The 3rd Wave of China's ICT Growth: Internationalization

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Wave 1: National Reform

Build it and they will come

- Beginning in 1978 and running through to 1990
  - The Open Door Policy focused on bringing in foreign capital, foreign technology and foreign expertise – albeit in a limited fashion.
  - Deng Xiaoping's exhortation to pursue Science & Technology as one of the key pillars of economic reform and national strength

- The real focus, however, for the ICT in China was the period beginning in 1986 and running through to the early 1990s.
  - The launch of the 863 program, followed by a host of subsequent S&T and hi-tech government sponsorship programs.
  - The focus throughout was on fundamentals – basic infrastructure, building basic skills (engineering, science, maths)… application was to come later.

- Effectively the focus was on the development of (nascent) demand through feeding supply.
  - This found it's greatest expression in the large (large!) network development programs of the 1990s – the Golden Projects

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Wave 2: National Consolidation

The Creation of National IT 'Champions'

- In the early-90s the Chinese government began focusing on the computer industry to the benefit of the university-backed conglomerates Legend and Founder. Initially, these two were distribution channels for Compaq, HP, and IBM. But they re-engineered each of the foreigners out of the China market, and today dominate the Asian market.

	1994	1995	1996	1997	2000
Foreign Manufacturers (%)	96	90	65	46	15
Domestic Manufacturers (%)	4	10	35	54	85

- In 1993, China Unicom was created (by the Ministry of Electronics Industry) to compete with the Ministry of Posts and Telecommunications.
  - Unicom was created to "provide phone services where the waiting time (for connection) is longer than 3 months… and to provide value-added services (e.g., mobile telephony)" Today Unicom is one of the 10 largest mobile carriers in the world.
  - The MPT subsequently went through its own round of corporatization and "privatization", creating China Mobile (now the world's largest mobile carrier); China Telecom (the world's largest fixed line provider, largest Internet provider, and largest broadband provider), and China Netcom.

- In the late-1980s, Ren Zhengfei, an ex-military official, established Huawei Corporation in Shenzhen, to re-sell PBX systems from a Hong Kong company.
  - Having successfully built a manufacturing and distribution business in China, selling the equipment at rates that were far cheaper than those achieved by the Hong Kong originator, Ren instructed his company to turn their attentions back to Hong Kong as well – competing with his former supplier at far cheaper prices. Within months he had driven them out of business.
  - Through the 1990s, Huawei – followed by ZTE – continued to repackage, redistribute and re-engineer telecommunications equipment from leading global vendors, eventually winning markets for themselves.
  - By the end of the 1990s Huawei and ZTE between them dominated 70% of the basic China telecom equipment market. Their prices are up to 70% cheaper than their foreign competitors. For the same equipment.

- ***The same stories hold for the likes of Haier, TCL, Changhong, AUX, Bird, Panda, etc etc.***

Wave 3: Internationalization

Go West, young man!

- With China's WTO accession, the domestic market has increasingly opened to foreign competition.
  - For both the government and enterprises this meant that leading Chinese companies *need* to compete internationally so as to:
    - increase the overall size of the market accessible to Chinese companies, and
    - so that Chinese companies will be "internationally competitive" when competing on domestic turf.
  - If such a development does not occur, the fear (for policy-makers) is that Chinese companies will end up fighting for ever smaller shares of a domestic market increasingly dominated by leading global multinationals.

- **To address this concern the government came up with the so-called "Go Out" (*zouqu*) policy in the late 1990s, and began promoting it as part of the Tenth Five Year Plan.**

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China's Internationalization Strategy
Why?

- China's national goal is to be a world-class competitor, owning a leading brand in all domestic and foreign ICT sectors: hardware, software, IT services, telecommunications and semiconductors.
- Three significant changes in recent years have focused both the Chinese government and leading Chinese enterprises and companies on expanding into the international market –
  - an increasingly open domestic market,
  - the perceived success of enterprise reform (and the associated need to continue to tap international financial markets), and
  - the need to continue to expand China's economic growth.
- The cheap labor advantage, and what is perceived to be a potentially saturated domestic market is one part of the trend forcing domestic IT manufacturers to seek out international markets. The other parts of the equation are the cheap labour advantage which Chinese manufacturers enjoy, and enable them to benefit from comparative economies of scale, and the need to keep growing those economies of scale because of the razor thin margins which price wars (on everything from bras and watches to fridges and DVD players) have brought about. (The so-called 'race to the bottom').
- ***In order to decrease the time to develop and market new technologies and new products, IT manufactures are moving into international markets through acquisitions and the establishment of marketing branches.***

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Internationalization
Who Benefits?

- At the end of 2005, China's Ministry of Commerce issued an overview report on China's Overseas Direct Investment. According to Mofcom, the Telecom & IT, Energy & Resources, Transportation and Manufacturing sectors accounted for over 90% of China's overseas direct investment. Further, 86.7% of overseas employees were to be found in manufacturing, construction, transportation, and IT/ Telecom.
  - These were the sectors to be focused upon for successful *zouqu*
  - In 2004, Chinese multinational enterprises' overseas direct investment was US$4.25 billion, accounting for 77% of China's total overseas investment
- Companies such as Lenovo, TCL, CITIC, CNOOC, and so on, have benefited from enterprise reform and the growth of the domestic market such that they have become big enough to compete with foreign companies in international markets
  - These companies are typically benefiting from three factors:
    - i. comparatively cheap labour (and a well organized labour market);
    - ii. cheap and abundant access to foreign capital; and
    - iii. strong government support.
- To the latter point, with "Go Out" a central part of the development policy program, the government has promoted a range of deals with developing countries, or trade agreements with developed countries in manufacturing, IT infrastructure, or other development projects and then given these projects to the large state-owned enterprises or top Chinese companies.
  - For example, China agreed to help countries such as Pakistan, Cuba, Zimbabwe, and Nigeria to build basic telecom infrastructure, and then gave these projects to the likes of Huawei, ZTE, Datang, and China Telecom.

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The Impact of China's Internationalization

China's Increasing Global ICT Market Share

- The rise of Chinese manufacturing gave rise to fears that industry, trade and investment would be sucked out of other developing countries. With ICTs the picture is more complex than that. In the ASEAN countries trade and investment has been two-way and Chinese investors have become a major engine of growth for ASEAN countries.
- ICTs were one of the five priority areas identified at the 5th ASEAN-China Summit 2001. China is reinforcing its presence in the newer ASEAN countries by championing and part-funding the Greater Mekong Subsystem (GSM) infrastructure project of the Asian Development Bank that includes a major telecommunications backbone proposal linking Yunnan (China) with Myanmar (Burma), Laos, Vietnam, Cambodia and Thailand with China Telecom taking a leading role and Chinese vendors supporting it
- The developments are showing up internationally in two ways

1. China is increasing its exports (such as, for example, ICs) to third country markets, such as the ASEAN states where in 2004 exports were already US$2.4 billion. Some of these exports will go to Chinese-invested factories in countries such as Malaysia, Thailand and Vietnam, taking advantage of low costs and hedging against the revaluation of the Chinese yuan and also against trade restrictions in the US or the EU against Chinese exports. This is an important feature of the new economic relations developing within the Asia-Pacific region.
2. China's enhanced capabilities will show through in China's electronic products exports. This is probably already most advanced in the telecommunications equipment sector, led by Huawei.

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The *Regional* Impact of Internationalization

Singapore

- ASEAN countries divide between Singapore and the rest.
  - First, Singapore is a springboard to reach out to India, the rest of South Asia and ASEAN countries. For example, in January 2006 Shinco entered into a tie-up with Future Techno Design of Singapore to market its high-end portable DVD players in India.
  - Second, Singapore also offers Chinese ICT companies to list on the Singapore Stock Exchange. Chinese companies now account for 10% of SSE listings. For example, in September and December 2005 China-based Memory Devices Ltd and foundry HeJian Technology (Suzhou) Co. launched their IPOs in Singapore.

Malaysia, Brunei & Thailand

- For the rest, Malaysia and to some extent Thailand attract Chinese investment and vendors because local production costs are low, local markets are attractive and exports are competitive. For example, Chinese companies grabbed a 30% share of Malaysia's 29-inch television-set market (up from 9% in 2001), while Haier was reported as aiming to become one of the top 3 brands in the electrical appliances industry in Malaysia by 2008.
- Inevitably, Huawei and ZTE have both secured numerous telecom equipment contracts.
  - For example, Huawei is building 100 3G W-CDMA sites in Penang for Telekom Malaysia and was cited as offering 3G equipment at prices 25% below its European competitors.
  - In Thailand, Huawei won a contract with CAT to provide 51 provinces with CDMA 2000 equipment that was 60% of the benchmark price of Baht10 billion.

Regional Impact of Internationalization … cont.

IndoChina

- China has been particularly active in this region, partly for geo-political reasons and partly for raw materials, for example to secure access to Burma's extensive forest timber.
  - China Telecom has been assigned a lead role in promoting the GSM telecom infrastructure project, but also Huawei and ZTE and UT Starcom have won numerous telecom equipment projects in Cambodia, Laos and Vietnam, sometimes based upon soft loans from China and supported by China's Exim Bank.
  - China's IT companies, Lenovo and TCL are also active in Vietnam where TCL occupies second place behind Samsung of Korea.
  - Alcatel Shanghai Bell also has a strong presence, building upon traditional ties with France.

Indonesia & the Philippines

- Despite their size, these markets are fraught with country, regulatory and currency risk which has held back their development.
  - The usual Chinese brand names of Huawei, ZTE, Haier, TCL, Shanghai Bell are all active in Indonesia, in particular the sale of fixed-wireless CDMA and SCDMA technologies for the local loop.
  - TCL and Lenovo are present in the Philippines, but Chinese telecom equipment vendors have not had very much presence up to date.
  - In fact, the Philippines is one case where the shift of production to China does seem to be a threat, due in large part to the country's instability and lack of reliable infrastructure.

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Conclusions

- In summary, China's ICT sector is shifting up the value chain as its R&D capabilities grow, supported by state policies and the 11th Five Year Plan.
- The expansion of Chinese vendors overseas is still completely overshadowed by the dominance of foreign-invested companies exporting ICT products from China (nearly 90% of China's ICT exports), but in certain key areas Chinese companies, such as Haier, Huawei, Lenovo, TCL, Konka, et al., can already compete on global terms.
- They have several distinct advantages.
  i. low costs locally;
  ii. good access to lines of credit and the support of state policies;
  iii. they are also investing in overseas R&D and production facilities, in some cases as joint ventures or partnerships.
- Chinese multinationals are beginning to emerge, and Chinese telecom carriers and banks and other support service industries will follow them.
- But as the evidence from Asia suggests, this is not a zero-sum game. On the contrary, these developments open up more opportunities than they pose threats, but only if foreign companies can adjust and adapt accordingly.

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