Building an E-Business Strategy for Mainland China

By Ava Chien and Ellen Salem

As China prepares to join the World Trade Organization (WTO), the time seems ripe to explore e-business strategies in this rapidly growing market. While it may be getting easier for multinationals to invest in the Chinese market, there remain barriers and pitfalls that Western technology and business leaders need to build into their business plans and practices. Ava Chien and Ellen Salem, two business consultants with decades of experience with the Chinese market, give advice on how to make a go of e-business in the largest country in the world.

Growth of the Internet

The exponential growth that has occurred in the number of Internet users in China make it a prime target for foreign investment in e-commerce. In 1995, there were fewer than 50,000 Internet users in China. At the beginning of 1998, there were some 2.1 million users. By the end of 2003, the China Internet Information Center projects there will be 20 million users. While the statistics may be exaggerated, the growth rates to date suggest that they may not be far from the mark. This growth is all the more extraordinary when one considers that only 14 percent of the population has ever heard of the Internet. By the same token, that growth underlines the fact that the Chinese are quick to adopt technology as soon as it is available. In addition, there are now 48,000 domain names in China, three-quarters of them commercial. According to the official Wenhui Daily, in 1999, e-commerce sales leapt 400 percent from some $8 million to more than $40 million. And IDC (a sister company to CXO Media) expects sales of $3.8 billion by 2003. The government is investing heavily in technology. It recognizes the potential for e-business to transform China's distinct and complex markets into one e-marketplace. Teledensity is increasing rapidly. A fiber-optic grid is now in place, enabling the Ministry of Information Industry (MII) to install new lines at a stunning pace. While teledensity is still low with 11 lines for every 100 people, several more years of rapid growth will make China one of the most attractive telecom markets in the world. But it must also be kept in mind that there is no national payment system for buying goods online. Reliable distribution channels are lacking as well. Even in the prosperous coastal provinces in the East, transportation can be very problematic. Buyers are not confident about security and those who have credit cards are reluctant to use them over the Web.

The Legal Framework

The fact is, there is no legal framework. In 2000, Li Ying, the deputy head of the center of computer and microelectronics industry and development (CCID), which is controlled by the MII, said that work on an overall legal framework was underway.
Some rules, she said, are expected to be published on a gradual basis, following China's entry into the WTO. In addition, CCID is collaborating with the taxation authorities to draft tax regulations. Ying made special mention of the need to build a certificate of authentication system and the difficulties of constructing a healthy credit system. Another problem is the regulations now in place regarding encryption. Initially foreign businesses were required to register the encryption products they used in China. This would have given the state the ability to decode traffic passing through the Internet between branches of the same business. The state has since backed down on this requirement. But Chinese firms are still forbidden to use any foreign-made standalone encryption products. They may only use Chinese-made products registered with the new State Encryption Management Commission. This gives the state a means of monitoring computer traffic. It is not clear if that regulation will apply to joint ventures that are over 49 percent foreign owned.

The Culture of the Market

First and foremost, there is no one Chinese market. Management gurus stress that it is key to realize that companies are working in cultures, not markets. China is one culture and many cultures at once. It is beyond the scope of this paper to provide a cultural map of China, but part of any preparatory work for e-business investment in China should include a series of briefings on the complexities of China's many cultures and on the "rules of the game" in the Chinese market.

Equally important will be your choice of an international law firm with proven China expertise. We advise those new to the market to consult the American Chamber of Commerce in Hong Kong prior to selecting both a law firm and an accounting firm. We also advise employing an outside consultant to serve as an overall facilitator and troubleshooter in China. This same individual—ideally with a U.S. base—should be responsible for briefing the head office on the complexities of the Chinese market.

One key element in China's culture is the role of the government. The first thing to understand about the government is that it is both authoritarian and chaotic. It is a dictatorship, but is neither efficient nor consistent. The Chinese have a saying: "Heaven is high and the emperor is far away." In other words, the dictates of Beijing can often be ignored with no repercussions. Knowing when is the difficulty. Here you will have to rely on your joint-venture partner and your lawyers. In addition, provincial and local officials have numerous de facto powers and will sometimes use their position to favor one company over the other.

That said, establishing a transparent judicial framework is a work in progress. Beijing is working hard to draft laws to adapt to the demands of the global marketplace and to modernize its own legal codes in its effort to speed economic development. The process is a difficult one. It is compounded by the sheer size and complexity of China, and the absence of a legal tradition as we understand it. While this process is under way, expect to see the rivalry that exists between different government regulatory
agencies come into play, particularly when the stakes are high. Beyond that, regulations are sometimes contradictory, altered or changed without prior notice. This usually occurs because of political considerations or in rear-guard actions to protect domestic industry.

**The Joint Venture**

Since 1978, China has utilized more than $300 billion in foreign investment in cash and equipment. The greatest amounts were seen in 1997 and 1998 when that level of investment exceeded more than $40 billion each year. One must note, however, that many of the investments in joint ventures saw little or no profits for the foreign investor. While it is impossible to obtain data on either the number of joint ventures operating in the red or in the black, our small samplings combined with anecdotal evidence suggests that the number of successful joint ventures have increased as the learning curve has accelerated.

Investment in Internet market content and service providers is in its infancy, and even if profits and figures were available, they would be meaningless. Once investment in Internet content and service providers is permitted—which will occur when China joins the WTO—foreign ownership in Internet joint ventures will be limited to 49 percent of the venture. But the same factors that determined the difference between success and failure in investment in "old economy" companies will hold.

**Strategic Planning: The Initial Stage**

The path to a successful e-business strategy for Mainland China starts with the basic tenet of all good strategies—planning. This means that 12 months prior to your launch date, you should identify a China team to set goals, draft a strategy and map out the enterprise architecture to attain your business objectives. Who should be involved in this initiative?

We recommend that they be key representatives of the marketplace (such as customers), those with execution capability (such as IT), and finance people. We've seen a maximum of four team leaders with 15 managers focused on project management, and a minimum of eight managers from IT and customer service involved at any one time.

**The Human Element**

Think global, hire local. Leverage the strengths of your multinational or U.S.-owned company to attract local talent. Because of the worldwide shortage of qualified IT personnel, multinationals are competing for the best and brightest, particularly in India and China, and often bring these recruits to the head office to woo them. When recruiting, make it clear that your company is committed to the career development of
its employees. Be specific. The career development program should both cater to the specific talents of your employee and be aimed at fostering corporate integration and identification.

In addition to customized ongoing management training programs designed for your Chinese staff, include a cultural sensitivity seminar on helping them understand Americans and the ways we conduct business. You should take all steps to ensure that key Chinese staff participate in management seminars for regional staff and attend meetings at global headquarters as well. Funds spent on training will reap no rewards unless your Chinese staff members are promoted both in China and to responsible positions in regional headquarters and in the United States as well.

Management Pitfalls

Do not fall victim to "virtual management"-it may work for London but it does not work in Tianjin, where you're 17 time zones away. Make sure that there is regular personal interaction. A manager at an Asian-based portal company who is located in Southern California mentioned to us that her China-based team members are "very abrupt when they send me e-mail." Most Chinese managers who are well-educated are trained to write in a shortened, abbreviated language that is very different from the Chinese spoken language. Not understanding that distinction, Americans are under the impression that the Chinese are terse, abrupt and rude. Had the woman spent more time socializing with the colleagues on her Asia trips, she'd realize that her counterparts are not impolite at all.

In all probability your biggest expense will be labor. Of course, this varies depending on your business, technology and what model you choose (build versus buy). As a general rule, in-house built systems can cost close to 10 times the amount of choosing an end-to-end, B2B vendor application that allows your system to grow over time. According to Gartner, up to 80 percent of costs can be attributed to labor, with software and hardware about 10 percent each.

Find the Right Ally

If you anticipate substantial technology costs or substantial operational expenses like brand recognition (such as advertising), then it would make sense to consider a partnership or alliance with a Chinese counterpart who already has a related business vehicle up and running. For example, consumer-oriented offerings require heavy investment in branding because of the fight for eyeballs in a crowded market. By choosing the partnering route, you avoid spreading your resources thin, and you're building expertise for the future.
Moreover, a joint venture partner will have knowledge of the market, commercial network and political savvy that you, both as a newcomer and outsider, lack. They will realize, for instance, that China is not a single market but a complex business nexus with Shanghai situated in the East (think New York City), Guangzhou down South (Dallas) and Chengdu in the West (San Francisco). Just like the United States, China is fragmented into many smaller regions, each with its distinct cultures and business practices. Make sure that your partner is selected with all due diligence.

**Executing Strategy**

You cannot have a successful e-business strategy in China without these three things: project management, a realistic perspective and flexibility. The old economy's project management techniques have not lost their effectiveness. Success requires skilled and dedicated professionals to define design, implement and deploy e-business models. A realistic evaluation of the market is the core of every successful undertaking. Flexibility will require adapting an e-business strategy to changing industry standards, competitive forces and partnering needs.

In the end, however, the challenge will lie in the transition from execution to support. Frequently the best person to get e-business off the ground is not the best person to maintain and manage for sustained growth and evolution. To ensure that you overcome this challenge, select team members with different core capabilities. This makes for a smooth transition, with gradual phased-in implementation over time.

**Conclusion**

No one will deny that China is a difficult market. But our experience has shown that those corporations that are willing to follow the general guidelines stipulated above have reaped rewards that have stunned their less able competitors. In the e-business market, the early entrant will have a clear advantage. Through their own success, they will create, among other things, a barrier to entry for those who follow. Again, do not be deterred by the perceived difficulties of this market. But as always, remember that success lies in the details.

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