

# China Business Survey 2014

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# LETTER FROM THE RESEARCH TEAM

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We are pleased to present the 4<sup>th</sup> annual CEIBS China Business Survey.

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

- China Integrated Co. Ltd., Swiss Center Shanghai, SwissCham and Swissnex
- China-Italy Chamber of Commerce
- Confederation of Indian Industry

We also thank Foro Brasil, Cámara Oficial de Comercio de España en China and Cámara Argentino-China.

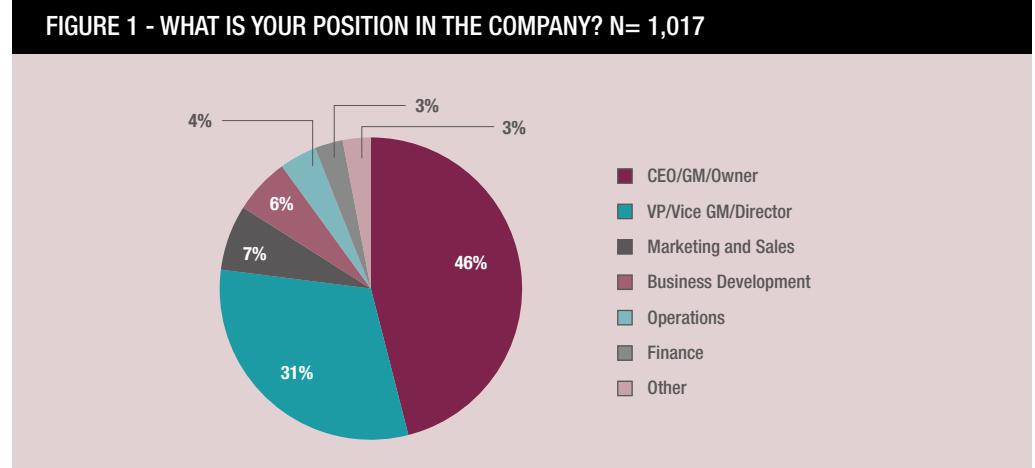
Finally, we acknowledge the financial support from CEIBS Research Fund, support from the Alumni, MBA, EMBA and Executive Education offices at CEIBS, and the many friends that helped us with their network. We are grateful to all of them.

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 2013 and their expectations for 2014 and the future.

The survey took place in November 2013 and was answered by 1,017 executives, 77% of whom are at top levels of management: 466 of them are CEOs, General Managers or owners, and 314 are Vice Presidents, Vice General Managers or Directors. The other 23% is comprised of executives working in different functional areas: Business Development and Project Management, HR, Finance, R&D, Operations and Logistics, Marketing and Sales.

Of the respondents, 82% are from the Chinese mainland, Taiwan, Hong Kong or Macao, and 18% from 24 different countries all over the world. The great majority of them (92%) have more than 10 years work experience, with an impressive 47% of them being seasoned executives with more than 20 years work experience. Only 15% of respondents were female.

FIGURE 1 - WHAT IS YOUR POSITION IN THE COMPANY? N= 1,017



# THE RESEARCH TEAM

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Prof. Juan Antonio Fernandez

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

Prof. Fernandez has co-authored five books: 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 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.



Junjun Li

**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.

# REPORT HIGHLIGHTS

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Our 2014 Business Survey has reached a total of 1,017 companies, domestic and international, private and state owned, and from diverse industries.

## **Improved 2013 vs. 2012 with a positive outlook for 2014**

Firms surveyed, whether Chinese or foreign owned, report an improvement in sales and profits in 2013 compared to 2012, and showed optimism for their 2014 business, more than they did in last year's survey (2014 Survey Expected Performance Index of 77 for Chinese firms and 72 for foreign firms, vs. 68 and 65 respectively in 2013 Survey).

For the next year and for the next 5 years, both Chinese and foreign owned firms now claim to be close to "confident" in their success (Confidence Indices of 6.5 for next year and 6.9 for the next 5 years). This closes the gap that existed between the two groups in previous editions (where foreign firms showed a higher level of confidence).

## **With HR issues and fierce competition still at the top of business challenges, innovation capability has now emerged as an important challenge as well**

The main challenges to doing business in China remain HR related, followed by the fierce competitive environment. Finding and retaining talent and rising labor costs are the most frequently reported challenges, with middle and top management level being the toughest to fill in. Intense competition is still mainly attributed to Chinese private enterprises by our respondents (72%). In addition, foreign companies also compete strongly against each other (59%).

However, in line with the better performance indices, the importance of the slowdown in the Chinese and Global economies as sources of challenges to doing business decreased in 2013 compared to 2012 (45% vs. 55% for slowdown in the Chinese economy; 21% vs. 32% for slowdown in the Global economy).

Interestingly, innovation capability has now emerged as an important internal challenge, especially for Chinese state-owned companies (challenging for 65% of Chinese state owned firms, 45% of Chinese private firms and 33% of foreign firms).

## **Perception of corruption and unstable macroeconomic policies are now lesser worries**

2013 saw the new Chinese government clarify a number of its policies and priorities. From our survey questions on government and legal environment concerns, although unclear and changing policies, regional disparity in their implementation, and corruption remain the top concerns of our respondents, we observe that macroeconomic policy adjustment now appears less worrying than last year (33% vs. 43%). Similarly, while our survey respondents continue to identify corruption as an existing and important problem, we also note a reduction in the perception of corruption by surveyed firms, with some groups more than others.

It is very probable that these changes in perception with respect to government policies and the legal environment are linked to the consolidation of power around the new Chinese government.

## **High awareness and expectations on Shanghai Free Trade Zone**

This year's survey explores the reactions of executives on the establishment of Shanghai Free Trade Zone in late 2013, revealing a high level of awareness and expectations. All Chinese executives and almost all foreign executives (96%) have heard about the Zone, and the majority of them expressed a high or moderate expectation on its future development.

While the interest in Shanghai Free Trade Zone is high, many executives, especially foreign executives, felt that there had not been enough information for their decisions on being involved in the Zone. Both domestic and foreign companies hope to see more government services in the Zone, while Chinese companies, especially the ones in the financial sector, hope to also see more liberalized financial transactions to be allowed in the Zone.



## CURRENT DEVELOPMENTS

The following have been important developments in China in 2013. They have caught the attention of the media and the business community, as well as of the overall society in the past year:

- Shanghai Free Trade Zone
- Fight on Corruption

The purpose of this section is to give an in-depth overview of how the above developments have been perceived by the executives in our sample, and how they have affected their businesses.

## SHANGHAI FREE TRADE ZONE

The current edition of this Survey includes questions on Shanghai Pilot Free Trade Zone (Shanghai FTZ) awareness, interest and expectations.

The Shanghai FTZ was announced in July 2013, by the Chinese government, and personally endorsed by Premier Li Keqiang, with the objective of making the zone a showcase of how China can upgrade its economic structure. A first of its kind in mainland China, the Shanghai FTZ will initially span 28.78 square kilometers in the city's Pudong New District, and is seen as a testing ground for a number of economic reforms. It has received great interest from companies, investors and the media, creating a high level of awareness for the FTZ, as also demonstrated by our survey results.

The detailed plan for the Pilot Free Trade Zone has been launched on September 29, 2013, with a first batch of 25 Chinese and overseas companies being granted the licenses to register in the trial zone. The plan has been qualified as a landmark moment similar to the creation of the Shenzhen special economic zone 30 years ago. It introduces a number of changes to the existing regulatory framework to facilitate foreign investment in China and overseas investment of Chinese firms. Notable new measures include a simplified registration procedure to all foreign invested firms through the introduction of a "Negative List".

According to local media, 1,434 new enterprises, including 38 foreign firms, had already been registered in the FTZ as of November 22, 2013.

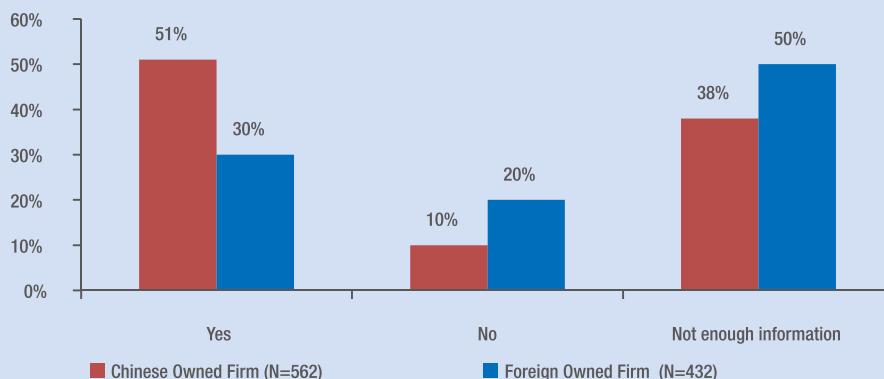
Our survey results show a very high level of awareness amongst the business community, with 100% of the Chinese firms and 96% of the foreign firms surveyed having heard about it by November 2013. Results on interests and expectations have been summarized below.

### INTEREST:

*Interest level depends on type of company and industry. Chinese state-owned firms and firms operating in the financial sector show the most interest while foreign firms show cautiousness about the benefits.*

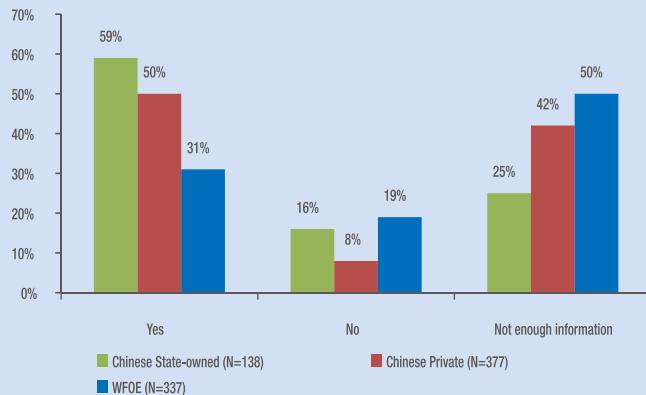
51% of Chinese owned firms surveyed have an interest in the FTZ, in contrast to a much lower 30% of foreign firms (Figure 2). Overall, a sizable group of interviewed firms consider there is lack of information to decide on their interest at this point, with foreign owned firms showing more hesitation (50% of foreign firms and 38% of Chinese owned firms interviewed answered "not enough information for my company to decide if it has an interest in the zone").

**FIGURE 2 - DOES YOUR COMPANY HAVE AN INTEREST IN SHANGHAI FTZ?**

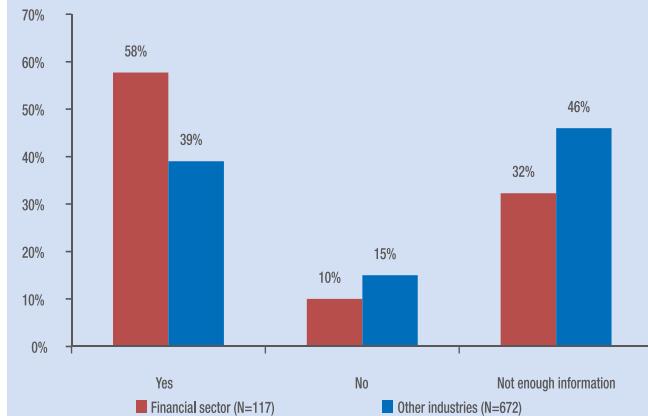


Within the different groups of companies surveyed, we note that it is Chinese state-owned firms and firms operating in the financial sectors that express more often their interest in the zone: 59% of Chinese state-owned firms and 58% of financial firms are interested (Figures 3 & 4).

**FIGURE 3 - DOES YOUR COMPANY HAVE AN INTEREST IN SHANGHAI FTZ? By type of company**



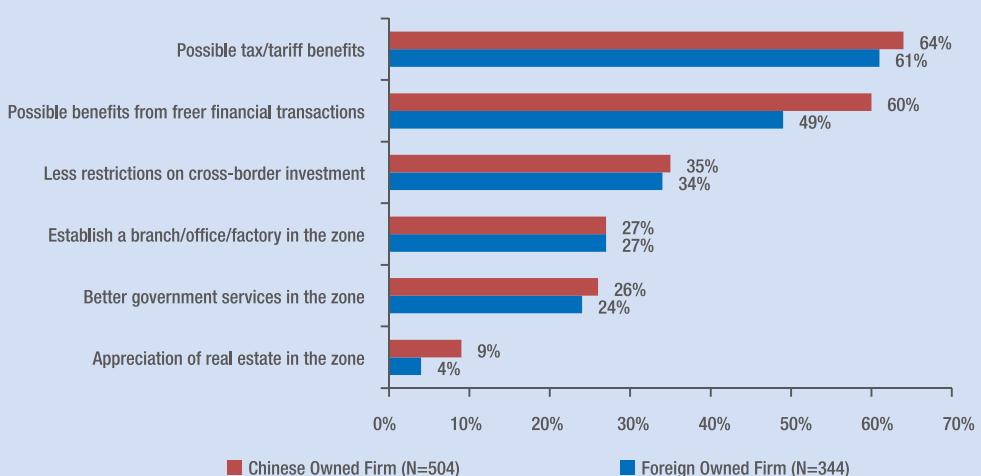
**FIGURE 4 - DOES YOUR COMPANY HAVE AN INTEREST IN SHANGHAI FTZ? Financial sector vs. other industries**



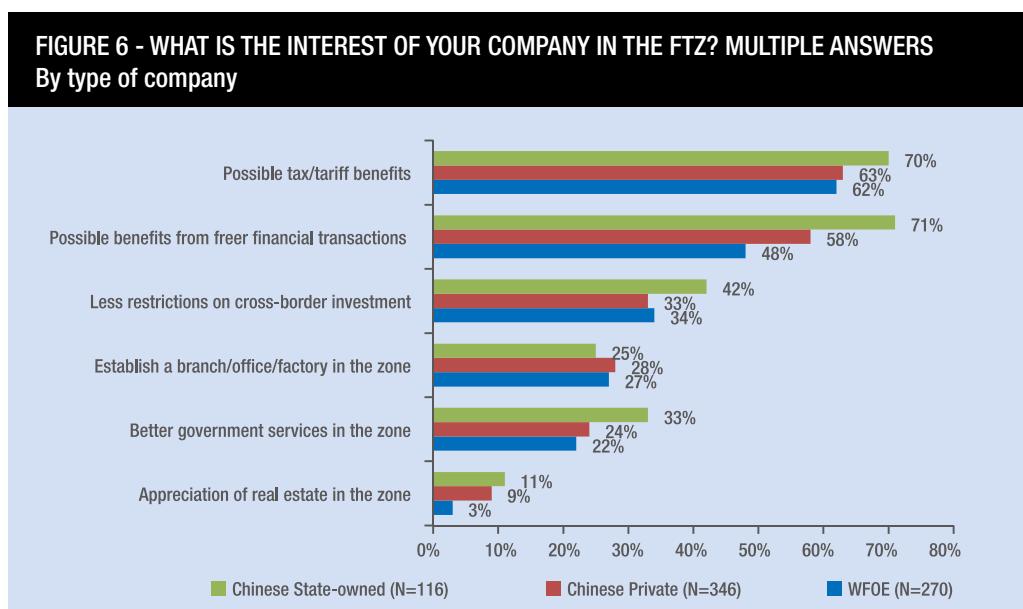
The main interests in the zone for all companies interviewed are tax benefits and freer financial transactions, 64% and 60% respectively of Chinese firms, and 61% and 49% of foreign firms (Figure 5).

Even if the top 2 interests are equal for both groups of firms, a higher percentage of Chinese firms are interested in “Freer financial transactions” than foreign ones (60% of respondents vs. 49% respectively). This gap is partly explained by a higher proportion of financial companies within the Chinese firms in our sample (19% of Chinese firms in our sample operate in the financial sector, vs. 6% of foreign firms). However, excluding financial sector companies, the gap between the two groups still exists; although it is less pronounced (54% of Chinese firms are interested in freer financial transactions vs. 47% of foreign ones).

**FIGURE 5 - WHAT IS THE INTEREST OF YOUR COMPANY IN THE FTZ? MULTIPLE ANSWERS**



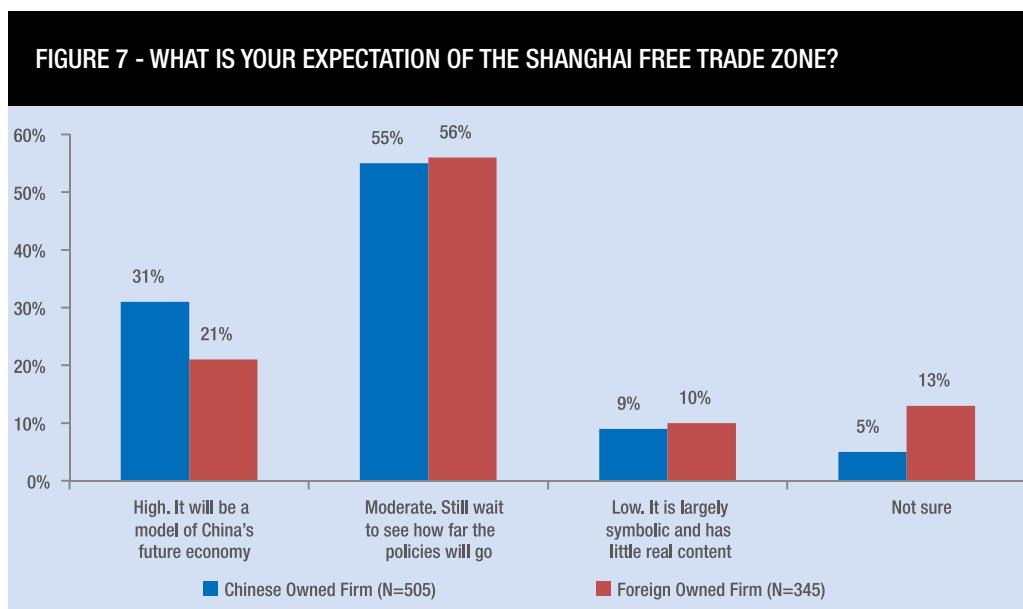
When analyzing by type of companies (Figure 6), we note again that more Chinese state-owned firms than other types of firms search different advantages from the zone: tax or tariff benefits (70%), freer financial transactions (71%), less restrictions in cross border investment (42%) and better government services (33%)



### EXPECTATIONS:

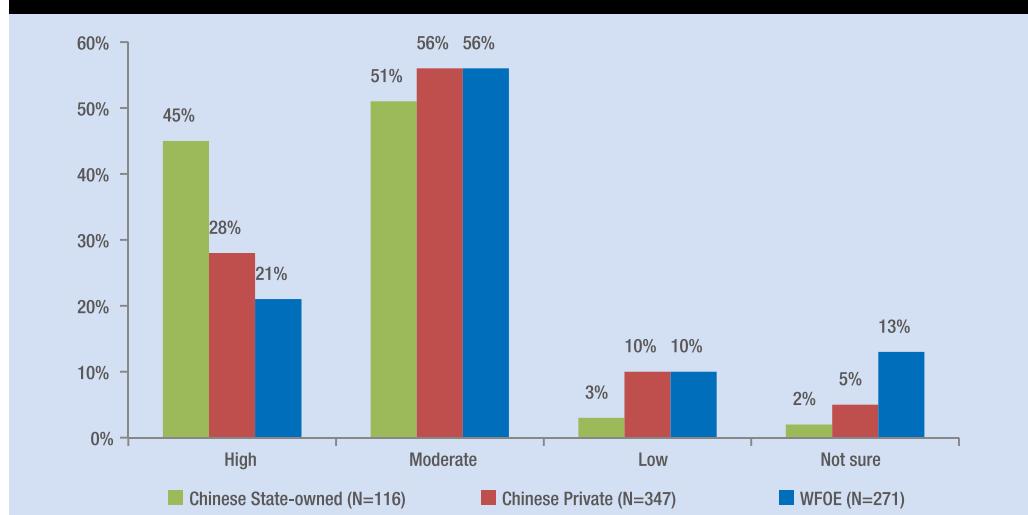
Expectations are “moderate” to “high”, with higher level of optimism among Chinese firms.

Moderate to high expectations for the FTZ for the majority of firms surveyed (86% of Chinese firms, 77% of foreign owned firms). We note that Chinese owned firms show higher optimism in the zone (31% of Chinese firms interviewed state high expectations versus a 21% of foreign firms), while a larger proportion of foreign firms remain cautious for the time being ( 13% of foreign firms vs. 5% of Chinese firms are “not sure” of their expectations).

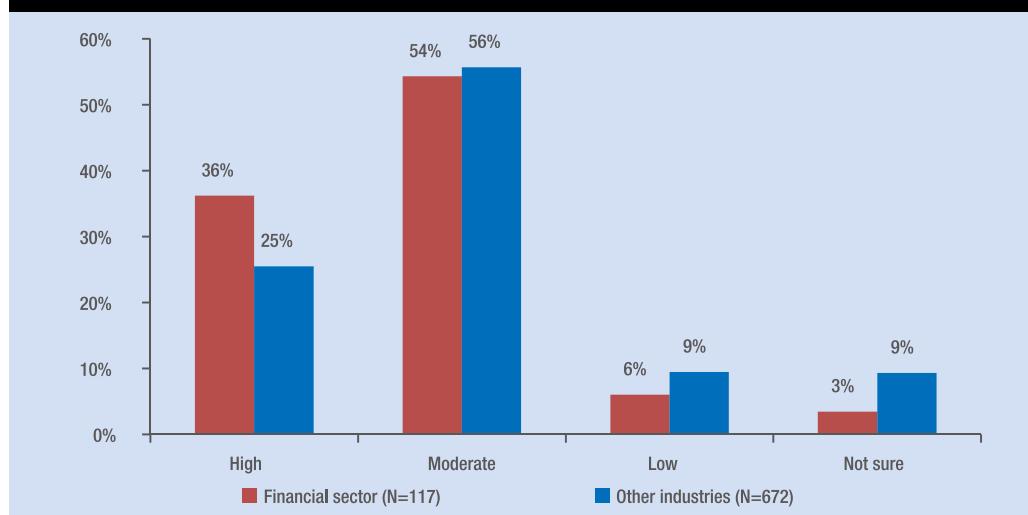


Chinese state-owned companies and companies operating in the financial sector show the most optimism for the zone (Figure 8 and 9).

**FIGURE 8 - WHAT IS YOUR EXPECTATION OF THE SHANGHAI FREE TRADE ZONE?**  
By type of company



**FIGURE 9 - WHAT IS YOUR EXPECTATION OF THE SHANGHAI FREE TRADE ZONE?**  
Financial sector vs. other industries

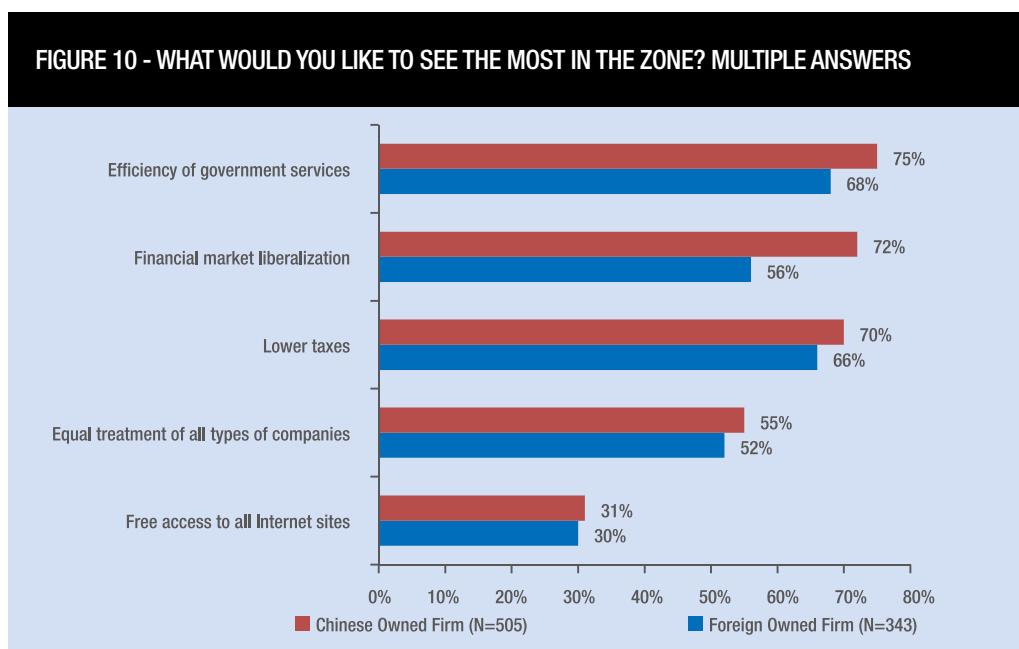


#### **WISH LIST: "Efficiency of government services" is No. 1 wish.**

The "Wish List" of Chinese firms is topped by "Efficiency of government services", "Financial market liberalization" and "Lower taxes" (favored by 75%, 72% and 70% of Chinese firms surveyed respectively).

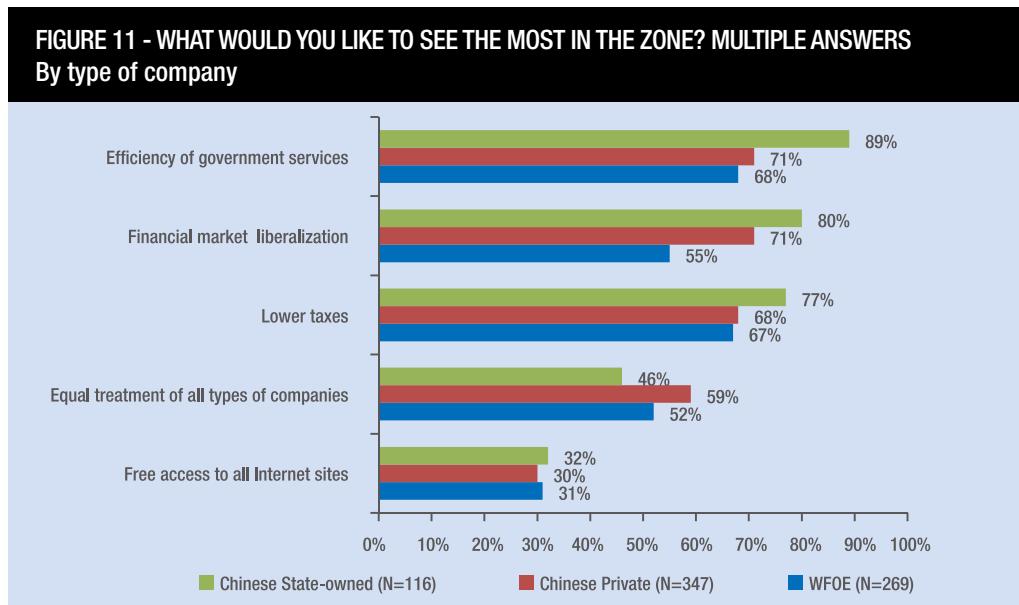
For foreign firms, "efficiency of government services" and "Lower taxes" top their list (68% and 66% of foreign firms, respectively), with a lower 56% of firms seeking "financial market Liberalization".

Half of the companies surveyed in both the groups would like to see “Equal treatment of all types of companies in the zone”. Almost one third of the total sample wishes free access to all internet sites (Figure 10).

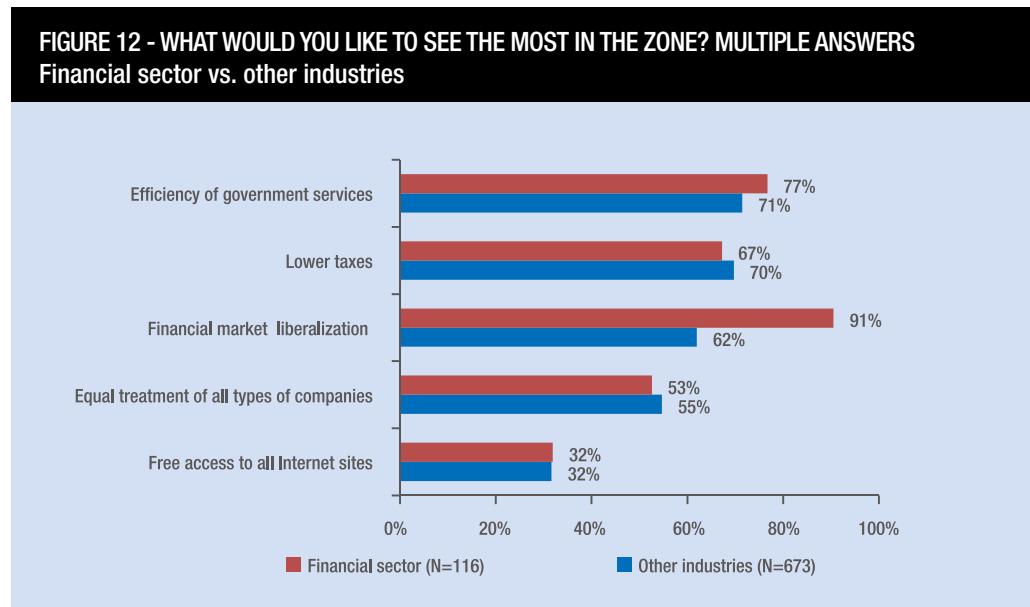


There are a few interesting differences in the weight of some factors between Chinese state-owned companies and other types of companies (Figure 11):

- “Efficiency of government services”, although it is the number 1 wish for all groups, it is emphasized much more by state-owned companies than it is by Chinese private companies or WFOEs (89% of respondents vs. 71% and 68% respectively).
- “Financial market liberalization” is desirable for 80% of state-owned firms, 71% of Chinese private firms and a significantly lower 55% of WFOEs.
- Chinese private firms in our survey wish for “Equal treatment of all types of companies” in the new zone more often than State-owned firms (59% of private firms vs/ 46% of state-owned).



The “wish list” for financial companies is somewhat different from the rest of the sample (Figure 12). This type of companies prefer to see financial market liberalization the most (91% of them), followed distantly by “Efficiency of government services” (77%) and “Lower taxes” (67%).



## CORRUPTION IN CHINA - FIGHT ON CORRUPTION

The anti-corruption campaign has been one of President Xi Jinping's most eye-catching measures in 2013. President Xi Jinping's famous analogy of a "fight against flies and tigers" has summed up the government's intention to spare no-one in the battle against graft. According to the Chinese news magazine Legal Weekly, eighteen officials at or above the ministerial level were investigated for corruption in 2013, compared with an average of 5.8 such probes per year between 2008-12. In the first nine months of 2013, a total of 129,000 corruption and disciplinary cases were processed nationwide, up 13.5% from the same period last year. The anti-corruption campaign has also targeted highly visible extravagant government spending and perks for officials, like upscale liquor and delicacies in banquets, ostentatious luxury watches and other accessories.

This survey has been following perceptions of respondents about corruption for the past four years. This year, in order to better compare the perceived changes on corruption by different groups with previous surveys, we have elaborated a directional index measuring corruption evolution in the past year. While it is difficult to establish a link between the new government efforts, we note that for the first time, a slight improvement is perceived.

### Good news ahead: Corruption Variation Index over 50 for all groups

In previous editions of this survey most executives believed that corruption had remained unchanged vs. previous years. However, this time we note a perception of improvement in all groups surveyed. Among the surveyed executives, those working for Chinese state-owned companies are the group most often perceiving improvement.

The corruption index is based on the multiple choice question "In your view, how is corruption in your industry compared to last year?" and it is built in similar way to the well-known Purchasing Managers' Index (PMI)<sup>1</sup>. A reading of 50 means that corruption is unchanged; a number over 50 indicates an improvement while anything below 50 suggests a worsening of the situation in the past year. The further away from 50 the index is, the stronger the improvement over the year.

When comparing the index for the different types of companies and vs. last year's survey (Figure 13), we observe:

- All types of companies, Chinese and foreign-owned, state and privately owned, believe corruption has decreased in the last year, with Chinese-state owned being the most optimistic (Index of 61).
- There is an improvement vs. last year, where all surveyed groups believed corruption to be unchanged or slightly worse than the previous year

<sup>1</sup> INDEX = (P1\*1) + (P2\*0.75) + (P3\*0.5) + (P4\*0.25) + (P5\*0)

P1 = Percentage number of answers that reported a substantial improvement.

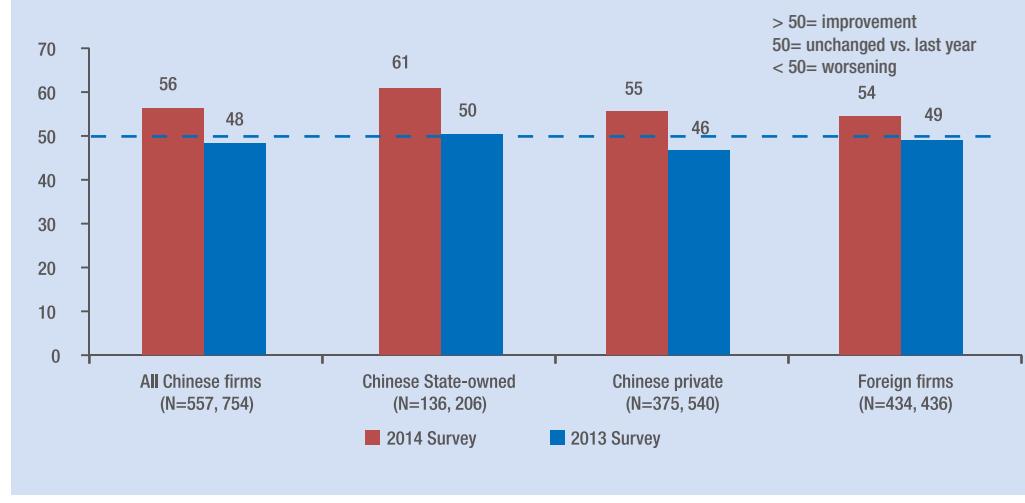
P2 = Percentage number of answers that reported an improvement.

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.

FIGURE 13 - CORRUPTION VARIATION INDEX BY COMPANY TYPE (IN YOUR VIEW, HOW IS CORRUPTION IN YOUR INDUSTRY COMPARED TO LAST YEAR?)

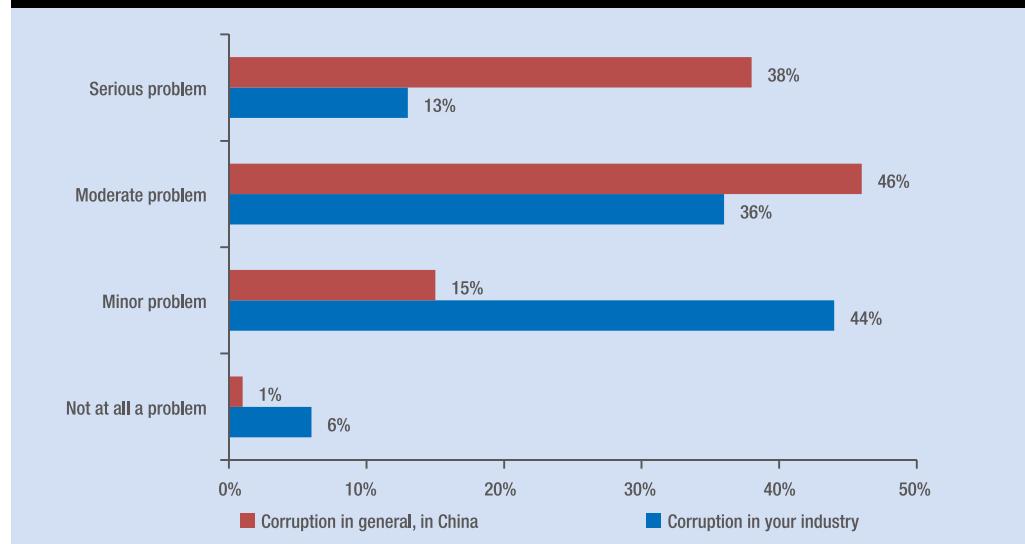


All industries surveyed report a Corruption Index higher than 50 indicating they perceive an improvement (decrease in corruption) in their sector; Consumer goods and services, Corruption Index of 55; Technology and Telecommunications, 55; Basic materials, including chemicals and mining, 55; Energy, 58; Financials, 57; Health Care, 56; and Industrial goods and services, 54.

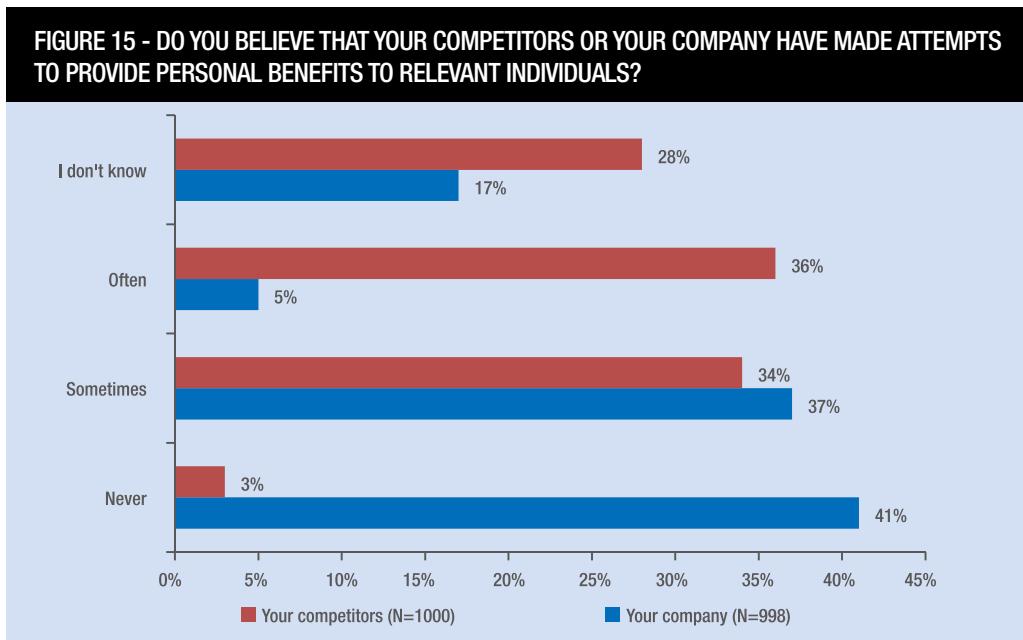
#### Corruption in China vs. industry:

Regarding corruption, when specifically asked about the issue, a large majority (84% of respondents) view corruption in China to be a problem (moderate to serious). However, when asked about corruption in their industry, the number of respondents seeing it as a problem drops by almost half. This phenomenon of corruption in China being perceived as less acute when asked about one's own industry is observed with respondents from all types of companies (both Chinese-owned and foreign-owned firms, Chinese state-owned and private-owned firms), and in previous editions of this survey as well (Figure 14).

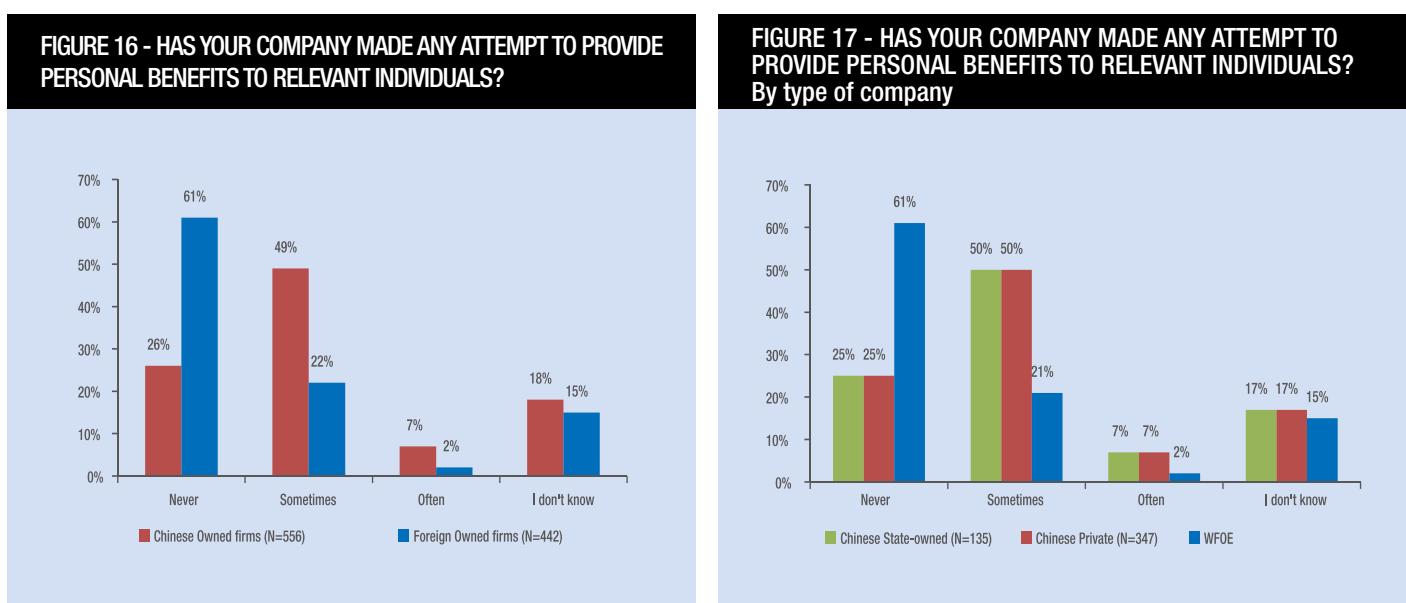
FIGURE 14 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA, IN GENERAL, AND IN YOUR INDUSTRY? N=1008



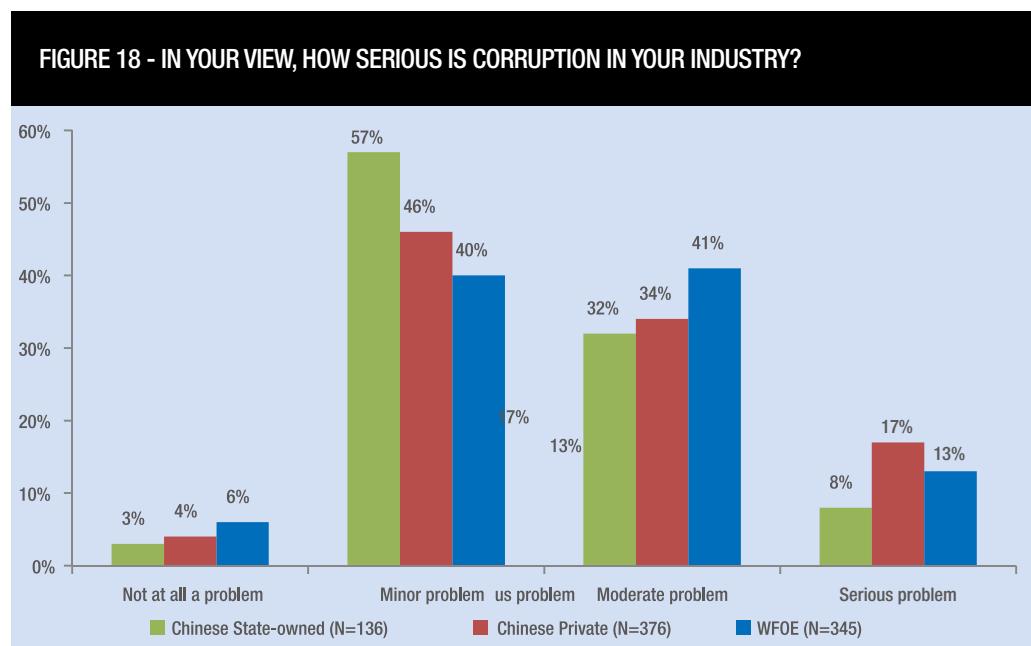
Similarly, corruption is perceived to be more acute when asked about competitors than about one's own company. A large majority (78% of respondents) considers that their company has never or sometimes made attempts to provide personal benefits to relevant individuals. However, when asked about their competitors, 70% of respondents believe their competitors have often or sometimes made attempts to provide personal benefits to relevant individuals (Figure 15).



We observe a few differences between Chinese and foreign owned companies in the sample. When asked if their company has made any attempt to provide personal benefits to relevant individuals, 49% of executives working for Chinese firms respond "sometimes" vs. a lower 22% of those working for foreign firms; 26% and 61% respectively state that their company has never indulged in such practices (Figure 16). When comparing by legal status of the firm, we note that Chinese state-owned and privately owned both respond in the same way (Figure 17).



With respect to corruption, an interesting aspect is that State-owned companies appear to perceive corruption as less problematic than those in the private sector. This same situation is observed whether asked about corruption in China in general or corruption in one's own industry.



Also, different industries seem to perceive different levels of corruption. Of the executives surveyed, those working in healthcare and the industrial sectors emphasize the existence of corruption in their industry more often than others. Those working in consumer goods & services, technology and telecommunications seem to perceive corruption in their industries less often (Figures 19 to 21).

FIGURE 19 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY? MINOR PROBLEM

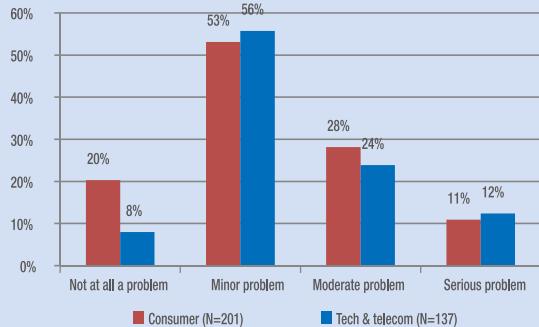


FIGURE 20 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY? MINOR TO MODERATE PROBLEM

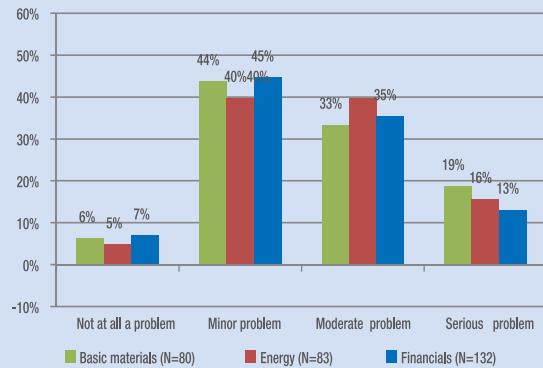
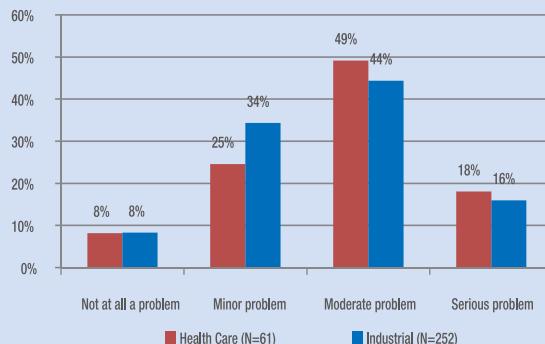


FIGURE 21 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY? MODERATE PROBLEM





## SECTION 1

# DESCRIPTION OF THE COMPANIES PARTICIPATING

This section details the following information about the companies that have participated in the 4<sup>th</sup> 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.

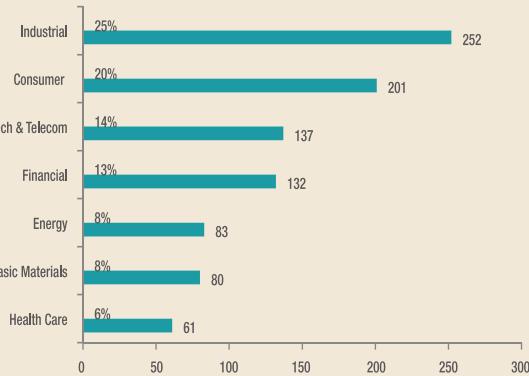
## SECTION 1: DESCRIPTION OF THE COMPANIES PARTICIPATING

A total of 1,017 companies operating in China have participated in the 2014 edition of the CEIBS China Business Survey. This sample of businesses includes 564 (55%) Chinese owned companies (i.e. with 50% or more Chinese ownership)<sup>2</sup> and 453 (45%) foreign-owned companies (i.e. with more than 50% foreign ownership).

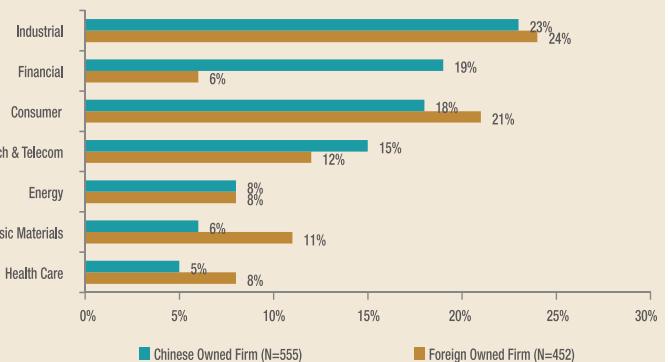
In terms of business activity, the sample is well balanced with 476 firms (47%) having their main activity in manufacturing and 541 (53%) in services. 73% of the total sample of firms are B2B companies, having other businesses as main clients, while 22% are B2C companies, offering products and services directly to consumers.

The industries represented are varied, topped by industrial products and services (252 firms, 25% of total sample), consumer goods and services (201 firms, 20%), Technology and Telecommunications (14%) and Financials (13%). However, we observe a considerably larger presence of financial companies within the Chinese-owned firms of our sample (19% versus 6% of foreign firms), a consequence of existing regulations limiting or constraining foreign investment in the sector. Foreign-owned firms are slightly more represented in "Basic materials" (chemicals, forestry, mining) with 11% of them vs. 6% of Chinese-owned firms in the industry (Figures 22 and 23).

**FIGURE 22 - WHAT IS THE MAIN INDUSTRY WHERE YOUR COMPANY OPERATES? (N=1,017)**



**FIGURE 23 - WHAT IS THE MAIN INDUSTRY WHERE YOUR COMPANY OPERATES? (CHINESE VS. FOREIGN-OWNED FIRMS)**



In terms of market position, the firms surveyed operate mostly in the mid and high ends of the market. According to survey answers<sup>3</sup> , 412 firms (48%) in our sample operate mainly in the premium segment, another 406 (47%) in the middle segment and only 48 (6%) in the low-end of the market. Moreover, 251 companies (29%) identify themselves as market leaders for their main business line and 229 (26%) 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 63% of foreign companies in the sample in the premium segment vs. a lower 37% of Chinese-owned firms. Inversely, 57% of Chinese-owned firms operate in the middle segment of the market, while only 33% of foreign-owned do so.

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

<sup>2</sup> Including Chinese controlled Joint Ventures

<sup>3</sup> N=866

FIGURE 24 - WHERE ARE YOUR GLOBAL HEADQUARTERS LOCATED? N= 1,017

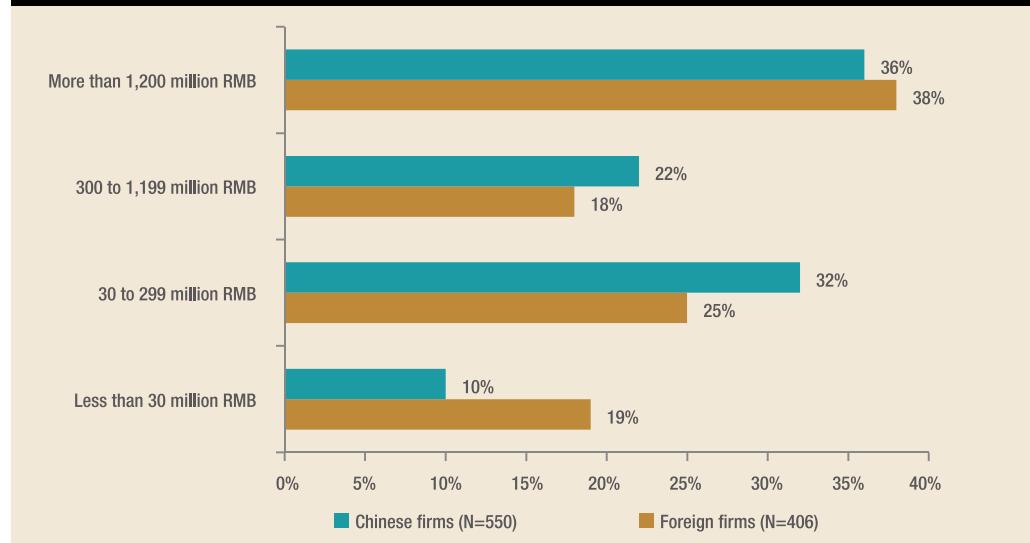


The **China headquarters** of 78% of the total sample are located in coastal China, in central China for 18% and in west China for only 4% of respondents. However, we do observe that foreign firms concentrate on the coastal region more than Chinese firms do (85% of foreign firms vs. 72% of Chinese firms).

In 2013, participating companies had generated collective revenue of more than 500 billion RMB and were employing more than 3.6 million people in China alone.

Of participating companies, 58% of the Chinese-owned firms and 56% of the foreign-owned firms surveyed are considered large (Figure 25)<sup>4</sup>.

FIGURE 25 - WHAT ARE YOUR COMPANY'S TOTAL CHINA SALES IN 2013?

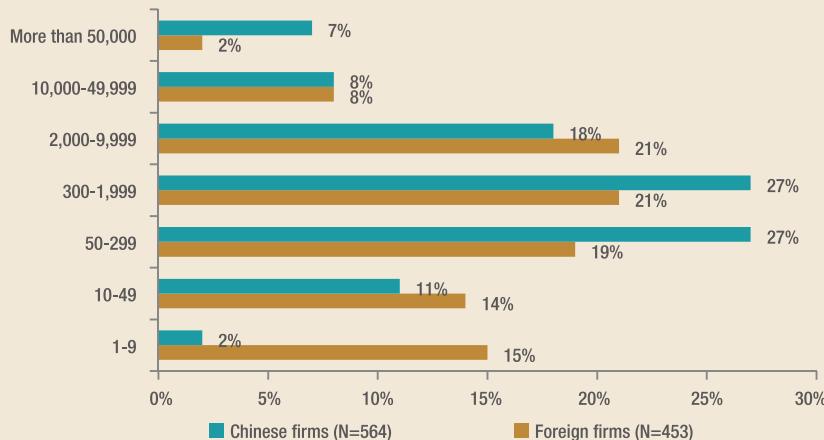


<sup>4</sup> According to China official definition companies with more than 300 million RMB are considered large.

## SECTION 1: DESCRIPTION OF THE COMPANIES PARTICIPATING

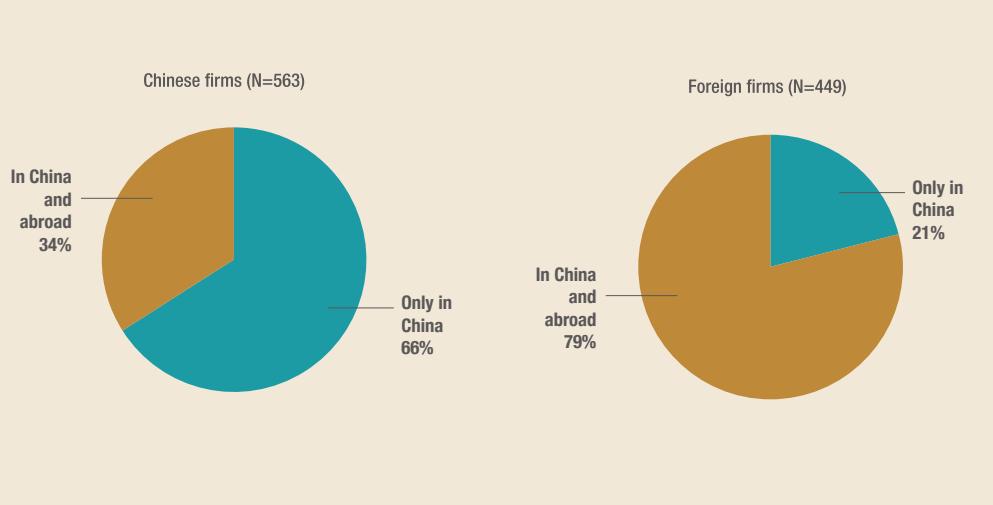
The sample of companies varies widely in size, ranging from companies with less than 10 employees in China to those with more than 50,000. However, we observe that Chinese firms surveyed are larger than foreign-owned firms in respect to number of employees in China. Chinese firms surveyed have an average 4,700 employees in China or more, compared to 2,300 or more for foreign-owned firms. Likewise, 15% of foreign-owned firms surveyed have less than 10 employees versus only 2% of Chinese firms; 7% of Chinese firms employ more than 50,000 people in China compared to a lower 2% of the foreign firms (Figure 26).

FIGURE 26 - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?

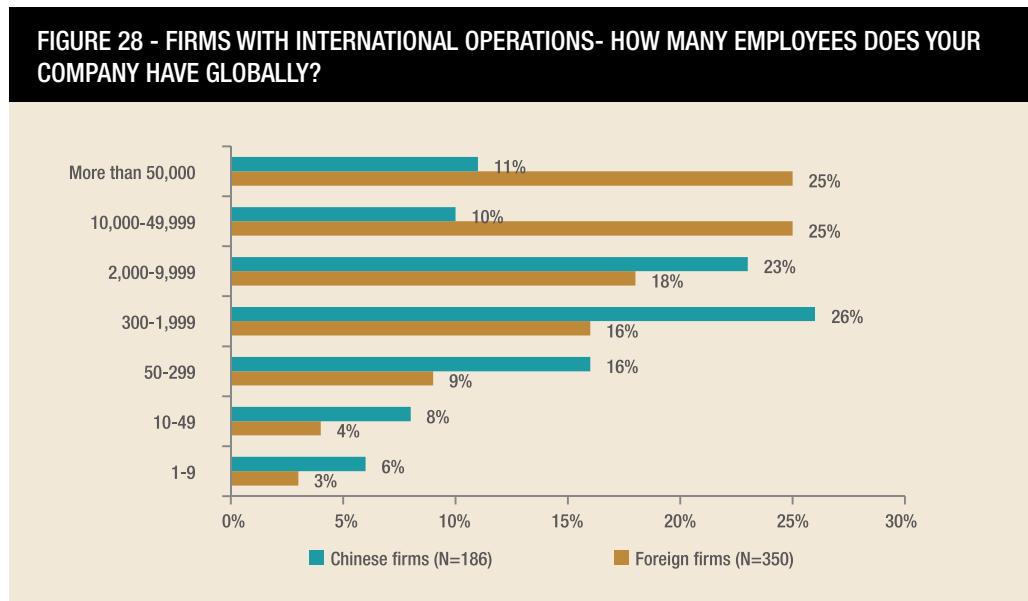


One third of the Chinese owned firms in our sample have operations abroad too (34%, 192 firms with 9% of them being Joint Ventures). Excluding JV, 30% of the Chinese owned firms in our sample are international. And although 4 out of 5 foreign firms in our sample are international (353 firms, 9% of which are JV), there is a non-negligible 21% of foreign owned firms that only operate in China (96 companies).

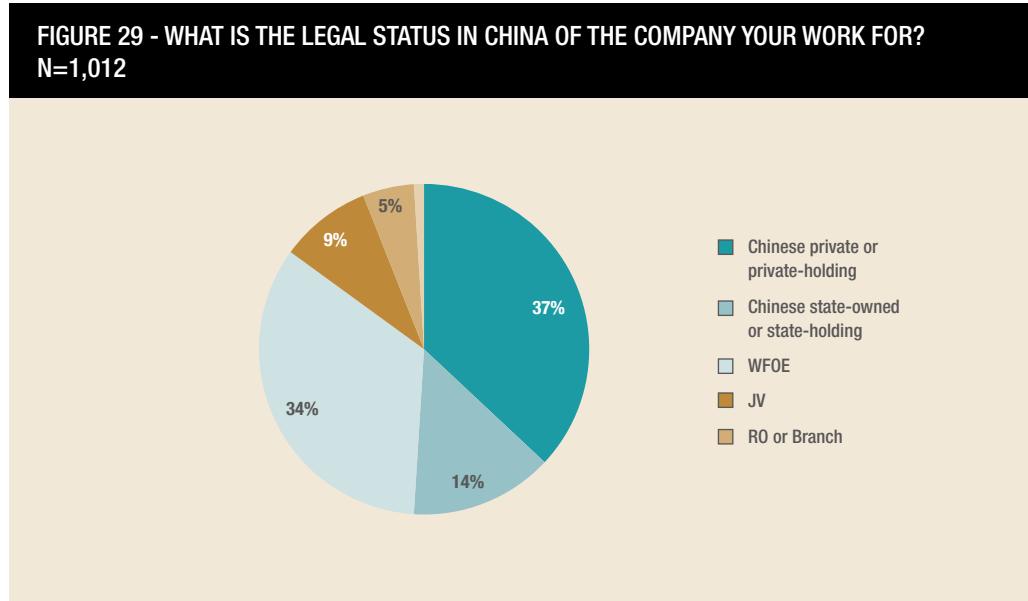
FIGURE 27 - WHERE DOES YOUR COMPANY HAVE OPERATIONS?



Foreign-owned firms are overall larger in their global operations than Chinese-owned firms. 84% of the surveyed foreign companies with international operations are large (34% with 300-9,999 employees, 50% with >10,000) vs. 21% of their Chinese-owned counterparts. Chinese international firms in our survey fall mostly within the small and medium categories (30% with < 300 employees, 49% with 300-9,999)<sup>5</sup> (Figure 28).

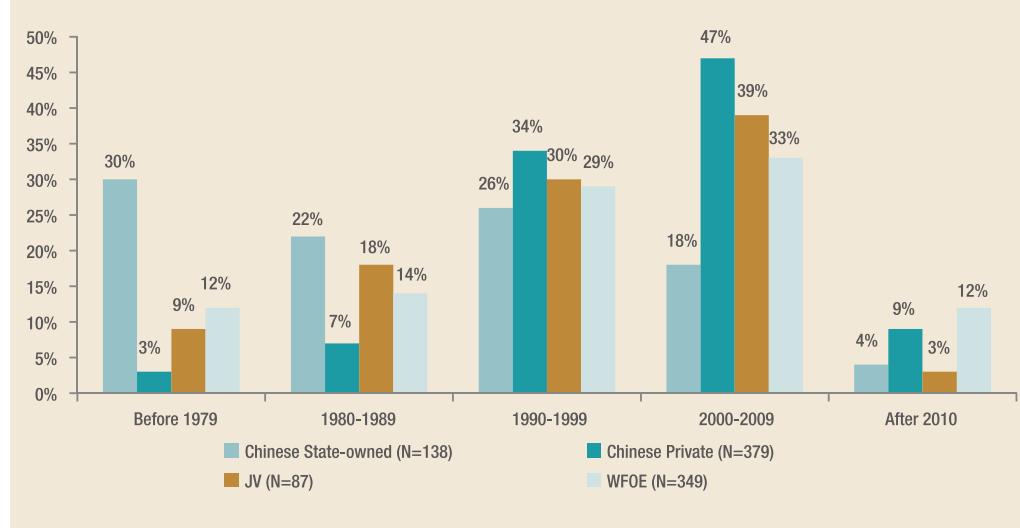


37% of surveyed companies are Chinese privately owned or private-holding companies and 14% are state-owned or state-holding enterprises. Joint Ventures (JV) constitute 9% of the sample, with different levels of Chinese and foreign ownership. Most of the foreign-owned companies are Wholly Foreign Owned Enterprises (WFOE, 34% of total sample), with Representative Offices (RO) and Branches of foreign companies making up the rest (Figure 29).



<sup>5</sup> 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 30 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?





# SECTION 2

# BUSINESS INDICES

In this report, we are using two Business Performance Indices to measure directional and performance variation compared to the previous year.

These two Business Confidence Indices give an absolute reading on the degree of optimism and confidence among respondents.

#### Business Performance Indices include:

- 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<sup>6</sup>.

Business Confidence Indices include:

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

The Business Confidence Index is a measure of the optimism stated by executives in our sample with respect to the evolution of their businesses for the next year (2014) and the next 5 years (2014 to 2018).

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

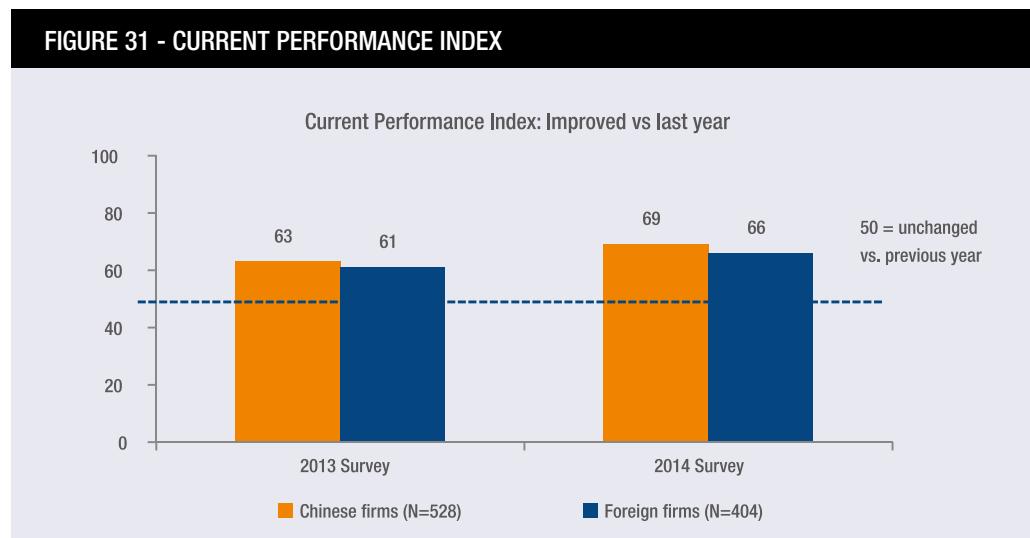
These 2 indices have been part of the CEIBS Business in China Survey since its inception 4 years ago, which allows us to start recognizing emerging trends as well as current values.

<sup>6</sup>  $INDEX = (P1*1) + (P2*0.75) + (P3*0.5) + (P4*0.25) + (P5*0)$   
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 with performance improved from last year.*

The Current Performance Index is 69 for Chinese companies and 66 for foreign companies, reflecting an improvement for both types of firms in their 2013 business results when compared to 2012, 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 up from last year for both groups (63 and 61 respectively last year), implying higher growth in sales and profit in 2013 than in 2012 (Figure 31).



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

**Revenues:** More than half the companies surveyed stated positive revenue growth for 2013 (69% of companies, both Chinese and foreigners) and 20% stated almost the same as last year. Amongst businesses experiencing slow down, 11% stated lower revenues, an improvement compared to 18% last year.

**Profit:** Overall, 76% of the companies in the sample declared being profitable or very profitable in 2013, while 9% incurred losses, a situation very similar to last year's survey. The situation was better for Chinese companies with 82% of them being profitable in 2013, vs. 70% of foreign firms. 7% of Chinese companies and 12% of foreign companies surveyed reported losses (similar level to 9% and 14% last year).

FIGURE 32 - HOW DOES YOUR COMPANY'S SALES REVENUE IN CHINA IN 2013 COMPARE TO 2012 RESULTS?

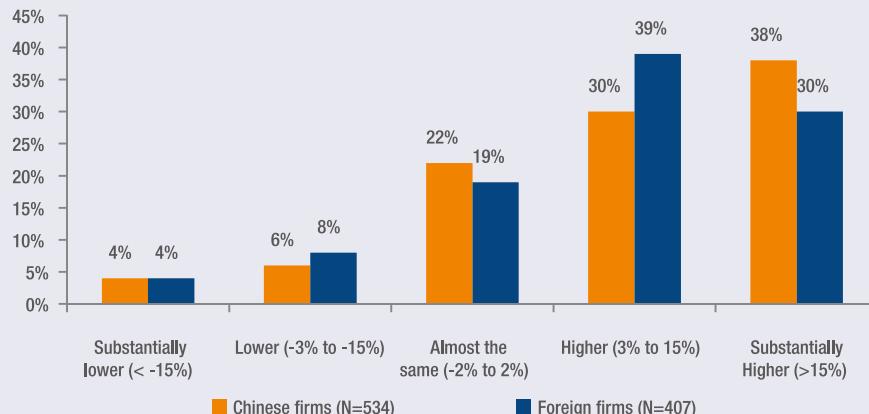
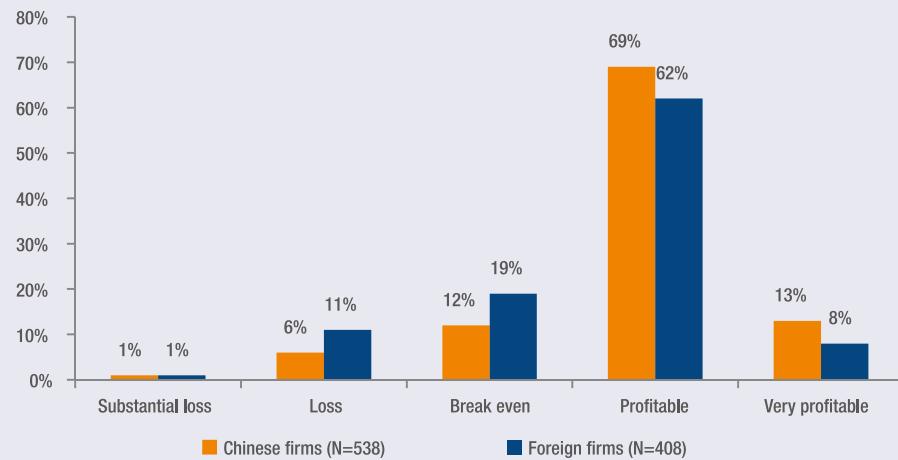


FIGURE 33 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2013?

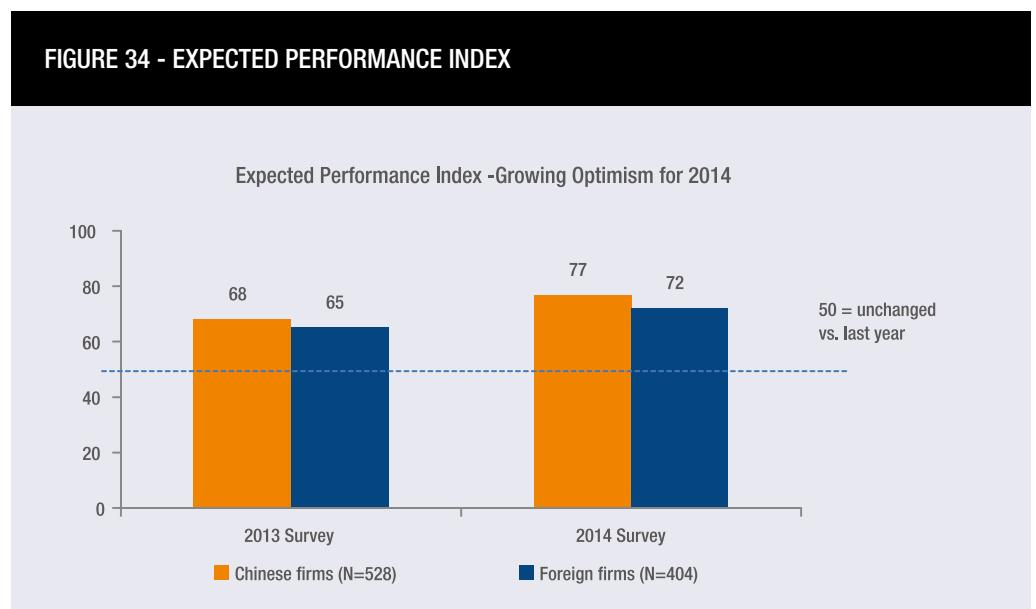


## 2.2. EXPECTED PERFORMANCE INDEX – EPI

### *Growing optimism for 2014*

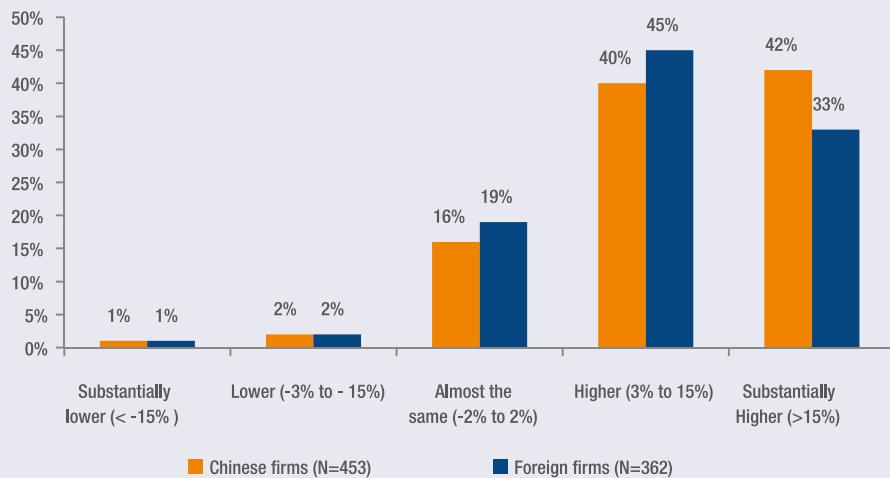
A majority of the Companies surveyed are optimistic for the 2014, more so than they were for 2013 in last year survey. The Expected Performance Index amounted to 77 (Chinese companies) and 72 (foreign companies), reflecting an expected better 2014 performance than 2013 for both types of companies (an index above 50 indicates an improvement, the further away from 50 the index is, the stronger the change over the period). Of the total sample, 80% of executives expect their company sales in 2014 to be better or much better than in 2013 (only 3% expect a decline) and 64% of executives expect their company profit level to be better or much better (only 6% see profits decreasing in 2014).

Last year survey's Expected Performance Index was lower than this year's for both groups: 68 for Chinese companies and 65 for foreign companies. These results indicate improved performance and expectations of companies in 2013 when compared to 2012. Chinese firms seem more optimistic and expect better results than foreign ones (Figure 34).



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.

FIGURE 35 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES IN 2014 COMPARED TO 2013?



This optimism is reflected in planned investments in China, as 69% of the total sample of companies declares an intention to increase investment in China in 2014 with only 1% of total respondents anticipating decreases in investments. Moreover, 94% of total sample of companies plan to increase or maintain marketing and sales budgets as percentage of revenues; among those companies having production facilities in China, 96% will either increase or maintain current capacity, and among those companies having R&D in China, 98% will either increase or maintain current R&D investments in the next 3 years (Figures 36 to 39).

FIGURE 36 - WHAT INVESTMENTS DO YOU PLAN FOR 2014 IN CHINA?<sup>7</sup>

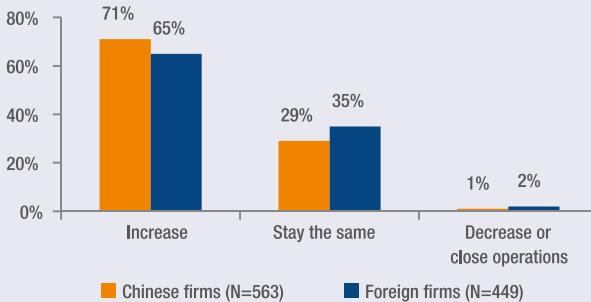
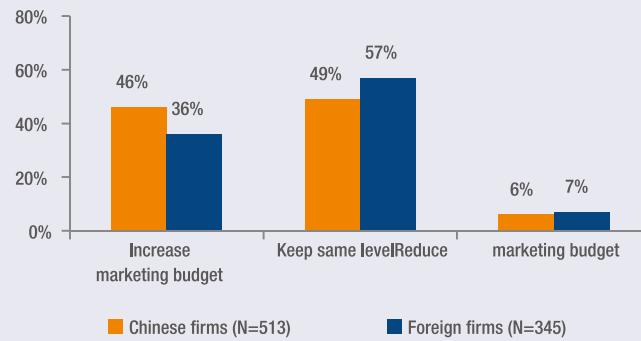
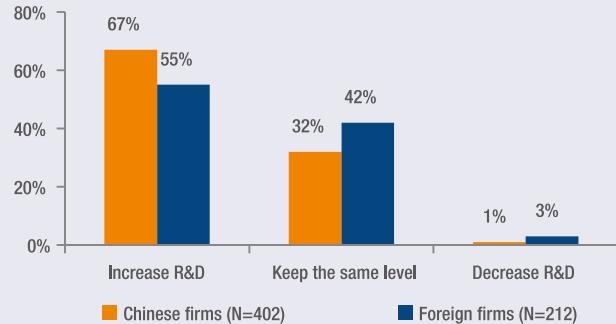


FIGURE 37 - MARKETING & SALES AS % OF REVENUES: WHAT ARE YOUR PLANS FOR 2014?

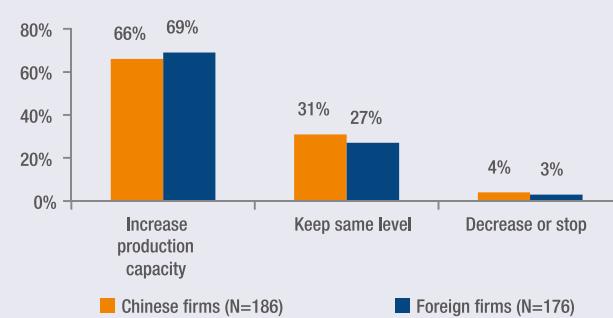


<sup>7</sup> Due to rounding, % totals may not add up to 100%

**FIGURE 38 - R&D AS % OF REVENUES: WHAT ARE YOUR PLANS FOR THE NEXT 3 YEARS?**

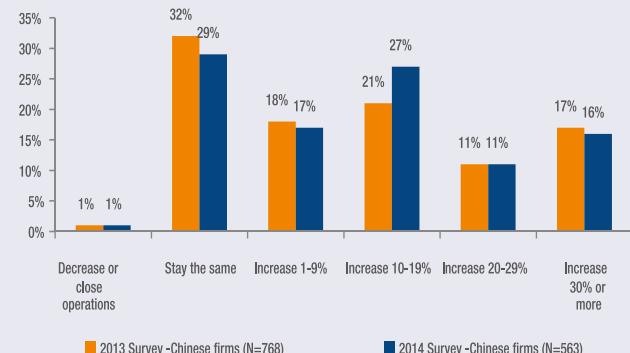


**FIGURE 39 - WHAT ARE YOUR PLANS FOR PRODUCTION CAPACITY IN CHINA IN THE NEXT 3 YEARS?**

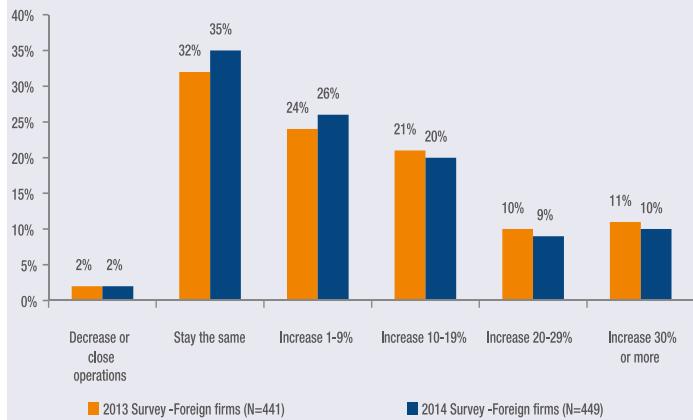


When comparing to last year's survey investment intentions, we observe that 71% of Chinese-owned firms plan to increase investment in China in 2014 vs. a lower 67% of them responding to increase investments for 2013 in last year's survey. For foreign firms, increase investment intentions remain similar to last year's survey (Figures 40 and 41).

**FIGURE 40 - CHINESE-OWNED FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR 2013 IN CHINA? (2013 SURVEY) / WHAT INVESTMENTS DO YOU PLAN FOR 2014 IN CHINA? (2014 SURVEY)**



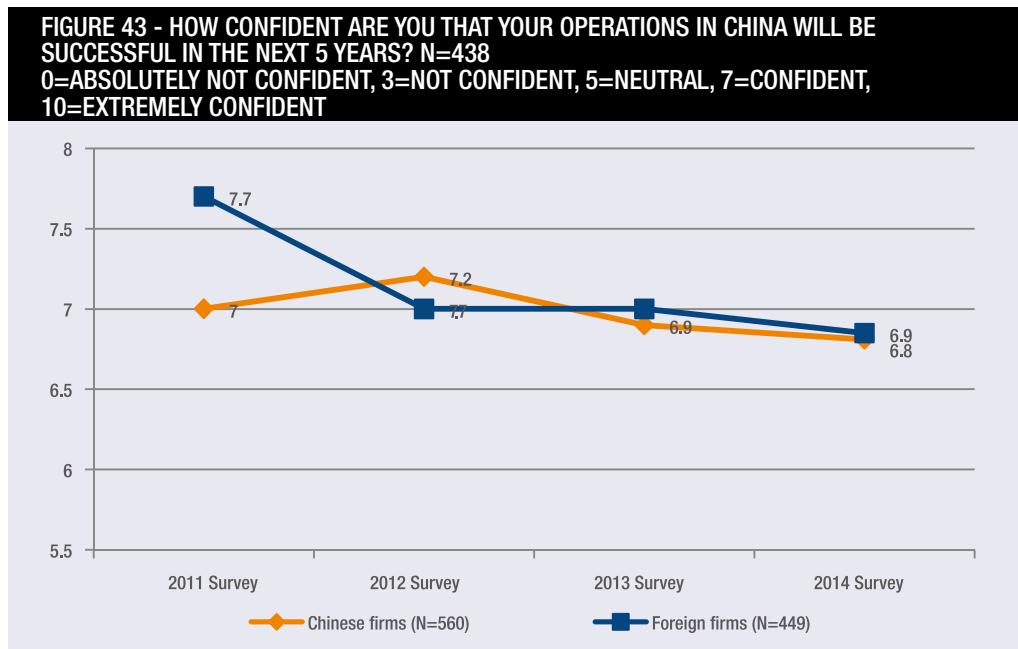
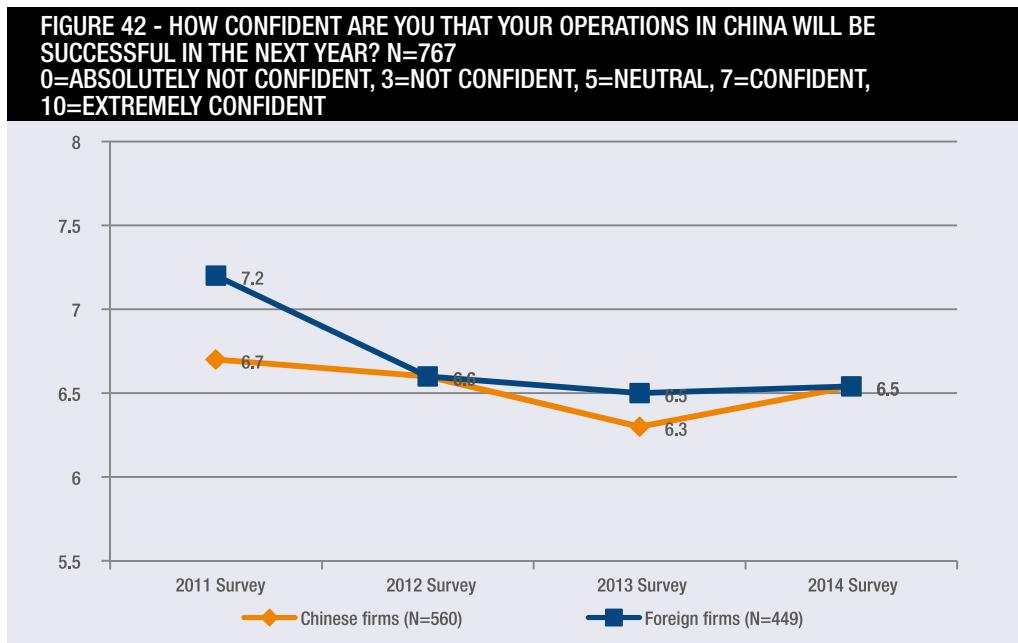
**FIGURE 41 - FOREIGN-OWNED FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR 2013 IN CHINA? (2013 SURVEY) / WHAT INVESTMENTS DO YOU PLAN FOR 2014 IN CHINA? (2014 SURVEY)**



## 2.3. BUSINESS CONFIDENCE INDICES – BCI

**Optimistic view for the next year and the next 5 years. Gaps are closing and levels are stable.**

In the current issue of the CEIBS Business in China Survey we observe how Chinese and foreign firms show identical levels of business confidence as both claim to be close to “confident” that their operations in China will be successful in the next year and in the next 5 years (Figure 44 and 43).

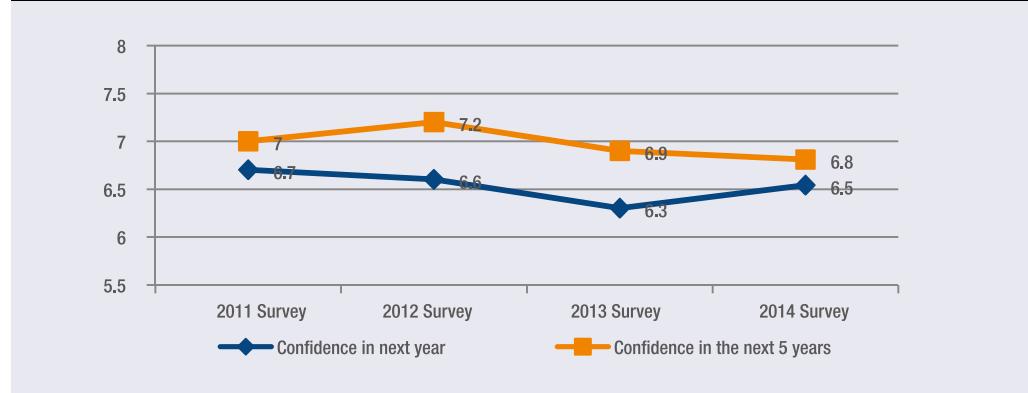


The gap in business confidence between foreign-owned firms and Chinese-owned firms has been narrowing during the 4 years covered by this survey until reaching equal levels this year. This trend applies both to confidence in the next year and in the next 5 years.

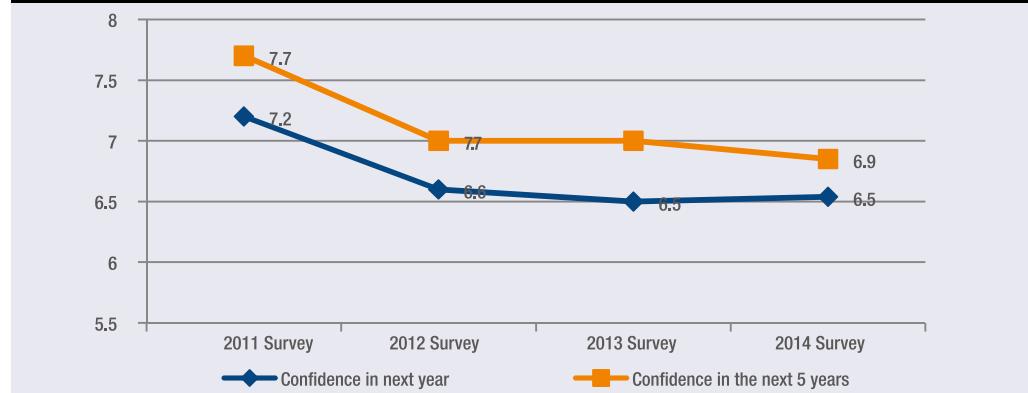
In 2010, for the first issue of this survey, China was still growing strong under the effect of the 2008-2009 Chinese economic stimulus plan that was scheduled to finish by end of 2010<sup>8</sup>. The Chinese market was very attractive to foreign firms when compared to their home economies and they probably remained overly optimistic by 2010. On the other hand, Chinese firms were more aware of the real situation of the Chinese economy and were already forecasting lower growth. By last year's edition of this survey, foreign firms had adjusted to the more difficult reality of the Chinese economy and therefore, levels of confidence had decreased. On the other hand, Chinese companies were in 2012 under the uncertainty brought by the political changes and showed hesitation for the near future. This situation has been corrected in this year's edition with Chinese firms showing an increased confidence for 2014.

Previous editions of this survey had shown both Chinese and foreign firms having more confidence in their success in the medium term than in the immediate future. In this year's 4<sup>th</sup> edition, although this gap still exists, it has narrowed. This may mean that executives in our sample believe that Chinese economy is approaching a point of stability. They still expect to see improvements and growth over the next 5 years but maybe not as steep as in the past.

**FIGURE 44 - CHINESE FIRMS - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS?**



**FIGURE 45 - FOREIGN FIRMS - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS?**



<sup>8</sup> RMB 4 trillion stimulus package issued by the Chinese Government to minimize the impact of the global financial crisis



## SECTION 3

# CHALLENGES AND SUCCESS FACTORS

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

- External Challenges
- Managerial Challenges
- Success factors

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

### 3.1. EXTERNAL CHALLENGES

*Rising labor costs, fierce competition and economy slowdown remain the key challenges*

The main external challenges for companies doing business in China are “Rising labor costs”, “Fierce competition”, “Economy slowdown in China” and “Government & Legal environment”. In line with the better performance indices this year we observe how both “Economy slowdown in China” and “Slowdown of the global economy” decrease in importance for our sample of surveyed companies compared to last year’s survey. On the other hand, “Government & Legal environment” becomes more prominent and enters the group of main challenges (Figure 46).



The following table reflects the evolution of the Top 3 External Challenges for both Chinese and foreign companies in the last two years. Although “Slowdown of Chinese economy” is still in the top of the external challenges, it has lost some importance for both groups compared to the 2013 Survey. 47% of Chinese firms worry about it now vs. 54% in the previous survey and 45% of foreign firms consider it to be a challenge versus 60% last year.

#### Chinese firms – Top 3 External Challenges

|   | 2014 Survey                     | 2013 Survey                     |
|---|---------------------------------|---------------------------------|
| 1 | Rising labor cost (66%)         | Rising labor cost (65%)         |
| 2 | Fierce competition (59%)        | Fierce competition (55%)        |
| 3 | Economy slowdown in China (47%) | Economy slowdown in China (54%) |

#### Foreign firms – Top 3 External Challenges

|   | 2014 Survey                     | 2013 Survey                     |
|---|---------------------------------|---------------------------------|
| 1 | Rising labor cost (61%)         | Economy slowdown in China (60%) |
| 2 | Fierce competition (59%)        | Fierce competition (59%)        |
| 3 | Economy slowdown in China (45%) | Rising labor cost (57%)         |

“Slowdown of global economy” also loses importance for both groups compared to the previous edition of the survey, worrying 17% of the Chinese firms (vs. 29% last year) and 27% of foreign firms (vs. 36% last year). Foreign companies surveyed are relatively more affected by global economy slowdown than Chinese ones, which is due to larger global exposure of foreign companies in our sample (79% of the foreign firms surveyed have global operations, vs. a much lower 34% of the Chinese firms)

While worries over economic slowdown decrease, concerns about “Government and legal environment” increase, mainly for foreign companies, from 28% of firms concerning about it last year to 41% this year.

Overall, differences in the weight of the different factors by Chinese and foreign firms have been reduced from last year. However, “IP Infringements” worry 17% of executives working for foreign firms vs. a lower 8% 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 (see Section 4.2.2).

### 3.2. INTERNAL CHALLENGES

*Finding and retaining talent still a top concern for both Chinese-owned and foreign-owned firms. Innovation capability a greater concern for Chinese firms vs. support from head office for foreign owned firms.*

Most cited internal management challenge faced by companies operating in China is “Finding and retaining talent” (63% of respondents in Chinese companies and 67% in foreign companies). This is consistent with previous surveys. However, we observe a slight improvement vs. last year survey where it was cited by a higher 72% of Chinese firms and 70% of foreign firms.

The next set of concerns more often encountered are “Innovation Capability” (42% of total sample) and “Marketing Capability” (34%). However, we note important differences between Chinese and foreign firms in our sample.

While “Innovation capability” worries 50% of the Chinese firms surveyed, it is a concern for a lower 31% of foreign firms. In a similar way, 38% of Chinese firms worry about “Marketing capability” vs. 29% of foreign ones. This may be due to the fact that Chinese companies in our sample are younger and smaller, in general, than foreign ones (80% of foreign companies surveyed have global operations as well, compared to a lower 30% of Chinese firms), and therefore are still learning these capabilities.

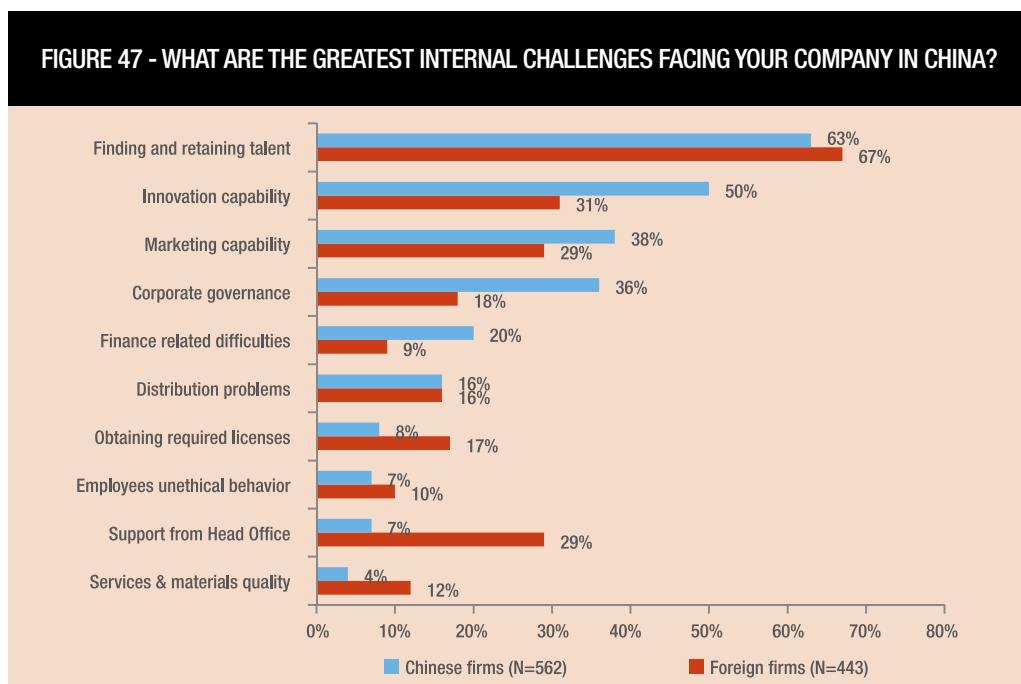
The gap between the two groups is even wider in the case of “Corporate governance”, which is a challenge for 36% of the executives working for Chinese firms but only for 18% of those working for foreign companies, as was already observed in last year’s survey. Foreign companies tend to have these systems already in place, while many Chinese firms have only been putting them in place recently. This being said, there seems to be an improvement vs. last year’s survey 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 29% of them, and at same level as marketing and innovation capability. A much lower 7% of Chinese firms consider it to be a challenge, suggesting that distance matters. “Obtaining required licenses” is a challenge for 17% of foreign firms vs. 8% of Chinese ones.

“Finance related difficulties” is a worry for 20% of the Chinese firms vs. 9% of the foreign ones (see Section 5.2 for more details on these issues).

“Distribution problems” is the next difficulty in the list as reaching target clients and consumers in different areas of China proves to be a challenge for 16% of both Chinese and foreign firms. There seems to be a direct relationship with headquarter location as distribution problems increase with distance to coastal China: 14% of firms in coastal areas vs. 20% of those in central China and 33% in West China. Overall, distribution problems have improved slightly vs. last year’s survey when 26% of Chinese firms and 22% of foreign firms were concerned about it.

“Services and materials quality” worries 12% of foreign companies in our sample vs. only 4% of Chinese firms. This is consistent with the fact that foreign companies in China are often positioned in the higher end of the market and the quality of the end product depends on quality of the input. Specifically for our survey sample, 63% of the foreign-owned companies operate in the premium segment of the market versus 37% for the Chinese-owned ones.

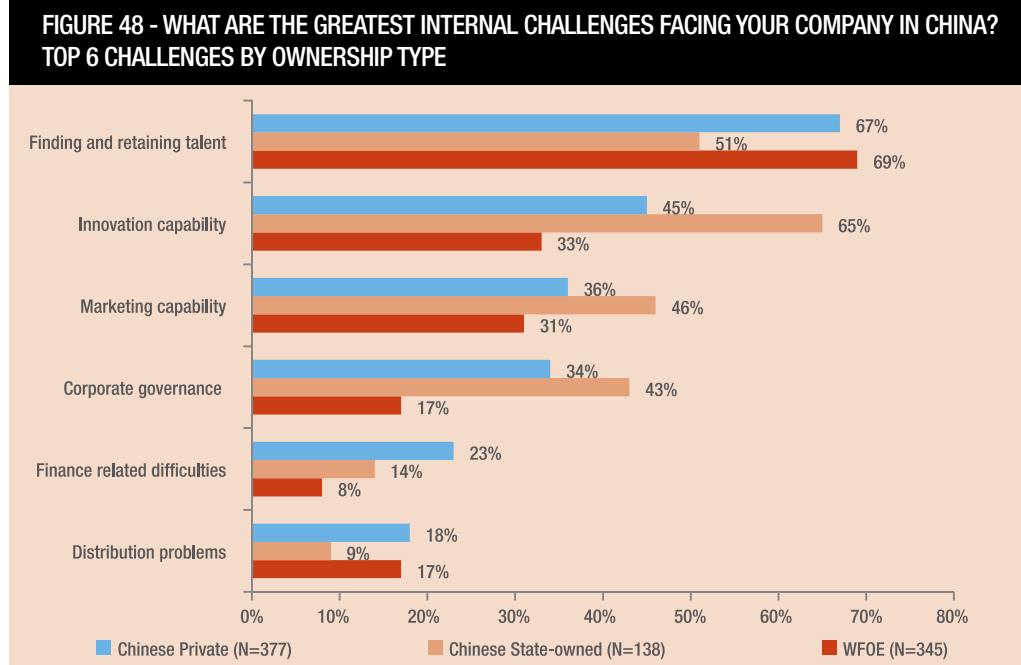


When we evaluate the top 6 internal challenges according to the type of company, taking only the 3 main types of companies surveyed (Chinese private and private holdings, Chinese state-owned and WFOE), we observe that Chinese private firms perceive most of these challenges in a similar way to foreign ones, setting Chinese state-owned companies apart.

“Finding and retaining talent” is an issue for more Chinese private and foreign companies than it is for state-owned companies.

“Innovation and Marketing capabilities” is a challenge for more state-owned companies than it is for Chinese private or foreign firms. This is also the case for ‘Corporate governance’. On the other hand, “Finance related difficulties” touches a higher proportion of Chinese private firms compared to state-owned ones.

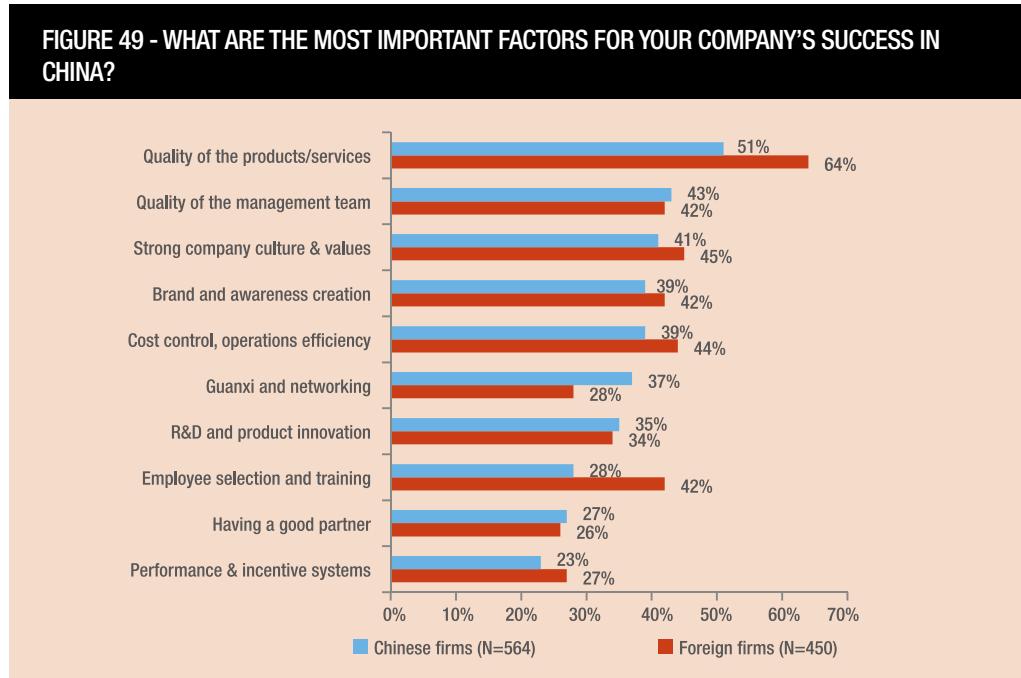
“Support from Head Office” is an issue for 28% of WFOEs vs. a much lower 4% Chinese private firms, and 12% of state-owned companies.



### 3.3. SUCCESS FACTORS

*Not a single key to success, but a complex recipe of factors.*

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 quality of the management team and company culture & values, and to capability factors such as brand creation, R&D and product innovation and running operations efficiently.



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 (65% of foreign firms vs. 51% of Chinese firms). This is consistent with the fact that 63% of foreign companies in the sample operate in premium segment versus a lower 37% of Chinese ones. Also, as we develop later in Section 4.2, foreign firms innovate more often their products and services than Chinese ones (75% vs. 69%).

However, when digging deeper into the type of company, we observe notable differences: while 65% of executives working for WFOEs consider “quality of products and service” to be a key success factor, a lower 54% of those working in Chinese private companies and 41% in Chinese SOEs agree. On the other hand, the two success factors most often cited by state-owned firms are “Brand awareness and creation” (49%) and “Guanxi and networking” (47%)

“Guanxi and networking” is emphasized more by Chinese companies than by foreign ones (37% of Chinese vs. 28% of foreign firms), and in particular by state-owned companies (47% of SOEs, 35% of Chinese private firms and 23% of WFOEs)

“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).



## SECTION 4

# FOCUS BY TOPIC

This section gives an overview of the following topics:

- Market Environment

This chapter covers competition and regulatory environment and Government related issues affecting companies operating in China. It includes a new section on Shanghai Free Trade Zone.

- Innovation, R&D and Intellectual property

This chapter covers how companies in our survey address innovation in China. It provides an overview of the types of innovations more frequently introduced, and gives the perspective from our sample of executives on IPR protection in China.

- China/Global Focus

This chapter gives an in-depth commentary on the weight that China has in the global operations of the foreign-owned firms in our sample, and how this weight is evolving versus previous years. Likewise, we analyze the importance of international expansion to the Chinese-owned companies in our sample.

## 4.1. MARKET ENVIRONMENT

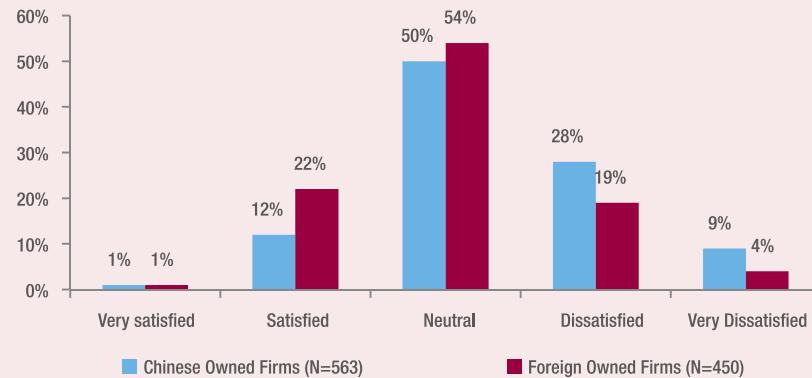
### 4.1.1. Regulatory Environment and China Government

Policies and regulations rated "moderate" to "severe constraint" for 62% of the respondents, and, government relations are considered important for business success. Satisfaction with services provided by the government is neutral to low. According to our survey, corruption is recognized as an existing and difficult to solve problem. However, respondents rate it as a lesser problem when asked about the level of corruption in their own industry or company. Overall, all companies perceive a reduction of corruption in China in 2013.

For 60% of Chinese firms and 66% of foreign firms, government policies and regulations have a moderate to severe constraint on their industry (with 20% and 16% respectively stating "severe constraint"). However, there is a minority of 11% of Chinese firms and 9% of foreign firms that find the effect of these policies and regulations helpful or very helpful.

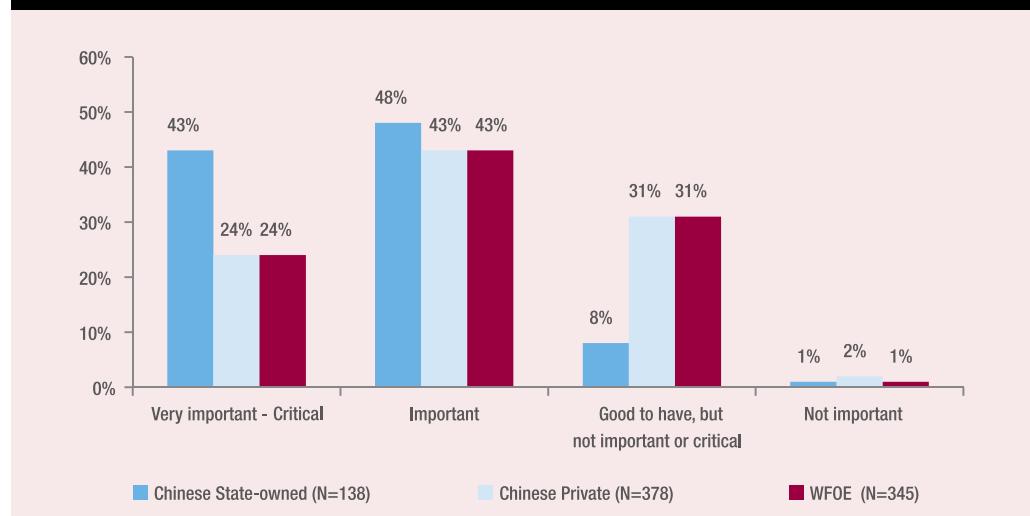
This being said, only 12% of the Chinese firms surveyed declare to be satisfied with the services provided by the Chinese government and its related agencies, compared to 22% of foreign firms. The services are judged insufficient by 37% of Chinese firms and 23% of foreign firms, who declare to be dissatisfied or very dissatisfied (Figure 50).

**FIGURE 50 - ARE YOU SATISFIED BY THE SERVICES PROVIDED BY THE CHINESE GOVERNMENT AND RELATED AGENCIES?**



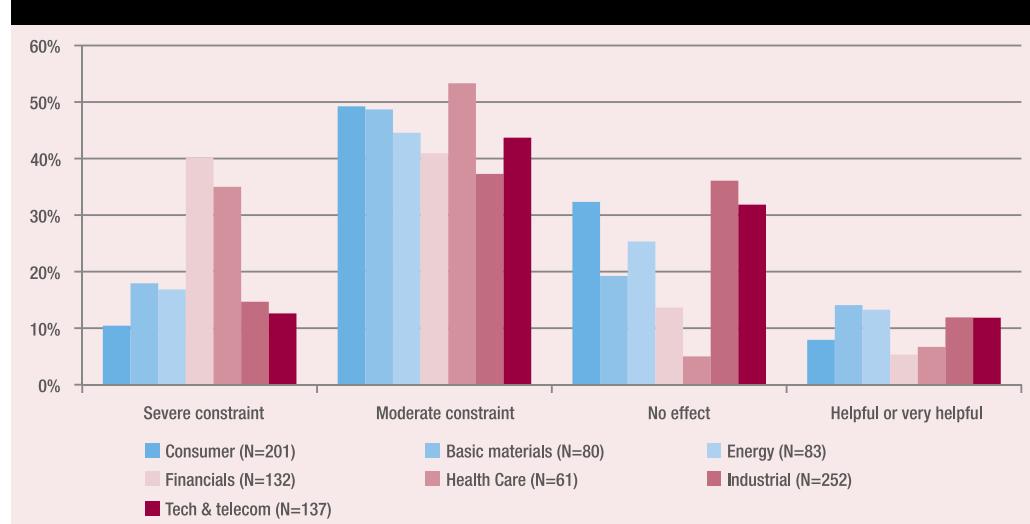
70% of the sample executives view the relationship with the Chinese authorities as important or very important to their businesses, regardless of whether they work for a Chinese or foreign firm. Moreover, 56% of the foreign-owned firms declare to allocate more or much more resources to building these relationships than in their home markets. However, it is Chinese state-owned firms that emphasize most the importance of this relationship, with 43% of them labelling it critical for business success (Figure 51).

**FIGURE 51 - HOW IMPORTANT FOR YOUR BUSINESS SUCCESS ARE THE RELATIONSHIPS WITH THE AUTHORITIES?**

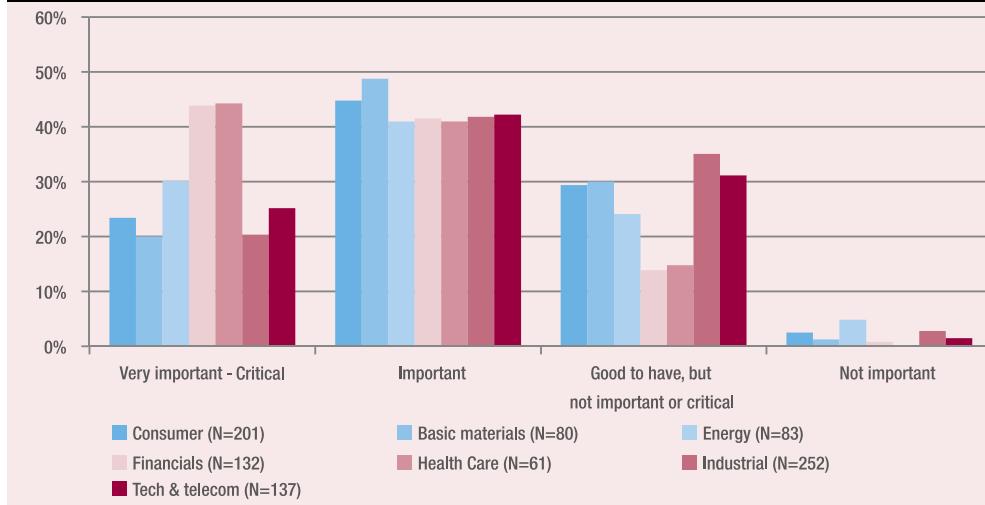


When analyzing by industry, we observe different levels of effect of government policies regulations by industry. Companies in the Financial and Healthcare industries most frequently state to be severely constrained by government policies and regulations. Moreover, 81% of surveyed firms in the financial sector and 88% of those in healthcare state to be either severely or moderately constrained by the government, vs. lower levels in other industries (51% in industrial sector, 56% in technology and telecommunications, 60% in consumer products and services, 61% in the energy sector and 67% in basic materials like chemicals and mining). It is also executives working in companies in the financial and healthcare sectors who most often claim relationship with authorities to be very important or critical for business success (Figure 52).

**FIGURE 52 - WHAT IS THE EFFECT OF GOVERNMENT POLICIES AND REGULATIONS ON YOUR INDUSTRY?**



**FIGURE 53 - HOW IMPORTANT FOR YOUR BUSINESS SUCCESS ARE THE RELATIONSHIPS WITH THE AUTHORITIES? By industry**



**Main concerns regarding the Chinese government and the legal environment:**

*Unclear and changing regulations, regional disparity in policy implementation and corruption are top concerns. Macroeconomic policy adjustment is less worrying than last year.*

Perception between Chinese and foreign firms vary slightly, and we observe certain important differences with last year's survey.

"Unclear and changing regulations" has become the government related aspect that worries most of surveyed companies in both groups. It represents a concern for 57% of Chinese firms and 66% of foreign firms, an increase from 42% and 61% respectively in last year's survey. It continues to be emphasized by more foreign firms given that they are usually less familiar with the China regulatory and legal systems.

While "Macroeconomic policy adjustment" was last year's survey top concern for Chinese firms, its appearance has been reduced considerably this year with 38% of Chinese firms and 26% of foreign firms worrying about it vs. 46% and 37% respectively last year. The consolidation of the new government in China has probably greatly reduced uncertainty in this area.

On the other hand, regional disparity of central government policy implementation has become the number two concern for both Chinese and foreign firms, with 46% and 42% of firms worrying about it in each group respectively. A considerably lower 36% of Chinese firms worried about this item last year.

"Corruption" comes next and remains in the top of the list for both groups as well as "Stricter regulations" increasingly difficult to fulfill.

"Government involvement in the economy" is also an important concern, more so for Chinese firms than for foreign ones (37% and 26% respectively). Inversely, more foreign firms worry about difficulty in obtaining required licenses than Chinese firms (36% and 29% respectively)

FIGURE 54 - WHAT ARE YOUR MAIN CONCERNs REGARDING THE CHINESE GOVERNMENT AND THE LEGAL ENVIRONMENT? MULTIPLE ANSWERS POSSIBLE.



The following table reflects the evolution of the Top 5 concerns regarding the Chinese government and the legal environment for both Chinese and foreign companies:

| Chinese-owned firms |   |   |
|---------------------|---|---|
|                     | 2014 Survey                                       | 2013 Survey                                       |
| 1                   | Unclear & changing regulation (57%)               | Macroeconomic policy adjustment (46%)             |
| 2                   | Regional disparity in policy implementation (46%) | Unclear & changing regulation (42%)               |
| 3                   | Corruption (39%)                                  | Corruption (37%)                                  |
| 4                   | Stricter regulations (39%)                        | Regional disparity in policy implementation (36%) |
| 5                   | Macroeconomic policy adjustment (38%)             | Government involvement (33%)                      |

| Foreign-owned firms |   |   |
|---------------------|---|---|
|                     | 2014 Survey                                       | 2013 survey                                       |
| 1                   | Unclear & changing regulation (66%)               | Unclear & changing regulation (61%)               |
| 2                   | Regional disparity in policy implementation (42%) | Corruption (45%)                                  |
| 3                   | Corruption (39%)                                  | Regional disparity in policy implementation (39%) |
| 4                   | Stricter regulations (39%)                        | Macroeconomic policy adjustment (37%)             |
| 5                   | Obtaining licenses (36%)                          | Stricter regulations (33%)                        |

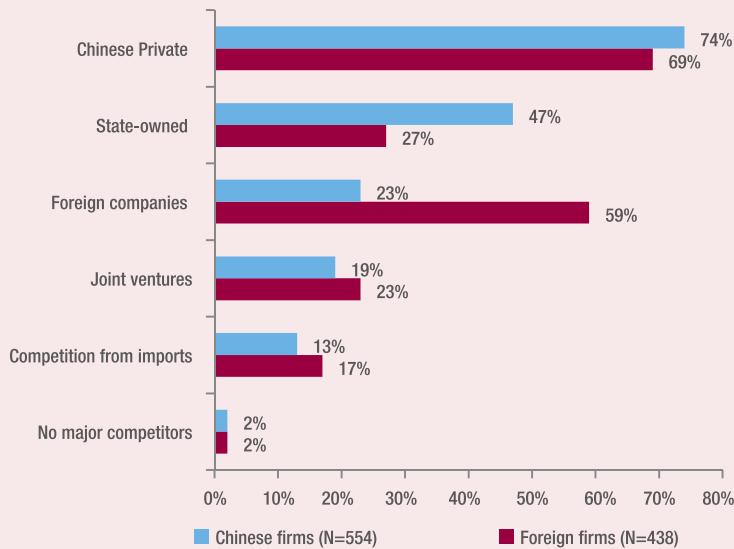
#### 4.1.2. Competitive Environment and Market Advantages

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

Competition remains very intense for both Chinese-owned and foreign-owned companies with no significant differences in their views. 87% of total surveyed companies consider they are facing intense or very intense competition in China (up from 80% two years ago), with only 2% considering competition as “not intense”.

A majority of respondents cited their main competitors to be Chinese private enterprises (74% of Chinese firms and 69% of foreign firms). Chinese-owned respondents cite State-owned enterprises as a distant second (47%). In contrast, foreign companies measure themselves also amongst each other, citing WFOE (60%) close to Chinese private enterprises as their major type of competitors. These results are consistent with previous surveys (Figure 55).

FIGURE 55 - WHO ARE YOUR MAIN COMPETITORS IN CHINA? (MULTIPLE ANSWERS)



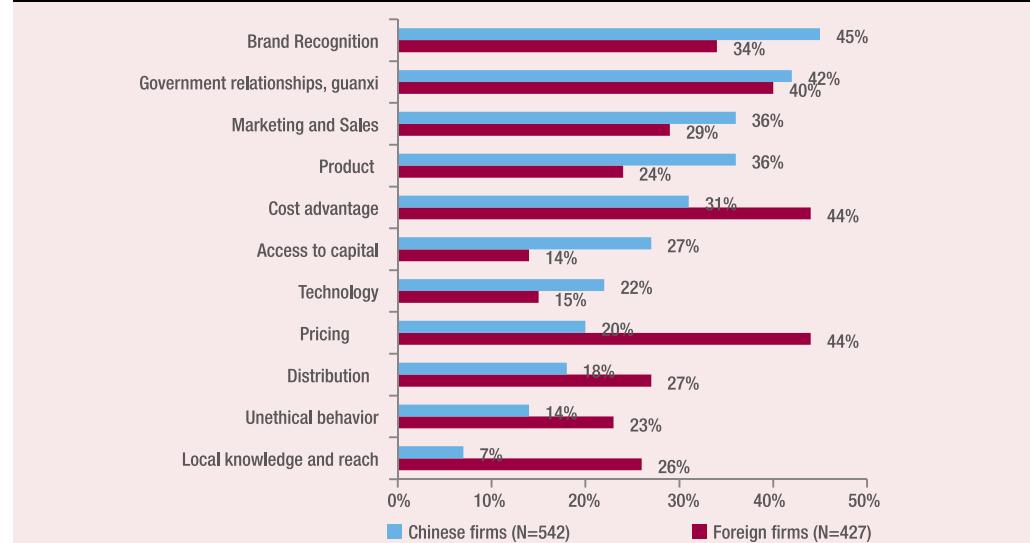
The top strengths of competitors cited by Chinese firms relate to their product or service and the way they are marketed: “Brand recognition” (45%), “Relationships with Government and other guanxi” (42%), “Marketing and Sales” (36%) and “Product” (36%).

In contrast, foreign-owned firms consider that their main weaknesses vis-à-vis their competitors lay in competitors’ superiority in “Price” (44%), “Cost advantages” (44%), and “Relationships with Government and other guanxi” (40%).

“Unethical behavior” is seen as competitor’s strength by 23% of foreign-firms in the sample vs. a lower 14% of the Chinese ones. Foreign companies sometimes claim that they apply stricter environmental control policies in their production sites, thus increasing their costs.

“Local knowledge and reach” is seen as competitor’s strength by 26% of foreign-firms in the sample vs. only 7% of the Chinese ones.

**FIGURE 56 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN COMPETITORS IN CHINA? (MULTIPLE ANSWERS)**



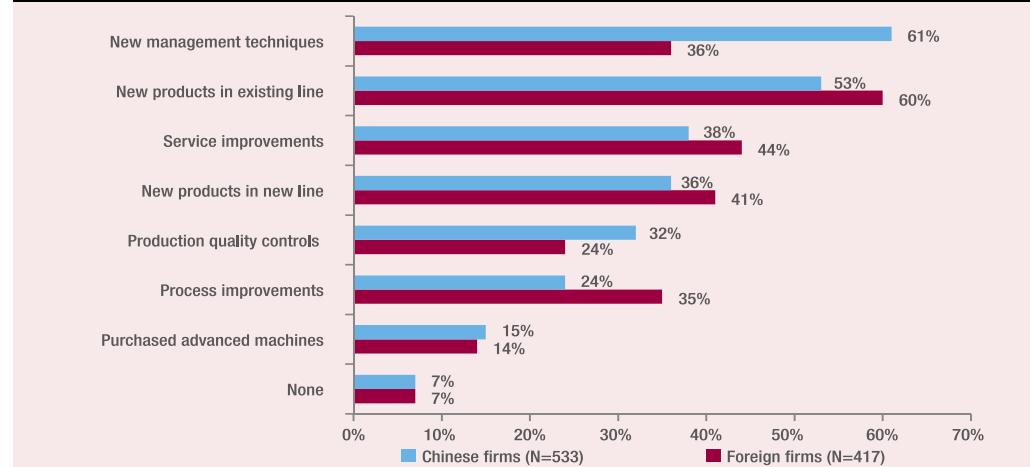
## 4.2. INNOVATION, R&D AND INTELLECTUAL PROPERTY IN CHINA

*Surveyed companies introduced innovations not only at product and service level but also in new forms of management. A majority of surveyed firms intended to increase their R&D investment in the next three years, with Chinese private firms leading. Infringement of intellectual property rights is still an issue and is considered damaging to the business for most of respondents.*

### 4.2.1. China Innovation and R&D in 2013

Large numbers and types of innovations were introduced by both Chinese and foreign-owned companies in 2013. Most frequently mentioned are innovations in management techniques and introduction of new products or services in existing lines. Service improvements and introduction of new lines of products and services are also mentioned as an important source of innovation in 2013. Companies, especially foreign-owned ones, have also been working in process improvements (Figure 57).

**FIGURE 57 - WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED SINCE THE BEGINNING OF 2013? (MULTIPLE ANSWERS)**



More than 60% of the total pool of companies has innovated in their products or services in 2013. This is in line with the fact that 65% of the firms surveyed (76% of Chinese-owned firms and 51% of foreign-owned firms) have R&D activities in China.

We notice that 61% of Chinese-owned firms in our sample are focusing on implementing “New management techniques” (vs. 36% of foreign firms), reflecting the overall effort that Chinese companies all over the country are making to develop their managerial systems and catch up with their international competitors in this respect. As we saw in Chapter 3.6, more Chinese firms than foreign ones are concerned about managerial capability, in the different departments and functions. Likewise, the work that Chinese firms are doing upgrading their product quality is reflected in this survey as 32% of Chinese firms have innovated in “Production quality controls” (vs. 24% of foreign firms).

In contrast, 35% of foreign-owned companies in our sample have innovated in “Process improvements” versus 24% of the Chinese-owned ones. This reflects the importance of efficiency and cost control for foreign firms given the competitive environment and, according to survey results, the fact that they consider strength of their competitors to have lower costs and prices.

The investment in R&D in 2013 varied largely with roughly one third of companies with R&D in China (612 in total, 65% of total surveyed firms) investing less than 2% of revenues, another third spending between 2 and 5 %. However, 63% of respondents intend to increase and expand their R&D investments in China in the next 3 years.

When looking at R&D spending by type of company (Figure 58), we observe that foreign companies in our sample spend a higher proportion of their revenues in R&D (41% spend more than 5% of revenues in R&D), followed closely by Chinese private firms (36% spend more than 5% of revenues in R&D). State-owned firms lag behind with 20% of them spending more than 5% in R&D. This being said, state-owned firms in our sample are larger than other types of firms (85% of state-owned companies surveyed have more than 300 million RMB in revenues in 2014 vs. a lower 47% of Chinese private firms and 57% of WFOEs ), and we also observe an inverse relationship between size and % of revenues spent in R&D amongst companies in our sample.

In terms of their plans for the next 3 years, 71% of Chinese private firms surveyed plan to increase R&D vs. a lower 62% of state-owned firms and 55% of foreign WFOEs (Figure 59).

FIGURE 58 - WHAT IS YOUR ANNUAL EXPENDITURE IN R&D AS A % OF REVENUES? N=658

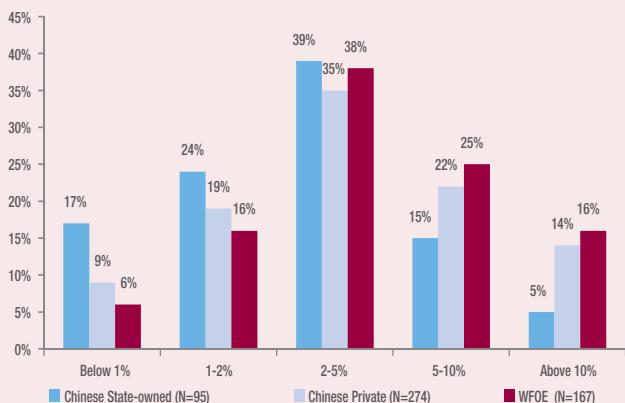
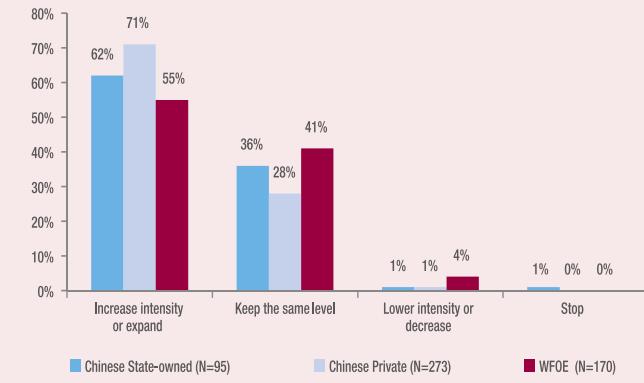


FIGURE 59 - WHAT ARE YOUR PLANS FOR THE NEXT 3 YEARS? R&D

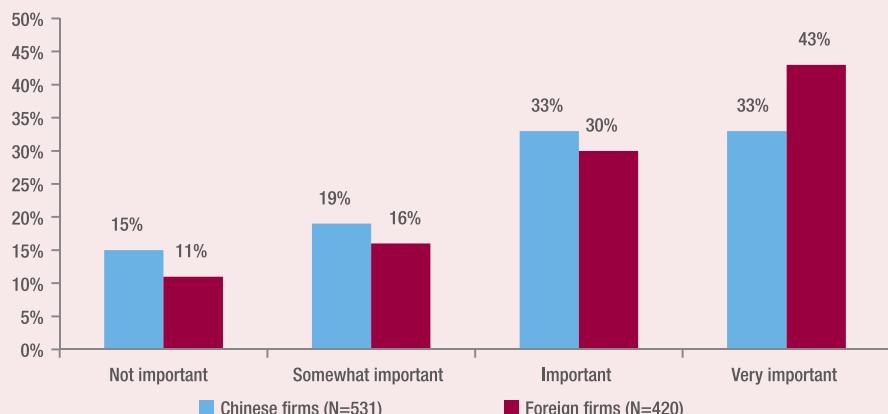


#### 4.2.2. Intellectual Property in 2013

*IP infringements remain damaging to business while no perceived improvement versus last three years. Chinese competitors are most often the perpetrators.*

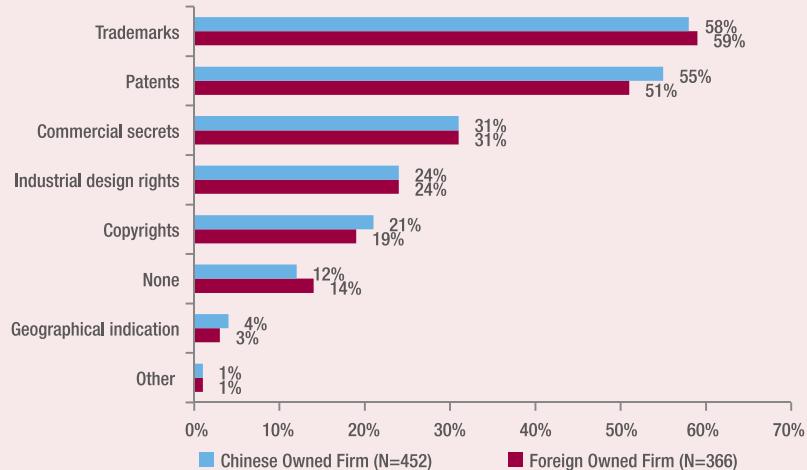
Intellectual Property is important for all businesses in China and this is true for most companies (only 13% of the total sample of firms qualify it as not important). However, a larger proportion of foreign-owned companies (44%) rate it as very important (vs. 33% of their Chinese counterparts).

FIGURE 60 - HOW IMPORTANT IS IP (INTELLECTUAL PROPERTY) TO YOUR BUSINESS IN CHINA?



As we can see below, Trademarks and Patents are the most commonly owned types of IP in China, followed by commercial secrets and copyrights.

FIGURE 61 - WHAT TYPE OF IP DO YOU OWN IN CHINA? MULTIPLE ANSWERS POSSIBLE



IPR infringement is still an issue in China with only 21% of the total sample claiming to never have suffered from it. The vast majority of the firms in our sample consider IP infringement to be damaging their business: 65% claim some damage and 21% claim serious or very serious damage.

Moreover, the opinion of the firms in our survey is that there has been little or no improvement in the last 3 years regarding IPR infringements. Over the total sample, only 9% of firms surveyed believe that the amount of IP infringement in their business in China has decreased during the past 3 years; for 64% of firms there has been no variation while 28% believe that it has gotten worse. We observe similar responses among Chinese and foreign firms (Figure 62).

However, there seems to be a positive feeling growing amongst Chinese companies surveyed regarding the efforts of the Chinese government to solve this issue: 57% of respondents working for Chinese firms describe IP protection from the government in the past 3 years to be better or much better, contrasting with a lower 44% of foreign firms (Figure 63).

FIGURE 62 - COMPARED WITH THE PAST 3 YEARS, WOULD YOU CONSIDER THAT THE AMOUNT OF IP INFRINGEMENT IN CHINA IN YOUR BUSINESS HAS:

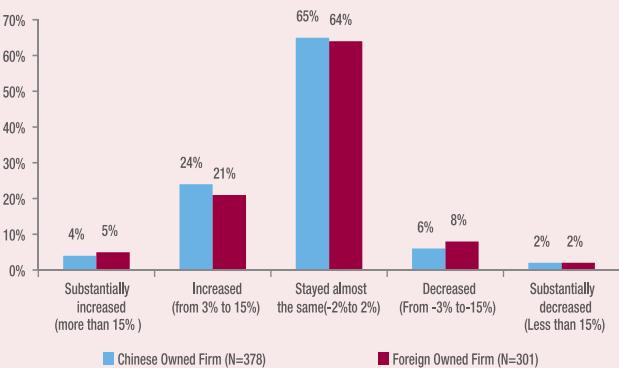
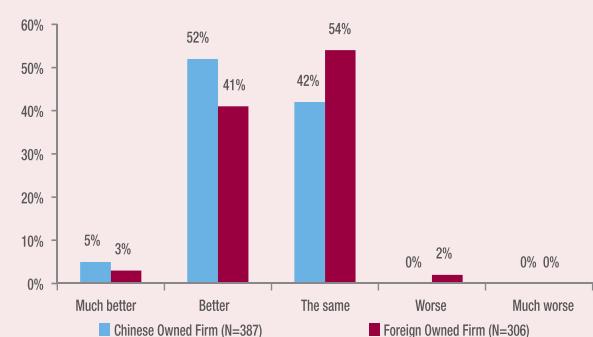


FIGURE 63 - IN THE PAST 3 YEARS, HOW DO YOU DESCRIBE THE IP PROTECTION FROM THE GOVERNMENT IN CHINA?



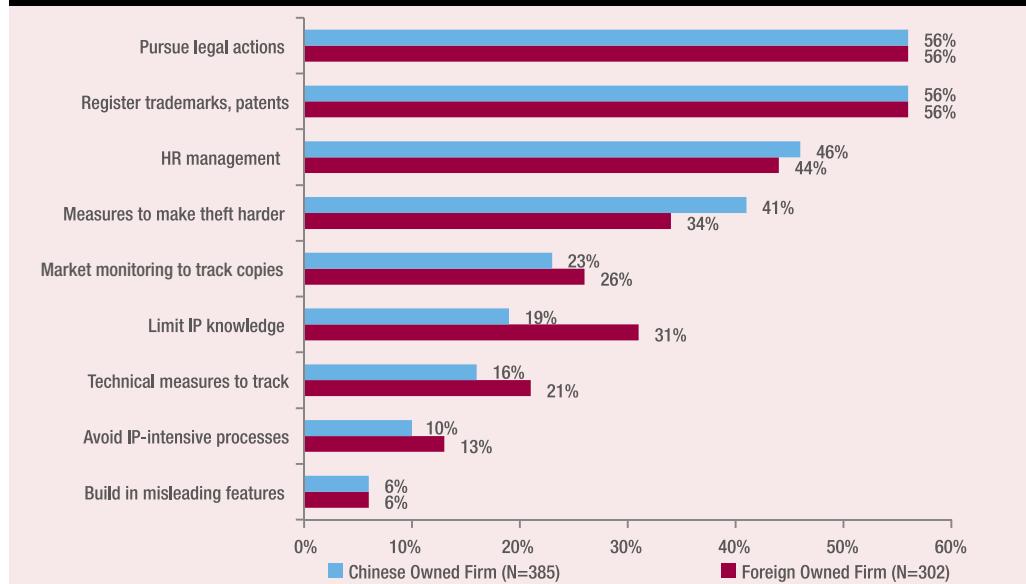
IP infringement perpetrators are Chinese competitors for 79% of the executives surveyed. 26% answered that perpetrators are often employees, followed by clients (21%), suppliers (18%), and with lower frequency foreign competitors and JV partners (8% and 7% respectively).

Although the above is true for both Chinese-owned and foreign-owned firms, we do observe some differences: Employees are reported to be IP infringers for 30% of the Chinese-owned firms compared to 21% of the foreign-owned firms, while suppliers are considered infringers by 21% of the foreign firms vs. 15% of Chinese firms.

The measure most favored by executives to protect their IP in China is the combination “Trademark registration or patent filing in China” and “Pursuing legal actions against infringers” (56% of answers) for both. A third measure to fight IP infringement is HR management (44% of the surveyed executives), such as IP specific clauses in employment contracts and company regulations, screening job applicants for honesty and IPR training.

Another popular course of action (34% of answers) is to take measures to make the theft of commercial secrets harder and therefore reduce infringement. This measure is favored more by Chinese firms (41% of respondents) than foreign firms (34%)

FIGURE 64 - WHICH ARE THE MOST EFFECTIVE MEASURES YOU USE TO PROTECT YOUR IP IN CHINA?



## 4.3. CHINA / GLOBAL FOCUS

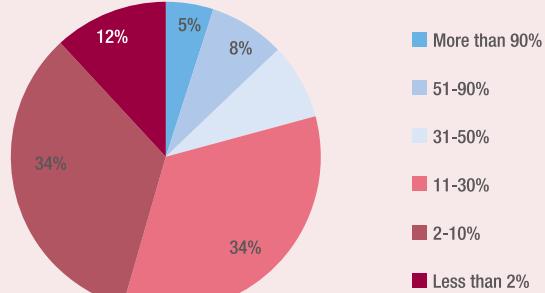
### 4.3.1. China focus for foreign-owned firms

*China is within the Top 3 global investment priorities for most of foreign firms surveyed, with investments expected to increase for 65% of them. Still, China's weight in global portfolios is stabilizing.*

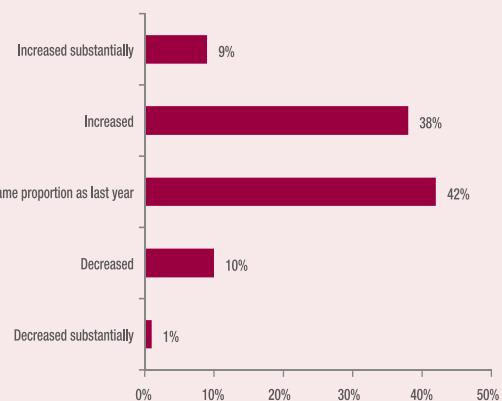
China is ranked in the Top 3 global investment priorities for 58% of the foreign-owned companies in our sample, and it is the Number 1 priority for 33% of them. Nearly two thirds of the sample currently generates 2 to 30% of their global sales in China, with just more than 20% of survey respondents generating more than 30% of their global sales in China (Figure 65).

This year we observe a tendency amongst foreign firms surveyed to stabilize the weight of China in their global portfolio when compared to last year's survey (42% of respondents claim China constitutes the "same proportion as last year" vs. 33% last year). Still, 47% of surveyed foreign companies cite an increase or a substantial increase in the weight of China within their global portfolio (compared to 11% citing a decreasing share).

**FIGURE 65 - FOREIGN FIRMS, WHAT % OF YOUR COMPANY'S 2013 GLOBAL REVENUE WILL BE GENERATED IN CHINA?  
N=321**

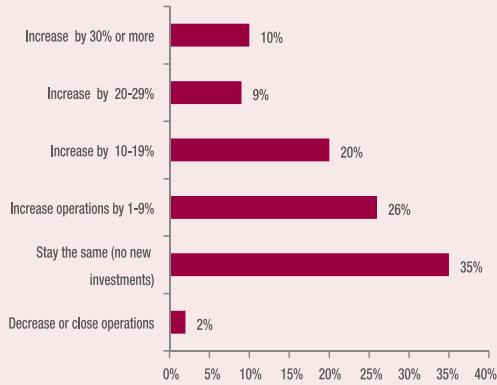


**FIGURE 66 - HOW DOES THIS % COMPARE TO LAST YEAR?  
N=320**

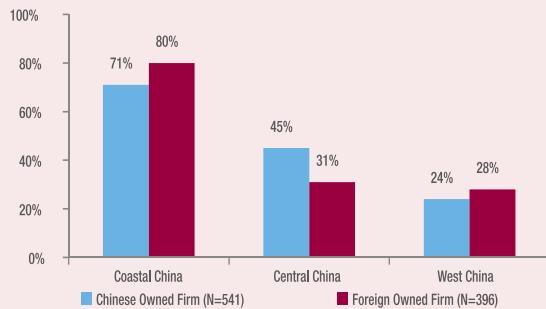


Investments in China by foreign firms are expected to increase in 2014 for 65% of our sample of foreign firms. Moreover, 19% of them have the intention to increase investments by more than 20%. The most cited area for investment in China in 2014 is Coastal China, mentioned by 71% of companies. Central China follows with 45% of companies, and 24% of them plan to invest in West China. This pattern of investment differs from that of domestic firms surveyed, with a higher reliance of foreign firms on the coastal areas, and a lower frequency of exploration of central areas (Figures 67 and 68).

**FIGURE 67 - FOREIGN FIRMS, WHAT INVESTMENTS DO YOU PLAN FOR 2014 IN CHINA? (N=449)**



**FIGURE 68 - WHERE IN CHINA DO YOU PLAN TO INVEST?**



Another sign of commitment to China by foreign companies is the increase in the number of companies spending more than 10% of their China revenues in marketing and sales when compared to two years ago (26% of respondents, up from 20% two years ago).

Similarly, 51% of foreign companies have R&D activities in China, up from 39% two years ago. Moreover, 40% of them invest more than 5% of their revenues in research and development activities in China (an increase from 33% last year) showing the growing emphasis on innovation related investments in China for foreign firms (Figure 69).

FIGURE 69- WHAT IS YOUR ANNUAL EXPENDITURE IN R&amp;D AS A % OF REVENUES?



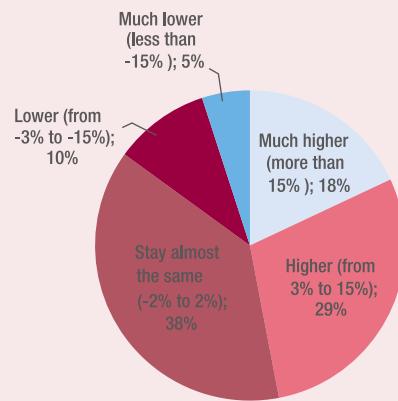
#### 4.3.2. Global focus for Chinese-owned firms

Chinese firms continued the globalization of their business in 2013. US & Canada and Latin America gained in attractiveness vs. last year's survey.

**Outbound Trade of Chinese-owned companies:** *Increasing revenue vs. last year for half the sample*

Export remains the most widespread form of reaching out for Chinese firms with 45% of the companies exporting their products or services abroad.

FIGURE 70 - CHINESE FIRMS - HOW DO YOUR EXPORTS IN 2013 COMPARE TO 2012? N=253



Amongst respondents, export revenues reach on average 30% of their total revenues. For 47% of them, the export revenue is higher or much higher than last year, for 38% it remains unchanged, while 15% have experienced a decrease in export revenues.

**Outbound Investment of Chinese-owned companies:** *Similar to the last two years, but interest to invest abroad in the next years is growing.*

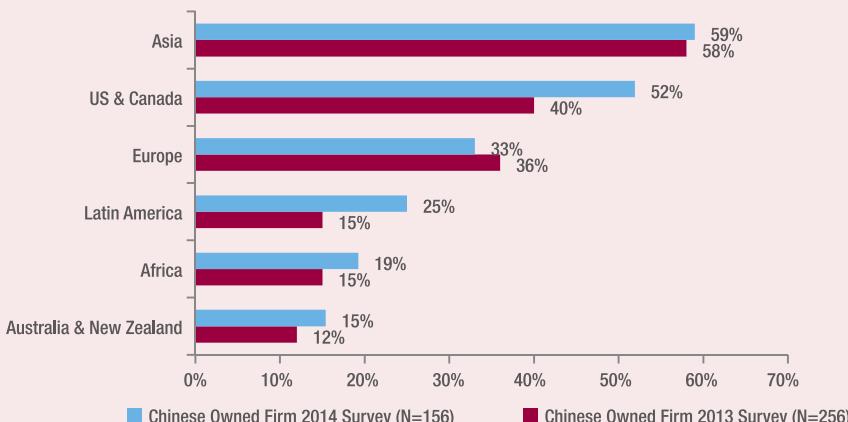
Overseas expansion is one of the Top 3 business priorities for 29% of surveyed Chinese companies with operations abroad, and for 60% of them it is important or very important.

#### SECTION 4: FOCUS BY TOPIC

In terms of investment outside of China, we see the same proportion of companies going abroad as in the previous two years (34% of the Chinese companies surveyed). The preferred targets are Asia for 59% of them (East and south-east Asia, South Asia, Central Asia and Middle East), US and Canada for 52% of them, and coming third, Europe for 33% of them.

The US & Canada have gained popularity as an investment destination for Chinese firms surveyed when compared to last year's results (52% of respondents have invested in US & Canada vs. a lower 40% last year). Similarly, Latin America, although still a less popular destination overall, has increased from 15% last year to 25% this year.

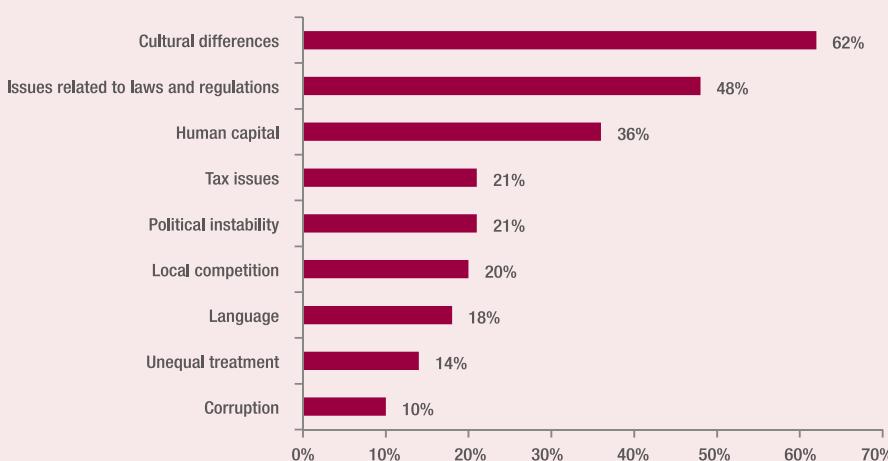
**FIGURE 71 - CHINESE FIRMS - WHERE ARE YOUR FOREIGN INVESTMENTS LOCATED? MULTIPLE ANSWERS POSSIBLE (N=156)**



Most of these companies feel neutral or satisfied about their investment results abroad (53% and 47% of them, respectively). Only a very small 1% of our pool of Chinese companies declares to be dissatisfied. These results are better than last year's where 7% of surveyed companies expressed dissatisfaction and only 34% of them were satisfied with their investments abroad.

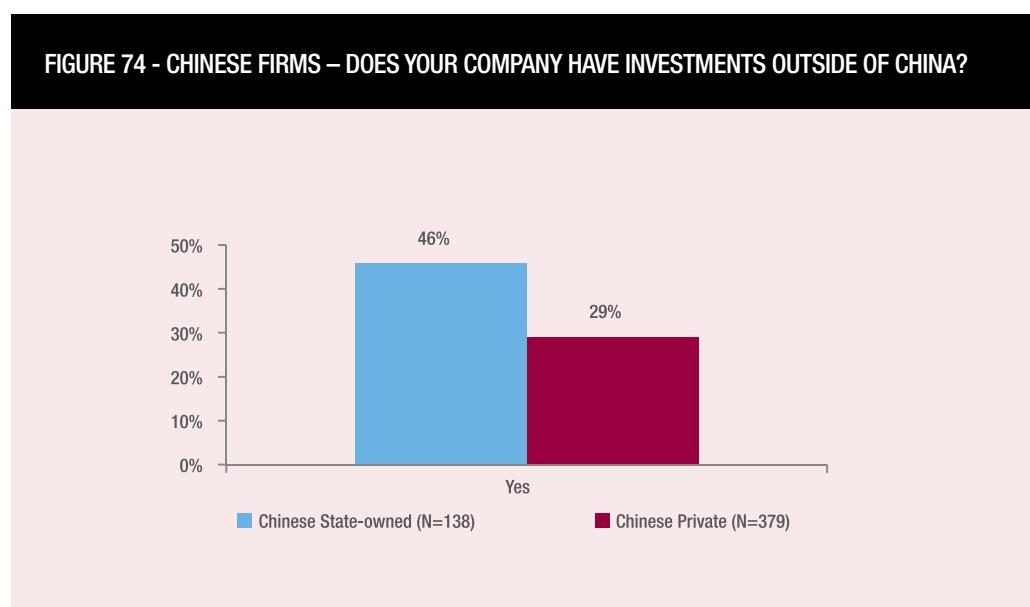
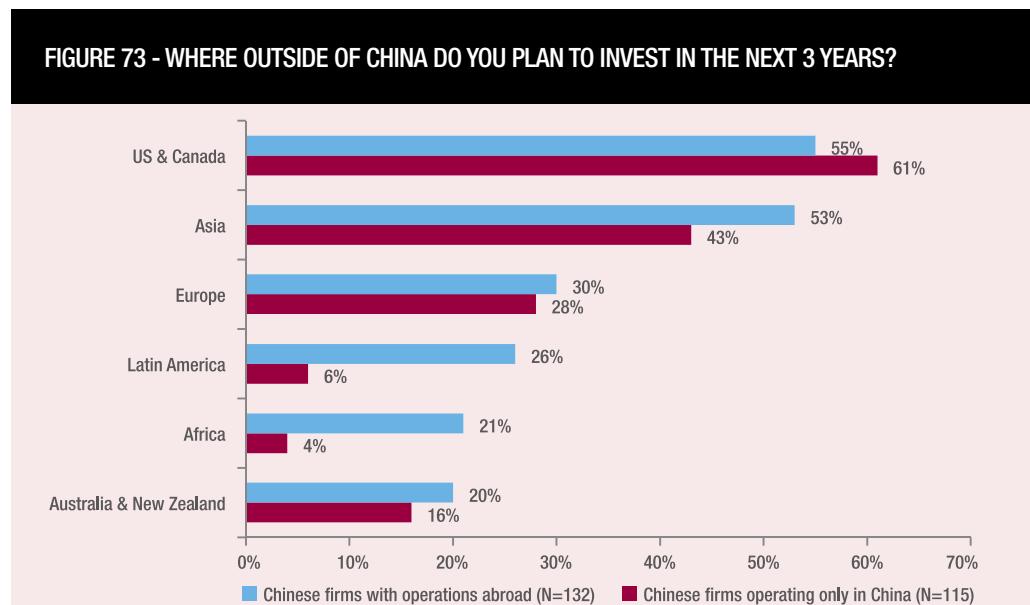
The major challenges for Chinese companies doing business abroad are cultural differences, laws and regulations, and finding the appropriate human capital (Figure 72).

**FIGURE 72 - WHAT ARE THE MAJOR CHALLENGES OF DOING BUSINESS IN THOSE REGIONS? MULTIPLE ANSWERS (N=153)**



Nevertheless, the above challenges do not seem to hinder Chinese firms from going abroad. The upward trend in out-of-China investment is shown by a higher number of companies planning to invest abroad in the next 3 years (47% versus 34% of firms currently investing abroad).

For Chinese companies already having an international presence, the targeted geographies are similar to those where they are currently invested. On the other hand, companies still purely domestic choose the US & Canada as their preferred destination (61% of them), with Asia as a distant second (43%), followed by Europe (28%) and Australia & New Zealand (20%). Interest in Latin America or Africa as 1st international destination is low with 6% and 4% of respondents respectively (Figure 73).

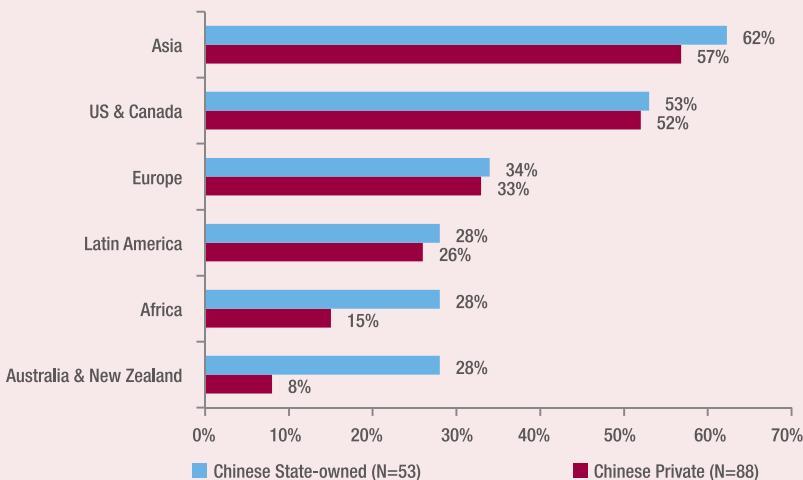


When analyzing in detail the presence of Chinese enterprises abroad, we observe that it is the state-owned or state-holding enterprises that proportionally go abroad more often with 46% of them having investments outside of China; Chinese private firms show a lower relative international presence (29% of them).

We also notice that Chinese state-owned companies have a different pattern of expansion as they go more broadly to more regions than the other 2 groups. They favor Asia expansion with 62% of them citing investments in the region, followed by US & Canada for 53% of them, Europe (34%), Africa (28%), Latin America (28%) and Australia (28%).

In contrast, private-owned companies, first choose Asia and the US (57% and 52% of them respectively), before Europe (33%) and Latin America (26%). Their investments in the other geographies are minimal (Figure 75).

**FIGURE 75 - WHERE ARE YOUR FOREIGN INVESTMENTS LOCATED? MULTIPLE ANSWERS POSSIBLE**



**Out of China manufacturing activity of Chinese-owned companies:**

40% of the Chinese manufacturing firms having investments outside of China (18% of total sample of Chinese-owned firms) have plants abroad, 76% of them plan to increase their overseas production capacity in the next 3 years.



## SECTION 5

# FOCUS BY FUNCTIONS

This section provides perspectives on three functional areas:

- **Human Resources**

The chapter covers the top HR issues that companies in our sample face in China. It also gives an in-depth commentary on what the executives in our sample think are the most effective measures to retain employees.

- **Finance**

This chapter gives an overview of the most frequent sources of funding for the Chinese-owned firms in our sample by type of company.

- **Marketing, Sales and Distribution**

This chapter includes an overview of market segments where companies in our sample operate 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.

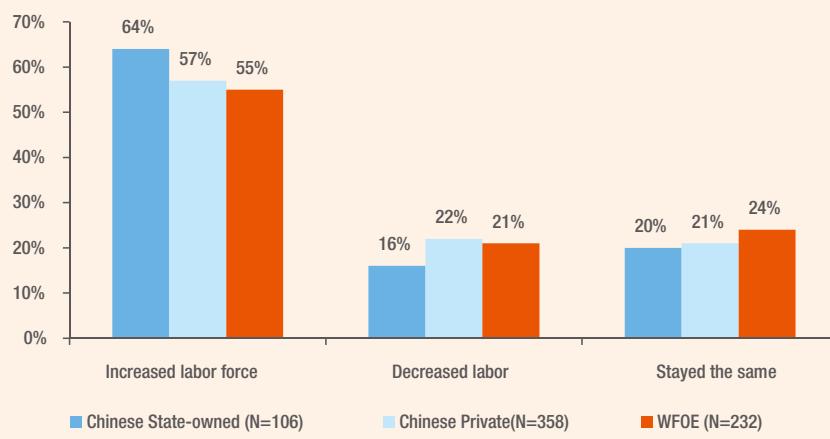
The purpose of this section is to understand challenges and success factors of our respondents in these functional areas.

## 5.1. HUMAN RESOURCES

*Labor force increased in 2013 for more than half of the sample. Average turnover is 12%. Average salary increase is 12%. Finding talent and rising labor costs are cited as the top HR issues for managing businesses in China.*

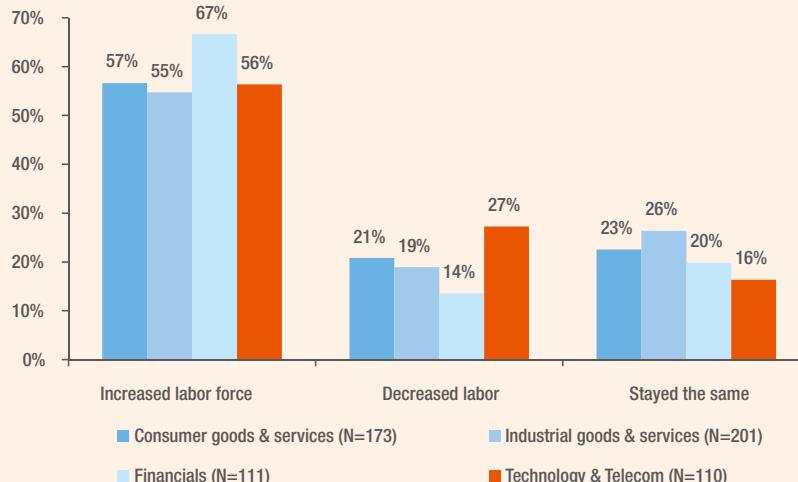
More than half of surveyed companies increased their labor force in 2013 (57% of total respondents), 23% of them kept the same labor force, and 20% of respondents decreased it. 64% of Chinese state-owned enterprises saw their labor force increase, somewhat more than the proportion of Chinese private-owned firms (57%) and foreign WFOEs (55%) having increased labor force (Figure 76).

**FIGURE 76 – DID YOU INCREASE OR DECREASE YOUR LABOR FORCE IN 2013 VS. 2012?**

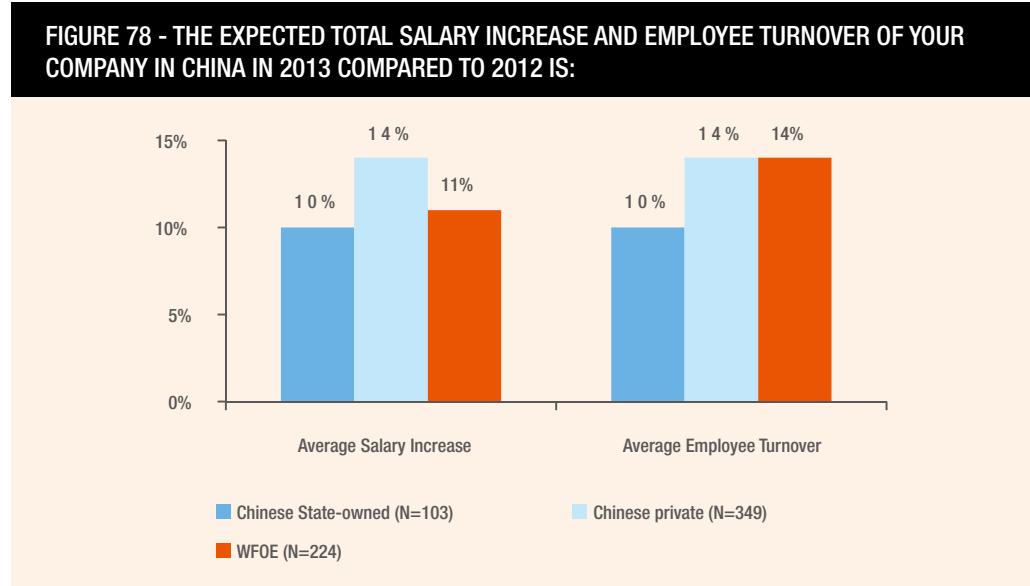


When analyzing in detail the situation in the four industries most represented in our sample, we observe that it is financial sector firms that have proportionally increased their labor force the most in 2013, with 67% of them expanding in number of employees. This compares to 55% to 57% of other industries that stated an increase in labor force (Figure 77).

**FIGURE 77 – DID YOU INCREASE OR DECREASE YOUR LABOR FORCE IN 2013 VS. 2012?  
By industry**

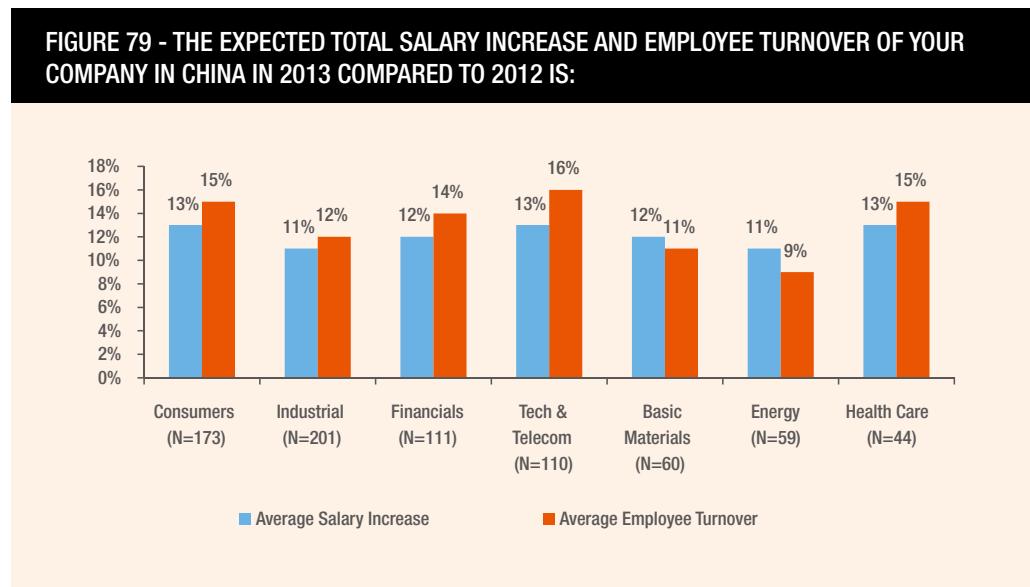


The average expected salary increase for the totality of firms surveyed is 12%. The average employee turnover is also 12%



Here again, we observe differences by company type and by industry. Chinese private firms increased their salaries the most in 2013 with an average of 14%, vs. a lower of 10% for Chinese state-owned firms and 11% for foreign enterprises.

When studying the results by industry, Consumer goods & services, Technology and Telecommunications and Healthcare appear to be the industries suffering from a higher employee turnover at levels of 15 to 16%. Industrial goods & services, Basic materials (chemicals, mining) and Energy show lowest levels from 9 to 12% (Figure 79).



### 5.1.1. Top Human Resources issues in China

HR issues remain the top challenge faced by companies in China, just as in previous editions of this survey. Finding suitable resources, especially in middle and top management, and rising labor costs are main issues.

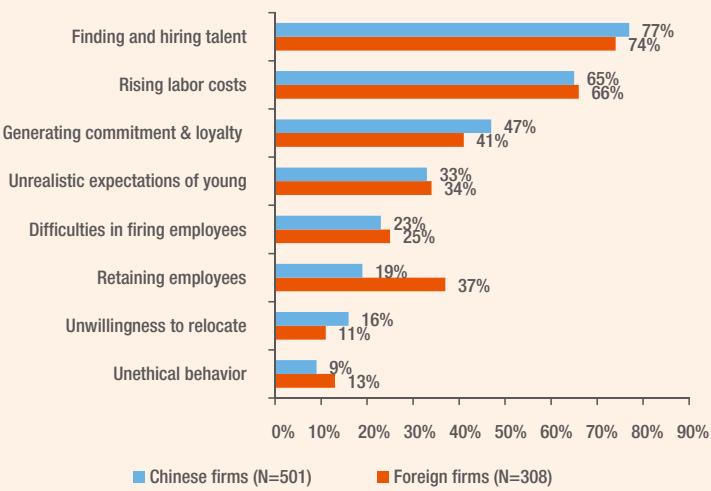
“Finding and hiring suitable talent” is the Top HR concern for foreign and Chinese owned firms (76% of surveyed executives). Further in this section we provide deeper analysis of this challenge.

“Rising labor costs” follow as the second major HR related concern worrying 66% of surveyed executives. It is also the number one external challenge for doing business in China (see Section 3).

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

“Unrealistic expectations of the new generation” are the next most cited cause of HR challenges for 33% of our sample of companies. This item gained importance in last year’s editions of the survey and continues this year as China’s Generation Y hits the labor market.

**FIGURE 80 - WHICH ARE THE MAJOR HUMAN RESOURCES ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)**



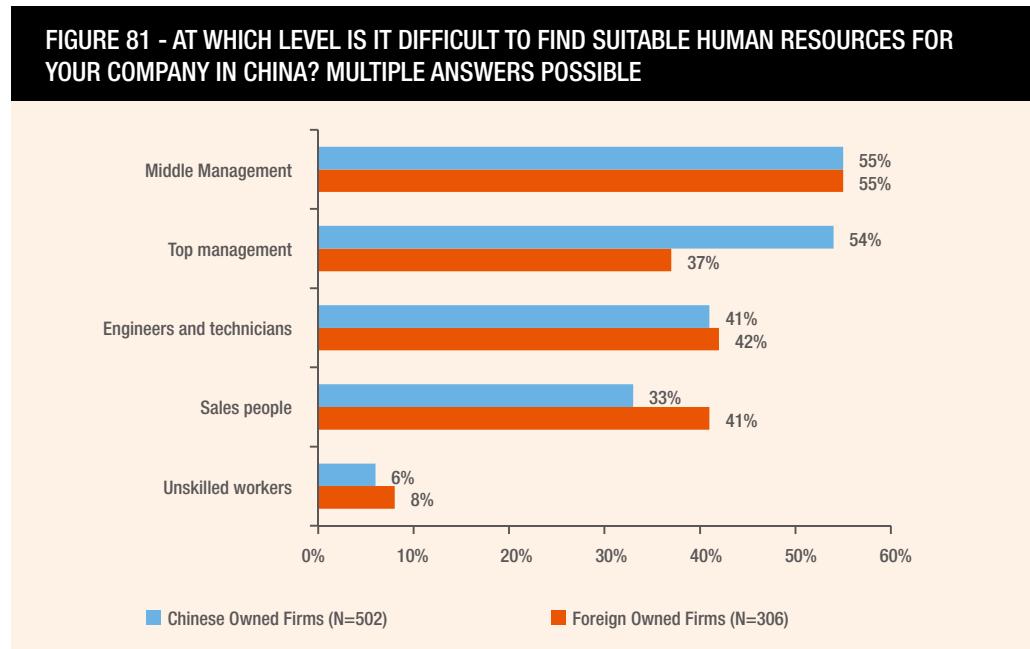
Although the above described challenges are common to the total sample of companies, we do observe differences in relative weight of some of the issues depending on the type of company:

- “Retaining employees” worries 37% of foreign companies vs. only 19% of Chinese ones. A possible explanation is that foreign-owned firms are targeting just a section of the labor market while Chinese firms target the whole market. It could also be that the level of expectations is different. Also, sometimes Chinese employees see foreign companies as a training ground, especially multinationals.
- “Rising labor costs” worried 46% of companies operating in the financial sector, while it is a concern for a much higher 67% of non-financial companies.

“Finding and hiring suitable talent” has been the main HR related difficulty for all types of companies since the inception of this survey four years ago. When asking our sample of executives at which level they found most difficulties, “Middle Management” comes up more often (55% of respondents), followed by “Top Management” and “Engineers and Technicians” (47 and 41% of respondents respectively).

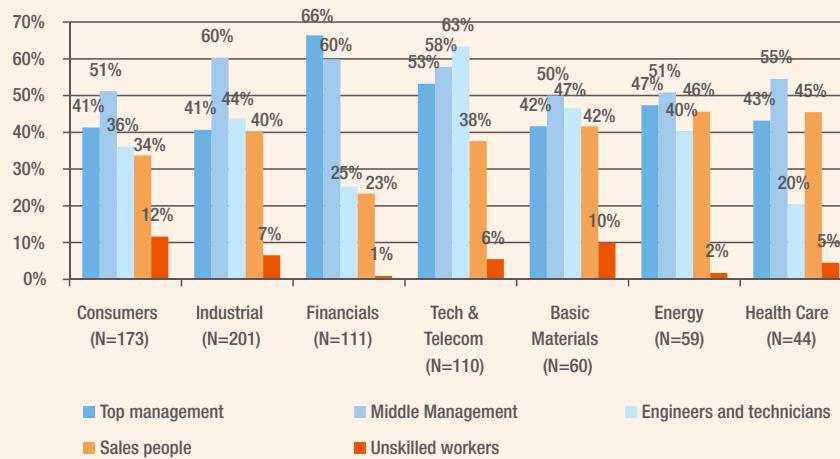
Despite the above being true for the total sample, it is important to note that hiring top management is more of an issue for Chinese companies than it is for foreign firms (54% of Chinese firms vs. 37% of foreign firms). Foreign firms still often bring their top management from their subsidiaries in other countries or from their main offices, a trend that is declining but still exists. Within Chinese companies, SOEs suffer most in finding top management talent, with 56% of them citing the issue, compared to 46% for Chinese private-owned firms.

On the other hand, hiring sales people is, relatively speaking, a lesser problem for Chinese-owned firms than it is for foreign companies (33% of Chinese firms vs. 41% of foreign ones).



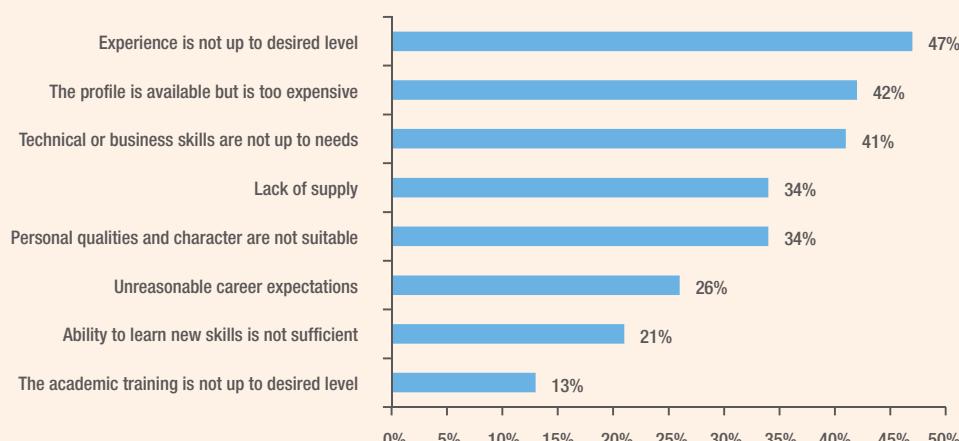
When analyzing by industry (Figure 82), we observe a few particularities and exceptions to the overall trends. For example, financial sector firms have more difficulty to find top management executives than middle managers (66% of them vs. 60% respectively); Technology and Telecommunications companies struggle the most to find suitable engineers and technicians (63% of respondents in the industry). Healthcare firms have proportionally more difficulties in finding sales people than other industries.

**FIGURE 82 - AT WHICH LEVEL IS IT DIFFICULT TO FIND SUITABLE HUMAN RESOURCES FOR YOUR COMPANY IN CHINA? MULTIPLE ANSWERS POSSIBLE By industry**



The reasons most often mentioned by our sample of executives are a combination of experience or skills not being up to the desired levels and, when available, the candidates being too expensive (47%, 41% and 42% of respondents respectively). Despite lack of business and technical skills, only a minority of respondents believe academic training to be the issue (13%). We did not observe significant differences between responses of Chinese owned firms and foreign owned firms.

**FIGURE 83 - FOR THE PERSONNEL YOU HAVE DIFFICULTY ACQUIRING, WHAT ARE THE KEY REASONS? MULTIPLE ANSWERS (N=779)**



### 5.1.2. Most effective measures to retain employees

In order to retain employees, executives in our survey cited the importance of creating a feeling of belonging to the company (67% of respondents) and offering interesting career path within the company (60% of respondents). It is interesting to note, this top set of measures comes before paying above market (third with 45% 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 last year's survey.

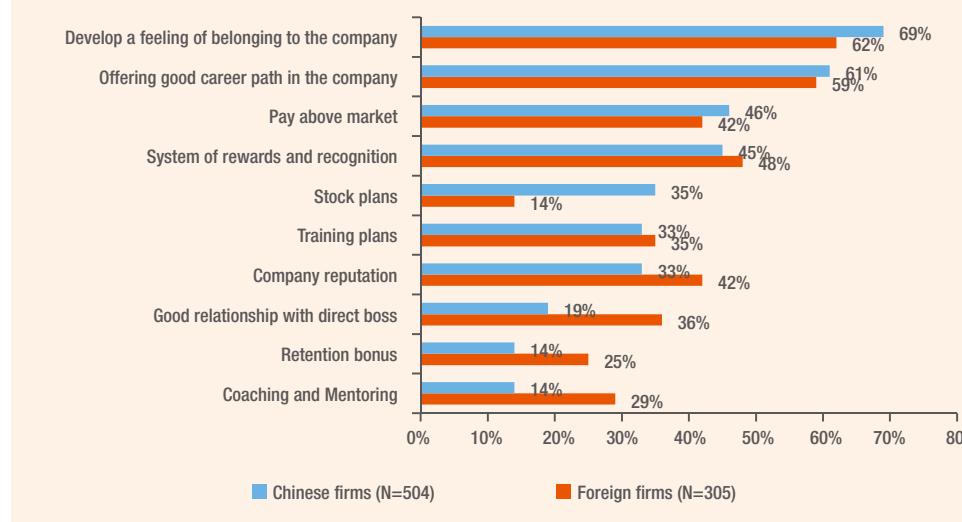
Even if the above selection of most effective HR measures is shared by both Chinese and Foreign companies, we observe differences in the relative weight of some of the strategies between both types of firms:

A larger proportion of Chinese-owned firms favor “Develop a feeling of belonging to the company” (69% of respondents) when compared to foreign-owned firms (62%).

“Stock plans”, even if less frequent, are more successful amongst Chinese firms (35% of them) than foreign ones (14%). 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 42% of foreign-owned firms vs. 33% of Chinese-owned firms), “Good relationship with direct boss” (36% vs. 16%) and “Coaching and Mentoring” (29% vs. 14%).

**FIGURE 84 - WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES?  
MULTIPLE ANSWERS**



## 5.2. FINANCE (CHINESE FIRMS ONLY)

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

*Self-financing is the most widely used source of funding. Bank loans follows, but access to bank-funding is highly dependent on size and type of company: private firms and smaller firms encountering most issues.*

**FIGURE 85 – CHINESE FIRMS - WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? N=509**



The financing sources of Chinese firms surveyed remain unchanged from last year's survey. 59% of the surveyed companies rely mainly on self-financing as they choose retained earnings as the primary source to finance their expansion. Bank loans are the second most commonly used means of funding favored by 43% of our sample. Capital markets (23%) and investments from either private firms (17%) or private investors (16%) come next. Notably, there is little presence of venture capital funding (only cited by 6% of respondents), or of government and foreign investments.

When looking at the total sample of Chinese firms, 52% of companies qualified access to bank loans as relatively easy (Figures 86 & 87). However, 43% of surveyed Chinese private firms consider access to bank loans to be difficult to very difficult, contrasting with a much lower 14% of state-owned firms. It is worth noting that only 14 state-owned firms answered "difficult" or "very difficult" (which accounts for 14% of all the state-owned firms answering the question). On the other hand, 155 private firms answered "difficult or "very difficult" (43% of private firms).

FIGURE 86 - YOUR ACCESS TO BANK LOAN IS: N=507

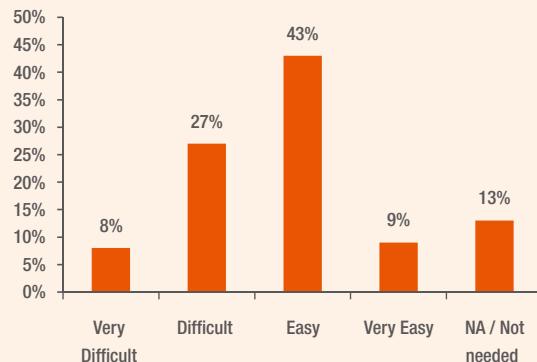


FIGURE 87 - YOUR ACCESS TO BANK LOAN IS: By type of company



When asking our sample of Chinese firms about the effect of the recent removal of restrictions on bank lending rates, half of respondents (51%) see no effect in their businesses while for 46% of them, the situation has improved. A minority of 4% of firms consider the new policy to bring negative effects, mainly an increase in interest rates which will in turn diminish their profits. Some respondents worry that banks could become too strong. As one of our surveyed executives notes, "for not fully standardized lending market, lifting restrictions would be more conducive of monopoly industries" (Figure 88).

The new policy removing restrictions on bank lending rate, although it is evaluated similarly by both state-owned and private firms, seems to be slightly more positive for state-owned companies, with 53% of them considering it to have positive effects vs. 45% of Chinese private firms (Figure 89).

FIGURE 88 - THE CHINESE GOVERNMENT HAS REMOVED THE RESTRICTION ON BANK LENDING RATE, HOW DOES IT AFFECT YOUR COMPANY'S FINANCING? (N=504)

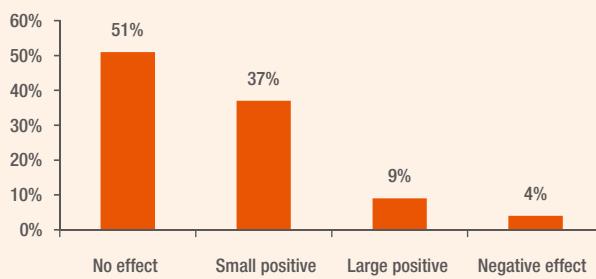
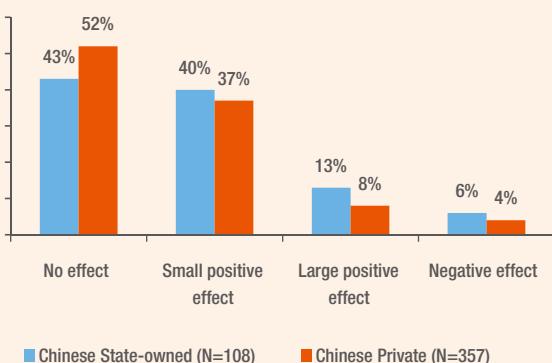


FIGURE 89 - THE CHINESE GOVERNMENT HAS REMOVED THE RESTRICTION ON BANK LENDING RATE, HOW DOES IT AFFECT YOUR COMPANY'S FINANCING? By type of company



Access to non-bank financing is considered difficult to very difficult for 47% of Chinese firms surveyed. Similarly to what happened with access to bank financing, Chinese state-owned firms seem to have less difficulty to access non-bank financing than private firms (Figures 90 and 91).

FIGURE 90 - CHINESE FIRMS - YOUR ACCESS TO FINANCIAL RESOURCES FROM NON-BANK SOURCES (STOCK MARKET, BOND MARKET ETC.) IS: N=506

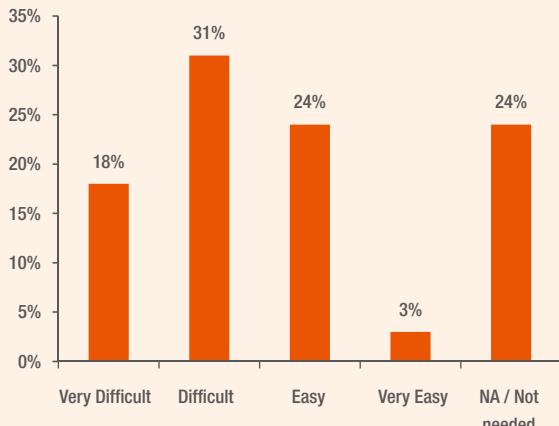
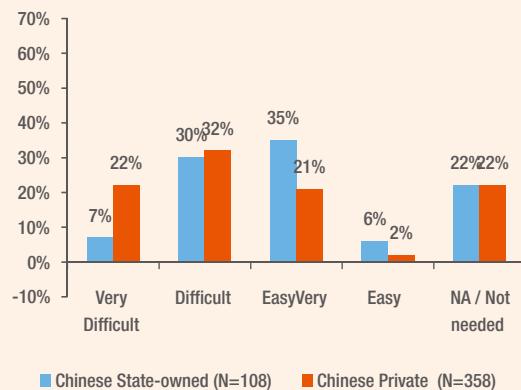


FIGURE 91 - CHINESE FIRMS - YOUR ACCESS TO FINANCIAL RESOURCES FROM NON-BANK SOURCES (STOCK MARKET, BOND MARKET ETC.) IS: By type of company

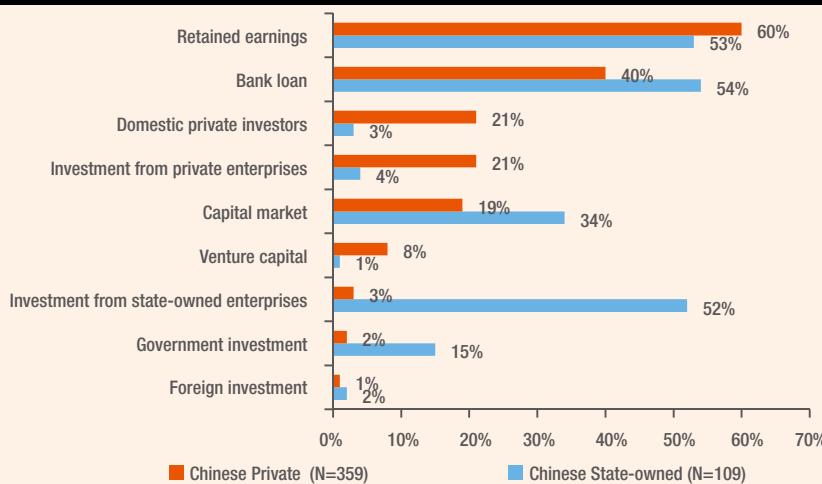


### 5.2.1. By legal entity

For Chinese state-owned companies in our sample, “Retained earnings”, “Bank loans” and “Investment from state-owned enterprises” are equally frequent (52% to 54% of responses) sources of funding. The “Capital market” follows very closely, mentioned by 34% of respondents with State ownership.

On the other hand, “Retained earnings” is the most favored source of funding mentioned as a main source of funding by 60% of Chinese Private enterprises. “Bank loans” come second, with 40% of respondents. Less frequently, “Domestic private investors”, “Investment from private enterprises” and the “Capital market” are cited by 21%, 21% and 19% of the concerned respondents respectively. Only 8% of private companies use “Venture capital”, low but still higher than the 1% of state-owned companies using VC funds in our sample.

FIGURE 92 – CHINESE FIRMS - WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? (MULTIPLE ANSWERS)



### 5.2.2. By company size

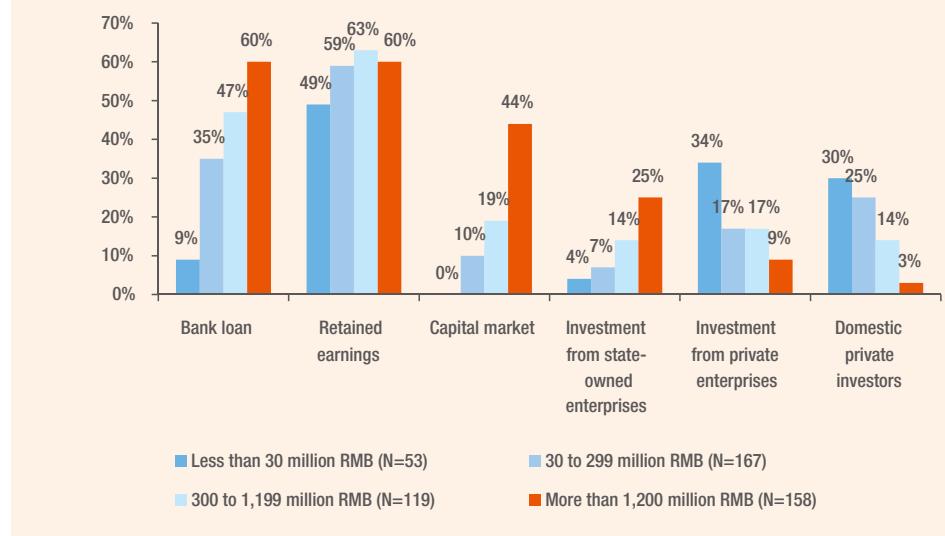
In terms of company size, we observe a direct relationship between size in annual revenues<sup>9</sup> and funding through bank loans. Bank loans are mainly used by the two larger categories of companies (47% of companies with size 300-1,199 million RMB and 60% of companies with size > 1,200 million RMB use bank loans as a main source of funding, vs. 9% of companies <30 million RMB in size). This is true for both Chinese private firms and state-owned firms, although the relationship seems to be stronger for private firms.

Similarly, the capital market is almost only used by the largest companies (>1,200 million RMB in revenues, with 44% of them using it as a main source of funding).

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

Government investment and funds from State-owned enterprises have relatively more importance within the larger companies of our sample (>1,200 million RMB in revenues), even if they are overall one of the least frequently mentioned funding means together with foreign investment and private capital.

FIGURE 93 – WHICH ARE THE MAIN SOURCES OF FUNDING FOR YOUR COMPANY? (MULTIPLE ANSWERS) By size



The above situation is linked to access. Our sample shows a clear relationship between company size and access to bank loans: 52-53% of small and medium companies in our sample claim access to bank loans to be “difficult” or “very difficult”, compared to 26% for large firms, and 17% for the largest companies in our sample (>1,200 million RMB). Moreover, it is small companies that are less affected by recent removal by Chinese government of restrictions on bank lending rate with 72% of them claiming no effect whatsoever of the new policy on their financing situation.

<sup>9</sup> China company definition is Small (<30 million RMB), Medium (30-300 million RMB) and Large (>300 million RMB)

Similarly, access to non-bank sources is easy or very easy for 49% of the super-large companies in our sample (>1,200 million RMB), 26% for large companies and a much lower 13-14% for those medium and small (30-300 million RMB).

FIGURE 94 - YOUR ACCESS TO BANK LOAN IS:

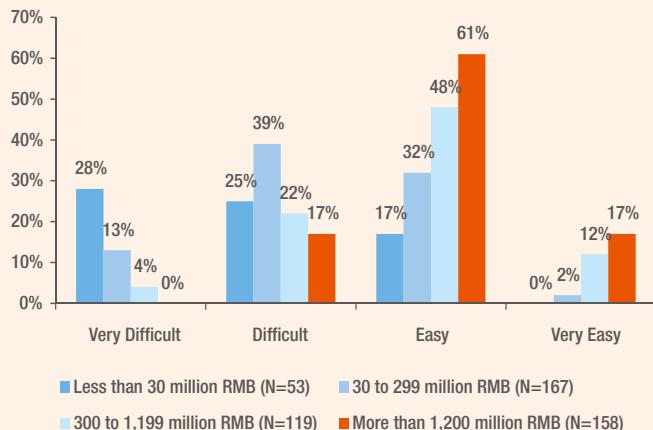
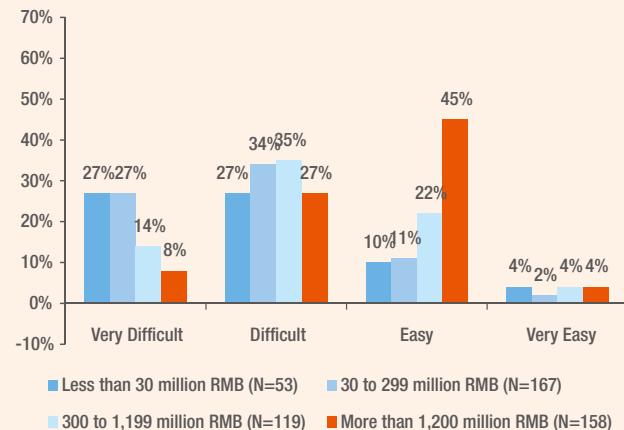


FIGURE 95 - YOUR ACCESS TO FINANCIAL RESOURCES FROM NON-BANK SOURCES (STOCK MARKET, BOND MARKET ETC.) IS:



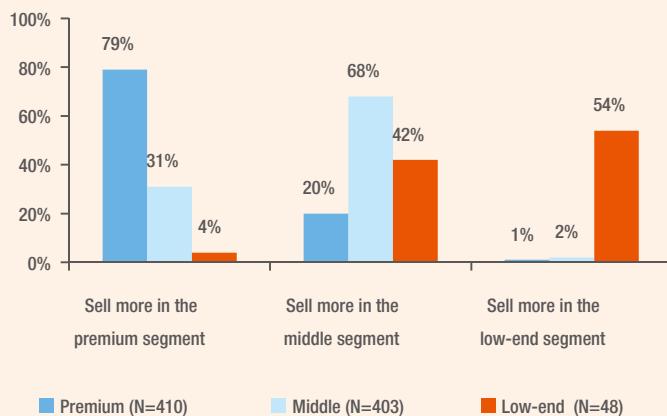
### 5.3. MARKETING, SALES AND DISTRIBUTION

#### Market segments and mobility: Clear market positioning with slight trend to move upscale

Our sample of companies operates mainly in the premium and middle segments with 48% and 47% of companies respectively, and only a small 6% in the low-end.

In terms of segment mobility we see that even if a majority of companies plan to grow future sales within their existing segment (79% for those operating in the premium segment and 68% 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 42% and 31% of them respectively to move up into the next segment. For companies currently operating in the premium segment, a smaller proportion (20%) of them wants to expand down into the middle segment (Figure 96).

FIGURE 96 - WHAT ARE YOUR PLANS FOR THE FUTURE?

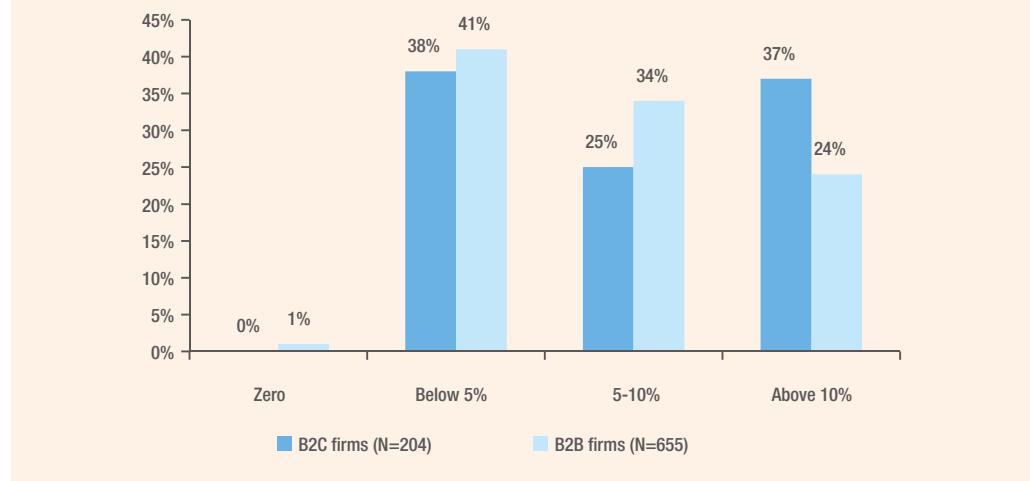


**Marketing and sales budgets and most effective strategies:** No significant difference in behavior between Chinese and foreign firms, but type of company matters (B2B or B2C, premium or middle segment). B2C companies increase spending vs. last year's survey.

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

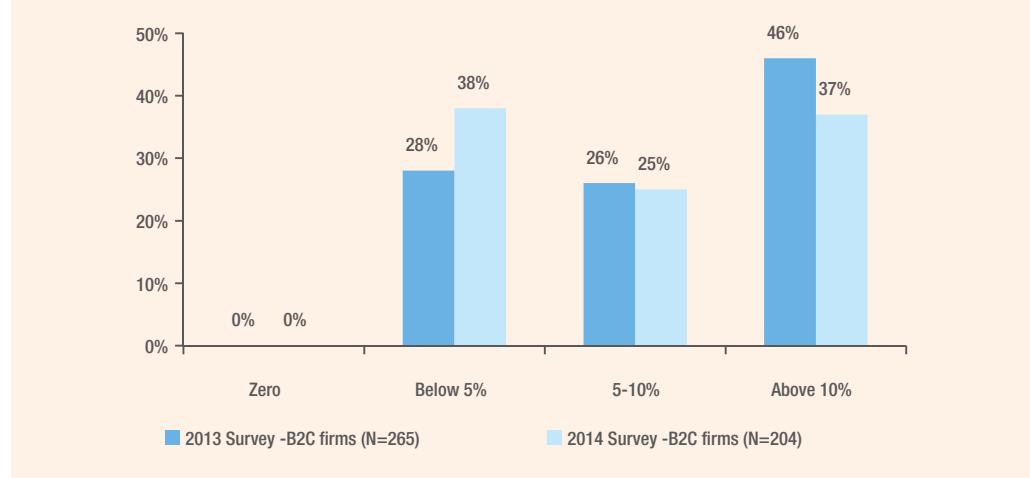
Unsurprisingly, firms selling directly to consumers have larger marketing and sales budgets (above 10% of revenues for 37% of them).

**FIGURE 97 - WHAT PERCENTAGE OF YEARLY REVENUES DO YOU SPEND IN MARKETING AND SALES? B2C VS. B2B**



Although marketing & sales spending as percentage of revenues remains unchanged vs. last year for B2B companies, we observe an increase in spending for B2C companies, when comparing to last year's survey (Figure 98).

**FIGURE 98 - WHAT PERCENTAGE OF YEARLY REVENUES DO YOU SPEND IN MARKETING AND SALES? 2014 SURVEY VS. 2013 SURVEY**



Although there is no significant difference in marketing and sales spending for Chinese owned and foreign-owned firms, proportionally more Chinese firms state their intention to increase spending next year (46% of respondents vs. 36% of foreign firms).

FIGURE 99 - WHAT % OF YEARLY REVENUES DO YOU SPEND IN MARKETING & SALES?

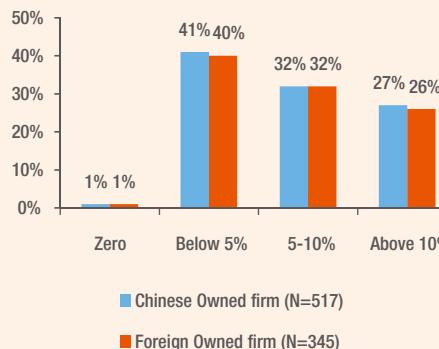
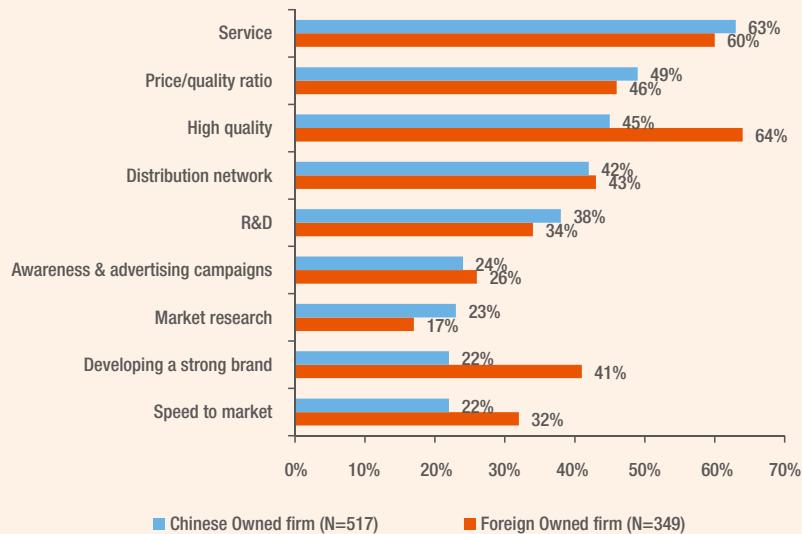


FIGURE 100 - WHAT ARE YOUR PLANS FOR NEXT YEAR?



The most cited factors for success for Chinese firms is “Service” (63% of respondents), followed distantly by “Price/Quality ratio” (49%), “High quality” (45%), “Distribution network” (42%) and “R&D” (38%). Foreign firms emphasize “High quality” most often (64%), followed by “Price/Quality ratio” (46%), “Distribution network” (43%) and “Developing a strong brand” (41% vs. a lower 22% of Chinese owned firms).

FIGURE 101 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA. MULTIPLE ANSWERS POSSIBLE

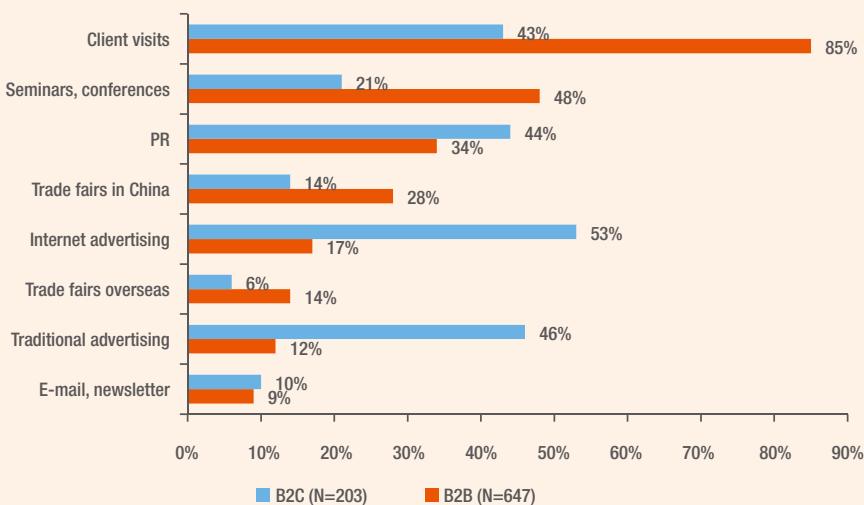


### Marketing strategies:

Most cited marketing expenditures for B2C companies are in Internet advertising and traditional advertising (TV, print) favored by 53% and 46% of respondents respectively. Other marketing strategies used by close to half the sample are public relations (44%), as well as visits to clients (43%).

In contrast, B2B firms favor mostly clients visits (85% of respondents), followed very distantly by seminars and conferences and other public relations activities (48% and 34% of respondents respectively).

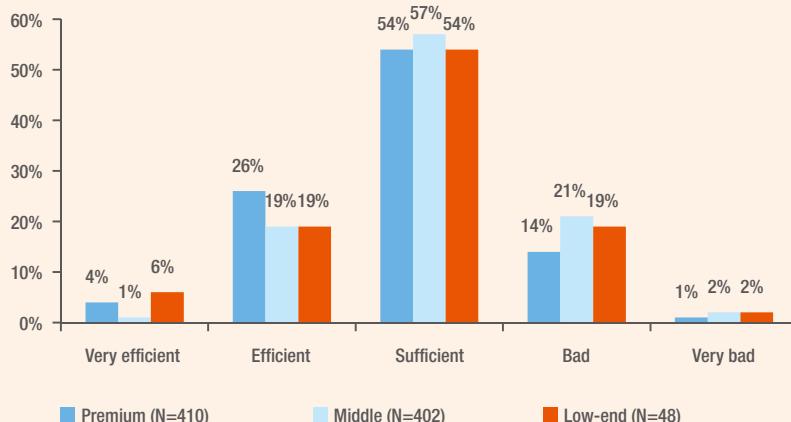
**FIGURE 102 - WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS?**



### Distribution network:

Only 20% of the total sample evaluates their national distribution network as bad or very bad. It is considered sufficient by 55% of surveyed firms. There are proportionally higher levels of satisfaction amongst surveyed firms in the premium segment than in the middle and low-end segments.

**FIGURE 103 - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?**



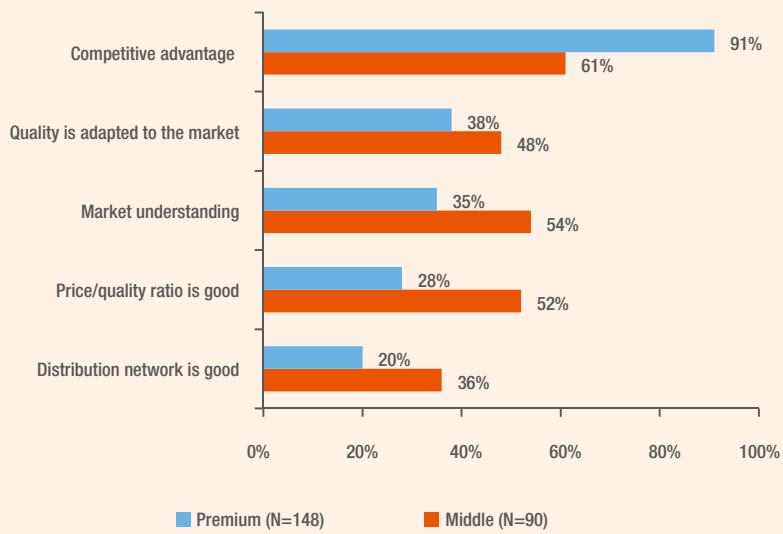
**Market leaders' keys to success:**

251 companies (29%) in our sample claim to be market leaders for their main business line and 390 (45%) are within the Top 5 players.

Their key to success is having a competitive advantage for the majority of them (79% of respondents), followed distantly by understanding the market better than their competitors (44%), and offering a quality adapted to the market needs (41%). Both Chinese and foreign firms agree on these factors.

36% of premium firms surveyed are market leaders compared to a lower 22% of firms operating in the middle segment. For companies in the premium segment, "Competitive advantage" is by far the most often cited key to success (91% of respondents). Firms operating in the middle segment, although also cite "Competitive advantage" (61%), they also mention other strategies with similar frequency, like "Market understanding" (54% vs. only 35% of premium firms), "Price/quality ratio" (52% vs. 28%), and "Quality adapted to the market" (48% vs. 38%).

**FIGURE 104 - FOR MARKET LEADERS - WHY ARE YOU AT THAT POSITION? MULTIPLE ANSWERS**



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