
Hitachi Construction Machinery: Becoming a Wholly Owned Chinese Entity

8

8.1 Introduction

In 1995, Hitachi Construction Machinery Co., Ltd. (HCM) established a Chinese subsidiary, Hitachi Construction Machinery (China) Co., Ltd. (HCMC). Since then, the company has established close relations with the city of Hefei in the Anhui Province and has steadily built a strong business reputation of being a quality committed local firm. HCM's operations in China began as a joint venture (JV) with a local, state-owned firm, Hefei Mining Equipment (Hefei Mining). Later dissolving this JV, HCM now operates as a wholly owned subsidiary. HCM's China business is often cited as a successful example of a global business, although the road to acquiring that success was not often smooth and included negotiations with the JV partner and the creation of an internal management system.

In 1970, HCM spun off from Hitachi Ltd. to become an independent construction machinery manufacturer. It currently holds the world's third largest market share in construction machinery manufacturing following Caterpillar and Komatsu (Table 8.1).

Apart from HCM's widely popular hydraulic excavator, the company is also globally known for its other construction machinery, such as wheel loaders, mini excavators, dump trucks, cranes, and forklifts. The company does not rely too heavily on demand from any one specific region, and its sales headquarters in Japan manage operations in six regions throughout the world, in addition to Japan: North America, EMEA (Europe, Russia, and the Middle East), China, Asia-Pacific, India, and Africa (as of October 2012).

Responsible for this global expansion is the powerful "Made by Hitachi" brand that delivers the same quality no matter its country of origin. Along with the increase in headcount as a result of the group's overall expansion, HCM has built an education system for global employees and has aggressively attracted employees from overseas companies to its research institute in Kasumigaura, Japan, built in 2007. The Kasumigaura Institute offers programs for language instruction, development

Table 8.1 Global construction machinery manufacturers' revenue (fiscal year 2011)

Company	Revenues (100 millions of yen)
Caterpillar	15,734
Komatsu	18,431
Hitachi Construction Equipment	7,738
Volvo Construction Equipment	7,279
Case New Holland	3,038

Source: Corporate annual reports

Table 8.2 Hitachi Construction Machinery's revenue by region

Units: M yen	2004	2005	2006	2007	2008	2009	2010
Japan	150,029	203,425	238,549	248,733	213,703	171,700	172,700
US	91,490	119,222	125,129	88,518	79,178	37,200	62,400
EMEA	92,304	132,647	195,209	291,942	180,843	97,000	131,600
APAC	75,423	103,608	126,280	184,021	151,148	141,200	202,400
China	38,797	67,555	71,286	127,323	119,295	158,700	204,800
Total	448,043	626,457	756,453	940,537	744,167	605,800	773,900

Source: Hitachi Construction Machinery Co., Ltd

of overseas application skills, and strengthening in areas of specialization. In addition, the increasing demand in emerging markets has accelerated the transfer of production technology to overseas manufacturing locations to reduce costs. In 2005, HCM created the "Global Production Improvement Headquarters," sending welders and other skilled technicians to visit foreign plants and partner companies to improve quality. Seen from a company-wide perspective, in 2011 HCM's global operations remained high, with overseas sales constituting 75 % of its total. However, the Chinese share of overseas revenue is the largest; therefore, making it a strategically important market for HCM (Table 8.2).

8.2 Hitachi Construction Machinery (China) Co., Ltd

8.2.1 Background

Since the latter half of the 1980s, HCM has implemented a global strategy of expansion by creating sales and manufacturing bases in North America, Europe, and Asia. The construction machinery market in the 1980s was dominated by Chinese-made hydraulic excavators that sold for CNY 400,000 apiece. By comparison, HCM's hydraulic excavators were CNY 800,000. However, Chinese excavators did not meet customer requirements in China; therefore, second hand excavators by Japanese manufacturers are imported and mainly used in China. In the beginning in

the 1990s, HCM was attracted to China not for its factories, but for its markets, because it anticipated strong Chinese economic development. After evaluating manufacturing sites in China, HCM established a list of candidates in several regions. Around this time, China was coming off Deng Xiaoping's Southern Tour Speech, which for the city of Hefei meant pressure to bring in foreign capital. Hefei was searching for a JV partner for the local powerhouse, Hefei Mining. Hitachi was already well known in China at the time and its brand name was the source of government incentive for the JV.

The head of the Anhui Province, Hui Liangyu, as well as Hefei's mayor, Zhong Yongsan, played key roles in the initial stage of HCM's into China. Former Deputy General Manager of HCMC, Norio Hirota, noted the fervent invitations of Mayor Zhong to HCM (Japan Association for the Promotion of International Trade 2004):

As China began to attract foreign capital, Mayor Zhong approached Qiu Yonghan, known for being highly knowledgeable about Japan, serving as an economic advisor to the city of Hefei, while he was on a trip down the Three Gorges, and repeatedly informed him about the level of urgency with which China wanted to bring in foreign capital into Hefei. Because of an introduction from Qiu Yonghan's company, Hefei was included in a feasibility study that listed strong equipment manufacturers. Therefore, a relationship with Hefei began, and Mayor Zhong invited all involved parties to visit our company's factory. Interactions of company executives and the parties associated at the factory, resulted in clearing of any doubts about Mayor Zhong's fervency toward the introduction of foreign capital; it was just as Qiu Yonghan had described. (Interviews with Norio Hirota, July–October 2009)

On witnessing the mayor's zeal and the support system put in place by the city government, Hirota reflected that "the support system of the mayor's city government and its strong leadership was an important factor in our decision to enter into the JV at Hefei, and this became a key to resolving issues that arose later." (Interviews with Norio Hirota, July–October 2009)

For HCMC, the city of Hefei was attractive for reasons other than the mayor's warm invitation. Hefei Mining, a worthy partner for HCM, was located there. In addition, Hefei is the capital of the Anhui Province and government organizations are concentrated there, making it easier to gain necessary approvals to operate a business. Additionally, Hefei has the China University of Science and Technology, a well-respected school, providing not only a readily available quality workforce, but also cheap labor because of Hefei's location toward the interior. Other factors included the ease of distribution due to the presence of a port, proximity to areas in need of construction machinery, and the ease in securing a vast site of 360,000 square meters.

8.2.2 Creation of a Joint Venture

In April 1995, a JV called "Hefei Hitachi Excavating Equipment Co., Ltd." was created in the economic technology development zone outside Hefei, some distance from Hefei Mining. The JV was primarily involved in the production of hydraulic

excavators. The major shareholders were HCM, Hefei Mining, and Mitsubishi Shoji, in addition to Qiu Yonghan's investment company, the Qiu Yonghan Group. The company began with a total of 320 employees, with HCM bringing over 20 expatriates from Japan and 300 employees from Hefei Mining. HCM was responsible not only for sales, manufacturing, production technology, production management, and procurement functions, but was also in charge of management, because it had a 55 % majority stake and had provided the chairman of the board and general manager of the JV. At the time, it was rare for foreign firms to control management of JVs in China, and there were complicated negotiations regarding which side would lead the company. However, these difficulties were overcome through the efforts of the Hefei government. The JV primarily focused on sales and manufacturing of construction machinery. It procured simple parts (plate structures from welded steel plate, for example, booms, arms, and buckets) domestically, and imported all strategic parts (cylinders, engines, and hydraulic pumps) from Japan (Fig. 8.1 and Table 8.3).

Hefei Mining was a typical, large-scale, state-owned company with 2,500 employees with its own dormitories, hospitals, and schools. Although regarded as a quality manufacturer of mining equipment, it was incapable of designing the equipment independently, and the WY-type hydraulic excavators it produced, although less than half the price of Hitachi-manufactured excavators, exhibited poor performance and broke down quickly. With foreign firms' entry into the Chinese market via the market-liberalizing policies of the Chinese government, Hefei Mining's construction machinery quickly lost its market competitiveness. After the merger, HCMC made several proposals to revive Hefei Mining's operations; they also constructed a parts factory for HCMC within Hefei Mining that employed about 300 workers. This parts factory received technical guidance from HCMC. It primarily manufactured plate structures and supplied them to the JV, using production facilities and jigs loaned by HCMC.

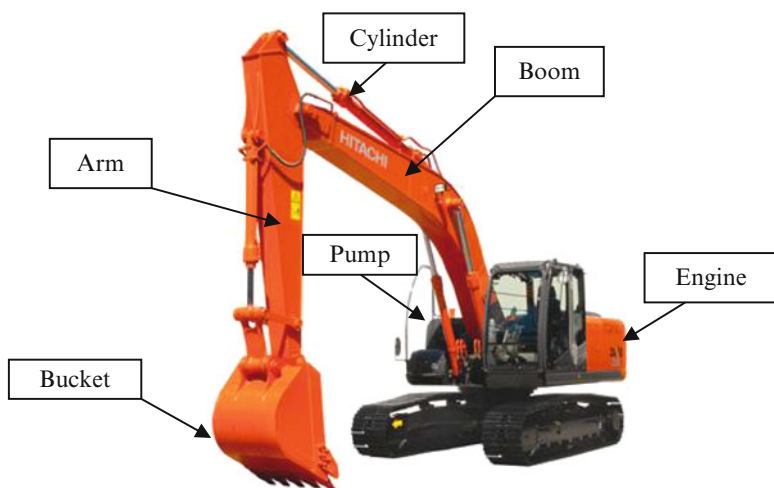


Fig. 8.1 Hydraulic excavator

Table 8.3 Development of Hitachi Construction Machinery (China)

1995	Creation of the joint venture
1997	Change in brand name from “Hefei Hitachi” to “HITACHI”
1998	Conversion from joint venture to wholly owned subsidiary
	Creation of Hitachi Construction Machinery (Shanghai) to provide sales and service
	Cumulative sales reach 1,000 units; operations in black
1999	Kigawa Rijiuro awarded by China’s State Administration of Foreign Experts Affairs
2001	Cumulative sales reach 5,000 units
2002	50 hydraulic excavators exported to Japan
2005	Creation of wholly owned subsidiary, Hefei Hitachi Construction Machinery
	Creation of joint research center with Zhejiang University
2006	Release of ZAXIS60 model for the Chinese market
2007	Creation of Hitachi Construction Machinery Leasing (China) Co., Ltd.; 51 % participation in Qingdao Chengri Construction Machinery sales company
2008	Deputy General Manager Xian Feng selected as National People’s Congress Representative from Anhui Province

8.2.3 Dissolution of the Joint Venture and the Move to a Wholly Owned Subsidiary

Hefei Mining’s operation suffered from poor performance, and profits from the HCMC parts factory were transferred to support the Hefei Mining employees. After completing the JV, Hefei Mining’s anticipated performance gains failed to materialize, and due to a mindset that the perception of JVs would be damaged if state-owned firms acting as JV partners performed poorly, it continued to compensate for Hefei Mining’s deficits, making the JV non-profitable. This continued through the second and third years of the JV, after which HCMC began to work on dissolving it. However, it was not that simple. Hefei Mining had many employees and, as a powerful local firm, many of its former employees worked as executives in the city government. For example, the head of Hefei’s “Foreign Economic Trade Committee,” the Hefei government organization that oversees foreign firms, was formerly the Communist Party Secretary for Hefei Mining. Because Hefei Mining was a large enterprise and there was a danger of its poor performance being reflected over the local economy, the dissolution of Hefei Mining is difficult choice for the local government.

Hirota describes the situation: “The city’s Communist Party Secretary, Mr. Zhong saw that nothing was happening even with intervention of the city government, so he began to help us out of our plight.” (Japan Association for the Promotion of International Trade 2004) Thus, Zhong, who was mayor when the JV was created, began to work toward a solution. The solution was finally achieved in July 1998 wherein the board of directors dissolved the JV agreement. Out of concern of a negative effect on the local economy, the two companies agreed on two measures to support Hefei Mining. The first was not only for HCMC to buy back 25 % of the JV’s shares from Hefei Mining despite the venture’s losses, but to also pay the employee tuition costs. The second was to enter into an agreement to give priority

to Hefei Mining for parts to support the company's production volumes. When reflecting upon on the dissolution of the JV, Hirota mentioned of the deep impression that Zhong's words left on him: "You are now free to make your way in the market without any hindrance, but you will find it difficult!"

As Zhong said, after the JV was dissolved the company ran into various issues, including contract defaults. Hefei Mining was dissatisfied with the price-setting rules outlined in the above mentioned agreement and intentionally made late shipments before finally halting these shipments altogether. Because HCMC had entered into an agreement that did not allow procurement from other vendors, it had a tremendous impact on HCMC's production lines. Therefore, HCMC proved that Hefei Mining breached the contract merely 3 months after signing the agreement and cancelled the prioritized procurement agreement. A failure to maintain standard practices in international trade on the part of Hefei Mining, such as not returning equipment, manufacturing counterfeit HCMC parts, and supplying HCMC parts to other manufacturers, led HCMC to take legal measures and the two companies entered into arbitration. There are two methods in China for legally resolving disputes: litigation in court and arbitration via organizations created for that purpose. Litigation in China is mostly similar to civil litigation in Japan. However, arbitration is not done in court, and when disputes arise decisions are handed out by mutually agreed upon arbitrators. Sales contracts in China generally have conditions regarding arbitration of disputes. In the event that no such condition exists in a sales contract, neither company can request arbitration. Disputes between foreign and domestic firms fall primarily under the Chinese International Economic Trade Arbitration Committee (CIETAC), which took 4 years to pass judgment in the HCMC case, handing down its final findings in 2003. However, under the Chinese system, if the conditions of an arbitration decision are not enacted within 6 months of the decision, then the arbitration decision is no longer in effect and litigation becomes impossible thereafter. HCMC's former JV partner used this to its advantage, not abiding by the decision of arbitration before it expired in August 2003. In the end, HCMC recovered the loaned jigs and manufacturing equipment as the city government forced Hefei Mining's top management into taking action. In addition to these direct troubles with Hefei Mining, company employees close to Hefei Mining disclosed confidential information, thus sabotaging production. Resentful terminated employees forced the company into labor arbitration.

Hirota commented, "We thought a joint venture was a good idea because of the Chinese government's policies for foreign capital introduction at the time, and to secure employees and sales channels, but in reality we faced many troubles with our joint venture partner. Also, because companies do not generally know the inside details of our joint venture partners in China, it can be difficult to ascertain their real financial status. For example, it is difficult for foreign companies selling and producing locally to know the actual production cost of the joint venture's products. This is because the accounting system in China is unique, and the joint venture company normally holds accounting information close to the vest."

8.2.4 Post-joint Venture Management

HCMC worked on product quality control, developing their resellers, and understanding market needs while expanding their business in China. Because it provided thorough direction on technical and quality issues from the time its subsidiary was created, currently, from a technical perspective, the welding, assembly, and other areas in its Chinese products are indistinguishable from its Japanese counterparts.

Because of briskness of demand and a skyrocketing used-vehicle market, work previously done with small- and mid-sized hydraulic excavators was accomplished through the use of mini excavators, making HCMC's operating environment extremely difficult; Japanese-style excavators did not fit the needs of the Chinese market, and so, with the cooperation of its distributors, HCMC researched on how customers were using their equipment. The result of this research was the development of the ZAXIS60 mini excavator, specifically designed for the Chinese market. The ZAXIS60 has the durability of a mid-sized excavator, increased horsepower, a faster front arm, and other features that reflect the needs of Chinese operators more closely. This Chinese model has been received well, resulting in the company being able to increase its market share in the mini excavator market, which was previously an oligopoly by Korean manufacturers.

Although the company had huge operating losses at the outset of its establishment, as a result of the above efforts, HCMC realized an annualized profit within 3 years (1998). In the decade between 1998 and 2008, revenues grew dramatically. Even in the initial stages when the company's revenues were small, its market share stood at 30 %. The company sold only 30 units in 1996, growing to more than 5,000 in 2003. However, due to tighter auto loan policies, including loans for construction machinery implemented by the People's Bank of China in 2004 and 2005, the number of units subsequently sold dropped to around 3,500. Yet, sales figures recovered after 2006, and the company sold more than 10,000 units in 2008. HCMC expanded production in 2008 due to a lack of capacity; however, with the impact of the economic crisis in the fall of 2008 and the wearing off of the Chinese government's measures to bolster the economy, production of equipment in recent times has been sluggish.

HCMC succeeded in producing low cost machinery at the same level of quality expected in Japan; this has been a source of strength for HCMC overall. In 2007, HCMC began exporting products to other countries, and has made many innovations toward technological improvement and personnel development, such as creating a school for technical development and sponsoring a skills competition. The Hitachi Technical School is a joint collaboration with a local vocational training school that provides training for second- and third-year students. In their first year, students learn the basics, such as reading design drawings and welding in theory, while in the second year they are taught to weld (lean practice) and other work. In 2008 the school received more than 1,000 applications, out of which it accepted 200. Graduates are given priority placements at HCMC. In addition, since 2007, HCM has sponsored an annual international skills competition that includes all factories in HCM group companies worldwide. In 2008, measuring and painting events were included.

When running a JV in the Chinese market, companies often use the sales channels of their JV partner. However, because HCMC became a wholly owned subsidiary, it had no sales network, and therefore the process of creating resellers was cumbersome. Customer service creates future demand, however, because Chinese resellers were unaware of the concept of customer service that exists in other countries, HCMC needed to exhaustively teach its resellers that service was something that was directly tied to revenue. In the early stages, 80 % of its resellers were state-owned businesses that thought of customer servicing as incomprehensible and subsequently, but they are dropped out from HCMC partners. In 1998, HCMC split its manufacturing and sales functions, creating HCM Shanghai (HCMS), which manages 28 resellers. As an incentive, HCMS has 1-year agreements with each reseller. Operating times for hydraulic excavators in China have increased to 20 h daily, including weekends, a figure much higher than in Japan. The company has placed service personnel at each reseller, sending these personnel to repair broken down machinery, a system that was set up to meet the needs of customers requiring immediate repairs. In 2008, for the first time, HCMC invested in a Shandong reseller, Qingdao Chengri Construction Machinery Co., Ltd., and is in the planning stages of creating a direct sales structure. Elle Construction Machinery (Tianjin) Int'l Trade Co., Ltd. imports HCM machinery to China, catering to those customers who insist on having "Made in Japan" products. As a means of further expanding its sales channels and retaining customers, HCMC created the Hitachi Construction Machinery Leasing (China) Co., Ltd. Direct purchases are currently the most common way to purchase machinery in China, and leases make up only 10 % of sales. In Japan, however, the reverse is true, with 70 % of acquisitions made via leasing. Late lease payments are increasing due to the economic crisis, and bad debt prevention is a concern.

As of October 2012, HCMC had almost ten subsidiaries and affiliated companies in China, each of which is managed by the China division at HCM's headquarters (Fig. 8.2).

8.2.5 China's Business Environment and Its Risks

The complexity of running a business in China generally boils down to "sudden policy changes," especially the frequent changes in customs inspection standards. When importing an engine into China, one must file monthly applications, even though the annual total number of engines is already established. Thus, a sudden change in policy may cause the number of permissible imports to be lower than the previously set annual total. Also, even though imports may have tariffs levied on them as finished goods, the tariff rate is often left to the whim of the customs officer. China also poses land use risks. For example, although a company may have a 50-year lease agreement to use a property, it may suddenly be asked to return the property. Preferential policies set by local governments are also subject to risk, which may be eliminated by central government policies. Hirota explains "I learned the importance of maintaining relationships through the many troubles we faced

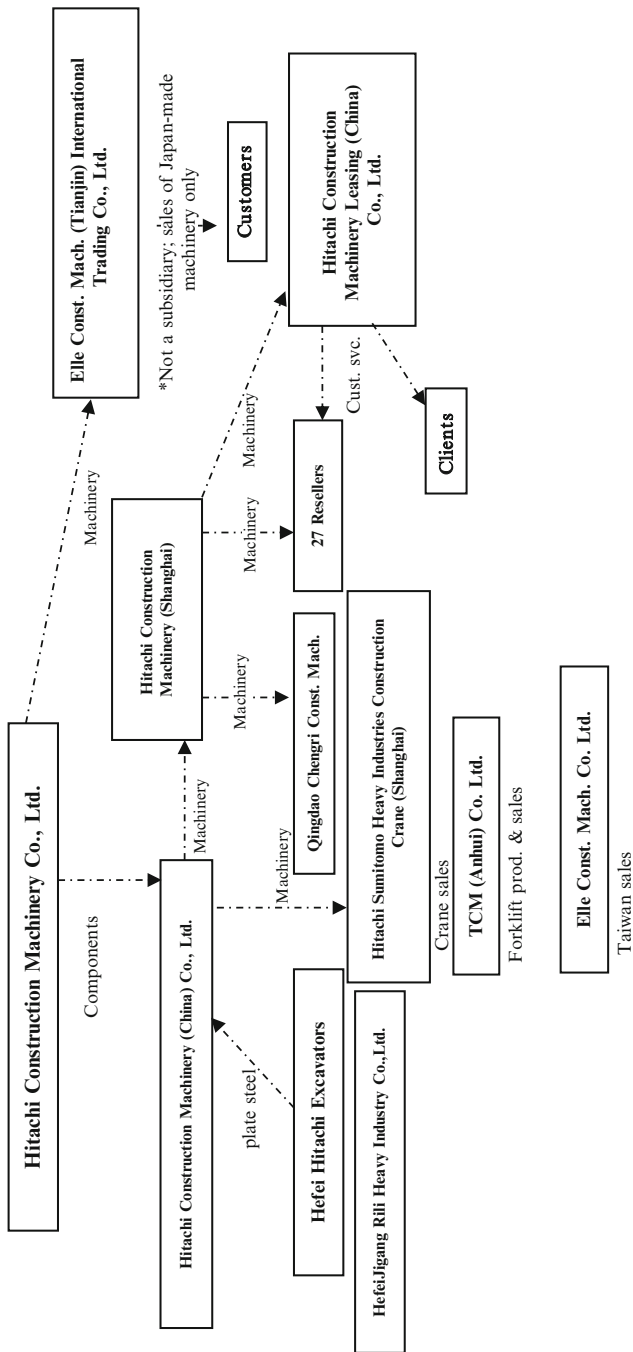


Fig. 8.2 Structure of HCMC and its subsidiaries (*Source:* Interviews with Hitachi Construction machinery personnel)

and while confronting various risks.” To build relationships based on trust, Central government officials must be treated cordially on their visits. Compensation standards must be clarified to employees, with employee benefits made available to them according to Chinese practices (such as the distribution of moon cakes in mid-autumn). HCMC was one of only five companies recognized as an A-grade business by the Anhui Province Taxation Bureau for its efforts in maintaining good relationships with local government and employees. This made things convenient for the company in a number of ways. Hirota says, “We can solve most issues through our networking and legitimate activities.”

Aside from “sudden policy changes,” China presents risks in regard to debt collection. Construction machinery products in China are often sold in installments, and many customers do not pay even if they have the cash to do so. HCMC has fought exhaustively to obtain payment through litigation. The advent of GPS monitoring systems made possible through recent technological advances, allows HCMC to remotely monitor the location and operating information of its equipment. Therefore, in case of delayed customer payments, HCMC can have its equipment as inoperable. The company also set a down payment of 30 % in an effort to reduce non-payment.

Protecting intellectual property is an increasingly important issue for conducting business in China. The country as a whole has a low awareness of the necessity of protecting IP, which has become a constraint on the sale of new products. For example, because the number of quality local parts manufacturers is limited, a parts manufacturer may supply multiple customers. Sometimes price, design, or other information may leak from these suppliers to competitors. Preventing these technological leaks by former employees is also an important issue. Dealing with this problem is difficult; HCMC employees are rigorously trained and are required to sign non-disclosure and non-compete agreements.

8.3 Global and Chinese Construction Machinery Markets

The internationally highest selling five types of excavating and loading machinery are as follows: hydraulic excavators, mini excavators, wheel loaders, bulldozers, and backhoes. Of these, hydraulic excavators have the largest share. Since 2008, due to urban infrastructure and resource development in China, India, and other emerging nations, global demand for hydraulic excavators has risen sharply. These countries have more than a 60 % market share, which now dwarfs that of Japan, North America, or other developed markets (Fig. 8.3).

Evidently, whether a construction machinery manufacturer succeeds is absolutely dependent upon its success in China and other emerging markets. HCM ranks third in global sales. Caterpillar, ranking first, is strong in transportation equipment such as wheel loaders, but weak in hydraulic shovels. HCM, on the other hand, is overwhelmingly strong in hydraulic excavators, but weaker in transportation equipment. Number two Komatsu’s strength lies in its optimum balance of products in its portfolio.

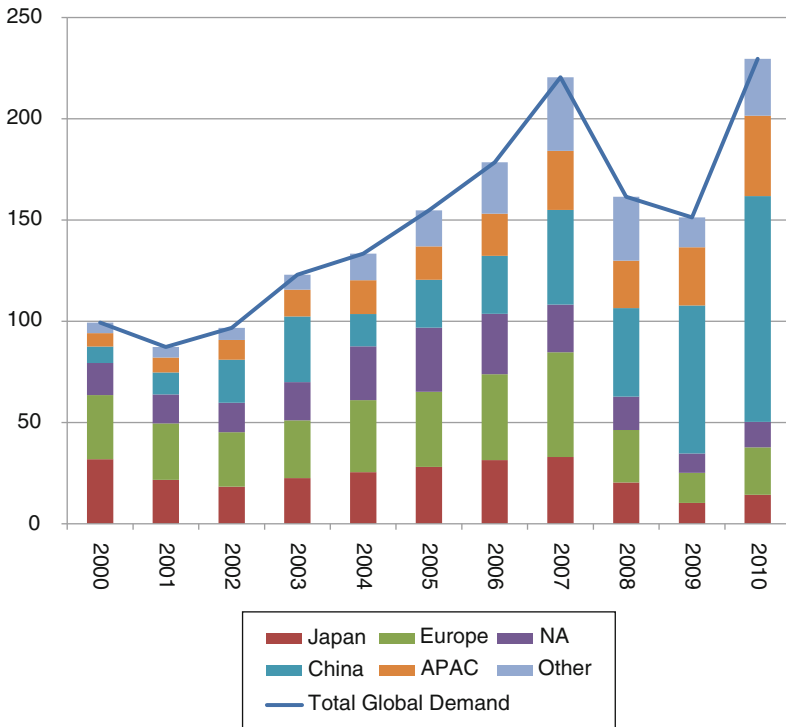


Fig. 8.3 Global demand for hydraulic excavators (units: in thousands) (Source: Hitachi Construction machinery)

In examining country-wise demand for hydraulic machinery, China has the largest market for hydraulic excavators in the world. Demand for hydraulic excavators diminished somewhat in 2009 due to the 2008 economic crisis, although the impact of the crisis was set off by the Chinese government’s economic policies (infrastructure construction in the country’s interior). In examining region-wise demand structures, the Huadong region, including its coastal areas that are experiencing ongoing development, has the largest market. However, it is expected that future demand will originate from the interior sources such as large government development projects in western China and plans to promote growth in northeastern China. These trends are becoming particularly evident in light of lessened construction demand from export bases along the coast due to the recent economic crisis (Fig. 8.4).

In terms of competition for the Chinese market, Japan clearly has the largest share, dueling with its second place counterparts in South Korea (Doosan Infracore and Hyundai Heavy Industries). Hyundai Heavy Industries’ share of the six-ton-or-larger hydraulic excavator market dropped significantly between 2002 and 2008, with Komatsu gaining some market share during that period. As of 2008, HCM held a market share of slightly less than 20 %, Komatsu of more than 20 %, and Doosan Infracore, Hyundai Heavy Industries, and Caterpillar each held between 10 and

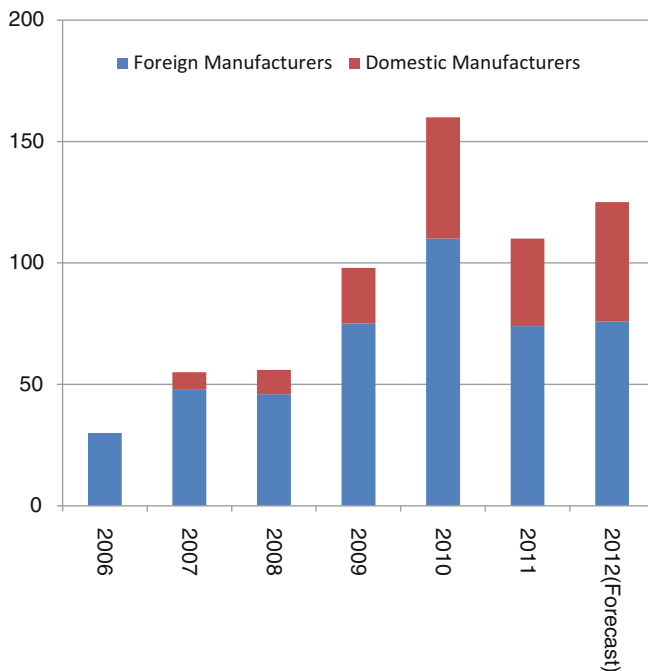


Fig. 8.4 Chinese demand for hydraulic excavators (units: in thousands) (Source: Hitachi Construction machinery)

20%. In the less-than-six-ton hydraulic excavator market segment, in which Doosan Infracore had a virtual monopoly, Hyundai Heavy Industries, HCM, and Komatsu increased their market share from 2002 to 2008, while that of Doosan Infracore dropped dramatically. As of 2008, Hyundai Heavy Industries and Doosan Infracore each had a 30% market share, while HCM had nearly 20% and Komatsu less than 10%. As seen from these figures, Komatsu is HCM's largest competitor in China in the six-tons-or-larger segment, while Doosan Infracore and Hyundai Heavy Industries are the largest competitors in the less-than-six-ton segment. Komatsu has a long history in the Chinese market, first exporting finished products to China in the 1950s and subsequently working to help state-owned enterprises on technology improvements during the late-1970s through the mid-1990s. Their serious efforts to enter the Chinese market began in 1995, with the creation of three JVs around that time: Komatsu Changlin Construction Machinery Co., Ltd. and Komatsu Changlin Foundry Corporation, both with Changlin Co., Ltd.; and Komatsu Shantui Construction Machinery Co., Ltd. with Shantui Construction Machinery Co., Ltd. Komatsu currently has eight production facilities in China, procures most of its parts locally, and is dramatically increasing its share in the Chinese market. However, Komatsu also faces issues, such as slow decision-making, due to the JV arrangement and sales channel distribution problems resulting from using the JV sales network. Doosan Infracore belongs to the Doosan Group and is a Korean manufacturer

of construction machinery. In 2007, the company announced its mid-term goal of becoming the world’s third largest construction machinery manufacturer after Caterpillar and Komatsu by 2012. Within Korea, Doosan competes with the general heavy industries manufacturer, Hyundai Heavy Industries.

In addition to foreign firms, local companies in China have increased their competitiveness. This is due to startups being established by engineers from former foreign firms, the purchase of strategic parts, and the supply of low cost parts. The market share of these local firms has risen to 20–30 %. For example, Sany Group Co., Ltd. is a large construction machinery manufacturer that looms as a fierce competitor. Sany Group is a private company listed on the Shanghai Stock Exchange. In 2007, the company planned to construct factories in India and the state of Georgia in the US. Sany focuses on research and development, and has more than 2,000 employees dedicated to R&D, which is about 10 % of its total employees. In addition, it pays higher wages compared with other companies in the industry, and is said to attract top talent.

8.4 A Company with Balanced “Hardware,” “Software,” and “Regions”

HCMC has steadily improved its performance to date, although it faces barriers to achieve further gains. In addition to Komatsu from Japan, the Korean companies have focused on small-sized excavators, and apart from the world’s largest construction machinery manufacturer, Caterpillar, other local companies such as Sany Group are becoming strong competitors within the Chinese market.

Ever since the economic crisis, Sichuan redevelopment construction and government economic stimulus measures worth four trillion yuan (approximately JPY 56 trillion) for projects such as public works infrastructure in the Sichuan Province, the demand for construction machinery has increased in the country’s interior. However, HCMC’s resellers have a weak presence in the interior, which has caused a drop in market share. Furthermore, an increase in demand stemming from public works investment in China ceased, causing a larger than anticipated drop in demand for construction machinery.

According to HCMC’s general manager, “the question of which is better, a JV or wholly owned subsidiary, depends on the JV partner. We had disagreements with our partner, and therefore chose to create a wholly owned subsidiary, but I think there are positives to a JV if one can find a good partner. For example, foreign firms find it difficult to obtain information regarding contracts for public works projects, and a company with a JV partner might be able to win more contracts.”

Another issue is the best use of high-quality workforce. For example, when HCM implemented finance and accounting systems in China, a young Chinese employee was sent to Japan for 4 months. Before his visit, the employee understood no Japanese, but studied Japanese during the non-working hours during his 4 month stay, learning to read and write the language for the most part. China has many human resources who possess a strong desire and extensive ability to learn, and using them well has many advantages for HCM on a whole.

HCM Global is expanding production not only in China, but also in the emerging markets such as Indonesia and India. In September 2007, the company built a manufacturing facility in Indonesia for ultra-large hydraulic excavators used in large structures in the Cibitung plant that has operated since 2001. In India, HCM sells hydraulic excavators through Tercon Construction Equipment as a JV with the Tata Group (of which HCM has 40 % ownership). This venture has approximately 50 % of the Indian market. In March 2010, HCM increased its ownership in the JV to 60 %, and has aggressively begun to operate as a subsidiary within India.

HCM's 2011–2013 mid-term plan titled “Go Together 2013” lists the three axes of its management foundation: hardware (products), software (services), and regions. The plan states that a balanced strengthening of these axes is critical.

The theme of the first axis “hardware” is “strengthening what is already strong.” For example, the company aims to further improve the development, production, sales, and service capabilities of its cornerstone product—hydraulic excavators—and thereby accelerate its growth. In addition to hydraulic shovels, the company aims to increase its competitiveness in mini excavators, wheel loaders, dump trucks, cranes, and forklifts as its next cornerstone product. Due to increased awareness of rising energy prices and global environmental issues, HCM aims to focus on the development of energy-saving technologies. In terms of “software,” HCM aims to differentiate itself from its competition by providing a total solution that combines qualities of all its group companies in system sales, repair services, rentals, used and refurbished equipment, financing, and logistics.

Finally, HCM aims to strengthen its sales and service network and expand its market share in emerging markets, or “regions.” To quickly provide products that precisely respond to market needs in each region of the world, HCM is aiming toward the localization of its business by locating engineers throughout the world. They are exploring diversity in its organizations, including new human resource systems that provide positions to quality local personnel. Caterpillar, Komatsu, and other global players are also committed to emerging markets, and Korean firms must be analyzed closely, due to their low cost strategies. For the HCM group, moving ahead toward the localization for each country and region may lead to decentralization of management resources. HCM stands at a strategic crossroads as it moves forward with global-minded management, whether to further strengthen its response to the Chinese market that accounts for a large share of its global revenues or to make long-term investments in regions such as India.

8.5 Importance of This Case Study and Suggested Questions

HCMC entry into the Chinese market started as a JV with a local firm. However, it is an important case study from the standpoint of a company that ultimately became a wholly owned subsidiary after facing several drawbacks, the process of which has been depicted vividly. It unfolds the realities of the post-hoc JV risks, as explained in Chap. 7. HCM perhaps did not have the option to set up operations in China as a

wholly owned subsidiary because companies entering the Chinese market in the mid-1990s did so at the behest of the government. This situation is far widely different from the foreign capital deregulation that companies enjoy today, but it nevertheless provides valuable information to global companies as they consider how to balance reducing market entry risk as a JV versus the increased risk they experience from entering into the JV.

There are hints to be gleaned and considerations to be made regarding the necessity of alliance strategies in light of increasing competition between foreign and local firms. Furthermore, HCM operates worldwide, and not just in China. This case study provides the basis for further reflection regarding the positioning of Chinese operations and the integration of management strategies on a global level.

Using this case study, the following questions can be considered to further deepen the understanding of global strategy.

- What are the various strengths and weaknesses of JV's and wholly owned subsidiaries as a company expands into foreign countries?
- What did the mayor of Hefei mean when he said, "You will find it difficult!" after the HCM JV was dissolved?
- As competition with other foreign and local firms increases, what strategy should HCMC pursue?
- For HCM overall, should its focus be on strengthening operations in China or in Indian and other emerging markets?

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Reference

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