

USCBC 2011 China Business Environment Survey Results: Market Growth Continues, Companies Expand, But Full Access Elusive for Many

- » US-China Business Council (USCBC) member companies continue to experience healthy market growth in China. Eighty percent of respondents reported double-digit revenue growth in 2010, and over 40 percent had revenue growth of more than 20 percent. In comparison, average revenue growth in 2010 for the S&P 500 companies was 11.4 percent over the previous year. Most surveyed companies had higher profit margins in China than in their worldwide operations in 2010 and view China among their top five priorities for their global strategic plans.
- » Despite the fact that China provides an important source of growth and profitability for US businesses, companies face real challenges when doing business in China and have significant concerns about their ability to compete on a level playing field.
- » USCBC's 2011 survey echoes the same top five issues from its 2010 survey: Significant staffing challenges, licensing and approval barriers, cost increases, competition with Chinese companies, and intellectual property rights (IPR) protection remain top concerns.
- » Incremental progress continues to be made on some issues, but problems remain. This year's survey again showed gradual improvements in IPR enforcement and transparency – but both issues remain in the top 10 list of concerns.
- » Progress in other areas seems to have stagnated. USCBC member companies view a number of key issues – including administrative licensing, competition with Chinese companies, restrictions on foreign investment, and market access for services companies – as largely unchanged since 2010.

USCBC Members' Top 10 Issues

1. Human resources: Talent recruitment and retention
2. Administrative licensing, including difficulties gaining business licenses and product approvals
3. Cost increases, including labor and materials inflation
4. Competition with Chinese companies (state-owned or private)
5. Intellectual property rights enforcement
6. Standards and conformity assessment
7. Restrictions on inbound foreign investment, including ownership limits
8. Transparency
9. Nondiscrimination/national treatment (equal treatment with Chinese enterprises)
10. Market access in services, including financial, legal, information, and telecom

- » Companies are also adjusting to the new realities of the China market, particularly rising costs. This rose through the rankings to become members' third-ranked issue. Members reported a variety of higher costs, especially increasing labor costs, but also noted higher costs for materials, utilities, and transportation.
- » Despite rising costs, companies are committing more resources to their China operations. This increased commitment reflects the fact that 93 percent of respondents affirm that they are in China to reach the China market, not use the country to serve as a low-cost export platform. Cost increases are part of the landscape in China's fast-growing economy.
- » Companies remain relatively optimistic about business prospects despite continued concerns. Fifty-eight percent of respondents said they are optimistic about the five-year outlook for their operations in China, with another 33 percent saying they are "somewhat optimistic." This optimism is tempered by a sense of caution about policy trends, with 30 percent of respondents saying they are less optimistic than they were three years ago, even if still optimistic overall.
- » The exchange rate does not impact US company competitiveness in China, compared to other market access issues. The exchange rate issue ranked 26, five slots lower than last year.
- » US companies operating in China remain positive models for their Chinese counterparts. Nearly 70 percent of US companies in China pay wages higher than the average in their area. More than 90 percent bring their global environmental, health, and safety standards to their China facilities, which in nearly all cases provide better protections to workers and the environment than required by local standards.
- » Other topics of interest in this year's report include competing with China's state-owned enterprises (SOEs, p.12); "forced" technology transfer (p.20); and how to effectively address trade and investment issues with the Chinese government (p.7).

Key Takeaways

- » Impressive market growth, positive top and bottom line impact, important to company health and US jobs
- » Considerable array of issues: Talent shortage tops the list again, but Chinese government policies, market access restrictions, and level playing field concerns weigh heavily in key sectors
- » Incremental progress on many issues, supporting the need to continue to engage the Chinese government on reducing barriers across the board
- » China is a \$150–\$200 billion market for US companies—and probably should be even more

Market Growth Continues, Companies Expand, But Full Access Elusive for Many

Table of Contents

1. Human Resources: Talent Recruitment and Retention	8
2. Administrative Licensing, Business and Product Approvals	9
3. Cost Increases	10
4. Competition with Chinese Companies	12
5. Intellectual Property Rights Enforcement	14
Box: Courts as an Enforcement Tool	16
6. Standards and Conformity Assessment	17
7. Restrictions on Foreign Investment	19
Box: “Forced” Technology Transfer—Some Context	20
8. Transparency	21
9. Nondiscrimination/National Treatment	22
Box: Indigenous Innovation	22
10. Market Access in Services	24
Respondent Profile	25

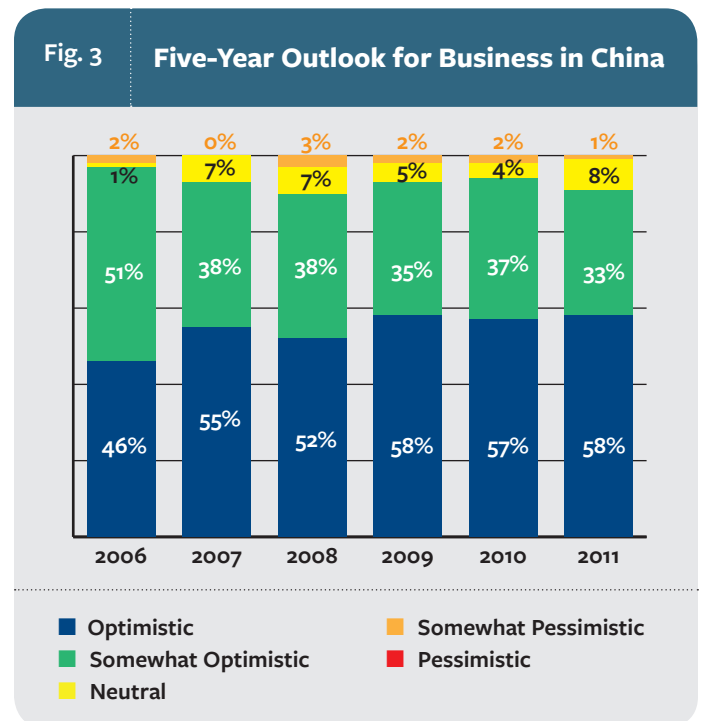
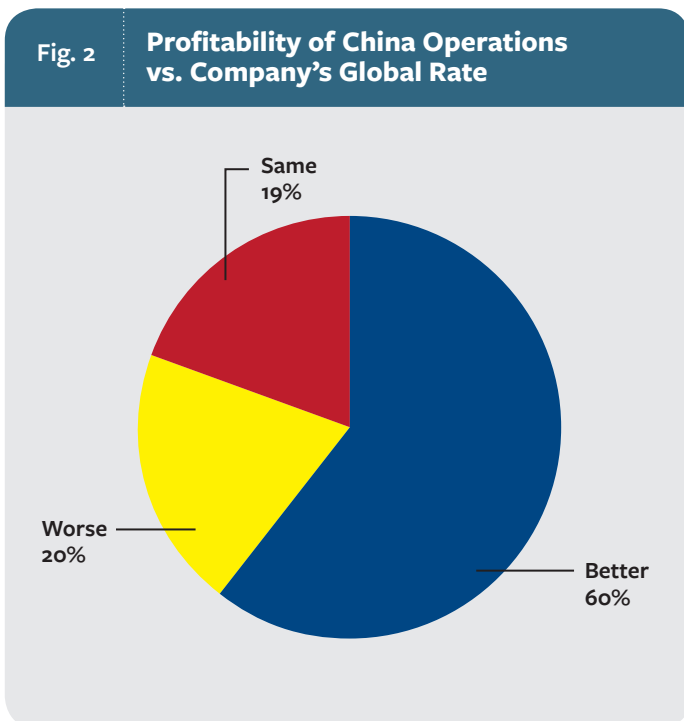
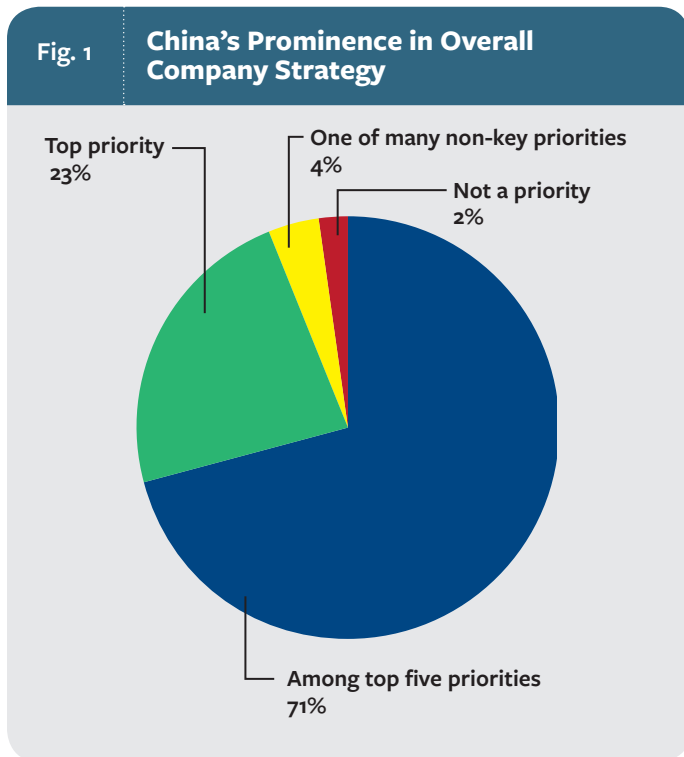
USCBC 2011 Member Priorities Survey Results

The US-China Business Council (USCBC) surveys its member companies annually to determine their views of the business climate in China and assess the top challenges of doing business there. As in past surveys, USCBC members report strong revenue and profit growth and likely

an even stronger commitment to build business there in the coming year. Three-fourths of respondents note that they will increase resources devoted to China business in the next 12 months. These numbers have remained high for the last several years, reflecting China's status as a top performing market, even through the global recession.

Survey data indicates that China is becoming more important as a market for overall company growth strategies. Twenty-three percent of respondents cite China as their top priority market (see Figure 1), up from 18 percent last year, and 60 percent said that the profitability margin of their China operations was better than their company's global profit margin (see Figure 2).

USCBC companies also remain fairly optimistic about the future: Roughly 91 percent of respondents stated they were either optimistic or somewhat optimistic about the five-year outlook for their business in China. This optimism is tempered to some extent by a sense of caution about policy trends, with 30 percent of respondents saying they are less optimistic than they were three years ago, even if still optimistic overall (see Figures 3 and 4).

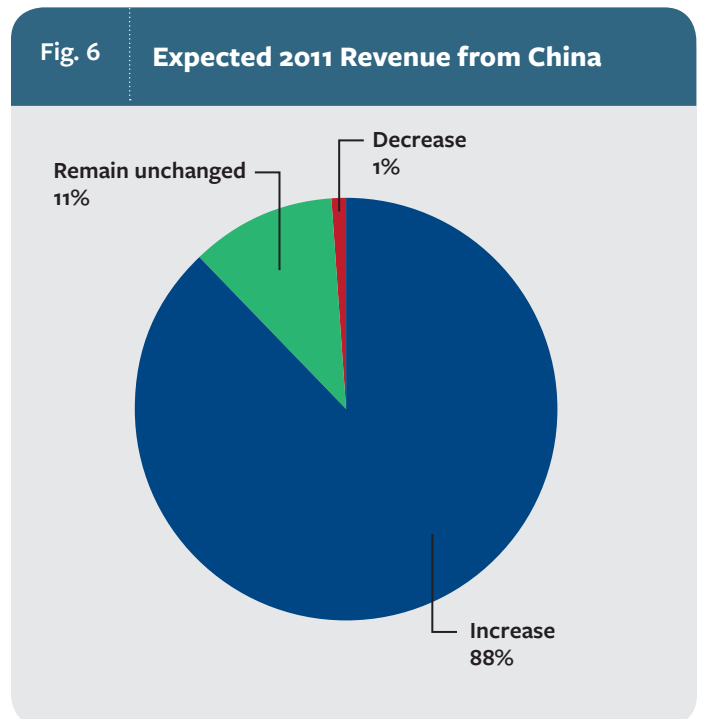
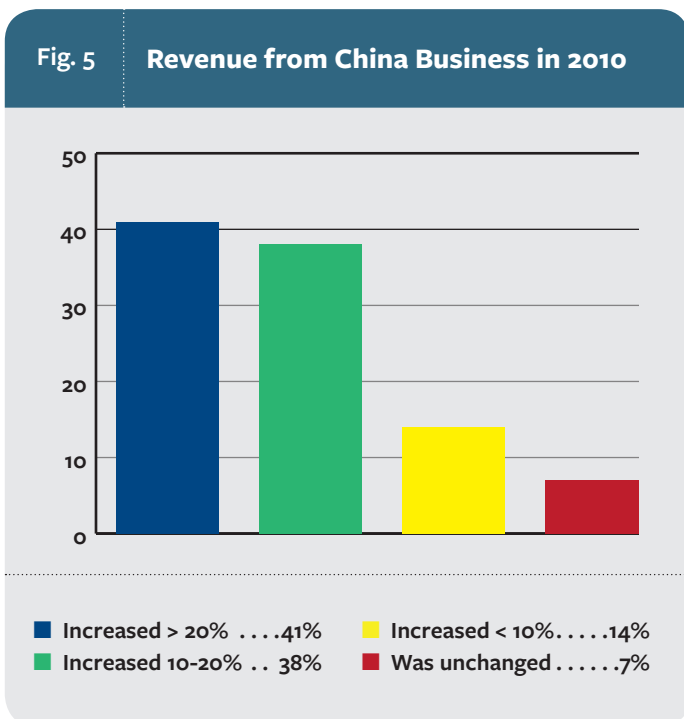
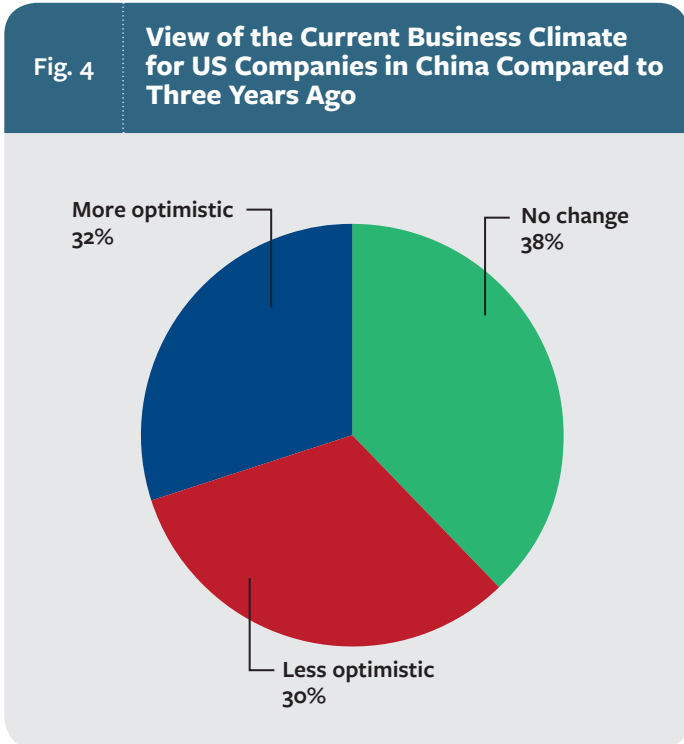


What is the key driver behind this optimism? Market growth—growth that drives US exports to China, in-country sales, jobs, and overall company health. China (including Hong Kong) is now America's third-largest export market, receiving \$118 billion in exports in 2010. US exports to China

have risen 468 percent since 2000—ten times faster than US exports to the rest of the world.

In addition, US companies' China operations are an important contributor to overall corporate sales. According to the latest available statistics from the US Bureau of Economic Analysis, US subsidiaries in China sold \$87 billion in products in-country in 2008. The same year, services contributed another \$12 billion in local sales by US companies' China operations. Add it all up and eliminate overlaps, and China is at least a \$150 billion market for US companies and is probably closer to \$200 billion.

To illustrate the importance of this growth, while the global economy continues to recover in fits and starts from the economic recession of 2009, nearly 80 percent of USCBC's 2011 survey respondents reported double-digit revenue increases in China. Even more impressive, over 40 percent had revenue growth of more than 20 percent. Eighty-eight percent of respondents said they expect their revenue from China will rise again this year (see Figures 5 and 6).



These numbers underscore a key point: USCBC companies are in China to access the rapidly expanding domestic China market. Ninety-three percent of respondents indicated they are primarily in China to access or serve the China market, as opposed to seeking an export platform. Therefore their success is tied to the growth and productivity of the Chinese economy as a whole. When the Chinese economy

does well, so do American companies. Respondents saw their companies' fortunes rise throughout the second half of 2010 and the first half of 2011, roughly running in parallel to China's economic recovery. Eighty-five percent of respondents recorded a profit in 2010; nearly 80 percent say profit margins in China are the same as or better than their company's margins globally (see Figures 7-9).

Significant Challenges Remain

Despite these successes, survey respondents also consistently point out concerns with a long list of operational and policy-related challenges. Difficulties in finding and retaining top talent and managing rising costs are two of the most intractable challenges that companies face. Both are part of the landscape of doing business in China. The persistent presence of these issues near the head of the top 10 list suggests that solutions are likely to be longer term.

At the same time, many of the issues on the list have clear links to PRC government policies, indicating that there is much more the government can do to improve the business operating environment and, ultimately, market access. Though "protectionism" itself did not make the top 10 list as it has in past years, it is important to note that protectionism plays a role in many top 10 items, such as licensing, investment restrictions, and national treatment.

Fig. 7 Company Objectives in China

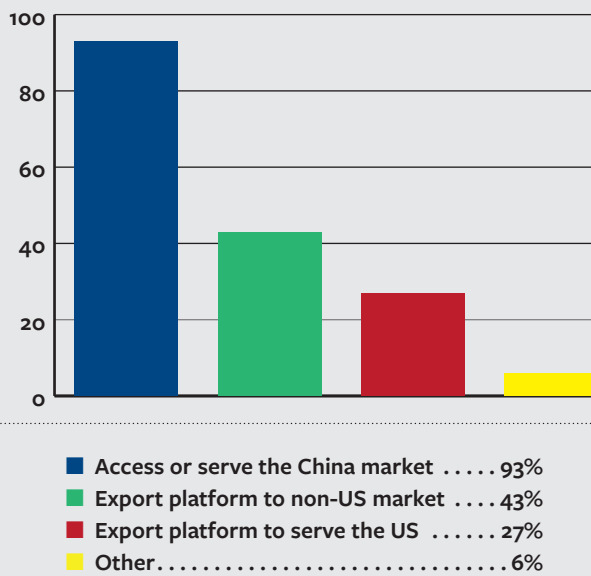


Fig. 8 Are Your China Operations Profitable?

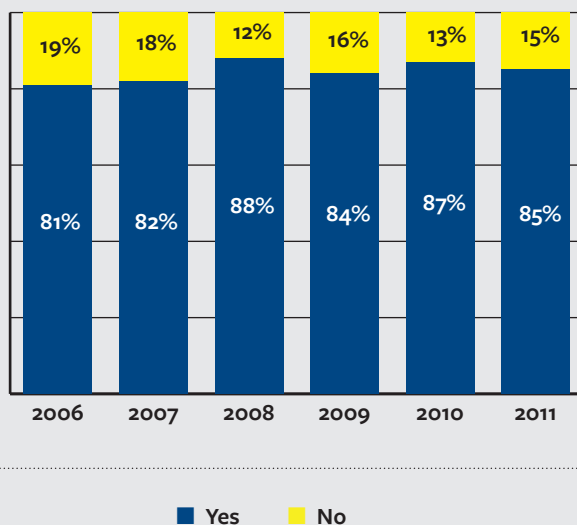
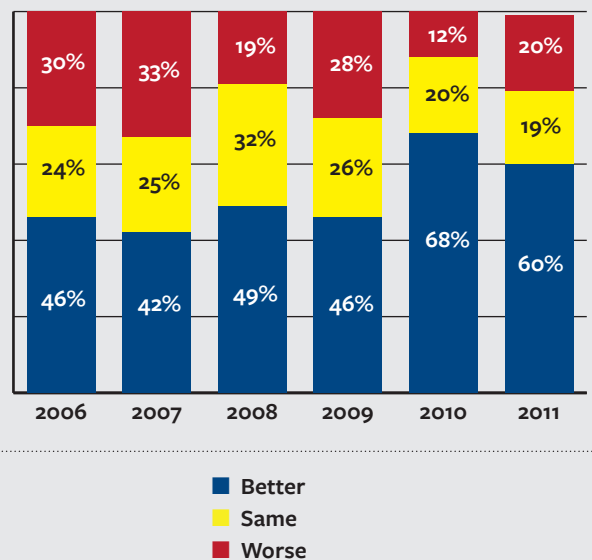


Fig. 9 Profitability of China-based Operations Compared to Company's Overall Operations



As a further illustration, respondents also cited PRC government policies and regulation as one of the top three restraints on their profitability in China. The high rank given by respondents to restrictions on foreign investment suggests that companies are increasingly concerned about discriminatory treatment. Such concern may be exacerbated by the absence of meaningful reductions in investment restrictions in the most recent draft of China’s Catalogue Guiding Foreign Investment in Industry, which sets the guidelines for foreign investment in China.

Unfortunately, there is no easy, simple fix to the array of market access and level playing field issues in China. Protectionism can manifest itself in multiple, disparate and often uncoordinated ways. It is important to accurately define issues and identify appropriate, effective actions to address them. Engaging in focused, well-coordinated, and

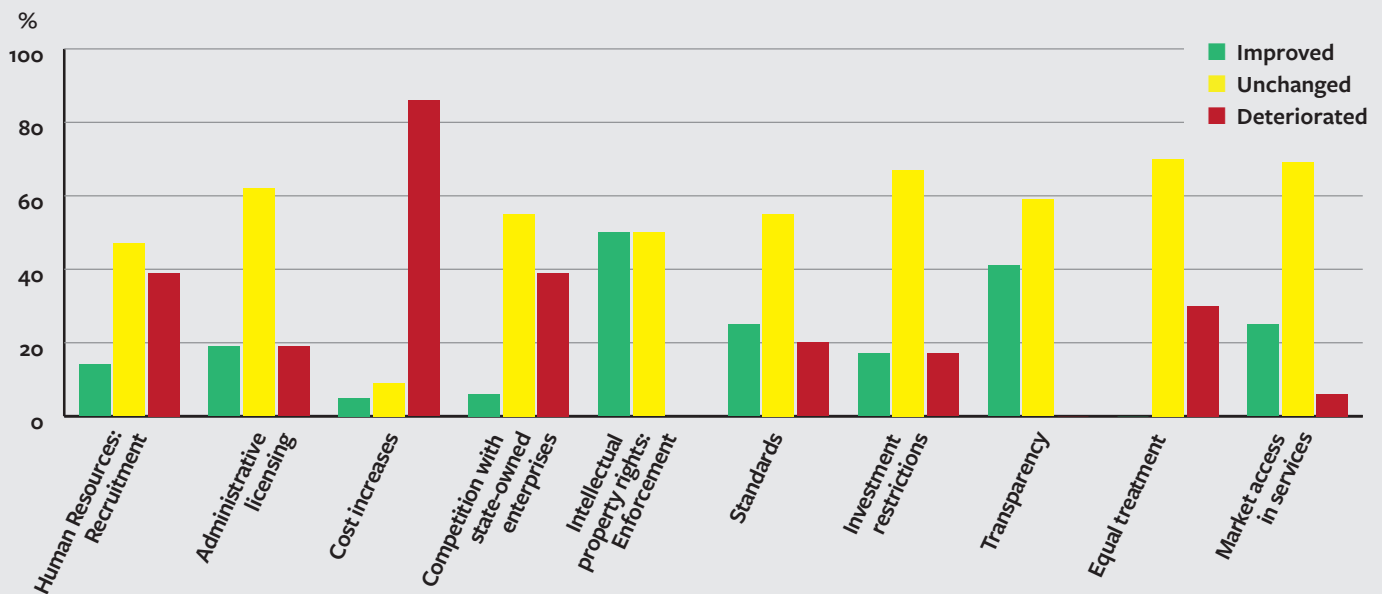
regular dialogue with the PRC government on both the broad principles and the specific issues is the best way to achieve solutions. But when good-faith negotiations fail, using internationally accepted, rules-based legal remedies—such as antidumping investigations and World Trade Organization cases—is appropriate.

Top 10 Business Issues in China

As in past years, USCBC’s 2011 survey asked respondents to rank the top five challenges they face when doing business in China. Respondents were then asked to assess whether those areas have improved, remained the same, or deteriorated over the past year (see Figure 10).

The results form USCBC’s top 10 list, which is ranked in order of priority and explained in the sections that follow.

Fig. 10 Progress on Top 10 Issues



1. Human Resources: Talent Recruitment and Retention

Progress: Unchanged
 Rank in 2010: 1 (tie)
 Rank in 2009: 3
 Rank in 2008: 1 (tie)
 Rank in 2007: 1
 Rank in 2006: 1

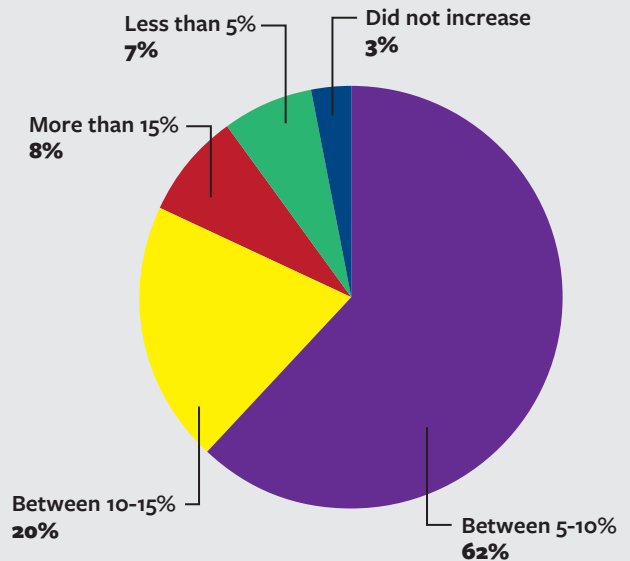
Human resources was the uncontested top challenge for member companies in China in this year’s survey, continuing a six-year trend of being at or near the top of USCBC’s survey.

The human resources challenges companies face encompass finding, hiring, and retaining employees in China’s highly competitive environment. Companies reported that it is becoming increasingly difficult to recruit and retain talented employees because the demand for such employees – by multinational corporations (MNCs) and, increasingly, Chinese employers – outstrips availability. In particular, companies noted difficulties in recruiting qualified managerial and technical talent.

Increased competition is not simply for experienced managerial professionals, however. Companies looking to find skilled blue collar factory workers are facing labor shortages in eastern China, and these shortages are expected to intensify. According to a director of the Chinese Academy of Social Sciences, China’s coastal region is already short an estimated 10 million workers.^[1]

These shortages frequently affect bottom lines as companies seek to retain employees through improved compensation and benefits packages. One USCBC survey respondent noted factory wages increased 20 percent year-on-year in 2010, causing labor costs to inflate quickly and make retention more difficult due to an even more aggravated shortage of labor. Companies report the same challenges with retaining skilled and white collar workers. According to a 2011 MRI China survey of more than 3,000 mid- to senior-level managers in China and Hong Kong, workers changing jobs

Fig. 11 Wage Increases in 2011



received significant increases in compensation, with nearly half reporting an increase of more than 30 percent. Such compensation jumps are likely fueled by high turnover figures: Sixty-four percent of respondents in mainland China reported they had received at least one offer from another company over the previous 18 months.^[2] Towers Watson noted earlier this year that employee turnover rates for China reached almost 25 percent in 2010.^[3]

Across all types of workers, wages continued to rise in 2010. More than a quarter of survey respondents indicated wages had increased by at least 10 percent in the past year (see Figure 11).

In short, the talent shortage is one of the greatest restraints on company growth in China.

[1] Cai Feng, Director, Institute of Population and Labor Economics, China Academy of Social Sciences, *China Times*, March 4, 2011. (www.chinatimes.cc/cns/subsite/2011lh/ygh/2011-03-04/1227.shtml)

[2] MRI China Group, “2011 Greater China Talent Environment Index,” April 2011. (www.development-ybc.com/wp-content/uploads/2011/08/MRI_China_Group_Greater_China_Talent_Environment_Index_English.pdf)

[3] Towers Watson, “Towers Watson Newest Survey Shows Compensation Increases Across Industries More than Predicted in 2010; Rising Incomes Concentrated for Working-Level Staff Expected to Continue in 2011” (Taorui Huiyue Zui Xin Tiaoyan Xianshi 2010 Nian Ge Hangye Shiji Xinchou Zengfu Gaoyu Yuqi, 2011 Nian You Wang Jixu Pansheng Liudong ‘Dahu’ Jizhongyu Jiceng Yuangong),” February 2011. (www.towerswatson.com/china/press/3919)

2. Administrative Licensing, Business and Product Approvals

Progress: Unchanged
 Rank in 2010: 1 (tie)
 Rank in 2009: 1
 Rank in 2008: 1 (tie)
 Rank in 2007: 2
 Rank in 2006: 2

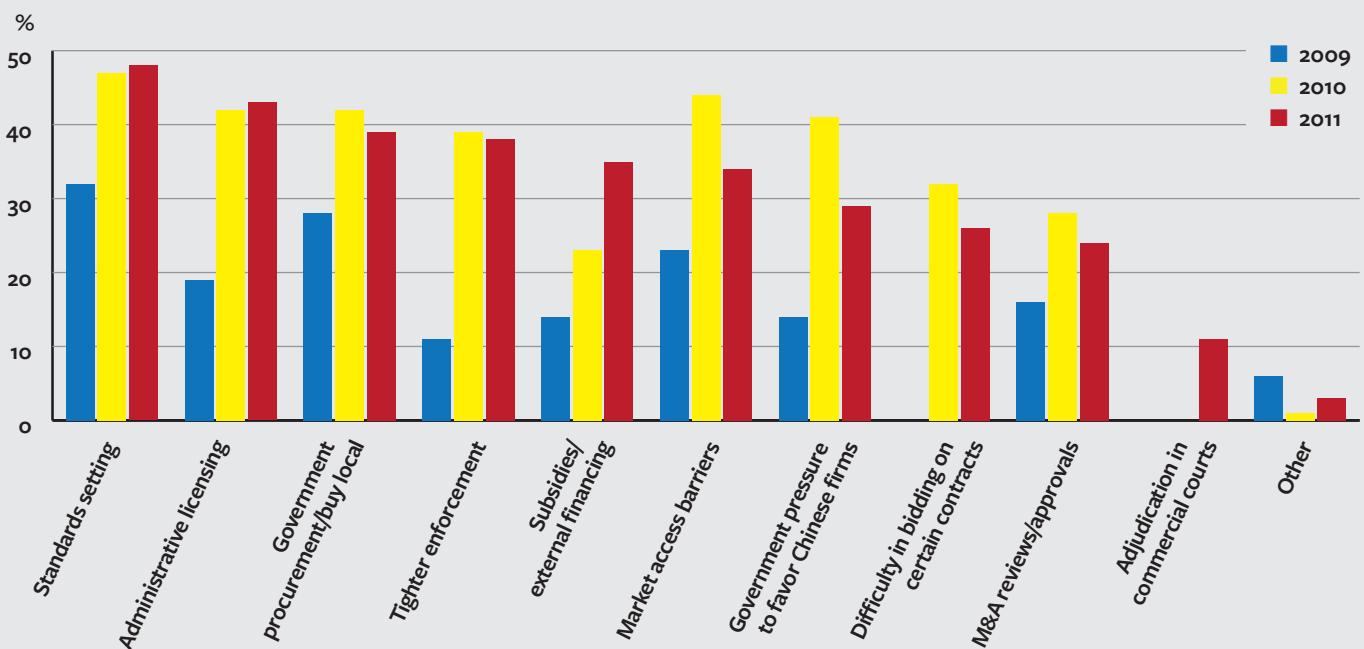
Administrative licensing has taken the first or second spot in USCBC’s top issues list since 2006. Administrative licensing covers a number of business operating, product approval, investment review, and related issues that challenge companies on a daily basis and slow investment and expansion. Companies face ongoing difficulties in obtaining required licenses for doing business, with firms in some sectors waiting months for business license approvals despite regulations that require decisions in a matter of weeks. Disagreements between regulators often result in confusion and delay in applying for and receiving permits.

The ability of foreign companies to receive required operating licenses in a timely, efficient way is linked to other top 10 issues, particularly transparency and national treatment. Unclear regulations and approval procedures and inconsistent implementation by central and local government agencies often lead companies to believe that the licensing system may be biased against them, particularly if domestic competitors seem to more easily obtain licenses and approvals. Indeed, 43 percent of survey respondents reported seeing signs of protectionism in administrative licensing (see Figure 12).

Most companies surveyed – 62 percent – had not seen improvements in the administrative licensing process compared with the previous year, while 19 percent indicated the situation has deteriorated since the year before. As one company explained:

“We move tens of thousands of shipments across the border every day. [China] Customs has gone backward recently. New rules require importers of low-value samples and advertising materials and samples to register with Customs – a time consuming and frustrating process – or to hire an agent with the appropriate registration. Customs has also published, but not fully implemented, strict new rules on advanced cargo declarations.”

Fig. 12 Areas with Signs of Protectionism



3. Cost Increases

Progress:	Deteriorated
Rank in 2010:	5
Rank in 2009:	13
Rank in 2008:	3
Rank in 2007:	Not asked
Rank in 2006:	Not asked

Cost increases returned to its pre-global economic crisis ranking in the survey, indicating that companies may be back to “business as usual” in China, with labor and material demand at pre-crisis levels and rising costs weighing heavily on executives’ minds. Most respondents (85 percent) said rising costs are a problem, and nearly 80 percent noted that rising costs will have “some impact” on long-term investment plans and strategic planning (see Figures 13 and 14).

Companies reported across-the-board cost increases, affecting labor, raw materials, land, utilities, and transportation prices. Yet most companies – 65 percent – reported that labor was the greatest source of concern, and several companies said their labor costs have increased more than 20 percent annually (see Figure 15).

Companies expressed great concern that inflation has been driving up the cost of doing business. Member companies explain:

“Inflation in China has been a long-standing issue. Employees are willing to change jobs readily for a slight increase in pay in order to ‘stay above water’ with the increasing cost of living. With inflation in all areas, particularly housing and food, at such a rampant pace, the dynamics of retaining employees, managing profitability, and investing for growth adds new challenges to maintaining a flourishing business in this market.”

Fig. 13 Are Rising Costs in China a Concern?

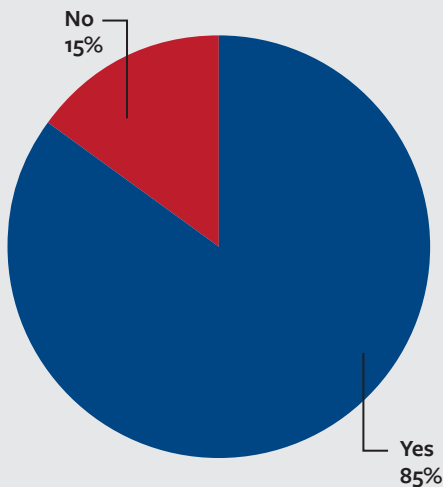


Fig. 14 Impact of Rising Costs on Long-Term Planning

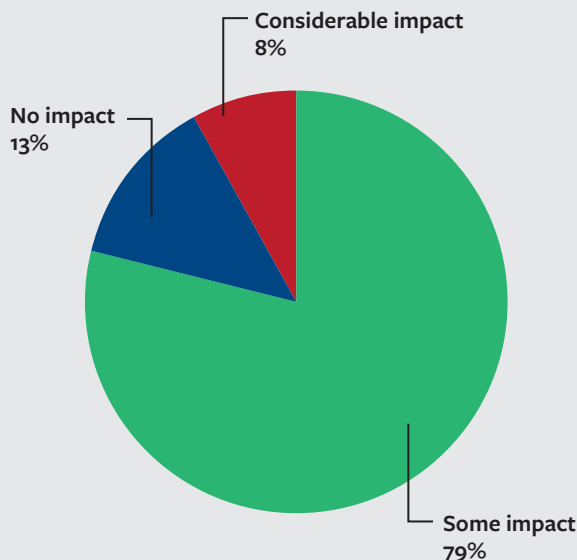


Fig. 15 Rising Cost of Most Concern

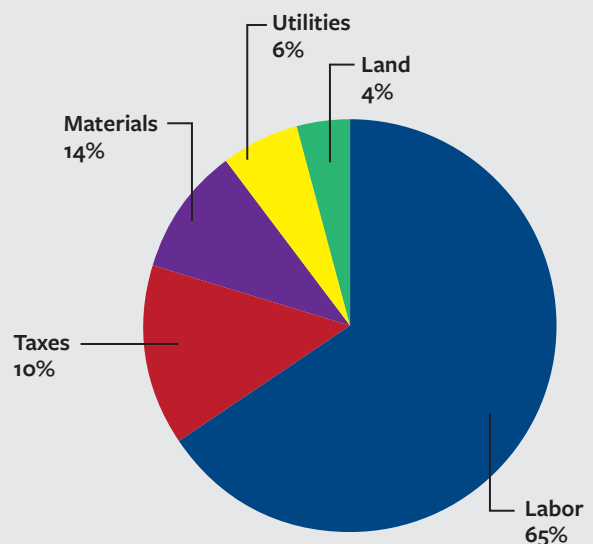
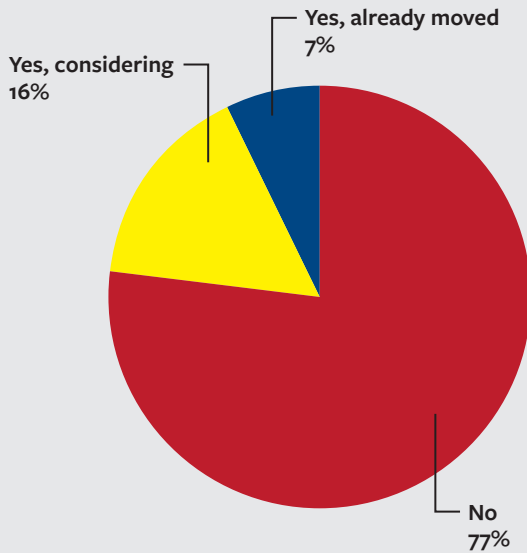
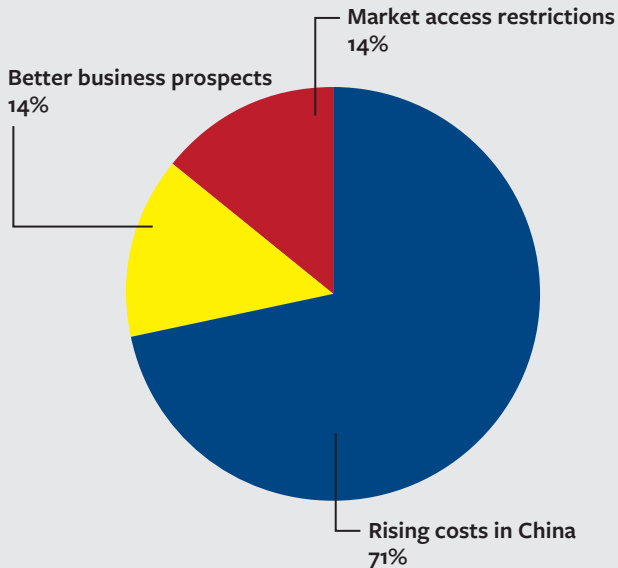


Fig. 16

Has Your Company Considered Moving Operations from China to Another Asian/East Asian Country?



Why?



"The raw material costs have greatly increased whether from overseas or domestic sources. With the labor cost increases and higher inflation rate than officially published, it impacts the costs greatly. Cost increases mean less profit for reinvestments."

"Raw material and other cost increases have brought great financial burden to our business last year and this year."

Rising costs are a genuine concern to companies, but they are also a fact of life for companies committed to serving the China market. Of the companies that said rising costs were either having some or considerable impact on future investment plans, 74 percent said their resource commitment in China would nonetheless accelerate over the next 12 months. The large majority of those companies (86 percent) are also optimistic or somewhat optimistic about their five-year outlook.

Several companies noted that despite incurring higher costs, they have not been able to raise prices due to concerns from Chinese policymakers about the impact of inflation on consumers. PRC government regulators are more carefully scrutinizing pricing through enforcement of China's Antimonopoly Law. In the words of one company: "Raw materials, labor, utilities, and other costs increased, but it's difficult to deliver these increases downstream."

Despite these cost increases, very few respondents have considered relocating their operations, or some functions of it, to lower-cost markets in Asia (see Figure 16). This reflects the key point that USCBC companies are in China to reach the China market, not establish a low-cost export platform (see Figure 7).

4. Competition with Chinese Companies (SOEs and Private)

Progress:	Improved
Rank in 2010:	1 (tie)
Rank in 2009	4
Rank in 2008:	7
Rank in 2007:	4
Rank in 2006:	4

In five of the six past years, USCBC member companies ranked competition with PRC companies roughly in the middle of the top 10 challenges. In the 2010 survey, the issue tied for number one with administrative licensing and human resources. The tie was due in part to company concerns about proposed PRC policies that favored domestic companies in innovation and government procurement policies.

Competition with Chinese companies encompasses two elements: market competition and policy preferences. On the one hand, PRC companies are aggressively moving up the value chain to capture market share both in China and globally and are increasingly competitive in those markets. At the same time, respondents expressed concern about competition with Chinese companies because of discriminatory favorable treatment received by domestic enterprises from central and local governments.

The concerns extend beyond just state-owned enterprises (SOEs), though SOEs provide a good example. Nearly three-quarters of respondents said their companies directly compete with SOEs in China for business opportunities. Of those companies, 96 percent indicated they believe SOEs receive tangible benefits or subsidies from the government. Only 36 percent of respondents said they have concrete knowledge of SOEs receiving tangible benefits or subsidies, but another 60 percent reported that they suspected their SOE competitors might receive favorable treatment (see Figures 17-20). Favorable treatment comes in various forms, but the most frequently cited benefits are preferential licensing and approvals, access to government contracts, and preferential government financing.

Significantly, nearly 40 percent of respondents also said these benefits were being received by non-SOE competitors. This data is a useful reminder that the goal should be to level the playing field for all enterprises in China by focusing on the behaviors or discriminatory advantages enjoyed by domestic enterprises, regardless of the form of ownership.

Fig. 17

Do You Compete Directly with SOEs in China?

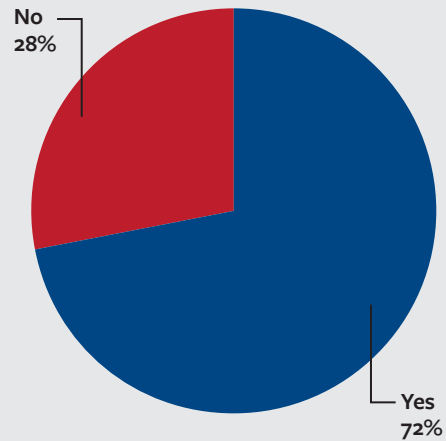


Fig. 18

Are your SOE Competitors Receiving Tangible Benefits?

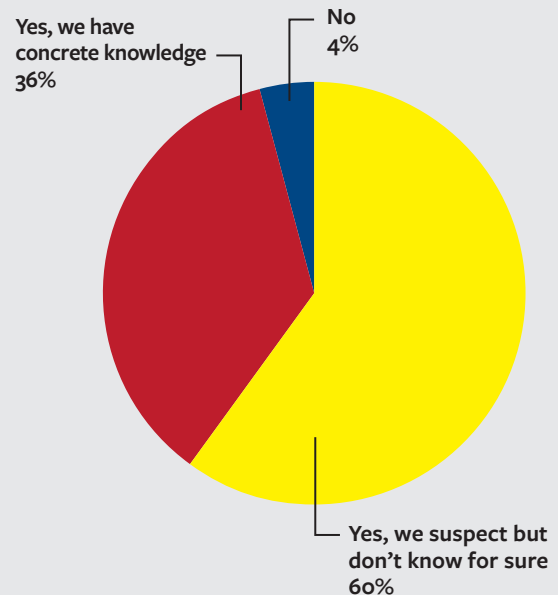


Fig. 19 Areas of Preferential Treatment for SOEs

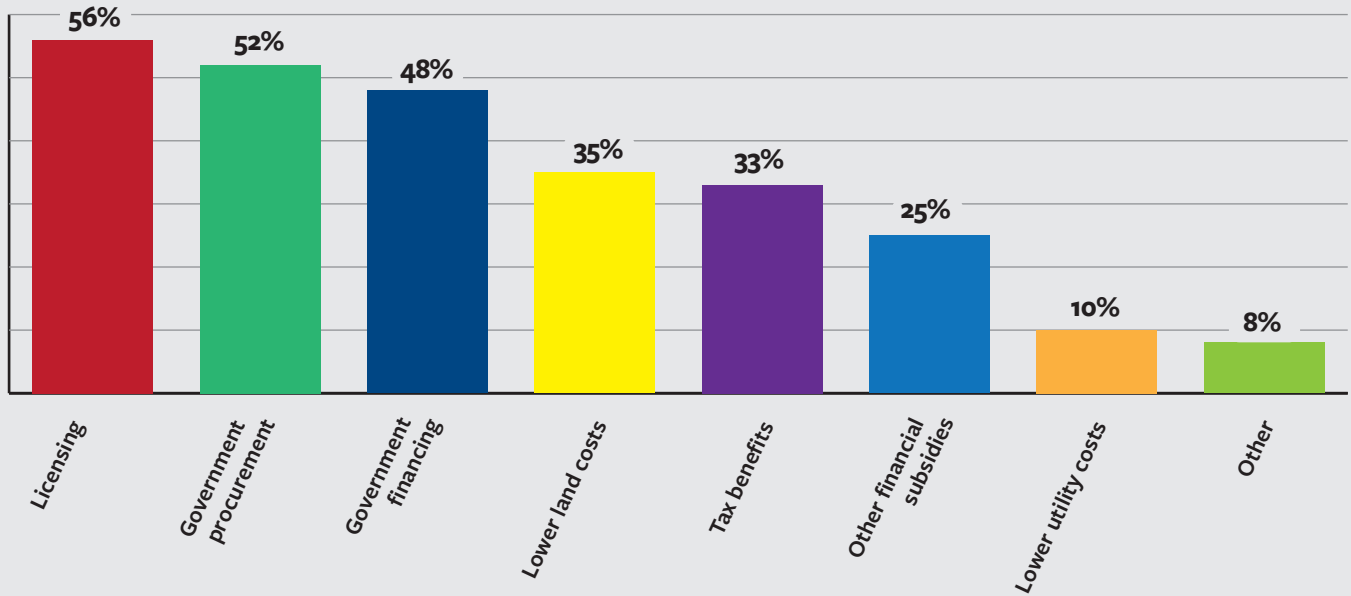
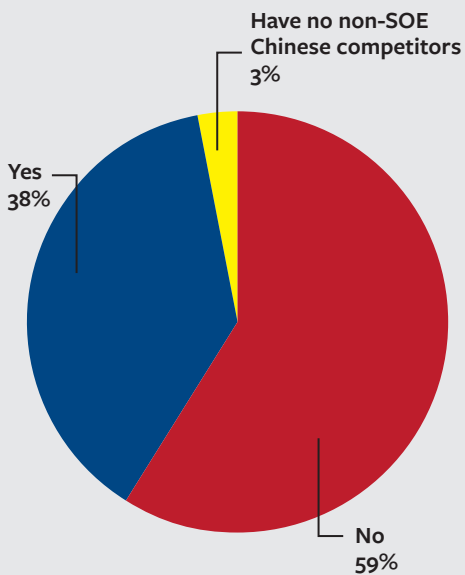


Fig. 20

Are Your Non-SOE Chinese Competitors Receiving These Benefits?



The root problem for US companies competing with Chinese companies appears to be the lack of a clear dividing line between the government and enterprises. As companies explained:

“First, domestic competitors are progressing with their skills and product quality. At the same time it is easier for them to receive government support. Their way of making products and doing business is usually more ‘flexible,’ which gives them certain advantages.”

“The Chinese government has provided higher R&D [research and development] grants or development funds to Chinese companies in our industry. It is difficult for us to compete with this.”

“Domestic players dominate the channels and customers, and [the domestic players] enjoy favorable policy and regulatory treatment.”

5. Intellectual Property Rights Enforcement

Progress:	Improved/Unchanged
Rank in 2010:	4
Rank in 2009:	8
Rank in 2008:	6
Rank in 2007:	3
Rank in 2006:	3

Companies remain focused on their inability to sufficiently protect and enforce their intellectual property rights (IPR) in China, as this issue remains entrenched in USCBC’s top 10 list. Of those surveyed, 93 percent indicated they were either somewhat or very concerned about IPR enforcement (see Figures 21–23).

In light of these concerns, it is important to note that recent central government efforts to promote IPR protection – most notably its recent special campaign to combat IPR infringement – have had a positive impact according to survey respondents. Companies indicated that government officials have been paying greater attention to IPR enforcement, resulting in incremental improvements. More than half (57 percent) of respondents believed that IPR enforcement improved in 2010, a sharp uptick from the previous year. Companies saw progress during the campaign and affirmed the importance of focused government attention to resolving the problems:

“The State Council ‘special campaign’ has created favorable visibility among Chinese policymakers on the problems associated with counterfeits and pirated goods. We have seen some improvement as a result of concerted government attention.”

Fig. 21 Concern about China’s Enforcement of Its Regulations Protecting Intellectual Property

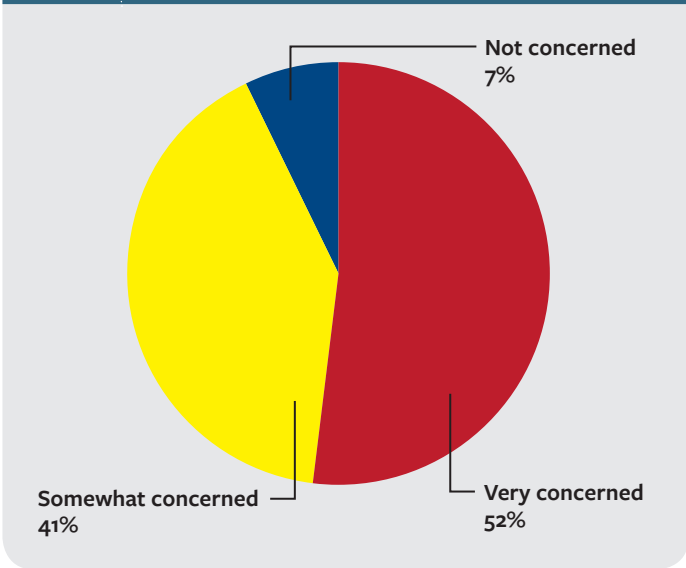


Fig. 22 Over the Past Year, China’s Protection of IPR...

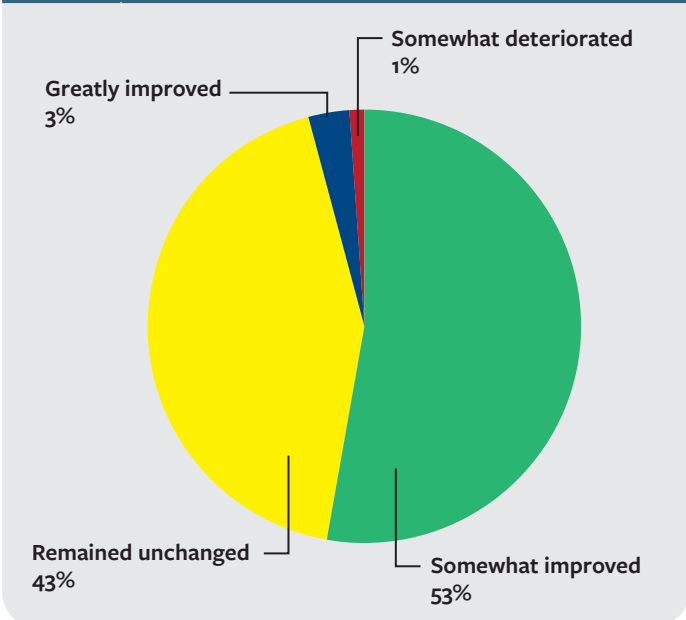
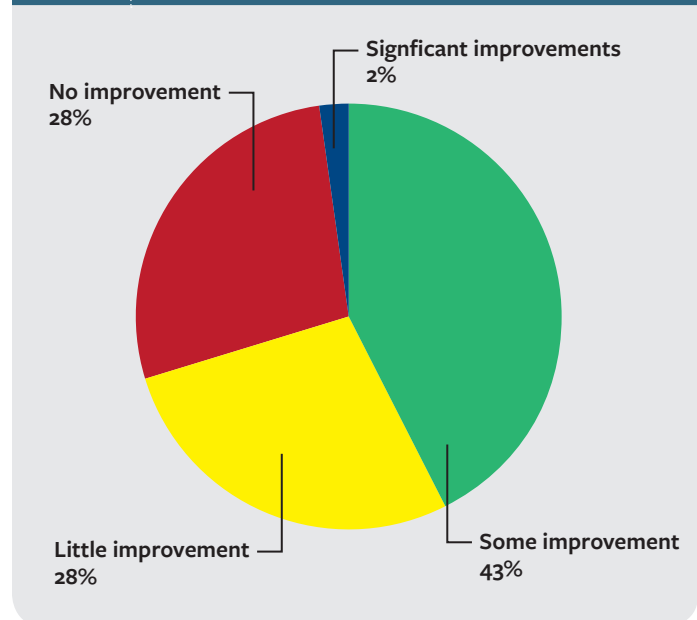


Fig. 23 Did China’s 2010-2011 IPR Campaign Improve Enforcement?



Though many of the improvements are attributed to greater awareness of and willingness to tackle IPR infringement under the campaign, several respondents also pointed to specific legal changes, such as those made to the PRC Patent Law, as improvements. Respondents noted other positive developments including more active enforcement of IPR rules by local Administrations for Industry and Commerce and a visible increase in the number of anti-counterfeiting raids.

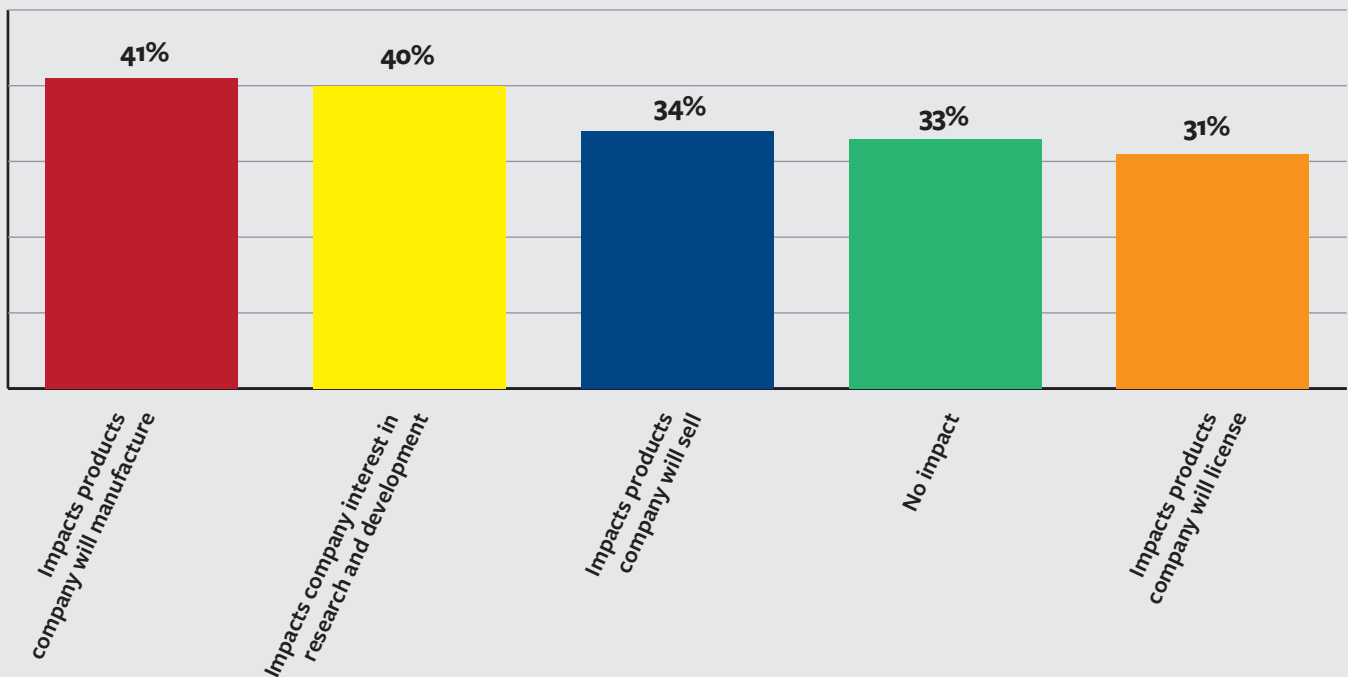
Yet the success of China’s IPR campaign also highlights the continued shortfalls of IPR enforcement. China’s weak IPR enforcement regime negatively affects the types of commercial activities that companies are willing to undertake in China. A significant percentage of respondents said they remain reluctant to sell, manufacture, or co-license products in China because of lingering concerns over IPR enforcement (see Figure 24). As in previous years, only one-third of respondents said China’s inadequate IPR enforcement had no impact on their approach to the market.

According to one company:

“The continued overall lack of deterrence against piracy, market closures or barriers for creative content, and the imposition or specter of discriminatory policies toward foreign content, suggest a conscious policy seeking to drive Chinese competitiveness while permitting free access to foreign content through unapproved pirate channels. China’s principal reliance on its woefully under-resourced administrative system to deal with IPR infringements rather than through criminal enforcement presents a significant hurdle to effective enforcement.”

It is precisely because the IPR challenges are so unrelenting that USCBC continues to advocate for improved enforcement measures such as automatic criminal prosecution for certain types of IPR crimes, the removal of value-based thresholds on counterfeit goods for criminal prosecution, and simplifying the procedures to file IPR cases. In addition, institutionalizing the campaign, including the increased attention and material resources allocated to IPR protection at all levels, would greatly improve the prospects for IPR enforcement in China.

Fig. 24 Does the Level of IPR Enforcement Negatively Affect the Type of Activities Undertaken in China?



Courts as an IPR Enforcement Tool

Outside of administrative channels, companies appear to have increasing confidence in PRC courts as a viable tool for combating IPR infringement. Significantly, 71 percent of respondents said the courts can be viable to varying degrees, while 29 percent said the courts are not viable, which is down from 43 percent in USCBC's 2010 survey. Only 17 companies reported bringing an

IPR infringement case to a Chinese court within the past three years, but three-quarters of those indicated they had secured a successful ruling. The jurisdictions with the most viable courts were reported to be in unspecified "big" and "developed" cities such as Beijing, Shanghai, and Guangzhou (see Figures 25 and 26).

Fig. 25 Has Your Company Brought an IPR Infringement Case to Court in the Last Three Years?

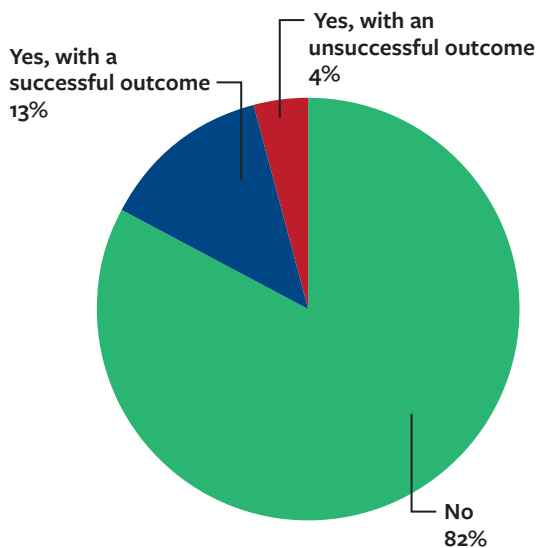
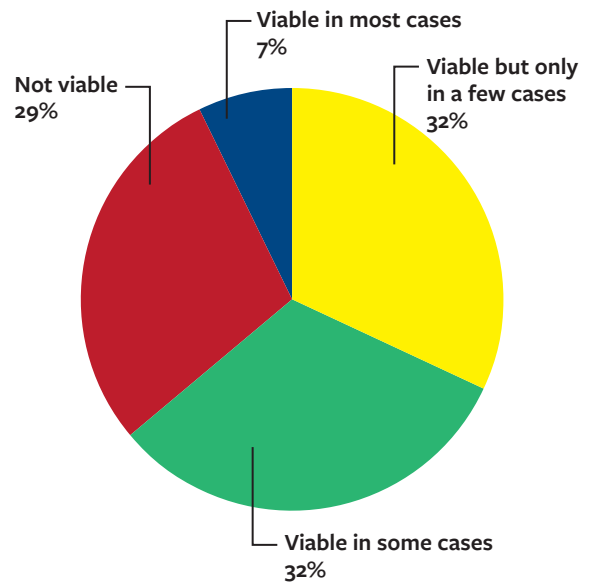


Fig. 26 Are China's Courts a Viable Tool for Fighting IPR Infringement?

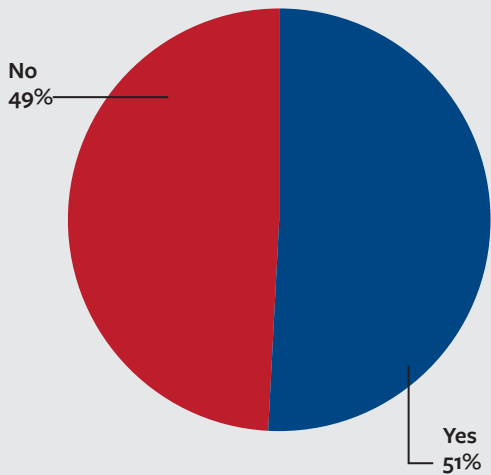


6. Standards and Conformity Assessment

Progress:	Unchanged
Rank in 2010:	10
Rank in 2009:	6
Rank in 2008:	14
Rank in 2007:	6
Rank in 2006:	6

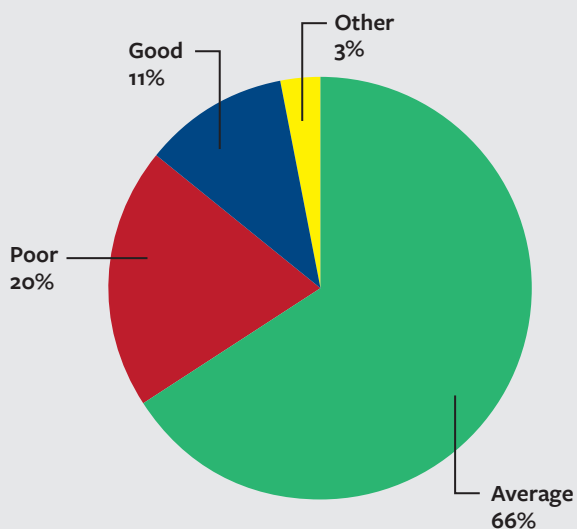
Another top area of concern for USCBC companies is China’s standards and conformity assessment system, in which participation and compliance remains problematic for many foreign companies. Both standards and conformity assessment provide critical ground rules for products entering the market as companies determine how products are designed, manufactured, sold, used, and disposed of, and how they are certified in compliance with each of these steps.

Fig. 27 Does Your Company Participate in China’s Standards and Conformity Assessment System?



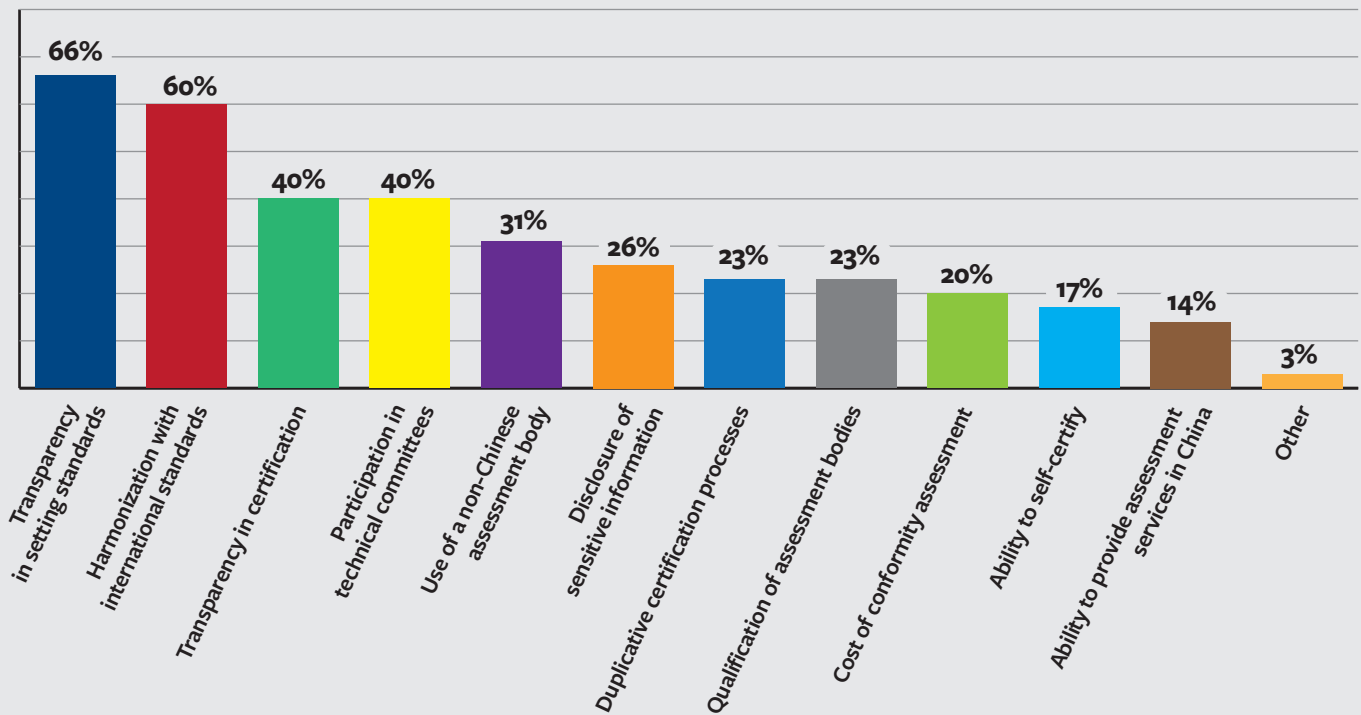
Though China has made some progress on this issue, foreign companies remain especially concerned about barriers to participate in standards-setting activities. While overall US company participation remains roughly the same as last year – around 50 percent – those rating their ability to participate as “good” fell from 20 percent to 11 percent, and those rating their ability to participate as “poor” jumped from 8 percent to 20 percent (see Figures 27 and 28). These types of negative changes feed company belief that China’s standards-setting process is primarily a tool to protect the local market. Nearly half (48 percent) of respondents indicated as such; more than half of respondents said standards was the most prevalent form of protectionism in China (see Figure 12).

Fig. 28 Ability to Participate in China’s Standards Setting Process



PRC regulators have adopted international standards in some sectors but continue to impose unique standards for many products, creating significant hurdles for US companies attempting to bring their products to the China market. As survey respondents noted, the situation is not improving. More than half (60 percent) of respondents reported that the lack of harmonization with internationally accepted standards was a problem, compared with only 48 percent indicating so in the 2010 survey. Similarly, many respondents pointed to a lack of transparency in China’s standards conformity assessment systems. Two-thirds said the standards-setting system is not transparent, while 40 percent flagged a lack of transparency in testing and certifying products. Forty percent of respondents cited the inability to participate as a voting member of technical committees in China as a top problem. Other company concerns with China’s standards and conformity assessment system include the inability to use a non-Chinese government conformity assessment body, duplicative testing and certification, the lack of qualified conformity assessment bodies, and high costs associated with the conformity assessment process (see Figure 29).

Fig. 29 Top Concerns With China's Standards and Conformity Assessment System



One company explained the challenges of China's standards system, noting that China should use and recognize international standards instead of setting its own regional standards, further open and allow foreign entities to participate in standards setting, and stop replacing text from international standards with text that favors indigenous innovation.

For more information about specific problems US companies face in participating in China's standards and conformity assessment process, and recommendations on ways to improve the system, see the March 2011 Letter and Paper on Standards and Conformity Assessment drafted by USCBC and a group of US industry associations (www.uschina.org/public/documents/2011/03/standards_letter.pdf).

7. Restrictions on Foreign Investment

Progress: Deteriorated
Rank in 2010: 14
Rank in 2009: Not asked

Due to various government regulations, opportunities for foreign investment are uneven across China’s commercial landscape. Though companies in many sectors can establish wholly foreign-owned enterprises (WFOEs)—in fact, 77 percent of foreign direct investment in China last year was in WFOEs—others are limited to joint ventures and minority stakes. Some companies face licensing criteria that effectively exclude them from the market altogether. Notable industries affected by investment restrictions are in key sectors such as agriculture, automobiles, chemicals, energy, express delivery, insurance, securities, and telecommunications.

In 2011, the PRC government released a draft revised version of the Catalogue Guiding Foreign Investment in Industry, which categorizes foreign investment in various products or sectors as “encouraged,” “restricted,” or “prohibited.” Ownership restrictions are imposed in many sectors, including those in the “encouraged” category. Though the release of a draft catalogue marked a step forward for transparency, the draft itself was disappointing. Despite numerous statements from senior PRC leadership that the revised catalogue would introduce more sector openings and present substantial new investment opportunities for foreign companies, the updated catalogue retained nearly all the restrictions that have raised concerns among USCBC member companies in the past and imposed new constraints.

In particular, continued restrictions in financial services are extremely concerning and counter China’s goal of increasing its domestic demand. Financial sector reforms and market openings would help reduce China’s excessively high savings rate and stimulate consumption. A number of companies in other industries also noted greater restrictions on their investments. For example, the draft

revised foreign investment catalogue proposes a reduction in permitted foreign ownership from 100 percent to 50 percent for enterprises producing key parts and systems used in electric vehicles, such as batteries. The revised catalogue also raises concerns about increasing restrictions across the agriculture sector.

Moreover, the few positive changes made to the catalogue—such as removing healthcare from the restricted category and thus allowing wholly foreign-owned medical facilities to operate on a pilot basis—might not necessarily mean a more open environment. For example, one healthcare company noted:

“Healthcare has been taken off the restricted category on the investment catalogue, but [it has] not gone on to the encouraged list. We are still subject to many restrictions; specifically, not being allowed to open branch operations is currently the biggest troublesome issue. In addition, the draft removed from the catalogue biomedical material and product manufacturing, which previously fell under the encouraged category.”

The continued use of an extensive foreign investment catalogue, which is in some ways a relic of China’s planned economy, and significant ownership restrictions in many key sectors are gaining increasing attention from the American business community. As China seeks to invest more in the United States, it is likely that a natural ally for such investment—the business community—will instead object to providing open access to Chinese investors here while US companies face extensive restrictions in China. Reducing investment barriers is one of the best opportunities to significantly improve the commercial relationship on a mutually-beneficial basis.

For more on specific concerns about the catalogue, see USCBC’s recommendations for revisions to the 2011 Draft Catalogue Guiding Foreign Investment in Industry (www.uschina.org/public/documents/2011/04/catalogue_recommendations_eng.pdf).

“Forced” Technology Transfers—Some Context

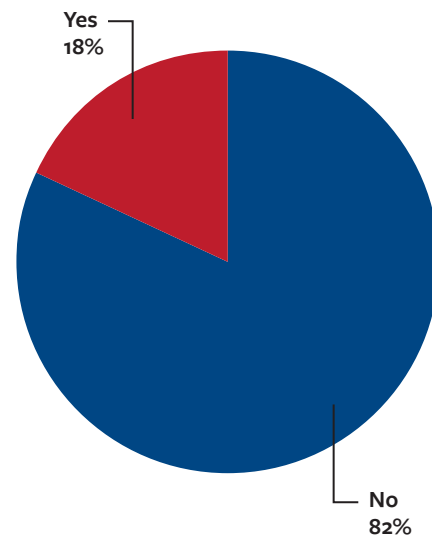
It is not uncommon to hear voices in the United States decry “forced technology transfer to China” in return for market access, but this year’s survey shows that the issue is more nuanced than the headlines suggest.

The PRC government certainly has a long-term strategy to bring in foreign technology. But technology is not simply “given to China.” Instead, technology is typically licensed to a China-based entity in which the foreign company has an ownership stake. In many cases the foreign company owns 100 percent of the entity in China; in some cases, the foreign company must form a joint venture with a Chinese partner. (This is one reason the foreign ownership restrictions cited above are so important to address.) In exchange, the company determines a value of the technology to be transferred and negotiates a payment—the technology is rarely “given” for free.

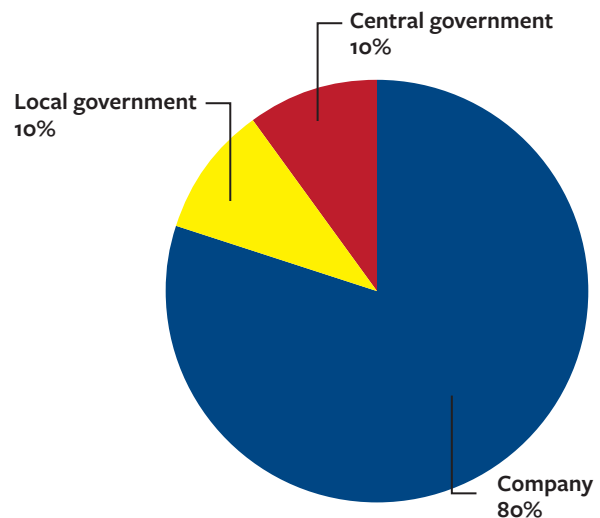
In addition, the pressure to transfer technology is not felt by all companies doing business in China, although it does take place in key industries such as energy and transportation. Of surveyed companies in industries where tech transfer is a relevant issue, only a small number (18 percent) indicated they had been asked to transfer technology as a condition for a business transaction, with most respondents (82 percent) indicating they had not been pressured to transfer technology. Of that 18 percent, 40 percent of those companies (7 percent overall) found the requests acceptable and transferred the technology requested. Thirty percent (5.4 percent overall) refused or avoided the requests as unacceptable. Fifteen percent (3 percent overall) were able to mitigate the scope but still had to transfer some technology, and 10 percent (just under 2 percent overall) had to transfer all of the requested technology to do business in China.

It is important to note that the sizable majority of tech-transfer requests did not come from the government directly but from Chinese entities as part of their own business negotiation strategy. But it would be naïve not to assume that in at least some cases the need for government approval of the investment gave the Chinese entity the leverage to negotiate for the transfer. Though companies are often sufficiently compensated or find ways to make the tech transfer acceptable, the pressure to transfer technology negatively affects the foreign investment environment overall. Also, if the pressure stems officially or unofficially from government sources, it violates World Trade Organization rules (see Figure 30).

Fig. 30
Has Your Company Been Asked to Transfer Technology to China Over the Past Three Years?



By Whom?



8. Transparency

Progress:	Improved/Unchanged
Rank in 2010:	7
Rank in 2009:	8
Rank in 2008:	4
Rank in 2007:	5
Rank in 2006:	5

The lack of rulemaking and government decisionmaking transparency has remained a key concern over the years for companies doing business in China. Transparency also touches other top 10 issues. Lack of transparency makes it more difficult for companies to receive necessary licenses, protect their IPR, participate in the standards and conformity assessment process, and ensure they are being treated the same as domestic companies.

The general consensus among USCBC member companies is that there has been noticeable improvement in the willingness of the PRC government to invite foreign entities to comment on draft regulations. But the pace of change has been slow and uneven across agencies. Of the respondents who viewed it as one of their top five concerns, 41 percent said China had become more transparent over the past year, and 58 percent said there had been no change. According to one company, “While we are asked to comment more often on pending regulations... these requests typically come at the 11th hour and we are given little time for translation and comment.” Further, a number of

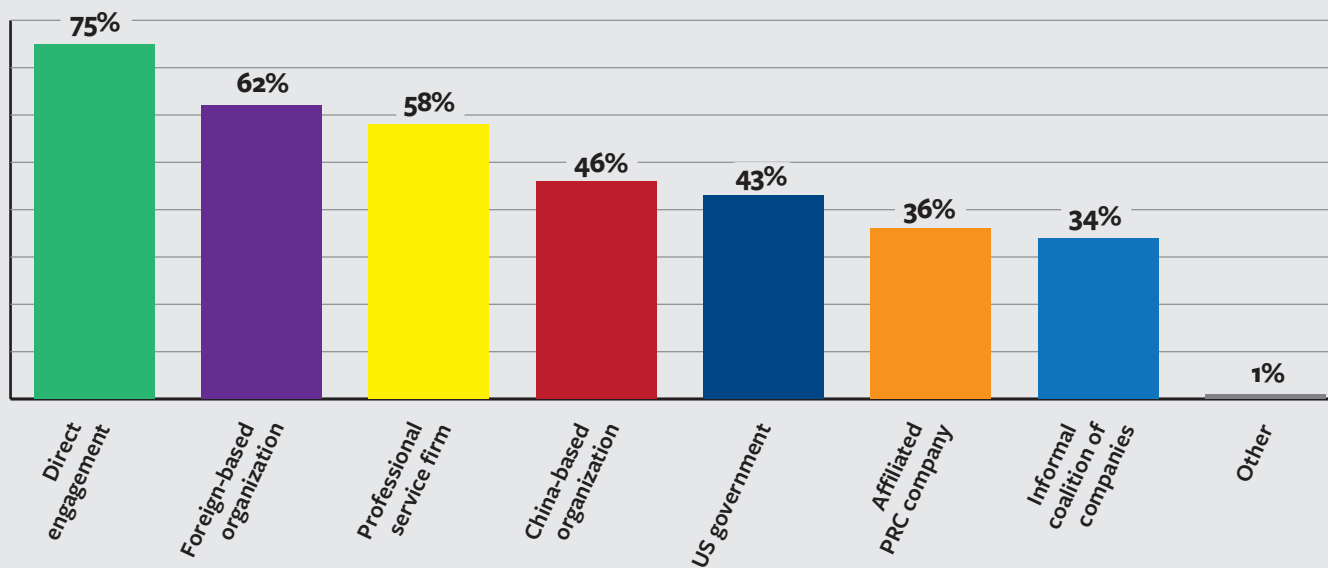
companies noted they have yet to see policies modified based on their comments and suggestions, raising questions about whether such processes are mere window-dressing.

In addition to providing comments on draft regulations, companies want greater transparency in a range of regulatory processes, especially for matters such as licensing and government procurement. One company expressed concern about the transparency in government procurement, stating: “We still experience a lack of transparency in many areas, such as on bidding information for government procurement, and the process and types of products that will be added to the product catalogue.”

USCBC closely tracks China’s transparency efforts. Though the National People’s Congress has complied fairly consistently with commitments to provide a 30-day public comment period for new draft laws, PRC ministries and agencies under the State Council have a much poorer record, especially in allowing a full, 30-day comment period. This lack of transparency not only impacts a host of issues that affect companies’ daily operations – such as administrative licensing, IPR protection, and standards setting – but it also exacerbates perceptions of favoritism toward Chinese companies. For more information, see USCBC’s 2011 transparency report (www.uschina.org/public/documents/2011/04/transparency_tracking.pdf).

Similar to last year, 75 percent of respondents said they use direct company engagement with the Chinese government as the primary advocacy approach to address concerns and gather information that is not readily available to their business (see Figure 31).

Fig. 31 Advocacy Channels Pursued by US Companies to Address China Issues



9. Nondiscrimination/National Treatment (equal treatment with Chinese enterprises)

Progress:	Unchanged
Rank in 2010:	12
Rank in 2009:	12
Rank in 2008:	17
Rank in 2007:	15
Rank in 2006:	9

As China becomes a more important market globally, companies are looking even more closely at potential business opportunities. As a result, ongoing concerns with discrimination and a lack of national treatment for foreign companies operating in China have attracted greater attention, which may explain why this topic moved into the top 10 in the survey this year. Of respondents who included nondiscrimination/national treatment as one of their top five challenges, 70 percent reported the situation was unchanged from the previous year and 30 percent said it had deteriorated. In other words, no respondent said there has been improvement.

Companies noted they are concerned about—or are already facing—unequal treatment in areas such as:

- » Indigenous innovation preferences;
- » Ability to open branches at the same pace as domestic firms;
- » Being allowed the same scope of business as domestic firms;
- » Project bidding; and
- » Being considered for and receiving incentives.

Respondents suggested that discriminatory policies were part of a broader effort to build up or protect domestic industries and create national champions. One member noted:

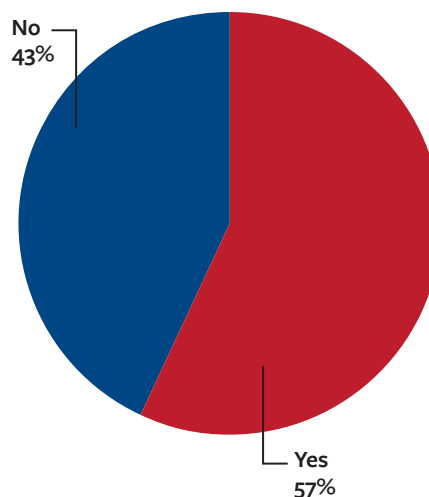
“Chinese regulatory agencies, which had been formally tasked with non-discriminatory regulation of specific markets ... are now specifically engaged with the job of promoting Chinese national champions. The Chinese claim that there is a difference between ‘protecting’ local firms and ‘promoting’ their growth, but it is hard to see where that difference lies.”

Indigenous Innovation

Indigenous innovation, one of the “hot-button” issues of the last two years, remained a significant concern in this year’s survey. “Indigenous innovation” is the PRC government’s term for a policy initiative to foster domestic innovation, move up the product value chain, and build domestic brands. More than half (57 percent) of survey respondents reported concern about China’s indigenous innovation policies, down somewhat from last year’s 72 percent. Just under one-fourth of respondents reported loss of actual sales opportunities from the policies, nearly identical to last year.

Indigenous innovation policies first appeared in 2006, when the central government began a concerted effort to promote the development of locally created (i.e. “indigenous”) brands, technologies, and intellectual property. Government agencies were responsible for developing specific tactics to implement “indigenous innovation,” one of the more egregious of which was to give preferences to companies with locally-owned intellectual property during the government procurement process. PRC President Hu Jintao in early 2011 committed to eliminating the link between innovation policies and the provision of government procurement preferences. For more detail on the evolution of these policies, see USCBC’s briefer on indigenous innovation policy (www.uschina.org/public/documents/2011/innovation_procurement_brief.pdf).

Fig. 32 Is China’s Indigenous Innovation Policy a Concern for Your Company?



Indigenous Innovation continued

Despite this pledge, most companies had not yet seen results at the time the survey was conducted in summer 2011. Only 6 percent of respondents said they had seen a positive impact on sales opportunities because of the delinking pledge. Several companies also noted that some local governments are still adhering to existing innovation policies and ignoring, whether deliberately or otherwise, the pledge to delink. As one company said:

“The problem of indigenous innovation continues to pose challenges. Yes, there have been some improvements seen through the commitments China made at the JCCT [Joint Commission on Commerce and Trade], S&ED [Strategic and Economic Dialogue], and during the President Hu visit, but then indigenous innovation will arise in different guises.”

Because the survey was conducted while the PRC government was starting to implement some of these changes, survey results may not fully reflect the changes made since June 2011, such as the elimination of some key regulations and local catalogues that tie indigenous innovation to government procurement. And while some progress has been made in the government procurement aspects of the policies, the issue will likely remain a key concern for US companies going forward as indigenous innovation spurs domestic preferences in areas such as product and technology standards (see Figures 32–34).

Fig. 33 **Impact of Indigenous Innovation Measures on Business Environment**

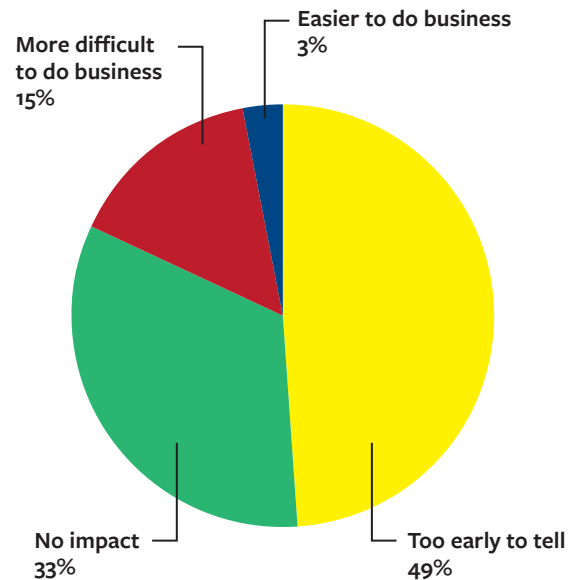
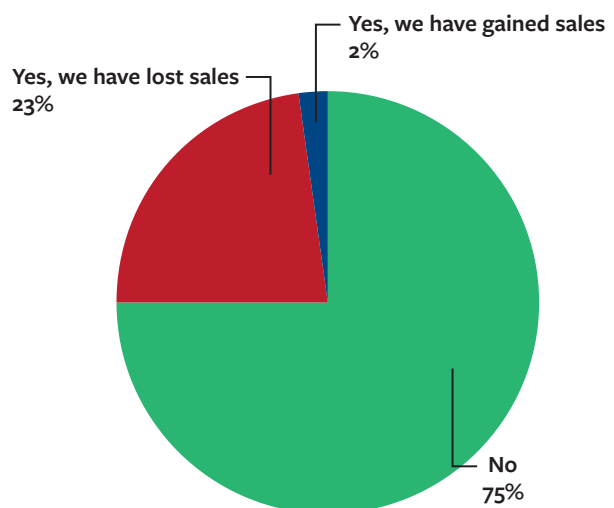


Fig. 34 **Have China's Indigenous Innovation Policies Had a Direct Impact on Your Company's Sales?**



10. Market Access in Services

Progress:	Improved
Rank in 2010:	6
Rank in 2009:	5
Rank in 2008:	12
Rank in 2007:	9
Rank in 2006:	10

The services market in China is expected to provide significant growth opportunities in the future, particularly as the PRC government launches its 12th Five-Year Plan for Economic and Social Development (2011–15), which aims to move the economy toward greater reliance on service industries. Despite this, market access restrictions are still prominent in services industries, and progress in the area has been slow, as indicated by its consistent spot in the top 10 list. Given that just under half of survey respondents are in services sectors, the appearance in the top 10 shows that affected companies rank the issue highly.

The services industry covers a wide variety of sectors, including financial, legal, construction and engineering, healthcare, and telecom services. Survey respondents cite a number of problems that affect their ability to operate in these sectors, including unequal treatment, administrative licensing, competition from Chinese companies, inadequate human resources, and investment restrictions as their top five concerns (see Figure 35).

Of respondents that cited market access in services as a top issue, 25 percent reported seeing progress in the area, while 69 percent said the situation had not changed. Six percent said market access had deteriorated. Survey respondents reported lack of progress across the range of services sectors, indicating the depth and breadth of the problems that companies face.

Financial services were most widely cited as the industry that faces market access barriers. As one member said, “The financial industry is highly regulated. Almost everything you do—bringing new products, new branches, etc.—needs some sort of approval from the regulators. It seems that it is getting more and more difficult to get anything approved.”

The pace of reform in financial services has slowed over the past few years. Companies in the banking, securities, and insurance industries, for example, continue to face ownership restrictions (see Section 7). All are required

to submit applications to open new branches to central-level government agencies (the China Banking Regulatory Commission, China Insurance Regulatory Commission, and China Securities Regulatory Commission). Domestic companies, however, can submit multiple applications to local-level government agencies, allowing them to apply for more than one branch at a time (see Sections 2, 8, and 9).

In addition to financial services, other important sectors that continue to face substantial market entry barriers include telecom, legal services, logistics, and conformity assessment services. Increasing foreign company participation in the services sectors would benefit China’s economy and help the government create jobs, promote domestic consumption, and improve market efficiency.

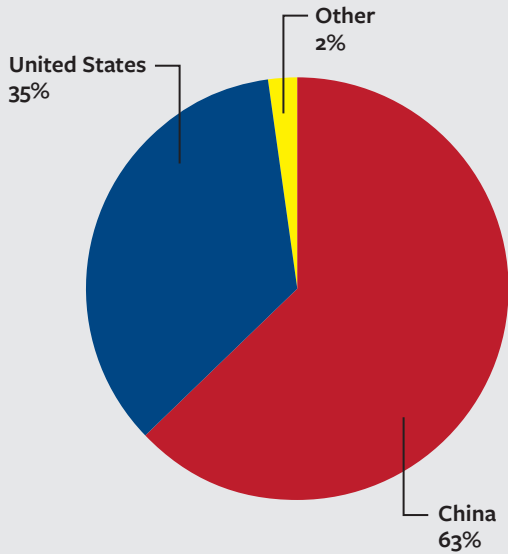
Fig. 35

Top 8 Constraints on Growth in the Service Sector

RANK	
1	Human resources: Finding and training enough qualified workers
2	Administrative licensing, business, and product approvals
3	Competition from Chinese companies
4	Lack of equal treatment with domestic companies
5	PRC government policy direction; pace of reform
6	Competition from other foreign companies
7	Investment restrictions
8	Lack of customer awareness about/ understanding of product

Respondent Profile

Fig. 36 Location of Survey Respondents



Cross-Sector Representation

USCBC members who completed this year’s survey represent a cross section of US companies doing business in China. Roughly two-thirds of respondents are based in China and one-third is based in the United States. Fifty-seven percent of respondents represent manufacturing companies, and 45 percent represent service providers – and many respondents work in both sectors. The remaining 12 percent work for companies in primary industries such as agriculture and oil and gas. Respondents’ companies are divided roughly evenly between small-, medium-, and large-sized enterprises, with the largest number of respondents (39 percent) having between 1,001 and 10,000 employees in China (see Figures 36–38).

Fig. 37 Survey Respondents’ Main Area of Business

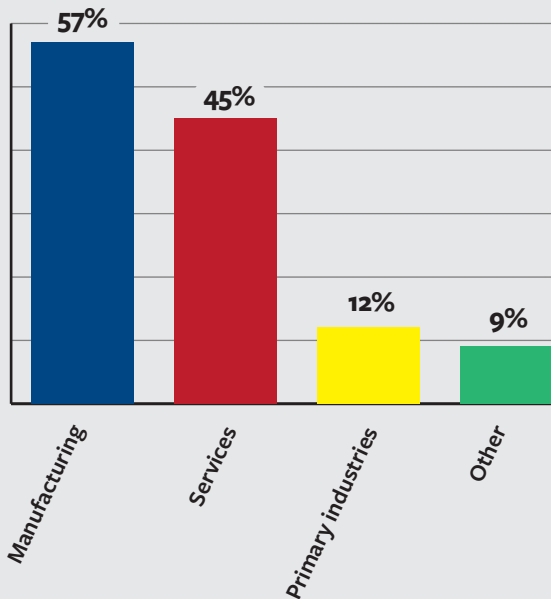


Fig. 38 Number of Employees in China

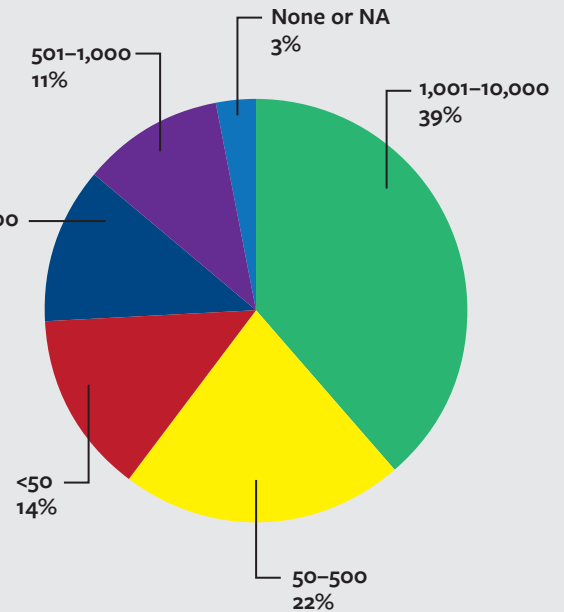
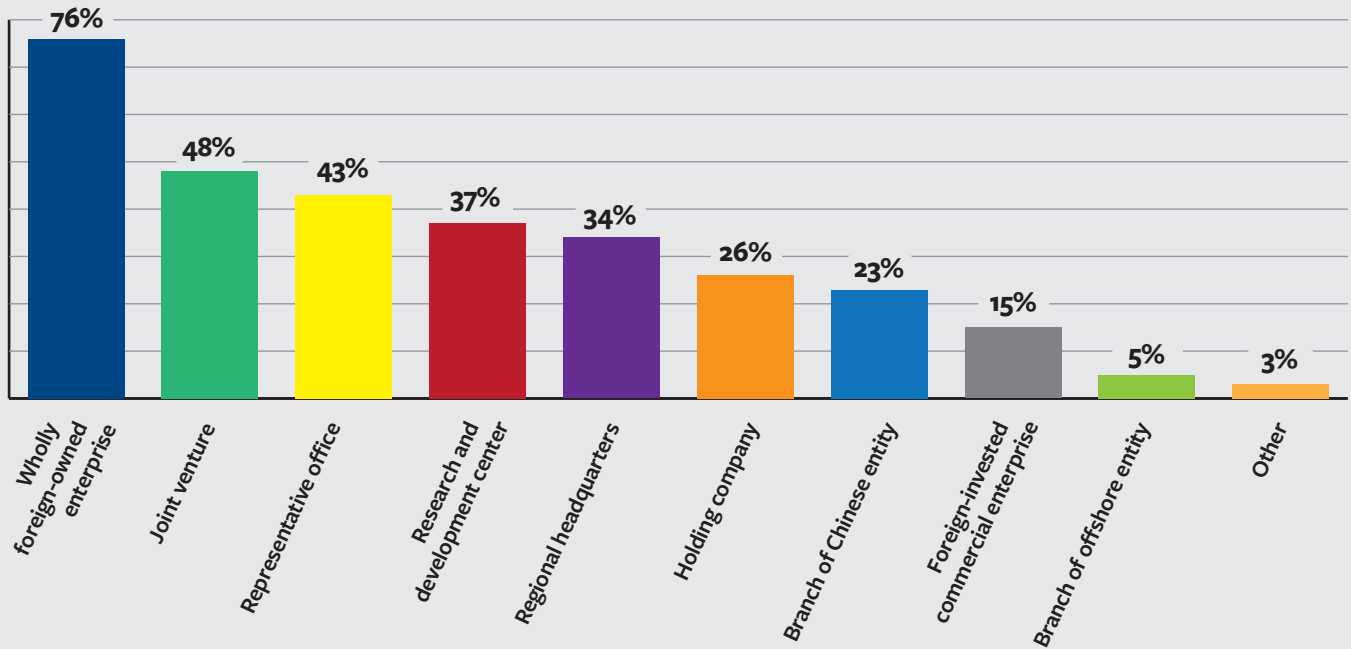


Fig. 39 Investment Vehicles and Legal Entities



Various Ownership Structures

A large majority (76 percent) of respondents' companies operate in China in the form of a WFOE, but representative offices (43 percent) and joint ventures (48 percent) are also common. Compared to last year's survey results, fewer of this year's respondents reported using branch offices and regional headquarters, while more set up foreign-invested commercial enterprises, which are sales and distribution entities (see Figure 39).

Long-Term Commitment to China Market

USCBC member companies have a long history of doing business in China: Fifty percent of respondents' companies have been in China for more than 20 years, and 29 percent have been in China for 11-20 years (see Figure 40).

Fig. 40 Years Experience in China

