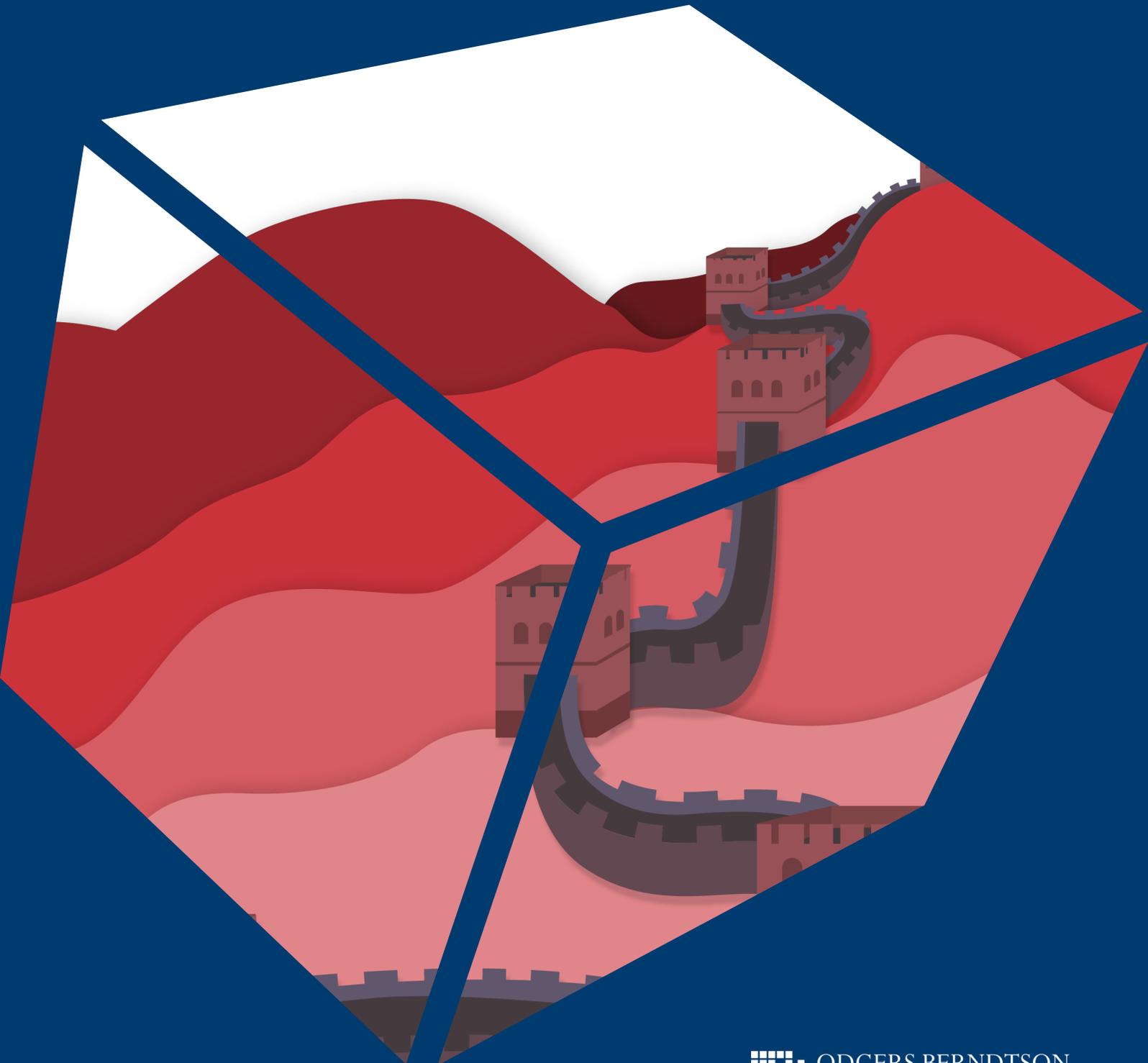


Odgers Berndtson Technology Pulse - China



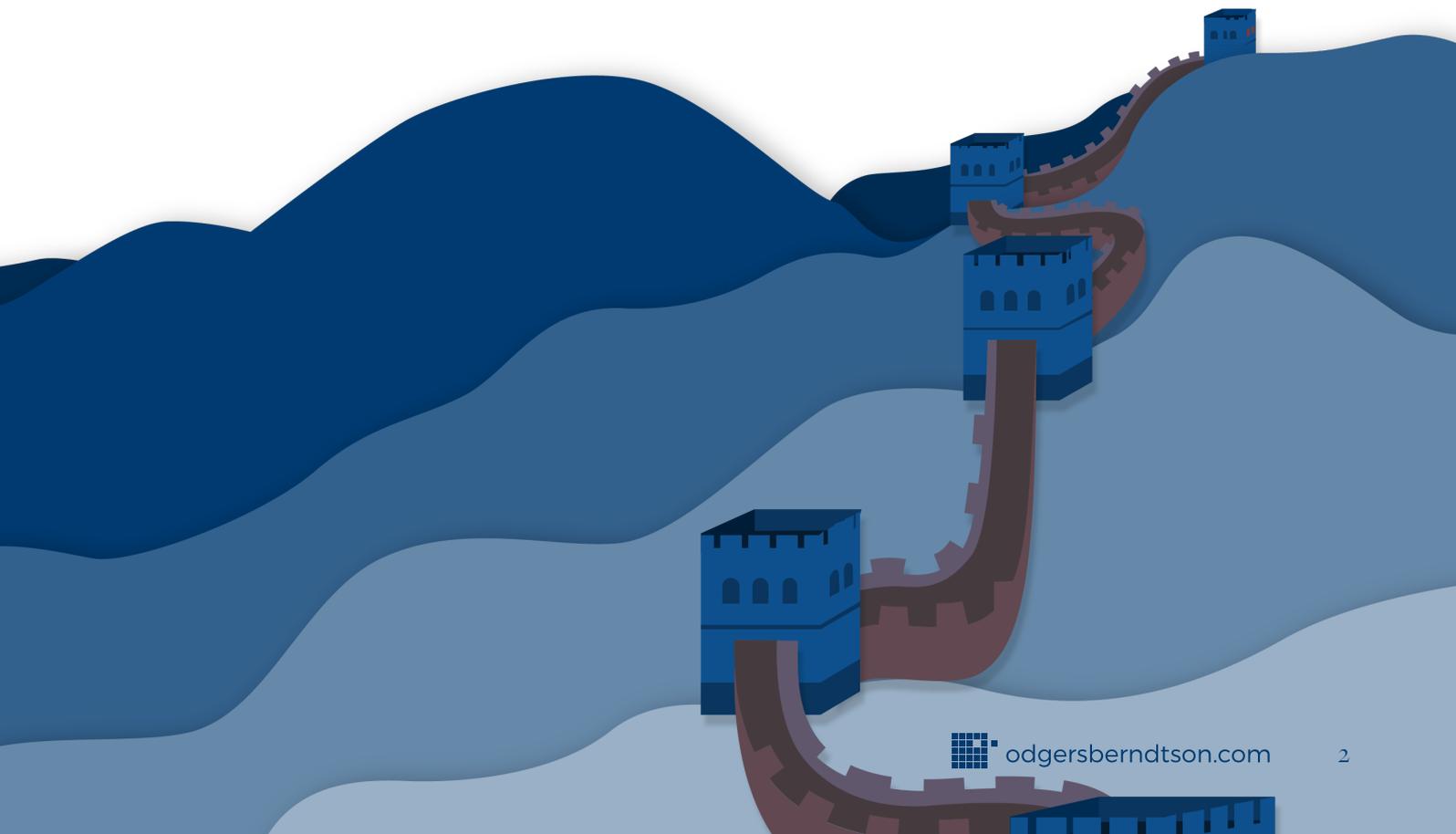
Insights from the experts

Most technology MNCs are facing the critical question of how to transition their businesses in today's fast-paced, disruptive technology market, having to re-define business models and go-to market strategies in order to capture future market share. They are facing the enormous challenge of working, partnering and competing with Chinese tech companies, many of which already lead the trends. One has only to think of Alibaba in the digital commerce space and Tencent's Super Apps WeChat.

To explore and identify how businesses have been impacted by disruptive technologies, Odgers Berndtson interviewed almost thirty business leaders from sizeable European, American and Chinese enterprises based within Greater China. Our aim was to probe their perceptions of the current and future tech market in the region.

From discussions, four key areas emerged as crucial for consideration by tech companies. They are presented here as:

- New technology market – public cloud computing and SaaS: off-premise IT solution
- Traditional IT market: on-premise IT solution
- Challenges for tech MNCs in China
- Reasons for optimism: Why tech MNCs in Greater China expect a bright future



Where to for IT?

According to a recent report by Bain & Company, cloud computing, e-commerce and SaaS (Software as a Service) are key business focuses for most technology companies. Given the significant government support for home-grown technologies and the lack of existing infrastructure, China is adopting the new technology of computing and IT architecture at a rapid rate, and aggressively narrowing the technology gap between China, the US and other developed nations.

Evolution of computing models

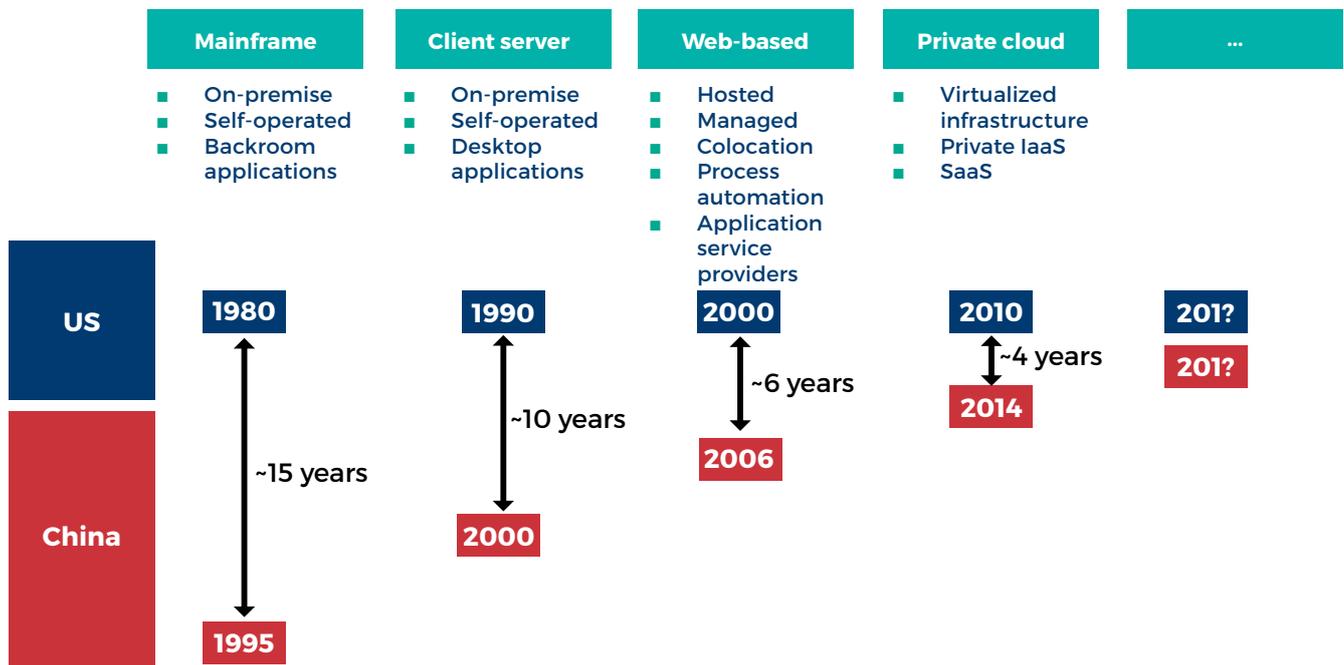


Figure: China's adoption of computing model and IT architecture have historically followed that of the US, but the lag has shortened considerably. **Source:** Bain analysis; industry interviews

The evolution of the Chinese economy – its impact on the China Tech market:

China is facing its lowest economic growth rate in 25 years, but remains the largest GDP growth contributor in Asia and is still regarded as one of the most dynamic and complex markets globally.

With the implementation of the 13th China five-year plan, China is clearly switching its economic growth strategy from traditional manufacturing, construction, natural resources and import & export to technological innovation. Heavy investments have been planned and deployed in national science and research institutes, with the Chinese venture capital market supporting domestic technology start-ups.

According to a recent Bloomberg report, the Chinese government is managing a USD 338-billion fund to drive the concept of “everyone is an entrepreneur; creativity of the masses”. Its aim is to develop new GDP growth engines, by encouraging domestic technology innovation in the light of advancements in internet access, mobile and digital commerce and technology services. At the same time, the Chinese government is also motivating Chinese enterprises to be more proactive in developing their international presence through both organic and inorganic growth.

The “Internet Plus” plan, proposed by China’s Prime Minister, Li Keqiang, is another strong indication that the Chinese government is committed to encouraging the development of new technologies and the integration of new technologies with traditional industries.

China is undoubtedly evolving its economic model to ensure healthy future growth.

China’s new way forward:

- 1. Shifting consumption**
- 2. Increasing digital commerce and services**
- 3. Moving from imitation to innovation**
- 4. Going global**
- 5. Revitalizing the core**

Source: World Bank; Mickinsey Global Institute analysis

Ten priority strategic industries

	The next generation information technology		Energy saving and new energy vehicles
	Numerical control tools and robotics		Power equipment
	Aerospace equipment		New materials
	Ocean engineering equipment and high-tech ships		Medicine and medical devices
	Railway equipment		Agricultural machinery

Source: PWC report: Prosperity for the masses by 2020

New technology market: Off-premise IT solution

60% of our interviewed business leaders, particularly those who lead public cloud and SaaS businesses, feel positive about the new technology market. In their view, the on-premise IT market is where critical challenges lie, with recent sales showing significant decreases.

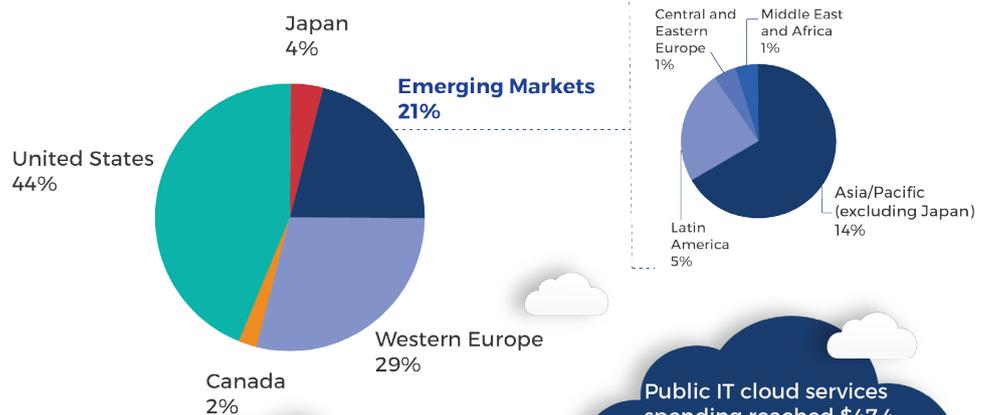
According to Gartner, the worldwide public cloud service market grew by 16.5% in 2016, to a total of USD 204 billion, up from USD 175 billion in 2015. Gartner saw SaaS growing by 20.3% in 2016, to USD37.7 billion. IDC research has predicted that the value of SaaS globally will reach USD 112.8 billion by 2019.

What does this cloud growth look like?

\$127B Worldwide Public IT Cloud Services Revenue in 2018¹

\$256B The managed services opportunity in 2018²

1. 2014 IDC study commissioned by Microsoft
 2. Markets and Markets: Managed services markets worth \$256.05 Billion by 2018(c) 2014 M2 COMMUNICATIONS



Public IT cloud services spending reached \$47.4 billion in 2013, and will grow 5 times faster than the IT industry as a whole

Emerging markets will grow 1.8X faster than developed markets and by 2017 will account for 21.3% of the public cloud opportunity

Source: Microsoft Cloud Landscape Update 2015 rhipe Limited

Technology Business Research shared similar findings: “Data centre hardware suppliers are seeing their profits dwindle as enterprises adopt virtualisation, and hyper-convergence and cloud technologies divert IT budgets away from traditional servers, storage and networking kits.” Technology Business Report also reported data centre hardware suppliers saw a 4.3% year-on-year drop in revenue during the second quarter of 2016, with IT companies suffering a 5.4% fall in gross profit.

One business leader mentioned that “companies are relocating their IT investment budgets in software-defined functionality and service-based delivery towards data centre consolidation initiatives. Companies like F5, A10 and Akamai that specialise in SDN (Software-Defined Networking) are enjoying a significant growth in FSI, government and e-commerce spaces.”

Business leaders are fighting hard to restructure their organisations and product/solution offerings, developing new business models to maximise market share. It is an interesting and critical time for traditional on-premise IT companies; company “re-invention” is essential. In the near future, it is possible that we will witness the fall or rise of both large IT empires and new start-ups.

An interesting insight from one of the Greater China business leaders was, “With the disruptive technology of public cloud, today’s China tech market is like the Warring States period in Chinese history; companies are either actively moving towards to the cloud war, or they are being forced to.”

More than one leader commented that “China is adopting new technologies on the public cloud faster than expected.” Companies that have witnessed significant growth in the public cloud space are AWS, Microsoft, Google, Aliyun and others. This does not leave much room for on-premise IT infrastructure businesses. As China has fewer existing infrastructure concerns, companies can be extremely flexible in switching their business IT to the public cloud platform.

“With the disruptive technology of public cloud, today’s China tech market is like the Warring States period in Chinese history; companies are either actively moving towards to the cloud war, or they are being forced to.”

In summary, business leaders point to the following as key drivers for SaaS and public cloud solutions in Greater China:

- Leaner alternatives with lower upfront expenditure, given the need for tighter capital budgets during the current economic down-turn
- Improved productivity, connectivity and efficiency
- More predictable ROI.

Traditional IT: On-premise IT solution

On the flip side, about 40% of the interviewed business leaders see promising market growth for traditional on-premise IT infrastructure companies, helping Chinese enterprises and government bodies to expand their in-house business IT environment. These traditional IT optimists also share positive views on off-premise IT solutions for the long term, but see challenges for implementation in China due to a number of critical factors:

“Apart from China, the rest of the world seems to be in favour of the public cloud. Given that China has challenges with data security and sensitivity, Chinese enterprises, especially state owned enterprises (SOEs), might prefer to further develop their own in-house, on-premise IT infrastructure.”

Regulation and security: The Chinese government has a very strong influence in determining where and how to store sensitive data across industry sectors; in particular, in the telecom, healthcare and financial services sectors. Some comments from business leaders:

“Apart from China, the rest of the world seems to be in favour of the public cloud. Given that China has challenges with data security and sensitivity, Chinese enterprises, especially state owned enterprises (SOEs), might prefer to further develop their own in-house, on-premise IT infrastructure.”

“Companies like Aliyun, AWS and Oracle are investing a lot in the public cloud in China, but their services and applications focus on social media rather than on mission-critical applications for enterprises or the public sector.”

Support and monitoring: Off-premise platform or service providers have little understanding of their clients’ businesses. They may find it efficient or cost-effective to manage common IT problems, but are not necessarily equipped to understand and solve clients’ core business IT issues.

“To me, off-premise IT services are somehow similar to shared-services, and there is only a number of tasks that can be carried out by shared services. Major business activities still need to be led or managed by the core intern business team.”

“Off-premise and on-premise have different agendas and levels of understanding of the service and support needed. Also, there is the issue of priorities; the efficiency and profitability of my business versus the efficiency and profitability of the platform which supports hundreds or thousands of companies.”

Customisation: On-premise IT infrastructures allow companies to freely design and deploy business IT systems, tools and applications, but off-premise platforms offer only standard services with limited levels of customisation.

“In China, small firms and start-ups might benefit more from the public cloud; however, large enterprises may still prefer to invest more in their in-house, on-premise IT infrastructure to achieve higher levels of customisation and data security.”

Challenges for Tech MNCs in China

The following themes were identified through our interviews:

“As the market is becoming more and more competitive and dynamic, we need to become more focused yet flexible to adapt to market changes.”

Business strategies and models need to adapt to the changing market:

- “There is a strong need to re-define the business model to capture China’s new technology market. We cannot replicate market approaches from the US, Europe or even any countries in Asia.”
- “The business model had to change. Most companies are transitioning from product to platform, and cloud is one of the key tools for driving this initiative. For example, Gmail has become the main access point to enter the Google platform, in order to connect with its other applications and third-party services. Other examples are Microsoft, Apple, Amazon and Facebook. Similar Chinese companies would be BAT (Baidu, Alibaba and Tencent), Xiaomi and Didi.”
- “Companies have to keep examining existing product offerings in the light of market trends; look for any gaps between what they have and what is needed. Those gaps change fast—you have to be quick!”
- “For us the critical question is how to steal market share from existing products and solution lines and create a greater need for new technologies and service offerings.”
- “A higher degree of flexibility and customisation needs to be considered when designing the business strategy and model, to add more competitive advantages within the China market.”
- “The biggest challenge for us is balancing standardisation and flexibility.”
- “In a game of chess, the player needs to think of the next five moves in advance in order to win. Likewise, playing in the dynamic cloud space, a leader needs to be a visionary and a strong decision maker.”
- “We had to re-evaluate the key differentiators of our product and solution offering, re-study the unique selling proposition for the company, and become more focused and driven on our core competency.”
- “As the market is becoming more and more competitive and dynamic, we need to become more focused yet flexible to adapt to market changes.”

“There is strong local competition such as BAT, Baihui, etc. Local tech companies are getting stronger, and local players are also going global. For example, Aliyun opened its first US data centre in Silicon Valley early in 2016.”

Recognize the competition:

- “There is strong local competition such as BAT, Baihui, etc. Local tech companies are getting stronger, and local players are also going global. For example, Aliyun opened its first US data centre in Silicon Valley early in 2016.”
- “Chinese technology innovations on social media have made local companies market leaders, rather than followers—for example, WeChat. It is a combination of Facebook, Twitter, PayPal and Amazon. Didi is another example—a Chinese version of Uber.”
- “Start-ups are springing up like mushrooms in China!”
- “Competition is fierce. We have to come up with more value-added services.”
- “There is a need to strengthen R&D, as the NPL (New Product Launch) or product upgrade rate on cloud is a weekly process, compared to a quarterly or yearly process for the traditional IT business.”

Is the China market ready to adopt new technologies?

- “The China market is certainly more willing to apply the public cloud in non-critical businesses, but it will be a long journey before Chinese enterprises adopt the public cloud for critical businesses.”
- “I am not sure that there is sufficient market maturity for China and Greater China to accept new technologies and solutions on the cloud or SaaS. There might be a two to three year gap for the China market to be fully ready.”
- “How do we balance investment and resources between existing traditional software, which contributes 80% to 85% of the business revenue, against the most popular cloud technologies, which require heavy investments whilst contributing less than 20% of company’s revenue? It’s a challenge.”
- “One of my key challenges is to ensure that our regional office has a good understanding of the China market, in order to set and manage their expectations. The success of new technology markets might not necessarily be measured in revenue, as all the major

“The business culture in China has changed; traditional ‘relationship sales’ is no longer the key for winning new business. The solution and consultative approach is now playing a much more critical role. Our talent needs to reflect this.”

off-premise platforms or service vendors are still at the market investment stage.”

Bear in mind regulatory limitations and strong government support for domestic companies:

- “Government regulations give a strong signal of support for ‘home technologies’. For example, you’ve got de-IOE, IBM, Oracle and EMC which are being replaced by Lenovo, Huawei and Inspur.”
- “The Chinese government is pushing and encouraging local technology innovation.”
- “China’s strong intention to protect and develop local technology firms will raise the market barriers for MNCs.”

Understand the local partner eco-system for technology and services:

- “We need to be more creative in working and partnering with local companies in achieving top-line growth.”
- “The capability of service partners in both selling and delivering cloud solutions is pretty crucial.”
- “Partners are not always proactive in investing resources or money into the cloud or SaaS.”

Make the most of the local talent pool:

- “There is no lack of raw talent in China. The gap lies in senior coaches and mentors to grow that talent to leadership level.”
- “Do we hire and promote from within the organisation and invest time in training, or look outside for experienced and ready talent? This is a constant dilemma.”
- “Companies need to take more risks in hiring, as proven talent may not exist.”
- “We need to increase the level of internal collaboration between cross-functional teams, in order to provide a better customer experience. It takes a different approach in hiring and training.”
- “The business culture in China has changed; traditional ‘relationship sales’ is no longer the key for winning new business. The solution and consultative approach is now playing a much more critical role. Our talent needs to reflect this.”

Reasons for optimism: the future of Tech MNCs in China

Our respondents believed that amazing opportunities exist for MNCs in China if they have the flexibility and strategy to read and respond accurately to market changes:

- “The hardware technology gaps between China and other developed countries are closing fast, but there is still a long way to go for Chinese tech companies to catch up in the enterprise-related application, software and services space. One of the key reasons is that China lacks depth of industry know-how. For example, SAP’s success was built upon its deep understanding of its home country’s great engineering and industrial evolution. Here, as in the US, its advanced branding and marketing experience provides the quantified measurement model for companies like Salesforce.com, Microsoft, Adobe, Oracle, etc. to develop their sales management, user experience and customer-relations management solutions.”
- “Chinese tech companies might have the most flexible and customised solutions for sales and marketing companies in China, but lack the ability and the know-how to develop or provide enterprise solutions to leading Chinese enterprises to fulfil China’s strategy of overseas market expansion.”
- “Government regulations and support for local companies will certainly help China businesses grow stronger initially, but without continued investment and innovation in product development, they will never be key players in the market. For example, Kingdee and Yonyou were key local ERP players, but nowadays, most large SOEs and privately-owned Chinese companies still prefer to use solutions from SAP, Oracle, Microsoft and QAD. Local technology vendors cannot fulfil their business needs. “
- “Many Chinese companies are acquiring international companies globally and are not only buying the technology and people, but also gradually learning how to manage their businesses like MNCs. The acquisitions journey has been a tremendous learning curve for sizeable Chinese companies, enabling smarter investments in critical business functions. They have become more open to adopting advanced solutions supporting their businesses, not only in Greater China but globally.”

Conclusion

The message from the Greater China leaders interviewed by Odgers Berndtson is clear:

IT companies in Greater China need to be shrewd in managing their on/off-premise solution balance. Off-premise technology such as public cloud and SaaS are the direction in which the economy is moving, yet traditional on-premise business is still where greater revenues lie, given the regulatory environment and the high level of customisation required. Diversification, localisation of products and services, and training of talent to match the new process-driven approach is essential for tech companies to remain competitive, but the prize is not easy to win.

The key challenges discussed in this paper are complex and will remain so for the foreseeable future. It is an exciting and challenging time for IT companies, with core competencies needing to be defined and strengthened, and a leaner, more focused approach adopted. The next big transition is underway; the winners will be those who see the wave and ride it, demonstrating nerves of steel and a combination of great patience and agility.





ABOUT THE AUTHOR

Frank Xu is a consultant for Odgers Berndtson in Singapore. He specialises in executive search across the TMT (Technology, Media and Telecom), Digital Commerce and Entertainment sectors, with a particular focus on Greater China and Asia.

Frank has rich experience in project execution, candidate universe development, talent mapping and candidate assessment. He has an excellent track record in helping clients to fill critical leadership positions such as General Manager, Chief Technology Officer, Director of Business Development, Marketing Director, Group CFO, Finance VP and Managing Director. Prior to joining Odgers Berndtson, he was with a US executive search firm, where he moved from Research Associate to Associate Consultant, focusing on senior search assignments in Greater China region. Frank has over seven years' education and working experience in UK, holding a Master's degree in Marketing from the University of Bath

Frank Xu

Consultant
Odgers Berndtson
158 Cecil Street, #06-02,
Singapore 069545
Telephone: +65 9853 8316
frank.xu@odgersberndtson.com

OUR TECH TEAM IN APAC



Andie Rees
Singapore
andie.rees@odgersberndtson.com
+65 9029 9992



Paul Kelly
Sydney
paul.kelly@odgersberndtson.com
+61 2 8905 3710



Gaurav Seth
New Delhi
gaurav.seth@odgersberndtson.com
+91 124 4758302



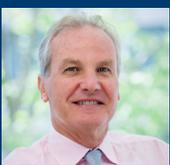
Paul Rush
Sydney
paul.rush@odgersberndtson.com
+61 2 8905 3734



Johan Uittenbogaard
Tokyo
johan.uittenbogaard@odgersberndtson.com
+81 3 6206 1878



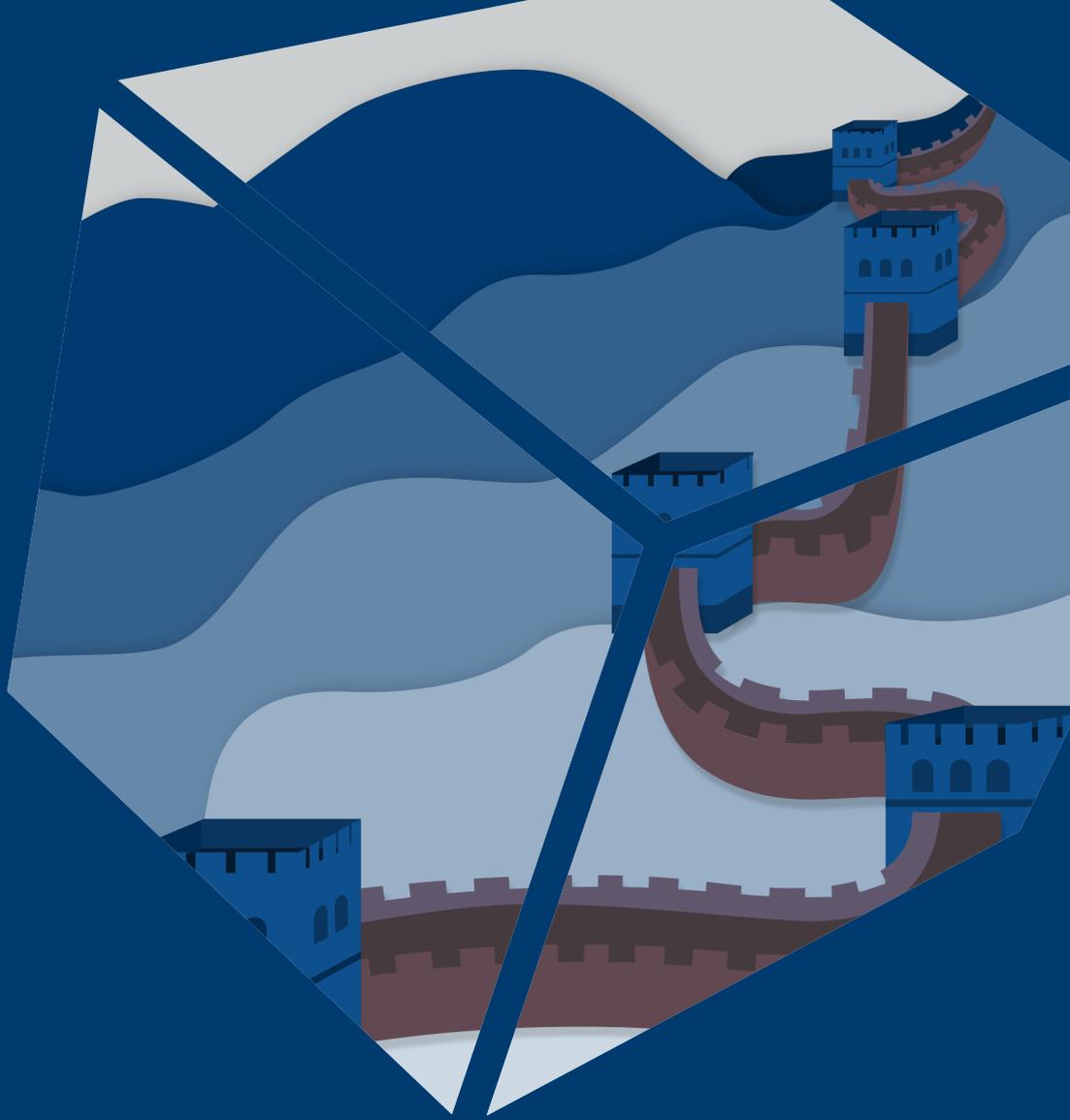
Steve Ford
Sydney
steve.ford@odgersberndtson.com
+61 2 8905 3715



Mark Pretty
Sydney
mark.pretty@odgersberndtson.com
+61 2 8905 3708



Tim Sleep
Sydney
tim.sleep@odgersberndtson.com
+61 2 8905 3723



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