2016 China Business Survey

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

2016 Swiss Business in China

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2016 Swiss Business in China

A CEIBS – Swiss Center Shanghai Survey & China Integrated Analysis

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China Europe International Business School

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Exclusively involved in China trade, investment, strategy and project management, he has resided 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), Nicolas 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 supporting international companies in successfully establishing and developing their businesses in China, whether their needs are market entry, growth or acquisition. Building on 20 years of experience and the skills of internationally trained Chinese professionals, China Integrated provides the expertise needed to ensure the long-term, superior success of foreign businesses in China. China Integrated's team is comprised of about 25 skilled entrepreneurs, strategists, managers, engineers and service professionals with complementary backgrounds in business research, Chinese law, recruitment, tax, finance, IT, ERP and PR.

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 company research and experience, China Integrated regularly publishes books and analyses to facilitate the decision making of managers at international companies doing business in 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 2015 Business in China Survey, which analyzes the business landscape for foreign companies in China.

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

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Founded in 2000 as a non-profit, Sino-Swiss, public-private partnership, Swiss Center is by far the largest cluster of Swiss enterprises in Asia. With five locations strategically located on the dynamic East coast of China (Shanghai, Beijing and Tianjin), Swiss Center not only offers virtual and instant office space as well as ready-to-use workshops and showrooms, but also supports member companies with government relations, technology transfer and a broad network of experts. Swiss Center has served more than 300 companies in China – both SMEs and large enterprises. Swiss Center experts have established 30 production companies and more than 50 commercial offices for Swiss companies. Swiss Center also conducts surveys and expert analyses of China's business opportunities and challenges, and at the same time promotes the Swiss Made brand and Switzerland as a country for innovation and an industrial leader.

Aline Ballaman is the General Manager of the Swiss Centers China. 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 program at Suzhou University before joining the Swiss Center Shanghai in 2012 as Operation Manager. For the past four years, she has been responsible for the Shanghai Office in advising and supporting Swiss businesses entering the Chinese market. In early 2014, she managed a new and successful 4000 sqm facilities project dedicated to Swiss businesses complete with a showroom, offices, and a warehouse in the China (Shanghai) Pilot Free Trade Zone.

Emmanuelle Roduit holds a Bachelor of Science in History and Political Economy from the University of Fribourg, Switzerland. She also holds a diploma in Hospitality Management from the Hospitality School Geneva. Emmanuelle has spent the past 3 years working in multiple regions of of China (Beijing, Inner Mongolia, and Shanghai). Emmanuelle has worked both for Chinese and foreign companies in different business areas such as hospitality, wine and tea. Emmanuelle joined in 2015 the Swiss Center Shanghai as the Operation Manager.

Jérémy Chiffelle works for swissnex China as a Junior Project Leader. He finished a commercial apprenticeship at Emile Egger & Cie SA, an international SME, and is currently pursuing a Bachelor in Business Administration at the University of Applied Sciences in Neuchâtel.

swissnex's goal is to promote Switzerland's excellence as one of the world's leading countries in the fields of innovation, research, technology and higher education, to connect academia and business and to facilitate cooperation between China and Switzerland.

PREFACE & KEY TAKEAWAY

In cooperation with the China Europe International Business School (CEIBS) [1], the Swiss Center Shanghai [2], China Integrated [3], the Embassy of Switzerland in Beijing [4], swissnex China [5], Switzerland Global Enterprise [6], and SwissCham [7] are pleased to bring you the findings of Swiss respondents who participated in the CEIBS Business in China Survey 2016. In analyzing these responses, we intend to **draw conclusions that 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 790 responses, this survey gathers the **largest amount of respondents in one such yearly survey** (by comparison there are 406 in the 2016 American Chamber in Shanghai survey and 541 in the 2015 European Chamber in China survey).

- It is the only survey that collects responses from **both Chinese and foreign companies** in China. Furthermore, this year's edition once **again contains a unique analysis of international and Chinese SMEs**.

- This survey allows **comparisons among firms of different national origins that operate** in China, based on a sufficient number of replies from each region.

This is the **only business survey that is able to gather a sizeable sub-sample of foreign and Chinese SMEs** in China. Though just around 30 foreign (Swiss, EU, US) companies employing 300 employees or less globally (classified as SMEs) answered the survey, this sample and a sample of 200 Chinese SMEs show that SMEs are maintaining stability in the face of slower economic growth.

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

Comparisons with findings on European and American companies allow us to feel comfortable about the accuracy of the major trends affecting Swiss companies that we report on, despite the small absolute number of respondents (around 100).

Generally speaking, **Swiss, international and Chinese companies are doing well in China**. Over 50% of Swiss, EU, and US companies stated an intention to increase investments in China in 2016.

Challenges are also growing for foreign companies. For the third year in a row, competition from private Chinese companies is perceived to be more important than competition from other foreign firms.

R&D has increased as a priority for Chinese businesses; an initiative that one can see reflected in the shift toward quality from Chinese SMEs and continued strength of the Chinese respondents as competitors in general.

[1] *http://www.ceibs.edu/*
[2] *http://www.swisscenters.org/*
[3] *http://www.ch-ina.com*
[4] *https://www.eda.admin.ch/beijing*
[5] *http://www.swissnexchina.org/en/*
[6] *http://www.s-ge.com/en*
[7] *http://cn.swisscham.org/*

In terms of **internal challenges**, as always, **attracting top talent tops the list of foreign companies' and Chinese SMEs' managers**, **however, Chinese companies see innovation as a far bigger challenge than foreign companies do**.

Managers of foreign companies 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 a top management challenge**. This illustrates the continuing **perception gap between head offices and their subsidiaries** operating in China.

Contrary to what is usually reported in the media, **international companies continue to succeed** in the form of growing sales and profits in China, despite slower growth.

In addition, we find **a general overestimation of the impacts that corruption and IP infringements have on foreign companies** in China. In fact, corruption and IP infringements rank in the bottom third of reported external challenges by respondent companies.

The slower economy has a silver lining though: employees are much more stable. For Swiss companies, "retaining talent" has dropped from a top 3 HR management challenge to a much less relevant 6th place.

Finally, with 70% expecting increasing sales, Chinese SMEs are extremely positive for 2016, and more so than all other categories of firms. This indicates that **reforms directed to support the private sector in China are working**.

Hopefully, this latest survey edition will contribute to **the clarification of common misperceptions and highlight the actual situation that Swiss and international businesses face in China**.

Additionally, we hope that these facts, analyses and the benchmarks that they provide will help Swiss companies to be even more successful in the coming years, if only by providing facts that will improve the understanding of headquarters.

We also want to express our sincere gratitude to all the respondents: thanks to them, a representative and objective point of view on Sino-Swiss business is available to all. At the same time, we would like to take the chance to encourage everyone to participate in the 2017 survey, so that we can further expand the knowledge pool available and continue to do successful business in China.

The first part of this report emphasizes Swiss companies, with specific comparisons between Swiss and Chinese companies, SMEs and larger companies, and companies of Swiss, American, European, and Chinese origin. The overall results of the CEIBS survey and analysis of foreign and Chinese companies are presented in the second part of the report.

1 FOREIGN COMPANIES, AND SMES IN PARTICULAR, CONTINUE FINDING BETTER SUCCESS IN CHINA

Approximately 15% of foreign respondents can be classified as small and medium enterprises (SMEs), defined as companies with less than 300 employees globally, just more than 46% are large companies with over 10'000 employees worldwide. SMEs are even more prevalent among Chinese companies sampled, with nearly 45% qualifying as SMEs in contrast to just 12% with over 10'000 employees.[5]

Of the foreign companies sampled, **Swiss companies present the largest proportion of SMEs, totaling nearly 20% of Swiss respondents**. By comparison, other western SMEs are much less represented with only 5% of European and 6% of American companies employing less than 300 employees globally.

These figures do not necessarily represent the proportion of SMEs in the total number of foreign companies.

Yet, it is reasonable to believe that Swiss SMEs are proportionally more numerous in China than respondents of other nationalities. Indeed, due to the small size of the Swiss domestic market, Swiss SMEs need to be more adapted and geared towards internationalization than those originating in larger western markets.

Taken together, the sample of around 30 foreign SMEs that answered the survey is similar in size to the samples in 2013, 2014, and 2015. This sample is still small, but it allows for comparisons with larger foreign companies. Considering that the proportion of the 2016 SME respondents from different countries and other 2016 findings are generally consistent with those of previous years, we are generally confident in the relevance of the results despite small samples.

[5] *(A significant proportion of Chinese companies sampled did not have operations abroad. As a result, Chinese SMEs have been defined according to the number of their employees in China.)*

Again this year, this survey allows us to make comparisons between foreign invested and Chinese SMEs.

Interestingly, in terms of company size (both globally and in China), the Swiss set of respondents is closer to the Chinese set. The US and EU companies who participated are generally bigger (both globally and in China) than the Swiss and Chinese companies:

FIGURE 1 - HOW MANY EMPLOYEES GLOBALLY?

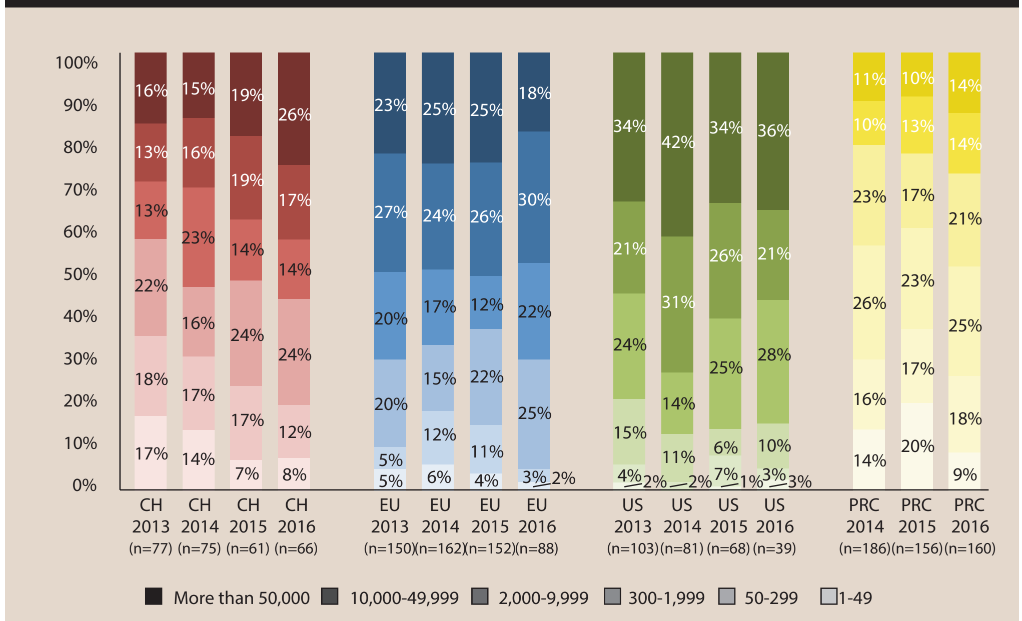
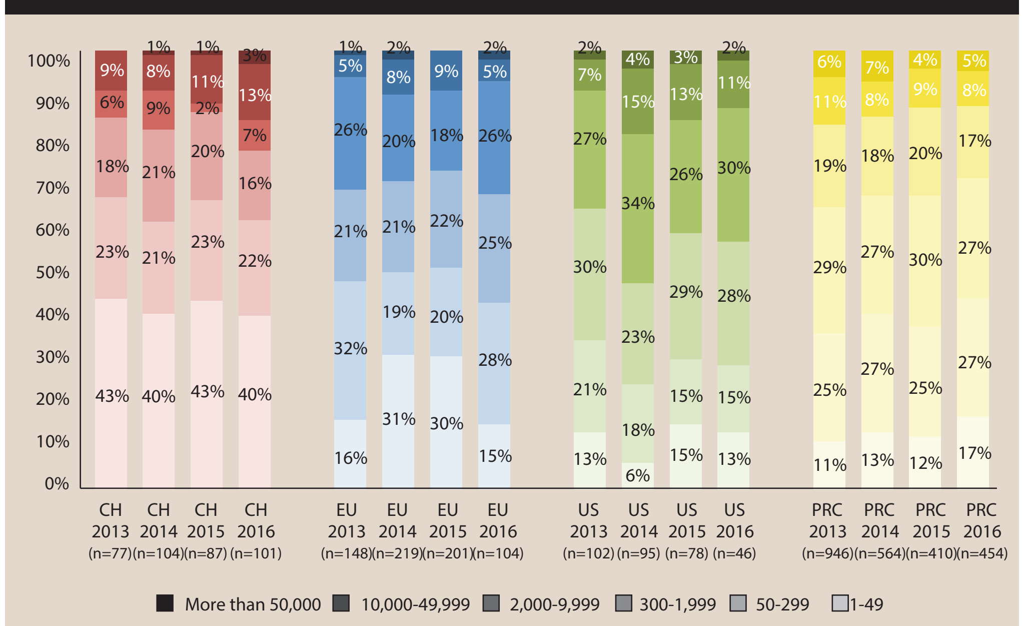


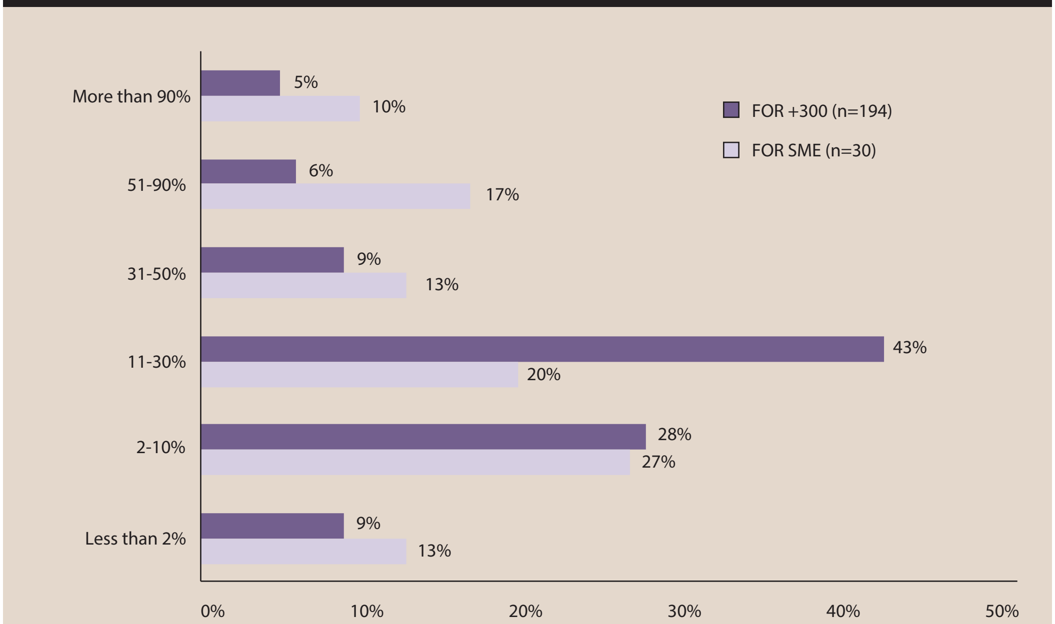
FIGURE 2 - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?



1.1 Conditions remain positive for SMEs in China

Foreign SMEs in China are seeing higher percentages of their global sales generated in China. 11% of large foreign firms expect more than half of their sales to be generated in China, against 27% of SMEs:

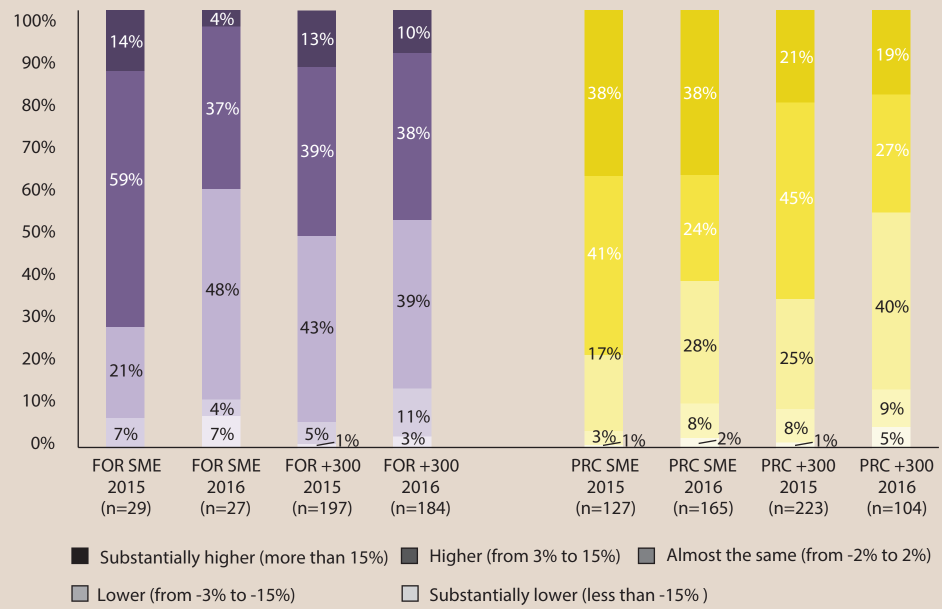
FIGURE 3 - WHAT PERCENTAGE OF YOUR COMPANY'S GLOBAL SALES IN 2015 WERE GENERATED IN CHINA? FOREIGN COMPANIES



This year, foreign SMEs report slightly lower profit growth projections than their counterparts in larger firms. The proportion of SMEs seeing increased profits in 2016 (41%) is less than the larger firms (48%). However, only 11% of foreign SMEs expect lower profits in 2016 compared to 2015, while 14% of larger companies do.

Chinese SMEs, as in the previous survey, expect better profits than larger companies.

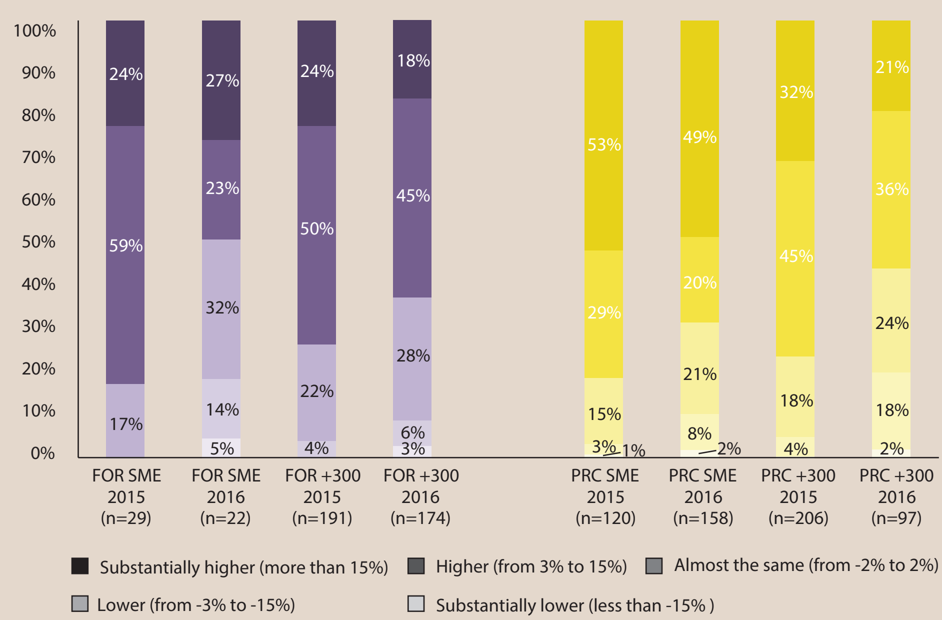
FIGURE 4 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA PROFIT THIS YEAR COMPARED TO LAST YEAR? SME VS. LARGER FIRMS



While foreign SMEs have a less optimistic outlook than in 2015, respondents report largely positive expectations, with 50% looking forward to increased sales and another 32% expecting similar sales. Larger international firms, however, forecast significantly better increases in sales than international SMEs expect less loss than larger Chinese companies.

Chinese SMEs have the highest sales growth expectations of all respondents in 2016, with nearly 70% looking forward to increased sales, outpacing larger firms under both foreign and Chinese ownership:

FIGURE 5 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES THIS YEAR COMPARED TO LAST YEAR? SME VS. LARGER FIRMS



1.2 Less intense challenges for SMEs

When examining how SMEs and larger companies perceive challenges, few critical differences can be noticed with one exception: Chinese SMEs do suffer more than their foreign counterparts from rising labor costs and competition, indicating that they have lower margins or are less organized in increasing their efficiency. Indeed, improving productivity has clearly become a new imperative due to rising costs and minimum wages while sales prices are also under pressure.

It is also worth noting that Chinese SMEs appear to feel much less of an impact from the global economic slowdown, indicating a more local orientation of Chinese SMEs' activities.

One may note additionally that foreign SMEs perceive the top challenges with less intensity than the larger foreign firms (Economy Slowdown in China: 54% versus 68%; Fierce Competition: 43% versus 65%; Rising Labor Costs: 51% versus 58%). It can be interpreted from this that SMEs are conducting business in China with more ease.

Reduced challenges for SMEs when compared to larger firms could well be due to SMEs' very nature of doing business: focusing on niches. Indeed, China's mass market is very attractive, but therefore also terribly competitive. Niches, however, are less crowded.

Chinese SMEs, too, report less pronounced challenges than larger Chinese companies.

This is confirmed as well by the competition picture (pg 20): there are no fundamental differences between SMEs and larger firms with the exception that more SMEs have few to no major competitors, which is typical of niche businesses.

FIGURE 6 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? SME (MULTIPLE ANSWERS)

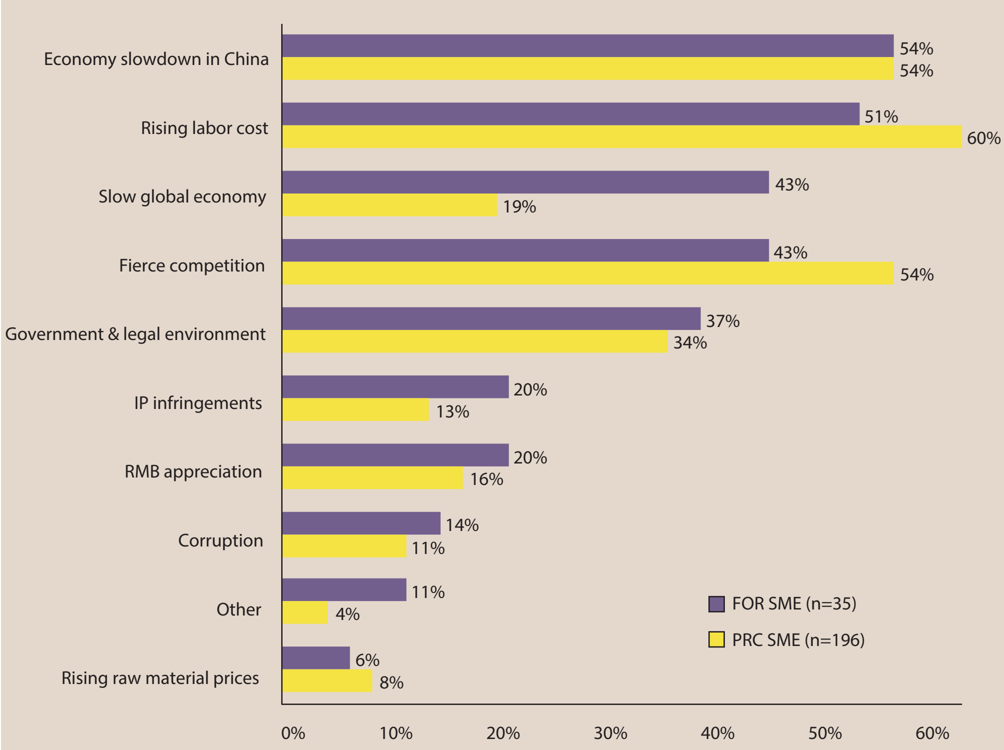
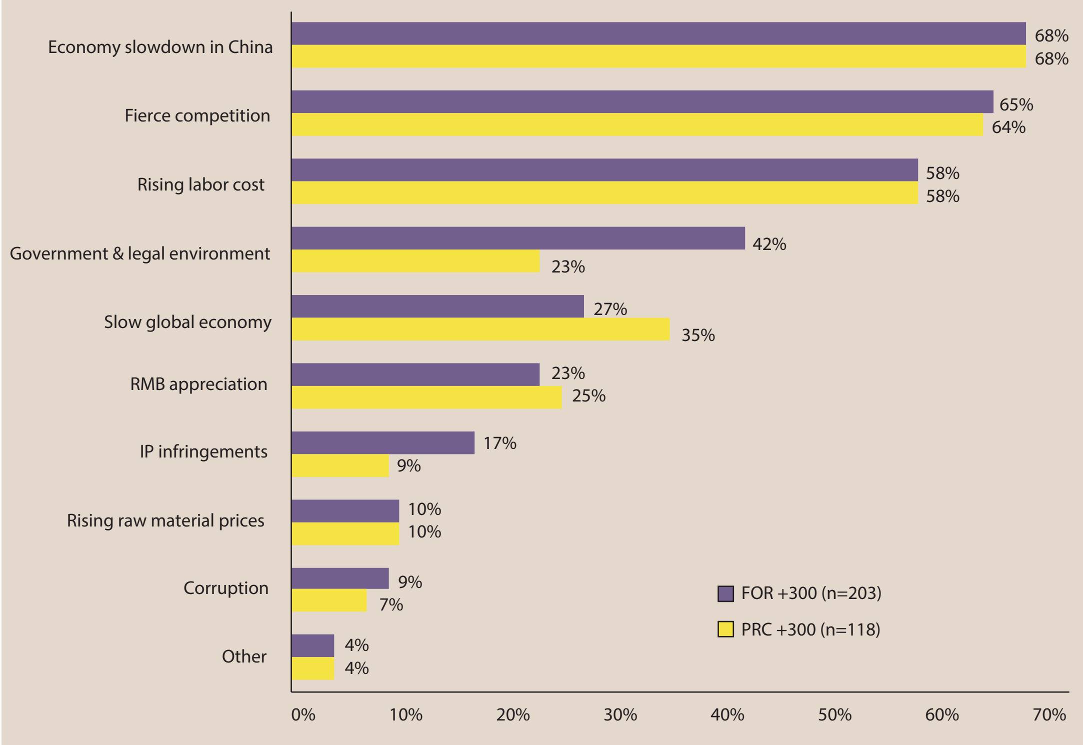


FIGURE 7 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? LARGER FIRMS (MULTIPLE ANSWERS)



A noticeable difference is found between foreign and Chinese companies with regard to competition from state-owned enterprises (SOEs), with **Chinese companies of all sizes viewing SOEs as competitors markedly more than foreign companies do**. This may be attributable to restrictions in certain industries that prevent foreign companies from operating in some of the areas where state-owned companies are active.

FIGURE 8 - WHO ARE YOUR MAJOR COMPETITORS IN CHINA?
SME (MULTIPLE ANSWERS)

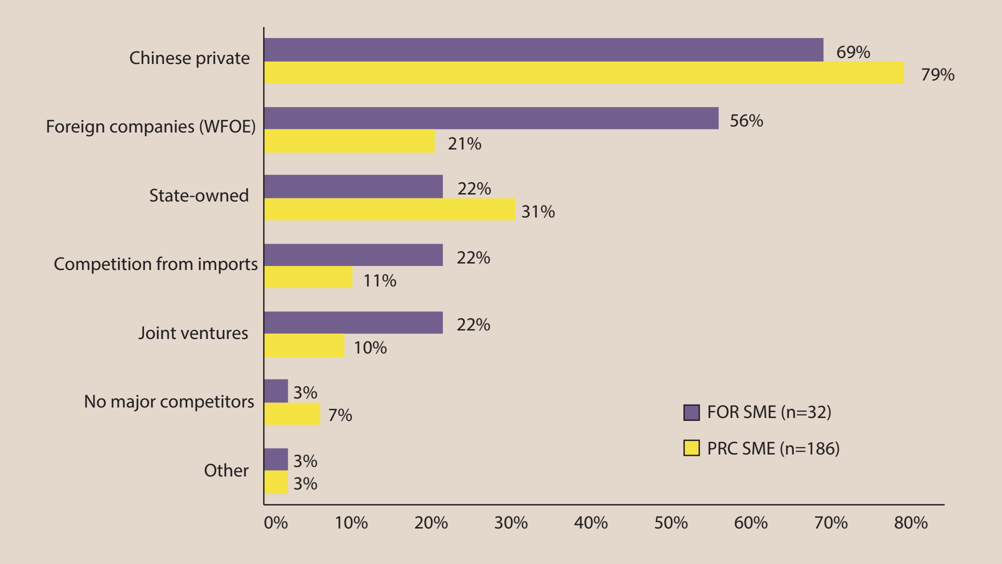
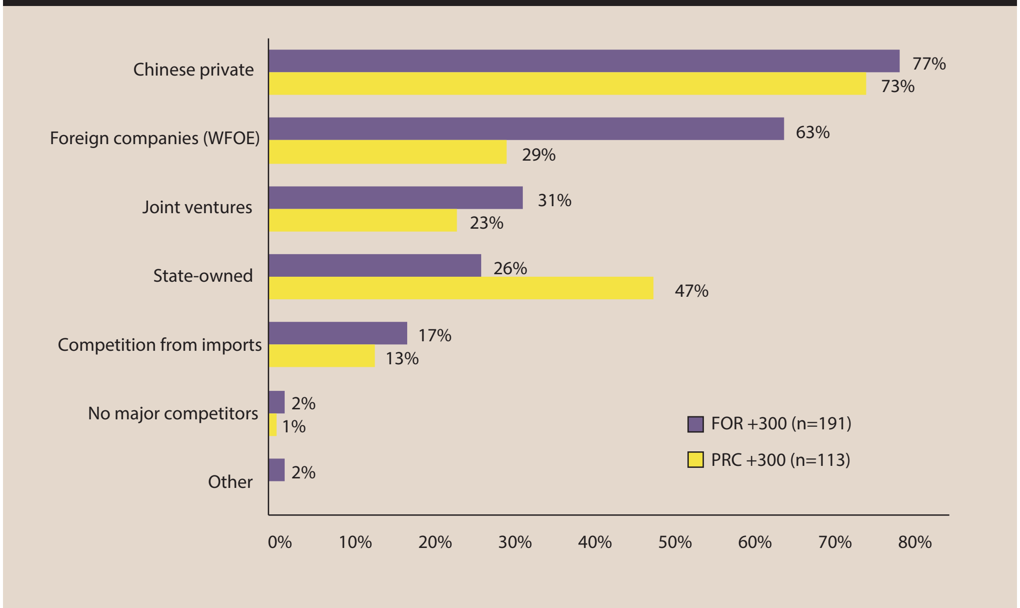


FIGURE 9 - WHO ARE YOUR MAJOR COMPETITORS IN CHINA?
LARGER FIRMS (MULTIPLE ANSWERS)



This year again, Chinese private companies are regarded as the most imposing competitors, while Wholly Foreign Owned Enterprises (WFOEs) are seen by other foreign companies as a close second largest source of competition.

Internal challenges do not differ greatly between SMEs and larger companies. However, “Support from the head office” is of greater concern to large foreign firms than it is to SMEs, suggesting that foreign SMEs’ headquarters are closer to their subsidiaries and more able to understand local trends.

“Corporate governance” is clearly a greater internal challenge for Chinese firms than it is for foreign firms, suggesting a difficulty in managing businesses within a tightening regulatory environment, whereas foreign firms likely have stronger governance provisions in place as a prerequisite from having operated in other countries.

“Innovation capability” is an issue especially present for Chinese companies, **and is the top challenge for large Chinese companies**. Nevertheless, “Finding and retaining talent” is listed by Chinese SMEs and large companies as the top internal challenge for the second year in a row.

It is noteworthy that Chinese companies of all sizes state more of a challenge posed by marketing capabilities than foreign companies do. This may be surprising given that Chinese companies have grown through the domestic market and are not faced with the same distance-from-headquarters issues that foreign companies are. This may speak to the ability of foreign companies to differentiate through innovation, being able to offer better products and services and leveraging marketing skill to maximize these advantages.

It can also be seen in the next section that foreign companies place great importance on the development of strong brands and may also be more effective than their Chinese counterparts in doing so.

FIGURE 10 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FOR YOUR COMPANY? SME (MULTIPLE ANSWERS)

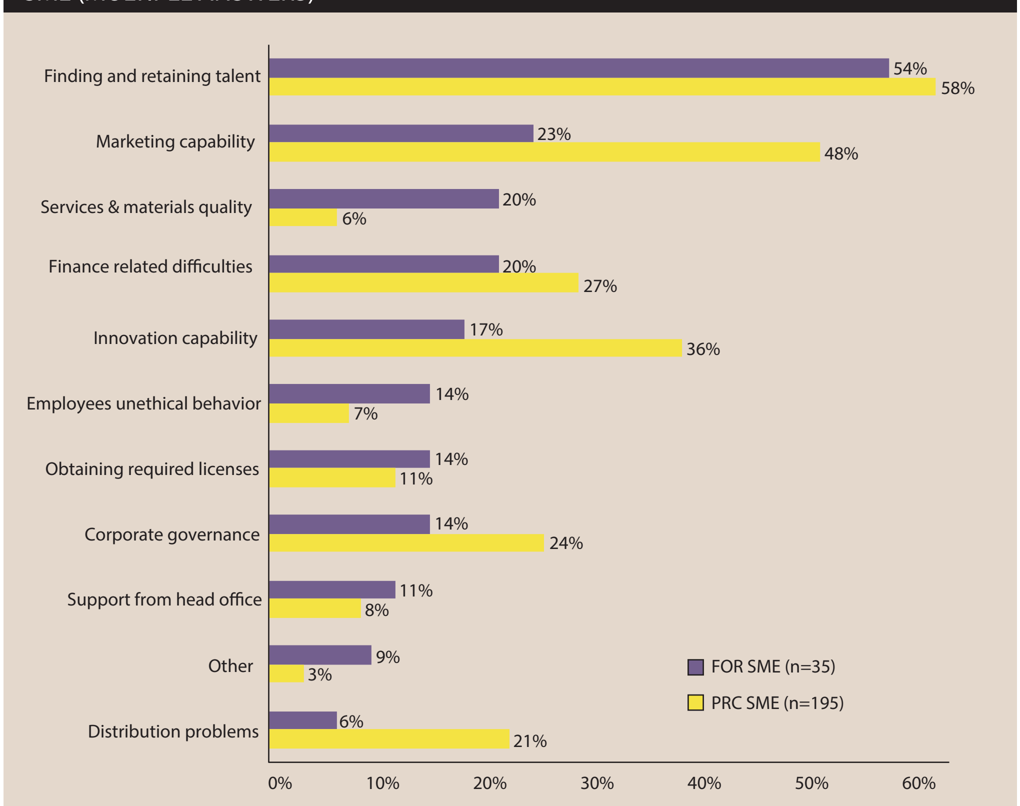
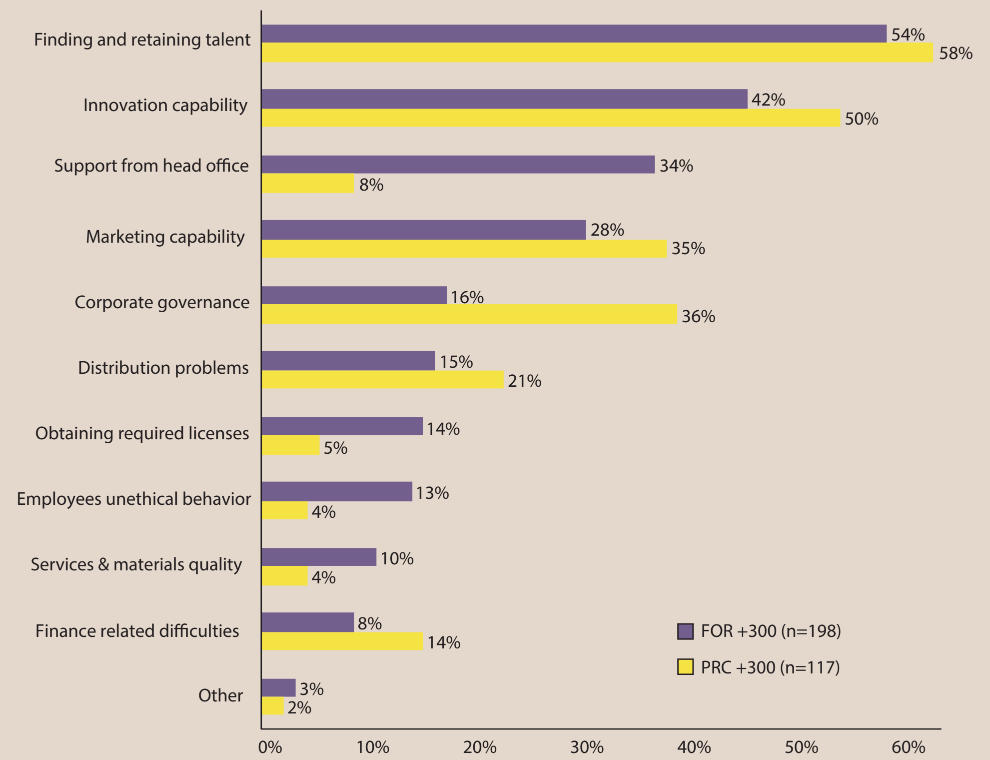


FIGURE 11 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FOR YOUR COMPANY? LARGER FIRMS (MULTIPLE ANSWERS)



Section 5 of this survey offers a more in-depth analysis of internal challenges for companies of all sizes.

Again this year, there are no fundamental differences to be observed between SMEs and larger firms with regard to factors for sales success. Chinese firms are less insistent on quality as a success factor and focus more than foreign firms do on service, distribution and market research. R&D is also more emphasized by Chinese respondents, which illustrates the drive to catch up with foreign companies' ability to offer high quality.

FIGURE 12 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR YOUR SALES IN CHINA: SME (MULTIPLE ANSWERS)

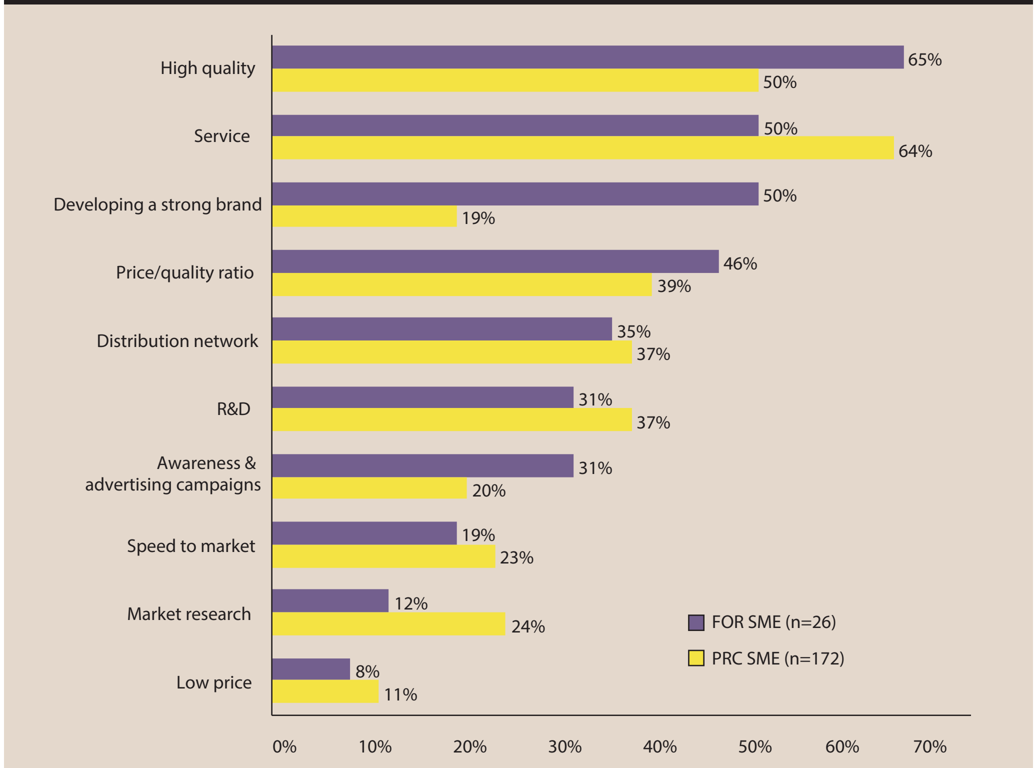
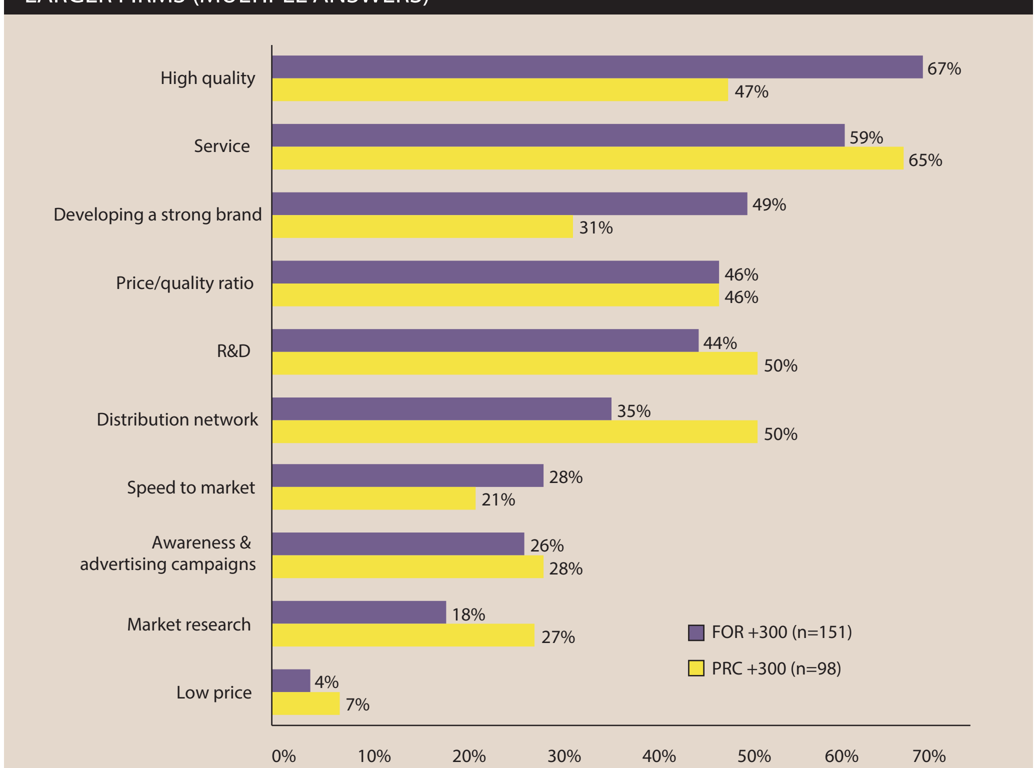


FIGURE 13 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR YOUR SALES IN CHINA: LARGER FIRMS (MULTIPLE ANSWERS)



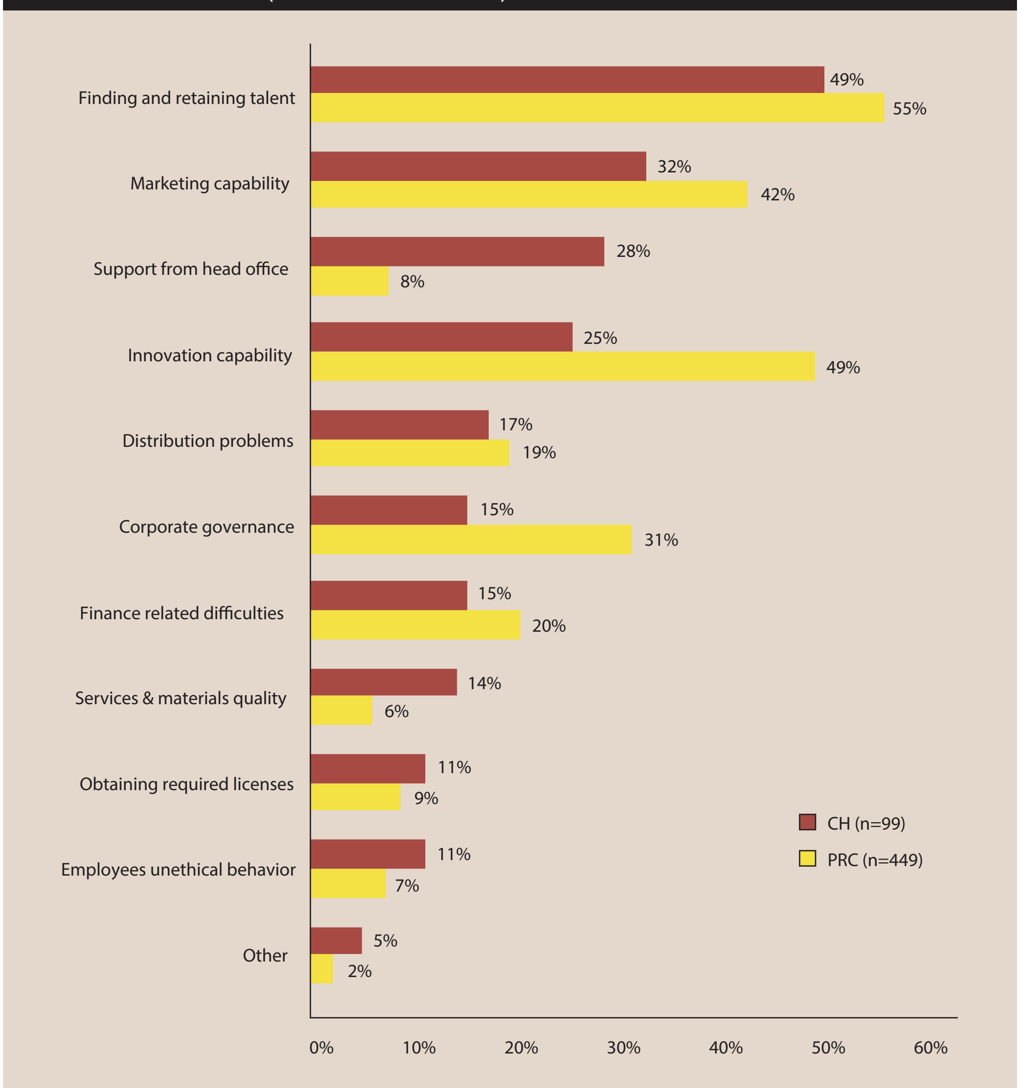
2 A CLOSER LOOK: COMPARING SWISS AND CHINESE PERSPECTIVES

"Finding and retaining talent" is the top internal challenge for both Swiss and Chinese businesses. Marketing and innovation capability are also within the top challenges for both sets of enterprises.

However, "Innovation capability" is a close second to "Finding and retaining talent" in terms of challenges for Chinese firms and it is cited by Chinese firms twice as much as it is by Swiss firms. Clearly Chinese firms see it newly as a very major issue.

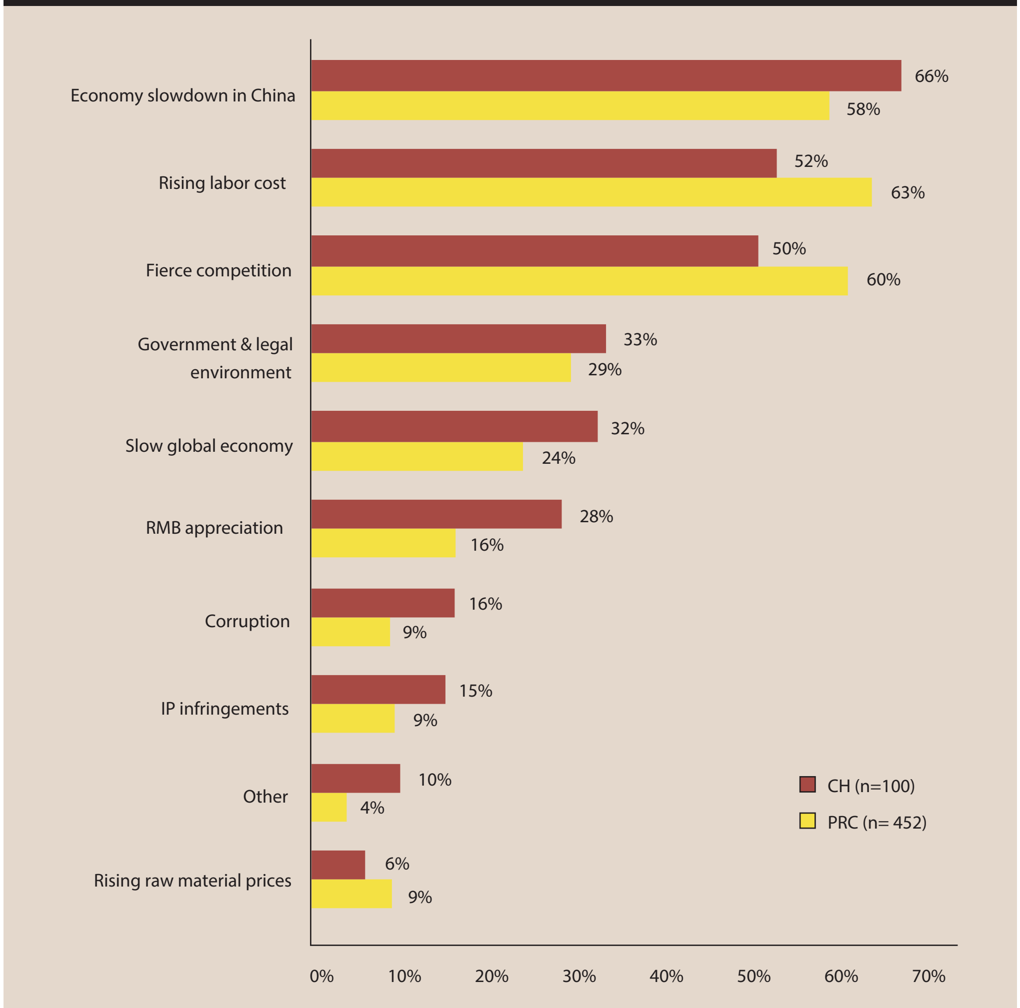
With the exception of "Support from the head office" (which barely affects Chinese companies as a result of operating in a home market), **most challenges are felt more acutely by Chinese companies**. The most considerable disparities are seen in "Innovation capability" and "Corporate governance", areas where Swiss companies have a very strong track record.

FIGURE 14 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



In comparison with last year's survey, Swiss companies are now experiencing less of a challenge posed by competition and more difficulties from the economic slowdown and rising labor costs. Chinese companies, too, state challenges from the economic slowdown and rising labor costs but report the same level of difficulty with competition that was stated in the 2015 survey.

FIGURE 15- WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? (MULTIPLE ANSWERS)



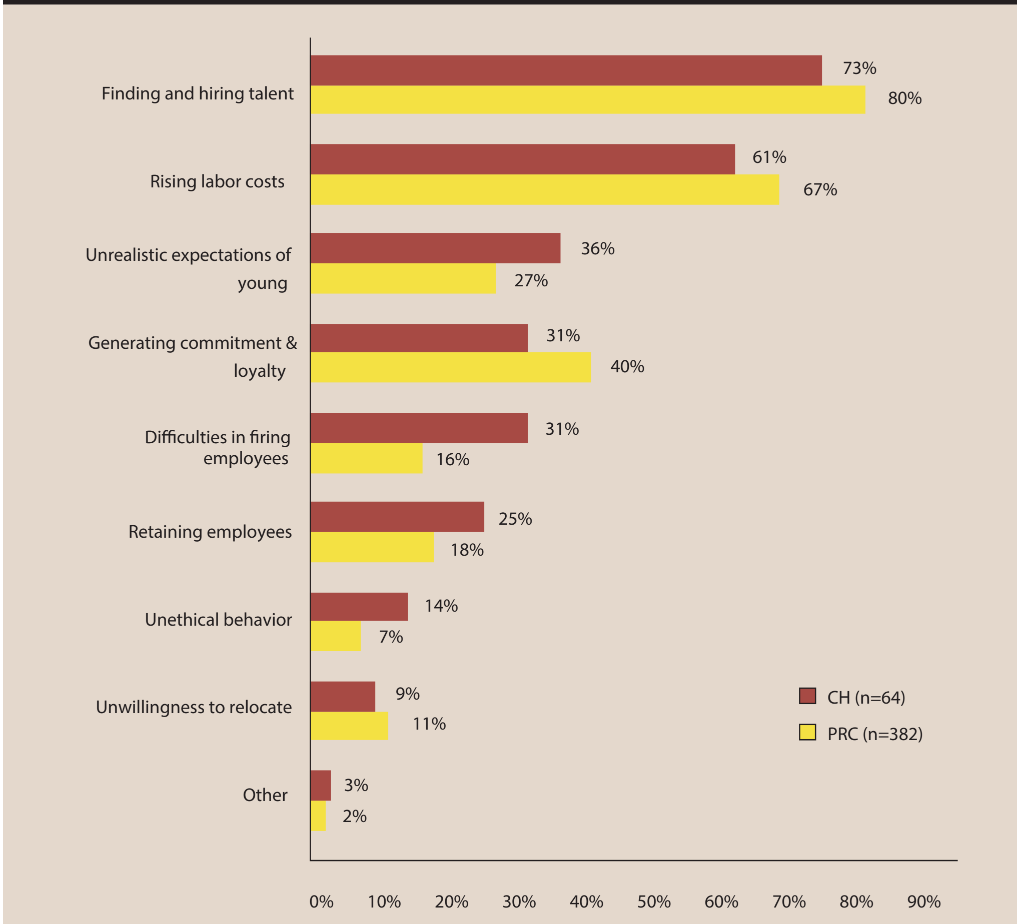
Altogether, it does appear that **Chinese companies are more affected by common challenges and have to fight harder** to maintain their growth than Swiss firms do.

2.1 HR issues: Similar Challenges, Differing Strategies

When looking specifically at HR management challenges, both Swiss and Chinese firms present answers that are nearly identical with last year's responses. The most notable difference is that the challenge of **"retaining employees" has dropped by 15% for Swiss companies, moving this concern from the 3rd most important issue down to the 6th**.

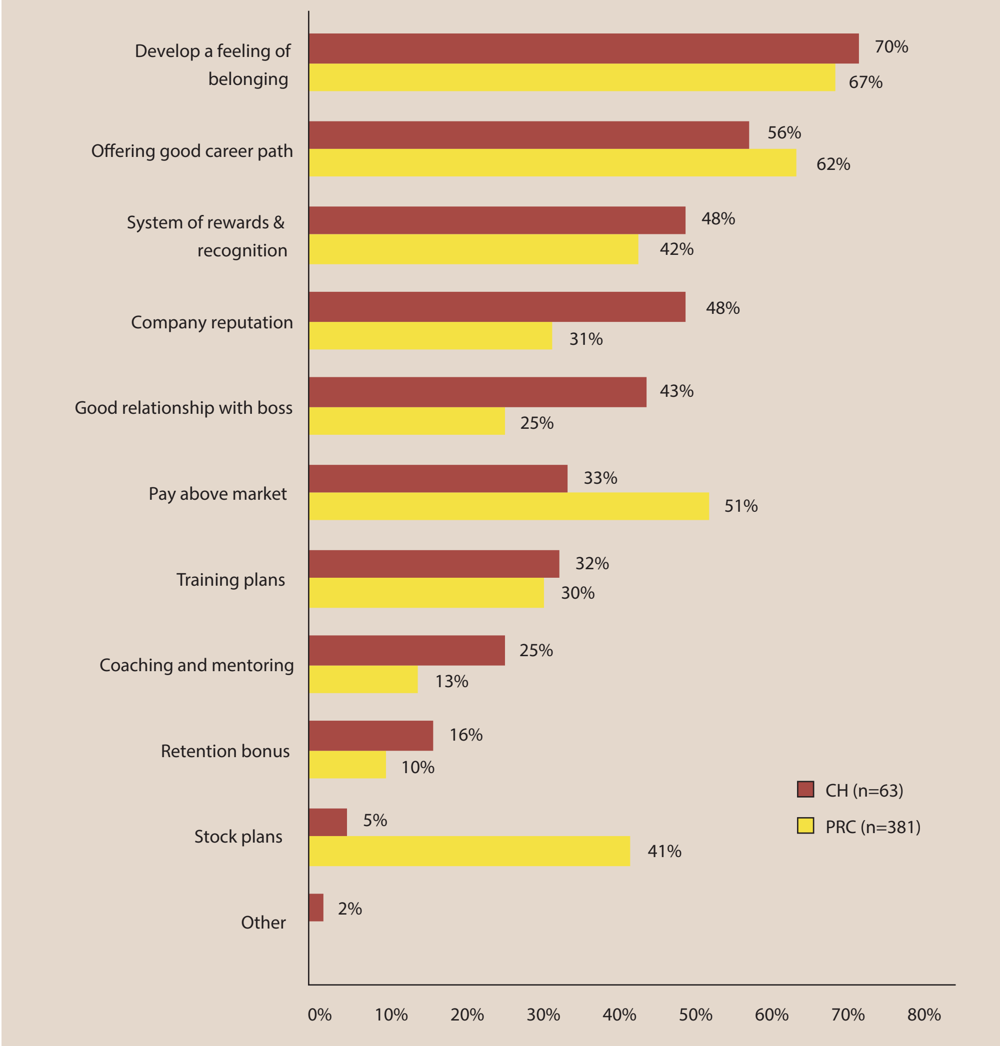
Respondents from both countries see more of a challenge from rising labor costs than in previous years. It may be inferred from this that **rising wages and a slowing economy are creating a better incentive for workers to remain in current positions**.

FIGURE 16 - WHAT ARE THE MAJOR HUMAN RESOURCE ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



To deal with the still very critical HR issue and in order to retain employees, “pay(ing) above the market” is historically not the primary solution used by Swiss companies. “Offering a good career path” and “develop(ing) a feeling of belonging” appear to Swiss and Chinese companies alike as more efficient tools for retaining employees, as these options offer opportunities for promotions and the prospect of substantial salary improvements. **Still, and quite surprisingly, Chinese companies use “pay above market” and “stock plans” as key means to retain employees.** This seems to be needed for Chinese companies **to compensate for a top-down management style**, less “good relationship with the boss” and a lower “company reputation”.

FIGURE 17 - WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES? (MULTIPLE ANSWERS)

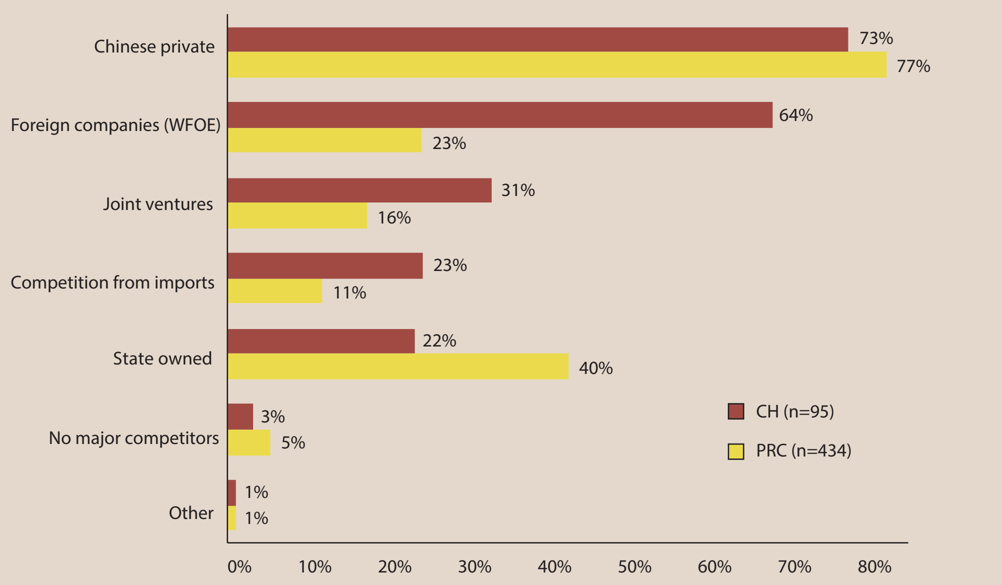


2.2 Chinese competitors' advantages

Swiss companies in China perceive local private players to be their greatest competitors, closely followed by other foreign companies, a continuation of the trend witnessed beginning in 2014 and **a clear indication that domestic players are rapidly advancing in capability**.

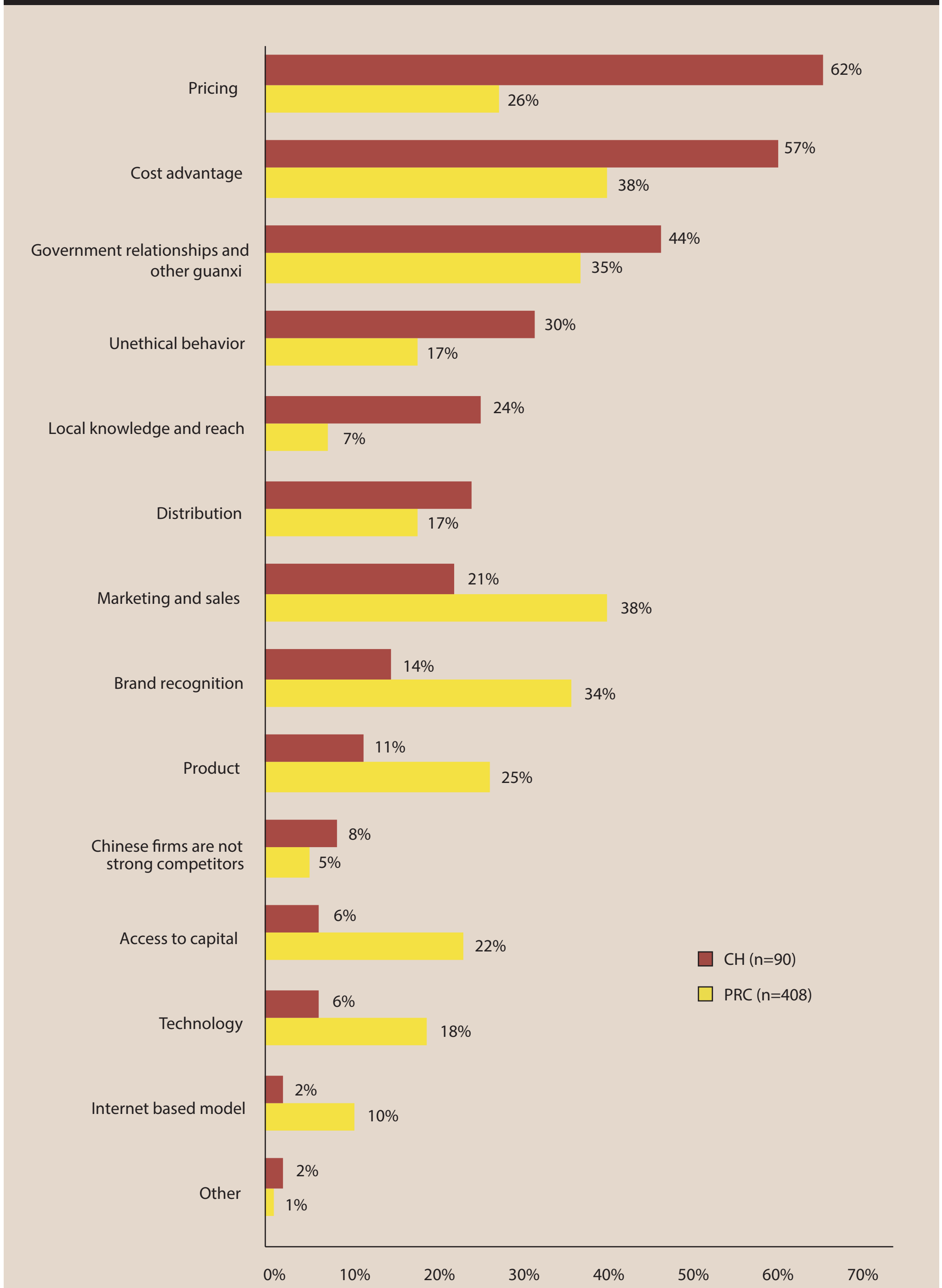
This perspective is shared by Chinese companies that see Chinese private companies as their most important competitors.

FIGURE 18 - WHO ARE YOUR MAJOR COMPETITORS IN CHINA? (MULTIPLE ANSWERS)



It appears in the chart below that, for Swiss companies, the very competitive landscape is once more highlighted by the fact that “pricing”, “cost advantages”, and “government relations & network (guanxi)” are clearly perceived as Chinese competitors’ main advantages.

FIGURE 19 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN CHINESE COMPETITORS? (MULTIPLE ANSWERS)



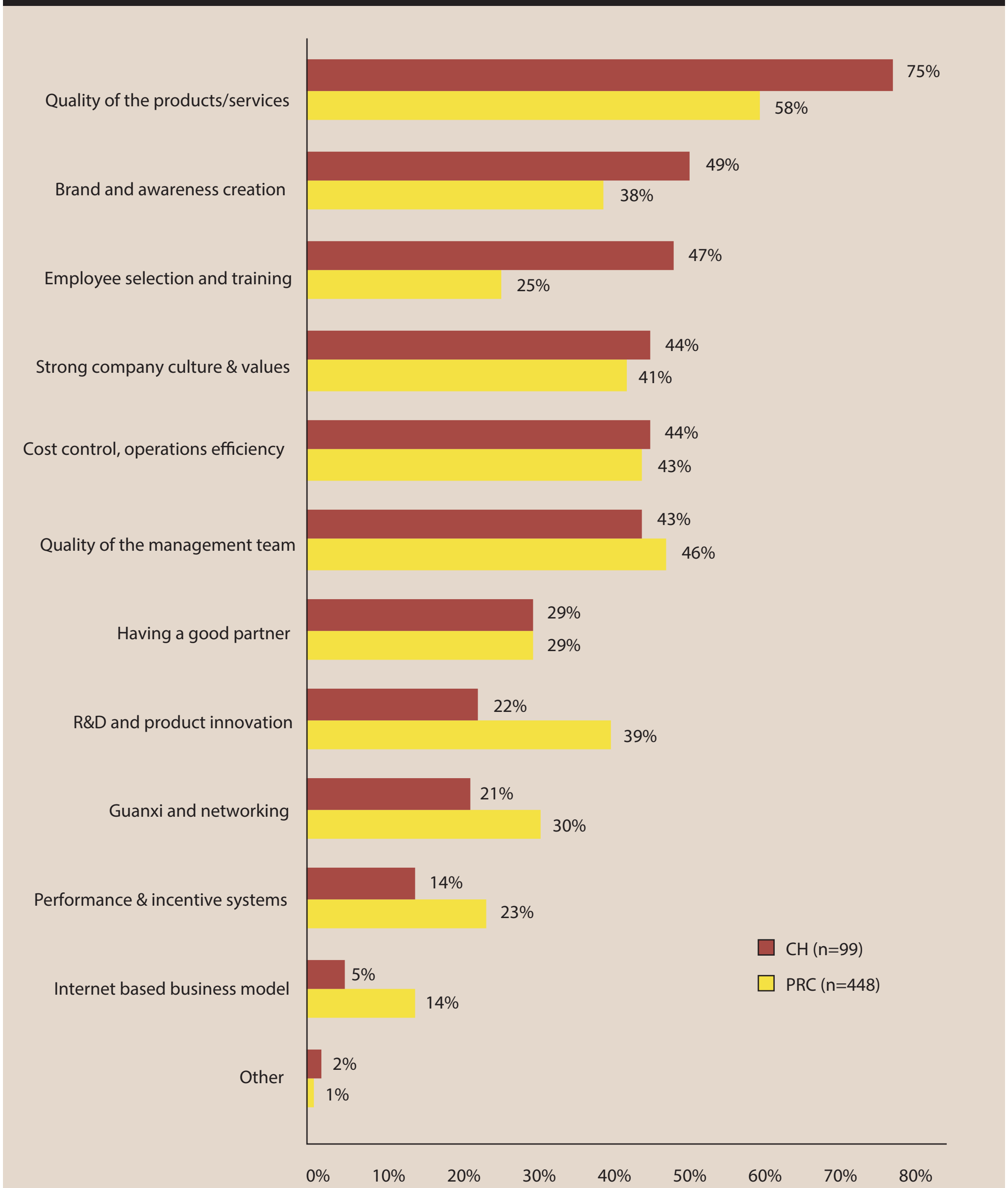
2.3 Quality remains the key to Swiss success in China

It is not surprising in this very competitive environment that the key factors of success cited are first "quality of the products/services", "brand and awareness creation", and human resources (HR) considerations, specifically "employee selection and training" and "strong company culture & values". This is naturally coherent with HR being singled out as the greatest management challenge.

The Swiss emphasis on quality and good HR certainly creates opportunities for stronger brand reputation. In the previous chart, Chinese companies saw "brand recognition" and "marketing and sales" as advantages of their competitors far more so than Swiss companies did.

Below, Swiss companies state "brand and awareness creation" as the second most important success factor, demonstrating again that Swiss companies are able to differentiate and overcome pricing disadvantages by offering stronger and more reliable brands.

FIGURE 20 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA? (MULTIPLE ANSWERS)

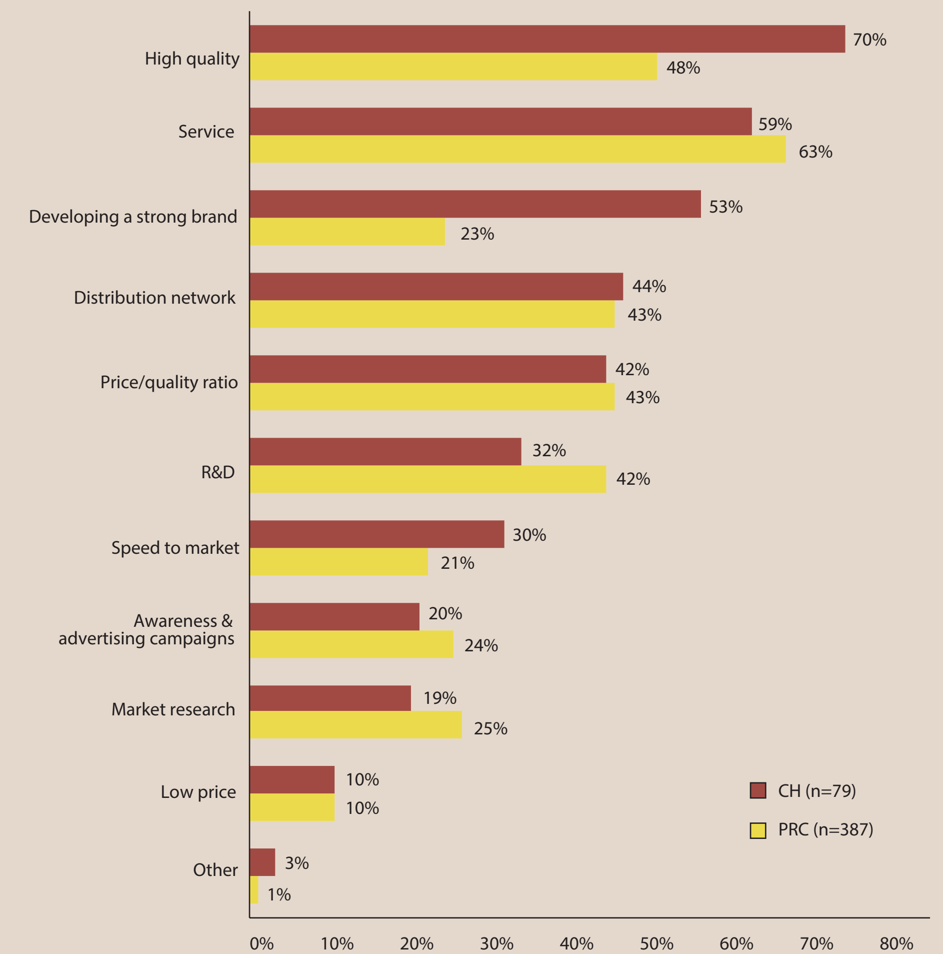


Still, Chinese companies recognize quality as the top factor for success, and place slightly higher importance on quality of management team and a much higher importance on R&D. This indicates yet again a desire of Chinese companies to catch up with foreign companies over time.

Swiss companies maintain growth in sales and profits by offering products that Chinese companies still find it difficult to offer in terms of quality.

This also explains why Swiss companies in China have been competing as much with foreign competitors as they have with Chinese ones.

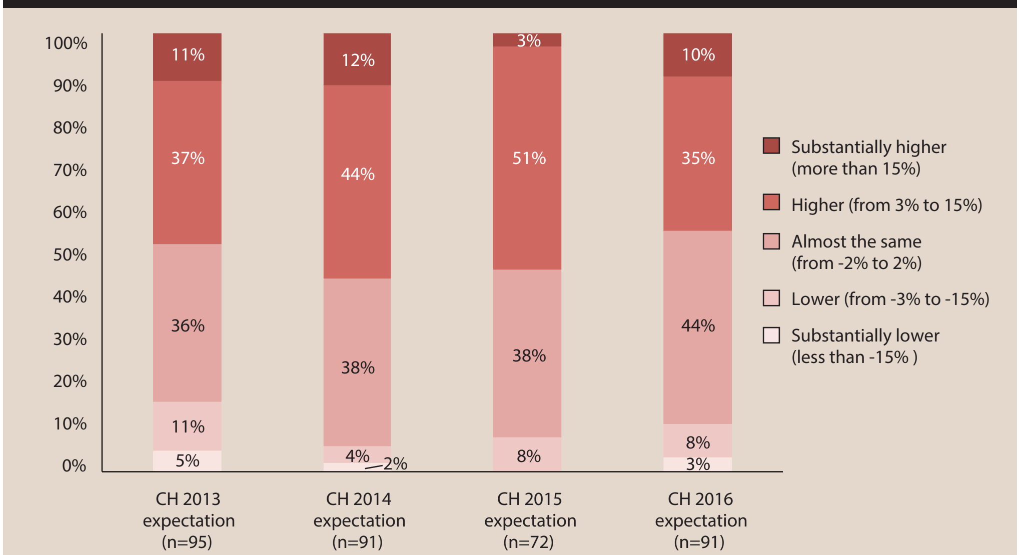
FIGURE 21 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR THE SUCCESS OF YOUR SALES IN CHINA? (MULTIPLE ANSWERS)



3 STABLE CONFIDENCE CLIMATE: REVENUES, PROFITS AND INVESTMENTS REMAIN STRONG ACROSS THE BOARD

Swiss companies, like the other respondents, are succeeding in maintaining growing profits in a time of slowing growth. Despite a slightly lower proportion of Swiss companies expecting higher profits than in 2015, only 11% of Swiss respondents expect lower profits, a smaller proportion than in 2013.

FIGURE 22 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA PROFIT? (CH COMPANIES)



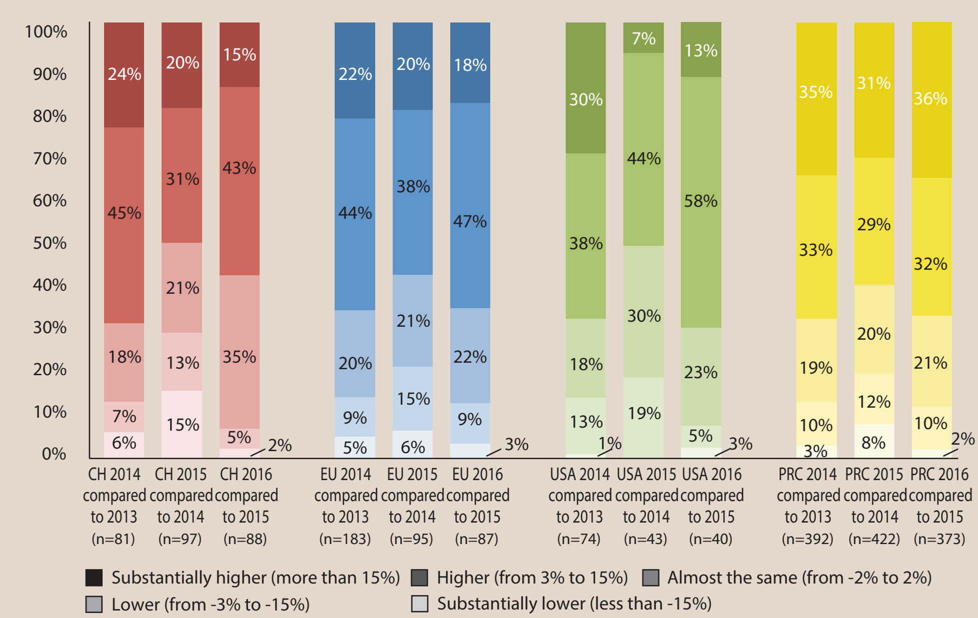
Companies of all demographics report higher average expectations for their sales in 2016 as compared to 2015. Predictions of loss are down from last year and the previous year as well.

This confirms that **slowing growth of the Chinese economy is not resulting in reduced growth for the respondents to the survey**, as would be expected.

This result may appear extraordinary in light of the many media reports on China's decelerating growth and the occasional catastrophic predictions. However, it is important to remember that decelerating growth on a larger GDP base results in the addition of more absolute GDP increase than in previous years. Indeed, today's "new normal" of single-digit growth generates a consistent or even larger increase in sales and profit from all companies, both foreign and Chinese.

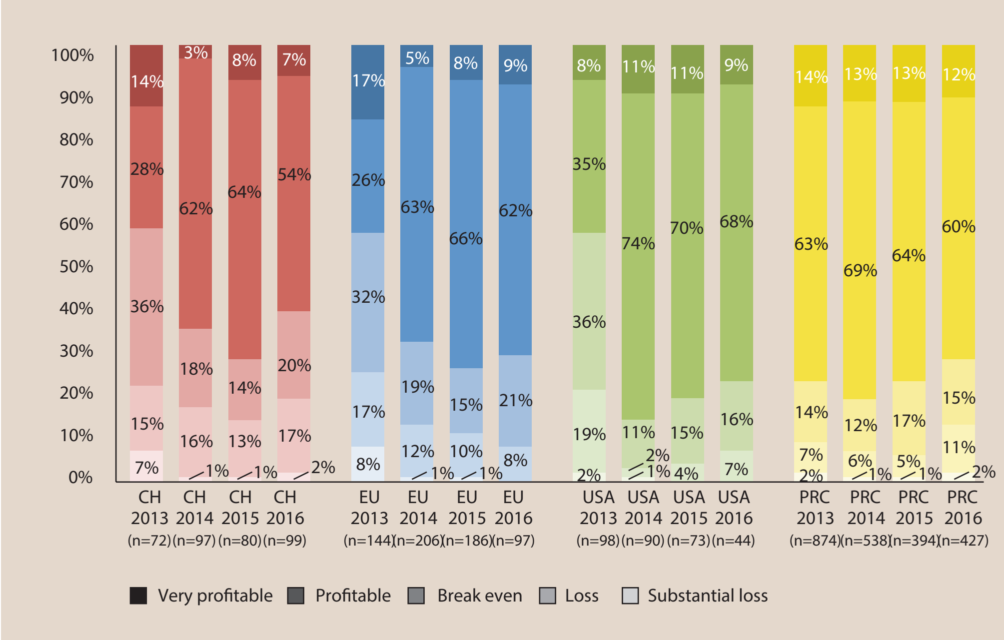
In addition, growth is now generated less and less from traditional and heavy industries, driven by construction and civil engineering works. The proportion of growth coming from services and higher or new technologies is increasing, which allows foreign and good Chinese companies to capture more of the growth.[6]

FIGURE 23 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES COMPARED TO LAST YEAR?



[6] *Chinese companies' respondents are alumni of CEIBS, and therefore most likely to be from top Chinese companies.*

FIGURE 24 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION FOR THE CURRENT YEAR?



All respondents announce being less profitable for 2016 than they did for 2015. Overall, more respondents from the U.S. and China expect to be “profitable” and “very profitable” than respondents from the EU and Switzerland do.

3.1 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.

57% of the Swiss companies surveyed plan to increase investment in China in 2016 and 48% consider China to be a top 3 investment destination.

Chinese firms are clearly the most aggressive investors, continuing substantial investment increases at the same pace as those made in 2014 and 2015.

FIGURE 25 - WHAT INVESTMENT DO YOU PLAN FOR 2016 IN CHINA?

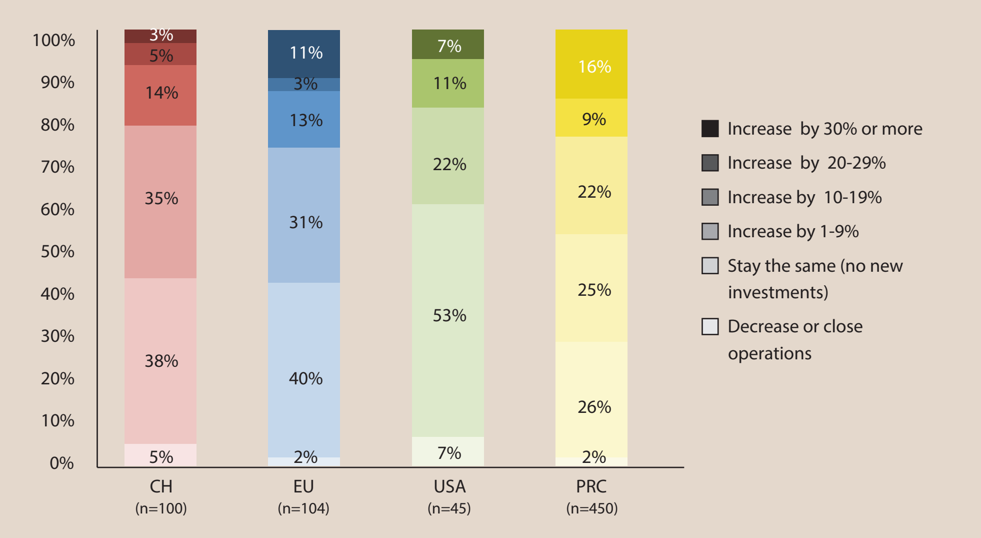
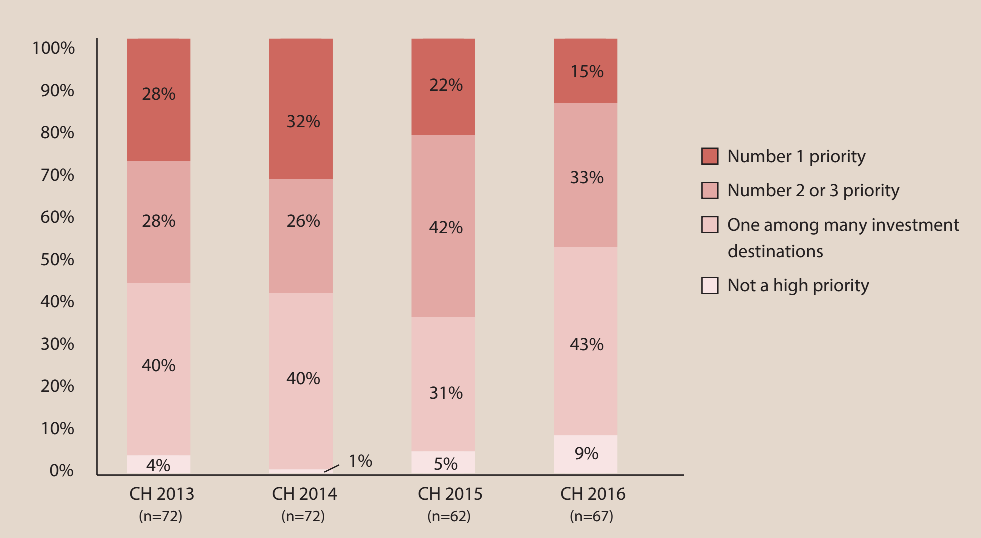


FIGURE 26 - HOW DOES CHINA RANK IN YOUR GLOBAL INVESTMENT PLANS? (CH COMPANIES)



3.2 Predictions reflect prudence of businesses

The Swiss are the least confident this year after being the most confident in previous years. All respondents converge to a confidence level of around 6.8 for the next 5 years and 6.2 for 2016, while Swiss firms react much stronger and dip to 6.6 and 5.9 for the next 5 years and for 2016. Yet, despite this (maybe typically Swiss) cautious evaluation, Swiss enterprises are not pulling away as investment figures clearly illustrate.

FIGURE 27 - HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR, AND THE NEXT 5 YEARS? CH COMPANIES

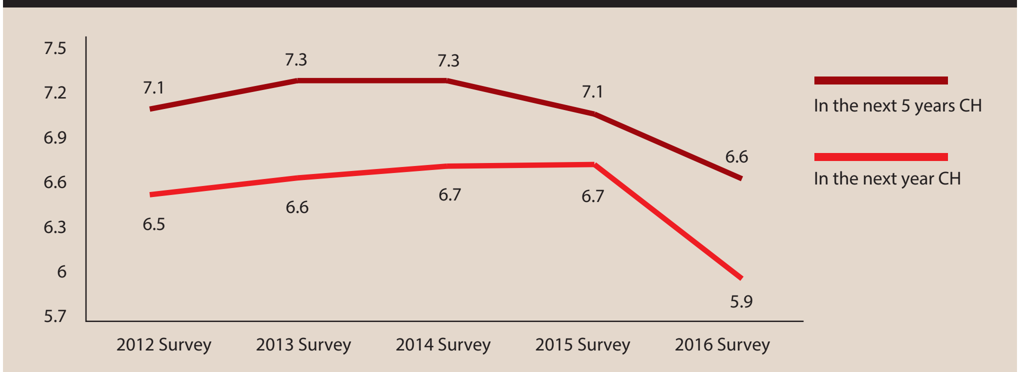
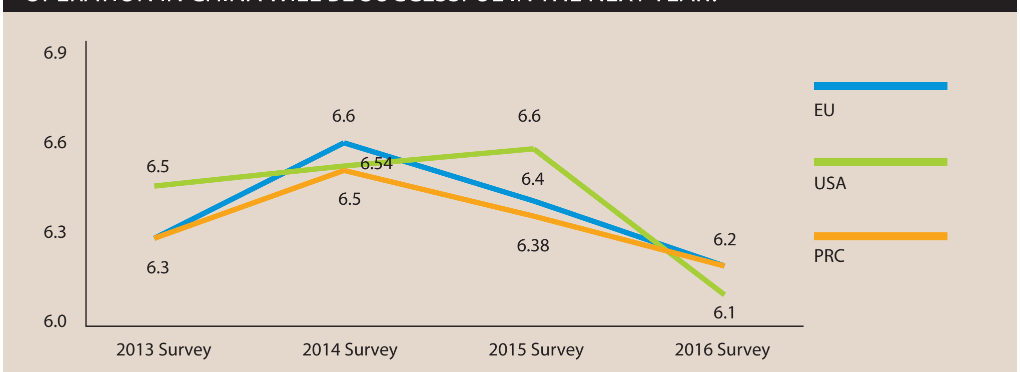


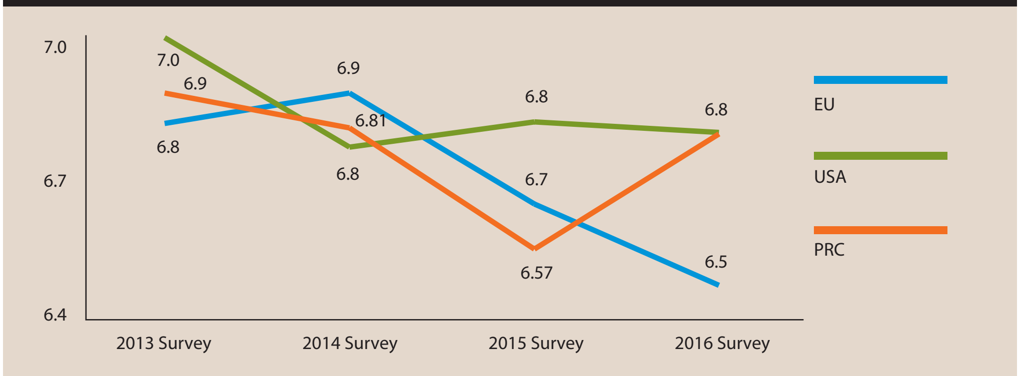
FIGURE 28 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR?



European companies are the most pessimistic over the long term. Their confidence for the next 5 years is even lower than in 2013. Still, European confidence for the next year is on par with that of Chinese companies and marginally higher than American and Swiss companies. American companies are expecting stability in the next 5 years, even as much so as Chinese companies.

Taken together, the statements on confidence reflect a measured pragmatism from respondents; the coming years may not allow for the same rate of acceleration that the previous years did, but prospects for growth within China remain ample enough to justify continued expansion and investment.

FIGURE 29 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT 5 YEARS?

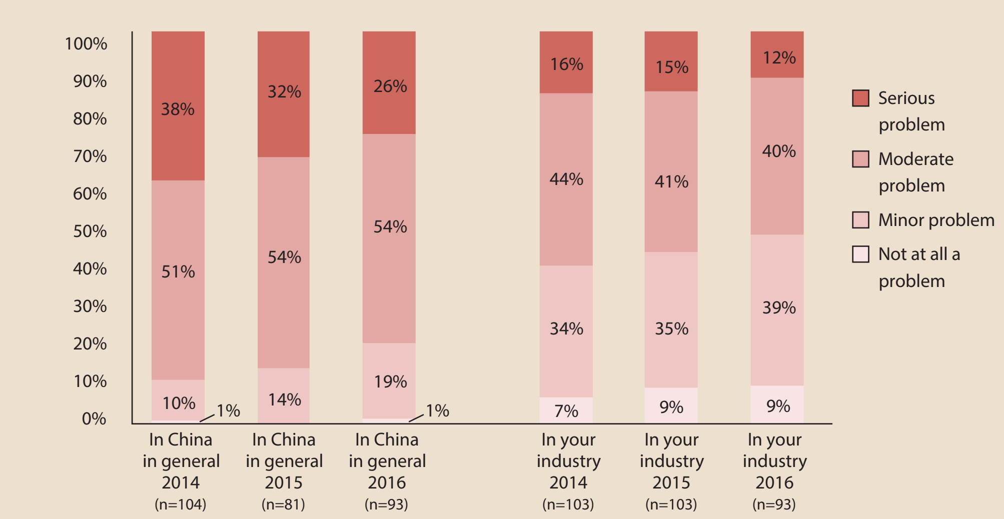


4 A FREQUENT PERCEPTION GAP ON THE REGULATORY ENVIRONMENT

4.1 Corruption & legal environment

When asked if corruption is significant in China in general, a sizeable proportion (26%, more than 1 in 4) of Swiss companies see it as a "serious problem".

FIGURE 30 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA IN GENERAL, AND IN YOUR INDUSTRY? (CH COMPANIES)



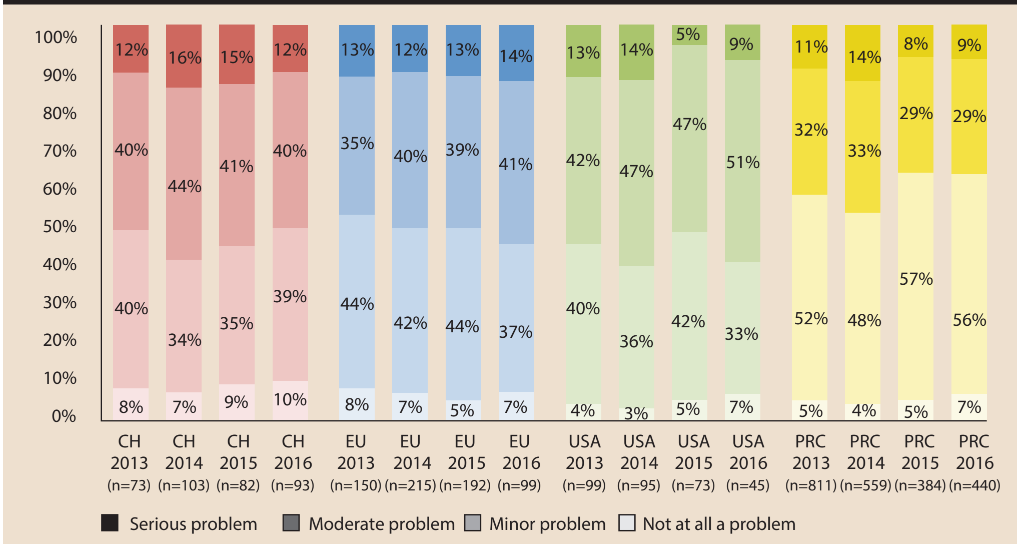
However, when asked how serious corruption is in their industry, around 88% of the respondents see it as a "moderate problem", "minor problem", or "not at all a problem". Only 12% (1 out of 8) Swiss companies say that corruption is a serious problem in their industry.

This is not the first time that a perception gap has been revealed in this survey. However, this gap is shrinking every year, likely as a result of continued attention from the Chinese government to enforce a fairer environment.

It is also worth noting that over the past 3 years, the trend shows less and less concern over corruption from Swiss companies, pointing to an improvement in the overall situation and in specific industries.

Interestingly, the picture is quite similar for Chinese companies but not so for EU and US ones.

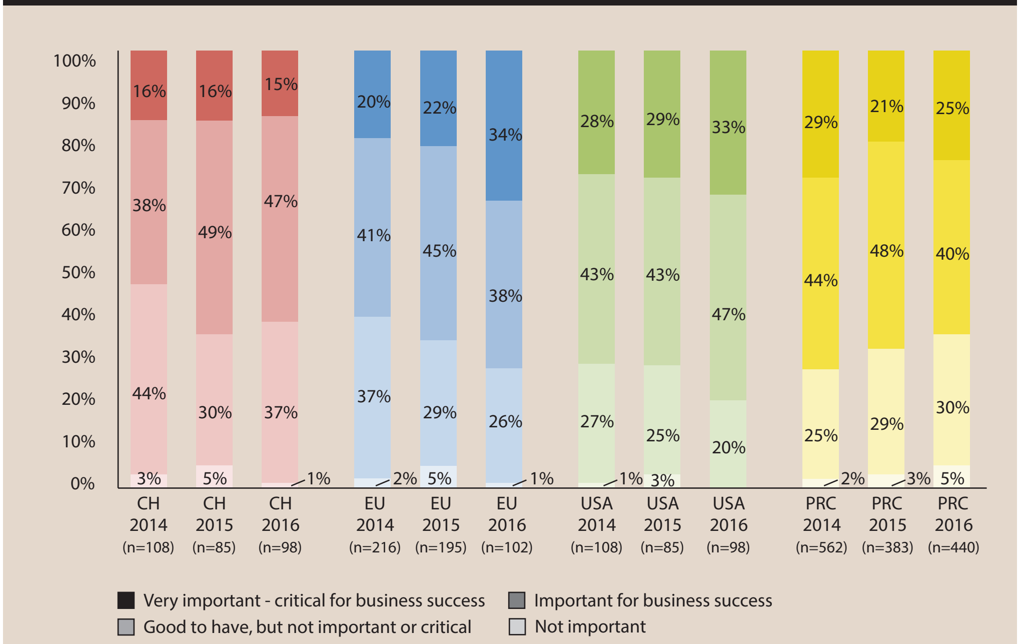
FIGURE 31 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY?



These paradoxical answers highlight a critical phenomenon. On one hand, there is the general sentiment that “China is corrupt”, a belief fueled by foreign media reports of scandals and countless anecdotes of official misdoings. On the other hand, there is the reality of doing business in China, where corruption is one of many issues that managers deal with, though not the most important one as shown by the low ranking of corruption in terms of challenges (See Section 5).

When asked about the importance of relationships with authorities, only Chinese companies continue to report a decrease from previous years. This may indicate that the anti-corruption drive is having more of an effect among Chinese companies, which may also be the case because Chinese companies have traditionally relied more on their relationships with authorities than foreign companies have.

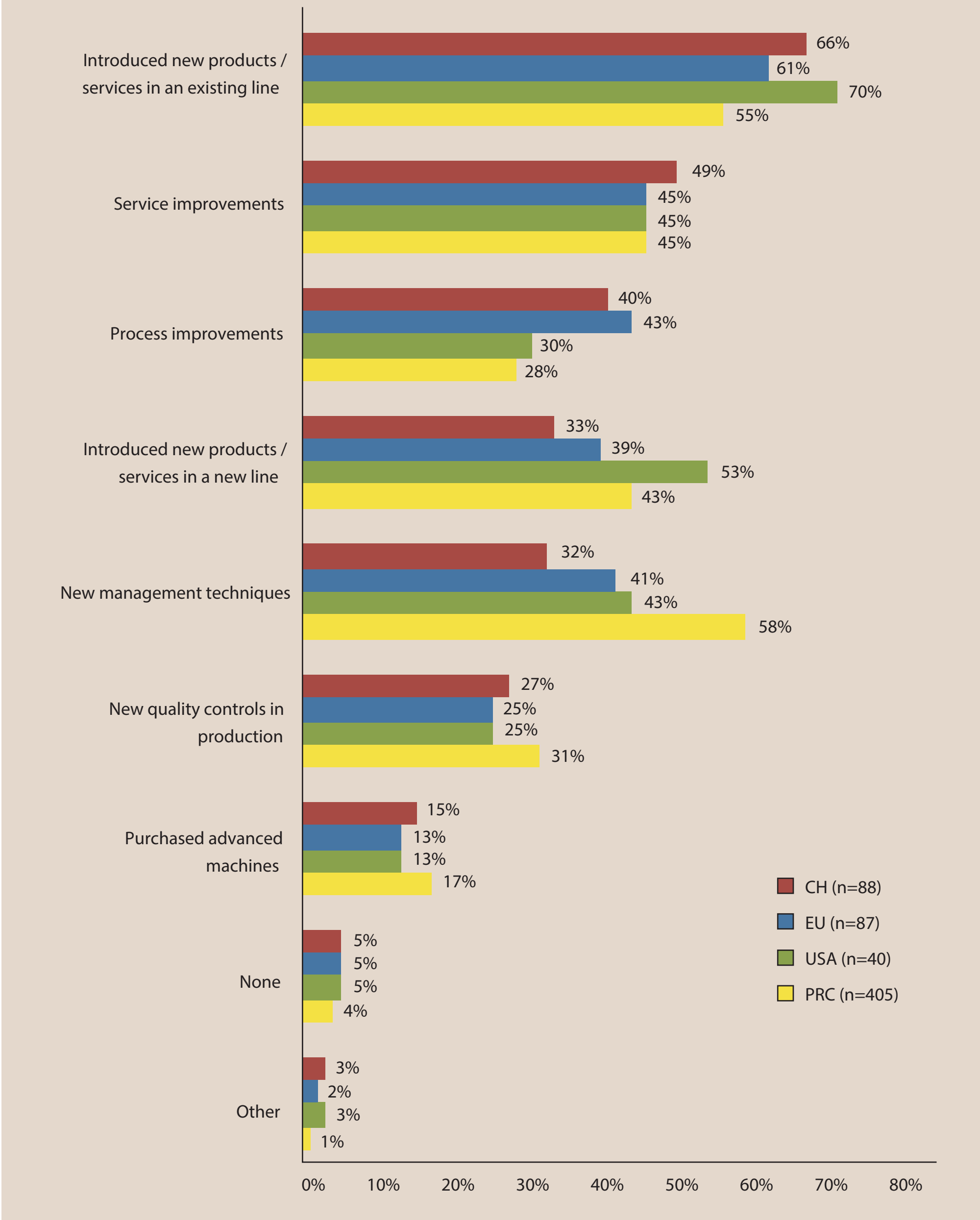
FIGURE 32 - HOW IMPORTANT ARE THE RELATIONSHIPS WITH THE AUTHORITIES?



4.2 Innovation and intellectual property

Swiss companies continue their traditional focus on innovations in new and existing product lines. However, **Chinese respondents place a heavier emphasis on innovation of management techniques**, possibly because they lag behind in this respect and can make quick gains from improvements in management.

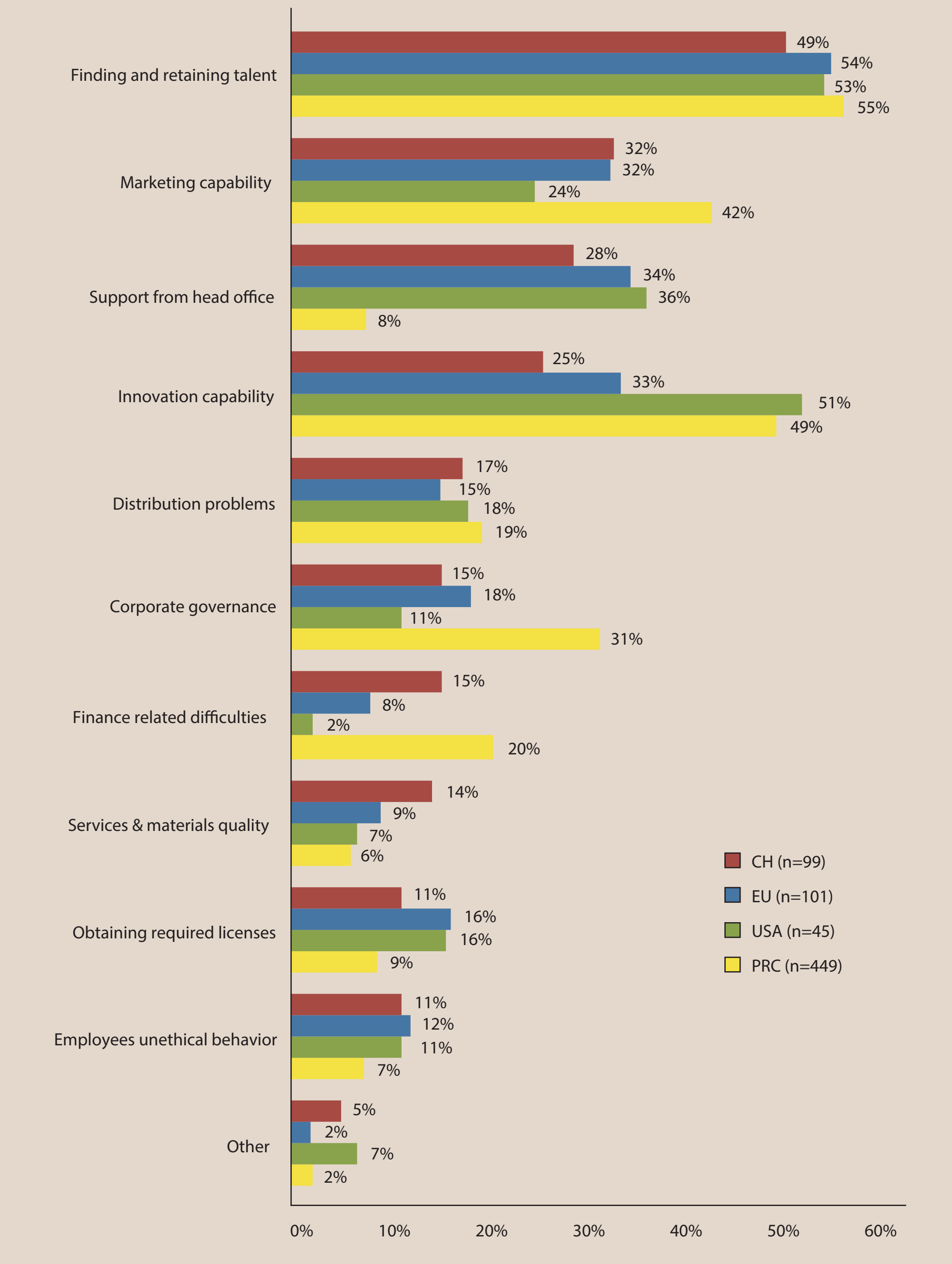
FIGURE 33 - WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED SINCE THE BEGINNING OF 2015?



5 CHALLENGES AND HR EVOLUTION: DETAILED CHARTS BY REGION

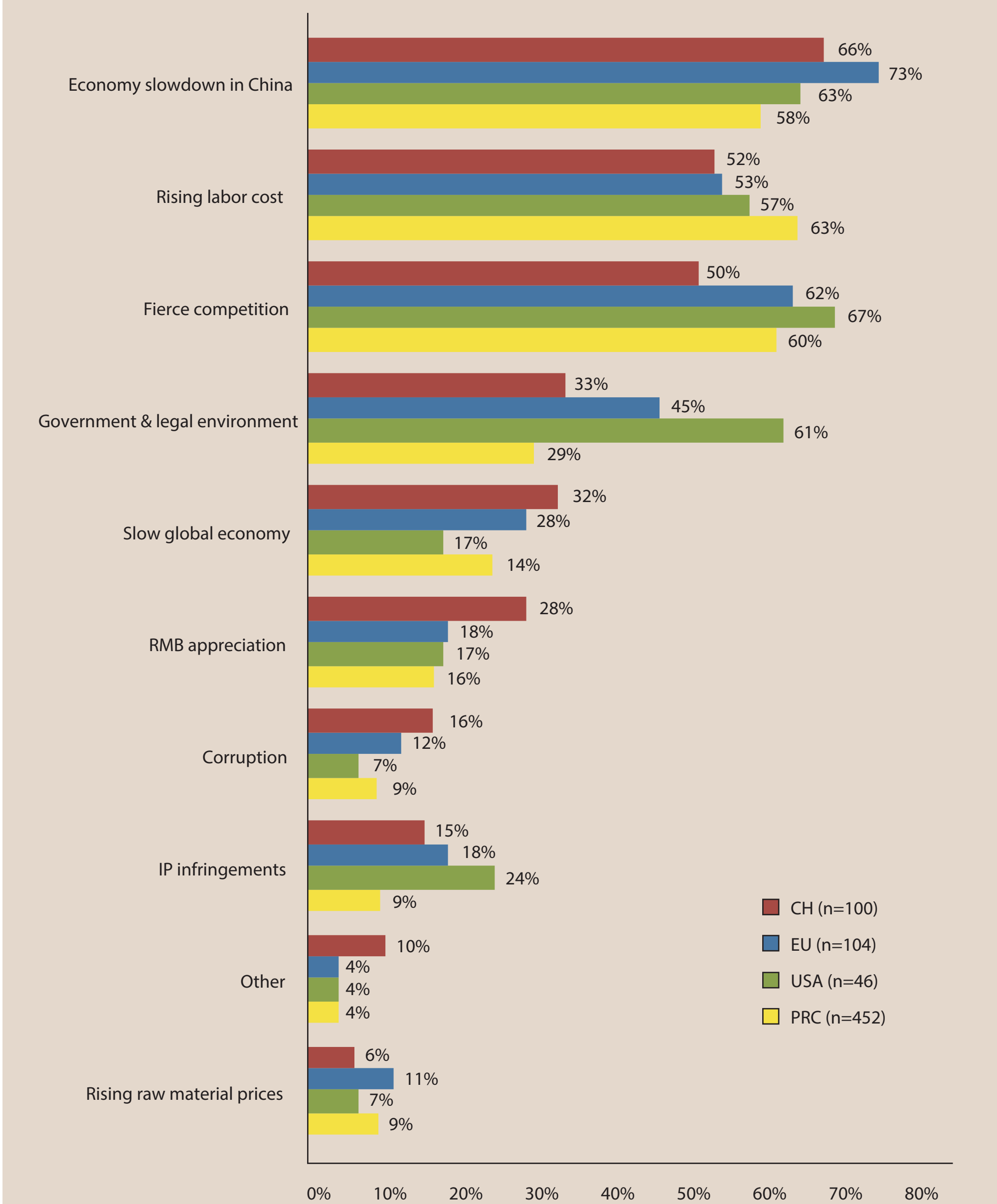
The key internal challenge remains finding and retaining talent. Human resources management remains a central element for success, as it has been since this survey began 8 years ago. Yet, the HR challenge now clearly appears to be easing: just less than 50% of Swiss companies mention it this year while more than 60% mentioned it in 2015 and nearly 80% in 2014. Slower economic growth is certainly a factor in the softening of HR challenges, with many employees more carefully considering job changes.

FIGURE 34 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



Swiss companies are struggling less with fierce competition than companies from other demographics, they also see government and legal environment issues as much less of a challenge than other foreign companies do. As in 2015, U.S. companies state “government & legal environment” as an external challenge in a significantly higher proportion than other demographics do, this is consistent with figure 40 in which U.S. companies consider “government relationships and guanxi” an advantage of Chinese competitors in the highest proportion.

FIGURE 35 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? (MULTIPLE ANSWERS)

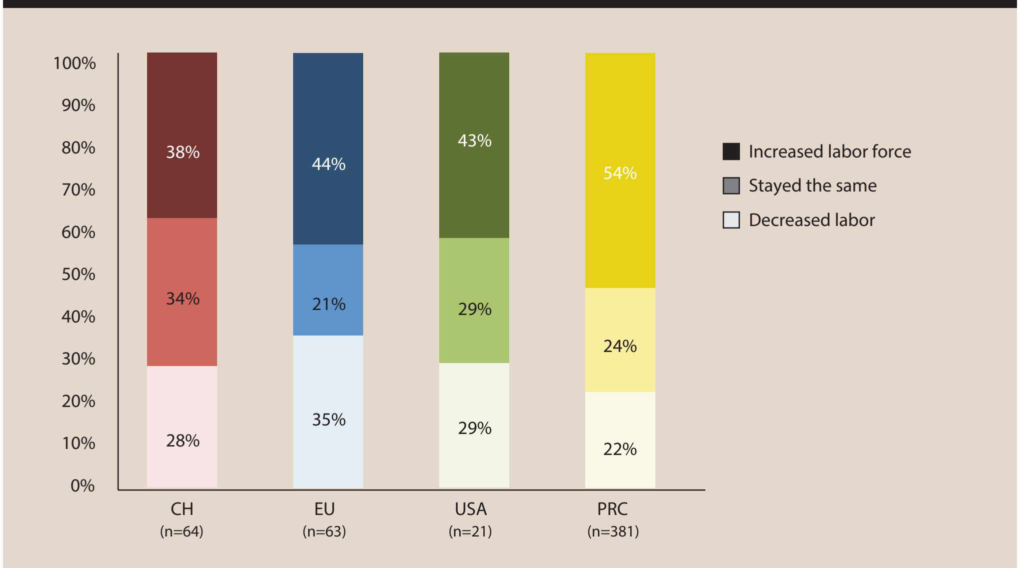


5.1 Labor force evolution

Swiss companies are hiring the least and decreasing the least labor out of the foreign respondents. Furthermore, Swiss companies report the largest proportion of labor forces that were kept the same size between 2015 and 2014. Labor changes are not mutually inclusive with expansion and increased investment, since Swiss companies likely use more technology and management techniques that emphasize efficiency.

Labor changes from Chinese companies, however, are on par with plans for investment; Chinese companies are hiring the most and decreasing the least labor. The internal contrast observed within the responses of EU companies shows divergent paths; some EU companies are growing in China amidst the decline of others.

FIGURE 36 - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2015 VS. 2014 WAS:



5.2 HR issues in general remain management's top internal priority.

Compared to other demographics, Swiss companies seem to be facing HR challenges with slightly more ease this year. "Finding and hiring talent" remains the top challenge for most respondents and a close second for European companies, who report a greater issue with rising labor costs than other respondents do.

(Interestingly, in figure 36 European responses show a growing disparity in the hiring trends of individual companies; Europeans companies both sharply increased and reduced labor in 2015).

FIGURE 37 - WHAT ARE THE MAJOR HUMAN RESOURCE ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)

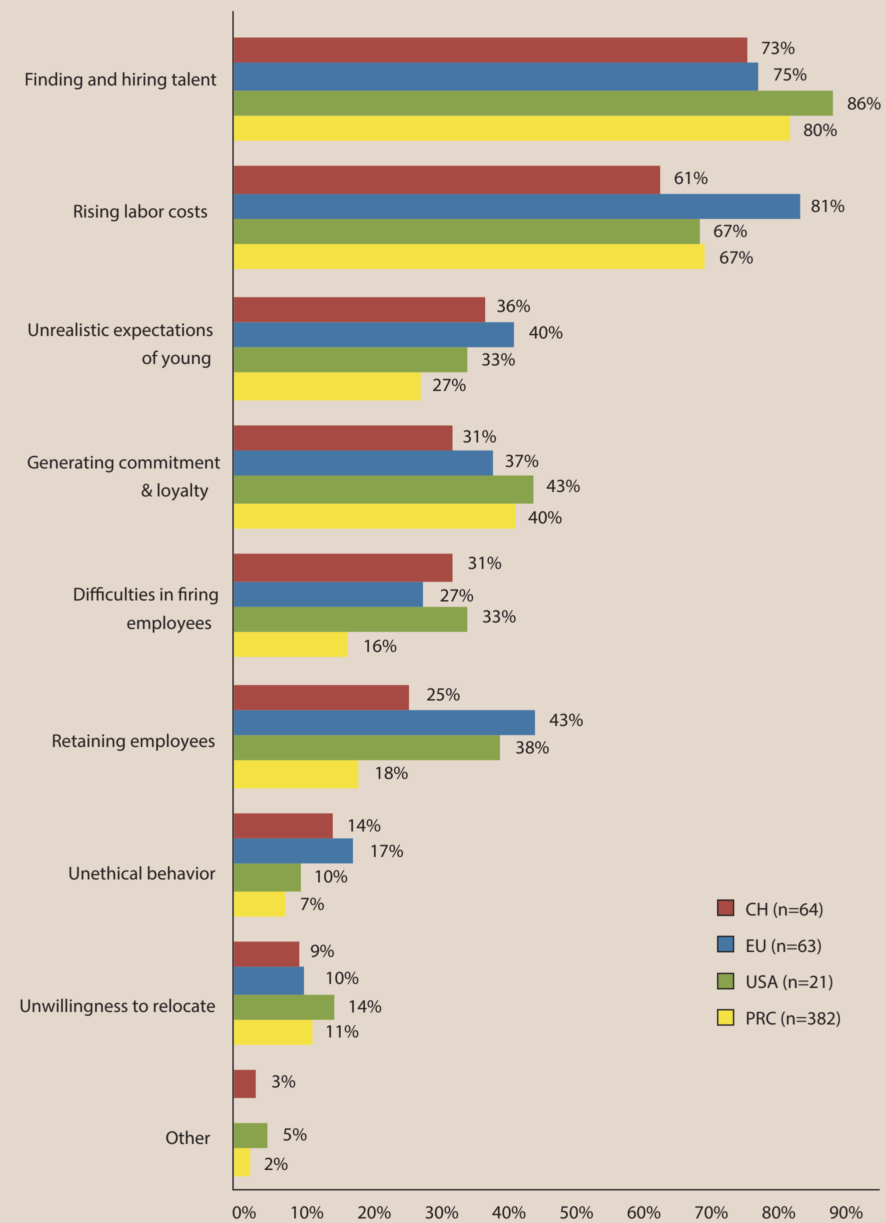
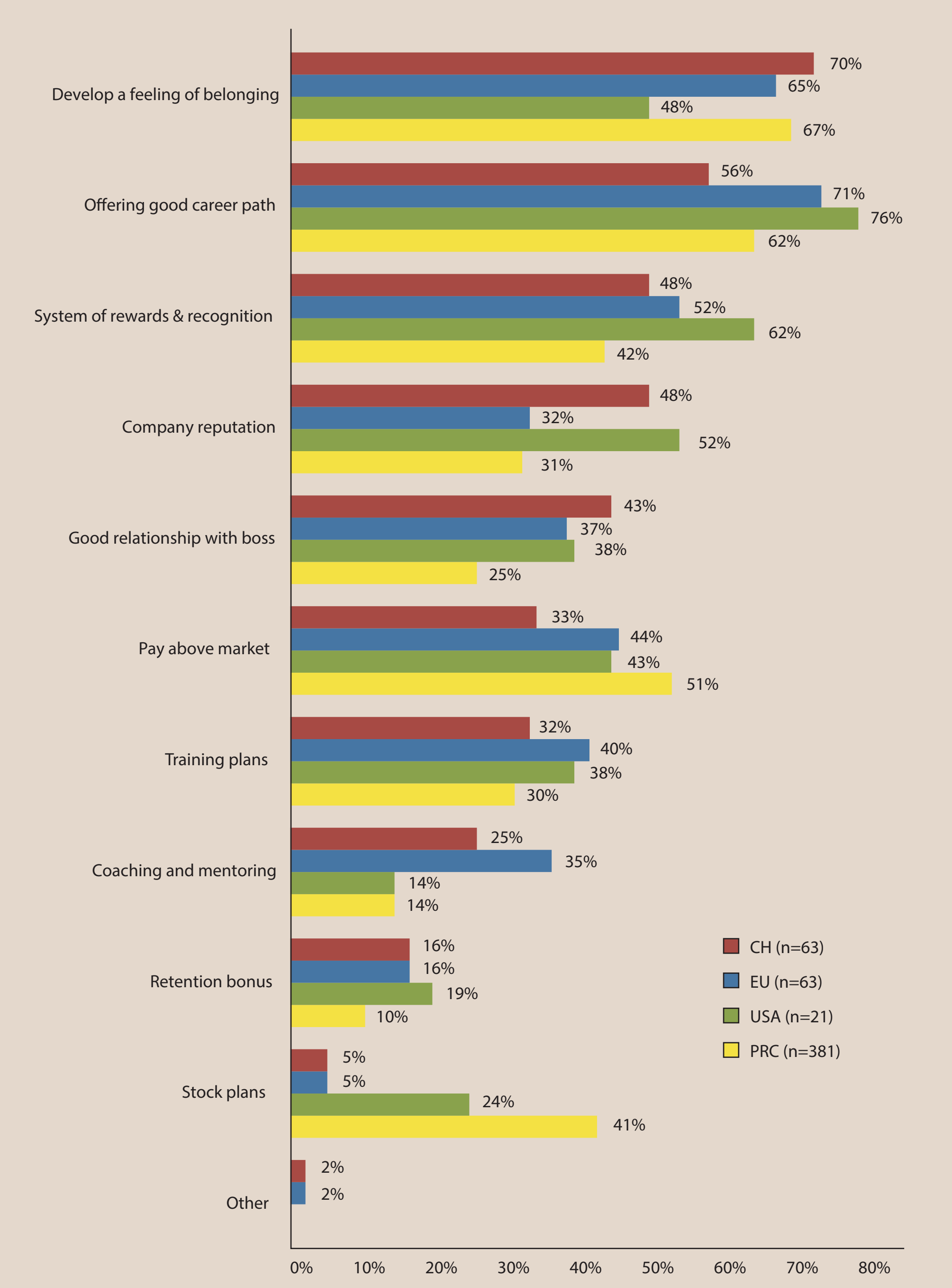


FIGURE 38 - WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES? (MULTIPLE ANSWERS)



5.3 Chinese competitors' advantages

FIGURE 39 - WHO ARE YOUR MAJOR COMPETITORS IN CHINA?

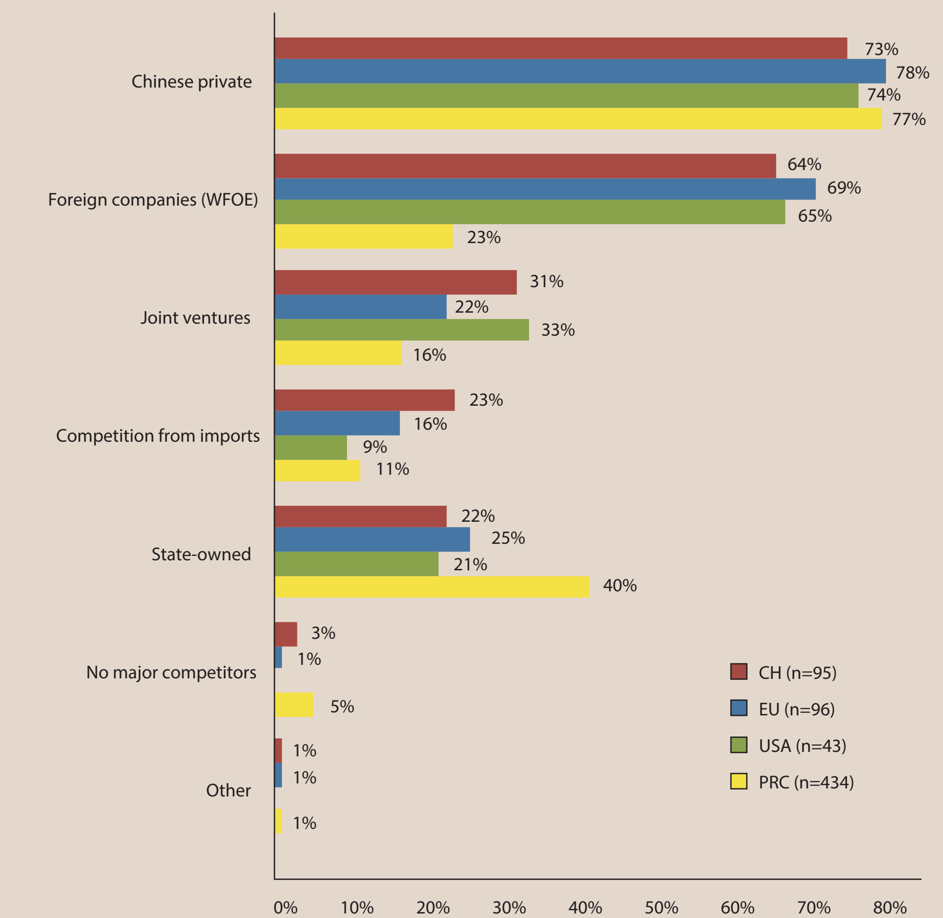
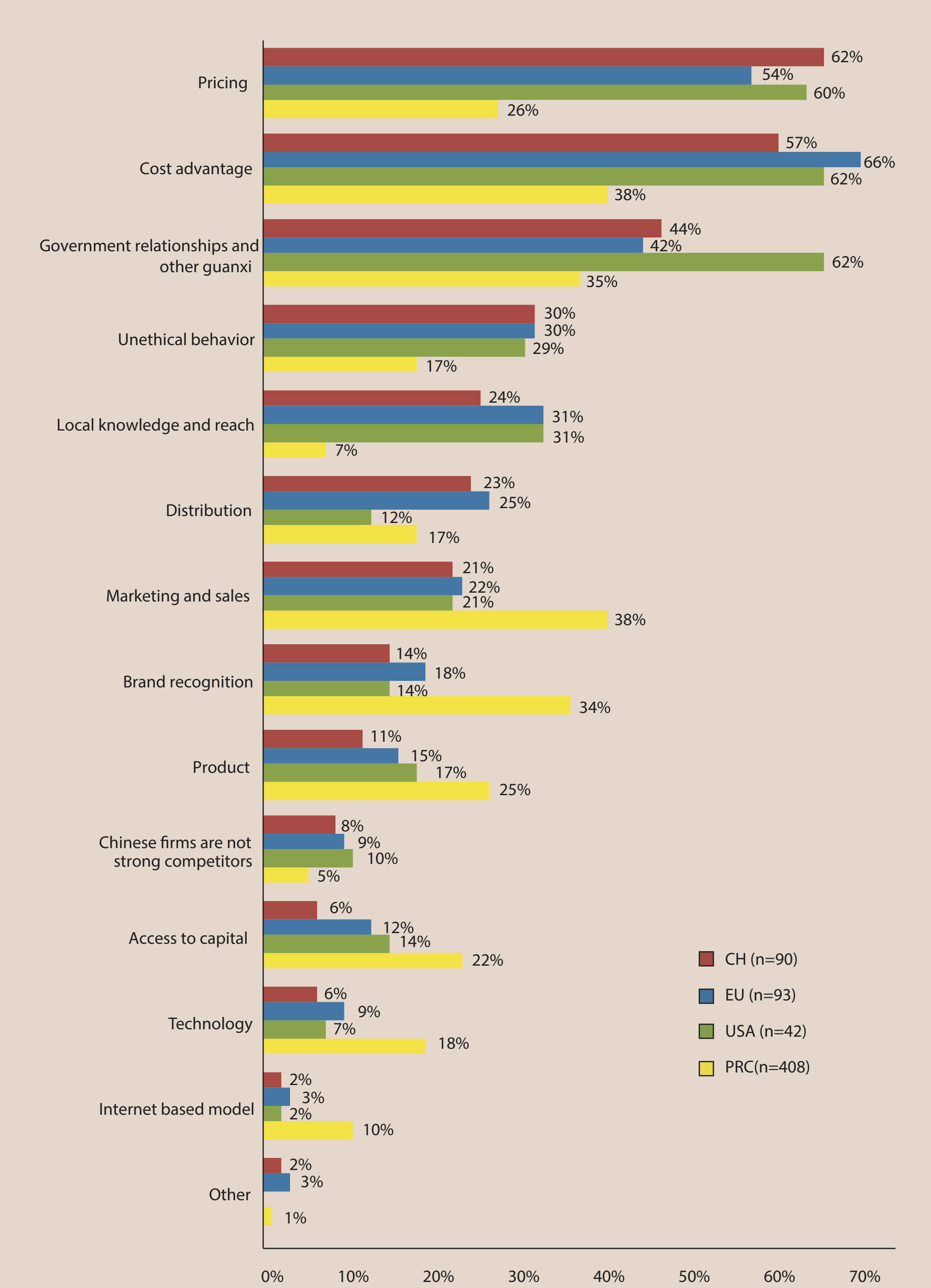


FIGURE 40 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN CHINESE COMPETITORS? (MULTIPLE ANSWERS)



Despite a more level playing field, competition from private Chinese companies is only likely to become fiercer as the Chinese government is due to support the Chinese private sector with more incentives as part of its economic reform agenda.

5.4 The key success factors: superior product quality and human resources

As seen in the past two surveys as well, quality tops success factors for all respondent demographics. In this area, U.S. companies present some interesting outliers, stressing "R&D and product innovation" considerably more than other foreign demographics and placing much less of an emphasis on "cost control, operations efficiency". Earlier in this survey, U.S. companies listed "innovation capability" as a much greater internal challenge than did EU and Swiss companies, which explains the push on R&D and innovation.

FIGURE 41 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA? (MULTIPLE ANSWERS)

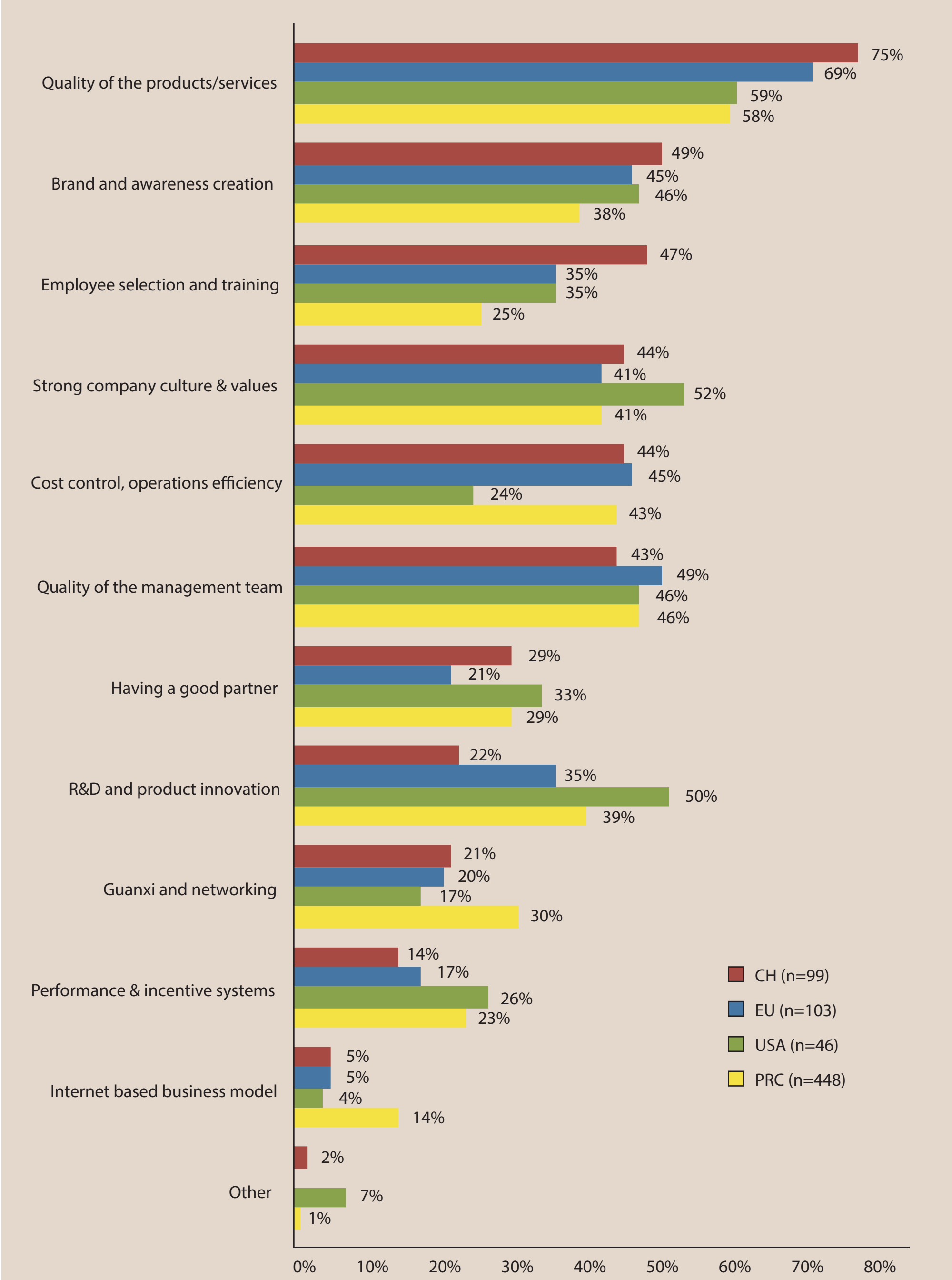
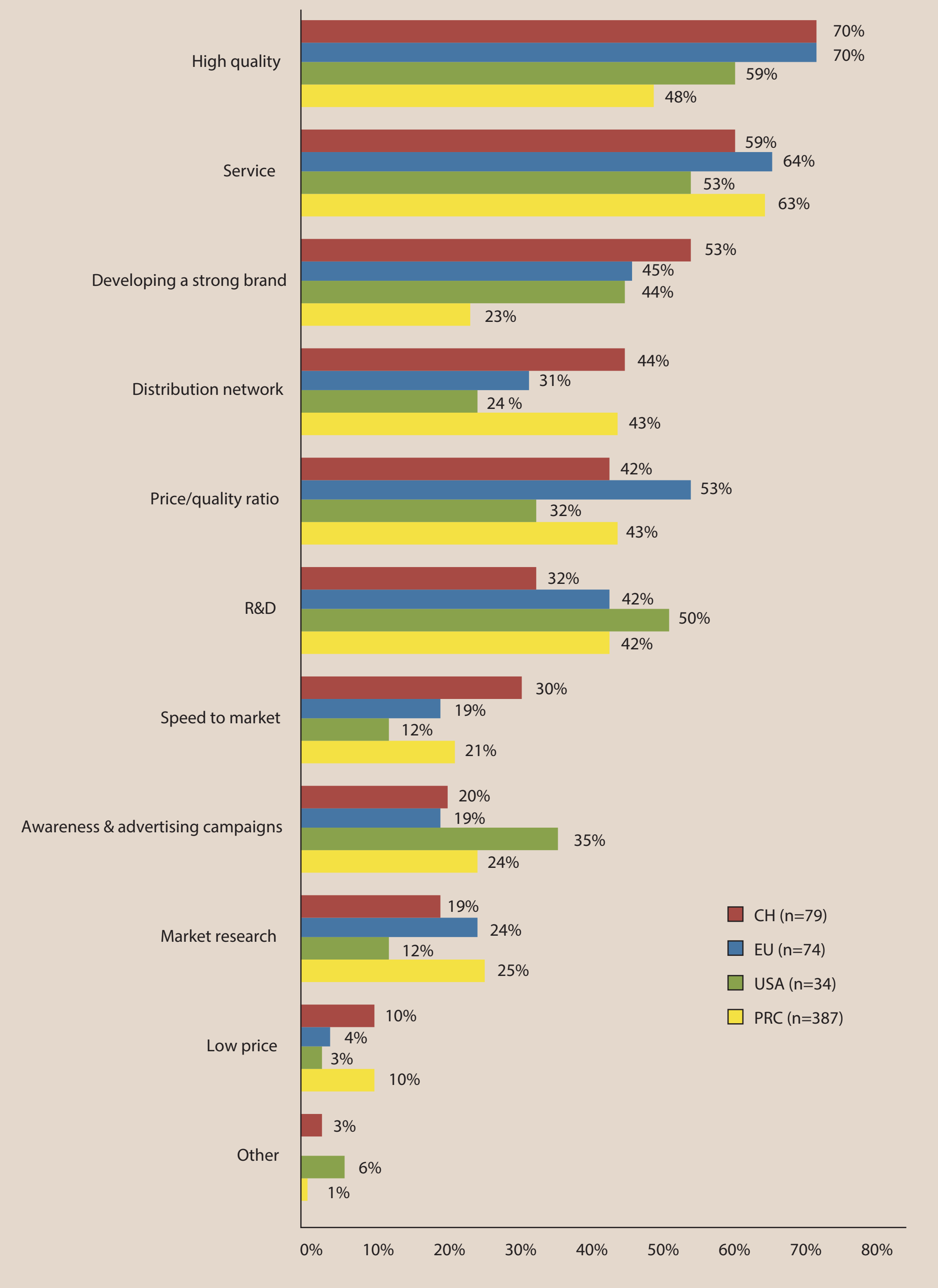
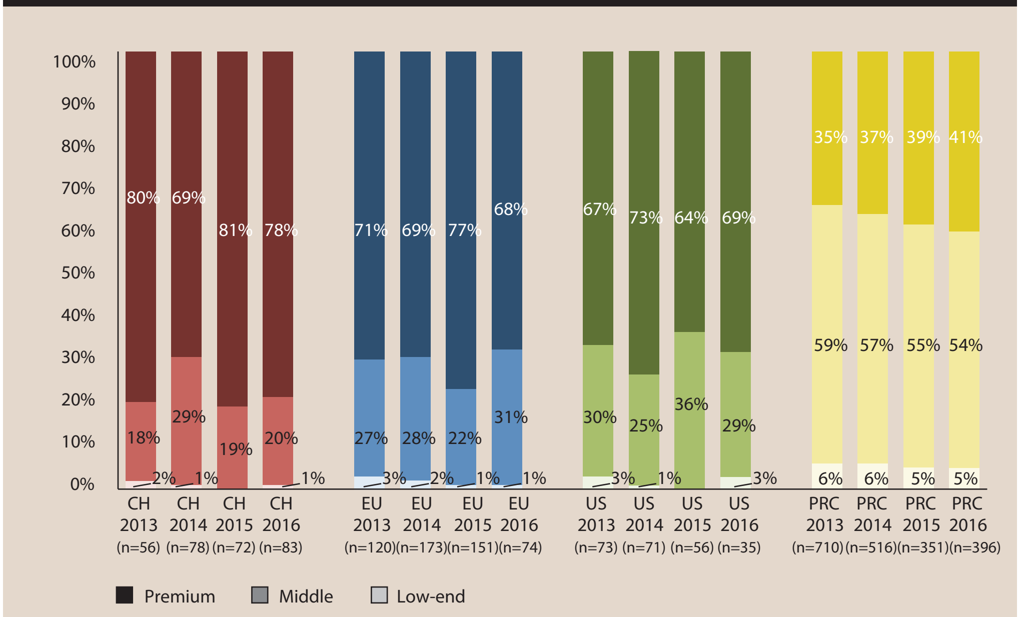


FIGURE 42 - PLEASE CHOOSE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA? (MULTIPLE ANSWERS)



The focus on quality and brand awareness by foreign companies is clearly understood when analyzing the segments within which foreign companies operate; **foreign companies are considerably more focused on the premium segments than their Chinese** counterparts:

FIGURE 43 - WHICH IS YOUR MAIN MARKET SEGMENT IN CHINA?

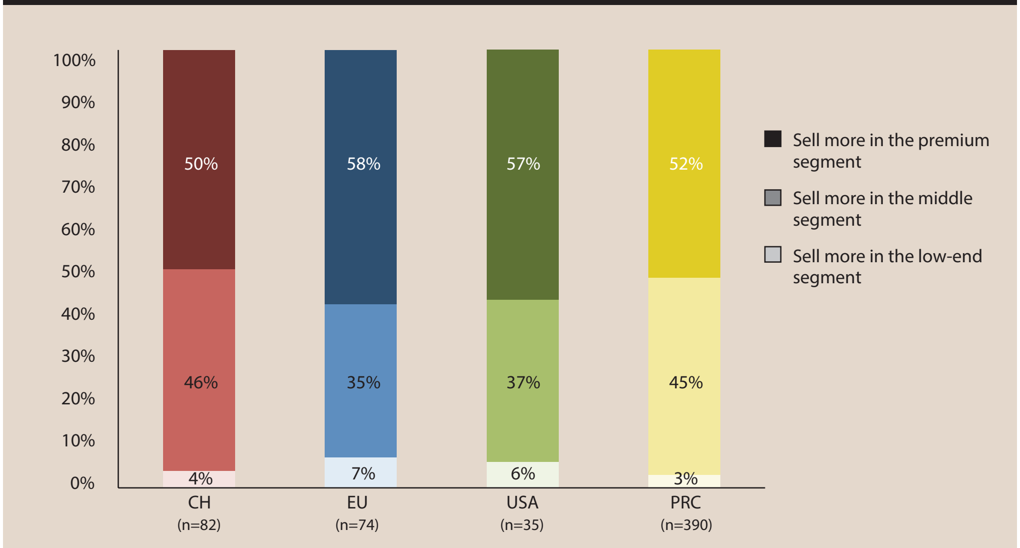


As expected, a very large majority of Swiss companies compete for the premium segment, unquestionably helped by a continued focus on high quality.

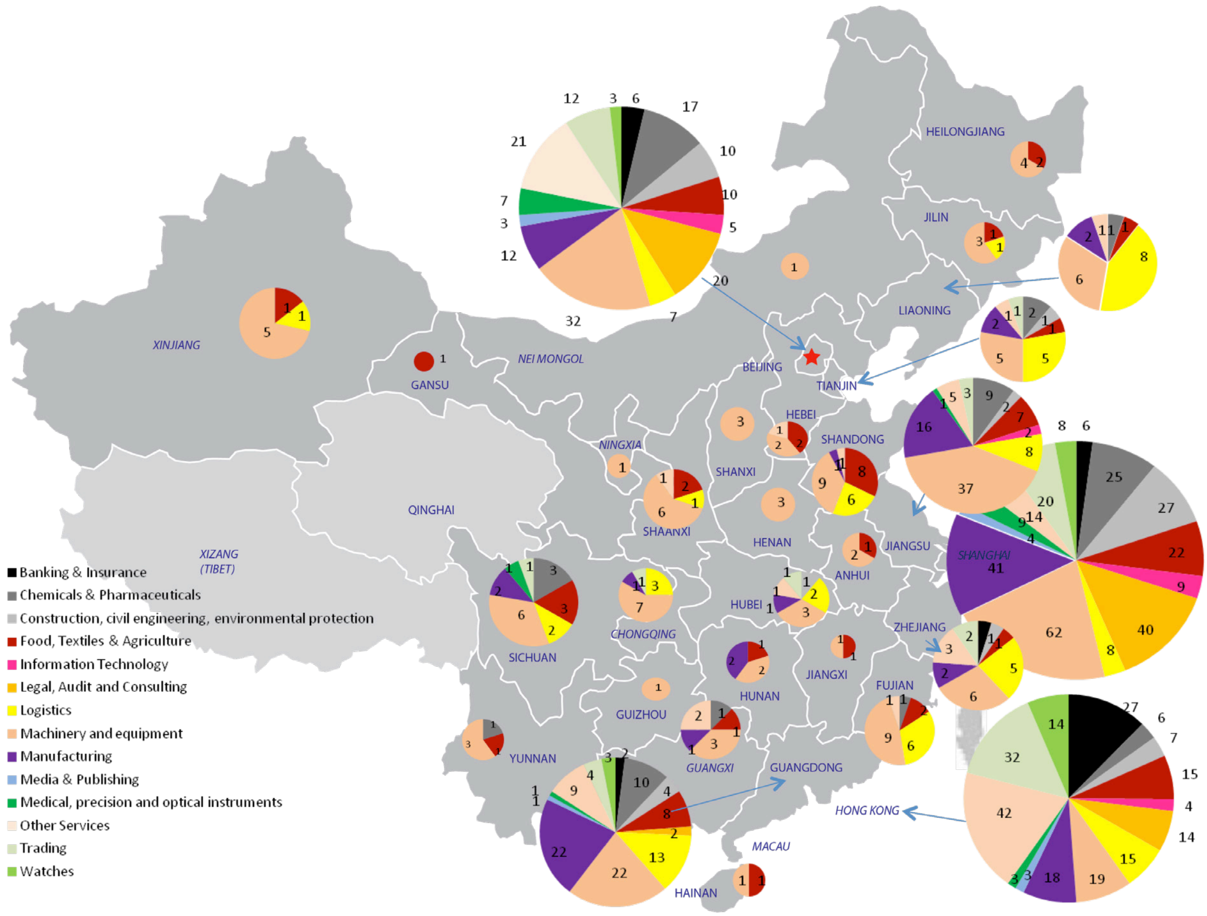
One may wonder if **leaving the mid-segment alone will provide too much of a fertile ground for local players to develop, improving quality and then challenging premium segment actors** on their own turf.

The intention in the chart below is to indicate very similar strategies of all players in terms of market segment development. Since Chinese are more active than foreign firms in the lower segments, **we may still expect foreign companies to dominate higher segments for a while.**

FIGURE 44 - WHAT ARE YOUR SALES PLANS FOR THE FUTURE?



5.5 Distribution of Swiss companies in China



5.6 Years in the market

With regard to establishment year, one can again note similar distributions among Swiss, European and American companies.

FIGURE 45 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? (CH COMPANIES)

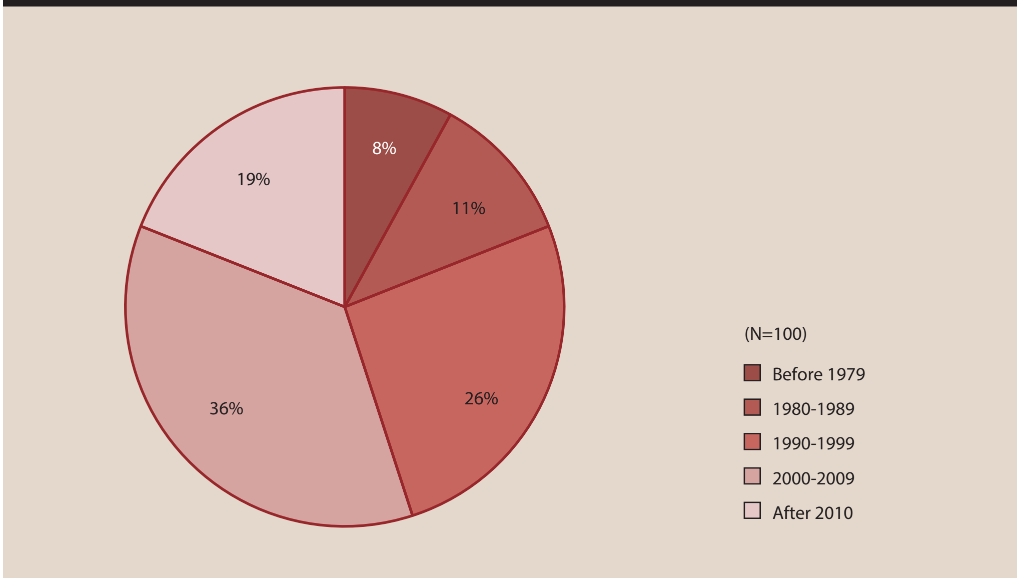


FIGURE 46 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? (EU COMPANIES)

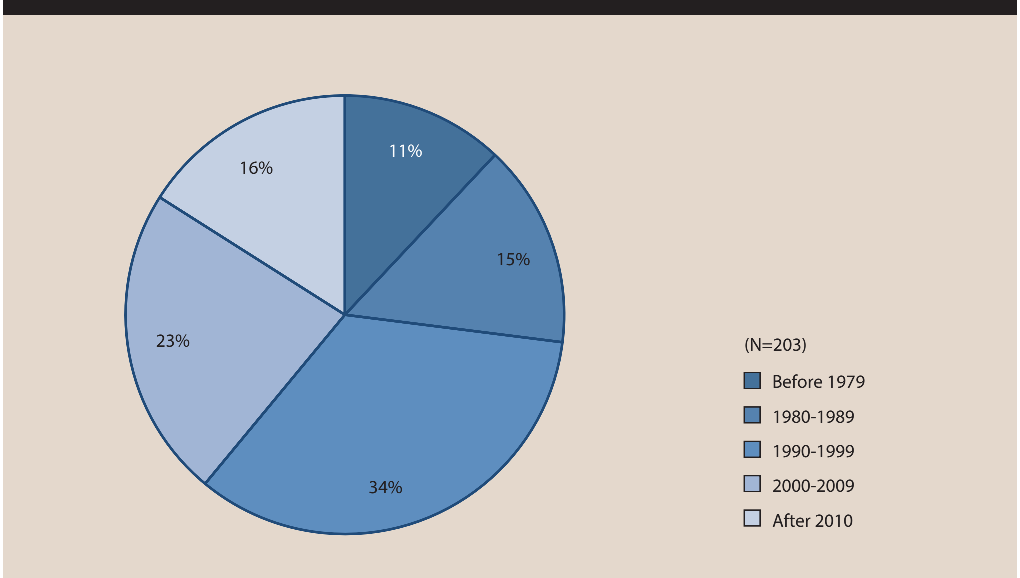


FIGURE 47 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? (US COMPANIES)

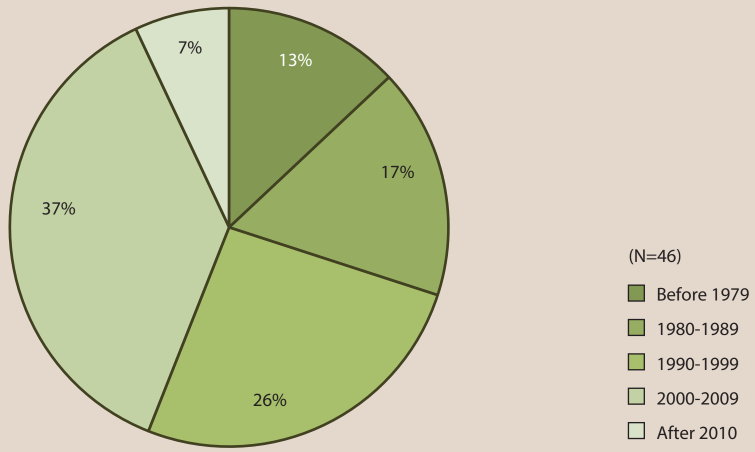
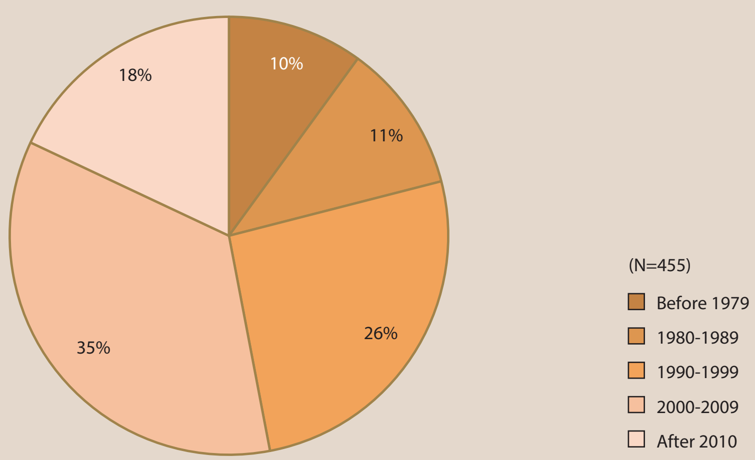


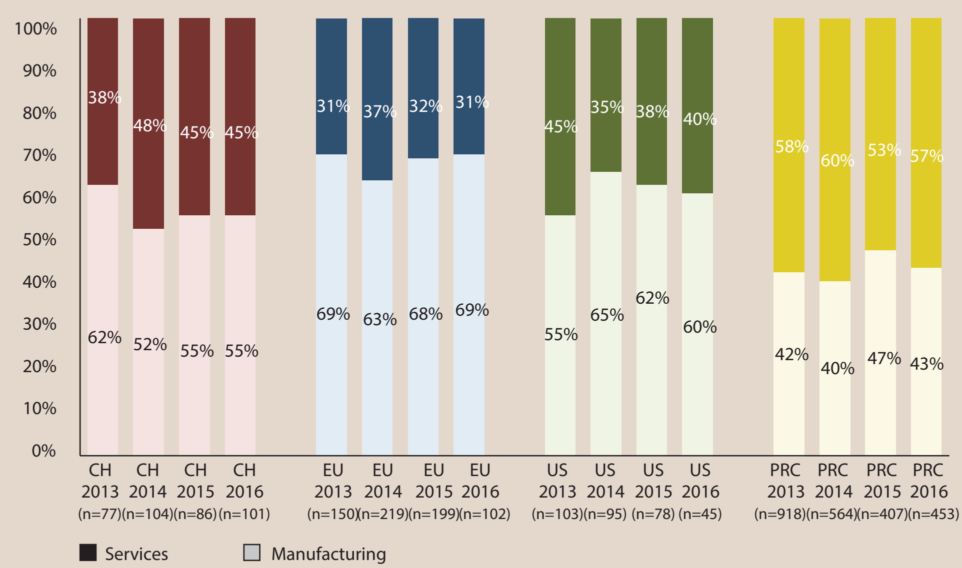
FIGURE 48 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? (PRC COMPANIES)



5.7 Industrial sectors and types of clients

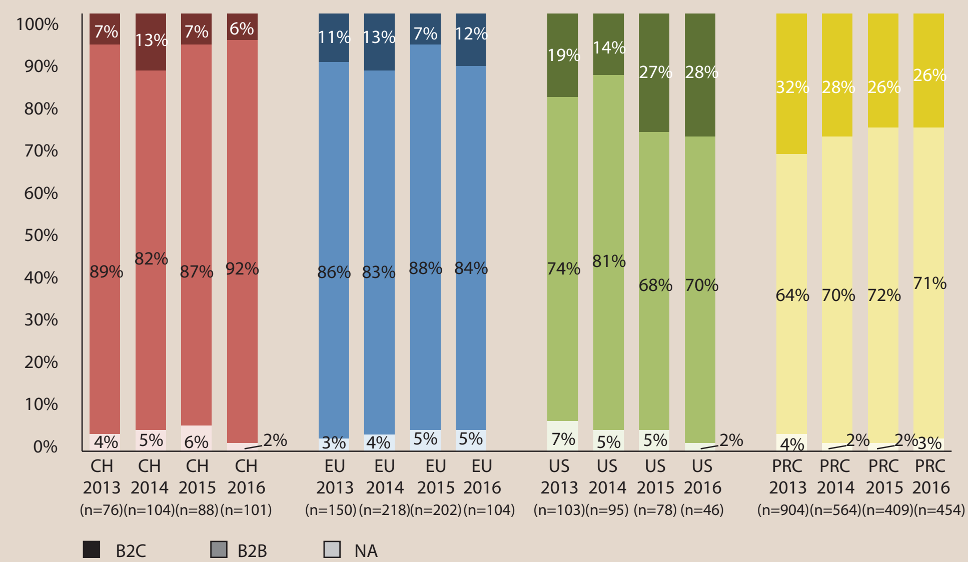
More than half of Swiss firms represented in the survey are manufacturing companies. This is again quite similar to American and European companies, while the Chinese companies answering are more in the service sector (57%).

FIGURE 49 - WHAT IS YOUR COMPANY MAIN ACTIVITY IN CHINA?



A similar situation occurs when looking at the customer base: Chinese and American companies are selling significantly more to the consumer segment than the EU respondents, who are more strongly focused on B2B clients, with Swiss companies predominantly in B2B (92% of the Swiss companies in this sample).

FIGURE 50 - WHO ARE YOUR CLIENTS IN CHINA?



2016 China Business Survey

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

China Europe International Business School

This research was supported by grants from CEIBS

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LETTER FROM THE RESEARCH TEAM

We are pleased to present the 6th annual CEIBS China Business Survey.

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

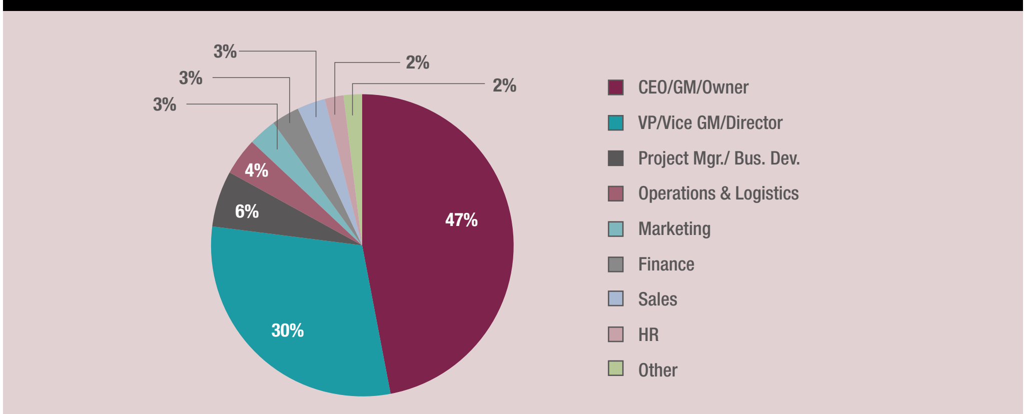
- Swiss Center Shanghai, Swiss Embassy in China, Swiss Business Hubs, Swissnex China, SwissCham, China Integrated. Ltd.
- China-Italy Chamber of Commerce

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 2015 and their expectations for 2016 and the future.

The 2016 CEIBS Business in China Survey was completed by 790 executives between November and December 2015, with 455 from Chinese companies and 335 from foreign companies. Among them were 374 CEOs, GMs, and company owners; 237 Vice Presidents, Deputy General Managers or Directors. The rest represented all the remaining business functions: HR, Finance, Marketing, Sales, Operations and Research & Development. Of the respondents, 80% are from the Chinese mainland, 3% from Taiwan, Hong Kong or Macao, and 17% from foreign countries. This broad and experienced sample added rich and valuable perspectives to the survey.

FIGURE 1 - WHAT IS YOUR POSITION IN THE COMPANY? N= 790



THE RESEARCH TEAM


Prof. Juan Antonio Fernandez

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


Prof. Bin Xu

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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. Zhou's research focuses on marketing strategies, game theory, MNE strategies in China and China's private enterprises. His research has been published in the Academy of Management Review, International Business Review, International Marketing Review, and others. Dr. Zhou has conducted consulting services for a number of firms (e.g. IBM, DuPont).


Maria J. Puyuelo

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

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

SPECIAL TOPICS

This section tackles subjects that are particularly relevant to current business life in China. This year, we examine the emergence of the service economy in China, and we delve into what Chinese companies need the most in order to succeed abroad.

- The Two Faces of the Chinese Economy
- Developing Global Leaders: the Missing Link of Chinese Firms Globalization

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

THE TWO FACES OF THE CHINESE ECONOMY

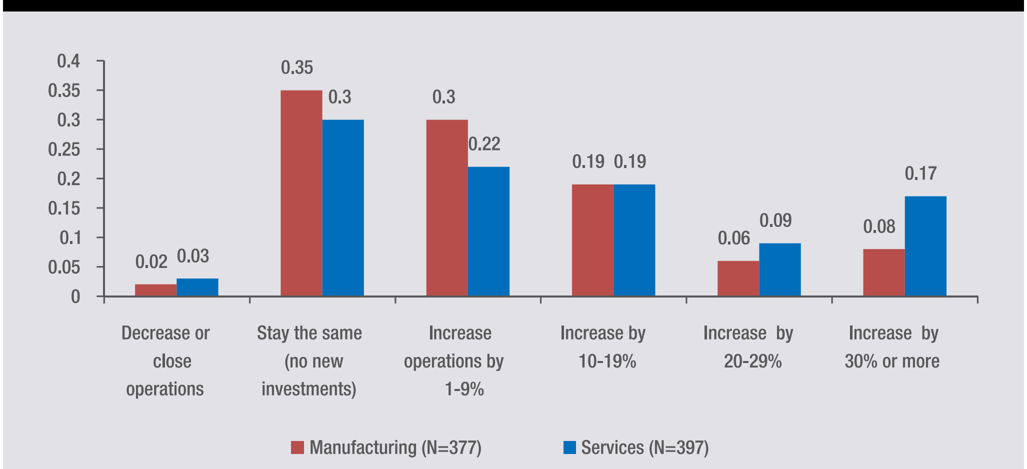
Business confidence levels in China are the lowest they have been in the last five years, according to the CEIBS Business in China Survey 2016. Hiding behind this dismal overall picture, however, are two distinctly different stories: a struggling manufacturing sector and a nascent service sector.

The business confidence levels of both Chinese and foreign executives polled last year for the CEIBS Business in China Survey 2016 are the lowest they've been in the last five years. However we see a different picture if we look at the Chinese economy in terms of its industrial and service sectors. On the one hand, the industrial and material sectors continued to struggle in 2015: on a scale from 0 to 10 (with 10 being the maximum) their executives said they were below 6 when it comes to business confidence. On the other hand, China's services and consumer goods sectors are on the rise and their executives said their confidence levels were 6.5 or above, with a remarkable 7.0 in the healthcare services subsector. These sharply contrasting "two faces" of business confidence reveal an important characteristic of the current Chinese economy which is undergoing a fundamental transition from its old investment-driven, industrial-centered growth model to one that is consumer-oriented and service-centered.

Service Sector Expected to Expand Further

China's service sector is expected to grow further in 2016 and beyond, fueled by investment. When asked about their plans for 2016 in China, 17% of service company executives in our survey said they will pump at least 30% more investment into the sector. In contrast, only 8% of manufacturing company executives said they plan to have such a huge increase in their China investments. The service sector's tendency to attract more investment is also evident at lower levels of the scale. While 45% of companies in the service sector said they plan to up investments by at least 10% this year, only 33% of those from the manufacturing sector were willing to make that commitment (Figure 2). So overall, with more investment planned, we expect that China's service sector will continue its expansion this year.

FIGURE 2 - WHAT IS YOUR INVESTMENT PLAN FOR 2016 IN CHINA? MANUFACTURING / SERVICES



The service sector will also see fast growth this year as a result of companies' increasing utilization of the Internet, which has already played a major role in transforming the country's business landscape in recent years. Looking ahead, many companies operating in China are planning on further harnessing the Internet's power to grow their business. However the degree of preparation differs across companies and sectors. Our survey findings suggest that, compared with manufacturing companies, those in the service sector are more proactive in taking advantage of Internet-related opportunities. Compared to 43% of the service sector companies in our survey that were already selling their services/products on the Internet in 2015, the number was only 32% for manufacturing companies (figure 3). Furthermore, 65% of the service sector companies said they plan to make their businesses more digitized; compared to 51% for the manufacturing companies (figure 4). Overall, given the continued strong growth of Internet use in China in terms of both customer bases and business applications, service sector companies seem to be better positioned to ride the Internet wave and further grow their businesses.

FIGURE 3 - DO YOU SELL YOUR PRODUCTS/SERVICES THROUGH ANY INTERNET BASED PLATFORM? MANUFACTURING / SERVICES

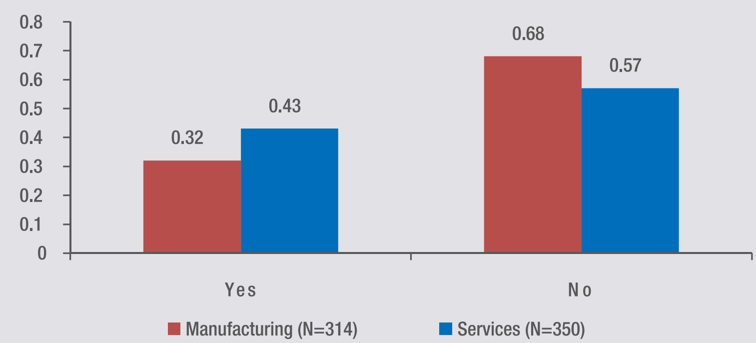
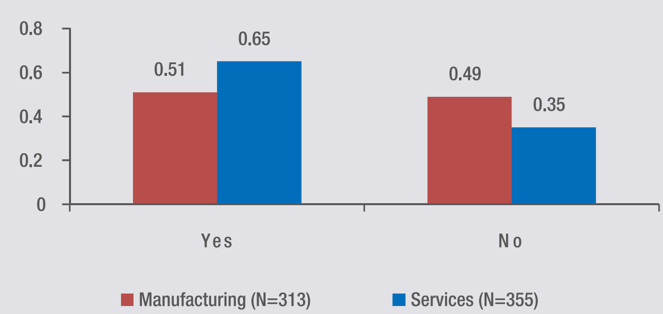


FIGURE 4 - DO YOU PLAN TO EXPAND THE DIGITIZATION OF YOUR BUSINESS? MANUFACTURING / SERVICES



Challenges Ahead

Despite the differences between the manufacturing and service sectors in terms of business confidence levels, planned investment and pace of growth, our survey reveals that all companies in China face the same challenges of rising labor costs and fierce competition. Looking more closely, though, we find that companies in the manufacturing sector are more affected by the slowdown of the Chinese and global economies than those in the service sector (figure 5). Among those polled, 67% of the executives from the industrial and basic material sectors said the economic slowdown in China is the greatest external challenge to their businesses. Meanwhile only 42% of the executives from the healthcare, technology and telecommunication sectors shared this view. In a similar pattern, 38% of the executives from the industrial and basic material sectors cited the slow global economy as a significant external challenge to their businesses, compared to only 12% of their counterparts from the healthcare, technology and telecommunication sectors.

FIGURE 5 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? ZOOM INDUSTRIES

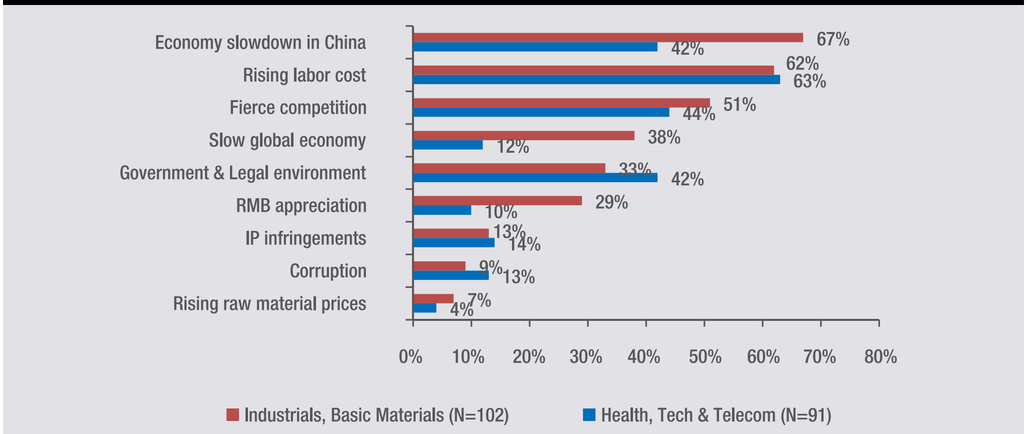
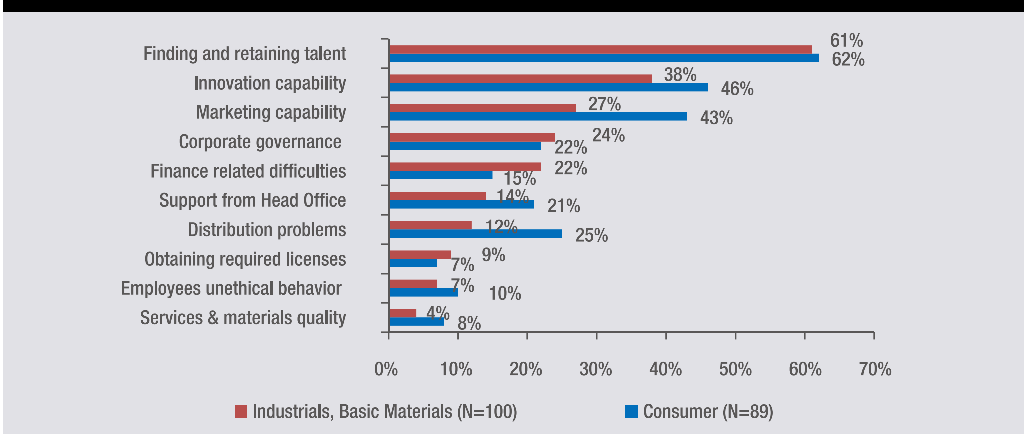


FIGURE 6 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA? ZOOM INDUSTRIES



In addition to these external challenges, companies in China also have to grapple with internal ones, especially in managing human resources and building innovative capability. The country's transition from an investment-driven economy to a consumer-oriented one poses different sets of internal challenges to companies from different sectors. We found that executives from the consumer goods and services sectors rated innovative and marketing capabilities significantly higher than their counterparts from the industrial and basic material sectors when asked about their internal challenges. Specifically, 46% of the executives in the consumer goods and services sectors considered innovative capability a top internal challenge to their business management, while only 38% of their counterparts from the industrial and material sectors thought so. With regard to marketing capability, the numbers are 43% versus 27%.

In addition, Figure 6 shows that for foreign subsidiaries in China, when it comes to getting support from head office, more executives from the consumer goods and services sectors (21%) considered it a serious challenge, compared to 14% of their counterparts from the industrial and basic material sectors. Figure 6 also shows, understandably, that more executives from the consumer goods and services sectors (25%) viewed distribution problem as a challenge than those from the industrial and basic material sectors (12%).

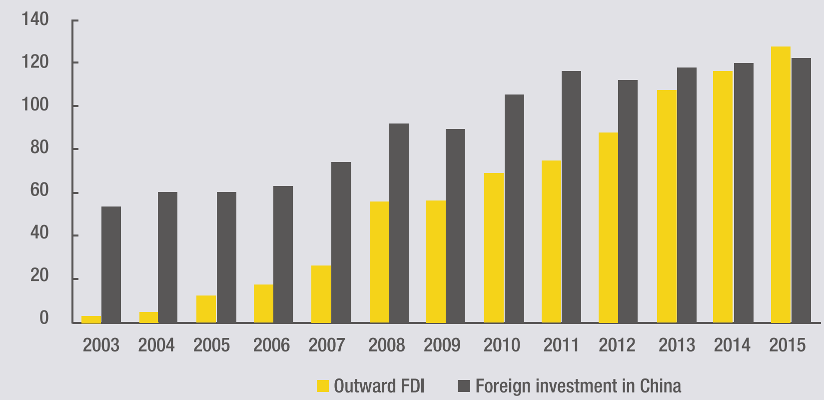
Thus, despite the fact that business confidence of both Chinese and foreign executives is the lowest it has been in the last five years, we find encouraging evidence of new growth momentum from service sectors and consumer-related industries. In evaluating China's business environment and formulating future business strategies, companies should not overlook this fundamental and positive transformation of the Chinese economy.

DEVELOPING GLOBAL LEADERS: THE MISSING LINK OF CHINESE FIRMS GLOBALIZATION

Globalization of Chinese companies is growing and success in foreign markets is becoming critical. In this article, we examine what it takes to win abroad and we uncover a key for Chinese business managers to become global leaders: develop their cultural intelligence.

China and Chinese companies are taking an increasingly significant global presence. According to a recent report by Ernst & Young[1], China is the world's third largest overseas investor and its investment is directed to practically every region of the world.

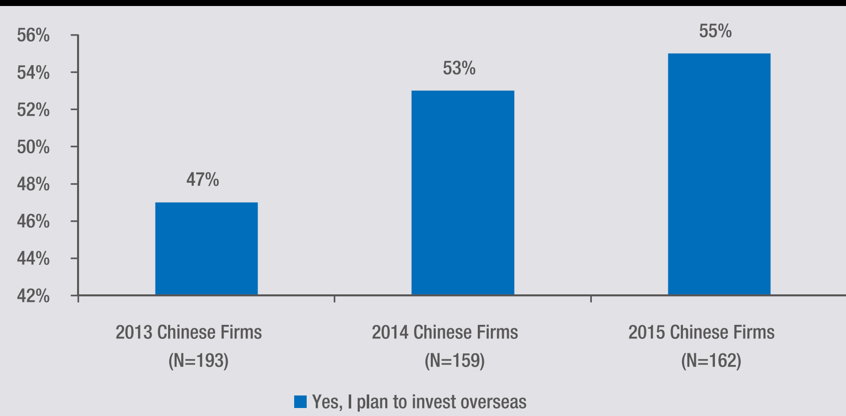
FIGURE 7 - CHINA'S OUTWARD FDI AND FOREIGN INVESTMENT IN CHINA DURING 2003-2015 (USD BILLION)



Source: National Bureau of Statistics of China, Ministry of Commerce.
Financial investment is not included in the data for 2006 or before; the data for 2015 is predicted by EY Knowledge.

The 2016 CEIBS China Business Survey confirms that overseas investment is becoming an integral part of the growth strategy of Chinese firms, with 36% of Chinese companies polled viewing it as a top business priority and 42% of them labeling it as important for their future. The importance of overseas expansion is growing when compared to previous editions of our survey (figure 8).

FIGURE 8 - THREE YEAR EVOLUTION: DO YOU PLAN TO INVEST OUTSIDE OF CHINA IN THE NEXT 3 YEARS?



[1] *Riding the Silk Road: China sees outbound investment boom. Ernst & Young, March 2015.*

However, FDI alone does not guarantee success; it is not just about investing money. Success overseas is a complex matter. The renowned economist Pankaj Ghemawat, introduced the CAGE Distance Framework in his article Distance Still Matters [2]. CAGE is an acronym that stands for Cultural, Administrative, Geographic and Economic distance. Companies have to consider cultural, administrative, geographical, and economic differences when investing abroad. The larger the differences, or distances, the bigger the challenges for success:

Cultural Distance	Administrative Distance	Geographical Distance	Economic Distance
Different languages Different ethnicities Different religion Different social norms	Absence of shared monetary or political association Political hostility Government policies Institutional weakness	Physical remoteness Lack of common border Lack of sea or river access Size of country Weak transportation or communication links Differences in climate	Differences in consumer incomes Differences in cost and quality of: • Natural resources • Financial resources • Human resources • Infrastructure • Intermediate inputs • Information or knowledge

To manage this complexity, global companies require a pool of global leaders to run their international operations. A report by the World Economic Forum [3] on Chinese global companies indicates that among the best practices are: developing global teams from the top, hiring and incentivizing local talents, and providing development for expatriates and deploying them in local teams. The WEF indicates that top leaders at head office must have global vision, be able to communicate effectively with people from different cultures, and deal with cultural conflicts. Regarding expatriates, they must have at least equal compensation than their local peers, marginal benefits regarding family support, and opportunities to attend global training. In summary, Chinese global companies need global leaders abroad but also at home.

The Global Leader in Chinese companies

Now the key question is what those Chinese companies can do to develop global leaders. Top management and Human Resource departments have a critical role. Designing career paths that include international experience as a requisite to reach higher positions in the organization is one important action. International assignments have to be considered as a necessary step in a corporate career not as a kind of exile or punishment. It is also important to provide the right support to the expatriate. Support includes training, attractive economic conditions and support to the family. A successful international assignment is the combination of three elements: company objectives, expatriate career objectives, and wellbeing of the expatriate's family.

How are Chinese companies preparing their global leaders? Basically, most companies use a strategy not very different from "Sink or Swim". According to Ernst & Young [4], many Chinese investors consider that their own culture is always the right way and even more, many of the overseas Chinese teams are formed by junior or middle-level managers with limited international experience. These two factors are a sure recipe for misunderstanding and eventually failure. This is a strategy with many risks. Besides the personal risk for the executive, we have the cost of failure for the company. A different and better strategy is to hire an executive with experience in international markets. However, the supply of these highly skilled executives is limited and therefore it can only be considered an enhancement approach. The only sustainable strategy in the long run for any company with international ambition is to form its own global executives. Unfortunately this is not always the preferred approach used by Chinese companies. Our own experience is revealing, as professors of leadership, we teach many courses to Chinese companies' executives. However, these companies almost never ask for specific trainings in cross-culture leadership.

[2] *P. Ghemawat. Distance Still Matters. Harvard Business Review, September, 2001.*

[3] *Emerging Best Practices of Chinese Globalizers: Tackle the Operational Challenges. World Economic Forum 2014.*

[4] *Riding the Silk Road: China sees outbound investment boom. Ernst & Young, March 2015.*

CEIBS China Business Survey gives us the opportunity to test the situation among Chinese top executives. Almost one third of the 586 Chinese executives polled, 28% of them, have worked abroad at some point in their career. Within these 164 Chinese executives with international experience, 75% declare to have five years or less of experience abroad, whereas 6% of them have spent more than ten years working outside of China. This number is very low considering that our sample includes some of the top companies in China and also Chinese citizens working for multinationals.

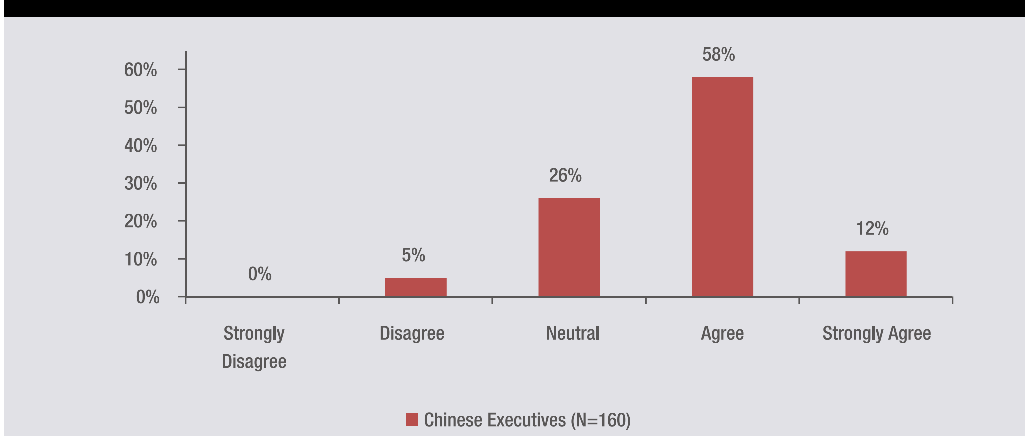
The Role of Cultural Intelligence

Having established the importance of developing global leaders in organizations and stressed the role of the top leaders and of their HR departments, it is important to now focus on the leader's role. What is required to become a global leader? For us, the answer is to develop Cultural Intelligence (CI) which can be defined as awareness to subtle differences in people's behavior due to culture differences and consequent adjustments in their behavior. CI is related to Emotional Intelligence. P.C. Early and E. Mosakowki [5] state, "A person with high emotional intelligence grasps what makes us human and at the same time what makes each of us different from one another. A person with high cultural intelligence can somehow tease out of a person's or group's behavior those features that would be true of all people and all groups, those peculiar to this person or this group, and those that are neither universal nor idiosyncratic." Psychologists consider three aspects of personality: cognition or thinking, behavior and emotions. Personality is what integrates those three aspects in different combinations. Early and Mosakowski called these three aspects in their CI model: head, body, and heart. By head, they mean learning strategies to notice clues to culture's shared understandings. In a way, it means to be open to differences and commonalities between our culture and others. But understanding, "head", others' culture is not enough; one needs to prove it by adapting one's behavior. That is the "body" element in Early and Mosakowski's model. Finally, "heart" refers to motivation to confront obstacles, setbacks and even failure and continue. Based on these three elements, Early and Mosakowski developed a questionnaire to measure CI. Using our survey, we selected three questions to represent the three components of CI. These three questions are:

1. Cognition CI (Head): When I come into a new cultural situation, I can immediately sense whether something is going well or something is wrong.
2. Behavior CI (Body): I easily change the way I act when a cross-cultural encounter seems to require it.
3. Emotion/Motivational CI (Heart): I can adapt to the lifestyle of a different culture with relative ease.

The results from these questions are shown in figures 9 to 11:

FIGURE 9 - COGNITIVE CQ: WHEN I COME INTO A NEW CULTURAL SITUATION, I CAN IMMEDIATELY SENSE WHETHER SOMETHING IS GOING WELL OR SOMETHING IS WRONG.



[5] *P.C. Early and E. Mosakowski. Cultural Intelligence. Harvard Business Review, October, 2004.*

FIGURE 10 - PHYSICAL CQ: I EASILY CHANGE THE WAY I ACT WHEN A CROSS-CULTURAL ENCOUNTER SEEMS TO REQUIRE IT.

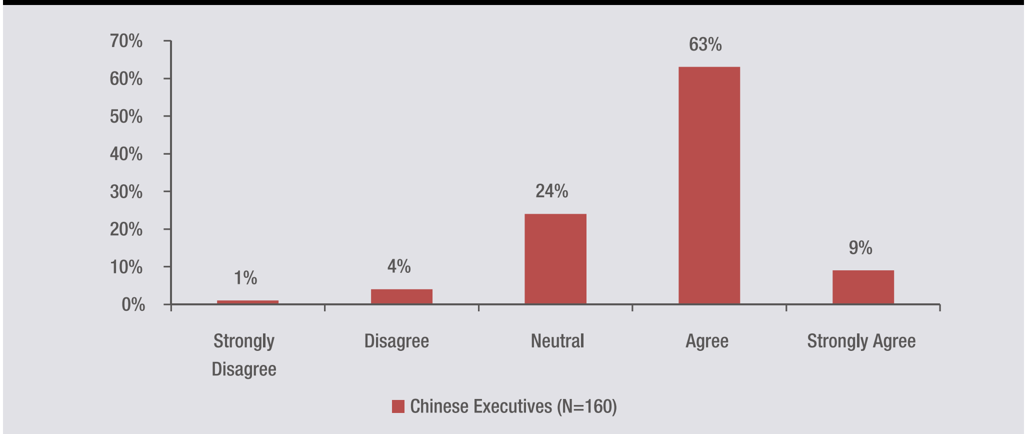
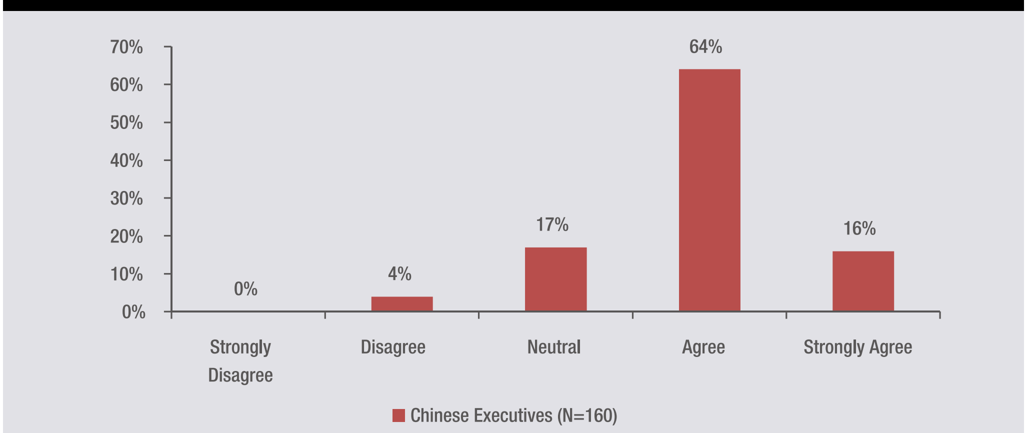


FIGURE 11 - EMOTIONAL/MOTIVATIONAL CQ: I CAN ADAPT TO THE LIFESTYLE OF A DIFFERENT CULTURE WITH RELATIVE EASE.



When we aggregate the results of the above three CI questions into one number expressing "Average CI" we obtain a value of 3.8, out of a maximum possible of 5, for Chinese executives in our sample. When analyzing by type of company they work for, we observe a slightly higher value of CI for those working for Chinese private firms (3.9) than for executives in SOE companies (3.7). Those Chinese executives with international experience in our sample show good CI. This is of course a limited sample, only 160 Chinese executives, that does not represent the universe of Chinese executives. Chinese companies need more of those if they want to be successful in foreign markets.

How can we develop CI?

Adults mainly learn by experience. So having international experience is the way to go. If we use the "Sink or Swim" method we run a high risk of failure. Some executives are better learners than others and, furthermore, some of them are more talented to surviving in a foreign environment. We cannot leave this outcome to chance. This experience needs to be accompanied by reflection and subsequent behavior adjustment. However, most executives are action oriented, and do not dedicate enough time to reflect. Another important component besides experience, reflection and behavior adjustment is training. The right training can help us avoid some of the most common mistakes in cross-cultural situations and give us a push in the right direction. But training in cross culture leadership is challenging. We are talking about changing mindsets, and that is always difficult.

One option is the Four E's model [6]. The Four E's stands for Examine, Expect, Educate, and Experience. Examine refers to being aware of our own cultural perspective. This is probably the most difficult step. People without self-cultural awareness usually react to cultural differences with "what's wrong with them?" Understanding that our culture is just one possible perspective and that other people see the world in a different light is the first step in cultural intelligence. The second E stands for Expect cultural differences. We must open our mind and try to be aware of differences; some can be very subtle others are very explicit. Thirdly, Educate yourself about different cultures. This can be by reading books about other cultures, trying different cuisines, watching movies, having friends from other countries and participating in global training. Finally, Experience cross-cultural interaction and learn from these situations. You will not be perfect from day one, you will certainly make mistakes. Do not give up, learn from those mistakes and adapt. Acquiring CI is a trial and error method and the only critical condition is to have an open mind, or as it is often called in psychology, a growth mindset.

Leading in a different culture can be challenging. It certainly adds complexity to an already difficult job. But at the same time it can be an enriching and transforming experience. If you want to be a rounded leader, cross-cultural savvy is something you should possess.

[6] *The Four E's model was developed by Juan A. Fernandez, professor at CEIBS.*

SECTION 1

DESCRIPTION OF THE COMPANIES PARTICIPATING

This section details the following information about the companies that have participated in the 6th edition of the CEIBS China Business Survey

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

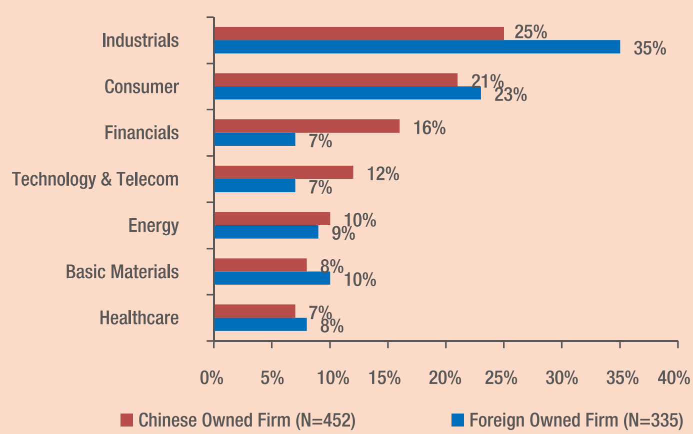
The purpose of the section is to give a general overview of the type of companies that took part in the survey. This information helps clarify the scope of the survey and provides background to interpret survey results.

A total of 790 companies operating in China have participated in the 2016 edition of the CEIBS China Business Survey. This sample of businesses includes 455 (58%) Chinese owned companies (i.e. with 50% or more Chinese ownership)[7] and 335 (42%) foreign-owned companies (i.e. with more than 50% foreign ownership).

In terms of business activity, the sample is well balanced with 49% of firms having their main activity in manufacturing and 51% in services. 75% of the total sample of firms are B2B companies, having other businesses as main clients, while 25% are B2C companies, offering products and services directly to consumers.

The industries represented are varied, topped by industrial products and services (228 firms, 29% of total sample), consumer goods and services (174 firms, 22%), Financials (94 firms, 12%), Technology and Telecommunications (10%), Basic Materials like chemicals, forestry and mining (9%), Energy (9%) and Healthcare (8%). However, we observe a considerably larger presence of financial companies within the Chinese-owned firms of our sample (16% versus 7% of foreign firms), a consequence of existing regulations limiting or constraining foreign investment in the sector. Foreign-owned firms are markedly more represented in "Industrials" with 35% of them vs. 25% of Chinese-owned firms in the industry (Figure 12).

FIGURE 12 - WHAT IS THE MAIN INDUSTRY WHERE YOUR COMPANY OPERATES?



In terms of market position, the firms surveyed operate mostly in the mid and high ends of the market. According to survey answers [8], 339 firms (52%) in our sample operate mainly in the premium segment, another 292 (44%) in the middle segment and only 27 (4%) in the low-end of the market. Moreover, 207 companies (31%) identify themselves as market leaders for their main business line and 281 (43%) 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 67% of foreign companies in the sample in the premium segment vs. a lower 41% of Chinese-owned firms. Inversely, 54% of Chinese-owned firms operate in the middle segment of the market, while 31% of foreign-owned do so.

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

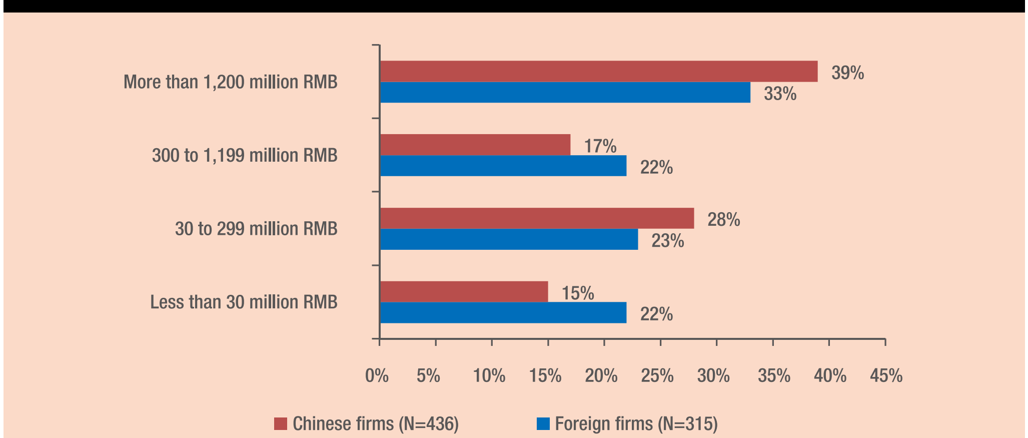
[7] *Including Chinese controlled Joint Ventures*
[8] *N= 607*

FIGURE 13 - WHERE ARE YOUR GLOBAL HEADQUARTERS LOCATED? N=790

In 2015, participating companies had generated collective revenue of more than 380 billion RMB and were employing more than 2.5 million people in China alone.

Of participating companies, 56% of the Chinese-owned firms and 55% of the foreign-owned firms surveyed are considered large [9] (Figure 14).

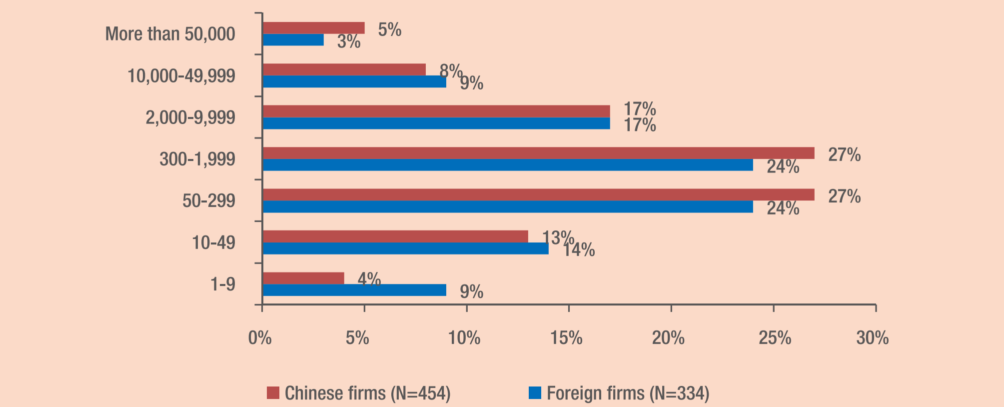
FIGURE 14 - WHAT ARE YOUR COMPANY'S TOTAL CHINA SALES IN 2015?



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

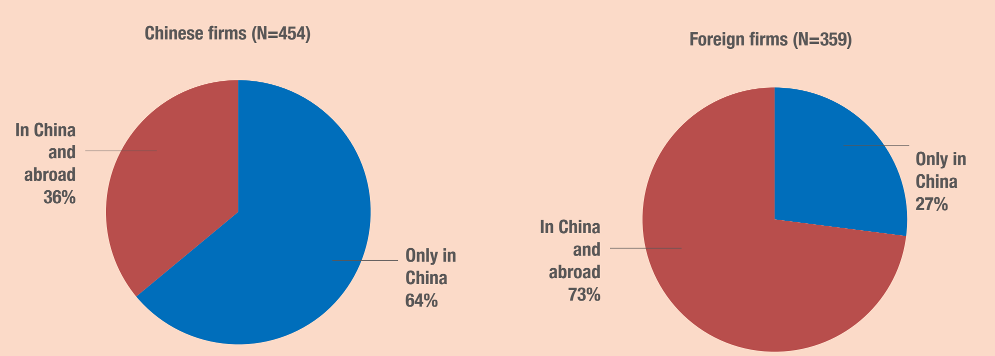
The sample of companies varies widely in size, ranging from companies with less than 10 employees in China to those with more than 50,000. Surveyed Chinese firms tend to be larger than foreign ones with, in average, 3,700 employees in China or more, compared to 2,800 or more for foreign-owned firms. Moreover, 23% of foreign-owned firms surveyed have less than 50 employees versus only 17% of Chinese firms (Figure 15).

FIGURE 15 - HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?



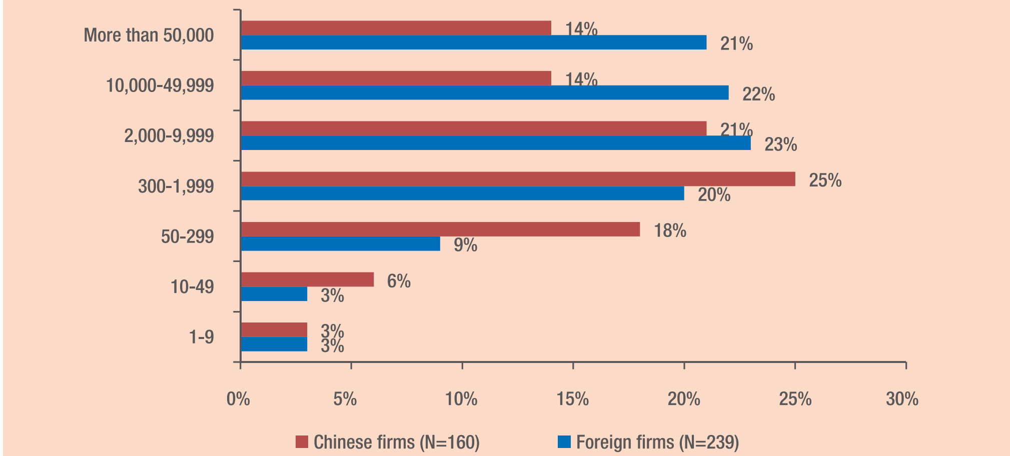
36% of the Chinese owned firms in our sample have operations abroad too. And although 73% of foreign firms in our sample are international, there is a non-negligible 27% of foreign owned firms that only operate in China. These are foreign entrepreneurs who have started their business ventures in China (Figure 16).

FIGURE 16 - WHERE DOES YOUR COMPANY HAVE OPERATIONS?



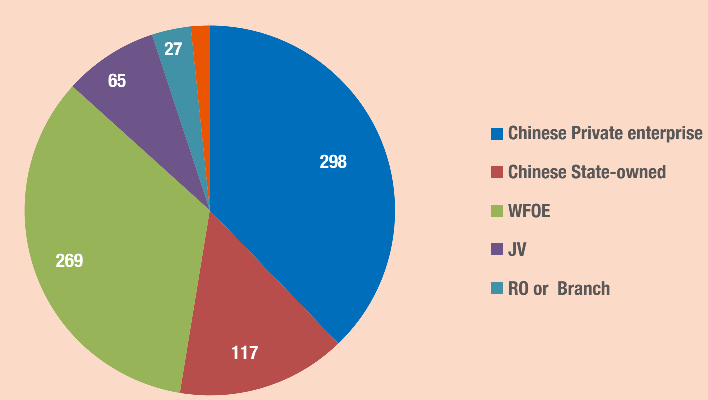
Within the companies that operate both in China and abroad, foreign-owned ones are overall larger in their global operations than Chinese-owned firms. 43% of the surveyed foreign companies with international operations have more than 10,000 employees globally vs. 28% of their Chinese-owned counterparts. Chinese international firms in our survey fall mostly within the small and medium categories (27% with < 300 employees, 46% with 300-9,999)[10] (Figure 17).

FIGURE 17 - FIRMS WITH INTERNATIONAL OPERATIONS- HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE GLOBALLY?



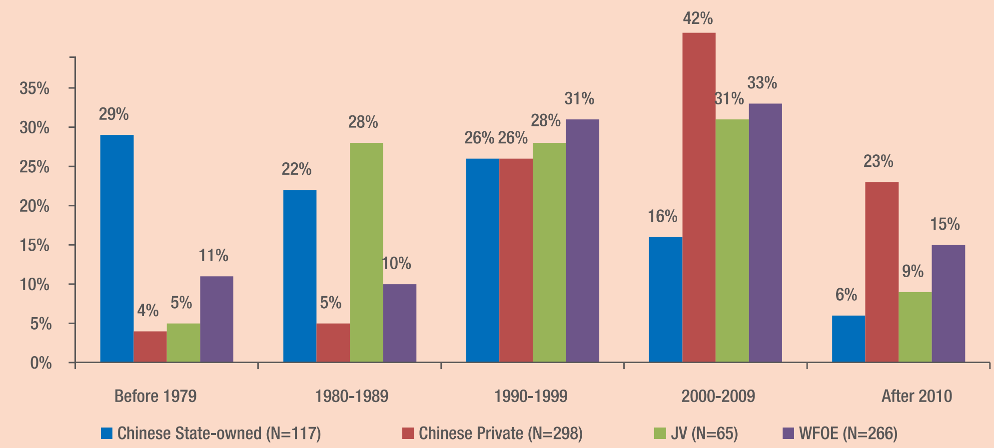
38% of surveyed companies are Chinese privately owned or private-holding companies and 15% are state-owned or state-holding enterprises. Joint Ventures (JV) constitute 8% of the sample, with different levels of Chinese and foreign ownership. Most of the foreign-owned companies are Wholly Foreign Owned Enterprises (WFOE, 34% of total sample), with Representative Offices (RO) and Branches of foreign companies making up the rest (Figure 18).

FIGURE 18 - WHAT IS THE LEGAL STATUS IN CHINA OF THE COMPANY YOUR WORK FOR? N=790



[10] *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 19 - WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?



Most of Chinese private companies in our sample, 91%, have been established after 1990 following the economic reforms initiatiated by Deng Xiaoping in the late 1980s and early 1990s, which triggered a remarkable growth of the private sector (Figure 19). In contrast, half of the SOE in our sampled were established before 1990.

SECTION 2

BUSINESS INDICES

This section presents four Indices:

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

Business Performance Indices are:

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

These two directional indices were introduced in the 2013 report to measure variation both in current and expected performance of the surveyed companies. Each index (ranging from 0 to 100) is constructed similarly to the well-known Purchasing Managers' Index (PMI): an index reading of 50 means that performance is unchanged compared to previous year, a number over 50 indicates an improvement while anything below 50 suggests a decline. The further away from 50 the index is, the stronger the change over the period. The indices are based on multiple choice questions with 5 possible answers [11] .

Business Confidence Indices are:

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

The Business Confidence Index is a measure of the optimism stated by executives in our sample with respect to the evolution of their businesses for the next year (2016) and the next 5 years (2016 to 2020). These 2 indices have been part of the CEIBS Business in China Survey since its inception 4 years ago, which allows us to start recognizing emerging trends as well as current values.

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

*[11] 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.

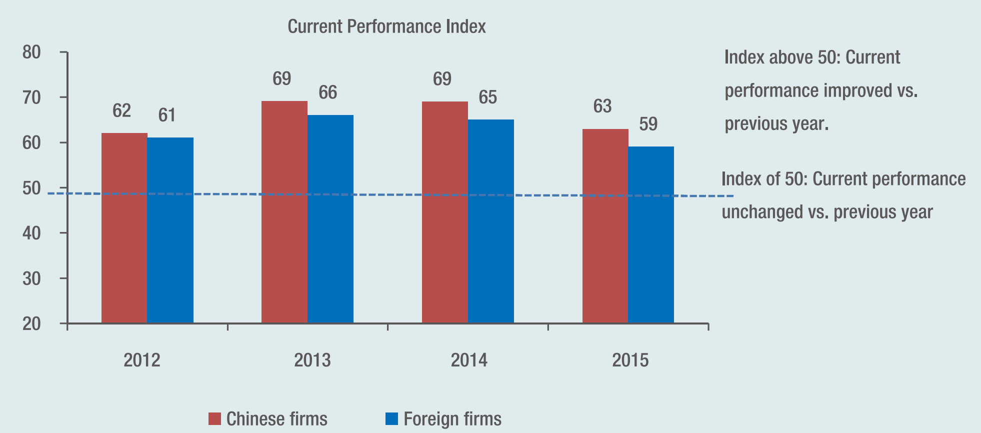
2.1. CURRENT PERFORMANCE INDEX – CPI

Majority of respondents reports revenue & profit growth. However, we notice a downtrend versus last year.

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

2015 Current Performance indices (CPIs) are higher than 50, reflecting an improvement for both sampled Chinese and foreign firms in their 2015 business results, when compared to 2014. Chinese owned companies in our sample reflect slightly better results than foreign ones. The indices are lower than in 2014 and 2013, reflecting a slight deceleration in results for polled companies, which declare sales and profit growth in 2015 in levels similar to those in 2012. These results are consistent with the evolution of the Chinese economy in 2015: Current Performance Index for 2015 is 63 for Chinese companies and 59 for foreign companies, versus last year's indices of 69 and 65 respectively. An index above 50 indicates performance improvement vs. the previous year, the further away from 50 the index is, the stronger the change over the period. Performance is based on both revenue and profit evolution in 2015.

FIGURE 20 - CURRENT PERFORMANCE INDEX



Given that the CPI integrates sales and profits results into one index, we can explore both business indicators separately to better understand the growth decline in 2015.

<u>Sales:</u>
Figures 21 and 22 reflect the answers of our sample to the question "How do you expect your company's China sales compared to last year?" as asked in 2015 and 2014. We observe that 50% of Chinese firms reported higher or substantially higher sales for 2015, vs. a higher 59% in 2014. Within foreign firms, less than half of our sample reports sales growth in 2015 (46%) and 22% of them experience decrease in sales vs. 2014.

FIGURE 21 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES IN 2015 COMPARED TO 2014?

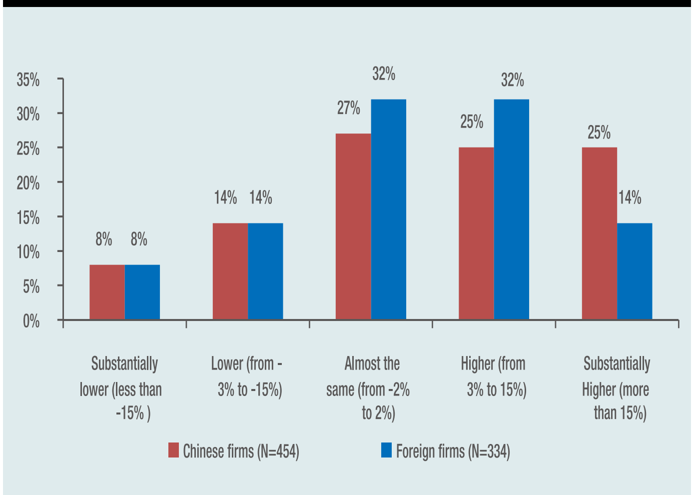
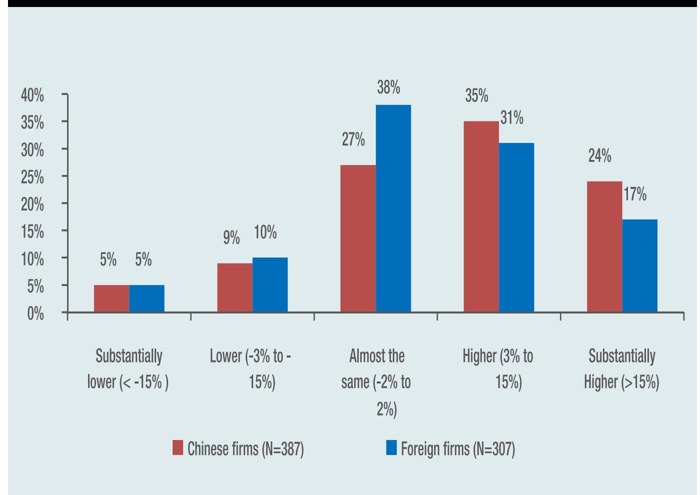
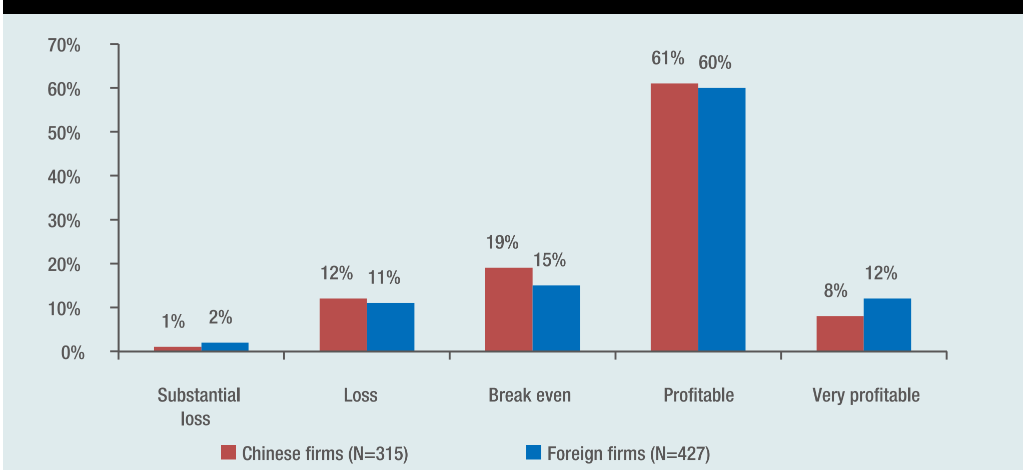


FIGURE 22 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES IN 2014 COMPARED TO 2013?



Profits:
In our overall sample, 71% of the companies declared being profitable or very profitable in 2015, while 13% incurred losses, a situation degraded versus last year's survey in which 76% of firms declared profits and 8% of them declared losses. Figure 23 reflects the profit situation of our sample in 2015, separating the results of Chinese and foreign firms.

FIGURE 23 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2015?



When we focus further on the profit evolution in the past four years, we notice that within the Chinese firms, the proportion of profitable firms has been decreasing since 2013. Nevertheless, there is still a majority of 69% of polled Chinese companies profitable or very profitable in 2015 (Fig. 24). Foreign firms in our sample exhibit a more stable profitability for the past four years (Fig. 25). When we look into legal status of the sampled Chinese companies, we observe that Chinese Private Companies have been hit harder in their profitability than SOEs, with 65% of them declaring profits versus a higher 76% last year.

In terms of industry, Industrials and Energy firms in our sample report the biggest deceleration in profits with 38% and 40% of them expecting growth in profits in 2015 (vs. 47% and 47% respectively in 2014). Technology and Telecom reports a positive evolution, with 56% of our sample declaring increase profits in 2015, vs. a lower 52% in 2014.

FIGURE 24 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2015? CHINESE FIRMS

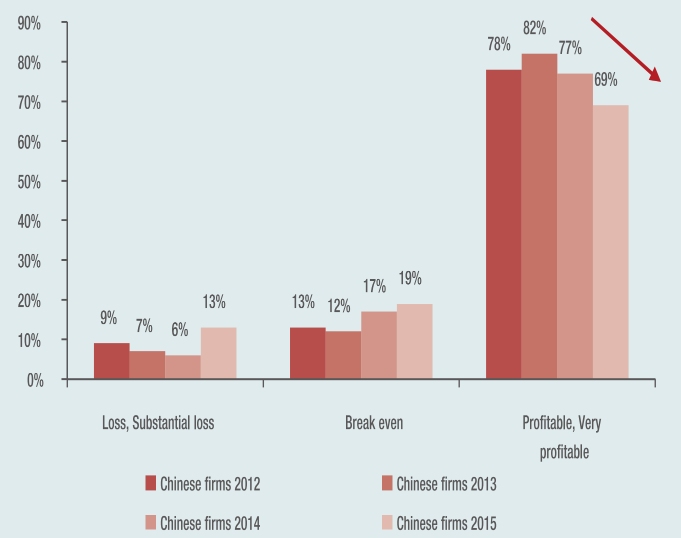
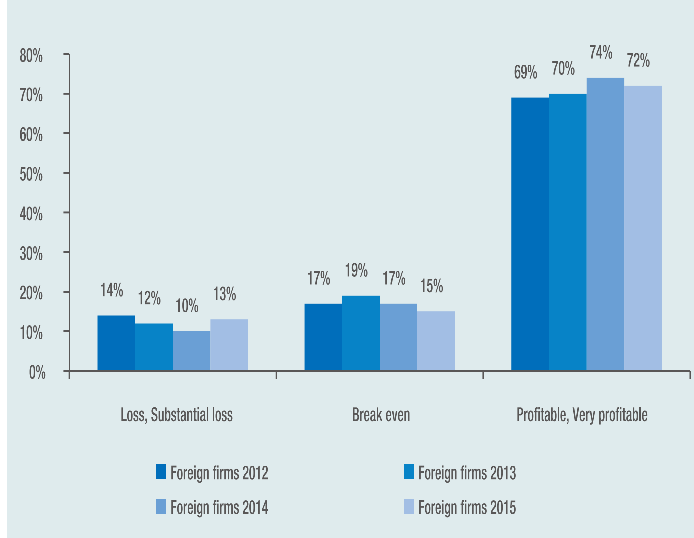


FIGURE 25 - HOW PROFITABLE DO YOU CONSIDER YOUR CHINA OPERATION IN 2015? FOREIGN FIRMS



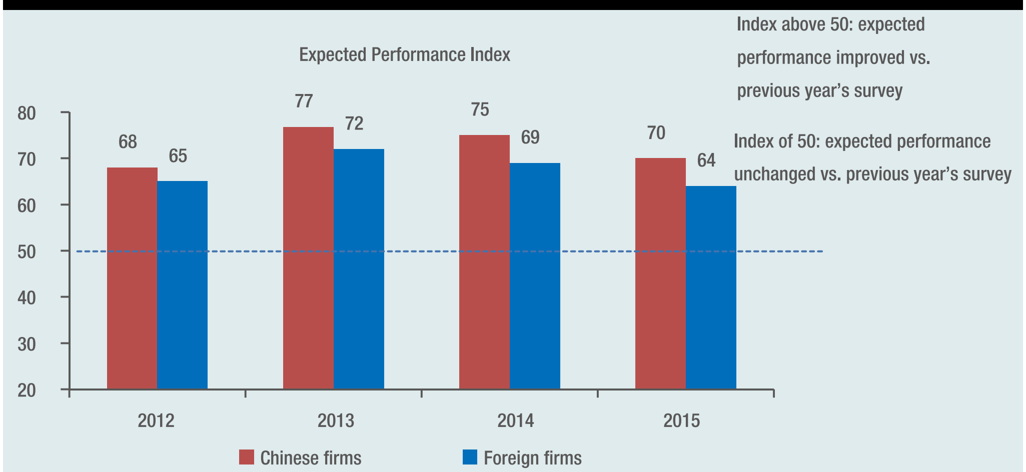
2.2. EXPECTED PERFORMANCE INDEX – EPI

Growth expectation for 2016 is cooling down although not dramatically.

A majority of the companies surveyed are optimistic for 2016, although less than what they were in 2014 and 2015 surveys. The Expected Performance Index (EPI) amounted to 70 (Chinese companies) and 64 (foreign companies), reflecting an expected growth in 2016 for both types of companies (an index above 50 indicates expected growth in sales and profit, the further away from 50 the index is, the stronger the change over the period).

Last two year's survey EPI was higher than this year's EPI for both groups of firms: 75 and 77 for Chinese companies and 69 and 72 for foreign companies, reflecting a cooling of expectations for the future. In terms of expected evolution of performance for 2016 (sales and profit compounded), our polled companies are at a level similar to what they declared in 2012 for 2013 (Figure 16). The EPI is calculated as a composite of 2 survey questions: Revenue and Profit Level expectations for 2016. Each variable is attributed the same weighting.

FIGURE 26 - EXPECTED PERFORMANCE INDEX



When we look at planned investments in China for 2016, which are closely related to growth expectations, a cautious optimism is observed. A large 65% of the total polled companies declare an intention to increase investment in China in 2016, with only 3% of total respondents anticipating decreases in investments. These investment plans are robust and represent only a slight decrease versus last year's survey declared intentions (67% of firms claimed intentions to increase investment in 2015 and 2% to reduce operations). However, when we examine the data more in detail we detect cautiousness compared to the previous two survey editions:

- We notice a negative evolution in the intention to increase investments in China for foreign firms and for the past four years (66% in 2013, 65% in 2014, 61% in 2015, 56% in 2016 - Figure 27)
- Although Chinese firms show relative stability in their intention to increase investments in China compared to previous years (67% in 2013, 71% in 2014, 73% in 2015, 72% in 2016 - Figure 28), Figure 29 reveals a relative drop in percentage of Chinese companies planning large investments (of more than 10% increase) in 2016 coupled with an increase in percentage of Chinese companies planning investments increases of less than 10% .

FIGURE 27 - FOREIGN FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR THE NEXT YEAR IN CHINA?

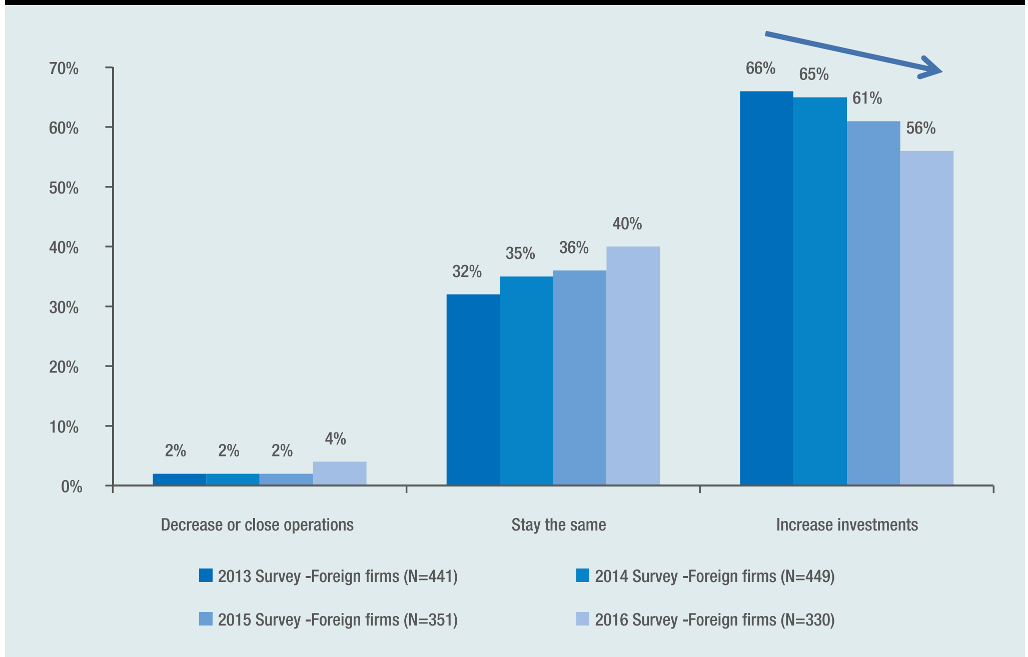


FIGURE 28 - CHINESE FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR THE NEXT YEAR IN CHINA?

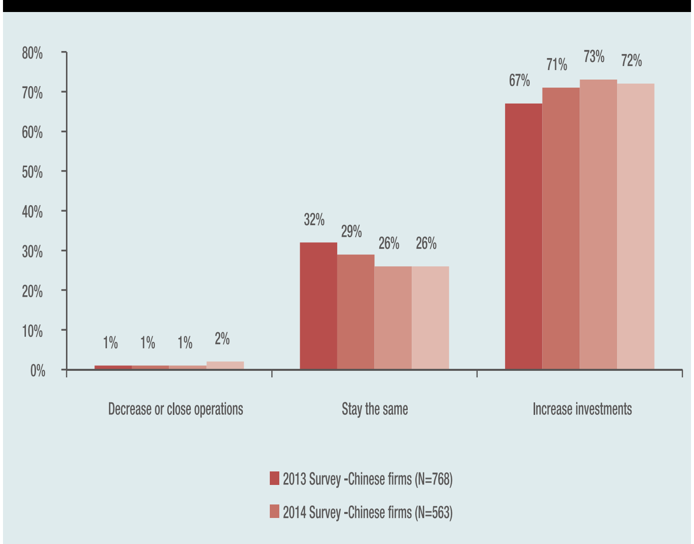
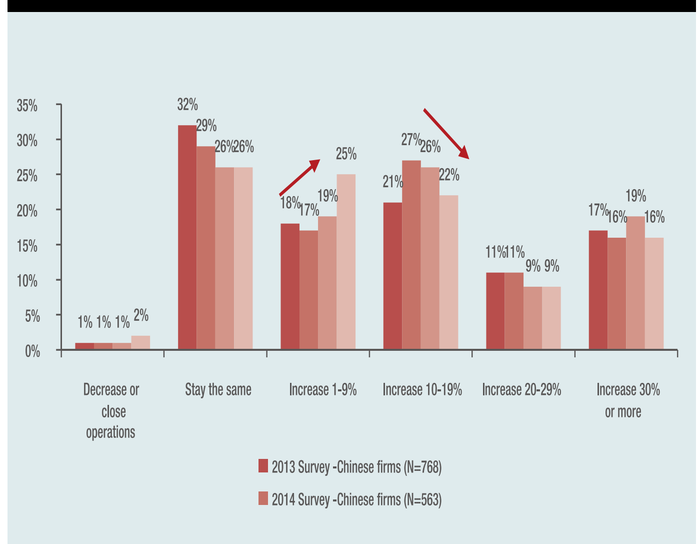


FIGURE 29 - CHINESE FIRMS: WHAT INVESTMENTS DO YOU PLAN FOR THE NEXT YEAR IN CHINA (DETAILED)?



2.3. BUSINESS CONFIDENCE INDICES – BCI

Although still confident, polled executives moderate their optimism for 2016 but stay more upbeat for the next five years.

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

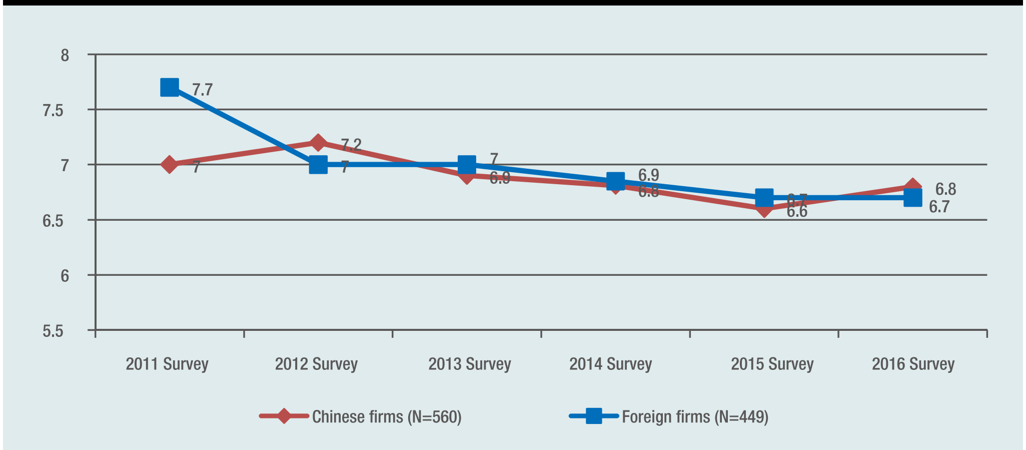
The current issue reveals very similar levels of business confidence for Chinese and foreign firms as both claim to be close to “confident” that their operations in China will be successful in 2015 and in the next 5 years (Figure 30 and 31).

When examining the six year trend we remark that in the past four years, the value of the one-year confidence index has been moving down and in 2016 converges to a level of 6.2 for both Chinese and foreign companies (Figure 30). This trend reflects the fact that all companies operating in China have adjusted their expectations and accepted the “new normal” status of the Chinese economy. Nevertheless, there is a drop in confidence from 6.5 to 6.2 when compared to the last two years, reinforcing the message on tougher business conditions in China that the Performance Indices also showed in Section 2.1 and 2.2 of this report.

FIGURE 30 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR?
0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT

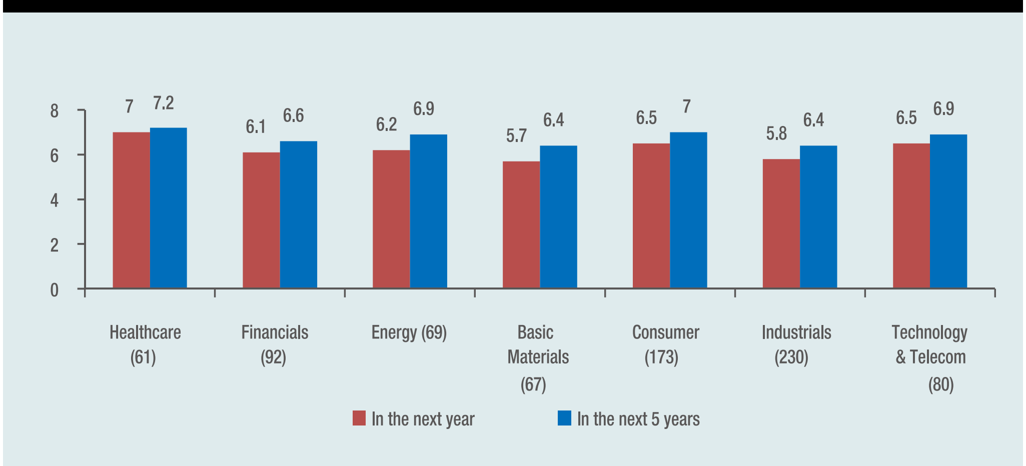
In terms of five-year confidence of polled executives, we notice that the downward trend in confidence recorded for the past four editions of this survey shows a slight increase in 2015. This may be a sign of perceived consolidation of the “new normal” stage in the Chinese economy that brings hopes of increased future growth (Figure 31).

FIGURE 31 - HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT 5 YEARS? 0=ABSOLUTELY NOT CONFIDENT, 3=NOT CONFIDENT, 5=NEUTRAL, 7=CONFIDENT, 10=EXTREMELY CONFIDENT



Analyzing by industry, we discover interesting differences in confidence sentiment amongst sectors. Companies in Healthcare or Consumer Goods and Services or Technology and Telecommunications show the highest optimism for 2016 of sampled companies. On the other hand, firms in the Basic Materials or Industrial sectors show lower levels of confidence for 2016. Across all industries we recognize improved levels of confidence for the next 5 years than what they have for 2016 (Figure 32).

FIGURE 32 - BY INDUSTRY: HOW CONFIDENT ARE YOU THAT YOUR OPERATIONS IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR AND IN THE NEXT 5 YEARS?



SECTION 3

CHALLENGES AND SUCCESS FACTORS

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

- External Challenges
- Managerial Challenges
- Success factors

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

3.1. EXTERNAL CHALLENGES

Rising labor cost and Fierce competition stay as top worries, while Chinese and global economy slowdown gain strength. Issues with government and the legal environment are still present and challenges derived from RMB fluctuation arise.

When comparing the evolution of the Top 4 External Challenges for both Chinese and foreign companies in the last two year, we observe significant changes:

“Rising labor costs” has become the number one concern for Chinese firms in our sample, and while “Fierce competition” is still an important challenge, it has dropped to second position in the worry list.

“Slowdown of Chinese economy” gains strength for both groups, as 58% of surveyed Chinese firms and 65% of foreign firms select it as a main external challenge versus lower 53% and 54% respectively last year and 47% and 45% two years ago. It is interesting to note that for foreign companies “Economy slowdown in China” has become the Number One worry. This change is in line with the lower confidence and performance indices observed in this year’s edition of the survey and discussed previously in this report. Reflecting the slowdown of the Chinese economy, concerns about “Rising price of raw materials” are decreasing, worrying 9% of the Chinese firms (vs. 11% in 2014 and 21% in 2013) and 8% of foreign firms (vs. 16% in 2014 and 20% in 2013).

“Government and legal environment” remains the top 4 external challenge of surveyed companies: 29% of surveyed Chinese firms and 39% of foreign firms select it as an external challenge. It remains stable versus last year, whereas the 2014 Survey witnessed a sizeable decrease in this concern reflecting the reform efforts of the Chinese government during 2013. Also related to government resolutions, “Corruption” loses importance for foreign firms compared to the previous edition of the survey, worrying 10% of the foreign firms (vs. 15% last year), while it stays stable for Chinese firms worrying 9% of them.

Chinese firms – Top 4 External Challenges

	2016 Survey	**2015 Survey**
1	Rising labor cost (63%)	Fierce competition (64%)
2	Fierce competition (60%)	Rising labor cost (62%)
3	Economy slowdown in China (58%)	Economy slowdown in China (53%)
4	Government and legal environment (29%)	Government and legal environment (31%)
5	Slowdown of global economy (24%)	Slowdown of global economy (18%)

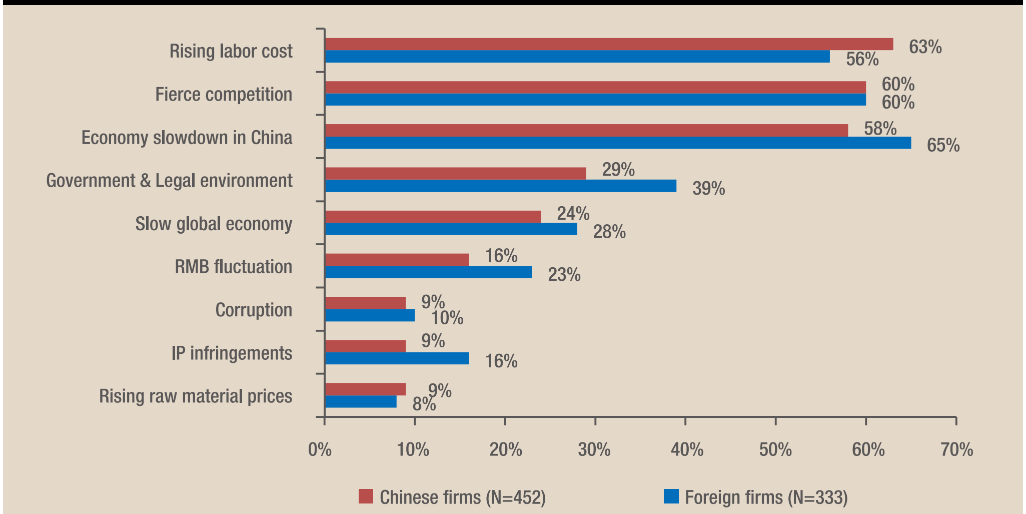
Foreign firms – Top 4 External Challenges

	2016 Survey	**2015 Survey**
1	Economy slowdown in China (65%)	Fierce competition (62%)
2	Fierce competition (60%)	Rising labor cost (57%)
3	Rising labor cost (56%)	Economy slowdown in China (54%)
4	Government and legal environment (39%)	Government and legal environment (39%)
5	Slowdown of global economy (28%)	Slowdown of global economy (23%)

“Slowdown of Global Economy” is in the fifth position of external challenges for both Chinese and foreign firms however it worries a larger proportion of surveyed firms: 24% of Chinese companies and 28% of foreign ones vs. lower 18% and 23% respectively last year.

A noteworthy difference between this year’s edition and last year’s is the weight of RMB fluctuations as an external challenge: currency position now worries 16% of polled Chinese firms and 23% of foreign firms vs. lower 9% and 17% last year.

FIGURE 33 - WHAT ARE THE GREATEST EXTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?



"Labor Costs" and "Competition" *are explored further in Section 4 of this report, Focus by Area. .*

3.2. INTERNAL CHALLENGES

Three top internal challenges are shared by both Chinese and foreign owned firms and remain unchanged from previous years' polls: Finding and retaining talent and both innovation and marketing capabilities.

Most cited internal management challenge faced by companies operating in China is "Finding and retaining talent" (55% of respondents in Chinese and in foreign companies). This is consistent with previous surveys. However, we observe an improvement vs. last year's survey notably for Chinese firms, as it was cited as an issue by 61% of Chinese firms and 58% of foreign firms in 2015 (Figure 34).

When the economy matures and competition heats up, coming up with innovative products and services and effective marketing tactics increase in importance. Consequently, "Innovation Capability" and "Marketing Capability" are the next most mentioned internal issues for both sampled groups although there are differences between them worthy to be mentioned. While "Innovation capability" worries 49% of the Chinese firms surveyed, it is a concern for a lower 37% of foreign firms. When exploring deeper by legal status, we remark that it is SOEs that struggle more often with innovation (cited by 60% of them vs. a much lower 46% of those working for Chinese private companies).

Chinese firms – Top 4 Internal Challenges

	2016 Survey	2015 Survey
1	Finding and retaining talent (55%)	Finding and retaining talent (61%)
2	Innovation capability (49%)	Innovation capability (51%)
3	Marketing capability (42%)	Marketing capability (40%)
4	Corporate governance (31%)	Corporate governance (36%)

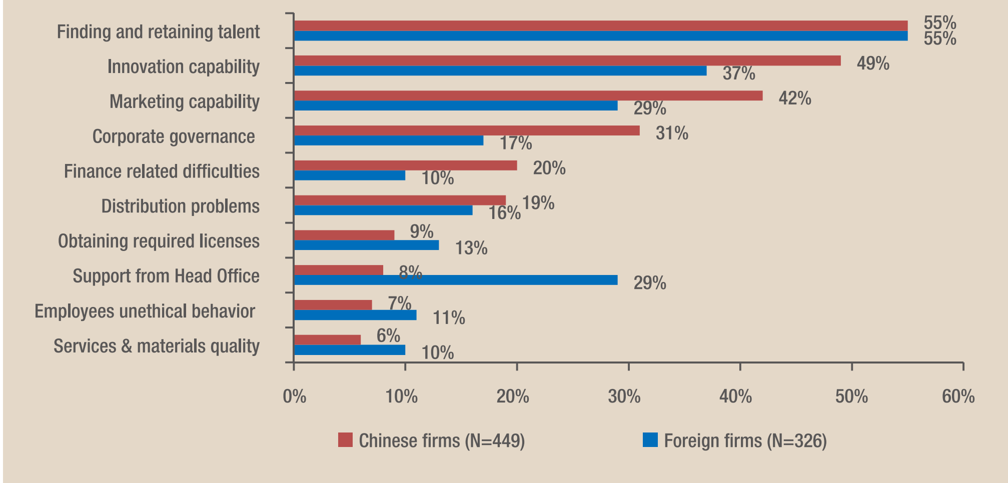
Foreign firms – Top 4 Internal Challenges

	2016 Survey	2015 Survey
1	Finding and retaining talent (55%)	Finding and retaining talent (58%)
2	Innovation capability (37%)	Marketing capability (36%)
3	Marketing capability (29%)	Innovation capability (35%)
4	Support from head office (29%)	Support from head office (26%)

The 4th challenge on the top list differs for both groups. "Corporate governance" is a concern relatively more prevalent in Chinese firms with 31% of the executives working them selecting it vs. a lower 17% of those working for foreign companies. This effect was already observed in previous editions of this survey although there seems to be an improvement vs. three years ago where a higher number of executives (49%) working for Chinese firm worried about this topic. On the other hand, for executives working for foreign-owned companies "Support from Head Office" is one of the top issues more frequently mentioned, cited by 29% of them and this is also consistent with previous polls (vs. a much lower 8% of Chinese firms) and with the physical and cultural distance with their global headquarters.

Other group-specific challenge is "Finance related difficulties" which worries 26% of the Chinese private firms vs. a much lower 9% of SOEs and 10% of foreign firms. Likewise, "Services and materials quality" worry 10% of foreign firms in our sample vs. only 6% of Chinese ones. The latter is consistent with the fact that foreign companies in China are often positioned in the higher end of the market and the quality of the end product depends on quality of the input. Specifically for our survey sample, 67% of the foreign-owned companies operate in the premium segment of the market versus 41% for the Chinese-owned ones.

FIGURE 34 - WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA?



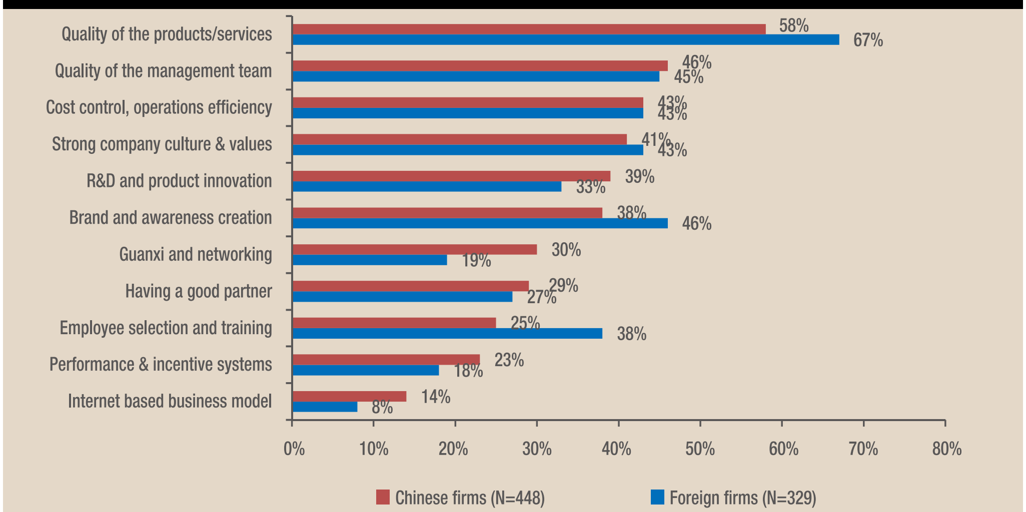
*A **zoom on the two top internal challenges, talent and innovation** is presented in Section 4 of this report, .Focus by Area.*

3.3. SUCCESS FACTORS

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

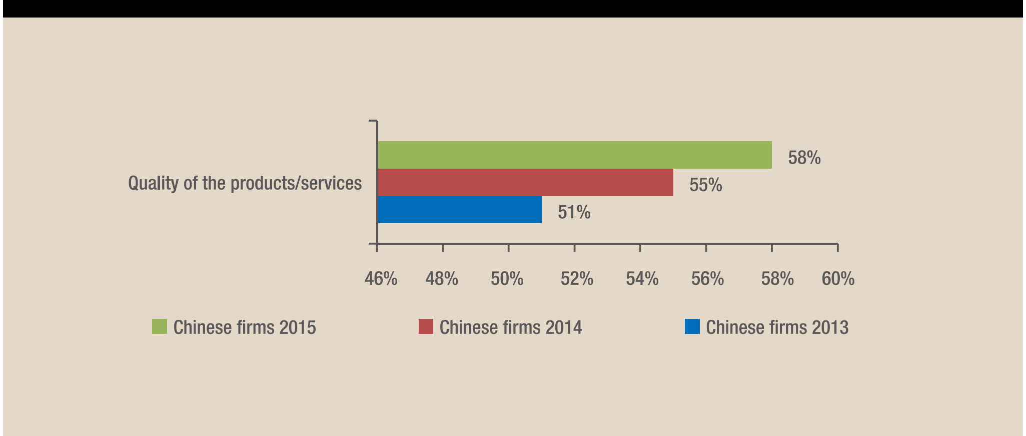
Both executives from Chinese and foreign-owned companies in our sample believe that success in China is linked to product and service quality superiority, to soft factors such as company culture & values and quality of the management team, and to capability factors such as brand creation, R&D and product innovation and running operations efficiently (Figure 35).

FIGURE 35 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA?



Although there is overall consensus between both groups, it is interesting to note that "Quality of the products/services", although considered the top success factor for both Chinese and foreign companies, is more often cited by executives working in foreign companies (67% of foreign firms vs. 58% of Chinese firms). This is consistent with previous surveys; however we observe a trend within Chinese owned companies in our poll for which the quality of their products and services increases its importance year after year (Figure 36) .

FIGURE 36 - WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA? "QUALITY OF PRODUCT/SERVICES"



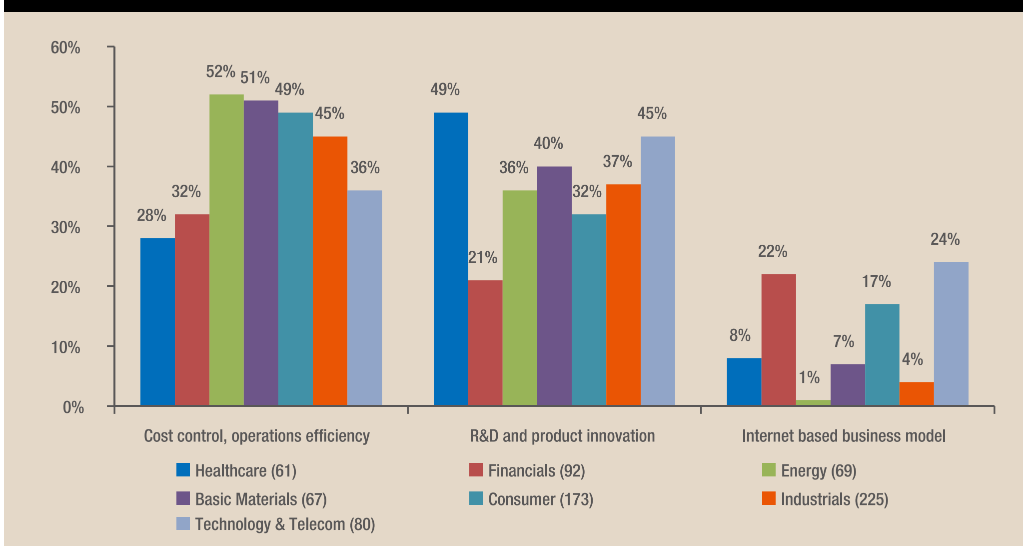
"Employee selection and training" also stands out as a factor more frequently considered key to success by foreign companies than by Chinese companies, 38% of foreign firms vs. 25% of Chinese firms.

When analyzing success factors by type of industry (Figure 37), some differences are revealed: According to our sample of surveyed companies, cost control and operations efficiency is considered a success factor more often for companies operating in mature sectors like Energy, Basic Materials and Consumers (52%, 51% and 49% of them, respectively). In contrast, more recently established sectors like Healthcare, Financials and Technology & Telecommunications seem to rely less often in operation efficiency as key to their success (28%, 32% and 36% of them, respectively).

Healthcare and Technology and Telecommunications firms rely in R&D and Product Innovation more often than firms in other sectors, with 49% and 45% of them choosing it as a success factor. This contrasts with a much lower 21% of companies in the financial sector emphasizing the role of innovation in their success.

The internet is revolutionizing the way business is conducted in China and around the world. However, our sample reveals that for the time being, its effect in China is stronger in some industries than for others. Firms in Technology and Telecommunications, Financials and Consumer sectors seem to rely on internet based business models more often than firms in other sectors (24%, 22% and 17% of sampled firms, respectively).

FIGURE 37 - BY INDUSTRY: WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR COMPANY'S SUCCESS IN CHINA?



SECTION 4

FOCUS BY AREA

This section gives an overview of the following topics:

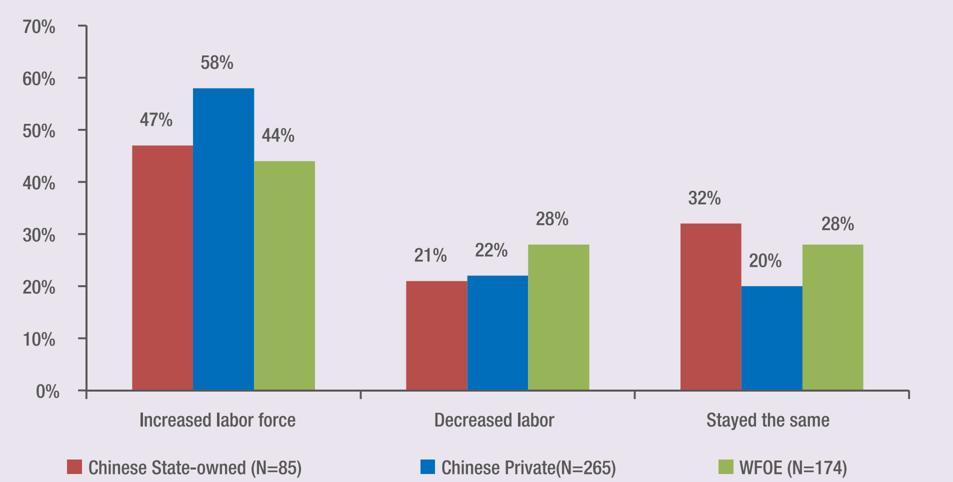
- Human Resources
  The chapter covers the top HR issues that companies in our sample face in China. It also gives an in-depth commentary on what the executives in our sample think are the most effective measures to retain employees.
- Sales and Marketing
  This chapter includes an overview of market segments where companies in our sample operate and looks at mobility of companies within segments. It also details which are the most effective sales and marketing strategies for the companies in our sample.
- Research & Development
  This chapter presents a summary of main learning's on innovation trends from our sample of surveyed companies.
- Government and Legal Environment
  This chapter discusses the perceived important of establishing relationships with the Chinese government as well as polled executives' outlook on corruption in their industries and in general.

4.1. HUMAN RESOURCES

Labor force increased in 2015 for half of the sample while it stayed stable or decreased for the other half. Chinese private companies and firms in rapidly growing sectors like Healthcare and Technology & Telecom lead the workforce growth. Average salary increase and turnover is still more than 10% for total sample although there are important variations by type of company and sector. Finding talent and rising labor costs are cited as the top HR issues for managing businesses in China.

Half of surveyed companies increased their labor force in 2015 (50% of total respondents), 26% of them kept the same labor force, and 24% of respondents decreased it. Last year's survey showed a lower percentage of firms decreasing their labor force in China in 2014, 17% of them. Within Chinese companies, 58% of Chinese private-owned firms saw their labor force increase, more than the proportion of Chinese state-owned enterprises (47%) and foreign WFOEs (44%) having increased labor force (Figure 38).

FIGURE 38 - BY LEGAL STATUS - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2015 VS. 2014 IS



The transformation of the Chinese economy from heavy industry and manufacturing to a more modern one with a higher representation of services and technologies can be witnessed in our sample of surveyed companies. Analyzing the data by industry, we discover that it is Healthcare and Technology and Telecom firms that have proportionally increased their in labor force the most in 2015, with 69% and 61% of them expanding in number of employees. This compares to a significantly lower 39% for and industrial goods and services (Figure 39). Interestingly, Healthcare and Technology and Telecomm firms also declare the highest business confidence for 2016, with confidence indices of 7 and 6.7 respectively, compared to a lower 5.8 for industrial firms (Section 2.3 of this report).

Also in line with the economy transformation of China, we note 57% of firms dealing with services increased labor force in 2015 compared to a lower 41% of firms in the manufacturing side of their industries (Figure 40).

FIGURE 39 - BY INDUSTRY - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2015 VS. 2014 IS:

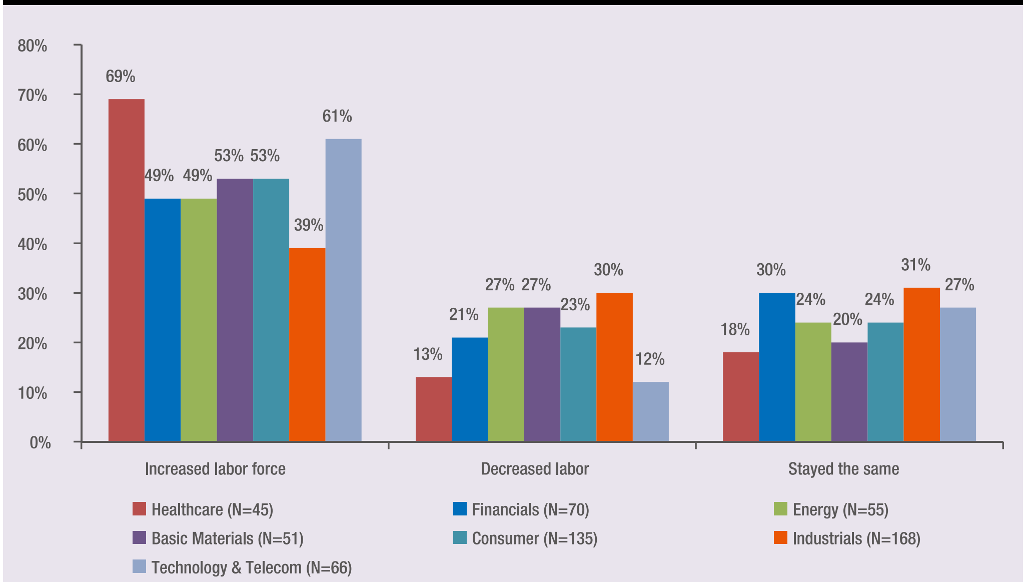
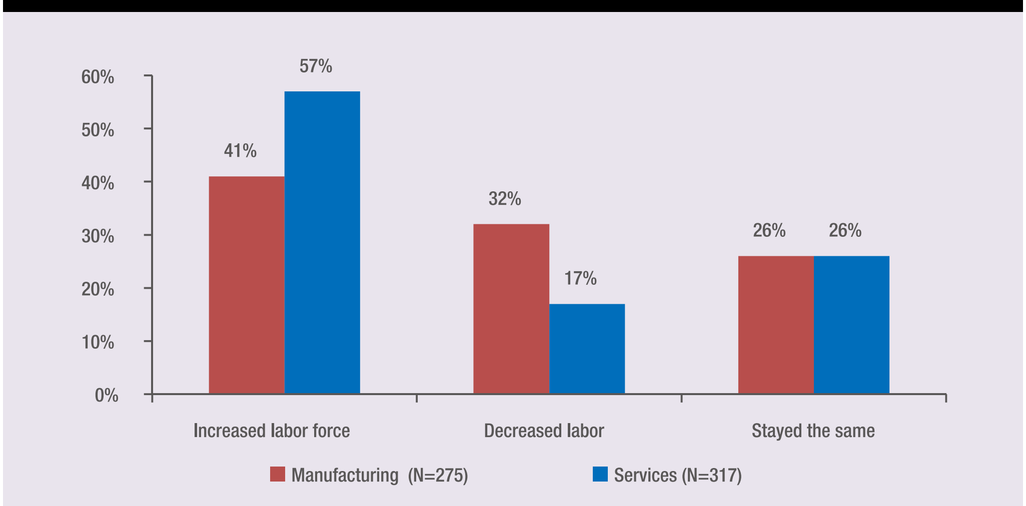


FIGURE 40 - BY SECTOR - THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2015 VS. 2014 IS:



The average salary increase for our total sample of companies is 11% and the average employee turnover is 12%. However, we observe that it is Chinese private firms that experience most workforce instability declaring 14% of salary increase and 14% employee turnover vs. lower 7% and 9% for SOEs and 9% and 10%, respectively, for WFOEs (Fig 41). By industry, sampled Healthcare companies report 16% salary increase, the highest of all sectors, consistent with being the industry most often declaring labor force increase for 2016. Consumer sector industries report the highest employee turnover, 15%, which is consistent with other editions of this survey and with the characteristic of the sector which often sees high turnover (Fig 42).

FIGURE 41 - THE TOTAL SALARY INCREASE AND EMPLOYEE TURNOVER IN 2015 COMPARED TO 2014 IS:

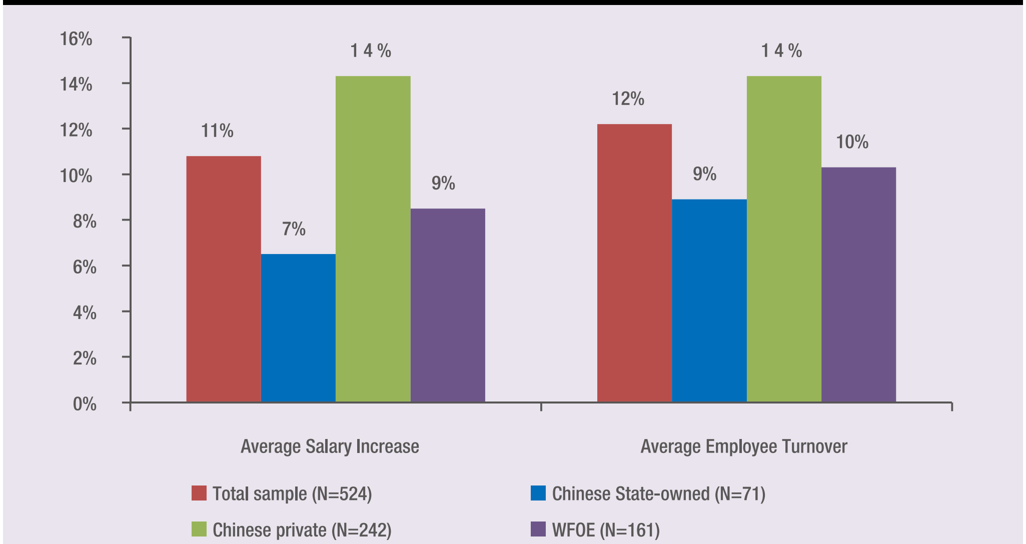
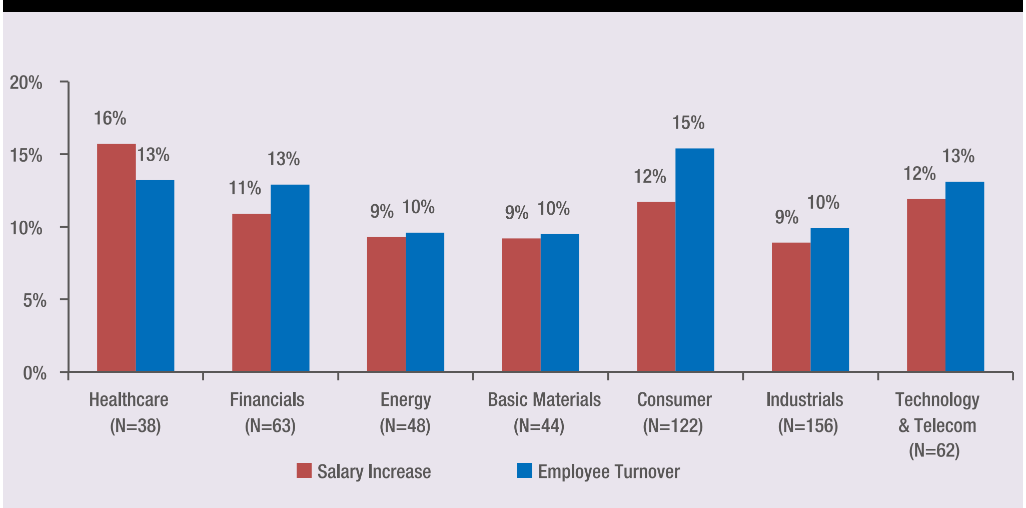


FIGURE 42 - BY INDUSTRY - THE TOTAL SALARY INCREASE AND EMPLOYEE TURNOVER IN 2015 COMPARED TO 2014 IS:

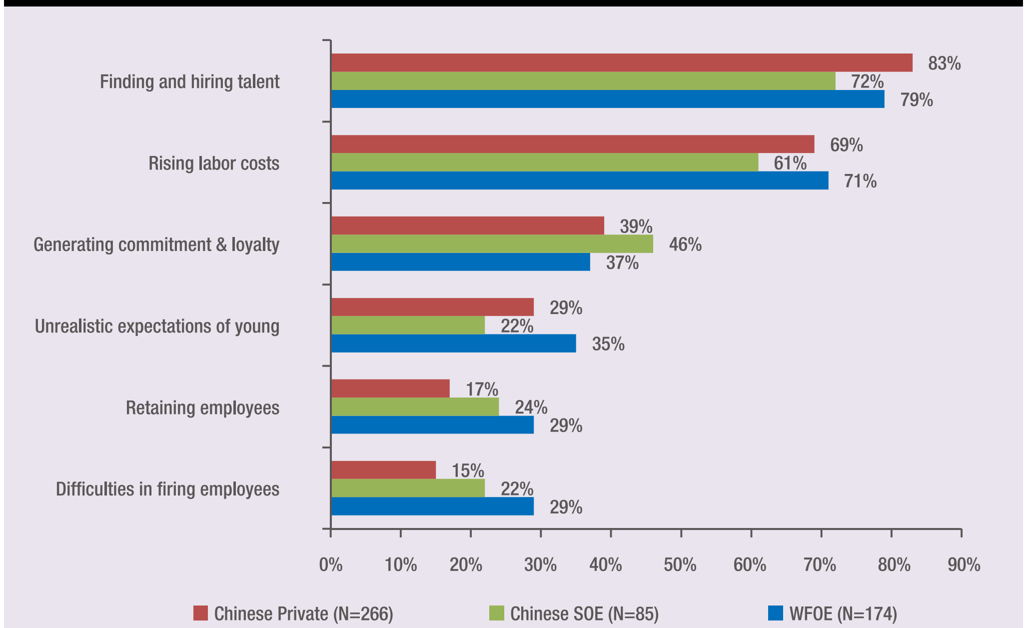


4.1.1. TOP HUMAN RESOURCES ISSUES IN CHINA

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

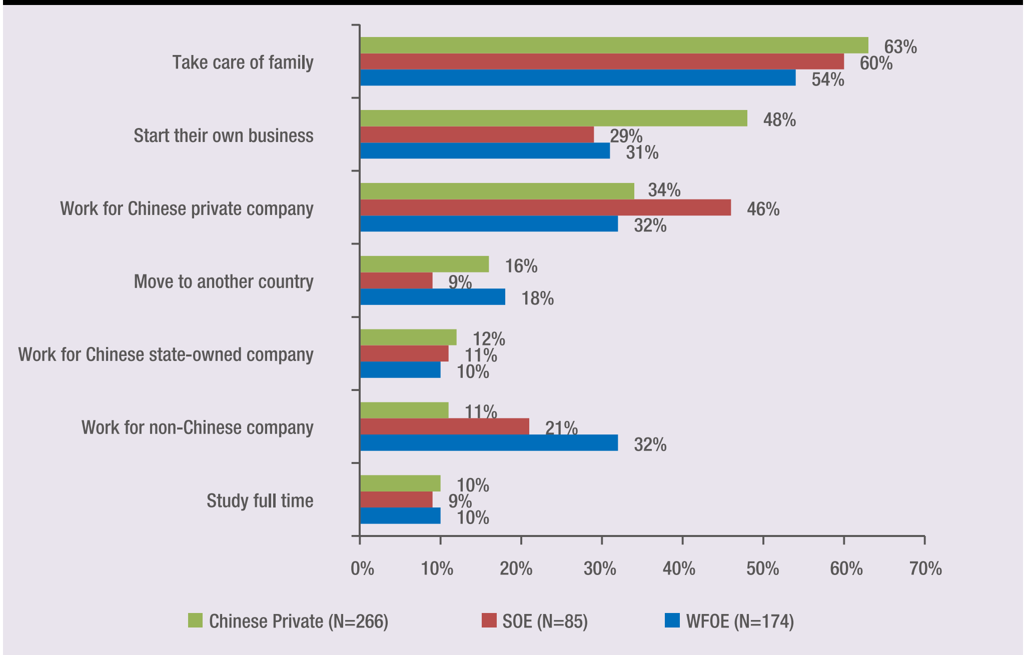
Consistent with previous years, "Finding and hiring suitable talent", "Rising labor costs" and "Generating commitment and loyalty" are the top HR concerns for surveyed Chinese and foreign companies. The rapid growth of Chinese private firm results in them struggling relatively more than SOEs and foreign firms with "Finding and hiring suitable talent" (83% of Chinese private firms, vs. 72% of SOEs and 79% of foreign firms declare issues in hiring suitable talent – Figure 60). Healthcare, Financials and Technology & Telecommunications, rapidly developing industries in China, encounter the most problems finding fitting talent with 84% and 83% and 82% of them reporting staffing to be a key HR issue in 2015. Not surprisingly, a substantially lower 65% of firms in the established sector of Basic Materials (chemicals, mining and forestry) declare to have issues staffing suitable talent (Fig 43).

FIGURE 43 - BY COMPANY TYPE: WHICH ARE THE MAJOR HUMAN RESOURCES ISSUES FACING YOUR COMPANY IN CHINA?



The most cited causes why sampled companies loose employees are them leaving to take care of their family, start their own businesses or work for other Chinese private companies. On the other hand, foreign-owned firms (WFOEs) lose their employees also to other foreign firms although this happens less often to Chinese owned firms. On the other hand, Chinese SOEs lose employees to Chinese private companies more often than WFOEs and Chinese private companies (Figure 44).

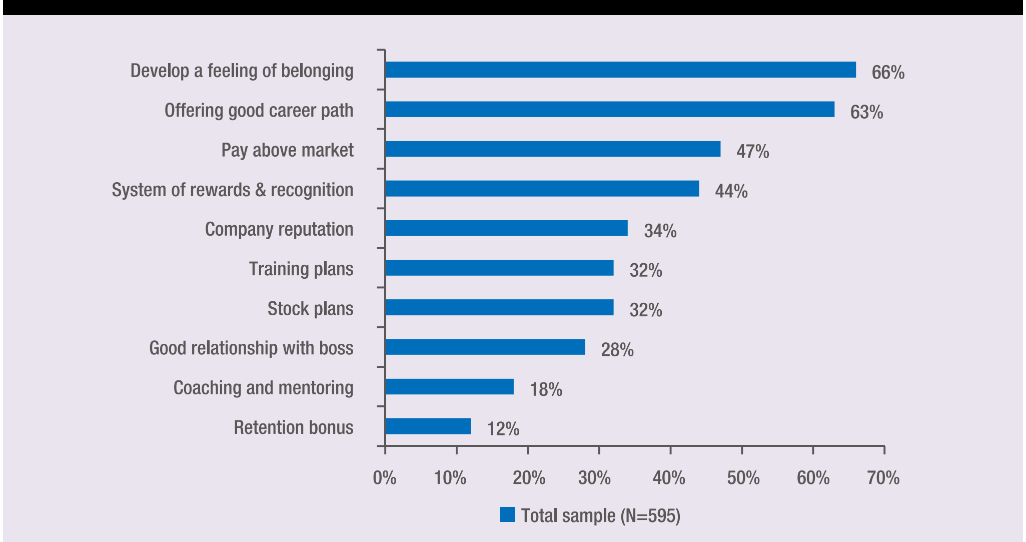
FIGURE 44 - BY COMPANY TYPE: PEOPLE WHO LEAVE YOUR ORGANIZATION USUALLY GO TO:



4.1.2. MOST EFFECTIVE MEASURES TO RETAIN EMPLOYEES

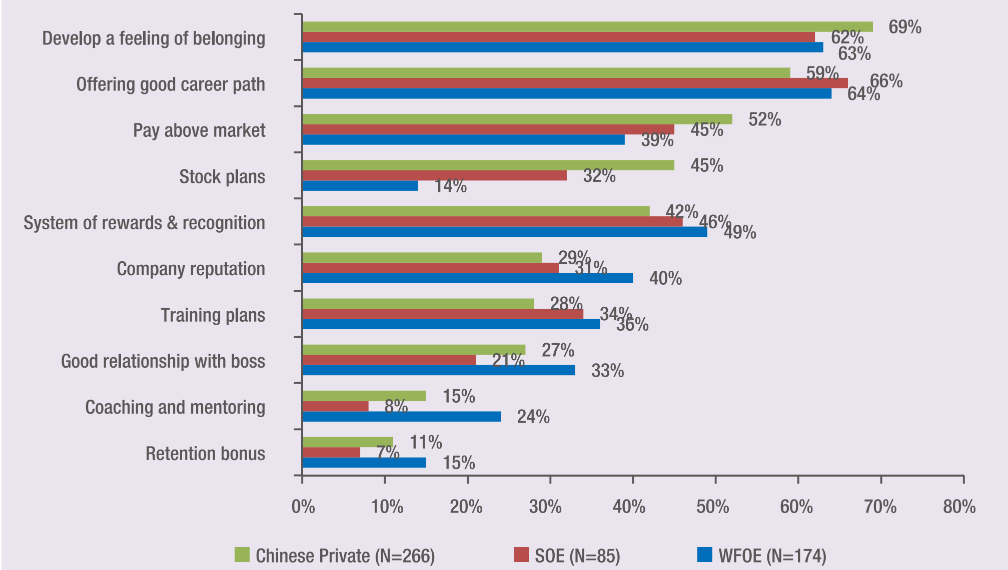
As consistently observed in previous editions of this survey, company culture matters (Figure 45). According to our sample, it appears that cultural fit is the most important retaining factor ("Develop a feeling of belonging", 66% of respondents), together with the possibility of career advancement ("Offering good career path" 63% of respondents). It is interesting to note, this top set of measures comes before paying above market (third with 47% of respondents) and having a system of rewards and recognition (44%).

FIGURE 45 - TOTAL SAMPLE - WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES?



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 compensation related measures when compared to foreign-owned firms. “Pay above market” is cited by 52% of respondents working in Chinese private firms, 45% for those in SOEs and 39% for those in foreign companies. Similarly, “Stock plans”, even if less frequent, are more successful amongst Chinese firms (45% of Chinese private firms and 32% of SOEs) than foreign ones (14% of WFOEs). This may be related to regulations regarding foreign stock ownership by Chinese citizens. On the other hand, foreign firms put more emphasis to “Company reputation” which is considered an efficient measure of retention by 40% of WFOEs vs. 31% of SOEs and 29% of Chinese private firms (Figure 46).

FIGURE 46 - BY COMPANY TYPE: WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES?



4.2. SALES AND MARKETING

4.2.1 COMPETITION

84% of Chinese firms and 88% of foreign firms polled consider the competition in China to be intense or very intense, which is consistent with competition being in the Top 3 of External Challenges faced by our sample of companies. Despite the fact that the environment seems to be fairly competitive overall, we notice certain differences across industries, with 25% of respondents in the more recent field of Technology & Telecom labeling the competition as "not intense" versus a lower 8% in Basic Materials or 10% in Energy (Fig 47 and 48).

FIGURE 47 - HOW INTENSE IS THE COMPETITION YOU ARE FACING IN CHINA?

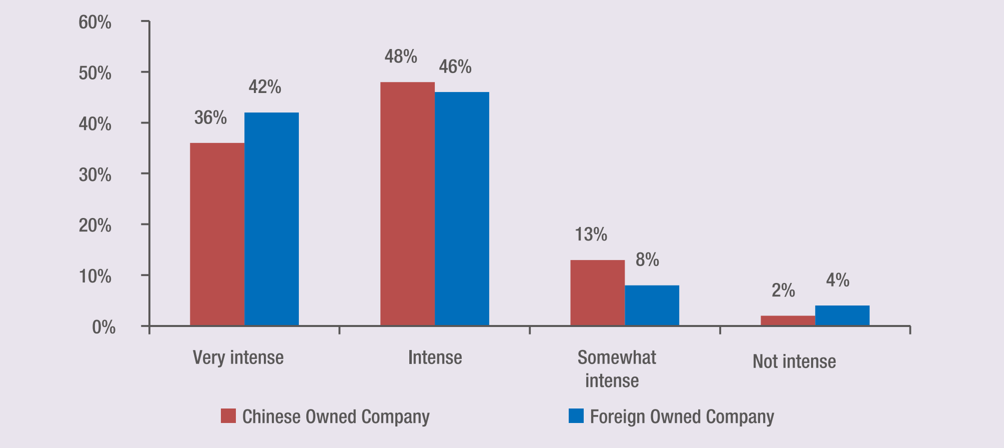
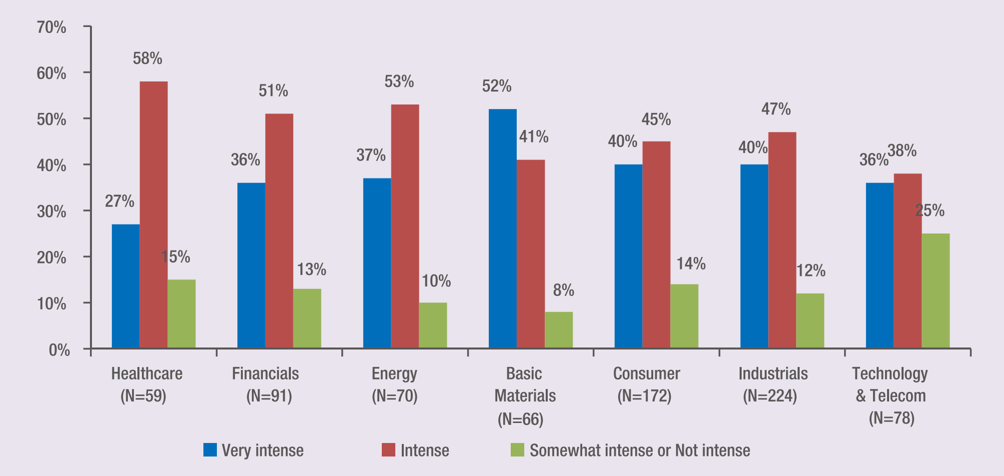
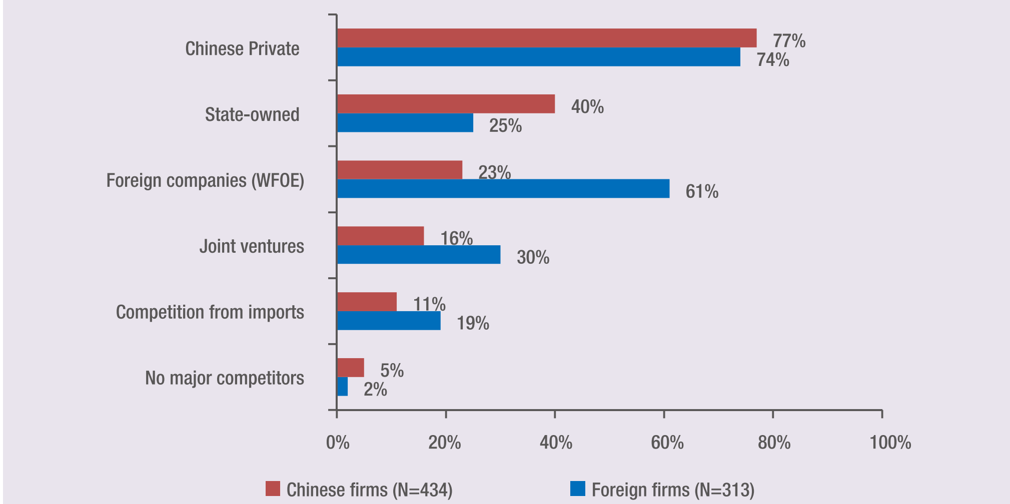


FIGURE 48 - BY INDUSTRY - HOW INTENSE IS THE COMPETITION YOU ARE FACING IN CHINA?



A majority of respondents cited their main competitors to be Chinese private enterprises (77% of Chinese firms and 74% of foreign firms). Chinese-owned respondents cite State-owned enterprises as a distant second (40%). In contrast, foreign companies measure themselves also amongst each other, citing WFOE (61%) close to Chinese private enterprises as their major type of competitors. These results are consistent with previous surveys (Figure 49).

FIGURE 49 - WHO ARE YOUR MAIN COMPETITORS IN CHINA? MULTIPLE ANSWERS



When we ask executives working for Chinese firms what the competitive advantages of their foreign competitors are, and we ask those working for foreign firms what the competitive advantages of their Chinese competitors are we obtain an interesting picture of their perceived relative strengths and weaknesses (Figures 50 and 51).

The top strengths of foreign firms according to their Chinese competitors are related to strength creating brands, superiority of products and technology (mentioned by 73%, 52% and 46% of the surveyed executives working in Chinese firms). In contrast, foreign-owned firms consider that their main weaknesses vis-à-vis their Chinese competitors lay in Chinese firms' superiority in "Cost advantages" (57%), "Price" (51%), and "Relationships with Government and other guanxi" (43%).

"Unethical behavior" is seen by 29% of polled executives working for foreign-firms as a competitive advantage of Chinese firms. On the contrary, a much lower 5% of executives in Chinese firms mention "Unethical behavior" as a strength of their foreign competitors. This difference may be due to the sometimes stricter environmental control policies that foreign firms apply in their production sites, thus increasing their costs.

"Local knowledge and reach" is seen as a competitive advantage of Chinese firms by 27% of polled executives working for foreign-firms while only 7% of those in Chinese firms mention it as a capability of their foreign competitors.

FIGURE 50 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN FOREIGN COMPETITORS IN CHINA? MULTIPLE ANSWERS

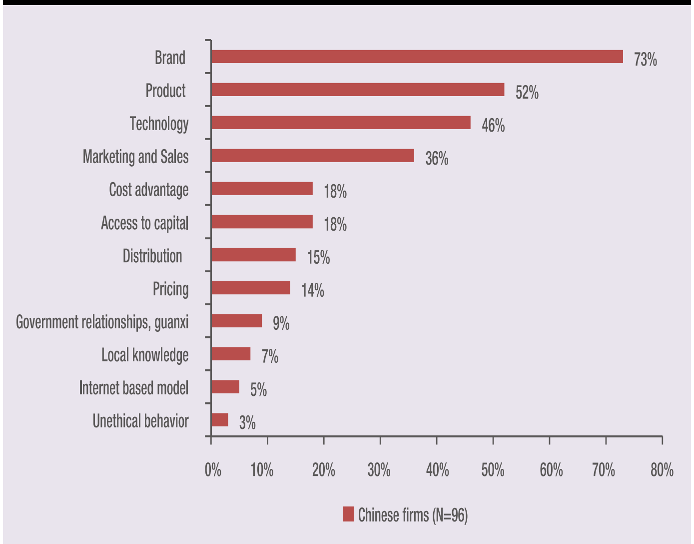
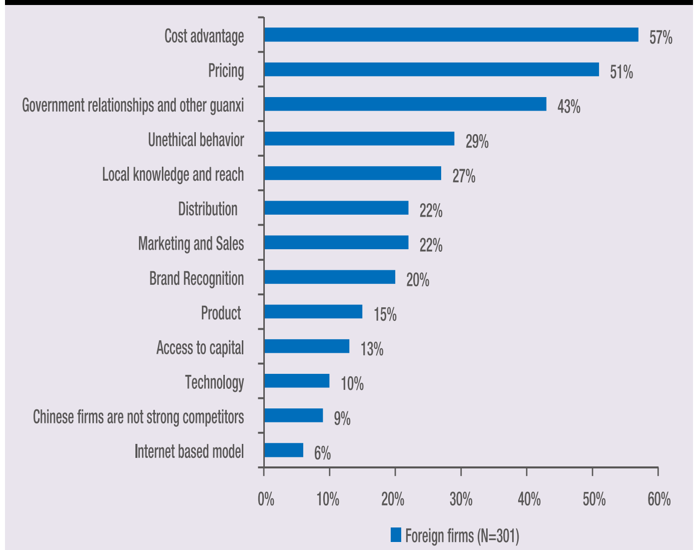


FIGURE 51 - WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN CHINESE COMPETITORS IN CHINA? MULTIPLE ANSWERS



4.2.2. MARKET SEGMENTS AND MOBILITY

Our sample of companies operates mainly in the premium and middle segments with 52% and 44% of companies respectively, and only a small 4% in the low-end. The foreign firms sample is slightly more skewered towards high end markets than the Chinese sample: 41% of Chinese firms declare to operate in the middle market while 67% of foreign firms sample position their products and services in the high end of the market (Figure 52).

In terms of segment mobility we see that even if a majority of companies plan to grow future sales within their existing segment (74% for those operating in the premium segment and 64% 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 33% of them plan to move up into the next segment. For companies currently operating in the premium segment, a smaller proportion (26%) of them wants to expand down into the middle segment (Figure 53).

FIGURE 52 - WHICH IS YOUR MAIN MARKET SEGMENT IN CHINA?

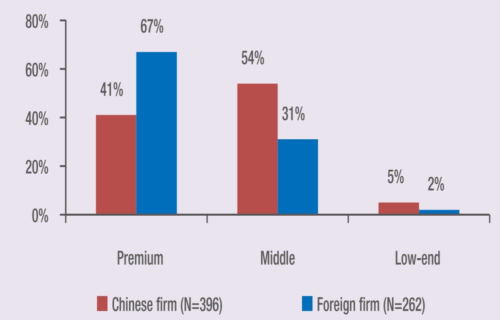
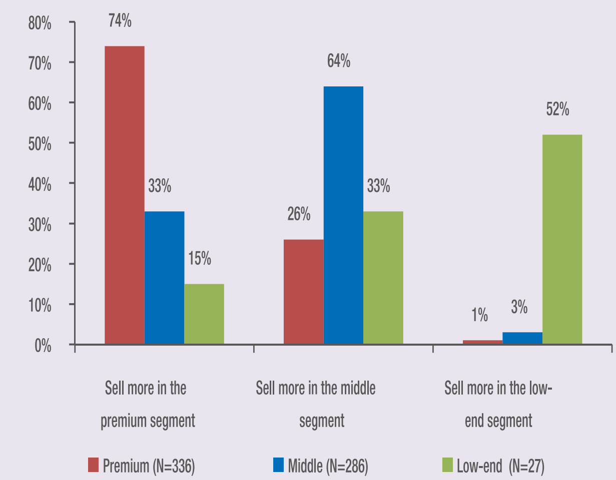


FIGURE 53 - WHAT ARE YOUR PLANS FOR THE FUTURE?



4.2.3. MARKETING, SALES AND DISTRIBUTION STRATEGIES

No significant difference in behavior between Chinese and foreign firms, but type of company matters (B2B or B2C, premium or middle segment) as well as industry. Strategies for selling successfully are complex for B2C companies. Social media emerges as a key marketing tool for B2C companies.

There is no significant difference in marketing and sales spending for Chinese owned and foreign-owned firms or in their spending intention for the coming year. However, we remark important differences between B2C and B2B companies with the former dedicating more important budgets to marketing and sales activities. These results are consistent with previous edition of this survey not surprising given the high cost in China of advertising and promotion activities directed to the consumer.

FIGURE 54 - BY B2B/B2C: WHAT % OF YEARLY REVENUES DO YOU SPEND IN MARKETING & SALES?

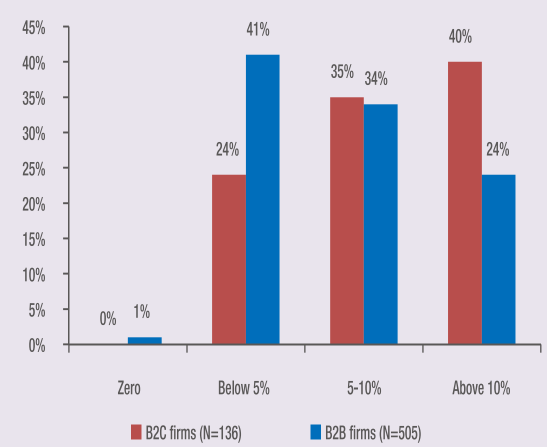
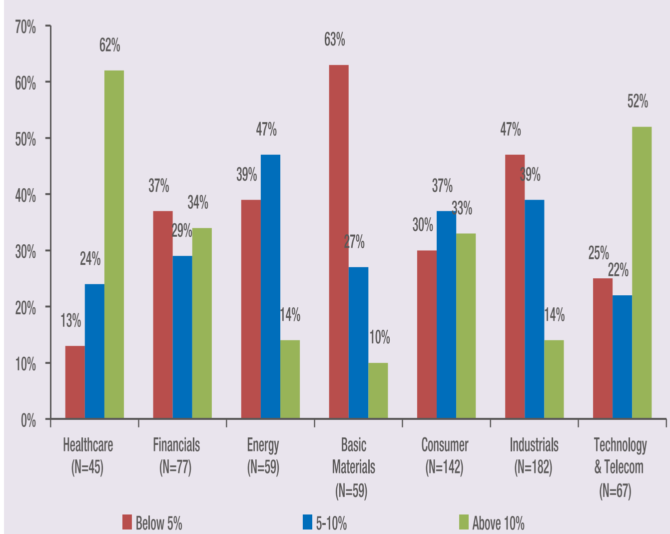
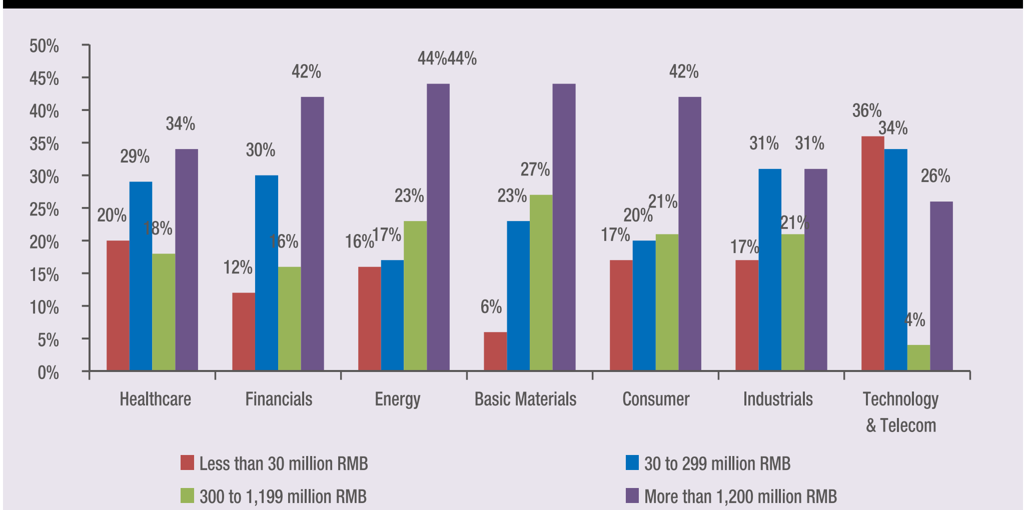


FIGURE 55 - BY INDUSTRY - WHAT % OF YEARLY REVENUES DO YOU SPEND IN MARKETING & SALES?



When analyzing marketing investments by sector, the industries with larger percentage of players declaring marketing investments of above 10% of revenues are Healthcare and Technology & Telecommunications (62% and 52% of them respectively). In contrast, 63% of respondents working in Basic Materials and 47% of those in Industrials claim to spend in marketing & sales activities below 5% of their revenues. It can be surprising that the Consumer sector companies in our sample do not appear within the largest investors in sales & marketing as percentage of revenues, as only a third of them declare investments of more than 10% of revenues. However, this is understandable when we look at the size of our sample companies, 42% of polled firms in the Consumers sector have more than 1,200 million RMB of China revenues in 2015, contrasting with 26% of companies in Technology & Telecomm and 34% in Healthcare (Figures 55 and 56)

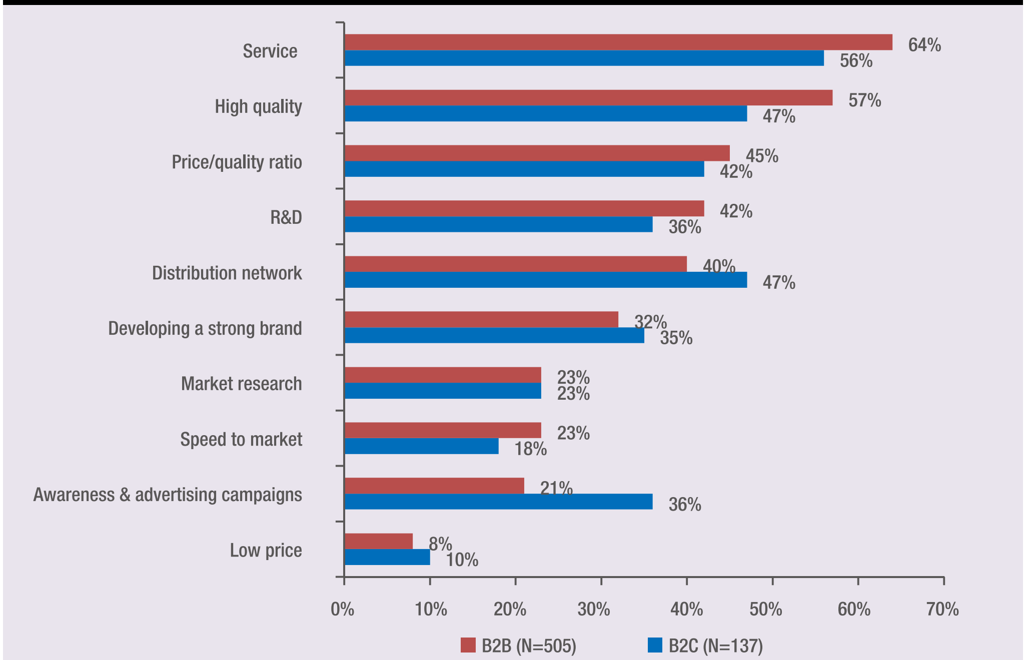
FIGURE 56 - WHAT ARE YOUR COMPANY'S FORECASTED TOTAL CHINA SALES FOR 2015?



Sales strategies

B2B companies in our sample emphasize providing service and high quality above other factors (66% and 57% of executives working in B2B companies cite them as key success factors, respectively). However, executives in B2C companies rate many factors similarly resulting in a list of key sales success strategies for B2C firms in our survey without a clear winner: "Service" (cited by 56% of polled executives in B2C firms), "Distribution network" (47%), "Quality" (47%), "Price/Quality ratio" (42%), "Awareness and advertising campaigns" (36%), "R&D" (36%) and "Brand" (35%). The absence of a clear recipe for success reflects the complexity of selling products directly to consumers in a country as vast and as diverse as China (Figure 57).

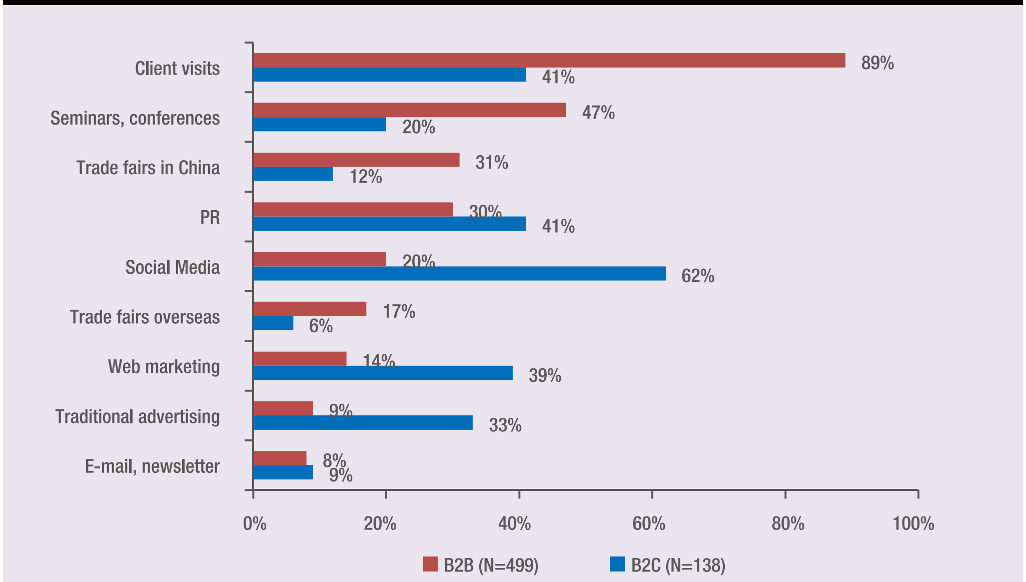
FIGURE 57 - BY B2B / B2C: PLEASE CHOOSE THE MOST IMPORTANT FACTORS ON THE SUCCESS OF YOUR SALES IN CHINA. MULTIPLE ANSWERS POSSIBLE



Marketing strategies:

Most cited marketing expenditures for B2B companies in our sample are visits to clients or prospective clients (89% of respondents), followed very distantly by seminars and conferences and trade fairs (47% and 31% of respondents respectively). In contrast, B2C firms favor mostly Social Media (62%) and Web marketing (39%) and Traditional Advertising (33%). Visiting clients and PR activities are also important and mentioned by 41% of firms in B2C. Social media is the number one marketing strategy mentioned by our B2C sample, which is remarkable as it didn't even exists as a medium a few years ago (Figure 58).

FIGURE 58 - BY B2B/B2C: WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS?



When trying to understand more about main users of social media as a marketing tool, we see that 40% of sampled low-end companies rely in it (amongst other marketing tools), 33% of companies in the middle segment and 26% of those operating in the higher end of the market (Figure 59). In terms of industry, 53% of firms operating in the consumer sector rely on social media to advertise their products and services, the highest proportion of social media use for the polled sectors. Financials, Technology & Telecom and Healthcare follow with 37%, 34% and 30% of them declaring social media as one of the most effective marketing tools for their businesses. In contrast, a much lower 5% of polled firms in the Industrial sector and 10% in Basic Materials seem to depend on it (Figure 60). This is consistent with previously commented results of 62% of firms in B2C favoring social media vs. a much lower 20% of firms operating in B2B, area where companies in Energy and Basic Materials naturally operate.

FIGURE 59 - BY MARKET SEGMENT - WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS? SOCIAL MEDIA

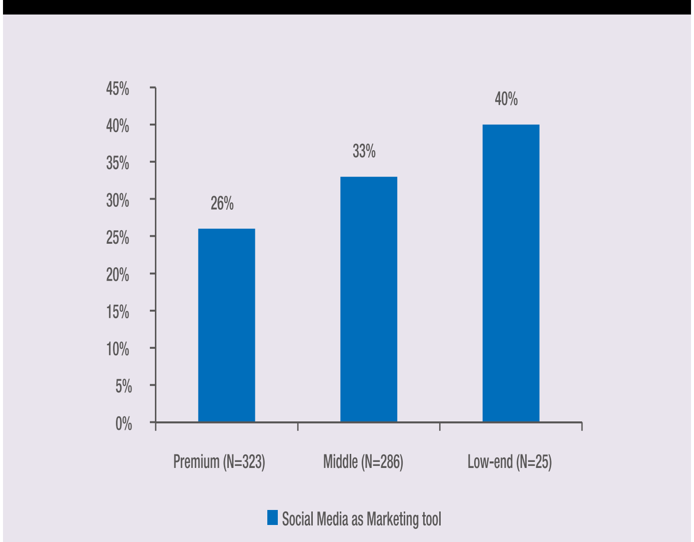
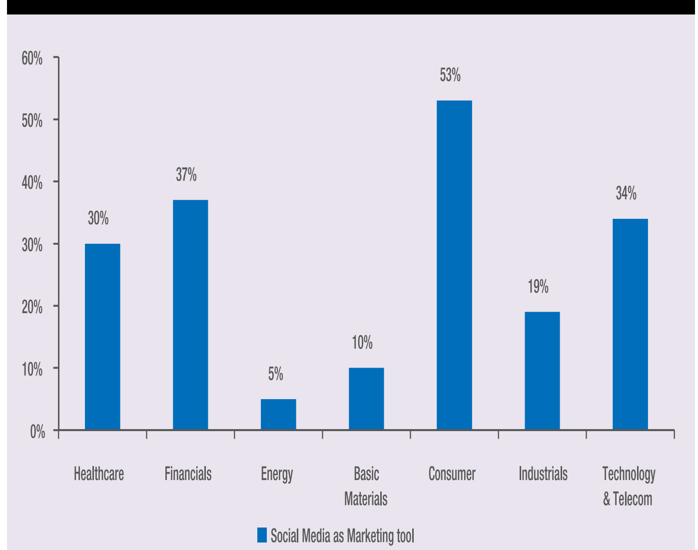


FIGURE 60 - BY INDUSTRY - WHICH MARKETING ACTIVITIES ARE MOST EFFECTIVE FOR YOUR MAIN BUSINESS? SOCIAL MEDIA



Distribution network

23% of the total sample considers their distribution network in China to be bad or very bad, 48% consider it sufficient and according to 29% of them it is efficient or very efficient.

There are similar levels of satisfaction amongst Chinese and foreign firms surveyed, and amongst firms in B2B or B2C arenas (Figures 61 and 62). Companies operating in the he low-end segment appear to be the most concerned by this problem with 34% of their executives declaring their distribution networks to be bad or very bad (Figure 64).

FIGURE 61 - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?

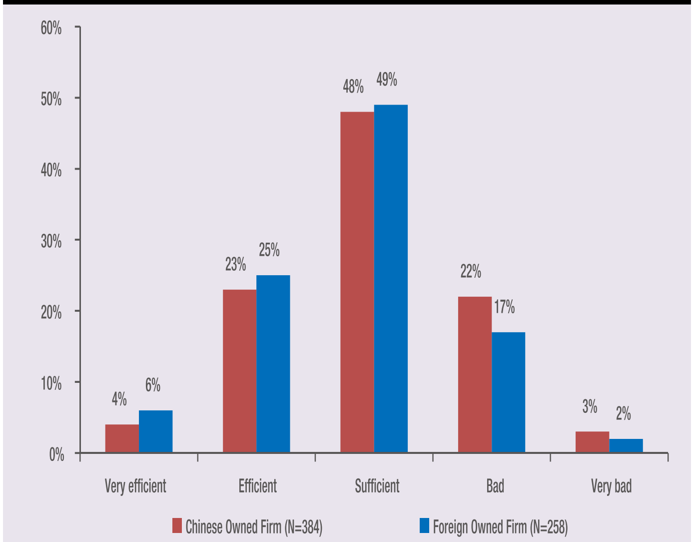
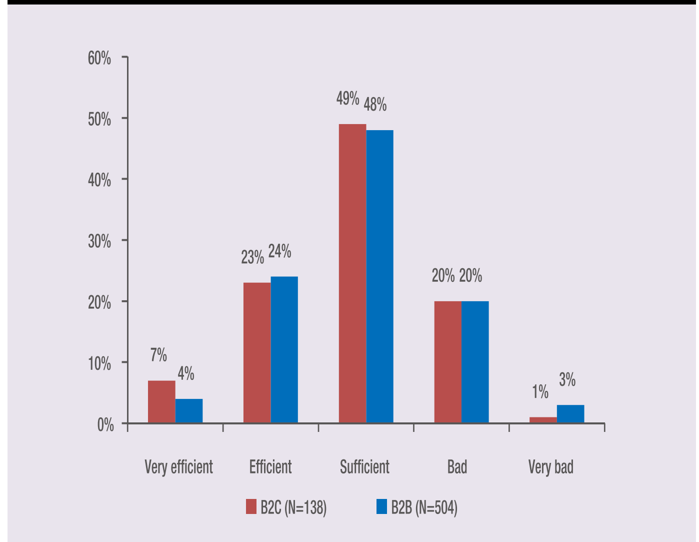


FIGURE 62 - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?



Companies using internet as sales channel report higher levels of satisfaction than those keeping traditional channels with 36% of them claiming to be satisfied or very satisfied with their distribution network vs. 24% of companies without internet sales (Figure 63).

In terms of industry, it appears that there are higher levels of satisfaction in sampled companies operating in the Energy and basic Material sectors (Figure 64).

FIGURE 63 - INTERNET SALES YES/NO - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?

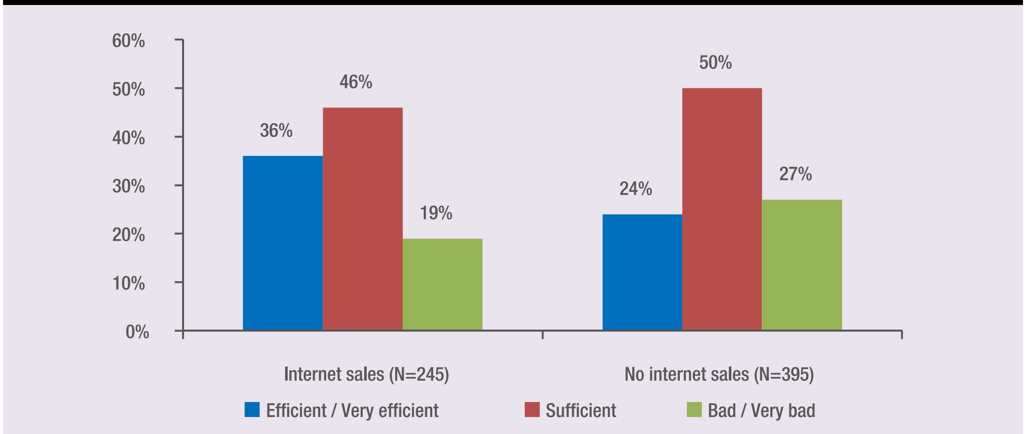
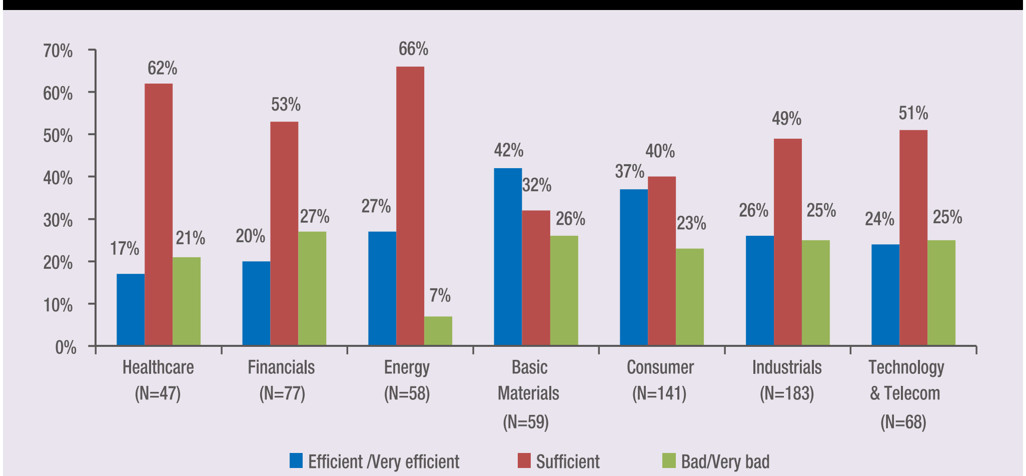


FIGURE 64 - BY INDUSTRY - HOW DO YOU EVALUATE YOUR COMPANY DISTRIBUTION NETWORK IN CHINA?

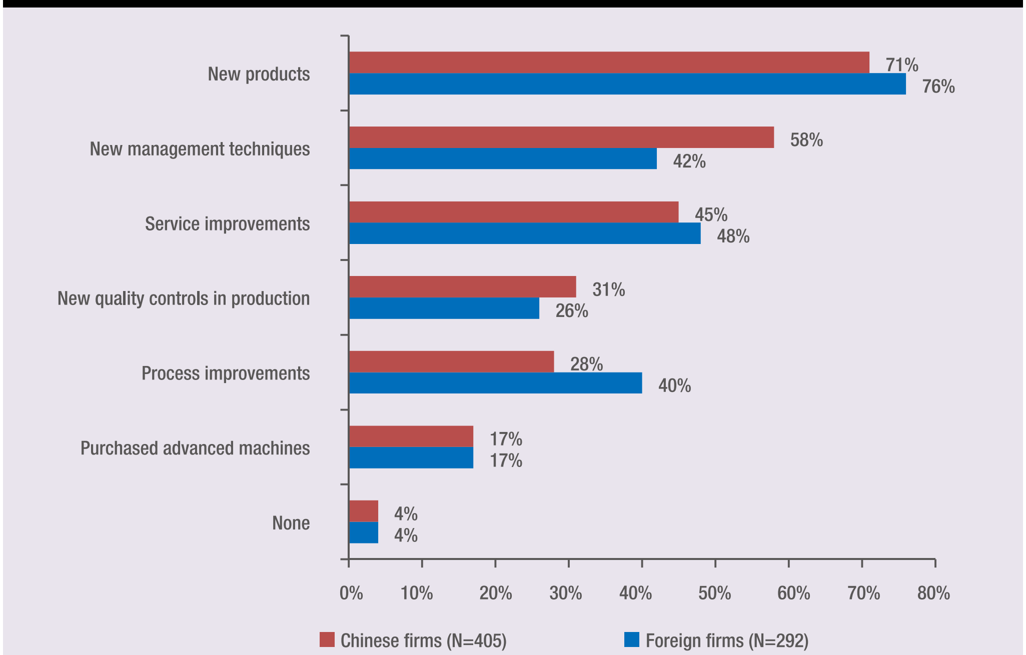


4.3. RESEARCH & DEVELOPMENT

Our sample shows important levels of innovation for sampled companies. Chinese firms take the lead in R&D investment, reversing the situation from three years ago. More specifically, Chinese private firms stand out as the group with highest percentage of firms investing more than 5% of their revenues in R&D. Within industries, Technology and Telecomm and Healthcare firms appear as the biggest spenders in R&D.

Chinese and foreign executives who participated in this year CEIBS China Business Survey report high levels of innovation for their companies as 71-76% of them have introduced new products or services in 2015. More Chinese firms declare introducing new management techniques than foreign ones (58% vs. a lower 42% of foreign firms). This gap is consistent with previous surveys; however it seems to be fading down. Service improvements gain popularity compared to other years, in line with the growing importance of services in the Chinese economy. Quality control and process improvements follow mentioned by approximately one third of sampled companies. It is important to note that 40% of foreign companies declare having worked in process improvements in 2015 vs. a lower 28% of Chinese firms (Figure 65).

FIGURE 65 - WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED IN 2015?



Levels of R&D investment vary for Chinese and foreign companies in our sample with Chinese firms leading in large investments, reversing the situation from a few years ago when foreign companies tended to invest larger share of revenues (according to our samples). In 2015, 39% of polled Chinese firms invested more than 5% of their revenues in R&D vs. a lower 34% of foreign firms. This contrasts with 2013 where 32% of Chinese firms invested more than 5% of their revenues in R&D vs. a higher 40% of foreign firms (Figures 66 and 67).

FIGURE 66 - WHAT IS YOUR ANNUAL EXPENDITURE IN R&D AS A % OF REVENUES?

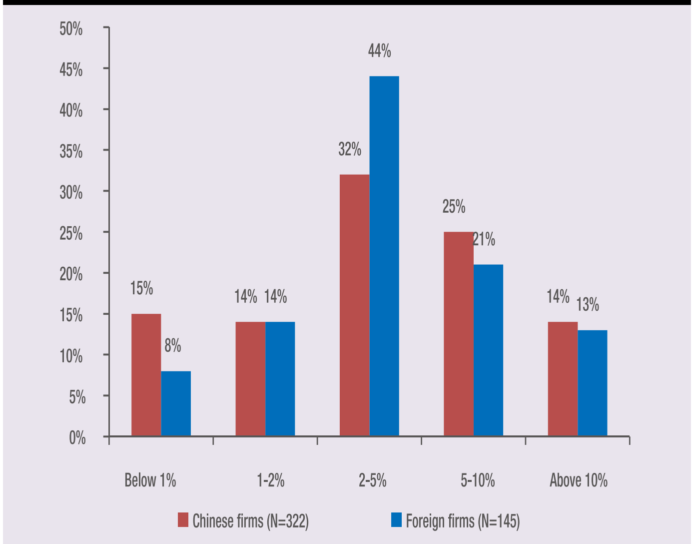
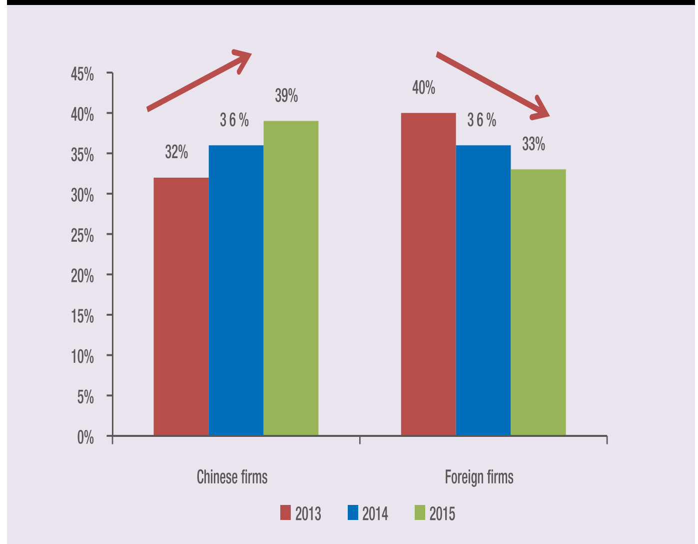
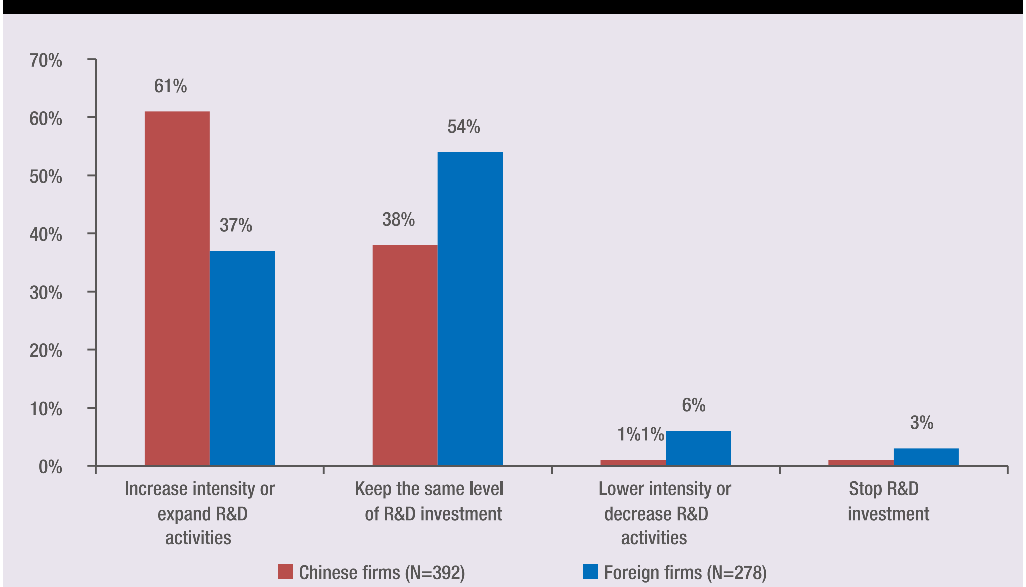


FIGURE 67 - IS YOU ANNUAL EXPENDITURE IN R&D ABOVE 5% OF REVENUES?



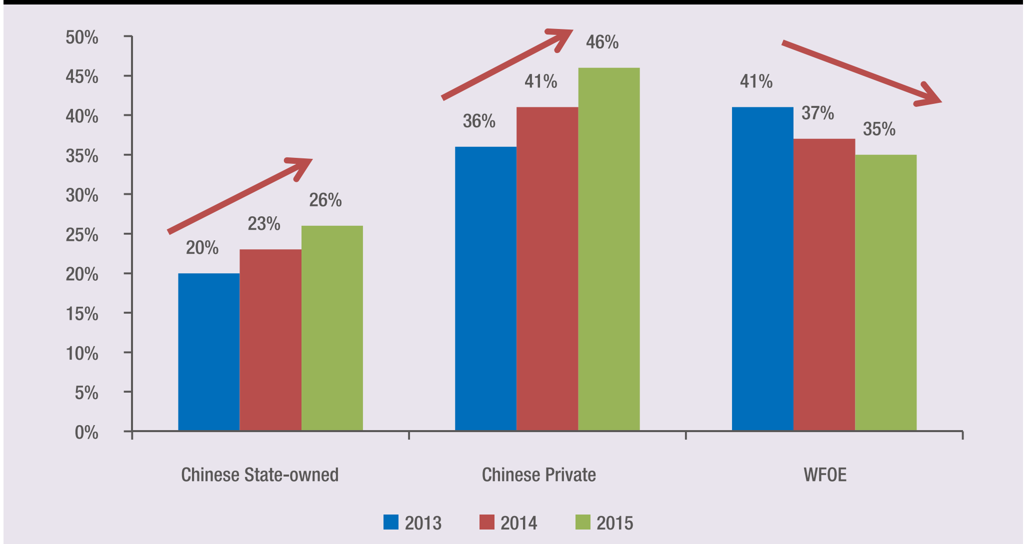
This tendency appears to be consolidating further as 61% of executives working for Chinese firms declare intention of their company to increase R&D spending in the next three years vs. a significantly lower 37% of executives working for foreign firms, hinting at a potential deepening of this new trend of Chinese companies taking the lead in R&D investment in China (Figure 68).

FIGURE 68 - WHAT ARE YOUR PLANS FOR THE NEXT 3 YEARS?



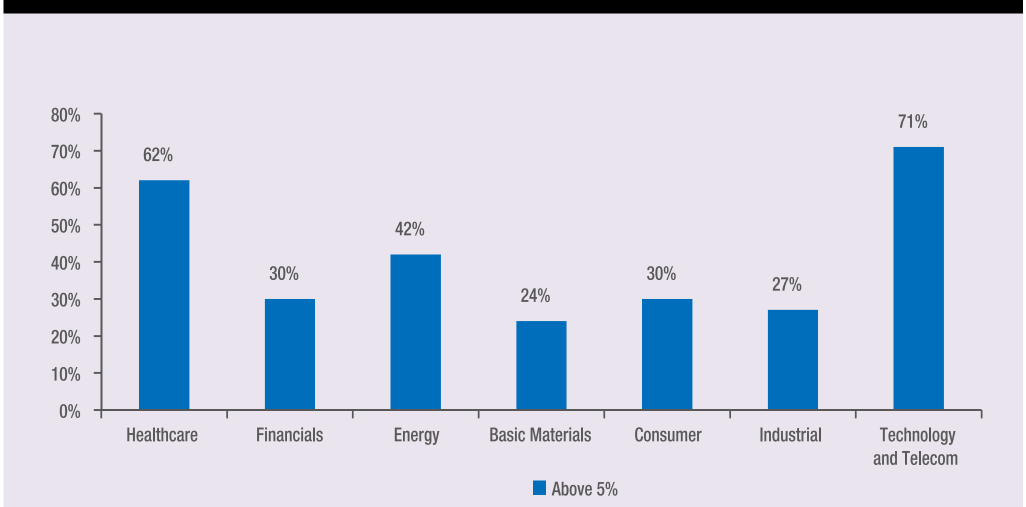
Furthermore, it is interesting to note differences by legal status of the companies: 46% of polled executives working for Chinese private firms have invested above 5% of their sales revenues in innovation, compared to a much lower 26% of SOEs and a lower 35% of foreign owned firms. This data, and the three year trend exposed in Figure 69, confirms a burgeoning trend of Chinese private companies taking the lead in China's business landscape.

FIGURE 69 - EVOLUTION OF R&D SPENDING BY TYPE OF COMPANY: IS YOU ANNUAL EXPENDITURE IN R&D ABOVE 5% OF REVENUES?



When we explore R&D investment by industry in our sample we discover that Technology and Telecommunication have the highest percentage of "big R&D spenders", or firms that devote more than 5% of their sales revenues to R&D (71% of them), very closely followed by healthcare (62% of them). In contrast, lower 24% of Basic materials companies and 27% of Industrial companies declare such high R&D investments (Figure 70).

FIGURE 70 - ZOOM BY INDUSTRY: ANNUAL R&D EXPENDITURE ABOVE 5% OF SALES REVENUES



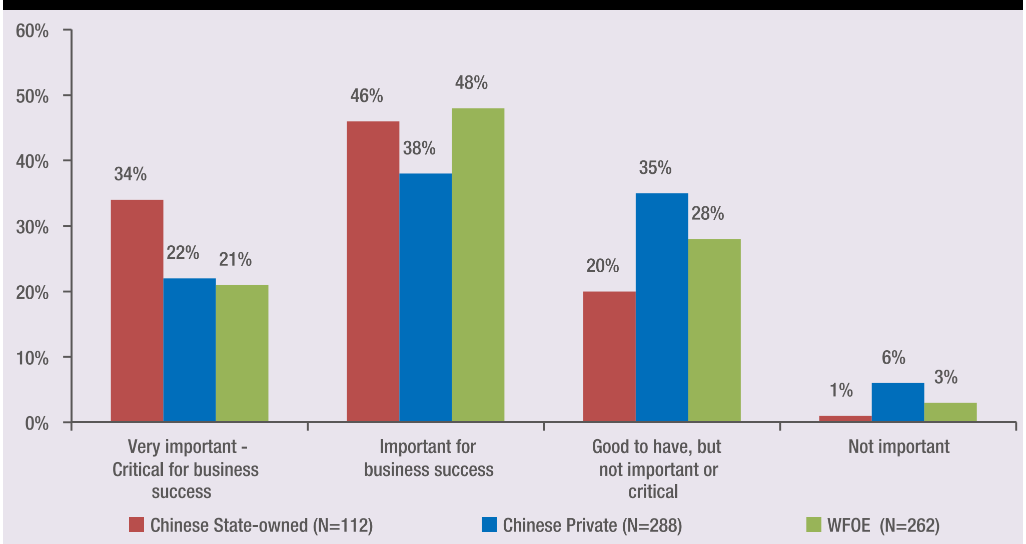
4.4. GOVERNMENT & LEGAL ENVIRONMENT

4.4.1. GOVERNMENT RELATIONSHIPS

Government relations are considered important for business success, more so for companies in Healthcare and Financial sectors, and for Chinese SOEs. However, compared to previous survey editions, the percentage of firms labeling government relationships as "critical for success" is decreasing.

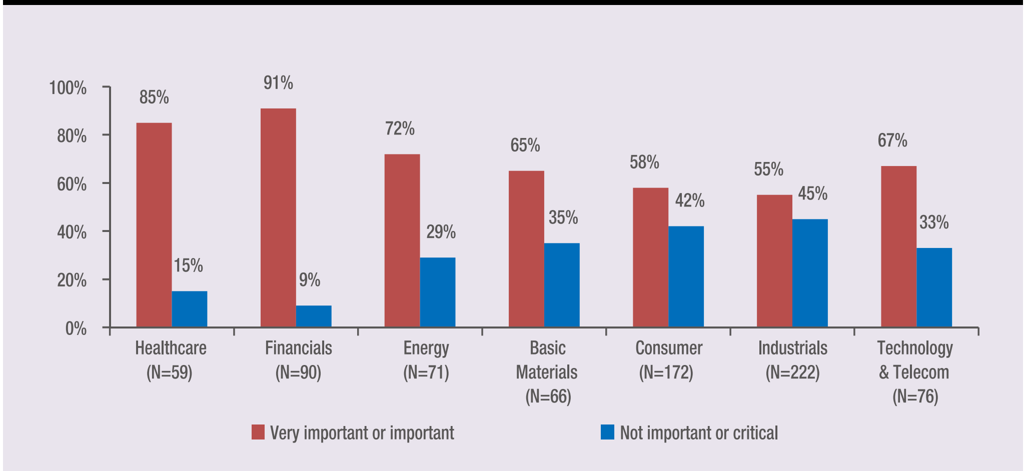
66% of the sample executives view the relationship with the Chinese authorities as important or very important to their businesses, regardless of whether they work for a Chinese or foreign firm. However, it is Chinese state-owned firms that emphasize most the importance of this relationship, with 34% of them labeling it critical for business success (Figure 71). Nevertheless, the percentage of SOEs and of total companies labeling the relationships with authorities as "Critical for business success" is decreasing year after year, according to our poll, suggesting that although such relationships are useful and important, they may be becoming less imperative for business success.

FIGURE 71 - HOW IMPORTANT ARE THE RELATIONSHIPS WITH THE AUTHORITIES?



When analyzing by industry, we observe different levels of importance of government relationships. Our polled sample would suggest that such relations may be more significant for companies operating in Financials or Healthcare, where 91% and 85% of their executives in our sample have labeled them important or critical. This is consistent with previous surveys where companies in the Financial and Healthcare industries most frequently stated to be severely constrained by government policies and regulations. On the other side of the spectrum, a much lower 55% and 58% of executives working in Industrials or Consumer sector firms declare government relationships to be important or very important for their businesses (Figure 72).

FIGURE 72 - BY INDUSTRY HOW IMPORTANT ARE THE RELATIONSHIPS WITH THE AUTHORITIES?



4.4.2. CORRUPTION

According to our survey, corruption is recognized as an existing problem in China however, starting from 2013; a perception of improvement is constant. Corruption Improvement Index is over 50 for all groups, indicating a belief that there has been an improvement in corruption in 2015 in China across industries, compared to 2014. Healthcare is the polled sector with higher proportion of executives believing corruption is a problem. Proportionally less executives report corruption in SOEs than in Chinese private companies or WOFEs.

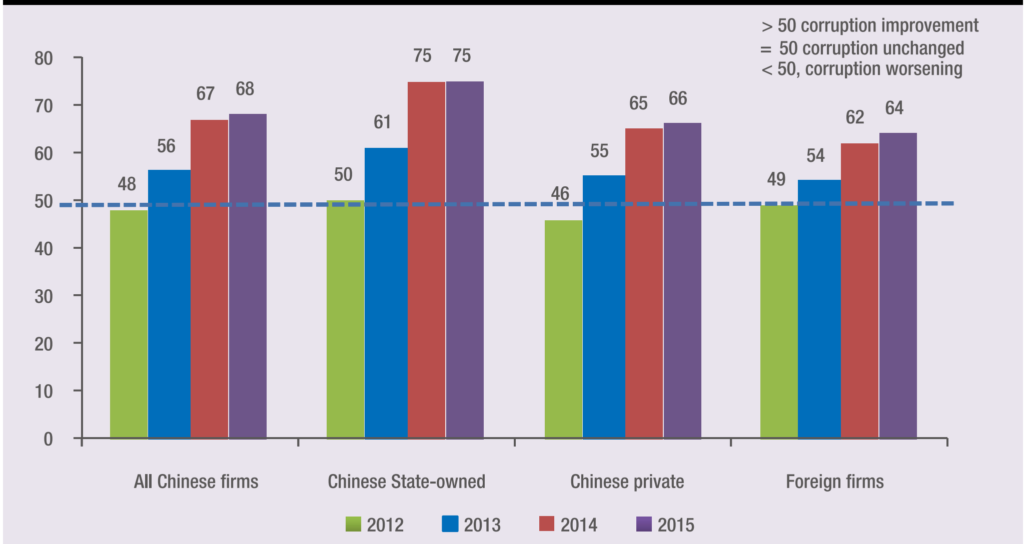
In editions of this survey dating 2012 and earlier, most executives believed that corruption had remained unchanged vs. previous years. However, as of 2013, we note a perception of improvement in all groups surveyed. 2015 consolidates this perception of improvement. Among the surveyed executives, those working for Chinese state-owned companies are the group most often perceiving improvement.

The Corruption Improvement 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) [12]. 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 73), we observe that 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 75). The trend is consistent with 2014 and 2013.

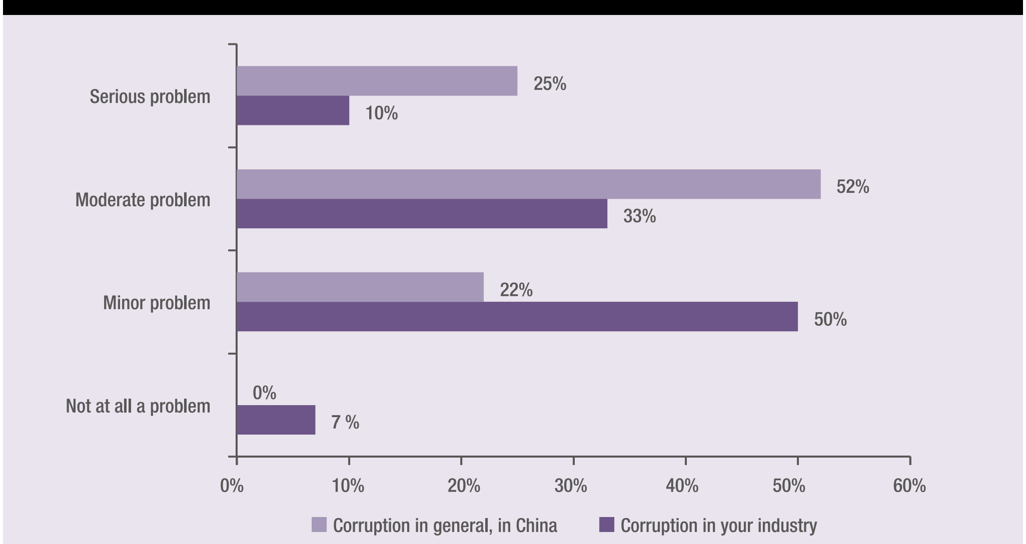
[12] *INDEX = (P1*1) + (P2*0.75) + (P3*0.5) + (P4*0.25) + (P5*0)*
P1 = Percentage number of answers that reported a substantial improvement.
P2 = Percentage number of answers that reported an improvement.
P3 = Percentage number of answers that reported no change.
P4 = Percentage number of answers that reported a deterioration.
P5 = Percentage number of answers that reported a substantial deterioration.

FIGURE 73 - CORRUPTION IMPROVEMENT INDEX BY COMPANY TYPE (IN YOUR VIEW, HOW IS CORRUPTION IN YOUR INDUSTRY COMPARED TO LAST YEAR?)



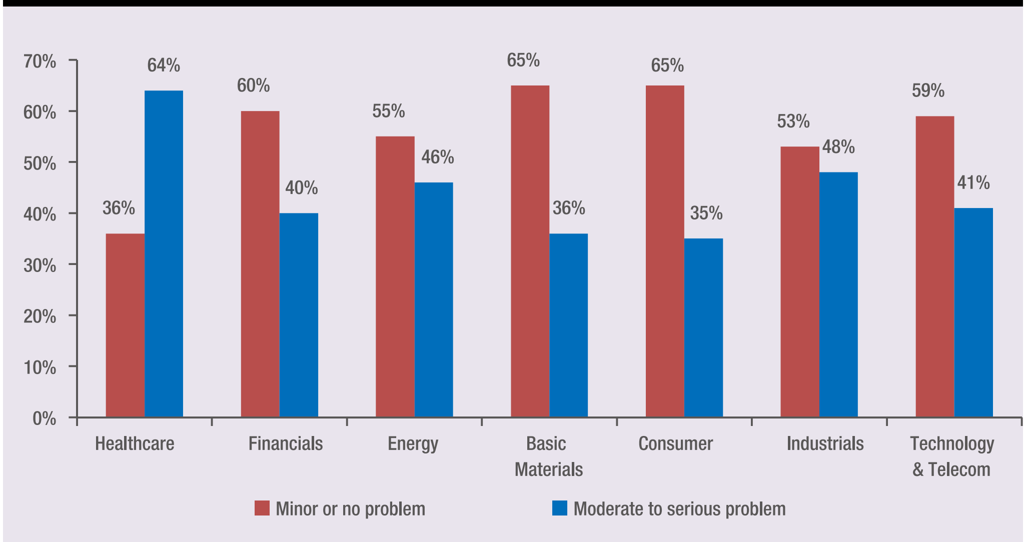
An interesting phenomenon that we have been observing in all editions of this survey is that respondents perceive corruption in China as being less acute when asked about one's own industry than when asked about the country in general. When we ask our sample about general corruption in China, a large majority (77% 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 to 43% (Figure 74). This circumstance is observed with respondents from all types of companies (Chinese private-owned firms, WFOEs and Joint Ventures), and across industries.

FIGURE 74 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA, IN GENERAL, AND IN YOUR INDUSTRY? N=758



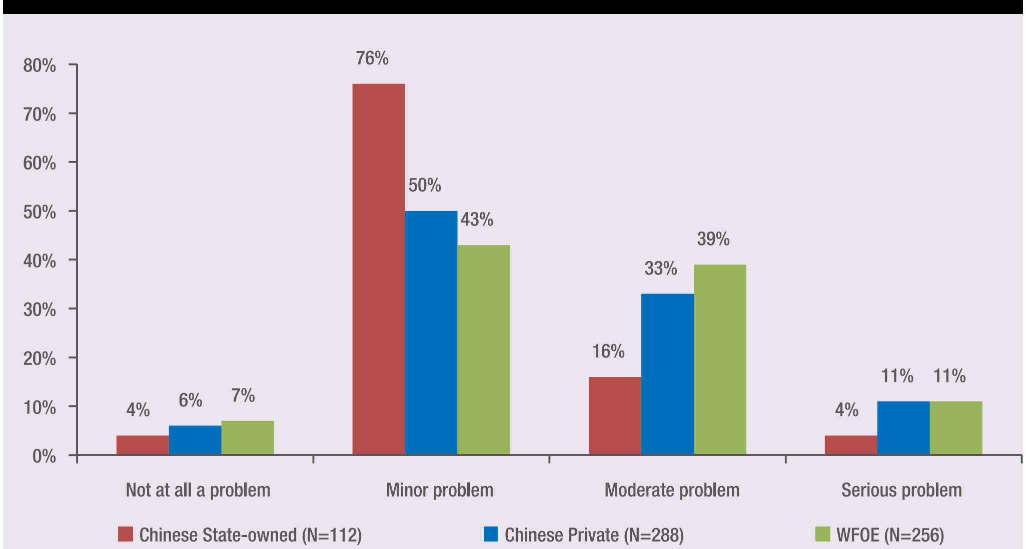
Different industries seem to perceive different levels of corruption. Of the executives surveyed, those working in Healthcare emphasize the existence of corruption in their industry much more often than others with 64% of them rating corruption in their industry as being a moderate or serious problem. Those working in consumer goods seem to perceive corruption in their industries the least often with 65% of them considering corruption to be either nonexistent or a minor problem in their industry (Figure 75).

FIGURE 75 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY?



With respect to the legal status of the company, 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 (Fig 76).

FIGURE 76 - IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY?



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