THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

US-China Business Council 2012 China Business Environment Survey Supplement: An In-Depth Look at Selected Top Issues

Introduction

Each year, the US-China Business Council (USCBC) surveys its member companies to gauge the business climate in China and assess the top challenges of doing business there. In October 2012, USCBC released a report on the major findings of its annual survey, including the top 10 priority issues identified as by USCBC member companies.

This report dives deeper into five key areas touched upon in the initial survey report: human resources and rising costs of doing business in China; competition with Chinese companies; technology transfer issues; intellectual property rights (IPR) protection; and China's overall investment environment and policies designed to promote investment outside of traditional regions and into central and western China.

Key findings from the detailed survey questions explored in the survey:

» Most companies expect to expand their headcount in China in 2013, even though wages are expected to increase at least 5-10 percent next year.

» More respondent companies compete with non-state owned companies than state-owned companies in China and most suspect that both types of companies receive tangible benefits that foreign companies do not receive.

» Most companies have not been asked to transfer technology to China in the past three years, but many of those that have been asked faced tough choices about how to handle the requests.

» Nearly all companies remain concerned about China's IPR enforcement, but IPR protection continues to slowly improve and some are finding China's courts as a viable means to enforce their rights.

» Companies plan to continue expansions of their operations in China, and some are looking to China's central and western provinces as new markets where they may be able to expand their sales in the country.

The full survey report can be found on USCBC's website: https://www.uschina.org/info/members-survey/.

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USCBC 2012 China Business Environment Survey Results
Focus: The Human Resources Challenge and Rising Costs

Executive Summary

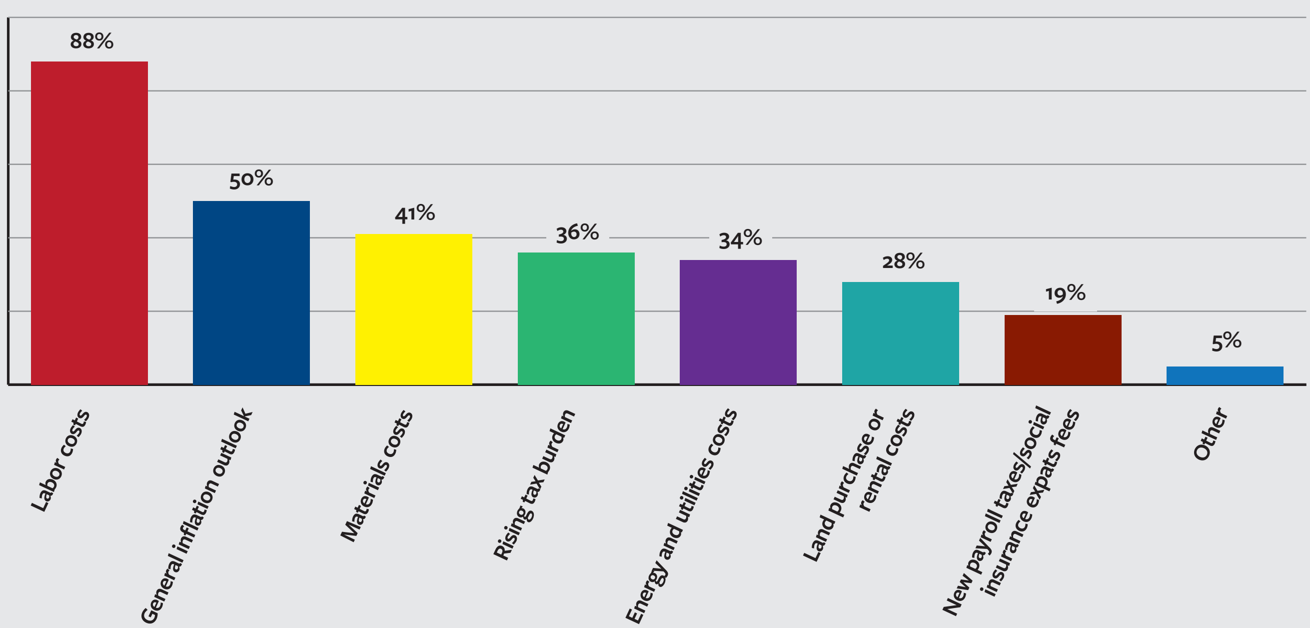
» The problem of finding, training, and retaining qualified local talent has ranked as one of the top three challenges that companies report facing in China for all but one of the last seven years of USCBC's survey, and 89 percent of survey respondents in 2012 reported the problem is unchanged or worsening.

» Wages are increasing in China, especially in comparison with wage movements globally: more than a third of respondents reported increasing wages more than 10 percent in 2012, and another 60 percent raising wages between 5-10 percent. Most respondents expect similar wage increases in 2013.

» Companies are particularly squeezed in seeking middle management and skilled technical staff, where a limited talent pool and high turnover rates drive up human resources costs. Compensation and benefit packages for upper and middle management in China are at or approaching levels comparable to those in the United States.

Anyone doing business in China knows that rising costs have made the competitive landscape more challenging. According to data collected from the US-China Business Council's (USCBC) annual membership survey, rising costs are the fourth-ranked challenge for American companies and one of the primary restraints on companies' ability to grow profits. Respondents note that cost increases include everything from raw materials to utilities to land use. The rising cost of most concern, however, is associated with human resources.

Top Cost Concerns

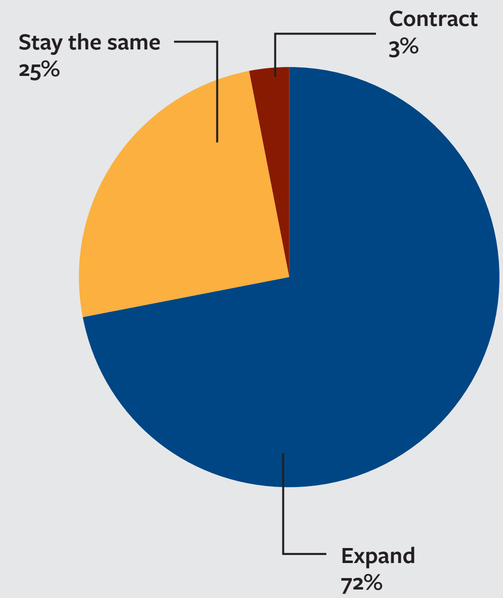


Human resource issues have long been a challenge for US and other companies in China. The problem of finding, training, and retaining qualified local talent has ranked as one of the top three challenges that companies report facing in China for all but one of the last seven years of USCBC's survey. Companies disclose that demand for qualified employees frequently outstrips availability, especially for skilled technical and managerial talent. The shortage of talent relative to demand pushes wages up to global levels for some positions. Moreover, 89 percent of survey respondents report the problem is unchanged or deteriorating.

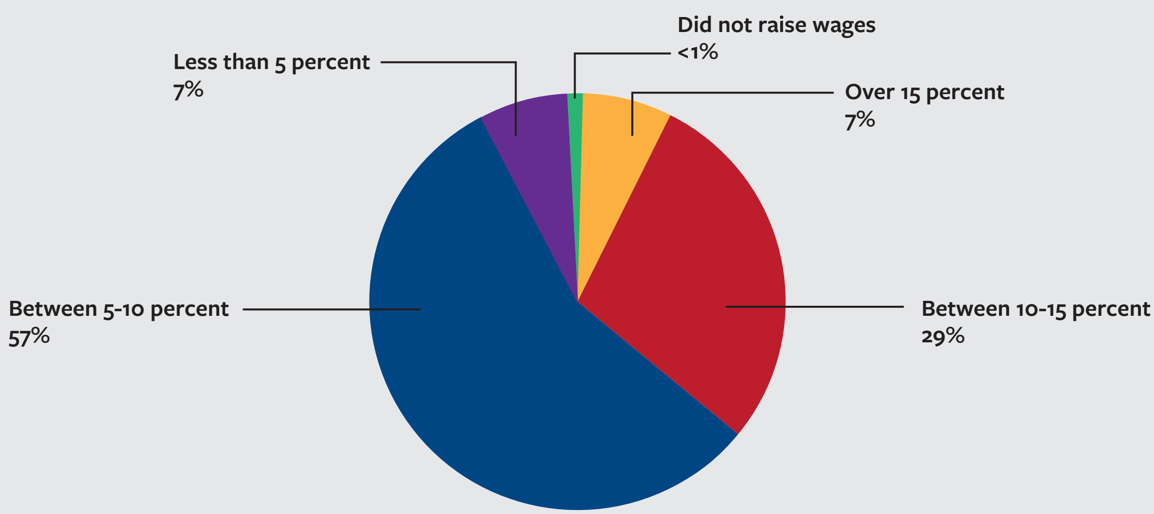
Human resource challenges are especially pressing in light of companies' projected business expansion in the coming years. Roughly 60 percent of survey respondents said they will invest in a new production facility or business unit or will expand their existing operations in 2013. Expansion invariably requires people—72 percent of survey respondents expect to increase their local work force.

More than a third of respondents reported boosting wages more than 10 percent in 2012, with roughly a quarter of respondents expecting to raise wages again in 2013 by similar amounts. Nearly 60 percent say they raised wages between 5-10 percent in 2012 and will do so again in 2013. These increases are high in comparison with wage movements in much of the rest of the world, highlighting how costly China is becoming from a human resource perspective.

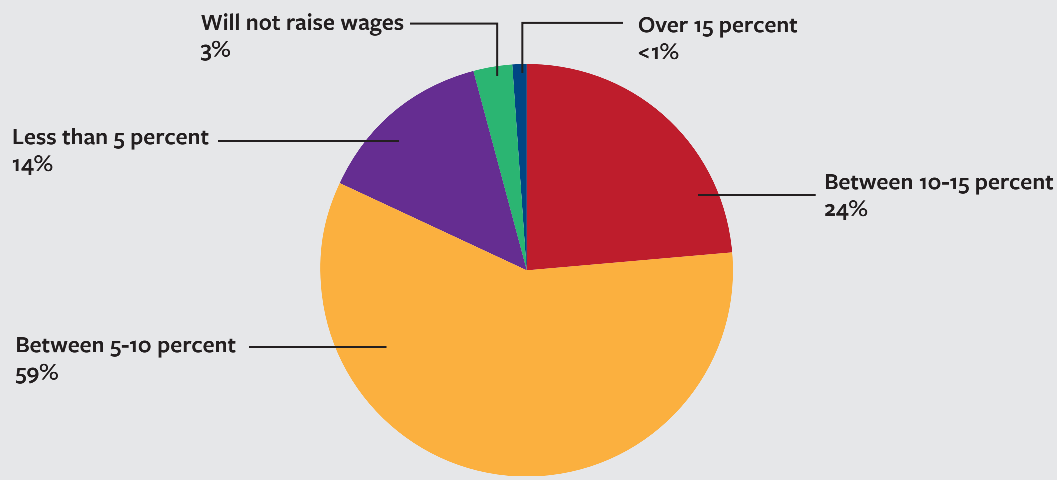
Company Head Count in 2013 Expected to...



Wage Increases in 2012

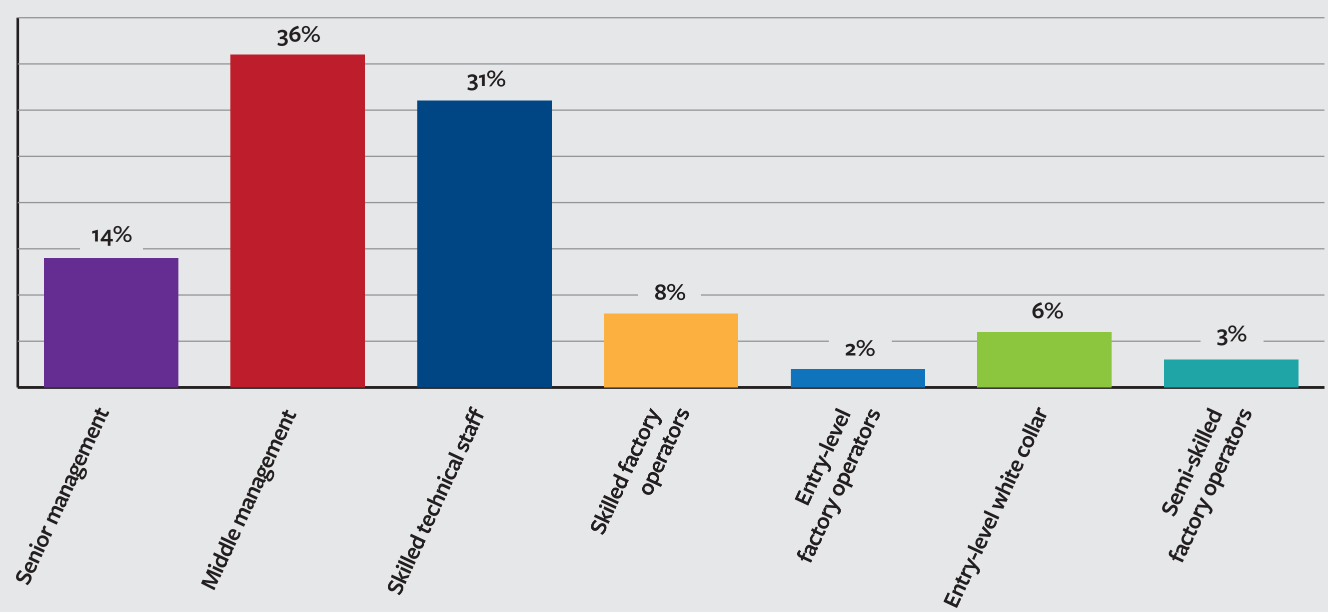


Estimated Percentage of Wage Increases in 2013

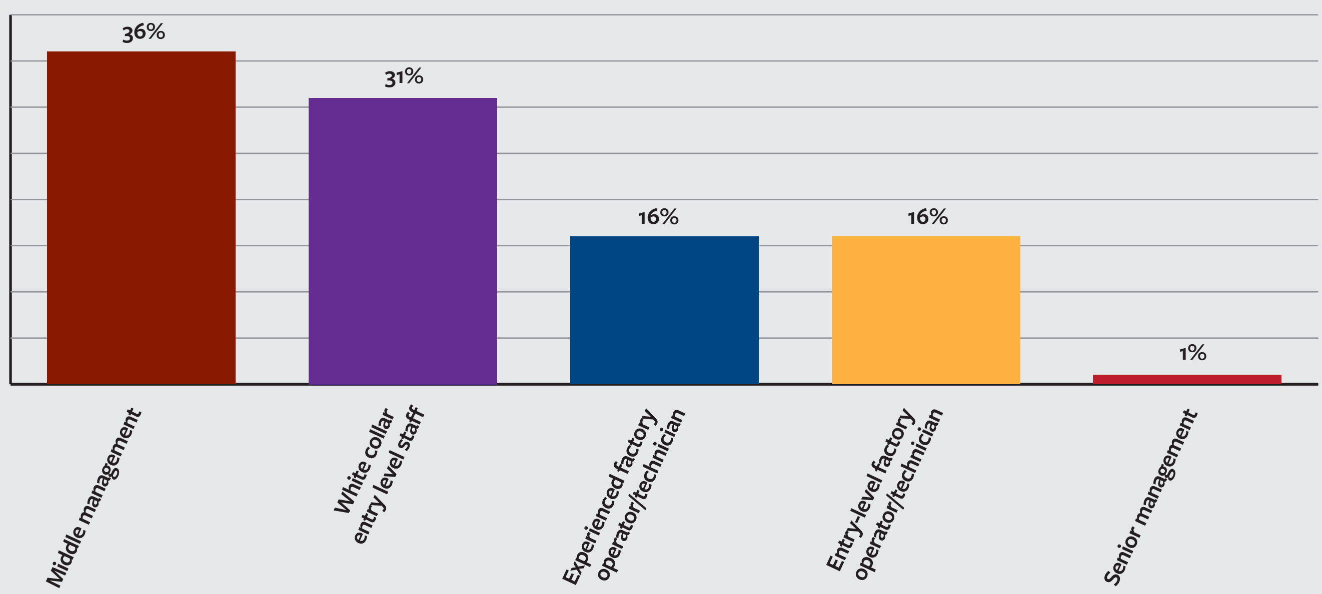


Although China's dwindling supply of factory labor has been widely reported, USCBC members are actually feeling the greatest human resource pressures in middle management and skilled technical staff. The competition among Chinese and foreign enterprise for this talent pool means that turnover rates tend to be high, driving up the cost of training and retaining skilled managers More than one-third of respondents noted that wages were rising fastest for middle management, and roughly the same number of respondents reported that turnover in the ranks of middle management was most acute.

For Which Positions are Wages Rising Fastest?



At What Level Was Turnover Most Acute?



As companies prepare to expand investments and raise headcount in China, they should also prepare for an even more competitive hiring landscape, with significantly higher costs to find, hire, train, and retain competent staff. Compensation and benefit packages for upper and middle management in China are at or approaching levels comparable to those in the United States.

USCBC 2012 China Business Environment Survey Results
Focus: Competition with Chinese Companies

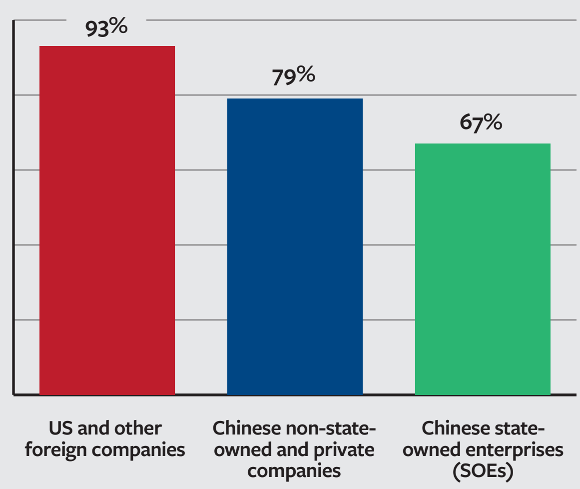
Executive Summary

- American companies in China face an increasingly competitive market, with strong competition not only from other multinationals and Chinese state-owned enterprises (SOEs) but also from a multitude of private and non-SOE Chinese companies.
- Competing with Chinese enterprises – both state-owned and private – is challenging since many survey respondents believe that domestic companies – whether SOE or non-SOE – receive benefits unavailable to other companies in the market.
- Identifying these preferences, and who may be receiving them, is critical in order to find effective approaches to level the playing field. Respondents identified three areas where Chinese government support of domestic companies appears to be the most prevalent: preferential government financing (71 percent), preferential licensing and approvals (66 percent), and preferential access to government contracts (59 percent).

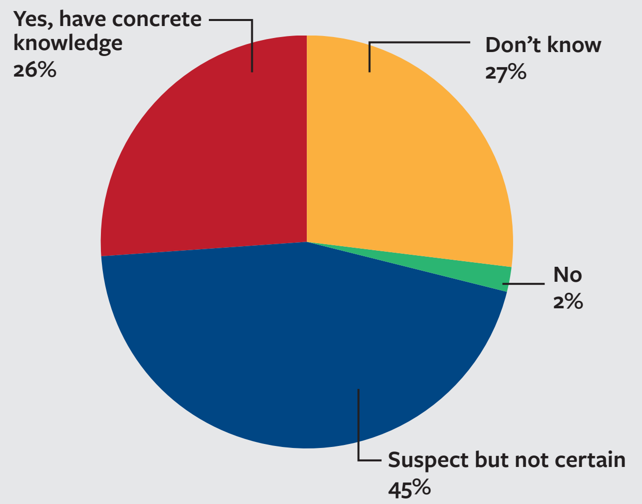
China's market has become extremely competitive for American companies. Contrary to many assumptions, competition is coming from all types of enterprises, not just China's state-owned enterprises (SOEs). Almost all survey respondents (93 percent) report that they compete against other foreign companies in China, including American ones. Nearly 80 percent compete with Chinese non-state-owned and private companies. And roughly two-thirds (67 percent) of companies have Chinese SOE competitors.

The diverse competition that US companies face is reflected in this year's top 10 list of concerns, as competition is central to three separate issues: competition with Chinese enterprises (#3); competition with foreign companies (#8); and competition with foreign or Chinese companies not subject to the US Foreign Corrupt Practices Act (#9). These results show that competition issues are not limited to state-owned enterprises, but require a comprehensive approach targeted at the specific preferences given to domestic enterprises, regardless of ownership.

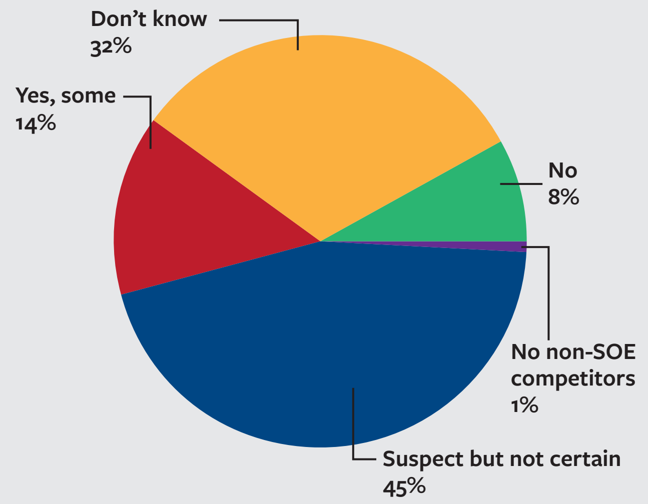
Who are Your Competitors in China?



Are State-Owned Competitors Receiving Tangible Benefits?



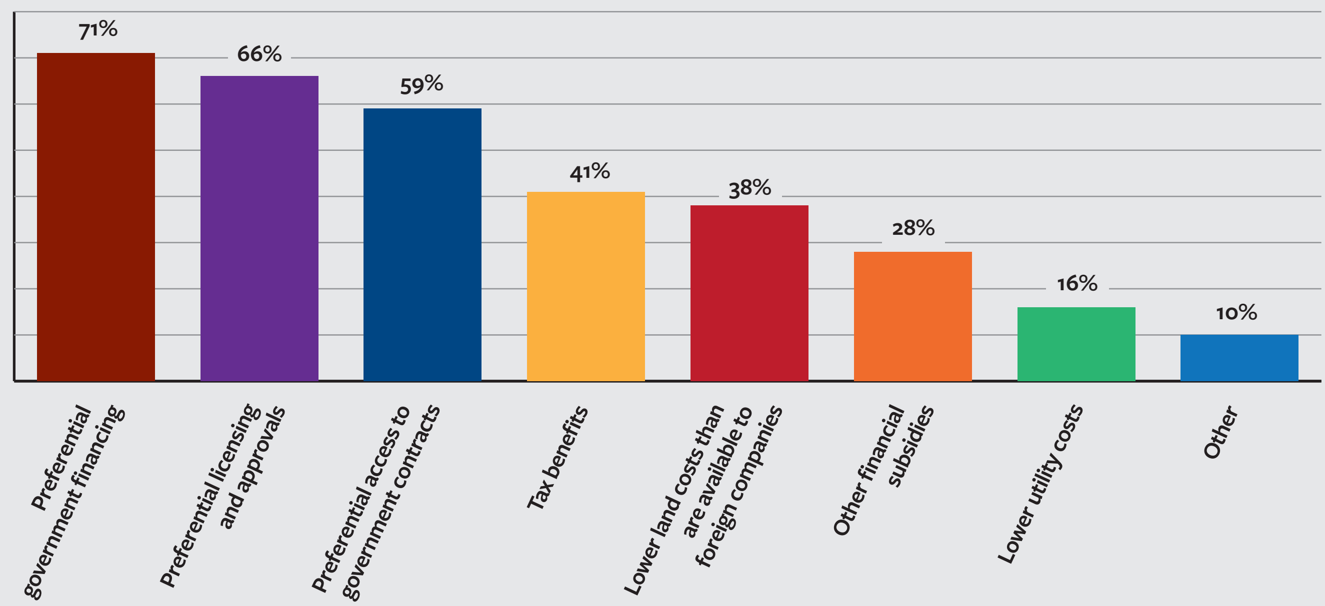
Are Non-SOE Chinese Competitors Receiving Same Benefits?



Most survey respondents believe that SOEs receive benefits unavailable to foreign-owned companies. Identifying what those benefits are and who is receiving them can be difficult, however. Only 26 percent of companies that compete with SOEs report that they have concrete knowledge that those competitors receive tangible benefits or subsidies that are unavailable to foreign companies. Another 45 percent suspect that benefits are being provided, but are not certain; and almost 30 percent of respondents said they simply do not know. Only 2 percent of companies said their SOE competitors were not receiving benefits unavailable to foreign firms.

In addition, most survey respondents believe that their non-SOE competitors also receive benefits that foreign-owned companies do not. Fourteen percent of companies report that they know that some of their non-SOE Chinese competitors are receiving similar benefits to SOEs, while 45 percent suspect that such assistance is being provided. Only 8 percent indicated that their non-SOE Chinese competitors do not receive the same benefits as SOEs. As a result, ensuring a level playing field for all enterprises in China may be a better approach than just focusing on SOEs.

Areas of Preferential Treatment for State-Owned Enterprises



To properly address the problems of unequal access to benefits and subsidies, it is vital to understand what those benefits are, so that appropriate policies can be crafted in response. As in USCBC's 2011 survey, companies identified three areas where Chinese government support of domestic companies appears to be the most prevalent: preferential government financing (71 percent), preferential licensing and approvals (66 percent), and preferential access to government contracts (59 percent).

Initiatives that focus on these three preferences – regardless of ownership – would yield the greatest impact for leveling the playing field for American companies.

USCBC 2012 China Business Environment Survey Results
Focus: Technology Transfer

Executive Summary

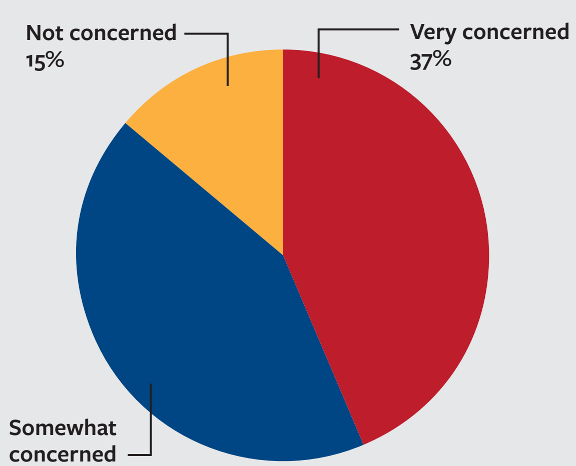
- US companies continue to express concern about technology transfer issues, whether they have been directly impacted or not. Eighty-five percent of companies report that they are at least somewhat concerned about transferring technology to China, with slightly greater concern among manufacturing members.
- Company views of technology transfer issues did not necessarily reflect whether they had been asked to transfer technology, as most respondents indicated they have not been asked to do so. However, 36 percent of respondents indicated they were asked in the past three years to make such a transfer as a requirement for gaining an investment, project, product, or market entry approval.
- Tech transfer requests included requirements to share technology with a joint-venture partner or other entity; product approvals or standards determinations that require disclosure of proprietary intellectual property rights (IPR); encryption rules that require companies to hand over source code; or other related transfer requests. These requests came from various entities, including central and local government entities, and companies, and were often a part of commercial negotiation strategy.
- In all instances, the results suggest that companies receive requests for technology transfer on a project-by-project basis, rather than as a uniform prerequisite for doing business in China and were often able to negotiate whether to transfer technology and the terms for doing so.
- Companies also noted that even when technology is transferred, it usually is not simply "given" to China, but is typically licensed to a Chinese entity in which the foreign company has an ownership stake. Reducing ownership restrictions on foreign companies in China would therefore also positively impact technology transfer concerns for many – but not all – American companies.

Over the course of several recent bilateral meetings, the United States and China have discussed the issue of requirements to technology transfer as a condition of gaining market access in China. China has reiterated its World Trade Organization (WTO) commitment that such transfers will not be used as a condition for market access. Despite this pledge, concerns about "forced" technology transfer continue to get attention in the United States.

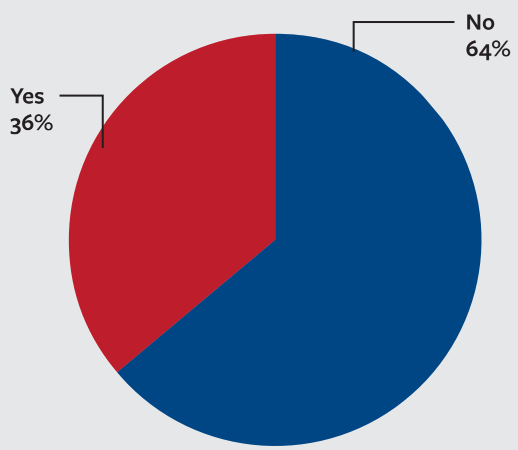
In order to better understand the issue, the 2012 US-China Business Council (USCBC) member survey asked companies about their experiences with requests for technology transfer – and the outcomes.

To begin with, whether impacted or not, companies do express concern about the issue. The majority of companies – 85 percent – report that they are at least somewhat concerned about transferring technology to China. Of those, 37 percent are very concerned and the remaining 48 percent are somewhat concerned. Only 15 percent of respondents indicated that they are not concerned about tech transfers,

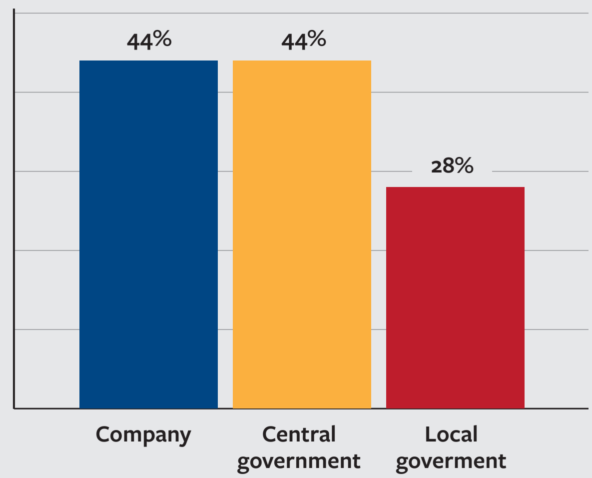
Company Concern About Transferring Technology to China



Has Your Company Been Asked to Transfer Technology Over Past 3 Years?



By Whom?



explaining that such arrangements are a part of normal international business practices.

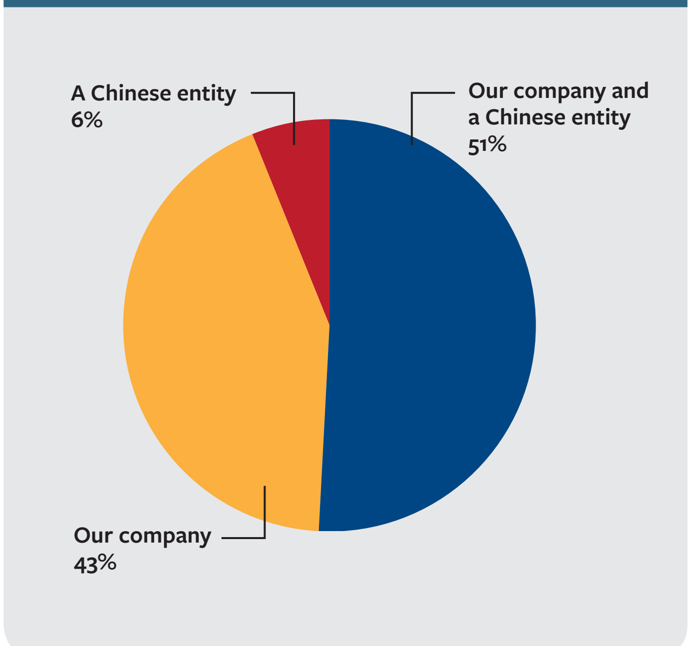
Of the companies that do have concerns, there is a small difference between manufacturing companies and others. Based on business sector of respondents, slightly more manufacturers (38 percent) reported they were very concerned about the issue, versus 35 percent of companies in other sectors; 50 percent of manufacturers were somewhat concerned, versus 43 percent of other types of companies.

Companies' views of technology transfer issues did not necessarily reflect whether they had been asked to transfer technology – most report that they have not. Thirty-six percent of respondents indicated they been asked in the past three years to make such a transfer as a requirement for gaining an investment, project, product, or market entry approval. Such requests included requirements to share technology with a joint-venture partner or other entity; product approvals or standards determinations that require disclosure of proprietary intellectual property rights (IPR); encryption rules that require companies to hand over source code; or other related transfer requests. The majority – 64 percent – reported that they had not received such a request. Those numbers held true for manufacturing companies: 61 percent of manufacturing companies participating in the survey indicated they had not been asked to transfer technology in the past three years.

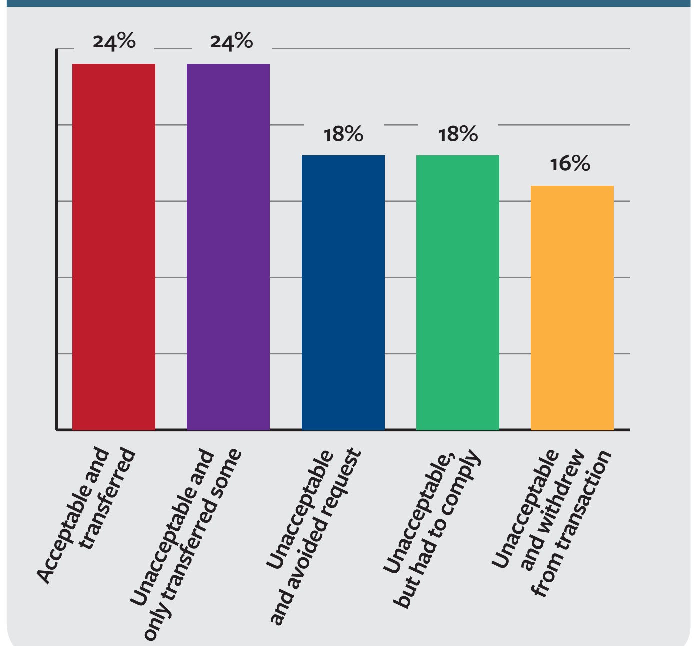
As noted in last year's survey, even when technology is transferred, it is not simply "given" to China. Instead, technology is typically licensed to the Chinese entity in which the foreign company has an ownership stake. In exchange, the company determines a value of the technology to be transferred and seeks to negotiate a payment –that is, the technology is rarely transferred for free without a commercial negotiation. In many cases, the foreign company owns 100 percent of the entity in China receiving the technology; in other cases, the foreign company must form a joint-venture with a Chinese partner. This is one reason the foreign ownership restrictions cited in USCBC's 2012 survey are of concern. Companies required to form a joint-venture to operate in China may have to share technology with their partner, whereas companies that can operate as a wholly-foreign owned enterprise retain ownership of their technology at their Chinese facilities.

In all instances, the 2012 survey results suggest that companies receive requests for technology transfer on a project-by-project basis, rather than as a uniform prerequisite for doing business in China.

Who Would Control the Technology in China After Transfer?



Company Response to Technology Transfer Request

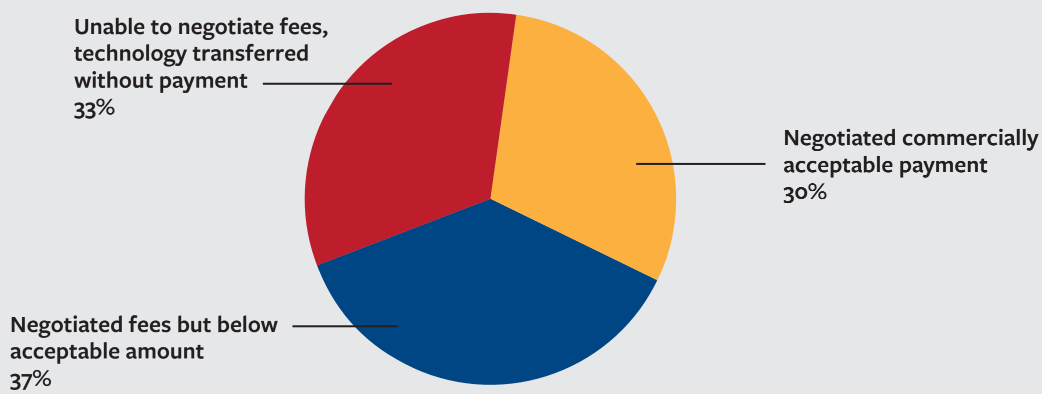


Of the 36 percent of companies who had been asked to transfer technology, the requests came from a variety of entities. Forty-four percent of companies were approached by either a central government entity or a company as a part of a commercial negotiation strategy. Twenty-eight percent were approached by a local Chinese government entity. Several companies were contacted by two or more different entities.

In this year's survey, 43 percent of companies asked to transfer technology said the technology would remain under their company's control after it was transferred into China. Just over half indicated that the technology would fall under the joint control of their company and a Chinese partner. Only 6 percent of respondents said the request would require them to transfer the technology entirely to a Chinese entity.

Companies had varied responses to the transfer requests. Only one-quarter of respondents said they viewed the requests as acceptable and proceeded to transfer the technology. The remainder found the request to be unacceptable. Of those, 15 percent simply withdrew from the proposed business transaction entirely as a consequence. Almost one-fifth of those asked to transfer technology reported that they were able to avoid complying with the request entirely. Twenty-four percent found the request unacceptable but were able to mitigate the terms somewhat and transferred only some of the requested technology. The remaining 18 percent found the requests to be unacceptable, but felt they had to comply in order to do business.

To What Extent was Your Company Able to Negotiate Licensing Fees for the Technology Transferred?



USCBC conversations with companies indicate that the ability to negotiate commercially viable terms for the licensing, use and protection of, and payment for the technology is a significant determinant of how companies view technology transfer. Companies who were asked to transfer technology in China are not experiencing the commercial terms that might be expected as a part of a normal international business transaction. Only 30 percent of companies reported that they were able to negotiate commercially acceptable payments for the technology that they transferred into China. The remaining 70 percent reported that they were either unable to negotiate licensing fees and had to transfer the technology at no charge (33 percent) or that they received a lower amount than they would otherwise consider commercially acceptable (37 percent).

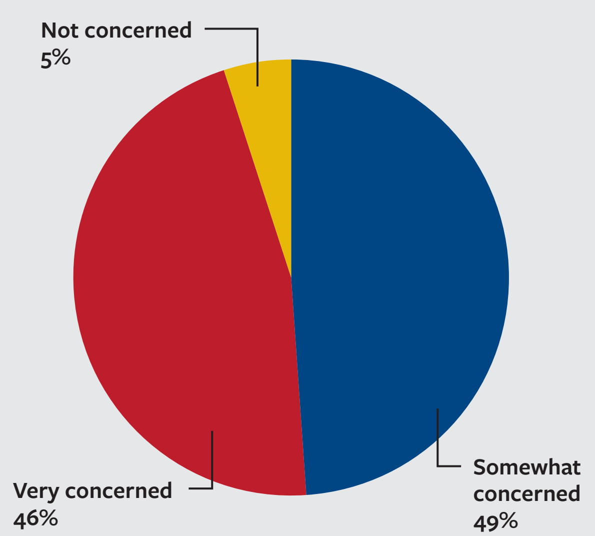
USCBC 2012 China Business Environment Survey Results
Focus: Intellectual Property Rights Protection

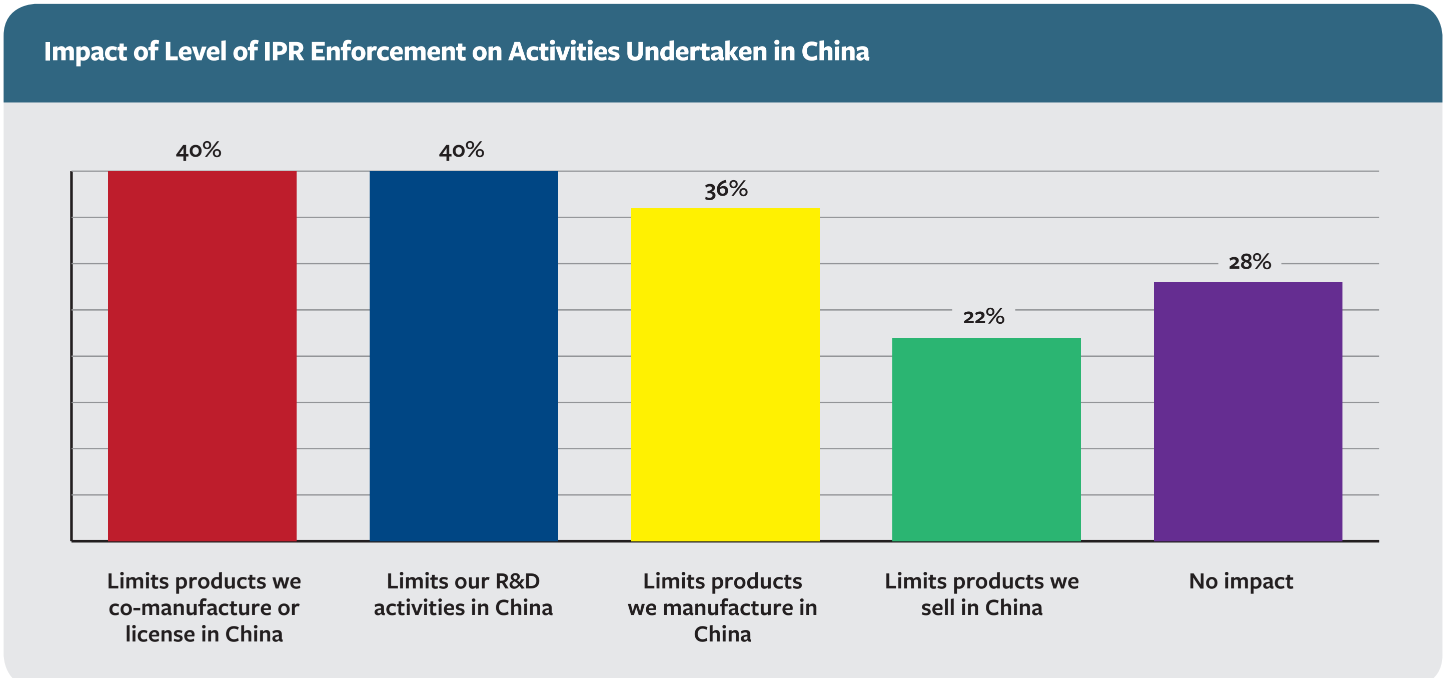
Executive Summary

- Intellectual property protection in China ranked fifth in this year's US-China Business Council survey, as companies continue to experience problems registering and enforcing their patent rights, protecting brands and trademarks, and fighting copyright piracy in China. Ninety-five percent of all companies surveyed this year indicated they were concerned about IPR enforcement.
- There is no "one size fits all" strategy for improving IPR protection, however, as concerns about IP differ across a broad range of sectors and IP types: trademarks, copyrights, patents, trade secrets, and other areas. In asking respondents for their top area of IP concern, trade secrets (36 percent) ranked first, followed by trademarks (29 percent), patents (26 percent), and copyrights (6 percent).
- Concerns about IPR infringement continue to an impact on company operations in China, constraining what US firms are willing to manufacture, research, sell, and license in China.
- Companies also continue to have mixed views about their ability to use China's existing administrative, civil, and judicial channels to address IPR infringement, with barriers created by criminal thresholds and low levels of administrative fines and civil damages.
- At the same time, companies note that China is making slow progress in protecting intellectual property rights, highlighted by a series of high-level Chinese government efforts to protect IPR. More than half of the companies surveyed (51 percent) indicated that IPR protection had improved at least somewhat over the last year.
- Company views of enforcement channels are also slowly improving. For example, 82 percent of companies in this year's survey indicated that the courts were an at least somewhat viable option for resolving IPR disputes to some degree, up from 29 percent in 2011. A growing number of companies report successful outcomes from court cases taken to enforce IPR.

US company concerns about intellectual property protection in China are not a new issue, but they remain an important one. The US-China Business Council (USCBC) member companies continue to experience problems registering and enforcing their patent rights, protecting brands and trademarks, and fighting piracy of copyrighted works in China. Indeed, the protection of intellectual property rights (IPR) ranked fifth among this year's top issues. It has ranked consistently in the top 10 issues each year that USCBC has conducted its survey. In fact, 95 percent of all companies surveyed this year indicated they were concerned about IPR enforcement, and approximately half of those firms indicated they were "very concerned."

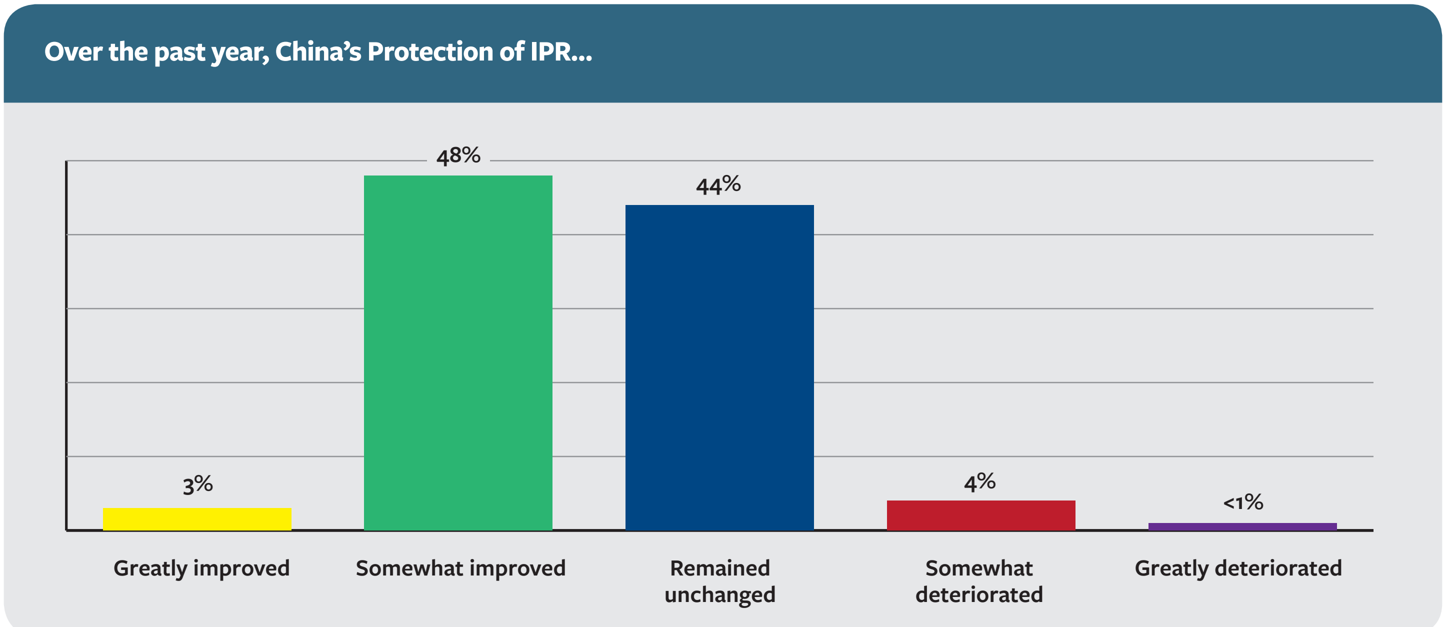
Level of Concern about IPR Enforcement



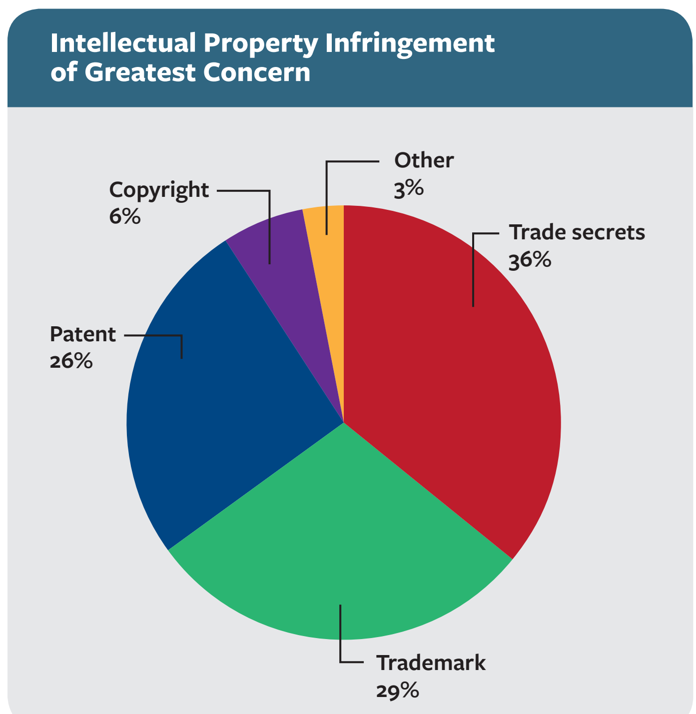


Concerns about counterfeiting, piracy, and other forms of IPR infringement have a broad impact on company operations in China, constraining what US firms are willing to manufacture, research, sell, and license in China. Forty percent of companies indicated that China's inadequate IPR protection limits the products they will license or the types of research and development (R&D) they are willing to carry out in China, while 36 percent of firms say that IPR concerns limit what they are willing to sell in China.

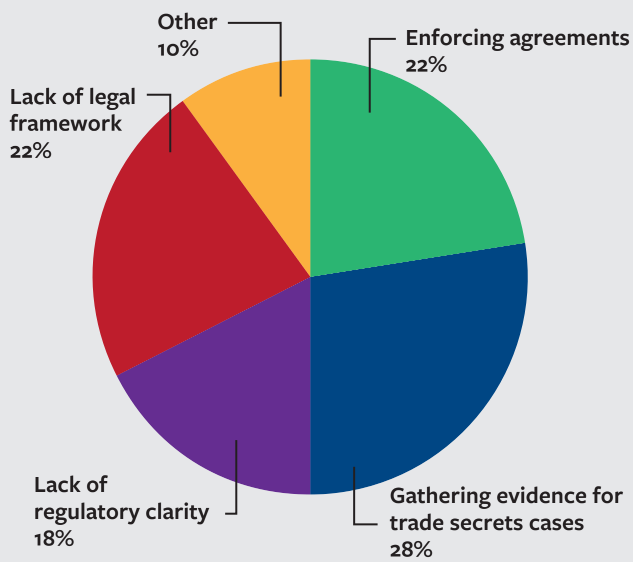
While companies report persistently high levels of concern about IP protection in China, companies also note that China has made some progress in protecting intellectual property rights in recent years, highlighted by three high-level Chinese government efforts to protect IPR, including the 2008 National IPR Strategy, 2010-2011 special campaign for IPR protection, and the November 2011 creation of a new central government leading group to promote IPR protection. More than half of the companies surveyed (51 percent) indicated that IPR protection had improved at least somewhat over the last year. In contrast, only 5 percent of companies reported that IPR protection had deteriorated.



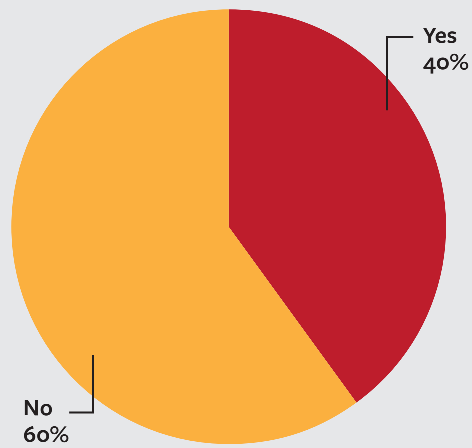
IPR protection, however, remains challenging because of its diversity, including not only a broad range of sectors but also a mix of IP types: trademarks, copyrights, patents, trade secrets, and other areas. There is no "one-size-fits-all" approach to tackling IPR protection. Each set of IPR issues involves different government agencies and different strategies. A review of the IPR areas of greatest concern illustrates this difficulty clearly. This year's member survey asked respondents to list their greatest IPR concerns, and the top choices listed were trade secrets (36 percent), trademarks (29 percent), patents (26 percent), and copyrights (6 percent). The advocacy approaches and solutions sought from PRC government agencies must be tailored to tackle each of these challenges, yet coordinated to provide leverage and to show progress across the board.



Aspect of Trade Secret Protection in China of Greatest Concern



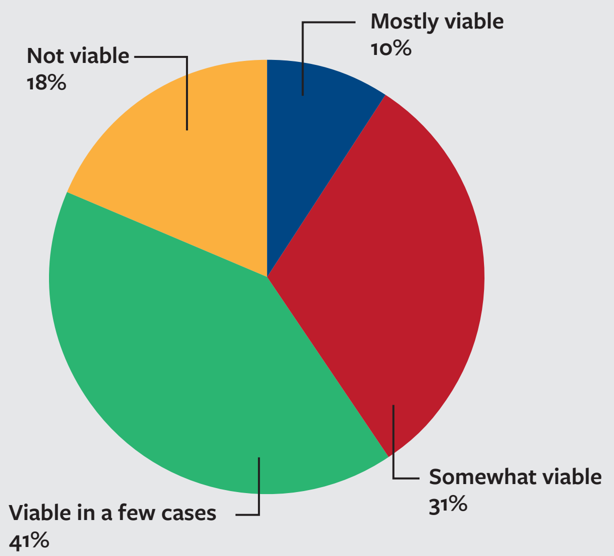
Is Online Intellectual Property Infringement a Problem for Your Company?



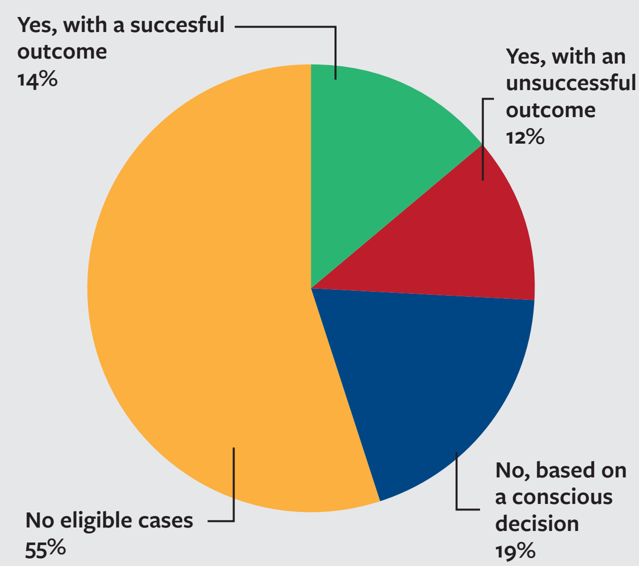
Trade secrets represent an emerging issue, rising to take the top spot this year. The challenges companies face in seeking to protect their trade secrets are complex, ranging from the difficulties in gathering evidence in trade secrets cases to difficulties in enforcing trade secret-related agreements, as well as the lack of a clear legal framework or regulatory process in China for handling trade secrets problems. Other emerging challenges relate to new vehicles of infringement, such as websites, file sharing services, and other online platforms. Although the majority of companies surveyed said that online IP infringement is not a concern for them, two-fifths of those surveyed indicated it was a concern, up from years past and reflecting the rising profile of this issue.

Companies also continue to have mixed views about their ability to use China's existing administrative, civil, and judicial channels to address IPR infringement. High thresholds for triggering criminal penalties continue to prevent companies from making better use of criminal penalties to battle counterfeiting and piracy. Administrative fines and penalties are low in comparison with the scope of the problem. Civil damages remain insufficient in many cases to compensate companies for infringement, and civil cases take considerable time and resources to pursue. While companies have seen improvements in using administrative and court channels in jurisdictions like Beijing, Shanghai, and Shenzhen, IPR enforcement outside of these locations is more mixed.

Are China's Courts a Viable Tool for Fighting IPR Infringement?



Has your Company Brought an IPR Case to China's Courts within Past Three Years?



At the same time, company views of some enforcement channels are improving. For example, 82 percent of companies in this year's survey indicated that the courts were a viable option for resolving IPR disputes to some degree, compared to the 18 percent who indicated they did not consider China's courts a viable option. The numbers of those saying they did not consider China's courts a viable option have fallen from 43 percent of respondents in 2010 and 29 in 2011, suggesting that US companies may be seeing slow improvement in China's official IPR judicial regime.

There are, in fact, tangible success stories to report. Companies indicated some success in using administrative and judicial tools to address counterfeiting and IPR infringement. Of the companies surveyed this year, just under half (44 percent) indicated that they had considered taking an IPR infringement case to court within the last three years. Of those that considered bringing a case, more than half (56 percent) indicated they had chosen to pursue cases in the courts. Fifty-eight percent of those firms who brought cases to trial reported a successful outcome.

USCBC 2012 China Business Environment Survey Results
Focus: Investing to Reach the China Market

Executive Summary

» Over 90 percent of survey respondents say they invest in China primarily to reach the China market, not establish an export platform. Most will expand investment in the coming year.

» Companies are looking to expand their operations to central and western China to tap new markets and take advantage of rapidly growing business opportunities, as well as to take advantage of lower costs. Over half of respondents report plans to relocate or establish new operations there in the future.

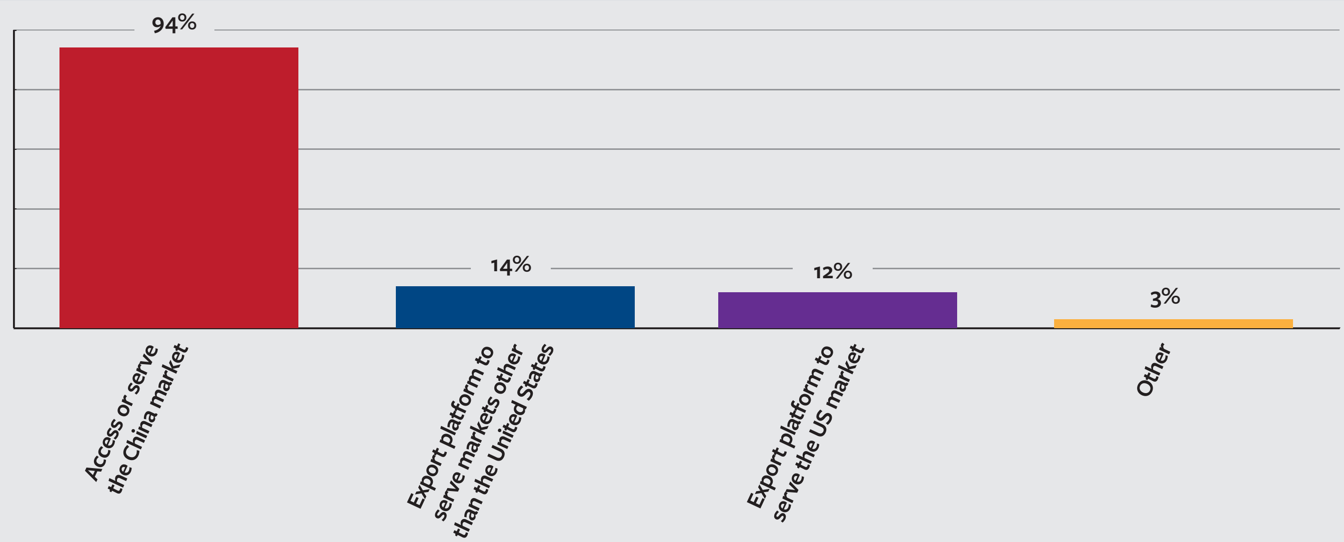
» Central government policy, coupled with increased economic development in those provinces, has made the central and western provinces increasingly attractive to foreign investors. Cities such as Wuhan, Chengdu, and Xi'an are attractive destinations for companies moving inland due to their emerging middle class and comparatively well-educated populations.

» Nevertheless, investing away from the developed coastal regions brings its own set of challenges, including a less qualified workforce and a less business-oriented mindset for local regulators with whom the company must interact on a daily basis.

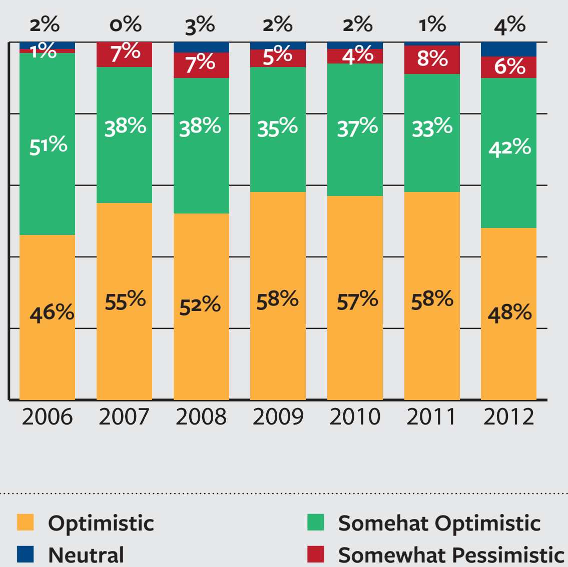
US companies continue to invest in China to reach the growing market there, according to respondents to the US-China Business Council's (USCBC) annual survey of its membership. Over 90 percent of respondents report that their objective for existing and future investments in China is to access and serve the China market, not to establish an export platform.

The survey respondents show a strong sense of general optimism about market growth. Ninety percent of respondents say they are optimistic or somewhat optimistic about business prospects over the next five years. Fueling this sentiment, in part, are successful business operations that have helped US companies increase their market share in China.

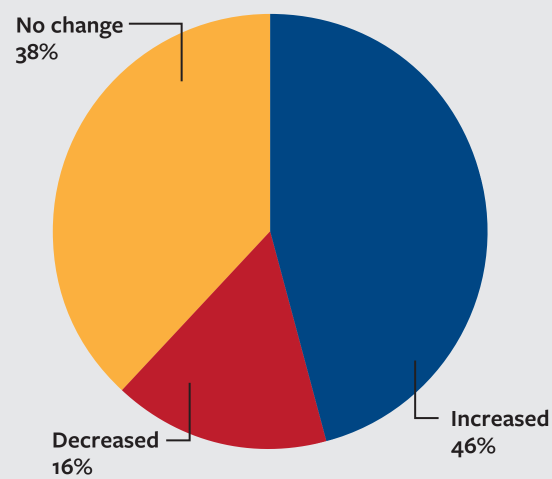
Objectives for Existing and Future Investments in China



Five Year Outlook for Business in China

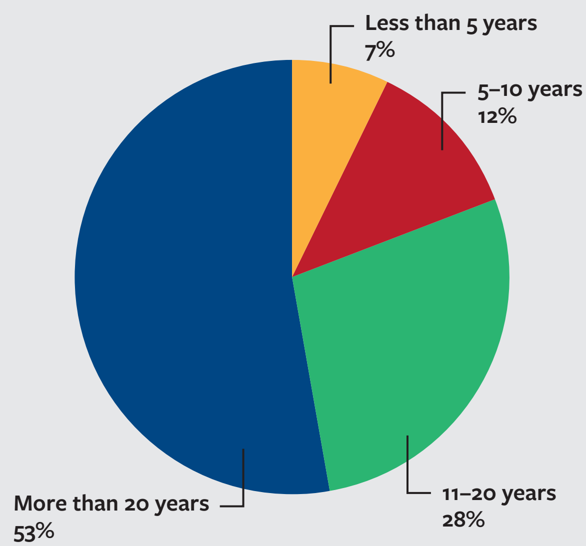


Did Market Share for Company Products or Services Change from the Previous Year?

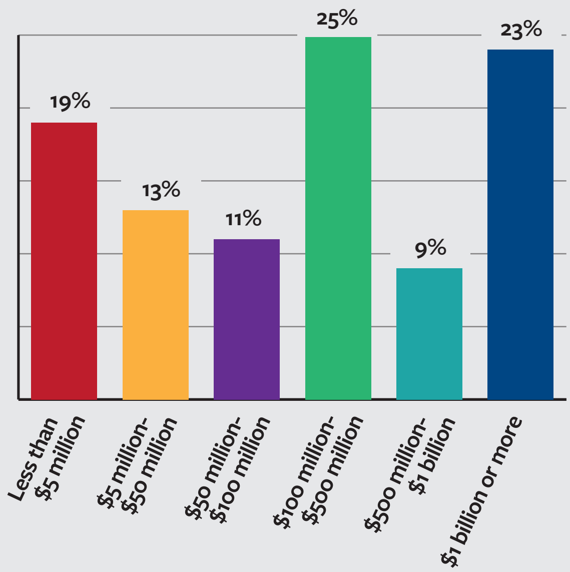


This success has not happened overnight, however. Companies have committed considerable time and money to create a business strategy over the long term. Over half of respondents have been active in China for more than 20 years, with nearly a quarter committing one billion dollars or more in China investments. In recognition of the market's strategic importance and China's comparative growth rate in the global economy, respondents are also projecting increases in resource commitments: over half of respondents plan to invest in a new production facility or business unit, expand an existing production line or business unit, introduce a new product or service to China, or expand the company's commercial sales footprint.

Years Doing Business with China



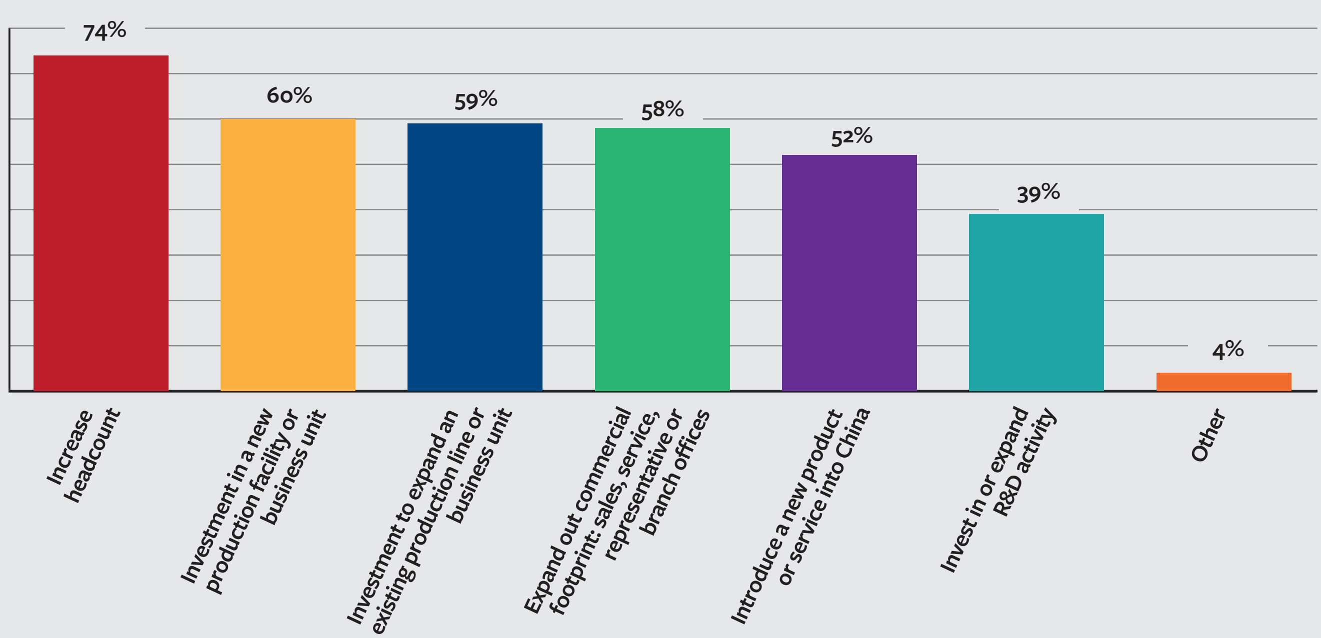
Total Direct Investment Committed to the China Market



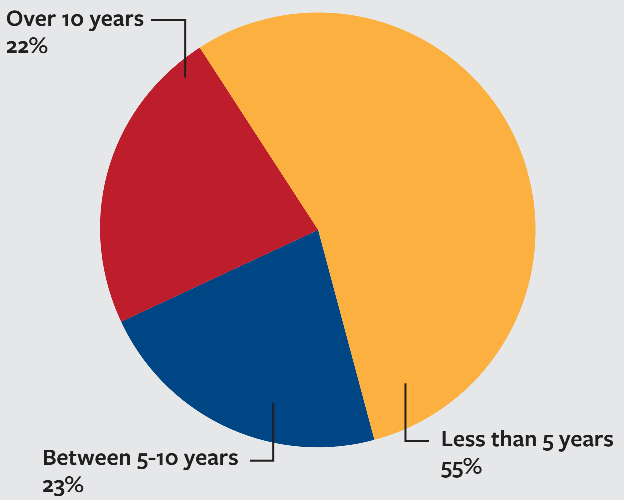
A relatively new focus for companies invested in China is the goal of accessing the county's central and western regions. Only a quarter of respondents have had operations in the central and western provinces for more than 10 years, with the majority of companies establishing a presence in these regions only in the past 5 years.

Central government policy, coupled with increased economic development in those provinces, has made the central and western provinces increasingly attractive to foreign investors. Over half of respondents report plans to relocate or establish new operations in the future. Cities such as Wuhan, Chengdu, and Xi'an are increasingly attractive destinations for companies moving inland due to their emerging middle class and comparatively well-educated populations. In addition, the central government's 12th Five-Year Plan for developing western China highlights industries such as railway, renewable energy, resource extraction, aerospace, and high-end equipment manufacturing as sectors in which investment will receive favorable treatment.

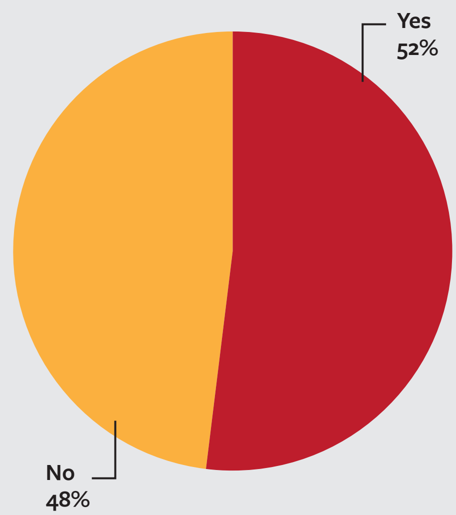
How Will Your Company Accelerate Investment in China Next Year?



How Long Have You Had Operations In Central or Western China?



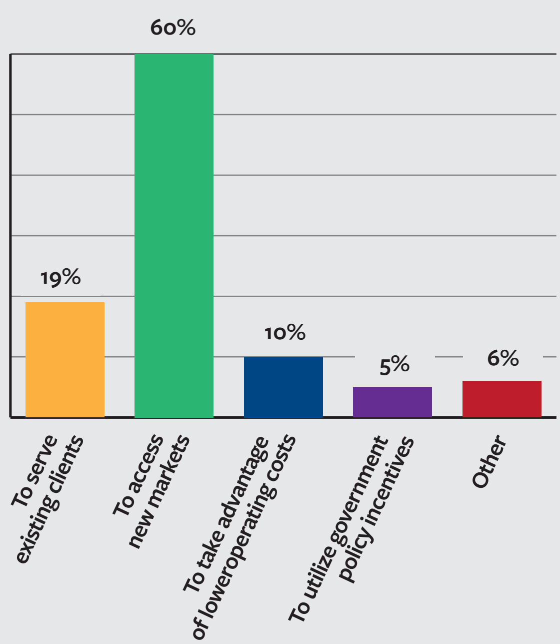
Plans to Relocate or Establish New Operations in Central or Western China in the Future?



What is the primary motivation for this expansion? Similar to why US companies began investing in China in the first place, companies are now heading west in order to tap new markets. While some operating costs are indeed lower in provinces away from the coast, this is not the overwhelming driver for westward expansion, however. US companies are looking at the inland cities as a fast-growing source of new business opportunities.

Nevertheless, investing away from the familiar and developed coastal regions brings its own set of challenges. Companies report that the workforce may be less qualified for some positions, especially if the immediate area lacks high-quality universities and technical schools. Of great importance, too, is the mindset of local regulators with whom the company must interact on a daily basis. Follow-up conversations with survey respondents indicate that local government officials in the central and western regions are roughly 10-15 years behind their coastal counterparts in terms of understanding international business practices and needs.

Primary Motivation for Moving or Expanding into China's Central or Western Regions



In the long term, companies that are committed to being "in China for China" will need to incorporate into their China strategy plans to manage and take advantage of growth and investment opportunities beyond the coast.

What is the Greatest Challenge Associated with Establishing Operations in Inland China?