



Doing Business in China: Opportunities and Challenges for European Companies

Overview of the Chinese Economy

The growth of the Chinese economy is well known and well documented. The compound growth since 1995 has been 9%, and with an impressive rate of 10.7% in 2006. Now China's overall GDP ranks sixth in the world, and the country also has the world's second-largest foreign exchange reserve. Furthermore, it is the most popular destination for foreign direct investment, taking in some one billion dollars a week.

With about the same land area as the USA but with four times the population, China provides potentially the world's greatest internal market. The Chinese economy is also becoming substantially more sophisticated and advanced technologically, and this tendency is also evident in the patterns of its own internal market. Take the information communication sector as an example, China is the world's largest market for mobile telephones, with over 450 million users by the end of 2006, while it is issuing licences for third-generation operations during 2007. It is the world's largest market for semiconductors. It is the second-largest market in the world for personal computers and also for Internet services, with 123 million users as of the end of 2006. The Chinese software industry is usually regarded as lagging that of India, but this also is developing rapidly.

These more advanced developments proceed against a background of continual development in more traditional industries such as steel and cement, where China is by far the largest producer and consumer in the world as it continues to develop its housing, its industrial plant and its infrastructure. A large part of the new industrial development is concentrated in number of powerful municipalities of Beijing, Tianjin, Shanghai, Guangzhou, located in the Bohai Rim, Yangzi Delta, and Pearl River Delta respectively.





No longer a Cheap Sweatshop

Although it is popular in 'the West' to depict China's economic development as one driven by an endless supply of cheap labour, with figures like €2 a day being frequently cited for manual workers, China is less and less a low-wage-cost country. Social costs are substantially higher than in most other Asian countries, while increasing labour shortages, and especially shortages in skilled operatives, are driving up production costs. At the same time, however, the efficiency of the productive apparatus is increasing with such rapidity as to more than compensate for these increases in labour and associated costs. The attractions of a more highly skilled and better-educated workforce, allowing research and development also to be localised and even outsourced and off-shored, together with the associated high quality of outsourced manufacturing and its close proximity of the rest of the Asian market, continue to make China a most interesting proposition for business investment and development.

When Chinese cost structures are seen in relation to those of UK, it is clear that the lower wages (and then only in exchange rate terms, these being much higher in purchasing-power terms) can be counterbalanced by the higher levels of knowledge encapsulated in such areas as automation and process control. But then cost is not the only driver, and indeed much of the attraction of China today resides in the higher efficiencies of many of its supply chains. These are in turn often associated with a rapid increase in the number and variety of research and development centres in China.

Emerging S&T Power

The country is emerging as a strong science and technology (S&T) base. About 250 000 engineering students are currently enrolled in higher education every year and China becomes increasingly competitive in advanced technologies, with new technology standards being created by Chinese for China. Sophisticated local taste and preference are strong drivers for a Chinese way of technology approach and development. The Government is keen to encourage S&T as a driver of the new economy. For example, the Chinese Ministry of S&T launched S&T funding programmes worth € 10 billion in 2005, the lion part of which is dedicated to high technology R&D, but key basic research gets its fair share as well. R&D intensity, has more than doubled from 0.6% of GDP in 1995 to just over 1.34% in 2005. In 2007 two-thirds of Chinese research spending is expected to come from industry and one-third from the government. In the meantime the number of foreign R&D centres in Shanghai, Beijing, and Chengdu is steadily increasing, reach over 720 by end of 2006.

China's goal for S&T is from a big nation to a strong nation based on an innovative society. Even though currently only 5% of patents filed by Chinese nationals are on inventions, the country focuses on technology development for scientific and technological independence, in a well-promoted drive known as "self-innovation".

At the same time as these internal transformations are proceeding, China is itself becoming a major overseas investor. The investments cover a wide field, ranging from securing sources of industry-strategic raw materials to such purchases as that of IBM's PC business by Lenovo.



Key Areas for Development

Looking forward, the Chinese economy is expected to grow at an annual rate of 8 per cent during the period of the 11th Five-Year Plan (2006-10). Accelerated industrialization and local governments' strong desire to develop their economy will be the backbone of future economic growth. The per capita income of urban and rural residents grew by annual averages of 9.2 per cent and 5.2 per cent from 2001 to 2005.

This improved standard of living allowed for increased spending on healthcare, transportation, telecommunications, education, entertainment and housing, rather than just food and clothing. The urban population of 450 million, largely housed in 34 cities with more than a million inhabitants, includes a rapidly emerging and developing middle class. The upgrading of the consumption structure will cause an upgrading of the industrial structure.

However China will continue facing a number of obstacles in the course of its future economic development. The nation's resources and the environment are coming under greater pressure as China strives to maintain sustainable development. China's market economy is far from perfect, resulting in poor quality growth. The gaps between different regions, and rural and urban areas, and the income gap between different groups will also have an impact on social stability.

The key areas for economic and social development in China for the next 15 years include:

- *Manufacturing & information industries* - to master core technologies for global competitiveness
- *Agricultural S&T*- to promote comprehensive productivity capabilities & ensure food safety
- *Energy* - exploration, energy saving technology and clean energy
- *Environment* - major cities & industries to set up technological development modes for a recycled economy
- *Healthcare* - disease prevention & management. Development and manufacture of new drugs, medical equipment and industrialisation
- *New technologies* - nanotechnologies and convergence of technologies
- *Natural resources* - water and natural resources from mining to distribution
- *Communication & Transport* - include equipment for building & maintenance of infrastructure; new energy automobiles

Along with China's integration into the global economy, the nation will further increase the levels of capital, advanced technology and management expertise introduced from developed countries, to expand its development.

Challenges

Clearly China has a lot to offer to Europe and especially in the areas of science and technology and their relations to a variety of markets. Europe also has much to offer China, and indeed in these areas also, but then as these originate within very different social and cultural contexts. It will therefore be useful here to review the pragmatics of this relation, beginning with the most common issues, as follows:



- Among the most commonly cited of difficulties for Europeans when trading and working with Chinese are the barriers to effective communication that arise through differences of language and culture. Although the extraordinary statistic that 300 million Chinese are currently learning English the overall English speaking level is still very low, particularly among mid-aged management level.
- The next-most cited issue when trading in China is the lack of knowledge of the market. This is often closely related to the cultural issue but also the market still has legacy from the previous planned economy with complicated regulatory issues for different industries.
- The difficulty experienced in recruiting and retaining local staff of a suitable quality is another issue that often arises. Due to a huge influx of foreign investment into China and also the rapid growth of the Chinese economy, the market for skilled labour is very competitive and some foreign companies have reported over 20 % annual staff turnover, in particular related to high and new technologies.
- Issues that are more widely shared - and the pain from which is more evenly spread - are those of over-administration, bureaucracy and corruption.
- The last major issue and one that is often not taken seriously enough, has to do with lacunae in the rule of law in particular on intellectual property rights: obtaining some kind of justice in the first place and enforcing any resulting court orders subsequently. These are problems that require excellent partners who are able to find their way through 'the system' - but then such problems are by no means limited to China, and indeed many European companies have experienced such problems also in the USA.

We may then summarise the success factors as follows:

- There must be a commitment from the leadership of the company to a long-term, value- building perspective. China is a market that requires ongoing sponsoring and support from the top executives and decision makers.
- The technologies brought into play must be the 'best in class', and supported by a sound understanding of their sociotechnical environments.
- A proper attention must be given to training and education in Chinese culture and business practices.
- A considerable effort must be put into identifying and securing a good local business partner.
- The ability to recruit and retain best people. The local staff should be motivated by promoting their all-round development and by consequent promotion.

For European companies with drive, flexibility and innovation, there are enormous opportunities to be had in China. And there is no better timing that now to start doing business in China.

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Published on CHEManager Europe, May 2007 Issue.