



中国发展高层论坛
China Development Forum

2013 China Development Forum
survey report

Choosing China: Insights from multinationals on the investment environment



普华永道



中国发展研究基金会
China Development Research
Foundation

Coping with common challenges through cooperation



The world around us is undergoing a historic transformation: From one in which a minority enjoys the fruits of economic development to a new global reality where a majority can share these privileges. As the middle class of developing economies such as China, India, Brazil and Indonesia emerge as a whole, the next 20 years of humanity will bear witness to a brilliant landscape—where over half of the world’s population will rise to become part of the middle class. This transformation will undoubtedly offer enterprises and individuals unprecedented opportunity, but will also bring about a series of great challenges. These include the rebalancing of the world economy, a restructuring of the international order, and the sustainability of our environment and natural resources. Such challenges require the governments of every nation, international organisations and the private sector to build broader and more effective avenues of dialogue and collaboration. As key players in the globalisation process, multinationals play a particularly important role in progressing these dialogues.

Ever since its founding by the Development Research Center of the State Council in 2000, the China Development Forum has served as a platform for international dialogue and collaboration. With the aim of establishing “a dialogue with the world, a mutual path for development,” the Forum is dedicated to serving delegates with a rich intellectual banquet of varying viewpoints that merge, collide, and mutually inspire. Through the Forum, we’ve established a network of knowledge partners that are both open minded and imbued with a rich creativity. The delegates who represent the various government ministries, domestic and foreign enterprises, international organisations and academic institutions are all indispensable members of this network. With the care and dedication of representatives from numerous fields, this network has only deepened, strengthened and grown more fruitful over time.

One day, in September 2012, I suggested in a meeting with Mr. Dennis Nally, Chairman of PwC International,

that PwC conduct a survey on behalf of the China Development Forum in order to understand and assess the expectations of multinationals on China's investment environment. This suggestion was greeted with enthusiasm by Mr. Nally. PwC, officially set this piece of research in motion by setting up a professional project and research team.

This survey report is a shining example of the deepening and strengthening of our network of knowledge partners. The report encompasses the responses of CEOs from 227 multinationals, and features 11 in-depth interviews with CEOs. Not only does this study reflect the engaged outlook of global multinationals towards their investment prospects in China, it also deftly captures the tremendous opportunities inherent in the current transformation of China's economic model. The expectations of these global multinationals towards the optimisation of China's investment environment deserve careful reflection and consideration. I believe this report is of great value in promoting understanding between

China and the world and in creating win-win situations for all stakeholders.

At this time, I would like to extend my sincere gratitude to the highly professional efforts of the PwC survey team, as well as the staff of the China Development Research Foundation who supported this research. My hope is that the scope of cooperation between the Forum's knowledge partners will further expand, our research further deepen, relationships become more enduring, platforms become more diverse and the fruits of our collaboration more rich and plentiful.



Lu Mai
Secretary General
China Development Research Foundation

Foreword: a bright future



I'm delighted to introduce this insightful research study of how multinational companies perceive the investment opportunities in China – and their expectations of the changes that the Chinese Government might make to enhance those opportunities. I'd like to thank the China Development Research Foundation for working closely with us to produce this report.

As Chairman of PricewaterhouseCoopers International Limited, a prominent organisation with members from around the world and with a strong interest in, and commitment to, the Chinese market, I have read the findings with particular interest. And I've found it especially encouraging that many of my counterparts in other industries share my optimistic view of China's long-term economic prospects.

As the study highlights, foreign investment in China is currently at a defining moment. On the one hand, China's economic progress in recent decades has been breathtaking: in just four years' time, we project that it will overtake the US as the world's largest market in purchasing power parity terms. And a major factor in China's rapid growth has been its spectacular success in attracting foreign direct investment (FDI). In 2012, China attracted US\$111.7 billion of global FDI. Equally positively, more than 70% of our survey participants with operations in China plan to increase their investment here over the coming five years.

China being a recipient of foreign investment can deliver mutual value to its stakeholders. Going forward, it's clear that FDI will remain key to China's economic well-being. As the country moves up the value chain, shifting from 'made in China' to 'designed in China' and finally to 'innovated in China', will lead to significant opportunities for all parties.

But recent changes to the global economic landscape means China will face new challenges in attracting foreign investment. International investors are increasingly focused on emerging markets as they overtake developed countries to become the driving force for growth in the global economy. The choices available to multinationals are also widening, as India, Brazil, Turkey and several African nations become more competitive in attracting foreign investment.

A further consideration is that China faces the most intense competition for foreign investment in many of the sectors that it is targeting most actively. In some sectors, such as consumer, industrial products and services, our survey participants continue to regard China as having the best growth prospects. But competitors such as Brazil are closing the gap – to the extent that our interviewees in technology companies now regard Brazil as offering better growth prospects than China.

The Chinese Government is responding actively to this growing competitive challenge by taking steps to boost domestic consumption, double per capita incomes by 2020 and reinforce social security. Many of the international companies surveyed in our report believe that these measures have increased China's attractiveness as an investment destination.

Asked about further measures by the Chinese Government to further improve the country's attractiveness as a place to invest, our respondents voice a broad wish list of enhancements – headed by 'improving transparency and anti-corruption measures', and 'reducing intervention in the economy and allowing an increase in private competition'.

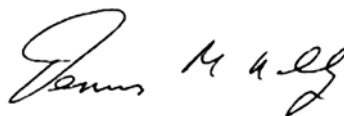
A further area that stands out in our study is the intensifying war for talent. As local Chinese companies mature and expand – often into other markets – international inward investors are facing growing competition for the best Chinese candidates, reflected by staggeringly high staff turnover rates. Significantly, the international companies we spoke to accept that this is primarily a challenge for them, not for China: they need to work out how to attract, develop and retain the best local talent including by offering them opportunities to work internationally.

Our respondents also highlight other opportunities for China to improve its attractiveness. For example, less than 10% of the smaller companies in our study – those with operations in fewer than five countries – have operations in China. By moving to become a more knowledge-oriented economy, China could win investment from the smaller and specialist foreign technology companies that are currently underrepresented. And relaxing the restrictions imposed on foreign investors in China could ensure a reciprocal opening-up of markets, both for Chinese outbound and multinational inbound investors, creating a 'win-win' scenario on each side.

Overall, it's clear that China faces growing competition to its global leadership in FDI. But, given China's ability

to capitalise on its natural advantages, I believe this escalating competitive challenge presents an opportunity as much as a threat. And crucially, our study confirms that international companies are ready and willing to work in partnership with local companies and policymakers to ensure their investments deliver value both for themselves and for China. In an increasingly competitive world for FDI, the future for China remains bright.

My sincere thanks go to the CEOs from around the world for contributing their valuable time and insights. I'm especially grateful to the business leaders who took part in the in-depth interviews. You can see some of their comments in the report.



Dennis M. Nally
Chairman
PricewaterhouseCoopers International Ltd.

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Redefining the foreign investment environment in China: The next 30 years

China has reached a critical stage in its development. Its growing middle class and transformation into a consumption-driven market have prompted many foreign firms to reassess how they do business there. To capitalise on this major opportunity, both sides are walking a common path to adapt to this new reality. Finding new ways to work together through mutual trust and cooperation can lead to a sustainable future.

A generation ago, China's reformers took a decision to engage with the global community. The result? Few nations in recent history can match China's economic achievements over the past 30 years.

Foreign-invested enterprises and China's transformation

As multinationals or foreign-invested enterprises (FIEs) invest in China to develop their businesses, they have also made significant contributions to China's economic progress, resulting in a win-win situation. Not only have they provided capital, technology and management expertise, they have also nurtured local talent, helping to drive the modernisation of China's industries. They have also made a significant contribution to employment.¹

FIEs support for long-term business sustainability is further reflected in their readiness to actively compete and collaborate with Chinese domestic companies. Competition has prompted companies such as Haier to improve their business practices and become more efficient. It also led to the emergence of global brands such as Lenovo, ZTE and Huawei.

Chinese companies can also benefit from the technical expertise, standards and management best practices and customer service capabilities of global multinationals to cater to a growing middle class in China and abroad. More importantly, foreign enterprises help develop Chinese home-grown talent, which plays a significant role in building a culture of innovation in China.

Encouraging mutual trust and co-operation between government and enterprise may be important in attracting the optimal type of investment. Greater private sector involvement in research and development (R&D) can help unlock China's innovation potential. Steps to alleviate concerns over technology transfer, the rule of law and enforcement of laws protecting intellectual property rights will help to foster such an environment, and encourage the development of more home-grown innovation.

"We are bringing 15 new vehicles to China by 2015. We are doubling retail and production capacity here. In doing all this, we also are providing good jobs and careers, and becoming a key part of the communities in which we operate. This is Henry Ford's original vision from more than 100 years ago and we are so proud to be delivering this vision to China today."

Alan Mulally, President and CEO, Ford Motor Company

¹ 'China 2012 FDI inflows slow, stay on track for \$100 billion.' Reuters, 19 November 2012.

“China’s ambitious economic plans, as outlined at the 18th Party Congress, call for greater urbanisation as a path to prosperity. IBM is proud to be working closely with local authorities in China to build Smarter Cities that are efficient, safe, and environmentally friendly.”

Virginia M. Rometty, Chairman, President and Chief Executive Officer, IBM Corporation

Many of our in-depth interview respondents, including General Electric and Boeing, have stressed the importance of collaboration in building their business in China and in assisting Chinese partners to grow and compete on an international level. In fact, technological collaboration with multinationals such as General Electric and Boeing is playing a role in the growth of the Commercial Aircraft Corporation of China (Comac), which is the first major entrant to the global commercial aircraft market in many years.

But China is in the midst of an economic transformation, aimed at boosting domestic consumption to diversify and strengthen its economy. It aims to increase the contribution of technological advancements to GDP growth in creating ‘an innovation-based economy’. So while foreign investment has helped China to greatly expand the capacity and potential of its economy over the past 30 years, China is now faced with another question: How can the country channel and direct FDI in the future to better complement this economic transformation, and lead to win-win outcomes?

Moving up the value chain

“The first big challenge for China is to continue moving up the value chain,” said OECD Secretary-General Angel Gurría on his official visit to China in March 2012. As China increases its capacity to innovate and transforms into a leading knowledge-based economy, what role will foreign investment and foreign-invested enterprises play in this transformation? Research has shown that foreign competition and collaboration can help boost China’s global competitiveness, and develop and pioneer next-generation technologies. One study suggests that foreign ownership is a predominant factor in the transfer of foreign technology, in turn boosting total factor productivity (a measure of long-term technological dynamism) growth among Chinese firms.²

China stands on the cusp of generational change in the way it attracts and views foreign investment. And it is this investment that will have a critical role in shaping its future. At this stage, there are a few key questions to be pondered. How can China best optimise its foreign investment environment? How can foreign investment be directed in a way that better facilitates China’s economic transformation, while leading to mutually beneficial outcomes? What investments are needed to attract and develop the best talent? How can investments in R&D and innovation allow China to move up the value chain? We hope our study can help to address some of these issues.

The global CEOs we surveyed and interviewed for this report tell us that reform is moving in the right direction. The key element now is the forging of mutual trust and good faith between government and foreign enterprise, to ensure that China continues along its path towards long-term prosperity.

² Xu, Bin. Foreign Competition and Productivity of Chinese Firms. Shanghai: China Europe International Business School and University of Florida, 2003.

What CEOs are telling us

China's economic focus is shifting from low-cost labour to an expanding middle class, from 'made in China' to 'designed in China', and with it the nature of the opportunities and challenges for foreign enterprises.

Existing players are moving quickly to capitalise on the opportunities opened up by China's economic transition. The new focus of growth could also create fresh openings for smaller and specialised high-tech businesses. But higher labour costs may make some areas of production less sustainable for foreign enterprises. The move up the value chain could also heighten the sensitivities over technology transfer and the protection of intellectual property rights.

The findings from the CEO survey carried out for this report confirm that China is seen as offering the strongest growth prospects among a range of leading global markets, which include India, Brazil and the US (see page 11). But China is facing strong competition for international investment, especially within the high-tech sectors targeted for growth. The survey also highlights a number of barriers and concerns that will be important to address if China is to make the most of its global investment potential.

When asked what the Government could do to improve the investment environment, 'improving transparency and anti-corruption' headed the list. This was followed by 'reducing intervention in the economy and allowing an increase in private competition' (for more details please see page 21).

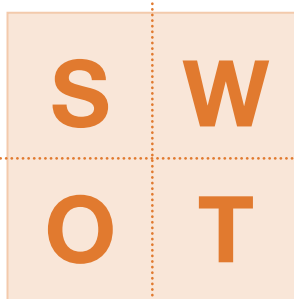
Drawing on the findings from this report, we believe that these are the key strengths and opportunities that China can build on, and the issues and potential threats it should address as it seeks to promote foreign investment and commercial development.

Strengths

- Recognition of China's new leadership's continued commitment to "deepening reform and opening up"
- On track to becoming the world's biggest economy
- Number one target for foreign companies, especially among consumer, industrial products and services groups
- Strength of domestic demand, though considerable potential for further growth
- Accelerating investment in research and development (R&D)

Weaknesses

- Concerns over technology transfer and protection of intellectual property rights
- Concerns over the pace of liberalisation
- Lack of transparency in areas such as target setting and the awarding of contracts
- High level of red tape in areas including licensing and work permit approval
- Perception of favouring domestic companies



- Enhanced accountability and transparency would help to overcome competition issues and make it easier for foreign enterprises to plan ahead
- Phasing out the forced transfer of technology and allowing joint ventures to forge their own partnership arrangements would strengthen mutual trust and encourage greater investment
- Giving multinational companies that are established in China and employ local people the same status and access to the market as domestically based counterparts would strengthen their commitment to the market
- Relaxing the conditions set out in the 'Catalogue for the Guidance of Foreign-Invested Industries' would allow greater policy and commercial freedom, and ensure a reciprocal opening up of markets for Chinese outbound and multinational inbound investors

Opportunities

Threats

- Mounting competition for foreign investment from other fast growth markets, especially in sectors targeted for growth
- Concerns over protection of intellectual property rights could discourage high-tech businesses from committing investment
- If China does not open up further to inbound investment it may face further restrictions on Chinese outbound investment

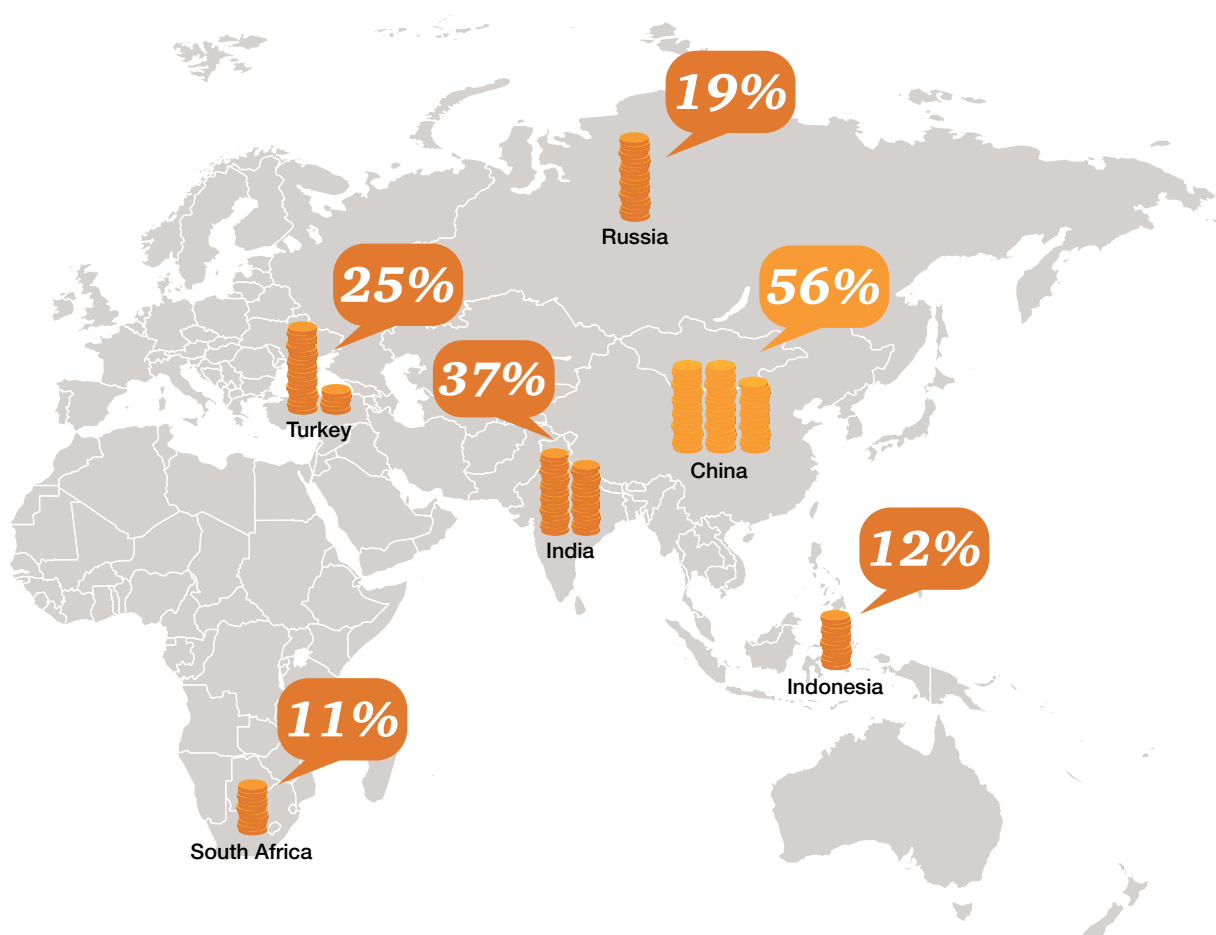
Number one target for investment

China remains the number one target for investment worldwide. But other leading economies are pushing it hard, especially within the key sectors China is targeting for growth.

Target growth markets

Figure 1

Which three of these key markets would you invest in?



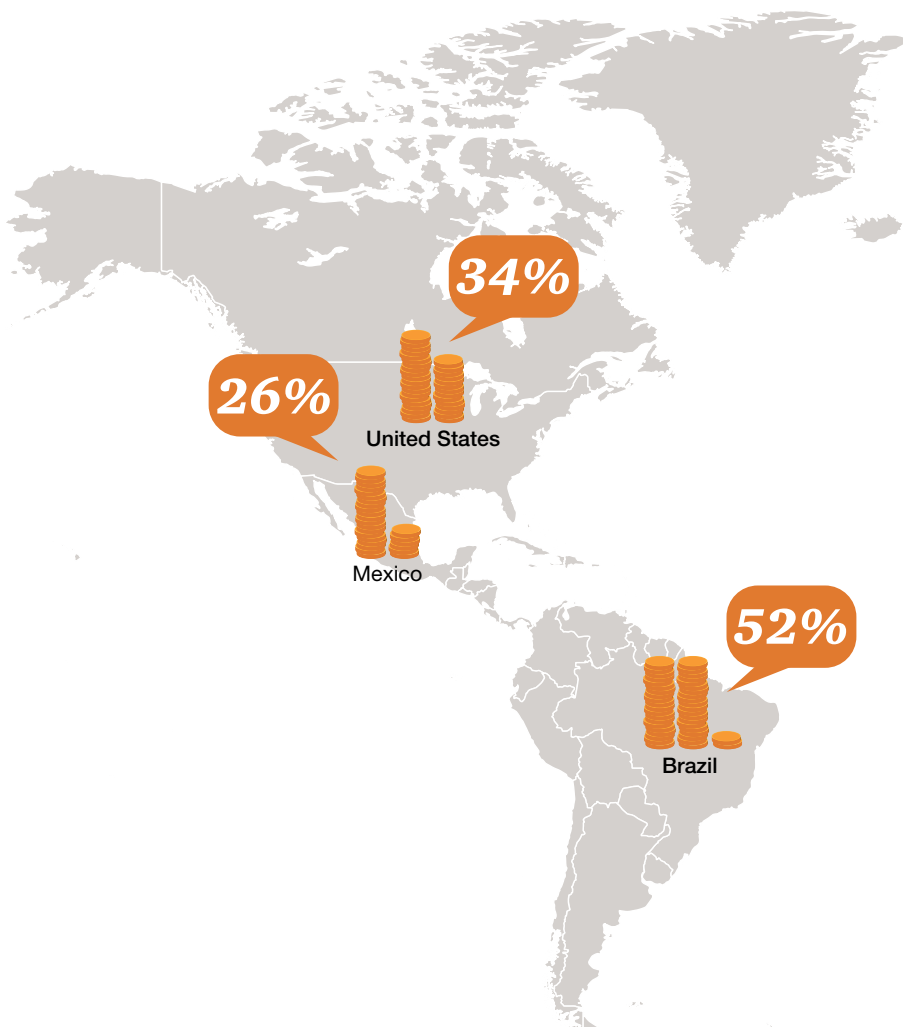
Source: The PwC Global CEO Panel (227 respondents)

Note: The results exceed 100% because each respondent chose more than one destination for investment.

“In recent years the idea has gelled across the overwhelming majority of US companies that, ‘If I don’t win in China, I don’t win,’” said Marc Allen, President, Boeing China.

Mr Allen’s comments reflect the importance of China for global business. China is seen by survey participants as

offering the best prospects for growth (see Figure 1) and more than 80% anticipate that their revenues in the country will increase in 2013. This echoes the findings of PwC’s 16th Annual Global CEO Survey, in which China once again topped the list of countries seen as having the biggest potential for business expansion.³



“China is a very important market to Ford Motor Company. By mid-decade, many third parties expect the automotive industry in China to grow to 28 million vehicles each year, surpassing the Americas and Europe to become the largest auto market in the world. It is important to Ford Motor Company’s future that we position ourselves, in conjunction with our partners, to deliver great products for these customers.”

Alan Mulally, President and CEO, Ford Motor Company

³ PwC. ‘16th Annual Global CEO Survey: Dealing with disruption – Adapting to survive and thrive.’ 2013.

Investment in China by region

The survey carried out for this report reveals that North American companies are most likely to have investments in China (see Figure 2).

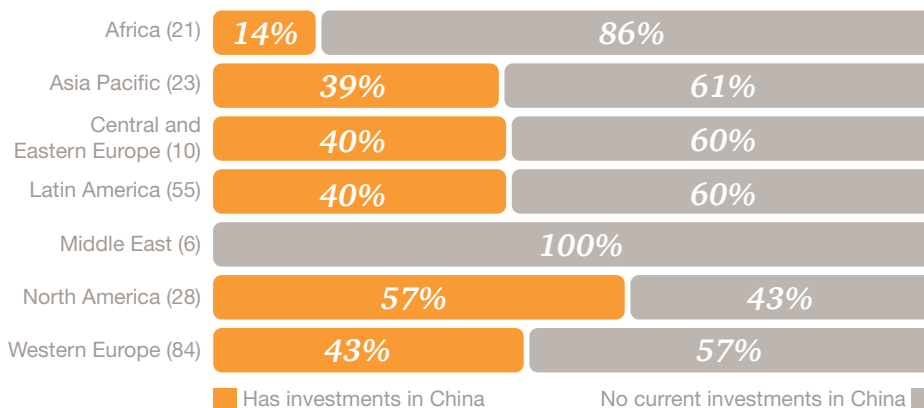
Similarly, confidence in China's prospects is strongest in North America (more than 80% of participants from the region see China as a top three investment priority); though at least 40% of participants from most other regions are targeting China (the only exception is the Middle East) (see Figure 3).

"Investment conditions in China are generally very good. Economic growth remains high and China is still very competitive compared to other countries, as demonstrated by the high level of foreign investment."

Jean Lemierre, Senior Advisor to the Chairman, BNP Paribas and Former President, European Bank for Reconstruction and Development

Figure 2

Investment status of CEO respondents (by region) in China

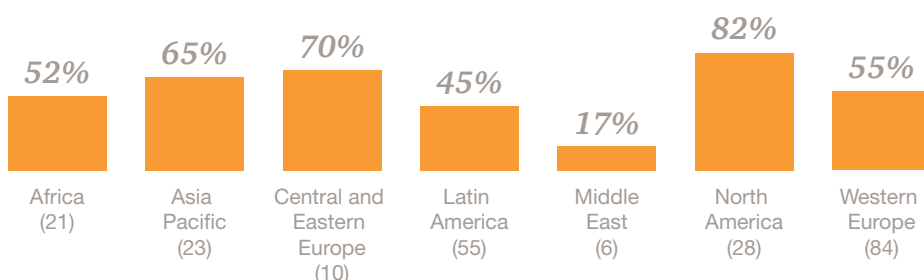


Source: The PwC Global CEO Panel (227 respondents)

Note: The figures in the graphs in this report have been rounded to the nearest percentage so overall percentages may total 101% or 99% in some cases.

Figure 3

Proportion choosing China as one of the three markets offering the best prospects for growth for their business and a top target for investment.



Source: The PwC Global CEO Panel (227 respondents)

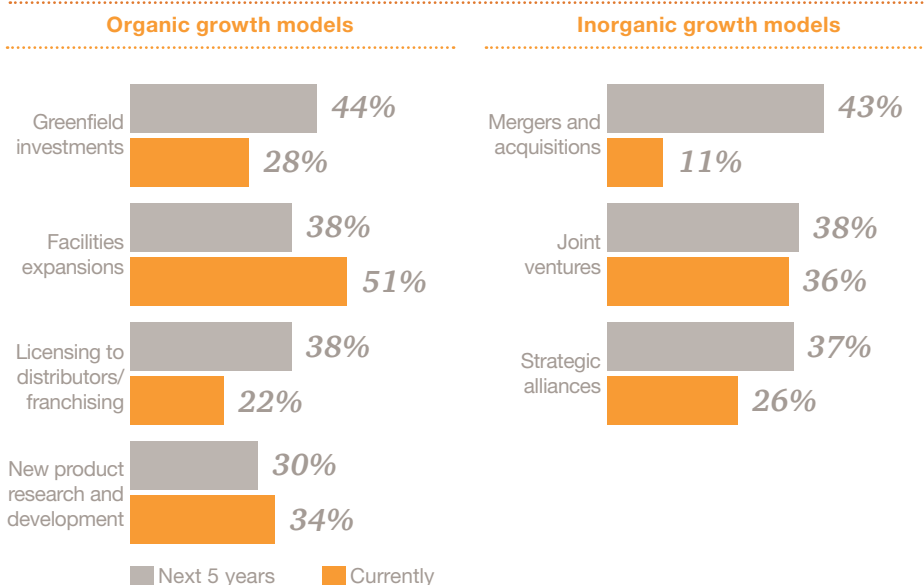
Strategies for growth

As Figure 4 highlights, M&A and greenfield development are the favoured growth strategies (more than 40% of participants citing each), though more collaborative ecosystems characterised by alliances, joint ventures and licensed production are likely to be an important route for many. The value of inbound acquisitions fell in 2012, following the record highs of 2011, but is expected to pick up again in 2013.⁴

In a further vote of confidence, more than 70% of the survey participants that have operations in China plan to step up their level of investment over the next five years (see Figure 5).

Figure 4

Considering the options below, what are your three main growth models in China currently? What are your three main growth models in China in the next five years?



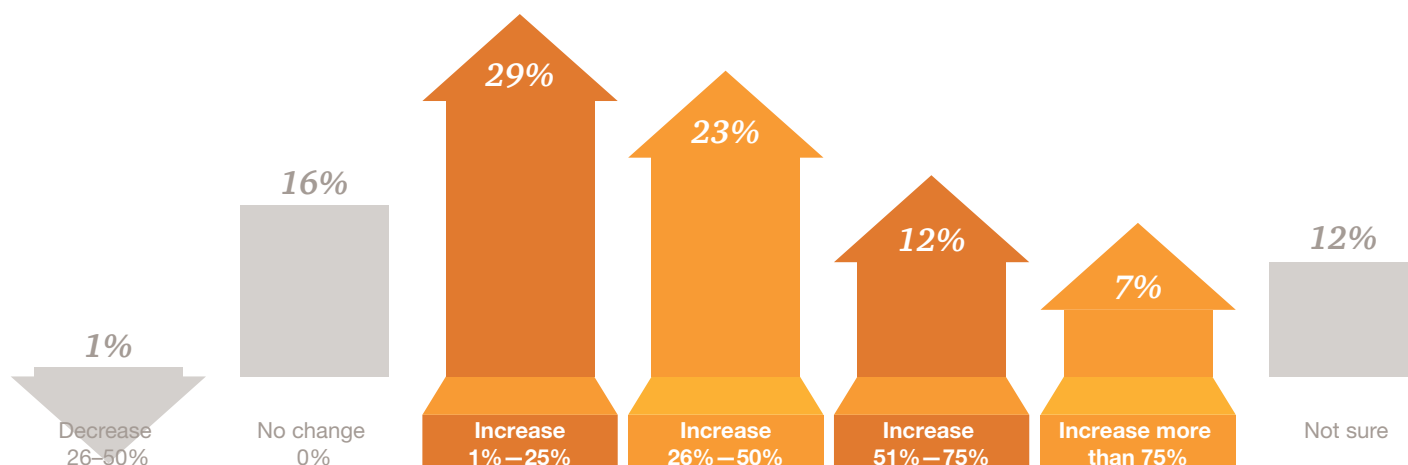
Source: The PwC Global CEO Panel (90 respondents who have investments in China)

⁴ PwC M&A 2012 Review and 2013 Outlook, published January 2013.

Investment plans

Figure 5

CEOs planning on changing the level of investment into China in the next five years.



Source: The PwC Global CEO Panel (90 respondents who have investments in China)

But the survey also stresses the extent to which multinationals are re-assessing where they allocate resources globally as they seek the best investment opportunities. We asked participants to state how they would divide up their investment funds between their top three target markets. More than 30% of the participants targeting China for investment would commit half or more of their available funds to the country

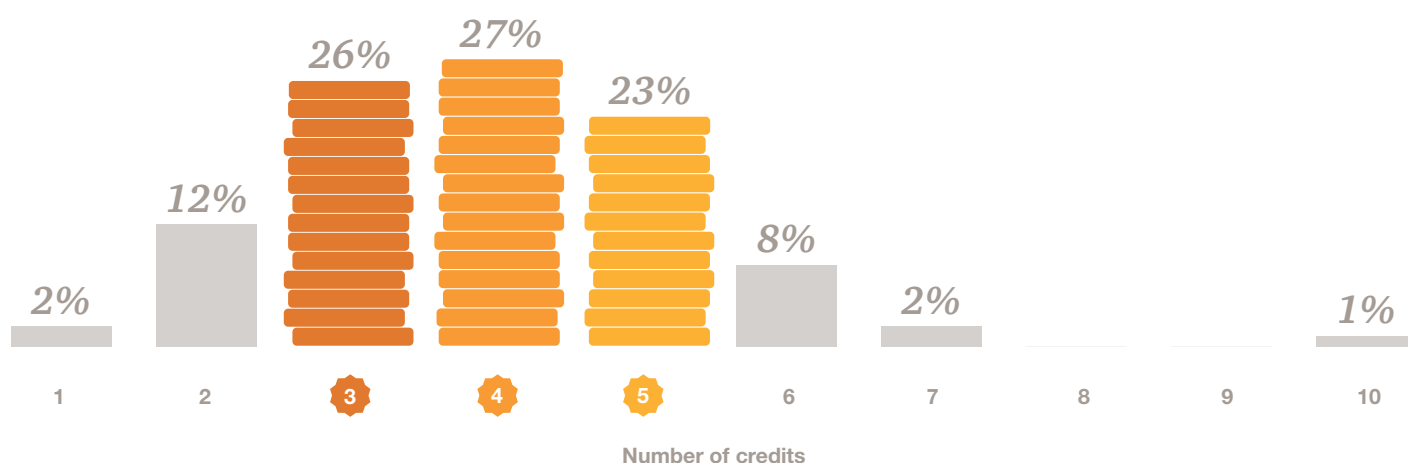
(participants allocating five or more credits),⁵ which is encouraging (see Figure 6). But for most participants the spread between the targeted countries is much wider, highlighting the competition from other markets.

As Figure 7 highlights, China is behind the US in its share of participants' investment 'wallet', though it comes out ahead of Brazil and India.

Allocation of investment in China

Figure 6

If you were given 10 credits to invest in your three markets targeted for investment, how many of these credits would you invest in China?



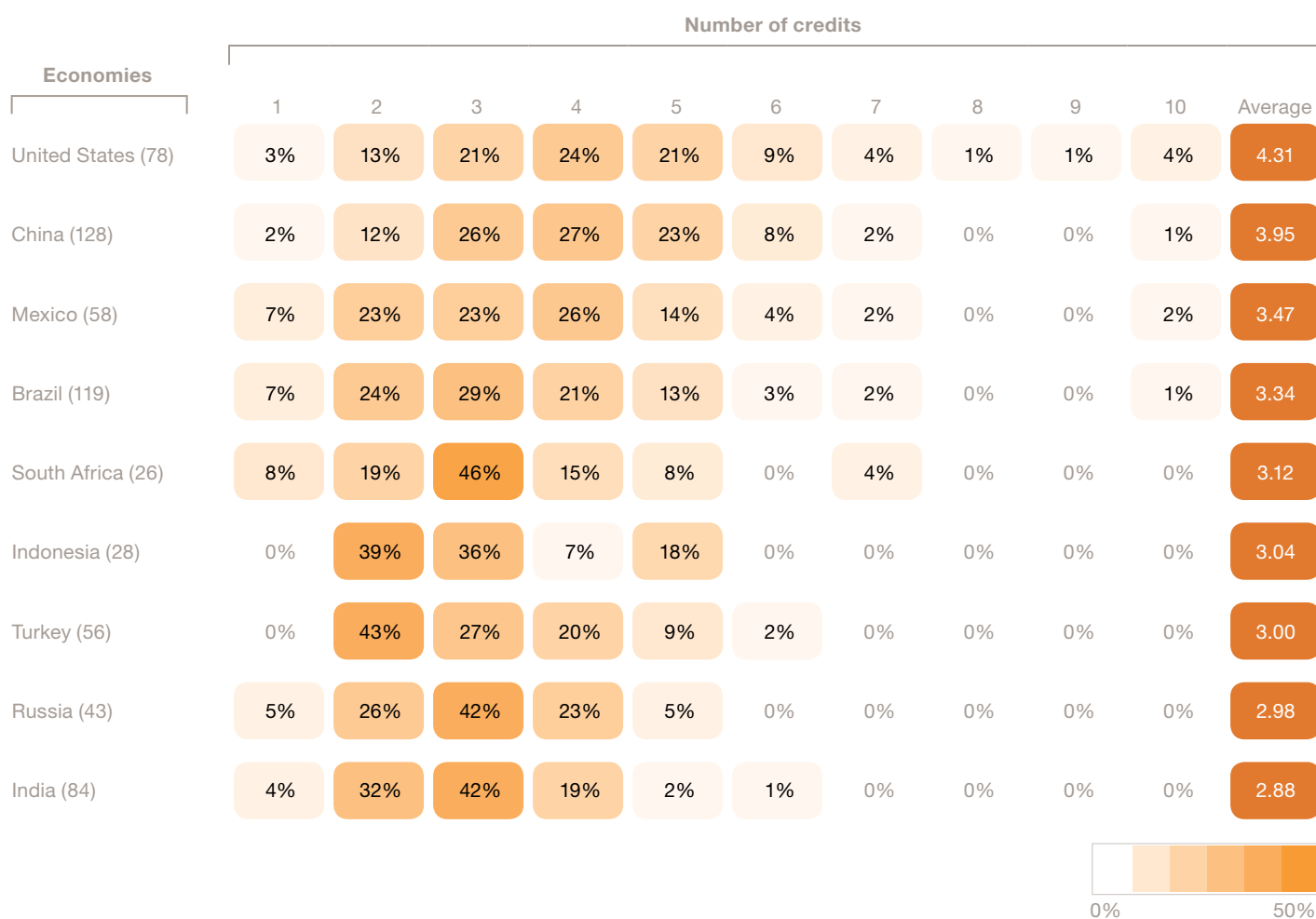
Source: The PwC Global CEO Panel (128 respondents who chose China as one of their three top markets to invest in)

⁵ Participants were asked to share out 10 nominal credits across their chosen three target markets.

Allocation of investment in global markets

Figure 7

How CEOs would allocate their investment across markets out of a total of 10 credits.



Source: The PwC Global CEO Panel (varying base sizes contingent on those who allocated at least one credit to a particular market)

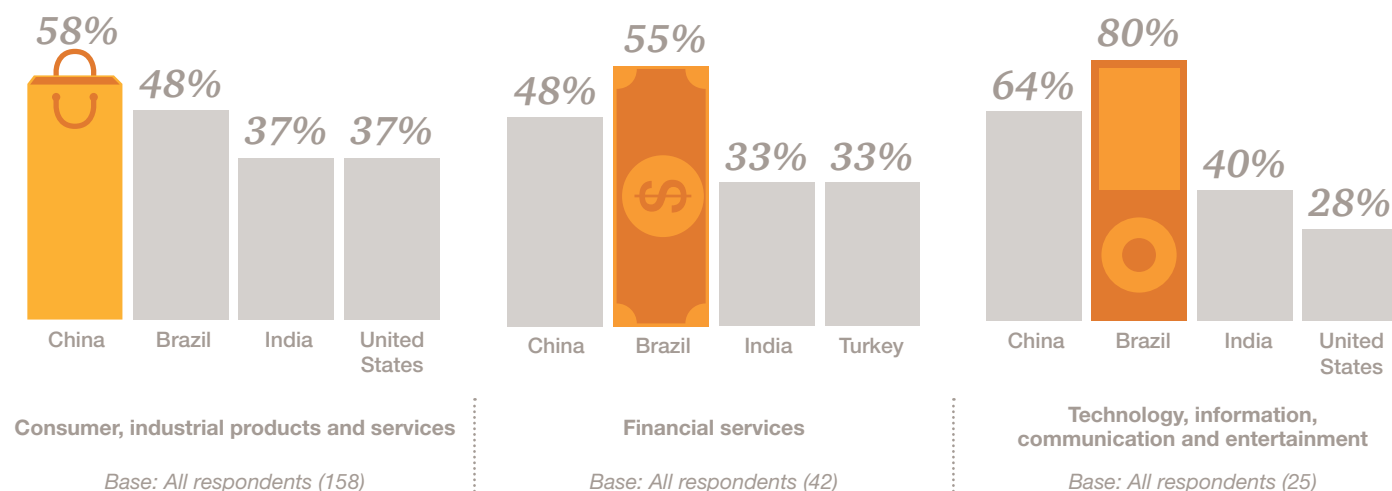
Target markets by sector

Technology companies favour Brazil

The competition for investment is further highlighted by the strong showing for Brazil. Brazil is only just behind China in growth prospects (see Figure 1). China is seen by consumer, industrial products and services companies as offering the best prospects (see Figure 8), reflecting its well-developed manufacturing base. But Brazil is favoured by technology businesses and the financial services sector, highlighting the challenges China faces in attracting investment into these two target sectors.

Figure 8

Top four growth markets chosen by CEOs in each sector.



Source: The PwC Global CEO Panel (225 respondents from consumer, industrial products and services, financial services, and technology, information, communication and entertainment companies)

“Dow Corning is in China to support our customers here and because our expertise and technology and innovation portfolio are a good match to the trends that are shaping the economy here and the priorities of the Chinese Government.”

Jeremy Burks, Greater China President, Dow Corning

The challenge of building up China’s target sectors is heightened by the fact that many of them are already a source of potential trade tensions and protectionist measures around the world including aerospace, electronics and renewable energy. The frictions are highlighted by the instances of inbound Chinese acquisitions being barred in the US. The EU is generally seen as being more open. But a recent European Union Chamber of Commerce in China report into outbound Chinese investment in the EU highlighted concerns among Chinese companies over the potential for new restrictions. These include concerns that possible barriers faced by EU companies in China could result in retaliatory measures preventing Chinese companies from making acquisitions or building up their businesses in the EU.⁶

Freer access for foreign enterprises within China in return for making it easier for Chinese companies to build up their business abroad is going to be increasingly important in an ever-more interlinked and interdependent global economy. “Helping multinationals win in China is important to China,” said Mark Hutchinson, President and CEO, General Electric China.

⁶ ‘Chinese outbound investment in the European Union’, published by European Union Chamber of Commerce in China, January 2013.

Attractions for investment and growth

Domestic demand heads investment attractions

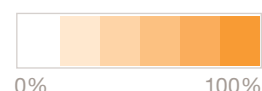
So how does China compare with other key markets across a range of investment drivers? Figure 9 reveals the main reasons

why multinationals are targeting a particular country for investment and growth. China's biggest attraction is its expanding domestic demand (34% of participants citing this), though the rating for Brazil (81%) is much higher in this area.

Figure 9

Which of the following factors most influenced your selection in each country?

	China (128)	Brazil (119)	India (84)	United States (78)	Mexico (58)	Turkey (56)	Russia (43)	Indonesia (28)	South Africa (26)
Expanding domestic market and demand	34%	81%	46%	23%	29%	23%	60%	39%	38%
Level playing field with local competitors	30%	24%	23%	28%	26%	30%	19%	32%	15%
Government incentives	27%	22%	18%	27%	31%	25%	16%	21%	31%
Skilled talent pool	27%	18%	35%	27%	26%	21%	23%	18%	38%
Lower labour costs	26%	18%	48%	24%	21%	23%	21%	25%	19%
Favourable tax regime	22%	5%	23%	28%	22%	20%	12%	21%	23%
High quality and cost competitive suppliers	21%	18%	11%	31%	22%	29%	16%	11%	31%
Proximity to supply chain	20%	20%	14%	22%	19%	25%	26%	14%	15%
Advanced infrastructure	20%	11%	12%	23%	22%	25%	14%	18%	12%
Low level of bureaucracy and regulations	17%	6%	11%	22%	31%	23%	9%	14%	23%



Source: The PwC Global CEO Panel (227 respondents)

India scores poorly in its share of investment wallet (see Figure 7). But a higher proportion of participants cited growing domestic demand as a spur for investing in India rather than in China. India also has a more skilled talent pool according to participants, which is an area that is likely to be significant in attracting investment into high value-added sectors.

Such comparisons do of course need some qualification. China is a much bigger market than India or Brazil. The countries are also at different points in their development as China seeks to create a better balance between consumer-led growth and export-led and investment-led expansion that has been its mainstay, while India and Brazil look to move the other

way. Moreover, China wins high ratings across a broader range of areas than India or Brazil, suggesting that its attractions to investors may be more evenly spread.

Nonetheless, the comparisons suggest that while China has many attractions to multinationals, it is less strong in a number of key areas that may need to be addressed. If China's improvements in these areas are not obvious, the country could be overtaken by other markets in the competition for investment, especially in some of the sectors most closely targeted for growth.

Multinationals missing full implications of change

Multinationals recognise the potential created by an expanding consumer market. But the implications of higher incomes needed to sustain this growth may be less well appreciated. There also appears to be surprisingly little focus on the opportunities opened up by the move to an innovation-based economy.

When asked to identify which three of the commitments outlined at the 18th National Congress of the Communist Party of China would have the most significant impact on their company, the drive to increase domestic demand came first (see Figure 10). This reflects the chief reason why international groups are targeting China, outlined in the previous section. China's rising consumption is also going to be a critical element of economic growth worldwide.

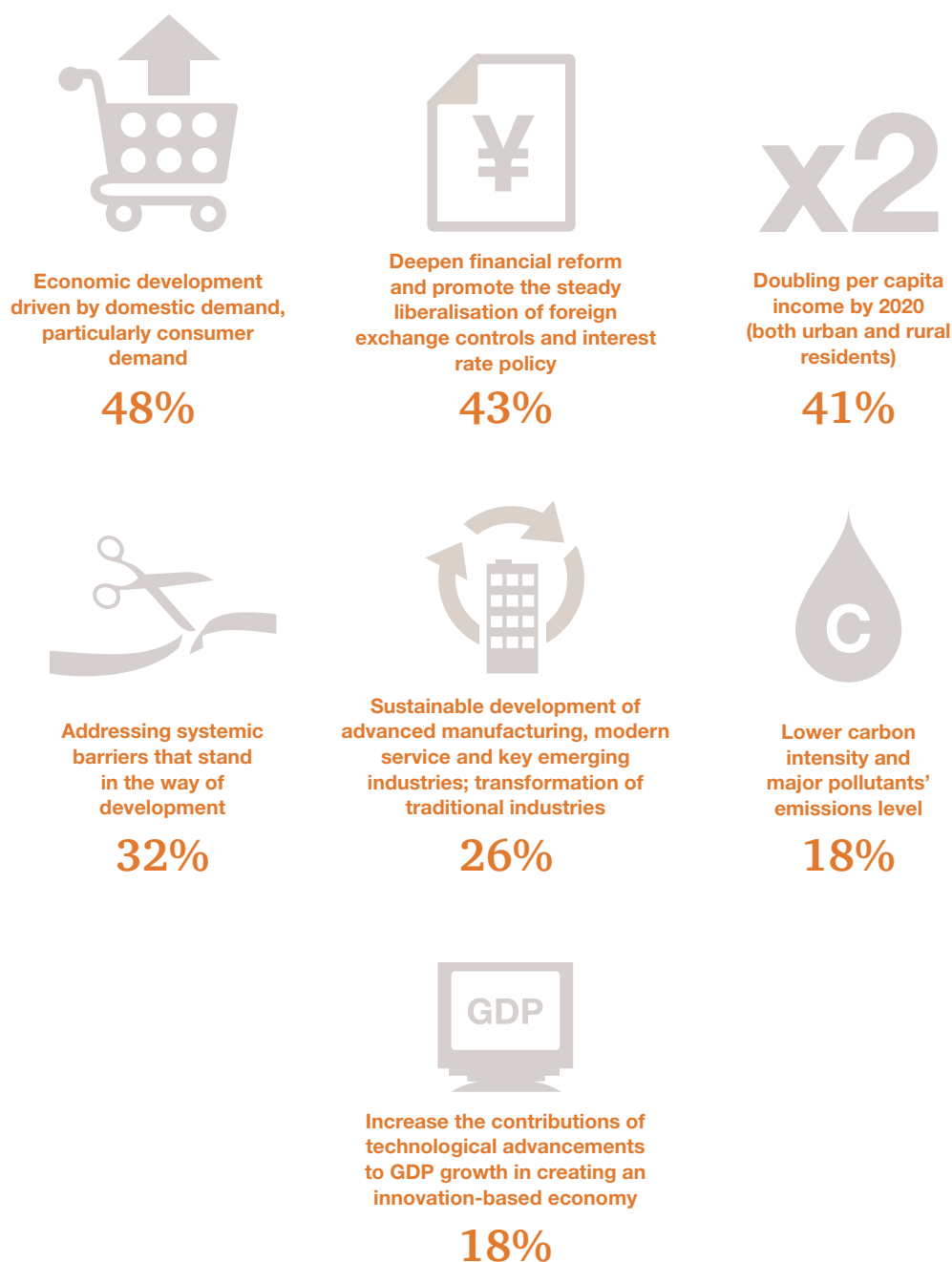
"We invest where we see growth and stable and predictable conditions for our businesses. A fair, transparent and open business environment and sufficient protection of intellectual property rights are also of great importance to us. The availability of a skilled workforce, the quality of infrastructures, as well as open markets and the promotion of trade are further considerations."

Peter Löscher, President and CEO of Siemens AG, and Chairman of the Asia-Pacific Committee of German Business (APA)

Impact of government priorities

Figure 10

Top issues for CEOs from the list of key areas of commitment identified during the 18th National Congress of the Communist Party of China.



Source: The PwC Global CEO Panel (227 respondents)

“GE’s been here a while; originally we were here to make stuff cheap. And then there’s the ‘How do we access the China market?’. And then the third phase is, ‘How can we innovate here?’. And we’re in that innovation phase now.”

Mark Hutchinson, President and CEO, General Electric China

The commercial potential of continuing financial reform is also recognised. Key developments include the continuing internationalisation of the renminbi and relaxation of interest rate controls. Foreign banks had their most profitable year in 2011, though market share is still less than 2%.⁷ The economic transition will open up important opportunities for product and service development within financial services, with foreign institutions able to bring product design and risk management expertise to bear.

Technology opportunities downplayed

If low labour costs were one of the main attractions in the first wave of foreign investment, there will be fewer such openings as the government seeks to move up the value chain and double incomes by 2020 (number three in the list of priorities with the greatest impact cited in Figure 10). But the implications of this shift in the cost base may not be fully appreciated as yet. Our survey shows that low labour costs are still seen as a major reason for targeting China, with only India seen as more favourable in this respect.

China’s move up the value chain and commitment to green development are seen as having a much lower impact, despite the opportunities to bring expertise and technology to bear in a new wave of investment. Even among technology, information, communication and entertainment companies, less than 30% of participants feel that the move to a more innovation-oriented economy will have a significant impact on their business. The lack of focus is echoed in PwC’s latest global CEO survey, in which only 19% of the business leaders targeting China for

“China will eventually have to commit to a major overhaul of its domestic capital market, and allow companies to use more of this market. And to do so, perhaps skills like ours could be useful in helping to build the Chinese capital market.”

Jean Lemierre, Senior Advisor to the Chairman, BNP Paribas and Former President, European Bank for Reconstruction and Development

investment and growth said that increasing innovation and R&D capacity is a priority.⁸ Comparable figures for India and the US are higher.

Are foreign enterprises missing valuable opportunities in China? Could there also be barriers that are discouraging foreign interest? As we explore later in the paper, some of the concerns highlighted by survey participants include the protection of intellectual property and the clarity and direction of regulation.

“Well, I think the West has got it wrong, because I don’t think the West really understands what happens, and we’ve had the 12th Five Year Plan on the table for about two years, and yet we’ve only just woken up to the fact that what they’re saying is they want higher quality, lower quantum growth.”

Sir Martin Sorrell, Chief Executive, WPP

“The challenge China faces is to keep a balanced growth model that all stakeholders can benefit from. The income divide is a crucial element here, along with the increasing role that China will have to play as a contributor to global stability, in an ever-more interlinked world.”

Claudio Facchin, Senior Vice-President, ABB Group, Head of ABB North Asia Region, Chairman and President, ABB China Ltd.

It will be important for policymakers to highlight the commercial potential created by the commitments to innovation and green development and look at ways to encourage greater interest. Policymakers have tended to favour large foreign corporations capable of bringing in significant amounts of capital and export reach – one of the clearest findings in our survey is how few (less than 10%) of smaller companies (operations in fewer than five countries) have operations in China. A more knowledge-oriented economy would benefit from some of smaller and specialist foreign technology companies that are as yet under-represented in China.

⁷ ‘Foreign banks in China’, published by PwC, July 2012.

⁸ PwC. ‘16th Annual Global CEO Survey: Dealing with disruption – Adapting to survive and thrive.’ 2013.

Multinationals call for greater transparency

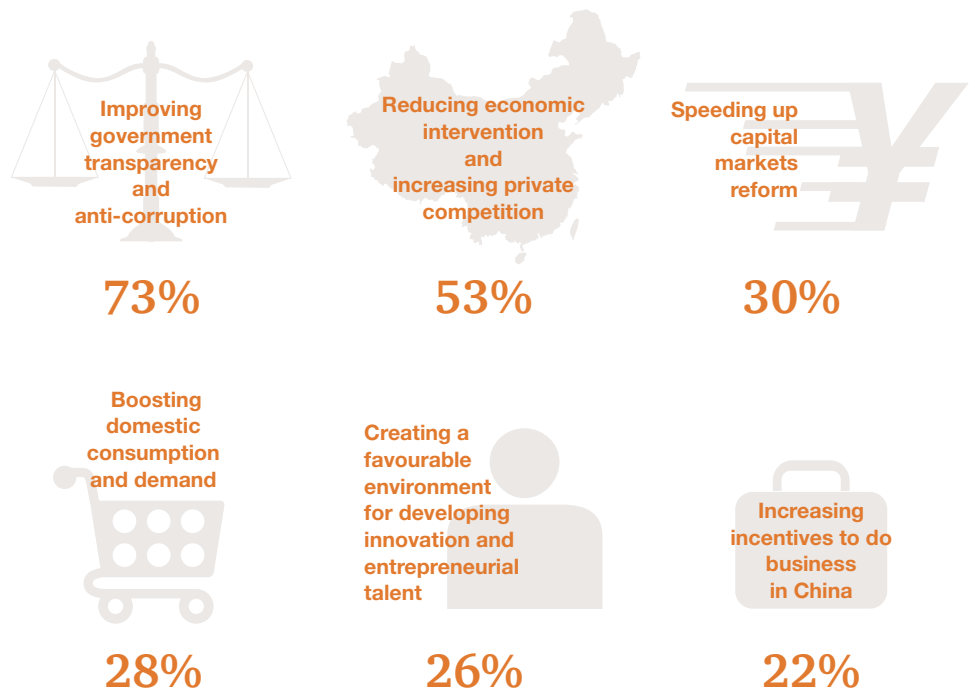
Survey participants believe that a number of regulatory and competition issues will need to be resolved if China is to maximise its investment potential.

Impact of government priorities

When asked what the government could do to improve the investment environment, ‘improving transparency and anti-corruption’ headed the list by a significant margin (see Figure 11). This was followed by ‘reducing intervention in the economy and allowing an increase in private competition’. While the sector-specific findings are broadly in line with the wider survey population, technology, information, communication and entertainment companies are especially focused on the competition and market opening issues.

Figure 11

Areas CEOs would like the Chinese Government to focus on.



Source: The PwC Global CEO Panel (227 respondents)

Developments in regulation

Greater transparency is seen as vital in creating a level playing field across the market. Among the areas that will be important to address are the awarding of government contracts and the setting of economic plans and targets.

To attract further foreign investment and create a more welcoming environment for foreign investors and businesses, Peter Löscher, President and CEO of Siemens AG, encourages public authorities “to embrace knowledge and innovation as key societal values, to recognise the efforts of innovators and inventors, to effectively protect intellectual property rights, notably through enhanced transparency, and to place greater emphasis on the quality of innovation rather than the quantity of patents”.

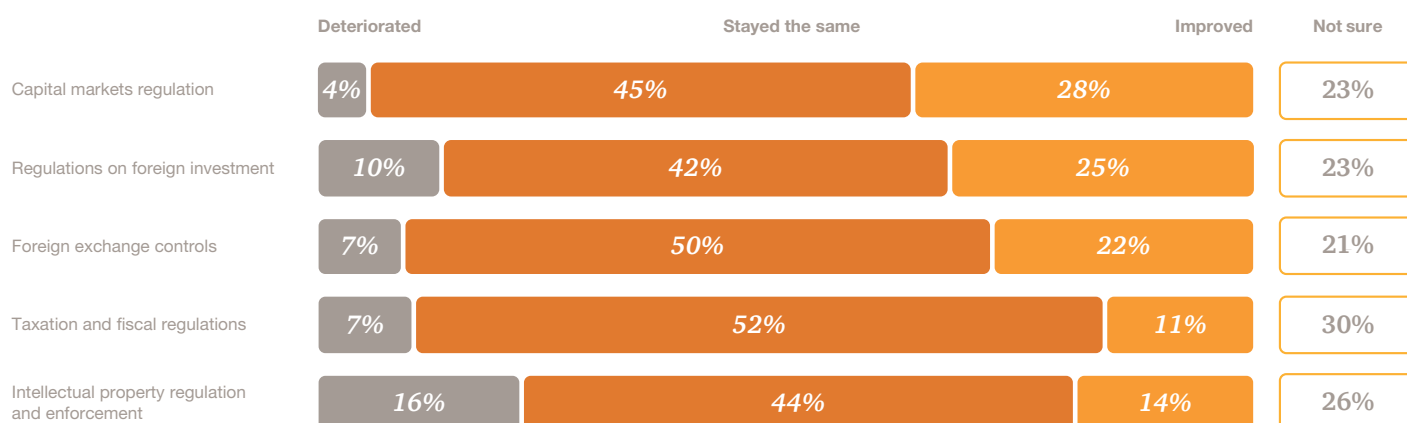
A recurring theme in the interviews is the need for faster, more efficient and more open licensing processes. When asked about potential barriers for foreign enterprises and how they could be overcome, Jeremy Burks, Greater China President, Dow Corning, said: “If you want a vibrant business environment, you want the companies to seize opportunities right away, not have them say ‘my business licence does not cover this venture and I need six months to apply for a new one’. This is where you will find many missed opportunities”.

Concerns over pace of reform

Our survey highlighted concerns over the pace of reform, with the bulk of participants believing that the regulatory environment has remained largely unchanged over the past three years (see Figure 12).

Figure 12

In the following key areas, would you say that the regulatory environment in China has improved, deteriorated or stayed the same over the past three years?



Source: The PwC Global CEO Panel (227 respondents)

“In a world that is rapidly becoming instrumented, interconnected and intelligent, every economy’s success depends on interchange and collaboration. That is why I encourage all governments – developed or developing – to cooperate in allowing the free flow of innovation across borders.”

Virginia M. Rometty, Chairman, President and Chief Executive Officer, IBM Corporation

A particular focus of concern is the 'Catalogue for the Guidance of Foreign-Invested Industries', which specifies which activities are encouraged, restricted or prohibited. This is seen as a potential barrier to open competition in many sectors. Several interviewees also noted how certain policies may be making it harder for China to compete internationally.

Recognising the regulatory shift

But some participants believe that the attitude of regulators and policymakers is changing. Referring to innovation policy in particular, Mark Hutchinson, President and CEO, General Electric China, said: "I think they [policymakers] are more open now. And the attitude now is more open too, 'Well we need the multinationals as well [as local companies]', which they do."

Further signs of the commitment to reform come from the recent Government Work Report⁹. The report recognised reform and opening up as the fundamental force driving China's development and progress, with the need to bring about quicker changes to the fiscal and taxation systems, and deepen reforms to the financial system.

"I have a distinct admiration for the Chinese model. I think it has its issues and challenges, but I think if you learn to operate in the Chinese system, and try and change it from within, then you can make progress. The Chinese do listen. They have a great strength of listening, and they do learn, which is a big strength and one that we have forgotten in the West."

Sir Martin Sorrell, Chief Executive, WPP

⁹ Delivered on 5 March 2013 at the First Session of the Twelfth National People's Congress in Beijing.

Intellectual property concerns

Concerns over the transfer of technology and protection of intellectual property will need to be addressed if China is to move up the value chain and harness real creativity and innovation.

Relatively few participants (14%) believe that the regulation and enforcement of intellectual property rights have improved. Nearly 50% of respondents in a 2011 survey carried out by the Economist Intelligence Unit (EIU) were concerned or very concerned that they would be expected to give up their intellectual property in exchange for market access.¹⁰ These concerns may explain why only 19% of the business leaders in PwC's latest global CEO survey who are targeting China are looking to increase their innovation capacity.¹¹

"I'm a huge fan of China and I think they've done some amazing things over the last 20 years, but the rule of law is probably the most critical thing that they need to fix to harness real creativity and real innovation. And that's going to make the difference to it being stuck in the middle income trap or getting to, like a Korea."

Mark Hutchinson, President and CEO, General Electric China

¹⁰ 'Multinational companies and China: What future?', a report published by the EIU, December 2011.

¹¹ PwC. '16th Annual Global CEO Survey: Dealing with disruption – Adapting to survive and thrive.' 2013.

Ian Bremmer, President of Eurasia Group, argues that a lack of more effective protection for intellectual property rights in China could impede a push by Chinese firms into foreign markets. Mr Bremmer believes that more effective protection would help to foster closer partnerships with foreign enterprises and sustain long-term investment and growth in key target sectors. He also believes that the kind of expertise that China may need is going to evolve as it reaches into new markets. “Increasingly we’re talking about softer skills, so we’re talking about organisational management, we’re talking about corporate governance at the highest levels. Country risk analysis is also going to be important as their need to secure commodities takes them into unfamiliar and potentially unstable markets,” he said.

Intellectual property concerns are also a key issue raised in the American Chamber of Commerce in Shanghai’s China Business Report 2012-2013: “... longstanding issues around the enforcement and protection of intellectual property rights (IPR) continue to hinder U.S. companies in China. The number of companies that said the protection of IPR is ‘critically important’ or ‘very important’ to their business increased to 70 percent in 2012. Survey results also indicate IPR has increased as a top concern over the past 12 months with 66 percent saying enforcement has stayed the same and 6 percent responding that it has deteriorated, a slight increase from 2011.”¹²

¹² The American Chamber of Commerce in Shanghai. ‘China Business Report 2012-2013.’ February 2013.

New industries heighten competition for talent

The ability to attract and develop talent (including skilled people from abroad and returning Chinese nationals) are clearly crucial in sustaining China's transition to the next level and competing internationally.

More than 40% of the business leaders targeting China in PwC's latest global CEO survey said that accessing local talent is a key objective over the next 12 months, making it the second highest business priority.¹³

The challenges are set to increase as demand and competition for technical and creative talent continues to rise. "Human resources are really the biggest constraint, including pilots, mechanics, etc.," said Marc Allen, President, Boeing China. "We're even beginning to hear from operators that they are sometimes having a hard time taking delivery of the new airplanes they need to service busy routes because they don't have sufficient pilot and other resources on hand to put the plane into operation. This needs to be solved as a priority."

"The challenge for us is to develop our local presence in a much more potent form, and not be regarded as a foreign company in China, as to a great extent we're not, because we're run by nationals, not run by expats. We have some plans for developing WPP in a different form in China, more locally based, and I think that in the fullness of time, I'm sure we'll have an even stronger position."

Sir Martin Sorrell, Chief Executive, WPP

¹³ PwC '16th Annual Global CEO Survey: Dealing with disruption – Adapting to survive and thrive.' 2013.

So is China generating sufficient talent with the right skills? The comparison of what is influencing investment in key markets carried out for this report found that China is behind India on its skilled talent pool, but ahead of Brazil, highlighting this as a key area of competition (see Figure 13).

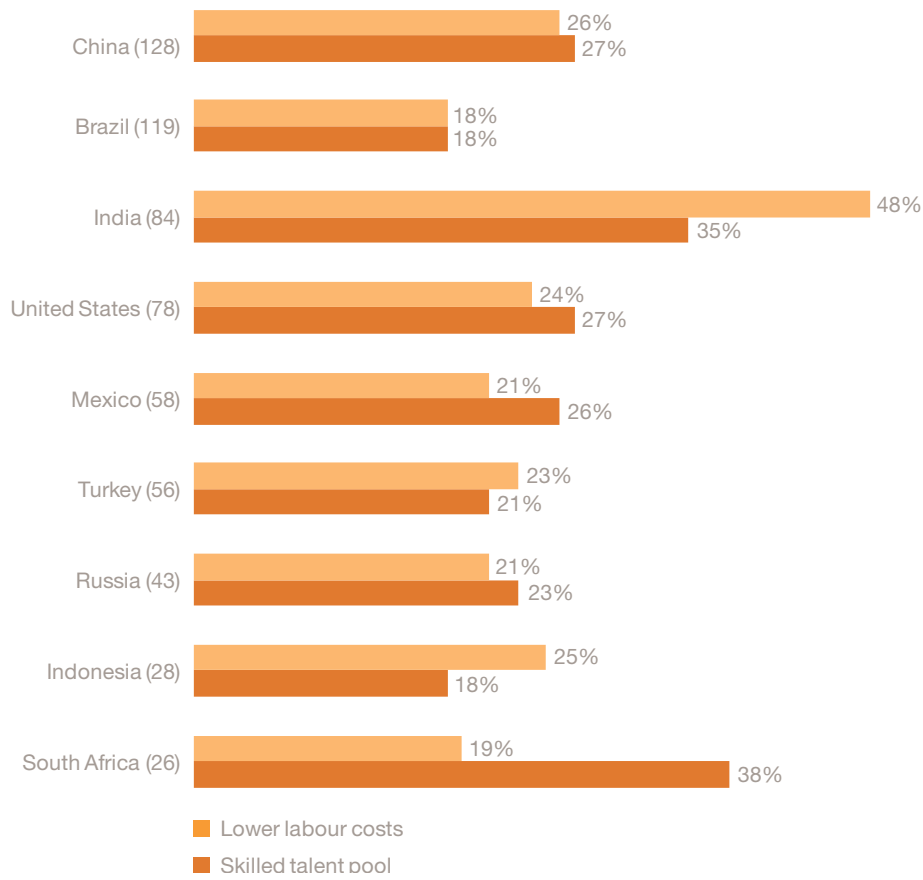
Several interviewees believe that the challenge is not how much talent is being generated, but how to attract it. As domestic companies expand and move into new commercial fields they are able to offer ever-more attractive packages and prospects. This is certainly borne out by the staggeringly high staff turnover rates.

“The quantity of production is certainly okay. We’re actually operating in operational bases in Chengdu and Yulin; potentially, with 1,000 technical staff in both areas – maybe more over time, with success. Chengdu, in particular, has excellent local universities,” said Simon Henry, Executive Director, Chief Financial Officer, Royal Dutch Shell Group. “The challenge, for us, is attracting the best and the brightest because it’s a very competitive market. And then, developing people in a way that motivates those individuals to work with Shell and stay with Shell through the long-term and become future leaders of Shell, not just in China, but around the world.”

Talent factors most influential to investment decisions

Figure 13

CEOs indicating that talent factors are influential to their decision to invest in each market.



Source: The PwC Global CEO Panel (varying base sizes contingent on those who allocated at least one credit to a particular market)

Western and Central provinces' potential moves onto radar

The wealthy and highly developed coastal clusters remain the primary focus for foreign investment, though multinationals increasingly recognise the potential of the less developed Western and Central provinces.

The EIU's 2011 *Multinational companies and China: What future?* survey indicated that wealthier coastal cities remain the primary target for growth. But foreign investment in the Central and Western regions has continued to rise over the past decade (from 13% of FDI in 2002 to 17% in 2011).¹⁴ Could this growth now accelerate as China's economy continues its transition?

Opportunities are opening up for foreign enterprises as the government seeks to spread development and wealth more evenly across the country. In particular, there could be opportunities to move their labour-intensive industries to the Western and Central parts of China to reap benefits from preferential treatments, while partnering with more developed cities to cultivate the inland market.

"Overall, R&D and manufacturing expansion are growing fast in inland regions. ABB's customer industries, such as oil and gas, electric machinery and equipment manufacturing, and power equipment will grow much faster than average in the West. Inland regions, especially some key inland cities with top science and engineering universities, also provide a large talent pool."

Claudio Facchin, Senior Vice-President, ABB Group, Head of ABB North Asia Region, Chairman and President, ABB China Ltd.

Royal Dutch Shell is one of the companies that stress the importance of a pan-China presence. "Our head office, of course, is in Beijing and we do have other offices in Shanghai and in Guangdong for the variety of marketing and other activities – access to suppliers, for example. A lot of the service sectors operate out of the Shanghai area. We need to be a national player, but focused where either the markets or the resources are," said Simon Henry, Executive Director, Chief Financial Officer.

Siemens AG is also looking to reach into new areas and adjust its operational focus as the economy continues to evolve. "With our large footprint and 65 regional offices across China, we have implemented a 'zero distance to the customer' approach that enables us to capitalise on the market opportunities in all major regions of China. In addition, we are expanding our value chain in Central and Western China.

This setup also greatly facilitates the continuous expansion of our supplier base in China," said Peter Löscher, President and CEO. "At the same time, we expect China's urbanisation to be of increasing importance for our business. Meanwhile, Siemens AG is further committed in supporting China's industrial upgrade and development of renewable energy especially offshore wind power as well as improvement of social healthcare through advanced technologies."

"I don't think that competition from neighbouring countries for labour costs is a threat to China since Western China has a strong outlook in terms of competitiveness. However, China could continue strengthening its financial system."

Jean Lemierre, Senior Advisor to the Chairman, BNP Paribas and Former President, European Bank for Reconstruction and Development

Nonetheless, attracting companies away from the coastal regions will remain a challenge when the East and South and Central regions account for more than half of the population and an even larger proportion of GDP.¹⁵ Incentives such as tax breaks will be important. But it will also be important to make the process of setting up factories and other business operations easier and more transparent.

¹⁴ Ministry of Commerce, People's Republic of China, November 2012.

¹⁵ 'Doing business and investing in China', published by PwC, January 2013.

Headquarter choices don't reflect market size

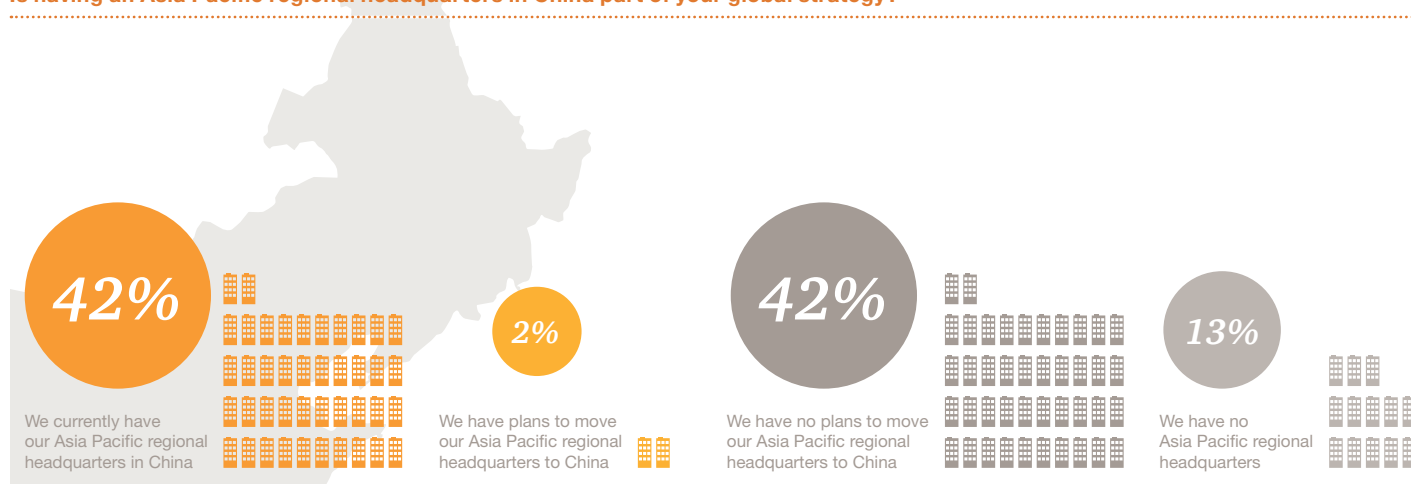
The low number of participants that have or are planning to site regional headquarters in China raises questions about the attractiveness of operating in the country.

Siting of regional HQ

The presence of an HQ is a sign of being comfortable with doing business in the country and the quality of the living and working environment. But less than half of survey participants with operations in China have or are planning to site their Asia Pacific HQ in China, despite China being the largest market (see Figure 14).

Figure 14

Is having an Asia Pacific regional headquarters in China part of your global strategy?



Source: The PwC Global CEO Panel (90 respondents who have investments in China)

A study by the European Union Chamber of Commerce in China found that Singapore and Hong Kong are the most common locations for Asia Pacific HQs, with Shanghai ranked third.¹⁶ According to the report, proximity to clients and markets is the most important criterion, followed closely by a favourable legal and regulatory environment.

PwC's *Cities of opportunity* study looked at how Shanghai and Beijing are positioned on a number of variables ranging from economic clout, openness to innovation

and ease of doing business to quality of life factors such as health, housing and the environment. Both score well in economic clout, but less well in key aspects of doing business such as ease of entry and employee regulations. The environmental indicators also leave room for improvement.¹⁷

To attract more HQs, it will be important to make it easier to move funds around and facilitate visas and work permits on the one side and provide attractive quality of life on the other.

¹⁶ European Business in China: Asia-Pacific Headquarters Study', published by the European Union Chamber of Commerce in China in partnership with Roland Berger, April 2011.

¹⁷ 'Cities of opportunity 2012', published by PwC, October 2012.

Towards long-term prosperity

Our report confirms that the perceptions and strategies of multinational companies are shifting as the economy continues to evolve, though some of the implications of these changes and the opportunities they open up have yet to be fully appreciated and addressed. The CEOs also highlight some potential barriers to investment, which will be important to address. But the report confirms multinational companies' willingness to work in partnership with local companies and policymakers to resolve issues and realise their mutual goals.

This partnership, and the mutual trust and good faith needed to sustain it, are central to improving the environment for foreign investment in China. The benefits include helping to develop the leading-edge talent, technology and capacity for innovation that will ensure China realises its full economic potential and builds a prosperous future for its people.

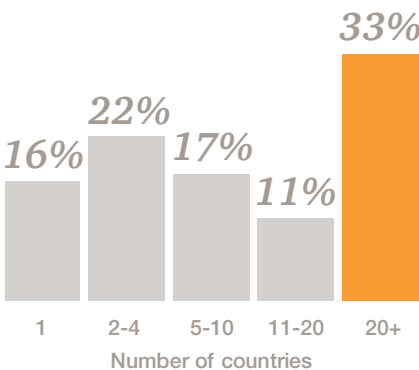
Research methodology

This report explores how CEOs from multinational companies view investment prospects in China and what they think the Chinese Government could do to attract more investment in support of its economic goals. Our aim is to foster greater understanding between policymakers and foreign enterprises and stimulate debate on how to meet their mutual goals. The report has been produced by PwC in support of the China Development Forum.

The primary research includes the views of 227 CEOs from PwC’s Global CEO panel, polled at the beginning of 2013. PwC’s panel is made up of a cross-section of multinational companies across all sectors, company sizes and home locations (both from developed and emerging economies). It includes businesses with operations in China and those without, at present, to provide a balanced understanding of what markets they are focusing on and what part China plays in

their plans. Eleven in-depth interviews were also carried out with executives from a number of leading corporations worldwide. The report also draws on recent research from international organisations, trade associations and advisory agencies to provide comprehensive and objective perspectives. We would like to thank all the participants for kindly contributing their time and insights.

How many countries does your company operate in?



Number of countries	Consumer, industrial products and services (158)	Financial services (42)	Technology, information, communication and entertainment (25)
1	10%	38%	12%
2-4	25%	14%	16%
5-10	17%	19%	12%
11-20	13%	2%	16%
20+	34%	26%	44%

Source: The PwC Global CEO Panel (225 respondents from consumer, industrial products and services, financial services, and technology, information, communication and entertainment companies)

Number of countries	Africa (21)	Asia Pacific (23)	Central and Eastern Europe (10)	Latin America (55)	Middle East (6)	North America (28)	Western Europe (84)
1	19%	30%	–	20%	50%	11%	10%
2-4	29%	30%	20%	29%	17%	21%	14%
5-10	5%	17%	30%	5%	33%	21%	24%
11-20	29%	9%	20%	9%	–	7%	11%
20+	19%	13%	30%	36%	–	39%	42%

Base: All respondents (227)

Acknowledgements



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Acknowledgements

The following individuals and groups in PwC and the China Development Research Foundation contributed to the production of this report.

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