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Business Climate Survey 2012

Presentation deck

Paris
Toronto
Shanghai
Buenos Aires



Connection creates value



I. Context & Methodology



Context (1/2)

- Conducted by the French Chamber of Commerce and Industry in China (CCIFC) in cooperation with IFOP, the French Business Climate Survey 2012 is the first most representative independent business survey of its kind in China.
- The Business Climate Survey has been developed to provide insight into French business confidence in the Chinese market:
 - It provides insight into the current business environment encountered by French companies in China;
 - Moreover, the survey identifies the reasons why the French business community is adopting certain business strategies and also assesses the challenges faced by their operations in China.
- It is not a census, but a survey conducted on a sample of companies ; looking into stated behaviors and opinions from representatives of such companies ; as opposed to hard facts that can be collected by various organisms for other purposes. As such, the results of this survey only reflect responses and opinions of individuals.
- The survey will be conducted and published annually.



Context (2/2)

- The French Chamber of Commerce in China invited its member companies to respond to the 2012 Business Climate Survey over July 2012. The survey was conducted in cooperation with Ifop and will be published in November 2012. Out of **1,347 eligible entities** who have received the questionnaire, **138 completed the survey, achieving a response rate of 10%**, what can be considered a high one.
- An online password-required survey platform was used to address the member companies of the French Chamber of Commerce in China. This comprised 59 questions, grouped under three core themes (see in the appendix).



Methodology

- Introduced as an initiative for the French Chamber, this Business Climate Survey was conducted in two phases:
- **A quantitative research:** the first phase was mainly administrated through the online questionnaire:
 - ✓ The fieldwork started on July 5th and ended on July 26th, 2012
 - ✓ Most respondents hold a direction position in their respective company (Ex. managing director, general manager, operations director, area manager, HR manager, secretary-general, etc.).
 - ✓ Most respondents came from tier 1 cities such as Beijing, Shanghai, Guangzhou and Shenzhen. At the same time, there were also a few respondents from Jiangsu, Shandong, Hebei, Sichuan, Yunnan and Zhejiang provinces.
 - ✓ In total, we gathered **138 respondents to the questionnaire**
 - ✓ The questionnaire covered the following topics:
 - Previous & Current strategy in China
 - Evaluation of the business environment (opportunities and threats)
 - Anticipation of future developments
- **A qualitative follow up :** in order to get more in-depth understanding of the findings from the quantitative research, several individual interviews were conducted to complete the survey. During the interview, the focus was on the various challenges the respondents had stated their company is faced with.

II. Executive summary



Executive summary (1/4)

- The results of French Chamber's first Business Climate Survey 2012 reveal that interviewed French companies are generally doing well. These French companies also seem to encounter various issues on the Chinese market. However, the majority of the expatriates from these companies express a global optimism about business in China.

- The three key messages from this survey and the comments made are the following:

- China is viewed as a more strategically important market than ever before.
 - ✓ Despite various challenges foreign companies may encounter, presence in China is a must...

"We do not have the choice. Our first market is about our XX machines, and nowadays, half of the XX machines around the world are made in China. We must be in China, and there is no choice. Then the question is how to do business in China and how to avoid the risks that goes with."

- ✓ ...Almost half of the interviewed companies report that their revenue results have significantly improved in 2011.
- ✓ Beyond being a "must", China is also **synonymous with huge opportunities in the future:**

"Activity and business prospect are excellent"/"Perspectives are optimistic"



Executive summary (2/4)

- **Challenges and difficulties have intensified.**
 - ✓ **Labor shortage is becoming a big issue for French companies in China**, especially for those with a significant revenue growth; 74% of the interviewed companies also recognize the challenge of **labor cost rising** more and more in China
 - ✓ **The protection of Intellectual Property rights is another serious issue during the development of these French companies in China**
 - ✓ The majority of the French companies interviewed acknowledge that they miss out business opportunities in China **due to regulatory barriers, market access, or even unequal license attributions**
 - ✓ French companies are also facing the **pressure of domestic companies, especially in terms of price**
 - ✓ Finally, nearly half of the respondents admit that the **RMB appreciation and inflation represent a significant risk to their activity ; and even more so for the macro economic environment**

“Any appreciation of the RMB has a direct impact on our margin”



Executive summary (3/4)

- **Optimism about the future growth in 2012 is however shared by most interviewed companies**
 - ✓ **Most companies are rather optimistic in terms of revenue growth for the coming years.**
 - Investments will improve, and companies plan to expand deeper into China
 - Above all, business in China for French companies has been profitable for almost half of them – still meaning there is room for improvement for the others...
 - ✓ **Greenfield activity companies claimed higher growth rates vs others in 2011**
 - Greenfield activity companies feel more optimistic regarding the future in terms of both productivity improvements and growth. They also feel more protected from IP rights infringement than JV companies do, more likely to meet copyright issues and interest conflicts

“Look at what happened to some of our French companies [...] A JV is simply more risky”



Executive summary (4/4)

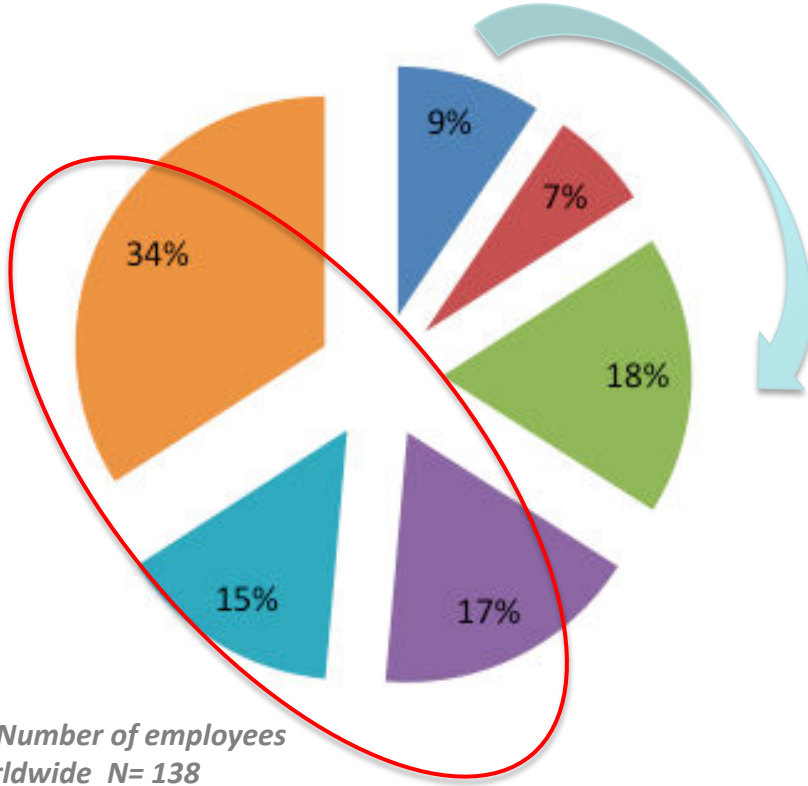
- In this survey report, the above key findings will be examined over three chapters:
 - **Chapter 1 Current picture of the French companies interviewed**
 - **Chapter 2 Challenges and difficulties in the chinese market**
 - 2/1 – Staff issues
 - 2/2 – Intellectual property challenges
 - 2/3 – Discrimination and market troubles
 - 2/4 – Local competition improvements
 - **Chapter 3 Market entry strategy : Greenfield vs JV/Acquisition**
 - **Chapter 4 Companies with high revenue forecast**

III. Who are the interviewed companies?



The majority of the interviewed companies are intermediate and large companies, with more than 250 employees worldwide. However, these enterprises are presented in China mostly in form of small companies with less than 250 employees

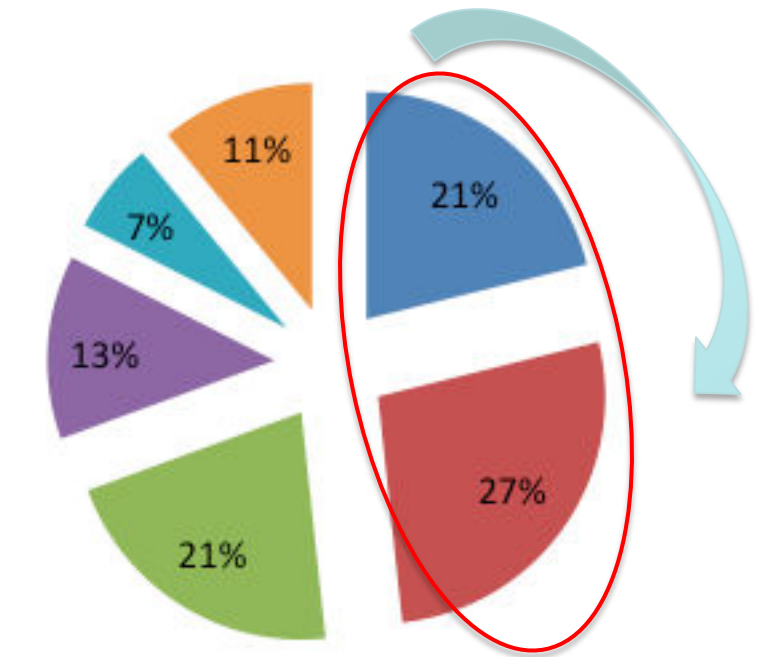
Number of employees - worldwide



Q3 Number of employees worldwide N= 138

- <10
- 10-50
- 50-250
- 251-1000
- 1000-5000
- >5000

Number of employees – mainland China



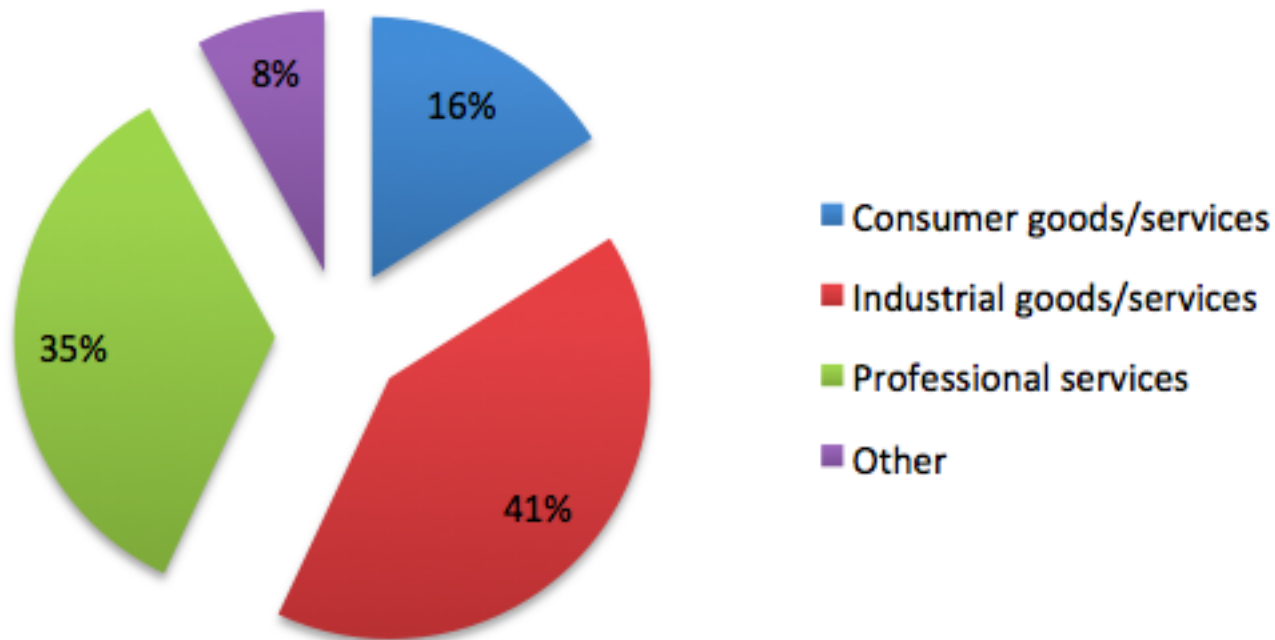
Q4 Number of employees mainland China N= 138

- <10
- 10-50
- 50-250
- 251-1000
- 1000-5000
- >5000

Most interviewed companies come from B2B activity such as industrial goods/services sectors and professional services sectors.

Repartition by sector

Repartition of the respondents



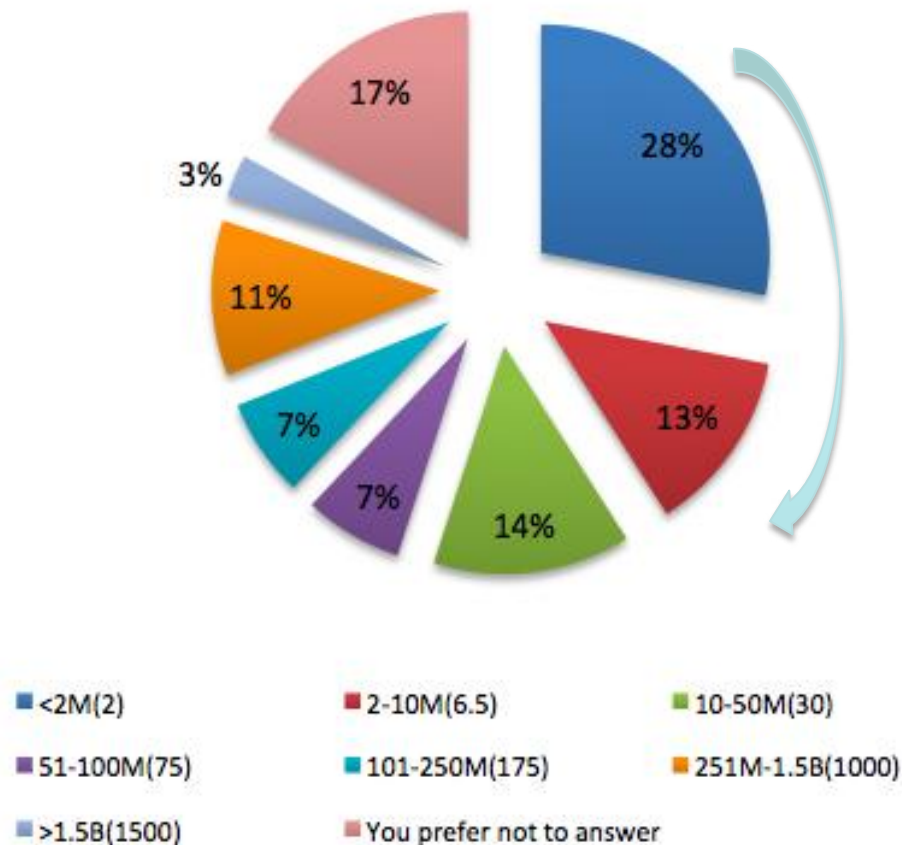
Q1 Industry's sector

N= 138



When it comes to annual turnover in China, over half of the interviewed companies generate less than 50M Euro , half of which only generate less than 2M euro annually

Annual turnover 2011 (Euro) - China



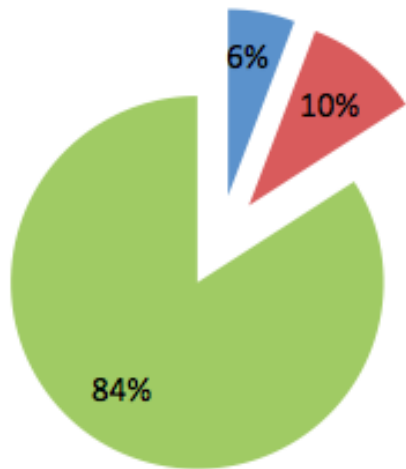
Q12 Annual turnover 2011 in Euro

N= 138

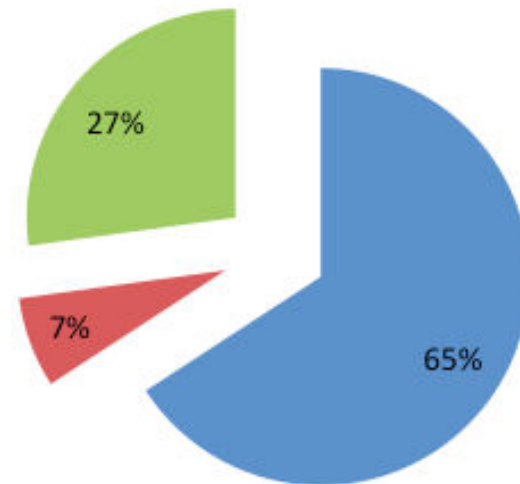


In terms of legal status, most of the interviewed companies have a physical presence in China. The most common pattern adopted by French companies is WFOE/WOFE, followed by Joint Venture

Legal status of French companies in China



- Supply the Chinese market from France/overseas
- Have representation and / or partner in-market
- Have a physical presence in China



- WFOE/WOFE
- Foreign Invested Commercial Enterprise
- Joint Venture

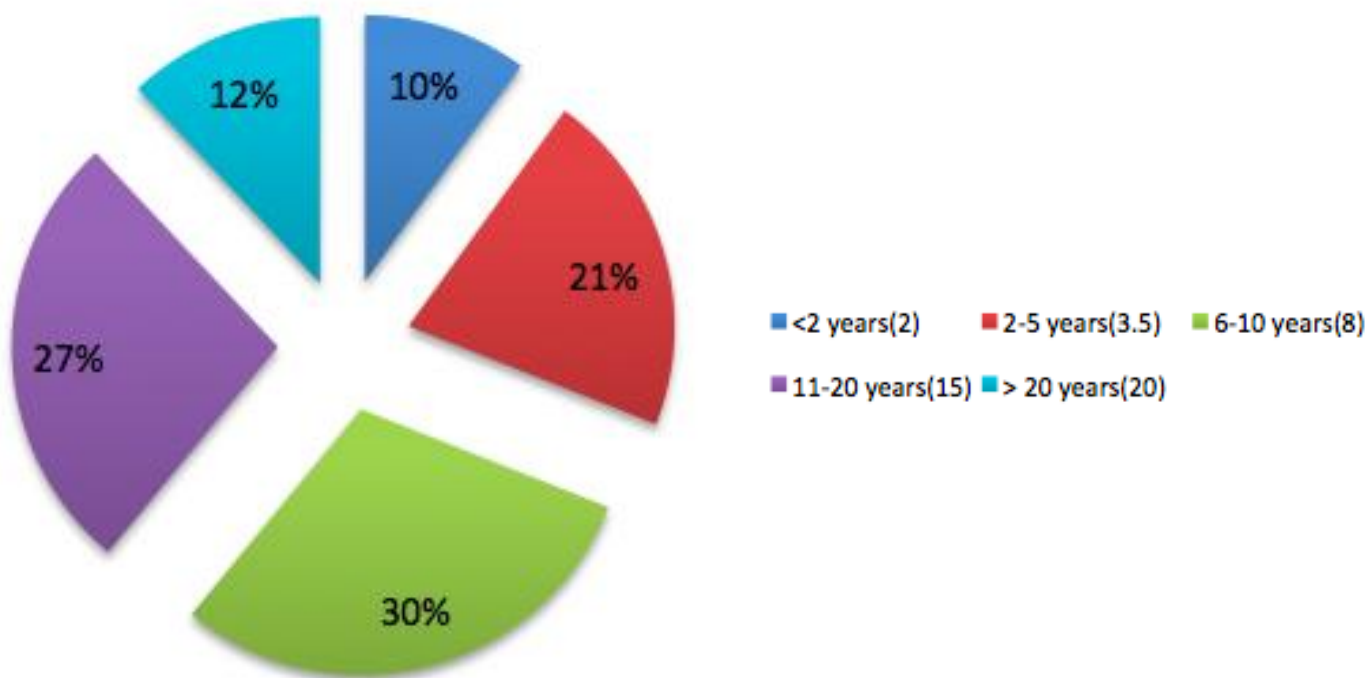
Q5 Legal status

N= 138

*WFOEs are often used to produce the foreign firm's product in mainland China for later export to a foreign country. They do not automatically have the right to distribute their products in mainland China, though a recent variant (the Foreign Invested Commercial Enterprise FICE) has the ability to do so.

69% of the interviewed companies have been operating in mainland China for more than 5 years, and over a third more than 10 years. Only one third of the interviewed companies came to China recently

Length of operation in China

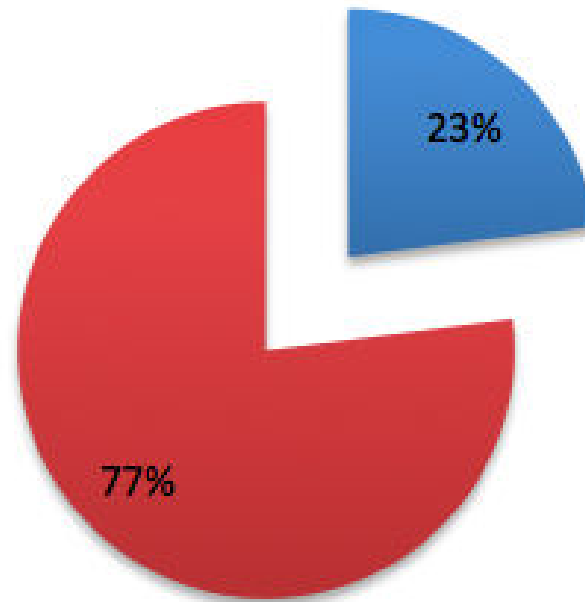


Q7 Length of operation

N= 138

Among all the interviewed companies, only 23% built up an R&D center in China. The majority haven't started their R&D activity in China so far.

R&D center in China



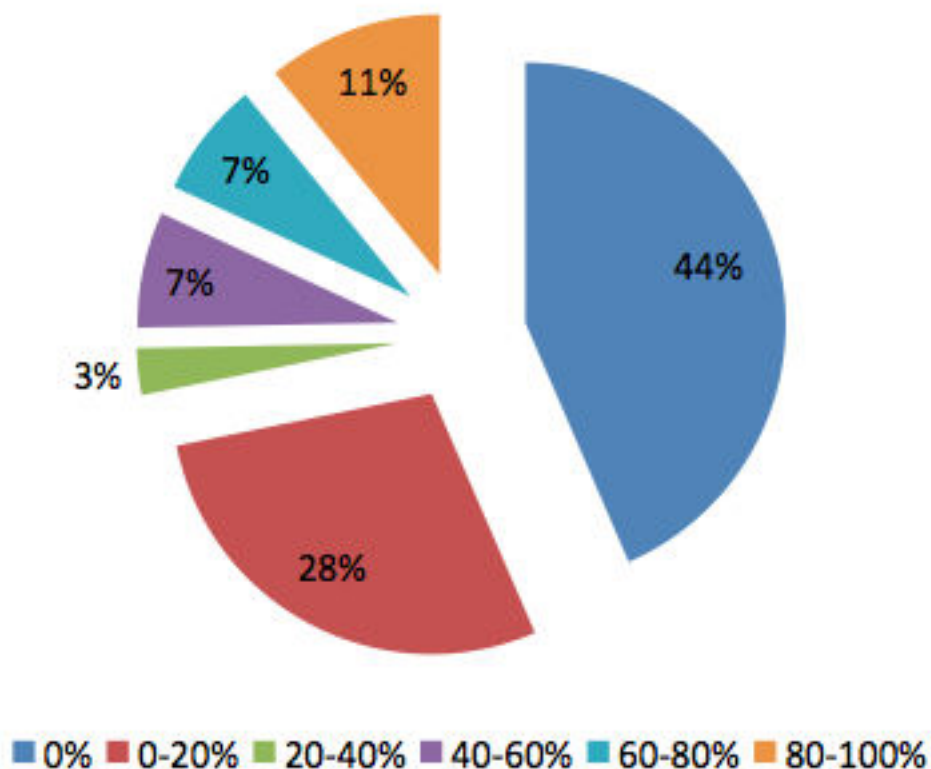
Q20 R&D center in China

N= 138

■ Yes ■ No

Over half of the interviewed French companies generated revenue from export in 2011. For the majority of these companies, export represents 0-20% of their total revenue in 2011. There are still 43% of the sample that do business only within China

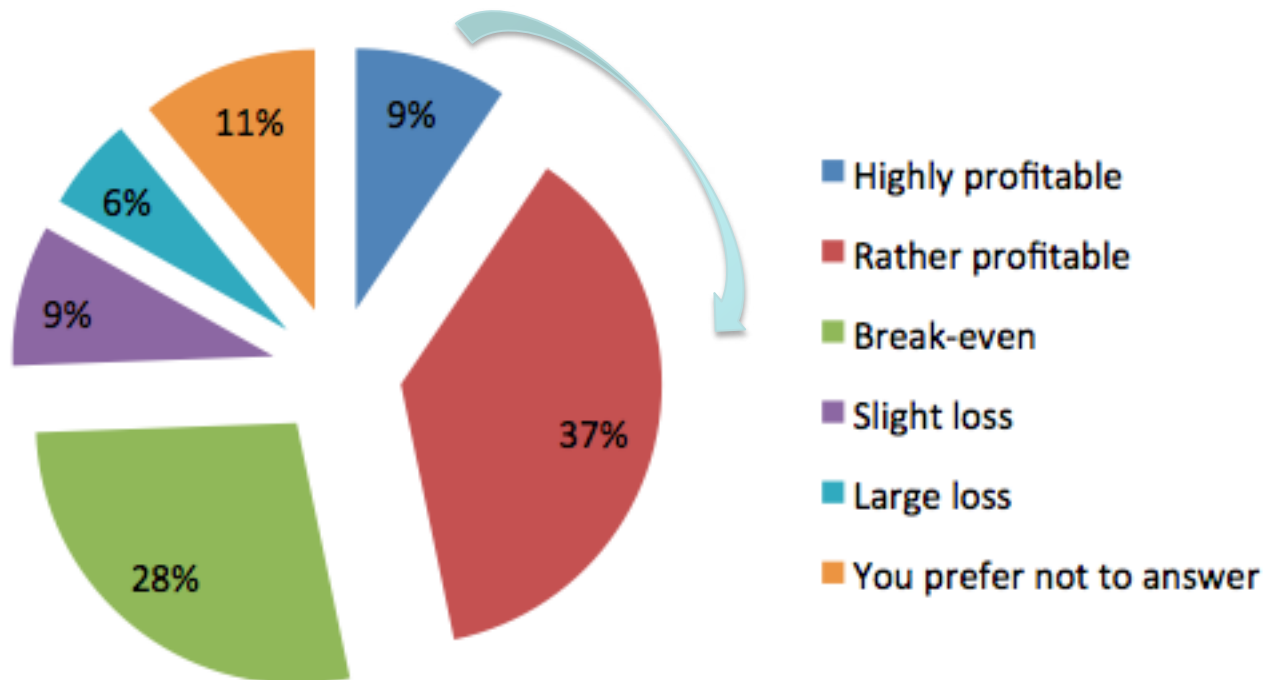
Proportion of revenue generated from export





Overall, the financial performance of the interviewed companies can be read like a glass half full, half empty : 2011 seemed profitable for almost half the companies. Meaning over half of French companies are still in need of getting to or above breakeven.

Financial performance in 2011

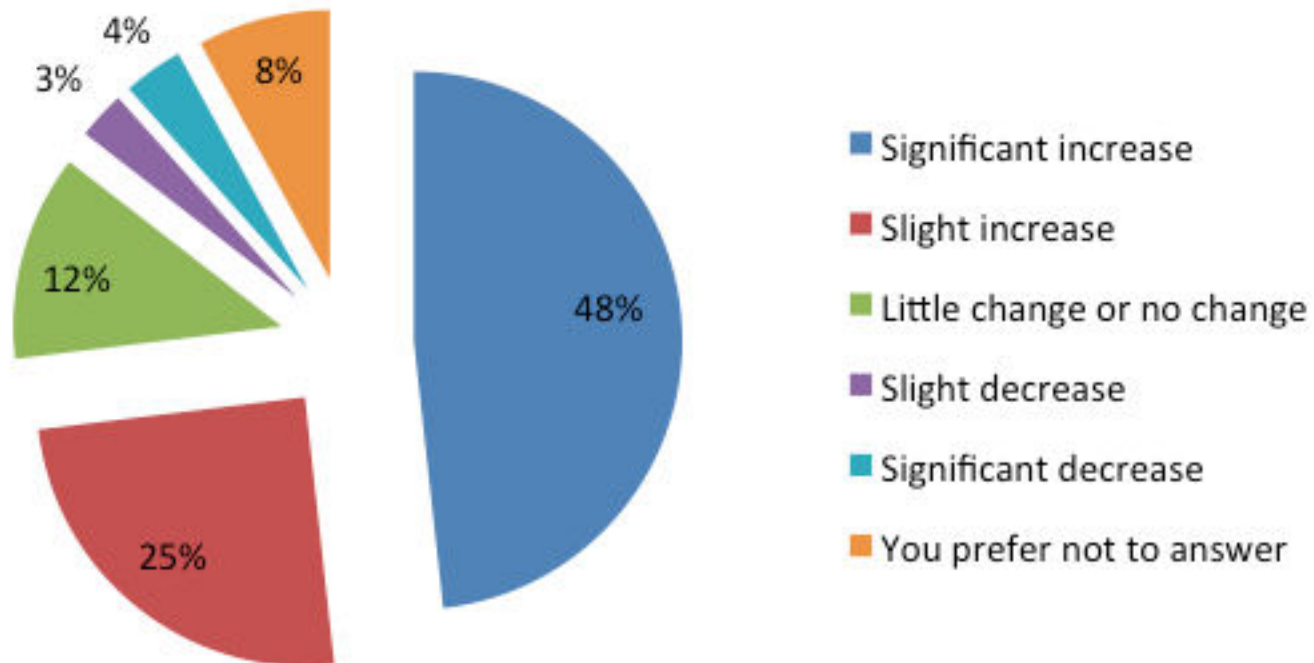


Q17 Financial performance

N= 138

A general healthy revenue dynamics : 3/4 of responding French companies in China claimed an improvement of their revenue in 2011, almost half stated it a significant increase.

2011 Revenue improvement

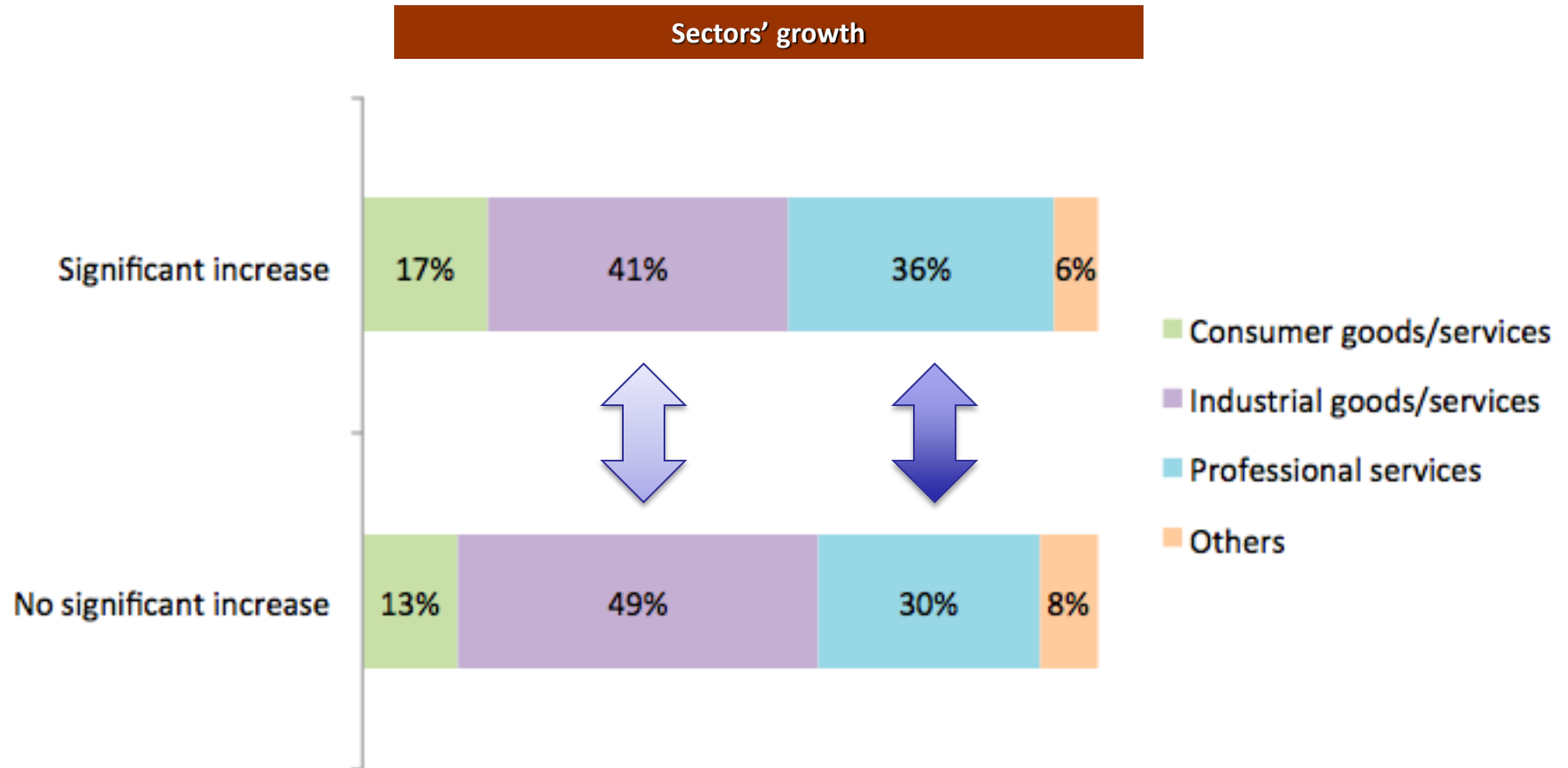


Q13 Revenue 2011

N= 138



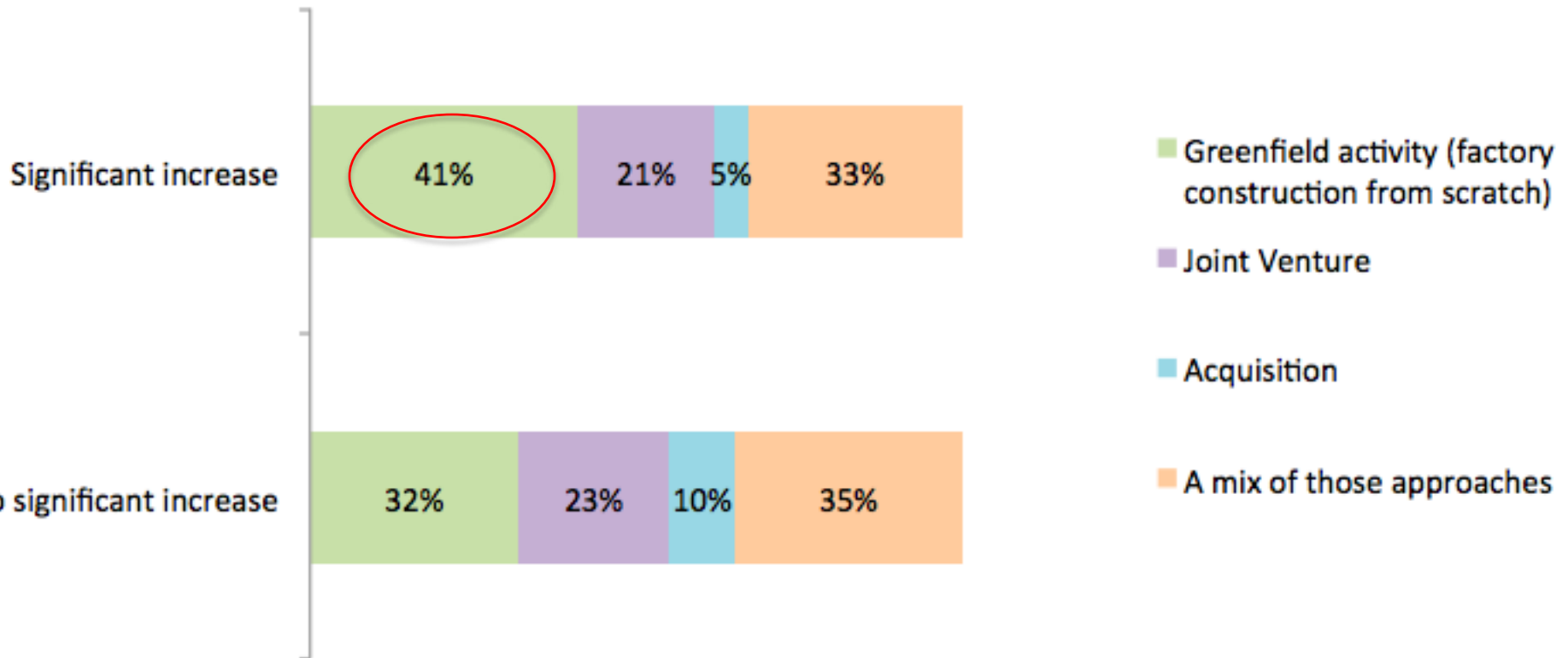
Operating on high growing market sectors is one of the elements that can contribute to revenue growth. These high growing market sectors are particularly services and new sectors (ex. Banking, consulting, biotechnology)



Q13/Q2 N= 138

Among those companies that witnessed a significant increase, there are more companies that adopted a greenfield strategy

Primary market entry strategy



Q13/Q24 N= 138

V. *Challenges and difficulties on the Chinese market*

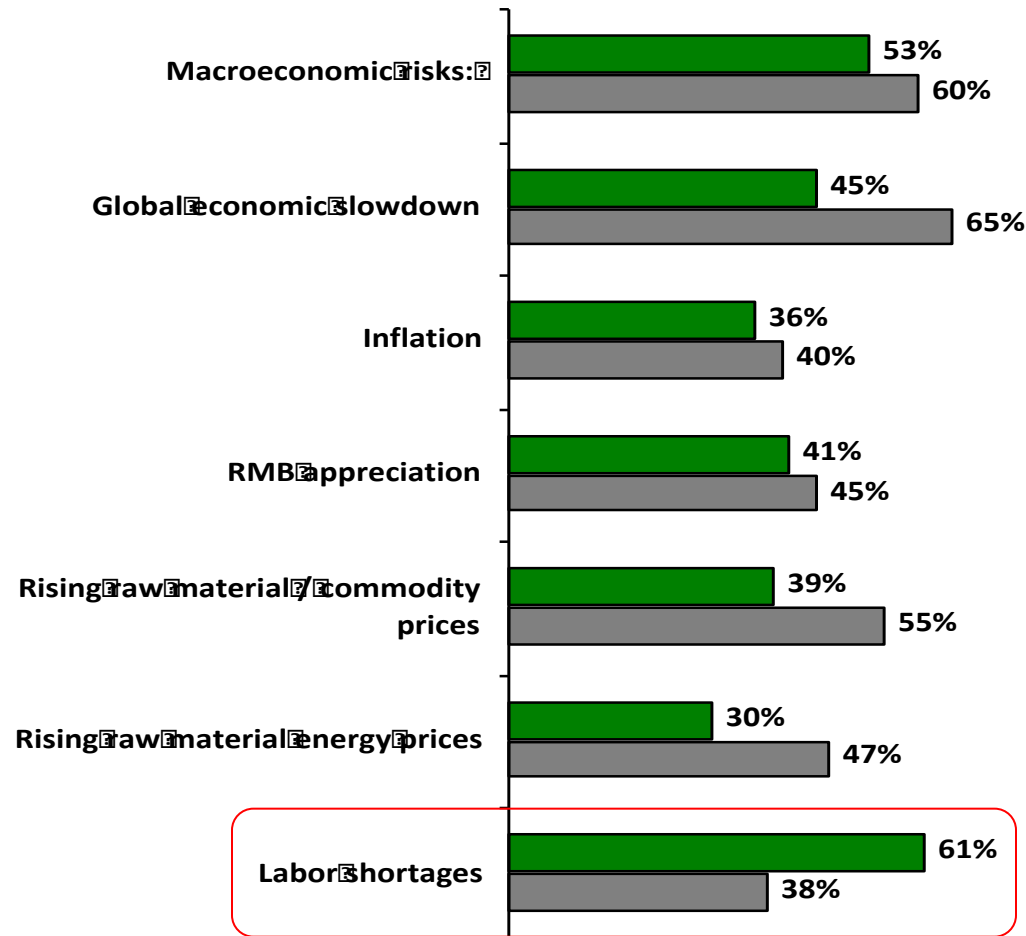
- 1. Staff issues*
- 2. Intellectual property challenges*
- 3. Discrimination & market troubles*
- 4. Local competition improvements*

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Obviously, macro economic environment is more of a concern for slower developing companies, whereas labor shortage is number 1 risk for faster developing companies

■ 2011 Revenue Significant Increase ■ No Significant Increase

% of 'this risk is significant'

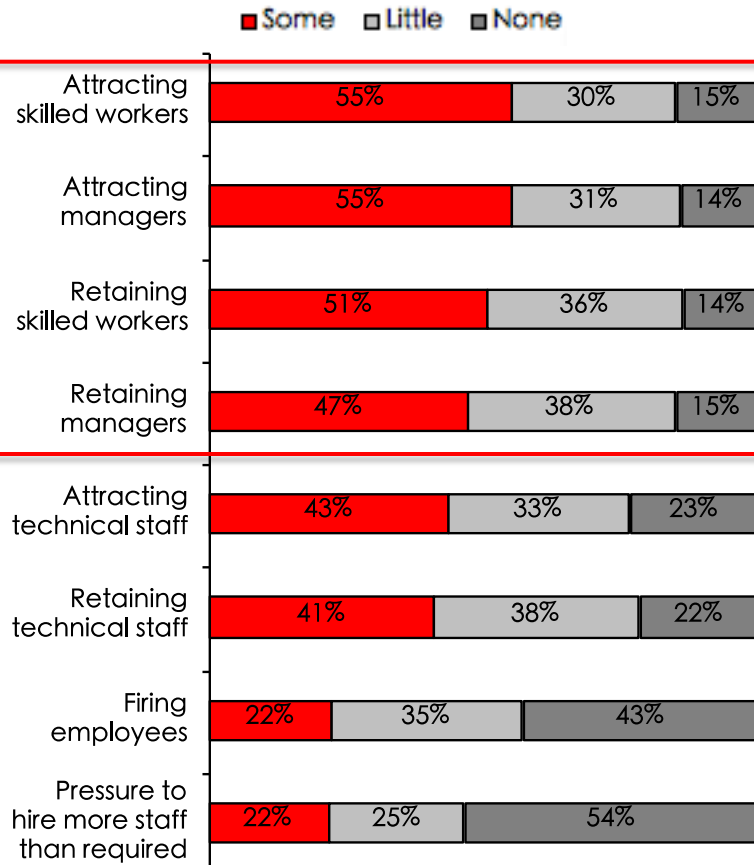


Q13/Q24 N= 138



And for most companies, human resource challenges deal first with attracting talents, then retaining them.

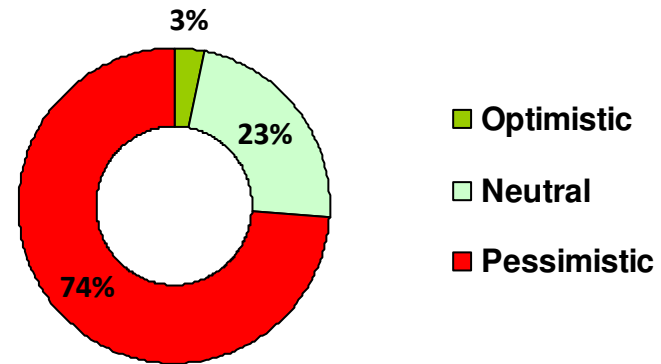
Besides, a good $\frac{3}{4}$ of these companies anticipate a further rise of labor costs



Human Resource main challenges

Q40 With regard to HR, have you experienced any difficulties in the following areas? N= 138

Connection creates value



Business outlook toward the labor costs evolution

Q43 Labour costs evolution – next two years N= 138

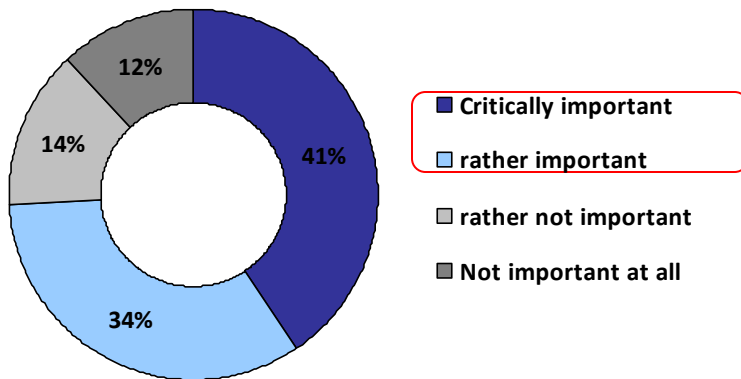
V. *Challenges and difficulties on the Chinese market*

- 1. Staff issues*
- 2. Intellectual property challenges*
- 3. Discrimination & market troubles*
- 4. Local competition improvements*

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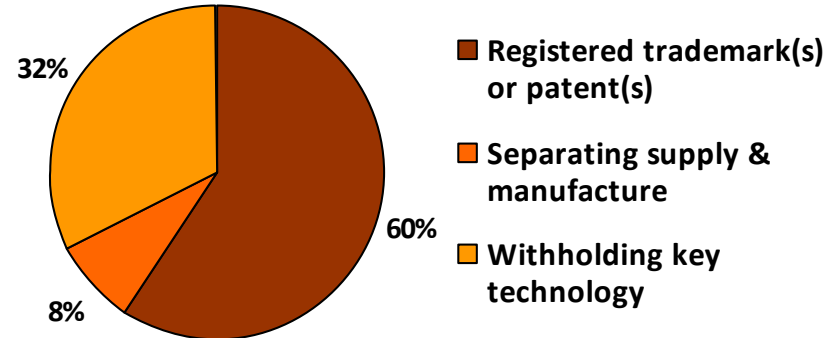
Second, intellectual property is given great importance by the majority of the interviewed companies. Various solutions have been adopted in order to protect their intellectual property.

Importance of IP rights in China



Q32 N= 138

Mechanisms thus put in place to protect IP



Q33 N= 138

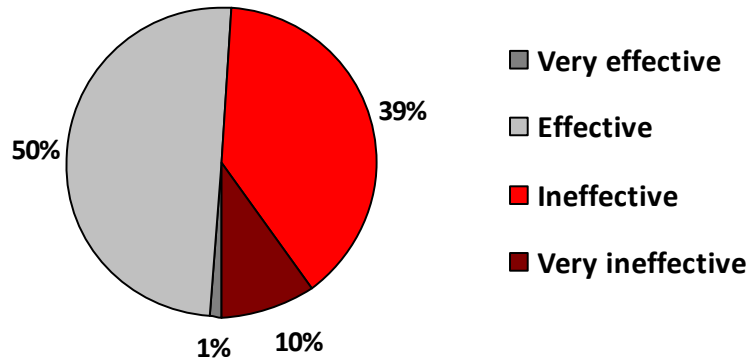
IT company

- *"This is a really sensitive topic"*
- *"We remain careful in the development of our Chinese branch. If the legal environment was more trustful, maybe we would invest more"*
- *"This is the Far-West – one should be prudent"*



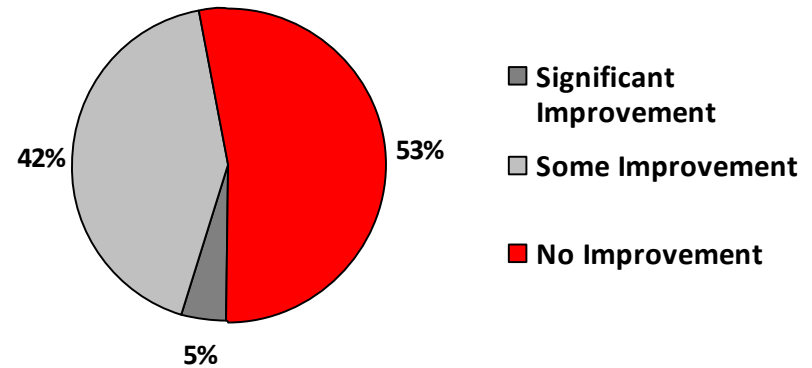
And French companies are really split when it comes to both the efficiency of the mechanisms put in place to protect IP, and the improvement of enforcement of the IP rights

Effectiveness of the IP protection put in place



Q39 N= 138

Business challenges improvement – Enforcement of IP rights



Q34 N= 138

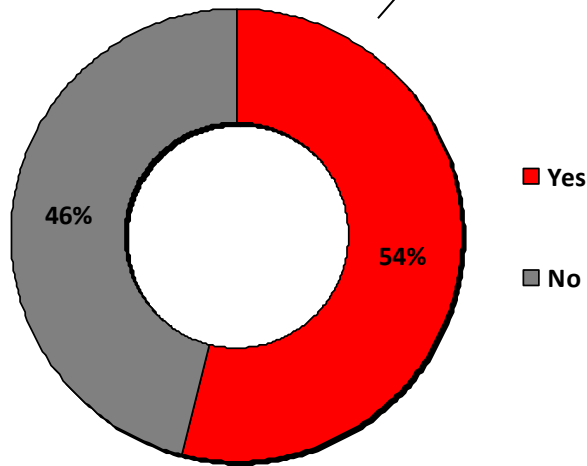
- *“In China we patent our new products, however we are more protected by the technological content of these products rather than by their exclusive rights” – Equipment company*
- *In case of IP infringement, “we can attack directly the Chinese company, however this is not the option we will take since it is dangerous, long and without any guarantee to recover the loss” - Logistics company*

V. *Challenges and difficulties on the Chinese market*

1. *Staff issues*
2. *Intellectual property challenges*
3. ***Discrimination & market troubles***
4. *Local competition improvements*

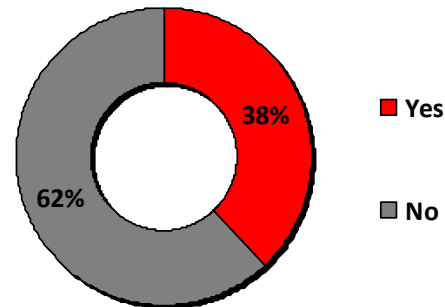
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Third, due to regulatory barriers and market access, a majority of French companies interviewed admit that they have missed opportunities on the Chinese market ; even more so for the larger and longer established ones.

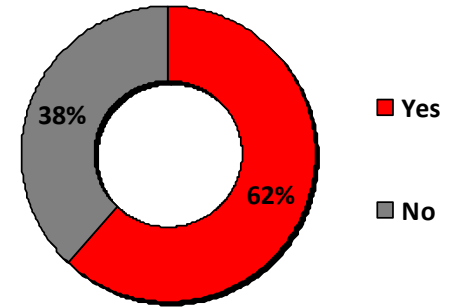


1. Affect most large companies than small ones

Small companies (<2M turnover)

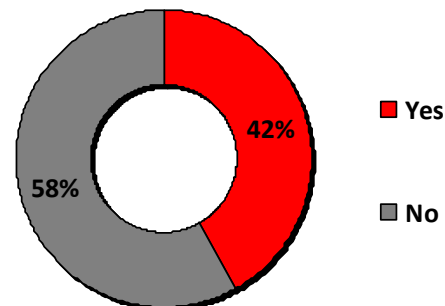


Large companies (>51M turnover)

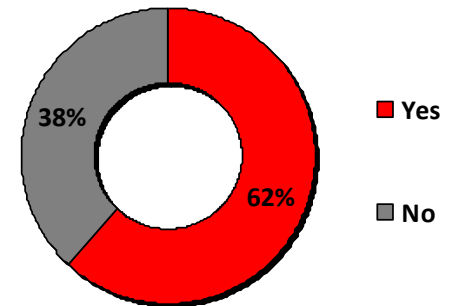


2. Affect companies operating in China for a long time

In China for less than 5 years

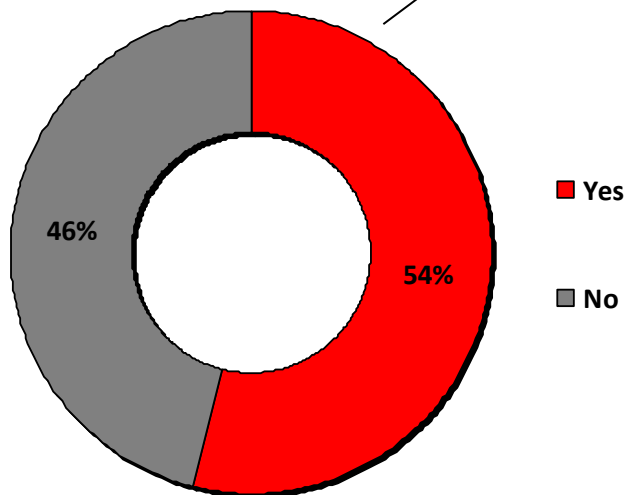


In China for more than 10 years





Third, due to regulatory barriers and market access, a majority of French companies interviewed admit that they have missed opportunities on the Chinese market ; these challenges come in different shape...



- French companies interviewed generally identify different **kinds of barriers** when they operate in China, among which :
 - ➔ **Non-custom barriers** such as governmental regulations or precise norms

“The regulation of some product makes it difficult for us to enter the market”
 - ➔ **Public Market unequal treatments** that are likely to exclude foreign companies (a kind of economic nationalism)

“From the beginning, we are already aware that a domestic company would win the pitch”



Third, due to regulatory barriers and market access, a majority of French companies interviewed admit that they have missed opportunities on the Chinese market ; these challenges come in different shape...

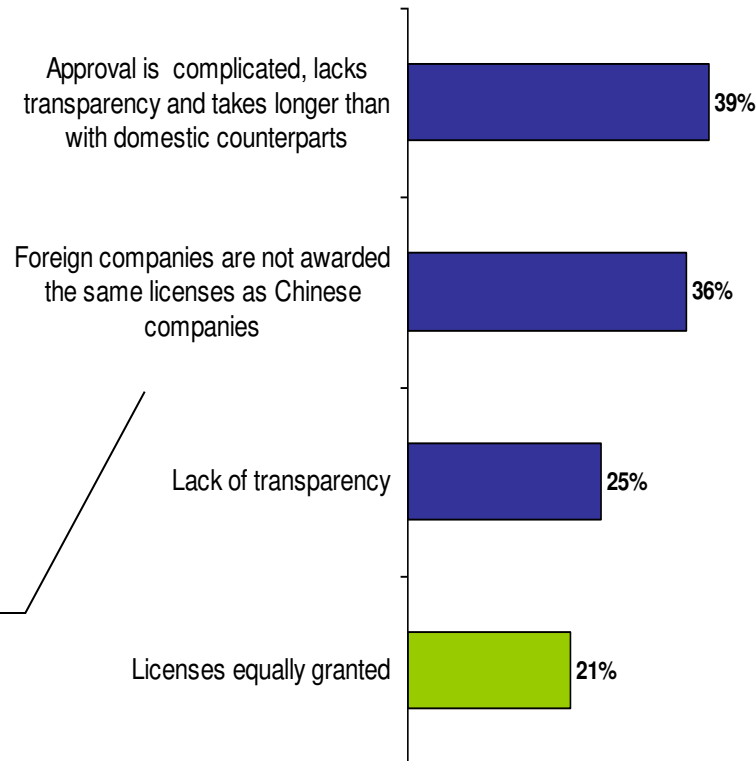
→ **Forbidden activities for foreign operators.**

i.e computing and housing sectors are not open for foreign companies

→ **Custom barriers** that block imported products for French companies in China

→ **A licensing procedure that favors domestic companies over foreign invested companies.**

French companies struggle to obtain all their licenses.



V. *Challenges and difficulties on the Chinese market*

- 1. Staff issues*
- 2. Intellectual property challenges*
- 3. Discrimination & market troubles*
- 4. Local competition improvements*



When competing with domestic companies, French companies keep an advantage in terms of product, brand recognition and service ; while price remains as the key differentiator for local companies

Key advantages of domestic companies

Top 3

1. Pricing	29%
2. Marketing and sales	13%
3. Product quality innovation and design	10%

Key advantages of French companies

Top 3

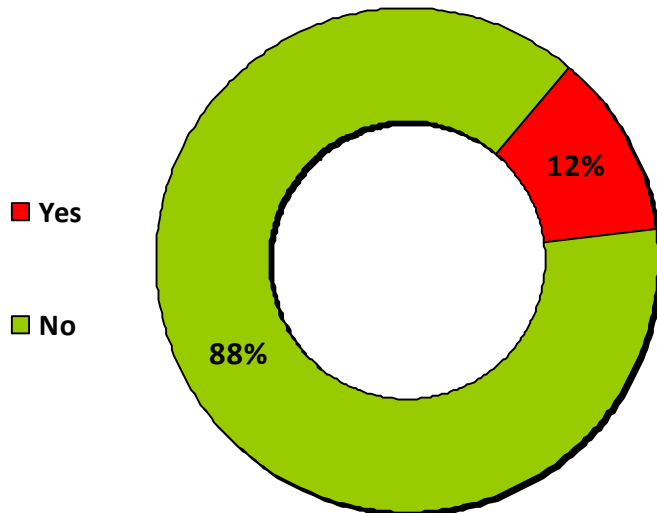
1. Product quality innovation and design	21%
2. Brand recognition	19%
3. Customer services	12%

“We propose products of good quality... but the price of domestic companies is often more competitive. ” - Equipment company



But finally, despite the challenges, French companies operating in China still intend to maintain all their activities in China instead of looking for relocation

Is your group considering relocating all or part of your capacity to other countries?



Even though French companies operating in China face several issues, only a small proportion plans to relocate their activity.

“when you have already invested millions in China, you hope it to generate profit for you”.

Nevertheless, the 12% that consider relocation :

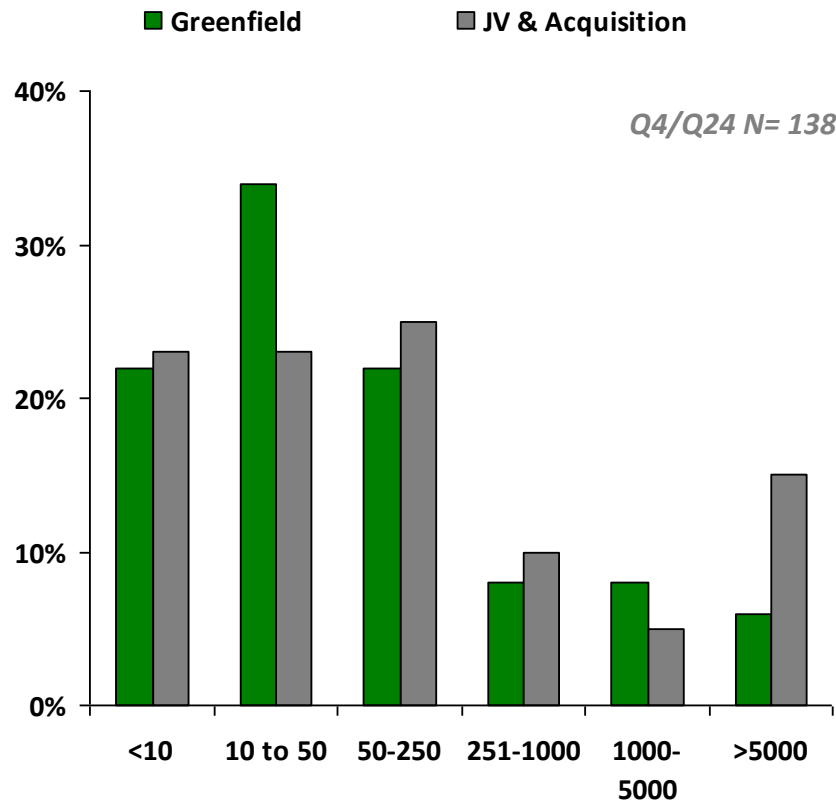
- Mostly plan to **stay in Asia Pacific** (excluding India)
- Plan to relocate in order to **reduce production cost** or to **avoid some troubles related to customs**. In that case, they prefer to choose Hong Kong where companies encounter less difficulties

VI. Market entry strategy: Case study of Greenfield vs. JV & Acquisition



Greenfield companies are mostly small companies with still limited businesses

Number of employees - China

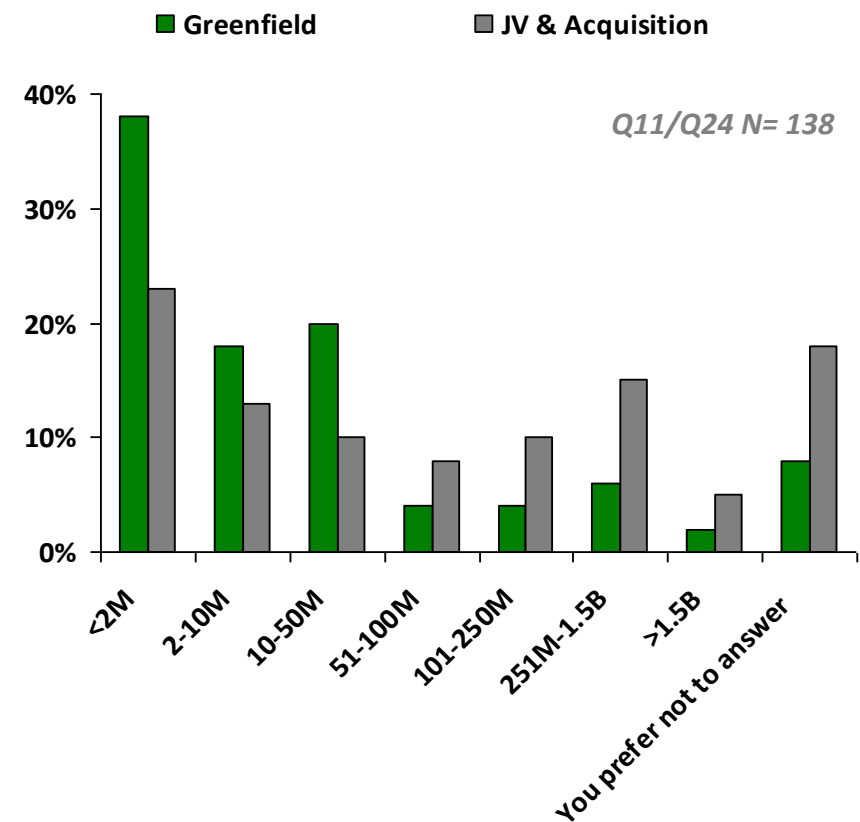


Mean:

635

1009

Turnover (in Euro)- China



Mean:

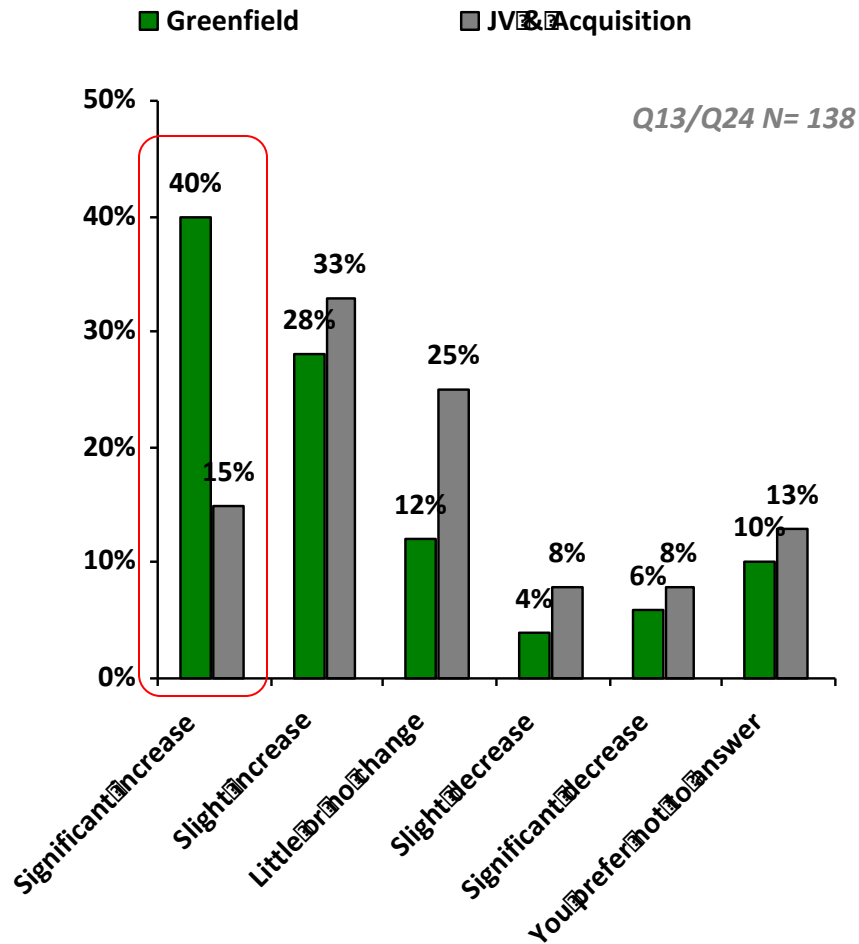
117M

306M

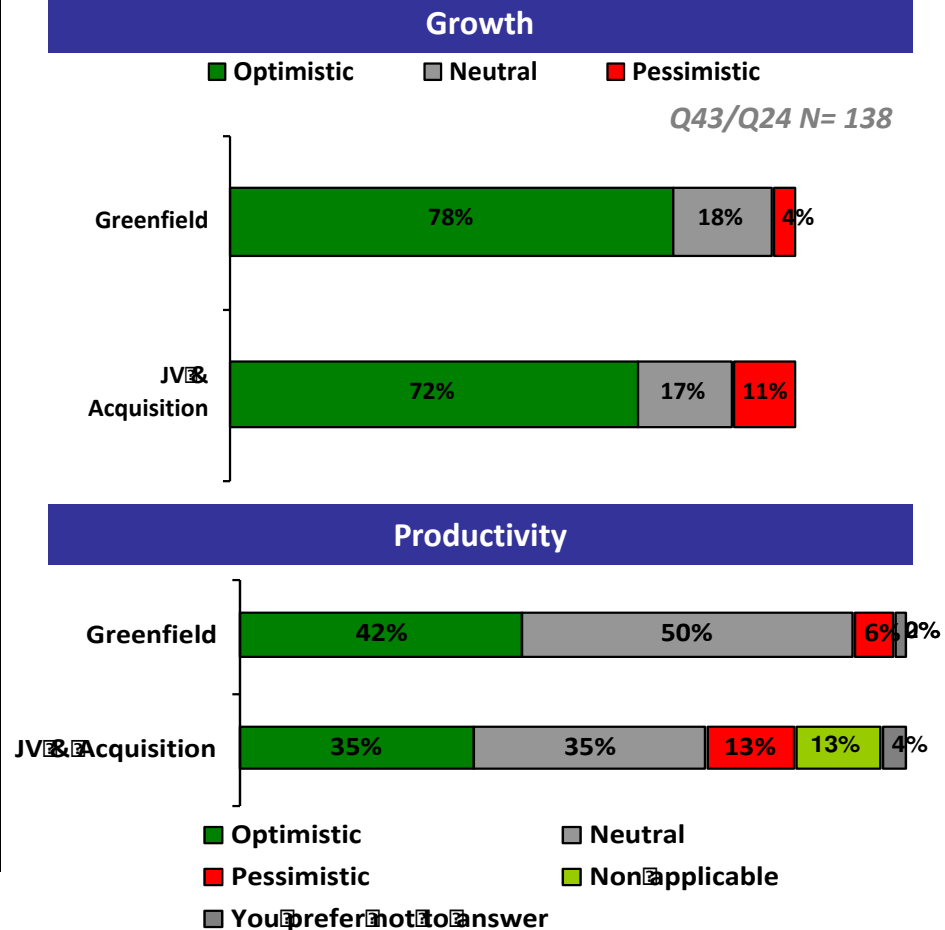
ifop

Greenfield activity companies had in general higher income improvement in 2011 than JVs and appear to be more optimistic towards economic growth and productivity for the coming years.

Overall net income evolution in 2011



Business Outlook





JV: a strategic market insertion or a risky strategy?

- The convenience of JV is clearly perceived by the interviewed French companies:
- It allows a foreign company to settle down in China more easily and quickly with the help of local partners who have sufficient knowledge of the market
- However, a lot of companies believe that finding a good partner is a critical footing stone of this strategy

"The main advantage of a JV is the simplicity and the rapidity of the settlement" Y.Y - Logistics

"The interest of a JV is to work with a Chinese company that knows the market well which normally lets you increase your trading channels" Z.Z - IT

- In the meantime, some companies have also expressed their concerns of this form of union:
- They mainly worry about the infringement of intellectual property right by local partners which often leads to a break-up of the two companies in the long term

"JVs are not trustful"

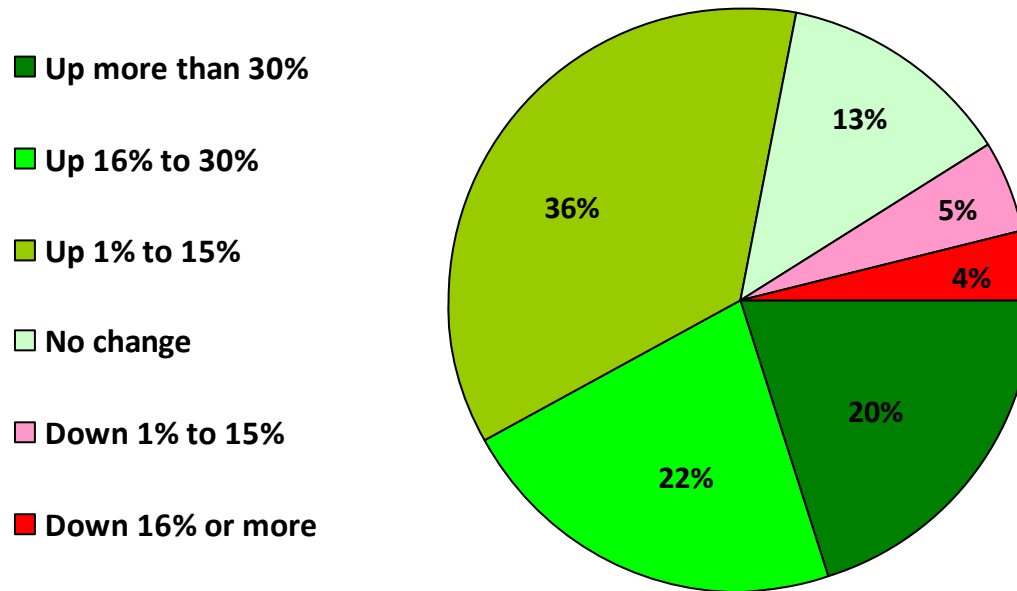
Concerning the transfer of technology, "The main risk is that your Chinese partner leaves you" Y.Y - Logistics

"When you do a Joint Venture, you are more likely to face interest conflicts or even IP right infringements"

VII. Companies that forecast revenue growth in 2012

The majority of the interviewed companies have expressed a quite optimistic outlook on their revenue growth in 2012

Revenue forecast for 2012

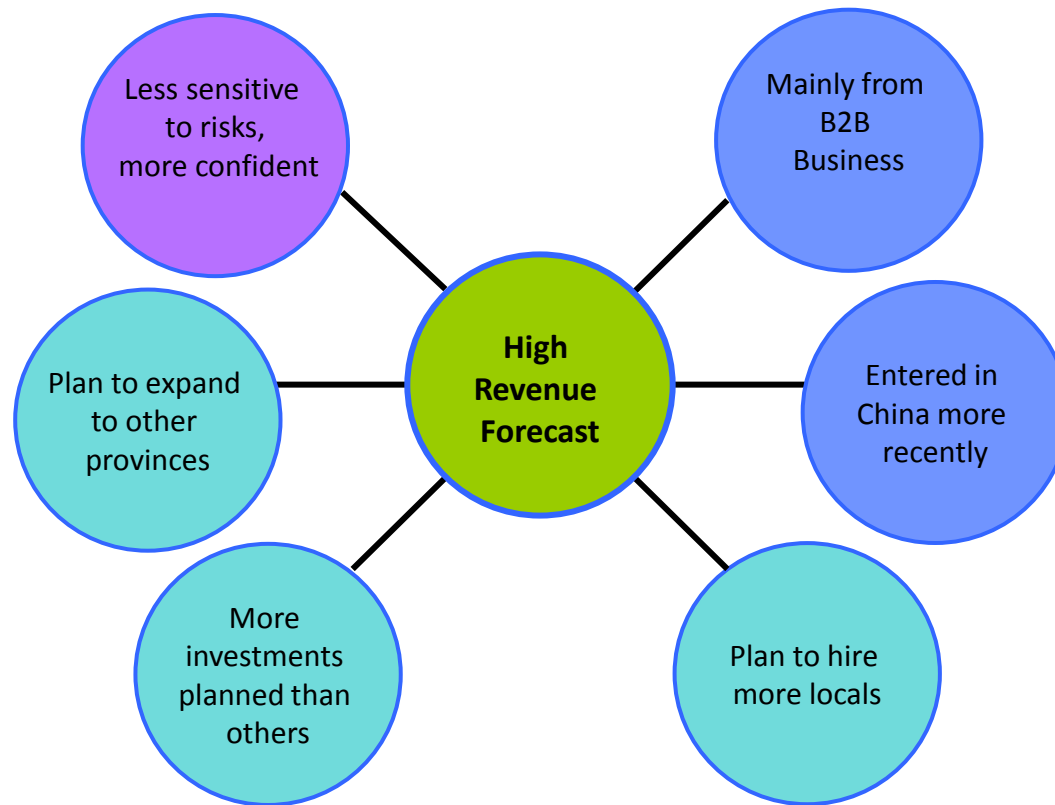


Q45. Revenue forecast 2012 as opposed to 2011

N = 138



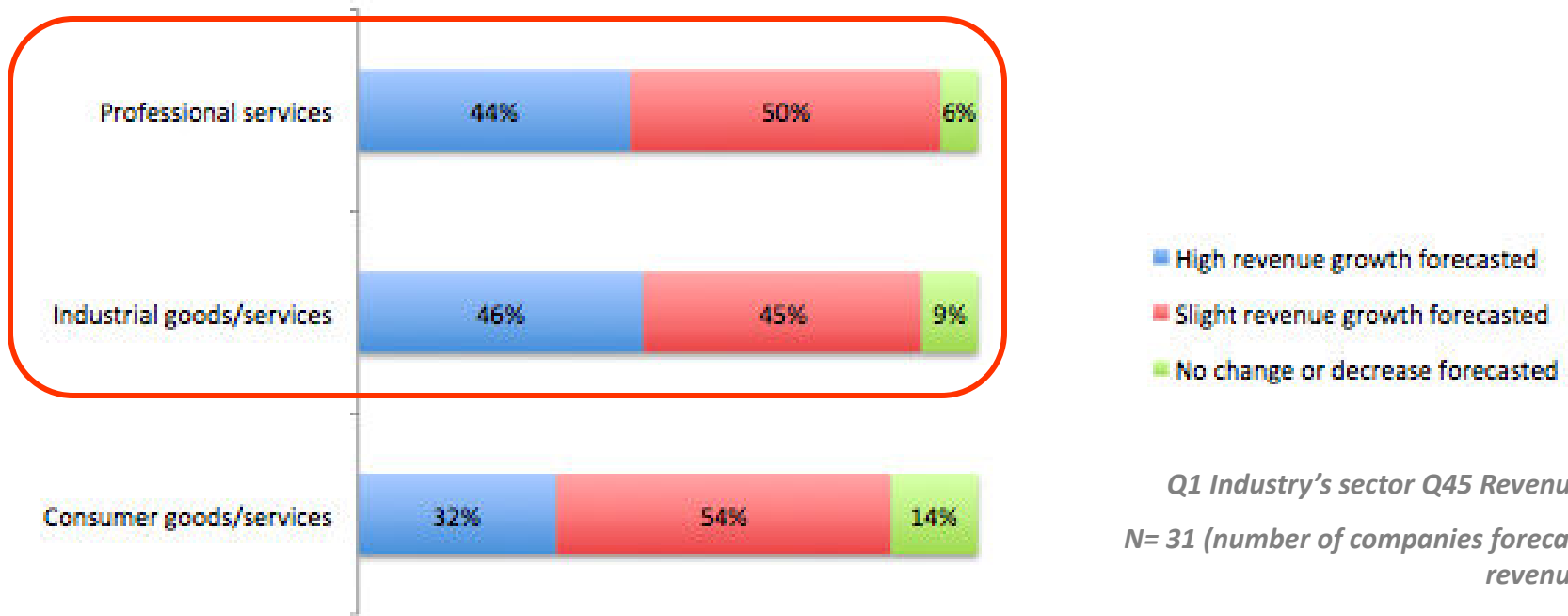
Who are these companies that forecast a high revenue growth in 2012 (up more than 16%)?





These companies that forecast a high revenue growth in 2012 mostly come from B2B goods and services sectors, and especially sectors with strong growth

Industry – by groups



Q1 Industry's sector Q45 Revenue forecast

N= 31 (number of companies forecasting high revenue growth)

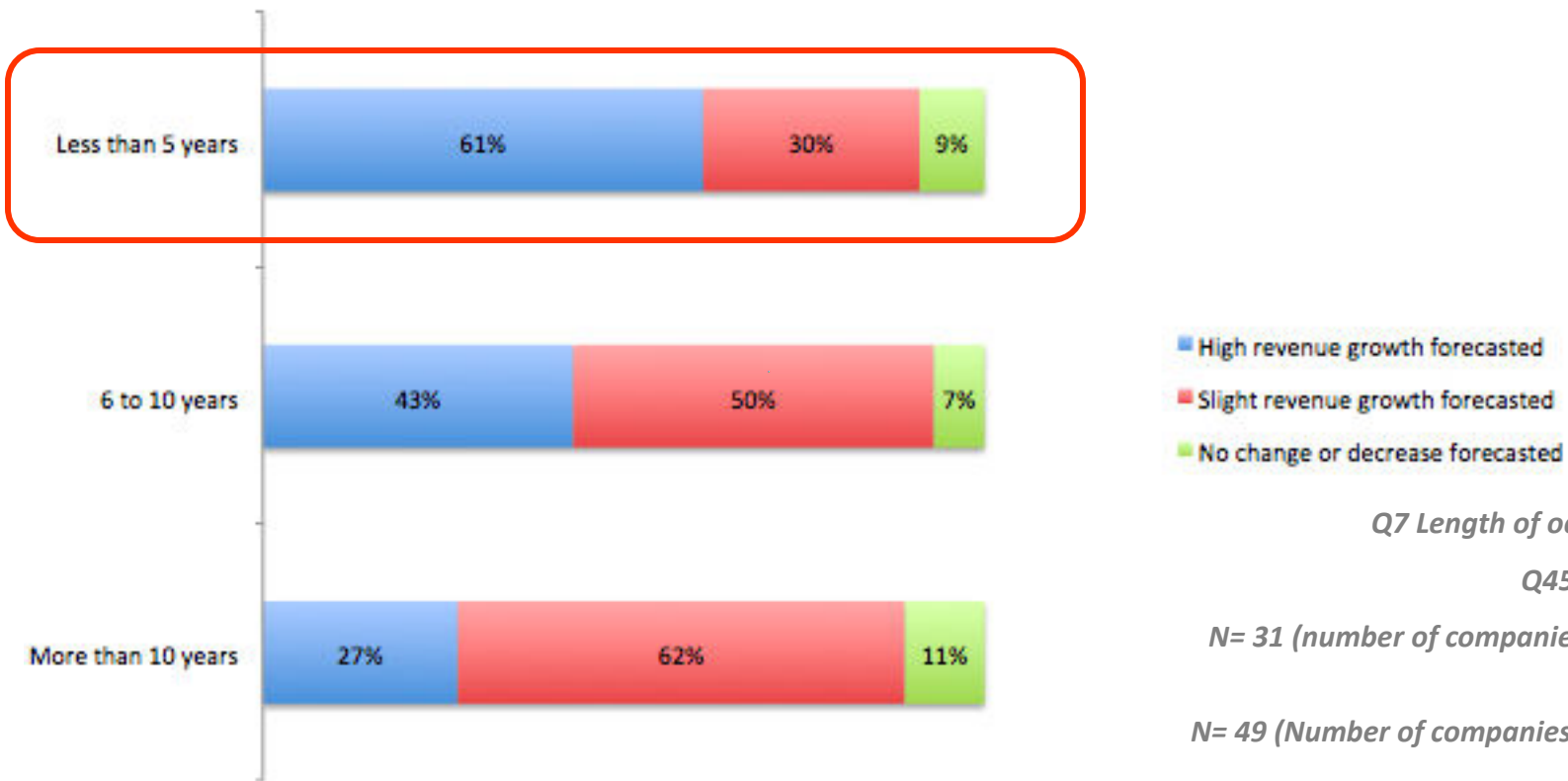
N= 49 (Number of companies forecasting slight revenue growth)

N= 58 (number of companies forecasting no change or revenue decrease)

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New comers seem to be more optimistic towards revenue growth than long-established companies who have been operating in China for more than 5 years.

Length of operation in China – by groups



Q7 Length of occupation in China

Q45 Revenue forecast

N= 31 (number of companies forecasting high revenue growth)

N= 49 (Number of companies forecasting slight revenue growth)

N= 58 (number of companies forecasting no change or revenue decrease))



Companies who forecast a high revenue growth plan to increase their investment in China significantly

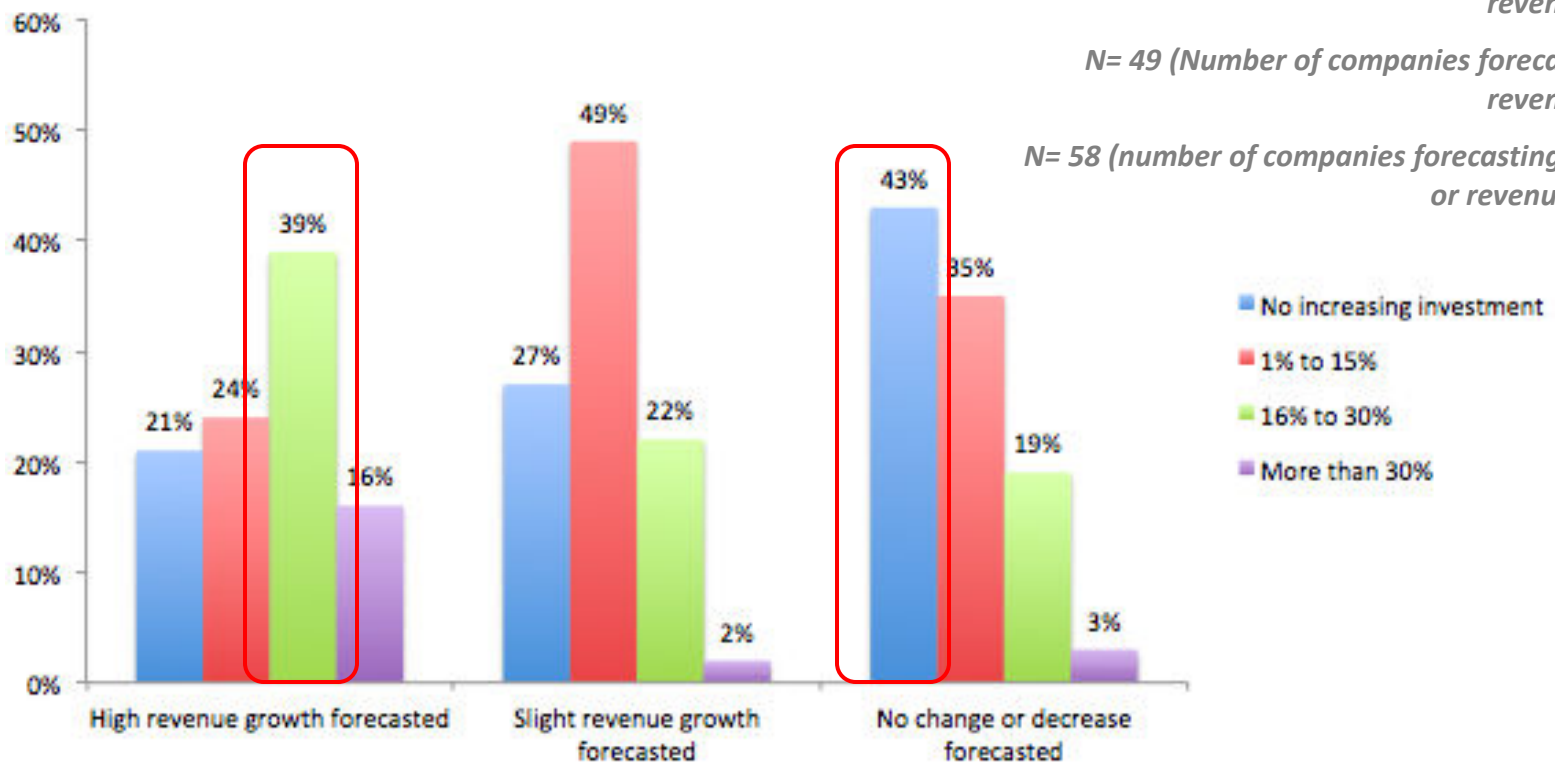
Plan for further investment

Q44 Investment improvement China 2012 Q45
Revenue forecast

N= 31 (number of companies forecasting high revenue growth)

N= 49 (Number of companies forecasting slight revenue growth)

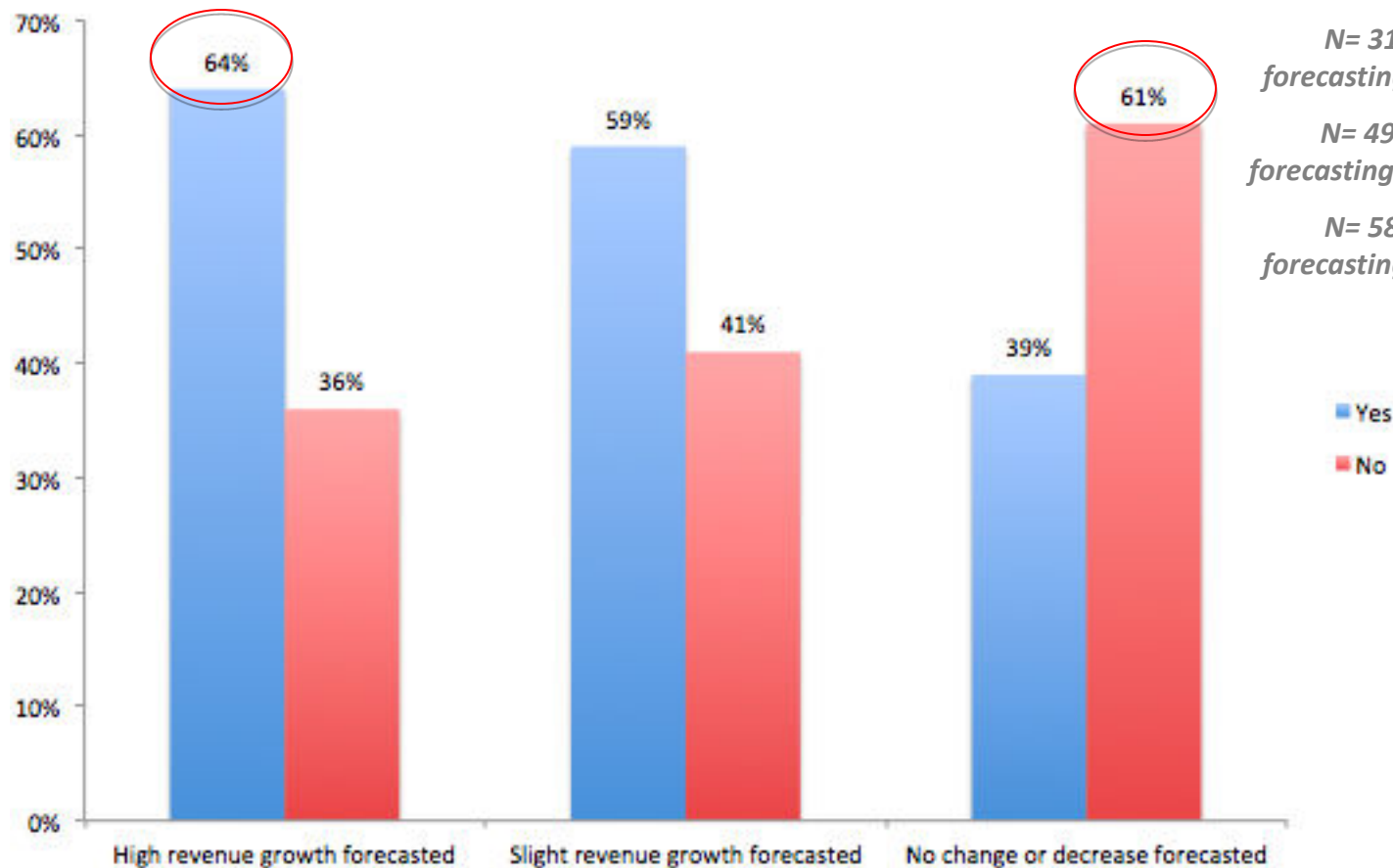
N= 58 (number of companies forecasting no change or revenue decrease)





They also plan to expand across other PRC provinces

Plan to expand to other PRC provinces



Q29 Plan to expand in China Q45
Revenue forecast

N= 31 (number of companies
forecasting high revenue growth)

N= 49 (Number of companies
forecasting slight revenue growth)

N= 58 (number of companies
forecasting no change or revenue
decrease)

■ Yes
■ No

ifop

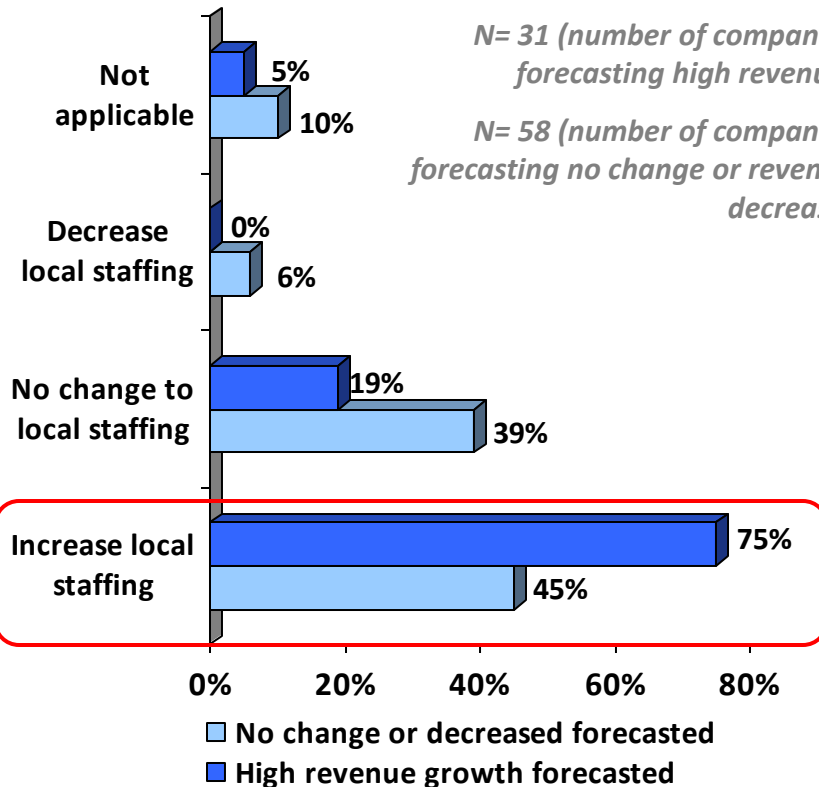
companies with high revenue growth forecast also show even stronger willingness to recruit local staffs and maintain expat staffing

Increased level of new local hires in China for 2012

Q47 Local hires improvement China
2012 Q45 Revenue Forecast

N= 31 (number of companies
forecasting high revenue)

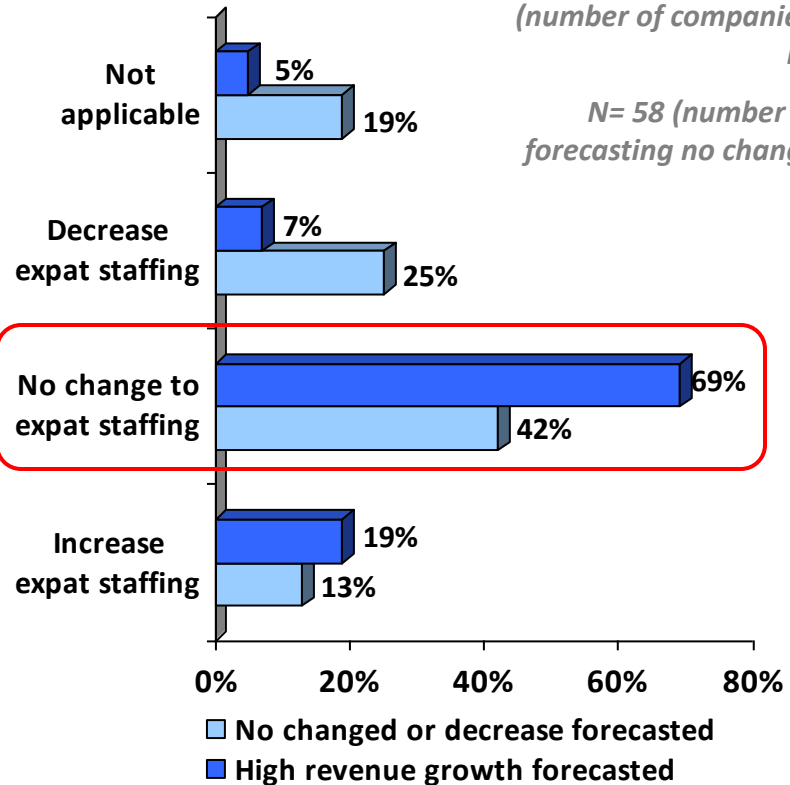
N= 58 (number of companies
forecasting no change or revenue
decrease)



Increased level of new expatriate hires in China for 2012

Q48 New expatriates hires
improvement China 2012 Q45 N= 31
(number of companies forecasting
high revenue)

N= 58 (number of companies
forecasting no change or revenue
decrease)



ifop

Beyond a different identity, those companies forecasting a high revenue growth also display a different appreciation of risks compared to the others : only shared those dealing with labor, payments, cost of money. They tend to feel more immune to other macro economic environment factors

Which of those risks are significant?

