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European Chamber
中国欧盟商会

CELEBRATING 20 YEARS
OF THE EUROPEAN CHAMBER
2000–2020

EUROPEAN BUSINESS IN CHINA

BUSINESS CONFIDENCE SURVEY 2020

NAVIGATING IN THE DARK

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European Union Chamber of Commerce in China

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EXECUTIVE SUMMARY

Faced with an unprecedented crisis resulting from the COVID-19 outbreak, first in China, then globally, China-based European companies now find themselves navigating in the dark, trying to find the best way forward. This is totally different compared to the situation in February 2020, when members of the European Union Chamber of Commerce in China completed the annual Business Confidence Survey (BCS). Many of the initial findings painted an outlook for 2020 that no longer accurately represent the views of the vast majority of member companies that have endured a tumultuous first half of the year.

In February, nearly half of respondents reported optimism about growth over the next two years, and only 17% said they were pessimistic. Even small and medium-sized enterprises (SMEs), which are now being hit the hardest by the crisis, reported only a minor increase in negative outlook, with 22% of respondents forecasting opportunities for SMEs over the next five years to be “not very good” or “poor”, a mere four percentage point increase from the previous year.

How times have changed.

In February, when the survey was being conducted, most companies thought COVID-19 would only add an extra week or two to the Chinese New Year holidays, before the situation would eventually normalise. Instead, they were stifled by weeks of near complete paralysis as China went into lockdown. Efforts to restart the economy soon ground to a halt, as a patchwork of local fiefdoms, in which officials imposed their own rules, brought the movement of goods and people to a standstill. Even as we passed into April, the Austrian, French, German and Italian chambers noted that a significant number of companies were still not fully staffed or back to full capacity, and that developing outlooks were grim. Data also shows that, until mid-April, the rate of work resumption for SMEs was consistently lower than for bigger companies, again emphasising the additional difficulties they face in China.[1]

The list of unknowns that Chamber members are facing only grows as they extend their views beyond China. Although the Chinese economy is now getting back on its feet, companies are still finding upstream supplies running dry, while demand downstream plummets. The fragility of highly efficient global supply chains has been exposed as economy after economy is hit by rolling outbreaks. For example, even if an automotive manufacturer somehow manages to get 95% of its global supply chain moving, it cannot sell a car without brakes, a steering wheel or a radiator. Such single constraints then disrupt not only the demand for upstream inputs from manufacturers and their suppliers, but also the energy and financing that fuels the entire chain. Even in isolated sectors with fully secured and onshore supply chains, like tourism and hospitality, general drops in demand are hitting revenues hard, leaving only a scant few companies unscathed.

The situation is in constant flux, as known unknowns and unknown unknowns drive novel challenges and uncertainty to levels that have not been seen in generations. This has left companies, as one member put it, “not moving towards the light at the end of a tunnel, but feeling your way in the dark for an exit.”

However, survey respondents have provided extensive data pinpointing underlying issues that fall under the control of the Chinese Government. So, while China can do little to patch holes in global supply chains, it can accelerate its reform agenda and, by doing so, vastly improve business sentiment.

Despite reflecting a ‘time before COVID-19’, financial reporting for 2019 still shows significant downward trends. This is seen especially in logistics, chemicals and petroleum, construction and the automotive industry; sectors that have the highest share of respondents reporting negative growth. Year-on-year (y-o-y) revenue growth dropped to the lowest levels seen since the 2010 BCS, and earnings before interest and tax (EBIT) growth, which was reported by 62% of respondents two years ago, is now only indicated by 43% of those surveyed. These downward trends are reported disproportionately by SMEs, with only 46% seeing increased revenue and 40% experiencing higher EBIT, compared to

1 *Getting China Back to Work*, Trivium China, 16th April 2020, viewed 21st April 2020, <https://triviumchina.com/2020/03/07/coronavirus-getting-china-back-to-work/>

56% and 47% of multinational companies (MNCs), respectively.

These numbers are worrisome and require bold action. China now faces an even greater challenge to boost the allure of its market. For decades, business leaders leaned on efficiency-based strategies to streamline supply chains and minimise costs, strategies that aligned well with China's development aspirations. Now, resiliency is being prioritised, with companies looking to diversify supply chains and end overreliance on any one link. This could be extremely bad news for China's economic interests unless it too adapts to the emerging situation.

Prior to the COVID-19 outbreak, China's limited and selective opening-up agenda only saw modest progress, with reforms inching forward. In 2019, 41% of companies reported at least some market opening. However, most advances were related to the fixing of minor irritants, such as improved bureaucratic procedures, rather than the deep and substantial reforms needed to create a truly open, fair and competitive playing field. Almost half of respondents continue to face market access barriers. While 15% report facing mainly direct obstacles, like the negative lists, twice as many report indirect hurdles such as opaque licensing procedures and other complicated administrative approvals. That this data point is the same as a year ago calls into question just how useful those openings in 2019 really were.

While still welcomed by the European business community, the grab-bag of incremental improvements to the regulatory environment that were noted in 2019 yet again failed to adequately counteract the challenges being faced. The reforms are viewed as even more inconsequential in the present climate. Doing business in China has become more difficult over the past year for 49% of members, a four percentage point decrease from 2019 – a marginal improvement. However, with the COVID-19 outbreak suppressing demand in ways unseen for nearly a century, this sentiment will doubtless have taken a nosedive. Baby steps are simply not enough.

Unfortunately, over the next five years, 44% of respondents expect to see an increase in regulatory obstacles, while only 29% foresee a decrease. Significantly, European companies say that regulations are often implemented in a discretionary manner, with 40% reporting enforcement as unfavourable to them.

European companies have long been drawn to the China market, chiefly due to its sheer size and growth potential, as well as its world-class industrial clusters from which links in global supply chains can be sourced. Plummeting demand and the need to diversify supply chains have made it critical that China's leaders increase the pull of the market in other ways. This will necessitate market opening and regulatory reform consistent with China's level of development and economic might.

Any economic liberalisation that has already taken place in recent years continues to be overshadowed by the resurgence of China's state-owned sector. Almost half of BCS respondents believe that state-owned enterprises (SOEs) will gain opportunities at the expense of the private sector in 2020, which is up seven percentage points on the previous year. Those reporting that they expect the private sector and state sector to experience equal opportunities slipped from 39% to 35%. The COVID-19 outbreak looks likely to further exacerbate this problem, with the government now turning to SOEs as a source of stability in uncertain times, which can only be achieved by draining yet more resources from the private sector.

Incremental but insufficient liberalisation in some areas, coupled with regression in SOE reform, reinforces the perception of a division being drawn between sectors, with China moving towards a 'one economy, two systems' model: on one side, market forces and modern regulatory mechanisms look increasingly international; on the other, critical sectors of the economy are dominated by state-owned national champions, while private enterprises are at best stifled or at worst forced out of the market entirely.

The emergence of this 'one economy, two systems' model badly impairs business sentiment. Optimism will deteriorate further when economic headwinds from COVID-19 force European companies to make extensive cutbacks and other difficult choices – companies that may otherwise have been looking to increase investment in China. The Chinese leadership has a ready-made answer to this crisis, by employing the same tools that Deng Xiaoping and Zhu Rongji did during previous major economic upheavals. These two leaders did not waste their respective crises, and the European business community hopes that the current administration will not waste its own.

China now has the strength and experience to become a leading force in a global recovery, but this brings with it a significant responsibility. By carrying out necessary reforms at home and collaborating with the global community to build a modern, rules-based order, and free and fair markets, while implementing basic principles of reciprocity, China can yet again become a catalyst for progress and growth, both at home and globally.

1 NAVIGATING IN THE DARK

Collected in February, the initial data for this report painted an outlook for European business operating in China that will now seem like a distant memory for those dealing with the aftermath of COVID-19. Forward-looking sections of the survey have been upended by the uncertain nature of the situation. Nevertheless, much of the backward-looking data provides ample perspective on many of the underlying concerns of European business, before the outbreak drastically magnified every problem that foreign companies have had to endure in China over the years.

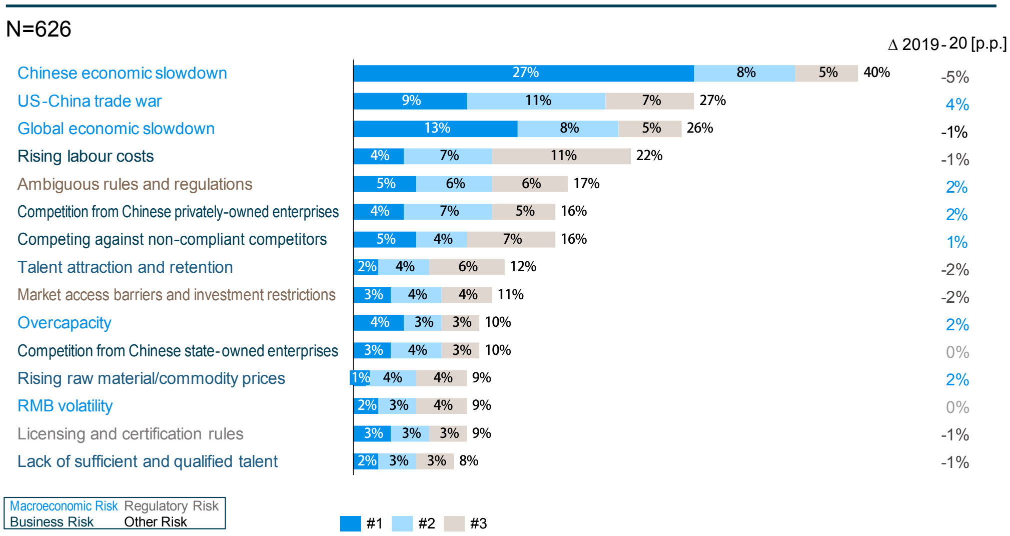
1.1 Pressure before the pandemic

The COVID-19 outbreak has profoundly challenged existing ways of doing business. Economists have already predicted grim outlooks for growth in the first half (H1) of 2020 in China and elsewhere, and global supply chains have already been severely rattled. In April 2020, the World Bank forecast a sobering drop in growth to 2.3% in China in its baseline scenario, and slipping to 0.1% in a worst-case scenario,[2] compared to the 6.1% growth in 2019 that was then the lowest in nearly three decades.[3]

Yet even before the onset of the pandemic, European companies operating in China were already seeing a soft downturn that challenged their confidence in the Chinese market, with 40% of respondents ranking the Chinese economic slowdown as one of the top obstacles to future business in the country. Although this represents a five percentage point drop from the previous year, signalling incremental improvement, it is expected that long-term economic stagnation from COVID-19 will negate any progress, especially as the global economy offers little consolation; 27% of members ranked the global economic slowdown as a top-three challenge as well.

Figure1: Macroeconomics factors remain top challenges

Please rank the top three business challenges that you selected as significant above [1)]



1) Asked to rank top three challenges selected for previous question: "Please choose at least three challenges your company perceives as having the greatest impact on future business in Mainland China"

2 *East Asia and the Pacific in the Time of COVID-19 – Regional Economic Update, April 2020*, World Bank, 30th March 2020, viewed 11th April 2020, <https://www.worldbank.org/en/region/eap/publication/east-asia-pacific-economic-update>

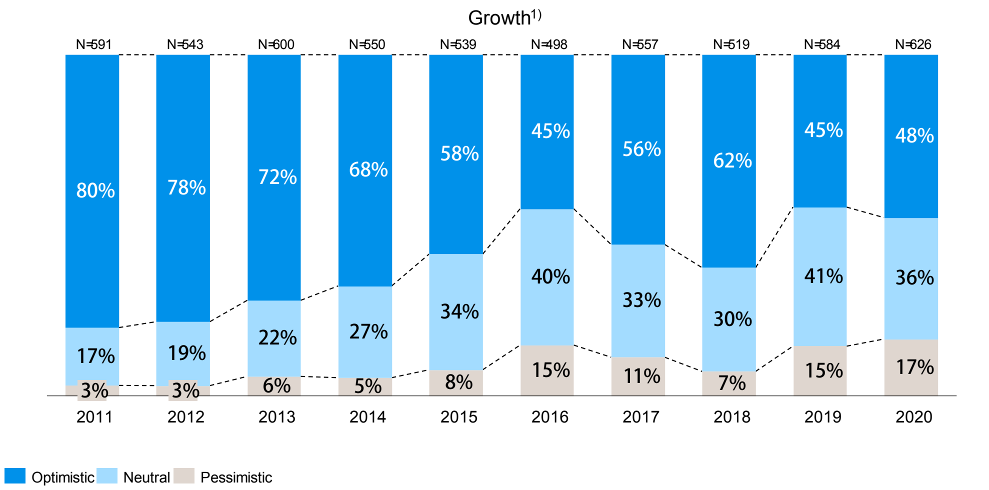
3 Areddy, James T. and Deng, Chao, *China's Slowing Growth Underlines Stress Facing Its Economy in 2020, Wall Street Journal*, 17th January 2020, viewed 27th April 2020, <https://www.wsj.com/articles/chinas-economic-growth-slows-to-6-1-as-trade-and-business-confidence-suffer-11579236022>

In short, macroeconomic forces were already putting significant pressure on European companies in China before the shockwaves of COVID-19 were felt.

At the time of the survey, nearly half of respondents were optimistic about growth over the next two years, against only 17% who said that they were pessimistic. Even for SMEs, which are now being hit the hardest, there was only a minor increase in members forecasting a negative outlook, with 22% of respondents saying that the opportunities for SMEs over the next five years were either “not very good” or “poor”, a mere four percentage point increase from the previous year. It would be a challenge to find many companies with such an upbeat perspective now.

Figure 2: Pre-COVID 19, moderate optimism on growth

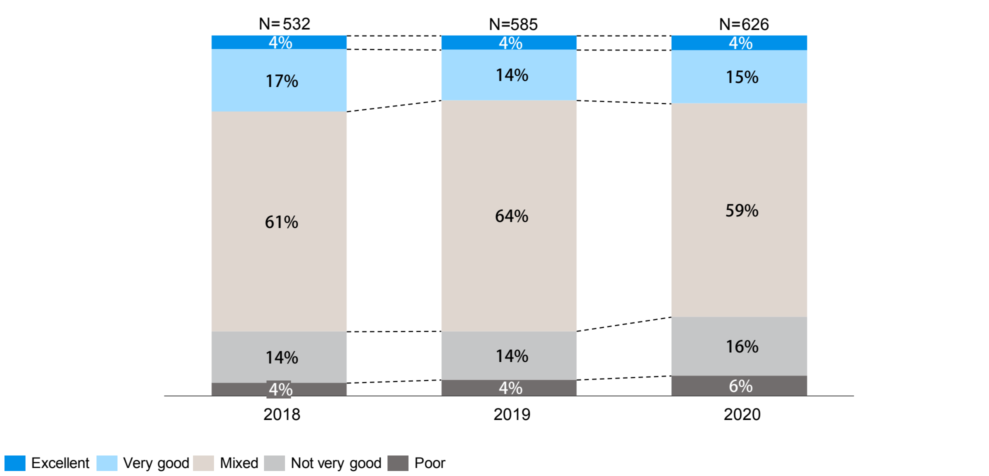
How would you describe the business outlook for your sector in China over the next two years?



1) Excludes answer “Not applicable”, which was a possible answer up until and including 2018

Figure 3: Even SME outlooks held fast prior to the pandemic

What do you think of the opportunities for European SMEs in your sector over the next five years?



1.2 Sentiment plagued by COVID-19

The spread of COVID-19 was only just starting when members were surveyed in February.[4] At that time, many companies faced challenges caused by the extended Chinese New Year holiday or anticipated short-term disruptions to logistics.[5] After weeks of a near complete shutdown of the Chinese economy, companies that were eager to resume production hit roadblock after roadblock.[6] Moving goods or people across a hundred different jurisdictions became an impossible task, as China's response to the outbreak empowered local authorities to impose their own rules, quickly turning the country into an impassable logistical labyrinth.[7]

According to a survey jointly carried out by the European Chamber and the German Chamber of Commerce in China in February 2020 to assess the impact of the COVID-19 epidemic (COVID-19 survey), 70% of respondents predicted revenue decreases as a result of the virus and associated prevention and control measures, with 48% forecasting a drop of more than 10%.[8]

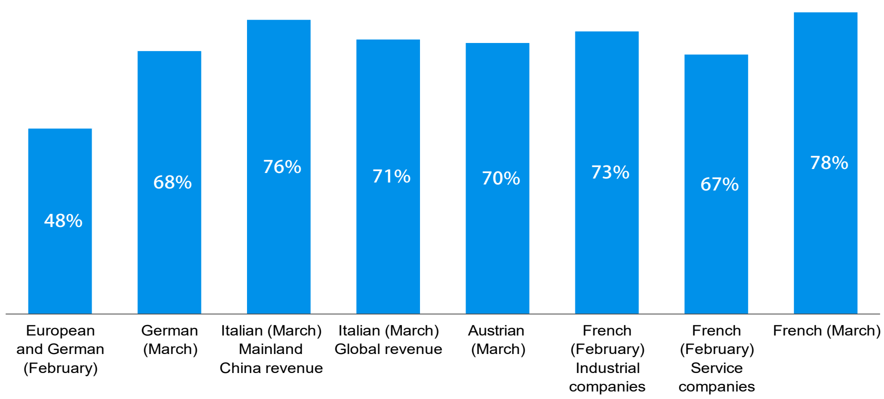
Other chambers of commerce reported even worse situations as time went on. In another survey carried out by the German Chamber in March, 68% of respondents anticipated a revenue drop of more than 10% in the first half of 2020, a 20 percentage point increase from just a month before. Unsurprisingly, 57% of respondents reported that they would lower their 2020 business performance targets.[9] Out of the French Chamber members surveyed in February, 73% of manufacturing companies and 67% of service companies predicted revenue drops of at least 20%,[10] which rose to 78% of the companies surveyed in March.[11] A significant 70% of Austrian Chamber members expect more than a 10% decline in revenue.[12]

In a survey conducted by the Italian Chamber in late March, 76% of respondents foresaw at least a 10% decrease for their mainland China revenue, and 71% anticipated at least a 10% decrease for their global revenue.[13] Even as the spread of the virus slows in China at the time of writing, its global spread will still have catastrophic repercussions; 58% of respondents believe that the outbreak in Italy will have an extremely or very significant impact on their business in China.

4. Muccari, Robin and Chow, Denise, *Coronavirus Timeline: Tracking the Critical Moments of COVID-19, NBC News*, 9th April 2020, viewed 21st April 2020, <https://www.nbcnews.com/health/health-news/coronavirus-timeline-tracking-critical-moments-covid-19-n1154341>
5. Wu, Huizhong, *China's Cabinet to Extend Lunar New Year Holidays: State Broadcaster, Reuters*, 27th January 2020, viewed 21st April 2020, <https://www.reuters.com/article/us-china-health-holidays/chinas-cabinet-to-extend-lunar-new-year-holidays-state-broadcaster-idUSKBN1ZP0PQ>
6. Cheng, Evelyn, *Roughly 5 Million People in China Lost Their Jobs in the First 2 Months of 2020, CNBC*, 16th March 2020, viewed 21st April 2020, <https://www.cnbc.com/2020/03/16/china-economy-millions-lose-their-jobs-as-unemployment-spikes.html>
7. Mitchell, Tom, Weinland, Don and Greely, Brendan, *China: an Economy in Coronavirus Quarantine, Financial Times*, 15th February 2020, viewed 21st April 2020, <https://www.ft.com/content/a7a8bf98-4f12-11ea-95a0-43d18ec715f5>
8. *COVID-19 Severely Impacting Business: trade associations call for proportionate measures to get real economy back on track*, European Union Chamber of Commerce in China, 27th February 2020, viewed 11th April 2020, <https://www.europeanchamber.com.cn/en/press-releases/3161/covid_19_severely_impacting_business_trade_associations_call_for_proportionate_measures_to_get_real_economy_back_on_track>
9. *COVID-19's Future Impact on Foreign Companies in China: German Businesses on Track to Recovery – Demand now Major Concern*, German Chamber of Commerce in China, 2nd April 2020, viewed 11th April 2020, <https://china.ahk.de/news/news-details/covid-19s-future-impact-on-foreign-companies-in-china-german-businesses-on-track-to-recovery-demand-now-major-concern>
10. Note: Options for revenue decrease were: 'Negligible', '20% decline', '50% decline' and '80% decline': *Evaluation of the Impact of Covid-19 for French Companies in China*, Chambre de Commerce et d'Industrie Française en Chine (CCI FRANCE CHINE), 18th February 2020, viewed 11th April 2020, <https://www.ccifc.org/publication/news/detail-dune-actualite/news/evaluation-of-the-impact-of-covid-19-for-french-companies-in-china.html>
11. *COVID-19: Impact for French Companies in China 1 Month After*, CCI FRANCE CHINE, March 2020, viewed 15th April 2020, data unpublished.
12. *Effects of COVID-19 on Austrian Companies in China*, Advantage Austria, 2nd April 2020, viewed 11th April 2020, <https://www.advantageaustria.org/cn/oesterreich-in-china/news/local/Covid_Survey_2020.en.html>
13. *Results of the Second Edition of the Survey "The Impact of the Novel Coronavirus Pneumonia on the Italian Business Community in China*", China-Italy Chamber of Commerce, 30th March 2020, viewed 11th April 2020, <https://www.cameraitacina.com/en/news/results-second-edition-survey-impact-novel-coronavirus-pneumonia-italian-business-community>

Figure 4: National chambers predict sharp revenue decrease from COVID-19

Percentage of respondents forecasting >10% revenue drop from COVID-19

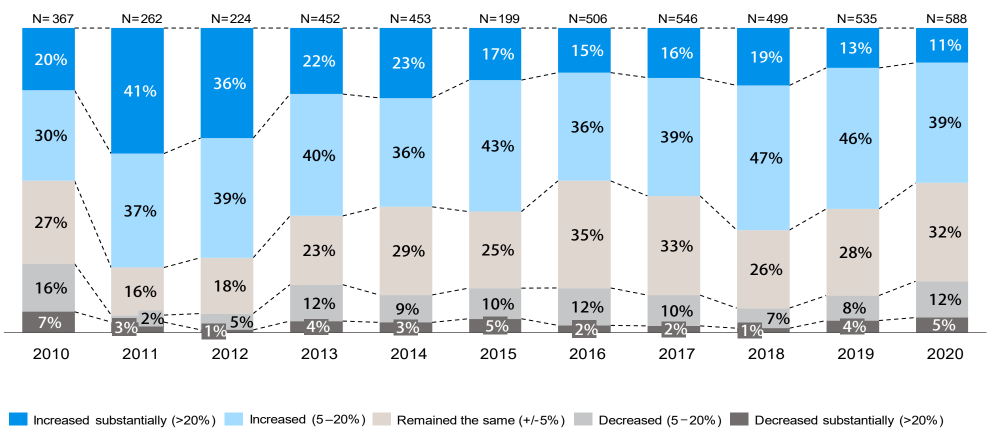


1.3 Pandemic magnifies existing issues in China

The full extent of the negative impact from COVID-19 on revenue growth remains unclear, but the trend is undeniably bleak. In February, only half of European Chamber members reported that their total 2019 revenues in Mainland China increased by at least 5% compared to 2018. This is a nine percentage point drop y-o-y, and the lowest in the past decade. The percentage of members reporting a decrease in revenue has also risen to a decade-high of 17%, which represents a five point increase compared to the previous year.

Figure 5: Revenue growth continued to slip in 2019

How did your company's total 2019 revenue in Mainland China evolve compared to 2018? 1)



1) Excludes answer "Not Applicable"

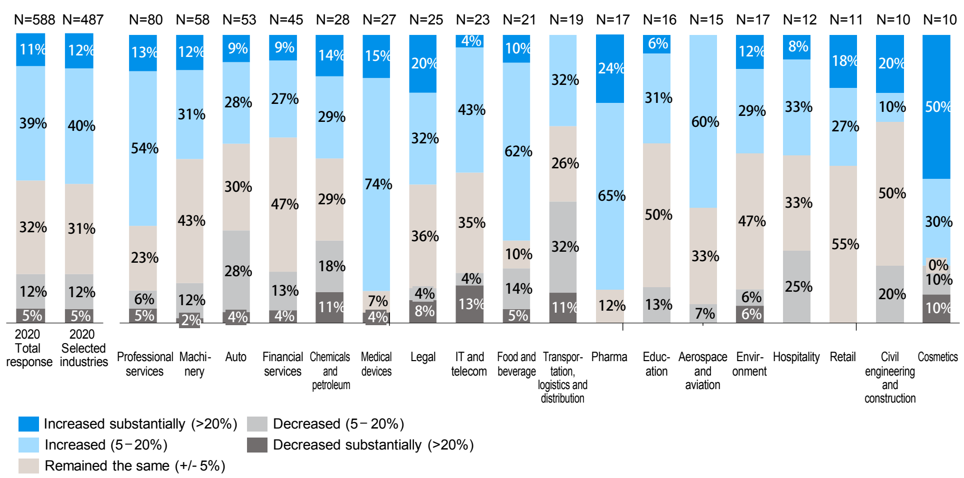
The sectoral breakdown of revenue growth offers an even more pessimistic view in light of the virus situation. Transportation, logistics and distribution, automotive, and chemicals and petroleum enterprises report the highest rates of revenue decrease in 2019. Those sectors are now being hit especially hard by the pandemic. For example, the logistics industry relies on the demand for goods and then the ability to actually transport them, while chemicals find their way into nearly every product, leaving chemicals and petroleum enterprises extremely exposed to a general drop in demand.

Automotive manufacturers are also highly exposed to supply chain disruptions due to the sheer number of inputs they require from a variety of different sources. Hubei Province, for example, is the fourth largest producer of automobiles in China and is home to many foreign producers.[14] Being the initial epicentre of the COVID-19 outbreak meant that production shutdowns there began earlier and lasted longer than in other regions in China, seriously disrupting those companies. Meanwhile, some were less impacted, such as German automotive manufacturers, which have the bulk of their operations in other regions like China's northeast or the Sichuan Basin. However, according to a survey by the German Automotive Industry (VDA) in February, the large concentration of Chinese original equipment manufacturers, joint ventures (JVs) and suppliers in Hubei meant that even those German manufacturers spread across other regions were still impacted.[15]

A second survey by the VDA in March found that the global automotive supply chain was still crippled at that point due to the virus moving from China to Europe. As many European automotive manufacturers shut down plants and production there came to a near standstill, the reopening of China's automotive production has not been as quick as expected.[16]

Figure 6: Cosmetics, pharma and medical devices benefit from reform; auto, chemicals and logistics struggle

How did your company's total 2019 revenue in Mainland China evolve compared to 2018? 1) 2)



1) Industries selected are those for which there were at least 10 responses;

2) Excludes answer "Not applicable"

14 Huang, Zili, He, Peng, *This Industry was Crippled by the Coronavirus – Here's How it's Fighting Back*, World Economic Forum, 25th February 2020, viewed 30th April 2020, <https://www.weforum.org/agenda/2020/02/coronavirus-china-automotive-industry/>

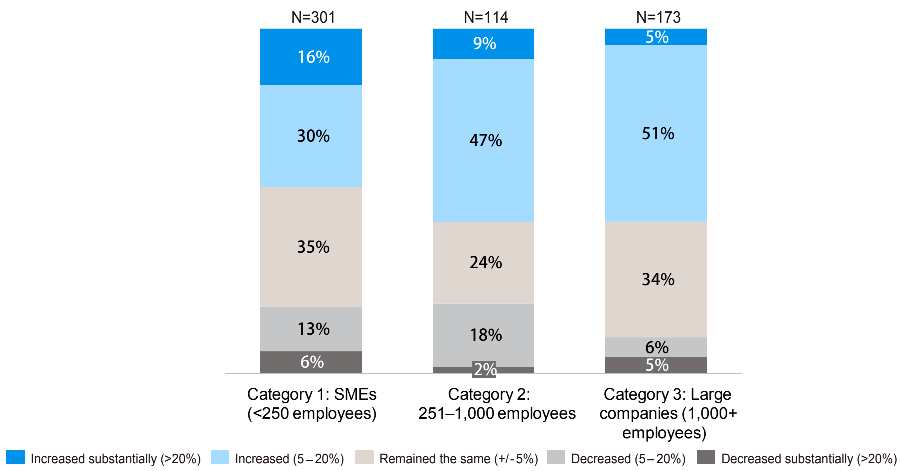
15 Sun, Amy, Ding Ying, Dou Ying, Zhang Lin, and Thomas Meurers, *Impact of COVID-19 on German Automotive Industry in China*, VDA, 24th February 2020, viewed 11th April 2020, <https://vdachina.sharepoint.com/>

16 *Report of 2nd VDA Survey for Corona Impacts in China*, VDA, 24th March 2020, viewed 11th April 2020, <https://vdachina.sharepoint.com/>

Unsurprisingly, SMEs—defined in Europe as having fewer than 250 employees worldwide—are more severely impacted by economic volatility than larger companies. Only 46% of SMEs reported a revenue increase in 2019, compared to 56% of both Category 2 (between 251 and 1,000 employees) and Category 3 (more than 1,000 employees) companies. SMEs will therefore also be the most negatively impacted by COVID-19, as the majority lack either the capability to divert their supply chains or the financial cushion against significant and short-term revenue drops that larger firms might enjoy.

Figure 7: 2019 results mixed for SMEs; MNCs' growth more stable

How did your company's total 2019 revenue in Mainland China evolve compared to 2018?1)



1) Excludes answer "Not applicable"

Small European businesses consulted in mid-February as part of a larger Ministry of Industry and Information Technology (MIIT) survey on the impact of COVID-19 on SMEs reported a variety of challenges.[17] For instance, in the case of small and medium-sized manufacturers, the main issues encountered were a reduction in client orders, supply chain disruptions (especially with smaller suppliers) and liquidity/financing issues. Companies in the service sector, such as consultancies and information and communication technology (ICT) enterprises, projected significant negative impacts on their operations, with some expecting a 50% reduction in operating income in H1 2020 compared to the same period in 2019. This was the case even for those that did not stop operations during Chinese New Year or resumed work soon afterwards.

This feedback largely correlates with the data found in surveys conducted on a wider sample of companies, such as those led by Tsinghua and Peking universities from early February to April, as well as the information provided through government agencies such as the China Centre for the Promotion of SMEs.[18] Many of the European SMEs surveyed also serve foreign clients and have at least part of their supply chains abroad, which means that they are liable to take a double hit due to the disruptions experienced within China followed by those in the rest of the world.

The list of unknowns for companies only grows as they extend their view beyond China. Even as the local economy gets back on its feet, companies are finding upstream supplies running dry while demand downstream crashes. The fragility of highly efficient global supply chains has been exposed as rolling outbreaks alternate between major economies.[19] Each single bottleneck then weakens demand for upstream inputs from manufacturers and their suppliers, as well as the energy and financing that fuels the entire chain. Even in isolated sectors with fully secured and onshore supply chains, like tourism and hospitality, general drops in demand will hit hard, and few companies will be left unscathed.

17 *Notice on Launching a Questionnaire Survey on the Impact of New Coronavirus on SMEs*, MIIT, 3rd February 2020, viewed 21st April 2020, <http://www.miit.gov.cn/newweb/n1278117/n1648113/c7664045/content.html>

18 *Tsinghua University and Peking University Jointly Investigate How 995 SMEs Cross the Three-month Line of Life and Death*, MBA China, 25th February 2020, viewed 21st April 2020, <https://www.mbachina.com/html/tsinghua/202002/214377.html>

19 Doherty, Sean and Botwright, Kimberly, *What Past Disruptions can Teach us About Reviving Supply Chains After COVID-19*, World Economic Forum, 27th March 2020, viewed 21st April 2020, <https://www.weforum.org/agenda/2020/03/covid-19-coronavirus-lessons-past-supply-chain-disruptions/>

1.4 Diversification accelerates

The shock of the COVID-19 outbreak and ensuing economic shutdown has rattled corporate strategies, as recognition grows that 'just-in-time' supply chains can also be extremely volatile. While this has sparked calls from many corners to diversify away from an overreliance on any single market, the centrality of China cannot be overlooked.[20] Compared to the Severe Acute Respiratory Syndrome (SARS) outbreak in 2002/2003, when China's manufacturing export share was only 8%, its share now is 19%. The rest of the world's reliance on Chinese intermediate goods means that domestic production downturns can cause huge disruptions worldwide.[21]

Yet diversification was already a growing trend in certain places. For some time, investments in Mainland China from South Korea, Taiwan and Japan have been moving elsewhere, for example to Southeast Asia.[22] In response to the coronavirus, Japan has even created a United States dollar (USD) 2 billion fund to help finance companies moving investment in certain sectors out of China, and either back into Japan or into other markets.[23] Meanwhile, the political pressure heaped onto American companies to 'decouple' continues to grow in spite of any progress being made in the deferred US-China trade war.

Europe has not been silent on this issue either. Some leading European figures have for years called for such steps, but the COVID-19 outbreak has amplified their voices.[24] Even the European Commission has made no secret of its deep concern over an overreliance on China for things as basic, yet critical, as medical masks.[25] The list of such essential products is extensive, reaching far back into supply chains that, while they may end in Europe, start in China.

However, most European Chamber members are chiefly 'in China, for China'. Some still rely on China as part of a broader supply chain, but the days of European companies being in China mainly to export elsewhere are in the past. The need to build resilient supply chains to serve the China market is driving some companies to consider further onshoring suppliers or diversifying sourcing across the whole market. The aim is to ensure that especially acute shutdowns in one part of China, such as in Hubei during the COVID-19 outbreak, will not have such an intense impact on downstream operations. In February, European Chamber members remained largely committed to the China market, with only 11% of them considering shifting their current or planned investments to other markets.

That being said, some MNCs still export portions of their production out of China to add to global supply chains. It is not yet clear how they will change this strategy as part of a broader push for diversification. Many European companies without a presence in China rely on suppliers here: the COVID-19 pandemic will undoubtedly impact demand for these suppliers if and when diversification takes place.

20 Garcia-Herrero, Alicia, *Companies Must Move Supply Chains Further From China, Nikkei Asian Review*, 26th February 2020, viewed 21st April 2020, <https://asia.nikkei.com/Opinion/Companies-must-move-supply-chains-further-from-China>

21 *China's Larger Role in Export of Intermediate Goods Makes Corona Virus an Even Bigger Risk to Global Value Chain*, Natixis, 12th February 2020, viewed 11th April 2020, <https://research.natixis.com/Site/en/publication/vRUNiE74ktwL1O75GhH2FQ%3D%3D?from=share>

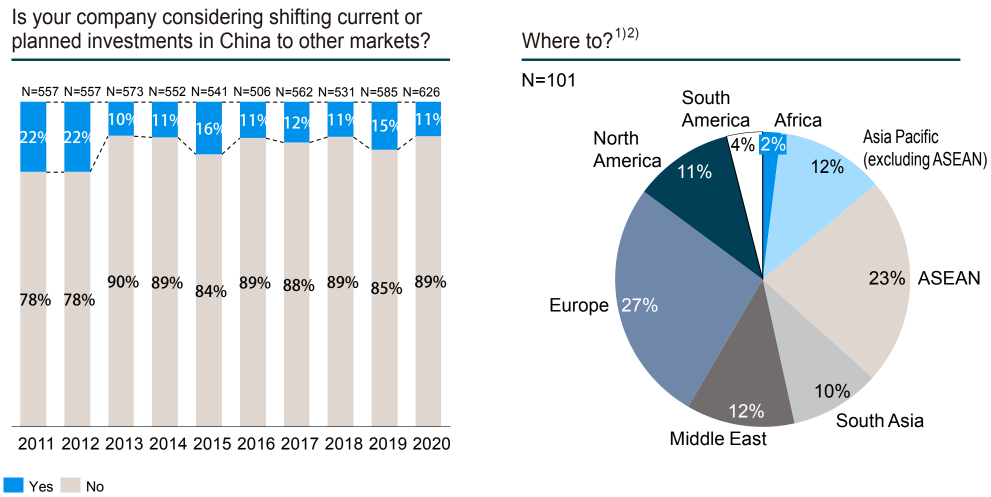
22 *North Asia Reshuffling Supply Chain to Southeast Asia in Response to China's Vertical Integration*, Natixis, 13th November 2019, viewed 11th April 2020, <https://research.natixis.com/Site/en/publication/bAPYMpWIxG0Ywh7lfKuYwA%3D%3D?from=share>

23 Reynolds, Isabel and Urabe, Emi, *Japan to Fund Firms to Shift Production Out of China, Bloomberg*, 8th April 2020, viewed 11th April 2020, <https://www.bloomberg.com/news/articles/2020-04-08/japan-to-fund-firms-to-shift-production-out-of-china?srnd=next-china>

24 Cerulus, Laurens, *Coronavirus Forces Europe to Confront China Dependency, Politico*, 6th March 2020, viewed 21st April 2020, <https://www.politico.eu/article/coronavirus-emboldens-europes-supply-chain-security-hawks/>

25 Guarascio, Francesco and Blenkinsop, Philip, *EU Fails to Persuade France, Germany to Lift Coronavirus Health Gear Controls, Reuters*, 6th March 2020, viewed 11th April 2020, <https://www.reuters.com/article/us-health-coronavirus-eu/eu-fails-to-persuade-france-germany-to-lift-coronavirus-health-gear-controls-idUSKBN20T166>

Figure 8: Most companies remain committed to China

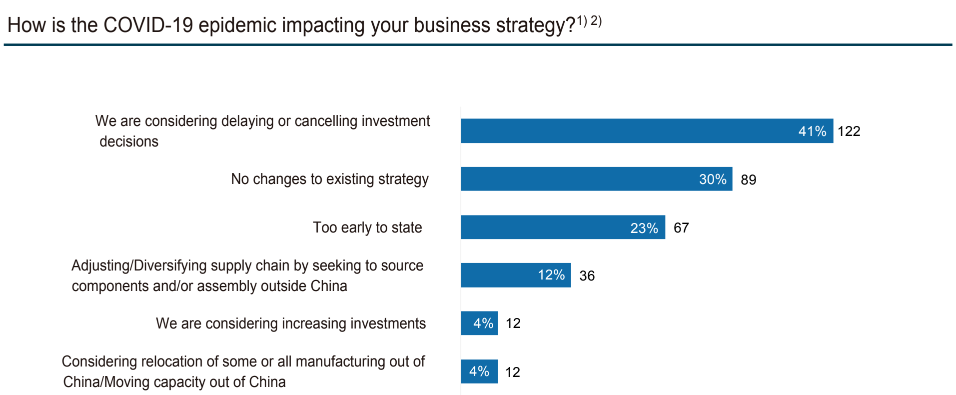


1) Asked only if answer to "Is your company considering shifting current or planned investments in China to other markets?" is "Yes"

2) Multiple answers possible; percentage divided by number of respondents

Despite the figures showing that a majority of European companies currently remain committed to the market, it would be unwise to take this for granted. Already, 41% of German companies in China surveyed by the German Chamber say that they are considering delaying or cancelling investment decisions, as indicated in the chart below from their March survey.[26]

COVID-19 has seriously rattled investor sentiment



1) *Multiple answers possible; percentage divided by number of respondents;*
2) *From German Chamber survey of 294 members in March 2020*

26 *COVID-19's Future Impact on Foreign Companies in China: German Businesses on Track to Recovery – Demand now Major Concern*, German Chamber of Commerce in China, 2nd April 2020, viewed 11th April 2020, <https://china.ahk.de/news/news-details/covid-19s-future-impact-on-foreign-companies-in-china-german-businesses-on-track-to-recovery-demand-now-major-concern>

Fallout from the US-China trade war, compounded by the pandemic, has proven that overreliance on any single country can lead to the shutdown of companies. China must reassure investors by creating an environment that will instil trust and confidence in the country as a reliable link in the global supply chain. While it currently seems far-fetched that the European Union (EU) would ever create a fund for decoupling, it is not so long ago that the idea of Japan taking such measures seemed similarly unimaginable. A bold acceleration of China's reform agenda can nip this trend in the bud.

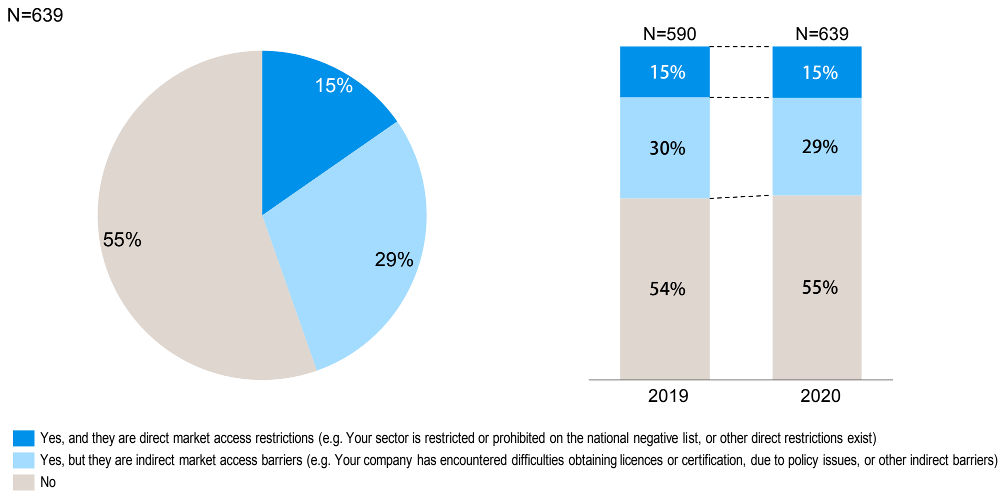
1.5 Promise fatigue endures as progress lags behind expectation

Even without the COVID-19 outbreak, reduced revenue trends and the persistence of the many unnecessary challenges faced by European companies in China demand change. Adding the macroeconomic avalanche of a prolonged economic shutdown to the equation simply reduces companies' justification for further investment. Beijing is limited in what it can do to affect the macroeconomic picture at home and abroad, but it can deal with the negative factors under its control.

Some market opening has been noted by 41% of companies, but this reflects only minor steps that have been taken. Just under half of respondents continue to face market access barriers. While 15% say that they mainly face direct barriers like the negative lists for foreign investment and market access, twice as many report indirect ones such as licensing processes and other opaque administrative approvals. That this data point was the same as a year ago calls into question just how complete openings in 2019 actually were.

Figure 9: No change y-o-y; indirect barriers remain twice as common as direct ones

Does your company face market access restrictions in China? 1)



1) Multiple answers possible; percentage divided by number of respondents

The impact of market opening through the revision of the negative lists in 2019 has been marginal. In July 2019, revisions to the *Special Administrative Measures on Access to Foreign Investment*,[27] and its equivalent for free trade zones (FTZs),[28] were implemented. A few months later, the *Negative List for Market Access* was updated.[29] This list defines market access for foreign and domestic businesses, and covers SOEs, private companies, joint-ownership models and wholly foreign-owned enterprises.

27 *Special Administrative Measures on Access to Foreign Investment (Negative List),* National Development and Reform Committee (NDRC) and Ministry of Commerce (MOFCOM), 30th June 2019, viewed 11th April 2020, <http://www.mofcom.gov.cn/article/b/f/201906/20190602876999.shtml>

28 *Special Administrative Measures on Access to Foreign Investment in Free Trade Zones*, NDRC and MOFCOM, 30th June 2019, viewed 11th April 2020, <http://www.mofcom.gov.cn/article/b/f/201906/20190602877000.shtml>

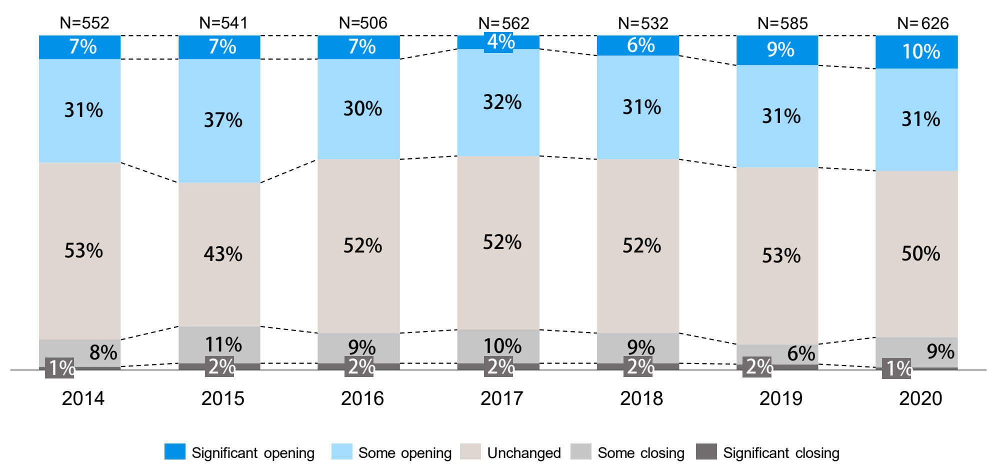
29 *Notice of Market Access Negative List*, NDRC and MOFCOM, 22nd November 2019, viewed 11th April 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/201911/t20191122_1204473_ext.html>

Nevertheless, only 10% of respondents saw significant opening, with another 31% reporting some increases in market access in their industry over the last year, a one percentage point increase from 2019. Sectors like financial services and environment have benefitted the most from the recent relaxations, with 64% and 59%, respectively, noting market opening.

In areas where market opening has been meaningful, it has produced positive results for foreign companies. Cosmetics, medical devices and pharmaceutical enterprises, for example, have all benefitted from such opening, and also led survey participants in terms of revenue growth, with more than 80% reporting an increase in 2019.

Figure 10: Most openings bring limited results for major European players

Has there been any market opening in your industry in Mainland China for foreign companies (y-o-y)?



While all reforms are welcome, the opening up of sectors that are already in a late stage of development has left international investors struggling to make the most of the market.[30] Financial services opening, for example, only took place after the entire market was saturated with Chinese SOEs, leaving only niche, albeit profitable, roles to the few European players that were able to obtain the necessary operating licences. This situation has severely hampered China's decade-long plan to turn Shanghai into an international financial centre.[31]

Oil and gas exploration faces a similar issue.[32] Having recently gained more complete access to the market, European energy companies have found there is no room for other players, as the best fields have already been explored—mostly by Chinese-owned firms—and the quality of remaining hydrocarbon resources is low.[33] Opening up only after market domination is complete does not represent sustainable, nor meaningful, reform.

30 Cai, Jane, *Too Little, Too Late? Foreign Bankers Fall Out of Love with China as Beijing Fails to Open Up, South China Morning Post (SCMP)*, 4th March 2018, viewed 21st April 2020, <https://www.scmp.com/news/china/economy/article/2135623/too-little-too-late-foreign-bankers-fall-out-love-china-beijing>

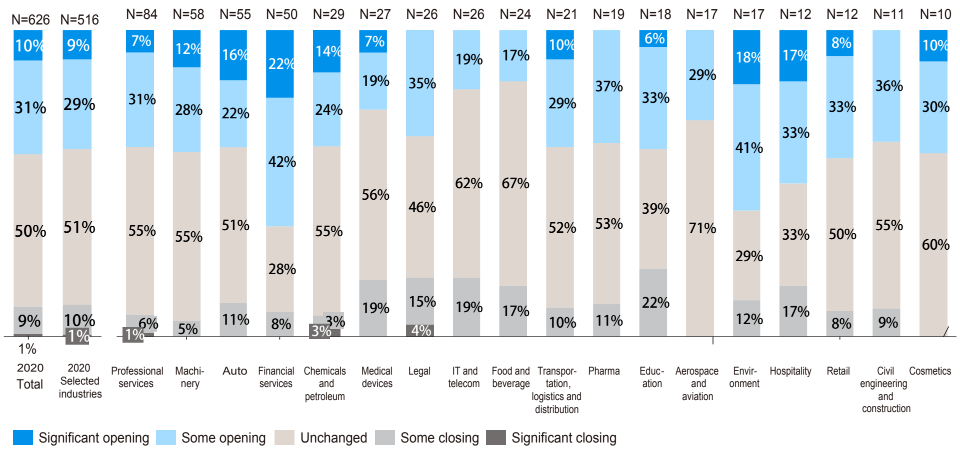
31 *Not Now, Maybe Later: Shanghai as an International Financial Centre*, European Union Chamber of Commerce in China, 13th December 2019, viewed 15th April 2020, <https://www.europeanchamber.com.cn/en/publications-archive/768/Not_Now_Maybe_Later_Shanghai_as_an_International_Financial_Centre>

32 *China Touts Foreign Access to Oil and Gas Ahead of US Trade Deal, Bloomberg*, 9th January 2020, viewed 21st April 2020, <https://www.bloomberg.com/news/articles/2020-01-09/china-touts-foreign-access-to-oil-gas-ahead-of-u-s-trade-deal>

33 Chen, Aizhu and Xu, Muyu, *China Opens Up Oil and Gas Exploration, Production for Foreign, Domestic Firms, Reuters*, 9th January 2020, viewed 11th April 2020, <https://www.reuters.com/article/us-china-oil-mining/china-opens-up-oil-and-gas-exploration-production-to-foreign-firms-idUSKBN1Z806Q>

Figure 11: Opening more pronounced in selected industries; critical sectors like aerospace and IT and telecom see little improvement

Has there been any market opening in your industry in Mainland China for foreign companies (y-o-y)?[1)]



1) Selected industries are those for which there were at least 10 responses

Another opening that delivered limited value was the removal of the requirement for domestic shipping agencies to be controlled by a Chinese majority stakeholder. While a step in the right direction, it does not present meaningful new opportunities to European shippers: the domestic shipping market is already heavily saturated and therefore of little interest. The chief market access issue for the sector is the restriction on performing international relay,[34] which can only be carried out at Chinese ports by Chinese-flagged vessels operated by wholly-owned Chinese companies. Meanwhile, Chinese shippers can perform this within the EU, as long as the vessels are meeting in a port in a different member state than where they initially picked up the cargo. This non-reciprocal access gives Chinese shippers a substantial competitive advantage.[35]

It is notable that there are areas where further opening has resulted in large investment deals. Major chemicals companies, for example, have initiated billions in investment now that they can own their operations outright,[36&37] as have automotive manufacturers eager to seize market share in China's new energy vehicle industry.[38&39] This is the sort of opening that foreign investors are looking to capitalise on.

Asked when they expect meaningful opening to occur in their respective industries, 21% of respondents say they do not expect to see it within the next decade; this pessimistic outlook is especially high for legal firms, 62% of which do not expect meaningful opening to ever take place.

34 International relay refers to the practice of two or more vessels coming from different ports meeting at another port to reconfigure containers that are then shipped to other markets. For example, one foreign-flagged vessel moving goods out of Tianjin and another shipping goods out of Shanghai cannot consolidate and reorganise their cargo in Qingdao for shipment to North America and Europe, which would allow the shipping lines to more efficiently move goods to their final destination.

35 Mitchell, Tom, *Beijing Misses Chance to Show Trump it Has Friend in Brussels, Financial Times*, 30th October 2019, viewed 21st April 2020, <https://www.ft.com/content/ae8e6f04-fa05-11e9-a354-36acbbb0d9b6>

36 *BASF Commences its Smart Verbund Project in Zhanjiang, China*, BASF, 23rd November 2019, viewed 11th April 2020, <https://www.basf.com/global/en/media/news-releases/2019/11/p-19-403.html>

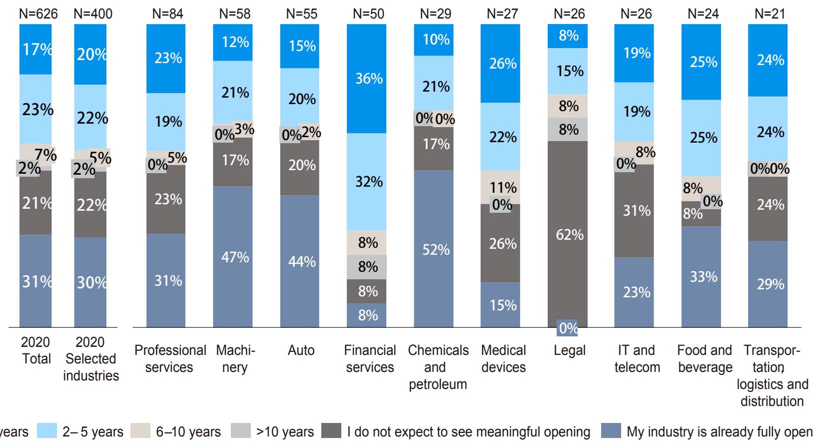
37 *ExxonMobil signs Framework Agreement for Proposed Chemical Complex in China*, ExxonMobil, 5th September 2018, viewed 11th April 2020, <https://corporate.exxonmobil.com/News/Newsroom/News-releases/2018/0905_ExxonMobil-Signs-Framework-Agreement-for-Proposed-Chemical-Complex-in-China>

38 *15 Years BMW Brilliance Automotive: BMW Group Strengthens Commitment to China*, BMW, 11th October 2018, viewed 11th April 2020, <https://www.press.bmwgroup.com/global/article/detail/T0285823EN/15-years-bmw-brilliance-automotive:-bmw-group-strengthens-commitment-to-china>

39 Isidore, Chris and Jiang, Steven, *Tesla is Going Big in China, CNN*, 10th July 2018, viewed 11th April 2020, <https://money.cnn.com/2018/07/10/news/companies/tesla-china-factory/index.html>

Figure 12: Sectors such as legal services, IT and telecom least likely to expect opening

When do you expect to see meaningful opening in your industry?

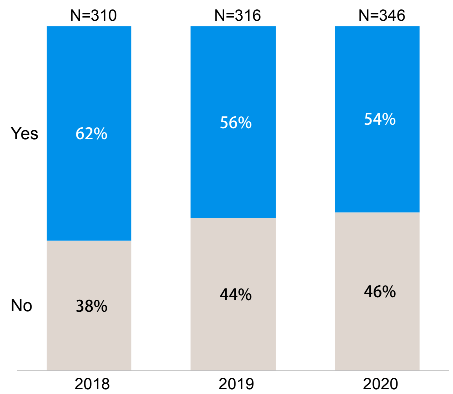


Meanwhile, there is an equal number of civil engineering and construction companies that see the industry as already being fully open as those do not expect to see meaningful opening at all. This indicates that the experience of firms within industries varies wildly, depending on which specific part of the value chain they operate in. For example, materials suppliers can thrive in the Chinese market while contractors cannot even enter the market due to restrictions.

In addition to the opening up of its markets, China must also make sure that equal treatment is afforded to local and foreign firms, and that overall access and treatment is reciprocal to that enjoyed by Chinese firms that have invested in Europe.

Figure 13: More than half of members believe Chinese companies receive better market access in Europe than vice-versa

Do you feel that Chinese companies in your sector enjoy better market access in Europe than European companies enjoy in China?[1)]



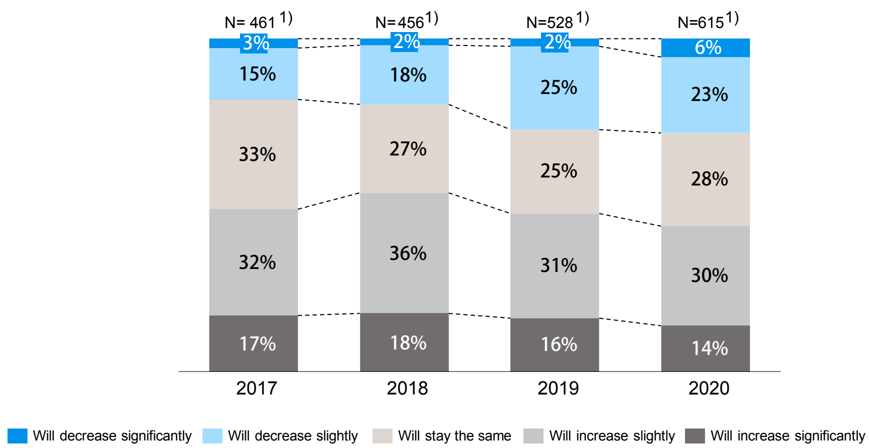
1) Excludes answer "Do not know"

1.6 Regulatory reform brings more quality, less equality

Respondents have noted some marginal improvements in the regulatory environment, which is welcome progress: business became more difficult over the past year for 49% of members, a four percentage point decrease from 2019. However, the reform agenda must continue at a faster pace if it is to keep up with the demands of the times: over the next five years, 44% of respondents expect to see an increase in regulatory obstacles, while only 29% foresee a decrease.

Figure 14: Near majority expect more burdensome regulation

How do you expect the number of regulatory obstacles facing your company in Mainland China to change over the next five years? 1)



1) *Excludes answer "Do not know"*

Significantly, regulations are often implemented in an unfair manner, with 40% of respondents reporting that they receive unfavourable treatment compared to domestic firms and 29% foreseeing no level playing field in the next decade. This unfair treatment is compounded by the discretionary enforcement of rules and regulations, which 27% of respondents see as a top-three regulatory challenge for doing business in China. When asked to explain these discrepancies, most members stated that rules are too ambiguous, and that interpretation varies among different authorities.

Figure 15: Unequal treatment decreasing, but still high

How does your company perceive foreign-invested companies' treatment by the Chinese Government in your industry compared to that of domestic Chinese companies?

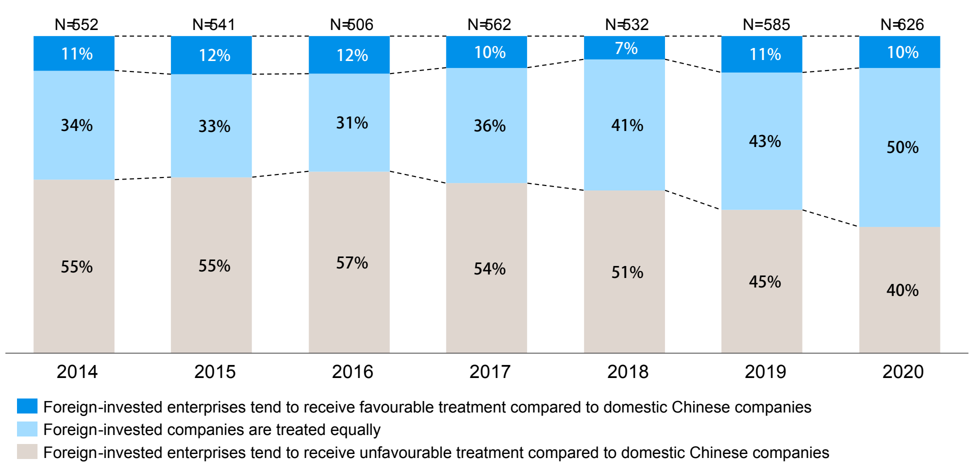


Figure 16: Three out of 10 members don't expect a level playing field

When do you expect to see a level playing field through national treatment for foreign enterprises in your industry?

N=626

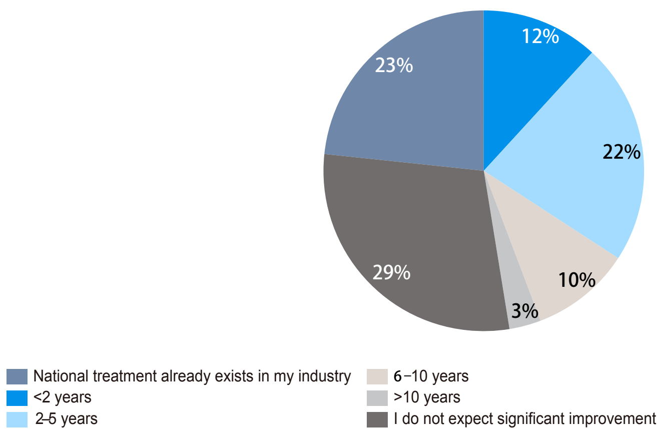


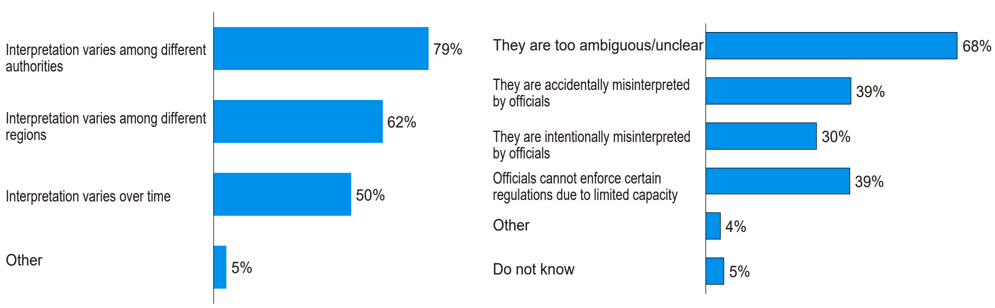
Figure 17: Unequal treatment driven by variety of factors, none of which are acceptable

Which of the following best describes the discretionary enforcement of rules and regulations your company has experienced?1)

N=173

For what reasons does your company think that rules and regulations are enforced in a discretionary way?1)

N=173



1) Asked only when "Which are the top three most significant regulatory obstacles for your company when doing business in Mainland China?"' included "Discretionary enforcement of rules and regulations"; multiple answers possible, percentage calculated by the total number of respondents

Some companies are confused by overlapping legislation in their sectors. One example on the horizon is that food labelling regulations currently covered by the National Health Commission may come into conflict with new draft measures from the State Administration for Market Regulation. During a consultation on the draft SAMR measures, the European Chamber recommended that the upcoming regulations align with those from the NHC, otherwise companies are likely to find themselves trapped between two sets of rules.[40]

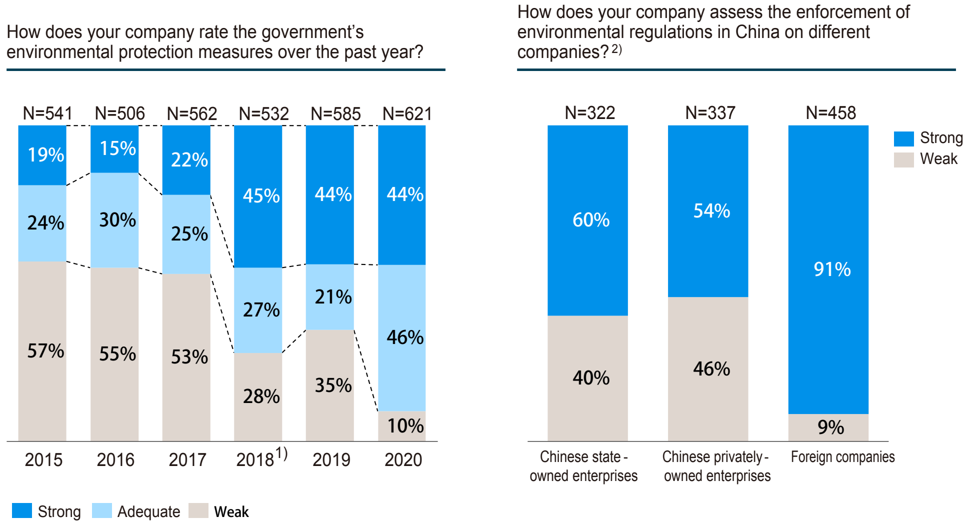
Respondents hold a very favourable opinion towards the environmental protection measures implemented by the Chinese Government in the last year, with 90% considering these measures strong or adequate, a recognition of the strides made in enforcement in recent years.[41]

40 *Comments to SAMR on Administrative Measures on Food Labelling (Draft for Comments),* European Union Chamber of Commerce in China, 20th December 2019, viewed 21st April 2020, <https://www.europeanchamber.com.cn/en/lobby-actions/3811/Comments_to_SAMR_on_Administrative_Measures_on_Food_Labelling_Draft_for_Comments_#>

41 Fuller, Gary, *Pollutionwatch: China Shows How Political Will Can Take On Air Pollution, The Guardian*, 14th March 2019, viewed 21st April 2020, <https://www.theguardian.com/environment/2019/mar/14/pollutionwatch-china-shows-how-political-will-can-take-on-air-pollution>

Yet respondents signal a discrepancy in enforcement on different types of companies, with 91% assessing enforcement of environmental laws on foreign companies as strong, compared to 60% for Chinese SOEs and 54% for Chinese privately-owned enterprises (POEs). Manufacturers also often face one-size-fits-all shutdown approaches in winter, as authorities do not recognise the different levels of maturity of operational practices, meaning that compliant companies often suffer from unreasonable enforcement.[42]

Figure 18: Environmental protection is improving, but applied unequally



1) Answers "Weak" and "Poor" added for 2018; 2) Excludes answer "Do not know"

1.7 Better interaction with business shows potential for reform cooperation

Challenges aside, the Chinese Government has certainly made notable progress in making the business environment more accessible. For the fourth straight year, an increased percentage of respondents feel more welcome than when they first entered the Chinese market. The most cited reasons were improved communication with the government and greater market access.

42 Yang, Ge, *Winter Smog Fight Should Ditch 'Single Knife Cut' Approach, Caixin*, 14th September 2018, viewed 21st April 2020, <https://www.caixinglobal.com/2018-09-14/winter-smog-fight-should-ditch-single-knife-cut-approach-101326260.html>

Figure 19: Members feel more welcome than in previous years

As a foreign investor in China, do you feel:

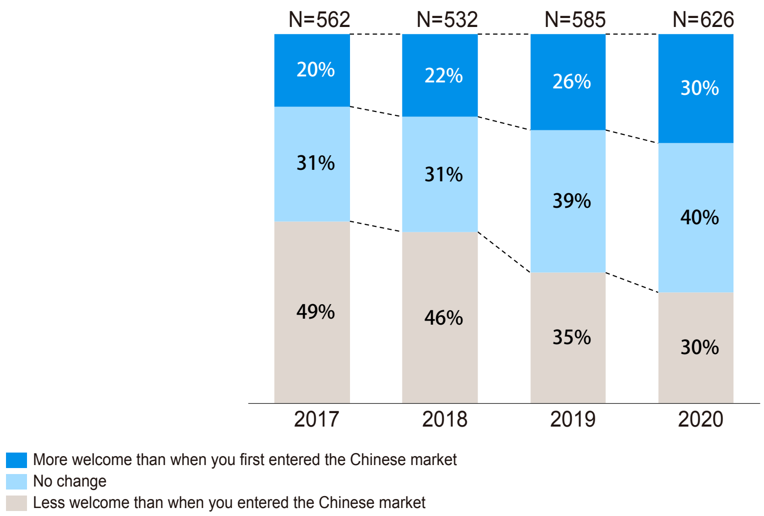
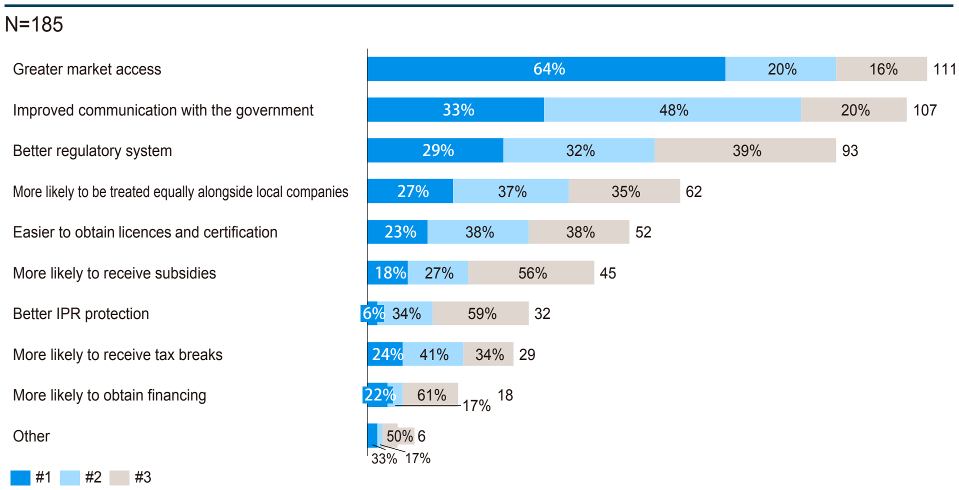


Figure 20: Better government communication and market access drive positive sentiment

What are the most significant reasons that you feel more welcome?[1) 2)]



1) Asked only when the answer to "As a foreign investor in China, do you feel:" was "More welcome than when first entered China"; 2) Multiple answers possible, percentage divided by number of respondents

Government communication has endured, even as the COVID-19 outbreak was at its peak in March 2020. Several high-profile meetings were held between the European Chamber and Vice Minister Wang Shouwen of the Ministry of Commerce in March that allowed for very frank and direct communication on key issues.[43] All of the European Chamber's

43 *European Chamber's Conference Call with Vice Minister of Commerce Wang Shouwen Joined by Multiple Departments on COVID-19 Impacts to FIEs*, European Union Chamber of Commerce in China, 13th March 2020, viewed 21st April 2020, <https://www.europeanchamber.com.cn/en/lobby-actions/3949>

seven chapters have enjoyed access during the outbreak to local leaders, who have been forthcoming with key information during a variety of different meetings.

Such opportunities are meaningful to European companies that are eager to develop clarity on policy. Furthermore, these meetings have already produced some tangible results. The MOFCOM created a new communication mechanism with the European Chamber to more quickly and directly raise concerns and give recommendations. This has resulted in several victories for European business, in both horizontal issues like gaining clarification on the new procedures for foreign businesspeople to return to China and in industry specific ones, like a grace period for companies to come into compliance with tighter standards in the automotive industry in the wake of the pandemic.

The Chinese Government has proved that it is capable of quickly delivering results. In financial services, for example, the China Securities Regulatory Commission announced in April 2020 that the limits for foreign ownership in securities and fund management firms would be removed immediately.[44] As Chinese media recognised when reporting this example, “the accelerated pace of China's opening-up could help boost confidence for global companies, many of which have been hit hard by the coronavirus pandemic and are grappling to mitigate its economic fallout”.[45] Similar reforms across other industry sectors would provide reassurance to those European companies reeling in the aftermath of COVID-19.

A viable opportunity for doing so would be for China to deepen and expand its market access offer in the ongoing negotiations for the EU-China Comprehensive Agreement on Investment (CAI).[46] While the goal of concluding negotiations by the end of 2020 may no longer be feasible because of COVID-19, the business community nonetheless expects serious progress and a timeline that is realistic, but not so far on the horizon as to be irrelevant.

When asked about their expectations of the CAI, respondents prioritise the removal of direct and indirect market access barriers and implementing a level playing field with China’s SOEs. Respondents argue that introducing measures that would allow them to increase market share would be the most tangible metric for measuring this progress.

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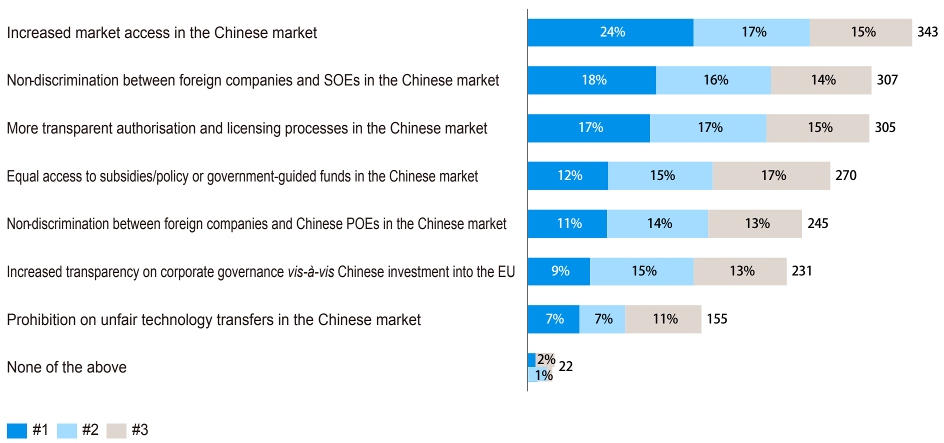
Figure 21: European companies prioritise market access and SOE competition under CAI

Please rank your top three priorities for outcomes of the Comprehensive Agreement on Investment (CAI).[1)]

N=626



1) Percentage divided by number of respondents

44 He, Xiyue, Sang Tong and Zhou Erjie, *China Lifts Foreign Ownership Limits on Securities, Fund Management Firms, Xinhua*, 1st April 2020, viewed 11th April 2020, <http://www.xinhuanet.com/english/2020-04/01/c_138938273.htm>

45 Ibid.

46 *EU-China Comprehensive Agreement on Investment*, European Commission, 14th February 2020, viewed 21st April 2020, <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2115>

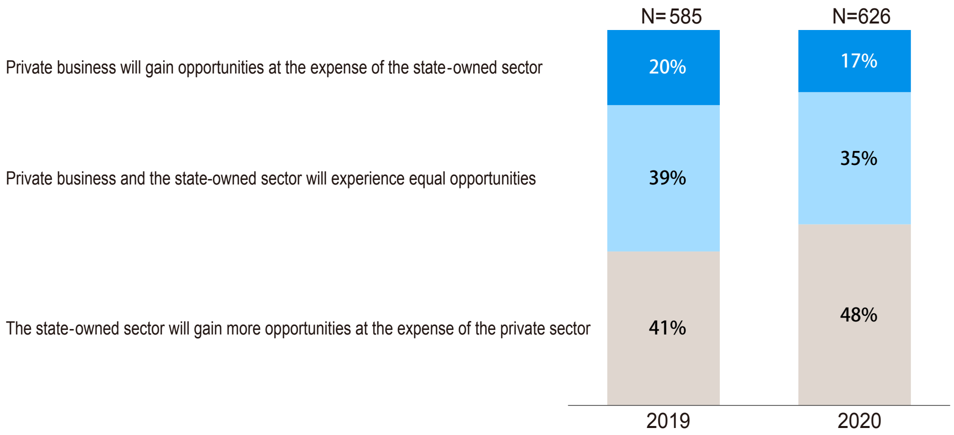
1.8 'One Economy, Two Systems'

Instead of broad and sweeping reforms across China's entire market, European companies have so far seen the emergence of a 'one economy, two systems' model. On one side is a range of industries that have been opened up to foreign investors and an increasingly sound regulatory regime, albeit one that has developed slower than many would like. On the other side, key industries remain open only to China's state-owned national champions at worst, or heavily distorted by state-owned players that control the majority of the market at best.[47]

European companies exposed to China's SOEs have little good news to report. Just under half of respondents believe that the state-owned sector will gain opportunities over the next year at the expense of the private sector, up seven percentage points since 2019, while those expecting the private sector and state sector to experience equal opportunities slipped from 39% to 35%. Significantly, this does not reflect the many European companies that may otherwise be interested in entering the China market, but which are completely unable to do so in the sectors cordoned off for SOEs.

Figure 22: Despite reform rhetoric, SOEs are "stronger, better, bigger"

What best describes your outlook on the relationship between private business and the state-owned sector in China over the next two years?

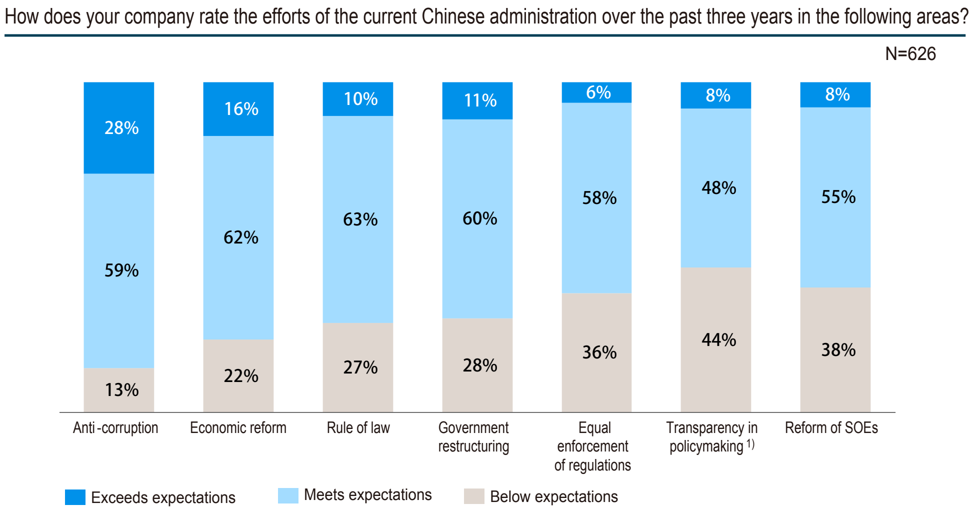


This finding highlights an unfortunate and enduring trend in China's SOE reform, best summed up by the mantra "stronger, better, bigger."[48] Responses reflected this, with 38% rating government SOE reform efforts over the last three years as below their expectations. Although this poor rating has decreased 10 percentage points since 2017, it is still the area found to be below expectations by more respondents than any other, except for government transparency.

47 *State-Owned Enterprise Policy Reform*, Asia Society Policy Institute, Winter 2020, viewed 21st April 2020, <https://chinadashboard.asiasociety.org/winter-2020/page/state-owned-enterprise>

48 Yeung, Karen, *China Will Make State Economy 'Stronger, Better And Bigger', Top Trade Negotiator Liu He says, SCMP*, 22nd November 2019, viewed 27th April 2020, <https://www.scmp.com/economy/china-economy/article/3038993/china-wont-give-its-state-led-economic-model-top-trade>

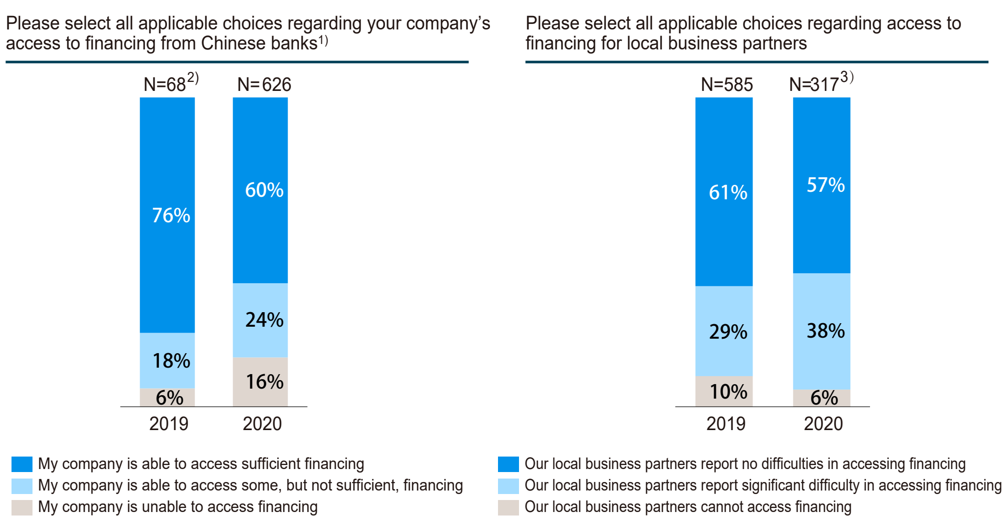
Figure 23: SOE reform fails to rise to the occasion yet again



1) New option added in 2020

While the 'one economy, two systems' model is most significant for companies eager to do business in areas reserved for China's SOEs, the impact of the state-owned sector is felt across the entire market. This is perhaps most clear in the steady sucking up of financing by SOEs—which has been well documented in the last half decade—as capital flows to the least productive fields.[49] Only 60% of respondents report that they have sufficient access to financing from Chinese banks, down 16 percentage points from 2019, while 16% are unable to access any in the first place. The impact of this financing drought in the private sector is perceived by members to be more severe for Chinese POEs, with 44% of respondents reporting that their local partners have insufficient or no financing.

Figure 24: 40% of European companies cannot access enough financing, if any



1) Multiple answers possible; percentage divided by number of respondents;

2) In 2019, this question is asked only when the answer to "What is your main source of financing in China?" is "Bank loans";

3) Answers exclude "Not applicable"

49 Mitchell, Tom and Liu, Xinning, *China's Private Sector Struggles for Funding as Growth Slows, Financial Times*, 21st January 2020, viewed 21st April 2020, <https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65>

1.9 Financing shortages felt more acutely with COVID-19

Being able to access sufficient financing will be crucial for many European companies fighting to survive the COVID-19 crisis. The March 2020 German Chamber survey on the COVID-19 outbreak recognised financial support, in the form of rent reduction, wage compensation and bank loans, as the area in which government support measures are most needed.[50] Addressing this will necessitate a re-examination of the factors that push Chinese banks to direct so much financing to SOEs.

China's SOEs have absorbed the bulk of financing for several years, as the de facto guarantees they enjoy make them irresistible to China's mostly state-led banks that are eager to benefit from protected returns. A significant 40% of European companies cannot access either enough or any financing from Chinese banks. Fortunately, European and other international banks are usually able to fill this gap. However, although international banks' Chinese subsidiaries and branches are well capitalised and have sufficient liquidity to increase financial support to their clients, they remain constrained in their capacity to do so due to various Chinese banking regulations.

In recent years, China's regulators have published a series of policies and measures to advance healthy and stable development of the Chinese financial system. These rules are welcomed, as they enhance supervision and improve fair competition among banks in a more disciplined market environment. However, these rules are usually linked to the business and/or capital size, as well as to banks' deposit volumes in China. Unlike most of their Chinese counterparts, European banks in China cannot rely on an extensive branch network to collect retail and corporate deposits, so their onshore business and capital size are still quite small. Such structural constraints will be difficult to overcome in the short term and are, unfortunately, limiting the capability of the European banks to provide support to their clients when it is most needed.

Furthermore, these regulatory issues have been magnified by the COVID-19 outbreak and ongoing economic downturn. To meet the resulting needs of their clients, Chinese banks have already granted 70% more loans in March 2020 than they did in March 2019. In parallel, European banks have taken various measures to quickly extend credit to clients that might require urgent assistance but, given the uncertainty of the environment, it is expected that both Chinese and international clients might require their further support.

To overcome these regulatory hurdles, the European Chamber has recently proposed to the China Banking and Insurance Regulatory Commission a few targeted amendments to regulations that would take into consideration the strength of European banks operating in China and their specific business models, as well as the complementarities of their products and services with their Chinese counterparts. Quite a few of these proposals correspond to similar amendments European regulators have granted to Chinese banks operating in Europe. If these proposals from the European Chamber are implemented, they will enable European banks to better support their clients in China and to contribute significantly more to the rebound of the Chinese economy.

Local business partners similarly struggle to access sufficient financing from Chinese banks.[51] These firms, mostly SMEs, are now being hit especially hard by the COVID-19 outbreak. While support measures were quickly brought about in reaction to the subsequent downturn, the core issue driving insufficient financing remains the dominance of implicitly guaranteed SOEs.[52]

Financing issues are further aggravated when SOEs do not make payments in a timely manner. Only 75% of the arrears owed to private companies by government departments and SOEs were cleared in 2019,[53] leaving several hundred billion more Chinese yuan to be paid. Although the Chinese Government has recently put more pressure on SOEs to pay their debts, the persistence of this problem indicates a sort of 'hidden subsidy', disadvantaging the private economy that has not been compensated for its work.[54] As COVID-19 continues to put huge financial pressures on private companies, further delays to payments could prove deadly.

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50 *COVID-19's Future Impact on Foreign Companies in China: German Businesses on Track to Recovery – Demand now Major Concern*, German Chamber of Commerce in China, 2nd April 2020, viewed 11th April 2020, <https://china.ahk.de/news/news-details/covid-19s-future-impact-on-foreign-companies-in-china-german-businesses-on-track-to-recovery-demand-now-major-concern>

51 Mitchell, Tom and Liu, Xinning, *China's Private Sector Struggles for Funding as Growth Slows, Financial Times*, 21st January 2020, viewed 21st April 2020, <https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65>

52 Maiello, Michael, *China's Economic Response to COVID-19 Has Helped, For Now, Chicago Booth Review*, 7th April 2020, viewed 21st April 2020, <https://review.chicagobooth.edu/economics/2020/article/china-s-economic-response-covid-19-has-helped-now>

53 *Li Keqiang Presided Over the Convening of the Executive Meeting of the State Council to Further do a Good Job of Clearing the Government and State-owned Enterprises 'Arrears of Private Enterprises' SMEs, etc*, State Council, 8th January 2020, viewed 15th January 2020, <http://www.gov.cn/premier/2020-01/08/content_5467600.htm>

54 Lelyveld, Michael, *China Cracks Down on Debts to Workers and Private Firms, Radio Free Asia*, 27th January 2020, viewed 15th April 2020, <https://www.rfa.org/english/commentaries/energy_watch/china-cracks-down-on-debts-01272020120303.html>

SOE resilience increases at expense of private sector

The COVID-19 outbreak and subsequent economic downturn demand significant reform to China's economic structure. The knee-jerk reaction of the government will likely be to lean even more on SOEs. At first glance, the state-owned sector may seem to be the more resilient side of the economy due to, for example, the extensive state support it receives and its ability to make non-market-orientated decisions in areas like employment and the production of strategic goods.

But despite the dominance of SOEs, China's vibrant, yet constrained, private sector remains the chief driver of growth, employment, capital development and innovation.[55] China's leaders have recognised its value in previous times of crisis, and provided the private sector with the necessary space and resources to grow. Doing so paid off in the late 1970s, when China began its opening-up and reform period; in the early 1990s, when Deng Xiaoping made his Southern Tour to visit the special economic zones he set up the decade prior; and in the late 1990s, when Jiang Zemin and Zhu Rongji answered the Asian Financial Crisis with SOE reform and China's accession to the WTO.

1.10 Don't waste this crisis

The aftermath of this year's crisis could prove similarly beneficial to the business environment if China's leadership repeats its recipe for success and lays the foundation for a post-COVID-19 recovery that exceeds the rest of the world's expectations. However, 2020 could also become a different kind of marker if the 'one economy, two systems' model is reinforced, which would only further diminish business confidence within the foreign business community.

As companies around the world suffer from the long-lasting consequences of a global pandemic, the Chinese Government now has an opportunity to show its strength and leadership by following in the footsteps of the country's great reformers of the last forty years, and to take full advantage of this crisis by further liberalising the market.

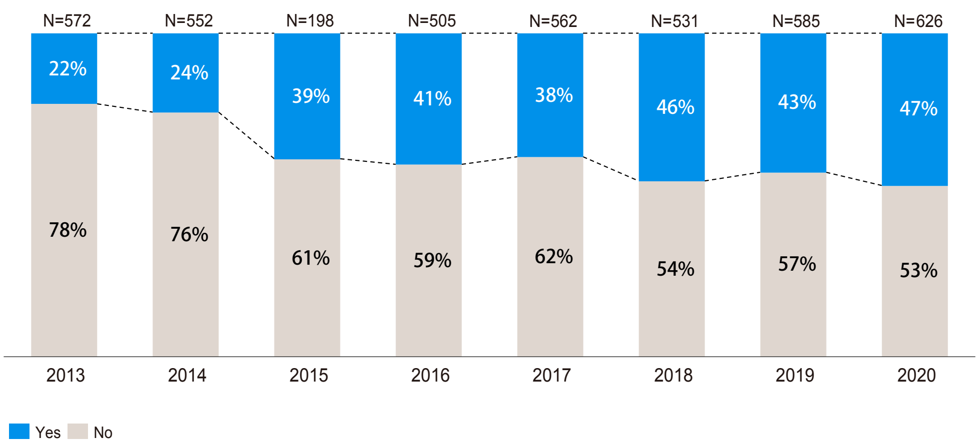
55 *China's Private Sector is Pivotal to its Economy, Financial Times*, 2nd December 2019, viewed 21st April 2020, <https://www.ft.com/content/438ff8da-12a1-11ea-a7e6-62bf4f9e548a>

2 HUMAN RESOURCES

The COVID-19 outbreak will have a pronounced impact on the labour market and employment, and is likely to invert some of the more common human resources (HR) challenges faced by European companies in China. As economic pressure swells, European companies are eager to find cost-saving strategies. In February, 47% of members were already planning to cut costs in China in the coming year, compared to 43% in 2019. The low revenues now expected in the first quarter (Q1) of 2020 as a consequence of the virus will most likely result in many more members employing similar strategies.

Figure 25: Even before COVID-19, an all-time high number of members planned to cut costs

Does your company plan on cutting costs in China in 2020?



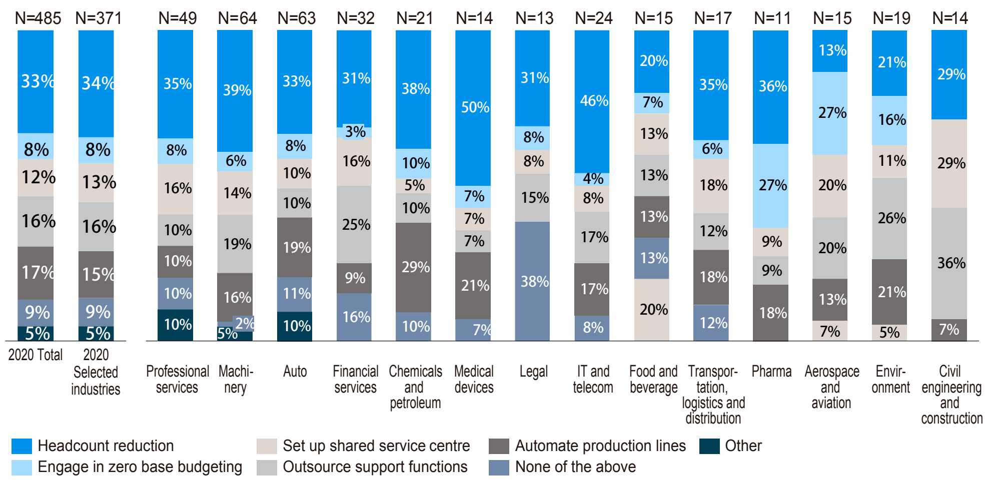
A share of the economic headwinds will likely be passed on to employees, as high labour costs and HR challenges have snowballed in recent years. For those members already planning to cut costs in 2020, the most popular strategy (33%) is through headcount reduction. Reinforcing this trend, according to the COVID-19 survey conducted by the Austrian Chamber, 27.5% of respondents plan to reduce their workforce,[56] while 21% of French Chamber members surveyed in March have already done so.[57]

56 *Effects of COVID-19 on Austrian Companies in China*, Advantage Austria, 2nd April 2020, viewed 11th April 2020, <https://www.advantageaustria.org/cn/oesterreich-in-china/news/local/Covid_Survey_2020.en.html>

57 *COVID-19: Impact for French Companies in China 1 Month After*, CCI FRANCE CHINE, March 2020, viewed 15th April 2020, document not published.

Figure 26: Members plan to cut costs with headcount reduction, particularly within the medical devices and IT/telecom sectors

Will the reduction of costs be achieved by any of the following?[1) 2)]

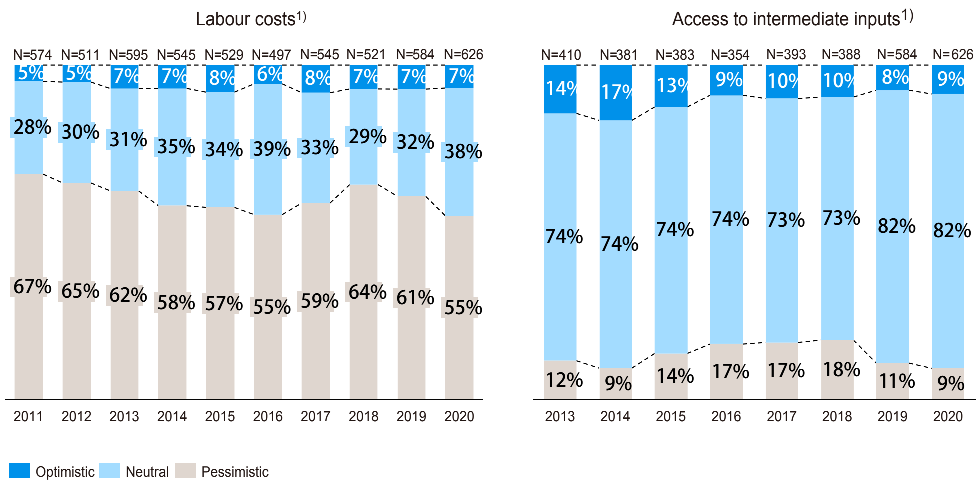


1) Industries selected are those for which there were at least 10 responses; 2) Asked only when answer to "Does your company plan on cutting costs in China in 2020?" was "Yes"

Even before feeling the full impact of the virus, rising labour costs were mentioned as a challenge by more than half of Chamber members. Although pessimism about the outlook of labour costs dropped slightly between 2019 and 2020, from 61% to 55%, the outlook will likely become more negative in light of the COVID-19-induced slowdown.

Figure 27: More than half of members are pessimistic about labour costs

How would you describe the business outlook for your sector in China over the next two years?

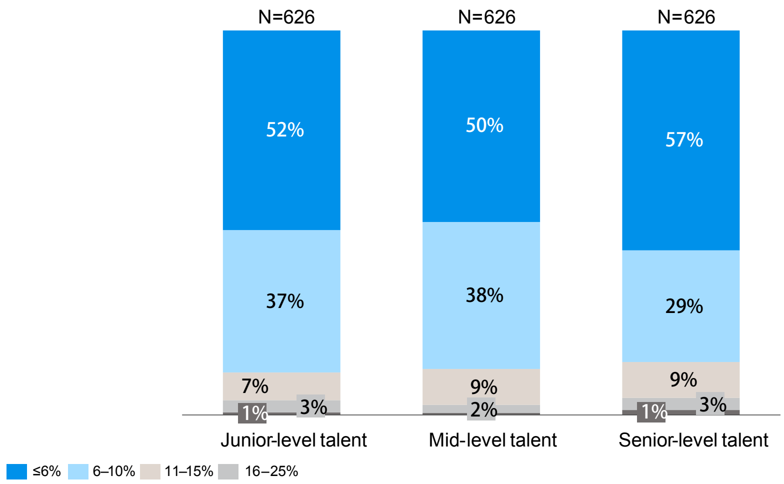


1) Excludes answer "Not applicable"

Correspondingly, the costs of wages and salaries have increased for nearly all respondents, with roughly a third indicating increases of between 6% to 10%, and around a tenth of respondents reporting even higher rates.

Figure 28: Salaries have risen for all talent categories

By how much did your company's wages and salaries increase in 2019 (not including taxes and social security contributions)?



When the BCS was conducted, prospects for talent attraction and retention were reported to have improved slightly since 2019. The ratio of Chamber members facing challenges in attracting and retaining the right talent decreased by six percentage points and 10 percentage points respectively.

Figure 29: Attracting the right talent has become a bit easier, but remains difficult

Is your company currently facing any challenges in attracting the right talent in China?

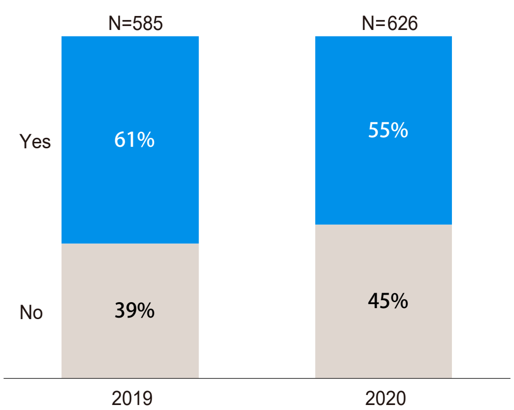
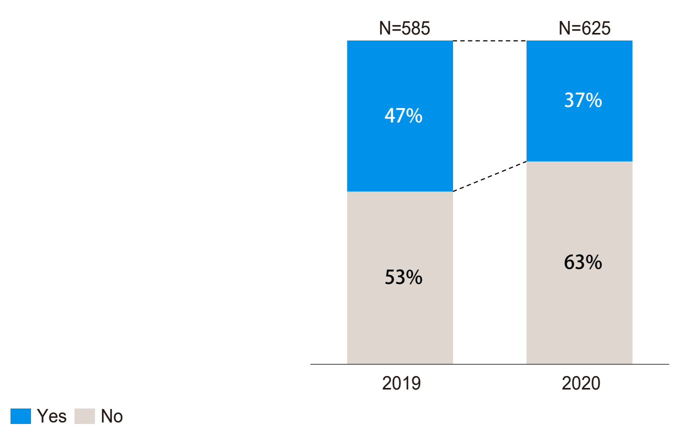


Figure 30: Easier to retain talent than to attract it

Is your company currently facing any challenges in retaining the right talent in China?

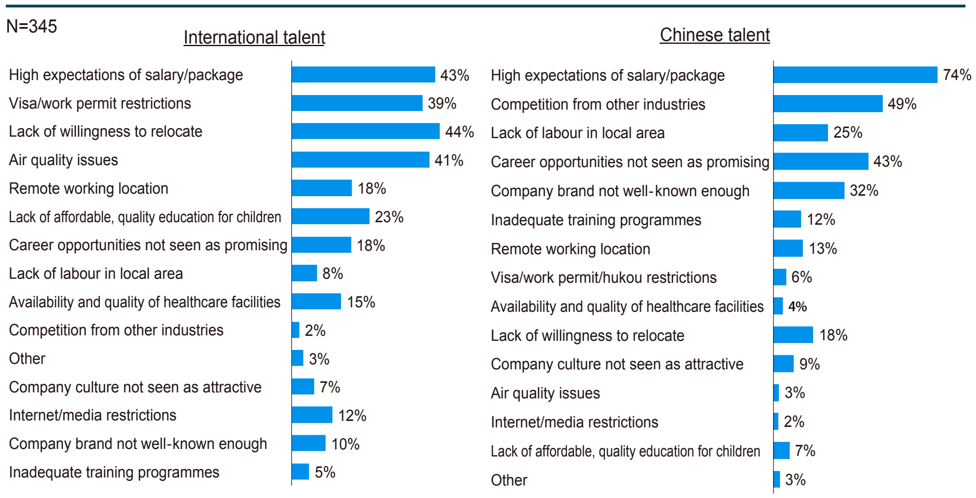


However, the economic downturn is likely to aggravate these challenges, as talent retention will shift from an issue of preventing staff from leaving to one of trying to maintain optimal staffing levels while enacting necessary cost-cutting measures.

The issue of cost proved a key factor even before the outbreak. For both talent attraction and retention of international and Chinese staff, high expectations of salary/package is the top challenge.

Figure 31: High salary expectations the biggest challenge to attracting and retaining staff

Please list the top three challenges in attracting the right talent in China[1)]



1) Asked only if answer to "Is your company currently facing any challenges in attracting the right talent in China?" was "Yes"

1) Asked only if answer to "Is your company currently facing any challenges in retaining the right talent in China?" was "Yes"

Companies already struggling with the cost of talent will be in even more trouble due to the potentially long-lasting effects of COVID-19. As countries around the world experience their own lockdowns, travel restrictions and visitor bans, the outlook for talent is bleak. According to the European and German chambers' February COVID-19 survey, 46% of respondents faced staff shortages. This issue is disproportionate for enterprises engaged in manufacturing; it affects 46% and 72% of automotive and machinery enterprises, respectively, compared to only 17% of the business services sector. A second survey conducted by the German Chamber indicated that, by the end of March, only 69% of respondents had seen their staffing rate return to normal.

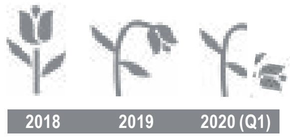
Another significant HR-related finding from the BCS concerns the heavy restrictions placed on the internet in China. The COVID-19 outbreak necessitated that many employees work remotely from home. Tight internet restrictions have prevented workers from accessing official virtual private networks (VPNs) that they would have in their offices, and created significant lag on normally accessible platforms.

In the BCS 2020, 80% of respondents report internet instability, slowness or access restrictions as having an impact on company operations, and nearly half report that it has a negative economic impact. While internet use is a perennial issue in China, the potential for further future business disruptions that will result in large sections of the workforce having to work remotely demands a reconsideration of how mechanisms used to restrict access are applied.

BUSINESS CONFIDENCE SURVEY 2020 FINDINGS

SOFT DOWNTURN ALREADY IN PLACE PRIOR TO COVID-19

Only **50%** saw any year-on-year revenue growth, the lowest level seen since 2010



For **40%** of respondents, the Chinese economic slowdown is one of the top obstacles to future business

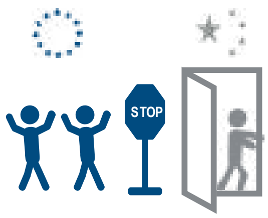
Only **46%** of SMEs reported a revenue increase in 2019

49% of members report business became more difficult in past year

47% planned to cut costs this year

FOREIGN BUSINESSES SEE MARGINAL IMPROVEMENTS IN CHINA

41% of respondents saw market opening in 2019



30% feel more welcome than when they first entered the market (+4% y-o-y)

Firms feel more welcome thanks to:

- Greater market access and improved communication

11% planning to shift investments to other markets (-4% y-o-y)

BOLD REGULATORY REFORM IS NEEDED, ESPECIALLY WITH COVID-19

37% of respondents say regulations curbed their net profit margin

44% believe regulatory obstacles will worsen over next five years

30% feel less welcome than when they first entered the market (-5% y-o-y) because of:

- regulatory burdens
- market access barriers
- unequal treatment

Increased market access is top priority for CAI

UNEQUAL TREATMENT PREVAILS EVEN AS ECONOMIC POWERHOUSE CHINA ENTERS FIFTH DECADE OF OPENING UP

40% find that European investors in China face unequal treatment

29% do not expect to see a level playing field

91% see strong enforcement of environmental laws on foreign companies, compared to…

60% for Chinese SOEs and

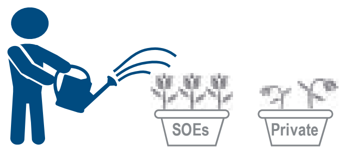
54% for Chinese POEs

SOE-LOVING LEADERSHIP LIKELY TO LEAN EVEN MORE ON STATE-OWNED COMPANIES IN COVID-19 AFTERMATH

Top three areas where SOEs hold the advantage over private firms

- Market access
- Communication with the government
- Public procurement

44% of respondents believe that their local POE partners have insufficient or no financing, largely as SOEs soak up local financing



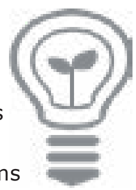
48% of respondents believe SOEs will gain at expense of POEs

38% of respondents rate SOE reform as below their expectations

R&D AND INNOVATION ENVIRONMENT CONTINUES TO IMPROVE

40% of respondents see China's R&D and innovation environment as more favourable than the worldwide average (+2% y-o-y)

69% of the respondents think Chinese firms are equally or more innovative than European firms



16% of members feel compelled to transfer technology

26% are unwilling to bring their latest technology to China, mostly due to risk of IP infringement

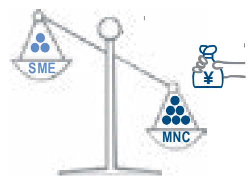
40% rate the enforcement of IPR laws positively

SMES ARE IN FOR A BUMPY RIDE

87% of SMEs state that market access restrictions have impacted potential revenue

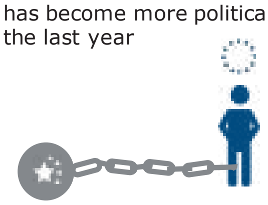
Market access barriers and lack of financing choices limit European SME growth in China

Only **36%** of SMEs benefitted from subsidies last year, compared with **71%** of MNCs



EUROPEAN COMPANIES IN CHINA INCREASINGLY UNDER POLITICAL PRESSURE

43% believe that business in China has become more political in the last year

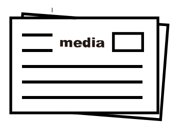


Pressure most likely to come from the Chinese Government

47%

and Chinese media

44%



Nearly **25%** report pressure from the Chinese Government to join certain events or review internal policies to align with China's political agenda

HR DEPARTMENTS LIKELY TO SEE CHALLENGES RAPIDLY DEVELOP AFTER COVID-19

48% cite internet restrictions as having negative economic impact on their company, doubly an issue with many working at home away from official VPNs

For both talent attraction and retention, high expectations of salary/package are the top challenge, though COVID-19 likely to remove retention issues

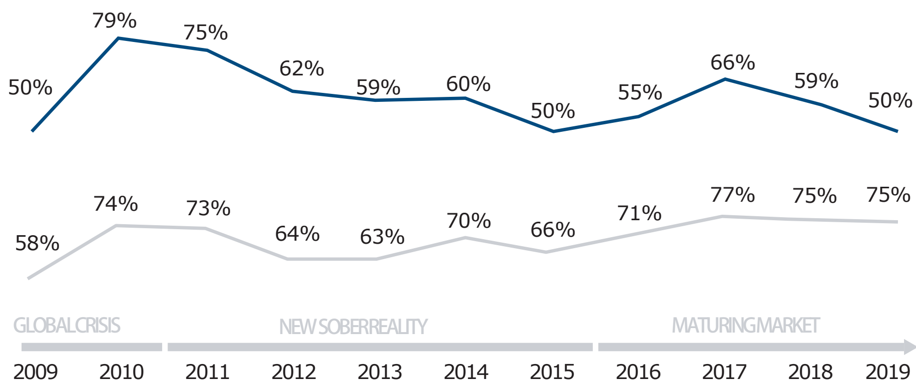
BUSINESS CONFIDENCE SURVEY 2020 FINDINGS

FINANCIAL PERFORMANCE

(Financial year)

Increased revenues

Profitable companies

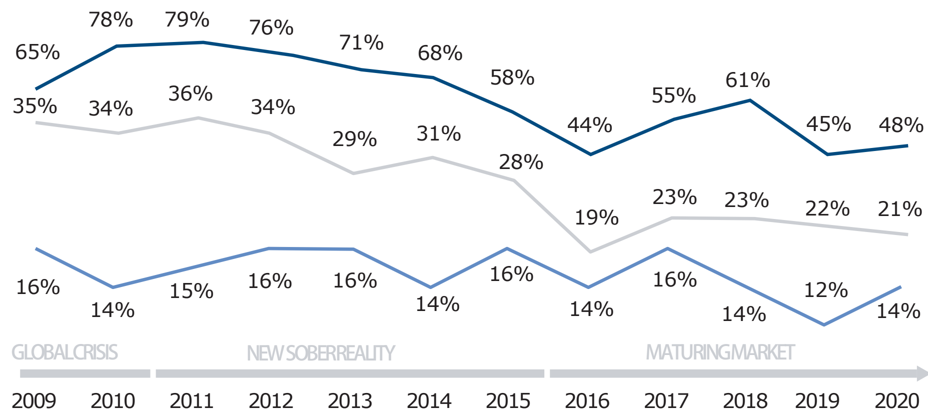


OPTIMISM

Optimistic about growth

Optimistic about profitability

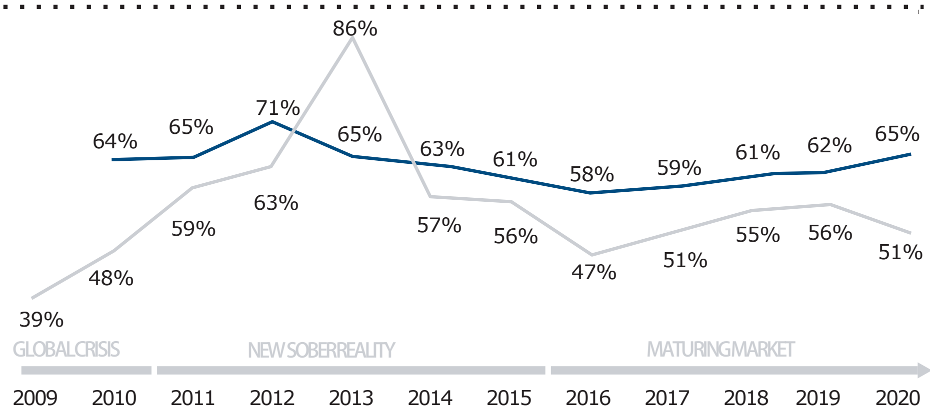
Optimistic about competitive pressure



IN CHINA TO STAY

Rank China among the top three destinations for new investments

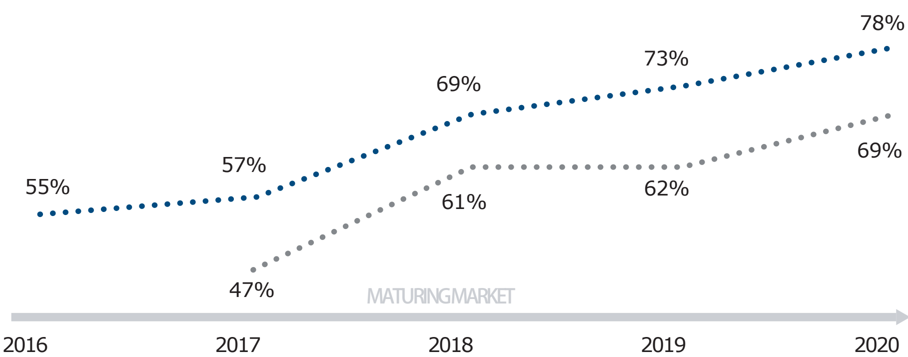
Consider expanding their China operations



R&D IN CHINA

Consider China R&D environment equally or more favourable than worldwide average

Consider Chinese firms equally or more innovative than European firms



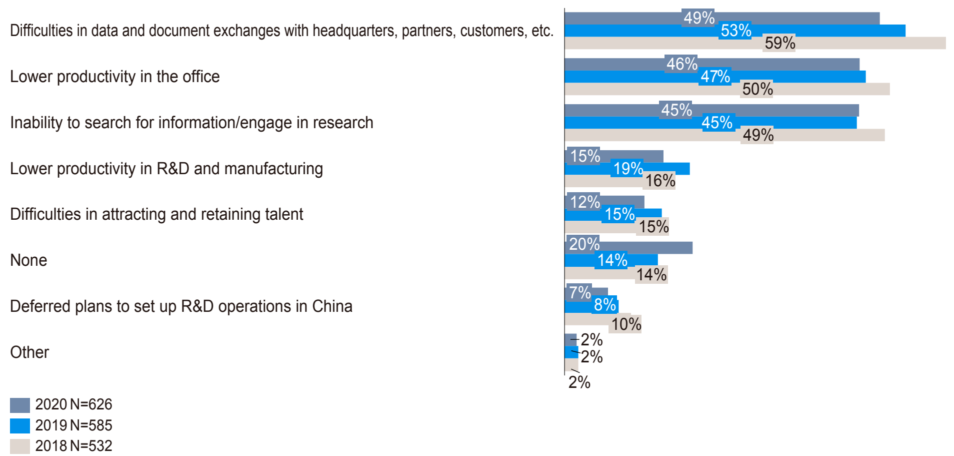
TOP-RATED REGULATORY OBSTACLES

The reform process has stalled and regulatory obstacles persist

	#1	#2	#3
2020	Ambiguous rules and regulations	Unpredictable legislative environment	Discretionary law enforcement
2019	Ambiguous rules and regulations	Unpredictable legislative environment	Administrative issues
2018	Ambiguous rules and regulations	Administrative issues	Discretionary law enforcement
2017	Ambiguous rules and regulations	Administrative issues	Unpredictable legislative environment
2016	Unpredictable legislative environment	Administrative issues	Discretionary law enforcement
2015	Unpredictable legislative environment	Administrative issues	Discretionary law enforcement
2014	Unpredictable legislative environment	Discretionary law enforcement	Administrative issues

Figure 32: Internet issues impact company operations

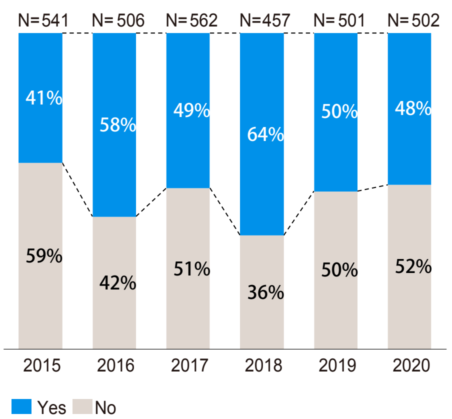
What is the impact on your company due to internet instability, slowness or access restrictions in China?[1)]



1) Multiple answers possible; percentage divided by number of respondents

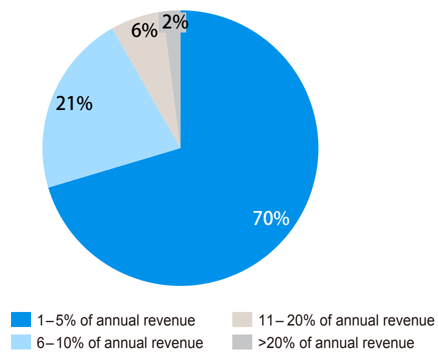
Figure 33: Internet restrictions carry a hefty price tag

Do internet restrictions have a negative economic impact on your company?[1)2)]



Please estimate the cost of internet restrictions on your company [3)]

N=243



1) *Asked only if answer to "What is the impact of Internet instability, slowness and/or access restrictions on your company in China?" was not "None of the above";*

2) *In 2017, the question was "Has the continued strengthening of measures to tighten Internet control and access restrictions in China been having an even bigger negative impact on your company?"*

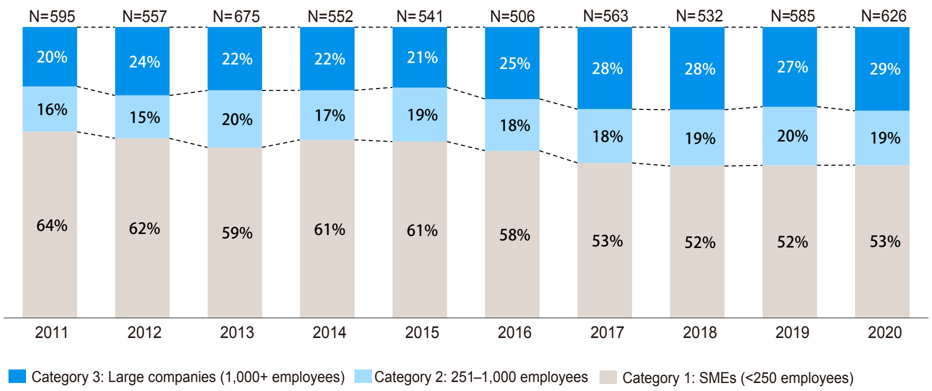
3) *Asked only if answer to "Do internet restrictions have a negative economic impact on your company?" was "Yes"*

3 SMEs

European SMEs play a key role in the Chinese economy as contributors to GDP, creators of employment and innovators.[58] They also constitute a large share of the European business community in China. More than half of the respondents to the BCS 2020 are companies with less than 250 employees.

Figure 34: More than half of respondents are SMEs

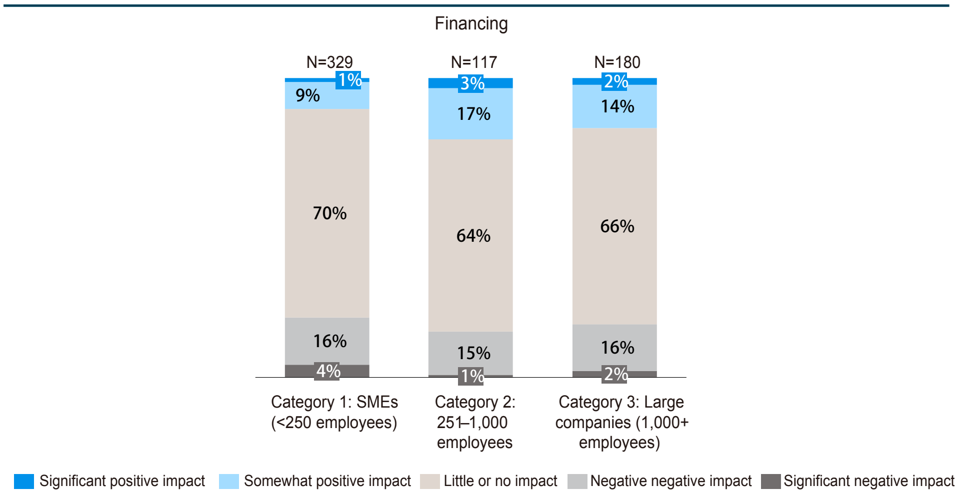
How many employees does your company have in Mainland China?



Market access restrictions and a lack of financing opportunities have been identified by SMEs as the main factors that limit their growth in China.

Figure 35: SMEs suffer most from financing challenges

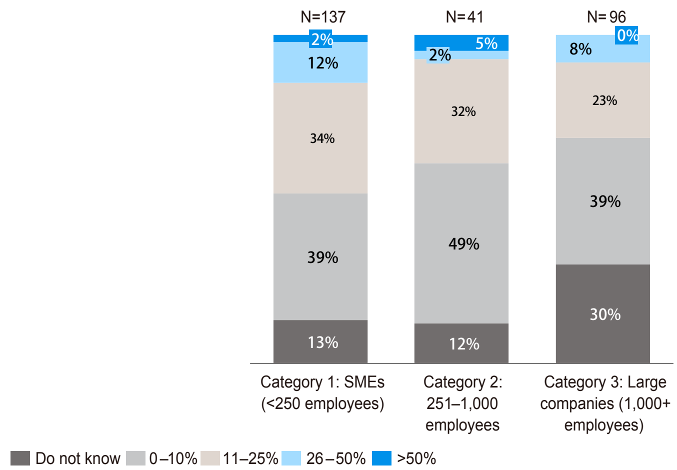
Please indicate the significance of the following factors affecting your company's net profit margin in 2019



58 According to the latest data from the National Bureau of Statistics, as of 2018, SMEs constituted 99.8% of the total number of companies and employed 79.4% of the total working population in China: *Report: China's SMEs Important Contributors to Economy, China Daily*, 29th December 2019, viewed 27th April 2020, <https://www.chinadailyhk.com/articles/246/77/157/1577593659496.html>

Figure 36: Missed opportunities cost many SMEs more than a quarter of annual revenue

What percentage of your company's annual revenue in China do these missed opportunities represent?[1)]

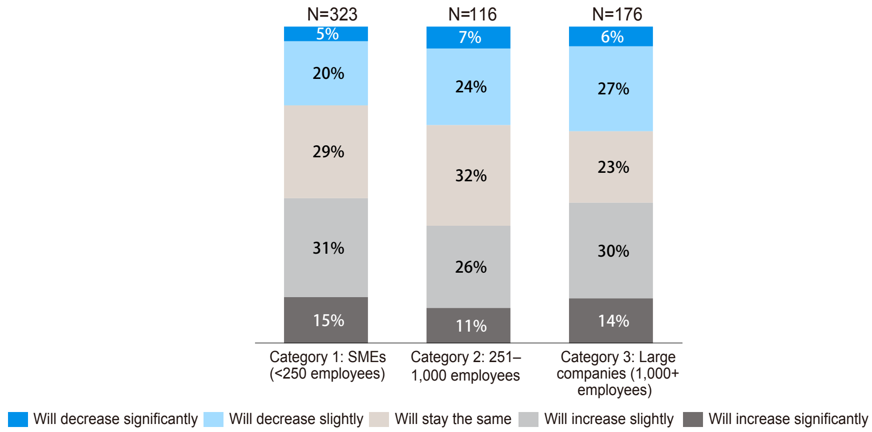


1) *Asked only if answer to "Has your company missed business opportunities in Mainland China as a result of market access restrictions or regulatory barriers?" was "Yes"*

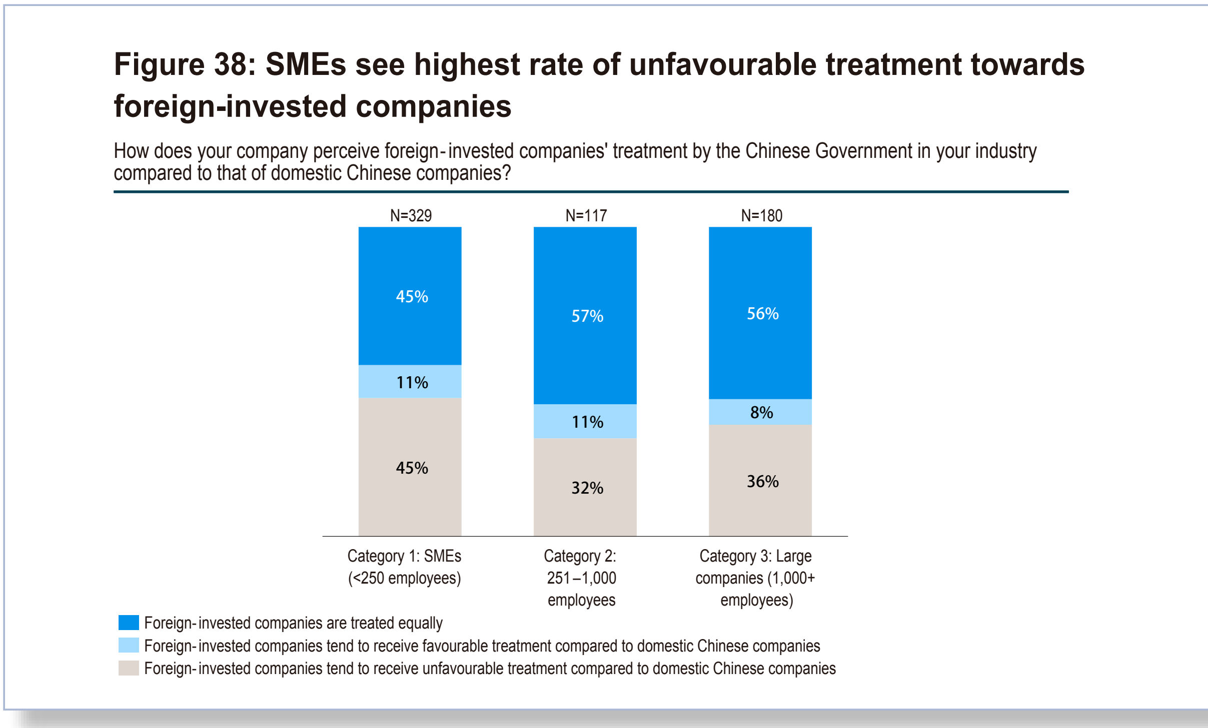
Additionally, SMEs are most pessimistic about regulatory obstacles over the next five years, with 46% expecting an increase. They are also most likely among survey respondents to receive unfavourable treatment compared to domestic Chinese companies.

Figure 37: SMEs foresee a rise in regulatory obstacles

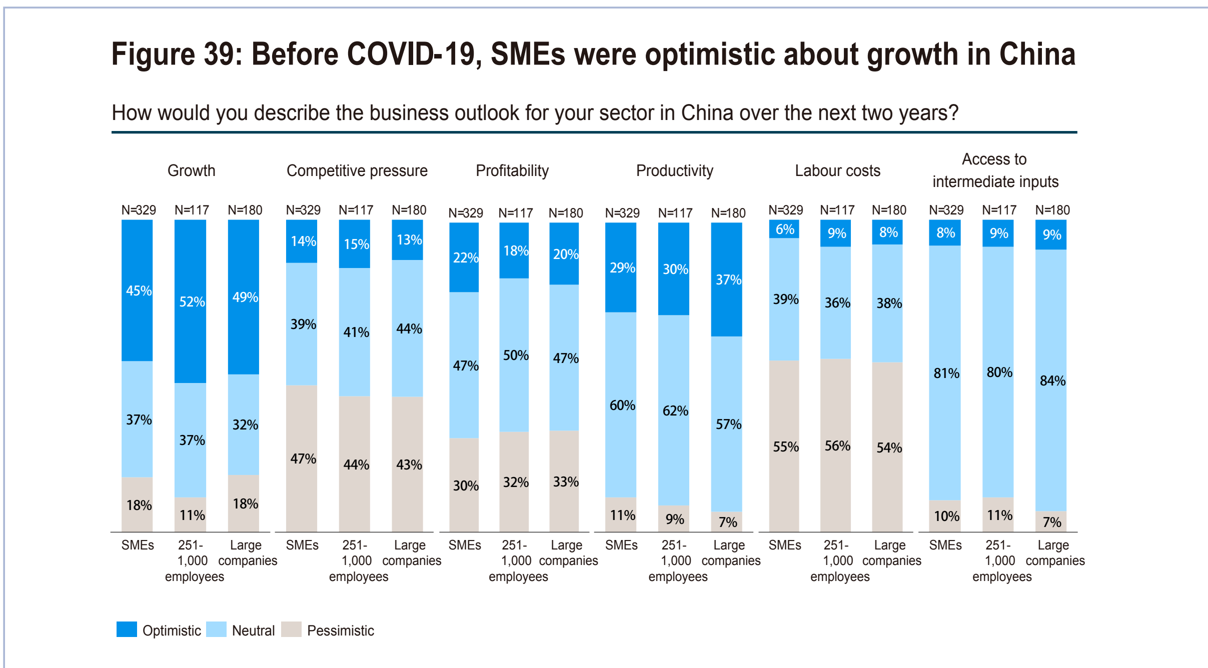
How do you expect the number of regulatory obstacles facing your company in Mainland China to change over the next five years?[1)]



1) *Excludes answer "Do not know"*



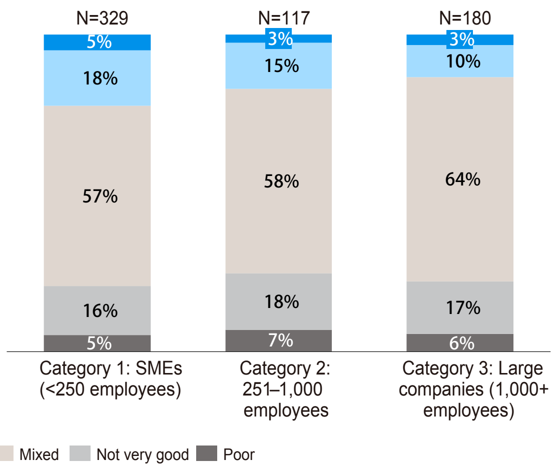
When the BCS was conducted in February 2020, SMEs stated that they were quite optimistic about profitability (22%) and growth (45%) in the coming year. Relative to larger companies, SME respondents also had a positive attitude towards the opportunities for them in the next five years, with 23% calling the opportunities either "very good" or "excellent". Being among the companies hardest hit by the COVID-19 outbreak, due to their limited reserves and heavy reliance on steady business, the business outlook for SMEs is now distinctly less hopeful. Although the government recognised the plight of SMEs and acted quickly by rolling out a slew of measures to support them during the crisis, the reality is that, in Q1 of 2020, 460,000 companies closed permanently and the registration of new businesses went down by 29%.[59]



1) SMEs: enterprises with less than 250 employees; Large companies: enterprises with more than 1,000 employees

Figure 40: SMEs most optimistic about their own opportunities

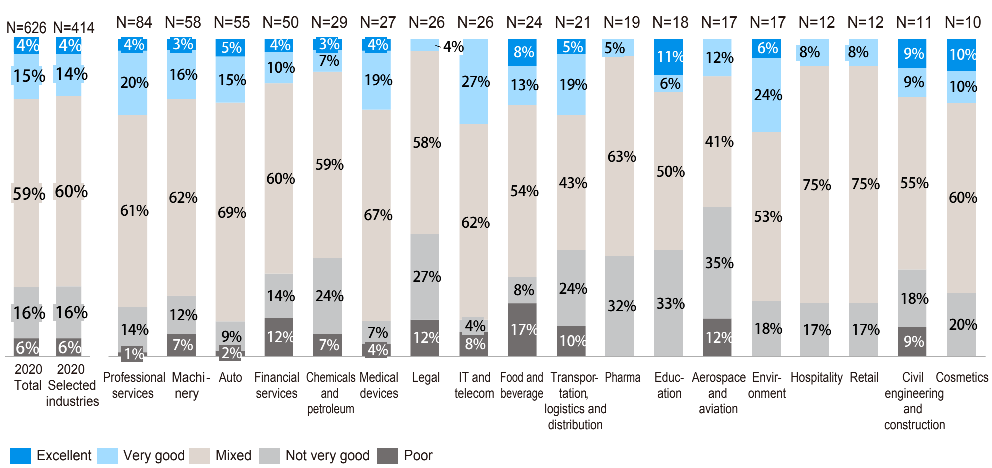
What do you think of the opportunities for European SMEs in your sector over the next five years?



Members do, however, see opportunities for European SMEs in the environment, IT and telecom, education, and food and beverage sectors.

Figure 41: Members see the most opportunities for SMEs in environment and IT/telecom

What do you think of the opportunities for European SMEs in your sector over the next five years?[1)]

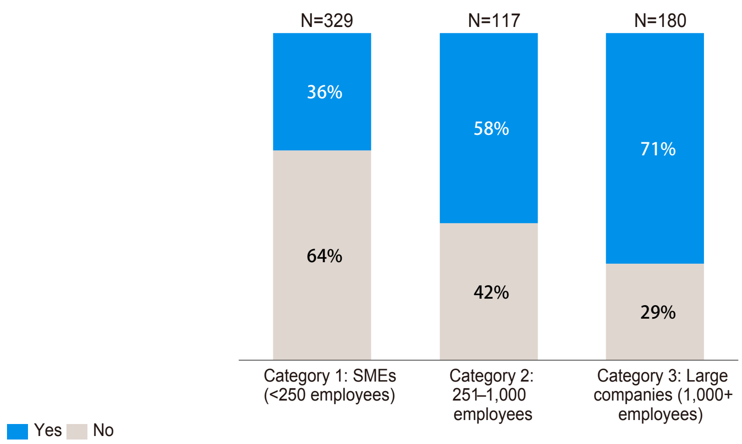


1) Selected industries are those for which there were at least 10 responses

The support required by SMEs during the current economic crisis includes measures to ensure liquidity—such as strengthening regulations related to late payments, with a special enforcement focus on debt owed by local governments and SOEs to smaller suppliers—as well as measures to help reduce costs for SMEs. Access to financing will also be key in the coming months, and this is an area where there is considerable room for improvement when it comes to implementation – especially indirect private financing. In terms of government financing, only 36% of SMEs benefitted from subsidies in 2019, and although this rate increased eight percentage points from the previous year, it is expected that more SMEs will apply for subsidies in order to keep their businesses afloat in the wake of COVID-19.

Figure 42: SMEs benefit from subsidies much less than MNCs

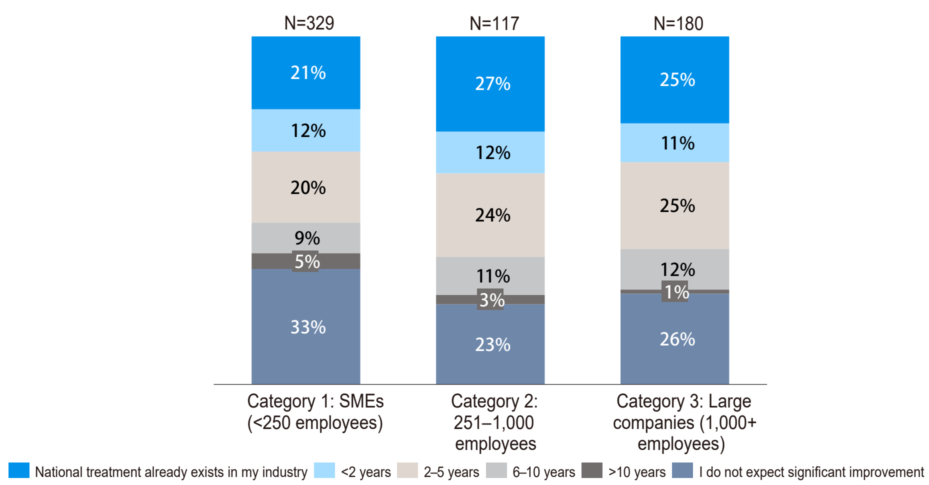
Has your company benefitted from any subsidies in China?



Now, more than ever, creating parity with domestic SMEs is necessary. Even before the crisis, SMEs were not optimistic about achieving a level playing field, with 33% stating that they do not expect any significant improvement.

Figure 43: SMEs are most pessimistic about achieving a level playing field for FIEs

When do you expect to see a level playing field through national treatment for foreign enterprises in your industry?

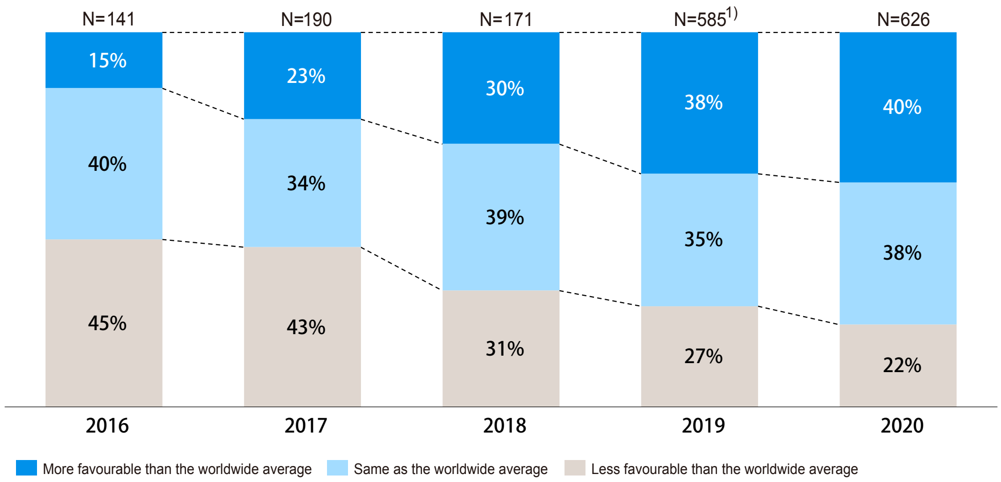


4 R&D AND INNOVATION

A key benefit of the Chinese market is its world-class research and development (R&D) and innovation environment, with a steady improvement in how Chamber members view it since 2016: 40% of members now believe the Chinese market to be more innovative than the worldwide average, particularly in the financial services, professional services, medical devices, aerospace and aviation, and environment sectors. This positive sentiment is fuelled by the availability of government incentives for foreign-invested enterprises (FIEs) to engage in R&D, which 33% of members rank as favourable and 8% rate as very favourable.

Figure 44: China has increasingly favourable environment for innovation and R&D

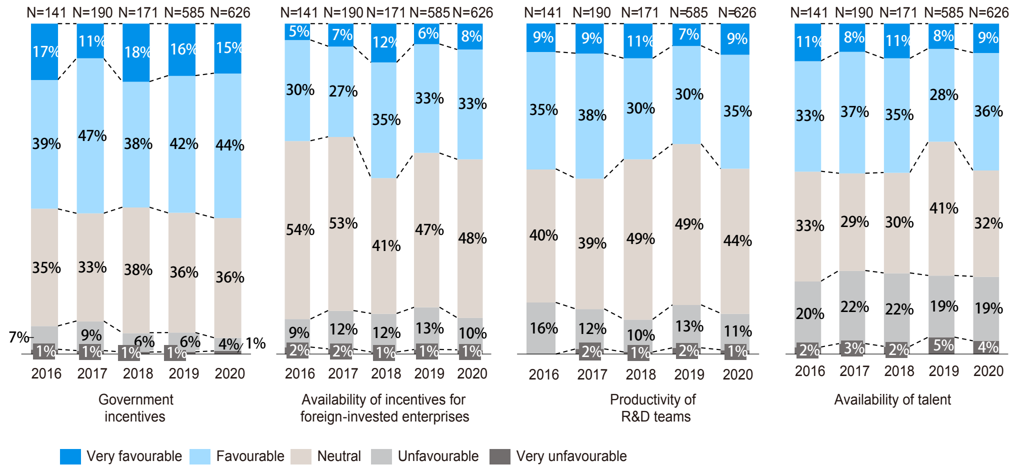
How do you consider China's innovation and R&D environment compared to the worldwide average?



1) Up until 2019, asked only when the answer to "Does your company have a R&D centre in Mainland China" was "Yes", which explains the surge in the number of respondents in 2019

Figure 45: Availability of incentives for FIEs makes China attractive for R&D

How does your company evaluate the following factors regarding R&D in China?[1)]



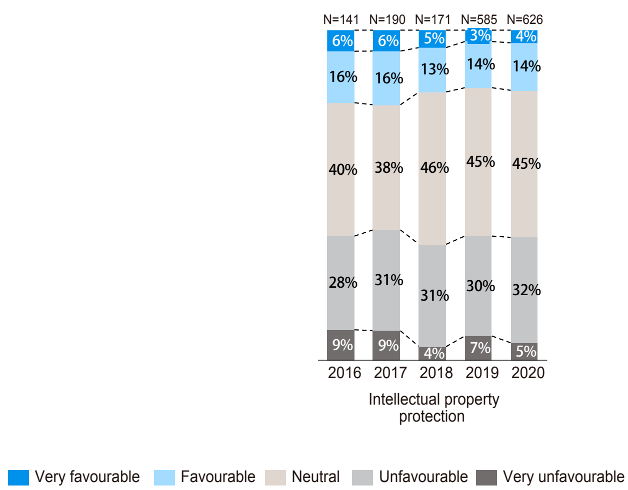
1) Up until 2019, asked only if the answer to "Does your company have a R&D centre in Mainland China" was "Yes". In 2019, the question was asked to all participants, which explains the surge in number of respondents

Yet European companies still have a number of concerns. For example, more than a fifth of members struggle to find suitable talent. In light of the COVID-19 situation, bringing talent from other countries, or even other regions of China, will become even more difficult.

R&D teams also still feel the threat of intellectual property (IP) infringements. Despite general improvements in IP protection under Chinese law, 37% of Chamber members identify IP issues as being "unfavourable" or "very unfavourable" to China's R&D environment.

Figure 46: IP issues damaging to China's R&D environment

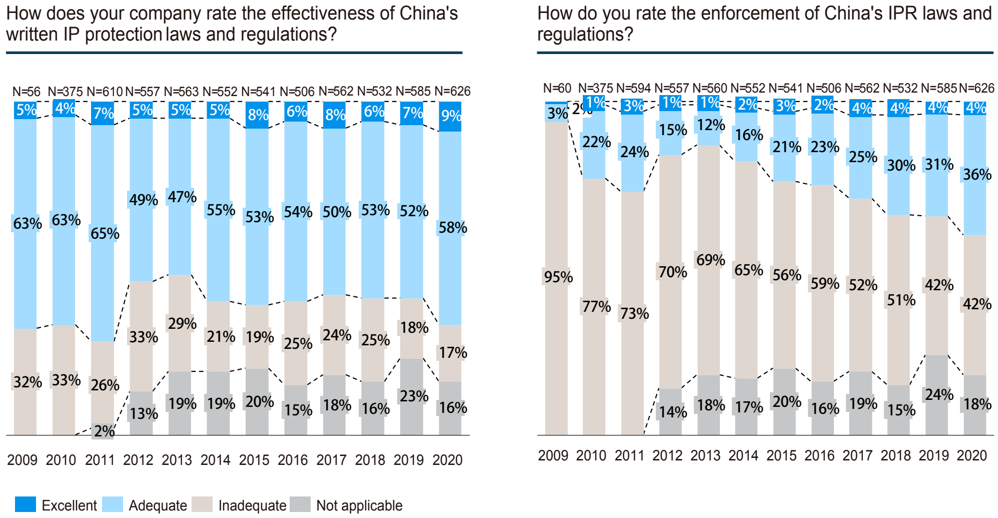
How does your company evaluate the following factors regarding R&D in China?[1)]



1) Up until 2019, asked only if the answer to "Does your company have a R&D centre in Mainland China" was "Yes." In 2019, the question was asked to all participants, which explains the surge in number of respondents

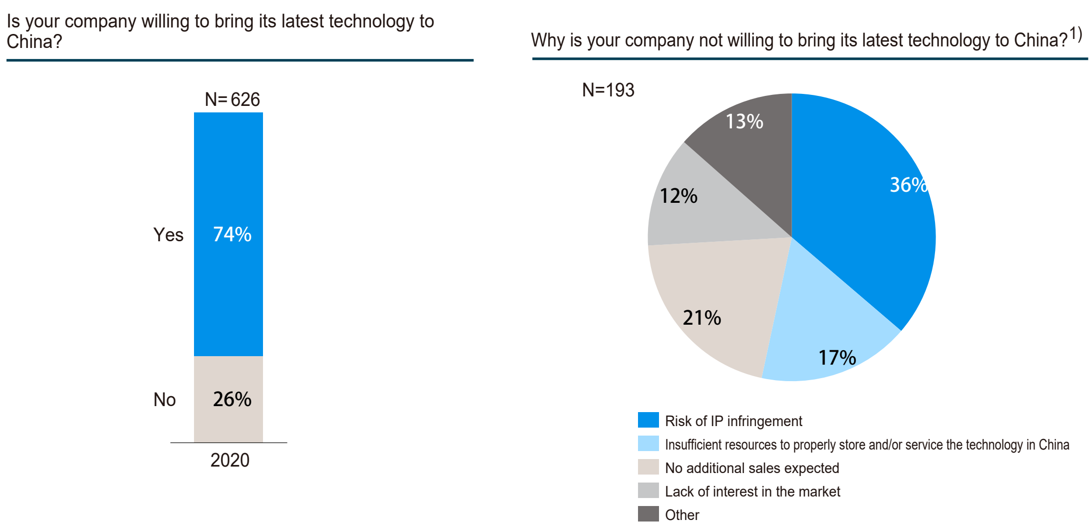
Intellectual property rights (IPR) protection has long been a source of unease for European companies operating in China or looking to enter the market. When it comes to the impact of IPR on R&D, members do acknowledge that continuous progress has been made on the drafting and enforcing of IPR-related regulations in China, although the improvement since 2019 is small. Two-thirds of respondents rate the effectiveness of China's IP protection laws and regulations as either "excellent" or "adequate", while 40% have rated the enforcement of said laws as such. For both legislation and enforcement, this is the highest rate of positive sentiment since 2012.

Figure 47: Marked improvement in IP protection laws and enforcement over the past decade



Nevertheless, the risk of IP infringement remains the leading reason why 36% of respondents are unwilling to bring their latest technology to China.

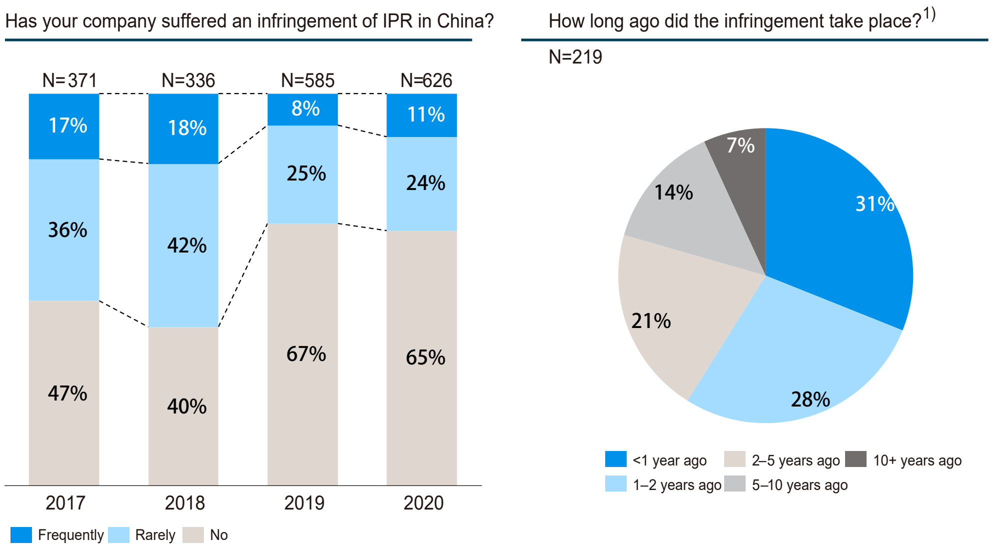
Figure 48: Fears of IP infringement means latest European technology remains at home



1) *Asked only if the answer to "Is your company willing to bring its latest technology to China?" was "No"; multiple answers possible; percentage divided by number of respondents*

In fact, more than one third of respondents have suffered IP infringements in China, with most happening within the past year.

Figure 49: IP infringements still happening, many within the past year



1) Asked only when the answer to "Has your company suffered an infringement of IPR in China?" was not "No"

The issue of technology transfer has also improved: 16% of respondents report having felt compelled to transfer technology in order to maintain market access, down four percentage points from 2019. However, a sectoral breakdown shows that industries have very different technology transfer experiences. In industries like medical devices, aerospace and aviation, and environment—the crown jewels of European innovation—nearly a third of members report having been compelled to transfer technology in order to maintain market access. Furthermore, of the respondents that felt compelled to do so, 36% report that the incident happened less than a year ago, with one-fifth of those saying it was taking place while the BCS was being conducted.

Figure 50: Incidences of compelled technology transfer reducing, but still too high

Has your company felt compelled to transfer technology in order to maintain market access?

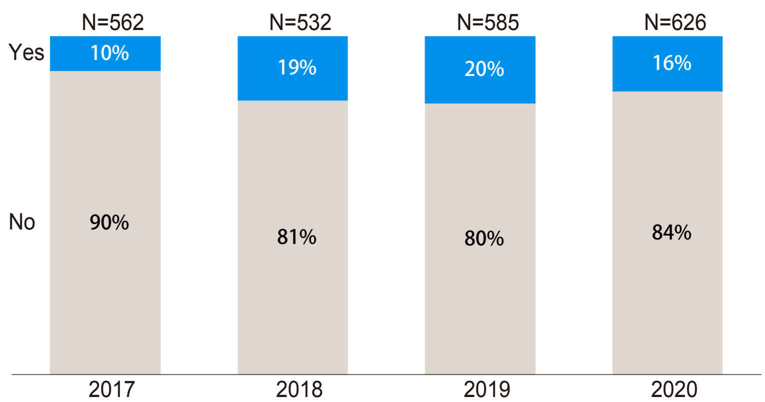
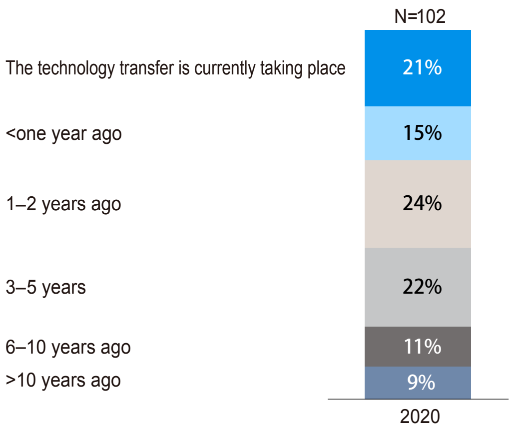


Figure 51: Many compelled technology transfers took place recently

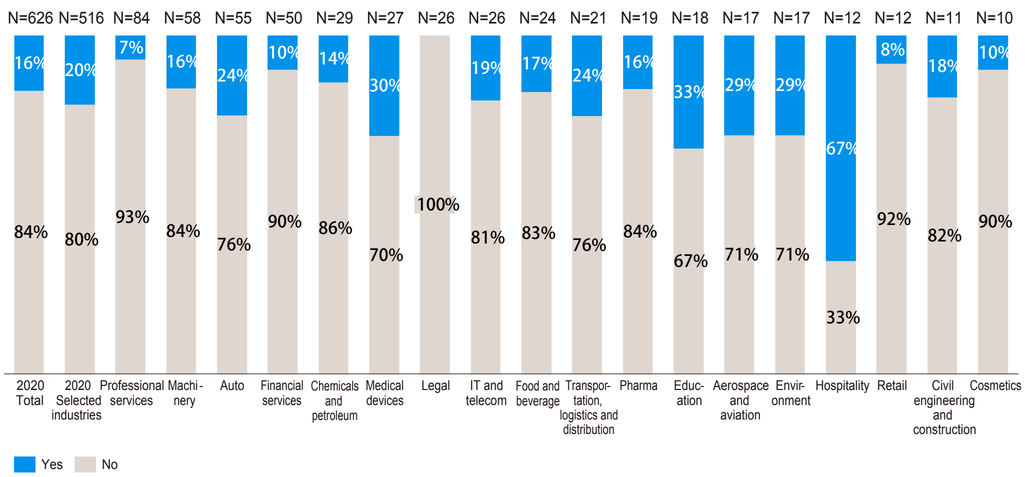
How long ago did the compelled transfer take place?[1)]



1) *Asked only if the answer to "Has your company felt compelled to transfer technology in order to maintain market access?" was not "No"*

Figure 52: Particularly innovative European industries face higher-than-average compelled tech transfer rates

Has your company felt compelled to transfer technology in order to maintain market access?[1)]

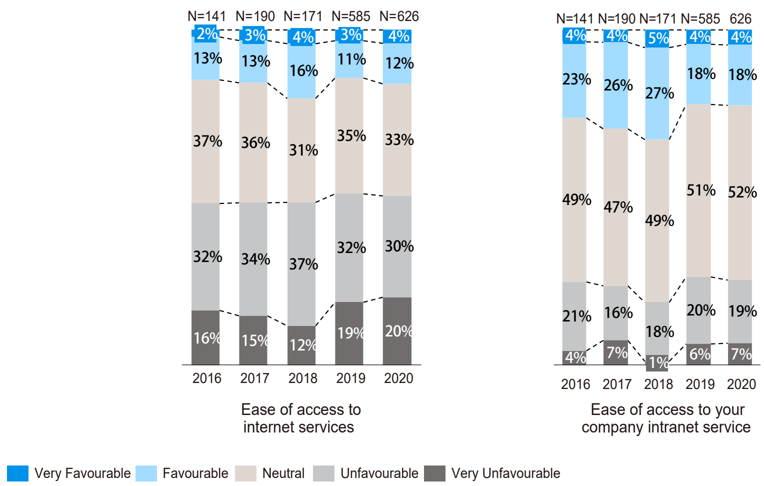


1) *Selected industries are those for which there were at least 10 responses*

Another challenge to the development of China's R&D environment is access to internet services and company intranet services, which are ranked unfavourably by a half and a quarter of respondents respectively.

Figure 53: Connectivity issues hinder R&D

How does your company evaluate the following factors regarding R&D in China?1)



1) *Up until 2019, asked only if the answer "Does your company have an R&D centre in Mainland China?" was "Yes". In 2019, the question was asked to all participants, which explains the surge in the number of respondents*

Furthermore, companies with their R&D centres in China have limited access to some Chinese databases with local data, due to either direct restrictions or the lack of clarity about which are open to FIEs. Data underpins the development of artificial intelligence, the Internet of Things and other frontier technologies, therefore whether or not innovation is successful depends largely on access to such data. Many of the challenges arising from COVID-19 have seen digital solutions accelerate in the wake of the pandemic, therefore the lack of adequate open databases will continue to stifle the R&D capabilities of firms in China.[60] As a leader in many of these technologies, China should be doing more to increase access to legitimate, globally-available information.

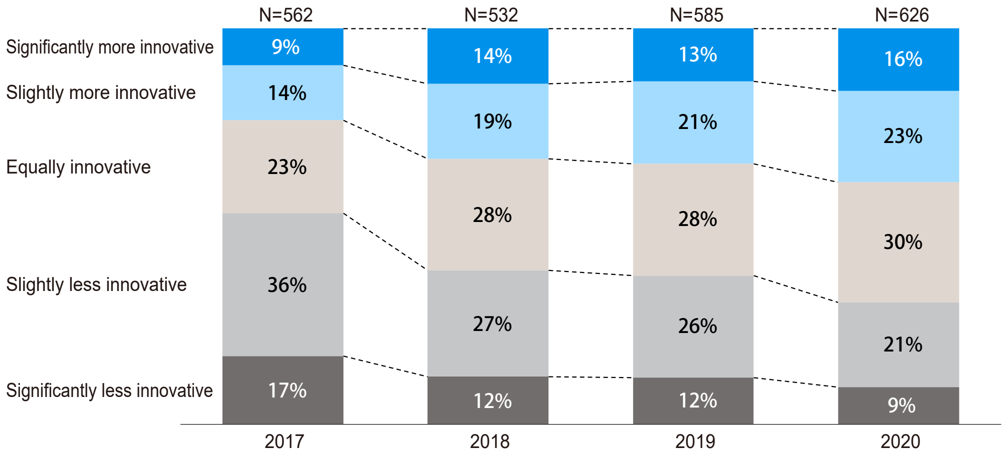
Increasing competition in order to continually improve products and services is at the core of R&D. This requires an open and fair environment for all market participants, regardless of their origin. Chinese firms have already proved themselves capable of standing on their own two feet, without the need for discriminatory treatment in their favour. In fact, 69% of members believe that Chinese firms are already equally innovative as, or more innovative than, European firms. This is the highest percentage since 2017, and has shown steady improvement over the years, supported by the fact that in April 2020, China surpassed the US to lead in the number of international patent applications filed.[61]

60 *European Business in China Position Paper 2019/2020: Research and Development Working Group*, European Union Chamber of Commerce in China, 24th September 2019, <https://www.europeanchamber.com.cn/en/publications-archive/712/Research_and_Development_Working_Group_Position_Paper_2019_2020>

61 Hosokawa, Rintaro,*China Overtakes US as Leader in International Patent Filings, Caixin Global*, 8th April 2020, viewed 13th April 2020, <https://www.caixinglobal.com/2020-04-08/china-overtakes-us-as-leader-in-international-patent-filings-101540010.html>

Figure 54: Chinese firms are increasingly competitive

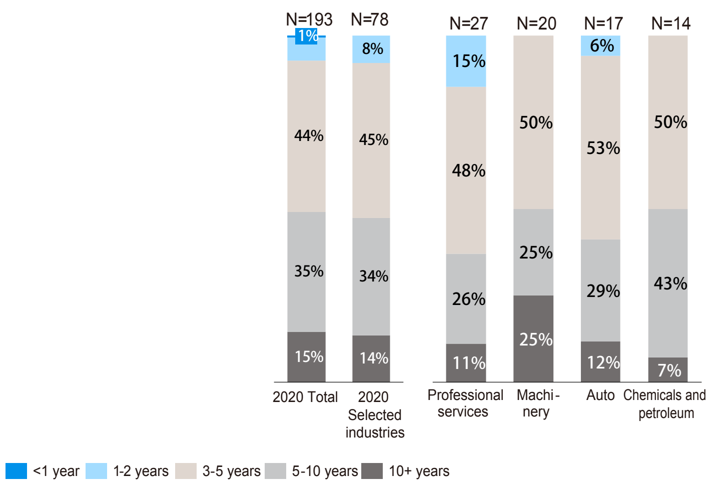
Within your industry, how innovative do you feel Chinese firms are compared to European firms?



For those that do not think Chinese firms are equally innovative as, or more innovative than, European firms, more than half expect this milestone to be reached within the next five years.

Figure 55: Chinese firms catching up quickly in some industries

How long do you think it will take before Chinese firms in your sector are equally innovative as, or more innovative than, European firms?[1] [2]

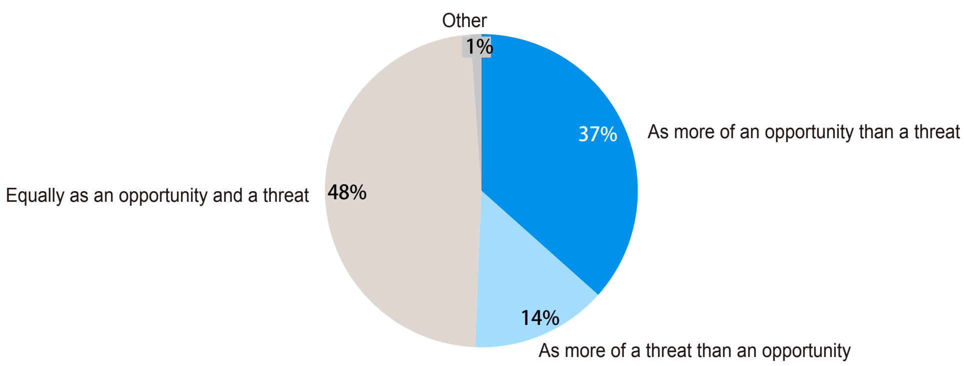


1) *Selected industries are those for which there were at least 10 responses;*
2) *Asked only if the answer to "Within your industry, how innovative do you feel Chinese firms are compared to European firms?" was "Slightly less innovative" or "Significantly less innovative"*

The majority of respondents are not threatened by competition with their Chinese counterparts; only 14% see domestic Chinese innovation as more of a threat than an opportunity, compared to 37% who identify more the opportunity that it provides.

Figure 56: European companies see opportunity in Chinese innovation

How does your company see domestic Chinese innovation?



5 POLITICISATION OF BUSINESS

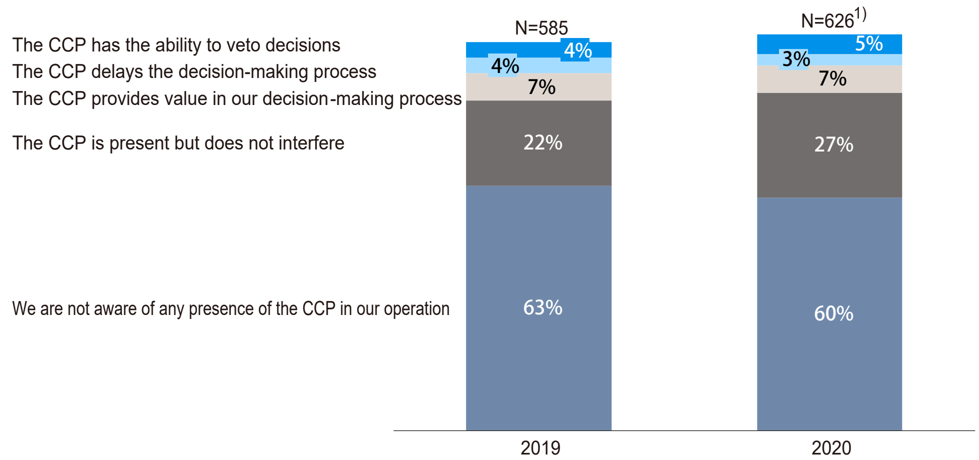
In recent years, the political aspect of doing business in China has often been featured heavily in media and government rhetoric, especially with the drawn-out US-China trade war serving as a clear and unfortunate example of how politics and business can collide with disastrous consequences. As one member stated:

"Business is there to answer market needs; to do so, [companies] need authorities to set up and monitor a transparent and clear framework, where appeal is possible. When politics interfere directly in business and distort market fairness or overall assessment, it only hinders overall efficiency of the business response."

Yet the link between business and politics in the Chinese market remains conspicuous for European Chamber members. Although a minority of respondents (40%) note the presence of the Chinese Communist Party (CCP) in their operations, a slight increase from 2019, 43% believe that the business environment in China became more political over the last year.

Figure 57: A minority of members see any CCP presence in their business operations

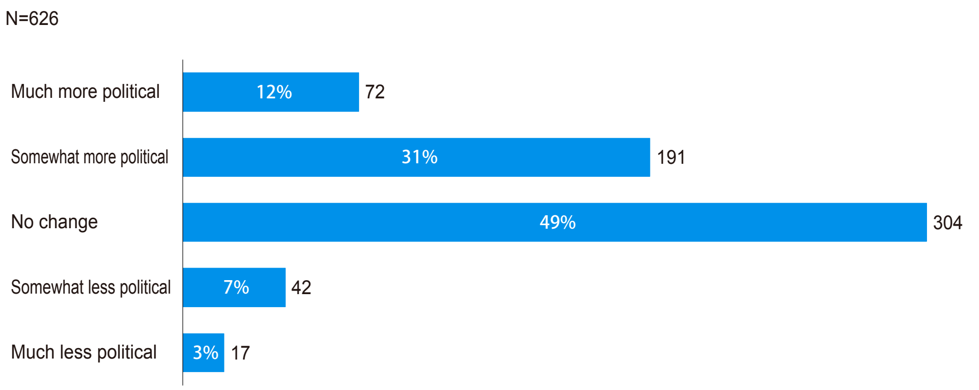
What role does the Chinese Communist Party (CCP) have on operational decision-making in your company?



1) *Multiple answers possible; percentage divided by number of respondents*

Figure 58: Politicisation of the business environment has increased

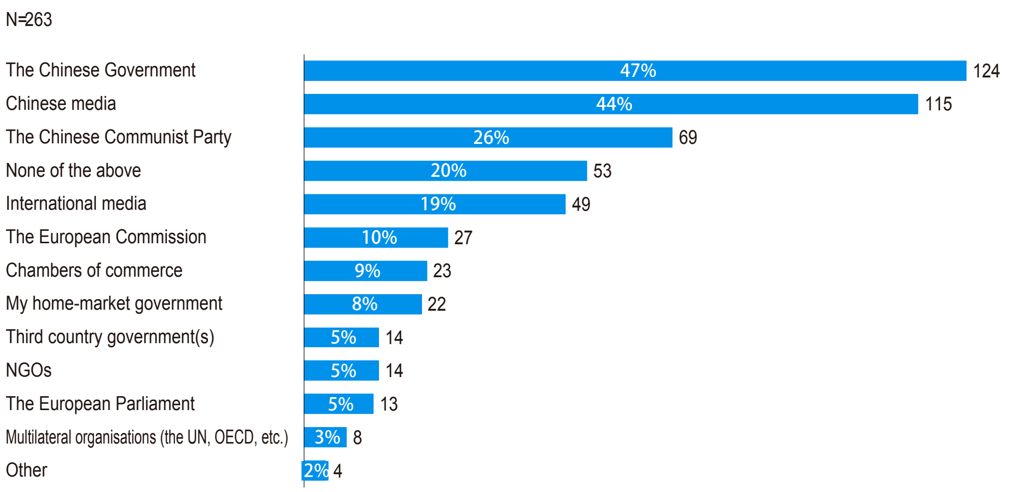
Has the business environment in China become more political in the last year?



The politicisation of business emanates from external and internal sources. European businesses operating in China state that they feel most external pressure from the Chinese Government (47%) and from Chinese media (44%).

Figure 59: External political pressure comes from Chinese government and media

From which of the following external and/or non-business sources has your company felt increased political pressure?[1)2)]



1) Asked only when the answer to "Has the business environment in China become more political in the last year?" was "Much more political" or "Somewhat more political";

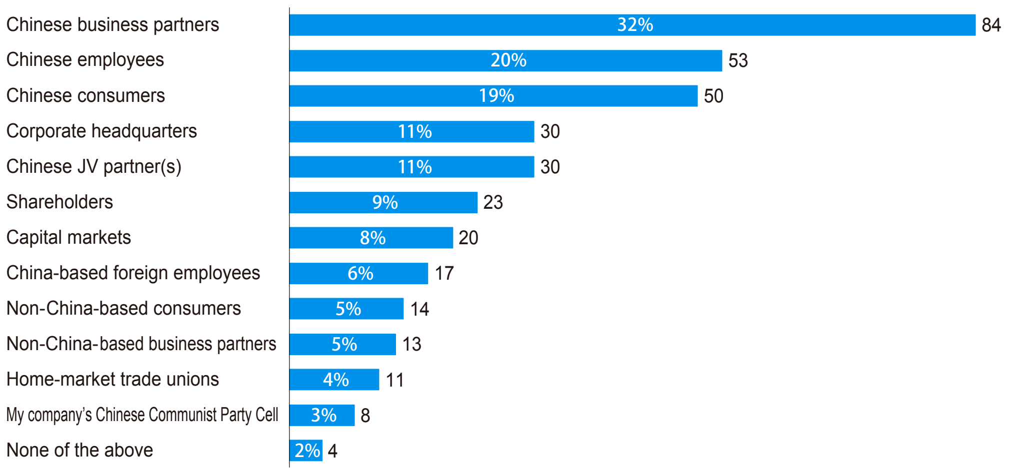
2) Multiple answers possible; percentage divided by number of respondents

Internally, around a third of firms that experienced increased politicisation in the last year say it has come from their Chinese business partners, and a fifth say it comes from their Chinese employees.

Figure 60: Internal political pressure comes from Chinese business partners, employees and consumers

From which of the following internal and/or business-related sources has your company felt increased political pressure?[1)2)]

N=263



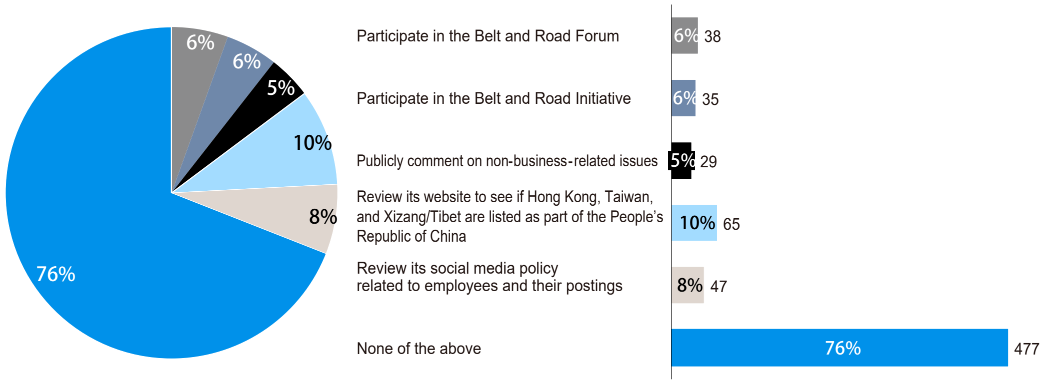
1) *Asked only when the answer to "Has the business environment in China become more political in the last year?" was "Much more political" or "Somewhat more political";*
2) *Multiple answer possible, percentage calculated by the total number of respondents*

The vast majority of respondents (76%) report not having felt pressure from the Chinese Government to participate in events or review internal policies to align with China's political agenda. Even so, this still leaves a substantial chunk of members who did feel pressured to take some action, sometimes under the threat of punishment by authorities. The most common actions taken by members were the reviewing of corporate websites to see if Hong Kong, Taiwan and Tibet were listed as part of the People's Republic of China (10%) and the reviewing of policies regarding their employees' posts on social media (8%).

Figure 61: A quarter of members felt political pressure to carry out certain actions

In the last 12 months, has your company felt pressure from the Chinese Government to do any of the following?[1)]

N=626



1) Multiple answers possible; percentage divided by number of respondents

While members may not face explicit pressure to take action, underlying worries of retribution may influence their behaviour. As one member writes:

"Similar to censorship in the media, all business decisions are influenced by their perceived or potential impact on local government or party attitude, even if there is no specific action from the government."

6 ANNEX

Figure 62: The majority of respondents are based in Shanghai and Beijing

In which European Chamber Chapter is your company located?

N=626

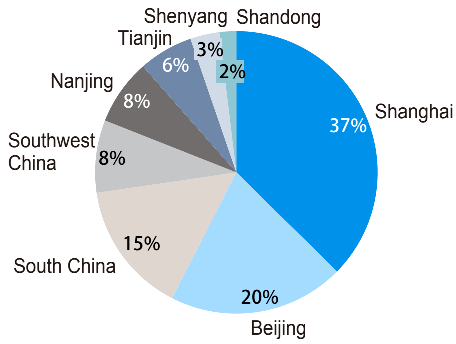


Figure 63: Most respondents have been operating in China for more than 10 years

How long has your company been operating in Mainland China?

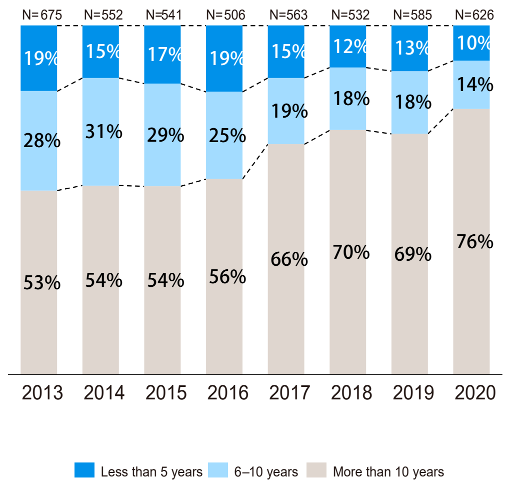
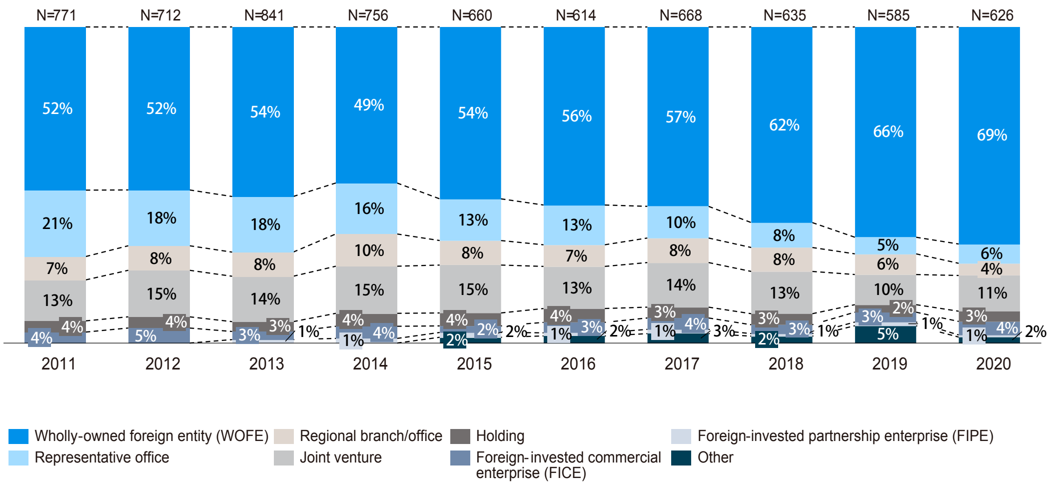


Figure 64: The share of wholly foreign-owned enterprises (WFOEs) continues to rise, representing 69% of respondents

Under which legal entity is your company registered in Mainland China?[1)]



1) *Multiple answers possible up to and including 2018*

Figure 65: 65% of respondents come from professional services and industrial goods/services sectors

Please indicate the main sector of your company

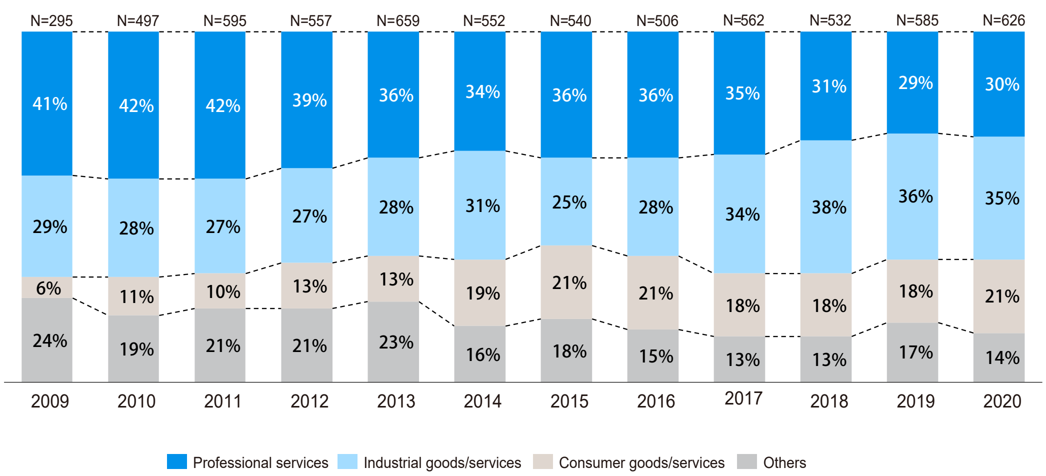


Figure 66: 15% of member companies made over one billion euros in revenue in 2019 for their Mainland China entities

What was the 2019 total revenue of your company in Mainland China to the nearest million EUR?

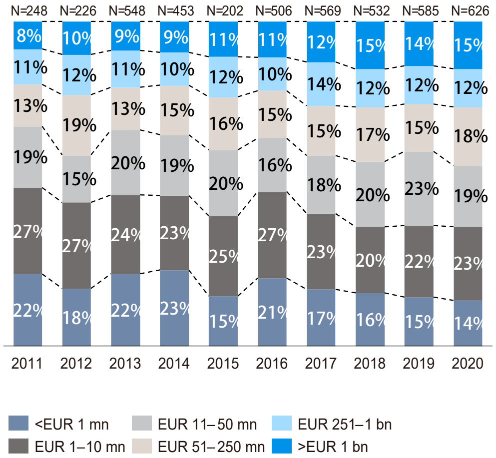
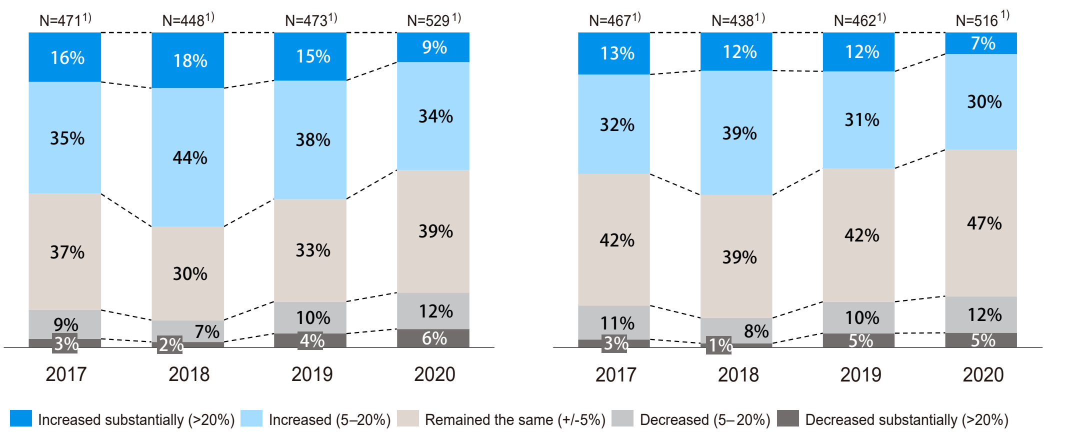


Figure 67: The percentage of respondents with decreasing EBIT and EBIT margins has increased

How did your company's 2019 EBIT in Mainland China evolve compared to 2018?[1]

How did your company's 2019 EBIT margin in Mainland China evolve compared to 2018?[1]



1) *Excludes respondents who were unable to answer*

Figure 68: Cost, competition and macroeconomic factors have the most negative effect on members' profit margins

Please indicate the significance of the following factors affecting your company's net profit margin in 2019

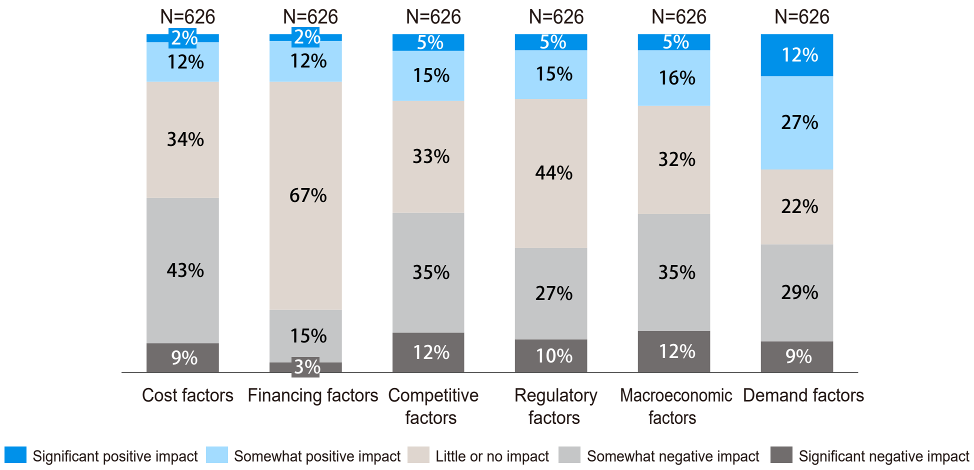


Figure 69: SMEs have the highest rate of negative EBIT

Please describe your company's EBIT in Mainland China in 2019

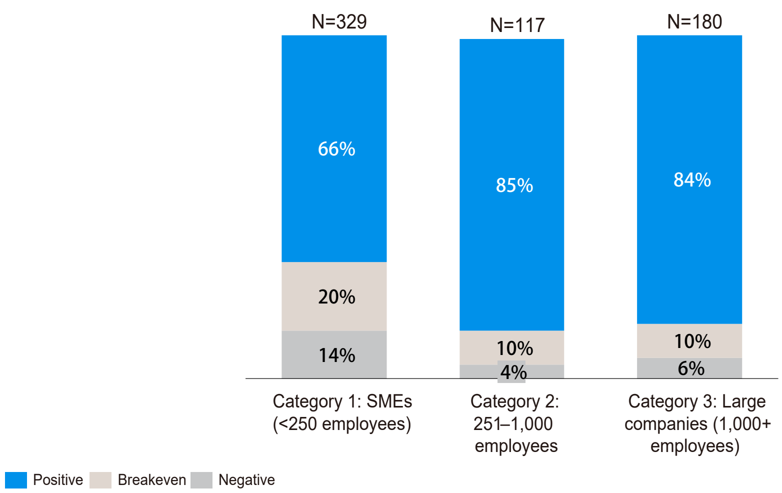


Figure 70: SMEs feel the most unwelcome

As a foreign investor in China, do you feel:

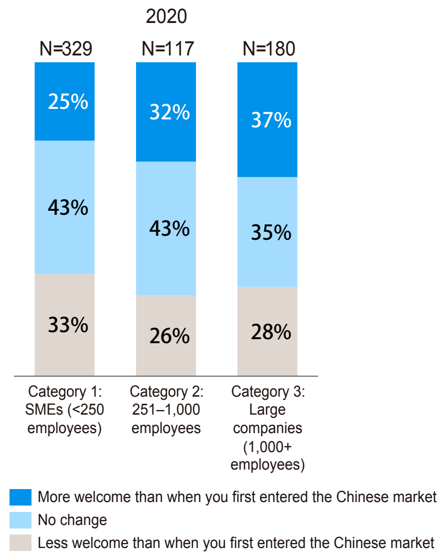
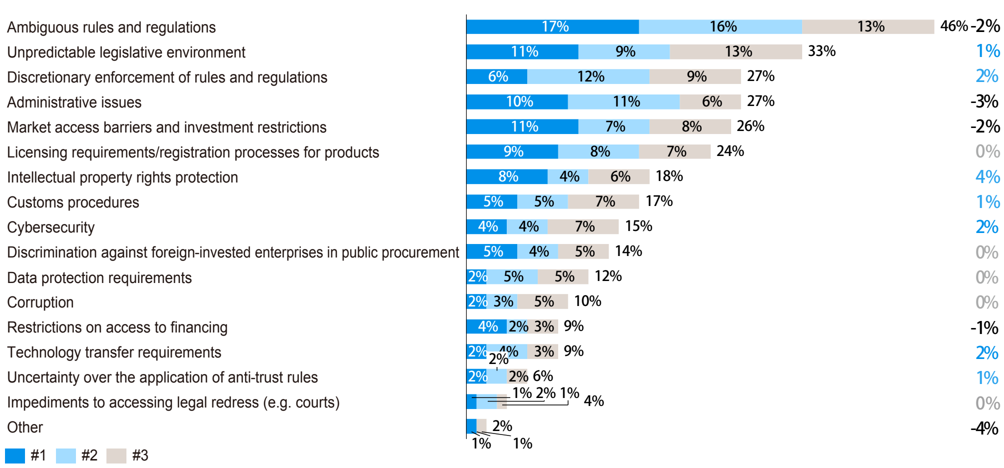


Figure 71: Ambiguous rules and regulations, unpredictable legislation and discretionary enforcement are the main obstacles for European business

Which are the top three most significant regulatory obstacles for your company when doing business in Mainland China?[1)2)]

N=626

Δ 2019–2020 [p.p.]

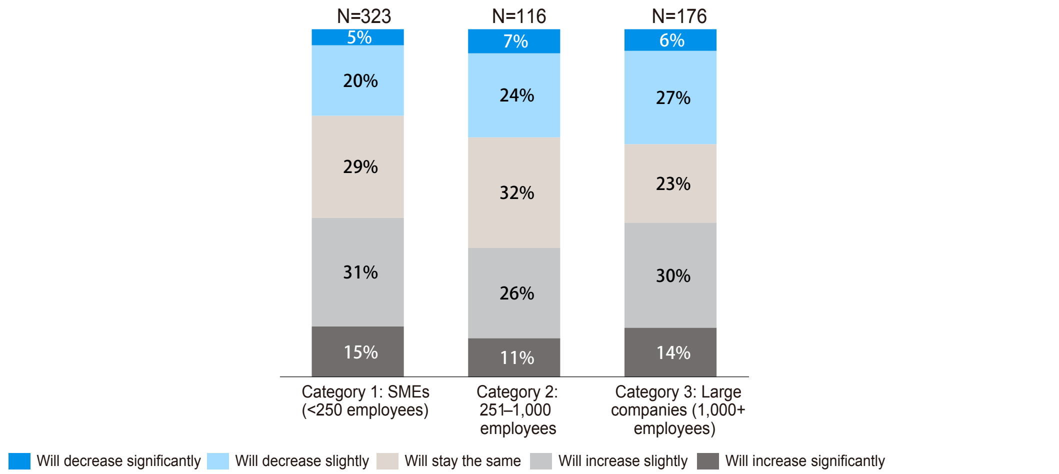


1) Figures represent the proportion of respondents who rated each issue their #1–3 most significant regulatory obstacles;

2) Percentages divided by number of respondents

Figure 72: 44% believe that regulatory obstacles will worsen over the next five years

How do you expect the number of regulatory obstacles facing your company in Mainland China to change over the next five years?[1)]



1) *Excludes answer "Do not know"*

Figure 73: 44% have lost out on business opportunities due to market access restrictions or regulatory barriers

Has your company missed out on business opportunities in China as a result of market access restrictions or regulatory barriers?

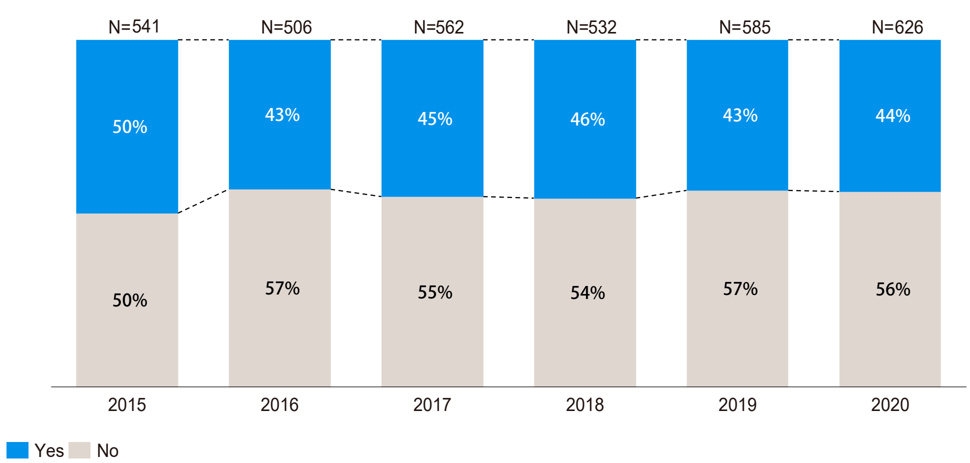
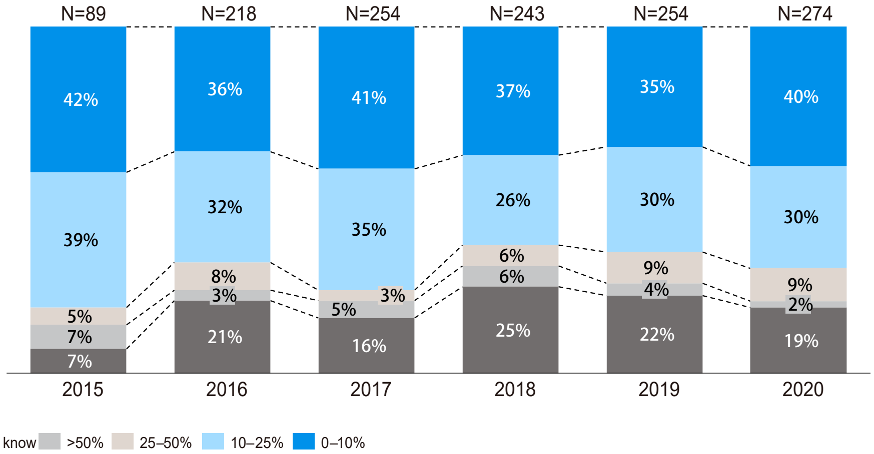


Figure 74: Nearly 80% of members have experienced revenue losses as a result of these missed opportunities

What percentage of your company's annual revenue in China do these missed opportunities represent?[1)]

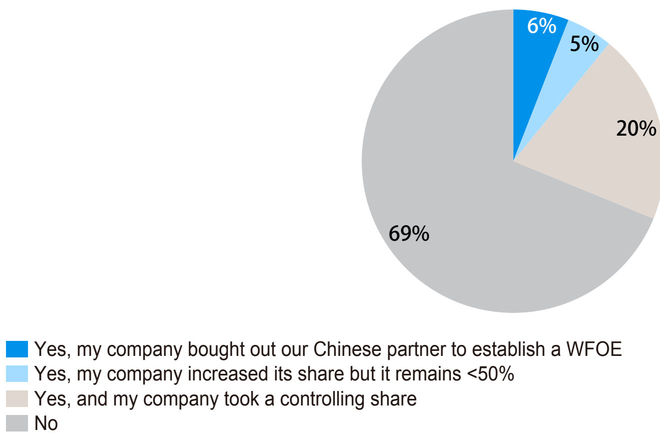


1) Asked only if the answer to "Has your company missed business opportunities in Mainland China as a result of market access restrictions or regulatory barriers?" was "Yes"

Figure 75: Only 31% increased their share in a joint venture (JV) following market-opening announcements and lifting of equity caps in 2019

In light of market-opening announcements and lifting of equity caps in 2019, has your company increased your share in a JV?[1)]

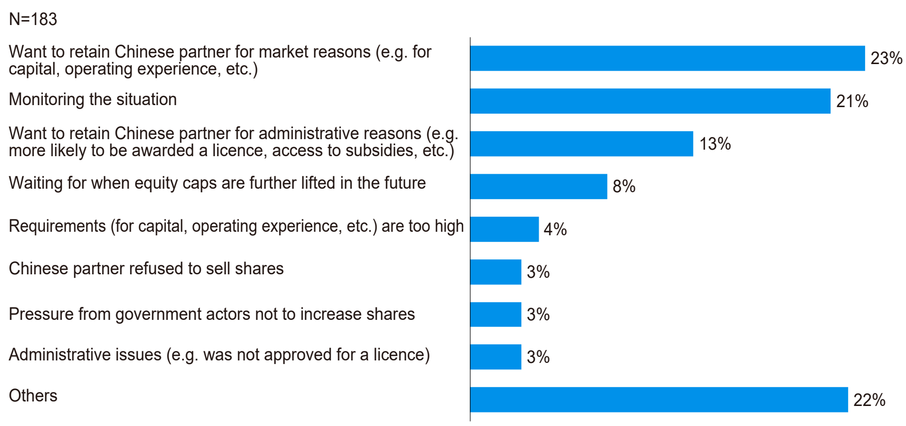
N=202



1) Asked only when the answer to "Does your company have a JV with a Chinese company (including SOEs and POEs)?" was "Yes"

Figure 76: Of those who did not increase their share in a JV, many are monitoring the situation

Why did your company not increase its share in a JV in 2019?[1)2)]

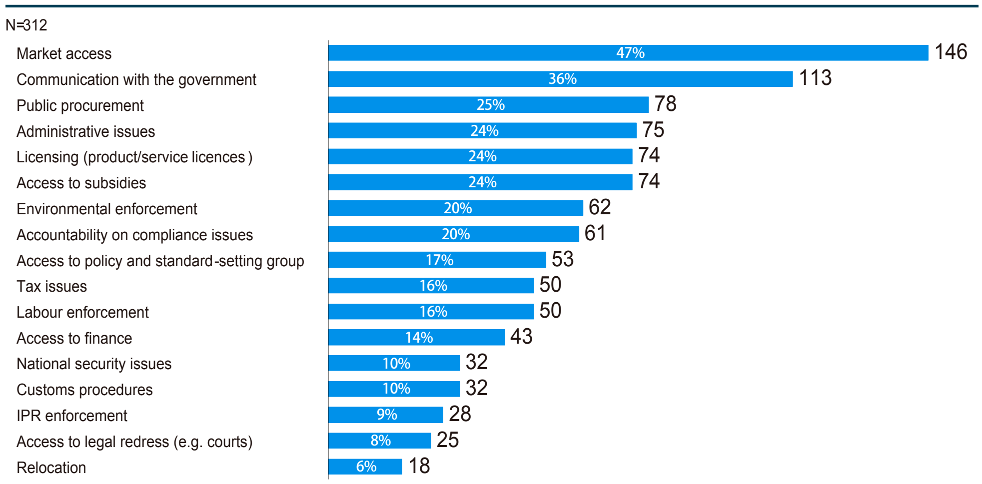


1) Asked only when the answer to "In light of market-opening announcements and lifting of equity caps in 2019, has your company increased your share in a JV?" was "No";

2) Multiple answers possible; percentage divided by number of respondents

Figure 77: Market access and communication with the government are areas in which members experience differentiated treatment from domestic companies the most

In which areas have you experienced differentiated treatment?[1)2)]

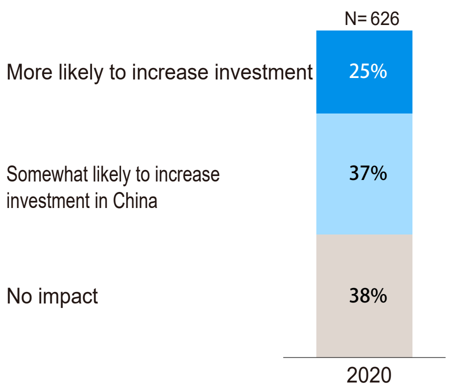


1) Asked only if the answer to "How does your company perceive foreign-invested enterprises' treatment by the Chinese Government in your industry compared to that of domestic Chinese companies?" was not "Foreign-invested enterprises are treated equally";

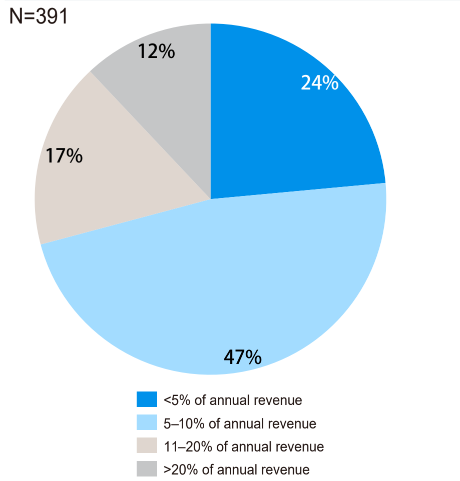
2) Multiple answers possible; percentage divided by number of respondents

Figure 78: If granted greater market access, 62% would increase China investment, nearly half of whom would invest 5% to 10% more

If greater market access were granted to foreign companies in your industry, how would this impact your company's investment decisions in China?



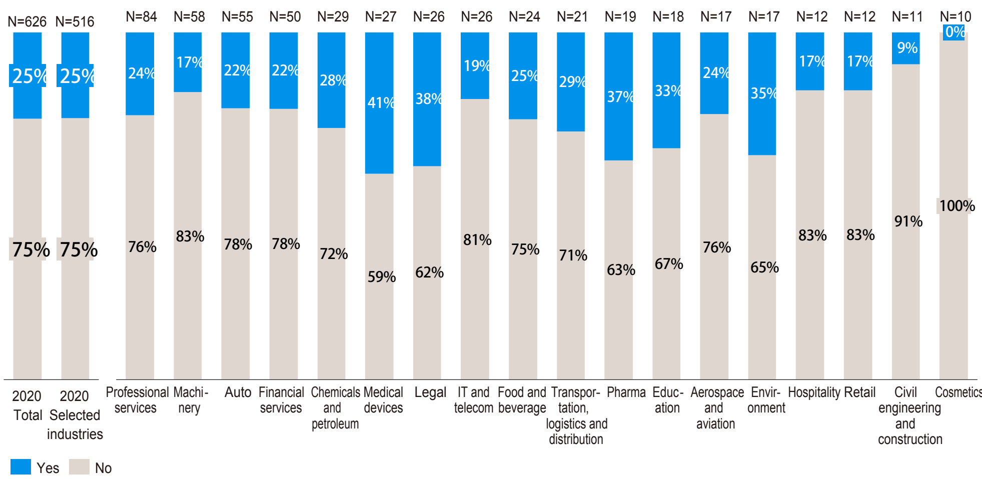
By how much would you be likely to increase your company's investments into China?1)



1) *Asked only if the answer to "If greater market access were granted to foreign companies in your industry, how would this impact your company's investment decisions in China?" was not "No impact"*

Figure 79: Quarter of members see subsidies offered to Chinese firms that foreign firms cannot access

Are you aware of any subsidies offered to Chinese firms in the last two years that foreign firms cannot access?1)



1) *Selected industries are those for which there were at least 10 responses*

Figure 80: Majority of members identify China as a top or top three destination for present and future investments

On a global scale, where does China rank as a destination for present and future investments for your company?

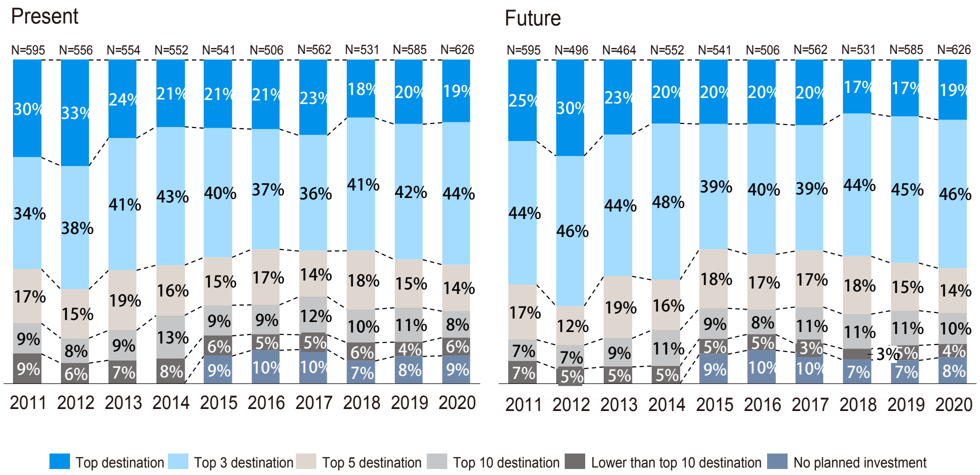
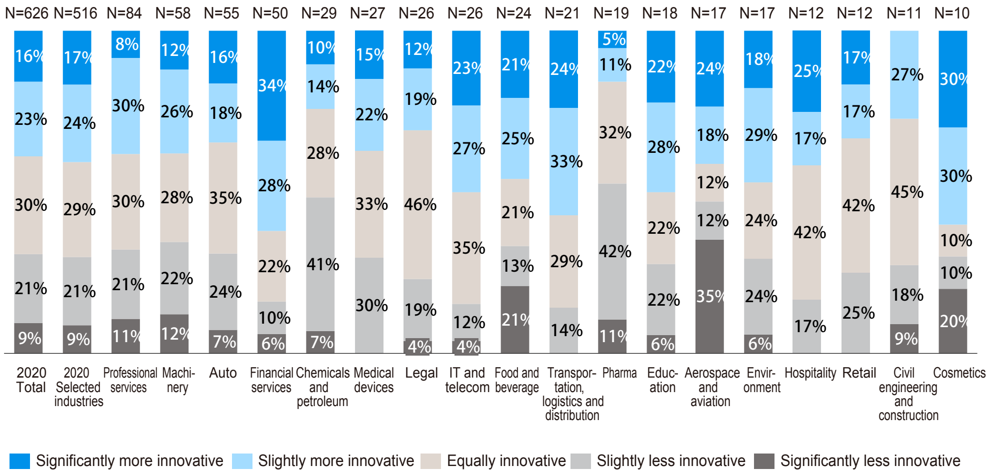


Figure 81: Members in financial services and cosmetics sectors most positive about Chinese firms' innovation capabilities

Within your industry, how innovative do you feel Chinese firms are compared to European firms?[1)]

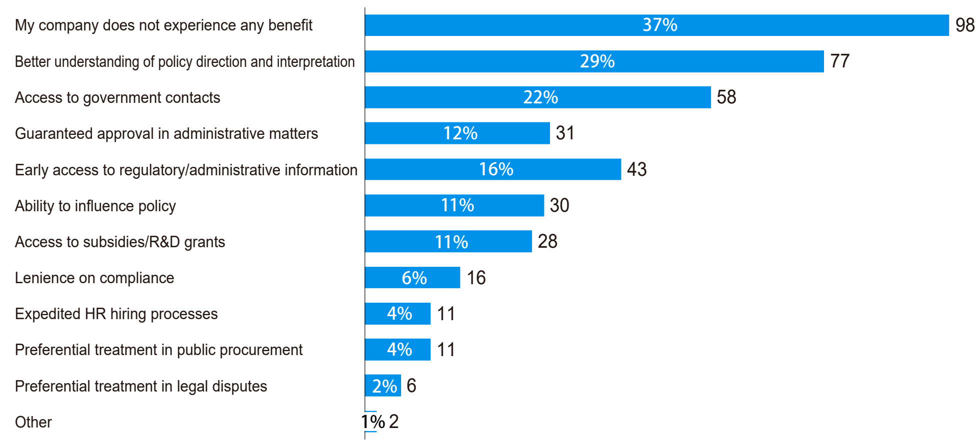


1) Industries selected are those for which there were at least 10 responses

Figure 82: Most companies experience no benefits from CCP presence

What benefits, if any, does your company experience from CCP presence in your company?1)2)

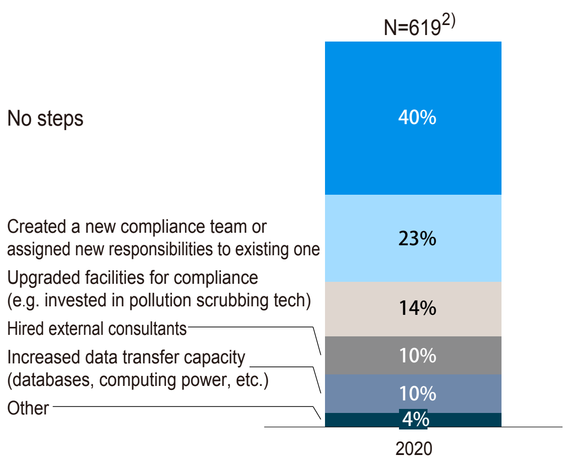
N=264



1) *Asked only when the answer to "What role does the CCP have on operational decision-making in your company?" was not "We are not aware of any presence of the CCP in our operation"*
2) *Multiple answers possible; percentage divided by number of respondents*

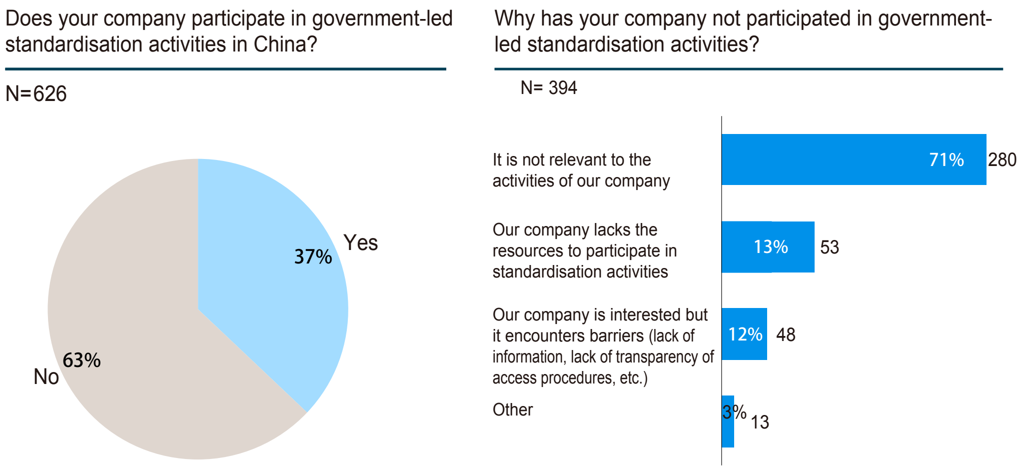
Figure 83: Most members have not taken steps to prepare for the implementation of the Corporate Social Credit System (SCS)

Which of the following steps has your company taken to prepare for the implementation of the Corporate SCS?1)



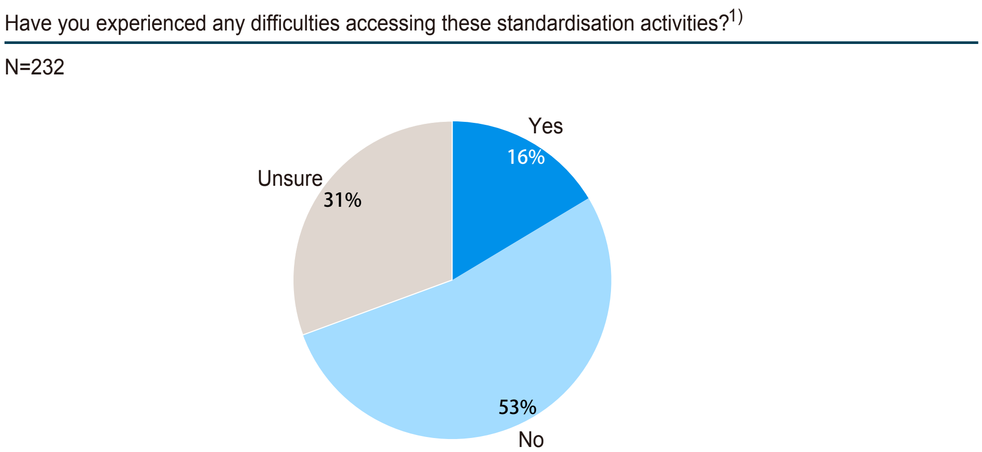
1) *Asked only when the answer for "Has your company been impacted by the Corporate Social Credit System (SCS)?" was not " I am not aware of the Corporate SCS";*
2) *Multiple answers possible; percentage divided by number of respondents*

Figure 84: One third of members participate in government-led standardisation activities, most find them irrelevant



1) Asked only when the answer to "Does your company participate in government-led standardisation activities in China?" was "No"

Figure 85: Most companies who participate in standardisation face no difficulties

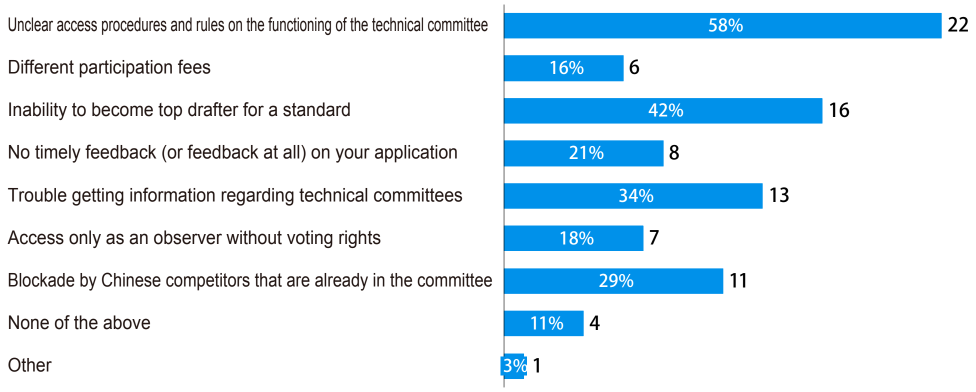


1) Asked only when the answer for "Does your company participate in government-led standardisation activities in China?" was "Yes"

Figure 86: Those who do face difficulties report unclear access procedures and rules on the functioning of the technical committee

What difficulties have you experienced accessing these standardisation activities?[1)2)]

N=38



1) Asked only when the answers for both "Does your company participate in government-led standardisation activities in China?" and "Have you experienced any difficulties accessing these standardisation activities?" were "Yes";

2) Multiple answers possible, percentage calculated by the total of respondents

7 ABOUT THE SURVEY MOTIVATION AND DESIGN

The purpose of the European Chamber's *European Business in China Business Confidence Survey* is to take an annual snapshot of European companies' successes and challenges in China. Published annually since 2004, the survey has enabled the European Chamber to build a rich data set that serves as a broad indicator of how European companies judge the business environment in China.

The European Chamber invited its members to take part in the 2020 survey over a four-week period during January and February 2020. The survey was conducted in cooperation with Roland Berger and was published in June 2020. There were 1,308 eligible entities. With 626 respondents completing the survey, the 2020 survey achieved a response rate of 47.9%.

In order to obtain a high response rate, which is an essential feature for high-quality results, the survey was condensed as much as possible, while keeping the appropriate questions to make comparisons over time. An online and password-required survey platform was set up for European Chamber members. The survey comprised 68 questions, grouped under three key themes:

- Company Profile and Financial Performance;
- Outlook on the Chinese Business Environment; and
- Outlook on Company Strategy.

A European Chamber chapter-specific section was also added as of 2015, but these questions are not included in this report.

Consistency was one of the key factors that guided the design of the questionnaire and data analysis. We gathered similar data from previous years so that we could trace and understand the development of company strategies and perceptions. We focused on capturing the key issues for European companies operating in China and designed up-to-date questions that are in line with typical issues European companies faced in China in 2019 and 2020.

8 ABOUT ROLAND BERGER

Roland Berger is an independent company, solely owned by our partners, who are responsible for overall corporate performance and business success. Founded in 1967, Roland Berger remains the only leading global consultancy firm with non-Anglo-Saxon roots. We are German by origin, European by nature and global by ambition, including a strong footprint in Asia and other geographies where we feel that we can truly make an impact.

We have always strived to provide a different perspective in the field of consulting and business, and today we continue to constructively challenge standard patterns of thought and provide clients with new solutions to manage disruption and transformation.

Our entrepreneurial spirit has shaped our growth and fuelled our outstanding achievements since the early days of the firm. In short, being a game changer is in our DNA. With over 50 years of continuous growth behind us and 2,400 employees working in 35 countries, we are one of the leading players in global top-management consulting and have successful operations in all major international markets.

Through mutual trust and sustainable value added for our clients, we have become a long-standing advisor of major international industry and service companies as well as public institutions worldwide.

9 ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 31 working groups and fora representing European business in China.

The European Chamber now has more than 1,700 member companies in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Executive Committee.

The European Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is also recognised as a foreign chamber of commerce by the Ministry of Civil Affairs. The European Chamber is part of the growing network of European Business Organisations (EBO), which connects European business associations and chambers of commerce from 37 non-EU countries around the world.

Principles:
- We are an independent, non-profit organisation governed by our members.
- We work for the benefit of European business as a whole.
- We operate as a single, networked organisation across Mainland China.
- We maintain close, constructive relations with the Chinese and European authorities, while retaining our independence.
- We seek the broadest possible representation of European business in China within our membership: small, medium and large enterprises from all business sectors and European Member States throughout China.
- We operate in accordance with Chinese laws and regulations.
- We treat all of our members, business partners and employees with fairness and integrity.

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