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SOFTWARE COMPANIES THAT THOROUGHLY UNDERSTAND – AND ADDRESS – THE CHALLENGES OF ENTERING THE CHINESE MARKET WILL BE WELL-REWARDED FOR THEIR EFFORTS.

SOFTWARE DISTRIBUTION IN INA: TAMING THE GUARDIAN LIONS

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Any visitor to China, or to Chinatown for that matter, will be familiar with the ferocious-looking pair of lions that guard the entrances to many temples, homes, businesses and streets. These guardian lions, also known as "Fu Dogs," have stood as powerful mythic protectors of China since the Han Dynasty in 206 BC–220 AD).

U.S. software vendors gazing longingly at China may well imagine similar lions are blocking their entry to this potentially lucrative market. How to avoid the swift claws of impenetrable government regulations, the sharp teeth of a complex distribution system and the sudden pounce of competitors all too ready to pirate your intellectual property?

The guardian lions of the China market can't be transformed into domesticated pussycats, but they can be tamed. Software companies that thoroughly understand the challenges and skillfully face up to them will be well-rewarded. Let's take a look at the five major challenges – and how to overcome them – for U.S. companies looking to distribute their software products in China.

Challenge 1: A convoluted distribution system: It can be a marriage made in heaven. China's software development industry is still in its infancy, while the United States can offer world-class software. Conversely, Chinese software companies have excellent sales and marketing channels, while most U.S. software companies are clueless about how to get their products into the hands of Chinese end users.

This situation puts a premium on choosing the right distribution partner. A few lessons in this regard:

Choose a distributor that can give you accurate market intelligence. A distributor that delivers unvarnished advice about the potential market for your product and where/how to "pitch" your software to that market is worth its weight in gold.

Be prepared to offer your distributor massive support. Think you can fly into Shanghai, spend a few days scoping out prospective distributors, get your targets to sign your standard reseller/referral agreement, then jet back home and wait for the fees to come rolling in? Think again. It's easy enough to sign up distributor who will be glad to sell your software to anyone who asks. But if you're looking for a committed partner who will treat your software as one of its core products, you'll need to invest in training, support and "feet in the street."

Supporting your distributor also means offering adequate pre- and post-sales support. China has many strong local companies that operate call centers and have the technical proficiency, assuming appropriate training, to provide local technical support. No matter how effective your distributor, your demonstration of local support and market presence can weigh heavily in the eyes of a large potential customer and can make the difference between winning and losing a large contract.

Make your distributors rich, and they will make you rich. Don't be stingy about giving your distributors a big discount. You need to make sure your pricing is consistent and well-planned, but increasing your distributor's margin will encourage the distributor to single out your software from the 20 to 50 products that distributor may well be representing.

Be sure to consider the OEM market. Finding a local Chinese software vendor with complementary technology could provide a path to rapid market penetration. For instance, a local vendor could integrate your product with its own, offering to provide specific additional functionality to broaden its potential market. Your licensee will be able to tap into an established customer base and existing channel networks at a low cost. OEM suppliers also come equipped with their own first-line and sometimes second-line support, giving your product a big image boost in terms of support capabilities.

The benefits of such an arrangement, however, will have to be balanced against the risks, such as the absence of brand awareness. In addition, you'll want to consider holding OEM partners to performance requirements and tying product discounts to their sales volume.

Remember the 80/20 rule. Great technology is not enough. If 80 percent of what it takes to close a deal in the United States is product quality, and 20 percent is marketing/distribution, in China it's the reverse. So choose your partners wisely.

Challenge 2: Dense government regulations: Finding your way through the thicket of Chinese government regulations governing software distribution may feel like a forced march along the full length of the Great Wall of China – all 4,000 miles of it.

Among the myriad laws the U.S. software vendor in China will face:

Copyright registration: Registration of software with the National Copyright Administration is voluntary but is useful for copyright enforcement purposes because it's regarded as *prima facie* evidence of copyright ownership. Beware the downside, however. Sections of source code must be disclosed, and the contents of registration are made publicly available. For that reason, you'll want to think long and hard before going the copyright registration route.

Contract registration: Parties to an exclusive software license (including reseller or referral) agreement may register their contract with the Software Registration Center of the Ministry of Information Industry (MII). Registration is voluntary, but the certificate issued upon registration is required by the State Administration of Foreign Exchange in order for foreign currency to be purchased and paid to a foreign software owner. Since payment is something most foreign software owners are fond of, contract registration is strongly recommended.

Product registration: The MII requires foreign software sold in China to be registered. There are no specific penalties for breach of this requirement, but the MII can stop the sale of the unregistered software. Registration is the responsibility of the local importer, but the foreign vendor's cooperation in providing information, such as proof of copyright, is necessary. The registration certificate is good for five years and is renewable.

Technology importation: China's software regulations require a Chinese entity entering into a software licensing arrangement with a foreign offshore party to comply with certain rules governing technology imports. Such imports are divided into three categories: free, restricted and prohibited. Fortunately, because computer software is not specifically listed in either the restricted or the prohibited categories, it can be freely imported. Software imports are not entirely off the hook, however; there's a requirement that the technology contract be registered with the Ministry of Commerce.

Sale and use of encryption software: Encryption products face additional requirements, namely, approval by the State Encryption Management Commission, which involves a detailed certification process. In addition, the Ministry of Public Security requires every security vendor to obtain a sales permit before making any sales.

Chinese government policy openly favors domestic encryption software and hardware products. Nevertheless, Western manufacturers are making surprisingly strong inroads into Chinese markets, including sales into both Chinese enterprises and government agencies.

The good news is that the regulatory framework for software distribution is well-developed in China. So surviving the long trek is just a matter of understanding what's required.

Challenge 3: The mysteries of *Guanxi*: It's no exaggeration to call China a "relationship economy." Personal relationships, or *guanxi*, have historically served as the most important organizing principle for Chinese economic and political life. As the manager of one of the leading U.S. software companies in China succinctly noted: "The most important factor for business success in China is not technology, it is relationships."

U.S. software companies ignore that admonition at their peril, especially when choosing partners in China.

Patience, commitment and personal contacts are the keys to building a solid base of *guanxi* in China. Hiring experienced consultants who already have established an extensive *guanxi* network relevant to your business can save you one or two years of groundwork as well as millions of dollars in wasted investments.

Please note that *guanxi* doesn't equal corruption. A U.S. company can reap the rewards of cultivating *guanxi*, while at the

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same time strictly observing the requirements of the U.S. Foreign Corrupt Practices Act as well as Chinese law. But software vendors unwilling to spend substantial hours going to dinners and banquets, drinking, making friends and building trust may find the door to China profits barred. The same goes when recruiting people on the ground; you'd better pay as much attention to their networking skills as their academic qualifications or technological background.

Challenge 4: Weak intellectual property protection: The current street price of pirated copies of Microsoft Office in China is 50 *yuan*, or about 73 cents. You may well be wondering, once you enter China, how long before your own prized software is selling for similar pennies on the dollar?

This is a legitimate concern, but keep in mind that the enterprise software market is a different kettle of fish. Chinese enterprises require implementation services, maintenance, support, corrections, updates – none of which they'll get using pirated software. In fact, one chairman of a major U.S. software company has only half-joked that he's happy to see his company's software copied in China, because it just opens up new opportunities for providing professional services.

There's no question that foreign software enjoys full copyright protection under Chinese law, provided that China and the copyright owner's country of residence have entered into a bilateral agreement or are signatories to certain international treaties, such as the Berne Convention, which is the case with China and the United States. What's more, thanks to China's commitments to the World Trade Organization, the protection afforded to U.S. software companies is equal to what they enjoy at home.

The sticking point is enforcement. Despite China's laws against IP rights infringement, it's estimated that more than 90 percent of the Chinese market for copyrighted material is pirated. Globally, only Vietnam has a worse copyright enforcement record.

China is gradually coming to realize that IP rights violations hurt its own domestic industries as much as foreign competitors. Where is the incentive to develop a home-grown software industry if pirates have seized the products as soon as they hit the streets?

For the time being, however, the first line of defense for foreign software companies must be prevention, not enforcement.

Challenge 5: Adapting your product for the Chinese market: Were you hoping you could simply put a Chinese-language cover on your software package, prepare a few Chinese-language marketing brochures and you were "localized"? Abandon that hope. Localization is much more than translation. You'll need to offer localized versions of documentation, support and your Web site, including localized graphics and text styles. Note also that you'll need to address subculture differences among China, Taiwan, Hong Kong and other Chinese-speaking nations. The most sure-fire protection against committing cultural *faux pas* during the localization process is to have localization handled by a local Chinese firm well acquainted with dealing with Western products.

All that said, however, don't let China's guardian lions discourage you from entering the China market. Because so few foreign companies are properly prepared to make the attempt, you'll find success to be that much more rewarding. And you'll learn that the noble Fu Dogs can be your allies as well as your foes.

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