


• Emerging ICT Market Strategy: China



Published by
Corporate Public Affairs
Department of Infrastructure
Level 29, 80 Collins Street, Melbourne

October 2006

Also published on www.mmv.vic.gov.au

© State of Victoria 2006

This publication is copyright. No part may be reproduced by any process except in accordance with the provisions of the *Copyright Act 1968*

Authorised by Marsha Thomson,
80 Collins Street, Melbourne, Victoria

Printed by Impact Digital
32 Syme Street, Brunswick, Victoria 3056

Further copies of this document and other information on how the Victorian Government can help local ICT companies can be obtained from:

Multimedia Victoria
Level 20, 80 Collins Street
Melbourne VIC 3000

E: queries@mmv.vic.gov.au

W: www.mmv.vic.gov.au

Minister's Message

There is no doubt that the emerging Chinese market presents the Victorian economy and Victorian businesses with exciting opportunities.

China (including Hong Kong) was already Victoria's largest goods export market in 2005-06 and is now one of Victoria's largest trading partners. For the Victorian ICT industry, access to China's electronics and IT market – worth more than \$640 billion in 2005 - holds incredible potential.

The China market opportunity was recognised in the Victorian Government's *China, 2005 and Beyond*. However, this document, the *Emerging ICT Market Strategy: China* specifically addresses the ICT market. It complements the Government's aim to assist Victorians to work cooperatively with a new global trading giant such as China.

Last year Victoria's ICT industry was responsible for approximately \$1 billion in exports – success in the Chinese market will be an additional economic boost for our state.

The *Victorian Government ICT Industry Plan 2005-2010* (the Industry Plan) aims to develop the ICT sector and maximise the economic benefits that a robust industry will deliver.

Targeting China as a market for Victorian companies, networks and clusters with their entrepreneurial skills, know-how, services and products is a priority.

A highly successful ICT trade mission to China supported by the Victorian Government has already paved the way for greater cooperation and investment between both markets.

The Emerging Market Strategies, outlined in the Industry Plan will, through the provision of comprehensive research reports, further assist local ICT companies to gather the market intelligence they need to identify and seize opportunities in emerging markets around the globe.

Emerging ICT Market Strategy: China is informed by research undertaken by industry analyst Terranovate on the Chinese ICT market, the trends that will drive and shape the market into the future and the opportunities and lessons the market offers the Victorian ICT sector.

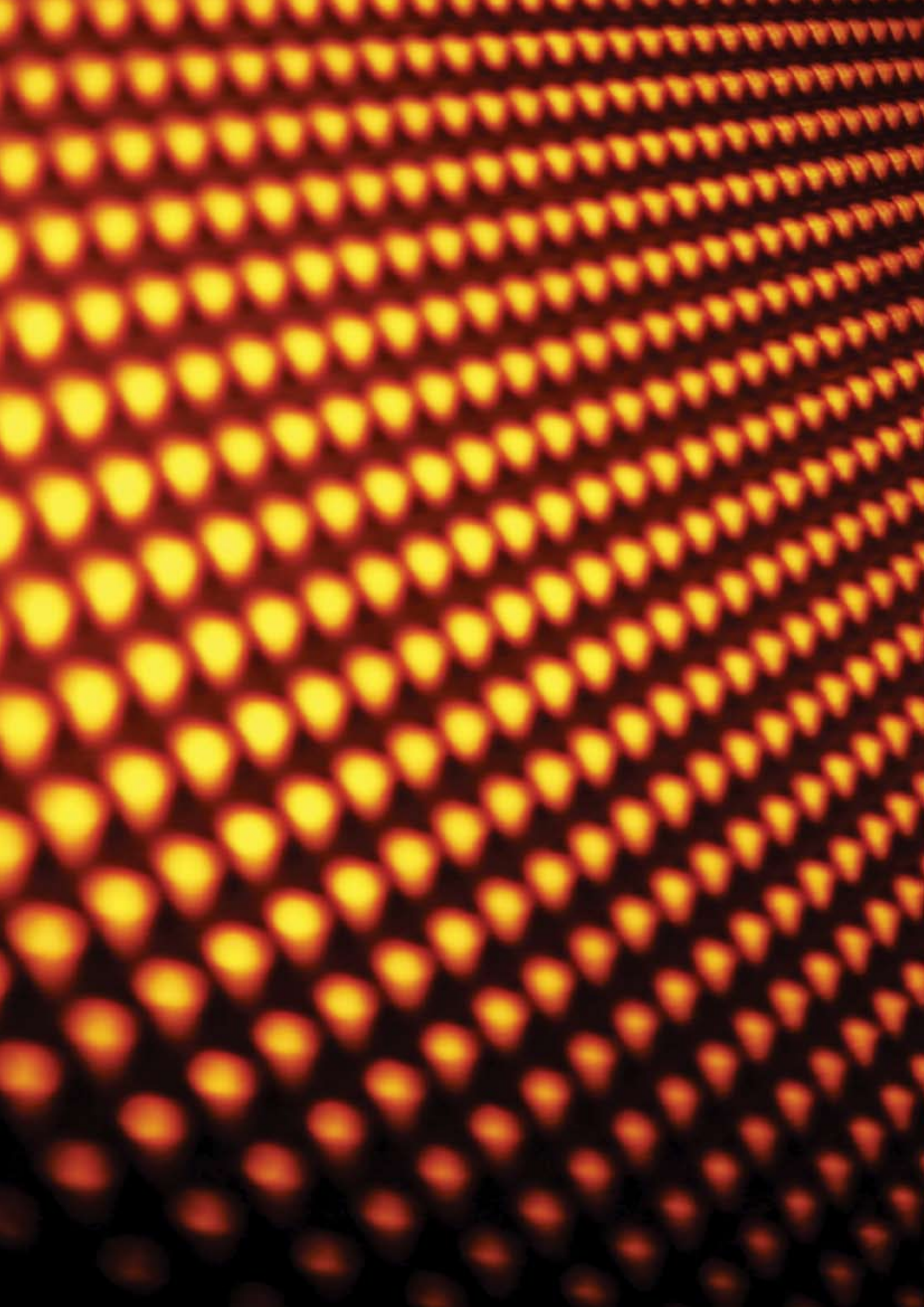
This document draws on the Terranovate research and I invite all Victorian ICT companies with an interest in China to request a full copy of the research by contacting Multimedia Victoria.

Emerging ICT Market Strategy: China is part of the Victorian Government's contribution to building a strong foundation for our innovative ICT sector to make sustainable connections into one of the world's most challenging and lucrative markets.



A handwritten signature in black ink that reads "Marsha Thomson". The signature is fluid and cursive, with a long, sweeping underline.

Marsha Thomson
Minister for Information and
Communication Technology



Contents

Minister's Message	1
Introduction	5
1. China's Place & Ambitions in the Global ICT Market	6
2. Overview of the Chinese ICT Market	7
2.1 Market Segmentation	7
2.2 Key Sector Trends	8
3. China's Policy Framework	10
3.1 Central Policy-making Structure	10
3.2 Central Policies	10
3.3 Provincial ICT Policy	10
4. Victoria & China: Relations, Opportunities, Challenges	11
4.1 ICT Trade Flows	11
4.2 The Victorian ICT Industry	11
4.3 Opportunities	12
4.4 Challenges	12
5. Approaching the Chinese Market	14
5.1 Market Entry Approaches	14
5.2 Attitudes to Market Entry	14
5.3 China Market Business Myths and Realities	14
6. Market Lessons	18
7. Connecting Victorian ICT with China	19
7.1 Emerging Markets Strategies	19
7.2 ICT Trade Events and Export Assistance Program	19



Introduction

The Victorian information and communication technology (ICT) industry is a significant contributor to the economic performance and wealth of Victoria and this is acknowledged in the *Victorian Government ICT Industry Plan 2005-2010*.

A key aim of the Industry Plan is to encourage a more innovative, collaborative, specialised and entrepreneurial ICT industry with global ambitions.

The Industry Plan offers a suite of programs to assist local companies to achieve their global ambitions, including providing support to attend trade fairs, leading trade missions to key international markets and providing assistance for companies planning and executing export strategies.

In addition, the Government committed through the Industry Plan to "help local ICT companies to gather market intelligence and identify strategic opportunities in high-potential overseas markets through a series of Emerging Markets Strategies".

This document is the first Emerging Market Strategy and it takes as its subject the rise of China as an ICT producer and consumer. It draws on research undertaken by Terranovate which addresses in detail the opportunities, threats and environmental constraints that Victorian ICT companies need to be aware of when doing business in China.

The Terranovate research is available exclusively to Victorian ICT companies by contacting Multimedia Victoria on **queries@mmv.vic.gov.au**. For up to date information on opportunities for engagement with the Chinese ICT market check the Multimedia Victoria website at **www.mmv.vic.gov.au**

1. China's Place & Ambitions in the Global ICT Market

Few countries have been able to match the pace and breadth of China's economic growth over the past 25 years. With gross domestic product (GDP) increasing annually at more than eight percent since 1978, China has become a major player in all segments of the global economy. This has led some observers to suggest that we are experiencing the start of a "China Century", which will have a profound impact on all world markets.

The availability of comparatively cheap yet reliable manufacturing capacity initially led to the establishment of China as the "world's factory". According to Organisation for Economic Cooperation and Development (OECD) statistics, in 2004 China became the world's leading exporter of high-tech goods like laptop computers, mobile phones and digital cameras. China exported US\$180 billion worth of ICT goods in 2004, compared with US exports of US\$149 billion.¹

More recently, China's capabilities and aspirations have begun to move up the value chain, and the development of the ICT sector is a key part of that trend. ICT is seen as a segment of massive market potential and a key enabler of business success. As a result, the ICT sector has received substantial attention in the formulation of central plans for China's growth and development.

China's ICT objectives are two-fold: sustainable domestic development and international competitiveness. In other words:

- A Chinese market for Chinese companies – no economic sector, and certainly no strategic sector, is to be dominated by foreign companies; and
- The creation of a leading international brand in each sector – eg, a Chinese Microsoft, a Chinese Cisco, a Chinese Ericsson, a Chinese IBM, a Chinese Accenture, and so on.

Specifically China is seeking to:

- Create a "harmonious society" by driving technology adoption to address economic disparities;
- Move from rapid development to "sustainable development" by adopting ICT systems to improve efficiency and reduce waste;
- Promote indigenous innovation by encouraging the creation of technologies, products and standards for which China owns and controls the intellectual property rights (IPRs);
- Change the composition of ICT investment from low value-added activities to intermediate- and high-technology goods and services;
- Promote overseas expansion of trade and investment in high-technology areas by encouraging Chinese manufacturing and services enterprises to 'go global' including investing overseas in R&D, manufacturing and service networks;
- Move up the value chain by developing core technologies and improving systems integration in important industries;

- Focus on a fair, reasonable and non-discriminatory regime of IPRs;
- Transition from state-driven to enterprise-driven adoption of ICT into all sectors of the economy.

China's strategic approach to these objectives has been simple and effective: use the size and potential of the domestic market to attract the necessary capital, technology and expertise; use state guidance and the scale of the domestic market to enable national champions to dominate each key ICT sector of the domestic economy; and provide state support to promote these national champions internationally.

The expansion of Chinese vendors overseas is still overshadowed by the dominance of foreign-invested companies exporting ICT products from China. Nevertheless, in certain key areas Chinese companies, such as Haier, Huawei, Lenovo, TCL and Konka, already compete on global terms. The emergence of Chinese multinationals will accelerate, and as it does, Chinese telecommunications carriers, banks and other support service industries will follow them to become not only domestic but global industry leaders over the next 5 years.

However, the emergence of truly multinational Chinese ICT companies is not a zero-sum game. On the contrary, these developments offer more opportunities than threats, provided that Victorian ICT companies can adapt accordingly.

1. OECD ITS database url: <http://www.oecd.org/document/8> ; See also 'China topples US as world's top high-tech exporter', Reuters, December 12, 2005.

2. Overview of the Chinese ICT Market

China's electronics and IT market was worth US\$480 billion in 2005 with the revenue of the top 100 Chinese manufacturers reaching US\$120.5 billion – a year-on-year increase of 18.2 percent.

Nevertheless, foreign organisations often overestimate Chinese spending on technology. Although China is a fast growing ICT market, the enterprise ICT market is still comparatively small. However, privatisation of the state-owned enterprise (SOE) sector is accelerating and the Chinese SME sector is booming, and for these reasons it is the enterprise ICT market rather than the consumer technology market that is now seen to be at the forefront of the Chinese Government's ICT objectives.

In contrast, foreign organisations still often underestimate China's consumer technology market. China is the world's largest telephony market, the world's second-largest internet market, and the world's fastest growing major broadband market.

2.1 Market Segmentation

2.1.1 Information Technologies

The information technology sector in China comprises the following sub-sectors:

Computers

The leading companies are Lenovo, which recently acquired IBM's PC business and holds nearly 38 percent share of the Chinese market, Founder with 14 percent and Tongfang with just under ten percent.

Electronic Components

While China accounts for around 25 percent of the world's production of LCD screens, most of the screens produced are not competitive with the larger and more advanced screens coming from Korea and Japan. As a result, China is trying to move up the value curve in electronic component production, and as such, the markets for third generation (3G) handsets, Internet protocol TV (IPTV), digital TV, individual video and music terminals and other digital products are expected to be the most important emerging markets of China's consumer electronics over the next several years.

Integrated Circuits & Semi-Conductors

In 2005, China represented 21 percent, or approximately US\$40 billion, of the world's US\$192.4 billion in integrated circuit (IC) consumption. Forecast demand for IC chips is US\$124 billion by 2010. China-based IC production, concentrated at the low-value end of semiconductors, amounted to about US\$2.6 billion in 2005 and is expected to grow at an annual rate of 36 percent to US\$12.1 billion by 2010. Again, the ambition is to move up the value curve, and to garner an even greater share of the global market.

Software

Software sales in China reached US\$4.5 billion in 2005, increasing 22.2 percent year-on-year.² The software industry is now a key strategic development objective for China, having been identified as coming off a comparatively low base as compared to countries such as India.

IT Services

The market size for IT services in China reached US\$1.4 billion in the first quarter of 2006, representing an increase of 7.1 percent quarter-on-quarter and 46.5 percent year-on-year. As the market share of the top ten IT service vendors only accounts for 19.6 percent of the market total, there are still major opportunities for Victorian ICT companies in this segment of the market.

2. Ministry of Information Industry, China

Offshoring and Business Process Outsourcing (BPO) Services

One estimate suggests China currently has around US\$2 billion of the outsourced-services market. The market share of the top ten outsourcing service providers in China is only 19.2 percent, suggesting an open market that may offer opportunities to suitably qualified Victorian ICT companies.

Domestic Outsourcing Services

China's ICT outsourcing services market reached US\$400 million in 2005, increasing about 16 percent over the previous year, and market growth is expected to average over 20 percent compound annual growth rate for the coming four years to reach US\$1 billion by 2009. This growth will, in part, be driven by a change in attitude by Chinese companies, which unlike multinationals, have thus far preferred to keep IT in-house.

2.1.2 Telecommunications Equipment

Capital expenditure by China's telecommunication operators reached a high point of US\$33 billion in 2001, sliding back to under US\$25 billion by 2005. Growth areas are in NGNs (next generation networks) and Internet protocol-based networking, such as IPTV, which is currently on trial.

The two major equipment manufacturers, Huawei and ZTE account for around 70 percent of telecommunication equipment sales in China. Other Chinese companies take up another ten percent of the market.

The telecommunication equipment market comprises the following sub-sectors:

Network Equipment

Total sales in the Chinese network equipment market have been valued at US\$3.6 billion for 2005 with modest predicted growth of nine percent per annum. The low demand for NGNs and NGN-enabled services by both the enterprise and consumer sector has resulted in Chinese companies entering joint ventures with international companies to exploit overseas markets as a means of expanding their broadband and IP technologies.

Broadband Wireless

China is the world's largest wireless market, with over 400 million wireless accounts as at the end of March 2006. China has yet to decide on the deployment of 3G networks, and standards issues are among the factors currently slowing down a more rapid expansion of other broadband wireless networks, but growth in these markets offers enormous opportunities to capable Victorian companies.

2.2 Key Sector Trends

The ICT sector in China is changing rapidly in response to technology developments, market expansion, competition and regulation change. This section outlines the major changes by segment.

2.2.1 Fixed-Wireless Public Switched Telephone Network

For China's fixed-line operators, fixed mobile substitution has been a concern as mobile users outgrow fixed line users. The growth areas are Internet and value-added services. For example, China Telecom's revenue in 2005 from Internet services was up from US\$1.7 billion to US\$2.2 billion, while value-added services revenue was up from US\$1.3 billion to US\$1.7 billion.

2.2.2 Broadband and Value-Added Applications

China now has more than 77 million broadband subscribers.³ Other services explored by China's carriers are IPTV, TV broadcast to cellphones, IPv6 infrastructure and applications, and continuing the evolution of higher speeds for broadband access such as ADSL2+.

3. 'NasionCom in China's VoIP', The Edge Financial Daily, April 10, 2006



2.2.3 Mobile Cellular

Cellular subscriber growth in China has been maintained by turning to the poorer provinces as the richer markets start approaching saturation levels. 'New business revenue' - from non-voice services such as short message service (SMS), and ring tones - increased considerably between 2004 and 2005.

2.2.4 3G and Mobile TV

It is widely expected that the Ministry of Information Industry (MII) will announce the licensing of 3G services sometime during late-2006 or early-2007, giving network operators sufficient time to build 3G networks for the Beijing Olympics in 2008. W-CDMA and CDMA 2000 licences are also expected.

Mobile TV subscriptions in China are predicted to grow to 94 million by 2009.⁴

2.2.5 Increasing Focus on Value-added Services

In the telecommunication services market, China's carriers have been increasing their focus on value-added services including the development of mobile data services, such as SMS, wireless application protocol, colour-ring tones, and multimedia messaging service. The services potential of 3G is enormous and all China's carriers have been actively participating in 3G testing and, in many cases, rolling out networks.

2.2.6 Computer, Communication and Consumer (3C) Convergence

For the first time, the Chinese Government has endorsed 3C convergence as a major technological trend in its 11th Five Year Plan 2006–2010 (11th FYP) and as a result broadband-based 3C convergence should become one of the primary drivers of the information industry from 2006. The initial 3C implementation will promote growth in demand for products such as smart phones, entertainment PCs, flat-panel PCs and content and security authentication.

2.2.7 Industry Merger and Acquisition

In recent years, industry mergers and acquisitions have been increasing in frequency across China's ICT market, as industry participants seek economies of scale and scope, diversify their businesses and begin looking to move overseas.

This trend is expected to continue and increase across the ICT landscape over the coming years.

4. Business Wire, March 13, 2006.

3. China's Policy Framework

This section outlines the major policy actors and priorities that will impact on Victorian ICT firms seeking to engage with the Chinese market.

3.1 Central Policy-making Structure

As the Chinese Government continues to restructure and the economy continues to grow, the ICT sector has become a key focus for China. As a result, an ever-increasing number of government agencies have become involved. Formerly, it was just the MII and the State Administration of Radio, Film, and Television who played the key roles in ICT industry administration, but now other Government players have entered the picture, including:

- the National Development and Reform Commission;
- the Ministry of Science and Technology;
- the Ministry of Commerce; and
- the State-owned Assets Supervision and Administration Commission.

3.2 Central Policies

Key central Government policies which hold implications for the Victorian ICT industry include:

- market entry limitations;
- foreign direct investment rules;

- central policies related to China's 11th FYP including:
 - the 11th FYP itself
 - the MII's FYP for telecommunications
 - the National Informatization Development Strategy for 2006-2020
- the forthcoming Telecommunications Law;
- China's NGN policies; and
- industry funding including:
 - National Key New Products Plan
 - MII Electronics & IT Development Funds.

3.2.1 China's 11th Five Year Plan

China's 11th FYP, presented in March 2006, outlines the strategic priorities for achieving economic and social development while maintaining social harmony. The role of ICT is recognised as impacting all of the priorities in some way - particularly, through the encouragement of innovation in processes, products and services, and management systems.

The message implicit in the 11th FYP is that the real test for China will be its ability to move from comparatively low-end value assembly, testing and packaging of items to high-end value design and manufacturing of components, such as microprocessors, digital signal processors and ASICs (application specific integrated circuits) in which China can file applications for patents.

The big question for potential international entrants, including the Victorian ICT sector, is to what extent the central Government will remain the central arbiter of key resources and procurement decisions. While the 11th FYP shifts non-strategic decisions to the business sector, central Government support continues to be central to gain permits and permissions, access to finance and lines of credit and procurement contracts.

3.3 Provincial ICT Policy

Provincial ICT policy-making largely follows central policies.⁵ But each local government tends to compete in attracting investment into the local sector. In strong ICT industry regions the local governments are able to provide funds for R&D. In the more peripheral provinces local governments try to provide more in the way of incentives such as free land leasing, cheap utilities, and tax incentives to attract ICT companies to locate there. Victorian ICT companies should take this consideration into account when approaching China; the Chinese market is not homogenous and the most attractive opportunities for Victorian firms may well be found in places far away from Beijing and Shanghai, the current epicenters of global attention.

5. In China's centralised system provincial policy-making plays the role of implementing central government policies and ideas.

4. Victoria & China: Relations, Opportunities, Challenges

4.1 ICT Trade Flows

China (including Hong Kong) is one of Victoria's largest trading partners. In the financial year 2005-06 trade between China (including Hong Kong) and Victoria was more than \$10 billion. With respect to ICT trade however, there is currently insufficient data to specify flows between Victoria and China.

However, statistics highlighting ICT trade flows between Australia and China provide a broad picture of what is happening in this area.

Overall, ICT trade flows between Australia and China have been steadily growing over the past five years.

In keeping with its rise as the global centre for ICT manufacture, China (including the Hong Kong and Macao SARs) now provides 29 percent of Australia's ICT equipment imports, far out-stripping the contribution of the two dominant providers of a decade ago, USA (13 percent) and Japan (eight percent). In fact, Australia's ICT equipment imports from China more than tripled between 2000 and 2005. With respect to Australian ICT equipment exports, China is ranked fourth among export destinations and in 2005 accounted for about seven percent of total exports.⁶

As a point of general comparison, Victoria exported approximately 42 percent of total Australian ICT equipment exports.

ICT services trade flows between Australia and China are much lower than those for ICT equipment but are growing strongly, albeit from a small base. ICT trade flows in services are extremely difficult to measure with any confidence, but the trends are illustrative. With respect to Australian ICT services exports between 2000 and 2004, China represented a notable growth market for both communications services and computer and information services.

In the case of ICT services imports it is not possible to put a figure on the total amount sourced from China. However, the available evidence suggests that in 2004 Australia had a positive balance on trade with China in the communications services category of ICT services.⁷ In summary, as China makes the transition to a services economy the opportunities for Victorian ICT firms will increase markedly.

4.2 The Victorian ICT Industry

As at June 2006, the Victorian ICT industry:

- employed over 76,500 people;
- comprised some 7,700 companies; and
- had a revenue of more than A\$22.9 billion.⁸

The Victorian ICT industry is home to a host of innovative and responsive small to medium enterprises (SMEs) that are making significant inroads into international export markets. It is also recognised for world-class capabilities in a number of key product segments, including:

- telecommunications;
- niche software and services;
- web applications software; and
- electronic games.

Efforts by the industry to leverage these strengths are supported through the suite of programs included in the Industry Plan. Of special note is the Government's support of key networks and clusters. By encouraging collaboration these networks drive innovation, boost capability and increase profile and scale. Support has been provided to eleven such networks, in diverse areas including: radio frequency identification (RFID), intelligent transport systems, .NET, computer games, photonics, microelectronics, eLearning, open source software and eSecurity.

6. John Houghton, The Australian ICT Trade Update 2006, p 21ff

7. John Houghton, The Australian ICT Trade Update 2006, p36ff

8. Whitehorse Strategic Group, The Whitehorse 'Top 250' Report, June 2006

4.3 Opportunities

In assessing the opportunity for export of products and services to China four key factors should be considered:

- **Scale** – Expansion into the large and complex China market can be time and resource demanding. As a result it should only be attractive to companies with sufficient resources to invest in the expansion activities, which may extend over a number of months.
- **Accessibility** – China-based customers and partners will similarly be concerned about the cost of doing business with Victorian-based companies. While Victoria has the advantage of working within a similar time zone, it is 12-18 hours (or more) travelling time away, so access to resources on the ground in China is an issue.⁹
- **World class capabilities** – China's ICT market intends to harness world's best practice and is prepared to make ties anywhere such expertise is available. Only companies that are world-class will succeed in China.
- **Maturity** – The Chinese ICT market is complex on a number of levels and its financial, tax and legal arrangements are quite different from those available in Australia. Dealing with these issues on an on-going basis requires patience, depth and maturity from Victorian companies engaging with China.

These factors will be as important for individual ICT companies as they are for sub-sectors or clusters contemplating the Chinese market.

The Terranovate research contains an assessment of the Chinese ICT market with reference to sectors of interest to Victorian ICT clusters. Briefly, the Chinese market displays strong demand for games and content, e-learning, spatial information, .NET, intelligent transport systems and RFID.

4.4 Challenges

4.4.1 Local Contact Requirements

Under the World Trade Organisation (WTO) Trade Related Investment Measures Agreement, China is obliged to eliminate a range of restrictions on international trade and investment, including local content requirements, regardless of whether they are contained in national or local legislation. While there no longer appears to be any explicit local content requirements in published regulations, there is the possibility that these may exist in internally circulated administrative directives (known as Neibu).

4.4.2 Taxes and Tariffs

China is a moderately taxed country and non-tariff protection measures have been falling progressively as China implements its commitments under its Protocol of Accession (to the WTO.) In parallel with these changes, Chinese trade policy has shifted away from direct intervention in the economy. However, the central Government continues to provide "guidance" to the economy using measures such as interim export taxes and VAT rebates to "manage" exports of products in short supply.

4.4.3 Legal & Regulatory Systems

China's policy toward foreign investment in the ICT industry will continue to be very cautious with the emphasis placed on local market protection and development. Victorian ICT companies seeking to develop in the China market must also be cautious, seeking local partners to ensure they remain well informed and prepared to accept the risk that comes with the market uncertainty.

9. An air flight from Melbourne to Shanghai is approximately 11 hours on a direct connection, but if the partner organisation is based in Chongqing, Dalian, or some other 2nd or 3rd Tier city, then anywhere from three to 10 extra hours traveling time is faced.



4.4.4 Corporate Governance Standards

Since the establishment of China's security regulator, the China Securities Regulatory Commission in 1992, more than 300 laws concerning the securities and future markets have been passed.¹⁰ These regulations and the adoption of the key legal framework for corporate governance have slowly pulled corporate managers and their directors into the mainstream of modern capital markets as it relates to corporate governance. This should make the business environment in China more transparent for Victorian companies interested in entering the market.

4.4.5 Protection of Intellectual Property Rights

While the central Government's focus on the development of the software and media industry as well as the development of innovation means IP protection is becoming more important, international companies entering the China market and wanting to protect their proprietary techniques, knowledge and processes need to understand that intellectual property rights are difficult to enforce in China.

4.4.6 Repatriation of Funds

Chinese banks are authorised to transfer the money in and out of current accounts. These transactions can include import/export payments and fees for services. However, there is considerable paperwork involved in these transactions - several accounts are required and approvals from government departments must be sought - so, profit repatriation continues to be a complex and challenging process for foreign companies.

4.4.7 Government Procurement Policies

According to the Development Research Centre of the State Council, Chinese Government procurement of information technology products totalled US\$5.1 billion in 2004 and will increase steadily for about five years.

Under the Law on Government Procurement, which covers purchasing by government departments and public and social institutions (but not state-owned enterprises), procurement is expected to facilitate the achievement of state goals for economic and social development. This overarching policy dictates that purchasing preferences exist for 'domestic goods, construction and services' - although these may be purchased from foreigners under exceptional circumstances. This again highlights the benefits for Victorian companies of identifying reliable and knowledgeable local partners, to compete in the market.

10. Thomas W. Lin, "Corporate Governance in China: Recent Developments Key Problems and Suggested Solutions," Marshall School of Business, University of Southern California, Los Angeles, Fall 2004,

5. Approaching the Chinese Market

China has been a challenging market for many companies over the years. The different business practices and legal system have meant that foreign companies have had much to learn when entering the market.

5.1 Market Entry Approaches

China can be a confusing environment in which to launch a business and new entrants receive much “advice” based on perceived successes and failures of previous ventures. Generally speaking, there are five market entry approaches that a Victorian ICT firm might employ in establishing a business in China:

- wholly-owned foreign enterprises;
- joint ventures;
- strategic partnerships;
- distribution agreements; and
- representative offices.

The Terranovate research suggests that distinct issues, benefits and implications will be associated with each approach and companies will need to weigh all carefully before committing to any one.

5.2 Attitudes to Market Entry

For companies new to the China market there are also important lessons in the more common “attitudes” that are expressed by market entrants. The Terranovate research outlines a set of common “attitudes” expressed by market entrants and explores their applicability and implications for Victorian ICT firms.

The attitudes reviewed include:

- “To be successful in China you have to be in for the long haul.”
- “The way to approach China is to start slowly, to test the waters.”
- “China is just like other markets, and should be treated no differently.”
- “To succeed in China requires local knowledge and local players, the key is local representation.”

5.3 China Market Business Myths and Realities

As China continues to develop as a world force, many market factors are changing. The Chinese Government is building industries that can both attract and compete with the best in the world and which support business practices that are acceptable at a global level. As market factors change so do the business realities facing foreign companies operating in China.

The following table summarises the current status of some of the more common “myths” about doing business in China.



Myth	Perception	Today's Reality
<p>1. Nobody makes money in China.</p>	<p>Foreign firms are targeted by Chinese companies for their capital, technology and expertise.</p> <p>They have to put down large-scale investments to enter the market for "the long haul", often with a questionable joint-venture partner.</p> <p>Once the capital, technology and/or expertise has been transferred to the local partner, the foreign investor is marginalised.</p>	<p>McKinsey (China) estimates 88 percent of foreign invested companies operating in China made money in 2003.</p> <p>The Chinese market is hard work and there is an active policy of technology and expertise transfer but China is the world's biggest recipient of foreign investment.</p> <p>Many foreign companies have invested and, in some cases, lost large amounts of money.</p> <p>However, many companies are now making money in China as a result of patient investment.</p>
<p>2. When they do make money in China, foreign companies cannot access the profits outside China.</p>	<p>Chinese regulations and currency controls mean that foreign companies are unable to repatriate any profits from China into their global operations.</p>	<p>All businesses in China with foreign trade are required to maintain RMB accounts – for domestic business – and foreign currency accounts for international business, including onward transmission of group profits and payments for foreign workers, etc.</p> <p>While dual accounts must still be maintained, currency controls and account rate discrepancies have largely disappeared.</p>
<p>3. Chinese law does not support clear contracts.</p>	<p>Chinese business is conducted verbally, not contractually.</p> <p>The arrangements (requirements) are inevitably complex; the court system provides little recourse and favours the local partner.</p>	<p>The entire Chinese economic system (ie, not just the legal environment) is set up on a simple premise - the goal posts must keep moving if the economy is to successfully continue expanding.</p> <p>Thus, the legal environment in China is set up such that everyone is able to clearly know exactly what is not allowed.</p> <p>But it is never totally clear just what is allowed. In this way, businesses are taught to experiment, to continue to push at the boundaries, and to recognise that what appears to be out of bounds today may be acceptable tomorrow.</p> <p>In June 2006, the State Council recognised a new law enabling arbitration in disputes between local and foreign companies to take place in Hong Kong and thus be subject to Hong Kong law.</p>



Myth	Perception	Today's Reality
<p>4. Complex regulation limits the ability to do business in China.</p>	<p>Because each level of the administrative hierarchy in China (eg, central-level vs. provincial-level) has its own set of regulations to be followed, there is often more than one regulation covering a specific business area – and often they can be directly at odds with each other.</p>	<p>The regulatory complexity of China is a fact, but different locality regulations can be as much a business protection or enabler as a hindrance.</p> <p>More often than not, local level regulations are the local government's means of developing the local economy, and therefore enable a business to successfully work into the locality's development cycle.</p>
<p>5. All decisions go through Beijing.</p>	<p>A relationship with a senior official in the central Government will result in business proceeding smoothly on the ground.</p>	<p>Beijing is potentially an important entrée point into the China market, but any business in a province outside Beijing will likely have to be negotiated at both the local level and the central level.</p> <p>While any local level deal will need to abide by central regulations, central-level deals will not be automatically accepted at the local level.</p>
<p>6. Intellectual property is not respected and is usually "stolen".</p>	<p>Products and processes introduced by foreign companies into China will be re-engineered and reproduced at a far cheaper price than the foreign company can compete with.</p>	<p>Intellectual property rights are difficult to enforce in China.</p> <p>However, with the development of the software and media industries high on the Government's priority list, as well as the development of innovation more generally, protection for IP is gaining traction rapidly.</p>
<p>7. There is no real innovation in China – China imitates.</p>	<p>China's key economic strength has been to take goods/ technology made elsewhere and re-engineer them in China for a fraction of the cost.</p> <p>These goods are then mass-produced and sold back onto the global market.</p> <p>As a result, China is able to imitate, but not innovate.</p>	<p>China is now producing more engineers, more scientists, and more PhDs than any other country.</p> <p>Chinese companies and individuals cumulatively now apply for more patents than any other nationality, submit more peer-based academic journal submissions and register more products.</p> <p>In addition, the "brain drain" that characterised China's elite through the first two decades of the Reform period actually reversed at the end of the 1990s – Chinese with experience in everything from running humanities departments at Ivy League colleges to running computer and media conglomerates began returning to China.</p>



Myth	Perception	Today's Reality
<p>8. Physical infrastructure is immature.</p>	<p>China is still a poor, developing country, where the basic infrastructure – roads, ports, telecommunications, air transport, utilities, etc – work sporadically at best.</p> <p>The costs are inflated and the service is poor.</p>	<p>China's railway network is the most extensive in the world; China's road and toll way system, while not as large, is also extensive and well-engineered.</p> <p>The major metropolises of Beijing, Shanghai, and Guangzhou are as urban as anything in the West – the electricity grids servicing them do so effectively.</p> <p>The telecommunications networks are far and away the largest in the world – between 1993 and 2003, China added the equivalent of a France Telecom network every 18 months, and in the Lunar New Year week of 2006, some 12 billion SMS messages were sent.</p>
<p>9. Service sector does not exist.</p>	<p>There is no service culture in China – it runs contrary to the culture and people are not willing to pay for it or deliver it.</p>	<p>China does not yet have a fully developed service sector.</p> <p>Because the market economy has broken through the State apparatus in the distribution and sales of goods, the culture of selling (charging money for) a service has been slow in taking a hold.</p> <p>As quality has become important as a differentiator of high-value goods, and as companies such as China Mobile and Air China have come to realise the economic importance of keeping customers, this is beginning to change.</p>
<p>10. China is a monopolistic market dominated by state owned enterprises.</p>	<p>In China everything is (eventually) owned and run by the central Government, most major service sectors - such as telecommunications - are dominated by single-monopoly providers.</p>	<p>China's telecommunication market is probably the most competitive market in the world today.</p> <p>Price warfare between the four major carriers has taken domestic carriage (including for Internet & broadband) prices to some of the cheapest in the world.</p>

6. Market Lessons

Market lessons that Victorian ICT companies seeking to trade with China should take into account include:

- Companies need excellent distribution channels and that means reliable and knowledgeable local partners, to compete in the market.
- Knowing the market is always the key to success.
- Protect IP with cautious technology transfer policies and the establishment of good working relationships with all relevant authorities.
- Establish a China office with staff that can speak Mandarin committed to a long-term presence.
- In third-country markets, look to establish long-term relationships that stress customer care and long-term service level agreements where relevant.
- Walk away from uneconomic deals unless absolutely convinced about their strategic value.
- Victorian ICT companies must decide whether their goals in China are to extend market share or increase profitability. It will be difficult to achieve both at the same time.¹¹
- Companies should extend their area of investigation well beyond the confines of Shanghai and Beijing. Indeed, given the specialist characteristics of the Victorian ICT sector, the diversity of the Chinese market, and the level of international attention focused on China's key cities, opportunities for Victorian companies may well be richer 'off the beaten track'.

Services providers have only limited access to the China market due mostly to policy and regulatory restrictions, but also to market conditions.

- It is vital to understand the market in detail before entering, and to choose local partners with great care because management control is not guaranteed.
- Never accept assurances from local partners that the regulatory permissions will be forthcoming, and never invest upon such assurances alone.

- Victorian services companies' competitiveness in international markets may be an opportunity to foster collaboration and even partnerships with Chinese companies, but don't count on that leading to concessions in China's domestic market.

Aconex

Aconex started providing its online information management service to China's construction and engineering industries in 2004. The company decided to establish a direct presence after evaluating market size, forecast construction growth and general economic growth. Aconex opened offices in Beijing, Shanghai and Hong Kong, to provide business development and client service.

The company's Greater China team has since secured some of the largest deals to date, with the Aconex system in use on a \$2.6

billion casino resort project in Macao, the Mandarin Oriental Hong Kong Hotel renovations, and the landmark \$1.2 billion Ocean Park theme park redevelopment.

Although patience was required when first establishing in the market, Greater China is one of the fastest-growing Aconex operations outside Australia and Aconex is building a long-term leadership position in the Chinese market.

Leigh Jasper, Managing Director, Aconex

11. *Key Issues for China's ICT Industry, 2006, Gartner, 10 April 2006*

7. Connecting Victorian ICT with China

The Industry Plan, launched in December 2005, identified the need for the State's ICT sector to be more globally focused in order to grow and prosper.

The Government has undertaken to assist the sector in meeting this need by providing support for companies planning and executing export strategies including:

- providing country specific market intelligence to facilitate inward investment and exports; and
- providing financial and other assistance for companies to attend overseas trade fairs.

This will be achieved through the implementation of two major initiatives:

- the Emerging Market Strategies; and
- ICT Trade Events and Export Assistance Program.

7.1 Emerging Markets Strategies

The Emerging Market Strategies are designed to assist local ICT companies to gather market intelligence and to identify strategic opportunities in high potential overseas markets.

China is the focus of the first of these Strategies and this document is a key component. Building on this foundation, the Government will work with industry to implement an initiative that addresses China-specific investment and trade opportunities including:

“The 2006 trade mission to Shanghai, which was funded and led by Multimedia Victoria and the Victorian Government Business Office in Shanghai has produced results and business leads far beyond what we had expected. We discovered that the quality of our products, our willingness to learn and our flexible can-do approach was much appreciated and recognised. We are confident we will be successful in China”.

E. Peter Boudville, Managing Director, Challenger Momentum Pty Ltd

- a commitment of resources to pursue Chinese opportunities;
- a selection of services to assist Chinese companies to establish themselves in Victoria;
- understanding the needs of Chinese investors and easing access to them;
- assisting selected Chinese companies in accessing Victorian market information;
- providing Victorian companies with access to interpreting services;
- providing specialised, market-specific web-based information through a number of government and industry websites; and
- providing market updates and promotions.

7.2 ICT Trade Events and Export Assistance Program

The ICT Trade Events and Export Assistance Program provides financial support for Victorian ICT companies to undertake international networking, exhibiting and exporting.

Eligible companies are now able to receive funding of up to \$10,000.

Since 2002, the Government has generated approximately \$900 million in exports for the Victorian ICT sector through the program, supporting missions to Japan, US, India and Israel.

In the 2005-06 year the Program provided 207 grants to companies to attend ICT. Participants reported potential exports of more than \$200 million.

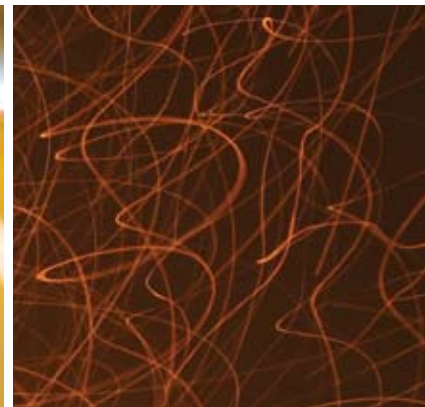
For more information visit www.mmv.vic.gov.au/TradeEventsandExportsProgram.



To find out more about what the rise of China means for you as a Victorian ICT company, access the Terranovate research by contacting Multimedia Victoria on queries@mmv.vic.gov.au

This research is available exclusively to Victorian ICT companies.

For up to date information on opportunities for engagement with the Chinese ICT market, check the Multimedia Victoria website at www.mmv.vic.gov.au



www.mmv.vic.gov.au

