



German Business in China

Business Confidence Survey 2021/22



 Partner For Advocacy



PREFACE

This report, published by the German Chamber of Commerce in China in cooperation with KPMG, is based on the Business Confidence Survey. With a 15 years history, this is our longest-running instrument to measure the business sentiment of German companies operating in China. This also marks our third cooperation with KPMG in Germany in preparation of this survey.

To cope with the global economic downturn amid COVID-19, businesses underwent changes and redefined themselves, adjusting to the new reality that the pandemic and geopolitical developments have brought upon them. China steadily recovered economically, with a GDP growth rate of 8.1% for 2021 (preliminary estimates; National Bureau of Statistics, China), and more than half of the German companies in China experienced an improvement in their industry in 2021. It is equally important to note, however, that German companies' outlook for 2022 is less optimistic than the outlook toward 2021, signaling that realism replaced strong positivity.

The level playing field is a major concern for German companies in China, who face increasing regulatory business challenges, especially through preferential treatment of local companies. The current travel restrictions also disrupt German businesses, negatively

impacting mutual understanding, knowledge transfer, investments, and growth.

Mainly driven by opportunities and constraints, the second localization wave – 'localization 2.0' - is accelerated by decoupling and the current travel restrictions, pushing German companies to localize or 'miss out' on China's domestic market opportunities. In addition, there is a growing necessity for risk and compliance management, as complex regulatory challenges remain.

The German Chamber of Commerce in China comprises 2,300 member companies, representing roughly 50% of all German companies operating in China. 596 member companies responded to this survey, making 2021 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, and we want to use this opportunity to thank the participating member companies for their valuable contribution. This also demonstrates the companies' growing interest in making their voices, expectations, and concerns heard. We trust the survey provides valuable and founded guidance to further expand economic relations between China and Germany. It will also guide the Chamber's advocacy work through the year 2022.

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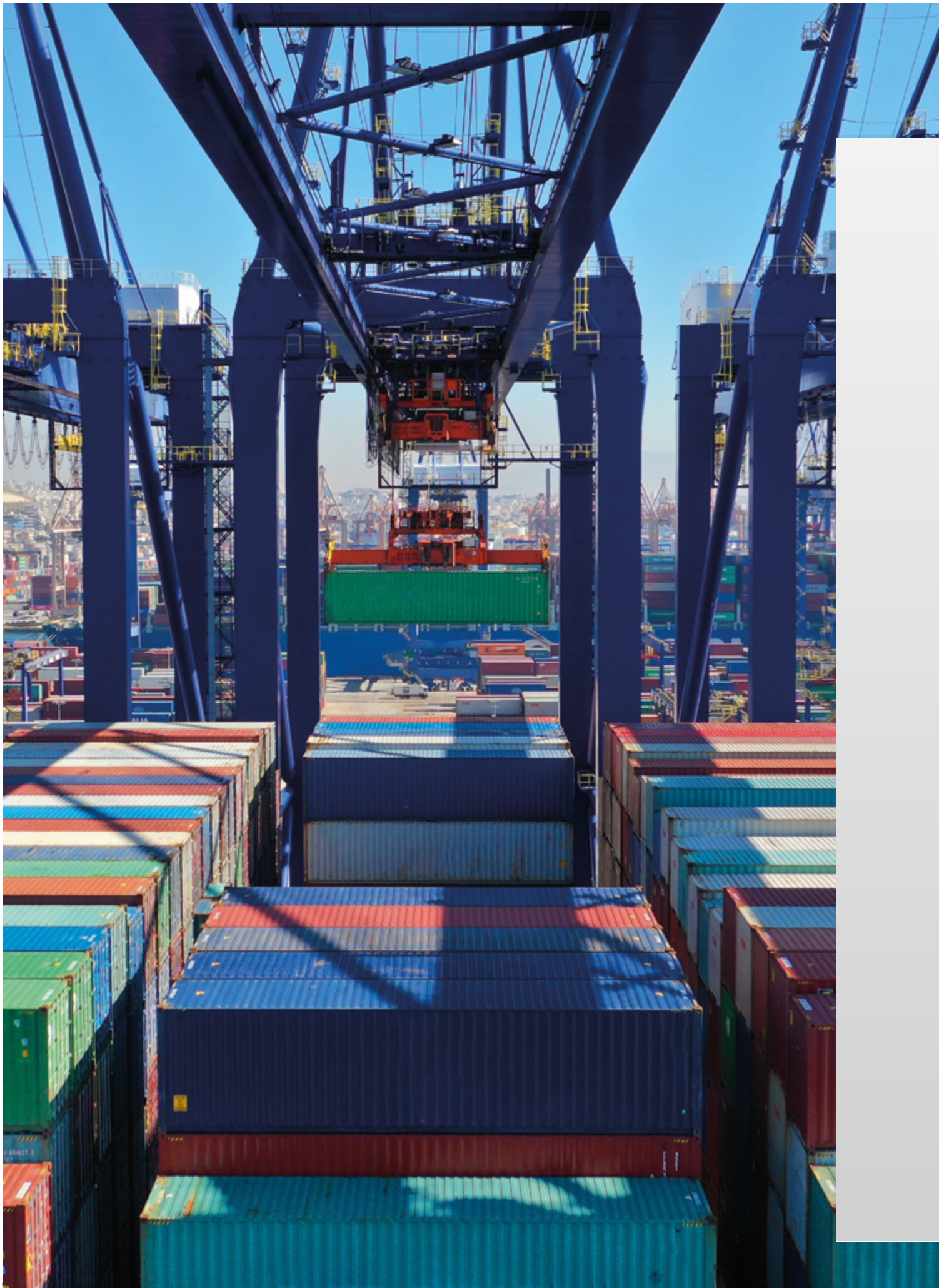
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EXECUTIVE SUMMARY

CONFIDENCE IN THE MARKET REMAINS CONSISTENT

German companies in China are confident about the current year: in 2021, almost 60% of companies in China reported an improvement in their industry, and more than half expect a further increase in their industry in China in 2022. The Chinese market remains one of the most significant global markets for German companies: 71% of companies intend to increase their investments here. Only 4% are even thinking about leaving the country. However, a new realism is emerging regarding business opportunities in China, replacing the previous strong positivity. For example, only 51% of companies now see growth in domestic consumption as the biggest opportunity for their business in China. In the previous year, 73% of companies still shared this view.

Nevertheless, the number of companies planning further investments in China remained almost unchanged from the previous year. The focus is on new production facilities (49%), the expansion of research and development (47%), and automation and further productivity development (37%). Companies active in the market with decarbonization technologies, products, and services could particularly benefit from China's ambitious plans: Around half (49%) of respondents regard China's goal of becoming carbon neutral by 2060 as a business opportunity.

“SELF-RELIANCE” TENDENCIES AFFECT LEVEL PLAYING FIELD

German companies in China are quite optimistic about the new year, and their commitment to the market remains firm. However, economic tendencies toward ‘Self-Reliance’ seem to have left their mark: lack of equal treatment has become the most significant regulatory challenge for German business in China. This moves the challenge from 6th to 1st place in the study's ranking compared to the previous year. According to the survey, one-third (34%) of German companies report preferential treatment of local companies, especially in the areas of market access, government procurement, and regulatory environment. 42% of the companies active in public procurement have been affected by preferential treatment of local competitors. Furthermore, these companies report a lack of transparency, ‘buy-local’ policies, and preferential treatment for state-owned enterprises, among other issues.

Travel restrictions are among the top operational challenges (42%) for German companies in China. The strict entry regulations represent an almost insurmountable impediment to doing business with China for German companies. According to the

survey, they affect mutual understanding (72%), prevent foreign investment (56%), and ultimately the country's growth (45%).

LOCALIZATION 2.0 – BUSINESS DRIVEN BY BUSINESS OPPORTUNITIES AND CONSTRAINTS

The localization of German companies' operations in China has accelerated over the past decade. The first wave of localization was driven mainly by regulatory constraints - such as the obligation to establish a joint venture with a Chinese partner. However, the second wave - “Localization 2.0” - is being driven more by changing consumer behavior, market expectations, innovation speed, and general decoupling tendencies. German companies in China are countering this by increasing cooperation with local partners as well as localizing procurement and research & development. The ongoing travel restrictions are also accelerating localization: Around a third (33%) of German companies are localizing technical and operational know-how in China.

GROWING NECESSITY FOR RISK AND COMPLIANCE MANAGEMENT

Issues revolving around compliance and risk management have been increasingly important for German companies as recent legislation in both China and Germany, coupled with the COVID-19 pandemic, demonstrate a growing necessity for risk and compliance management in China. With 55% of the surveyed companies facing IP challenges, the Chinese Cyber Security Law added difficulties in complying with technical requirements (49%) and the limitations of data-cross border transfer (46%). In terms of compliance management, 70% of German companies use China's Corporate Social Credit System (CSCS) to mainly acquire credit information of potential business partners before a transaction.

PRIORITIES OF GERMAN COMPANIES: IMPROVED LEVEL PLAYING FIELD, EASE OF TRAVEL RESTRICTIONS, AND GERMAN-CHINESE COOPERATION

Against the backdrop of the aforementioned developments, opportunities, and challenges, the German business community in China put forward its expectations for the new German government's China strategy: From the German companies' perspective, the new German government should continue to advocate for a level playing field and an easing of travel restrictions. At the same time, it should continue the dialogue and strive to adapt Sino-German economic cooperation in various areas.

KEY FINDINGS



BUSINESS CONFIDENCE AHEAD – REALISM REPLACES STRONG POSITIVITY

- ➔ German companies' performance and outlook robust but damped after COVID-19 recovery expectations
- ➔ Business opportunities in China continue to lose significance
- ➔ Half of the surveyed German companies regard China's upcoming '30-60' decarbonization goals as a business opportunity
- ➔ 71% of German companies plan to invest in China in the next two years, in particular in manufacturing facilities and R&D
- ➔ 96% of German companies stay put in the Chinese market
- ➔ A third of German companies that are decreasing investments in China name politicization of business and increased domestic competition as main reasons



SELF-RELIANCE – IMPACT ON LEVEL PLAYING FIELD

- ➔ Preferential treatment of local companies has become the top regulatory business challenge in 2021, with One-Third of German companies experiencing unfavorable treatment
- ➔ Legal uncertainty is the second biggest regulatory challenge for German companies in China
- ➔ German companies see dual circulation as both a challenge and an opportunity
- ➔ Travel restrictions are among the top challenges for German companies, negatively impacting mid-term mutual understanding, foreign investment, and growth
- ➔ More than half of the German companies face negative impact due to decoupling in terms of hampered cooperation and exchange and decreasing investment confidence in the next two years



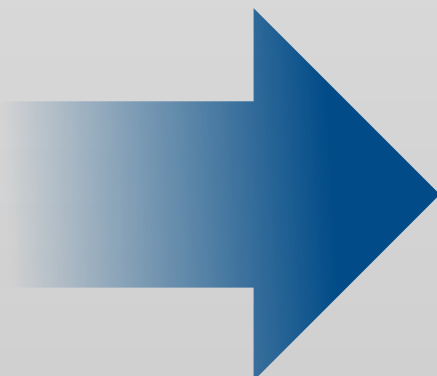
LOCALIZATION 2.0 – DRIVEN BY OPPORTUNITIES AND CONSTRAINTS

- ➔ Becoming more local by cooperating with partners, sourcing, and R&D, mitigates decoupling tendencies
- ➔ Travel restrictions accelerate localization, with one-third of German companies localizing technical and operational know-how in China
- ➔ 50% of the surveyed companies expect Chinese competitors to become innovation leaders in their industry within the next five years



GROWING NECESSITY FOR RISK AND COMPLIANCE MANAGEMENT

- ➔ 40% of the surveyed companies are indirectly or directly affected by the US sanctions on Chinese businesses or individuals
- ➔ Almost half of the companies are planning – or have already started – to implement new compliance measures for the German Supply Chain Law
- ➔ 70% of German companies use the CSCS platforms, mainly for obtaining credit information of potential business partners before a transaction
- ➔ IP enforcement continues to pose challenges for German companies in China
- ➔ Technical requirements and limitations of cross-data transfer are the main concerns attributed to the Chinese Cyber Security Law



From German companies' perspective, the new German government should continue to advocate for an improved level playing field, the ease of travel restrictions, and the deepening of German-Chinese economic cooperation in various fields.



CONFIDENCE AHEAD – REALISM REPLACES STRONG POSITIVITY

REALISM IN BUSINESS PERFORMANCE AND OUTLOOK

After 2020's global economic downturn, where China still recorded a GDP of RMB 101,356.7 billion with a growth rate of 2.2%,¹ China steadily recovered economically with a year-on-year (YoY) growth rate of 9.8% for the first three quarters of 2021². The World Bank predicts China's real gross domestic product (GDP) growth will reach 5.1% in 2022³. German companies have a positive outlook for next year, with over half of the surveyed German companies expecting an improvement in the development of their industry in 2022. However, in 2020 the expectations for 2021 were more positive, possibly due to the expected recovery from the contraction caused by COVID-19. Comparing the outlook for 2022 to the outlook towards 2021, the expectations are less optimistic (decrease of 15 percentage points, from 66% to 51%) – showing that realism replaced strong positivity.

- ▶ German companies' performance and outlook robust, but damped after COVID-19 recovery expectations.

REALISM IN BUSINESS OPPORTUNITIES

China remains an indispensable market for German companies, who still seek market growth and expansion in the country. However, since 2019, the positivity towards China's business opportunities has been replaced by realism, and business opportunities of all kinds are steadily losing significance for German companies.

- ▶ Business opportunities in China continue to lose significance.

In September 2020, at the 75th United Nations General Assembly, China stated that it strives to have carbon dioxide emissions peak by 2030 and reach carbon neutrality by 2060. With the im-

plementation of China's carbon neutrality policies, China's large domestic market represents an opportunity for companies involved in decarbonization technologies, products, and services.

- ▶ Half of the surveyed German companies regard China's upcoming '30-60' decarbonization goals as a business opportunity.

POSITIVE INVESTMENT TREND CONTINUES

China is Germany's most important trading partner for the fifth consecutive year, with a trade volume (import and export) of EUR 213.2 billion between the two countries in 2020⁴. The majority of German companies regard China as a key market for their industry, and the willingness to invest remains strong.

- ▶ 71% of German companies plan to invest in China in the next two years, in particular in manufacturing facilities and R&D.
- ▶ 96% of German companies stay put in the Chinese market.

However, companies that choose to decrease investments in China cited the ongoing political conflicts, foreign trade frictions, and growing competition in China as the main reasons for reducing investments.

- ▶ A third of German companies that are decreasing investments in China name politicization of business and increased domestic competition as main reasons.

1: NBS (National Bureau of Statistics, China). 2021. Announcement of the National Bureau of statistics on the Final Verification of GDP in 2020. [online] Available at: <www.stats.gov.cn/english/PressRelease/202112/t20211220_1825480.html> [Accessed: 28 December 2021].

2: NBS (National Bureau of Statistics, China). 2021. Preliminary Accounting Results of GDP for the Third Quarter of 2021. [online] Available at: <www.stats.gov.cn/english/PressRelease/202110/t20211019_1823616.html> [Accessed: 28 December 2021].

3: The World Bank. 2021. China Economic Update – December 2021. [online] Available at: <<https://www.worldbank.org/en/country/china/publication/china-economic-update-december-2021>> [Accessed: 28 December 2021].

4: Statistisches Bundesamt (Destatis). 2021. The People's Republic of China is again Germany's main trading partner. [online] Available at: <<https://www.destatis.de/EN/Themes/Economy/Foreign-Trade/trading-partners.html>> [Accessed: 28 December 2021].



BUSINESS AND COMPANY PERFORMANCE 2021 AND OUTLOOK 2022

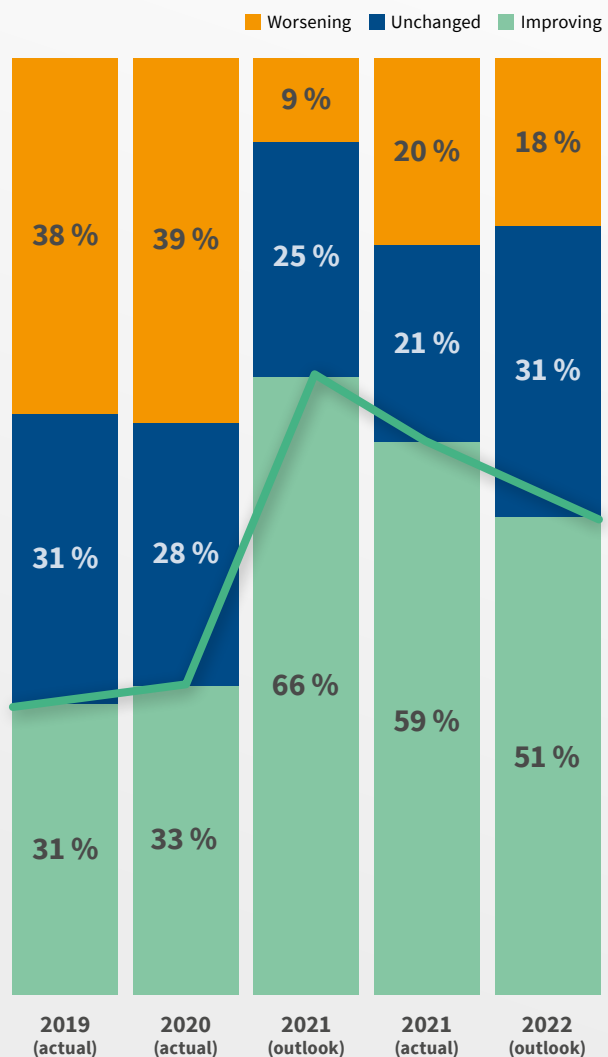
After COVID-19's impact on China's economy reached its peak in 2020, China's GDP growth for the first three quarters of 2021 was 9.8%, indicating a steady economic recovery. The YoY GDP growth for the first quarter of 2021 amounted to 18.3% – the highest quarterly growth since China started recording in 1992. However, the 18.3% is less indicative for strong growth as it is compared to the contraction caused by the peak of COVID-19 in the first quarter of 2020. A more accurate indicator is gained by using China's GDP of the first quarter of 2019 as a base for comparison with 2021: the two-year growth averages 5%. In the second quarter of 2021, the GDP grew YoY by 7.9%, and in the third quarter – by 4.9%. The two-year growth amounts to 5.5% and 4.9%, respectively⁵. China's robust but damped GDP growth is correlated with German companies' assessment of their industry development in 2021.

59% of the surveyed companies experienced an improvement in their industry in China in 2021 compared to 2020, whereas only 20% experienced a worsening. Compared to the outlook companies had for their industry for 2021 in 2020, the actual development is not as positive as expected. This is not surprising, as toward the end of 2020, when the outlook for 2021 was surveyed, companies were recovering from the COVID-19 downturn, assumed no further impact from the pandemic on China and demonstrated a very positive view of the next year.

Compared to the actual development in 2019, as well as the outlook made in 2019 for 2020, the industry development expectation for 2022 is relatively positive, with 51% expecting an improvement of their industry (Figure 1.1).

Figure 1.1: Industry Development and Outlook Robust but Damped After COVID-19 Recovery Expectations

*How do you evaluate the development of your industry in China in 2021 compared to last year? And what are your expectations for 2022? ((2020/21 n=535; 2021/22 n=587)**



* Note: „I don't know“ answers excluded

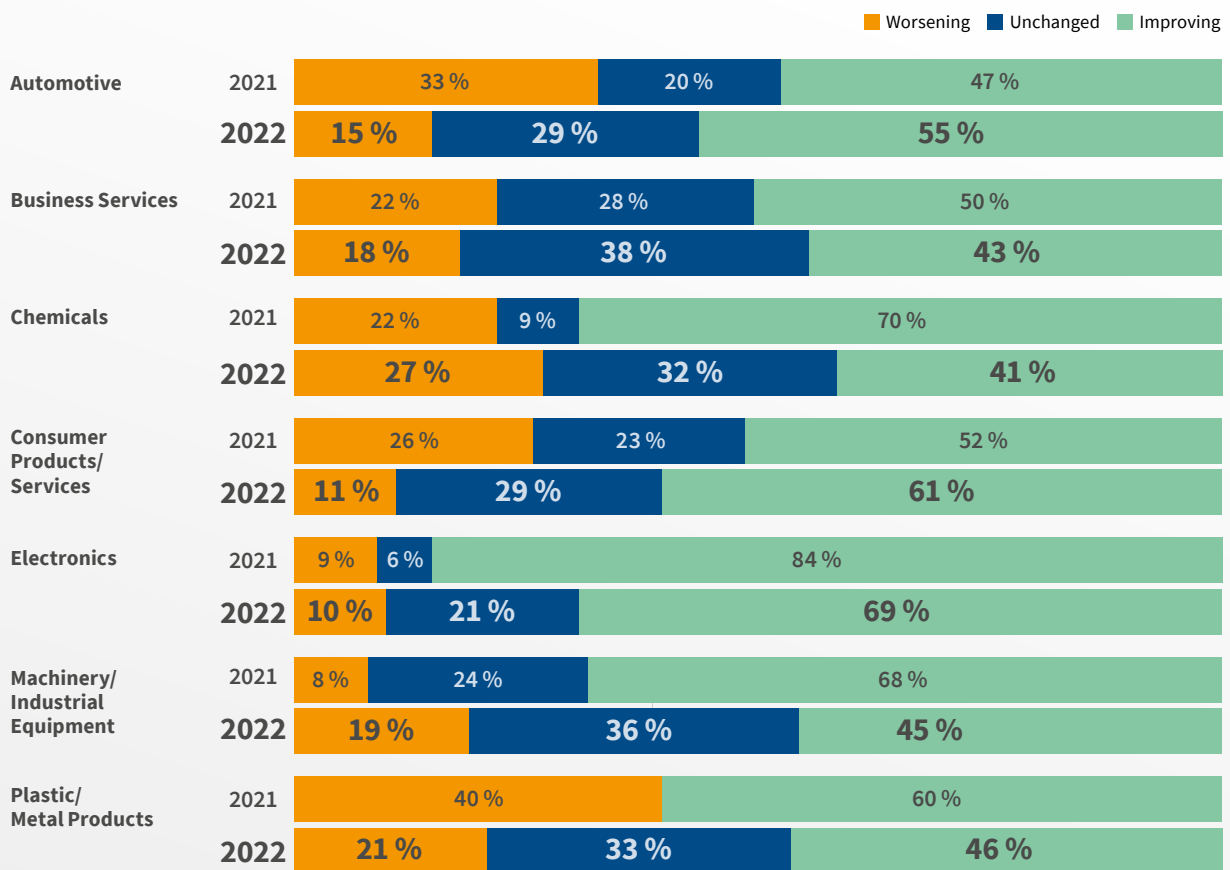
5: NBS (National Bureau of Statistics, China). 2021. National Economy Continued to Recover and Real Economy Showed Steady Growth in November. [online] Available at: <www.stats.gov.cn/english/PressRelease/202112/t20211215_1825291.html> [Accessed: 28 December 2021].

On the industry level, electronics (84%), chemicals (70%), and machinery and industrial equipment (68%) experienced an improvement in their industry in 2021 compared to 2020. Most companies in electronics (69%), consumer products and services (61%), and automotive (55%) expect

an improvement in their industry development in 2022. It is noteworthy that only 41% in the chemical industry expect an improvement and 27% foresee a worsening for 2022 – turning from a very positive industry development for 2021 to the least optimistic industry for 2022 (Figure 1.2).

Figure 1.2: Electronics Leading Positive Development Expectations

How do you evaluate the development of your industry in China in 2021 compared to last year? And what are your expectations for 2022? (n=587)*



* Note: „I don't know“ answers excluded

Looking at the key performance indicators, turnover, profit, investment, and employment, German companies' assessment of their performance is relatively positive, with 63% anticipate an increase in turnover, 48% an increase in profits, 32% an increase in investment, and 36% an increase in employment by the end of 2021, compared to 2020 (Figure 1.3).

The positive view remains reflected in the outlook for 2022, especially for turnover, where 60% of German companies expect an increase. Profits are expected to rise for less companies (41%) and employment and investments are not following at the same pace (Figure 1.4). A review by the size of companies reveals that larger companies are more optimistic than smaller ones.

Figure 1.3: Positive Performance in the Second Year of COVID-19

*How do you expect your company to perform in the following areas by the end of 2021 compared to 2020? (n=587)**

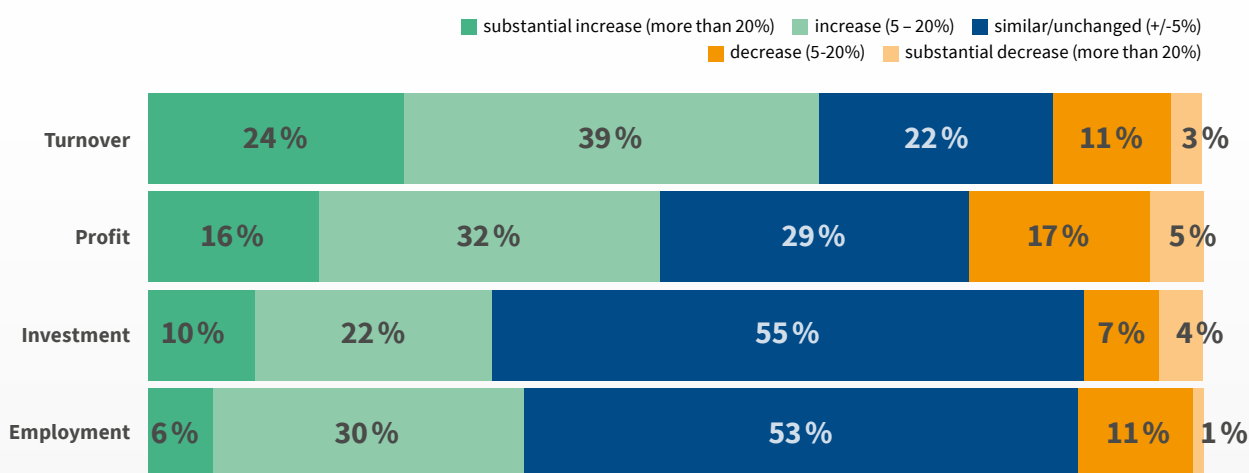
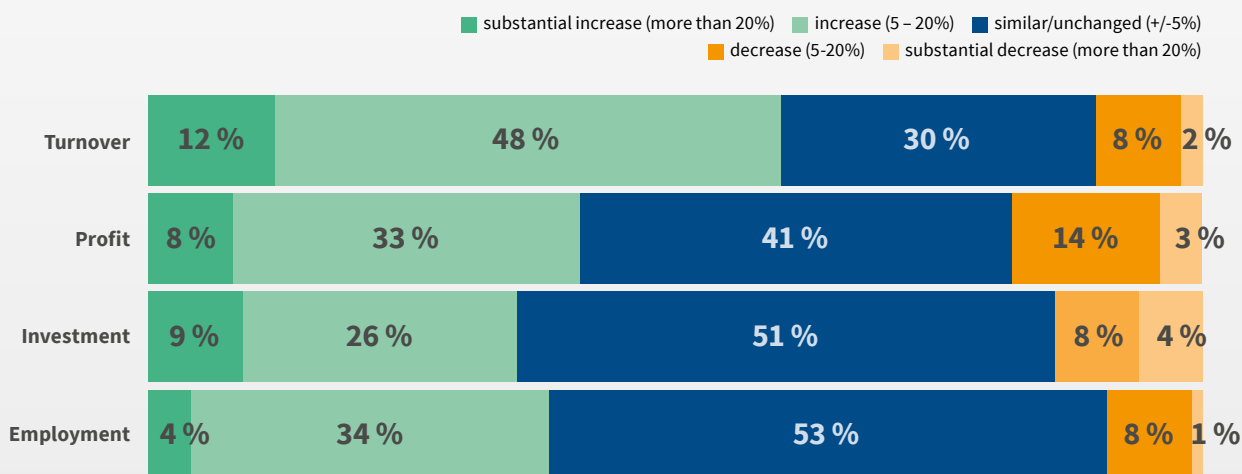


Figure 1.4: German companies' Outlook for 2022 remains robust

*What is your view on the outlook of your company for 2022 across the following areas, when compared to 2021? (n=585)**



* Note: „I don't know“ answers excluded

BUSINESS OPPORTUNITIES

Over half of the surveyed companies consider domestic consumption growth the top opportunity for their business in China, marking the third consecutive year that domestic consumption tops the list. However, it is losing its relevance: the percentage of companies evaluating consumption growth as a significant opportunity dropped from 73% in 2020 to 51% in 2021.

This downward trend of the significance of China's business opportunities can be found throughout the whole range of business opportunities. For the second most relevant business opportunity, participation in domestic innovation, the significance decreased from 58% in 2020 to 42% in 2021. In 2019, 59% of German companies regarded

sourcing and procurement as a significant business opportunity in China. In 2021, the number went down to 39%.

The strongest decline in significance can be found in the opportunity of increasing demand for foreign brands and quality, with a 26 percentage points drop over two years: in 2021, only 39% consider it an opportunity (Figure 1.5, see full version in the Appendix, Figure A.1).

German companies are faced with increasing regulatory and operational business challenges, such as preferential treatment of domestic companies, that might diminish opportunities in the market (see chapter 2 for more details).

Figure 1.5: Business Opportunities in China Continue to Lose Significance

Please rate the following opportunities for your company's China business. (2019/20 n=512; 2020/21 n=452; 2021/22 n=571)

	2019	2020	2021
Growth of domestic consumption	68 %	73 %	51 %
Participate in domestic innovation	61 %	58 %	42 %
Sourcing/Procurement	59 %	45 %	39 %
Increasing demand for foreign brands and quality	65 %	49 %	39 %
Participation in digital technologies	51 %	51 %	37 %
Internationalization of Chinese companies	54 %	45 %	37 %
Growth due to decarbonization			29 %
Production of goods and services to be exported	50 %	39 %	28 %

Note: Only percentage of companies displayed that rated the business opportunity as "significant".
The complete results can be found in the Appendix, Figure A.1

3 4 BUSINESS OPPORTUNITIES: CARBON NEUTRALITY

In September 2020, at the 75th United Nations General Assembly, China stated that it strives to have carbon dioxide emissions peak by 2030 and reach carbon neutrality by 2060. With the implementation of China's carbon neutrality policies, China's large domestic market represents an opportunity for companies involved in decarbonization technologies, products, and services.

This statement is supported by almost half of the German companies in China, considering China's upcoming '30-60' decarbonization goals as an opportunity for their products, services, and solutions (Figure 1.6). More specifically, in manufacturing industries like chemicals (61%), electronics (58%), and machinery and industrial equipment (53%) – sectors in which German companies are playing a leading role – respondents consider

the decarbonization goals an opportunity. However, while companies consider the decarbonization goals an opportunity, 57% expect rising operation costs due to stricter environmental regulations and energy pricing at the same time.

In the plastic and metal products industry, 80% of companies are more concerned with the increasing operating costs of their companies due to stricter environmental regulations, and only 16% see it as an opportunity – a number that is extremely low compared to other industries (Figure 1.7). Companies with a negative development in 2021 and lower expectations for 2022, less participation in domestic innovation and digital development, less domestic consumption opportunities and less local sourcing, are more concerned about rising cost.

Figure 1.6: Half of German Companies See The Chinese Decarbonization Goals as an Opportunity

What are your expectations regarding China's upcoming '30-60' Decarbonization Goals (carbon peak by 2030, carbon neutrality by 2060)? (n=576)

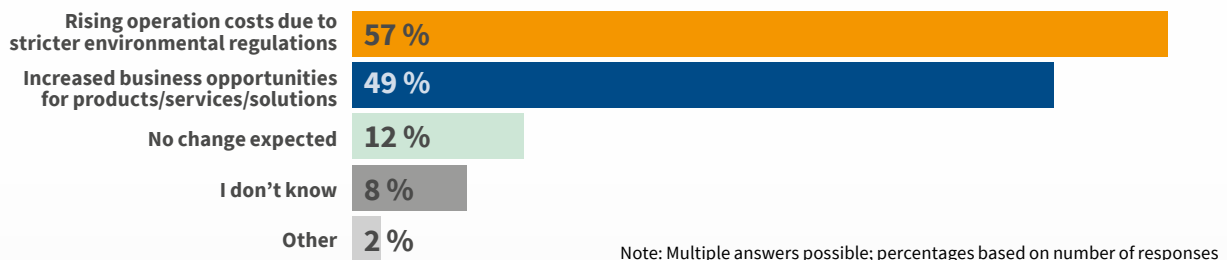


Figure 1.7: In Particular Chemicals And Electronics Companies Consider The Chinese Decarbonization Goals as an Opportunity

What are your expectations regarding China's upcoming '30-60' Decarbonization Goals (carbon peak by 2030, carbon neutrality by 2060)? (n=576)

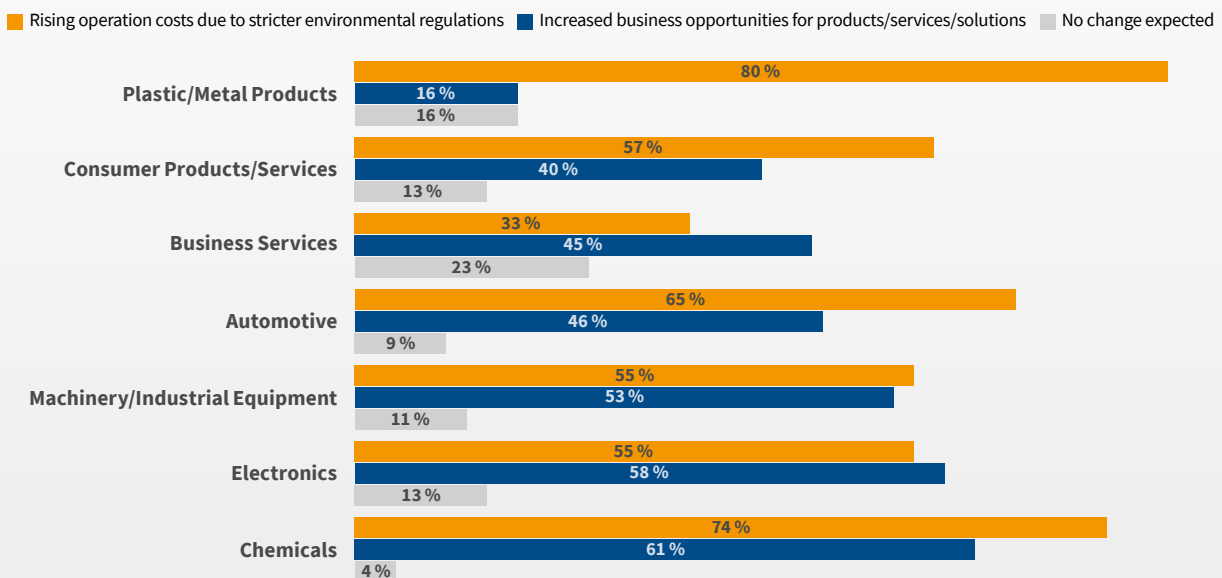
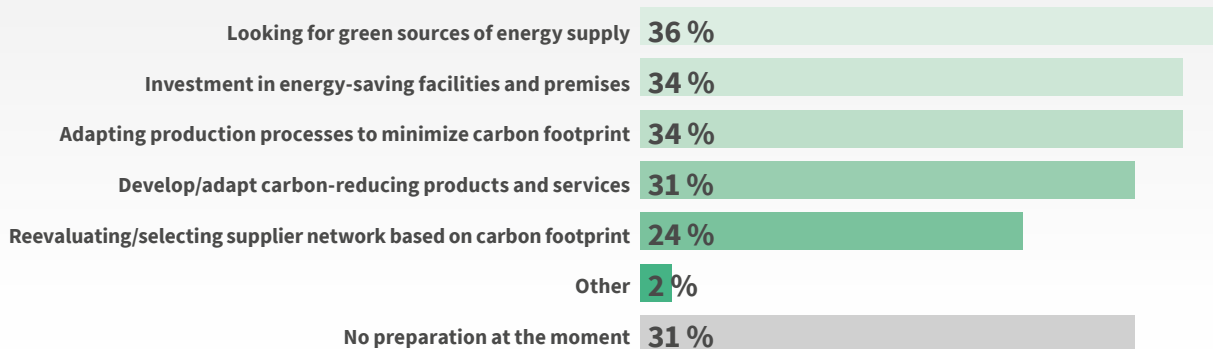


Figure 1.8: Two-Thirds of German Companies Prepare for Upcoming Implementation of The Decarbonization Goals

How do you prepare your company for the upcoming implementation of the decarbonization goals? (n=576)



Note: Multiple answers possible; percentages based on number of responses

69% of German companies are preparing for carbon neutrality in various ways, including green sources of energy supply (36%), investment in energy-saving facilities and premises (34%), and carbon-reducing products and services (31%). In particular the automotive and chemical industry work actively with suppliers and energy providers towards decarbonization. However, still 31% of all surveyed companies have not made any preparations at this stage (Figure 1.8).

One-third of German companies invest up to 5% of their revenues into carbon neutrality. One percent of surveyed companies invest even more than 20% of their company’s revenue (Figure 1.9). In particular the chemical and automotive industry announced strong investment plans in their company’s carbon footprint (70% and 63%, respectively) (Figure 1.10).

Figure 1.9: A Third of Companies Invest Up to 5% of Revenues in Carbon Neutrality

How much do you plan to invest in your company’s Carbon Neutrality in China? (n=575)

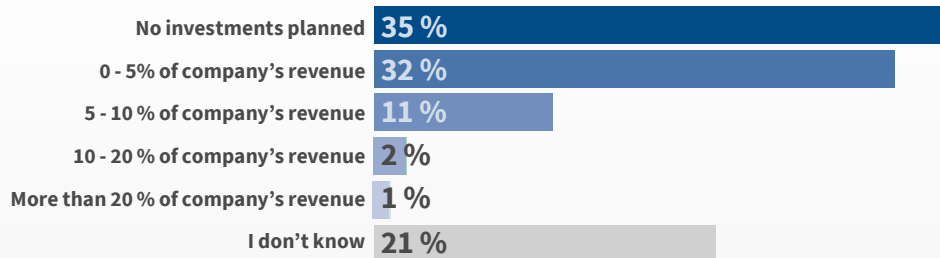
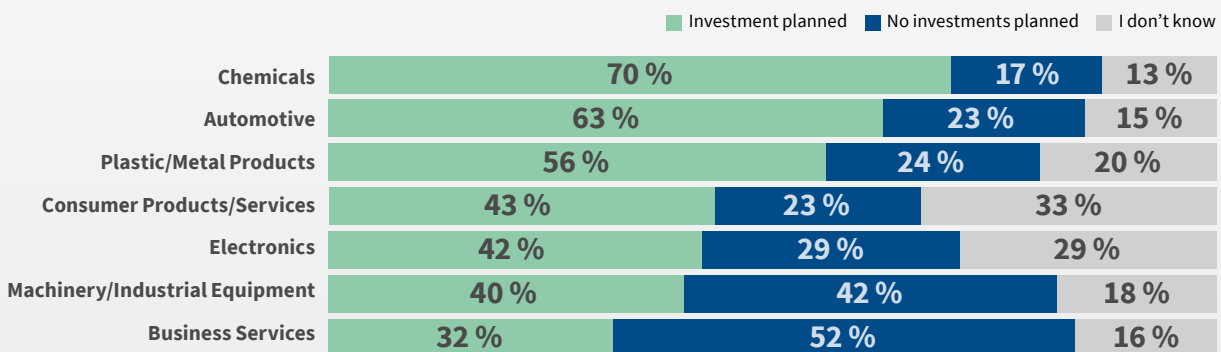


Figure 1.10: Strong Investment Plans for Chemicals and Automotive Companies in Carbon Neutrality

How much do you plan to invest in your company’s Carbon Neutrality in China? (n=575)



Note: "Investment planned" is the sum of "0 – 5% of company’s revenue", "5 - 10 % of company’s revenue", "10 – 20 % of company’s revenue", "More than 20 % of company’s revenue"



INVESTMENT CONFIDENCE

71% of the surveyed companies plan to further invest in China within the next two years. In 2019, 67% and in 2020, 72% of the surveyed companies planned to further invest, showing that the investment confidence of German companies in China remains strong (Figure 1.11). 90% of

companies in the electronics industry and almost 80% in the automotive industry plan to further invest in China within the next two years – the two industries with the most substantial investment plans (Figure 1.12).

Figure 1.11: Investment Remains Strong, With More Than 70% Investing in China

How is your company planning to further invest in China within the next two years? (2020/21 n=462; 2021/22 n=576)

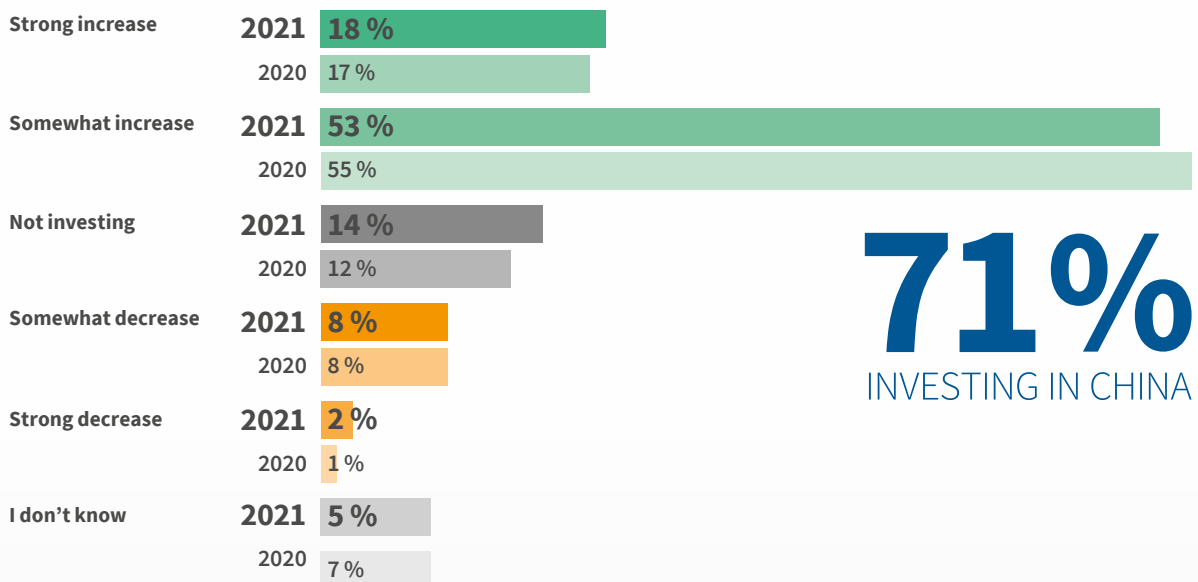
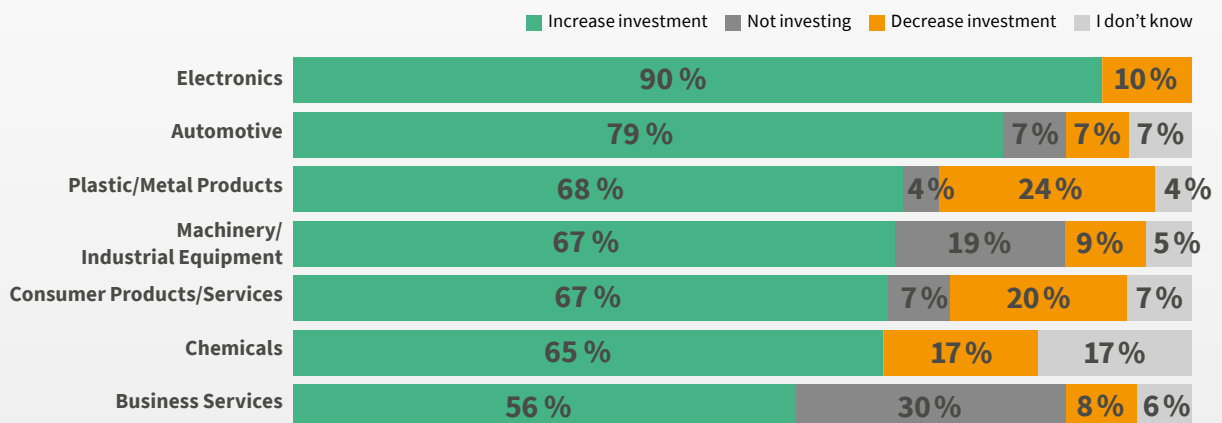


Figure 1.12: Electronics and Automotive Companies Express Strong Investment Plans

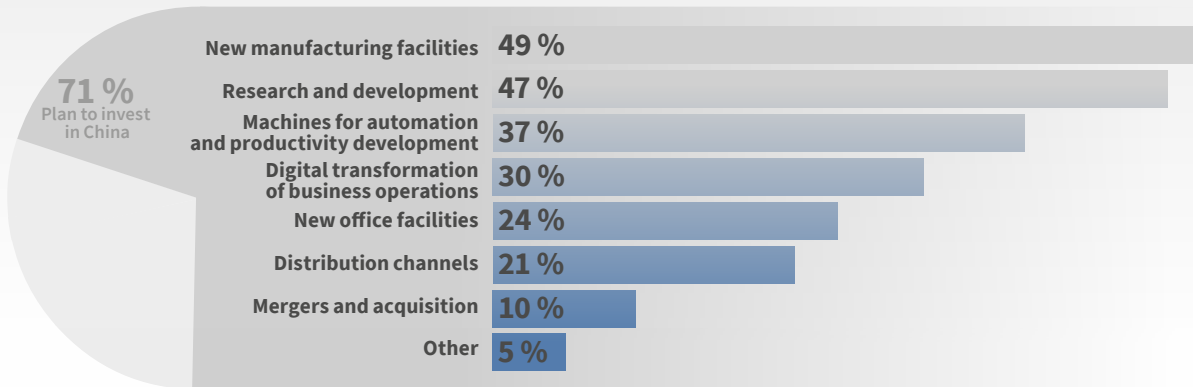
How is your company planning to further invest in China within the next two years? (n=576)



Note: "Increase Investment" is the sum of "strongly increase investment" and "somewhat increase investment"; "decrease investment" is the sum of "somewhat decrease investment" and "strongly decrease investment"

Figure 1.13: Strong Investment Plans in New Manufacturing Facilities and R&D

In which areas are you planning to invest in China within the next two years? (n=404)



Note: Multiple answers possible; percentages based on number of responses; question only asked to respondents who answered: strongly increase investment" or "somewhat increase investment" in Figure 1.11

Of the 71% planning to further invest in China, the majority plans to invest in new manufacturing facilities and research and development, e.g., through collaborations and skills development (Figure 1.13). This shows the Chinese market's growing importance in research and development.

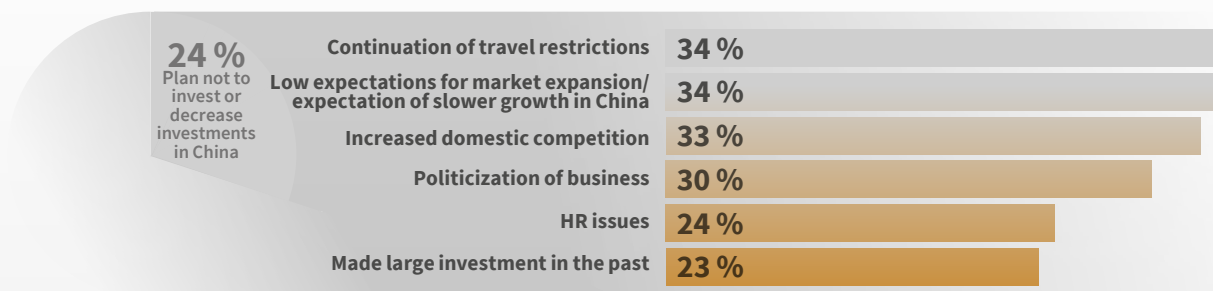
14% of the surveyed companies have no investment plans for the following years, and 10% plan to decrease investment (Figure 1.11). The main reasons for these companies to reduce investment are the continuation of travel restrictions (34%), low expectations for market expansion (34%), increased domestic competition (33%),

and politicization of business (30%). Companies naming politicization as a major reason for decreasing or halting investment in China increased from 12% in 2020 to 30% in 2021 (Figure 1.14, full version in Appendix, Figure A.2).

Similar to recent years, the vast majority of companies (96%) do not have plans to completely leave China within the next year. Only 4% indicated they consider leaving the country, but do not have any specific plans yet (Figure 1.15). This shows that China remains an indispensable market for German companies.

Figure 1.14: One Third of German Companies Decrease Investments in China due to Business Politization

What are the main reasons for your company not to invest or decrease investments in China? (n=134)



Note: Multiple answers possible; percentages based on number of responses; question only asked to respondents who answered "not investing", "strongly decrease investment" or "somewhat decrease investment" in Figure 1.11. The complete results can be found in the appendix, Figure 6.2

Figure 1.15: Vast Majority of German Companies Stay in China

Is your company planning to completely leave China within the next 12 months? (2020/21 n=458; 2021/22 n=538)

	2020	2021
No, we do not have any such plans	96 %	96 %
No, currently no specific plans, but we are considering	3 %	4 %
Yes	1 %	0 %



SELF-RELIANCE – IMPACT ON LEVEL PLAYING FIELD

For the first time since the German Chamber started surveying its members business sentiment in 2007, preferential treatment of local companies ranked as the top regulatory business challenge of German companies in China, followed by increasing legal uncertainties. According to the surveyed companies, preferential treatment of local companies is prevalent in the areas of market access, public procurement, and the regulatory environment. One-third of German companies expressed experiencing unequal treatment, and a change toward a level playing field is still needed.

- ▶ Preferential treatment of local companies has become the top regulatory business challenge in 2021, with one-third of German companies experiencing unfavorable treatment.
- ▶ Legal uncertainty is the second biggest regulatory challenge for German companies in China.

CHINA FIRST – DUAL CIRCULATION

The concept of dual circulation is twofold: it presents opportunities and challenges for German companies in China. An increasing domestic consumption would enlarge the consumer market of which domestic as well as foreign companies could benefit from. At the same time, China's aspiration not to be dependent from foreign technologies could cost market shares of foreign companies in the long run.

- ▶ German companies see dual circulation as both a challenge and an opportunity.

CHINA FIRST – TRAVEL RESTRICTIONS

The current travel restrictions are among the top 3 operational business challenges in 2021, closely following behind HR challenges. Due to the travel restrictions, a decrease in foreign employees in the next three years in China is expected, directly affecting the knowledge transfer and information exchange between the German headquarters and its entities in China. The current travel restrictions – a result of China's zero-tolerance policy toward COVID-19, negatively affects mutual understanding on a political and business level. Furthermore, surveyed German companies expect less foreign investment and slower economic growth of the Chinese market due to ongoing restrictions.

- ▶ Travel restrictions are among the top challenges for German companies, negatively impacting mid-term mutual understanding, foreign investment, and growth.

CHINA FIRST – DECOUPLING

In a decoupling scenario, German companies are mostly concerned with political and financial decoupling; different standards and norms hampering cooperation and exchange; decreasing investment confidence; and business slowdown. Costly restructuring of supply chains also causes worries regarding trade decoupling. Innovation decoupling is another concern, mainly due to costs stemming from catering of different standards.

- ▶ More than half of the German companies expect to face a negative impact due to decoupling in terms of hampered cooperation and exchange, and decreasing investment confidence in the next two years.

1 2 PREFERENTIAL TREATMENT OF LOCAL COMPANIES

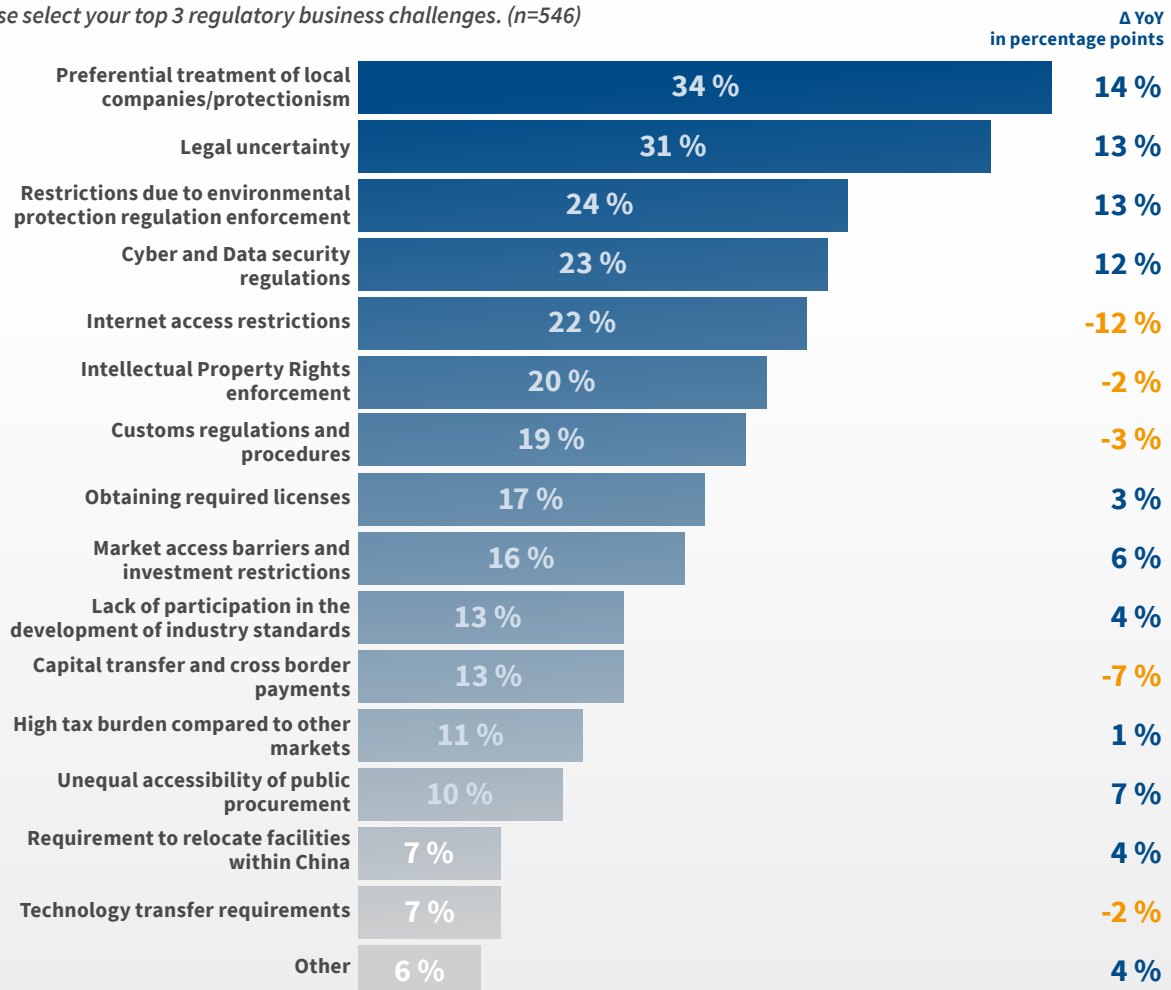
For the first time in the publication's history, preferential treatment of local companies and protectionism is the top regulatory business challenge for German companies in China and the ranking looks significantly different compared to 2020. This obvious change in priorities of challenges and increasing uncertainty is consistent with the difficulties for the surveyed companies in judging the impact from the self-sufficiency policies and latest interaction of the regulators on various markets. In 2020, preferential treatment of local companies was the 6th most dominant business challenge. Climbing up 14 percentage points, it ranks as the top challenge with 34% in 2021 (Figure 2.1). Legal uncertainty is the second biggest challenge with 31% – a 13 percentage point increase from 2020, where it ranked 8th. Restrictions due to environmental protection regulation enforcement also ranked high this

year with 24% – a 13 percentage point increase compared to 2020 (Figure 2.1). Internet access restrictions saw a substantial decrease (-12 percentage points) in the share of respondents that listed it among their significant challenges in 2021 (Figure 2.1).

In particular for the machinery industry (37%) and business services (41%) preferential treatment topped their list of challenges, whereas for electronics (52%) and consumer products/service (39%) legal uncertainties are prevailing. For the chemical industry, obtaining required licenses (38%) is especially challenging followed by restrictions due to environmental protection regulation enforcement, which is dominant for the automotive (32%) and also significant for the plastic industries (41%) (Figure 2.2).

Figure 2.1: Preferential Treatment of Local Companies Top Regulatory Business Challenge

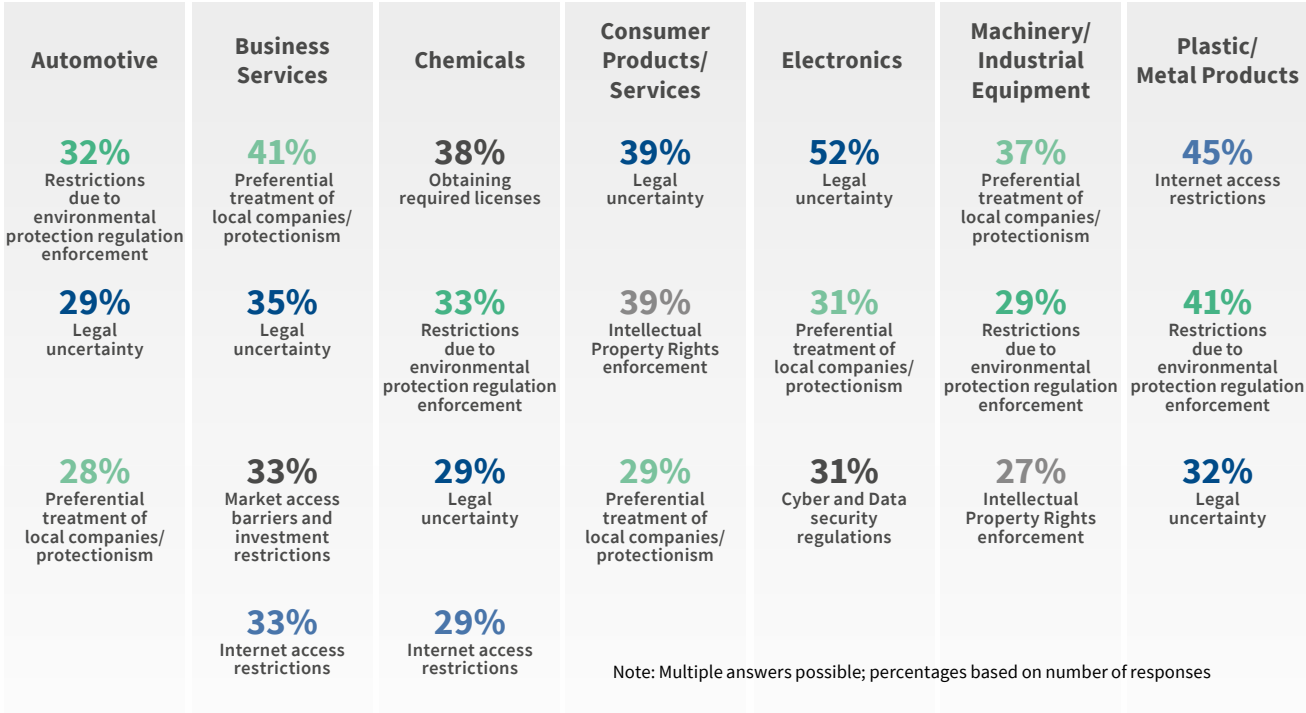
Please select your top 3 regulatory business challenges. (n=546)



Note: Multiple answers possible; percentages based on number of responses

Figure 2.2: Legal Uncertainty and Preferential Treatment of Local Companies Dominating Top Regulatory Business Challenges Among Industries

Please select your top 3 regulatory business challenges. (n=546)

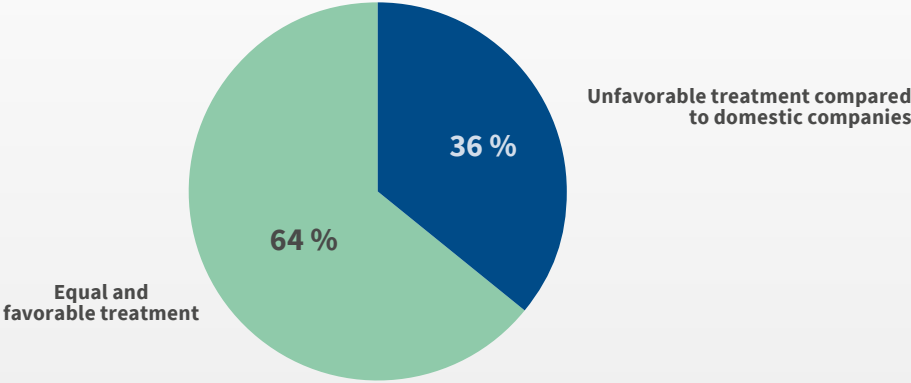


The dominance of preferential treatment of local companies can also be found in the response of German companies to whether they feel treated equally compared to domestic companies by Chinese authorities. One-third (36%) of the companies believe there is unfavorable treatment of FIEs compared to domestic companies. 64% of the surveyed companies feel they are treated equally or favorably (Figure 2.3, full version in Appendix Figure A.3).

This finding is in accordance with one-third of the surveyed companies facing market access restrictions in China. Most companies face indirect market access restrictions like disproportionate bidding and tendering processes (16%), difficulties obtaining licenses, certifications, or product approvals (14%), or insufficient lead time to implement new regulations (6%). 5% of the surveyed companies face direct market access restrictions (Figure 2.4).

Figure 2.3: One-Third of German Companies Express Unfavorable Treatment

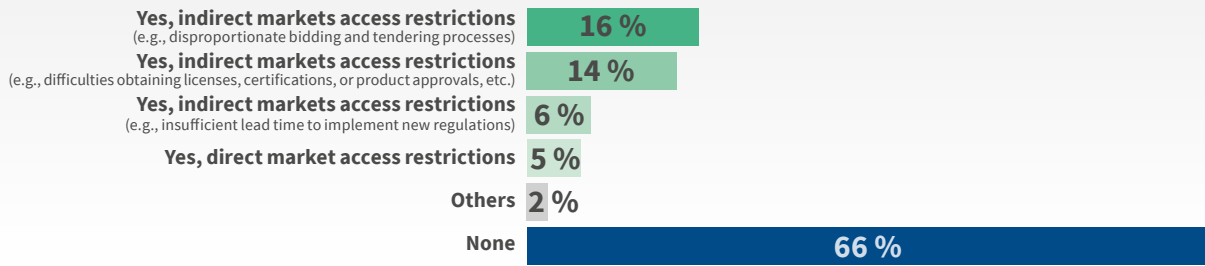
In your industry, how do Chinese authorities treat Foreign Invested Enterprises (FIEs) compared to domestic companies? (n=536)



Note: „Unfavorable treatment compared to domestic companies“ is the sum of „FIEs receive full unfavorable treatment compared to domestic companies“ and „FIEs receive some unfavorable treatment compared to domestic companies“; „Equal and favorable treatment“ is the sum of „FIEs and domestic companies are treated equally“, „FIEs receive some favorable treatment compared to domestic companies“ and „FIEs receive full favorable treatment compared to domestic companies“. Full version in Appendix, Figure A.3.

Figure 2.4: Market Access restrictions Still Persist for One-Third of German Companies

Does your company face market access restrictions or obstacles in China? If so, what kind of market access restrictions is your company facing? (n=533)

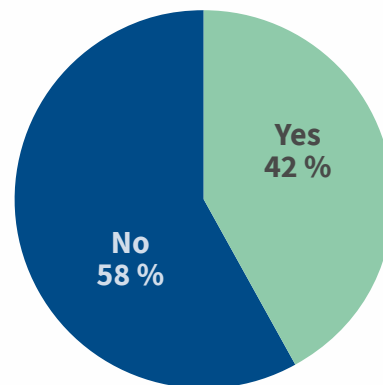


Preferential treatment of Chinese companies is also a challenge for companies participating in public procurement. Of the companies that participate in public procurement, 42% have been affected by preferential treatment of Chinese competitors (Figure 2.5, full version in Appendix, Figure A.4). The most common discriminatory measures experienced by the respondents are lack

of transparency (e.g., no publication of notices or only fragmented information on the public procurement procedures) (16%); requirements that a significant part of the value of a tender originates locally (“buy-local” policies) (12%); and preferential treatment of state-owned enterprises (12%) (Figure 2.6).

Figure 2.5: 42% of the Companies Participating in Public Procurement Have Been Affected by Preferential Treatment of Chinese Competitors

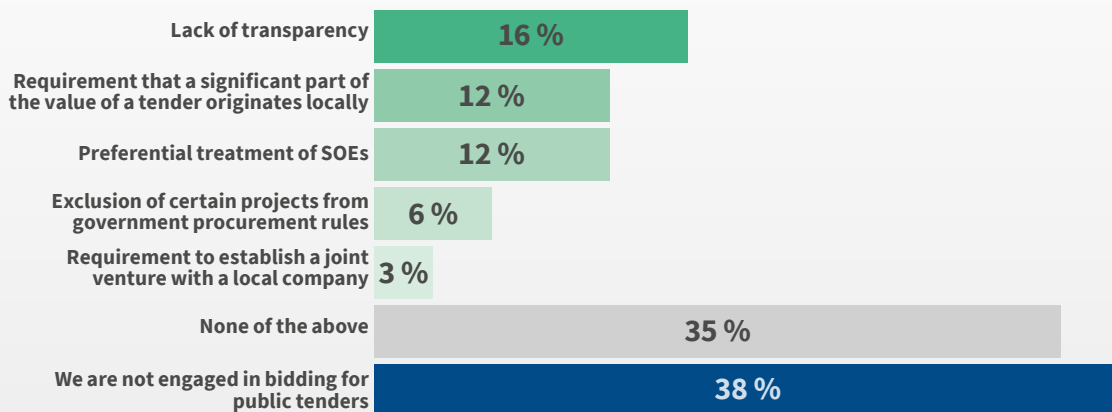
Has your company been affected by public procurement measures leading to favoring / preferential (treatment of) Chinese competitors? (n=245)



Note: Full version in Appendix Figure A.4

Figure 2.6: Discriminatory Measures for Public Procurement Still in Place

In your industry, what kind of barriers or discriminatory measures to public procurement have you experienced over the past year? (n=535)



Note: Multiple answers possible; percentages based on number of responses

DUAL CIRCULATION

German companies in China have mixed views on the overall impact of China's national dual circulation strategy and its strive for self-sufficiency on their businesses in China. 44% of the surveyed companies view it as an opportunity, whereas 37% consider it a challenge. 20% of the respondents cannot estimate the impact by now (Figure 2.7). From an industry perspective, the majority of companies in most industries see dual circulation as an opportunity.

72% of the companies involved with consumer products and services consider dual circulation an opportunity, and 28% consider it a challenge. Similarly, 67% of the surveyed companies in the automotive industry consider dual circulation an opportunity, whereas 33% see it as a challenge. In business services, this picture is reversed, with 57% of the surveyed companies considering dual circulation more of a challenge (Figure 2.8).

Figure 2.7: Dual Circulation Is Seen As a Challenge or Opportunity

How do you assess the overall impact of China's national dual circulation strategy and China's strive for more self-sufficiency on your business? (n=518)

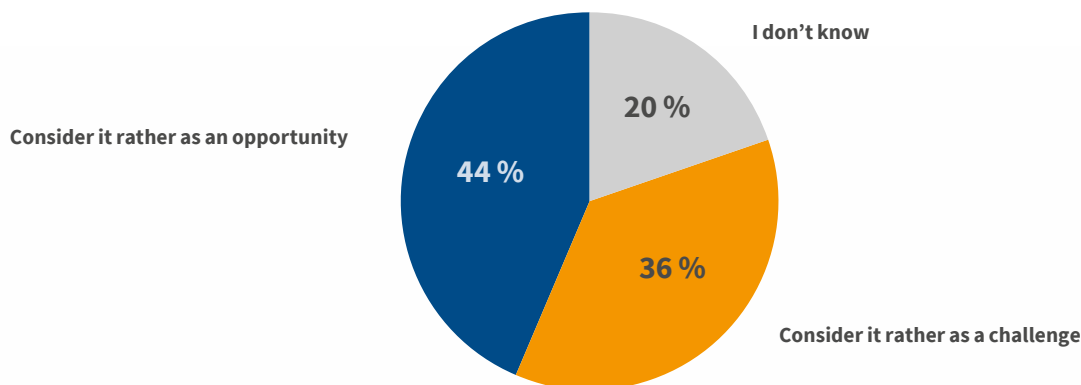
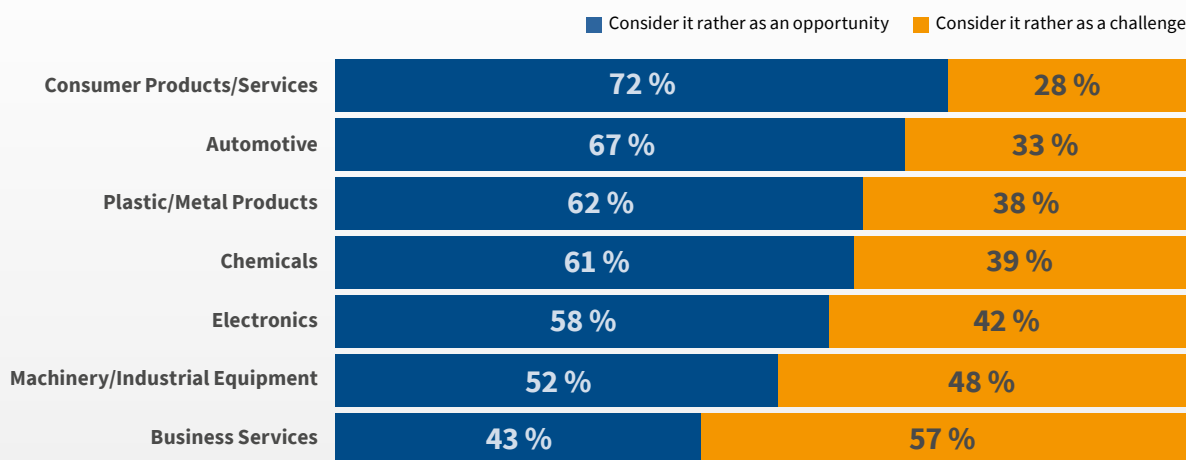


Figure 2.8: Producing Companies Rather See Dual Circulation as an Opportunity

How do you assess the overall impact of China's national dual circulation strategy and China's strive for more self-sufficiency on your business? (n=518)

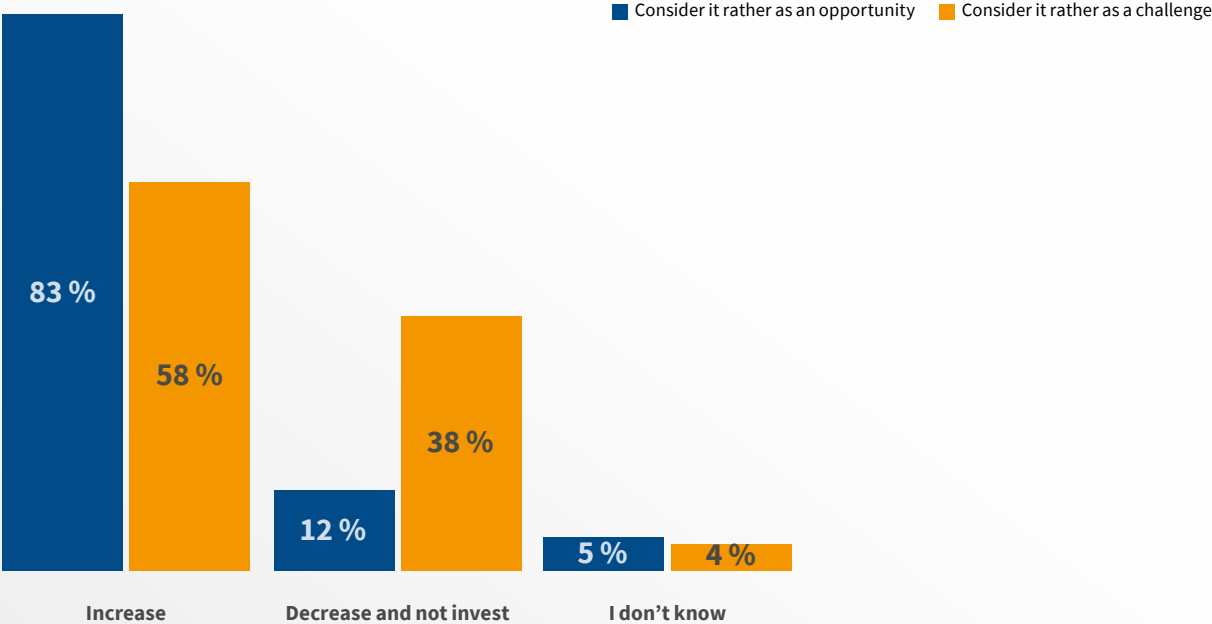


The findings of the business sentiment of respondents who consider dual circulation an opportunity or a challenge show that companies that view dual circulation as a challenge plan consequently to decrease investments or not invest in China within the next two years, to a higher amount than companies that see dual circulation as an opportunity. In contrast, companies that consider dual circulation and China's strive for more self-sufficiency an opportunity for their business plan to further invest in China (Figure 2.9).

These results suggest that German companies largely form two groups: One sees dual circulation as an opportunity and, hence, tends to continue investment; the other group views it as a challenge, which in turn negatively influences investment behavior.

Figure 2.9: Most Companies That Plan To Decrease Investment Consider Dual Circulation a Challenge

How is your company planning to further invest in China within the next two years? (n=417)



Note: „Increase“ is the sum of „strong increase“, „somewhat increase“, and „Decrease and not invest“ is the sum of „strong decrease“, „somewhat decrease“ and „not invest“.

CURRENT TRAVEL RESTRICTIONS AMID COVID-19



Human Resource challenges like finding and retaining qualified staff (49%) and increasing labor costs (49%) remain among the most significant operational and macroeconomic business challenges for German companies. The third top operational business challenge is the current travel restrictions (42%), followed by rising transportation and raw material costs (39%) (Figure 2.10).

The travel restrictions negatively affect the investment confidence of German companies: 34% of the surveyed companies that plan to decrease investment in China or not invest at all in the next two years state the continu-

ation of travel restriction as a reason (Chapter 1, Figure 1.14). This is consistent with the negative economic impact surveyed companies expect if China continues its zero-tolerance policy toward COVID-19 and quarantine and visa restrictions while other countries open borders: more than half of the companies expect less foreign investment. 72% expect a decrease in mutual understanding on political and business levels. Further 45% expect lower growth of the Chinese economy, and 32% foresee slower innovation due to current travel restrictions (Figure 2.11).

Figure 2.10: Current Travel Restrictions Among Top Operational Business Challenges

Please select your top 3 operational and macroeconomic business challenges. (n=546)

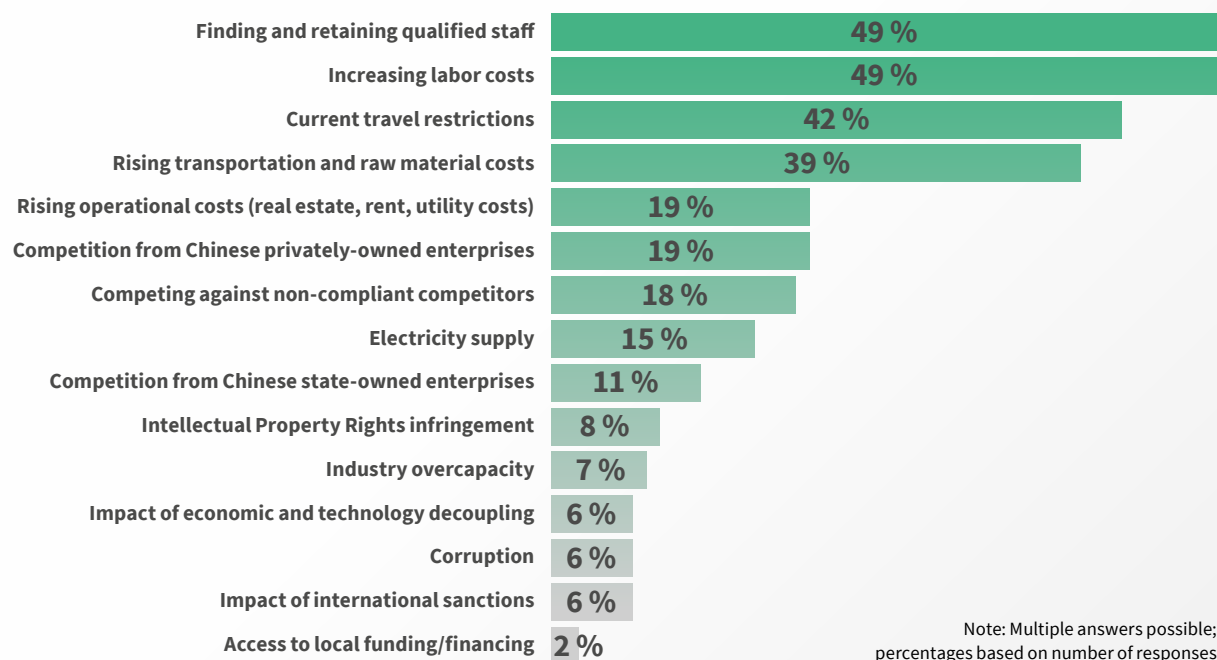


Figure 2.11: Travel Restrictions Are Negatively Impacting Mutual Understanding, Foreign Investment, And Growth

What negative economic impact do you expect by continuing a zero tolerance policy towards COVID-19 combined with the quarantine and visa restrictions for China while the rest of the world is opening borders? (n=517)

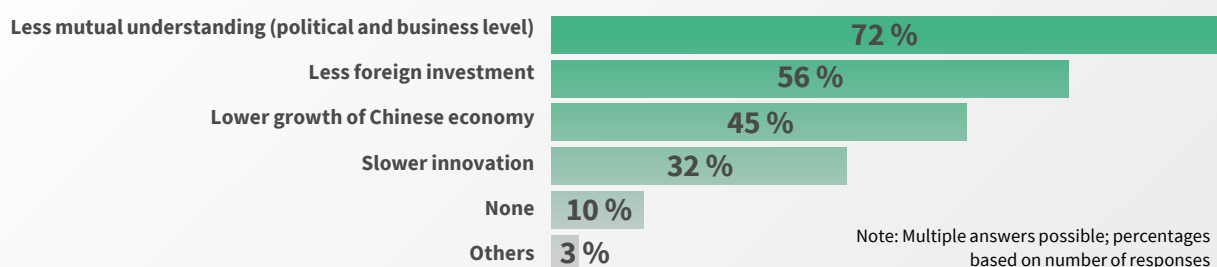
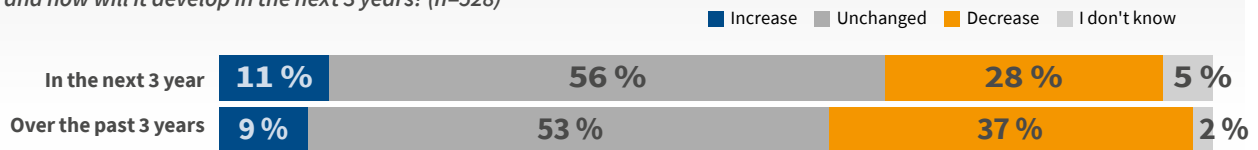


Figure 2.12: One-Third of German Companies Expect Decrease in Foreign Personnel in Upcoming Years

How has the number of expats and/or local foreign personnel changed in your company in China over the past 3 years, and how will it develop in the next 3 years? (n=528)



The impact of the ongoing travel restrictions is also evident in the dwindling numbers of expats or local foreign personnel in China. Retaining foreign personnel in China and recruiting new foreign talents became increasingly difficult with the ongoing restrictive travel policies. Over the past three years – of which two years were already affected by travel restrictions – 37% of the surveyed companies decreased the number of foreign personnel, and 28% are planning to decrease in the next three years (Figure 2.12). The most common reason for reducing foreign personnel is the restrictive travel, visa, and immigration policies amid COVID-19 (50%), followed by the localization of staff functions (47%), less relevant are the potential higher cost (Figure 2.13).

The decrease in foreign talents leads to further challenges in exchange and discussion between the headquarters and the subsidiary in China. 54% of the German companies experience a decline in knowledge exchange between the Chinese entity and the headquarters in Germany after 1.5 years (Status in October 2021) of ongoing travel restrictions (Figure 2.14). This consequently also affects the innovation capacity and development of companies in China. On the other hand, the results show that the stronger separation from the headquarter due to travel restrictions lead to a higher independence of the subsidiaries from an increase of localization and delegation of decision-making power. A regional decoupling seems to lead also to a decoupling from the headquarter which cannot be mitigated by the new technical communication media.

Figure 2.13: Travel Restrictions And Localization Drive The Reduction Of Foreign Personnel

What are the reasons for a decrease in the number of expats and/or local foreign personnel at your China locations? (n=465)

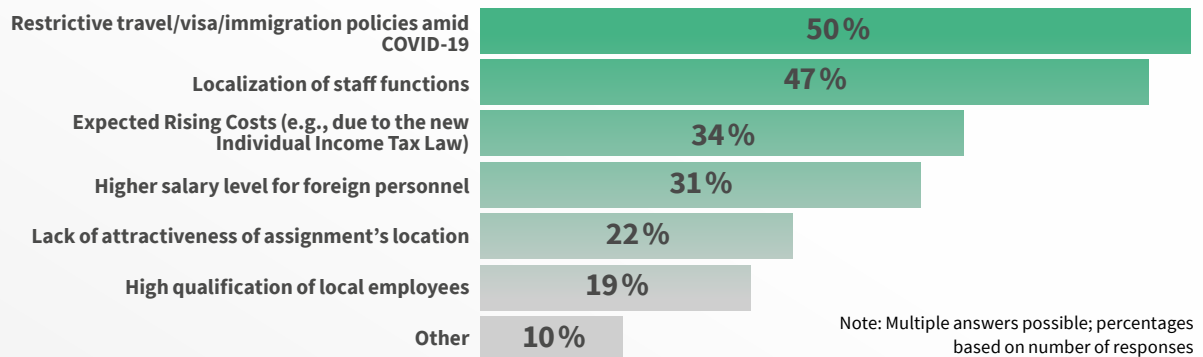
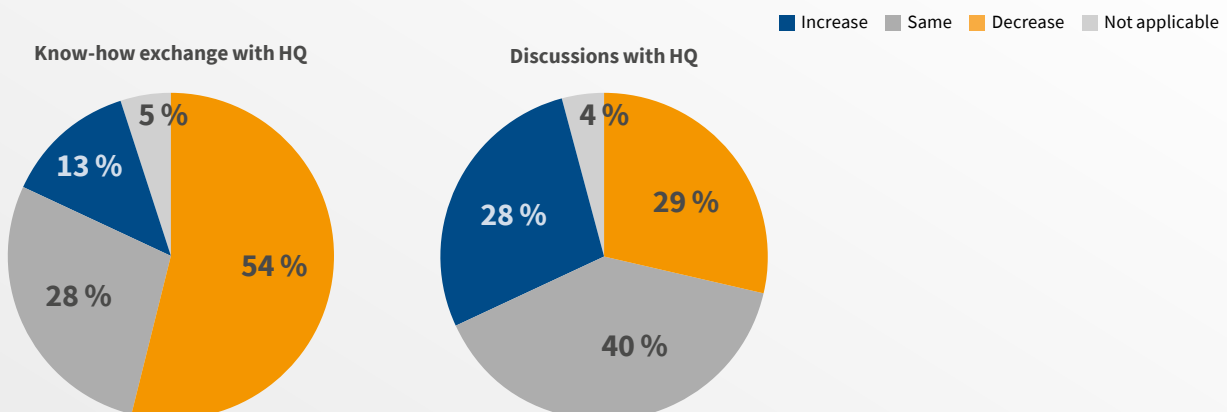


Figure 2.14: Half of Companies Decrease in Know-How Exchange With HQ Due To Travel Restrictions

Which of the following consequences does your company face after more than 1.5 years of ongoing travel restrictions? (n=524)



DECOUPLING

55% of the surveyed companies expect economic and technological decoupling to negatively impact their China business in the next two years. 7% assess the impact of decoupling on their business as positive, and 26% expect no impact (Figure 2.15).

Almost 90% of the companies surveyed expect business risks due to the rising economic and technological de-

coupling tendencies. The main risk mentioned is hampered cooperation and exchange (39%), followed by decreasing investment confidence (38%) and business slowdown (34%). Costs are also a major risk of decoupling, such as the restructuring of global value chains (30%) and rising costs due to catering of different standards (29%) (Figure 2.16).

Figure 2.15: 55% of German Companies Face a Negative Impact Due to Decoupling

How do you assess the impact of economic and technological decoupling for your specific China business in the next 24 months? (n=520)

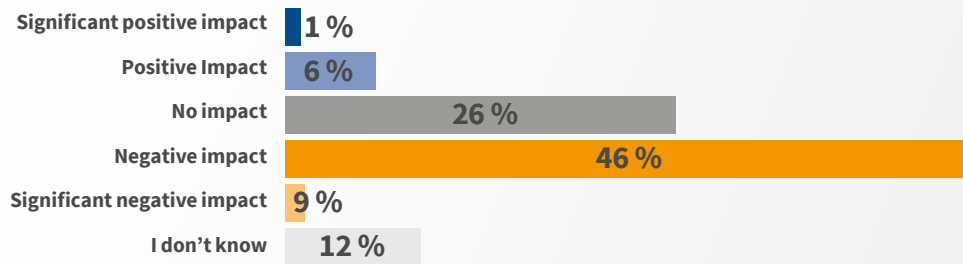
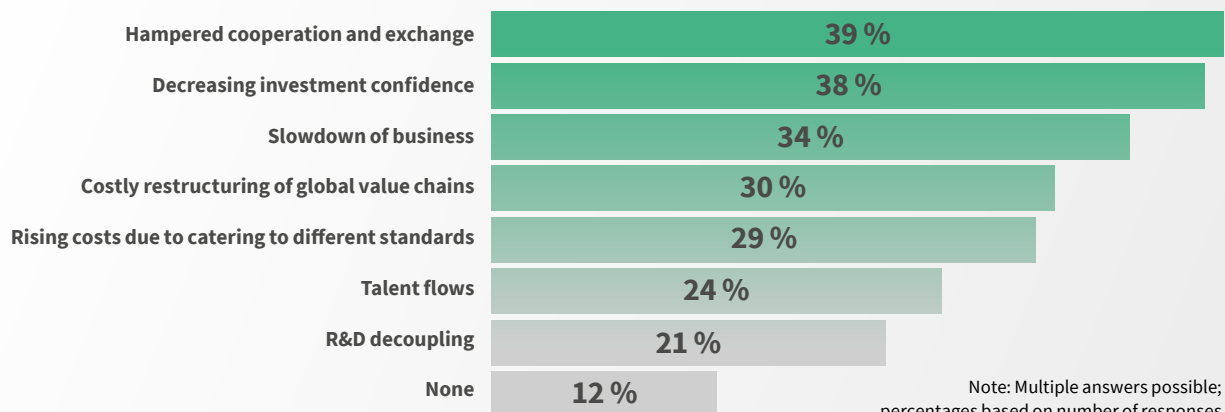


Figure 2.16: Almost 90% of German Companies See Business Risks Due to Rising Economic and Technological Decoupling Tendencies

What kind of business risks do you see due to rising economic and technological decoupling tendencies? (n=528)







LOCALIZATION 2.0 – DRIVEN BY OPPORTUNITIES AND CONSTRAINTS

The localization of German companies' businesses in China has been accelerated during the last decade. The first wave of localization was mainly driven by regulatory constraints – such as the obligation to establish a joint venture with a Chinese partner. However, the second wave – 'localization 2.0' – is driven by China's strive for self-sufficiency and growing independence from global players. This localization wave is accelerated by decoupling and the current travel restrictions amid COVID-19, pushing German companies to localize to not miss out on China's huge domestic market opportunities. Meanwhile, competition with local companies is getting fierce – driving German companies to engage more with Chinese partners and localize their products and services to better suit the domestic market.

FACING DECOUPLING TENDENCIES

Most German companies react to the decoupling tendencies (mentioned in Chapter 2) by becoming more local. They engage with Chinese partners, build resilient supply chains, invest in R&D, and develop more market-specific products – all measures leading to localization.

- **Becoming more local by cooperating with partners, sourcing, and R&D, mitigates decoupling tendencies.**

TRAVEL RESTRICTIONS ACCELERATE LOCALIZATION

As the COVID-19 pandemic continues, travel restrictions are accelerating companies' localization – not only by hiring more local personnel and gaining extensive local expertise, but also by localizing technical know-how, R&D activities, and sourcing.

- **Travel restrictions accelerate localization, with one-third of German companies localizing technical and operational know-how in China.**

COMPETITION IN DOMESTIC MARKET: BOTH CHALLENGE AND CATALYST FOR LOCALIZATION

Accelerated by COVID-19, the Chinese domestic market's competitiveness and speed of change have intensified. In this environment, localization of R&D is essential in order to respond to market needs and keep up with China's fast-moving innovation. Furthermore, the competition with Chinese players is getting more intense: In 2016, 35% of the surveyed companies believed it is likely that Chinese competitors would become innovation leaders in their industry within the next five years. In 2021, every second surveyed company consider it likely. In a competitive environment a level playing field for foreign companies is a requisite, which would benefit the economy.

- **50% of the surveyed companies expect Chinese competitors to become innovation leaders in their industry within the next five years.**

1 LOCALIZATION TO MITIGATE 3 DECOUPLING TENDENCIES

To mitigate rising economic and technological decoupling tendencies, 38% of the surveyed German companies are becoming more local by cooperating with local players or setting up joint ventures. Building up resilient supply chains is another measure taken by surveyed companies to mitigate decoupling risks (34%). This is done through nearshoring of suppliers and production, regionalization, increased inventory of critical products, etc. Another measure taken is investing in local R&D (34%), and every third German company develops more market-specific products. 20% of the surveyed companies have not taken any measures to mitigate decoupling tendencies at this stage (Figure 3.1).

Different industries choose different measures to mitigate decoupling tendencies. For the automotive and chemical industries, developing core technologies catering to varying standards is with roughly 20% more prevalent than in any other industry. Becoming more local is a measure taken to a higher degree by the automotive (46%) and machinery and industrial equipment (40%) industries. In the chemical industry, companies invest in local R&D (63%) and build up resilient supply chains (63%) to mitigate decoupling tendencies. For business services, the development of more market-specific products (34%) is the most common measure, whereas 36% do not take any measures to mitigate decoupling tendencies (Figure 3.2).

Figure 3.1: Becoming More Local Through Cooperation with Partners, Sourcing and R&D Mitigates Decoupling Tendencies

What measures is your company taking to mitigate rising economic and technological decoupling tendencies? (n=520)

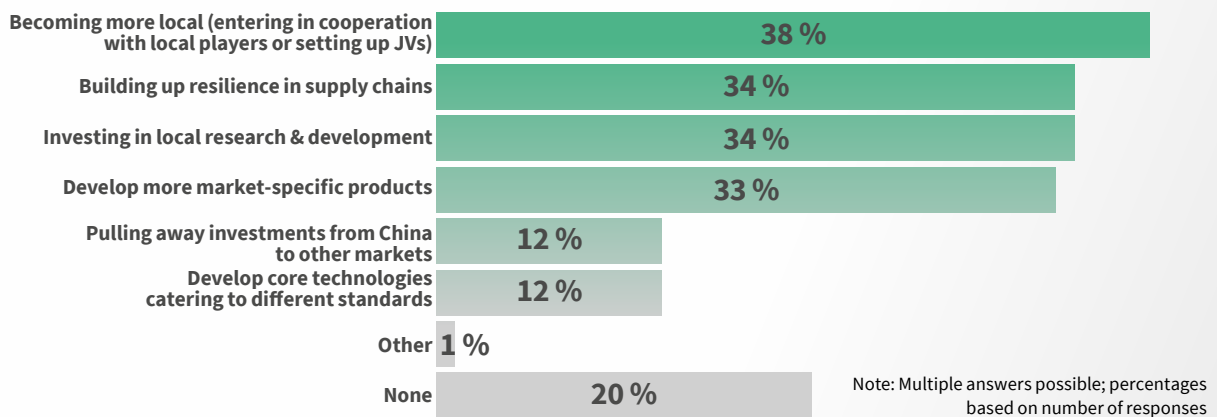


Figure 3.2: Industry Specific Measures Taken To Mitigate Decoupling Tendencies

What measures is your company taking to mitigate rising economic and technological decoupling tendencies? (n=520)

	Automotive	Business Services	Chemicals	Consumer Products/ Services	Electronics	Machinery/ Industrial Equipment	Plastic/ Metal Products
Becoming more local	46 %	25 %	37 %	30 %	32 %	40 %	23 %
Building up resilience in supply chains	36 %	9 %	63 %	48 %	39 %	36 %	45 %
Investing in local research & development	48 %	12 %	63 %	15 %	36 %	31 %	41 %
Develop more market-specific products	26 %	34 %	58 %	22 %	39 %	36 %	32 %
Pulling away investments from China to other markets	5 %	14 %	26 %	11 %	11 %	13 %	14 %
Develop core technologies catering to different standards	20 %	8 %	21 %	7 %	4 %	10 %	9 %
None	13 %	36 %	0 %	33 %	18 %	18 %	18 %

Note: Multiple answers possible; percentages based on number of responses

TRAVEL RESTRICTIONS ACCELERATE LOCALIZATION PLANS

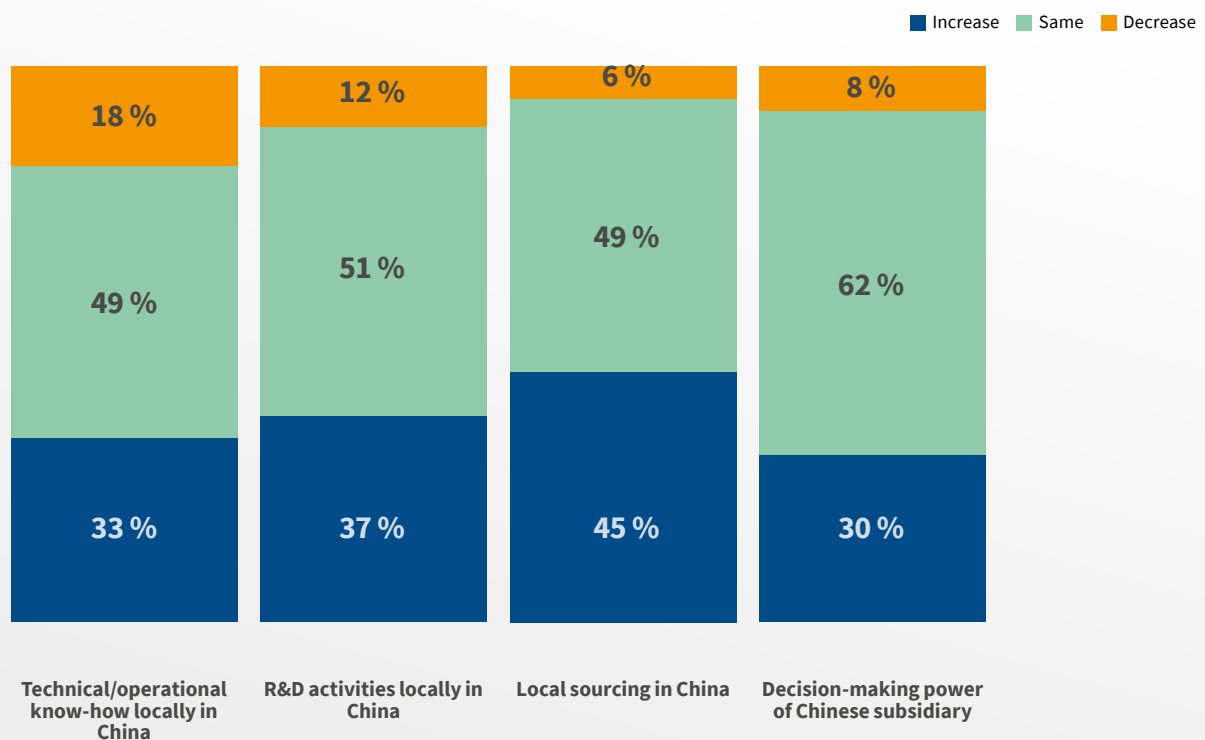


As mentioned in Chapter 2.3, the current travel restrictions lead to a shrinking foreign talent pool in China and a decrease in mutual understanding. On the company level, this is demonstrated through a decrease in exchange and discussion between the headquarters and its local subsidiaries. At the same time, travel restrictions accelerate localization tendencies.

45% of the German companies experienced an increase of local sourcing after 1.5 years of ongoing travel restrictions (at the time of the survey, in October 2021). 37% of the surveyed companies have increased their R&D activities in China. This is most evident among large companies with more than 3,000 employees, of which 50% ramped up R&D localization efforts. As a consequence of the ongoing travel restrictions another 35% of all surveyed companies face an increase of local technical and operational know-how in China (33%) (Figure 3.3).

Figure 3.3: Travel Restrictions Accelerate Localization, With One-Third of German Companies Localizing Technical Know-How in China

Which of the following consequences does your company face after more than 1.5 years of ongoing travel restrictions? (n=524)



Note: "Not applicable" answers excluded



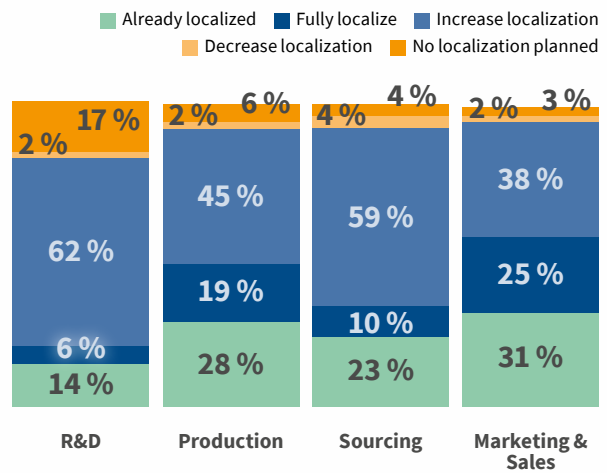
AREAS OF LOCALIZATION AND ITS DRIVERS

Among all German companies surveyed, the trend of localization, with companies having already localized or planning to localize, is strong in the four major business areas of R&D (81%), production (92%), sourcing (92%), and marketing and sales (95%). 25% of the surveyed companies plan to fully localize marketing and sales. 62% of the respondents plan to increase localization in R&D and 59% in sourcing. (Figure 3.4)

52% of the surveyed companies indicate that they plan to further localize in China mainly due to the proximity to key customers, while 41% name cost savings and 33% supply chain localization (Figure 3.5).

For the localization of R&D, the main drivers are customer and market requirements (57%) and the increasing innovation speed in the Chinese innovation ecosystem (38%) (Figure 3.6).

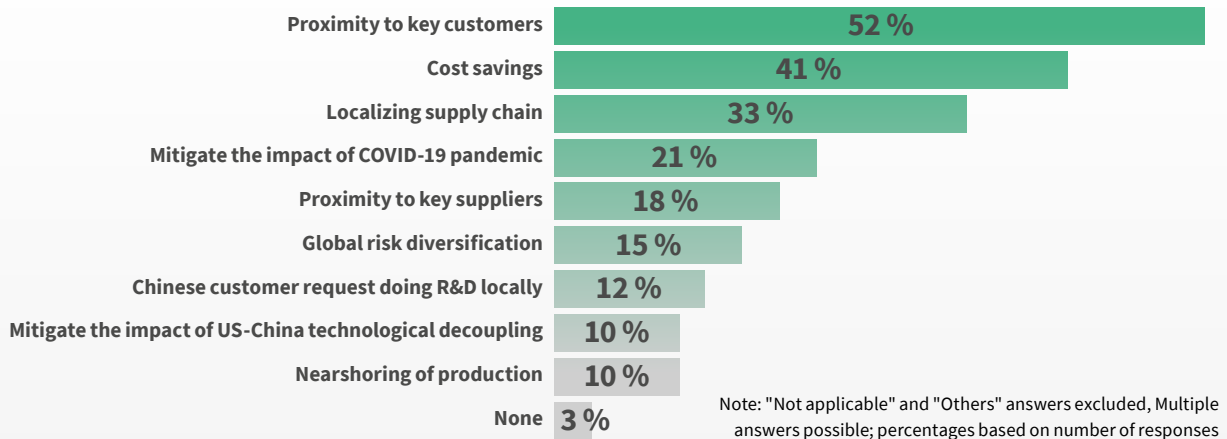
Figure 3.4: Localization Across All Business Areas
What are your plans for the localization of the following business operations in China? (n=516)



Note: "Not applicable" answers excluded

Figure 3.5: Customers Proximity Key Driver for Localization

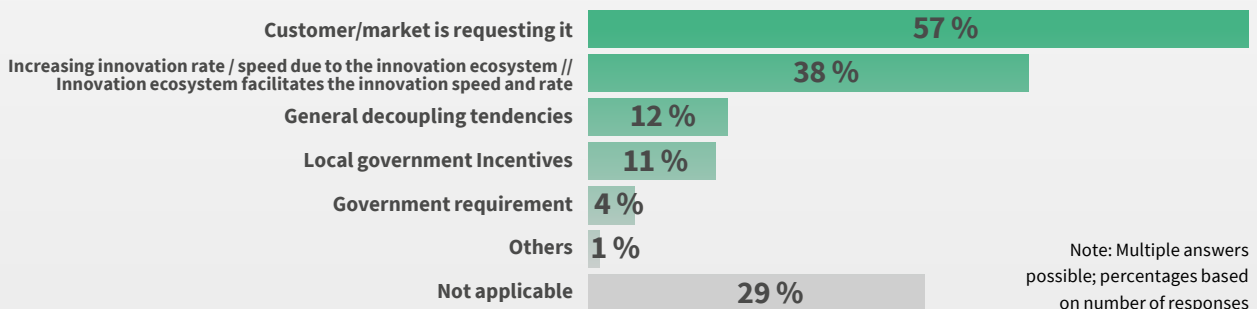
If you are planning to further localize in China, what are your motivations? (n=528)



Note: "Not applicable" and "Others" answers excluded, Multiple answers possible; percentages based on number of responses

Figure 3.6: Chinese Customers and Innovation Speed Drive R&D Localization

What are the reasons behind your company's decision to expand/localize R&D capacities in China? (n=512)



Note: Multiple answers possible; percentages based on number of responses

INCREASED COMPETITION WITH LOCAL COMPANIES

50% of the surveyed companies expect Chinese competitors to become innovation leaders in their industry within the next five years. This is a significant increase to 2016, where only 35% of the surveyed companies considered it likely (Figure 3.7, full version in Appendix, Figure A.6). 70% of companies in the chemical industry, 61% in consumer products and services, and 57% in

the automotive industry consider it likely that Chinese competitors become innovation leaders within the next five years (Figure 3.8). This resonates with the fast development and increasing innovative power of Chinese companies. It also mirrors the Chinese government's desire to be more self-sufficient and to grow domestic companies into global players.

Figure 3.7: 50% Expect Chinese Competitors Will Become Innovation Leaders in Their Industry Within The Next Five Years

Do you think Chinese competitors can become innovation leaders in your industry within the next five years? (2020/21 n=458; 2021/22 n=537)

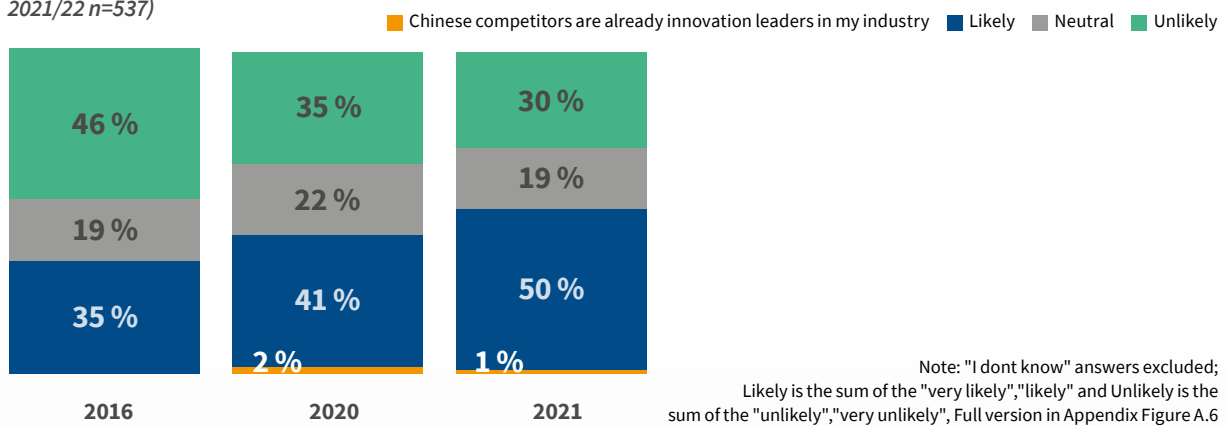
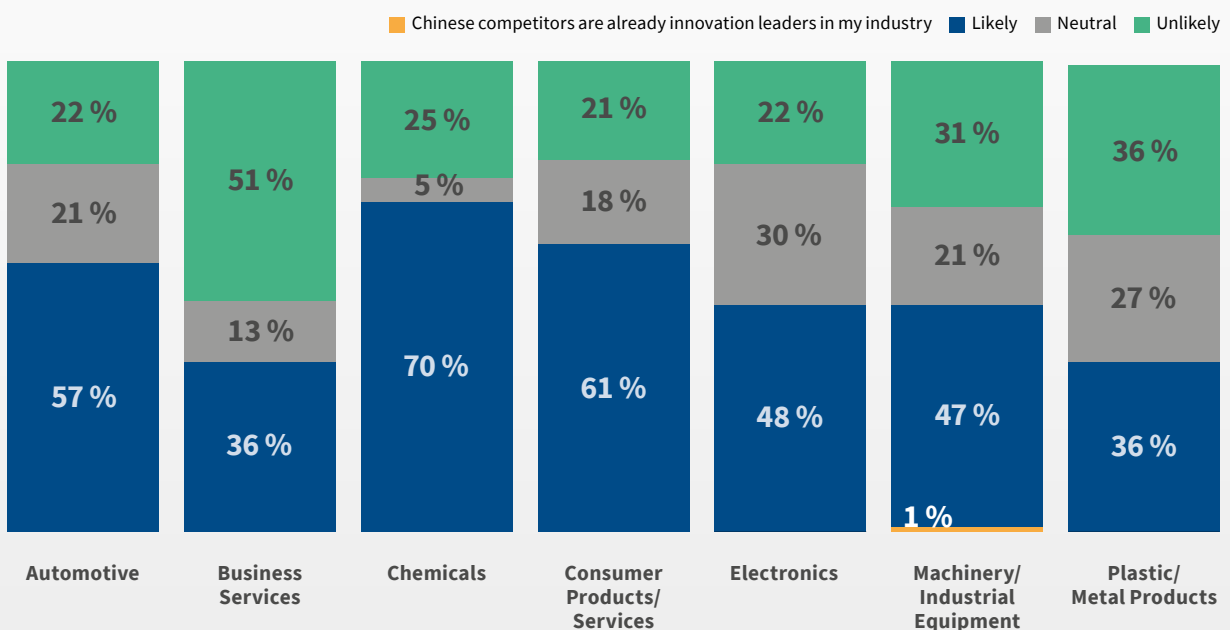


Figure 3.8: Expectations for Chinese Competitors to Become Innovation Leaders Especially Strong in Chemicals, Consumer Products, and Automotive

Do you think Chinese competitors can become innovation leaders in your industry within the next five years? (n=542)



Note: "I dont know" answers excluded; Likely is the sum of the "very likely","likely" and Unlikely is the sum of the "unlikely","very unlikely"

Despite the strong competition and the difficult market environment German companies still have confidence that their products are competitive: 9% of the surveyed companies believe it is impossible to substitute their products within the next year and further 52% of the surveyed companies consider a substitution as possible but not at the desired quality (26%), technical level (23%), or cost (3%). 24% consider it too early to assess and only 14% believe that Chinese products and services can substitute German products without limitations within the following year (Figure 3.9).

As Chinese companies become more dominant market players, engagement with them – especially in the form of a strategic partnership (29%), is becoming more attractive for German companies (Figure 3.10). When partnering with a Chinese company the acceptance from other market participants and business partners increases (57%), and it supports the development of the customer base (55%). Furthermore, engagement with Chinese partners is also considered by one-third of the survey respondents to fulfill sourcing requirements (29%) (Figure 3.11).

Figure 3.9: Quality And Technical Level of German Products Still Competitive

How do you assess the feasibility of substituting your company’s products/services with Chinese components in the next 12 months? (n=515)

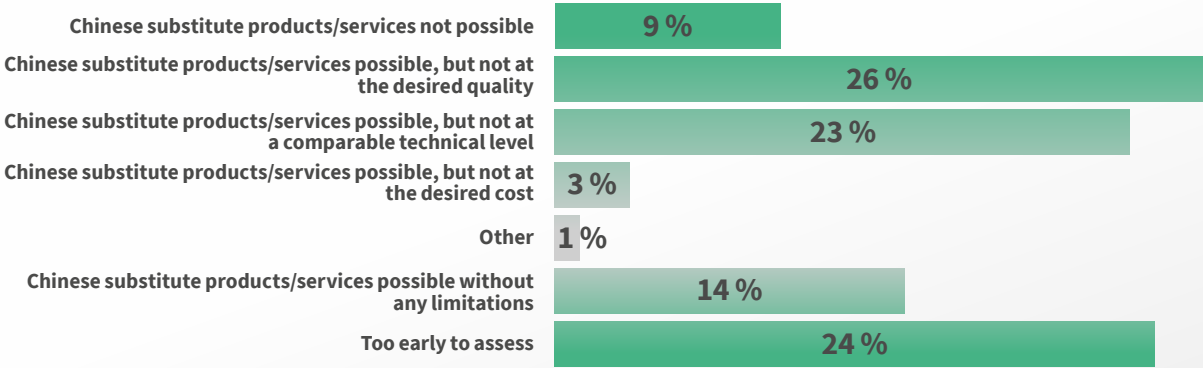
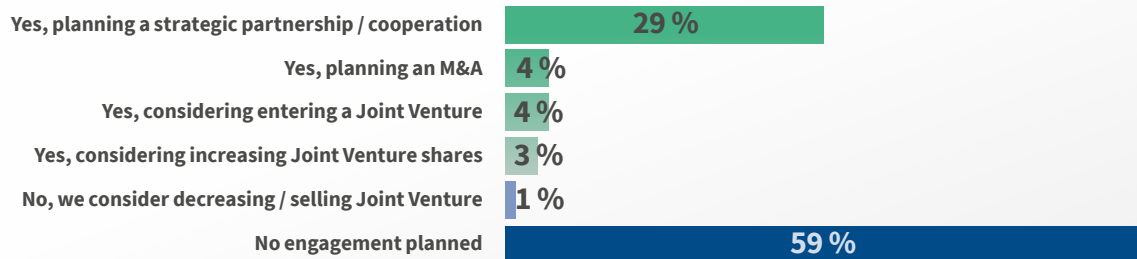


Figure 3.10: 40% of Companies Plan to Engage More With Chinese Partners

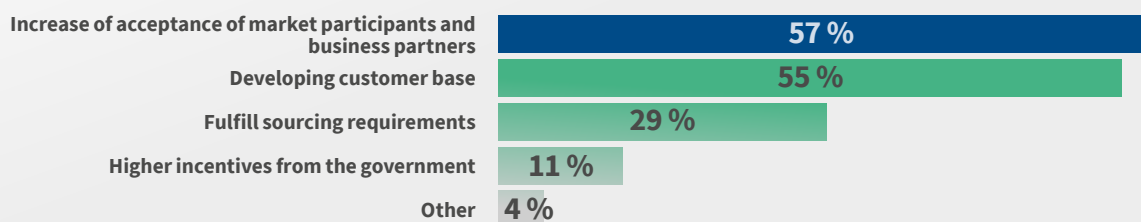
Is your company currently considering more engagement with Chinese partners? (n=456)



Note: "I don't know" answers excluded

Figure 3.11: Market Participation And Customers Drive The Desire to Engage More With Chinese Partners

If you are considering more engagement with a Chinese partner, what are your motivations? (n=184)



Note: Multiple answers possible; percentages based on number of responses



GROWING NECESSITY FOR RISK AND COMPLIANCE MANAGEMENT

Issues revolving around compliance and risk management have been growing in importance for German companies in recent years. Recent legislation in both China and Germany, as well as the pandemic, increased the need for risk and compliance management in China.

CAUGHT BETWEEN LEGISLATIONS

German companies are affected by current US sanctions on Chinese businesses and individuals, and experience growing pressure to justify to foreign stakeholders business ties to certain companies.

- ▶ 40% of the surveyed companies are indirectly or directly affected by the US sanctions on Chinese businesses or individuals.

On the other hand, with the new Anti-Foreign Sanctions Law, German companies might feel pressured in front of Chinese customers.

Finally, German companies in China need to prepare for the Supply Chain Due Diligence Act, adopted by the German Parliament on 11 June 2021. The law will take effect in 2023 depending on the size of the group and place legal obligations on companies in Germany to ensure that social and environmental standards are observed on all levels of the Supply Chain.

- ▶ Almost half of the companies are planning – or have already started – to implement new compliance measures for the German Supply Chain Law.

MANAGING CHINA'S CORPORATE SOCIAL CREDIT SYSTEM

China's Corporate Social Credit System (CSCS) is a government initiative to monitor and rate compliance with laws and regulations of individuals, businesses, and institutions in China. The

credit information of companies and potential or existing business partners is available on different CSCS platforms. Therefore, compliance management that ensures no negative rating for the company and its business partners is essential.

- ▶ 70% of German companies use the CSCS platforms, mainly for obtaining credit information of potential business partners before a transaction.

MANAGING INTELLECTUAL PROPERTY & CYBER SECURITY LAWS

55% of the surveyed companies face Intellectual Property (IP) challenges, like insufficient protection by IP-related laws and regulations or challenging processes when prosecuting IP infringements in court.

- ▶ IP enforcement continues to pose challenges for German companies in China.

Recent months saw growing activity on the data regulation front. With both the Data Security Law (DSL) and the Personal Information Protection Law (PIPL) coming into effect, the three pillars of China's Cyber Security framework (together with the Cyber Security Law of 2017) are now in place. Drafts of important regulations for cross-border transfer of data and on data processing activities domestically and overseas have also been released recently.

To deal with these requirements, German companies in China need to take additional measures or adjust procedures and processes with business partners.

- ▶ Technical requirements and limitations of cross-data transfer are the main concerns attributed to the Chinese Cyber Security Law.



RETALIATORY INSTRUMENTS

More than one-third of the surveyed German companies expect retaliatory instruments created by multiple governments to impact their business in various ways: New strategy coming from the companies' headquarters in Germany (13%), rearrangement of suppliers (9%) and customer relationships (9%), and realignment with sister companies in other countries (7%) (Figure 4.1).

Among the retaliatory instruments faced by businesses are also the current US sanctions. Almost 40% of the surveyed companies state that they are indirectly or immediately affected by the current US sanctions on Chinese businesses or individuals (Figure 4.2).

Figure 4.1: More Than One Third of Companies Expect Retaliatory Instruments to Impact Business
In the last months, retaliatory instruments have been created by (multiple) governments. What consequences/implications do you expect for your business (e.g., sanctions, entity lists, extraterritorial laws)? (n=503)

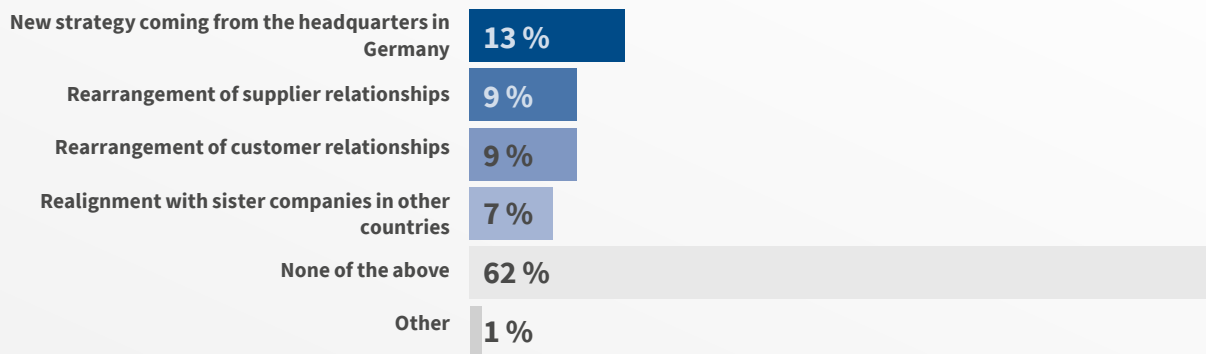
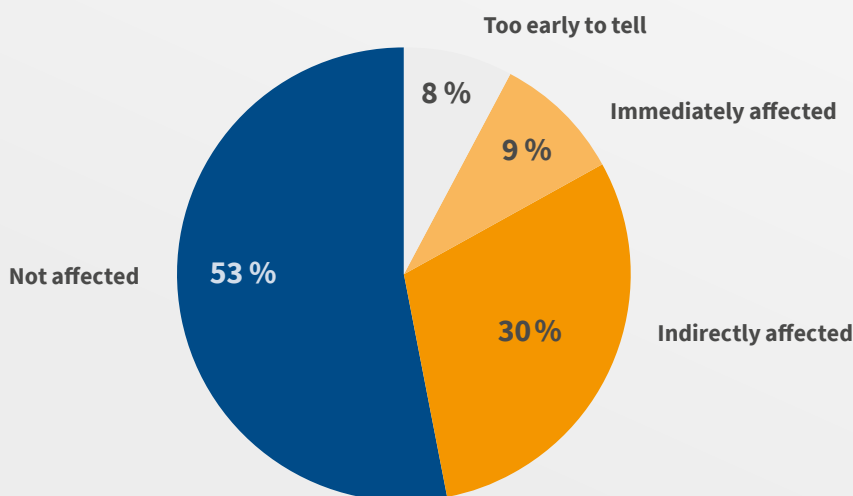


Figure 4.2: 40% of the Companies Are Either Indirectly or Directly Affected by the US Sanctions on Chinese Business or Individuals

Is your company in China affected by current US sanctions on Chinese businesses or individuals? (n=504)



SUPPLY CHAIN LAW

The Supply Chain Due Diligence Act was adopted by the German Parliament on 11 June 2021. The law will implement central provisions of the UN Guiding Principles on Business and Human Rights and the National Action Plan for Business and Human Rights to ensure that social and environmental standards are observed on all levels of the global supply chains. The law will initially cover companies with more than 3,000 employees in Germany starting in 2023, and from 2024 on will be expanded to companies with more than 1,000 employees. While the law hasn't taken effect yet, it demands time for preparation – not only from large companies, but also from suppliers who have already received related requests from German customers.

Still more detailed information on the implementation is yet to be released, therefore, it is not surprising that 53% of the surveyed companies have not yet started to implement related additional compliance measures for their business in China. Almost half of the companies are planning to implement new compliance measures for the German Supply Chain Law: 32% have not yet started but are planning to in the near future; another 15% started implementing new compliance measures (Figure 4.3). Looking at the company size, a higher proportion of larger companies has already or is planning to implement new compliance measures (Figure 4.4).

Figure 4.3: Almost Half of Companies Are Planning to Implement New Compliance Measures for the German Supply Chain Law

*Have you started to implement new compliance measures for your business in China due to Germany's newly released Due Diligence Act (Supply Chain Law) that will become effective in 2023? (n=381)**

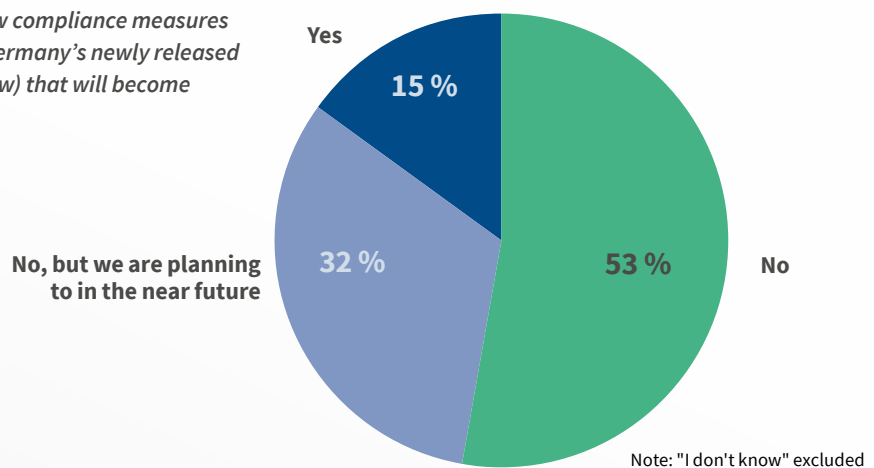
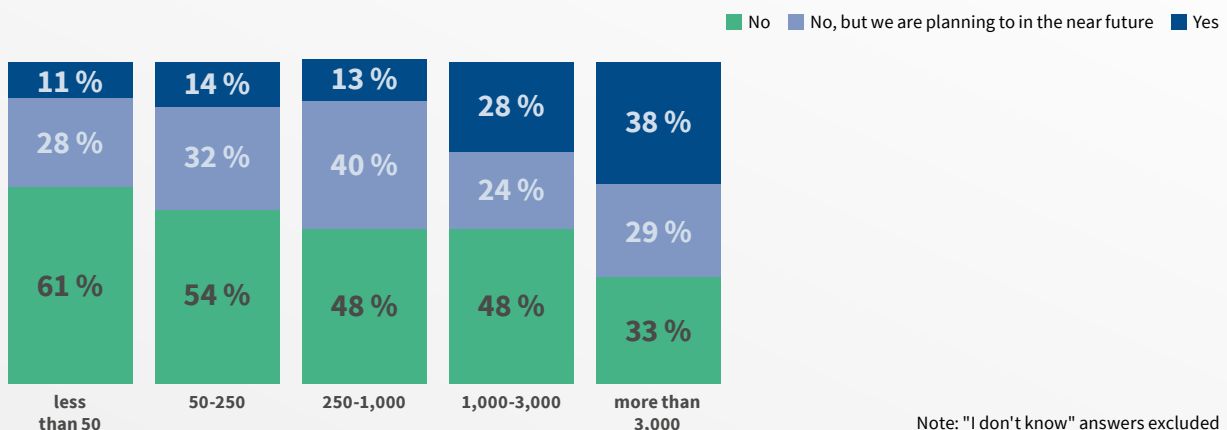


Figure 4.4: Larger Companies Started To or Plan To Implement Additional Compliance Measures

*Have you started to implement new compliance measures for your business in China due to Germany's newly released Due Diligence Act (Supply Chain Law) that will become effective in 2023? (n=381)**

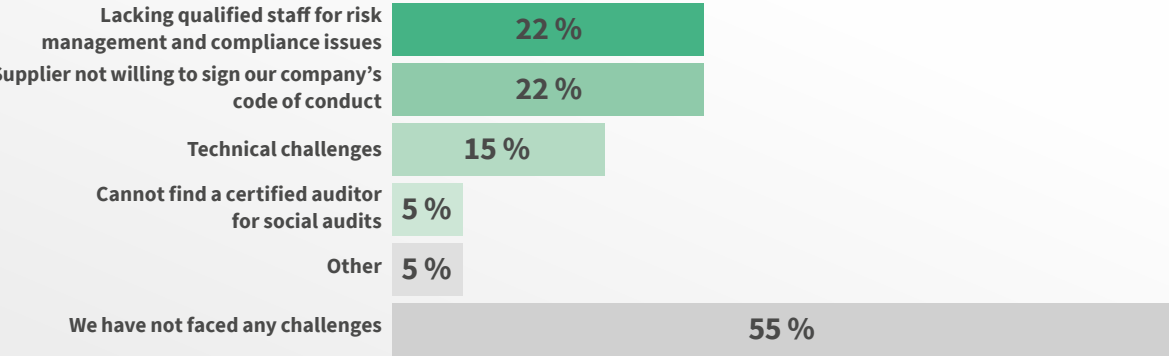


Almost half of the surveyed German companies encounter challenges while implementing measures to comply with the German Supply Chain Law in their business in China. The biggest challenge is the lack of qualified staff for risk management and compliance issues (22%), followed by the missing willingness of suppliers to sign the

company’s code of conduct (22%). German companies also struggle with technical challenges (15%) and with finding certified auditors for social audits (5%). 55% do not face any challenges implementing the needed compliance measures (Figure 4.5).

Figure 4.5: Almost Half of the German Companies in China Face Challenges Implementing Compliance Measures for the German Supply Chain Law

Has your company faced any of the following challenges while implementing compliance measures to fulfill the requirements of the German Supply Chain Law in your business in China? (n=176)



Note: Multiple answers possible; percentages based on number of responses

CHINA'S CORPORATE SOCIAL CREDIT SYSTEM

For the future engagement of German business in China, the country's Corporate Social Credit System (CSCS) is of high relevance: control mechanisms of the market and the legal system are being transformed using 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' 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 the subsequent consequences of the ratings. 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.

In 2021, 70% of the surveyed German companies in China reportedly use CSCS platforms, mostly to obtain credit information about potential business partners before a transaction. German companies further use the platforms to check whether credit information about their company is correct, which credit information is included about their own company, and whether their organization is listed on black or red lists. Only 4% have filed a complaint about the information displayed on the CSCS platforms (Figure 4.6).

73% of respondents did not have a negative entry on one of the information displaying platforms of the CSCS in the past. Only 7% of the respondents reported having a negative entry and every fifth company is not aware of a potential negative entry (Figure 4.7).

Figure 4.6: 70% of Companies Use the CSCS Platforms – Mostly for Obtaining Credit Information on Potential Business Partners Before a Transaction

For which purpose does your company use the information displaying platforms of the Corporate Social Credit System (CSCS)? Platforms like e.g., National Enterprise Credit Information Publicity System or Credit China or Qichacha (n=488)

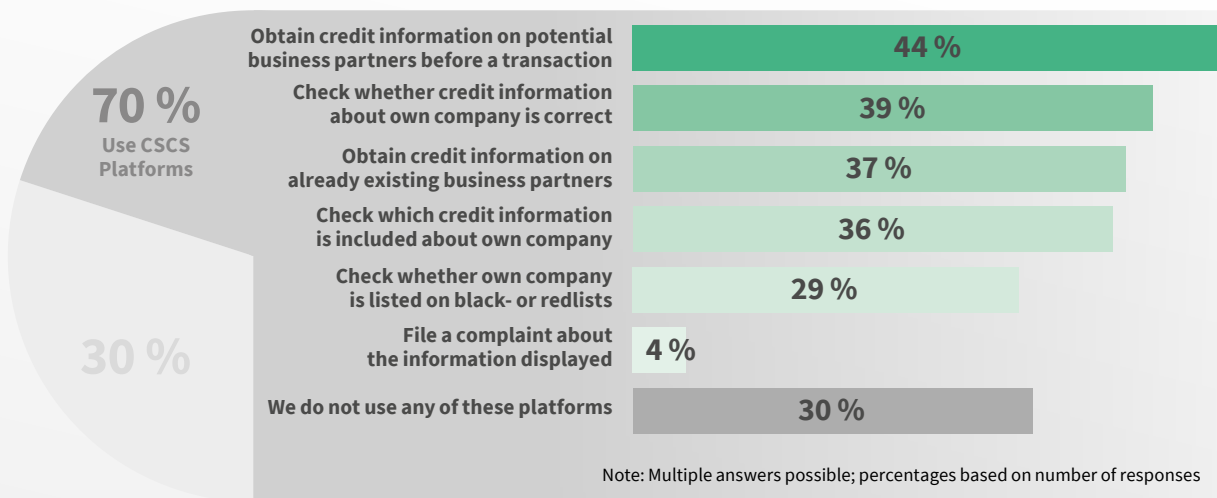
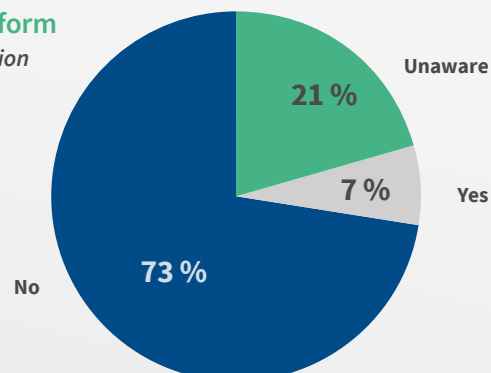


Figure 4.7: 7% Had a Negative Entry on a CSCS Platform

Did your company have a negative entry on one of the information displaying platforms of the CSCS in the past? (n=493)



INTELLECTUAL PROPERTY & CYBER SECURITY LAW

45% of companies have not experienced any issues around Intellectual Property so far, – a 5 percentage point drop from 2020. However, 55% of the surveyed companies faced IP challenges, like insufficient protection by IP-related laws and regulations (24%), challenging processes when prosecuting IP infringements in court (23%), and IP theft among employees (19%) (Figure 4.8).

The main concerns for the surveyed companies related to the implementation of the Chinese Cyber Security Legislation are additional efforts to comply with the technical requirements (49%) and the limitations of data-cross border transfer (46%) (Figure 4.9).

Figure 4.8: IP Challenges Ongoing Issue for German Companies

Has your company been faced with IP challenges? (2020/21 n=386; 2021/22 n=442)

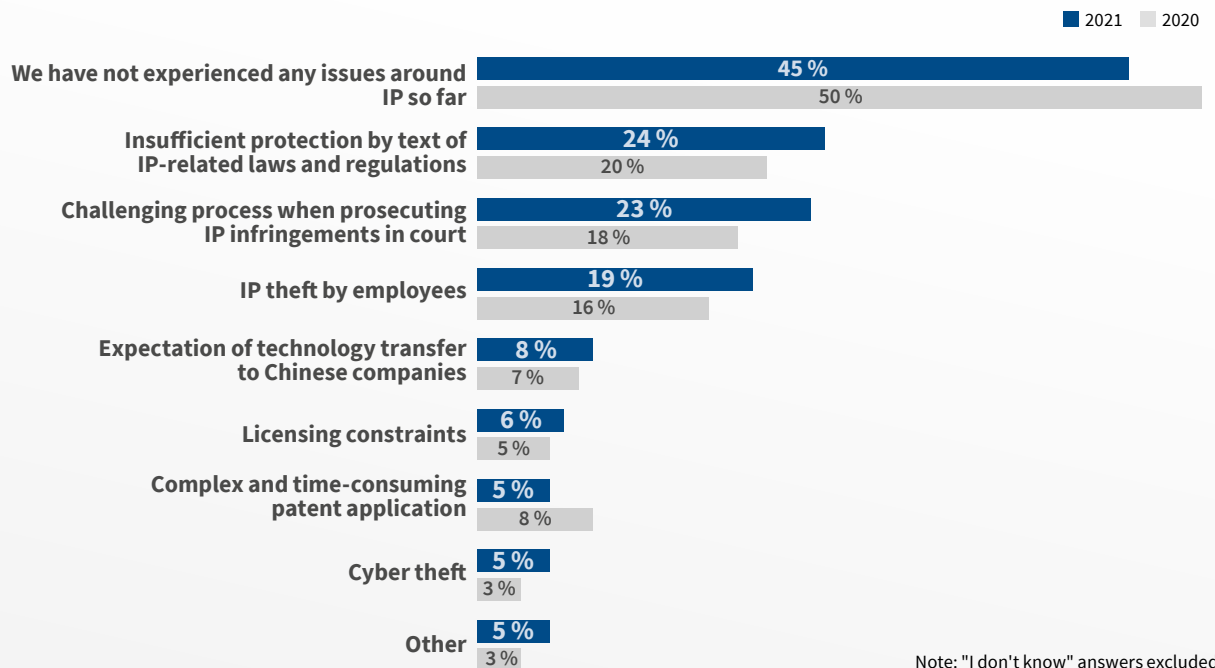
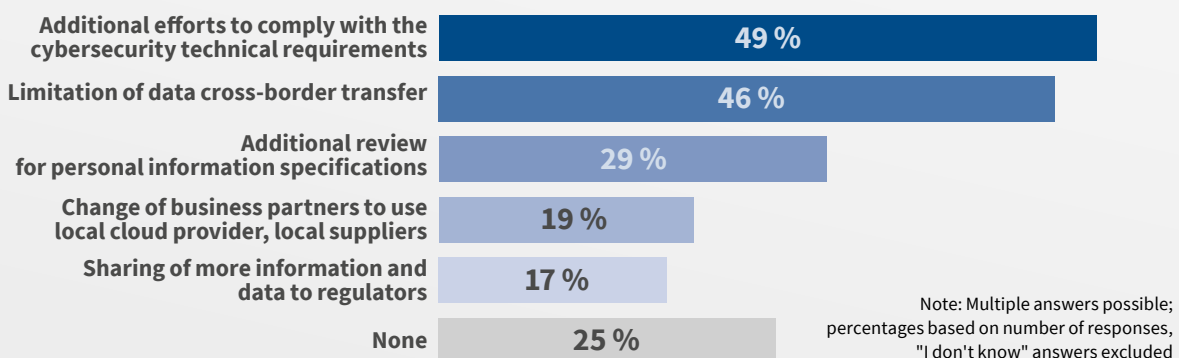


Figure 4.9: Technical Requirements and Limitation of Cross Data Transfer Are Main Concerns Related to the Chinese Cyber Security Law

What kind of business implications are you experiencing related to the implementation of the Chinese Cyber Security Legislation, especially the Data Security Law? (n=408)

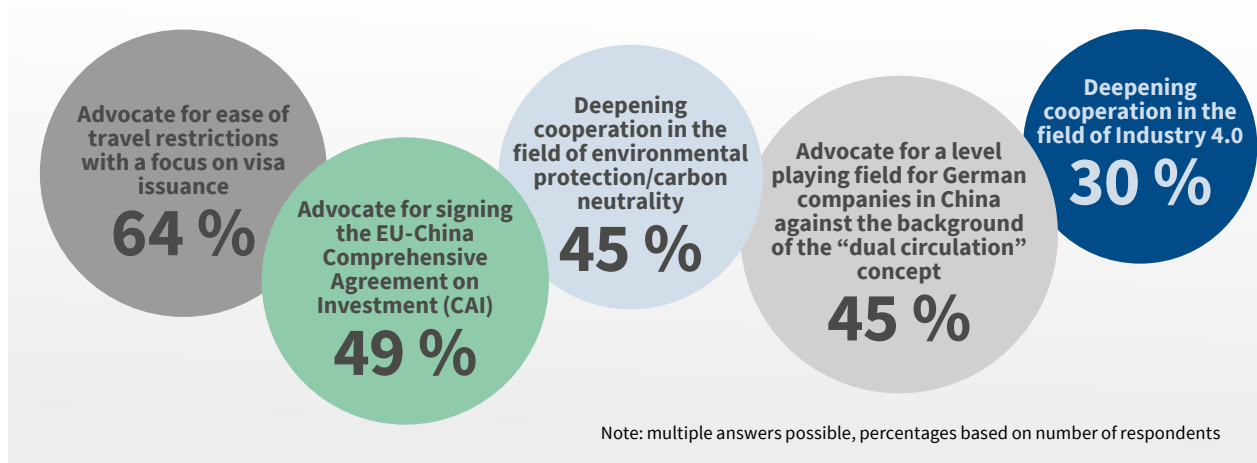


PRIORITIES OF GERMAN COMPANIES: IMPROVED LEVEL PLAYING FIELD, EASE OF TRAVEL RESTRICTIONS, AND GERMAN-CHINESE COOPERATION



Figure 5: German Government to Advocate for Improved Level Playing Field, Ease of Travel Restrictions, and German-Chinese Cooperation

Which economic topics should be prioritized in the China strategy of the new German government? (n=520)



The topics surveyed German companies believe should be included in the new German government’s China strategy mirror the key challenges raised in this edition of the Business Confidence Survey.

A desire for enhanced cooperation can be found in several of the topics brought forward: the signing of the EU-China Comprehensive Agreement on Investment (CAI) (45%), deepening the cooperation in the field of environmental protection (45%) and Industry 4.0 (30%).

The CAI is the second-most mentioned topic that should be advocated for – showing the importance of the key areas that were addressed in the agreement: Market access in new relevant economic sectors (like aviation, health care, cloud services, finance, etc.); improved and transparent level playing field; and sustainable development in environmental protection and labor issues.

The CAI – along with the request to advocate for a level playing field – is a response to the main regulatory challenge mentioned by survey participants: the preferential treatment of local companies.

Topping the list of priorities is the need for advocacy to ease travel restrictions, with a focus on visa issuance (64%) (Figure 5.1, full version in Appendix, Figure A.9). This is a vital issue for the German business community in China, which is highly affected by the travel and visa restrictions – from less mutual understanding, to decreasing knowledge transfer and fears of a decline in investments and economic slowdown.



From German companies’ perspective, the new German government should advocate for an improved level playing field, the ease of travel restrictions, and the deepening of German-Chinese economic cooperation in various fields.

6

ABOUT THE SURVEY

The current report was made possible thanks to the contribution of 596 member companies of the German Chamber of Commerce in China to the online survey conducted from October 14, 2021, to November 3, 2021. The response rate reflects 29% of all member companies. Since 2007, this report has been a key instrument for measuring the business sentiment of German companies operating in China.

PROFILE OF CONTRIBUTORS

Most of the German companies in China are located in coastal areas, thereby mainly concentrating in the main economic clusters of the Yangtze Delta in the east (Shanghai: 40%, Jiangsu: 19%, Zhejiang: 3%), the Bohai Economic Rim in the north (Beijing: 9%, Liaoning: 6%, Tianjin: 6%) and the Pearl River Delta in the south (Guangdong: 9%) (Figure 6.1).

Traditionally, German companies in China engage in industries such as machinery/industrial equipment (33%) and automotive (21%), as well as business services (11%) – summing up to almost two-thirds of all respondents. The remaining one-third of respondents consist of companies from a broad range of different industries, with electronics (5%) and consumer products/services (5%) making up another 10% (Figure 6.2).

Manufacturing and production (64%) and sales and marketing (56%) are the main fields of business for more than half of the respondents, followed by services (46%) (Figure 6.3). Independent from the main field of business, 70% of the surveyed companies have production in China (Figure 6.4).

Small size companies represent 28% of all responding companies; medium-sized companies account for 36%; large companies with more than 250 employees make up for the remaining 36% of the respondents (Figure 6.5).

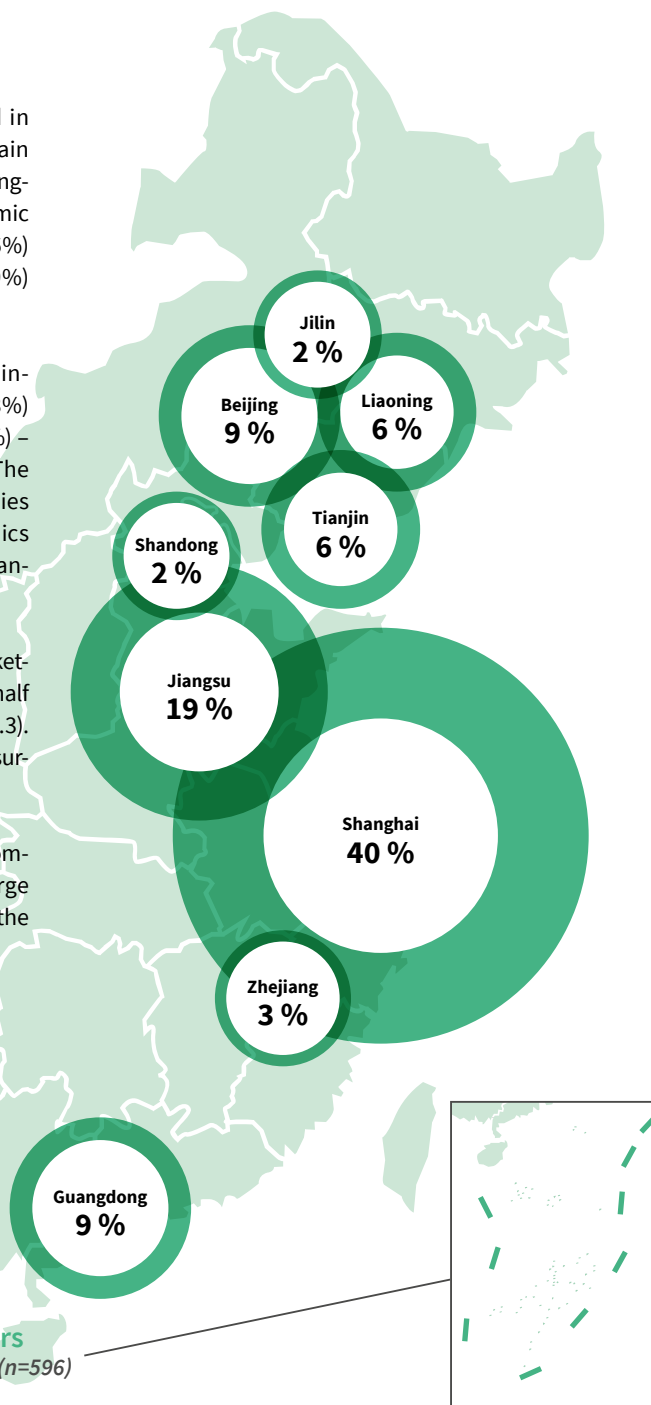
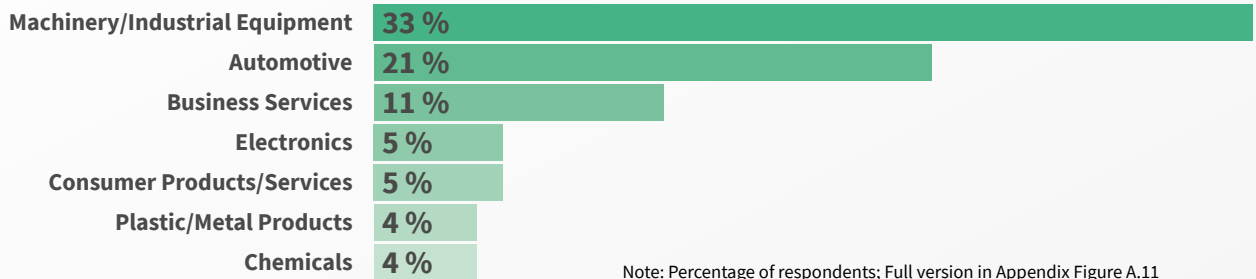


Figure 6.1: Regional Distribution of Contributors
In which province/region/city is your company located? (n=596)

Note: Percentage of respondents; Full version in Appendix Figure A.10

Figure 6.2: Distribution of Contributors by Industry

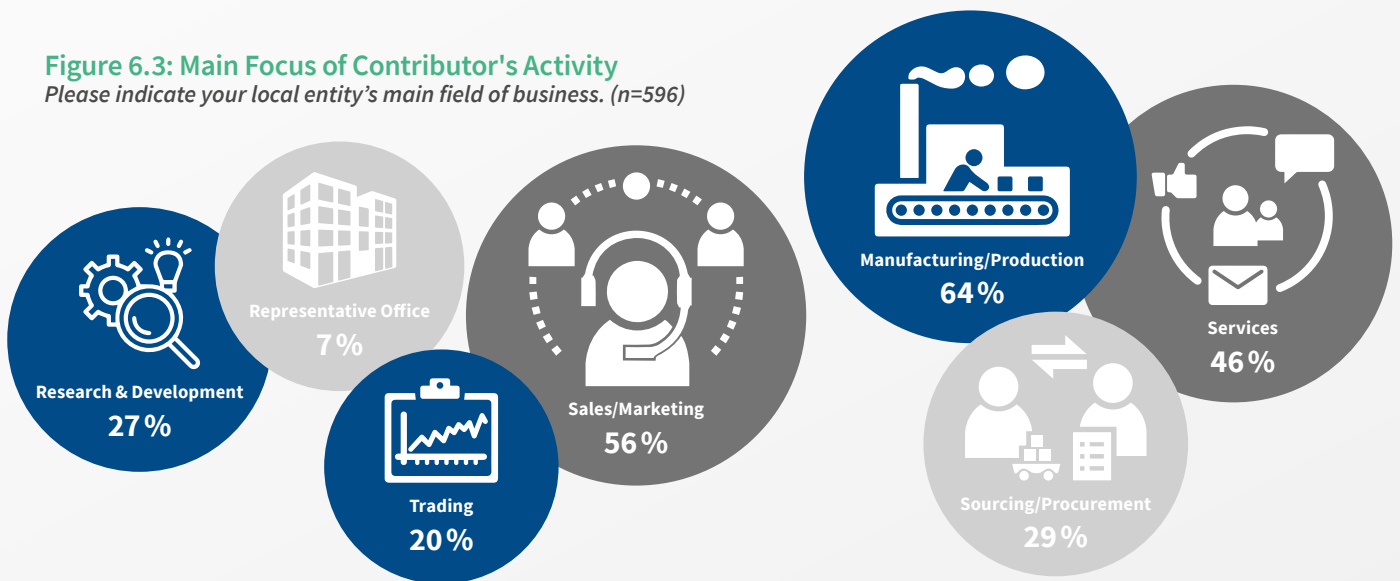
Please specify the main industry of your company. (n=596)



Note: Percentage of respondents; Full version in Appendix Figure A.11

Figure 6.3: Main Focus of Contributor's Activity

Please indicate your local entity's main field of business. (n=596)



Note: Percentages based on number of responses

Figure 6.4: Producing Contributors in China

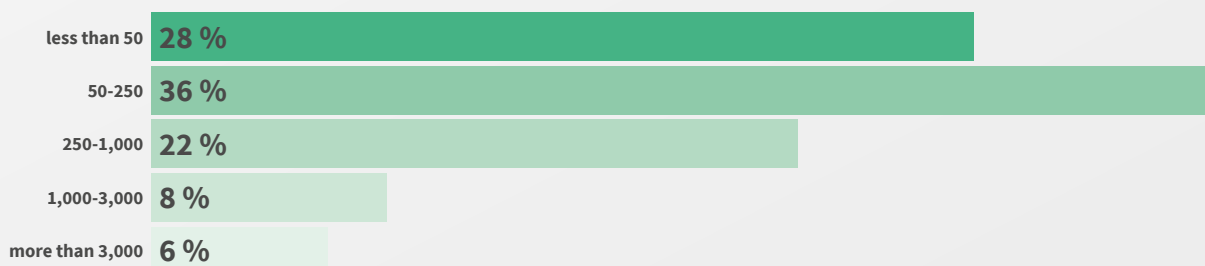
Do you have production in China? (n=596)

70%
PRODUCTION IN CHINA

30%
NO PRODUCTION IN CHINA

Figure 6.5: Distribution of Contributors by Company Size

Please indicate the number of employees working at your company's local operation. (n=596)

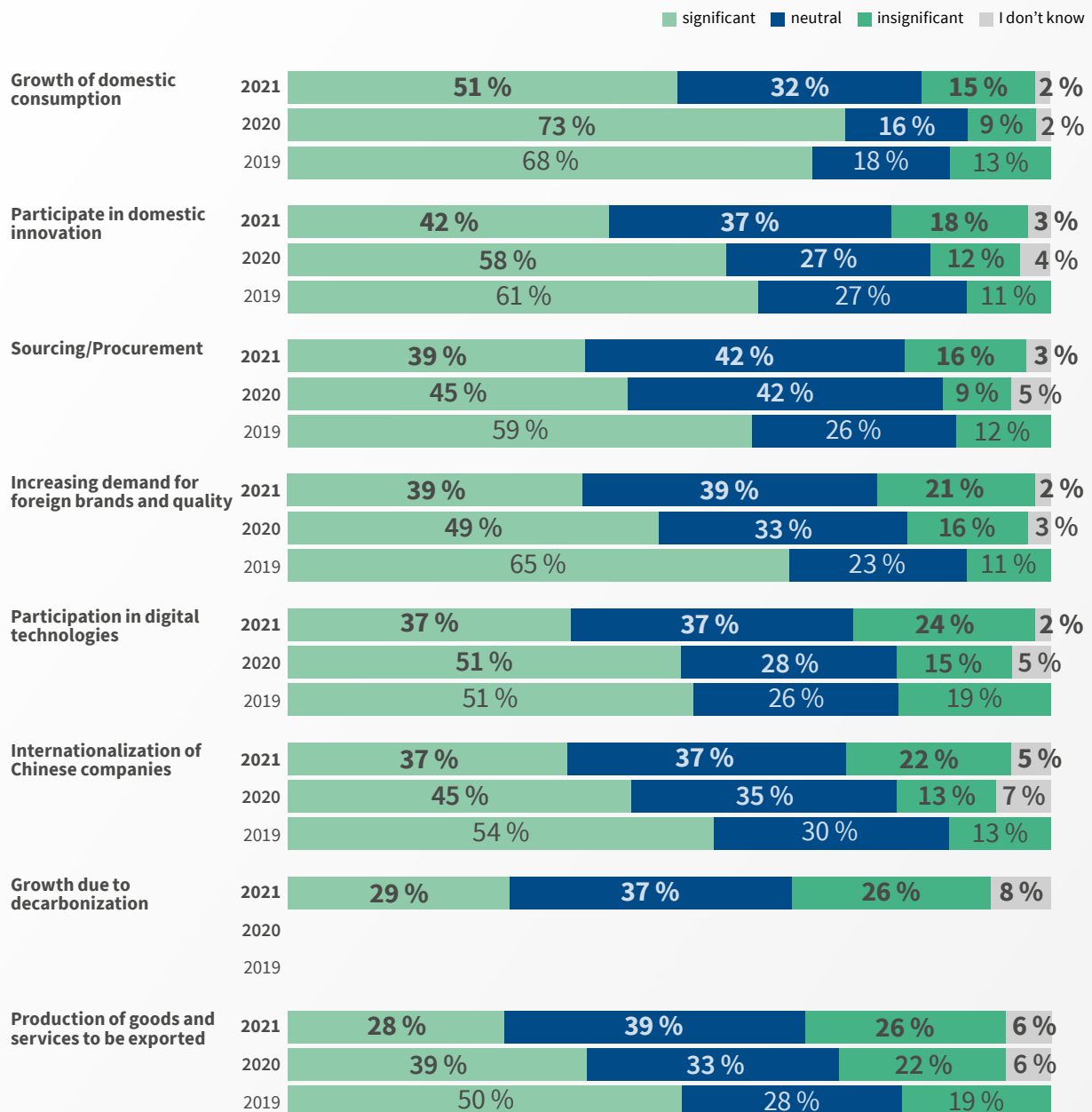


Note: Percentage of respondents

APPENDIX

Figure A.1: Domestic Consumption & Innovation still Drivers but Decreasing Trend

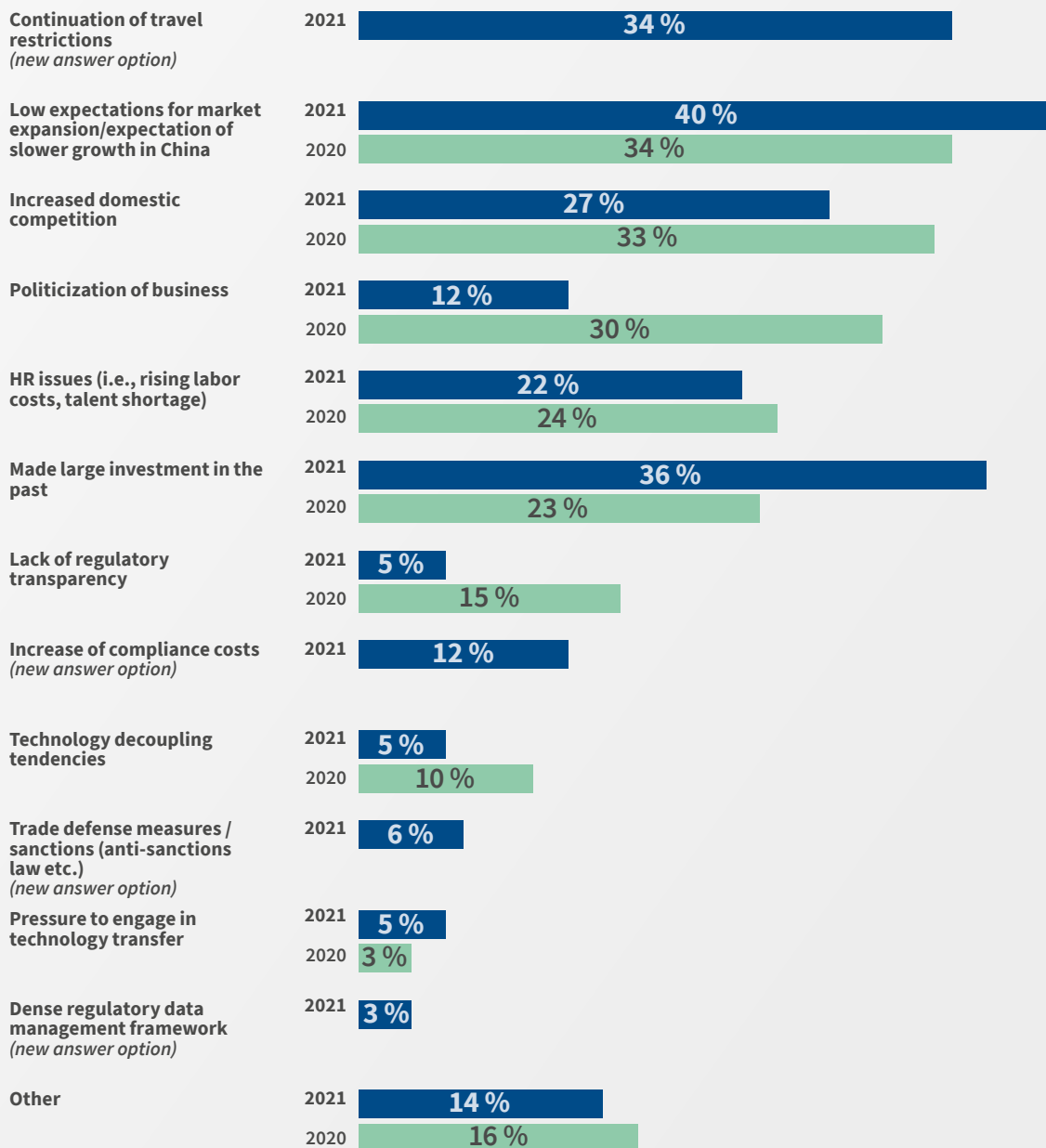
Please rate the following opportunities for your company's China business. (2020/21 n=452, 2021/22 n=571)



Note: Multiple answers possible; percentages based on number of responses; Full Version of Figure 1.5

Figure A.2: Continuation of Travel Restrictions, Increased Domestic Competition and Politization of Business Leads German Companies to Decrease Investment

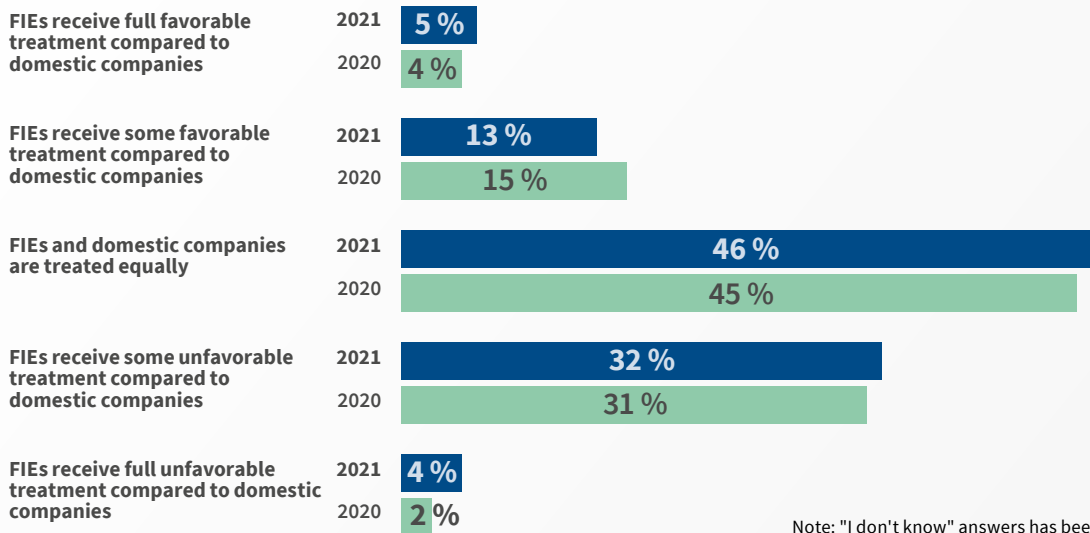
What are the main reasons for your company not to invest or decrease investments in China? (2020/21 n=81; 2021/22 n=134)



Note: Multiple answers possible; percentages based on number of responses; Full Version of Figure 1.14

Figure A.3: One-Third of German Companies Express Unfavourable Treatment

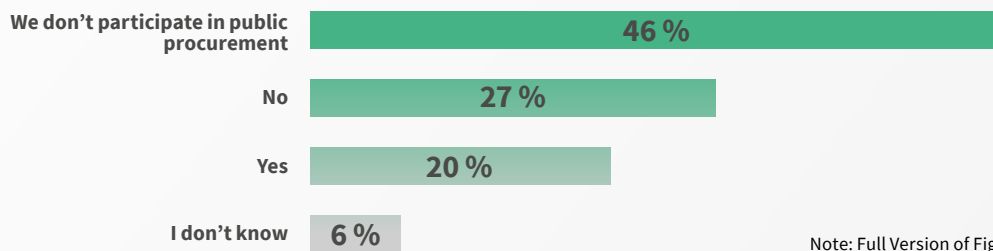
In your industry, how do Chinese authorities treat Foreign Invested Enterprises (FIEs) compared to domestic companies? (2020/21 n=365; 2021/22 n=411)



Note: "I don't know" answers has been deleted; Full Version of Figure 2.3

Figure A.4: Almost Half Affected By Preferential Treatment of Chinese Competitors

Has your company been affected by public procurement measures leading to favoring / preferential (treatment of) Chinese competitors? (n=518)



Note: Full Version of Figure 2.5

Figure A.5: One Fourth of Companies See a Negative Effect From a Change of Sentiment Towards Foreign Brands

Do you think your company can be affected by a change of sentiment of Chinese customers towards foreign companies or foreign brands? (n=519)

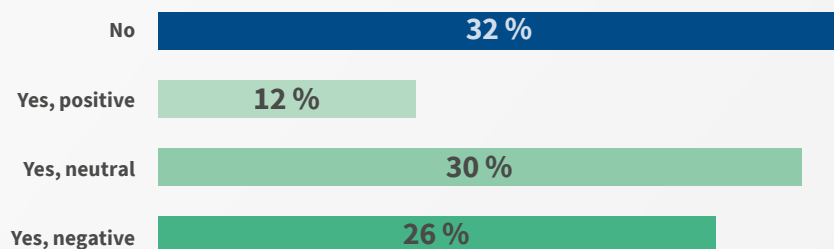
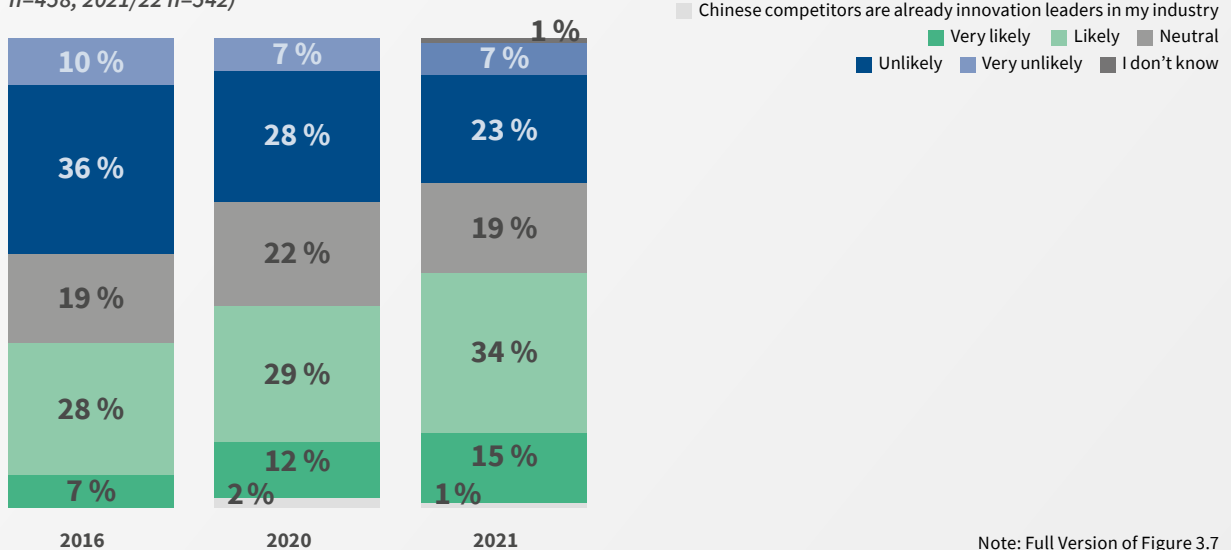


Figure A.6: 50% Expect Chinese Competitors Will Become Innovation Leaders in Their Industry Within the Next Five Years

Do you think Chinese competitors can become innovation leaders in your industry within the next five years? (2020/21 n=458; 2021/22 n=542)



Note: Full Version of Figure 3.7

Figure A.7: Business Operations Are Increasingly Put Under Pressure

Does your company expect to see its business operations put under more or less political pressure by the following parties over the next 12 months? (n=505)

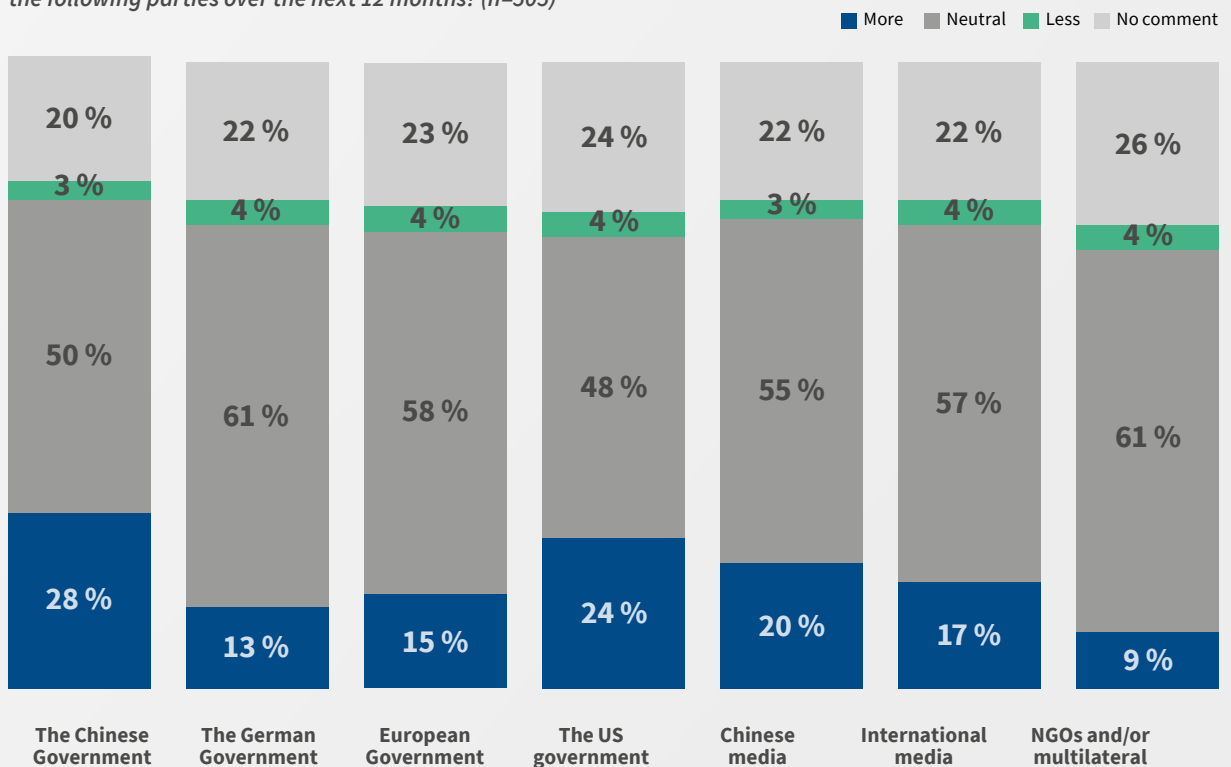


Figure A.8: Half of The Companies Do Not Face Consequences of Negative Entry In Their Business Operations

What were the consequences for your company from that negative entry on one of the information displaying platforms of the CSCS? (n=32)

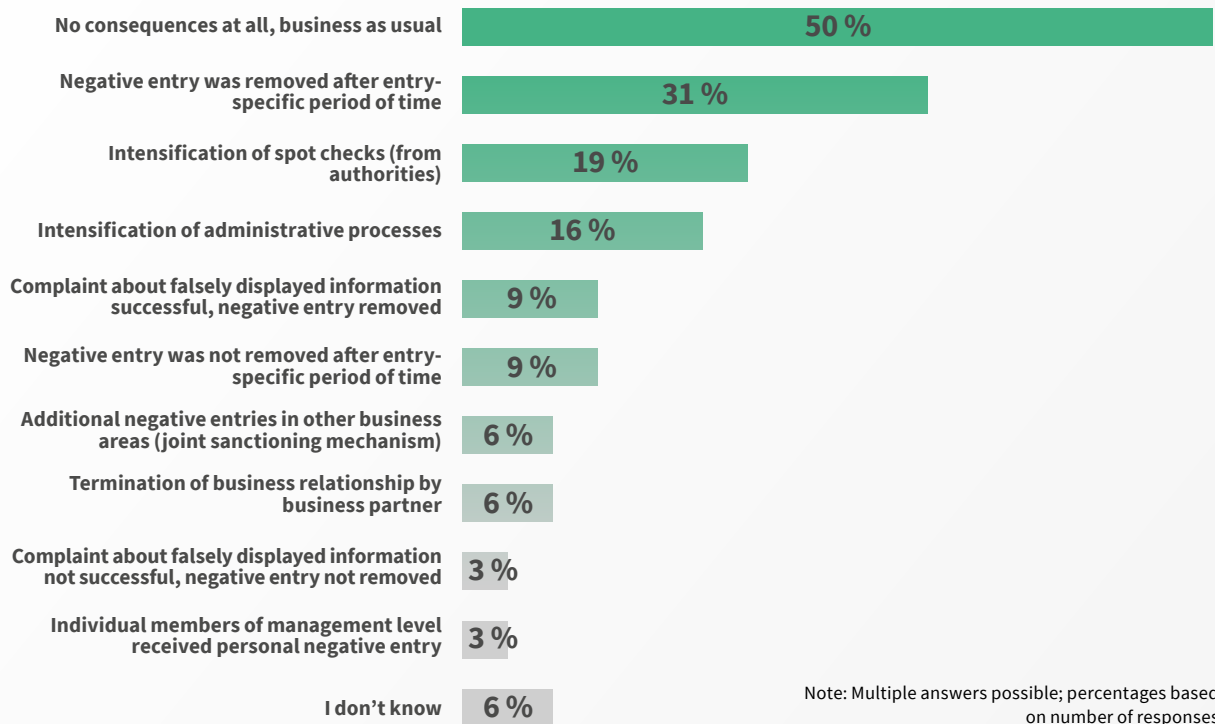


Figure A.9: German Government to Advocate For Improved Level Playing Field, Ease of Travel Restrictions, And German-Chinese Cooperation

Which economic topics should be prioritized in the China strategy of the new German government? (n=520)

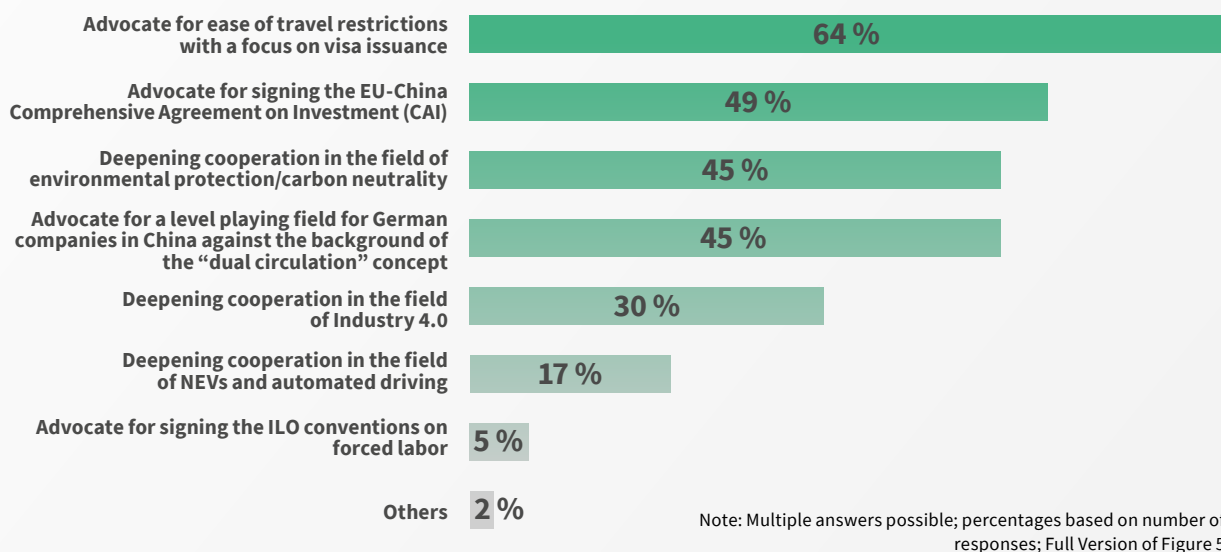
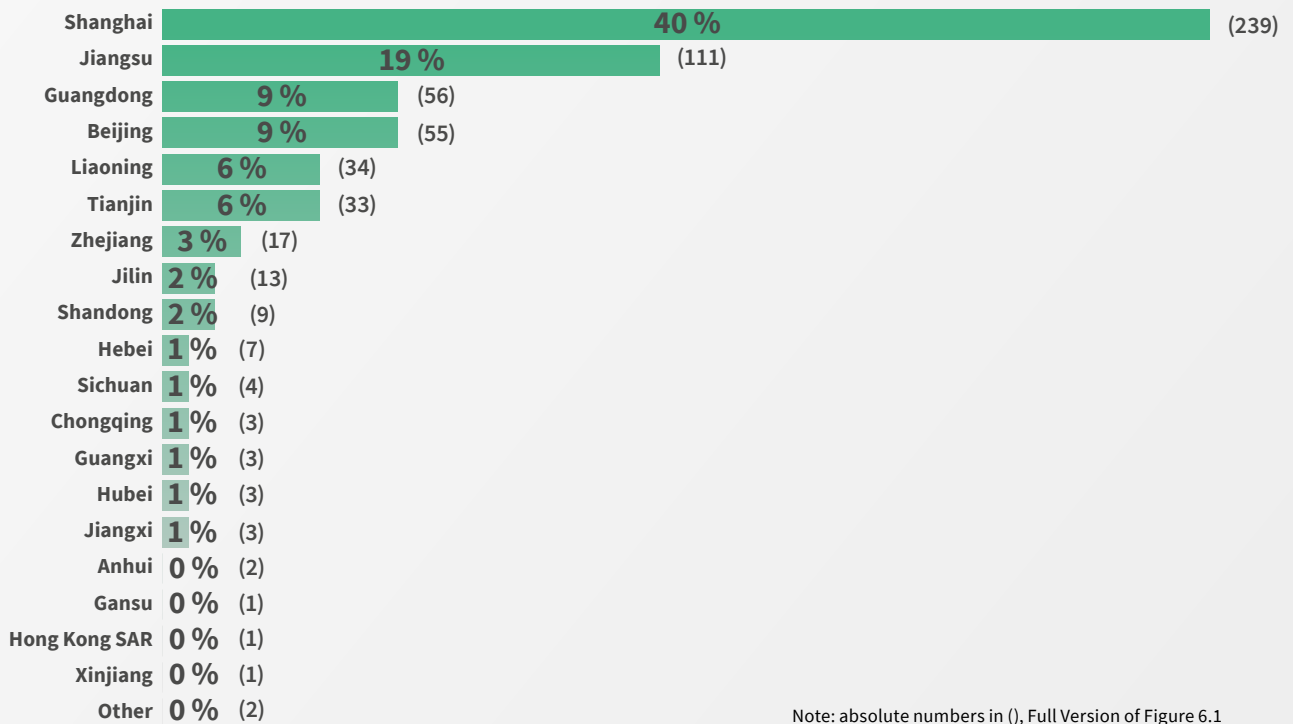


Figure A.10: Regional Distribution of Contributors

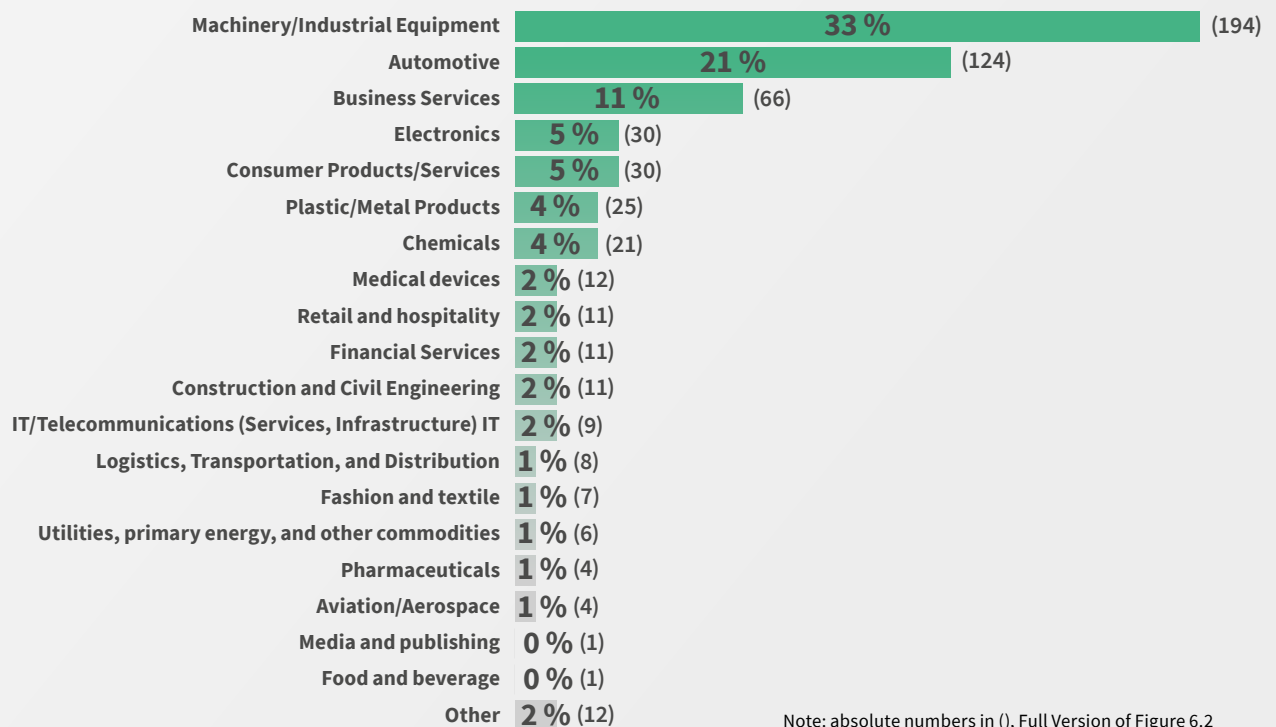
In which province/region/city is your company located? (n=596)



Note: absolute numbers in (), Full Version of Figure 6.1

Figure A.11: Distribution of Contributors by Industry

Please specify the main industry of your company. (n=596)



Note: absolute numbers in (), Full Version of Figure 6.2

CONTACTS

GERMAN CHAMBER OF COMMERCE IN CHINA

The German Chamber of Commerce in China currently has 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.

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The German Chamber of Commerce in China's Business Confidence Survey 2021 | 2022, as well as former editions of the report, are available on our website under the Economic Data & Survey section at www.china.ahk.de.

KPMG AG WIRTSCHAFTSPRÜFUNGSGESELLSCHAFT

KPMG is an organization of independent member firms with around 227,000 employees in 146 countries and territories. KPMG in Germany is one of the leading auditing and consulting firms and employs around 12,500 people in 26 locations.

KPMG's services include Audit, Tax, Consulting and Deal Advisory. The Legal services are provided by KPMG Law Rechtsanwaltsgesellschaft mbH.

KPMG in Germany has established Country Practices for all relevant business corridors between Germany and foreign countries. All Country Practices consist of multi-disciplinary country experts who are familiar with the particularities and regulatory environment of these markets, who work regularly in these countries and who are involved in the corridor-related issues of the German and the respective international companies on a day-to-day basis.

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