

COMPETITIVENESS OF LATVIAN FIRMS IN CHINA

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Abstract

The results of the firms' performance are one of the key aspects in the research of competitiveness. The competitiveness of firms is a concept that involves many aspects of measurement. There are many models that can be used to assess the international competitiveness of firms, including the competitiveness of foreign firms in the Chinese market. The opportunities of Latvian firms to enter China market and the capabilities of Latvian firms to compete in China have not so far been sufficiently studied. In 2010 the export volume of Latvian firms to China was 25 million EUR and more than half of it was export of raw materials. The model of SME competitiveness is used to research the competitiveness of Latvian firms in Chinese market. This paper analyses the theoretic concepts for competitiveness of the firms in China and the competitiveness of Latvian firms in China.

Keywords: China, competitiveness of firms, export.

JEL Classification: D21, D22, F14, F23.

Introduction

The competitiveness is a multidimensional research phenomenon. There are several forms of competitiveness that makes it necessary to study of various types of competition: the competitiveness of nations, the competitiveness of firms, the competitiveness of regions, the competitiveness of cities, the competitiveness of industries and the international competitiveness. Various competition levels and diversity of approaches makes it widely applicable and valid in economic studies. The competitiveness has become an important object of economic research of both developed and developing countries, especially since 1990s which was contributed to increase of international competition and globalization of world economy.

Since the beginning of economic downturn in 2008, international economic environment changes therefore the need to research the competitiveness of firms has become more actual. The results of the firms' performance are one of the key aspects in the research of competitiveness as a whole. The competitiveness of firms cannot be measured the same way as national competitiveness and industrial competitiveness. The competitiveness at the firm level means that firms compete for markets and it is measured by looking at market shares or profitability (Kao et al., 2008). Highly profitable firms do not necessarily lead to highly competitive industries or countries, and the opposite (Blaine, 1993). The competitiveness of firms is a concept that involves many aspects of measurement. There are many models that can be used to assess the competitiveness of firms abroad. The most widespread methods to analyze the competitiveness of foreign firms in People's Republic of China (China) are the diamond model study, SWOT analysis, the Transaction Costs Analysis (TCA) and different models to assess firms' competitiveness. Bontempi and Prodi (2009) points out: „The Chinese market is extremely complex, hard to describe, and not easily interpretable with the same theoretical and analytical tools applied to other developed/developing countries. As far as its dimensions, institutional assets, development rate, data availability and quality, China is a case by itself” (pp. 11-12).

In the 21st century there is growing interest of European firms to enter Chinese market, and there are growing number of scientific research on various aspects of firms' competitiveness and strategies in China. The competitiveness of Latvian firms in China has not so far been sufficiently studied. There is lack of studies how to increase the competitiveness of Latvian firms and entry opportunities in China.

The object of the paper is the competitiveness of Latvian firms in China.

The objective of the paper is to assess the competitiveness of Latvian firms in the Chinese market.

The tasks of the study are to analyze the theoretical concepts for assessment of firms' competitiveness in Chinese market, to analyze the operation of Latvian firms in China and to perform proposals for improvement of competitiveness of Latvian firms in China.

The methods of the study are systematic, logical and comparative analysis of scientific literature, analysis of statistical data and expert method.

The paper is organized as follows: the first part outlines the theoretical concepts for assessment of firms' competitiveness in Chinese market. The operation of Latvian firms in China is analyzed in the second part.

Theoretic framework for analyzing the competitiveness of foreign firms in China

The operation of foreign firms in China is investigated in the context of competitiveness of firms and industry competitiveness. The competitiveness and strategies of particular firm or group of firms in China are studied in the context of the firms' competitiveness (Liao & Yu, 2012; Burt et al., 2011; Carlsson et al., 2005; Gleason et al., 2002; Luo, 2001). The study of industry competitiveness means that the foreign firms' operation of specific industries in China can be studied where there are numerous studies on the architectural and engineering industry (Zhao et al., 2012; Ling & Low, 2007; Ling et al., 2005), the consulting industry (Zhao et al., 2011; Ling & Gui, 2009), the real estate industry (Sun et al., 2010; Zhu et al., 2006), the chemical and pharmaceutical industry (Festel et al., 2005; Vermeer & Landsberger, 1987). The most widespread analysis methods of the competitiveness of foreign firms in China are the diamond model study, SWOT analysis, the Transaction Costs Analysis (TCA) and different models for assessment of firms' competitiveness.

The main motivation of foreign firms to enter into Chinese market can be looking for new markets, seeking natural resources, restructuring existing production through rationalization and finding strategically related assets (Chen&Reger, 2006). The important point in the discussion about the operation of European firms in China is the differences of market potential and cultural differences between Europe and China. Carlsson, Nordegren and Sjöholm argue: „Western firms locating in China face a business environment that differs from their home country environment. The differences increase uncertainties and are negative for economic performance” (Carlsson et al., 2005. p. 21). Chinese market is attractive for foreign firms because China is a rapidly growing economy and its domestic demand is growing. China's GDP in the first decade of 21st century grew at least 8% per year and China has more than 1,3 billion potential customers (OECD, 2011).

Since 1979 there are currently almost 660,000 foreign investment projects in China from over 150 countries, contributing to almost one-third of China's industrial outputs and 56 per cent of its total exports in 2010 (Chang & Park, 2012). Local firms form a substantial competition in Chinese market: local competitors challenge foreign multinationals with low costs, managerial flexibility and extensive distribution networks (Hexter & Woetzel, 2007). Liao and Yu have found that the performance of foreign firms in China can be improved by both knowledge transfer from local suppliers and regulatory support from local governments (Liao & Yu, 2012). The transfer of local suppliers' knowledge can be encouraged by moral and pragmatic interpartner legitimacy but regulatory support can be advanced, if business development of foreign firm is in line with the interests of local government that might be creating the prosperous future and stimulating economic development. The firm entering Chinese market may face a number of obstacles that affect the operation of firm: government intervention, cultural differences and manage those differences, highly competitive and unpredictable business environment (Zhao et al., 2012); the Chinese government forced foreign firms to establish joint ventures with local firms as a condition of market access (Chang & Park, 2012). China's 12th Five-Year Strategic Plan is related to opportunities and risks for operation of foreign firms in China because it provides to rebalance the economy by encouraging domestic consumption, developing the service sector, shifting to higher value-added manufacturing, conserving energy and cleaning up the environment (Casey & Koleski, 2011). The Comprehensive work plan of energy conservation and emission reduction during the Twelfth Five-Year period is scheduled.

The competitiveness of Latvian firms in China can be assessed applying one of the models of firm competitiveness. A number of characteristic aspects of Latvian firms should be taken into account choosing a competitiveness model for assessing of Latvian firms' competitiveness in China. Firstly, Latvia has a great number of small and medium sized enterprises (SME). The proportion of the SME in total number of Latvian enterprises was 99,7% in 2008 (Central Statistical Bureau). Secondly, Latvian firms have short experience in the operation in foreign markets and relatively short experience in the internationalization of business compared with firms from Western Europe. Latvia is an independent country since 1991 and Latvian firms operate in the free market conditions and accumulate experience operating in foreign markets since 1990s. It indicates that the model of SME competitiveness can be useful for assessment of competitiveness of Latvian firms in foreign markets. Appropriate model in this case is the SME competitiveness model that is performed by Man, Lau and Chan and developed by analyses of numerous studies on firms' competitiveness. These researchers argue that „the competitiveness studies focusing on large corporations may not be applied directly to the SME level” because „larger and smaller firms differ from each other in terms of their organizational structures, responses to the environment, managerial styles and, more importantly, the ways in which they compete with other firms” (Man et al.,

2002, pp. 128-129). Man, Lau and Chan reviewed the relevant literature on SME competitiveness and summarized three major conclusions. Firstly, models of competitiveness should take the threefold dimensions of potential, process and performance into consideration, although it is necessary to specify appropriate constructs to these dimensions for different contexts and for operationalization. Secondly, the choices of constructs and variables should also meet the characteristics of long-term orientation, controllability, relativity and dynamism. Thirdly, the competitiveness of SME should comprise the four major constructs relating to the firm's internal factors, external environment, influences of the entrepreneur and the firm's performance. The relationship between the constructs, the characteristics and the dimensions of competitiveness are summarized in Figure 1.

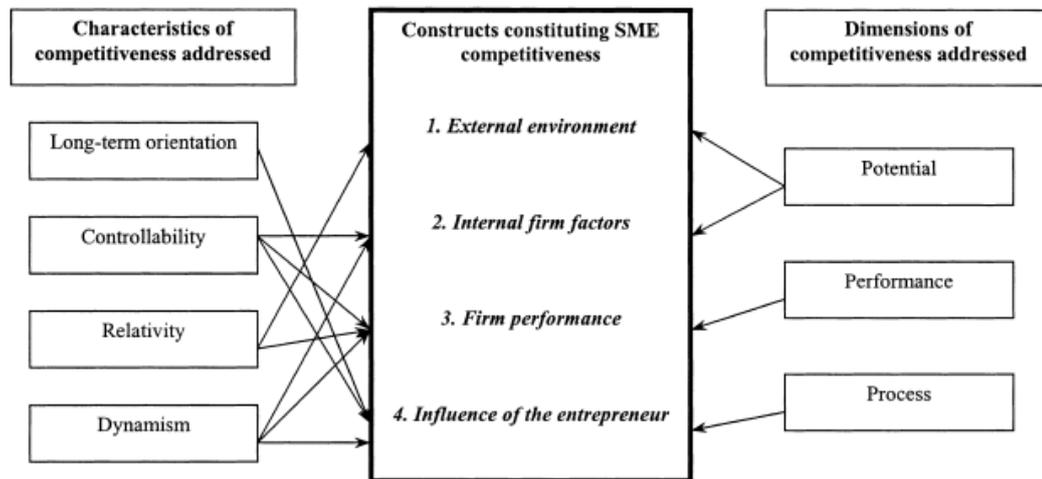


Figure 1. SME competitiveness. The relationship between the constructs, characteristics and dimensions of SME competitiveness

Source: Man T.W.Y. et al., 2002, p. 131.

Internal firm factors are financial, human and technological resources, organizational structure and systems, productivity, innovation, quality, image and reputation, culture, product/service variety and flexibility, and customer service. The external environment is particularly influential in determining the competitiveness of SME because the lack of market power and the turbulent nature of newly emerging markets faced by many SMEs often make them more vulnerable to external influences than larger firms, as MNC. The important feature of SME operation is the influential role of the entrepreneur in affecting the performance of the firm, particularly when the firm remains small. Competitiveness is only a means to an end, that is, the performance of firm. The performance resulting from the competitiveness of SME should be long-term focused than short-term oriented. These principles of constructs as well as the context of the characteristics and dimensions were applied to analyze 3 round table discussions that were conducted from June 2011 until March 2012. The topics of the round table discussions were the competitiveness of Latvian firms in China and the export performance of Latvian firms to East Asian countries. All round tables were noted and transcribed for data analysis. The participants of the round table discussions were experts on East Asia issues, policy makers whose work with export promotion as well as representatives from firms which operate in Chinese market or are planning to enter into Chinese market.

Operation of Latvian firms in China

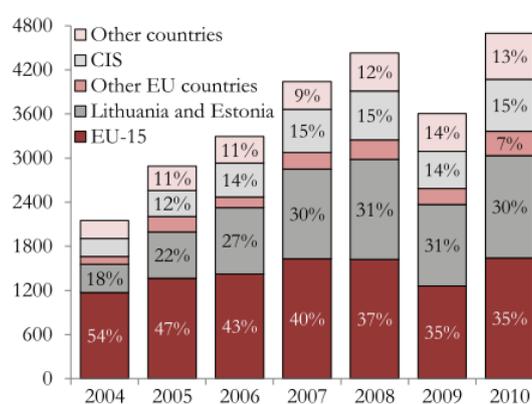
The competitiveness of Latvian firms in China and export to China are important for several reasons. Firstly, Latvia has a negative trade balance with China. In 2010 the export from Latvia to China was 8,6 times less than the import from China. The export volume was 25 million EUR in 2010 (Table 1). The export to China accounted 0,4% of total Latvian export volume in 2010 which is the 28th greatest export market for Latvian companies.

Table 1. Trade balance between the Republic of Latvia and the People's Republic of China 2004-2010

Year	Export	Import
2004	10 644 726	88 572 605
2005	10 202 262	128 883 337
2006	19 281 413	190 443 275
2007	22 461 082	350 663 668
2008	27 406 788	364 748 182
2009	15 809 104	141 570 432
2010	25 019 350	216 102 263

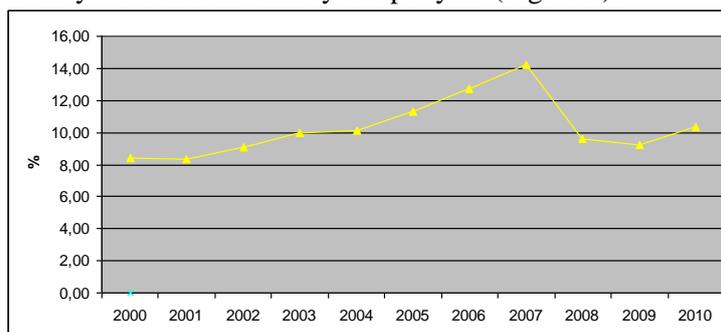
Source: the data of the Central Statistical Bureau

Secondly, it is significant for Latvia to diversify the export markets because the export of Latvian firms to European Union countries (EU-15, other EU countries, Lithuania and Estonia) accounts 72% from total export volume (Figure 2). Increasing export to the Chinese market is the opportunity to diversify export of Latvia.

**Figure 2.** Structure of Latvian export by groups of countries, 2004-2010 (million LVL)

Source: Economic Development of Latvia. Report., 2011, p.21.

Thirdly, Latvian firms do not use sufficiently the growth of China to boost their export. In 2010 China became the second largest economy in the world and its growth continued during the global economic downturn: in 2008 China's GDP grew by 9,6% and in 2009 it grew by 9,2% (OECD, 2011). China's GDP in the first decade of 21st century increased at least by 8% per year (Figure 3).

**Figure 3.** China real GDP growth, 2000-2010

Source: the data of the OECD

According to the model of SME competitiveness performed by Man, Lau and Chan, the SME competitiveness consists of four constructs: external environment, firm's internal factors, influences of the entrepreneur and the firm's performance. The empirical data of the research is analyzed basing on these constructs. The empirical data is obtained and summarized conducting 3 round table discussions that were attended by 23 experts on East Asia issues, policy makers whose work with export promotion as well as representatives from firms which operate in Chinese market or plan to enter into Chinese market.

External environment. An expert with more than three years work experience in China and more than three years experience in promotion of international economic relations argues that „the number of Latvian

firms operating in China is low because the registration procedures are very long and complicated in China which makes it difficult to start business in China” (The University of Latvia the Faculty of Economics and Management, 2012). One of the best ways for firms to promote export to China is establishing its own office in China in order to access directly contacts in China and to provide better opportunities for trade. Experts of the round table discussions noted that China for Latvian firms is far and obscured market, the patent issues are important in China as well as the business culture and business conditions differ in China. Experts from the Latvian government institutions working with the promotion of economic relations with China said that companies can use the official government visits in China to build contacts with partners in China but the number of firms interested in this opportunity is low; Latvia has very good political relations with China but the economic cooperation between both countries are with low intensity (The Ministry of Foreign Affairs of the Republic of Latvia, 2011). The disadvantage is that there are not visa-free regime between Latvia and China, excluded Hong Kong and Macao, which complicates the operation in Chinese market.

Internal environment. The expert with more than three years working experience in China and more than three years working experience in export promotion to China finds that “the Latvian foreign service support Latvian firms strongly but the problem is that firms have the lack of skills to use these opportunities” (The University of Latvia the Faculty of Economics and Management, 2012). Firms entering Chinese market have to use not only governmental support but also other professional assistance – the solutions of banking and legal services. Experts argue that Latvian firms do not have a deep knowledge and experience about Chinese market. The establishment of own office in China is important for successful business in China but Latvian firms have difficulties to provide it as well as Latvian firms have lack of funding for marketing entering Chinese market. The entrance to China market is easier for internationally well-known firms rather than for small and internationally unknown firms, as most of the Latvian firms. Experts emphasized that Latvian firms have the difficulties to provide necessary volume of export to China.

Influence of the entrepreneur. The head of food company with over 5 years working experience in the export organization believe that that “important motivation for the firm to enter the Chinese market is the need to diversify export markets because Latvian firms have experienced in the past that a large share of firm’s export in one particular foreign market from total firm’s export may have negative effect on the long-term performance of firm” (The Investment and Development Agency of Latvia, 2011). Latvian entrepreneurs lack knowledge about China as well as they lack experience and skills for operation in Chinese market. The preparatory work made by entrepreneurs before entering the Chinese market is insufficient therefore they loose their investments in China. The entrepreneurs can use the appropriate support from the institutions of European Union in China in order to enter into Chinese market but entrepreneurs do not know about these opportunities or don’t use good enough them.

Firm performance. The export volume of Latvian firms to China was 25 million EUR in 2010 that was one of the lowest among member states of the European Union in 2010. The competitiveness of Latvian firms in China is insufficient because export to China constitute 0,4% of total Latvian export and more than half of the export was export of raw materials (Table 2).

Table 2. Latvian export to China by commodity groups in 2010, EUR

Commodity groups	Volume (EUR)	Share of total export to China (%)
Metals and metal products	9 687 086	38,72
Mineral products (peat)	3 554 804	14,21
Vegetable products	3 159 030	12,63
Machinery and mechanical appliances, electrical equipment	1 881 223	7,52
Various manufactured goods	1 444 276	5,77
Chemical industry	1 263 867	5,05
Wood and wood products	1 093 963	4,37
Plastic products, rubber and rubber products	951 317	3,80
Vehicles	857 414	3,43
Optical instruments, clocks, music products	523 316	2,09
Textiles and textile goods	375 290	1,50
Others	227 764	0,91
Total	25 019 350	100,00

Source: the data of the Central Statistical Bureau

Expert who works in promotion of Latvian export to China gave an example that “appealing to the food companies to bring their goods in China, these companies did not have the capability to register their products in China because the main obstacle is that it is very difficult to find partner in China who really wants to distribute Latvian goods in China” (The University of Latvia the Faculty of Economics and Management, 2012). The representatives from governmental institutions underline that perspective sectors for Latvian export to China are food, pharmaceutical goods, services (tourism, IT products). The choice of these perspective sectors are not based on research. Expert with more than 10 years working experience in the promotion of cooperation between Latvia and China argue that the Chinese language skills do not guarantee success in China, but it can facilitate the entrance in Chinese market.

Conclusions

The competitiveness of Latvian firms in China has not so far been sufficiently studied as well as there are lack of studies how to increase the competitiveness of Latvian firms and entry opportunities in China. The structure of Latvia’s export shows that Latvian firms have low volume of export to fast growing markets, the most promising of which is rapidly and steadily growing Chinese market. China’s GDP in the first decade of the 21st century increased at least by 8% per year giving opportunities for Latvian export to China but these opportunities is insufficiently used – Latvian export to China was 25 million EUR in 2010. The competitiveness of Latvian firms in China is insufficient because the annual export of Latvian firms to China in the period from 2004 to 2010 was at least 8 times less than import from China, the export to China accounted 0,4% of total Latvian export volume in 2010 as well as more than a half of the export was export of raw materials.

Three round table discussions on Latvian export and the competitiveness of Latvian firms in China were analyzed in the paper. The round table discussions were assessed applying the model of SME competitiveness performed by Man, Lau and Chan. According to the model the competitiveness of firms is characterized by external environment, internal firm factors, firm performance and influence of the entrepreneur. Latvian firms have difficulties to enter Chinese market and they are insufficiently active in using existing export support opportunities to enter the Chinese market. The main obstacle for Latvian firms in entering the Chinese market is inability to register their company and products in China as well as the lack of resources to provide own representative in China. To improve the competitiveness of Latvian firms in China, the firms have to enhance knowledge, skills and capabilities for the operation in the Chinese market. Firms have to invest more resources in activities which promote their entrance to Chinese market.

The limitations of the research are related to the fact that the empirical material consists of round table discussions but there was no other quantitative or qualitative data gained in empirical way. The wider range of the quantitative or qualitative methods should be used in studies in the future to analyze the competitiveness of Latvian firms in China.

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