



CEIBS 2012 SURVEY

Challenges and Success Factors for Foreign Companies in China

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中欧国际工商学院

China Europe International Business School

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LETTER FROM THE RESEARCH TEAM

We are pleased to present our second annual CEIBS Survey on the 'Challenges and Success Factors of Foreign Enterprises in China'.

We would like to thank all respondents for their valuable contribution to the survey. In particular we thank the CEIBS alumni community and current EMBA/EDP students that have supported this research. In addition, our sincere gratitude is extended to the institutions and organizations that have participated in this work. They are (in alphabetical order):

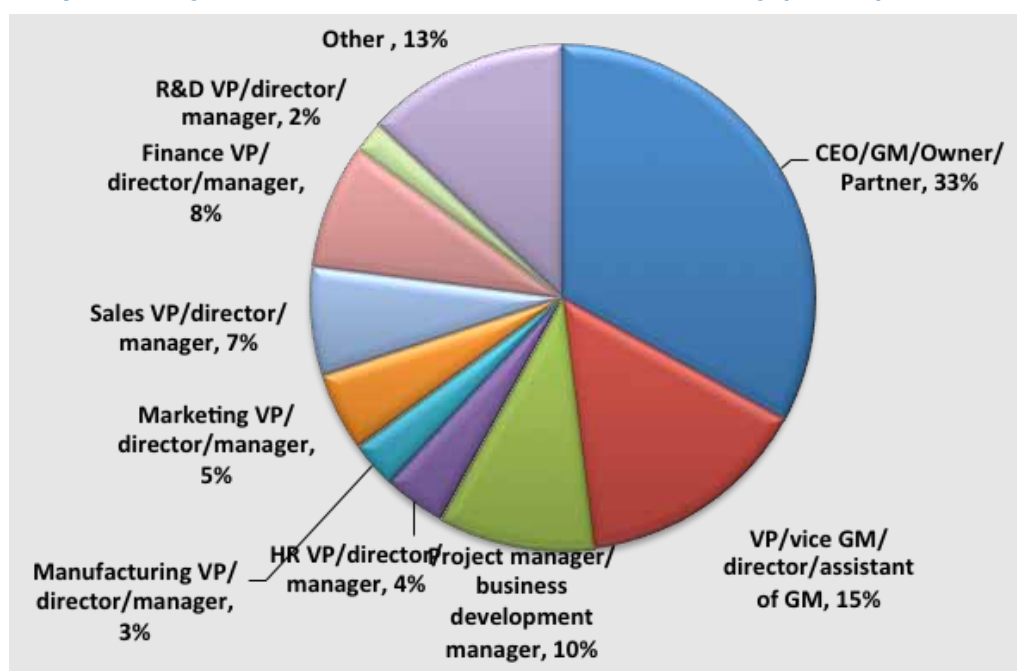
- China Integrated Co. Ltd, Consulting Firm
- Confederation of Indian Industry China
- Italian Chamber of Commerce
- Spanish Chamber of Commerce
- Latin American Chambers and Embassies

And the many friends that helped us with their network.

Finally, we acknowledge the financial support of CEIBS Research Fund, and the support of the Alumni, EMBA and EDP offices at CEIBS.

This survey measures various aspects of doing business in China, ranging from success factors and challenges to specific functional issues. It has been well supported in terms of participation; in total 254 executives responded the survey. These executives occupy a variety of positions in their organizations. Amongst them 83 are CEOs, General Managers, company owners or partners, whilst the remainder represents all the main business functions: HR, Finance, Marketing, Sales, Operations and Research & Development. This broad participation adds rich and valuable perspectives on the issues experienced by their organizations in China.

Responsibility of the Executives Included in the Survey (N=253)



Note: The 'other' category includes BU General Manager and Chief Representative.

The Research Team



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Dr. Juan Antonio Fernandez is Professor of Management at China Europe International Business School (CEIBS), in Shanghai, China.

Prof. Fernandez has co-authored six books: CHINA CEO, Chinese SOEs Reform, China CEO: A Field Guide, China (Foreign) Entrepreneur, Chinese Entrepreneurs, and 2010 Doing Business in China Survey. He has given presentations about his Chinese research in U.S.A, India, Japan, Korea, UK, France, Italy and Spain.



Prof. Dongsheng Zhou

Dr. Dongsheng Zhou is Professor of Marketing and Associate Dean (in charge of Alumni) at CEIBS. He is also the academic director of SEPC, a joint executive training program with Harvard Business School and SEM with Tsinghua University. Dr. Zhou received his Ph.D. from the Faculty of Commerce and Business Administration, University of British Columbia (UBC), Canada.

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



Lijia Chen

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Junjun Li

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Her research focuses on marketing strategies. She has written several cases and been involved in various consulting projects.



Montserrat Delgado

Montserrat Delgado is a CEIBS 2012 MBA. She has been in China for four years, working as a business developer for a European multinational corporation before starting her MBA at CEIBS.

Montserrat graduated in 2002 from the University of Zaragoza (Spain), having studied Business Administration, and has pursued her international career in sales and marketing in Europe, America and Asia.

Section I

COMPANIES INCLUDED

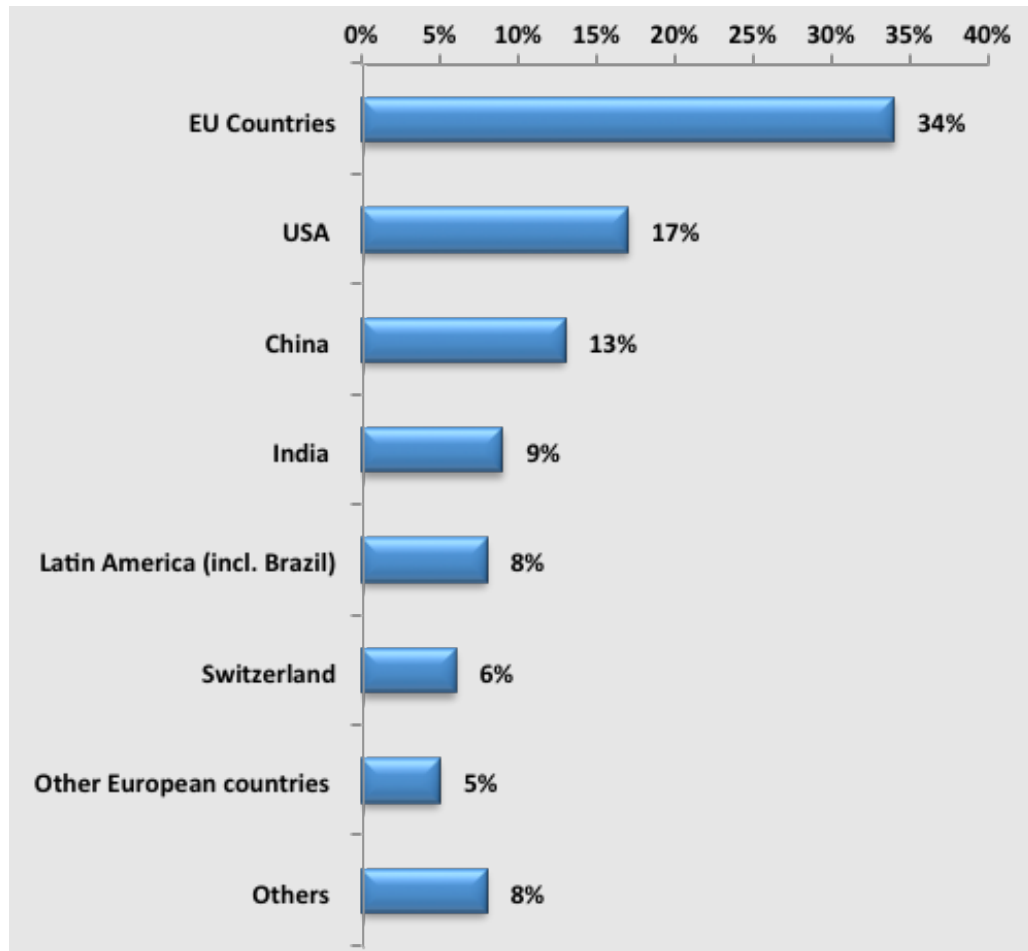
This section details the following information about the companies that participated in the on-line survey:

- Location of companies' headquarters in China
- Years of operation
- Number of employees in China
- Legal form
- Business activity in China: manufacturing or service, B2B or B2C

The purpose of this section is to give a general overview of the type of companies included in the survey.

Of the companies surveyed, 58% have their main offices in Shanghai, 18% in Beijing, 8% in Jiangsu and the remainder in other coastal provinces. Most of them are headquartered in Europe (34%), USA (17%) or China (13%) (Chart I.1).

Chart I.1 In what region are the company headquarters located? (N=252)

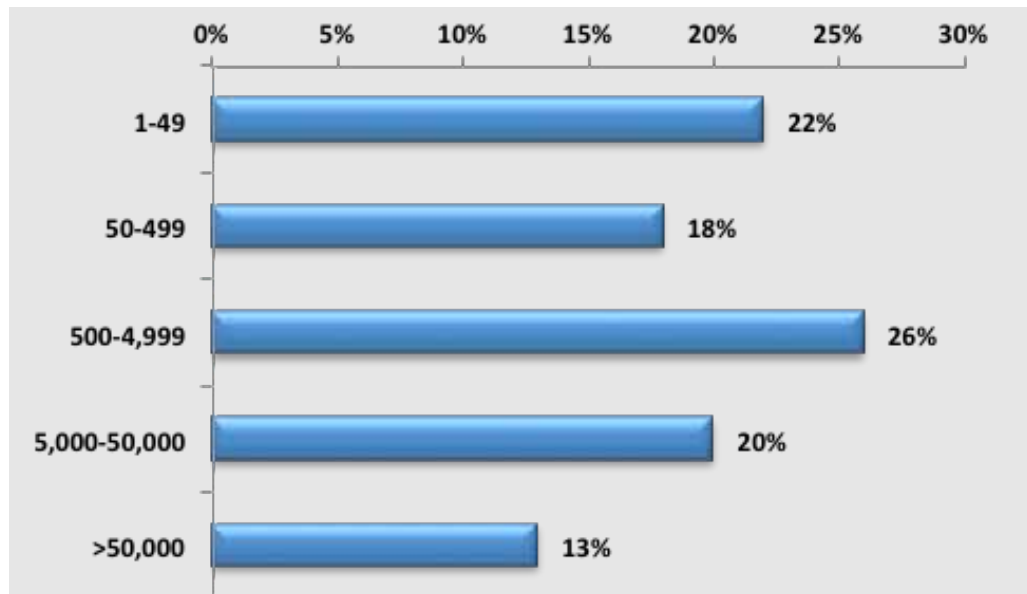


Note 1: The "other" category includes Hong Kong (China), Japan, South Korea, and Singapore.

Note 2: Those with headquarters in China have a majority foreign ownership.

Our sample includes companies of varying proportions, measured by their world total employee numbers. All sizes of companies are part of the survey (Chart I.2).

Chart I.2 How many employees does your company employ globally? (N=249)



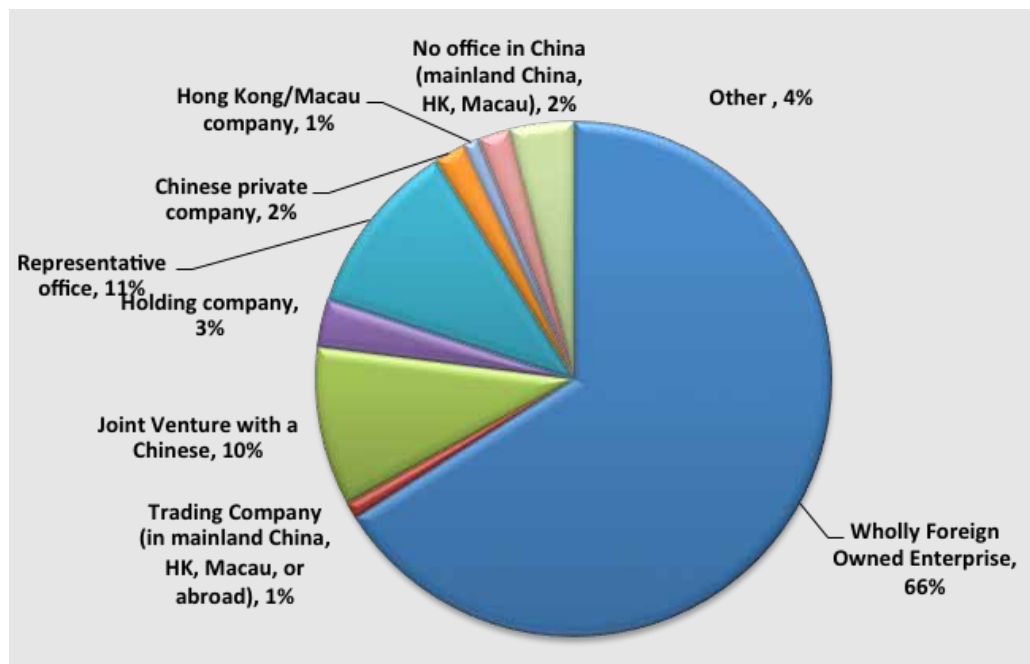
Amongst the companies researched, 57% of them (139 respondents) have 1 to 500 employees in China. The rest, 43% (107 respondents), are organizations with more than 500 employees. This means that our sample shows an almost equal balance between SME (small medium size) and large organizations (Chart I.3).

Chart I.3 How many employees do you have in China? (N=246)

Number of Employees	Responses	%
1-500	139	57%
>500	107	43%
TOTAL	246	100%

Regarding the legal form adopted for their China operations (Chart I.4), the majority (66%) are wholly foreign owned enterprises. The number of representative offices included in the survey has decreased from 18.5% in 2010 to 11% in 2011. This drop may reflect an effect of the global crisis.

Chart I.4 What is the legal status in China of the company you work for?(N=250)



Note: The "other" category includes branch of a foreign bank and government offices.

Of a total of 253 replies, 40% state that the main activity of their company in China is in services, whilst 60% are in manufacturing. Regarding the type of client they serve, 90% are Business to Business.

Chart I.5 reveals more specific information on the type of manufacturing industry. The top three main industries are manufacturing of machinery & equipment, chemicals, petroleum and gas, automotive.

Chart I.5 What is the main industry you are active in?

Answer	Response
Manufacturing of Machinery & Equipment (excluding instruments & lab equipment)	39
Chemicals, petroleum, gas	21
Automotive	20
Construction and Civil Engineering(incl. materials of construction and building)	10
Pharmaceuticals	11
Food & Dietary supplements	9
Energy & Utilities (Power, Gas, Water and etc.)	9
Medical Equipment & Health care Products (Excl. Pharmaceuticals)	8
Material & Commodities Production (Steel & Metals, Plastics)	8
Telecommunications & IT (hardware)	7
Light Consumer Goods (consumer electronics, household appliances, toys, bicycles, furniture, etc.)	7
Mining	4
Manufacturing of Testing Measurement & Scientific Instruments; Laboratory equipment	5
FMCG	5
Apparel & Toiletries (Clothing, accessories, toiletries, and etc.)	1
Railway & Metro	1
Shipbuilding	1
Luxury (watches, fashion, jewelry, cosmetics, wines, etc.)	1
Waste Management, Recycling & Clean Technologies	2
Printing/paper manufacture	2
Other	15

Note: The 'other' category includes Lithium batteries manufacture, seeds, industrial and commercial cooling and air conditioning.

Chart I.6 What is the main type of services that your company is providing?

Answer	Response
Consulting (Strategy, HR, legal, investment, etc.)	23
Trading Export/Import	15
Financial services (Banking, insurances, investment, etc.)	14
Engineering & design	6
Software	5
Distribution and logistics	5
Medical and wellness	4
Telecom services	3
Transportation (Air companies, bus, train, etc.)	3
Wholesale and retail	3
PR, advertisement, media, publishing, etc.	2
Tourism	2
Internet, and E-business(B to B, B to C)	1
Education	1
Restaurants, bars, entertainment	1
Real Estate	1
Other	13

Note: The 'other' category includes outsourcing, lobbying, executive search and architecture.

Section II

BUSINESS PERFORMANCE AND CHALLENGES

This section gives information about the business performance and the challenges faced by the companies interviewed such as:

- Confidence in the Chinese market
- Sales revenue in China - past and present
- Profitability
- Future expectations
- Major difficulties of running their businesses and possible solutions
- Main challenges expected in the coming years
- Success factors

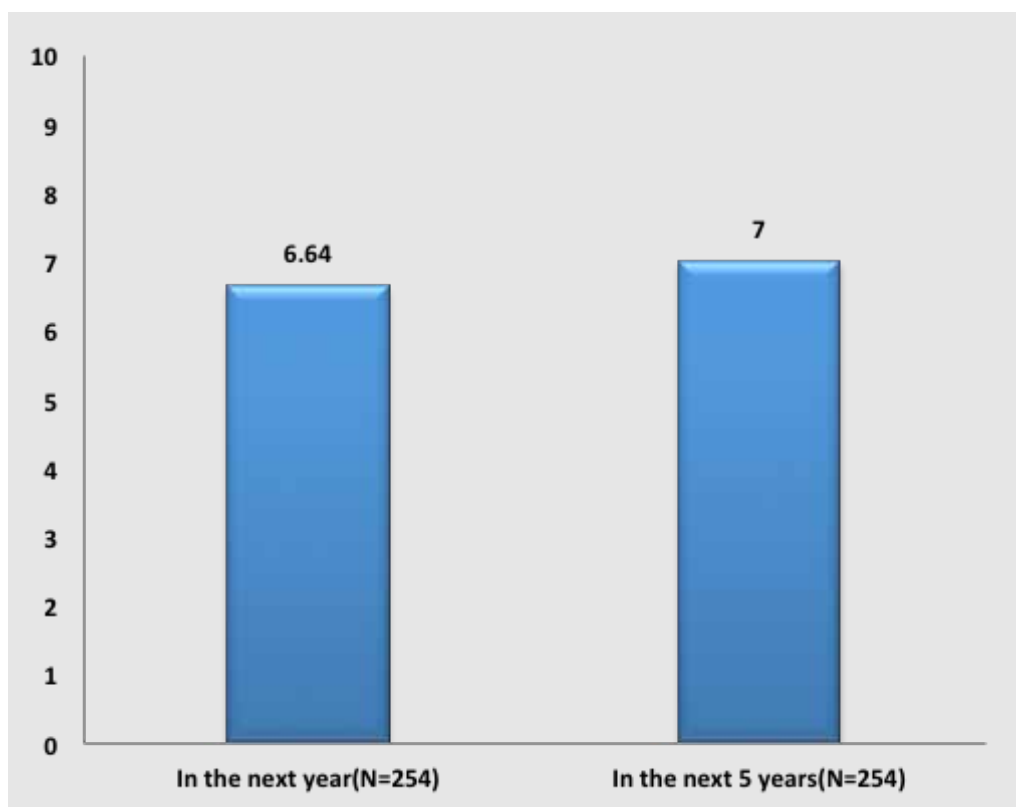
The purpose of this section is to understand the major problems faced by these companies and how they respond to them.

II.1. Confidence Index and Business Performance in 2011

The majority of the respondents are very confident about their future in China. They make substantial revenues in the Chinese market and healthy profits. Although their global revenues have generally decreased compared to those of previous years, due to the global crises, companies expect higher sales revenues in the Chinese market. According to them, the key success factor in developing their businesses in this dynamic market place is excellent HR management. Recruiting, training and retaining key employees, in conjunction with a well prepared management team, are two essential factors in outperforming the competition in the China - yet they are difficult to execute. Talent retention is a major challenge, along with rising costs and increased competition.

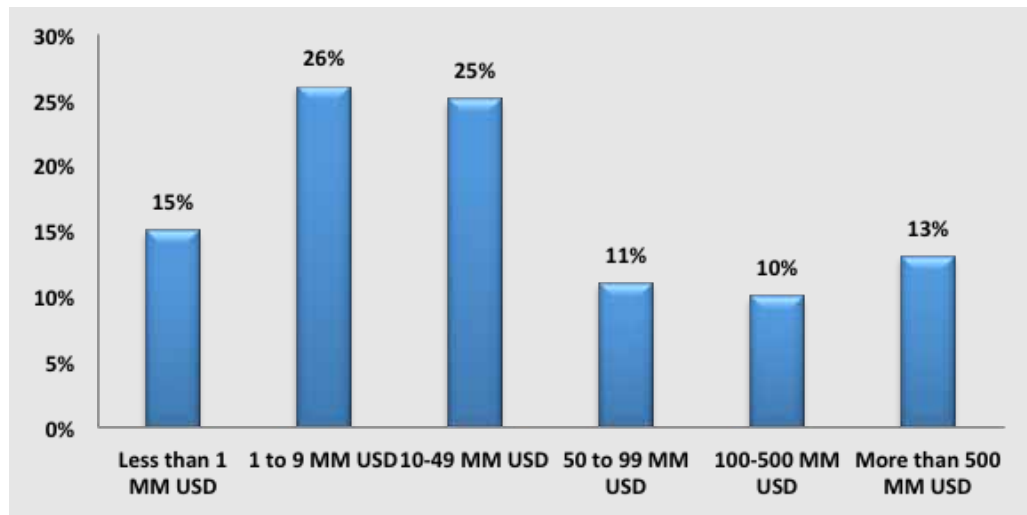
Broadly speaking, most of the companies interviewed remain confident about their future in China, especially over the next five year period. (Chart II.1.1) However, when we compare these results with those of the 2011 survey, we can see how confidence has slightly decreased from 7.23 for the year 2011 to 6.64 the for the year 2012, and from 7.71 to 7 for the next five year period.

Chart II.1.1 How confident are you that your operations will be successful in the next year, and over the next 5 years?



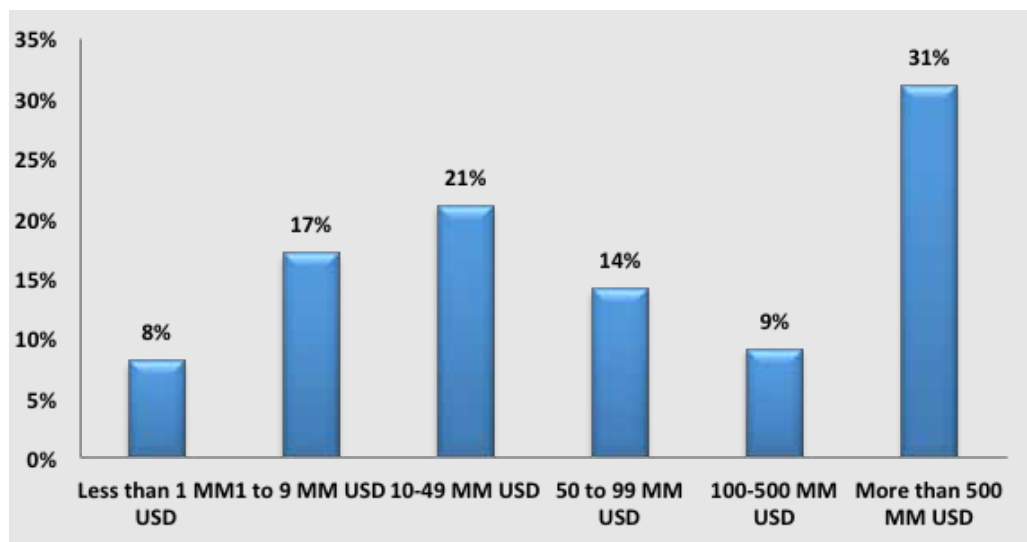
Regarding their China sales, 41% of the respondents declared annual revenues of up to 9 MM USD, and 25% declare revenues between 10-49 MM USD. Only 13% of the companies noted more than 500 MM USD of revenues (Chart II.1.2).

Chart II.1.2 What is your company's CHINA sales revenue in 2011? (N=243)



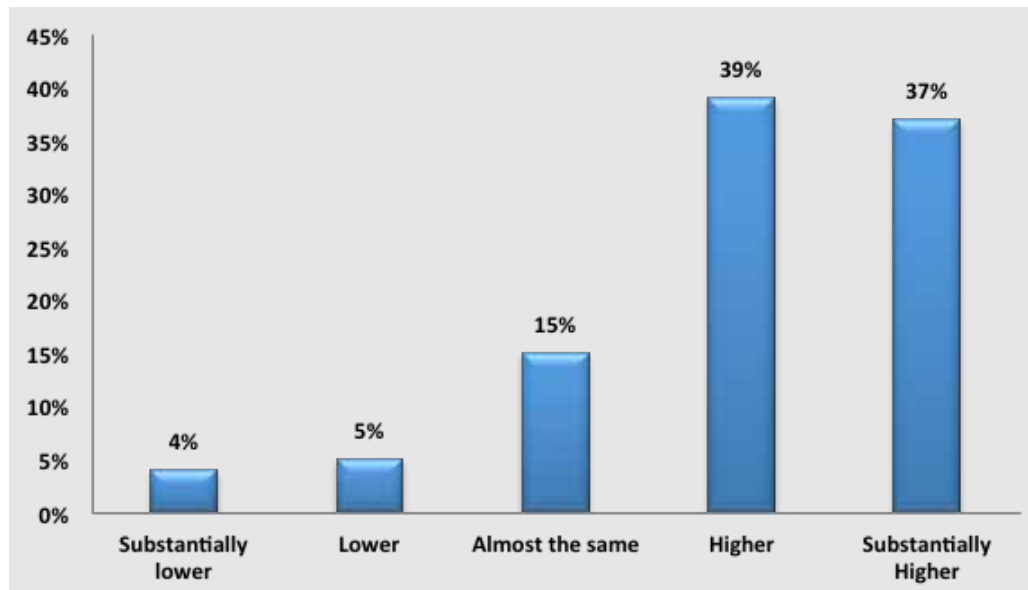
Regarding their global sales, (Chart II.1.3) the number of companies that declare global sales revenue over 500 MM USD has decreased from 52% last year to 31% this year. Consequently, the companies declaring global sales revenue of between 10 and 49 MM USD has increased dramatically from 7.8% in 2010 to 21% in 2011.

Chart II.1.3 What is your company's GLOBAL sales revenue (including China) in 2011? (N=240)



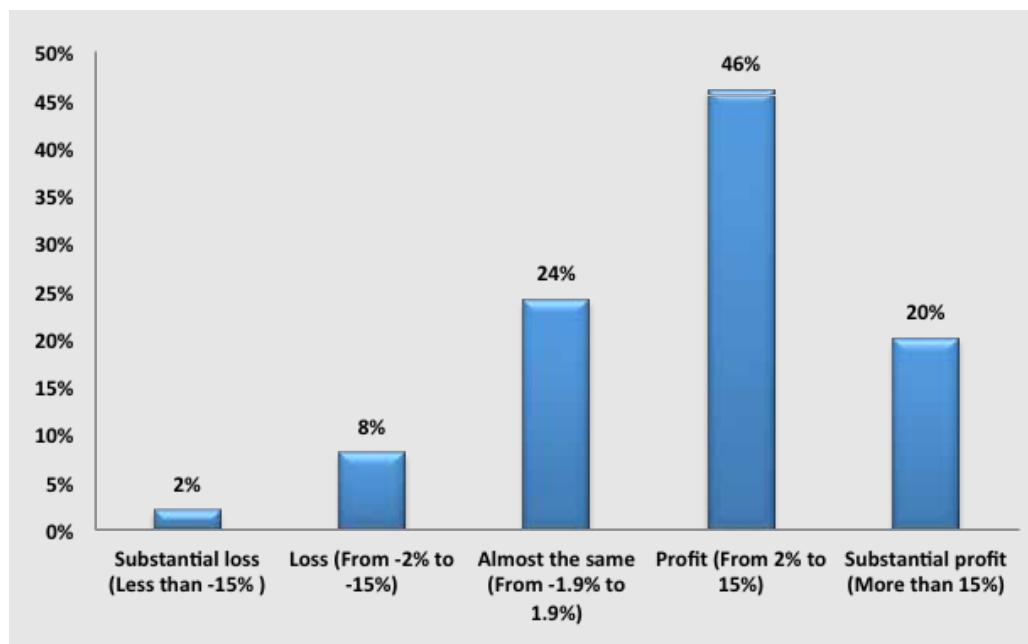
More than 75% of the companies we interviewed had, in 2011, higher (39%) or substantially higher (37%) revenues than that of 2010. Most companies in our sample were optimistic about the future and only 9% of the companies had lower (5%) or substantially lower (4%) revenues in 2011 (Chart II.1.4).

Chart II.1.4 What were your company's revenues in China in 2011 compared to 2010? (N=240)



Most companies in our survey (66%) made profits in China in 2011. 24% broke-even whilst only 2% of the respondents declared substantial loss. On the other hand 20% of respondents stated profits of over 15%. As a whole, it is clear that the Chinese market environment is very profitable for our sample companies (Chart II.1.5).

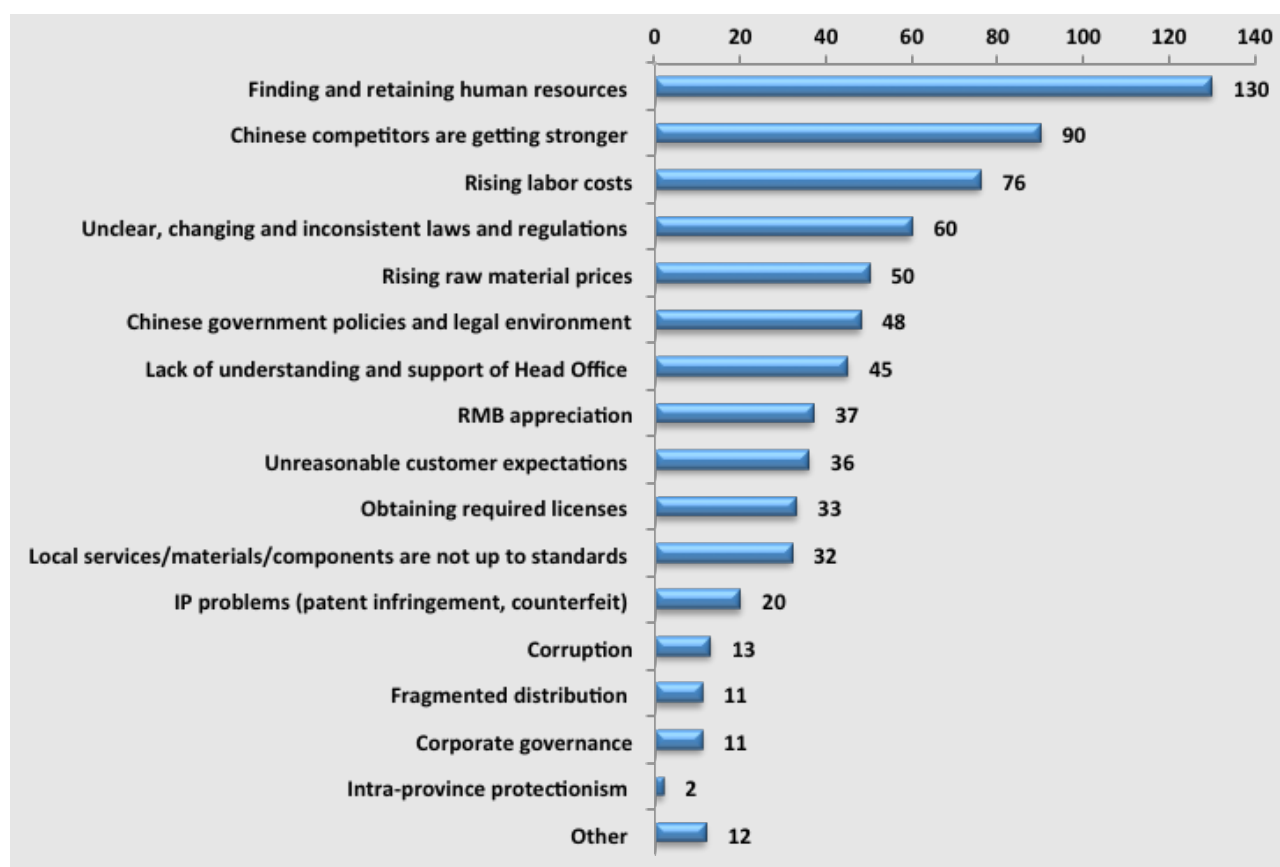
Chart II.1.5 What was your company's profitability in China in 2011? (N=242)



II.2. Challenges and Success Factors

The majority of the companies that we interviewed faced the similar challenges in 2011 as in the 2010 survey. Acquiring and retaining talented employees continues to be the top issue. In general, employee turnover is high, there is difficulty in consolidating them into their roles, and demand for frequent training of incoming employees is high. This creates an extra burden on companies. Apart from the HR problem, competition is seen as fierce by our respondents. Not only do they compete against other foreign companies but also against local Chinese companies, which are becoming better and more responsive by the day. Rising costs is also a major problem for all companies interviewed. (Chart II.2.1).

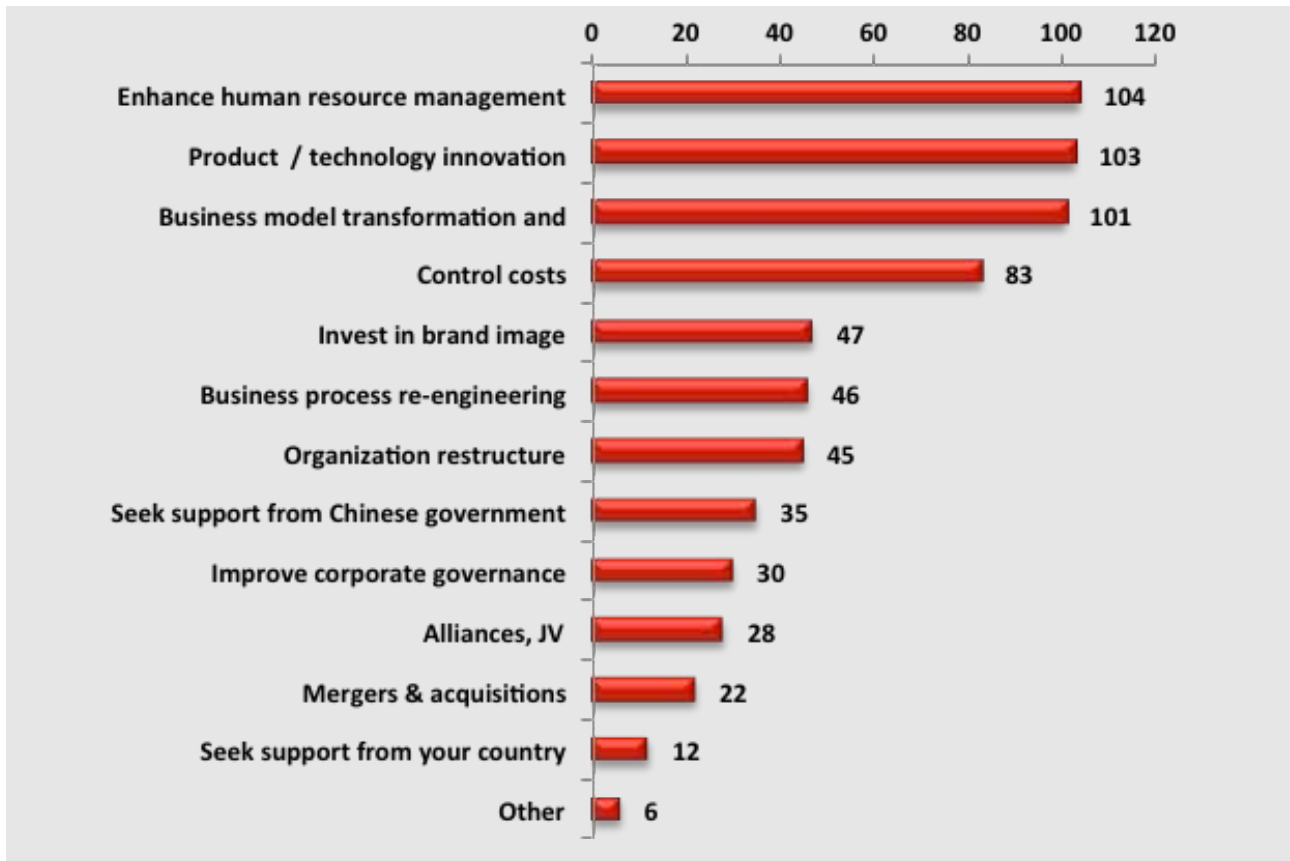
Chart II.2.1 What is presently causing you the most difficulty in running your company in China?



Note: The 'other' category includes competition with global competitors, delayed payments and price pressure.

In order to address these challenges, our interviewees focus their efforts mostly around three major areas: HR, innovation and business model transformation. The respondents work on fostering valuable HR practices to retain key talent. Secondly, they pay attention to product/technology innovation so as to better meet market needs whilst, in some cases, decreasing costs. Lastly, they work on transforming their business models, refocusing their strategy to meet customer's expectations based on their core competencies (Chart II.2.2).

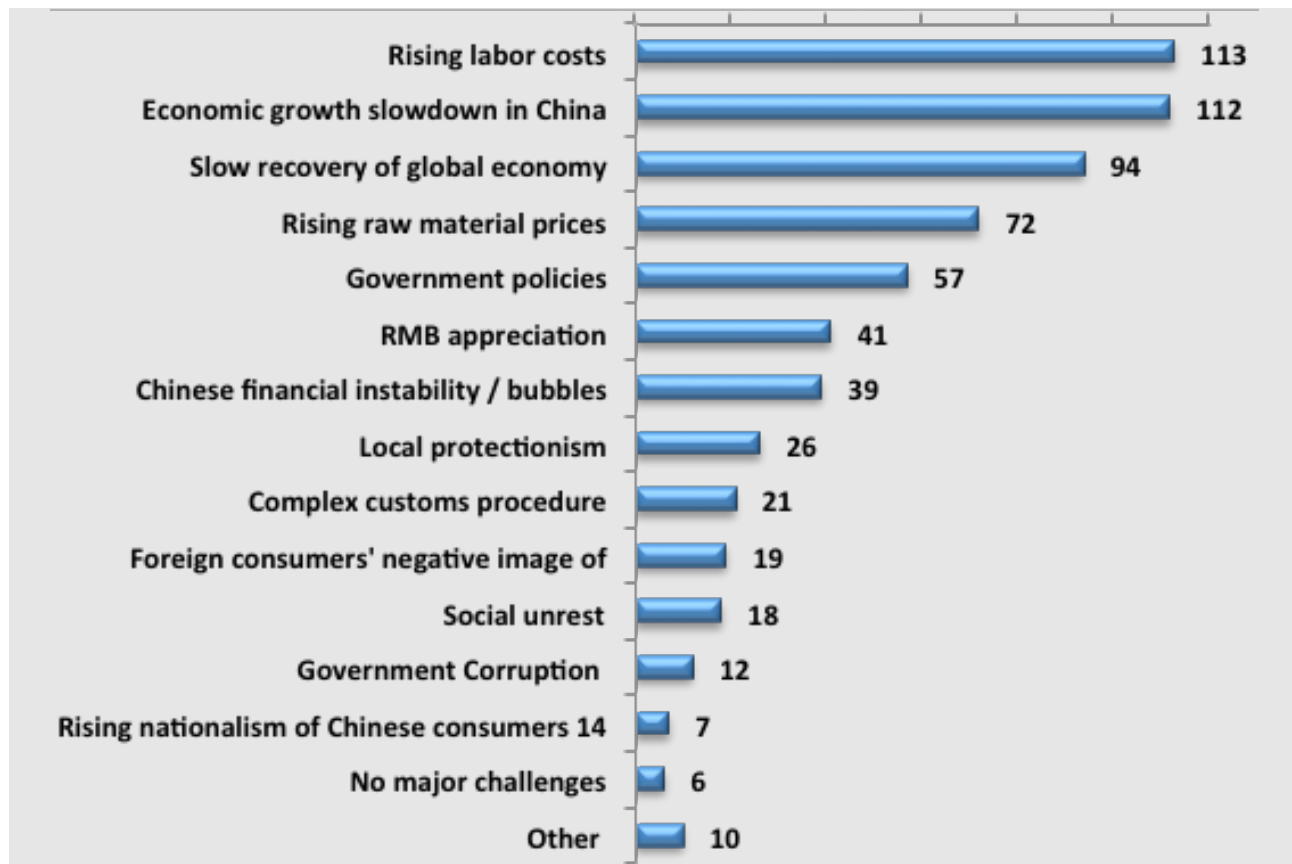
Chart II.2.2 How do you respond to the above challenges in China?



Note: The 'other' category includes working closely with Chinese suppliers, moving labor intensive activities to cheaper locations and diversifying suppliers.

When we asked them about the future, most companies interviewed saw rising labor costs and the economic slow down as the major challenges for their companies in the coming years. Interestingly, social unrest and government corruption occupy some of the lowest positions in this ranking according to our respondents (Chart II.2.3).

Chart II.2.3 Which are the main challenges facing your company in the coming years?



Note: The 'other' category includes the Chinese way of doing business, company strategy in China and market access.

According to the majority of the companies interviewed, the most critical factors for their company to succeed in China are related to people. Specifically they highlighted selecting, training and retaining talent (1st place) and the quality of the management team (2nd place). Reputation and strong company culture and values are also key factors for success (Chart II.2.4).

Chart II.2.4 How important were these factors for your company's success in China?



Note: The 'other' category includes stable investment, strong relationships with global customers and networking with real estate developers.

Section III

BUSINESS ENVIRONMENT

This section includes information about the business environment in which these companies operate, from two different perspectives:

- **Market competition: degree and type of competition, the competitive advantages of our respondents, and the main concerns about competition.**
- **Government policies: its impact, the degree of satisfaction, views on corruption, other major issues, and the importance of “guanxi” .**

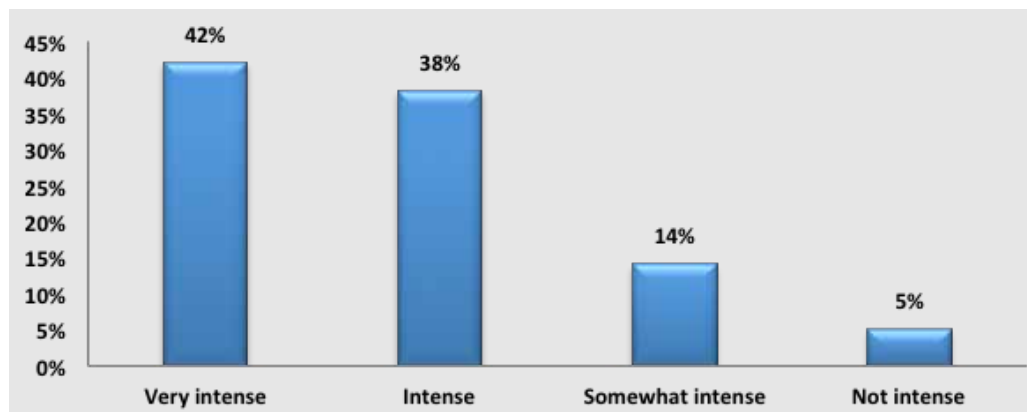
The purpose of this section is to give an understanding of the specific issues related to the external environment within which these companies conduct their business.

III. 1. Market Competition

Most respondents agree that the competition in China is fierce. They consider their major competitors to be Chinese local companies, mostly due to more competitive prices and better “guanxi” with local government and other institutions. On top of this, they believe that Chinese companies are getting stronger and that this is making the Chinese market tougher than their home markets.

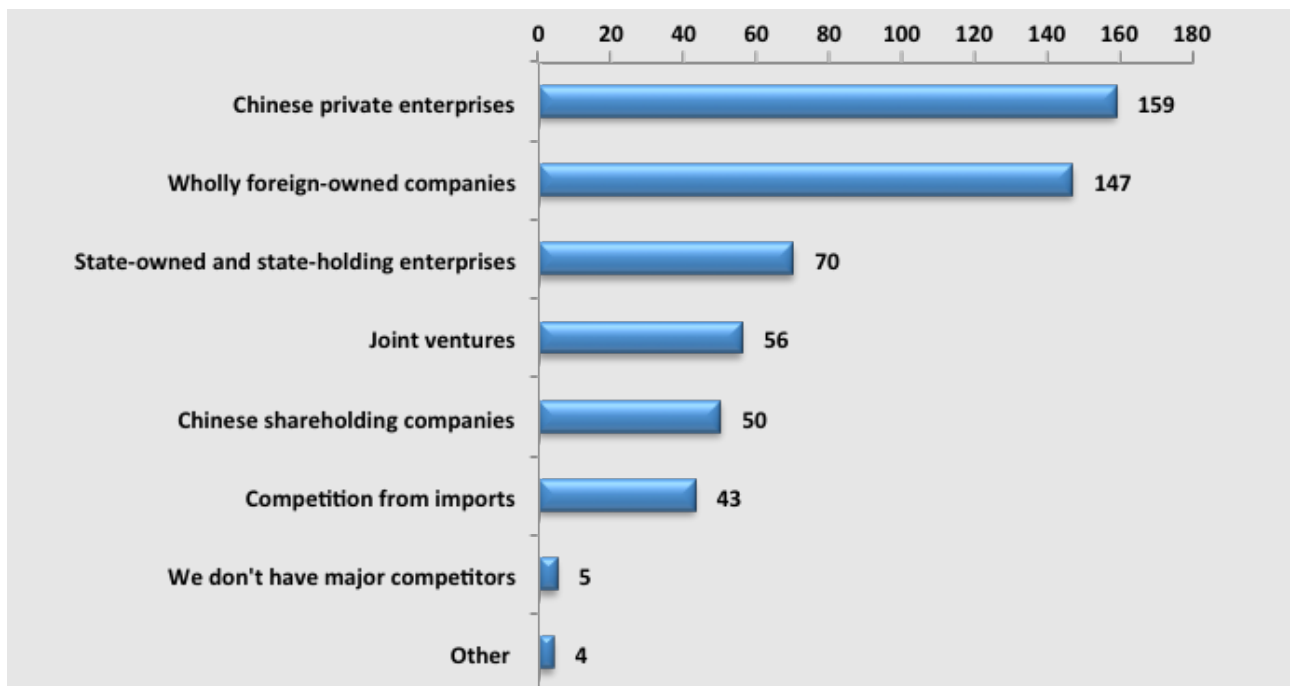
In our sample, 80% of the respondents agreed that competition in China is intense (38%) or very intense (42%). They not only face competition from international companies but also from local Chinese businesses (Chart III.1.1).

Chart III.1.1 What is the degree of competition facing your company in China? (N=250)



Our executives point to Chinese private enterprises as their number one competitors, followed by wholly foreign owned companies. Local companies have not only become more responsive to customer demands, they have also made in roads to improving quality and innovation (Chart III.1.2).

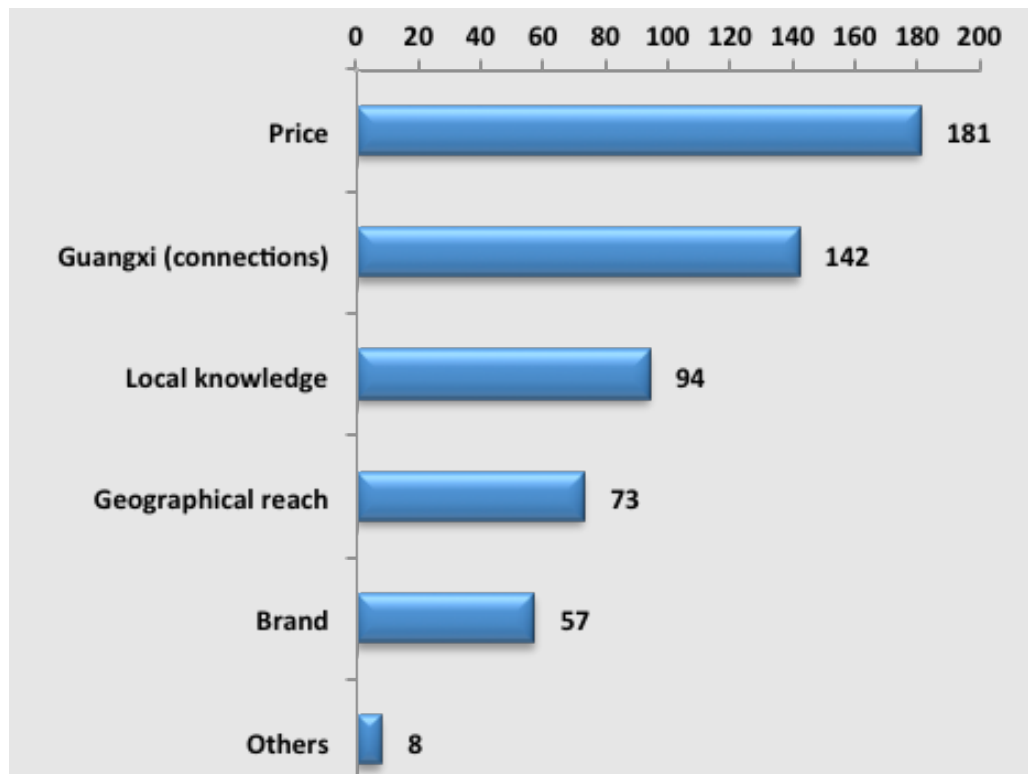
Chart III.1.2 Who are your major competitors in China?



Note: The 'other' category includes Chinese banks, foreign consultants and freelancers.

According to our respondents, the key competitive advantage of local manufacturers is lower prices. Additionally, better “guanxi” or local connections allows them to run their businesses more smoothly. Local knowledge and better understanding of the market are obviously also to their advantage. Brand is listed lower down as less of a factor (Chart III.1.3).

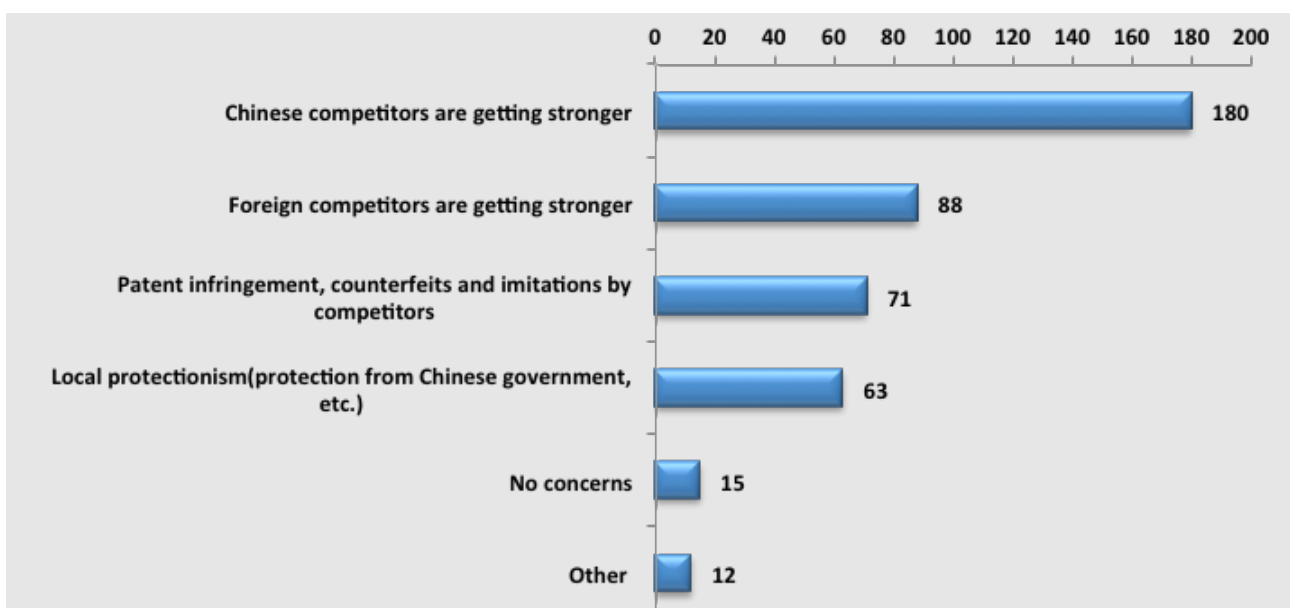
Chart III.1.3 What are the competitive advantages of your main Chinese competitors?



Note: The 'other' category includes deliverable time, finance, quality and quantity.

The increasing strength of Chinese competitors is clearly identified as a main concern by our respondents. Patent infringement and local protectionism are still seen as problematic factors. Although the government is working on these two issues there is still a long way to go, especially in IP protection, as the survey illustrates in the following pages (Chart III.1.4).

Chart III.1.4 What are your main concerns regarding competition?



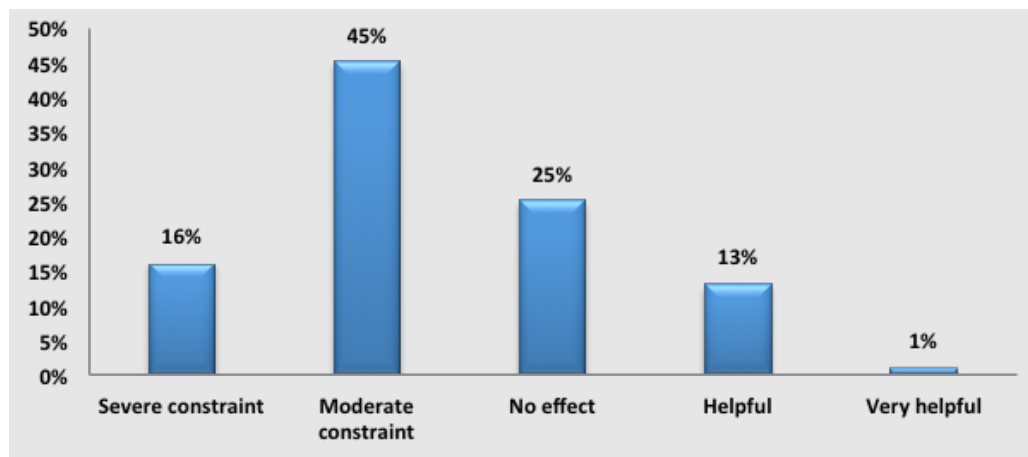
Note: The 'other' category includes Chinese competitors going global, quality, and corruption.

III.2. Government Policies

More than half of the respondents perceive Chinese government policies as a constraint to the development of their businesses, and almost half of the sample are unsatisfied with the policies implemented. Although corruption is still considered a problem in China which affects their business activity, it is not flagged as the main concern by foreign companies. Inconsistent changes in laws and regulations, as well as macro environmental policy adjustments, are noted as major problems. Government relationships are seen as essential for the development of their business activities in China and our executives spend more time fostering ‘guanxi’ in China on average than they do in their home countries.

The effect of Chinese policies and regulations is perceived negatively by 61% of our respondents, with 45% declaring that it is to some extent an impediment, whilst 16% of them claim that it is a severe constraint. On the other hand 14% of them argue that Chinese policies are helpful for the deployment of their activities (Chart III.2.1).

Chart III.2.1 What is the effect of Chinese government policies and regulations on your business? (N=251)



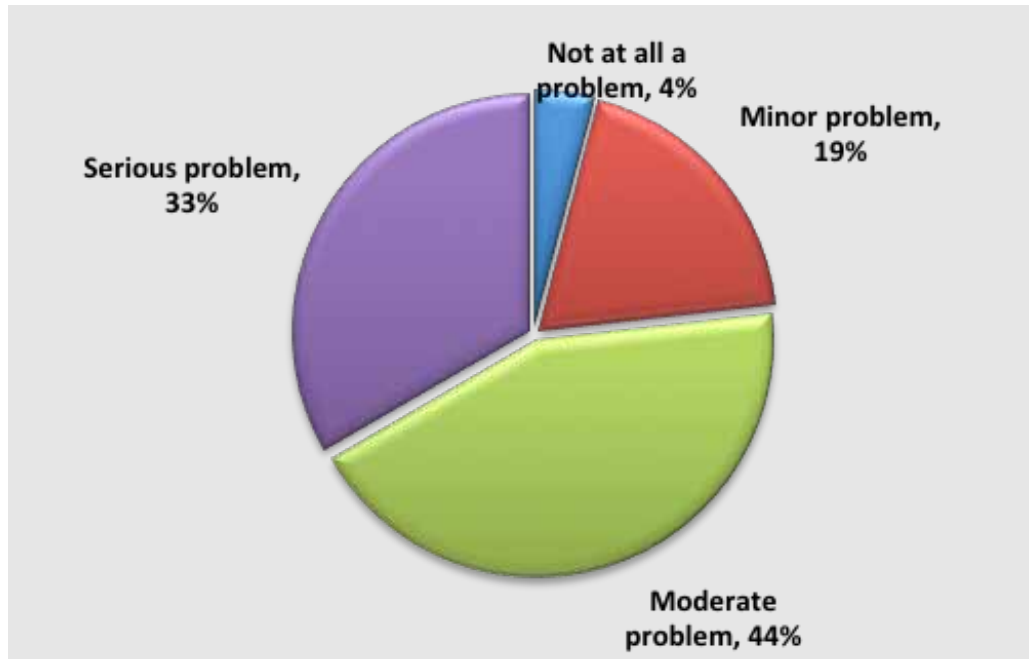
Regarding satisfaction with Chinese government services, there is a clear a balance distribution with 55% of respondents satisfied or highly satisfied, whilst the remaining 45% are dissatisfied or very dissatisfied (Chart III.2.2).

Chart III.2.2 Are you satisfied with the services that Chinese government provides? (N=249)



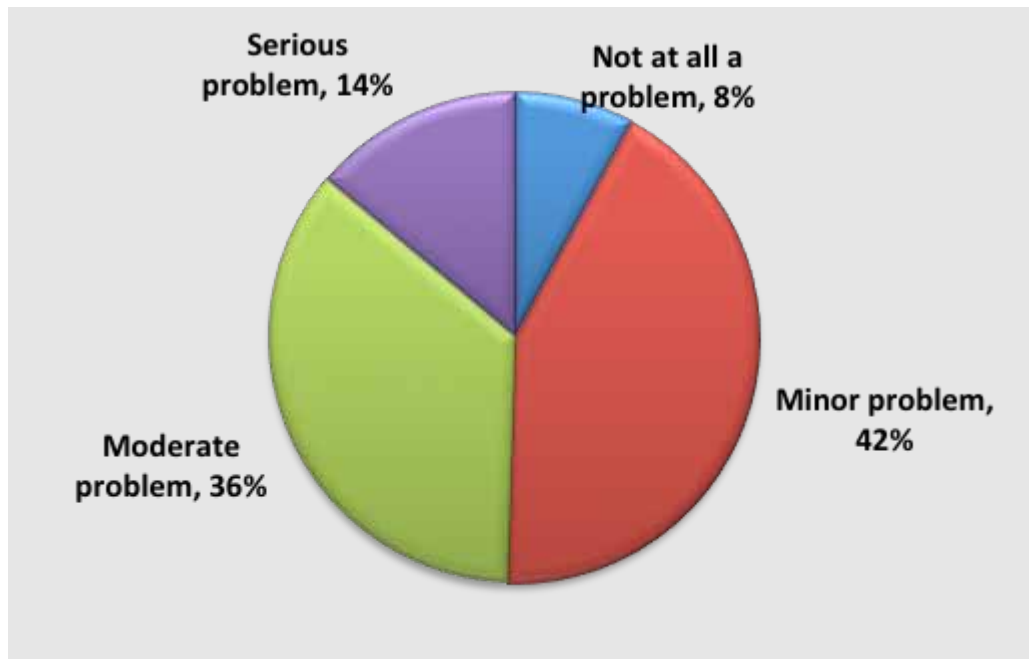
About 33% of the respondents say that corruption is a serious problem whilst 44% of them see it as moderate issue (Chart III.2.3).

Chart III.2.3 In your view, how serious is corruption in China, in general? (N=248)



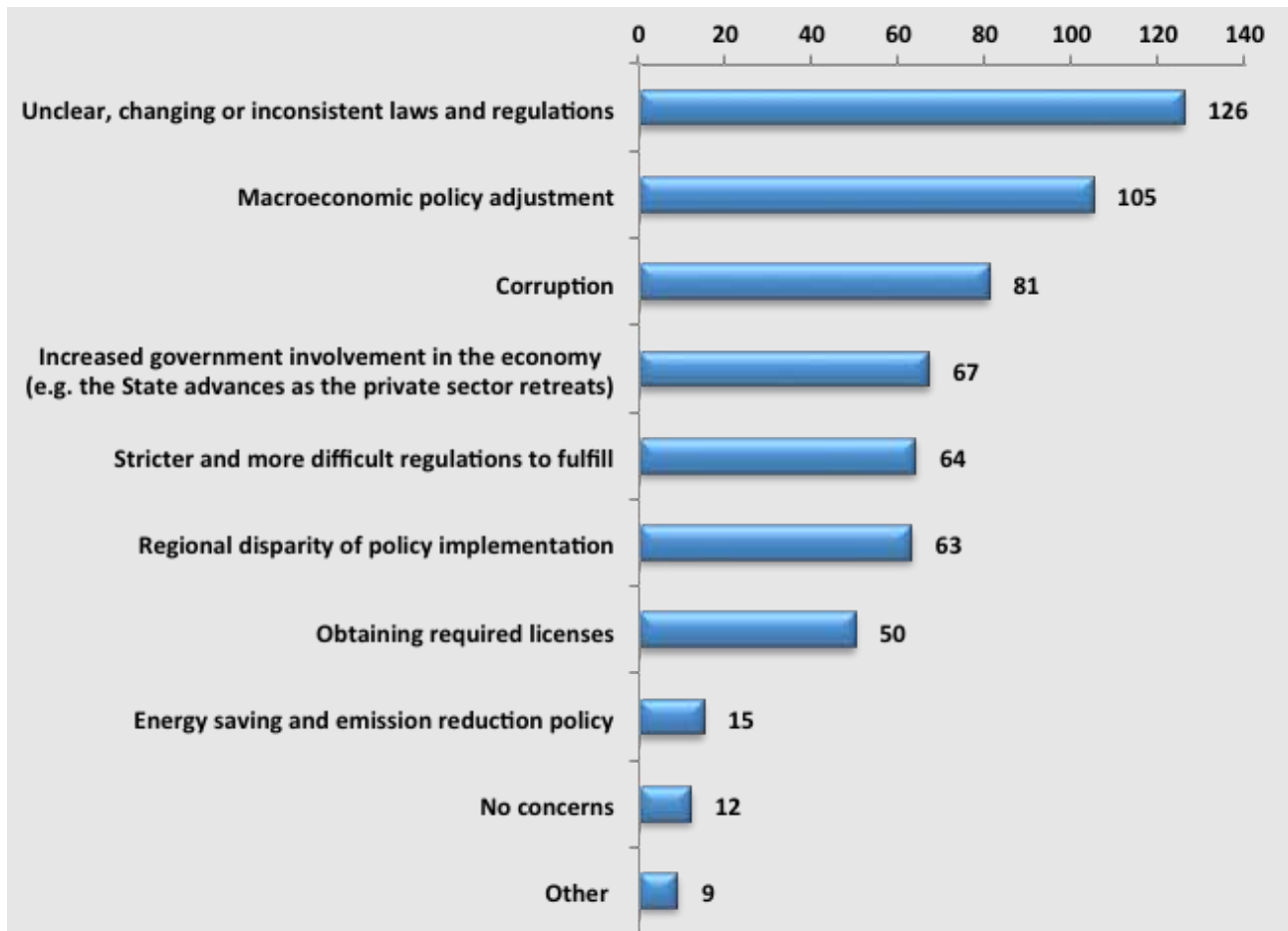
However, when we asked interviewees how important corruption was in their industries, only 14% of them thought that it was a serious problem, and 36% believed that it is of moderate concern (Chart III. 2.4).

Chart III.2.4 In your view, how serious is corruption in China, in your industry? (N=249)



When we asked our executives about their main concerns regarding the Chinese legal environment they did not isolate corruption as the number one problem. They perceived unclear and inconsistent changes in legal regulations as their key concern. In this unstable context, it is very difficult for companies to conduct their business. Micro environmental policy adjustments were also a major concern. How well the government will manage the economy, and whether they are able to maintain high economic growth despite the global crisis, will undoubtedly affect these companies' performance in the future (Chart III.2.5).

Chart III.2.5 What are your main concerns regarding the Chinese government and legal environment?



Note: The 'other' category includes internal disputes, taxation and labor laws.

Almost all respondents (91%) agreed that building good relationships with Chinese authorities is a critical factor to succeed in China. More than 50% of the companies spend more time building and preserving these relationships in China than in their home countries (Charts III.2.6 and III.2.7).

Chart III.2.6 How important is it for your business to build and maintain good relationships with Chinese government authorities?

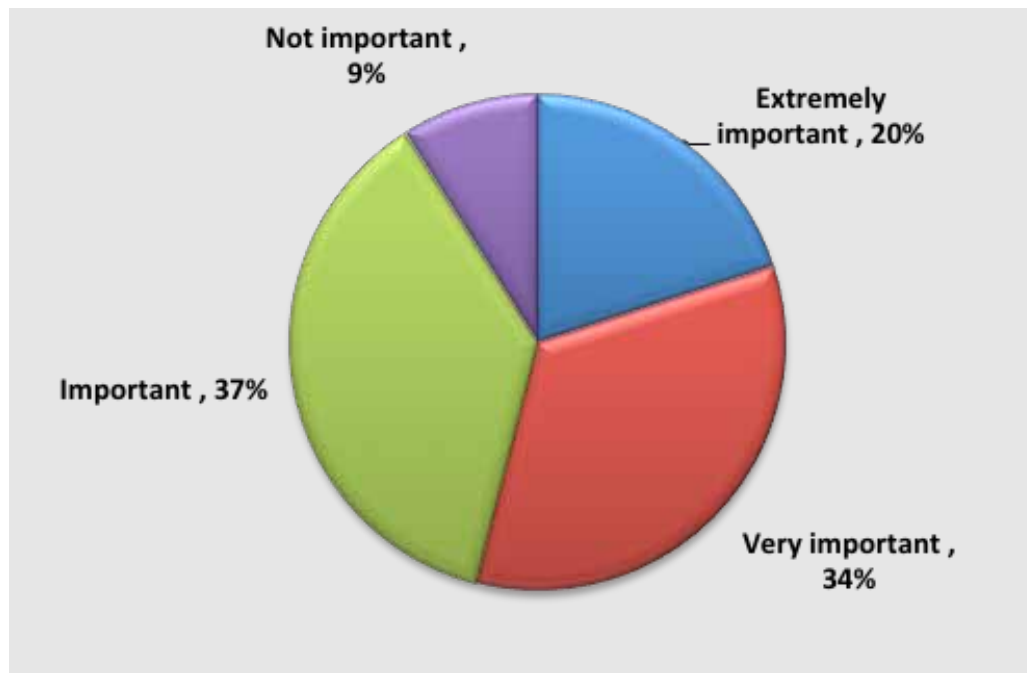
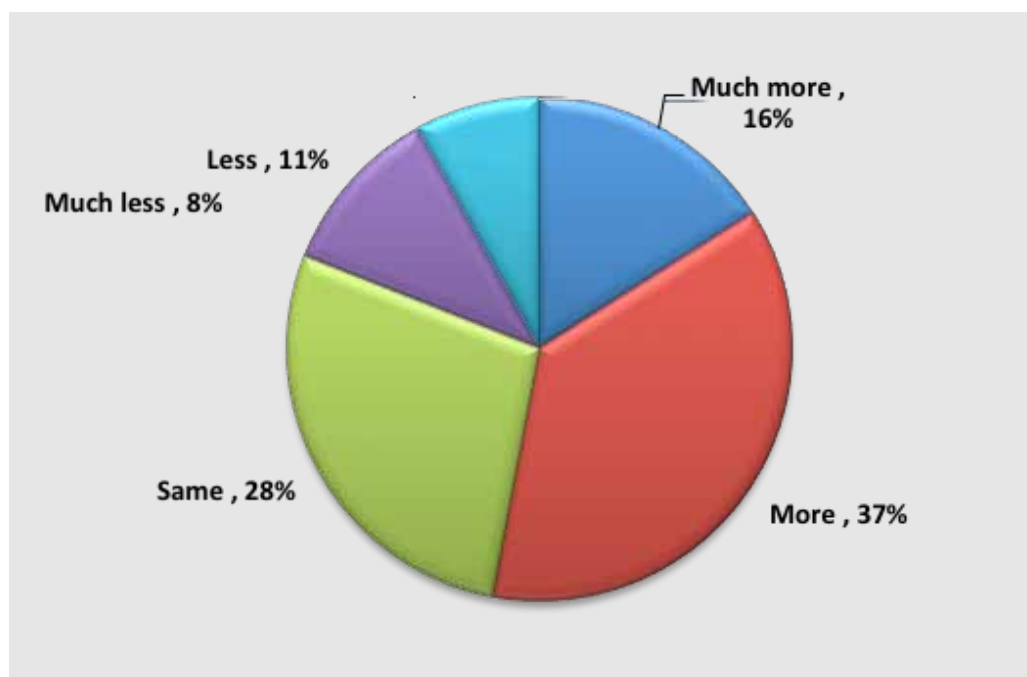


Chart III.2.7 How much time do you allocate to building and maintaining good relationships with government authorities in China when compared to your home country? (N=248)



Section IV

FUNCTIONAL PERSPECTIVES

This section gives perspectives of three different functional areas:

- **Production and Supply:** number and location of plants, decision processes to choose locations of facilities in China, main suppliers, key decision factors in choosing a supplier and major challenges dealing with them.
- **Marketing and Sales:** positioning in the market, percentage of sales spent on marketing, effectiveness of marketing efforts and distribution.
- **Human Resources:** major issues, solutions, salary evolution, turnover rate and talent retention.

The purpose of this section is to bolster understanding of the internal operations of the respondents, and the challenges and success factors they face in these functional areas.

IV. 1. Production and Supply

The majority of the companies interviewed had at least one facility located in the coastal provinces, Shanghai, Beijing or Tianjin. When selecting where to place their manufacturing plant, our respondents listed prime proximity to their customers and the quality of public infrastructure as important. On the other hand, when selecting suppliers, they valued quality over price, which poses a challenge as Chinese suppliers commonly do not meet international standards.

The majority of the respondents (52%) have only one manufacturing plant in China. The rest vary from two to more than nine plants (Chart IV.1.1).

Chart IV.1.1 How many plants do you have in China? (N=83)

Answer	Response	%
0	9	11%
1	43	52%
2	6	7%
3	6	7%
4	2	2%
5	4	5%
9	6	7%
More than 9	7	8%

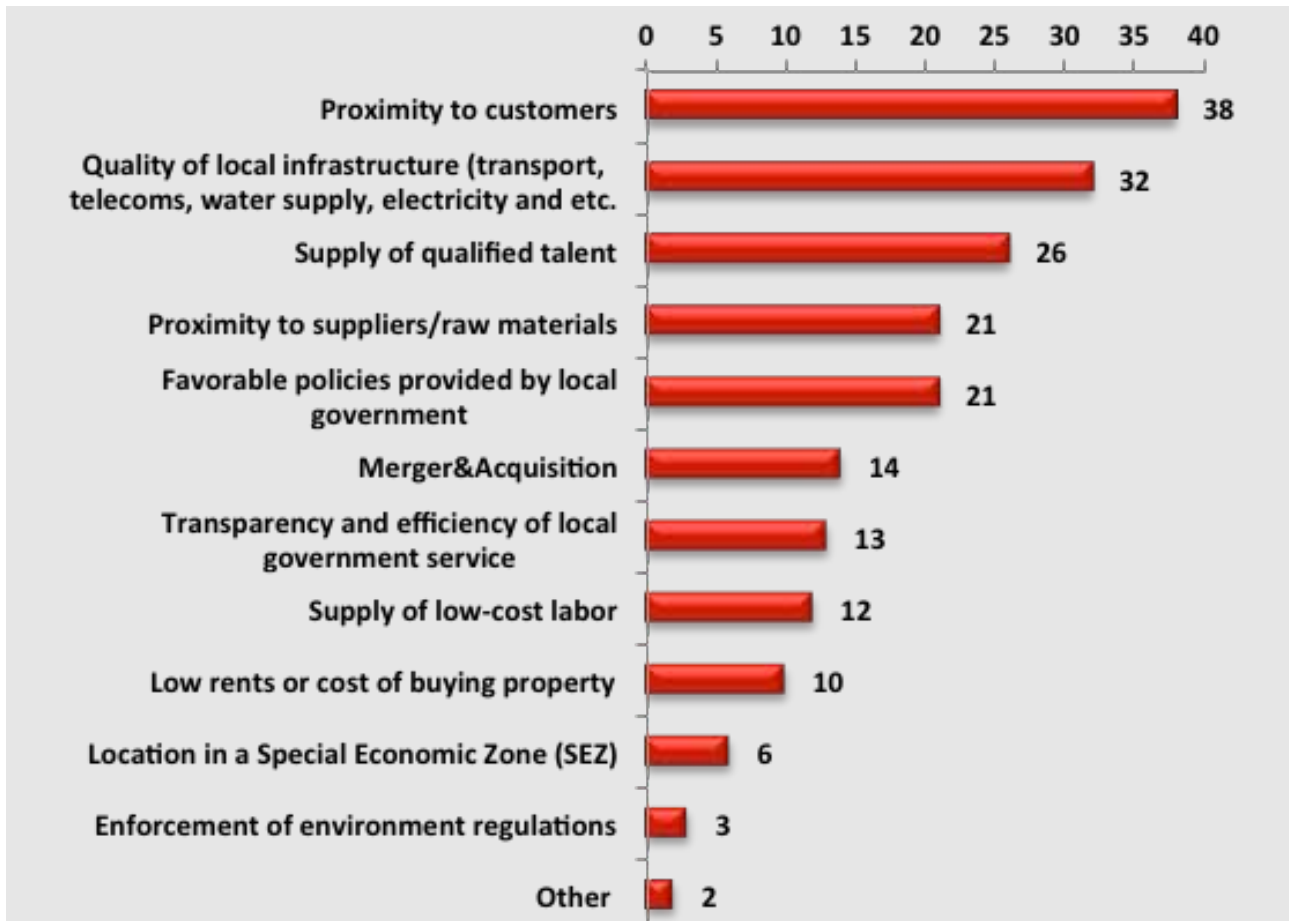
Most companies are located in the coastal areas, Shanghai, Beijing and Guangdong. The Chinese government is currently promoting other provinces and trying making them more attractive for foreign investors. Accordingly, those other provinces have cost advantages over the more developed coastal regions. These factors may over time increase the number of foreign operations in the other parts of China (Chart IV.1.2).

Chart IV.1.2 These plants are located in:

Answer	Response
Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong	48
Shanghai	29
Beijing	11
Guangdong, Guangxi, Hainan	11
Chongqing	8
Sichuan, Guizhou, Yunnan, Tibet	8
Tianjin	7
Henan, Hubei, Hunan	7
Hebei, Shanxi, Inner Mongolia	3
Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang	3
Shenzhen	2
Liaoning, Jiling, Heilongjiang	2

The most important consideration cited in deciding where to locate a factory is proximity to customers. It not only decreases distribution costs but also allows a better coordination of the supply chain. Additionally, the quality of local infrastructure, the availability of qualified talent and the proximity to suppliers are also key considerations noted when selecting locations for their plants. Surprisingly, being a Special Economic Zone seems to be one of the least important factors (Chart IV.1.3).

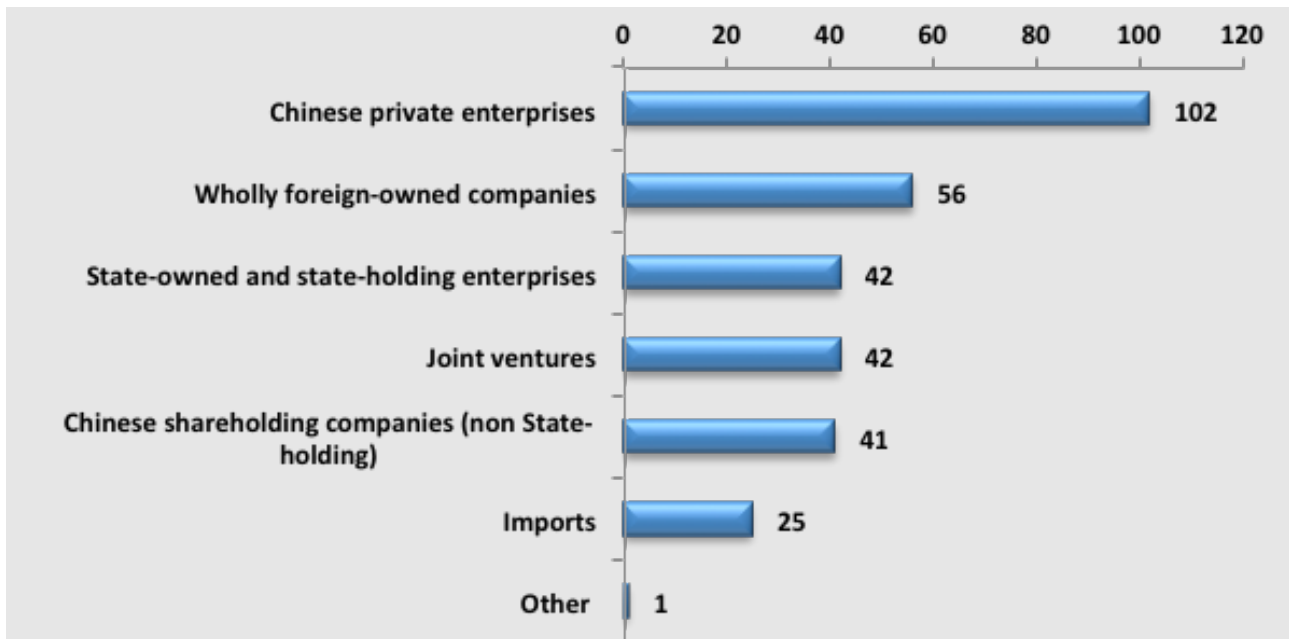
Chart IV.1.3 Which of the following factors are important in deciding the location of your plant?



Note: The 'other' category includes historical reasons and logistics costs.

The majority of the suppliers for our sample companies are private Chinese companies. They were favored twice as strongly as WFOEs and SOEs. The least important source of supplies are imports (Chart IV.1.4).

Chart IV.1.4 Who are the main suppliers to your company?



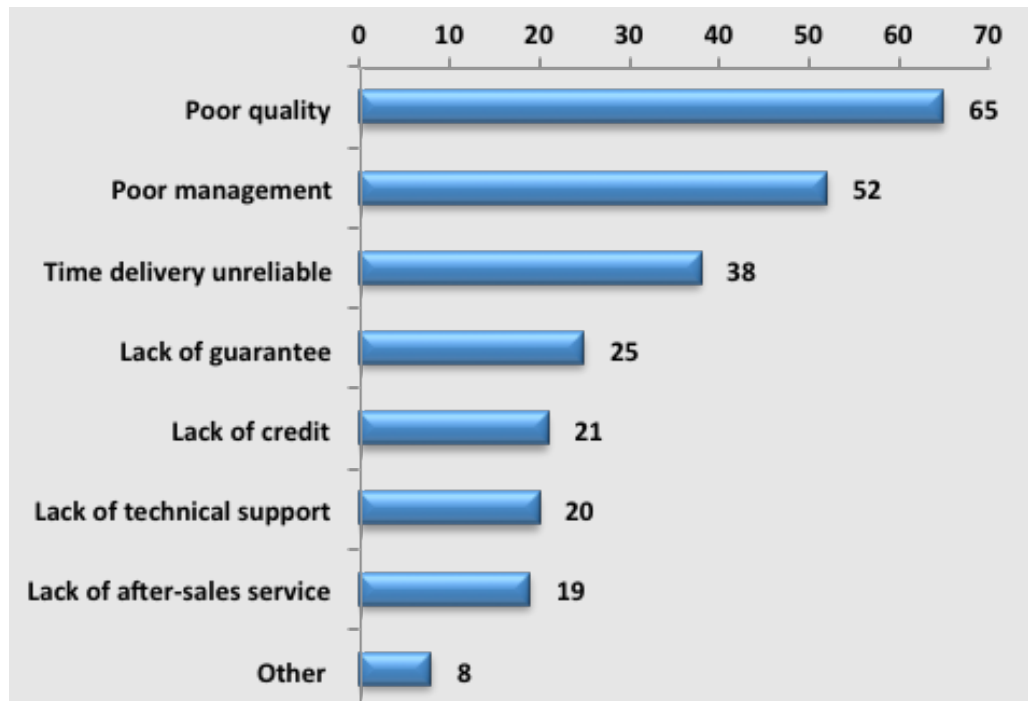
When selecting a Chinese supplier, our respondents seek quality first and price second. This pushes Chinese companies to improve the quality of their products and services whilst maintaining competitive prices (Chart IV.1.5).

Chart IV.1.5 What are the key decision factors when selecting a Chinese supplier?



Of a total of 132 responses, 77% state that it is very difficult to find a qualified supplier in China. The reason most cited are low quality and poor managerial skills (Chart IV.1.6).

Chart IV.1.6 Why is it difficult to find a qualified supplier?



Note: The 'other' category includes knowledge or awareness of standards, professionalism and inconsistent quality.

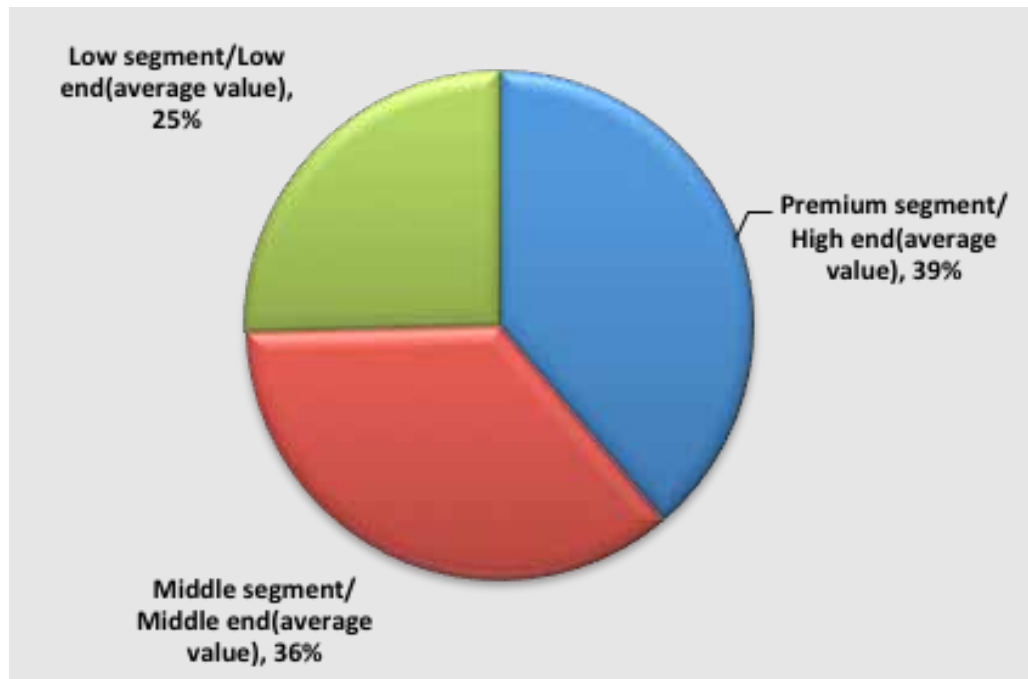
IV.2. Marketing and Sales

A large proportion of the companies interviewed still spends less than 5% of their sales revenues on marketing. The most effective marketing activities are seminars, conferences and events where the seller positions themselves as an expert. These events build brand value amongst their target customers.

In terms of distribution, most companies interviewed either own the channels or do direct sales. A second common way to distribute products is through local agents or distributors that allow our respondents to reach out to new geographies, which would otherwise be very costly to attain.

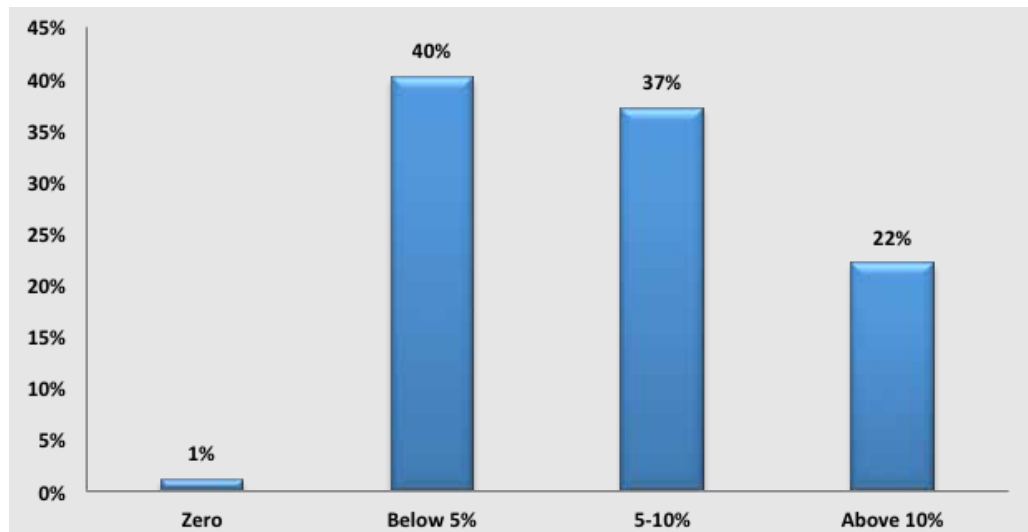
The companies we interviewed sell their products in all three market segments (low, medium and premium) with a preference for the high segment (39%). In a sense, one could argue that the high end segment has less competition from the domestic companies. Those experiencing more fierce competition are those foreign companies positioned on the low end and medium end segment of the market (Chart IV.2.1).

Chart IV.2.1 In what segments in China are you selling your products as % of revenue?



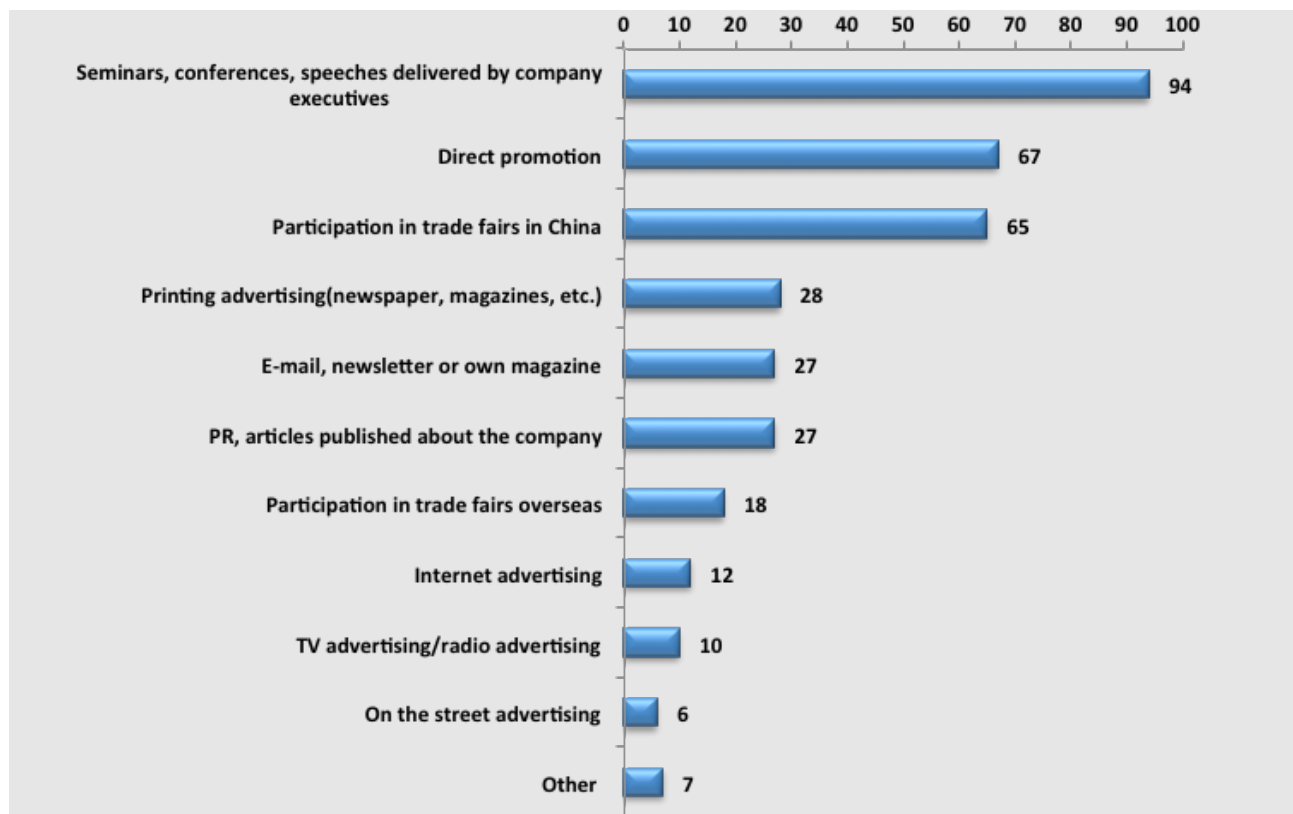
Most companies interviewed spent less than 5% (40%) or between 5 to 10% (37%) of their yearly revenues on marketing and sales (Chart IV.2.2). As branding acquires increasing relevance and the Chinese market matures, the percentage of yearly revenues spent on marketing and sales is expected to grow.

Chart IV.2.2 What percentage of yearly revenues do you spend on marketing and sales? (N=156)



Events such as seminars, conferences and direct promotion are seen as the most effective way to promote our interviewees businesses. Additionally, executives can expand their network during these events. Participation in trade shows, which was the most popular in our 2010 survey, falls to the number three position in this year's ranking (Chart IV.2.3).

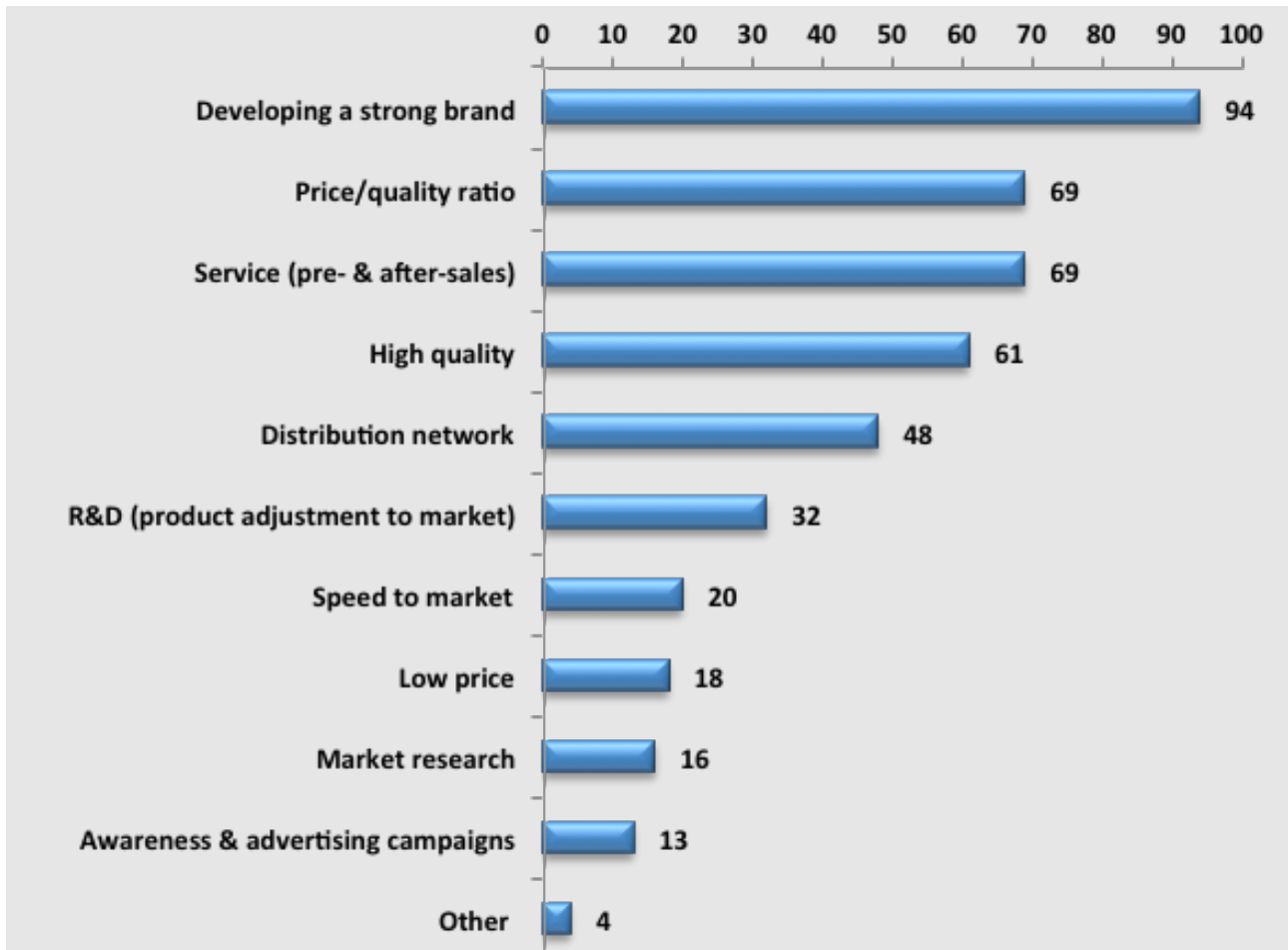
Chart IV.2.3 Which marketing activities are most effective for your main business?



Note: The 'other' category includes word of mouth, test drive events, internet searches by customers and roadshows at the customer's location.

The majority of the companies interviewed believed that the impact of their marketing efforts on the success of their sales in China is the same as that of last year. Developing a strong brand, the price/quality ratio and service are the top three factors in this category. As mentioned before, brand development is becoming more important as the Chinese income levels increases (Chart IV.2.4).

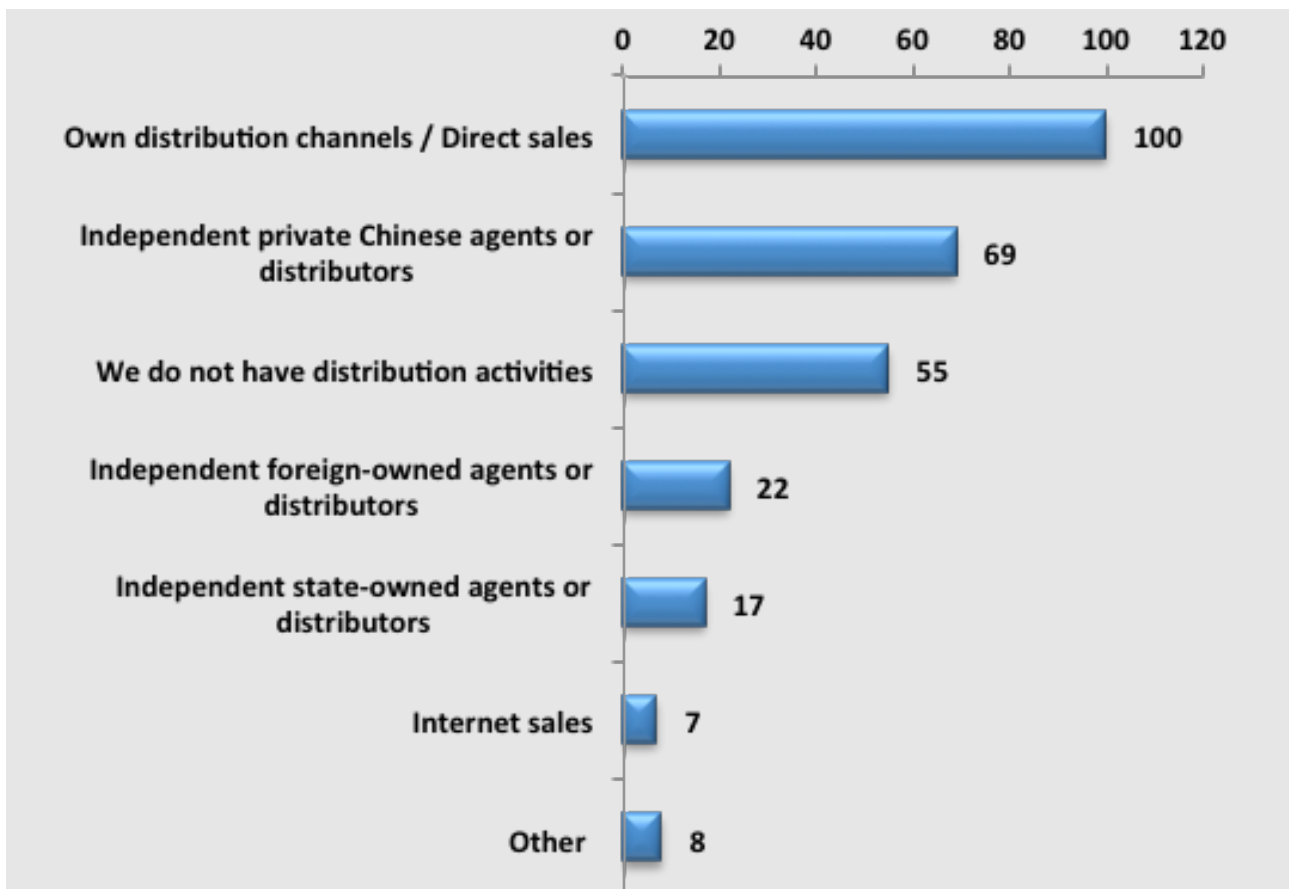
Chart IV.2.4 Please rate the influence of these different factors on the success of your sales in China.



Note: The 'other' category includes 'guanxi' and strong relationships with global customers.

Most of the companies in our survey own their distribution channels or sell directly. The second most common way to distribute their products is through Chinese agents or distributors. In a vast and heterogeneous country such as China, where infrastructure is still developing it is essential, if not indispensable, to team up with Chinese distributors to reach second or lower tier cities (Chart IV.2.5).

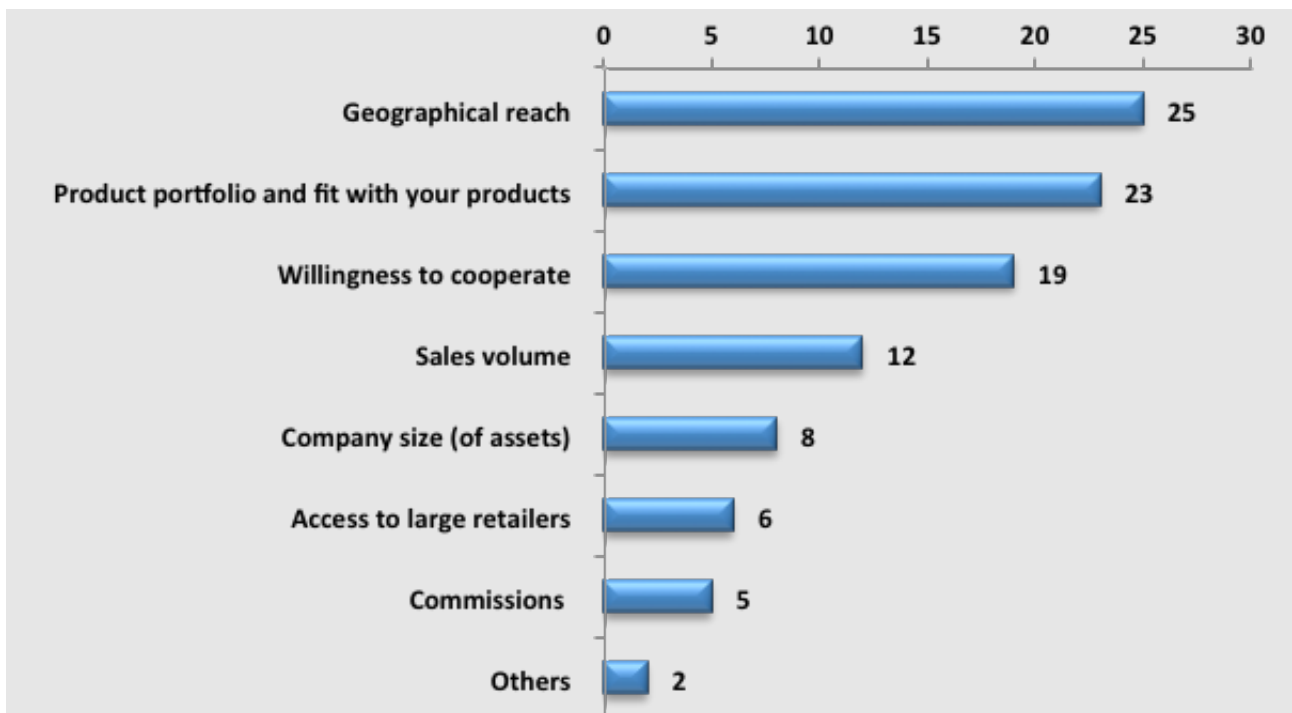
Chart IV.2.5 How do you distribute your products in China?



Note: The 'other' category includes banks and JVs with local partners.

Those foreign companies using local distributors do so to reach new market geographies. In some other cases, there is a good fit in the product portfolio offered by the local partner and that of the foreign business (Chart IV.2.6).

Chart IV.2.6 What are the key decision factors when partnering with domestic wholesalers or distributors?



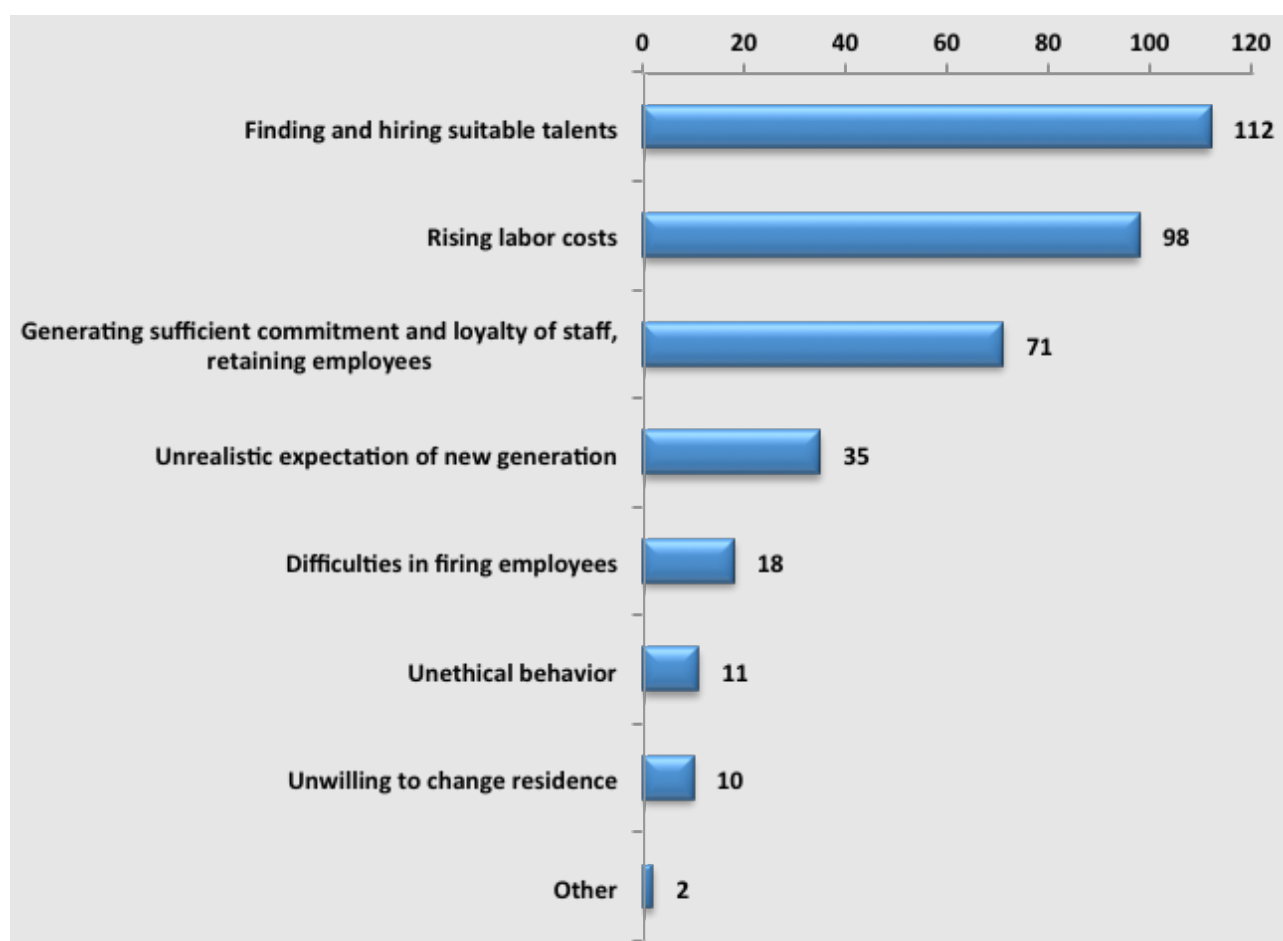
Note: The 'other' category includes acceptable business practices and technical knowledge of products.

IV.3. Human Resources

The average increase in the Chinese labor force of our respondents in 2011 was 16.4%. This increase is an indication of the positive development of their operations in China, whilst their operations in the more developed countries suffer the consequences of the economic downturn. The average salary increase in 2011 was 13.18%. Companies found it especially difficult to hire middle managers because they either lacked experience and skills or their monetary expectations were too high.

The majority of the companies agree that human resources is their top concern in successfully running their businesses in China. Rising labor costs and hiring and retaining key employees are the top challenges (Chart IV.3.1).

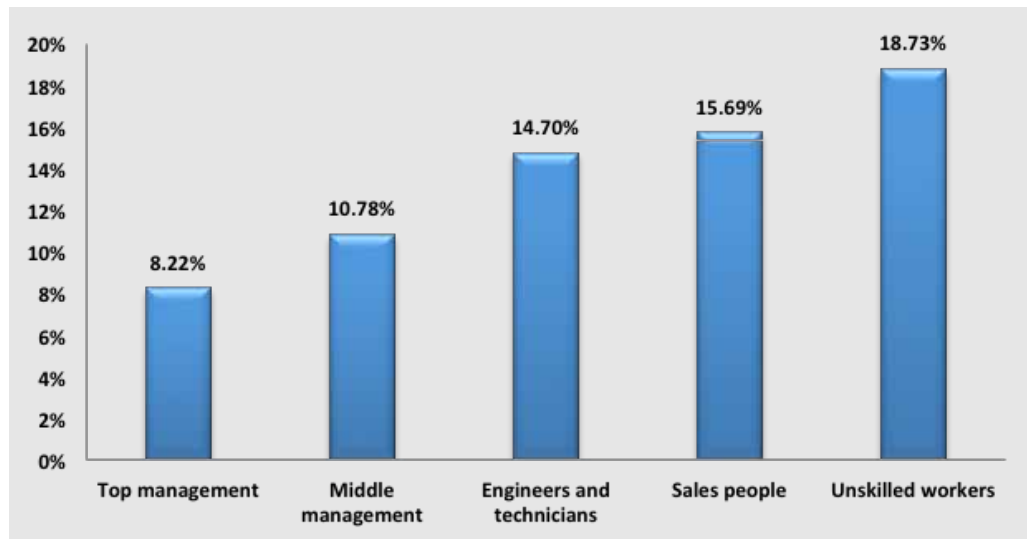
Chart IV.3.1 Which are the major human resource issues your company is facing in China?



Note: The 'other' category includes internal and professional training and high living cost in big cities.

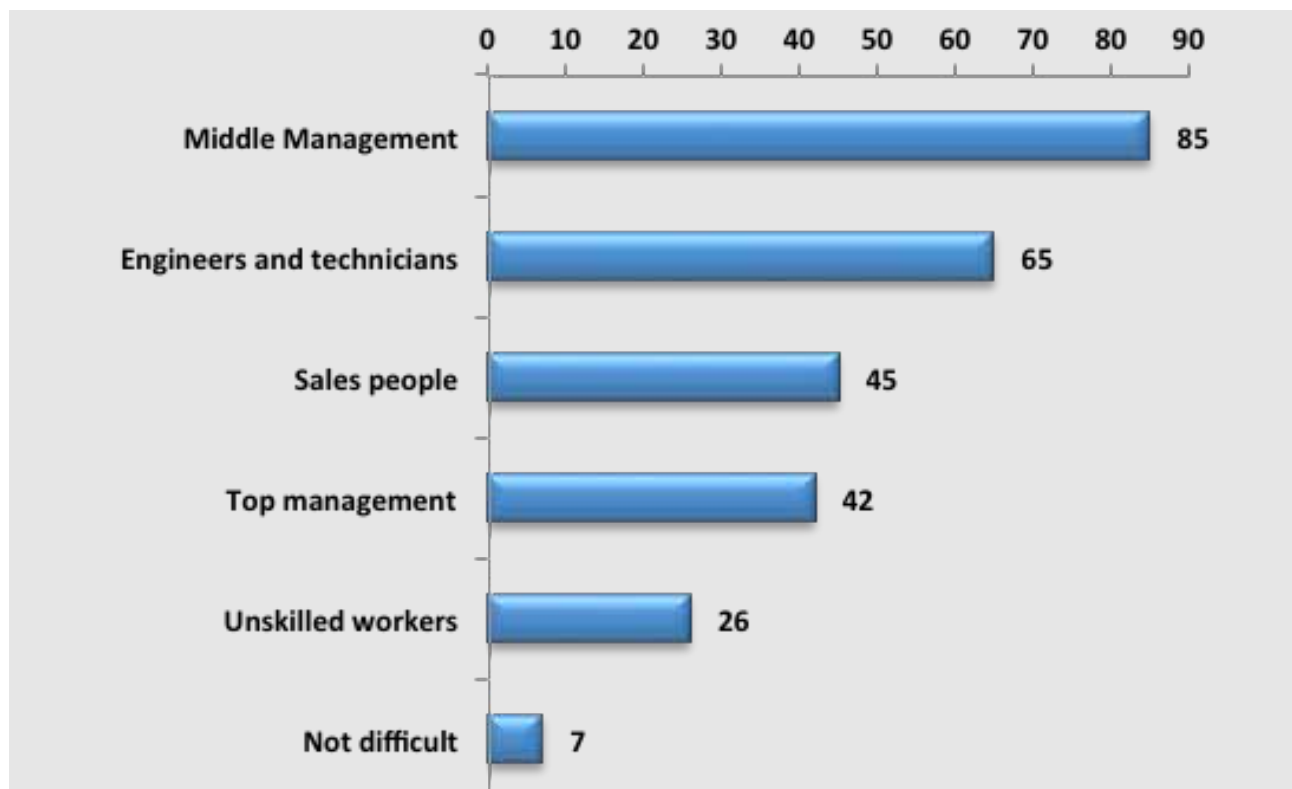
The average employee turnover in 2011 amongst the respondents' companies was 15.41% compared to 12% in 2010. Unskilled employees are the most difficult to retain and their turnover rate is 18.73% versus a top management churn of 8.22%. Companies needed to spend significant resources to hire new employees, train them and especially in the case of unskilled employees, make sure that quality is stable (Chart IV.3.2)

Chart IV.3.2 What is your company's average employee turnover in 2011 by category?



Our respondents agree that middle managers are the most difficult to find in the Chinese labor market along with engineers and technicians. Top management appears to be moderately difficult to source (Chart IV.3.3).

Chart IV.3.3 At which level is it difficult to find suitable human resources for your company in China?



Why is it difficult to find suitable talent? The respondents point to the lack of experience as a critical problem. Furthermore employees' technical or business skills are not up to the needs of the company, and if they are, they are usually too expensive. Often this talent comes with unreasonable expectations in terms of salary and career (Chart IV.3.4).

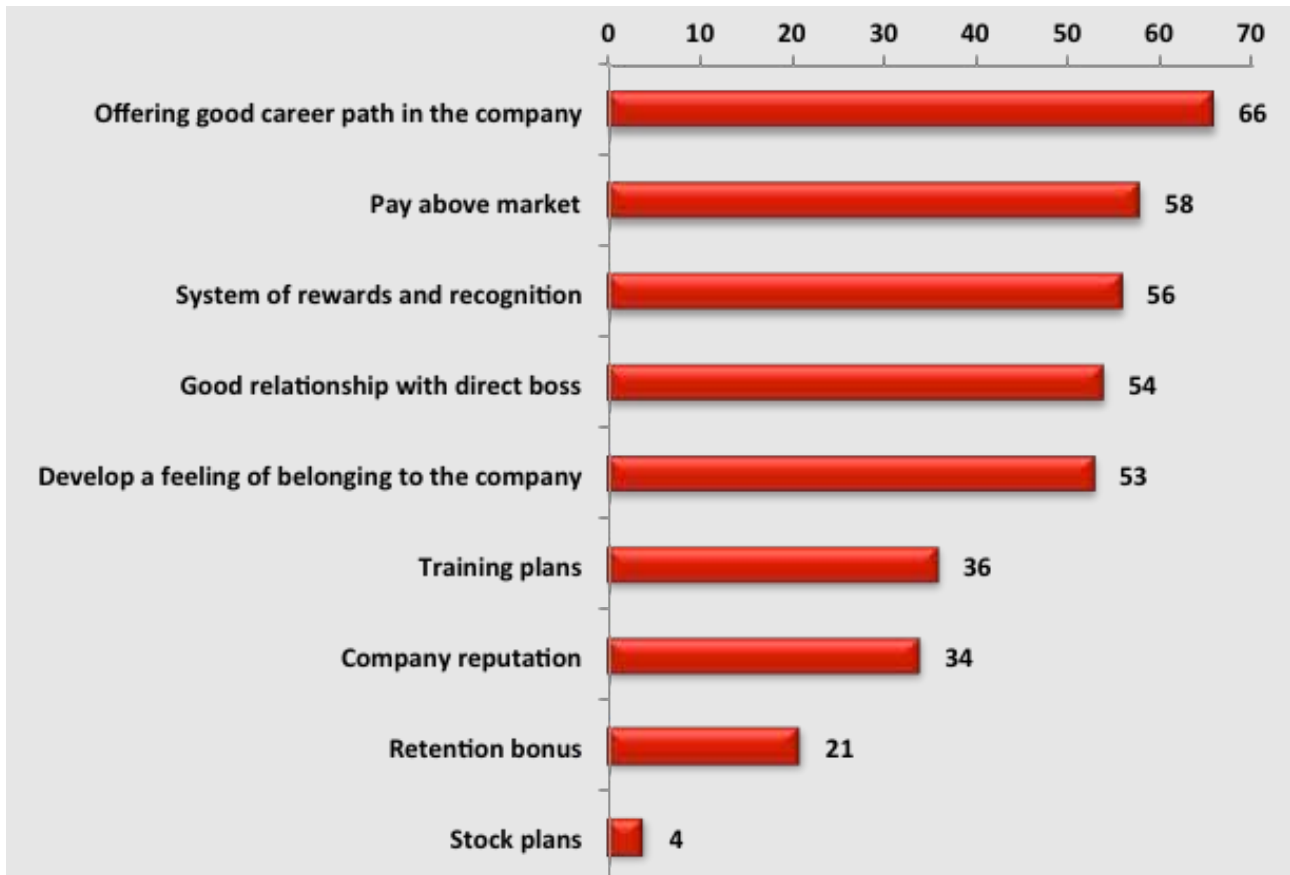
Chart IV.3.4 For the personnel you have difficulty acquiring, what are the key reasons?



Note: The 'other' category includes unreasonable salary expectations and English proficiency.

Our respondents use different ways to retain key employees such as offering good career prospects, above market average pay, rewards and recognition, good relations with their direct bosses and creating a feeling of belonging to the company. Besides good career opportunities, there is not big difference amongst the other factors. What is clear is that companies need to pay special attention to all HR practices in order to retain talent and reduce turnover at all levels (chart IV.3.5).

Chart IV.3.5 What measures do you find most efficient in retaining employees in China?



Section V

JOINT VENTURES

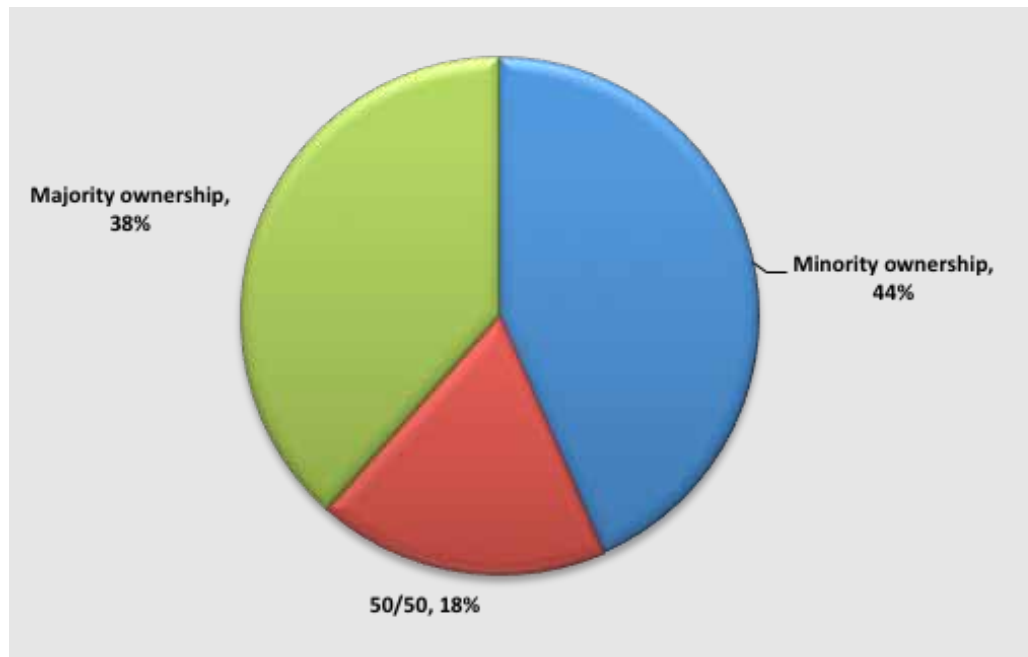
This section covers information about joint ventures with foreign partners, specifically:

- **Ownership positions**
- **Main difficulties in working with foreign partners**

The purpose of this section is to give a sense of the main challenges faced when partnering with a foreign entity.

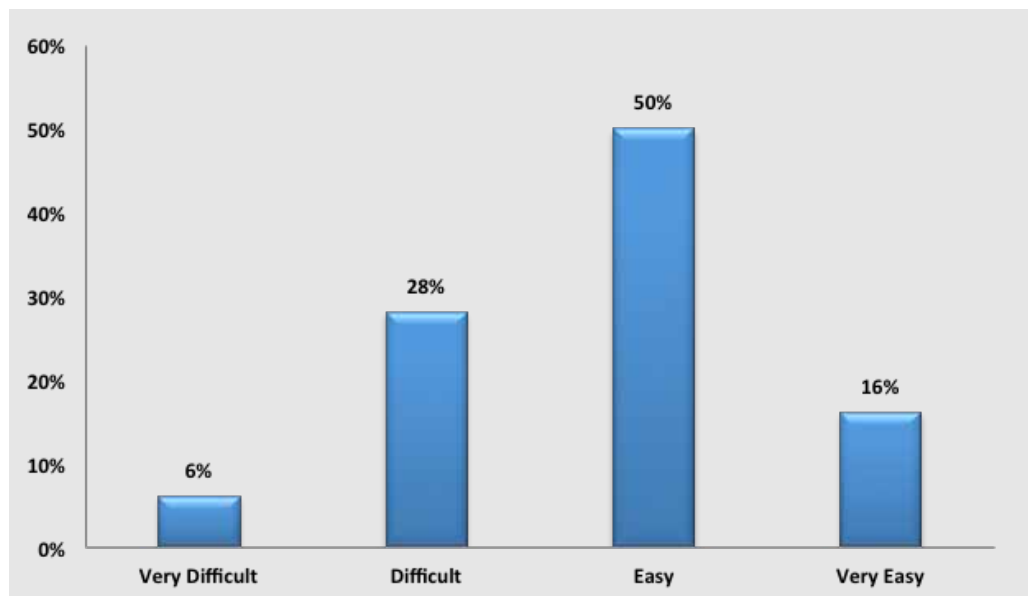
Of a total of 208 responses, 67 (32%) of our surveyed companies have a Chinese partner. Among those, only 18% are in a 50-50% ownership. In most cases (44%) the foreign side controls the JV (Chart V.1).

Chart V.1 What is the ownership position of your Chinese partner? (N=67)



About 34% of respondents find it difficult (28%) or very difficult (6%) to work with their Chinese counterparts (Chart V.2).

Chart V.2 How difficult/easy is working with your Chinese partner? (N=68)



The main reasons volunteered for these challenges are due to cultural differences and communication problems. The second most prominent is differences in strategy and, in third place, conflict of priorities. Building personal relations and understanding cultural differences seem to be essential to have a smooth JV operation (Chart V.3).

Chart V.3 In your view, what are the main difficulties with your Chinese partner?



Note: The 'other' category includes implementation of long term strategy and the Chinese partner not contributing enough.

Section VI

INNOVATION

This section details information about the kind of innovations the respondents' companies developed in China. We have classified the answers into three groups:

- **Innovation:** types of innovations, number of new products/services launched in 2011 and contributions of these new products to the last year's sales.
- **R&D:** type of research activities, size of R&D centers, locations, numbers of employees, research budget and reasons for opening an R&D center in China.
- **Intellectual Property Rights:** importance of IP, type of IP owned, IP infringements experienced, resultant damage to their businesses, ways to protect against infringements and government IPR protection.

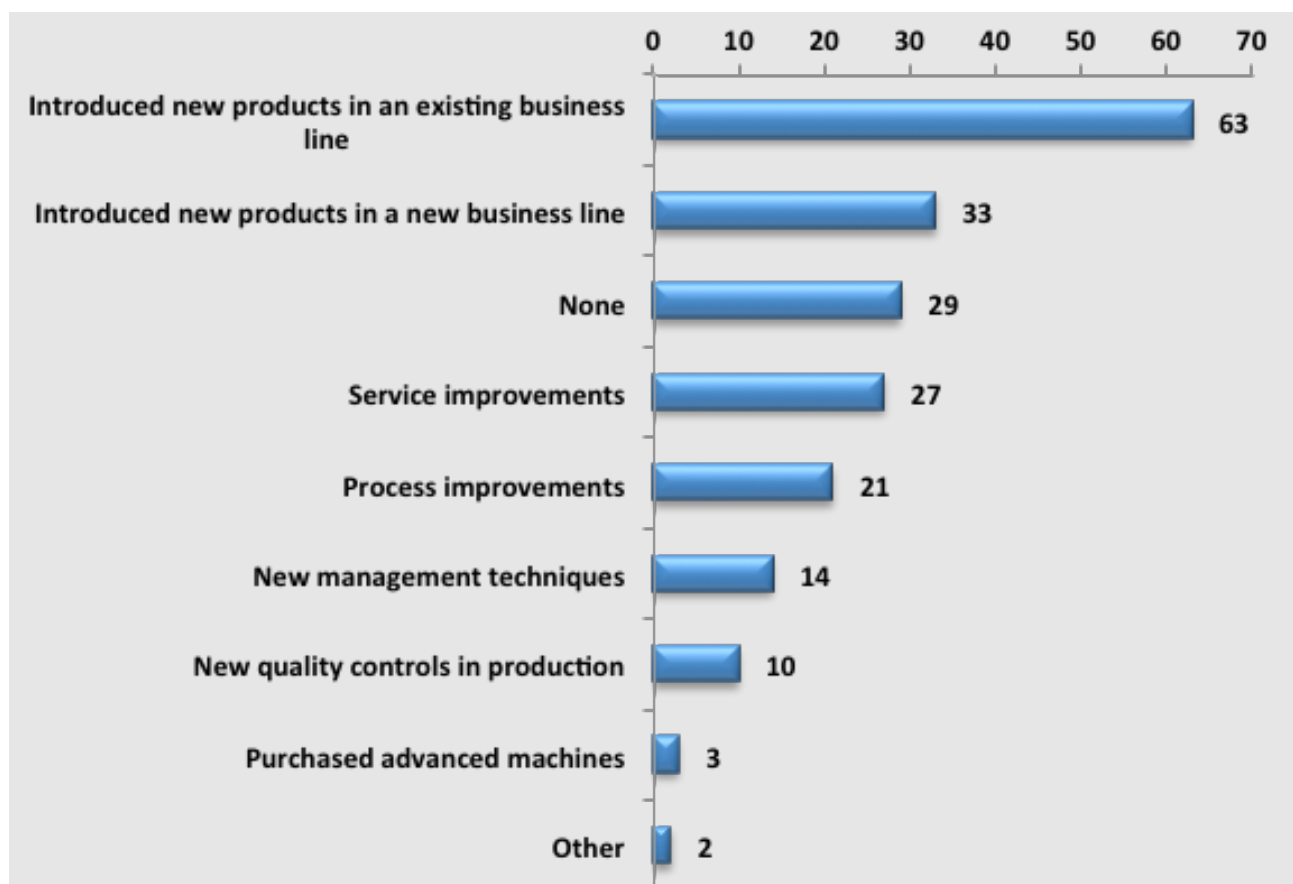
The purpose of this section is to give a summary of the innovation tendencies of Chinese companies and trends regarding intellectual property rights protection.

VI.1. Innovation and R&D

The companies in the survey actively innovate in China mostly by either launching new products in an existing business line or creating a new business line. A total of 80 executives stated that their companies had R&D centers in China. Most of the R&D centers in China are located in the coastal provinces, Shanghai, Beijing and Tianjin. The funding and the number of employees of these centers varies widely across the sample, although most companies (57%) spend less than 5% of their revenues in R&D activity. Nonetheless, more and more companies understand the necessity of bringing their R&D to China in order to adapt products to local preferences and be able to respond faster to market needs.

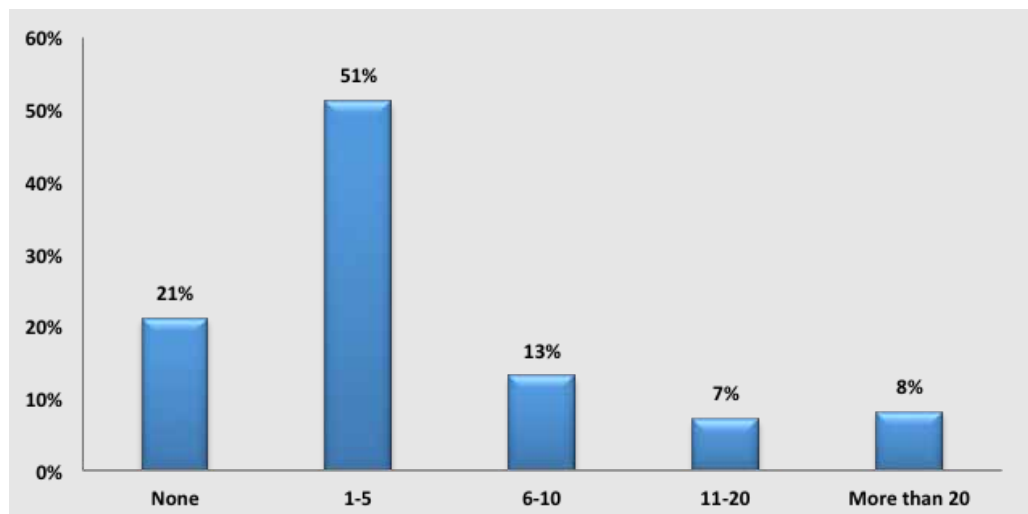
The most common manner for our respondents to innovate is to introduce a new product in an already existing business line or in a new business line. Surprisingly, the third most common response in our survey was not to innovate at all (Chart VI.1.1).

Chart VI.1.1 What types of innovation have you introduced since the beginning of 2011?



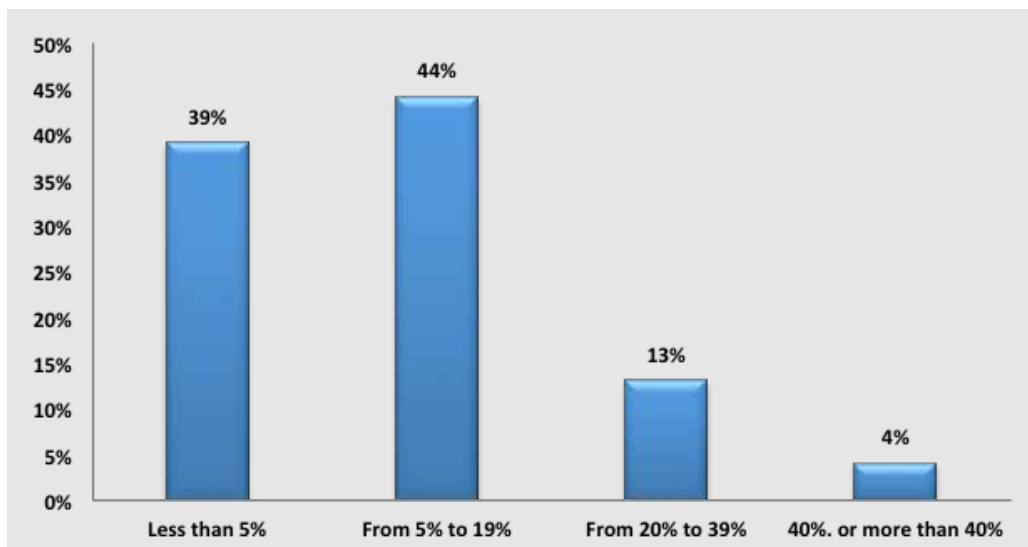
In line with the previous chart, 21% of respondents launched no innovation in 2011. On the other hand, 51% of the respondents introduced 1 to 5 new products, with 8% of the sample launching more than 20 new products in 2011 (Chart VI.1.2)

Chart VI.1.2 How many new products/services have you introduced in 2011? (N=198)



This innovation effort is also reflected in the percentage that new products represent of the China total sales (Chart VI.1.3).

Chart VI.1.3 For new products/services introduced in 2011, what percent of China total sales do they account for? (N=158)



Of a total of 209 responses, 38% of companies conduct R&D in China. We expect this figure to increase in the near future as more and more companies compete to be closer to Chinese consumers, responding ever faster to market needs. Similar to the locations of production plants, most of the R&D centers are located in Beijing, Shanghai, and the coastal areas of China (Chart VI.1.4).

Chart VI.1.4 Where are your R&D centers in China located?

Answer	Response
Beijing	17
Tianjin	2
Shanghai	46
Shenzhen	7
Chongqing	0
Hebei, Shanxi, Inner Mongolia	1
Liaoning, Jiling, Heilongjiang	2
Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong	25
Henan, Hubei, Hunan	1
Guangdong, Guangxi, Hainan	6
Sichuan, Guizhou, Yunnan, Tibet	4
Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang	4

The size of the R&D centers varies, as do the number of employees and annual funding budgets. On average, companies are citing bigger budgets to develop their R&D activities compared to last year's survey. Again, we would expect this figure to escalate in keeping with the increasing importance of the China market (Charts VI.1.5 and VI1.6).

Chart VI.1.5 How many people are there in your R&D center in China? (N=80)

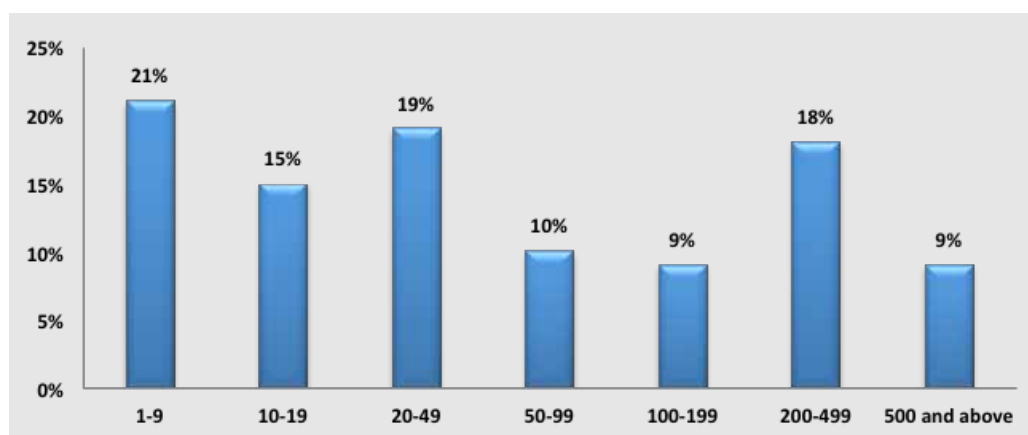
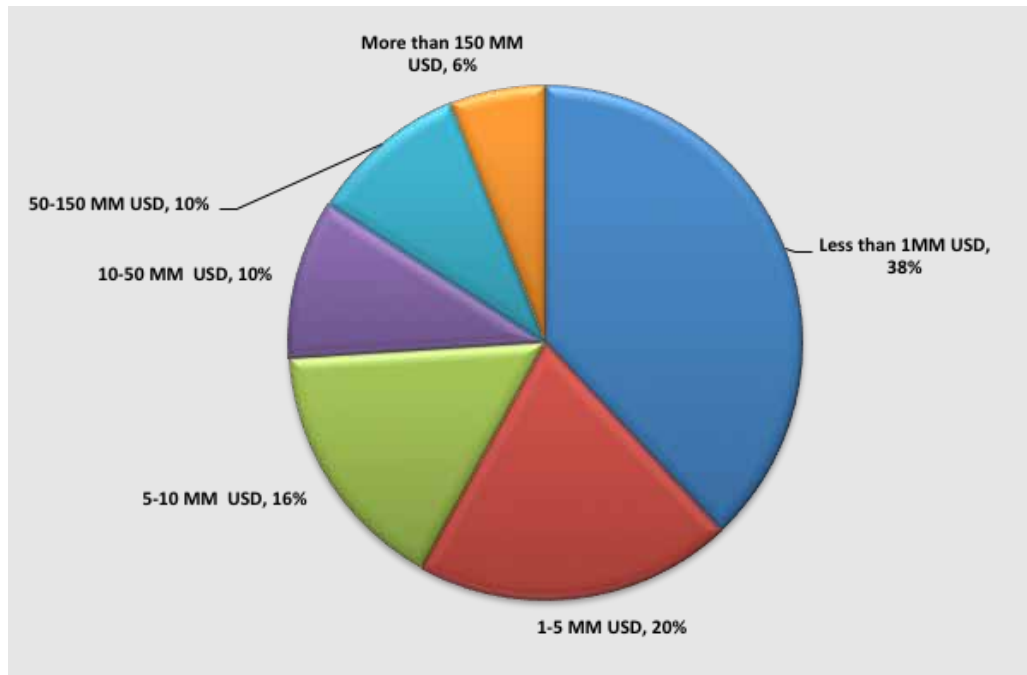
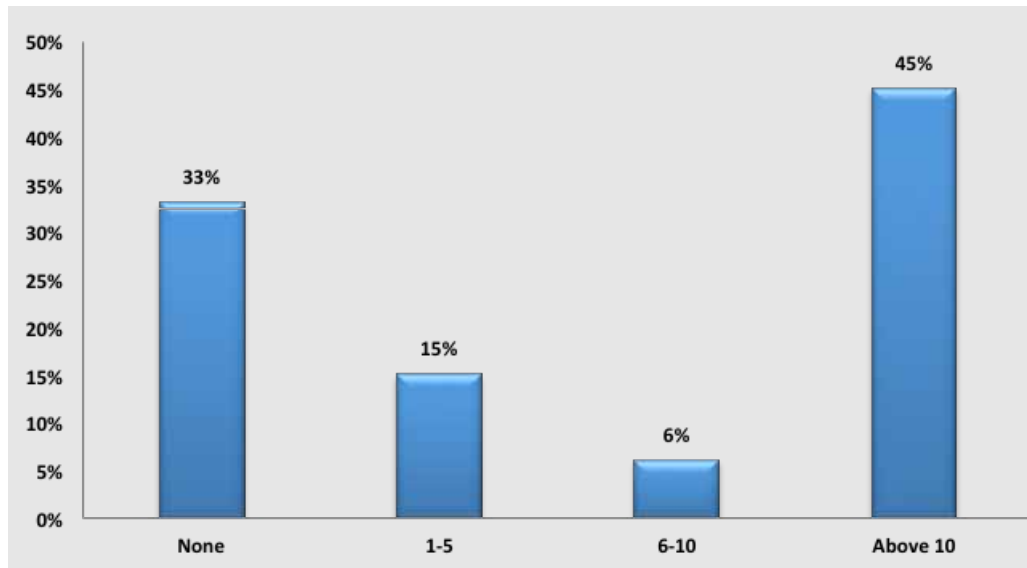


Chart VI.1.6 What is your R& D China Center's annual funding? (N=80)



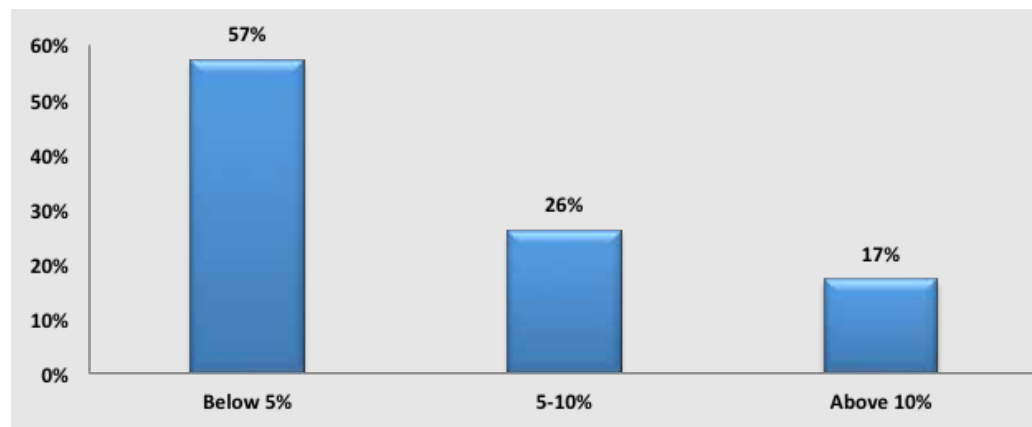
When we asked the surveyed companies how many patents they registered in the past 2 years, we received two predominant answers. Either they have never registered a patent (33%) or they registered more than 10 (45%) (Chart VI.1.7).

Chart VI.1.7 Have you obtained any patent in China in the last 2 years? (N=78)



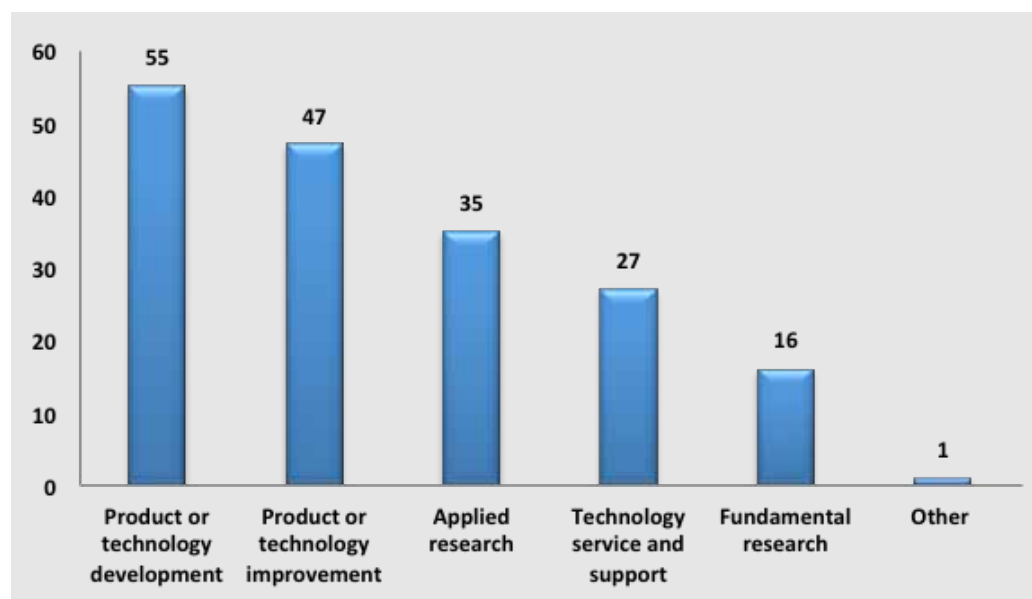
The majority of respondents spend 5% or less on their R&D in China (57%), probably indicating that those centers are more focused on development than research (Chart VI.1.8).

Chart VI.1.8 What is your annual expenditure on R&D in China as a percent of revenues? (N=77)



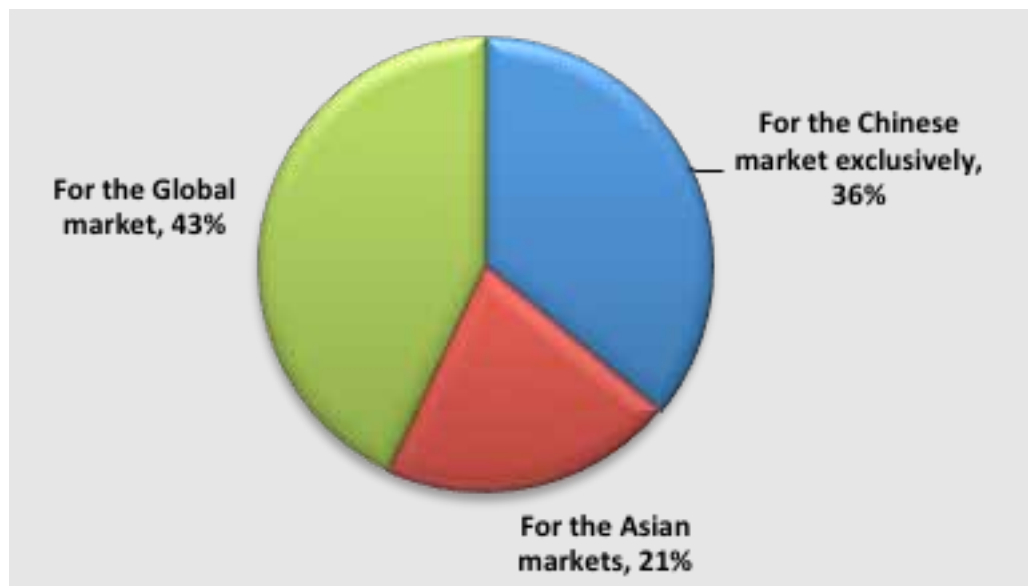
Companies' R&D focuses are mainly new product and technology development or improvement (Chart VI.1.9).

Chart VI.1.9 What type of R&D activities do you do in China?



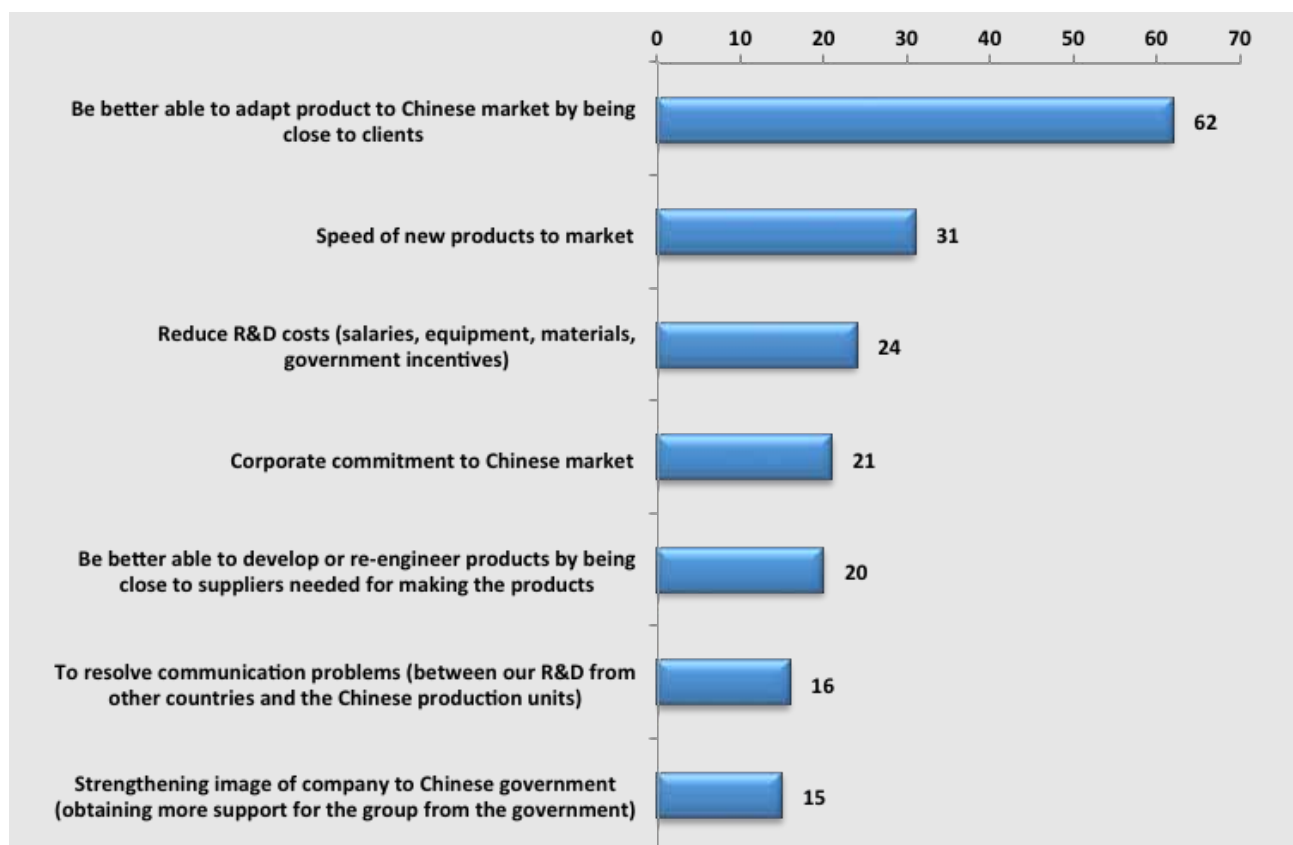
Interestingly, 43% of respondents declared that the R&D activities performed in China are expected to have an impact in their global operations. So in other words, these foreign companies are using China as a platform for innovations not just for China, but for their global markets, taking advantage of cost advantages and synergies (Chart VI.1.10).

Chart VI.1.10 For what market(s) are your R&D activities intended? (N=80)



The reasons for having R&D in China are consistent year on year. As the Chinese market gains relevance and traction in the global economy, companies need to not only to gain the ability to adapt products to Chinese consumers, but also need to become more responsive by being closer to them (Chart VI.1.11).

Chart VI.1.11 How important are the following reasons for having R&D in China?



Shanghai, Beijing and the Eastern Coastal areas are still seen as the most attractive places to locate R&D centers, followed by Tianjin and the Western provinces (Chart VI.1.12).

Chart VI.1.12 Where do you plan to open R&D centers in China in the next 2-5 years?

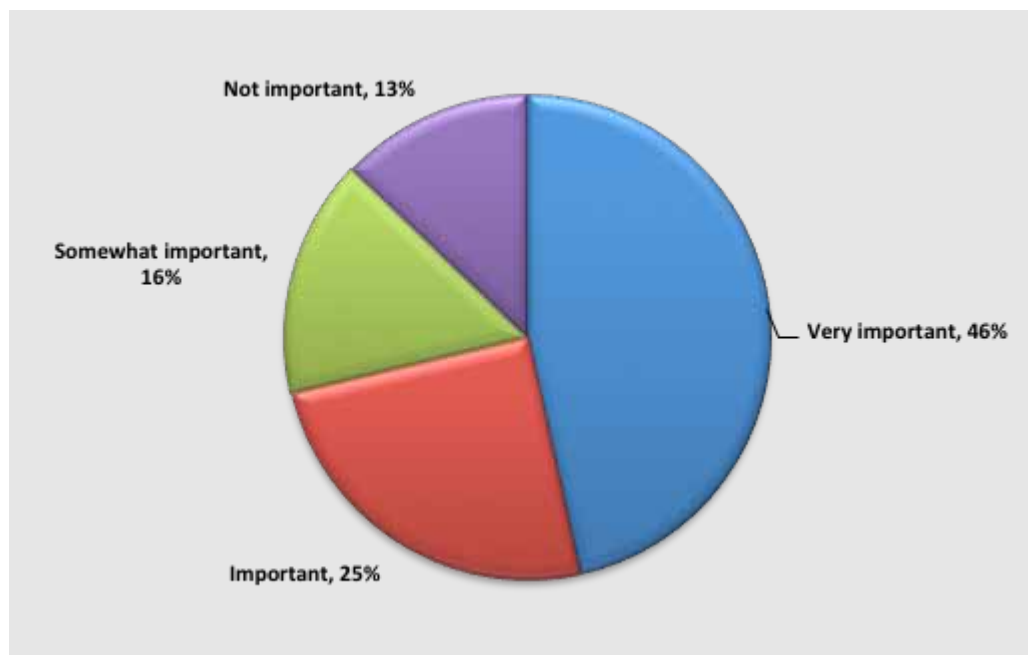
Answer	Response
Shanghai	40
Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong	19
Beijing	15
Tianjin	6
Sichuan, Guizhou, Yunnan, Tibet	6
Shenzhen	4
Guangdong, Guangxi, Hainan	4
Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang	3
Chongqing	2
Henan, Hubei, Hunan	2
Hebei, Shanxi, Inner Mongolia	1
Liaoning, Jiling, Heilongjiang	1

VI.2. Intellectual Property Rights

The majority of the respondents are affected by intellectual property infringement. In most cases, a Chinese manufacturer, a JV partner or its own employees/ suppliers are behind the problem. This situation has an impact on our respondents' results, severe in some cases. To protect their IPR they advocate for registering IP and HR management actions. Although the government is making positive advances in IPR protection, the perception of our executives on this regard is that those initiatives are insufficient and/or ineffective, 56% of the respondents believe that the situation is the same as that of three years ago.

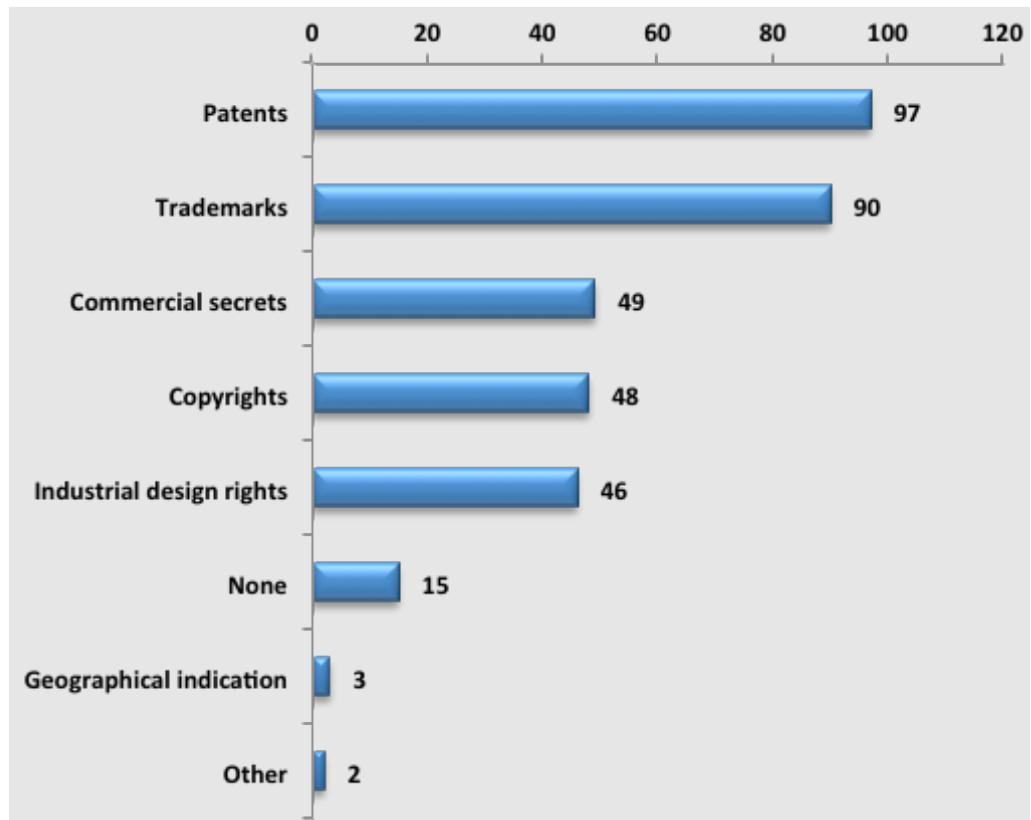
Among the companies participating in the survey, the majority (87%) believe that intellectual property has a discernible impact on their business results and therefore should be protected (Chart VI.2.1).

Chart VI.2.1 How important is IP (intellectual property) to your business? (N=206)



Regarding the type of IPR, the majority of the respondents own patents and trademarks. Copyrights have ended up much further down the list (Chart VI.2.2).

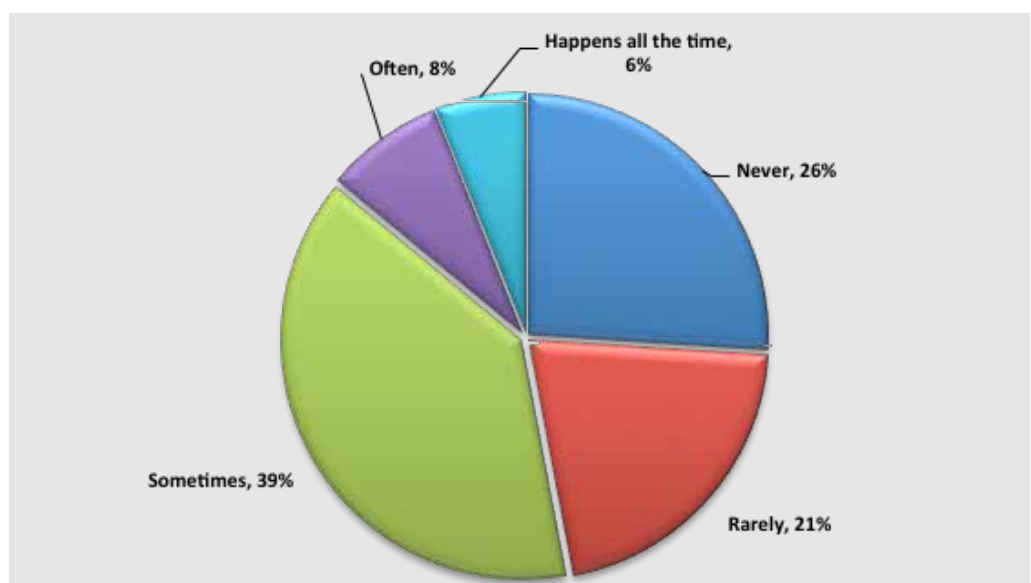
Chart VI.2.2 What type of IP do you own?



Note: The 'other' category includes license rights.

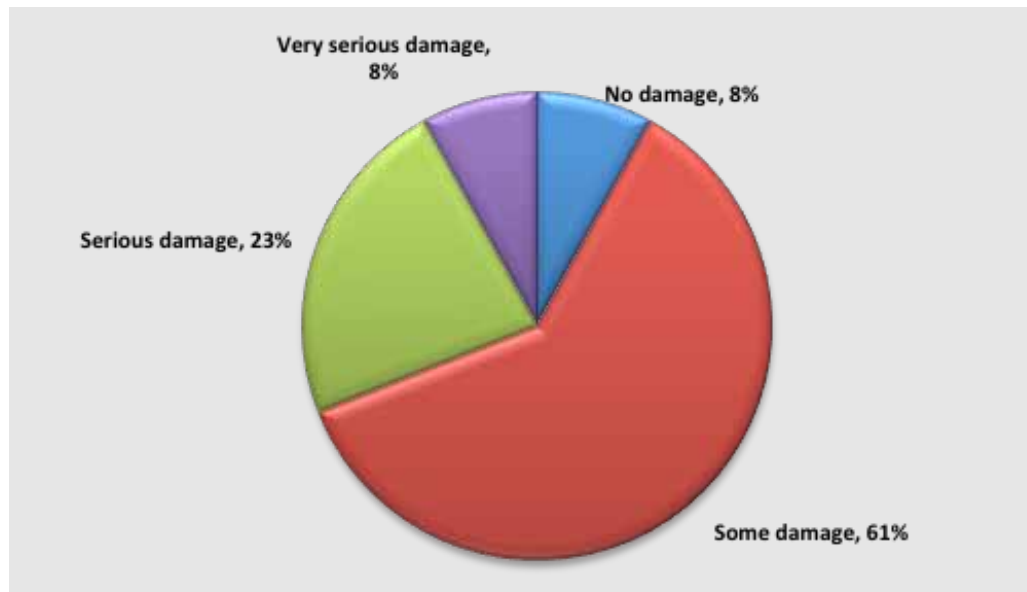
Amongst the respondents who own IP, only 26% of them claim that their intellectual property has never been infringed. About 8% of them report that it is often violated and 6% of the sample state that infringement happens all the time. Although new initiatives have been put into place to protect this kind of property ownership, China needs to make more efforts in this regard to promote innovation and R&D. (Chart VI.2.3)

Chart VI.2.3 How often have your IP rights been infringed in 2011? (N=164)



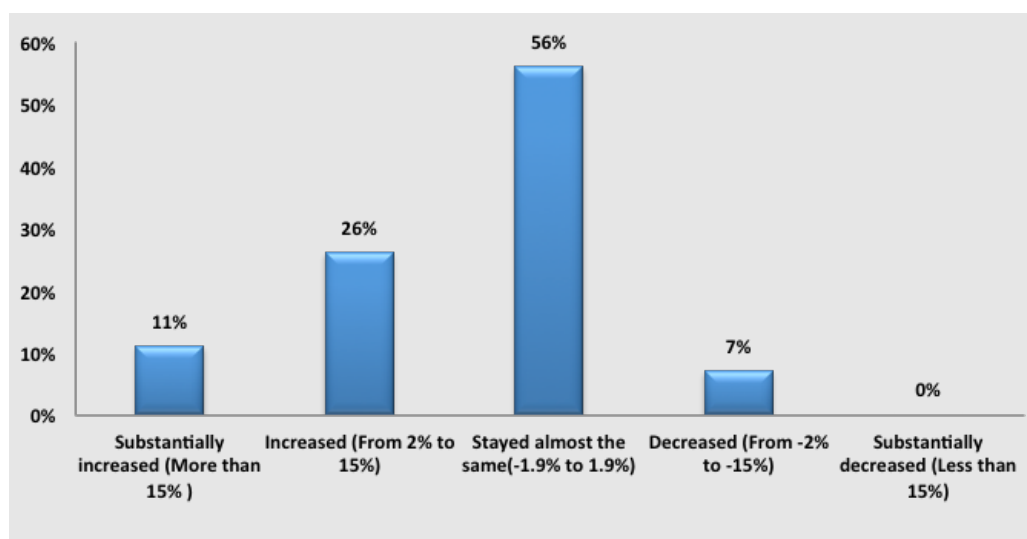
IP infringement damages business and has a negative impact on the profits of our respondents. Only 8% of them hold the view that IP violation has not caused them any harm. 8% report that the damage has been very serious and 23% say it has been serious (Chart VI.2.4).

Chart VI.2.4 What is the extent of damage caused by IP infringement on your business? (N=88)



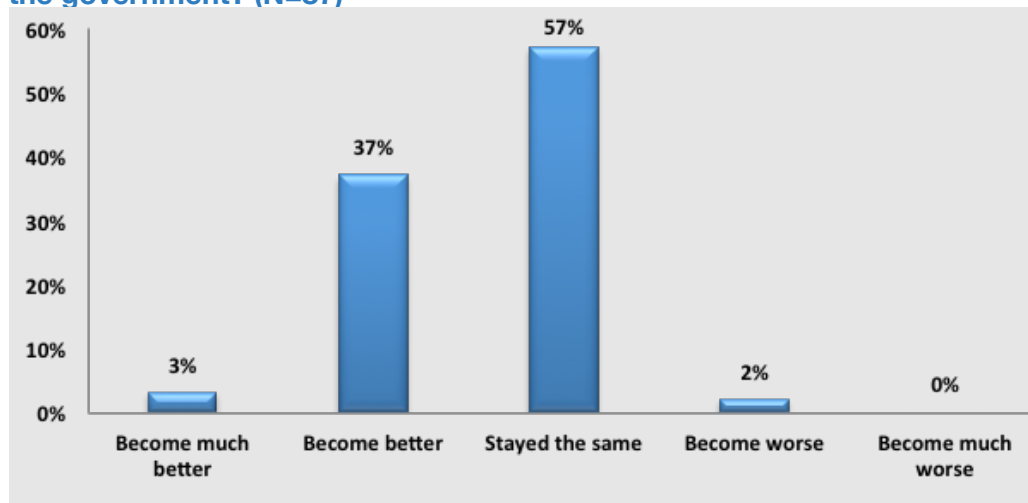
Most companies interviewed (56%) believe that IP infringement remains the same compared to previous years. Government plans to protect intellectual rights seem to be insufficient and ineffective. It appears that more work needs to be done in this area by the Chinese government. (Chart VI.2.5)

Chart VI.2.5 Compared with the past three years, would you consider that the amount of IP infringement in your business has: (N=84)



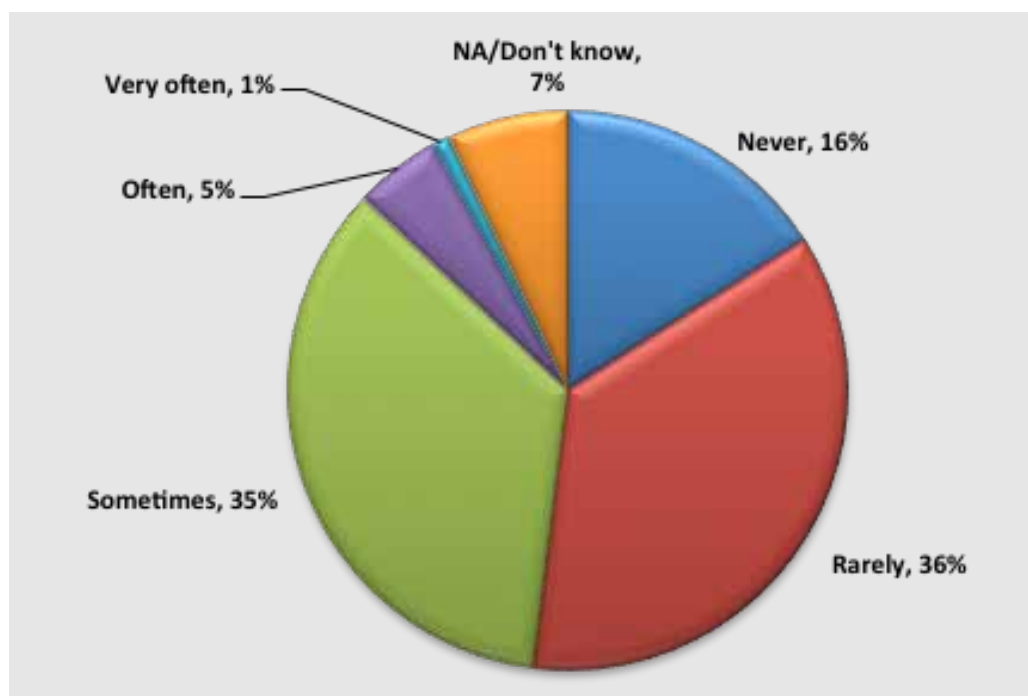
57% of the respondents believe that IP protection from the government has not changed in the past three years. On the other hand, almost 40% believe that it has improved, with 3% observing a great improvement (Chart VI.2.6). These percentages are similar to those of the 2010 survey.

Chart VI.2.6 In the past three years, how would you describe the IPR protection from the government? (N=87)



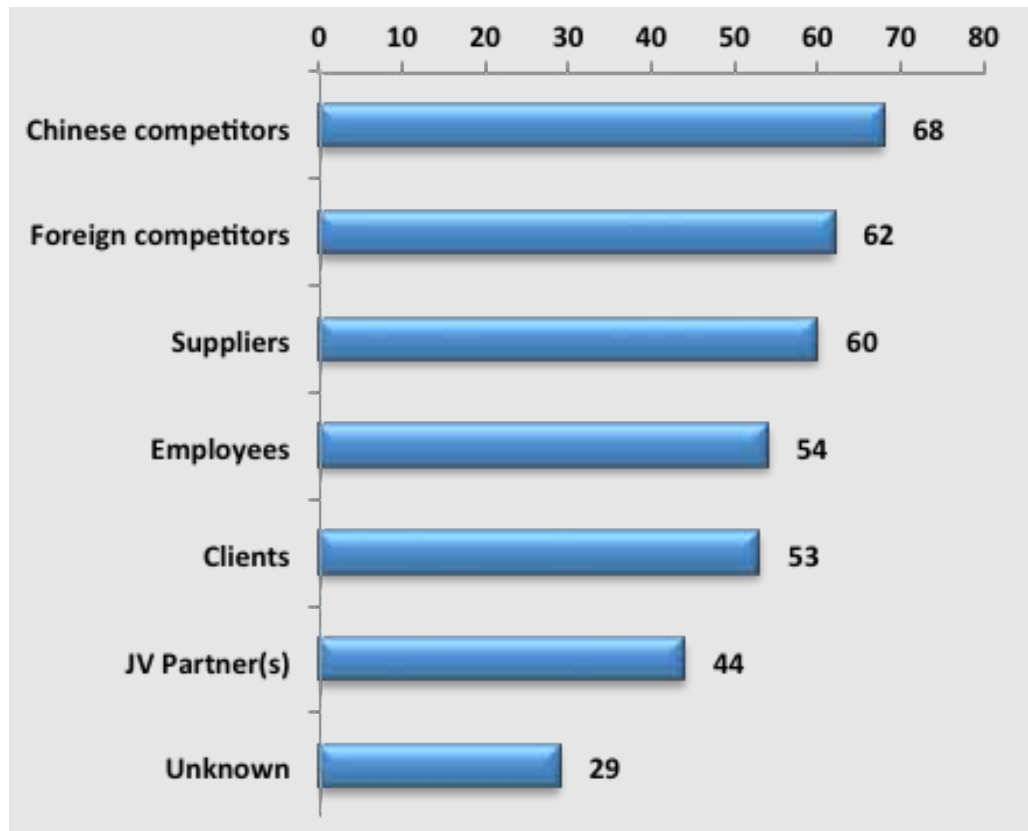
The majority of the respondents never (16%) or rarely (36%) take legal action to protect their IPR. It seems that our respondents opt not spend time and money on the courts to fight for their IP rights (Chart VI.2.7).

Chart VI.2.7 How often do you take IP cases to Chinese courts? (N=81)



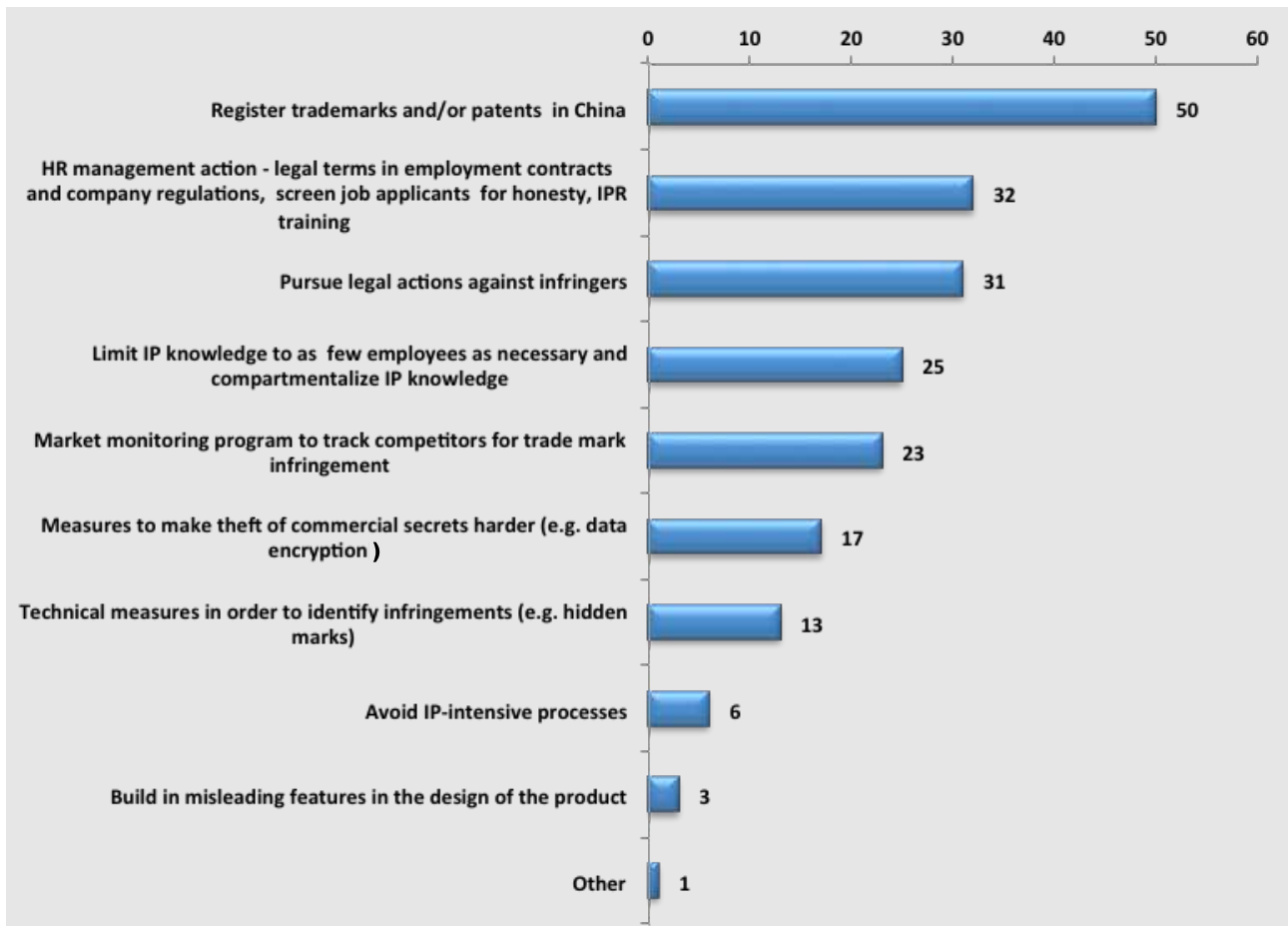
According to our executives, most of the time Chinese companies are behind IP infringement, followed closely by other foreign companies and suppliers (Chart VI.2.8).

Chart VI.2.8 Who have been the perpetrators of the IP infringements?



According to the respondents, the most effective way to protect intellectual property in China is to register it. Second on the list are HR actions such as employment contracts, checking for honesty in the hiring process and providing IPR training (Chart VI.2.9). These results are similar to last years survey.

Chart VI.2.9 What are the most effective measures you use to protect your Intellectual Property in China?



According to our sample, it takes competitors about 8 months to a year to launch similar products. This fact puts pressure on the innovation process in order to keep ahead of those competitors (Chart VI.2.10).

Chart VI.2.10 How long after one of your new products has come to the market in China do you see the competition releasing the same kind of product, or copies? (N=78)



Section VII

INVESTMENT AND EXPORTS

This section includes information about future investment plans and exports:

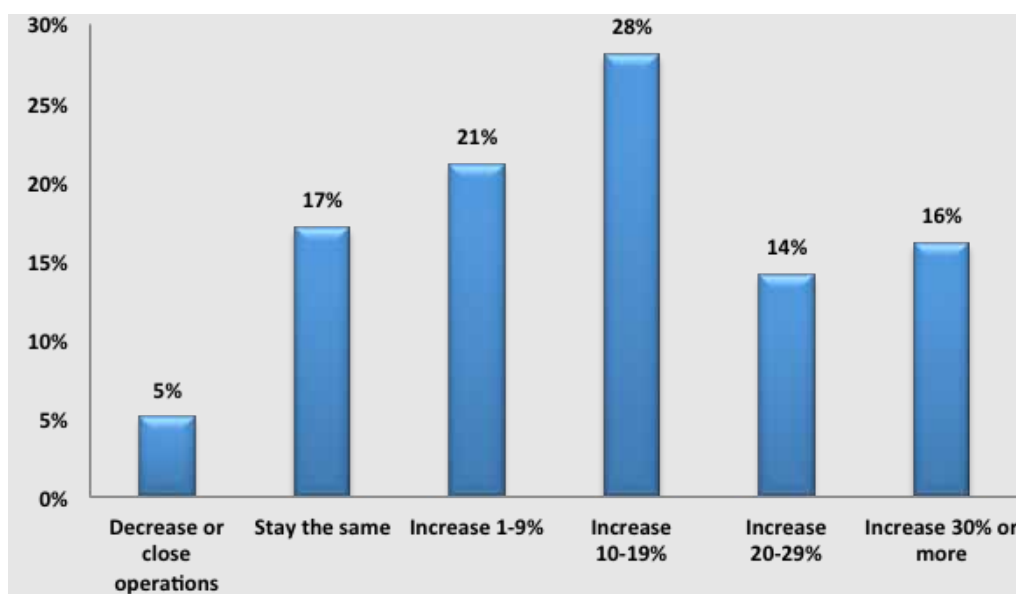
- **Investment: future plans and locations.**
- **Exports: compared to previous year and main destinations.**

The purpose of this section is to give a general idea of our respondents' investment plans and their export performance.

VII.1. Investment

The majority of the companies included in the survey plan to invest more in China in 2012 than in 2011. 79% will increase their investments, and only 5% will decrease or close their operations in China (Chart VII.1.1).

Chart VII.1.1 What investments do you plan for 2012? (N=250)



Although some companies are moving westward, the majority of the investment will be done in the Eastern Coastal provinces and the four biggest cities (Shanghai, Beijing, Tianjin and Chongqing) (Chart VII.1.2).

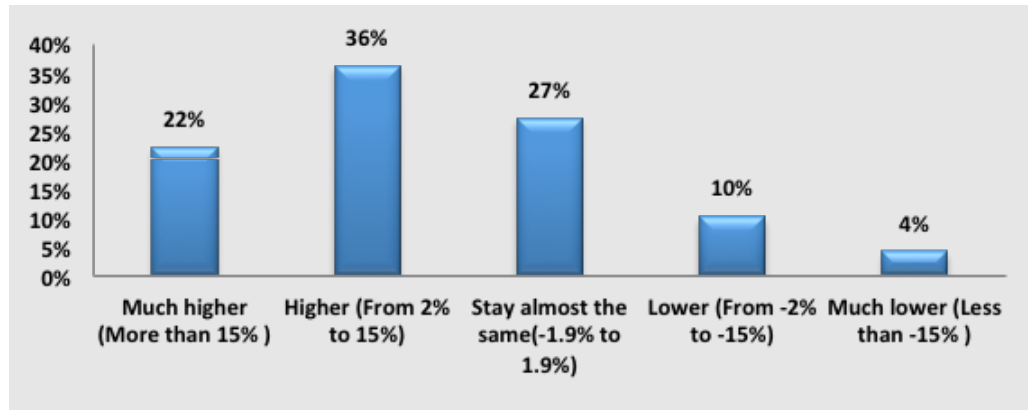
Chart VII.1.2 Where in China do you plan to invest?

Answer	Response
Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong	92
Shanghai	85
Beijing	49
Guangdong, Guangxi, Hainan	44
Chongqing	39
Tianjin	28
Sichuan, Guizhou, Yunnan, Tibet	28
Shenzhen	19
Liaoning, Jiling, Heilongjiang	18
Henan, Hubei, Hunan	17
Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang	17
Hebei, Shanxi, Inner Mongolia	16

VII.2. Exports

The majority of our respondents have export operations from their base in China (91%). Of these, they report exporting more (58%) or the same (27%) in 2011 than in 2010 approximately (Chart VII.2.1).

Chart VII.2.1 How do your exports in 2011 compare to 2010? (N=91)



Most of the companies' exports were to the US, East and South East Asian countries (especially Japan), Western Europe (particularly Germany), India and Latin America (Chart VII.2.2).

Chart VII.2.2 Which is your key export market for your China operation?

Destinations	Response
US	37
Canada	7
Latin America (including Mexico and Brazil)	18
Other American countries	3
Germany	22
UK	15
France	15
Other Western Europe	25
Russia	6
Other eastern Europe	8
Japan	22
South Korea	23
Taiwan(China)	18
H.K.(S.A.R.)	19
Other East and Southeast Asian Countries	38
India	25
Pakistan	5
Other South Asia Countries	10
Middle East(incl. Turkey)	14
Central Asia	3
Australia and New Zealand	14
Other	3

THANK YOU!

Juan A. Fernandez

Dongsheng Zhou

Lijia Chen

Junjun Li

Montserrat Delgado