9

The growth and internationalisation of Geely – the Chinese car manufacturer

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In March 2010, Chinese car maker Geely (a Chinese word meaning auspicious or lucky) signed a deal to buy Volvo from the US car giant Ford for US$1.8 billion. The acquisition is considered to be an example of China's growing influence in a range of industries on the international stage. It is fresh evidence of foreign direct investment (FDI) being made by Chinese car makers in a bid to gain access to European markets and Western technology. The Volvo deal placed Geely – which was barely known outside of China – in the spotlight. It also raised questions about just how ready Geely was to be a major player on the global stage. Did Geely have a clear and robust strategy for further development of its fledging international strategy? Was the purchase of an extremely well-established Western auto manufacturer by Geely – an emerging market automobile manufacturer – an act of egotism or a sound and strategic long-term investment? This case provides an insight into the global automobile market and China's growing interest, as well as an indication of Geely's growth and expansion, culminating in the takeover of Volvo.

Background: the automobile industry worldwide

The automobile industry is a large and critical sector of the global economy. Over the last few years, there have been dramatic changes affecting the industry. For example, significant changes are evident in the European Union and the United States, whose economies have suffered as a result of the global economic slowdown, leading to a decrease in car sales and a decline in the relative markets. In contrast to these declining trends in developed countries, emerging economies have become fast-growing markets for the automobile industry. China became the world's third largest car market in 2006, and then the largest in 2009; additionally, India recently posted its highest ever car sales figure – 195 million cars in 2011 (Gulati & Choudhury 2012). It is anticipated that the emerging markets will experience continued growth, with drivers including rising incomes, increasing availability of credit and falling car prices.

These emerging economies are also becoming the main players in car manufacturing. In 2005, a total of 46.86 million cars were produced worldwide. One-third of the cars were produced in the European Union, and 19.24 per cent were produced in Japan. In contrast, in 2011, production globally reached 58 million, of which 24 per cent (14.49 million cars) were produced in China. This made China's production for 2011 twice as large as Japan's, which first lost its title of the world's largest car manufacturer to China in 2009 (OICA n.d.).

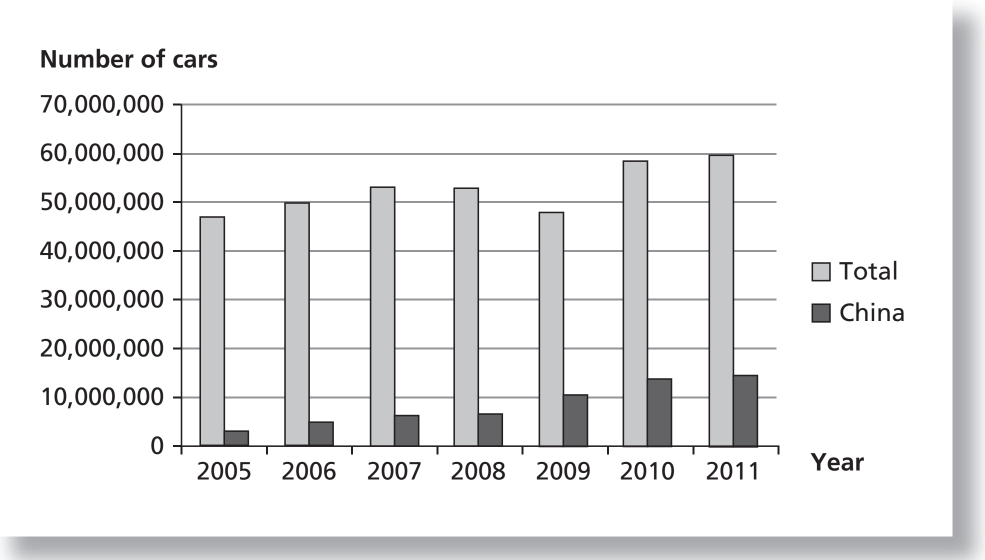
Ongoing investment in new technologies will doubtless help the auto industry become even more competitive than it currently is. In 2011, five out of the top 20 research and development (R&D) spenders around the world were from the automotive sector. In particular, Toyota spent more on R&D than any other company in the world, largely to improve fuel efficiency and electronics (Jaruzelski, Loehr & Holman 2012; *Economist* 2012). Studies have also shown that profitability in the industry results not only from the *amount* of R&D spending, but also from *how* the money is spent, and whether it is utilised effectively – including effectiveness in defining new concepts and executing strategic plans (Booz Allen Market Services 2003; Booz & Co. 2010). While cars makers from advanced economies invest significantly in new technology, there seems to be persistent under-investment in R&D in emerging economies, such as those of India and China.

China's automobile industry

Nevertheless, the growth of the Chinese automobile industry – the origins of which were in the 1950s – is clearly evident. In 1965, the annual combined production volume of nine key Chinese manufactures (all state-owned) was less than 60 000 cars. After the initiation of its open door policy in 1978, China started to encourage FDI into the automobile industry and set up alliances and joint ventures with major foreign auto manufacturers, such as Volkswagen, General Motors, Toyota and Honda. Only state-owned enterprises were allowed to engage in automobile manufacturing and form joint ventures with international automobile manufacturers. Since the 1990s, with further advancement of the economic reform and open door policy, several new domestic enterprises have entered the Chinese automobile industry, including some privately owned companies, such as Geely Automobile. By the end of 1998, China's annual vehicle output had reached 1.6 million, making China the tenth largest auto producer in the world. Eleven years later, in 2009, China's annual automobile production capacity exceeded 10 million. It was at this point that China surpassed Japan for the first time as the largest automobile maker in the world. Approximately one-quarter of the cars in the world are now produced in China (see Figure 9.2).

Today, more cars are sold in China than in any other nation, and strong markets have emerged for cars at different price levels, from inexpensive sedans and vans to expensive Cadillacs and German luxury cars. While some developed countries, such as

Figure 9.1: Car production statistics between 2005 and 2011
Data Source: OICA (n.d.).



the United States, have experienced domestic market declines over the last few years, China has consistently registered high growth rates for its domestic automobile market.

The sale of automobiles within China has increased from 2.36 million in 2001 to 13.64 million in 2009, resulting in an astounding compound annual growth rate (CAGR) of 24 per cent. By the end of 2009, China had become the world's largest automobile market, and it continues to hold this position. This is a significant achievement, attained over a relatively short period of time, and it is the first time that China's automobile market has surpassed the market in the United States. In addition to locally manufactured cars, the Chinese market attracts a large number of imported cars, mainly from Europe, the United States, Japan and Korea. China's overall auto usage increased from five cars per 1000 persons and 2.6 cars per 100 households respectively in 2002 to 22 cars per 1000 persons and 8.3 cars per 100 households in 2009 (National Bureau of Statistics of China 2009). Although the vehicle penetration level has increased, it is still lower than in developed countries. As a result of its significant population of 1.3 billion, and its fast economic development, China's market size and growth potential make the country a game-changer in the international car market (US-China Economic and Security Review Commission 2006).

It has become evident, too, that the Chinese auto manufacturers now include both state-owned and privately owned enterprises. Since the 1980s, the majority of the state-owned enterprises have formed joint ventures with international auto manufacturers, with the joint ventures successfully becoming leaders in the automobile production market. Given that China's automobile industry was under the protection of high tariffs during the 1990s, the fast-growing automobile market has provided domestic auto manufacturers with great opportunities. Local governments have been supporting local automobile manufactures by providing financial assistance, reducing the local auto manufacturers' tax liability, reducing overhead costs – for example, through free use of industrial land – and so on. Consequently, some local automobile enterprises, especially locally state-owned car makers, have experienced rapid growth during this period. Since China entered the World Trade Organization (WTO) in 2001, central government control over local automobile enterprises has gradually loosened. The role of local government has also changed from direct intervention in the local automobile industry (mainly in support of local, state-owned enterprises) to support for all types of companies, including joint ventures and privately owned enterprises. Some local privately owned manufacturers quickly gained market share through the use of imitation and low-price strategies, without support from international enterprises. In 2010, among the top 10 automobile manufacturers in China, seven were joint ventures and two were privately owned enterprises, namely BYD and Geely. In 2011, Geely dropped out and BYD was the only privately owned automobile manufacturer in the top 10.

The Chinese government continues to play a central role in shaping the automobile industry. For example, Beijing launched a raft of policy measures that included automobile buying incentives to boost spending on cars; these incentives act to promote the continued growth of the automobile industry, and they resulted in continued growth during the global economic downturn. In terms of managing FDI, ownership policies mandate that foreign automobile manufactures enter into 50/50 joint ventures with local auto makers. The central government is strongly encouraging of R&D on alternative sources for power trains, including electric cars and gasoline–electric hybrids to help cope with energy shortages and rampant pollution.

During the last couple of years, on average, 10 per cent of automobile sales were allocated to R&D in China's automobile industry (National Bureau of Statistics of China 2009). Despite this investment in R&D, Chinese-owned brands are still underdeveloped, and face big challenges both domestically and internationally. Chinese auto makers appear to be heavily reliant on international suppliers for automobile parts; furthermore, many auto manufacturers in China suffer from a shortage of talent and a lack of experience in managing across borders.

Automobile manufacturers in China have, however, outpaced global automakers in developing cars specifically for emerging markets. As a result of China's automotive industry developing extensively through FDI in the form of alliances and joint ventures, international automobile manufacturers are unlikely to promote Chinese exports that compete with their own products in other markets (Tang 2009). Additionally, some Chinese self-owned brands seeking to enter industrialised countries are finding it next to impossible, partly because they are struggling to meet the safety and emission standards for these countries. Other emerging markets are therefore the main target of Chinese companies seeking to export cars.

Geely's venture into China's domestic markets

Geely Automobile Holdings Ltd is the tenth largest automobile manufacturer in China (Geely n.d.). Headquartered in Hangzhou, Zhejiang Province, Geely has six car-assembly plants and power train manufacturing plants in China, enabling a production capacity of approximately 300 000 cars per year.

Geely was founded in 1986 as a refrigerator maker, then switched to producing decorating materials. In 1992, Geely started to make motorcycle parts, followed by the manufacture of the entire motorcycle. By 1994, its motorcycles were being sold in 22 countries worldwide, an indication of its determination to succeed in whatever product it manufactured. Continuing its entrepreneurial spirit, in 1996 Geely bought the shareholdings of an automobile manufacturer in Sichuan province, a purchase that provided the company with an automobile manufacturing licence. In 1997, Geely officially launched its automobile manufacturing business for RMB 50 million (US$8 million). A year later, the first Geely car – the Geely Haoqing SRV – rolled off the production line. Geely's mission was to produce affordable cars that would become available to the ordinary citizens of China; consequently, most of the cars it produced were reasonably priced, around and even below RMB 40 000 (US$6000). Such prices were bound to attract local share.

As one of the first entrepreneurial, privately owned auto manufacturers, Geely experienced difficulties in attaining sufficient support from the local government of Zhejiang province, where it was located. This lack of local government support was clearly evident when Geely's founder and chairman, Li Shufu, invited local government officials to the launching ceremony of Geely's automobile business – only a few of them showed up. This lack of support was more than likely due to the fact that Geely was not yet one of the high-ranking local enterprises in the province at the time.

Geely operated in this 'awkward' situation until it was officially listed in China's automobile manufacturer index in 2001. This official recognition provided the company with excellent opportunities to compete against the more than 40 other private enterprises that reportedly wanted to enter the automobile industry. China's entry into the World Trade Organization (WTO) in the same year did not influence Geely much, given that China's car manufacturing sector – as a fledgling industry – was granted five to six years of protection. It was during these years that Geely became one of the fastest growing companies in the automobile industry in China.

The history and growth of Geely as a company is an interesting example of low-cost strategy and entrepreneurial leadership. The business venture commenced from humble beginnings as a family business, with its operating capital coming from Li Shufu's family and friends. In 2002, in a strategic move, Li Shufu invited a former accountant from the Zhejiang Provincial Local Tax Bureau, Xu Gang, to join Geely as the president. Using his networks, Xu set the framework for Geely to establish contacts and build relationships with many banks at the provincial level. Before long, Geely was able to raise a loan of RMB 100 million. In yet another strategic move, in the same year Geely signed a significant agreement with the China Everbright Bank, one of the largest banks in China.

Geely also sought to attract capital from overseas. In 2004, Geely purchased a shell company in Hong Kong, and had its Initial Public Offering (IPO) on the Hong Kong Stock Exchange in 2005. This brought Geely HK$2 billion by June 2007 – a development that was critical to Geely's growth and development. Being listed on the stock market in Hong Kong also attracted attention from well-known investment banks, which prepared Geely for its acquisition of Volvo.

Geely's transformation from a small family business to a public company listed on stock exchanges required dramatic and sweeping changes within the organisation. During the transition, two-thirds of the senior management was replaced, and 90 per cent of the old employees, including almost all of Li's family members and relatives, were forced out (Wu, Cao & Chen 2010). In a country like China, where *renqing* (mutual obligation) plays an important role in the culture, these changes could not be made by Li Shufu himself. Rather, the new senior executives were the implementers of the organisational transition process, and they managed the changes through processes in the human resources department of the company. The intention was to revitalise the workforce, and Geely has continued with its approach of attracting skilled automobile executives from established auto manufacturers or suppliers. Human talent is considered to be the most important resource by Li Shufu. Geely also has its own schools and colleges to educate and train people to meet the company's needs. In 2008, Geely donated RMB 12.5 million and established the Geely Future Talent Fund and the Li Shufu Education Fund, to ensure that it is continuously building its talent pool.

Geely's venture into international markets

Having established itself firmly in the local domestic market of China, Geely was ready to venture into feasible international markets. It began with exporting cars in 2003, and developed a strategy for a continuing growth in export numbers. In 2008, Geely sold over 220 000 cars, with 24.5 per cent of its cars being sold to 55 countries – mainly emerging nations around the world. Geely had tried to enter the developed markets in Europe and the United States. For example, earlier in 2005 it became the first Chinese automobile manufacturer to participate in the 61st Frankfurt Auto Show, held in Germany. A year later, Geely made history at the Detroit Auto Show by showcasing the first Chinese automobile at the biggest show in North America. Unfortunately, despite its intentions of asserting its presence and becoming known in the United States, its lack of international experience led to a rather ordinary, lack-lustre display, featuring a small silver sedan that attracted criticism rather than admiration. The low-cost car was unsuccessful and uncompetitive on many fronts, and failed to meet the developed world's stringent safety and environmental regulations. It was mercilessly panned at the show.

Geely's senior management realised that it had to do better, and that focusing on low-cost cars would neither sustain the company in the long term – especially in the global automobile market – nor enable it to gain the international profile it desired. Geely kicked off a major transformation in 2007. A new mission was announced: 'Produce the safest, most environmentally friendly and most energy saving cars. And let Geely cars go all over the world.' (Geely n.d.) The transformation initiatives were carried out in an effort to get rid of Geely's image as a 'cheap' car manufacturer and to help the company become a technology-driven auto maker (Chen 2010). In 2007, Geely added another development to its strategy of innovation and entrepreneurship. The company entered a joint venture with Manganese Bronze Holdings, the established manufacturer of the London taxi. It strategically established Shanghai LTI Automobile Ltd as an arm of Geely, and commenced producing the iconic London taxi in China. Furthermore, in 2008 the company halted production of its three best-selling models, Haoqing, Meiri and Youliou, and planned to replace them gradually with better and more technologically sophisticated models in the form of the Free Cruiser, Kingkong and Prospect.

In the same year, at the biggest automobile show in China, Geely presented 23 new models in keeping with its strategy for change and ongoing innovation. All the new models employed new technologies and fell within the mid-range to high-end levels of car manufacturing. The shift in price is indicative of the shift in image building. For example, one of Geely's new high-end models cost RMB 3.6 million (US$580 000), which was several hundred times the price of Geely's old, inexpensive models. At the same time, Geely returned to the next international Detroit Auto Show in the United State, and presented two strongly competitive vehicles: the FC sedan featuring Geely's G-Power four-cylinder engine, and its newly revised version of the London taxi TX4. Even though Geely was still developing its overall strategy and schedule for entry into the US market, it was making progress in reaching US federal crash safety requirements and building a better perception of its product quality with reviewers.

In 2009, Geely made further strides forward in the international arena and bought Drivetrain Systems International Pty Ltd (DSI), a global transmission developer headquartered in Australia. It then proceeded to build three DSI plants in China to produce gearboxes. Geely intended to equip all its passenger cars with automatic gearboxes made by DSI. In the same year, Geely also opened overseas car assembly plants in the Ukraine, Russia and Indonesia.

On another level, to attract international market share, Geely rolled out a major initiative to classify all of its new models under three major marketing brands – Gleagle, Emgrand and Englon – and segmented its advertising and sales channels by brands instead of the traditional approach of segmentation by models. It strategically removed the name 'Geely' from the nameplate of its three new brands in a move intended to avoid people connecting the new brands with Geely's existing reputation for low prices and poor quality. The revised branding strategy sought to put Geely in a stronger position to meet new market challenges and attract new customers. While features of the 'Gleagle' brand targeted fashionable young people, the 'Emgrand' and 'Englon' brands were defined as luxury and classic brands, and targeted buyers from middle- and upper-income groups. These brand-focused strategies prepared the way for Geely's next target – a world-class international brand. Hence it commenced its acquisition deal with Volvo.

Geely's takeover of Volvo

By August 2010, Geely was able to proudly announce that it had formally completed a deal to buy Sweden's prestigious Volvo Cars from the US auto giant Ford for US$1.8 billion. It simultaneously proceeded to raise an additional US$900 million to keep Volvo operating. The total cost of US$2.7 billion included US$2.1 billion in loans from the Bank of China, China Construction Bank, Export–Import Bank of China, Geely Automobile Holdings and the government of Gothenburg, where Volvo is headquartered. The move was welcomed not only by Geely but also by the Chinese government, with China's Minister of Industry and Technology, Li Yizhong, appearing at the signing ceremony in Gothenburg, sending a strong signal of support from the Chinese government. The message seemed to be that Geely was buying Volvo, but so too was China (*Economist* 2010).

Geely was determined that the Volvo brand and its reputation of prestige and quality would remain intact. It announced that Volvo would still be operated as a separate subsidiary, managed by Swedish personnel, and the Volvo China team – including its marketing and public relations staff – would operate independently of Geely. This distinctive approach is captured in the words of Geely's Chairman, Li Shufu, who noted that 'Geely is Geely, Volvo is Volvo' (ChinaBizGov 2012). On 15 July 2010, Li Shufu became chairman of the Volvo board; the then CEO, Stephen Odell, left Volvo and returned to Ford as CEO of Ford Europe. Before he left Volvo, he told the media: 'Volvo is well positioned for the future with an exciting range of products that remain true to its core values: safety, quality, environmental responsibility and modern Scandinavian design.' (Ford 2010). A few weeks later, Stefan Jacoby – the previous head of Volkswagen's operations in the United States – was appointed the new president and CEO of Volvo Cars and a new board of directors was elected. A Volvo–Geely Dialogue and Cooperation Committee (DCC) was set up to steer the communications and joint efforts of both parties (*Global Times* 2010).

Volvo's main production sites will continue to be in Sweden and Belgium, but Geely plans to open two factories and an engine-assembly plant in China. Li Shufu has claimed that the corporate synergy could help Volvo nearly double its sales to 600 000 vehicles by 2015. Geely-Volvo is considering selling Volvo cars manufactured in China into the US markets, which could help reduce exchange-rate risks for Volvo, and make it one of the first companies to bring Chinese-made vehicles into the United States.

However, as in all acquisitions in international business (Datta 1991), bringing together two very different organisations can be problematic. In this instance, three months after Geely's official takeover of Volvo, Li Shufu admitted that there were severe conflicts between the Geely management team and the Volvo management team, mainly due to strategic differences. For Li Shufu, selling big and luxurious cars was the only way the Swedish brand could make up for lost time in the Chinese market. 'The fancier the better,' he said. 'Few have an eye for Volvo's Scandinavian no-frills style, to be honest.' (Yan & Pollard 2011). Yet Volvo's management advocated – at least initially – that Volvo stick to its tradition of focus on core mid-size models, where safety and fuel-efficiency are important.

Li Shufu responded by saying that Jacoby needed to understand China better. He told the media that many of China's new rich 'behave outrageously, showing off their wealth', and are willing to buy upscale car brands. He also inferred that it was like producing cigarettes, noting that 'smoking is bad for your health, but tobacco companies make and sell cigarettes. The same is true with Volvo.' (Shirouzu 2011)

In May 2011, four months after the establishment of a new Volvo China headquarters in Shanghai, Volvo's new S60 model – targeting the world's largest vehicle market – was launched in China. It was considered the blueprint for Volvo's expansion into luxury cars (Shirouzu 2011), and also seen as a sign of the smoothing over of the significant misalignment between the Geely and Volvo management teams (Yan & Pollard 2011). Whether Geely and Volvo can overcome their differences and steer Volvo towards success in the long term is still uncertain, but what is clear is that there are broad implications for China's global expansion. Chinese companies have poured tens of billions of dollars into foreign acquisitions in recent years, such as Lenovo's purchase of IBM's personal computer business and TCL's acquisition with Thomson, but have done so with little success. Although in a different industry, Geely and Volvo are facing similar challenges to those faced by other Chinese companies and their partners when involved in international acquisitions. Not only are there differences in strategy, but there are also cultural conflicts, and differences in management style and values (Krolicki, Pollard & Yan 2010).

There is one factor that is clear, though. Geely's takeover of Volvo did not stop it from the global expansion of its own brands. More recently, in 2011, Geely entered into the Australia markets with a Geely MK city sedan selling for around A$11 990 (US$12 350), which is believed to be one of Australia's cheapest cars. Another model, the Geely Panda, will be launched in Australia very soon – probably at an even lower price. Interestingly, the company decided to return to using the 'Geely' nameplates on these two models, two years after they were removed from the new brands launched in 2009. It was thought to be important to market and continuously strengthen the 'Geely' brand in the international arena – a sign of a successful auto brand from China!

Appendix 1: Volvo

Volvo was a Swedish car maker officially founded in 1927, when its first car rolled out of the factory in Gothenburg. Sweden's Volvo is the epitome of good middle-class taste. Volvo's very safe and practical cars were, in better days, the default choice on many a suburban driveway in the United States and Europe. Volvo was the first car manufacturer in the world to equip its cars with three-point safety belts as a standard fitting (1959). Volvo passed the two million car production mark in the 1970s. In 1976, the US traffic safety administration (NHTSA) purchased a number of Volvo 240s, which were used to set the safety standards against which all new cars on the US market were tested. Volvo cars became more powerful, faster and safer in the 1980s. The 1990s marked the biggest technical transition for Volvo. In 2007, the ReCharge plug-in hybrid concept was unveiled, signalling a new emphasis on environmental solutions. In 2008, Volvo introduced two mid-size models with extremely economical and clean diesel engines (Volvo, n.d.a). Table 9.1 presents the sales figures for Volvo between 2000 and 2011.

Volvo Car Corporation was sold to the Ford Motor Company in 1999 for US$6.45 billion. Before being taken over by Geely in 2010, the last time that Volvo had shown an annual profit was in 2005. In 2010, the president and CEO of Volvo Car, Stefan Jacoby, announced that Volvo had witnessed a turn-around in the car market and had returned to profitability. Volvo's retail sales for 2010 increased by 11.6 per cent to 373 525 units, compared with 334 808 units in 2009. In China, 2010 sales improved against 2009 sales by 36.2 per cent, and in the Nordic region they grew by 29 per cent. Corresponding European sales grew by 10.4 per cent, and market share improved by 0.14 per cent to 1.2 per cent. However, during this period of global growth, Volvo sales volumes in the United States decreased by 12.2 per cent to 53 952 units, compared with 61 246 in 2009 (Volvo, n.d.b).

Table 9.1: Volvo sales figures, 2000–11

Year	No. of cars (thousands)
2011	449
2010	373
2009	334
2008	374
2007	458
2006	428
2005	444
2004	456
2003	415
2002	407*
2001	412
2000	409

* As of 2002, sales are defined as cars delivered to end-customers.
Source: Volvo (n.d.b).

Appendix 2: Li Shufu vs Stefan Jacoby

'Mr Jacoby and Mr Li are a study in contrasts.' (Shirouzu 2011)

Geely's founder and chairman, Li Shufu, is being heralded as the equivalent of Henry Ford in China. He was born into a farmer's family in a poor village in Taizhou, Zhejiang province. Using the 120 Chinese yuan (US$15) he got from his father, he started a photography business after finishing high school. He also tried producing and selling silver and gold using a chemical separation, an 'innovation' that came from his experience while processing photos. The story of Geely Corporation began one day when Li Shufu saw four shoemakers producing refrigerator parts. He started to make refrigerator parts at home by himself, and before long set up a factory with his brothers to manufacture the entire refrigerator. After that, he dabbled in various business areas, such as producing decoration materials and brokering real estate. Not all of these attempts were successful. His failure in the real estate business, which he rarely mentions, made him believe he was not a good player in capital markets. Yet he was still extremely ambitious in pursuing his automobile manufacturing dream. His vision was one of China walking down a new Silk Road with Geely leading the way.

Volvo's CEO, 53-year-old Stefan Jacoby, is a reserved German with a sports streak: 'I am an athlete at heart and have always been inspired by the challenge of climbing Mount Everest.' (Mbuya 2008) Jacoby earned a MBA degree at the University of

Cologne in 1985 before starting a lengthy career at Volkswagen AG, where he was a Secretary General, Executive Vice President for the Asia-Pacific Region, Executive Vice President for Marketing and Sales, and finally accepted the position of CEO and president of the Volkswagen Group of America in 2007. As a VW golden boy in the United States, he had engineered both the building of a $1 billion plant in Chattanooga and an ambitious recovery plan for Volvo (Motavalli 2010). Jacoby's jumping to Volvo in 2010 was a surprise to both those inside and outside of Volkswagen.

Discussion questions

9.1 What is Geely's business strategy? Do you think Geely's choice to discontinue the production of cheap cars in favour of concentrating on the high-end market is risky?

9.2 What kind of foreign entry mode did Geely use in this case study? What are the advantages and disadvantages of using this (these) entry mode/modes?

9.3 What factors motivated each company during Geely's takeover of Volvo? What benefits can both Geely and Volvo expect to gain?

9.4 What do you think will be the main issues faced by Geely after its purchase of Volvo? Is Geely ready for further expansion and takeovers?

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