The **China Integrated** Analysis
July 2012

European Firms Earn more in China than Elsewhere

And the trend is intensifying, heralding growing opportunities in China

Two recent articles in the NZZ (Neue Zürcher Zeitung)[1] are implying that Swiss companies are not making profit and that EU companies are shifting their investments out of China. We feel it worthwhile to take a deeper look at the recently released 2012 EU Chamber Business Confidence Survey[2], which is the source of the statistics cited in the mentioned NZZ articles.

When analyzed, this survey provides very interesting insights of the business situation of EU companies in China. Besides, it corresponds to our experience, based on guiding numerous Swiss and EU companies to successful activities in China in the last 20 years.

Rather than a decline, this EU survey and other available data on Swiss companies unmistakably points to **increasingly positive results** of European companies in China over the years.

We focus below on a couple of key indicators from the survey, which we analyze in light of our firsthand experience guiding hundreds of Swiss and European companies, now doing successful business in China.

Profitability

Profits of China operations are on average higher than in the rest of the world

Figure 6: **EBIT margins of China operations compared to worldwide margins, 2010-2012**

Question: How did the EBIT margin of your Mainland China operations compare to your company's worldwide margins this past year?

Answers	Respondents		
	N = 389	N = 262	N = 224
	2010	2011	2012
Better than company average worldwide	37%	33%	42%
Same as company average worldwide	29%	37%	29%
Lower than company average worldwide	34%	30%	29%

EBIT = Earnings Before Interest and Tax

Over the last 3 years, more EU companies' subsidiaries in China declare a higher profitability than in the rest of the world, than a lower profitability, so that on average we can expect higher overall

[1] "China ist ein hartes Pflaster", Gabriela Weiss. *NZZ am Sonntag*, 24 June 2012
"China für europäische Firmen ein notwendiges Übel", Markus Ackeret. *NZZ*, 30 May 2012.
[2] Available at www.euccc.com.cn, carried out by Roland Berger & Partners

profits of EU companies in China compared to the rest of the world. Furthermore, the trends go towards less and less companies with lower profitability in China compared to rest of the world.

Those are extremely encouraging trends in the current international situation, highlighting that despite the difficult setting (rightfully highlighted in the articles, such as rising labor costs, unclear regulatory aspects, IP infringements), a large majority of companies are managing to establish themselves in the market and tap to their best advantage the promised potential of the Chinese market.

Survey data published beginning of this year by the China Europe International Business School[3] confirms this picture even for Swiss companies, with more than 80% of the respondents announcing a profit.

Investments

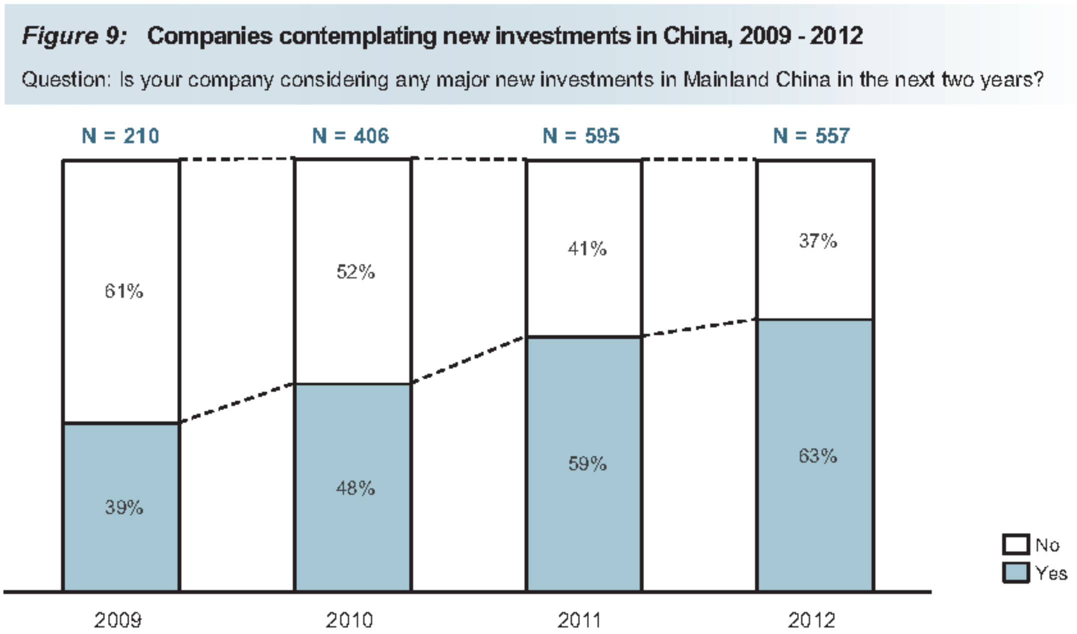
22% considering moving investment, yet growing number considering "major new investments" in China!

China as an investment destination is certainly complex. Competition in China is indeed getting tougher, with local companies becoming technology and management savvy, while labor costs are rising so that maintaining profitability needs constant care, creativity and improvement of operations.

Though 22% of EU companies in China are considering to "move investments to other markets outside PRC", a large and increasing majority are considering "major new investments" in China.

A breakdown of respondents is not available, yet we would guess that most of the 22% of companies considering shifting investments are essentially labor intensive low cost manufacturing operations focusing on exports. Indeed 78% (in 2011) and 85% (2012) of EU respondents to the survey announce being in China mainly for the local market or for European customers requesting their presence in China.

This adjustment of EU companies gradually more "in China for China" only confirms the rise of China as an increasingly better market for European companies.



When placed in an international context, 87%-88% of companies consider China as a top 5 investment destination now and in the future. Additionally, today and tomorrow, the trend is towards

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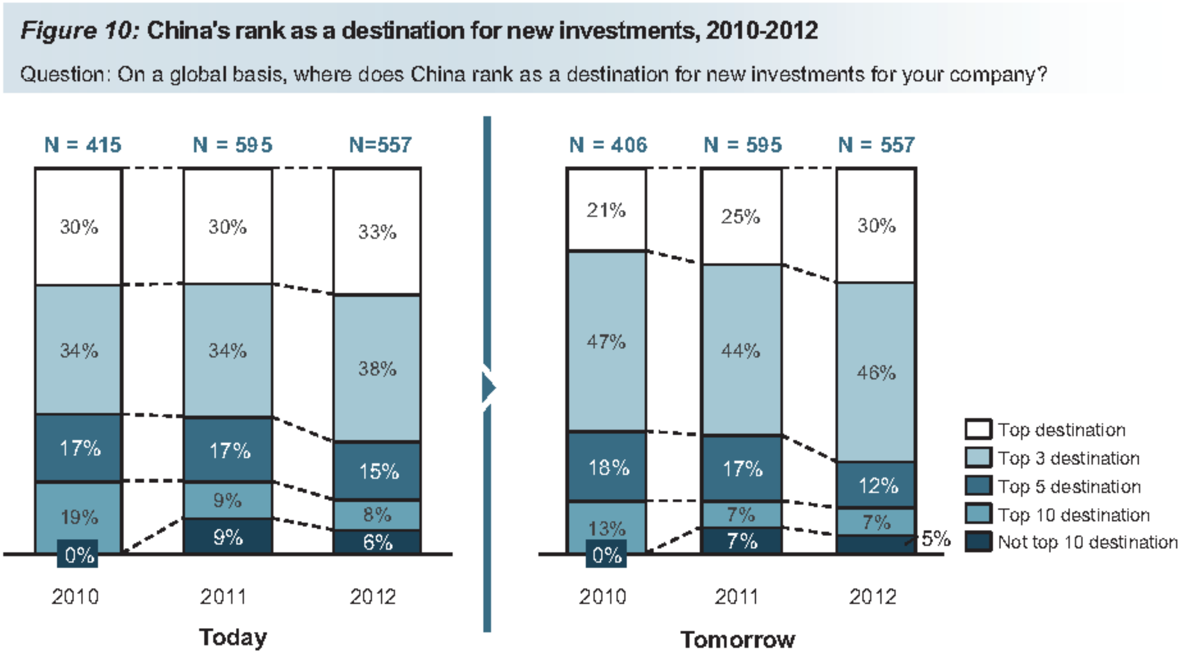
[3] "CEIBS 2012 Survey – Challenges and Success Factors for Foreign Companies in China", CEIBS.

more and more companies ranking China as a top destination (and less and less as not a top 10 destination).



Hard market but high rewards and growing revenues

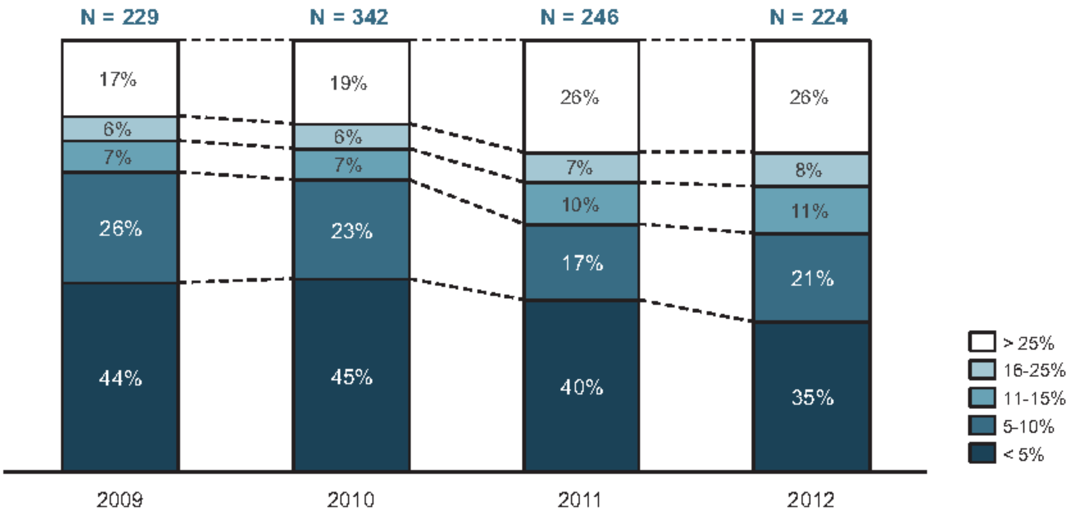
Growing importance of China in global strategies

While it is true that the Chinese market is a hard one to crack (and generally perceived to be harder than others), it is also a source of greater profits and faster growing revenues than other markets. That is only natural: if China was easy, profits would have no reason to be higher as even more companies would be able to compete on the market. Conquering the Chinese markets is indeed a fight against improperly enforced IP, biased regulatory conditions in favor of Chinese companies, highly rotating personnel and a host of other problems.

Still China is not considered as a necessary ill by the Swiss (and EU) business community but as an important source of revenues and profits, actually very much growing in importance at the moment:

Figure 4: **Proportion of companies' global revenue generated in China, 2009 - 2012**

Question: What proportion of your global revenue was generated in China this past year?



The largest customer of Switzerland for new orders

China is the key source of additional business for both Swiss MNCs and SMEs

Greater China not only represents 9% of all Swiss exports, but also, since two years, is the No 1 source of additional exports for Switzerland.

China is therefore Switzerland‘s export client adding most to our country’s GDP. As such it is a key source of our continuing prosperity in a negative European conjuncture. Businesses appreciate this boom and we believe it should not be ignored, particulalrly since this trend has all chances to continue intensifying with the explosion of the middle class in China’s cities[4]. This means growing opportunities not only for MNCs, but also SMEs, especially in traditionally strong Swiss sectors who are much sought after in China (machinery, technology, luxury goods, precision, clean and medtech among others).

It is always possible to find SMEs with unsuccessful China experiences, and unlike MNCs, SMEs don‘t get second chances due to their limited resources. However our experience is that those who make use of suitable local support when entering and expanding are practically all successful. Over the last 10 years, we experienced only 2 SMEs closing, both linked to the 2009 economic crisis – those are indeed some pretty good odds.

Should you have any question or query do not hesitate to let us know!

[4] “Meet the 2020 Chinese Consumer”, McKinsey Consumer & Shopper Insights. March 2012.