



GERMAN CHAMBER
of Commerce in China
中国德国商会

in cooperation with **KPMG**

German Business in China

Business Confidence Survey 2019/20

Preface

The Business Confidence Survey published by the German Chamber of Commerce in China has been a key instrument for measuring the business sentiment of German companies operating in China since 2007. For the first time the German Chamber of Commerce in China was supported by KPMG in Germany to undertake this survey in 2019. This year's online survey was conducted from 29 July to 12 September 2019 among all member companies in Mainland China.

2019 was significantly affected by the US-China trade dispute and a (related) slow down of the global economy. Globally, a rising wave of protectionism is affecting the opening of markets. Open markets are extremely important to worldwide trade and growth and they are particularly important to the export-oriented German economy. Despite the challenges, German-Chinese economic relations have grown and developed well for decades. In 2018, bilateral trade increased, totaling almost EUR 200 billion.

German companies in China currently operate in an environment characterized by enormous market opportunities, complex regulatory challenges and increasing local competition. The survey, therefore, focuses on the general Perfor-

mance and Business Outlook, Market Access and Investment, Reform Efforts, as well as Operational and Regulatory challenges. The impact of the trade dispute between the US and China will also be illustrated before further analyzing other pressing topics, such as the introduction of a Corporate Social Credit System in China, Innovation & Digitalization, the Competitive Situation and the Belt and Road Initiative (BRI).

The German Chamber of Commerce in China numbers 2,300 member companies, representing roughly 50% of all German companies operating in China. With 526 member companies responding, 2019 is an all-time high in terms of participation. It is the most representative sample for the analysis of German Chamber members' business sentiment in China to date. This demonstrates the companies growing interest in making their voices, hopes and concerns heard.

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

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Executive Summary

2019 was significantly affected by the US-China trade dispute and a rising global tendency for rather protectionist economic policy developments paired with a decelerating global economy. Economic slowdown and political uncertainty point to a mixed year for German companies in China. For Germany as an export-oriented economy in particular, open markets and a rules-based trade system are cornerstones of its companies' success worldwide. Against this backdrop, and in times of uncertainty, German companies are eager to see more signals from the Chinese Government showing its commitment to deepen and thoroughly implement necessary economic reform and opening-up measures. The conclusion and implementation of a high-quality EU-China Comprehensive Agreement on Investment (CAI) next year – with scope beyond the usual investment protection dimension to also cover fair market access – would create new momentum and also bring Sino-German relations to a new stage.

Business Outlook Gloomy With Small Signs Of Hope

The slowdown of the Chinese economy combined with uncertainty due to the ongoing US-China trade dispute has left its mark. China remains a significant market for German companies, but the momentum of recent years has diminished. Industry forecasts for 2019, in particular for Germany's traditionally strong Automotive and Machinery/Industrial Equipment sectors have significantly decreased. Business expectations are reported at their lowest level in years, with only 27% of surveyed German companies expecting to reach or exceed their business targets in 2019. However, for 2020 surveyed enterprises report tentative signs of recovery with slightly improved industry development.

Investment Growth Needs Improved Market Access

China has taken a number of steps this year towards implementing reforms aimed at greater openness and equal treatment of foreign entities in the Chinese market. Almost half of the surveyed companies (45%) positively acknowledge China's commitment to further open its market. This is indeed progress, but is still far from a comprehensive systematic market opening at all levels. Direct and indirect market access barriers still exist in China, with two in three respondents (66%) reporting that they face restrictions. The survey results also reveal that the more challenging market access barriers for German companies are indirect, such as obtaining licenses, disproportionate tendering processes, and insufficient lead time when implementing new regulations.

Despite reported market access barriers, the surveyed companies see various significant opportunities emerging in the Chinese market. Consistent with this finding, two thirds of surveyed German firms plan to invest in China within the coming two years, with new manufacturing (46%) topping the list.

However, limited market access remains a barrier to further growth. One in two (53%) of all surveyed companies are likely or very likely to increase their investments in China if greater market access were granted.

Reform Efforts Acknowledged but Regulatory Challenges Remain

The need to level the playing field for foreign companies remains challenging and skepticism continues on several reform promises. More than one third of surveyed German companies assess some of the structural economic policy reforms as insufficient. On the other hand, policy reforms with regards to “enforcement of environmental regulations”, as well as China’s “anti-corruption campaign” are perceived as sufficient. While acknowledging the progress of environmental law enforcement, the implementation of these regulations has nonetheless been accompanied by disproportionately strict measures that affect production, supply chains and, ultimately, the strategic investment decisions of German companies.

More than two thirds (73%) of companies surveyed noted that their most important regulatory business challenge in 2019 is market access barriers and investment restrictions. For around every second respondent, legal uncertainty/unclear regulatory frameworks, as well as technology transfer requirements are the top prioritized pressing hurdles.

Human-resource related challenges remain at the top of the list of obstacles facing the operational business of the companies surveyed. Around three out of four respondents state that finding and retaining qualified staff is their no.1 operational business challenge. This year, the issue of difficulties obtaining visa/work permits for foreign employees in China significantly rose from rank 13 to 3 when compared to last year’s survey results.

Furthermore, about half a year ahead of the planned introduction of a comprehensive national scoring system for companies, seven out of ten German companies in China are not familiar with the system, its mode of operation and its objectives.

Trade Dispute Impacts Noticeably

In 2019, bilateral relations between China and the US were characterized by their ongoing trade dispute, resulting in mutual implementation of punitive tariffs. More than 8 in 10 (83%) of the surveyed German companies operating in China feel either directly or indirectly affected by this dispute. More than every second company reports being indirectly impacted via supply chains or through growing volatility in global markets. While 40% do not intend to implement any changes, other companies surveyed see diverse potential consequences ranging from revisions of product portfolios, shifting focus to other markets through to relocating production sites. However, the majority (77%) of surveyed companies are not considering moving operations out of China, which demonstrated the importance of the market to them.

Key Facts

Performance & Business Outlook



- **Only 27%** of German companies **expect to reach or exceed their business targets**, while **41% expect a negative deviation**. (Fig. 3)
- However, **44% of the surveyed companies expect an increase of their net sales in 2020** of more than 5%. (Fig. 5)
- China remains to be at the top of the agenda for **53% of the surveyed companies as a top 3 market** in terms of net sales, but decreased from last year. (Fig. 6)

Market Access & Investment



- Almost half of the companies (**45%**) **acknowledge China's commitment to further opening up** the Chinese market (Fig 10), while nearly **2 of 3 companies experience either direct or indirect market access restrictions**. (Fig. 11)
- **67%** of the surveyed companies **are planning to invest in China within the next two years**. (Fig. 14)

Reform Efforts & Business Challenges



- **The ranking of the top 5 regulatory business challenges is led by market access barriers (73%),** legal uncertainties (54%) and followed by technology transfer requirements (49%). (Fig.18)
- **42%** of the surveyed companies **believe that domestic companies experience a more favorable treatment**. (Fig 21)
- The **top ranked operational and macroeconomic business challenges** are **finding and retaining qualified staff** (77%), increased labor costs (29%) and access to local funding (17%). (Fig. 23)



Trade Dispute, Reactions & Consequences

- **83%** of the participants **feel either directly or indirectly affected by the US-China trade dispute** (Fig. 24), 40% of the companies stating not planning measures at this point. (Fig. 27)
- **10% of German companies are planning to move capacity out of China**, which is slightly **less than in the previous year** (Fig. 28), primarily due to rising labor costs and not the trade dispute. (Fig.30)



Corporate Social Credit System

- **68%** of German companies **do not feel sufficiently informed about the Corporate Social Credit System**. (Fig. 32)



Innovation & Digitalization

- **Top 3 digital challenges** are finding skilled employees (43%), internet access restrictions (37%) and internet speed (35%). (Fig. 40)
- Approx. **1 of 2 companies are not collaborating with start-ups, research institutes or universities in China**. (Fig. 42)



Competition

- **47%** of German companies **assume that their Chinese competitors can become innovation leaders**. (Fig. 43)



Belt and Road Initiative (BRI)

- 33% of German companies assess business opportunities from the Belt and Road-Initiative as insignificant and 29% (Fig. 45) as significant. **BRI only rated 10th of the top business opportunities**. (Fig. 12)



01 Performance & Business Outlook

Overall Economic Development in China

Economic activity in China has weakened since 2018. Official statistics placed real GDP growth at 6.6% in 2018, the lowest rate since 1990. Between January and June 2019 real gross domestic product (GDP) grew even less with only a 6.3% increase.

Under the pressure of subdued domestic and global demand, three of China's main economic indicators had decreased sharply by September 2019: industrial production dropped from 6.2% in 2018 to 5.6%, as did retail sales dropping from 9.0% to 8.2%. Moreover, fixed asset investments fell from 5.9% in 2018 to 5.4% in 2019, with investment in the manufacturing sector dipping from 4.9% in 2018 to an alarmingly low rate of 2.5% in 2019. After year-on-year expansion for two decades, China saw its first contraction of automobile sales of 3% in 2018, with the 2019 contraction projected at 5%. By August, according to

the latest data, the aggregated profits of the Automotive sector contracted by 16.6%, comparing to the 1.8% decline in 2018. As German companies in China are concentrated in the Automotive sector, they are disproportionately affected.

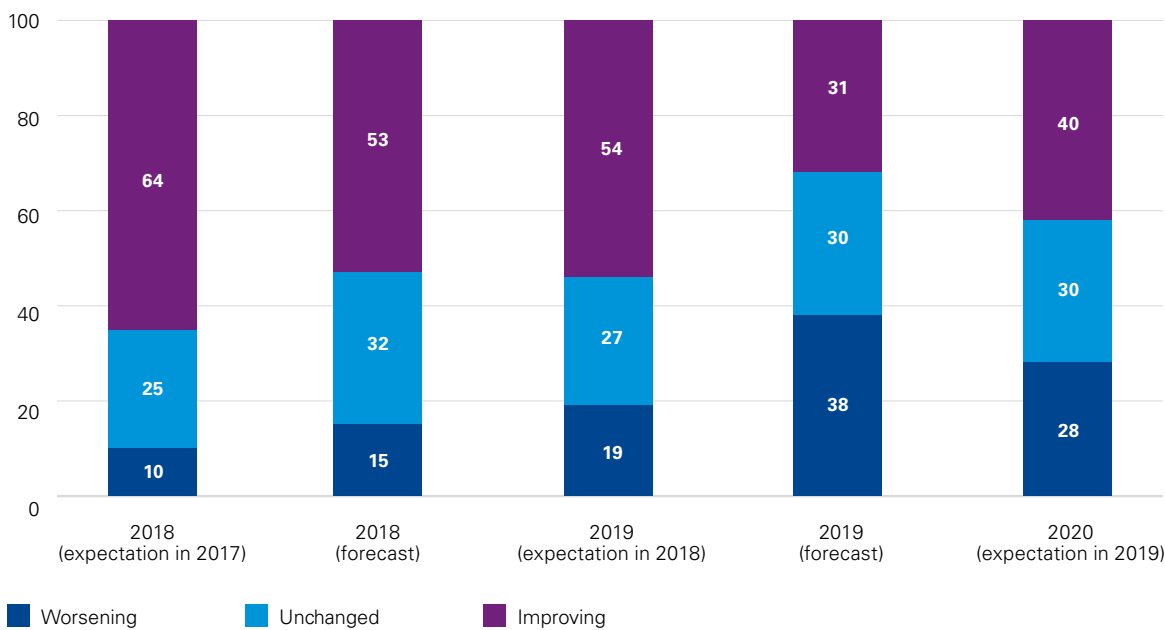
However, some recent signs are encouraging when looking at the purchasing manager indexes (PMIs), which are the leading indicators of sales, employment, inventory, and pricing. PMIs showed signs of recovery in August 2019, as domestic demand and production both stabilized slightly. Also aggregated enterprise profits reversed its previous contraction of - 3.1% in June 2019 and saw a 2.6% expansion in July 2019. The same development was observed for the producer price level, which after being negative in July and August 2019 at -0.3% and -0.8% respectively, was expected to expand at the end of 2019, likely reversing that contraction slide going forward.

Industry Development

When compared to 2018, German companies' industry development in China carries less optimism in 2019. Roughly one third of the companies surveyed (31%) assume an improvement in their industry based on the forecast from 2019. This is significantly lower compared to the prior year when a 54% majority of the surveyed companies rated the expected development of their industry in China as improving. At the same time, the percentage of companies expecting industry development to worsen in 2019 doubled to 38%. This is the lowest level of expectation in years.

However, the expectation for industry development has improved to 40% for the year 2020 compared to the forecast growth of 31% for 2019. Correspondingly, a decrease in development is expected to occur for 28% of the surveyed companies compared to the forecasted negative growth of 38% for 2019.

Fig. 1: How do you evaluate the development of your industry in China? (n=460)



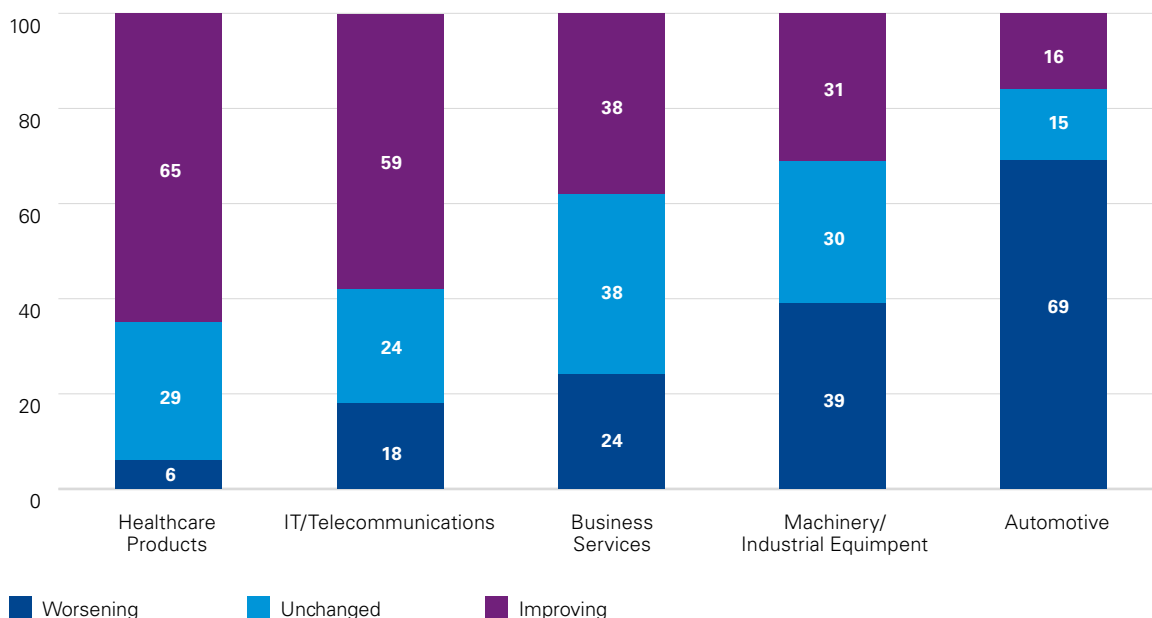
Figures in percent

Please note: Deviations from 100 percent are due to rounding differences and the answer option

In terms of the development outlook for specific industries, Automotive companies have the lowest expectation with 69% expecting a worsening in 2019, followed by Machinery/Industrial Equipment with 39%. In contrast, German

companies in the Healthcare Products (65%) and IT/Telecommunications (59%) sectors reported the largest levels of confidence with regard to the development outlook.

Fig. 2: Industry-related assessment: How do you evaluate the development of your industry in China for 2020?



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

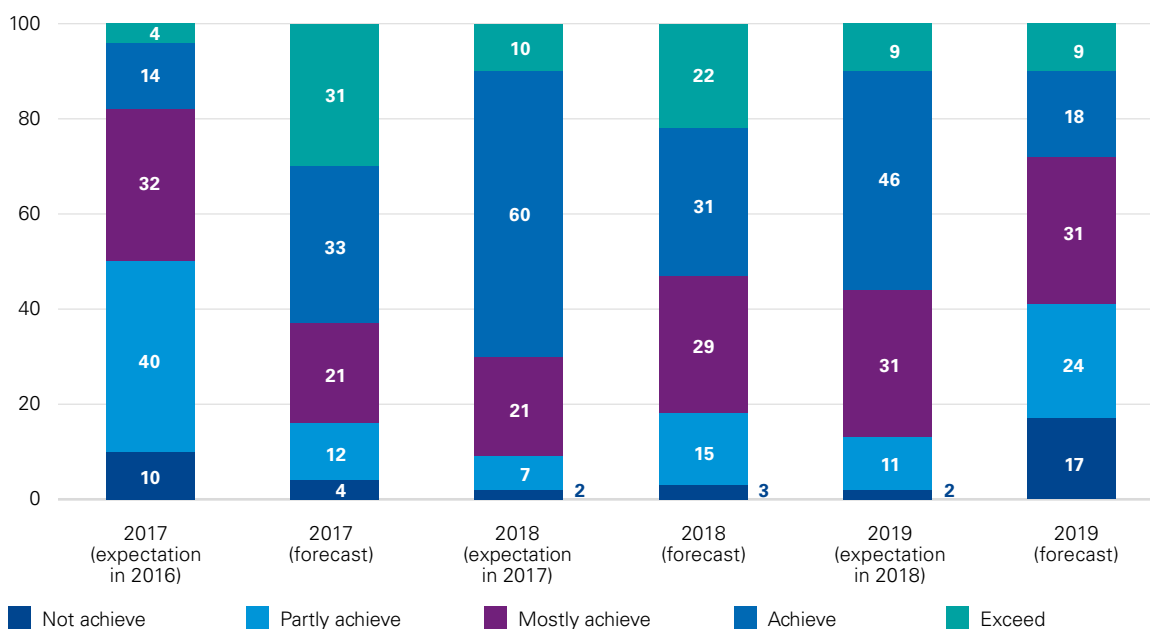
Business Target Achievement

While more than half of the surveyed companies (55%) expected in 2018 that they would exceed or achieve their business targets in 2019, the 2019 forecast looks worse. Only 27% expect the same, whereas 41% actually expect a negative deviation. The slowdown of the Chinese economy paired with uncertainty due to the ongoing US-China trade dispute has left its mark, as in 2017 64% and in 2018 53% of the respondents stated that they exceeded or achieved respective targets for 2018.

It is also noteworthy that for 2018 and 2019 the original expectation for meeting business targets was better than the later updated forecasts.

Automotive companies struggled more than any other sector to achieve their targets, whereas companies in the Healthcare Products and IT/Telecommunication industries achieved their targets for the most part.

Fig. 3: To what extent will you be able to achieve your business targets? (n=455)



Figures in percent

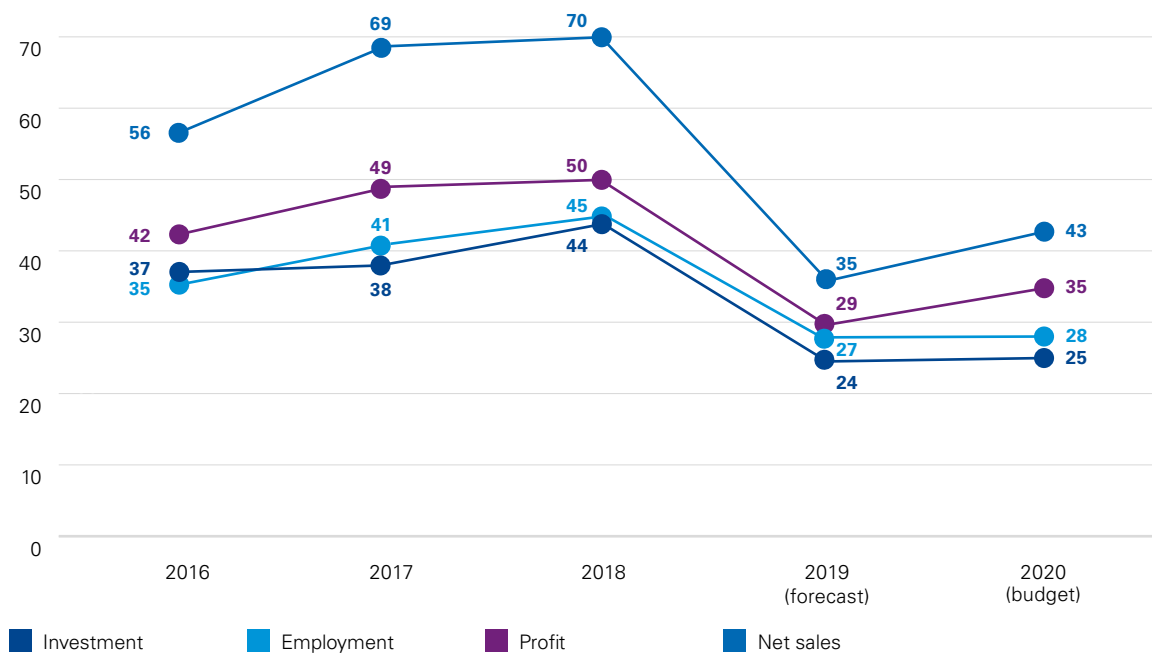
Please note: Deviations from 100 percent are due to rounding differences

Year-on-Year Development for Companies in China

Like overall economic development in China, the growth of the surveyed companies is also expected to slow down in 2019. Roughly one third of the surveyed companies (35%) expect net sales growth of more than 5% for 2019 – down from 70% in 2018 – and to grow profits of more than 5% (29%) – down from 50% in 2018.

However, when compared to 2019, expectations for 2020 are more promising. 43% of the companies surveyed expect net sales growth and 35% of profit growth of more than 5%. Furthermore, 25% of the companies expect to increase their investment by more than 5% (up from 24% for 2019) and 28% forecast an increase in their number of employees by more than 5% (up from 27% for 2019).

Fig. 4: Will your company generate growth of at least 5% in regards to investment, employment, profit, and net sales? (n=458)

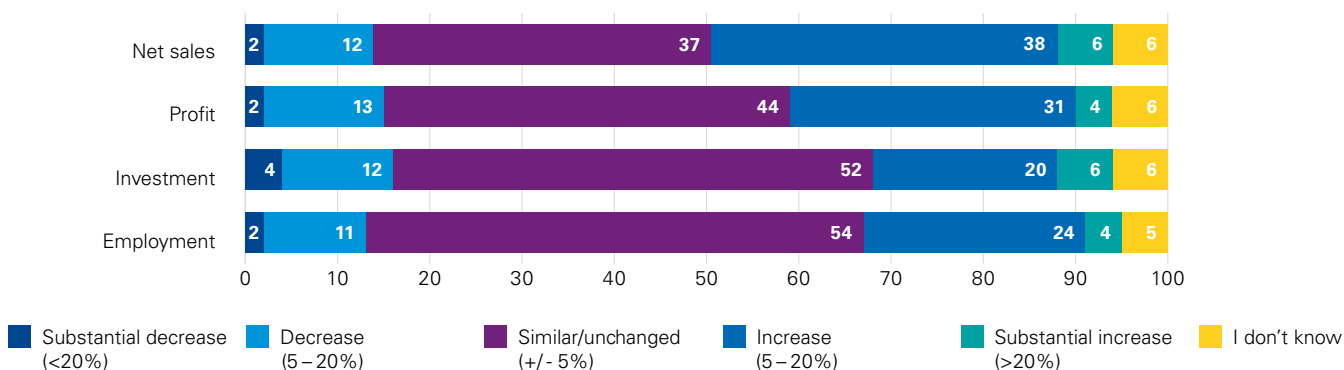


Figures in percent

The expectation for 2020 when compared with the forecasts in 2019 shows a diverse picture. Increases are expected to range between 44% (net sales) and 26% (investment), whereas decreases are expected to range

between 13% (employment) and 16% (investment) for the key performance indicators (KPIs) net sales, profit, investment and employment. In general, the outlook seems to be improving slightly.

Fig. 5: Please indicate the year on year development for your company in China in the following areas: 2020 (Budget) compared to 2019 (Forecast). (n=460)



Figures in percent

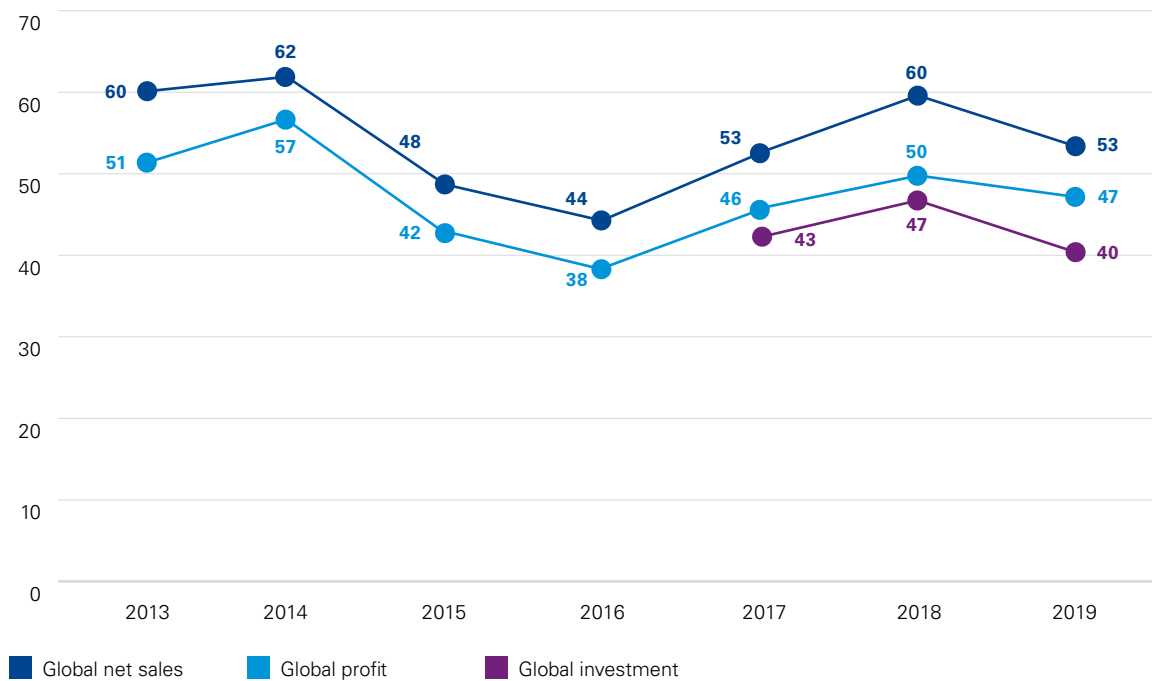
Please note: Deviations from 100 percent are due to rounding differences

Importance of Chinese Market to German Companies

Firms operating in China will continue to enjoy numerous market opportunities, albeit fewer than in prior years. Most of these relate to steady growth in private consumption as a share of GDP. This will benefit the Business Services sector in particular. Opportunities may be more hard to convert for traditional economic drivers, such as the Heavy Industry and Construction sectors because policy efforts are underway to reduce overcapacity and move the broader economy elsewhere.

China is among the top 3 markets by net sales for 53% of the German companies surveyed, top 3 in terms of global profit for 47%, and top 3 in terms of global investment for 40%. For all three performance indicators the share of China as a top-3 has decreased compared to 2018.

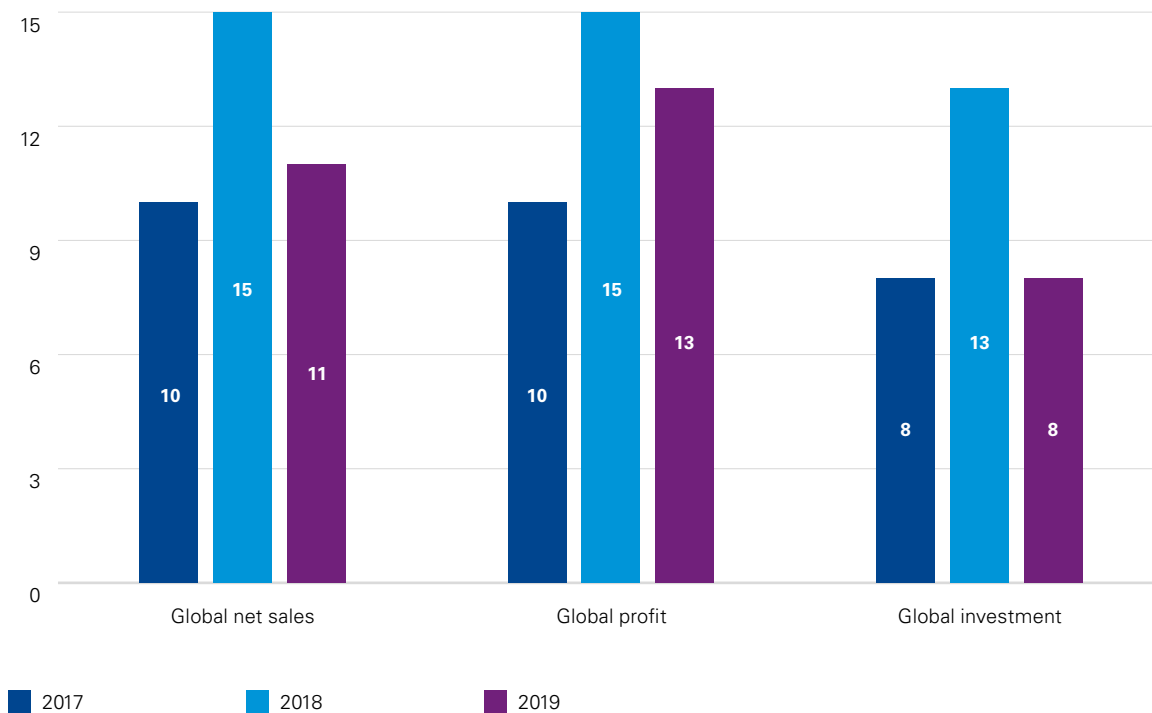
Fig. 6: Does your company's China business rank as one of the top 3 markets for your parent company in Germany? (n=457)



Figures in percent

For roughly one out of ten of the surveyed companies, China remains their No. 1 global market for all three metrics. The share of companies that place China as their No. 1 market decreased slightly in all indicators when compared to 2018. This, however, does not predict a trend as the 2019 and 2017 results are almost identical.

Fig. 7: How does your company’s China business most recently rank within your parent company’s global net sales, profit, and investment? (Share of respondents indicating that China is their No. 1 market) (n= 457)

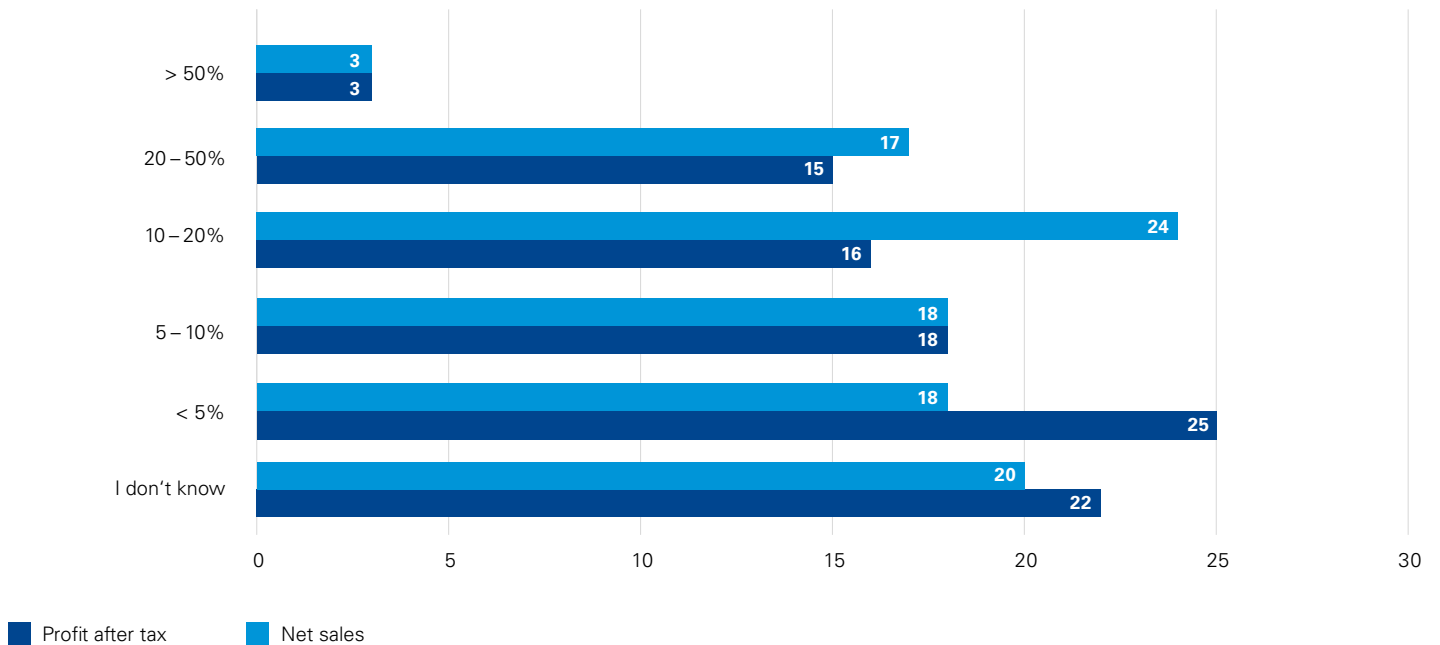


Figures in percent

In terms of net sales, 20% of the surveyed companies in China generate more than 20% of net sales of the overall group net sales of the parent company based in Germany. 24% generate between 10–20% and a further 18% generate at least 5% of the overall group net sales in China.

The survey shows that 18% of the surveyed companies in China generate more than 20% of the overall group profits after tax in China. A further 16% make between 10–20% of their profits after tax from their Chinese operations and further 25% generate less than 5% of the profit after tax in China. Global net sales in China appear to be stronger than profits.

Fig. 8: What is the percentage of net sales and profit after tax generated by your China operations for the overall German Group? (n=453)

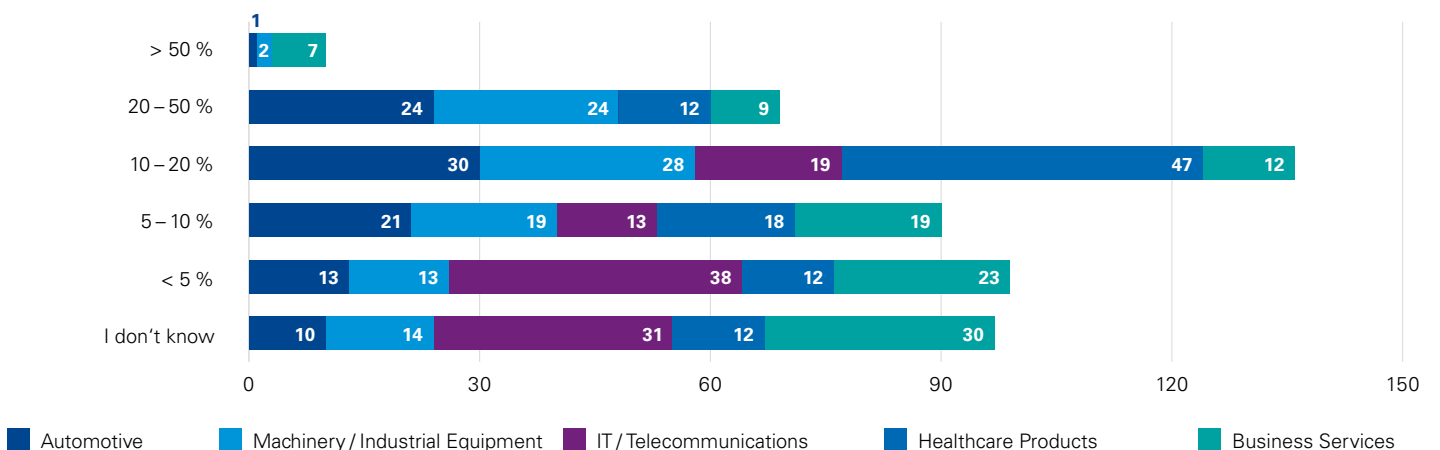


Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Based on these results it is obvious that German groups consider China to be one of their most important markets. In terms of industries, the Chinese market appears to be very important for the Business Services, Automotive and the Machinery/Industrial Equipment industries. China also continues to be a significant market for the Healthcare Products and IT/Communications sectors.

Fig. 9: Industry-related assessment: What is the percentage of net sales generated by your China operations for the overall German Group?



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences



02 Market Access & Investment

The fact that German trade with Asia has reached almost double the size of trade with the US underscores the relevance of the Asian market to the German economy. China is Germany's most important trading partner in goods (exports and imports), with more than EUR 199.3 billion traded between Germany and China in 2018.

China's Commitment to Market Opening and Recent Policies

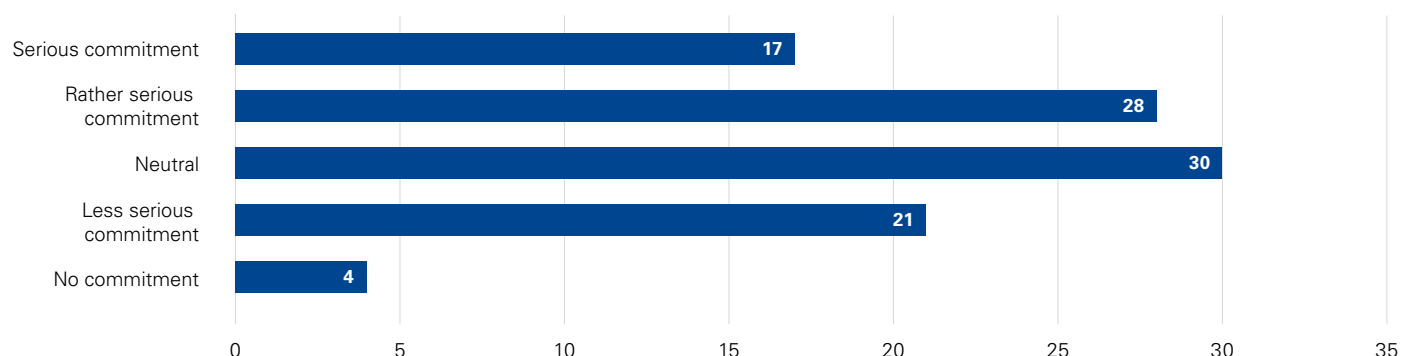
China has taken a number of steps this year towards implementing reforms aimed at greater openness and equal treatment of foreign entities in the Chinese market. In March 2019, the Chinese National People's Congress passed the new Foreign Investment Law (FIL), effective from 1 January 2020. This marks the first legally binding prohibition of forced technology transfer, albeit limited to administrative measures. The explicit and implicit pressures forcing technology transfers have often hampered close and sustainable cooperation in the past, especially in highly innovative areas such as Industry 4.0.

Almost half of the surveyed companies (45%) assess China's commitment to further opening the Chinese market to foreign investment as serious or rather serious. However, 25% do not acknowledge this commitment. The Healthcare Products and Automotive sectors both believe (with 50% and 48% respectively) that China is seriously or rather seriously committed to further opening its market.

In 2018, China announced its intention to remove foreign equity caps and other restrictions in the Automotive manufacturing sector by 2022. Despite the surprising tightening of the Healthcare market on a national level beginning in 2015, it is inevitable that this market will be opened more. Although the FDI Negative List still allows to prohibit 100% foreign-owned hospitals, local authorities are already preparing initiatives in their regions to open up the sector to foreign investment. In fact, Chinese premier Li Keqiang announced at the Boao Forum in March 2019 that foreign investor access to China's Healthcare market will be further expanded.

It is important to note that all restrictions that are still being applied, yet are no longer mentioned in the new FDI Negative List, should cease to be applied by the end of 2019. It is also worth noting that foreign investment is still completely prohibited in several sectors, including internet services and platforms, genetic engineering in agriculture and the tobacco industry.

Fig. 10: How do you rate China's commitment to further opening the Chinese market to foreign investment? (n=517)



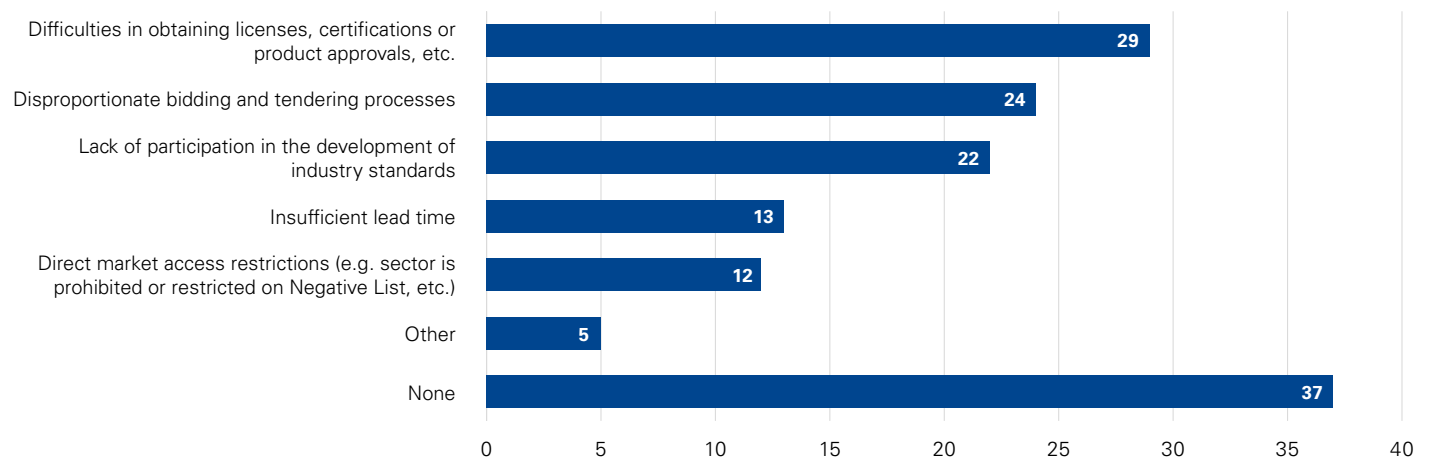
Figures in percent

Market Access

While formal market access restrictions are slowly lifted, mainly through the revisions of the FDI Negative List, indirect regulatory market access barriers remain a hurdle for German companies operating in China. 63% of all surveyed companies face restrictions to accessing the Chinese markets. The significance of the market access barriers and investment restrictions is underscored by it topping the list of regulatory business challenges (see pg. 26).

12% of this survey’s participants face “direct market access restrictions” with a further 29% experiencing “difficulties in obtaining licenses, certifications or product approval” and 24% being confronted by “disproportionate bidding and tendering processes”. However, 37% of surveyed companies reported experiencing no market access restrictions.

Fig. 11: What kind of market access restrictions is your company faced with in China? (n=517)



Figures in percent

Please note: Multiple answers possible

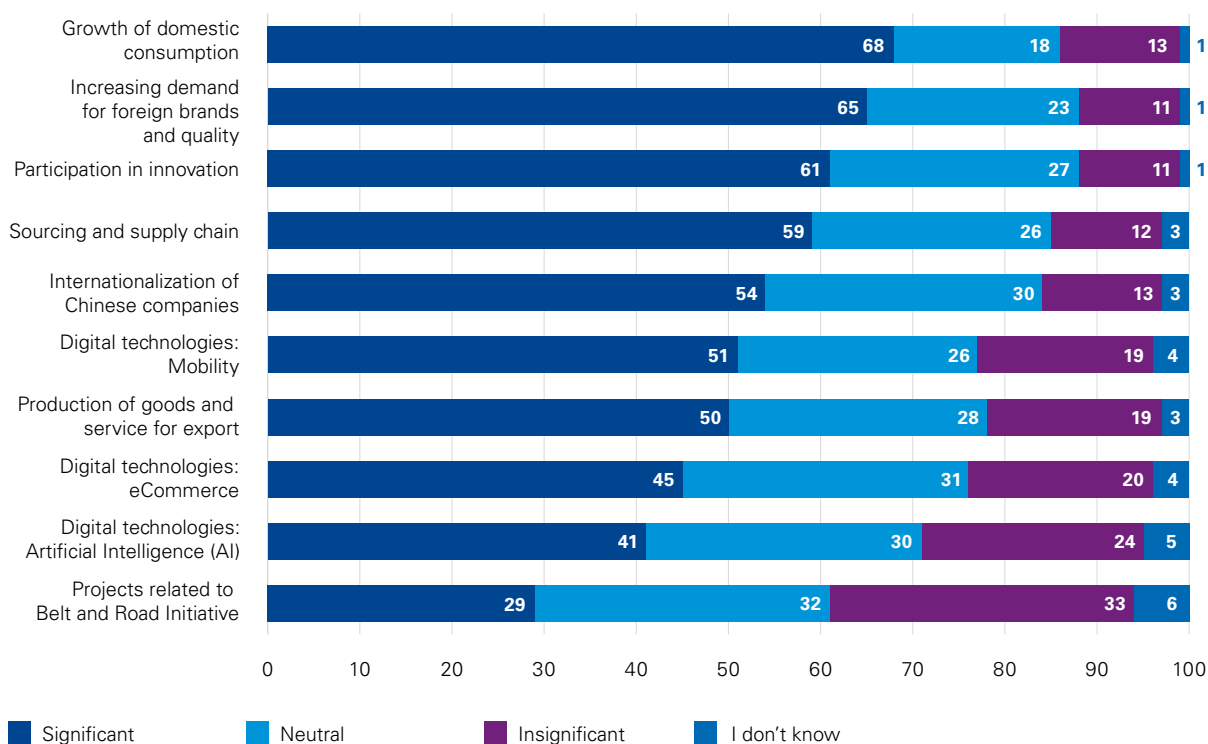
Potential Sources of Business Opportunities

Despite reported market access restrictions, the surveyed companies see a variety of significant or somewhat significant opportunities emerging in the Chinese market.

68% of the surveyed companies see growth of domestic consumption as the top opportunity for their businesses. In addition, structural reforms and consumption upgrading mean that China’s economy has moved away from its typical reliance on trade and heavy investment.

This is followed by increasing demand for foreign brands and quality (65%), participation in innovation (61%), sourcing and supply chain (59%) and internationalization of Chinese companies (54%) as further significant sources for business opportunities.

Fig. 12: Please rate the following opportunities for your company’s China business. (n=512)

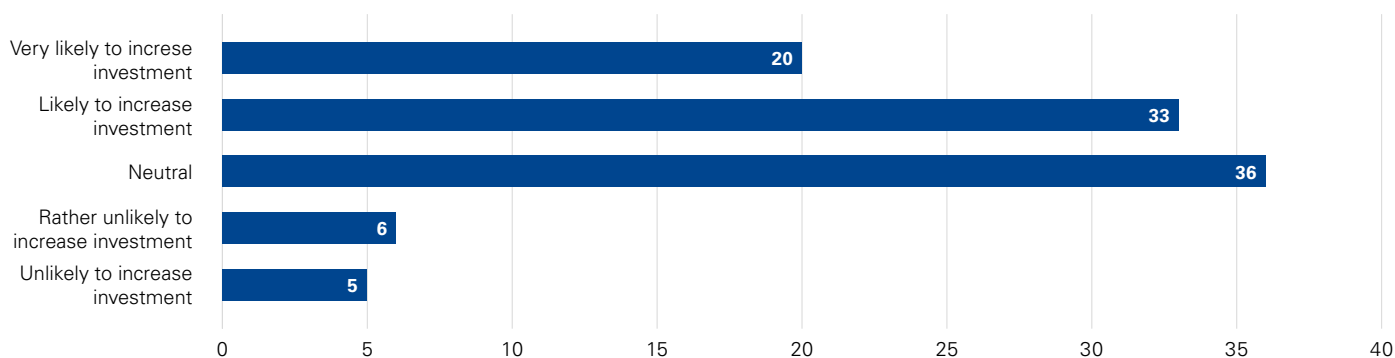


Figures in percent

German businesses see various possibilities in the Chinese government’s plan to transform its economy into a sustainability-oriented, innovation-driven and domestic consumption-focused one. This is the case for various German industries, e.g. car manufacturers, as China is by far their most important market.

However, market access remains a critical topic for a number of industries. 53% of all surveyed companies would likely or very likely increase their investment in China if greater market access were granted.

Fig. 13: If meaningful or greater market access were granted to your industry, how would this impact your company’s investment decisions in China? (n=514)



Figures in percent

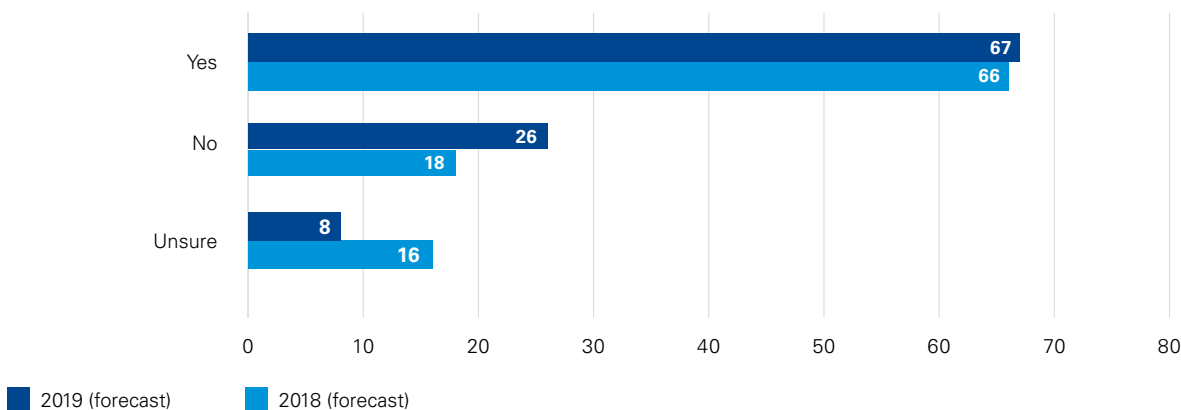
Investment Trends

A comparison between 2018 and 2019 shows that German investors in China are acting more cautiously this year. German investment in 2018 totaled USD 3.68 billion. From January to September 2019, however, German investment in China dropped substantially to only USD 1.38 billion with most investment coming in February and March (USD 290 million and USD 260 million respectively). Despite this drop, Germany still ranks 8th amongst the top 10 countries and regions investing in China in the first half of 2019. The USA with an investment volume of USD 2.52 billion and Great Britain at USD 1.98 are ranked 6th and 7th respectively by

September 2019. Most investment flowing into China comes from Hong Kong SAR, making up slightly more than 70% of the total amount of FDI in China from January to September 2019. The restraint in 2019 amongst German investors appears to be due to the sluggish development of the Chinese economy and the still hesitant opening of the Chinese market. The uncertainty surrounding the US-China trade dispute may also play a role in this respect, albeit minor.

Investment Planning in China

Fig. 14: Is your company planning to further invest in China within the next two years? (n=512)

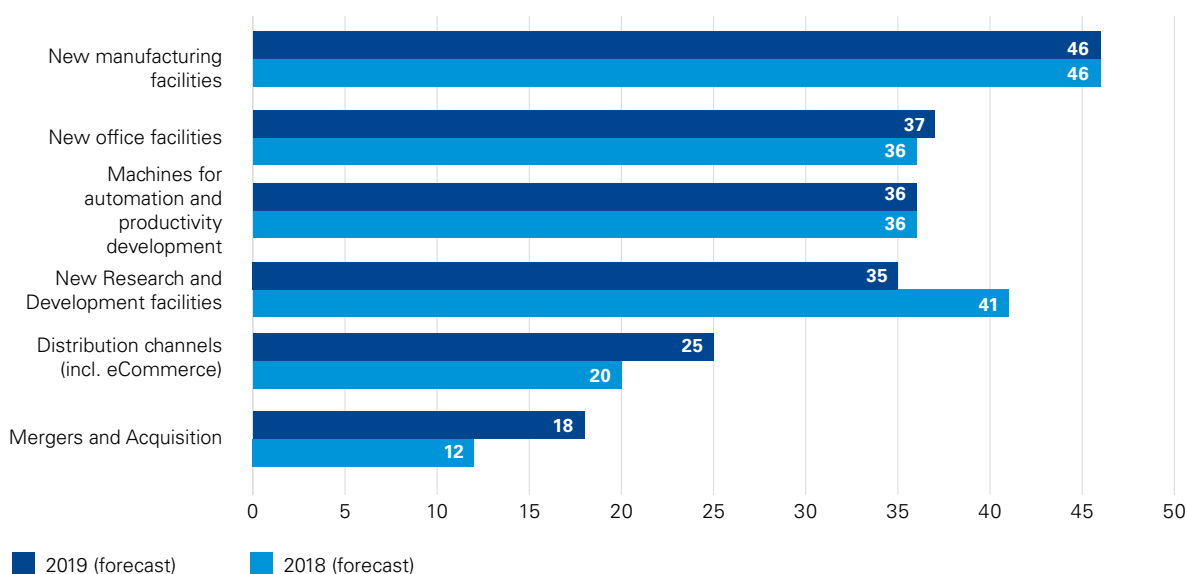


Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

As 67% of the surveyed companies state that they are planning to further invest in China in the next two years, the outlook is strong. Most investments are intended in new manufacturing facilities (46%), new office facilities (37%), machines for automation (36%) and also new R&D facilities (35%). Only the volume of intended investment in R&D facilities decreased from 2018 (41%) to 2019 (35%).

Fig. 15: In which areas are you planning to expand your investment in China within the next two years? (n=341)

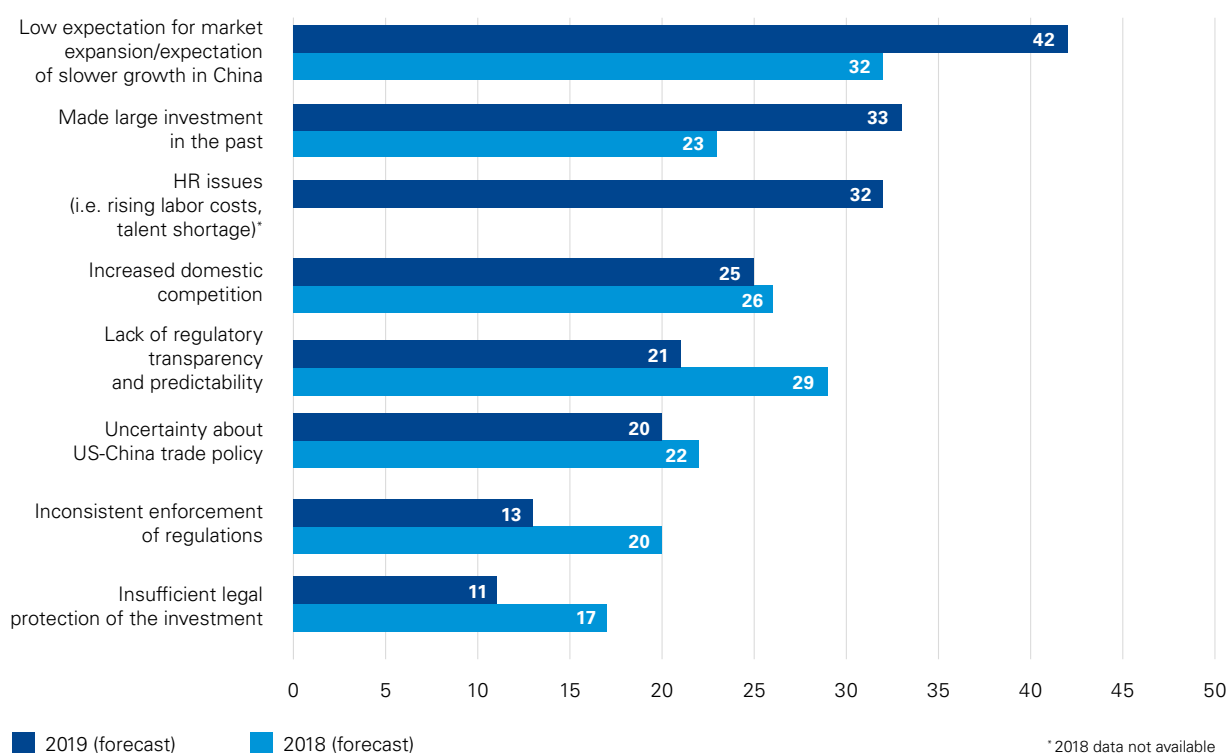


Figures in percent. Please note: Multiple answers possible

Reasons for not Investing

In 2019, the main reasons for not investing in China are lower growth expectation (42%), large investments already made in the past (33%) as well as HR issues (32%), while the dominating reason in 2018 was rising labor costs (45%). The trade dispute between the US and China is not yet seen as a dominating reason for not investing in China; it may actually trigger localization in China and Asia (please see pgs. 33–37).

Fig. 16: What are the main reasons for not investing in China? (n=169)



* 2018 data not available

Figures in percent. Please note: Multiple answers possible



03 Reform Efforts & Business Challenges

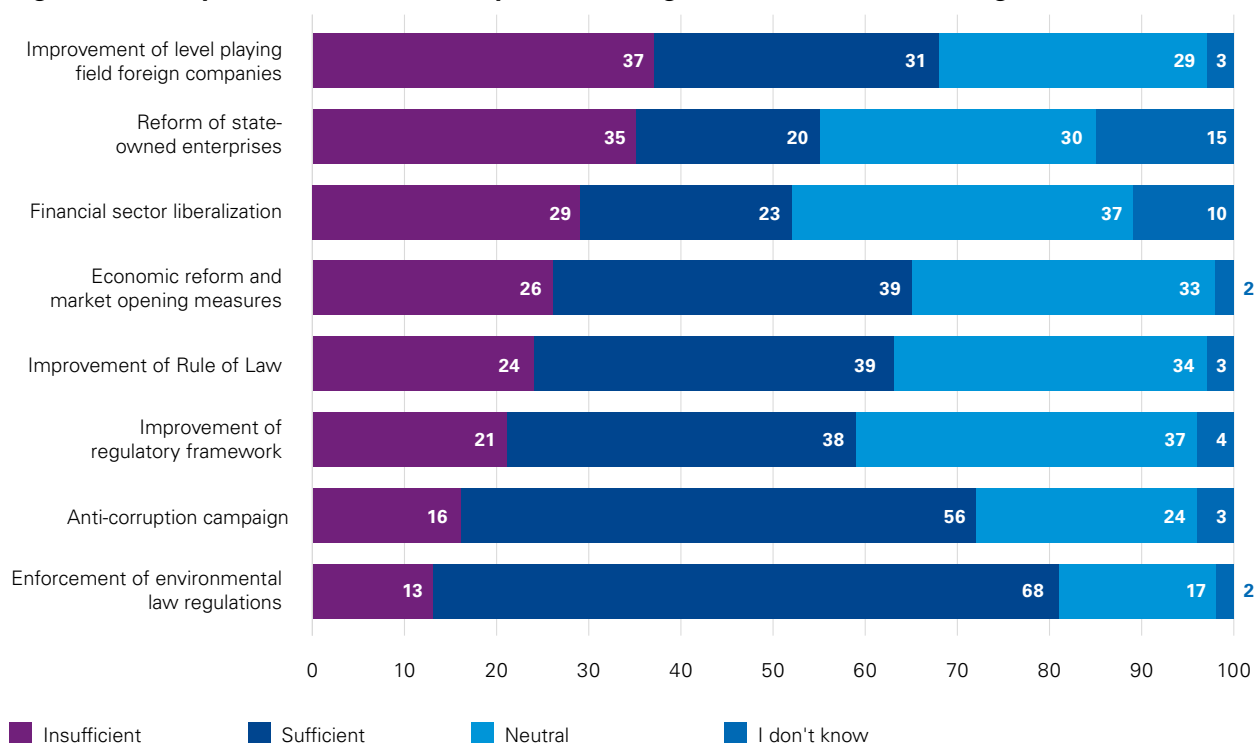
Evaluating the Chinese government’s recent efforts, not only in the area of market opening to global investors, but in various fields of the Chinese economic policy, there are areas where companies still see demand for further action. In particular, more than one third of surveyed companies rate “Improvement of level-playing field for foreign companies” (37%), “Reform of state-owned enterprises” (35%) as well as “Financial sector liberalization” (29%) as insufficient. Furthermore, one in four companies are not satisfied with the efforts made in “Economic reform and market opening measures” (26%) and “Improvement of Rule of Law” (24%).

With the 13th Five-Year Plan and the reform of the Environmental Protection Law at the beginning of 2015, many topics have gained in importance, such as renewable

energy production, CO₂ reduction measures in the industrial and transport sectors, recycling and circular economy, water treatment and electromobility. German companies operating in China give strong consideration to environmental protection. In this regard, 68% of the surveyed German companies see sufficient or rather sufficient efforts being made by the Chinese government to “enforce environmental law regulations.” This represents a slight increase when compared to 2018, when 66% of the respondents found those efforts sufficient. At the same time, the implementation of the enforcement of these laws challenges the affected companies (please see pg. 28).

The Chinese government’s engagement in its “Anti-corruption campaign” is a positive move for more than half the companies surveyed (56%).

Fig. 17: How do you rate recent efforts by the Chinese government in the following areas? (n=526)



Figures in percent. Please note: Deviations from 100 percent are due to rounding differences

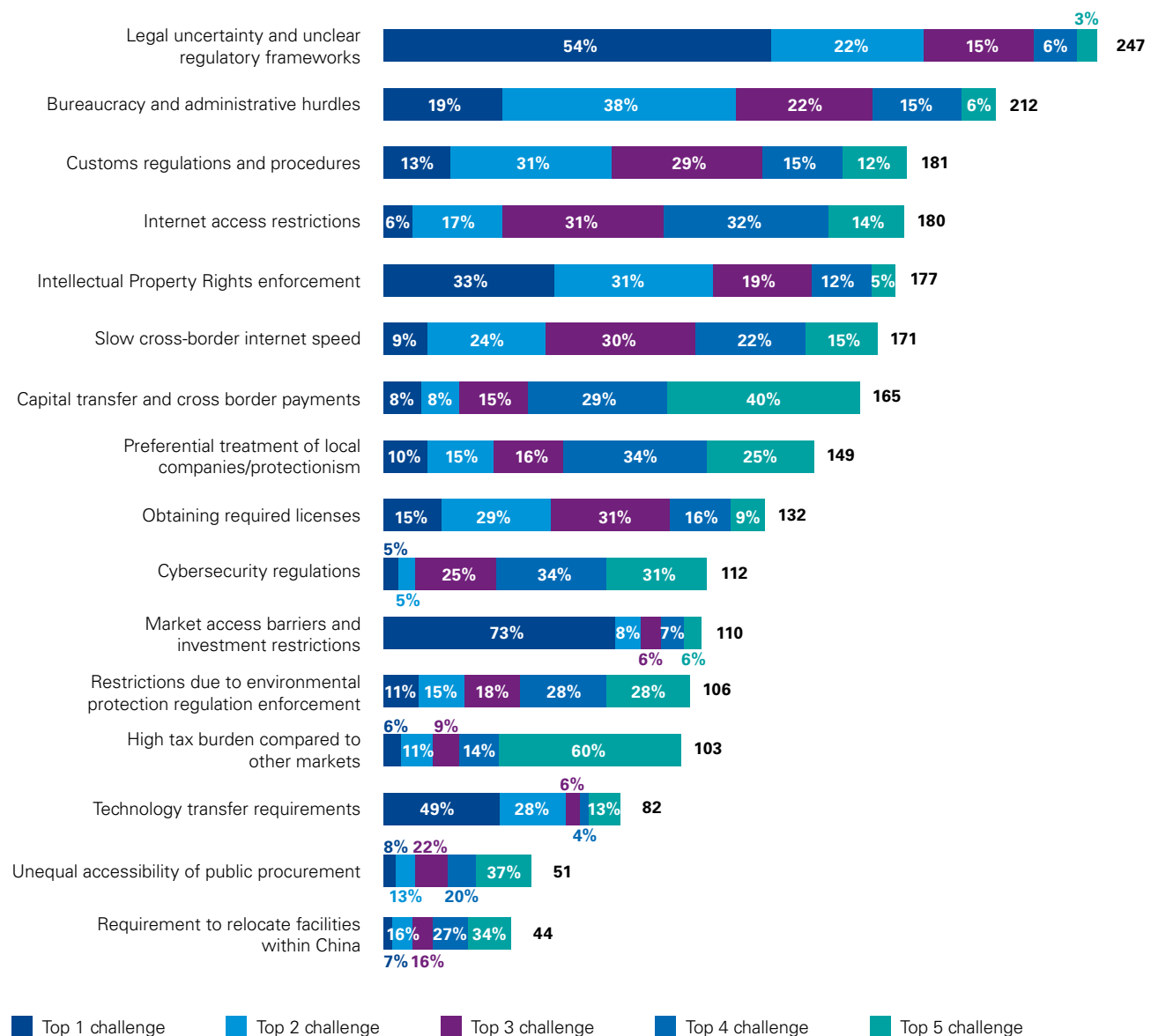
Regulatory Business Challenges

German companies in the Chinese market face various regulatory business challenges. Analyzed by frequency “Legal uncertainty and unclear regulatory frameworks” has been named most often (247 times, equaling 52% of all respondents to this question), followed by “Bureaucracy and administrative hurdles” (212 times) and “Customs regulations and procedures” (181 times). When prioritizing the regulatory challenges, “Market access barriers and investment restrictions”, “Legal uncertainty and unclear regulatory requirements” as well as “Technology transfer

requirements” have been stated most often as Top 1 priorities for companies with rates of 73%, 54% and 49%. In 2018 internet-related challenges topped the list, e.g. slow cross-border internet speed, followed by bureaucracy/ administrative hurdles, legal uncertainty and a lack of clarity in regulatory frameworks.

With respect to market access barriers and investment restrictions please refer to the corresponding chapter on page 20.

Fig. 18: Please rank your top 5 regulatory business challenges. (n=480)



Answers ranked in descending number of total respondents

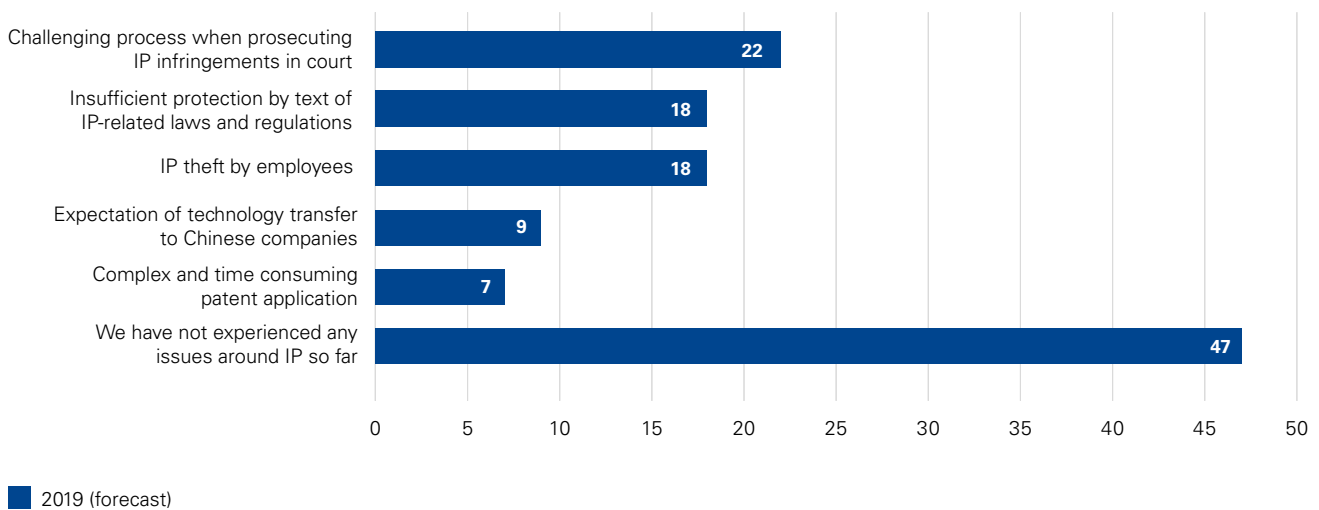
Please note: Deviations from 100 percent are due to rounding differences

Intellectual Property

The challenges with respect to intellectual property (IP) seem to have diminished this year when compared with 2018. The main challenges concern “prosecuting IP infringements in court” (22%), “insufficient protection by laws and regulations” (18%) and “IP-theft by employees” (18%). 47%

of surveyed German companies stated they have not experienced challenges with respect to their IP. Despite significant improvements to IP regulations over recent years, it appears that IPR protection is still a significant business challenge.

Fig. 19: Has your company been faced with IP challenges? (n=438)



Figures in percent

Please note: Multiple answers possible

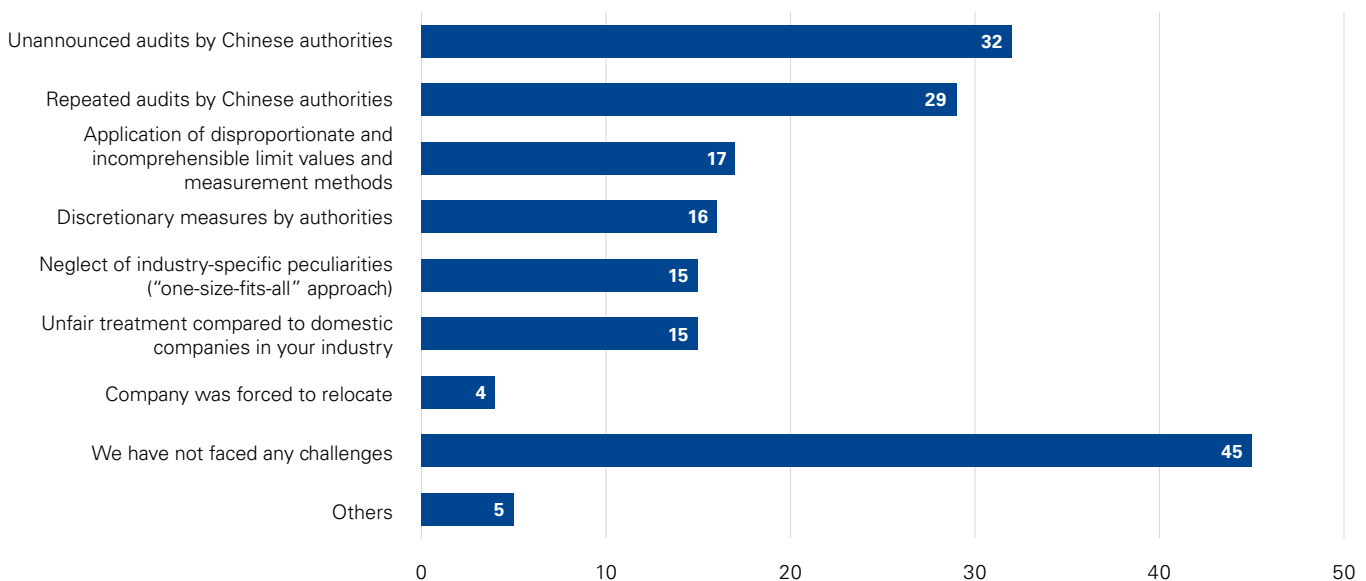
Environmental Regulations Enforcement

The protection of the environment is of utmost concern to modern industry. In 1979, the Chinese government passed its first environmental law, building a solid foundation for their national sustainability strategy. As a result of the government's 13th Five-Year Plan and the reform of the Environmental Protection Law at the beginning of 2015, topics such as renewable energy production, CO₂ reduction measures in the industrial and transport sectors, recycling and circular economy, water treatment and electromobility gained in importance. German companies operating in China give strong consideration to environmental protection and welcome the Chinese government's efforts to reduce overall pollution in China. The implementation of Chinese environmental law, however, is accompanied by disproportio-

tionately strict measures that affect production, supply chains and, ultimately, the strategic investment decisions of German companies. Often, Chinese government authorities apply a one-size-fits-all approach that does not necessarily take into account industry-specific features.

This year, respondents to the survey reported that the situation they face with respect to environmental concerns in China is difficult due to increased regulatory enforcement measures. In particular, the main challenges are unannounced audits (32%) and repeated audits (29%) by Chinese authorities. However, 45% of the companies surveyed state that they are not facing any challenges as regards the enforcement of these actions.

Fig. 20: Has your company encountered any of the following issues during the enforcement of environmental protection measures? (n=448)



Figures in percent

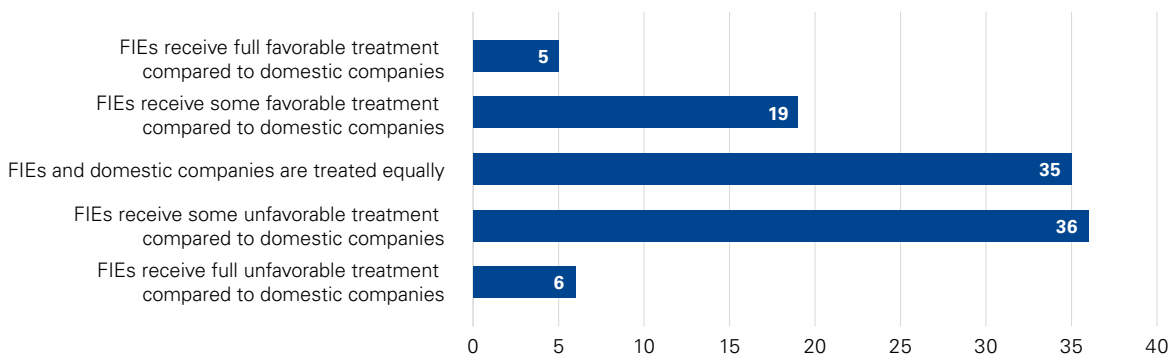
Please note: Multiple answers possible

Leveling the Playing Field Remains Challenging

International companies have been part of Chinese market development for decades. The German economy is deeply anchored in China: German companies have so far invested an overall amount of approx. 81 billion EUR in China, created more than one million jobs and have thus contributed largely to growth, innovation and society. However, the picture with respect to the perception of differences in treatment

between foreign and domestic companies is diverse. 42% of the German companies surveyed report that they as FIEs are treated unfavorably compared to domestic companies, while around one third (35%) think FIEs and domestic companies are treated the same. However, 1 in 4 (24%) companies surveyed believe that FIEs receive some or full favorable treatment.

Fig. 21: In your industry, how do Chinese authorities treat Foreign Invested Enterprises (FIEs) compared to domestic companies? (n=396)



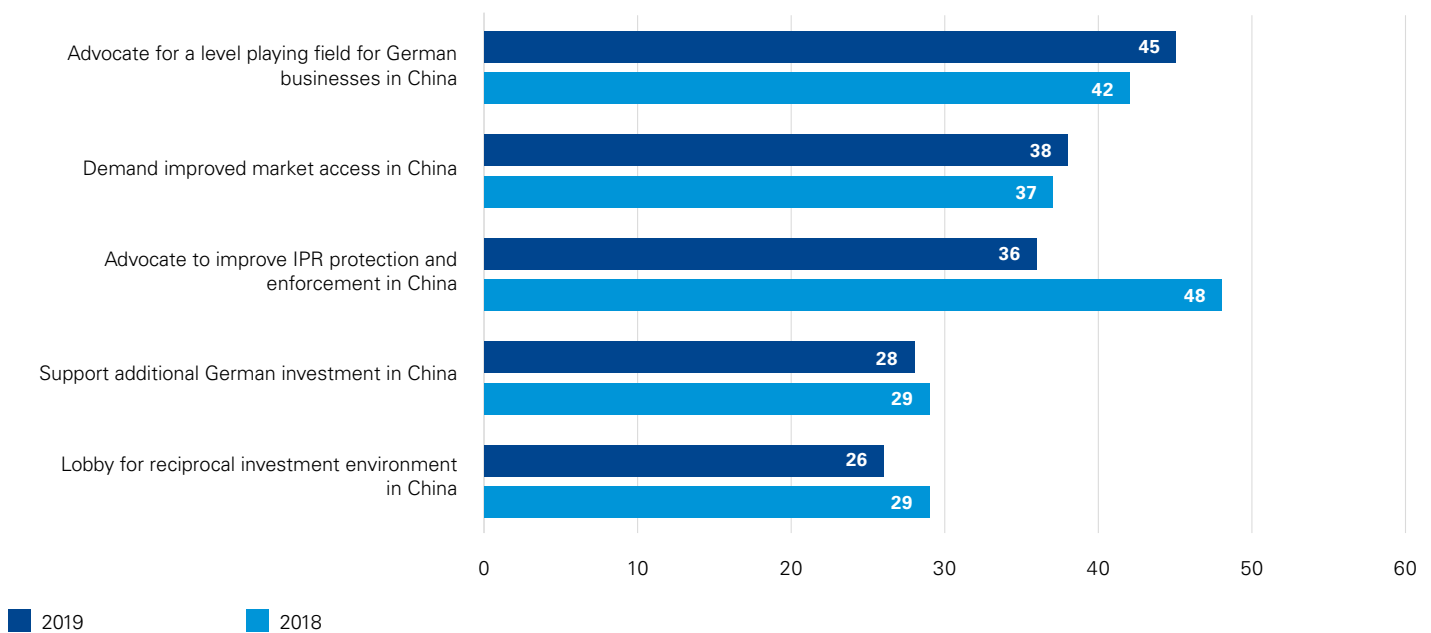
Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Asking for the most important issues that the German government should address to support German businesses in China, for 45% of the companies surveyed, “absence of a level playing field” is the primary concern.

This is followed by “limited market access” (38%) and “intellectual property protection” (36%) as the next most pressing concerns.

Fig. 22: What do you consider most important that the German government should do to support German businesses in China? (n=466)



Figures in percent
Please note: Multiple answers possible

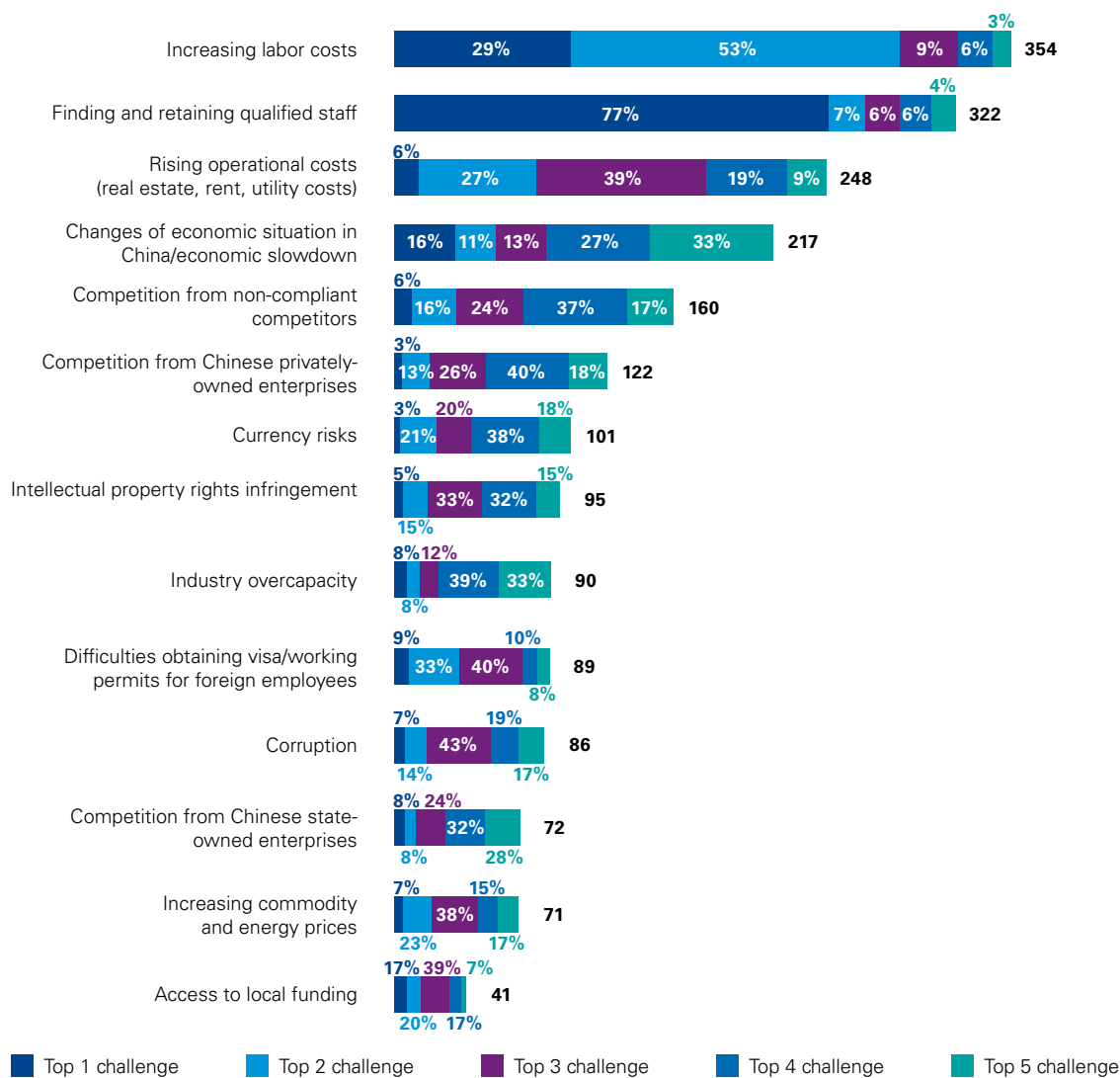
Operational Challenges for German Entities in China

German companies in China also face operational hurdles. “Increasing labor costs” are the leading operational challenge for 354 respondents (74% of all respondents to this question) followed by “Finding and retaining qualified staff” (322 respondents), equaling 68% on rank 2.

The annual wage in China averaged RMB 82.461 in 2018, an 11% increase in comparison to 2017. In its Labor Market and Salary Report 2019/20, the German Chamber of Commerce in China reported that after last year’s slight rise in the expected wage growth, the average expected wage growth of German companies in China resumed its downward trend, reaching a record low of 5.53% for 2020 – the lowest expected wage cost rise since the Chamber started collecting data at a China level in 2012.

When prioritizing the operational challenges, “Finding and retaining qualified staff” and “Increasing labor costs” are the Top 1 priority for most respondents (i.e. for 77% respectively 29%). Next to this “Access to local funding” has been stated as Top 1 priority for 17% of those respondents for which this is a challenge. Foreign firms operating in China generally find it difficult to access funding or loans from local banks. Often, these enterprises have sufficient capital, but non-ownership of production facilities that could be used as guarantees means they have little basis for procuring funds from banks in China.

Fig. 23: Please rank your top 5 operational and macroeconomic business challenges. (n=476)



Answers ranked in descending number of total respondents
 Please note: Deviations from 100 percent are due to rounding differences



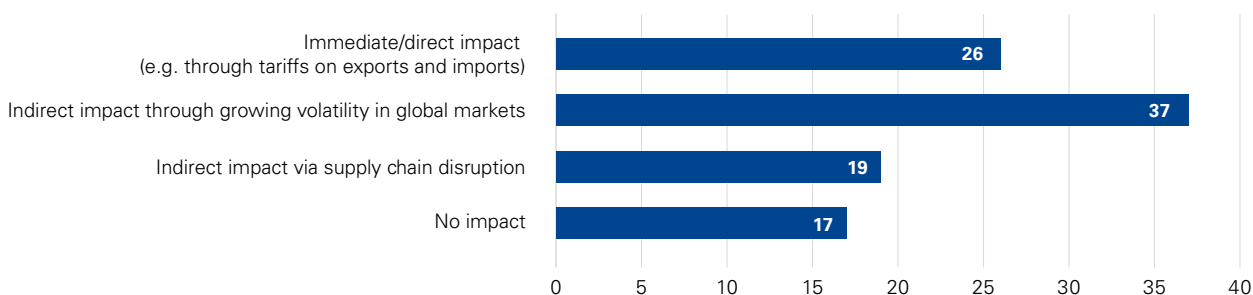
04 US/China Trade Dispute – Reactions & Potential Consequences

As the tit-for-tat trade dispute between the US and China entered its second year in 2019, a sharp escalation of bilateral tensions could be seen during the summer (especially in August), followed by some signs of deceleration from both sides recently. While there are hopes for a so-called phase one agreement between both countries, it will be limited to the suspension or removal of some punitive tariffs in the best case, plus Chinese promises to purchase US farming goods.

In August 2019, the US announced new tariffs, resulting in almost all Chinese goods under sanction excluding only

items such as rare earths. As China pledged own tariffs, more than 60% of US goods are now under sanctions. Bilateral trade has thus contracted significantly in 2019. By September, according to the latest available data, bilateral trade had dropped by 14.8% from 2018, with China's imports from the US shrinking by an alarming 26.4%. Even if some agreements are made this year, as many hope for – there are incentives for both sides to stall until late 2020 before announcing a deal. The long-term confrontation of the US and China in technology may carry on, meaning continued movement amongst supply chains in 2020 and beyond.

Fig. 24: What impact does the US-China trade dispute have on your company in China? (n=457)



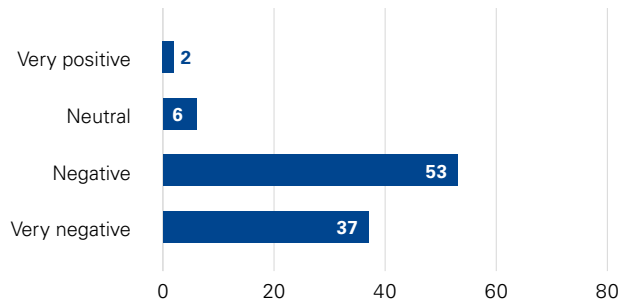
Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

83% of the surveyed German companies feel either directly or indirectly affected by the US-China trade dispute. 90% of the companies who are directly affected by the trade dispute expect negative or very negative outcomes. The effects are more negative than for those companies that are only indirectly affected. 78% of these companies reported negative or very negative effects.

56% are indirectly negatively affected by the trade dispute, where the main indirect negative effect being the result of instability in the market (37%). 26% report to be directly affected via customs and duties.

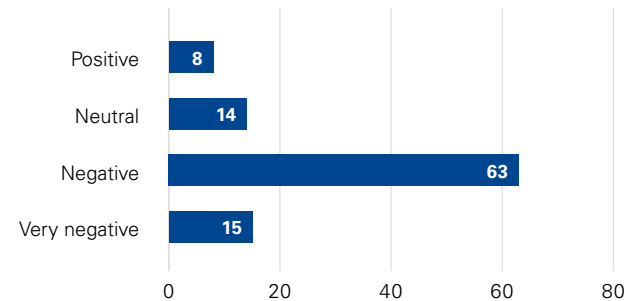
Fig. 25: If your company in China is directly affected by the US-China trade dispute, how would you rate the effects? (n=120)



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Fig. 26: If your company in China is indirectly affected by the US-China trade dispute, how would you rate the effects? (n=87)

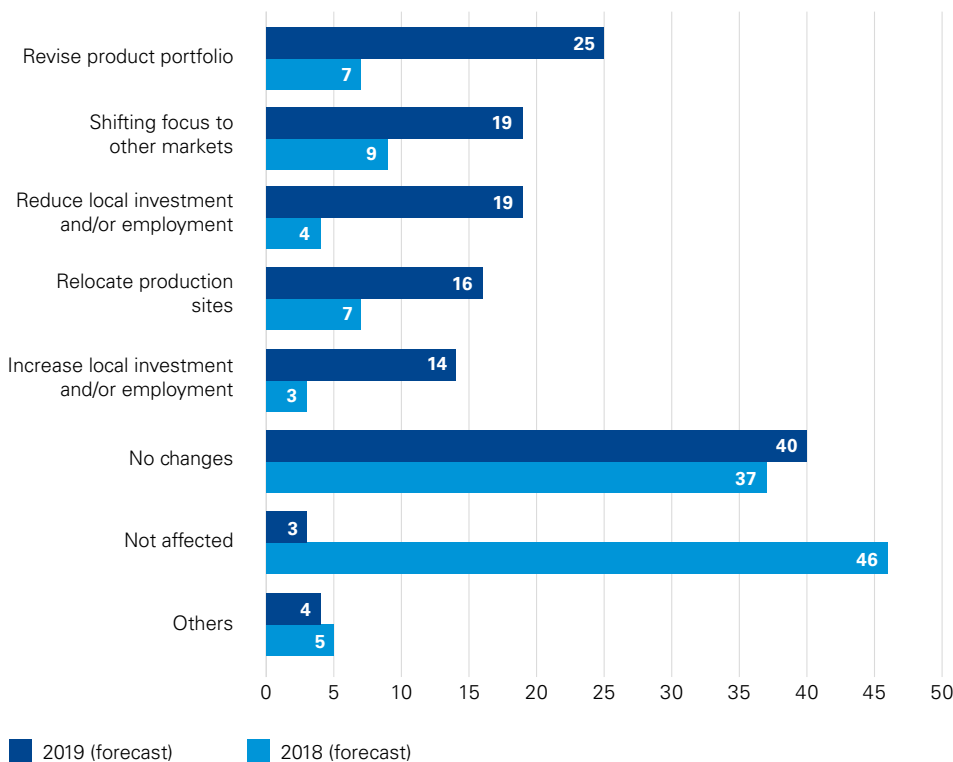


Figures in percent

The Business Services, Healthcare Products, Auto and Machinery/Industrial Equipment sectors are mostly negatively affected. In contrast, half of the IT companies surveyed are experiencing no effects from the trade dispute. According to the surveyed companies, textile and electronic producers are leaving China to gain from lower wages in other countries, a trend only accelerated by the trade dispute.

The measures being taken to counter the trade dispute are diverse, with 40% of the surveyed companies stating that they are not planning measures at this point. The most significant change for 2019 is expected in the category "not affected by trade disputes", where 46% of German companies felt this influence in 2018.

Fig. 27: If your company in China is directly or indirectly affected by the US-China trade dispute, are you considering changes to your local business? (n=205)



Figures in percent

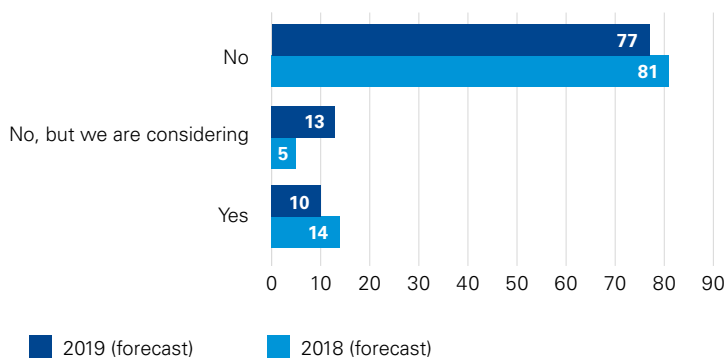
Please note: Multiple answers possible

Moving Capacities / Operations

The majority of German companies in China manufacture for the local and Asian markets, albeit partly with worldwide supply chains. For many German companies, China is an accordingly significant market in their enterprise portfolio (see pg. 13) and changes to this situation would be long-term strategic decisions. According to the findings of this

survey, 77% of German companies have not considered moving operations out of China, which is slightly less vis-à-vis 2018 (81%). However, 10% are in fact considering this, which is slightly less than the 14% that stated so in 2018, with no particular deviations across industries.

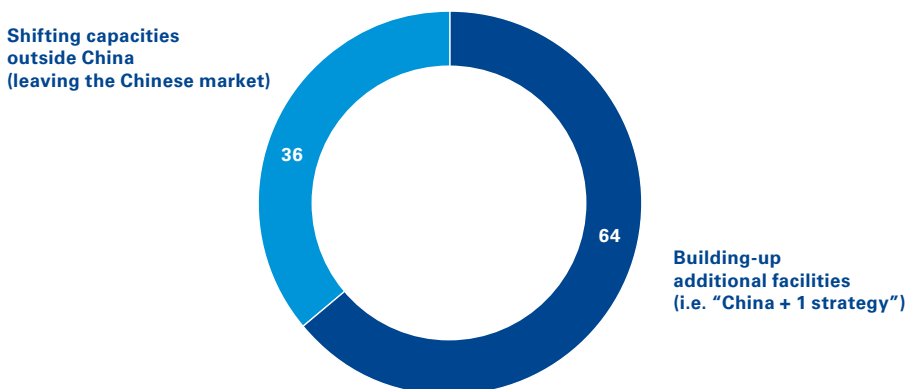
Fig. 28: Has your company recently made the decision to move capacity away from China? (n=458)



Figures in percent

Out of the companies in 2019 that plan to or are considering moving, 64% plan to build up additional facilities in another country (“China + 1 strategy”), whereas 36% intend to shift capacities outside China entirely, i.e. leave the Chinese market.

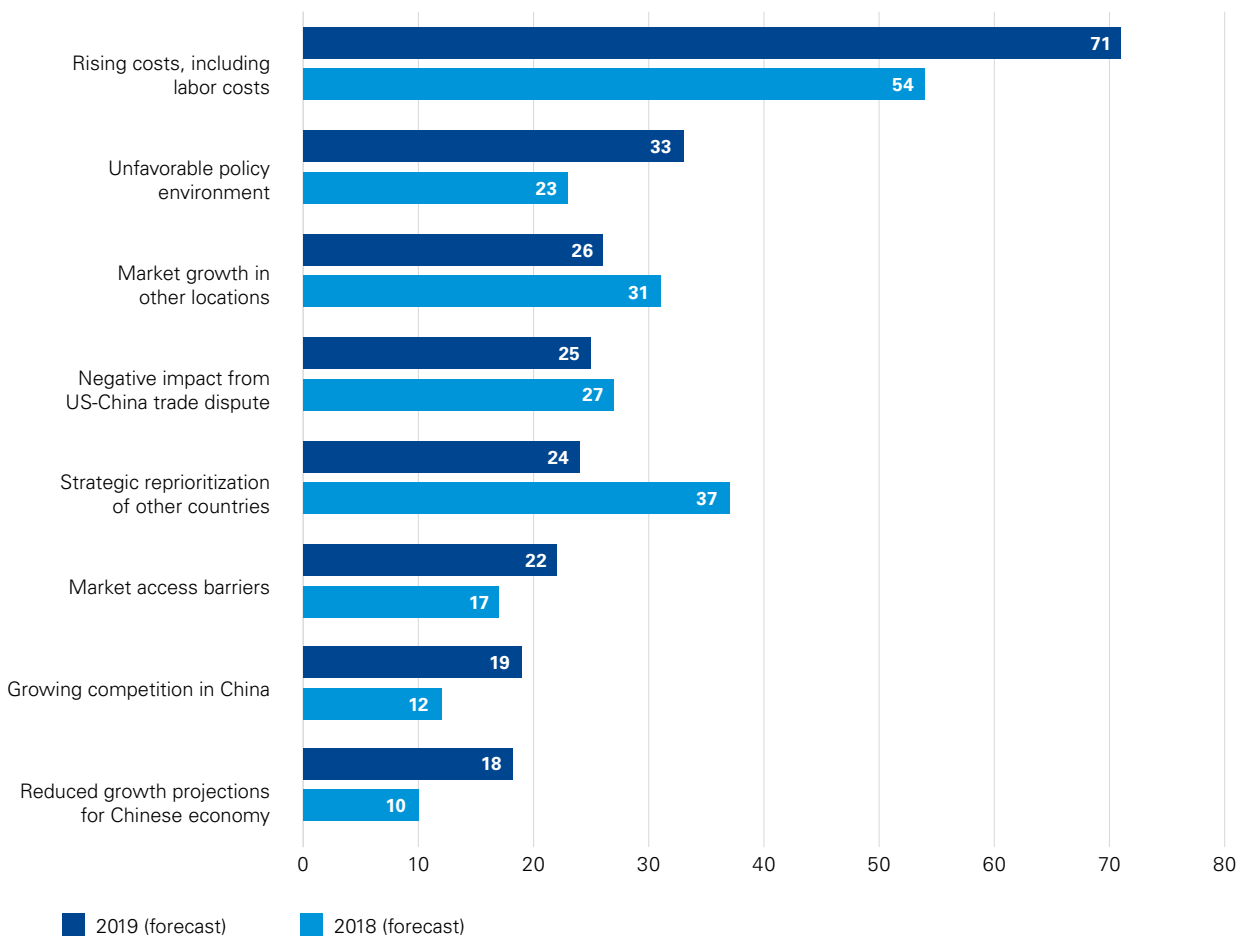
Fig. 29: What are you doing or considering doing outside China? (n=103)



Figures in percent

Rising costs, including labor, is by far the dominating factor for 71% of those companies who are considering moving out of China, followed by what is seen as an unfavorable policy environment (33%).

Fig. 30: What are the most important reasons for moving capacity outside China? (n=104)

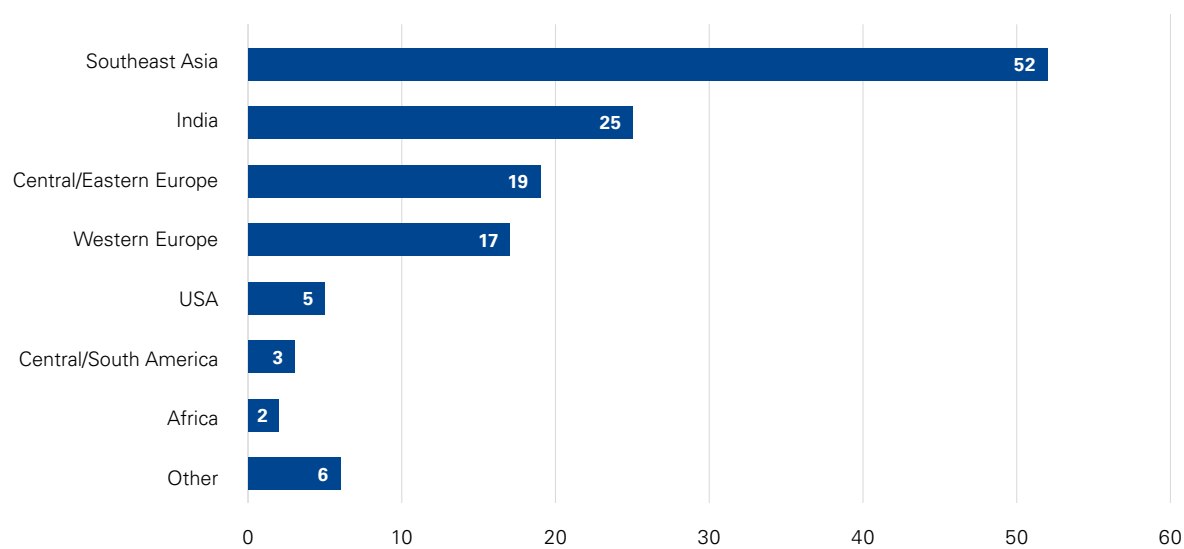


Figures in percent

Please note: Multiple answers possible

Of those considering such a move, their preferred destinations are South East Asia (52%), followed by India (25%) and Central/Eastern Europe (19%).

Fig. 31: If your company recently made the decision to move capacity outside China, where to? (n=99)



Figures in percent

Please note: Multiple answers possible



05 Spotlight on Current Topics

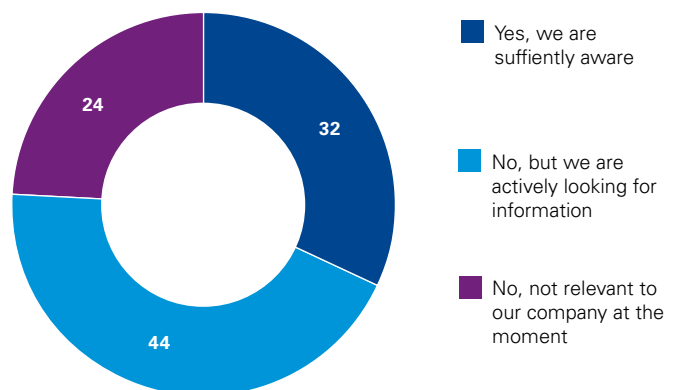
Corporate Social Credit System

Since the end of the 1990s, China's policy makers have been working on a credit rating system for society as a whole. In 2014, the State Council published the "Planning Outline for the Construction of a Social Credit System", which is considered a draft and roadmap for the Social Credit System (SCS). The SCS has distinctive targets: citizens, businesses, organizations, as well as institutions and Chinese authorities themselves. The purpose of the comprehensive national scoring system for companies is to develop a tool to evaluate corporate behavior, assess creditworthiness and to create a holistic solution against market problems, such as fraud, corruption or disregard of contracts. Among the targets of the SCS is a more extensive surveillance, rating and control of individual market players. The Corporate SCS will be implemented gradually and in operation by the end of 2020. The system enables the Chinese government to efficiently monitor companies and individuals and – in the case of non-compliance with the law – to impose sanctions.

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

A year ahead of the implementation, 68% of the surveyed companies do not consider themselves to be sufficiently informed about the "Enterprise Credit Information Publicity System". There is high demand from German companies in China for additional information about it (44%).

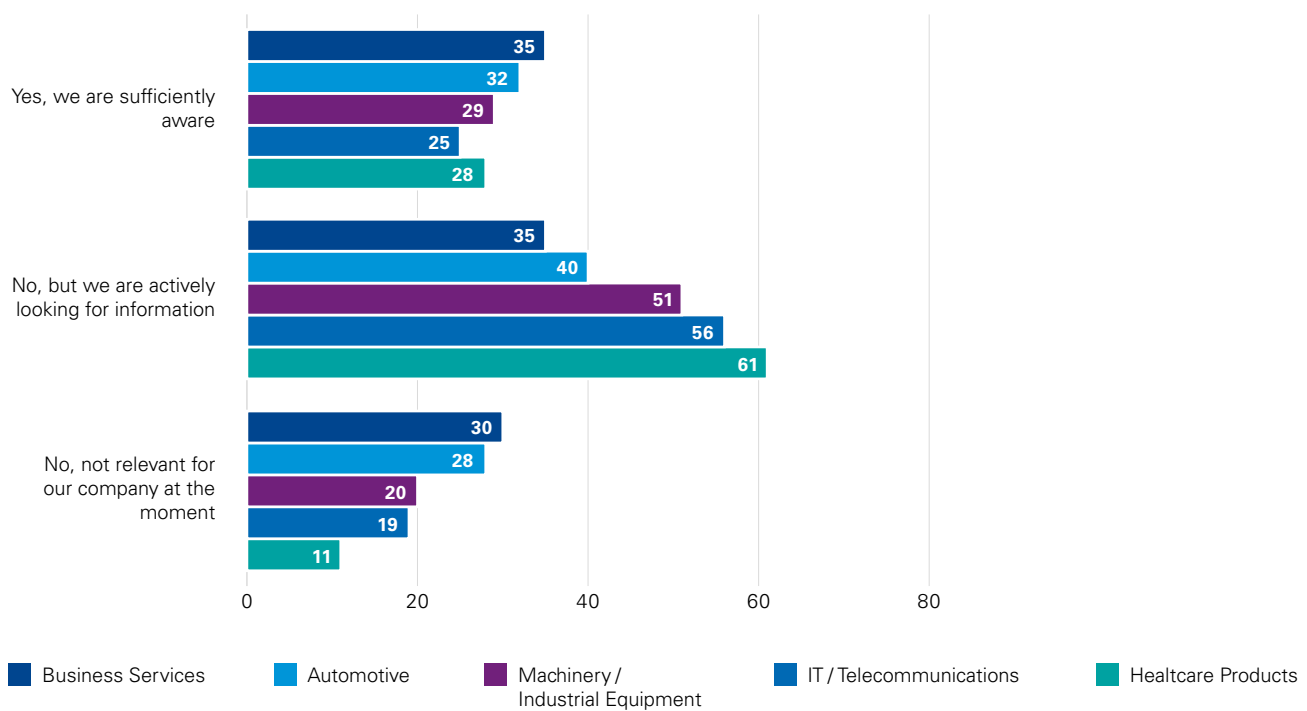
Fig. 32: Are you aware of your company's records on the "Enterprise Credit Information Publicity System" (n=465)



Figures in percent

At 35%, companies in the Business Services sector are the most sufficiently aware sector in terms of SCS, whereas at 61% of participants, the Healthcare Products industry is the one most actively seeking more information about it.

Fig. 33: Industry-related assessment: Are you aware of your company’s records on the “Enterprise Credit Information Publicity System”?

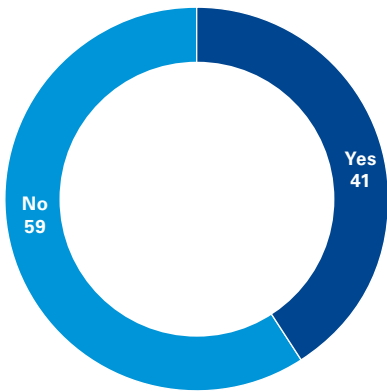


Figures in percent

Similar results were found regarding German companies’ familiarity of the rating score and their awareness of their own score, where 59% of the surveyed companies stated they are not familiar with this information. The surveyed companies also state that they first need to obtain respective information or that they are uncertain of where they can obtain relevant information.

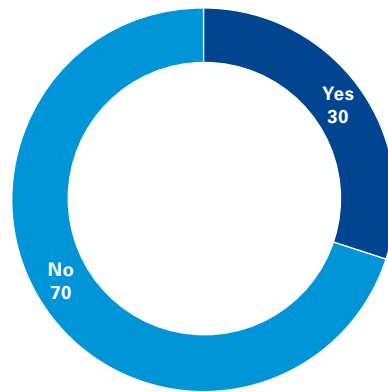
So far, 70% of the surveyed companies consider themselves unprepared for the SCS due to lack of information or other reasons, such as preparation/application difficulties and uncertainties vis-à-vis the rating system. This applies equally to all industries in the same way.

Fig. 34: Are you also familiar with your company's rating results in the two most advanced Social Credit System ratings, the tax and the customs authentication ratings? (n=339)



Figures in percent

Fig. 35: Is your company actively preparing for the Social Credit System and its ratings? (n=436)



Figures in percent

Companies will have to deal with about 30 different ratings categorised according to their performance in sectors like environmental protection, tax and quality controls, which in total will be drawn from compliance records based on roughly 300 requirements.

These requirements will cover areas such as tax, customs authentication, environmental protection, product quality, work safety, e-commerce and cybersecurity.

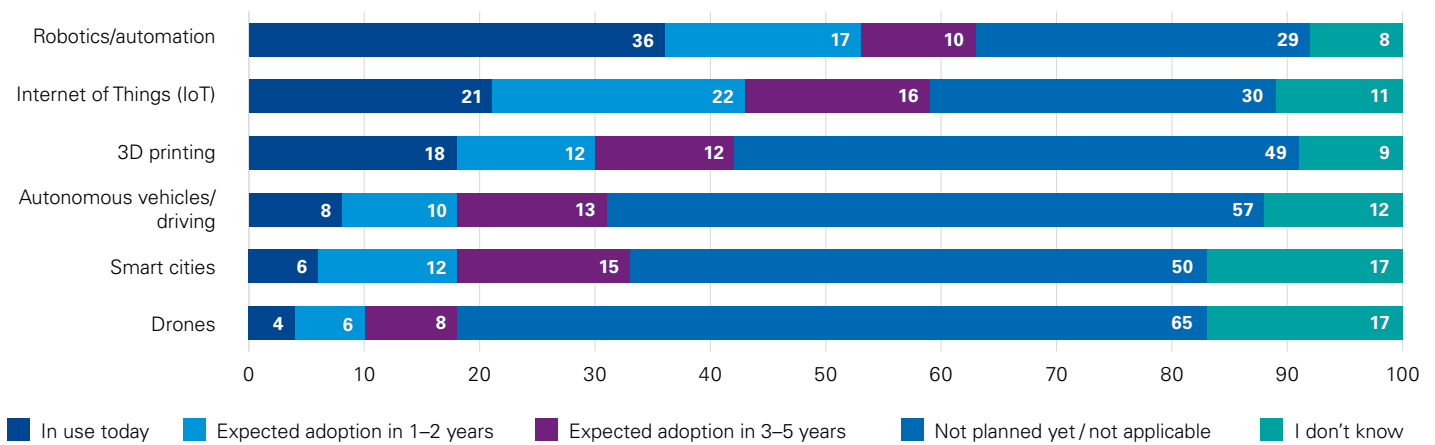
Innovation & Digitalization

Use of Technology

Robotics and Automation (with 36% in use today and 17% expecting adoption within 2 years), as well as the Internet of Things (IoT) (with 21% in use today and 22% expecting adoption within 2 years) are the most relevant topics around digitalization for German companies in

China today. 3D printing is consistently increasing in importance (18% of Germany companies using it today and 12% expecting adoption within 2 years). In comparison, the use of “autonomous vehicles/driving” and “smart cities” lags behind.

Fig. 36: What applies to your company in China regarding the following digital innovations? (n=468)

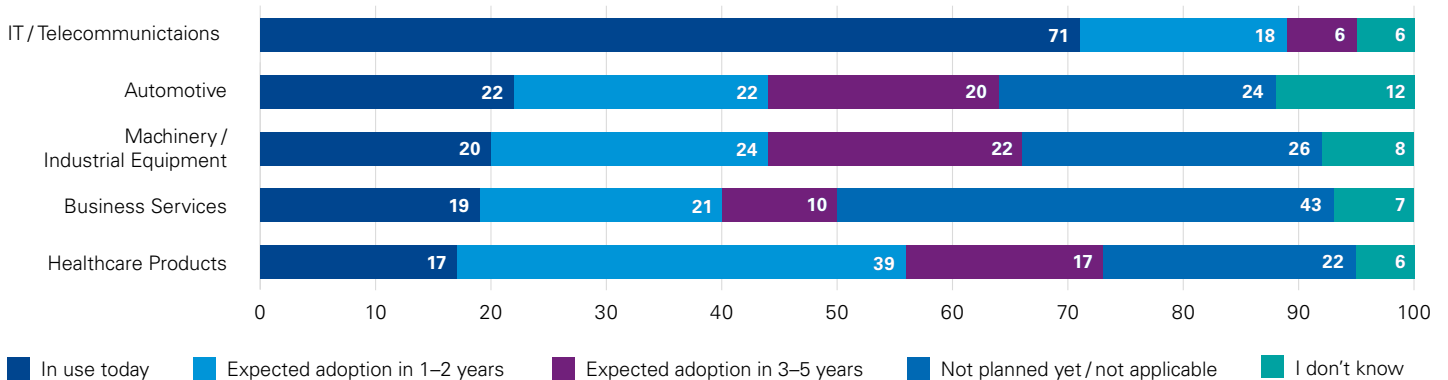


Figures in percent

Different degrees of usage are prevalent in different industries. 71% of IT/Telecommunication companies use the Internet of Things (IoT), 65% of companies in the Automotive industry use robotics and automation in their products, also roughly 1/3 of the Automotive companies surveyed use 3D printing.

Fig. 37: Industry-related assessment: What applies to your company in China regarding the following digital innovations?

Use of Internet of Things

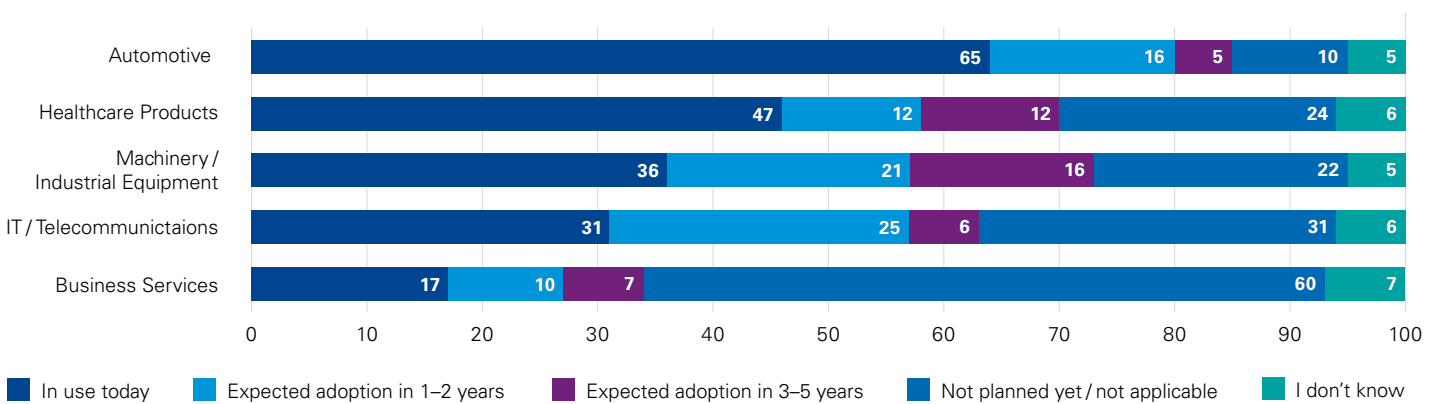


Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Fig. 38: Industry-related assessment: What applies to your company in China regarding the following digital innovations?

Use of Robotics

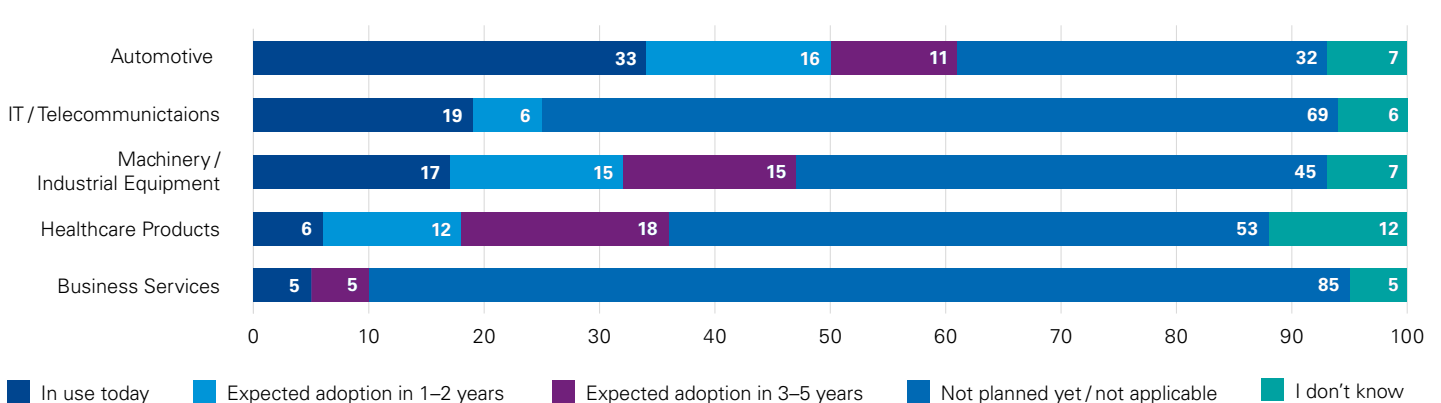


Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Fig. 39: Industry-related assessment: What applies to your company in China regarding the following digital innovations?

Use of 3D printing



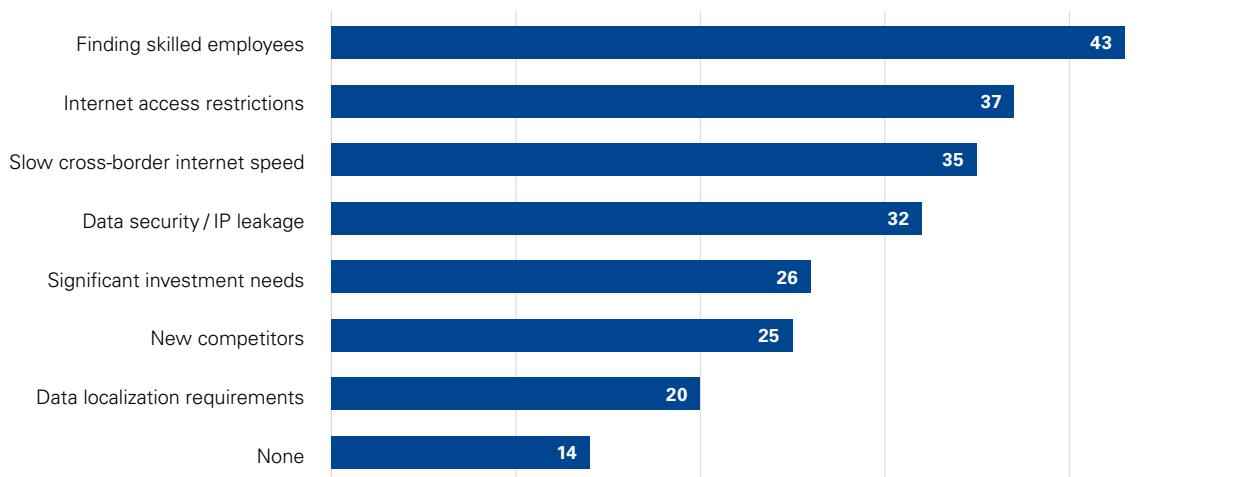
Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

43% of the companies surveyed state “finding skilled employees” to be a challenge facing them in terms of digital innovations, followed by “internet access restric-

tions” (37%) and “slow cross-border internet speed” (35%) as the next two most prevalent challenges.

Fig. 40: Which challenges does your company in China experience with regards to digital innovation? (n=461)



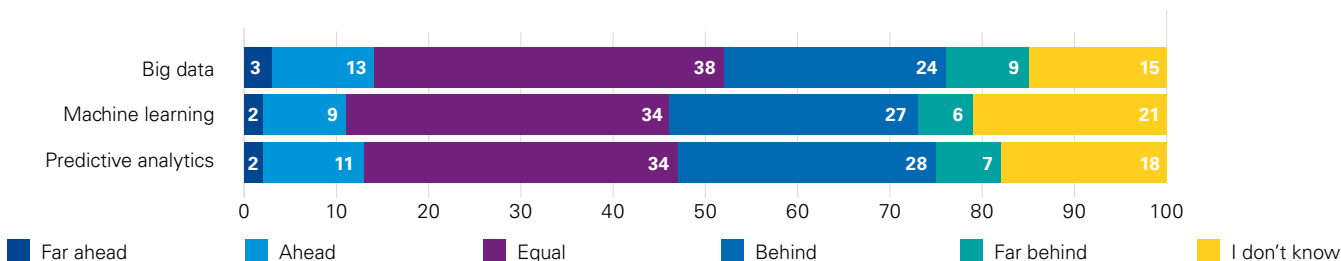
Figures in percent

Please note: Multiple answers possible

Between 11% and 16% of the respondents believe they are ahead or far ahead of their German headquarters in terms of the three digitalization issues; “big data”, “machine learning” and “predictive analytics”. Most of the

surveyed companies seem to be equal to (roughly 1/3) or behind (roughly 1/4) the German parent companies on these topics.

Fig. 41: When comparing to your parent company, do you consider yourself ahead or behind in applying digitalization processes like...? (n= 461)



Figures in percent

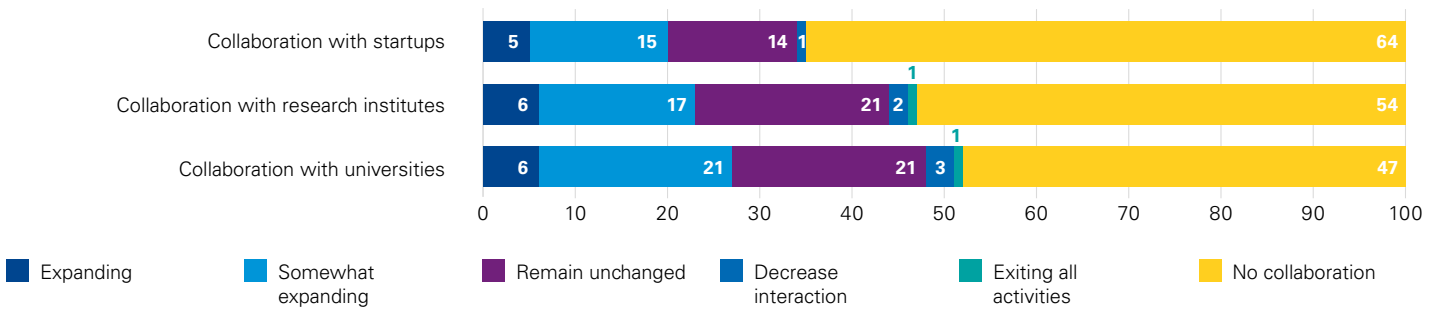
Please note: Deviations from 100 percent are due to rounding differences

Collaboration

According to the findings of this survey, German companies report to notice various potential sources of business opportunity emerging in the Chinese market (see pgs. 20–21). There is room for further improvement regarding

collaboration with startups, universities or research institutes. Approx. 1 of 2 companies are not collaborating with startups, research institutes or universities in any manner at all.

Fig. 42: Are you collaborating with startups, research institutes and/or as universities in China? If you do, how do you rate your interaction and collaboration? (n=464)



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

IT/Telecommunication companies seem to be front-runners in collaborations with startups. Moreover, Healthcare Products firms show increasing collaboration with research institutes and universities in China.

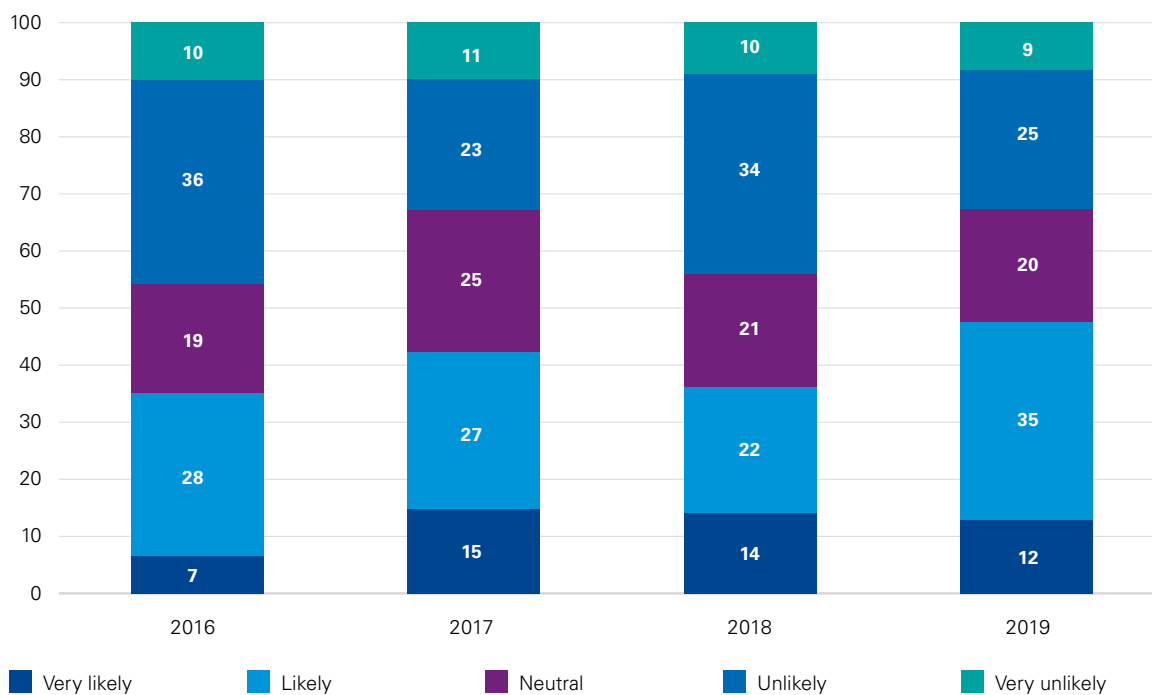
This contrasts with the Machinery/Industrial Equipment and Business Services sectors, who indicate hardly any form of collaboration with Startups or research institutes.

Competitive Situation

Competition with Chinese companies has increased sharply in recent years and remains a challenging issue for the surveyed companies. Over the past years, domestic Chinese companies were able to keep up with technological innovations and to reduce a gap to their foreign competitors that existed for years.

In 2019, 47% of the surveyed companies believe that Chinese competitors can become innovation leaders in their industry within the next five years, which is up from 36% of respondents in 2018. Moreover, 34% believe that it is unlikely or very unlikely that competitors will make this move, which is down from 44% of respondents in 2018.

Fig. 43: Do you think Chinese competitors can become innovation leaders in your industry within the next five years? (n=507)



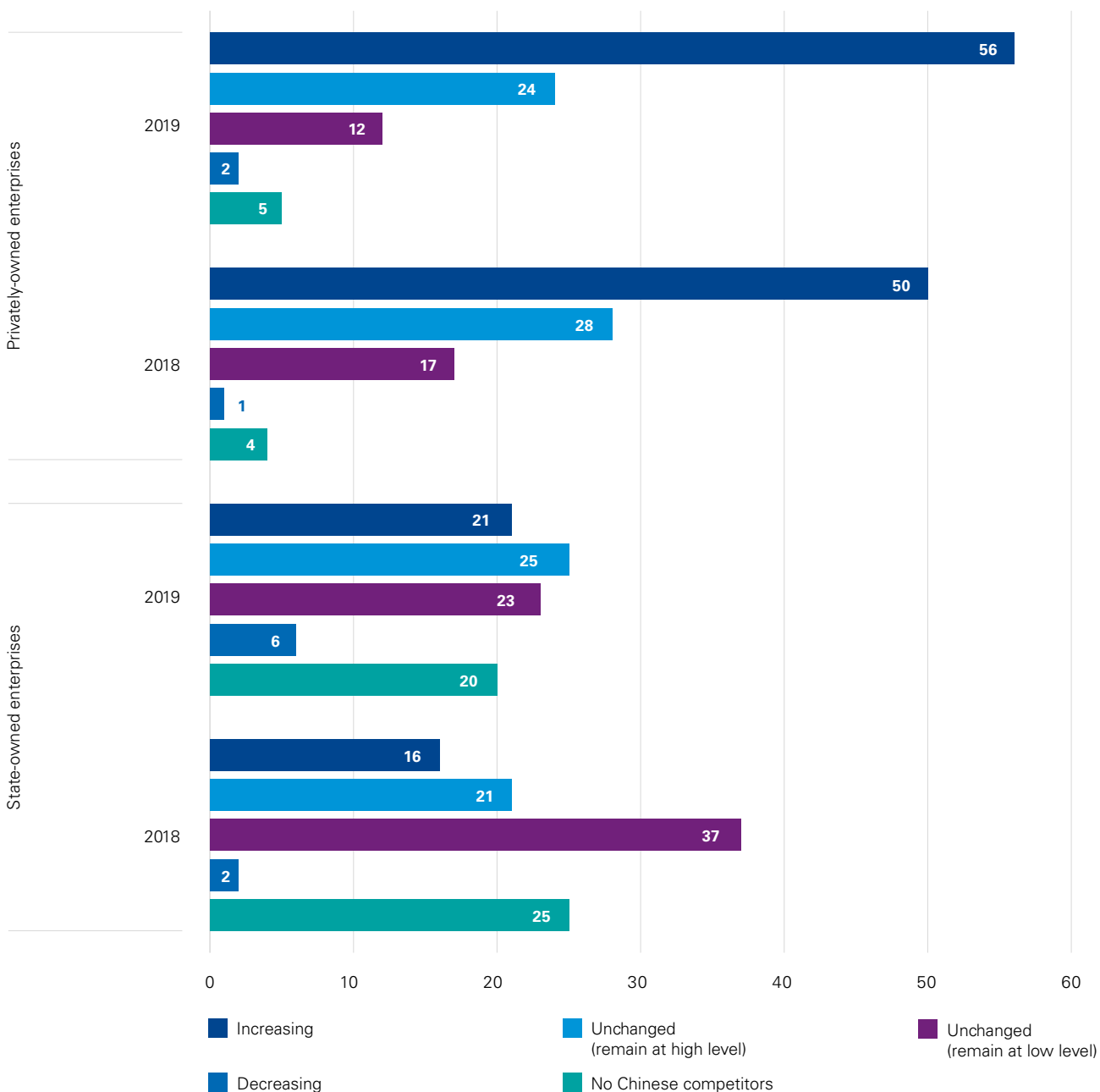
Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

According to the findings of this survey, Chinese privately-owned enterprises (POEs) are much stronger competitors for German companies than state-owned enterprises (SOEs). Furthermore, competition from POEs is increasing for 56% of the surveyed companies, up from 50% in 2018.

From SOEs it has increased by 5%-points from 2018 to 21% in 2019. In contrast, in 2019, 27% of the surveyed companies believe that they are not experiencing competition or experiencing decreased competition from SOEs, whereas just 7% feel the same about POEs.

Fig. 44: Please evaluate the competition your company is facing from Chinese companies. (n=460)



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

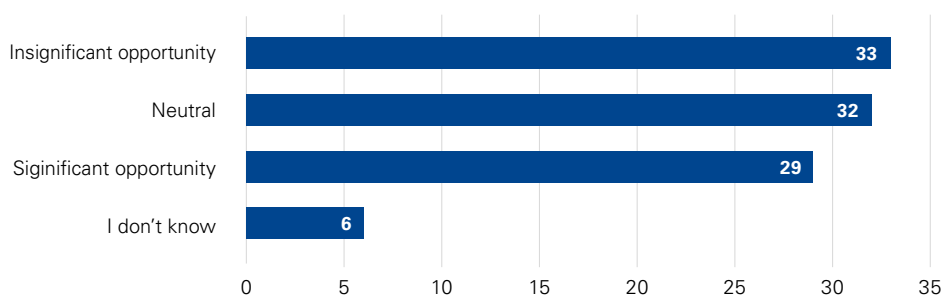
Belt and Road Initiative (BRI)

The BRI is a major project initiated by China to establish an intercontinental infrastructure network between Europe, Africa, Asia and China that aims to open market access and investment opportunities and promote trade and cooperation with the European Union. The expansion of infrastructure via the BRI initiative will change the economic situation of the countries affected and will impact global trade flows. China cooperates strongly with 71 countries that make up 65% of the world's population (including China). Since the initiative was launched in 2013, investment and construction contracts worth USD 489 billion have been realized in these countries.

For many nations along the "New Silk Road", the initiative is a vehicle that supports national development goals. Despite business opportunities and promising projects, there are also challenges, arising in large part from a combination of risks inherent to infrastructure projects, as well as political, social and economic risks in host markets.

For 33% of the surveyed German companies, the Belt and Road Initiative is not a significant opportunity at this point in time, whereas 29% believe it to be significant or somewhat significant. It is only ranked number 10 of the business opportunities (see pg. 21). It is clear that to date the potential of BRI has yet to fully materialize.

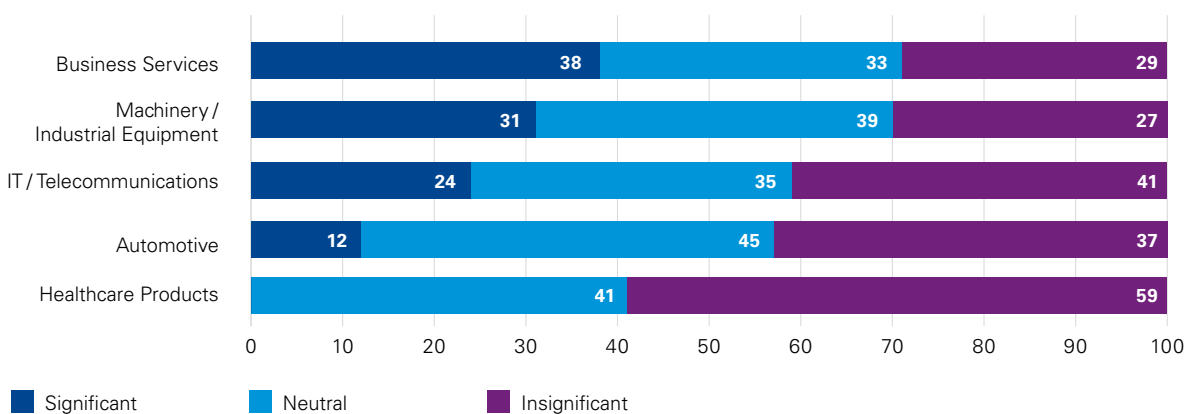
Fig. 45: In what way do you view the Belt and Road Initiative as an opportunity for your company's China business? (n=512)



Figures in percent

It is Business Services, Machinery/Industrial Equipment and the IT/Telecommunications industry that see significant opportunities in BRI projects.

Fig. 46: Industry-related assessment: Do you see Belt and Road initiative as an opportunity for your company's China business?



Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

The Business Confidence Survey conducted in 2018 shows that more than two-thirds of the surveyed companies were not engaged with Chinese business partners in relation to the BRI. The most apparent reason for this is the perception amongst German companies that their industry or business

model is of low relevance to the Initiative (72%). 22% of the respondents cited a lack of suitable projects and insufficient availability of information (16%) as reasons for not engaging in BRI-related business.



06 Profile of Surveyed Companies

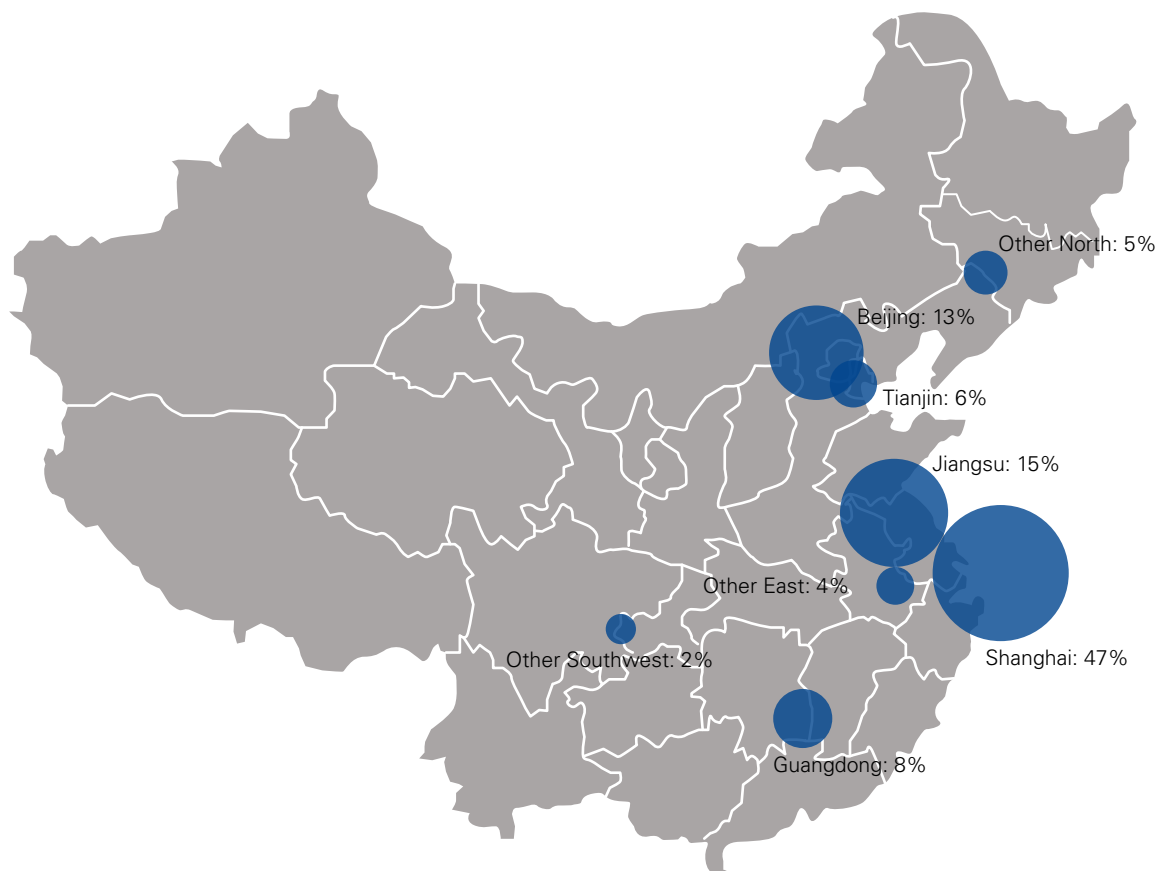
The German Chamber of Commerce in China numbers 2,300 member companies, representing roughly 50% of all German companies operating in China.

This year's online survey was conducted from 29 July to 12 September 2019 and covered all member companies in China. As the 2019 company profile of the surveyed companies is very similar to that of the prior year, the results from both years can be reliably compared, which is also the case with respect to industries and other variables relevant in both surveys. Furthermore, the 526 respondents surveyed in 2019 marks a record high and well exceeds the 423 respondents from 2018.

Company Location in Mainland China

At 47%, the largest amount of the responding companies are located in Shanghai with Beijing next at 13%. In 2018, 11% of respondents stated that their company was located in Beijing and 43% in Shanghai. This slight change nevertheless forms a strongly representative picture of the members of the German Chamber of Commerce in China.

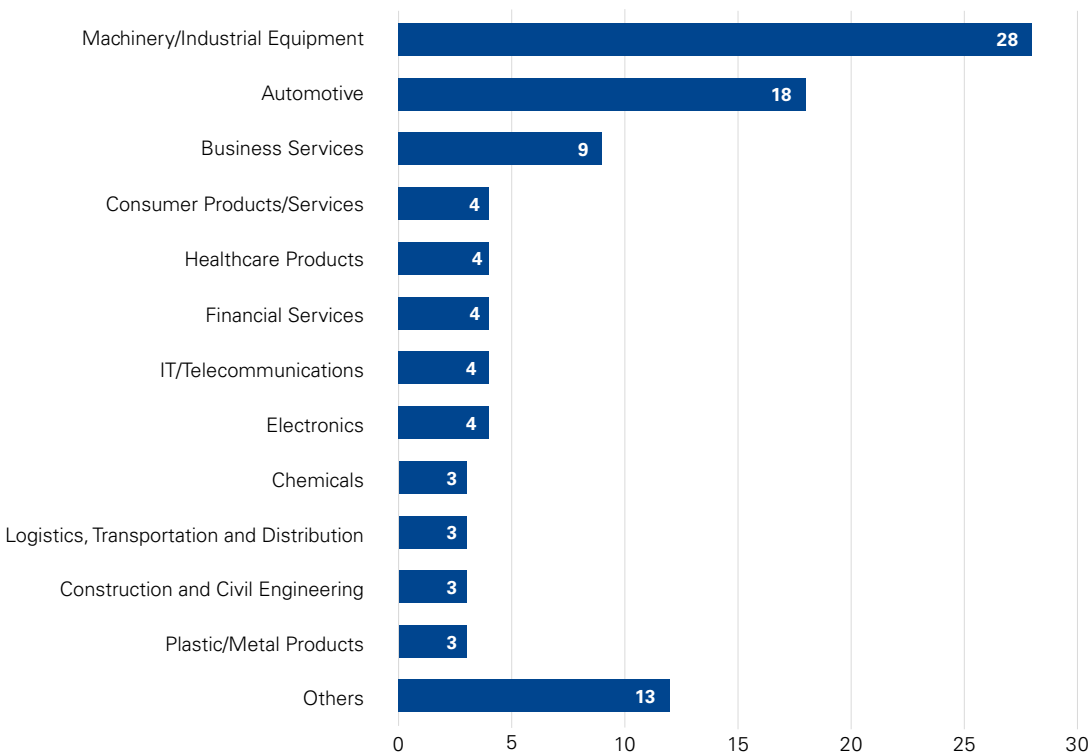
The majority of German businesses in China are located on the periphery of the country in coastal areas. They are particularly concentrated in the main economic clusters of the Yangtze Delta (East), the Bohai Economic Rim (North) and the Pearl River Delta (South). Relatively few companies are located in the interior of the country.



Surveyed German companies in China are mainly engaged in industries such as Machinery/Industrial Equipment and Automotive – together totaling 46%. A further 9% of

companies operate in Business Services. The remaining 45% consist of companies from various industries ranging from Healthcare Products to IT/Telecommunications.

Fig. 47: Please specify the main industry of your company. (n=458)

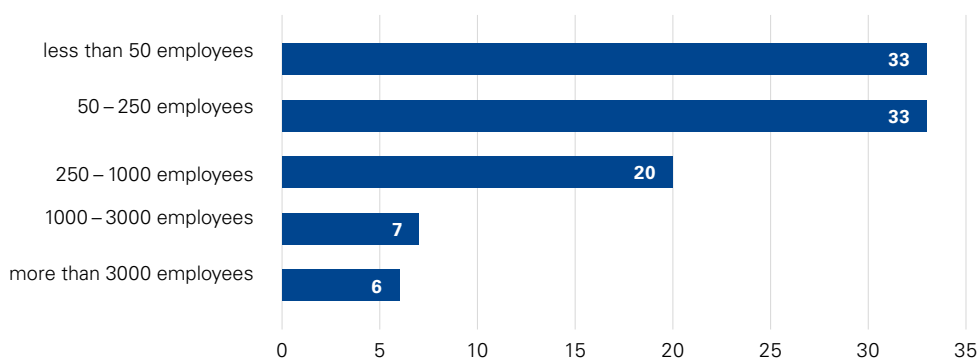


Figures in percent

Small and medium-sized enterprises (SMEs) still constitute the largest share of German companies in China. The share of companies employing up to 250 employees at

their local operation is 66% of all surveyed companies. Companies with more than 1,000 employees make up 13%.

Fig. 48: Please indicate the number of employees working at your company's local operation. (n=459)

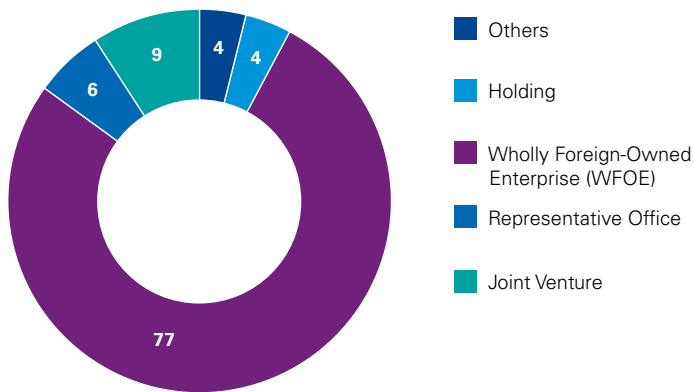


Figures in percent

Please note: Deviations from 100 percent are due to rounding differences

Most surveyed German companies (77%) in China are characterized as a Wholly Foreign-Owned Enterprise (WFOE), followed by joint venture (9%), representative office (6%) and holding (4%).

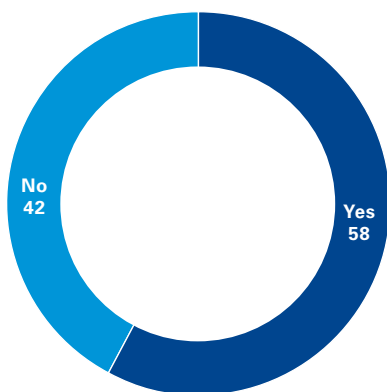
Fig. 49: Please indicate the legal status of your company in China. (n=459)



Figures in percent

Over half of the German companies surveyed (58%) manufacture goods in China.

Fig. 50: Is your company manufacturing goods in China? (n=445)



Figures in percent

07 Contacts

German Chamber of Commerce in China

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

#PartnerForAdvocacy

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