Sector Report

The Construction Sector in China
China’s economy is in the midst of structural change. Sustainability and quality are the cornerstones of “new normal” theory (18th CCCPC 3rd Plenary Session, November 2013), which reaffirms that slow growth is a precondition to an equitable economic structure. The services industry and innovation are key drivers. In the meantime, China’s construction sector is facing a downturn. An immediate effect of China’s new policy perspective was the National New-Style Urbanization Plan (2014–2020), together with sustainable urban development. These are based on basic human needs, such as quality of life. To stabilise economic conditions, shift to the up-value chain, and rescue the construction sector from its current downturn, the Chinese government has begun implementing actions to increase growth rates in the real estate market.

The bulk of the construction market is dominated by Chinese enterprises. However, niche markets, which are available to foreign companies, can grow quickly and be very profitable. The rapid changes in many aspects of the Chinese society have created opportunities for companies that can offer technologies to support labour productivity, energy saving, and high quality products and services. Entering the Chinese market is both an enormous challenge and a good opportunity for European SMEs.

Table of Contents

1. The Construction Market in China ........................................................................... 4
   1.1 A Definition of the Construction Sector ................................................................. 4
2. Regulation .................................................................................................................... 4
   2.1 Regulators ............................................................................................................. 4
   2.2 Real Estate Market Control and Foreign Investment ............................................. 6
   2.3 Green Housing Policies ......................................................................................... 6
   2.4 Social Housing Policies ....................................................................................... 7
   2.5 Builders’ Permits .................................................................................................. 7
3. Market Size .................................................................................................................. 8
   3.1 Green Development ............................................................................................. 11
   3.2 Regional Differences ........................................................................................... 12
   3.3 Who is Servicing the Market? ............................................................................... 14
   3.4 The S-curve Shift ................................................................................................ 15
   3.5 Forecasts ................................................................................................................. 16
4. Major Trends and Industry Drivers ............................................................................... 17
<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1</td>
<td>Continuing Urbanisation</td>
<td>18</td>
</tr>
<tr>
<td>4.2</td>
<td>Demographics</td>
<td>20</td>
</tr>
<tr>
<td>4.3</td>
<td>Regulation</td>
<td>20</td>
</tr>
<tr>
<td>4.4</td>
<td>Economic Growth</td>
<td>20</td>
</tr>
<tr>
<td>4.5</td>
<td>Social Aspects</td>
<td>20</td>
</tr>
<tr>
<td>4.6</td>
<td>EU-China Partnerships and Initiatives</td>
<td>21</td>
</tr>
<tr>
<td>4.7</td>
<td>Labour Efficiency</td>
<td>23</td>
</tr>
<tr>
<td>4.8</td>
<td>Energy Efficiency</td>
<td>2</td>
</tr>
<tr>
<td>4.9</td>
<td>Design and Quality</td>
<td>24</td>
</tr>
<tr>
<td>5</td>
<td><strong>Opportunities for European SMEs</strong></td>
<td>26</td>
</tr>
<tr>
<td>5.1</td>
<td>China is not about Making a Fast Buck</td>
<td>26</td>
</tr>
<tr>
<td>5.2</td>
<td>The Basic Building Blocks: Know-how, Brand and Niche</td>
<td>26</td>
</tr>
<tr>
<td>5.3</td>
<td>Opportunities Offered by the “National New-Style Urbanization Plan (2014-2020)”</td>
<td>26</td>
</tr>
<tr>
<td>5.4</td>
<td>Labour Efficiency</td>
<td>2</td>
</tr>
<tr>
<td>5.5</td>
<td>Energy Efficiency</td>
<td>30</td>
</tr>
<tr>
<td>5.6</td>
<td>Design and Quality</td>
<td>31</td>
</tr>
<tr>
<td>6</td>
<td><strong>Challenges for SMEs</strong></td>
<td>33</td>
</tr>
<tr>
<td>6.1</td>
<td>The Basics: Risk Management</td>
<td>33</td>
</tr>
<tr>
<td>6.2</td>
<td>Timing it Right</td>
<td>34</td>
</tr>
<tr>
<td>6.3</td>
<td>Finding the Right Partner</td>
<td>34</td>
</tr>
<tr>
<td>6.4</td>
<td>Finding the Right Business Model</td>
<td>34</td>
</tr>
<tr>
<td>7</td>
<td><strong>Ways to Enter the Market</strong></td>
<td>35</td>
</tr>
<tr>
<td>7.1</td>
<td>Know your Market</td>
<td>36</td>
</tr>
<tr>
<td>7.2</td>
<td>Define your Business Model</td>
<td>36</td>
</tr>
<tr>
<td>7.3</td>
<td>Looking for a Partner</td>
<td>37</td>
</tr>
<tr>
<td>7.4</td>
<td>Characteristics of the Construction Sector</td>
<td>37</td>
</tr>
<tr>
<td>7.5</td>
<td>Implementation and Follow-up</td>
<td>37</td>
</tr>
<tr>
<td>8</td>
<td><strong>Conclusions</strong></td>
<td>38</td>
</tr>
<tr>
<td>9</td>
<td><strong>Resources</strong></td>
<td>40</td>
</tr>
<tr>
<td>9.1</td>
<td>Further reading</td>
<td>40</td>
</tr>
<tr>
<td>9.2</td>
<td>Exhibitions</td>
<td>42</td>
</tr>
<tr>
<td>9.3</td>
<td>Administration and Associations</td>
<td>42</td>
</tr>
</tbody>
</table>
1. The Construction Market in China

1.1 A Definition of the Construction Sector

The construction sector traditionally covers a wide and complex range of activities. Three main intertwined subdivisions – construction, services and materials – will be defined and discussed in this report.

a. Construction

Construction refers to project management and building activities usually carried out either in full by contractor companies or partially by subcontractors. Construction activities include building work, civil engineering and specialised construction activities.

b. Services

Services relate to companies who provide architectural and design services (drawings, calculations, plans and concept design), supervision and survey services, as well as wholesale.

c. Materials

This section will cover the materials and technical equipment used in construction activities. Chinese authorities use a classification system\(^1\) which is different from that outlined here. This paper will categorise construction industry products and services under the following headings:

- Building and civil engineering;
- Construction installation;
- Building decorations;
- Other construction.

2. Regulation

2.1 Regulators

A number of Chinese government departments are involved in regulating the construction industry. The major parties involved are listed below:

- The Ministry of Housing and Urban-Rural Development of the PRC (MoHURD) (www.mohurd.gov.cn) is responsible for the administration and supervision of construction work including licences, requirements, surveys, designs, tenders and bidding procedures. MoHURD is also responsible for the supervision and administration of construction enterprise requirements in China;

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\(^1\) Chinese standard GB/T 4754-2002, category E: Construction.
• The Ministry of Transportation of the PRC (MoC) (www.moc.gov.cn) is responsible for the administration and planning of ports, highways, waterways, airport constructions, water conservation projects and hydropower facility projects. MoC is also in charge of project maintenance and quality control. Meanwhile, the Ministry of Transportation also supervise the railways’ administrative functions, as the former Ministry of Railways was dissolved in 2013;

• The National Development and Reform Commission of the PRC (NDRC) (www.ndrc.gov.cn) is responsible for macroeconomic planning linked to the construction industry;

The Ministry of Environmental Protection of the PRC (MoEP) (www.zhb.gov.cn) is in charge of environmental protection administration and supervision during the construction process;

• The State Administration of Work Safety (www.chinasafety.gov.cn) is responsible for work safety supervision in construction projects;

• The Ministry of Science and Technology (MoST) (http://www.most.gov.cn/eng/) is responsible for science and technology development plans, policies, laws, regulations, and department rules relating to drafting and promotion. MoST is also responsible for implementing the work listed above;

• The Ministry of Industry and Information Technology (MIIT) (http://www.miit.gov.cn) is responsible for the postal service, the internet, wireless networks, broadcasting, communications, electronics production, and the regulations and development of IT goods and services;

• Chinese Academy of Governance (CAG) (http://nsaww.nsa.gov.cn/) is a ministerial-level institution directly affiliated to the State Council. CAG provides training for high-level administrators and policy researchers.

Major European Union Regulators are listed below:

• DG Connect (http://ec.europa.eu/dgs/connect/en/content/dg-connect): The Directorate General of CNETC is in charge of cooperation projects in smart cities;

• DG Energy (http://ec.europa.eu/energy/): DG Energy focuses on EU energy policy development and implementation. DG Energy is also in charge of the EU-China Partnership on Urbanization and other cooperation projects. These include, among others, the Europe China Clean Energy Centre (EC2 Centre) and the EC-Link Project;

• DG Environment (http://ec.europa.eu/dgs/environment/index_en.htm): DG Environment comes up with policies to ensure a high level of environmental protection within the EU as a means to preserve EU citizens’ quality of life;

• DG Growth (http://ec.europa.eu/growth/index_en.htm): DG Growth fosters entrepreneurship and growth by reducing the administrative burden on small businesses. The organisation facilitates access to funding for SMEs, and supports access to global markets for EU companies;

• DG Regio - Regional and Urban Policy
Investors still need to "innovation and overall improvement. The further reshuffling of the industry chain design and technical innovation. The green housing industry is expected to bring a standardised new green building evaluation standard replaced the previous standard building evaluation standard.

2.3 Green Housing Policies

In 2015, China’s Ministry of Housing and Urban-Rural Development (MoHURD) approved the “green building evaluation standard” related to the national standard (Numbers for GB - T50378-2014) that replaced the previous standard (GB3T50378-2006) on January 1st of this year. The change will further standardise market rules and competitive regulations for green building industries, as well as promoting industry chain design and technical innovation. The green housing industry is expected to bring about a further reshuffling of the market.

The new green building evaluation standard uses a sub-item allocation system. A total score of 45 to 50 points is classified as “one star”; 60 points is “two star”; and 80 points is “three star”. The new standard gives extra credit to green projects, meaning innovative green building projects receive more evaluation points. Experts believe that this scheme will encourage green building technology, management innovation and overall improvement.

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The hope is that this could start a virtuous cycle. By conforming to the requirements of the new standard, companies could increase innovation and achieve prominent scores for green residential projects. Conversely, those projects that do not possess a competitive advantage will face challenges, or even be eliminated from the market. This will further improve green residential market competition, and promote green residential initiatives.

It is important to note that the new version of the green building evaluation standard is also viewed as a steel structure development opportunity. Data shows that steel structures make up less than 5% of China’s total housing at present. However, this figure is over 40% in developed countries. Steel structures can meet the new demands for energy-saving and environmental protection, and are being actively promoted.

Xiamen, Hainan, Shandong and other regions have released green building action plans, and launched a series of preferential policies to encourage development of the green residential market. The market will have the support of a number of government policies, such as deed tax relief and diversified incentives.

2.4 Social Housing Policies

The China National Urbanization Plan on New Urbanization (2014-2020): Turning Migrants into Urban Citizens (cont.) envisages the settlement of a further 100 million urban dwellers by 2020, raising the urbanisation rate to 60%. Further large-scale rural-to-urban migration makes it all the more urgent to address the question of migrants’ status. Access to social housing is projected to nearly double to at least 23% by 2020.

The total annual costs of all urban public services, infrastructure, and social housing is expected to average 6.1 percent of GDP between 2013–30, with a peak of 7.3 percent in the early part of this period. A top-down approach to social housing exacerbates distortions in the housing market and results in a mismatch of supply and demand. A key challenge for local governments in China is to make sure that targets and objectives for social housing are determined by central government.

These policies outline the range and level of coverage. They even stipulate planning, design, size, quality, and safety requirements, thereby creating a system of unfunded mandates for local governments. Moreover, the social housing provided in an attempt to respond to targets set by central government is not necessarily what is needed or demanded by households. In many large cities, it results in comparatively high vacancy rates in suburban locations, and a lack of sufficient housing in more central areas.

2.5 Builders’ Permits

Permits for construction companies are strictly regulated in China. According to existing regulations, new companies are required to prove their building experience in advance in order to obtain a licence. Thus, few foreign companies – if any – succeed in entering the market. Acquiring or investing in local companies is hence the only viable way to reduce or avoid these measures.

The key local planning institutions are listed below. These bureaus, excluding the National Bureau of Statistics, operate at municipal and city levels. It is therefore recommended to check the relevant website for each city. The links are references to Beijing-based institutions:
• Urban Planning Bureau (http://www.bjghw.gov.cn/web): Managing the urban planning process as well as planning related projects;

• Bureau of Land and Resources (http://www.bjgtj.gov.cn/): Master plan for managing land use and other land related activities;

• Water Resources Bureau (http://www.bjwater.gov.cn/): River basin and flood control plans;

• Transport Bureau (http://www.bjjtgl.gov.cn): Participating in the urban planning process and transport planning;

• Environmental Protection Bureau (http://www.bjepb.gov.cn): Developing local environmental regulation and monitoring environmental protection;

• Public Works/Infrastructure Bureau: Maintaining public infrastructure;


3. Market Size

China’s construction market is the largest in the world, having surpassed that of the US in 2010. According to the latest available figures, construction output value accounted for 26.4% of the China’s GDP in 2012 – a significant factor in the country’s overall economic growth.

The following table re-affirms the size and value of the Chinese construction industry. Business opportunities in this sector for companies – including SMEs – are large. However, the table does not take account of the fact that the market has undergone structural changes in the last couple of years, resulting in a slowdown in overall industry performance.

Table 1: Basic Economic Indicators

<table>
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<tr>
<th>Indicator</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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<tr>
<td>Household consumption (CNY billion)</td>
<td>11,167</td>
<td>12,358</td>
<td>14,076</td>
<td>16,896</td>
<td>19,042</td>
<td>n/a</td>
</tr>
<tr>
<td>Sales of commercial buildings (CNY billion)</td>
<td>2,507</td>
<td>4,436</td>
<td>5,272</td>
<td>5,859</td>
<td>6,446</td>
<td>8,143</td>
</tr>
<tr>
<td>Total sales of residential buildings (CNY billion)</td>
<td>2,120</td>
<td>3,843</td>
<td>4,412</td>
<td>4,820</td>
<td>5,347</td>
<td>6,769</td>
</tr>
<tr>
<td>Share of residential building sales in household consumption (%)</td>
<td>19.2%</td>
<td>31.7%</td>
<td>33.1%</td>
<td>29.2%</td>
<td>28.1%</td>
<td>n/a</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>105.9</td>
<td>99.3</td>
<td>103.3</td>
<td>105.4</td>
<td>102.6</td>
<td>n/a105.4</td>
</tr>
<tr>
<td>Gross fixed capital formation (CNY billion)</td>
<td>12,808</td>
<td>15,668</td>
<td>18,362</td>
<td>21,568</td>
<td>24,176</td>
<td>n/a</td>
</tr>
<tr>
<td>Foreign direct investments (USD million)</td>
<td>92,395</td>
<td>90,033</td>
<td>105,735</td>
<td>116,011</td>
<td>111,716</td>
<td>n/a</td>
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Report: *The Construction Sector in China*

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<td><strong>Total investment in fixed assets (CNY billion)</strong></td>
<td>17,283</td>
<td>22,460</td>
<td>27,812</td>
<td>31,149</td>
<td>37,469</td>
<td>n/a</td>
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<td><strong>Investment in residential buildings (CNY billion)</strong></td>
<td>3,088</td>
<td>3,643</td>
<td>4,594</td>
<td>5,782</td>
<td>6,441</td>
<td>n/a</td>
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<tr>
<td><strong>GDP (CNY billion)</strong></td>
<td>31,405</td>
<td>34,090</td>
<td>40,120</td>
<td>47,212</td>
<td>51,947</td>
<td>n/a</td>
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Source: EMIS – Emerging Markets Information Service

**Chart 1: Growth Rates of Construction Output Value and GDP in China**

During the first decade of the 2000s, China’s construction sector expanded at an extraordinary pace, with an average revenue growth rate of 23%. The above table shows that the industry’s output value has decreased since 2011. This is in line with the general trend of GDP, which slowed to 16% between 2012 and 2013.

Market segmentation analysis provides an interesting insight into industrial trends and influences for each respective sub-market.

A closer look at the residential and non-residential housing markets reveals a nationwide slowdown. According to data released by the National Bureau of Statistics, real growth for the sector is expected to be around 6.2% in 2015. This is significantly lower than the 14.3% per annum between 2009 and 2013.

The infrastructure segment, however, performed better. This is due to the fourth CNY stimulus investment package launched by the Chinese government at the end of 2008 as a response to the global economic crisis. The majority of this investment went into building an impressive infrastructure network, with over CNY 600 billion invested in railways, CNY 600 billion in highways, and CNY 300 billion in subways and airports. Although this industry has also shown signs of slowdown recently, its compound growth rate remains consistent, with 7.2% and 7.9% year-on-year growth in 2013 and 2014 respectively.

Although the current market trend is cooling, the Chinese construction industry is certainly performing better than its European counterparts, where the market is yet to recover from the 2008 financial crisis.

There are a number of reasons for these changes. The government lent great support to the construction sector over the last decades, pushing China to the level of a mid-income country. As a result, they are
now more likely to tighten controls as a way of balancing demand-offer dynamics and avoiding the risk of a real estate bubble.

The measures adopted by relevant government departments are currently in line with the new economic vision promoted by President Xi Jinping: “New Normal Theory”. The approach acknowledges that the double-digit growth of past decades is no longer sustainable, and that slower growth is necessary to achieve a more balanced economic structure, with the service industry and innovation as key drivers.²

**Chart 2: Total Nationwide Investment in Fixed Assets for the Construction Industry**

![Chart](image)

*Source: National Bureau of Statistics of China (NBSC)*

The above chart shows investment trends for the Chinese construction sector in the last 10 years. Total investment in the sector reached about CNY 367 billion in 2013.

With the government resorting to adjustments in real estate parameters (interest rates and regulations) and fixed assets investments (via bank financing) as a tool for macroeconomic policy, construction sector growth will be largely dependent on the central government’s future plans. With consumption expected to balance investment as a main driver of economic development, it is very likely that the authorities will try to reduce the weight of construction in future GDP figures.

**Geographical Distribution:** The sector’s geographical distribution remains skewed towards Eastern China. As shown in the pie chart below, Western China has gradually increased its market share. However, this “east to west” movement will remain a medium-long term process, with more than 85% of building activity currently taking place in Eastern China. The pie chart also shows that building activities are shifting from first-tier cities (e.g. Beijing or Shanghai) to second-tier cities (e.g. Chengdu or Chongqing).

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² An interesting insight into “New Normal Theory” can be found in this commentary by the China Daily: [http://www.chinadaily.com.cn/opinion/2014-10/10/content_18716671.htm](http://www.chinadaily.com.cn/opinion/2014-10/10/content_18716671.htm).
From the above, it is clear that “construction of buildings” – including residential, public and industrial buildings – makes up the lion’s share of the market.

3.1 Green Development

According to statistics from the MoHURD, more than 80% of buildings under construction each year are non-energy saving buildings, and 47% of overall energy usage comes from the building industry and related energy consumption. This marks a change in the historical trend, with energy efficiency gaining momentum. Together with sustainable development, this is now one of the top priorities on the Chinese government’s agenda. Besides the “China’s New-Style Urbanization Plan (2014-2020)” mentioned above, many other reforms and policies share the same objective of promoting a “greener” and more environment-friendly society.

The green building sector still represents a very small portion of the overall construction industry. However, it has become increasingly relevant over the last few years. It is estimated that by 2020 the projected floor area of China’s green buildings will amount to more than five million square meters – five times more than in 2013. The market value of the green construction sector is also expected to rise to CNY 122 trillion over the same timeframe.

Analysis of the number of green-certified projects in China, according to the Chinese “Evaluation Standard for Green Building”, gives further proof of this positive trend.

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4 The “Evaluation Standard for Green Building”, or “Three-Star Building Rating System”, is a label system specifically dedicated to buildings, to certify their level of environmental sustainability. Issued in 2006, and initially conceived for residential and public buildings, it was followed by the “Evaluation Standard for Green Industrial Building” (GB/T 50878) in 2013 and the “Evaluation Standard for Green Office Building” (GB/T 50908) in 2014.
In 2014, the Chinese government issued the new “Environmental Protection Law”, the aim of which was to “protect and improve the environment, prevent and control pollution and other public hazards, safeguard public health, and facilitate sustainable economic and social development”\(^5\). It is difficult to check the effectiveness of this law, as it was only implemented in January 2015. However, there have been almost 30 reported cases of local governments handing onerous fines to heavy polluters since this time.

Green development offers vast opportunities for EU SMEs that can bring “green” technologies, expertise and products to the Chinese market. Western companies are often at the top end of the technology and quality spectrum, where many interesting niches exist.

3.2 Regional Differences

Due to government intervention aimed at reining in the overheating of the sector and developing the infrastructure network in western provinces, growth rates on the Eastern Seaboard have declined. China’s large inland cities will be able to compete with coastal cities wherever they have strong infrastructure connection to both eastern and western markets.

The above charts show how western and central regions have played a significant role in overall development. GDP growth per capita has increased since 1997 in less developed regions, such as Western and Central China. Meanwhile, interregional inequality has declined over the same period.
Researchers assert that industrial manufacturing and factories being relocated to Central and Eastern China are behind this GDP growth. Second-tier cities are also more likely to house land-intensive factories, particularly those that have migrated from first-tier cities.

Better allocation of land, labour and capital will accelerate this industrial movement towards second-tier cities. Correspondingly, migration pressures in large cities will lessen as job opportunities open up in these new areas. The “One Belt, One Road” (OBOR) economic development strategy will be the main driver for international development. This ambitious, all-inclusive plan, put forward by President Xi in 2013, is set to promote the development of countries located in the so-called “new silk road economic belt” and the “21st-century maritime silk road”. The plan will involve a total of more than 65 countries spread over three continents.

However, this should not lead foreign investors to abandon the seaboard and focus only on inland areas. The eastern provinces will remain a key market for more sophisticated Western products for the foreseeable future.

3.3 Who is Servicing the Market?

Figures from the National Bureau of Statistics (NBS) clearly illustrate that Chinese private enterprises are the key players in the construction market, with a group of large state-owned enterprises (SOEs – mostly involved in infrastructure building) accounting for the rest. Foreign companies make up almost 1% of the Chinese construction industry (as defined by the statistical authority) – a figure that has seen a steady decline over the past five years.

The latest data shows that Western companies are mostly focusing on niche markets in which they enjoy a technological or brand advantage over local competitors. This limited exposure is the result of a series of factors, which can be summarised by the following categories:

**a. Regulation:** in many construction industry subsectors, foreign or even recently established Chinese entities experience strong regulatory constraints. European CSPs, including architects, quantity surveyors, project managers and contractors, face legal barriers to entering the Chinese market, preventing them from sharing their world-class expertise and cutting-edge technology with Chinese CSPs. In the building sector, for instance, licences are difficult to come by, and take a long time to obtain, assuming this is possible at all. The amendments contained in the latest *Catalogue for the Guidance of Foreign Investment Industries*, which was officially released on March 2015, show consistent signs of opening the way for investment by foreign companies. The document lists the sectors where foreign investment is “encouraged, restricted or limited”, and the 2015 version...
removes restrictions on foreign investment in real estate development. Unfortunately, there is no similar opening regarding the provision of services and supplies by foreign companies.

b. Business Practices: As in many other Chinese sectors, business is often awarded by means of “guanxi”. Relationships are often more important than the quality of products and services. Business is to some extent promoted through practices that Western companies are unable to follow. Indeed, in many areas of the construction market, the Western “advantages” – higher quality, innovative products and established business processes – are not enough to level the playing field.

c. Price Competition: the Chinese construction market is still in the relatively early stages of development, and social structures do not foster quality considerations. Builders (very often local mayors or real estate developers) are keen to use their budget to build more. Their focus is generally not on creating a better quality infrastructure. As builders and buyers are not the same people, the total cost of ownership rarely enters the equation, with price often being the only criteria in play.

3.4 The S-curve Shift

Although China is in the process of developing an advanced infrastructure network, many of the innovative products and techniques adopted in Europe are yet to appear in the country. These products belong to different sections of the S-curve, and require different market approaches.

Geographical S-curve shifts must also be taken into account. New technologies, concepts and products are first introduced in major centres (tier-one cities such as Beijing, Shanghai or Guangzhou), creating a distinct shift in the product development curve.

Chart 8: China’s construction sector and the S-curve

Some examples of this “S-curve shift” are given below:

Green – Smart – Cultural Cities: According to the guidelines and the targets laid out by “China’s Urbanization Plan”, there is a clear strategy for the development of these three “city types“, as well as a detailed description of its goals. EU SMEs could find medium- to long-term opportunities in the following relevant sectors:


Priorities for the construction of **Cultural Cities**: Protect cultural and natural heritages – Strengthen construction of protection facilities for major national cultural and heritage sites – Build cultural facilities – Build sport facilities – Build leisure facilities.

**Services and Facilities for Elderly People**: The ratio of elderly people is rapidly increasing, with the elderly becoming a large potential consumer group. The demand for services and facilities aimed at elderly people can provide consistent and long-term business opportunities.

**Furniture and Home Accessories**: The slowdown in “China’s growth began in 2013, and it may now be necessary to find new ways of marketing furniture products and attracting new customers. Consumers’ increased purchasing power over the past ten years has led to the rapid, wide-scale development of the Chinese furniture market. From 2010 to 2013, the sales value of medium- and large-sized wholesalers and retailers grew at an average annual rate of 41%. Due to the slowdown in the Chinese real estate market, growth in furniture sales slowed to around 20% after 2013. Last year, furniture sales surpassed CNY 200 billion, and despite the decline in the real estate market, this trend shows no sign of reversal. China’s furniture and interior design market has vast room for expansion.

**Precast**: While Western Europe developed a large range of precast technologies in the 1950s and 1960s, China is still largely dependent on on-site casting. Cheap (unskilled) labour, cost pressure and less stringent quality requirements have hindered the development of precast technology in the construction industry. Due to increasing labour costs, quality and time restrictions, environmental regulation and government incentives, the first precast factories are being built at the moment, mostly in tier-one cities. Currently, the main operational issue concerns unclear local regulations regarding standards and certification.

**Gas Boilers**: Central heating of large city areas by power stations or other boilers has been the standard model in Northern China. In the warmer southern parts of the country, heating was not even considered until recently. The demand for comfort, the growth of villa estates, government regulation, and the rapid development of gas distribution have created a new market for individual gas boilers, which hardly existed ten years ago. The more expensive and efficient “condensing” technology, which has become commonplace in Europe over the last 15 years, still has a tiny market share in China.

**LED Lighting**: LED lights are expected to be accepted by the Chinese market as readily as they were in Europe. The forecast is for large growth in this sector.

### 3.5 Forecasts

Forecasts for the short- to medium-term future of the market remain positive, as shown in the table below. With the government focussed on projects and reforms, China offers considerable opportunities in urban infrastructure.
Table 2: Forecasts for Selected Indicators in China’s Construction Sector

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2014f</th>
<th>2015f</th>
<th>2016f</th>
<th>2017f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction % in GDP</td>
<td>5.55%</td>
<td>5.58%</td>
<td>5.65%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Total output value of construction (CNY billion)</td>
<td>18,002</td>
<td>20,162</td>
<td>22,582</td>
<td>25,337</td>
</tr>
<tr>
<td>Construction output growth (%)</td>
<td>13.0%</td>
<td>12.0%</td>
<td>12.0%</td>
<td>12.2%</td>
</tr>
<tr>
<td>Output value of building construction (CNY billion)</td>
<td>7,297</td>
<td>8,173</td>
<td>9,154</td>
<td>10,270</td>
</tr>
<tr>
<td>Growth of output value of building construction</td>
<td>15.2%</td>
<td>14.1%</td>
<td>14.0%</td>
<td>14.8%</td>
</tr>
<tr>
<td>Value added by construction (CNY billion)</td>
<td>2,956</td>
<td>3,192</td>
<td>3,416</td>
<td>3,655</td>
</tr>
<tr>
<td>Growth of value added by construction (%)</td>
<td>11%</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: EMIS – Emerging markets Information Service

4. Major Trends and Industry Drivers

We expect the following major trends to be the most influential in shaping the future development of the construction market in the medium to long term:

- EU-China partnerships and initiatives;
- Increased labour efficiency;
- Increased energy efficiency;
- Design and quality.

The impressive urbanisation process has been one of the main forces driving the construction sector boom. The guidelines and directions contained in the “New Style Urbanization Plan”, issued in 2014, will influence the model for cities’ future development. In particular, the plan focuses on key areas that require specific intervention measures. These include: urbanisation of the rural migrant population; urbanisation layout and pattern optimization; urban space and management structures; and the integration of urban and rural development. Thanks to their strong background and skills, EU SMEs may envisage a wide range of opportunities in each of the target areas identified. However, it should be noted that local governments are likely to pay much more attention to social issues. That is, to prioritize those issues that impact citizens’ daily lives – the “hukou” system, first and foremost – over new construction activities.

The urban development process is also fundamental to what has become the centrepiece of President Xi’s foreign policy and international economic strategy: the so-called “One Belt, One Road” (OBOR) plan. As mentioned in the first part of this report, OBOR will bring together 65 countries and 4.4 billion people from Xi’an in Western China (the old imperial capital and start of the original silk road), across Central Asia to the Middle East, Russia and Europe. The maritime road is designed to link the South China Sea to the Indian Ocean, East Africa, the Red Sea and the Mediterranean. OBOR will be financed by China’s development banks, the largest of which, the China Development Bank, recently received

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6 The hukou is a household registration system that defines the place where individuals are resident and, accordingly, identifies a series of formal residency rights that provide access to public services, such as healthcare and education. Without hukou, these services are precluded, and moving the hukou from one city to another involves long bureaucratic procedures.
over USD 60 billion in new capital to help fund new operations. China will doubtless see fit to put more of its nearly USD 4 trillion foreign exchange reserves towards achieving this goal.

OBOR functions alongside other important initiatives in which China has sought to raise the profile of its global financial diplomacy. Externally, it has joined forces with others in the BRICS group to co-sponsor the New Development Bank, as well as creating the Asian Infrastructure Investment Bank, for which OBOR will provide half the capital.

**Chart 9: Major Drivers and Trends in China’s Construction Sector**

Besides these trends, other forces play an important role in driving the market:

**4.1 Continuing Urbanisation**

The main driver behind the Chinese construction industry boom is certainly the massive urbanisation process that has transformed the country over the last decades. Since the reforms launched by Deng Xiaoping at the end of the 1970s, China has undergone unparalleled urban development. In around 30 years, the residential urban population surged from 170 to 730 million people, with an annual growth rate of about 1%. 
From 1978 to 2010, the number of cities with a population of 5-10 million passed from 2 to 10, and the cities with a population of 3-5 million increased from 2 to 21. By 2025, it is estimated that China will have:

- 221 cities with more than 1 million inhabitants (Europe currently has 35);
- 23 cities with more than 5 million inhabitants;
- 22 cities with more than 10 million inhabitants;
- 15 cities with more than 25 million inhabitants.

At the time of this expansion, Chinese cities offered the perfect mix to attract investment in industrial development: cheap land, good infrastructure, and a copious labour force. At the same time, China was able to avoid some of the common “side effects” of rapid, large-scale urbanisation, such as unemployment, urban poverty, and suburban degradation. However, this incredibly fast development came with high costs in terms of resources, environmental impact, and quality of life for those living in cities and towns. Moreover, this urbanisation relied excessively on land conversion and land financing, leading to urban sprawl and, in some cases, wasteful real estate development.

For these reasons, in 2014 the government issued the “China’s New-Style Urbanization Plan (2014-2020)” – a historic document that addresses the need to pursue sustainable and qualitative growth, considering the needs of both the rural and urban populations. The plan presented answers to the above challenges. Its aim was to establish a new people-centred model that is able to support growth more efficiently through better allocation of land, labour, and capital; to be more inclusive and share the benefits of urbanisation more widely than in the past; and to be environmentally sustainable and safeguard China’s food security. The document indicates guidelines and targets in three main areas:

- Green cities;
- Smart cities;
- Cultural cities.
4.2 Demographics
China is undergoing a process of continuous urbanisation. More than the 50% of the population now live in urban centres – a number that is expected to reach 70% by 2020. This has profound effects on the required living areas in urban centres and the infrastructure needed to support them (road, rail, subways, etc.). In addition, factors related to demographics, such as the tendency to relocate elderly people to nursing homes, a decreasing supply of unskilled workers, a growing elderly population, etc., play a major role in driving the expansion of the market.

In 2001, China became an “aging society”. Forecasts are that it will become an “aged society” between 2024 and 2026. The proportion of the overall population aged 65 and over will increase sharply from 7.6% in 2011 to more than 30% by 2050.

4.3 Regulation
Because of its strong influence on the overall economy, the future expansion of the Chinese construction sector requires regulation. This will take effect not only in terms of the total number of buildings but also in regard to the technologies and other inputs used. Regulations and subsidies will also play an important role in “greening” the building industry.

4.4 Economic Growth
As economic growth slows down and becomes more volatile, the Chinese economy and its local and multinational players are facing uncertain times.

For the government, decisive action by transparent and accountable agencies, in particular at the local level, needs to be taken. Faced with structural economic change, the “old toolbox” methodology of pumping more money into the economy is not as effective as it once was. New economic drivers will be put in place to bring about the “new normal” – an era that will be defined by qualitative economic growth.

The expectation is that this “new normal” will be driven by market forces that create a level playing field for all, with the Chinese Government guaranteeing fair competition through the equitable and transparent implementation of regulations, and the appropriate enforcement of laws.

4.5 Social Aspects
On the one hand, urbanisation has raised living standards and given life opportunities to hundreds of millions of Chinese; on the other, it has brought about significant social challenges. Interpersonal inequality has risen sharply – something reinforced by hukou, which has a profound effect on people’s lives. Hukou defines individuals as either urban or rural dwellers, a distinction that is particularly salient for access to education, health care, pensions, social protection systems and other key services, as well as land rights.

Policies that restrict access to education and training for tens of millions of migrant children are inefficient from a purely economic perspective, as well as being unfair, as they undermine the country’s future growth potential.
In terms of the Chinese urban model, a more sustainable, equitable and efficient version will require policy changes in three broad areas: social and labour-market policies affecting internal migrants and their integration into cities; land use, transport and urban planning; and local public finance and governance. China is considering additional changes to its family planning laws after an initial relaxation in the “one child policy” failed to bring about a higher birth rate. Strict family planning rules were imposed by the ruling Communist Party in the late 1970s to limit population growth, with most couples being forced to have only one child. While the strict rules sparked major criticism, the official argument was that the laws were a “fundamental national strategy” and a major factor in China’s rising prosperity. More recently, an ageing population and a shrinking labour force have forced officials to rethink family planning laws.

In late 2013, couples where at least one parent was an only child were allowed to have two children. However, the changes failed to boost the country’s birth rate (only 470,000 babies were born as a result). Reasons for this include the rising cost of living, as well as women’s increasing interest in pursuing a professional career. The controversial one child policy is a major factor behind the severe gender imbalance in a country where there is a traditional preference for sons. In 2014 alone, as many as 116 boys were born for every 100 girls.

EU-China Partnerships and Initiatives: Recent years have seen a progressive strengthening of relations between EU and China on topics such as urbanisation and innovation. Now more than ever, the two governments are keen to share their experiences and knowledge in these fields. Both parties are willing to find new ways of cooperation that can be mutually beneficial.

The following are the main relevant partnerships and agreements signed so far by China and the EU:

The China-EU Partnership on Urbanisation (launched on 14/02/2012 and officially signed on May 3rd 2012) was created to offer a natural framework for concerted actions, such as a new program designed to assist Chinese mayors. It also included the creation of an annual EU-China Urban Forum that has taken place from 2012 onwards.

The partnership is aimed at tackling challenges through cooperative efforts by stakeholders at national, regional and local levels. Key subjects include:

- Strategies and polices relevant to the development of urbanisation;
- Spatial distribution of urbanisation;
- Sustainable development of the urban industrial economy;
- Urban public services;
- Urban infrastructure investment and financing mechanisms;
- Urban housing supply systems and patterns;
- Urban energy supply and demand management;
- Urban mobility, public transport and smart transport;
- Urban green building;
- Urban ecological protection, environmental protection and treatment;
Protection of urban historical and cultural features and formation of the urban landscape;
- Urban government;
- Urban – rural integrated development;
- Exchanges and discussions, as well as personnel training on urbanisation development.

The Partnership encourages and supports existing and upcoming cooperation initiatives. These include: the EU-China Mayors’ Forum; the EC-Link Project; the EU-China Emissions Trading Scheme; the EU-China Social Protection Reform Project, the EU-China Disaster Risk Management Project; and the Satellite Cities and Metropolitan Governance Project.

Particularly relevant is the EC-Link project, which has already been initiated and is currently in operation. The project’s purpose is to assist “China’s cities in adopting energy- and resource-efficient ecological solutions by sharing European and Chinese know-how on sustainable urbanisation and other relevant policies.

The technical assistance team will assist the Chinese Ministry of Housing and Urban-Rural Development (MoHURD) to deliver the results outlined below:

- Result 1: an appropriate “support mechanism” to improve networking between European and Chinese cities, as well as advising and assisting Chinese municipalities on urban ecological/low-carbon planning and management. The support mechanism will rely on a bilingual knowledge hub/platform;
- Result 2: MoHURD is supported in preparing low-carbon eco-city management toolboxes for local governments;
- Result 3: Europe-China pilot low-carbon eco-city;
- Result 4: improved exchange of information and knowledge sharing between municipalities within China, between Chinese and European cities, and between different actors/donors. This will also include cooperation schemes between European cities and Chinese cities;
- Result 5: strengthened capacities for municipalities to plan, identify, implement and monitor low carbon and ecological solutions;
- Result 6: improved potential for municipalities to finance eco/low-carbon solutions, including knowledge of innovative financial schemes;
- Result 7: visibility/dissemination of project results both within China and internationally are maximized.

**EU-China Innovation Cooperation Dialogue:** Following the EU-China Joint Declaration on Innovation of 24 September 2012, the first meeting of the Innovation Cooperation Dialogue (ICD) took place on 21 November 2013 in Beijing. The DG Research & Innovation on the EU side, and the Ministry for Science and Technology (MoST) on the Chinese side, were the institutional bodies in charge.

The objectives of the ICD as set out in the joint declaration are as follows:

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- Share experiences and best practices for defining, implementing and assessing a broad-base policy approach to innovation. This also applies to specific issues such as framework conditions leading to innovation;

- Address major economic and social challenges by focusing and strengthening cooperation on challenges of common interest (e.g. low-carbon energy systems, energy efficiency, sustainable and resilient cities, green transport, water, space technologies, active and healthy ageing, health, safety and security, information and communication technologies, maritime issues, disaster prevention, and response and relief);

- Develop cooperation on different aspects related to the development (research) and deployment (framework conditions) of innovative solutions;

- Identify and address horizontal issues such as innovation in strategic emerging industries, with a view to facilitating SME internationalisation on both sides;

- Structure, support and facilitate future ICD meetings; finalize preparatory work; and report on good practices, obstacles to innovation, and possible solutions to promote innovation cooperation between Europe and China.

Current proposals for general measures to boost innovation are listed below:

- Regular dialogues
- Joint platforms
- Mutual funding programmes
- Science parks and innovation clusters cooperation

4.6 Labour Efficiency

As shown by the chart below, “China’s construction sector has seen a dramatic increase in labour productivity over the past few years. In 2013, the number of employees peaked at 45 million. While construction used to be a welcome source of employment for unskilled labour – rice in summer, buildings in winter – the sector now needs to cope with fast increasing salaries (>10% annually) and shortages of unskilled labour in many areas of the country.

Chart 11: Labour productivity in China 2008 – 2013

Source: National Bureau of Statistics of China
The sector has historically been founded on a pool of unskilled, cheap and untrained labour. And it cannot be expected that this will develop into a skilled model overnight. However, productivity has almost doubled since 2008, with the sharpest increases seen after 2011.

4.7 Energy Efficiency

Chart 12: China’s Energy Usage (% of total)

The 12th Five-Year Plan (2011-2015) set a new 16% energy intensity reduction target for 2015, compared with figures from 2010. China plans to invest USD 372 billion to save energy and launch anti-pollution projects as part of a push to cut its coal consumption by 300 Mt. USD 155 billion will go towards these energy savings projects. A report from China’s State Council said the move would take the country about halfway towards its 2015 energy intensity reduction target. Several types of policy measure have been implemented to promote energy efficiency and conservation, including energy efficiency labels, minimum efficiency standards, financial incentives, and pricing and government procurement. Financial tools include direct funding of energy efficiency projects for industry and buildings, subsidized loans, and loan and credit guarantees. European SMEs have to achieve a thorough understanding of China and its practices before introducing their products/solutions to the market. A wide range of opportunities are currently open to EU SMEs in the fields of energy dispatch and production (heating, and also energy efficiency).

4.8 Design and Quality

As home ownership and disposable incomes increase, people want to enhance their quality of life and differentiate themselves through lifestyle and design.

Experience made with previous constructions and building materials has also increased quality awareness in the market. People are conscious of the high cost of low quality in terms of maintenance, decreased aesthetic value or replacement costs. The market for quality products is hence growing faster than average, leading to the creation of more “European” market models.
In particular, China’s furniture market contains a wide range of business opportunities. The market can be classified according to the following sub-groups:

1) Home furniture
2) Hotel and service apartment furniture
3) Office furniture
4) Public building furniture (specialist products).

The rapid growth of the Chinese economy has created a complex stratification of customer tastes. Influential factors include social status, location, age and social media exposure.

In this market environment, it is important that importers and distributors define their target and update their strategies on a yearly basis. This in turn puts huge pressure on resellers, who need to increase their flexibility. Traditional strategies are less and less feasible. One reason for this is the increasing cost of renting premium commercial space. Another is that large retailers are unable to keep up with the speed of the changes in customer demand. E-commerce has thus become an essential tool for operators in the market.

Different kinds of O2O e-commerce models are gaining popularity in China’s furniture market.

O2O refers to the way that online marketing and purchasing can be linked with offline operations and consumption. There are various types of O2O e-commerce operators in Mainland China, and the O2O model takes a range of different forms. For the furniture market, O2O strategies place a lot of emphasis on so-called “soft-décor” (i.e. curtains, sofas, lighting, decoration and homeware). As Chinese customers’ traditional preference for materials shifts towards decorative items, this soft décor market has become increasingly important. It is also the most suitable for e-commerce, and mainly targeted at high-end consumers.

The Chinese furniture market involves several different models. Among these is the typical manufacturing and e-commerce operation, where the company uses its website as a platform to showcase its various products and accept online orders. Consumers may also choose to visit dealers’ physical stores and place orders there at online prices. This not only allows furniture brands to carry out sales and marketing but also boosts product sales within a short timeframe. And this in turn has the effect of speeding up cash flow and reducing inventory pressure.

Some O2O e-commerce operators begin as solely online brands, and open up their offline stores at a later date. In other words, they build their e-commerce platform by extending their coverage from online to offline channels. Meilele is an example of a company that has followed this model.

Foreign enterprises are generally more prone to hybrid models that combine online stores with traditional showrooms. Consumers can browse the website at home, select their preferred products, and place their order online. Consumers who want to experience the product in real life can contact the showroom and make an appointment to view.
5. **Opportunities for European SMEs**

5.1 **China is not about Making a Fast Buck**

Entering the Chinese market is a long-term proposition. Establishing an effective business model, building a critical mass, launching your brand name, knowing the regulations, training the team, understanding the fast evolving market and creating a “China experience” at home are long-term goals that make market entry both time- and work-intensive. Cash flow forecasts and “time management” estimations should take this into account.

Although the initial hurdles can be daunting, the rewards for successful entry are large. Successful business models can be replicated in other provinces and cities, and business can grow at rates unheard of in a European context.

The ability to replicate successful models in different areas and locations is crucial. It would be a missed opportunity to spend time and energy perfecting a business model only to let your local competitors reap the profits by emulating your approach.

5.2 **The Basic Building Blocks: Know-how, Brand and Niche**

As mentioned above, the Chinese “mass” market is a difficult arena for large Western companies, let alone SMEs. It is therefore imperative to focus on a niche market where the company has distinct know-how – either through intellectual property (IP) or a special skill – that can be defended in the market and used to create strong (European) brand awareness.

Owing to the experience and the business practices that local competitors have gained and developed over time, engaging in a price war is not a good strategy. Reliability, quality, European branding, innovation, niche markets and premium prices are better tactical approaches.

5.3 **Opportunities Offered by the “National New-Style Urbanization Plan (2014-2020)”**

As mentioned in the first chapter, EU SMEs can benefit from the new urbanisation plan issued last year by the Chinese government. In particular, opportunities are available in the following areas:

5.3.1 **Priorities for the Construction of Green Cities**

**Green Energy:**

- Promote the pilot construction of new energy cities and smart micro-grids,
- Construct pilot areas of solar panel power generation in the newly built new-energy pilot cities;
- Develop pilot projects for heating supply using clean wind energy in Northern China;
- Develop pilot projects for renewable energy in selected regions and strengthen the development of green energy regions.
Green Cities Opportunities
- Green Energy
- Green Buildings
- Green Transportation
- Recycling Renovation in Industrial Parks
- Comprehensive Governance of Urban Environment
- Initiative for a New Green Lifestyle

Green Buildings:
- Promote measurement of heating supply and energy saving renovation in existing buildings;
- Complete measurement of heating supply and energy-saving renovation of residential buildings in heated areas of Northern China;
- Actively promote energy saving renovation of residential and public buildings in areas without properly installed heating systems.

Green Transportation:
- Speed up development of new-energy and low-emissions cars, as well as other types of green cars;
- Accelerate construction of complementary facilities including recharging stations, recharging poles, filling stations etc.;
- Actively promote pilot demonstrations of vehicles using new energy and clean fuel including mixed energy, electricity and natural gas in public transport vehicles;
- Promote water saving and energy saving renovation in airports, bus stations and harbours;
- Promote application of renewable energies including solar energy;
- Continuously implement the entry permission system for fuel consumption by operational vehicles;
- Phase out all yellow label cars.

Recycling Renovation in Industrial Parks:
- Promote recycling renovation focusing on national and provincial level industrial parks;
- Strive for collective and economical land use, exchangeable utilisation of waste, cascade utilisation of energy, use of recycled waste water, and the collective treatment of pollutants.

Comprehensive Governance of the Urban Environment:
- Implement clean air projects; strengthen the comprehensive prevention and control of air pollution, and achieve an evident improvement in urban air quality;
- Implement safe drinking water projects;
- Carry out surface water and groundwater treatment to ensure both water quantity and water quality;
- Carry out treatment of leftover household garbage;
- Implement heavy metal pollution prevention and control projects, and promote the rehabilitation and treatment of key polluted sites and soil.
• Implement the protection and rehabilitation of forests and wetlands.

Initiative for a New Green Lifestyle:
• Accelerate the transformation to a simple, appropriate, green and low-carbon lifestyle with a focus on basic necessities such as clothing, food, accommodation, transportation, travel, etc.;
• Promote ecological social attitudes;
• Encourage green consumption;
• Promote energy saving and green vehicles, as well as energy saving and land saving houses;
• Improve recycling systems for urban waste and old products, as well as reutilisation systems for kitchen waste;
• Reduce the use of disposable products and control the over-wrapping of products.

5.3.2 Priorities in the Construction of Smart Cities

<table>
<thead>
<tr>
<th>Smart Cities Opportunities</th>
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<tbody>
<tr>
<td>- Develop Broadband Information Network</td>
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<tr>
<td>- Computerisation of Planning and Management</td>
</tr>
<tr>
<td>- Intelligent Infrastructures</td>
</tr>
<tr>
<td>- Convenient Public Services</td>
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<tr>
<td>- Modernisation of Industrial Development</td>
</tr>
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Develop Broadband Information Network:
• Promote fixed fibre-optic cables fixed for households as a substitute for copper cables;
• Achieve full fibre-optic coverage for urban households;
• Attain broadband speeds in urban areas of 50Mbps, with 100 Mbps in 50% of households, and certain households in developed cities reaching 1Gbps;
• Promote the building of a 4G network;

Computerisation of Planning and Management:
• Develop digital urban management;
• Promote the building of platforms and expand their functions;
• Establish a unified urban geospatial information platform and database for buildings;
• Build a public information platform for smart cities;
• Comprehensively promote the digital and accurate management of urban infrastructure, such as urban planning, land usage, urban pipelines (for heat, water, electricity, etc.), networks, landscaping, environmental protection, and so on.

Intelligent Infrastructures:
• Develop intelligent transportation systems;
• Build intelligent systems for traffic guidance, transportation command and control of emergency responses;
• Develop an intelligent power grid;
• Develop support for the intelligent management of distributed energy access, residential electricity and corporate power;
• Develop intelligent water supply systems;
• Construct intelligent drainage, water and sewage recycling systems, which cover the whole process of water supply and guarantee its quality and safety;
• Develop intelligent pipeline networks to build underground urban spaces for future use;
• Develop pipeline networks with computerised management and intelligent monitoring systems;
• Develop intelligent buildings and build smart management and control systems for facilities, equipment, energy saving and safety.

Convenient Public Services:
• Establish systems for public services and information services, which will be jointly built and shared across different sectors and districts;
• Apply information technology to develop creative service models for urban education, employment, social security, pensions, medical care and culture.

Modernisation of Industrial Development:
• Accelerate the digitalisation of traditional industries;
• Promote the digitalisation of manufacturing models to incorporate service-oriented networking and intelligent design;
• Positively develop information service industries;
• Enhance the integrated development of e-commerce and logistics;
• Create and foster new business models.

5.3.3 Priorities in the Construction of Cultural Cities

Cultural Cities Opportunities
- Protection of Cultural and Natural Heritages
- Cultural Facilities
- Sports Facilities
- Leisure Facilities

Protection of Cultural and Natural Heritages:
• Strengthen the construction of protection facilities for major national cultural and heritage sites, national archaeological heritage parks, sites for the protection of important national relics, and renowned historical and cultural towns and villages;
• Strengthen the protection of important historical buildings and historical communities in cities;
• Promote facilities aimed at the protection of intangible cultural heritages.

Cultural Facilities:
• Build cultural facilities in cities, such as public libraries, cultural centres, museums, art galleries etc.;
• Build cultural activity facilities within each community, and develop cinemas and theatres in small- and medium-sized cities.
Sport Facilities:
- Construct sport stadiums (gymnasiums) and public outdoor sports venues;
- Install convenient and practical sports facilities in each community.

Leisure Facilities:
- Build ecological leisure parks, cultural communities, leisure paths, outskirts recreation zones, etc.

5.4 Labour Efficiency
Increasing labour costs (from 2008 to 2013, average wages increased at an annual rate of around 13%) and workforce shortages are forcing builders and owners to seek out labour saving practices. This will affect:

- The production of building materials (increased mechanisation);
- Installation procedures (a movement towards integrated systems, rather than single components);
- Systems and technologies with limited manual maintenance requirements;
- Higher demand for reliable systems, reducing maintenance and replacement costs.

As a result there is a growing demand for training, both of the workforce and of those involved in the overall construction process: architects, designers, design institutes, builders, contractors, subcontractors and real estate developers.

5.5 Energy Efficiency
Government subsidies and regulations aimed at increasing awareness of the total cost of ownership (TCO) and rising energy costs will have a profound effect on the construction of green buildings. The introduction of the Chinese Green Building Standard\(^8\) for public buildings has led to an annual growth rate of 60% in the green building sector, compared to a general market growth rate of about 5%. Despite

\(^8\) China launched its Green Building Evaluation Standard in 2006, and the evaluation work was formally carried out in 2008. The Green Building Label, also known as the Three Star System, assesses buildings using several environmental indicators such as energy and water efficiency, indoor air quality, and maintenance requirements.
starting at a low level – green buildings were unheard of in 2009 – and taking account of the current slowdown in the real estate market, these growth rates will ensure that China becomes the largest market for green buildings within a few years.

The effects of this will be mainly concentrated in the Eastern Seaboard cities, as can be seen from the distribution of green building projects in 2012. The expected “green building boom” will provide a wide range of opportunities to those companies that can offer the right services and products. SMEs can capitalise on this either through the direct provision of services and products to builders and architects, or through cooperation with builders and suppliers. As Chinese companies are only now starting to develop the necessary know-how and technology, this is ideal time to enter this market via distributors, technology licences or joint ventures with local agents.

We foresee excellent market opportunities for businesses with capabilities in specialised construction technology, building upgrades, energy efficient devices (e.g. LED lighting, heating devices), insulation techniques and products, smart systems (energy monitoring and energy consumption control), building elements such as cold bridges, energy generating devices for buildings, heat pump systems, energy storing technology, retrofitting know-how and products, etc. Potentially, in the longer term due to necessary policy revisions, for there are also opportunities for Esicos (energy service companies that pay for energy upgrade equipment in exchange for a part of the savings) or other service companies.

In almost all aspects of the construction sector, European companies possess know-how and advanced technologies that are ahead of current Chinese practices. However, not all of them can find an immediate application in China, and will need to be introduced gradually over the next 5-10 years.

5.6 Design and Quality

The desire to enhance living comfort is stimulating a growing demand for high-end design products. European designs and brand names are leading the way in this area, gaining large market shares at significant premiums compared to local products.

Demand for services and facilities aimed at elderly people is rapidly increasing. As such, it presents a source of consistent, long-term business opportunities.

There are currently opportunities for decorative products, high-tech design, architecture, supervision (quality labels), as well as comfort devices (e.g. individual gas boilers), lighting, etc.

Luxury furniture/home accessories in China can be divided in three main sub-groups, each with its own unique selling point:

a) Classic furniture. These products are most popular among customers aged 45+. Classic products are marketed by demonstrating the value coming from precious materials and fine artisanship. It is important to show the exclusivity of the materials used and the handicraft that goes into them.
b) Fashion furniture. These products are most popular among customers aged 35+. They are generally purchased by successful businessmen and -women, who want to belong to an exclusive community. Having spent their youth trying to make money, they have reached a level of financial stability that allows them to explore their tastes and improve their quality of life. They often choose luxury brands, even though these products in fact contain a low amount of creativity, materials or craftsmanship relative to their price. However, it’s precisely this low level of creativity and innovation that satisfies these consumers’ need for social acceptance. It doesn’t matter if the brands are famous mainly for clothes and accessories. Furniture products can be marketed together with their fashion counterparts. Social events are a good way to engage this demographic.

c) Design furniture. Design products, especially furniture, are still a tiny niche market in China. Customers are generally not familiar with these products. The market’s niche status will continue, and these products are sold by giving potential customers the story behind each project and designer. Younger and well-educated customers with international backgrounds will eventually gravitate towards this product group. Creativity is increasingly valued in China, but do not expect anybody to pay premium prices for products they don’t understand, made by brands they have never heard of. Organise your display space as if it were a design museum, and let the product tell its story. Include such details as how it became part of the company’s design history; the research that went into making it so comfortable; the shapes and colours that it wants to express.

Guidelines

1- Foreign companies willing to market their furniture to Chinese customers should be aware that many middle-class shoppers have very busy work schedules. As such, they will only be able visit to your showroom on weekends and public holidays. Young families make up the biggest share of the B2C furniture market. So allow them to shop at their leisure by adding a children’s playground and childcare facilities to the showroom.

2- Online marketing usually means working with Google, Facebook, etc. For online marketing in China, however, you will have learn how to use the Chinese platforms Baidu, Weibo, QQ, and WeChat. While communication in English is possible in some other Asian countries, China requires an ability to use the local language. Company websites should all come with a translated version, and a Chinese name for the company.

3- E-magazines, e-commerce, physical displays and event management should all be part of the same system, where customers are treated as members of an exclusive club. Traditional furniture companies that are used to marketing their products through distributors, specialised stores and chain stores, or by displaying and selling their products in large furniture outlets, face enormous difficulties in transitioning to an O2O business model.

E-commerce cannot be a stand-alone tactic. Rather, it should fit into the big picture of a new marketing strategy. Customer involvement through media and events planning should be central to brand management. You need to build “stories” that explain the added value of the products that you want your customers to buy.

4- It may sound obvious, but it’s vital that resellers truly understand where the value of their products comes from. Some resellers do not know how to display their products in a way that demonstrates this value. And the reason for this is they do not know its source.
6. Challenges for SMEs

In principle, the challenges for SMEs in the construction sector are no different to those in most other industries. However, the prevailing culture, the overwhelming dominance of Chinese companies, and the fast-growing nature of the market present challenges that are in most cases unfamiliar to European SMEs. We have summarised them in the table below:

<table>
<thead>
<tr>
<th>Risk management</th>
<th>Timing</th>
<th>Partner</th>
<th>Business model</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Stay up to date with changes in the regulatory framework;</td>
<td>• Long profit horizon;</td>
<td>• Find the right partner (distributor, licensee, etc.);</td>
<td>• Localise the business model;</td>
</tr>
<tr>
<td>• Protect your IP;</td>
<td>• Choose the right moment on the S-curve.</td>
<td>• Manage relationships personally.</td>
<td>• Find best practices through experimentation;</td>
</tr>
<tr>
<td>• Avoid price competition.</td>
<td></td>
<td></td>
<td>• Be cautious with local business practices (guanxi 关系);</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Prepare a plan B in advance.</td>
</tr>
</tbody>
</table>

6.1 The Basics: Risk Management

**Government Regulation:** as a developing country, China’s regulatory framework is in a state of constant evolution. Amendments to existing regulations or the introduction of new norms should be expected at any time, creating new opportunities or ruining business models. The most sensitive horizontal topics are: **Company Law** (a new law that will introduce significant differences is currently in the final stages of revision), **Public Procurement** (China is currently negotiating its accession to the Government Procurement Agreement (GPA) in the World Trade Organization (WTO)) and **Standards**.

**Intellectual Property-Trade Mark:** Chinese companies are less likely to respect IP. Products, technologies, colours, designs and brands are easily copied, quite often by the local partner or the employees themselves. Although the range of possible actions companies may take to protect themselves is increasing, businesses should act proactively. Measures should include: registration of brands and website addresses; use of non-compete contracts with employees; keeping sensitive data (customer lists, production manuals, cost prices, etc.) confidential within the company; training employees; and avoiding any potential misunderstandings when entering into agreements with partners on IP items. European companies can contact the EU-funded China IPR SME Helpdesk in Beijing for further information (see below).

The China IPR SME Helpdesk is a free service which provides practical, objective and factual information aimed at helping European SMEs understand business tools for developing IPR value and managing risk: [http://www.china-iprhelpdesk.eu/](http://www.china-iprhelpdesk.eu/)

**IP Key** project is a three-year-long project (July 2013 - June 2016) implemented by the Office for Harmonization in the Internal Market (OHIM) in partnership with the European Patent Office (EPO). Co-chaired by China’s Ministry of Commerce (MOFCOM) and the EU Delegation to China, it focuses on facilitating development of an intellectual property rights framework in China that is increasingly effective, fair, transparent, and otherwise based upon international best practices. It is a
platform for cooperation and acts as bridge between EU and Chinese agencies in order to create an IP landscape that benefits both Chinese and EU industry operating in China. For more information see: http://www.ipkey.org/en/about-ip-key

Price Competition: a business model based on price competition is hard to sustain in a Chinese environment where local competitors are capable of rapid cost cutting and are able to employ sales practices that are unavailable to Western companies. Western companies therefore need to build a business model based on niche products, branding and marketing, and quality. The current state of the real estate market has created a wider gap between Chinese and EU companies in the medium term. When the market recovers, however, quality issues such as product durability, low maintenance, and energy saving will once again be key factors for improving market share.

6.2 Timing it Right
The best time to enter the Chinese market may not necessarily coincide with your company’s intended entry point. Entry strategies will differ dramatically depending on the market situation and the position on the S-curve of a specific product or service. Understanding the market, the S-curve, growth rates, and other factors linked to success is crucial before entering the Chinese market. Enter too early, and you will spend a disproportionate amount of time convincing the market of the benefits of your product. Enter too late, and you will lose the benefits associated with being recognised as a premium brand.

6.3 Finding the Right Partner
Many SMEs opt to work with a local partner. The choice of this partner is one of the most crucial decisions facing the company. Developing personal relationships and doing basic due diligence is time consuming, but vital. Too often partners are chosen based on a chance encounter, not via an evaluation of the kind of partnership best suited to the business (see section 6 for a recommended strategy). Compared to larger companies, SMEs have less time and resources to spend on the research and evaluation of potential partners. However, a wrong choice here can seriously damage the prospects of successful entry to the market. Adequate resources should be allocated to the careful selection of a business partner.

6.4 Finding the Right Business Model
The dynamics of the Chinese market are different to those encountered in Europe, making the wholesale transfer of business models unfeasible. Many companies will be tempted to adopt the model that they have used successfully in their home country or other markets. In most cases, however, these business models will need to be adapted for China – and in some cases a totally different business model will emerge. Finding an effective model and experimenting with different product offerings, pricings and sales channels can take a considerable amount of time. It is compulsory to be well prepared in advance. Solid market research, a willingness to adapt, and hiring talented local employees form the basis of a good approach to entering the Chinese market.
7. **Ways to Enter the Market**

We recommend a route that has proven successful for many companies in the past. As with other markets, China requires that companies do their homework before entry. There are some fundamental questions that companies should address before implementing their entry strategy.

Too often, companies commit to a distributor or partner without considering the following basic questions:

- Is the timing correct for my product or service?
- Which sectors, areas and customers should I sell my product or service to?
- Should I use a distributor or sell the product or service myself?
- If I use a distributor, who would be the best fit for my business model?
- What technical competences should the distributor have?
- Where should the distributor have sales representatives?
- Which skills and connections does the distributor need?
- What is normal practice in this market?
- How does reasonable pricing work?
- What targets do I have in the Chinese market?
- How much technical support, marketing support and training can I devote to the Chinese distributor?
- Do I want to develop a broader Asia strategy?

Besides these, there are many other questions to be answered before choosing a potential partner and discussing business terms. A large number of private and public service providers concerned with EU-China business relations will be able to help you to come up with a list of both questions and answers in regard to this.

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9 Gauge your readiness for the Chinese market by taking the EU SME Centre online quiz “Are you ready for China?” at the following link: [www.eusmecentre.org.cn/quiz](http://www.eusmecentre.org.cn/quiz).
Chart 13: Basic Steps for Market Entry

7.1 Know your Market
The first step should always be thorough market research, either by your own people, external advisors or a combination of both. This research should address questions on the following topics:

- Timing - is this the correct time to enter the Chinese market?
- Market structure - who are the customers, competitors and intermediaries?
- Price levels - which products and services are in the market and at which prices? How is the pricing formulated?
- Evolution - how will the market evolve in the coming years?
- Government and social environment (something hugely important in China) - which current and future changes will have an impact on my market?

Without adequate preparation it is impossible to outline an initial business model that will define the entry strategy.

7.2 Define your Business Model
Defining the business model is the next step. Companies should not be afraid of exploring ideas that differ from their domestic model. The Chinese market, even more so than in other Asian countries, has marked differences to comparable EU markets. You should consider the following:

- The product - what kind of product or service will I offer? What kind of packaging will I use?
- Price - how will I price my product or service?
- Customers - who are my target customers? How will I reach them? Where is my niche?
- Distributor/partner - do I really need a local partner? What kind of distributor or partner do I need? What would be their ideal profile? What are this partner’s interests in the venture?
- Structure - do I need my own people on the ground or can I use other organisations to represent my company?
• Intellectual property - how will I protect my IP/trade mark against counterfeiters and my partner?
• Growth - if market entry proves to be successful, how and where do I expand my business?
• Plan B - if the approach does not work, what are the alternatives?

7.3 Looking for a Partner

Only when the market is known and the role of the partner/distributor has become clear should you start discussions with potential partners and suppliers. Doing your homework will help you when it comes to:

• Knowing the partner/distributor’s strong and weak points;
• Negotiating on equal terms;
• Understanding their long-term goals;
• Aligning interests.

As discussions and negotiations with partners can take a long time, it is recommended that you work in parallel with several potential candidates.

7.3.1 The Search for a Distributor/Partner

Attending trade fairs is a valid way to approach business partners, and is highly recommended. The appearance of the booths, the quality of presentations, and language skills will all contribute to making a first impression. However, these impressions can be misleading. Do not overlook the necessity of getting to know your partner or conducting basic due diligence.10

7.4 Characteristics of the Construction Sector

When it comes to the construction sector, there are some extra reasons for caution. The sector is prone to practices that are incompatible with Western codes of conduct. Distributors and partners do not necessarily follow the Western way of doing business. This issue needs to be clearly addressed during partnership negotiations. An independent source of information on the distributor/partner is strongly recommended in any case, to ensure a full understanding of the circumstances.

7.5 Implementation and Follow-up

Following up with distributors and partners is normally quite labour intensive, especially in the start-up phase. It involves setting up reporting systems, understanding how the partner works, negotiating issues that have not been clarified beforehand, customer issues, training, preparing marketing materials, checking translations, and setting boundaries about what can be sold and what cannot. Experience with partners and distributors in other countries will certainly help with implementing the partnership. Temporary support for this phase can also be sought from consultancies.

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10 Learn how to conduct due diligence on potential Chinese partners though the EU SME Centre guide “Knowing your Partners in China” available at: http://www.eusmecentre.org.cn/content/known-your-partners-china.
8. Conclusions

The Chinese economy is facing a structural paradigm shift. This has come about due to changes in the economic development model, which in recent years created unprecedented overcapacity and debts across many sectors.

Two-digit growth proved unsustainable, and this strategic turnabout has been clearly visible since the 3rd Plenary Session of the 18th Central Committee of the Communist Party of China, in November 2013, when it was stated that new reforms should focus on promoting more sustainable, quality-driven development.

China’s economy still has room for growth, and remains a key market. European companies want the “new normal”, just as China wants to move its economy up the value chain. However, a new regulatory framework has yet to come into place. Notably, a better implementation of the rule of law is seen as the main driver for China’s economic development going forward.

The construction sector is currently experiencing a downturn, fluctuations and unequal growth paths. However, it remains a pillar industry for the domestic economy, and as such should not be ignored by any company with international ambitions.

In 2014, the government issued “China’s New-Style Urbanization Plan (2014-2020)” – a historic document that addresses the need to pursue sustainable and qualitative growth. The plan identifies strategies and actions to be implemented in key macro areas, including the improvement of the integration between urban and rural areas, the strengthening of environmental protection, the preservation and promotion of historical heritage, and increased efficiency for land use.

The plan sets high targets that could offer extensive opportunities to EU service providers and suppliers for the “green, smart and cultural cities” development project. Currently, the focus is on the planning and execution of economic, financial (three new Free Trade Zone Areas, after the Shanghai Pilot Zone launched in late 2013) and social reforms (the hukou system) rather than on technical issues and large-scale project development.

The Chinese government has already implemented actions aimed at increasing the growth of the real estate market. These include increased availability of mortgages and reduced down payments, funding costs for buyers who want to finance their second homes with bank mortgages, confirming financial support for provincial-level public projects, and further opening up the local market to foreign investors. A top-level national conference on urbanisation is being held in July 2015, and the relevant new strategy will be issued by the end of August. This document will provide a clear roadmap, including all main targets and a timeline. At the end of this year, the government will be also issuing the 13th release of the Five Years Plan. It is foreseeable that the real estate market could find a new equilibrium, leading to a period of more sustainable growth by the second half of 2016. This growth would be lower in terms of percentage increase, but more stable and with more focus on overall quality.

As a secondary effect of the “one child policy”, the ratio of elderly people is increasing, to the point that the elderly now represent a potentially vast consumer group. Elderly people’s demand for services and facilities has risen sharply, providing a consistent source of long-term business opportunities.

Recent years have witnessed a progressive strengthening of relations between the EU and China on issues such as urbanisation and innovation. Now more than ever, the two governments are keen to share
their experiences and knowledge in these fields. Both are willing to find new ways of cooperation that benefit both parties.

Other economic strategy planning (One Belt One Road – China 2025) recently launched by the Chinese government can also be a source of medium-term opportunities for EU SMEs.

The bulk of the market is dominated by Chinese enterprises. Niche markets – more often than not at the top end of the spectrum – are the only area left to foreign companies. However, these niche markets can grow quickly and be very profitable for businesses able to offer technological solutions and build a brand name in China.

EU SMEs should pay careful attention to protecting their IPR and trade marks. Local standards for materials and equipment are frequently very different from the international standards. The same is true more generally for operations in the professional consulting sector (engineering, architectural and project management firms).

The rapid changes experienced by many aspects of Chinese society have led to increased labour costs, mounting pressure regarding environmental issues, and the emergence of a middle class endowed with financial resources to spend on comfort and quality of life. This creates opportunities for companies that can offer technologies to support labour productivity and energy saving. Equally, there are openings for companies providing high-quality, sophisticated products adapted for the Chinese market.

Entering the Chinese market remains an enormous challenge, as well as a good opportunity for EU SMEs. It requires a thorough study of the local market, conducted in advance; an understanding of requirements and rules (both written and “unwritten”); consistent investment (a new company will usually break even within three to five years); good economic and strategic planning; appropriate financial and human resources; good timing; and an effective choice of business partner.
## 9. Resources

### 9.1 Further Reading

<table>
<thead>
<tr>
<th>Further Readings</th>
<th>URL</th>
<th>Published by</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2015 is the Year for Green Housing</strong></td>
<td><a href="http://www.ditan360.com/News/Info-145931.html">www.ditan360.com/News/Info-145931.html</a></td>
<td>Low Combine Online, December 2014</td>
</tr>
<tr>
<td>The Green Building Component Sector in China</td>
<td></td>
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<tr>
<td><a href="http://www.eusmecentre.org.cn/content/green-building-component-sector-china">http://www.eusmecentre.org.cn/content/green-building-component-sector-china</a></td>
<td></td>
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<tr>
<td>Published by: EU SME Centre</td>
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| Prospects and Challenges on China’s “One Belt, One Road”: A Risk Assessment Report |
| Published by: The Economist Intelligence Unit |

| Interim Measures on the Review and Management of Total Emission Targets of Key Pollutants in Construction Projects |
| Published by: China’s Ministry of Environmental Protection |

| CCCC Tracks Projects in 65 Nations Covered by China’s “Belt and Road” Plan |
| http://www.yicai.com/news/bd/2015/05/4619151.html |
| Published by: Yicai |

| Catalogue for the Guidance of Foreign Investment Industries (Amended in 2015) |
| http://www.fdi.gov.cn/1800000121_39_4830_0_7.html |
| Published by: National Development and Reform Commission and the Ministry of Commerce |

| China’s New-Style Urbanization Plan (2014-2020) |
| Published by: NPC, National People's Congress |
### 9.2 Exhibitions

<table>
<thead>
<tr>
<th>Exhibitions</th>
<th>Date and Location</th>
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<tbody>
<tr>
<td>Architect @ Work China 2015</td>
<td><a href="http://www.awcn.info/">http://www.awcn.info/</a> July 2nd to July 3rd 2015, Shanghai Exhibition Center, China</td>
</tr>
<tr>
<td>CBD 2015 - The 17th China (Guangzhou) International Building Decoration Fair</td>
<td><a href="http://www.cbd-china.com">www.cbd-china.com</a> July 8th to July 11th 2015, China Import and Export Fair Pazhou Complex, Guangzhou, China</td>
</tr>
<tr>
<td>International Green Building Expo China 2015</td>
<td><a href="http://www.igbchina.com">www.igbchina.com</a> November 24th to November 26th 2015, Poly World Trade Expo Center, Guangzhou, China</td>
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9.3 Administration and Associations

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<thead>
<tr>
<th>Administration and Associations</th>
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<tbody>
<tr>
<td>The Ministry of Housing and Urban-Rural Development of the People’s Republic of China</td>
<td><a href="http://www.mohurd.gov.cn">www.mohurd.gov.cn</a></td>
</tr>
<tr>
<td>China Construction Industry Association</td>
<td><a href="http://www.zgjzy.org/">www.zgjzy.org/</a></td>
</tr>
<tr>
<td>China Building Decoration Association</td>
<td><a href="http://www.cbda.cn/">www.cbda.cn/</a></td>
</tr>
<tr>
<td>China Building Materials Federation</td>
<td><a href="http://cbmia.cbminfo.com/">http://cbmia.cbminfo.com/</a></td>
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<tr>
<td>China Architectural Design Association</td>
<td><a href="http://www.zgjzsjxh.org/">www.zgjzsjxh.org/</a></td>
</tr>
<tr>
<td>International Construction Decoration Interior Design Association</td>
<td><a href="http://www.icda-hk.com/index_1.asp">www.icda-hk.com/index_1.asp</a></td>
</tr>
<tr>
<td>China Exploration &amp; Design Association</td>
<td><a href="http://www.chinaeda.org/">www.chinaeda.org/</a></td>
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The EU SME Centre helps EU SMEs prepare to do business in China by providing them with a range of information, advice, training and support services. Established in October 2010 and funded by the European Union, the Centre has entered its second phase which will run until July 2018.

The Centre is implemented by a consortium of six partners – the China-Britain Business Council, the Benelux Chamber of Commerce, the China-Italy Chamber of Commerce, the French Chamber of Commerce in China, the EUROCHAMBRES, and the European Union Chamber of Commerce in China. All services are available on the Centre’s website after registration, please visit: www.eusmecentre.org.cn.

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