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Swedish Business in China:

TRENDS AND CHALLENGES



Preface

China is Sweden's largest trading partner in Asia and the volume of trade between our countries is growing. Most Swedish companies are successful in China. They are also appreciated for being well-run, having good products, and for bringing high-technology to China as well as for respecting the environment and treating employees in a fair and respectful manner. This can be seen from the low staff turnover of Swedish companies in China.

Swedish imports from China are considerably larger than Swedish exports to China, according to Swedish statistics. Sweden has a long tradition of being devoted to free trade. In no way do we see increased imports from China as a problem, since we derive considerable benefits from our imports from China. However, Swedish exports to China are not particularly large, in relation to some of our competitors, accounting for only 3 percent of EU exports to China. By comparison,

Sweden accounts for more than 7 percent of total EU exports to the world.

There are many reasons for our relatively limited exports to China. One, I believe, is that Swedish companies were early in locating production in China and are now supplying European markets from here. Another reason, however, is the multitude of formal and informal trade barriers that continue to limit market access in China, not least in strategic sectors. This report will highlight some of these barriers, but also – and this is a new feature of this year's edition – suggest some possible ways to deal with them.

The trends and challenges facing Swedish business in China are dealt with in this report, which is the result of collaboration between the Swedish Embassy, the Swedish Chamber of Commerce and the Swedish Trade Council.

Mikael Lindström
Swedish Ambassador to China





Introduction

China is a bright spot in an otherwise bleak global economy. The Chinese economy is expected to have grown by more than 8 percent in 2009, while the growth rate of OECD member countries economies, representing two-thirds of Swedish exports, is expected to see a fall of 4.3 percent. The number of Swedish companies in China continues to increase.

Despite the global economic crisis and discrimination against foreign entities in certain sectors, more than 50 percent of responding Swedish companies reported growing market shares. A majority of the Swedish companies in China estimated that they had directly or indirectly benefited from the stimulus package launched in November 2008, with 60 percent of the companies holding a market share of 0-5 percent. Less than 5 percent had a market share of more than 50 percent.

The share of companies that were not making a profit increased significantly from 34 percent in 2008 to 39 percent in 2009. However, most Swedish companies planned to maintain or increase investments, indicating the increasing importance of the Chinese market.

Swedish companies reported that the dominating government related obstacles to trade were import and export procedures and non-transparent

governance. Government procurement was also regarded as an increasingly troublesome area.

This report is based on a yearly survey of Swedish companies in China conducted by the Swedish Embassy in Beijing, the Swedish Chamber of Commerce in China and the Swedish Trade Council. The survey was sent out to around 200 member companies of the chamber and the response rate this year was 72 percent, which is slightly higher than in previous years.¹

Swedish companies in China

The percentage of small- and medium-sized Swedish companies in China seems to have increased in the last 10 years. Smaller- and medium-sized companies constituted 93 percent of the responding companies in 2009, compared to 87 percent in 2001. This trend is supported by studies carried out by the Swedish Trade Council and SEB.

The main reason for this development is almost certainly that most large Swedish companies, e.g. Ericsson and SKF, have already been active in China for many years, meaning that the companies that are entering the Chinese market at this point

¹ Comparisons with previous years should be considered in light of the fact that the companies that replied to the survey this year may be different from companies replying in previous years.



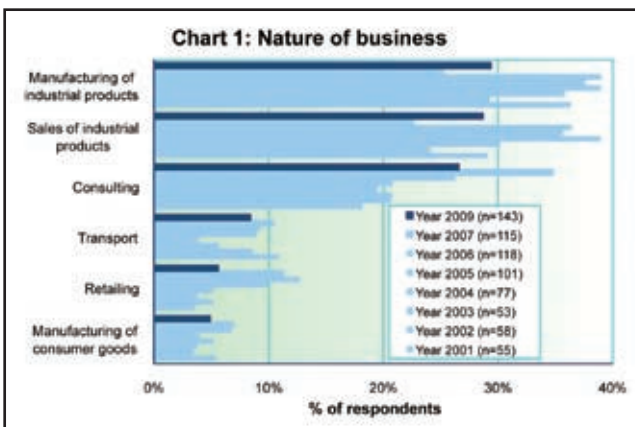
Trelleborg's CEO Peter Nilsson at the opening of a new factory in Qingdao.

are almost exclusively small- and medium-sized (SMEs). Although this cannot be seen in the statistics, many large companies have recently expanded their operations in China. For example, Ericsson, SKF, Sandvik and Trelleborg have inaugurated new factories in China in the last few months.

In addition to those that are established in China through their own legal entities, over 10,000 companies in Sweden do business with Chinese counterparts.

Swedish companies in China are mainly focused on three sectors: manufacturing of industrial products, sales of industrial products and consulting. Areas such as transport, retailing and manufacturing of consumer goods, however, are also important. The “nature of business” distribution chart is similar to previous years and mainly indicates sectors in which Sweden for a number of years has had a comparative advantage.

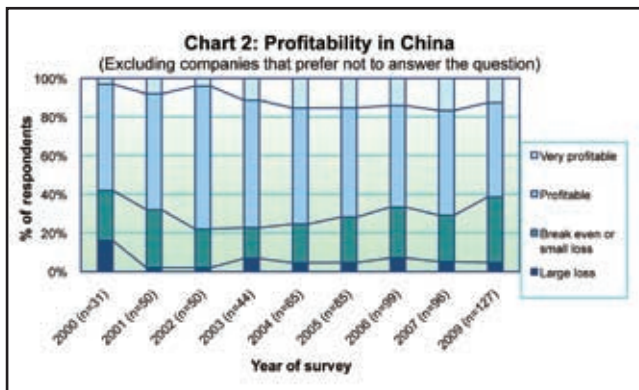
Overall, 98 percent of the companies’ workforces are locally employed. There is a clear trend towards an increase of white collar workers. About 50 percent of the respondent companies answered that their management offices were located in Sweden, with the others divided between China and other regions.



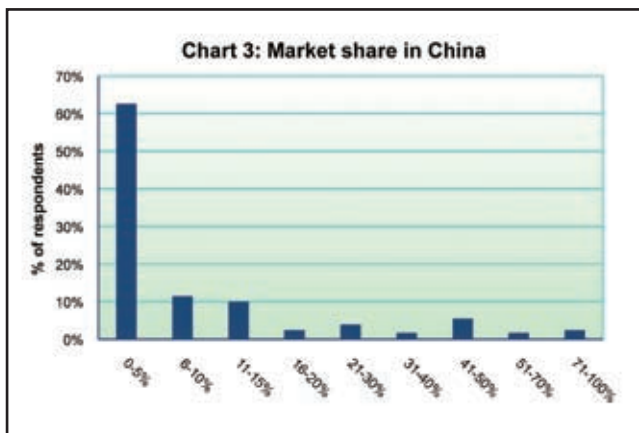
When asked their primary reason for entering the Chinese market, 46 percent of the companies replied that the potential of the Chinese market was the main reason. This was the lowest share since 2001 when the number was 50 percent. “To serve existing customers” has become increasingly important. This is a natural development given that an increasing

number of the SMEs have come to China to serve large companies that have been present in China for a considerable amount of time.

Profitability, investments and confidence



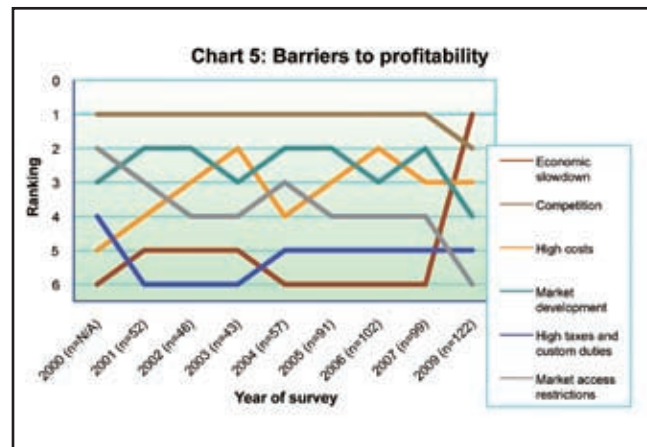
A negative development in 2009 was a significant increase in the number of companies that were not making a profit, rising from 34 percent in 2008 to 39 percent in 2009. It is obvious that the economic downturn following the financial crisis has had an impact on profitability. As the economy recovers, the share of respondents reporting profitability will likely rise.



Sixty percent of Swedish companies held a market share of 0-5 percent, while only about 15 percent had a market share of more than 15 percent. This is an indication that China has a large market in which most Swedish companies are small players subject to considerable competition.



Although profits have diminished, Swedish companies have in most cases increased their market share. Over half of the responding companies stated that they had gained market shares in 2008. This is a clear indication that Swedish companies are competitive and gaining ground vis-à-vis their competitors. Less than 20 percent of Swedish companies reported a lower market share in 2008.



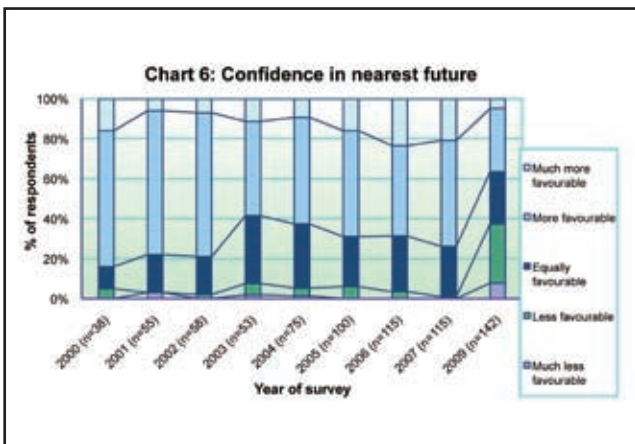
The economic slowdown was the main barrier to profitability. However the survey was conducted in the first half of 2009 and due to the recent Chinese economic recovery the negative impact of the economic crisis has most likely decreased considerably.

The Chinese market was seen as less favourable in 2009 compared to previous years. It should, however, be emphasised that a majority of companies continue to see the Chinese market as a favourable one. Among the cited advantages of the Chinese market were the strong economy in a worldwide perspective, rapid and stable growth, well established supply chains, low-



cost human resources and substantial government investments in infrastructure. On the negative side were restricted market access for foreign companies in some industries, lack of transparency, corruption, poorly developed banking and taxation systems and poor enforcement of IPR regulations.

The year 2009 witnessed a dramatic change in confidence in the near future among companies. Only 37 percent of the responding companies thought that the near future would be more favourable, which is an all time low, whereas 38 percent assessed the near future as less favourable or much less favourable. To a large extent this can be attributed to the global economic crisis, and a survey today, at the very end of 2009, would most likely show an increase in confidence among Swedish companies. This view is supported by the fact that a huge majority of Swedish companies were confident in the mid-term future and plan to increase investments.



The considerable appreciation of the CNY against the SEK in the beginning of the year resulted in higher costs for most Swedish companies with production in China. The exchange rate is now (November) almost back to the same level as before the recession.

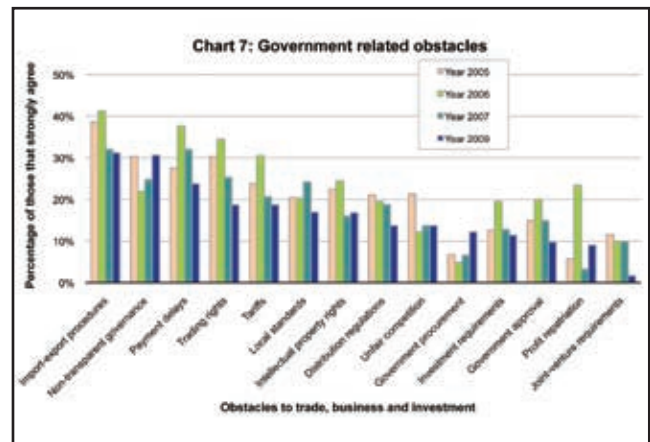
The 4 trillion RMB government stimulus package has kept the Chinese economy growing during the global economic downturn, with 45 percent of respondents expected to benefit indirectly from the package and 12 percent directly. The fact that about half the companies do not expect to benefit directly or indirectly is probably partly due to the “buy Chinese” sentiment and regulations.

A majority of Swedish companies are planning to maintain or increase investments in China, although the number of companies planning to increase investments was lower than in recent years. The fact that so many Swedish companies plan to expand investments at a time of global economic uncertainty clearly indicates the increasing importance of the Chinese market.

Barriers to trade

The Chinese market is still characterised by considerable barriers to trade. Every year these cost Swedish companies effort, market share and profits. According to a recent study commissioned by the European Chamber of Commerce in China, barriers to trade currently cost EU businesses over EUR 21 billion in lost business opportunities every year. The percentage of companies that feel strongly about market barriers has decreased to about 30 percent in 2009. It is, however, plausible that the economic

downturn overshadows government related barriers to trade, and that the reduced concern reflects a decreased importance relative to the global downturn even while few real improvements have been made. Sweden is a free-trade nation and the Embassy underlines concerns about various protectionist measures in all of its communications with Chinese authorities. The main results of the Swedish survey regarding barriers are shown in Chart 7.



Import and export procedures

Import and export procedures were seen as the No 1 obstacle in 2009. The Embassy has received ample evidence that protectionist measures have increased in China lately due to the economic instability.

Assessment and recommendations:

In order to minimise friction with customs, based on the experience of the Swedish Trade Council, companies should make sure to employ dedicated people that know how to deal with Chinese authorities. To obtain the preferred tariff classification in China, companies should provide a clear description of the product and its functions. However, since China’s tariff classifications are still somewhat undeveloped, different authorities in different ports can give the same product different product codes.

To come to terms with different classifications Chinese customs have recently established new network connections that allow port authorities to share information, a fact that

makes the first custom declaration especially important. Once a company’s product has been classified its product category will be used as a reference by customs authorities in other ports. The wrong classification will be both difficult and time consuming to change. When this happens, companies should try to use examples of classifications from other markets in order to argue their case.

In order to avoid misunderstandings and unnecessary delays companies should provide correct documentation and certificates, as well as make sure that duty free goods are not mixed with cargo that needs to be declared, since this might result in extra time-consuming procedures.

Non-transparent governance

Non-transparent governance is another major concern for Swedish companies. It is related to decisions such as whether to hand out, or not to hand out, licences; the awarding of contracts in public procurement etc. Non-transparent decision-making is sometimes more pronounced at a local and provincial level than at the central government level. The lack of transparency permeates the whole society both in legislation and its implementation. While transparency creates predictability, trust and a fair, competitive environment, lack of transparency does the exact opposite. It should, however, be acknowledged that some improvements have been made when it comes to public consultations on draft legislation in the last year.

A considerable problem for companies is inconsistency in various requirements by local and central government as well as constantly changing rules, sometimes favouring domestic or local companies. Lack of transparency is also a problem when it comes to public information and trade statistics, a fact that makes reliable forecasts difficult to come by. Local authorities in China, in an attempt to attract investments, sometimes also promise too much.

Assessment and recommendations:

Companies must be prepared that rules and regulations will continuously be adjusted and modified. A practical example is the list of "strategic industries". The list is continuously changed, with industries both added and removed. With a well planned and flexible budget companies will be prepared for new costs and lower subsidies.

To avoid encountering problems, companies should always verify with the central government before investing locally. It is also advisable to always double check information from Chinese authorities.



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Payment delays

Payment delays worry many Swedish companies. The situation has been described as a vicious circle where a delay at one stage of the supply chain affects subsequent payments. Customers often delay paying (usually 60-90 days). Consequently, the seller cannot and will not pay their suppliers in time. An important reason is that companies are only allowed to charge a symbolic interest. A higher interest on overdue payments might be a solution to the problem, but presently such a policy change is unlikely.

China, furthermore, does not yet have a credit register and published figures are often not trustworthy, making it difficult to check Chinese companies creditworthiness.

Assessment and recommendations:

Foreign companies must thus be alert and absolutely certain of their Chinese counterpart's credibility before entering into a business agreement. Companies should also have payment delays in mind when making budgets and not have too tight a cash flow. To diminish the risk for payment delays when doing business in China, companies could initially use letters of credit and deliver upon payment, implement instalment plans or make sales people accountable for collecting payments. It is also important to build a relationship with the customer based on mutual dependency and trust, as well as to seek legal advice when needed.

Local standards

Chinese standards continue to be a headache for Swedish companies as many Chinese standards are different from well established international standards. Chinese standards are often a mixture of Japanese, Russian, American and European standards. Some foreign companies have tried to influence the government to use their product

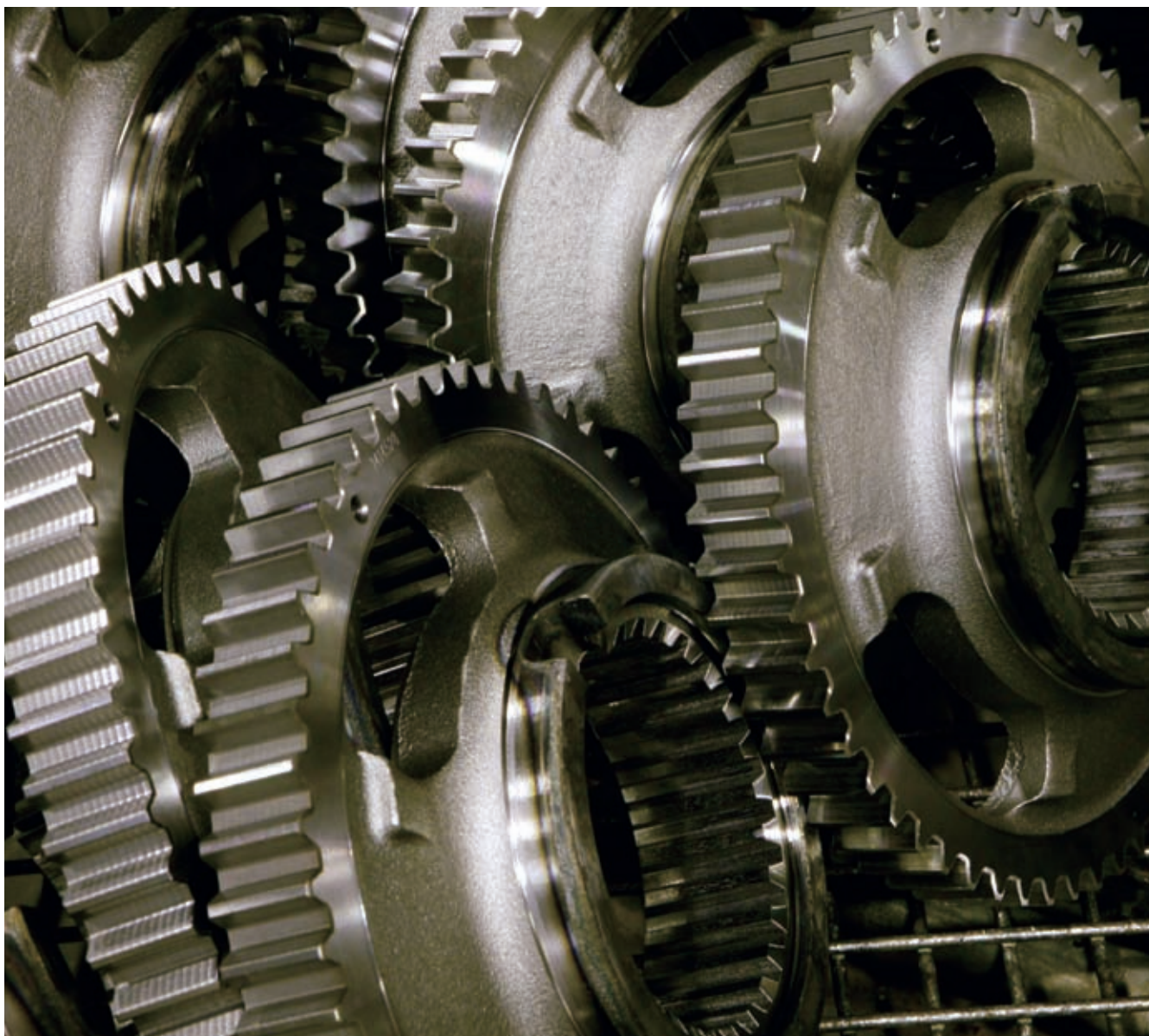
standards as a market strategy, with the consequence that China today has a plethora of different standards. Swedish products are generally of a much higher standard than Chinese products and thus usually have no problems passing for example the China Compulsory Certification (CCC).

The Embassy of Sweden and the European Commission's delegation continue to request China to simplify and streamline the CCC, which is non-transparent and unnecessarily burdensome for Western companies of which the automobile, machinery and ceramics sectors are worst affected.

The scope of the CCC scheme, including factory inspections and uncertain application of national treatment, are some notable problems.

Assessment and recommendations:

Companies wanting to sell their products in China must be prepared to modify their products as well as pass required certifications before being able to enter different sectors. Certificates such as the CCC are, unfortunately, expensive and time consuming for companies to obtain but presently still necessary to do business. It is important to always make sure to use a legitimate certification company.



Intellectual property rights

Protection of intellectual property rights (IPR) is a global problem, but particularly so for companies with operations in China. The Chinese judicial enforcement system is lagging and IPR protection is generally inadequate. Improved IPR protection is highly prioritised by Sweden and the European Union. This year the problem was perceived as slightly more serious by Swedish companies compared to last year. Insufficient IPR protection hinders companies from transferring vital technology and may affect their decision whether to invest or not. Chinese authorities sometimes go as far as to demand highly confidential information from companies that is not needed in order to approve their projects in China – information that is sometimes passed on to Chinese competitors.



Assessment and recommendations:

Swedish companies must make sure to properly protect their products and patterns before entering China and an application for a patent should officially be submitted and confirmed before any discussion to set up business in China. It is also advisable to outsource production to a number of well evaluated manufacturers and to keep the core of the product in the mother country.

Government procurement

Government procurement is an increasingly troublesome trade obstacle to Swedish companies, with growing nationalistic tendencies and “invisible barriers”. The “buy Chinese” clause in the financial stimulus package is of particular concern. It excludes many foreign companies from benefiting from parts of the 4 trillion RMB stimulus package. There is also limited access to and insufficient publicity of many public tenders. The problems are most severe in sectors of “strategic interest” as for example Clean Development Mechanism projects. China is still not a member of the WTO Government Procurement Agreement (GPA) and unfortunately membership may take years to negotiate.



Tariffs

Tariffs are not a major problem for Swedish companies doing business in China. After the EU won a WTO-dispute concerning auto-parts, China has now also complied and reduced its previously discriminatory tariffs on imports of auto parts. The risk, however, of Chinese authorities taking retaliatory measures against countries applying anti-dumping duties to Chinese products is not insignificant. For example China immediately started anti-dumping investigations against US chicken as soon as the US dumping duty on Chinese tyres was decided in September 2009.

Concluding remarks

China is a market with great opportunities and remarkable potential. The Chinese economy's ability to sustain high growth in 2009, a year when almost all other major economies have contracted, is impressive. This growth is mainly due to China's huge stimulus package and massive lending by state banks.

However, barriers to trade and macroeconomic difficulties continue to worry Swedish companies in China. Non-tariff barriers, e.g. a painstakingly slow bureaucracy, unnecessary import and export procedures, lack of transparency, IPR infringement, unfair competition and government procurement policies, are some of the major concerns and represent substantial costs for Swedish companies.

When discussing the obstacles companies face when doing business in China, the Chinese market can easily be perceived as too challenging. Companies should remember, however, that not all of these challenges are relevant to each individual organisation and that the opportunities in many cases outweigh the obstacles.

It is important to be aware of the problems and the competition in the Chinese market and to keep updated on applicable laws and regulations. Companies with a well thought through business plan often do well in China, better than those entering China with insufficient experience and understanding of the Chinese market. Companies should therefore evaluate alternatives thoroughly before setting up business in the Middle Kingdom.

The Swedish Embassy is working closely together with the Swedish Chamber of Commerce and the Swedish Trade Council to promote Swedish business interests in China. The Embassy gives Swedish companies access to Chinese officials in various ways. Good relations with the authorities are particularly important in China, a country where the government has considerable influence over businesses.

High level visits between Sweden and China present a valuable opportunity to raise specific trade and investment related issues. The Embassy and the



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Chamber generally give Swedish companies the chance to communicate any trade and investment problems prior to these meetings. Also, when possible, company representatives are invited to attend. This provides them with a unique opportunity to voice their concerns and to get privileged contact with high-level decision makers. A number of issues have been resolved at these occasions.



The Swedish and Chinese governments have a joint committee for discussing trade and investment relations, which meets approximately every two years. At the latest meeting in Stockholm in July 2009 Sweden provided China with documentation on company related concerns. China responded with a written reply that the Embassy has distributed to the concerned companies.

In order to successfully deal with trade barriers, it is also important to work through the EU framework. The Embassy has regular meetings with commercial, financial and agricultural attachés from other EU embassies to discuss common problems and possible ways to deal with them. The Swedish Chamber of Commerce interacts with the EU Chamber of Commerce and its lobbying channel to the Chinese authorities.

In the second half of 2009, Sweden holds the presidency of the European Union. If all 27 member states speak with one voice much can be done to improve the business climate for European companies in China. The EU has completed a list of 12 prioritised trade issues to stress in its dialogue with China. The listed barriers are not necessarily the most important to European businesses but are areas in which China may most realistically be willing to modify its policies.²

The Embassy, the Swedish Trade Council and the Swedish Chamber of Commerce in China organise various activities such as seminars, workshops and matchmaking sessions. The embassy, and its environmental technology centre, CENTEC works together with the Swedish Trade Council to promote

Swedish exports in areas where Swedish know-how and Chinese demand meet. The Swedish Trade Council, in addition, provides hands-on assistance to companies on an individual level, assisting companies to reach their goals in the Chinese market.

It is crucial to remember that a free and fair trade and business environment is in the interest of both Sweden and China. Both countries stand to gain from efficient and non-distorting trade practices.

*Written by Markus Lundgren,
Embassy of Sweden in China*

*Co-authors:
Haizi Xu, Swedish Chamber of Commerce in China
Helena Hjorth, Swedish Trade Council*

² The EU Market Access Priority List: Clean Development Mechanism (CDM), Compulsory Certification System (CCC), Computer Reservation System (CRS), insurance, intellectual property rights (IPR), IT-Security, medical devices, pharmaceuticals, postal and courier services, public procurement, raw materials, sanitary and phytosanitary measures.

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EMBASSY OF SWEDEN

Embassy of Sweden

3 Dongzhimenwai Dajie
Sanlitun, Chaoyang District
Beijing 100600
P.R. China

Tel: +86-(0)10-6532 9790

Fax: +86-(0)10-6532 5008

E-mail: ambassaden.peking@foreign.ministry.se
www.swedenabroad.se/beijing



Swedish Chamber of Commerce in China

Room 313, Radisson SAS Hotel
6A, East Beisanhuan Road
Chaoyang District
Beijing 100028
P.R. China

Tel: +86-10-5922 3388 ext. 313

Fax: +86-10-6462 7454

www.swedishchamber.com.cn



Swedish Trade Council

Swedish Trade Council Beijing
Room 609, 6/F, CYTS Plaza
No. 5 Dongzhimen Nandajie
Dongcheng District
Beijing 100007
P.R. China

Tel: +86 10 5815 6006

Fax: +86 10 5815 6223

www.swedishtrade.se/kina