



# Navigating China's Public Procurement Market: Background, Challenges, and Best Practices

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## Executive Summary

- China's public procurement market is regulated by two major pieces of legislation, the Government Procurement Law (GPL) and the Tendering and Bidding Law (TBL). The Chinese government estimates the market covered under the GPL at approximately \$180 billion in 2011, while outside estimates of market size covered under the TBL are as high as \$1 trillion per year.
- Consistent stakeholder outreach, strong internal communication, and creative approaches to access local knowledge are keys to performing well in China's public procurement market.
- Companies view fragmented markets, uneven access to information, and transparency in determining bid criteria and bid winners as priority concerns.
- The lack of an effective appeals process is one of the greatest hurdles to creating a competitive procurement system in China.
- Continued protectionist tendencies by local governments and lack of rule of law undermine progress that has been made in improving China's public procurement system.
- China would benefit from making a substantive offer to join the World Trade Organization's (WTO) Agreement on Government Procurement (GPA). GPA membership would provide Chinese government agencies greater access to high-quality, cost-effective goods and services, while allowing Chinese companies to expand their investment opportunities in the nations that are GPA members.

## Introduction

China's public procurement policies – regulations that govern how and what products can be purchased using public funds – have been a source of controversy in recent years, both for their connection to protectionist practices and policies and for their influence over China's negotiations to join the World Trade Organization's (WTO) Agreement on Government Procurement (GPA).<sup>1</sup> According to the Ministry of Finance (MOF), China's public procurement market grew 10-fold over the last 10 years to \$180 billion in 2011, with analysts

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<sup>1</sup> China's bifurcated public procurement system makes defining government procurement in China complicated. The term "public procurement" is used to include all tendering and bidding done with public funds, including that carried out by SOEs that falls under the Tendering and Bidding Law and purchases made by government agencies under the Government Procurement Law.

anticipating solid growth for years to come.<sup>2</sup> While government statistics put the Chinese market at less than half of the US government procurement market covered under the GPA, these statistics do not take into account purchases made by China's large state-owned enterprises (SOEs) and other provincial and city institutions that would ordinarily be associated with public procurement processes in GPA signatory countries.<sup>3</sup> The sheer size and potential of China's public procurement market means that market access in these sectors remains a vital issue for international companies doing business in China.

In the summer of 2012, the US-China Business Council (USCBC) interviewed more than 20 companies from a broad range of industries to learn more about the current realities of China's public procurement market. The interviews covered the tendering and bidding process, the challenges companies face in navigating the system, and the best practices they use to overcome those challenges and sell into China's public procurement market. This report is based on those interviews.

## China's Dueling Public Procurement Laws

China's tendering and bidding system began in the 1980s, when the State Council ordered reforms in the construction and public works sectors to increase competition between state-owned enterprises, creating several localized tendering and bidding markets throughout China. While these reforms successfully introduced market mechanisms and increased efficiency in allocating capital, fragmented markets and continued corruption made it clear to the central government that national laws were needed to regulate these emerging markets.

In the mid-1990s relevant ministries began drafting legislation to regulate agencies under their jurisdiction (see Table 1). The Ministry of Finance (MOF) drafted a series of ministerial orders that were used as the basis for China's Government Procurement Law (GPL), which took effect in 2003. The law's scope was limited to regulating the purchases of goods and services made by central government agencies and their provincial branches. All other forms of tendering and bidding, including tenders that may be considered public procurement in other jurisdictions, such as purchases made by SOEs and many large-scale public works projects, fall under the jurisdiction of the Tendering and Bidding Law (TBL), which was implemented in 2000 by the National Development and Reform Commission's predecessor, the State Development Planning Commission.

Goods and services covered under the GPL are listed in China's centralized government procurement catalogue as well as local government procurement catalogues. The catalogues use broad terminology to cover a host of products, making it simple for any company's product to fit into the catalogue system and become eligible for purchase. As such, foreign companies are not concerned about their ability to get products listed in a government procurement catalogue, though there continues to be concerns regarding preliminary standards written into individual bid criteria that may discriminate against foreign-invested companies.

The fractured administrative authority and ambiguous coverage that results from the two laws has affected China's accession to the GPA. One reason for the rejection of China's two previous offers by GPA members was a lack of coverage of sub-central entities and SOEs. As the agency that administers China's Government Procurement Law, MOF is the lead for GPA negotiations. Much sub-central bidding or contracts offered by SOEs do not fall under MOF's jurisdiction, thus complicating negotiations as many of the important

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<sup>2</sup> "Ministry of Finance: Ten-fold Growth of Government Procurement Market Does Not Conflict with Statistics for Cuts in Expenditure (财政部: 政府采购规模增长 10 倍与精简开支不矛盾)," *Gov.cn*. July 9, 2012. [http://www.gov.cn/jrzg/2012-07/09/content\\_2178960.htm](http://www.gov.cn/jrzg/2012-07/09/content_2178960.htm)

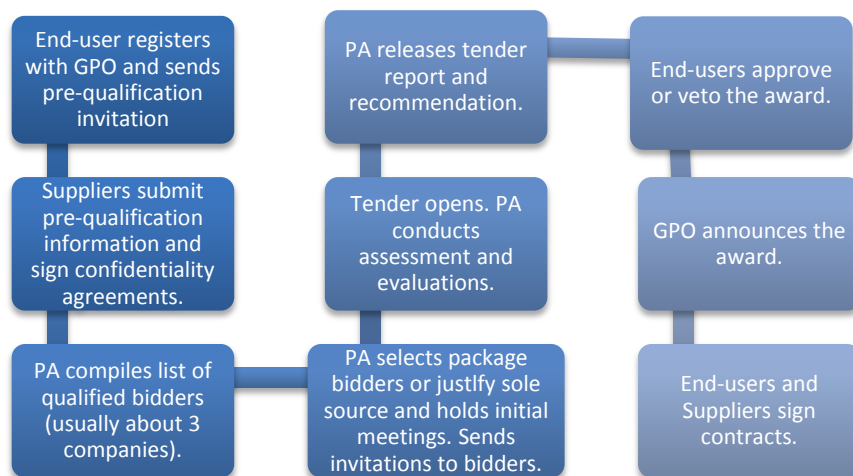
<sup>3</sup> See European Union Chamber of Commerce, "Public Procurement in China: European Business Experiences Competing for Public Contracts in China." 2011. <http://www.eucc.com.cn/en/chamber-publications>.

stakeholders in China’s public procurement system are not at the table during negotiations with the United States and other GPA signatory governments.

**Table 1: Relevant Laws and Regulations for Public Procurement in China**

No.	Name of Law	Administering Agency	Year of Release
1	<u>The Tendering and Bidding Law of China</u>	NDRC	2000
2	<u>The Government Procurement Law of China</u>	MOF	2003
3	<u>Administrative Measures for the Tendering of Goods and Services in Government Procurement</u>	MOF	2004
4	<u>Administrative Measures for the Publication of Information related to Government Procurement</u>	MOF	2004
5	<u>Measures for Managing Complaints by Suppliers Participating in Government Procurement</u>	MOF	2004
6	<u>Interim Measures on Inter-ministerial Cooperation Mechanisms on Tendering Procedures</u>	State Council	2005
7	<u>Administrative Regulations on the Government Purchase of Imported Products</u>	MOF	2007
8	<u>Implementation Regulations for the Tendering and Bidding Law of China</u>	NDRC	2012

**Figure 1: The Basics of China’s Tendering and Bidding Process for Public Procurement**



Note: GPO = Government Procurement Office, PA = Procurement Agency

### The Chinese Tendering and Bidding Process

Chinese regulations clearly lay out the tendering and bidding processes, which follow similar basic steps regardless of whether the bid is taking place under the GPL or the TBL. The process may vary in practice, however, depending on the size of the bid, the industry involved, and the company that is doing the procuring

(end-user). Variations may include more stringent pre-qualification standards for high-value bids or the addition or omission of certain steps based on industry. These variations are allowed under PRC law, and are common international practice for tendering and bidding.

There are different types of tendering and bidding used in China and around the world (see Table 2). This report focuses on open tendering, as a majority of tenders in the China market fall into this category.

**Table 2: Categories of Tendering Allowed in China**

Type of Tendering	Description
Open tendering	Main type of tendering practiced in China, in which a project is offered publically to all qualified bidders.
Selective tendering	Where a company limits the number of bidders to a few qualified, pre-determined suppliers. Allowed in the tendering of key projects.
Competitive negotiation	Allowed in cases of failure of tendering procedure, for example when standards are too technically complex, or when there is urgent need of a good.
Single source procurement	Allowed in the case that there is only one possible supplier, in cases of unpredictable emergency, or a supplementary procurement with a low value (lower than 10 percent of original contract).

To begin the process, the end-user will first inform the relevant government procurement office of the new project (see Figure 1). Government procurement offices are government agencies that register and publish bidding contracts and are affiliated with regional and municipal branches of MOF. After announcing the project to the government regulators, the end-user may then select a procurement agency to aid them with the administrative functions associated with the tendering and bidding process. Procurement agencies are not always used, as it is unnecessary to commission a procurement agency for non-catalogue items. Government-affiliated procurement agencies (often called centralized procurement agencies) must be commissioned for the tendering of products listed in either central or provincial government procurement catalogues, however. Many large SOEs use a procurement agency they have established as a subsidiary to aid them through the tendering and bidding process. Since procurement agencies are little more than an administrative arm aiding the end-user through the bidding process, the relationship between SOEs and their subsidiary procurement agencies were not generally mentioned as a concern by companies.

**Table 3: Examples of Differing Types of Procurement Agencies**

- [China CNT International Tendering Corporation](#) Central government-affiliated procurement agency
- [Henan International Trade & Tenders Co., Ltd](#) Local government-affiliated procurement agency
- [Shanghai Comservice Bidding Co., Ltd](#) Subsidiary of China Comservice, an SOE
- [Beijing Jingyuan Chengdexin Engineering Management Co., Ltd](#) Privately owned procurement agency

The procurement agency then works with the end-user to create proper specifications for their bidding request, producing initial bidding information that is published on official bidding websites or other forms of authorized media, including newspapers. Companies interviewed noted that they were familiar with all of the official media used for publishing bids and that transparency in official bid announcements is not a concern. Some companies noted concerns about certain domestic companies having access to bidding information before official publication, an issue many potential suppliers have tried to combat through marketing campaigns to educate potential buyers of the quality and specifications of their product.

Educating stakeholders involved in a bid has two primary benefits. First, it helps end-users to understand the benefits of having inclusive standards and review criteria written into a bid, thus increasing the likelihood of selecting the highest quality product for purchase. Second, it may balance against the ability of local stakeholders with superior access to information influencing bid criteria early in the process to discriminate against foreign competitors.

In many cases, there is a pre-qualification process during which the procurement agency selects from a list of companies compiled through end-user recommendations, well-known industry players, and companies that have responded to the pre-qualification notice with all the necessary information. The procurement agency works with the end-user to create a final list of eligible bidders, which in most cases includes roughly 3-4 bidders. Consistent outreach to multiple stakeholders can help a company educate end-users and relevant personnel in procurement agencies to ensure that all key stakeholders understand the quality and specifications of their products. During this early stage process the list of potential bidders gets significantly reduced, so it is vital for potential buyers to be fully aware of a company's product before pre-qualification begins. This key step is elaborated upon further in the section on best practices.

**Figure 2: Sample List of National, Provincial, and Municipal Websites for Government Procurement**



After pre-qualification, formal tendering documents are produced by the procurement agency and purchased by qualified bidders. Tendering documents contain detailed product specifications produced by the technical staff of the end-user, as well as specific review criteria to be implemented by the review panel during bidding. There are three basic criteria designated by law to be used in each bid: commercial factors (price), quality and functions of the product, and an evaluation of life-cycle costs of the product. The weight given to each of these criteria varies from bid to bid, as end-users are allowed by law to define the criteria to their own specifications. Member companies consistently note that buyers in the China market tend to overly focus on price, thereby hindering the ability of foreign companies with high-quality products to compete in the market.

By the time tendering documents are issued, the review panel of certified industry experts that evaluates each of the products according to the bid criteria, has been selected by either the procurement agency or the end-user. Generally speaking, companies noted that they were familiar with many of the experts that could be selected for review panels and were comfortable with how the panels were selected.

Upon receipt of the tendering documents, the bidding process begins. Bidding takes place through multiple rounds, with the total number of rounds varying from bid to bid. Suppliers offer bids that illustrate product quality as well as detail a price they see as reasonable.

Once the bidding rounds are completed, the panel reviews final offers using the pre-established review criteria and selects what they believe to be the best bid. This recommendation is passed on to the end-user who then makes the final decision on which product to purchase. Once the end-user and the procurement agency have agreed on a winner, they notify the government procurement office and announce the winning bid through the same official media outlets that initial bids are published.

Upon announcement of a winning bid, there is a brief period (15 days) during which losing bidders can file a challenge to the decision. If no challenge is filed, the procurement agency releases notification of the award, and contracts are signed by the end-user and supplier. Appeals are reviewed by the procurement agency that did the initial review. Many companies noted that filing an appeal with the same agency that made the original decision makes it difficult to win. In addition, winning an appeal could negatively affect long-term sales by alienating potential buyers. While a small number of companies have attempted to appeal decisions related to their bids, some eventually winning their appeal, companies agreed that the appeals system is ineffective. While member companies did note improvements to the tendering and bidding process in China over the past 10 years, the lack of an effective appeals process was noted as one of the greatest hurdles to creating a competitive procurement system.

## **Challenges**

Though many companies agree that the process for tendering and bidding in China has improved over the last 10 years, companies still face a number of inter-related challenges in navigating China's public procurement market.

### **Transparency**

Companies noted improvements in transparency in China's public procurement system over the past 10 years. Many pointed out that large SOEs and central government agencies have strong incentives to comply with regulations to maintain a good reputation with suppliers, international and domestic regulators, and the public. But problems with government transparency, especially at the local and provincial level, contribute to other major concerns, such as price pressures and internal compliance.

Lack of transparency can take many forms. Multiple firms stated that "under-the-table deals" occur between certain end-users and suppliers that come from China and other countries with more lax anti-corruption laws than the United States. Others noted concerns on "local branding," which in practice means unwritten quotas that require local government agencies to purchase brands that are majority or wholly Chinese-owned. The ability to appeal unfair decisions is central to enforcing a transparent system, but the tendering and bidding system also lacks a functioning appeals system. Without it, review panels and end-users have little incentive to keep detailed records of how they make a decision.

### **Price Pressure**

Price pressure influences multinational companies' ability to compete in China's public procurement market. As noted above, Chinese review panels are expected to evaluate products by price, quality, and life-cycle costs to pick the most valuable product for purchase. Due to a variety of factors, however, government agencies usually end up choosing the most inexpensive products. Reasons for this include pressure from leadership to

maintain a low annual budget and, at times, support of local companies that produce for lower prices. Lower prices often translate into lower quality goods with shorter life-cycles, however, which may actually drive up government spending in the long term.

Multinational companies are not able to compete in such an environment and would benefit from clearer standards for calculating review criteria.

### **Low Barriers to Entry**

The lack of adequate pre-qualification assessments – such as due diligence on companies’ financial standing – also contributes to fragmented markets. Under the current system, procurement agencies and government procurement offices do little to no pre-qualification assessments, allowing virtually any company that has a quality sample of an eligible product to become a qualified bidder. This drives prices to unsustainably low levels and increases the risk of selecting low-quality or substandard goods for the end-user. Having strong pre-qualification assessments of suppliers’ technical and financial background would create a more efficient system that could deliver quality, reliable products to end-users.

### **Company Example 1**

China’s medical devices industry suffers from fractured markets. Tendering and bidding in this industry falls under the Ministry of Health (MOH), but due to a lack of central regulation, local branches of MOH tend to do the majority of regulating on tendering and bidding for medical devices. Lack of central-level regulation combined with transparency issues leads to conditions that often favor local companies and fractured markets, which makes it difficult for foreign companies to compete in certain regions in China.

One company tries to mitigate these issues by selling through distributors to take advantage of their local market knowledge. To manage relations with distributors and other stakeholders in the market, the company breaks their procurement teams into three units that interact with each other often.

- **Sales team** Focuses on interaction with end-users, procurement agencies, and key-opinion leaders to ensure that all stakeholders fully understand the quality of the company product.
- **Tendering team** Deals directly with the tendering process to ensure that administrative aspects of the process run smoothly.
- **Distributor team** Deals directly with the distributor to maintain a strong working relationship, educate them on product specifications, and ensure distributor practices match company values.

### **Domestic Content**

Several company respondents cited the lack of clearly defined domestic content regulations as another challenge for multinational companies. Domestic content refers to establishing a clear definition of what is considered a “Chinese product.”

Many foreign firms manufacture products in China, hiring Chinese employees, and sourcing many of their materials locally. China has yet to finalize domestic content regulations, however, leading some government agencies to interpret a domestic product by a company’s country of origin without considering products manufactured in China by foreign invested firms. MOF has stated that it will release final domestic content standards by the end of 2012, but the regulations had not been released at the time this report was published. Once China joins the GPA, it will need to designate a formula of “substantial transformation” similar to those used by the United States to determine the nation of origin of a product, rather than the approach included in

draft versions of Chinese regulations. To that end, it may be prudent for China to incorporate such an approach into its regulations now, rather than waiting for its GPA membership to be finalized.

Information technology (IT) firms are particularly affected by the use of domestic content rules. IT firms noted that the Draft Implementation Regulations for the Government Procurement Law, follow-up regulations under formulation that would add detail to the enforcement of the GPL, includes a formula that confuses the concept of value and cost in its definition of what constitutes a “local product.” The definition also does not include IT-sector carve-outs that the United States and other developed economies include for their non-GPA trading partners. Due to the global nature of supply chains and the premium placed on creativity in the IT sector, IT companies argue that including product value in the formula for determining product origin is misleading. Such valuation may distort the amount that an IT firm has invested in locally-sourced products and employees and makes it extremely difficult for IT products to qualify as domestic products.

## Best Practices

Despite these problems, there are a series of best practices that companies have found can mitigate challenges and increase success in China’s public procurement market.

### Stakeholder Outreach

Developing relationships is vital to any business endeavor, both to maintain long-standing customers and educate potential customers about the benefits of a company’s product. China’s public procurement market is no different, though outreach is complicated by the diverse range of stakeholders that are involved in the stages of the tendering and bidding process. The term “stakeholders” refers to all actors involved in the tendering and bidding process, including those involved in the application, standards setting, review, and selection of winners processes for each individual tender (see Table 4).

Problems with early access to information are a great challenge for companies navigating China’s public procurement market. Company representatives stated that local business executives with close relationships to end-users can often obtain vital information on a potential bid before it is officially published, giving their company an unfair advantage in preparation time over the competition. A full-scale education campaign led by a company’s marketing and sales teams can help a company overcome some of the challenges caused by a lack of transparency. Such a campaign should inform key stakeholders of what sets the company’s product apart from the competition.

**Table 4: Stakeholders**

Stakeholder	Identity	Importance to Supplier
<b>End-user</b>	Purchasing company or government agency	Holds ultimate decision-making power on product choice; also key in setting standards; interacts with other stakeholders
<b>Procurement agency</b>	Institutions dedicated to managing the process of tendering and bidding. May be private, government-affiliated, or a branch of an SOE, depending bid type	Sets product specifications, implements bidding process, and forms review panel
<b>Review panel</b>	A group of technical experts from both industry and academia that are hired by the end-user or procurement agency to review a tender	Recommends preferred product to the end-user, and may veto decisions made by government agencies in cases of strong disagreement
<b>Government procurement office</b>	Affiliated with MOF; exist at both central and provincial levels	Companies must file with these offices to become eligible to apply for tenders, and work with them to sign contracts



<b>Design institute</b>	Organization that is commissioned by the end-user to design large projects using the specifications provided by the end-user	Advises the end-user on the project scope, the types of materials, technologies, products, components, and suppliers necessary to complete the project
<b>Key opinion leaders</b>	Technical experts with a trusted reputation in a given industry	Influential throughout the industry and possible candidates for review panel

Practices for stakeholder relations varied among companies, but most companies adhered to several general principles.

- **Engage stakeholders early and regularly** All companies noted it is critical to actively seek out and engage stakeholders, both to educate them on product specifications and to gain leads on possible upcoming bids. For most companies, sales teams take the lead in engaging stakeholders. Suppliers either provide technical training courses to sales staff or pair them with product engineers to ensure they can speak in detail on product specifications.
- **Combine research with outreach** Similar to a traditional business development model, many companies pair their sales and marketing teams to exchange market intelligence that sales personnel can act upon. Several companies said their marketing teams scour the Internet for media articles about end-users' future investment plans or research government policies and plans, such as China's various five-year plans or regional development plans. They then combine that macro-knowledge with sales personnel's local intelligence to identify potential end-users and projects.
- **Focus on industry-specific stakeholders** While it is important to engage with the stakeholders listed above, there may be others that are more vital to engage with based on product or industry. Some companies target only large SOEs or central government agencies that are more likely to buy their high-quality products. Many companies that sell products related to large public works projects focus resources on outreach to design institutes, which advise the end-user on project scope, specifications, product selection, and can influence the review panel as well.

## Company Example 2

One company that manufactures communication products and supplies SOEs in China takes a "holistic" approach to engaging stakeholders. The company holds routine roadshows to display and demonstrate its new products and hosts technology exchange seminars to educate design institute employees about cutting-edge innovations coming from the industry. These types of events target technical staff at design institutes because their input about products and technology form the basis of the product specification as written in the tendering documents. Through hosting these types of events, the company builds trust with key stakeholders, who eventually share information with the company about what tenders are in the pipeline.

In addition to building trust with design institutes, the company deploys its business unit president to meet with senior officials within its SOE customers. The objective of these meetings is to strengthen relations with the end-user, and to raise its profile with another key stakeholder – in this case, a provincial procurement department. In this industry, provincial procurement departments have a significant amount of influence over the public tendering and bidding process. Initially, the company had limited access to the provincial procurement department. After several successful meetings with senior SOE officials, however, the company was able to gain recognition among other key stakeholders and have meaningful relations with them.

### **Maintain Strong Internal Communications**

Internal communications can be key to maintaining business relationships and discovering new clients in China. In many companies, there are an array of offices that need to stay in touch to make sure that the sales team is knowledgeable about potential clients, product specifications, regional markets, and internal compliance standards. As such, companies use a variety of methods to ensure that sales, marketing, business development, technical, and legal teams maintain good communication, including weekly meetings, ad-hoc phone calls, and locating department heads in adjoining offices.

### **Strategic Partnerships with Local Business**

Given the size of the Chinese public procurement market, many foreign companies find it beneficial to engage with local Chinese companies to improve their performance. Strategic partnerships vary and include moving product through third-party distributors, contractual partnerships with local vendors or joint ventures with local companies. Working with local companies can increase local knowledge and company resources, expand bandwidth, and aid with funding for new investments. Working with distributors can be particularly useful in selling to certain government agencies that exclusively buy through them.

Working with local companies also has its challenges. For example, working with a distributor or local vendor limits the company's ability to control price, since local companies often sell with razor thin profit margins to compete. Local companies also may have limited technical knowledge of a company's products, making stakeholder education more difficult. Finally, local companies may also have limited knowledge of the regulations for ethics and compliance that foreign companies and their partners must meet, which can lead to high costs in training local staff or possible compliance problems.

### **Company Example 3**

One company formed a "strategic partnership" – but not a joint venture – with a domestic manufacturer of a related product to jointly bid on public tenders. China's industry regulator for this sector has rules that require joint bids for component parts. Under that framework, each side's interests are served: the company has greater access to the tendering market and the domestic partner has access to best practices and, over time, overseas markets.

To manage the strategic partnership, the company designated a "relationship manager" – a specific function within the corporate structure that is responsible for overseeing the day-to-day operations and joint-activities between the two sides. Specific functions within each company, such as sales and business development personnel, also regularly communicate with each other to identify new business leads and maintain existing customer relationships.

### **Conclusion**

China has made progress over the last 20 years in creating a more structured public procurement system, but faces continuing challenges with transparency and gaps in regulation. Foreign products that are locally sourced and produced continue to face discrimination, both through standards written before the tendering process begins, or through de facto quotas that force local governments to buy local products even when they would prefer to invest in a higher-quality item produced by a foreign company.

An important step in moving towards a more transparent government procurement system would include joining the WTO's GPA. USCBC encourages China to work with the US government and other international

actors to submit a robust GPA offer as soon as possible. Such an offer will significantly increase the number of sub-central entities and publicly funded enterprises and organizations covered under the GPA, as well as significantly expand coverage of the construction and services sectors. Joining the GPA would not only improve Chinese government agencies' access to high-quality, cost-effective products, but would also be a boon to China's private sector as Chinese companies look to invest in infrastructure projects in the US and Europe.

Even as problems remain, companies must continue to operate in China's current public procurement market to stay competitive. The strategies listed above can not only aid foreign companies now, but will also likely be useful as China moves to improve transparency and decrease discrimination in its market. Patient and consistent outreach to key stakeholders combined with strong internal communication and a focus on key markets can help more companies as they look to maintain old clients and seek new ones in China's public procurement market.