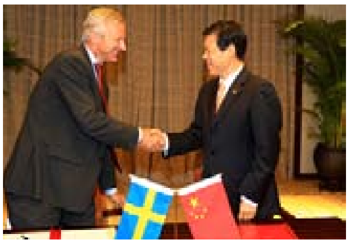
2011 / 2012



SWEDISH BUSINESS IN CHINA

TRENDS AND CHALLENGES

SWEDISH CHAMBER OF COMMERCE IN CHINA
中国瑞典商会

EMBASSY OF SWEDEN

EXPORT RÅDET
SWEDISH TRADE COUNCIL

Embassy of Sweden
Swedish Chamber of Commerce
Swedish Trade Council

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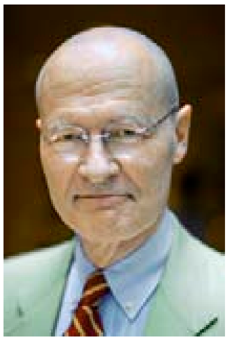
Preface



The Chinese economy has grown tremendously over the past three decades. Adjusted for inflation, GDP per capita has increased more than ten times since the outset of economic reforms, and more than 600 million people have left absolute poverty. Having lived here as a student in the early 1980s, I can literally see the changes with my own eyes.

But to ensure continued growth, China is in urgent need of further economic reforms. The 12th Five-Year Plan highlights the need to find a new growth model, based on domestic demand instead of export growth. It also emphasizes the need for innovation and entrepreneurship, quality and sustainability, and a strong service sector.

Sweden can assist in the difficult process of industrial upgrading and economic restructuring. Swedish technology and expertise in system solutions match the current and future needs of the Chinese economy. With a reputation for quality and sustainability, I am convinced that Swedish companies can play a constructive role in the reshaping of the Chinese economy in the 21st century.

This will only be possible if economic reforms are paired with an increased openness toward foreign investment. Swedish companies face substantial obstacles to trade, as well as uncertainty regarding IPR protection and an unpredictable policy process. These issues must be addressed to create a level playing field for all companies.

This report is an attempt to shed light on the situation of Swedish companies in China. We use it in our continuous dialogue with the Chinese government, and it is a tool in our work within multilateral bodies such as the WTO. The report is also a good example of the close cooperation between the Swedish Embassy, the Swedish Trade Council, and the Swedish Chamber of Commerce. To promote Swedish interests in a complex and ever-changing economy, it is more important than ever to speak with one voice.

Lars Fredén
Ambassador of Sweden to China

Introduction

China is Sweden's biggest trading partner in Asia. Swedish exports to China were in 2010 worth approximately 35 billion yuan, up 14 percent from the previous year, and more than 400 Swedish companies are established in China, owning assets worth at least 36 billion yuan.

This report aims to shed light on the situation of Swedish companies in China. It is based on the 2011 Business Confidence Survey, the tenth since 2000, conducted among member companies of the Swedish Chamber of Commerce.

The survey shows that most Swedish companies are doing well in China. A clear majority of the surveyed companies were profitable in 2010 and are planning to expand their operations in China in 2012.

63 percent of the surveyed companies reported increased market shares in 2010

The results also indicate that the immediate business outlook is bright: 63 percent of the companies reported increased market shares in 2010, and 64 percent expect their business to perform better during 2011 and 2012. However, since the survey was conducted between June and August of 2011, the data may not reflect eventual shifts in future expectations owing to the subsequent escalation of the sovereign debt crisis.

Industrial firms are the biggest winners among Swedish companies in China

Industrial firms are the biggest winners among Swedish companies in China. The data show that companies manufacturing or selling industrial products are outperforming Swedish companies in other sectors, with higher profits and larger market shares. Also, many of the most successful industrial firms are limited in size but highly specialised, with production in Sweden and sales in China.

Import and export procedures and non-transparent governance are the biggest obstacles to trade

Nearly all companies were negatively affected by one or more obstacles to trade in 2010. The two biggest issues are non-transparent governance and import- and export procedures, which affected almost 50 percent of the companies. At the same time IPR issues, financial red tape, tariffs, and problems with compliance of local standards affected one-third of the responding companies.

Local competitors are perceived to benefit from superior government relations

Product quality is on average seen as the biggest advantage in the competition against Chinese firms, while pricing and government relations are seen as the biggest disadvantages vis-à-vis local competitors.

The results are in line with the findings of recent surveys done by the US and EU chambers of commerce. The US survey shows similar levels of profitability among American companies in China, as well as an upward trend in profitability since 2009. The European survey reveals similar patterns in comparative advantages, with EU companies maintaining their competitive edge by keeping a high product quality, while local competitors are perceived to benefit from superior government relations.

The results are in line with those of recent surveys conducted by the EU and US chambers of commerce

About the survey

The 2011 Business Confidence Survey was conducted among member companies of the Swedish Chamber of Commerce between June and August 2011. The response rate was 78 percent, with 166 out of 213 eligible companies responding to the survey.

The response rate was 78 percent, with 166 companies responding to the survey

73 percent of the responding companies' head offices are registered in Sweden, while most of the remaining companies are registered in other Scandinavian countries, Mainland China or Hong Kong. 38,8 percent of the surveyed firms either sell or manufacture industrial goods, 30 percent are in the service sector, 9,4 percent are selling and/or producing consumer goods, while the rest labeled themselves as "others."

Apart from a few exceptions all of the major, multinational Swedish companies that are active in China participated in the survey. Small- and medium-sized enterprises are also well represented. In light of the high response rate and the relatively even distribution of company size and sector, the survey should represent Swedish business interests in China accurately. Companies that are not registered in Sweden are assumed to be Swedish-run or Sweden-related. For the sake of clarity, all of the participating companies will be referred to as "Swedish."

Swedish Business in China: Current Trends

Most of the major, multinational Swedish companies are firmly established in China, and hundreds of small- and medium-sized companies have entered China during the last decade. In 2010, Swedish companies owned assets worth 36 billion yuan in China, compared to 10 billion yuan a decade earlier.[1]

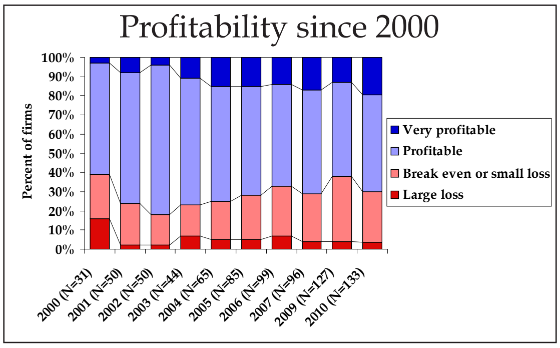
More than 70 percent of the responding companies established themselves in China after 1999. The biggest influx of companies occurred between 2005 and 2009, when 43,3 percent of entered China.

Time of Establishment in China

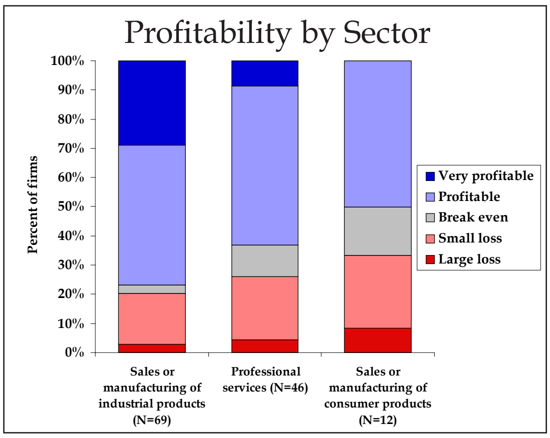
1982-1984	2,5%
1985-1989	5,1%
1990-1994	6,4%
1995-1999	14,6%
2000-2004	21,0%
2005-2009	43,3%
2010-2011	7,0%
Total	**100%**
N=157	

The participating companies employ 75 000 people in China, of which 96,6 percent are Chinese nationals. While the majority of the responding companies are small- and medium-sized (67,5 percent have less than 100 employees), these companies are not the biggest employers. The ten biggest companies in the sample employ 54 000 people, or 73 percent of all employees.

Profitability



70 percent were profitable in 2010, up from 62 percent in 2009



The majority of the responding companies were profitable in 2010. Fifty percent replied that their China operations were "profitable" in 2010, while 20 percent were "very profitable."

Profitability has recovered significantly since the 2009 survey. The percentage of profitable companies has increased by eight percent since 2009, and the share of "very profitable" firms is higher than ever before, currently at 20 percent. These figures indicate that Swedish companies benefited from China's strong recovery after the financial crisis, in the wake of the 4 trillion RMB stimulus package of 2008-2009.

The survey also reveals a difference in profitability between sectors. Firms that manufacture or sell industrial products are the biggest winners, with 29 percent reporting that their China operations were "very profitable" in 2010. At the same time, companies in the consumer goods sector had the highest proportion of loss-making companies, and the lowest share of profitable firms.

[1] Statistiska centralbyrån (Statistics Sweden), Direktinvesteringar: Tillgångar och avkastning 2010, p. 25.

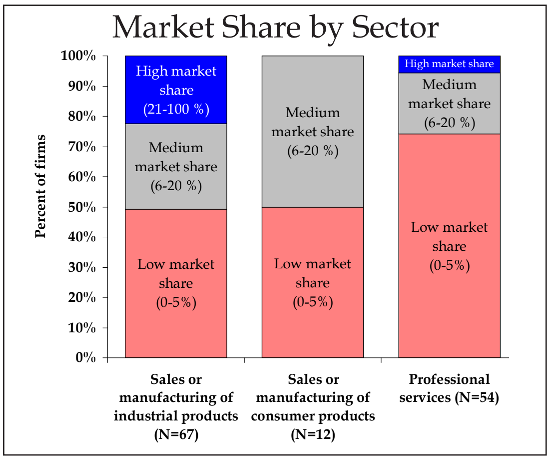
The three sectors also differ in terms of market shares, which may explain the difference in profitability. More than one fifth of the industrial companies reported a market share between 21 and 100 percent, while none of the consumer goods firms had a market share over 21 percent.

In total, 13 industrial companies reported market shares between 21 and 100 percent. Of these companies only one failed to make a profit in 2010, and of the 12 profitable firms, half were "very profitable" in 2010.

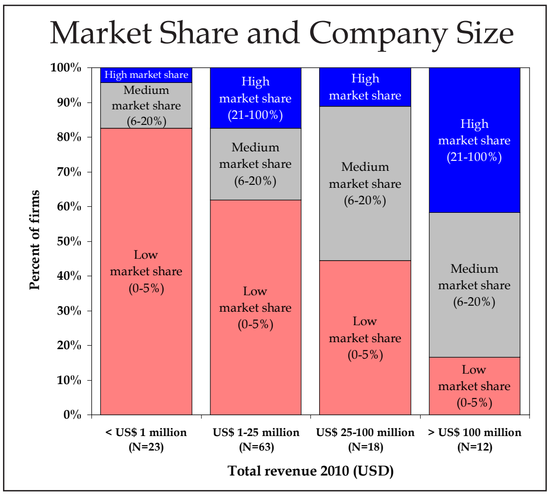
Overall, bigger companies have larger market shares, but it is noteworthy that several of the medium-sized companies have considerable market shares. 14 percent of all the medium-sized firms in the sample (defined as those with 2010 revenues of 1-25 million USD) have a market share between 21 and 100 percent.

This trend is particularly striking in the industrial sector. The majority of the industrial firms with large market shares are medium-sized. Only one of these firms (mid-sized with high market share) have production in China, while the rest still produce in Sweden.

While it is expected that small companies are specialized and operate within narrow niche markets, it is still evident that these firms have been successful in turning their strong market positions into profits. Only one of the medium-sized industrial firms with a high market share (21-100 percent) failed to make a profit last year, and 38 percent were reported to be "very profitable." No such trend can be found in the other two sectors.

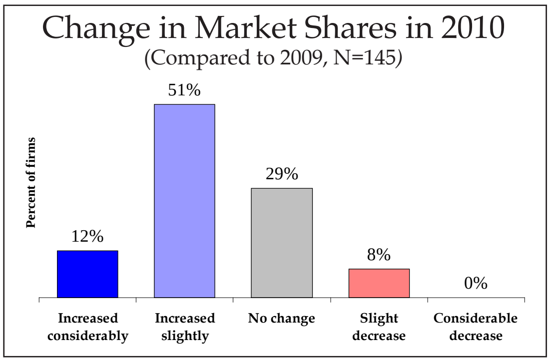


Relatively small but highly specialised companies enjoy stronger market positions and higher profitability



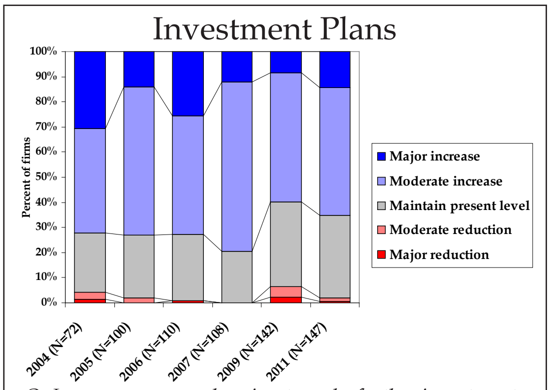
Swedish industrial products are in high demand on the Chinese market

Growing market shares and high expectations



Immediate growth prospects seem bright. 63 percent of the surveyed companies increased their market share during 2010, while only 8 percent reported a "slight decrease" in their market shares.

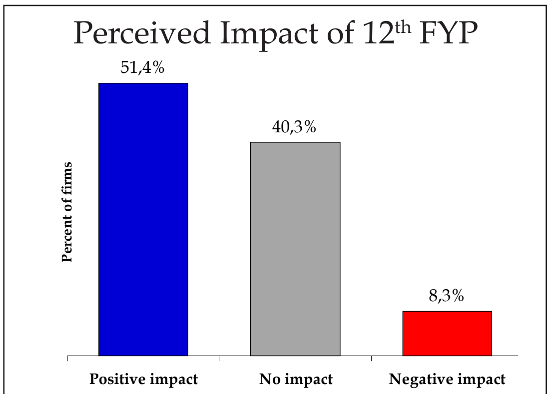
This positive trend should enable Swedish companies to achieve higher profit margins in 2011 and 2012. These figures also correspond well with the short-term business confidence of the surveyed firms. Almost 65 percent of the companies expect that their business will perform better in 2011 and 2012 – almost exactly as many as those who reported increased market shares.



Q: Is your company planning to make further investments in 2011 and 2012?

Although profitability and market shares have increased since the last survey, investment plans have yet to recover to pre-crisis levels. About 65 percent are planning to make further investments in 2011 and 2012, compared to the record-high 80 percent in 2007. The relatively modest investment plans indicate that some uncertainty remains regarding the macroeconomic environment.

The 12th Five-Year Plan



Q: How will China's 12th Five-Year Plan affect your business?

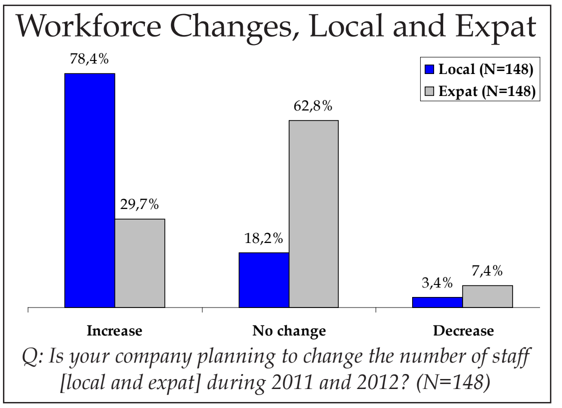
The Chinese government launched the 12th Five-Year Plan (FYP) in the spring of 2011. The FYP is a wide-ranging policy document, containing both specific and general policy initiatives. The 12th FYP aims at finding a growth model based on domestic consumption rather than labour-intensive exports, and to promote qualitative and sustainable growth. The new FYP also emphasizes industrial upgrading and development of the service sector. Although the FYP's ultimate effect on the economy depends on how it is implemented, it does nonetheless indicate the priorities of China's central government.

More than half of the companies believe that the 12th Five-Year Plan will affect their business positively

The data show that 51,4 percent of the companies believe that the 12th FYP will affect their business positively, reflecting a good match between Swedish business strengths and Chinese ambitions.

Human Resources

Almost 80 percent of the companies are planning to increase the number of local (Chinese) staff in 2011 and 2012, and 30 percent plan to increase their expatriate workforce. Very few of the companies are planning to reduce their workforce. This confirms the finding that most of the companies are committed to expanding their operations in China.



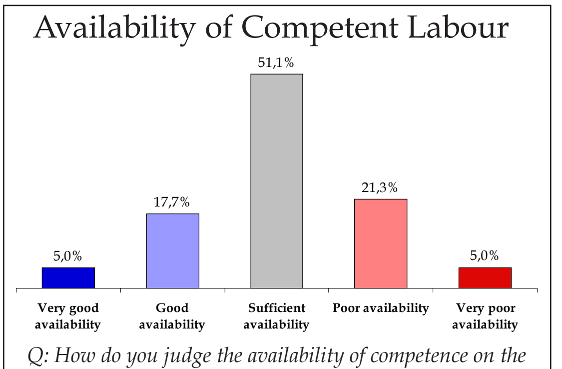
Q: Is your company planning to change the number of staff [local and expat] during 2011 and 2012? (N=148)

Almost 80 percent of the companies are planning to expand their local workforce

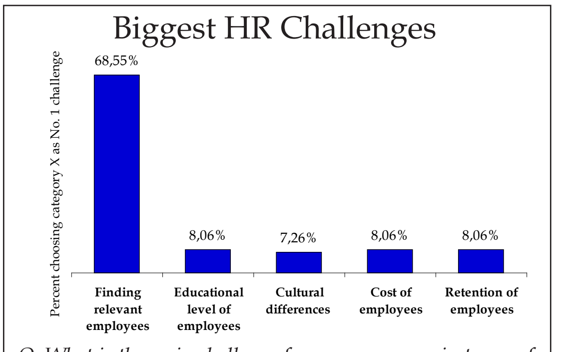
However, when expanding their labour force, companies are facing an increasingly competitive market for skilled workers. For the first time, this year's survey included questions about HR-related challenges.

The majority (74 percent) answered that the availability of competence on the Chinese labour market is either sufficient, good, or very good. But at the same time, the data also show that "finding relevant employees" ranked highest among the companies' HR-related challenges.

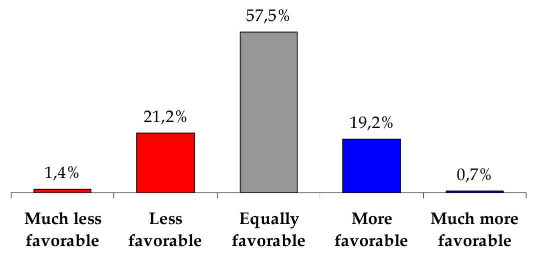
Although few companies seem to be seriously affected by a lack of competent labour, the fact that only 22,7 percent of the companies believe that availability of competence is "good" or "very good" – combined with the finding that "finding relevant employees" is seen as the biggest HR challenge – seems to indicate the search for good and relevant staff is a challenge for many companies.



Q: How do you judge the availability of competence on the Chinese labour market? (N=141)



Q: What is the main challenge for your company in terms of HR issues? (N=124)

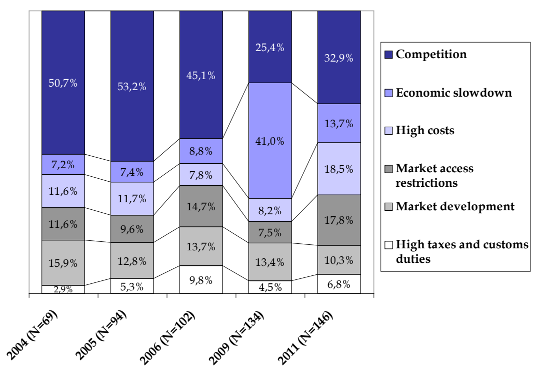


Q: How do you think the investment climate will change during the coming two years? (N=146)

The investment climate

The respondents are not as optimistic about the future investment climate as about their own growth prospects. Only 20 percent of the firms believe that the investment climate will develop in a positive direction in the coming two years, while almost 23 percent believe that it will become less favorable.

The following sections outline the main challenges that Swedish companies are facing in China. This includes economic competition as well as challenges of a regulatory type, such as formal and informal obstacles to trade.



Q: What do you perceive as your company's biggest barrier to profitability?

Barriers to profitability

Since the 2004 survey, companies have been asked to list their biggest barriers to profitability. Before the financial crisis, competition was consistently ranked as the biggest barrier to profitability. In the 2009 survey, however, competition was replaced by economic slowdown, showing the effects of the financial crisis on Swedish companies in China.

The Chinese economy has grown rapidly since the 2009 survey. "Economic slowdown" is no longer a significant barrier to profitability, showing that demand for Swedish products has recovered over the past two years. In this year's survey, competition ranks first once again.

Competition and high costs are the two biggest barriers to profitability

An interesting development is that high costs has increased in significance, and is now considered by 18,5 percent of the companies as their biggest barrier to profitability. This is likely is a result of the inflationary trends of the past two-three years, including rapidly rising wages.

Market access restrictions now rank as the third biggest barrier

Market access restrictions now make up the third biggest barrier to profitability, ranked first by 17,5 percent of the respondents. This echoes the findings of the 2011 EU Chamber of Commerce Business Confidence Survey, in which 43 percent of the member companies stated that government policy has become more discriminatory over the previous two years.

Competition

To shed light on the dynamics of the competition from Chinese firms, companies were asked to answer what they perceive as their biggest advantages and disadvantages in the competition with Chinese companies.

Product quality stands out as the biggest perceived advantage, with 36 percent of the respondents regarding this as their biggest advantage. Apart from this, product design, brand recognition and management are also seen as major advantages. All in all, 69 percent of the participating companies perceive quality, design or brand recognition as their biggest advantage.

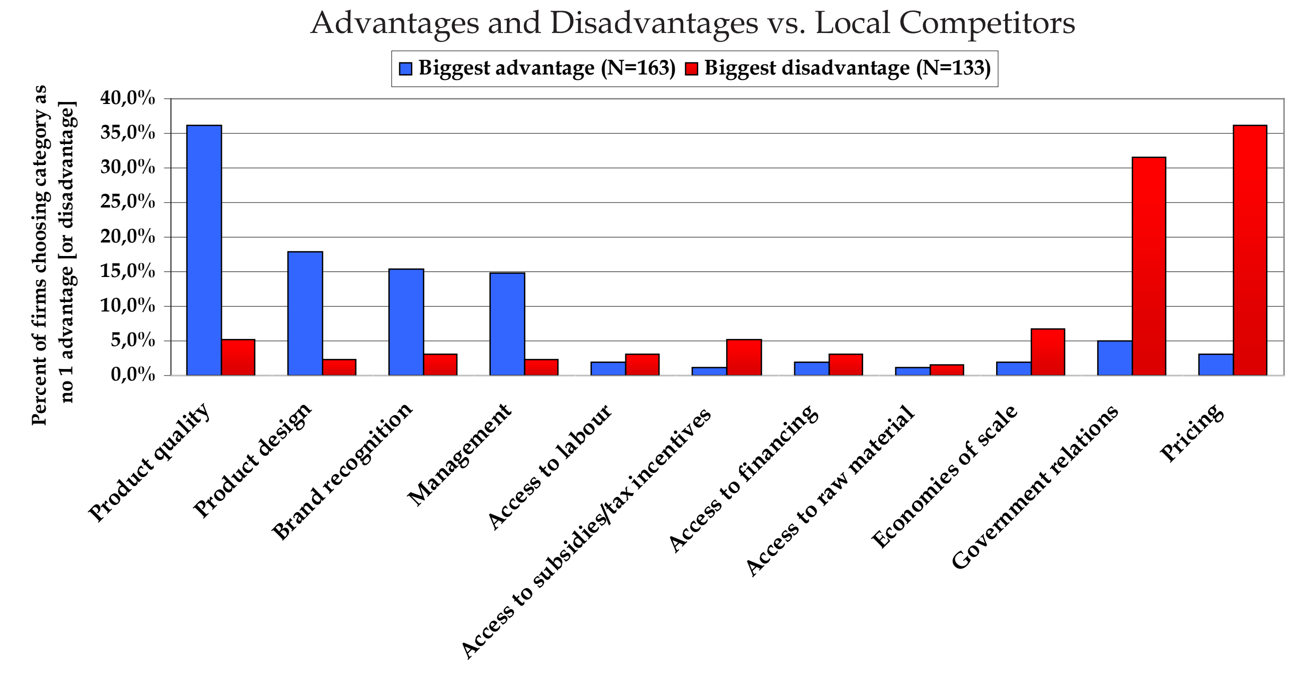
Product quality is seen as the biggest advantage in the competition with local firms

Pricing is the biggest perceived disadvantage. Quality and pricing mirror each other almost perfectly, both chosen by 36 percent as the biggest advantage and disadvantage. This is not surprising given that products of high quality cost more. Seen this way, quality is both an advantage and a disadvantage.

36 percent see pricing as their biggest disadvantage

More worrying is the fact that one-third of the companies believe that government relations is their biggest disadvantage in the competition with local firms. Government relations should have no value in a market-based economy and this result shows that China has yet to create a regulatory environment in which foreign-owned and local companies are treated equally.

One-third of the companies believe that superior government relations is the biggest advantage of local companies



Q: What do you perceive as your biggest advantage [and disadvantage] in the competition with Chinese firms?

Obstacles to trade

Foreign-owned companies face substantial obstacles to trade when doing business in China. These obstacles take many forms, both formal and informal, and give rise to substantial monetary and societal costs.

First and foremost, foreign companies face a host of formal obstacles to trade in China. For instance, according to the EU Chamber of Commerce, limited access to China's public procurement market effectively bars foreign companies from access to more than one-fifth of the Chinese economy. Foreign firms are also obstructed from participating in many parts of the financial and telecom sectors, and joint venture requirements remain in the automotive sector.

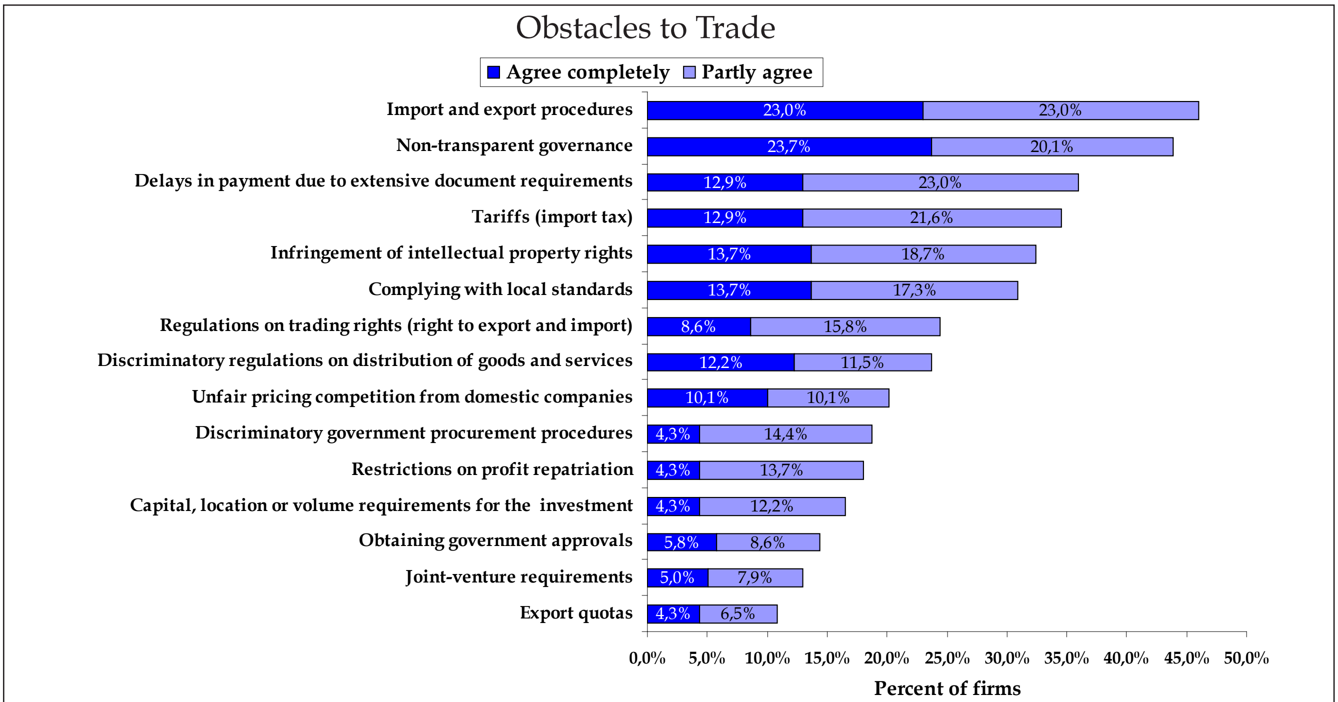
Companies also face substantial informal obstacles, mainly resulting from unclear or arbitrary implementation of existing regulations. Non-transparent governance and intellectual property infringement are the two biggest informal obstacles to trade.

Although in many ways overlapping, these two types of obstacles are costly in different ways. While the effects (and costs) of formal obstacles can be assessed relatively easily, informal obstacles are more difficult to approach.

For instance, a lack of transparency in local government makes it difficult for companies to make long-term investments, especially if permits and licenses are issued arbitrarily, and weak IPR protection make companies hesitant to bring their core technology to China.

It is also important to note that obstacles to trade are not equally pronounced in every industry and region. Individual companies must therefore make sure to learn the specific barriers that affect their line of business in China.

In the questionnaire, respondents were given a list of 15 obstacles to trade and asked if their China operations were negatively affected by these obstacles in 2010. The results are shown below, and the main obstacles are discussed on the next page. Assessments and recommendations to companies are written in italics.



Q: Did the following obstacles to trade, business, and investment in China affect your business negatively in 2010?
15 individual questions presented jointly (N=139)

Import and export procedures

Import and export procedures affected 46 percent of the companies in 2010, making it the single biggest obstacle to trade – just as in the 2009 survey. In terms of efficiency, Chinese customs authorities are still far behind Western or other East Asian countries. The logistics sector accounted for 18 percent of China's GDP in 2010, twice as much as in developed countries. Bottlenecks in the customs process lead to customer dissatisfaction and increased costs, and affect both Chinese and foreign companies.

When shipping products in and out of China, companies can benefit from having in-house knowledge of customs procedures. The first contact with Chinese port authorities is usually the most important, since this is when your product is classified. Re-classifying a product is difficult and time-consuming, and incorrect classification may lead to administrative or criminal penalties. Since implementation often differs between different port authorities, problems can sometimes be solved by changing ports.

Intellectual property rights

Protection of intellectual property rights (IPR) is a major concern for Swedish companies in China. One-third of the companies report that their business was negatively affected by IPR infringement in 2010.

Companies are advised to take all necessary precautions when protecting their intellectual property in China. No product is too advanced to be copied and applications for patents should be officially submitted and confirmed before setting up business in China.

It can also be useful to separate core intellectual property that is business-critical from other IPR, and keep the core IPR in Sweden.

A related problem is so-called bad faith trademark registration, which is when someone registers a trademark in China without the consent of the original trade mark owner. This can either be done by your local agent or business partner, or preemptively by someone else before your company has entered China. It is difficult, or nearly impossible, to win such cases in court. Swedish companies should keep this risk in mind and register every trademark that they will use in China, in both Chinese and other languages.

Non-transparent governance

Lack of transparent governance affected 43,8 percent of the companies. Lack of transparency, both on local and national level, results in uncertainty and reduces companies' willingness to make long-term investments.

Rules and regulations are often changed without prior notice, and are in many cases implemented retrospectively. This requires a high degree of flexibility of the local management, as well as patience from headquarters in Sweden. Before setting up company or investing in China, companies should always verify with the government that their line of business is legal for foreigners. Also, unlike most Western countries, government approval is required to form and register a company. Companies are strongly advised to apply zero tolerance toward corruption, to avoid a vicious circle in which one bribe leads to another.

Local standards

One-fifth of the companies were negatively affected by problems arising from compliance with local standards. Many Chinese product standards differ from established international standards, and are a mix of Japanese, Russian, American, European, and other standards. The standardisation process is also characterized by a lack of transparency and short transition periods.

Companies must pass certification in order to sell their products in China, and must in some cases alter their product to conform with local standards. The certification process, especially for China Compulsory Certification, can be time-consuming and expensive. It is important for companies to follow the standardisation process. Try to make your voice heard already during the drafting process since foreign companies are often invited to comment on draft legislation.

Tariffs

Tariffs affected one third of the companies, making it the fourth biggest obstacle to trade. China lowered its tariffs substantially before its WTO accession, and today the average Chinese tariff rate is 9,8 percent. But tariffs for certain products are substantially higher and constitute a problem for Swedish companies exporting to China. Sweden is a strong advocate of free trade and works within the WTO Doha Development Round to push for substantial tariff cuts in all sectors.

Concluding remarks

The survey shows that the Chinese economy offers Swedish companies many opportunities for growth. Most Swedish companies in China are profitable, gained larger market shares in 2010, and are planning to step up investments. Rising market shares in 2010 also indicate that profitability will continue to rise.

Some of the most successful companies in the survey are small-scale industrial companies, many of which are highly specialised and still have production in Sweden only. These companies are generally world-leading in their niche markets and have no local and only a few international competitors.

65 percent of the companies are planning to step up investments during 2012

The positive outlook is also evident in the investment plans of the surveyed firms: More than 65 percent plan to step up investments in the coming two years, while almost 80 percent are planning to increase the number of local staff. Only a small number of firms are planning to cut investments and reduce staff. Also, 51 percent expect that China's 12th Five-Year Plan will affect their business positively.

Substantial obstacles to trade remain in place

But the survey also shows that substantial obstacles to trade remain. When doing business in China, Swedish companies face a non-transparent and unpredictable regulatory environment, weak IPR protection, unnecessary import and export procedures, and many other obstacles to trade.

Swedish companies should be aware of the potential hazards of doing business in China

Swedish companies should be aware of the potential hazards of doing business in China. Setting up business in China requires extensive preparations and a business plan that takes into account potential regulatory obstacles. But judging from the rapid inflow of Swedish companies over the last decade, the opportunities of doing business in China still outweigh the obstacles.

The Swedish Embassy is working closely with the Swedish Trade Council and the Swedish Chamber of Commerce to promote Swedish interests in China. A crucial part of this work is to maintain good relations Chinese authorities. Sweden has a continuously ongoing dialogue with Chinese authorities, bilaterally, through the EU, and multilaterally within the WTO framework.

Specific company issues can be raised during high-level meetings between Sweden and China

The Embassy can provide companies with official communication channels and give access to Chinese officials when problems arise. High-level meetings between Sweden and China provide Swedish companies with opportunities to voice concerns over the business climate. For example, in October 2011 the 18th Sino-Swedish Joint Commission Meeting on Trade and Investment was held in Guangzhou, between Sweden's State Secretary for Trade Gunnar Oom and Vice Minster of Commerce Zhong Shan.

The Swedish Trade Council also offers business support for Swedish companies through their offices in China, and the Swedish Chamber of Commerce provides individual companies with a platform for networking and lobbying.

Sweden gains leverage on trade issues through the EU framework

The European Union also gives Sweden more leverage on trade issues, and the Embassy actively works with trade barriers through the EU framework. Meetings are frequently held between commercial, financial, and agricultural counsellors from all EU embassies.

A fair business environment is in the interest of both China and Sweden

China has made considerable progress in opening up the economy since the beginning of reforms, and such progress enabled China to join the World Trade Organization ten years ago. But reform efforts must continue in order to create a fair business environment. Regulatory obstacles lead to unhealthy forms of competition and make the Chinese market less attractive for investors. Further regulatory reforms are therefore in the interest of both China and Sweden.

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