CHINA'S DOMESTIC CERAMICS MARKET A GREAT OPPORTUNITY FOR EUROPEAN COMPANIES

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1. ABSTRACT

China has experienced an amazing growth in its economy, doubling its per capita income every five years, and becoming the largest economy in the world in terms of GDP. By 2014, China had a population of 1,340 million people, of whom 652 million were living in urban areas. A total of 69 million households have a middle class status and 53 million households have an upper middle class status. 40 million people join the middle class every year, and its average GDP growth is still more than 7% per annum. These macroeconomic data point to the great consumption potential of the Chinese giant, although the main problem facing European businesses is ignorance of the possibilities and the real opportunities. Innovation, added value and ecology are appearing as new challenges facing the country and provide enormous business opportunities that the Spanish ceramics sector can take advantage of.

The aim of this paper is to study the potential of the Chinese market for the European ceramic industry.

The European ceramic product has advantages in terms of differentiation and prestige that can be exploited in the upper middle class segment of the population. To gain access to the Chinese upper middle class, it is essential to have a direct knowledge of this market, access to objective information and professional advice that would help in designing the penetration strategy that is suitable and relevant to each

company. Tailored strategies that are well-designed taking into account the characteristics of each company, the search for partners in China that enable access, knowing the rules and areas of priority in China's political economy, the legal issues governing trademarks and contracts, as well as the importance that aspects such as *guanxi* have in the negotiations, are crucial. The tastes of Chinese consumers are different from those of Europeans due to the major cultural differences between the two worlds, but the fact that that the current consumption habits of the generation of Chinese consumers born from the 1980s onwards is going to mean a significant change in their consumption parameters should also be borne in mind.

Gaining a deeper understanding of the strategies adopted by leading companies from countries that are traditionally ceramics manufacturers, and of the tools that are provided by the Chinese government to foreign companies in search of the cooperation needed in order to supply the Chinese market, will provide interesting data to take into account before designing a strategy for accessing this market. An example is the development project in the Chaoshan region area, regarded as the latest emerging coastal region of China, where the GDP is growing by 15% per annum, almost double the national average. In the next few years its development will accelerate thanks to a number of large projects such as a new refinery, a liquefied gas plant, two fossil fuel power stations, the Wuyu nuclear power station and Metal Eco-City, one of the largest projects under way in the whole province of Guangdong. Its aim is to welcome new non-polluting industries, in collaboration with European partners and with a support infrastructure such as vocational training centres, a centre for metal treatment technologies or a technology centre for new materials. Keeping abreast of the PPP projects (Public Private Partnerships), whose legal protection for foreign investment is being resolved by the Chinese government at an accelerated rate, is also important for the Spanish ceramics sector, which can discover great business opportunities in these.

The key conclusion is that, in order to do business in China, it is very important to have a long-term vision, to have a permanent presence in the country and to seek advice from experts in this market. Our aim with this study is to throw light on the keys to competitiveness for accessing the Chinese market, as well as establishing comparisons with other industrial sectors whose successful access to the Chinese can contribute innovative ideas for Spanish ceramics companies.

2. INTRODUCTION

Spain is the number one producing and second exporting country in Europe, and the third exporting country worldwide for ceramic tiles, only surpassed by Italy and China. In 2013, the global turnover of the Spanish industry reached 2,797 million euros, of which 80% was exported, and it is estimated that the Spanish ceramics sector gives direct employment to about 14,300 workers in companies which are mostly small and medium-sized, with a high geographic concentration of the industry in the province of Castellón (approximately 81% of the companies in the sector, which account for 94% of national production) (ASCER).

The global market in ceramic tiles is expected to attain a value of USD 125,320,000,000 by 2020. This data is primarily explained by the growth of the construction industry in the BRICS countries, which include China and India, because of planned urban development based on ceramic tiles. Strict environmental regulations regarding greenhouse gas emissions during the production of ceramic tiles has forced Chinese manufacturers to increase their spending on R&D in search of greener products, which will probably lead to new opportunities in the near future.

As for the global demand for tiles, it was 12,328.3 million square metres in 2013 and is expected to reach 21,822.7 million square metres by 2020, with annual growth rates of 8.5% from 2014 to 2020.

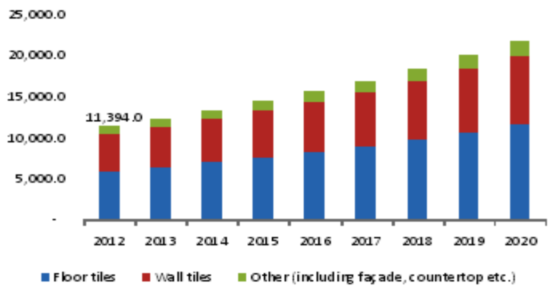
Ceramic floor tiles accounted for over 50% of the market volume in 2013. The emergence of such flooring as a replacement for wood, and offering better properties such as high durability, resistance to frost and thermal shock, points to a likely increase in demand for this product in China.

Asia and the Pacific was the biggest market for ceramic tiles, accounting for more than 60% of the global consumption in 2013. The governments of India and China have increased spending on infrastructure improvement, which is expected to lead to an increased demand for residential and commercial construction, resulting in an increase in the consumption of ceramics in these markets.

The emergence of West Africa is also envisaged as a manufacturing centre for the ceramic industry. This is justified by the search for low cost manufacturing, in comparison with the countries of North America and Europe, which has encouraged ceramic manufacturers to relocate their production in West Africa. In December 2013, West Africa Ceramics Ltd. (WACL) announced an investment of more than 50 million USD to begin production of ceramic tiles in Nigeria.

2.1. PERSPECTIVES FOR THE INDUSTRY

Ceramic tiles are essentially a mixture of clays that have been pressed and fired at high temperatures. The growth of worldwide construction activities is expected to continue being a key driving factor for the market in the coming years. The growth and development of the construction industry and of major infrastructures will be the main driving force of this market due to urban development, the increase in per capita income and the growth of the population. Other driving forces in this market include technological progress, environmental regulation in the growing economies of Asia-Pacific, such as India, China and Indonesia, and R&D initiatives to develop new eco-friendly products. Furthermore, a trend towards the replacement of paints, marble floors and metal slabs can be seen. In these countries, ceramic tiles are considered to be a symbol of high status and lifestyle.



GLOBAL CERAMICS MARKET, VOLUME BY TYPE OF PRODUCT, 2012-2020 (Millions of sq. metres)

2.2. APPLICATION PERSPECTIVES

Residential, commercial, new residential applications and others (facades, countertops). Residential use is expected to continue dominating the market overall in terms of share, since ceramics can be used as a substitute for marbles and paints. Applications in new residential buildings are expected to grow significantly due to the boom in construction and infrastructure in the emerging markets of China, India and Brazil.

2.3. REGIONAL PERSPECTIVES

Asia and the Pacific were the biggest markets in terms of global consumption in 2013; then Europe and Central and South America, which accounted for about a quarter of the total market in 2013. North America is expected to grow to a lesser extent, due to strict environmental laws. These stringent regulations are forcing companies to locate their production facilities in developing countries. However, it is expected that companies will invest heavily in R&D activities to develop new production processes capable of respecting the environment in order to reduce emissions of greenhouse gases.

2.4. THE CERAMICS SECTOR IN CHINA

The Chinese ceramics market currently has many brands such as Dongpeng, Marco Polo, Hongyu, Newpearl, New Zhongyuan, Nabel, Bode, Eagle Ceramic, Ocean, etc., together making up the ten leading manufacturers with a 9.93% market share. The new regulations in the field of environment affecting the ceramic industry in China are expected to give rise to a greater concentration of companies, and therefore mergers and acquisitions are envisaged.

With economic growth, the increase in the rate of urban development and in disposable income, the demand for quality housing and comfort, the market for ceramic tiles in China will continue to boom, rising from a market of 3,030 million square metres in 2009 to 6,281 million square metres in 2012, which means that consumption has doubled in 4 years. However, just as the growth of investment in real estate has slowed down, the ceramic tile market in China has also entered a period of adjustment. Chinese ceramic companies are mainly concentrated in the coastal areas of the Southeast, and the province of Jiangxi. Guangdong and Fujian belong to the traditional ceramic production area, while Jiangxi is an area of emerging production where a large number of good brands resulting from the transfer of the ceramics industry in Guangdong and the coastal cities are appearing.

RANKING	PROVINCE	SIZE (Mill. sq. metres)
1	GUANDONG	1.905
2	FUJIAN	874
3	JIANGXI	867
4	LIAONING	766
5	SHANDONG	682
6	HENAN	331
7	HUBEI	287
8	GUANGXI	278
9	SICHUAN	208
10	HEBEI	199

Source: ResearchInChina, WIND
TOP10 AREAS OF CERAMICS PRODUCTION IN CHINA, 2013 (millions of square metres)

Ceramics China, es la feria de referencia sectorial que se celebra en el *China Import and Export Fair Complex* de Guangzhou (Pazhou Complex). Este evento se ha convertido en uno de los principales puntos de encuentro para la industria cerámica en Asia. Desde sus inicios en 1987, la feria ha experimentado un notable crecimiento siendo referencia debido a que China es hoy en día el mayor productor, consumidor y exportador de productos cerámicos, situándose en la provincia de Guangdong su principal clúster productivo a nivel nacional.

El producto importado no puede competir, en el mercado chino, en costes con el producto local, por lo que se recomienda a las empresas castellonenses compitan "en términos de calidad, diseño y novedad".

También es importante conocer sus costumbres que influyen directamente en hábitos de consumo en este sector en particular, como, por ejemplo, saber que en China es frecuente entregar el piso totalmente vacío, dejando la tarea de decorarlo al consumidor. Este último suele ir acompañado de un diseñador a la hora de la compra del azulejo. En el caso de preferir el producto importado al local, el consumidor tendrá un poder adquisitivo superior que el del producto chino.

3. OPPORTUNITIES IN THE CHINESE MARKET AND STRATEGIC APPROACH FOR EUROPEAN CERAMICS

Having described the ceramic tile sector and market in China, we shall identify the business opportunities opening up in the next few years and suggest the strategy for taking advantage of them. In this sense we would like to highlight the importance of bearing in mind that China is a political economy, the great penetration of online sales, the adoption of new legislation on public-private partnerships (PPP), the need to understand the cultural differences and a good brand positioning strategy.

China is a **political economy**, and therefore foreign companies who know the political priorities of the country and take advantage of them will have a faster path to the market, and that will ensure better results.

At the moment, the implementation of free trade zones is being favoured. Following the adoption and implementation in 2013 of the Shanghai free trade zone, in March 2015 China approved three more areas, in Guangdong, Tianjin and Fujian. Discovering the advantages offered in accessing ceramic material for exhibition in the free trade zone and subsequent entry to the Chinese market via these custom routes, known as express routes due to the speed of the process, will provide a distinct advantage to those European companies intending to have a permanent presence in the Chinese market.

The Chinese government sees free trade zones as crucial for boosting trade and promoting investment. The pilot zones operate on what they call a 'negative list', i.e. that there are specific investment areas that are outside the scope of foreign investors. This list includes, for example, some non-ferrous minerals, the management of air traffic control systems, mail or communications companies, or the production of radio and television programmes. In other sectors, foreign investment is only permitted as part of joint ventures with Chinese companies, as for example the exploration of oil and natural gas, aeroplane design, manufacturing and maintenance, or rare earth smelting. In January 2015, China announced that it will allow entry to foreign investors who create their own private e-commerce companies, giving them access to the Shanghai free trade area as part of a pilot scheme.

The second important point to take into account is the way the **Chinese market in online sales** has evolved. Since 2013, China has become the world's largest eCommerce market, and the country offers great opportunities to European companies wishing to sell online. This sector is yielding unprecedented figures, and has more than 590 million users. The Chinese eCommerce market is growing at a very rapid pace, which represents a great opportunity for all those companies, whether Chinese or not, that are committing themselves to this option as a sales channel. With more than 40% internet penetration, Chinese online consumers connect for an average of four hours and thirty minutes a day. We should mention an example which was launched in August 2010, www.cnxz.cn, with an offer that includes a large number of Chinese footwear manufacturers. This website is frequently consulted by Chinese consumers in search of information. It is not for selling. It should be borne in mind that Chinese consumers use the network as the main source of information, before making a purchase. Consequently the presence of brands on Chinese microblogs or social networks like *sina weibo* with 400 million users (comparable to Twitter in Europe), is very important.

A third relevant point that will contribute to the growth in demand is the recent adoption of the **PPP Act** and the Chinese government's plans to increase infrastructure development projects throughout the country. Understanding the public-private partnerships (PPP) law approved by the National Assembly in China in July 2015 will give us an idea of the Chinese market's potential for the European ceramic industry and the opportunities that can be exploited from participating in such projects.

At the end of the twentieth century, there were projects in China which were built according to the BOT (*build - operate - transfer*) model. In 2004, after several years of experience, the Chinese Ministry of Construction issued the measures for regulating the Administration of Public Service Concessions, which was the first regulation in China concerning the management of concessions. Following this measure, many of the projects, especially in public services and infrastructure were invested in and / BOT / TOT BT (*build and transfer*) models built. However, few people, even in the government, talked about the concept of PPP in those years.

In 2014, the Chinese government proposed the concept of PPP and encouraged private investment to invest in PPA projects (those called private public alliance up till then) at the national level. Under instructions from the central government, the two main ministries responsible for supervising and managing PPA projects, i.e. the Ministry of Finance ("MOF") and the National Development and Reform Commission ("NDRC") issued a series of regulations, notifications and guidelines ("Regulations") on PPP. According to the Regulations, the government encourages private investment to invest in various sectors which are suitable for the PPP model, and establishes rules and procedures for PPA projects. At present, the main method by which PPA projects are adopted in China is by concession, which is used mainly in infrastructure and public service projects.

The new regulation in China on infrastructure and public service concessions replaces the existing regulation on concessions, which will only continue to exist in urban public services. China's National Development and Reform Commission (NDRC) has announced the details of 1,043 proposed PPP projects, which requires about 1.97 trillion yuan (322 billion $) of private investment. As of June, investors have a greater financial security and better credit support by Chinese banks and local institutions in the financing of projects involving energy, transport and real estate. These well-structured projects can lead to stable income in the long term that is attractive to private investors. However, this success will be based on the distribution of risks and the cooperation between the government and the private sector, as well as a transparent regulatory framework.

Due to the growing interest by foreign private companies in investing in China, and given the events adopted in legal matters recently by the Chinese government, this market offers enormous investment opportunities for foreign companies to exploit. The fact that the project is a concession does not absolve those involved from any of the rules governing foreign investment in China, as explained by CERD. Foreign investors are welcome as long as they belong to categories that are encouraged or permitted in the Catalogue for the Foreign Investment Guide published by the Chinese government. In all the infrastructure projects on offer, there are real opportunities for the European ceramics industry as well as for the auxiliary companies developed by these, with a clear innovative component regarding the Chinese offer. Innovation, added value and ecology are appearing as new challenges in the country and provide enormous business opportunities that the Spanish ceramics sector, in particular, can take advantage of.

As a fourth point, we should take into account **cultural aspects** that help us ensure that the sale of our brands of ceramics in China progress properly. It is important to know how to do business in the Chinese market, and the crucial role of factors such as *Guanxi*: the main thing is to build up the relationship in order to then do business. Learn about the history of the country, go to the market without preconceived prejudices about the Orient, become familiar with aspects of Confucianism whose values are still very present today, such as humility as a virtue, respect and obedience towards older people and their wisdom as well as the authority deriving from it, without forgetting the ground-breaking changes impacting on the generation born since the nineteen eighties and which are current concerns in China. Aspects such as the *Mianzi*, the reason why the Chinese avoid any confrontation and try to always remain polite so as not to "lose face" (*mianzi* literally translates into English as *keeping face*). The Chinese market is attributing much more value to a professional who understands their culture and way of doing business, over and above professionals who arrive with language skills but do not have this experience.

The last point in this approach explains that, in order for Chinese consumers to decide which brand to have in their home, it will be important for them to identify us clearly as a brand country, since Spain is very well positioned in this regard in this sector along with Italy, and in addition, **they associate us with fashion**. Spain is a benchmark country in terms of fashion in the minds of Chinese consumers, who admire our style and leading brands such as Zara and Massimo Dutti. Since the luxury brands began to open sales outlets in the Chinese market in the 1990s (Louis Vuitton opened its first store in China in 1992), enthusiasm for such products has spread like wildfire, with the country becoming the largest market for luxury goods.

In response to the growth of the market for luxury goods in China, some Chinese brands such as Exception emerged, with a concept opposed to ostentatious, luxury and striking items. The new trend, something like a 21st century Zen, is a local antidote for glamour. At the forefront of this movement is the brand Exception, whose soul is entirely Chinese. Their pricing strategy is in line with the foreign brands, and judging by their sales figures, the Chinese consumer is recognising their work and wearing their clothes with pride. Another local Zen-type brand is Zuczug, which has succeeded in making itself stand out clearly by using organic cotton. Its design is sportier and its target is the generation of the 1980s (Chinese thirty-somethings, among whom there are a very high percentage of millionaires). Another designer who is succeeding in this segment is Uma Wang, a member of the Vogue China team.

China is clearly a growing market for fashion, where there is room for a wide range of concepts aimed at different segments. On a general level, the Chinese consumer is attracted to foreign brands by their logos, but there is also a significant quota for those brands with their own well-defined style, as in the case of these three local brands. The competition will be increasingly fierce for international firms, as Chinese brands with their own identity begin to emerge. We also predict that this trend will emerge in the ceramics sector, and can perhaps be used to advantage by ceramics companies from Castellon committed to incorporating any of these designers as a clear commitment to the *Chinifying* of their products for their sale in China.

4. CONCLUSIONS

Up to now China and the West are still like water and oil, i.e. impossible to mix. Yet since many of us in the Western world are already fully aware that the Chinese are here to stay, it seems clear that we will have to learn to live with this fact and take advantage of its benefits.

We must try to understand the cultural differences, since they are crucial to making the business successful. It is important to have a general idea of the goals of the Chinese strategy and on which the country's growth is based (productive leadership, financial leadership (the World Bank) and technological leadership (technology transfer)).

Awareness of how the country functions, and of legislation in matters such as trade mark registration, is essential, since these are not like the rest of the world. It should be remembered that copying is very present in their cultural DNA.

Given all the above, we propose the following reflections for Spanish ceramics companies - ideas that are within reach of their possibilities - in the hope that they will prove useful, yet with the warning that it will be important to adapt them to fit each particular case in order to help those companies to access a market with great opportunities in coming years.

- Having a permanent presence in the country, given that changes are occurring constantly and at a rapid pace, and need to be adapted to on a day by day basis. We should briefly mention the case of Torres, their beginnings in China, and how they were able to re-orientate their business and succeed in becoming what is today the third most important drinks importer in China. It is only with a daily presence in the market that it is possible to detect where the initial strategy went wrong, to 'Chinify' it and be able to redirect it, because a market there certainly is.
- Creating a joint platform for all the manufacturing companies that, despite being smaller, are yet capable of offering "Ceramic fashion from Spain", an online platform for consumer information, plus a showroom in one of the free trade zones, which would enable them to share costs in order to access the market in a way that would make it possible for the brands to reach the Chinese end-user and for the latter to be able to purchase them via an online BTC platform. The advantage will also be real in terms of logistical costs, as a result of operations being grouped together.
- Taking advantage of the trend in China for creating style clubs made up of similar members (It is typical of us as humans that we like to associate with people that we consider to be the same as us, and the Chinese also behave in this way, grouping themselves together according to more than high levels of purchasing power, and forming groups for purchasing, or at least for influencing the consumption of brands), and communicating with these clubs is relatively easy in terms of access, and brand fame has a low cost/impact.
- The expected growth based on PPP projects, supported by the law passed by the National Assembly in 2015, whose changes minimise risks for the private investor compared to the current law, together with the size of the country, point towards a high level of growth in the consumption of ceramic products in this segment, providing companies know how to take advantage of it. In this sense, access could be supported for projects requiring materials that

are not greatly differentiated, based on joint ventures with Chinese companies that have the market know-how to enable access. As for the type of construction material and ceramics that there will be room for, it will be that type that provides a clear differentiating value for surfacing façades in public work projects such as hospitals, public authority institutions and buildings, interiors designed for signs, equipping areas where there is an obvious need to preserve specific hygiene conditions, such as operating theatres or specific places, maternity centres, etc. Being open-minded, while establishing the necessary red lines, in order to know how to use Chinese ceramics companies and their associations and institutions as a vehicle for positioning our brands in the highest segment of the Chinese market, will give us a clear advantage over other European companies.

- Mentioning the successful strategy of the biggest and leading companies in the panorama of the Spanish ceramics sector. Doing things very well all the time and with unity, building up an important brand value associated with fashion, manufacturing in Spain, leadership and prestige, and having achieved recognition in the most important international markets, so that it will be the Chinese customers/consumers who, attracted by the value of a world-famous brand, will be willing to pay out more RMB in order to acquire these products. Taking advantage of this 'sweet moment' in order to produce profitable results in a Chinese market also has its complex side, and requires an equally ambitious and perfectly defined strategic plan.

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