

Chinese Market Offers Rewards For Firms Willing To Take The Risks



By Cindy Payne, Managing Director, Asia-Pacific Connections Ltd.

A Good News, Bad News Scenario

Since China flung open its door in 1979, signaling the shift to a market economy, high-tech marketing in this vast Asian country has been somewhat of a "good news, bad news" proposition.

The good news is that in recent years the government has taken concrete steps to attract foreign investors, establishing 1994 reforms in banking, investments, taxation, patent protection, foreign exchange, and the nation's legal framework.

Also in the good news department, the country's Ninth Five-Year-Plan (1996-2000) solidifies on-going policy directives and highlights five industry priorities, mostly focused on domestic technological development.

- Development of telecom equipment and software.
- Development of networking products and implementation of major networking projects (especially those used to build China's "Golden" networking projects).
- Home computer market development.
- Development of industry conglomerates.
- In addition, sliding scales for income and capital gains taxes

have been introduced, and a standard value-added tax now stands where consolidated commercial and industrial sales taxes were once the norm. An average tariff of 36% is targeted to fall to 15% by 1997.

However, despite these and other efforts on the part of the Chinese to lure foreign business, the bad news is that foreign information technology (IT) companies still face undeniable political, economic and cultural hurdles. Restrictive employment rules and strict banking controls remain. Overhead costs are high, and operations are further hampered by overloaded, outdated infrastructure. Bureaucracy, red tape and corruption reign. The distribution channels are notoriously immature and inefficient. At times, the gap separating the Chinese and Western cultures is formidable.

Other risks loom large: Can Beijing maintain control over economic development and its provincial governments? Might U.S. pressure over human rights and nuclear proliferation issues dampen Chinese enthusiasm for U.S. technology? Will brisk inflation or a remimbi devaluation hinder foreign investment?

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M&T International Advisor

Chinese Market

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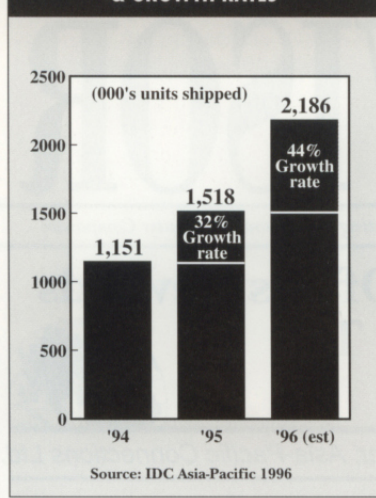
It's not surprising that the response of foreign investors has not met Chinese expectations. In 1994, over half of all overseas investment in China still flowed from Hong Kong.

Staggering Market Potential

Despite these troubles, China's market, with its more than 1.2 billion people, keeps foreign IT companies knocking at China's door. Analysts are not exaggerating when they describe the potential of the Chinese IT market as poised to become the largest in the region. According to International Data Corporation (IDC), China's PC market is slated to grow 44% this year, after growing 32% last year.

Although the Chinese IT market is growing quickly, the nation's low

CHINESE PC SHIPMENTS & GROWTH RATES



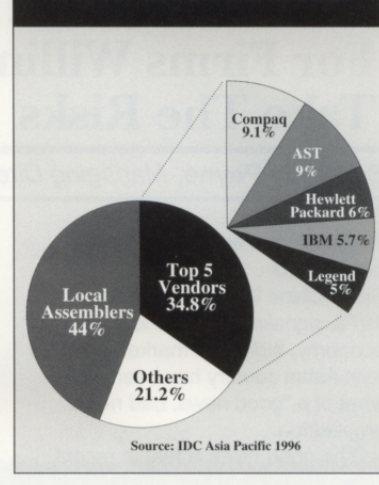
GNP—close to that of developing Southeast Asian countries—explains

why China represents only a modest part of the overall Asia/Pacific market today.

Shifts in the PC Playing Field

PC market dynamics shifted in 1994 when Compaq displaced consumer PC leader AST with a two-prong strategy of lower prices and higher credit limits to its channel partners. Faced

1995 TOP PC VENDORS IN CHINA



last year with payment defaults and a subsequent credit collapse, Compaq has tightened up its channel and allowed AST to regain the number one spot in China during the first quarter 1996.

In business and government sales, Hewlett-Packard is showing steady growth. With its focus on new channels, IBM is recruiting a number of new joint venture partners, including some from Compaq's channel.

Local vendor Legend's ability to draw business in the government and education markets landed Legend a spot on the top five PC vendor list in 1995. Other branded local vendors are rapidly gaining market share, at the expense of the foreign vendors who have typically secured more than two-thirds of all PC sales in China. The local assemblers dominate the home and small office/home office

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Chinese Market

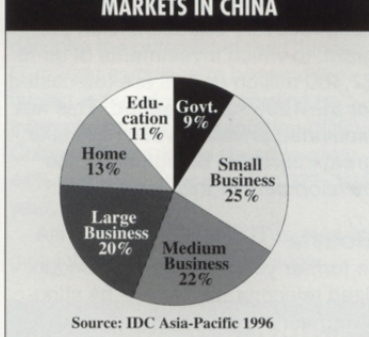
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market with about 44% market share in 1995.

Joint Ventures Encouraged

Since the late 1980s, joint ventures have emerged as the best way for Western high-tech companies to enter the China market. Alliances have

1995 KEY PC VERTICAL MARKETS IN CHINA



paired Compaq and Stone, IBM and Great Wall, Digital Equipment and Founder, Apple and Legend, and AST and Tianjin. To stimulate partnerships, the government offers a variety of incentives including development

money and other support on a case-by-case basis.

Special economic zones have been established to allow duty-free movement of goods including Shanghai's Pudong New Area—home to the Caohejing Emerging Technologies Zone—Wuxi, Shenzhen and several other cities in southeast China.

The appeal of joint ventures is buoyed by Equity Joint Venture (EJV) laws. Foreign partners must provide at least 25% of the venture's registered capital, although equity contributions may also include technology or equipment. Because Chinese state enterprises are cash-poor, Chinese partners may make non-cash contributions, usually in the form of land.

Less popular is the wholly foreign-owned enterprise. A requirement that these businesses export 50% of the value of their output each year often stymies this investment alternative.

Distribution Channels Improving

Although today's channels are chaotic and frequently clogged by credit shortages, the system is consolidating and offering credit flexibility and support not plausible with direct sales. Today, over 75% of all workstations

are sold through channels (mostly VARs) and over 95% of all PCs are sold through partners (mostly distributors and dealers).

Foreigners seeking sales in the Chinese market must adapt. A two-tiered distribution system may include a series of distributors based in large cities such as Shanghai or Beijing, and a wide network of local dealers scattered throughout the country. Alternatively, three-tier distributor/reseller/dealer systems are also common.

Creating an effective channel is worth the investment in time and energy. It is best to join up with two or three distributors who are able to untangle government red tape, oversee currency exchange with little expense, obtain necessary licenses, and finesse customers on behalf of the vendor. However, finding the right partners can prove to be a daunting task. In doing so, it is important to bear in mind that technical competence, financial strength and distribution savvy are only part of the equation.

Bridging Cultures

East-West cultural differences may pose the greatest stumbling block for foreign vendors in China. Despite Chinese appreciation for Western technology, an inherent skepticism permeates the business climate. The Chinese are often reluctant to accept a single-vendor solution out of fear of losing options later. This skepticism also applies to vendor hype: a sales pitch in China needs to be a little gentler, more civilized and more honest than in Western cultures.

Westerners accustomed to contracts and other legal agreements must learn the concept of Guanxi—which elevates personal and high-level relationships to a fine art—in order to succeed in business and legal affairs. The Chinese expect to spend time developing a mutual trust before diving into business relationships. Chinese expectations for personalized after-sales support must be

Golden Projects

In an effort to become part of the global information highway and truly bring economic automation to China, several nationwide network development projects have been funded by the Ministry of Electronics with multiple satellite projects running concurrently. The national projects include:

The Golden Card Project will broaden credit and ATM card transactions for residents in 400 cities via a national financial institutions network.

The Golden Bridge Project will network major national and provincial government offices throughout 500 cities with more than 12,000 industrial enterprises.

The Golden Port Project will build a national e-mail system to exchange foreign trade information, and manage customs payments and export licenses, via a high-tech overhaul to the import/export system.

The Golden Tax Project will expedite money circulation throughout the country by networking thousands of tax-collecting units with banks.

Foreign vendors will have many opportunities to participate in these programs vis-a-vis hardware/software sales, technology transfers and funding options.

understood as well. Where Western users are satisfied with problem-solving via telephone support or remote diagnostic software, the Chinese often expect a personal visit by a senior employee to solve problems. Conventional wisdom suggests

that foreign vendors who commit sufficient resources, intelligence and endurance to forays into the Chinese market will be well-rewarded. Success may be within reach, but only if the formula also includes local management talent, strong relationships

throughout the industry as well as in the government, the necessary licenses/permits to pass regulatory barriers, and a long-term outlook.

Despite all these challenges, high-tech companies continue to plunge into the Chinese market. Let's face it, if you wait until the risks in China are lower, you will simply be too late. ♦

International High-Tech Trade Shows 1997

April

4/7-4/11	Network + Interop/Interop Dotcom	Singapore
4/8-4/10	Internet World Brazil	São Paulo, Brazil
4/8-4/11	Internet World Argentina	Buenos Aires, Argentina
4/8-4/11	COMDEX Japan	Tokyo, Japan
4/8-4/13	COMDEX Rio	Rio de Janeiro, Brazil
4/21-4/25	COMTEK '97	Moscow, Russia
4/22-4/25	COMDEX UK	London, England
4/23-4/25	Internet World Japan	Tokyo, Japan

May

5/5-5/9	Network + Interop/Interop Dotcom	Las Vegas, NV
5/13-5/15	PC '97	Brisbane, Australia
5/13-5/15	ATUG	Sydney, Australia
5/13-5/16	Network + Interop/Interop Dotcom	Singapore
5/14-5/17	International Computer Expo for Asia	Hong Kong
5/20-5/22	Internet World UK Spring '97	London, UK
5/20-5/23	COMDEX Argentina/Infocom/Windows World	Buenos Aires, Argentina
5/21-5/24	Intermedia/Internet	Singapore
5/27-5/29	Web Interactive Australia	Melbourne, Australia

June

6/2-6/5	COMDEX Spring/Windows World	Atlanta, GA
6/2-6/6	Network + Interop/Interop Dotcom	Toyko, Japan
6/9-6/14	Asia Telecom	Singapore
6/17-6/19	PC Expo	New York, NY
6/26-6/29	The PC Show/The Software Show/Biz-Comm'97	Singapore

July

7/9-7/11	COMDEX Canada/Windows World and LAN Expo	Toronto, Canada
7/12-7/16	Softel	Chile
7/21-7/26	Fenasoft	São Paulo, Brazil

August

8/12-8/14	COMDEX/Infocom	Buenos Aires, Argentina
8/18-8/22	COMDEX/SUCESU-SP	São Paulo, Brazil
8/26-8/30	COMDEX/Korea	Seoul, Korea

Cindy Payne is founder and managing director of Asia-Pacific Connections Ltd. She has eighteen years of diversified sales and marketing experience in the Asia-Pacific region.

Asia-Pacific Connections Ltd. was established in 1993 to assist IT companies with the expansion of their business activities in the region. The company offers a wide range of services including market research and analysis, competitive analysis, strategic planning, distribution search and channel management, product marketing and program management, public relations and event management, marketing collateral design and writing, management consulting, executive search and local office set-up.

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M&T International Advisor

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