

## Opportunities for the Development of China's Purchasing

a report by

**Professor He Mingke**

*Professor, Logistics Management, Business School of Beijing Technology and Business University of China*



He Mingke is Professor of Logistics Management in the Business School of Beijing Technology and Business University of China. He has been Head of the school since 1993 and Vice President of China Federation of Logistics and Purchasing (CFLP) since 2001. He was previously Visiting Professor of Gothenburg University of Sweden in 2002 and 2003. Professor Mingke presented papers at the 2000 World Congress of International Federation of Warehousing and Logistics in Paris in 2000 on behalf of China Federation of Warehousing and Logistics and at the IFPMW World Congress in Lucerne, Switzerland, in 2003 on behalf of CFLP. Professor Mingke is a frequent and well-known speaker in China's logistics industry and is a senior consultant to many companies. He has published more than 100 papers and 10 books and completed six nation-level research projects.

### Brief Introduction to China's Purchasing

The robust advancement of the Chinese economy promotes the development of China's procurement. Purchasing in China consists of government procurement and company purchasing and also of purchasing in China and abroad by domestic and international companies. In 2002, purchasing by the Chinese government and domestic and foreign invested companies in China from foreign countries was US\$300.16 billion (24.27% of Chinese gross domestic product (GDP) for the year), and purchasing by foreign governments and foreign companies from China was US\$320.64 billion (25.92% of Chinese GDP in 2002). Foreign invested companies in China sourced US\$169.94 billion worth of products from China in 2002 – an increase of 27.4% over that in 2001 – and the foreign invested companies in China made purchases abroad worth US\$160.29 billion – an increase of 27.04% over the previous year. The procurements from both China and foreign countries made by the foreign invested companies in China accounted for 13.73% and 12.95% of GDP in 2002, respectively.

The fact that the import and export volumes increased sharply in the first year after accession to the World Trade Organization (WTO) revealed that the sourcing scales by the multinational companies (MNCs) from China and by Chinese companies from abroad are likely to continue to increase. At the same time, China's government procurement has just started, so there will be dramatic growth in government procurement with the expansion of the government budget scale of China. Now, the increase of the proportion of government procurement to the government budget expenditure is reinforced by related laws. With the adoption of an internationalisation strategy, Chinese companies will extend their sourcing abroad too. For example, some well-known big brands in China, such as PetroChina, Sinopec, Shanghai Bao Steel, China Telecom, Haier and Lenovo, etc., have set up their own worldwide sourcing networks.

### Opportunities for the Development of China's Purchasing

The purchasing scale, advantages and effectiveness of a country are enslaved to the economic development of the country. The progress of China's economy provides a wide market for foreign products and meanwhile offers plentiful competitive goods that can be sourced by overseas companies. The development of sourcing in China and selling in China is the result of the globalisation of the Chinese economy, which creates great opportunities for China's purchasing.

#### Global Manufacturing Sites in China

By 2002, more than 400 companies had already invested in China and nearly 400 companies had set up research and development centres with Fortune 500 top companies. The leading manufacturers in the world in the fields of integrated circuits, computers, information products and cars, etc., such as Motorola, Nokia, Sony, Siemens, Intel, IBM, General Electric, Bell, Samsung, General Motors, Honda, Toyota and Volkswagen, have set up their world manufacturing centres in the following Chinese cities: Shanghai, Beijing, Guangzhou, Tianjin, Shenzhen, Wuxi, Suzhou, Nanjing, Dalian and Qingdao, for example. By the end of 2002, Intel had invested more than US\$500 million in the integrated circuit assembly plant in Shanghai, with plans to set up a manufacturing base in Xi'an, Shaanxi Province. From May 2003, it began to sell Pentium 4 processors made in Shanghai, China, to the world.<sup>1</sup>

There are many reasons for foreign companies to build their global manufacturing sites in China. China is the biggest potential market in the world. The manufacturing sites built in China can help to meet local market demands.

China's economy has been developing at an average annual speed of 9.5% for almost 20 years. In addition, the low price, low inflation and stable policies attract foreign investors to make long-term investments.

1. Wang Yuzhong, Intel began to sell the Pentium 4 processors made in Shanghai, China, "Sina News", <http://www.sina.com.cn>, 15 May 2003.

The labour cost in China is low, but the quality of the human resources is very high. There are more than two million new graduates in China every year. Comparably, the salary of a common worker in China is US\$0.50 per hour, on average, but it is US\$2.30 in Mexico and US\$0.80 in India. Therefore, the Chinese workforce has obvious comparative advantages in the world, and the manufacturing cost of products in China is low. Generally speaking, sourcing costs in China can be 20% to 50% lower than for similar products in other countries.<sup>2</sup> It is therefore economical to make products in China and sell them worldwide.

China is open to the outside world with the most attractive foreign investment policies and the most favourable services and infrastructure. After entry into the WTO in 2001, China's economy is deeply integrated with world economy. The Chinese government protects overseas interests by enforcement of laws.

The Pearl River Delta, the Yangtze River Delta and the Bohai Sea Belt of China have already been invested in heavily by foreign interests. They are the main world manufacturing sites in China with a strong aggregation effect, and all foreign investments have gained good returns. Thus, the majority of foreign investors in China plan to expand their investment and sourcing in China. At the same time, an export-oriented industrial structure and supply chain have been established, so any kind of product can be made in China. Foreign manufactures in China can source locally so as to reduce sourcing costs of raw materials made by MNCs in China.

China has gradually established its market economic system, which helps to integrate the Chinese market with the global market. More MNCs plan to set up their manufacturing sites in China because they hold optimistic views on the long-term development of China.

### **Global or Asian-Pacific Sourcing Centres in China**

China is now the location of global or Asian-Pacific sourcing centres for more than 200 MNCs. Nearly 30 well-known MNCs have set up their global or Asian-Pacific procurement headquarters in Shanghai alone. Some have expanded their purchasing scales in China, for example Wal-Mart will purchase US\$15 billion worth of goods in China in 2003, and US\$2.5 billion was sourced by Dell in China in 2002. Other well-known multinationals, such as Hewlett-Packard, General Motors, General Electric and Carrefour, etc., spend above US\$1 billion yearly on sourcing in China.

Products and services sourced in China by MCNs vary from satellite launching equipment, aeroplane empennages for Boeing, the biggest oil tankers in the world, rice crossbreeding technology, silk clothing and Christmas trees to toys for children. In order to provide convenience for MNCs with procurement in China, multinational sourcing centres have been built in some developed cities of China, such as Shanghai, Beijing, Guangzhou, Tianjin, Shenzhen, Dalian, Qingdao, Nanjing and so on. Governments of all levels, cities and companies of China are all ready for large-scale procurement by more foreign companies. In fact, many cities hold international sourcing fairs every year. The Chinese Export Commodities Fair in Guangzhou has been held 93 times. Chinese suppliers or foreign suppliers in China are the sourcing channels dependent on MNCs.

### **Sourcing Abroad by the Chinese Government and Companies**

Currently, Chinese people, especially the younger generation, are proud of consuming foreign brands. Chinese consumption is becoming increasingly internationalised. Every fashionable product or service in the world is likely to prevail or has already prevailed in China. The haute couture of Paris may sell more and may be more expensive in China than in Paris. There are steady consumption colonies in China for well-known Swiss watches. This fashion-oriented consumption creates a large group of consumers of high-grade goods and services in China.

According to the ambitious infrastructure construction plan of China in the coming 20 years or more, Chinese government and companies will source, by international bidding, asphalt originating from the Trinidad Lake of Trinidad and Tobago, a magnetic levitation or high-speed train system and its technology and the automatic fare collection system on the subway from Germany, Airbuses from Europe, Boeings from America, nuclear power and airport management technologies from France, computer hardware and software from America and heavy construction machinery from Japan, for example. Because the Chinese market has become an internationalised market, to satisfy these demands, sourcing abroad is a must, otherwise the related multinationals had better establish factories in China to produce the products locally.

### **Enforcing Government Procurement Law**

Sourcing of goods and services listed in the government's budget should be open to the world. Chinese government procurement amounted to

2. Zhang Tingbin, "Go to Shanghai for shelter: intuition or illusion", 21 Century Economic Guide, 28 April 2003, p.29.

US\$12.7 billion in 2002 (0.97% of GDP for that year), which will be up to US\$29.3 billion in 2005. Compared with developed countries, the proportion of Chinese government procurement is still low, but will increase gradually in the future, so there are plenty of opportunities for international suppliers. The Procurement Law of the People's Republic of China (the first purchasing-related law for regulating the behaviour of government procurement) was implemented on 1 January 2003. The law includes the regulations and mandatory requirements for the behaviour of the Chinese government, the enforcement of which is the representation of China's commitment to implementing government procurement protocol with the WTO. Accordingly, the relevant laws have also been promulgated, for example the Bidding and Tendering Law of the People's Republic of China and the Anti-Unfair Competition Law of the People's Republic of China. These laws play an important role in eliminating corruption in procurement, reducing government procurement cost, increasing efficiency and maintaining market order in impartial competition and providing a legal guarantee for international suppliers to participate in competition in government procurement.

#### **Favourable and Attractive Foreign Investment Policies and a Gradually Perfected Investment Environment**

The Chinese government is aware that the development of China's economy relies heavily on investments from private sector and foreign channels. Therefore, a lot of economy and technology development zones have been set up in many cities. These zones are all free-trade areas, where very favourable policies are applied, including tax reimbursement for export, reduction or remittance of some expenses and taxation when purchasing with international sourcing centres in China, favourable and flexible foreign currency management policies, preferential policies in land renting for the building of sourcing centres and in talents employed by the sourcing centres in China, etc.

In spring and summer 2003, China was attacked by Severe Acute Respiratory Syndrome (SARS) – a new type of virus to human beings. As a result, business people made enquiries for quotations, negotiated with their remote partners and placed orders on the Internet. Accordingly, e-commerce developed at high speed in China in this period, which facilitated the development of China's purchasing because e-commerce is a facility of purchasing. In order to support the further magnification of foreign trade and rapid progress of

the domestic economy, the Chinese government has strengthened the construction of roads, railways, seaports and airports. To adapt to the fast growth in air transport of passengers and cargo, China is transforming three trunk airports in Beijing, Shanghai, Guangzhou into hub airports, meanwhile reconstructing and building other airports to become spoke airports accordingly so as to shape them into a hub-spoke airport network.

China has also developed a comparatively perfect logistics infrastructure, including logistics centres and distribution centres, which can support large-scale and rapid procurement and distribution operations. The Chinese logistics industry is growing at a 20% to 30% increase every year.<sup>3</sup> Now, most of the foreign logistics partners of transnational purchasing companies have relocated to China with them. At the same time, the local third-party logistics service providers of China are also advancing rapidly. Currently, Chinese Customs is implementing the Integrated Customs Clearance Plan to integrate order processing, taxing, auditing, cargo inspection, quarantining, information processing and other related operations in Customs clearance. According to the new plan, the cycle time in Shanghai Customs for Customs clearance is shortened to four hours at the quickest from 12 hours previously. Other Customs departments in China are taking Shanghai as an example. The Chinese government is determined to perfect the logistics environment required by global manufacturing sites and global sourcing centres.

#### **The Bigger Role of Non-governmental Organisation**

To strengthen the self-discipline and management of the Chinese purchasing industry, the central government approved the establishment of the China Federation of Logistics and Purchasing (CFLP). The mission of CFLP is to promote the growth of the Chinese procurement industry, the increase of purchasing efficiency, the reduction of procurement cost, the recommendation of international products and services, the improvement of the quality of products manufactured in China, the elimination of procurement corruption and the performance of government function, etc. So far, members of CFLP are all well-known companies in purchasing, logistics, transportation, warehousing, distribution, IT, consultation, education, exhibition and other services related to logistics and procurement. CFLP plays an important role in helping the domestic and foreign enterprises and government to deal with procurement business in China and the rest of the world.

3. Morgan Stanley consultation report, "China Logistics", 2002.

### Conclusion

All in all, China is the biggest emerging market in the world. China's market is a market for global manufacturers, suppliers, distributors, consumers and other operators who provide products and services. It is a market for profit-seeking investors. When large groups of MNCs set up their global manufacturing sites and global sourcing centres in China, purchasing in China becomes economical.

With the promulgation and enforcement of related purchasing laws, the perfection of logistics infrastructure and the functioning of non-governmental organisations like the CFLP, Chinese

procurement must contribute greatly to the development of China's economy. ■

### Additional References

*China National Statistics Bureau, "Statistical Communique of the People's Republic of China on the National Economic and Social Development in 2002", <http://www.stats.gov.cn>*

*Kym Anderson, Jikun Huang and Elena Ianchovichina, "Long-Run Impacts of China's WTO Accession on Farm-Nonfarm Income Inequality and Rural Poverty", The World Bank Research Record, [http://econ.worldbank.org/files/26863\\_wps3052.pdf](http://econ.worldbank.org/files/26863_wps3052.pdf)*