



**Huawei's Internationalization Process And Its Competitive Position In Foreign Markets: The Demand For Mobile Devices In The Modern Era**

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### **Short abstract (Executive Summary)**

This paper is aimed at making a brief analysis to the internationalization process that Huawei has undertaken making a PEST analysis on the general framework on which the company is operating. From this analysis this team concluded that there is a moderate-risk level political and economical environment for the company arising from diplomatic tensions between the United States and China and the recent trade war.

During the analysis, we also drew the conclusion that the R&D centers of Huawei around the world and the demand for mobile devices are crucial for its economic performance. We were also able to establish the characteristics of the demand for mobile devices today from which our proposal to the company arises.

According to the research we did, the demand for mobile devices is going to be strengthened by new users in younger ages and the replacement of the old devices that have fulfilled their product life-cycle. Therefore, our idea is to tackle this segment of the demand designing products or services for younger users taking advantage of the capabilities of the company in R&D.

In **Chapter 4** we analyzed the risks of getting this new product to the American market. The main risk which arises from the political difficulties of China and the US is the imposition of tariffs for the mobile devices coming from China. In that chapter we propose different

The risks of trying to get this new product to the American market are described. We also offer three different alternatives to sort out the increase in tariffs.

The most suitable option for Huawei is to diversify its production to Peru. This country has an FTA with the US which means that tariffs can be avoided, it is strong in mining which means that the raw material is available there and the labor force price is still competitive.

### ***Introduction of the Company: Huawei***

Huawei is a multinational private high-technological company specialized in research and development, electronic production and marketing of telecommunication equipment. The headquarters of the company are located in **Shenzhen** but it has research and development centers in countries such as: *Sweden, United States, Ecuador, Ireland, Colombia, Mexico, India and Brazil*.

The company was founded in 1987 by Ren Zhengfei in the framework of the reforms to the Chinese market carried out by the Secretary General of the Communist Party, Deng Xiaoping, in the 1980s. These reforms brought an economic special zone to *Shenzhen* in which companies such as Huawei had benefits on their operations. Most of the companies created during this reform period were state-owned. However, Huawei was an exception to that.

Today, the company is one of the leading companies in the technological sector with an estimated of 180.000 employees and total revenues around the world over 92.5 billion dollars in 2017. Huawei is also a major supplier for the 35 largest operators of telecommunications in the globe and around 10% of the total earnings are reinvested in research and development.

### ***Internationalization Process: Huawei***

The company's development since the 1980s can be divided into three stages according to Victor Zhang, the CEO of Huawei in Europe. The first stage of the development of Huawei was the conquest of its local market and the last two stages concern the internationalization process that the company has undertaken.

***Stage 1 (1987-1992): Conquest of the local market (R&D)***

During its early years Huawei began as company selling PBX products. A few years later they started to manufacture their own motherboards using their own designs. The company started its operations in rural areas with very low competitions from any other companies which referred the more developed urban areas.

The company started its first research and development center in 1990 establishing a crucial competitive advantage over the rest of the Chinese firm competing in the telecommunications industry. This R&D centers allowed Huawei to conquer its local market differentiating itself from the competitors. The other firms were operating solely as business agents for Western firms entering into the new Chinese market with no real component of innovation.

***Stage 2 (1993-2000): Growth and organizational structuring***

During this second phase the company suffered from an accelerated economic growth and it restructured itself in organizational terms. These developments positioned Huawei as a company with international competitiveness and potential.

During this stage the government of China opens up its market gradually for multinational foreign companies. This process of "*liberalization*" increased the demand for fixed and mobile equipment of telecommunication.

The increased demand allowed Huawei to grow and the company maintained its leading position in the market arising from the lower costs resulting from the capacities that the company had in research and development. R&D has proven to be one of the company's most important elements for success.

In 1997, Huawei signed partnership agreements with corporate consulting firms specialized in organizational structure such as **Hay Group, IBM and Price Waterhouse Cooper**. These consulting firms accompanied Huawei through a process of international transformation to transform the company and bring it into compliance with the best global practices.

***Stage 3 (2000 onwards): Accelerated international expansion***

By the year 2000, only 10% of the company's income came from international market. In contrast to that, in 2006, about 65% of the total company's income was coming from the international market. This reflects the quick rate of expansion the company has suffered since the year 2000.

The economic context under which Huawei suffered such a high international expansion rate is an environment in which the demand for mobile phones saw a dramatic increase around the globe. The number of mobile phones being used in the world went from one billion in 2000 to six billion in 2012. It is estimated that around 30% of the mobile phones being used are in China and India.

This positive international environment on which the demand of mobile phones skyrocketed was also reinforced by the strong capabilities of the company to compete in the global market. Huawei has managed to maintain its core competitive advantages in the international market. It has been very difficult for other competing companies to imitate the advantages in research and development that Huawei has developed throughout its history.

Huawei's R&D centers are located in different countries across different continents. This geographic diversification has allowed the company to innovate according to local needs and maintain a sustained competitive advantage over its competitors over time.

## **Chapter 2: Background of the Idea**

### ***Idea (Product/Service)***

The idea is to use the R&D capabilities of the company to design new products to tackle a younger market segment. This entails creating products that are more intuitive and simpler to use. It can be supported by the design on new applications to support the learning process of children at the early stages of their development.

### ***Market opportunity analysis***

According to the AAP (American Academy of Pediatrics) the children in the US start using smartphones before their first birthday and by the age of four at least 75% of children have already owned a phone.

The market opportunity relies on the fact the the US has a birth rate of 12.4 births for every 1000 inhabitants. With a total population of 329.256.645 inhabitants this results in 4.115.708 new-born babies every year. We are going to focus entirely in the US market. Nonetheless, there are many other markets which the population is growing steadily and there are a lot of newborn babies every year.

The trick is that the authorities in the US are discouraging the use of mobile devices by the children under the age of two. This is because they are using the generic devices that are meant to be used by grown-up people. This is where the R&D centers of Huawei play a key role to design specialized devices for children at early stages of their development.

### ***Political environment***

The political environment today for Huawei is very uncertain. Since the current president of the US, Donald Trump, took office in 2017 the diplomatic relationship between the People's Republic of China and the United States has been deteriorating.

The huge trade deficit that the US faces against China has led Donald Trump to review its trade policy with the Asian giant. This has resulted in a trade war between the two largest economies in the world which is going to be discussed in detail later. This trade war has also had political implications.

The US has also taken back steps in the relationship with many countries in Latin America and the Middle East. This has created a void in power which is being filled up by China. The Asian giant is already the second most important trading partner of Latin America and the region is being flooded by chinese investments and loans. The Middle East is also a region on which China is positioning its political power throughout the "One Belt One Road" (OBOR) project which connects Europe to East Asia through the Middle East and Central Asia.

In December 2018, the political difficulties escalated affecting Huawei directly. The Chief Financial Officer (CFO), Meng Wanzhou, was detained in Vancouver at the request of US authorities. She is accused of helping Huawei cover up violations of sanctions against Iran and some US lawmakers have qualifies the company as a threat to the national security of the US.

China has called for the liberation of the executive. They have deemed the detention as an attempt to weaken one of Apple's main competitors. In retaliation the government of China detained a Canadian officer in the country. As a consequence, the US advised its citizens to avoid travelling to China. Therefore, the situation is very tense for the company and it is still unresolved.



In the most recent developments of this crisis the United States has recommended not to use Huawei devices and technology to its citizens and allied countries. This has the potential to put the company against the ropes.

### ***Economic environment***

The economic environment also poses several threats to Huawei. There is a lot of uncertainty because the trade war between China and the United States is putting at risk the revenues of the company that come from the North American market.

Trump has confirmed the imposition of 25% import-tariff on 50.000 million USD of imports coming from China. The measures were announced as a response to alleged “*unloyal trade practices*” and violations to the protection of intellectual property rights. The industries affected for the imposition of the tariffs were: aerospace, **information technologies**, robotics, machinery and automotive.

Huawei could have been potentially affected by the tariffs but the products that the American families consume have been excluded. Therefore, mobile phones and appliances are not going to suffer an import-tariff increase. This does not mean that the risk has completely disappeared since there is always the possibility of an escalation in the trade war.

On the other side, China has accused the United States of initiating a trade war and has retaliated against the US imposing tariffs in more than 128 products being imported from the US. Particularly, **soja** which is the main US exportation to China

### ***Social and technological environment***

Huawei is operating in a positive social environment. As it was mentioned in the introduction of the company, its rapid growth in the international markets has been driven by the increased use of the mobile devices.

According to “*Euromonitor International*” it is very unlikely that the demand for mobile phones is going to grow due to new traditional consumers. Instead, the demand for mobile phones is being impelled by the need of people to replace the old devices and the use of mobile phones by increasingly younger consumers. The central idea of this paper arises from this trend in the social environment of Huawei. It is also very important to mention that the industries related to telecommunications and the information technologies are crucial for the social structure of the world today.

In regards to the technological environment the main competitor of this Chinese firm in the global market is *Apple*. For both companies the technological component is very relevant for their competitive advantages.

This industry has the shortest product life-cycle in the market. Therefore the maturity of the products is reached quickly and innovation is essential. Huawei has this sorted out with their R&D centers scattered around the globe. This short product-life is related with the planned obsolescence which consists on the design of a product with an artificially limited useful life, so it will become obsolete after a certain period of time.

### **Chapter 3: Justification of the Idea**

A case of study of Huawei is relevant as a business case study due to the following reasons. It is the only Chinese company listed in the *Forbes* magazine as the 87th most valuable brand worldwide. This case study is also very useful to show the interplay between the government and the private companies.



Huawei is the living example on how the reforms by the Chinese government during the 80s fostered the creation of this huge multinational. This case study reflects how the governments create conditions that private companies then exploit which is very useful for the analysis of public policy making. It also shows the importance of R&D for improving the competitive position of a company and drive the economic growth of its home country.

Huawei's case study is also a good analysis opportunity for the field of international relations. It exemplifies how the state is not the only actor in the international arena and it demonstrates the increasing importance that multinational companies play in world affairs and international politics due to their increased economic capacity and their lobbying ability. As we analyzed during **Chapter 2**, Huawei is at the center of an international political scandal involving the United States and China.

Our idea fits into Huawei's case study because it provides a business idea for the company to exploit a new segment of the market. More important perhaps, our idea will also explore the different alternatives that the company has to get around the political difficulties arising from the tense relationship of China with the United States.

#### **Chapter 4: Application of the Idea**

##### ***R&D***

At the core of our proposal to Huawei is the innovation. Therefore, the R&D centers of the company are going to play a key role for the first stages of the implementation of the idea we are proposing.

Historically, Huawei has been able to reach such a rapid growth thanks to its research centers which are located all over the world. This diversification has played a very important role in innovation oriented to fulfill the needs of a specific market with unique consumer traits. Our proposal is to introduce a new product in the American market to tackle a new segment of the market which consists of younger customers.

Therefore, the R&D center located in New Jersey and San Diego must get their hands to work on the development of a new device aimed at young children. This device would have to initially fulfill the following characteristics.

- The product must be aimed specifically to the children under the age of two. This is to avoid the recommendations in the American market to maintain newborn babies away from traditional mobile devices meant for grown-ups.
- This product can be supported by the creation of applications that strengthen the brain development of those kids at the early stages of their contact with the world. It must also be intuitive and very easy to use to fit with the limited usage that the children may give to the final version of the device.

Once the product has been developed the next stage is to produce it and take it to the market in the United States. This is perhaps the most tricky stage for the application of our idea and it implies several risks. Huawei must establish strategies to get around those risks.

##### ***Risks and entry modes***

There are several risks for the application of the idea. As discussed during the PEST analysis both the economic and political environment is tricky due to the trade war and the diplomatic tensions between the US and China.

Although, Huawei was not immediately affected by the increase in the tariffs for a myriad of Chinese products, there is still a high risk that the government in the United States is going to eventually

include mobile devices in the list of the regulated products. It is also worth to mention that US has deemed Huawei as a threat for national security and has emitted various recommendations against the use of technology from this company.

Therefore, it is important for the company to try to have a set of alternatives to sort out the tariffs. It is a crucial element because a 25% tariff on the products from Huawei would render the idea completely unfeasible.

Almost a 100% of Huawei's production is performed within China. This means that entering the american market would require the importation of products from China which are affected by tariffs. This means that in order to be able to sort out th tariffs the company would have to start producing elsewhere. Our analysis has concluded that the company has three options to get around these tariffs requirements which are:

- The first option is to establish a production facility in the United States. This would be very expensive. It would also take too long and there may be requirements for FDI coming from China in the United States. Besides, the workforce in the US is much more expensive and this would affect the final price of the product in the market and the competitiveness of the product.
- The second option for Huawei is to license the intellectual property of this product to a manufacturer in the US. This is a quick entry mode. However, the company would completely lose control over the product within the American market and they will still have the problem of the high wages that must be paid to the workforce.
- The third and the last option for Huawei is to establish a manufacturing facility in an emerging market from Latin America or the Caribbean. The selected country must have a Free Trade Agreement (FTA) with the United States such as *Colombia, Chile, Peru, Dominican Republic or Panama*. Those countries can be used as a new export platform to the American market taking advantage of the trade agreement.

This option would take time but the labor force is more competitive in terms of price, it would also allow Huawei to skip tariffs and the raw materials for the manufacturing of the devices are available in those markets. *Peru and Chile* for instance have strong mining industries which produce silver and copper.

This the most difficult stage for the implementation of our proposal in Huawei arising from the political differences between China and the United States. The most suitable entry mode out of the three presented possibilities is the third one. It offers the best cost-benefits analysis with the only drawback of the time needed to build up a plant.

### **Starting operations**

With the entry mode selected the next stage for the implementation of the idea is to build up the manufacturing plant. This is undoubtedly going to take time and it is essential to perform a viability analysis on which the financial insights of the company are included.

This paper is not going to include such an analysis due to the restrictions in terms of information and time. We do not have access neither to the financial information of Huawei nor to the data about the time required to build up a production plant from scratch and the costs associated with it.

## **Chapter 5: Recommendations**

Our recommendation to the company is to be careful with this idea. The analysis shows that it has potential within the American market due to amount of babies being born every year and the

characteristics of the demand for mobile phones/devices. Nonetheless, the environment for the company is very risky in political and economical terms due to instability of the China and the US relationship.

Therefore, we suggest the company to be very careful with the timing of the entrance of this potential new product to the US. We strongly advise to start working on the product in the R&D center and wait until the political turmoil has passed to implement the entry strategy into the North-American market.

This team also recommends to make a strict follow up of the trade war and the diplomatic tensions between China and the US. This dispute has gone beyond an inter-state issue and is now affecting Huawei directly as Donald Trump said that the company is a threat to the US national security.

In terms of the entry mode, we strongly suggest the third option. We strongly advise Huawei to open up a manufacturing plant in Peru. We selected this country because it has an FTA with the United States, it has strong and very good relationships with China and Peru also has an FTA with China.

Finally, we decided to select Peru because it has a strong mining industry that can provide a lot of the raw materials needed for Huawei to manufacture the devices. The second best option is Chile because it has higher wages for the workforce than Peru which means that the price of the products manufactured in Peru will be more competitive in terms of price.

Our final comment on this paper is that at the end it may not be feasible for Huawei to enter the US market with a new product like the one we are proposing. The situation is very tense and the consequence is that Huawei may lose all the revenues coming from the US.

This tension is translated into a very low and remote possibility of launching a successful new product in that market. As long as the political turmoil continues there is not much that can be done in the United States. Huawei may consider this type of product in another market such Europe but further analysis is required.

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