Business in China Survey

2013

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CEIBS

中国深度 全球广度
CHINA DEPTH GLOBAL BREADTH

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LETTER FROM THE RESEARCH TEAM

We are pleased to present the 3rd annual CEIBS Business in China Survey.

This year, we have had unprecedented high participation from executives working in China both from Chinese-owned and foreign-owned firms. We want to sincerely thank all of them for their time and valuable contribution. In particular we thank the CEIBS alumni community and current MBA, EMBA and Exec Ed students who have given their support to this research. Our sincere gratitude is also extended to the institutions and organizations that have participated. They are:

- China Integrated Co. Ltd. / Swiss Center Shanghai
- China-Italy Chamber of Commerce
- Confederation of Indian Industry
- MexCham, Cámara de Comercio de México en China.

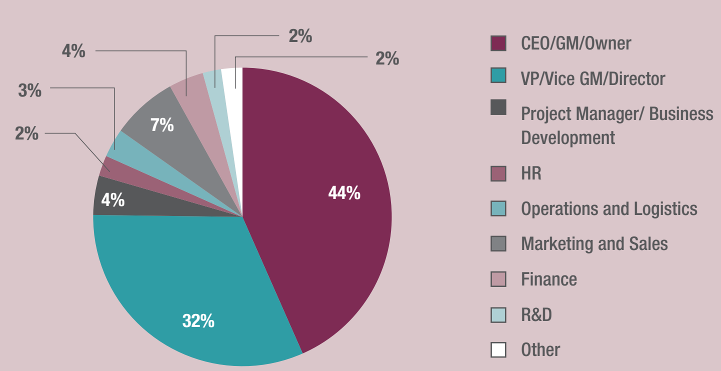
Finally, we acknowledge the financial support of CEIBS Research Fund, the support of the Alumni, MBA, EMBA and Exec Ed offices at CEIBS, and the many friends that helped us with their network. We are grateful to all of them.

Top management executives and also functional experts have given us a very valuable and rich perspective of the situation of their businesses in China in 2012 and their expectations for 2013 and the future.

The survey has been answered by 1,214 executives, 76% of which at the top levels of management: 539 of them are CEOs, General Managers or owners, and 388 are Vice-Presidents, Vice-General Managers or Directors. The other 24% is composed of executives working in different functional areas: Business Development and Project Management, HR, Finance, R&D, Operations and Logistics, Marketing and Sales.

Of the respondents, 81% are from the Chinese mainland, 3% from Taiwan, Hong Kong or Macao, and 16% from 28 different countries all over the world. The great majority of them (92%) have more than 10 years work experience, with an impressive 40% of them being seasoned executives with more than 20 years work experience. Only 17% of respondents were female.

FIGURE 1 - WHAT IS YOUR POSITION IN THE COMPANY? N= 1,214



THE RESEARCH TEAM


Prof. Juan Antonio Fernandez

Dr. Juan Antonio Fernandez is a Professor of Management at China Europe International Business School (CEIBS) in Shanghai, China.

Prof. Fernandez has co-authored six books: CHINA CEO, Chinese SOEs Reform, China CEO: A Field Guide, China (Foreign) Entrepreneur, Chinese Entrepreneurs, and 2010 Doing Business in China Survey. He has given presentations about his Chinese research in USA, India, Japan, Korea, UK, France, Italy and Spain.


Prof. Bin Xu

Dr. Bin Xu is Professor of Economics and Finance, Associate Dean (Research) at CEIBS. He received his B.A. and M.A. from Fudan University, and Ph. D. from Columbia University.

Dr. Xu's current research focuses on the global and Chinese economy, multinational enterprises in China, and trade and finance issues of emerging markets. He has published extensively in both international and Chinese journals, and is author of International Trade (Peking University Press, 2009). Dr. Xu has worked as a consultant for International Monetary Fund (IMF) and the World Bank.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Dr. Zhou's research focuses on marketing strategies, game theory, MNE strategies in China and China's private enterprises. His research has been published in the Academy of Management Review, International Business Review, International Marketing Review, and others. Dr. Zhou has conducted consulting services for a number of firms (e.g. IBM, DuPont).


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Maria started her career at Procter & Gamble and has held various senior marketing positions at L'Oreal Luxury Goods Division. Most recently, she has worked as a free lance consultant, helping businesses develop and grow their markets in China.


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Her research focuses on marketing strategies. She has written several cases and been involved in various consulting projects.

EXECUTIVE SUMMARY

The 2013 Business in China Survey offers interesting insights from a broad cross-section of companies in China.

With 2012, the year of slowest economic growth for China since 1999, companies in China are adapting to the new business environment, while recognizing existing challenges.

Although at lower levels than previous years, business confidence remains positive, with a majority of firms still reporting profits and growth. Companies keep a positive outlook for 2013 and even more so for the next 5 years. This year's edition introduces two new performance indices Current Performance Index and Expected Performance Index, which help us better analyze trends. Foreign companies have tempered their initially higher optimism to a level more in-line with the new reality in China. As in earlier editions of this survey, a gap between foreign and Chinese firms is still observed in their stated level of optimism, but so is the trend to see this gap becoming narrower. Companies are looking at innovation, both in products and in management methods to increase their competitiveness. A majority of Chinese firms are focusing on improvement of quality and management systems, while in contrast foreign firms emphasize the reduction of their costs. Moreover, Chinese companies are increasing their presence abroad, while foreign firms continue to invest more in China. Overall, all companies are increasing investments in R&D and marketing in order to compete in the market.

In 2013, success in China will come from the ability of firms to address the challenges they face. In many regards, Chinese and foreign firms perceive the same difficulties: finding and retaining talent, addressing raising labor costs, growing competition and the slowdown of the Chinese economy.

Companies in our survey declare that their key to success in this environment is increasing quality of their products and services, through R&D and product innovation, and branding. A strong company culture with high quality management team is also considered a success factor.
Firms are also working on HR management practices: developing a feeling of belonging to the company, offering a good career path to employees, paying above market, and establishing a system of rewards and recognition.

Nonetheless, the playing field is not leveled for domestic and foreign firms. Foreign firms continue to have specific issues related to understanding the Chinese the legal and regulatory environment, and to communicating the challenges of the Chinese market to their head office. Additionally, IP infringements are considered a key challenge by more foreign firms than domestic firms.

Domestic firms also have specific issues, like corporate governance and financing difficulties. Even though access to bank loans is relatively easy for larger firms, most companies in our sample still rely mainly on self- financing, with capital markets less frequently available.

Finally, our survey also provides valuable insights regarding firm's perception of their competitors, with interesting differences between Chinese and foreign firms. Domestic firms see their competitors as stronger when it comes to branding, marketing & sales capability, and product superiority. This contrasts with cost advantages, lower prices and government relationships and other guanxi, which are the strengths that foreign firms see primarily in their competitors in China. Both foreign and Chinese firms think they are facing strongest competition from Chinese private firms, with foreign firms also measuring themselves strongly against each others.

SECTION 1

DESCRIPTION OF THE COMPANIES PARTICIPATING

This section details the following information about the companies that have participated in the 3rd edition of the CEIBS Business in China Survey

- Type of ownership (Chinese or foreign), business sector and type of activity
- Location of Global Headquarters
- Location of China Headquarters
- Number of employees in China and globally
- Revenue level in China
- Legal form in China
- Years of operation

The purpose of the section is to give a general overview of the type of companies that took part in the survey. This not only helps clarify the scope of the survey, but also provides more background in interpreting survey results.

Our sample of businesses included 768 (63%) Chinese-owned companies (i.e. with more than 50% Chinese ownership) and 446 (37%) foreign-owned companies (i.e. with more than 50% foreign ownership).

The sample is well balanced in terms of business activity with 596 companies having their main activity in manufacturing and 618 in services. 74% of manufacturing companies operate in industrial products with the rest in consumer products. Our sample of service companies is split between professional (38%), consumer (36%) and industrial services (26%).

In terms of market position, we surveyed a sample of firms which operate mostly in the mid and high ends of the market, with almost half of them considering themselves as market leaders in their business. According to survey answers[1], 452 firms (45%) in our sample operate mainly in the premium segment, another 512 (50%) in the middle segment and only 49 (5%) in the low-end of the market. Moreover, 445 companies (44%) identify themselves as market leaders for their main business line.

The location of their **Global headquarters** is shown in the following map:

FIGURE 2 - WHERE ARE YOUR GLOBAL HEADQUARTERS LOCATED? N= 1,214

The **China headquarters** of both Chinese-owned and foreign-owned companies are located on the main coastal economic centers for 85% of the total sample (Shanghai, Beijing, Guangdong, Jiangsu and Zhejiang). However, we do observe a higher concentration on these areas for foreign companies (93% of foreign firms vs. 81% of Chinese firms).

In 2012, participating companies have generated collective revenue of more than 500 billion RMB and were employing more than 4 million people in China alone.

Of participating companies, 42% of the Chinese-owned firms and 36% of the foreign-owned firms have more than 900 million RMB in revenue in 2012 in China. 19% and 20% of companies respectively have 300 to 900 million RMB in revenue[2].

[1] N= 1,013

[2] According to China official definition companies with more than 300 million RMB are considered large.

FIGURE 3 - WHAT IS YOUR COMPANY TOTAL CHINA FORECASTED REVENUES IN 2012?

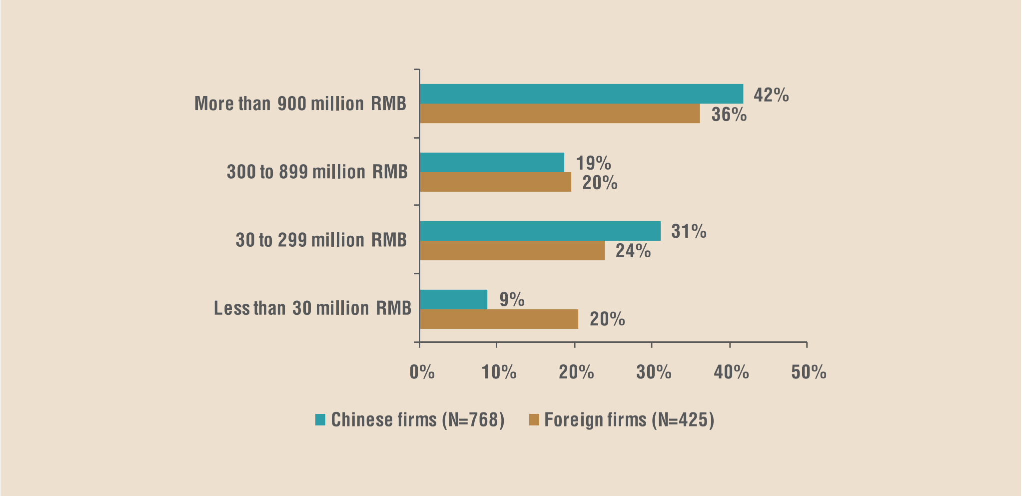


FIGURE 4 - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?

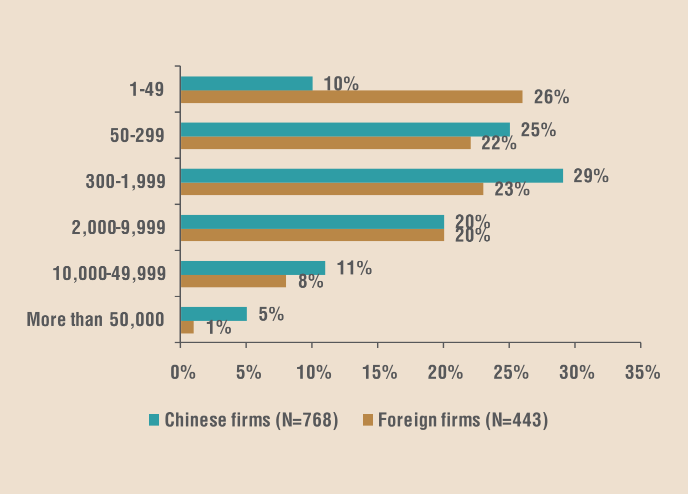
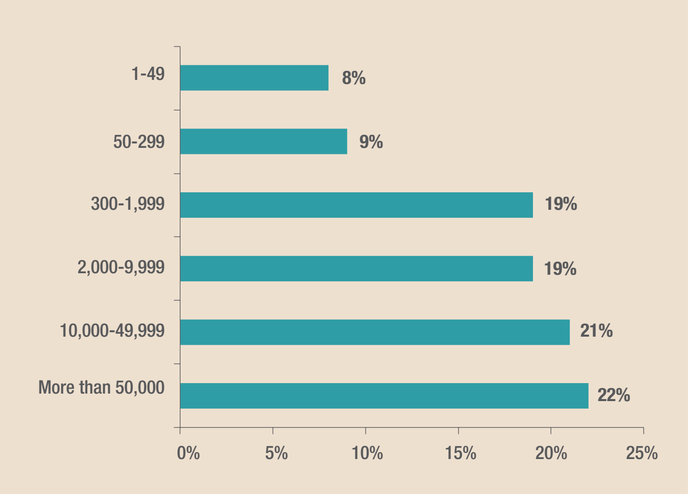


FIGURE 5 -- FOREIGN FIRMS - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE GLOBALLY? N=443



Most of the foreign companies in our sample belong to the medium and large categories (38% with 300-9,999 employees, 43% with >10,000) in their global operations. Their Chinese operations fall mostly within the small and medium categories (48% with < 300 employees, 44% with 300-9,999)[3]

[3] *In our survey, companies are classified in terms of number of employees as Small (<300 employees), Medium (300-10,000) and Large (>10,000)*

31% of surveyed companies are Chinese privately owned, 16% are state-owned or state-holding enterprises[4], and 10% are Chinese non-state shareholding companies. Joint Ventures (JV) constitute 9% of the sample, with different levels of Chinese and foreign ownership. Most of the foreign-owned companies are Wholly Foreign Owned Enterprises (WFOE), with Representative Offices (RO) and Branches of foreign companies making up the rest.

FIGURE 6 - WHAT IS THE LEGAL STATUS IN CHINA OF THE COMPANY YOUR WORK FOR? N=1,210

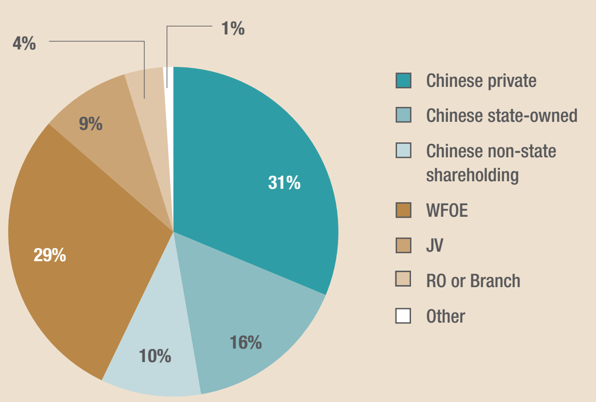
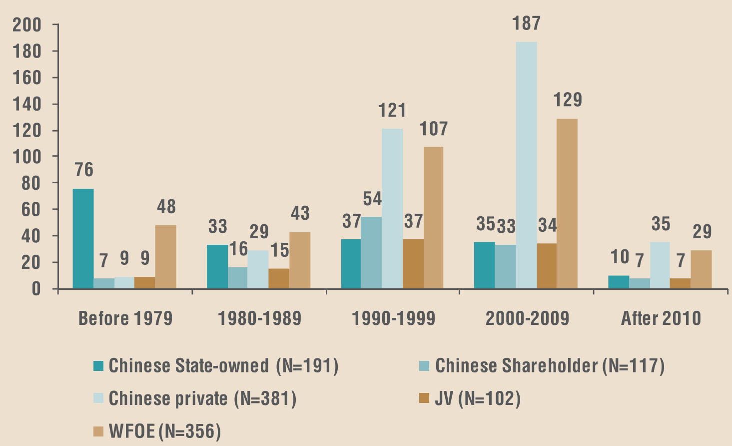


FIGURE 7 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?



The effects of the economic reforms initiatiated by Deng Xiaoping in the late 1980s and early 1990s are visible in our survey (Figure 7). These reforms involved the privatization of much state-owned industry, which triggered a remarkable growth of the private sector.

[4] *"Chinese state-owned" refers to all companies having ownership granting control to the State – includes state-holdings*

SECTION 2

BUSINESS INDICES

Business Performance Indices include:

- Current Performance Index (CPI)
- Expected Performance Index (EPI)

This year the survey introduces 2 directional indices to measure variation both in current and expected performance of the surveyed companies. Each index (ranging from 0 to 100) is constructed similarly to the well-known Purchasing Managers' Index (PMI): an index reading of 50 means that performance is unchanged, a number over 50 indicates an improvement while anything below 50 suggests a decline. The further away from 50 the index is, the stronger the change over the period.

The indices are based on multiple choice questions with 5 possible answers[5].

Business Confidence Indices include:

- Business Confidence Index, for next year
- Business Confidence Index, for the next 5 years

The Business Confidence Index is a measure of the optimism stated by executives in our sample with respect to the evolution of their businesses for the next year (2013) and the next 5 years (2013 to 2018).

The reading ranges from 0 to 10 (0 = Absolutely Not Confident, 3 = Not Confident, 5 = Neutral, 7 = Confident, 10 = Extremely Confident). The executives in our survey are asked to state their confidence level in the short term (next year) and in the medium term (next 5 years)

These 2 indices have been part of the CEIBS Business in China Survey since its inception 3 years ago, which allows us to start recognizing emerging trends as well as current values.

[5] *INDEX = (P1*1) + (P2*0.75) + (P3*0.5) + (P4*0.25) + (P5*0)*
P1 = Percentage number of answers that reported a substantial improvement.
P2 = Percentage number of answers that reported an improvement.
P3 = Percentage number of answers that reported no change.
P4 = Percentage number of answers that reported a deterioration.
P5 = Percentage number of answers that reported a substantial deterioration.

2.1. CURRENT PERFORMANCE INDEX - CPI

Large majority reports revenue growth but with reduced margins

The Current Performance Index is 63 for Chinese companies and 61 for foreign companies, reflecting an improvement for both types of firms in their 2012 business results when compared to 2011, with slightly better results for the Chinese owned companies in our sample. Performance is based on both revenue and profit evolution.

The CPI Index is calculated as a composite of 2 survey indices: Revenue and Profit Level. Each variable is attributed the same weighting.
Revenues: More than half the companies surveyed stated positive revenue growth for 2012 (62%

FIGURE 8 - HOW DOES YOUR COMPANY'S EXPECTED REVENUE IN CHINA IN 2012 COMPARE TO 2011 RESULTS?

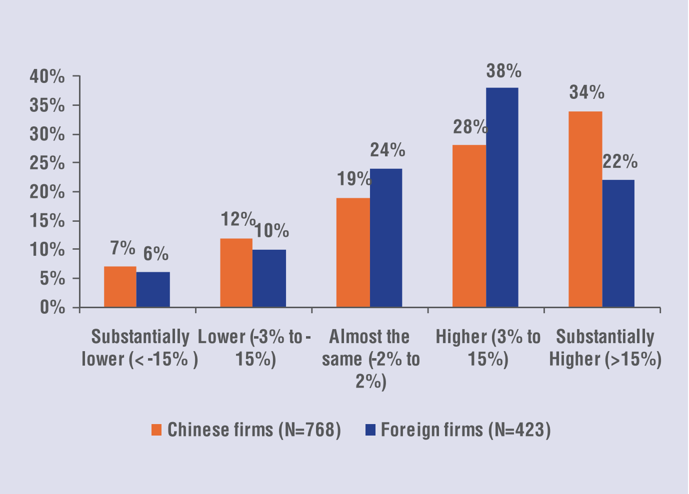
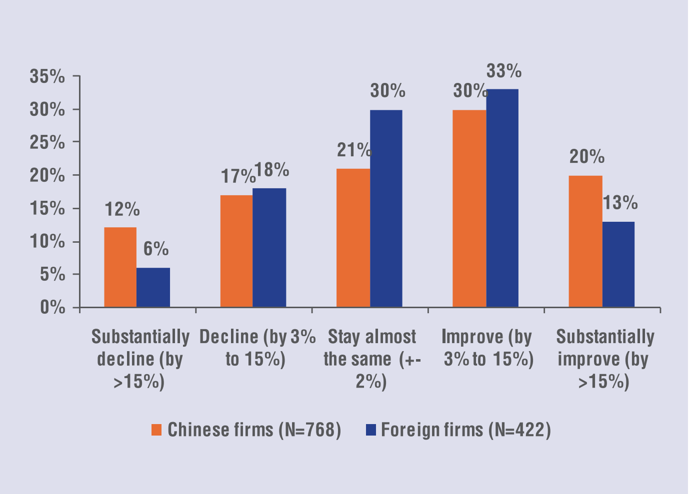


FIGURE 9 - HOW DO YOU EXPECT YOUR COMPANY'S PROFIT LEVEL IN CHINA TO DEVELOP IN 2012 COMPARED TO 2011?



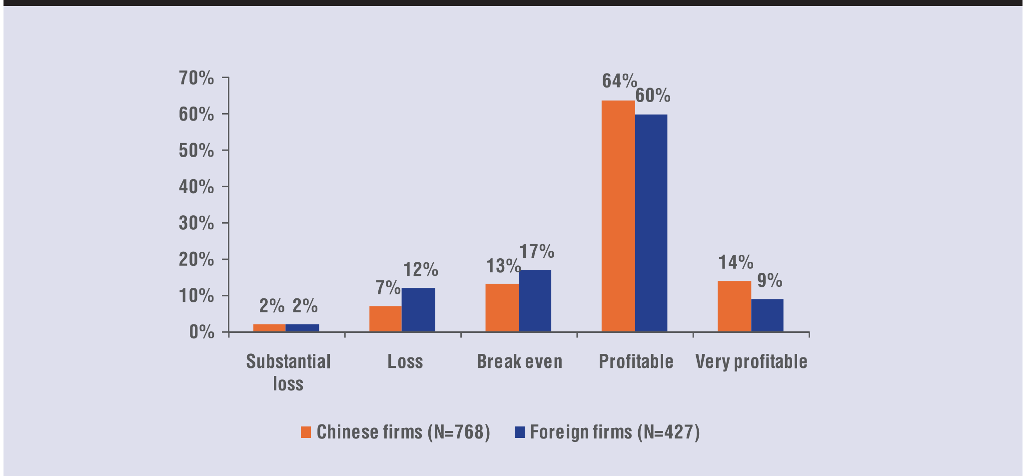
of companies, both Chinese and foreigners) and 20% stated almost the same as last year. This shows that businesses in China are still holding well despite global instability. However the data compares negatively with last year where 75% of companies reported positive growth and 15% stable level of revenues.

Amongst businesses experiencing slow down, 18% stated lower revenues compared with 10% last year (i.e. almost twice as many companies saw decreasing revenues vs. previous year)

Profit: companies were still profitable for the most part but profit margins were thinner overall, with a sharp increase in those losing money amongst foreign-owned businesses.

Overall, 75% of the companies in the sample stated to be profitable or very profitable in 2012, while 11% incurred in losses. The situation was worse for foreign owned companies where 14% lost money up from 10% last year. 9% of Chinese companies surveyed reported losses (similar level to 10% last year).

FIGURE 10 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2012?



2.2. EXPECTED PERFORMANCE INDEX - EPI

Optimistic outlook for 2013

A majority of the Companies surveyed are optimistic for 2013. The Expected Performance Index amounted to 68 for Chinese companies vs. 65 for foreign companies, reflecting an expected 2013 performance better than 2012 for both types of companies. 71% of executives expect results in 2013 to be better or much better than in 2012, and 17% see stability in their results. Chinese firms seem slightly more optimistic than foreign ones.

The EPI Index is calculated based on one multiple choice question describing future business evolution (Figure 11).
This optimism is reflected in planned investments in China that are up from 2012 for 76% of the total sample surveyed and with only 2% of respondents anticipating decreases in investments. Moreover, amongst those companies having R&D in China, 98% will either increase or maintain current R&D investments.

FIGURE 11 - HOW DO YOU EXPECT YOUR COMPANY'S BUSINESS TO PERFORM NEXT YEAR (2013) COMPARED TO THIS YEAR (2012)?

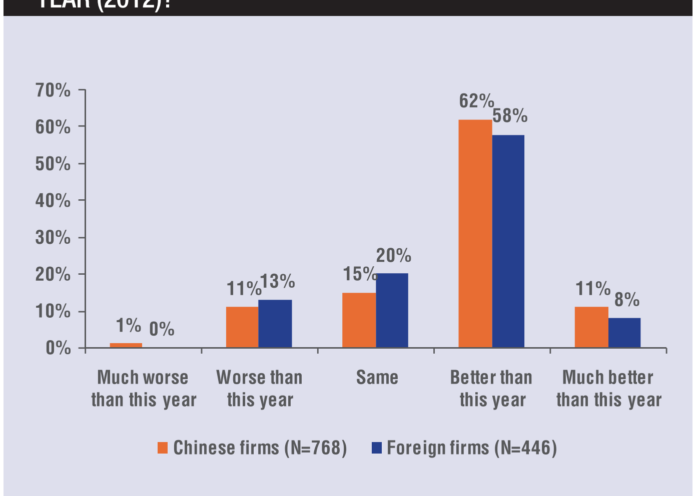
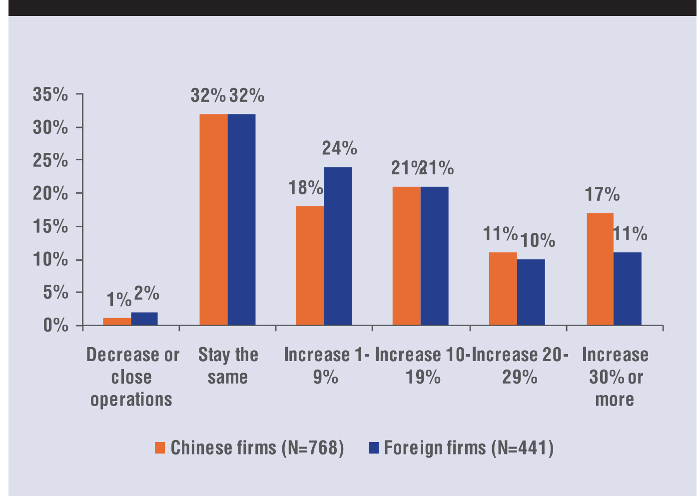


FIGURE 12 - WHAT INVESTMENTS DO YOU PLAN FOR 2013 IN CHINA?

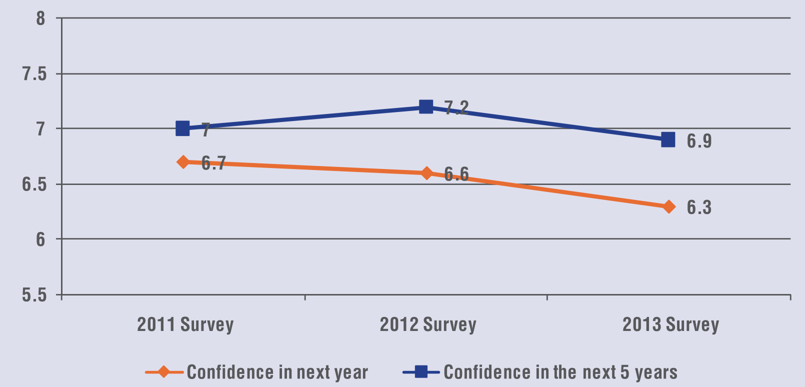


2.3. BUSINESS CONFIDENCE INDICES - BCI

Optimistic view for the next year and the next 5 years

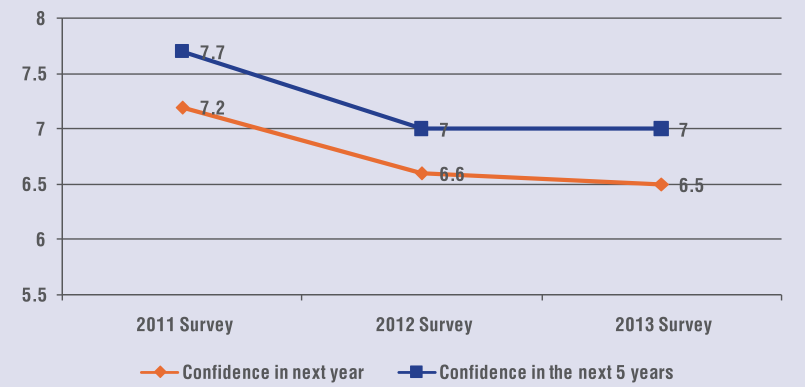
In the 2013 issue of the CEIBS Business in China Survey we observe similar levels of business confidence within Chinese and foreign firms as both claim to be “close to confident” that their operations in China will be successful in the next year and in the next 5 years.

FIGURE 13 – CHINESE FIRMS - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS? N=767



0=Absolutely Not Confident, 3=Not Confident, 5=Neutral, 7=Confident, 10=Extremely Confident

FIGURE 14 –FOREIGN FIRMS - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS? N=438



0=Absolutely Not Confident, 3=Not Confident, 5=Neutral, 7=Confident, 10=Extremely Confident

There are 3 important trends emerging:

1. Executives working for Chinese firms seem to be slightly more cautious than their counterparts in foreign firms when stating their confidence in business success, both for short and medium term.

This trend contrasts with both Current Performance Index and Expected Performance Index where Chinese companies reflect higher values than foreign ones. These indices are based on quantitative responses regarding evolution of sales and profits.

Possible explanations could be more aggressive targets in Chinese companies after being used to years of double-digit growth, or cultural differences affecting confidence levels amongst different nationalities (96% of the executives working for Chinese owned firms are Chinese nationals compared to only 55% in foreign-owned companies)

2. The gap in business confidence between foreign-owned firms and Chinese-owned firms appears to have narrowed in the 3 years covered by this survey: 2010, 2011 and 2012. This trend applies both to confidence in the next year and in the next 5 years.

In 2010, for the first issue of this survey, China was still growing strong under the effect of the 2008-2009 Chinese economic stimulus plan that was scheduled to finish by end of 2010[6]. The Chinese market was very attractive to foreign firms when compared to their home economies and they probably remained overly optimistic by 2010. On the other hand, Chinese firms were more aware of the real situation of the Chinese economy and were already forecasting lower growth. By the 3rd edition of this survey, foreign firms have adjusted to the more difficult reality of the Chinese economy and therefore, levels of confidence are getting closer.

3. Both Chinese and foreign firms claim more confidence in their success in the medium term than in the immediate future. This trend was observed in previous editions of this survey as well.

This may mean that executives in our sample trust the soundness of the Chinese economy despite current adjustments, and believe they can solve current challenges and continue being successful in China in the coming years.

[6] *RMB 4 trillion stimulus package issued by the Chinese Government to minimize the impact of the global financial crisis*

SECTION 3

CHALLENGES AND SUCCESS FACTORS

This section details the difficulties encountered in China by the firms in our sample and the keys to their success:

- External Challenges
- Managerial Challenges
- Success factors

The purpose of this section is to identify the main challenges faced in China by the companies surveyed, explore the relevant differences in the difficulties faced by Chinese companies compared to foreign companies, and learn how the companies in our survey deal with these challenges.

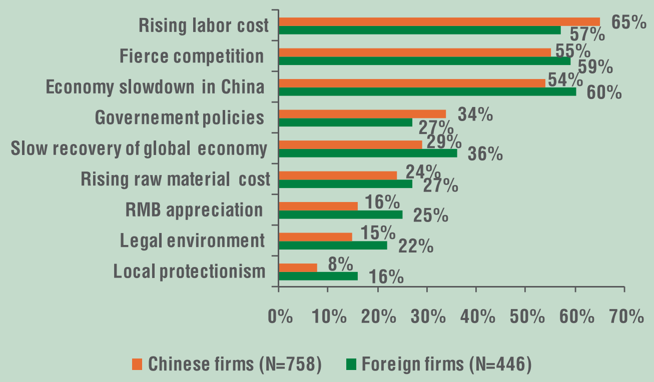
3.1. External challenges:

Consolidated in 3 main areas

The main external challenges for companies doing business in China are “Rising labor costs”, “Fierce competition”, and “Economy slowdown in China”. A very distant number four is “Government Policies” for Chinese-owned companies and “Slow recovery of global economy” for foreign-owned companies.

These concerns were also present in previous year surveys. One notable difference with the 2012 survey is that Chinese companies had cited Government Policies as one of their top 3 worries while this time it has significantly dropped to a much lower 4th position.

FIGURE 15 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?



The survey catches the transition of the Chinese economy well. The three areas that consolidate executive concerns – rising labor cost, stronger competition and slowing China economy – reflect the change that China is undertaking, going from a low-income country with an economy driven by cheap labor to a middle-income country.

There are a few interesting differences in the weight of some factors by Chinese and foreign firms:

- “Rising labor cost”, although it is the number 1 concern for both groups, it is stated as a concern by Chinese firms more than it is by foreign firms (65% of respondents vs. 57% respectively). This is consistent with the fact that the Chinese companies in our sample are in general larger in number of employees in China than the foreign ones (Chinese-owned firm in our sample average >4,000 employees vs. >2,000 for foreign firms).

- “Local protectionism” worries 16% of the foreign firms in our sample while only 8% of the Chinese firms. This may be due to the relative difficulty for foreign firms to navigate the differences existing in China at provincial levels, and the fact that they are currently more concentrated around the coastal areas and still need to learn how to penetrate the country.

- Chinese firms in our survey worry about “Government policies” more often than foreign ones (34% of the Chinese firms vs. only 27% of foreign).

3.2. MANAGERIAL CHALLENGES:

Finding and retaining talent a top concern for both Chinese-owned and foreign-owned firms; Organization derived issues are a distant 2nd

Most cited internal management challenge faced by companies operating in China is “Finding and retaining talent” (70% of respondents both in Chinese and in foreign companies). This is consistent with previous surveys.

Organization derived problems hold the second position, however, these issues translate very differently for Chinese and foreign owned companies:

49% of the executives working for Chinese firms worry about “Corporate governance”, which is only an issue for 24% of those working in foreign firms. Foreign companies tend to have these systems already in place, while many Chinese firms have only been putting them in place recently.

On the other hand, for executives working for foreign-owned companies, “Support from Head Office” is the 2nd more frequently mentioned managerial challenge (27% of the sample), proving that distance matters.

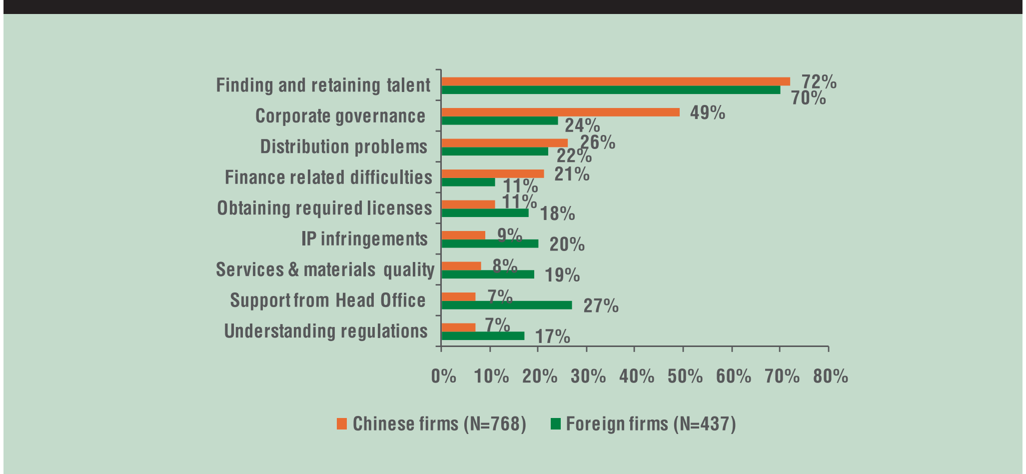
“Distribution problems” is the next difficulty in the list as reaching target clients and consumers in different areas of China proves to be a challenge for 26% of Chinese firms and 22% of foreign firms in our sample.

“IP infringements” concern more foreign companies (20% vs. 9%). This is consistent with the fact that foreign companies in our sample encounter IP infringements more frequently than their Chinese counterparts (see Section 4.2.2). Foreign companies in China tend to invest more in design and innovation and therefore could be more vulnerable to IP infringements.

“Services and materials quality” worries 19% of foreign companies in our sample vs. only 8% of Chinese firms. This is consistent with the fact that foreign companies in China are often positioned in the higher end of the market and the quality of the end product depends on quality of the input. Specifically for our survey sample, 65% of the foreign-owned companies operate in the premium segment of the market versus 34% for the Chinese-owned ones.

“Finance related difficulties” is a worry for 21% of the Chinese firms vs. 11% of the foreign ones (see Section 5.2 for more details on these issues).

FIGURE 16 - WHAT ARE THE GREATEST MANAGEMENT CHALLENGES FACING YOUR COMPANY IN CHINA?



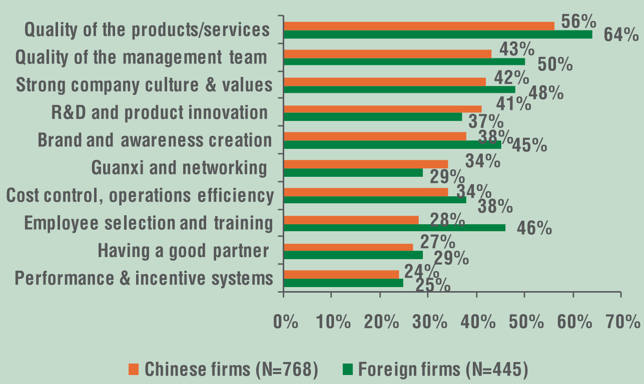
3.3. SUCCESS FACTORS:

Product and service quality should come first

Both executives from Chinese and foreign-owned companies in our sample believe that success in China is linked to product and service superiority, and to soft factors such as quality of the management team and company culture & values.

Chinese companies also emphasize other product related attributes: "R&D and product innovation" and "Brand and awareness creation", while foreign companies emphasize "Brand and awareness creation" as well as proper "Employee selection and training".

FIGURE 17 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA?



It is interesting to note that while "Finding and retaining talent" has been selected as the number one managerial challenge for both Chinese-owned and foreign-owned firms (by 72% of Chinese firms and 70% of foreign firms), 46% of foreign-owned firms consider "Employee selection and training" to be a success factor versus only 28% of the Chinese firms.

"Brand and awareness creation" also stands out as an strategy considered more often considered key to success by foreign-owned companies than by Chinese-owned companies (45% of foreign firms vs. 38% of Chinese-owned firms)

SECTION 4

FOCUS BY TOPIC

This section gives an overview of the following topics:

- Market Environment
  This chapter covers competition and regulatory environment and Government related issues affecting companies operating in China.
- Innovation, R&D and Intellectual property
  This chapter covers how companies in our survey address innovation in China. It provides an overview of the types of innovations more frequently introduced, and gives the perspective from our sample of executives on IPR protection in China.
- China/Global Focus
  This chapter gives an in-depth commentary on the weight that China has in the global operations of the foreign-owned firms in our sample, and how this weight is evolving versus previous years. Likewise, we analyze the importance of international expansion to the Chinese-owned companies in our sample.
- Joint Ventures
  This chapter provides details about the Joint Ventures in our sample.

4.1. MARKET ENVIRONMENT

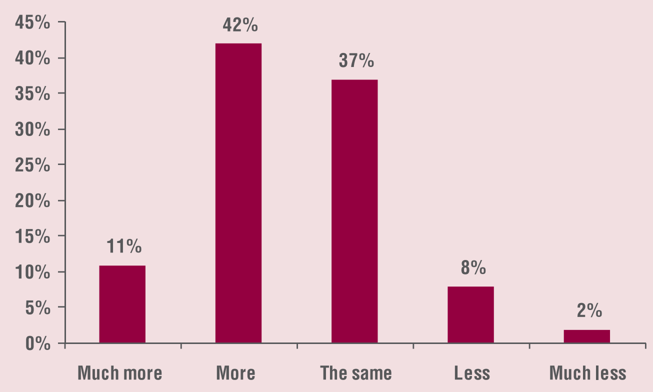
4.1.1. Regulatory Environment and China Government

Policies and regulations rated "moderate" to "no effect" for most industries, yet, government relations are important. According to our survey, corruption is recognized as an existing and unsolved issue. However, respondents rate it as a lesser problem when asked about the level of corruption in their own industry.

For most of the companies in our sample, government policies and regulations have a moderate to no effect on their industry (40% moderate, 32% inexistent). However, 19% of surveyed companies operate in industries that are heavily regulated and where government regulations pose severe constraints to their activities in China. We observe similar results for Chinese owned and foreign owned firms.

On the other hand, 90% of the interviewed executives view the relationship with the Chinese authorities as important or very important to their businesses, regardless of whether they work for a Chinese or foreign firm. Moreover, 53% of the foreign-owned firms declare to allocate more or much more resources to building these relationships than in their home markets.

FIGURE 18- FOREIGN FIRMS - HOW MUCH RESOURCES DO YOU ALLOCATE TO BUILD OR KEEP GOOD RELATIONSHIPS WITH CHINESE AUTHORITIES WHEN COMPARING TO YOUR HOME COUNTRY? N=436



The level of satisfaction with the services provided by the Chinese government and its related agencies is low. They are judged insufficient by almost half of the Chinese companies in our sample, who declare to be dissatisfied or very dissatisfied, with only 10% of respondents satisfied.

Main concerns regarding the Chinese government and the legal environment:
Unclear and changing regulations, policy adjustment and corruption

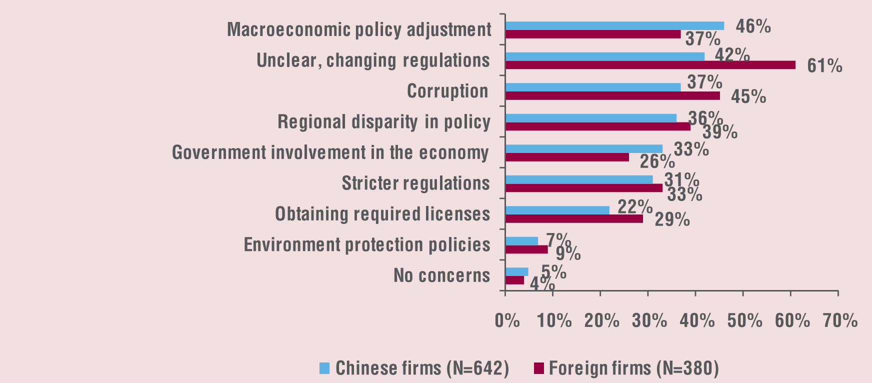
Perception between Chinese and foreign firms vary slightly.

Foreign firms are usually less familiar with the China regulatory and legal system triggering "Unclear, changing regulation" to be the main source of worry for them (61% of foreign respondents) "Corruption" comes second (45% of respondents).

For Chinese firms, the number one concern comes from “Macroeconomic policy adjustment”: 46% of them declare it to be a main concern vs. 37% of foreign firms (which are probably looking at it from a global context, within which China policy adjustment may be seen as comparatively softer than in Europe or the US). “Unclear and changing regulations” is the second most mentioned concern for Chinese firms (42%) proving how this is a troublesome matter in China even for domestic firms.

Regional disparity of central government policy implementation is also an important concern as it hinders business roll-out into greater China for both Chinese and foreign-owned firms (36% and 39% of them respectively).

FIGURE 19 - WHAT ARE YOUR MAIN CONCERNS REGARDING THE CHINESE GOVERNMENT AND THE LEGAL ENVIRONMENT? MULTIPLE ANSWERS POSSIBLE. N FOR CHINESE FIRMS =640, N FOR FOREIGN FIRMS = 380



Corruption in China:
Own industry versus others. State-owned companies versus the private sector.

Regarding corruption, when asked specifically about the issue, a large majority (83% of respondents) view corruption in China to be a problem (moderate to serious). However, when asked about corruption in their industry, the number respondents seeing it as a problem drops by almost half. This phenomenon of corruption in China being perceived as less acute when asked about own industry is observed with respondents from both Chinese-owned and foreign-owned firms, and in previous editions of this survey as well. Most executives believe corruption in their industry has remained unchanged in 2012 versus previous years.

FIGURE 20 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA, IN GENERAL, AND IN YOUR INDUSTRY? N=1,202

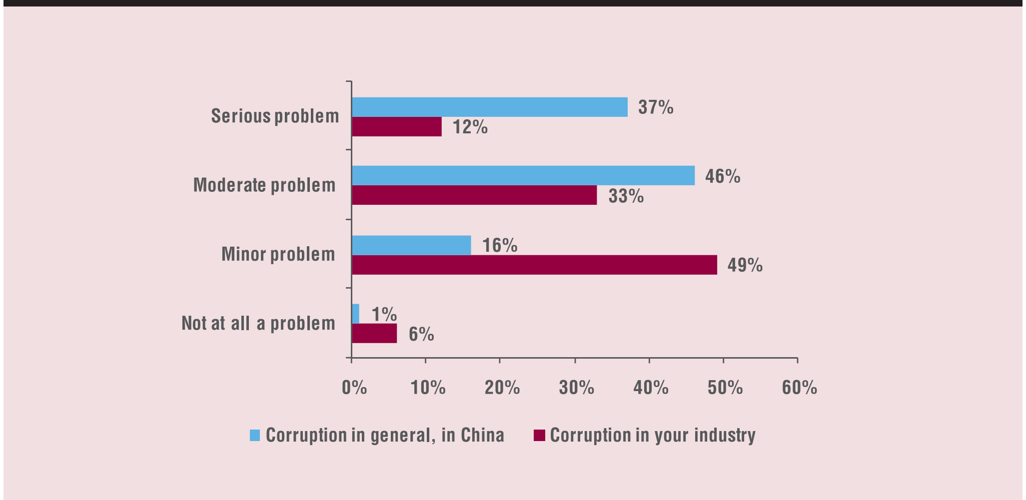
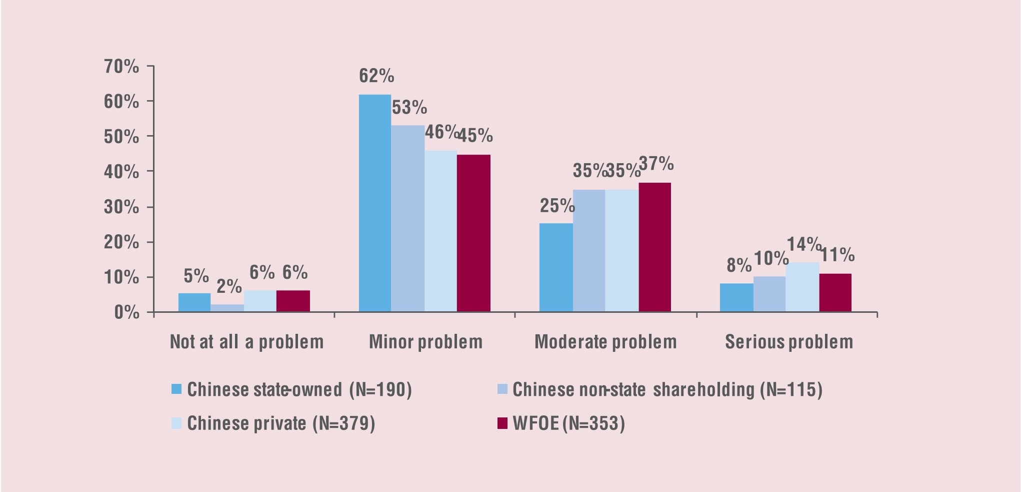


FIGURE 21 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY?



With respect to corruption, an interesting aspect is that State-owned companies appear to perceive corruption as less problematic than those in the private sector. This same trend is observed both when asked about corruption in China in general and corruption in own industry.

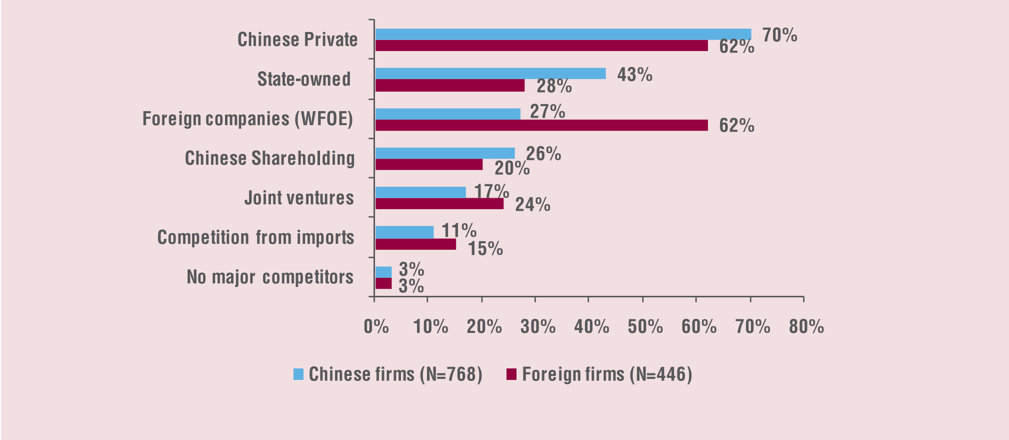
4.1.2. Competitive Environment and Market Advantages

Intensely competitive environment with Chinese private enterprises seen as the major competitive threat. Chinese firms' see advantages of their competitors in branding and marketing capabilities while foreign firms consider those advantages to reside in lower costs and guanxi.

Chinese-owned and foreign-owned companies had no significant differences in their views regarding competitive intensity. 86% of companies (up from 80% last year) consider they are facing intense or very intense competition in China, with only 2% considering competition as not intense.

A majority of respondents cited their main competitors to be Chinese private enterprises. This is particularly marked amongst Chinese-owned respondents (70%), who cite State-owned enterprises as a distant second (43%). In contrast, foreign companies measure themselves also amongst each other, citing WFOE at par (62%) with Chinese private enterprises as their major type of competitors.

FIGURE 22 - WHO ARE YOUR MAIN COMPETITORS IN CHINA? (MULTIPLE ANSWERS)



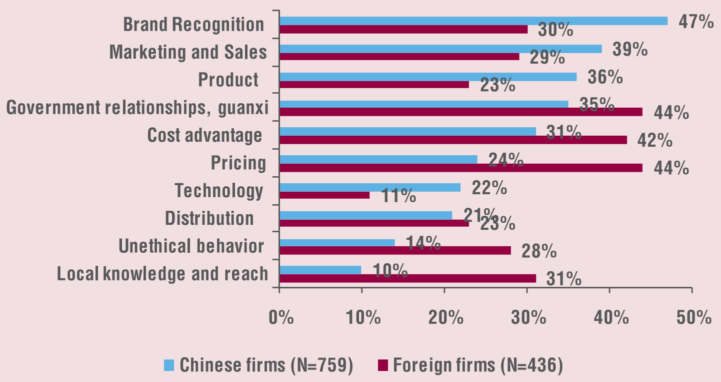
There are very interesting differences in the perceptions of the competitive advantages of other players between Chinese-owned firms and foreign-owned firms:

The top 3 strengths of competitors cited by Chinese firms relate to their product or service and the way they are marketed: “Brand recognition” (47%), “Marketing and Sales” (39%) and “Product” (36%).

In contrast, foreign-owned firms consider that their main weaknesses vis-à-vis their competitors lay in competitors’ superiority in “Price” (44%), “Relationships with Government and other guanxi” (44%) and “Cost advantages” (42%)

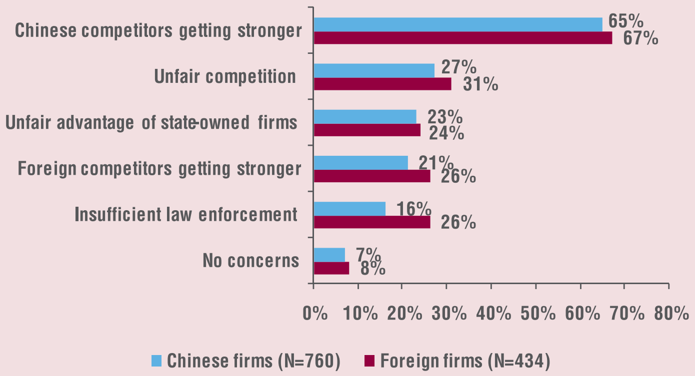
“Unethical behavior” is seen as competitive strength of the competitors by 28% of foreign-firms in the sample vs. only 14% of the Chinese ones. Although it is gradually changing as environmental sustainability becomes more important in China, foreign companies sometimes claim that they apply stricter environmental control policies in their production sites, thus increasing the cost of their finished products.

FIGURE 23 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN COMPETITORS IN CHINA? (MULTIPLE ANSWERS)



“Chinese competitors getting stronger” is the main source of worry mentioned by as much as two thirds of our pool. Fairness issues, like “Unfair competition” and “Unfair advantage of state-owned firms” follow, but each issue is mentioned by less than one third of companies. It is interesting to note as well that 26% of surveyed foreign companies believe that there is insufficient law enforcement in the competition arena, while only 16% of Chinese firms are worried about it.

FIGURE 24 - WHAT ARE YOUR MAIN CONCERNS REGARDING COMPETITION? (MULTIPLE ANSWERS)



Insufficient law enforcement is more worrisome for companies in the premium segment (25%) than in the other segments (13%). Additionally, foreign companies are perceived as comparatively stronger in the premium sector (48%) than in the medium and low-end segments (33% and 27% respectively).

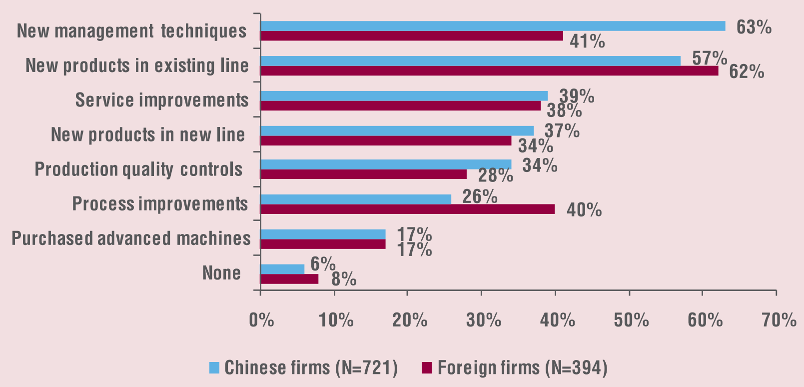
4.2. INNOVATION, R&D AND INTELLECTUAL PROPERTY IN CHINA

Surveyed companies introduced innovations not only at product and service level but also in new forms of management. In spite of varying levels of R&D spending, a large majority of respondents intended to increase their R&D spend in the next three years. Infringement of intellectual property rights is reported damaging to both foreign and Chinese firms, even if it is seen as infrequent.

4.2.1. China Innovation and R&D in 2012

Large numbers and types of innovations were introduced by both Chinese and foreign-owned companies in 2012. Most frequently mentioned are innovations in management techniques and introduction of new products or services in existing lines. Service improvements and introduction of new lines of products and services are also mentioned as an important source of innovation in 2012. Companies, especially foreign-owned ones, have also been working in process improvements.

FIGURE 25 - WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED SINCE THE BEGINNING OF 2012? (MULTIPLE ANSWERS)



More than 60% of the total pool of companies has innovated in their products or services in 2012. This is in line with the fact that 66% of the firms surveyed (75% of Chinese-owned firms and 52% of foreign-owned firms) have R&D activities in China.

We notice that 63% of Chinese-owned firms in our sample are focusing on implementing "New management techniques" (vs. 41% of foreign firms), which is in line with the overall effort that Chinese companies all over the country are making to develop their managerial systems and catch up with their international competitors in this respect. Likewise, the work that Chinese firms are doing upgrading their product quality is reflected in this survey as 34% of Chinese firms have innovated in "Production quality controls" (vs. 28% of foreign firms).

In contrast, 40% of foreign-owned companies in our sample have innovated in "Process improvements" versus 26% of the Chinese-owned ones. This reflects the importance of efficiency and cost control for foreign firms given the competitive environment and, according to survey results, the fact that they consider a strength of their competitors to have lower costs and prices.

The investment in R&D in 2012 varied largely with roughly one third of companies investing less than 2% of revenues, another third spending between 2 and 5 %. However, 66% of respondents intend to increase and expand their R&D investments in China the next 3 years.

FIGURE 26 - WHAT IS YOUR ANNUAL EXPENDITURE ON R&D AS % OF REVENUE? N=658

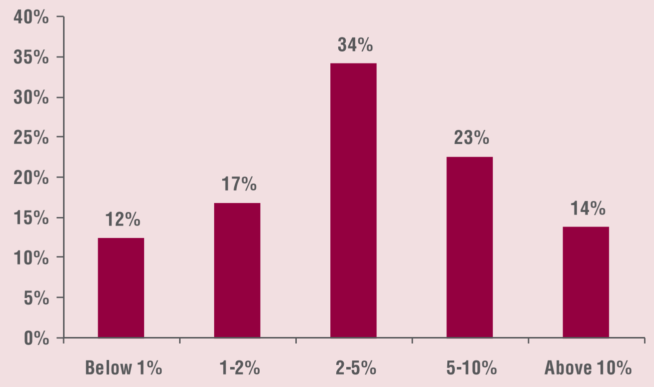
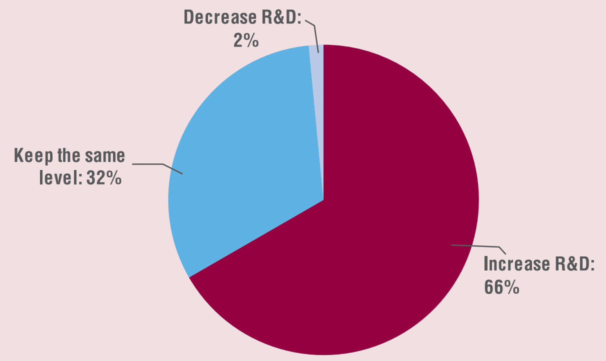


FIGURE 27 - WHAT ARE YOUR PLANS FOR THE NEXT 3 YEARS? N=658

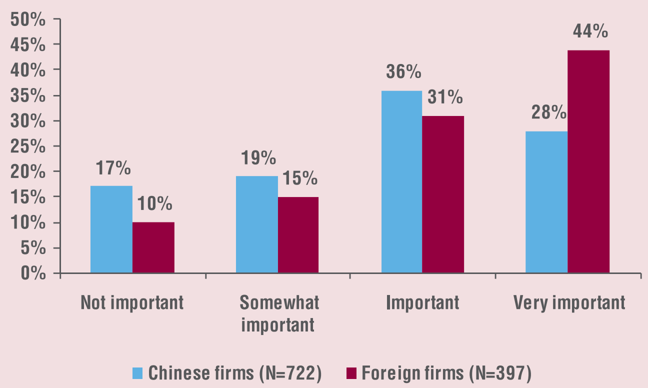


4.2.2. Intellectual Property in 2012:

IP infringements damaging to business while no perceived improvement versus last three years

Intellectual Property is important for all businesses in China and this is true for most companies (only 14% of the total sample of firms qualify it as not important). However, a larger proportion of foreign-owned companies (44%) rate this issue as very important (vs. 28% of their Chinese counterparts).

FIGURE 28 - HOW IMPORTANT IS IP (INTELLECTUAL PROPERTY) TO YOUR BUSINESS IN CHINA?



Despite the fact that two thirds of companies in our survey pool have R&D in China, only half of them have obtained a patent in China in the last 2 years. The most commonly owned types of IP in China are patents and trademarks, followed by industrial design rights and copyrights.

FIGURE 29 - WHAT IS THE EXTENT OF THE DAMAGE CAUSED BY IP INFRINGEMENT IN CHINA IN YOUR BUSINESS? N=940

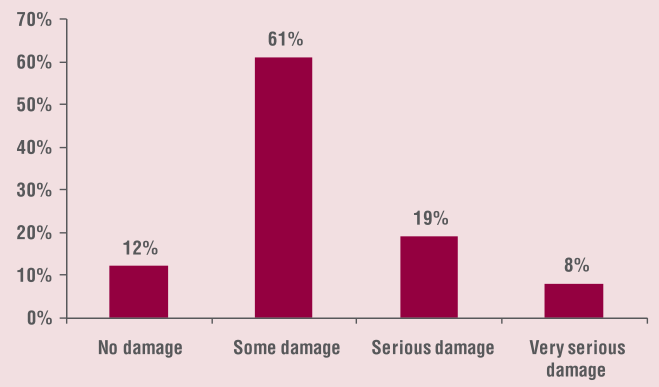
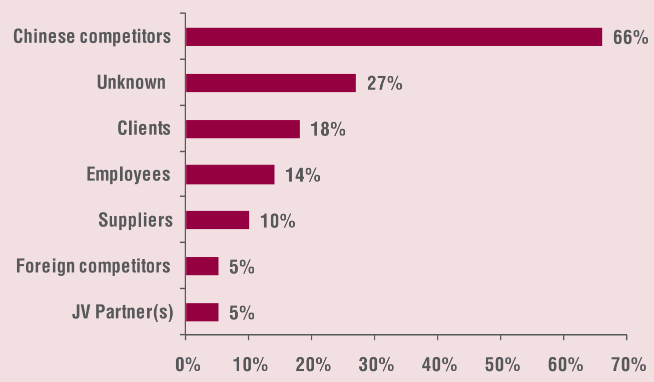


FIGURE 30 - WHO HAVE BEEN THE PERPETRATORS OF THE IP INFRINGEMENTS? N=167



IPR infringement is still an issue in China. The vast majority of the firms in our sample consider IP infringement to be damaging their business: 61% claim some damage and 27% claim serious or very serious damage. On the other hand, it doesn't seem to be happening very frequently (surveyed firms cite "sometimes" and "rarely" in most cases). Both groups of firms agree on this point.

IPR infringement seems to be more frequently encountered by foreign firms (most answers are "sometimes" vs. "rarely" and "sometimes" for Chinese firms).

Moreover, the opinion of the firms in our survey is that there has been little or no improvement in the last 3 years regarding IPR infringements. For most firms (71%) there has been no variation in the amount of infringements in their business for the last 3 years while 35% believe that it has gotten worse.

IP infringement perpetrators are Chinese competitors for two thirds of the executives surveyed (functional experts working in marketing, sales or R&D). 27% answered that perpetrators are often unknown, followed by clients, employees and suppliers.

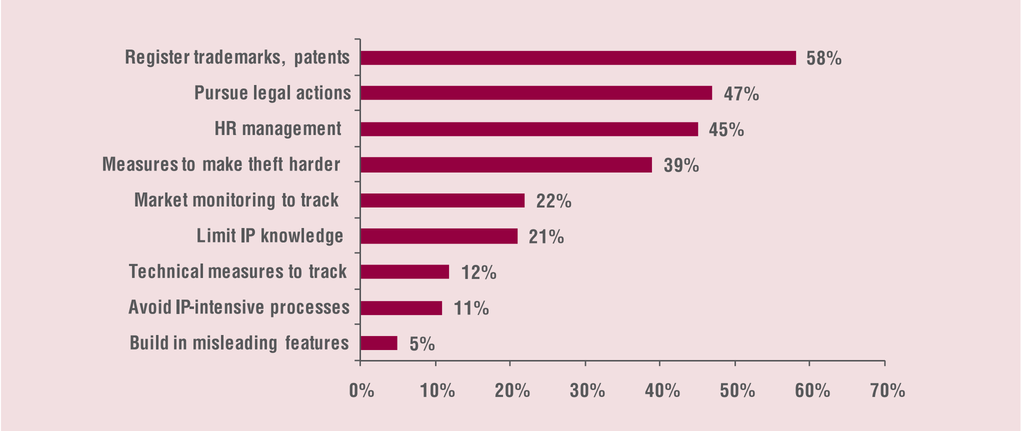
Although the above is true for both Chinese –owned and foreign-owned firms, we do observe some differences: Clients are reported to be IP infringers for 14% of the foreign-owned firms while only for 8% of the Chinese-owned firms, while JV Partners are considered infringers for 6% of the Chinese firms and only 2% of the foreign ones.

According to the Chinese firms in our sample, market release of copies or very similar products by competitors comes very quickly (4 to 6 months), this contrasts with responses from foreign firms (more than 12 months).

The measure most favored by executives to protect their IP in China is trademark registration or patent filing in China (58% of answers). Seeking legal actions against infringers comes second (47%). A third measure to fight IP infringement is HR management (45% of the surveyed executives), such as IP specific clauses in employment contracts and company regulations, screening job applicants for honesty and IPR training.

Another popular course of action (39% of answers) is to take measures to make the theft of commercial secrets harder and therefore reduce infringement.

FIGURE 31 - WHICH ARE THE MOST EFFECTIVE MEASURES YOU USE TO PROTECT YOUR IP IN CHINA? N=935



4.3. CHINA / GLOBAL FOCUS

4.3.1. China focus for foreign owned firms

In comparison to previous years, the attitude of foreign firms towards China, as well as their commitment to doing business in the region has been reinforced, according to survey answers. Overall, relative size of China compared to global business is expected to increase. Accordingly investment is increasing. Spending levels are growing in Marketing and there has been a steep increase in R&D activities in China vs. previous years.

FIGURE 32 – WHAT % OF YOUR COMPANY'S 2012 GLOBAL REVENUE WILL BE GENERATED IN CHINA? N=436

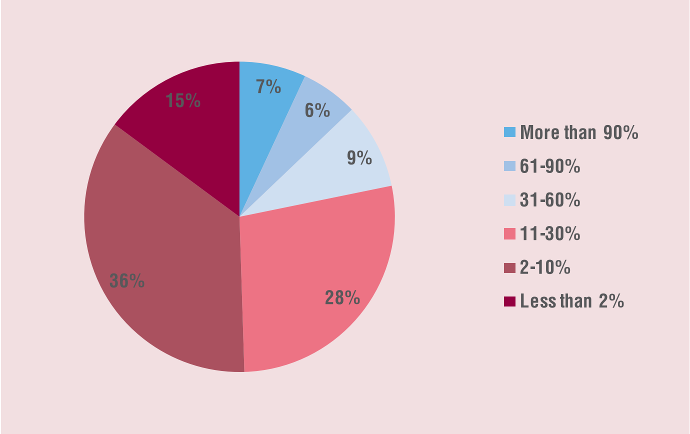
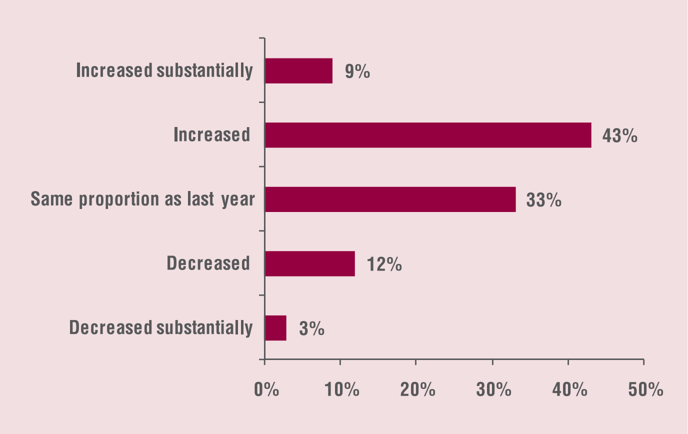


FIGURE 33 – HOW DOES THIS % COMPARE TO LAST YEAR? N=432



Half of foreign-owned companies in our sample generate more than 10% of their global sales in China. This level of China focus represents an increase versus last year: 52% of surveyed foreign companies cite an increase or a substantial increase of this weight (compared to 15% citing a decreasing share). Moreover, China is ranked within the Top 3 global investment priority for 60% of the foreign-owned companies in our sample.

Investments in China by foreign firms are going to increase in 2013 for 66% of our sample of foreign firms. Moreover, 21% of them claim an intention to increase investments by more than 20%. The most cited areas for investment in China in 2013 are Shanghai (mentioned by 55% of companies), Beijing (35%), Jiangsu and Zhejiang (34%), Guangdong and Shenzhen (33%), Sichuan, Tianjin and Chongqing with 22%, 16% and 15% of respondents respectively.

FIGURE 34 - FOREIGN FIRMS - WHAT INVESTMENTS DO YOU PLAN FOR 2013 IN CHINA? N=435

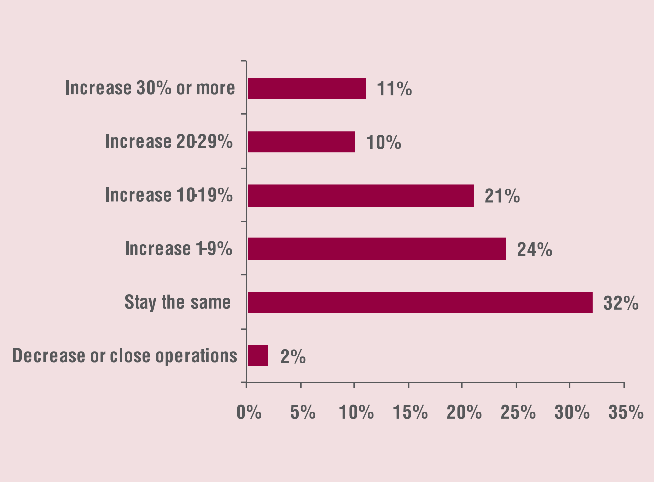


FIGURE 35 - FOREIGN FIRMS - WHERE IN CHINA DO YOU PLAN TO INVEST? (MULTIPLE ANSWERS) N=288

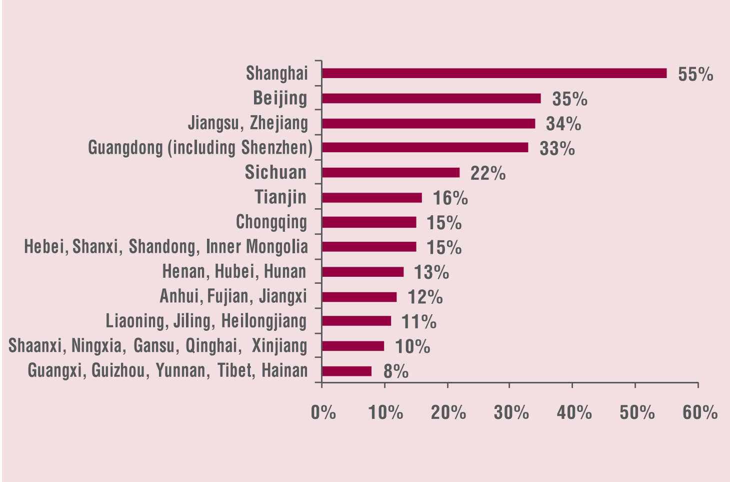
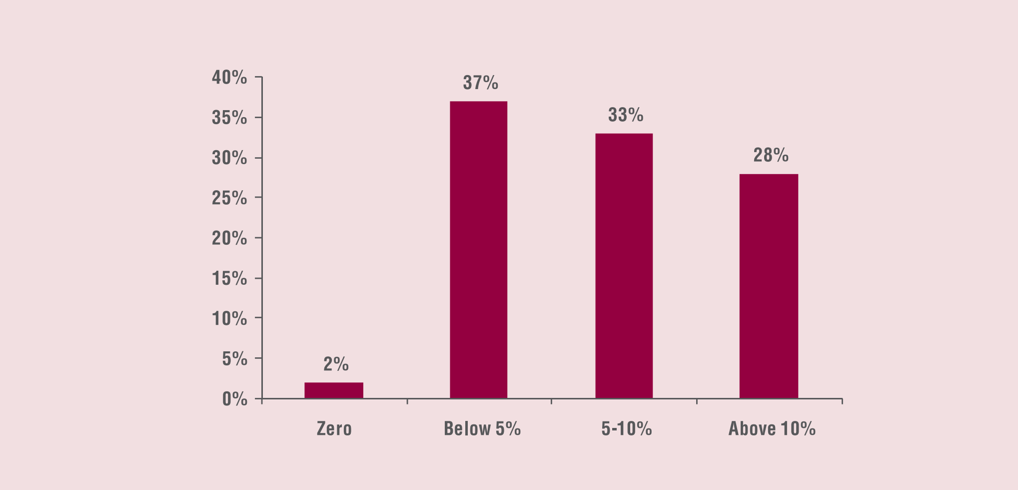


FIGURE 36 - FOREIGN FIRMS - WHAT % OF YOUR YEARLY REVENUES DO YOU SPEND ON MARKETING AND SALES? N=335



Another sign of commitment to the China market by foreign companies is the increase in the number of companies (28% of respondents, up from 20% last year) spending more than 10% of their China revenues in marketing and sales for the China market. The levels of investment in marketing and sales of foreign-owned companies in our sample are similar to those of Chinese-owned ones.

Similarly, 52% of foreign companies now have R&D activities in China, up from 39% last year. One third of them invest more than 5% of their revenues in research and development activities in China, showing the emphasis in innovation related investments in China for foreign firms.

4.3.2. Global focus for Chinese-owned firms

Chinese firms continued the globalization of their business in 2012. This is visible from an increase in their export revenues and stated intentions to invest outside of China.

Export is the most widespread form of reaching out for Chinese firms with about half of the companies exporting their products or services abroad. Amongst respondents, export revenues have increased from last year to reach one third of their total revenues. Asia and Europe are the main export markets at a similar level, followed by North America.

33% of respondents have investments abroad, with most of them close to home in Asia, followed by the US and Europe. This data is similar to previous surveys. However, there is a trend to increase these investments, with 42% of companies stating plans to invest outside of China in the next 3 years.

Regarding outsourcing of manufacturing operations by Chinese firms, one third of the companies have plants abroad, mostly concentrated in Asia.

Outbound Trade of Chinese-owned companies: *Up from 2011*

FIGURE 37 – CHINESE FIRMS - HOW DO YOUR EXPORTS IN 2012 COMPARE TO 2011? N=366

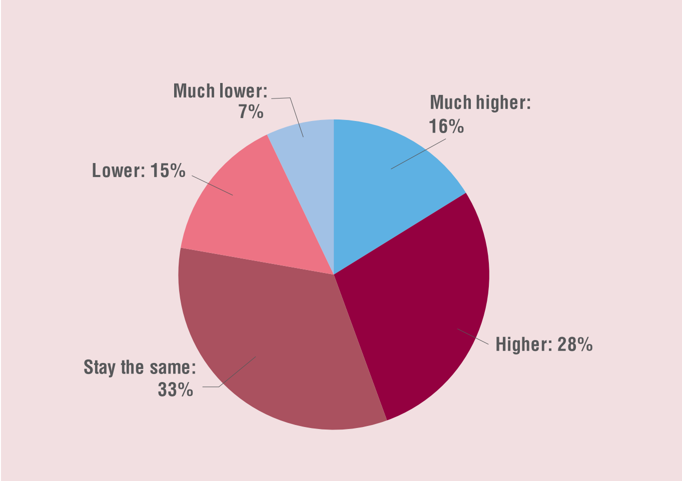
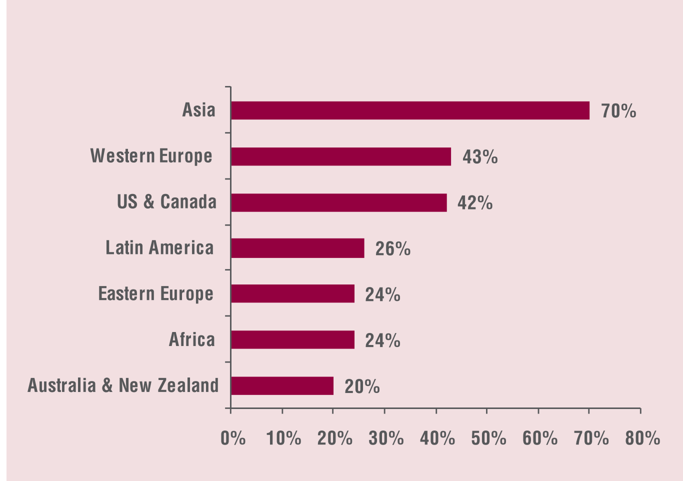


FIGURE 38 – CHINESE FIRMS - WHICH ARE YOUR KEY EXPORT MARKETS? (MULTIPLE ANSWERS) N=376



Almost half of the Chinese firms in our sample export their products and services and these exports represent one third of their total revenue. Moreover, export revenue is up in 2012 compared to 2011 for a majority of the firms.

Key export markets are Asia and Europe both regions with the same weight. The third preferred export market is the US & Canada.

Outbound Investment of Chinese-owned companies: *Similar to last 2 years but intent is growing*

In terms of investment outside of China, we see the same proportion of companies going abroad as in the previous two years (33% of the surveyed Chinese companies). The preferred targets are Asia (Hong Kong and Taiwan, Middle East, Singapore etc.) for 56% of the surveyed companies, US and Canada for 40% of them, and in a third place, Europe for 35% of them.

Most of these companies (55%) feel neutral about their investment results abroad or satisfied (34% of them). Only a small percentage (7%) of our pool of Chinese companies declares to be dissatisfied.

The major challenges for Chinese companies doing business abroad are cultural differences, laws and regulations, and finding the appropriate human capital.

Nevertheless, the above challenges do not seem to hinder Chinese firms from going abroad. The upward trend in out-of-China investment is shown by a higher number of companies planning to invest abroad in the next 3 years (42% versus 33% of firms currently investing abroad). The targeted geographies are similar to those where Chinese firms have currently invested.

FIGURE 39 – CHINESE FIRMS - WHERE ARE YOUR FOREIGN INVESTMENTS LOCATED? (MULTIPLE ANSWERS) N=256

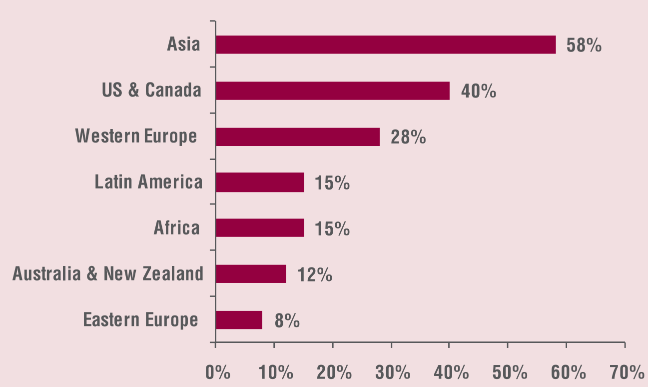
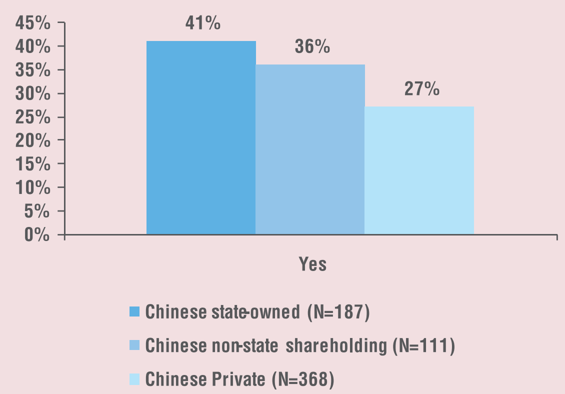


FIGURE 40 – CHINESE FIRMS – DOES YOUR COMPANY HAVE INVESTMENTS OUTSIDE OF CHINA?



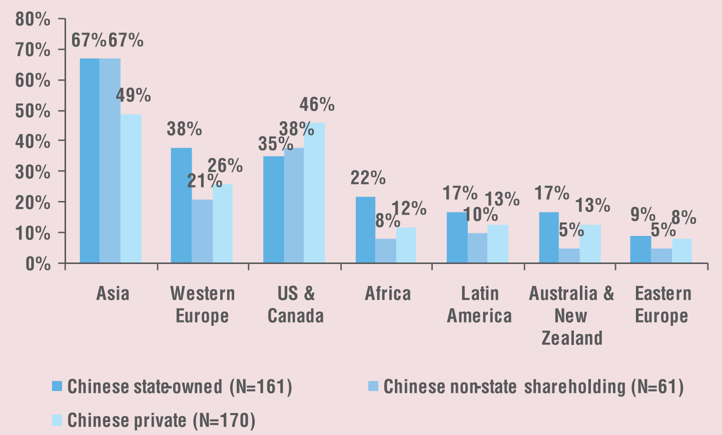
When analyzing in more detail the presence of Chinese enterprises abroad, we observe that it is the state-owned or state-holding enterprises that proportionally go abroad most often with 41% of them having investments outside of China. They are followed by private shareholding companies (non state-holding) with 36% of them having investments abroad. The lowest relative international presence is for Chinese private firms (27% of them).

We also notice that Chinese state-owned companies have a different pattern of expansion as they go more broadly to more regions than the other 2 groups. They favor Asia expansion with 67% of them citing investments in the region, followed by Europe for 41% of them (38% go to Western Europe, 7% go to Eastern Europe), US & Canada (35%), Africa (22%), Latin America (17%) and Australia (17%).

In contrast, non-state shareholding companies, by far, first choose Asia (67% of them), before the US (38% of them), and Western Europe (21%). Their investments in the other geographies are minimal with less than 10% of them citing this region.

Chinese private enterprises select Asia and the US at an almost equal weight (49% of them invest in Asia, 46% of them invest in US) with Western Europe coming 3rd (26%).

FIGURE 41 – CHINESE FIRMS - WHERE ARE YOUR FOREIGN INVESTMENTS LOCATED? (MULTIPLE ANSWERS)



Manufacturing activity abroad of Chinese-owned companies: *Mostly in Asia*
35% of the Chinese manufacturing firms having investments outside of China (14% of total sample of Chinese-owned firms) have plants abroad, and two thirds of them state satisfaction. These manufacturing sites are located in Asia for 56% of them, while the rest are spread amongst the rest of the globe.

4.4. JOINT VENTURES

Half of JV foreign partners come from Asia.

311 executives state to work for a Joint Venture or for a company with Joint Ventures. This is 26% of the total sample, with 9% of the total sample working directly for a JV (105 companies). 52% of JVs in our sample are Chinese controlled (more than 50% of ownership is Chinese)

FIGURE 42 - WHICH REGION IS YOUR MAIN FOREIGN OR NON-MAINLAND CHINESE PARTNER FROM? N= 237

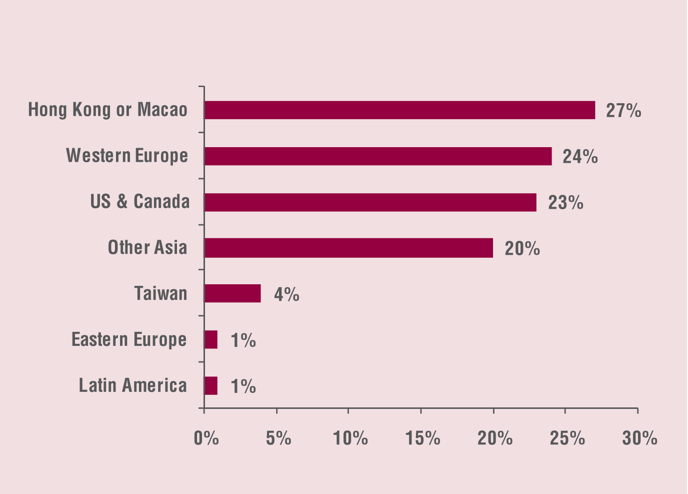
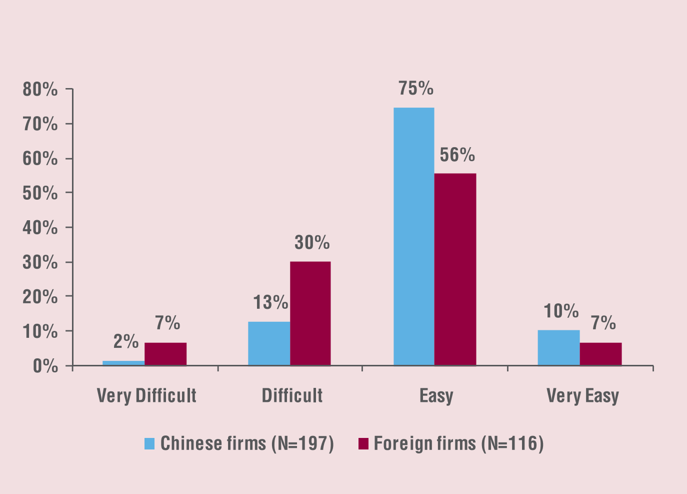


FIGURE 43 - HOW DIFFICULT/EASY IS WORKING WITH YOUR PARTNER?



The foreign or non-mainland partner comes from Asia for 51% of the JVs, more than half of them from Hong Kong. 24% come from Western Europe and another 23% from the US & Canada.

When asked about difficulties in working with their partner, more difficulties are reported by the foreign side (37%) than the Chinese side (15%). Difficulties most frequently mentioned are: differences in management styles or business concepts, cultural differences and communications problems, strategy differences and conflicts of priorities.

SECTION 5

FOCUS BY FUNCTIONS

This section provides perspectives on three functional areas:

- Human Resources
  The chapter covers the top HR issues that companies in our sample face in China. It also gives an in-depth commentary on what the executives in our sample think are the most effective measures to retain employees.
- Finance
  This chapter gives an overview of the most frequent sources of funding for the Chinese-owned firms in our sample by type of company.
- Marketing, Sales and Distribution
  This chapter includes an overview of market segments where companies in our sample operate as well as mobility of companies within segments. It also details which are the most effective sales and mar keting strategies for the companies in our sample, and particularly for those companies in our sample that are leaders in their markets.

The purpose of this section is to understand challenges and success factors of our respondents in these functional areas.

5.1. HUMAN RESOURCES

Finding talent and rising labor costs are cited as the top HR issues for managing businesses in China

5.1.1. Top Human Resources issues in China

HR issues remain the top challenge faced by companies in China, just as in previous editions of this survey. In spite of continuous efforts from executives, they have remained a major concern.

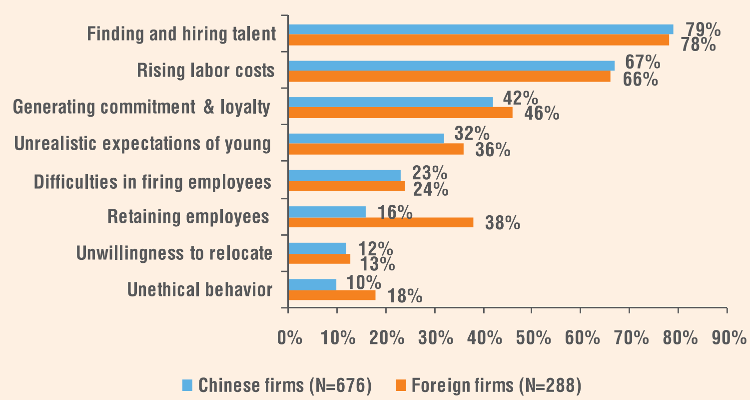
"Finding and hiring suitable talent" is the Top HR concern for foreign and Chinese owned firms (78% of surveyed executives). The issue appeared particularly acute for Engineers and Technicians as well as at Management (both top and middle levels). The origins of this difficulty in hiring talent range from lack of experienced talent to inability to afford available talent.

"Rising labor costs" follow closely as the second major HR related concern. It is also the number one external challenge for doing business in China (see Section 3).

"Generating commitment and loyalty" comes third (43%) in the HR related concerns cited by surveyed executives.

"Unrealistic expectations of the new generation" are the next most cited source of worries at 33% of our sample of companies. This item didn't appear as strongly in previous editions of the survey (10%) and it seems to become more important as the Generation Y hits the labor market.

FIGURE 44 - WHICH ARE THE MAJOR HUMAN RESOURCES ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



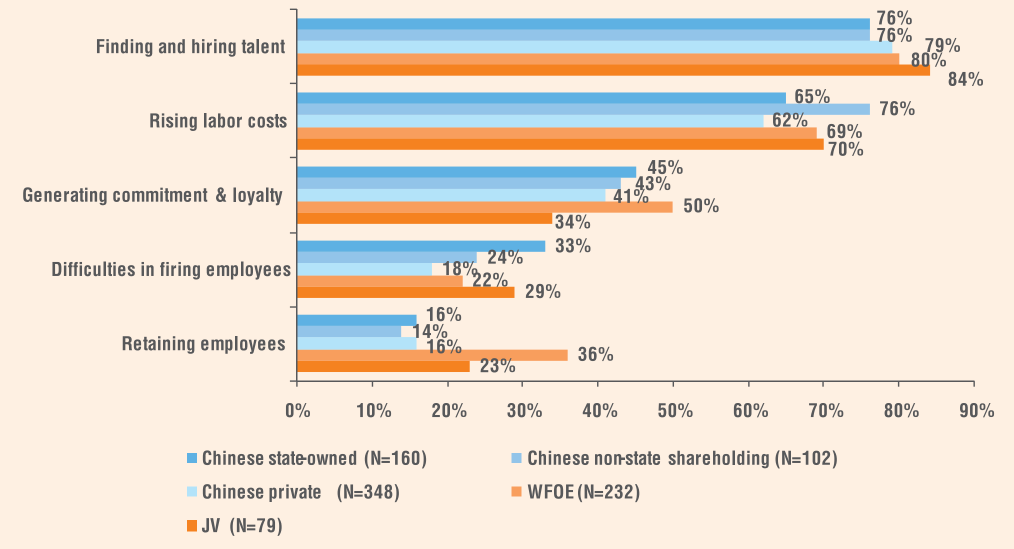
Although the above described challenges are common to the total sample of companies, we do observe differences in relative weight of some of the issues depending on the legal status of the company:

- "Finding and hiring talent" is, relatively speaking, a lesser problem for state-owned companies and non-state shareholding companies. It is possible that these two kinds of larger Chinese enterprises are better equipped than others to attract local talent.

- Both “Generating commitment and loyalty” of staff and “Retaining employees” seem to be more problematic for foreign companies than for their Chinese counterparts. In particular, “Retaining employees” worries 38% of foreign companies vs. only 16% of Chinese ones. A possible explanation is that foreign-owned firms are targeting just a section of the labor market while Chinese firms target the whole market.

- “Difficulties in firing employees” are more acute for State-owned companies and JVs (where the Chinese side is often a state-owned company). This is a problem that happens with state-owned enterprises in other countries as well.

FIGURE 45 - WHICH ARE THE MAJOR HUMAN RESOURCES ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



5.1.2. Most effective measures to retain employees

In order to retain employees, executives in our survey cited the importance of creating a feeling of belonging to the company (69% of respondents) and offering interesting career path within the company (66% of respondents). It is interesting to note this top set of measures comes before paying above market (third with 51% of respondents) and having a system of rewards and recognition (47%). Company reputation and training plans represent the next set of measures cited by executives.

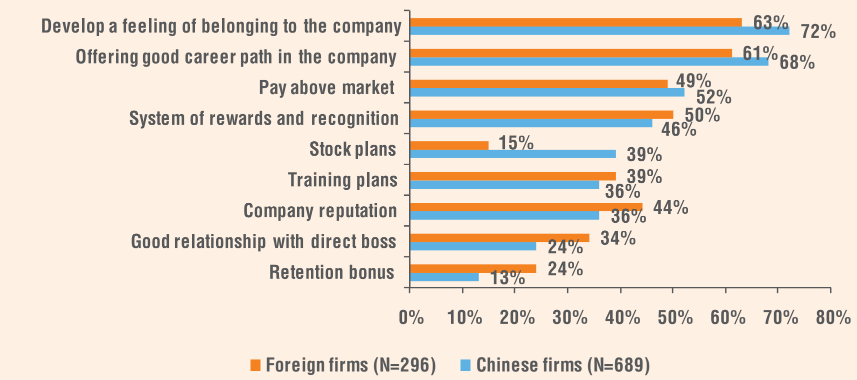
Even if the above selection of most effective HR measures is shared by for both Chinese and Foreign companies, we do observe differences in the relative weight of some of the strategies between both types of firms:

A larger amount of Chinese-owned firms favor “Develop a feeling of belonging to the company” (72%) and “Offering good career path in the company” (68%) when compared to foreign-owned firms (63% and 61% respectively).

“Stock plans”, even if less frequent, are more successful amongst Chinese firms (39% of them) than foreign ones (15%). This may be related to regulations regarding foreign stock ownership by Chinese citizens.

On the other hand, foreign firms put more emphasis (when compared to Chinese firms) to "System of rewards and recognition" (considered most efficient by 50% of foreign-owned firms vs. 46% of Chinese-owned firms), "Company reputation" (44% vs. 36%) and "Good relationship with direct boss" (34% vs. 24%).

FIGURE 46 -WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES? (MULTIPLE ANSWERS)



5.2. FINANCE

This set of questions was asked to Chinese-owned companies only.

Two thirds of the surveyed companies rely mainly on self-financing as they choose retained earnings as the primary source to finance their expansion. Bank loans are the second most commonly used means of funding favored by half of our sample. Capital markets (23%) and investments from either private investors (16%) or private firms (16%) come next. Notably, there is little presence of venture capital funding (only cited by 6% of respondents), or of government and foreign investments.

FIGURE 47 – CHINESE FIRMS - WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? N=684

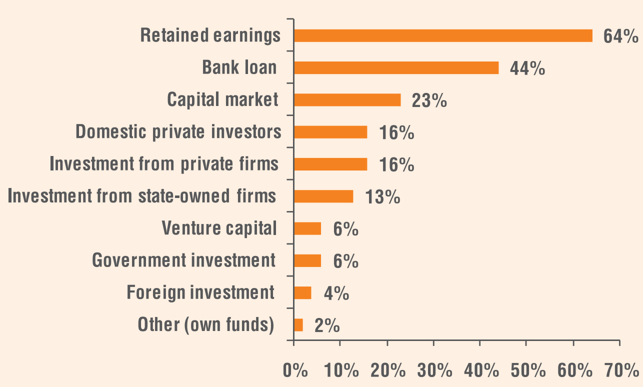
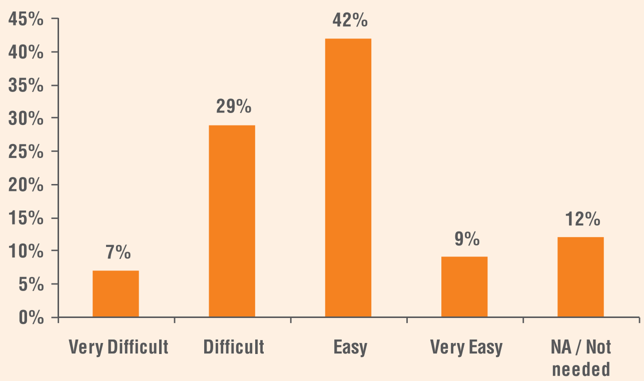
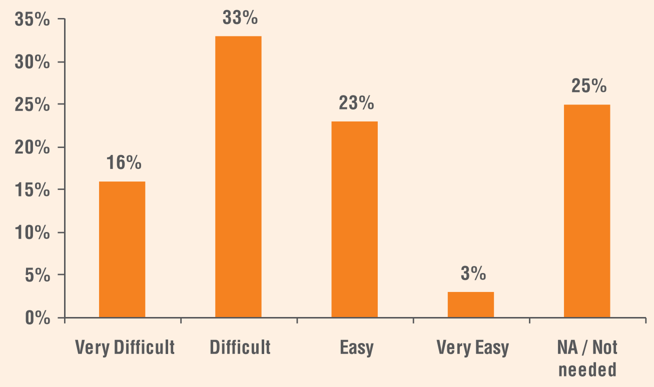


FIGURE 48 - CHINESE FIRMS - YOUR ACCESS TO BANK LOAN IS: N=681



A great majority of surveyed companies qualified access to bank loans as relatively easy, which could explain its popularity. In contrast, access to financial resources external to the company and not coming from bank sources is seen as relatively difficult to very difficult. Policy restrictions are the most frequently mentioned obstacles.

FIGURE 49 – CHINESE FIRMS - YOUR ACCESS FINANCIAL RESOURCES FROM NON-BANK SOURCES IS: N=675



5.2.1. By legal entity

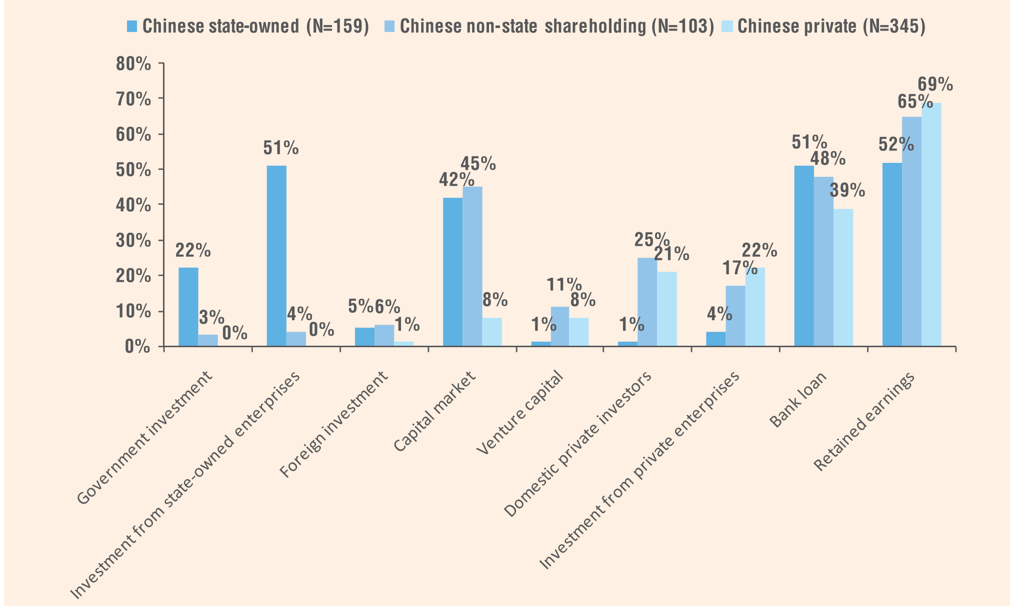
Chinese state-owned companies
“Retained earnings”, “Bank loans” and “Investment from state-owned enterprises” are equally frequent (51% of responses) sources of funding for companies having State ownership in our sample. The “Capital market” follows very closely, mentioned by 42% of respondents with State ownership.

“Government investment” is the 4th most significant source of funding mentioned by 22% our respondents working for this category of companies.

Chinese non-state shareholding companies
“Retained earnings” are number one source of funding favored by 65% of our sample in this category of companies. It is followed by “Bank loans” (48%) and “Capital market” (45%). Less frequently, “Domestic private investors” and “Investment from private enterprises” are cited by 25% and 17% of the concerned respondents respectively. Although only 11% of companies Chinese shareholder companies use “Venture capital”, it is still the category of companies most frequently using VC funds in our sample.

Chinese private enterprises
“Retained earnings” are, by far, the most favored source of funding mentioned as a main source of funding by 69% of Chinese Private enterprises. “Bank loans” come as a distant 2nd, with 39% of respondents. This is consistent with the data exposed later in this chapter where access to bank loans decreases rapidly with company size, whereas private enterprises are in average smaller businesses than state-owned or non-state shareholding companies (59% of them are small or medium enterprises, compared to 22% within the Chinese non-state shareholding firms and only 14% of the state-owned companies).

FIGURE 50 – CHINESE FIRMS - WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? (MULTIPLE ANSWERS)

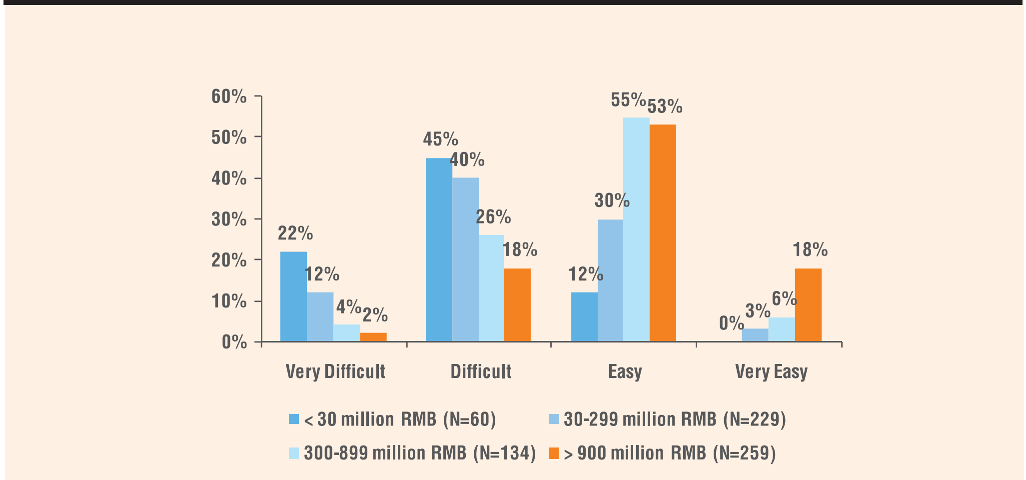


5.2.2. By company size

In terms of company size, we observe a direct relationship between size in annual revenues and funding through bank loans. Bank loans are mainly used by the 2 larger categories of companies (58% of companies with size 300-899 million RMB and 54% of companies with size > 900 million RMB use bank loans as a main source of funding, vs. 12% of companies <30 million RMB in size).

Similarly, the capital market is almost only used by the largest companies (>900 million RMB in revenues, with 44% of them using it as a main source of funding).

FIGURE 51 - CHINESE FIRMS - YOUR ACCESS TO BANK LOANS IS?

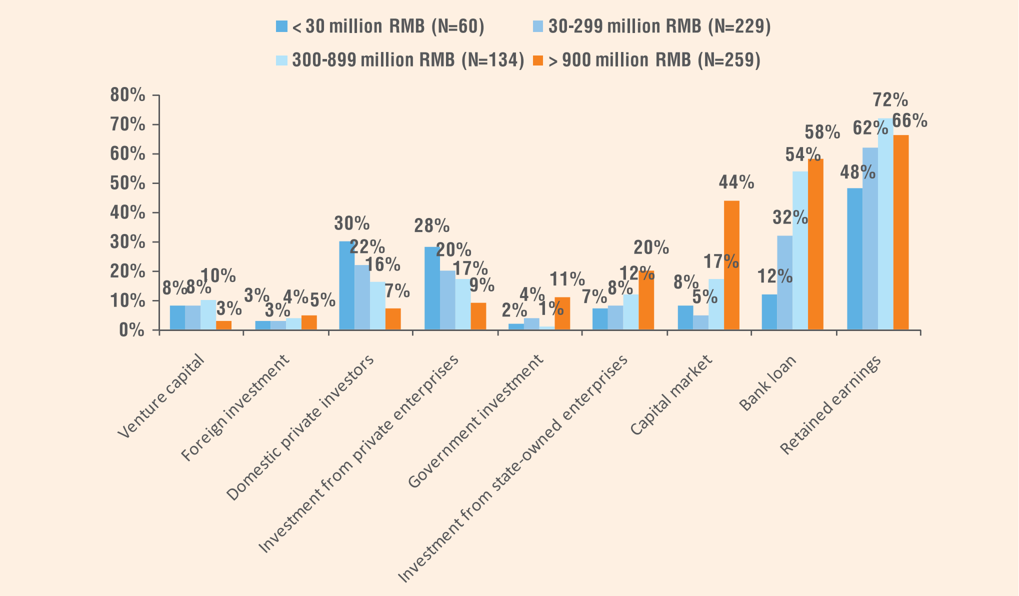


This situation is linked to access. Our sample shows a clear relationship between company size and access to bank loans: 67% of small companies in our sample claim access to bank loans to be “difficult” or “very difficult”, compared to 52% for medium size companies, 30% for large firms, and 20% for the largest companies in our sample (>900 million RMB).

Investment from private enterprises and private investors, although not the main source of funding for any of the company types, is more favored by small and medium companies.

Government investment and funds from State-owned enterprises have relatively more importance within the super-large companies of our sample (>900 million RMB in revenues), even if they are overall one of the least frequently mentioned funding means together with foreign investment and private capital.

FIGURE 52 – CHINESE FIRMS - WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? (MULTIPLE ANSWERS)



5.3. Marketing, Sales and Distribution

Market segments and mobility: *Clear market positioning with slight trend to move upscale*
Our sample of companies operates mainly in the middle and premium segments with 50% and 45% of companies respectively, and only a small 5% in the low-end.

In terms of segment mobility we see that even if a majority of companies plan to grow future sales within their existing segment (77% for those operating in the premium segment and 62% of those operating in the middle segment), there is still a significant amount of companies that plan to grow outside of their current segment. This trend is stronger for companies in the middle segment where 36% of them want to move into the premium segment. For companies currently operating in the premium segment, a smaller proportion (22%) of them wants to expand down into the middle segment.

Marketing and sales budgets and most effective strategies: *No significant difference in behavior between Chinese and foreign firms*

In terms of marketing & sales budgets and strategies, we observe a marked difference between firms operating in the Business-to-Business (B2B) area and those in the Business-to-Consumer (B2C) area. Within those two groups, Chinese-owned and foreign-owned companies follow similar patterns without significant differences.

FIGURE 53 - WHAT PERCENTAGE OF YEARLY REVENUES DO YOU SPEND IN MARKETING AND SALES?

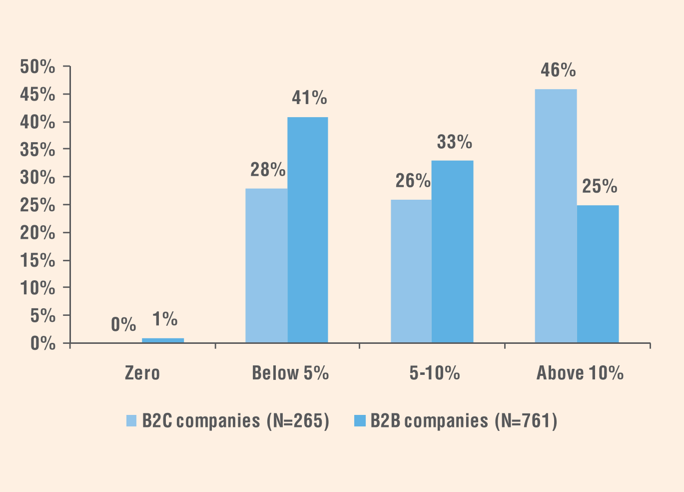
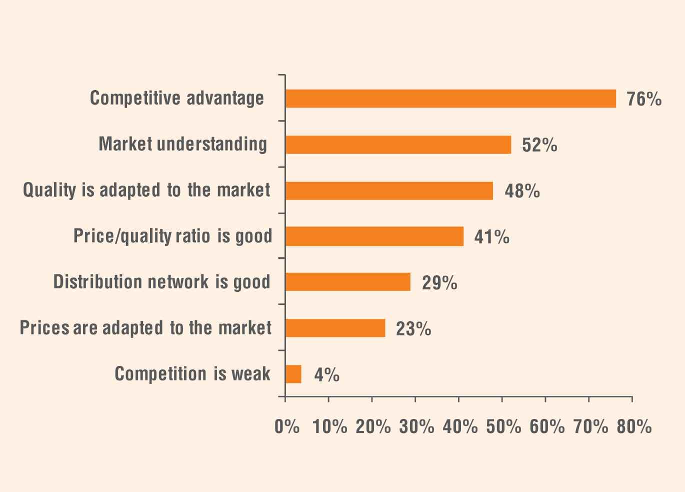


FIGURE 54 - FOR MARKET LEADERS - WHY ARE YOU AT THAT POSITION? MULTIPLE ANSWERS N=444



Unsurprisingly, firms selling directly to consumers have larger marketing and sales budgets (above 10% of revenues for almost half of them). Most cited marketing spend are traditional advertising (TV, print) and Internet advertising. Other marketing strategies are public relations, as well as newsletters and emails. In terms of success factors in China, access to a good distribution network, developing a strong brand, and advertising are most frequently cited.

In contrast, B2B firms favor seminars, conferences and other public relations activities, followed by attending trade fares, mainly in China.

The most cited success factors are good service, high quality and developing a strong brand.

Distribution network:

Only 20% of the total sample evaluates their national distribution network as bad or very bad. The main issue for 50% of them is the lack of experienced professionals in the distribution field followed by fragmentation and limited geographical reach of the distribution chain (20%). Foreign-owned and Chinese-owned firms also have similar views in this respect.

Market leaders keys to success:

445 companies (44%) in our sample claim to be market leaders for their main business line.

Their keys to success are having a competitive advantage, understanding the market better than their competitors, and offering a quality adapted to the market needs (see figure 54). Both Chinese and foreign firms agree on these factors.

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