



2014 China Business Survey

Juan Antonio Fernandez | Bin Xu | Dongsheng Zhou | Maria J. Puyuelo | Junjun Li

2014 Swiss Business in China

Nicolas Musy | Zhen Xiao | Augustin Romaneschi | Aline Ballaman



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A CEIBS – Swiss Center Shanghai Survey & China Integrated Analysis

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China Europe International Business School

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Table of Contents

The research team.....	3
PREFACE & KEY TAKEAWAY	5
EU & SWISS SMES: MORE SUCCESSFUL IN CHINA THAN LARGER FIRMS!	7
INCREASING REVENUES, PROFITS, INVESTMENTS AND CONFIDENCE ACROSS THE BOARD	14
Expectations of annual profit increase has doubled for Swiss companies since 2012	14
Investment plans in China naturally follow profits and remain a top priority	16
Swiss respondents remain the most confident.....	18
A WIDE PERCEPTION GAP BETWEEN VIEWS FROM CHINA AND SWITZERLAND	19
Corruption & legal environment	19
Intellectual property	21
Challenges to overcome for success.....	21
A first: private Chinese players pose the most competition	24
The key success factors: superior product quality and human resources.....	26
RESPONDENT COMPANIES DEMOGRAPHICS	29
ADDITIONAL ANALYSES: ACCELERATING GROWTH & REFORMS	34
What growth for businesses in China in the coming years?	34
China is at a turning point - Reforms 2.0	37

The research team

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Exclusively involved in China trade, investment, strategy and project management, he has been residing in the Shanghai area since 1988. He co-founded the first Swiss industrial SME in China, Suzhou 2-ply Co. Ltd (www.2-ply.com) and is the co-owner of LX Precision (www.LXprecision.com).

Founding Partner of China Integrated (Shanghai) Co. Ltd. (www.ch-ina.com), He has successfully supported a number of multinationals and over 300 mid-sized companies on market entry, operations management and restructuring in the past 20 years.

China Integrated is a solution provider dedicated to support international companies to successfully establish and develop their business in China, whether their needs are market entry, growth or acquisition. Building on its **20 years of experience** and its internationally trained Chinese professionals in business research, Chinese law, recruitment, tax & finance, IT & ERP and PR, **China Integrated provides the expertise needed to ensure the long-term, superior success** of foreign businesses in China.

China Integrated has successfully served about 300 International firms, large and small, with innovative solutions and cost-effective best practices developed through its decades of experience in Shanghai, Beijing, Hong Kong and Mongolia.

Based on its research and experience, China Integrated regularly publishes books and analyses, to facilitate the decision making of managers at international companies dealing with China. In 2007, China Integrated conducted the first business survey of Swiss companies in China, "Behind the China Kaleidoscope", highlighting success factors of local Swiss companies and offering a comprehensive roadmap for those planning to do business and operate in China. This was followed in 2009 by an analysis of human resources practices, the "China HR Paradox", identified as the key challenge and success factor in the 2007 research. Then, in collaboration with CEIBS, "2010 Doing Business in China: A Survey of European Companies" was published, integrating both analysis and contributions from experts. The success of this publication led to yearly surveys and this 2014 Business in China Survey, which analyzes the business landscape for foreign companies in China.

You can find more information on www.ch-ina.com.

Zhen Xiao is the General Manager of Swiss Center Shanghai. Mr. Xiao obtained his engineering education from Nanyang Technological University, Singapore. He then worked in Singapore and in Switzerland for more than 10 years as an engineer, researcher, and manager. He has been working with the Swiss Federal Institute of Technology, Lausanne since 2005 as China Relation Coordinator. Over the past 4 years, he has advised and supported a dozen Swiss companies and organizations in relationship building and business development in China.

Founded in 2000, Swiss Center Shanghai (SCS) is a non-profit organization supporting Swiss companies in business set-up, expansion and operations in China. SCS not only offers instant workshop, showroom, warehouse, and office space, but also supports its members with government relations and a comprehensive network of experts. Together with its service partners, SCS has served more than 250 companies in China – SMEs and large enterprises alike. SCS is by far the largest cluster of Swiss companies in Asia, with 30 Swiss companies in one industrial park (SHXIP) accounting for over 50'000 sqm of industrial space.

Since 2014 Swiss Center has operated the Machinery, Trading and Business Center in the China (Shanghai) Pilot Free Trade Zone where 4000 sqm is dedicated to Swiss Businesses.

Augustin Romaneschi is a Project Assistant at Swiss Center Shanghai. Augustin has a double Bachelor's Degree in Law from University of Fribourg, Switzerland (www.unifr.ch) and University Panthéon Assas (Paris II) (www.u-paris2.fr). Motivated by the challenges met in his legal and educational experience, he chose to finish his Master's of International Business Law at East China University of Political Science and Law. In early 2014 he founded Young Swiss in China, a forum for Swiss in China to exchange ideas and explore career opportunities.

Aline Ballaman is the Operation Manager of the Swiss Center Shanghai. Aline holds a Bachelor's degree in Business and Administration from La Chaux-de-Fonds. After 8-years management experience in the tourism and watch industries in Switzerland, she came to China in 2011 and enrolled in a 1-year Chinese language at Suzhou University before joining the Swiss Center Shanghai in 2012 as Operation Manager. For the past two years, she has been responsible for the Shanghai Office in advising and supporting Swiss businesses entering the Chinese market. In early 2014, she successfully managed a new 4000 sqm facilities project dedicated to Swiss businesses complete with a showroom, offices, and a warehouse in the China (Shanghai) Pilot Free Trade Zone.

PREFACE & KEY TAKEAWAY

In cooperation with the China Europe International Business School (CEIBS) (www.ceibs.edu), the Swiss Center Shanghai (www.swisscenters.org), swissnex China (www.swissnexchina.org), SwissCham (www.cn.swisscham.org) and China Integrated are pleased to bring you the findings of Swiss respondents who participated in the **CEIBS Business in China Survey 2014**, to analyze them and draw conclusions that we hope will be useful for Swiss companies and their activities in China.

This latest CEIBS survey is of particular interest not only for its findings but also because:

- With over 1'000 responses it gathers **the largest amount of respondents** in one such yearly survey. (by comparison, 557 companies participated in the 2014 EU chamber survey and 365 in the 2014 American Chamber in Shanghai survey).
- It is the only survey that collects responses from **Chinese** as well as **foreign companies** in China.
- It allows **comparisons among firms of different national origins**, based on a sufficient number of replies for each origin.

This is also the **first time that a business survey has been able to analyze a sizeable sub-sample of foreign SMEs in China**. Though barely 50 Swiss and EU companies employing 300 employees or less globally (classified as SMEs) answered the survey, this sample shows among others **that SMEs are generally more successful in China than larger firms** and the probable reasons for this success.

For the Swiss business community, it is for the second time possible to understand **how similar Swiss, European and American companies perceive their China environment**.

As a result, some findings on European and American companies can also be used to estimate and confirm Swiss companies' trends. Globally speaking, Swiss, European, and American companies in China are doing well. **On average they doubled their average profit growth expectations from 2012 to 2014**.

The confidence level of Swiss companies for 2014 continues its upward trend since 2012, though going up only slightly compared to 2013. **Swiss companies are also markedly more positive** than their EU, US and Chinese counterparts. Interestingly, the latter (non-Swiss) are all announcing very similar levels of confidence.

And while non-Swiss respondents have only very little more confidence in the future (in 5 years) than in 2014, **Swiss companies keep seeing much brighter prospects for the long term** than other respondents.

And, in a change from last year's survey, Chinese companies, too, are more confident in the success of their business in 2014.

All but the EU companies are planning to invest more on average than the previous year, **with the Swiss increasing most**, certainly reflecting their generally higher levels of confidence. Bad economic conditions in the EU, no doubt, are the reason for the absence in EU investment growth.

All foreign companies are, however, united in expecting better sales and better profits on average in 2014 when compared to 2013. Profitability increase expectations are considerably higher for foreign firms than for the Chinese ones.

Challenges are growing as well. **Increasing competition from Chinese companies** is again the most important management challenge. However, **it is the first time that competition from private Chinese companies is perceived to be more important than from other foreign ones**, regardless of their nationality.

Thus, managers who are facing the market in China see different challenges than managers in the headquarters. Like last year, **lack of understanding and support from the head office** is the **second most important management challenge**. This illustrates the constant perception gap between head offices and their subsidiaries operating in China.

In addition to the common misperception reported in the media about Swiss and foreign companies' lack of success in China, we find a **general overestimation** of the importance that **corruption and IP infringements has on companies in China**.

This year again, **a much larger proportion of Swiss SMEs is answering the survey** when compared to the EU and US respondents (in proportion Swiss SMEs respondents are almost twice as many when compared to EU SMEs), lending credence to the fact that **a larger proportion of Swiss smaller companies are successfully penetrating the Chinese market** when compared to other international companies

In addition to an analysis of key answers from Swiss companies in China, you will find some **additional analyses** that we believe are of much interest. In particular, a review of China's growth that explains why in business terms, **China's GDP growth is actually accelerating** and not slowing down. You will also find a review of the reasons why China has no other choice but to reform and **provide a more level playing field to the private sector**.

The first part of this report emphasizes Swiss companies, while the overall results of the **CEIBS survey and analysis of foreign and Chinese companies** are presented in the second part of the report.

Hopefully, this survey will dispel misperceptions and **highlight the actual situation that Swiss and international businesses face in China**. Additionally, we hope that these facts and analyses as well as the benchmarks they provide will help Swiss companies to **become even more successful** in the coming years.

We also want to express our **sincere gratitude to all the respondents**: thanks to them, a representative and objective point of view on Swiss-China business is available to all. At the same time, we take the chance to **encourage everyone to participate in the 2015 survey**, to expand the knowledge pool available to do successful business in China.

EU & SWISS SMES: MORE SUCCESSFUL IN CHINA THAN LARGER FIRMS!

About 31% of Swiss respondents can be classified as Small and Medium Enterprises (**SMEs**) defined as companies with **less than 300 employees globally**; and close to 31% are large companies with over 10'000 employees worldwide.

By comparison, other western SMEs are much less represented with only 18% of European and 2% of American companies having less than 300 employees.

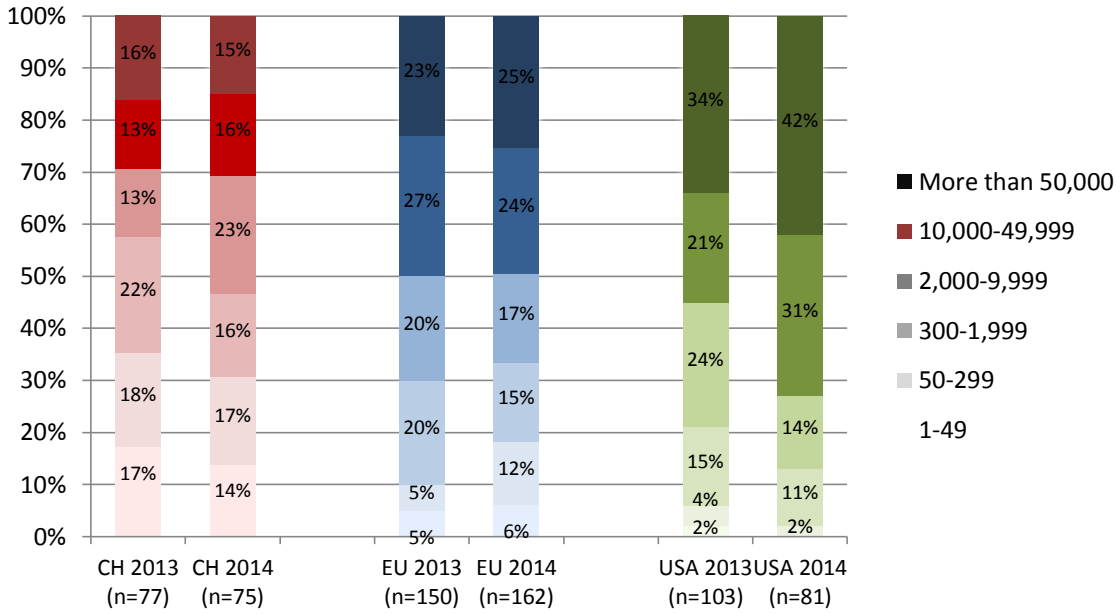
We cannot determine for sure that the firms who responded to the survey are representative in terms of size of the total Swiss, European and American population.

Still, this difference which was uncovered in 2013 persists in 2014 and creates grounds on which to believe that Swiss SMES have been comparatively faster at establishing themselves in China than their counterparts from Europe and America.

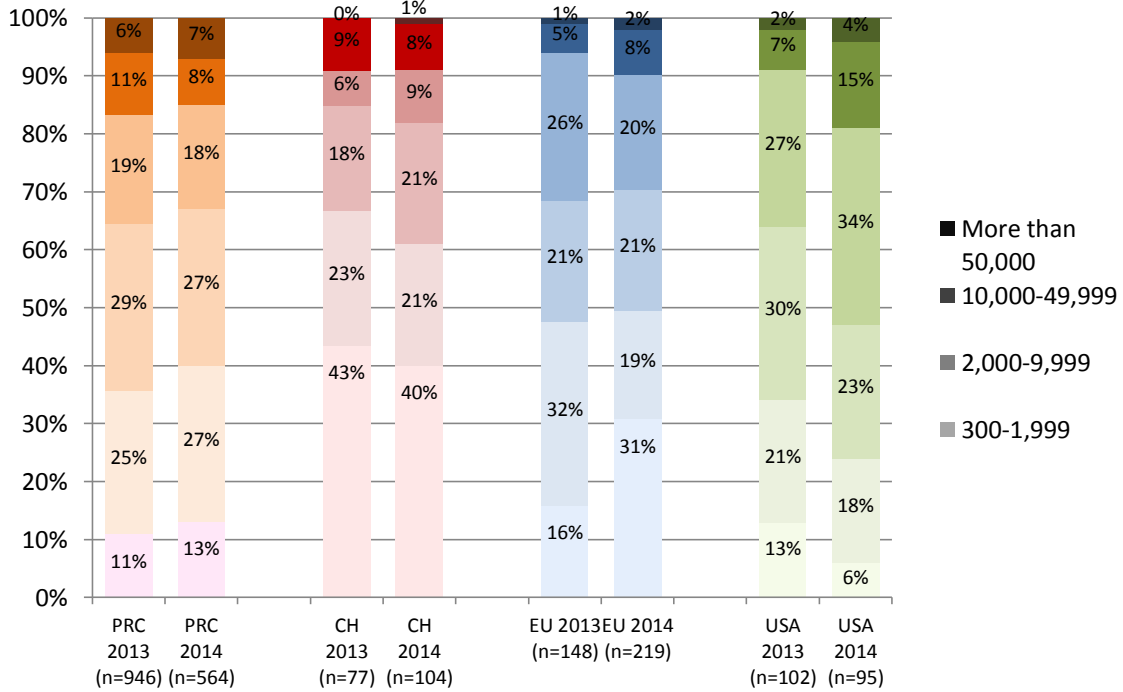
These results are also consistent with the fact that Swiss SMEs, due to the small size of their domestic market, are more adapted and geared towards internationalization than their counterparts.

The 2014 respondent companies' size is generally consistent between 2013 and 2014, at least for the EU and Swiss respondents, allowing us to compare the evolution between the two years with some confidence.

HOW MANY EMPLOYEES GLOBALLY?

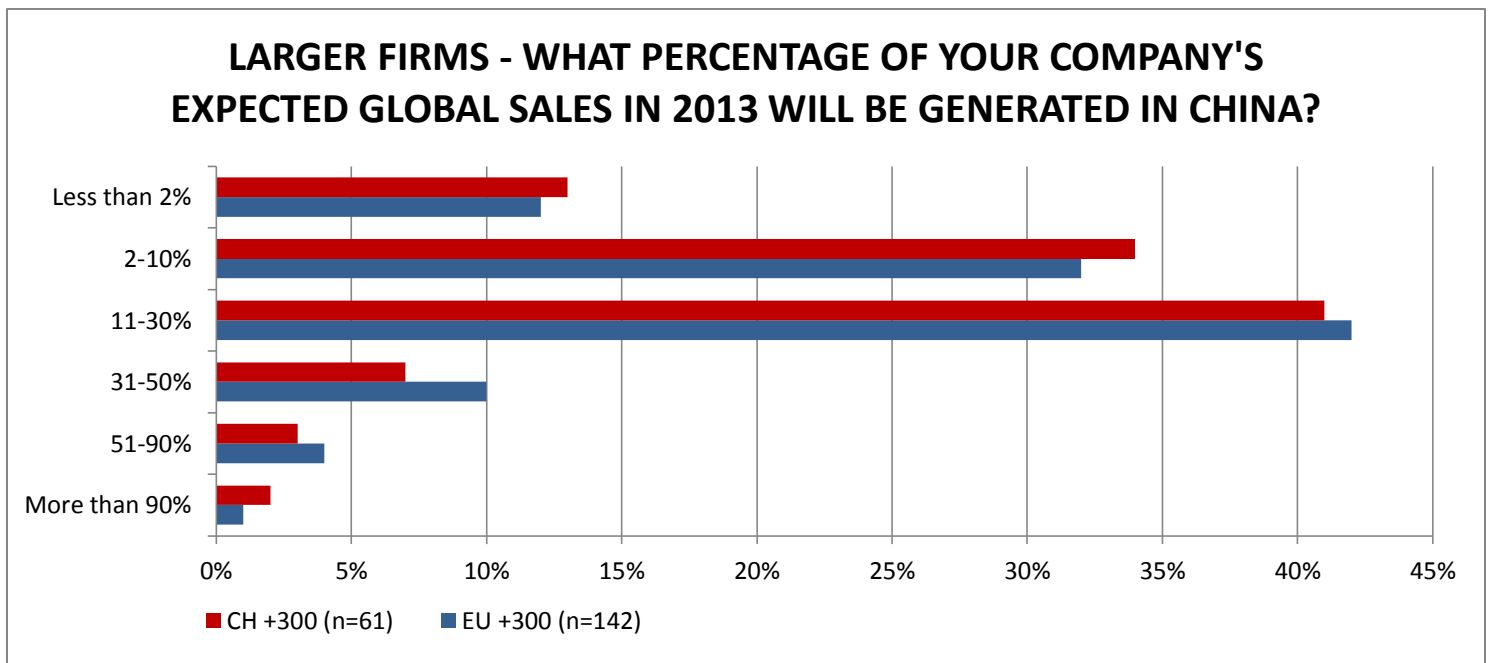
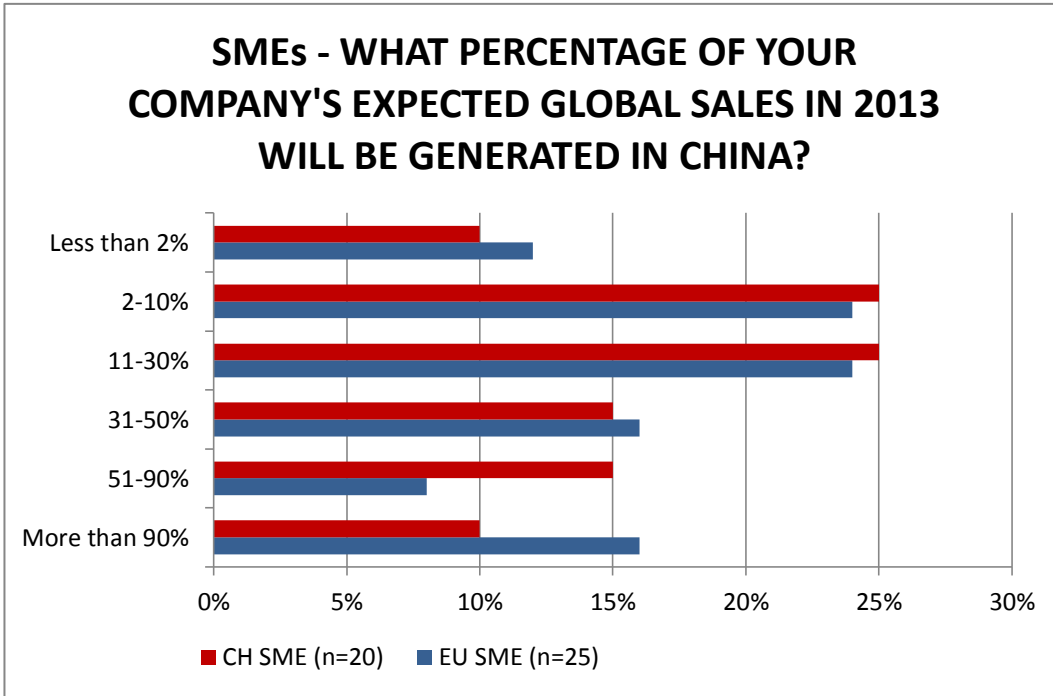


HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?



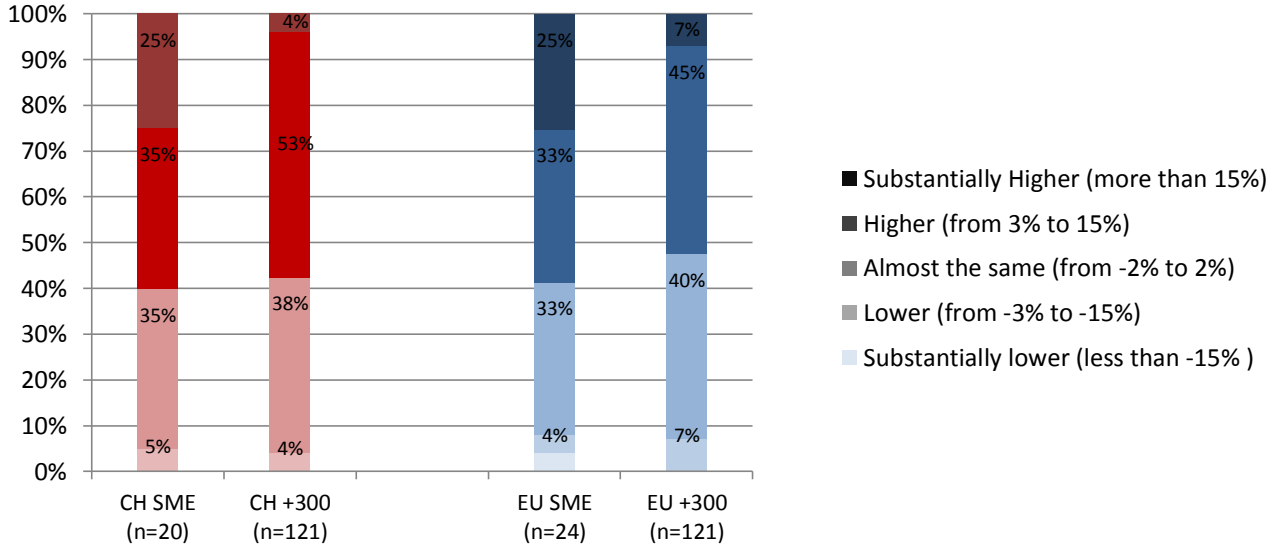
China, contrary to its portrayal in the media, is becoming a venue for SME success

Swiss and European SMEs in China are now more than ever seeing higher percentages of global sales being generated in China.



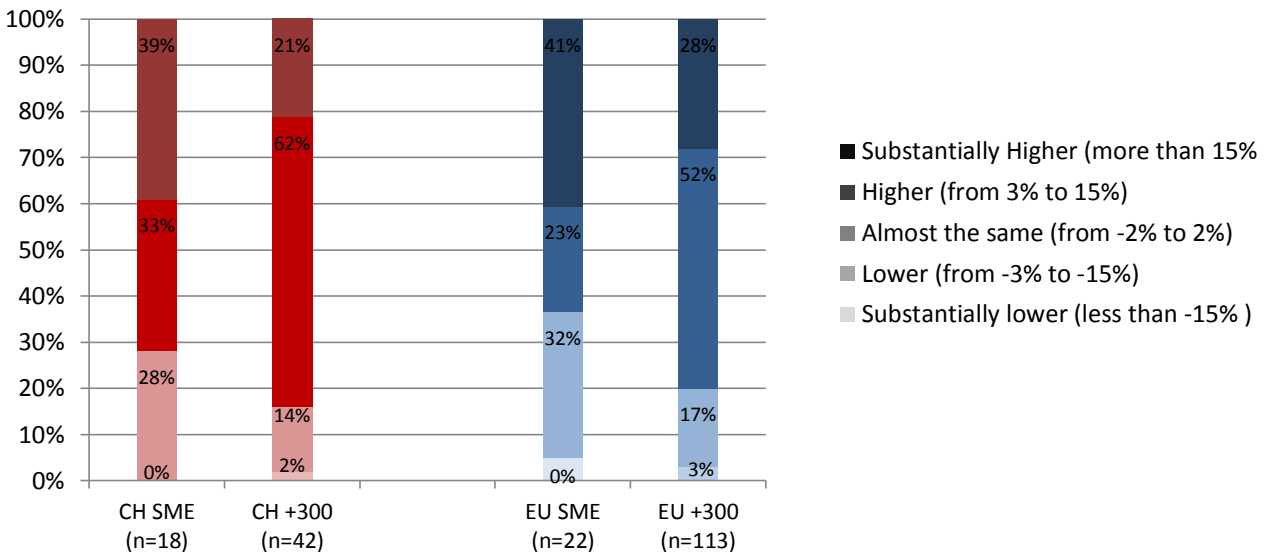
And while all companies see their sales and profits improving in 2014 on average, **respondents from SMEs see their sales increasing significantly faster than their colleagues in larger firms.**

SMEs vs. LARGER FIRMS - HOW DO YOU EXPECT YOUR COMPANY'S CHINA PROFIT FOR 2014 COMPARED TO 2013?



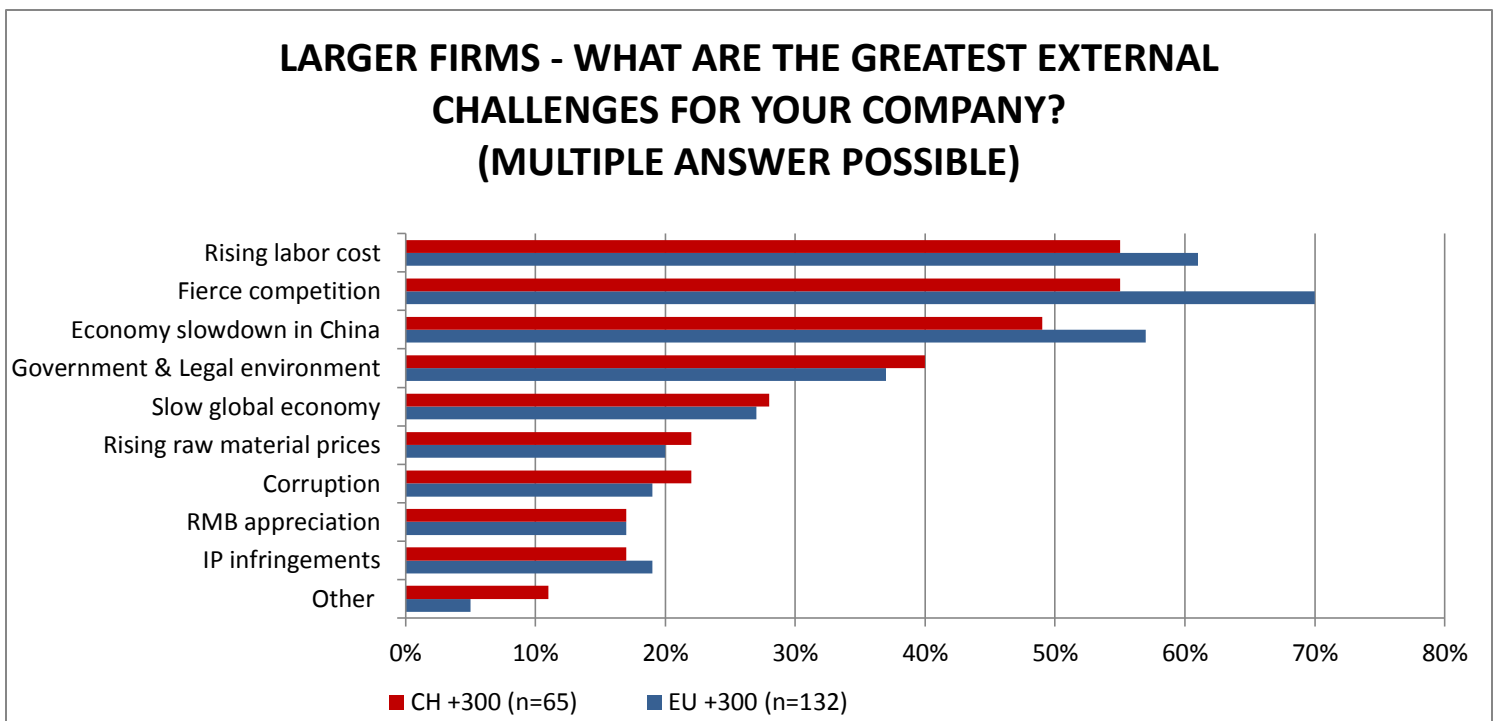
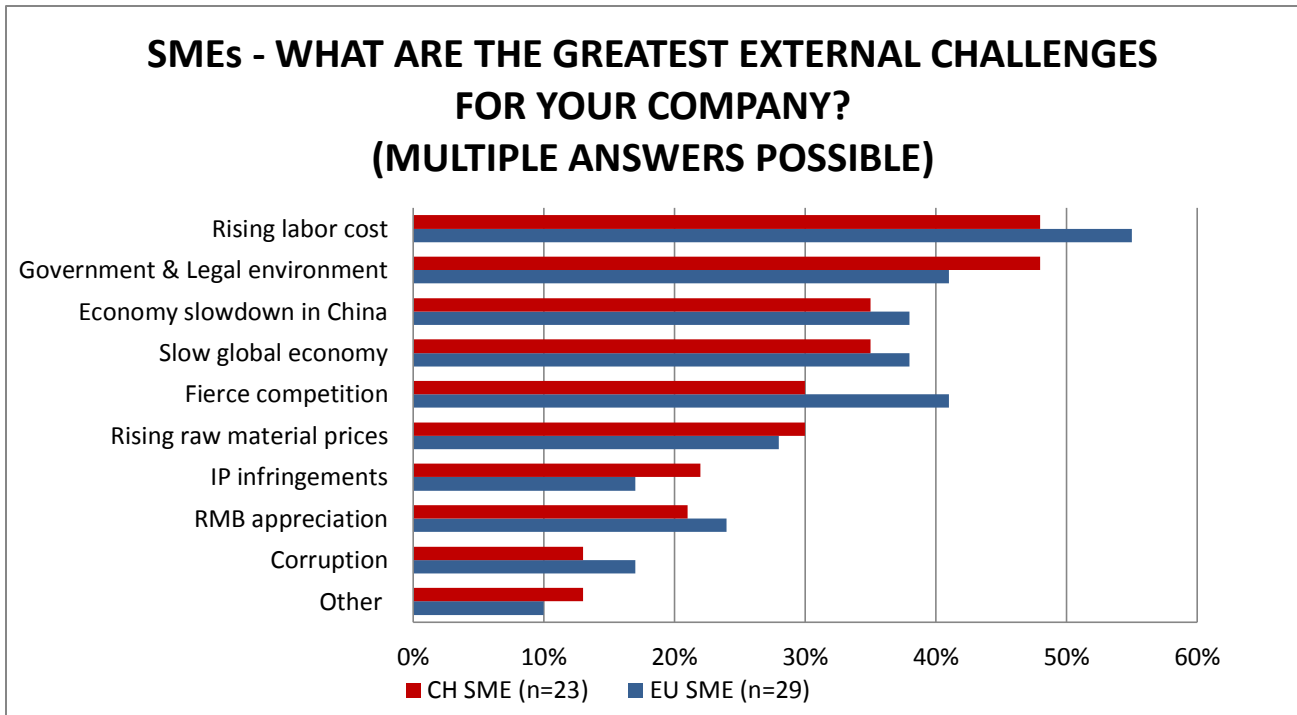
In terms of sales growth the picture is more uneven with more SMEs doing much better than larger firms while at the same time a larger number are not doing as well.

SMEs vs. LARGER FIRMS - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES FOR 2014 COMPARED TO 2013?



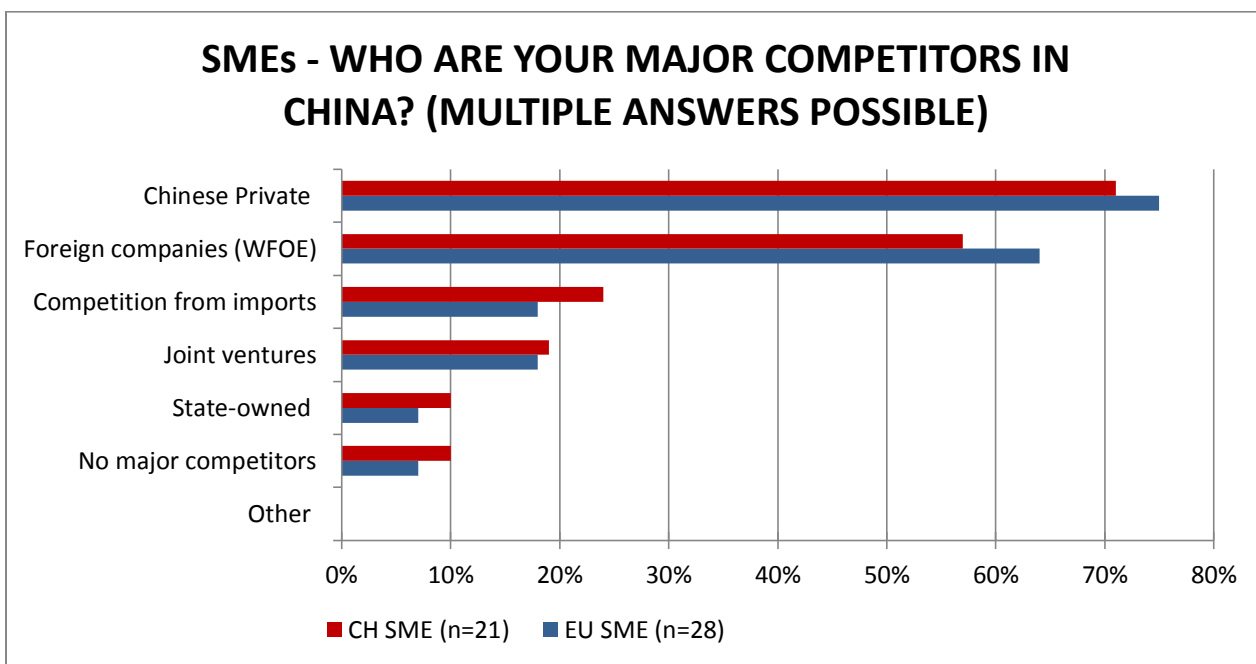
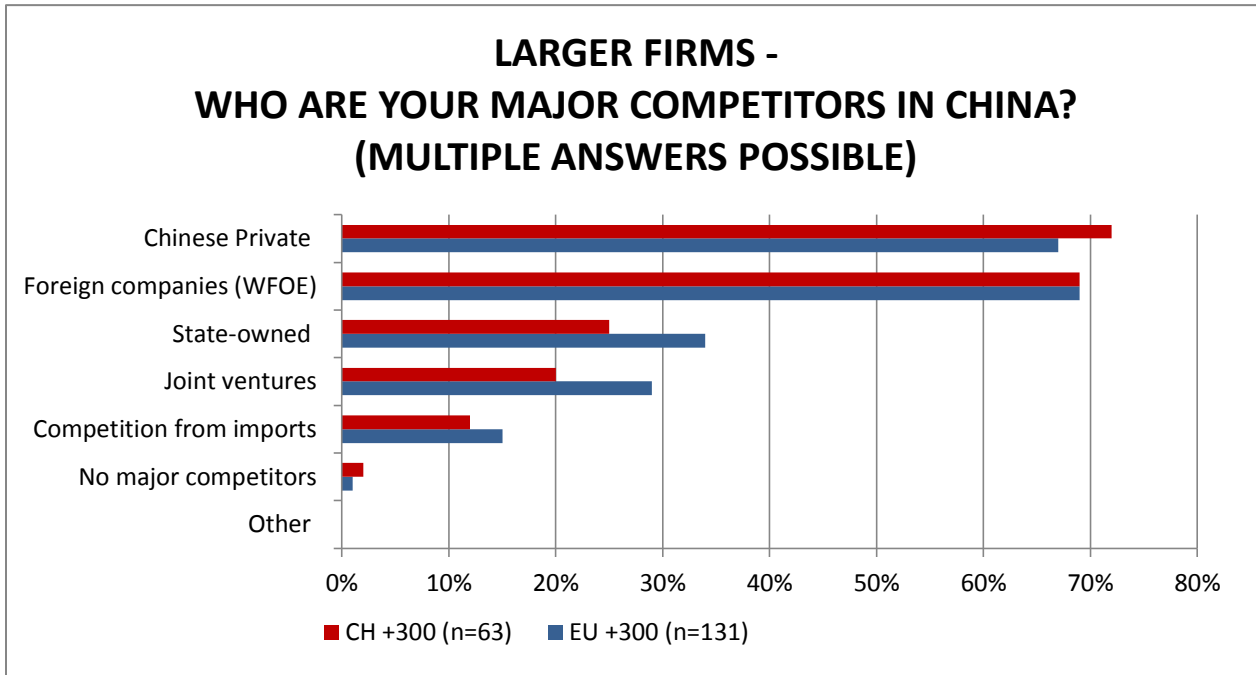
A possible reason for the success of SMEs is an environment that is less competitive for them. Indeed **“Fierce Competition”** comes quite a few steps lower in the ranking of external challenges they face when compared to the larger firms. In addition and very interestingly, SMEs rank their external challenges lower than their larger counterparts, with the exception of **“Government & Legal Environment.”**

For example **“Rising Labor Costs”** is mentioned as a challenge by 50% of SMEs but close to 60% of larger firms. **“Economy Slowdown”** is mentioned by less than 35% of Swiss SMEs but by close to 50% of larger firms.



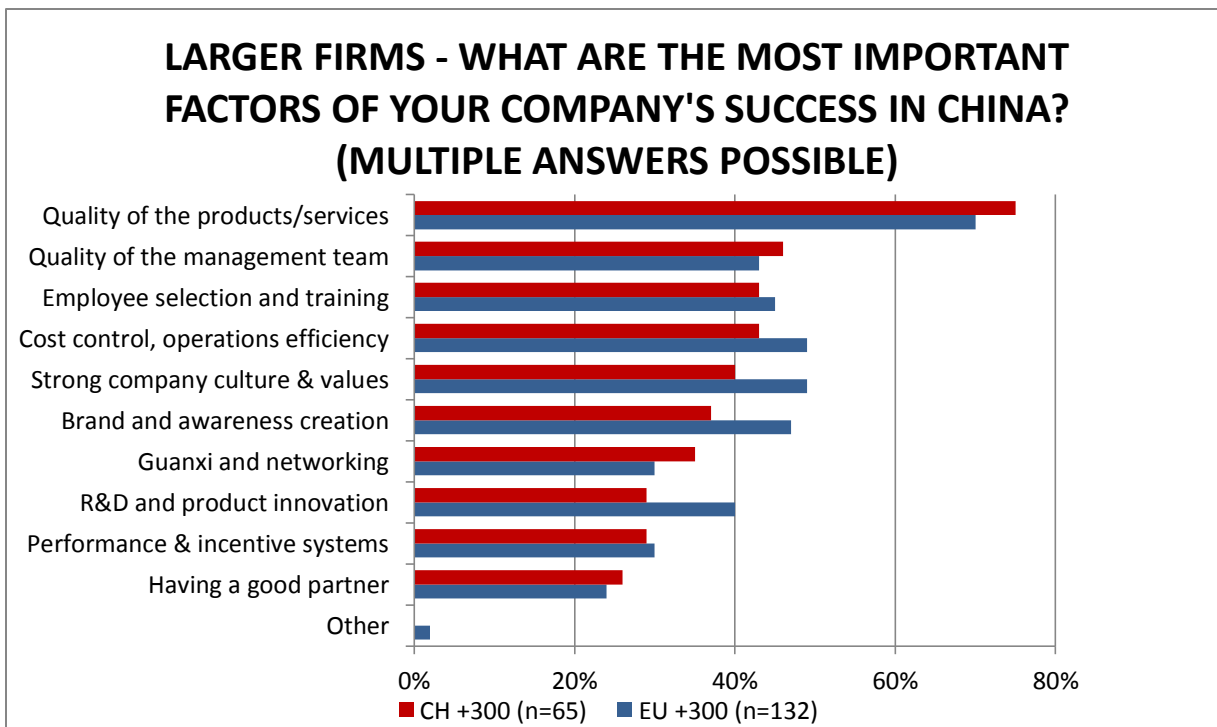
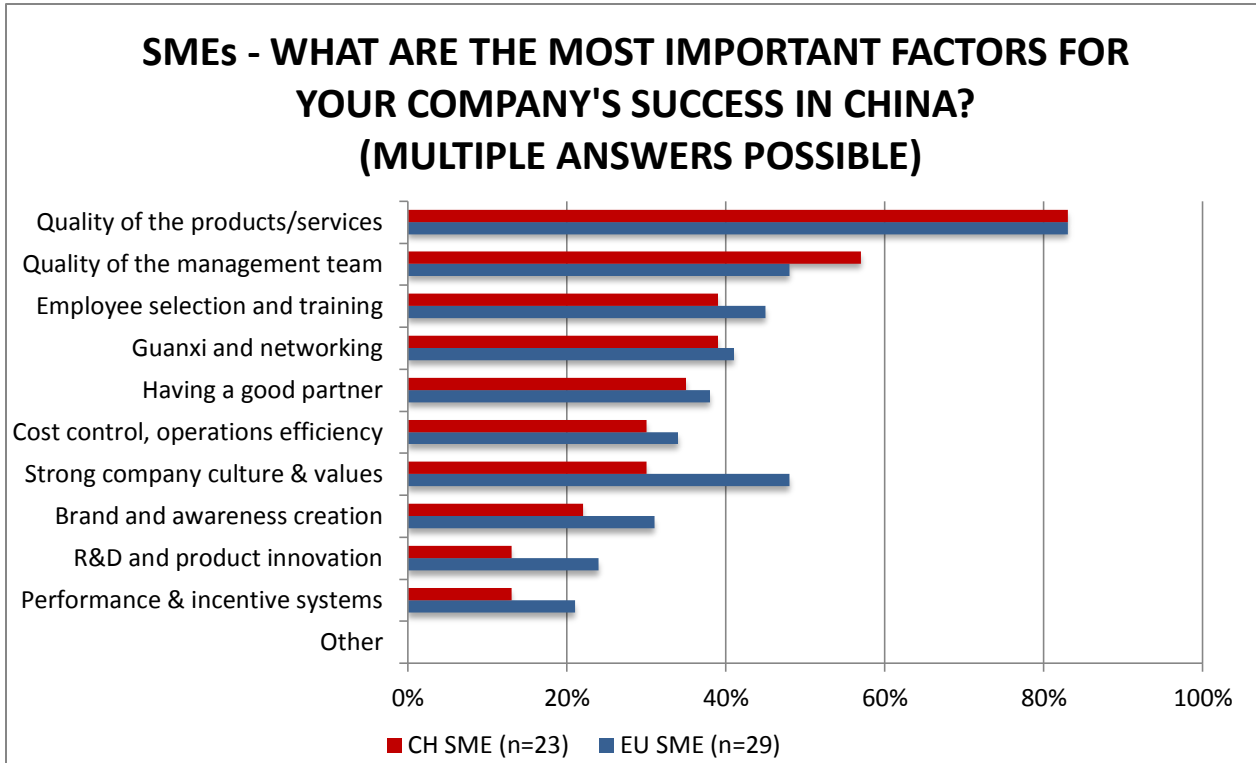
This lower level of competition and challenges could well be due to the SMEs' very nature of doing business: focusing on niches. Indeed, China's mass market is very attractive, but therefore also terribly competitive, but niches are less crowded.

This is generally confirmed by the competition picture (below): it is not fundamentally different for SMEs and larger firms with the exception that more SMEs don't have major competitors, which is typical of niche businesses.



In terms of success factors, SMEs and larger firms do not differ fundamentally either, which again speaks in favor of the niche business advantage to explain the better success level.

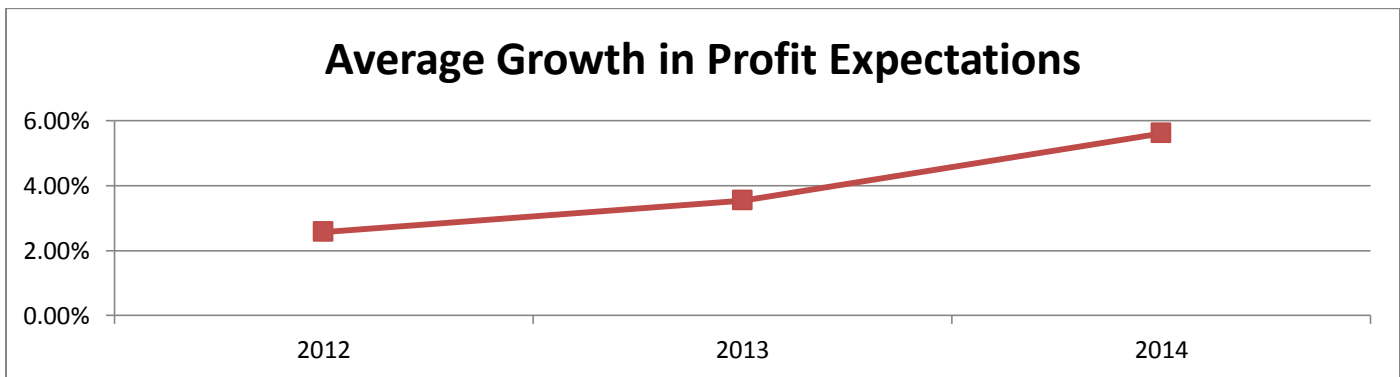
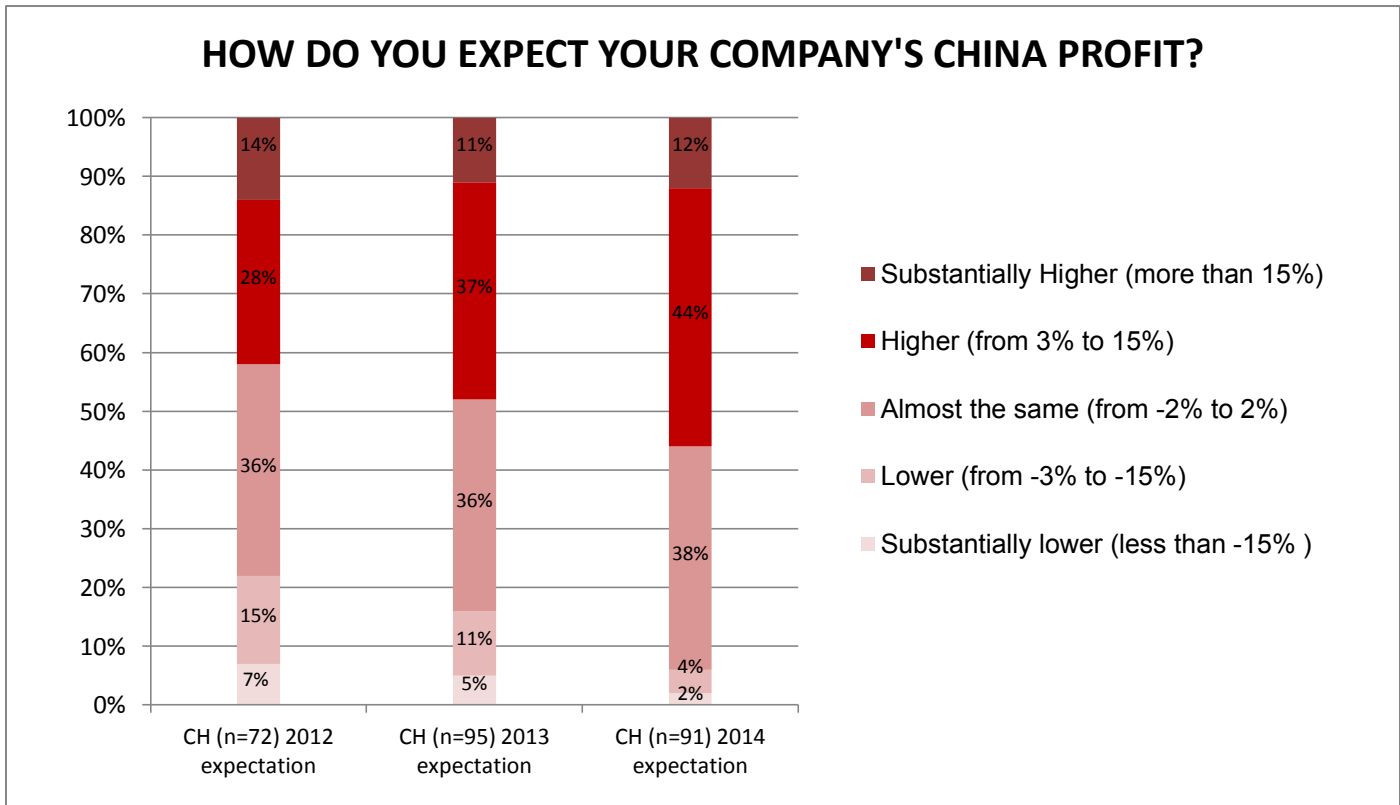
However, SMEs pay even more attention to the quality of their products and management team and they tend to rely more on their network and partners. But the latter is probably natural anywhere for smaller companies.



INCREASING REVENUES, PROFITS, INVESTMENTS AND CONFIDENCE ACROSS THE BOARD

Expectations of annual profit increase has doubled for Swiss companies since 2012

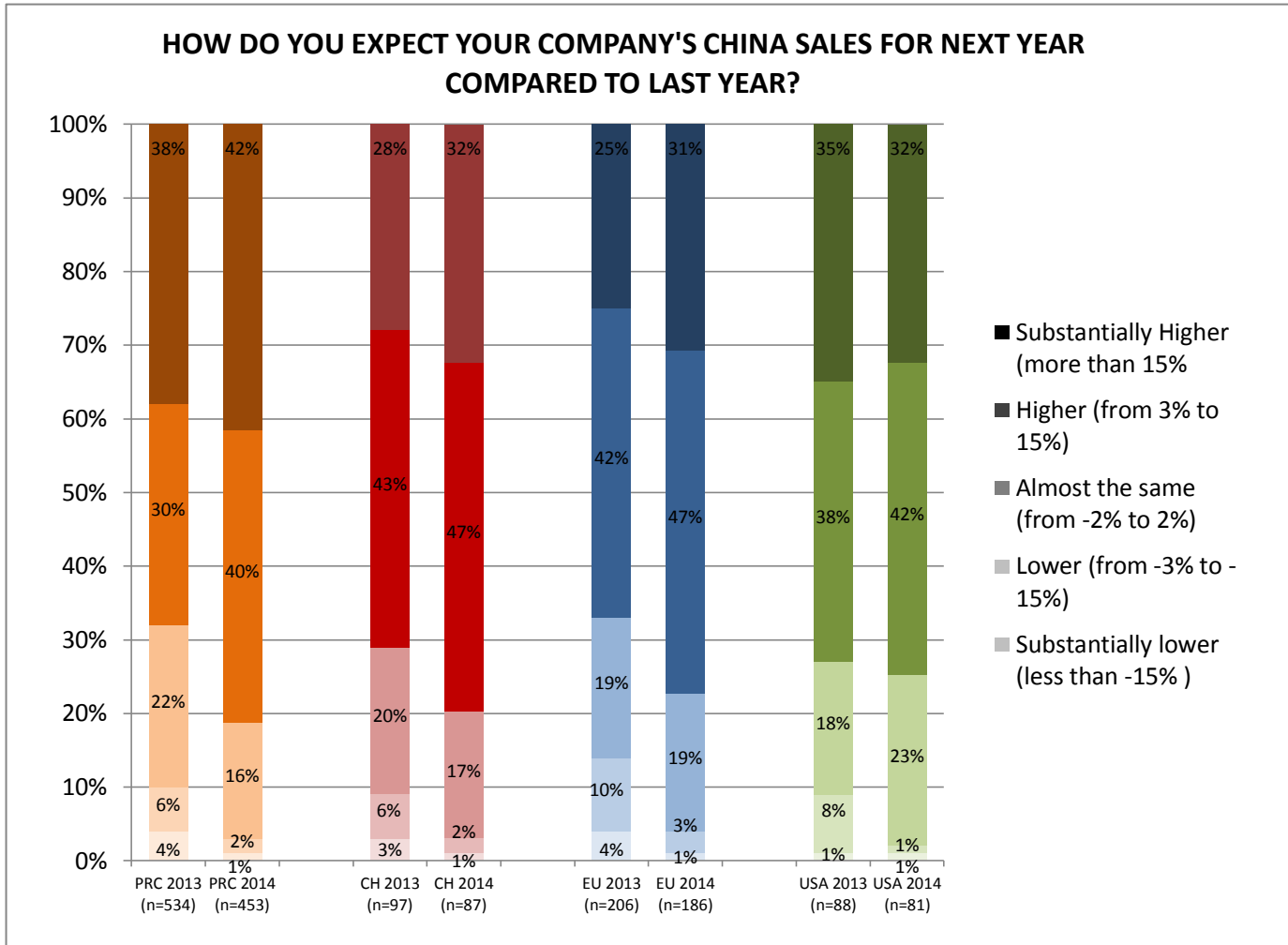
In 2014, sales and profits of Swiss and foreign companies are in continued acceleration. In 2014, Swiss firms in China expect profit increases of 5.6% on average compared to 2013. In comparison, the figure was 3.5% in 2013 and 2.6% in 2012, so that profit increases have been every year higher since 2012.

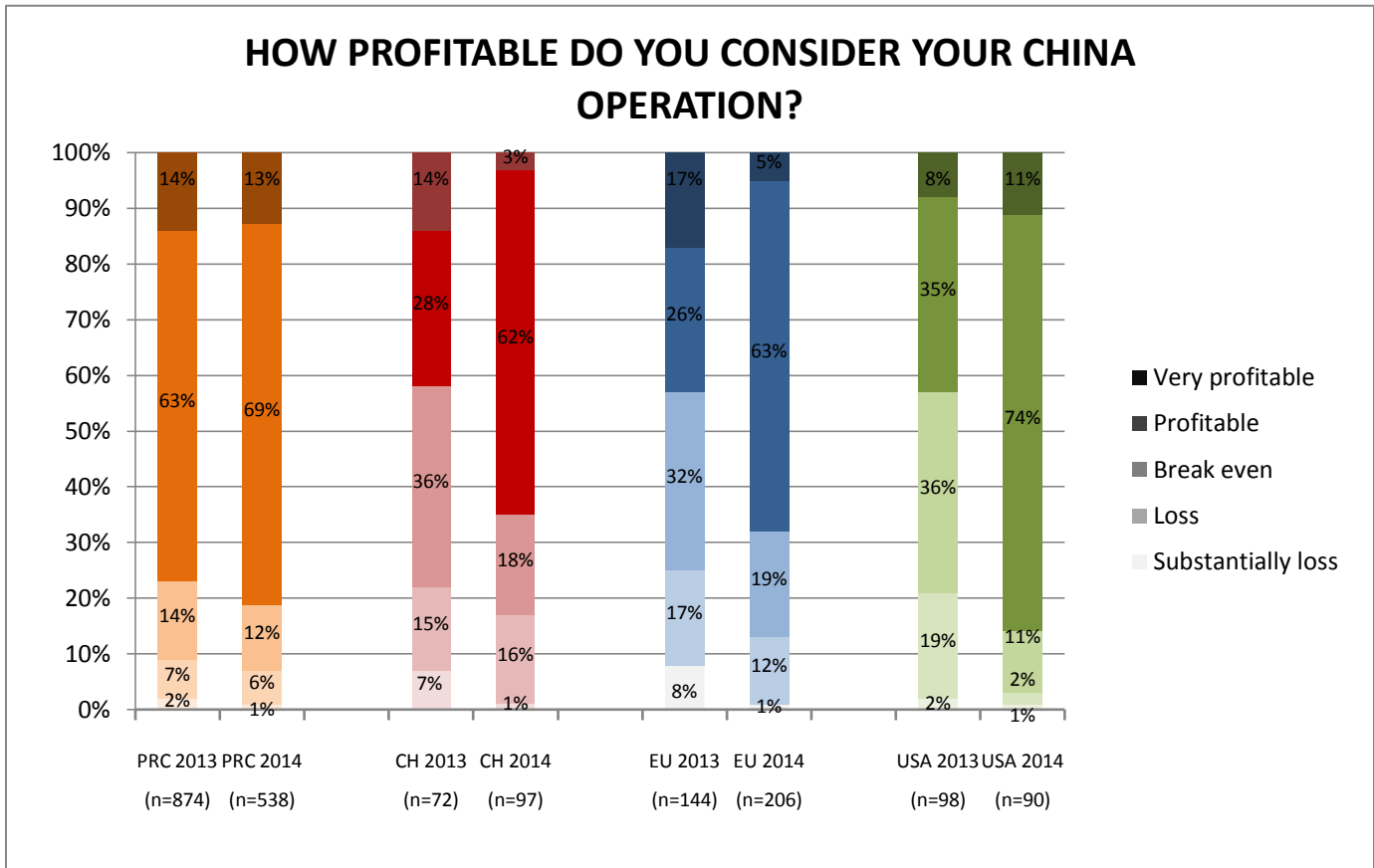


The sales growth situation is the same: **companies of all origins surveyed expect on average a stronger increase in sales in 2014** compared to 2013 and compared to the previous year.

This result may appear extraordinary in light of the media reports constantly commenting on China’s decelerating growth.

For an explanation of this paradox do read our “**Additional Analysis: What Growth for Businesses in China in the Coming Years**” at the end of this report ([Page 34](#))





While American (USA) companies are increasing their profitability rather than their sales, the answers of Swiss (CH) and European (EU) respondents are tightly matched both on revenue and profits.

Investment plans in China naturally follow profits and remain a top priority

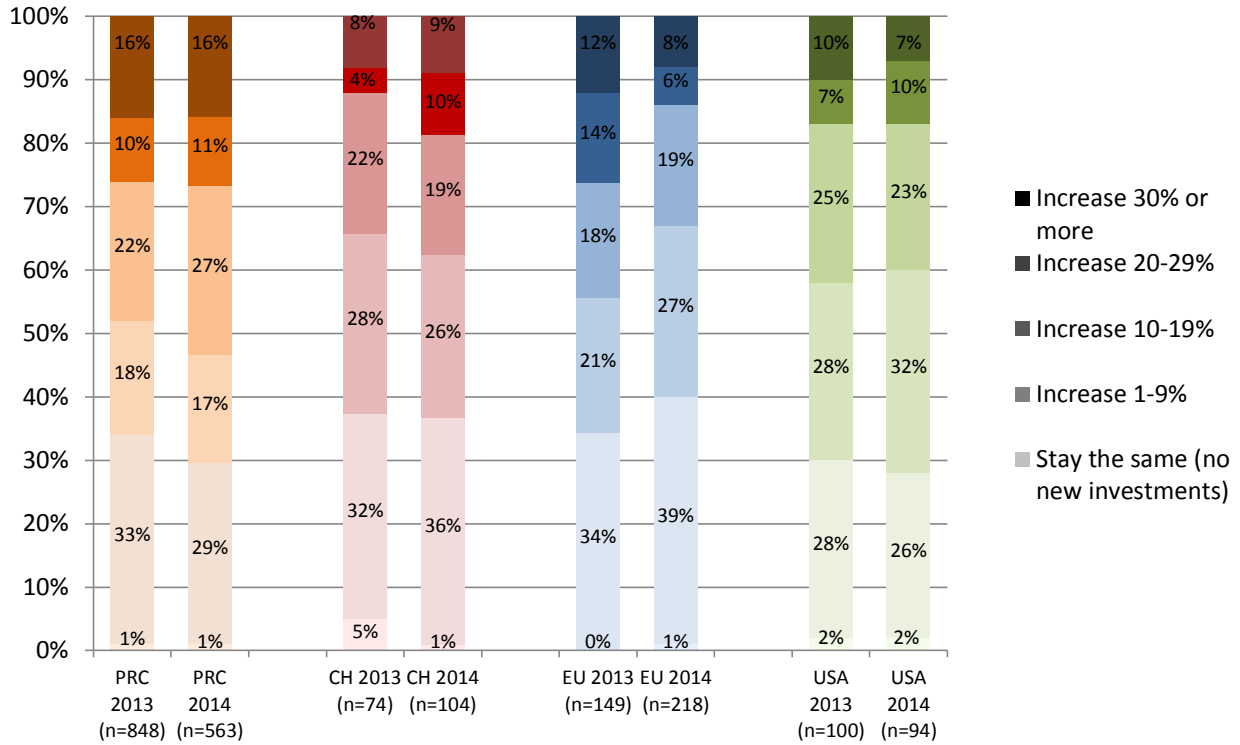
Based on the profit and revenue picture, it is not surprising to see that growing investment plans and investments in China command a high priority.

64% of the Swiss companies surveyed plan to increase investment in China in 2014 and more than half of them consider China as a top 3 investment destination.

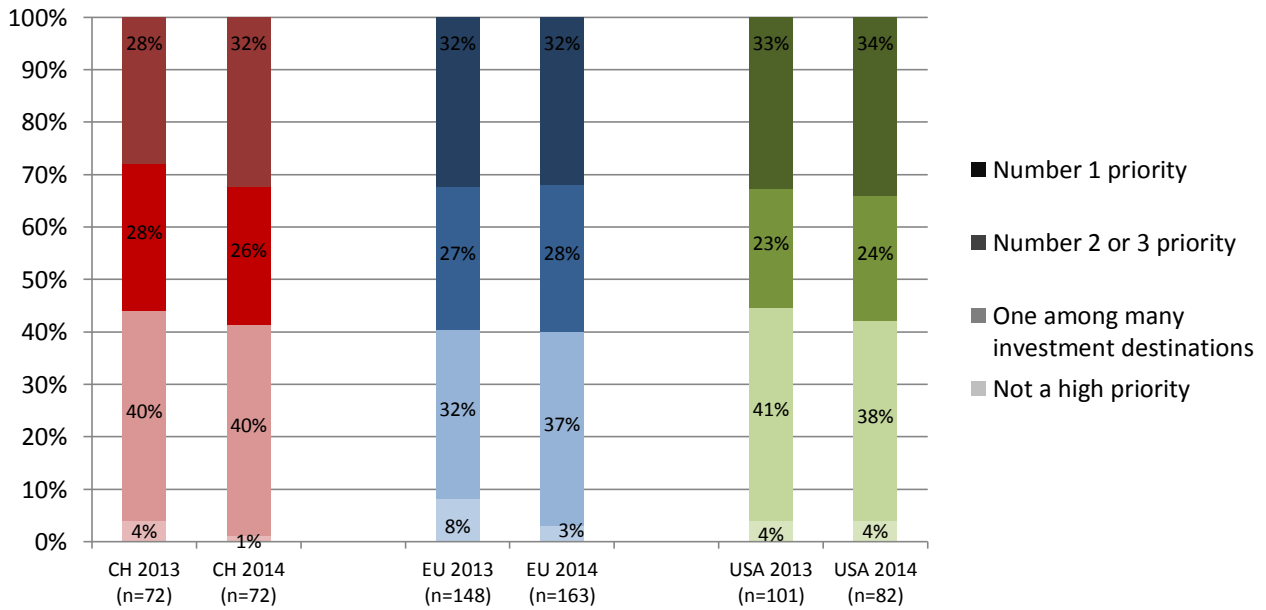
Despite their lower level of confidence, the **Chinese firms are clearly the most aggressive investors**, planning to accelerate their investments importantly in 2014 compared to 2013.

Although Chinese respondents' confidence is lower than foreign firms, it is interesting to note that Chinese nevertheless intend to invest more than their foreign competitors. This indicates either more appetite for risk or a different way to rate confidence, but in any case it shows a definitely positive outlook from Chinese firms as well.

WHAT INVESTMENT DO YOU PLAN IN CHINA?

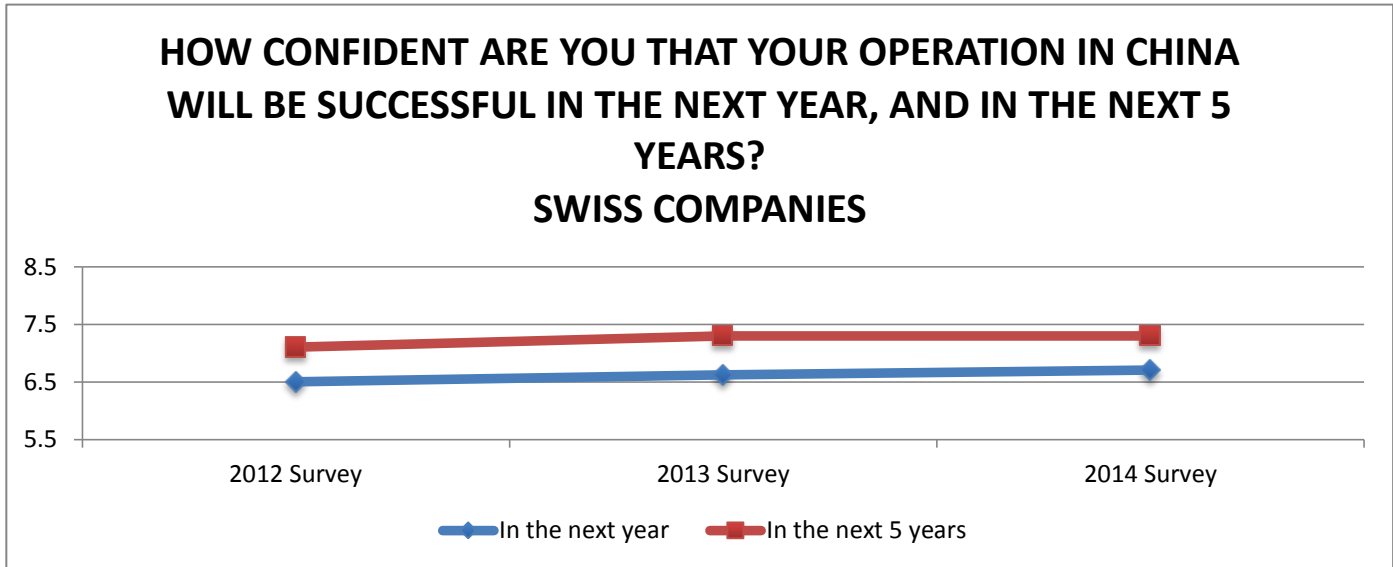


HOW DOES CHINA RANK IN YOUR GLOBAL INVESTMENT PLAN?

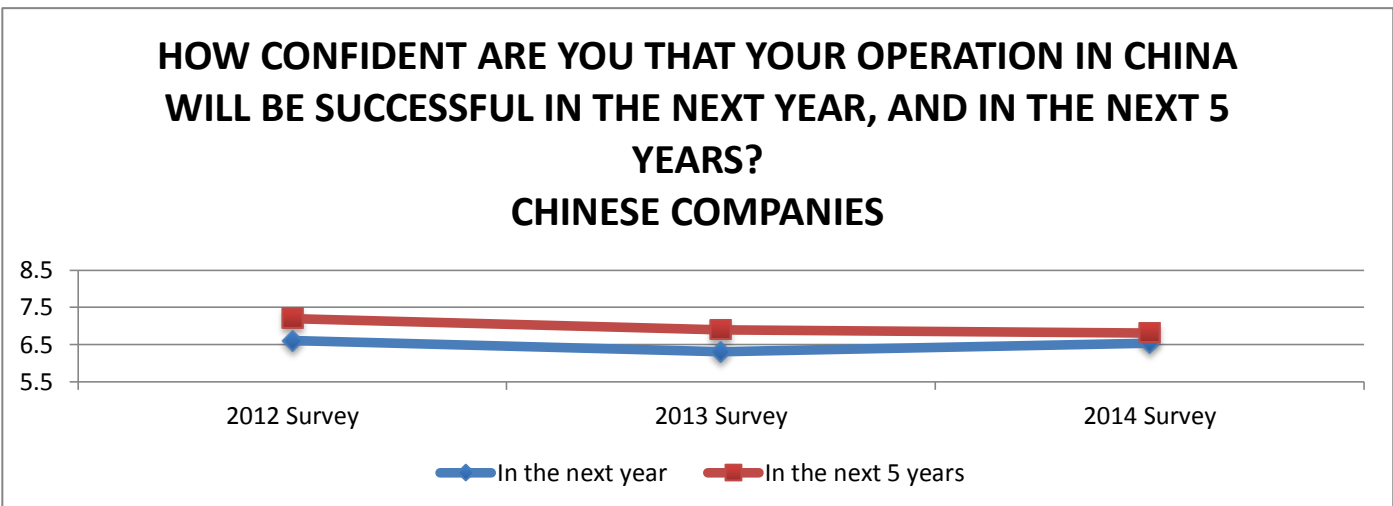


Swiss respondents remain the most confident

Swiss respondents are more positive than all others and particularly on the long term: for the next 5 years, respondents are more than “confident” (7 on the scale) on average that their operations in China will be successful.



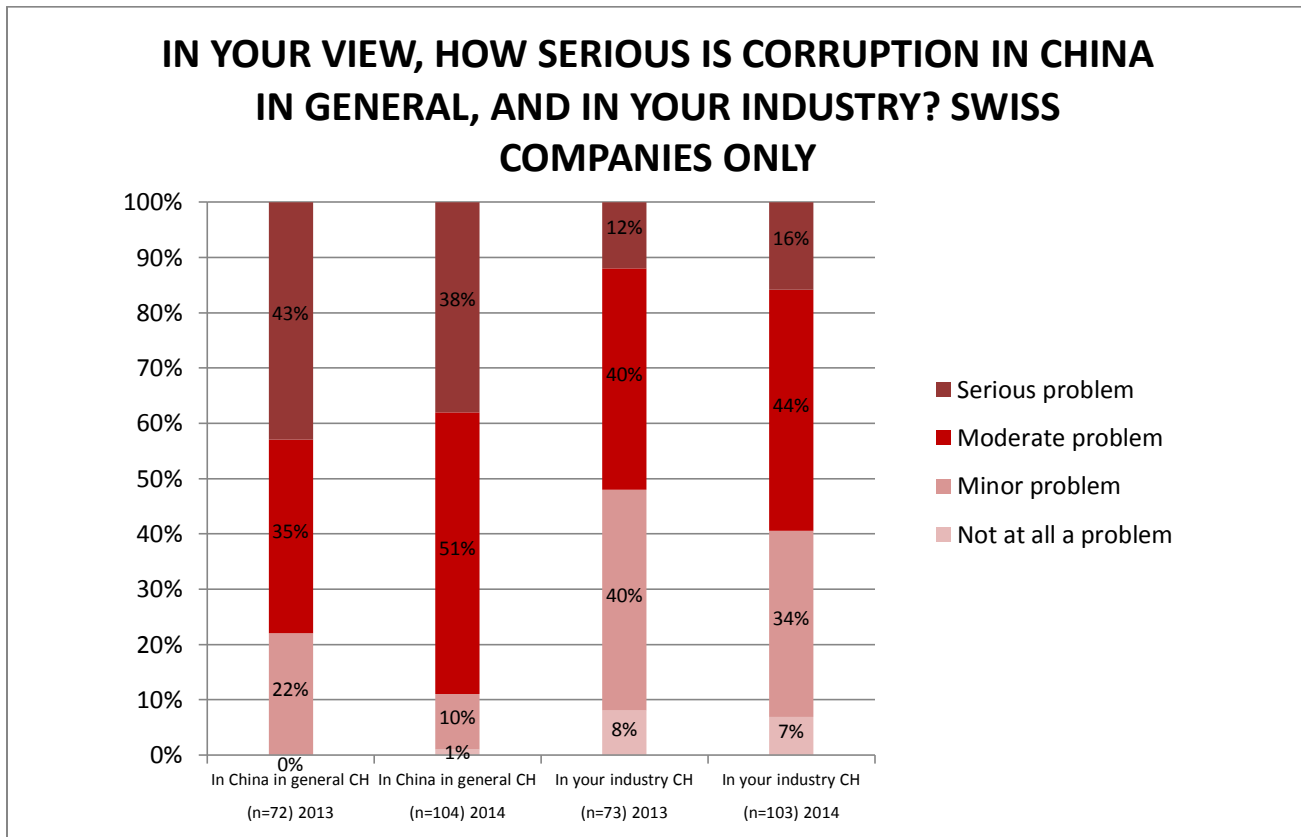
Other companies are quite confident (the Chinese are charted below, the EU and US firms confidence level is very similar) but they don't expect as good results as the Swiss do in the long term.



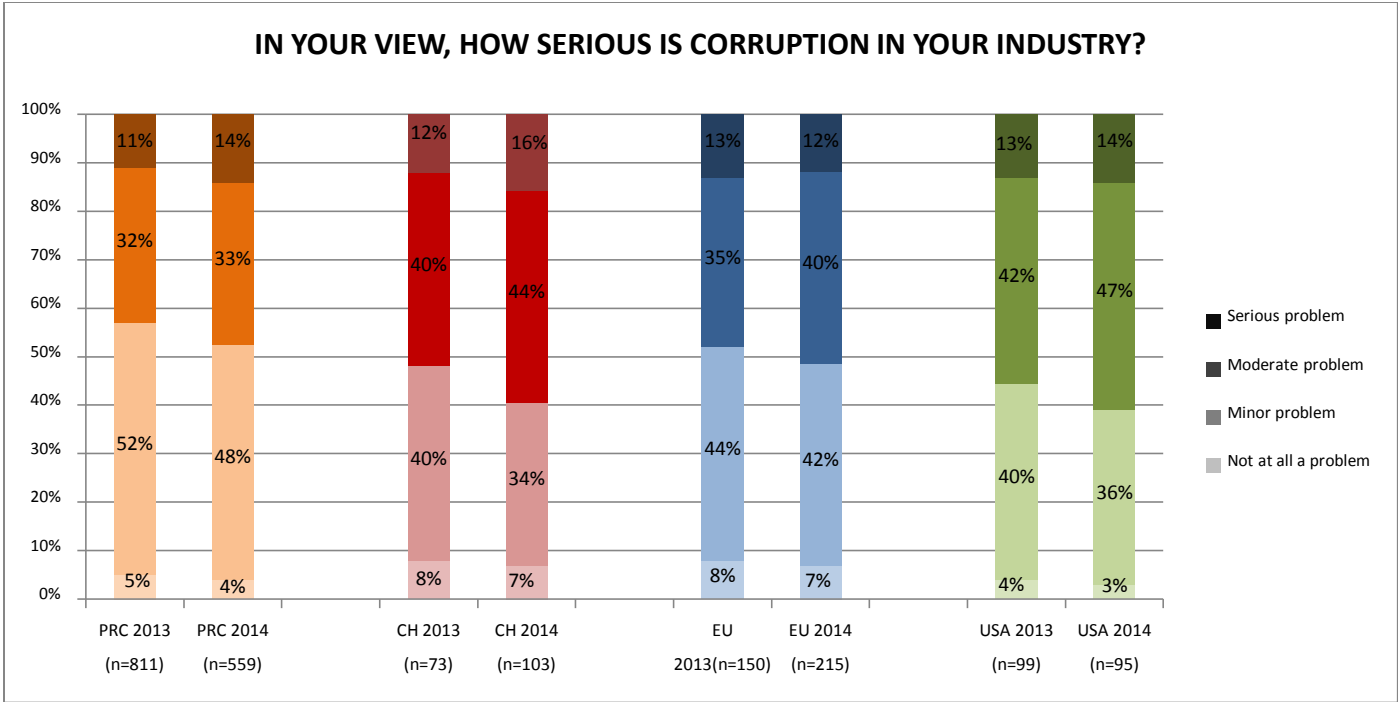
A WIDE PERCEPTION GAP BETWEEN VIEWS FROM CHINA AND SWITZERLAND

Corruption & legal environment

When asked if **corruption** is important **in China in general**, a sizeable proportion (**38%**, almost 2 out of 5) of Swiss companies see it as a “**serious problem**.”



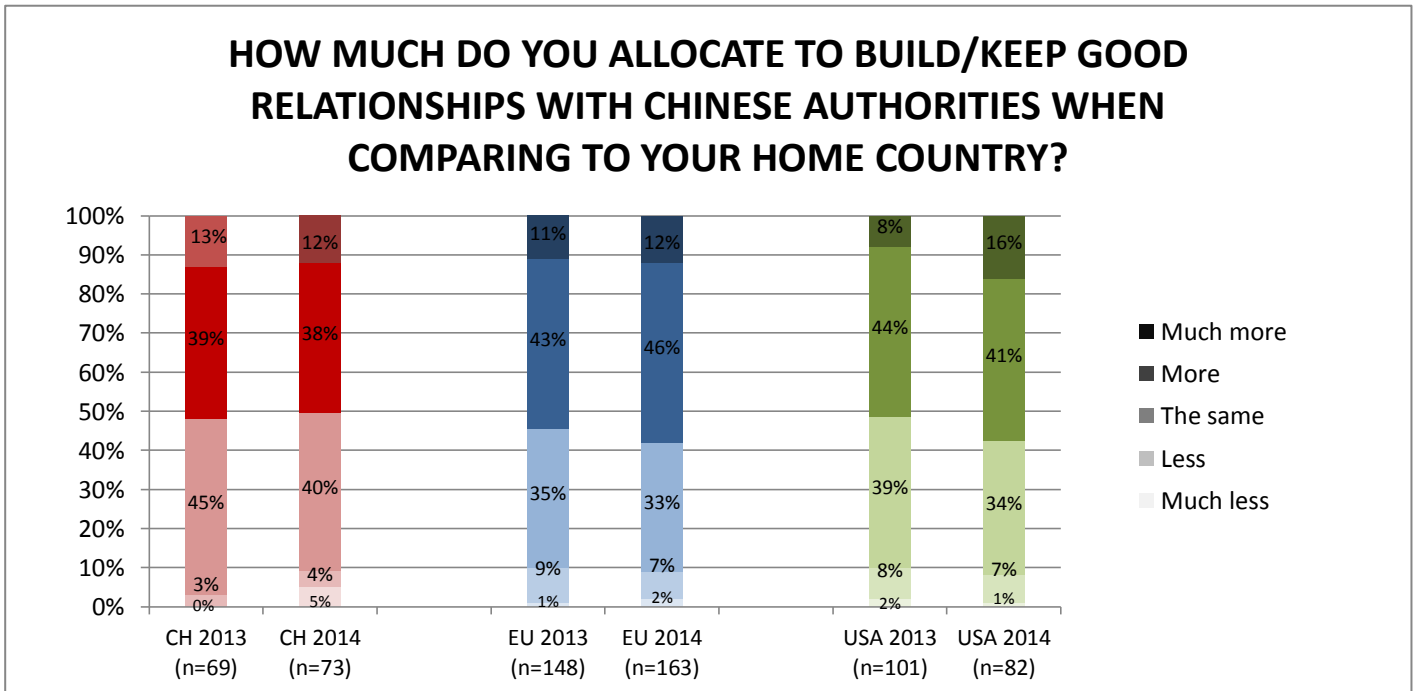
However, when asked how serious corruption is **in their industry**, around 78% of the respondents see it as a “moderate” or “minor problem.” **Only 16% (1 out of 7) Swiss companies** say that corruption is a **serious problem** in their industry. Interestingly, the picture is very similar for other foreign companies **as well as for Chinese companies**.



These paradoxical answers highlight a critical phenomenon. On one hand, there is the general feeling that “China is corrupt”, fueled by scandals and countless anecdotes, which is also the aspect that foreign media report on.

On the other hand there is the reality of doing business in China, where corruption is one of many issues to deal with, though certainly not the most important one as shown by **the low ranking of corruption in terms of challenges** (See “Challenges to Overcome for Success”, [Page 21.](#))

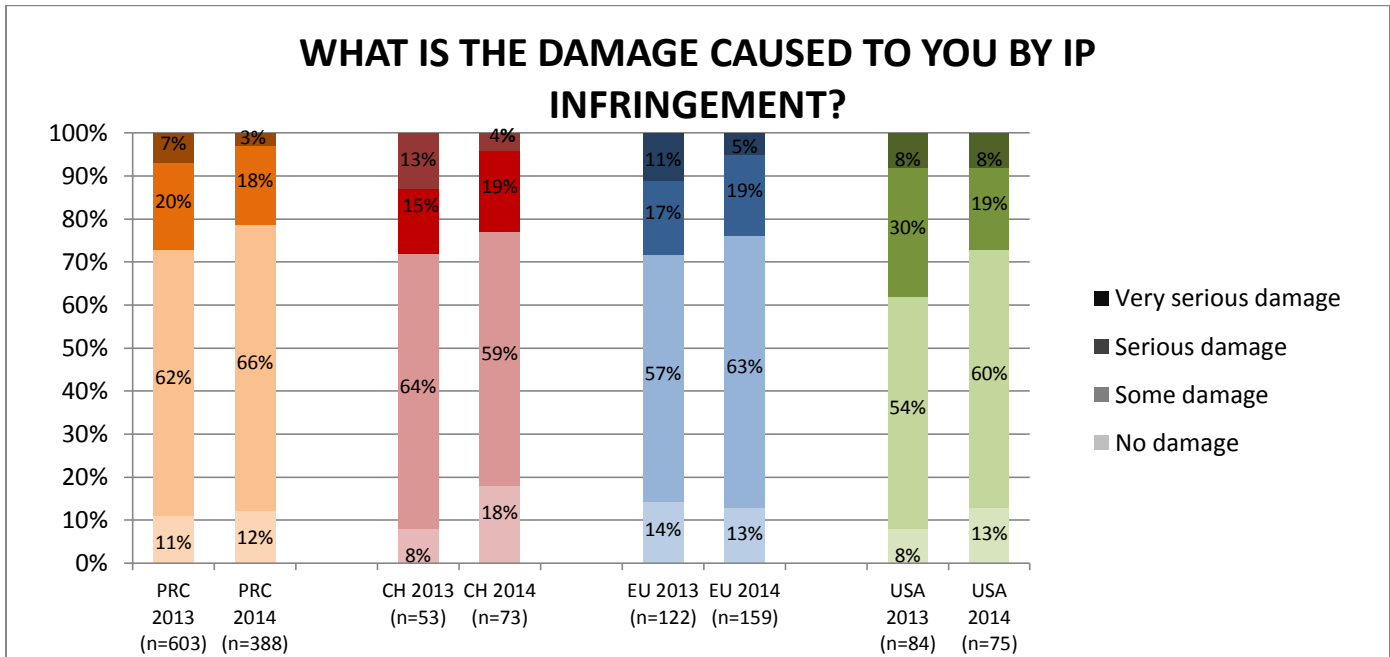
In terms of evolution, the perception of corruption has increased in 2014 compared to 2013, despite the anti-corruption drive of the government. On the other hand, companies allocate fewer efforts to deal with the government than previously, so that we may expect corruption to go down in the 2015 survey.



Intellectual property

A strong misperception that foreign companies are seriously affected by intellectual property infringements in China also prevails in home countries. While it is true that IP infringements occur in China more than elsewhere, the damage they generate is not as serious as one would expect. Close to **80% of Swiss companies report “some” or “no damage.”**

More importantly, all companies, regardless of national origin, including the Chinese, suffer from IP infringement in very similar ways. Moreover, **the trend clearly shows an improving situation** for all respondents.



Contrary to the general perception, **there is clearly no discrimination against foreign companies in the protection of IP.**

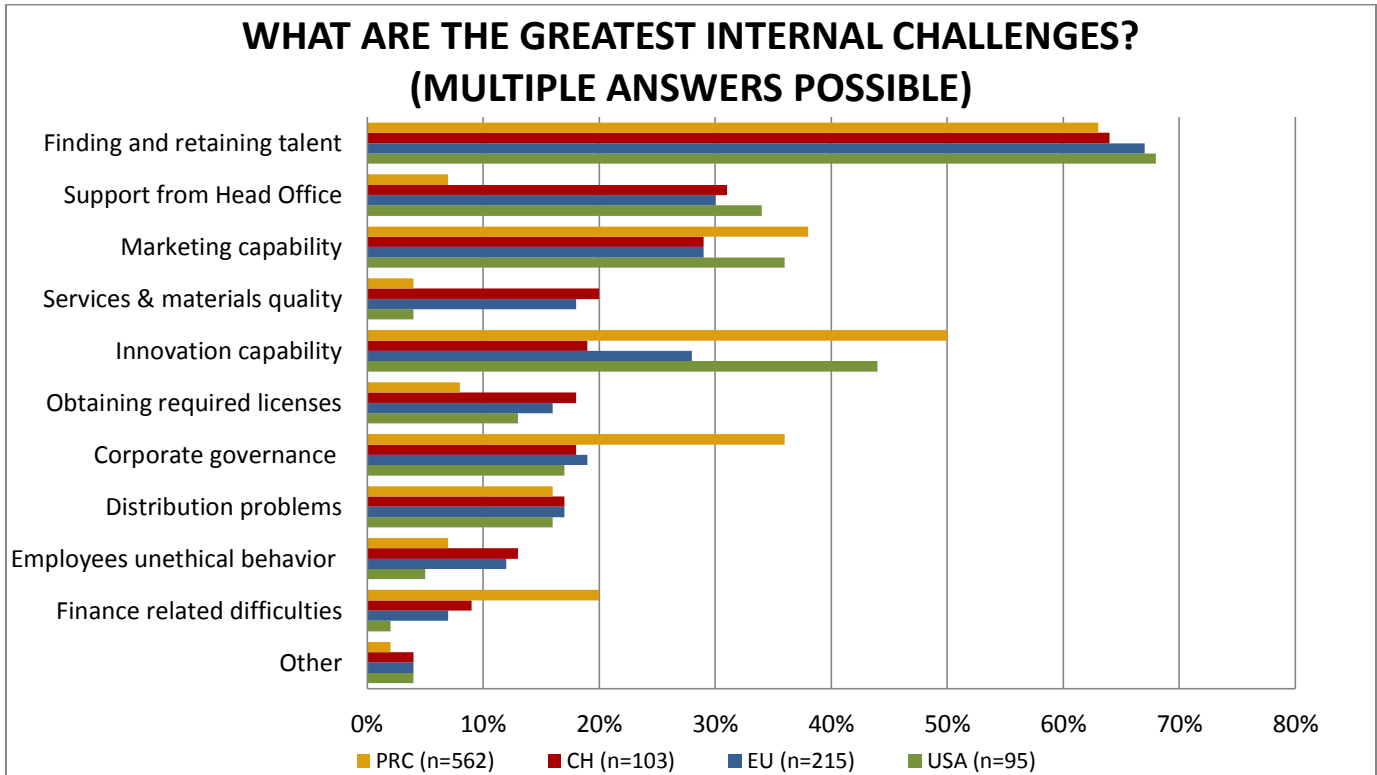
Again, these survey results highlight the widening gap between the perception of China from abroad and the actual situation for managers on the ground.

Challenges to overcome for success

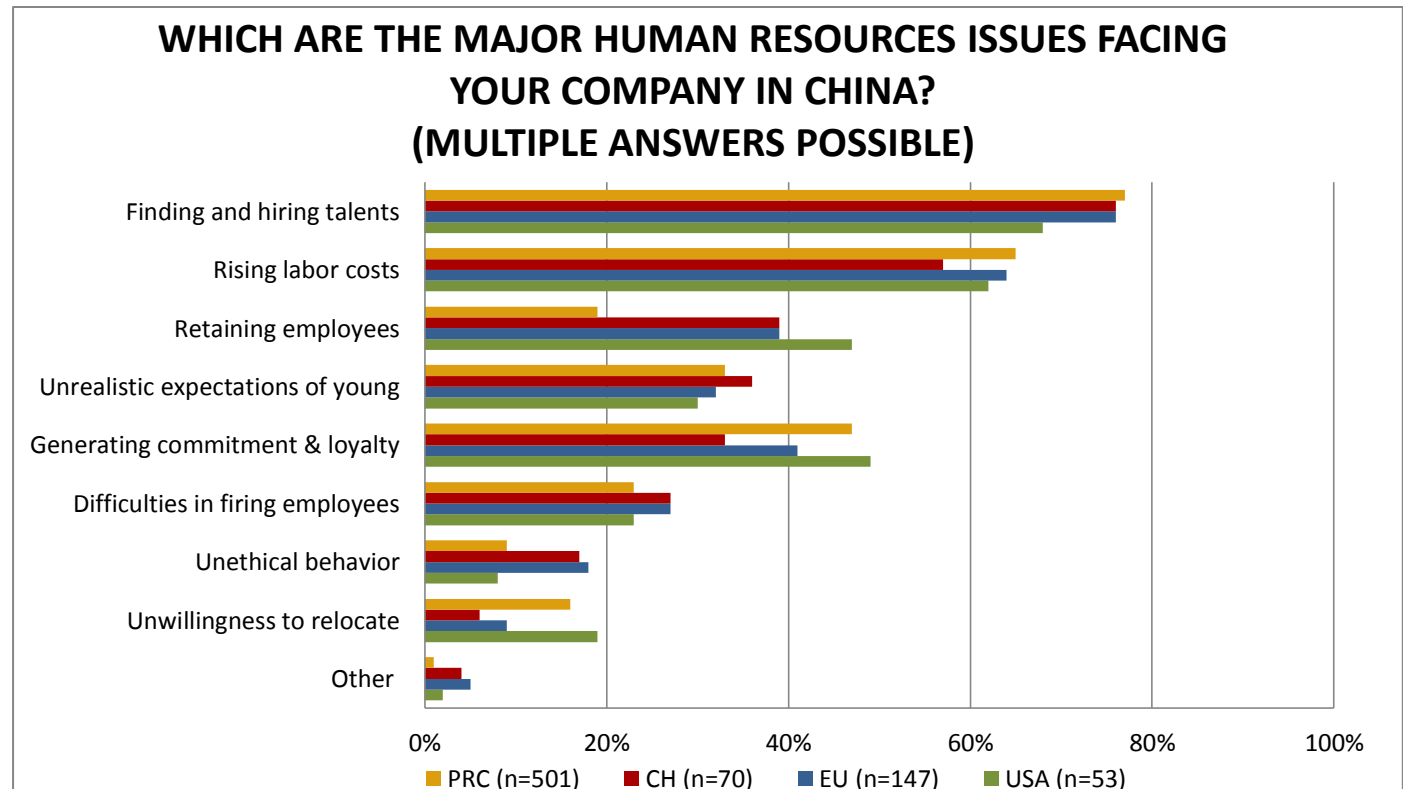
The key management challenge remains finding and retaining human resources (HR). As a consequence, **human resources remain a central element for success**, as it has been since we started surveying companies 7 years ago. **The HR challenge has, however, eased** since last year: a bit over 60% of Swiss companies mention it while they were close to 80% a year before.

However, for the second year in a row, “Lack of understanding and support from the head office” is the second most important management challenge for international companies and an issue for 30% of them, confirming the perception gap when seeing China from abroad and managing in China. This also indicates that bridging this understanding gap will support the business development of Swiss and foreign companies in China.

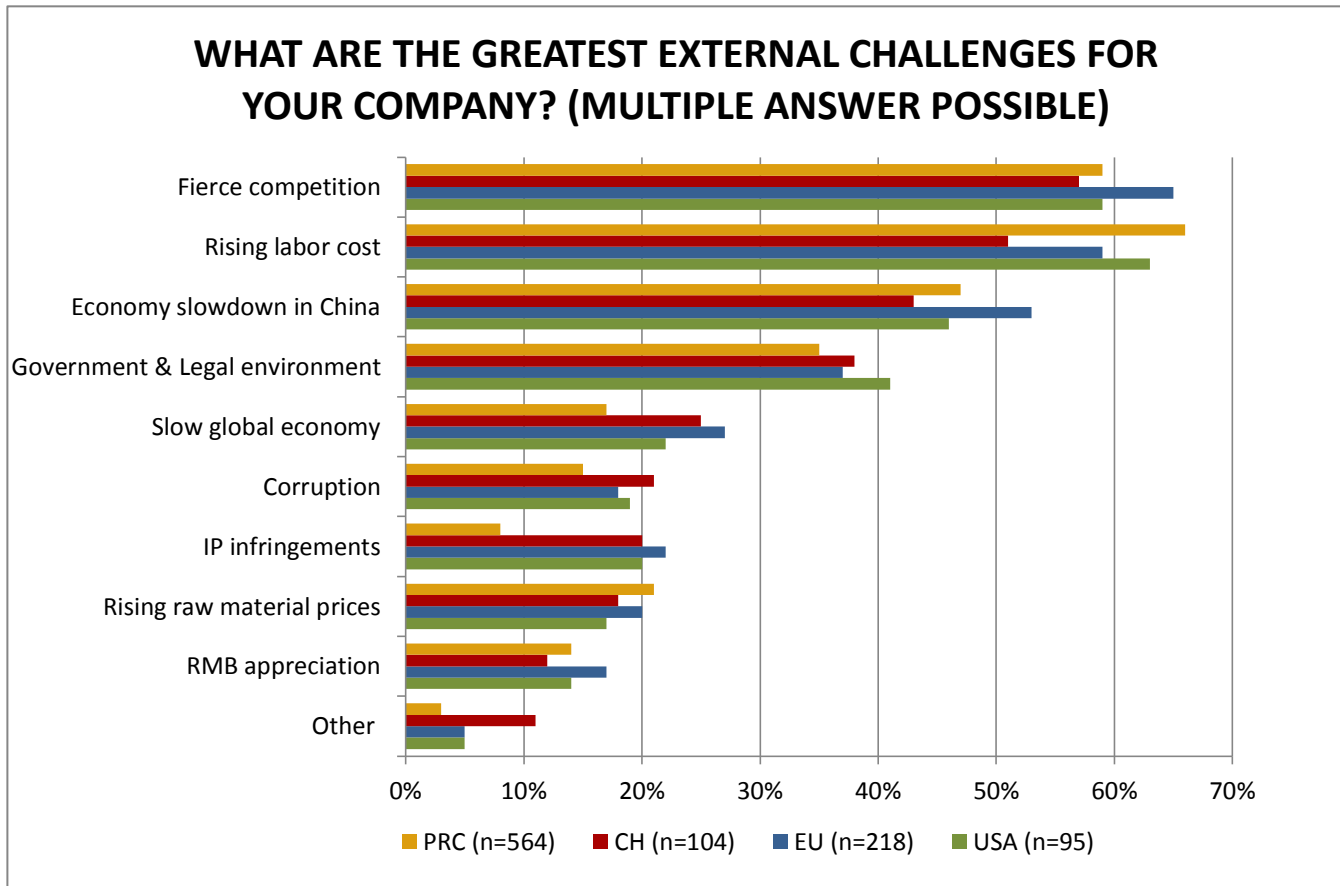
Marketing capabilities are also an issue for close to 30% of Swiss companies.



HR issues in general, while critical, are perceived less acutely by respondents and particularly Swiss companies. Our last survey had 80% of them mentioning “Rising labor costs” as an issue while in 2014 it is less than 60%. The same is true for “Retaining employees”: over 50% last year and less than 40% today.

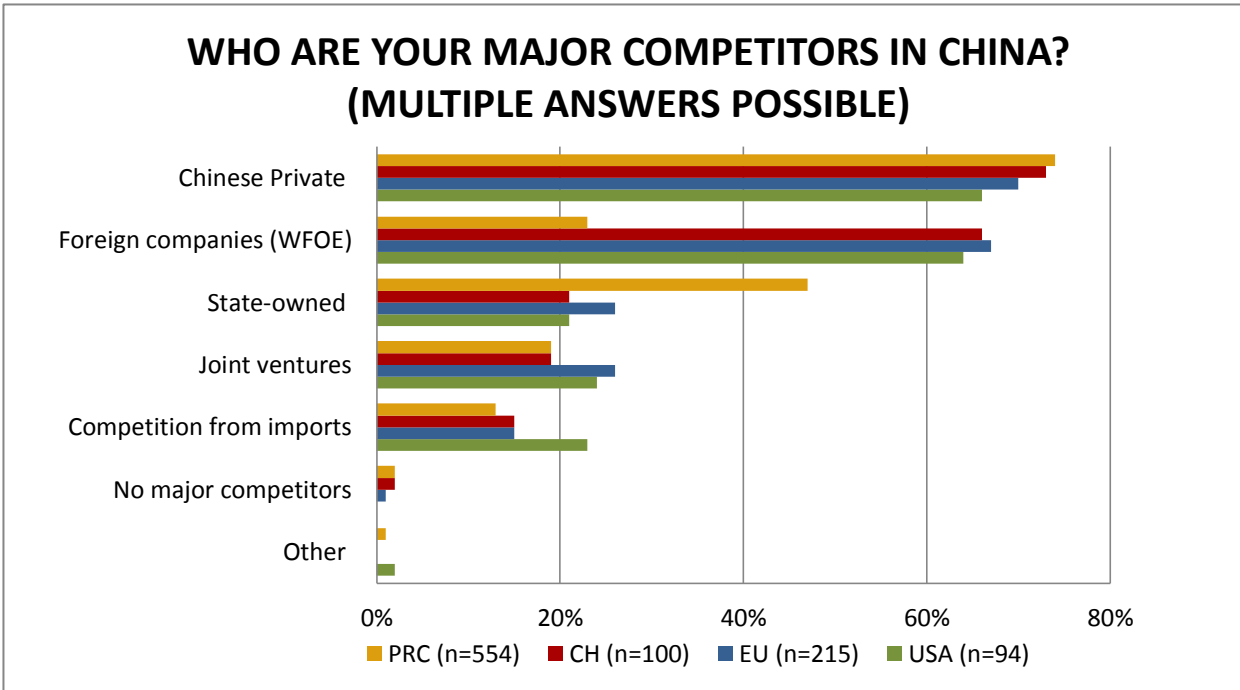


In terms of external challenges, when compared to last year, competition is further intensifying while the rising costs of labor affect companies a bit less.



A first: private Chinese players pose the most competition

Most interestingly, international companies in China perceive local private players as their greatest competitors, a marked shift from the past years where such companies reported international companies as posing the greatest competition.



This perspective is shared by Chinese companies that see Chinese private companies as their most important competitors by far.

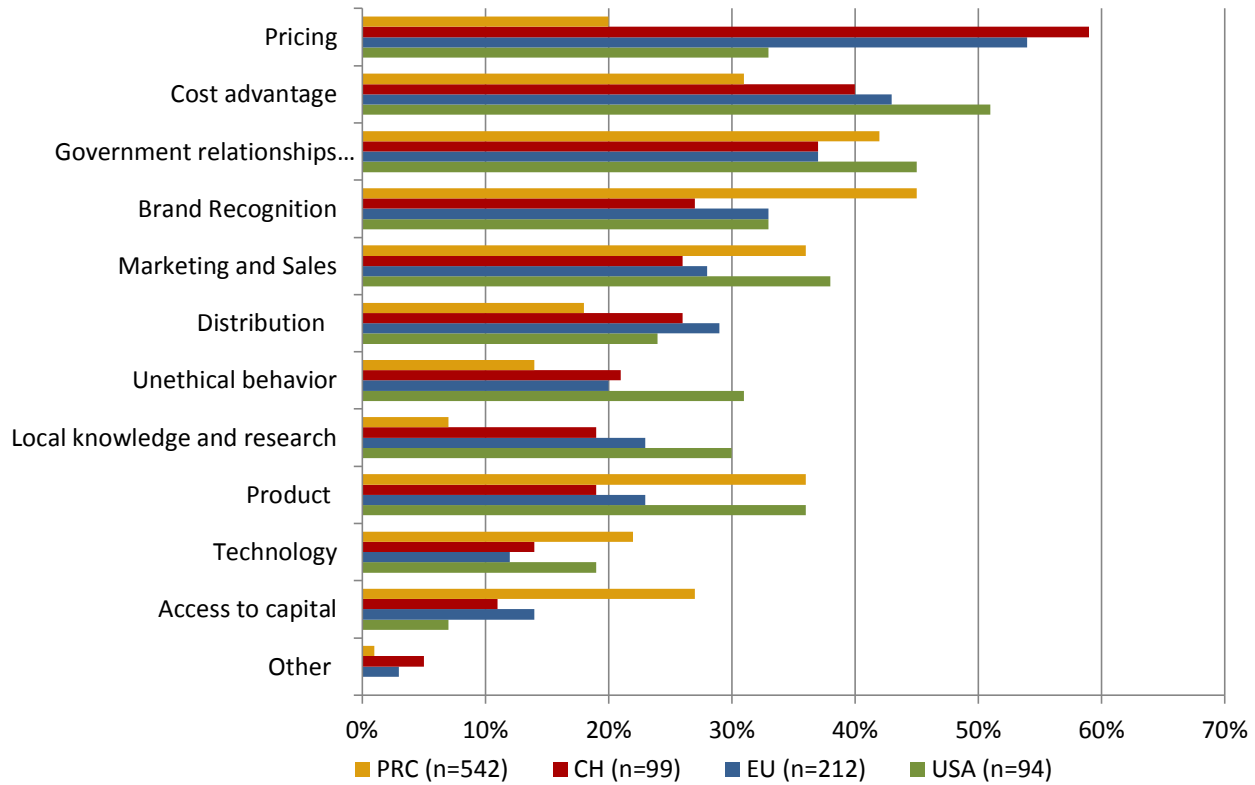
Besides, **competition from Private Chinese companies is only likely to become fiercer** as the Chinese government is due to support the private sector with more incentives as part of its economic reform agenda.

For Swiss companies particularly, the very competitive landscape is once more highlighted by the fact that “pricing,” “cost advantages,” and “government relations & network (guanxi)” are clearly perceived as the competitors’ main advantages.

The picture is very different for Chinese companies however, who see the main advantages of their competitors to be “brand recognition”, “government relations & network”, “marketing and sales” as well as “product.”

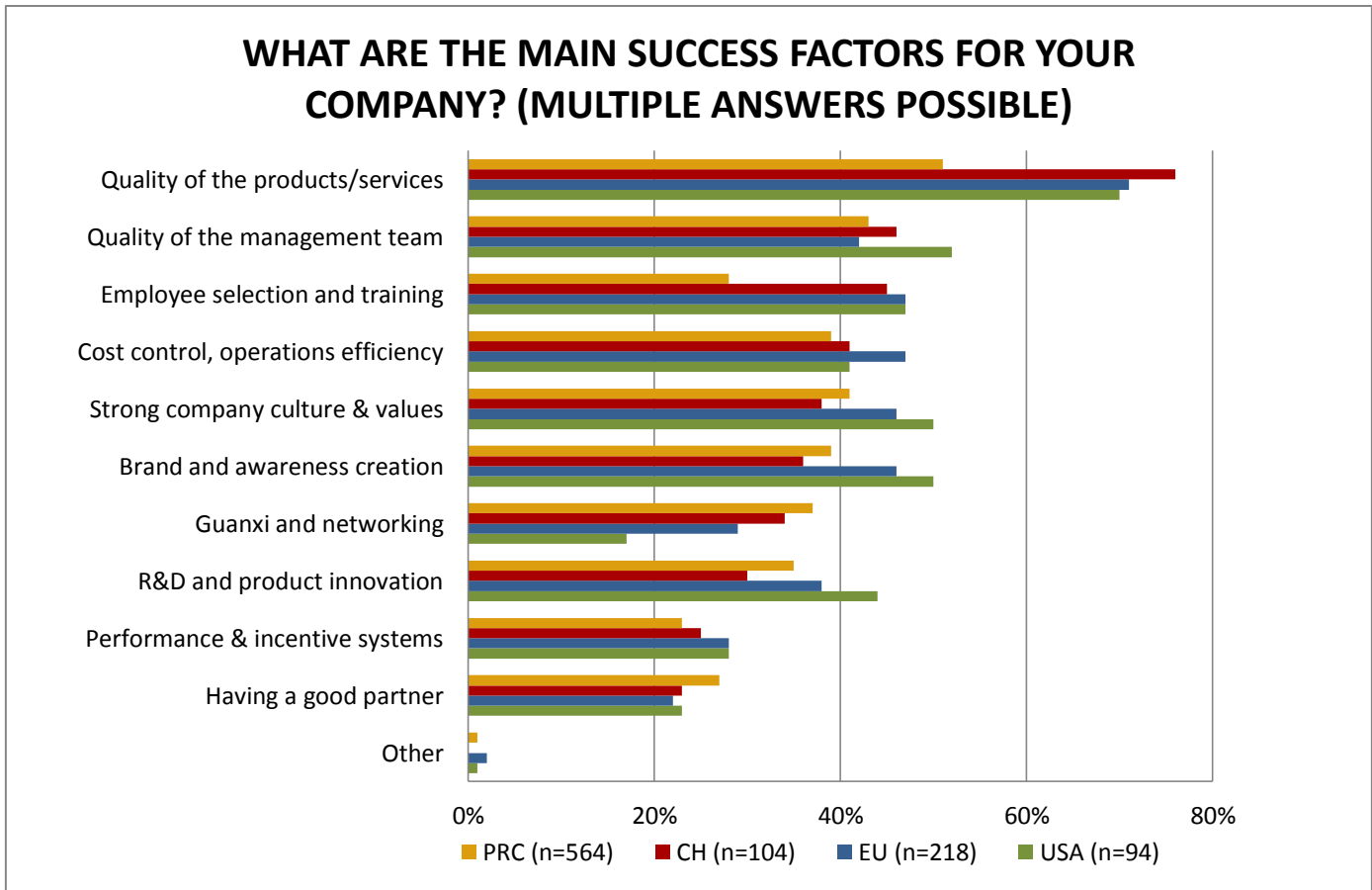
All in all, **foreign companies still compete on product and brand performance against their Chinese counterparts having cost and relationship advantages.**

WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN COMPETITORS IN CHINA?



The key success factors: superior product quality and human resources

Key factors of success clearly are first the “**superior quality of the products/services**” and **human resources** (HR) with “Employee selection and training” and “quality of the management team.” This is naturally coherent with HR being singled out as the greatest management challenge.

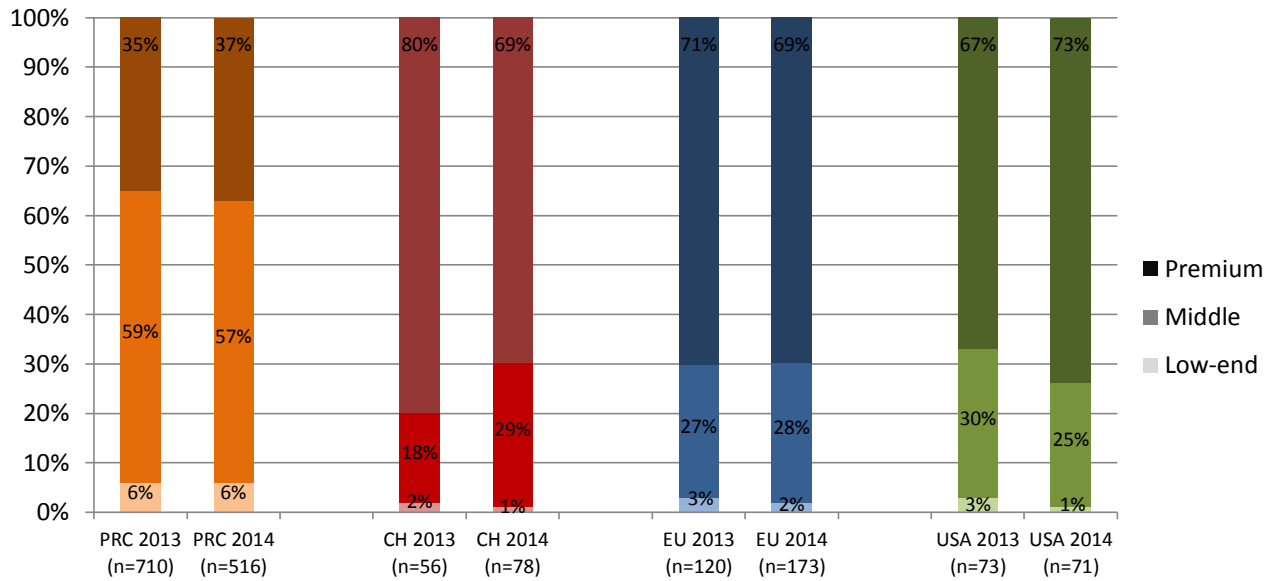


The focus on superior products/services by foreign companies is understandable when keeping in mind the heavy competition and the need for differentiation through quality versus price.

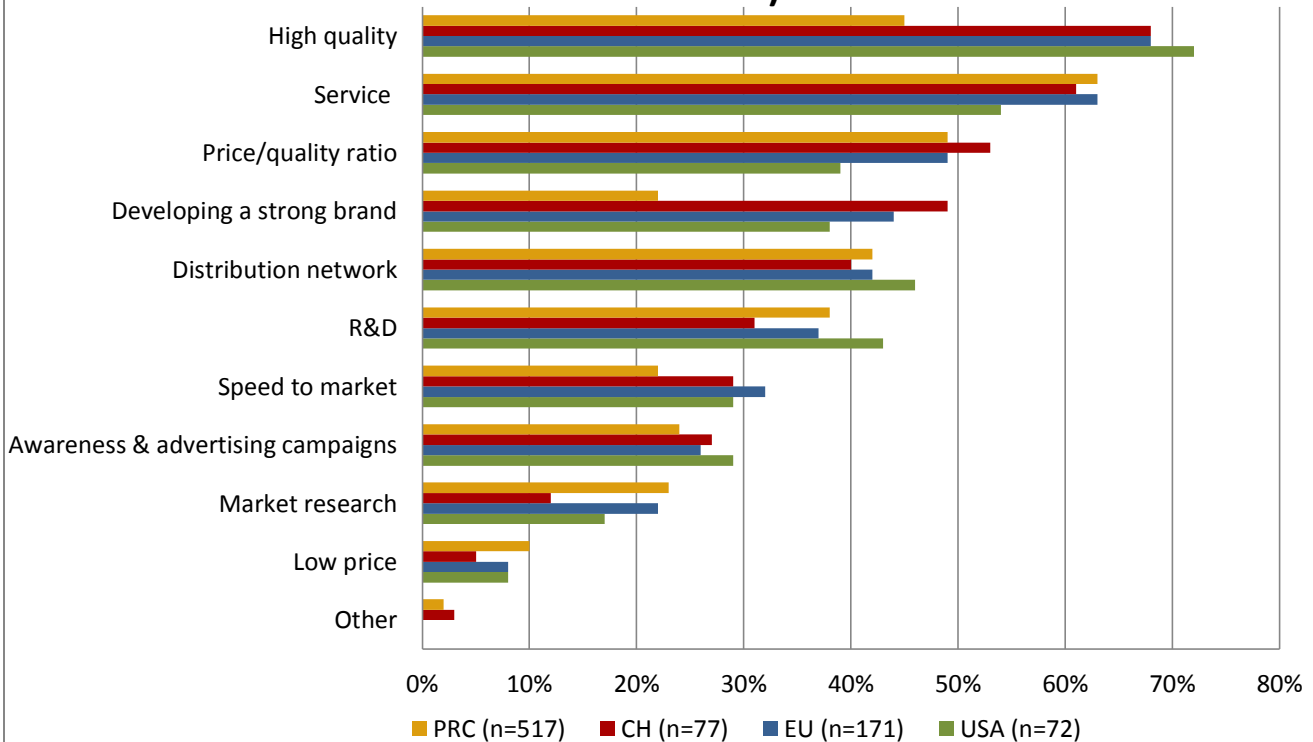
Foreign companies maintain and grow market shares and profits by offering products that Chinese companies will find difficult to offer in terms of quality. This also explains why foreign companies in China have been competing as much with foreign competitors as with Chinese ones.

The high-end focus is also clearly illustrated by the market segments targeted by the different companies. **Foreign players are by far mostly focused on the premium segments.**

WHICH IS YOUR MAIN MARKET SEGMENT IN CHINA?

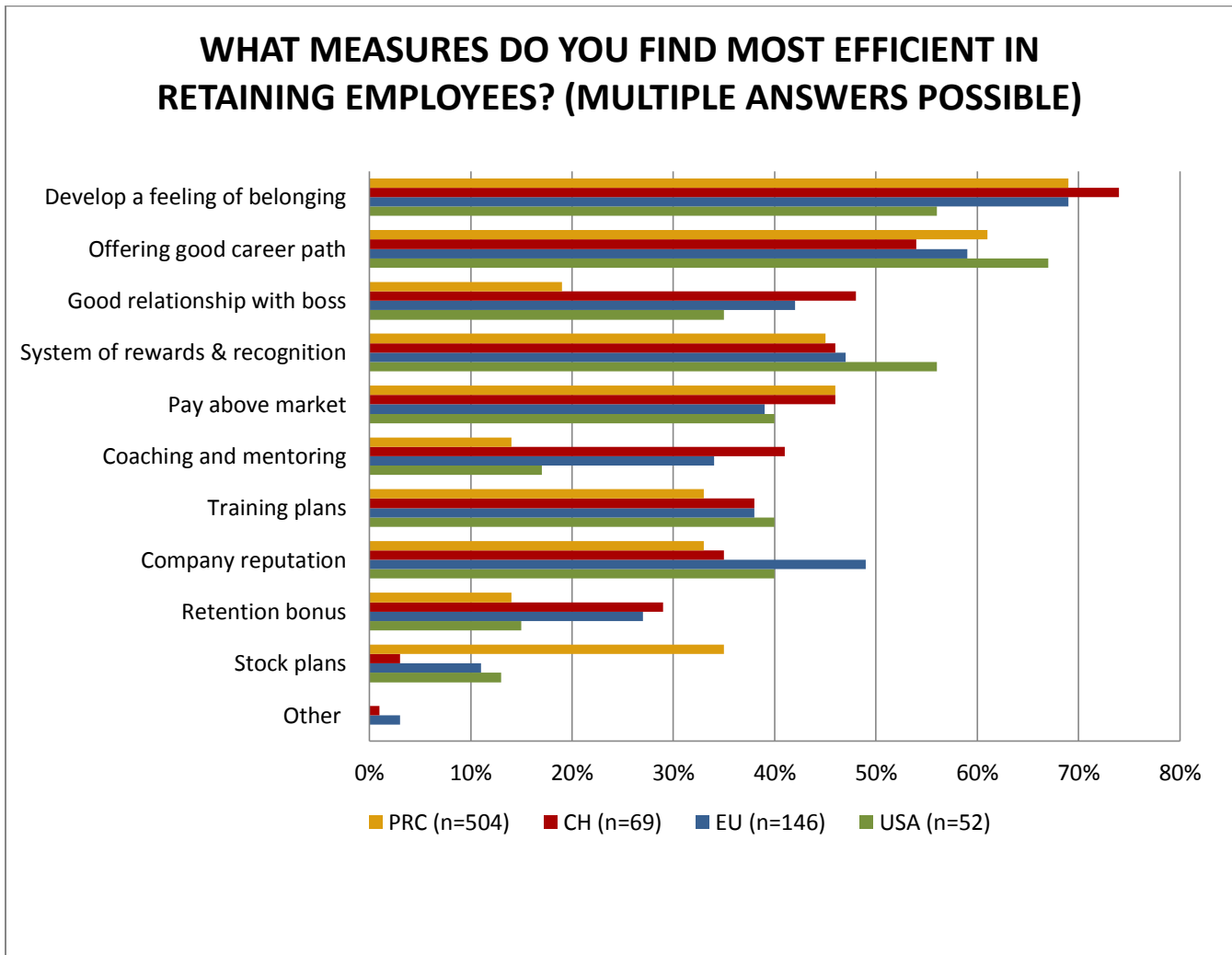


WHAT ARE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA? (MULTIPLE ANSWERS POSSIBLE)



To deal with the critical HR issue and in order to retain employees, “paying above the market” is not the main solution used by foreign companies. Actually, “**offering a good career path**” and “**develop a feeling of belonging**” appear to foreign and Chinese companies alike as a more efficient tool for retaining employees, as it offers opportunities for promotions and the perspective of substantial salary improvements. Almost as important is to provide “**rewards and recognitions**” to those who deserve it.

Swiss companies stand out by considering “**good relationship with boss**” as another efficient tool to retain employees.

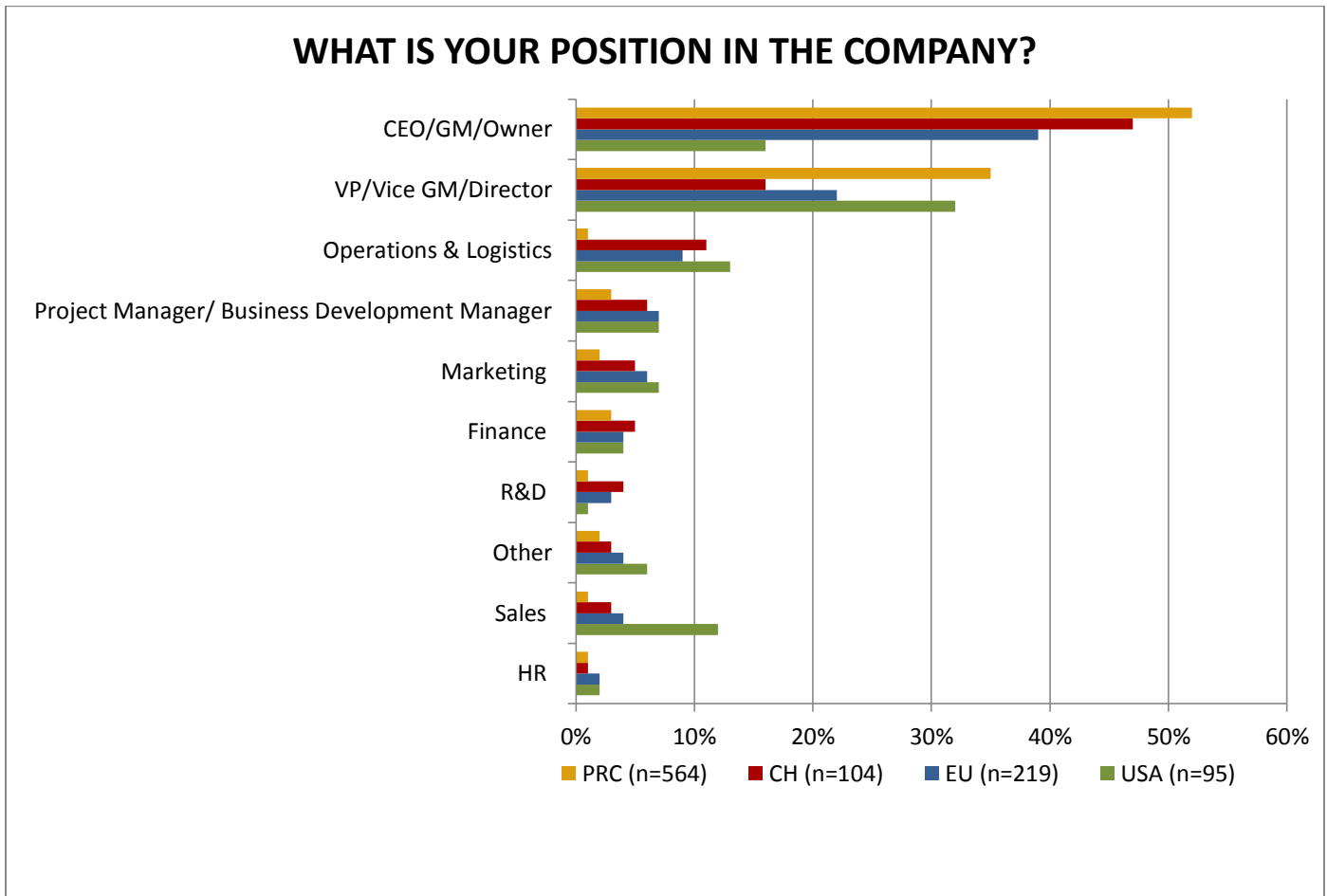


RESPONDENT COMPANIES DEMOGRAPHICS

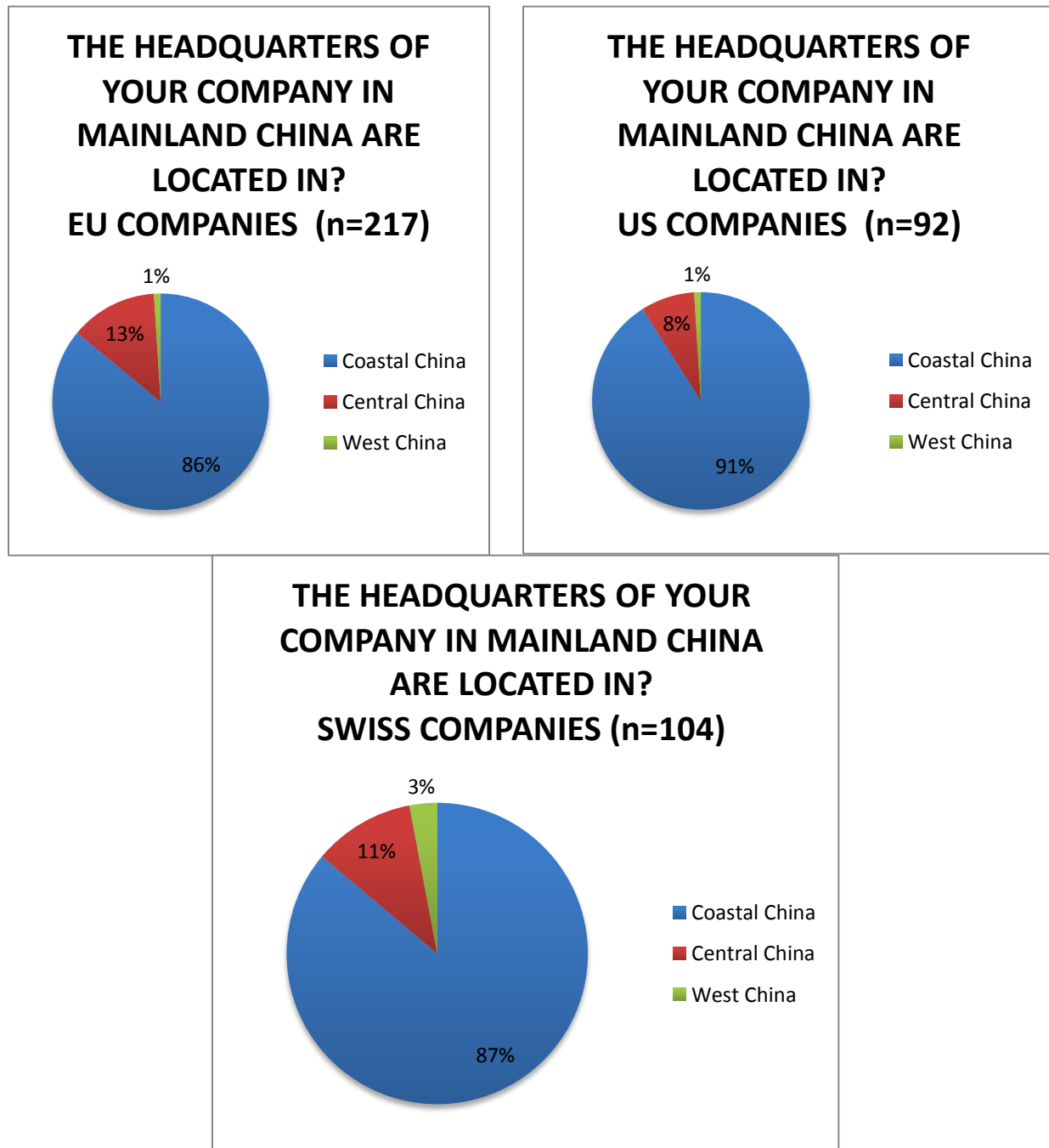
With 104 Swiss respondents out of the 419 foreign-owned company respondents, the Swiss sample is well represented in the overall CEIBS survey.

Compared to the 254 different companies registered with SwissCham China (not counting separate subsidiaries of the same company), this represents a strong sample of the affiliated Swiss firms in China.

Additionally, with 63% of top managers (Owner/CEO/GM & VP/Vice-GM/Director) answering the survey, the data from Swiss companies is reasonably credible. Respondents are noticeably more senior than those from the American (48%) and European companies (61%). Only Chinese companies' respondents have a higher percentage of top managers answering (87%).

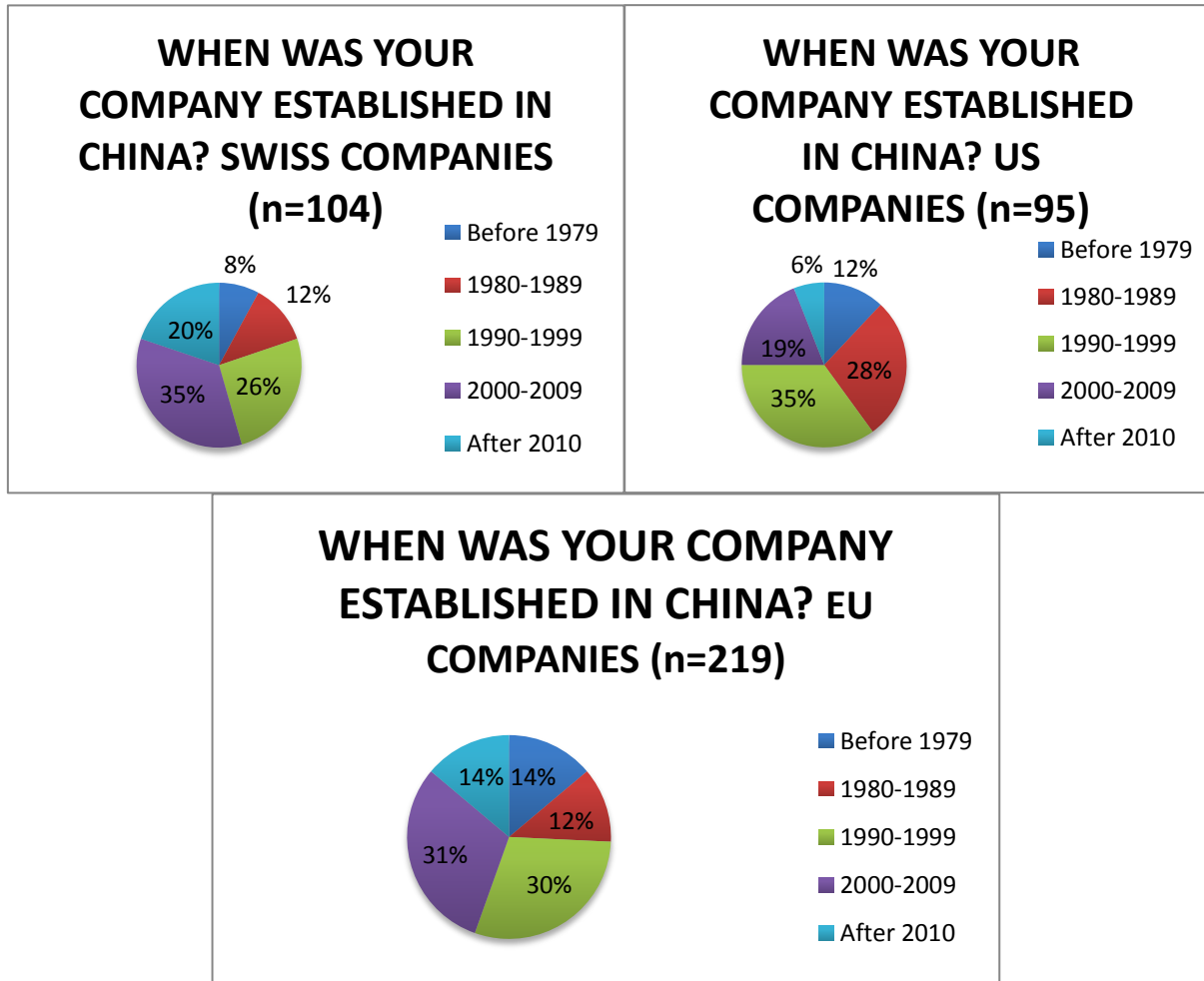


Interestingly enough, American and European respondents' geographical representation is also quite similar:



When looking at the establishment year, we see again pretty similar distributions among Swiss European and American companies, though there are proportionally slightly more answers from Swiss companies that have been more recently established in China.

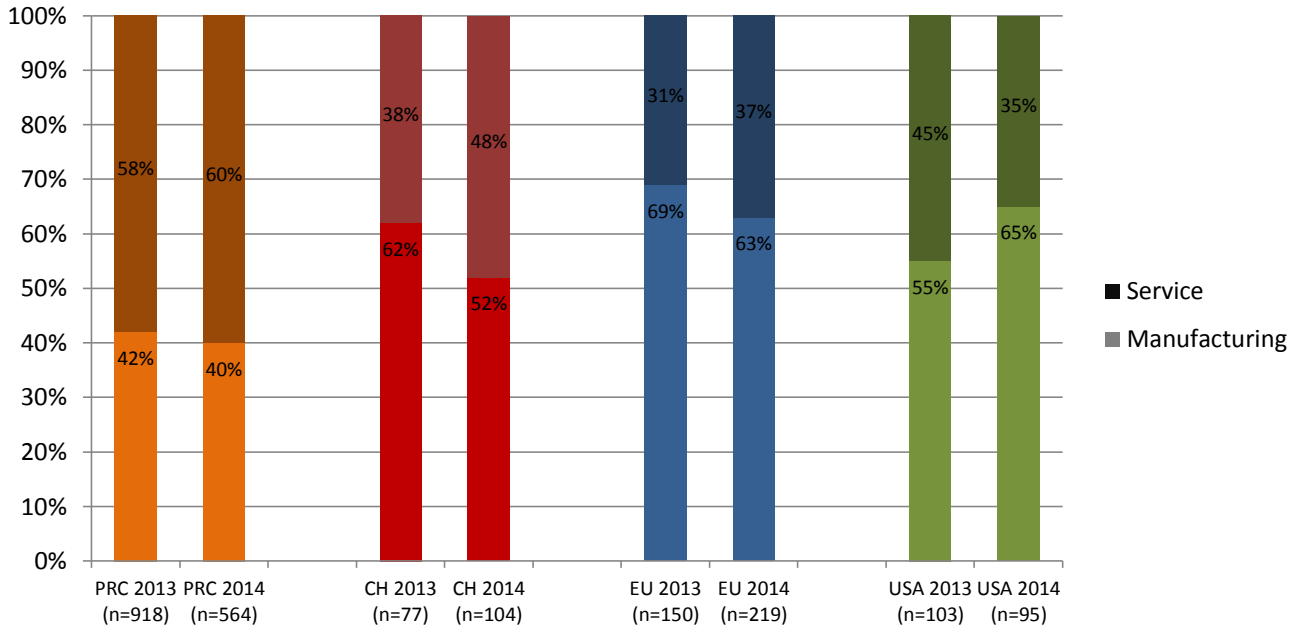
When was your company established in China?



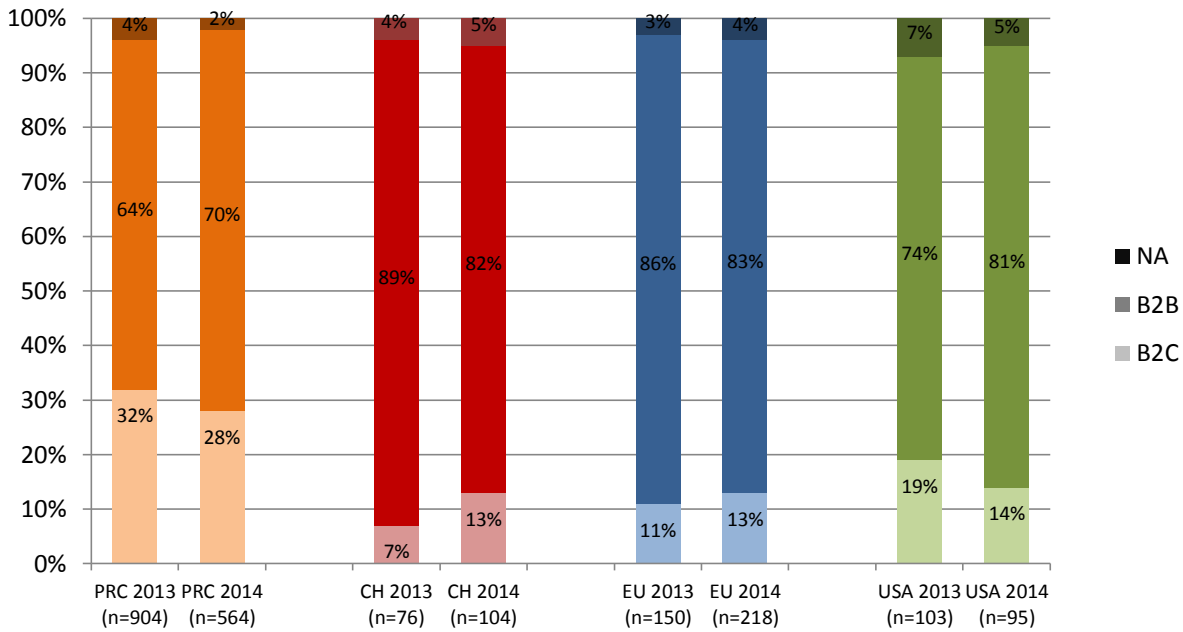
More than half of Swiss firms represented in the survey are manufacturing companies. This is again quite similar to American and European companies, while the Chinese companies answering are predominantly in the service sector (60%).

A similar situation occurs when looking at the customer base: Chinese are selling significantly more to the consumers segment than the western respondents, who are more strongly focused on B2B clients, with Swiss companies predominantly in B2B (82% of the Swiss companies in our sample).

WHAT IS YOUR COMPANY MAIN ACTIVITY IN CHINA?



WHO ARE YOUR CLIENTS IN CHINA?



While the above already provides good reasons to think that the sample of Swiss respondents to this survey is representative, we believe that the general similarity between the Swiss and EU data gives additional credibility to the results obtained for Swiss companies.

However, in this year's data US companies have more significant differences than in 2013. This may be explained by the fact that, proportionally, a much larger number of US respondents are in sales and a lower number of US respondents are from the top management. Still, since a reasonably large number of European companies – about 220– report patterns and trends in consistent and similar ways, **we believe that the results for the Swiss (and EU) companies are generally correct.** In addition, the significant differences between Swiss and European firms' answers do make sense when analyzed along with the current EU economic sluggishness and well-known particularities of Swiss companies.

As a consequence, we are convinced by the general representativeness and value of the results and hope that they will be seen as such.

ADDITIONAL ANALYSES: ACCELERATING GROWTH & REFORMS

What growth for businesses in China in the coming years?

A number of media have suggested that the current restructuring will be made at the cost of fast economic growth, but we are experiencing instead an acceleration of business results for international companies here in China. On the eve of Chinese New Year, we felt that it was timely to review the widely discussed growth and “slowdown” figures of China’s economy in order to understand their meaning for our businesses.

While it is true that China’s real GDP growth is not any more in the double digit range and that it is likely to decrease from 7.8% in 2014 to 7.2% in 2015, GDP growth, as a macro-economic measure, this does not actually capture China’s business potential for foreign enterprises.

Indeed, what matters to companies doing or intending to do business in China, is the amount of GDP the economy will be adding in the coming years in terms of Euros, US dollars or Swiss francs. To understand China’s business potential better and how it is changing, one must first compare how much GDP the Chinese economy is projected to add in the future with the amount it has added in the past. To get a global picture, it is also useful to compare this absolute increase with the amount of GDP growth generated by other countries in home currency values.

As with every other country, China’s real GDP is reported as the added growth in economic value in Chinese Yuan, minus local inflation. This growth rate makes complete sense, inasmuch as it captures the real economic progress (with inflation deducted) that the country is making with respect to its previous year’s performance.

This said, because companies throughout the world account for their growth in their local currencies, without deducting inflation from their performance results, they measure a country’s market potential in absolute volumes (millions or billions of USD) and not in growth percentage.

To illustrate this, take the case of Mongolia. With a 2013 real GDP growth rate of [12.5%](#), Mongolia is considered by the IMF to be “[one of the fastest growing economies of the world.](#)” This growth, however, is based on a 2012 GDP of about USD 10 bil. Taking inflation (approx 10%) and currency devaluation (approx. 27%) into consideration, in 2013, Mongolia only added slightly more than one billion USD to its economy. In comparison, the USA, which only grew by [1.9% in the same year](#), has added approximately USD 500 bil to its GDP.

Ultimately, when managing a company, the absolute growth of a market is the useful figure to evaluate how much more business can be generated in the future.

From this business point of view, it is striking to note that **the Chinese market is actually growing faster than it ever has.**

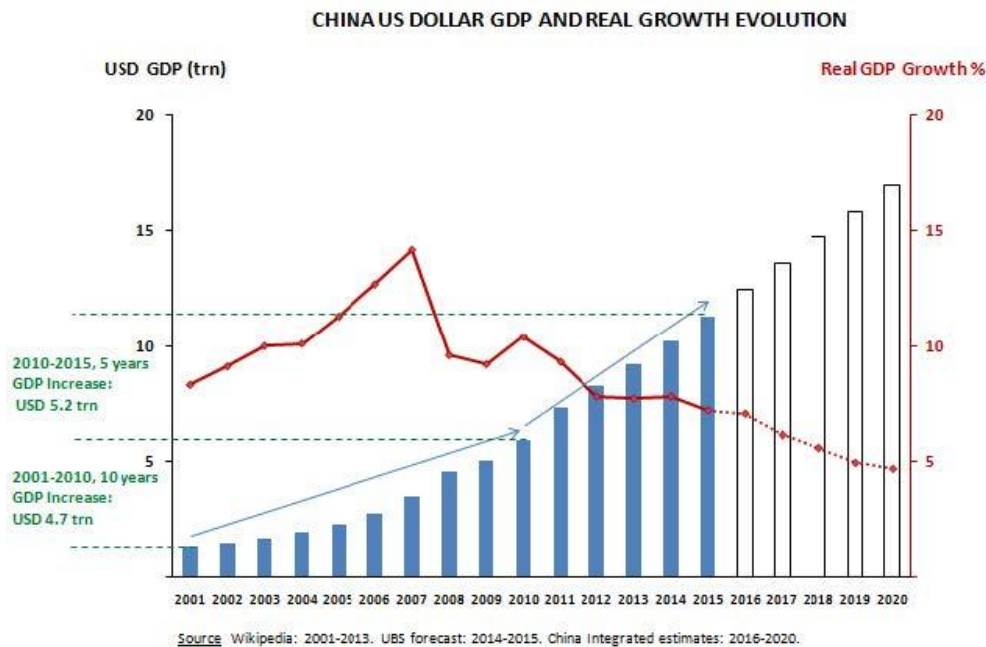
To illustrate this fact, the chart below, shows a clear acceleration of China’s GDP growth in USD terms.

Even though China is only projected to grow by 7.2% in 2015, it will likely add more GDP in USD terms in 2015, than it did in each of the years of 2012, 2013, and 2014, which saw growth rates of 7.8%, 7.7 % and

7.8 % respectively. Indeed, should China sustain constant percentage growth rates, its GDP would increase exponentially.

As it stands, however, even with slowing percentage growth, China's GDP will carry on accelerating (though not exponentially). Ultimately, it is this continuous acceleration in absolute GDP growth that has an impact on businesses potential.

Most importantly, between 2011 and 2015, China has and is projected to add more than USD 5 trillion to its GDP, compared with USD 4.7 trillion in the whole decade of 2001 to 2010. **In terms of business opportunities and in USD terms, this means that China is growing on average twice as fast today, than it did the previous decade.**



When compared to other countries, China, which is adding approximately USD 1 trn more per year to its GDP, represents by far the greatest business growth opportunity in the world. **In 2013 alone, the business opportunities offered by China were twice as large as the USA's**, which is the second biggest growing market in absolute terms.

If we are to apply the same GDP calculations to other countries such as India, Brazil or Russia, it becomes clear that China's economy is the largest business opportunity in today's globalised world. Ultimately, the Chinese economy keeps accelerating in absolute GDP terms and this is what actually matters to businesses.

In light of the constant reminders of a Chinese economic slowdown conveyed by the media, we felt it was necessary to explain the situation in greater detail.

This business acceleration has been confirmed by the 2014 "Swiss Business in China" Survey ([pages 14-17](#)): sales, profits, and worldwide share of sales for foreign companies in China grew faster in 2013 than in 2012 and are generally expected to grow even higher in 2014.

Now what are the implications for businesses and how can we benefit from these trends?

The first conclusion we can reach from this, is that international companies may not be ambitious enough in China. If accounted for in USD terms, business in China should have grown by 13.4% only to keep up with market growth, without gaining any market share. (This figure is obtained by taking 7.7% growth, plus 2.7% inflation, plus 3% currency appreciation.) By comparison, business in the US would have had to grow by only 3.4%, or 1.9% growth plus 1.5% inflation to keep up with the USA's market growth.

For those measuring China's GDP in Euros or Swiss francs, there is a 2 to 3% difference that must be accounted for due to the appreciation of the Euro, which would bring the average market growth of China to 11%.

In 2014, the minimum rate of business growth necessary to keep up with China's growing market will stand at approximately 11.3% in USD. (Growth will still differ across industries and that is just a general average.) This figure takes into account an expected inflation rate of 3.5% and a steady USD/Chinese Yuan exchange rate.

Another important point to keep in mind is that the expected growth will come more from the private than the state-owned sector.

Indeed the Chinese government will be providing incentives to the private sector, as a measure to increase domestic consumption and productivity (private enterprises are doing much better than the state sector in terms of return on investment). (See one of our [analyses](#))

While an increasingly privatized Chinese market with greater domestic consumption will be a welcome development for the world economy, it also means that competition in China will intensify. Local market players will therefore become more efficient and resourceful.

In fact, results from the "Swiss Business in China" survey ([pages 24-25](#)) also point to the fact that international companies in China perceive local players as their greatest competitors. (This is a marked shift from past years where such companies reported international companies as posing the greatest competition.)

In other words, opportunities will increase considerably, but competition will be all that much hotter!

Under these circumstances, managers have two paths to follow: **improve operational efficiency** (to deliver more with the same resources) and **move up the local value chain** (improve products and technologies to command better margins).

Harnessing the productive potential of technology will be a crucial step towards achieving these goals. Indeed, for companies to improve internal efficiency, it will be essential for them to implement greater automation (using more automated machinery to produce goods or using better software and IT systems to improve business processes).

Moreover, in this very competitive environment, improving or adjusting products and services to sell with higher margins will also require, more often than not, the use of technology.

However, in the context of such a competitive Chinese environment, being successful will also mean having the right mix of imported and **locally developed** products, equipment, and IT. Indeed, local capabilities are improving considerably and if the world top math score in 2013 of Shanghai's 15 year old students is a pointer to the future, those capabilities will keep improving.

China is at a turning point - Reforms 2.0

China has reached the limits of its current “business model” and must reform in order to continue to grow in ways that are sustainable in the long term. A change of model, as business leaders know, necessitates far reaching changes in an organization. In China’s case, this calls for not only decisive overhauls of economic policy but also fundamental changes in the leadership culture. Considering the size of the country and the importance of the vested interests, particularly in the state sector, the efforts underway to carry out the new reforms are assuredly as challenging and intense as the opening up of China that Deng Xiaoping launched 35 years ago, with the success that we all witnessed.

An unsustainable development model

Under China’s current growth model, which aims to maintain rapid economic development at virtually any costs, the environment has deteriorated in alarming ways; air, water, and soil pollution, coupled with the public health risks caused by them increasingly drawing the ire of China’s populace. Moreover, unabated greed prevails to the extent that food safety has become the number one concern of the population and good medical care depends on direct cash payment to doctors.

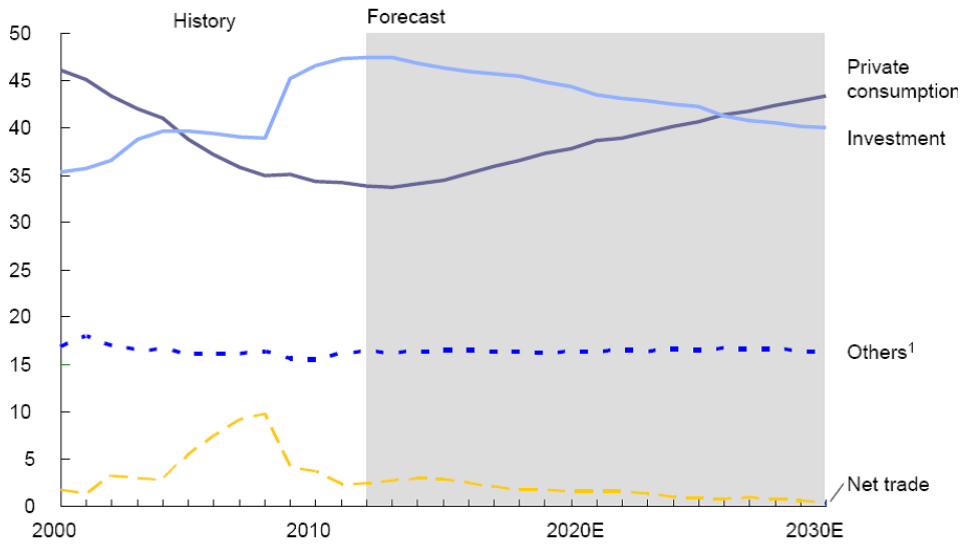
Rumor has it that 225'000 officials have been or will be arrested in China through the current anti-corruption drive, another 18'000 who are currently abroad are being actively pursued. The total amounts embezzled are said to have reached USD 2-3 trillion, about 70% of which are expected to be recovered, adding high profitability to a good policy move!

In addition, investments have become increasingly prominent as a share of China’s GDP, resulting in a galloping government debt, which, if unchecked, could be the cause for a financial crisis.

Needless to say, such developments have alienated a sizeable portion of the population which cares about its health as much as it cares about its material wealth.

The charts below demonstrate the degree to which China's development model of the last decade has relied on favoring investments carried out by the state sector at the expense of private enterprises and domestic consumption. From 2000 to 2012, consumption decreased from 46% as a share of GDP to 33%. (By comparison, in the USA and Switzerland, the private consumption share of GDP is slightly under 60% and 70%, respectively.)

Share of components
%

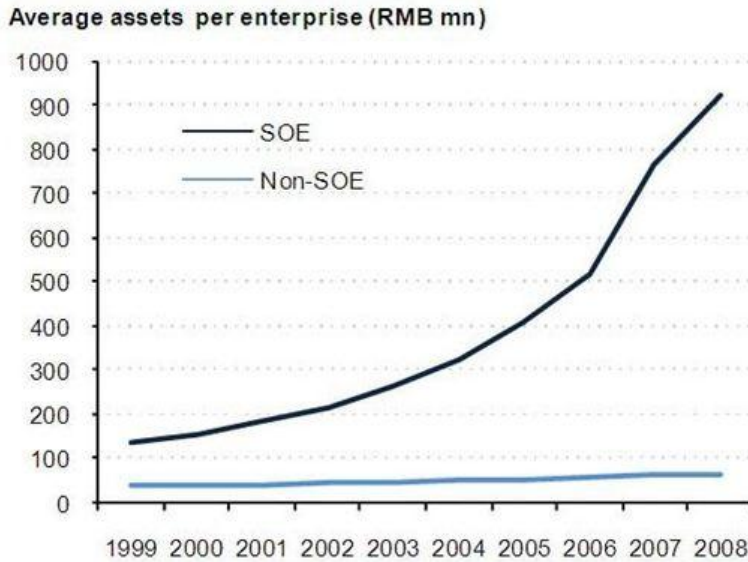


¹ Others include government consumption and inventory.

Source: Global Insights; McKinsey Insights China macroeconomic model update (2012)

Meanwhile, state-owned companies grew exponentially bigger, using their size and political connections to maintain their advantages, strengthen their monopolistic positions, and resist change.

Figure 2. Average asset size of SOEs and non-SOEs



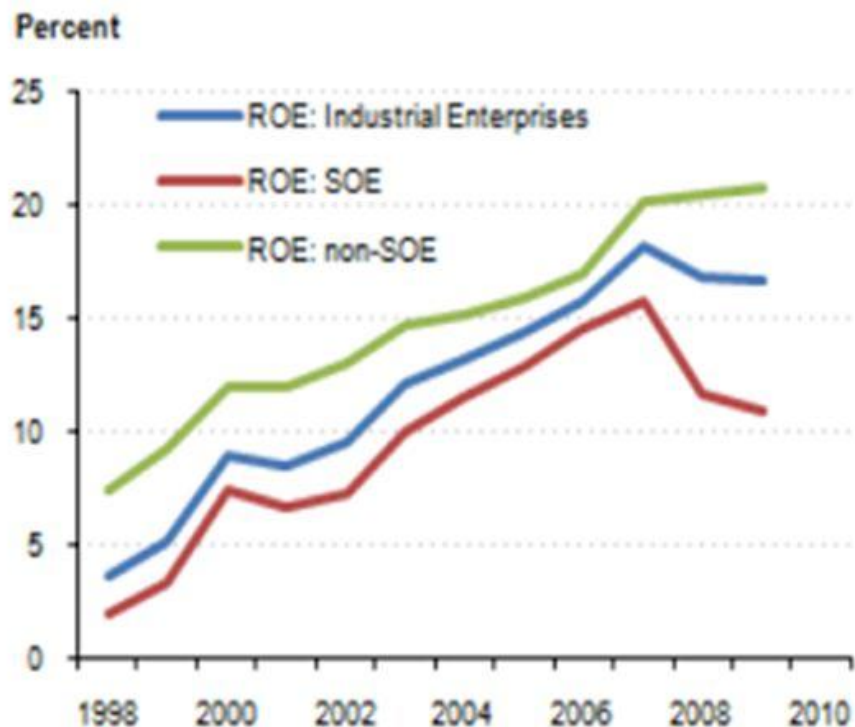
Source: CEIC, and author's calculation.

After the courageous reforms of the 1990s, which reduced the size of the state sector and freed the natural entrepreneurial spirit of Chinese individuals, the “fourth generation” of Communist leaders, Hu Jintao and Wen Jiabao, turned to a form of state capitalism, under which growth and economic development became increasingly dependent on state investments financed by state banks.

With interest rates fixed by the state, Chinese citizens today have no better choice than to deposit their savings into state banks that yield interests often lower than inflation. This process has funded the state’s investments cheaply and at the expense of its citizens.

All the while, families and friends of politicians and past leaders took advantage of their privileged relations to obtain contracts from state-owned companies or to buy shares in these companies at the right time. They enriched themselves easily via the state system which, despite its advantages, returned steadily lower profits than the private sector.

This trend accelerated after the financial crisis which forced the government to further accelerate investments, giving State-Owned Enterprises (SOE) the opportunity to continue growing.



Unsurprisingly, this investment-based growth model led to a sharp surge in government debt. In the first 6 months of 2013, total (including local government's) debt was evaluated by a state audit and found to have increased by 13%, or 26% if accounted for annually. From 2010 to June 2013, the total government debt grew by 6.6 percentage points as a share of GDP.

With a total government debt of only 56%, China remains far healthier than all but some small Western countries, but the trend is definitely alarming.

Clearly, China's growth model has become unsustainable for the long-term and would likely result in a financial crisis or very slow growth if not addressed properly. Additionally, in a depressed world economy, exports can no longer be counted on to contribute significantly to GDP growth.

What is to be done?

Sluggish growth (or a financial crisis which would ultimately turn into a recession) is an unacceptable outcome for the population. Indeed, such a situation would erode the unspoken contract that binds the Chinese government to its people, whereby the leadership continuously provides improved living conditions while the population accepts not to be directly involved in the political decision-making process.

The obvious solution is to turn China's growth model away from its current reliance on investment towards greater domestic consumption and private investments. This means encouraging citizens to spend more of their money on setting up businesses and improving their lives, instead of having to lend their savings to the government who spends it on infrastructure projects or lends it further to state-owned companies.

Increasing private consumption and investments is only part of the solution to achieve sustainable growth. Since the working population (the number of people generating GDP) is reaching a plateau, productivity needs to improve to maintain a growing economy. Without more people joining the workforce, each person working will need to generate more economic output to deliver overall growth.

Given that state-run companies are less profitable and efficient, encouraging the private sector to expand and providing opportunities to entrepreneurs is the obvious way to swiftly increase productivity and private consumption while keeping the increasing government debt under control.

Corruption must be stopped

The solution is evident, but its implementation goes against the vested interest of the state-owned sector, the politicians who control it, and their entourage who derives gains from it.

A telling example of the pre-eminence of SOEs' vested interest is the fuel and oil industry. In 2009 the State Council (China's Cabinet) issued the China III Diesel Standards, which were simply ignored by the

(state-owned) oil companies¹ in order to maintain their profits. These SOEs would not have been able to do so without the patronage of high level officials such as Zhou Yongkang, a former Standing Member of the Politburo and a former Head of China National Petroleum Corporation.

Clearly, to ensure long-term sustainable growth and eventually **nothing less than the future of China**, there was no alternative than to reduce the influence of the state sector and therefore the power of those who benefit from it. Government clampdown on graft, bribery, and embezzlement was an absolute necessity for a number of reasons, not the least of which was to prevent large State Owned Enterprises (SOEs) to operate under de facto immunity from government prescribed policies.

It is no wonder then, that China's new President warned in his acceptance speech that corruption had become a threat to the Communist Party and its leadership of the country, and that he made fighting corruption his first priority.

From then on, a key question that would decide China's future was whether the current government could be strong and determined enough to eradicate the politicians' traffic of influence and rein in the state sector.

Fortunately enough, events of the past year have provided room for quite some optimism.

A clear indication of both the new government's determination and the support that it commands is the decision to arrest top level officials (including the Army's No 2) and to investigate the former security Czar (Zhou Yongkang) for "serious disciplinary violations." Remarkably, **it is the first time in the history of the People's Republic of China that a former Standing Member of the Politburo is investigated**. Though the move is certainly part of power-consolidation, it is also to show that in today's China, no one is untouchable. What's more, it warns officials that no former leader will be strong enough to protect allies and former subordinates against their unethical behavior. As a result, any official that wants to feel safe will have to apply policy ethically.

This in itself is a strong indication that corruption at high levels will be considerably reduced (if not eradicated) in the short term. By ensuring discipline among officials, this drive is empowering the Chinese administration and fulfilling the first necessary step for the success of the much needed reforms.

¹ [The situation is detailed in New York Times article "As Pollution Worsens in China, Solutions Succumb to Infighting", of March 21, 2013](#)

What is next? Building a level playing field

It is also important to note that Zhou Yongkang was most recently in charge of China's internal security which includes the police and judiciary, a department endowed with a bigger budget than China's military. The internal security system's first mission is to maintain social stability, the Chinese government's overarching priority. Fairness and equality of economic opportunity came at a distant second in terms of objectives of the legal system.

Yet, once unethical civil servants are out of the way, reforming the legal system towards impartiality is a natural next step. A well-performing and ethical judiciary is needed, first of all, to ensure that corrupt practices do not resurface, but it serves additional purposes too. Social fairness is the only sure avenue to win back the hearts and mind of the population at large, without which the Party's legitimacy would remain in doubt. Not least, it is the essential tool to bring about equal economic opportunities for companies small and large, private or state-owned. This economic fairness is the best instrument to motivate the private sector, and to generate confidence and individual consumption.

It is therefore no surprise that the main themes of the coming October plenum of the Communist Party have been announced to be “**Rule by Law**” (the officially sanctioned term for the role of the law in China's constitution) and the **economy**.

While the new set of reforms clearly intend to instill dynamism in the private domestic economy rather than encourage foreign investment as was the target 30 years ago, foreign companies will still benefit from further opening up to foreign investments but most importantly from the more level playing field that will undoubtedly be built.

The testing ground: Shanghai pilot FTZ

To realize how urgent the new reforms are perceived by the government, one may remember that the Shanghai Pilot Free Trade Zone (Pilot FTZ) was officially opened at the end of September 2013, **prior to** the third plenum of the Communist Party, which debated and issued the new reform policies. It is rumored that that the Prime Minister, facing opposition from the bureaucracy, literally banged on the table to push the project through.

In addition to opening the education, healthcare, and financial industries to foreign investments, the pilot FTZ is changing the current concept of approving new companies to one of simply registering them. While for many, this is the normal understanding of how the law should work, what is being experimented in the pilot zone is turning around a basic principle of Chinese law.

In effect, what is not explicitly allowed in China is forbidden. However, in Shanghai's new pilot zone, a “negative list” has been set out, outlining the list of business activities that are not allowed. Anything falling outside of it should now be automatically authorized. This is a major philosophical change for China, since it will no longer allow the government to micromanage business.

What is happening in the Shanghai Pilot FTZ is particularly significant precisely because of the zone's "Pilot" status. Indeed, once the new policies are tested in this framework and become successful, they will be rolled out to the rest of China.

The current edition of this Survey includes questions on Shanghai Pilot Free Trade Zone (Shanghai FTZ) awareness, interest and expectations. See this survey in pages 6-11 of the 2014 CEIBS China Business Survey in the second part of this report.

As a conclusion, one cannot help but draw parallels between the establishment of the Shanghai Pilot Zone and the policies that were tested in Shenzhen in the 1980s by Xi Zhongxun, none other than the new President's father. These were the policies that launched China into becoming one of the world's economic giants.

The direction is clear. The new government and the new set of reforms aim at enabling China to continue to grow fast but at the same time sustainably.

This is good news for the world: should the new reforms succeed as it seems they will, we can expect both **economic opportunities the size of China and a much more favorable environment for private and smaller size enterprises!**

2014 Business in China Survey

Juan Antonio Fernandez | Bin Xu | Dongsheng Zhou | Maria J. Puyuelo | Junjun Li

TABLE OF CONTENTS

LETTER FROM THE RESEARCH TEAM	2
REPORT HIGHLIGHTS	4
CURRENT DEVELOPMENTS	5
Shanghai Free Trade Zone	6
Corruption in China - Fight on corruption	12
SECTION 1: DESCRIPTION OF THE COMPANIES PARTICIPATING	17
SECTION 2: BUSINESS INDICES	23
2.1. CURRENT PERFORMANCE INDEX – CPI	25
2.2. EXPECTED PERFORMANCE INDEX – EPI	27
2.3. BUSINESS CONFIDENCE INDICES – BCI	30
SECTION 3: CHALLENGES AND SUCCESS FACTORS	32
3.1. EXTERNAL CHALLENGES	33
3.2. INTERNAL CHALLENGES	34
3.3. SUCCESS FACTORS	36
SECTION 4: FOCUS BY TOPIC	38
4.1. MARKET ENVIRONMENT	39
4.1.1. Regulatory Environment and China Government	39
4.1.2. Competitive Environment and Market Advantages	42
4.2. INNOVATION, R&D AND INTELLECTUAL PROPERTY IN CHINA	44
4.2.1. China Innovation and R&D in 2013	44
4.2.2. Intellectual Property in 2013	46
4.3. CHINA / GLOBAL FOCUS	48
4.3.1. China focus for foreign-owned firms	48
4.3.2. Global focus for Chinese-owned firms	50
SECTION 5: FOCUS BY FUNCTIONS	54
5.1. HUMAN RESOURCES	55
5.1.1. Top Human Resources issues in China	57
5.1.2. Most effective measures to retain employees	60
5.2. FINANCE (CHINESE FIRMS ONLY)	61
5.2.1. By legal entity	63
5.2.2. By company size	64
5.3. MARKETING, SALES AND DISTRIBUTION	65
TABLE OF FIGURES	70

LETTER FROM THE RESEARCH TEAM

We are pleased to present the 4th 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.

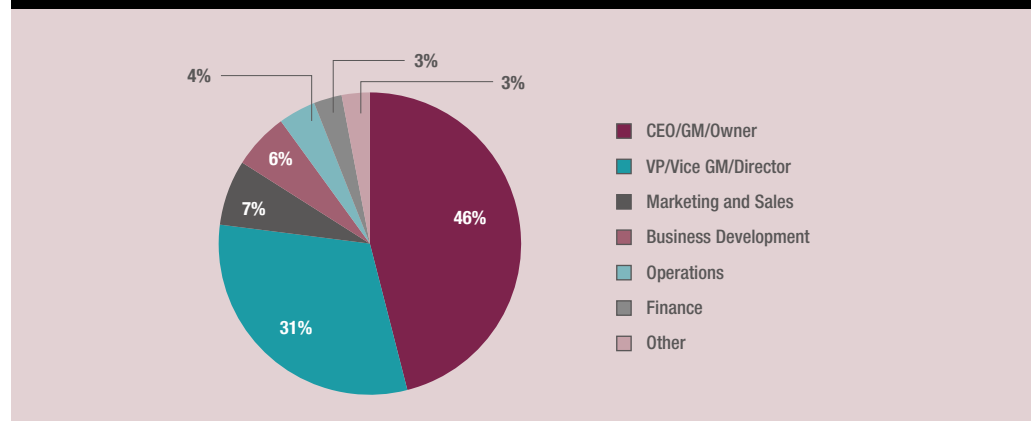
Finally, we acknowledge the financial support from CEIBS Research Fund, support from the Alumni, MBA, EMBA and Executive Education offices at CEIBS, and the many friends that helped us with their network. We are grateful to all of them.

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



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.



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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).



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



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

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".

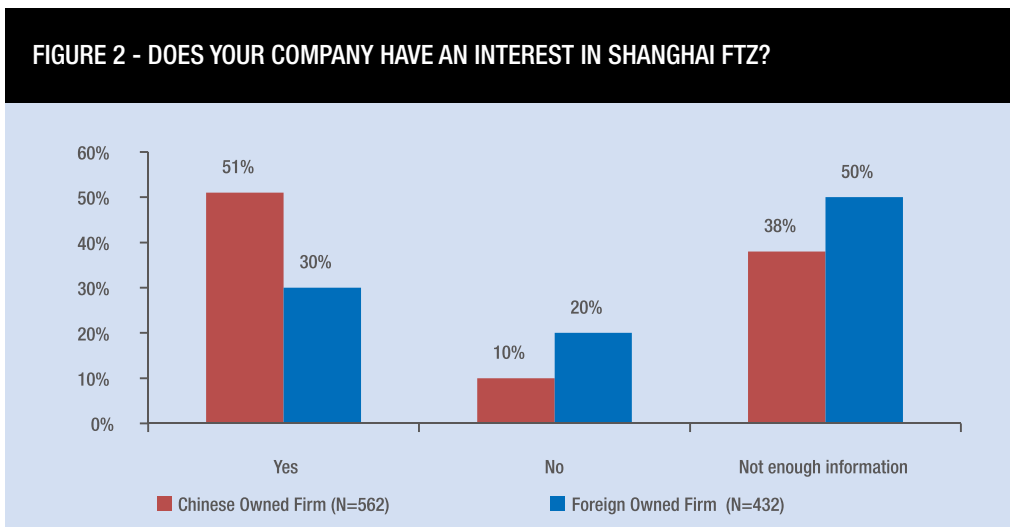
According to local media, 1,434 new enterprises, including 38 foreign firms, had already been registered in the FTZ as of November 22, 2013.

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.

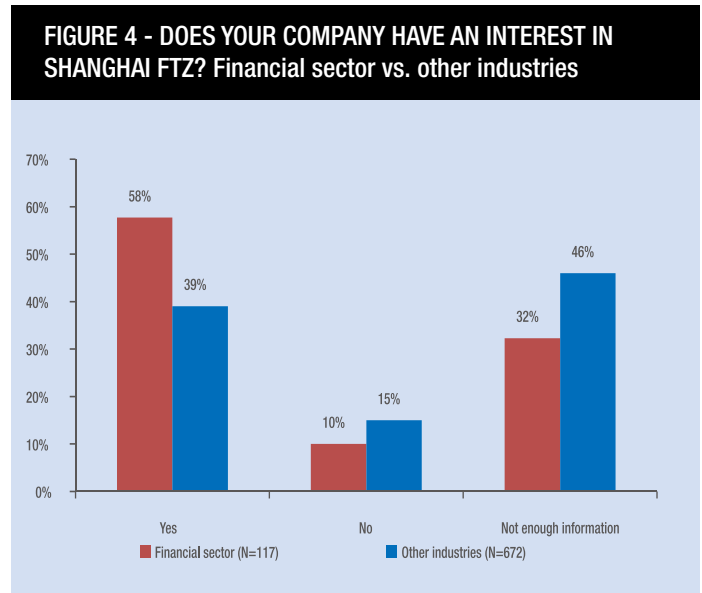
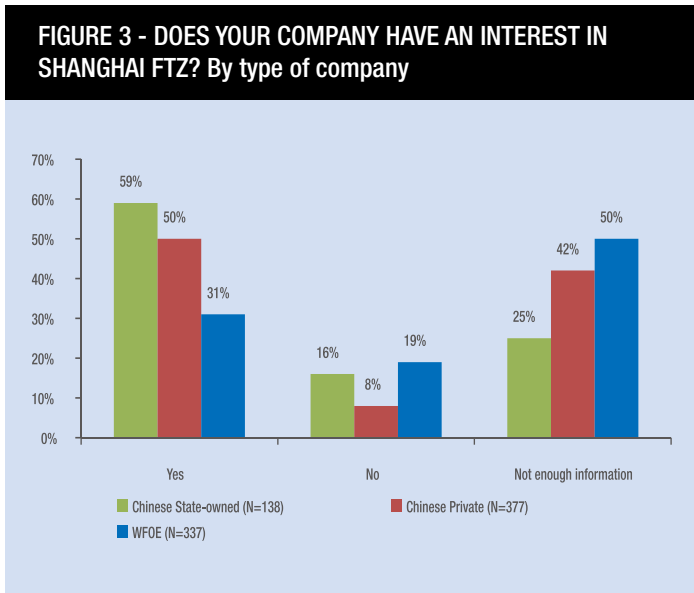
INTEREST:

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").

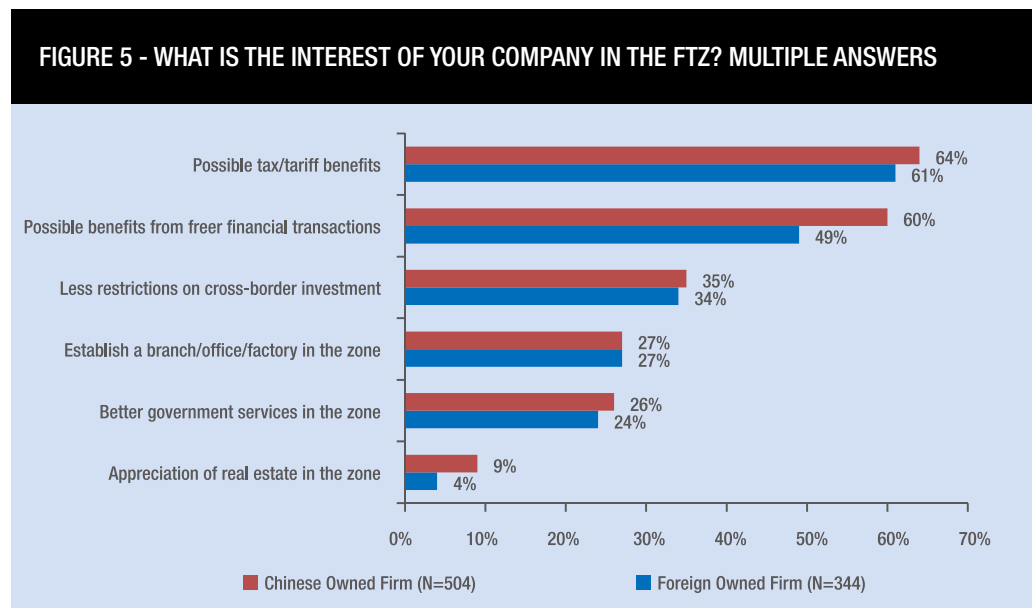


Within the different groups of companies surveyed, we note that it is Chinese state-owned firms and firms operating in the financial sectors that express more often their interest in the zone: 59% of Chinese state-owned firms and 58% of financial firms are interested (Figures 3 & 4).

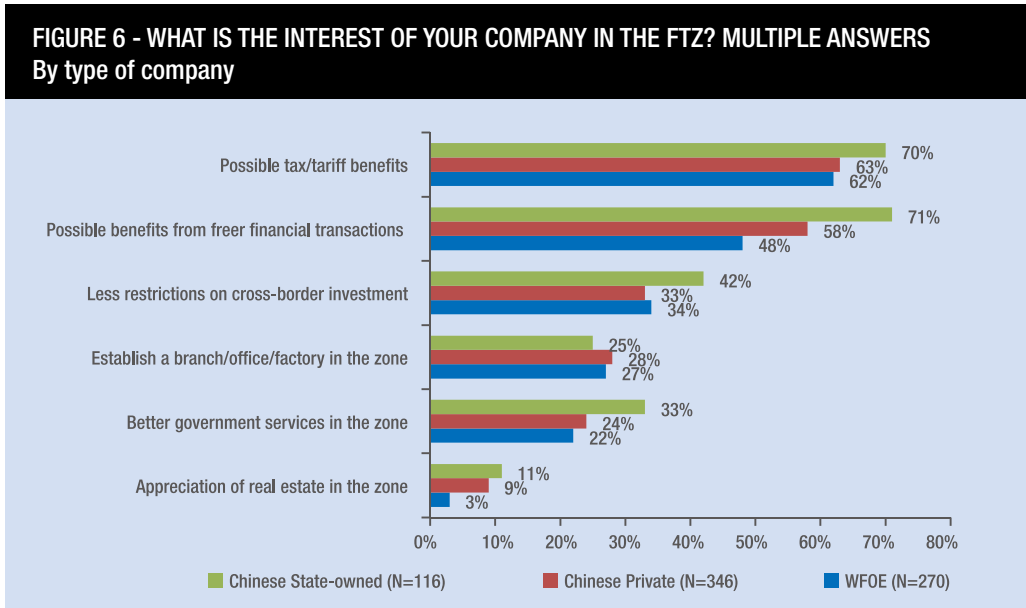


The main interests in the zone for all companies interviewed are tax benefits and freer financial transactions, 64% and 60% respectively of Chinese firms, and 61% and 49% of foreign firms (Figure 5).

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).



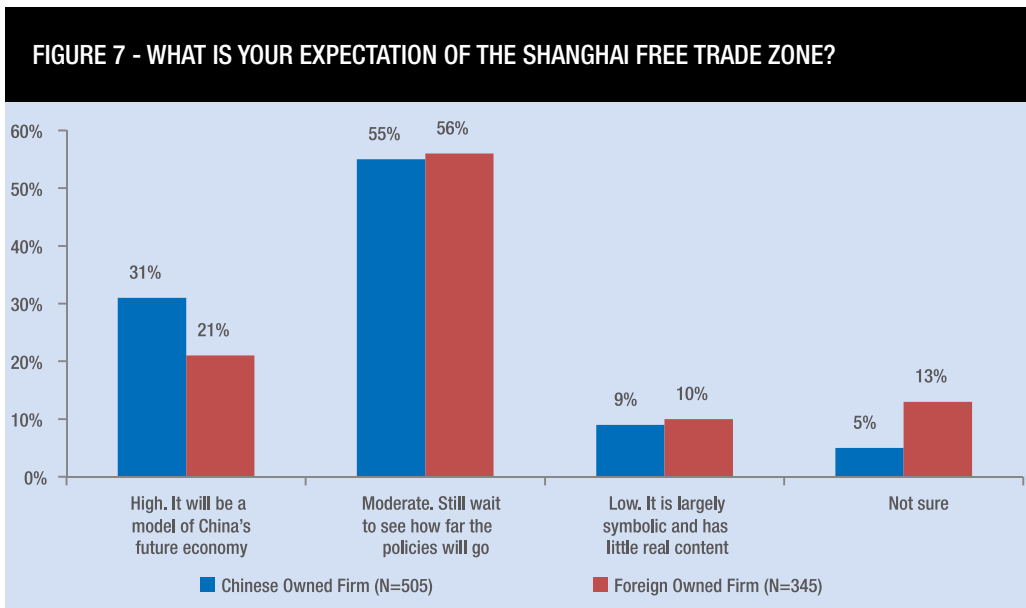
When analyzing by type of companies (Figure 6), we note again that more Chinese state-owned firms than other types of firms search different advantages from the zone: tax or tariff benefits (70%), freer financial transactions (71%), less restrictions in cross border investment (42%) and better government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



EXPECTATIONS:

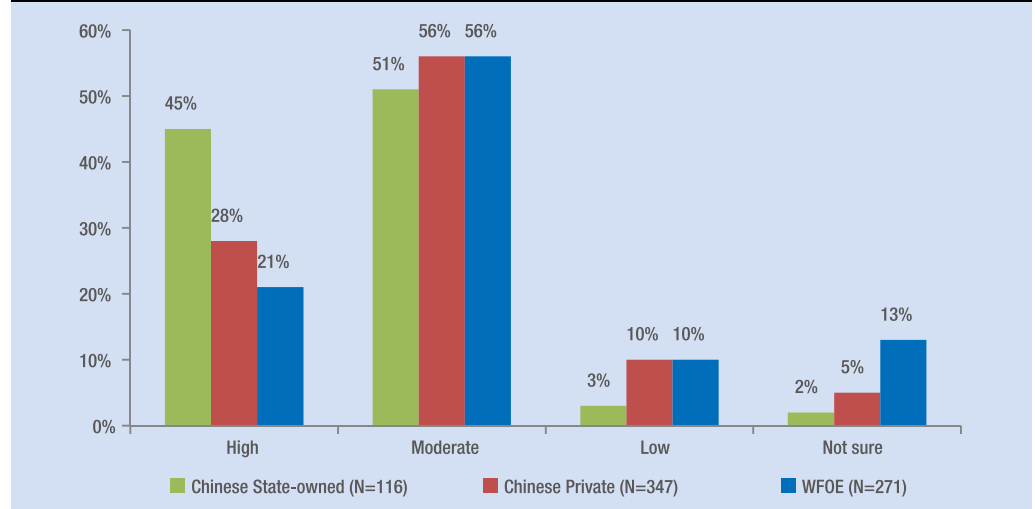
Expectations are “moderate” to “high”, with higher level of optimism among Chinese firms.

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).

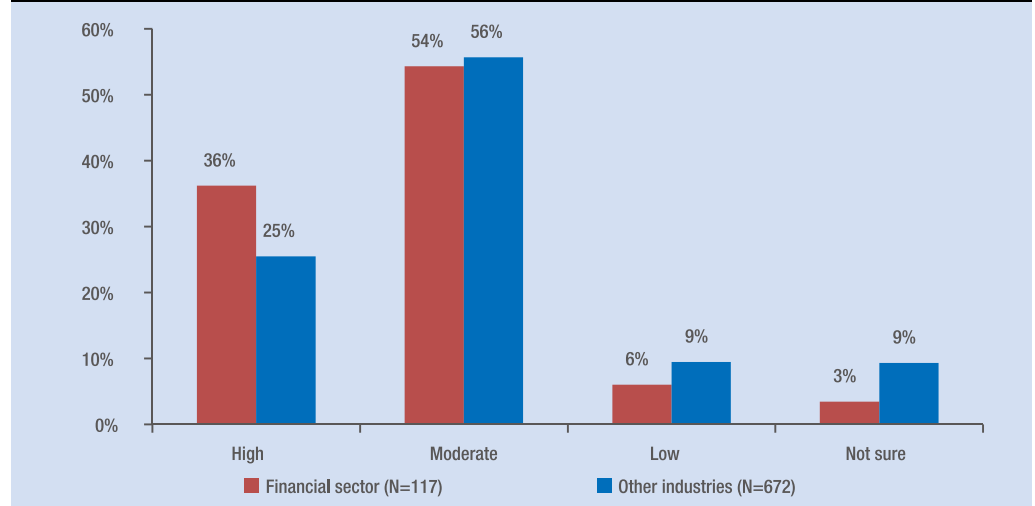


Chinese state-owned companies and companies operating in the financial sector show the most optimism for the zone (Figure 8 and 9).

**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**

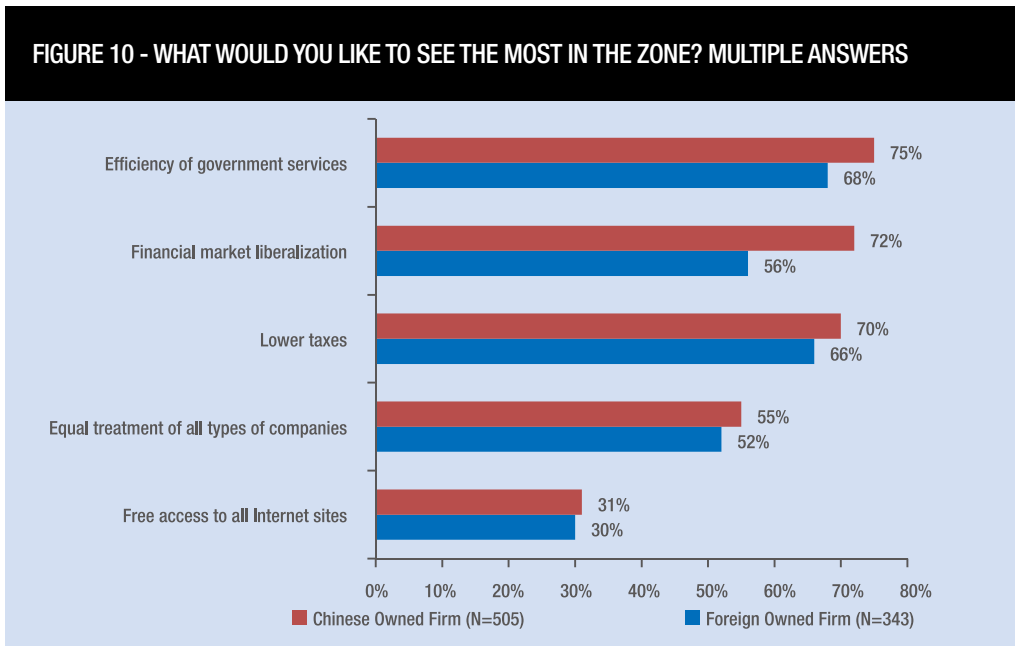


WISH LIST: “Efficiency of government services” is No. 1 wish.

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).

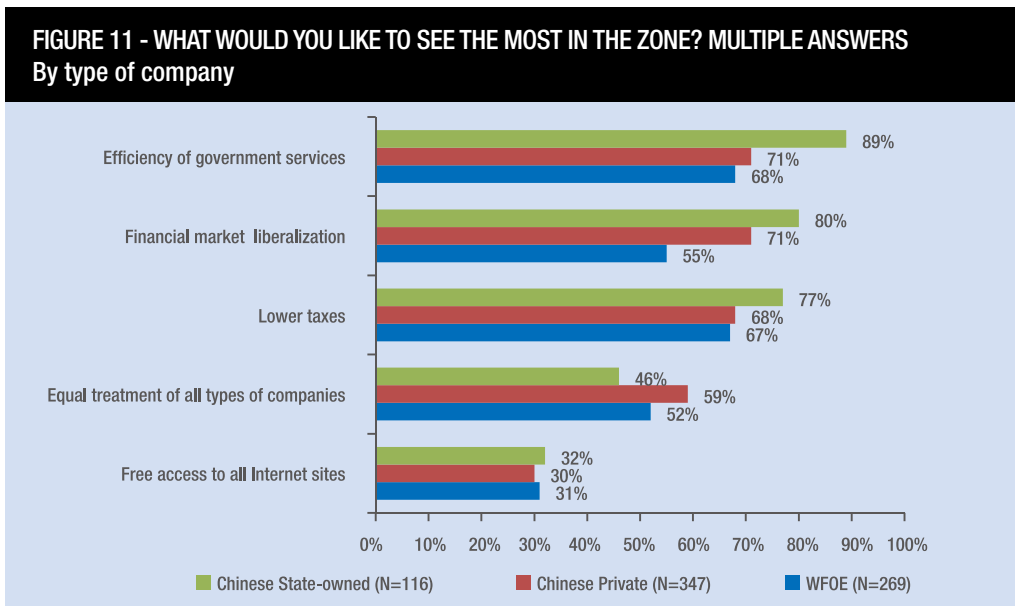
For foreign firms, “efficiency of government services” and “Lower taxes” top their list (68% and 66% of foreign firms, respectively), with a lower 56% of firms seeking “financial market Liberalization”.

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).



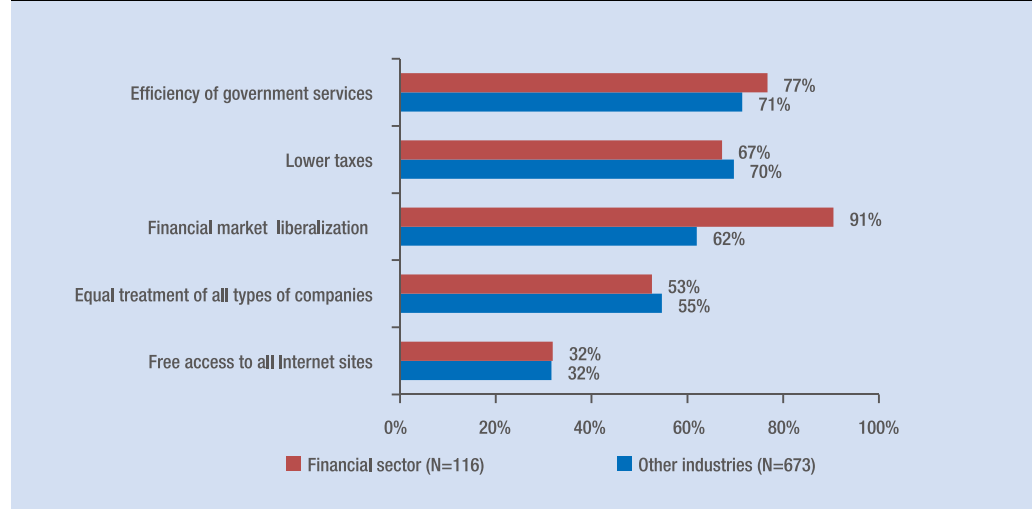
There are a few interesting differences in the weight of some factors between Chinese state-owned companies and other types of companies (Figure 11):

- “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 WOFEs.
- 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%).

FIGURE 12 - WHAT WOULD YOU LIKE TO SEE THE MOST IN THE ZONE? MULTIPLE ANSWERS
Financial sector vs. other industries



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)¹. 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

¹ $INDEX = (P1*1) + (P2*0.75) + (P3*0.5) + (P4*0.25) + (P5*0)$

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

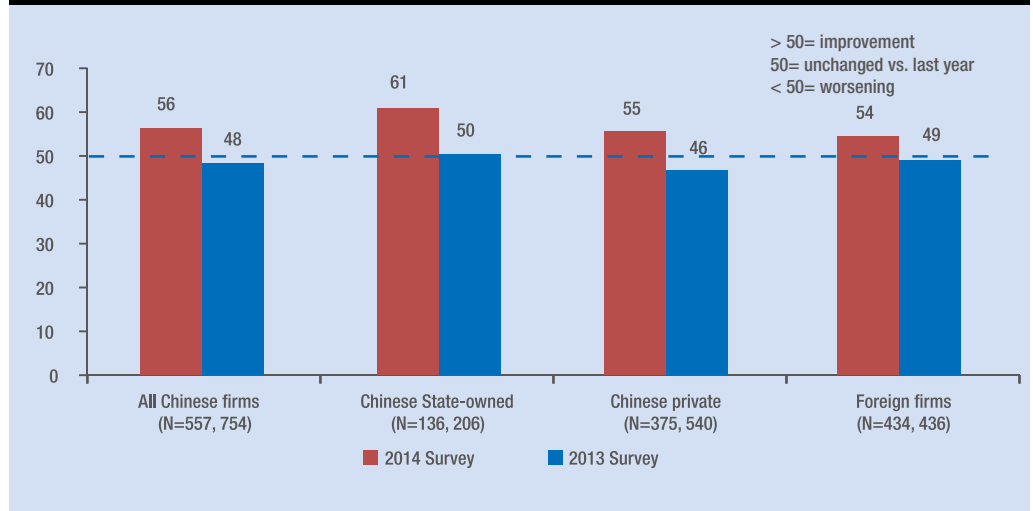
P2 = Percentage number of answers that reported an improvement.

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?)

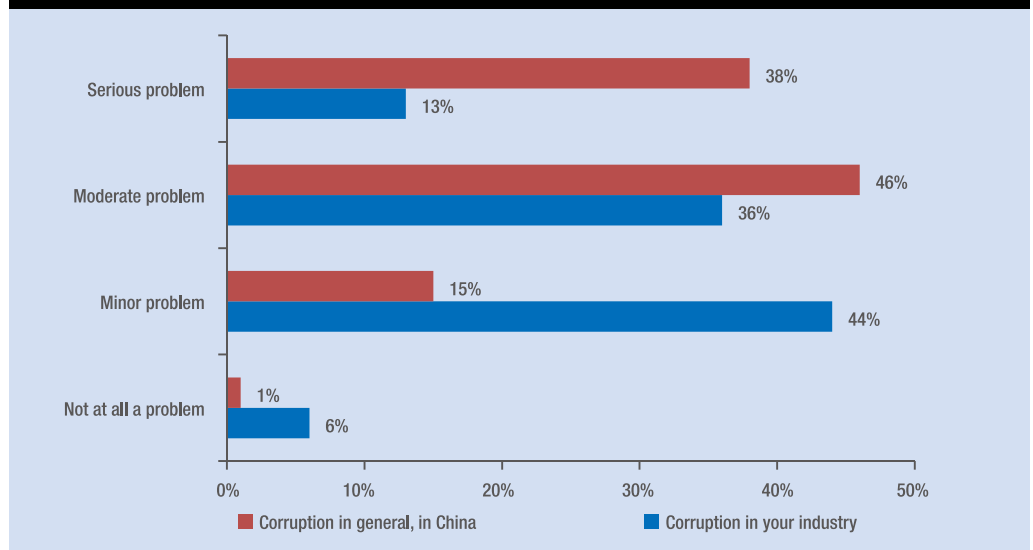


All industries surveyed report a Corruption Index higher than 50 indicating they perceive an improvement (decrease in corruption) in their sector; Consumer goods and services, Corruption Index of 55; Technology and Telecommunications, 55; Basic materials, including chemicals and mining, 55; Energy, 58;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

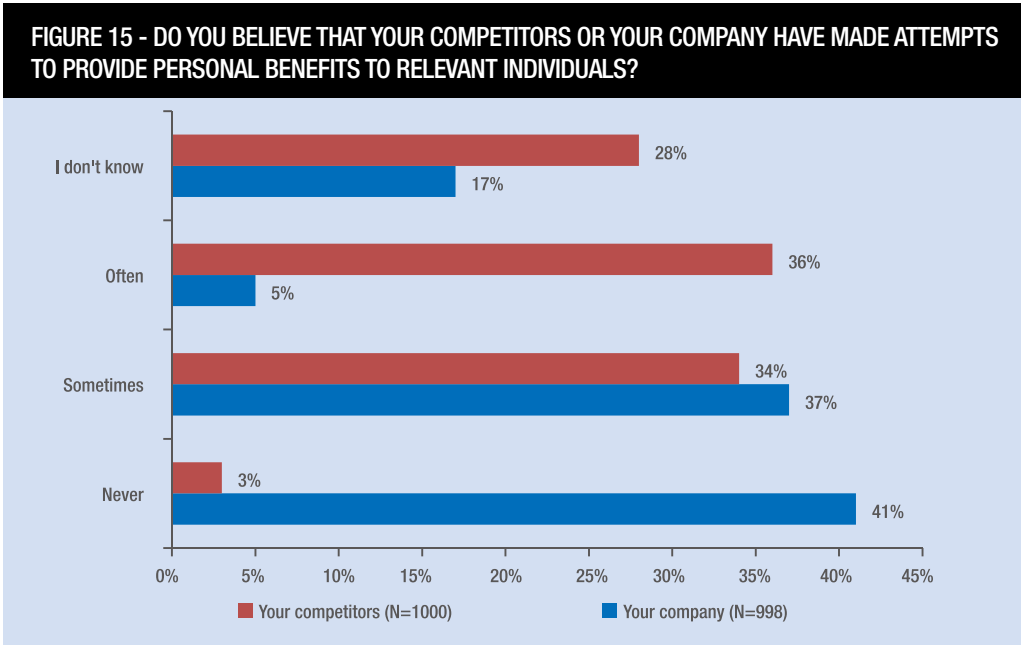
Corruption in China vs. industry:

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).

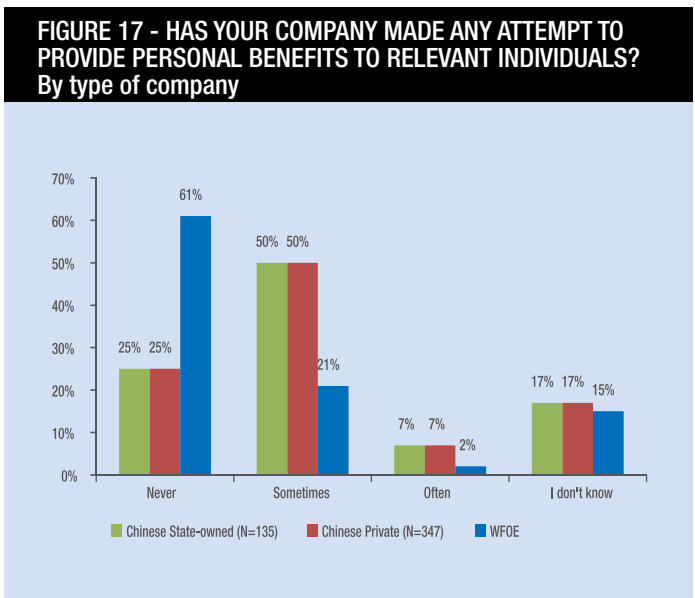
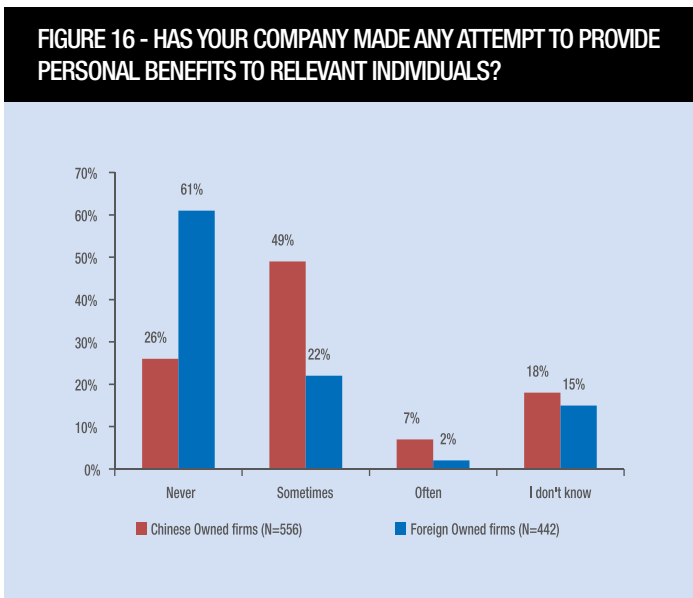
FIGURE 14 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA, IN GENERAL, AND IN YOUR INDUSTRY? N=1008



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).

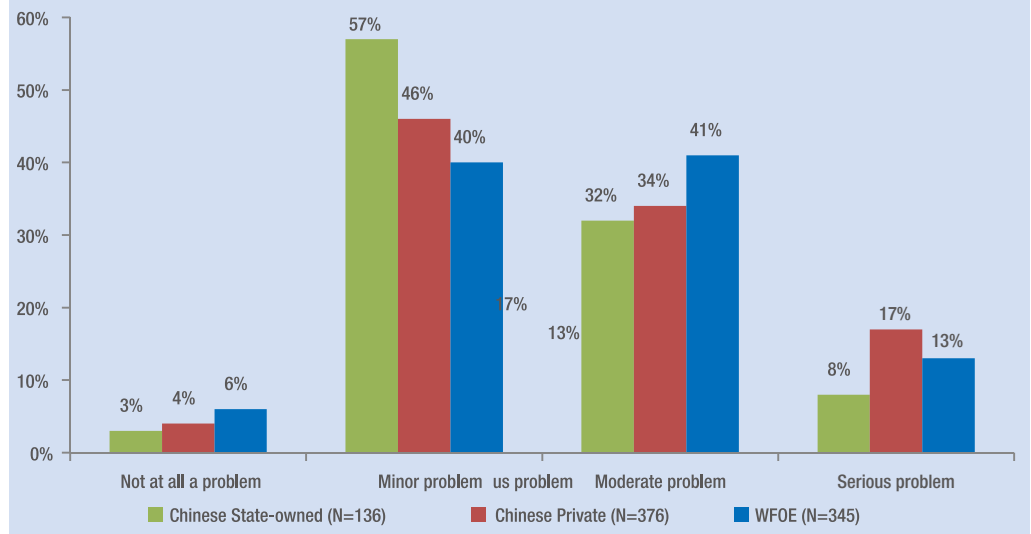


We observe a few differences between chinese and foreign owned comanies in the sample. When asked if their company has made any attempt to provide personal benefits to relevant individuals, 49% of executives working for chinese firms respond “sometimes” vs. a lower 22% of those working for foreign firms; 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.

FIGURE 18 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR 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

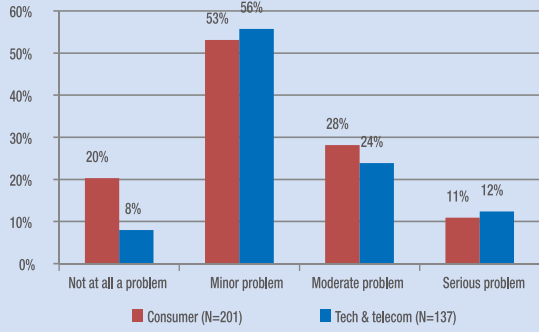


FIGURE 20 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY? MINOR TO MODERATE PROBLEM

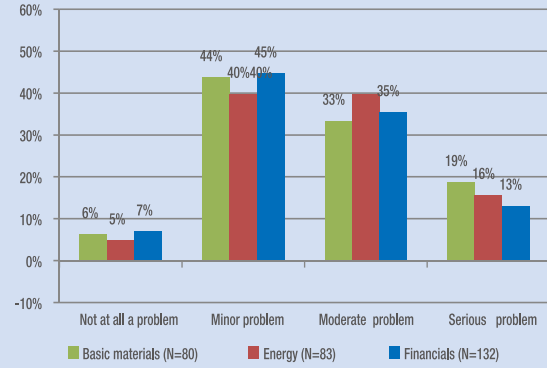
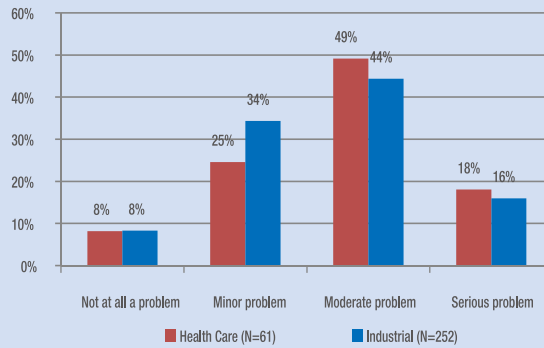


FIGURE 21 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY? MODERATE PROBLEM





SECTION 1

DESCRIPTION OF THE COMPANIES PARTICIPATING

This section details the following information about the companies that have participated in the 4th edition of the CEIBS China Business Survey

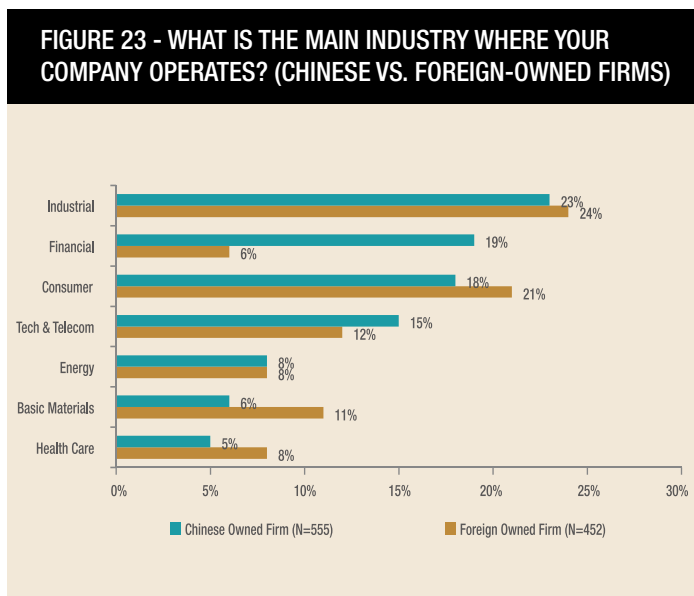
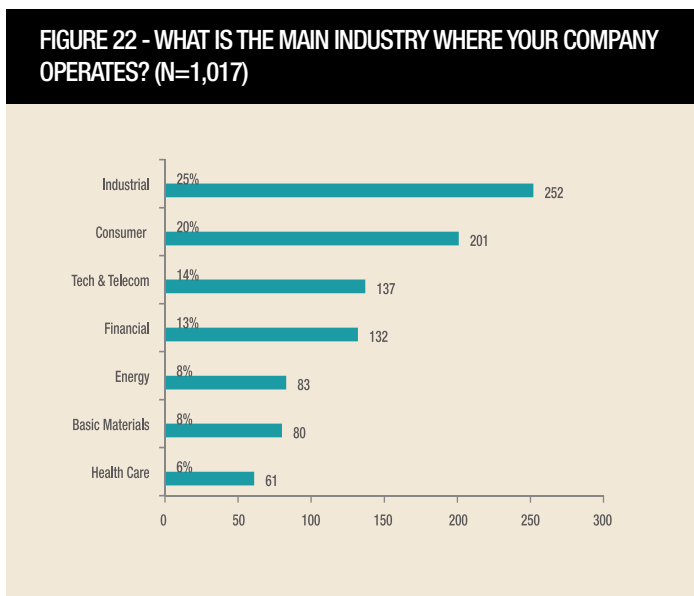
- Type of ownership (Chinese or foreign), business sector, industry and type of activity
- Location of Global Headquarters and China Headquarters
- Degree of internationalization
- Number of employees in China and globally
- Revenue level in China
- Legal form in China
- Years of operation

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

A total of 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)² 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).



In terms of market position, the firms surveyed operate mostly in the mid and high ends of the market. According to survey answers³, 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:

² Including Chinese controlled Joint Ventures

³ N=866

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

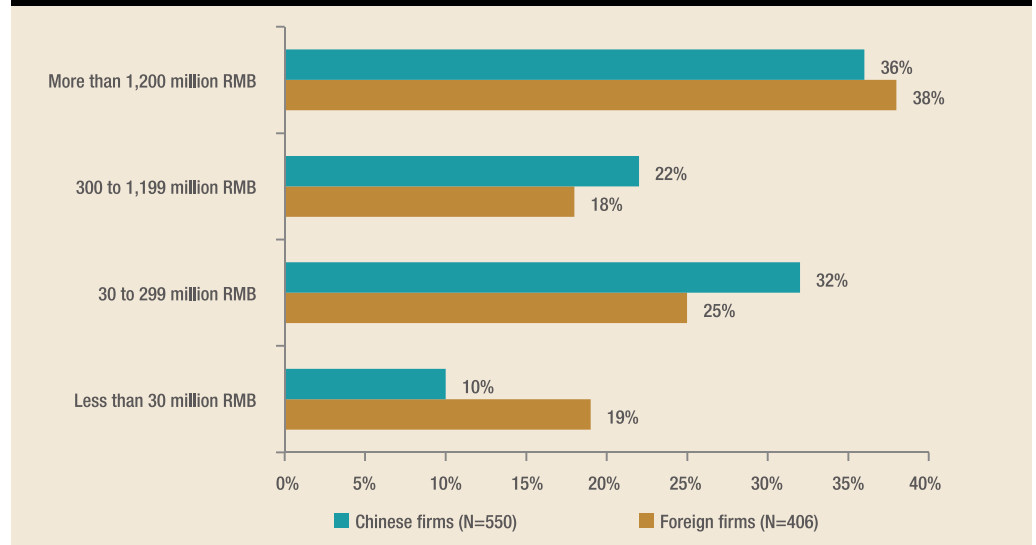


The **China headquarters** of 78% of the total sample are located in coastal China, in central China for 18% and in west China for only 4% of respondents. However, we do observe that foreign firms concentrate on the coastal region more than Chinese firms do (85% of foreign firms vs. 72% of Chinese firms).

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)⁴.

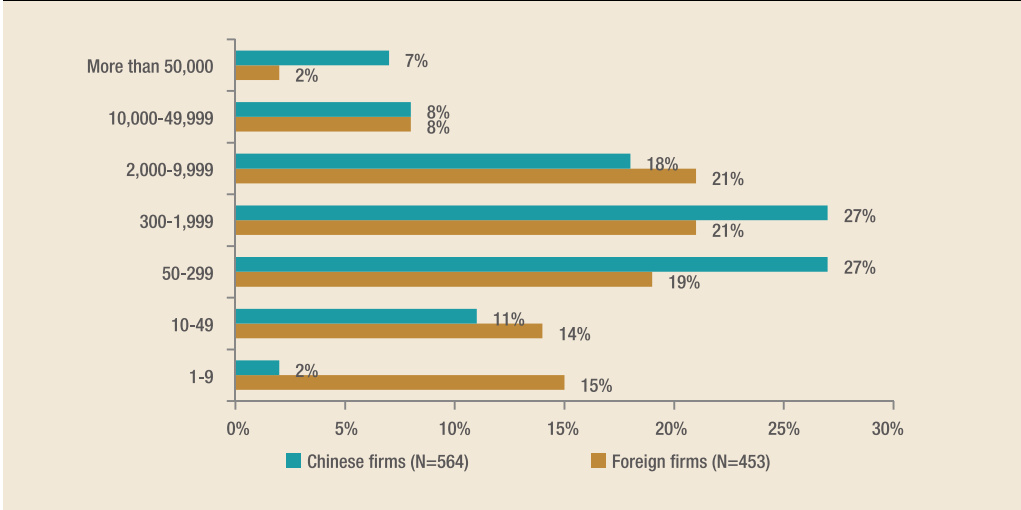
FIGURE 25 - WHAT ARE YOUR COMPANY'S TOTAL CHINA SALES IN 2013?



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

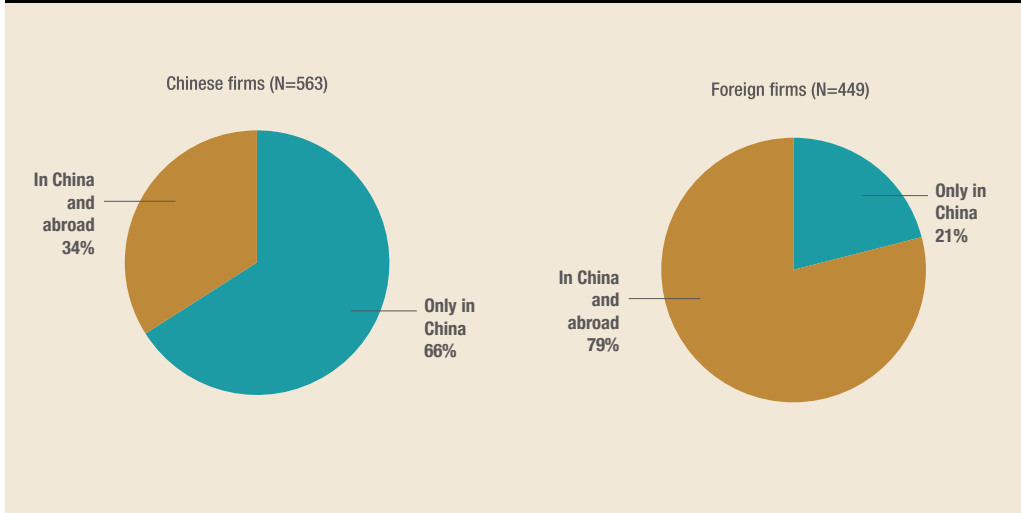
The sample of companies varies widely in size, ranging from companies with less than 10 employees in China to those with more than 50,000. However, we observe that Chinese firms surveyed are larger than foreign-owned firms in respect to number of employees in China. Chinese firms surveyed have in average 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?



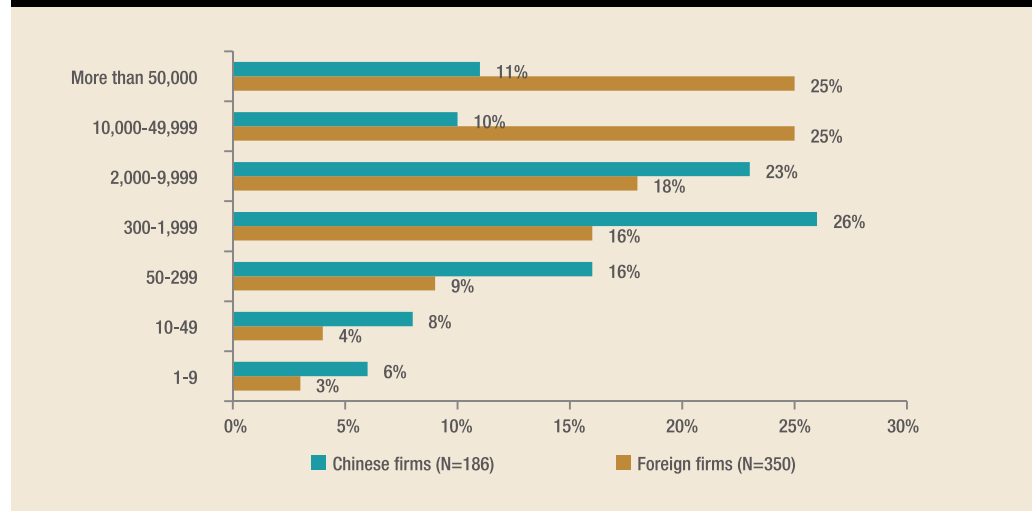
One third of the Chinese owned firms in our sample have operations abroad too (34%, 192 firms with 9% of them being Joint Ventures). Excluding JV, 30% of the Chinese owned firms in our sample are international. And although 4 out of 5 foreign firms in our sample are international (353 firms, 9% of which 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?



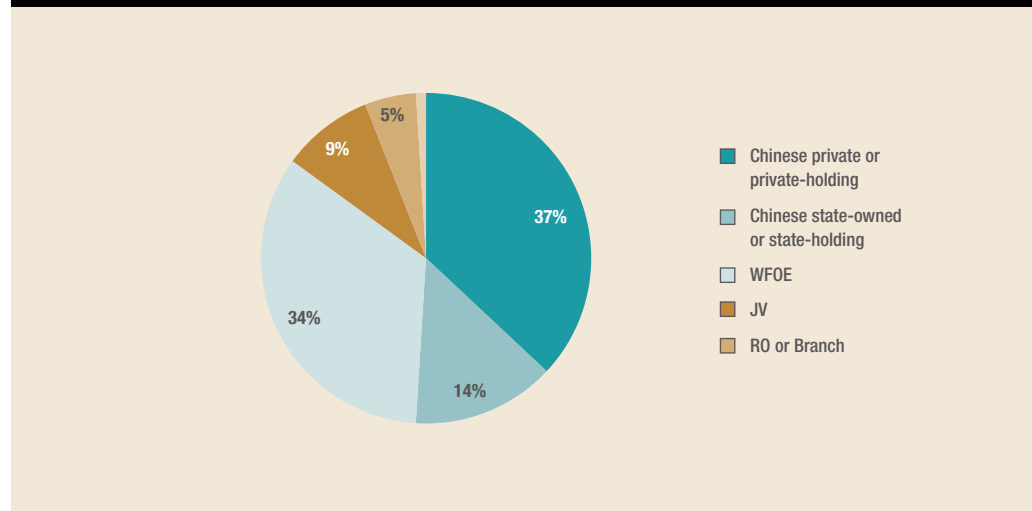
Foreign-owned firms are overall larger in their global operations than Chinese-owned firms. 84% of the surveyed foreign companies with international operations are large (34% with 300-9,999 employees, 50% with >10,000) vs. 21% of their Chinese-owned counterparts. Chinese international firms in our survey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

FIGURE 28 - FIRMS WITH INTERNATIONAL OPERATIONS- HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE GLOBALLY?



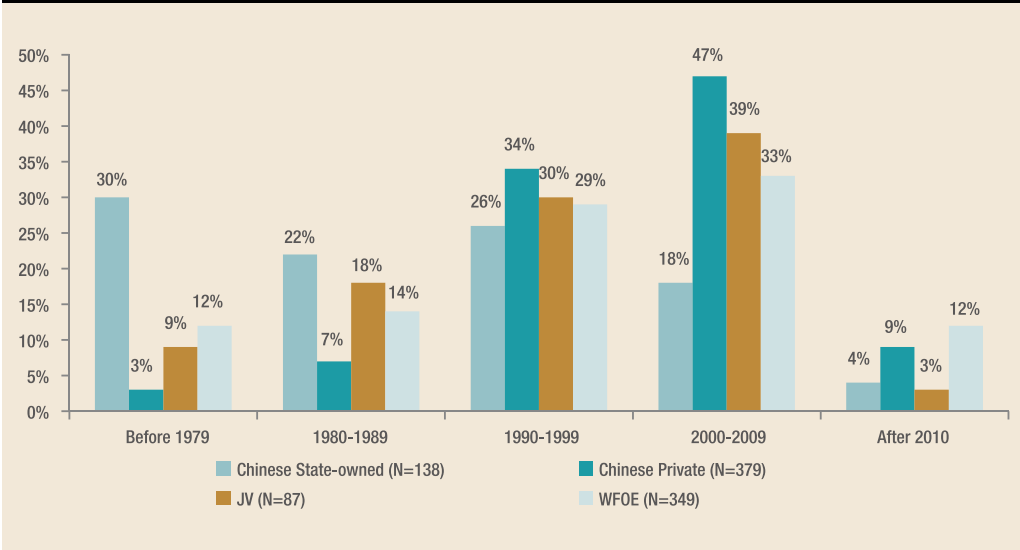
37% of surveyed companies are Chinese privately owned or private-holding companies and 14% are state-owned or state-holding enterprises. Joint Ventures (JV) constitute 9% of the sample, with different levels of Chinese and foreign ownership. Most of the foreign-owned companies are Wholly Foreign Owned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

FIGURE 29 - WHAT IS THE LEGAL STATUS IN CHINA OF THE COMPANY YOUR WORK FOR? N=1,012



⁵ 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?



The indices are based on multiple choice questions with 5 possible answers⁶.

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.

⁶ $INDEX = (P1*1) + (P2*0.75) + (P3*0.5) + (P4*0.25) + (P5*0)$

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.

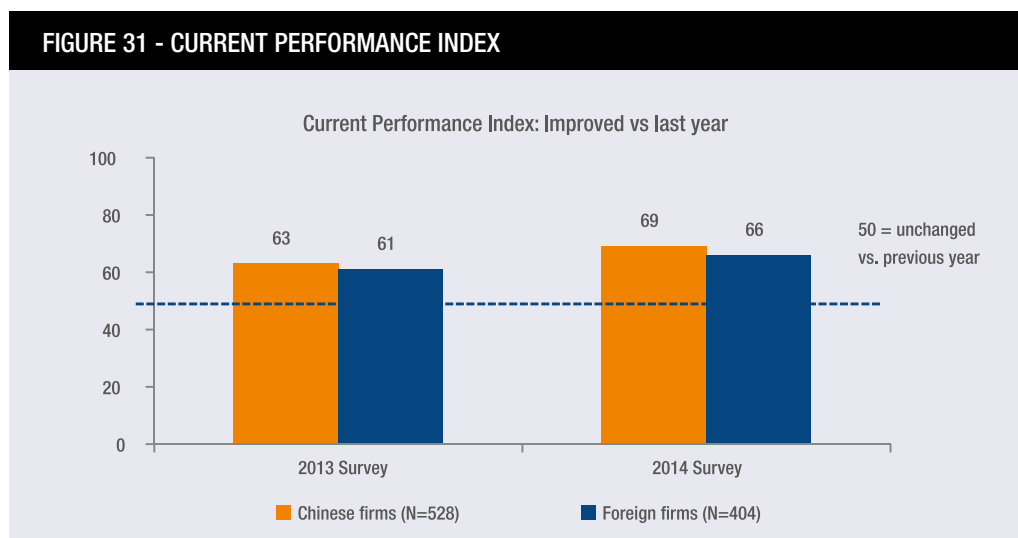
P4 = Percentage number of answers that reported a deterioration.

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?

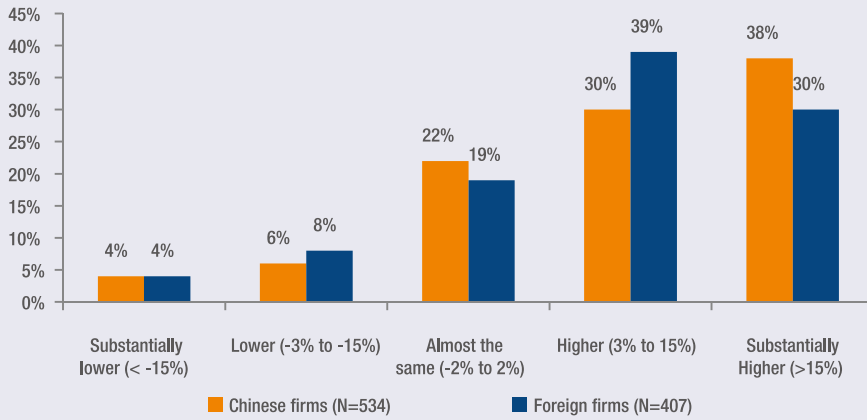
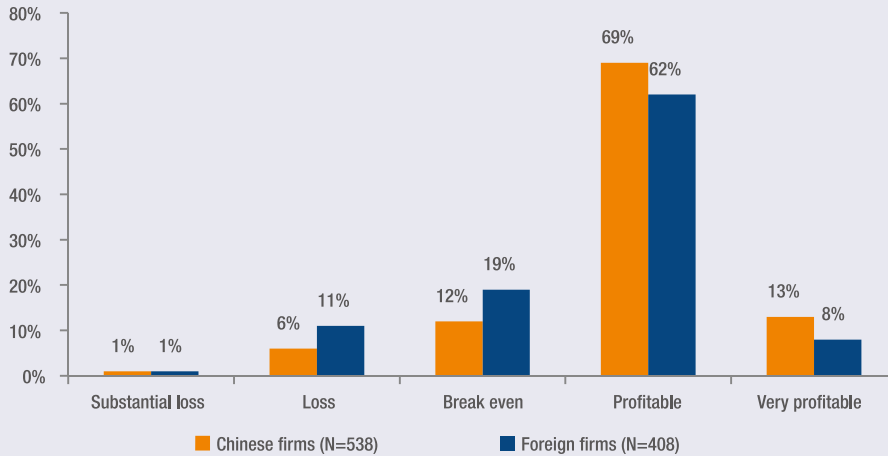


FIGURE 33 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2013?



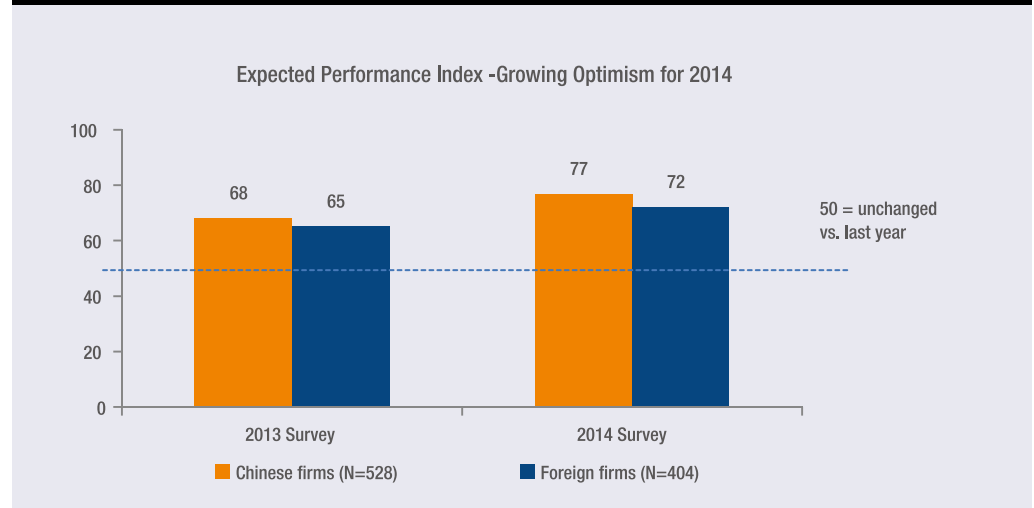
2.2. EXPECTED PERFORMANCE INDEX – EPI

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).

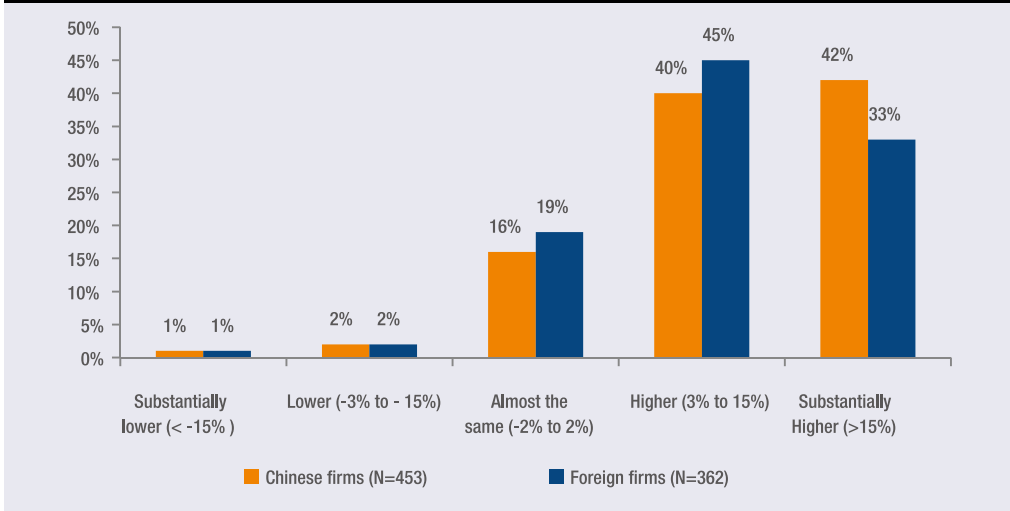
Last year survey's Expected Performance Index was lower than this year's for both groups: 68 for Chinese companies and 65 for foreign companies. These results indicate improved performance and expectations of companies in 2013 when compared to 2012. Chinese firms seem more optimistic and expect better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

FIGURE 34 - EXPECTED PERFORMANCE INDEX



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

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? ⁷

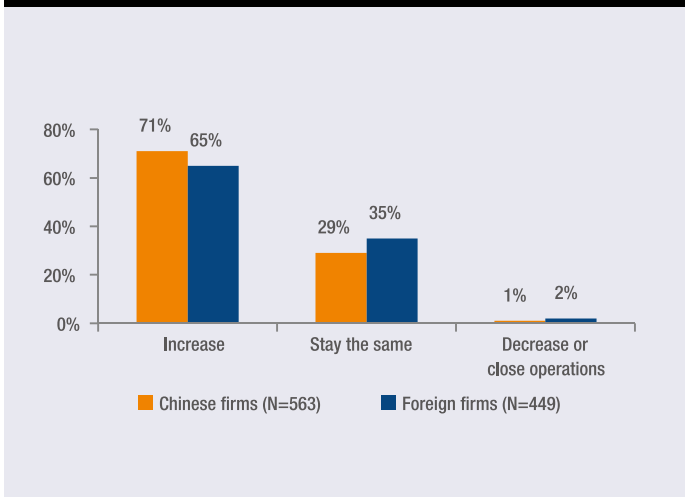
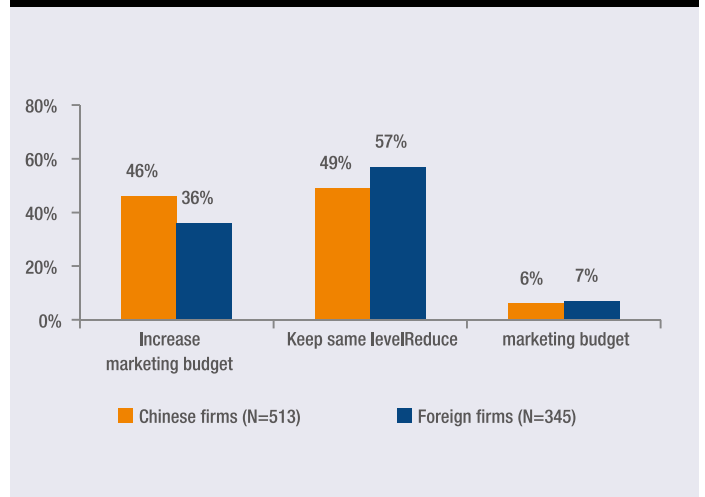


FIGURE 37 - MARKETING & SALES AS % OF REVENUES: WHAT ARE YOUR PLANS FOR 2014?



⁷ 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?

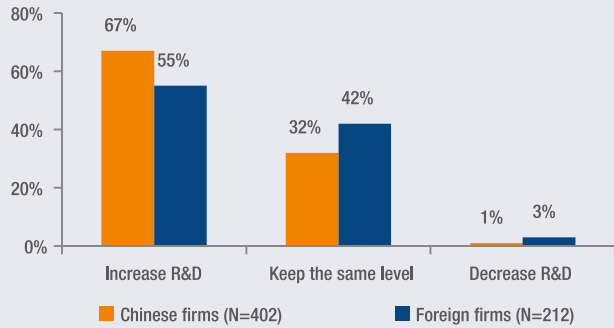
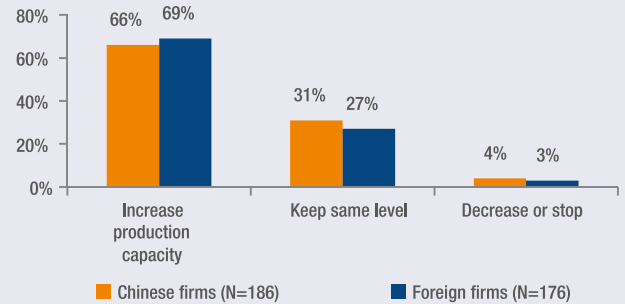


FIGURE 39 - WHAT ARE YOUR PLANS FOR PRODUCTION CAPACITY IN CHINA IN THE NEXT 3 YEARS?



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)

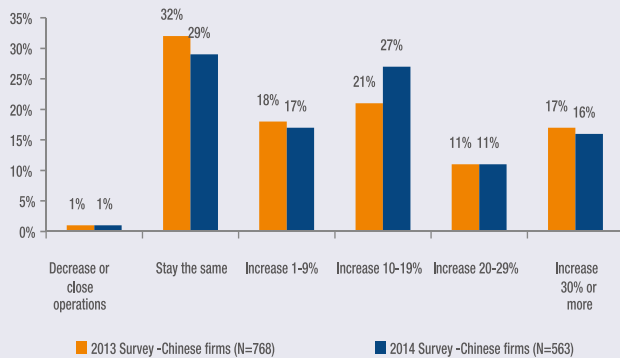
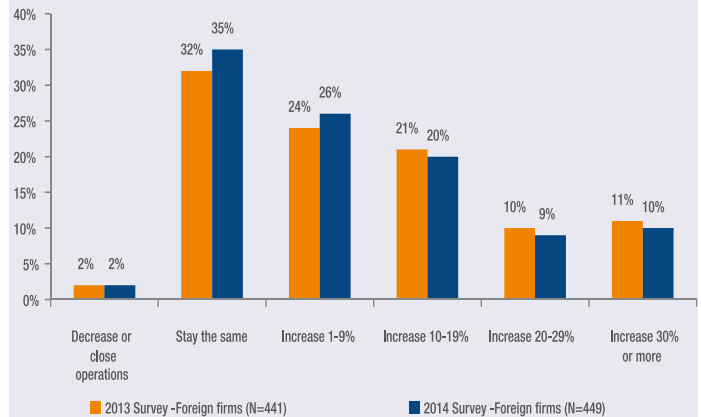


FIGURE 41 - FOREIGN-OWNED FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR 2013 IN CHINA? (2013 SURVEY) / WHAT INVESTMENTS DO YOU PLAN FOR 2014 IN CHINA? (2014 SURVEY)



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).

FIGURE 42 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR? N=767
 0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT

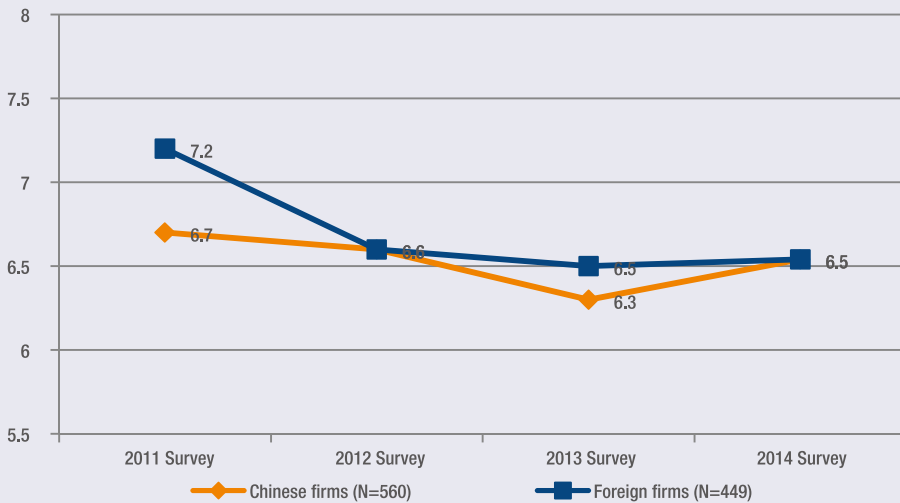
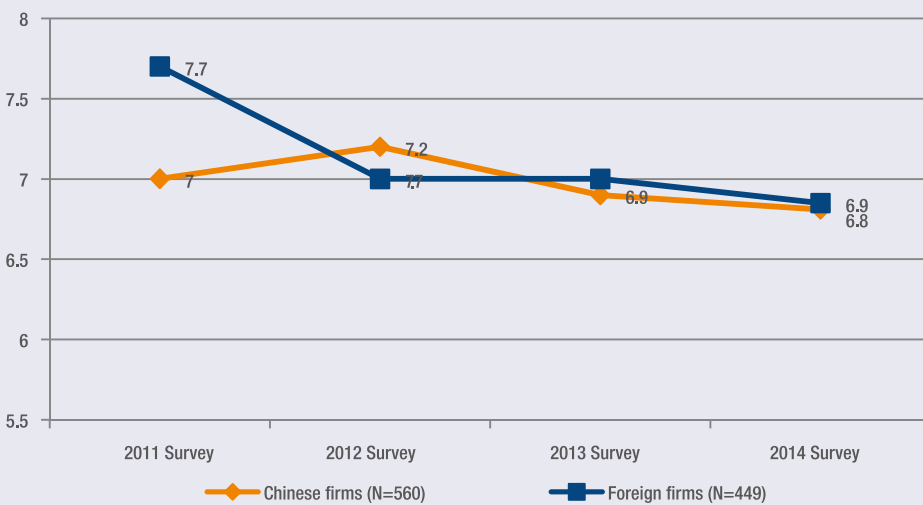


FIGURE 43 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT 5 YEARS? N=438
 0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT



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 2010⁸. 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 4th 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?

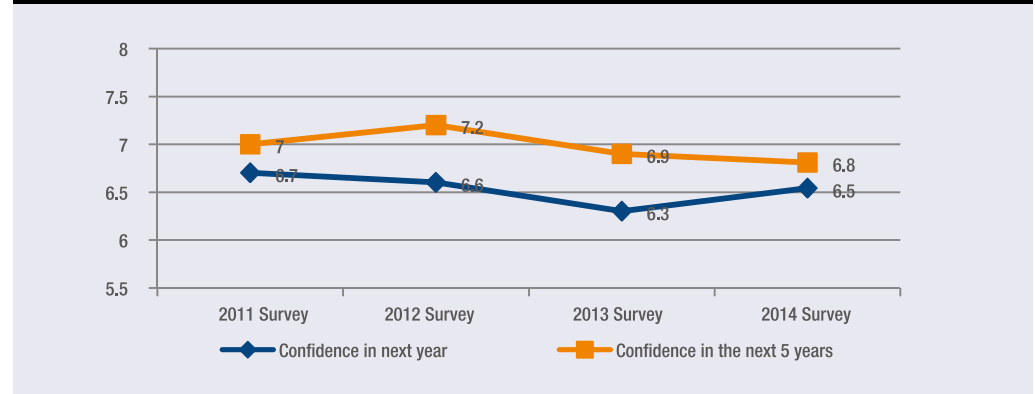
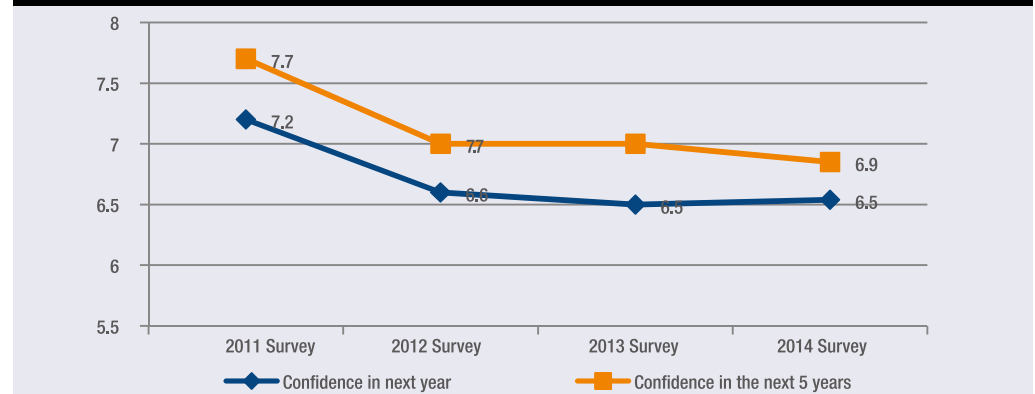


FIGURE 45 - FOREIGN FIRMS - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS?



⁸ 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

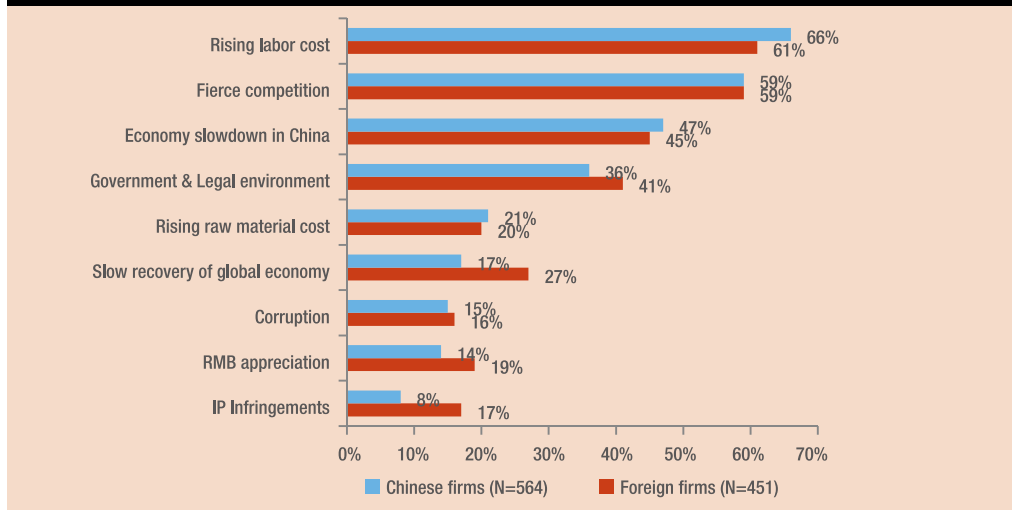
The purpose of this section is to identify the main challenges faced in China by the companies surveyed, explore the relevant differences in the difficulties faced by Chinese companies compared to foreign companies, and learn how the companies in our survey deal with these challenges.

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).

FIGURE 46 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?



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.

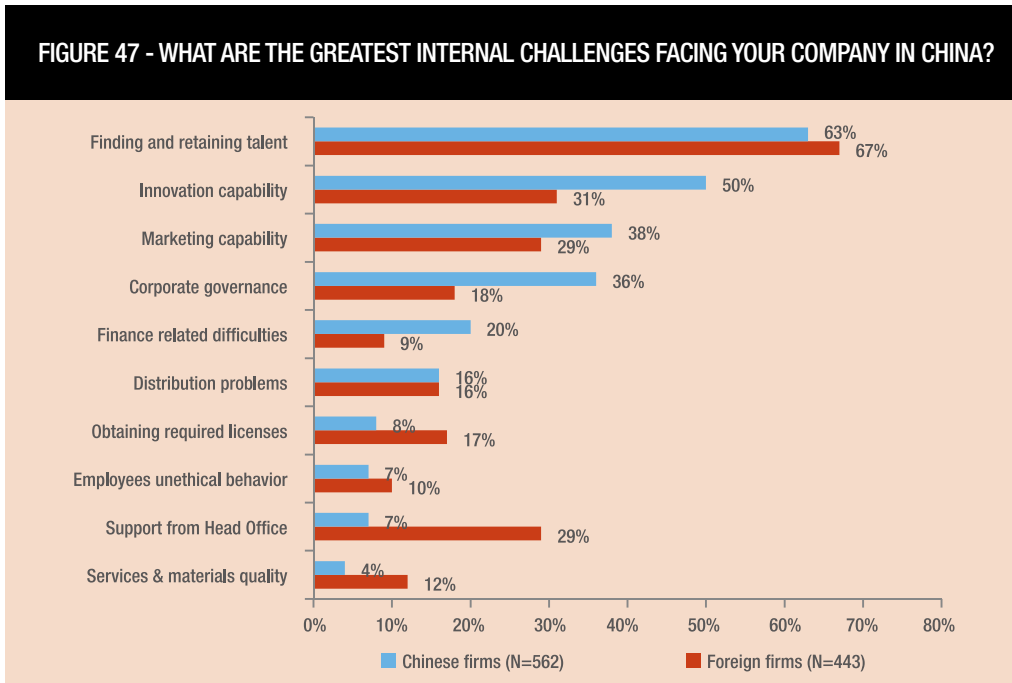
On the other hand, for executives working for foreign-owned companies, “Support from Head Office” is one of the top issues more frequently mentioned, cited by 29% of them, and at same level as marketing and innovation capability. A much lower 7% of Chinese firms consider it to be a challenge, suggesting 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.

FIGURE 47 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?



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.

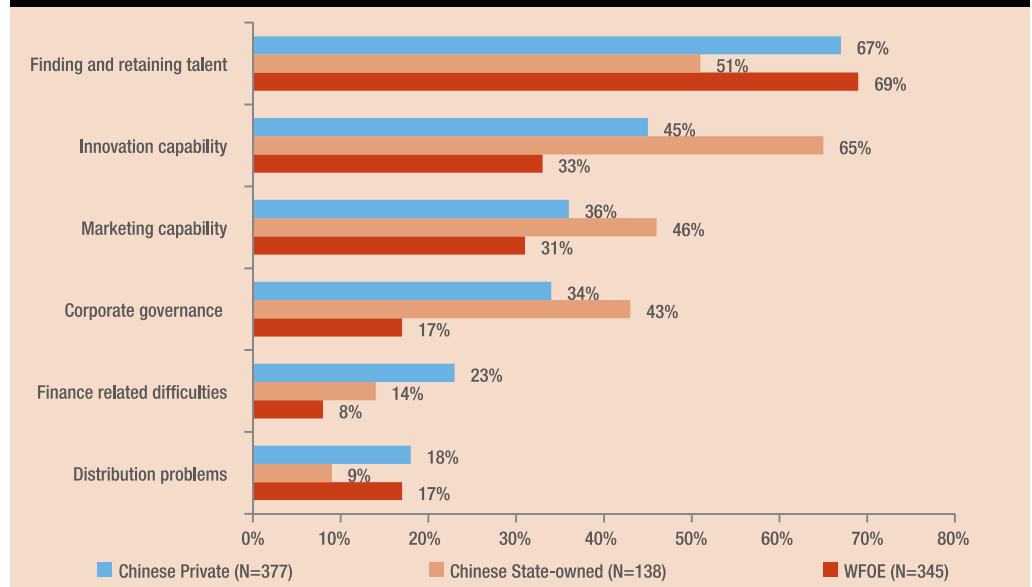
“Finding and retaining talent” is an issue for more Chinese private and foreign companies than it is for state-owned companies.

“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 WOFEs vs. a much lower 4% Chinese private firms, and 12% of state-owned companies.

FIGURE 48 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA? TOP 6 CHALLENGES BY OWNERSHIP TYPE

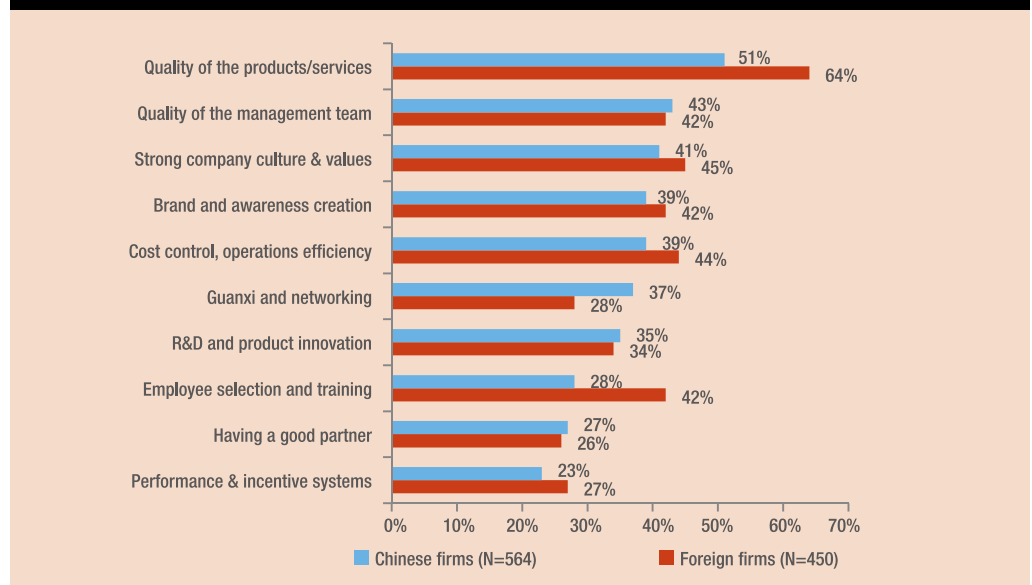


3.3. SUCCESS FACTORS

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.

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



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

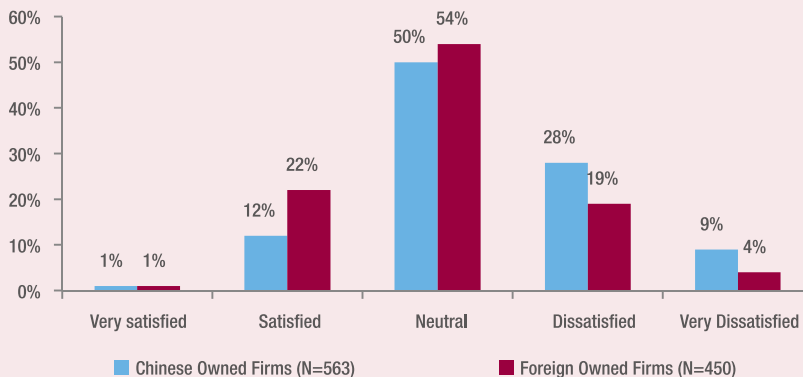
4.1.1. Regulatory Environment and China Government

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.

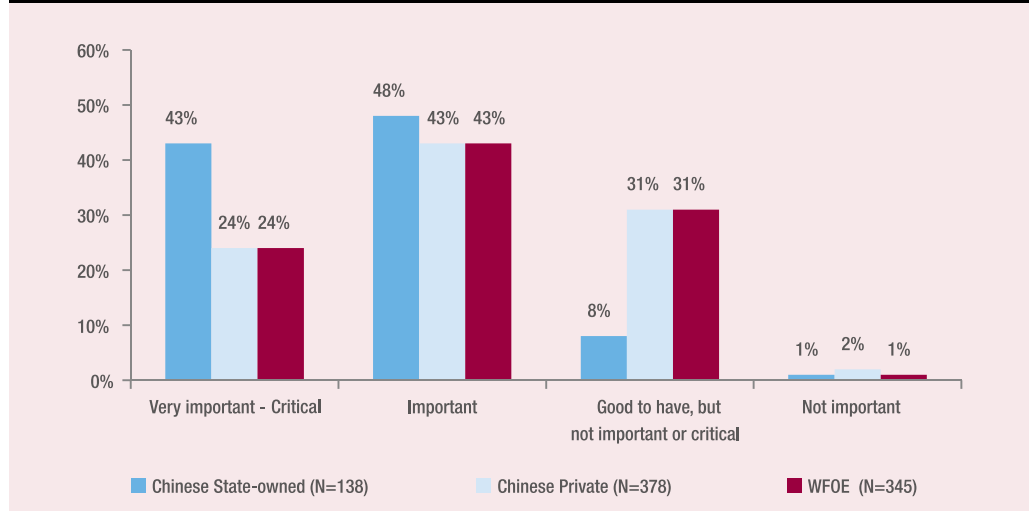
This being said, only 12% of the Chinese firms surveyed declare to be satisfied with the services provided by the Chinese government and its related agencies, compared to 22% of foreign firms. The services are judged insufficient by 37% of Chinese firms and 23% of foreign firms, who declare to be dissatisfied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

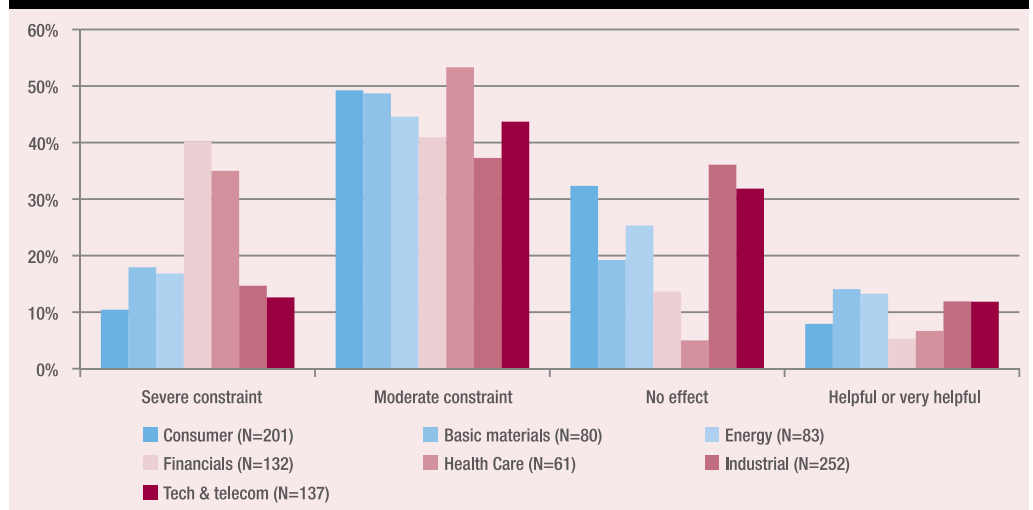
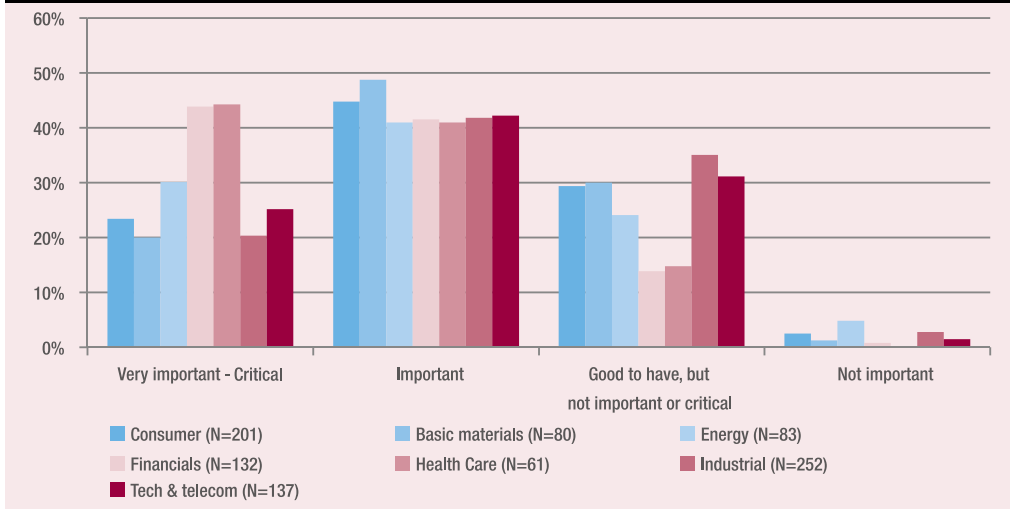


FIGURE 53 - HOW IMPORTANT FOR YOUR BUSINESS SUCCESS ARE THE RELATIONSHIPS WITH THE AUTHORITIES? By industry



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.

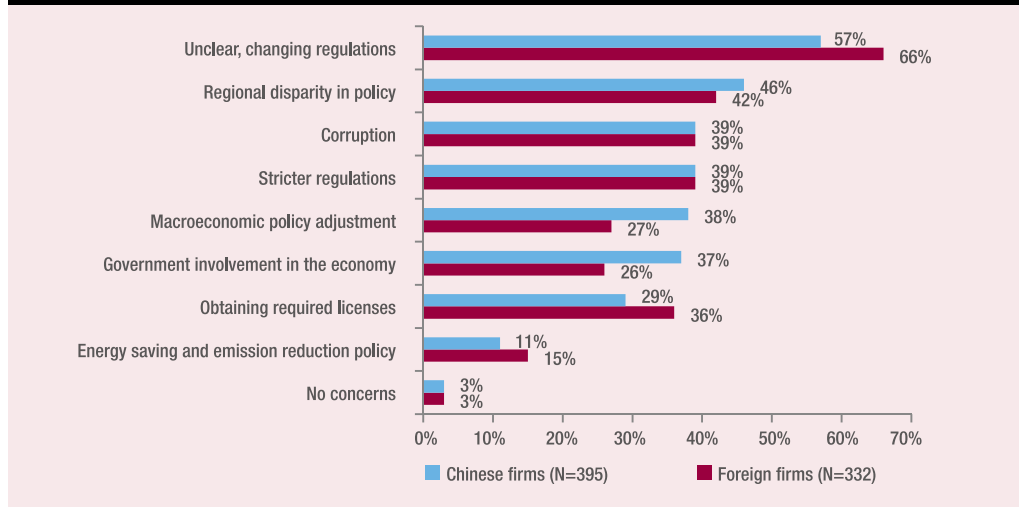
While "Macroeconomic policy adjustment" was last year's survey top concern for Chinese firms, its appearance has been reduced considerably this year with 38% of Chinese firms and 26% of foreign firms worrying about it vs. 46% and 37% respectively last year. The consolidation of the new government in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

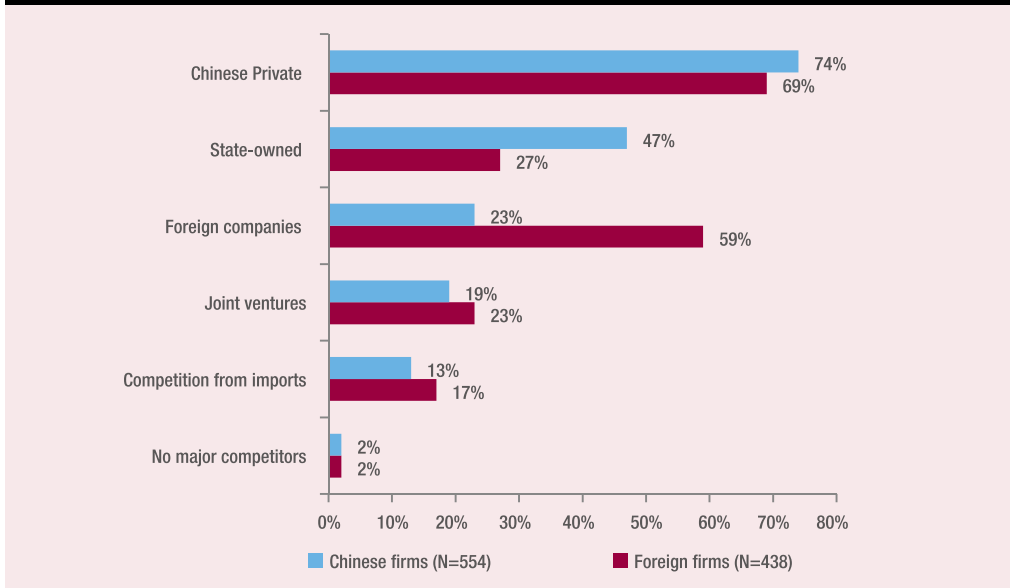
4.1.2. Competitive Environment and Market Advantages

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)



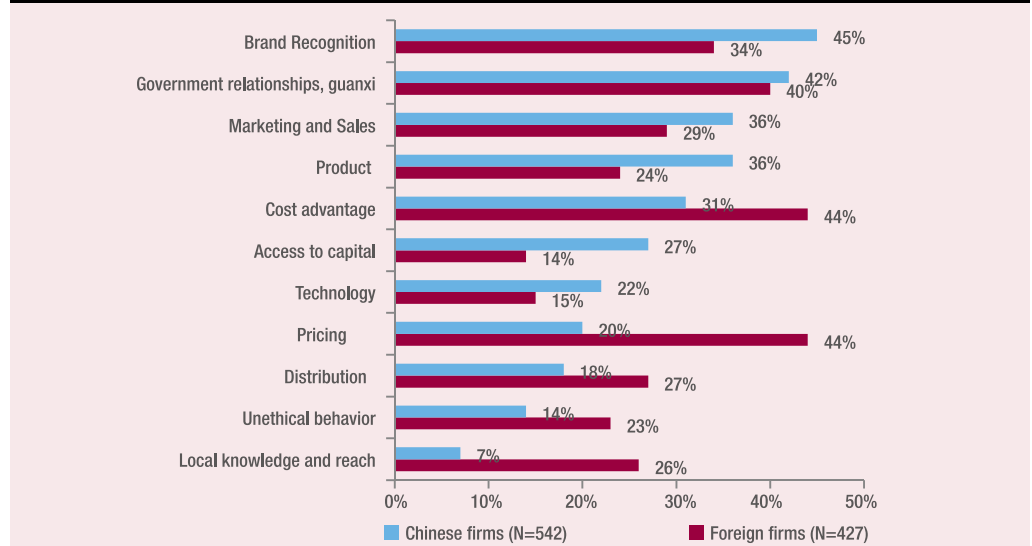
The top strengths of competitors cited by Chinese firms relate to their product or service and the way they are marketed: “Brand recognition” (45%), “Relationships with Government and other guanxi” (42%), “Marketing and Sales” (36%) and “Product” (36%).

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)



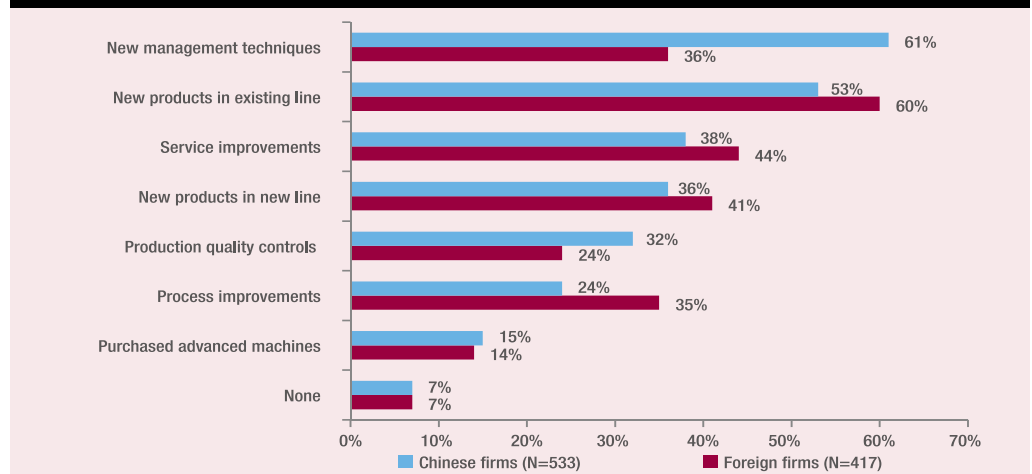
4.2. INNOVATION, R&D AND INTELLECTUAL PROPERTY IN CHINA

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.

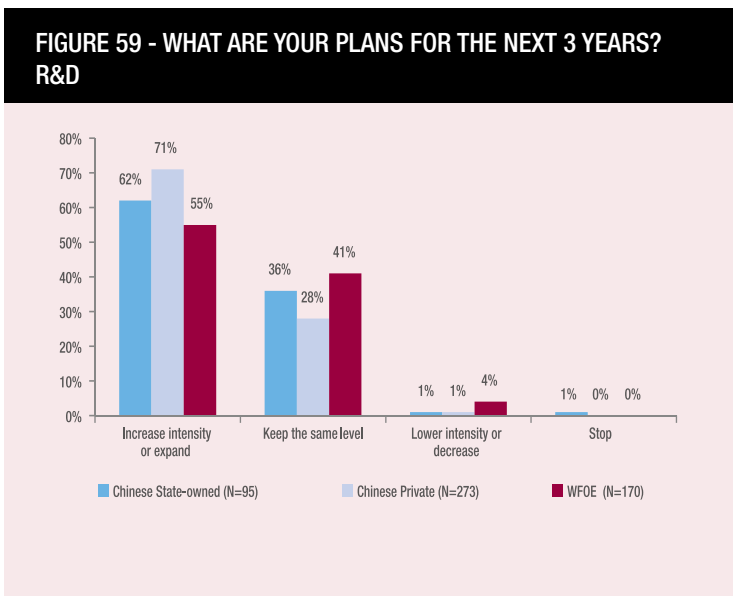
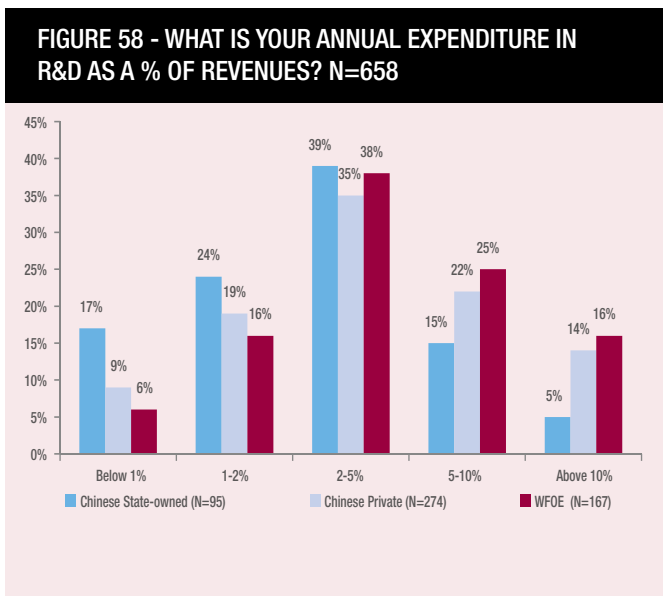
We notice that 61% of Chinese-owned firms in our sample are focusing on implementing “New management techniques” (vs. 36% of foreign firms), reflecting the overall effort that Chinese companies all over the country are making to develop their managerial systems and catch up with their international competitors 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).

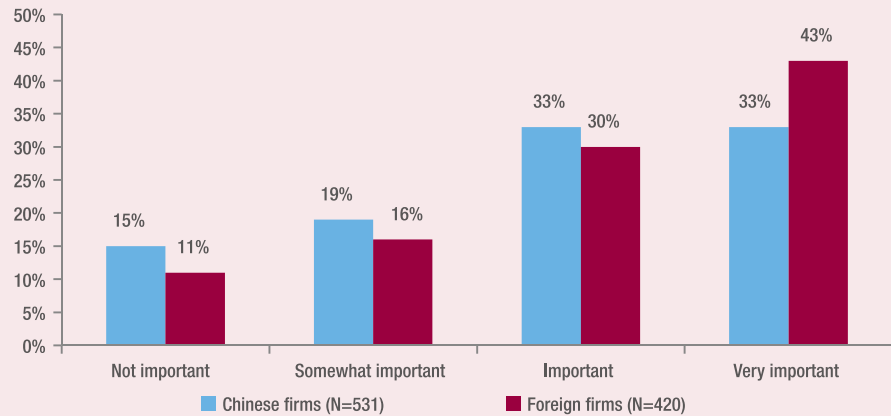


4.2.2. Intellectual Property in 2013

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

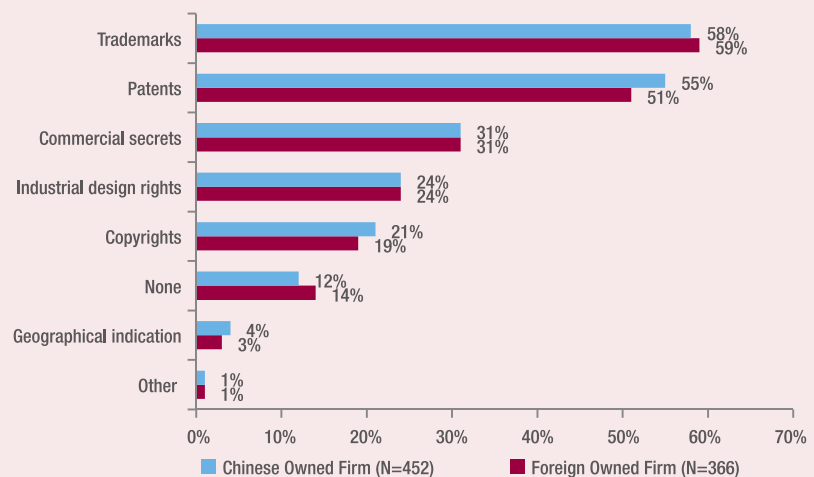
Intellectual Property is important for all businesses in China and this is true for most companies (only 13% of the total sample of firms qualify it as not important). However, a larger proportion of foreign-owned companies (44%) rate it as very important (vs. 33% of their Chinese counterparts).

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.

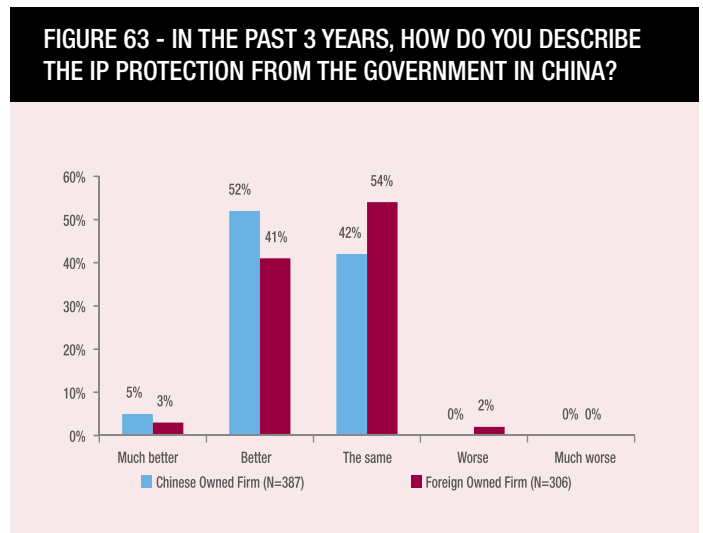
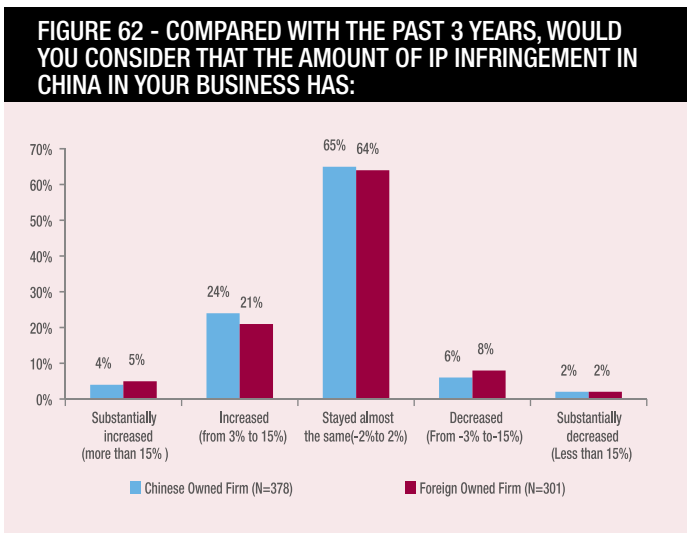
FIGURE 61 - WHAT TYPE OF IP DO YOU OWN IN CHINA? MULTIPLE ANSWERS POSSIBLE



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).



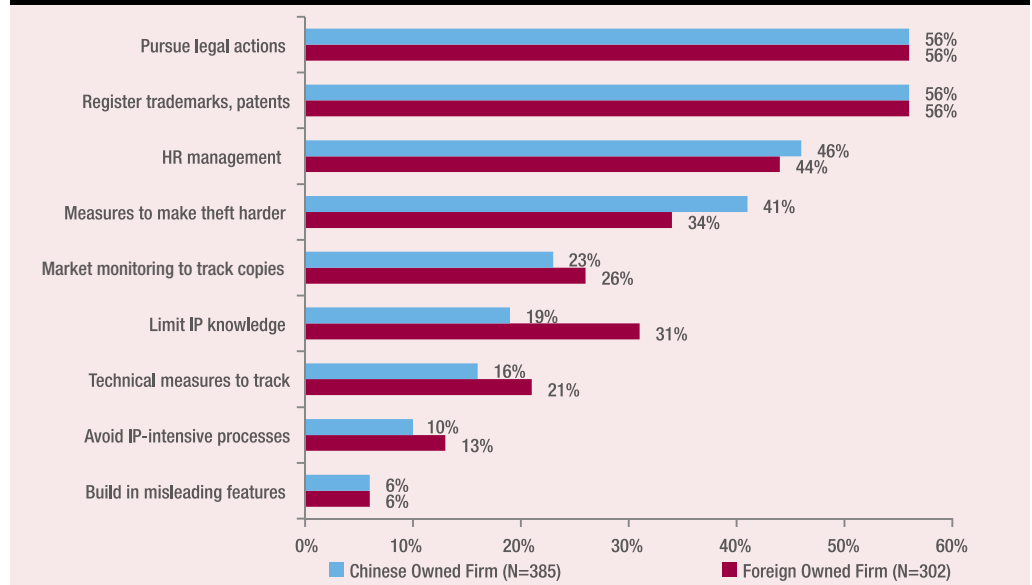
IP infringement perpetrators are Chinese competitors for 79% of the executives surveyed. 26% answered that perpetrators are often employees, followed by clients (21%), suppliers (18%), and with lower frequency foreign competitors and JV partners (8% and 7% respectively).

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

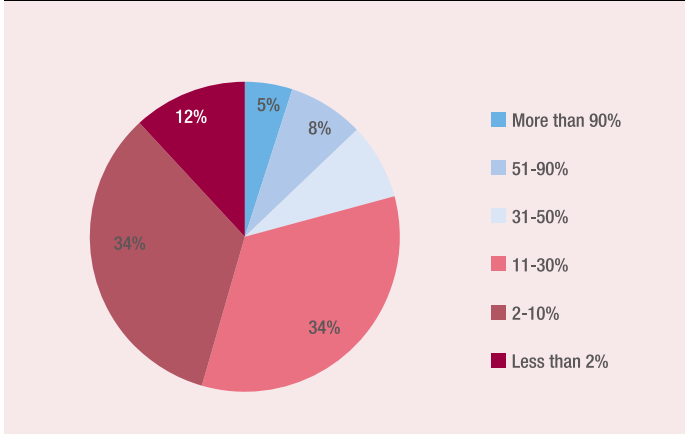
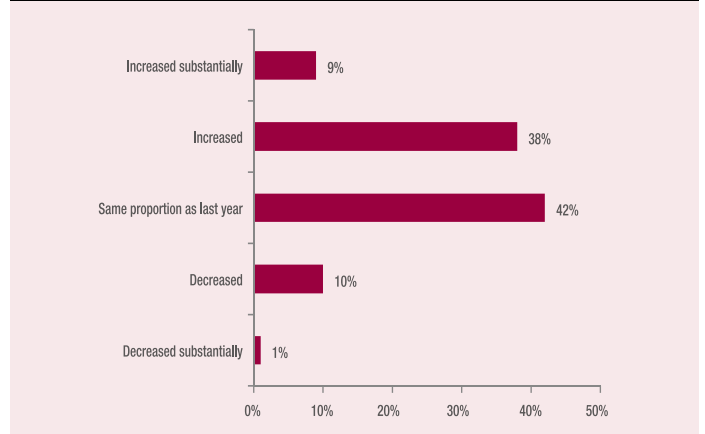


FIGURE 66 - HOW DOES THIS % COMPARE TO LAST YEAR? N=320



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)

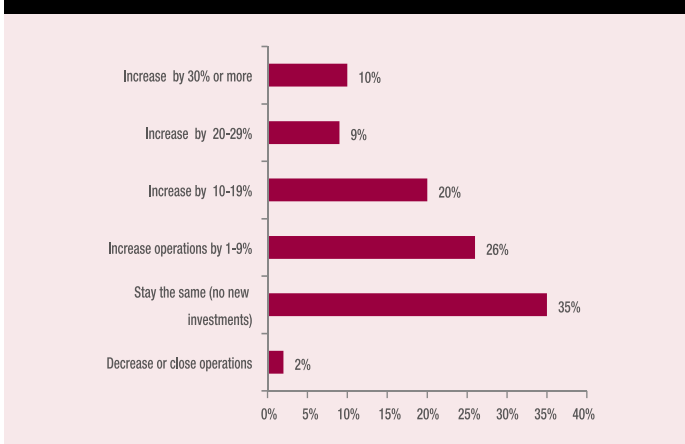
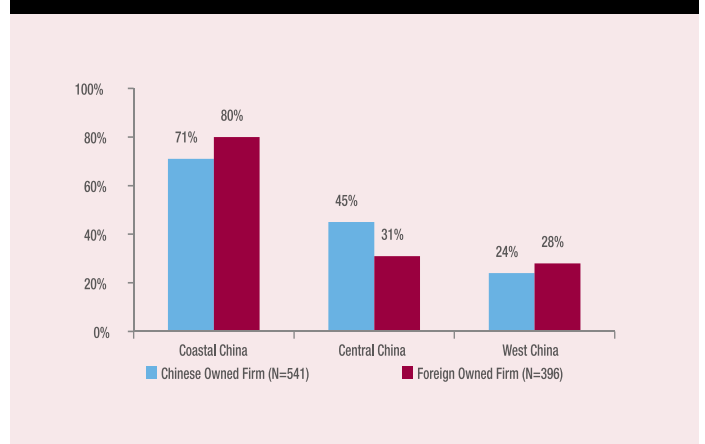


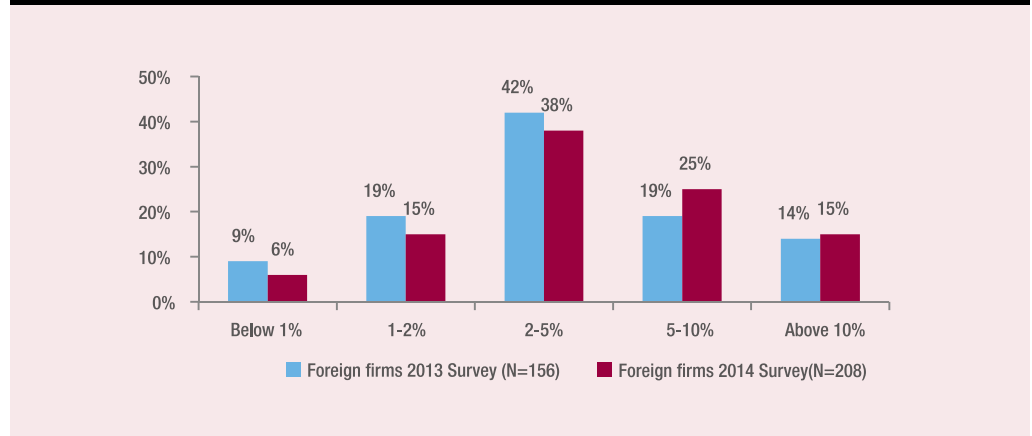
FIGURE 68 - WHERE IN CHINA DO YOU PLAN TO INVEST?



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&D AS A % OF REVENUES?



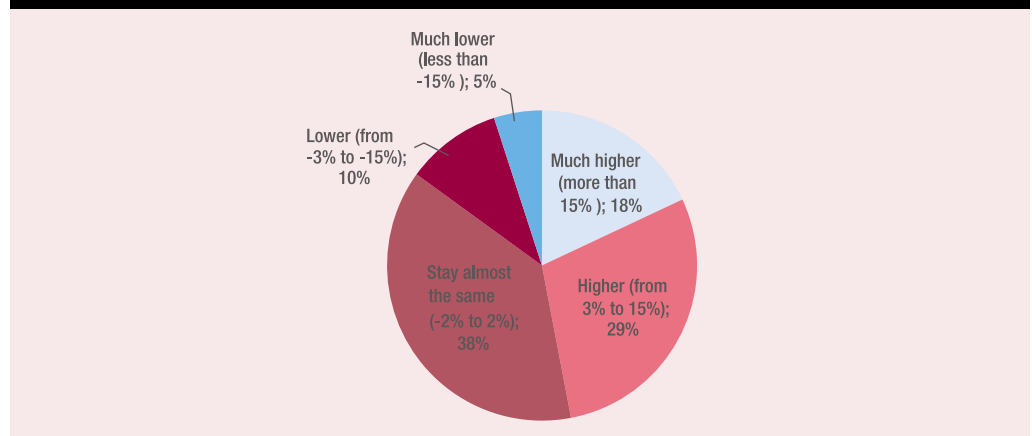
4.3.2. Global focus for Chinese-owned firms

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



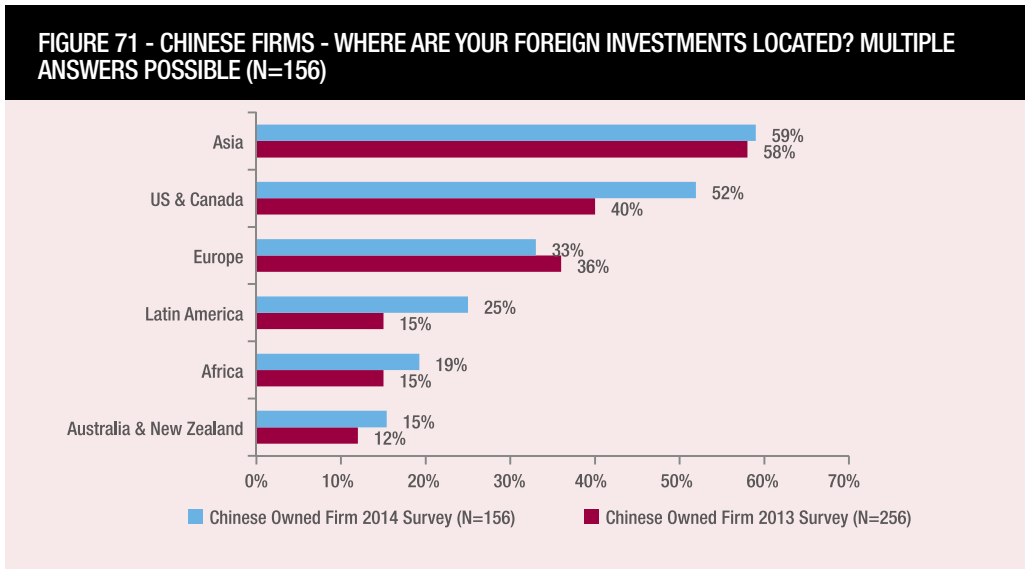
Amongst respondents, export revenues reach on average 30% of their total revenues. For 47% of them, the export revenue is higher or much higher than last year, for 38% it remains unchanged, while 15% have experienced a decrease in export revenues.

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.

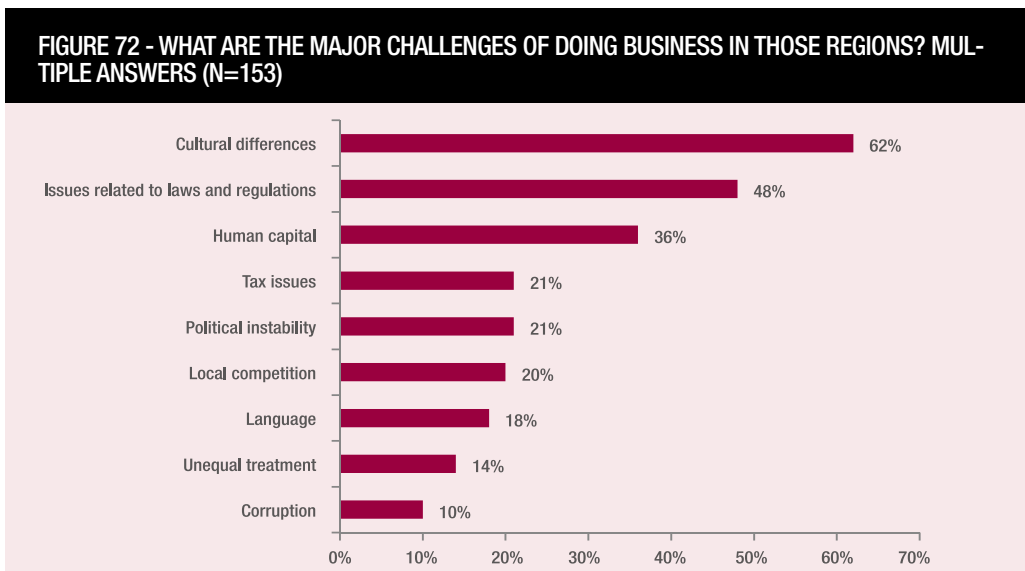
In terms of investment outside of China, we see the same proportion of companies going abroad as in the previous two years (34% of the Chinese companies surveyed). The preferred targets are Asia for 59% of them (East and south-east Asia, South Asia, Central Asia and Middle East), US and Canada for 52%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



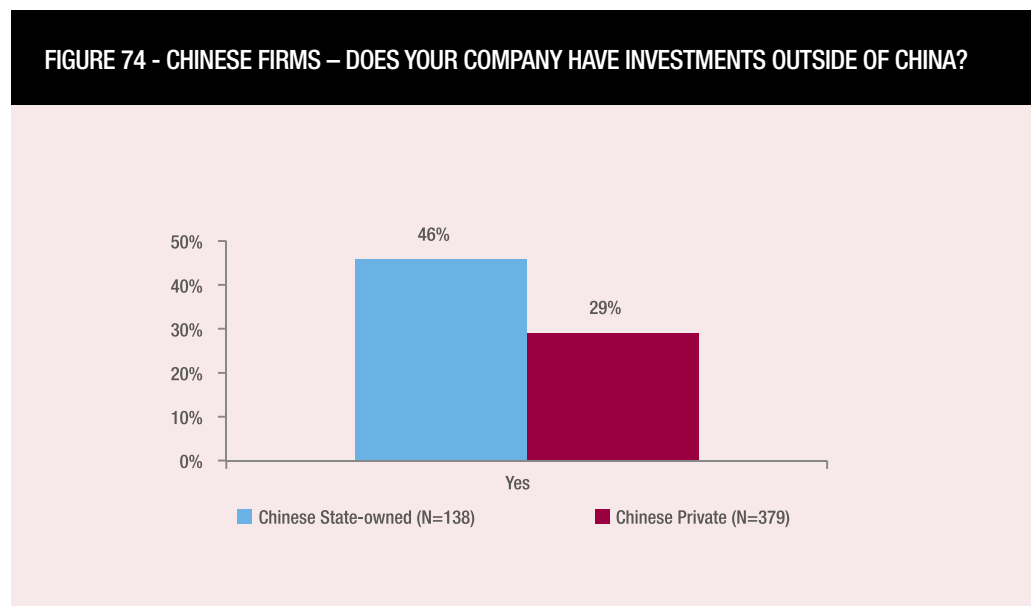
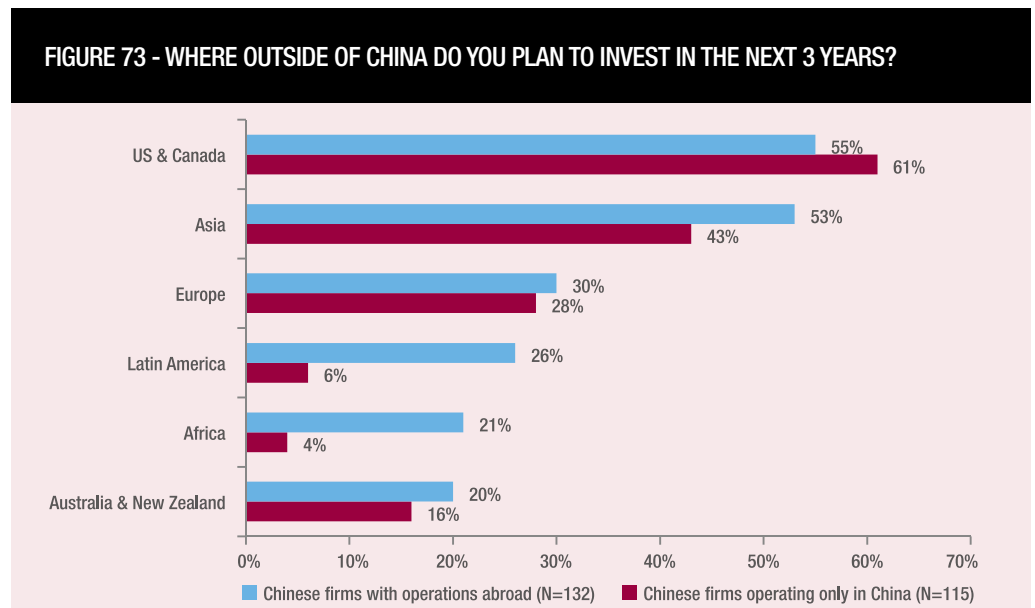
Most of these companies feel neutral or satisfied about their investment results abroad (53% and 47% of them, respectively). Only a very small 1% of our pool of Chinese companies declares to be dissatisfied. These results are better than last year's where 7% of surveyed companies expressed dissatisfaction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



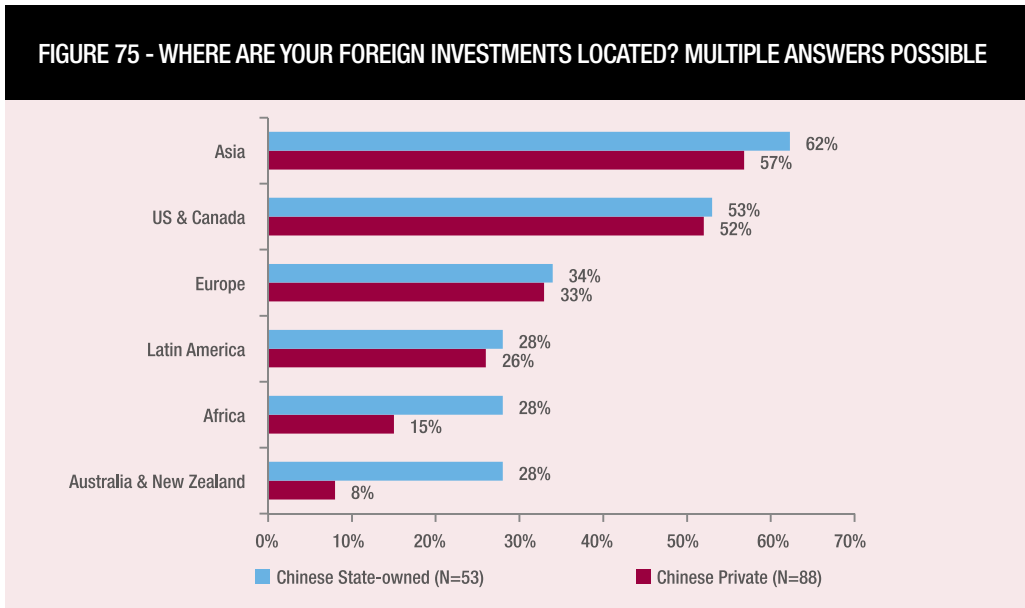
Nevertheless, the above challenges do not seem to hinder Chinese firms from going abroad. The upward trend in out-of-China investment is shown by a higher number of companies planning to invest abroad in the next 3 years (47% versus 34% of firms currently investing abroad).

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).



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:

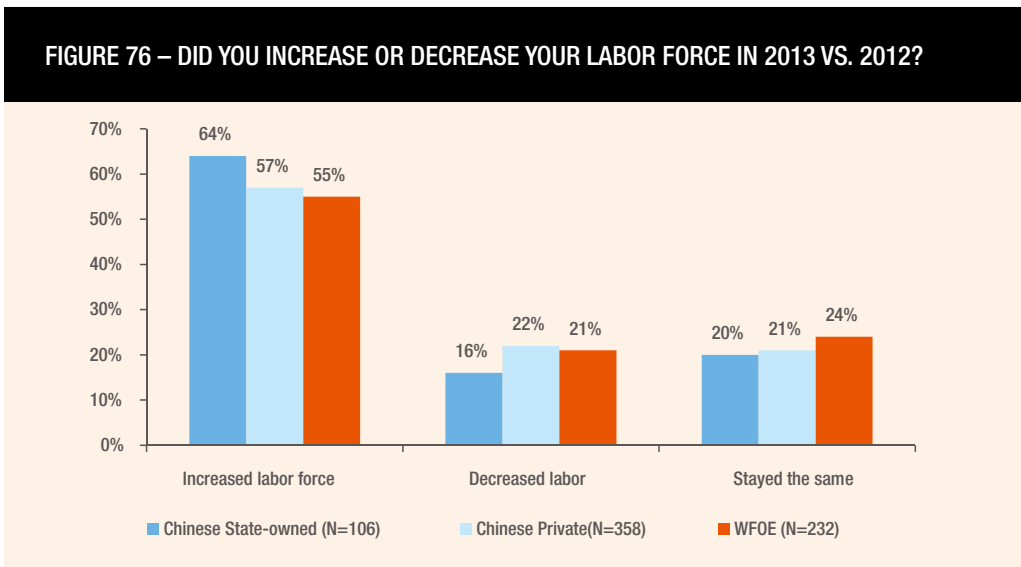
- **Human Resources**
The chapter covers the top HR issues that companies in our sample face in China. It also gives an in-depth commentary on what the executives in our sample think are the most effective measures to retain employees.
- **Finance**
This chapter gives an overview of the most frequent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

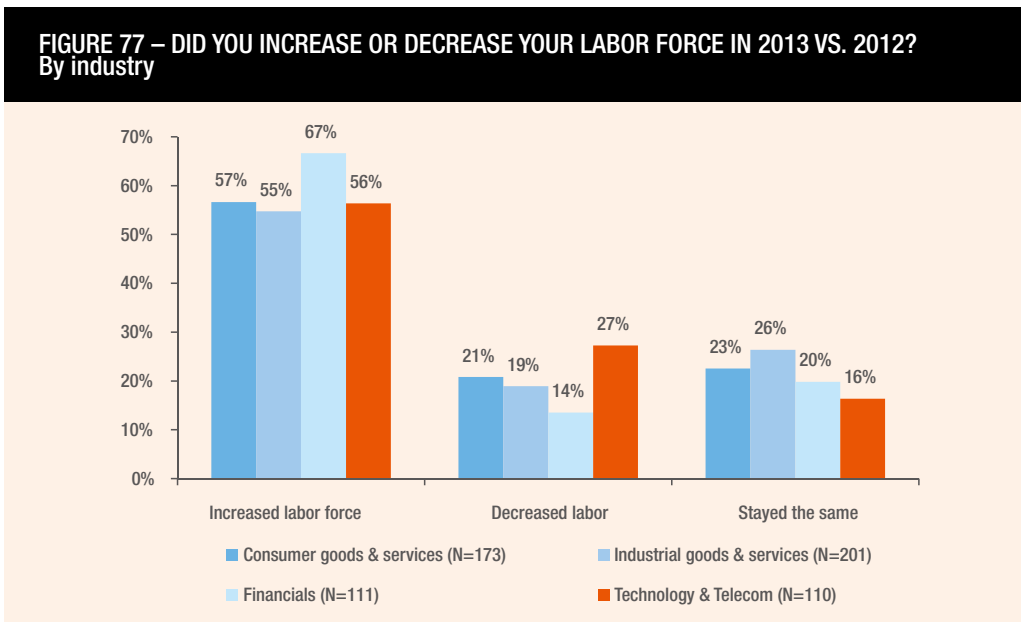
5.1. HUMAN RESOURCES

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.

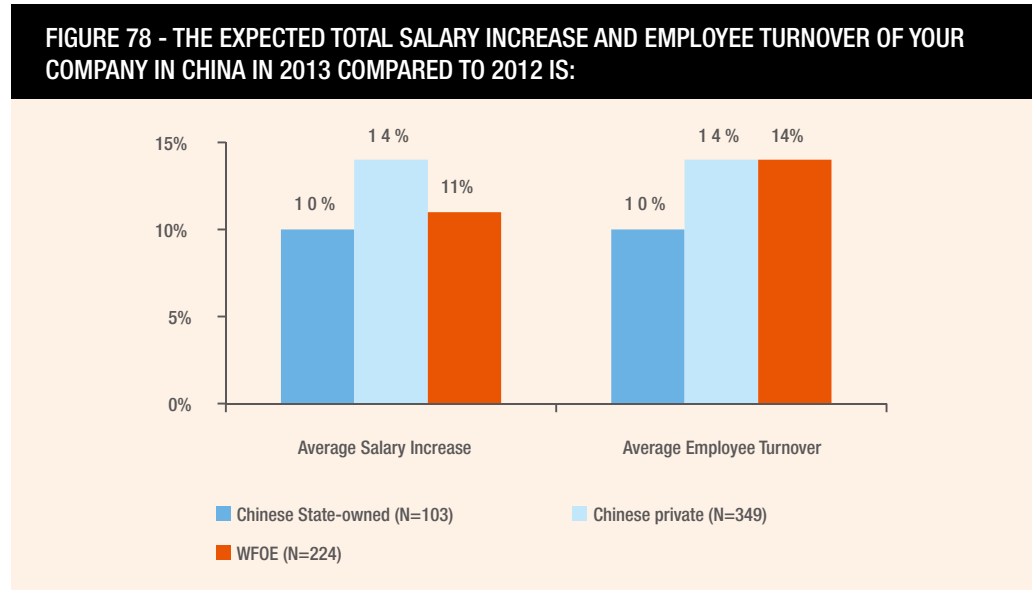
More than half of surveyed companies increased their labor force in 2013 (57% of total respondents), 23% of them kept the same labor force, and 20% of respondents decreased it. 64% of Chinese state-owned enterprises saw their labor force increase, somewhat more than the proportion of Chinese private-owned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



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 in 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).

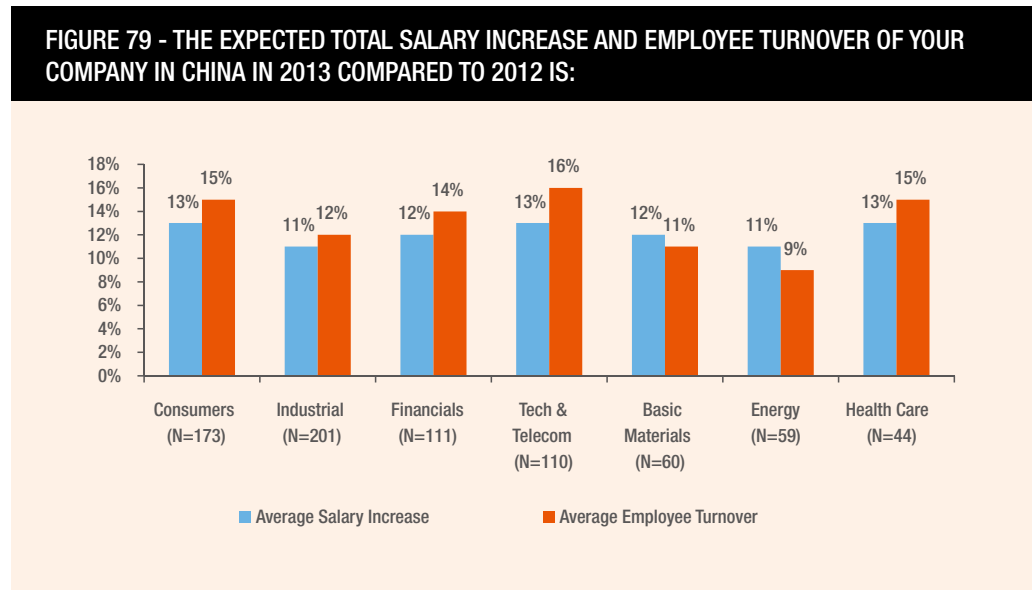


The average expected salary increase for the totality of firms surveyed is 12%. The average employee turnover is also 12%



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.

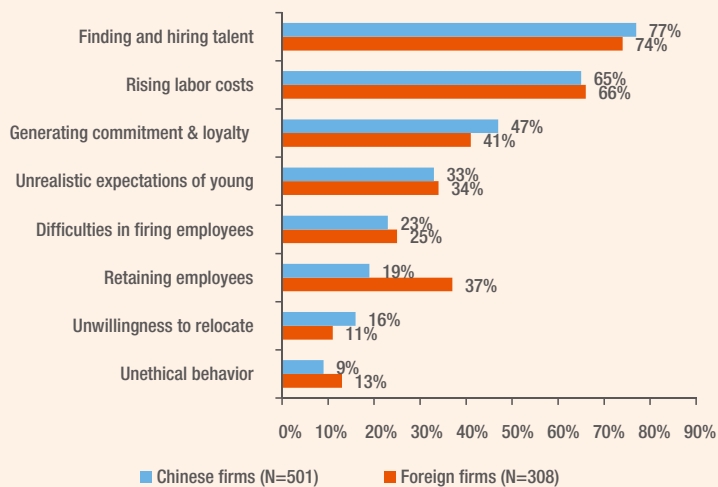
“Finding and hiring suitable talent” is the Top HR concern for foreign and Chinese owned firms (76% of surveyed executives). Further in this section we provide deeper analysis of this challenge.

“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:

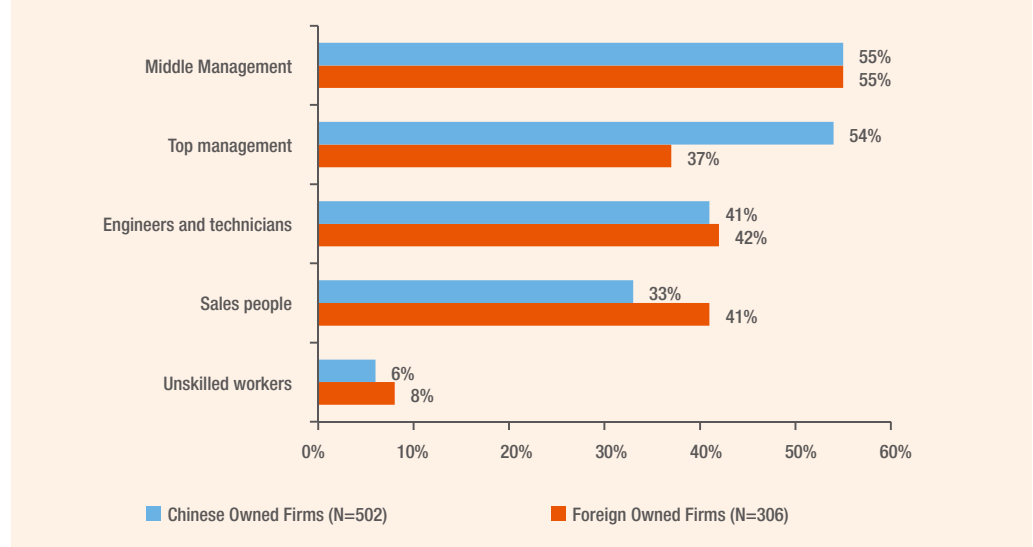
- “Retaining employees” worries 37% of foreign companies vs. only 19% of Chinese ones. A possible explanation is that foreign-owned firms are targeting just a section of the labor market while Chinese firms target the whole market. It could also be that the level of expectations is different. Also, sometimes 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.

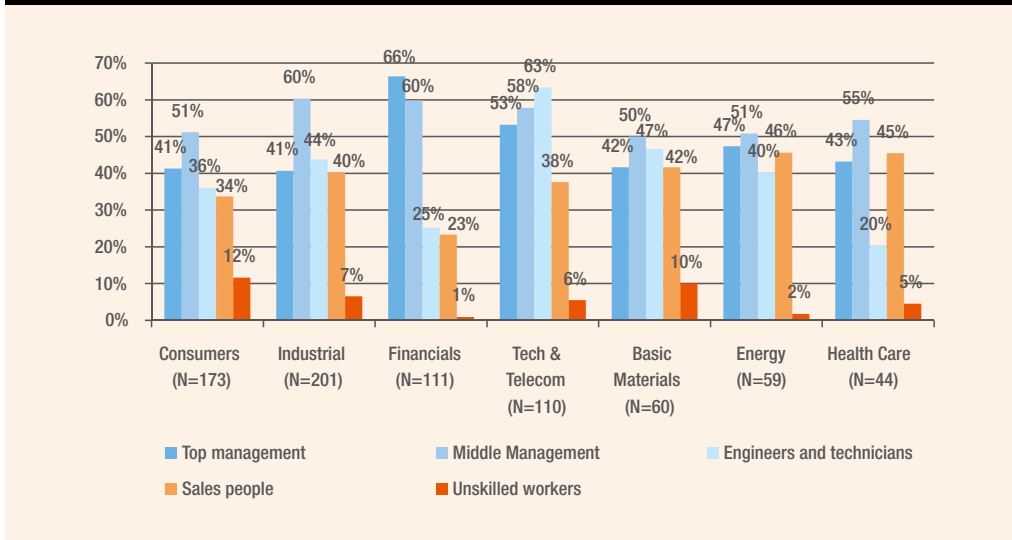
On the other hand, hiring sales people is, relatively speaking, a lesser problem for Chinese-owned firms than it is for foreign companies (33% of Chinese firms vs. 41% of foreign ones).

FIGURE 81 - AT WHICH LEVEL IS IT DIFFICULT TO FIND SUITABLE HUMAN RESOURCES FOR YOUR COMPANY IN CHINA? MULTIPLE ANSWERS POSSIBLE



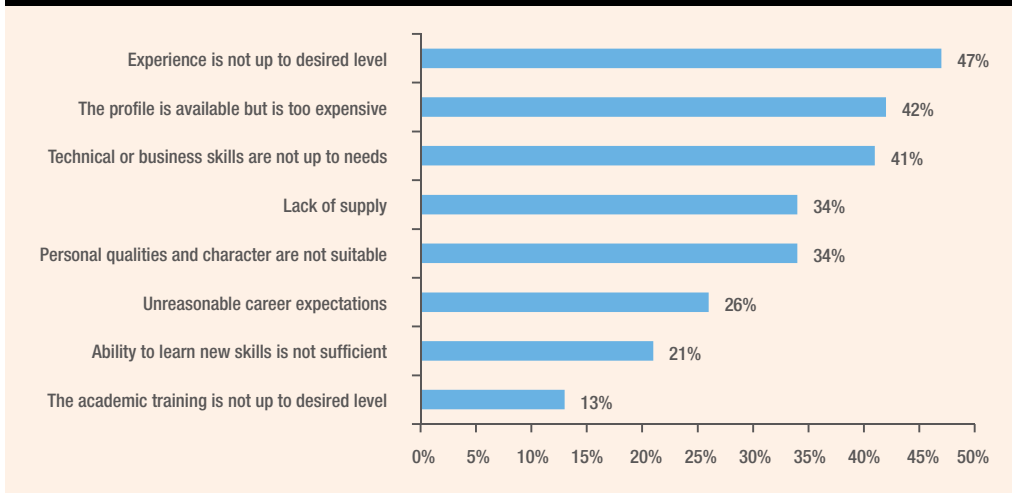
When analyzing by industry (Figure 82), we observe a few particularities and exceptions to the overall trends. For example, financial sector firms have more difficulty to find top management executives than middle managers (66% of them vs. 60% respectively); Technology and Telecommunications companies 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.

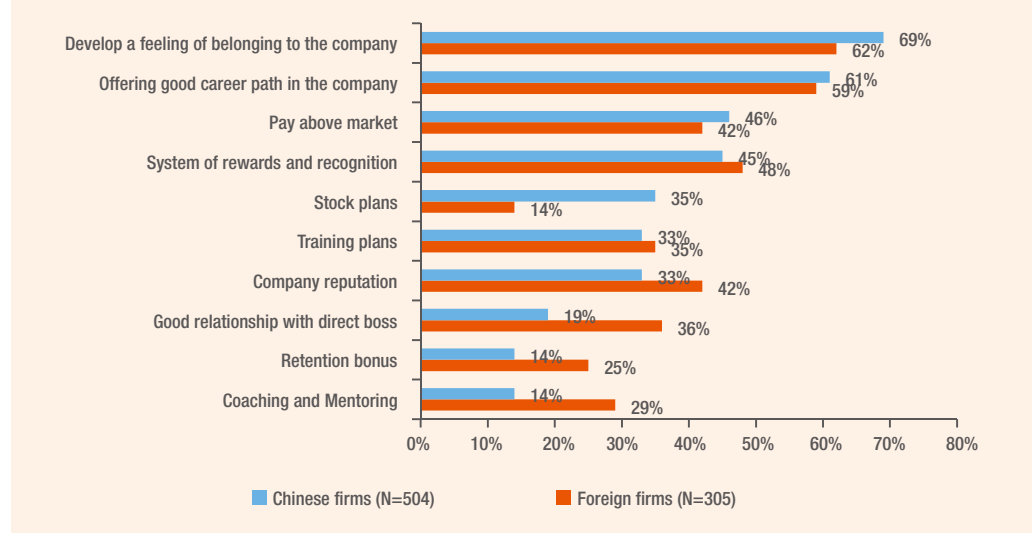
Even if the above selection of most effective HR measures is shared by both Chinese and Foreign companies, we observe differences in the relative weight of some of the strategies between both types of firms:

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

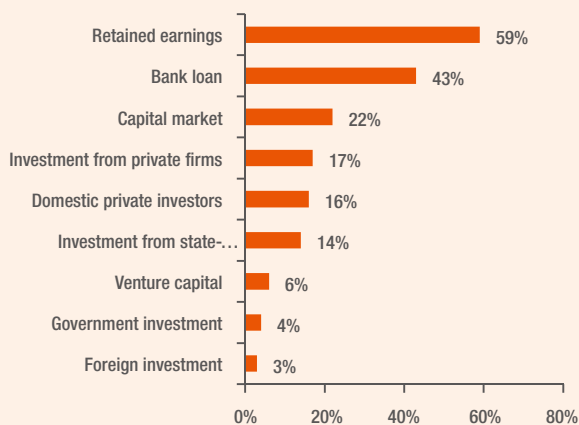


5.2. FINANCE (CHINESE FIRMS ONLY)

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

Self-financing is the most widely used source of funding. Bank loans follow, 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

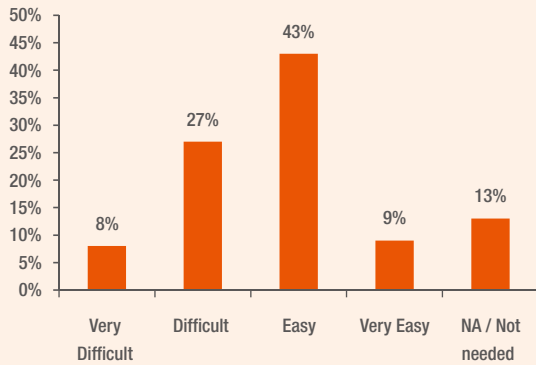
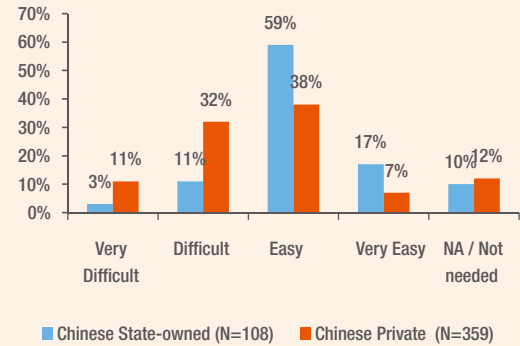


FIGURE 87 - YOUR ACCESS TO BANK LOAN IS: By type of company



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)

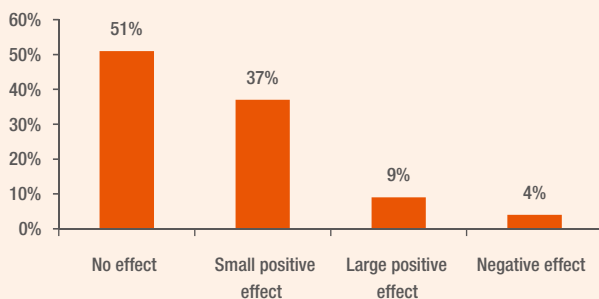
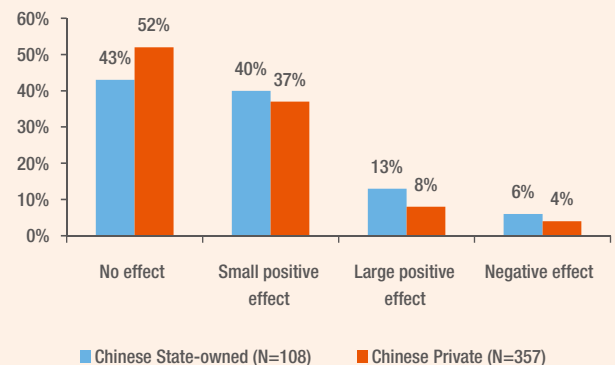


FIGURE 89 - THE CHINESE GOVERNMENT HAS REMOVED THE RESTRICTION ON BANK LENDING RATE, HOW DOES IT AFFECT YOUR COMPANY’S FINANCING? By type of company



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

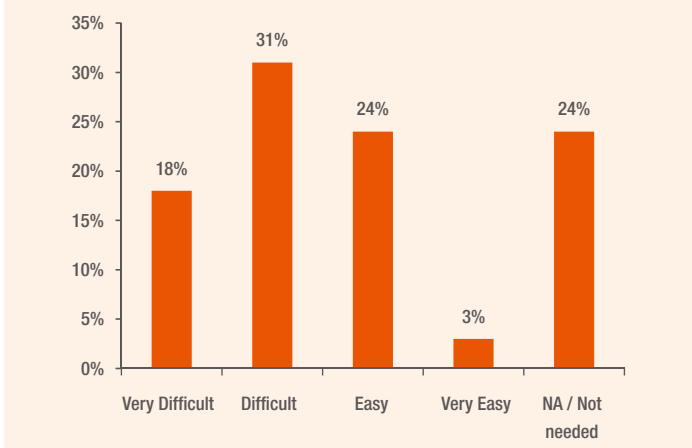
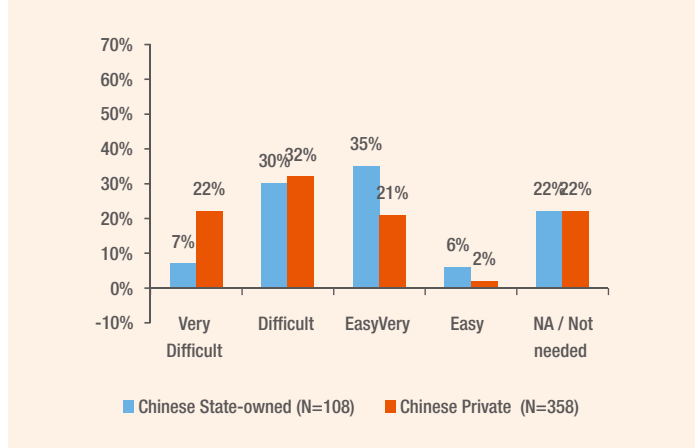


FIGURE 91 - CHINESE FIRMS - YOUR ACCESS TO FINANCIAL RESOURCES FROM NON-BANK SOURCES (STOCK MARKET, BOND MARKET ETC.) IS: By type of company

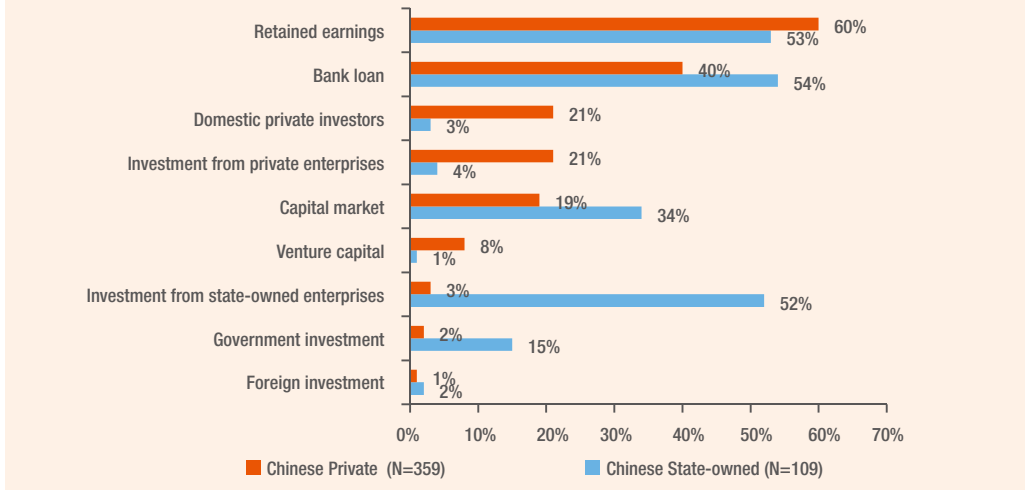


5.2.1. By legal entity

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)



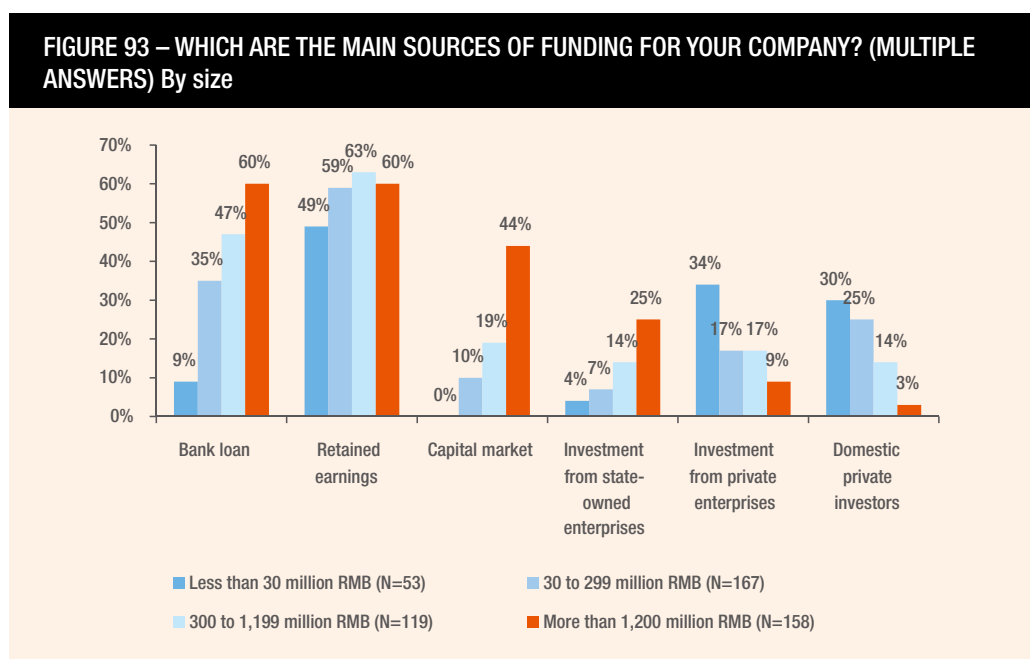
5.2.2. By company size

In terms of company size, we observe a direct relationship between size in annual revenues⁹ 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.

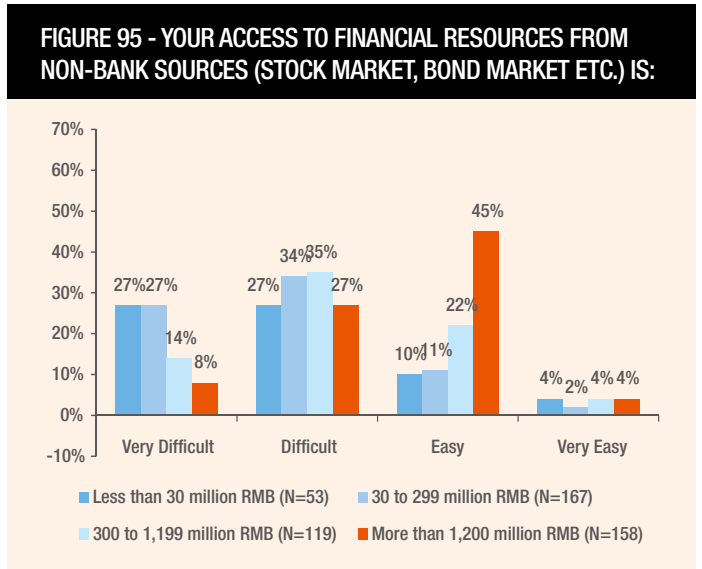
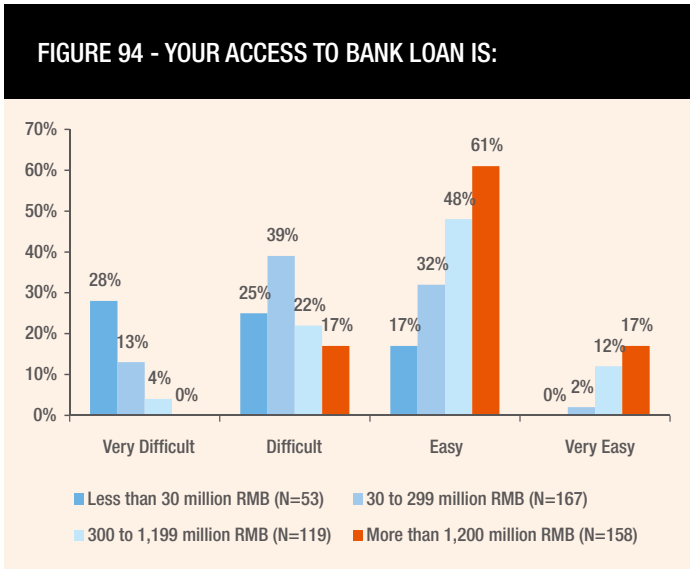
Government investment and funds from State-owned enterprises have relatively more importance within the larger companies of our sample (>1,200 million RMB in revenues), even if they are overall one of the least frequently mentioned funding means together with foreign investment and private capital.



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.

⁹ 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).

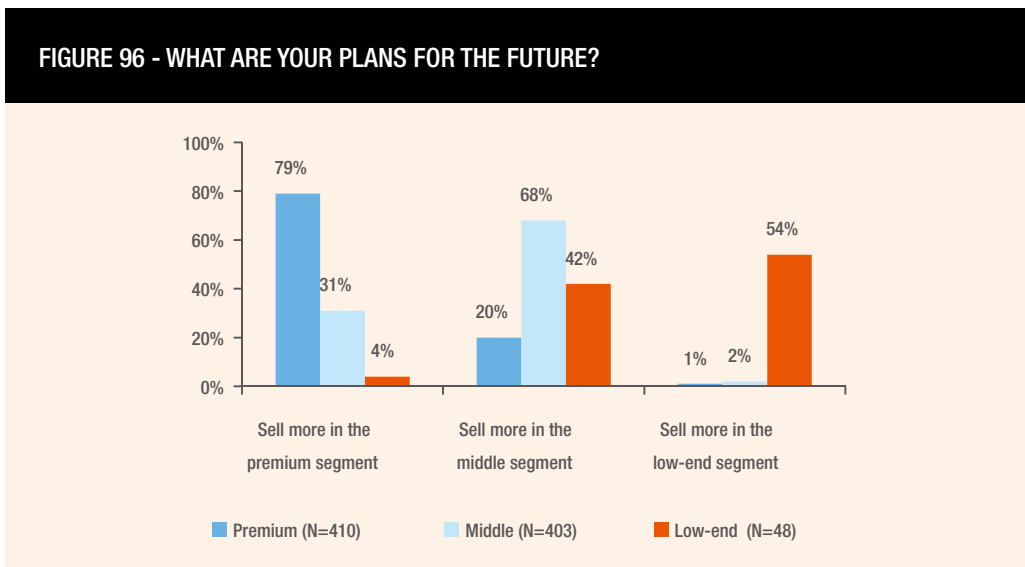


5.3. MARKETING, SALES AND DISTRIBUTION

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).

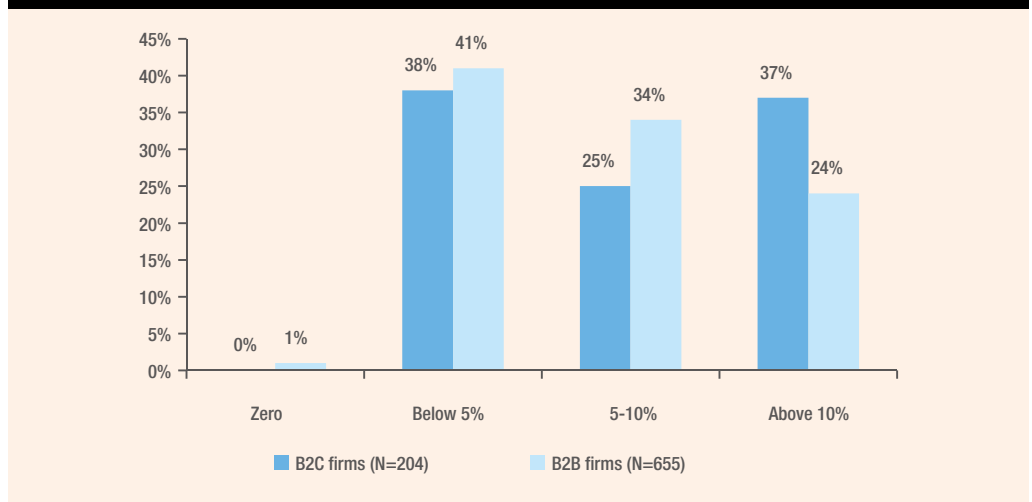


Marketing and sales budgets and most effective strategies: *No significant difference in behavior between Chinese and foreign firms, but type of company matters (B2B or B2C, premium or middle segment). B2C companies increase spending vs. last year's survey.*

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.

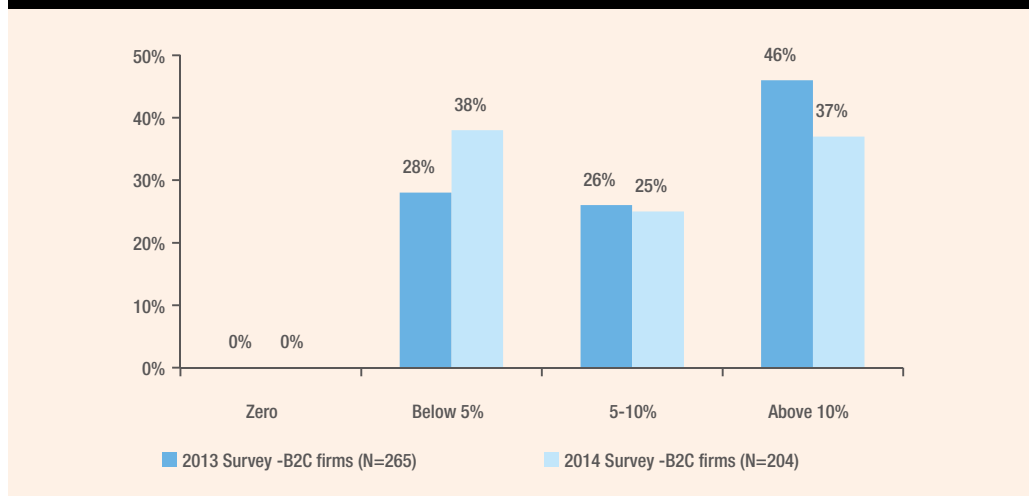
Unsurprisingly, firms selling directly to consumers have larger marketing and sales budgets (above 10% of revenues for 37% of them).

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?

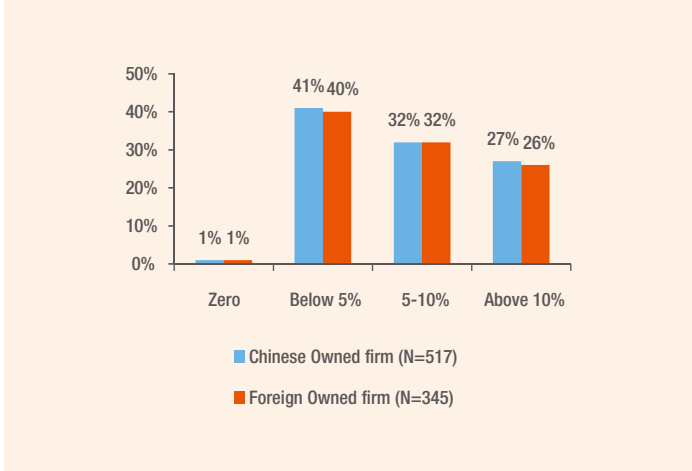
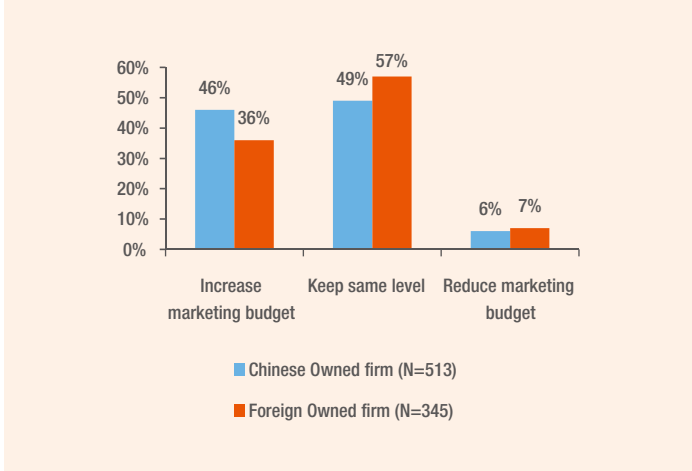
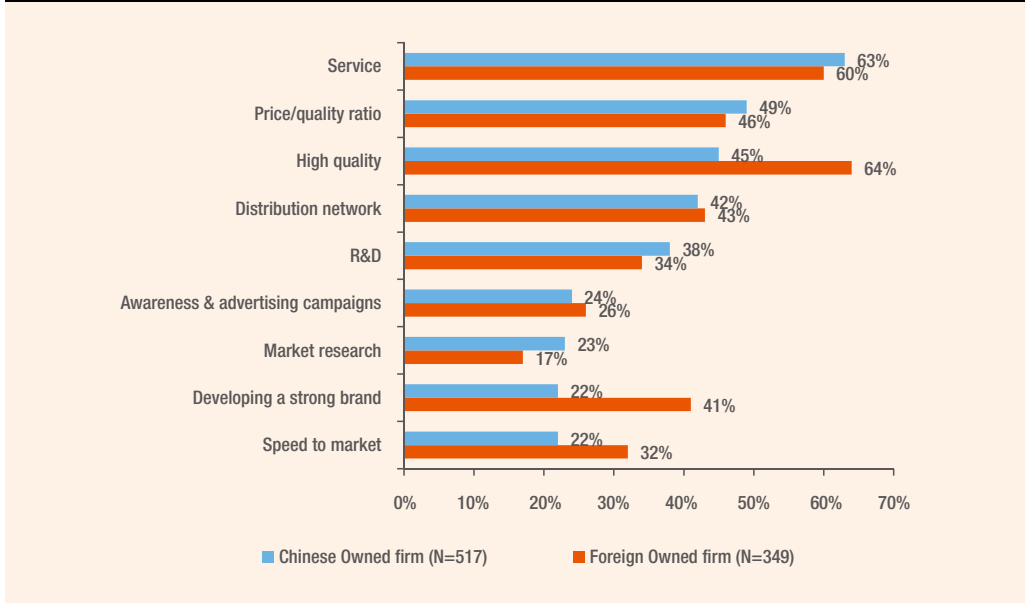


FIGURE 100 - WHAT ARE YOUR PLANS FOR NEXT YEAR?



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

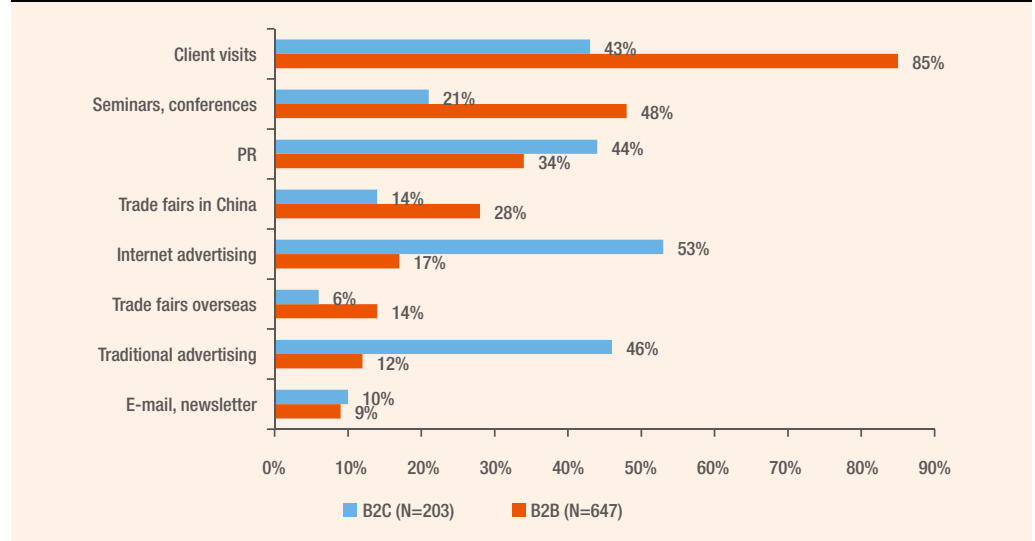


Marketing strategies:

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).

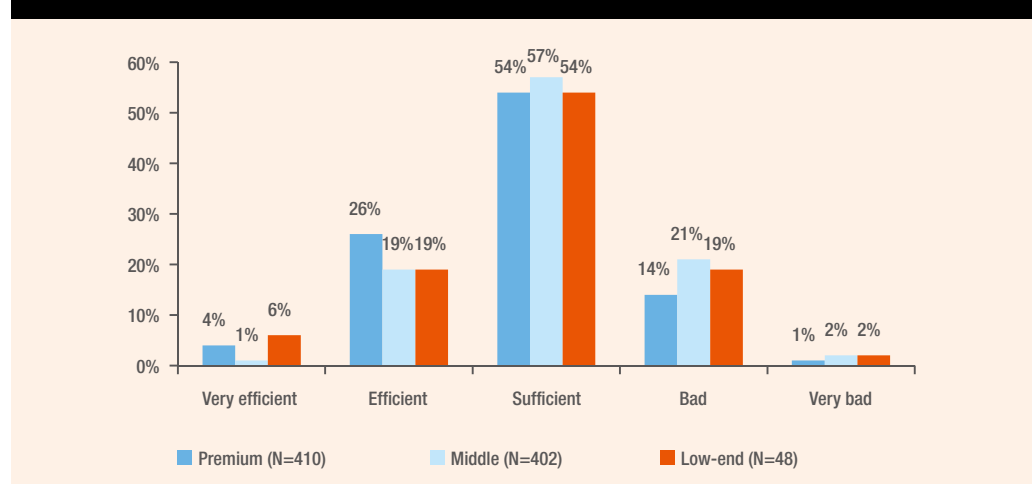
FIGURE 102 - WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS?



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

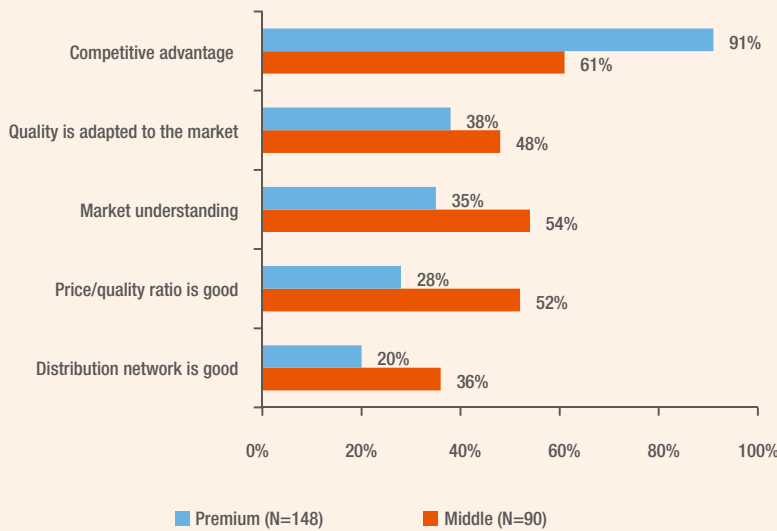


TABLE OF FIGURES

Figure 1 - What is your position in the company? N= 1,017 2	Figure 18 - In your view, how serious is corruption in your industry?..... 15
Figure 2 - Does your company have an interest in Shanghai FTZ? 6	Figure 19 - In your view, how serious is corruption in your industry? MINOR PROBLEM 16
Figure 3 - Does your company have an interest in Shanghai FTZ? By type of company 7	Figure 20 - In your view, how serious is corruption in your industry? MINOR TO MODERATE PROBLEM 16
Figure 4 - Does your company have an interest in Shanghai FTZ? Financial sector vs. other industries 7	Figure 21 - In your view, how serious is corruption in your industry? MODERATE PROBLEM 16
Figure 5 - What is the interest of your company in the FTZ? Multiple answers. 7	Figure 22 - What is the main industry where your company operates? (N=1,017)..... 18
Figure 6 - What is the interest of your company in the FTZ? Multiple answers By type of company 8	Figure 23 - What is the main industry where your company operates? Chinese vs. foreign-owned firms..... 18
Figure 7 - What is your expectation of the Shanghai Free Trade Zone? 8	Figure 24 - Where are your global headquarters located? N= 1,017 19
Figure 8 - What is your expectation of the Shanghai Free Trade Zone? By type of company 9	Figure 25 - What is your company's total China forecasted revenues in 2013? 19
Figure 9 - What is your expectation of the Shanghai Free Trade Zone? Financial sector vs. other industries..... 9	Figure 26 - How many employees does your company have in China? 20
Figure 10 - What would you like to see the most in the zone? Multiple answers 10	Figure 27 - Where does your company have operations? 20
Figure 11 - What would you like to see the most in the zone? Multiple answers By type of company 10	Figure 28 - FIRMS WITH INTERNATIONAL OPERATIONS- How many employees does your company have globally? .. 21
Figure 12 - What would you like to see the most in the zone? Multiple answers Financial sector vs. other industries..... 11	Figure 29 - What is the legal status in China of the company your work for? N=1,012..... 21
Figure 13 - Corruption Variation Index by company type (In your view, how is corruption in your industry compared to last year?)..... 13	Figure 30 - When was your company established in China?.22
Figure 14 - In your view, how serious is corruption in China, in general, and in your industry? N=1008 13	Figure 31 - Current Performance Index..... 25
Figure 15 - Do you believe that your competitors or your company have made attempts to provide personal benefits to relevant individuals? 14	Figure 32 - How does your company's expected sales revenue in China in 2013 compare to 2012 results?..... 26
Figure 16 - Has your company made any attempt to provide personal benefits to relevant individuals? 14	Figure 33 - How profitable do you consider your China operation in 2013? 26
Figure 17 - Has your company made any attempt to provide personal benefits to relevant individuals? By type of company. 14	Figure 34 - Expected Performance Index 27
	Figure 35 - How do you expect your company's China sales in 2014 compared to 2013? 28
	Figure 36 - What investments do you plan for 2014 in China?..... 28

TABLE OF FIGURES

Figure 37 - Marketing & Sales as % of revenues: What are your plans for 2014?	28	Figure 53 - How important for your business success are the relationships with the authorities? By industry.....	41
Figure 38 - R&D as % of revenues: What are your plans for the next 3 years?	29	Figure 54 - What are your main concerns regarding the Chinese government and the legal environment? Multiple answers possible.....	42
Figure 39 - What are your plans for production capacity in China in the next 3 years?.....	29	Figure 55 - Who are your main competitors in China? (Multiple answers)	43
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)	29	Figure 56 - What are the competitive advantages of your main competitors in China? (multiple answers)	44
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)	29	Figure 57 - What types of innovations have you introduced since the beginning of 2013? (multiple answers)	44
Figure 42 - How confident are you that your operations in China will be successful in the next year? N=767.....	30	Figure 58 - What is your annual expenditure in R&D as a % of revenues? N=658	45
Figure 43 - How confident are you that your operations in China will be successful in the next 5 years? N=438.....	30	Figure 59 - What are your plans for the next 3 years? R&D..	45
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?	31	Figure 60 - How important is IP (Intellectual Property) to your business in China?	46
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?	31	Figure 61 - What type of IP do you own in China? Multiple answers possible.....	46
Figure 46 - What are the greatest external challenges facing your company in China?	33	Figure 62 - Compared with the past 3 years, would you consider that the amount of IP infringement in China in your business has:.....	47
Figure 47 - - What are the greatest internal challenges facing your company in China?	35	Figure 63 - In the past 3 years, how do you describe the IP protection from the government in China?	47
Figure 48 - What are the greatest internal challenges facing your company in China? Top 6 challenges by ownership type.....	36	Figure 64 - Which are the most effective measures you use to protect your IP in China?.....	48
Figure 49 - What are the most important factors for your company's success in China?.....	36	Figure 65 - Foreign firms, what % of your company's 2013 global revenue will be generated in China? N=321	49
Figure 50 - Are you satisfied by the services provided by the Chinese government and related agencies?.....	39	Figure 66 - How does this % compare to last year? N=320.	49
Figure 51 - How important for your business success are the relationships with the authorities?	40	Figure 67 - Foreign firms, what investments do you plan for 2014 in China? (N=449).....	49
Figure 52 - What is the effect of government policies and regulations on your industry?	40	Figure 68 - Where in China do you plan to invest?	49
		Figure 69- What is your annual expenditure in R&D as a % of revenues?	50
		Figure 70 - CHINESE FIRMS - How do your exports in 2013 compare to 2012? N=253	50

TABLE OF FIGURES

Figure 71 - CHINESE FIRMS - Where are your foreign investments located? Multiple answers possible (N=156)	51	Figure 88 - The Chinese government has removed the restriction on bank lending rate, how does it affect your company's financing? (N=504).....	62
Figure 72 - What are the major challenges of doing business in those regions? Multiple answers (N=153)	51	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	62
Figure 73 - Where outside of China do you plan to invest in the next 3 years?	52	Figure 90 - CHINESE FIRMS - Your access to financial resources from non-bank sources (stock market, bond market etc.) is: N=506	63
Figure 74 - CHINESE FIRMS – Does your company have investments outside of China?	52	Figure 91 - CHINESE FIRMS - Your access to financial resources from non-bank sources (stock market, bond market etc.) is: By type of company.....	63
Figure 75 - Where are your foreign investments located? Multiple answers possible.....	53	Figure 92 – CHINESE FIRMS - Which are the main sources of funding for your company? (Multiple answers)	63
Figure 76 - Figure 76 – Did you increase or decrease your labor force in 2013 vs. 2012?	55	Figure 93 – Which are the main sources of funding for your company? (Multiple answers) By size	64
Figure 77 - Figure 77 – Did you increase or decrease your labor force in 2013 vs. 2012? By industry.....	55	Figure 94 - Your access to bank loan is:	65
Figure 78 - The expected total salary increase and employee turnover of your company in China in 2013 compared to 2012 is:	56	Figure 95 - Your access to financial resources from non-bank sources (stock market, bond market etc.) is:	65
Figure 79 - The expected total salary increase and employee turnover of your company in China in 2013 compared to 2012 is:	56	Figure 96 - What are your plans for the future?	65
Figure 80 - Which are the major human resources issues facing your company in China? (Multiple answers).....	57	Figure 97 - What percentage of yearly revenues do you spend in marketing and sales? B2C vs. B2B	66
Figure 81 - At which level is it difficult to find suitable human resources for your company in China? Multiple answers possible	58	Figure 98 - What percentage of yearly revenues do you spend in marketing and sales? 2014 Survey vs. 2013 Survey.....	66
Figure 82 - At which level is it difficult to find suitable human resources for your company in China? Multiple answers possible By industry	59	Figure 99 - What % of yearly revenues do you spend in marketing & sales?	67
Figure 83 - For the personnel you have difficulty acquiring, what are the key reasons? Multiple answers (N=779).....	59	Figure 100 - What are your plans for next year?.....	67
Figure 84 - What measures do you find most efficient in retaining employees? Multiple answers	60	Figure 101 - Please choose the most important factors on the success of your sales in China. Multiple answers possible	67
Figure 85 – CHINESE FIRMS - Which are the main sources of funding for your company? N=509	61	Figure 102 - Which marketing activities are most effective for your main business?	68
Figure 86 - Your access to bank loan is: N=507	62	Figure 103 - How do you evaluate your company distribution network in China?	68
Figure 87 - Your access to bank loan is: By type of company...62		Figure 104 - FOR MARKET LEADERS - Why are you at that position? Multiple answers.....	69