



China: Software Industry

Overview of Emerging Tier II Markets

INTRODUCTION

The objective of this report is to provide an overview of the Chinese market for software, with focus on five key emerging markets beyond already established cities such as Shanghai, Beijing, and Guangzhou. The report focuses on the business-to-business (B2B) market in two segments: software products¹ and software services².

EXECUTIVE SUMMARY

China software market. The software market in China has been growing at 44% CAGR (Compound Annual Growth Rate) between 2003 and 2006, reaching a total value of \$63³ billion in 2006. There are over 10,000 software companies in China, of which about 5% are foreign. The industry is very fragmented with the top 100 players accounting for only about 30% of the total revenue. In general, Chinese software companies focus on the low-mid market, and are stronger in application software (e.g. antivirus software), while foreign companies dominate in the system software segment.

Key trends. The industry is expected to consolidate over the next few years, and there is likely to be increased M&A (mergers and acquisitions) activity. This is in line with strong government incentives to encourage the growth of the industry and attract foreign investment in this sector. However, software piracy is still a major problem; it affects the markets for end-consumers and small-medium companies most

1 "Software products" include packaged software and customized products, and includes application software (e.g. Enterprise Resource Planning software, database software, etc.) and system software (e.g. operating system)

2 "Software services" include consulting, testing, training, processing, protection, system integration, and after-sales services

3 All US\$ equivalent in this report calculated at USD-RMB exchange rate of 7.6



Prospective industries and best prospects. Key industries for software are manufacturing, finance, telecoms, and the public sector, which together account for about 60% of total industry revenue. The best prospects for foreign exports are high-end products requiring a certain degree of customization, ranging from 3G software to Enterprise Resource Planning (ERP) software. For services, best opportunities are high value-added services such as complex IT solutions or service-oriented architecture⁴.

Establishing a local presence is generally necessary in order to compete with the many foreign companies already well-established in China

Market access. China market offers good opportunities for foreign companies but not without challenges; establishing a local presence is generally necessary in order to compete with the many foreign companies already well-established in China. Software industrial parks are good potential locations for foreign companies to locate in, while prospective customers are likely to be concentrated in other specialized or high-tech industrial parks (e.g. chemical industry parks, logistics parks).

Key emerging markets. Besides the established Tier I markets, there are opportunities in rapidly growing Tier II cities such as Shenzhen, Tianjin, Hangzhou, Qingdao and Ningbo, which all house high-prospect industries for software and a large potential customer base. Shenzhen is an important finance and electronics manufacturing base. Hangzhou and Ningbo have both invested in hi-tech industrial parks and research & development. Tianjin and Qingdao are both trying to become centers for IT industries in North China. Other emerging markets, not analyzed in this report, include Xi'an, Dalian, Nanjing and Chongqing.

⁴ "Service-oriented architecture" is a software architectural concept that defines the use of services to support requirements of software users and business processes and users.