2015 China Business Survey

Juan Antonio Fernandez | Bin Xu | Dongsheng Zhou | Maria J. Puyuelo | Junjun Li

2015 Swiss Business in China

Nicolas Musy | Zhen Xiao | Anthony DeOrsey | Aline Ballaman | Oliver Berger

CEIBS 中国深度 全球广度 CHINA DEPTH GLOBAL BREADTH

Integrated China

SWISS CENTER 瑞士中心 SHANGHAI 上海

2015 Swiss Business in China

A CEIBS – Swiss Center Shanghai Survey & China Integrated Analysis

Nicolas Musy | Zhen Xiao | Anthony DeOrsey | Aline Ballaman | Oliver Berger

TABLE OF CONTENTS

FOREWORD FROM THE SWISS AMBASSADOR IN CHINA

Switzerland and China enjoy strong, constructive and intensifying ties across a wide range of areas. Sino-Swiss exchanges date back centuries and were invigorated through Switzerland's recognition of the People's Republic of China in January 1950. We are now one of the first Western states to celebrate 65 years of bilateral relations with China.

Very much driving this relationship is the commercial acumen of our people. China has become the largest trade partner of Switzerland in Asia. The Sino-Swiss Free Trade Agreement is the first such arrangement between China and a top 20 economy. More exciting milestones lie ahead, ranging from our participation in the Asian Infrastructure Investment Bank as a founding member to the imminent creation of an offshore Renminbi market in Zurich.

From the early days of Schindler's first Sino-foreign joint venture in China to the present, Swiss companies have contributed greatly to our prosperous relations. They now employ over 200,000 people in China and are a standard-bearer for high quality and technology, precision, reliability and overall product excellence.

Recent somewhat tumultuous events and weaker activity data have reminded us of the dynamics underlying China's current stage of economic development. But let us take a step back from equity-price movements, macroeconomic output indicators and policy interventions and look at the larger picture. A bigger economy translates into more output than during the double-digit growth years, while an expanding middle class will lead to new sales prospects.

In fact, the report you are holding in your hands calls for continued optimism. Swiss companies mostly attribute their success in China to the quality of their products and services. Compared to companies from other countries, they are less concerned about their innovation capability, have higher sales expectations in China and penetrate the Chinese market in proportionally larger numbers. Moreover, around three-quarters of them reported that their Chinese operations were profitable at the end of 2014 and plan to increase investments against the backdrop of higher sales and steady profit expectations in 2015.

The Swiss Government will continue to attach great importance to the Sino-Swiss economic relationship, support its expansion and monitor the implementation of the Free Trade Agreement. By whatever measure you are looking at the Chinese business environment, I hope this report will serve as a helpful overview and enable a most profitable decision.

Jean-Jacques de Dardel
Ambassador of Switzerland to the People's Republic of China

THE RESEARCH TEAM

Nicolas Musy holds a MSc. in Physics Engineering from the Swiss Federal Institute of Technology, Lausanne (www.epfl.ch). He has won his university's first Special Alumni Award for demonstrating outstanding innovative and entrepreneurial spirit. He has also been the China Coordinator for EPFL since 2006.

Exclusively involved in China trade, investment, strategy and project management, he has resided in the Shanghai area since 1988. He co-founded the first Swiss industrial SME in China, Suzhou 2-ply Co. Ltd (www.2-ply.com) and is the co-owner of LX Precision (www.LXprecision.com).

Founding Partner of China Integrated (Shanghai) Co. ltd. (www.ch-ina.com), Nicolas has successfully supported a number of multinationals and over 300 mid-sized companies on market entry, operations management and restructuring in the past 20 years.

China Integrated is a solution provider dedicated to supporting international companies in successfully establishing and developing their businesses in China, whether their needs are market entry, growth or acquisition. Building on 20 years of experience and the skills of internationally trained Chinese professionals, China Integrated provides the expertise needed to ensure the long-term, superior success of foreign businesses in China. China Integrated's team is comprised of about 25 skilled entrepreneurs, strategists, managers, engineers and service professionals with complementary backgrounds in business research, Chinese law, recruitment, tax, finance, IT, ERP and PR.

China Integrated has successfully served about 300 International firms, large and small, with innovative solutions and cost-effective best practices developed through its decades of experience in Shanghai, Beijing, Hong Kong and Mongolia.

Based on company research and experience, China Integrated regularly publishes books and analyses to facilitate the decision making of managers at international companies doing business in China. In 2007, China Integrated conducted the first business survey of Swiss companies in China, "Behind the China Kaleidoscope", highlighting success factors of local Swiss companies and offering a comprehensive roadmap for those planning to do business and operate in China. This was followed in 2009 by an analysis of human resources practices, the "China HR Paradox", identified as the key challenge and success factor in the 2007 research. Then, in collaboration with CEIBS, "2010 Doing Business in China: A Survey of European Companies" was published, integrating both analysis and contributions from experts. The success of this publication led to yearly surveys and this 2015 Business in China Survey, which analyzes the business landscape for foreign companies in China.

You can find more information on www.ch-ina.com.

Zhen Xiao is the General Manager of Swiss Center Shanghai. Mr. Xiao obtained his engineering education from Nanyang Technological University, Singapore. He then worked in Singapore and in Switzerland for more than 13 years as an engineer, researcher, and manager. He has been working with the Swiss Federal Institute of Technology, Lausanne since 2005 as China Relation Coordinator. Over the past 5 years, he has supported and advised many Swiss companies in business development in China, and successfully expanded the Swiss Center cluster with the new facilities and services.

Founded in 2000, Swiss Center Shanghai (SCS) is a non-profit organization supporting Swiss companies in business set-up, expansion and operations in China. SCS not only offers instant workshop, showroom, warehouse, and office space, but also supports its members with government relations and a comprehensive network of experts. Together with its service partners, SCS has served more than 250 companies in China – SMEs and large enterprises alike. SCS is by far the largest cluster of Swiss companies in Asia, with 30 Swiss companies in one industrial park (SHXIP) accounting for over 50’000 sqm of industrial space.

Since 2014 Swiss Center has operated the Machinery, Trading and Business Center in the China (Shanghai) Pilot Free Trade Zone where 4000 sqm is dedicated to Swiss businesses.

Anthony DeOrsey is PR and marketing manager at China Integrated (Shanghai) Co. ltd. (www.ch-ina.com). Anthony has spent 5 years in China and specializes in marketing, PR, and branding, with ground-level experience in China-based start-ups. A key player in the beginning stages of two startups in Shanghai, Anthony was most recently as the head of marketing and PR for one of China’s first sustainable daily use brands. In 2010, Anthony graduated with a Bachelor of Arts in Political Science and Communications Studies from the University of Rhode Island and is currently pursuing a part-time Master’s Degree in Sustainability through the Harvard distance education program.

Aline Ballaman is the Deputy General Manager of the Swiss Center Shanghai. Aline holds a Bachelor’s degree in Business and Administration from La Chaux-de-Fonds. After 8-years of management experience in the tourism and watch industries in Switzerland, she came to China in 2011 and enrolled in a 1-year Chinese language program at Suzhou University before joining the Swiss Center Shanghai in 2012 as Operation Manager. For the past three years, she has been responsible for the Shanghai Office in advising and supporting Swiss businesses entering the Chinese market. In early 2014, she successfully managed a new 4000 sqm facilities project dedicated to Swiss businesses complete with a showroom, offices, and a warehouse in the China (Shanghai) Pilot Free Trade Zone.

Oliver Berger is a Swiss Citizen studying Economics at University of Basel, Switzerland.
In 2015, he joined Swiss Center Shanghai, China as a Project Assistant for a period of three months where he actively contributed to the Business Survey 2015.

PREFACE & KEY TAKEAWAY

In cooperation with the China Europe International Business School (CEIBS) (http://www.ceibs.edu/), the Swiss Center Shanghai (http://www.swisscenters.org/), swissnex China (http://www.swissnexchina.org/en/), SwissCham (http://cn.swisscham.org/) and China Integrated are pleased to bring you the findings of Swiss respondents who participated in the CEIBS Business in China Survey 2015. In analyzing these responses, we hope to draw conclusions that will be useful for Swiss companies and their activities in China.

This latest CEIBS survey is of particular interest not only for its findings but also because:

- With 780 responses, this survey gathers the largest amount of respondents in one such yearly survey (by comparison, 541 companies participated in the 2015 EU Chamber survey and 377 in the 2015 American Chamber in Shanghai survey).

- It is the only survey that collects responses from both Chinese and foreign companies in China. Furthermore, this year's edition contains a rare analysis of international and Chinese SMEs.

- This survey allows comparisons among firms of different national origins, based on a sufficient number of replies for each origin.

This is the only business survey that is able to compare a sizeable sub-sample of foreign and Chinese SMEs in China. Though just around 40 foreign (Swiss, EU, US) companies employing 300 employees or less globally (classified as SMEs) answered the survey, this sample and a sample of 150 Chinese SMEs show that SMEs are generally more successful in China than larger firms and explores the probable reasons for this success.

For the Swiss business community, it is for the third time possible to understand how similarly Swiss, European and American companies perceive their China environment.

As a result, some findings on European and American companies can also be used to estimate and confirm Swiss companies' trends. Globally speaking, Swiss, European, and American companies in China are doing well. On average, Swiss and EU companies have experienced an increase in profits, and American companies saw only a slight downturn in 2014.
The confidence level of Swiss companies in 2015 continues its upward trend that began in 2012.

65% of Swiss, EU, and US companies stated an intention to increase investments in China in 2015. All foreign companies are united in expecting better sales and profitability.

Challenges are growing as well. Increasing competition from Chinese companies is again the most important external challenge. For the second year in a row, competition from private Chinese companies is perceived to be more important than from other foreign companies, regardless of specific nationality. R&D has increased as a priority for Chinese businesses; an initiative that one can see reflected in the shift toward quality from Chinese SMEs and continued strength of Chinese companies as competitors in general.

In terms of internal challenges, as always, attracting top talent tops the list of foreign companies' and Chinese SMEs' managers, however, **larger Chinese companies see innovation as their biggest challenge**.

Managers who are facing the market in China see different challenges than managers in the headquarters. Like last year, lack of understanding and support from the head office is a top management challenge. This illustrates the continuing perception gap between head offices and their subsidiaries operating in China.

In addition to the common misperception reported in the media that Swiss and foreign companies lack success in China because of slowing growth, we find a general overestimation of the impacts that corruption and IP infringements have on companies in China. In fact, corruption and IP infringements ranked in the bottom third of reported external challenges by respondent companies.

In addition to an analysis of key answers from Swiss companies in China, an analysis of China's cost of production, which has been in decline since 2011 despite rising wages, is included. This analysis highlights the paradoxical situation that manufacturers experience in China and the opportunities for businesses moving forward.

Hopefully, this survey will dispel certain misperceptions and highlight the actual situation that Swiss and international businesses face in China. Additionally, we hope that these facts, analyses and the benchmarks that they provide will help Swiss companies to become even more successful in the coming years.

We also want to express our sincere gratitude to all the respondents: thanks to them, a representative and objective point of view on Sino-Swiss business is available to all. At the same time, we would like to take the chance to encourage everyone to participate in the 2016 survey, so that we can further expand the knowledge pool available and continue to do successful business in China.

The first part of this report emphasizes Swiss companies, while the overall results of the CEIBS survey and analysis of foreign and Chinese companies are presented in the second part of the report.

1 FOREIGN COMPANIES, AND SMES IN PARTICULAR, CONTINUE FINDING BETTER SUCCESS IN CHINA

Approximately 15% of foreign respondents can be classified as small and medium enterprises (SMEs), defined as companies with less than 300 employees globally, close to 50% are large companies with over 10'000 employees worldwide. SMEs are even more prevalent among Chinese companies sampled, with 37% qualifying as SMEs in contrast to 23% with over 10'000 employees.
(A significant proportion of Chinese companies sampled did not have operations abroad, as a result, Chinese SMES have been defined according to the number of their employees in China.)

Of the foreign companies sampled, **Swiss companies present the largest proportion of SMEs, totaling nearly 24% of Swiss respondents**. By comparison, other western SMEs are much less represented with only 15% of European and 8% of American companies employing less than 300 employees.

It cannot be fully confirmed that the firms who responded to the survey represent the full scope of all Swiss, European and American businesses. (Small Swiss companies could have responded in a higher proportion than EU and US companies, therefore presenting a biased picture of a larger proportion of Swiss SMEs.)

Yet, these results are consistent with the tendency of Swiss SMEs, due to the small size of their domestic market, to be more adapted and geared towards internationalization than other SMEs.

Taken together, the sample of around 40 foreign SMEs that answered the survey is of a similar size as the samples in 2013 and 2014. This sample is still small, but it allows for comparisons with larger foreign companies. Considering that the proportion of the 2015 SME respondents from different countries and other 2015 findings are generally consistent with those of 2014 and 2013, we can be confident in the relevance of the data despite small samples.

This is the first time, as far as we know, that comparisons have been made between foreign invested and Chinese SMEs within the same survey. Indeed, this year's survey includes a respectable total of 150 Chinese SMEs (37% of all Chinese respondents). What's more, Chinese respondents boasted the highest level of respondents by positions in their companies (53% CEO, GM, or owner and 32% VP, director, vice GM), offering an unique insight on the situation that managers of Chinese SMEs are facing.

FIGURE 1 – HOW MANY EMPLOYEES GLOBALLY?

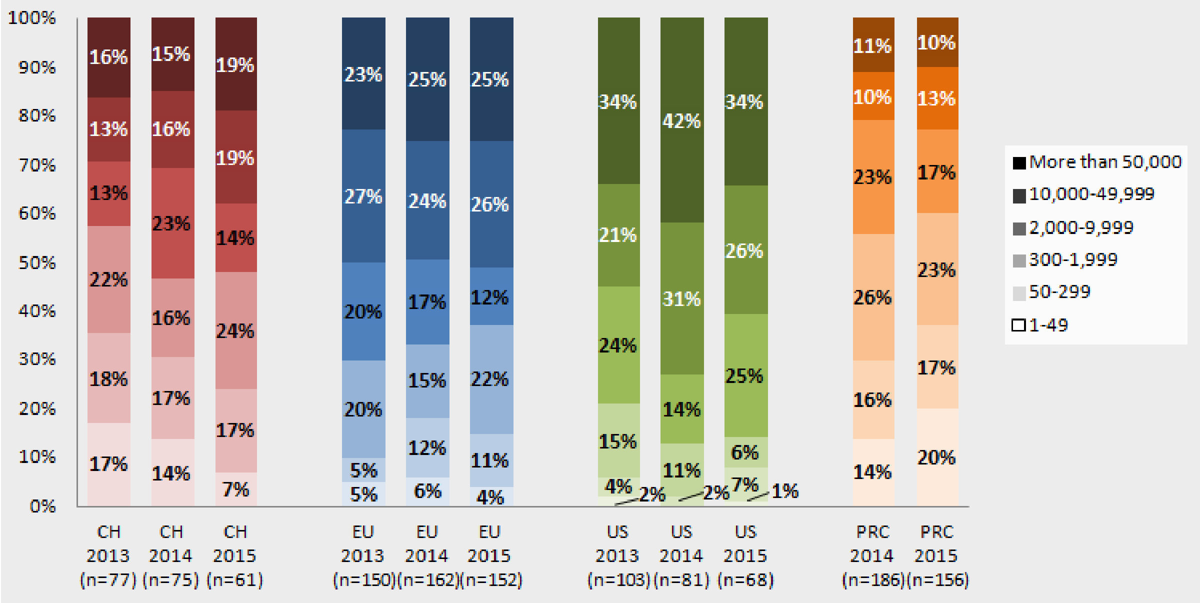
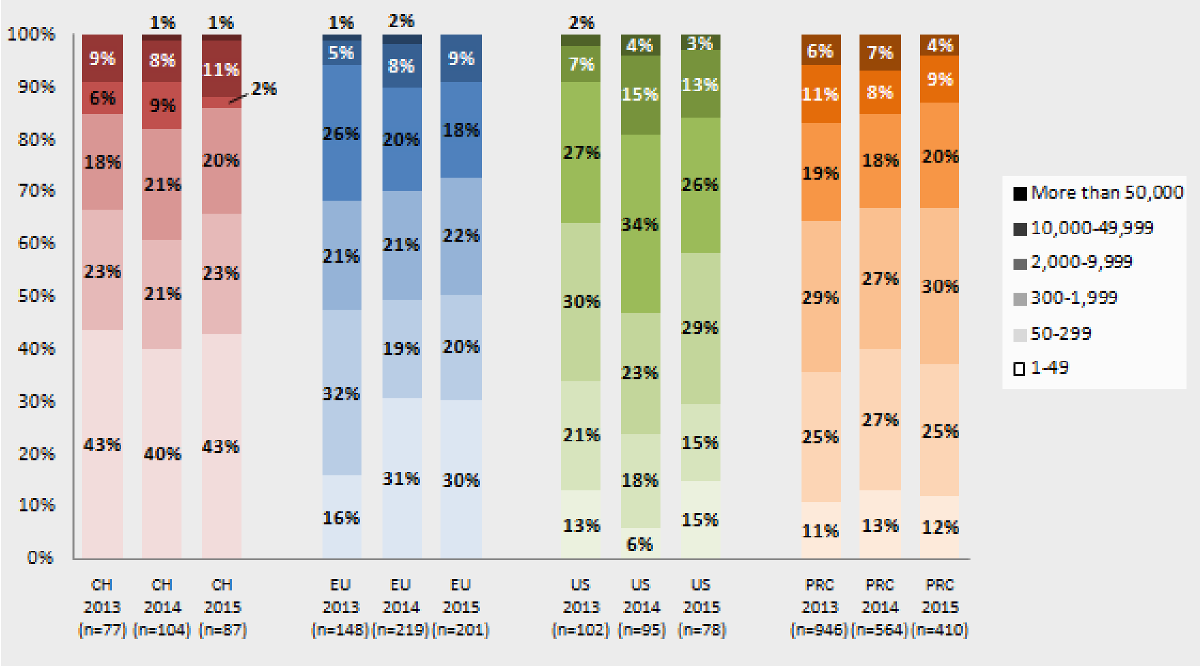


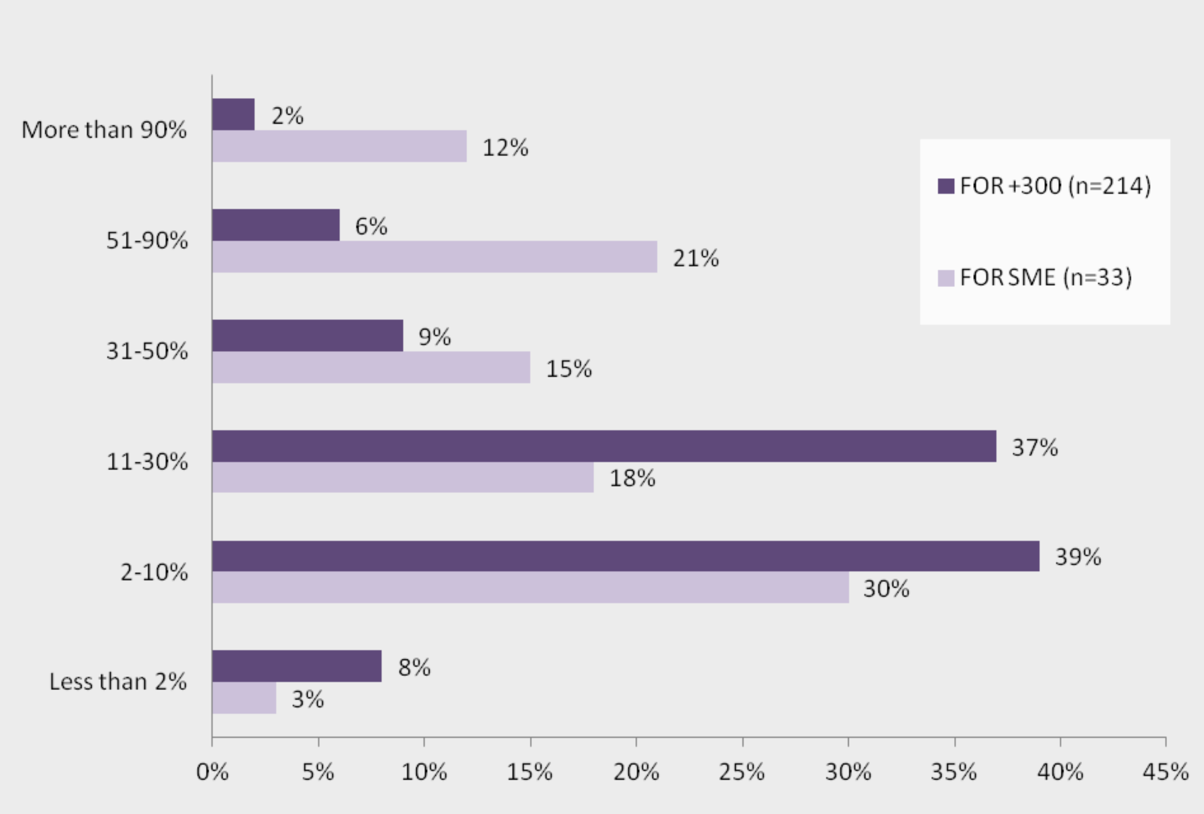
FIGURE 2 – HOW MANY EMPLOYEES DOES YOUR COMPANY HAVE IN CHINA?



1.1 China continues to evolve into a venue for SME success

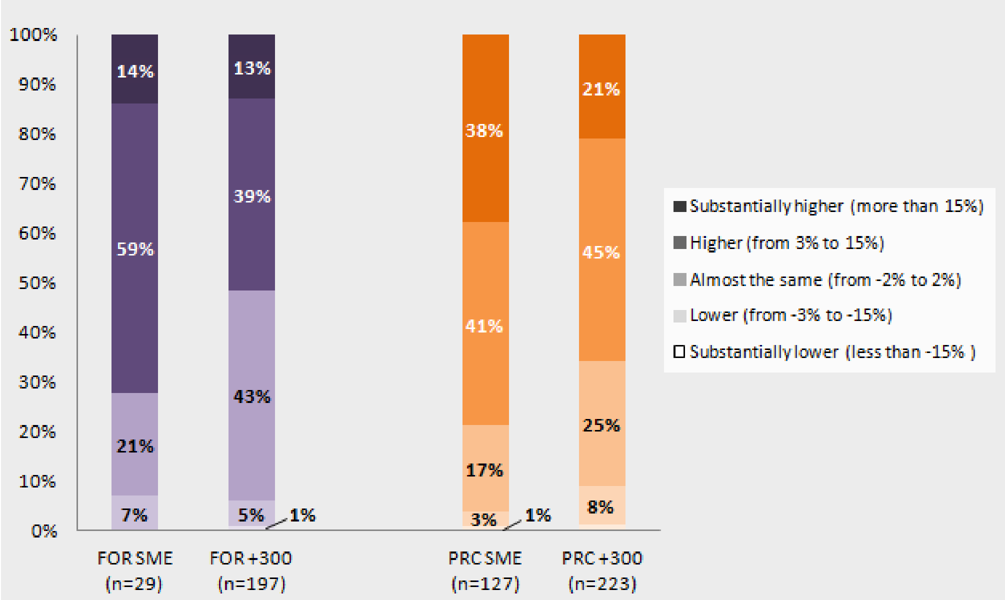
Foreign SMEs in China are seeing higher percentages of their global sales generated in China. Only 8% of large foreign firms expect more than half of their sales to be generated in China, whereas 33% of SMEs expect 51% or more of their sales to be generated in China.

FIGURE 3 – WHAT PERCENTAGE OF YOUR COMPANY'S EXPECTED GLOBAL SALES IN 2014 WERE GENERATED IN CHINA? FOREIGN COMPANIES



While all companies see their sales and profits improving on average in 2015, respondents from **foreign and Chinese SMEs see both sales and profits increasing significantly faster than their counterparts in larger firms.** 73% of foreign SMEs are expecting higher 2015 profits in China versus 52% of the larger foreign firms. Though less pronounced, the trend on the Chinese side is the same with 79% of SMEs expecting better profits against 66% for larger firms.

FIGURE 4 - HOW DO YOU EXPECT YOUR COMPANY'S CHINA PROFIT FOR 2015 COMPARED TO 2014? SME VS LARGER FIRMS

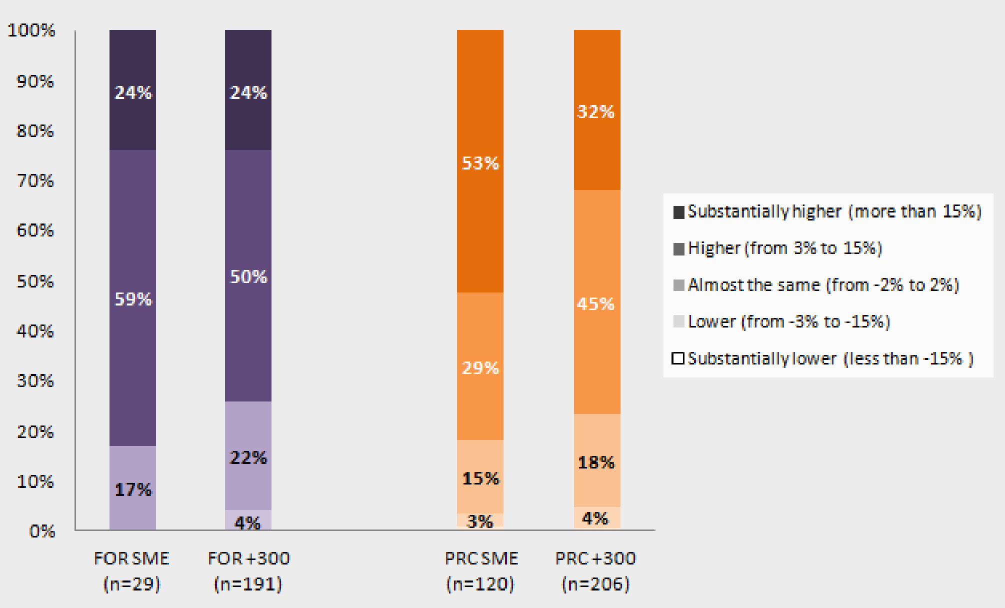


In terms of sales growth, the picture is also uneven: **more SMEs are looking forward to higher sales than larger firms**, and no foreign SMEs expect decreases in sales, while just 3% of Chinese companies do expect decreases in sales.

There are similarities in terms of sales for foreign and Chinese SMEs: 83% of foreign SMEs expect sales increases versus 82% of their Chinese counterparts. Large companies' sales expectations are nearly as close, with 74% of foreign companies and 77% of Chinese companies expecting sales growth.

However, one needs to note that Chinese firms, both large and small have a larger proportion of rapidly growing companies and companies expecting fast profit growth (the "substantially higher" portion of the columns for Chinese firms are always bigger than for foreign companies).

FIGURE 5 – HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES FOR 2015 COMPARED TO 2014? SME VS LARGER FIRMS

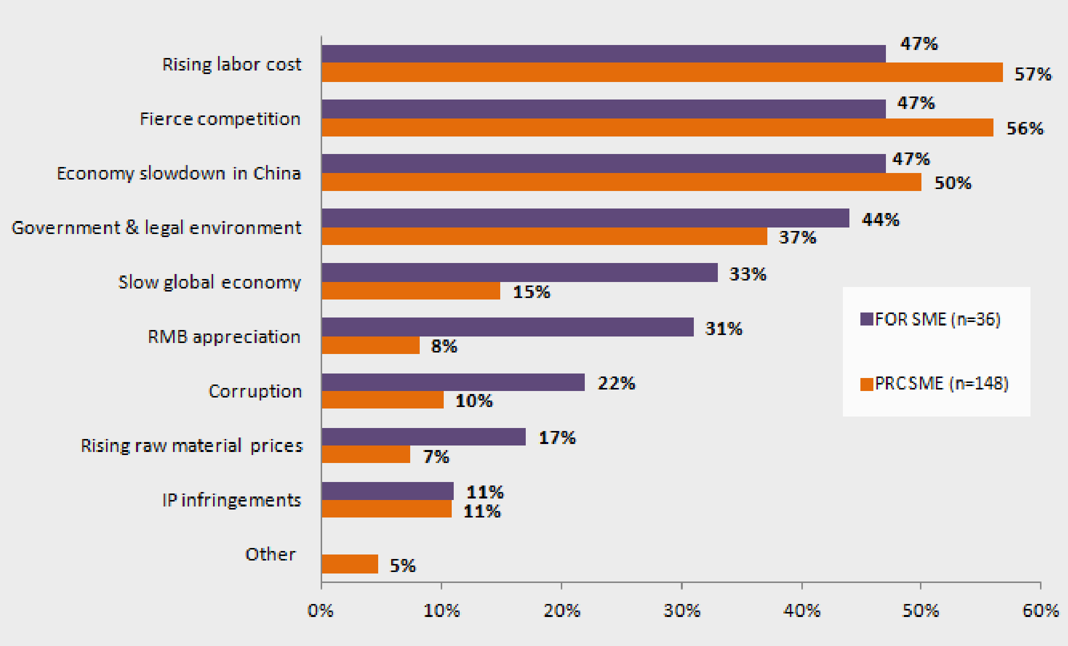


1.2 Fewer challenges for SMEs

When examining how SMEs and larger companies perceive challenges, few critical differences can be noticed with one exception: Chinese SMEs do suffer more than their foreign counterparts from rising labor costs and competition, indicating that they have lower margins or are less organized in improving their productivity. Improving productivity is a new imperative due to rising minimum wages and lower production prices (see appended analysis).

It is also worth noting that Chinese SMEs appear to feel much less of an impact from the global economic slowdown, indicating more local orientation of activities by Chinese SMEs.

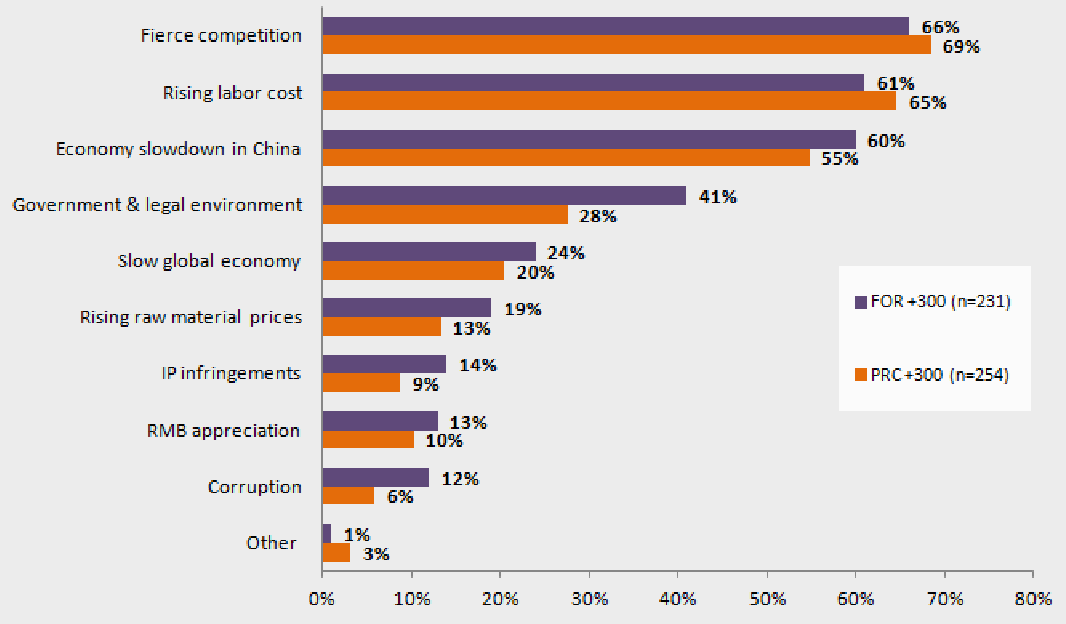
FIGURE 6 – WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? SME (MULTIPLE ANSWERS)



One may note additionally that foreign SMEs perceive the top 3 challenges with less intensity than the larger foreign firms (47% versus 60-66%). This also confirms that SMEs are conducting business with more ease. A seemingly lower level of competition and challenges for SMEs than larger firms could be due to SMEs' very nature of doing business: focusing on niches. Indeed, China's mass market is very attractive, but therefore also terribly competitive, niches, however, are less crowded.

This is generally confirmed by the competition picture (pg 14): there are not fundamental differences between SMEs and larger firms with the exception that more SMEs have few to no major competitors, which is typical of niche businesses.

FIGURE 7 – WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? LARGER FIRMS (MULTIPLE ANSWERS)



A pronounced difference is found between foreign and Chinese companies with regards to competition from state-owned enterprises (SOEs), with Chinese companies of all sizes viewing SOEs as competitors markedly more than foreign companies do. This may be attributable to restrictions in certain industries that prevent foreign companies from operating in some of the areas where state-owned companies are active. The fact that the Chinese SMEs in this survey are particularly local may also explain the severe competition that they feel from SOEs, which are also mostly concentrated on local activities.

FIGURE 8 – WHO ARE YOUR MAJOR COMPETITORS IN CHINA? SME (MULTIPLE ANSWERS)

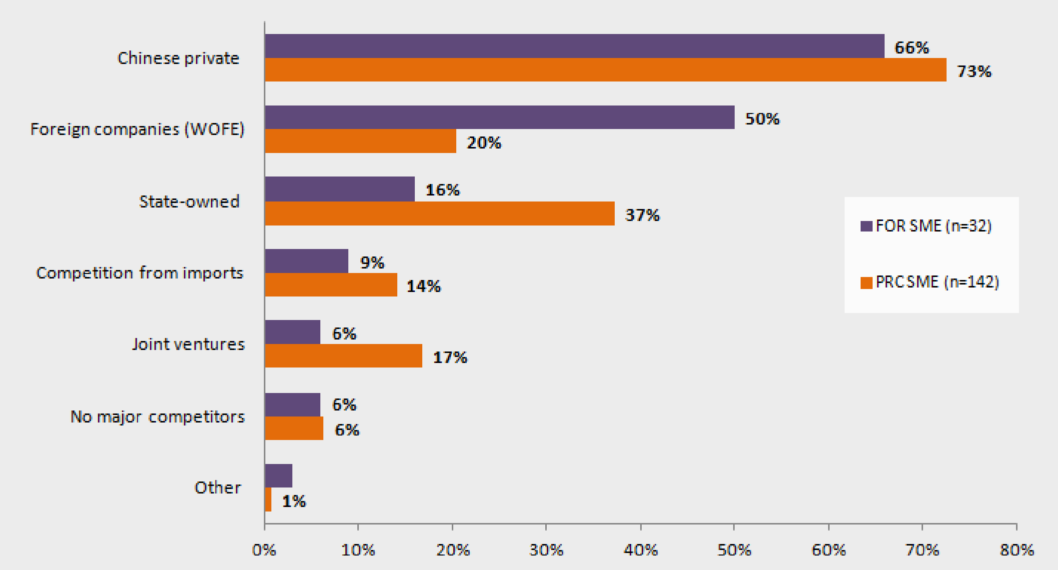
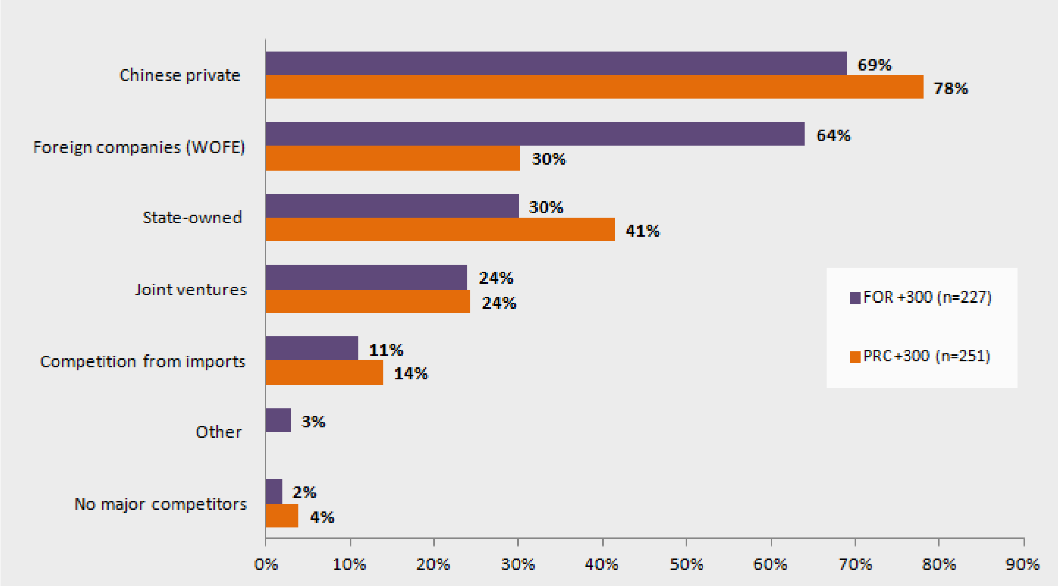


FIGURE 9 – WHO ARE YOUR MAJOR COMPETITORS IN CHINA? LARGER FIRMS (MULTIPLE ANSWERS)



This year again, Chinese private companies are regarded as the most imposing competitors, while Wholly Owned Foreign Enterprises (WOFEs) are seen by other foreign companies as a very close second largest source of competition.

Internal challenges do not differ greatly between SMEs and larger companies, differences are seen more so in the magnitude with which these challenges are felt and gaps between advantages specific to either foreign or Chinese businesses. “Support from the head office” is of greater concern to large foreign firms than SMEs, suggesting that foreign SME management in China is more nimble and adaptable to local trends. “Corporate governance” and “employees’ unethical behavior” rank higher for SMEs of foreign and Chinese origin, potentially related to a lag in reaction time by smaller companies to the recent anticorruption campaign (see more about how corruption is perceived in section 3.1).

“Innovation capability” is an issue especially present for Chinese companies. **Innovation capability is actually the top challenge for large Chinese companies**, whereas Chinese SMEs are struggling in this area less than larger enterprises are. However, “finding and retaining talent” is listed by Chinese SMEs as the top challenge by far.

FIGURE 10 – WHAT ARE THE GREATEST INTERNAL CHALLENGES FOR YOUR COMPANY? SME (MULTIPLE ANSWERS)

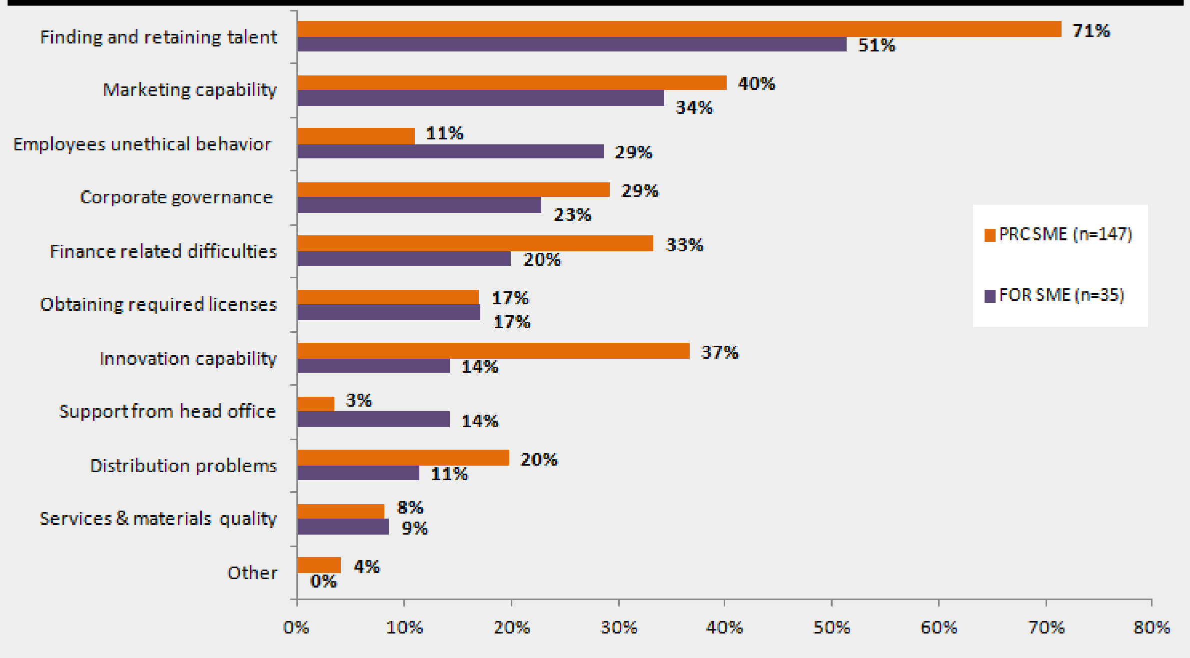
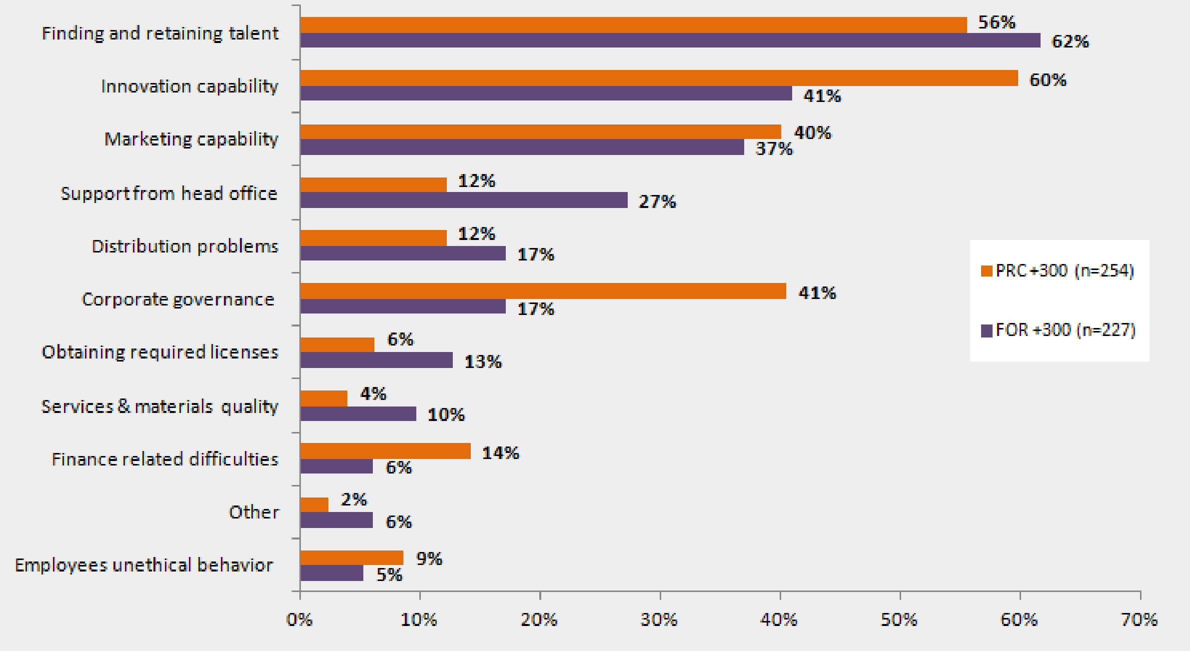


FIGURE 11 – WHAT ARE THE GREATEST INTERNAL CHALLENGES FOR YOUR COMPANY? LARGER FIRMS (MULTIPLE ANSWERS)



Section 4 of this survey offers a more in-depth analysis of internal challenges for companies of all sizes.

In terms of success factors, foreign companies clearly compete on quality, whereas Chinese companies use a combination of high price-quality ratio and service. However, Chinese companies still place a heavy emphasis on R&D.

FIGURE 12 – PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR YOUR SALES IN CHINA: SME (MULTIPLE ANSWERS)

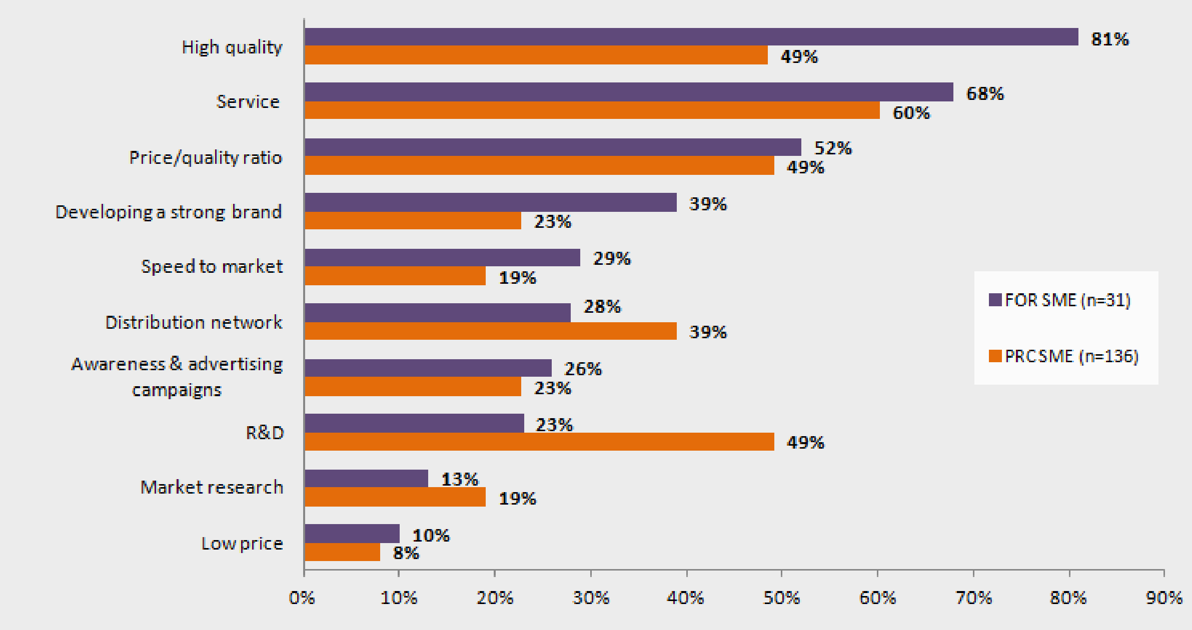
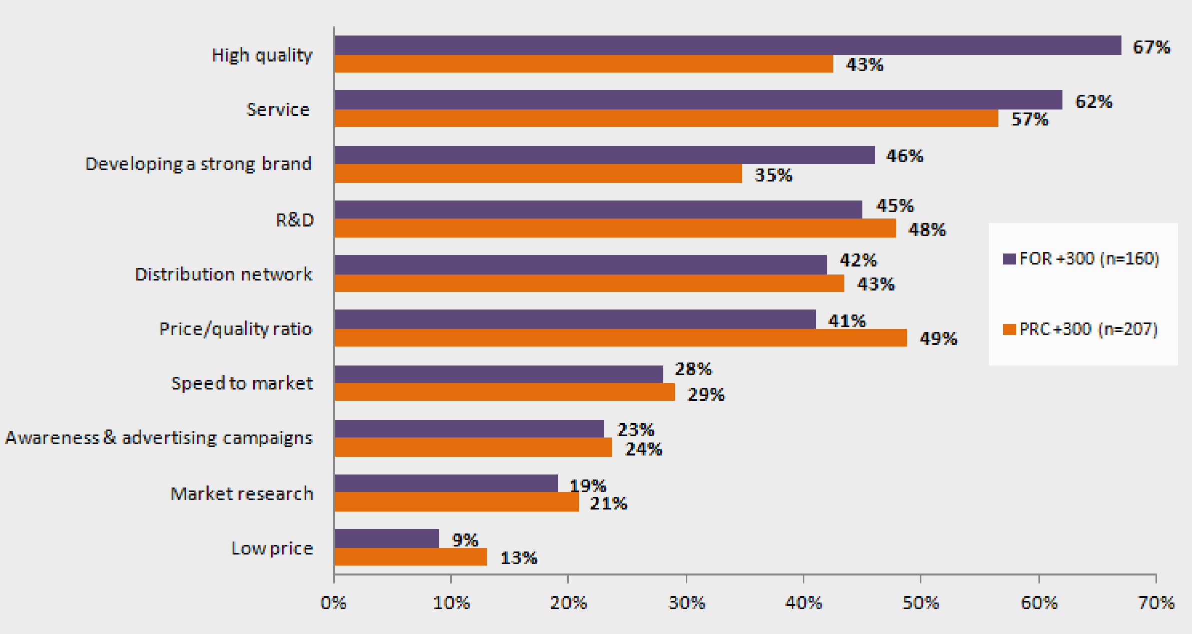


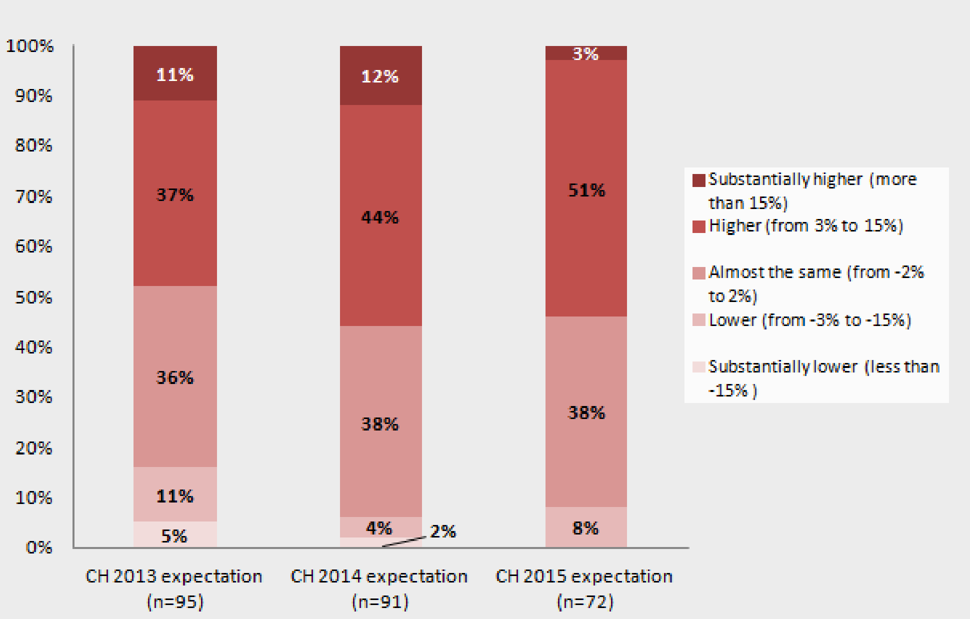
FIGURE 13 – PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR YOUR SALES IN CHINA: LARGER FIRMS (MULTIPLE ANSWERS)



2 STABLE CONFIDENCE CLIMATE: INCREASING REVENUES, PROFITS AND INVESTMENTS ACROSS THE BOARD

The majority of Swiss companies are still expecting higher profits in 2015. The outlook for Swiss companies is optimistic in 2015, as the coming data will demonstrate.

FIGURE 14 – HOW DO YOU EXPECT YOUR COMPANY'S CHINA PROFIT? CH COMPANIES



Sales growth is comparable to previous years: on average, companies of all origins surveyed expect a stronger increase in sales in 2015 compared to 2014.

This result may appear extraordinary in light of the many media reports commenting on China's decelerating growth and the occasional catastrophic predictions (recently those related to the stock market crash). However, it is important to remember that decelerating growth on a larger GDP base results in the addition of more GDP than previous years. Indeed, what has been dubbed by the current administration as the "new normal" of single-digit growth generates a consistent increase in sales and profit from all companies, both foreign and Chinese. This also explains that most businesses remain confident in the business opportunities that China offers.

FIGURE 15 – HOW DO YOU EXPECT YOUR COMPANY'S CHINA SALES FOR 2015 COMPARED TO 2014?

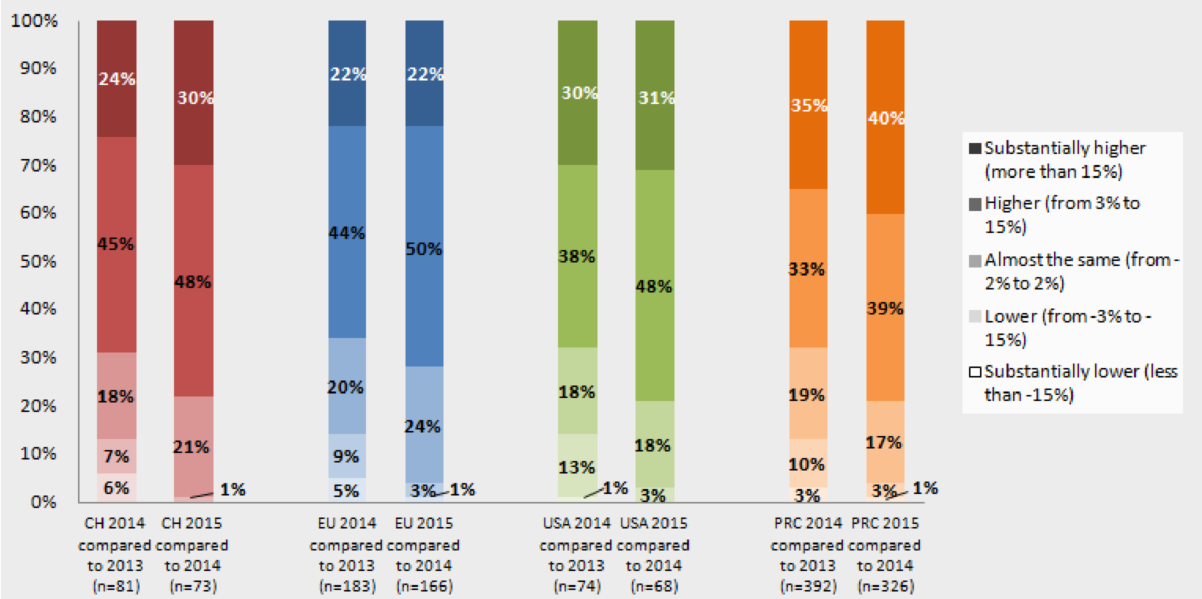
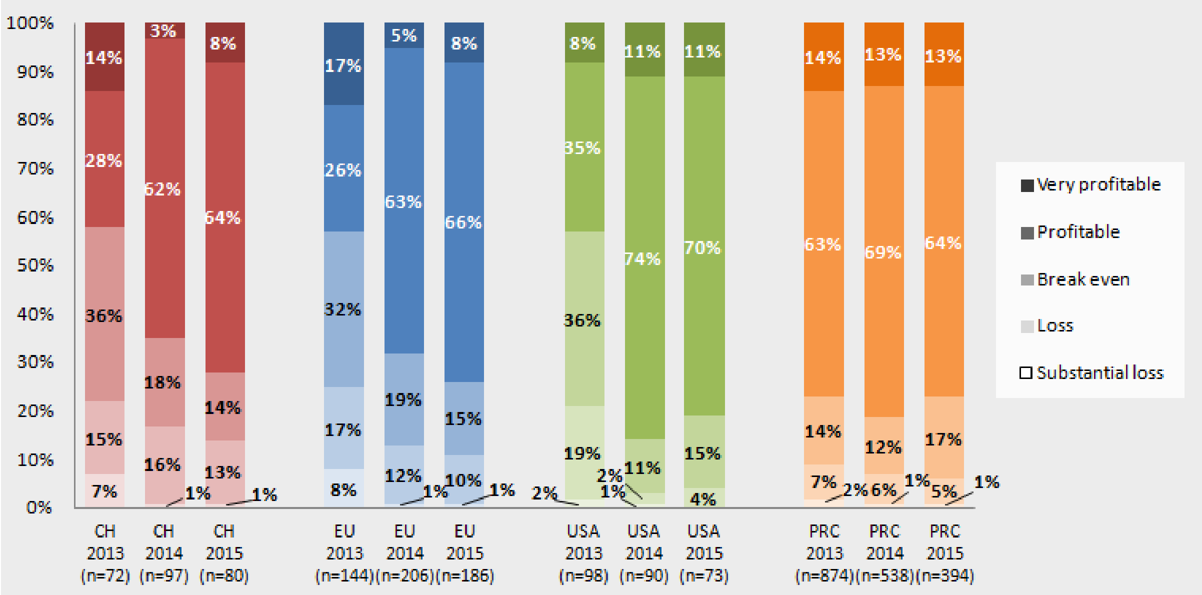


FIGURE 16 – HOW PROFITABLE DID YOU CONSIDER YOUR CHINA OPERATION IN 2014?



The answers of Swiss (CH) and European (EU) respondents are tightly matched both on revenue and profits, with respondents from these regions stating increasingly profitable operations yearly for the past 3 years. American and Chinese respondents cite relatively consistent yet slightly lower profitability compared to the previous year. Still, more US and Chinese firms report being "profitable" and "very profitable" than do EU and Swiss companies.

2.1 Investment plans in China naturally follow profits and remain a top priority

Based on the profit and revenue picture, it is not surprising to see that growing investment plans and investments in China command a high priority.

72% of the Swiss companies surveyed plan to increase investment in China in 2015 and 64% consider China to be a top 3 investment destination.

Chinese firms are clearly the most aggressive investors, planning to accelerate their investments significantly in 2015 compared to 2014.

FIGURE 17 – WHAT INVESTMENT DO YOU PLAN FOR 2015 IN CHINA?

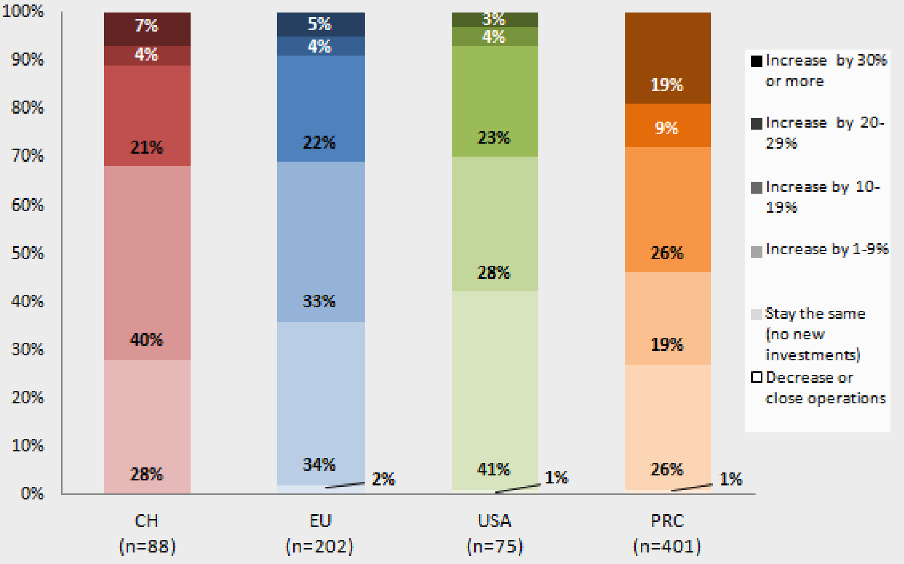
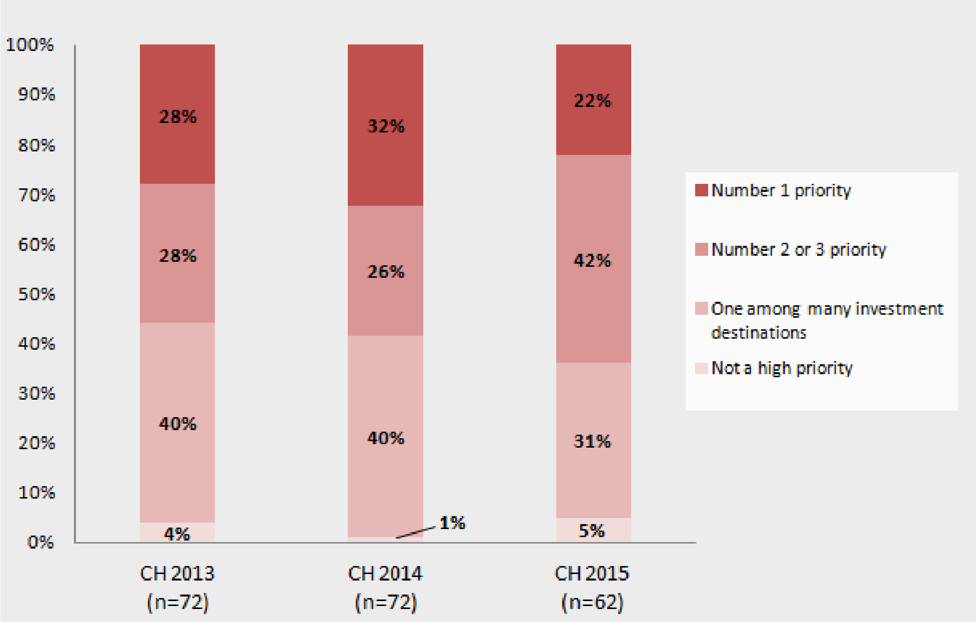


FIGURE 18 – HOW DOES CHINA RANK IN YOUR GLOBAL INVESTMENT PLAN? CH COMPANIES



2.2 Swiss respondents remain the most confident

Swiss firms, while showing less optimism for the coming 5 years, remain confident in their success over the next year. A variety of reasons are possible as to why the Swiss would feel less optimism for the coming 5 years, nonetheless, investment increases are still expected from the Swiss, demonstrating an absence of substantial hesitancy.

FIGURE 19 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR, AND IN THE NEXT 5 YEARS? CH COMPANIES

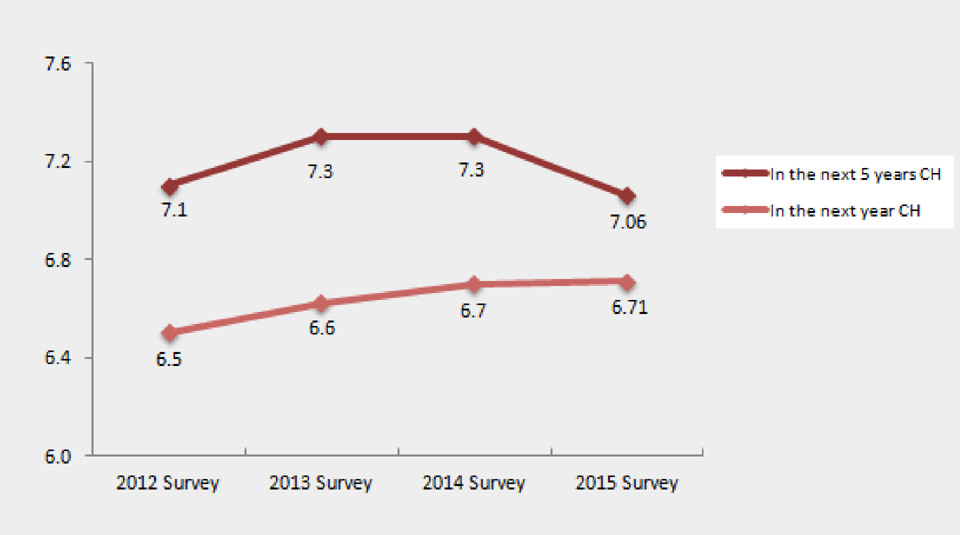
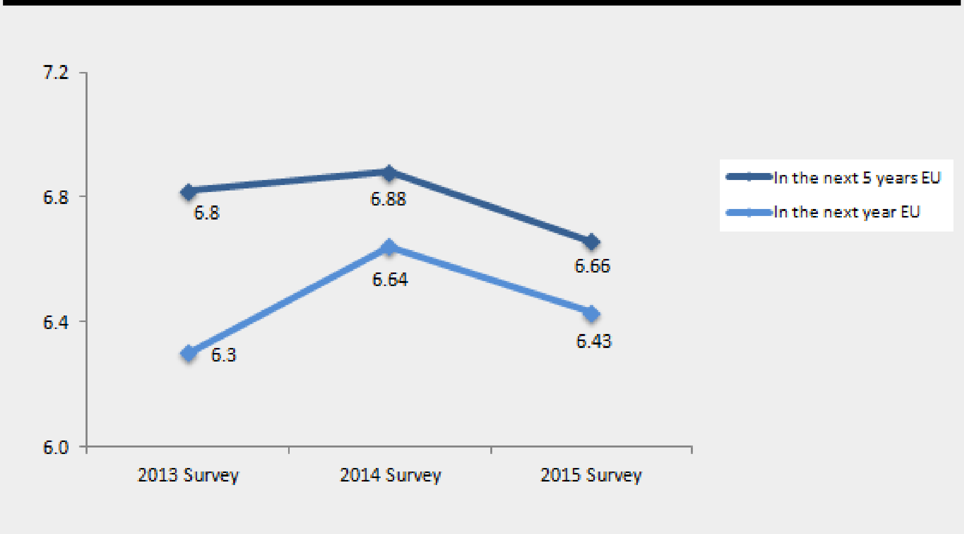


FIGURE 20 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR, AND IN THE NEXT 5 YEARS? EU COMPANIES

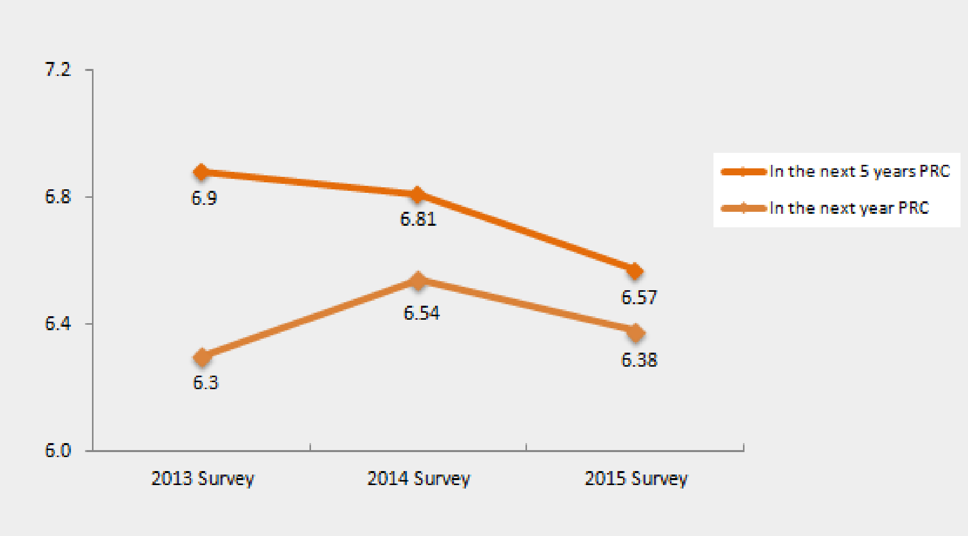


European companies are less confident than in last year's survey, confidence for the next 5 years is even lower than in 2013. American companies are more confident than their EU and Chinese counterparts in both categories, and falling only slightly behind the Swiss in absolute confidence ratings (companies are surveyed on a 1-10 scale).

FIGURE 21 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR, AND IN THE NEXT 5 YEARS? US COMPANIES

In comparison, Chinese companies are surprisingly less confident in 2015 than in previous years. Despite a sharp increase last year, Chinese companies' confidence for the next year has now decreased, and confidence in the coming 5 years has continued on a downward trend. This statement seems to contradict those stated earlier, that Chinese companies plan more investment and better sales in 2015. One interpretation of this statement is that while business is good for Chinese companies, the market continues to become more sophisticated, with competition intensifying (see section 4) and margins decreasing.

FIGURE 22 – HOW CONFIDENT ARE YOU THAT YOUR OPERATION IN CHINA WILL BE SUCCESSFUL IN THE NEXT YEAR, AND IN THE NEXT 5 YEARS? CN COMPANIES

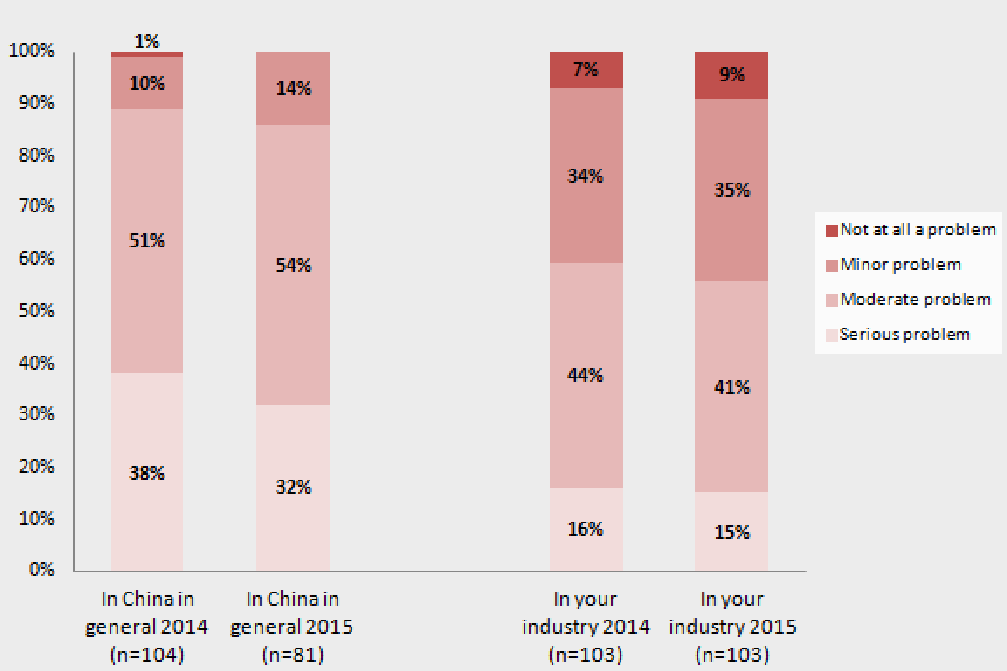


3 A FREQUENT PERCEPTION GAP ON THE REGULATORY ENVIRONMENT

3.1 Corruption & legal environment

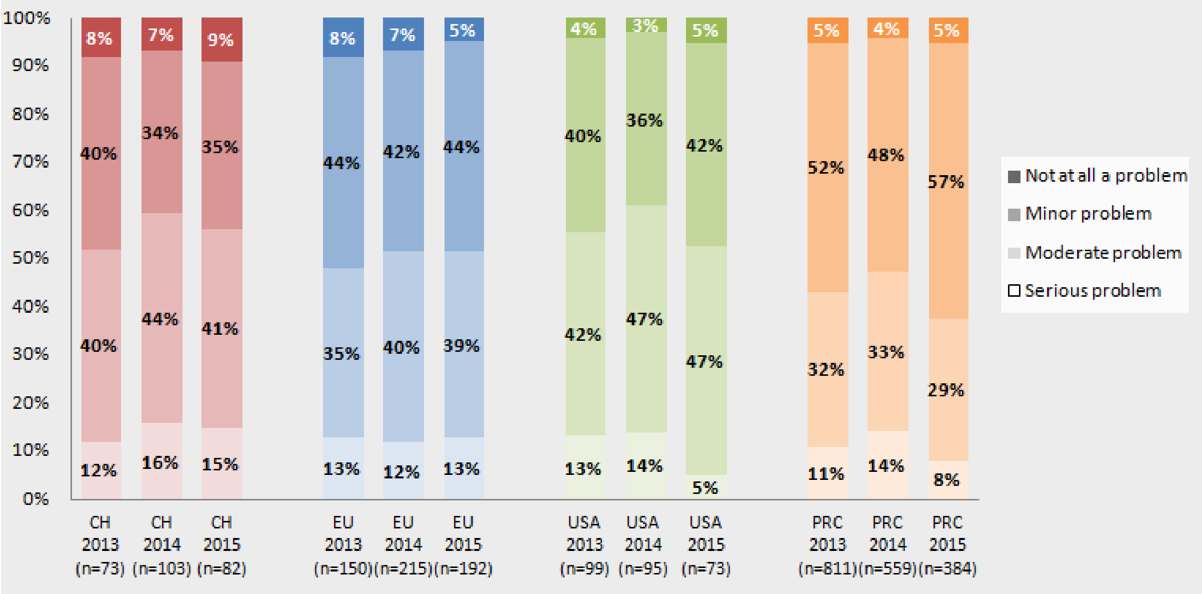
When asked if corruption is significant in China in general, a sizeable proportion (32%, nearly 1 in 3) of Swiss companies sees it as a "serious problem".

FIGURE 23 – IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN CHINA IN GENERAL, AND IN YOUR INDUSTRY? CH COMPANIES



However, when asked how serious corruption is in their industry, around 76% of the respondents see it as a "moderate" or "minor problem". Only 15% (1 out of 7) Swiss companies say that corruption is a serious problem in their industry. Interestingly, the picture is very similar for other foreign companies as well as for Chinese companies.

FIGURE 24 – IN YOUR VIEW, HOW SERIOUS IS CORRUPTION IN YOUR INDUSTRY?



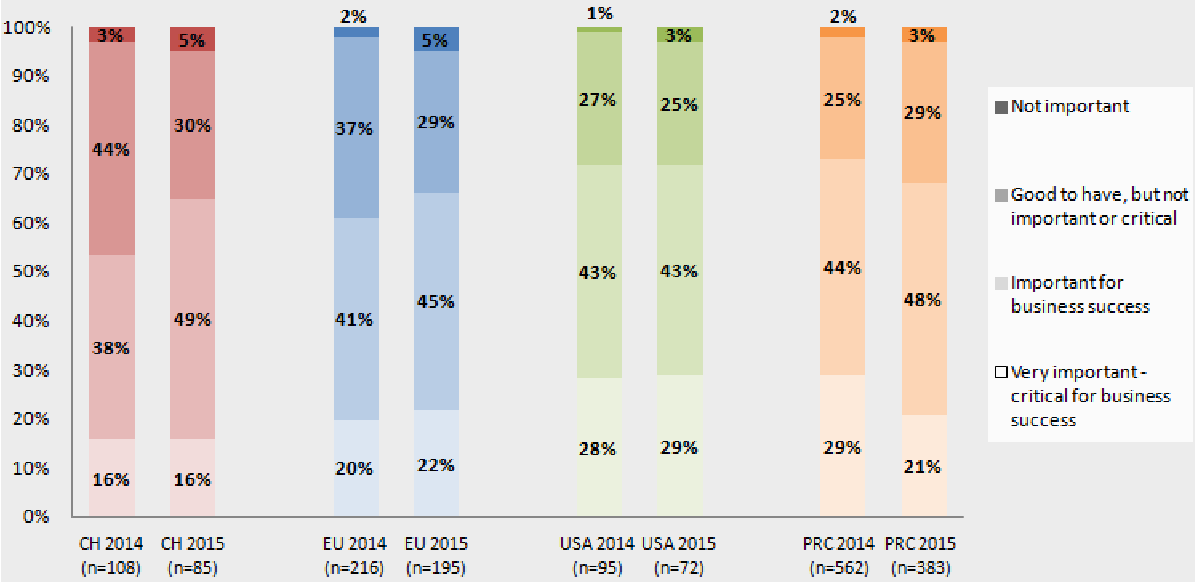
These paradoxical answers highlight a critical phenomenon. On one hand, there is the general sentiment that “China is corrupt”, a belief fueled by foreign media reports of scandals and countless anecdotes of official misdoings.

On the other hand, there is the reality of doing business in China, where corruption is one of many issues that managers deal with, though not the most important one as shown by the low ranking of corruption in terms of challenges (See Section 4).

In terms of evolution, the level of corruption seems to be improving, but modestly and only since 2014.

When asked about the importance of relationships with authorities, only Chinese companies reported a significant decrease in importance from last year. This may indicate that the anti-corruption drive is having more of an effect among Chinese companies, which may also be the case because Chinese companies tend to rely more on relationships with authorities than foreign companies do.

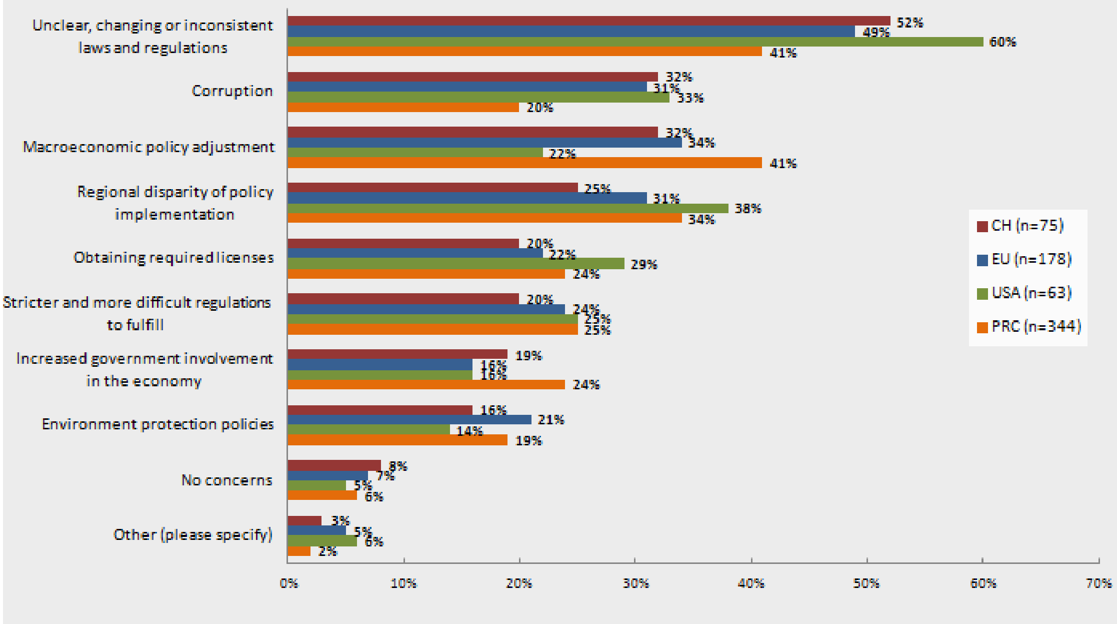
FIGURE 25 – HOW IMPORTANT ARE THE RELATIONSHIPS WITH THE AUTHORITIES?



3.2 Perception of Chinese government

Companies of all demographics surveyed cited “unclear, changing or inconsistent laws and regulations” as the top concern regarding the Chinese government and legal environment. Swiss and EU companies are more concerned than American companies about “macroeconomic policy adjustment”, and Chinese companies even more so. Concerns over corruption are equal amongst foreign respondents, whereas Chinese respondents see this as a lesser concern. One could interpret this sentiment as indicating more flexibility for Chinese companies when dealing with corruption.

FIGURE 26 – WHAT ARE YOUR MAIN CONCERNS REGARDING THE CHINESE GOVERNMENT AND THE LEGAL ENVIRONMENT?

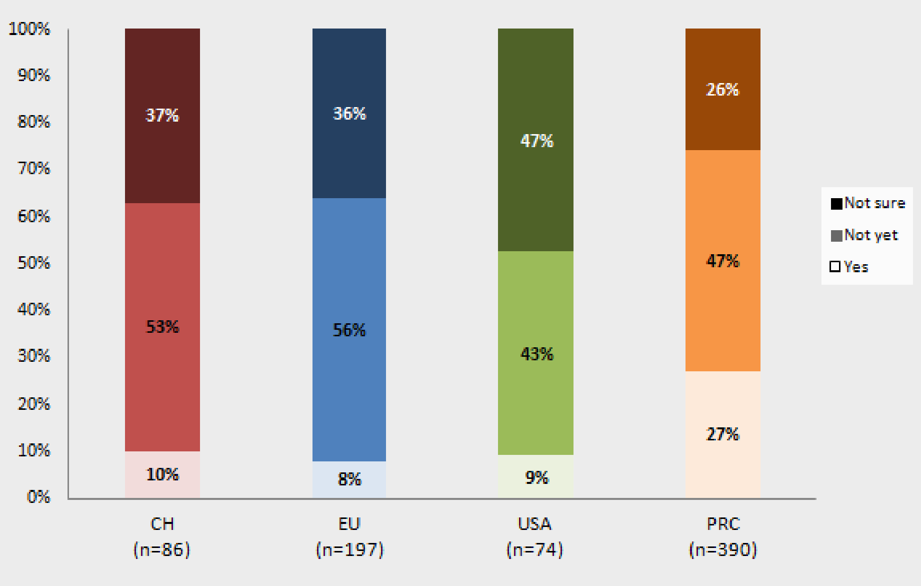


3.3 Reforms 2.0: first results

However, concerns over unclear and changing regulations may be eased over time as the effects and benefits of these changes become more apparent. From the chart below, one sees that a significant portion of foreign companies surveyed are simply not sure whether they benefit from new reforms or not. Chinese companies are more positive about recent government reforms, with 27% reporting tangible benefits from reforms, a pronounced difference from the percentages that foreign companies report.

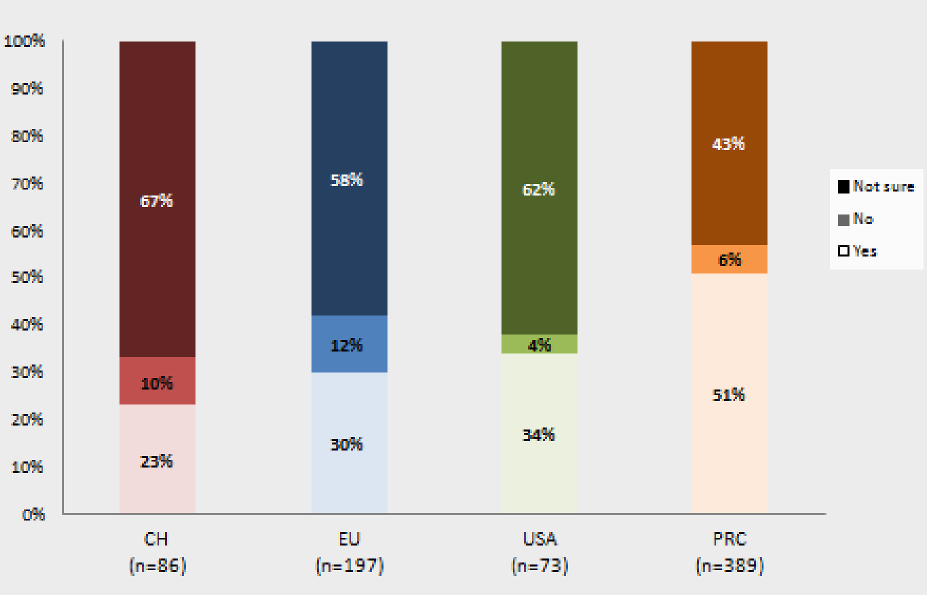
This illustrates the fact that while the reforms initiated in the 1980s aimed at attracting foreign investments, **the new set of reforms underway clearly intend to support the development of domestic companies.**

FIGURE 27 – DID YOUR COMPANY BENEFIT IN 2014 FROM ANY REFORM POLICIES OF THE NEW GOVERNMENT?



This is confirmed by the fact that Chinese companies state the most optimism regarding perceived future benefits from reforms, Swiss companies state the least certainty in this area, with 67% unsure about potential future benefits.

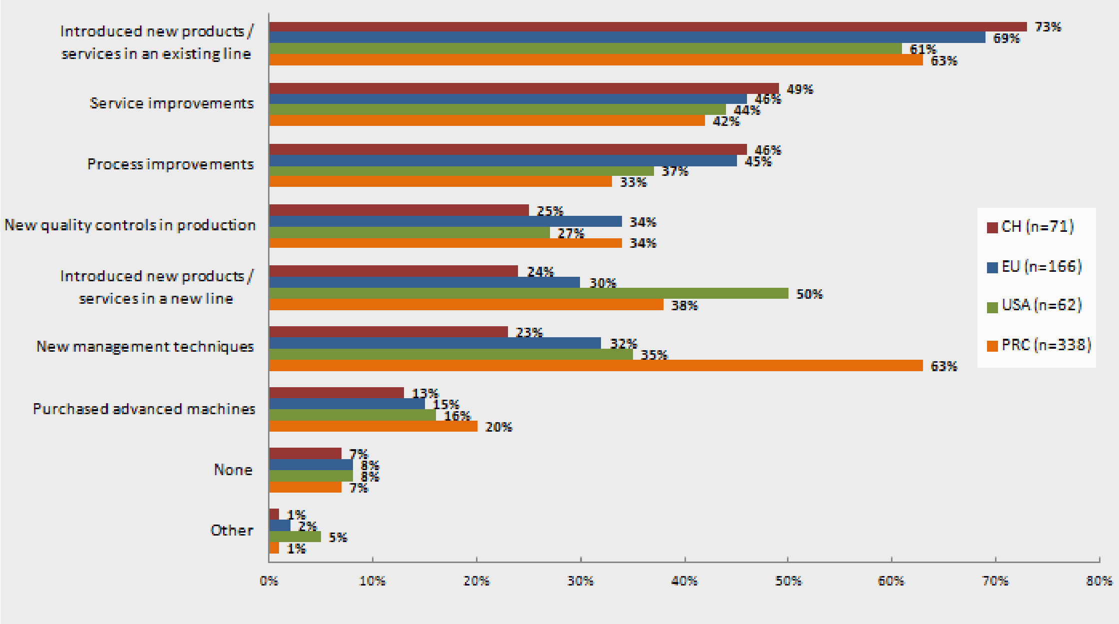
FIGURE 28 – DO YOU THINK YOUR COMPANY WILL BENEFIT IN THE FUTURE FROM CURRENT REFORM POLICIES OF THE NEW GOVERNMENT?



3.4 Innovation and intellectual property

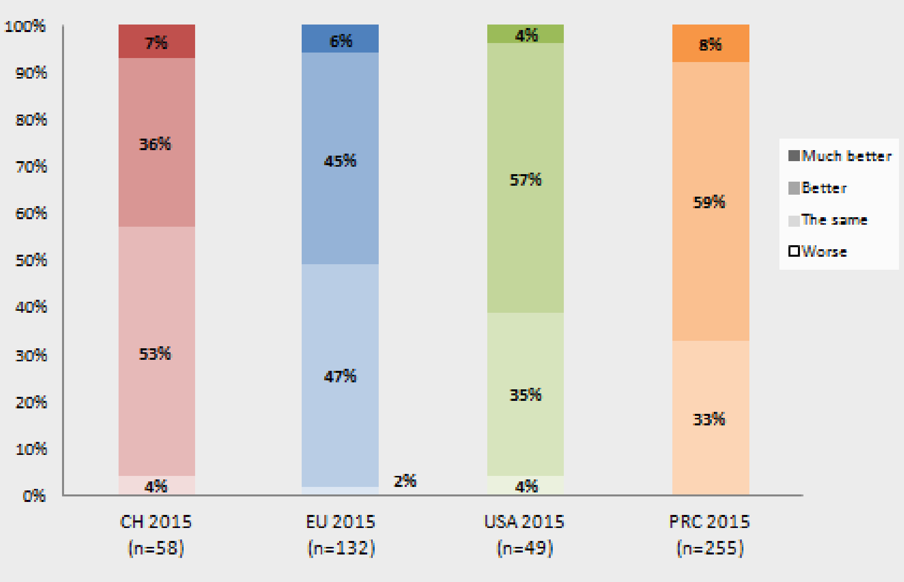
Swiss companies overwhelmingly report increased innovations in new and existing product lines. Improvements in processes and services are of comparable importance for Swiss and EU companies. **Chinese respondents place a heavier emphasis on innovation of management techniques, possibly because they lag behind in this respect and can make quick gains from improvements in management.**

FIGURE 29 – WHAT TYPES OF INNOVATIONS HAVE YOU INTRODUCED SINCE THE BEGINNING OF 2014?



Intellectual property (IP) protection is improving the majority of all companies surveyed, although, less than 50% of Swiss companies report an improvement.

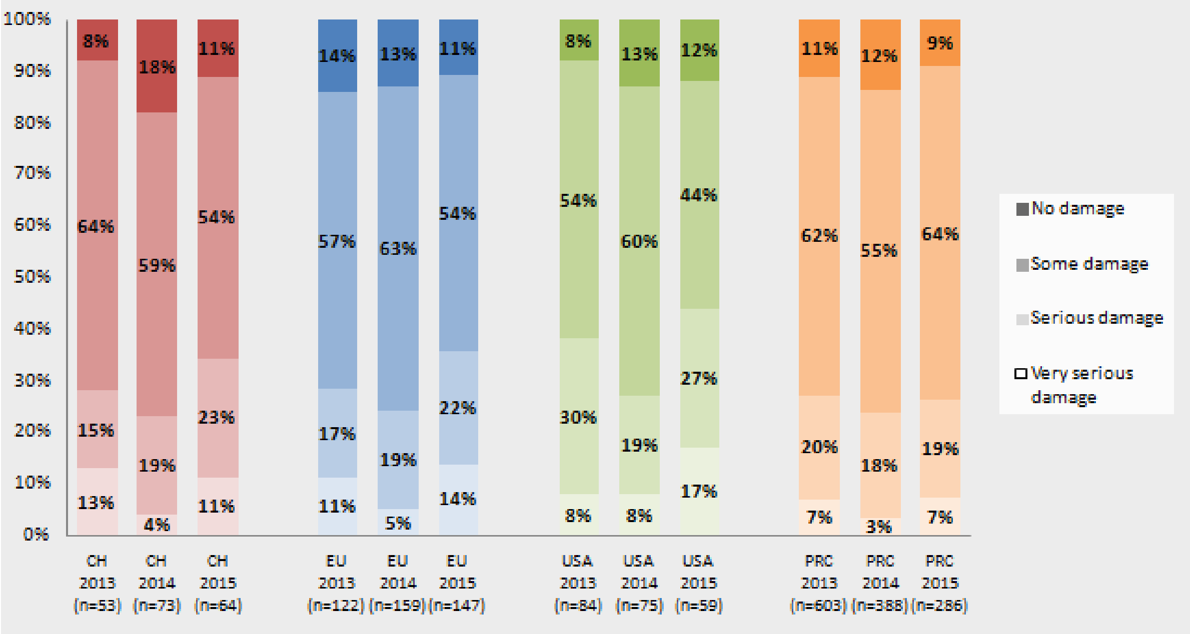
FIGURE 30 – IN THE PAST 3 YEARS, HOW WOULD YOU DESCRIBE INTELLECTUAL PROPERTY PROTECTION FROM THE GOVERNMENT IN CHINA?



A strong misperception that foreign companies are severely affected by intellectual property infringements in China also prevails in their home countries. While it is true that IP infringements occur in China more than elsewhere, the damage they generate is not as serious as one would expect.

Moreover, Chinese companies suffer slightly more from IP infringement when compared to their foreign counterparts. This invalidates the widely held perception that IP is stolen specifically only by Chinese from foreigners. The reality is that IP is being stolen from companies of all countries on a similar scale.

FIGURE 31 – WHAT IS THE DAMAGE CAUSED TO YOU BY IP INFRINGEMENT?



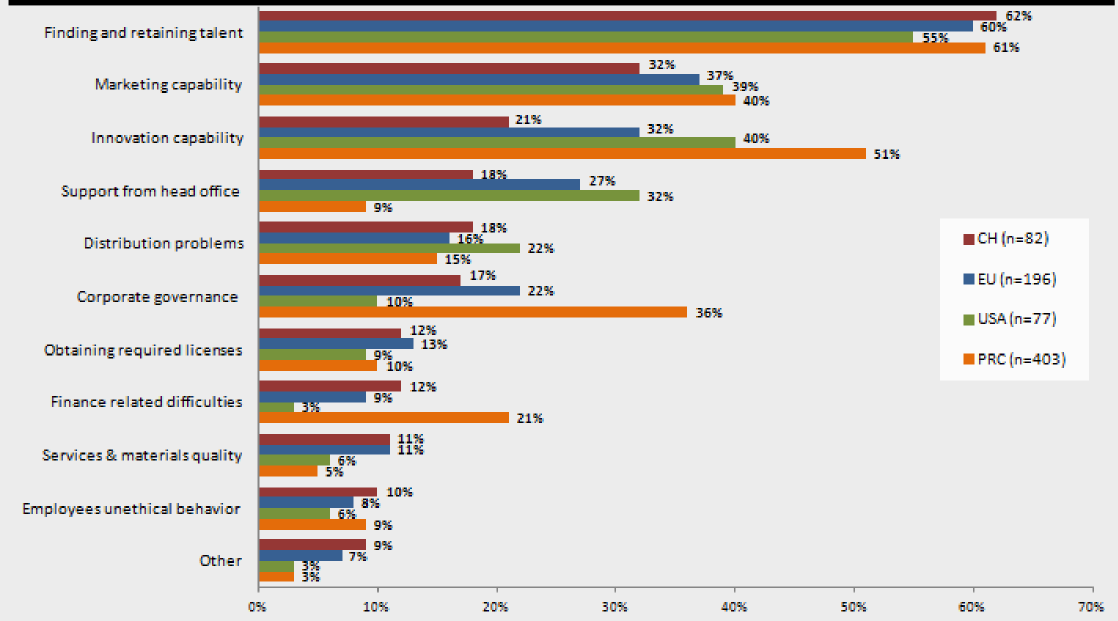
Interestingly enough, companies of all origins consistently report increasing damages, though only slightly so. While the corruption situation seems to be improving and the majority of respondents see government actions in IP protection as having improved, the reforms applied to the legal and IP environment have not yet reduced damages to businesses from infringement.

4 CHALLENGES TO OVERCOME FOR SUCCESS

The key internal challenge remains finding and retaining talent. Human resources management remains a central element for success, as it has been since this survey began 8 years ago. Yet, the HR challenge now appears to be easing: just more than 60% of Swiss companies mention it this year while nearly 80% mentioned it a year before. Slower economic growth is certainly a factor in the softening of HR challenges with many employees more carefully considering job changes.

“Support from the head office” has slid from the second to the fourth most challenging internal issues for Swiss companies, a significant difference from last year when over 30% of Swiss companies listed this as a key challenge. In the meantime, marketing and innovation capabilities have grown in importance, indicating once more the growing sophistication and competitiveness of the market.

FIGURE 32 – WHAT ARE THE GREATEST INTERNAL CHALLENGES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)

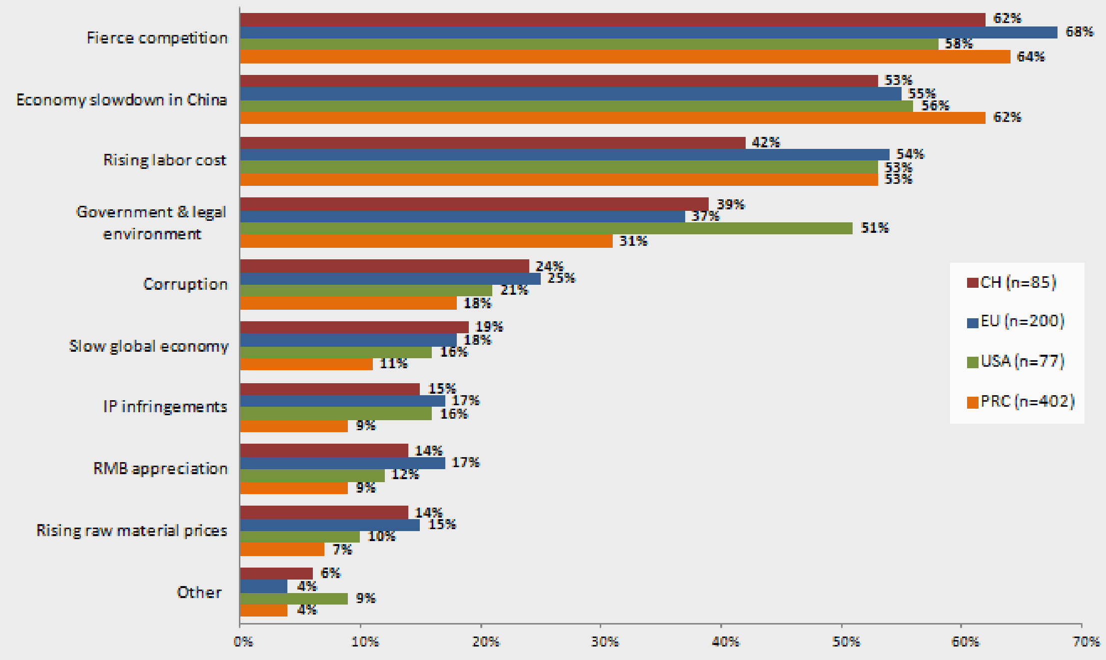


Innovation capability presents the most striking difference between Chinese and foreign companies in reported challenges, mentioned by 51% of Chinese respondents, while only 21% to 40% of the international firms reported innovation as an internal challenge.

In terms of external challenges, when compared to last year, competition is further intensifying while "economy slowdown" has become the second most important external challenge.

Concern over labor costs has receded as much as 10% for some companies (Chinese and American the most), while worries over a slowing economy have jumped up nearly 10% for all but EU companies, whose sentiments have not changed since last year.

FIGURE 33 – WHAT ARE THE GREATEST EXTERNAL CHALLENGES FOR YOUR COMPANY? (MULTIPLE ANSWERS)

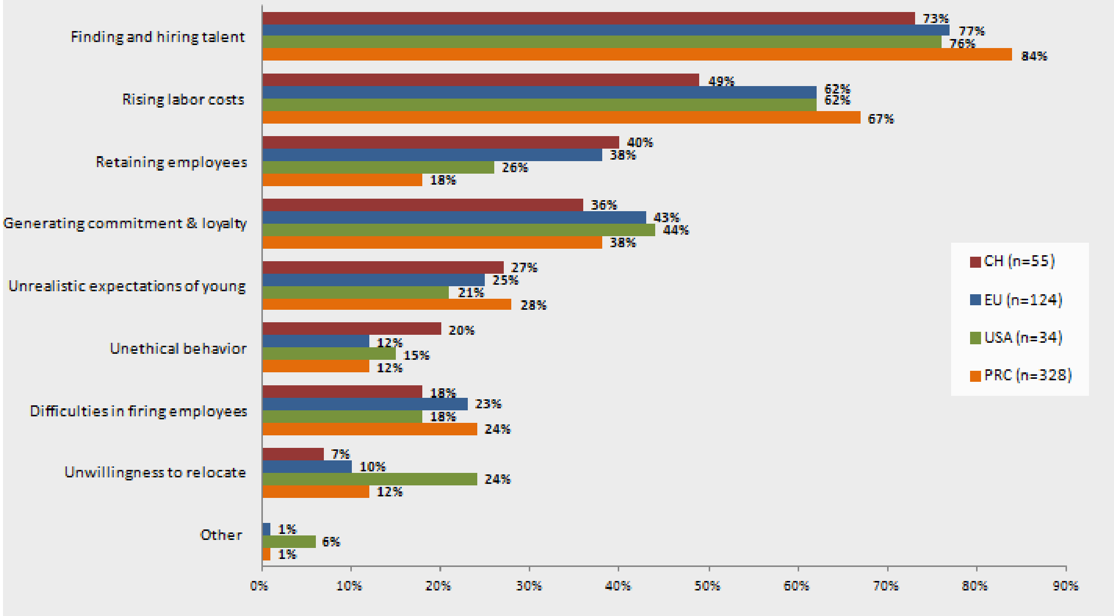


4.1 HR issues in general remain management's top internal priority.

When looking specifically at HR management challenges, last year's survey had nearly 60% of respondents of Swiss firms mentioning "Rising labor costs" as an issue, down from 80% in 2013, in 2015 this decrease has continued to 49%.

However, retaining employees has remained an issue for 40% of Swiss companies, with no change since last year.

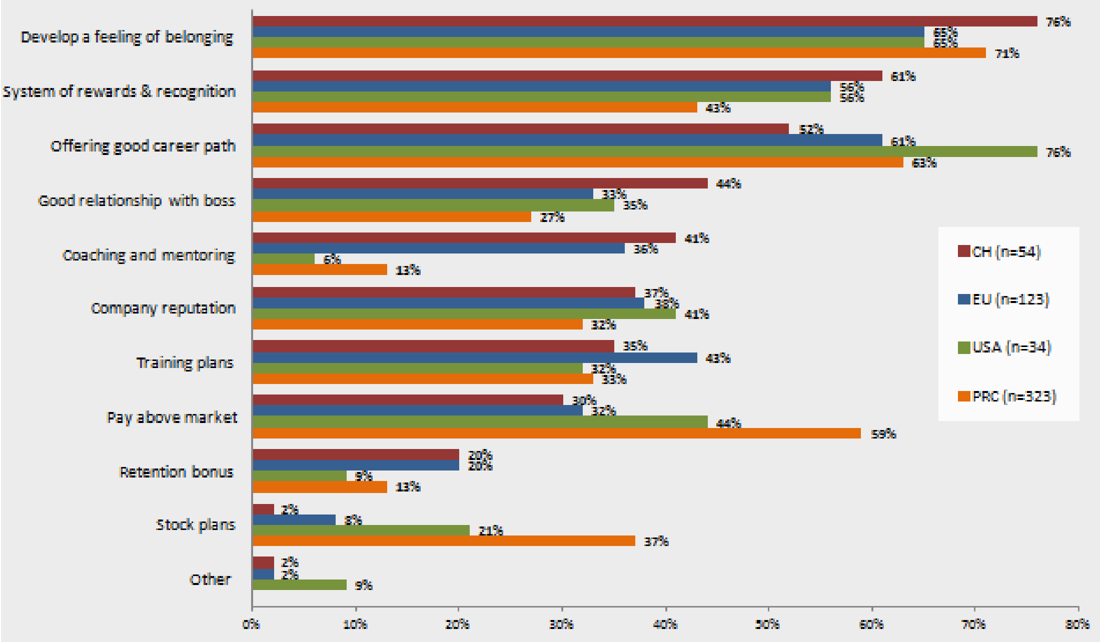
FIGURE 34 – WHAT ARE THE MAJOR HUMAN RESOURCE ISSUES FACING YOUR COMPANY IN CHINA? (MULTIPLE ANSWERS)



To deal with the critical HR issue and in order to retain employees, “pay(ing) above the market” is not the main solution used by foreign companies. “Offering a good career path” and “develop(ing) a feeling of belonging” appear to foreign and Chinese companies alike as more efficient tools for retaining employees, as these options offer opportunities for promotions and the prospect of substantial salary improvements. Still, Chinese companies use “pay above market” and “stock plans” as important means to retain employees. However, providing a “system of rewards and recognitions” has increased in importance for foreign companies compared to previous years.

Swiss companies stand out by considering a “good relationship with boss” and “coaching and mentoring” as efficient tools to retain employees.

FIGURE 35 – WHAT MEASURES DO YOU FIND MOST EFFICIENT IN RETAINING EMPLOYEES? (MULTIPLE ANSWERS)

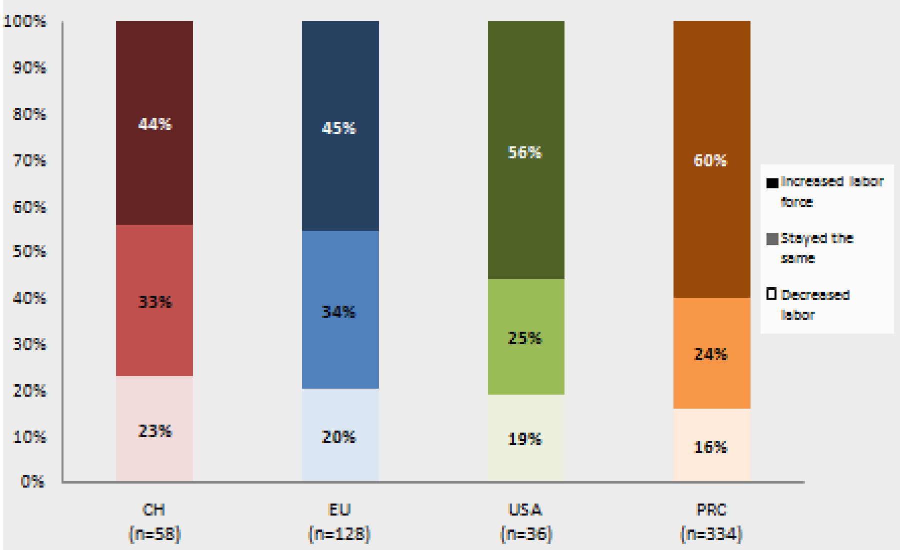


4.2 Labor costs

Swiss and EU companies are hiring the least and decreasing the most labor. Quite interestingly, Chinese companies are hiring the most and at the same time increasing wages most (see chart below) while still stating the most concern over labor costs compared to international firms.

This paradox may be understood when considered along with the innovation challenge strongly perceived by domestic firms. Indeed, their ability to offset the rising cost of labor by productivity innovations (be they technical or others) make them more vulnerable to rapidly increasing salaries.

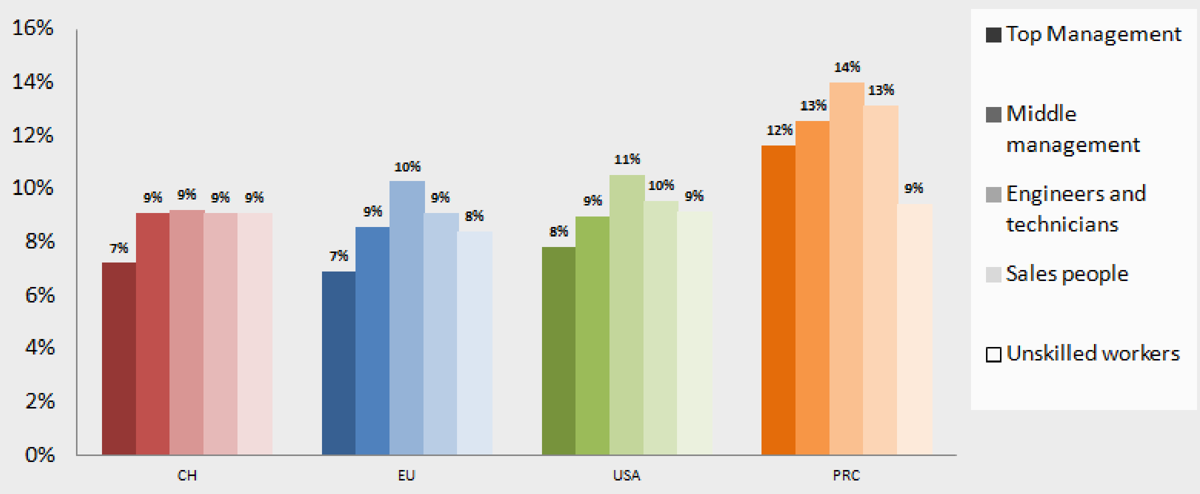
FIGURE 36 – THE CHANGE IN YOUR COMPANY LABOR FORCE IN 2014 VS. 2013 WAS:



From the chart below, we see that Chinese companies are increasing wages of their employees more significantly than foreign companies.

This may explain the bigger challenge that domestic firms face in terms of retaining employees and from a need to catch up and pay salaries comparable to those offered by foreign companies in order to be competitive.

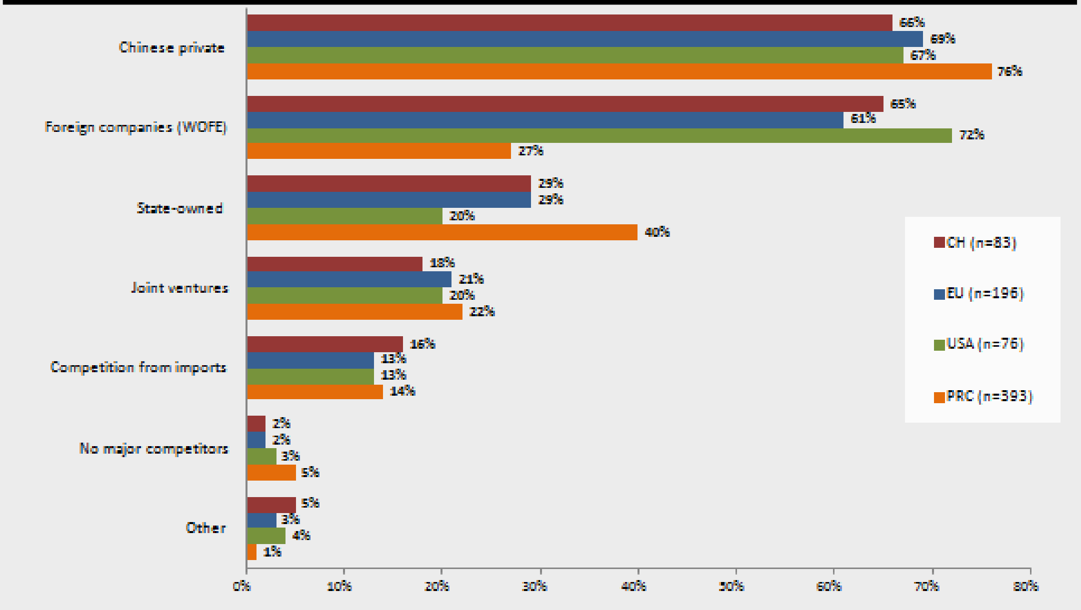
FIGURE 37 – TOTAL SALARY INCREASE BY LEVEL IN YOUR COMPANY IN CHINA IN 2014 COMPARED TO 2013:



4.3 Chinese competitors' advantages

International companies in China perceive local private players to be their greatest competitors, closely followed by other foreign companies, a continuation of the trend witnessed beginning in last year's survey and a clear indication that domestic players are rapidly advancing in capability.

FIGURE 38 – WHO ARE YOUR MAJOR COMPETITORS IN CHINA? (MULTIPLE ANSWERS)



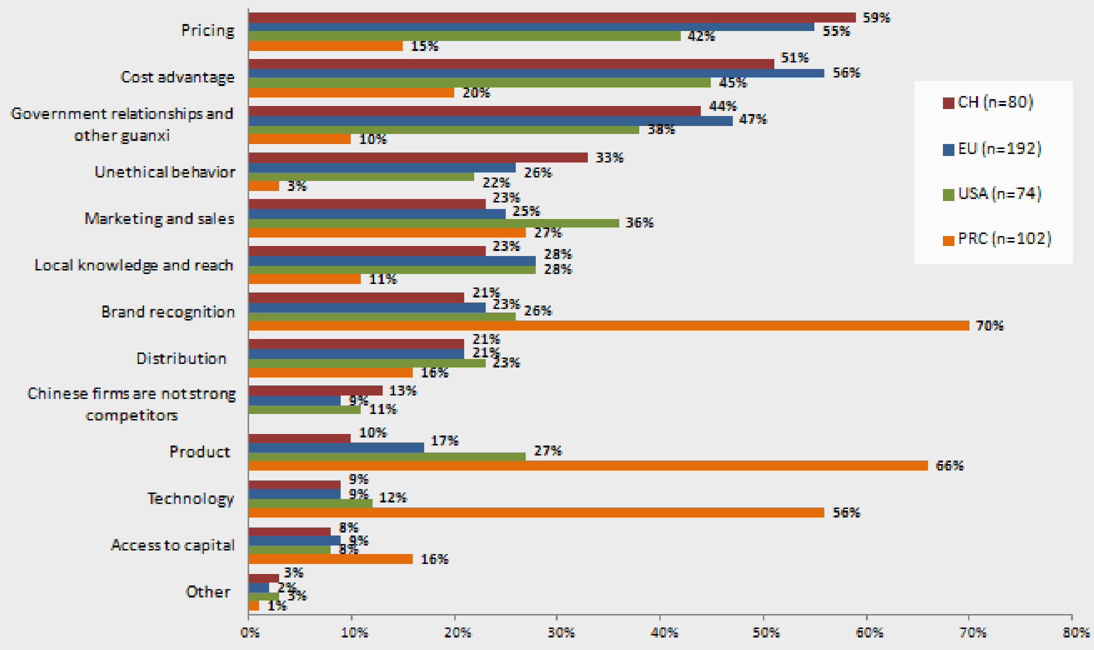
This perspective is shared by Chinese companies that see Chinese private companies as their most important competitors by far.

It appears in the chart below that, for foreign and Swiss companies particularly, the very competitive landscape is once more highlighted by the fact that “pricing”, “cost advantages”, and “government relations & network (guanxi)” are clearly perceived as the competitors’ main advantages.

The perception is very different for Chinese companies however, who see the main advantages of their competitors to be “technology” and “product” as well as “brand recognition”, once more highlighting that foreign companies compete on quality, brand recognition and technology to maintain their margins and positions.

An interesting development amongst Chinese companies is the stark decrease in reported government relationship advantages for Chinese competitors; last year over 40% of Chinese companies surveyed stated this as competitors’ advantage, this year only 10% state the same. Comparable too, is the result that “unethical behavior” was listed by nearly 15% of Chinese companies as an advantage for Chinese competitors last year, this number decreased to 3% in 2015. **This does indicate that the ongoing “War on Corruption” is already proving to be effective among Chinese companies.**

FIGURE 39 – WHAT ARE THE COMPETITIVE ADVANTAGES OF YOUR MAIN CHINESE COMPETITORS? (MULTIPLE ANSWERS)

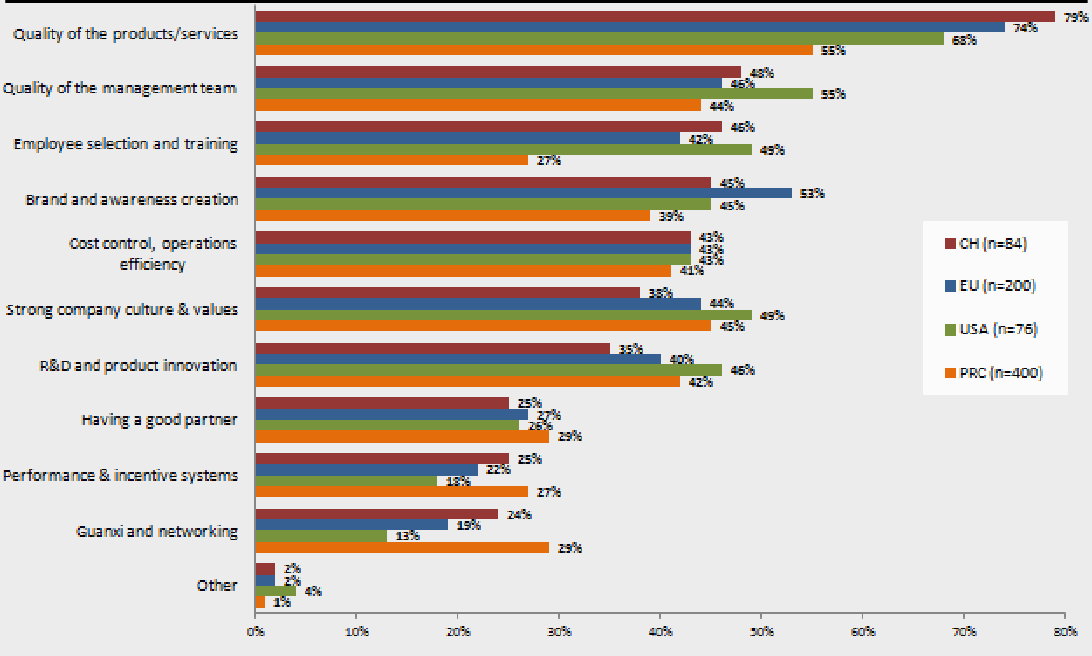


Despite a more level playing field, competition from private Chinese companies is only likely to become fiercer as the Chinese government is due to support the private sector with more incentives as part of its economic reform agenda.

4.4 The key success factors: superior product quality and human resources

It is not surprising in this very competitive environment that the key factors of success cited are first “quality of the products/services” and human resources (HR) considerations, specifically “employee selection and training” and “quality of the management team.” This is naturally coherent with HR being singled out as the greatest management challenge.

FIGURE 40 – WHAT ARE THE MOST IMPORTANT FACTORS FOR YOUR SUCCESS IN CHINA? (MULTIPLE ANSWERS)

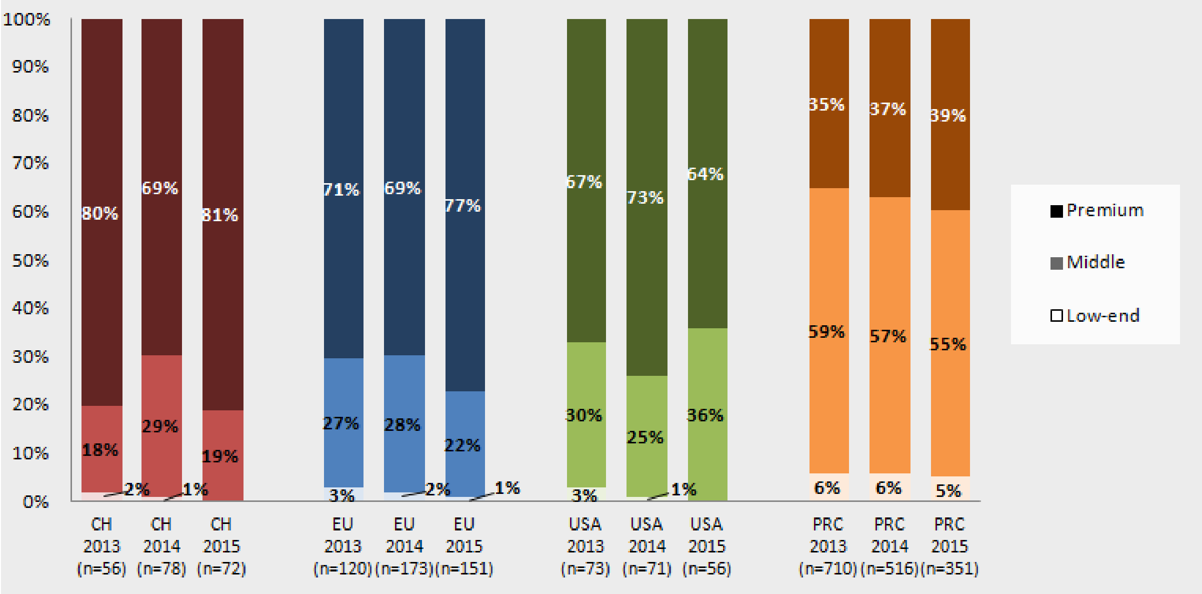


The focus on superior products/services by foreign companies is understandable when keeping in mind the need for differentiation through quality versus price.

Foreign companies maintain growth in market shares and profits by offering products that Chinese companies will find difficult to offer in terms of quality. This also explains why foreign companies in China have been competing as much with foreign competitors as they have with Chinese ones.

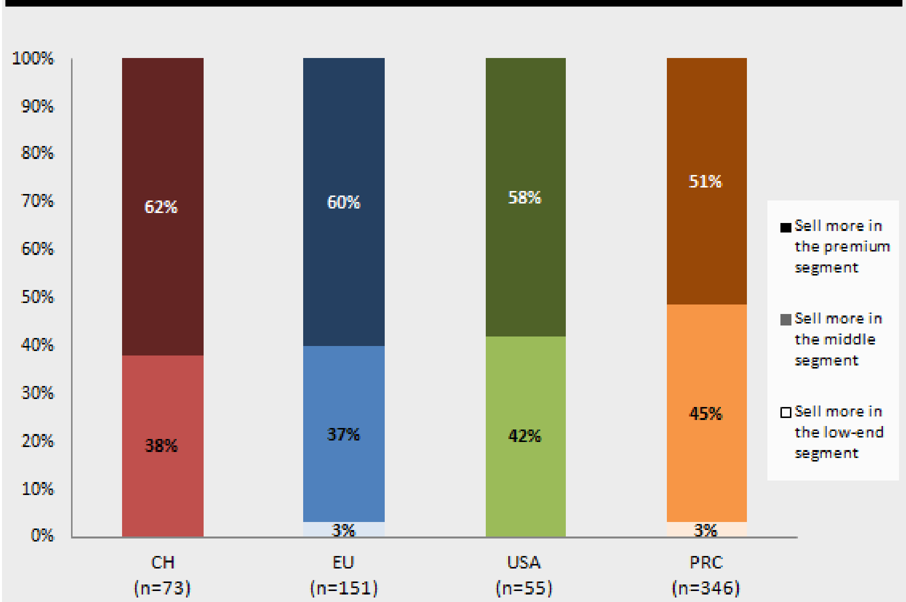
The high-end focus is also clearly illustrated by the market segments targeted by the different companies. Foreign players are by far mostly focused on the premium segments.

FIGURE 41 – WHICH IS YOUR MAIN MARKET SEGMENT IN CHINA?



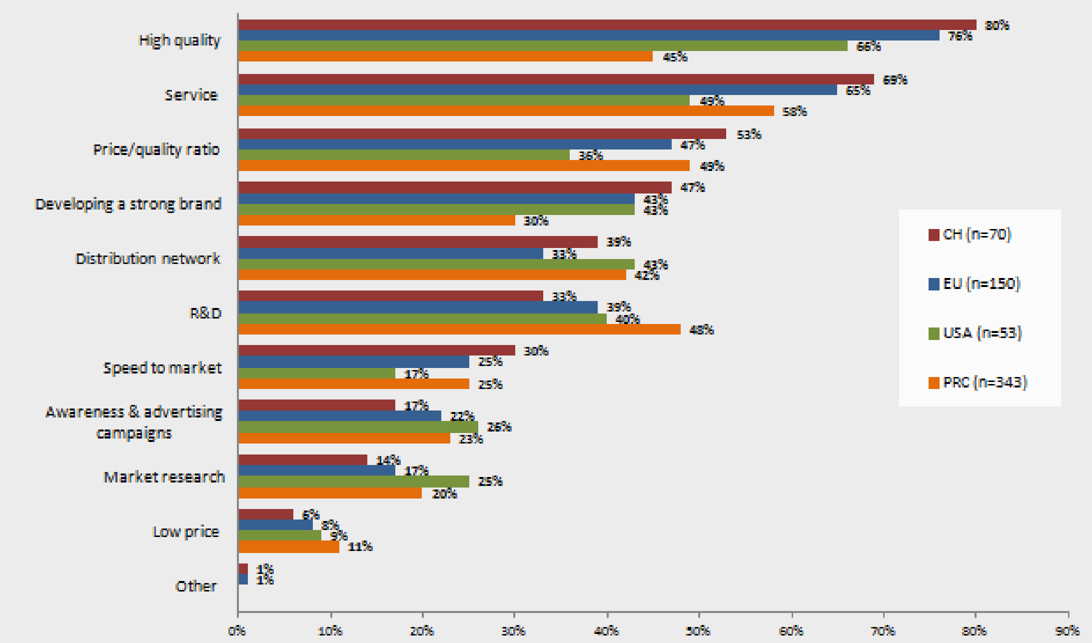
However, if the chart below is any indication, Chinese companies intend to catch up to foreign companies in their offerings to the premium segment.

FIGURE 42 – WHAT ARE YOUR SALES PLANS FOR THE FUTURE?



The ability of foreign companies to continue competing in the premium segment is unquestionably derived from a continued focus on high quality.

FIGURE 43 – PLEASE CHOOSE THE MOST IMPORTANT FACTORS FOR THE SUCCESS OF YOUR SALES IN CHINA: (MULTIPLE ANSWERS)



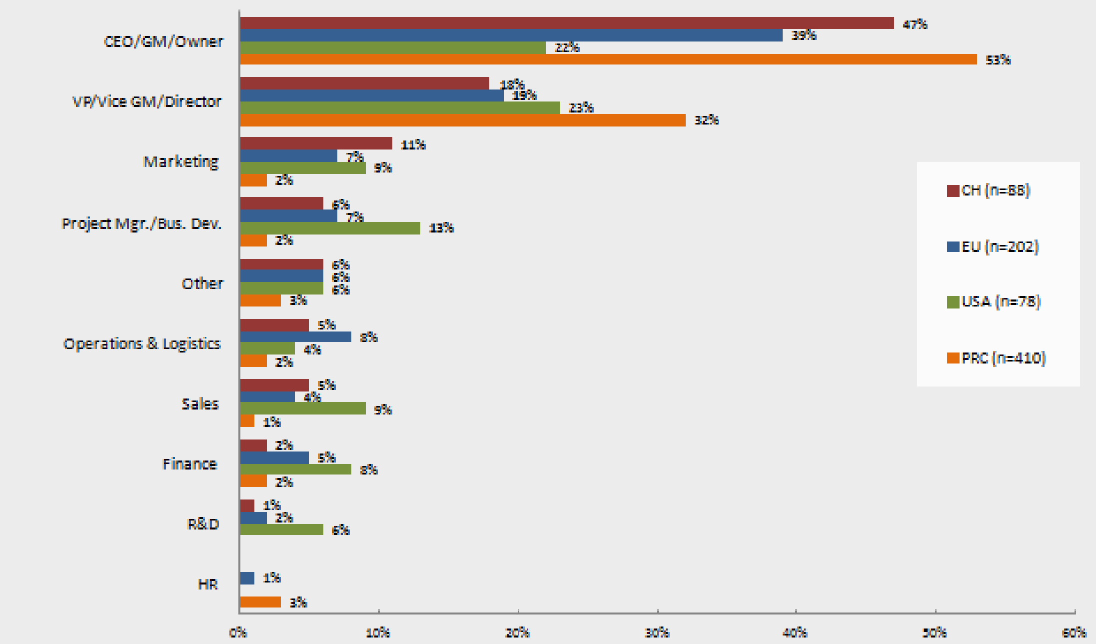
5 RESPONDENT AND COMPANIES' DEMOGRAPHICS

With 88 Swiss respondents out of the 368 foreign-owned company respondents, the Swiss sample is well represented in the overall CEIBS survey.

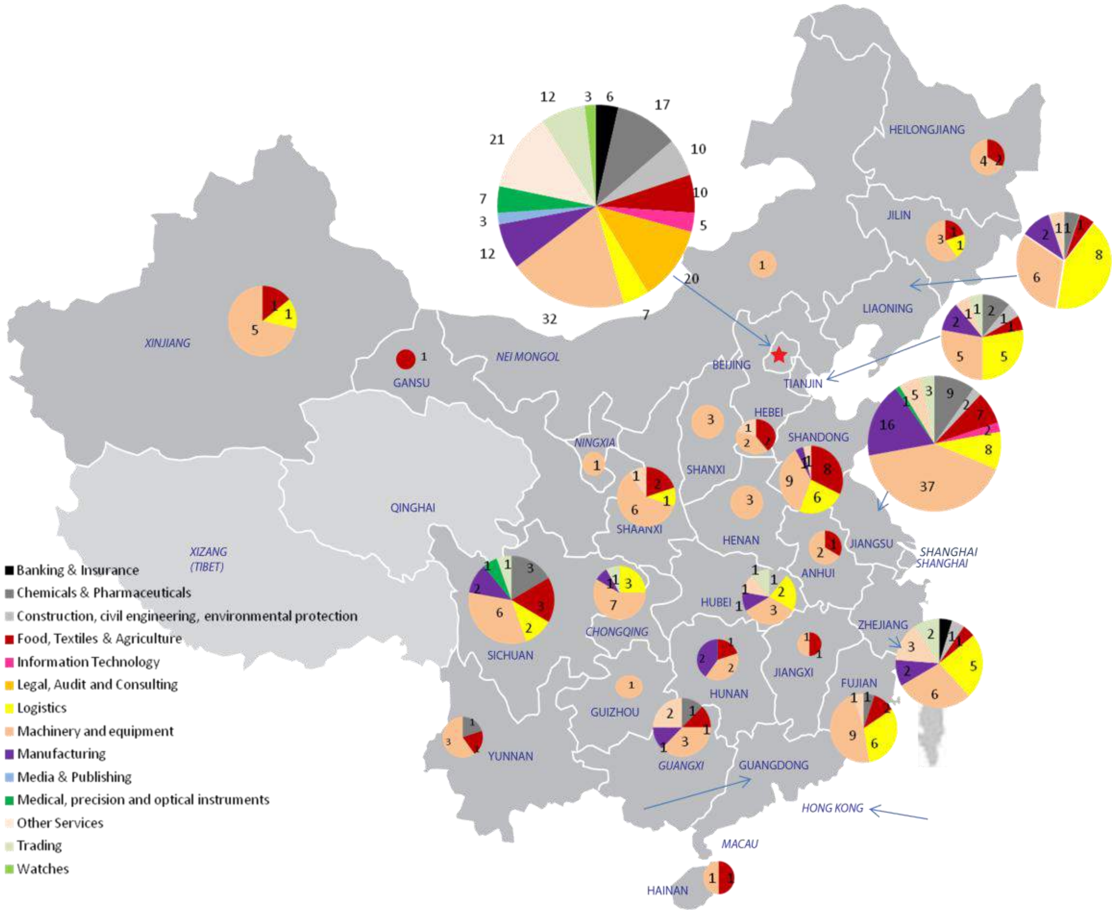
Compared to the 254 different companies registered with SwissCham China (not counting separate subsidiaries of the same company), this represents a strong sample of the affiliated Swiss firms in China.

Additionally, with 65% of top managers (Owner/CEO/GM & VP/Vice-GM/Director) answering the survey, the data from Swiss companies is reasonably credible. Respondents are noticeably more senior than those from the American (45%) and European companies (58%). Only Chinese companies' respondents have a higher percentage of top managers answering (85%).

FIGURE 44 – WHAT IS YOUR POSITION IN THE COMPANY?



5.1 Distribution of Swiss companies in China



5.2 Geographic distribution of respondents

When looking at the location of respondents, one sees generally similar distributions among Swiss, European and American companies. In comparison, Chinese companies are slightly more spread out, citing 24% of operations in non-coastal regions, the highest proportion of all respondent groups.

FIGURE 45 – THE HEADQUARTERS OF YOUR COMPANY IN MAINLAND CHINA ARE LOCATED IN? CH COMPANIES BY % (N= 86)

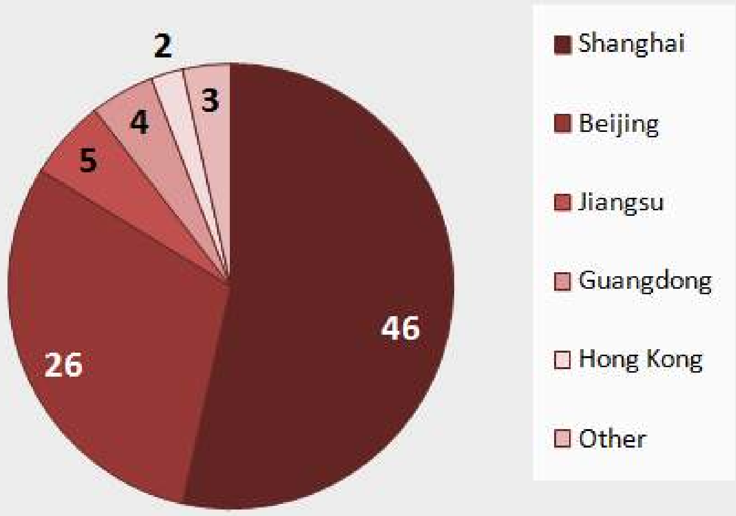


FIGURE 46 – THE HEADQUARTERS OF YOUR COMPANY IN MAINLAND CHINA ARE LOCATED IN? EU COMPANIES BY % (N= 117)

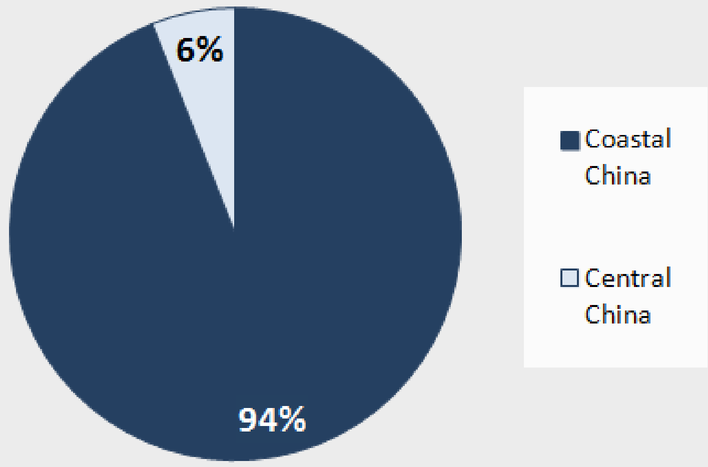


FIGURE 47 – THE HEADQUARTERS OF YOUR COMPANY IN MAINLAND CHINA ARE LOCATED IN? US COMPANIES BY % (N= 79)

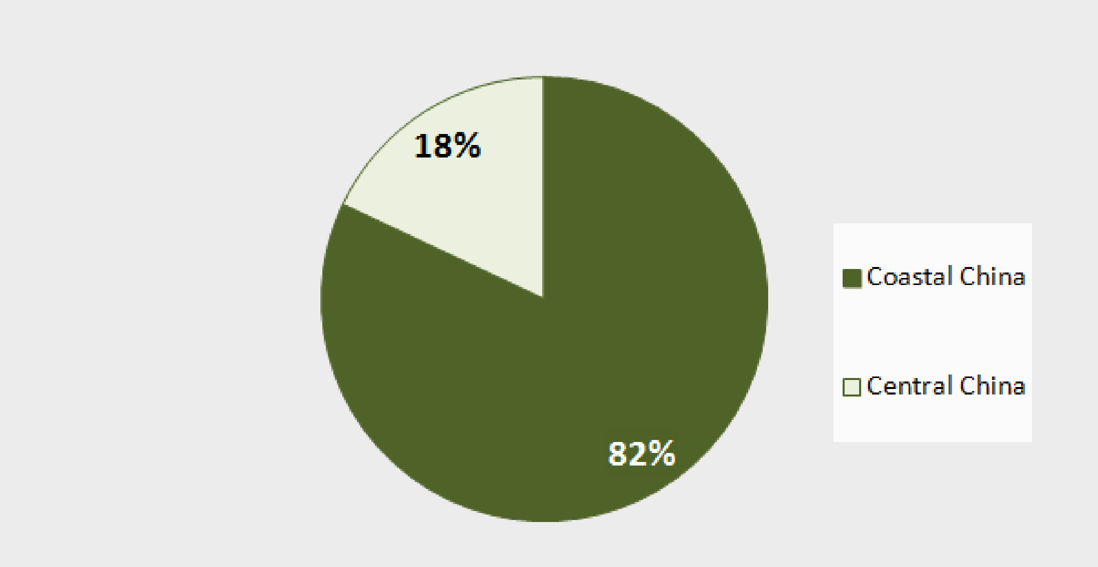
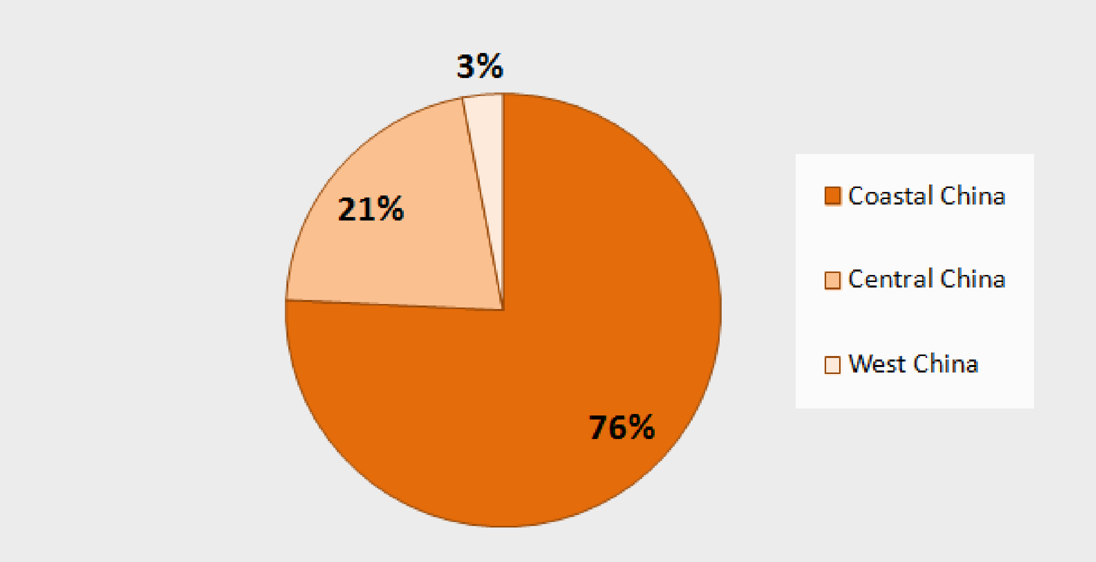


FIGURE 48 – THE HEADQUARTERS OF YOUR COMPANY IN MAINLAND CHINA ARE LOCATED IN? CN COMPANIES BY % (N= 406)



5.3 Years in the market

With regards to establishment year, one can again note similar distributions among Swiss, European and American companies.

FIGURE 48 – WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? CH COMPANIES (N=86)

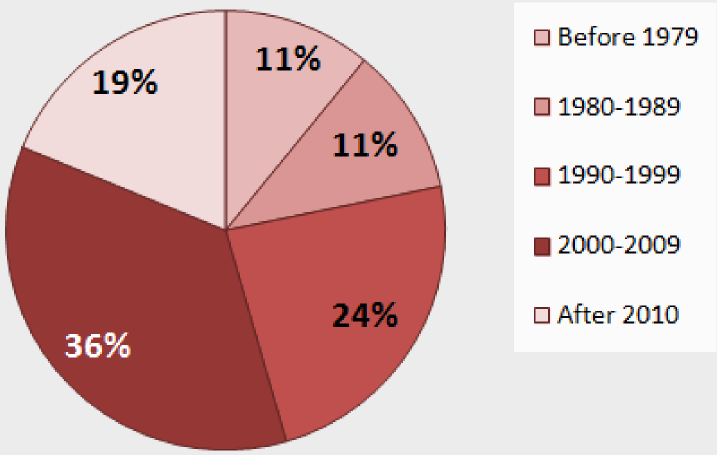


FIGURE 48 – WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA? EU COMPANIES (N= 203)

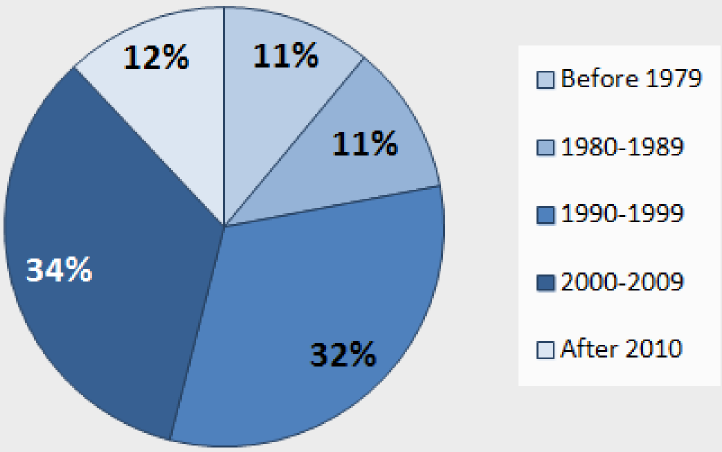


FIGURE 48 – WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?
US COMPANIES (N= 78)

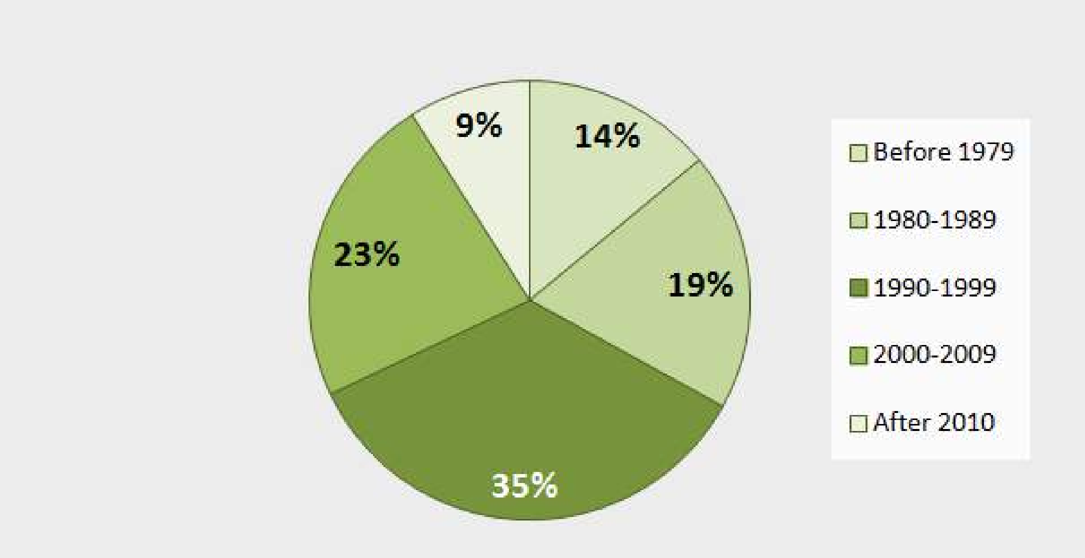
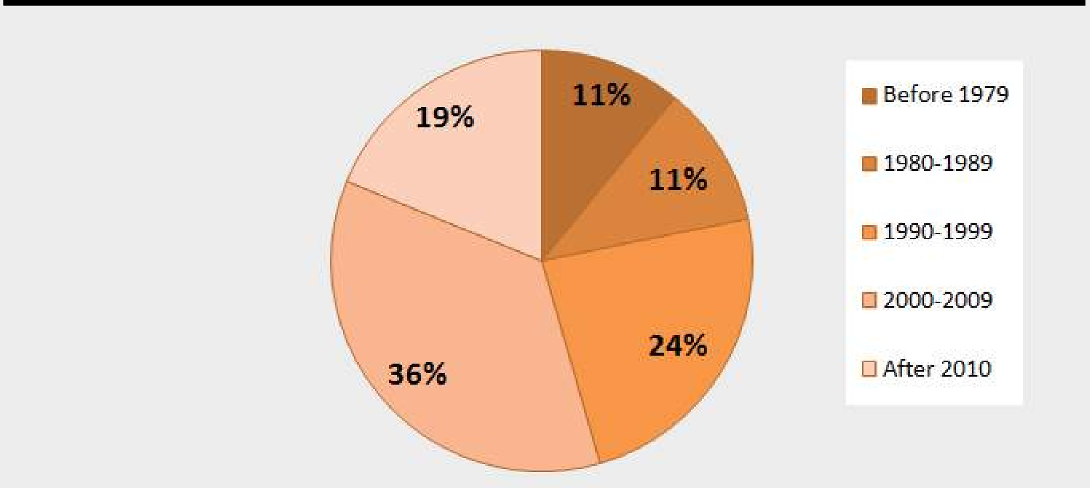


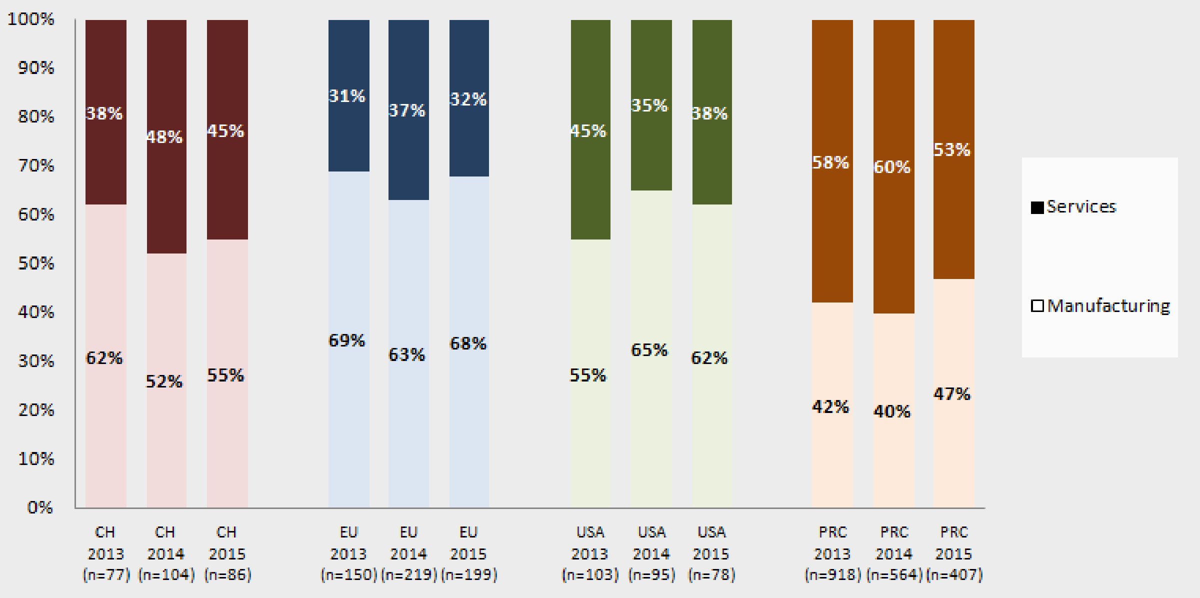
FIGURE 48 – WHEN WAS YOUR COMPANY ESTABLISHED IN CHINA?
CN COMPANIES (N= 252)



5.4 Industrial sectors and types of clients

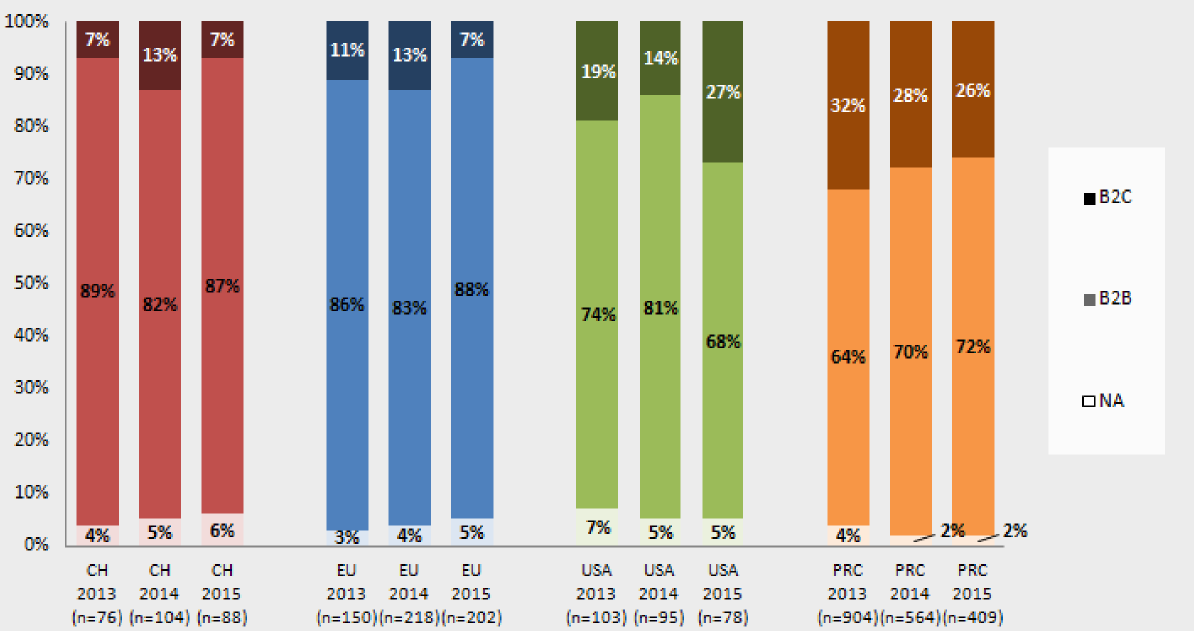
More than half of Swiss firms represented in the survey are manufacturing companies. This is again quite similar to American and European companies, while the Chinese companies answering are more in the service sector (53%).

FIGURE 49 – WHAT IS YOUR COMPANY'S MAIN ACTIVITY IN CHINA?



A similar situation occurs when looking at the customer base: Chinese and American companies are selling significantly more to the consumer segment than the EU respondents, who are more strongly focused on B2B clients, with Swiss companies predominantly in B2B (87% of the Swiss companies in this sample).

FIGURE 50 – WHO ARE YOUR CLIENTS IN CHINA?



While the above already provides good reasons to think that the sample of Swiss respondents to this survey is representative, a general similarity can be found between the Swiss and EU data that gives additional credibility to the results obtained for Swiss companies.

Yet, in this year's data, US companies demonstrate some significant differences from other foreign companies. This may be explained by the fact that, proportional to respondents of other origins, a much larger number of US respondents are in project management, business development and sales with a lower number of US respondents that are from the top management. Still, since a reasonably large number of European companies – about 152– report patterns and trends in consistent and similar ways, **we believe that the responses of the Swiss (and EU) companies are generally representative of their management's experience.** In addition, the significant differences between Swiss and European firms' answers do make sense when analyzed along with the current EU economic sluggishness and well-known particularities of Swiss companies.

As a consequence, we are convinced by the general representativeness and value of the results and hope that they will be put to good use by the business community and contribute to even more successful activities.

China's Production Costs are Steadily Decreasing, Year after Year

Despite near double digit salary increases in the past years, China's producer prices are lower than in 2008 and only 10.3% higher than in 1996.

What is happening? What does it mean for international businesses?

Europe, the USA, and Japan are faced with stagnating prices. Surprisingly, the same holds true for China where salaries have been increasing in the double-digits every year.

Moreover, China's business growth, in absolute GDP increase, is twice as large in this decade (2011 to 2015) as it was from 2001 to 2010. (See our previous Analysis)

Therefore, one would assume that production costs are increasing, in line with labor costs and the economy.

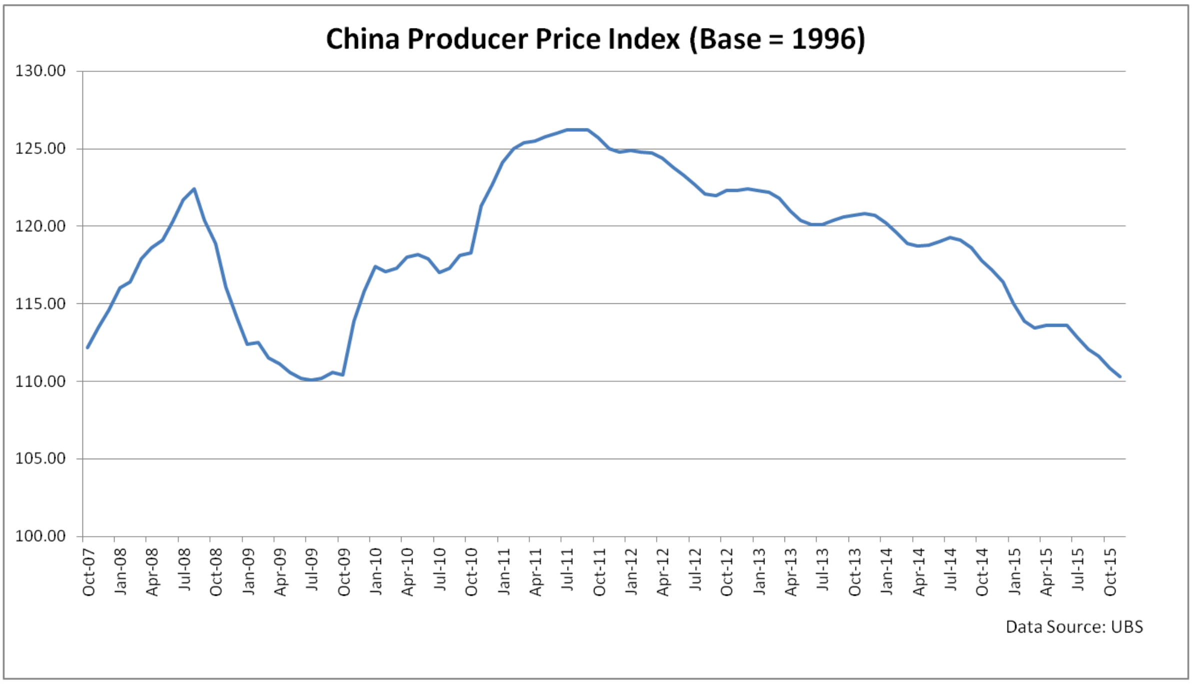
Yet, quite paradoxically, China's Producer Price Index (PPI), which records the price of goods when they are sold by the country's factories, has been going down every year since 2011. Recorded by the PPI, **the average prices paid to producers in China went down by as much as 4.8% in the first half of 2015,** and are forecasted (by UBS) to remain low or continue dropping in the second half of the year. A slow worldwide economy has created a drag on demand, noticeable in the lower producer prices, commodity prices certainly account for the particularly drastic drops in recent months. Nonetheless, lower commodities prices do not explain the steady drop of producers' prices from 2011.

The PPI is today at the level it held in 2008 and, very surprisingly, shows an increase in production costs of **only 10.3% since 1996** (which is the base for the index).

This is a critical (and little noticed) element of China's economy, in the current business era when controlling and reducing costs is crucial for businesses' leaders to maintain margins.

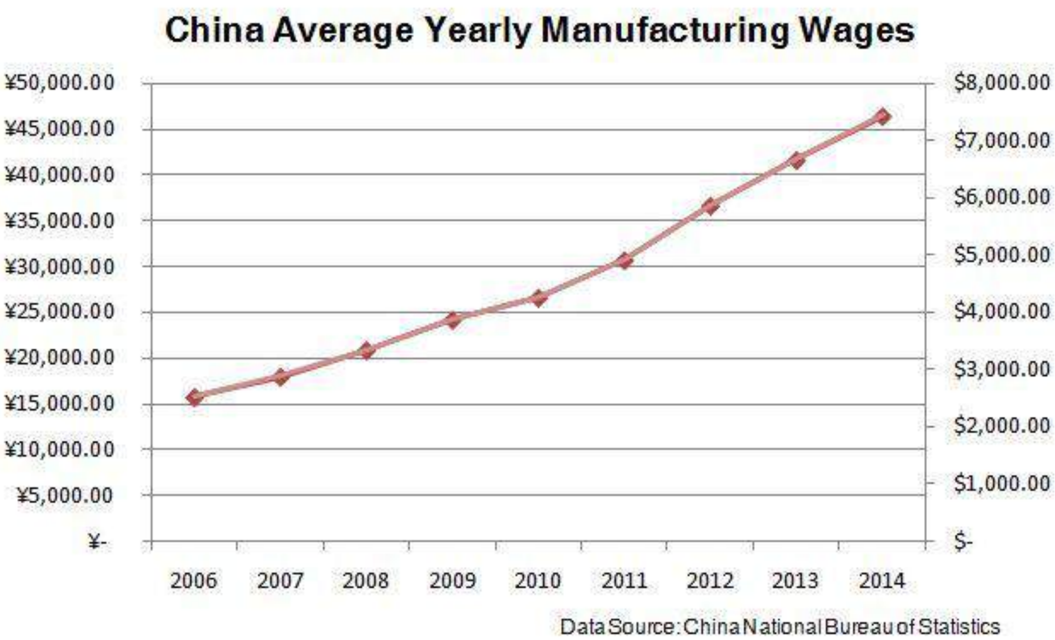
Understanding this appears even more important to us today, when uncontrollable external factors often come into play, such as the currency appreciation that Swiss enterprises experienced at the beginning of the year, sending the cost of Swiss products 15% higher on international markets.

How and why is this at all possible?



The explosion in labor costs is not eroding China's competitiveness

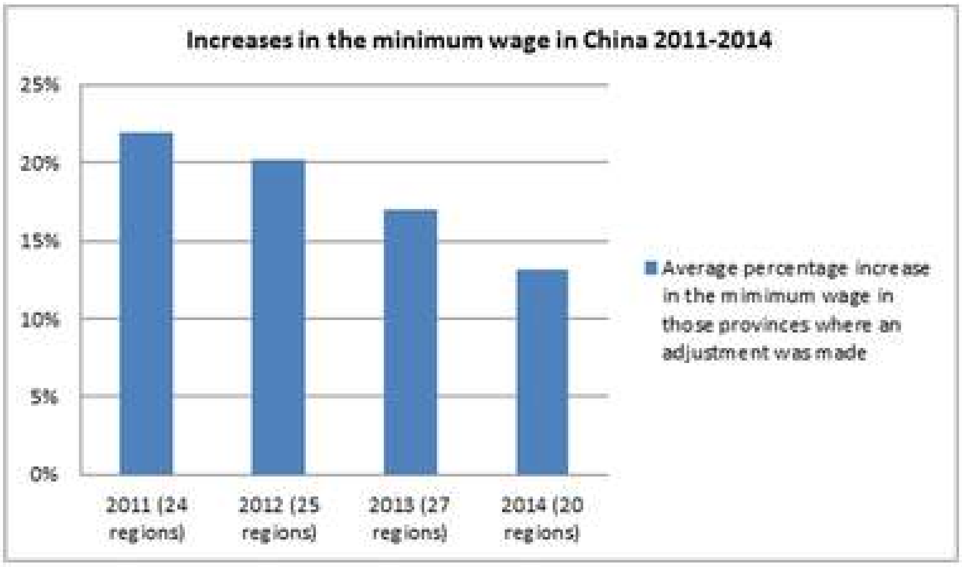
This is a first point to notice, even though from 2006 to 2014, **in just 8 years** that included the worst economic crisis that the world went through since World War II, **China's average manufacturing wages tripled.**



This explosion of labor cost is often mentioned as a defining point in China's overall economic direction and competitiveness, indicating that Chinese producer advantages have already peaked. International businesses moving operations to new low cost countries or back home are presented as examples of a new trend of China's competitiveness erosion.

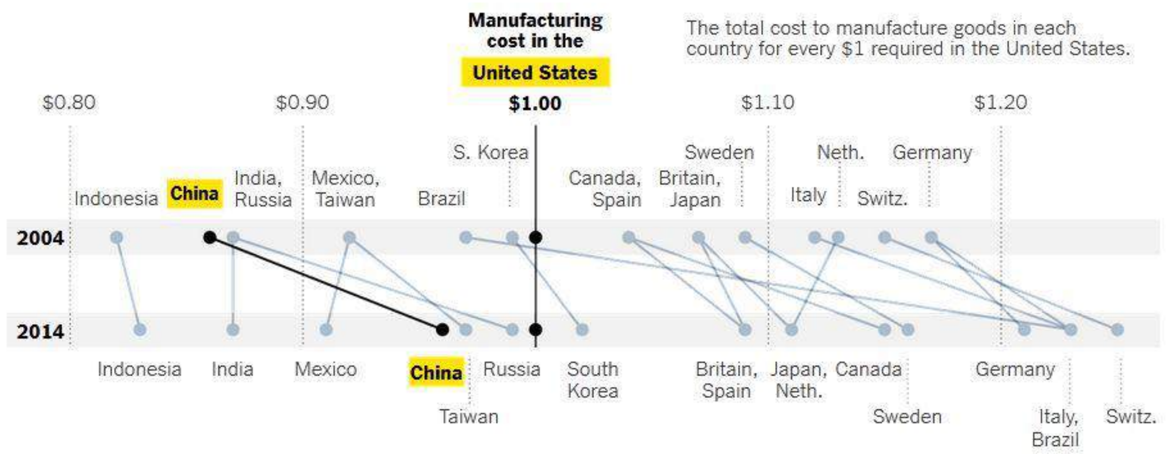
Sporadic reports of labor shortages in the coastal areas of China are highlighted to indicate that labor cost increases are due to market forces, which in turn are bringing China's manufacturing competitiveness to its limits. As a consequence, many believe that the time has come for businesses to look for new, more profit-friendly production locations.

Most of these reports overlook the fact that manufacturing wages increase for a large part because of government ordered increases in minimum salaries, which are part of China's overall strategy of increasing domestic consumption. Indeed, consumption rises most when those at the lowest salary level get a higher disposable income. The better-off are most likely to save a larger part of their salary. In addition, China's middle class is still today a minority of the consumers, further increasing their buying power will not be the optimal action for increasing the overall consumption in the country.



Data source: Asia Pacific Industrial Relations Network

The drastic increases in minimum wages represented above are certainly pushing manufacturing for low-cost, large quantity, labor intensive items (such as mass market cotton t-shirts, other similar garments, sports shoes, and plush toys) to lower cost destinations such as Cambodia or Bangladesh. In spite of the talk about this move to lower cost countries, we do not find evidence on a macro level.



The New York Times | Source: Boston Consulting Group

It is also a fact that international companies are "reshoring." According to a Boston Consulting Group survey, 21% of US companies in China are relocating production back to the USA or a planning to do so[1]. BCG estimates that at least 200 companies have already moved back.[2]

Japanese multinationals are also making the move. Panasonic's President announced in January that the company will be relocating most of their home appliance manufacturing out of China and back to Japan.[3]

The primary reason cited for moving production back home is fast increasing labor costs. However, if rising labor cost is the deciding factor, then it would stand to reason that these companies should be moving to lower cost countries such as Vietnam. Indonesia, as an example, has even lower costs than Vietnam (see chart below).

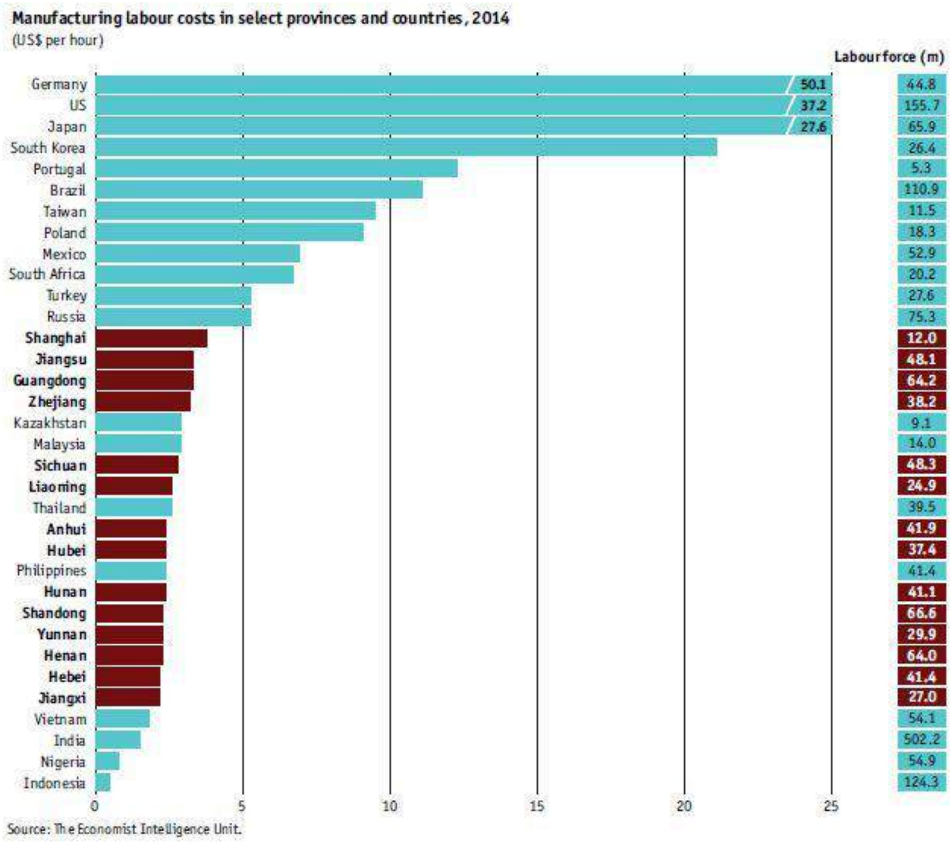
[1] Crooks, Ed. "US Manufacturers 'Reshoring' from China. *Financial Times*. September 24, 2013.

[2] Northam, Jackie. "As Overseas Costs Rise, More U.S. Companies are 'Reshoring.' *National Public Radio*. January 27, 2014.

[3] Wang, Z., Li, X. "Panasonic Joins Trend of Reshoring out of China." *China Daily*. January 8, 2015.

Despite the consistent double digit growth of labor costs in China, the inland China wages are still very close to those of Vietnam (as shown below). Anhui, for example, is only a couple of hours away from Shanghai by high-speed train and around 20% higher than Vietnam in terms of labor costs.

Surely other, more determining factors must be at play.



China's exports continue to gain world market share

If labor cost increases would be critical to the relocation of productions, one would expect Chinese exports to lose ground. Yet, the opposite is happening.

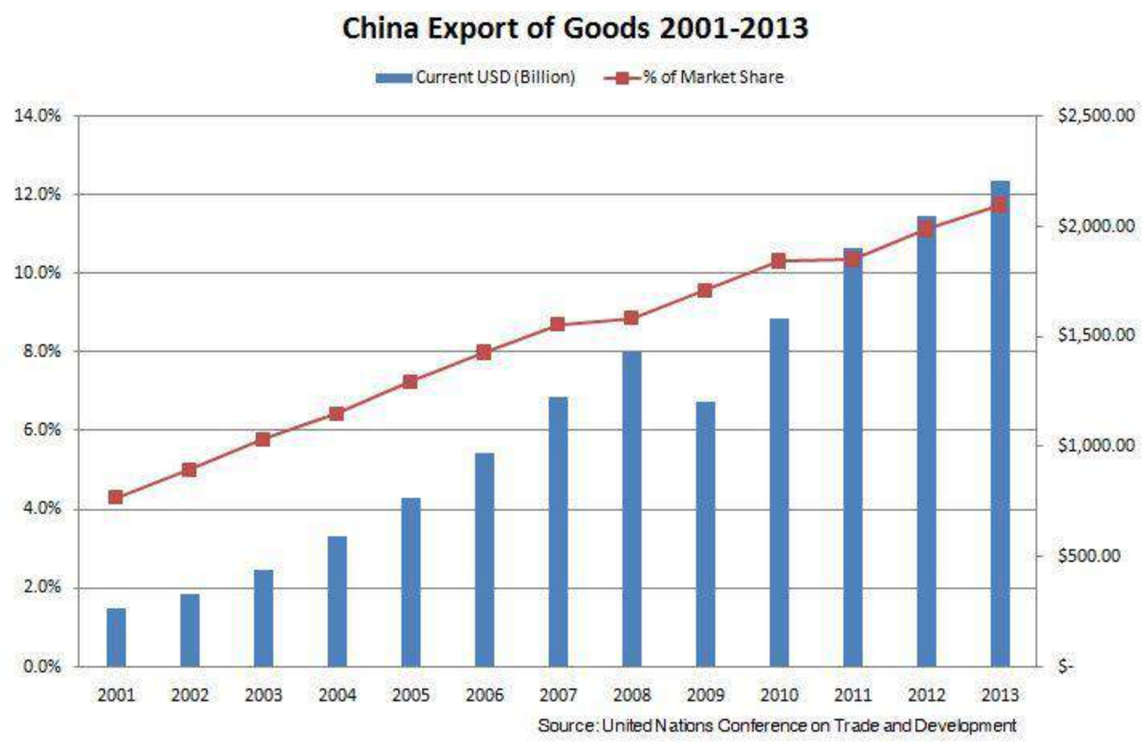
China's export performance has been stellar. After China's entry into the World Trade Organization in 2001, its exports increased at a dizzying rate to nearly 1.2 trillion U.S. dollars by 2009, the same year it eclipsed Germany to become the world's top exporter. China's global share of exports expanded from 4.3% to 9.6% in that same time period.[4] Moreover, these increases occurred in both labor-intensive assemblies and heavy industry/high-tech, increasing China's global share of exports from 17.4% to 32.1% in apparel, 7.5% to 25.9% in furniture, 4.1% to 19.5% in ships, 6.5% to 27.8% in telecom, and 4.9% to 32.6% in office machines and computers.[5]

Since then, China's export share of the world market continued to expand. The country doubled its exports from approximately USD 100 billion worth of goods per month in 2007 to 200 billion monthly at the end of 2014, consistently outperforming average world export growth. In 2009 China accounted for 9.6% of total world exports (in current US$), while in 2013 it accounted for 11.7%.[6]

	2009	2010	2011	2012	2013	2014	2015 forecast
China Export Growth	-16%	31%	20%	7.9%	7.8%	4.9%	7.5%
China Share of World exports	9.6%	10.3%	10.4%	11.1%	11.7%		

4 Sirkin, Harold., Zinser, Michael., Hohner, Douglas. "Made in America, Again: Why manufacturing will return to the U.S." *The Boston Consulting Group.* 2011, and United Nations Conference on Trade & Development Data

6 United Nations Conference on Trade and Development.

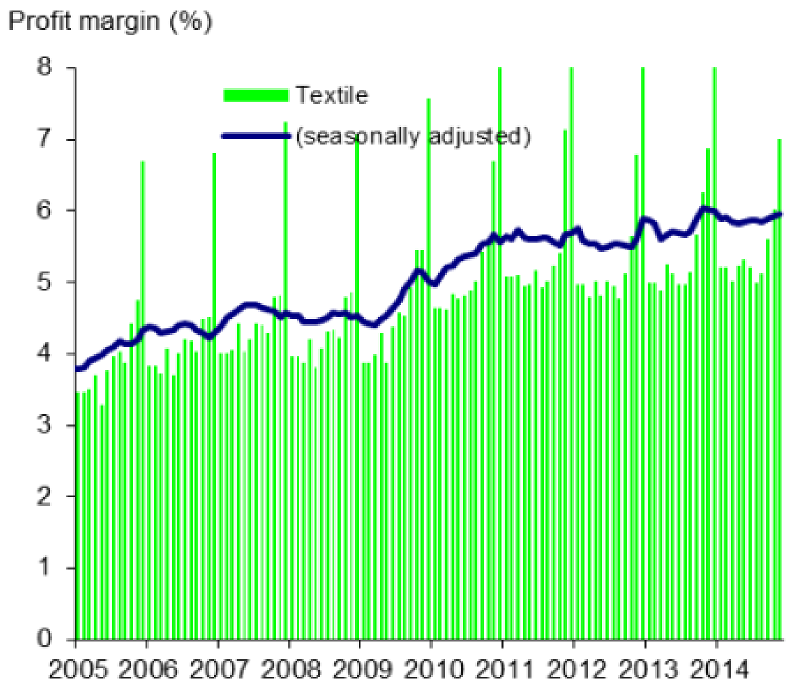


Automation is offsetting labor cost increases

All things considered, it is clear that much higher labor costs have not increased China's production costs or reduced China's export competitiveness. As a result, higher wages should not be a fundamental reason for reshoring or moving production to lower costs countries.

As a matter of fact, the textile industry is showing steadily increasing profits. This is taking place even though textiles are one of the most sensitive industries to labor cost increases. Due to high labor-intensiveness, textiles are traditionally the industries that move first to lower cost locations.

Figure 36: Textile



Source: CEIC, UBS estimates

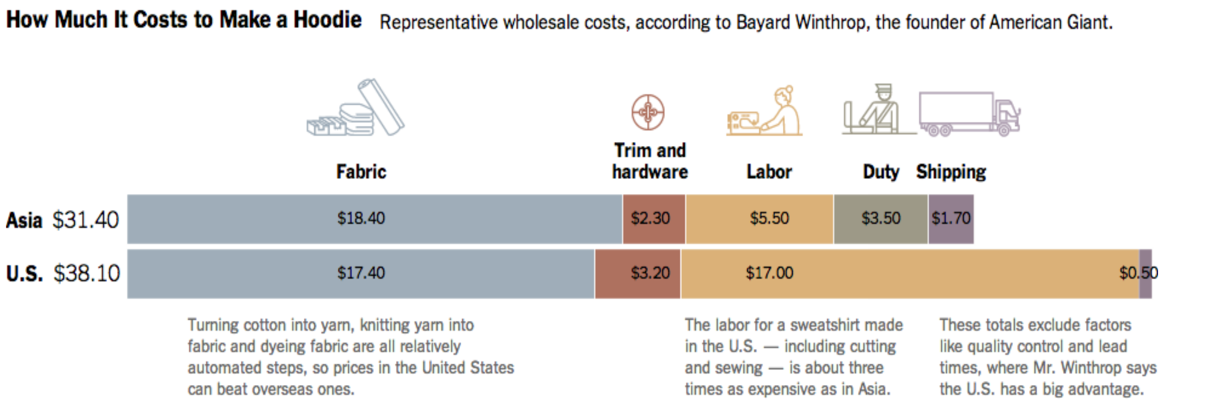
Moreover, in 2013 China was responsible for 37.1% of all textiles produced worldwide, and 80 percent of all man-made fibers are also delivered from China. In 2013, China's textiles industry grew 8.3% and it is estimated to have grown 7.4% in 2014.[7]

Instead of this growth both in turnover and profits, we should see decreasing profits and a decelerating or stable growth if the industry were under heavy pressure from relocation abroad.

Since there is some reshoring to the USA in the textile industry, such examples can provide us more interesting insights.

The cost of making garments, due to the incompressible labor-intensiveness of the activity (no one has invented sewing robots or machines that make garments, up to now), is still significantly more expensive in the USA than in Asia:

[7] Textile World. "A New Openness in China." November, 2014.



However, fabrics and the garment accessories (so-called "trims") actually cost less. All in all, the total cost difference is still 20% in favor of Asia. It is not high enough though, to make an Asian production a no-brainer. Indeed, being close to clients and therefore being able to deliver "in real time" allows adaptability to fashion or customer tastes and minimization of risk on inventory, as opposed to weeks spent travelling by sea. As a result, some garment companies are expanding again in the USA and in Europe; **US textiles export increased as much as 37%** in 2012.

A key factor enabling this (still modest) revival is the new competitiveness of textiles materials producers. This competitiveness is even luring Chinese companies to open spinning mills in the USA. The Hangzhou Ke'er Group is an example: it is currently building up a cotton yarn factory in South Carolina. In total, there are now more than 20 Chinese manufacturing facilities between the two Carolinas.

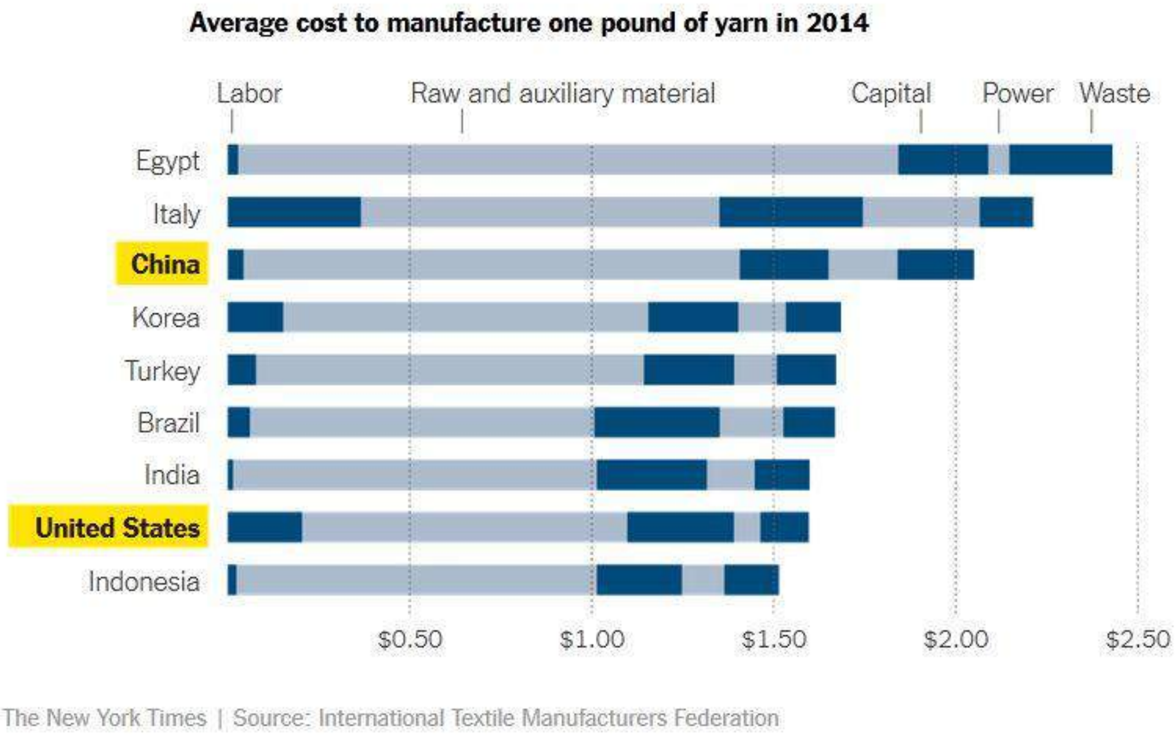
Spinning cotton in the USA has again become a lucrative activity, even attracting private equity investors. What has changed?

A U.S. cotton spinning mill which was closed in the 90s and has been re-opened in 2010 (by Parkdale Mills, in Gaffney, South Carolina) gives us an important clue. There is a fundamental difference in this mills' production today when compared to its previous life: the factory currently produces 1.1 ton of yarn per week with 140 employees. That **same production would have required over 2'000 people in 1980**.[8] As a result of adopting automation, yarn production in the U.S. is now 30% cheaper than in China according to the International Tex-

[8] Clifford, Stephanie. "U.S. Textile Plants Return, With Floors Largely Empty of People." The New York Times. September 19, 2013.

tile Manufacturers Federation. A telling indicator, Keer plans to hire only 500 workers at the newly opened plant in South Carolina.

In the specific case of cotton spinning, the USA has other advantages in addition to efficiency through higher technology. US cotton is competitive internationally and energy prices have come down to half the level in China. Land is also cheaper in the US than in China.



The resurgence in textiles seen in the U.S. is still not on a large enough scale to be considered as displacing China. Sheng Lu, an apparel and textiles expert at the University of Rhode Island, states that the cutting and sewing of textiles is still required to such an extent in normal operations that "it's just impossible for the U.S. to be competitive."[9] Still, the fundamental lesson is that, in much of the manufacturing sector, **automation in developed countries is making the cost of labor less and less relevant**, because plants can produce more and more with fewer and fewer workers.

In other words, the key factor providing renewed manufacturing competitiveness to developed economies is not so much the increase in labor costs in developing ones. What really is

[9] Tabuchi, Hiroko. "Chinese Textile Mills Are Now Hiring in Places Where Cotton Was King" The New York Times. August 2, 2015.

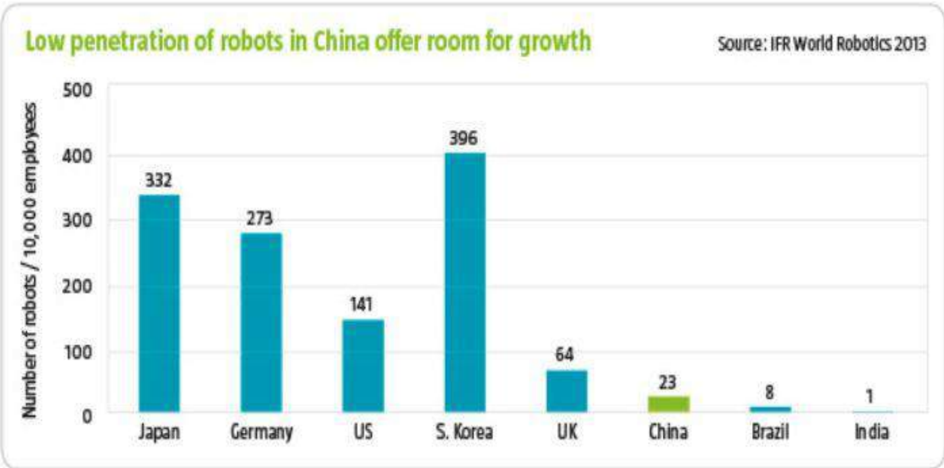
having a stronger impact is the ability of developed economies to replace workers with machines.

The process of replacing labor with machines is accelerating with technology developments in IT, artificial intelligence, while systems prices are falling fast. Today a robot performing repetitive tasks **costs 10 times less** than **10 years ago.**[10]

Automation is also a fundamental factor allowing China's manufacturing to remain competitive in the face of steep labor cost increases.

Little known is the fact that the People's Republic became the biggest robot market in 2013, accounting for about **20%** of world sales. On average, the **total supply of industrial robots in China has increased by about 36% every year between 2008 and 2013**.

If we were to hope that such large new installations of robots will soon realize China's productivity potential, we would be mistaken:
China had almost **20 times less robots** per manufacturing employee in 2013 than Korea.



Looking ahead, what does it all mean for us?

In addition to the obvious conclusion that it is the right time to expand in China for robotics and automation companies, below are some consequences that may be useful to most of us:

First of all, **technology is going to matter more and more** to businesses, not only in developed economies but also in China. Services, too, will gain enormous opportunities through

[10] http://www.reuters.com/article/2015/02/10/us-manufacturers-robots-idUSKBN0LE00720150210

technology thanks to the increasing availability of large sets of consumer data, allowing companies to better serve Chinese customers. Given the importance of this factor, it is crucial to understand what is happening in China on the science and technology scene.

Proximity to customers will also matter more and more, provided well educated people and machines are available. Indeed, when the cost of labor loses its relevance and technology takes over, costs in different locations will tend to get closer. If the capabilities to customize and operate the machines are available, production will be best carried out close to the customers. With similar costs, proximity to customers will allow businesses to provide the advantage of better understanding and satisfying client's needs. (That is additional to saving on customs duties as well as transportation costs and time.)

From this point of view, China's enormous potential market and enormous efforts put into developing technology provide the country the opportunity to become an even stronger manufacturer. (On the other hand, other developing countries with large populations will be slow to catch up, if they cannot keep up in technological development.)

For foreign companies this also means **providing sufficient flexibility to their local operations to gain advantage from clients' proximity** and to adjust to local customers. The "Challenges to Overcome for Success" section of this survey indicates "lack of support and understanding from the head office" as one of the top 5 internal challenges for foreign companies in China.

China will remain cost competitive for production. China's current export competitiveness and enormous potential for automation speak for themselves: wages can keep increasing and workers can be replaced by robots for a long time. (Meanwhile, wage increases are also slowing down. it will be interesting to know what the next 5-year plan, starting in 2016, has in store in terms of minimum wages increase.)

This, however, depends on China being able to train a well educated work force fast enough. Education will be a challenge, but China has the opportunity to draw on an enormous pool of Chinese studying abroad to compensate for the deficiencies of the local system. We then naturally see improving the education system as a key factor for the successful and long term fast development of the country.

Businesses, Chinese and foreign, have to become increasingly efficient. Prices are very unlikely to go up, at least for a few years; meanwhile, costs will still continue to rise. In addition to business growth, every manager will need to constantly have efficiency and productivity increases on her or his mind.

Swiss companies have additional challenges - and **opportunities**. The sudden increase in the Swiss Franc will mean even more efficiency for those who want to keep selling to the very price sensitive China market.

On the other hand, Chinese products are becoming cheaper in many ways. In addition to the exchange rate, the lower cost of production and the Free Trade Agreement (FTA) are reducing the landed costs of Chinese industrial goods in Switzerland and provide an opportunity to expand sourcing and production operations in China to offset the strong Franc.