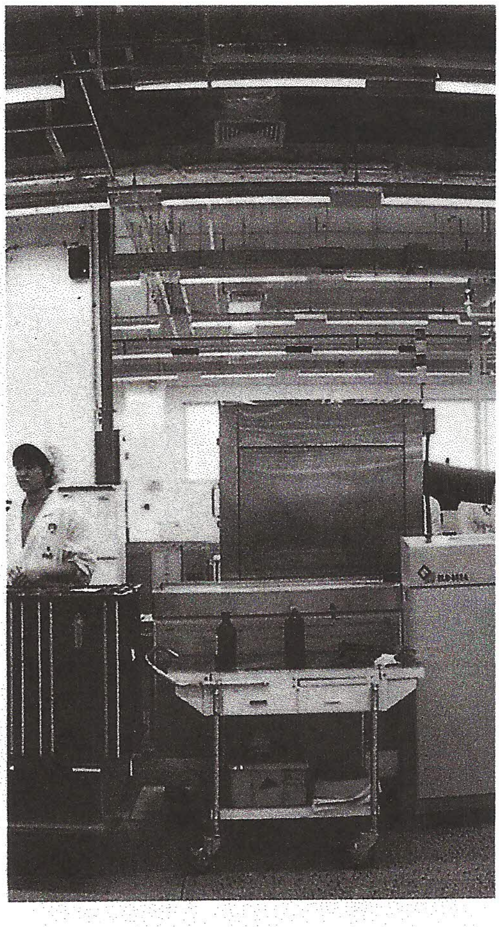

TELECOMMUNICATIONS

Huawei's Fixed Line to Beijing

Strong official backing has helped Huawei Technologies become a serious player in the global telecoms-equipment market. Will these ties prove a boon or hindrance to foreign partnerships?

By Bruce Gilley/SHENZHEN

ON THE FIRST FLOOR of Huawei Technologies' manufacturing centre is a holding area for completed telecoms gear. On a recent day, all three of the room-sized switching systems waiting to be shipped carried the same customer name: Telecommunications Bureau, People's Liberation Army.

That label reflects the powerful backing that has helped Huawei evolve from a small reseller of foreign equipment into China's biggest telecoms-infrastructure player. The company, based in Shenzhen, near Hong Kong, is the biggest maker of switching devices in China, and a top-10 player worldwide, employing 16,000 people and generating expected revenues of $1.5 billion this year alone. While its name doesn't ring as many bells as rivals Cisco Systems and Lucent Technologies, it may be only a matter of time before Huawei becomes a household word.

Already, the little-known company's sudden emergence in the world's largest and fastest-growing telecoms market has aroused interest abroad. Foreign telecoms companies in particular want to know who owns Huawei and who finances and supports it. The answers to these questions will determine whether they deal with Huawei as a partner or as a rival.

Huawei executives offer few answers. Executive Vice-President Hu Yong drops his ready smile for a blank stare when questions about the company's ownership and backing are raised. The company is wholly owned by its staff, he says, and has "no connections whatsoever" to any government or military organization in China.

However, a detailed investigation of the company by the REVIEW—based on interviews with company staff, industry figures and published information in China and Hong Kong—provides widespread evidence of strong official backing. Beijing wants Huawei to be its national champion, and it has the ability to make it happen. Not only is Huawei financially and politically supported by the Chinese government but also its origins as a military-backed company continue to pay dividends, including a contract to maintain the Chinese military's telecoms backbone.

Indeed, the company's senior vice-president, Fei Min, admits to significant government backing and modest military sales, though he maintains the company's prosperity is due to hard work.

"Because it is not a state company, Huawei has stayed below the radar screen until recently," says Ted Dean of BDA China, a telecoms consultancy in Beijing. "But the Chinese government is supporting them as part of its overall plan to build up domestic equipment makers."

Other governments around the world back state champions too, although it's becoming more difficult under World Trade Organization rules. But in China's often opaque and bureaucratic business environment, state backing can make a company virtually unbeatable.

China's WTO entry may increase pressure for the disclosure and reduction of Huawei's official links. But few expect rapid changes. In the meantime, Huawei's powerful official support means that China's telecoms-equipment market could become an increasingly unlevel playing field for suppliers. That may warrant a more careful approach by foreign companies that recently have signed cooperation deals with Huawei (*see article on page 96*).

Huawei was founded in 1988 by Ren Zhengfei, a former director of the Information Engineering Academy of the PLA's General Staff Department, according to company sources. The academy is responsible for telecoms research for the Chinese military.

Ren left the academy in 1984, aged 39, and went to work for the state-owned

Shenzhen Electronics Corp. Four years later, with a loan of 70 million renminbi ($8.5 million) from a state bank, he founded Huawei with 14 colleagues. He remains president and is believed to hold a 5% stake in the company.

Huawei became essentially a reseller of imported telecoms equipment. It also created a small cadre of researchers who reverse-engineered imported switching devices and network equipment to produce Huawei's own branded versions. Its timing was impeccable. In its efforts to build a modern military, the PLA was desperately in search of better information-technology equipment and saw Huawei as one way to obtain it, company sources say.

According to Huawei's deputy manager of sales in Russia, Alexei Shalaginov, the firm received a contract in the early 1990s to provide key equipment for the PLA's first national telecoms network, which it continues to supply and upgrade. "It is small in terms of our overall business, but large in terms of our relationships," he says.

The turning point for Huawei, however, came in 1996. In that year, Beijing introduced an explicit policy of supporting domestic telecoms companies to prevent foreign domination of China's equipment industry. Both the government and the military began to tout Huawei as a national champion.

The reasons for tapping Huawei over other up-and-coming suppliers like local rival Zhongxing Telecom—a state-owned equipment maker set up in 1993—remain unclear. Several foreign analysts believe the company's military connections were crucial. Certainly those connections remained strong. In November 1996, for example, Liu Huaqing, vice-chairman of the Central Military Commission, took time out from an inspection of PLA troops in Shenzhen to visit Huawei, according to a report by the official Xinhua news agency.

Whatever the reason, Huawei's sudden elevation to putative national champion was marked. The Shenzhen government declared the company to be one of 26 "key development projects" in the city that would enjoy state "support," according to local press reports. The local-government-owned Shenzhen Development Bank and the local branch of the state-owned China Construction Bank began to extend credit to buyers of Huawei products as well.

In the same year, state Vice-Premier Wu Bangguo, in charge of national industry, visited the company and promised it 50 million renminbi in loans to develop GSM mobile-phone technology, according to local press reports. "At present, this is a monopoly of foreign companies. I suggest that Huawei make new breakthroughs in the mobile area," Wu said, according to the reports.

When Huawei launched GSM-equipped components the following year, Wu returned to Shenzhen to praise company leaders. "By breaking the monopoly of Western companies and strengthening the creative capabilities of the Chinese people, Huawei has made a heartening achievement," he said.

Huawei was soon producing complete sets of relatively sophisticated fixed-line and mobile telecoms equipment. One of its first big contracts was a switching system ▶▶

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TED DEAN, MANAGING DIRECTOR, BDA CHINA

for a fixed-line network being installed in Hong Kong by Hutchison Telecommunications, part of the business empire of pro-Beijing tycoon Li Ka-shing.

At home, Huawei won big contracts to install telecoms systems for the national railway system, for the state body in charge of infrastructure along the Yellow River valley and for many major provinces and cities, including Beijing and Guangdong. That helped unlock more finance. In 1998, for example, the Beijing headquarters of China Construction Bank lent the company 3.9 billion renminbi in buyer's credit—representing 45% of the total such credit it extended that year, according to local press reports.

Huawei could do no wrong. Revenue quadrupled to $993 million in the four years to the end of 1999, while net profits rose tenfold to $182 million, making it the most profitable company in the telecoms-equipment industry in China. Zhongxing Telecom, by contrast, posted profits of $25 million on revenue of $300 million last year.

When Huawei exhibited at the International Telecommunication Union's trade fair in Geneva in October 1999, it caused a splash. "Everyone was shocked that this sort of stuff was being made in China," recalls Abdulrahman El-Sawy, chairman of Egyptian data carrier EgyNet, which began to buy network-access systems from Huawei because of its low prices.

> "We support 80 different component suppliers and are one of the top 10 taxpayers in Shenzhen"
>
> Fei Min, senior vice-president, Huawei Technologies

Since then, continued government and military backing has helped Huawei to consolidate its domestic presence and leap onto the world stage. At home, it has continued to snare major contracts, becoming the vendor of choice for telecoms giants China Telecom and China Mobile.

Huawei's relationship to the military shows no sign of weakening, even if military sales are a decreasing share of revenues. Fei says the company's sales to China's military account for less than 1% of its total sales. But analysts note that even small military sales in China can help ensure high-level state support in all aspects of business.

Huawei may even have expanded its military customer base to include the People's Armed Police, the paramilitary corps responsible for handling domestic unrest. A delegation of 70 senior PAP officers spent a day at Huawei in May 1999, according to local press reports. It was led by Zhang Zhenyuan, deputy director of the PAP's logistics bureau, which oversees the force's telecoms infrastructure.

Financially, the company is now flush with cash. The state-owned Industrial & Commercial Bank of China and Bank of China have both recently provided 3.5 billion renminbi in revolving buyer credit to Huawei, while ICBC lent the company an additional 200 million renminbi this year for GSM research. The company has even begun to attract loans from non-state banks.

The Shenzhen government, meanwhile, eager to enjoy the economic benefits of playing host to a burgeoning global giant, has bent over backward to make the company's life easier.

A new factory producing parts for network systems was declared this year to be one of 43 "key construction projects" eligible for special bank loans. The company also has been given one of 68 "priority in approvals" licences in the city, which means all its dealings with the government are handled before ▶▶

RIVAL ... OR PARTNER?

The robust government and military support Huawei Technologies receives leaves little doubt in the minds of most major foreign telecoms-equipment makers that the company should be viewed as a serious rival, both in China and abroad.

But whatever their misgivings, global players have responded to Huawei's rapid growth by striking partnerships with the company.

The earliest to spot Huawei's rise were U.S. companies Texas Instruments and 3Com, which in 1997 struck deals allowing Huawei to develop their products for the Chinese market. Since then, the courtship of Huawei has become a mad scramble. Lucent, Intel and AT&T have all signed partnerships with the company to develop network infrastructure. IBM has agreed to supply network components and software to Huawei and has offered access to its formidable research facilities.

Motorola, meanwhile, is providing its GSM base stations for use with Huawei GSM mobile-phone systems in China. Rueybin Kao, Motorola's chief of network solutions in China, says he has no doubt that Huawei plans to use the partnership to replace Motorola's stations with its own one day. But the U.S. communications giant hopes to postpone that day by continually offering a better service. "We have to stay ahead of the competition from our own partner," he says.

Indeed, for many of the foreign firms it makes more sense to work with Huawei than to compete against it, given its official backing.

Even if they lose technology and markets to Huawei, notes Ted Dean, managing director of consultants BDA China in Beijing, partnering with the company still makes sense.

Deals can help foreign firms maintain good relations with Beijing, he notes. They also can help meet domestic-content requirements for manufacturing facilities in China. But caution has to be the top priority, he says. "I think most foreign firms are aware of that."

Bruce Gilley


Xinhua

GET ME HUAWEI NOW! A military contract continues to pay dividends for the Chinese telecoms supplier

those of other companies, local press reports say.

Fei, the senior vice-president, says the company also receives "quite significant" support from the local government in other ways, including help in hiring staff from outside the province. But, he says, the support is justified by Huawei's huge contributions to the local economy. "We support 80 different component suppliers in this area and are one of the top 10 taxpayers in Shenzhen," he says.

Little is allowed to stand in the company's way in Shenzhen. Police were called in to arrest protesting peasants outside the company's main factory in Longgang district in August after they tried to prevent construction crews from building a road connecting the factory to a new highway. The peasants wanted more time to move ancestral graves from the land, but the government had promised Huawei it would open the link before a trade fair opened in the city in October.

"For a while, there was extremely great resistance," the *Shenzhen Commercial Daily* reported. "But the construction work finally commenced after ideological work on the peasants by local officials."

No less important are the streams of top state leaders who continue to visit the company in Shenzhen. This year alone, Communist Party General Secretary Jiang Zemin, Premier Zhu Rongji and Minister of Information Industry Wu Jichuan have all paid visits. Huawei, in turn, has gone to great lengths to maintain a politically correct image. It's one of the few private companies in Shenzhen that maintains an active branch of the Communist Party, according to local press reports. It also organized highly publicized staff meetings to denounce the Falun Gong after the religious group was banned by Beijing last year, local newspapers reported.

"It is a private company. But Ren can approach the government if he needs to overcome some problems, and of course he knows how to play that game very well," says Bill Wang, of technology consultancy China Research Corp. in Beijing.

Outside China, Huawei is becoming a player in developing-country markets, helped by sales offices in 45 countries from Algeria to Zimbabwe.

Senior Vice-President Fei says 10% of revenues currently come from overseas, but he expects the proportion to rise to 40% in three to five years because Huawei's low production costs mean it can undersell most global competitors.

ORDERS FROM LIBYA AND IRAQ

Often the buyers come from countries where Beijing maintains close, if low-profile, relations. Official delegations from Libya and Iraq have visited Huawei and placed orders several times in the past year, according to local press reports. Meanwhile, Western intelligence reports say Huawei's office in Libya is located inside the Chinese embassy there. The reports also note that the company keeps offices in Cuba, Iraq and Burma, although none are listed in company brochures. Fei says he's uncertain whether those offices exist.

In Asia, Huawei has won major public contracts in countries such as Thailand and Pakistan. Most interesting are Huawei's moves into Hong Kong. Pacific Century CyberWorks, the flagship of Li Ka-shing's son Richard, is a major buyer of Huawei equipment, which Huawei in a press release attributes to PCCW's "great interest in the national industry of the motherland." In turn, Huawei will become an anchor tenant of PCCW's government-backed science park in Hong Kong when it opens in 2004.

The company's Hong Kong subsidiary, Huawei Tech Investment, meanwhile, is responsible for planning the group's overseas listing, which Fei says will come "eventually."

By that time, Huawei may have made an indelible mark on the world telecoms-equipment market with its aggressive expansion. With help from the top, a giant is in the making in Shenzhen. "Our vision is to become a first-class supplier of information-industry equipment in the world," says Fei. "We want everyone to know the Huawei name."