

CHINA





Land of Contrasts

BY G. PATRICK PAWLING

WITH A NOD
TO THE OLD WAYS,
SMALL COMPANIES
THRIVE, RELYING ON
GRIT, TECHNOLOGY,
AND INTELLIGENT
INNOVATION.

An old Chinese story: A man doesn't like the way he walks, so he travels to the city of Handan, hoping to learn a better way. But Handan isn't the answer. He learns nothing and, worse, forgets everything he knew about walking. In the end, he crawls back to his hometown, shamed. The moral? Do not blindly follow others, even if they appear successful. Think critically. Embrace your natural, homegrown strengths.

Maybe this story helps explain why business in China is a mix of old and new, modern and proven.

Many state-funded businesses, remnants of the communist business model, lose money year after year. Some bookkeepers still use an abacus. When people think about *networking*, technology isn't the first thing that comes to mind: Networking is something you do with people to make sure things go smoothly. But in developed areas, private businesses are thriving. In many cases, these small private businesses are early adopters of technology, for they want every advantage they can get. They're operating with little or no government support and few of the personal connections that are often so beneficial.

This makes for a seemingly chaotic business environment—public and private, subsidized and unfettered, bureaucratic and unencumbered—but it works.

“The Chinese government is a very different animal,” says Jackie Chan, a senior analyst/consultant at AMI-Partners, who was born in Hong Kong. “In business and technology and in other things, they have their own way.”

China-based CCID Consulting expects the Chinese economy to grow at more than 8% annually over the next three years. While the nation's reputation as a manufacturing powerhouse is well deserved, a large part of its economic growth will come from small private companies. AMI-Partners estimates that small and medium-sized businesses account for about 99% of the country's total number of enterprises and more than 55% of the country's gross domestic product (GDP).

Amazingly, this is occurring in the country where PC penetration sits at just 32%, lower than some developing countries. PC penetration stood at 46% worldwide in 2004, according to AMI-Partners. The

United States and Australia are past 90% penetration; newly industrialized countries like Korea and Taiwan are past 50%.

“Right now a lot of people are afraid of computers,” Chan says. “I heard a story about somebody unplugging their PC from the wall because they were afraid [computer] viruses were coming in. This is the kind of thing that will be changing in the next couple years.”

ONE SMALL BUSINESS MAKING ITS WAY

Yu Hongping isn't afraid of computers, though some newer technologies do concern him. Hongping is a project manager for BBM Translation Service in the Chaoyang District of Beijing. With 12 employees, BBM translates for Chinese companies and overseas organizations. It has 14 PCs connected by a local-area network (LAN) that runs over ADSL-based broadband, which enables high-speed digital transmissions over existing phone lines.

Hongping cites the growing sophistication of computer-aided translation as a challenge to his business. But his company hopes to add applications for project management and enterprise resource planning (ERP) to improve its operations and competitive ability. The challenges faced by BBM in its quest to grow via the intelligent use of technology are

echoed throughout the country.

“I believe smaller companies in China want to use technology to manage their business, but some or maybe most businesses are still relying on the low cost of labor because most applications are too expensive,” Hongping says.

Asked whether private companies often face a more difficult business climate, Hongping says, “That is generally true. However, different regions have different business climates. For example, in Beijing it is favorable. Nobody interferes with you provided you have paid your taxes. Nevertheless, if you, as an owner of a small private company, want to get a loan from a bank it is almost impossible.”

THE BUSINESS STRATA

State-owned enterprises are typically large companies owned by the central government in strategic industries such as energy, manufacturing, automobiles, and steel. Some are profitable. Many rely on subsidies. Semiprivate firms, called *collectives* or *township-village enterprises*, are owned by local governments or by their own workers but are run like private companies.

About 90% of truly private companies have fewer than nine employees, according to AMI-Partners, and offer a limited presence in one single local market. Many are retail stores, restaurants, or repair shops. They tend to remain small because of political and regulatory restrictions, including very limited opportunities to borrow money. Remaining small also makes it easier to operate with little oversight.

While being private means businesses can make their own decisions about technology adoption, they are often hindered by budget. According to AMI-Partners, only about 18% of China's small private businesses have broadband, while only about 6% have a LAN. Chan points to two reasons: First, smaller private companies typically own only two PCs and see no reason to network them. Second, their PCs are mainly used for basic desktop productivity, which does not require network connectivity.

But collectively, these small companies provide amazing economic power.

“Although the very idea of private ownership and private business is counter to Communist ideology, private firms employ more workers than any other sector of the economy except for rural collectives, thereby contributing to social and political stability in China's cities,” says Chan.

One difference between these types of businesses: connections. “State-owned enterprises by their nature are hard-wired into the Chinese bureaucracy, but others must use their *guanxi*, or informal connections,” says Chan.

INCENTIVE PROGRAMS

The central government has implemented several programs to help smaller companies get started, obtain credit guarantees, and improve training. But these programs don't





always reach the companies they're intended to help. "Sometimes," Chan says, "provincial governments take a different route than the central government."

Central government programs include the following:

- The Spark Program, initiated in 1986, focuses on introducing appropriate technologies into rural areas, leading farmers to rely on science and technology to promote rural productivity and the development of agriculture and rural economies.
- The Torch Program includes the designation of High and Emerging Technology Industry Development Zones. The central government has approved 52 such zones, resulting in clusters of new-technology industries.
- The Innovation Fund for small technology-based firms supports technology innovation through grants, loan interest subsidies, and equity investment.

REGIONAL DIFFERENCES

Shanghai, Beijing, and Guangzhou have historically been pioneers in technology adoption in China. As a result they contribute a great deal to the country's overall GDP, and their consumers tend to have higher salaries. CCID Consulting believes several regions will continue to grow rapidly, including the Changjiang area (the Yangzi River Delta, around Shanghai); the Zhujiang area (the Pearl River Delta, around Guangzhou); and the Bohai Bay area.

More multinationals and private companies have taken root in the Yangzi River and Pearl River deltas, says Qin Deng, an AMR Research analyst. As a result, he adds, technology there tends to be more advanced than in North China where many state-owned enterprises are located.

The real takeaway, says Deng, is that the country is composed of many regions, each with its own economies and many different stories. These differences are reflected in

varying labor costs, differing IT budgets, and drastic variances in technology adoption.

"China is a polarized country," Deng says. "If you only visit Shanghai you have not revealed the complete China yet."

To Chan, the seeming disorder is more of a sorting-out process. "I believe China is on the right track," she says. "It takes more than a short period of time for people to change the way they think after hundreds of years. Still, one gets the sense that as much as [Chinese leaders] like to remain bureaucratic in their thinking, at the end of the day they make decisions to benefit China's economy."

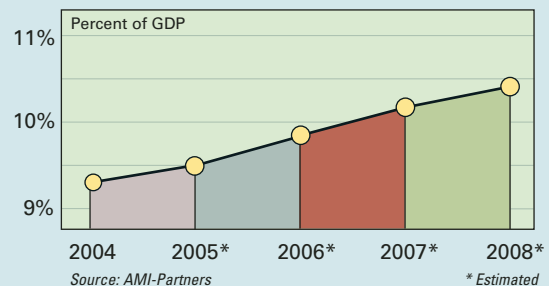
DEMAND DRIVERS

Multinational companies are eager to cultivate demand in China and are making good progress despite some cultural issues that occasionally impede understanding of the market. CCID postulates that the foreign investment rate in China will slow in the next few years, but growth will continue, with a projected foreign investment of \$101.45 billion in 2006.

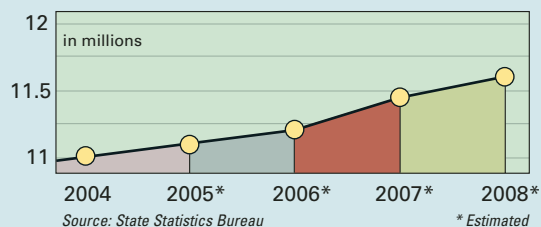
Deng cites pressure from customers, both abroad and domestic, as a primary motivation for technology adoption.

China's SMB Growth

Though many are composed of only a few employees, small private businesses are expected to grow as an essential part of China's economy, contributing 10.4% to the country's gross domestic product by 2008.



At the same time, the number of SMB companies is expected to rise incrementally every year.



One challenge to technology adoption that will remain for some time is the low cost of labor.

Chinese businesses “are used to doing things manually,” says Chan, and right now there are no incentives for changing that. “I can see labor being a major inhibitor [to adoption] in the near future, but with the growth that is coming, that will be a different story. A lot of companies in China are already outsourcing to places like Vietnam to take advantage of cheaper labor.”

Again, cultural issues play a part. “At the very basic level of PC adoption, perception and lack of awareness is a fundamental inhibitor among Chinese small businesses,” says Chan. “They fail to see the applicability of PCs for day-to-day business operations. They often have misperceptions about usage, security issues, and financing options around PCs. They feel service and support should come with a PC. That is a cultural thing. For them service shouldn’t be something that they have to pay for.”

In some of the more rural areas close to Mongolia, the electrical power infrastructure is not very stable, which can also lead organizations to distrust computers.



GROWTH AREAS

“WiMax will fuel explosive uptake of broadband adoption among Chinese SMBs,” Chan says. “Broadband is one of the keys. They need it to get to the next stage.” Though still in its infancy, WiMax promises to extend high-speed wireless Internet access far beyond the range of conventional Wi-Fi—from meters to kilometers. IT security and data storage are also “top-of-mind issues,” she says.

The Internet is having a profound impact, Chan adds. Many SMBs “are already using the Internet to expand their market reach and strengthen their customer relationships. And many SMBs now rely on the Internet to learn about IT products and make comparisons prior to purchases.”

In the mighty manufacturing sector, Deng believes, it’s also time for companies to apply technology to help them run more efficiently. Adopting new applications and improving their foundation technology will allow them to be more flexible when they want to adopt new technology, expand their operations, or work with other companies.

“Technology adoption among state-owned companies and private companies is relatively new,” he says. “Some are getting into ERP and customer-relationship management [CRM] applications, but not very many. To be honest, some are doing it because they think it looks good. Even the ones that have started migrating to ERP and CRM don’t have a clear understanding of how to use it.” Deng estimates that fewer than 5% of Chinese companies use ERP.

In manufacturing, he says, the key will be gaining the ability to handle the complete supply chain, enabling more efficient collaboration with the outside world and streamlining internal operation.

“At the level of one or two factories, [manufacturers] are doing well,” Deng says. “But a lot of work still needs to be done in terms of managing the overall supply chain. They are doing a lot of business. . . . Revenues are OK, but profits are the question. So far they cannot manage to cut the costs or to improve profitability because they cannot manage the supply chain properly.”

JOHN LUND




TECHNOLOGY AT WORK

When discussion in China turns to how new networking technology can directly benefit businesses, voice-over-IP (VoIP) technology is of interest. VoIP saves money on phone bills and network administration while enhancing employee productivity. Case in point: Sohu, the most powerful Internet brand in the Chinese world and a leading provider of new media, e-commerce, communication, and mobile services by providing the scalability to grow to meet the company's future needs.

In 2004 Sohu moved its headquarters to Vision International Center in Tsinghua Science Park, an incubator for high-tech companies in Beijing. It also simultaneously deployed 1,000 Cisco IP phones. Sohu officials say only VoIP could provide the flexibility, cost savings, and productivity enhancements required to support the company's growth. The move to VoIP also eliminated the need to upgrade the communications system every three to five years.

Employees access the company directory through the phone displays, move phones without relocation costs, and enjoy simple call forwarding and multiparty conference calling. One of the most significant benefits is savings on cell-phone bills. In the past, employees used their mobile phones to call other branches. Now they use the VoIP system. There are also savings in management expenses, and the single converged network for data and voice eliminates the need for separate IT and phone management teams.

As China and companies like Sohu continue on their own economic path, perhaps it is appropriate to consider a Chinese proverb: "Be not afraid of growing slowly, be afraid only of standing still." 

G. PATRICK PAWLING, LEAD WRITER AND FOUNDER OF PAWLING & ASSOCIATES, WRITES FREQUENTLY ABOUT TECHNOLOGY AND BUSINESS FOR A VARIETY OF ORGANIZATIONS.

NEXT STEPS

To learn more about SMBs in China, visit China's Virtual Small and Medium Enterprise Information Centre at www.sme.gcn.gov.hk.

For business and general news, visit the *People's Daily Online* (<http://english.people.com.cn/>).



FOCUS ON SMALL BUSINESS IN CHINA

HUANG YONG IS CEO and Executive President of CCID Consulting Co., Ltd., in China.

He offers insight in competitive environment, market opportunities, and challenges.

iQ: What are the obstacles to adoption of technology?

Yong: Chinese enterprises are very sensitive to product cost, but there are other issues. E-business is still facing many challenges, including the legal environment, official policies, credit and payment systems, and logistics. The Chinese government and relevant enterprises are making great efforts to improve the environment, and we believe use of the

Internet and e-business will increase rapidly in the future.

iQ: What can Cisco do to help SMBs?

Yong: Cisco is intensifying its efforts to introduce integrated, low-cost networks through cooperative partners and make it easier for companies to get technical support and professional services.

Though there are a large number of small and medium-sized enterprises in China, the technology application foundation is relatively weak. The best answers are industry-based solutions that are simple, integrated, and low cost. Cisco plays a role as the technology and products supplier, but also as a professional-services supplier.

iQ: What are the most pressing technology needs for SMBs?

Yong: The buildup and improvement of high-efficiency, low-cost network environments is critical. Helping organizations fully utilize their network infrastructures and develop IP and wireless LAN technology will help them communicate better and develop closer relationships with customers and partners. It will also reduce the operational costs, while improving customer relationships, coordination, and competitive abilities. Ensuring network security is vital. Besides the traditional networking products, demand is already strong for wireless, broadband, security, and storage products.—G.P.P.