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Building Global Brands for Chinese Private-Owned Enterprises: Strategic Paths to Upgrade the Value Chain

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While most private-owned enterprises (POEs) in China are engaged in subcontracting or do not own the product brands, the number of POEs with their own brands has increased rapidly, while some are even globally recognized. Since these POEs face high opportunity costs for own branding, given their dominant presence in the global subcontracting community, their own branding actions require contextual understanding of doing business in China. This study starts with the notion of how these POEs shift from subcontracting to own branding, and explores their respective own branding paths. We interviewed seven Chinese POEs in the fashion industry in Zhejiang Province: Babei, Baili, Sunrise, Aokang, Youngor, Kangnai, and JNBY. The case studies suggest how these firms built their brands in the global market, and why their trajectories differentiated in the course of own branding. Our study configures three types of own brand models for POEs: the competitive subcontracting, the toehold, and the home-linked organic models. POEs can continue subcontracting in their core business, while implementing own branding through diversification. Alternatively, they can segregate markets, pursuing own branding in one group of countries, while subcontracting elsewhere. In addition, they may establish wholly owned enterprises, and introduce their brands in a way that preserves their home market advantages. We identify two stimuli for Chinese POEs' global branding choices. Global branding strengthens domestic position as it becomes a signal for reputation. As the online platform reduces costs for global branding, and becomes popular, POEs are more likely to pursue global branding to become more competitive in the domestic market. Many POEs also continue to collaborate with the previous customers through strategic inter-dependence, such as distribution channel exchange.

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論 Due to unique co-existence with communism, China's private-owned enterprises (POEs) have attracted the attention of scholars, policymakers, and corporate managers. According to the State Council's latest release, POEs occupy approximately 60% of China's gross domestic production and 80% of social employment opportunities (The General Office of the State Council, 2016). Chinese POEs are the main actors that have contributed to "made-in-China" goods in the global market (D. Z. Zeng, 2010).

A recent particular note is that, while most are engaged in subcontracting, some POEs recently began to move positions on value chains through own branding. Despite the entrepreneurial spirit and strong profit-seeking motivation, POEs in China face visible disadvantages in own branding *vis-à-vis* state-owned enterprises (SOEs) (Fung, Kummer, & Shen, 2006; Huang, 2008). At the firm level, they have to challenge low-quality shadow casting over Chinese goods and stronger competition in price due to the policy bias under which POEs must compete against SOEs over resources in the domestic market. This has been a fundamental constraint for the growth of POEs (Ralston, Terpstra-Tong, Terpstra, Wang, & Egri, 2006; Tan, 2001).

Only a few being now recognized as successful businesses, it is noteworthy that POEs have achieved this status as a result of accumulation of technical knowledge of their core products, and acquisition of marketing capacity and market knowledge (Nie, Xin, & Zhang, 2009). Further, the upgrading mechanism occurs in combination with the globalization initiative. Some scholars argue that own branding triggers globalization. Owing to unfavorable local environment for subcontractors, competitive subcontractors that attempt own branding have to move overseas in order to lessen domestic disadvantages and explore the market to avoid competition (Lee, Song, & Kwak, 2015). Other scholars claim that own branding results from globalization. Firms can generate more gains from own branding when they pursue creation of learning, leverage, and linkage (LLL) overseas (Mathews, 2006) or when new entrants in the overseas market can possess dynamic capability, which increases awareness of brand equity, and leads to own branding (Amsden & Chu, 2003; Nie et al., 2009).

Because the interplay between local environment and firm strategy is substantial, paths to own branding are shaped by, for example, firm's capability (such as research and development (R&D) capacity) and the *chaebol*'s dominance in Korea (Lee & Lim, 2001), or strategic motivation (such as expected costs for marketing and distribution) in Taiwan (Chu, 2009). With this background, this study investigates how Chinese POEs have attempted to establish their own brands in the global market.

We select seven Chinese POEs with own brands in the fashion industry in the *Zhejiang* Province. In the fashion industry, the attempts for own branding are the most active and visible ones (Zhang, Kong, & Ramu, 2016). These firms reasonably represent the population of POEs in terms of experience and motivation. We consider the same locational context because the firms are under the same institutional environment.

We believe that our study contributes to relevant literature in at least two ways. First, it identifies how a path is created for Chinese POEs to build a brand globally. Existing studies on the own branding choices of Korean small and medium-sized enterprises (SMEs) (Lee et al., 2015) or Taiwanese SMEs (Chu, 2009) illustrate that the experience of being an own brand manufacturing/manufacturer (OBM) by non-national champions differs markedly to that of national champions. While existing studies focus on branding issues in Chinese multinational enterprises (MNEs) (H. Tang, 2011; D. Z. Zeng, 2010), we explore how POEs have implemented own branding in the global market. While most existing theoretical discussions focus on larger firms in advanced countries that outsource work (Chu, 2009), our research provides insights that can be used as a basis for future systematic analyses.

Second, while the benefits from own branding are known to be varied, such as brand awareness, brand equity, or profits, our study has found that brand building by Chinese POEs presumes growth of performance in the domestic market. The Chinese POEs in our research utilized global branding as a marketing tool for domestic operation. These firms also found the need for distribution channel exchange in their relations with the previous customers, managing the conflicts that arise from own branding at the low level.

This paper is organized as follows. In the following sections, we introduce relevant theories and explain our methodology, including the research setting and data. Subsequently, we present the case studies, and discuss the implications of our findings. The paper is then concluded.

Literature Review: Own Branding in Globalization by POEs

Own Branding in the Global Market

Subcontracting starts with own-equipment manufacturing (OEM), where a subcontractor can only produce as requested by the client. Experienced OEM firms may acquire product knowledge, called own-design manufacturing (ODM). ODM firms are engaged in both manufacturing and product design, and thus, charge a higher mark-up (Hobday, 1995).

In marketing research, the brand has been regarded as the most valuable asset (Aaker, 1991), while in literature on strategy, forward integration means that the margin available to OBM is higher than that for subcontractors (OEM or ODM) (From OEM to Brands, 2013). However, the higher mark-up is not the only motivation for OBM, which also stresses strategic independence. For example, Korean toy makers who did not shift from OEM to OBM were crowded out of the market as they became increasingly reliant on customers and low prices for winning orders (Lee, Kim, & Kwak, 2012; Wilson, 2013). In addition, brand building helps firms move away from their previous image as producers of cheap goods (P. Gao, Woetzel, & Wu, 2003).

Existing research illustrates that the drivers for own branding are highly country specific (Amsden & Chu, 2003; Yeung, 2007). Own brand presumes the search for new business momentum, and often coincides with global expansion. In Korea, the transition to OBM tends to produce conflicts with the buyer firm because own branding means competition with the buyer firm. New OBM entrants have pursued internationalization in order to avoid direct competition in their current markets, while simultaneously lowering production costs to stay competitive, because lawsuits have frequently followed (Lee et al., 2015). This view posits that, in the process of catching up on the value chain, the degree of tension over knowledge leakage is closely related to the nature of the knowledge and the bargaining power of the buyer firm or industry structure. Accordingly, "global" branding — OBM in the global market — depends on the "relational cost" in the domestic market, and globalization is a solution (Chu, 2009).

While literature on catch-up states that own branding drives globalization, another stream of literature posits that own branding is an inevitable result of globalization. The increasingly fierce competition in the global market has sometimes encouraged subcontractors in developing countries to change their strategies. These firms became OBM to adapt to the global business environment. In Taiwan, the price competitiveness of firms in developing countries is gradually offset by new entries from other lower-wage countries, which necessitate the former's continuous innovation, and ultimately, a shift to brand building (Amsden & Chu, 2003). Brand building was accompanied by foreign expansion from which new OBM entrants maintained price competitiveness *vis-à-vis* potential counterparts. The motivation was different from the Korean experience because some Taiwanese subcontractors remained without a brand in order to obtain strategic benefits.

Yeung (2007) observes three own branding strategies in leading Asian firms. In his study (2007), some firms, more than a mere subcontractor, have attained OBM through strategic partnership with leading MNEs. Alternatively, others have begun to explore niche markets with category-killer items, developing proprietary expertise. The third option is to become a "global brand owner" by continuous upscaling and capital investment. These strategies have been undertaken through varying OBM routes, such as technical arrangement, joint ventures, acquisition of foreign brands, or establishment (Child & Rodrigues, 2005).

POEs in Globalization

The Chinese government has emphasized own branding as a policy agenda (Cao, 2010; H. Tang, 2011). The pressure first reached large firms — those who had already built brands in domestic markets — because they lacked branding power in the foreign market. Large Chinese firms preferred acquisition of foreign brands, forming joint ventures or organic brand building (From OEM to Brands, 2013). With abundant financial resources, these firms have exercised multiple strategic options (M. Zeng & Williamson, 2003).

In contrast, Chinese POEs have, thus far, shown different behaviors to that of SOEs. Relevant studies have treated Chinese firms homogeneously, without considering ownership types (H. Li & Atuahene-Gima, 2001; Y. Li, Liu, & Zhao, 2006) or have examined POEs at the industry level only (Siu, Lin, Fang, & Liu, 2006; Siu & Liu, 2005; Wilson, 2013). A shortage of literature is also a problem because a majority of POEs are subcontractors. Although the number of own brand POEs has increased, they are definitely rare because the exit ratio in the post own branding stage still remains high (Wilson, 2013). Many Chinese POEs are dependent on past routines or are locked into subcontractor positions on their way to being an OBM (H. Tang, 2011). Alternatively, the POEs attempting to establish own brands often focus too much on acquiring marketing skills. Even the most innovative POEs often reduce their R&D investments, and thus, lose competitiveness in the course of own branding.

In general, POEs have gradually moved up the value chain through a step-by-step process that facilitates understanding foreign customers and building brand recognition (P. Gao et al., 2003). Owing to their smaller size, POEs have the advantages of being less bureaucratic, and having more flexible decision-making processes (Tan, 2001). Further, they can identify opportunities in uncovered markets relatively quickly (Tan, 1996, 2001). As marketization has deepened, and the government has begun to promote domestic consumption, Chinese POEs have introduced more brands in the domestic market, and have essentially attempted own branding in foreign markets, though not all from the beginning stage (Abrami, Kirby, McFarlan, Wong, & Manty, 2008).

Firms from developing countries can gain learning (access to technical knowledge), linkage (formation of forward or backward links overseas), and leverage (value increase for the headquarters as a result of foreign expansion) (Mathews, 2006). Unlike firms in advanced countries that go overseas based on firm-specific advantages, firms in developing countries go overseas in search of firm-specific advantages. By internationalization, POEs acquire valuable knowledge available in the foreign market; utilize the foreign subsidiary to enhance the status in the domestic market; and benefit from home production for foreign sales.

Methodology

Research Background

This study aims to understand the strategic model of Chinese POEs as they transform from subcontractors (OEM) to their own brand (OBM) in the global market. We adopt a research design that enables both exploratory and qualitative studies, as we try to answer "how" and "why" questions, given the goal of our research (Ghauri & Grønhaug, 2010). The exploratory and qualitative approach obtains "thick" in-depth insights that are particularly desirable for studies that deal with business dynamics (Yin, 2014).

We search for firms that satisfy the following criteria. First, the sample firms should currently be attempting own branding in the global market (in any manner), while also possessing their own brands in the domestic market, because we want to control for the experience and OBM motivation aspects in firms. Second, they should be established and managed by individual owners. Third, they should be engaged in a manufacturing industry, and conduct substantial R&D for new product development.

Overall, we select the fashion industry, which falls basically on the SIC 23 and SIC 31 industries including apparel, shoes, and accessories because the technologies required for successful business operation in the fashion industry are less path dependent and less capital intensive than those of high-tech industries.[1] In addition, both R&D and marketing, along with distribution, are important for successful own branding in this industry.

[1]SIC 23 represents the industry of manufacturing "apparel and other finished products made from fabrics and similar materials" and SIC 31 is the "leather and leather good" manufacturing industry. Although two industries are differently categorized, they share similar traits in terms of the fashion goods. Further, many apparel firms also sell shoes and accessories in their offline and online stores. Therefore, we recategorized them as the "fashion industry."

Our research setting consists of the POEs in *Zhejiang* Province, where China initially experimented with a market economy, and 87% of registered firms are privately owned (China Bureau of Statistics, 2016). Geographically closer to *Shanghai*, firms in *Zhejiang* Province obtain valuable information from *Shanghai* consumers about product design trends and consumer needs in the global market. We confine our sample to a single region on the assumption that policies in the local government may affect POEs. In addition, given that light-manufacturing clusters are common in this province, we can obtain a larger pool of firms in the interview list.

The POEs in this industry have been under the pressure of cost reduction, product development, marketing, and international management. The high-end goods in the fashion industry are normally oligopolistic, while the middle and the low ends are highly competitive. Entry and exit ratios have been high in the industry. Since the domestic wage has continued to increase, the POEs are more aware of the importance of revisiting the subcontracting business model (Zhang et al., 2016).

In 2005, the China State Council released the first policy to promote non-state economy, including self-employed businesses and POEs. The core contents of this policy were to lower the entry barriers in the private sector, to offer POEs with financial and tax-related benefits, and to ensure legitimatization in the rights and interests for the non-state firms (China State Council, 2005). Subsequently in 2009, the State Council began to promote SMEs into the overseas mergers and acquisitions for effective access to technologies or brands in order to explore the overseas market (China State Council, 2009). In 2010, the State Council announced policies to guide the POE investments, encouraging their internationalization. Detailed policies focused on the “globalization” efforts in R&D, production, and marketing (China State Council, 2010). The POEs were encouraged into the development of strategic resources and the establishment of international sales network. The 2010 policy is especially worthy of noting, since it is the first attempt to support POEs particularly for own branding, creation of intellectual property rights (IPR), and establishment of independent sales network (China State Council, 2010).

Data Collection and Analytical Method

From January to March 2016, we interviewed 15 firms in the fashion industry in *Zhejiang* Province. Interviews were semi-structured, and lasted for approximately two to three hours per person. Interviews were conducted in Chinese by at least two researchers. For each firm, we met two to three managers on average. The managers worked for the firm for more than 15 years, and were engaged in international operations or business strategies. After the interview, we cross-checked the research notes, and if necessary, proceeded with follow-up questions through e-mail or phone calls. The findings were then translated into English, as all authors are bilingual in English and Chinese.

After the field research ended, we identified patterns of brand building for Chinese brands. We excluded firms that did not make visible action for global branding or did not show global branding performance. A close examination of data collected from the fieldwork enabled us to finally select seven Chinese POEs that showed meaningful paths and performances to own branding. Table 1 presents the

Table 1.
Basic Profiles of the Firms in Our Case Study

	Babei	Baili	Sunrise	Aokang
Established year	1993	2003	1999	1988
Market share	25% in China	n.a.	Growth at 24% in 2016	Growth at 11.9% in 2016
Products	Neckties, interior textiles, fabrics	Neckties, rainboots	Glasses	Shoes and leather goods
Initial investment	10 million RMB	n.a.	n.a.	0.3 million RMB
Current employment*	3,478 employees	400 employees in neckties	500 employees	7,299 employees

	Youngor	Kangnai	JNBY
Established year	1979	1980	1997
Market share	Listed on Fortune China 500 in 2015	Growth at 6% in 2015	0.2% in China and 9.6% in China's designer's brand clothing market in 2015
Products	Mens' clothes	Shoes, leather goods, underwear	General clothes
Initial investment	20,000 RMB	n.a.	2 million RMB
Current employment*	42,000 employees	4,000 employees	886 employees

Note: *In the Chinese market.
Sources: Babei Necktie <http://www.babei.com/babei_about.php>; *Aokang Shoes Annual Report* (Zhejiang Aokang Shoes Co., Ltd., 2016); Youngor homepage <http://youngor.com.cn/>; Kangnai Shoes homepage <http://www.kangnai.com/about.aspx>; Kangnai news <http://www.kangnai.com/newslist.aspx?id=137> (accessed on July 22, 2016); *JNBY Annul Report (2017–2017)* (JNBY, 2017), complemented with authors' interviews.

basic profiles of our case firms, Babei Necktie (hereafter Babei), Baili Shoes (hereafter Baili), Sunrise Optical (hereafter Sunrise), Aokang Shoes (hereafter Aokang), Youngor, Kangnai Shoes (hereafter Kangnai), and JNBY. The sample firms do not necessarily perfectly match the population characteristics, but do sufficiently represent the fashion industry and the OBM markets.

In the case method, it is essential to ensure construct validity, internal validity, and reliability in data collection and analysis. First, construct validity identifies correct operational measures for the concept being studied (Yin, 2014, p. 46). In order to confirm construct validity, we use the operational measures that both industry and academia have agreed upon for usage, including the concepts of OEM, ODM, and OBM. Even when we define main constructs using specific concepts, the constructs are relevant to the original goal for the research.

Next, internal validity tests whether a suggested model is sensible (Yin, 2014, p. 46). In order to obtain internal validity, we conducted multiple-case study for pattern matching, rival theory explanation, and used replication logic across the cases. Since our study involves exploratory case studies, explanation building is less relevant. However, we try to build a general explanation that fits each individual case in attempt to produce an overall explanation. Seven firms differ in terms of sales growth rate, years of operation, product portfolio, target customers, product development, and branding strategy. This means we have enough similarities (ownership, business segment, and regional business environment and regulations) and variations to suggest a trustworthy model from which to draw conclusions (Sinkovics, Penz, & Ghauri, 2005).

Finally, reliability confirms the suggested model can be replicated by another rounds of research (Yin, 2014, p. 46). In order to demonstrate reliability, we document all procedures, and create multiple operational steps.

Case Studies

Competitive Chinese POEs on the own branding path have been acknowledged in the domestic market as “Chinese renowned brands,” or “inspection-free products” (Cao, 2010; Wilson, 2013). Chinese renowned brands are products manufactured by firms equipped with top-class production facilities and technologies. Despite these distinct commonalities, their strategic paths to OBM have varied. The following examination of seven firms in *Zhejiang* Province, Babei, Baili, Sunrise, Aokang, Youngor, Kangnai, and JNBY, illustrates the different paths.

Competitive Subcontractor Model: Babei, Baili, and Sunrise

Established in *Shengzhou* City in 1993, Babei has been a category killer for neckties since the outset. As *Shengzhou* is noted for silkworm farming, it has been ideally located for procuring silk for the raw material used in necktie production. *Shengzhou*'s necktie production started in 1984 when an international joint venture with a firm in *Hong Kong* introduced the necktie brand "Gent's." In the late 1980s, the necktie production firms in *Shengzhou* developed a direct sales method, where assistants promoted sales to the customer, which naturally led to own branding. The industry grew rapidly in the 1990s as the local government (*Zhejiang* Province) began to provide support for the necktie production clusters. As a result, firms moved into the clusters, and *Shengzhou* became the "global necktie factory" until the early 2010s, accounting for 90% of the domestic market and 60% of the international market (K. Gao, 2014, pp. 6–7).

In terms of production size, advancement in production facilities, and the product quality, Babei has been leading other products in the *Shengzhou* necktie clusters, representing the "made-in-China" neckties. The reputation is largely attributed to Babei's production technique. From the beginning, its founder, Jin Yao, actively sought to adopt upfront machinery, regarding the production line as the locus of competitiveness. Jin borrowed RMB 10 million to establish the business, and then continued to adopt leading-edge machinery (Shengzhou Necktie Industry Association, 2011).

As a result, 70% of Babei's total production is currently exported to advanced countries, including the United States, the European Union (EU), and Japan.[2] In 1996, Babei obtained exclusive subcontractor status to supply Pierre Cardin neckties, in addition to Valentino and Alpha Creation. The business strategy for Babei was centered on protection of the core market, and so was the global branding model. Babei has maintained the ODM position in the global necktie market because it fears customer loss with own branding, which would weaken the overall businesses. In the non-core market, Babei experimented with the launch of "Babei," its own brand, in the men's suit and home interior textile businesses, using the leverage of its reputation of offering exclusive global necktie brands. In order to promote "Babei," it participated in 20 exhibitions in both domestic and international markets. It once replicated "Qingming Shanghetu" (Along the River during Qingming Festival) with silk threads,

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[2] Sources are from Babei homepage (accessed on July 22, 2016 from <http://www.babei.com/babei_about.php>).

a painting by Zhang Zehuan during the North Song dynasty. The work was intended to publicly demonstrate Babei's possession of global leading-edge textile manufacturing technology and computer-aided design systems, and was included in the Guinness Book of Records (Baike, 2017).

In order to strengthen its global status as a leading subcontractor, Babei has invested in technical improvements on design and post-processing on fabrics. For quality enhancement of the textile texture, as well as on dyeing and textile finishing, R&D projects have proceeded jointly with the Ministry of Science and Technology. Aware that design is as important as quality control, Babei founded a design training school to increase the designer pool, and invested RMB 10 million in establishment of a necktie design institute. It also co-developed global uptrend fabric designs and digital non-circular application technology with McDearm, another renowned necktie subcontractor (K. Gao, 2014, p. 24).

In addition to the in-house development efforts, Babei exerted itself to acquire domestic and foreign firms in order to access design resources. In 2002, it acquired an Italian design company to strengthen the design capacity, and establish another design institute, Necktie and Fashion Design Research. This provided Babei with an internal database of more than 100,000 electronically documented designs. In addition, it spent RMB 60 million on collecting necktie designs distinct to ethnic groups around the world in order to better serve the varying needs of its global customers (K. Gao, 2014, p. 25).

At the same time, it continued to pay attention to cost reduction. In June 2012, Babei established two firms for the logistics of joint investments with eight firms and built a 653 km^2 silkworm production base in Western China, all of which was intended to reduce costs in raw materials and distribution ("Dachanye," 2010).

Every year, Babei spends 0.3% of annual sales revenue on R&D (Shengzhou Necktie Industry Association, 2011). However, most of its patents are design rights for fabrics. Among the 114 patents, it had registered by 2015, only four patents are related to inventions or utility models. Babei has highly focused on R&D related to design improvement for fabrics.[3]

Baili, an apparel and footwear firm in *Shengzhou* City, suggests a different aspect in the competitive subcontractor model. Baili started in 2003 with its first OEM subcontracting for manufacturing neckties. It used to focus on necktie items in the early business stage, but began to expand from 2004 to footwear (rain boots) manufacturing. As of 2017, the sales revenues for neckties and rain boots are almost equivalent. Rain boots are exported mainly through OEM, which accounts 80% of the

[3]Sources are from *Soopat* (accessed on January 15, 2017 from <http://www.soopat.com>).

total rain boots sales, while neckties are exported through ODM, which shares 95% of the total necktie sales.

Baili is assessed as competitive particularly in its capability of producing qualified products at lower costs, and managing customer relations. Despite the downturn in China's textile industry, it is still competitive with own design. The R&D team consists of more than 10 designers who work for improvement on product design and process. Despite the subcontractor position, Baili does not feel urged with the marketing needs. It has only 10 employees in marketing at the headquarters, and participation in major exhibitions is their marketing activity for buyer contact. However, Baili recently recognized the importance of brand building, which is a strategically significant shift, and began to sell in China with the "BL" brand. Although limited to the domestic market, Baili has been active with the BL branding through aggressive investments in advertising, and gaining experience, plans to go overseas.

The third case in competitive subcontracting model is Sunrise. Located in *Wenzhou* City, Sunrise is a subcontractor with design capacity for eyewear. Starting as a trading firm in 1999, it began manufacturing from 2011. *Wenzhou* used to be the popular location for manufacturing optical glasses, but several larger firms recently went bankrupt due to lower profitability. Albeit unstable prospects, it has maintained stable growth — 24% in 2016 and 15% in 2017. Sunrise introduces 1,000 new products every year, and 80% of them are manufactured under the ODM contract. Most clients are global multinational enterprises, and 90% of the sales revenue is generated from exporting. Like Baili, Sunrise has built its own brand "MiFan" in the domestic market. The firm is now preparing for overseas expansion with the same brand in the near future.

Toehold Model: Aokang and Youngor

Aokang has been a shoe manufacturer since 1988 in *Wenzhou* City. It operates two production lines in *Wenzhou* and one in *Chongqing*. In 1991, subsequent investments changed the ownership into the partnership form. Sales increased sharply from RMB 100,000 in 1988 to RMB 1 million in 1991. In 1993, it became an international joint venture, and it was the first firm in *Wenzhou* entitled by the government as a "national brand." From 1998, Aokang increased its direct store nationwide, and in the next year, it invested RMB 20 million to establish six additional production lines by importing machinery from Italy. The increase in production capacity led to the honorable title of a "Top 50 brand in *Zhejiang* Province" by the government (S. Tang, 2013). In 2015, Aokang was selected by the China Light

Industry Association for "The top 100 light manufacturing firms in China" (China National Light Industry Council, 2015).

Sales revenue for Aokang has continued to increase, with exports accounting for 10% to 20% of total revenue. Products are exported in the form of own design manufacturing, which means that Aokang conducted product designs. Aokang's domestic market share has also continued to rise, and is now the third largest in China.

Its domestic brand value continued to increase, and was estimated to be RMB 17.92 billion in 2016, because Aokang expanded its focus to include branding. As of 2013, it operated 3,000 stores and 800 off-store sales kiosks in China. Currently, Aokang possesses three product brands (Aokang, Kanglong, and Honghuoniao), among which the "Aokang" brand entered foreign markets. Although more than 90% of sales revenue is drawn from China, it has been devoted to global branding since 2002. As early as 1999, Aokang registered its brand in 40 countries in preparation of internationalization. In 2002, it opened the first foreign stand-alone store in New York, followed by Italy and Jakarta.

Nevertheless, the own brand strategy turned out to be unprofitable, and Aokang left most markets except the United States and Italy. The failure in own branding was attributed to the cultural distance, absence of branding professionals, financial liquidity problems, or conflicts with ODM customers over sharing the distribution channel. Since then, Aokang's own brand has focused on the domestic market, and the company continued to overcome low brand visibility by forming international partnerships. One example is its partnership with Geox, a well-known Italian shoe brand, with the fourth largest share in the global market for leisure-purpose shoes.

Aokang signed a strategic partnership with Geox in 2005 because the latter possessed more than 50,000 stores in 68 foreign countries. The contract specified a distribution channel exchange between Aokang and Geox, where the former would design, manufacture, advertise, and sell Geox products in China, and in return, the latter would distribute Aokang products outside of China. The partnership lasted from 2004 to 2012. During this period, Aokang learned advanced technologies from Geox in materials and site management. Through cooperation with Aokang, Geox enhanced its brand visibility in China, leading to 62 stores and sales revenue of RMB 100 million by 2007, representing 500% of its growth three years previously. Aokang expanded again to foreign markets, establishing subsidiaries in Italy, Spain, the United States, and Japan. However, the brand recognition did not grow as Aokang expected. Nevertheless, learning the advanced management skills was a meaningful result.

In 2008, it went through another international partnership with Valleverde, an Italian functional shoes brand. In 2010, Aokang further acquired Valleverde's brand ownership, taking responsibility for the production and sales. Valleverde provided R&D resources, patented technologies, and IPR-related legal services, while Aokang established an R&D center in Italy on the condition that any R&D outcomes would be shared by both parties (Dong & Zheng, 2013).

In order to maintain price competitiveness, Aokang has established production lines in Southeast Asia, while simultaneously endeavoring to diversify collaboration partners by acquiring agent status for Sketchers, a United States brand, which offers sales representative rights in *Hunan*, *Hubei*, *Zhejiang*, *Jiangsu*, and *Shanghai*. For the next few years, Aokang will assign foreign sales to prestigious foreign brands, rather than establishing wholly owned subsidiaries.

Since it established an R&D center in 2007, Aokang has tried to develop its own designs internally. Currently, 600 personnel are engaged in the R&D institute. Even imported machinery goes through internal adaptation to the Aokang design. As Aokang reinforced internal development, it stopped R&D cooperation with Geox in 2012. It established a technical college in 2007 to nurture engineers. However, Aokang assesses the R&D capability to be moderate, compared with industry leaders. It is strong with quality control, site management, and product design, but still needs more capabilities in material engineering and development. It requested the government to designate Aokang a state-level research lab in order to ease the problem of R&D personnel shortage because their problem is partially related to the typical dilemma of POEs — difficulty in recruiting personnel with advanced skills and expertise.

As its commitment to promote in-house R&D shows, the R&D expenditure by Aokang far exceeded the industry average (0.64% of sales revenue) (Zhejiang Aokang Shoes Co., Ltd., 2016). In 2015, it spent 1% of total sales revenue, but the budget was expected to increase to 3% in 2017. Of the 163 patents Aokang has registered, 12 patents are for inventions and 140 patents are utility models.[4] It also has 109 international patents, registered at the Espacenet.[5] Each year, Aokang introduces 8,000 to 10,000 new products.

Youngor, another firm in the toehold model, is the largest manufacturer for men's wear. Established in *Ningbo* in 1979, Youngor began OEM for Japanese shirts brands, and kicked off the "Youngor" brand as it formed the international joint venture in 1986. It went for initial public offering (IPO) at Shanghai Stock Exchange in 1998, and as of 2015, was the third largest textile and clothing manufacturer on the Fortune

[4]Sources are from *Soopat* (accessed on January 15, 2017 from <http://www.soopat.com>).
[5]Sources are from *Espacenet* (accessed on January 15, 2017 from <https://worldwide.espacenet.com>).

China 500 list. Currently, Youngor manages several brands, including Youngor, Hart Schaffner Marx, GY, Mayor, and Hanp.

The OBM strategy for Youngor is distinctively represented by overseas acquisition and distribution channel exchange. The first acquisition was Xin Ma Group, previously owned by a U.S.-based Kellewood, recording the most sizable acquisition in China's textile industry in 2008. The acquisition enabled Youngor to become equipped with production capacity of 80 million production units. Because the acquisition enabled Youngor to enhance design capacity, strengthen international manageability, and access international logistics channel because the Xin Ma Group worked with 20 global brands, either for subcontracting (including Polo and Calvin Kline) or for local licensing (including Nautica and Perry Ellis).[6]

After securing design capability through acquisition, it proceeded with the subsequent acquisition. In 2014, Youngor acquired Hart Schaffner Marx, a 130-year-old American men's wear brand. Before the acquisition, Youngor purchased the firm's Greater China local licensing rights in 2007. Collaboration over seven years enabled Youngor to understand the management structure and culture of Hart Scaffner Marx. After acquisition, Youngor took the approach to utilize the domestic sales network more, rather than aggressive advertising. It intended for viral marketing by displaying products of acquired brands at 447 local boutiques in China.[7]

As the global branding proceeded with distribution network exchange, Youngor began to sell multinational brands at local stores, including Pierre Cardin, which it franchises for, and in return, its products sell at the overseas stores of multinational brands.[8] Youngor has been regarded the most competitive men's wear brand in the domestic market, while starting to toddle in the overseas market. In order to strengthen brand recognition, Youngor introduced Mayor in the overseas market, a high-end brand for which it began to collaborate with global high-quality textile firms from 2016, including Zegna, Loro Piana, Cerruti 1881, Albini, or Alumo.

Home-Linked Organic Model: Kangnai and JNBY

Kangnai was established in *Wenzhou* City in 1980 as a shoes manufacturer. In 1990, it became the first in the region to adopt production automation. Subsequently, the firm started to target middle to high-end segments. Since 1993, it won several

[6]Details for this acquisition are also illustrated in M. Li and Wu (2010).

[7]It is evaluated as a successful approach inside the firm. Several magazines, for example, Lan (2017), also report perspectives of industrial specialists, and the opinions are generally convergent.

[8]This approach is also confirmed by Xiao and Liu (2015).

honorable labels from the government with regard to quality control, and as a result, established a trademark in 1999. Since 1996, Kangnai has attempted to franchise the products, establishing 1,700 stores nationwide in China by 2002 (Zheng, 2002). As of 2013, Kangnai operates 14 regional subsidiaries, 28 branches, and 2,800 stores in China, and exports to 30 countries. Its exports amounted to USD 40 million in 2014 (Wei, 2015). While Kangnai started as an OEM in 1987 to penetrate foreign markets, it had a clear orientation for OBM because it observed that shoes manufactured and exported by Kangnai at a price of RMB 200 were later imported to China with a foreign label priced at RMB 3,000. Accordingly, Kangnai undertook OBM earlier than its peers. Russia was the first market to sell as "Kangnai." However, it lost many customers in Russia as a result of own branding, which led to decline in the financial performance. Based on the Russian experience, from 2001, Kangnai began to actively use the overseas Chinese network for establishment of stand-alone boutiques. A foreign boutique, for example, was established in Paris and New York, both in 2001. Shortly after opening two flagship stores overseas, Kangnai also established a store in Rome, with the R&D mission of obtaining current information on market trends. The foreign stores were established by Chinese expatriates who were part of the *Wenzhou* network (Zhao & Niu, 2005). By 2012, Kangnai had established 230 foreign stores, including in Australia, New Zealand, and Vietnam (Bao, 2012).

Simultaneously, Kangnai became aware of the need to conform to technical standards and brand protection as an effective means to the global branding. In 2000, it joined SATRA, a shoe research institution, to update the technical standards in the industry. Its establishment of a joint venture with KKGG, an Italian firm, also reinforced Kangnai's focus on the international standard in the fashion industry (Zhao & Niu, 2005). Kangnai registered its local trademark in 40 countries. It was once considered a Westernized brand, but eventually decided back to the Kangnai brand to highlight Chinese-style design (C. Li, 2007, pp. 57–61).

Since 1994, Kangnai has focused on its overseas advertising through newspapers, magazines, signboards, and public transportation. As it gained popularity in the overseas market, it established a wholly owned subsidiary in major foreign markets, such as Italy and the United States. It has also been exploring emerging markets. For example, Kangnai invested and helped the Russian government construct the Far East Economy and Trade Cooperation District (FEETCD), located in *Ussuriysk*, formerly USSR. Major goods manufactured in FEETCD are shoes, textile, or construction materials. As of 2014, 27 firms entered the FEETCD (Ministry of Commerce, 2014), and Kangnai produced an amount of RMB 3.8 billion in 2014 (Wei, 2015).

Kangnai has operated R&D facilities in *Wenzhou*, *Guangzhou*, and in foreign markets, where it spends 3% of its annual sales revenue on new product development. As a result, Kangnai introduces more than 3,800 new models every year (Bao, 2012). Simultaneously, it has been active in co-development with foreign firms. For example, in 2006, it established a research laboratory in cooperation with SATRA, investing RMB 10 million, with a specific focus on shoe manufacturing technology, in order to enhance the brand power through increase in the functional effects.[9]

Another case is JNBY, a firm located in *Hangzhou*. Starting as a women's wear brand in 1997, JNBY now possesses five brands (JNBY, JNBY by JNBY, Croquis, Less, and Pomme de terre). It has pursued unique design, and been recognized as "Well-known Trademarks in China" by the government from 2010 to 2014. It used to focus on the offline sales, but recently began to be active in the use of online platforms like Tmall, JD, or VIP. In 2015, JNBY had 9.6% of the designer brand market, the largest share, and executed IPO at the Hong Kong Stock Exchange in 2016, which was the first among Chinese designer brands.

From the beginning, JNBY pursued own branding in both domestic and overseas markets. The first foreign entry was Russia in 2005, followed by Japan in 2006, Singapore in 2007, and the United States in 2010. As of 2016, JNBY entered 12 countries, and operates 29 stores. Except one store (in *Hong Kong*), overseas stores are managed by local licensees. In 2011, Forbes China selected JNBY as "Top 6 Chinese Brands with the Greatest Potential to Internationalize." However, it is still experiencing trials and errors in the overseas market, as the overseas sales share had continued to decrease from 2.3% in 2014 to 1.6% in 2015 and to 0.9% in 2016.

In order to survive in the competitive market, JNBY focuses on highly value-added functions, such as product design and marketing, and has committed more than 3% of sales revenue to product design for the recent five years. Production has been undertaken by a subcontractor.

Discussion

Our study suggests several noteworthy findings related to the own branding mechanism of Chinese POEs. First, the Chinese POEs prefer own branding in global markets through the outright acquisition of foreign brands. This is the same case with

[9]Sources are from Kangnai Group (accessed on July 22, 2016 from <http://www.kangnai.com/about.aspx>).

the "LLL model" suggested by Mathew (2006), but unlike the SOEs, the LLL effects for POEs were tied with own branding. Without own branding, the POEs would not be motivated to realize the LLL effects in countries where wages are higher than China. Further, global branding was intended for strengthening the position in the domestic market. More specifically, the POEs' efforts for brand building in the global market presume the existence of benefits for domestic performance. The POEs took advantage of the fact that they were building global brands as a selling point in the domestic market because own branding in global market signals product quality, production capacity, and reliability. Therefore, paradoxically, global branding by Chinese POEs was highly domestic market-oriented. In order to prosper in the domestic market, they had to demonstrate to domestic consumers their global presence; otherwise, it was increasingly difficult to survive in China's fashion-related industries.

Second, we have found that conflicts with the old subcontracting customers were also inevitable in the case of Chinese POEs when they began their own branding. However, the POEs adroitly managed to reduce the tension by distribution channel exchange with old customers, where Chinese firms take care of distribution for foreign brands and foreign brands, in return, import and distribute Chinese goods. According to our interviews, building distribution networks was the most expensive task for our sample firms, and although the customer relationship was no longer valid in own branding, the relationship with the previous customers did not necessarily turn hostile as long as both parties found mutual needs for cooperation.

Third, as recent improvement on the IT infrastructure provided the facilitated use of online platforms, Chinese POEs without exception were actively utilizing e-commerce as a marketing channel. Given that establishment of offline distribution network is highly costly, increasing popularity of such platforms is likely to encourage POEs to get involved in own branding in the overseas market.

In Table 2, we configure current OBM strategies for Chinese POEs in the fashion industry, where the POEs would fall largely in one of the three possible models. In the competitive subcontractor model, a subcontractor can build a firm's name as a brand. Firms remain subcontractors, but because the firm name becomes established among clients and the end-users, the end-users (usually consumers) may rely on the subcontractor brand for the product purchase. It has happened that, as the value chain becomes increasingly complicated, "made by whom" or "designed by whom" are differentiated from the product seller. In this model, own branding is undertaken at the minimal level.

In contrast, the toehold model enables a combination of subcontracting and own branding. It has been the most popular model among Chinese POEs that we visited.

Table 2.
Global Branding Model

	Competitive Subcontracting Model	Toehold Model	Home-Linked Organic Model
Initial condition	Exporting in mode of subcontracting	Domestic leaders (subcontracting and own branding)	Domestic leaders (targeting global markets with own branding)
Overseas entry timing	1993 as ODM for Babei; 2003 as OEM for Baili; 2011 as ODM for Sunrise	1993 as ODM and 2002 as OBM for Aokang; 1979 as OEM and 1986 as OBM for Youngor	1987 as ODM and 1999 as OBM for Kangnai; 2005 as OBM for JNBY
Strategic goal	Building firm reputation in the core market and the product brand in the non-core market (as a result of diversification)	Building the product and firm brand	Building the product and firm brand
Brand building strategy	Participation into overseas exhibition; Export increase	Partnership with global brands	Compliance with global standards; overseas flagship store operation; overseas production base building
R&D strategy	Based on current customers	Based on the global market trend	Based on the global market trend
Case	Babei, Baili, and Sunrise	Aokang and Youngor	Kangnai and JNBY

Deliberate segregation of markets would lead to differentiation in branding strategies. A firm can continue subcontracting where it is less experienced with local customers, or when building distribution channels is risky. Alternatively, it may pursue own branding, where it possesses sufficient market know-how. The toehold model is chosen when competition is fierce, and firms can differentiate products and services in one market, while coping with the cost pressure using economies of scale and location advantages.

The home-linked organic model posits that firms pursue own branding at the product level. This model is typical for own branding, where a firm establishes its product brands and firm reputation. Despite the higher risks, the Chinese rationale for

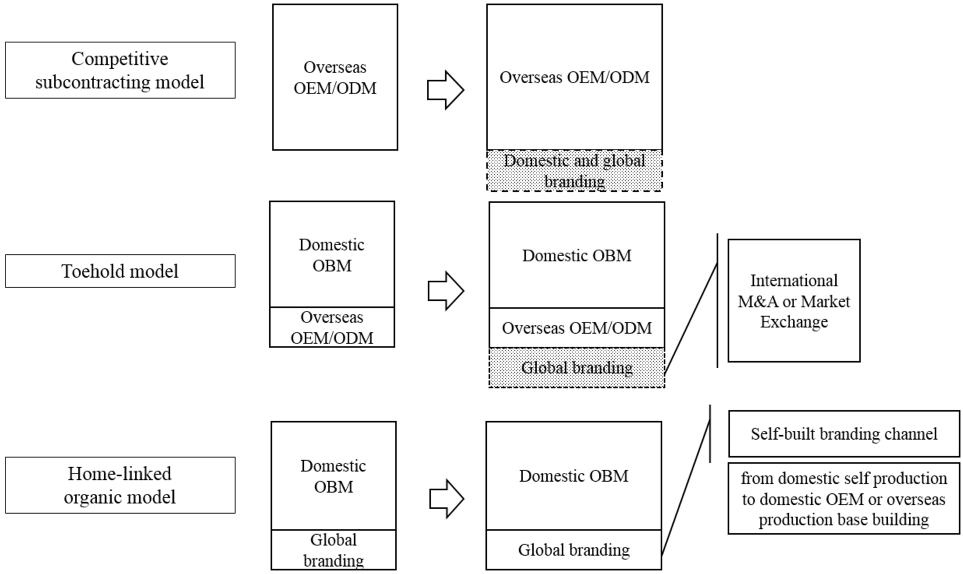

Figure 1. Findings: Transition from OEM to OBM.

the choice of the home-linked organic model is that, as long as the products satisfy the global standard, they offer a competitive price to local consumers. In this model, a linkage to the home country is still important, as illustrated by Mathews (2006). The firms in the home-linked organic model may conduct local production operations, but these should be pursued to maximally exploit home country advantages.

The firms in our cases showed differentiated choices over the own branding model, as Figure 1 shows. Their transition from OEM to OBM can be categorized into three types broadly. For example, Babei (competitive subcontractor model), owing to its subcontracting reputation, has exercised bargaining powers in its relationships with customers. Accordingly, even though the potential mark-up from own branding would be higher than that from ODM, Babei was cautious in using own branding.

The Babei strategy contrasts with the Aokang approach. Aokang still wanted to continue its subcontracting business with some partners because it focused on partnership formation. However, other partners were willing to let Aokang use their distribution channels in the host market in return for access to the Aokang sales network in China. Aokang confirmed similar needs for foreign entry, and based on mutual trust, agreed on cross-distribution, depending upon the attractiveness of the market for own branding.

The home-linked organic growth model illustrates the growth strategy of born-global firms. Kangnai, for example, noticed that, as the online purchase became more popular, once product quality would go viral, marketing costs could be reduced. It focused on establishing flagship stores, importing products from China. It started local production where the local sales were satisfactory. For firms in this model, quality control was the core task; otherwise, firms should overcome disadvantages of own branding, non-local status, and the developing-country origin.

Overall, each model has strength and weakness. The strength of the competitive subcontracting model is minimal loss of current clients. The toehold model enables strategic optimization with the geographic variable, and home-linked organic growth model benefits from the greatest profit perspective. Simultaneously, the competitive subcontracting model may be tardy in promoting awareness among consumers. Moreover, the toehold model may be stuck in the middle dilemma, while the home-linked organic growth model faces the highest risk in own branding.

The Chinese POEs in our study suggest an interesting comparison with POEs in other countries. Lee et al. (2015) find that Korean POEs internationalize for the purpose of own branding because the tension with the previous customers prevented further growth in the domestic market. In order to compete with the previous customers, the Korean POEs had to increase price competitiveness, and went overseas. Amsden and Chu (2003) illustrate that Taiwanese POEs went overseas as the domestic wage rose, and began to pursue own branding for higher mark up. In contrast, Chinese POEs, unlike Korean POEs, did not pursue internationalization due to competition with the previous customers or, unlike Taiwanese POEs, did not go overseas in search for lower wage. Yet, Chinese POEs were still domestic market-oriented even when they went overseas with own brands. These firms, unlike the large Chinese SOEs or Korean POEs, had more opportunities for continuous cooperation with the previous customers.

Conclusion

The primary aim of this study is to enhance the understanding of ongoing important issues in academia and business. We have examined the approaches used by competitive Chinese subcontractors (ODM) as they have moved up their value chains. Although Chinese POEs have shown a surprising capability to overcome impediments of ownership and size, and have grown to become international exporters, few studies have focused on identifying the OBM trajectories within the value chain. Our study has attempted to fill the gap by exploring the OBM based on case studies.

Weak stability in political status and poor accessibility to financial resources have prevented Chinese POEs from own branding, which poses risks in establishing distribution channels and recruiting marketing resources. Chinese POEs were previously engaged in subcontracting, making China a global factory. After accumulating decades of exporting experience, some POEs began to attempt own branding. The own branding movement, although not yet entirely popular, surely reflects a change in the business environment, where international customers who used to subcontract to Chinese firms have begun using subcontractors in other lower-wage countries.

Subcontractors who are able to conduct product designs may consider own branding as a response to this competitive pressure. Own branding requires marketing skills and distribution channels, a resource set different to that demanded as subcontractors. It also poses substantial risks as a result of severing the links with subcontracting clients, and turning them to the competitors. Therefore, own branding clearly presents a trade-off.

This study is based on the OBM cases of seven firms in *Zhejiang* Province that manufacture fashion-related products. Owing to increasing wages in China, we expected that subcontractors would face pressure with own branding, and that this would be strongest in the light manufacturing industry. Therefore, we chose *Zhejiang* Province, which possesses the largest number of POEs and several clusters of light manufacturing industries. One such industry is the fashion industry, which includes shoes, accessories, and clothing.

Our findings suggest that Chinese firms currently pursue three types of OBM strategies: the competitive subcontracting, the toehold, and the home-linked organic models. The competitive subcontracting model takes advantage of current production value chains that evolve into more divisions and specialization. For example, Babei, as a renowned necktie manufacturer, has continued subcontracting, but partially exposes its brand in non-core products. The toehold model exercises both subcontracting and own branding, depending on the market conditions. For example, Aokang has launched its own brand where its competitiveness is relatively strong, while still subcontracting elsewhere. The home-linked organic model shows that Chinese POEs possess own brands in foreign markets in a way that they still benefit from the low production costs in the home market.

Overall, we have found that Chinese firms consider three distinct ways to upgrade their value chains, while coping with the changing business environment. The call for own branding is clearer now than ever before. Although the risks of own branding perceived by Chinese POEs are distinct, we believe that this trend will continue to increase in future. Therefore, our study contributes to the literature in the areas of small- and middle-sized firm management and POEs in transitional economies by proposing that Chinese POEs, given the constraints and their respective strengths, devise optimal ways to move from being subcontractors to establishing their own brands.

Nevertheless, our study has some limitations that suggest a need for further research. First, because our study is exploratory, the sample is based on *Zhejiang* Province in China and selected firms. Given the large diversity within China, we hope to include POEs from different regions in future work. Second, because this study analyzes the fashion industry only (although we studied other light industries during the interview processes), our findings cannot be generalized across industries. Future research should consider a research setting with a greater number of industries in order to determine industrial differences.

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