

The Internationalization Strategy of Volkswagen in Entering China

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Abstract. Volkswagen, one of the world's largest automotive companies, has branches in 153 countries around the world. This study studies Volkswagen's internationalization strategy for entering China through qualitative research. This study makes an in-depth study of Volkswagen's internationalization strategy, provides help for the internationalization of other similar companies, and discusses the shortcomings of the internationalization strategy.

Keywords: Internationalization; China; Volkswagen; Dunning's OLI.

1. Introduction

Internationalization is a way of defining the process by "which firms adopt international business activities" [2] or the process by which firms "gradually increase their international involvement across the world" [11]. Cavusgil's [2] theory suggests that it is "a gradual process taking place in incremental stages, and over a relatively long period" which leads the business to a situation of unpredictable and higher input costs of information, and a lack of experiential knowledge within marketing activities globally. Additionally, the process of increased involvement in international operations includes both inward and outward processes linked with the dynamics of international trade [12]. Internal internationalization of businesses refers to non-material factors of production, which include technology, talent, and service. The epitaxial internationalization of enterprises refers to capital, equipment, plant, and other material production factors. The main purpose of internationalization is to investigate, through the international market, how factors of production combine to achieve higher product sales in order to maximize profit. Various models can be used to help us understand how and why enterprises internationalize, such as Dunning's OLI Model and the Uppsala Model. It is important to highlight and note the relative contribution that the theories of internationalization play and their important role in manufacturing firms. In this essay, after introducing the background of Volkswagen, I will outline the eclectic paradigm (OLI and OLMA), the Uppsala model, and the business network perspective. Volkswagen will be the main case study used to develop a better understanding of the theoretical frameworks and investigate Volkswagen's internationalization strategies on entering China. To conclude, a critical analysis of the theory will be discussed in an attempt to respond to the determination of limitations and inadequacies. Overall, this paper believes that the use of various business theories helps to develop a good understanding of an enterprise's internationalization experience.

2. Background of Volkswagen

Volkswagen was first founded in 1937 and located in Wolfsburg, Germany; it has now become one of the most successful car makers in the world. There are 120 production plants in 19 countries in Europe that are being operated by the business, and another 10 countries outside of Europe, in places such as India, China and South Africa (see figures 1 and 2). Volkswagen has a workforce of 662,575 employees, which allows the business to be capable of producing more than 34,900 vehicles daily, and vehicles are being sold in more than 153 countries [14]. In 1984, Volkswagen decided to engage with the Chinese market and became one of the first international car manufacturers to set up

business in China. Volkswagen has been keeping a leading position in China's car market ever since it first entered.



Fig. 1 VW production facilities worldwide



Fig. 2 120 Production Plants (Source: Volkswagen AG 2020)

2.1 Dunning's OLI

The "eclectic paradigm" (Dunning's OLI) is a key theory to explain the conditions required for internationalization, and it is one of the most cited and used analytical frameworks for studying international activities of multinational enterprises (MNEs) [5]. International production is a process which describes production activities formed by investing multinational corporations. Dunning expounds on the determinants of foreign investment by analysing the foundation of the formation of the international production pattern of multinational corporations. The significance of this theory lies in the fact that it makes up for the one-sidedness of previous international investment theories, inherits the core content of Heimer's monopoly advantage theory, absorbs Barclay's internalization view, adds location advantage factor, and introduces ownership, internalization, and location advantage as three variable factors for analysing investment decisions. The theory is used to explain how and why companies internationalize, which varies by firm, industry, and the market which they enter. Companies develop different suitable strategies when entering a new market, and this allows the company to get used to the new environment and to attract its new consumers.

The Volkswagen company will be used here to demonstrate how the OLI theory's three specific advantages help us to understand the way in which companies enter new markets.

2.2 Ownership Specific Advantage

Ownership specific advantage is when successful MNEs have company-specific advantages which enable them to overcome the costs of operating their business in a foreign country, as well as maximizing profit. Ownership specific advantages include asset ownership advantage (Oa), which denotes the tangible and intangible assets, the former referring to production equipment, workshops, capital, energy, and raw materials such as monopoly, the latter referring to the market and management, proprietary technology, trademarks, etc. Transactional ownership advantage (Ot) denotes the advantages obtained by enterprises in transnational operations, the rational allocation of various resources and the avoidance of various risks, which reduce the transaction costs of enterprises [4].

Volkswagen entered the Chinese market in the 1970s through a strategic alliance with the Shanghai Tractor and Automobile Corporation, the largest car manufacturer in China. This gave Volkswagen a huge advantage, because it was one of the first international car firms in China. Another asset ownership advantage of Volkswagen, which provided it with support as it entered the Chinese market, was that, back in the 1970s, it was one of the biggest car firms. This is shown by its annual report at that time, according to which 30.7% of consumers chose Volkswagen, compared to Ford or GM. In addition, Volkswagen also showed a competitive advantage in terms of remuneration, and it was also highly trusted by the public for its excellent performance and reliability. In terms of Volkswagen's transactional advantage in China at the time, the company was capable of handling international markets, and its many operations in Brazil, Mexico, etc., suggested that it had the experience for this kind of expansion. Another transactional advantage that Volkswagen possessed was that it had suppliers whose economical manufacturing enabled the production of cheaper car parts that the company could use to maximize its profit. As a result, these ownership advantages allowed Volkswagen a smooth entry into the Chinese market.

2.3 Location Specific Advantage

Location specific advantage is when investors are obtaining benefit from investing in another country or regions because of the advantages in that particular environment. There are four conditions that make up regional advantages: these consist of labour cost, market potential, trade barriers and government policy. If the foreign market is particularly favourable to the domestic market in terms of market environment, it will be more attractive to transnational enterprises [4].

Through the analysis of Volkswagen's internationalization strategy for entering China, it appears that the Chinese market had many location-specific advantages for Volkswagen. First of all, regarding government policies, the opening-up policy of the Chinese government in 1980 promoted a large amount of investment into the Chinese market in 1984. Secondly, in terms of market potential, China's car manufacturing technology was receding, while Volkswagen, with its advanced technology, had the potential to expanding rapidly in the Chinese market. Moreover, in order to develop the car market, the Chinese government had stipulated that joint ventures were the only way to enter the Chinese market. From an economic point of view, people had realized the great potential of the Chinese market, and from 1985 to 2016, China's GDP saw significant growth. Additionally, due to China's large population, labour costs were very low, and this provided an opportunity for Volkswagen to offer work opportunities for the unemployed at lower wages.

2.4 Internalization specific advantage

Internalization advantage is when businesses internalize benefits for themselves in order to avoid the impacts that an incomplete market might bring to the company and maintain the advantages owned by the enterprise. These include securing benefits from an economy governed by both contract parties, that is the buyers and sellers of the products, thereby improving a firm's competitive or strategic advantage and reducing the impact of risk [15]. Since 1985, Volkswagen has operated two joint ventures in China, SAIC Volkswagen and FAW-Volkswagen. Volkswagen cooperates with the local partners, providing them with technology; the local partners, in turn, provide local resources to Volkswagen. Volkswagen benefits from the local partners because of its joint ventures with Chinese companies, which allow Volkswagen to understand the needs and wants of the local market and seize market share more quickly. In addition, Volkswagen, through joint ventures, can decrease the amount of production costs and lower the impact risk with the local partners.

2.5 The critique of OLI (from OLI to OLMA)

An analysis of OLI shows that the opportunities for multinational companies to expand are endless; the questions that they need to consider are when, where and how. If a company's performance is unsatisfactory, it is often assumed that the business has opted for a wrong location or entry mode. However, this pattern has drastically limited the scope of their analysis and has rarely explored more

fine-grained corporate structures such as business processes. An enhanced eclectic paradigm, known as OLMA (ownership, location, entry mode, and adjustment), provides a set of concepts that needs to study the modern multinational corporation [6]. In recent years, people have realized that the performance of multinational companies is not only determined by geographical location and entry mode, because in the same industry, located in the same market—such as China—the use of the same manner of entry mode will cause multinational companies to have significantly different profit margins. Profitability ratio is usually affected by operational decisions, such as location of the market and entry mode. In a recent interview, Michael Porter mentioned the importance of operational improvement, placing it on a par with strategic positioning [7].

A considerable time after entering China, Volkswagen decided to use the global standardization strategy as a guide for investing in the Chinese market. In the 1990s, the company resolved to improve its investment strategy by using market-oriented investment. Due to expansion, demand in the Chinese car market had greatly increased and market competition had become more intense [7]. After 2001, the car industry, facing competition in the domestic market and further competitive pressures following China's accession to the WTO, launched new products to attract consumers; companies tried hard to compete in the price war, promoting the market with new products while at the same time attempting to pull away from the competition [16]. The entry of new competitors and potential competitors in the market reduced the competitiveness of Shanghai Volkswagen, and therefore Volkswagen changed its investment strategy by increasing investment in new products, constantly redeveloping old models, rapidly improving production capacity, and actively preparing for the establishment of the Volkswagen Group holding parts company.

2.6 The internationalization Process Mode: The UPPSALA MODEL

Based on the analysis of the internationalization process of Swedish enterprises, Johanson and Vahlne [11] believed that internationalization is the result of a series of progressive decisions by enterprises. In this model, enterprises gradually acquire, integrate and utilize foreign markets and knowledge to deepen their participation in foreign markets. The concept of "psychological distance" is also mentioned, which is the sum total of factors that hinder the flow of market information, and includes differences in language, education, business practices, culture and industrial development. This will potentially affect the pattern of outward direct investment (OFDI). For example, cultural issues are the main reason why it is through joint ventures that most companies enter the Chinese market. According to Hill [7], it is important to understand how cultural differences between two countries affect business practices. Mr Cai Qian, manager of Volkswagen, believes that although the number of foreign-owned investments will definitely increase in the future, joint ventures will still be the most popular way for foreign investors to enter the Chinese market. He believes that the most important factor influencing this choice is cultural issues rather than political reasons. Cultural issues such as "relationship" will remain a major obstacle for foreign investors; he thinks, therefore, that joint ventures are still their best choice [16].

2.7 The critique of the Uppsala model

The Uppsala model is the micro research of enterprise management and focuses on the internationalization strategy of the enterprise as well as being able to provide feasible suggestions for the actual operation of the enterprise. Compared with other theories, the Uppsala model is a competitive operability, which is a unique outstanding advantage. On the other hand, the scope of explanation becomes a disadvantage because it is limited or too narrow, and this leads to a situation of not providing a unified explanation for the argument related to OFDI [12]. Additionally, the theory suggests that maximizing profit is the motivation for an enterprise to become internationalized, and the enterprise will continue once the process of enterprise internationalization has started (Johanson and Vahlne, 1990). This is a disadvantage, therefore, because a simple theory description cannot be a persuasive explanation for the motivation of an SME's internationalization.

2.8 Network Perspective

According to Johanson and Vahlne [10], forming internationalization means developing business relationships in foreign networks. The authors proposed that for large manufacturing enterprises with extensive international business, the network perspective may be the most explanatory power. Internalization theory is also based on the assumption that manufacturing firms with international operations have some form of ownership advantage over local competitors.

However, according to Cannon [1], the buyer-seller relationship existing in service enterprises and services is usually generated through the personal interaction between buyers and sellers; therefore, the network is considered more important for service enterprises than for manufacturing enterprises. On 23 December 2020, Audi and its joint venture partners reached a consensus on the future sales and service model: "SaIC-Audi products will be provided with sale-related services and after-sales services by the existing FAW-VOLKSWAGEN Audi investor network", which is an example of network perspective. As a result of network perspective, Volkswagen has gathered its business supply chains and sales teams in order to satisfy its consumers and maximize its profit, which is the same objective as the Uppsala model.

3. Conclusion

To conclude this essay, Volkswagen's internationalization has achieved its aims and objectives in the Chinese market through business theories and strategies. Theories that account for Volkswagen's success are the eclectic paradigm (OLI and OLMA), the Uppsala model, and the business network. Volkswagen applied the theory of OLI to identify correctly when, where, and how it should enter the Chinese car market; this helped the business to become one of the first internationalized car businesses in China, which also relates to a business strategy that Volkswagen used to occupy the market. Compared with Dunning's OLI, the OLMA theory also emphasizes that, in the process of internationalization, enterprises should adjust their strategies timely according to market orientation. The internationalization strategy of Volkswagen in using OLMA went from a global standardization strategy at the beginning to a market-oriented investment, whereby it maintained its market edge. In addition, Volkswagen also used the "psychological distance" mentioned in the Uppsala Model. The cultures in different countries will affect the investment strategy for the internationalization of enterprises, just as Volkswagen adopted the strategy of joint venture rather than greenfield investment, which benefitted Volkswagen because it allowed the business to understand the Chinese culture well enough to make the right decisions and take more shortcuts. Volkswagen also utilized the business network theory, which is the buyer-seller relationship existing in service enterprises. Volkswagen strengthened its sales network construction, which promoted the business's reputation and maximized customers satisfaction. As a result, according to the research and analysis put forward in this essay, Volkswagen has successfully achieved its business goals in the Chinese market.

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