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CASE STUDY

Yunshi Mao, Tian Li, Yangchun Liu

Upgrading from OEM to OBM through Reverse Acquisition in China's Emerging Economy: The Case of Lacquer Craft Mfg

Abstract In this paper, we review how original equipment manufacturing (OEM) firms break the "lock in the global value chains" (GVCs) and upgrade to original/own brand manufacturing (OBM) through accelerated internationalization. We focus on investigating how Lacquer Craft Mfg (later referred to as Lacquer Craft), an OEM firm in southern China successfully upgraded to OBM through reverse acquisitions. By proactively utilizing the resources (including the mindset or perspectives formulated) generated from practicing OEM, Lacquer Craft developed the needed capabilities to build its own brand in an international setting. Lacquer Craft's successful experiences show that in a globalized economy, the ability to identify and exploit opportunities to link with established players, and the ability to search, acquire, and integrate strategic assets from the developed world rather than replicating the entire previous technological trajectory greatly facilitate the OEM firm in climbing up the value-added ladder and upgrading to OBM. This is a more aggressive upgrading approach. Its experiences also reveal that a firm's product and technological upgrading strategies are closely interwoven with its internationalization strategy.

Keywords OEM, OBM, GVCs, reverse acquisitions, strategic assets, upgrading

The development of global production networks offers possibilities for developing country firms (even small firms) to be drawn into the global economy. Yet as many of them supply global buyers as original equipment manufacturing (OEM) firms, they need only to acquire capabilities in a limited range of

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Yunshi Mao[a], Tian Li[b], Yangchun Liu[c] (✉)
Business School, Sun Yat-sen University, Guangzhou 510275, China
E-mail: [a]mnsmys@mail.sysu.edu.cn, [b]sunny0513@163.com, [c]mnslyc@mail.sysu.edu.cn

operations. Their continued involvement in the network depends on the strategic decisions of global buyers. As their cost advantages evaporate, and new production sites are integrated into the global economy, they may fall prey to global buyers' shifting orders away to new production sites. How to develop strategic assets and capabilities and sustain competitiveness has become a daunting challenge for the OEM firms in developing countries.

Because of the cost advantages they possess and the government's export-oriented growth strategy, large numbers of China's small and medium-sized firms (SMEs), even newly created firms, have entered the global economy via OEM arrangements since the late 1980s. Together they have contributed exceedingly to the rapid economic development of China. However, with the external environment changing extensively, the disadvantages of practicing OEM are becoming conspicuous. What was once a profitable and easy-to-enter business is now struggling. OEM firms in China have to change. Our field investigation into firms in southern China's Pearl River Delta region reveals that some OEM firms have managed to upgrade to original/own brand manufacturing (OBM) by way of acquiring companies from developed countries, for example, Lung Cheong International Holdings Limited based in Dongguan, Guangdong Province. Thanks to the strategic assets it acquired, such as the technological capabilities from research and development (R&D) establishments and brands from branded companies, it rose smoothly from OEM to original design manufacturing (ODM) and on to OBM. Guangzhou Guoguang Electric Company Ltd. upgraded from an OEM firm directly to an OBM firm by acquiring prominent global audio system brands such as Avlight, Wifa and Aivin. Since 2001, the case study company Lacquer Craft has acquired four branded companies from the U.S. and Western Europe. These acquisitions hugely enhanced its branding capabilities and provided easy access to developed markets, helping it leap from an OEM firm to an OBM firm and to emerge as a world-class hardwood furniture company. Our study will examine in detail this upgrading phenomenon. We hope our findings can disclose the role of high-risk internationalization, that is, acquisition, in the progression of OEM firms to OBM and highlight the practical and theoretical significance of our results.

Strong inter-firm connections within the global value chains (GVCs) can promote the upgrading of OEM firms. Normally upgrading occurs as a result of learning by exporting, buyer promotion of capabilities of OEM producers, or by

entering value chains with more demanding customers (Humphrey and Schmitz, 2000). Gereffi (1999), based on his research on the garment chain concludes that those producers that gain access to the chain have good prospects for upgrading within production and subsequently into design, marketing and branding. They may sequentially experience three types of upgrading: process, product, and functional upgrading. But Humphrey and Schmitz (2000) argue, after examining the upgrading effect of the Sinos Valley shoe cluster in Brazil, that in the quasi-hierarchical chains in which OEM firms operate, functional upgrading is limited. OEM firms may be locked in the lower value-added segments of the GVC, and refrain from or are prevented from occupying the strategic functions of the chain which tend to lie in product definition (design, branding, marketing) and chain coordination. Global chain governance can create barriers to the upgrading of firms. So how OEM firms break the lock and manage to move up to the value-added strategic functions remains a topic to be explored in depth. What are the factors for their successful upgrading? Are Chinese firms' upgrading different from cases examined by extant scholars? Our study aims to provide some answers to these questions. We present a detailed case study of Lacquer Craft that has managed to upgrade from the production of furniture parts and components as an OEM manufacturer to a spectrum of new product lines developed through their own design, branding and marketing capabilities.

We hypothesize that OEM firms use aggressive internationalization strategies to accelerate their upgrading from OEM to OBM since, in the process of supplying foreign buyers, they have accumulated capabilities and resources and knowledge of foreign markets. This international experience may also give them greater advantages to sense and capture opportunities in foreign markets. In order to change their position in the GVCs and realize fast discontinuous upgrading, they pursue high-risk internationalization modes, such as cross-border acquisitions, to acquire strategic assets such as technology, brands, distribution channels, or other sources of competitive advantages possessed by industrialized country firms. This acquisition of developed country firms by emerging economy firms is referred to as reverse acquisition by some scholars (Mao, Liu and Zheng, 2012). In this study, we adopt the term "reverse acquisition" to describe OEM firms' conscious seeking of strategic assets from firms based in developed countries.

We begin by giving a framework for understanding firms' upgrading from

OEM to OBM grounded in the existing literature on GVCs and accelerated internationalization. We then examine how the case company Lacquer Craft accumulated resources and capabilities via OEM production and how it achieved upgrading through several reverse acquisitions. At the same time, we probe the elements for its successful upgrading and link such elements to the theoretical framework. We conclude the paper by presenting our findings and practical implications for other firms struggling to climb the value-added and technology ladder.

1 Theoretical Background

We utilize two perspectives to explain the upgrading of OEM firms to OBM. The first is the GVC perspective, which suggests that inserting into global production networks can help firms with very limited capability bases enter the global market and accumulate resources and capabilities for further development; the second is the accelerated internationalization perspective, which indicates that the globalized economy has changed the logic of the competence creation process and emphasizes that latecomer firms internationalize rapidly to seek both market and strategic assets in order to expedite their ascendance to OBM. Below, we provide support for this description of the relationships among them.

1.1 Global Value Chain and Upgrading

A value chain is defined as the "full range of activities that firms and workers do to bring a product from its conception to its end use and beyond" (Gereffi and Fernandez-Stark, 2011). Since value chain activities such as design, production, marketing, distribution, and after-sales service etc. are increasingly spread over different countries in the world, the value chain is commonly referred to as the global value chain.

The concept of GVC has captured three characteristics of the world economy: the fragmentation of production across countries, which leads to the interconnectedness of economies; the specialization of countries in tasks and business functions rather than specific products; and the role of global buyers, suppliers, and networks, which gives insights on chain governance and helps to identify lead firms and actors that control and coordinate activities and latecomer firms that undertake organizational learning within the chain (Backer and

Miroudot, 2013). A major GVC argument is that participation in global production networks and linking with "the most significant lead firms in an industry" (Humphrey and Schmitz, 2002) is a good opportunity for the development of developing nations and firms.

Firms in developing countries rarely have strategic resources such as technological capabilities and brands, particularly at their early stages of development. However, through a linkage with global production networks and by performing OEM for subcontracting multinational company (MNC) customers, these latecomer firms can reverse their competitive disadvantages and eventually upgrade their technology capabilities (Hobday 1995; Mathews 2002). Via OEM arrangements, they only need to focus on the area in which they have advantages, namely production. There is no need for them to develop in-house R&D or marketing capabilities, the development of which is very expensive and time consuming, and full of uncertainty. Furthermore, an OEM strategy can help backward firms accumulate capabilities besides generating capital. OEM arrangements with global buyers provide OEM firms with information on product designs, quality, training and accounting procedures, essential financing for their operations, and low-cost, low-risk market learning (Kishimoto 2004; Yu, Yan and Chen, 2006). The importance of such buyer-supplier relationships appears particularly in the tacit knowledge transferred over time which could not easily be learned from manuals (Humphrey, 2004).

Lin (2004) suggests that for developing countries to catch up to developed countries, it is best for them to utilize their competitive advantage, that is, their backwardness, to develop labor intensive production and to borrow incumbent and tested technologies invented by advanced countries. According to Humphrey and Schmitz (2000), the GVCs that link together producers in developing countries and buyers in developed countries have a quasi-hierarchical governance structure. The lead firms set standards, give guidance, and exercise close monitoring to ensure that products meet the required standards. They even invest in specific suppliers and help them to upgrade. However, while integration into quasi-hierarchical GVCs facilitates OEM firms to embark on rapid product and process upgrading, it makes it difficult for firms to advance into the R&D and marketing functions because upgrading beyond production will encroach on the core competence of their major buyers and thus endanger the relationship with them. The requisite competencies and related know-how will be retained

and blocked by the lead firms in case the OEM firms launch their own brands and penetrate the global market with the same products. The Taiwanese bicycle company Giant learned that the hard way. In 1983, its entrenched customer Schwinn's purchasing accounted for 75 percent of Giant's total annual output. But when Giant's founder King Liu showed an ambition to establish his own brand, Schwinn switched orders away (Yan, Chiang, and Chien, 2014).

How then can a firm's repositioning within the GVC be brought about? Functional upgrading involves more than the passive acquisition and circulation of knowledge acquired through participation in global markets (the most simple form of the "learning by exporting" idea) (Humphrey and Schmitz, 2000). Bell and Albu (1999) point out that this type of upgrading will only occur when the search for knowledge is "structured, purposeful and open". This combines knowledge generated internally by firms with knowledge acquired from the outside. Functional upgrading is not easy even if OEM firms are within GVCs, for technological learning is a "dynamic, difficult and costly process" and it is one that needs strategic interventions by firms (Hobday, 1995). So firms' conscious effort to learn and their willingness to make the required intra- and inter- firm investment are essential to functional upgrading. (Humphrey and Schmitz, 2000).

1.2 Accelerated Internationalization and Upgrading

Although integration into the global production networks can help latecomer firms accumulate capital and upgrade their capabilities, there is no guarantee that OEM firms will spontaneously become OBM ones (Yan et al., 2014). Empirical studies indicate that one element is especially important in the rise of firms in East Asian countries, and it is a common factor that explains these firms' progression into value-added functions. That element is the strategic intent, that is, the firms' conscious effort and willingness to make strategic changes to better position themselves in the GVCs (Mathews, 2002; Hobday, 1995). The reason Hobday proffers for the upgrading of South Korean firms is that they engaged in a painstaking and cumulative process of technological learning. It is a hard slog rather than a leapfrog (Hobday, 1995). However, according to Mathews (2006), these firms from Asia-Pacific are firms that start from behind and overcome their deficiencies to emerge as industry leaders, in sometimes an astonishing short

period of time without any of the advantages of the incumbent industry leaders. They succeed in spite of these initial disadvantages by leapfrogging to advanced technological levels or by leveraging their way into new markets through partnerships and joint ventures. All these arguments converge to one point that capital and capabilities are essential for a firm's upgrading, but only the leaders who consider both the long-term viability and the short-term financial gains of the firm can really initiate upgrading and seek the necessary resources to expedite upgrading.

Latecomer firms with a very limited capability base have entered the global market via global inter-firm connections. Besides large amounts of capital generated and capabilities accumulated, operating for the global market also fosters insights about international markets. Their international experience has a imprinting effect on their subsequent development. When the leaders determine to change their firms' strategic direction, they no longer confine their future development only to the home market, especially for firms which conduct OEM from inception. They will target the world's strategic markets which they have been serving as OEM suppliers. Both Giant and Acer used the U.S. market as a launching pad when they started their own brands in 1980s (Hobday, 1998). One can easily find examples of OEM firms ascending to global branding enterprises once they have successfully upgraded. Therefore, OEM firms' upgrading cannot be isolated from their internationalization.

OEM firms' early internationalization comes with the identification of opportunities in foreign markets. Their motive is simply to seek markets. Their operations mainly center on production, the bottom part of the GVCs and there is no need for difficult-to-develop abilities of marketing or R&D because the lead firms in the GVCs will help them overcome the technological and market barriers to entry into the global market (Kishimoto, 2004; Humphrey, 2004). In the process of producing for multinational companies (MNCs), OEM firms with strategic intent will proactively cultivate capabilities for long-term goals based on their short-term financial performance. With their capabilities growing, MNCs will entrust more "non-core" functions to OEM firms (Gereffi, Humphrey, and Sturgeon, 2005), who then become original design manufacturing (ODM) firms. At this ODM stage they still rely on the lead firms to enter international markets. But when OEM/ODM firms decide to build their own brands and enter the global market with the same products, they may threaten the lead firms and arouse

wrath or even retaliation from them. So proceeding to a foreign market with their own brand is destined to be a lonely journey. The latecomer firms join the global economy through their global production networks. Their growth and emergence on the international stage do not follow the incremental expansion path predicted by the Uppsala school (Johanson and Vahlne, 1977; Petersen and Pedersen, 1995). One feature of their internationalization is their capacity to envision a global market for their products well before they achieve the scale needed (Barlett and Ghoshal, 2000). Some even serve the global market right from the beginning. This is what Perlmutter (1969) described as a "geocentric mindset", that is, a world-oriented concept (Bonaglia, Goldstein and Mathews, 2007).

When OEM firms decide to build their own brands overseas, they barely have the strategic assets needed to start with such as proprietary technology, brands, distribution networks or experienced management. Just to survive among sophisticated competitors is a challenge. To cultivate a brand in a gradual manner is very hard and full of uncertainty as almost all industrial sectors in the international markets are already heavily populated with world-class competitors. Moreover, they do not need to replicate the entire previous technological trajectory experienced by established MNCs since the increasingly globalized economy has changed the nature of the competence creation process. They pursue various kinds of strategic and organizational innovations to establish a presence in their important markets (Mathews, 2002, 2006). So in this brand building stage, the search for market and the search for created assets simultaneously exist. First, they internationalize very rapidly. So accelerated internationalization is a distinctive feature in OEM firms' upgrading. Second, they have been able to achieve accelerated internalization not through technological innovation, but through organizational innovations that are well adapted to the circumstances of the emergent global economy, providing access to sources of new capabilities and knowledge in innovative ways. They have exploited their latecomer and peripheral status to advantage and leveraged their way into new markets through reverse acquisitions, partnerships or joint ventures (Mathews, 2006; Bonaglia, Goldstein and Mathews, 2007).

In this paper we will examine in detail the case study of Lacquer Craft's upgrading in the era of the global economy and analyze how it developed or captured the resources needed through reverse acquisitions to accomplish this upgrading rapidly.

2 Methodology

We use a single case study to examine the dynamic process of OEM firm upgrading and develop the idea of upgrading-oriented reverse acquisitions by OEM firms. The case study is conducive to tracking and capturing new factors and issues related to management practice, as it allows an in-depth focus on the research question (Yin, 2004). It is also appropriate because we aim to build a model related to OEM firms' strategic choice to upgrade through purposeful reverse acquisitions. In-depth case analysis can show how changing forces in the external environment pressure OEM firms into upgrading rapidly, and how their capabilities and resources evolve with acquired assets, which ultimately contribute to effective upgrading.

2.1 Case Selection

Case selection is one of the most difficult procedures in case studies (Yin, 2004). The cases selected must be representative and able to clarify the concept or model proposed (Eisenhardt, 1989). We selected our case based on three factors. First, it had to be a firm with OEM as its major business, accounting for at least 50% of its total revenue, before conducting its first acquisition. Second, after acquiring its targeted strategic assets, the firm had to have upgraded from OEM to ODM and/or OBM. Third, the firm had to be an internationally active or dominant player in its industry. On the basis of these criteria and our preliminary investigation in Dongguan, Shenzhen and Foshan in the Pearl River Delta region of Guangdong Province, a number of firms were screened as candidates.

We chose Lacquer Craft for the case study because it was the most typical example and more than satisfied the required criteria. Before its first overseas acquisition, Lacquer Craft relied on OEM for survival. Almost 95% of its sales came from OEM. In 2001, the firm first acquired its long-term outsourcing customer in the U.S., from which it obtained brands, distribution channels and design capabilities. These acquired assets helped the firm establish its own brands in the U.S. the year following the acquisition. Together with the support of three other reverse acquisitions, Lacquer Craft upgraded directly from OEM to OBM. It has since become the largest furniture company in Asia and the second largest in the world. Apart from these three factors, there was also a practical reason for selecting Lacquer Craft: it presented ease of access to its informants.

In 2009, to determine positive methods of encouraging and facilitating industrial upgrading in Dongguan's Dalingshan Town, where large numbers of OEM firms such as Lacquer Craft are situated, the local government invited us to study and investigate the local industries' strengths and weaknesses and possible directions for future development. Through the introduction from the local government, we got to know Lacquer Craft and its leaders. At that time, the firm was considered a successful example of upgrading. The leaders showed an open mind and were very cooperative with our study.

2.2 Data Collection

To ensure the validity of our conclusions, we used the triangulation methods described by Miles and Huberman (1994) to collect data and develop a case study from many different information sources. We conducted in-depth interviews and conversations with senior executives and managers at the firm who had participated in the reverse acquisitions or had been involved in sales and distribution or administrative activities. The times, places and informants involved in the interviews are listed in Appendix A. The length of the interviews ranged from 50 minutes to 3 hours. The Special Assistant to the firm's President attended all of the interviews. We recorded all six of the interviews and took extensive field notes. To ensure the accuracy of the data, we transcribed the audio material within 24 hours of each interview. We then asked the informants to verify our transcripts and notes. The interviews were conducted over the period from June 2009 to July 2013. In addition to the interviews, we collected data from sources such as corporate memos, newsletters, flyers, brochures, websites, annual reports, published case descriptions, newspaper and magazine reports and research papers related to the firm.

3 The Case Study: Lacquer Craft's Upgrading from OEM to OBM

Lacquer Craft was founded in 1992 by Taiwanese businessman Shanhuei Kuo in Dalingshan, Dongguan, to seize low-cost opportunities in mainland China. In its first two years, it served as an OEM supplier to the U.S. furniture manufacturers. Its product focus mainly comprised fabricated furniture parts sold as original equipment. Each month it delivered 40 containers of product on average. Three

years later, with orders growing very quickly, Lacquer Craft began to build its production base in Dalingshan, commanding five manufacturing plants and extending its product line to dining room and bedroom furniture and other furnishings. The short-term future for Lacquer Craft seemed quite positive. However, similar companies sprang up in the same area to supply foreign buyers. The firm's long-term prospects were somewhat dismal. The founder had the idea of cultivating core competitiveness. He had the ambition to establish a unique brand for the firm. The establishment of an R&D center in China in 1996 was an important step toward that ambition.

The President of Lacquer Craft, Shanhuei Kuo, decided on the U.S. as the birthplace of the firm's first unique brand. In 1999, the firm set up its first U.S. subsidiary. In the meantime, it created the "Legacy Classic" brand for its products to be sold in the U.S. Despite the investment and effort involved, after two years the brand remained unknown on the U.S. furniture market. Lacquer Craft shifted to a different approach of acquiring strategic assets. Since 2001, it has made four reverse acquisitions, which have exceedingly advanced its R&D, marketing, distribution and manufacturing capabilities and allowed it to upgrade directly from an entirely OEM firm to an OBM firm, with OBM business surpassing its OEM business. Today, Lacquer Craft is a big multinational group with production bases, R&D centers, global brands and distribution channels around the world. Table 1 summarizes the firm's major characteristics.

3.1 Reverse Acquisition and Upgrading

Lacquer Craft's first reverse acquisition target was Universal Furniture, a U.S. listed company. This renowned furniture company boasted factories around the world, and its distribution channels ranked fifth in the entire industry. However, as the new century began, Universal Furniture was losing money, and it seemed that not much could be done to stem its losses. Lacquer Craft was its long-term OEM supplier, and embraced the opportunity to decisively acquire the ailing company in 2001. Within just one year, the acquired company was turned around and its business began to improve. With the well-known brand and established distribution channels purchased from Universal Furniture, Lacquer Craft quickly cracked the highly competitive U.S. furniture market, especially the midrange and high-end market segments, and Legacy Classic (Lacquer Craft created in

1999) filled the low-end market. The two brands complemented each other and achieved synergies that neither was able to realize alone. Sales in the U.S. were growing rapidly, and the company had to improve capacity. In 2002, rapidly increasing sales forced Lacquer Craft to build a second production base known as LCZJ in Jiashan, Zhejiang Province, where plants were finished and put into use in 2004.

Table 1 Major Characteristics of Lacquer Craft

Characteristic	Lacquer Craft
Time of formation	Lacquer Craft (Dongguan, Guangdong) was founded in 1995, and LCZJ (Jiashan, Zhejiang) was founded in 2002
Company type	Taiwan-funded enterprise, listed in Hong Kong
Location	Dongguan, Guangdong, Jiashan, Zhejiang
Industry	Furniture
Upgrading profile	Starting as an OEM firm, it launched its own brand in 1999. By 2008, its OBM business accounted for 60% of its total revenue, and the firm had 10 international brands
International configuration of businesses	Five manufacturing bases in North Carolina in the U.S., Dongguan and Jiashan in China, Chittagong in Bangladesh and Medan in Indonesia. Three R&D centers in China, the U.S. and Europe. Products sold mainly to Europe, the U.S., Japan and other developed countries. After the financial crisis, the firm targeted mainland China as an important market
Firm size	As of 2013, the firm has 9,050 employees working in subsidiaries situated in Chinese mainland, Chinese Taiwan, the U.S. and the U.K.
Sales	For four consecutive years from 2010 to 2013, each year's sales hit more than $400 million
Position in the industry	The world's second largest furniture company

Seeing the huge potential in combining Chinese manufacturing and U.S. marketing in North America, when a new opportunity for acquisition occurred, Shanhuei Kuo promptly seized it. In May 2006, he acquired the U.S. sofa maker Craftmaster Furniture Corporation. With this newly acquired asset, Lacquer Craft established its sofa facilities in the U.S. The subprime mortgage crisis caused a severe downturn in the U.S. housing market and hit the furnishing industry hard. Facing such unprecedented opportunities, Lacquer Craft made another two reverse acquisitions in two consecutive years. In 2007, it purchased the top U.S. wood furniture brand Pennsylvania House, which had a history of more than 150

years, securing its penetration into the top furniture market. The next year, it acquired British furniture brand Willis Gambier, paving the way for its entry into the European brand furniture market. Before its acquisition of Universal Furniture, OEM sales accounted for 95% of the firm's total revenues. In 2002, just one year after acquiring Universal Furniture, sales from OBM reached 50%. After four acquisitions, OBM sales comprised 60% of the total revenues.

Lacquer Craft has grown into a leading firm in the furniture industry. Its products are sold in the three most important markets (North America, Europe and Asia) in the world. It currently has over 3,000 clients, chiefly comprised of national or regional department stores and retail chains and independent retail stores scattered around the world, particularly in the U.S. and Canada. Table 2 summarizes Lacquer Craft's acquisition events and strategic assets obtained, and the positive effects on its upgrading in terms of the research framework.

3.2 Influencing Factors

Entrepreneurship and strategic leadership were indispensable for Lacquer Craft's growth and upgrading. Entrepreneurship involves the discovery and exploitation of opportunities and the creation of new organizations. (Shane and Venkataraman 2000). Entrepreneurial activities are also important to existing firms. In constantly changing environments, profitable niches evolve, shift, and disappear rapidly. A firm must be quick to seize new opportunities for its growth (Ireland and Hitt, 1999). Entrepreneurship includes innovation capabilities (Wenneker and Thurik, 1999). According to Hobday (2000), innovative entrepreneurs in emerging economies often pursue a catch-up strategy due to their backwardness in technology. They can innovatively overcome competitive disadvantages and enhance their dynamic capabilities by linking up with the global market, leveraging their comparative advantages of lower labor costs, and learning through repeated linkages and leveraging. Leadership in business pays specific attention towards creating vision and prospecting for change in order to assure the firm's long-term growth (Rowe 2001). Only exceptional entrepreneurs, with the competence to balance short-term stability and long-term growth, can initiate a radical change and transform the firm (Yan, Chiang, and Chien, 2014). Shanhuei Kuo is an entrepreneur who has these important qualities. He is astute, innovative, proactive and persistent, and is always ready to take risks.

Table 2 Lacquer Craft's Acquisition Events and Obtained Strategic Assets, and the Positive Effects on Its Upgrading in Terms of the Research Framework

		First	Second	Third	Fourth
Acquisition strategy and objectives	Time	2001	2006	2007	2008
	Target company /brand	Universal Furniture, one of the top five furniture sellers in the U.S.	Craftmaster Furniture	Pennsylvania House, top U.S. furniture brand	Willis & Gambier, Britain's top furniture brand
	Type of acquired company	Lacquer Craft's original outsourcing partner, a branded company	A branded company with R&D capability and production bases	Branded company	Branded company
	Upgrade target	OEM→OBM	OBM	OBM	OBM
Strategic assets secured	Capacity	Manufacturing facilities located in different countries and warehousing facilities in the U.S.	Ability to establish sofa-manufacturing facilities in the U.S.	——	——
	Brands and sales channels	Entry into the high-end furniture market due to the reputation and sales channels of Universal Furniture	Medium- and high-end sofa brands of Craftmaster and entry into the U.S. sofa market	A top furniture brand with a history of 150 years and entry into the U.S. top furniture market	Ability to enter the European market, and ability to diversify from household furniture offerings to various furniture offerings, including hotel, restaurant and office furniture
Effects on upgrading		Smooth upgrade from an OEM firm to a well-known furniture company, with OBM business surpassing its OEM business			

In 1992, still in his 30s, Shanhuei Kuo persuaded, by virtue of his confidence and persistence, five furniture suppliers in Taiwan to relocate to Dalingshan, which was then a greenfield site, offering them policy privileges. Neither his family members and friends nor his customers and partners considered the prospects of investing in Dalingshan to be hopeful. However, Shanhuei Kuo was determined. He reassured the supplying partners by striking his chest (a typical Chinese gesture meant to assure others) and saying, "We are sure to make money. If there is a loss, I will take it." The result was unexpectedly good. In the late 1990s, Dalingshan became an extremely prosperous furniture cluster with thousands of companies, attracting corporate buyers from all over the world, especially in the U.S. and Europe.

Since the founding of Lacquer Craft, Shanhuei Kuo dreamed of cultivating his own brand. As the firm prospered with its OEM business in the early stages, he began to develop the capacity for branding. He hired R&D people, and in 1996 he established the firm's R&D center in China. In 1999, Lacquer Craft's first brand, "Legacy Classic," was created for the U.S. market. These efforts did not immediately generate obvious effects. However, they prepared the firm to identify and exploit new opportunities and successfully integrate its acquired strategic assets. The four upgrading-oriented acquisitions in a row enabled Lacquer Craft to upgrade rapidly and accelerate its global configuration. In both reverse acquisitions and upgrading, the leader of the company assumed an irreplaceable role.

Capital accumulation and financial strength constituted the basis of Lacquer Craft's upgrading. A firm upgrading from OEM to a global enterprise practicing OBM requires plenty of capital to support functions such as R&D, distribution networks and promotion in foreign markets. Capital constraints may discourage firms from exploring new products and new markets, and from pursuing capital-intensive strategies such as purchasing or merging with foreign companies. Firms with large earnings are able to invest more, even in uncertain environments. The necessity for sufficient capital runs acute, because the investment on expanding into the global market might endure for a long time and prospective returns are usually precarious in the initial period (Inci, Lee and Suh, 2009; Yan, Chiang, and Chien, 2014).

Following the establishment of Lacquer Craft's first plant in mainland China, the firm's manufacturing productivity grew at a rate of 30%. Within four years,

its product line extended from furniture parts to complete bedroom furniture sets. Beginning in 1998, it manufactured and sold an average of 300 containers of furniture each month, with its production capacity surpassing those of many large U.S. furniture companies. Its profit margins were quite respectable. One inside informant admitted that in the late 1990s, the firm constantly had $200 million at its disposal. Large amounts of cash generated from OEM business permitted the firm to develop R&D capabilities and to launch its own brand in the U.S. market. The money for its first acquisition came from the company's own accumulated capital.

To raise capital for further expansion, Lacquer Craft floated shares under the name of Samson Holding Ltd. in Hong Kong in November 2005. $369 million was raised, increasing the firm's total capital by 2.69 times. After going public, Lacquer Craft transformed from a mid-sized enterprise with about $50 million in revenue into a firm with a market capitalization reaching $10.6 billion. The firm's financial management ability was greatly enhanced, and its turnover and profits hit an all-time high, which guaranteed its financial ability to support three reverse acquisitions over three consecutive years. In addition, the local government actively encouraged OEM firms by providing tax breaks and privileges and by creating a favorable operating environment, thus lessening its financial burden to a large degree.

Changing dynamics such as rising costs, shrinking profit margins, intensifying domestic and international competition, and international trade barriers increased pressure on Lacquer Craft to take quick measures to upgrade. According to Lacquer Craft's financial manager, the costs of various raw materials began to rise after the turn of the century and with increased rapidity from 2005 on. Furthermore, the Chinese renminbi kept appreciating, labor costs kept rising and tax rebates for the processing trade decreased considerably or were cancelled. The latter three combined to decrease the profit margins of 2007 by about 12%. In recent years, high inflation has driven costs up considerably. Meanwhile, OEM firms from other emerging economies are competing fiercely to grab more of the labor-intensive export market.

With OEM exports flowing in, many countries and particularly developed countries erected multiple trade barriers. In 2003, the U.S. lodged an anti-dumping complaint against Chinese wooden beds, which threatened the exports of Lacquer Craft. The company was determined to fight back. After

Table 3 Comparison of Internal and External Factors Behind Lacquer Craft's Upgrading through Reverse Acquisitions

		First (2001)	Second (2006)	Third (2007)	Fourth (2008)
Corporate resources and capabilities	Key resources before acquisition	Strong profitability, strong fund liquidity, always with $200 million at its disposal	Samson Holding Ltd. was listed in Hong Kong in 2005. Total market value increased 2.69 times, jumping to $369 million in 2005 from $137 million in 2004. Its sales and profits also reached a record high. They constituted a sound financial base for a series of acquisitions.		
	Key competencies before acquisition	Possession of manufacturing power, but lack of branding capability	Lack of local U.S. brands and sales channels	Lack of top brands in the U.S.	Lack of brands and sales channels in Britain and Europe
Entrepreneurial spirit	Entrepreneurial spirit	President Shanhuei Kuo is innovative, proactive, persistent, pragmatic and quick to capture business opportunities			
Changes in the external environment	Intense competition	Shrinking markets in developed countries following the financial crisis and rising competitors from other developing countries			
	Cost pressures	Appreciation of renminbi, higher labor costs, decreased export tax rebate rates and higher environmental protection costs caused profits to fall drastically			

investing a lot of time and money, Lacquer Craft received a favorable verdict in 2006. Faced with a deteriorating operating environment, the firm urgently needed to boost the value of its products. This triggered a series of reverse acquisitions for the purpose of upgrading.

The characteristics of the furniture industry have shaped Lacquer Craft's strategy of upgrading via reverse acquisitions. The furniture industry is a relatively low-tech industry characterized by long product life cycles. To excel in this industry, companies do not require R&D as much as original designs with practical value, along with brands and distribution channels. As furniture is a basic necessity of life, easy access and distinctiveness are particularly important for the success of a furniture company. As far as a company is concerned, understanding the core capabilities required to compete successfully is the first step toward correct decision making. Lacquer Craft is not only familiar with the core capabilities of the furniture industry, but also tries to embody them. By acquiring targeted companies with distribution networks and brand value, it upgraded directly from OEM to OBM. Table 3 presents the external and internal factors behind Lacquer Craft's reverse acquisitions.

4 Results

This case fits the theoretical framework advanced in the second section above. Lacquer Craft entered the global market through OEM arrangements upon its foundation. Via linkages with branded companies in developed countries, it accumulated resources and developed capabilities, and with the support of these, has established its own brands and become a full-blown multinational company in a very short period of time. We shall now examine the traits related to Lacquer Craft's upgrading strategies in the era of a highly integrated global economy.

4.1 Building Resources and Capabilities through OEM Arrangements

Lacquer Craft made use of the low cost advantages and policy privileges in Dongguan and engaged in OEM for branded furniture companies from the U.S. and other developed countries. Taking on the OEM strategy allowed it to enter the global market, and to benefit from economies of scale and inflows of knowledge and technologies from its customers.

In the beginning, Lacquer Craft only made furniture parts for U.S. buyers. But it grew and learned quickly. Within four years, its product lines extended from furniture parts to complete dining-room and bedroom furniture sets. From 1998 on, it sold an average of 300 containers of furniture per month. Profits came in steadily. In the late 1990s, it always had US$200 million cash at its disposal.

In addition to the large amounts of cash generated, Lacquer Craft's capabilities continued to improve. Improvements were embodied not only in volume and products, but more importantly in process, design, and management, etc. One interviewee summarized two ways of learning in the firm: learning from its multinational company customers and learning by doing.

Branded customers sent technicians and designers to the site of Lacquer Craft to train and discuss standards and requirements with its employees, especially tacit knowledge and skills. From carrying out the OEM contracts, Lacquer Craft became familiar with the buyer's philosophy, product idea and style, and product functionality, safety, fabrication, and environmental requirements and indirectly came to understand the target market preferences and needs.

As its business grew, Lacquer Craft's production capacity was enhanced. It was constantly investing in its plants and machinery to expand production and warehouse capacity to strengthen its production lines. Standards from stringent customers pressured it to build absolute product advantage. Manufacturing capabilities became its cornerstone of success.

In the process of supplying foreign customers, Lacquer Craft tried consciously to cultivate its R&D and marketing capability. As early as 1996, it set up an R&D center in China. It also took part in various international furniture trade fairs to attract clients, gathering details on the latest trends and market information. The linkages with established players provided initial opportunities for involvement in the global economy (Bonaglia, Goldstein and Mathews, 2007). Furthermore, they have laid a solid foundation for the OEM firm's further development.

4.2 Rising to a Globalized Company through Accelerated Internationalization

Besides building up a resource and capability base, producing for and cooperating with developed country companies shapes the latecomer firm's vision of internationalization. Recognizing that cost advantages would not last forever, and with branded company buyers always scouting for lower costs,

realizing that they would one day direct their orders to other places, Lacquer Craft decided to engage in outward foreign direct investment (FDI) and to seek their own markets abroad.

In 1999, the firm set up its first subsidiary in the U.S. and created its own brand "Legacy Classic" to sell products in the strategically important U. S. market. As a new brand in the mature furniture market, for two years business was not satisfactory. In 2001, Lacquer Craft, to penetrate the U.S. market, decided to adopt a high-risk entry mode—acquisition. This accelerated internationalization opened the world market for the firm.

The firm's first target was Universal Furniture, a renowned and listed U.S. furniture company. With a well-known brand and entrenched distribution channels acquired from Universal Furniture, Lacquer Craft expeditiously cracked the fiercely competitive U.S. furniture market, especially the midrange and upscale market segments. What was unexpected was that the acquired strategic assets activated Lacquer Craft's earlier created brand, Legacy Classic, which now became recognized. Only one year after the acquisition, the firm's branded sales in the U.S. market increased dramatically from almost nothing to about 50% of the total revenue.

In 2006, Lacquer Craft purchased the U.S. sofa maker, Craftmaster Furniture, entered the U.S. sofa market, and established a sofa production facility in the U. S. In 2007, it acquired the top U.S. wood furniture company Pennsylvania House and penetrated the high-end furniture market. In 2008 it entered Britain and other European countries through the acquisition of the British furniture brand Willis Gambier. Since 2006 it began to target the domestic Chinese market and in 2011, it released a five-year-plan to explore the Chinese market and to comprehensively upgrade its distribution networks by developing franchised chain stores. Currently, it has established a presence in all major developed countries and many developing countries.

Lacquer Craft has been coordinating and integrating its internationally dispersed operations and activities so as to achieve global efficiency and multinational flexibility. Its coordination ability came with its aggressive internationalization. When the firm assimilated the acquired assets, a globally-integrated company had emerged. By taking over well-known brands and distribution channels in advanced economies, sales picked up rapidly. A tremendous boost in sales in turn induced the expansion of the first production

facility in Dongguan and the construction of a second facility in Jiashan. Both facilities are now capable of producing 1800 containers per month. Although it has four production facilities (besides the ones already mentioned, one in the U.S. and one in Bangladesh), the great majority of its production capacity is in China. While enjoying high efficiency from centralized production, its advanced production facilities together with its automated storage and warehousing system are also able to provide its customers a greater degree of flexibility in customizing orders for mixed container shipments directly from warehouses at the manufacturing facilities in China.

Lacquer Craft has three R&D centers located on three continents that develop products for different national markets according to different tastes and needs while coordinating efforts on specific tasks. Its headquarters are in the U.S. From there it commands and coordinates the whole group.

4.3 Building Brands through Reverse Acquisitions

In 1999, Lacquer Craft made a strategic change to develop its own brand and created Legacy Classic in the U.S. market as its own first brand name when its OEM business was still very lucrative. In fact, the firm began a conscious effort to achieve this goal early on. Since 1996, with a stable income from its OEM business, Lacquer Craft began to invest in long-term goals. It took on R&D personnel, established an R&D center, and hired marketing people. However, the real OBM journey was far more difficult than expected. Although a significant investment was made into the effort to establish an independent brand, the firm did not initially see any results. At this turning point, Shanhuei Kuo once again exploited an opportunity to take the firm to a new level. Its outsourcing partner Universal Furniture was then in financial trouble. The President recognized that this ailing company had valuable assets essential to the furniture industry and took this opportunity to buy it. With those assets, Lacquer Craft's manufacturing power began to be converted into brand share (Hamel, Doz, and Prahalad, 1989).

The acquisition of the other three companies comprehensively enhanced Lacquer Craft's capabilities in R&D, manufacturing, and marketing. R&D centers were established in major strategic markets. Manufacturing capacity was drastically expanded using state-of-the-art technology and equipment. Lean production systems were applied in the workshops. By integrating and

Table 4 The Evolution of Lacquer Craft's Capabilities due to Its Four Reverse Acquisitions

	First (2001)	Second (2006)	Third (2007)	Fourth (2008)
Independent innovation capability	Cooperated with a Japanese company to develop an automated warehousing system known as ASRA. Set up R&D centers in the U.S. in 2002.	With a unique business model and strategic foundation in wooden furniture, Lacquer Craft successfully extended its business to sofas and children's furniture. Its branding business increased by 12.4%, reaching $50.2 million.	——	Established an R&D center in Italy in 2005, and carried out research grant projects in China.
Manufacturing and service capabilities	Lacquer Craft enhanced its manufacturing capability from three lines of low-end products to a spectrum of over 40 product lines, and upgraded to a production line capable of manufacturing more than 40 kinds of products. Automated warehousing systems greatly improved the firm's manufacturing services. Exports increased by more than 40%.	In 2006, Lacquer Craft expanded its factories in Dongguan and Jiashan and added production lines and warehousing space, increasing production by 1,600-1,800 containers of product each month. It simplified the manufacturing process for the Craftmaster brand, decreasing delivery time from four weeks to two weeks.	——	In 2008, Lacquer Craft spent $6.5 million on enlarging its warehousing capacity in the U.S. and production capacity in China.

(*To be continued*)

(*Continued*)

	First (2001)	Second (2006)	Third (2007)	Fourth (2008)
Marketing capabilities	The firm started to configure to the U.S. market.	The firm branched out into sofa offerings from solid wood furniture.	After this acquisition, Lacquer Craft pushed the series of premium solid wood furniture made in its own manufacturing base to the U.S. market, extended its business to hotel furniture and began to boast low, medium and high price products levels.	The firm nabbed a whopping 7-8% share of the British furniture market, and cracked the European furniture market. It offered complete sets of furniture for hotels, restaurants and offices while establishing a convenient logistics service "delivering to the house on a global basis." It also developed a distribution network consisting of large merchandisers, department stores and independent retailers around Britain.

assimilating these strategic assets, the firm established a wide series of global brands and international sales channels. Its nine international brands represent low to high-end products and price levels for different market segments. Its highly effective sales network is composed of independent retailers, large-scale merchandisers, department stores and others. With such assets in hand, Lacquer Craft successfully upgraded from OEM to OBM. We summarize Lacquer Craft's evolution of these three capabilities in Table 4.

5 Conclusions

The findings of our case study provide strong evidence that reverse acquisitions significantly promote OEM firm upgrading. Adopting a perspective that focuses on firms' resources and capabilities in an international environment, we examine the evolution of an OEM firm's capabilities and its brisk rate of upgrading. By identifying factors that push an OEM firm to upgrade, our findings offer insights into the burgeoning tendency in China for OEM firms to proactively or reluctantly engage in upgrading.

Our analysis of Lacquer Craft's upgrading indicates that OEM firms locked in the bottom part of a value chain can break the "captive linkages dominated by lead firms" (Gereffi, Humphrey and Sturgeon, 2005) and accomplish upgrading if their leaders have the strategic intent to climb the value chain and the courage to commit firm resources in the process. Many OEM firms are confined to a narrow range of low-value activities not because they lack the ability to move to higher value segments, but because they have no vision for the future and take it for granted that the market access provided by lead firms will last forever. Lacquer Craft was like other OEM firms that enter the global marketplace through linkages with global players. However, unlike its counterparts, it had the will to grow and/or develop capabilities to participate in higher value activities. Investments in such capabilities have formidable cumulative effects.

Our analysis also suggests that only with the accumulation and development of resources and capabilities and the resulting cumulative effects can an OEM firm identify and capture suitable opportunities for acquisitions and integrate and internalize its acquired strategic assets. Acquiring companies in higher segments from advanced industrial countries entails not only a large capital supply, but also and more importantly an absorption ability, without which the acquired strategic assets would contribute little to the evolution of the firm's capabilities,

not to mention its upgrading. Lacquer Craft's four reverse acquisitions boosted both its upstream and downstream capabilities in an incredibly short period. The firm's stock of knowledge, skills and people were essential to the turnaround of its acquired businesses. It is the conscious pursuit of strategic assets rather than the supply that determines the potential use and in turn the success of an acquisition. Only prepared firms with a good understanding of what it requires can capture synergies from acquired companies. Lacquer Craft's experience makes it abundantly clear that nurturing in-house capabilities is the guarantor of successful acquisitions.

The GVC and accelerated internationalization perspectives are applicable to OEM firms' upgrading to OBM. The firm's ability to identify and exploit opportunities to link with established players and leverage knowledge and the ability to search, acquire, and integrate strategic assets from developed countries can greatly enlarge an OEM firm's capability base and help them leapfrog to OBM. The firm's product and technological upgrading strategies become closely interwoven with their internationalization strategy.

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Appendix Interview Data Sources

Interview time	Interviewees	Interview Location
June 24, 2009	Vice-director of Industrial Upgrading Office in Dalingshan, Dongguan and Special Assistant to President of Lacquer Craft	Lacquer Craft conference room
July 9, 2009	Special Assistant to President of Lacquer Craft Manager responsible for Lacquer Craft's cross-border acquisitions Sales manager of Lacquer Craft	Lacquer Craft conference room
September 29, 2011	Special Assistant to President of Lacquer Craft	Lacquer Craft conference room
January 4, 2012	Special Assistant to President of Lacquer Craft	Lacquer Craft conference room
August 19, 2012	Special Assistant to President of Lacquer Craft	Enterprise and Market Research Center of Sun Yat-sen University
July 15, 2013	Special Assistant to President of Lacquer Craft	By telephone