

# UNDERSTANDING THE CHINESE CONSTRUCTION MARKET

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China has made remarkable achievements since Deng Xiaoping's economic reform and open door policy started from 1978. Many western construction companies are venturing into China in search of a stake in the world's fastest growing economy. However, while the market is there, and the potential is enormous, it is not easy to succeed. There is a need for western construction companies to understand this new market in order to do business successfully in China. Focusing on this issue, this paper first describes the economic climate, market features, and experiences from overseas participants. It then discusses what difficulties and differences exist in the Chinese construction market~ how to solve and overcome them, and what main factors should be considered. Finally, a conclusion is given highlighting key points.

Keywords: China, construction industry, construction market, transition economy.

## INTRODUCTION

Thinking of doing business in China, then you are not alone. China is becoming one of the most important strategies for many prospectors in Western countries. China's sheer size, with 1.2 billion people and a massive GDP growth potential, cannot be ignored. The country is on course to produce the greatest economic miracle in recorded history. Never before has such a large proportion of humanity risen from poverty so rapidly. It is a country of enormous potential and is reckoned to become the world's third or fourth largest economy by the year 2000. It is attracting more foreign investment than any other. The latest boom is only one in a series of investment cycles begun in 1978 when China began to open its doors to foreign investors.

In a study of the attitudes of UK companies to investment in China (Price Waterhouse, 1994), approximately one third of those surveyed had already made investment. A further 37 % planned to invest within a two year period. The major incentives were identified as the size of the Chinese market, low labour costs and access to wider Asian markets. The questions are not only asked by the Chinese themselves but also by the rest of the world. China's government faces the challenge of keeping the country's rapid growth under control while the Western world faces the challenge of how to turn the biggest opportunity since the Middle East in the 1970s into profit.

Understanding the importance of a market is much easier than entering the market. In recent years, UK construction organisations, whether they are manufacturers, contractors or consultants, have looked seriously at the potential of the Chinese construction market, and some of them have already tried. Many prospectors concluded that the market is there; the difficulties are huge; but the opportunities should not be ignored. A UK manufacturer expressed "a joint venture is like a marriage when you eventually get into bed with each other; only in China the

courtship tends to be longer than elsewhere; however, the marriage can be just as fruitful." A contractor from Holland said: "we met difficulties; we always complain about doing business with the Chinese; however, we never talk or think about giving up the potential huge construction market in China, and the more co-operation, the more understanding, the easier it will be."

Moreover, a US construction executive got the following impression:

- The market is huge, the potential is enormous, so we must be there;
- It is expensive; it is taking much longer than we thought; the negotiations are endless and the people we deal with keep changing;
- Euphoria, the job is starting, celebrate with rice wine, get the press release organised;
- Panic at the delay and the cost, hunt the guilty; we must recoup the loss on the next job;
- We have learnt a lot and now we will convert this into a win situation -the market is too huge to walk away

Why so many difficulties? What are the differences? How to overcome them and win the challenge? Obviously, the huge country with 1.2 billion population, in addition to its special approach in transformation and its strong business culture, lead to those difficulties. Therefore, getting a better understanding of this market is very important if one is to be successful in China. The following sections will discuss the differences, difficulties and the strategies concerned.

## **ECONOMIC CLIMATE IN CHINA**

Since the late 1970s, the world has witnessed rapid changes in the Chinese economy. The drastic changes, and the time scale in which they have happened, have attracted the attention of companies and investors world-wide. Real GDP per capita has increased at an average rate of over 10 per cent since 1979. According to State Statistical Bureau's statistics (1996), by the end of 1995, China had achieved an annual GDP of US \$ 664 billion representing an approximate increase of 10.2% over the previous year. Between 1990 and 1994, China experienced the highest international rate of real GDP per capita growth (averaging 8.54%). The peak growth rate was 12.8% in 1992. Other significant rates of growth were achieved by Colombia (7.38% - ranked 2) and Thailand (6.54% - ranked 3). During this period, Germany reached an average rate of 3.62% (ranked 13), USA 1.18% (ranked 23) and UK 0.51% (ranked 33).

Many Western companies have ventured into China in search of a stake in the world's fastest growing economy, as shown in Figure 1 and 2. By the end of 1995, the UK was the biggest European investor, with a total of over US \$ 5.4 billion in over 1300 joint venture projects. In 1995, the actual used foreign capital from UK was almost twice that of Germany and one-third more than France. Britain is also the biggest source of technology for China within the EU countries. UK trade with China stands in third place in Europe after Germany and Italy (Flanagan and Shirong, 1997).

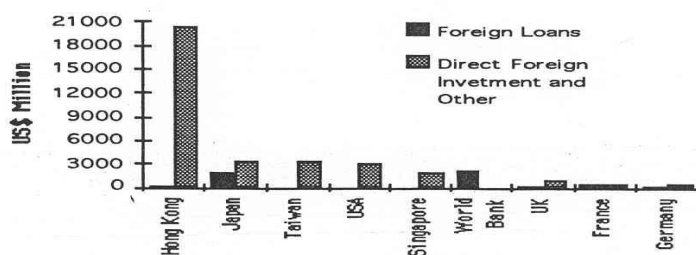


Figure 1 Foreign Investment Actually Used In China (1995)

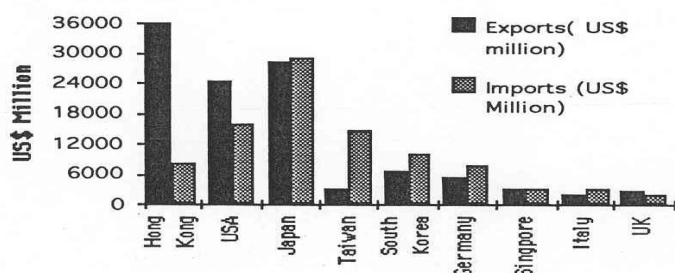


Figure 2 China's Trading Partners (1995)

During the eighth five-year plan (1991-1995), investment growth in the energy industry was 25 per cent, 55 per cent in transportation and 27 per cent in the raw material industries. The total housing construction accounted for 13 billion sq. m between 1980 and 1995. The ninth five-year plan (1996-2000) is well under way and highlights China's increasing need for infrastructure (Yao, 1994).

The scale of that need is illustrated by a few facts about China:

- The annual increase in capacity of power generation is more than 15,000 MW, the equivalent of the total installed capacity of the whole of Switzerland. Given the size of the Chinese market, such growth represents only a small part of the existing potential.
- Current power generation capacity per capita in China is only 6 per cent of that in North America and 10% of that in Western Europe.
- About 300 million people still have acute water supply needs.
- There are only 4.2 telephone lines for every 100 people even though China is adding the equivalent of the entire UK telecommunication infrastructure every two years.
- Road coverage is only about one-sixth of that of the USA 900 million sq. m of housing will be built during the Ninth five-year Plan with a total investment of 270 billion Yuan (US\$ 32.5 billion).

## UNDERSTANDING OF THE SOCIALIST MARKET ECONOMY

China is attempting a unique transition process from a central planned economy to a socialist market economy, without parallel in any other country. China is not rushing to take on board Western systems, but pursuing a fundamentally different path with a gradual approach to decentralisation. Every sector in China is adopting a step by step

change approach with a strong planned base so as to gradually realise the transformation which shows incremental, sequential and frequently experimental reform procedures. This approach does not involve large scale and fast privatisation.

Since the gradual approach adopted in China needs a longer time in transition, state planning and government control in macro level become more important. The Chinese government realised that planning is necessary in order to ensure that markets function more effectively than would otherwise be the case. The general strategy towards economic reform is to strengthen government macro control and give more freedom to enterprises. Therefore, China is adopting a special model which has the following features:

- plan-based at macro level;
- market-based at micro level;
- a mixed economy - a market economy performed according to a plan; a changing proportion between plan and market base.
- a long term strategy in transition.
- a final goal of reform not so much focusing on whether market economy or not but the improvement of economies and living conditions.

Therefore, Economic growth in China shows fundamentally different results compared with those in Western countries, and the boom-burst cycle theory does not apply to this market, as shown in Figure 3. In the construction industry, the construction output value in 1989 dropped, not as a result of market forces, but government planning to slow down the state-owned investment. A series of changes have already been taken in the Chinese construction industry, and it has been realised by western countries that China is trying to learn Western ways, and competition exists; tendering process has been introduced; material supply system has changed to a market-base; construction price system has been reformed; wage system and employment system have also been adjusted. However, although they are all true, there is still a long way to the free market. The liberalisation process of these aspects is gradual. Competition is undertaken with the supervision of the government, and protection policies are used both at central and local levels. Tendering process has been used only at 43% of the total construction projects. Construction prices are determined based on market prices with strong planned price adjustment.

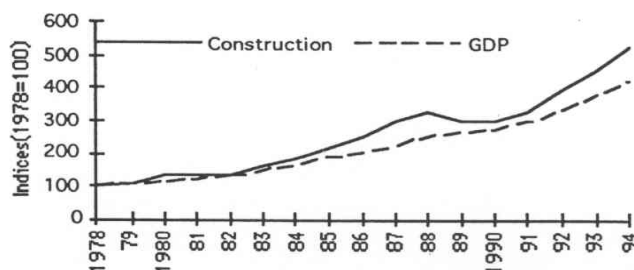


Figure 3 GDP and Construction Growth in China

Market analysis principles broadly used in Western countries cannot be fully applied in China because of a relative strong planned base. Government five-year Plan and Ten Year Planning at different levels from different aspects are still playing an Important role In the Implementation of the Industry, such as the Ninth-five Year Plan

and the Ten Year planning for construction plants, housing and real estate development.

## **THE CHINESE CONSTRUCTION MARKET**

China's construction industry is the biggest in the world. This is not only because of the big size of the country, but also the growth of the economy and the rising expectations of the people which create enormous demand for infrastructure improvements in power supply, water treatment, telecommunications and transportation, as well as housing. It is said that the changes to people's desires in the past 40 years have been as follows: plastic products in 1960's, chemical fibre products in 1970's, electronic products in 1980's and housing in 1990's.

The Shanghai construction sector (a city with 6,200 sq. km area and a population of 13.56 million) employs more people than the whole of the UK construction workforce. Obviously, this huge construction market provides huge and potential opportunities not only for local people but also for overseas contractors and consultants, and construction output volume keeps growing faster than GDP growing as shown in Figure 3.

There is no reason for overseas prospectors to ignore this huge construction market, and many have already had the experience. However, many of them did not achieve their objectives. Some contractors in USA explained the four stages of their feeling when doing construction projects in China: exciting -implementing -problem coming - and then losses. They took the losses to be the learning costs.

A contractor in Holland has done many successful projects in other countries, but met a lot of difficulties when undertaking the first project in China 15 years ago. The difficulties are in finding design partners, controlling quality of design, and the supervision of construction costs, schedule and quality. At last, they concluded that not every thing can be done by overseas contractors. They strongly recommended making use of the local workforce and finding good local partners.

## **SOME ISSUES TO BE CONSIDERED**

### **The key location and market dynamic changes**

The opportunities in China are distributed in different regions, and they are very different. China's geography, natural resources, changes in government policies and the people's demands, are the key factors that need to be considered. A poor choice in the initial stages could affect the success of any venture. The major part of China's swelling population is crowded along the eastern seaboard and the river valleys and lowlands of the east and Southeast. This area which has both the major share of agricultural development and the greatest concentration of industry in the country, yet it only represents 11% of China's total area. The density of population in Shanghai, for instance, is more than 2000 people per square kilometre, yet in Tibet it is only 2 people per square kilometre. Those provinces with higher GDP volume are all located in the eastern, south-eastern and south coastal areas.

Another strong feature in China market is the policy macro guide which, to most extent, determines the flow of foreign investment to different parts of China. Many overseas companies only know some key areas in China, such as the Five Special Economic Zones and Fourteen Open Coastal Cities, However, the government is



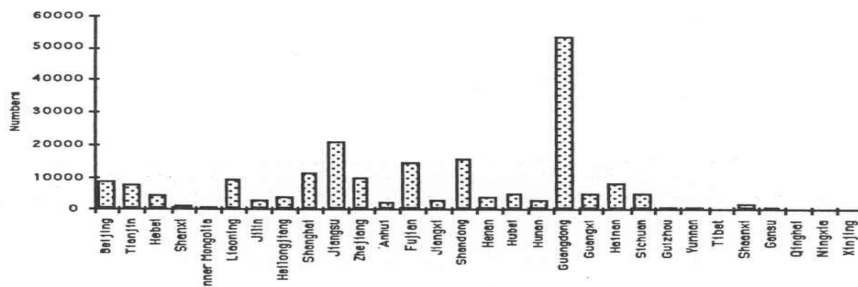


Fig. 6 Number of Registered Foreign Firms (by end of 1994)

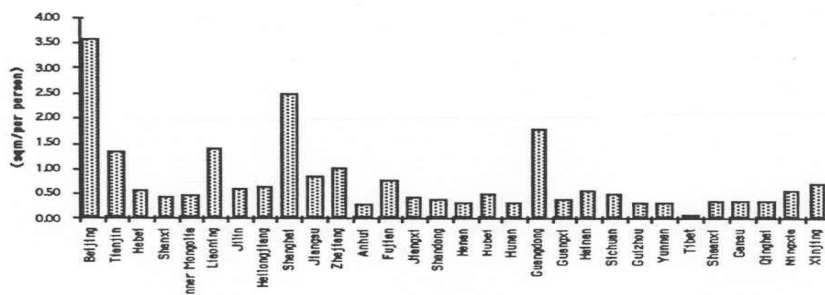


Figure 7 Floor Space of Building construction (under construction, 1994)

During the Ninth-Five Year Plan period, central and west parts of China become the key areas for economic development. In 1995, for example, 62.7% of the total investment was in the eastern part, 21.2% in the middle part and 12.3 in the Western part. However, the changes showed that the investment in the western and eastern parts were increasing. The differences can be seen from Table 1. Also, the average growth of total investment was 18.8%, but in the eastern part it was 17.5%, the middle part 20.7%, and the Western part 21.1%.

Table 1 The Changes in Investment in different parts of China

	Eastern Part	Middle Part	Western Part
Percentage of the Total Investment (% , 1994)	63.3	20.8	12
Percentage of the Total Investment (% , 1995)	62.7	21.2	12.3
Percentage Change	-0.7	+0.4	+0.3

### Competitive advantage

No foreign organisation will be able to compete for locally sponsored projects against the low cost base of a local indigenous firm. Local firms will always win the work on the basis of price. China is also unwilling to award its projects to foreign organisations unless there is a requirement for foreign investment or where the technological or management capacity is lacking. Overseas companies can compete successfully only by offering financial security, management, quality assurance, design innovation, advanced technology or assurance that overseas clients will get exactly what they contracted for.

China's construction market is huge. The construction workforce in China was 33 million in 1995. The reform of state-owned construction companies is still going on, and the market is not fully free. Therefore, the market is opened to overseas participants with certain conditions. Currently, overseas contractors are permitted to work in China on:

- Foreign investment projects;

- Projects funded by loans from international financial institutions and adopting international tendering processes;
- Project jointly invested by both Chinese and overseas investors which cannot be handled independently by Chinese contractors because of technical difficulties;
- Domestic investment projects with technical difficulties which can only be done with overseas contractor's co-operation. However, that co-operation can only be allowed after approval by local construction authorities.

In addition, build-operate-transfer (BOT) is another approach for foreign prospectors to do construction business in China because of a big shortage of state funding and huge demands in infrastructure.

### **Business culture**

A number of factors which had given rise to difficulties for UK companies investing in China were identified in a 1994 survey (Price Waterhouse, 1994). One of the most important related to cultural difficulties. A greater proportion of companies had experienced difficulties in understanding Chinese business culture. An even greater proportion had experienced difficulties in communicating western concepts and concerns.

"Western cultures and ideas should be adopted only if they fit guoqing - Chinese characteristics (Deng Xiaoping, 1984). Chinese culture is complex and requires a westerner to have patience, understanding, flexibility and respect for Chinese traditions and ways of doing business. Foreign companies entering China must adopt to gaoqing and be familiar with guanxi..

The most important cultural value is Confucianism. It demands respect for superiors and parents, duty to family, obedience, sincerity and courtesy. Thus, organisational hierarchy plays a central role. In business, rank and superiority increase with age - unquestioning obedience is demanded of juniors. Foreign business people may encounter varying degree of attention depending upon their age, Titles and rank are prized and must be considered during any negotiation. Protocol will frequently demand that foreign negotiators deal with the highest ranking Chinese executive. It is important that the seniority of the foreign negotiator matches this rank.

Commercialism in the Chinese construction industry is relatively new and most Chinese people have little or no experience in Western business methods and so establishing personal relationships with their foreign partners is an important step. Written contracts are now widely accepted as legally binding documents. However, many Chinese executives view written contracts as being of little importance - favouring personal commitment as a vehicle for business. The negotiated document is frequently less important than the relationship established during negotiation.

### **Organisation structures**

Finding a good local partner is another important factor for overseas companies to be successful in China. State-owned construction organisations are still the main force in spite of the recent increase of other forms of ownership. The small number of state-owned construction companies only accounts for 3% of the total construction enterprises in China, with 22% of total employees, and 32% of total output volume. Unlike most Western construction organisations, designers, contractors and consultants in China have different organisation structure which mainly result from



the classification of industry and the industries' responsibilities established during planned economy. Therefore, state-owned construction companies are either under the leadership of different industries or local government. This relationship lead to some features in Chinese construction organisations, such as the closer relationships with government, bigger size and wide working scope.

Design institutes and construction companies are large compared with Western ones. The average number of employees in state-owned construction company, for instance, is close to 1000, and the biggest, the China State Construction Engineering Corporation, has 225,000 employees.

Construction enterprises in China solicit and accept construction work according to their classes. In general, each profession of the construction industry is divided into three or four classes, A, B, C and D. The higher class, Class A, usually have a large number of employees and most of them are state or collective owned. The standards for each class mainly include the experience in accepting construction projects, the qualifications of the person in charge of the enterprise, the technology of enterprise work, the number of professionals in different aspects, the capital owned by the enterprise, the fixed assets, the quantity of machinery and equipment, and the output value.

Enterprises with Class A are entitled to do various types of works in their own professions. Those in Class B, do medium and small projects in their own professions and occasional large scale projects. Classes C and D, do medium to small scale projects in their own professions. In 1994, of the 94,000 registered construction enterprises, only 2,126 qualified with Class A.

The rural workforce constitutes the highest proportion of the construction industry. In 1995, there were 22 million rural employees, accounting for 67% of the total construction workforce. The ownership changes is shown in Figure 8 which includes state-owned (SO), urban collective-owned (UCO), rural units (RU) and others. Other units in Figure 8 include Urban Private and Individuals, Joint Owned, Share Holding, Foreign Funded, Overseas Chinese from Hong Kong, Macao & Taiwan Funded and others. This units account for very small number with 491,000 employees in 1995, only 2% of the total employment in the construction industry.

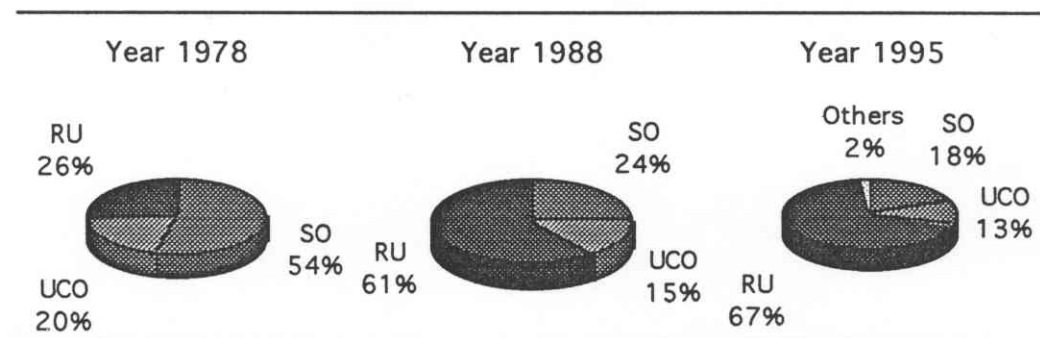


Figure 8 Employment Change by Ownership

## CONCLUSION

China is attempting a unique transition from a planned economy to a socialist market economy, without parallel in any other country. The reform has lead to massive

economic growth since 1978 which have provided a lot of opportunities to overseas business.

The market is there; the potential is huge, and nobody should ignore it. However, it is not yet a free market, and two features exist in the Chinese market: the plan-based at macro level, and the market-based at micro level. Therefore, to understand the market the key issues must be considered, and western approaches can not be applied fully there.

The Chinese construction market provides a big opportunity. However, doing construction business there is not easy. Learning costs should be budgeted for and short term profits are not easy to obtain.

It should never be forgotten that in such a big country, the geography feature, natural resources, changes in government policies and people's demands, make economic development of each region very different.

Competitive advantages, business culture and organisation structures need to be considered in the selection of construction projects, negotiating with Chinese people and finding good local partners.

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