degrees. Currently, some 150 local employees are working for SK China.

In order to enable locally recruited personnel resources to better understand and apply the SK culture and business methods, the SK Group has a program in which new employees are invited to Korea for three or four years' training, and then sent back to China to serve as key employees. To help Chinese employees become more familiar with SK's corporate culture, the company also runs a "Korea Experience Program." Participants in this program learn for themselves how

business is actually carried out at key business establishments and laboratories, such as the SK Ulsan plant and the SK Telecom Network Center. It also gives them hands-on experience with Korea’s economic development and its culture.

In this way, SK China secures the necessary human resources as a means of directly implementing its localization strategy. However, it also promotes localization by enhancing its corporate image from a longer-term perspective. One good example of this indirect localization strategy can be seen in a TV program entitled “SK Zhangyuanbang.”

SK Zhangyuanbang originated from the Korean program known as the “Janghak Quiz (Scholarship Quiz),” which was aimed primarily at high school students and designed to give back to society a certain portion of corporate profits. The purity of its objective to nurture human resources without pursuing profits was highly regarded, and the program ran for over 27 years. When permission was sought to broadcast a similar program in China, its predecessor’s success in Korea was rated so highly that permission was granted to use the company’s name in the title, SK Zhangyuanbang, despite the fact that the Chinese government has very strict rules about the use of company names in broadcast programs.

The Chinese version of this scholarship quiz program started in January 2000 and is now extremely popular in six major cities including Beijing and Dalian, where it is playing a role in spreading SK’s name in China. Even more important, it is increasing awareness among the local populace that SK is a company working for the Chinese people and contributing significantly to Chinese society.

V Common Characteristics in the China Strategies of Winning Korean Companies

As China’s strategic importance increases, companies from all over the world are intensely competing to succeed in the China market. Korean companies are no exception.

Samsung targets the top five-percent income bracket in China for its business of selling mobile phones, liquid crystal display monitors, digital appliances and other high value-added products. It sees China as second only to the United States as a strategically important market and is using its high-quality brand image as a means of securing success. For extra support, it has built an organization that is centered on its second headquarters.

LG’s approach is to advance into the China market with consumer-oriented products such as home appliances, and household chemical products such as deter-

gents, toothpaste and sanitary products. It has adopted a “bipolar” marketing strategy with a view to popularizing the LG brand throughout the country, and is promoting localization. At the group level, it is putting a great deal of effort into its China business by—among other things—building the LG Beijing Towers.

In order to create another SK with the slogan “Of the Chinese, by the Chinese, for the Chinese,” it is doing everything possible to ensure that its companies are truly Chinese. With the exception of a few representatives from Korea, it employs Chinese people in positions ranging from the CEOs of its local subsidiaries to general employees. In this sense, it is following a true policy aimed at a thorough Sinification of its China business.

Since individual companies feature different product line-ups, services and organizational cultures, the strategies they formulate will not work for all companies. Nevertheless, Samsung, LG, and SK have at least three basic points in common (Figure 1).

The first of these is the effort they put into place a thorough understanding of China and the Chinese, as symbolized by their attempts to localize their companies. In approaching China’s domestic demand markets, they strive to use localization as a means of pursuing a highly seamless business relationship with local communities. Although Samsung, LG and SK have made different levels of commitment, they are all in the process of building organizations to better control their operations. This includes, for example, positioning their main corporate entity in China as a second headquarters and carrying out research and development, production and marketing at the local level. SK is particularly notable for running operations with mostly Chinese personnel, ranging from the CEOs to staff employees, except for a handful of Korean expatriates. Samsung has also raised the status of the COO with

Figure 1. Three Commonalities of Winning Korean Companies in China



overall responsibility for its China business to the same rank as a vice chairman of its Korean head office.

The second is that they do not begrudge making long-term investments and do not seek short-term profits. The SK Zhangyuanbang scholarship quiz program is a good example of this.

Finally, most important is their strong determination to win whatever it takes. In other words they set high-level strategic targets and demonstrate the untiring leadership needed to guide long-term efforts to achieve these targets. These thoroughgoing efforts to localize,

together with supportive and unyielding long-term strategic leadership, almost certainly provide some valuable hints for Japanese companies, which are often considered unable to make strategic decisions that involve risk.

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