# Business Infrastructure in China: Infrequently Asked Questions

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Chinese growth rolls ever onward. Despite mounting uncertainty in global trade and international relations, China's economic growth is still on track and foreign direct investment – especially in high tech markets – has remained steady.

That means consistent, long-term opportunity for international businesses looking to expand into new Chinese markets.

Yet, while insight and advice is in strong supply, many of the recommendations can be generalist in tone, and may not take into account geographic nuances in what many misconstrue to be a homogeneous market. In a country as vast and diverse as China, it is essential to marry universal best practice with specific, new insight to stay up-to-date and thrive in new markets.

From transformation to talent and innovation, the changing infrastructure in China has significant impact on how foreign firms should approach market entry into one of the world's most opportunity-laden countries.

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# How have Chinese cities evolved to boost new growth industries?

Change is the only consistent theme that Chinese organisations – and foreign firms entering new Chinese markets – have been able to count on in recent years.

For example, in 1975 only 17 per cent of China's citizens lived in cities. By 2012, the country's rural and urban populations were split equally, and by 2050 the UN expects the urban share of China's population to reach 80 per cent. That migration has necessitated significant change to both consumer and business infrastructure.

Investment has been quick to follow. As McKinsey notes, "From the late 1990s to 2005, 100 million Chinese people benefited from power and telecommunications upgrades. Between 2001 and 2004, investment in rural roads grew by a massive 51 per cent annually."

For foreign firms, the sheer scale – China is the fourth largest country in the world by area – dictates entry into Chinese cities cannot follow a one-size-fits-all approach. KPMG underlines this challenge, "The first realisation made by new entrants is that China is actually comprised of numerous markets, with each having vastly different requirements and niche characteristics."

The largest, most famous cities, called tier-one cities, are the most visited by foreign enterprises. Defined by GDPs of more than USD$300 billion and populations of more than 15 million, tier-one cities are enormous, sprawling centres that compare with countries like Colombia (GDP of US$309bn) or Belgium (population of 12 million). Normally comprising Beijing, Shanghai, Guangzhou, Shenzhen, and Tianjin, tier-one cities sit at the centre of many market entry strategies.

But considering those names alone would be a mistake. Second-tier cities have GDPs of between US$68 billion and US$299 billion. And with more than 1 billion people living outside tier-one cities, it pays to expand your horizons.

In fact, looking beyond the big names can provide niche advantages. Competition between cities has led to certain locations beginning to specialise in the types of companies they aim to attract. From infrastructure platform to talent base, and from geographical position to regulatory benefits, cities are designing themselves from the ground-up with specific industries in mind.

The city of Zhongxian, for example, has invested more than US$200 million to dedicate its economy to the growing e-sports market. As Reuters notes, "When finished, the complex will include a 6,000-capacity stadium and an incubator for gaming start-ups - and this in a town that lacks an airport or railway station." There are plans for as many as 6,000 'specialty' towns across China, each with a close industrial focus.

As such, it's essential foreign firms are aware of the vertical markets that are seeing growth across the country. For example, China's over-60 population is predicted to exceed 248 million by 2020, with as many as 152 million using online health services in 2015. eHealth and aged care services are booming across provinces, underpinned by a government-level focus on improving the development medicine and medical devices under the Made in China 2025 initiative.

Foreign firms must also be aware of China's Special Economic Zones (SEZ) – areas that provide greater accessibility for international investment for specific verticals and levels of funding. Xiamen, for example, is a tier-two city regularly noted as one of China's most liveable cities – especially important to attract and retain talent – and one of the country's first SEZs. With an economy heavily based on the engineering and renewable energy industries, it is booming with a GDP per capita higher than that of much larger cities.

"Business and trade relationships with big population centres like Beijing or Shanghai are mature, and competition is as fierce as anywhere in the world. That's why many businesses are beginning to explore the growth opportunities outside the biggest cities. That includes second- and third-tier cities like Wuhan and Xiamen, but also even smaller cities. Manufacturing, engineering, innovation, and logistics industries are all spreading strongly across China."

**Nick Coyle**
**CEO**
**AustCham Beijing**

# How do changing Chinese demographics affect managing a diverse, local workforce?

While reaching new markets in China is inherently complex, many of the challenges closely echo those which foreign firms face in their own markets. Identifying and attracting key talent is the first key challenge. China is the largest source of international students in the world, with its population increasingly seeking a global education experience. In 2017, nearly 610,000 Chinese students attended schools and colleges overseas. Indeed, the perceived exodus of local talent prompted the government to create the Thousand Talents Program, encouraging key experts to move to China and providing students greater reason to learn in their home market.

It seems to be working. China's growth and emergence as a digital leader has seen more Chinese students returning home after studying abroad. In 2011, 55 per cent of Chinese overseas students returned home following graduation. But by 2016, nearly two-thirds (63 per cent) were lured back to China by an improving domestic job market and new, attractive opportunities.

Yet, despite the growing base of educated, digitally literate people of employable age, foreign firms continue to see challenges. A survey by the executive-recruiting firm Heidrick & Struggles found 77 per cent of senior executives from multinational companies said they have difficulty attracting managers in China, while 91 per cent regard employee turnover as their top talent challenge.

Indeed, creating a culture that encourages and rewards extended company tenure in China can be a challenge for foreign businesses. As McKinsey writes, "Chinese companies excel at creating a community-like environment to build loyalty to the institution." Similarly, cultural and managerial differences like differences in norms around hierarchies and delegation can lead to misunderstandings and difficulties in integrating foreign and local teams.

And, while foreign firms have significant brand recognition in China, the rocketing prominence of local firms is influencing recruitment. As recently as 2012, Apple topped the list of most attractive employers for students in several disciplines. Today, however, Chinese brands such as Huawei, Alibaba and Tencent had taken the top position in all areas except law and medicine.

So how can foreign firms best optimise the latent Chinese talent infrastructure? While hierarchical thinking is becoming less of a problem, foreign firms do need to emphasise to potential hires that they will be able to reach the highest levels of the organisation. McKinsey recommends companies that commit to developing meaningful career paths for Chinese employees have a better chance to recruit and retain talent, as competition with Chinese competitors ratchets up.

Secondly, it is contingent on foreign firms to seek out and align themselves with in-country best practice. Working with native firms demonstrates understanding of key local nuances, and provides reassurance to Chinese talent that may be found wanting in a foreign company with no Chinese ties. For example, General Motors sponsors projects in which leading universities research issues of interest to the automaker. That helps it to develop closer relations with the institutions from which it recruits and to train students before they graduate.

**Partnerships empower foreign enterprises to best create a talent infrastructure that promotes repeatable, long-term benefits.**

# How is China's legacy infrastructure enabling global innovation?

Until fairly recently, innovation in China was perceived to be the sole preserve of so-called 'copycat' inventions. That is, local firms would take existing products, services, or intellectual property and simply reproduce them – often at a much-reduced cost.

Yet, following a similar journey to that of other Asian economies like South Korea, China is increasingly using the infrastructure it used copying Western products to create an innovation infrastructure characterised by rapid, iterative change. The country is investing heavily – China is the second-largest global investor in R&D – culminating in businesses finding ways to use innovations in processes, business models, and customer experience to their disruptive advantage.

Foreign firms can learn a lot from Chinese firms in this respect. For example, as Harvard Business Review notes, business model innovation is as important locally as product innovation: "Xiaomi's phones are not technologically disruptive in hardware terms, but they are revolutionary in customer experience terms. Chinese customers come to expect and appreciate their weekly OS updates. Technologically, Tencent's WeChat may seem like a WhatsApp knockoff, but it allows users to do a multitude of things that other messaging apps cannot. Again, this is true disruption (although not particularly successful outside of China so far). Haier's organisational reinventions allow it to accelerate the time to market for its Tianzun advanced household heater/air conditioner/air purifier – a potentially disruptive advantage in what is a slow-moving industry."

These firms are taking advantage of China's rapid adoption of a mobile-first economy. Already China is responsible for 42 per cent of the world's e-commerce sales and completes more than 10 times as many mobile payment transactions than the US. With more than half of the population now being Internet users (95 per cent on mobile), adopting mobile business best practice is considered essential.

In particular, foreign firms should be aware of local routes to market – and WeChat in particular. Tencent's leading social network is the dominant mobile, social, and retail platform in China, alone accounting for more than a third (34 per cent) of the country's mobile traffic. Within China, the extension of social messaging to social payment has also been broadly adopted. Wharton University Press notes that, "Mobile payments soared to 58.8 trillion yuan in 2016 from just 1.2 trillion yuan to in 2013, according to iResearch Consulting Group in China. Between WeChat Pay and AliPay, owned by Chinese e-commerce giant Alibaba Group, the two platforms hold a combined market share of 92% of such transactions in the market of 1.4 billion people. AliPay says it processed 256,000 payment transactions per second during its peak Singles' Day festival on November 11, 2017."

Yet, while Chinese innovation infrastructure may seem uniquely adapted to domestic enterprise, China's biggest firms are increasingly using its lessons to conquer the globe. For instance, car-rental company eHi and electric car firm NIO both have R&D labs in California, while Tencent opened an AI research facility in Seattle in 2017 with a focus on speech recognition and natural language processing.

While global partnership and best practice is essential to the success of this infrastructure, so is localisation. Consider, for example, the joint venture between General Motors and the Shanghai Automotive Industry Corporation. The organisations initially adapted a US van for use in the Chinese market. However, more recently the companies introduced a new version that was designed and developed in China, for the Chinese market alone – a car that has seen enormous success.

Yet China is also using its infrastructure to drive cutting-edge innovation. Supporting this requirement is the development of 5G. GSMA forecasts that 5G connections in China will reach 428 million by 2025, just five years after the industry agreed timeline for 5G deployment. Initially, 5G will provide immediate, richer experiences for consumers in areas such as e-sports, autonomous driving, and faster smartphones, but it will also heavily impact business audiences through greater adoption of concepts like the Internet of Things and big data analytics.

# How can foreign firms support their digital transformation and thrive in China?

Our own research shows that China's infrastructure is perceived favourably by local-based businesses in supporting their digital transformation.

Telstra's recent *Connecting Commerce* study by The Economist Intelligence Unit ranked 45 cities around the world in terms of business confidence in the local digital environment. The categories assessed were in the following five key areas: innovation and entrepreneurship, financial environment, people and skills, development of new technologies, and ICT infrastructure.

Chinese cities reported strong results, as Beijing (5th), Shanghai (7th), Guangzhou (13th), and Shenzhen (18th) all appear in the top half of the ranking. These results underlined not only the strength of the local digital infrastructure, but also the opportunity for firms to partner with enterprise and government for mutual benefit.

The most successful global firms are tackling China by working closely with and alongside local firms. In addition to a range of chambers of commerce, trade organisations and advisory bodies, there are numerous multinational companies with relatively long histories in China with the expertise to support the market entry and expansion of organisations new to the country.

Telstra itself has been on a long journey in providing infrastructure services in China, having been present in the Chinese market for almost 30 years. This has contributed to Telstra having a depth of corporate knowledge and experience in building and navigating a successful business in China, as well as understanding the importance of partnering and how to build for long-term success.

Telstra's joint venture, Telstra PBS, has established itself as the largest foreign joint venture licensed to provide IPVPN and network services to over 20 provinces in China. This long-term investment has now grown to seven offices in China and staff on-the-ground across service, operations, and account management. By providing a range of ICT solutions in China to help support the required infrastructure and managed services needs of foreign multinationals, Telstra is able to help them achieve their China aspirations.

Despite the challenges in entering a vast, heterogeneous and complex market such as China, the business opportunities and rewards of doing so continue to draw foreign investments. By taking advantage of China's infrastructure, partnering with local organisations and drilling into infrequently asked questions about the Chinese market, foreign firms can be better prepared for the long term, and truly thrive in China.

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