EXECUTIVE INSIGHTS

eXchange In-Depth: What You Need to Know About China and IT

[Transcript of Dorothy Yang interview, posted on IDC eXchange on November 14, 2005]

In the following few minutes, I'll give you a brief introduction about China's business environment, as well as China's IT and Telecom market.

The Business Environment in China

Talking about the business environment in China, the country's economy has been keeping a very healthy growth at 7 to 10% in the past decade, and is projected to maintain such growth at least in the next five years. Since China became a member of the World Trade Organization (WTO) in late 2001, the country has been attracting a large amount of foreign investment. Ninety percent of Fortune 500 companies now have operations in the China market.

As many of you already know, China is a very diversified market. It's not equally developed from an economic standpoint. There is a huge gap between eastern China and western China. The government is now focusing on the development of SMB and private sectors, as those are playing an increasingly important role in the China's economy.

When we talk about Chinese enterprises, we usually mean the urban companies, because there is another special type of company in China – the rural companies. There are tens of millions of rural companies, many of them farmers and focused on agriculture-related business. The majority of them are very small: not much to do with IT adoption or IT investment, at least not at the current stage.

Among over 3 million urban enterprises, SOEs (state-owned enterprises) account for only 12% in terms of enterprise numbers, but they are contributing nearly 40% of the country's economy, because almost all the large conglomerates in China are owned by the state, such as China Mobile, China Telecom, Bank of China, China Grid, Air China, et cetera.

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IT Market Trends in China

IT is now increasingly considered an important vehicle to improve Chinese enterprises' competitive edge, so although the government is taking macroeconomic control to cool down the economy, to curb the overheated capital investment, the IT market is still enjoying a stable and fast growth. But, currently, IT spending accounts for only less than 2% of the country's GDP.

The present China IT market is a very much hardware-driven market. Services value has not been widely recognized and accepted. But this also differs by industries and different enterprise types. We've been doing several studies in China, and interestingly we've found that – for the top tier of enterprises in China – their IT investment structure is very similar to companies in the developed economies. But, of course, for the rest of the majority, it's obviously still at a very basic level.

From an industry point of view, Consumer, Finance and Telecom are currently the largest markets for IT spending. The demand from consumers is mainly for PCs. But with the market gradually getting saturated, we have seen a slowdown of this segment. Looking forward, we expect to see faster growth in Government, Manufacturing and Education markets.

As we mentioned, China is not equally developed. But when we look at IT adoption level, the gap is even much larger than the GDP number. The eastern market - which contains Shandong, Beijing, Shanghai, Guangdong, and other provinces - takes up over 80% of the market. This market hosts 90% of foreign-investment companies and joint ventures, and is enjoying fast economic development. And Beijing is the headquarters for most state-owned conglomerates. But with the country's westward expansion, we expect to see the steady rise of IT demand from western China in the next three years.

Telecom Market Trends in China

Like the Telecom industry in most other countries, the growth of China's Telecom industry is slowing down, from previous 18% CAGR between 1998 and 2004, to around 8% in the next few years. The fixed line operators China Telecom and China Netcom - which together take up about half of the market - are now facing the greatest challenges. There is not much room for the further growth of fixed line user base: the penetration rate is already 65%, and it is now challenged by mobile services. The ARPU (average revenue per user) of fixed line is also declining due to the shift to mobile, as well as the popularity of IP phones.

Data services will be the major driving force to the market, especially wireless data applications. Among the many data applications in China, short messaging services (SMS) is currently the most successful one. The market value is likely to reach three and half billion US$ in 2005.

The Telecom industry is an asset-intensive industry, and the government has been investing heavily in the past few years to improve the country's telecom infrastructure.

Now the country is committed to the adoption of 3G. The timeline is set at 2008. So if 3G can be released in early 2006, as expected, the telecom sector's investment will be reaching US$40-50B each year in 2006 and 2007 – which should present tremendous opportunity to both telecom and IT vendors. The release of 3G is also likely to trigger another round of industry restructuring.

Challenge Factors for Doing Business in China

I'd like to briefly talk about some challenges of doing business in China.

One of the most important things I'd like to draw attention to is the diversity of the country. We mentioned the economic gap between eastern and western China. But apart from that, the buying behavior as well as the IT adoption level is also very different - from north to south, from west to east, and of different industries. Banking and Telecom industries, for instance, require very different sales and marketing approach. Banks are more centralized in decision making, so it works well if you assign one account team to cover a bank's headquarters in Beijing. But for the Telecom sector, though we only have four major carriers in the country, you still have to maintain a large number of account sales team to cover dozens of provincial level carriers. It's like you're dealing with a hundred different customers. Similarly, in the southern China, in the Shanghai area, customers are more towards adopting standardized, packaged solutions, while in northern China, customers are more in favor of tailor made solutions.

Therefore, distribution channels and partners are very crucial in the China market. They are playing a most important role in the value chain to help global companies shorten their time-to-market, and have good geographic and industry coverage in the short time.

Secondly, companies had better prepare for the long-term in the China market. It takes time for the company to build up it brand image and sometimes even to educate the market. Volkswagen in auto industry is a classical example. Volkswagen started its operation in China when 99% of Chinese didn't have cars and didn't even know how to drive. Today, the auto industry booms. Over 5 million cars are sold each year. But the competition is also fiercer than ever. However, Volkswagen is still the most popular, most trusted brand in China. It dominates one-third of the passenger car market, two and half times larger than the second player.

A third factor is the government's influence. We mentioned that the largest (enterprise) IT spending sectors in China are Finance, Government, Telecom, Education and Manufacturing. In the Banking sector, the four largest banks in China are stated owned, which contribute over two-thirds of banking industry IT spending. All the four major Telecom carriers are also state owned. In the Education sector, 99% of schools in China are public schools. And in the Manufacturing sector, the top 500 manufacturers in China are also mainly stated owned. We estimate that at least 70% of today's enterprise IT spending is coming from state-owned enterprises and the Government sector. So no company can afford to underestimate the government's influence.

The last factor I'd like to mention is the impact of model. I think it's true in most markets, but it's especially important in China, partially because of culture and also the large number of state-owned companies (SOEs). SOEs are usually very reluctant to take any risk, and tend to adopt only those technologies that have been proved to be successful. So it's very important for global companies to develop a couple of successful cases in the industries that they are targeting.