GERMAN BUSINESS IN CHINA

Business Confidence Survey 2020/21

AHK

GERMAN CHAMBER
of Commerce in China
中国德国商会

#PartnerForAdvocacy

KPMG

PREFACE

The Business Confidence Survey published by the German Chamber of Commerce in China has been a key instrument for measuring the business sentiment of German companies operating in China since 2007. Since 2019, the German Chamber of Commerce in China is cooperating with KPMG in Germany in the preparation of this survey.

The year 2020 will go into history books under the title "Corona Year". People and Business around the globe were and still are severely affected by the outbreak of COVID-19. China is the first country that has returned to (relative) normality and is back on track with growth rates seen before the pandemic approached. German companies active in China benefit from this and thus are able to partly compensate some of the shortfalls that they are suffering from in other regions of the globe. The post-COVID-19 world will look different. During this survey we gathered first insights how German companies are positioning themselves and changing respectively sharpening their strategies as it relates to the mega-market China.

German-Chinese economic relations have grown and developed well for decades. In 2019, bilateral trade increased further, totaling EUR 206 billion. German companies in China currently operate in an environment characterized by optimism for the year ahead and a strong commitment to the market though complex regulatory challenges remain and domestic competition is growing. High expectations are linked to the just recently agreed EU-China Comprehensive Investment Agreement.

The survey, therefore, focuses on the general Performance and Business Outlook of German companies active in China, Market Access and Reform Efforts, Investment Confidence, as well as Operational and Regulatory Business Challenges. The survey also reflects the German Chamber member's assessment on Competition & Collaboration in China and further analyzes the impact of growing decoupling tendencies on German companies' operations in China.

The German Chamber of Commerce in China comprises 2,300 member companies, representing roughly 50% of all German companies operating in China. With 535 member companies responding to this survey, 2020 is an all-time high in terms of participation. It is the most representative sample for the analysis of German Chamber members' business sentiment in China to date and we want to use this opportunity to thank the participating member companies for their significant contribution. This also demonstrates the companies' growing interest in making their voices, expectations and concerns heard.

We trust the survey provides reasonable and founded guidance to further expand economic relations between China and Germany and will guide the Chamber's advocacy engagement in China for the next couple of months and through the year 2021.

German Chamber of Commerce in China

Andreas Glunz
Managing Partner International Business
KPMG in Germany

CONTENTS

EXECUTIVE SUMMARY

Continuous Recovery of Chinese Business of German Companies

Despite Covid-related declines in turnover in the first half of 2020, 39 percent of German companies in China managed to increase their turnover and 42 percent their profits in 2020, according to the survey. In addition, in 2020, around 25% of the surveyed German companies in China managed to achieve turnover and profits roughly at the same level as in the previous year. China is the only large economy that has managed to grow -even if only by about 2 percent in 2020. German companies also benefited from this and could partially compensate for the declines in the EU and the USA due to the recovered business in China in the second half of the year.

CAI: Expectations of German Companies in China Are High

Expectations for the upcoming EU-China Investment Agreement (CAI) are high: the companies surveyed by the German Chamber of Commerce in China and KPMG Germany stated that market access (40 percent) and equal treatment of all market participants in China (39 percent) were the main expectations for the agreement. However, the study results also showed quite positive assessments of formal market access. Compared to the previous year, fewer companies reported to fail at this first hurdle (30 percent). On the other hand, the challenges remain clearer at the indirect level. Summing up the regulatory challenges of German companies in China, administrative and bureaucratic hurdles are among the biggest obstacles: Customs regulations and procedures, obtaining the necessary licenses, the requirements of the Cyber Security Act, the Corporate Social Credit System, as well as capital transfers and cross-border payments.

China Remains an Important Investment Location

Optimism for 2021 is evident: 77 percent of respondents expect their industry to perform better in China than in other markets. As a result, 72% of respondents expect rising sales in China and 56% higher profits in 2021. This is also reflected in a strong commitment to the Chinese market: Almost all companies surveyed (96%) stated that they had no plans to leave China and 72 percent planned further investments in production facilities (44%) and machinery (34%) as well as in research and development (32%). Many key industries in China are setting the course for future developments. A local presence is important to generate sales in the Chinese market, enter into local partnerships, or closely observe tomorrow's competitors in their home market. The German companies surveyed see great business opportunities in China, especially with innovative technologies (58%) and digital solutions (51%).

New regulatory challenges and nearly unchanged operational business challenges

German companies in the Chinese market face various regulatory business challenges, with some persisting since years, some with changing priority. This year, especially the topic of internet access (34%) and internet speed (28%) is on top of the agenda, prominently gaining of importance in connection with COVID-19 implications and the boost in digitalization. New regulatory challenges arise from the Corporate Social Credit System and the Chinese Cyber Security Law where the majority of the surveyed companies (53%) expect a limitation of data cross border transfer. In terms of operational business challenges, HR related issues with increasing labor costs or difficulties in finding and retaining qualified staff remain on top of the list. The steady decrease of the number of expats or local foreigners will not make the latter challenge easier. One of the highest obstacles related to Covid19 are, in particular for SME driven companies, travel restrictions.

Chinese companies are becoming stronger competitors

41% of the German companies expect local companies to become innovation leaders in their industries within the next 5 years, 35% believe they will not and only 2% believe that Chinese competitors have already succeeded. Chinese POEs are considered stronger competitors for German companies than SOEs as they are general also seen as growingly important for the economy and innovation. For the moment German companies are confident that in the short term their products or services cannot be substituted at the same quality, technical level or cost (in total) since quality still matters.

Decoupling Tendencies Accelerate Localization Trend

The growing tensions between the US and China created additional uncertainties for German companies in China in the pandemic year 2020. In a decoupling scenario, the German companies in China are mainly concerned about the risks of rising costs due to various standard requirements in the markets (37%) and declining business in the long term (35%). German companies in China react with increasing localization of research and development (43%) as well as procurement (34%) and alignment of key technologies with different standards (33%). The economic impact of the pandemic and decoupling scenarios have accelerated the localization trend.

KEY FACTS

Business Performance 2020 and Outlook 2021

- Economic impacts of global COVID-19 pandemic translate into German companies' assessment of their industry development in China in 2020, with 35% of surveyed companies experienced a worsening industry development compared to 2019, while 39% of companies surveyed have grown in its turnover.
- Positive outlook of companies' performance for 2021, in particular regarding turnover (72%) and profit (56%) as the leading indicators.
- German companies' industry development compared to other markets in the rest of the world: 77% assess that in 2021 the Chinese market will develop far more positive than in other economies.

Market Access and Reform Efforts

- 70% of the companies do not face market access restrictions and 30% do so, in particular in connection to bidding and tendering processes (government support).
- The Foreign Investment Law is assessed by 22% with a positive impact and 71% with a neutral impact.
- High expectations on the CAI: Increased market access in the Chinese market and non-discrimination of foreign companies are on top of the list with 40% respectively 39% of companies surveyed choosing this as one of their top 3 priorities.

Investment Confidence

- 72% of the companies plan to further invest in the next two years, mostly in new manufacturing facilities (42%), machines for automation (34%) as well as new R&D facilities (32%). Only 9% are decreasing their investments.
- Reinvestment is main source for investments (63%). Loans from banks are very rare (7%) as local financing is hard to sought.
- 96% of the companies have no plans at all to leave China.

Business Challenges

- Regulatory business challenges are led by internet access restrictions (34%), slow cross-border internet speed (28%) and bureaucracy and administrative hurdles (24%).
- Main implications from China' s Cyber Security Law are limitation of data cross border transfer (53%), additional technical requirements (40%) and more data sharing with regulators (34%).
- More than 40% of respondents have set up a CSCS management monitoring within the past 12 months and 37% experience more dataflow.

Competition and Collaboration

- Only 2% believe that Chinese competitors are already innovation leaders, 41% expect they will achieve this target; 35% believe they will not become innovation leaders in the next five years.
- Competition is increasing, however mostly from Privately-Owned Enterprises (POE) (61%); Respondents report 36% unfavorable treatment in the Chinese market.
- German companies are confident that their products cannot be substituted at the same quality, technical level or cost (in total). 16% believe so and for 13% this is too early to assess.

Production, Localization and Decoupling

- 90% have not made a decision to move production capacity outside China, only 3% did.
- Motivations for further localization in China is the proximity to key customers (54%), cost savings (38%) and supply chain localization (29%), decoupling has no impact.
- Main risks seen from decoupling are rising cost (37%), a slowdown of business (35%) and decreasing investment confidence (31%).

BUSINESS PERFORMANCE 2020 & OUTLOOK 2021

Following an unexpected and sharp decline in the first quarter of 2020 due to the COVID-19 outbreak, **economic activity** in China has recovered fast, especially during the second half of the year 2020. The containment strategy pursued by the Chinese government as well as underlining policy measures helped to mitigate the impact of the crisis in China. While the pandemic has led to recession in other major economies in 2020, China's GDP has grown by 2.3%, with international financial institutions projecting a nearly 8% growth for 2021.

In 2020, **fixed asset investment** increased 2.9%, at a faster rate than the GDP. However, this number may disguise the structural unevenness: domestic investment in the private sector grew much slower than in the public sector, or 1.0% vs 5.3% respectively. Foreign invested enterprises, to the surprise of many, kept strong investment momentum throughout 2020, and recorded a 10.6% rise after a slight contraction in 2019. Investment in manufacturing contracted 2.2% in 2020, almost losing the 2019 gain of 3.1%. Nevertheless, driven by the pandemic, investment in pharmaceuticals, electronics and telecommunications, as well as healthcare increased 28.4%, 12.5%, and 26.8% respectively.

The **labor market** rebounded from the COVID-19 outbreak much in the same way as the overall economic activity. Unemployment rose sharply during the Spring Festival to 6.2%, but by the last quarter of 2020 had returned to 5.2%, comparable to pre-crisis levels. With growth picking up in the second half of the year, job creation exceeded even the government's pre-crisis goal of 11 million new jobs in 2020, however staying short of the 2019 record of 13.5 million. As a historical number of college graduates (8.74 million) joined the workforce, the unemployment situation of under 25-year-olds took another hit in the summer, but also recovered to normal levels by the end of the year.

China's foreign trade expanded slightly by 1.5% in 2020, carried by export growth over slightly declining imports. Trade with Germany expanded even stronger. In the bilateral trade relations, this was a continuation of previous years'trends, despite the global crisis. In pre-crisis 2019, Germany and China had traded goods worth 206 billion euros, making China Germany's most important trading partner for the fourth time in a row. China is the single country that Germany imports most goods from, and in 2020 it has furthermore moved up from third to second place among Germany's export destinations. More is still only exported to the USA.

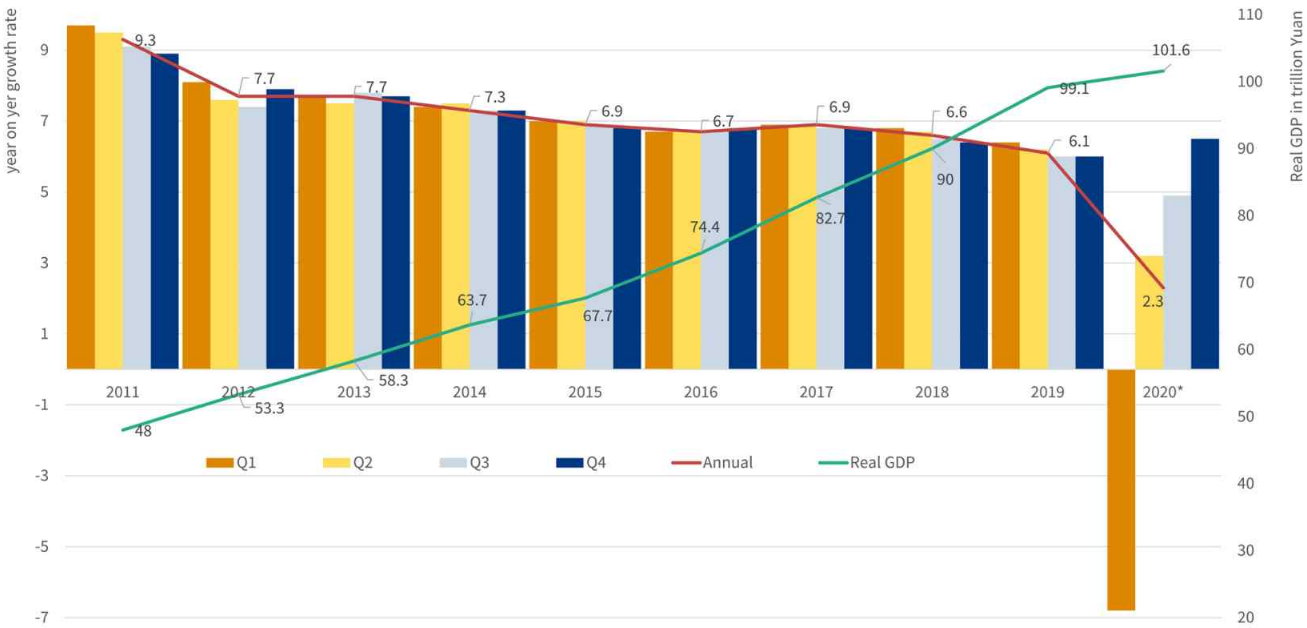
Overall Economic Development in China

In January 2021, China reported a year-on-year GDP growth of 6.5% in Q4 of 2020. China's quarterly figures thus appear to have returned to pre-crisis levels - in Q3 China's GDP had grown by 4.9% year-on-year. For the whole calendar year 2020, China's GDP growth of 2.3% year-on-year is above the estimates of the International Monetary Fund (1.9%). It is China's lowest annual growth rate in decades - since 1976 to be exact but in a year when a global pandemic crippled the world's major economies, it is the only economy globally that achieved a growth. In comparison the GDP forecasts for 2020 of the other Top 5 GDP-generating countries read -4.3% for the United States, -5.3% for Japan, -6.0% for Germany and -10.3% for India (according to IWF, World Economic Outlook (October 2020)).

China's industrial production rose by a solid 2.8% in 2020 (thanks to a 7.3% hike in December) and fixed asset investments grew by 2.9% year-on-year. Negative growth figures were only recorded in the retail sector. Sales in this sector fell by 3.9% compared to 2019. A first recovery had only been recorded in August 2020 with a 0.5% growth year-on-year, but most recently fell by 4.6% again in December. Consumer confidence has not fully rebounded yet.

For 2020 overall, the urban unemployment rate remained at a level of 5.6%, according to statistics. China's government had set itself a target of around 6% in this respect for 2020. The target for the creation of new jobs in the cities was at least 9 million jobs. According to the National Bureau of Statistics, almost 12 million newly created jobs could be achieved in 2020.

Despite the overall slowdown in the economy, but in line with the global sector developments 2020 was a year of strong momentum for China's high-tech sector, even stronger than 2019. Particularly high-performing manufacturing sectors include: Industrial robotics (+19.1%), new electric vehicles (+17.3%), computer chips (+16.2%) and microcomputers (+12.7%).

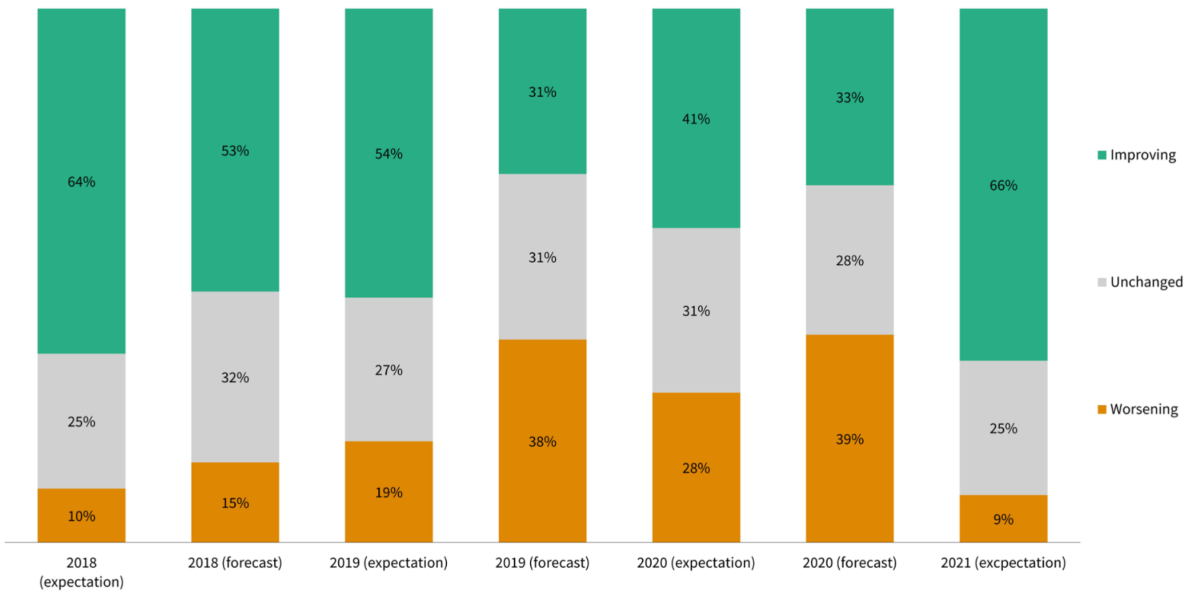


Industry Development

The year 2020 was significantly impacted by the global COVID-19 pandemic which also translates into German companies' assessment of their industry development in China. Almost 39% of the surveyed companies have experienced a worsening industry development in 2020 compared to the previous year. It is at about the same level compared to the quite negative evaluation of 2019, but clearly behind expectations expressed in 2019. In particular and not surprisingly, the sector Business Services experienced a negative development in 2020 resulting mainly from travel restrictions. At the same time one third (33%) evaluate the development of their industry in China in 2020 more positive than in 2019. For the year 2021 a quite optimistic perspective is seen by 64% of surveyed companies and only few (9%) expect a worsening development. The expectations for 2021 are for the first time back again on the level of the very positive expectations for 2018.

Figure 2

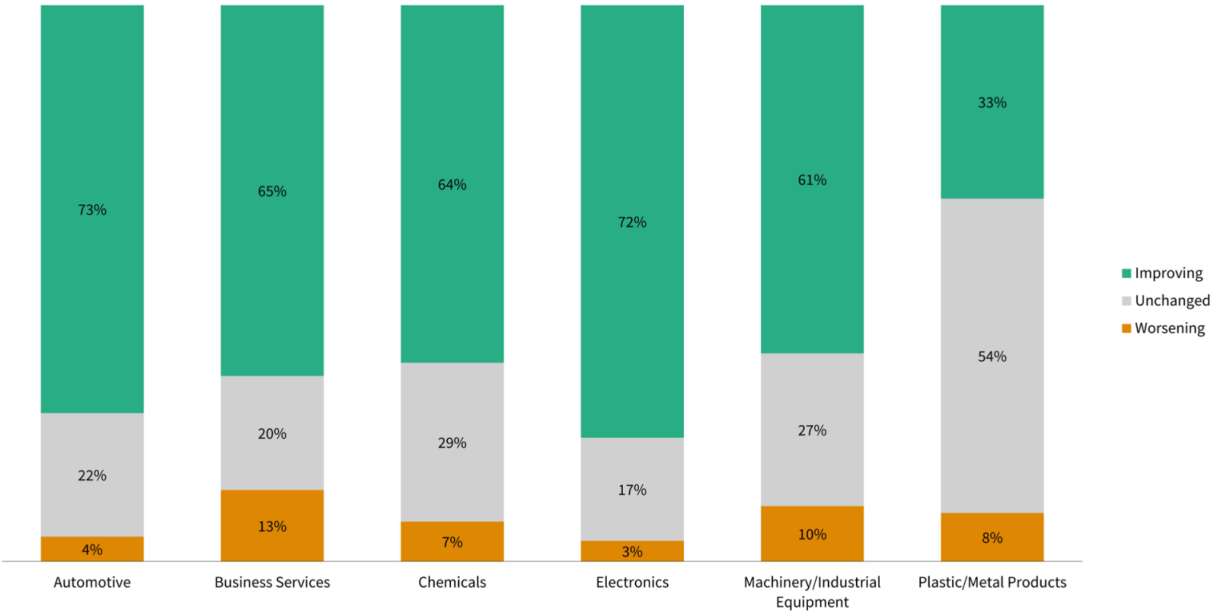
How do you evaluate the development of your industry in China in 2020 compared to last year? And what are your expectations for 2021? (n=535)



Industry-wise the Automotive and Electronics sector are even more positive than the average overall industries for 2021. The Plastic/Metal Products sector is far less optimistic in 2021 with only one third expecting an improvement in their industry development. However, every second in this industry (54%) assesses at least a stable industry development.

Figure 3

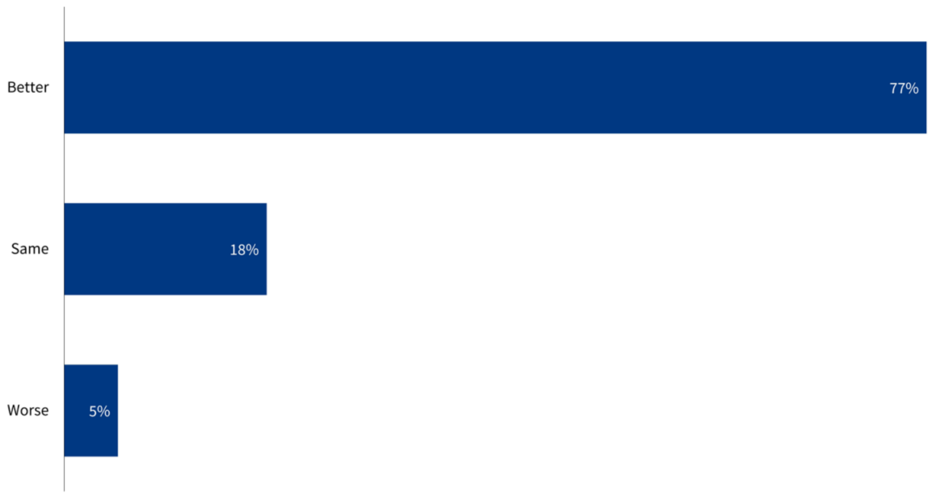
How do you evaluate the development of your industry in China in 2020 compared to last year? And what are your expectations for 2021? (n=535)(Industry focus)



When assessing German companies' industry expectations in China compared to other markets in the rest of the world, there is a clear statement that the Chinese market in 2021 will continue to develop far more positive than other economies (77%).

Figure 4

How do you think your industry in China will develop in 2021 compared to other markets in the rest of the world? (n=519)



Year-on-Year Development and outlook for Companies in China

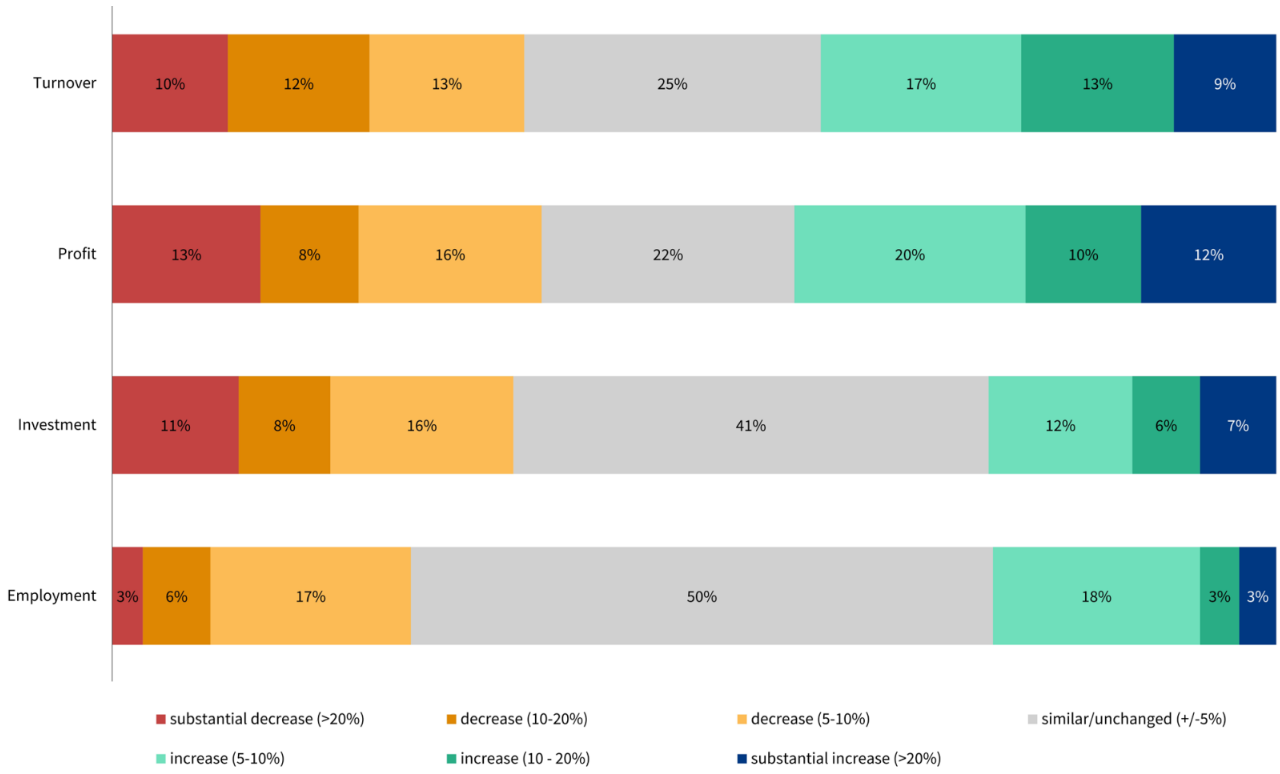
The economic hit caused by the impacts of the global COVID-19 pandemic in 2020 translated into slowing of growth rates or even decreases for German companies in China in terms of the key performance indicators turnover, profit, investment, and employment. Already in the prior year's survey, companies experienced a slowing down of these indicators fueled by the weakening development of the Chinese economy in recent years.

For 2020 the expectation for the own businesses is slightly better than the assessment of the overall industry development in China: For their companies roughly one third of the respondents are expecting decreasing turnover, profit and investment which is resembling the forecasted decrease of the overall industry developments for 39% of the respondents in figure 2 above. German companies operating in China were facing a pandemic-related sharp drop in sales in the first quarter of 2020. Since then, many German companies in China are on the path to recovery, but many have not yet returned to pre-crisis levels. Despite of COVID-19 strong 39% of the surveyed companies were able to increase their annual turnover compared to the previous year and 42% even achieved an increase of their profit compared to 2019. The overall picture correlates to the V-shape recovery in the second half of 2020 in line with a small growth of the GDP for the whole year 2020.

Employment remains less affected than turnover and profit of companies, with half of the companies (50%) surveyed expect this indicator to remain similar or unchanged by the end of 2020 to be ready for the recovery of the business.

Figure 5

How do you expect your company to perform in the following areas by the end of 2020 compared to 2019? (n=534)



Industry-wise it can be noted that companies in the Electronics sector developed comparatively better and companies in the Business Services and Plastic/Metal Products sector developed comparatively weaker as it relates to turnover (figure 6) and profit (figure 7) than the average.

Based on a survey of the Association of the German Chambers of Commerce and Industry (DIHK), turnover in Germany are expected to decrease for almost 69% of the companies.

Figure 6

How do you expect your company to perform in the following areas by the end of 2020 compared to 2019? (n=534) (Industry focus)

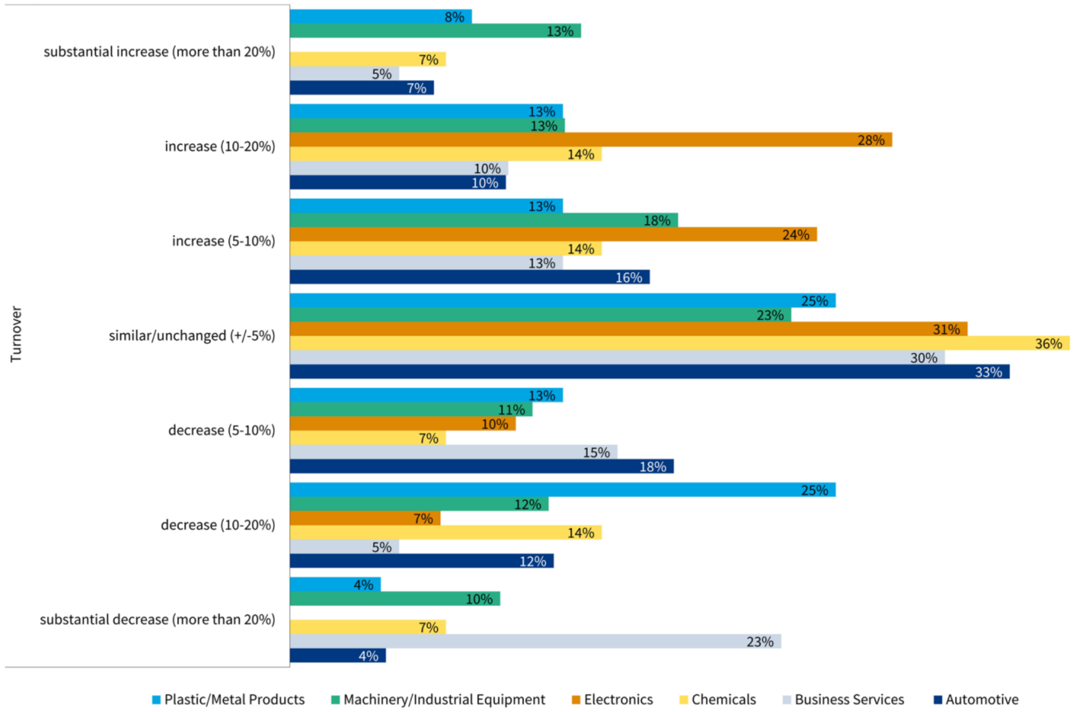
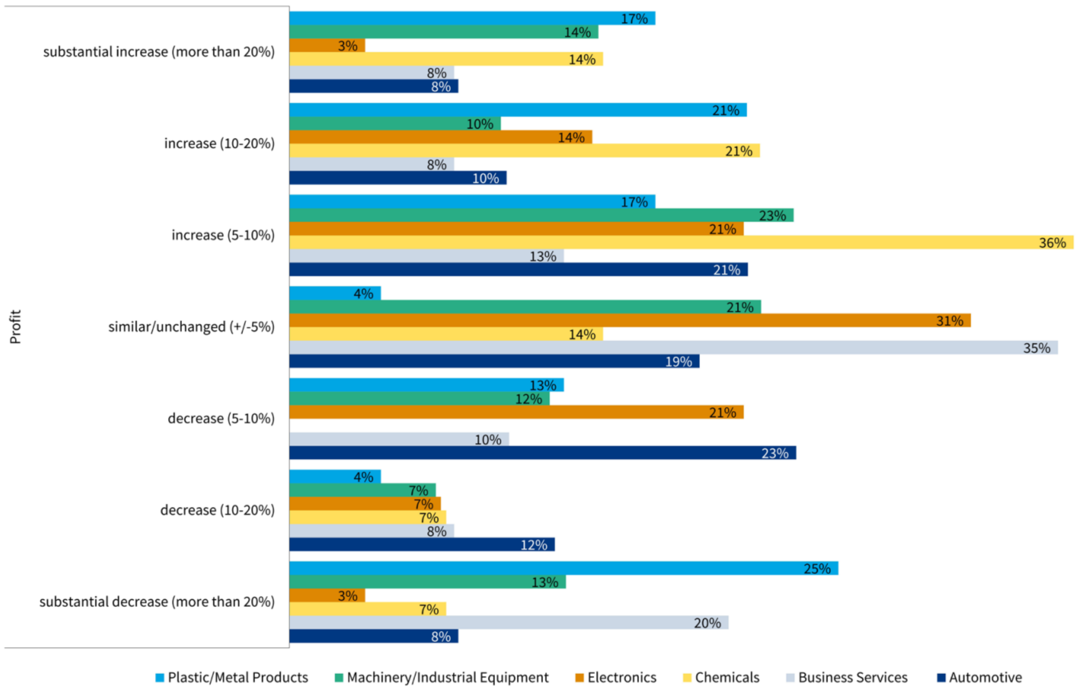


Figure 7

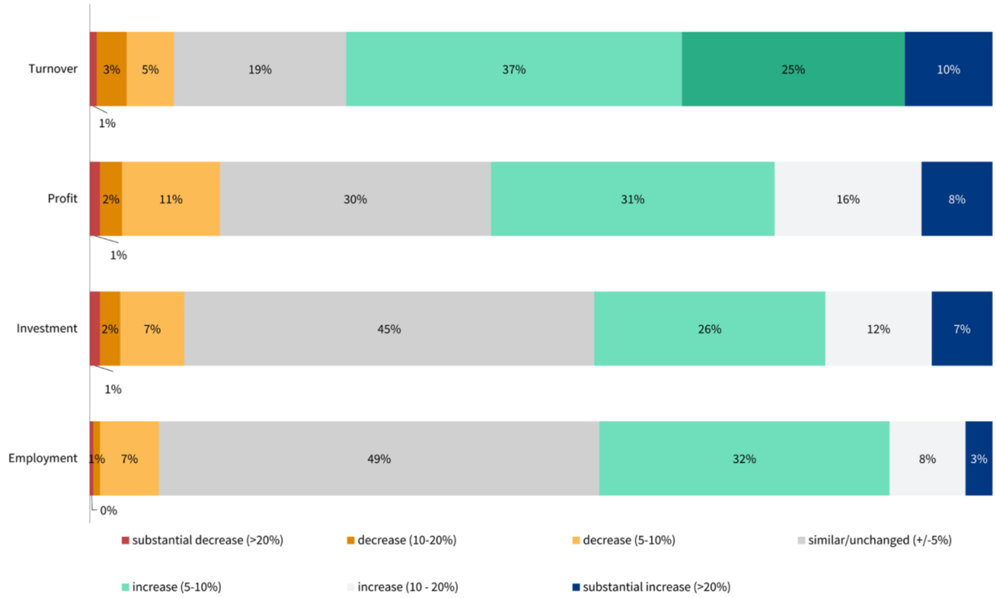
How do you expect your company to perform in the following areas by the end of 2020 compared to 2019? (n=534)(Industry focus)



Looking into the year 2021, the surveyed German companies'performance outlook is very optimistic, in particular as it relates to turnover and profit (72% respectively 56% expect increases). Even 35% of the companies await a growth rate of above 10%. The expectation assumes that there will be no second COVID-19 waive in China. Optimism is also backed by the recent GDP growth expectations of the International Monetary Fund (IMF) in the range of 8.1% for 2021 and the plan from government to further invest in high end manufacturing and technology related infrastructure, among other in the green development. Also, consumption shall improve to become a main driver for China's economy recovery.

Figure 8

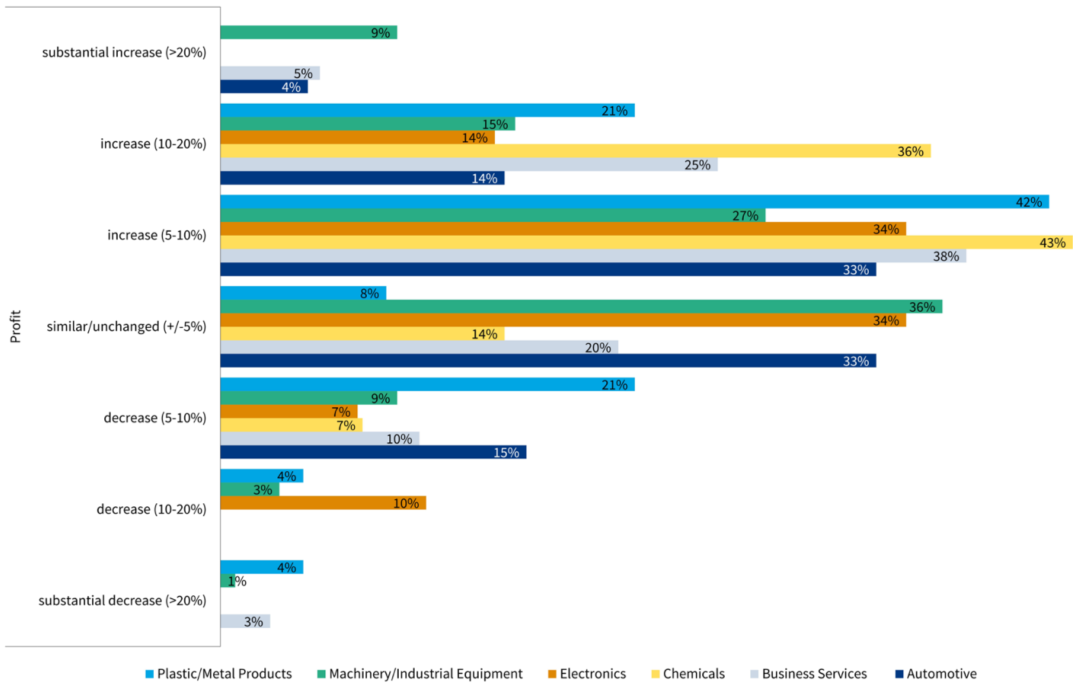
What is your view about the outlook of your company for 2021 across the following areas when compared to 2020? (n=535)



Industry-wise it can be noted that companies in the Machinery/Industrial Equipment sector are comparatively more optimistic and companies in the Plastics/Metal Products and Electronics sectors are slightly less optimistic as it relates to profit (figure 9) than the average. Overall, the positive attitude is remarkable since the clear majority (90%) of the surveyed companies do also expect an impact from COVID-19 still for the next year to come.

Figure 9

What is your view about the outlook of your company for 2021 across the following areas when compared to 2020? (n=535)(Industry focus)



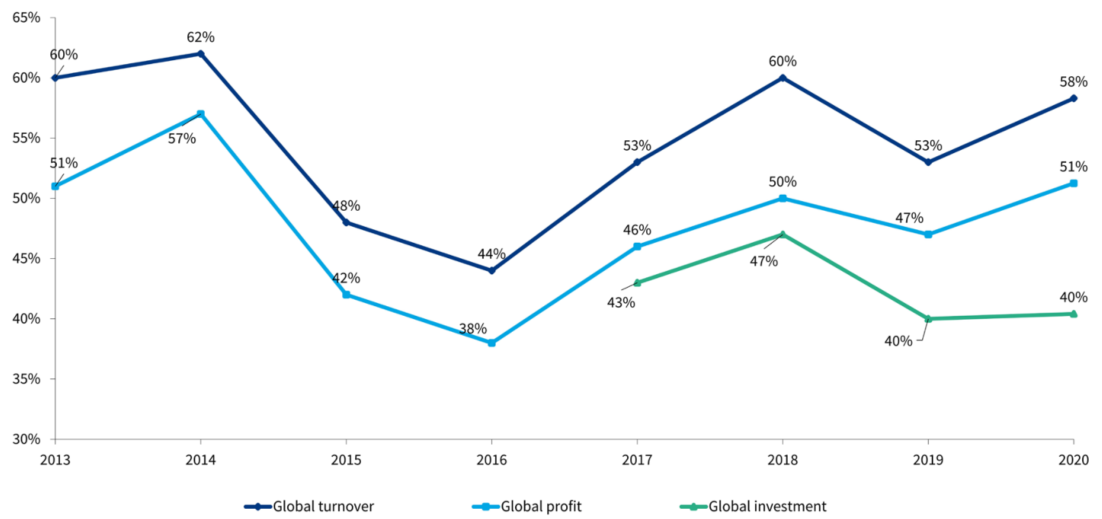
Importance of Chinese Market to German Companies

The Chinese market is of vital importance for the German economy. This is particularly true in times of the Corona-related weakness in world trade and the economy. According to current estimates by the Association of German Chambers of Commerce and Industry (DIHK), China overtook France in the export rankings of German companies last year and is expected to hold this second place after the USA in 2021.

For more than half of the surveyed German companies in China, the market is among the top 3 markets within their group company by turnover (58%), slightly less in terms of profit (51%), and less in terms of investments (40%). For 2020 those performance indicators increased which demonstrates that during the COVID-19 pandemic the relevance of the Chinese market increased for German groups.

Figure 10

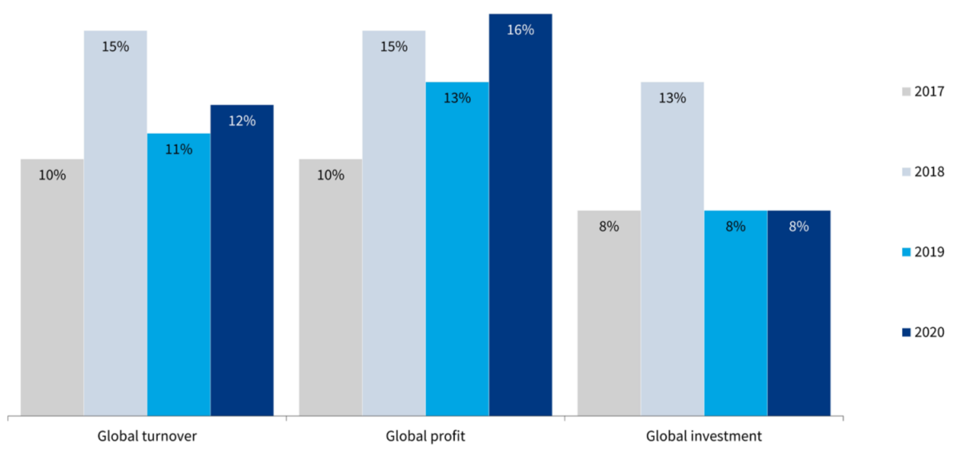
Does your company’s China business most recently rank as one of the top 3 markets for your parent company in Germany? (n=446)



For roughly one out of ten of the surveyed companies, China remains their number one global market for all three metrics. The share of companies that place China as their number one market increased slightly in terms of global turnover and profits when compared to 2019. However, two years ago in 2018 the shares were even higher than in 2020.

Figure 11

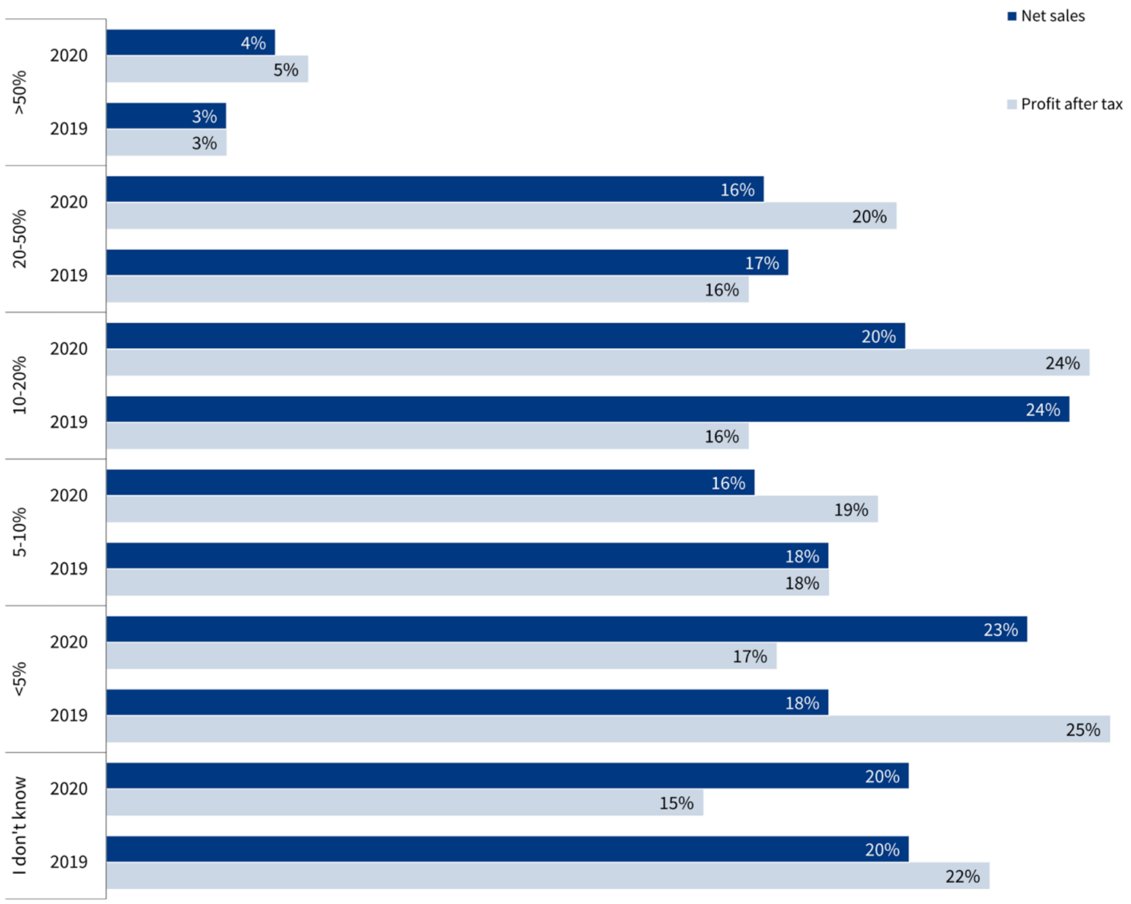
Share of respondents indicating that China is their top-1 market



In terms of net sales 20% of the surveyed German companies contribute to more than 20% to the overall group turnover. This figure remained stable compared to the prior year. At the same time 25% of the surveyed German companies (prior year 19%) contribute to more than 20% to the overall group profit after tax. It can also be seen that the profit contribution of China rose in 2020 against 2019 for German groups. China is an important market for German groups. However, it cannot be seen from the trend within the last years that German groups are overly dependent on China as a market since considerable turnover and profit contributions are obviously generated elsewhere, and some companies are not even present in the market at all.

Figure 12

What is the percentage of net sales and profit after tax generated by your China operations for the overall (German) Group? (n=437)



MARKET ACCESS & REFORM EFFORTS

The **Foreign Investment Law and its Implementing Regulations** came into effect on January 1, 2020, unifying into a single law the three previous legal foundations governing foreign investment. The law marked the first legally binding prohibition of forced technology transfer; and it addresses the issues of regulatory barriers to market access, standardization, intellectual property rights protection and enforcement, as well as public procurement. Nevertheless, the law still distinguishes between domestic and foreign investment. It is broadly termed in a general manner and the use of indeterminate legal terms leaves room for different interpretations and may create legal uncertainty.

Since market opening via a shortening of the negative list has come to the limits of what is deemed acceptable for now, efforts have been shifted to expanding the desired sectors. The revisions of the **Foreign Investment Catalogue for Encouraged Sectors** in the second half of 2020 bear testimony to this shift. The 2020 version of the Catalogue has taken effect on 27 January 2021. With industries on the list enjoying preferential treatments such as business income tax discounts of 10% and duty-free imported equipment for self-use, the list also grew, as China aims for world-class manufacturers and services providers.

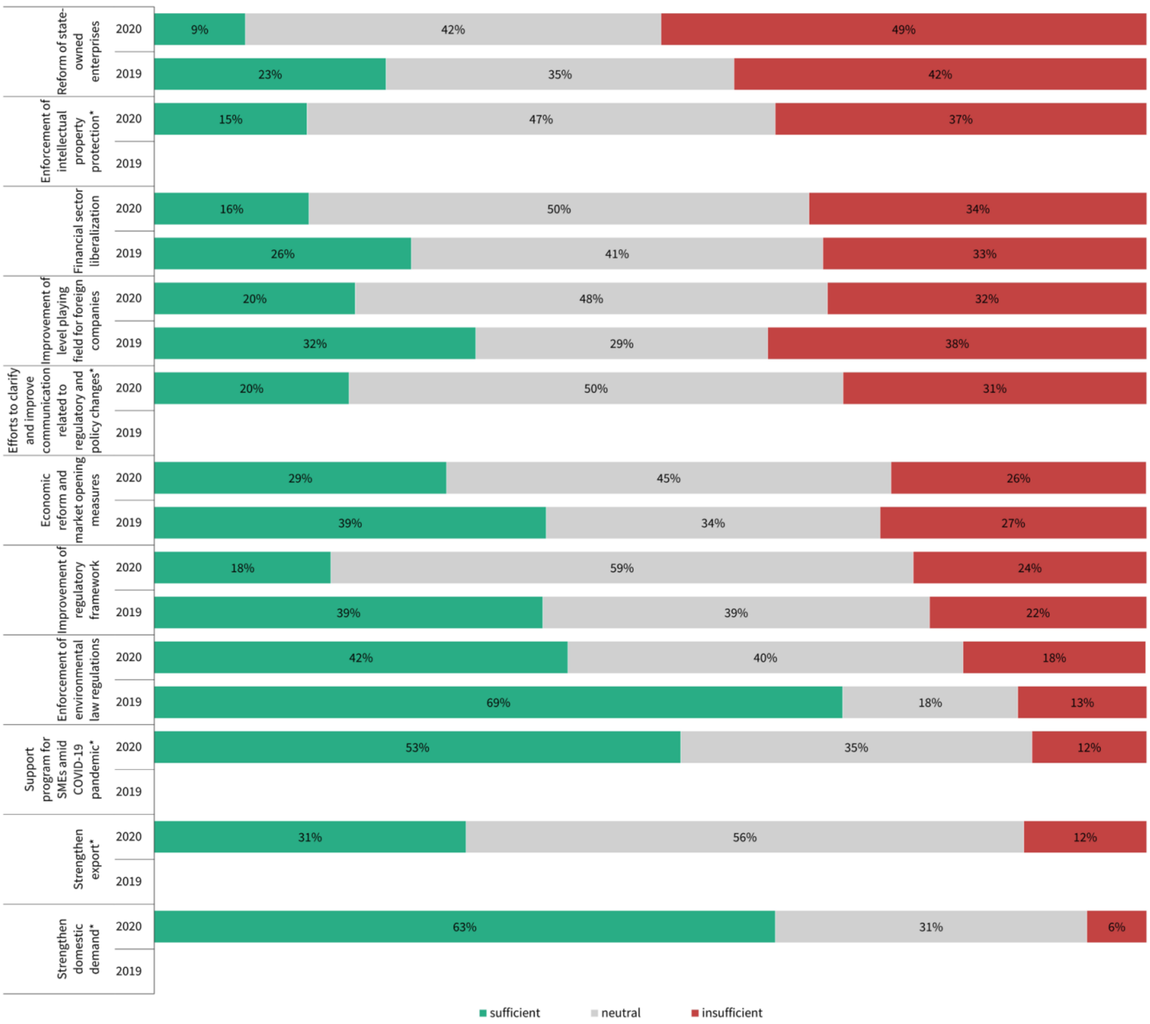
Major Regulatory Changes in 2020 and Beyond

Evaluating the Chinese government's recent efforts, not only about market opening to global investors, but in various fields of Chinese economic policy, there are matters where German companies surveyed still see demand for further action, though rates have improved for some indicators. For long-standing topics like the Reform of SOEs (49%, up 7% from 2019), or the enforcement of intellectual property protection (37%) the efforts so far are rated as insufficient. The improvement of leveling the playing field for foreign companies (32%, down 6% from 2019) and the liberalization of the financial sector (34%, up 1% from 2019) adding up the list of government efforts that have not yet catch-up with the expectation of companies surveyed. For nearly one third of companies (31%) the efforts taken to clarify and improve the government's communication related to regulatory and policy changes are rated as insufficient.

A topic German companies operating in China strongly consider is environmental protection. The satisfaction rate with various efforts taken was on the rise since 2018. However, this year, fewer companies rate the further enforcement of environmental regulations as sufficient (42%, down 27% from 2019) and more respondents take a neutral (40%, up 22% from 2019) stance in this regard. Very recent efforts taken in China regarding strengthening the domestic demand and the support program for SMEs during the COVID-19 pandemic received rather high rates of assessments as sufficient of 63% respectively 53%. This appears to be an evidence that China’ s containment and stimulus measures had been quite effective as Chinese government spent only around 6% of GDP compared to other countries (in Germany 39%) for the fight against the economic impact of the Covid19 pandemic.

Figure 13

How do you rate recent efforts of the Chinese government in the following areas? (n=491)



*Note: Certain areas/topics have been added newly in 2020 so that no comparative information is available for 2019

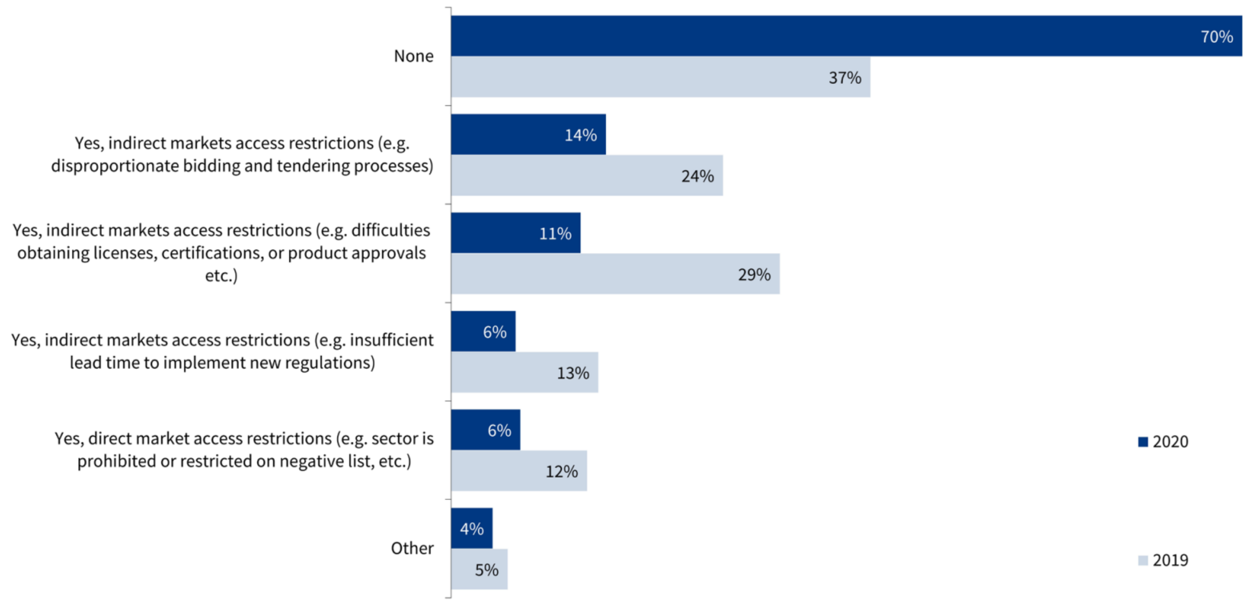
Restrictions and Barriers for German Companies in China

70% (prior year 37%) of companies surveyed do not face formal market access restrictions in China. Also, the level of each specific market access restriction reduced against 2019.The remaining 30% of the respondents do however still experience restrictions, mainly regarding disproportionate bidding and tendering processes (14% state so). Asked for specification, respondents explicitly named certain preferential government supports, such as subsidies, for local competitors on the ground. For about 11% difficulties in obtaining licenses, certifications, or product approvals indirectly hinder their market access to China. In general, the engagement with Chinese market players seems to get tougher as domestic competition is reflected as a predominant topic (see chapter 7 on Business Challenges, Fig 29 and chapter 6 on Investment Confidence, Fig 19).

36% of the German surveyed companies report that they as Foreign Invested Enterprises (FIE) are treated unfavorably to some or full extend compared to domestic companies (see chapter 8 on Competition and Collaboration, Fig. 41)

Figure 14

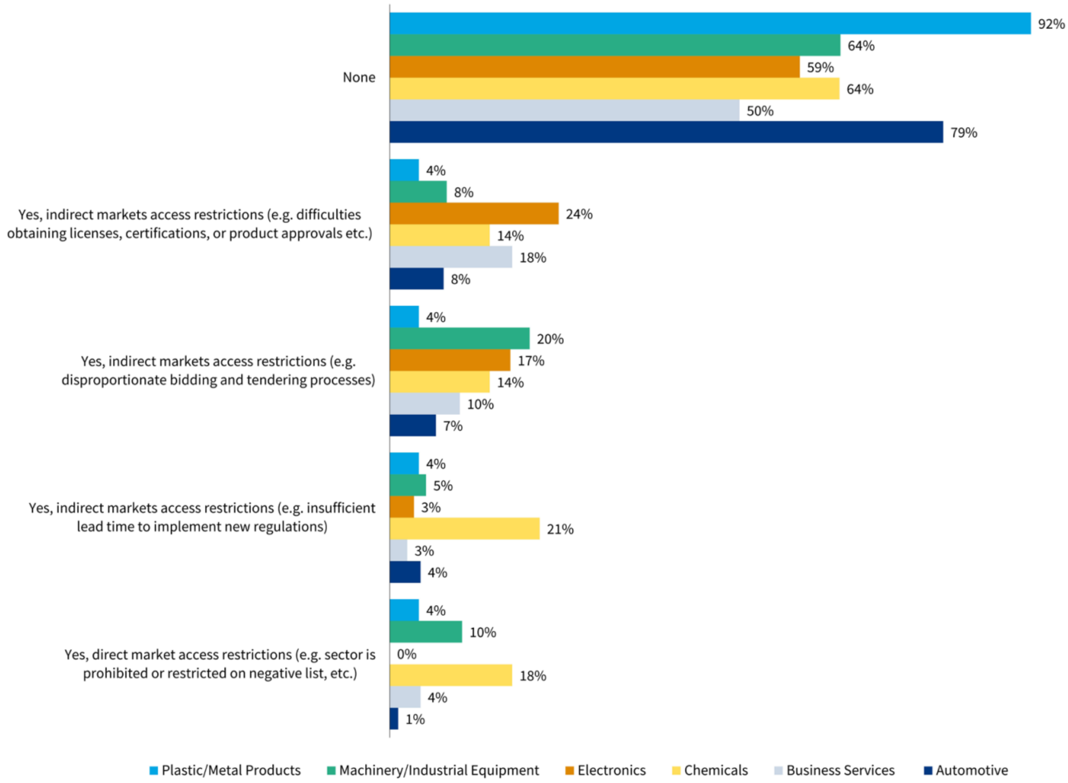
Does your company face market access restrictions in China? If so, what kind of market access restrictions is your company faced with? (n=490)



Fewest restrictions can be observed in the Plastic/Metal Products sector. Above average restrictions in the bidding and tendering processes are seen in the Machinery/ Industrial Equipment and Electronics sectors. Market restrictions due to insufficient lead time to implement new regulations are observed in the Chemicals sector and difficulties in obtaining licenses are mainly concerning the Electronics sector.

Figure 15

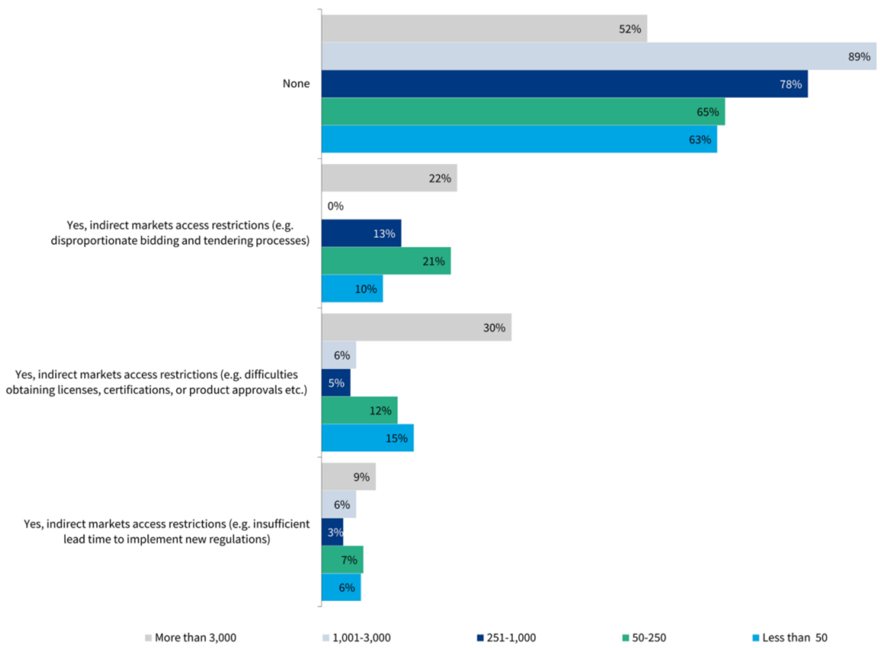
Does your company face market access restrictions in China? If so, what kind of market access restrictions is your company faced with? (n=491)(Industry focus)



Analyzing the responses by size of the surveyed companies it can be noted that smaller companies with lower number of employees are experiencing more restrictions (especially in bidding and tendering processes and in obtaining licenses, certifications and product approvals) than bigger companies with higher number of employees. Most likely it is more difficult for SMEs to get heard by local authorities or regulators compared to larger companies with more economic influence.

Figure 16

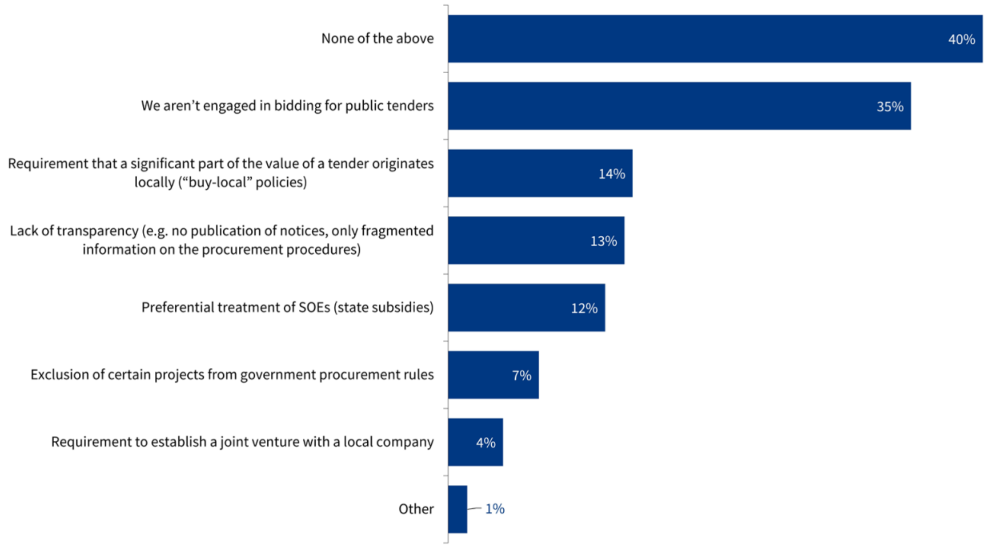
Does your company face market access restrictions in China? If so, what kind of market access restrictions is your company faced with? (n=490)(Employee focus)



More than one third of companies surveyed (35%) are not engaging in public procurement at all. Companies engaged in public procurement projects have experienced various barriers, such as "buy-local" policies (14%), lack of transparency (13%) and a preferential treatment of State-Owned Enterprises (12%). The general exclusion of certain projects from government procurement rules (7%) or a Joint Venture requirement with a local company (4%) only play a minor role. Looking only at the share of companies engaged in public procurement, result in a high portion of 38%which experience market restrictions, while 62% indicated none of them.

Figure 17

In your industry, what kind of barriers or discriminatory measures to public procurement have you experienced over the past year? (n=485)

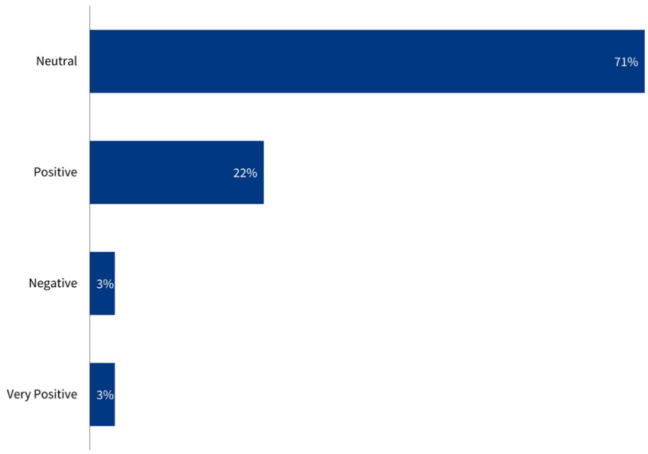


Foreign Investment Law's Impact Not Yet Determined

Since 1 January 2020 China's new Foreign Investment Law (FIL) is effective. This marks the first legally binding prohibition of forced technology transfer, albeit limited to administrative measures. The Foreign Investment Law is quite broadly termed, and the use of indeterminate legal terms leaves room for different interpretations and may create legal uncertainty. This might be one of the reasons, why companies surveyed might not experience a direct impact in their daily work yet, since this is a framework law, which needs to be further clarified by specific rules and regulations. Most companies assess the FIL as neutral (71%), whereas one quarter sees the impact of this legislation as positive or very positive (25%). The results, however, could also mean that this regulation might have missed the targeted goal to improve the business environment for foreign business.

Figure 18

How do you assess the overall impact of the Foreign Investment Law on your business? (n=405)



TTNU 106765 0
22G1
MAX. GROSS 30.480 KGS
67.200 LBS
TARE 2.100 KGS
4.630 LBS
NET 28.380 KGS
62.570 LBS
CU. CAP. 33.2 CU.M.
1.172 CU.FT.
GL Certified
MRKU 734 355 6
22G1
MAX. GROSS 30.480 KG
67.200 LB
TARE 2.170 KG
4.780 LB
PAYLOAD 28.310 KG
62.420 LB
CUBE 33.2 M³
1.170 FT³
maerskline.com
CIMC

Investment Confidence

China' s attraction of **foreign direct investment (FDI)** increased in 2020, breaking the 2019 record, as the pandemic was brought under control in the first half of the year. While the US continues to receive an overall FDI inflow of around twice the size of China's, the country is the second biggest host country worldwide in normal years.

German investment in China in 2020 has not exceeded the 2018 record of USD 3.67 bn but has remained relatively consistent at levels close to 2018 and 2019. While China has overtaken the US as biggest trading partner of Germany in 2017, the US remain the most important destination for German investment. At the end of 2018, the stock of German direct investment in the US accounted for more than half of Germany's total FDI and almost four times of German FDI in China. Within the EU, Germany and France tend to be the biggest sources of **European direct investment in China**. Reflecting own manufacturing strengths, German and French investment in China largely concentrates in automotive, chemicals and minerals, agriculture, and food. As China opens more services markets, German investment in financial services and insurance, real estate and hospitality is also increasing. The shift of German investment in China from manufacturing to services follows China's general trend. In 2020 services accounted for more than three quarters of China's total FDI inflow.

At the time of this survey, a quick conclusion of the **EU-China Comprehensive Agreement on Investment** seemed unlikely to many observers. However, a political agreement was reached in the final days of 2020 after a 7-year negotiation period. While the EU seeks greater market access in manufacturing and a level playing field for enterprises, the removal of joint venture requirements for business services and environmental services will be particularly welcome by German companies. The Agreement still must be ratified by the European Parliament and the European Council.

A blueprint for the **14th Five Year Plan (2021-2025)** was issued after the 5th Plenum of the Central Committee of the Communist Party of China in late October 2020. It is expected to be passed by the National People's Congress in March 2021. The Plan sets guidelines for the next period that define China's upcoming economic future. For the first time, no specific growth target was set in a bid to focus quality over quantity. The increasing emphasis on China's domestic market could be a double-edged sword for foreign invested companies. The expansion of China as a consumer market will increase the market share for companies in this sector, bringing new opportunities especially in high-end consumer goods. As China seeks to reduce dependence on global technology and supply chains, a certain level of decoupling, especially in advanced technology, is feared.

EU-China Comprehensive Agreement on Investment (CAI)

By the very end of December 2020 an overall political agreement on the conclusion on an EU-China Investment Agreement (CAI) has been reached – after more than seven years of negotiations. It still has to be ratified by the European Parliament and the European Council.

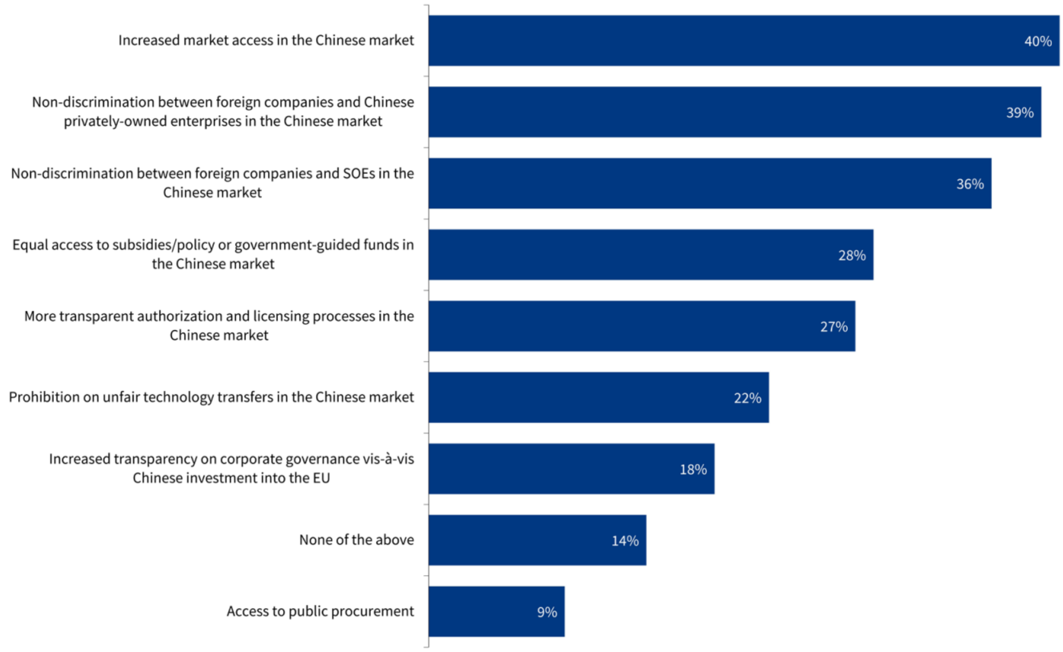
The aim of the agreement is to improve market access for European companies, to level the playing field with the often state-subsidized companies in China and effectively protect bilateral investment and competition conditions.

German companies in China currently operate in an environment characterized by optimism for the year ahead and a strong commitment to the market though complex regulatory challenges remain and domestic competition is growing (see also chapter 5 Market Access & Reform Efforts and 7 Business Challenges).

In our survey in November 2020, German companies in China formulated their expectations on the CAI: Increased market access in the Chinese market was on top of the list with 40% of companies surveyed choosing this as one of their top 3 priorities, followed by non-discrimination between foreign companies and Chinese POEs (39%) as well as SOEs (36%). But also, equal access to subsidies and more transparent authorization and licensing processes in the Chinese market rate high with 28% respectively 27%.

Figure 19

Please select your top 3 priorities for outcomes of the EU-China Comprehensive Agreement on Investment (CAI) (n=344)



Potential Sources of Business Opportunities in China

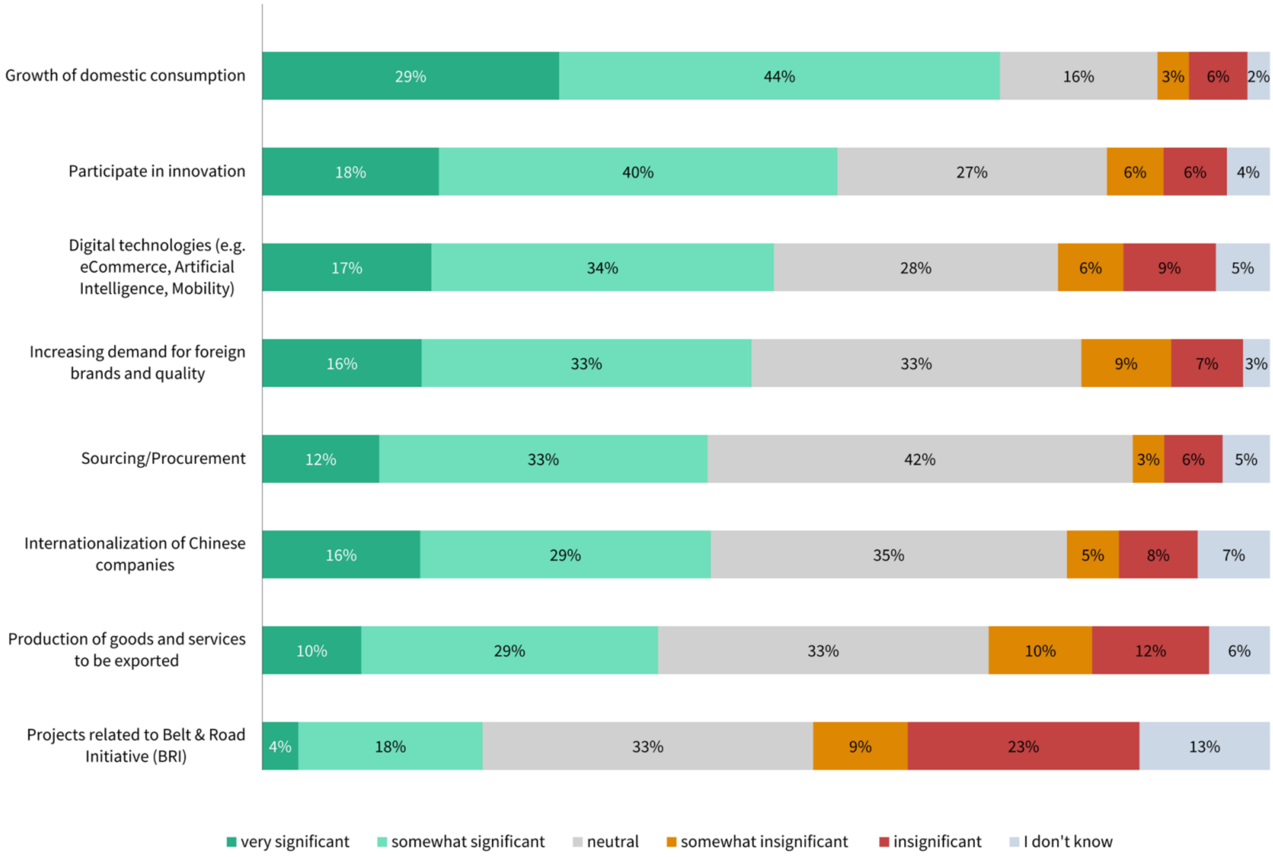
73% of the surveyed companies see growth of domestic consumption as the top opportunity for their businesses, for 29% of them it is even considered as very significant. Compared to last year's result (68% in 2019), this aspect has further gained in importance.

Further significant sources for business opportunities are centered around digitalization and innovation in line with the industry developments and market expectations: For 58% the opportunity to participate in innovation is somewhat or very significant and digital technologies, such as eCommerce or Artificial Intelligence follow thereafter (51%).

The relevance of increasing demand for foreign brands and quality in China significantly decreased from 65% in 2019 to 49% in 2020. Also, the export orientation of German companies in China further reduced from 50% in 2019 to 39% in 2020.

Figure 20

Please rate the following opportunities for your company' s China business.(n= 452)

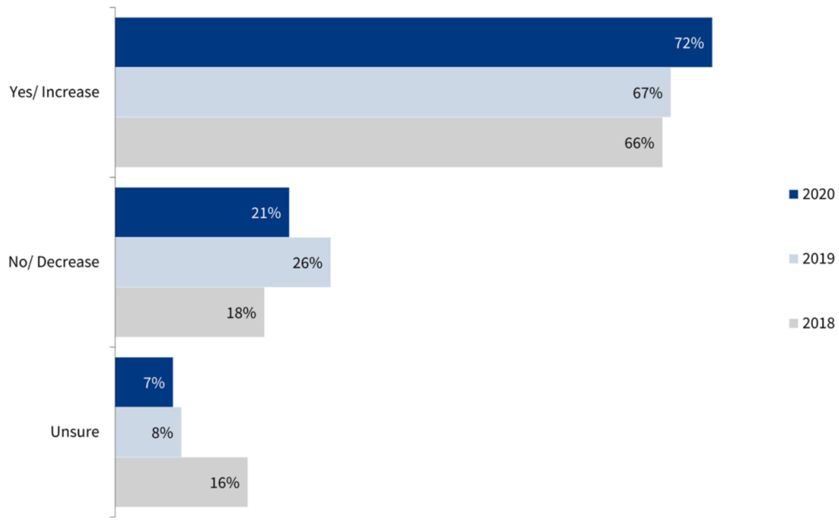


Investment Planning in China – Sources and Reasons

In 2019, 67% of the surveyed companies stated that they are planning to further invest in China in the next two years. One year later in 2020, 72% of companies plan to increase their investments in China. This confirms the remaining and even growing attractiveness of the Chinese market for German investors. Just 21% decided not to invest or somehow decrease their investments (5%-points down from 2019).

Figure 21

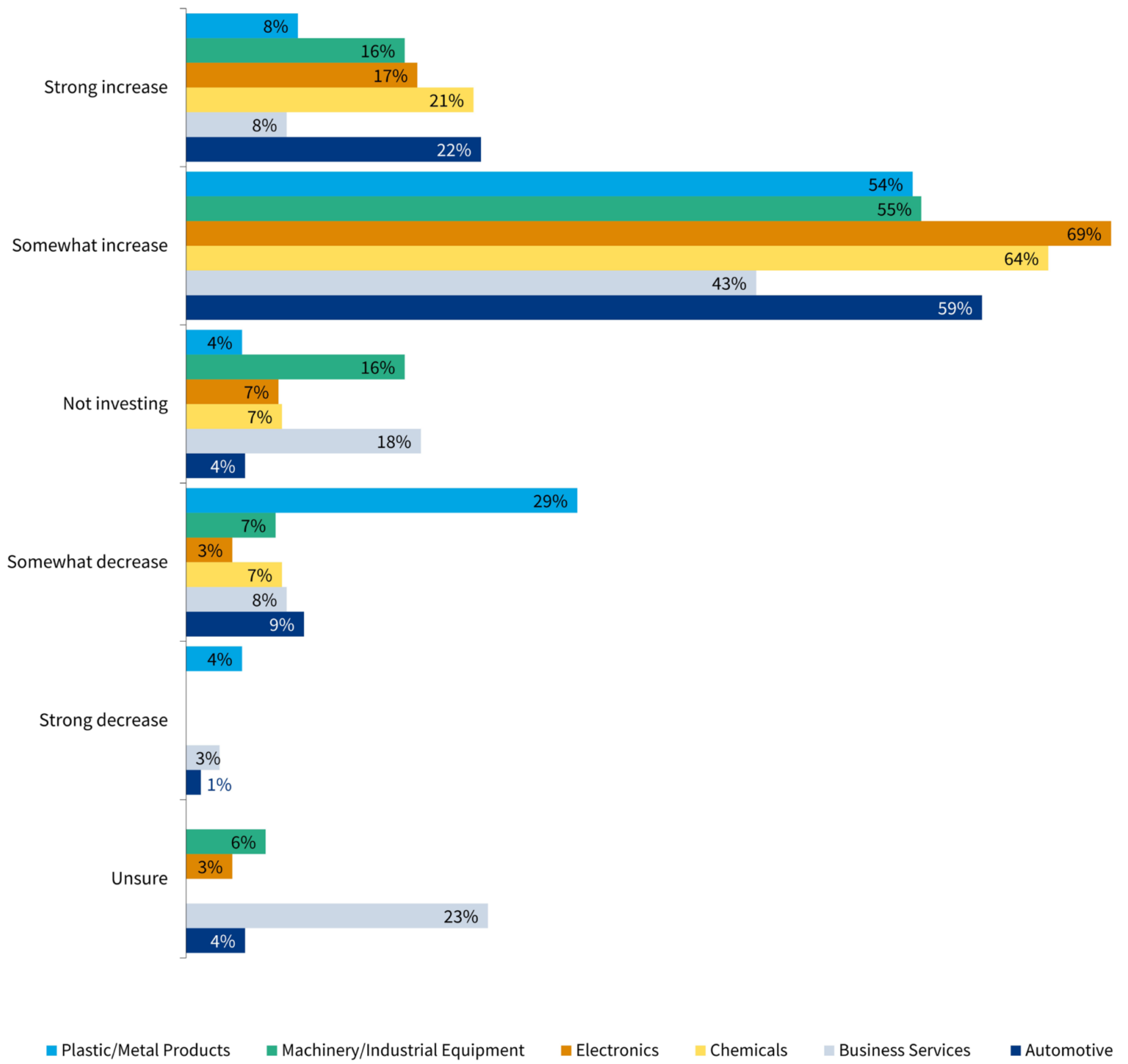
How is your company planning to further invest in China within the next two years? (n=462)



Above average, 86% of the companies in the electronics sector plan to further increase their investments and are thereby leading among the industries, followed closely by the Chemicals sector with 85%. The biggest skepticism exists in the Business sector since 23% of the companies are unsure whether they should invest or not and 18% already decided not to invest in the coming two years. Decreases of investments are mainly planned in the Plastic/Metal Products sector with 33%.

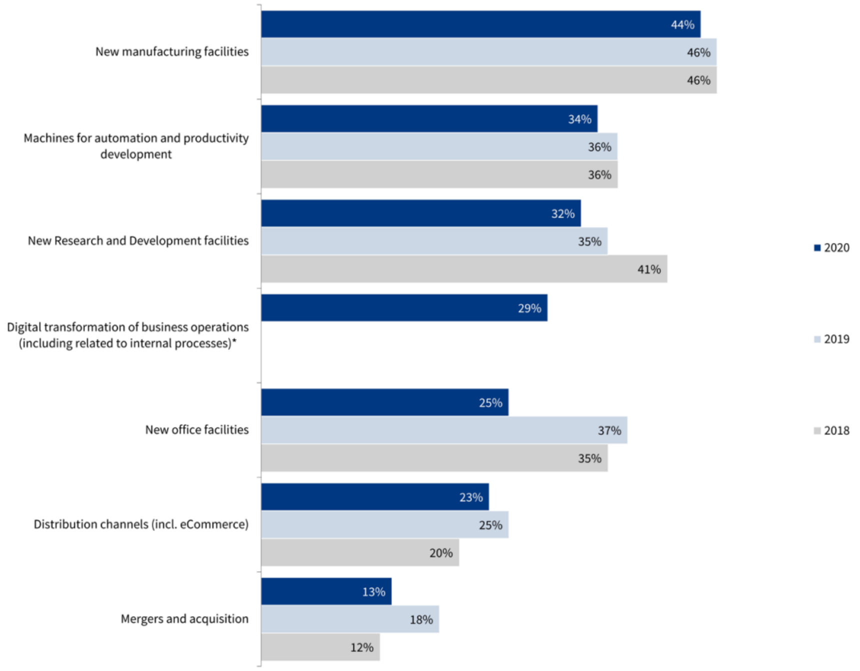
Figure 22

How is your company planning to further invest in China within the next two years? (Industry Focus)



Most investments are again intended in new manufacturing facilities (44%), machines for automation (34%) and new R&D facilities (32%). The percentages just shifted slightly as compared with 2019. Due to the experiences of the pandemic now 29% of companies plan to invest in the digital transformation of their business operations.

Figure 23
In which areas are you planning to invest in China within the next two years? (n=356)

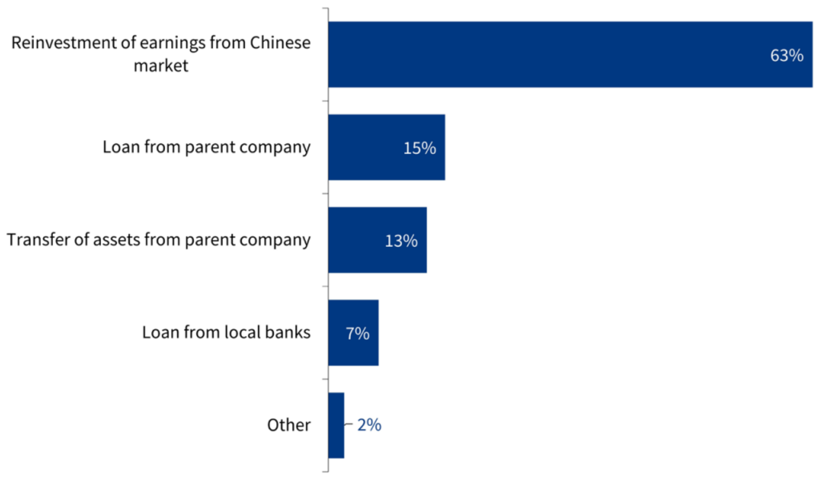


Note: Certain areas/topics have been added newly in 2020 so that no comparative information is available for 2019

The most significant source for the surveyed companies' investment in China is the reinvestment of their earnings from the Chinese market. For 63% of firms this is the case. Furthermore, for 15% of surveyed companies a loan from their parent company is the most important source of investment, followed by a transfer of assets from the parent company (13%).

Financing for SME in China is a generally difficult issue with companies facing high capital requirements from banks. According to the German Chamber's Advocacy Paper & Practical Guide published in July 2020, it is proven to be difficult for local banks in China to understand a risk assessment for foreign invested companies. As a result, foreign invested SME have to obtain most of their financing from net equity or through German headquarters.

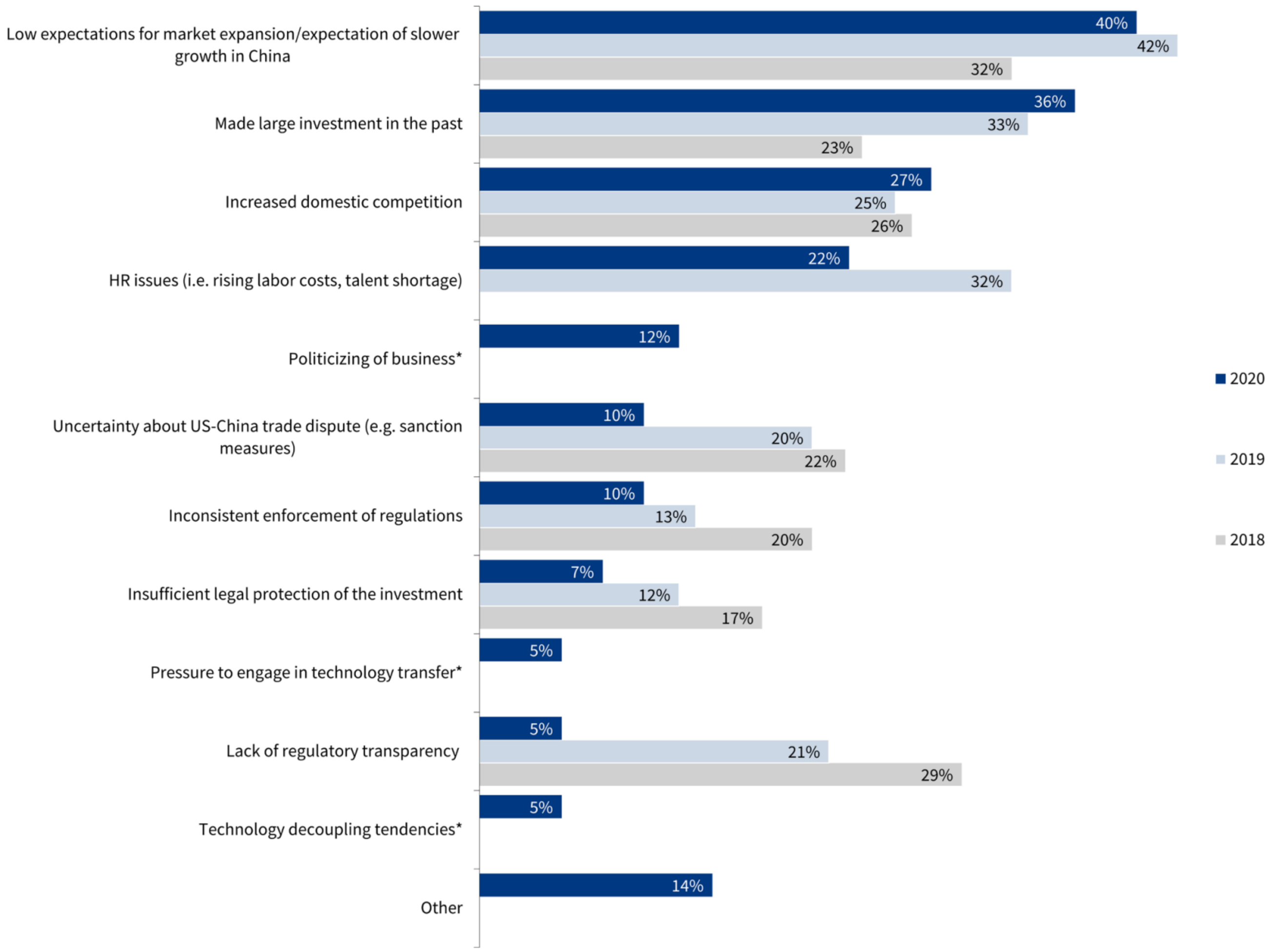
Figure 24
What is the most significant source for your investment in China?(n=334)



In 2020, for two in five companies (40%, prior year 42%) the main reason for not investing in China are lower growth expectations, followed by large investments already made in the past (36%, prior year 33%) as well as increased domestic competition (27%, prior year 25%). Only for 10% of companies, the uncertainty around the trade dispute between the US and China is a decisive reason for not investing in China in 2020, down from 20% in 2019 and 22% in 2018. It can also be not noted that inconsistent enforcement of regulations, insufficient legal protection and a lack of regulatory transparency have much less often been stated as reasons not to invest or decrease investments in China in comparison with 2019 and 2018.

Figure 25

What are the main reasons for your company not to invest or decrease investments in China? (n=81)

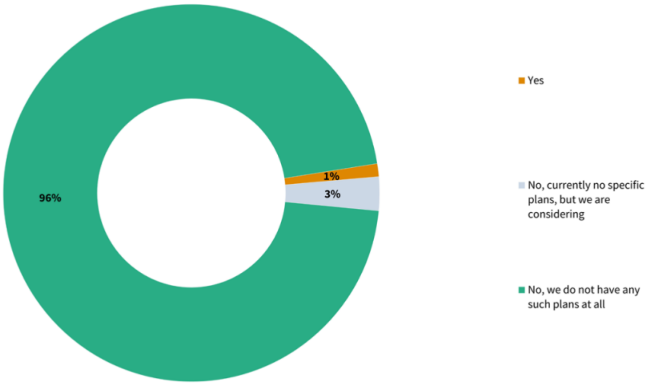


Note: Certain areas/topics have been added newly in 2020 so that no comparative information is available for 2019

The vast majority of companies (96%) do not have any plans to leave China within the next 12 months. Only 3% of surveyed companies are considering that option but do not have any specific plans yet. Those results clearly demonstrate the significance of the Chinese market for German companies and the commitment of German companies to China as a business location.

Figure 26

Is your company planning to completely leave China within the next 12 months? (n=451)



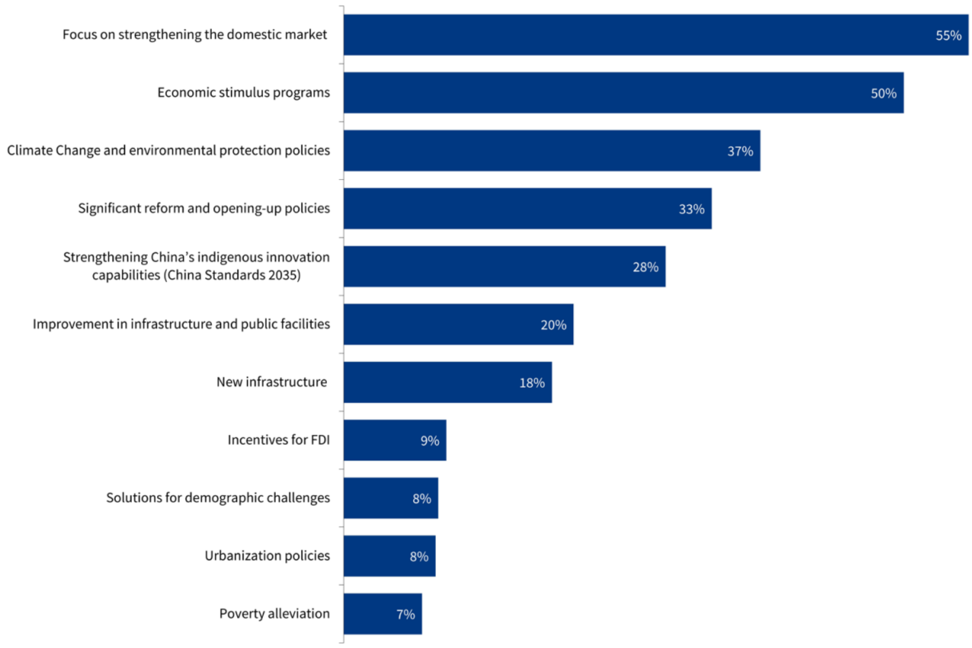
China' s 14th Five Year Plan

In late October 2020, the Central Committee of the Communist Party of China (5th Plenum) deliberated on the country's 14th Five-Year Plan, which will span from 2021 to 2025. It is expected to be passed by the National People's Congress in March 2021. The 14th Five-Year Plan sets guidelines for the next period that define China's upcoming economic future. The global economy and international trade and investment has played a central role in China's economic growth. Domestic circulation and the focus on resilience, independence from foreign markets and building domestic markets is now being emphasized as a response to the changing international environment.

55% of the surveyed companies in China expect a focus on strengthening the domestic market regarding the upcoming Five-Year Plan and half of the firms (50%) expect an economic stimulus program. Climate change and environmental protection policies (37%) and significant reforms and opening-up policies (33%) are also anticipated to be part of the new Five-Year Plan.

Figure 27

What are your expectations regarding the upcoming 14th Five Year Plan? (n=418)



BUSINESS CHALLENGES

This chapter takes a close look at the **regulatory environment** in which German companies operate in China, and it seeks to assess the impact of **macroeconomic developments and operational challenges** of the German Chamber's member companies, both in the current situation as well as over time.

Internet access, cyber security, environmental regulations enforcement and the Corporate Social Credit System are just some of the prominent **regulatory issues** companies are facing. The survey responses allow the Chamber to weigh and assess which challenges are most pressing. They provide information to relevant stakeholders and enable to enter into a dialogue with Chinese authorities, seek mutually beneficial outcomes and advocate for positive change.

The cluster of **macroeconomic and operational challenges** has been spearheaded by labor market issues for years. China's average wages have consistently increased, with wage growth only relatively recently decelerating in line with overall economic slowdown. Demographic developments such as an aging population, shrinking labor force and an ever-growing worker-to-pensioner ratio are likely to exacerbate the situation in the coming years and decades.

The German Chamber's Labor Market and Salary Report has been following these developments, and in the 2020/21 edition, German companies reported an effective wage growth 1.5 percentage points below the projected 5.53% for 2020. Two thirds of German companies stated the pandemic had a medium to high impact on the actual salary growth in 2020. More importantly, the expected salary growth for 2021 is even lower than the 2020 real one, as companies face uncertainties.

To help mitigate company losses, the government rolled out several programs in the first half of 2020: waivers on corporate contributions to the government pension and unemployment programs; waivers or reductions on enterprises rental costs when the landlord was in the public sector, and VAT reduction in designated sectors. Mandatory extension and deferral for corporate loans was also introduced.

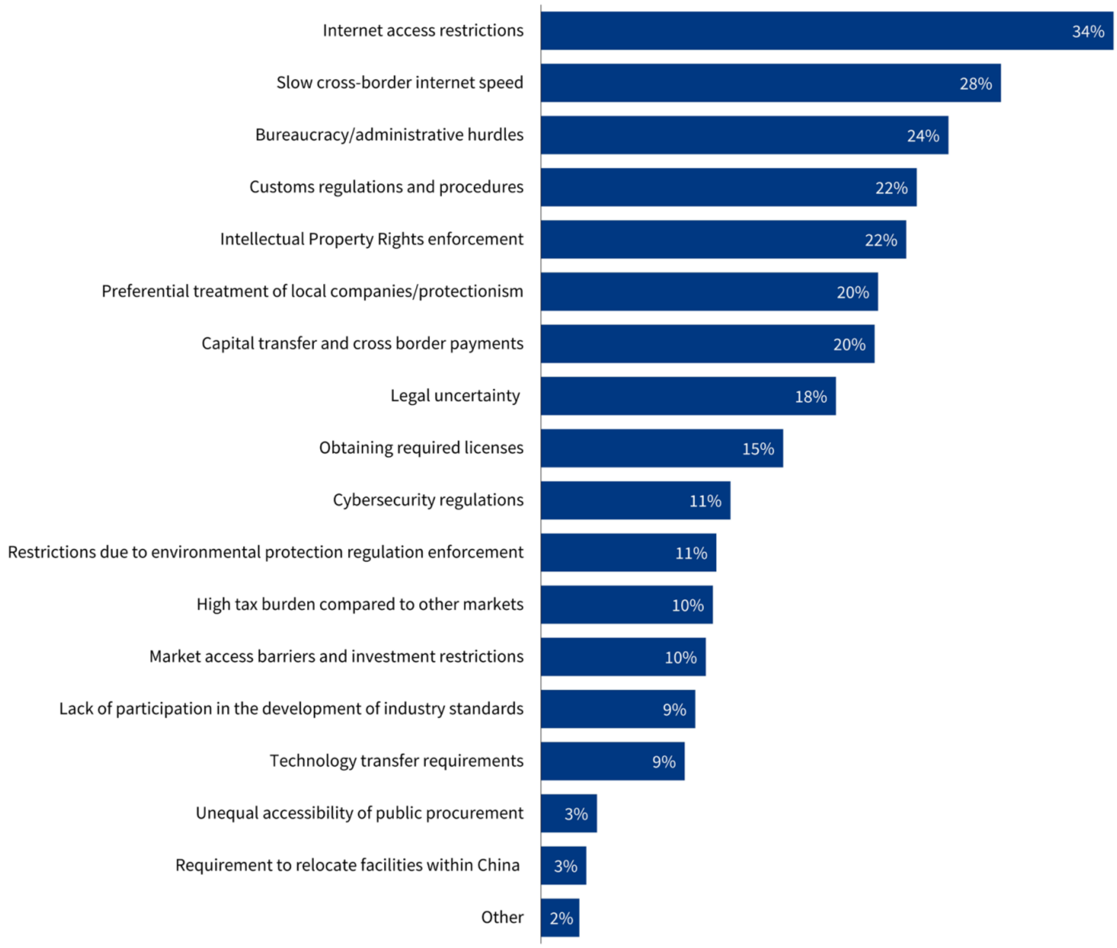
Regulatory Business Challenges

German companies in the Chinese market face various regulatory business challenges, with some persisting since years, some with changing priority for the German business community in China. This year, especially the topic of internet access - in terms of regulatory aspects – (34%) and internet speed – (28%) - is now on top of the agenda, prominently gaining of importance in connection with COVID-19 implications and the boost in digitalization. The top-6 list of regulatory business challenges is then followed by Bureaucracy/administrative hurdles in general (24%), Customs regulations and procedures (22%) and Intellectual Property (IP) Rights enforcement (22%).

In its Advocacy Paper and Practical Guide, the German Chamber advocates for unrestricted and faster internet. FIE are often at a disadvantage compared to local companies because of their need to connect to servers that are located abroad and work with foreign digital services or platforms for daily operational business. Their challenges seem to even grow in the future in regard to the Cyber Security Law.

The ranking of business challenges looks quite differently in comparison to 2019 where market access barriers and investment restrictions, legal uncertainty and unclear regulatory frameworks, technology transfer requirements and Intellectual Property Rights enforcement were named at the top regulatory business challenges. This is a sign for a different business focus in the year of mastering the COVID-19 pandemic.

Figure 28
Please select your top 3 regulatory business challenges. (n=476)

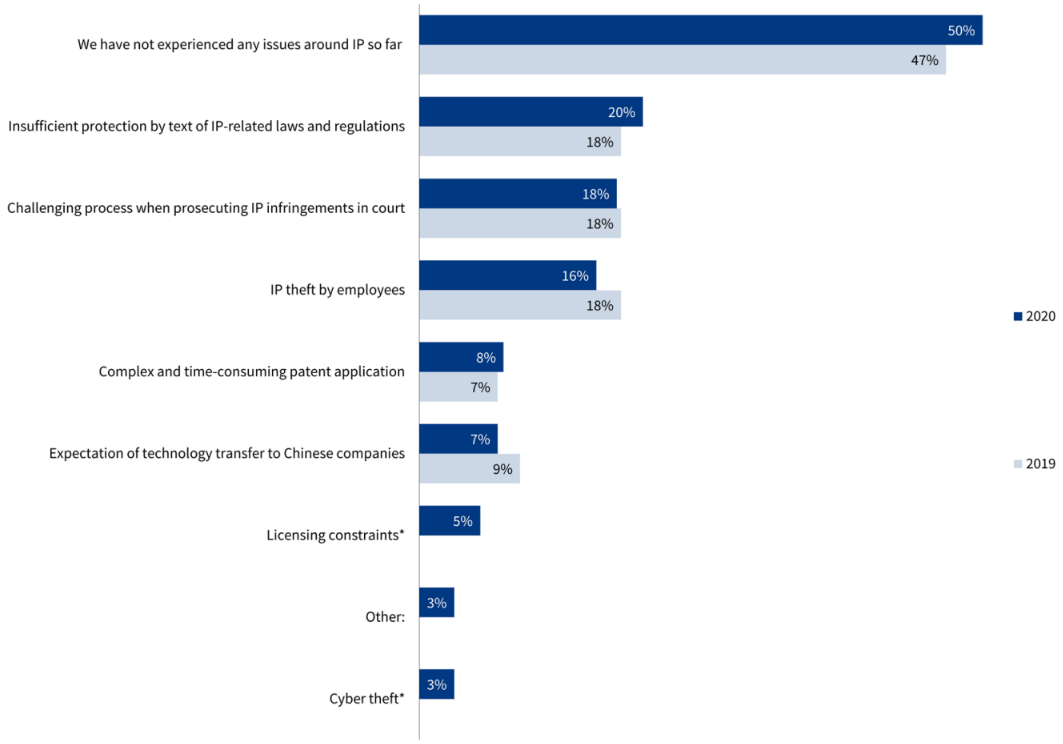


Intellectual Property

Rated as one of the top-6 regulatory business challenges, the enforcement of intellectual property (IP) rights still poses a challenge to almost one quarter (22%) of companies surveyed in this study. Despite undisputed improvements to IP regulations over recent years, it seems more a matter of enforcement. The perceptions of the surveyed companies have not changed significantly from previous year as again just half of the companies stated that they are not experiencing any issues around IP. Companies state that they still face insufficient protection by IP-related laws and regulations (20%) fighting against copycat cases, a challenging process when prosecuting IP infringements in court (18%) and IP theft by employees (16%).

Figure 29

Has your company been faced with IP challenges? (n=386)



Cyber Security Law

In June 2017, the Chinese Cyber Security Law (CSL) took effect and corresponding implementation regulations have been issued since then. The CSL regulates the cyberspace and imposes requirements on the use of the internet as well as the generation, use, storage, and transfer of data. Asked about the business implications related to the implementation of the CSL, most prevailing is the limitation of data cross border transfer for more than every second respondent (53%), followed by additional efforts to comply with the cybersecurity technical requirements for 41%. About one third of companies surveyed (34%) experience sharing of more information and data to regulators as one of the major business impacts related to the implementation of the CSL. Strongly related to these implications are the reported issues regarding internet access that top the list of regulatory business challenges in this year's survey. It can also be noted that larger companies with more employees are more affected than smaller companies with limited number of employees.

Figure 30

What kind of business implications are you experiencing related to the implementation of the Chinese Cyber Security Law? (n=314)

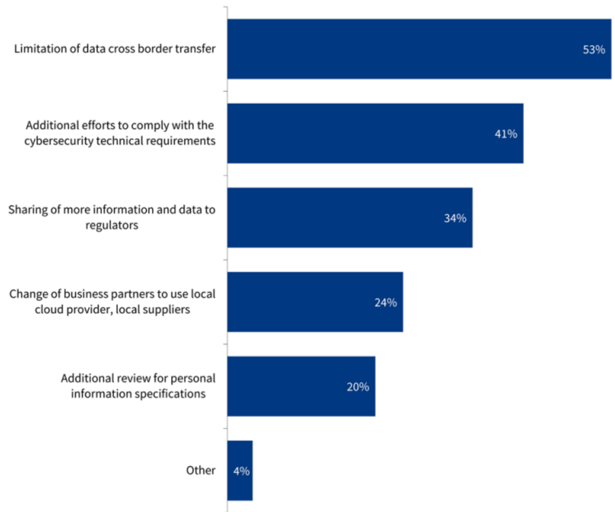
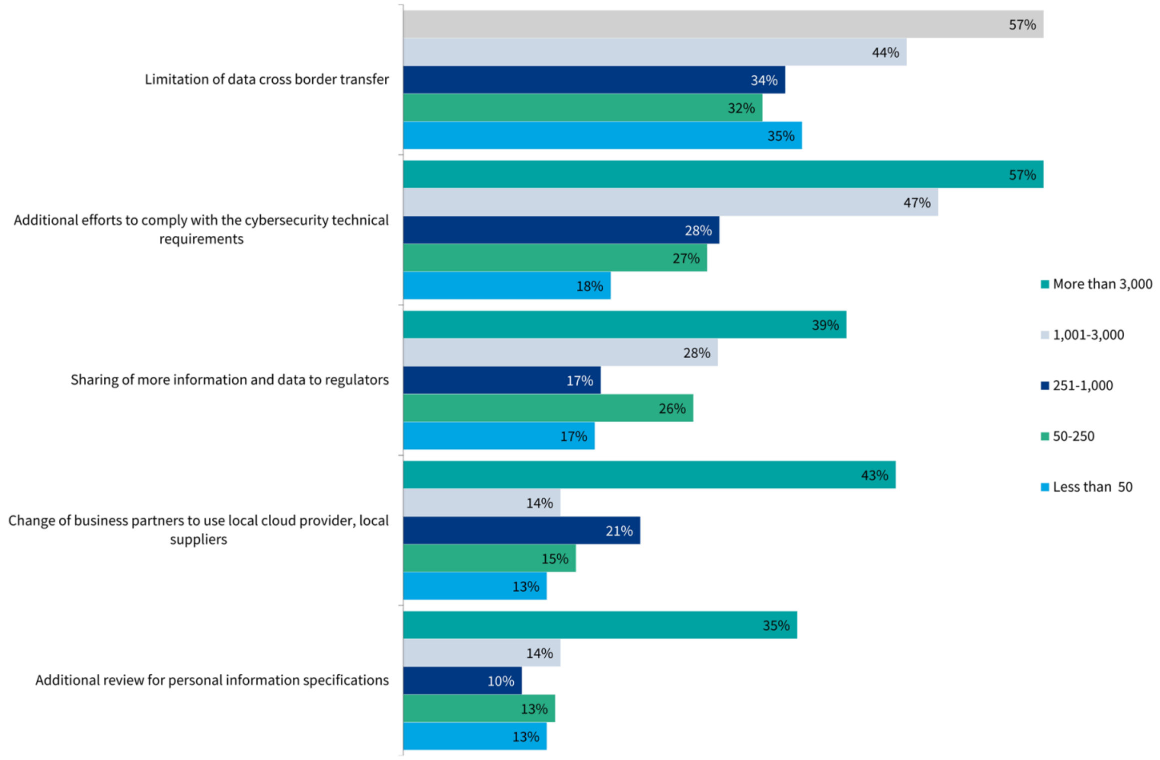


Figure 31

What kind of business implications are you experiencing related to the implementation of the Chinese Cyber Security Law? (n=314)(Employee focus)



Corporate Social Credit System

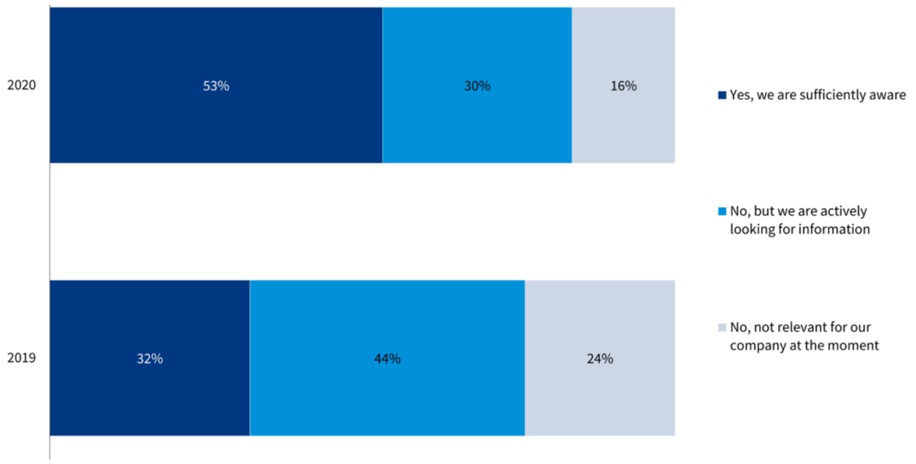
The "Corporate Social Credit System" (CSCS) is a government initiative to monitor and rate individuals', businesses' and institutions' compliance with laws and regulations in China. Since the end of the 1990s, China's policy makers have been working on a credit rating system and in 2014, the State Council published the "Planning Outline for the Construction of a Social Credit System", which is considered a draft and roadmap for the Social Credit System (SCS). Among the targets of the CSCS is a more extensive surveillance, rating, and control of individual market players. Once fully enacted, the system enables the Chinese government to efficiently monitor companies and – in the case of non-compliance with the law – to impose sanctions.

For the future engagement of German business in China, the topic is of high relevance, because control mechanisms of the market and the legal system are being transformed by means of a comprehensive corporate scoring system for companies into an unprecedented meta-system. This type of system could lead to a confidence-building effect on companies in their day-to-day business. For example, it might help to better assess potential business partners before entering or deepening a business relationship with them. However, it will only work if market participants are aware of how ratings are determined and what the subsequent consequences would be of a certain rating. If such transparency cannot be ensured, the scoring system leaves room for further market entry barriers, on top of existing market entry restrictions and regulations.

As the implementation of the CSCS is ongoing, more and more companies are trying to get hold of detailed information. Asked about their awareness on their company's own ratings in the two most advanced rating systems, more than half of all companies surveyed (53%) report to be sufficiently aware (up 21% from 2019). However, about one third (30%) are not aware about their company's record in "Enterprise Credit Information Publicity System" (国家企业信用信息公示系统) and/or "Credit China" (信用中国) but are actively searching for further information. Another 16% believe it is not relevant for them. The results, compared to 2019, show a higher awareness of publicly available information from accessible credit rating sources, however, still indicate a need for further review of these data to ensure only accurate company information is displayed in public.

Figure 32

The "Corporate Social Credit System"(CSCS) is a government initiative to monitor and rate individuals', businesses' and institutions' compliance with laws and regulations in China. Are you aware of your company's records on the "Enterprise Credit Informa Publicity System"(国家企业信用信息公示系统)and/or Credit China(信用中国)?



Asked about the consequences in terms of setting up internal management and monitoring systems regarding the CSCS, less than half (40%) have implemented such systems and at the same time nearly the same number of companies (37%) experienced more-than-usual data flows to regulators.

Figure 33

Has your company set-up internal management and monitoring activities in preparation for CSCS in order to check and possibly adjust credit records? (n=408)

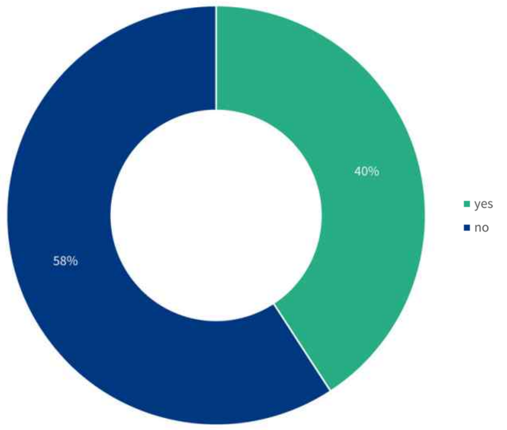
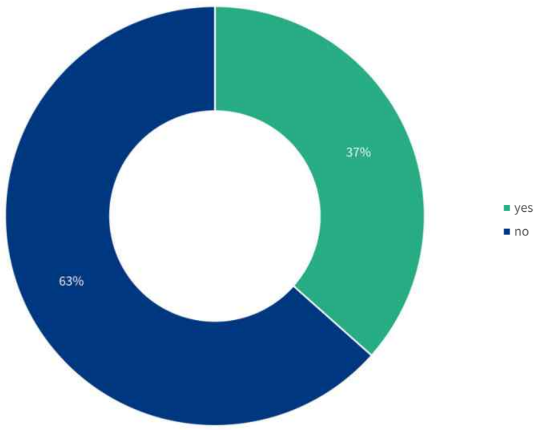


Figure 34

Has your company recorded more data flows to public authorities in the current financial year than in previous years? (n=361)



Environmental Regulations Enforcement

The protection of the environment is of utmost concern to modern industry. In 1979, the Chinese government passed its first environmental law, building a solid foundation for their national sustainability strategy. With the reform of the Environmental Protection Law at the beginning of 2015, topics such as renewable energy production, CO2 reduction measures in the industrial and transport sectors, recycling and circular economy, water treatment and electromobility gained in importance.

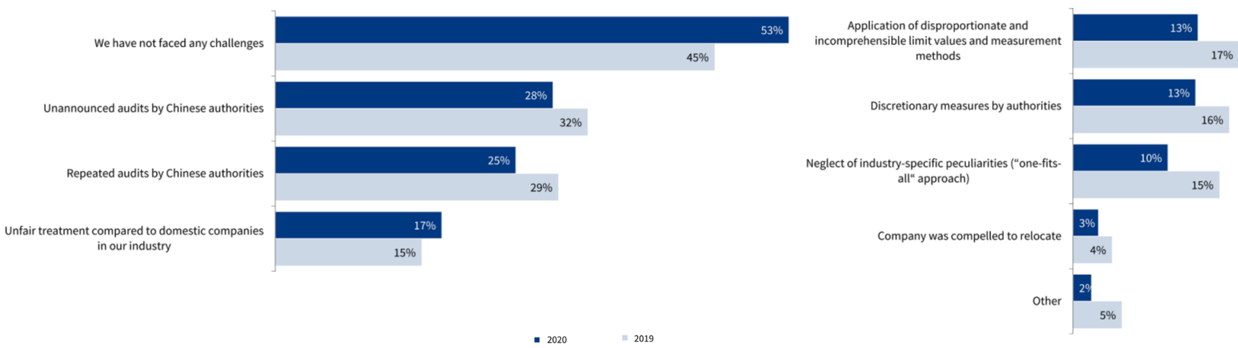
Against China's targets of **emission peak by 2030 and carbon neutrality by 2060**, the 14th Five Year Plan expected at the Two Sessions in March 2021 will reveal policy measures and actions towards them. As China take steps from going green to carbon neutral, **business opportunities may emerge** from environment related services as well as high-tech equipment. The so-called low carbon industry (including new energy equipment and vehicles, and energy-conservation and environmental protection) may double the size from 2020 to 2030, advanced equipment is expected to meet local and sectorial targets. No matter in transportation, construction, manufacturing, or infrastructure, high-efficiency equipment will be sought after. New technology will also be desired in large-scale energy storage, carbon capture, utilization and storage.

German companies operating in China give strong consideration to environmental protection and welcome the Chinese government's efforts to reduce overall pollution in China. The implementation of Chinese Environmental Laws, however, is accompanied by disproportionately strict measures that affect production, supply chains and, ultimately, the strategic investment decisions of German companies. Often, Chinese government authorities apply a one-size-fits-all approach that does not necessarily take into account industry-specific features.

Comparable to the 2019 results, again roughly half of the respondents to the survey (47% in 2020, 55% in 2019) are facing challenges with respect to environmental protection measures. In particular, the main challenges are unannounced audits (28%) as well as repeated audits (25%) by Chinese authorities. As figures compared to 2019 do not differ much, there seems to be neither a worsening nor an improving development regarding the impacts during the enforcement of the environmental regulations. This is also reflected in a lower satisfaction rate with efforts taken by the Chinese government in this regard compared to 2019 (see chapter 5 Market Access & Reform Efforts).

Figure 35

Has your company encountered any of the following issues during the enforcement of environmental protection measures? (n=422)



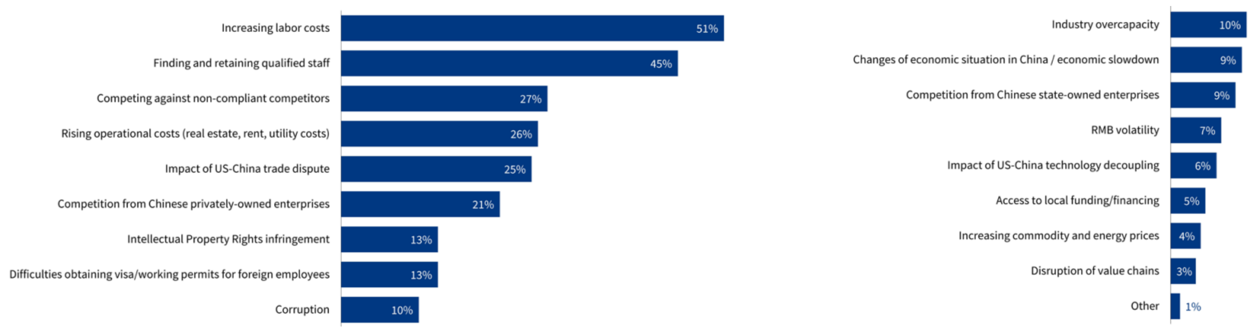
Operational Business Challenges

HR-related issues remain unchanged among the most severe operational challenges for German companies surveyed. Particularly increasing labor costs (see also the German Chamber's Labor Market and Salary Report) are challenging half of all respondents (51%), closely followed by finding and retaining qualified staff (45%). Domestic competition now plays a more significant role as for roughly one quarter of the respondents competing against non-compliant competitors is an issue (27%) as well as stronger competition from Chinese privately-owned companies (21%). Rising operational costs are challenging 26% of companies surveyed. For every fourth respondent (25%) the impacts of the US-China trade dispute pose one of their top challenges.

Last year the ranking of operational business challenges was only slightly different and was led by finding and retaining qualified staff, increasing labor cost and difficulties obtaining visa/working permits for foreign employees.

Figure 36

Please select your top 3 operational and macroeconomic business challenges. (n=476)

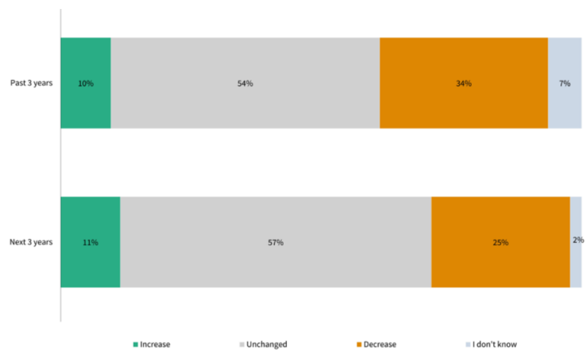


Staff Localization and Expatriate Development

Employing more local staff has been a cross-sectoral trend for German companies in China in recent years (see German Chamber's Advocacy Paper & Practical Guide, July 2020). Increasing long-standing challenges in HR coupled with strict travel restrictions since the outbreak of the COVID-19 pandemic in China, are fueling the trend towards more localization - also in HR. In terms of the development of expatriate assignees in China, more than half of the surveyed companies (54%) report no change in their expat numbers for the past three years. However, about one third (34%) have seen a reduction and only 10% an increase in foreign assignees to China. The expectation for the next three years is not differing significantly from the developments of the past three years since 57% of companies expect no change, while 25% predict a further decrease while only 10% increase of the number of expats in China.

Figure 37

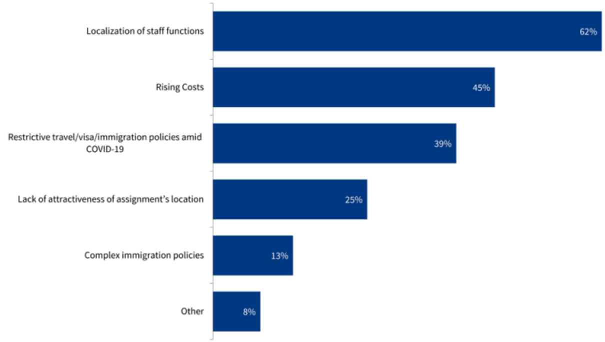
How has the number of expats and/or local foreign personnel changed in your company in China over the past 3 years and how will it develop in the next 3 years? (n=476)



For those companies who plan to decrease the number of expats in their company, this is mainly due to the localization of staff functions (62%), rising costs (45%) and restrictive travel/visa/immigration policies amid COVID-19 (39%).

Figure 38

What are the reasons for a decrease of the number of expats and/or local foreign personnel at your China locations? (n=211)



One of the top operational business challenges, the finding and retaining of qualified staff, is also linked to the restricted travel/visa/immigration policies amid COVID-19 which led to a decrease for the number of expats or local foreign personnel. Further brain drains can only be avoided with more global mobility and administrative flexibility. (see German Chamber's Advocacy Paper and Practical Guide).

COMPETITION & COLLABORATION

China's economic development has brought on a unique economic and business structure in which different levels of state-owned enterprises (SOEs) coexist and compete with a large private sector. The government seeks to increase efficiency and competitiveness of SOEs and position them as a driving force in China's economic and technological future. Depending on their role in national security and economic development, different categories of SOEs are subject to different regulations and have access to different levels of funding.

While the private sector is thriving at the same time, the halting of Ant Group's initial public offering made international headlines and was widely seen as an open conflict between dominant private business and state interests. As private enterprises are generally believed to be more innovative in many industries, the government's reforms have introduced new ways for SOEs to grow and innovate.

Hand in hand with structural reforms, China has rolled out successive ambitious plans, to make the country an innovative society, with a growing emphasis on science and technology. Not only can it follow a playbook on innovation written by catch-up countries from Japan to South Korea, but it also has unique opportunities for this: its ever-growing middle class, over 700 million internet users, and consumers who are receptive to new products and technologies. In such a large market, even small innovations often produce large returns.

Chinese officials are guiding these efforts at every stage: opening the market to foreign investors; formulating multi-year policies for science and technology as well as specific industries; cultivating an innovative ecosystem for the collaboration of industrial leaders and research establishments; and most importantly, developing various fiscal and financial programs and funds, and pouring money into where is needed.

As an indicator of progress, China has significantly risen in the ranking of the renowned Global Innovation Index, a list compiled by Cornell University, INSEAD, and the World Intellectual Property Organization: Since 2016, China has been featured in the top 25 group and has consistently climbed the rankings to be 14th in 2020.

However, transition does not necessarily go evenly across industries: China is doing well in some sectors like telecom equipment and online-based consumer services, as companies like Huawei and Alibaba have become household names and global leaders. In other sectors, like biotech and fine chemicals, China is still lagging behind advanced economies despite great efforts.

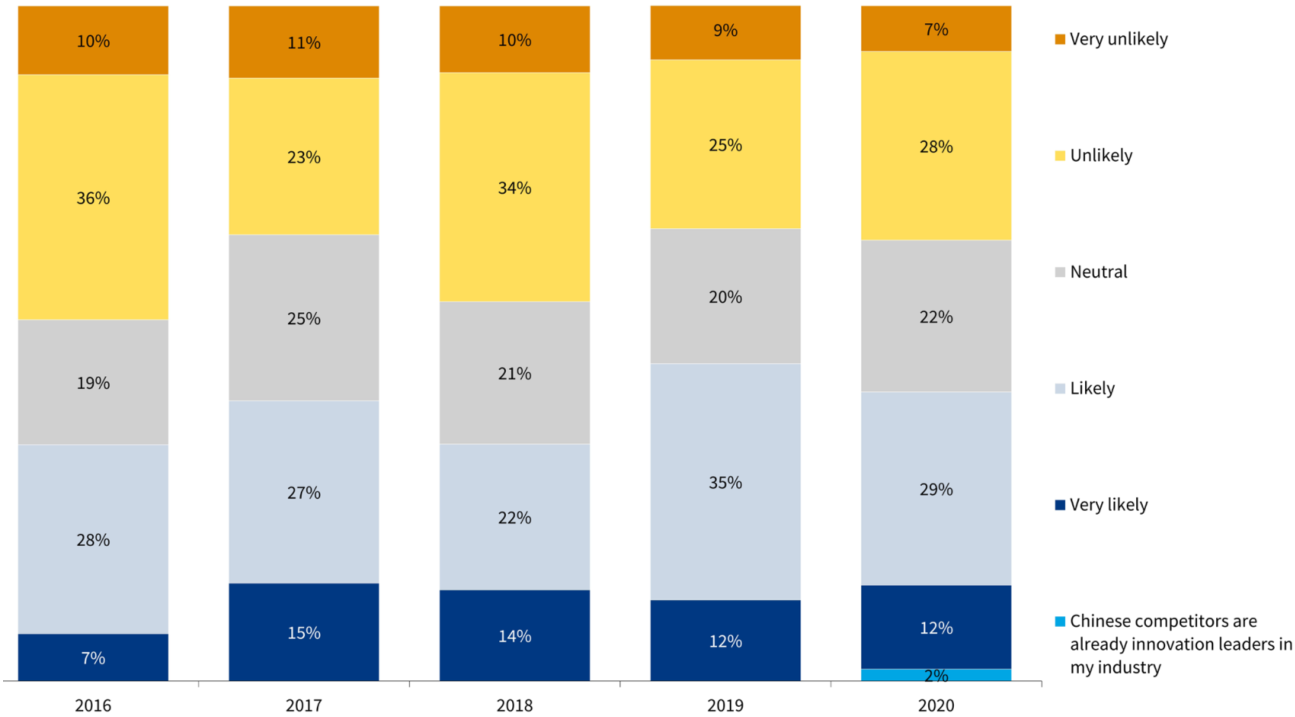
The German Chamber's Greater Shanghai Innovation Survey 2018/19 showed that most surveyed companies collaborated with external partners in doing innovation, with customers and suppliers being the most popular partners. The Survey also showed that companies are becoming more open in their choice of innovation partners, and increasingly collaborate with knowledge partners such as universities, research institutes, startups and even competitors.

Innovation Ecosystem

For 41% of the surveyed companies, it seems possible that Chinese competitors will become the innovation leaders in their industries within the next five years. This is slightly less than in 2019, when 47% of the surveyed companies stated this, which was up from 36% of the respondents in 2018. But 35% believe that it is unlikely or very unlikely that Chinese competitors will make this move, which is constant compared to 2019 (34%), down from 44% in 2018. Insofar in 2020 the overall assessment has not changed significantly from last year and currently only 2% state that Chinese competitors are already leading in their industry.

Figure 39

Do you think Chinese competitors can become innovation leaders in your industry within the next five years? (n=458)

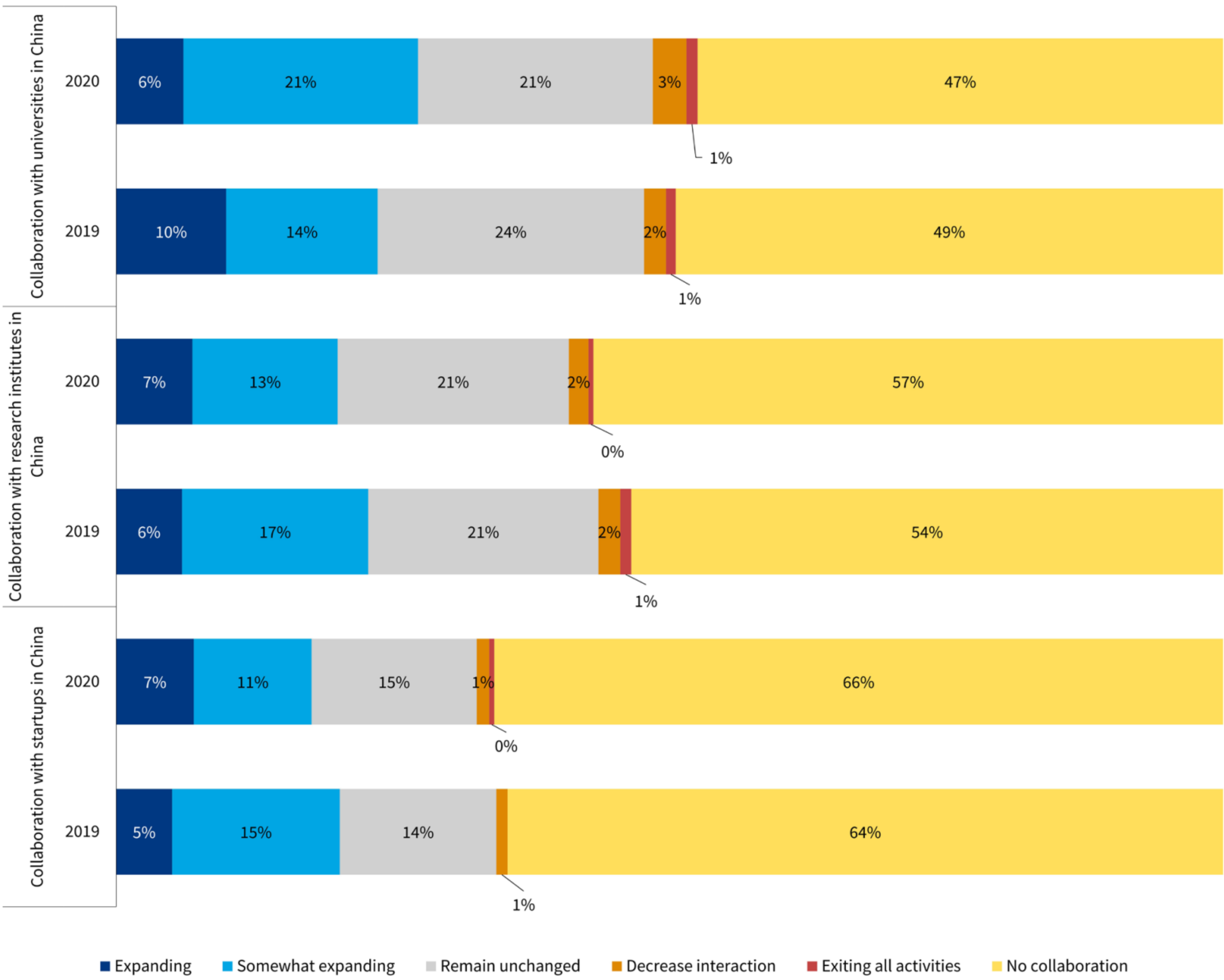


According to the findings of this survey, there is still room for further improvement regarding collaboration with startups, universities, or research institutes. Unchanged to the previous year, more than half of the companies are neither collaborating with startups, nor research institutes. The collaboration with universities in Chinas is expanding slightly (27% in 2020 against 24% in 2019). Whereas the collaboration with research institutes and start-ups is slightly decreasing.

Participants reported mixed successes with collaboration initiatives. Negative experiences mainly concern a "Take and Run" mentality, that the desired objectives are not always met and that it was difficult to find cooperation partners to collaborate with.

Figure 40

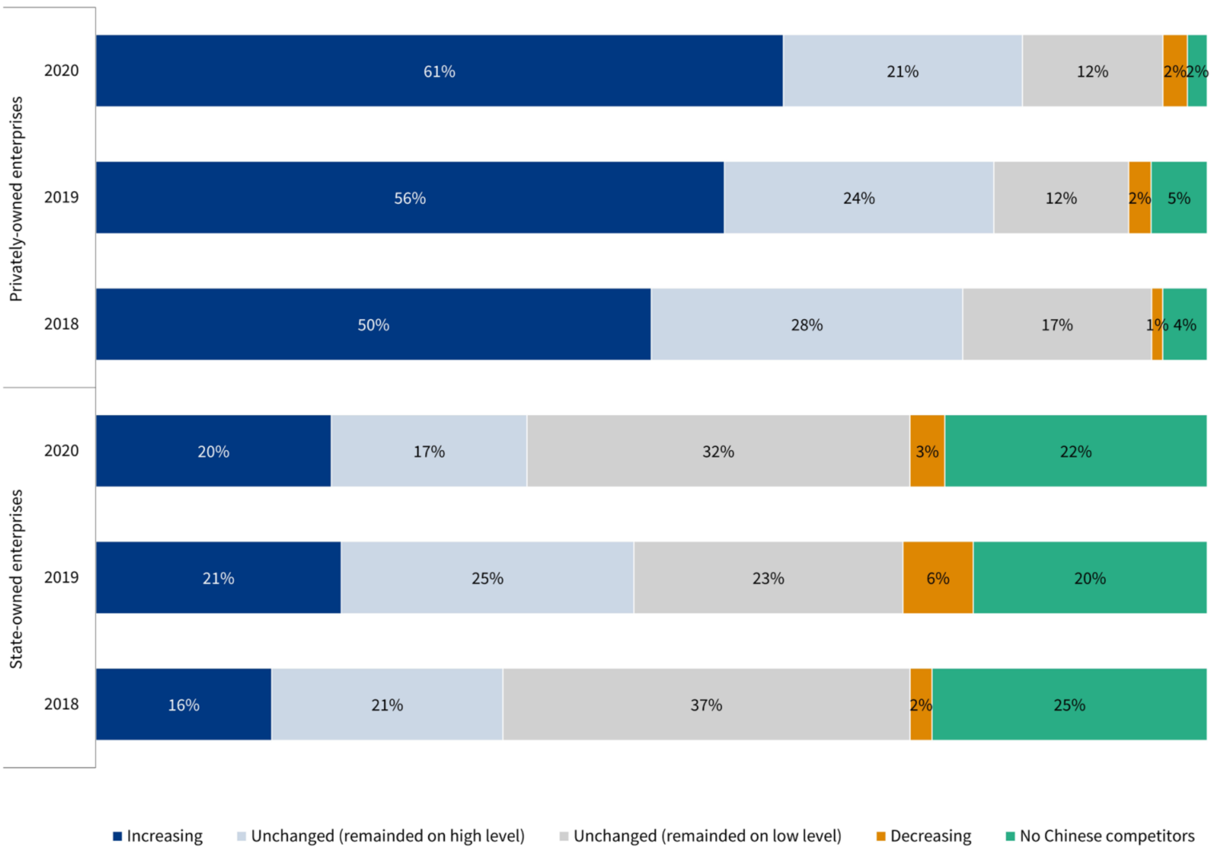
Are you collaborating with startups, research institutes as well as universities in China? If you do, how do you rate interaction and collaboration?) (n= 455)



Competing with China's SOEs & POEs

Chinese privately-owned enterprises (POEs) are becoming stronger competitors for German companies than state-owned enterprises (SOEs): 61% of the surveyed companies state that competition from POEs is increasing, up from 56% in 2019. From SOEs the rate remained nearly unchanged at 20% in 2020. At the same time 25% (prior year 26%) of the surveyed companies state that they are not experiencing competition or are experiencing decreasing competition from SOEs, whereas the same is only stated by 4% (prior year 7%) of the respondents in regard of POEs (to some extend due to the nature of their business).

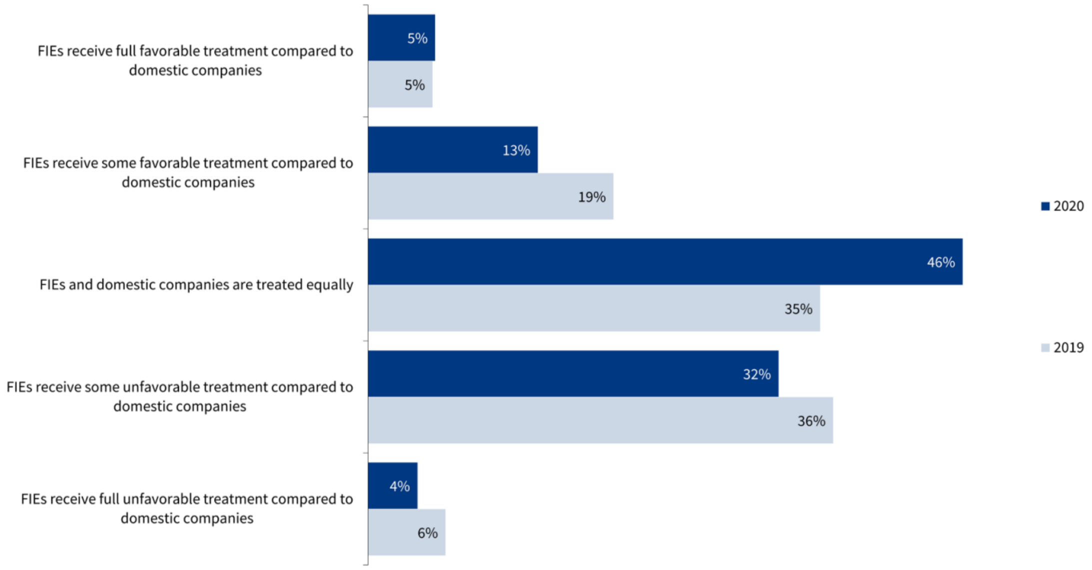
Figure 41
Please evaluate the competition your company is facing from Chinese companies.(n=462)



The picture with respect to the perception of differences in treatment between foreign and domestic companies remains diverse compared to the previous year. Roughly one third (36%) of the German companies surveyed, in particular from Business Services and Chemical industries, report that they as FIEs are treated unfavorably to some of full extent compared to domestic companies. This is a decrease of 6%-points compared to last year. This year, almost half of the companies (46%) perceive the same treatment between FIEs and domestic companies, an increase from 35% in 2019. A decreasing minority of 18% (24% in 2019) believe that FIEs receive some or full favorable treatment. The rational for this assessment needs to be considered in combination to the response of the survey on market access and business challenges.

Figure 42

In your industry, how do Chinese authorities treat Foreign Invested Enterprises (FIEs) compared to domestic companies?(n=365)

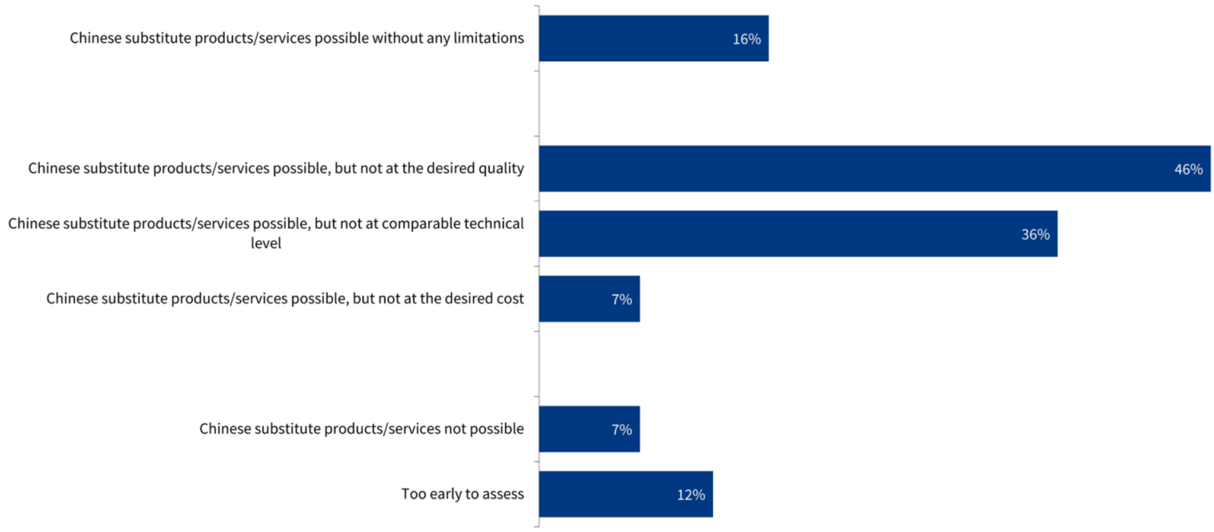


Substitution

16% of the surveyed companies assume that a short-term substitution of their products or services by Chinese equivalents would be possible without any limitations. For the overwhelming majority of 84% of respondents this does not seem to be likely to happen so fast. Roughly half of the respondents (46%) feel that a substitution by local Chinese products or services might in general be possible, yet not at the desired quality, for 36% it might be possible but not at the desired technical level and for 7% it might be possible but not at the desired cost.

Figure 43

How do you assess the feasibility, to substitute your company' s products/services with Chinese components in the next 12 months? (n=416)



PRODUCTION, LOCALIZATION & DECOUPLING

The commitment of German companies to China has many facets. On one hand, the Chinese consumer market has continuously grown in importance and has become significant in the enterprise portfolio of many German companies. On the other hand, operating costs have risen over the years, which is one of the reasons for few companies to diversify business into other countries, a strategy known as "China +1". However, our surveys continuously find that the overwhelming majority of German companies does not have any plans to move productions capacities from China to other markets, but instead German companies in China increase their levels of localization. This may encompass the localization of research and development, of sourcing, of management, and personnel, and may be done with a range of goals such as cost saving, better market adaptation and proximity to customers (businesses and consumers alike).

In the past years, China's ambition for global leadership in high tech has grown, as has its ambition to reduce dependence on global technology and supply chains. Amongst other measures, this has been expressed by target setting for domestic market share by domestic companies in certain strategic industries. While self-reliance may drive China's policy making, such plans are scrutinized from the perspective of substitution by the global business community.

Against this backdrop, the tensions between the US and China since 2018 have amplified such decoupling fears. Multinational companies depending on global supply chains are increasingly concerned about the US China tensions, especially in sectors with few alternatives to US input such as semiconductors and chips, also for the automotive industry. China's drive to promote Chinese standards heightens these fears, with worst-case scenarios requiring different sets of products, protocols, and supply chains for individual economies.

China's new Export Control Law (ECL) was introduced in 2020 and upgrades China's toolkit in protecting own interests. While on the government agenda for a while, the tensions with the US heightened the urgency, as highlighted by just one month lead time to its enaction on 1 December 2020. The ECL consolidates and codifies some long-running practices like control catalogues and permits in various regulations. Additionally, officials are granted increased power to not only enforce the law but also target specific items, countries/regions, or companies/individuals in controlling exports.

In China For China

The large majority of German companies in China manufacture for the local and Asian markets, albeit partly with worldwide supply chains. For many German companies, China is a very significant market in their enterprise portfolio (see chapter 4 Business Performance 2020 & Outlook 2021) and changes to this situation would be long-term strategic decisions. The commitment to China as a business location is even stronger than in the years before. According to the findings of this survey the vast and even increasing majority of companies surveyed (87% in 2020 against 77% in 2019) have not made any decision to move production capacity outside China, only 3% (prior year 10%) did. If any such decision was taken, the reasons behind were mainly cost-related (52%).

Figure 44

Has your company recently made the decision to move production capacity outside China?(n=458)

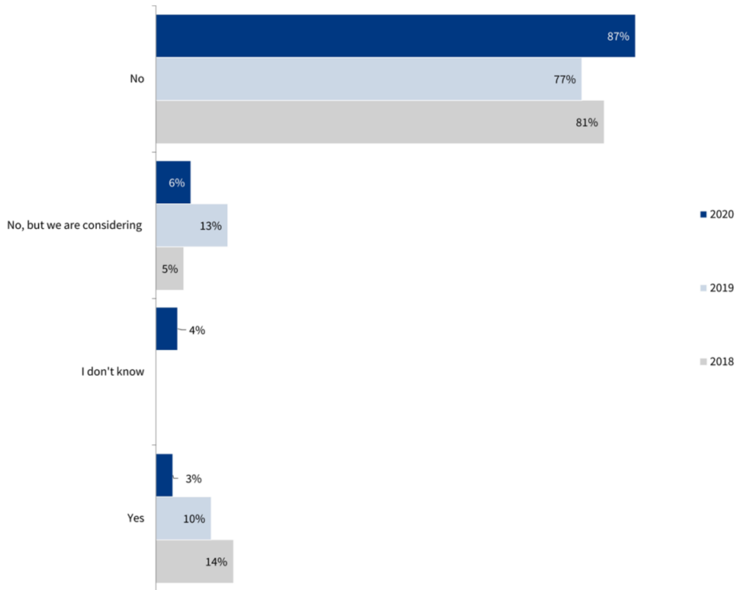
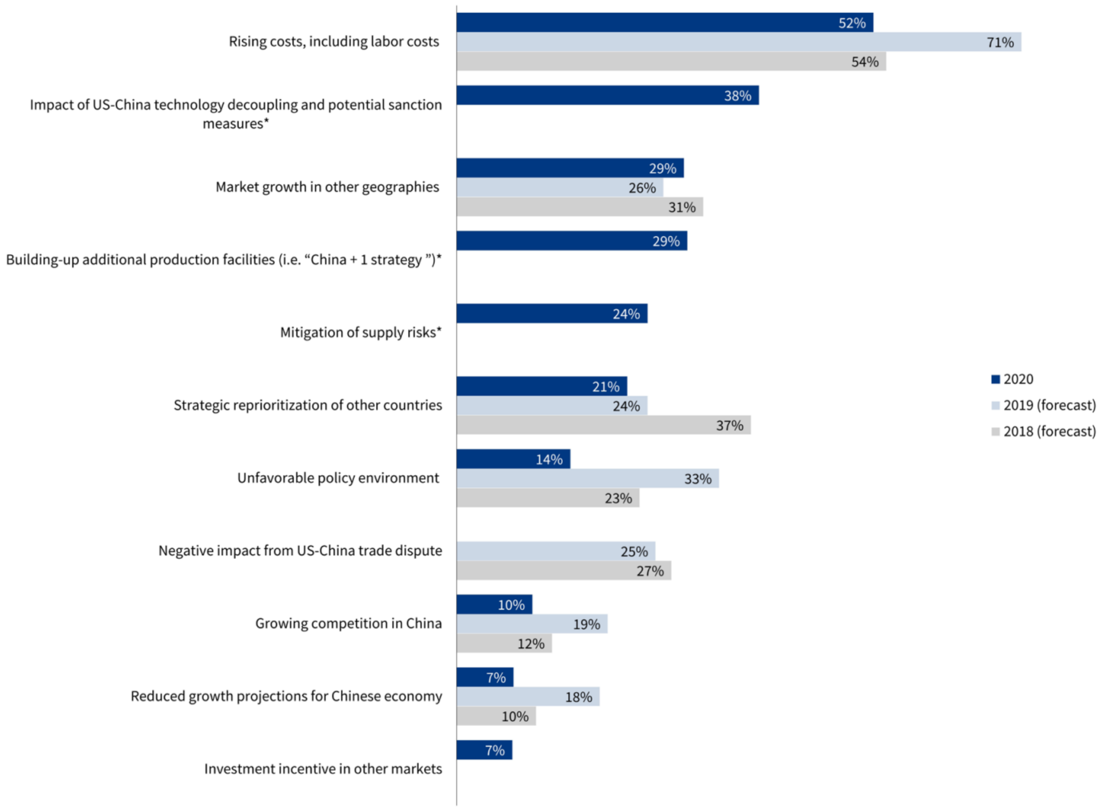


Figure 45

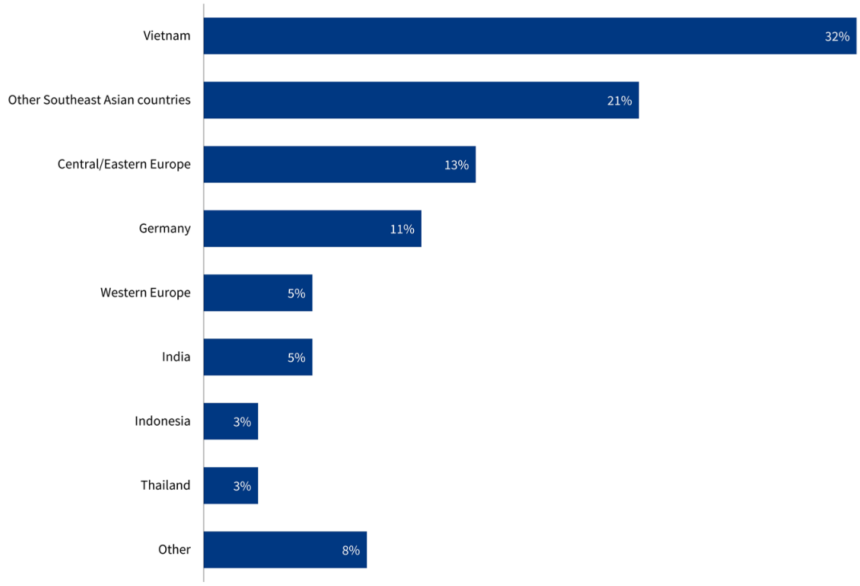
What are the most important reasons for moving part of your production capacity outside or completely leaving China? (n=42)



The limited number of companies that left China predominantly chose to relocate production, mainly as part of their "China+1"-strategy, to Vietnam (32%) or other Southeast Asian countries (21%). The attractiveness of India deteriorated significantly since only 5% in 2020 but 25% in 2019 chose to move there.

Figure 46

If your company recently made the decision to move capacity outside China, where to? (n=38)

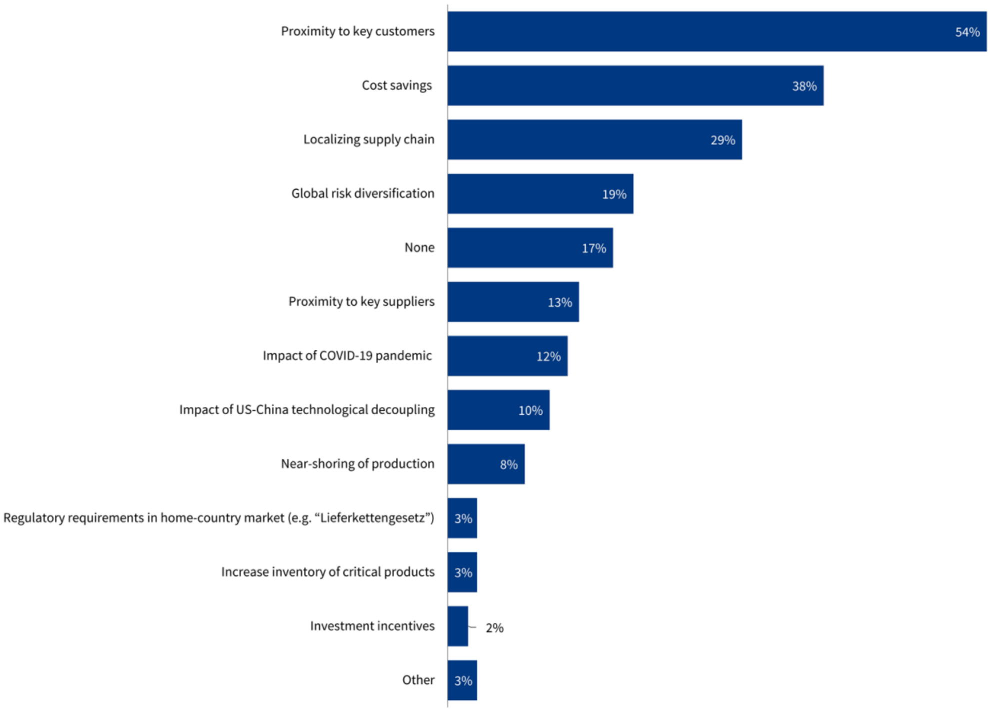


Accelerating Trend: Localization

As neither moving production capacities from China to other markets, nor divesting is an option for the vast majority of companies surveyed, further localization is much more a continuing trend: As per figure 44 above about 90% of respondents are intending to stay in China, though with differing motivations. The most prevailing motive for further localizing in China is the proximity to key customers (54%), followed by costs savings (38%) and the localization of supply chains (29%). At this point in time the COVID-19 pandemic as well as the US-China technological decoupling only play a minor role for further localization since only 12% respectively 10% stated so.

Figure 47

If you are planning to further localize in China, what are your motivations? (n=442)



Decoupling Tendencies

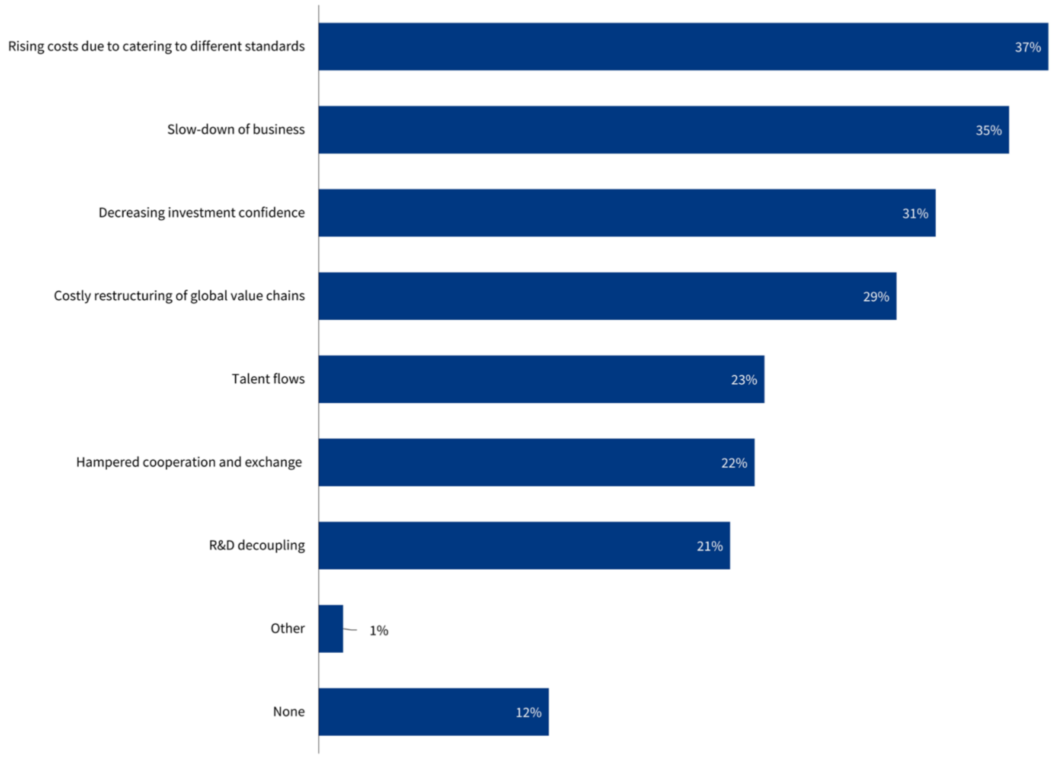
While this survey was still open during the US presidential elections, it has since become clear that under the new administration, the market in China expects a more stable and coherent US approach while there is no illusion for a reset of US-China relations. As the Biden administration prioritizes domestic issues in the first year, the tariffs from the Trump administration may remain at least for a while. On the other hand, the Biden administration may sort out the relations between national security and business interests in the technology sector, narrowing down on national security concerns while leaving space for commercial interests. A generally shared concern of German companies doing business in China is that the COVID-19 pandemic and the different technological and local regulatory requirements in major markets of the world will accelerate the trend towards global decoupling.

A worst-case scenario would be the total isolation of countries and economies. Borders and national markets would be closed, creating 'island solutions', each with its own standards and norms. Especially in the IT and telecommunication sector, companies would have to adapt to two systems and develop respective internet protocols, communication standards, and cyber security guidelines. But also, in the automotive industry, for example, companies would have to develop core technologies for each market individually.

Following these assumptions, the main risks seen deriving from rising economic and technological decoupling are increasing costs (37%), a general slowdown of the business (35%) and a decreasing investment confidence (31%).

Figure 48

What kind of business risks do you see due to rising economic and technological decoupling tendencies?(n=402)

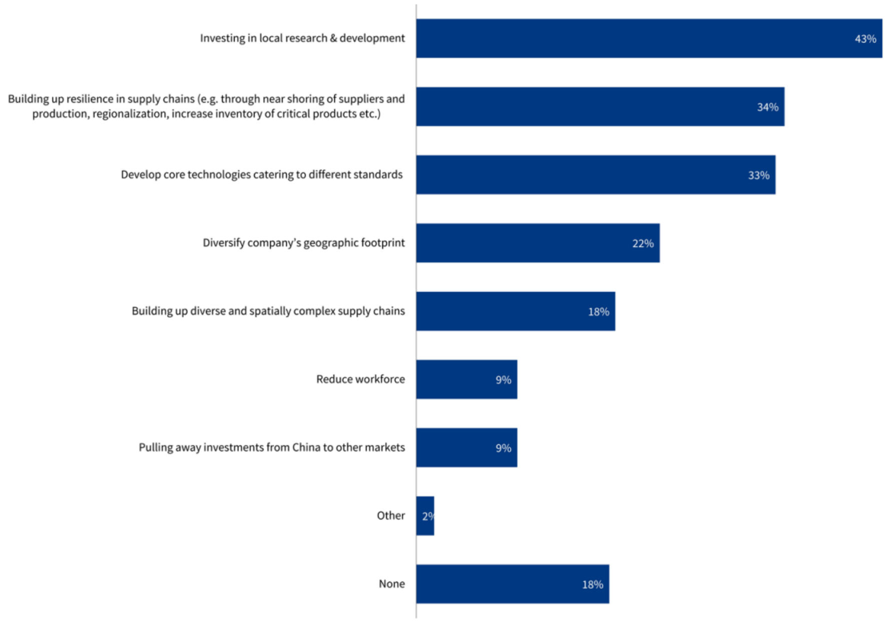


Long before the COVID-19 pandemic broke out, the US-China trade dispute had raised uncertainties among German companies in China regarding their supply chain management. COVID-19 has intensified the debate globally. Diversification of supply chains in critical industries is very likely (e.g. pharmaceuticals), but for most German companies doing business in China, it can be stated that supply chains as well as production capacities are increasingly localized.

German companies in China buy from the local market for the local market. This trend is even further accelerated by COVID-19 since proximity in terms of supply chain and products has become a decisive factor. The main consequences to mitigate rising economic and technological decoupling tendencies are investments in local R&D (43%), building-up resilience in supply chains (34%) and developing core technologies catering to different standards (33%).

Figure 49

What kind of consequences could you think of for your company to mitigate rising economic and technological decoupling tendencies? (n=368)



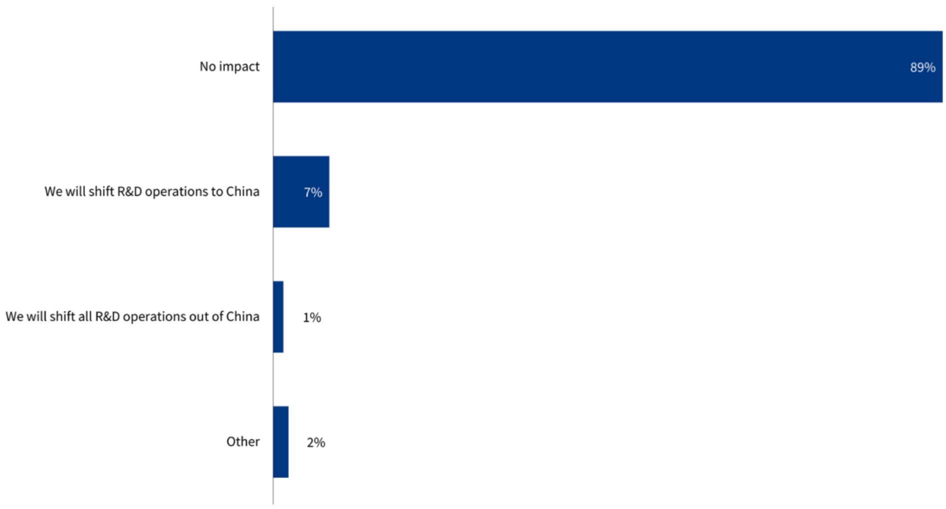
Impact of China's New Export Control Regime

China's new Export Control Law (ECL) took effect on 1 December 2020. Before the new regime came into effect, various regulations, industry-specific measures, and extensive lists were issued by several ministries since the 1980s, regulating sectors such as Chemicals, Biology, Missiles, Military Materials, Nuclear and Dual-Use Items are affecting respective enterprises. With the new ECL in effect, compliance responsibility is shifted to enterprises. Companies that export controlled goods from China or process them as preliminary or end products and then re-export them or hold shares in Chinese companies could be affected.

According to the findings of this survey, 89% of respondents report to experience no impacts from the export control framework on their local research and development (R&D) operations so far. Only 7% will shift R&D operations to China as a result from the newly introduced regime. It seems, the broader impact of the regulation us unclear as the law still contains vague legal terms in many aspects and the implementing regulations are still lacking. More precise effects will therefore only become apparent in companies' actual business practices in future.

Figure 50

How does China's recently expanded export control framework impact your company's research and development (R&D) operations in China? (n=441)



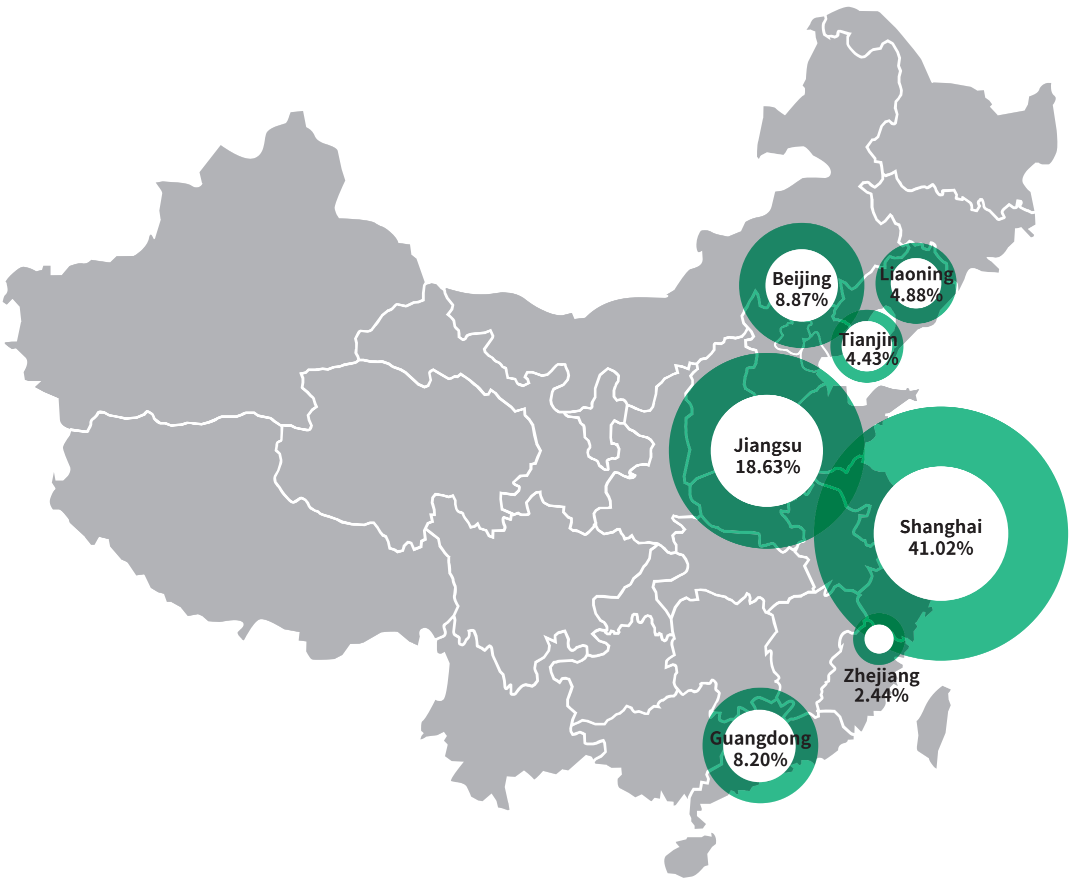
PROFILE OF SURVEYED COMPANIES

Around 5,200 German companies are active in China and have created around one million jobs (not including jobs throughout related supply chains and services). German companies in China are primarily active in industry (Automotive and Mechanical Engineering) and manufacturing. A further big group of German companies in China belongs to the sectors Business Services, Electronics, and Plastic/Metal Products. According to the Bundesbank, the accumulated direct investments from Germany in China amounted to about 86 billion euros in 2018.

The following provides a detailed profile of the 535 participating companies in the survey in 2020:

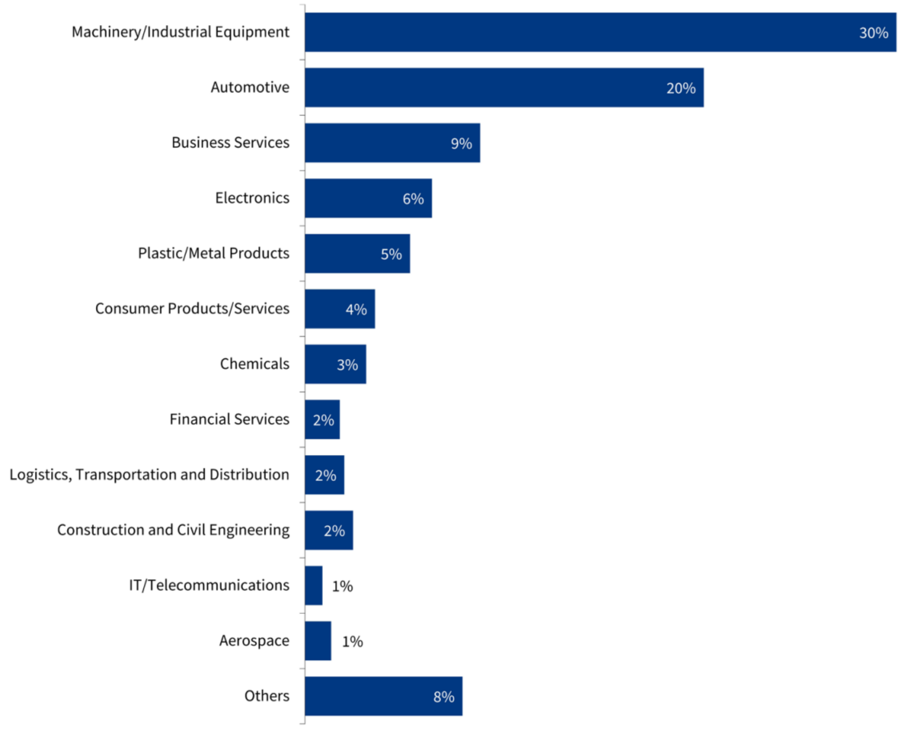
Most of the German business in China is located in coastal areas, thereby especially concentrating in the main economic clusters of the Yangtze Delta in the east (Shanghai: 41%, Jiangsu: 19%, Zhejiang: 2%), the Bohai Economic Rim in the north (Beijing: 9%, Liaoning: 5%, Tianjin: 4%) and the Pearl River Delta in the south (Guangdong: 8%).

Figure 51
In which province/region/city is your company located? (n=451)



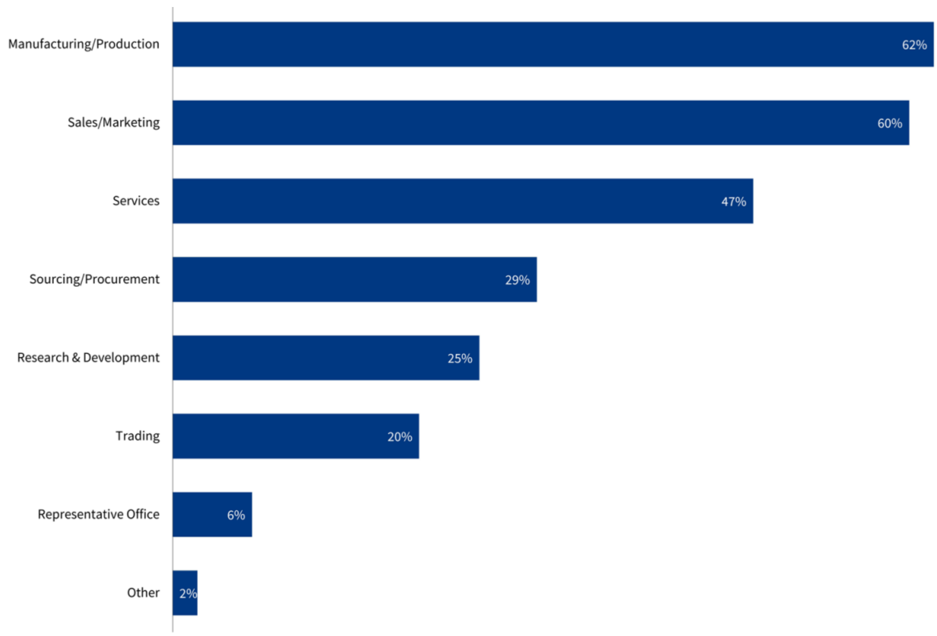
Traditionally, German companies in China engage in industries such as Machinery/Industrial Equipment (30%) and Automotive (20%) as well as Professional Business Services (9%) – summing up to more than half of all respondents. The remaining other half of respondents consist of companies from a broad range of different industries, with Electronics (6%) and Plastic/Metal Products (5%) making up another 10% share.

Figure 52
Please specify the main industry of your company. (n=451)



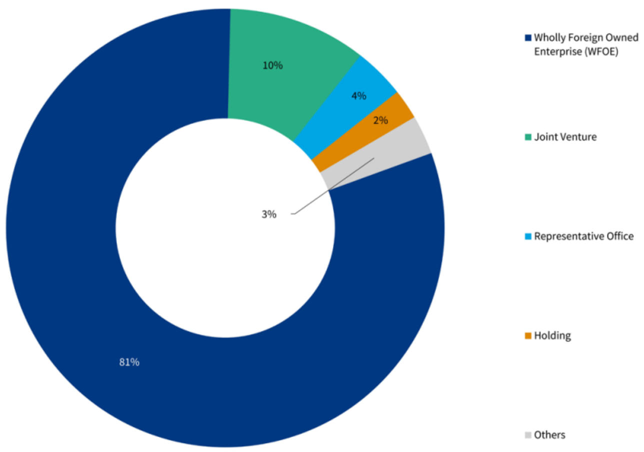
Manufacturing/Production (62%) and Sales/Marketing (60%) are the main fields of business for more than half of the respondents, while Services (47%) are following thereafter. More than one quarter of the surveyed companies are active in Sourcing/Procurement (29%), and another quarter in Research & Development (25%).

Figure 53
Please indicate your local entity's main field of business. (n=451)



The majority of German companies in China is organized as Wholly Foreign Owned Enterprise (WFOE), constituting 81% of the respondents and by far exceeding Joint Ventures (10%), Representative Offices (4%) and Holdings (2%).

Figure 54
Please indicate the legal status of your company in China. (n=451)



In terms of local personnel, small and medium sized enterprises (SMEs) still constitute the largest share among German companies in China with two thirds employing less than 250 employees at their company's local operation. Another 20% employ in a range of 251 to 1,000 employees in China.

More than half of the surveyed German companies operate in China for more than 15 years (53%); 21% for 11 to 15 years; 15% for 7 to 10 years; and around 10% for less than six years.

Figure 55
Please indicate the number of employees working at your company's local operation. (n=451)

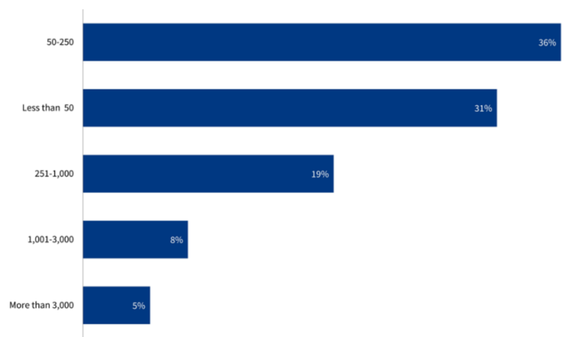
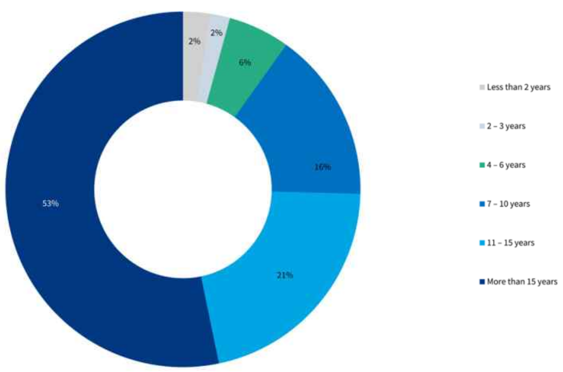


Figure 56
How long has your company been physically present in China? (n=445)



METHODOLOGY

This report is based on the German Chamber of Commerce's yearly Business Confidence Survey, which – since 2007 – has been a key instrument for measuring the business sentiment of German companies operating in China.

The online survey was conducted from 19 October 2020 to 30 November 2020 among all member companies in Mainland China. In total, the questionnaire comprised 54 questions focusing on business performance and outlook, market access and reform efforts, business challenges, competition and collaboration, investment confidence, production, localization, and decoupling.

535 valid responses were collected (approximately 23% of the membership of the German Chamber of Commerce in China), resulting in a representative sample for the analysis of German companies in China. Compared to earlier Business Confidence Survey studies these figures are stable.

This report is complemented by the German Chamber's previous publications such as earlier Business Confidence Surveys, Flash Surveys, Advocacy Papers as well as extensive data from publicly available economic data.

The results of the German Chamber's Flash Surveys 2020 related to the implications arising from the COVID-19 pandemic had been released separately last year with latest figures in December 2020 and are available online: https://china.ahk.de/market-info/economic-data-surveys/flash-surveys.

CONTACTS

German Chamber of Commerce in China

The German Chamber of Commerce in China currently has more than 2,300 members in mainland China and is the official member organization for German companies in China. By providing up to date market information and practical advice, the German Chamber helps its members to succeed in China. It offers a platform for the Sino-German business community and represents its members' interests towards stakeholders including government bodies and the public.

#PartnerForAdvocacy

German Chamber of Commerce in China | North China

Landmark Tower 2, Unit 0818
8 North Dongsanhuan Road
Chaoyang District, Beijing 100004
T +86 10-6539-6688
chamber@bj.china.ahk.de

German Chamber of Commerce in China | Shanghai

29/f Gopher Center
No. 757 Mengzi Road
Huangpu District, Shanghai 2000023
T +86 21 5081 2266
chamber@sh.china.ahk.de

German Chamber of Commerce in China | South & Southwest China

Room 1903, Leatop Plaza
32 Zhu Jiang East Road
Tianhe District, Guangzhou 510620
T +86 2087552353
chamber@gz.china.ahk.de

Lisa Fischbach

Director Media & Public Relations
T +86 10-6539-6670
fischbach.lisa@bj.china.ahk.de

KPMG AG Wirtschaftsprüfungsgesellschaft

KPMG is an organization of independent member firms with around 220,000 employees in 147 countries. KPMG in Germany is one of the leading auditing, tax and advisory firms in Germany and has around 12,600 employees at 26 locations.

KPMG in Germany

Andreas Glunz
Managing Partner International Business
T +49 211-475-7127
aglunz@kpmg.com

Jack Cheung
Partner, Head of Global China Practice in Germany
T +49 211-475-6688
JackCheung@kpmg.com

KPMG in China

Andreas Feege
Seconded Partner, Head of German Desk
T +86 10-8508-5000 ext 4455
a.feege@kpmg.com

Norbert Meyring
Partner, Head of Multinational Clients
T +86 21-2212-2707
norbert.meyring@kpmg.com

Published by

German Chamber of Commerce in China

www.china.ahk.de

LinkedIn WeChat Weibo

in cooperation with

www.kpmg.com

www.kpmg.de/socialmedia