

Are Chinese Companies the Next Generation of Multinational Corporations? Lenovo vs. Sony in the Global PC Industry

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Abstract

This research examines Chinese outward FDI (OFDI) today and Japanese OFDI in the 1960s. Furthermore, we compare the international expansion strategy of the established Japanese company Sony with emerging Chinese multinational corporation Lenovo in the global PC industry. Our study has important managerial implications for western companies as Chinese firms continue to expand globally.

Keywords: China, Japan, OFDI, multinational companies

1. Introduction

Outward foreign direct investment (OFDI) flows from China increased from \$44 million in 1982 to \$52 billion in 2008, according to the United Nations Conference on Trade and Investment (www.UNCTAD.org). What is even more remarkable is that the volume of OFDI flows from China more than doubled between 2007 and 2008, when the worldwide OFDI flows declined 13% due to the global economic recession (Zhao, 2011). The surge of Chinese companies' outward internationalization has been driven by both China's new role as a capital supplier--- China's foreign reserves hit \$2.4 trillion by the end of 2009 (*China Daily*, February 20, 2010) and by the Chinese government's "go-abroad" policy. According to Rossi and Burghart (2009), the Ministry of Commerce of China (MOFCOM) has published its first guiding catalogue for Chinese companies to invest overseas. As of May 1 2009, only outbound investments of \$100 million or more require MOFCOM approval. In addition, the State Administration of Foreign Exchange (SAFE) relaxed foreign exchange rules for Chinese companies to provide loans to their wholly or partially owned offshore subsidiaries and eased restrictions for small and medium-sized Chinese companies to expand overseas.

With all these favorable economic and political changes, Chinese OFDI stock remains "tiny" because it only accounts for about 3.4% of its GDP and 0.9% of the world total by the end of 2008. In contrast, OFDI stock from Japan is about 14% of the Japanese GDP and about 4.2% of the world's total. The number is even higher for the United States, where OFDI is 22% of its GDP and 20% of the world's total. In addition, the geographic distribution of Chinese OFDI flow is uneven; more than 80% of it goes to Hong Kong, the Cayman Islands and the British Virgin Islands. Although the largest destination of Chinese OFDI in developed countries is the United States, it accounted only for about 1% of Chinese OFDI in 2006. (Mock, Yeung, and Zhao, 2007).

The low level of China's OFDI to industrial countries has led to the debate over whether Chinese OFDI will follow a different path for OFDI from developed countries and whether Chinese companies will form a new type of multinational corporations (MNCs). Because of the limited number of Chinese MNCs, especially in developed countries, most research (Cai, 1999; Deng, 2004) so far has focused on the general trend and patterns of Chinese OFDI. There are two exceptions. Yang, Kang, and Ke (2007) compared the growth of Chinese and Japanese OFDI at three major historical junctures. They also examined how national institutions, industry structures, and firm resources affect the internationalization of the Chinese company Haier and the Japanese company Matsushita in home appliance industry. He and Lyles (2008) used mini case studies to illustrate the unique liability of foreignness that Chinese companies encounter in the United States. However, both studies emphasized the motivations of Chinese OFDI and provided limited analysis of the strategic positioning of Chinese MNCs in order to succeed in developed countries.

Consequently, the purpose of this study is to shed some light on the business strategy of emerging Chinese MNCs. More specifically, we compare the competitive strategies of the global PC Company Lenovo (China) with Sony (Japan). There are several reasons why Japanese MNCs will provide valuable insights for the growth of Chinese MNCs. First, because of their shared Confucian heritage, Japan and China have similar cultural, belief and value systems. Second, both countries are known for their export-led growth model and fixed exchange rate system in the early stage of economic development. Finally, government support and state-directed industrial policies play a pivotal role in both economies and hence have important implications for the international expansion of companies.

The rest of the paper is organized in the following way. We begin with a macro-level comparison of Chinese OFDI in 2003-2008 with Japanese OFDI in the 1960s, when the economic and political landscapes of these two countries were remarkably similar. Then, we compare the international expansion patterns and business strategies used by the Japanese electronics giant Sony with the Chinese company Lenovo. The managerial implications of the internationalization of Chinese MNCs are provided in the concluding section of the paper.

2. Chinese Outward FDI in the 21st Century and Japanese Outward FDI in the 1960s

According to Eichengreen and Hatase (2005), there are several similarities between China today and Japan in the 1960s. As shown in Table 1, Japan was a high-growth economy in the 1960s; its GDP growth rate averaging above 10 percent per annum between 1965 and 1969. In addition, like China today, Japan's GNI per capita was relatively low: around \$1,660 in 1969. Although the Chinese GNI per capita more than tripled from 2003 to 2008, it was still less than \$4,000 by 2008. Finally, gross capital formation accounted for about 35 percent of Japanese GDP in the 1960s and about 43 percent in China today. In other words, economic growth in both countries during the periods under consideration was fueled by investment in domestic construction.

Table 1. China in the 21st Century and Japan in the 1960s

China	2003	2004	2005	2006	2007	2008
Exports of goods and services (% of GDP)	30	34	37	40	43	35
GDP growth (annual %)	10	10	10	12	13	9
GDP (current US\$, trillion)	1.6	1.9	2.2	2.7	3.4	4.3
Gross capital formation (% of GDP)	41	43	44	45	43	43
GNI per capita (current US\$)	1270	1500	1740	2010	2460	3940
outward FDI flow (current US\$, million)	2,855	5,498	12,261	21,160	22,469	52,150
% of outward FDI in GDP	0.18	0.29	0.56	0.78	0.66	1.21
Japan	1965	1966	1967	1968	1969	
Exports of goods and services (% of GDP)	11	11	10	10	11	
GDP growth (annual %)	6	11	11	13	12	
GDP (current US\$, trillion)	0.09	0.11	0.12	0.15	0.17	
Gross capital formation (% of GDP)	32	33	36	37	38	
GNI per capita (current US\$)	890	1030	1200	1430	1660	
outward FDI flow (current US\$ million)	159	227	275	557	665	
% of outward FDI in GDP	0.18	0.21	0.23	0.37	0.39	

Source: *World Development Indicators, UN World Investment Report, and Japan External Trade Organization*

There are also several differences between China today and Japan in the 1960s. Although both countries relied on international trade as a growth engine, exports as a percentage of GDP in the 1960s were significantly lower in Japan than they are in China today. This may be due to the fact that the decline of trade barrier and transportation cost has made trade much easier than before. In addition, in historical terms, China's OFDI is not that "low": OFDI accounted for less than half a percentage point of the Japanese GDP in the 1960s while China's OFDI reached 1.21 percent of its GDP in 2008. In other words, although tariff-jumping and transportation costs are no longer the deciding factors for outward FDI, FDI remains a very important vehicle for Chinese companies to expand overseas.

Another important difference between China today and Japan in the 1960s is the geographic distribution of OFDI. As shown in Table 2, Japanese companies targeted developed countries such as the US and Europe while Chinese OFDI has been motivated mainly by tax incentives for "round-tripping" to Hong Kong and Cayman Islands (Rossi and Burghart, 2009). That being said, the destinations of OFDI from China and Japan have at least two things in common. First, OFDI from both countries went to destinations that are abundant in natural resources. This is evidenced by Japanese OFDI in Brazil, Indonesia, and Saudi Arabia and Chinese OFDI in Australia and Russia. In other words, resource-seeking is a very important motivation for Chinese and Japanese outward FDI in order to meet the demand of fast-growing domestic markets. Second, both Chinese and Japanese FDI went to countries with high economic growth rates. Consequently, the difference in geographic distribution of Chinese and Japanese OFDI is related to the change in the economic landscape from the 1960s to 2000s. In the 1960s, rebuilding the war-torn economy after World War II made industrial countries the fastest-growing markets. Today, the fastest-growing markets are in emerging not developed countries anymore. As we can see in the last column of Table 2, the average GDP growth rate in the US and Europe was about 7.1% and 4.8% respectively between 1961 and 1968. However, the average GDP growth rate in the US fell to 1.6% and 1.2% in European Union countries between 2003 and 2009. In contrast, the top destinations of Chinese OFDI such as Hong Kong, Russia, South Korea, and Australia had average GDP growth rate between 3.1% and 5.7% in the 2000s.

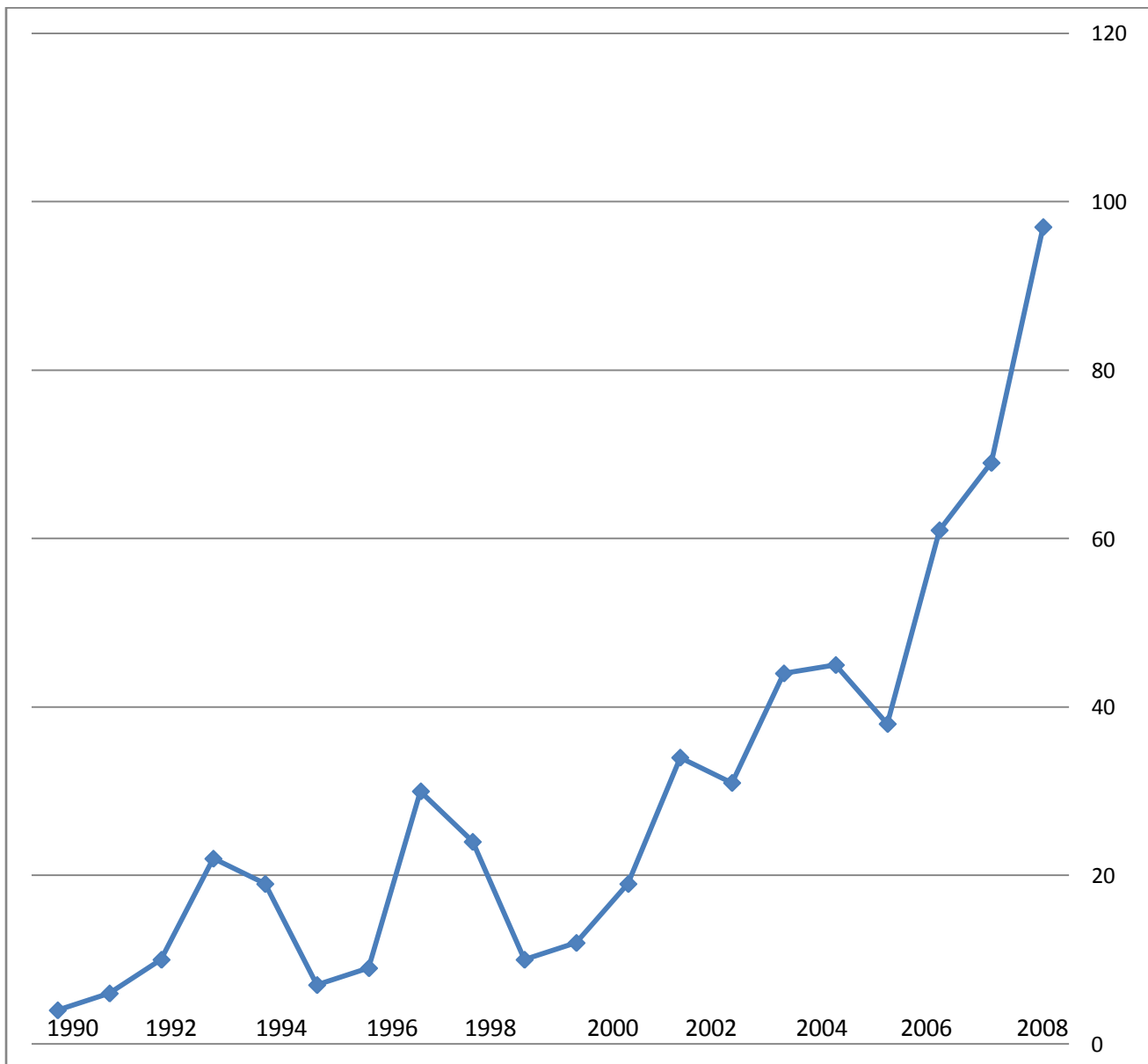
**Table 2. Destinations of Chinese and Japanese FDI
(Percent of total outward FDI)**

	1965	1966	1967	1968	1969	Average GDP growth rate (1961-1968)
Japan						
USA	0.21	0.31	0.19	0.26	0.18	7.1%
Indonesia	0.10	0.03	0.19	0.08	0.06	3.3%
Thailand	0.04	0.01	0.03	0.02	0.03	8.0%
Malaysia	0.03	0.03	0.01	0.00	0.01	6.8%
Brazil	0.11	0.10	0.09	0.02	0.04	5.4%
Chile	0.04	0.09	n.a.	0.03	0.04	4.5%
Peru	0.10	0.04	0.03	0.00	0.03	5.4%
Saudi Arabia	0.07	0.11	0.07	0.05	0.05	n.a.
Australia	0.00	0.01	0.10	0.05	0.04	4.6%
Europe	0.03	0.01	0.11	0.27	0.14	4.8%
China	2003	2004	2005	2006		Average GDP growth rate (2003-2009)
Hong Kong	40.4	47.8	27.9	39.3		5.7%
Cayman Islands	28.3	23.4	42.1	44.4		n.a.
British Virgin Island	7.4	7	10	3.1		n.a.
South Korea	5.4	0.7	4.8	n.a.		3.5%
Australia	n.a.	2.3	1.6	0.5		3.1%
USA	2.3	2.2	1.9	1.1		1.6%
Russia	1.1	1.4	1.6	2.6		5%

Source: US BEA, Japan External Trade Organization, and Mock et al. (2008)

Although the comparison of Chinese OFDI in the 2000s and Japanese OFDI in the 1960scan give us a general understanding of the motivations of Chinese MNCs, it is important to study the strategic actions of Chinese and Japanese companies when they expand overseas. There are at least two reasons why we believe that Chinese MNCs are likely to adopt a different strategy from their Japanese counterparts. Chinese companies are more likely than Japanese companies to rely on FDI to acquire new technology than to develop the technology internally. According to Child and Rodrigues (2005), an important driver for Chinese firms to expand globally is the need to secure advanced technology in order to differentiate them in a highly competitive domestic market. Given that Chinese per capita income remains low, the types of the technology and products that domestic market can afford are not the newest and the most expensive. Instead of waiting for technology transfer through inward FDI from Western countries, Chinese companies are going to take a more proactive approach by seeking newer technology through OFDI (Icksoo, 2009). Given that cross-border mergers and acquisitions (M&A) are the fastest and the most cost-efficient way to acquire foreign technology, it is not surprising that the number of cross-border M&A purchases by Chinese companies soared from 4 in 1990 to 97 in 2009 (Figure 1). In other words, we expect more Chinese OFDI to flow into developed countries such as Europe, Japan, and the US in the near future for knowledge-seeking purpose.

Figure 1. Number of Cross-Border M&As by China: 1990-2009



Source: UNCTAD

Another difference between new Chinese MNCs and established Japanese MNCs is that efficiency-seeking in terms of cost minimization is not a major motive for Chinese companies to expand overseas due to the abundant labor force at home. Instead, brand recognition, market share, and economies of scale will be the key drivers for Chinese companies' global expansion. Chinese companies have been known for their efficient production management and cost saving techniques. The only way for them to continue to maintain this cost advantage is to expand globally and achieve higher level of economies of scale.

To illustrate these two key differences, we conduct case analyses of Lenovo and Sony in the global PC industry. We focus on the PC industry because it is a very dynamic and competitive market that requires both cost efficiency and innovation. More importantly, although Sony is a well-established company, it tried to revive its PC business in 2003, just as Lenovo began its international expansion. Therefore, it offers a unique opportunity for us to compare Sony's new global strategy with newly globalized Chinese companies such as Lenovo. In the next section, we will review the history of Sony and Lenovo and then compare their competitive strategies.

3. The history of Sony and Lenovo

Sony's early ventures abroad were undertaken to expand its market and to serve its foreign customers. By the late 1950s, Japan's electronic market was maturing and Sony's patent was drawing to an end (Schlesinger, 1993). In the face of increasing domestic competition, Sony established its first operations abroad, one near Zurich, Switzerland (Sony Overseas), and the Sony Corporation of America (SONAM) in New York in 1960. These locations were distribution arms for Sony's exported products. In addition, in order to obtain more advanced technology, Sony set up regional research and development (R&D) centers in San José, California in 1977 and Basingstoke, United Kingdom in 1978. In their early stage, these R&D labs were responsible for modifying exporting products for local markets. Later, they became more locally focused and began to apply more advanced expertise in the local area than elsewhere (Sadanori, 1999).

Another reason that prompted Sony to invest abroad was the increasing trade tension between Japan and other industrial countries, especially the United States, in the 1970s. Sony's top management believed that it was better for Sony to move its production facilities overseas through OFDI. Japanese subsidiaries in the US show that the American workers were hired to produce Japanese goods. In addition, Sony was the first company to import American goods such as refrigerators to Japan through the creation of Sony's Trading Corporation in 1972.

It is important to remember that Sony was "neither a large corporation nor a government-funded transistor research laboratory" when it was founded (www.Sony.com). Even though the company was doing projects for Japanese government, it received little help from the government. Big Japanese companies, such as Matsushita and Toshiba, received more financial assistance. When Sony needed financing help to purchase the transistor patent from Western Electric for \$25,000, the Ministry of International Trade and Industry (MITI) immediately rejected the request (Colbert, 2010) because the Japanese government did not believe in Sony's ability to create transistor radios. In other words, the Japanese government had nothing to do with Sony's growth.

For Sony's Chinese counterpart, we choose Lenovo, founded by the Chinese Academy of Sciences with a capital outlay of only \$25,000. This marks the first significant difference between Lenovo and Sony: Lenovo received \$25,000 from a Chinese government-funded research institution while Sony did not get the \$25,000 it requested from MITI to purchase a transistor patent. Although Lenovo was initially allowed to use its parent company's connections to conduct businesses, like Sony it did not receive much government assistance (Xie and White, 2004).

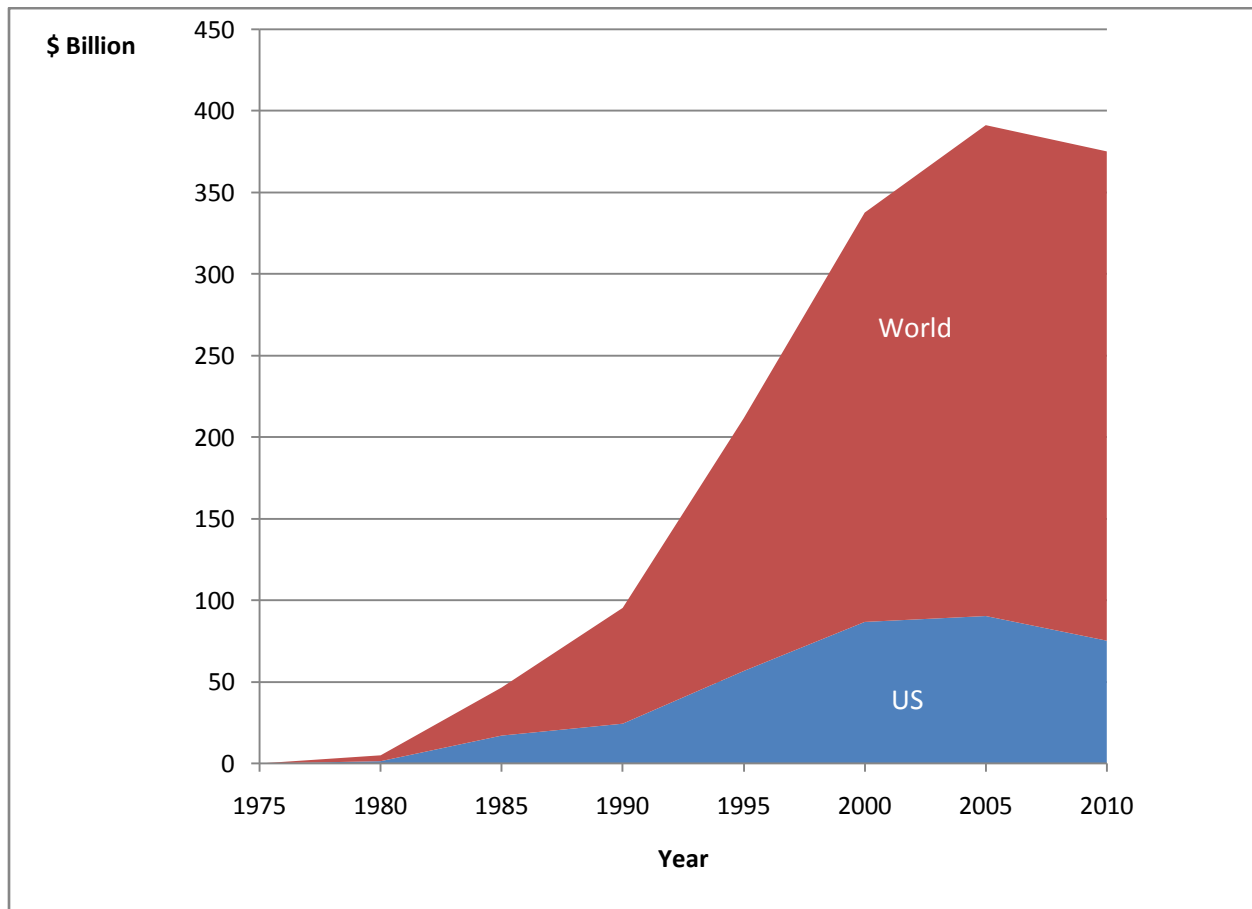
Lenovo's predecessor was the Legend Group. In 1990, the first Legend PC was brought to the market. By 1999, the Legend group had become a leader in the Chinese PC industry with 21.5% of market share and much recognition in Asia-Pacific region (Quelch and Knoop, 2006). Unlike Sony, Lenovo's decision to expand overseas was not to increase exports but to sustain its domestic market leadership. China's entry into WTO in 2001 brought more competition from large PC makers such as Dell and Compaq to Legend's backyard. In the face of increasing domestic competition, expanding overseas becomes more appealing and the Legend Group changed its name to Lenovo after the company discovered that Legend was a registered trademark in several Western countries. In other words, expanding overseas was a strategic move that Lenovo had to take in order to maintain its domestic leadership. Although its products are less expensive than foreign products in its domestic market, they are pricier than other local brand-name computers such as Great Wall and Founder.

In order to differentiate itself from local low-price and low-quality companies, Lenovo has to become a global company with a global brand name. As a result, Lenovo bought the low-performing PC division of IBM for \$1.75 billion in 2004. This acquisition turned the company from a top PC supplier in China to the third-largest supplier in the world. The acquisition also gave Lenovo the right to use the IBM logo on its products for five years along with IBM ThinkPad laptops and Think Center desktop brands. Nonetheless, this purchase was only the beginning of Lenovo’s international expansion. In 2011, the company formed a joint venture with Japanese PC maker NEC Corp. The new company, Lenovo NEC Holdings, makes Lenovo the largest PC maker in Japan. It also strengthened Lenovo’s brand image and expanded its customer base in the global PC market (Inagaki and Osawa, 2011).

4. Competing in the global PC industry

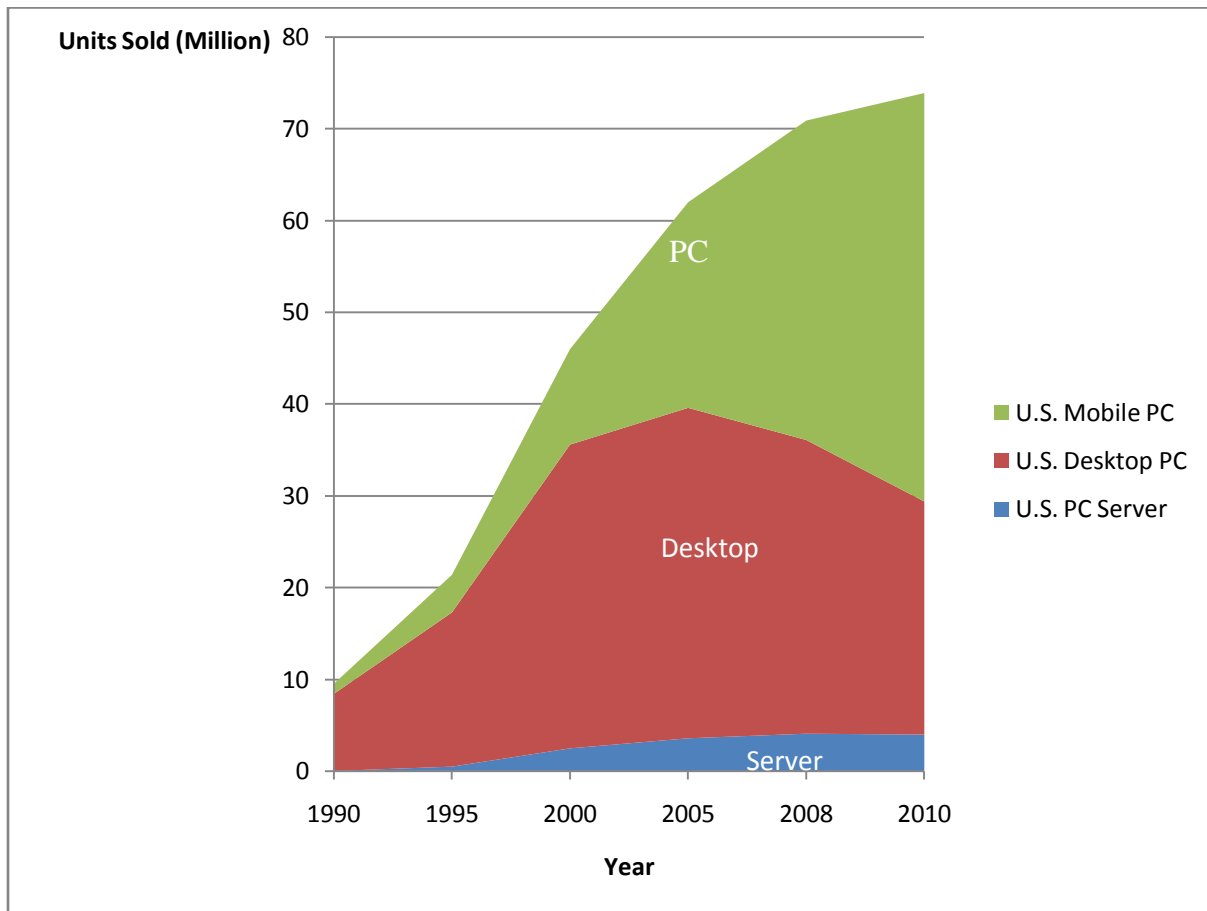
In less than 40 years, the global PC industry has changed from a young and growing industry to a mature and stagnant industry, with the average price of a PC dropping from \$3,000 in 1981 to less than \$1,000 in 2010. According to data released by Computer Industry Almanac, both the US and worldwide PC sales began to decline in 2005 (Figure 2). In terms of market segment, the most dramatic decline is in desktop PCs; the sales of mobile PCs have steadily increased since 2005 (Figure 3). By 2010, the US market still accounted for 20% of worldwide sales in PCs.

Figure 2. US and Worldwide PC Sale Revenue (\$Billion): 1975-2010



Source: Worldwide PC Market, Computer Industry Almanac Inc. www.c-i-a.com

Figure 3. US PC Market Segments by Units Sold (Million): 1190-2010



Source: *Worldwide PC Market, Computer Industry Almanac Inc. www.c-i-a.com*

In terms of global market share, HP, Dell, and Acer are the top three companies in the industry. Lenovo was ranked fourth, with 8% of worldwide market share in 2009 (Inagaki and Osawa, 2011). As shown in Figure 4, the percentage of Lenovo’s sales in emerging markets, including its home turf China, has increased from 2009 to 2010. In contrast, the majority of sales and growth for Sony came from mature markets such as the US, Europe, and its home market (Figure 5). The difference in each company’s geographic focus indicates that Lenovo and Sony have used very different strategies to compete in the global PC industry.

Figure 4: Lenovo Sales by Region (source: Wikiinvest)

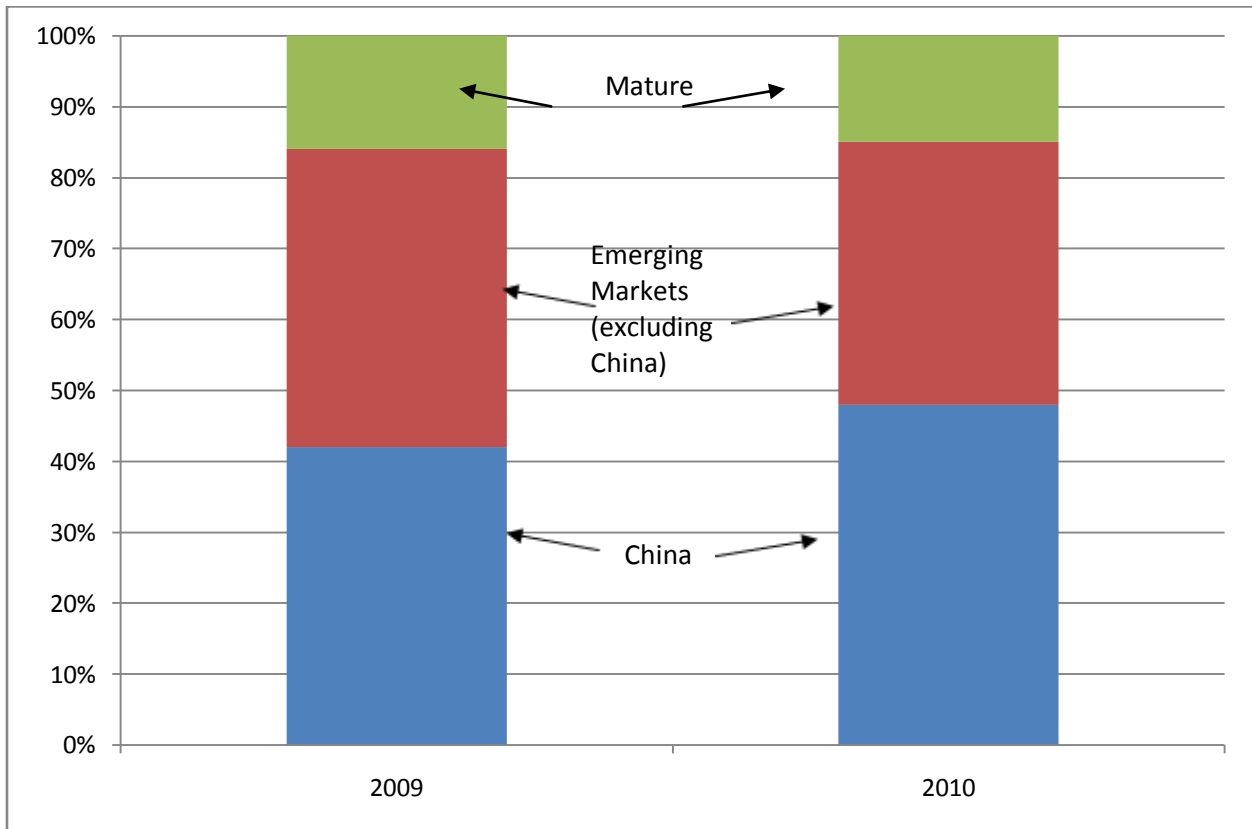
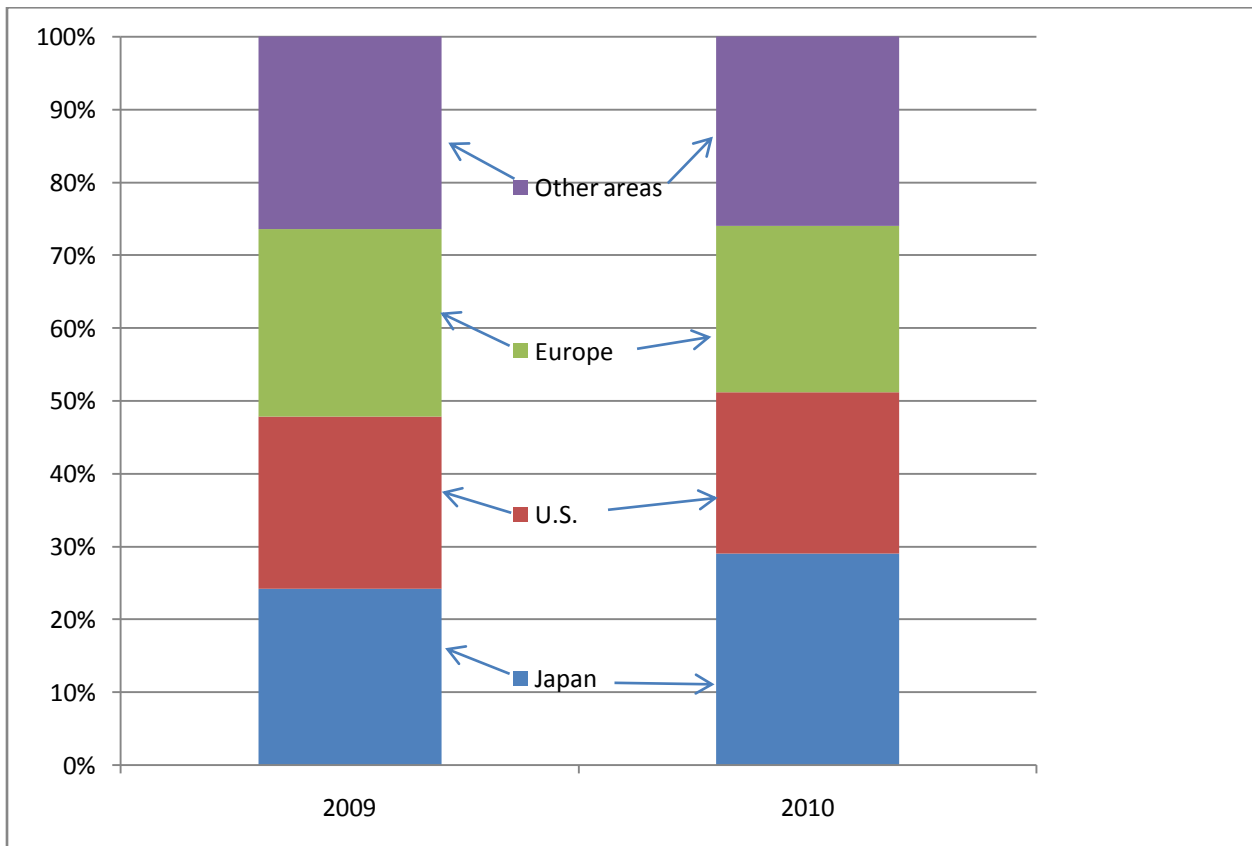


Figure 5: Sony Sales by Region (source: Wikiinvest)



For both Lenovo and Sony, the US market is an important location to penetrate. However, Lenovo sees the United States as a place to grow its brand-name recognition and market share. Its acquisition of IBM PC business in 2005 literally transformed the company from a regional company in Asia to a global player with customers and business in 138 countries. In addition, the right to use the IBM logo for five years improved Lenovo's image and brand name awareness. At the time of acquisition, only 16% of Americans claimed to be familiar with the Lenovo brand, compared to 25% in Japan and 61% in China (Quelch and Knoop, 2006). After the acquisition of IBM, Lenovo formed strategic alliances with well-known companies such as American Airlines, Microsoft, Verizon, and signed a contract with the National Basketball Association to increase its brand awareness (Datamonitor, 2008). By the end of the third quarter of 2010, Lenovo reported a year-over-year 23% increase in its PC shipments in mature markets despite an overall 3.6% industry decline in these markets. According to Lenovo Chairman Liu Chuanzhi, "...the outstanding result indicates that the strategy of Protect-Attack and balanced development has shown its effect...while driving for business momentum, Lenovo will further increase investment in brand building and product development..."(www.Lenovo.com)

For Sony, the US PC market is the primary location for it to use the high-end strategy that helps to establish itself in the consumer electronics market. As shown in Figure 5, the sales of desktop PCs started its decline in the US in 2005. However, the sales of mobile PCs, including all laptops, notebooks, and other mobile PCs, have increased 99% from 2005 to 2010. Sony saw this change in market segment as a great opportunity to revive its PC business. In the 1980s, Sony made computers exclusively for the Japanese market and it withdrew from the computer business in 1990. In 1996, Sony reentered the computer industry, this time globally, under the VAIO brand name. Instead of lowering prices and competing for market share, Sony decided to stick to its high-end strategy and offer superior multimedia technology (Rao, 2004). In only six years, Sony increased its PC sales revenue from zero in the US in 1995 to \$1,347 million in 2001, or about 8% of total US market share. By the second quarter of 2010, Sony posted a 5% increase in overall corporate sales; "this was mainly due to an increase in PC sales brought on by increased unit sales, which resulted from expanding market share in all regions driven by enhanced product appeal" (www.Sony.net).

The difference between the international expansion strategies of Sony and Lenovo is also evident in Lenovo's appointment of non-Chinese managers in their subsidiaries outside of China. In contrast, Sony preferred to have Japanese managers run its facilities abroad. In the 1990s, 20 years after opening its first production factory in the United States, Sony began relinquishing its top-down management style (Stevens, 1994). By 1993, there were only three non-Japanese board members and the "final word can still come from Tokyo" (Lubove and Weinberg, 1993). In contrast, Lenovo put non-Chinese managers in charge soon after its purchase of IBM to prove its commitment to becoming an international company. At the time of the merger with IBM, Stephen Ward was named CEO of Lenovo. He was then replaced by William Amelio, the head of Dell's Asia/Pacific operations (Dorsch, 2010). These managers had supply chain experience; Dell's former supply chain executive, Gerry Smith, now works under Amelio (Hannon, 2007). According to Lenovo's web site, seven out of fourteen Lenovo's top executives are non-Chinese.

5. Conclusion

As the growth of government-directed Chinese economy continues to challenge the norm of the Western free market system, the way in which Chinese MNCs interact and integrate with the global economy has become an important economic and political issue. The recent expansion of Chinese OFDI has generated both China "fear" and China "fever" (He and Lyles, 2008). By comparing Chinese OFDI with Japanese OFDI and by comparing the Chinese company Lenovo with the Japanese company Sony, the paper confirms that the reasons that Chinese companies are expanding globally are similar to those of their Japanese counterparts, although the world's economic and political landscape has changed significantly since the 1960s. In addition, the primary driver for Chinese MNCs is the need to increase brand name recognition in order to protect its domestic market share while Japanese companies will continue to maintain their technological leadership and high-end strategy. Consequently, the fear that the US market is going to be dominated by Chinese MNCs because many of them are supported by the Chinese government is unfounded. At this point, Chinese companies are still focusing on their domestic market and on fast-growing emerging markets. Furthermore, as pointed out by Boisot and Child (1996) and Child and Tse (2001), Chinese companies have their own institutional and cultural characteristics.

The reliance on personal relationships in business transactions, the involvement of the government in top management, and the emphasis on price rather than product differentiation determine that Chinese MNCs will face a steep learning curve in Western markets. Nonetheless, the early signs of success in Lenovo's acquisition of IBM's PC unit indicate that careful management can compensate for these disadvantages (Newman, 2007). In face of the distrust of former IBM employees of the new owner from China, Lenovo has appointed Westerners to key management positions. Meanwhile, the merged company has recruited talented ethnic Chinese expatriates to work in a home-grown company. In addition, Lenovo used IBM's name and logo to market its products until 2010, which allowed it to gain a quick traction in the world market. In sum, whether Chinese companies can become the next generation of MNCs depends on how they can evolve from strictly Chinese companies to global corporations that can successfully integrate their own management philosophy with western corporate practices. Unlike their Japanese counterparts, Chinese companies have continued to rely on economies of scale to gain their competitive advantage in the world market. At the same time, however, they also need to improve their product quality and innovation if they are to be globally competitive.

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