# 2015 China Business Survey

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China Europe International Business School


This research was supported by grants from CEIBS

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# LETTER FROM THE RESEARCH TEAM

We are pleased to present the 5th annual CEIBS China Business Survey.

We want to sincerely thank all of the executives working in China who have participated in this survey for their time and valuable contribution. In particular we thank the CEIBS alumni community and current MBA, EMBA and Executive Education students who have given their support to this research. Our sincere gratitude is also extended to the following institutions and organizations:

- Swiss Center Shanghai, Swiss Embassy in China, Swiss Business Hubs, Swissnex China, SwissCham, China Integrated. Ltd.
- China-Italy Chamber of Commerce
- Confederation of Indian Industry

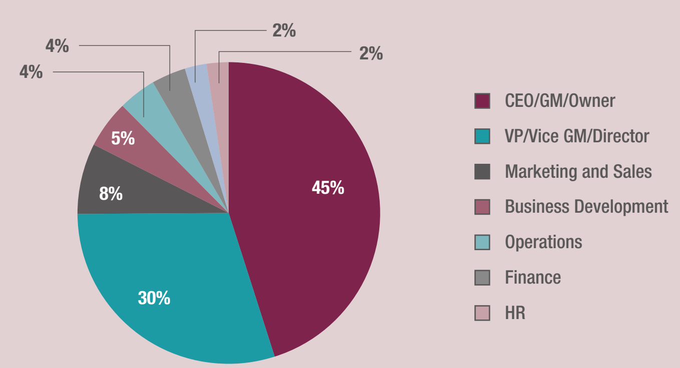
We are especially grateful to Nicolas Musy and the team at China Integrated for their in-depth article on innovation in China though history and today.

Finally, we acknowledge the financial support from CEIBS Research Fund, support from the Alumni, MBA, EMBA and Executive Education 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 2014 and their expectations for 2015 and the future.

The 2015 CEIBS Business in China Survey was completed by 773 executives between November and December 2014, with 412 from Chinese companies and 361 from foreign companies. Among them were 339 CEOs, GMs, and company owners; 220 Vice Presidents, Deputy General Managers or Directors. The rest represented all the remaining business functions: HR, Finance, Marketing, Sales, Operations and Research & Development. Of the respondents, 77% are from the Chinese mainland, 2% from Taiwan, Hong Kong or Macao, and 21% from foreign countries. Most of them (93%) have more than 10 years of work experience, with 53% of them having more than 20 years of work experience. This broad and experienced sample added rich and valuable perspectives to the survey.

FIGURE 1 - WHAT IS YOUR POSITION IN THE COMPANY? N= 773



# THE RESEARCH TEAM

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**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: America Latina en China, CHINA CEO, Chinese SOEs Reform, China CEO: A Field Guide, China (Foreign) Entrepreneur and Chinese Entrepreneurs. He has given presentations about his Chinese research in USA, India, Japan, Korea, UK, France, Italy, Spain, Vietnam, Mongolia and Ghana

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.

Prof. Dongsheng Zhou

**Dr. Dongsheng Zhou** is Professor of Marketing at CEIBS. He is also the academic director of SEPC, a joint executive training program with Harvard Business School and Tsinghua University. He received his Ph.D. from the University of British Columbia (UBC), Canada.

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).

Maria J. Puyuelo

**Maria J. Puyuelo** is Research Associate at CEIBS. She obtained her MBA from Stanford Graduate School of Business (USA) and her MSc in Engineering from the University of Zaragoza (Spain).

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. She has co-authored the book America Latina en China.

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**Junjun Li** is Research Assistant at CEIBS. She got her Bachelor of Art from East China Normal University.

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

# EXECUTIVE SUMMARY

*The CEIBS China Business Survey is an annual poll of business executives working in China for both Chinese-owned and foreign-owned companies. Among the findings from this year's poll we highlight the transformation of the Chinese economy and the new opportunities and strategies.*

**Business Climate Reflecting Chinese Economy's "New Normal"**

The Chinese economy was said to be in a "new normal" stage in 2014 as characterised by slower economic growth, higher labour cost, and more competition. When asked "What are the greatest external challenges for your company?" both Chinese and foreign companies listed these three themes as the top three challenges.

The "new normal" status of the Chinese economy posed new management challenges to companies in China. When asked "What are the greatest internal challenges facing your company in China?", 61% of Chinese company executives and 58% of foreign company executives said it was "Finding and retaining talent", which reflects the increasingly tight conditions of China's labour market. It is worth noting that 51% of Chinese company executives saw "Innovation capability" as a top management challenge, which indicates the rising importance of innovation in China's new business environment.

One pronounced feature of China's new business environment is the increasingly competitive power of Chinese private companies. When asked "Who are your major competitors in China?", 76% of Chinese company executives and 68% of foreign company executives pointed to Chinese private companies. It is also noticeable that less than 30% of Chinese company executives considered wholly foreign owned companies (WFOE) and joint ventures as their major competitors, which reflects a significant change of China's business climate. These findings are consistent with the latest trends in brand evolution in China. According to the 2015 *BrandZ* Top 100 Most Valuable Chinese Brands report[1], brands from private enterprises dominate in value growth, rising 97% since 2013, while SOEs declined 9%. Additionally, it is Chinese private companies in our sample that lead R&D spending with 41% of their polled executives declaring investing above 5% of their sales revenues in innovation, compared to a much lower 23% of SOEs and a lower 37% of foreign owned firms. These data confirm the burgeoning trend of Chinese private companies taking the lead in China's business landscape.

**New Opportunities, New Strategies**

*Companies continue expanding their work force*

China became a high-middle income country in 2010 when its per capita gross national income reached USD4,000. In this new development stage, China's economic growth rate has slowed down to 7.4% in 2014, while the country's economic structure has seen an expansion of the service sector (whose size exceeded the industrial sector in 2012) and the rise of the Internet-led new economy. In our survey, when asked about the change in employment, 60% of the surveyed Chinese companies and 48% of the surveyed foreign companies indicated an increase of their labour force in 2014, compared with 16% of Chinese companies and 20% of foreign companies which decreased their labour force in 2014. Therefore, despite the further slowdown of the Chinese economy in 2014, the majority of the companies in our sample still expanded their business operations.

Additionally, the transformation of the Chinese economy from heavy industry and manufacturing to a more modern one with a higher representation of services and technologies can be witnessed in our sample of surveyed companies. Analyzing the data by industry, we discover that it is healthcare and financial sector firms that have proportionally increased their in labor force the most in 2014, with 67% of them expanding in number of employees. This compares to 50% to 49% for more traditional industry related sectors like basic materials (chemicals, mining and forestry) and industrial goods and services.

*[1] Ranking elaborated by marketing and brand consultancy Millward Brown and WPP*

*Increasing role of technology and innovation*

In recent years, China has seen an increasing emphasis of the role of innovation. Our survey indicates that this trend will continue. When asked about their R&D plans for the next 3 years, 71% of Chinese company executives and 59% of foreign company executives said that their companies will increase R&D intensity. Another trend observed in China in recent years is the increasing use of the Internet for business operations. When asked about their plan to expand the digitisation of their businesses, 90% of Chinese company executives and 82% of foreign company executives said that their companies will have a plan to expand the digitisation of their businesses. These trends highlight the new business opportunities that have emerged as China moves up in its economic structure, which call for the design and adoption of new business strategies for companies operating in the country.


# SPECIAL TOPICS

This section tackles subjects that are particularly relevant to current business life in China. The first two topics have been selected as they reflect changes greatly affecting the business environment in China; one of them is originated by the nation's government and the other emerges from a global trend. The third topic is a compilation of key learnings from the 182 market leaders in our sample.

- Government New Policies
- The Digital Revolution in China
- Lessons from the Market Leaders

The purpose of this section is to give an in-depth overview of what we learn about the above topics from the diverse range of surveyed companies.

# GOVERNMENT NEW POLICIES

*The increasing role of the market and the decreasing role of the government is eagerly anticipated by both Chinese and foreign executives according to our poll of 773 executives from companies doing business in China.*

Chinese and foreign executives who participated in this year CEIBS Business in China Survey are anticipating that the new round of economic reform which got underway in China in 2014 will further increase market openness and reduce government intervention. They are likely reacting to signals from the Third Plenum of the 18th Communist Party of China Central Committee which set the new reform agenda in November 2013. As outlined in the blueprint for comprehensive reform in China for the next ten years, The Decision on Major Issues Concerning Comprehensively Deepening Reforms, "the basic economic system should evolve on the decisive role of the market in resource allocation." Chinese and foreign executives have heard this message loud and clear, based on their responses for this year's survey.

**New Reform Policies Anticipated but Uncertainty Remains**

Despite the Chinese government's efforts to kick-start new reforms in 2014, the benefits of these changes are yet to be felt by many companies. Among the 731 executives who answered the question "Do you think your company will benefit in the future from current reform policies?" 43% of Chinese company executives and 57% of foreign company executives said they were not sure (Figure 2). When we break down the sample by ownership, 48% of Chinese private company executives and 58% of foreign executives from wholly foreign owned companies said they were not sure about the future benefits of the current reform policies (Figure 3). These data indicate that there is still a lot of uncertainty about the potential benefits of the new reform policies, especially among private and foreign companies in China. It is interesting to observe that 65% of state-owned company executives felt that they would benefit from the current reform policies. While many new reform policies aim to reduce the power of state-owned enterprises, the majority of state-owned company executives in our survey (65%) expect to benefit from such policies which may breathe new life into these state-owned companies.

FIGURE 2 - DO YOU THINK YOUR COMPANY WILL BENEFIT IN THE FUTURE FROM CURRENT REFORM POLICIES?

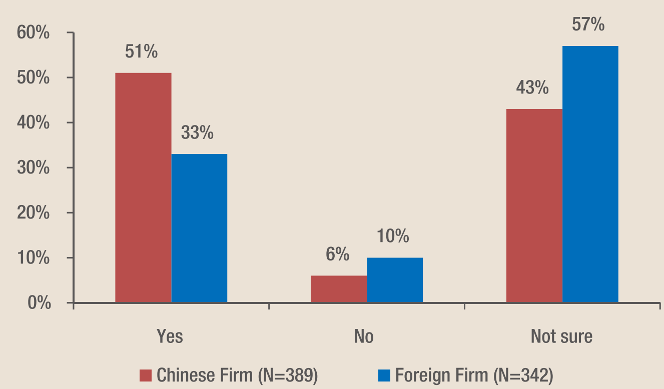
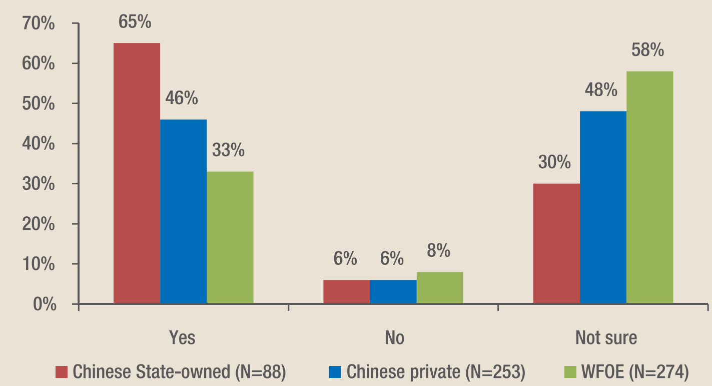
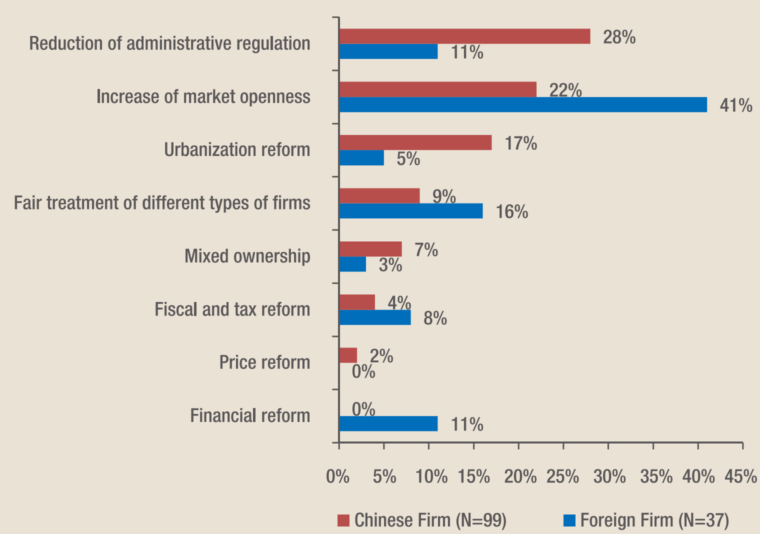


FIGURE 3 - DO YOU THINK YOUR COMPANY WILL BENEFIT IN THE FUTURE FROM CURRENT REFORM POLICIES?

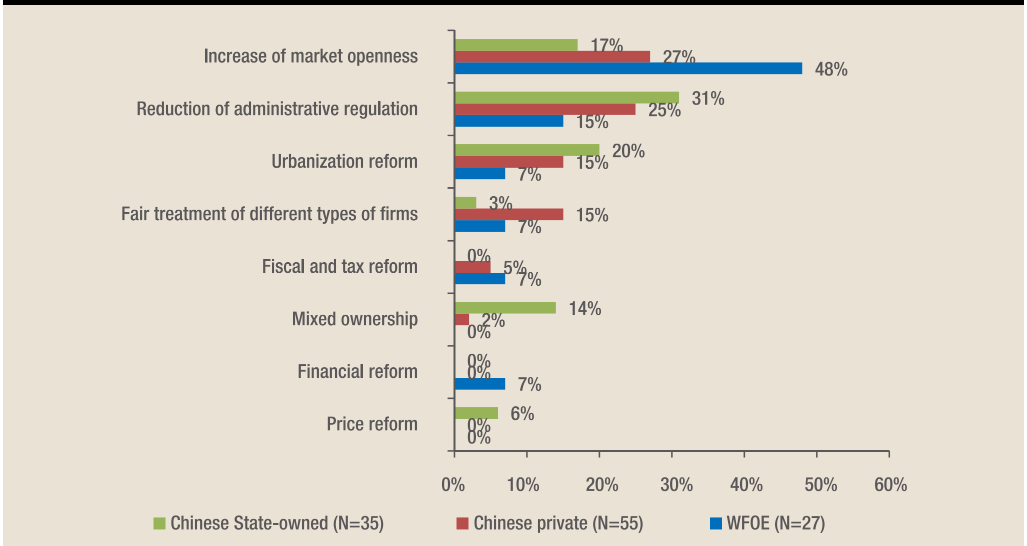



For the fraction of companies which already benefited from new reform policies in 2014, their answers reveal the areas of reforms that companies prefer. For Chinese companies, 28% of them listed "reduction of administrative regulation" (decreased government intervention) as the number one benefit. For foreign companies, 41% listed "increase of market openness" as the number one benefit (Figure 4). Figure 5 shows that the number one benefit listed by Chinese private companies was also "increase of market openness" (27%), while "reduction of administrative regulation" came a close second (25%). These answers reveal that companies prefer new reform policies that increase the role of the market and decrease administrative interventions.

FIGURE 4 - WHICH REFORM POLICY BENEFITED YOUR COMPANY IN 2014?



## FIGURE 5 - WHICH REFORM POLICY BENEFITED YOUR COMPANY IN 2014?



## THE DIGITAL REVOLUTION IN CHINA

The world is going through a digital revolution, and China is not lagging behind. More and more, China is becoming an active actor in this revolution with an increasing importance of digitalization in its economy.

From a very low starting point five years ago, China has grown to be the country with most internet users in the world. As of July 2014, China had 632 million internet users compared to 582 million in Europe and 277 in the US[2]. Nevertheless, the penetration of internet usage in China is much lower than the penetration in Europe and in the US (46% in China vs. 70.5% in Europe and 87% in the US). This indicates that despite the impressive internet usage numbers, China still has an enormous potential for development and growth.

What is also remarkable is the share that e-tailing (also called internet retailing or e-commerce) has in total retailing in China. The author still remembers how ten years ago it was very difficult to do a purchase on line. Today, it is almost the natural way of buying in China. According to McKinsey & Company's in an article published in January 2015 "China's rising Internet Wave: Wired companies", the market size of e-tailing in China is $295 billion compared to $270 billion in US. It terms of percentage, the share of e-tailing in total retailing is higher in China than US (7-8% vs. 6%) and still growing.

**Survey results**
In order to capture this situation, we included four new questions in our 2015 Survey. The first question just filtered those who use any internet platform to sell their products and services. 37% of the total respondents declared that they use internet platforms in their sales operations. For those that use internet platforms, we asked three more questions:

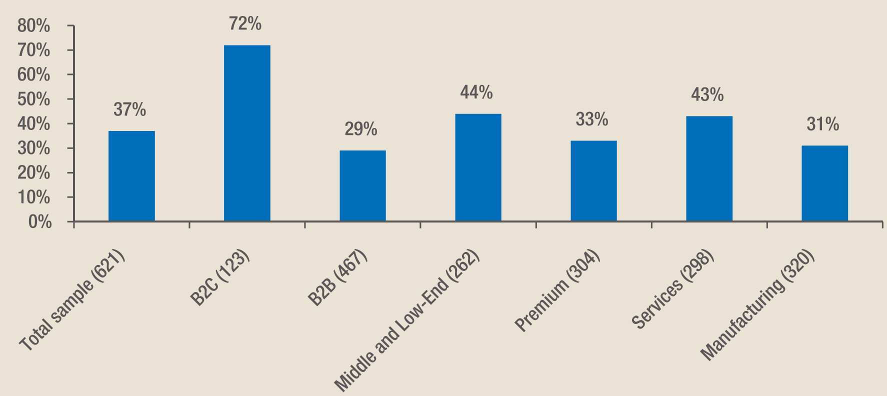
- Which is the percentage of sales that come from the above internet based platforms?
- Which internet based platforms do you use?
- Do you plan to expand the digitization of your business in China?

Based on these questions, we can share the following results:

*1. E-tailing penetration is highest in B2C companies and in the consumers sector.*
231 respondents (37% of our total sample) sell their products and services through an internet based platforms. However, we observe important variations in e-tailing penetration depending on the type of business, the market segment and industry type. 72% of the B2C firms in our sample declare using ecommerce, vs. a much lower 29% of the B2B firms. More firms targeting the Middle and Low-End segments of the market declare using e-tailing than in the Premium segment (44% vs. 33% respectively). Likewise, 43% of service companies in our sample use the internet to sell their services versus a lower 31% of the surveyed manufacturing firms (Figure 6).

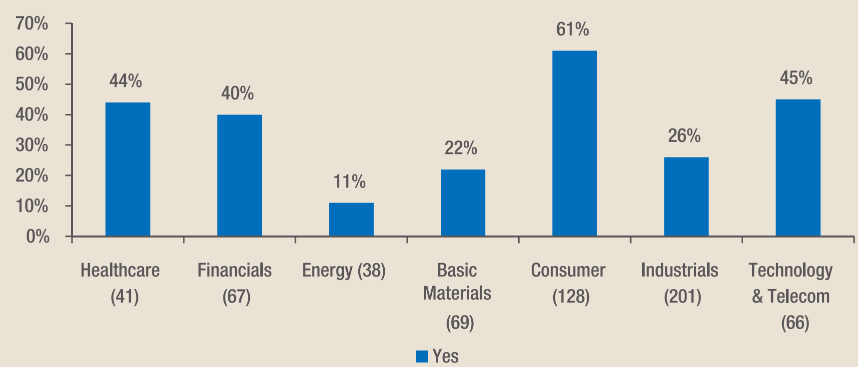
[2] *Source: Internet World Stats*

## FIGURE 6 - DO YOU SELL YOUR PRODUCTS/SERVICES THROUGH ANY INTERNET BASED PLATFORM? BY TYPE AND SECTOR



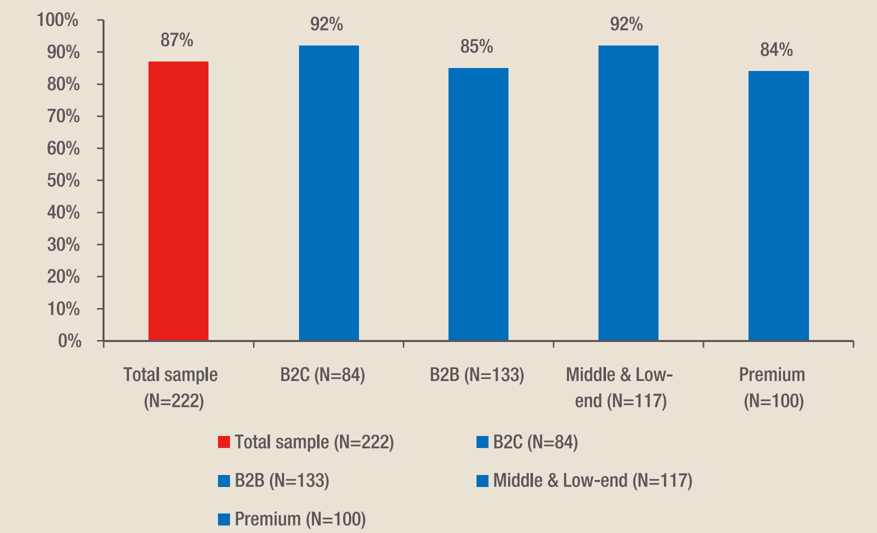

In terms of industry, 61% of surveyed consumer goods and services firms use ecommerce, making it the Number 1 industry for prevalence of ecommerce in our sample. It is followed by Technology and Telecomm with 45% of ecommerce penetration, Healthcare with 44% and Financials with 40%. In contrast, only 11% of firms operating in the energy sector declare to use the internet to sell their products and services (Figure 7).

## FIGURE 7 - DO YOU SELL YOUR PRODUCTS/SERVICES THROUGH ANY INTERNET BASED PLATFORM? BY INDUSTRY




Companies in our sample using ecommerce are probably quite satisfied with it as 87% of them declare to have expansion plans for 2015 (Figure 8). A higher percentage of B2C firms and of companies selling in the Middle and Low end markets state intentions to expand (92%).

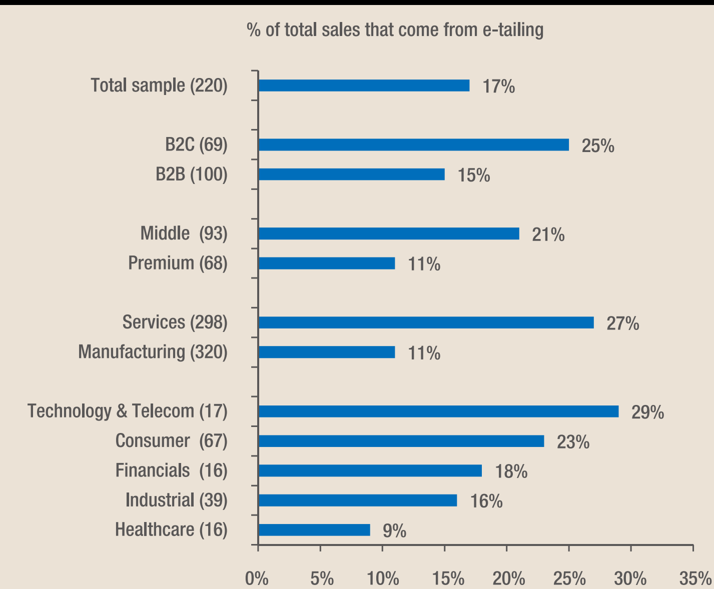
FIGURE 8 - DO YOU PLAN TO EXPAND THE DIGITIZATION OF YOUR BUSINESS?




2. *Technology and Telecom firms, B2C firms and Service companies declare highest e-commerce sales as percentage of total sales.*

In terms of percentage of total sales obtained through internet based platforms (for companies using e-tailing), we observe similar patterns as in e-commerce penetration: B2C firms, Middle and Low end firms and Service firms obtain higher percentage of sales from e-commerce than B2B firms, Premium segment firms or Manufacturing firms, respectively (Figure 9).

FIGURE 9 - - WHICH IS THE PERCENTAGE OF SALES THAT COME FROM INTERNET BASED PLATFORMS?



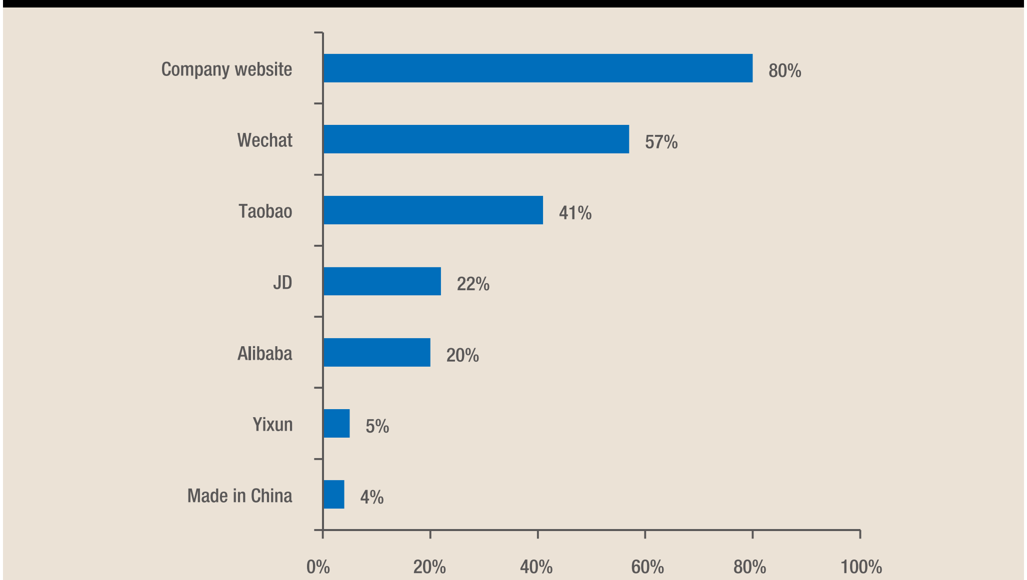
In our sample, B2B companies obtain, in average, 25% of their total sales through internet based platforms compared with 15% for B2C companies. Firms operating in the Middle and Low ends of the market obtain 21% of their sales through ecommerce vs. 11% for firms in Premium segments. Service firms declare that in average 27% of their sales in China come from internet platforms, while Manufacturing firms obtain a much lower 11%.

With regard to industries, Technology and Telecomm companies declare an average of 29% of their total sales coming through ecommerce. They are closely followed by Consumers, with 23% of their sales realized through the internet, in average. Financials and Industrials complete the top 4 with 18% and 16% in average.

*3. Company website, Wechat and Taobao most used internet based platforms for marketing and sales.*

80% of ecommerce companies declare using their company website to promote and sell their products, 57% of them utilize Chinese platform Wechat, while Taobao is the 3rd most used platform with 41% of sampled e-commerce companies utilizing it (Figure 10).

FIGURE 10 - WHICH INTERNET BASED PLATFORMS DO YOU USE? N=226




**Digital economy: threat or opportunity?**

The rapid development of the digital economy in China opens up a number of opportunities to expand the market and increase sources of revenues. On the other hand, new business models render some existing businesses and intermediaries obsolete. The digital revolution also poses a threat to companies unwilling or unable to adapt to the new tools and consumers habits. Amongst the opportunities we count direct access and increase proximity to customers as well as lowered barriers to entry to newly created and smaller companies.

1. *Direct access to customers.* Internet platforms allow companies to sell directly to their customers. This is happening not only in sectors like household durables, food, apparel and consumer services; but also in industries newer to e-tailing like the automobile industry, real estate or healthcare. When companies sell directly to their end customers bypassing intermediaries, costs and final prices are reduced, benefiting said customers.

2. *Increased proximity to the customers.* New techniques like big data open for companies a whole new word of consumer knowledge. Moreover, companies can now use the internet and social media to engage in two-way conversations with their customers. This

allows firms to develop individualized offerings which incorporate feedback received from customers, moving away from the mass market model. Internet is also a vehicle for personalized advertising and promotion, allowing companies segment and target their customers better than ever.

3. *Entrepreneurs and smaller firms easier access to the market.* The barriers to entry are lower, new companies enter the market offering very original products and services. For example, companies can now achieve wide distribution without the need of building a vast network of brick-and-mortar stores. They can also manage their supply chain effectively, reduce transaction costs and get to know their customers through internet based tools and business models, all for a fraction of a the cost and a fraction of the time than before.

Nevertheless, despite all its potential advantages, the digital economy can also be a menace. All revolutions involve changing some of the actors, especially those traditional businesses that fail to adapt to the new competitive environment and reality. Business processes and manager mentalities need to change as traditional business models risk survival in this new world. As Darwin said in the 19th century: “It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change.”

# LESSONS FROM THE MARKET LEADERS

*The 2015 CEIBS Business in China Survey found that, in 2014, most firms had profitable business in China. There seemed to be a positive relationship between market share and firm profitability with market leaders performed best. The key successful factors of doing business in China are service, quality, and distribution network. Market leaders also did very well in R&D and developing a strong brand, while non-market-leaders used price/quality ratio to win the market. However, with the non-market-leaders investing more on R&D, adopting more new sales channels, and increasing the digitalization of their business, they may close the gap with the market leaders. Furthermore, the implementation of new reform policies may bring additional challenges and uncertainties for the market leaders.*

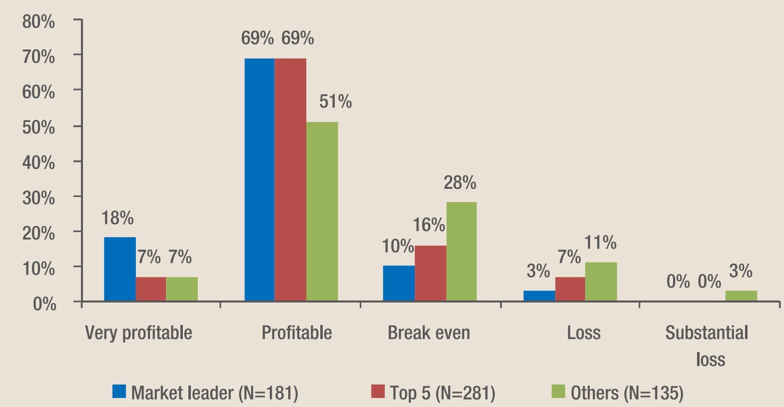
After rapid growth for over three decades, China's economic growth rate has slowed down to around 7.5% in recent years. Nevertheless, it is still by far the fastest growing market among all major economies, and more firms are now counting on China for their future business expansion. In 2014 Samsung Group sold over 60 billion U.S. dollars in China, this amount is larger than the revenue of BaoSteel, the largest Chinese steelmaker. General Motors sold more vehicles in China than in the U.S., and generated about half of its net profits from the China market. Similarly, a number of Chinese firms, by leveraging their deep understanding of their home markets, grew very rapidly in recent years. Xiaomi, a Chinese mobile phone manufacturer founded only 4 years ago, has become the No. 1 domestic brand in China with a market valuation of over 45 billion U.S. dollars.

While the strong economic growth has offered many opportunities for firms doing business in China, not everyone has performed well. As a matter of fact, due to the increasingly competitive and dynamic business environment, in the past decade, we have witnessed as many failed examples as the successful ones in China. Whirlpool, OBI, Mark & Spencer, eBay and Google…, these traditional as well as Internet firms that have been very successful in their home and many foreign markets all failed in China. Whirlpool, the largest white goods producer in the U.S. and one of the top players in the world, entered China in late 1994 with a total investment of 300 million dollars, but today its China operation contributed less than 0.5% of its global sales.

What are the key successful factors of doing business in China? Do market leaders perform better than non-market-leaders in China? What are the unique strengths of these market leaders? What challenges will firms face in China?

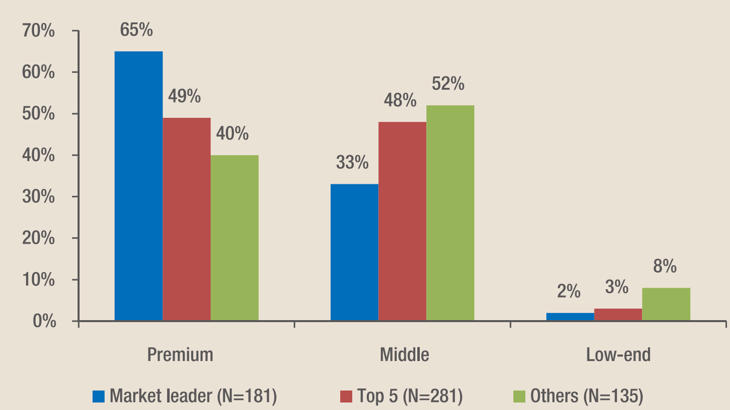
**Most Firms Did Well in China, and Market Leaders Performed Best**
Even though the China market has become increasingly competitive, most firms in China did well in 2014. Our findings suggested that more than 70% of all the surveyed firms considered their China operation “profitable” or “very profitable.” Less than 10% of the firms are losing money in China. Furthermore, there seemed to be a positive relationship between market share and firm profitability (Figure 11): 87% of the market leaders considered their China operation “profitable” or “very profitable”, while 76% for the top 5 firms in an industry, and 58% of the others considered their China operation “profitable” or “very profitable”. For the market leaders, 18% of them reported that their China operation were “very profitable,” much than non-market-leaders (7% of the top 5, and 7% of the others reported “very profitable”).

FIGURE 11 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2014?




One of the important reasons for market leaders to enjoy high level of profitability is that market leaders tend to generate more business from the premium segments, while the non-market-leaders tend to focus on middle or low-end segments. From Figure 12, we can see that for market leaders, 65% of their business have come from the premium segment, this number is 30% more than the top 5 (which have 49%), and 60% more than the others (which only have 40%).

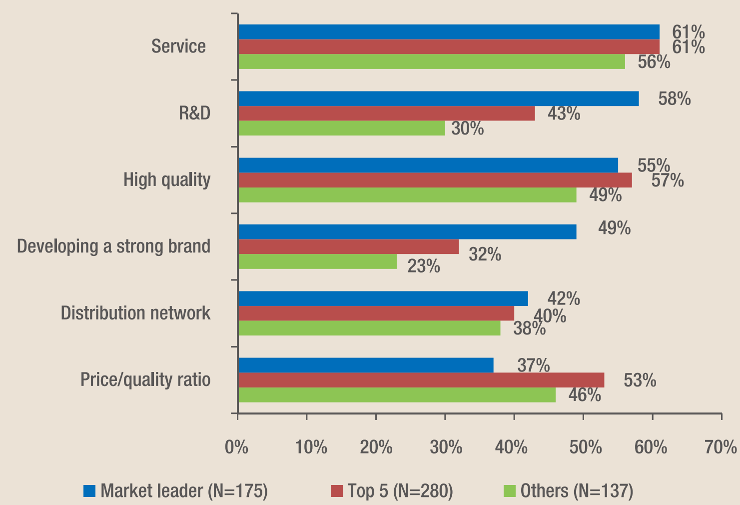
FIGURE 12 - WHAT IS YOUR MAIN MARKET SEGMENT IN CHINA?



**Key Successful Factors in China, and the Unique Strengths of Market Leaders**

When asked to "choose the most important factors on your sales in China", the respondents identified three common key successful factors (KSFs): service, quality, and distribution network. In addition to these common KSFs, the data also revealed some different KSFs for market leaders and non-market-leaders (Figure 13). For market leaders, two unique factors for their success in China are R&D, and branding. In Chart 3, we can see that a significant amount of market leaders (58% of them) choosing R&D as one of their KSFs, while 43% of the top 5 and only 30% of the others thought R&D as one of their KSFs. Similarly, almost half of the market leaders (49% of them) chose "developing a strong brand" as one of their KSFs, while 32% of the top 5 and only 23% of the others thought developing a strong brand have been important for their success in China. On the other hand, both the top 5 (46% of them) and the others (53% of them) chose "Price/Quality ratio" as one of their KSFs, while only 37% of market leaders think so. These differences suggested that market leaders have used branding and R&D, something that are firm-specific and to certain extent more sustainable, to win the China market, while the non-market-leaders more inclined to use value for money (Price/Quality ratio) strategy to compete in China.

FIGURE 13 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA (MULTIPLE ANSWERS POSSIBLE



Since market leaders ranked R&D as their second most important KSF in China, it is not surprising that our survey has found market leaders have conducted more R&D than both the top 5 and the other firms (Figure 14): 85% of market leaders have R&D in China, while the number was 68% for the top 5 and only 48% for the others. Furthermore, Figure 15 shows that market leaders have spent more money on R&D (23% of market leaders spent 10% or more of their revenue on R&D, the highest among all firms), and in Figure 16 we observe that they have put more importance on Intellectual Property (IP) rights (57% of market leaders thought IP is "very important" to their business in China, far ahead of all other firms).

FIGURE 14 - DOES YOUR COMPANY HAVE R&D IN CHINA?

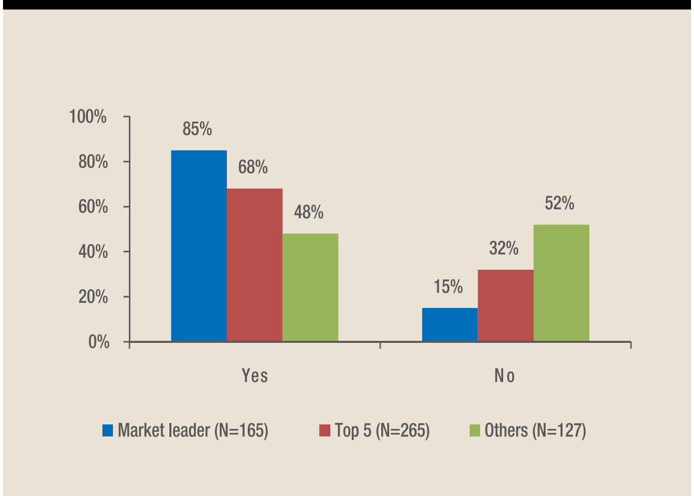



FIGURE 15 - WHAT IS YOUR ANNUAL EXPENDITURE ON R&D AS % OF REVENUES?

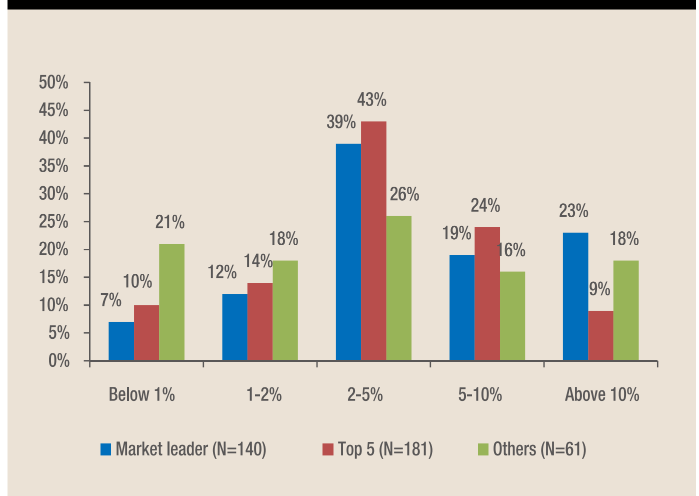
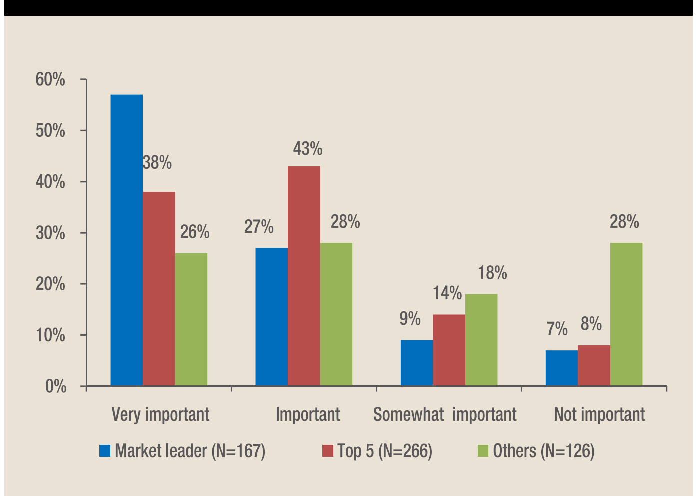
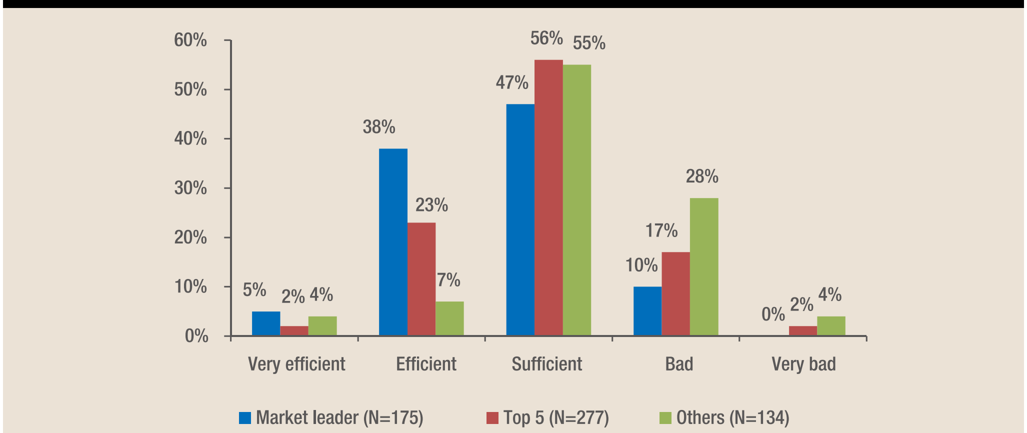



FIGURE 16 - HOW IMPORTANT IS IP TO YOUR BUSINESS IN CHINA?



Given the large size and the significant regional differences of the China market, efficient distribution network is a necessary condition to be successful in China. While all firms think distribution network is one of their KSFs, our findings suggested that market leaders have done a much better job in building an efficient distribution network. When asked “How do you evaluate your company distribution network in China?” 43% of market leaders chose “efficient” or “very efficient” while the number is 25% for the top 5 and only 11% for the other firms (Figure 17).

**FIGURE 17 - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?**



**Challenges for the Market Leaders**

As China has now become a must-win market for both global and local firms, the competition intensified in every segment. When asked "how intense is the competition you are facing in China?" More than 80% of the surveyed firms chose "intense" or "very intense." When asked "who are your major competitors in China?" over 70% chose "Chinese private firms." In addition to facing competition from local private firms, market leaders in China (48% of them) are also facing increasing competition from wholly-owned foreign enterprises (Figure 18 and 19). This is because these WFOE are more likely targeting the same premium segments. Furthermore, non-market-leaders are planning to target more of their business towards premium segments, the key segment that market leaders have focused on (Figure 20).

FIGURE 18 - HOW INTENSE IS THE COMPETITION YOU ARE FACING IN CHINA?

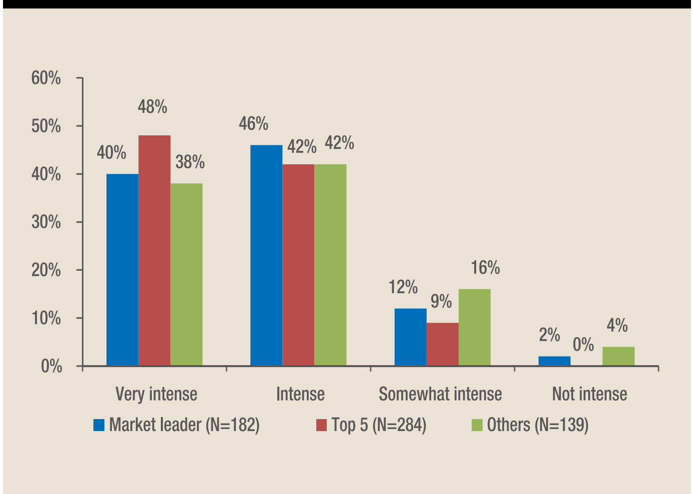



FIGURE 19 - WHO ARE YOUR MAJOR COMPETITORS IN CHINA? MULTIPLE ANSWERS

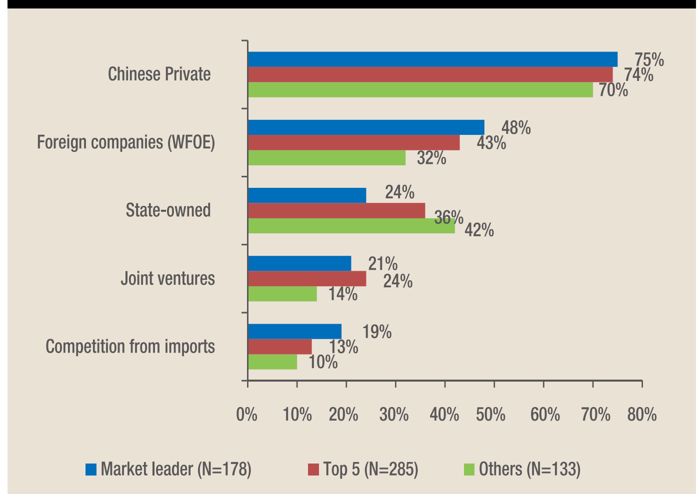
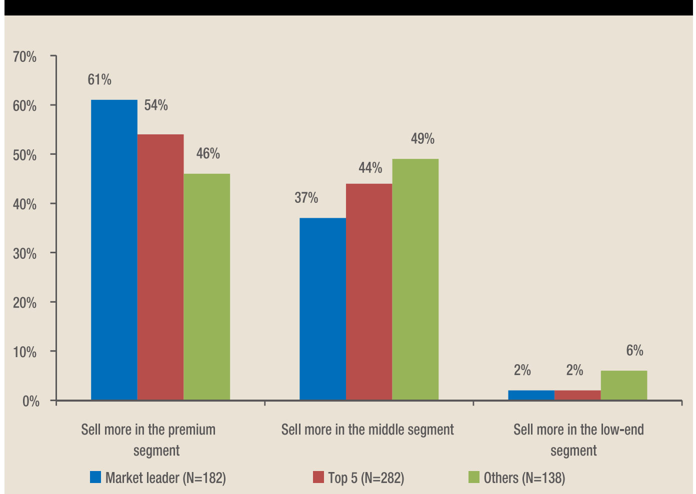
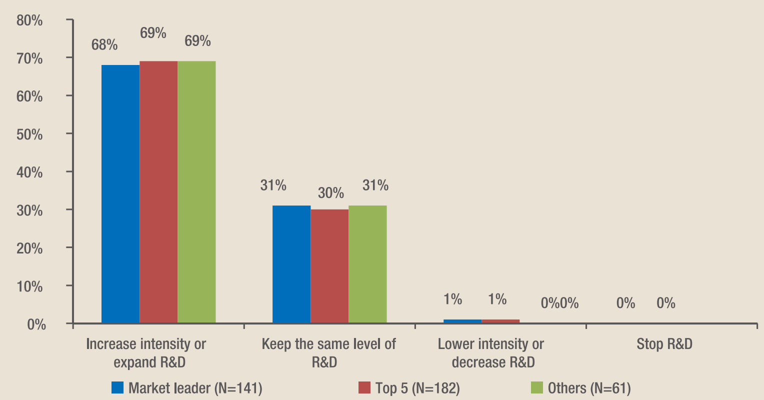



FIGURE 20 - WHAT ARE YOUR SALES PLANS FOR THE FUTURE?



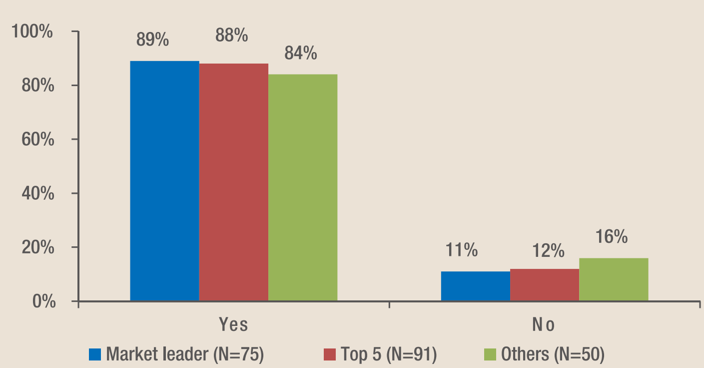
One of the unique strengths market leaders have in China is their R&D capabilities. But rival firms are catching up. When asked "what are your plans for the next 3 years?" 69% of non-market-leaders (both top 5 and the other firms) that have conducted R&D activities chose "increase intensity or expand R&D activities," this number is slightly higher than that of market leaders (68%). Market leaders' advantage in innovation may disappear if rivals keep investing more on R&D (Figure 21).

## FIGURE 21 - WHAT ARE YOUR R&D INVESTMENT PLANS FOR THE NEXT 3 YEARS?



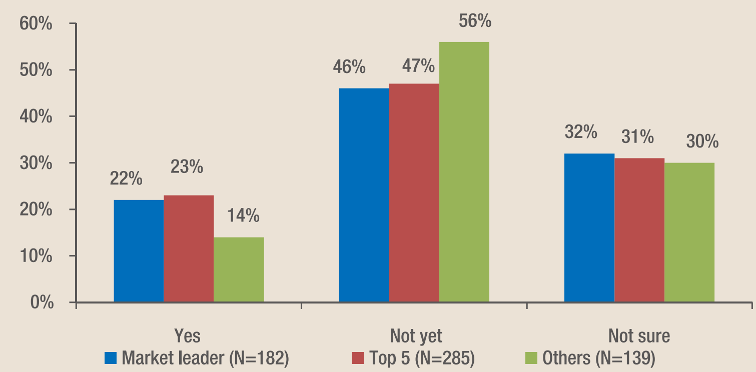

Non-market-leaders are also working hard to strengthen their distribution capabilities. The new sales channels such as the Internet may offer them some short cut to catch up with market leaders who have already built strong traditional distribution network. Xiaomi, by using Internet-based direct sales mode, defeated Lenovo, the market leader who has the best traditional distribution network in China, in only 4 years' time. Given the fact that less than 40% of firms have used Internet based platform to sell their products/services, there still exists plenty opportunities for all firms in China. It is not surprising that, when asked "do you plan to expand the digitalization of your business?" (Figure 22) 88% of the top 5 and 84% of the other firms answered "yes," these numbers are very close to that of market leaders (89%).

## FIGURE 22 - DO YOU PLAN TO EXPAND THE DIGITALIZATION OF YOUR BUSINESS?



The Chinese government has been playing a very important role in business. In 2014, a number of important new reform policies have been announced, and the goal of these new policies is to let market play decisive roles in resource allocation. But the impact of these new policies on business remains to be seen. When asked "did your company benefit in 2014 from any reform policies of the new government?" less than a quarter of the respondents answered "yes" (Figure 23). The new policies and the execution of these new policies will surely bring a lot of uncertainties and challenges for firms doing business in China.

FIGURE 23- DID YOUR COMPANY BENEFIT IN 2014 FROM ANY REFORM POLICIES OF THE NEW GOVERNMENT?




# INNOVATION IN CHINA

This section presents an inquiry on the current situation of innovation in China businesses. It includes two parts: a summary of main learning's on innovation trends from our sample of surveyed companies, and an in-depth article on innovation in China, history to current times and issues. The latter is collaboration of China Integrated[3] with CEIBS.

- Trends in innovations in companies in China
- China: Nation of Emulation or Future Center of Innovation?

The purpose of this section is to give an in-depth overview of innovation in China: history, current situation, trends and challenges.

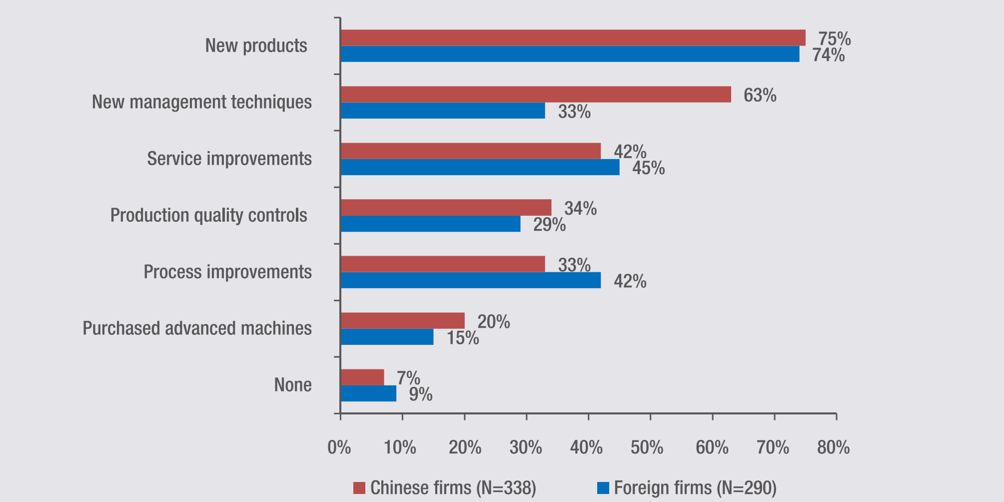
[3] *http://www.ch-ina.com/*

# TRENDS IN INNOVATION IN COMPANIES IN CHINA

*Our sample shows important levels of innovation for Chinese and foreign firms alike, with Technology and Telecomm firms being the big spenders in R&D and the most prolific in product and service introduction. Chinese private firms stand out as the group with highest percentage of firms investing more than 5% of their revenues in R&D. Despite growing commitment to R&D, IP protection is still a challenge.*

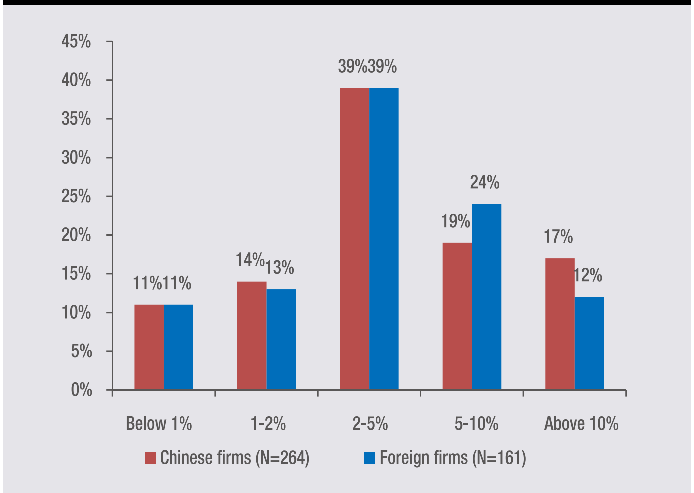
Chinese and foreign executives who participated in this year CEIBS Business in China Survey report high levels of innovation for their companies as 74-75% of them have introduced new products or services in 2014. Additionally 63% of executives working for Chinese firms declare introducing new management techniques (vs. a lower 33% of foreign firms). Quality control and process improvements follow mentioned by approximately one third of sampled companies (Figure 24). Within industries, Technology and Telecomm firms seem to be the most prolific with 85% stating having introduced new products or services in 2014. It is important to note that aside from management techniques innovation; there is no significant difference in innovation levels between foreign and Chinese firms.

FIGURE 24 - WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED IN 2014?

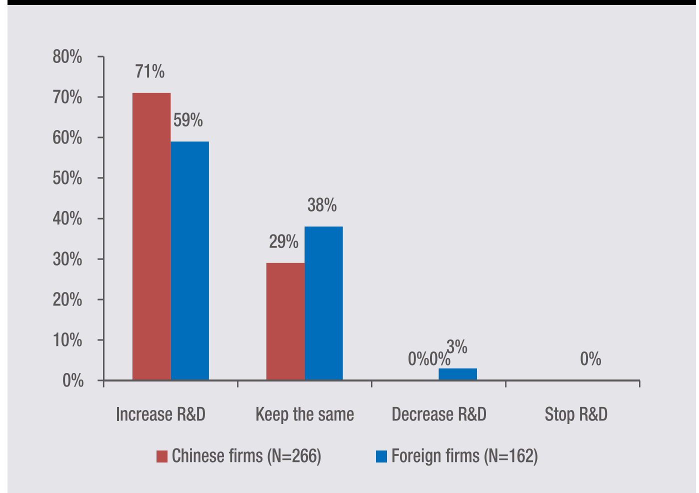



Likewise, levels of R&D investment are overall similar for Chinese and foreign companies in our sample. However, 71% of executives working for Chinese firms declare intention of their company to increase R&D spending in the next three years vs. a lower 59% of executives working for foreign firms, hinting at a potential trend of Chinese companies taking the lead in R&D investment in the coming years (Figures 25 and 26).

## FIGURE 25 - WHAT IS YOUR ANNUAL EXPENDITURE IN R&D AS A % OF REVENUES?



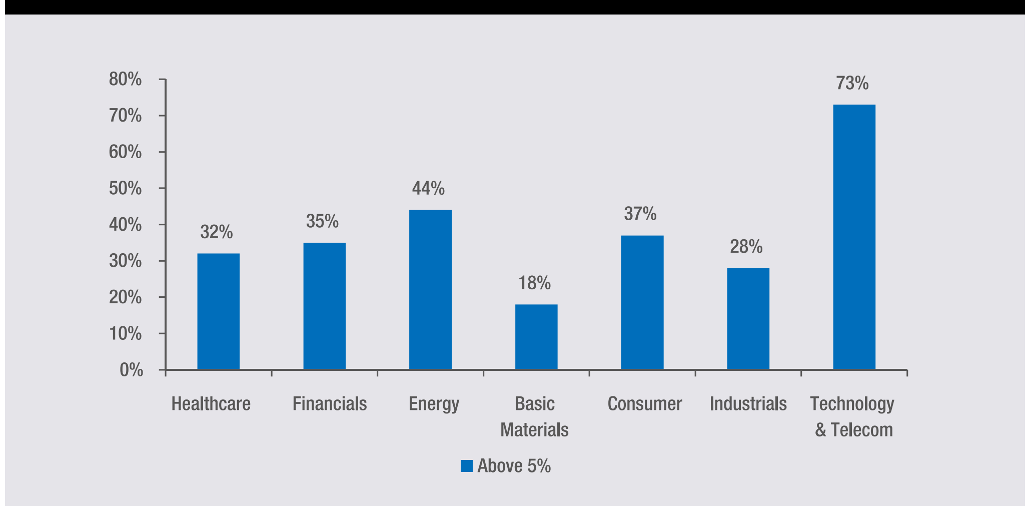

## FIGURE 26 - WHAT ARE YOUR PLANS FOR THE NEXT 3 YEARS?




When we explore R&D investment by industry in our sample we discover that Technology and Telecommunication have the highest percentage of "big R&D spenders", or firms that devote more than 5% of their sales revenues to R&D (Figure 27). These numbers are consistent with their highest product and service introduction in 2014.

Furthermore, it is interesting to note differences by legal status of the companies: 41% of polled executives working for Chinese private firms have invested above 5% of their sales revenues in innovation, compared to a much lower 23% of SOEs and a lower 37% of foreign owned firms. This data confirms a burgeoning trend of Chinese private companies taking the lead in China's business landscape.

## FIGURE 27 - ZOOM BY INDUSTRY: ANNUAL R&D EXPENDITURE ABOVE 5% OF SALES REVENUES



Despite the growing R&D investment by Chinese and foreign companies in China, IP protection is still a challenge in with 90% and 89% of polled executives working for Chinese and foreign firms declaring to suffer damage due to IP infringement (Figure 28). Additionally, 33% of executives working in Chinese firms and 49% of those in foreign firms claim no improvement in IP protection in China in the past three years (Figure 29) The data suggests that the government needs to continue efforts to strengthen IP protection to nurture the growing trend of innovation.

FIGURE 28- WHAT IS THE EXTENT OF THE DAMAGE CAUSED BY IP INFRINGEMENT IN CHINA IN YOUR BUSINESS?

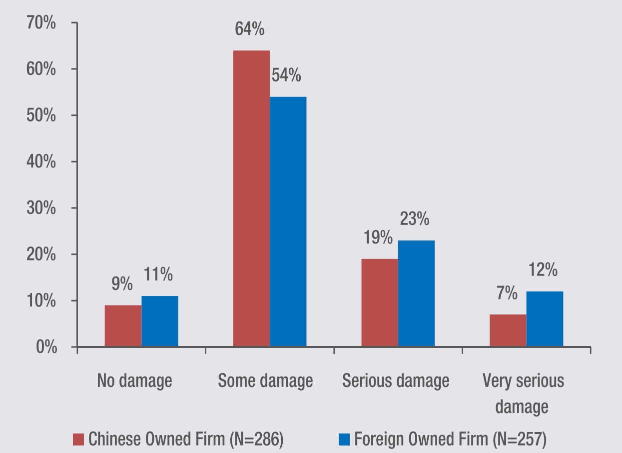
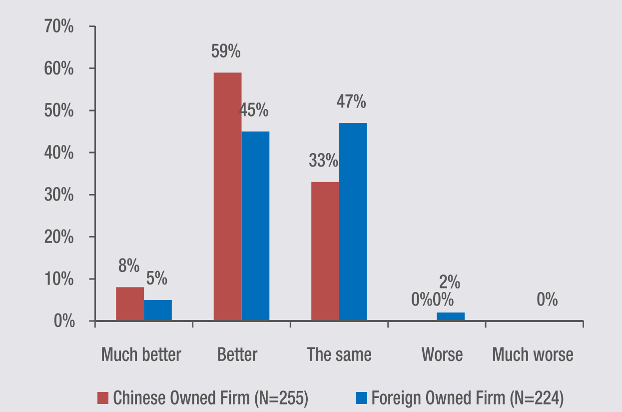



FIGURE 29 - IN THE PAST 3 YEARS, HOW DO YOU DESCRIBE THE IP PROTECTION FROM THE GOVERNMENT IN CHINA?



## CHINA: NATION OF EMULATION OR FUTURE CENTER OF INNOVATION?

*Despite 12% to 20% annual growth in research & development spending for each of the past 20 years[4] and a comprehensive 15 year science & technology development plan already in its 10th year, we are hard pressed to name a single recent technology innovation coming out of China. The People's Republic is still waiting for its first Nobel Prize in science. China also does not dominate any technology industry yet, while Japan, as an example, has excelled in the camera and consumer electronic industries for decades.*

**Can (and will) China become a source of global innovation? Will Chinese companies be able to compete in technology arenas as Japanese (and now Korean) firms do?**
In a world where technology is becoming indispensable for economic success and competitiveness, forming an answer to these questions becomes critical for all international businesses.

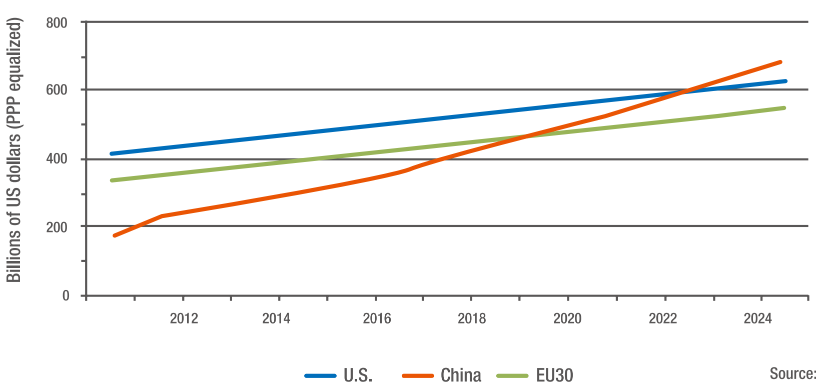
**The historical perspective helps: China was, until modern times, the main source of world innovation**
It is a little known fact that until the 15th century, before Europe's Renaissance made it the center of the world's arts and techniques, most of the West's technological breakthroughs had been achieved long before, in China.
The compass, gunpowder, and the moveable types printing on pulp based paper are the key Chinese inventions we may remember from our school days. In 1620, when Francis Bacon (the father of the scientific method) wrote that "printing, gunpowder, and the nautical compass . . . have altered the face and state of the world,"[5] these Three Great Inventions were considered to be European. Only later was it recognized that these were only just some of the discoveries originating in China.

In fact, the Chinese developed almost all pre-modern technologies. The mechanical clock with an escapement (which was actually an astronomical engine reproducing movements of the sun and the moon accompanied by a bell that rung each hour) is credited to a Chinese engineer and Astronomer (Su Song) in around 1090. This occurred centuries before French and British watch makers started building mechanical time measuring devices (The Swiss only perfected the art, after French immigrants brought their know-how to the country).
In 1420, China had a seafaring navy, trading all throughout Asia and to the West coast of Africa, while the Portuguese had barely discovered Madeira (in 1419).
In those days, the Chinese treasure ships were over 100 m. long, while 70 years later (in 1492) the Santa Maria, the biggest of Columbus' 3 ships, was about 20 meters long.[6]
During the Han dynasty (2'000 years ago), the Chinese were drilling as deep as 1'500 m. and collecting natural gas then piping it through bamboo tubes for lighting and evaporation of sea water to extract salt. 300 years later they were also the first to drill for and use oil.
Iron and steel metallurgy innovations were first developed and used in China. Stirrups, hand guns, exploding cannon balls (filled with gunpowder), fragmentation bombs, land and naval mines are all inventions of military significance credited to the Chinese.
For those living in China it is no surprise that paper money (banknotes issued as currency) was also a Chinese innovation (used nationwide in the Song dynasty in the 13th century).
Paper was also made into toilet paper for widespread use in China, while the toothbrush was also invented there.
On the more abstract side, evidence of negative numbers is recorded in China in 179 AD (a century before the Greeks) while they were considered absurd in Europe until the mid 1500s.[7]

*[4] Battelle. "2014 Global R&D Funding Forecast." http://www.battelle.org/docs/tpp/2014_global_rd_funding_forecast.pdf*
*[5] Paradigm Advanced Science. "A New Silk Road for Technical Exchange." http://www.pdgm.com/resource-library/articles-and-papers/archive/seg-china-a-new-silk-road-for-technical-exchange/*
*[6] Weaver, Troy. "Chinese Discoverers Dwarfed European Travels." http://www.iol.co.za/scitech/technology/chinese-discoverers-dwarfed-european-travels-1.97267*
*[7] http://en.wikipedia.org/wiki/List_of_Chinese_inventions*

**How is it, then, that the scientific and industrial revolutions did not happen in China?**
This is the so-called "Needham Question", named after Joseph Needham, a biochemist who retrained as a sinologist and chaired a Cambridge university program to understand Science & Technology in China's history (the program started in 1948 goes on and published 27 books.[8])
No one gave a simple answer to the question. Most likely, the reason is that China was already an advanced society and a large country, well protected from the rest of the world. The imperial focus on stability and management of the large numbers of Chinese did not favor individual creativity. At the same time, Europe was a patchwork of competing, smaller feudal nations, whose princes did not have the thousand year old, powerful bureaucracy of the Chinese emperor. More competition, less conformism, and more individual freedom provided the dynamic of the European scientific revolution, while the Ming and Qing emperors saw themselves as the guarantors of the immutable heavenly order.

**China is again becoming a world scientific and technological power**
In 1999, China spent 0.83% of its USD 1 trillion GDP (at the 1999 exchange rate) on R&D, or about USD 8.3 billion. In 2014, R&D expenditures were about 2.0% of a USD 10 trillion GDP, or about USD 200 billion (at the current CNY to USD exchange rate). Calculated in USD, this represents an average of over 23% increase of R&D spending per year, every year, for the past 15 years.
In terms of purchasing power parity (PPP), "China is forecast to overtake the European Union and the United States in (...) R&D, spending by the end of the decade." [9]




**Long-Term Outlook for R&D Expenditures**

Even if the historic stability of the U.S. and European commitment to research intensity (i.e., spending as a percent of GDP) continues, growth in China's economy is likely to propel it to the top position in absolute R&D spending by the early 2020s.

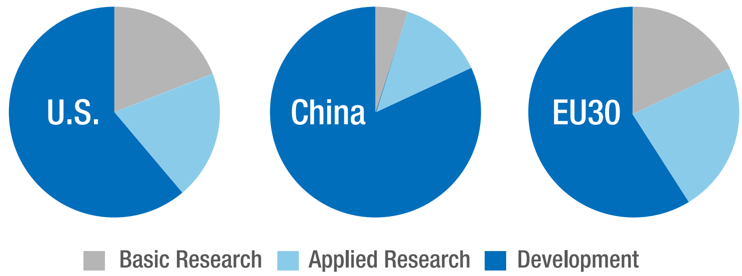
Source: Battelle and R&D Magazine

In terms of percentage of GDP, China is already spending more than the EU.

However, the amount spent in China goes much more to development than research when compared to the US and the EU. [10]

[8] *Needham, Joseph. "Science and Civilisation in China." (1959).*
[9] *Kigotho, Wachira. "China Heads for Top of World in R&D Spending – OECD." University World News. http://www.universityworldnews.com/article.php?story=20141114112226407*
[10] *http://www.scmp.com/news/china-insider/article/1410178/china-spending-more-europe-science-and-technology-gdp-percentage*

## Different Priorities Among Research Leaders




China places more emphasis on development, less on basic research

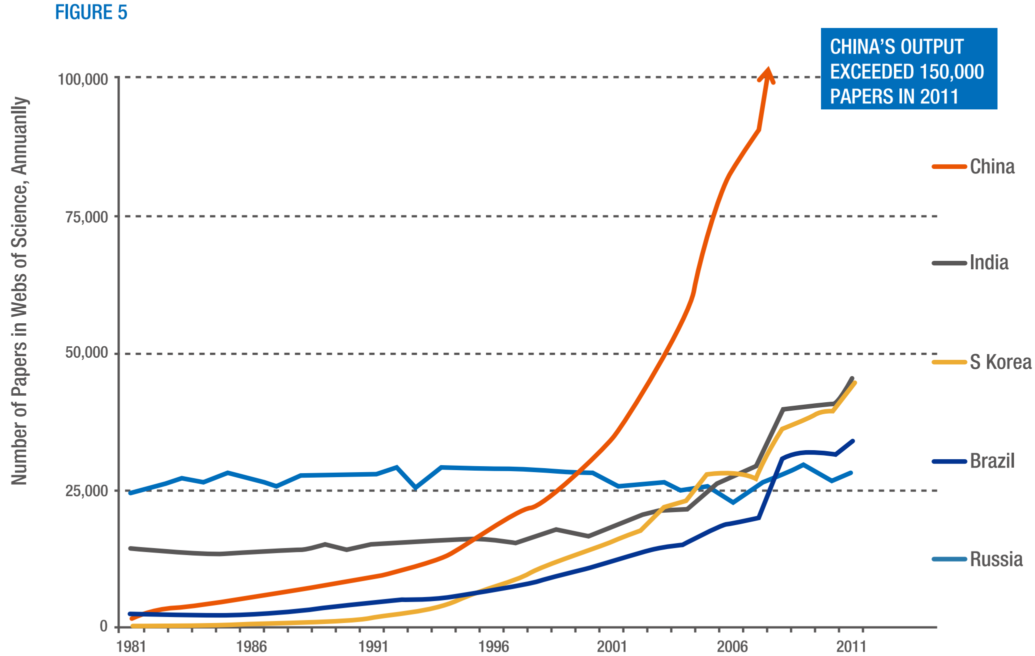
Source: Battelle and R&D Magazine

There are also many question marks when it comes to the effectiveness of this spending and the quality that results from research and patents generated in China.

Nonetheless, scientific production in China is indeed prolific.

## ANNUAL RESEARCH PUBLICATION OUTPUT OF THE FIVE BRICK COUNTRIES

FIGURE 5

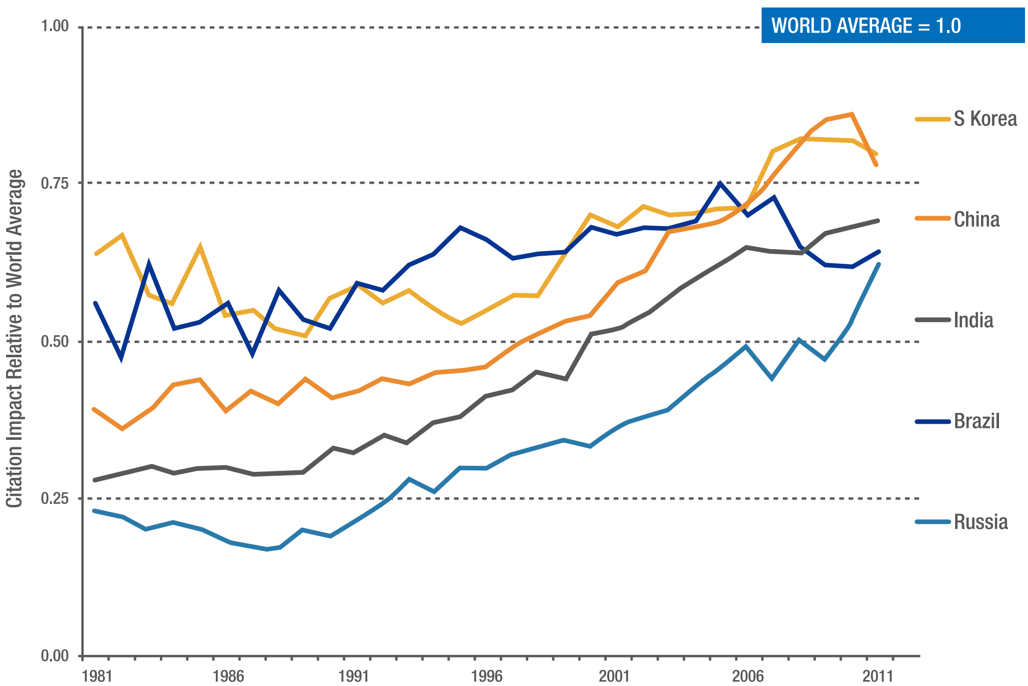



Source: Thomson Reuters Web of Knowledge. (See also Figure 7 on trajectories of patent output.)

And while the quality found in China's scientific papers does not compare to top Western nations, it has already caught up with Korea:

## CITATION IMPACT OF THE FIVE BRICK COUNTRIES RELATIVE TO WORLD AVERAGE

FIGURE 7




Source: Thomson Reuters Web of Knowledge. Although the average citation impact of much of the research remains below world average (which is set at 1.00), it is evident that the impact trend is generally consistently upwards for all these countries. Several BRICKs show an impact drop in the last few years, but this is a data artifact associated with atypically early citation of papers published in G7 economies.

It is the same in terms of excellent research (international scientific articles in the top 1% in number of citations per article):

## PAPERS PUBLISHED BY COUNTRY, CITED IN THE TOP 1 PERCENT FOR SUBJECT CATEGORY AND YEAR OF PUBLICATION

FIGURE 8

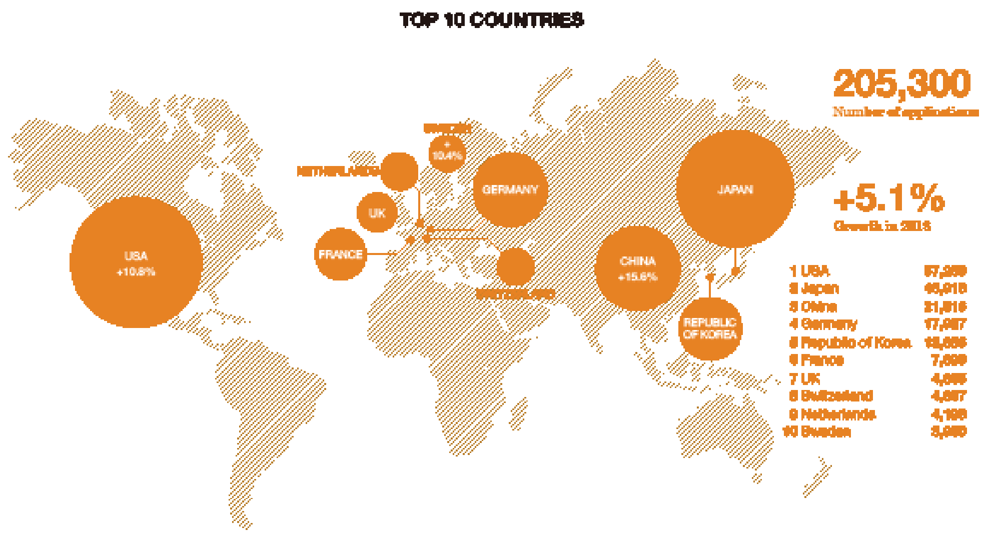
| | BRZEIL | | RUSSIA | | INDIA | | CHINA | | S.KOREA | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Highly cited papers | % of National Output | Highly cited papers | % of National Output | Highly cited papers | % of National Output | Highly cited papers | % of National Output | Highly cited papers | % of National Output |
| 2002 | 56 | 0.43 | 92 | 0.35 | 68 | 0.36 | 262 | 0.66 | 110 | 0.64 |
| 2003 | 71 | 0.49 | 86 | 0.33 | 77 | 0.36 | 334 | 0.70 | 127 | 0.60 |
| 2004 | 73 | 0.48 | 103 | 0.41 | 101 | 0.47 | 363 | 0.66 | 143 | 0.63 |
| 2005 | 98 | 0.55 | 106 | 0.41 | 108 | 0.41 | 514 | 0.70 | 181 | 0.65 |
| 2006 | 94 | 0.49 | 91 | 0.41 | 110 | 0.40 | 563 | 0.68 | 152 | 0.54 |
| 2007 | 98 | 0.50 | 106 | 0.41 | 124 | 0.42 | 618 | 0.68 | 202 | 0.74 |
| 2008 | 129 | 0.42 | 101 | 0.36 | 148 | 0.38 | 839 | 0.74 | 234 | 0.66 |
| 2009 | 133 | 0.42 | 120 | 0.40 | 191 | 0.47 | 995 | 0.78 | 253 | 0.66 |
| 2010 | 165 | 0.53 | 130 | 0.49 | 189 | 0.46 | 1113 | 0.83 | 275 | 0.70 |
| 2011 | 168 | 0.50 | 152 | 0.55 | 235 | 0.52 | 1131 | 0.72 | 328 | 0.74 |

Source: Thomson Reuters Web of Knowledge. Counts are shown as a percentage of national output in that year. Output of highly cited papers would match world average output of such papers if the count reached 1 percent of national output.

China is publishing about as many outstanding scientific publications in percentage as Korea (0.72%) and as many in absolute numbers as the UK (though half the proportion: 1.4% of UK papers are in the top 1%).

In terms of international patent filing (under the Patent Cooperation Treaty of WIPO, World Intellectual Property Organization) China was No 4 in 2013. However, 2 Chinese companies were in the top 3 patent filers: ZTE at No 2, Huawei at No 3.

In addition to these 2 Chinese telecom firms, the top 15 includes 2 Korean (Samsung and LG), 2 US (Qualcomm and Intel), 4 European (Robert Bosch, Ericsson, Philipps and Siemens) and 5 Japanese (Panasonic No 1 patent filer, Sharp, Toyota, Mitsubishi and NEC).[11]




The above does indicate that China's S&T development strategy is having some strong results.

**Where, then, is China's Innovation?**
Huawei and ZTE, though hugely successful and innovative are still "me too" companies, who started by making products similar to those of Cisco.

Lenovo became a global brand through its acquisition of IBM's Thinkpad. Xiaomi shot to fame launching its first smart phone in 2010 and reaching a valuation of USD 45 billion last December.[12]

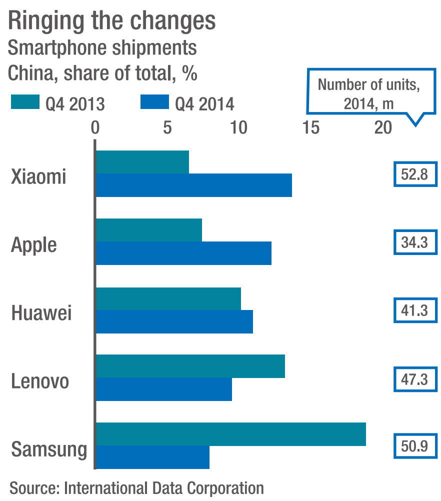
Alibaba, the largest stock market IPO in history, developed through the combination of an online trading platform (not a new concept then) and China's great production capabilities.

When we add household appliance brand Haier, these are probably all the Chinese companies with a global recognition. All appear to be "emulators" rather than innovators.

Though these companies are not groundbreaking innovators (like Facebook, Cisco, ABB or Siemens), we tend to overlook that they still innovate in business models. Xiaomi, for example, though using an Android OS and chipsets from the USA, is selling all its phones through internet exclusively. Additionally, they fostered active user clubs proposing improvements to their interface that they use to continuously develop their software and provide a better user experience.

[11] *World Intellectual Property Organization. "Who Filed the Most PCT Patent Applications in 2013." http://www.wipo.int/export/sites/www/ipstats/en/docs/infographics_patents_2013.pdf*

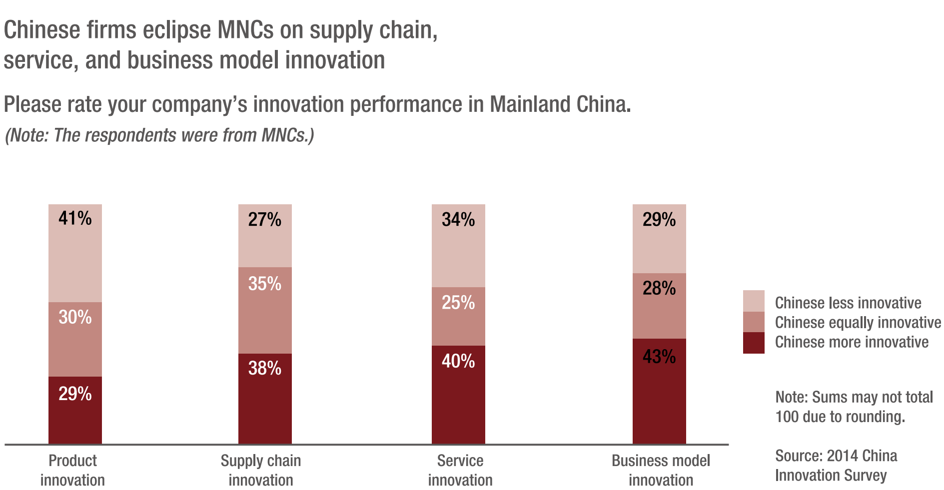
[12] *Olson, Parmy. "Xiaomi Raises $1.1 Billion at $45 Billion Valuation." Forbes. http://www.forbes.com/sites/parmyolson/2014/12/29/xiaomi-raises-1-1-billion-at-45-billion-valuation/*




We may think that the fundamental reason for this lack of technological innovation is the lack of capability to develop new technologies in China. There is another, however, very simple possible explanation: business model innovation is much easier and offers enough and much safer, high return opportunities in China at the moment.

In other words, why go about developing a new smart phone technology if you can build a USD 45 billion company in 4 years? It simply confirms that the Chinese have good business sense and know how to compare risks and returns on investment.

This is now also indicated by surveys of foreign companies in China:



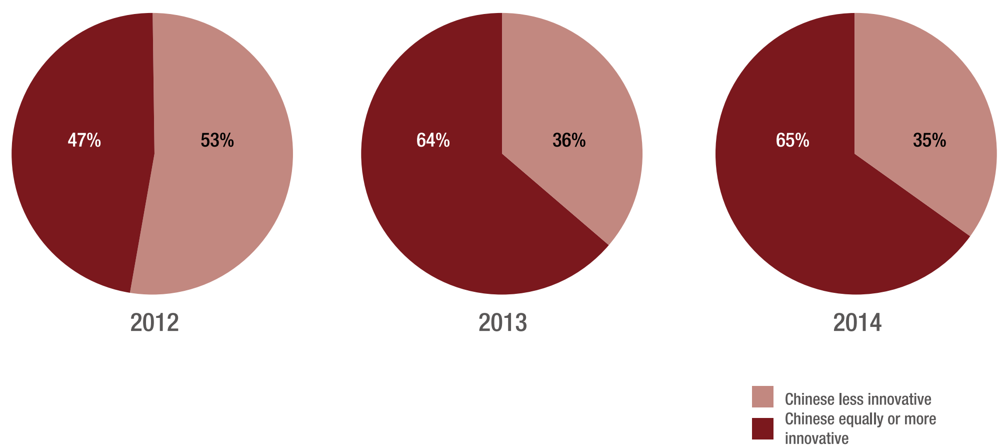

[13] Strategy&. "China's Innovation is Going Global. 2014 China Innovation Survey."
(386 respondents. Demographics: 52% WFOE, 11% Sino-foreign joint venture, 23% Chinese Company, 14% Other).

However, this still does not demonstrate the ability of China to become a fundamental innovator. And if the history does prove that the Chinese have been very prolific inventors, the history also indicates that stability and a bureaucratic and top down society may hinder the Chinese innovative spirit.

**Should we expect China to become, again, a technological innovator?**
Multinational companies in China believe so:

Chinese companies have arrived as innovators

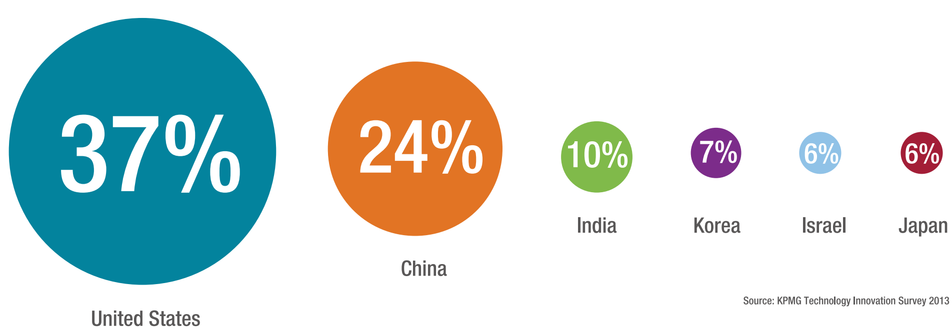
Please rate your company's innovation performance in Mainland China.
*(Note: The respondents were from MNCs.)*




Source: 2012, 2013, 2014 China Innovation Survey

And worldwide, there is also a strong sense that this will be the case:

Q: Which country shows the most promise for disruptive breakthroughs that will have a global impact?




Source: KPMG Technology Innovation Survey 2013 [14]

[14] *KPMG. "Technology Innovation Survey." (811 respondents, Demographics: 34% U.S., 30% Europe/Russia, 37% Asia. Organizations: 36% start-up, 37% mid market, 15% large enterprise, 5% venture capital, 4% angel investors, 4% other).*

Still, the speed and success of innovation development in China will depend on the willingness of the government to provide an environment conducive to entrepreneurship and start-ups. There is little doubt that building such an environment is now a high government priority. If there should be any illustration or important clue indicating this, a specific emphasis is expected to be put on innovation for the next five-year plan (2016-2020).
Indeed, as the National Development and Reform Committee's (NDRC) planning department states: "In the current situation where labor costs are higher and higher and environmental conditions are increasingly desperate, becoming a high income country requires innovation drivers and a structural upgrade...There is a chance to be stuck in the middle income trap for a long time. So, how can we better realize innovation drivers?"[15]

As the debate over China's innovation potential pushes on, one must conclude that the extent to which this potential is realized will much depend on the level to which the leadership advocates for it.

"New State Council releases have stated that it is within the "key spirit" of recent high-level government meetings, chaired by Xi Jinping, to stoke "hundreds of thousands of people's passion for innovation" via the twin engines of mass entrepreneurship and innovation[16]. If innovation indeed becomes a top priority of China, when looking at the Chinese leadership's past 30-year track record and the strength of the current one, we can be confident that China will again be a big contributor to the world's innovation!

*©This article was written by Nicolas Musy and the China Integrated team. For more information about this topic you can contact n.musy@ch-ina.com.*

*[15] Environmental Performance Index. "Five-Year Plan Process in the People's Republic of China." http://epi.yale.edu/visuals/china-five-year-plan/*
*[16] Chen, George. South China Morning Post. March 12, 2015. (http://www.scmp.com/business/companies/article/1735905/communist-party-calls-angel-investors-help-grow-start-ups-and)*


SECTION 1

# DESCRIPTION OF THE COMPANIES PARTICIPATING

This section details the following information about the companies that have participated in the 5th edition of the CEIBS China Business Survey

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

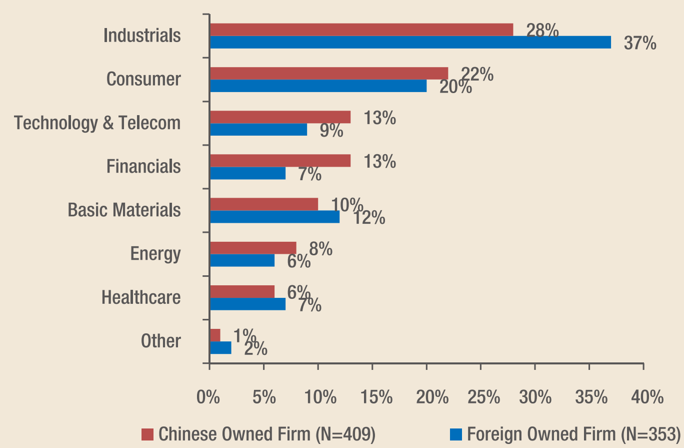
The purpose of the section is to give a general overview of the type of companies that took part in the survey. This not only helps clarify the scope of the survey, but also provides background in interpreting survey results.

A total of 773 companies operating in China have participated in the 2015 edition of the CEIBS China Business Survey. This sample of businesses includes 412 (53%) Chinese owned companies (i.e. with 50% or more Chinese ownership)[17] and 361 (47%) foreign-owned companies (i.e. with more than 50% foreign ownership).

In terms of business activity, the sample is well balanced with 53% of firms having their main activity in manufacturing and 47% in services. 75% of the total sample of firms are B2B companies, having other businesses as main clients, while 25% are B2C companies, offering products and services directly to consumers.

The industries represented are varied, topped by industrial products and services (245 firms, 32% of total sample), consumer goods and services (161 firms, 21%), Technology and Telecommunications (11%), Basic Materials like chemicals, forestry and mining (11%), Financials (10%), Energy (6%) and Healthcare (7%). However, we observe a considerably larger presence of financial companies within the Chinese-owned firms of our sample (13% versus 7% of foreign firms), a consequence of existing regulations limiting or constraining foreign investment in the sector. Foreign-owned firms are markedly more represented in "Industrials" with 37% of them vs. 28% of Chinese-owned firms in the industry (Figure 30).

FIGURE 30 - WHAT IS THE MAIN INDUSTRY WHERE YOUR COMPANY OPERATES?




In terms of market position, the firms surveyed operate mostly in the mid and high ends of the market. According to survey answers [18], 314 firms (52%) in our sample operate mainly in the premium segment, another 271 (45%) in the middle segment and only 22 (4%) in the low-end of the market. Moreover, 182 companies (30%) identify themselves as market leaders for their main business line and 286 (47%) consider to be in the Top 5. When splitting by type of company ownership, we do observe a considerable difference in market positioning between the two groups with 69% of foreign companies in the sample in the premium segment vs. a lower 39% of Chinese-owned firms. Inversely, 55% of Chinese-owned firms operate in the middle segment of the market, while 30% of foreign-owned do so.

[17] *Including Chinese controlled Joint Ventures*
[18] *N= 607*

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

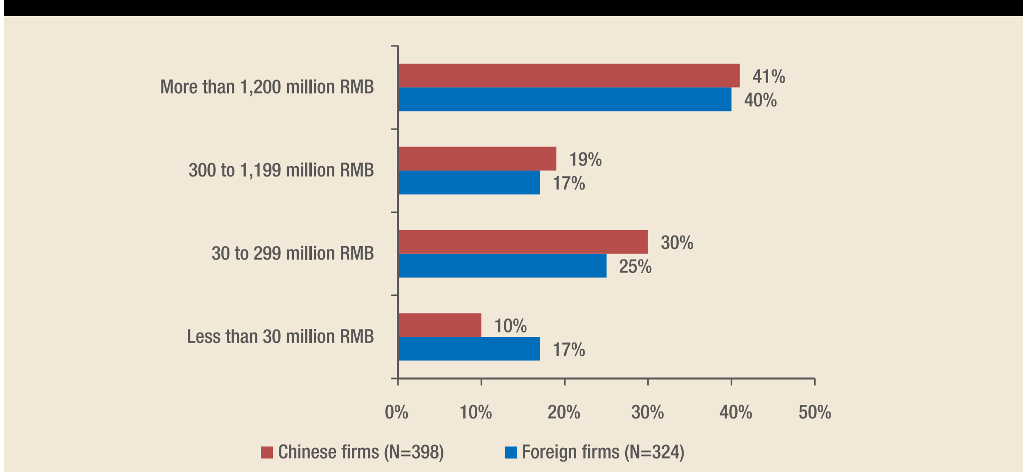
FIGURE 31 - WHERE ARE YOUR GLOBAL HEADQUARTERS LOCATED? N=767


The China headquarters of 80% of the total sample are located in coastal China, in central China for 17% and in west China for only 2% of respondents.

In 2014, participating companies had generated collective revenue of more than 400 billion RMB and were employing more than 2.5 million people in China alone.

Of participating companies, 60% of the Chinese-owned firms and 58% of the foreign-owned firms surveyed are considered large [19](Figure 32).

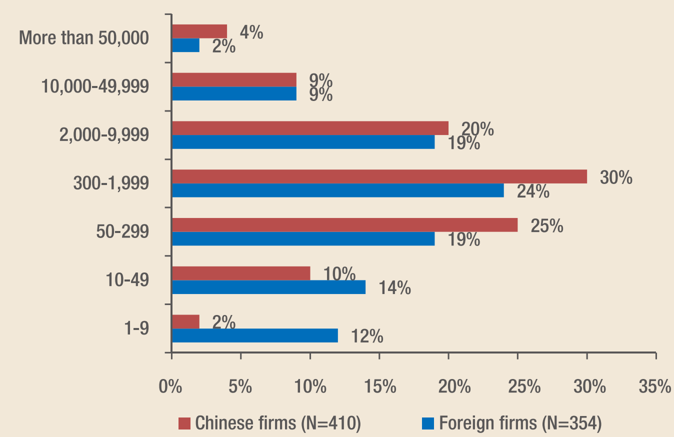
FIGURE 32 - WHAT ARE YOUR COMPANY'S TOTAL CHINA SALES IN 2014?




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

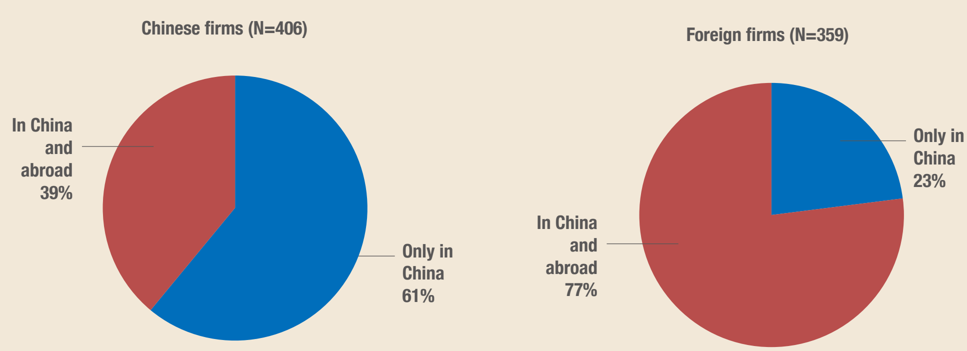
The sample of companies varies widely in size, ranging from companies with less than 10 employees in China to those with more than 50,000. Surveyed Chinese have in average 3,400 employees in China or more, compared to 2,400 or more for foreign-owned firms. Moreover, 12% of foreign-owned firms surveyed have less than 10 employees versus only 2% of Chinese firms (Figure 33).

## FIGURE 33 - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?



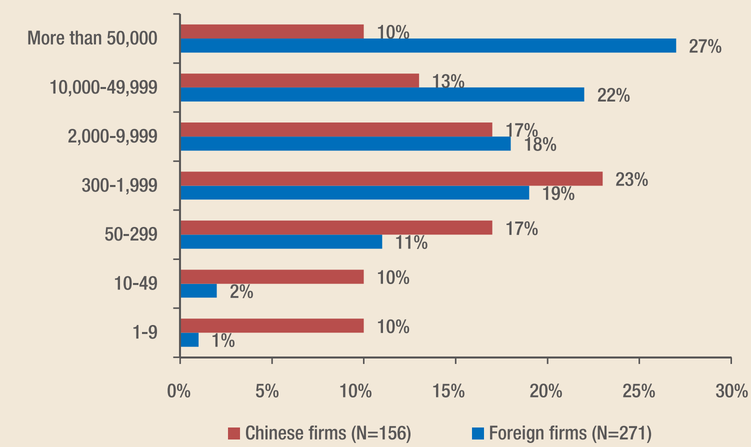

39% of the Chinese owned firms in our sample have operations abroad too. And although 77% of foreign firms in our sample are international, there is a non-negligible 23% of foreign owned firms that only operate in China (Figure 34).

## FIGURE 34 - WHERE DOES YOUR COMPANY HAVE OPERATIONS?



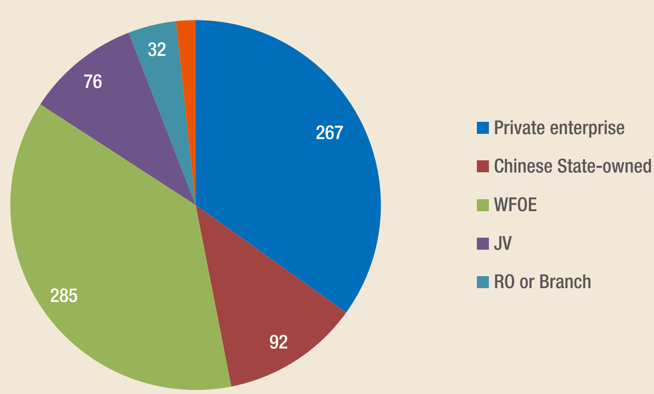
Within the companies that operate both in China and abroad, foreign-owned ones are overall larger in their global operations than Chinese-owned firms. 49% of the surveyed foreign companies with international operations have more than 10,000 employees globally vs. 23% of their Chinese-owned counterparts. Chinese international firms in our survey fall mostly within the small and medium categories (37% with < 300 employees, 40% with 300-9,999)[20] (Figure 35).

FIGURE 35 - FIRMS WITH INTERNATIONAL OPERATIONS- HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE GLOBALLY?



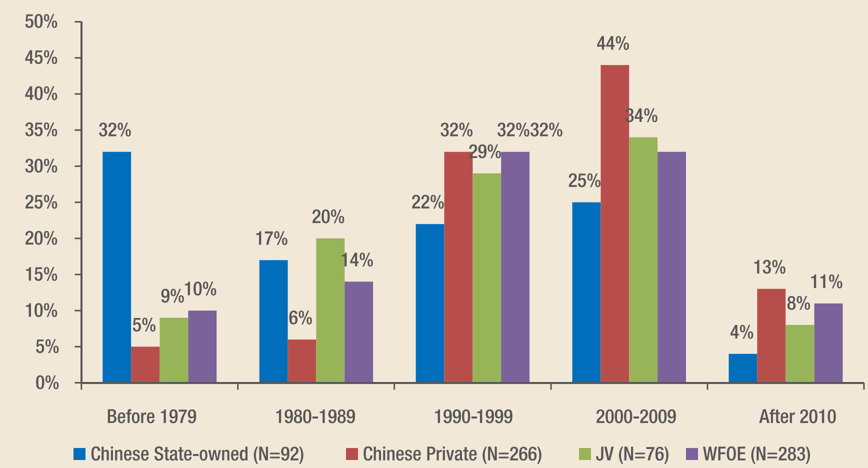

35% of surveyed companies are Chinese privately owned or private-holding companies and 12% are state-owned or state-holding enterprises. Joint Ventures (JV) constitute 10% of the sample, with different levels of Chinese and foreign ownership. Most of the foreign-owned companies are Wholly Foreign Owned Enterprises (WFOE, 37% of total sample), with Representative Offices (RO) and Branches of foreign companies making up the rest (Figure 36).

FIGURE 36 - WHAT IS THE LEGAL STATUS IN CHINA OF THE COMPANY YOUR WORK FOR? N=773




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

FIGURE 37 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?




Most of Chinese private companies in our sample, 89%, have been established after 1990 following the economic reforms initiatiated by Deng Xiaoping in the late 1980s and early 1990s, which triggered a remarkable growth of the private sector (Figure 37).


SECTION 2

# BUSINESS INDICES

This section presents four Indices:

- Two Business Performance Indices that measure performance variation compared to the previous year, and also expected performance for the next year. They are based on sales revenue and profit growth, realized and expected.
- Two Business Confidence Indices give reading on the optimism and confidence in business results declared by respondents.

Business Performance Indices are:

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

These two directional indices were introduced in the 2013 report 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 compared to previous year, 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[21] .

Business Confidence Indices are:

- 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 (2015) and the next 5 years (2015 to 2019). These 2 indices have been part of the CEIBS Business in China Survey since its inception 4 years ago, which allows us to start recognizing emerging trends as well as current values

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).

[21] *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.*

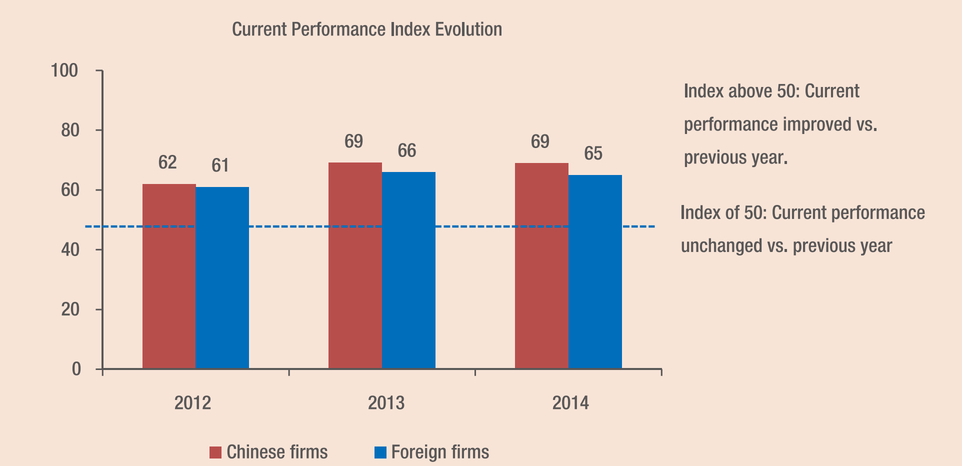
## 2.1. CURRENT PERFORMANCE INDEX – CPI

*Large majority of respondents reports revenue & profit growth, stable from last year.*

The CPI Index is calculated as a composite of 2 survey questions: Revenue and Profit Level. Each variable is attributed the same weighting.

The Current Performance Index is 69 for Chinese companies and 65 for foreign companies, reflecting an improvement for both types of firms in their 2014 business results when compared to 2013, with slightly better results for the Chinese owned companies in our sample (an index above 50 indicates an improvement, the further away from 50 the index is, the stronger the change over the period). Performance is based on both revenue and profit evolution. The indices are stable versus last year and higher that two years ago from last year for both groups ( 69 and 66 respectively last year, 63 and 61 two years ago), implying that 2014 was a positive but stable year for the majority of our sample (Figure 38).

FIGURE 38 - CURRENT PERFORMANCE INDEX




Overall, 76% of the companies in the sample declared being profitable or very profitable in 2014, while 8% incurred losses, a situation practically identical to last year's survey.

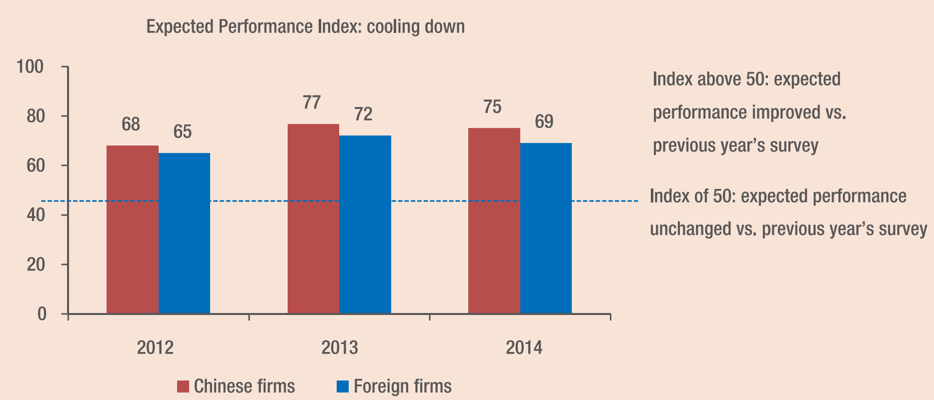
## 2.2. EXPECTED PERFORMANCE INDEX – EPI

*Growth expectation for 2015 is stabilized.*

A majority of the Companies surveyed are optimistic for the 2015, although slightly less than what they declared for 2014 in last year survey. The Expected Performance Index amounted to 75 (Chinese companies) and 69 (foreign companies), reflecting an expected growth in 2015 for both types of companies (an index above 50 indicates an improvement, the further away from 50 the index is, the stronger the change over the period).

Last year survey Expected Performance Index was higher than this year's for both groups: 77 for Chinese companies and 72 for foreign companies, reflecting a slight cooling of expectations for the future (Figure 39).

**FIGURE 39 - EXPECTED PERFORMANCE INDEX**




The EPI Index is calculated as a composite of 2 survey questions: Revenue and Profit Level expectations for 2014. Each variable is attributed the same weighting.

When we look at planned investments in China for 2015, which are closely related to growth expectations, the same overall moderated optimism is observed. A large 67% of the total sample of companies declares an intention to increase investment in China in 2015 with only 2% of total respondents anticipating decreases in investments. These investment plans, although still robust, represent a slight decrease versus last year's survey declared intentions (69% of firms claimed intentions to increase investment and 1% to reduce operations).

Analyzing the three-year evolution, we notice a positive evolution in the intention to increase investments in China for Chinese firms (67% in 2013, 71% in 2014, 73% in 2015 - Figure 40), but a negative evolution in said intention for foreign firms (66% in 2013, 65% in 2014, 61% in 2015 - Figure 41). This trend is consistent with the slightly lower performance and expectation indices of foreign firms, and also with the gradual recovering of the global economy that opens up investment venues overseas that had been put on hold during the worst years of the crisis.

FIGURE 40 - CHINESE FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR THE NEXT YEAR IN CHINA?

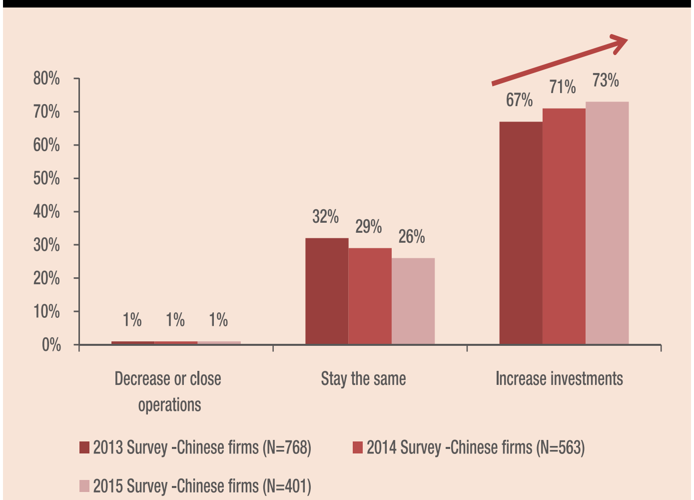
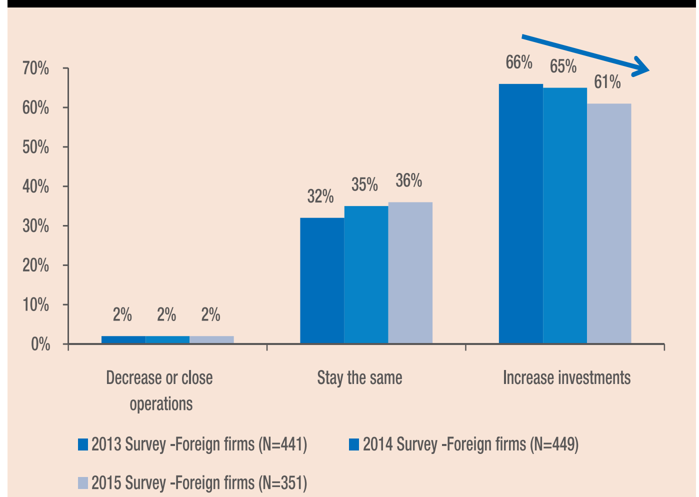



FIGURE 41 - FOREIGN FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR THE NEXT YEAR IN CHINA?



## 2.3. BUSINESS CONFIDENCE INDICES – BCI

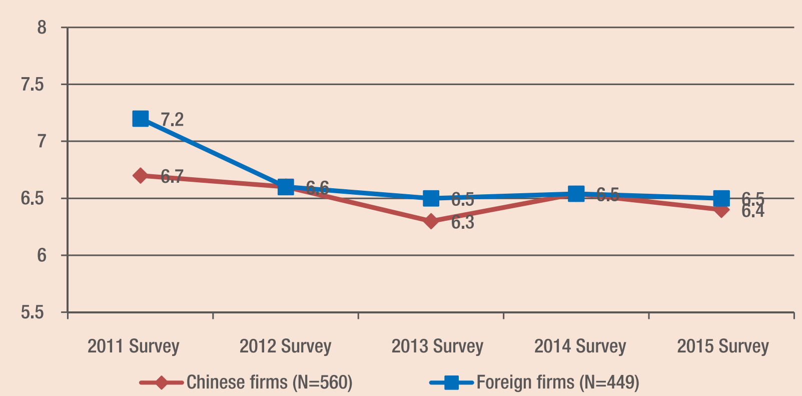
*Moderated optimism reflects a "new normal" for the Chinese economy*

The annual survey provides two confidence indices based on the question, "How confident are you that your operations in China will be successful in the next year and in the next 5 years?" The scale is from 0 (no confidence at all) to 10 (maximum confidence).

The current issue reveals very similar levels of business confidence for Chinese and foreign firms as both claim to be close to "confident" that their operations in China will be successful in 2015 and in the next 5 years (Figure 42 and 43).

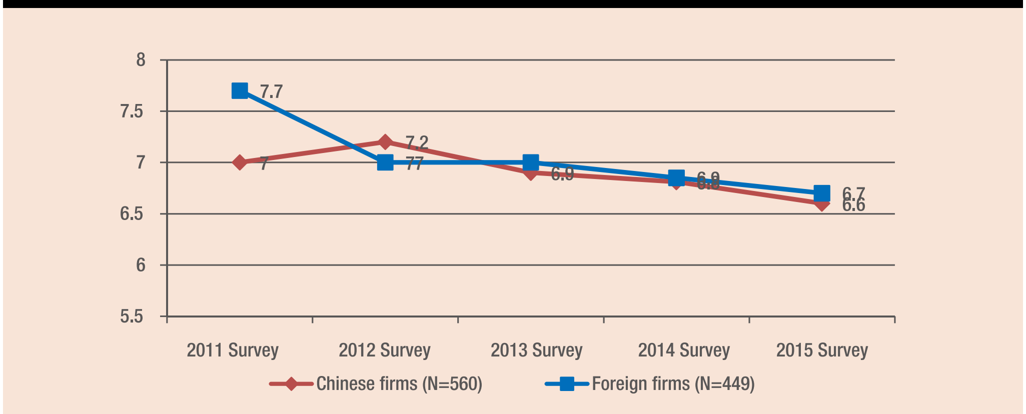
When examining the five year trend we remark that in the past four years, the value of the one-year confidence index moved down and converged to a level of around 6.5 for both Chinese and foreign companies (Figure 42). This trend reflects the fact that all companies operating in China have adjusted their expectations and accepted the "new normal" status of the Chinese economy. Nevertheless, executives working for Chinese firms declare slightly lower confidence levels for 2015 than their counterparts in foreign firms. This is despite Chinese firms showing stronger performance in 2014 and higher expectations for 2015 (see section 2 on business indices).

FIGURE 42 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR?
0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT



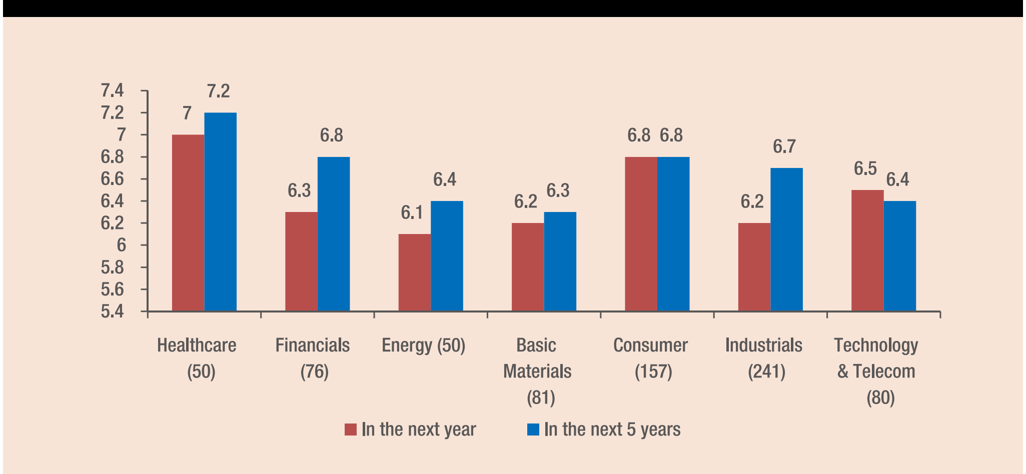
Additionally, the downward trend in confidence for the next five years consolidates for both Chinese and foreign. This trend is consistent with the "new normal" stage in the Chinese economy characterized by slower economic growth, higher labor cost, and more competition (Figure 43).

**FIGURE 43 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT 5 YEARS?**
**0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT**




Analyzing by industry, we discover interesting differences in confidence sentiment amongst sectors. Companies in Healthcare or Consumer Goods and Services show the highest optimism for 2015 of sampled companies. On the other hand, firms in the Financial sector or in Industry exhibit greatly improved levels of confidence for the next 5 years than what they have for 2014. This jump in future confidence may be linked to faith in future benefits resulting from on-going government reforms as 53% of Financials firms and 45% of Industrial firms in our sample declared to believe that their firm will benefit in the future from current reform policies of the new government (Figure 44).

**FIGURE 44 – BY INDUSTRY: HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS?**




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

*Fierce competition and economy slowdown gain strength while rising labor costs, issues with government and the legal environment and corruption improve a little.*

When comparing the evolution of the Top 4 External Challenges for both Chinese and foreign companies in the last two year, we observe significant changes. “Fierce competition” has become the number one concern for both Chinese and foreign firms in our sample, and while “Rising labor costs” is still an important challenge for both groups, it has dropped to second position in the worry list. Additionally, “Slowdown of Chinese economy” gains strength for both groups, as 53% of surveyed Chinese firms and 54% of foreign firms select it as a main external challenge versus lower 47% and 45% respectively last year. These changes are in line with what is expected from the gradual consolidation of a “new normal” in the Chinese economy; lower growth rates fuel competition as companies need to fight amongst each other to gain market share, relying less and less in simply catching the wave of a fast growing market. It is important to note as well some improvement in issues related to “Government and legal environment”. Although still in the top 4 of surveyed companies, 31% of surveyed Chinese firms and 36% of foreign firms select it as a main external challenge versus a higher 39% and 41% respectively in last year’s poll. This development may very well reflect the efforts of the Chinese government to reform and streamline certain areas. Also related to government resolutions, “Corruption” loses importance for Chinese firms compared to the previous edition of the survey, worrying 7% of the Chinese firms (vs. 15% last year), while it stays stable foreign firms (worrying 15% of them this year vs. 16% last year).

| | Chinese firms – Top 4 External Challenges | |
|---|---|---|
| | **2015 Survey** | **2014 Survey** |
| 1 | Fierce competition (64%) | Rising labor cost (66%) |
| 2 | Rising labor cost (62%) | Fierce competition (59%) |
| 3 | Economy slowdown in China (53%) | Economy slowdown in China (47%) |
| 4 | Government and legal environment (31%) | Government and legal environment (39%) |

| | Foreign firms – Top 4 External Challenges | |
|---|---|---|
| | **2015 Survey** | **2014 Survey** |
| 1 | Fierce competition (62%) | Rising labor cost (61%) |
| 2 | Rising labor cost (57%) | Fierce competition (59%) |
| 3 | Economy slowdown in China (54%) | Economy slowdown in China (45%) |
| | Government and legal environment (36%) | Government and legal environment (41%) |

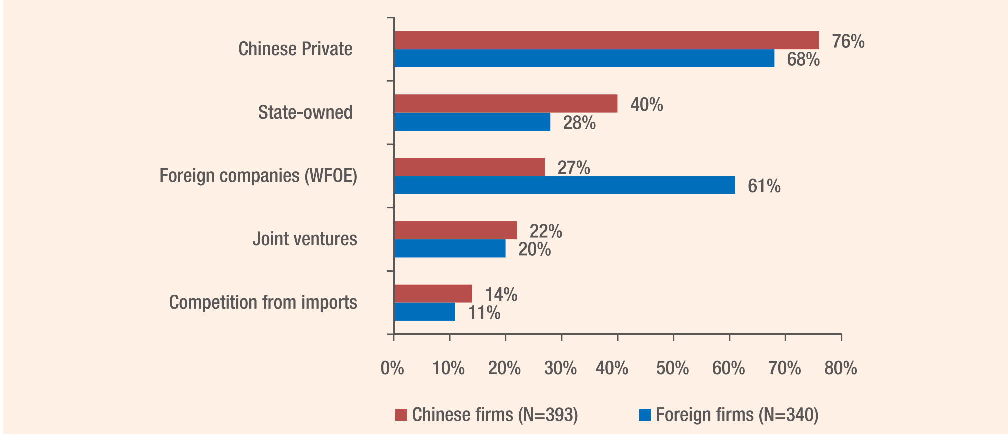
Other worries that decrease are concerns about “Rising price of raw materials” worrying 11% of the Chinese firms (vs. 21% last year) and 16% of foreign firms (vs. 20% last year). “RMB appreciation” decreases too although mainly for Chinese companies, from 17% of firms concerning about it last year to 9% this year.

A noteworthy difference between Chinese and foreign firms is the relative importance of “IP Infringements”, worrying 15% of executives working for foreign firms vs. a lower 9% of those working for Chinese firms. Foreign companies in China tend to invest more in design and innovation and therefore could be more vulnerable to IP infringements.

***Zoom on Number 1 external challenge: Competition***

A majority of respondents cited their main competitors to be Chinese private enterprises (76% of Chinese firms and 68% of foreign firms). Chinese-owned respondents cite State-owned enterprises as a distant second (40%). In contrast, foreign companies measure themselves also amongst each other, citing WFOE (61%) close to Chinese private enterprises as their major type of competitors. These results are consistent with previous surveys (Figure 45).

**FIGURE 45- WHO ARE YOUR MAIN COMPETITORS IN CHINA? MULTIPLE ANSWERS**



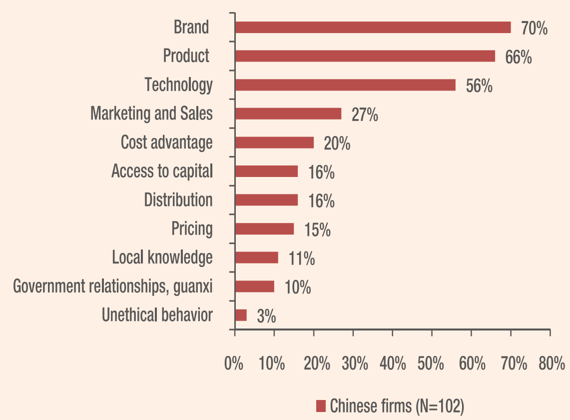

When we ask executives working for Chinese firms what the competitive advantages of their foreign competitors are, and we ask those working for foreign firms what the competitive advantages of their Chinese competitors are we obtain an interesting picture of their perceived relative strengths and weaknesses (Figures 46 and 47).

The top strengths of foreign firms according to their Chinese competitors are related to strength creating brands, superiority of products and technology (mentioned by 70%, 66% and 56% of the surveyed executives working in Chinese firms). In contrast, foreign-owned firms consider that their main weaknesses vis-à-vis their Chinese competitors lay in Chinese firms' superiority in "Cost advantages" (50%), "Price" (48%), and "Relationships with Government and other guanxi" (45%).

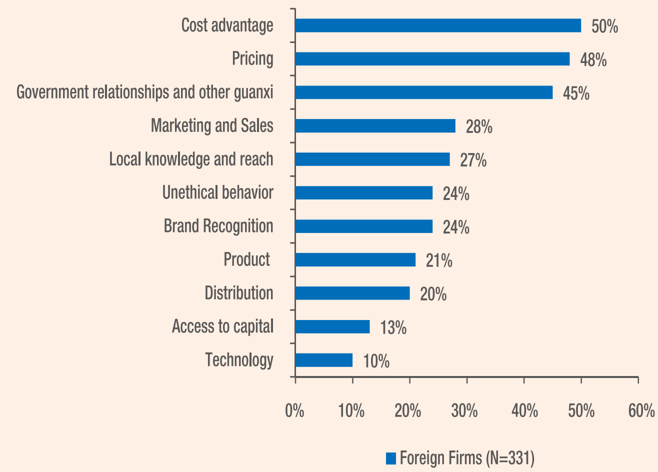
"Unethical behavior" is seen by 24% of polled executives working for foreign-firms as a competitive advantage of Chinese firms. On the contrary, a much lower 3% of executives in Chinese firms mention "Unethical behavior" as a strength of their foreign competitors. This difference may be due to the sometimes stricter environmental control policies that foreign firms apply in their production sites, thus increasing their costs.

"Local knowledge and reach" is seen as a competitive advantage of Chinese firms by 27% of polled executives working for foreign-firms while only 11% of those in Chinese firms mention it as a capability of their foreign competitors.

## FIGURE 46 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN FOREIGN COMPETITORS IN CHINA? MULTIPLE ANSWERS




## FIGURE 47 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN CHINESE COMPETITORS IN CHINA? MULTIPLE ANSWERS



## 3.2. INTERNAL CHALLENGES

*Three top internal challenges are shared by both Chinese and foreign owned firms and remain unchanged from last year's poll: "Finding and retaining talent", "Innovation Capability" and "Marketing Capability".*

Most cited internal management challenge faced by companies operating in China is "Finding and retaining talent" (61% of respondents in Chinese companies and 58% in foreign companies). This is consistent with previous surveys. However, we observe a slight improvement vs. last year survey notably for foreign firms, as it was cited by a higher 63% of Chinese firms and 67% of foreign firms (Figure 48).

"Innovation Capability" and "Marketing Capability" are the next most mentioned internal issues for both sampled groups although there are differences between them worthy to be mentioned. While "Innovation capability" worries 51% of the Chinese firms surveyed, it is a concern for a lower 35% of foreign firms. When exploring deeper by legal status, we remark that it is SOEs that struggle more often with innovation (cited by 67% of them vs. a much lower 44% of those working for Chinese private companies).

Regarding "Marketing capability", 40% of Chinese firms worry about vs. 36% of foreign ones. However this gap is narrower than last year where a lower 29% of executives working in foreign firms declared to be worried about it. When the economy matures and competition heats up, effective marketing tactics increase in importance.

**Chinese firms – Top 4 Internal Challenges**

| | 2015 Survey | 2014 Survey |
|---|---|---|
| 1 | Finding and retaining talent (61%) | Finding and retaining talent (63%) |
| 2 | Innovation capability (51%) | Innovation capability (50%) |
| 3 | Marketing capability (40%) | Marketing capability (38%) |
| 4 | Corporate governance (36%) | Corporate governance (36%) |

**Foreign firms – Top 4 Internal Challenges**

| | 2015 Survey | 2014 Survey |
|---|---|---|
| 1 | Finding and retaining talent (58%) | Finding and retaining talent (67%) |
| 2 | Marketing capability (36%) | Innovation capability (31%) |
| 3 | Innovation capability (35%) | Marketing capability (29%) |
| 4 | Support from head office (26%) | Support from head office (29%) |

The 4$^{th}$ challenge on the top list differs for both groups. "Corporate governance" is a worry relatively more prevalent in Chinese firms with 36% of the executives working them selecting it vs. a lower 17% of those working for foreign companies. This effect was already observed in previous editions of this survey although there seems to be an improvement vs. two years ago where a higher number of executives (49%) working for Chinese firm worried about this topic. On the other hand, for executives working for foreign-owned companies "Support from Head Office" is one of the top issues more frequently mentioned, cited by 26% of them and this is also consistent with previous polls (vs. a much lower 9% of Chinese firms) and with the physical and cultural distance with their global headquarters.

Other group-specific challenge is "Finance related difficulties" which worries 26% of the Chinese private firms vs. a much lower 9% of SOEs and 10% of foreign firms. Likewise, "Services and materials quality" worry 10% of foreign firms in our sample vs. only 5% of Chinese ones. The latter 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, 69% of the foreign-owned companies operate in the premium segment of the market versus 39% for the Chinese-owned ones.

FIGURE 48 - - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?

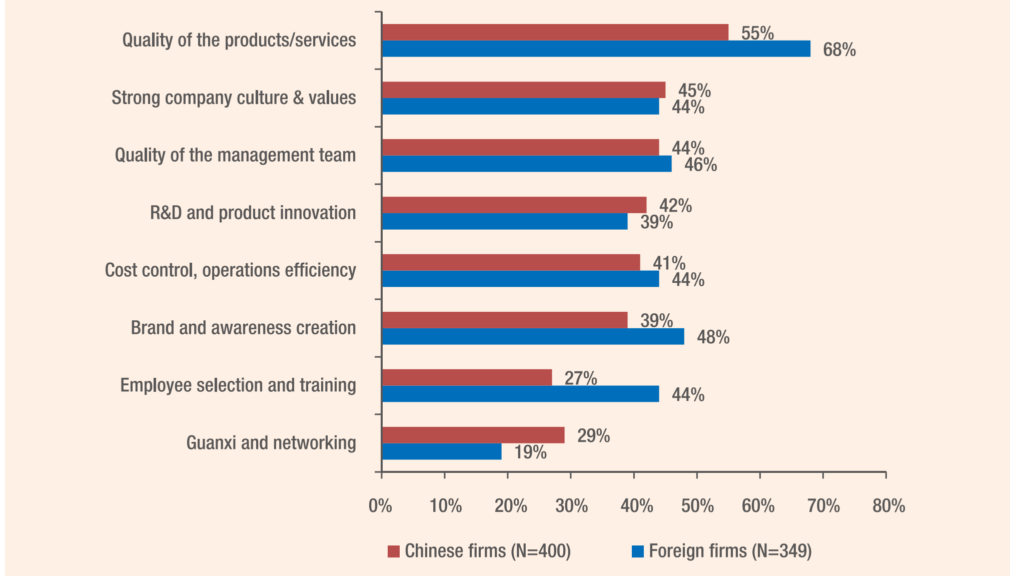

A ***zoom on Number 1 internal challenge, "Finding and retaining talent"*** is presented in Section 4 of this report, .Focus by Area: Human Resources.

## 3.3. SUCCESS FACTORS

*Not a single key to success, but a complex recipe of factors. Specificities by industry exist.*

Both executives from Chinese and foreign-owned companies in our sample believe that success in China is linked to product and service superiority, to soft factors such as company culture & values and quality of the management team, and to capability factors such as brand creation, R&D and product innovation and running operations efficiently (Figure 49).

FIGURE 49 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA?



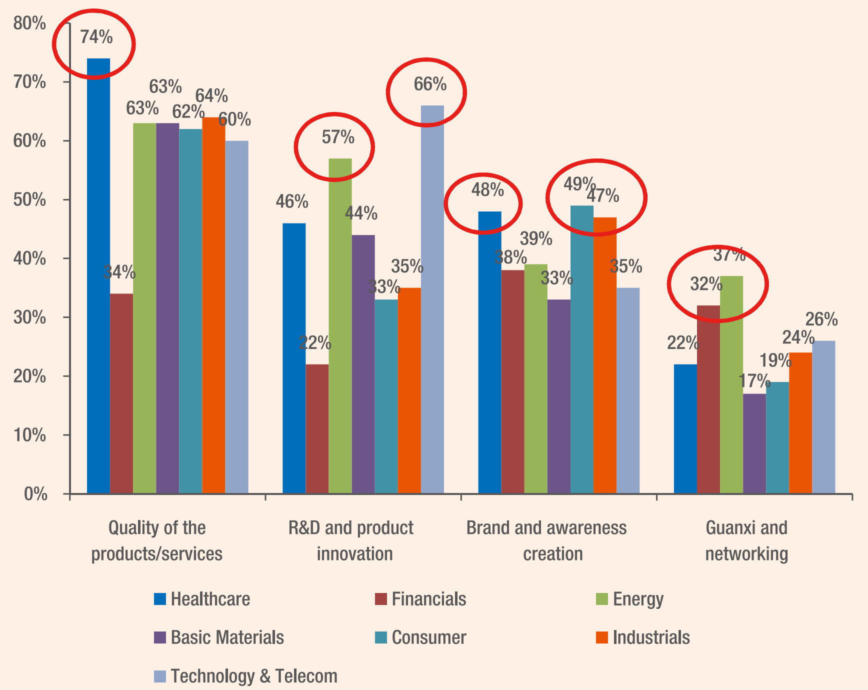

Although there is overall consensus between both groups, It is interesting to note that "Quality of the products/services", although considered the top success factor for both Chinese and foreign companies, is more often cited by executives working in foreign companies (68% of foreign firms vs. 55% of Chinese firms). This is consistent with the fact that 69% of foreign companies in the sample operate in premium segment versus a lower 39% of Chinese ones. "Employee selection and training" also stands out as a factor more frequently considered key to success by foreign companies than by Chinese companies (42% of foreign firms vs. 30% of Chinese private firms and 22% of Chinese SOEs).

However, more salient differences are revealed when analyzing success factors by type of industry (Figure 50). According to our sample of surveyed companies, Healthcare is the industry most concerned by "Quality of products and services" with 74% of its executives mentioning it, while Technology & Telecommunications and Energy firms select "R&D and product innovation" as key success factor more often than other industries (66% and 57% of their executives respectively).

In terms of "Brand creation", Healthcare, Consumer and Industrials companies are relatively more concerned about it than other sectors with respectively 48%, 49% and 47% of their executives considering it key to their success.

"Guanxi and networking" seems to have relatively more importance for the Energy and Financials sectors of our sample, with 37% and 32% of their executives mentioning it, respectively.

**FIGURE 50 – BY INDUSTRY: WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA?**




SECTION 4

# FOCUS BY AREA

This section gives an overview of the following topics:

- 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.
- Sales and Marketing
  This chapter includes an overview of market segments where companies in our sample operate and looks at mobility of companies within segments. It also details which are the most effective sales and marketing strategies for the companies in our sample, and particularly for those companies that are leaders in their markets.

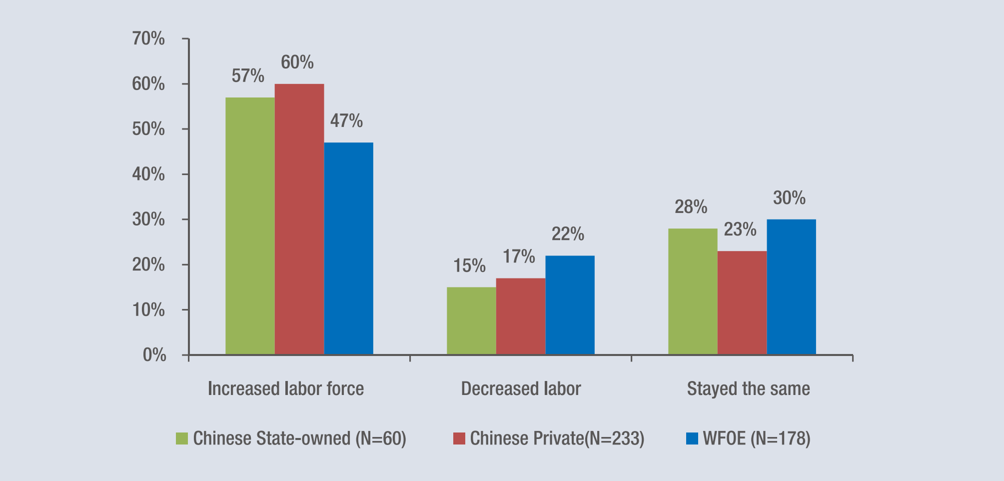
The purpose of this section is to understand challenges and success factors of our respondents in these functional areas.

## 4.1. HUMAN RESOURCES

*Labor force increased in 2014 for more than half of the sample with Healthcare and Finance industries experiencing leading. Average salary increase and turnover is still relatively high although depends on type of job in the organization. Finding talent and rising labor costs are cited as the top HR issues for managing businesses in China.*

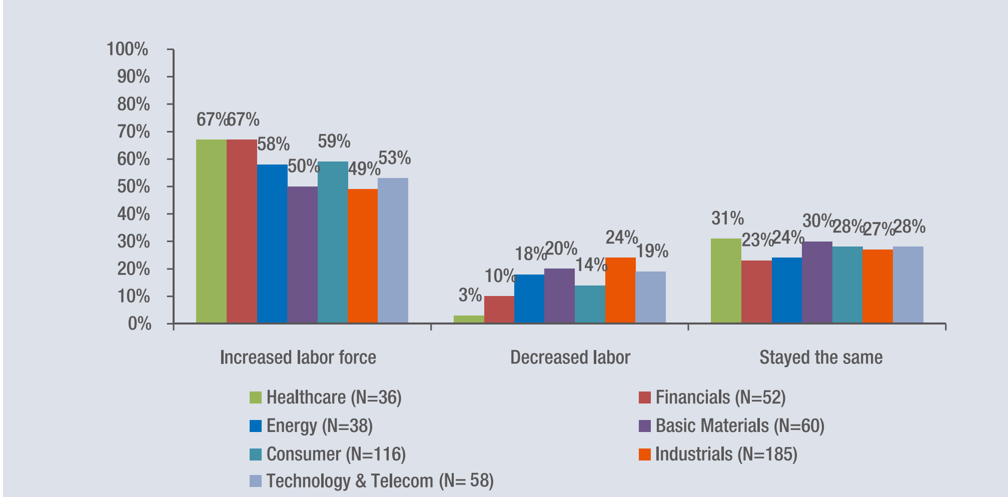
More than half of surveyed companies increased their labor force in 2014 (55% of total respondents), 27% of them kept the same labor force, and 17% of respondents decreased it. 60% of Chinese private-owned firms saw their labor force increase, somewhat more than the proportion of Chinese state-owned enterprises (57%) and foreign WFOEs (47%) having increased labor force (Figure 51).

FIGURE 51 - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2014 VS. 2013 IS:




The transformation of the Chinese economy from heavy industry and manufacturing to a more modern one with a higher representation of services and technologies can be witnessed in our sample of surveyed companies. Analyzing the data by industry, we discover that it is healthcare and financial sector firms that have proportionally increased their in labor force the most in 2014, with 67% of them expanding in number of employees. This compares to 50% to 49% for more traditional industry related sectors like basic materials (chemicals, mining and forestry) and industrial goods and services (Figure 52).

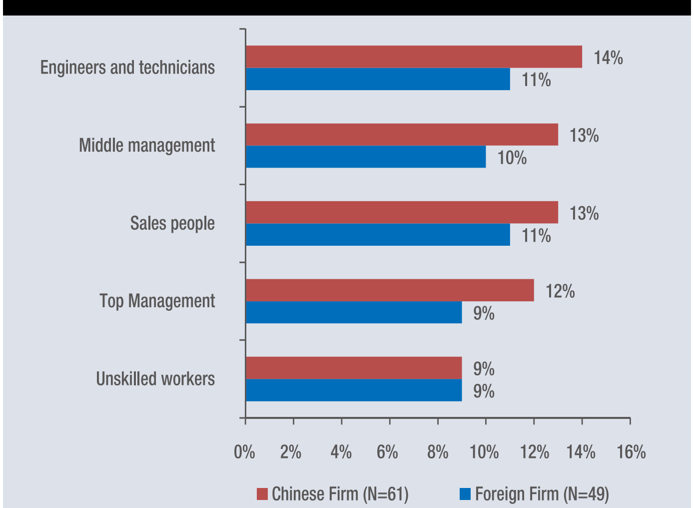
## FIGURE 52 - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2014 VS. 2013 IS:



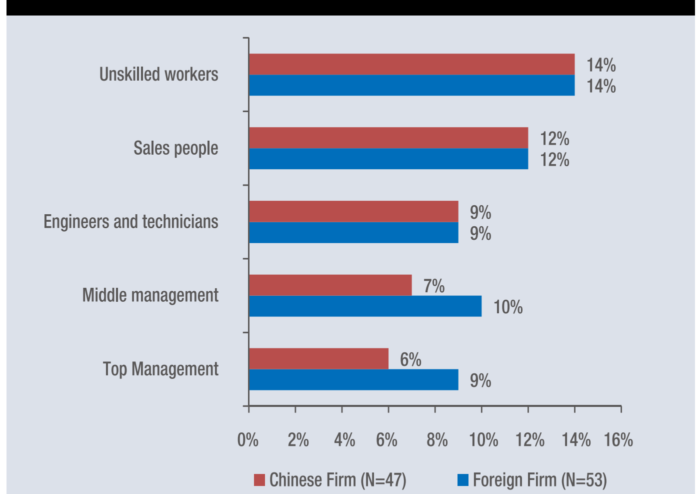

In terms of salary increase and employee turnover in 2014 for our sample of firms, we observe that Chinese firms are increasing salaries more than foreign firms. Engineers and technicians get the highest increase in average (14% in Chinese firms, 11% in foreign firms), very closely followed by sales people, middle and top management. The group receiving the lower increase are unskilled workers although, according to our respondents, they still obtain a non-negligible 9% rise in their wages in 2014, both in Chinese and foreign firms (Figure 53).

It is the group with the lowest salary increase, unskilled workers, that suffers most from turnover, with 14% average yearly turnover both for Chinese and foreign firms in our sample. Chinese firms endure the lowest turnover of their organization in their top and middle management position (6% and 7% respectively in average). In contrast, foreign-owned firms struggle more than Chinese counterparts retaining their management positions with 9% and 10% average turnover respectively (Figure 54). Turnover in all other levels (engineers, sales people and unskilled people) are identical for Chinese and foreign firms in our poll.

## FIGURE 53 - THE EXPECTED SALARY INCREASE BY LEVEL IN YOUR COMPANY IN CHINA IN 2014 COMPARED TO 2013 IS:




## FIGURE 54 - THE EXPECTED EMPLOYEE TURNOVER BY LEVEL IN YOUR COMPANY IN CHINA IN 2014 COMPARED TO 2013 IS:



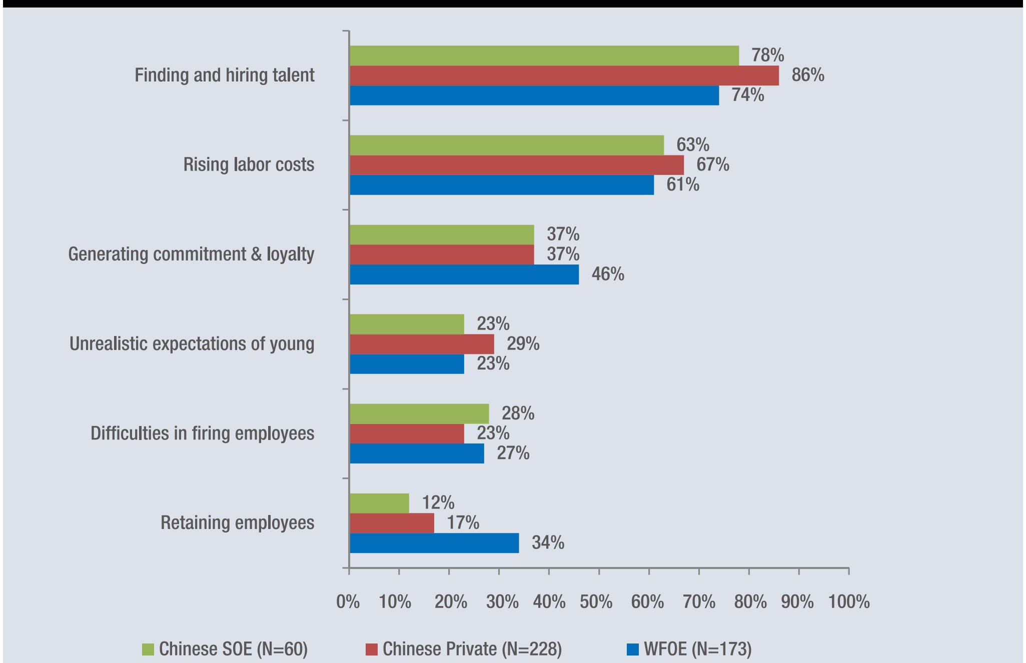
### 4.1.1. TOP HUMAN RESOURCES ISSUES IN CHINA

*HR issues remain the top challenge faced by companies in China, just as in previous editions of this survey. Finding suitable resources, especially in "hot" industries like technology, telecommunications and healthcare, and rising labor costs are main issues.*

Consistent with previous years, "Finding and hiring suitable talent" and "Rising labor costs" are the top two HR concerns for surveyed Chinese and foreign companies. The rapid growth of Chinese private firm results in them struggling relatively more than SOEs and foreign firms with "Finding and hiring suitable talent" (86% of Chinese private firms, vs. 78% of SOEs and 64% of foreign firms declare issues in hiring suitable talent – Figure 55). Healthcare and Technology & Telecommunications, two rapidly developing industries in China where a lot of the innovation is currently happening, encounter the most problems finding fitting talent with 91% and 89% of them reporting staffing to be a key HR issue in 2014. Not surprisingly, a lower 72% of firms in the established sector of Basic Materials (chemicals, mining and forestry) declare to have issues staffing suitable talent.

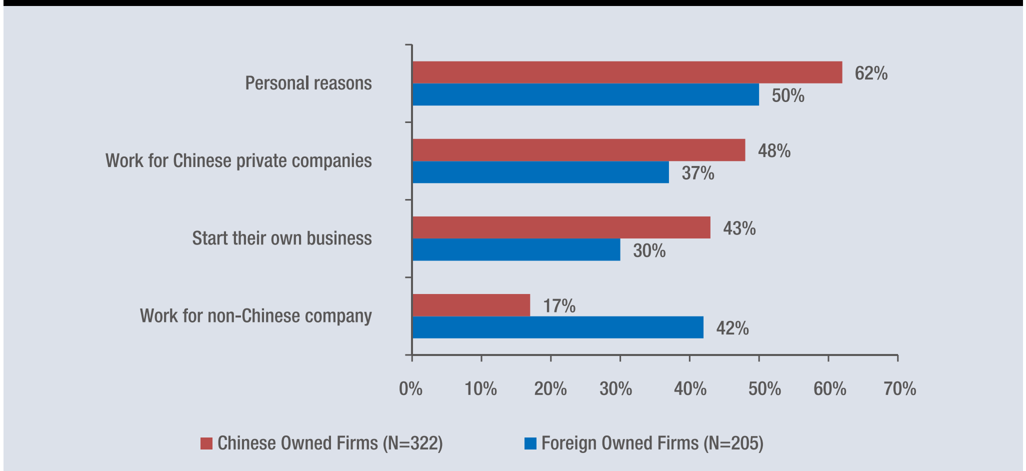
In line with the data on average employee turnover discussed previously, it is foreign firms that report issues with "Generating commitment and loyalty" and "Retaining employees" relatively more often. 46% and 34% of foreign firms declare them to be key issues, compared to a lower 38% and 18% of Chinese–owned firms respectively.

**FIGURE 55 – BY COMPANY TYPE: WHICH ARE THE MAJOR HUMAN RESOURCES ISSUES FACING YOUR COMPANY IN CHINA?**



The most cited causes why Chinese companies loose employees are personal reasons, work for other Chinese companies or start their own businesses. On the other hand, foreign-owned firms lose their employees mostly to personal reasons and to other foreign firms (Figure 56). The popularity of “personal reasons” reflects a common issue with exit interviews during which leaving employees often justify their leaving this way. In our experience talking with many companies, this “black box” often masks a bad relationship with a boss, frustration over a missed promotion or a feeling of having been unjustly mistreated. Certainly, it also comprises family and life changes related motives like getting married or wishing to take care of a new born baby.

**FIGURE 56 - PEOPLE WHO LEAVE YOUR ORGANIZATION USUALLY GO TO: MULTIPLE ANSWERS POSSIBLE**



### 4.1.2. Most effective measures to retain employees

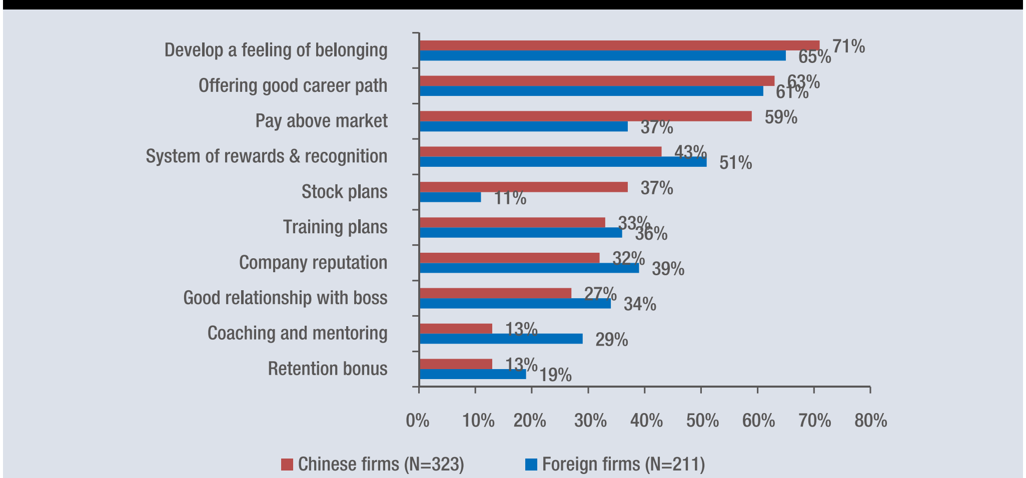
In order to retain employees, executives in our survey cited the importance of creating a feeling of belonging to the company (69% of respondents) and offering interesting career path within the company (62% of respondents). It is interesting to note, this top set of measures comes before paying above market (third with 50% of respondents) and having a system of rewards and recognition (46%). Company reputation and training plans represent the next set of measures cited by executives. These results are in line with previous years' surveys.

Even if the above selection of most effective HR measures is shared by both Chinese and Foreign companies, we observe differences in the relative weight of some of the strategies between both types of firms (Figure 57):

A larger proportion of Chinese-owned firms favor compensation related measures when compared to foreign-owned firms. "Pay above market" is cited by 59% of respondents working in Chinese firms vs. 37% for those in foreign companies. Similarly, "Stock plans", even if less frequent, are more successful amongst Chinese firms (37% of them) than foreign ones (11%). 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 "Company reputation" (considered most efficient by 39% of foreign-owned firms vs. 32% of Chinese-owned firms), "Good relationship with direct boss" (34% vs. 27%) and "Coaching and Mentoring" (29% vs. 13%).

**FIGURE 57 - WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES? MULTIPLE ANSWERS**



## 4.2. SALES AND MARKETING

**Market segments and mobility**

*Clear market positioning with slight trend to move upscale*

Our sample of companies operates mainly in the premium and middle segments with 52% and 45% of companies respectively, and only a small 3% in the low-end (Figure 58).

In terms of segment mobility we see that even if a majority of companies plan to grow future sales within their existing segment (75% for those operating in the premium segment and 66% 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 low and middle segments where 45% and 33% of them respectively to move up into the next segment. For companies currently operating in the premium segment, a smaller proportion (24%) of them wants to expand down into the middle segment (Figure 59).

FIGURE 58 - WHICH IS YOUR MAIN MARKET SEGMENT IN CHINA?

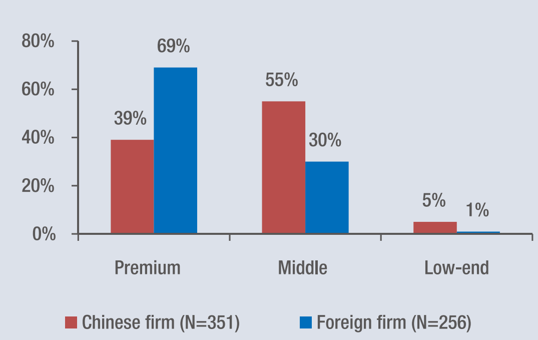
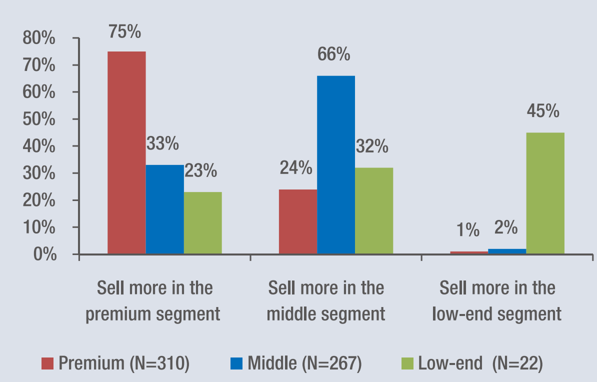



FIGURE 59 - WHAT ARE YOUR PLANS FOR THE FUTURE?

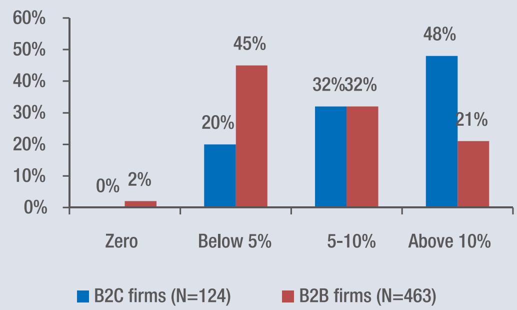



**Marketing and sales budgets and most effective strategies**

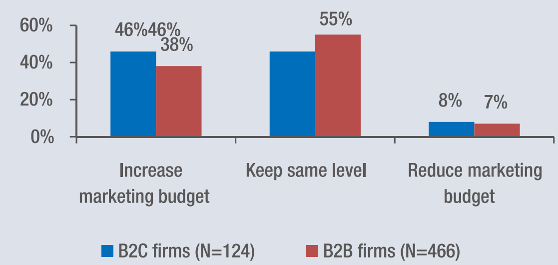
*No significant difference in behavior between Chinese and foreign firms, but type of company matters (B2B or B2C, premium or middle segment). Strategies for selling successfully are complex for B2C companies.*

There is no significant difference in marketing and sales spending for Chinese owned and foreign-owned firms or in their spending intention for the coming year. However, we remark important differences between B2C and B2B companies with the former dedicating more important budgets to marketing and sales activities. Moreover, it is also B2C firms that state more often an intention to increase their budgets in the coming year (Figures 60 and 61). These results are not surprising given the high cost in China of advertising and promotion activities directed to the consumer.

## FIGURE 60 - BY B2B/B2C: WHAT % OF YEARLY REVENUES DO YOU SPEND IN MARKETING & SALES?



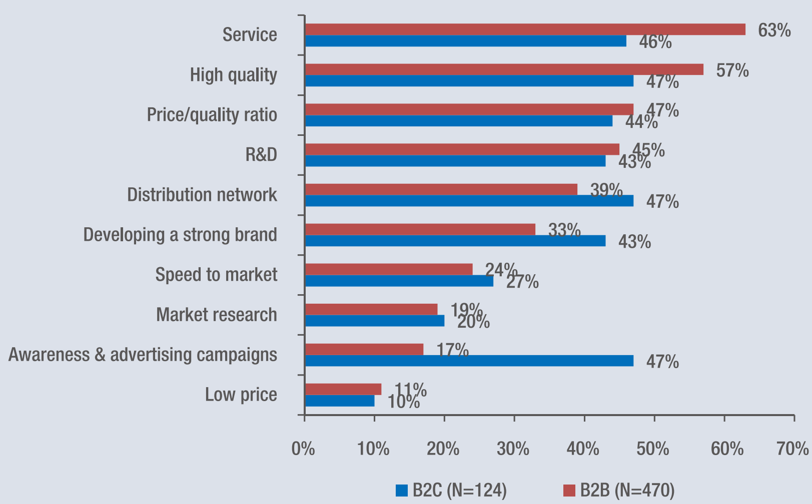

## FIGURE 61 - BY B2B/B2C: WHAT ARE YOUR PLANS FOR NEXT YEAR?




Sales strategies

While the B2B companies in our sample emphasize providing service and high quality above other factors (63% and 57% of executives working in B2B companies cite them as key success factors, respectively), executives in B2C companies rate many factors similarly. This results in a list of key sales success strategies for B2C firms in our survey without a clear winner: “Awareness and advertising campaigns” (cited by 47% of polled executives in B2C firms), “Distribution network” (47%), “Quality” (47%), “Service” (46%), “Price/Quality ratio” (44%), “Brand” (43%) and “R&D” (43%). The absence of a clear recipe for success reflects the complexity of selling products directly to consumers in a country as vast and as diverse as China (Figure 62).

## FIGURE 62 – BY B2B / B2C: PLEASE CHOOSE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA. MULTIPLE ANSWERS POSSIBLE

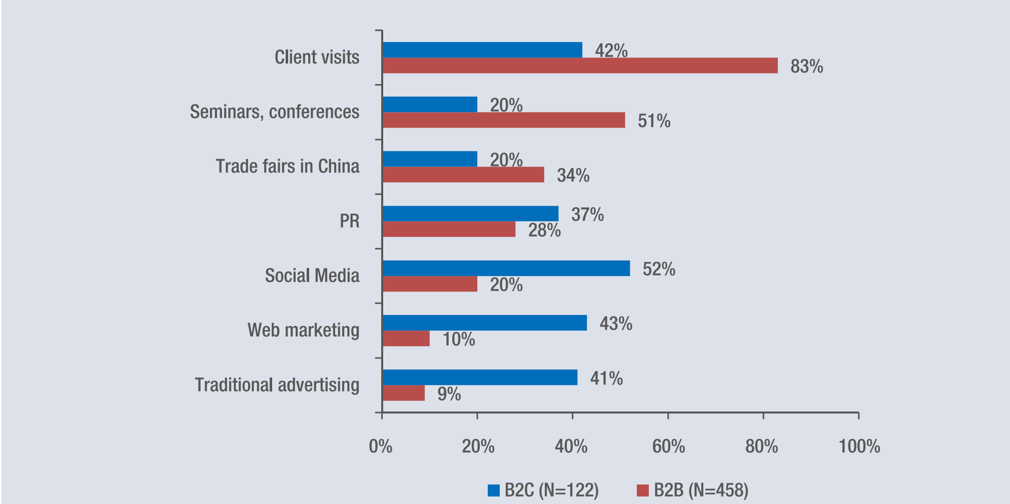


Marketing strategies:

Most cited marketing expenditures for B2B companies in our sample are visits to clients or prospective clients (83% of respondents), followed very distantly by seminars and conferences and trade fairs (51% and 34% of respondents respectively - Figure 63).

In contrast, B2C firms favor mostly advertising and promotion activities, with the internet and new technologies taking a prominent position: Social media is cited by 52% of executives working for B2C firms as one of most effective marketing activities, Web marketing including Search Engine Optimization (cited by 43%), and Traditional advertising like print, TV, radio or outdoors (41%).

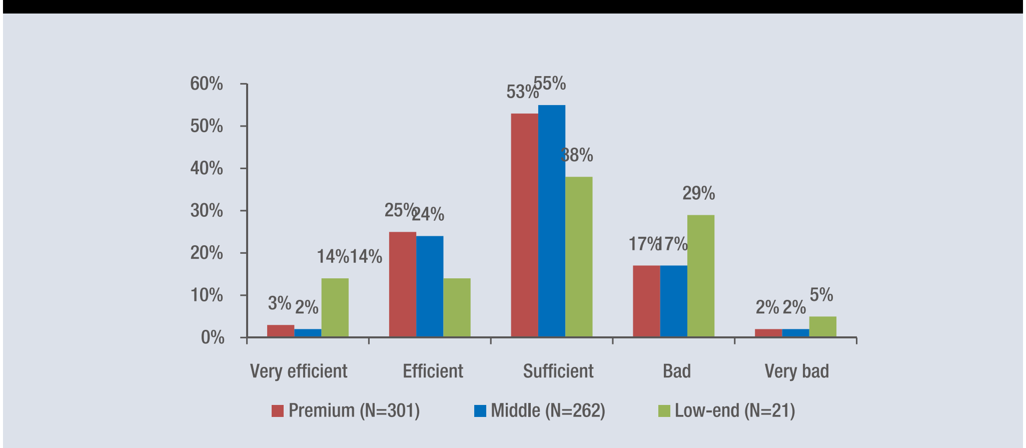
FIGURE 63 – BY B2B/B2C: WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS?




**Distribution network**

Two out of ten companies in our sample evaluates their national distribution network as bad or very bad. 55% of total executives surveyed labelled their distribution network as “sufficient” and 27% as “effective” or “very effective”. There are similar levels of satisfaction amongst surveyed firms in the premium and middle segments. Companies operating in the low-end segment appear to be the most concerned by this problem with 34% of their executives declaring their distribution networks to be bad or very bad (Figure 64).

FIGURE 64 - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?



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