

## I. INTRODUCTION

The main objective of this book is to shed light on the key success factors in accessing the Chinese market for Spanish companies, and to create a framework for companies wishing to sell their products in China and what they need to do to succeed.

For several years, many Western companies off-shored their production to countries with low cost labour, such as China. Today, these same companies, regardless of where they manufacture, are seriously considering accessing the emerging markets. In the case of China, we are talking about a market of over 1,300 million people, with a purchasing power, albeit limited, on the increase. How can companies try to start marketing their products there? It is an arduous, slow task and it can be very expensive with many potential pitfalls. The company that intends to access this market should consider well its strategy in order to succeed.

### 1. Research objectives

The world is changing at a pace we struggle to adapt to. There are new forces that are reshaping the environment of business and as a result we are living in a new era of rapid and unpredictable change. It seems highly likely that the levels of volatility and unpredictability that we have experienced in recent years will continue into the future. These changes are classified by Robert M. Grant<sup>1</sup> into (1) economic changes, with the world stuck in the worst economic downturn since the 1930s, which paint a picture of volatility and low growth, at least for the Western world, (2) technology changes with a “New Economy” that has moved from an industrial economy to a knowledge economy, driven by the digital revolution, and (3) societal pressures: “for organisations to survive and prosper it is required that they adapt to the values and expectations of society—something which organisational sociologists refer to as *legitimacy*. Loss of social legitimacy may be as great a threat to the survival of commercial and investment banks as are their weak balance sheets”.

In this situation of economic recession and lower demand for our products, Western companies are finding it more and more difficult to find customers in the domestic marketplace. In the search for more attractive markets, these businesses look around and observe how some emerging markets are growing at an unprecedented rate. They obviously wonder whether accessing these markets would be something they could do, whether it will be hard, whether it will be possible, whether anyone similar to them has done it before, and how a company can be successful. In short, businesses often feel at a loss when trying to enter a new market that is so unknown for them in terms of culture, language, geographical distance, distribution channels, and so on.

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<sup>1</sup> GRANT, R. M. *Contemporary Strategy Analysis*. John Wiley & Sons. Barcelona, 2010.

There are two main approaches when considering the access to global markets. On the one hand, Friedman states that the world is flat, in his book of the same name.<sup>2</sup> He explains how, during a trip to India, he discovered a large number of European and American companies operating in India, and how globalization has shifted the world. One can get an American-designed product built in different Asian countries, with outsourced technology from a third country, supported by call centres placed in India, for European customers, and so on. According to Friedman, ten forces have flattened the world, including the fall of the Berlin Wall, the connectivity achieved by the Internet, digital technologies and the improvement of communications and infrastructures.

This flattening of the world has opened up many opportunities and made the world smaller and perfectly accessible to everyone. National differences do not account for much and as such, it is easy to access foreign markets, even though they are far away and as different from us as the Chinese market is.

On the other hand, Ghemawat portrays a somewhat different picture<sup>3</sup>. According to him, the world is circular, countries are still not completely integrated, and borders still matter. These borders are developed in his well-known CAGE model: there are still large differences that can be cultural, administrative, geographic and economic distance. He concludes by airing caution for businesses that want to operate globally: “failing to keep [it] in view can be a recipe for poor performance”. Therefore, he warns that country and regional differences still matter and easily surpass the similarities of a flat world.

Therefore, following his theory, if a firm tries to compete in the same way in all the markets, it is in for an unpleasant surprise.

This book will try to analyse who is right: can we access the Chinese market using the same products, services and strategies as we do in our domestic market? Or do we have to adapt strategically to fit into a new market? How easy is it to access the Chinese market? Can small and medium-sized companies achieve the goal successfully or are we facing an impossible task? What are the obstacles and the opportunities? Summarising the question: is the world flat or is it round?

We shall try to answer these questions in the following pages.

But first, we need to focus on the country of China. We are going to study its enormous growth compared to that of Spain. We will try to prove that:

1. There are increasing opportunities due to the growth of the population (in particular urban population and middle classes), growth of the Gross

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<sup>2</sup> FRIEDMAN, T. L. *The world is flat. A brief history of the twenty-first century*. FSG Books. New York, 2005.

<sup>3</sup> GHEMAWAT, P. *Redefining global strategy. Crossing borders in a world where differences still matter*. Harvard Business School Press. Boston, 2007.

**Comentado [CR5]:** What in view? Put what the “it” refers to in square brackets [ ] to indicate that you inserted this information into the quote.

Domestic Product and Gross Domestic Product per capita, consumption growth and increase of imports.

2. Indicators of economic confidence are also positive. The recession suffered in Spain is not affecting China as greatly. Perhaps the economic growth will slow down but it will be a soft landing.
3. In spite of these opportunities, access to the market is proving difficult due to legal, cultural and language barriers, amongst others. But some large Spanish firms have successfully entered the market.
4. There are several hundred medium and small-sized Spanish businesses regularly doing business in China. A survey has been carried out to help draw a profile of these firms: why they set up business in China, what were their main obstacles, their priorities for the next few years and the best practices learned after the process. We determine how to take full advantage of the opportunities that open up to us.

## 2. Hypotheses

**H1:** Accessing the Chinese market requires foreign firms in general, and Spanish ones in particular, to adapt their products or services to that specific market. Moreover, the adaptation should not be restricted to the company's products but also be applied to the management style and strategic approach of towards China.

Explanation: in a world that is global, where tastes and habits are becoming increasingly homogeneous among countries, there is still a strong, specific, underlying culture, negotiation peculiarities and specific market needs in China that have to be addressed. Otherwise, the foreign company will not be successful.

**H2:** China offers an attractive market made up of many consumers and a significant emerging middle class. Spain is not taking full advantage of this opportunity.

Explanation: while the opportunities China presents are colossal (in terms of GDP growth, urban population with increasing disposable income, high consumer confidence levels, blooming middle class, rising demand for all products, etc.), Spanish firms have not taken as much advantage of these opportunities as expected: the trade balance is negative, exports are still very low, as is direct investment in the country.

**H3:** Accessing the Chinese market is full of obstacles: it requires significant investment, skilled staff, a long payback period, much patience and resilience. Therefore, it is a market only accessible for large firms.

Explanation: the path into China is long and winding. Examples of large firms setting up successfully in China are very well-known and are continuously portrayed in the

media. But what about the smaller or medium-sized ones? We need to give an answer to the following related issues:

- Detecting which Spanish companies are operating in the Chinese market and identifying the opportunities in accessing it;
- Sorting out the challenges for our companies: what their difficulties are and future plans in the country;
- Finding out the best practices and drawing up a practical framework for corporate performance that will support practical strategic action for Spanish businesses.

We shall try to deduce the keys to success, or best practices, so that companies in the future can use this knowledge to increase their chances when accessing the Chinese market.

### 3. Methodology

The present research is the result of several years of work, study and trips within Europe and China. Several different methods have been used in order to grasp the complexity of the subject:

Firstly, an extensive literature review on China (history, culture, economy, trade, etc.), and also on Spanish businesses, has been carried out.

Secondly, substantive research has been done on quantitative data. The main sources that have been used are all official databases from, amongst others, the International Monetary Fund, the World Bank, the Asian Development Bank (ADB), the US-China Business Council, Chinese Customs, the Spanish Statistical Office (INE), the Spanish Institute for Foreign Trade (ICEX), Casa Asia and Eurostat.

Thirdly, a research framework leading to a comprehensively-designed set of interview questions was created. Qualitative information was collected mainly from interviews done in China, Spain and different parts of Europe with experts in the following fields:

- Chinese economy and international relations,
- Foreign Trade between Spain and China,
- Businesses with Chinese marketplace experience,
- Export promotion agencies.

As a starting point, institutions and trade organisations (Chambers of Commerce, Casa Asia, Catalonian Government Agency ACC10, consulting companies, etc.) with a track record in the promotion of exports to China were identified. A selection of firms that actively export to China were interviewed as well. Other experts in economics and foreign trade from the finance sector and from academic institutions

were also consulted. These interviews took place between January 2011 and June 2012. Questions were open-ended to gain maximum insight. We would like to thank herein the availability of these individuals, and the generosity they showed when sharing their knowledge.

**Figure 1.** Collection of qualitative data through interviews with experts



Source: author

Last but not least, a survey has been carried out to help draw up a profile of Spanish firms operating in China: why they set up business in China, what their main obstacles were, what their priorities for the next years are and the best practices learned after the process. The survey was conducted between January and May 2012 among the 360 Spanish firms based in China.

**Table 1.** Summary of methodology for the survey

Concept	Dates
Date of the survey launching	January 2012
Dates of reminders	15 <sup>th</sup> February   1 <sup>st</sup> March   15 <sup>th</sup> March 2012 Some preliminary results were sent to all to encourage further answers in May. Telephone follow-up was carried out throughout the period.
Population	360 firms from two databases: Spanish firms belonging to the Spanish Chamber of Commerce in China plus the ICEX Database of Spanish firms in China.
Sectors	All sectors are represented, from industrial products, construction and civil engineering to all types of services.
Location in China	All firms in China are considered, regardless of the geographic area, although three areas are more

Concept	Dates
	represented: Pearl River Delta (Beijing Area), Yangtze River Delta (Shanghai Area), Bay of Bohai (South of China).
Collaborations	Different institutions have helped to encourage answers, namely Casa Asia and different Chambers of Commerce.
Number of questionnaires sent	360
Number of answers received	78 (i.e. 21.6% of the total) The survey represents the total population of firms, in terms of sector, size and geographical destination.

Source: author

Shortcomings of our methodology:

There are firms that are actually exporting to China but these are not, however, represented in our study. We believed that the main variables to take into account were firms that are trading in China regularly, not just on a one-off basis. Therefore, having some direct investment in the country was considered essential, from the simplest form, such as a Representation Office, to a production plant or other facilities.

#### What is not the objective of our research?

One of the problems encountered in our path has been the breadth of the subject, along with the huge volume of data and speed of change. For this reason, we find it relevant at this point to establish what has **not** been the specific object of our research:

- To analyse the history of China or the philosophy that underlies the Chinese culture;
- To study in depth the political or even the economic panorama of China. In that sense, we have only evaluated the indicators that could serve our purpose: the variables that explain China as an emergent market with plenty of opportunities;
- To explore the legal or fiscal framework of foreign firms in China;
- To compare the case of Spanish businesses with other Western countries.

#### 4. Acknowledgements

We would like to thank all the people who have helped us write this document. In fact, the research is the result of the cooperation of many individuals and organizations. First, we wish to thank the more than 40 talented experts who so

generously shared with us their experiences and accumulated years of knowledge about China and doing business in this fascinating country.

We also wish to thank the 78 firms that were so collaborative and helpful in filling in our questionnaire. In a hectic world where everybody is always in such a hurry, such generosity is doubly valued and appreciated.

Concerning the Abat Oliba CEU University, our special thanks go to Dr. Ferran Porta, for his guidance in the difficult paths of research, whose insightful comments on the key issues facing this work helped us clear the way ahead. Dr. Joan Ripoll was extremely helpful with data sources, data analysis and its comprehension. He spent many hours revising the document and he always provided very valuable and wise advice. The discussions we had helped me greatly to develop the ideas put forward in this work. Alejandro Gisbert gave me a very useful hand in accessing data, in particular with the Bloomberg database. He also offered much advice and insight in the latter phases of our work, and one could not hope for a friendlier advisor.

Finally, I wish to add special thanks to my family for their support, resilience and endurance during all this period.

## II. THE POPULAR REPUBLIC OF CHINA: AN INCREASINGLY ATTRACTIVE MARKET

### 1. Introduction to the Popular Republic of China. Key indicators.

The Chinese economy grew by 9.2% in 2011, a robust pace of growth that, even though it is the lowest in the last decade, shows that China's economy is not going to stop growing, as some reports have suggested. Instead, China is heading for a slow landing. The reasons for its downturn lie in the slow recovery of exports due to a lower demand of the global economy, plus a decrease in investment.

**Comentado [CR6]:** How about "soft landing"? That's the expression that is most often used. ☺

According to most of the surveys consulted, for instance, those of La Caixa<sup>4</sup>, the risks of a recession are very limited. In the first place, China still has enormous potential to increase its internal demand. Even though it is true that certain consumer goods are approaching saturation (mobile phones, televisions or home appliances), particularly in urban areas, other sectors, such as cars, still have a very long way to go. Regarding investment, the factors that suggest a decreasing trend are very limited, and centre on infrastructures and building. The former was seriously affected by the high-speed-train accident that took place in Wenzhou last summer. The latter is distressed due to credit restrictions being applied in order to stop the growth of inflation. However, bearing in mind that more than 300 million people in rural areas are willing to move into cities, the demand for housing is ensured. The activity indicators such as industrial production and electric production are still growing strongly (by 14% and 11% respectively in the third quarter of 2011). Finally, foreign trade, both exports and imports, are on the increase, even though not as strongly as in the past decade. Therefore, it can be concluded that the Chinese economy is not going to crash, but to cool down slightly.

Perhaps the main risk is the high rates of inflation, still at 6.1% in September 2011. The rate of inflation of food is at a worryingly high 13.4%, a factor of considerable social relevance that is a cause for concern for Chinese authorities.

Associated with price increases are swelling labour costs, which erodes the competitiveness of traditionally cheap Chinese labour. As a result, it obliges the country to reorient the economy towards more domestic consumption and to produce more sophisticated goods.

Therefore, we can conclude that growth is set to continue, even though perhaps at a slower rate. We would like to stress the idea at this point that, independently of whatever happens in the short term, the interest for China in the long run remains unaffected. This is not a fashion and does not depend on short-term indicators: China is here to stay and its influence as a second world power is unquestionable.

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<sup>4</sup> LA CAIXA. *Monthly and Annual Report*. November 2011 (p. 12-14).

**Table 2.** The Popular Republic of China: A selection of key indicators

	2006	2007	2008	2009	2010
<b>POPULATION</b>					
Total population <i>millions; as of 31 December</i>	1,314.5	1,321.3	1,328.0	1,334.7	1,339.7
Population density <i>persons per square km.</i>	136.9	137.6	138.3	139.0	140.0
Population <i>annual change, percent</i>	0.5	0.5	0.5	0.5	0.4
Urban population <i>percent of total population</i>	43.9	44.9	45.7	46.6	49.7
<b>LABOUR FORCE</b> <i>millions; calendar year</i>	782.4	786.5	792.4	798.1	...
Employed					
Agriculture	764.0	769.9	774.8	780.0	...
Manufacturing	325.6	314.4	306.5	297.1	...
Others	438.4	455.5	468.3	482.9	...
Unemployed	8.5	8.3	8.9	9.2	...
Unemployment rate <i>percent</i>	4.1	4.0	4.2	4.3	4.1
Labour force <i>annual change, percent</i>	0.5	0.5	0.8	0.7	...
<b>NATIONAL ACCOUNTS</b> <i>billions Yuan; calendar year</i>					
<b>At Current Prices</b>					
GDP, total at current market prices	21,631.4	26,581.0	31,404.5	34,050.7	39,798.3
<b>At Current Market Prices</b> <i>Yuan</i>					
Per capita GDP	16,500.0	20,169.0	23,708.0	25,605.0	29,762.0
<b>Price Indexes</b> <i>annual change, percent</i>					
Consumer price index	1.5	4.8	5.9	-0.7	3.3
Producer price index	3.0	3.1	6.9	-5.4	5.5
<b>EXTERNAL TRADE</b> <i>billions US Dollars; calendar year</i>					
Exports, <b>fob</b>	969.0	1,217.8	1,430.7	1,201.7	1,577.9
Imports, <b>cif</b>	791.5	956.0	1,132.6	1,005.6	1,394.8
Trade balance	177.5	261.8	298.1	196.1	183.1
<b>External Trade</b> <i>annual change, percent</i>					
Exports	27.2	25.7	17.5	-16.0	31.3
Imports	19.9	20.8	18.5	-11.2	38.7
<b>Balance of Payments</b> <i>percent of GDP at current market prices</i>					
Exports	35.7	34.9	31.7	24.2	26.9
Imports	-27.7	-25.9	-23.8	-19.1	-22.6
Balance on goods	8.0	9.0	8.0	5.0	4.3
Current account balance	9.3	10.6	9.6	6.0	5.2
<b>EXCHANGE RATES</b> <i>Yuan per US Dollar</i>					
End of period	7.81	7.30	6.83	6.83	6.62
Average of period	7.97	7.61	6.95	6.83	6.77

**Comentado [CR7]:** You need to explain what fob means

**Comentado [CR8]:** Ditto comment 10

Source: Asian Development Bank (ADB). www.adb.org. July 2012.

There are, however, certain facts that indicate that the economic growth model needs to be revised, in order to counterbalance certain challenges affecting the Chinese economy. These are increasing inequality, social contradictions, environmental hazards, weak technological innovation, irrational industrial structure and fragile agricultural structure, to name a few. This is the summary for China by the ADB Outlook 2012<sup>5</sup>. It reflects precisely the situation in a few lines:

Domestic demand rather than exports was the driving force behind 2011's strong performance, with high investment and consumption. The outlook for 2012 and 2013, despite uncertain global prospects, is for only moderately slower growth. The economy is gradually diversifying, with imports rising rapidly and the trade surplus now much less as a percentage of economic output. Currency appreciation, rising wage rates, increasing income disparities, and environmental concerns underscore the need for modifying the country's growth model. With a strong fiscal position and declining inflation, the Government is well positioned to implement the 12th Five-Year Plan, designed to further transform the economy.

The Chinese Government is aware of the need for a change of economic model and, to that purpose, it has developed a tool to implement such change: the 12<sup>th</sup> Five-Year Plan 2011-2015. Premier Wen Jiabao said in a speech at the Fifth Plenary Session in Beijing 6<sup>th</sup> March 2012<sup>6</sup>:

2012 is an important year for the 12th Five-Year Plan period and the last year of the current administration. We should accelerate the transformation of economic development model and adjustment of economic structure, strengthen self-innovation and energy saving and emission reduction, and facilitate socialist economic, political, cultural, social and ecological development in an all-round way.

Premier Wen Jiabao noted that the expected annual growth of GDP **this year** will be 7.5%, which, although slightly lower than that of last year, is in line with the targets of the 12th Five-Year Plan. It will guide each region and department to focus on accelerating the transformation of economic development model and raising economic development quality and benefits to achieve **long**, high-level and better development.

We will make new progress in areas such as industrial restructuring, self-innovation, energy saving and emission reduction (...) We will keep on the implementation of a steady monetary policy, and keep on strict control of the loans to the industries with high energy consumption, heavy pollution or excessive productivity. We will achieve better combination of keeping

<sup>5</sup> ASIAN DEVELOPMENT BANK (ADB). *ADB Outlook 2012. Confronting rising inequality in Asia*. www.adb.org. (p. 131 onwards). July 2012.

<sup>6</sup> Wen Jiabao stresses that China will not seek economic growth at the cost of the environment and public health at the Fifth Plenary Session of the 11th National People's Congress (NPC). Ministry of Environmental Protection. www.english.mep.gov.cn. August 2012.

**Comentado [CR9]:** Eva, I would put the actual year you're referring to (2013, right?). In which case, put: "...the expected annual growth of GDP for 2013 will be..."

**Comentado [CR10]:** Do you mean long-term?

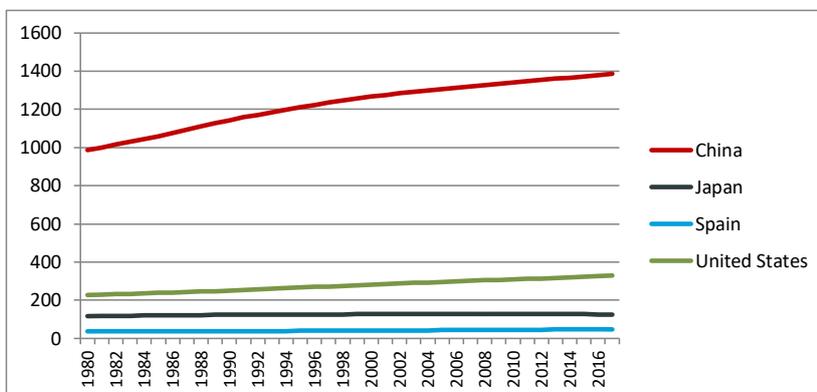
steady growth with controlling price, adjusting economic structure, benefiting public welfare, promoting reform and facilitating harmony.

To summarise, the Popular Republic of China is expected to continue growing, although at a slower pace compared to the last 25 years. With a population of over 1.3 billion people, it is surely going to surpass the US GDP within a few years, a fact that is perfectly natural due to its much larger population. In addition, several factors are challenging China's economy and they will have to be dealt with in the coming years. The following sections analyse in depth the accession of China to the World Trade Organization, the economic variables that influence the attractiveness of the Chinese marketplace (such as income, employment, an expanding middle class), and the challenges China faces in the future.

## 2. China, the most populated country in the world

The population of China was approximately 1,347 million people in 2011, around 30 times the population of Spain. As such, China is the most populous country in the world, accounting for more than 20% of the world's population. By 2016 the population is expected to be 1,380 million people, compared to 47 million in Spain (estimates carried out by the IMF<sup>7</sup>). In Figure 5 we can appreciate both the evolution and population difference between the two countries.

**Figure 2.** Evolution of Population: China, Japan, USA and Spain 1980-2017. In millions.

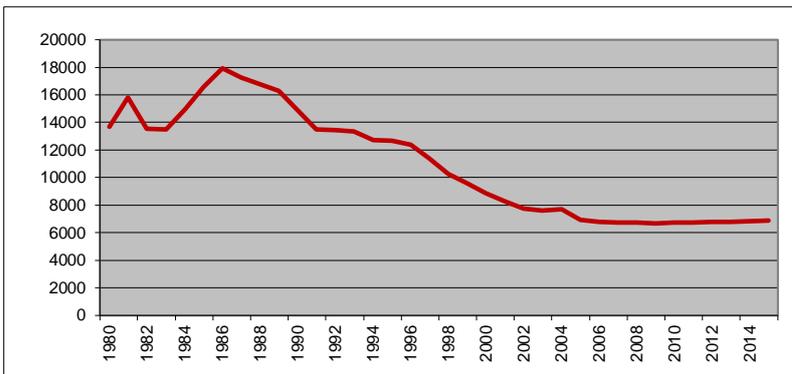


Source: IMF, World Economic Outlook Database (WEO), 2012. Estimates start after 2011.

<sup>7</sup> INTERNATIONAL MONETARY FUND (IMF). According to the official IMF web site ([www.imf.org](http://www.imf.org)), the International Monetary Fund (IMF) is an organization of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The IMF publishes a range of time series data on IMF external trade, exchange rates and other economic and financial indicators. Some IMF data have been used for the present research, mostly the World Economic Outlook Database (WEO), the International Financial Statistics (IFS) and the Direction of Trade Statistics (DOTS) Database. September 2012.

While the population of Spain has grown at a rate of 18% in the last twenty years (1996-2016), in the same period the population of China grew at a slower pace, at 12% over the time period. However, if we consider the absolute figures, the growth in China means that for every year, in the period 2000-2016, the total population increases by 6 to 8 million people.

**Figure 2.** Evolution of the annual population growth in China 1980-2014 (in thousands)



Source: IMF, World Economic Outlook Database (WEO), 2012. Estimates start after 2011

It is of special relevance in the case of China to establish a clear difference between the rural and urban population. While the majority of the population (55.1%) is still rural compared to the urban population (44.9%), the intense migratory movements leads us believe that by 2035, 70% of the population will be living in the five largest urban areas: Shanghai (18.9 million), Beijing (16.7), Canton (7.8), Tianjin (11.8) and Chongqing (28.4)<sup>8</sup>.

That means that the urban population—with access to products and services, with needs to be fulfilled and with considerable purchasing power—will grow from being around 600 million people at present to 1,000 million in the next 14 years.

To summarise, we can conclude that population growth accounts for an increase of 6-8 million people annually (80-100 million people in the next 14 years), but more importantly, some 400 million people will move from rural to urban areas in the same period of time.

At the end of 2012, the total employed population in China was over 800 million people, of whom around 128 million were employed in urban areas. According to the National Bureau of Statistics, the unemployment rate was 4.1%. This figure has been questioned by some surveys, which believe that the figure does not really reflect the real situation. Active population accounts for 59% of the total population (quite a low figure if we compare it with developed countries, where it stands

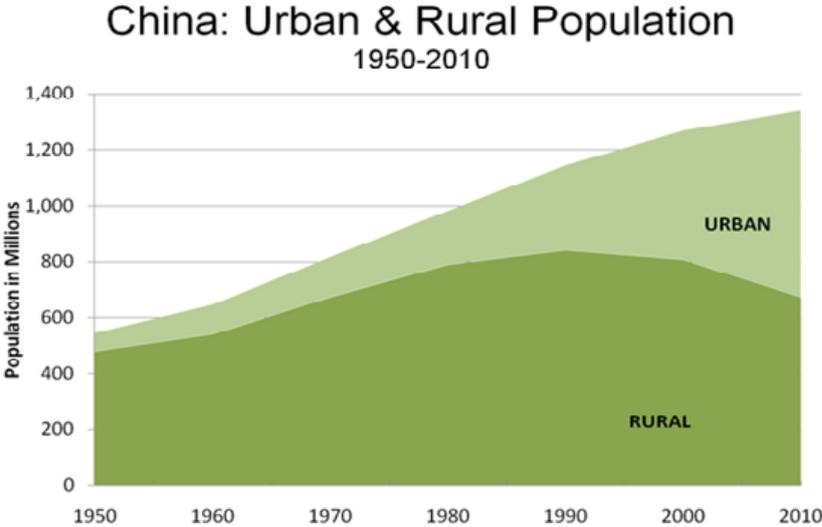
<sup>8</sup> INSTITUTO ESPAÑOL DE COMERCIO EXTERIOR (ICEX), *Country Guide, China*, 2010.

around 65%). The primary sector, which accounts for 11% of the GDP, employs 40% of the workers, indicating that productivity is very low in this sector. The secondary sector accounts for 27% of employment, while services employ the remaining 33%. To a certain extent, the growth of employment and productivity in China comes from the migratory movements from low productivity rural areas to urban areas, where activities are more productive.

As we can see, migratory movements towards urban areas, combined with the increase in wealth in these areas, represent a new world of opportunities in terms of market growth that are currently taking place and that can be expected to continue in the future.

In 2011, the proportion of urban population stood at more than 50% for the first time ever. Statistics show that from an urban population of 18% in 1978, it reached 51.3% in 2011. Figure 7 shows clearly the growing importance of the urban population over the whole, mostly since the 1980s.

**Figure 3.** Evolution of rural and urban population in China, 1950s-2010



Source: National Bureau of Statistics, Popular Republic of China.

Migration policy in China since the revolution has evolved significantly. According to Webber, Wang and Ying<sup>9</sup>, the period 1958-84 was one of restricted migration, since industrialization was unable to absorb all the peasants who had migrated to the cities. People could only move to cities if they had an employment certificate, were

<sup>9</sup> WEBBER, M.; WANG, M. *China's transition to a global economy*. Palgrave MacMillan. New York, 2002. (p. 12).