Rocky Roads Ahead

Business Confidence Survey 2022/23

AHK

GERMAN CHAMBER
of Commerce in China
中国德国商会

#PartnerForAdvocacy

Business
Confidence
Survey 2022/23

PREFACE

The German Chamber of Commerce in China represents more than 2,100 member companies, roughly half of all German companies operating in China This report is based on the Business Confidence Survey, conducted from August to September 2022. With a 16 years history, this is our longest-running instrument to measure the business sentiment of our member companies operating in China. 593 member companies responded to this survey, making this one of the most representative samples of German businesses' sentiment in China. We want to thank all participating member companies for their valuable contribution that helps guide the German Chamber's advocacy work.

2022 is of special significance to the Sino-German relationship, as the year marks the 50th anniversary of the establishment of diplomatic relations between Germany and China. Throughout this half-century, diplomatic and trade ties between the two nations have intensified greatly. In the past decade, the People's Republic of China advanced to become Germany's most important trading partner. In the export-oriented economies of both Germany and China, these economic relations sustain millions of jobs. The enormous size of the Chinese consumer market, its advanced supply chain infrastructure, and its status as an increasingly strong innovator make China one of the most important markets for many German companies.

Nevertheless, in the jubilee year of 2022, German companies in China are facing a multitude of challenges – from operating in an environment of continued zero-COVID-19 policies to international (geo-)political tensions. Lockdowns of entire cities and regions caused a sharp decline in China's GDP growth, with a year-on-year growth rate for the year's first three-quarters of just 3.0% (preliminary estimates; National Bureau of Statistics, China).

Hence, it's not surprising that this year's survey results reflect one of the most negative business environment assessments observed in recent years, with less than one-quarter of companies experiencing an improvement in their industry in China in 2022. German companies' optimism thus reaches a historical low. Nevertheless, German companies' outlook for 2023 is slightly more positive. While still not reaching levels comparable to pre-pandemic years, the anticipated rebound hints that China will remain a key market for German companies in the years to come.

COVID-19 and geopolitical tensions as well as the Russian war of aggression against Ukraine negatively affected global supply chains, logistics, consumption, and production. Those factors have put immense pressure on German companies in China.

Like their Chinese counterparts, German businesses shouldered the impact of zero-COVID-19 policies in 2022. The regulations further disrupted companies' supply chains and logistics in China, hampered production and economic recovery, sped up the outflow of foreign employees, and caused operational uncertainty. Legal ambiguity, preferential treatment, and cyber and data security regulations remain further concerns that negatively impact business confidence.

All these factors decrease China's attractiveness as a business location. For 2022, German companies in China report a significant decrease in investment confidence: only 51% of companies intend to further invest in China within the next two years. This marks a drop of around 20 p.p. from surveys of recent years, which historically report investment intentions at around 70%.

German companies are reacting to these multi-faceted challenges by applying a two-tracked adaptation strategy of localization and/or diversification. On the one hand, headquarters are accelerating the diversification of supply chains and investment in Asia. On the other hand, German companies further localize research and development, sourcing, production, marketing and sales, and staff in China.

China's recent pivot away from the zero-COVID-19 policy is a much-welcomed development and will help restore business confidence in the mid- and long term. The German Chamber advocates for a well-planned and implemented exit from the zero-COVID-19-approach in addition to leveling the playing field for domestic and foreign companies to help restore business confidence of foreign investors and their headquarters.

Through our year-round advocacy efforts, we make sure our members' voices, expectations, and concerns are heard – in China and in Germany. Thus, in this year's edition, for the first time, we directly communicate our advocacy points in the Business Confidence Survey 2022 | 2023. With our members' input, we trust that the report provides a reliable guide that will help shape Sino-German business relations in 2023 and beyond.

Jens Hildebrandt
Executive Director & Board Member
German Chamber of Commerce in China | North China

Maximilian Butek
Executive Director & Board Member
German Chamber of Commerce in China | Shanghai

Martin Klose
Executive Director & Board Member
German Chamber of Commerce in China | South & Southwest China

TABLE OF CONTENTS

TABLE OF FIGURES

TABLE OF FIGURES

EXECUTIVE SUMMARY

ROCKY ROADS AHEAD - BUSINESS CONFIDENCE OF GERMAN COMPANIES IN CHINA REACHES HISTORIC LOW

China's recent pivot away from the zero-COVID-19 policy is a much-welcomed development and will help restore business confidence. However, the disruption of business operations relating to China's zero-COVID-19 policy has left deep tracks: 2022 marks a historical low in business confidence and perceived attractiveness of the Chinese market for German companies, with 41% of the companies expecting a decrease in profits for 2022. Localization and diversification are the prevailing response by German companies to mitigate the risks associated with the continued zero-COVID-19 policy and the shifting geopolitical framework.

BUSINESS CONFIDENCE REACHES HISTORIC LOW

49% of German companies find China's attractiveness to be diminished compared to other markets. 58% of respondents say that China's attractiveness as an investment location is decreasing compared to other markets. Only 51% of German companies plan to increase their investment in China in the coming two years, compared to 71% last year – a drop of 20 percentage points. Also, views on business opportunities are more pessimistic. Only 30% of German companies rate growth in domestic consumption as a significant business opportunity - compared to 68% in 2019.

CHINA'S ZERO-COVID-19 POLICY WAS DETRIMENTAL TO BUSINESS SUCCESS IN 2022

This year, 66% of German companies named China's zero-COVID-19 policy as their top operational business challenge and as the main reason to decrease investment or exit the market entirely, which 10% of respondents were considering.

61% of companies that did not plan to invest or decrease investment over the coming two years in the Chinese market named the expected continuation of the zero-COVID-19 policy as the main reason. Out of the 10% of companies contemplating a market exit, 72% said it's because of COVID-19-related restrictions.

REGULATORY HURDLES REMAIN A CONCERN

The leading regulatory business challenges are legal uncertainty (33%) as well as cyber and data security regulations (31%), which are tied to the unclear implementation of China's Cyber Security Framework. More than half of the surveyed companies consider the cross-border data transfer legislation as challenging. Policy initiatives such as 'Made in China 2025' and the country's pursuit of self-reliance give local competitors a leg up, resulting in 29% of German companies reporting about unfavorable treatment. Out of the 29%, 64% say they experience unfavorable treatment in the context of market access.

DIVERSIFICATION AND LOCALIZATION ARE STRATEGIC DIRECTIONS

The headquarters' response to the extended zero-COVID-19 policy and rising geopolitical tensions is a combination of increased diversification outside of China and intensified localization inside China. 77% of German companies' headquarters have already adapted their strategy in response to China's continued zero-COVID-19 policy. 70% are taking steps to mitigate the risks tied to geopolitical tensions, such as an international sanctions regime. To build resilience, companies are localizing operations and supply chains inside China, diversifying in South-East-Asia, or simultaneously doing both. Building up parallel structures and diversifying outside of China is posing a bigger obstacle to smaller companies.

CAUTIOUS OPTIMISM FOR 2023

German companies' expectations for 2022 were adversely affected with 45% of the companies expect a decrease of the industry development. Only 24% of companies report that the development of their industry has improved in 2022, while 51% were forecasting a positive development when asked last year. Optimism returns in 2023, where 38% of German companies are expecting to see a positive development in their industry. 50% expect an increased business turnover and 37% forecast higher profits. Also, 77% of German companies expect an increasing annual growth in their industries for the next five years.

CHINA'S POLICY MAKERS NEED TO ACT NOW

The German Chamber welcomes the Chinese government's pivot away from the zero-COVID-19 policy. The new regulations must be well-planned and implemented swiftly on all levels throughout the country. German companies are committed to doing their share in managing the transition. Combined with leveling the playing field for domestic and foreign companies and a more transparent legal framework, this will help restore predictability and business and investment confidence across all market players.

KEY FINDINGS

1 2022 – A LOST YEAR; NEW HOPE FOR 2023?

- German companies' optimism reaches a historical low amid the continuation of zero-COVID-19-policies and geopolitical tensions
- As companies anticipate a rebound, outlooks for 2023 and beyond are considerably more positive

2 EXTRAORDINARY CHALLENGES IMPACTING CHINA'S ATTRACTIVENESS

- China's general attractiveness as a market decreased for almost half of German companies
- Views on business opportunities in China descended dramatically
- Investment confidence is decreasing significantly due to the zero-COVID-19 policies. Only 51% of German companies plan to further invest in China in the next two years, compared to 71% in 2021
- 58% of German companies believe the attractiveness of China as an investment location is decreasing compared to other markets
- The zero-COVID-19 policy remained the biggest operational business challenge for German companies in China in 2022
- Legal uncertainty, internet access restrictions, and cyber security are top regulatory business challenges for German companies in China
- One-fifth of the German companies consider "Made in China 2025" and "Buy China" as one of the top regulatory business challenges
- Preferential treatment of Chinese competitors is still an issue for nearly one-third of German companies
- Two-thirds of German companies report favorable treatment of domestic companies in market access

3 LOCALIZATION & DIVERSIFICATION - GERMAN COMPANIES' ADAPTATION STRATEGIES

- Despite headwinds: A large majority of German companies remain active in China
- German companies react to geopolitical tensions and the zero-COVID-19 policy with a two-tracked adaptation strategy: Localization in China and diversification outside of China
- Larger companies tend to diversify more outside of China than smaller companies
- 87% of the respondents are affected by rising economic and technological decoupling tendencies

WHAT WE ADVOCATE FOR

CHINA’S ROLE AS AN ATTRACTIVE INVESTMENT LOCATION

Stabilize China’s role as an attractive investment, production and sourcing market, by implementing an economy friendly exit strategy from zero-COVID-19-policies without compromising the health systems and continue to engage on an international diplomatic level in ending the ongoing war in Europe

CHANGE OF ZERO-COVID-19 POLICY

Push forward a well-planned and implemented exit from zero-COVID-19 including an easing of domestic and international travel restrictions, transparency, and early communication of anti-pandemic prevention measures

LEGAL FRAMEWORK

Create a transparent and predictable legal framework in which German companies can operate

CREATE A TRANSPARENT CYBERSECURITY ENVIRONMENT

Facilitate implementation and clarity of cybersecurity regulations and promote consistency of standard contract terms with international best practices, corresponding and operating better with the EU General Data Protection Regulation

CHINA’S CURRENT TREND TOWARDS SELF-SUFFICIENCY

Continue the policy of reform and opening-up in terms of both formal market access regulations and informal barriers such as in the licensing process

PREFERENTIAL TREATMENT OF DOMESTIC COMPANIES

Ensure that German companies receive the same incentives and supporting measures as their Chinese counterparts, have equal access to information and political stakeholders and that they receive the same treatment when it comes to participating in public procurement or when issuing licenses

SUSTAINABLE SUPPLY CHAINS

Create an ecosystem in which German companies can cooperate with their local counterparts to reach social and environmental standards throughout their supply chains and help achieve China’s decarbonization goals

2022 – A LOST YEAR; NEW HOPE FOR 2023?

Due to the spread of Omicron and China's zero-COVID-19 policy, the country saw an economic slowdown in 2022. Economic indicators on all levels have been comparably low, similar to the beginning of 2020. Foreign companies operating in China have been hit hard as well. While the economy showed signs of recovery toward the end of the year, the initial growth target of 5.5% set for 2022[1] will most probably not be reached. Current growth predictions by major banks vary between 2.8%[2] to 4.3%[3].

Throughout 2022, the continuation of the zero-COVID-19 policy meant recurring lockdowns, mass testing, supply chain disruptions, and severe travel restrictions. At the same time, the war in Europe and overall deepening decoupling tendencies have led to an increasingly intensifying geopolitical situation affecting foreign businesses – including German companies - operating in China.

For 2023, the outlook is slightly more optimistic, with profits and turnover expected to rebound. Optimism returns in the mid-term perspective: On a five-year outlook, over three-quarters of the companies expect positive developments for their industries in China, especially in the electronics, automotive, and chemicals industries.

German companies' optimism reaches a historical low amid the continuation of zero-COVID-19-policies and geopolitical tensions

As companies anticipate a rebound, outlooks for 2023 and beyond are considerably more positive

[1] *The State Council, The People's Republic of China. 2022. China sets 2022 GDP growth target at around 5.5%. [online] Available at: <https://english.www.gov.cn/premier/news/202203/05/content_WS6222c1cdc6d09c94e48a5f67.html>*

[2] *CNBC. 2022. Goldman Sachs and Nomura both cut China's GDP outlook, again. [online] Available at: <https://www.cnbc.com/2022/08/18/goldman-sachs-and-nomura-both-cut-chinas-gdp-outlook-again.html>*

[3] *The World Bank. 2022. China Economic Update – June 2022. [online] Available at: <https://www.worldbank.org/en/country/china/publication/china-economic-update-june-2022>*

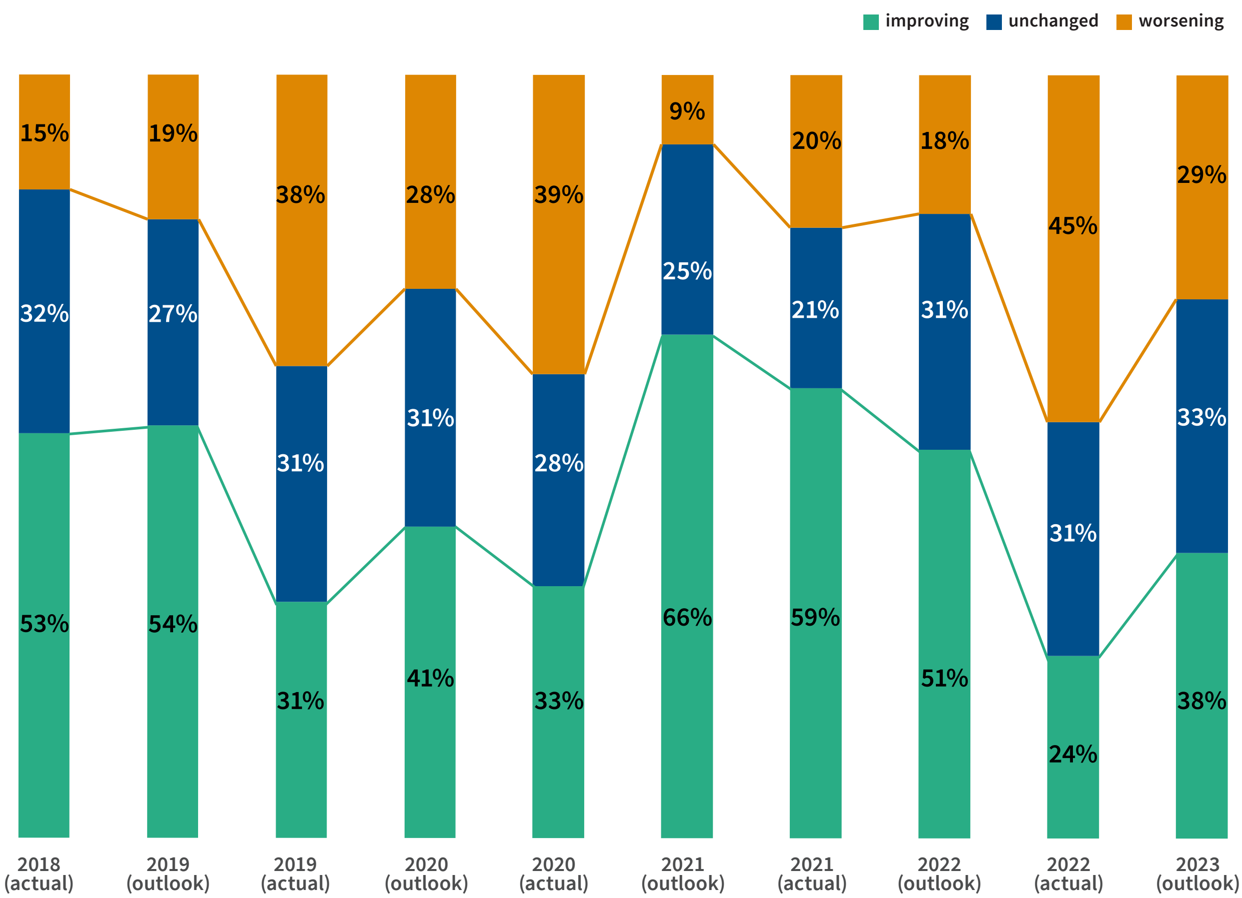
The World Bank. 2022. East Asia and Pacific Sustaining Growth, Restraining Inflation, but Facing Risks Ahead. [online] Available at: < https://www.worldbank.org/en/news/press-release/2022/09/26/east-asia-and-pacific-sustaining-growth-restraining-inflation-but-facing-risks-ahead>

Only 24% of the surveyed companies experienced an improvement in the development of their industry in China in 2022 compared to 2021, while 45% experienced a worsening. This is the most negative industry assessment observed in recent years. The expectations companies had for the following year in 2021 did not turn into reality: while in 2021, 51% of companies expected an improvement in their industry development in the following year, in 2022, only 24% actually perceived improvement. Similarly, in 2021, only 18% of the surveyed companies expected their industry development to decrease in the following year, while in 2022, 45% recorded an actual worsening (Figure 1.1). This could be explained by the continuation of China's zero-COVID-19 policies and geopolitical tensions. Both factors had severe effects on business operations.

The outlook for 2023 is slightly more optimistic, with 38% of companies expecting improvements in their industry in 2023, thus breaking the downward trend in recent years. The upward trend, however, is the least optimistic outlook during the entire crisis years of the COVID-19 pandemic. Furthermore, for 2023, 29% of German companies expect a decrease in development, and the remaining third expect no changes (Figure 1.1).

FIGURE 1.1: REBOUND OF INDUSTRY DEVELOPMENT IN 2023 - EXPECTATIONS STILL NOT COMPARABLE TO PRE-COVID TIMES

How do you evaluate the development of your industry in China in 2022 compared to last year? And what are your expectations for 2023? (2018: n=420; 2019: n=460; 2020: n=535; 2021: n=587; 2022: n=585)

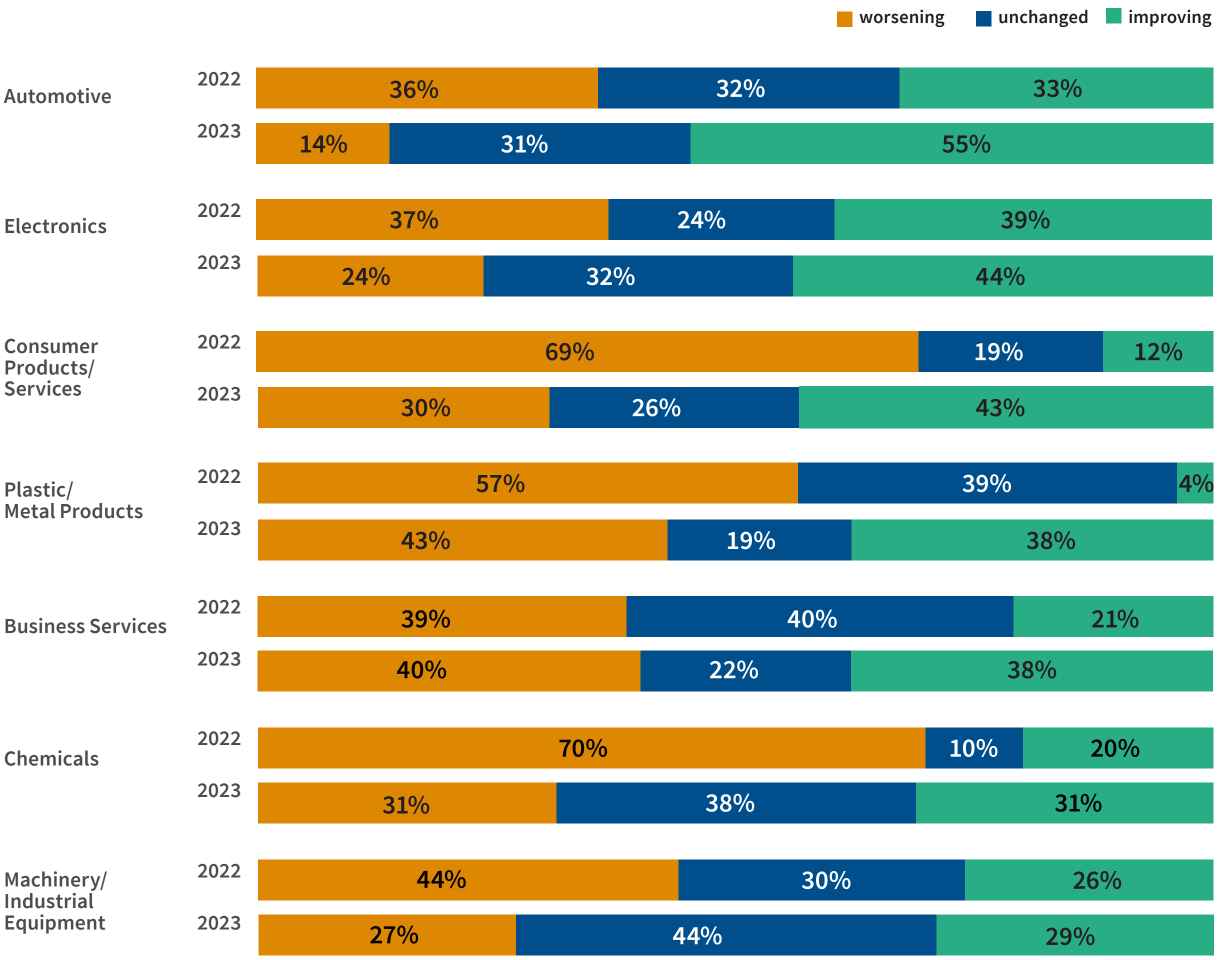


Note: "I don't know" answers excluded

All industries perceive negative development of their sector when compared on a year-on-year (YoY) basis. Whereas in 2021, several industries experienced improvement compared to the previous year, in 2022, development worsened across all industries compared to 2021. The most significant discrepancy is observed in the plastic and metal products industry: In 2021, 60% of surveyed companies in this industry expected an improvement for their sector, while in 2022, only 4% did so – a drop of 56 percentage points (p.p.). The most minor difference is identified in the automotive industry, with a 14 p.p. drop: In 2021, 47% of companies expected their industry to improve, while in 2022, only 33% did so (Figure 1.2).

FIGURE 1.2: 55% IN AUTOMOTIVE EXPECT IMPROVEMENTS IN 2023

How do you evaluate the development of your industry in China in 2022 compared to last year? And what are your expectations for 2023? (n=404)



Note: "I don't know" answers excluded

Similarly, in 2021, most companies in electronics, consumer products and services, and automotive expected an improvement in their respective industry for the next year, whereas in the actual assessment of 2022, there was no industry in which the majority of companies reported an actual improvement. In electronics, the 2022 development is viewed as the most positive among the industries, with 39% of respondents attesting to industry improvement. This is consistent with last year's results, where the electronics industry reported the most positive outlook for 2022. The chemicals and the consumer products and services industries report the most negative assessment of 2022, with 70% and 69% (respectively) experiencing worsening developments (Figure 1.2).

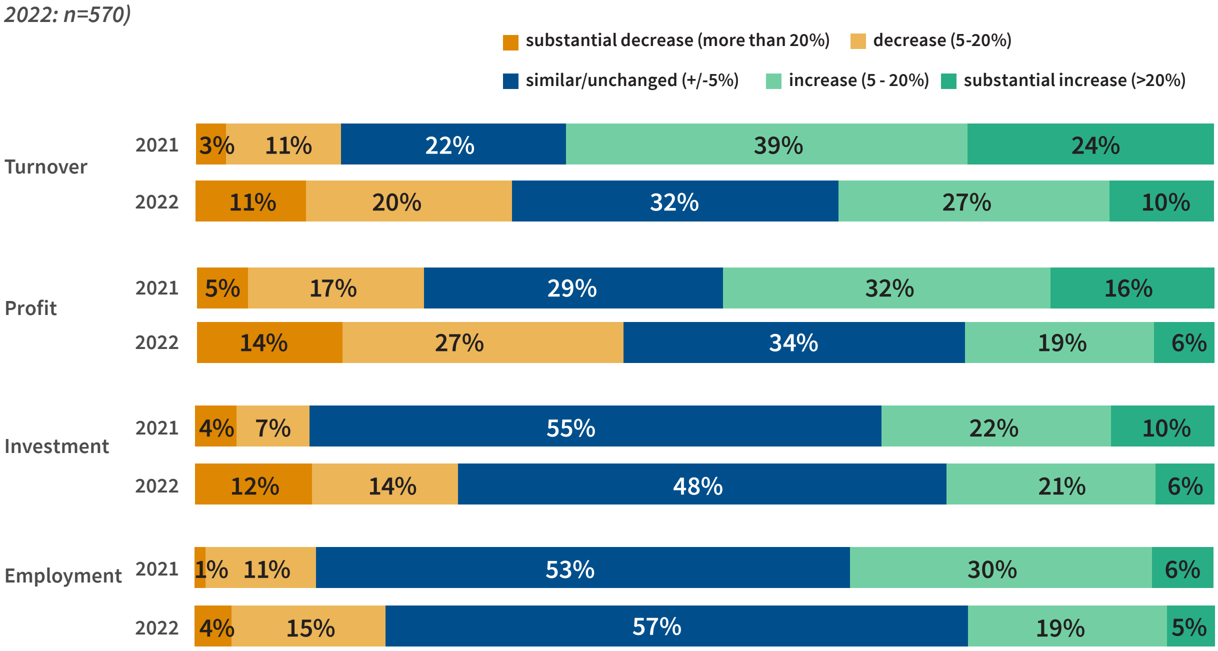
The outlook for 2023 is most favorable in the automotive industry, with 55% of respondents expecting positive developments. This makes automotive the only industry where a majority expects improvements. The most negative outlooks for 2023 are observed in the chemicals and the machinery and industrial equipment industries, with only 31% and 29% predicting improvements, respectively. Simultaneously, in the machinery and industrial equipment industry, the highest share of respondents expects no change for 2023 (Figure 1.2).

Expectations for all four key performance indicators dropped in 2022: for turnover, profit, investment, and employment, a larger share of companies reported decreases and a smaller share reported increases compared to 2021. In 2021, a majority of companies still expected an increase in turnover (63%), and nearly half the respondents expected an increase in profits (48%) compared to 2020. In 2022, however, there is no financial indicator where a majority of respondents expect increases (Figure 1.3). In 2022, expectations for turnover are more optimistic, with 37% expecting increases. 27% of German companies expect increases in investment, followed by 25% and 24% expecting increases in profit and employment, respectively. The sharpest decline in positive assessment is found in turnover (decrease of 26 p.p.) and profit (decrease of 23 p.p.).

Negative performance assessment rose sharply in profits (an increase of 19 p.p.), turnover (an increase of 17 p.p.), and investment (an increase of 15 p.p.), with profits rated overall most negatively: 41% of companies anticipate decreases in 2022, compared to 2021 (Figure 1.3).

FIGURE 1.3: TURNOVER AND PROFITS HEAVILY IMPACTED BY ZERO-COVID-19 POLICY

How do you expect your company to perform in the following areas by the end of 2022 compared to 2021? (2021: n=587; 2022: n=570)

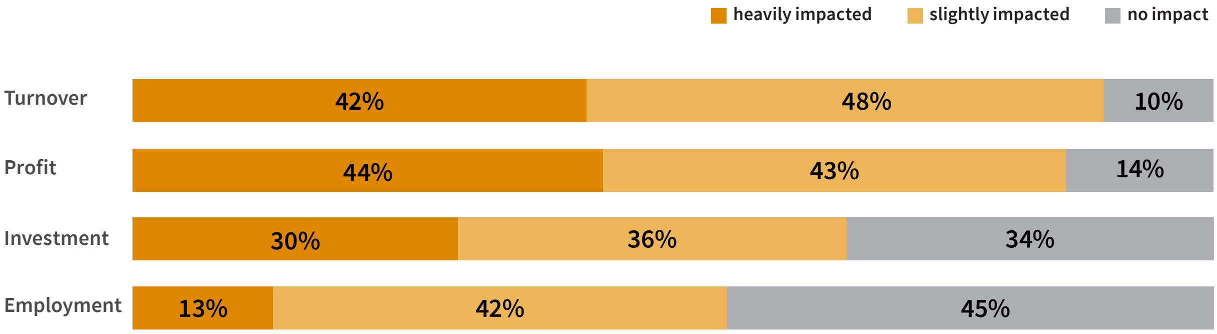


Note: "I don't know" answers excluded

Lockdown restrictions had a major impact on business performance in 2022, with all key performance indicators significantly impacted. Nine out of ten surveyed companies (90%) report lockdowns have negatively impacted their turnover, and 86% report an impact of the zero-COVID-19 policy on profits. Even though investment (66%) and employment (55%) have been impacted to a lesser extent, the majority of companies still report it affected both indicators. For German businesses, 2022 has been a year overshadowed by lockdowns (Figure 1.4).

FIGURE 1.4: LOCKDOWNS HAD A HUGE IMPACT ON BUSINESS OPERATIONS

How heavily have lockdowns throughout China affected your business performance in the following areas by the end of 2022, compared to 2021? (n=576)



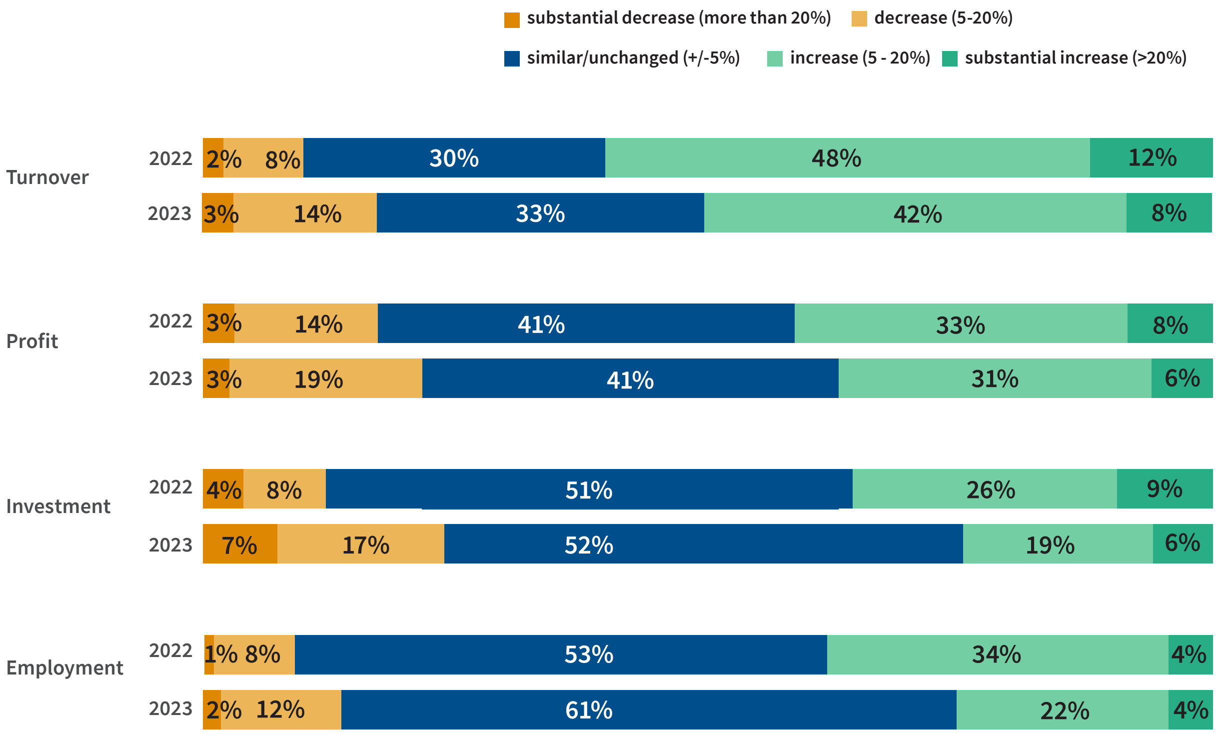
Note: "I don't know" answers excluded

The outlook on key performance indicators for 2023 is notably more optimistic than German companies' assessment for 2022. Half of the respondents (50%) expect increases in turnover for 2023, and over a third (37%) expect increases in profits (Figure 1.5).

Outlooks are less decisively positive on investment and employment; nonetheless, 26% expect increases in employment and 25% in investment. YoY differentials in outlooks on increases are largest in both turnover and employment, with a 10 p.p. and 12 p.p. drop from 2022 to 2023, respectively. Regarding investments, considerably more people expect a decrease in investments for 2023 compared to 2022. While for 2022, 12% of respondents expect a decrease in investments, for 2023, 24% do so - a difference of 12 p.p. (Figure 1.5).

FIGURE 1.5: REBOUND OF PROFITS AND TURNOVER EXPECTED FOR 2023

What is your view on the outlook of your company for 2023 across the following areas, when compared to 2022? (2021: n=585; 2022: n=563)

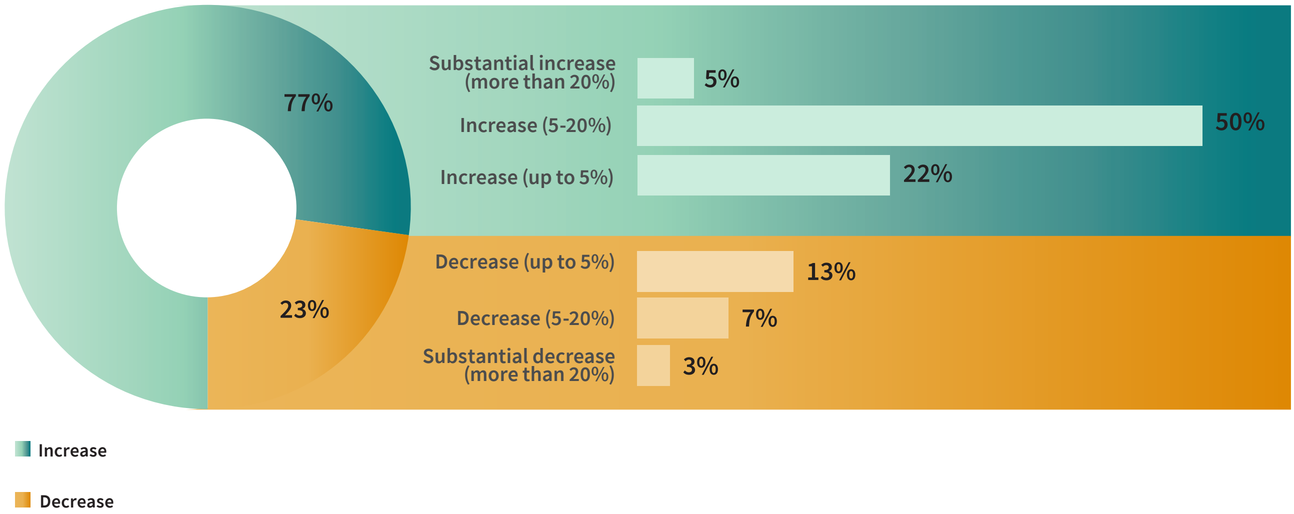


Note: "I don't know" answers excluded

In the next five years, more than three-quarters of German companies (77%) expect an increasing average annual year-on-year growth in their industry. Half of the respondents (50%) expect year-on-year growth of 5%-20%, and 5% even expect annual growth rates of over 20%. Nevertheless, a quarter (23%) is also expecting a decrease in YoY growth within the next five years (Figure 1.6).

FIGURE 1.6: MAJORITY STILL EXPECTS GROWTH IN THE NEXT FIVE YEARS

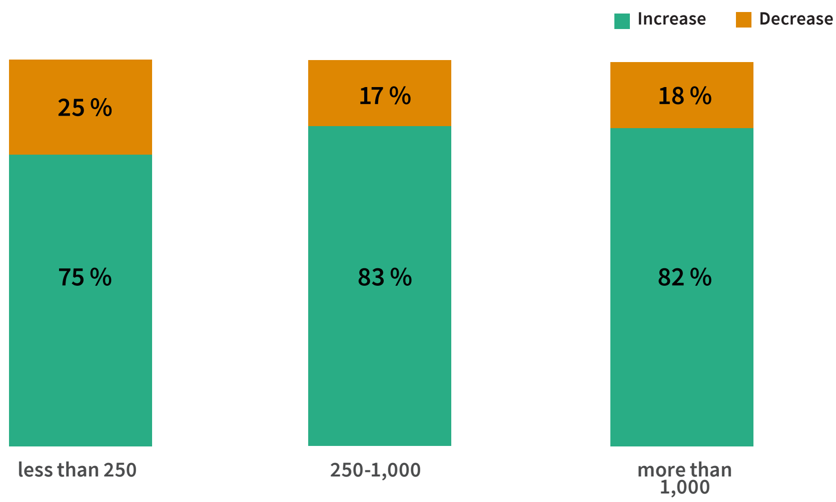
How do you expect the average annual (year-on-year) growth for your industry to develop in the Chinese market for the next 5 years? (n=586)



When observing company size, smaller companies (less than 250 employees in China) are comparatively less optimistic, with 75% expecting an increase in industry development and 25% expecting a decreasing average annual year-on-year growth in the next five years. Medium-sized companies with 250-1,000 employees and large companies with more than 1,000 employees are more optimistic, with 83% and 82%, respectively, expecting increasing growth, and correspondingly 17% and 18% respectively, expecting decreasing growth rates (Figure 1.7).

FIGURE 1.7: FIVE-YEAR-OUTLOOK: SMALLER COMPANIES LESS OPTIMISTIC

How do you expect the average annual (year-on-year) growth for your industry to develop in the Chinese market for the next 5 years? (n=586)

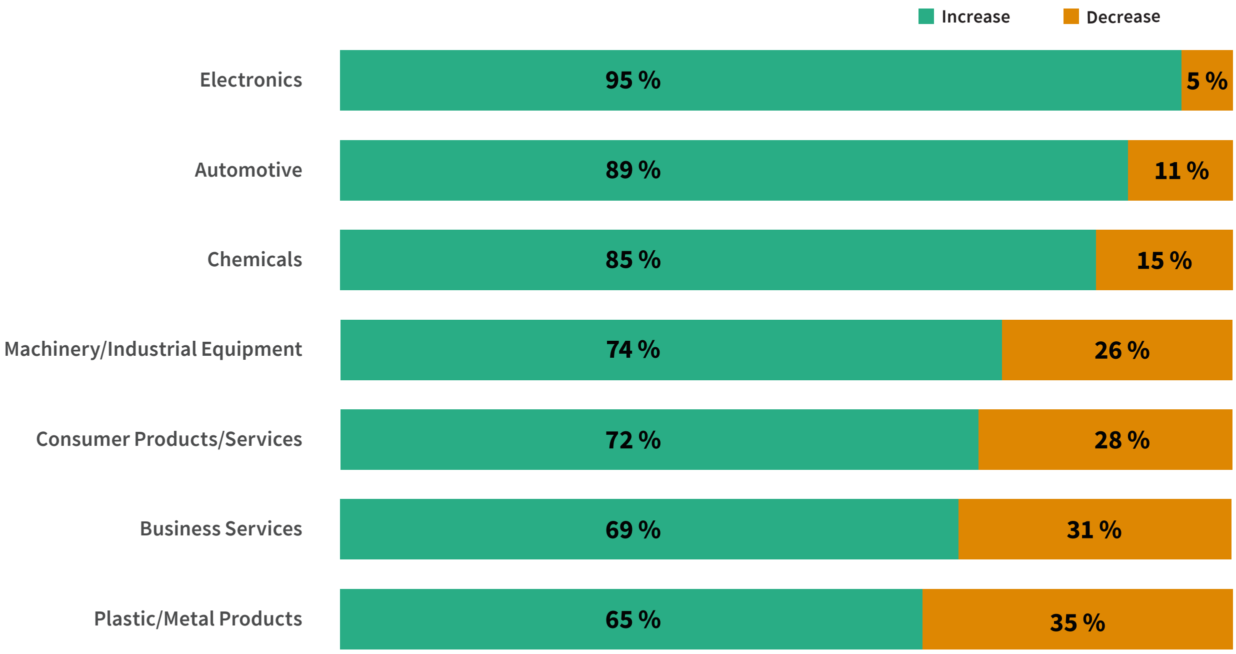


Note: Company size measured in number of employees

On the industry level, five-year growth expectations are optimistic above average in electronics, where 95% expect YoY growth increases within the next five years, followed by automotive (89%), and chemicals (85%). Machinery and industrial equipment, as well as consumer products and services, are slightly below the overall average, at 74% and 72% (respectively), predicting positive developments for their industries. Around a third of respondents in business services (69%), as well as plastic and metal products (65%), expect increasing YoY growth rates during the next five years, marking these the least optimistic industries in comparison (Figure 1.8).

FIGURE 1.8: FIVE-YEAR-OUTLOOK MOST POSITIVE IN ELECTRONICS, AUTOMOTIVE & CHEMICALS

How do you expect the average annual (year-on-year) growth for your industry to develop in the Chinese market for the next 5 years? (n=459)



EXTRAORDINARY CHALLENGES IMPACTING CHINA'S ATTRACTIVENESS

CHINA'S ATTRACTIVENESS AS A MARKET IS DECREASING

Geopolitical tensions – especially the Russian war of aggression against Ukraine – and the severe COVID-19 lockdowns left their mark on China's attractiveness as a market. 49% of the respondents rated China's attractiveness in general as decreasing compared to other markets.

Russia's invasion of Ukraine in February 2022 has led to a devastating war with no end in sight. German companies in China are indirectly affected by this war: Not only does it create disruptions across global value chains, but it also creates an unstable geopolitical outlook that impacts business confidence. Finally, the Russian war of aggression sparked a discussion surrounding dependencies in political Berlin, which is closely followed by the headquarters of German companies active in China.

Geopolitical tensions, combined with China's zero-COVID-19 policy, led to 43% of German companies indicating that China lost its attractiveness as a supplier market. Even as a sales market, China decreased in attractiveness for almost one-fourth of respondents.

This decreasing trend is also apparent when looking at business opportunities in China: Historically, the most significant business opportunity is the growth in domestic consumption. In 2022, only 30% of respondents rated growth in local consumption as a significant business opportunity - a severe drop when compared to the perceived significance in pre-COVID 2019, where 68% of respondents said so (a decrease of 38 p.p.). Dramatic drops in the significance of business opportunities are perceived among all other major areas as well.

China's general attractiveness as a market decreased for almost half of German companies

Views on business opportunities in China descended dramatically

WHAT WE ADVOCATE FOR

For German companies in China, the allure of the Chinese market has been on the rise in the last decades. However, recently, we saw a turn of the tide. We are witnessing doing business in China is becoming more challenging, and the Chinese market has been losing its appeal. Restoring predictability is key. A well planned and implemented exit from zero-COVID-19 policies will help restore business confidence with all market players. This is also important for headquarters in Germany. Furthermore, continuing the spirit of the last G20 meeting and China playing a role in ending the ongoing war in Europe would support improving the image of the Chinese market for the future.

ZERO-COVID-19 POLICY CHALLENGING INVESTMENT CONFIDENCE

The zero-COVID-19 policy, with recurring lockdowns and strict measures to combat the pandemic, has caused a lot of uncertainty among German companies. German headquarters of companies operating in China are slowly losing confidence in the Chinese market due to the country's anti-pandemic approach. Strict travel restrictions, mass testing, and the overall lack of predictability caused by the zero-COVID-19 policy have posed severe challenges for businesses and investments since the beginning of the pandemic. After strict measures throughout the nearly three years of the pandemic – and with no end in sight – these challenges only increased throughout 2022.

Investment confidence is decreasing significantly due to the continuation of the zero-COVID-19 policy. Only 51% of German companies plan to further invest in China in the next two years, compared to 71% in 2021

58% of German companies believe the attractiveness of China as an investment location is decreasing compared to other markets

The zero-COVID-19 policy remains the biggest operational business challenge for German companies in China

WHAT WE ADVOCATE FOR

China's zero-COVID-19 approach, with sudden lockdowns and international and domestic travel restrictions, disrupted business operations and supply chains and hampered innovation and R&D activities of German companies in the country. We strongly advocate for an environment in which companies can operate without such disruptions, and for an easing of travel restrictions in a scientific and controlled manner. The anti-pandemic prevention policies need to be transparent and communicated early to increase the reliability and certainty of operating in the Chinese business environment. To restore the confidence of German businesses in China and their headquarters in Germany, there needs to be clarity on the future approach and exit strategy.

LEGAL UNCERTAINTY AND PREFERENTIAL TREATMENT OF LOCAL COMPANIES ARE STILL MAJOR REGULATORY CHALLENGES

Legal uncertainty (33%), internet access restrictions (31%), and cyber and data security regulations (26%) are rated as the main regulatory business challenges for German companies in China. 20% of companies see "Made in China 2025" and "Buy China" efforts by the government as one of the top three regulatory hurdles: "Made in China 2025" is an economic policy document of the Chinese government targeting self-sufficiency in 10 industries; "Buy China" or "Buy Chinese" is the term commonly used to describe the – mostly informal - requirements by the Chinese government toward local companies to purchase components produced by Chinese companies, rather than from foreign companies.

Legal uncertainty, internet access restrictions, and cyber security are top regulatory business challenges for German companies in China

One-fifth of the German companies consider "Made in China 2025" and "Buy China" as one of the top regulatory business challenges

WHAT WE ADVOCATE FOR

A predictable and transparent regulatory framework is a precondition for German businesses to operate in China. In recent years, legal uncertainty for German companies in China has increased markedly. We strongly advocate for a clear, transparent, and predictable legal framework.

There needs to be more clarity about the implementation of cybersecurity regulations. Companies need to know which data can be transferred and under what circumstances. Only with the free flow of data between companies and their headquarters, innovation and R&D can be pursued. We would like the standard contractual provisions to be more consistent with international best practices, corresponding and operating better with the EU General Data Protection Regulation.

Companies are increasingly concerned about China's current trend toward self-sufficiency, and what it means for their future in China. We urge the Chinese government to continue the policy of reform and opening-up, from which China has benefited economically over the last 40 years. This applies not only to formal market access regulations, but also to informal barriers in the licensing process. Economic policy initiatives such as "Made in China 2025" and an ongoing "Buy China" trend should be congruent with the spirit of further opening.

Furthermore, preferential treatment of Chinese competitors is still a challenge for nearly one-third of German companies. 64% of German companies experience unfavorable treatment in the context of easier and broader market access for local companies.

Preferential treatment of Chinese competitors is still an issue for nearly one-third of German companies

Two-thirds of German companies report favorable treatment of domestic companies in market access

WHAT WE ADVOCATE FOR

German companies are not afraid of fair competition on equal footing. Governments on all level in China need to ensure that German companies get the same incentives and supporting measures as Chinese companies, have equal access to information and political stakeholders and that they receive the same treatment when it comes to participating in public procurement or when issuing licenses.

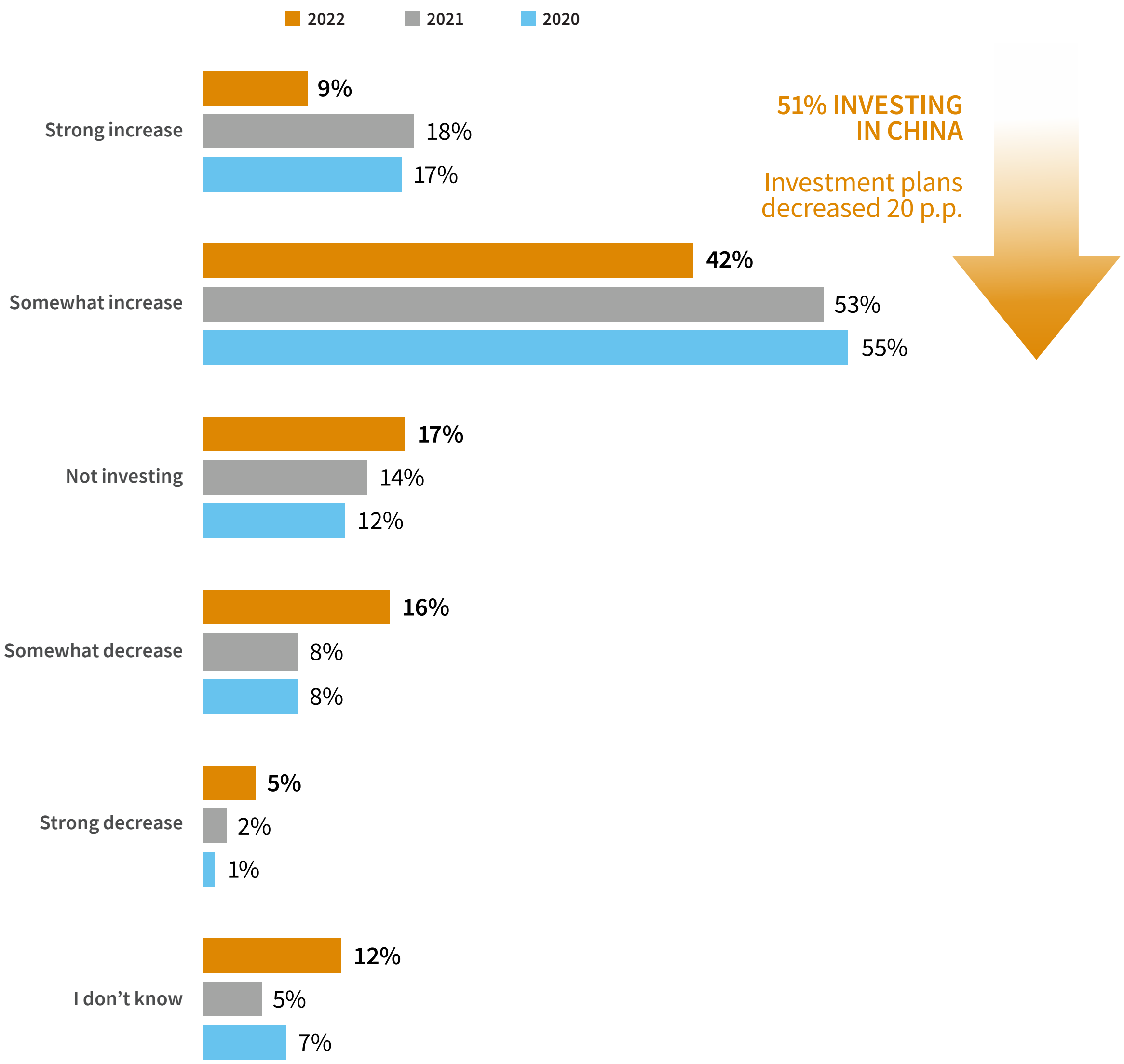
The Public Procurement Act and related regulations could form an essential basis for the equal treatment of German companies. However, it must be ensured that the "national treatment" requirement (according to which foreign companies should be considered as domestic companies) is put into practice. We would also welcome China adapting its procurement system to international practice and acceding to the WTO Agreement on Government Procurement.

INVESTMENT CONFIDENCE 2.1

51% of the surveyed companies plan to further invest in China in the next two years. This marks a significant drop in investment confidence, as in the previous two years, 71% and 72% of the respondents reported they plan to further invest in China, respectively. Surveyed companies that report a strong increase in investment plans for the next two years only amount to 9% in 2022 - compared to 18% in 2021. This decrease in investment confidence is also apparent in the 21% of German companies that plan to decrease investment in the next two years – in 2021, only 10% had such plans (Figure 2.1).

FIGURE 2.1: INVESTMENT CONFIDENCE DECREASES SIGNIFICANTLY

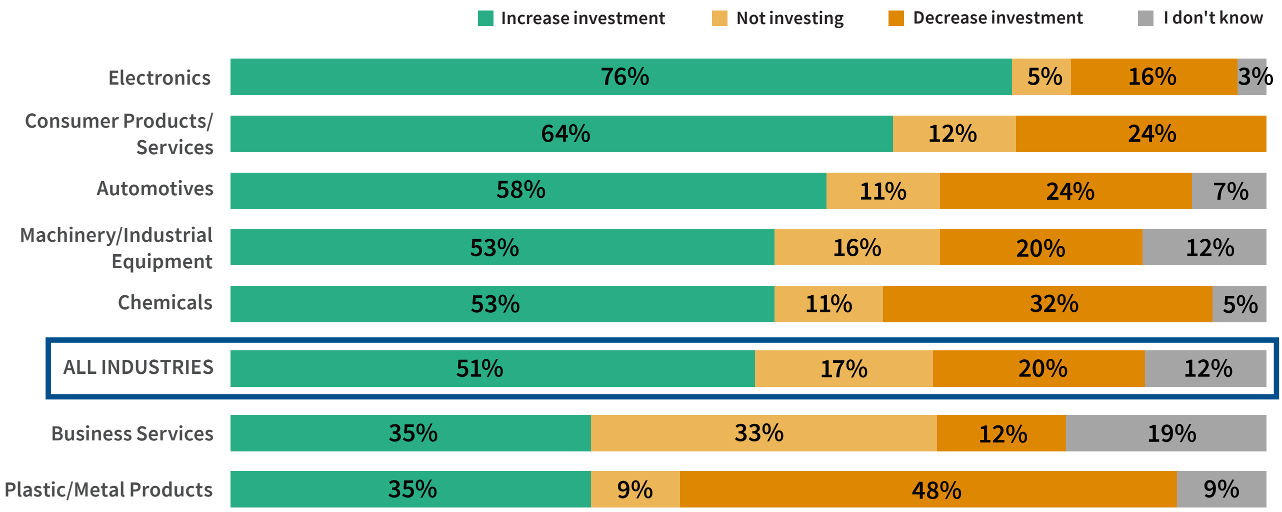
How is your company planning to further invest in China within the next two years? (2022: n=574; 2021: n=576; 2020: n=462)



Only 35% of companies in the business services and the plastic and metal products industries each plan to further increase investment in the next two years – marking the two industries with the least investment confidence (Figure 2.2).

FIGURE 2.2: BUSINESS SERVICES AND PLASTIC AND METAL PRODUCTS EXPRESS LOW INVESTMENT CONFIDENCE

How is your company planning to further invest in China within the next two years? (n=574)

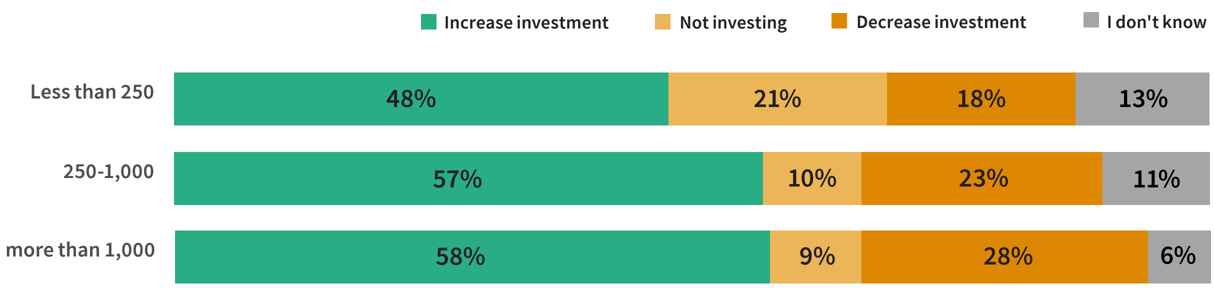


Note: "Increase investment" is the sum of "strongly increase" and "somewhat increase", "decrease investment" is the sum of "somewhat decrease" and "strongly decrease"

Investment confidence is similarly low among all company sizes. Larger companies are not planning to invest significantly more in China in the next two years compared to SMEs. 48% of the smaller companies (less than 250 employees) plan to further invest in the next two years. Among the medium-sized companies (250 to 1,000 employees) 57%, and among large companies (more than 1,000 employees) 58% plan to further invest in the next two years. Notably, small companies are, to the highest percentage (21%), not planning to invest in China, putting investment on hold. Larger companies are comparably more pronounced in decreasing investment in China within the next two years (28%) (Figure 2.3).

FIGURE 2.3: INVESTMENT CONFIDENCE SIMILAR FOR ALL COMPANY SIZES

How is your company planning to further invest in China within the next two years? (n=574)

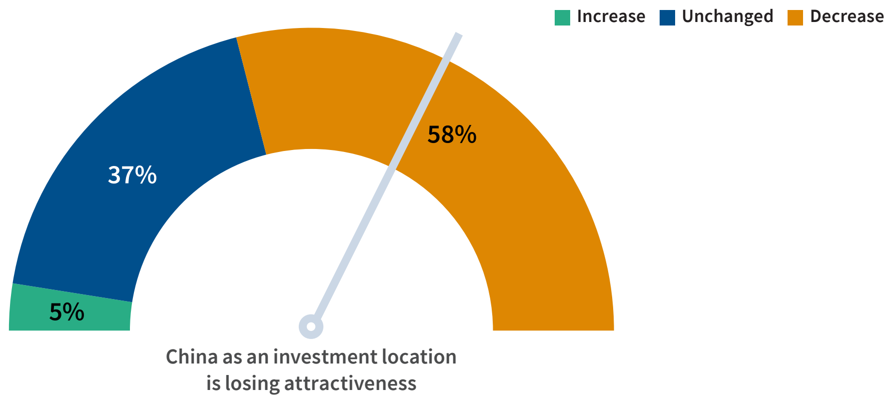


Note: "Increase investment" is the sum of "strongly increase" and "somewhat increase", "decrease investment" is the sum of "somewhat decrease" and "strongly decrease"
Company size measured in number of employees

The significant decrease in investment confidence is also prevalent in the perception of China as an investment location – 58% of the responding German companies believe China's attractiveness as an investment location is decreasing compared to other markets. Only 5% consider the attractiveness of China as an investment destination to be increasing (Figure 2.4).

FIGURE 2.4: CHINA A LESS ATTRACTIVE INVESTMENT LOCATION

Did China's attractiveness in the following areas change compared to other markets? (n=492)

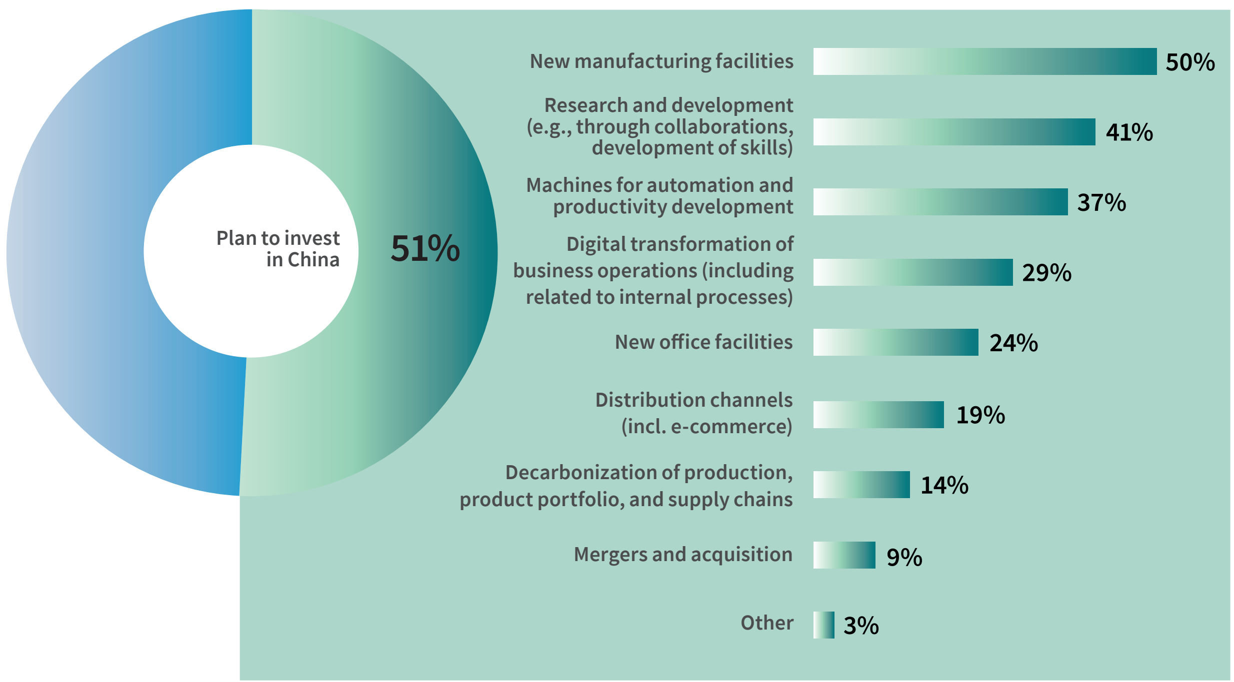


Note: "I don't know" answers excluded

Of the 51% respondents planning to further invest in China, half plan to invest in new manufacturing facilities. Other main areas of investments are research and development (41%), machines for automation and productivity development (37%), digital transformation of business operations (29%), new office facilities (24%), distribution channels including e-commerce (19%), and more (Figure 2.5).

FIGURE 2.5: MOST COMPANIES INVEST IN MANUFACTURING FACILITIES AND R&D

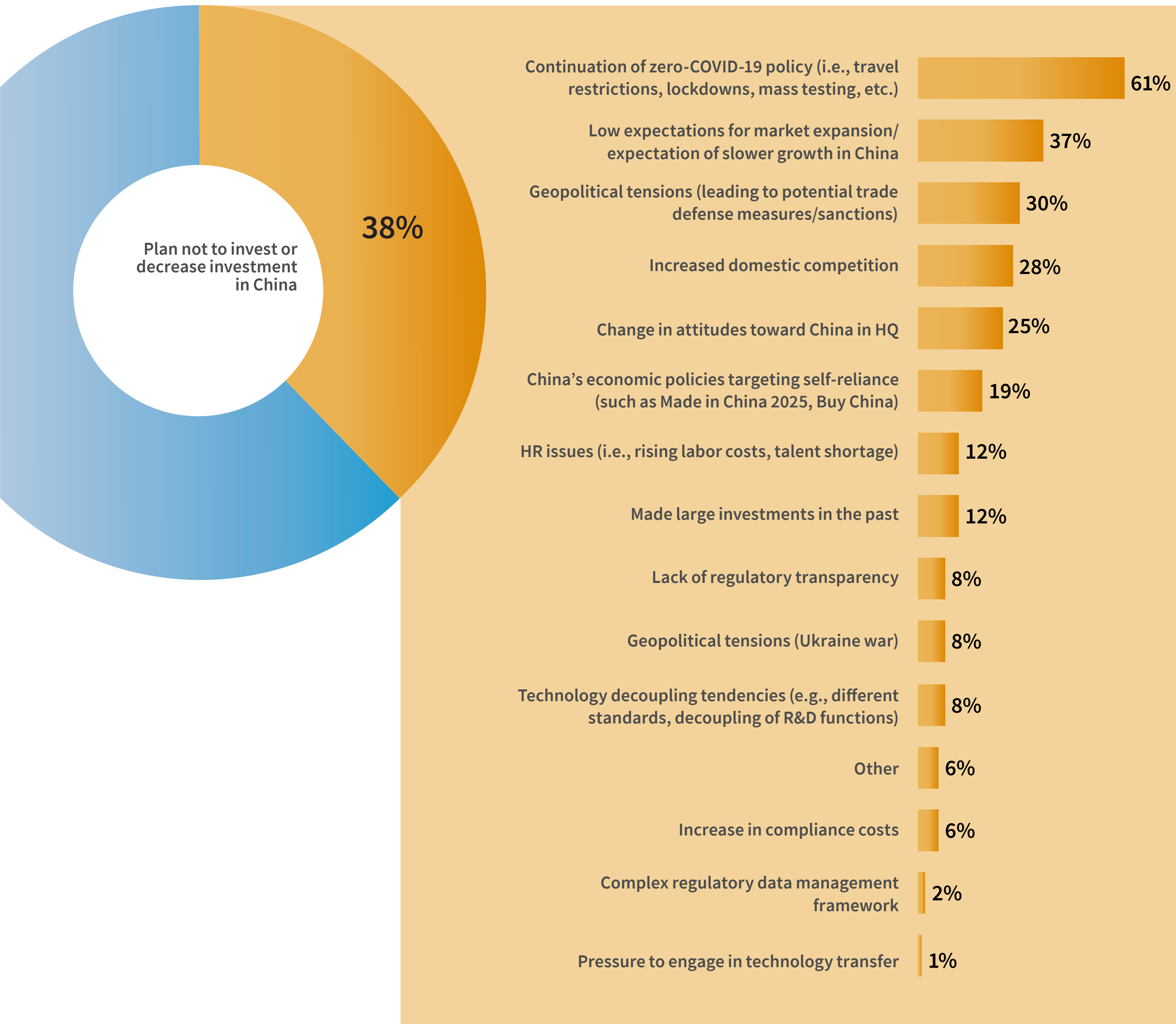
In which areas is your company planning to invest in China within the next two years? (n=291)



Note: Up to 3 answers possible; percentages based on number of responses; question only asked to companies who answered "strongly increase investment" and "somewhat increase investment" in Figure 2.1.

17% of the surveyed companies have no investment plans for the following years, and 21% of German companies plan to decrease investment (Figure 2.1). The extraordinary challenges German companies have been facing in 2022 become apparent when asked for the main reasons behind reducing investment. Two-thirds (61%) of the companies not investing or planning to decrease investments name the continuation of the zero-COVID-19 policy as one of the main reasons. 30% name geopolitical tensions, leading to potential trade defense measures and sanctions. Further reasons include low expectations for market expansions and expectations of slower growth in China (37%), increased domestic competition (28%), changes in attitudes toward China in headquarters (25%), and China's economic policies targeting self-reliance (19%). 12% of German companies made large investments in the past (Figure 2.6).

FIGURE 2.6: ZERO-COVID-19 POLICY NAMED MAIN REASON FOR NOT INVESTING
What are the main reasons for your company not to invest or decrease investments in China? (n=216)

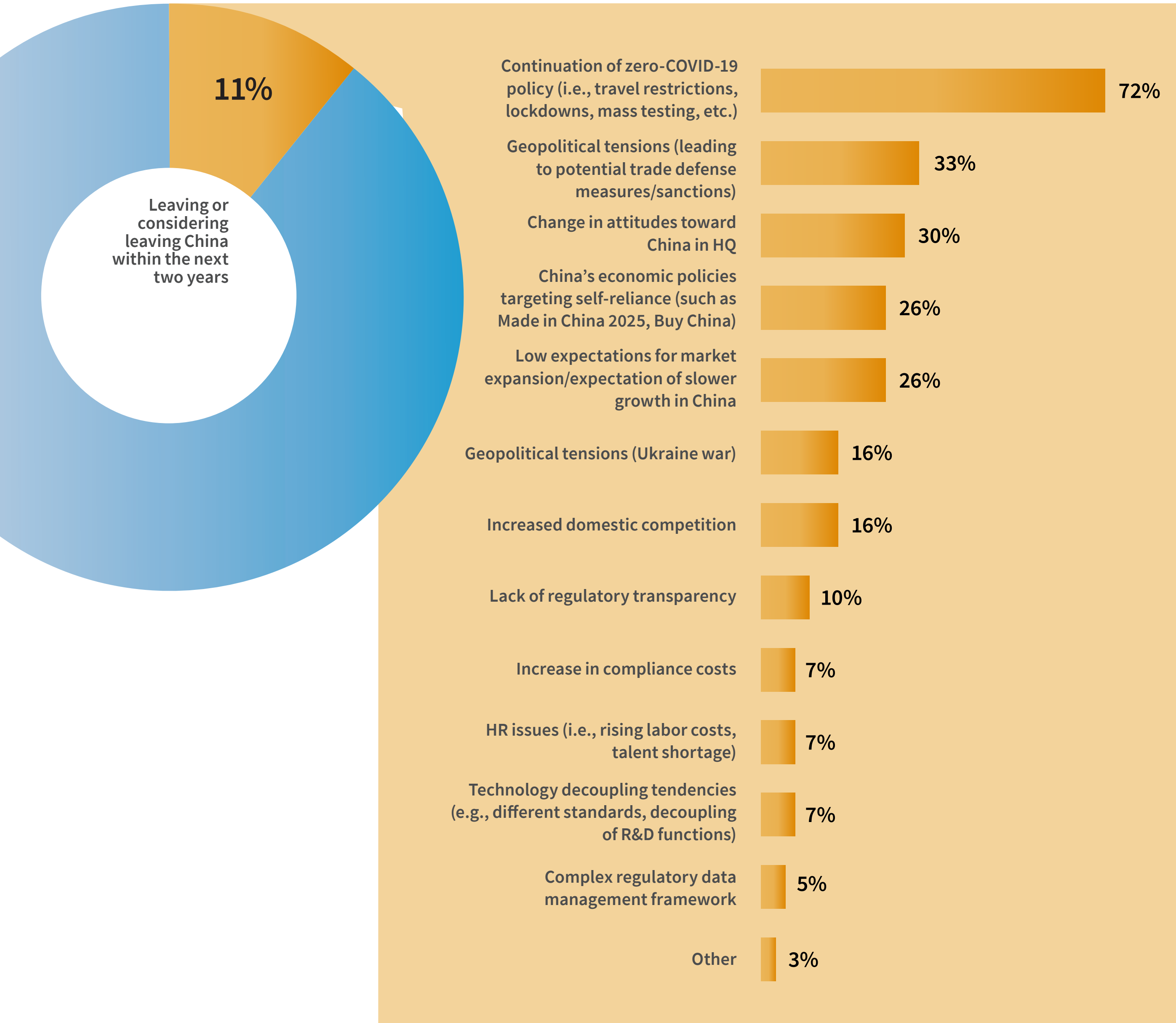


Note: Up to 3 answers possible; percentages based on number of responses; question only asked to companies who answered "not invest", "strongly decrease investment" and "somewhat decrease investment" in Figure 2.1.

11% of German companies are planning or considering leaving China within the next two years (further information in Chapter 3). Again, the main reason for this consideration is the continuation of the zero-COVID-19 policy (72%) (Figure 2.7).

FIGURE 2.7: ZERO-COVID-19 POLICY LEADS TO COMPANIES CONSIDERING LEAVING CHINA

What are the main reasons for your company to leave or consider leaving China in the next two years? (n=61)



Note: Up to 3 answers possible; percentages based on number of responses; question only asked to companies who answered "Yes" and "No, currently no specific plans, but we are considering" to the question "Is your company planning to completely leave China within the next two years?" in Figure 3.1.

OPERATIONAL AND REGULATORY CHALLENGES 2.2

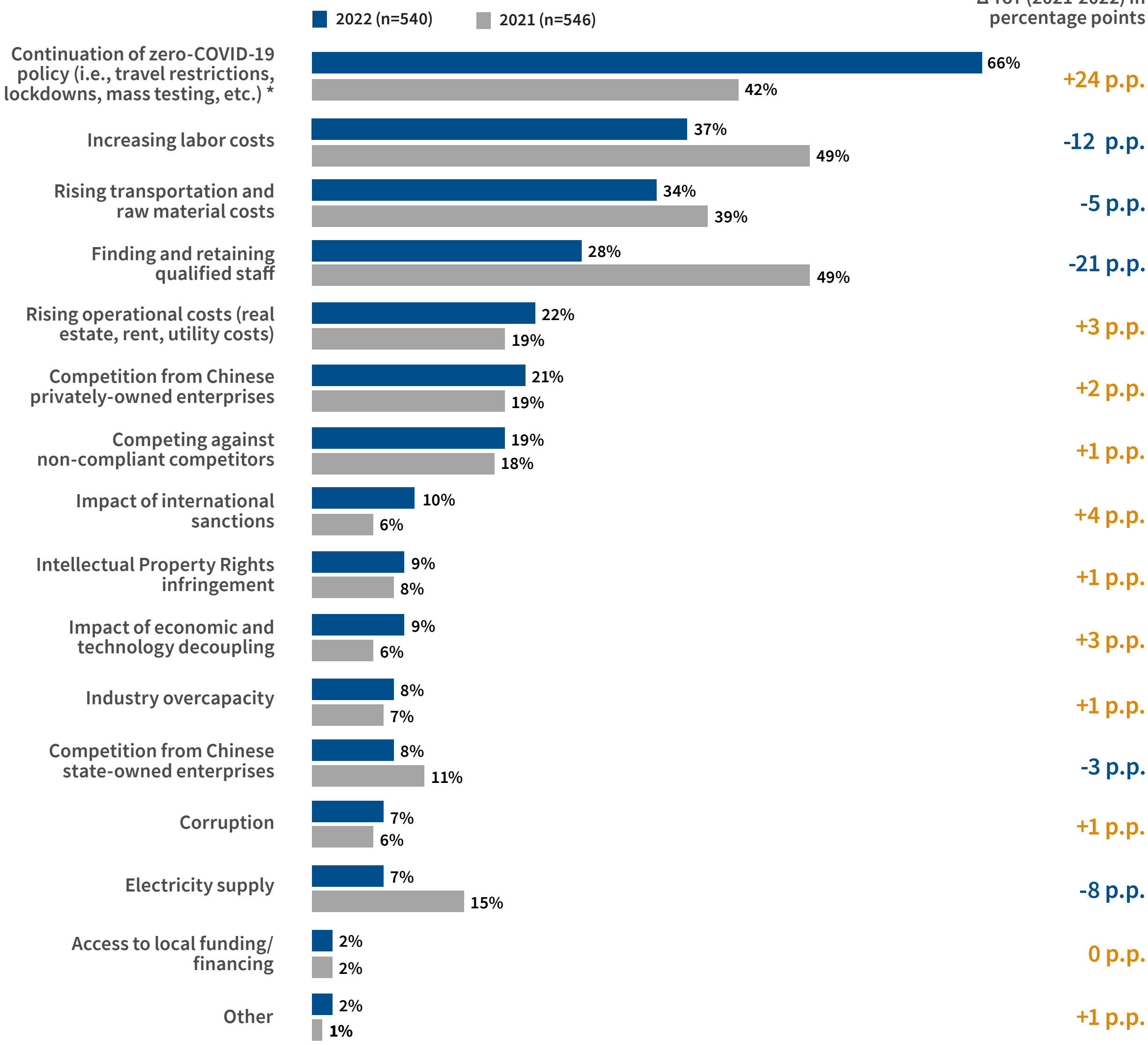
The zero-COVID-19 policy with recurring lockdowns and strict measures to combat the pandemic have caused a lot of uncertainties among German companies. Strict travel restrictions, mass testing and the overall lack of plannability caused by the zero-COVID-19 policy have been serious challenges for businesses and investments since the start of the pandemic. By entering into the third year of these strict measures – and with no end or adjustment in sight – these challenges further escalated throughout 2022.

The COVID-19 outbreak in China - peaking in the fourth quarter of 2022 - strongly disrupted the economy. As early as March 2022, the COVID-19 prevention measures led to around 50% percent of German companies reporting complete disruption or severe impact on logistics, warehousing, and supply chains (German Chamber Flash Survey: Current COVID-19 Outbreak and Ukraine War Heavily Impacting German Businesses in China, March 2022).

Back in 2021, travel restrictions were selected by 42% of German companies as one of their top 3 operational and macroeconomic business challenges. With the surge of lockdowns and restrictions in 2022, the continuation of the zero-COVID-19 policy is rated as the most significant operational and macroeconomic business challenge by 66% of respondents – an increase of 24 p.p. It replaced the traditional top HR challenges of increasing labor costs (37%) and finding and retaining qualified staff (28%). Rising transportation and raw material costs (34%) and rising operational costs like real estate, rent, and utility costs (22%) are also rated as significant challenges by survey respondents (Figure 2.8).

FIGURE 2.8: ZERO-COVID-19 POLICY: MAIN OPERATIONAL BUSINESS CHALLENGE

Please select your top 3 operational and macroeconomic business challenges. (n=540)

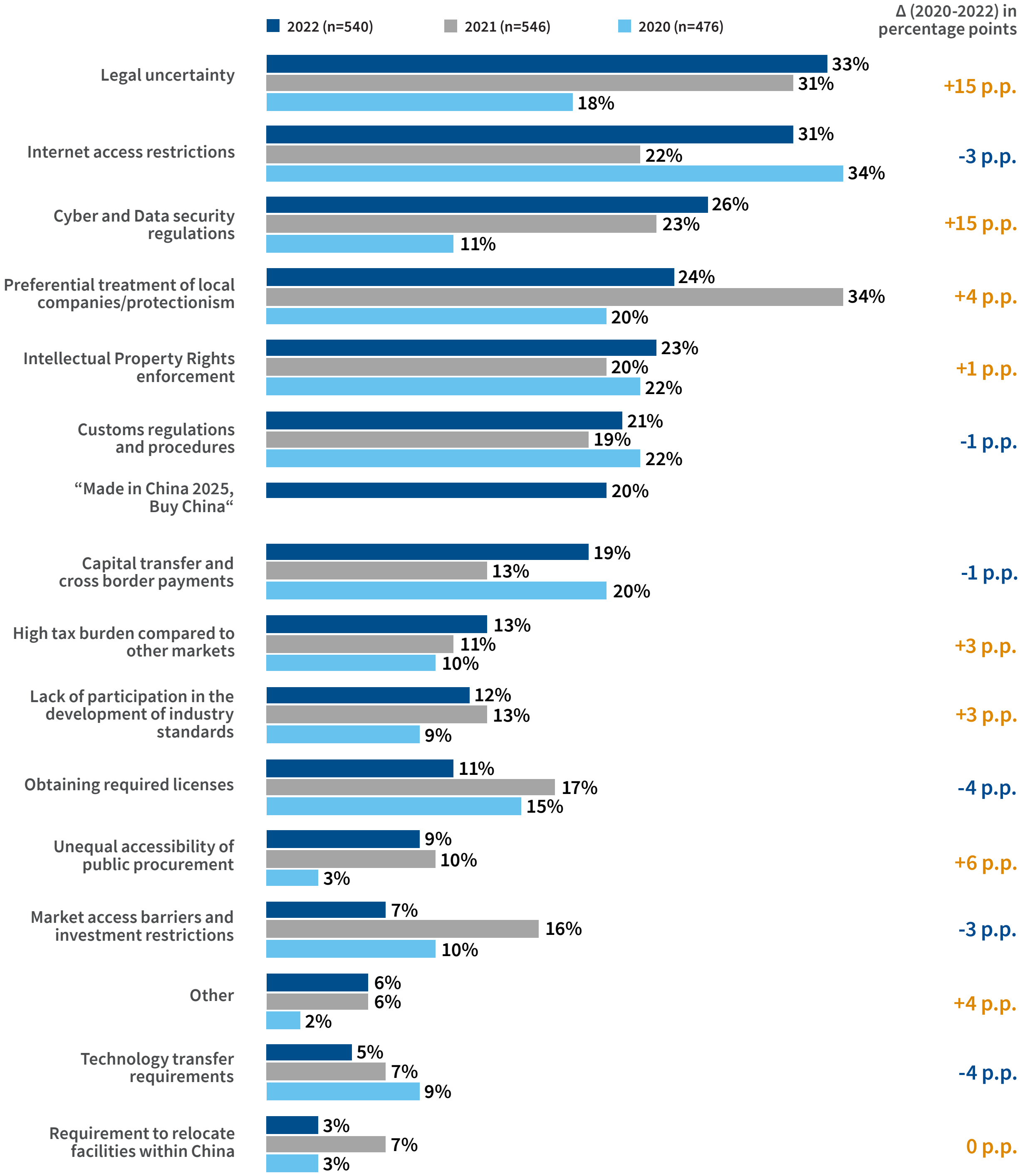


*Note: Up to 3 answers possible; percentages based on number of responses *In 2021 named "Current travel restrictions"*

Legal uncertainty (33%), internet access restrictions (31%), and cyber and data security regulations (26%) are rated as the primary regulatory business challenges. Comparing those challenges to 2020, respondents considering legal uncertainty and cybersecurity as a top 3 challenge have increased by 15 p.p. respectively (Figure 2.9). The increase in the perception of cyber and data security regulations as a challenge falls in the timeline of the implementation of the Chinese Data Protection Law (effective since September 2021) and the Personal Information Protection Law (effective since November 2021). Together with the Cyber Security Law of 2017, they create the three pillars of China's Cyber Security Framework. Since there is still uncertainty on how to comply with the law, this topic remains a major challenge for German Companies.

FIGURE 2.9: LEGAL UNCERTAINTY AND CYBERSECURITY INCREASINGLY CHALLENGING

Please select your top 3 regulatory business challenges. (n=540)

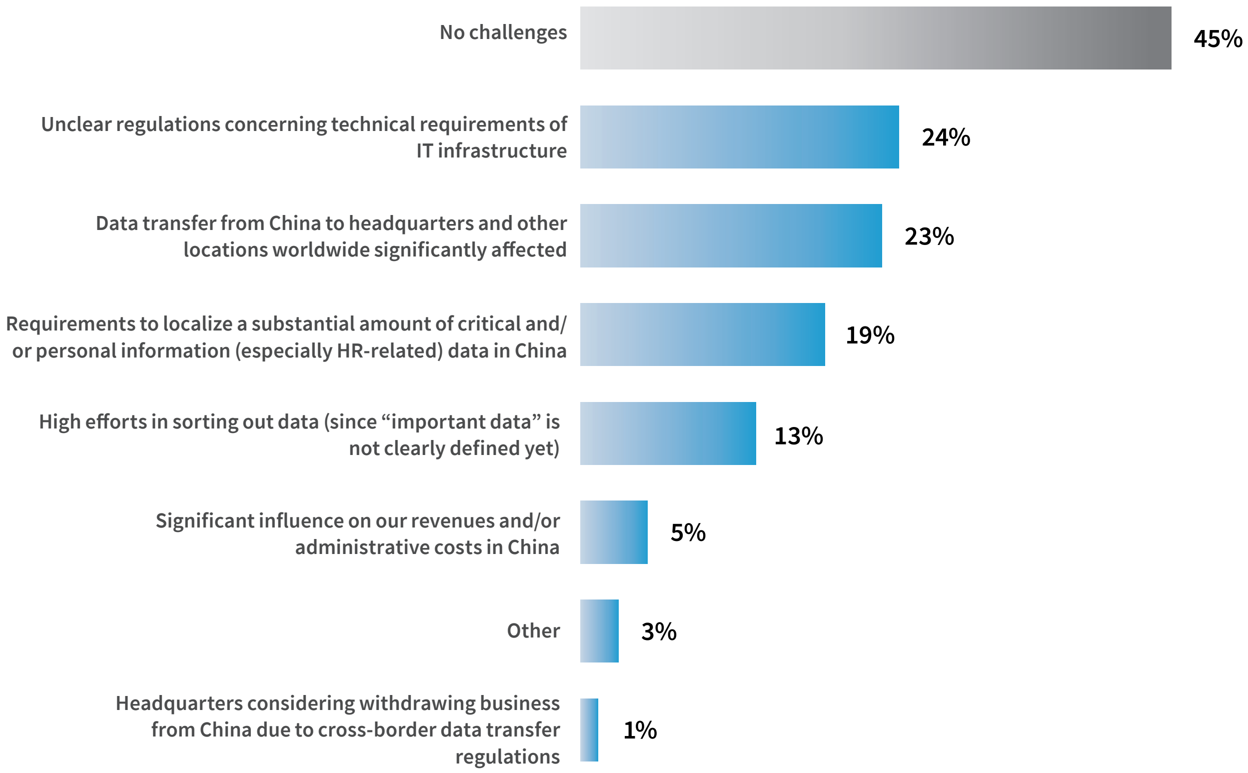


Note: Up to 3 answers possible; percentages based on number of responses

More than half of the surveyed companies consider the cross-border data transfer legislation challenging. German companies report challenges with unclear regulations concerning technical requirements of IT infrastructure (24%), claiming data transfer from China to headquarters and other locations worldwide is significantly affected (23%). Furthermore, 19% consider the requirement to localize a substantial amount of critical and/or personal information (especially HR-related data) in China a challenge (Figure 2.10).

FIGURE 2.10: MORE THAN HALF OF THE COMPANIES FIND CROSS-BORDER DATA TRANSFER LEGISLATIONS CHALLENGING

What are your main challenges regarding cross-border data transfer? (n=527)



Note: Multiple answers possible; percentages based on number of responses

Cyber and data security regulations are especially challenging for the business services (39%) and the chemical industries (33%) (Figure 2.11).

One-fifth (20%) of the respondents consider "Made in China 2025" and "Buy China" as one of the top regulatory business challenges (Figure 2.9). In the machinery and industrial equipment industry, 32% consider so. In the chemical (44%) and machinery and industrial equipment (34%) industries, intellectual property rights enforcement is named the top regulatory business challenge (Figure 2.11) – a significant deviation compared to the average of 23% among all respondents and industries. Preferential treatment of local companies and protectionism is considered by 24% of the respondents a severe regulatory business challenge (Figure 2.9) – even more so in the machinery and industrial equipment industry, where 34% stated protectionism is their main challenge (Figure 2.11).

FIGURE 2.11: TOP REGULATORY CHALLENGES DIFFER BY INDUSTRY

Please select your top 3 regulatory business challenges. (n=540)

Chemicals	Plastic/ Metal Products	Consumer Products/ Services	Electronics	Business Services	Automotive	Machinery/ Industrial Equipment
44% Intellectual property rights enforcement	45% Legal uncertainty	44% Capital transfer and cross-border payments	50% Legal uncertainty	48% Internet access restrictions	36% Legal uncertainty	34% Intellectual property rights enforcement
33% Obtaining required licenses	45% Customs regulations and procedures	39% Customs regulations and procedures	31% Internet access restrictions	39% Cyber and data security regulations	26% Customs regulations and procedures	34% Preferential treatment of local companies/ protectionism
33% Internet access restrictions	40% Internet access restrictions	35% Internet access restrictions	28% Cyber and data security regulations	37% Legal uncertainty	25% Capital transfer and cross-border payments	32% "Made in China 2025, Buy China"
33% Cyber and data security regulations	35% Capital transfer and cross-border payments				25% Cyber and data security regulations	29% Internet access restrictions

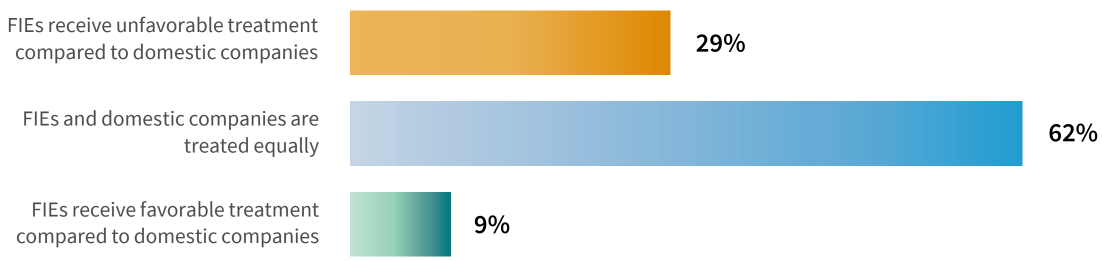
Note: Up to 3 answers possible; percentages based on number of responses

PREFERENTIAL TREATMENT OF DOMESTIC COMPANIES 2.3

29% of the surveyed German companies still state that foreign-invested enterprises (FIEs) receive unfavorable treatment compared to local companies (Figure 2.12). The favorable treatment for domestic companies is especially prevalent for 64% of German companies regarding easier and broader market access: 48% of the contributors report that Chinese competitors receive easier or preferential access to incentives and supporting measures, easier or preferential access to information (42%), political stakeholders (37%), public procurement (37%), and licenses (29%) (Figure 2.13).

FIGURE 2.12: PREFERENTIAL TREATMENT OF CHINESE COMPETITORS STILL AN ISSUE FOR NEARLY ONE-THIRD OF GERMAN COMPANIES

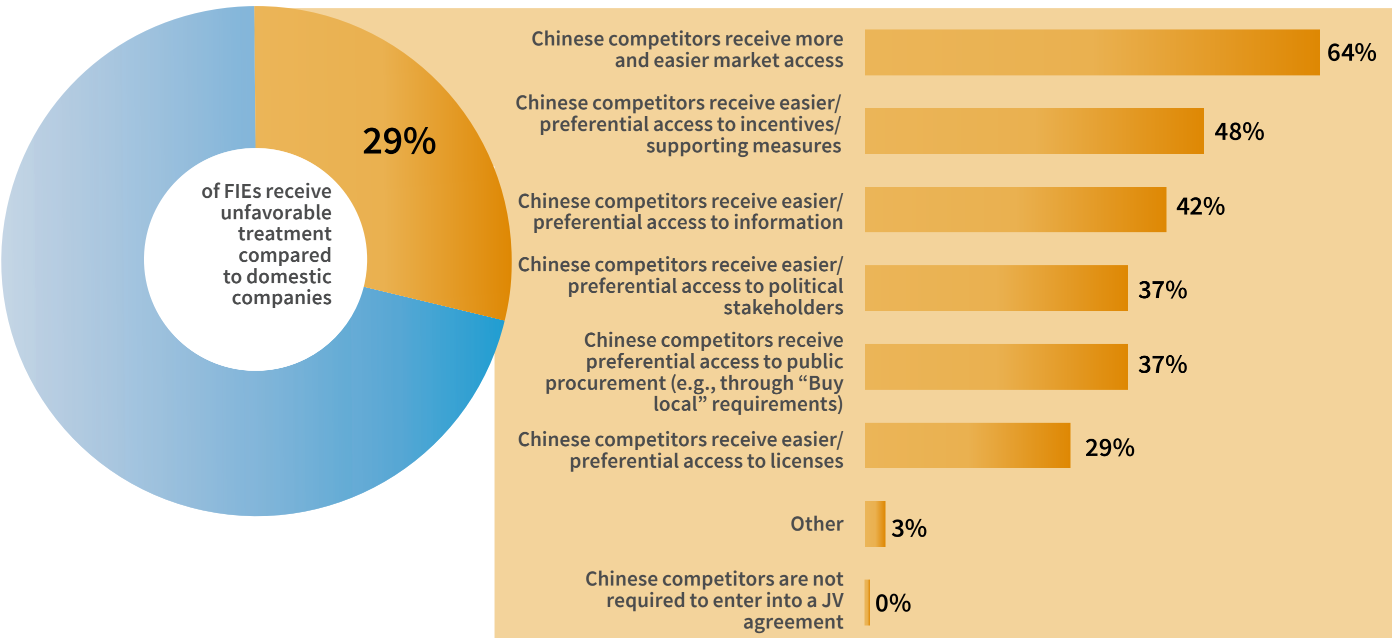
In your industry, how do Chinese authorities treat Foreign Invested Enterprises (FIEs) compared to domestic companies? (n=528)



Note: "I don't know" answers excluded

FIGURE 2.13: TWO-THIRDS OF GERMAN COMPANIES REPORT FAVORABLE TREATMENT OF DOMESTIC COMPANIES IN MARKET ACCESS

How are Chinese competitors treated differently? (n=379)

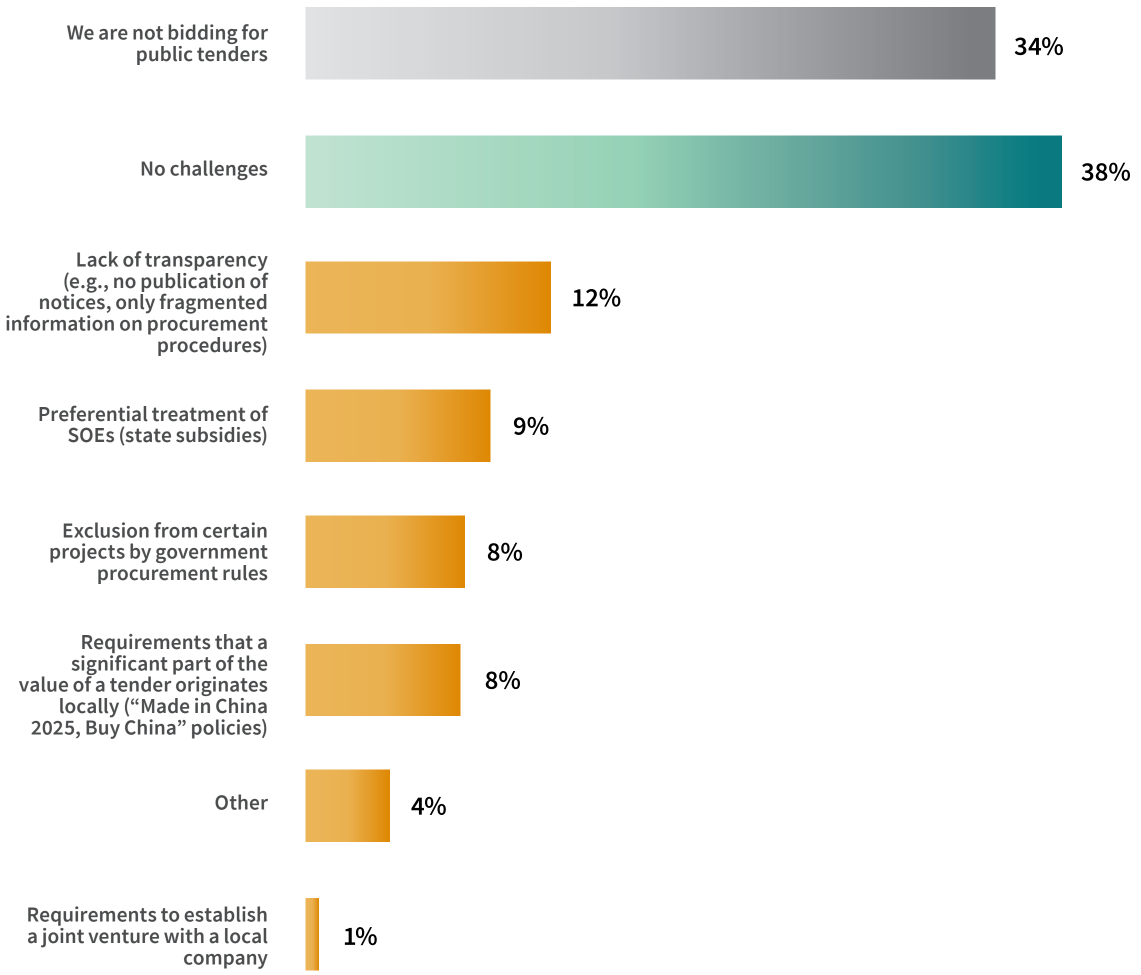


Note: Multiple answers possible; percentages based on number of responses; question only asked to companies who answered "FIEs receive unfavorable treatment compared to domestic companies" in Figure 2.12.

In public procurement, 12% of the respondents consider the lack of transparency challenging. 9% of the contributors report preferential treatment of state-owned enterprises, and 8% the exclusion from certain projects by government procurement rules. 34% of the survey participants do not bid for public tenders, and 38% do not face any challenges in public procurement (Figure 2.14).

FIGURE 2.14: LACK OF TRANSPARENCY IS THE MAIN CHALLENGE FOR PARTICIPATING IN PUBLIC PROCUREMENT

In your industry, what kind of barriers or discriminatory measures to public procurement have you experienced over the past year? (n=530)



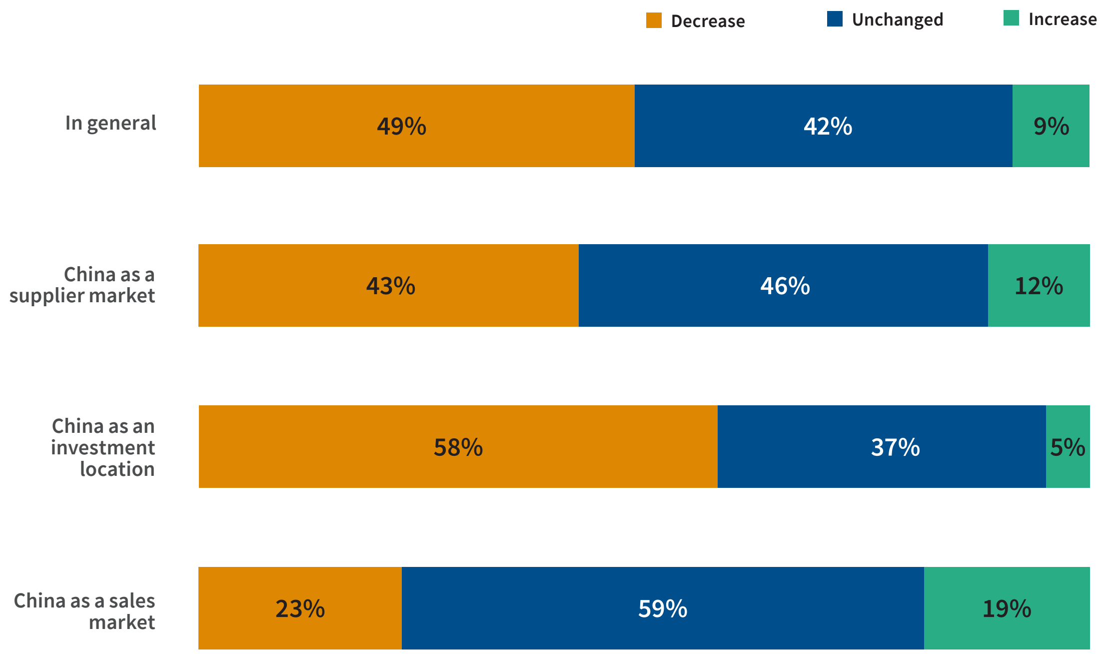
Note: Multiple answers possible; percentages based on number of responses

2.4 DECREASING BUSINESS OPPORTUNITIES AND ATTRACTIVENESS OF THE CHINESE MARKET

Geopolitical tensions - especially the Russian war of aggression against Ukraine - and the severe COVID-19 lockdowns left their mark on China's attractiveness as a market. 49% of the respondents rated China's attractiveness in general as decreasing compared to other markets. For 43%, China lost attractiveness as a supplier market, and for 58%, China decreased in attractiveness compared to other markets as an investment location (Figure 2.4). Even as a sales market, China decreased in attractiveness for almost one-fourth (23%) of respondents (Figure 2.15).

FIGURE 2.15: CHINA'S ATTRACTIVENESS DECREASED SIGNIFICANTLY IN 2022

Did China's attractiveness in the following areas change compared to other markets? (n=523)



Note: "I don't know" answers excluded

This decreasing trend is also apparent when looking at business opportunities: historically, the most significant business opportunity was the growth in domestic consumption. This year, only 30% of the respondents rated growth in local consumption as a significant business opportunity.

Compared to last year, it experienced a drop of 21 p.p., and a decrease of 38 p.p. compared to 2019, prior to the COVID-19 outbreak. (Figure 2.16).

Growth of domestic consumption is no exception: across business opportunities, dramatic drops ranging from 30 to 45 p.p. in significance are observed when compared to 2019. Sourcing is only perceived by 25% of the respondents as a business opportunity, which is also very consistent with the perceived low attractiveness of China as a supplier market. The internationalization of Chinese companies, the increasing demand for foreign brands and quality, and the participation in domestic innovation are reported by 20% each as a business opportunity (Figure 2.16).

FIGURE 2.16: BUSINESS OPPORTUNITIES DESCEND DRAMATICALLY

Please rate the following opportunities for your company's China business. (n=568)

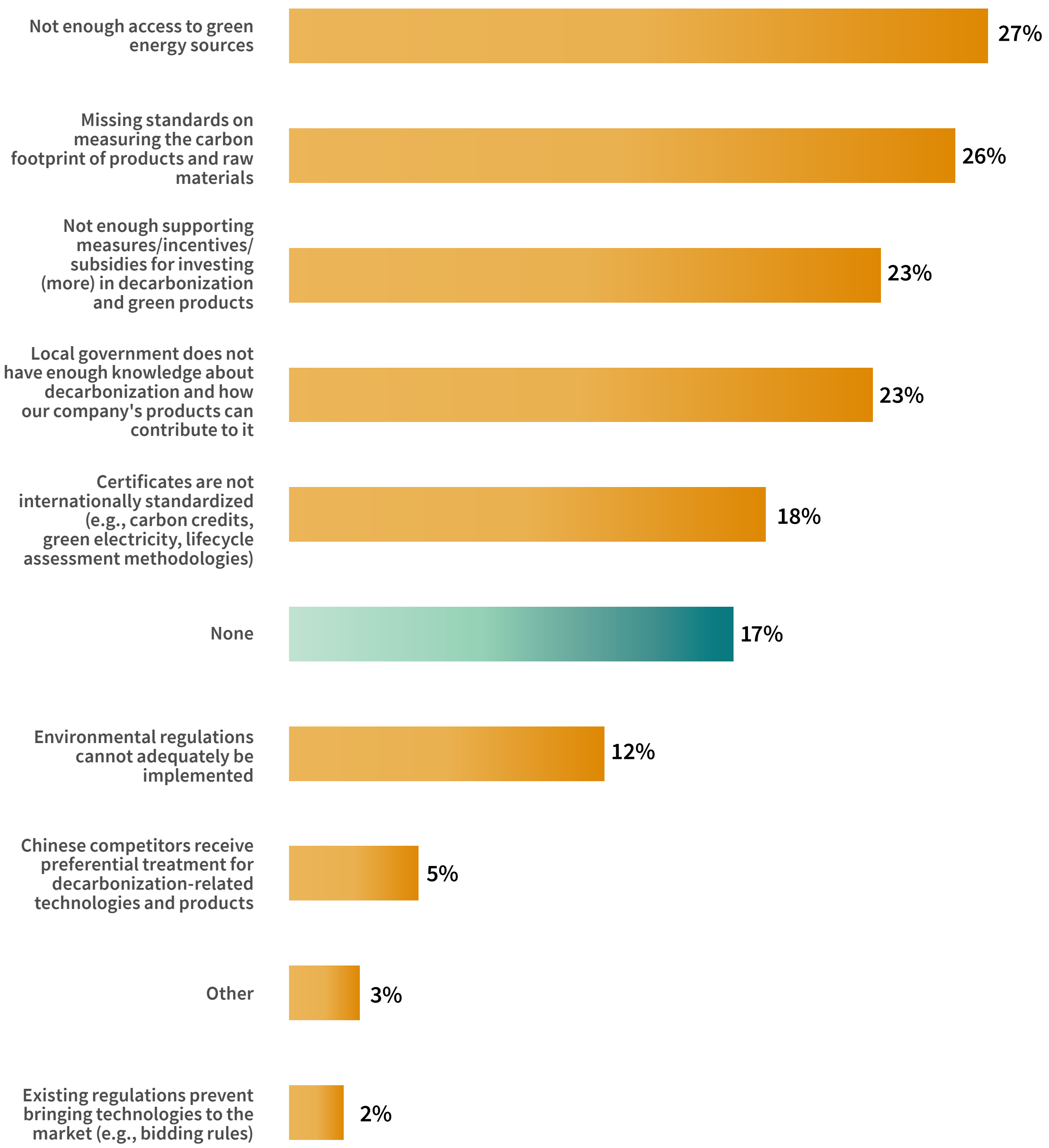
	2019	2020	2021	2022	Δ (2019-2022) in percentage points
Growth in domestic consumption	68%	73%	51%	30%	-38% p.p.
Sourcing/procurement	59%	45%	39%	25%	-34% p.p.
Participation in digital technologies	51%	51%	37%	21%	-30% p.p.
Participation in domestic innovation	61%	58%	42%	20%	-41% p.p.
Increasing demand for foreign brands and quality	65%	49%	39%	20%	-45% p.p.
Internationalization of Chinese companies	54%	45%	37%	20%	-34% p.p.
Production of goods and services to be exported	50%	39%	28%	19%	-31% p.p.
Growth due to decarbonization-related opportunities			29%	17%	

Note: Only percentages of respondents displayed that rated opportunities as "significant"

Growth due to decarbonization-related opportunities is named by 17% of the respondents as a significant business opportunity – a decrease of 12 p.p. compared to 2021 (Figure 2.16). This decrease could be related to the perceived challenges in the implementation of the "30-60 Decarbonization Goals." 27% of German companies in China report not having enough access to green energy resources, 26% are challenged by missing standards for measuring the carbon footprint of products and raw materials. 23% name not having enough support measures, incentives, and subsidies for investing in decarbonization and green products as challenging; 23% claim that local governments do not have enough knowledge on decarbonization and its implementation. Around 17% report no challenges with the implementation of the decarbonization goals (Figure 2.17).

FIGURE 2.17: IMPLEMENTING DECARBONIZATION GOALS STILL CHALLENGING

Which challenges does your company face when implementing the "30-60" Decarbonization Goals (which hinder your company from reaching its full potential)? (n=477)



Note: Multiple answers possible; percentages based on number of responses

LOCALIZATION & DIVERSIFICATION - GERMAN COMPANIES' ADAPTATION STRATEGIES

Localization tendencies among German companies in China have already been observed for about a decade. The first wave of localization was fueled by regulatory restrictions from the Chinese government, such as direct or indirect joint-venture requirements. The second wave was more market-driven: Companies decided to further localize mainly because of changing customer markets and the speed and dynamics of innovation.

The current third wave that started with the trade war between China and the United States and escalated and which is being reenforced by the zero-COVID-19 policy as well as rising geopolitical tensions now leads to twofold adaptation strategies. Sudden lockdowns and travel restrictions disrupt communication channels with headquarters and create considerable supply chain bottlenecks; Geopolitical tensions make companies become targets of sanction regimes and politically-driven decoupling agendas. To create resilience, companies need to adjust to these realities by either localizing inside China, diversifying to other parts of Asia, or doing both.

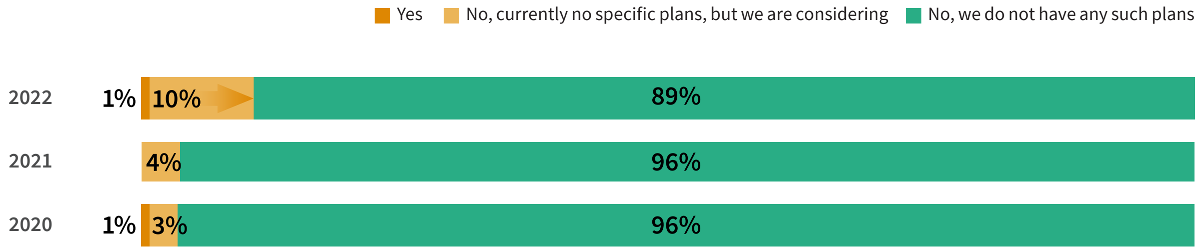
This means that German companies not only increasingly localize supply chains, production, and R&D capacities, but are also looking to build up parallel supply chain structures throughout Asia-Pacific. German companies in China are in close contact with their headquarters to find appropriate adaptation strategies for navigating geopolitical tensions, the zero-COVID-19 policy, and decoupling tendencies – inside and outside China.

- **Despite headwinds: A large majority of German companies remain active in China**
- **German companies react to geopolitical tensions and the zero-COVID-19 policy with a two-tracked adaptation strategy: localization in China and diversification outside of China**
- **Larger companies tend to diversify more outside of China than smaller companies**
- **87% of the respondents are affected by rising economic and technological decoupling tendencies**

Despite the severe challenges, the majority of responding companies remain active in China: 89% of German companies have no plans of leaving China within the next two years, and only 1% of the respondents will completely leave the country. However, while 10% of German companies have no specific plans to completely leave the country within the next two years, they nevertheless state that they are considering doing so. Compared to 2021, companies considering exiting China increased by 6 p.p. (Figure 3.1). It should be noted that in 2021 the survey asked companies about plans to leave China within one year, not two years.

FIGURE 3.1: DESPITE HEADWINDS: LARGE MAJORITY STILL STAYS IN CHINA

Is your company planning to completely leave China within the next two years?
(2022: n=573; 2021: n=538; 2020: n=458)



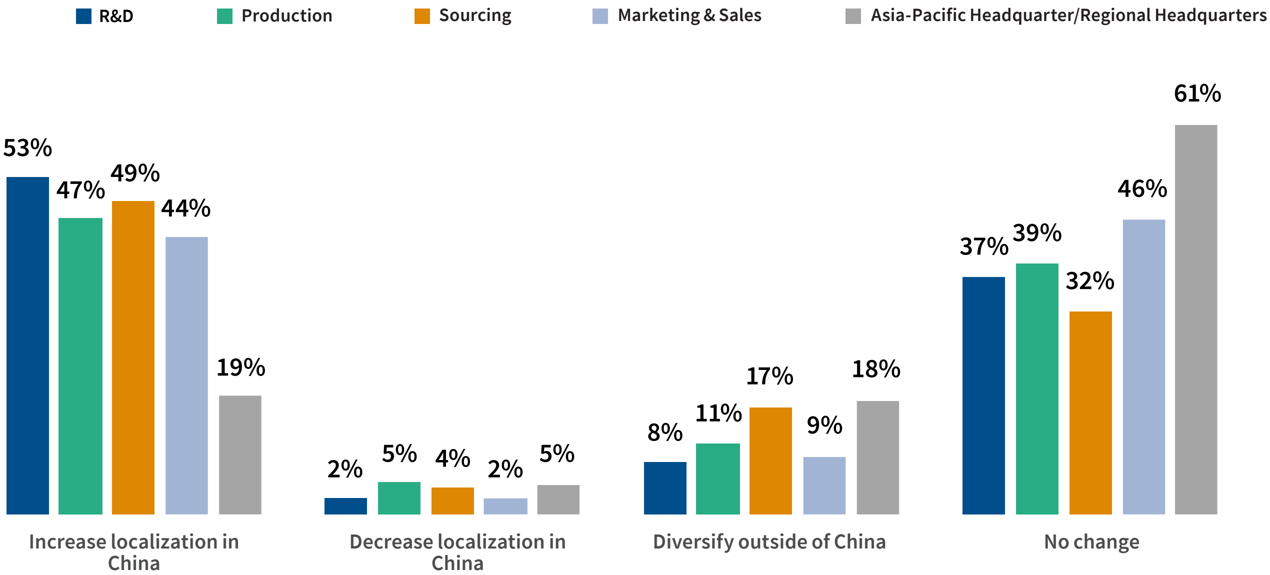
Note: In 2021 and 2020 question was formulated as followed "Is your company planning to completely leave China within the next 12 months?"

When restructuring their business functions, German companies in China rather localize in China than diversify outside of China. 53% of German companies plan to increase the localization of R&D functions in China over the next two years. 47% of respondents plan to increase localization of production, 49% will localize sourcing, and 44% marketing and sales. One-fifth (19%) of the respondents will localize their Asia-Pacific headquarters or regional headquarters in China, which is a high amount. However, a similar percentage of respondents (18%) are diversifying their regional headquarters outside of China. This shows that German companies are reacting to the zero-COVID-19 policy by steering their China business from other locations (Figure 3.2).

For other business functions, neither diversification outside of China nor decreasing localization in China are prominent strategies for German companies. 8% of German companies plan to diversify R&D functions outside of China in the next two years, and 2% plan to decrease localization in China in R&D. In production 11% and in sourcing 17% of the respondents are diversifying outside China, but only around 5% are decreasing localization in China (Figure 3.2).

FIGURE 3.2: BUSINESS FUNCTIONS BEING LOCALIZED RATHER THAN DIVERSIFIED

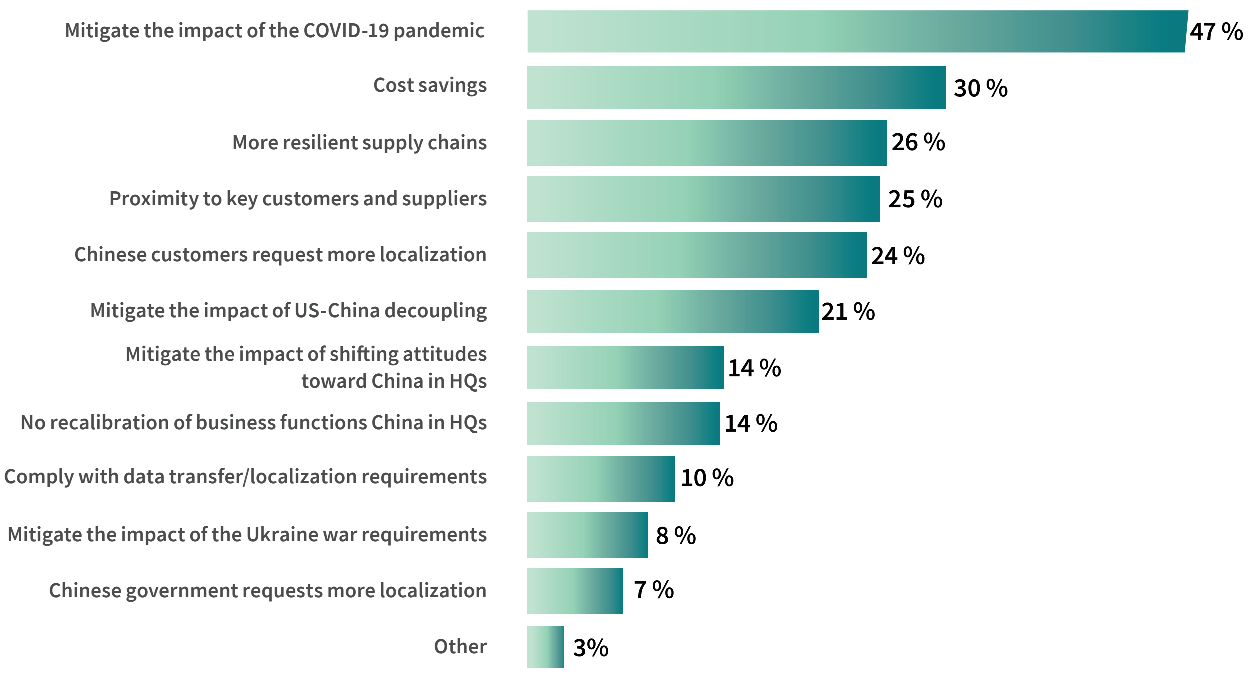
How does your company plan to restructure the following business functions in the next two years? (n=494)



For 47% of respondents, the recalibration of business functions is mainly driven by the need to mitigate the impact of the zero-COVID-19 policy. Other leading drivers include risk management and economic considerations, such as cost savings (30%), supply chain resilience (26%), and proximity to key customers and suppliers (25%) (Figure 3.3).

FIGURE 3.3: RECALIBRATION MAINLY DRIVEN BY COVID-19

What is your motivation behind recalibrating your business functions? (n=554)



Note: Up to 3 answers possible; percentages based on number of responses

Confronted with the major challenges posed by the continuation of the zero-COVID-19 policy, headquarters of German companies in China are adapting their China strategies. Faced with the possibility of a long-term zero-COVID-19 policy, German companies are either further localizing inside or diversifying outside of China. Both adaption strategies to the zero-COVID-19 policy are being implemented to similar degrees: While 29% of German companies localize supply chains and 28% localize production inside China, 29% are diversifying supply chains away from China, and 25% create back-ups for supply chains outside of China (Figure 3.4). Adaptation strategies to respond to the ongoing geopolitical tensions (e.g., sanctions, Ukraine war) are similarly divided: 29% of German companies are accelerating the localization of business functions, while one-third (33%) are diversifying their supply chain away from China (Figure 3.5).

FIGURE 3.4: LOCALIZATION AND DIVERSIFICATION AS RESPONSE TO ZERO-COVID-19

How is your headquarters adapting its China strategy for a possible long-term zero-COVID-19 policy in China? (n=551)

LOCALIZATION	
Localization of supply chains inside China	29%
Localization of production inside China	28%
Diversification of supply chains inside China (different locations)	13%
Diversification of production inside China (different locations)	7%
DIVERSIFICATION	
Diversification of supply chains away from China	29%
Back-ups for supply chains outside of China	25%
Diversification of investment away from China	19%
Shifting business functions to other parts of Asia	15%
Development of "worst case" scenarios including a (partial) withdrawal from China	14%
No impact on strategy	23%
Planned business/investment in China has been put on hold	17%
Other	3%

Note: Multiple answers possible; percentages based on number of responses

FIGURE 3.5: LOCALIZATION AND DIVERSIFICATION AS RESPONSE TO GEOPOLITICAL TENSIONS

How is your headquarters adapting its China strategy due to the ongoing geopolitical tensions (e.g., sanctions, Ukraine war, etc.)? (n=551)

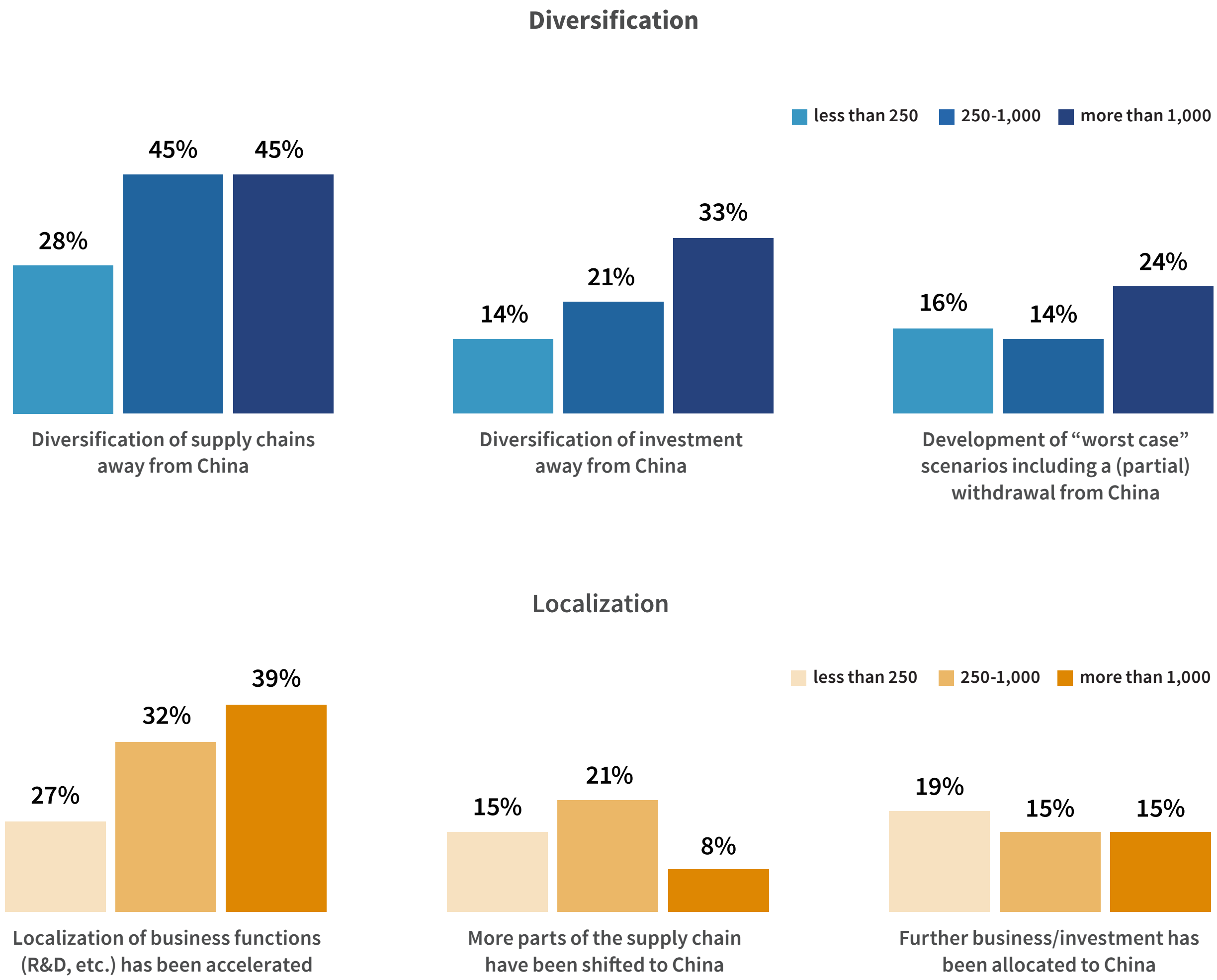
LOCALIZATION	
Localization of business functions (R&D, etc.) has been accelerated	29%
Further business/investment has been allocated to China	18%
More parts of the supply chain have been shifted to China	15%
DIVERSIFICATION	
Diversification of supply chains away from China	33%
Diversification of investment away from China	18%
Development of "worst case" scenarios including a (partial) withdrawal from China	17%
Current business has been moved away from China	5%
No impact on strategy	30%
Planned business/investment in China has been put on hold	20%
Other	5%

Note: Multiple answers possible; percentages based on number of responses

Larger companies tend to diversify more in order to adapt to the geopolitical tensions and the possibility of a long-term zero-COVID-19 policy. 45% of large companies (with more than 1,000 employees) diversify their supply chains, and 33% diversify their investments away from China in response to the ongoing geopolitical tensions. These strategies are less common in small companies (with less than 250 employees): 28% of small companies diversify their supply chains, and 14% diversify their investments away from China (Figure 3.6).

FIGURE 3.6: AMID GEOPOLITICAL TENSIONS – LARGER COMPANIES DIVERSIFY MORE

How is your headquarters adapting its China strategy due to the ongoing geopolitical tensions (e.g., sanctions, Ukraine war, etc.)? (n=551)

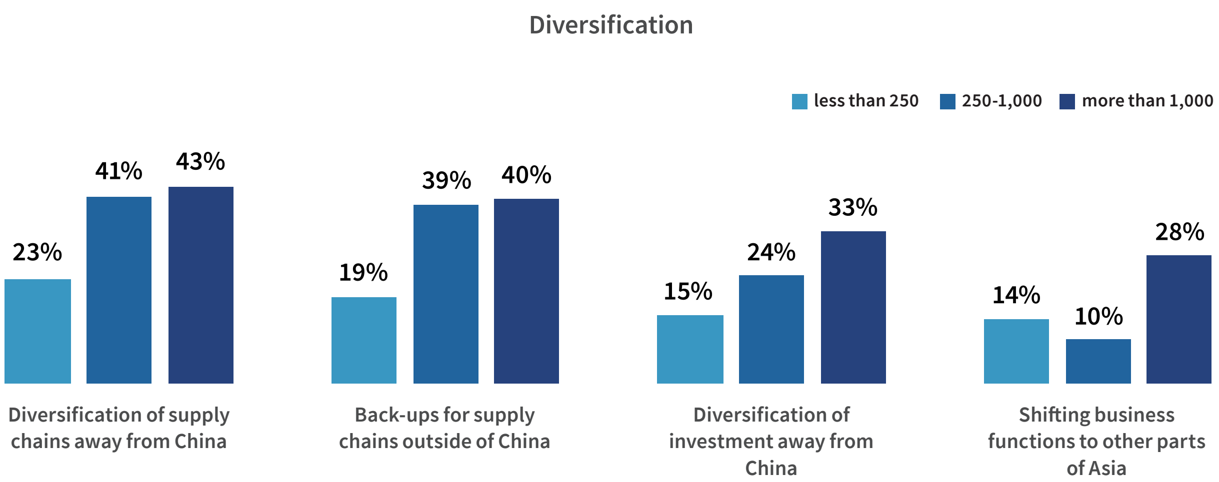


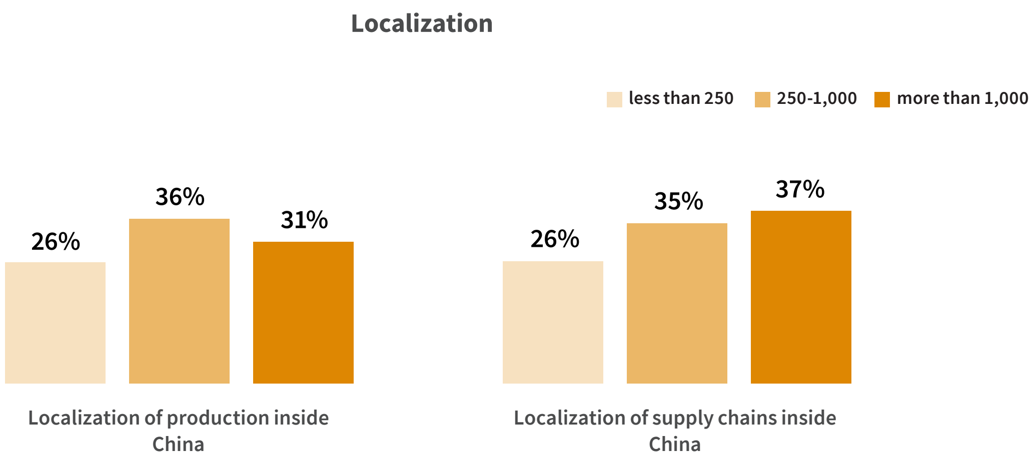
Note: Multiple answers possible; percentages based on number of responses
Company size measured in number of employees

Regarding diversification outside of China, larger companies tend to choose this adaptation strategy to cope with the zero-COVID-19 policy more frequently than smaller companies. 43% of large companies and 41% of medium-sized companies (250 – 1,000 employees) diversify their supply chains away from China as a response to the zero-COVID-19 policy; yet only 23% of small companies choose to do so. Similarly, 40% of large and 39% of medium-sized companies implement back-ups for supply chains outside China – versus only 19% of small companies. Diversification of investments away from China is a strategy to respond to COVID-19 for one-third (33%) of large, 24% of medium, and 15% of small-sized companies (Figure 3.7). This points to the fact that building up parallel structures and diversifying outside of China poses a bigger obstacle for smaller companies.

FIGURE 3.7: AMID ZERO-COVID-19 POLICY – LARGER COMPANIES DIVERSIFY MORE

How is your headquarters adapting its China strategy for a possible long-term zero-COVID-19 policy in China? (n=551)





Note: Multiple answers possible; percentages based on number of responses
Company size measured in number of employees

As a response to rising economic and technological decoupling tendencies, German companies localize in China or build up parallel structures to cater to the Chinese and other markets and their respective requirements and standards. 87% of the respondents claim to be affected by decoupling tendencies. Common localization strategies to respond to these tendencies include hiring local staff to have experts on the ground (34%), increasingly doing R&D in China (30%), requesting more independence for local operations from the headquarters (22%), and building up resilience in supply chains in China by nearshoring suppliers (16%). Strategies focused on building up parallel structures in response to the decoupling tendencies are the building up of independent supply chains serving different markets (27%), setting up parallel business models for China and other markets (22%), building up compliance capacities to suit different regulatory requirements (20%), and increasingly catering to different standards (14%) (Figure 3.8).

FIGURE 3.8: LOCALIZATION AND PARALLEL STRUCTURES AS A RESPONSE TO DECOUPLING

How is your headquarters preparing for rising economic and technological decoupling tendencies? (n=548)

LOCALIZATION

Hiring local staff to have local expertise on the ground	34%
Increasingly doing R&D locally in China	30%
Requesting more independence for local operations from HQ	22%
Building up resilience in supply chains in China by nearshoring suppliers	16%

PARALLEL STRUCTURES

Building up independent supply chains serving different markets	27%
Setting up parallel business models – one for China and one for the rest of the world	22%
Building up compliance capacities to suit different regulatory requirements	20%
Increasingly catering to different standards	14%

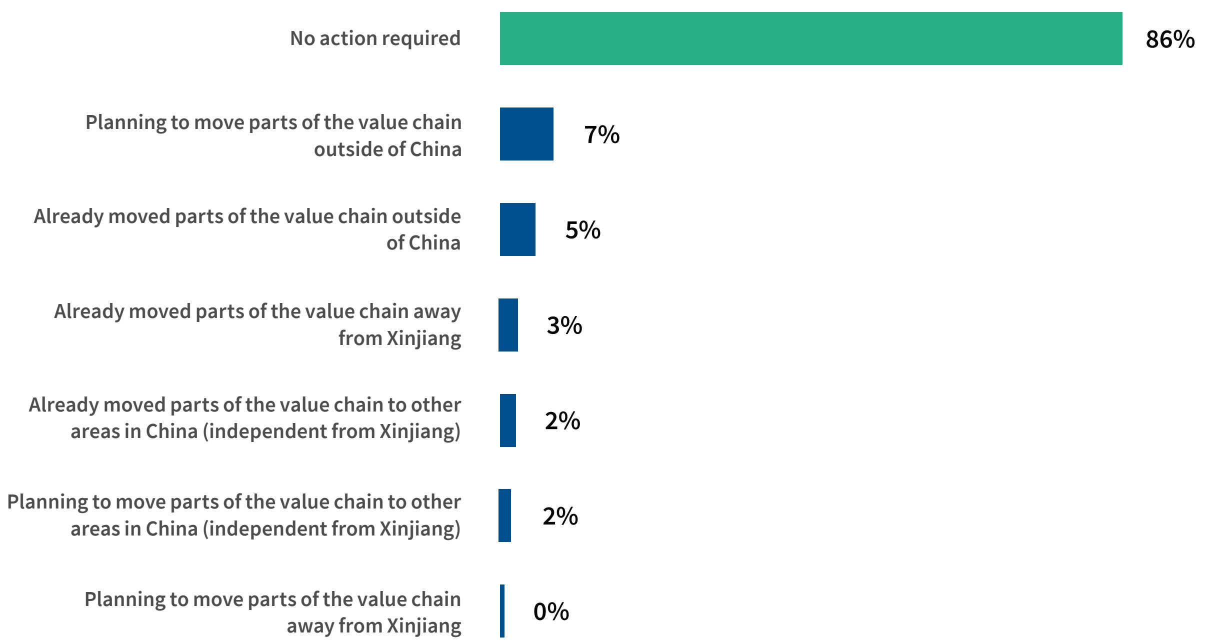
No preparation is needed at the moment	21%
Not affected by decoupling tendencies	13%
Other	2%

Note: Multiple answers possible; percentages based on number of responses

German companies in China are very committed to the principle of sustainable supply chains, and take their corporate social responsibility very seriously. At the same time, additional bureaucratic hurdles and legal uncertainty caused by the different supply chain due diligence legislations pose further challenges to companies. However, a majority of respondents (86%) are not moving parts of the value chain to other parts of China or out of China due to legislations targeting supply chain due diligence, such as the German Supply Chain Act, EU Supply Chain Directive, and Uyghur Forced Labor Prevention Act. However, 7% of the surveyed companies plan to move parts of their value chain outside of China due to the legislation, and 5% already did so. For this reason, 3% of German companies moved parts of their value chain away from Xinjiang (Figure 3.9).

FIGURE 3.9: ONLY A FEW COMPANIES REARRANGE SUPPLY CHAINS DUE TO DUE DILIGENCE LEGISLATIONS

Have you moved, or are you considering moving parts of your value chain to other parts of China or out of China due to legislation targeting supply chain due diligence (such as the German Supply Chain Act, EU Supply Chain Directive, Uyghur Forced Labor Prevention Act)? (n=287)

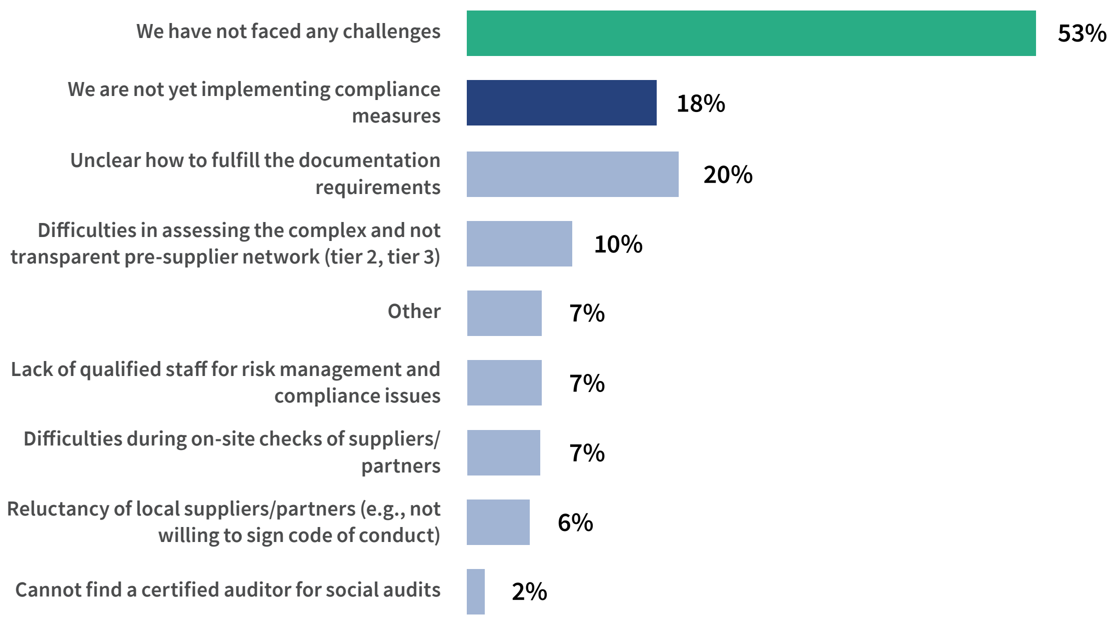


Note: Multiple answers possible; percentages based on number of responses, "Not applicable" answers excluded

The German Supply Chain Due Diligence Act — which was adopted by the German Parliament on June 11, 2021, and will take effect in 2023 — places legal obligations on companies in Germany to ensure that social and environmental standards are met along their supply chains. Many uncertainties remain regarding the imminent implementation of the law: One-third of German companies in China face challenges in fulfilling the requirements of the supply chain law. 20% of the respondents claim it is unclear how to fulfill the documentation requirements, and 10% of German companies face difficulties in assessing the complex and nontransparent pre-supplier network (tier 2 and tier 3 suppliers).

FIGURE 3.10: ONE-THIRD OF GERMAN COMPANIES FACE SUPPLY CHAIN CHALLENGES

What challenges does your company face in fulfilling the requirements of the upcoming German Supply Chain Law in China? (n=546)



Note: Multiple answers possible; percentages based on number of responses

WHAT WE ADVOCATE FOR

German companies are committed to the principle of sustainable supply chains and take their social and environmental responsibility very seriously. The German Supply Chain Due Diligence Law requires German companies worldwide to adhere to social and environmental standards. We appreciate that these requirements are also reflected in China's own legislation, as well as social and environmental commitments such as China's Human Rights Action Plan, ILO Conventions, and industry-specific supply chain due diligence initiatives. We advocate for more awareness and support from all levels of the government to create an ecosystem in which German companies can cooperate with their local counterparts to reach social and environmental standards and help achieve China's decarbonization goals.

4

ABOUT THE SURVEY

This report was made available thanks to the contribution of 593 member companies of the German Chamber of Commerce in China to an online survey conducted from August 23, 2022 to September 21, 2022. The response rate reflects 28% of all member companies. Since 2007, this report has been a key instrument for measuring the business sentiment of German companies operating in China.

PROFILE OF CONTRIBUTORS

Most German companies in China are based in coastal regions, primarily concentrating in the economic cluster of the Yangtze River Delta in the east (Shanghai: 43%, Jiangsu: 22%, Zhejiang: 4%), followed by the Bohai Economic Rim in the north (Beijing: 17%, Tianjin: 8%, Liaoning: 7%) and the Pearl River Delta in the south (Guangdong: 14%) (Figure 4.1).

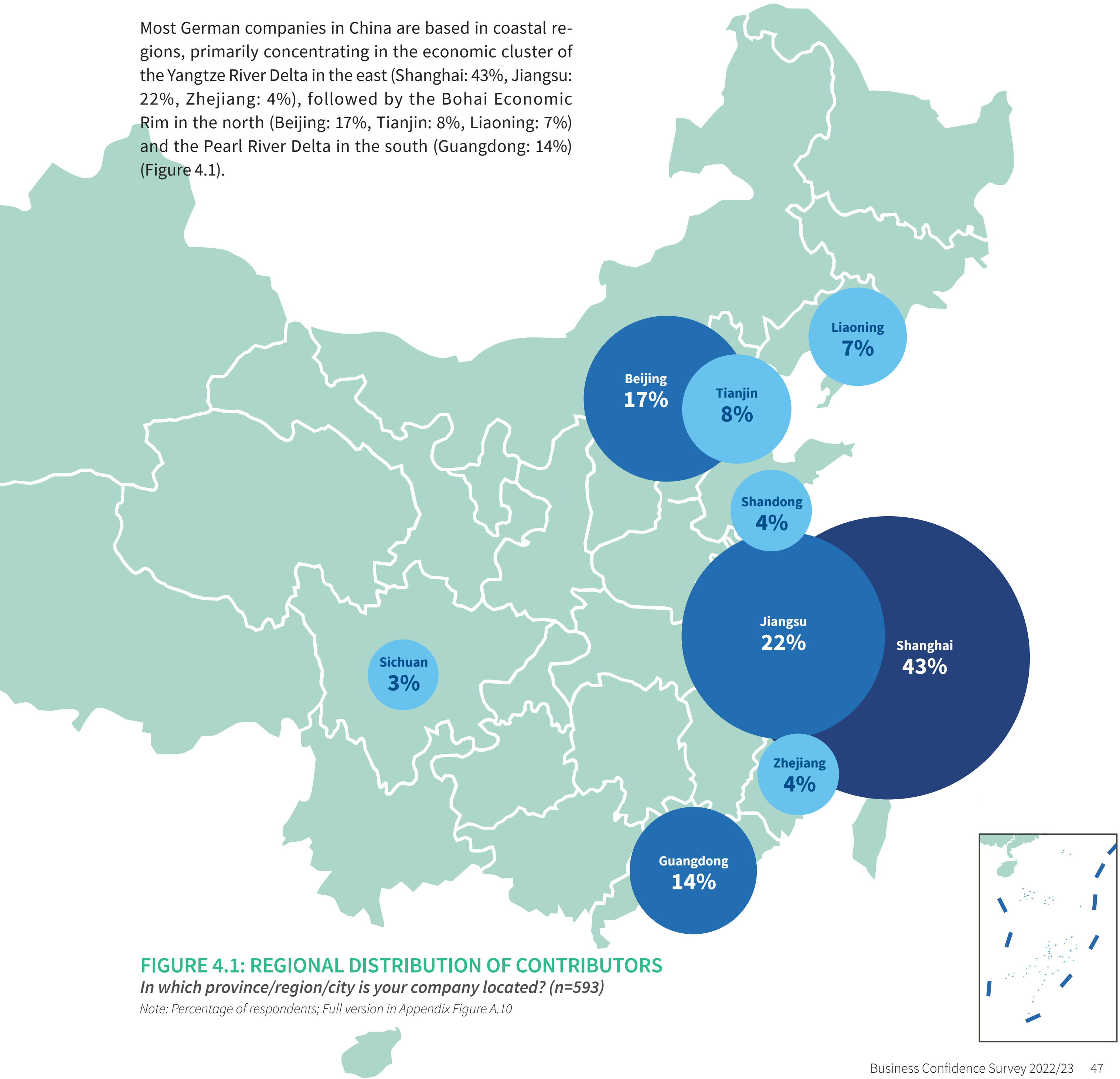


FIGURE 4.1: REGIONAL DISTRIBUTION OF CONTRIBUTORS

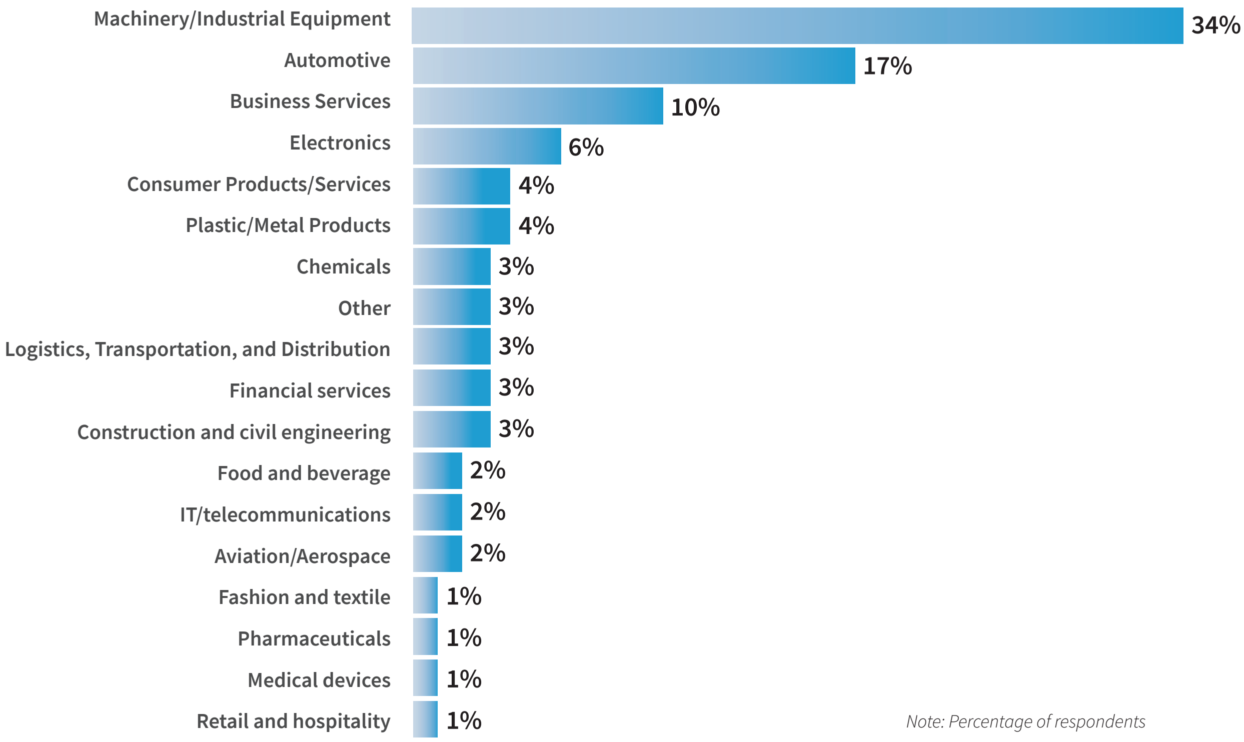
In which province/region/city is your company located? (n=593)

Note: Percentage of respondents; Full version in Appendix Figure A.10

German companies in China are notably represented in industries such as machinery and industrial equipment (34%) and automotive (17%), and business services (10%) – summing up to over 60% of all respondents. The remaining respondents consist of companies from a broad range of different industries, with electronics (6%), consumer products and services (4%), plastic and metal products (4%), and chemicals (3%) occupying another 17% (Figure 4.2). 66% of the surveyed companies maintain production in China (Figure 4.3).

FIGURE 4.2: DISTRIBUTION OF CONTRIBUTORS BY INDUSTRIES

Please specify the main industry of your company (n=589)



Note: Percentage of respondents

FIGURE 4.3: PRODUCING CONTRIBUTORS IN CHINA

Do you have production in China? (n=593)

66%

Production in China

34%

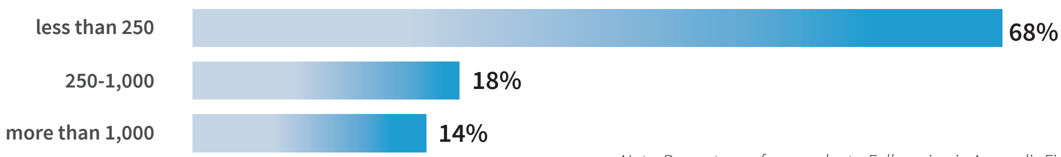
No Production in China

Note: Percentage of respondents

Small-size companies (less than 250 employees) represent 68% of all respondents; medium-sized companies account for 18%; large companies with more than 1,000 employees make up the remaining 14% of respondents (Figure 4.4).

FIGURE 4.4: DISTRIBUTION OF CONTRIBUTORS BY COMPANY SIZE

Please indicate the number of employees working at your company's local operation (n=593)

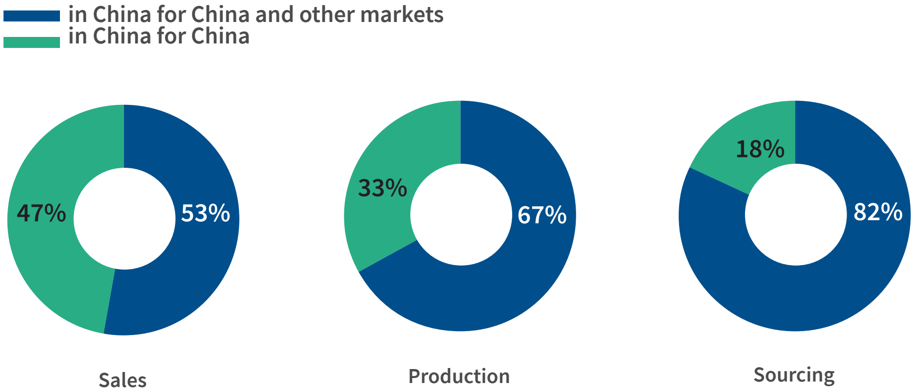


Note: Percentage of respondents; Full version in Appendix Figure A.1

The degree of localization of German companies is diverse: nearly half (47%) of the surveyed companies sell their products and services in China, while 53% of the contributors sell their products in China but also in other markets. In production, one-third (33%) of German companies produce in China for China exclusively, while two-thirds (67%) produce in China for China, as well as for other markets. 18% of German companies are sourcing in China exclusively for the Chinese market, whereas 82% of respondents are sourcing in China but are also targeting other markets. This indicates that German companies in China are deeply integrated with global supply chains (Figure 4.5).

FIGURE 4.5: CONTRIBUTORS‘ ACTIVITY IN CHINA FOR CHINA

To which degree is your company active in China, for China?

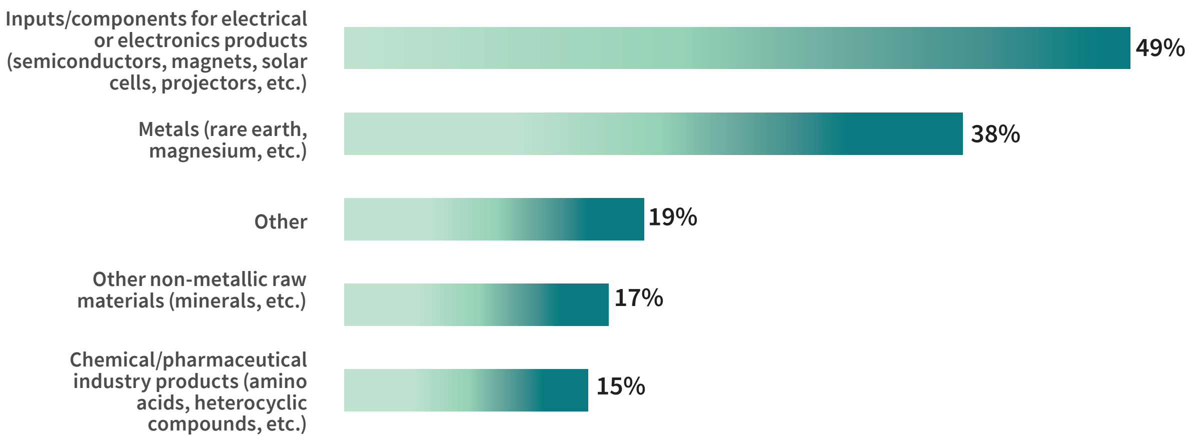


Note: Percentage of respondents; "Not applicable" answers excluded, Full version in Appendix Figure A.2

Considering critical products or resources sourced from China, half of the respondents (49%) are dependent on sourcing inputs or components for electrical or electronics products from China. 38% are dependent on sourcing metals, and another 17% are dependent on sourcing other non-metallic raw materials. 15% report dependencies when sourcing chemical and pharmaceutical products in China, while an additional 19% do so for various other products or resources (Figure 4.6).

FIGURE 4.6: CRITICAL PRODUCTS OR RESOURCES SOURCED FROM CHINA

Which critical products or resources is your company dependent on sourcing from China? (n=582)

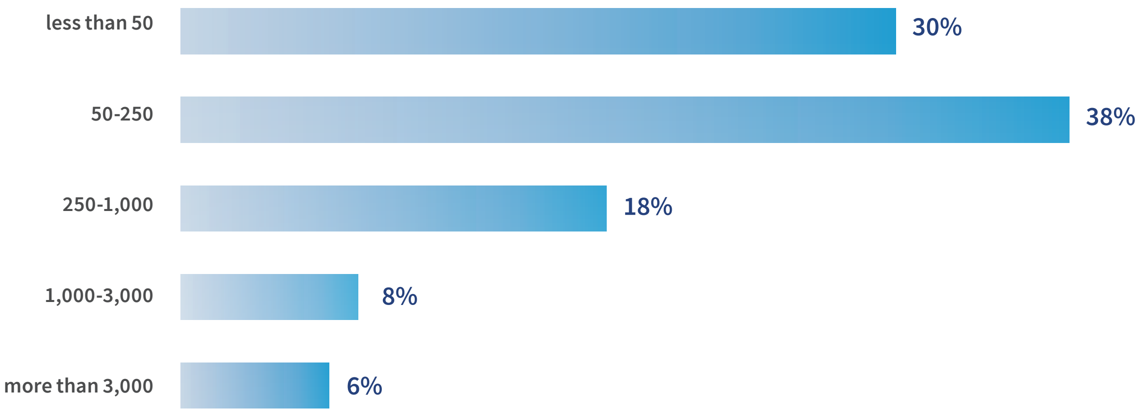


Note: Multiple answers possible; Percentages based on number of respondents; "Not applicable" answers excluded.

APPENDIX

FIGURE A.1: DISTRIBUTION OF CONTRIBUTORS BY COMPANY SIZE

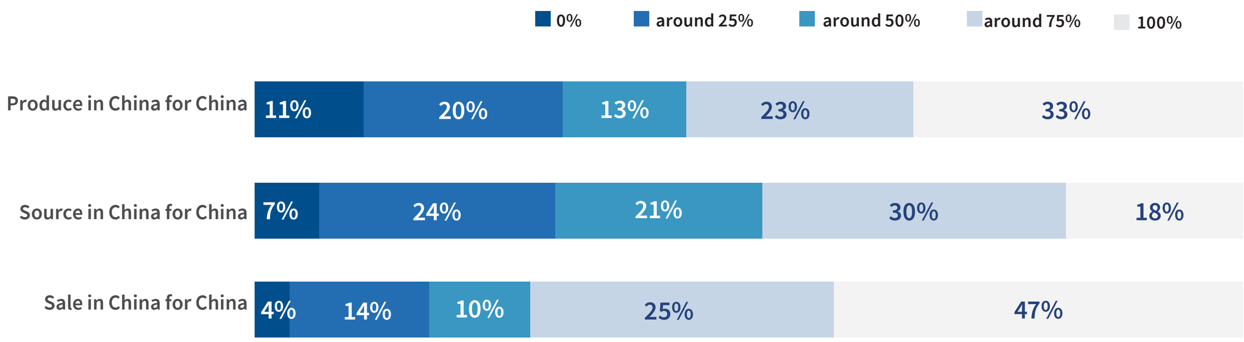
Please indicate the number of employees working at your company's local operation (n=593)



Note: Percentage of respondents; Full version of Figure 4.4

FIGURE A.2: CONTRIBUTORS' ACTIVITY IN CHINA FOR CHINA

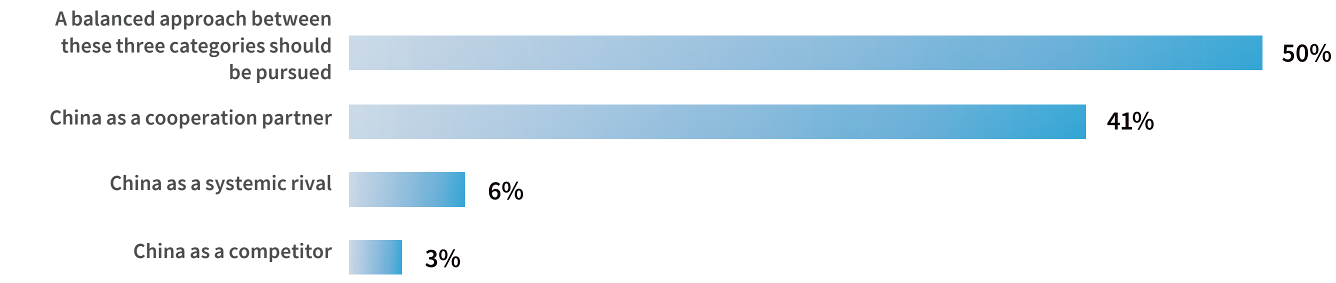
To which degree is your company active in China, for China ?



Note: Percentage of respondents; "Not applicable" answers excluded; Full version of Figure 4.5

FIGURE A.3: GERMAN COMPANIES PREFER A BALANCED APPROACH TOWARDS CHINA

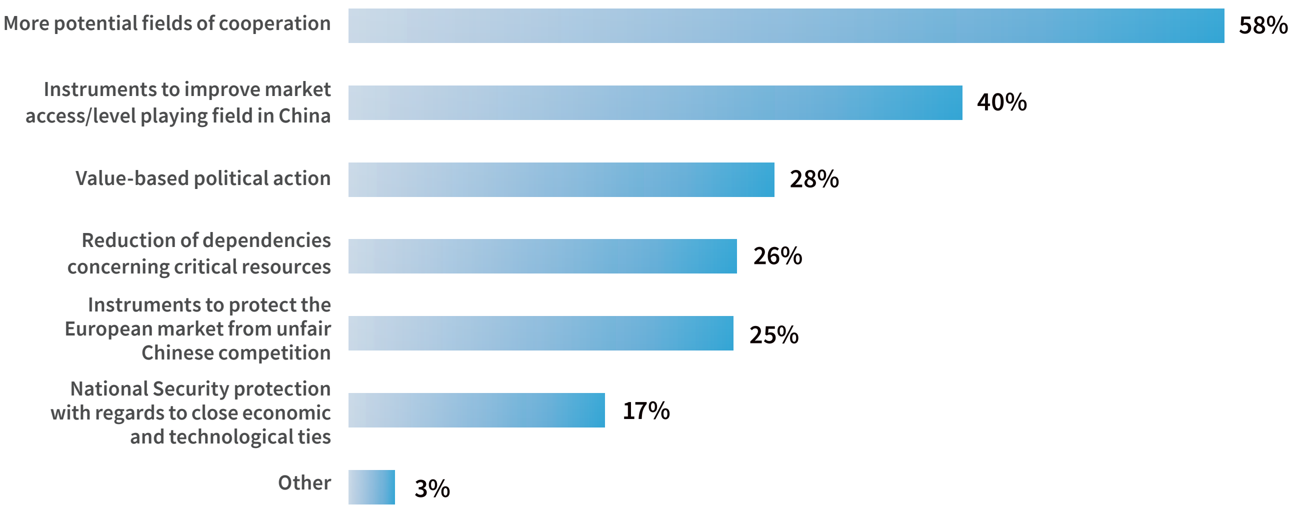
Which aspect of the German Federal Government's approach toward China should be highlighted in the new China Strategy? (n=522)



Note: Percentage of respondents

FIGURE A.4: CHINA STRATEGY SHOULD PAVE WAYS FOR MORE COOPERATION FIELDS

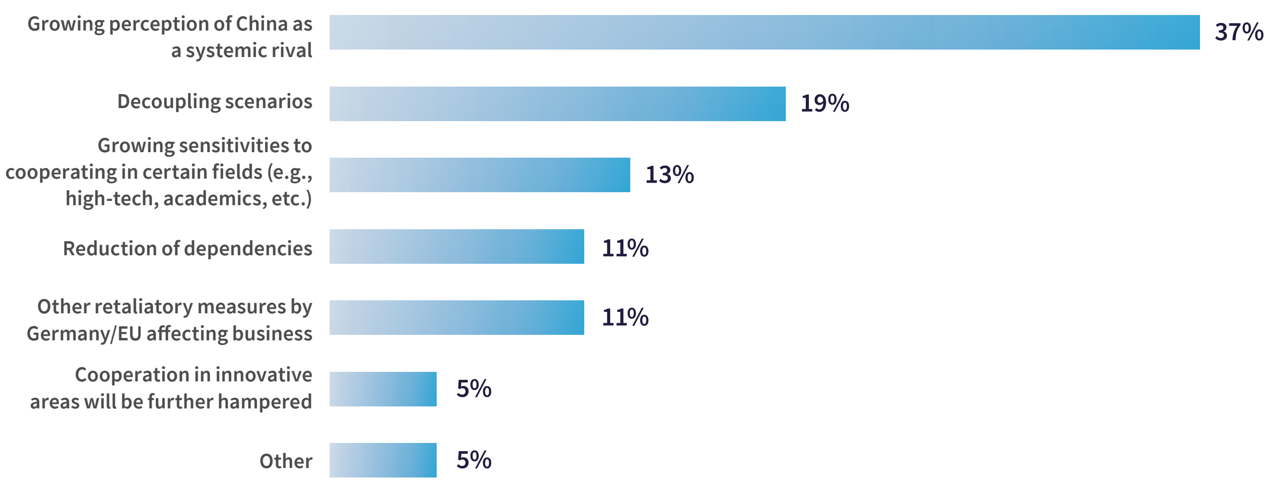
From your company's perspective, what should be prioritized in the new China strategy of the German Federal Government? (n=517)



Note: Multiple answers possible; Percentage of respondents

FIGURE A.5: GERMAN BUSINESSES REJECT THE RIVALRY NARRATIVE

What is particularly challenging for your business regarding the relationship between China and the EU/Germany? (n=510)



Note: Multiple answers possible; Percentage of respondents

CONTACTS

GERMAN CHAMBER OF COMMERCE IN CHINA

The German Chamber of Commerce in China currently has more than 2,100 members in China and is the official member organization for German companies in China. By providing up to date market information and practical advice, the German Chamber helps its members to succeed in China. The Chamber offers a platform for the Sino-German business community and represents its members' interests towards stakeholders, including government bodies and the public.

German Chamber of Commerce in China | North China
DRC Liangmaqiao Diplomatic Office Building, Unit 0601B
19 Dongfang East Road
Chaoyang District,
100600 Beijing
T+86 10 6539 6688
chamber-north@china.ahk.de

German Chamber of Commerce in China | Shanghai
Pingan Riverfront Financial Center, 29F
757 Mengzi Road
Huangpu District,
200023 Shanghai
T+86 21 5081 2266
chamber-east@china.ahk.de

German Chamber of Commerce in China | South & Southwest China
Leatop Plaza, Room 1903
32 Zhu Jiang East Road
Tianhe District,
510620 Guangzhou
T+86 20 8755 2353
chamber-ssw@china.ahk.de

Contact for Press Inquiries
Carina Mingle
Head of Media Relations & Corporate Communications
T +86 132 6043 8380
mingle.carina@china.ahk.de

Contact for Government Affairs
Dr. Constanze Wang
Head of Government Affairs & Advocacy
T +86 21 3858 5010
wang.constanze@china.ahk.de

Contact for Further Information
Philippa Hungar
Economic Analyst
T +86 21 3858 5246
hungar.philippa@china.ahk.de

#PartnerForAdvocacy

The German Chamber of Commerce in China's Business Confidence Survey 2022 | 2023, as well as former editions of the report, are available on our website under the Economic Data & Survey section at www.china.ahk.de.

For up-to-date information about the German business community, activities and events of the German Chamber, updates on policies and economic changes, and much more follow the German Chamber of Commerce on WeChat and LinkedIn.

Chamber North China

Chamber East China

Chamber South & Southwest

AHK Greater China (Chinese)

AHK Greater China

Published by
German Chamber of Commerce in China
www.china.ahk.de

WeChat
North China
East China
South & Southwest

LinkedIn
www.linkedin.com/company/ahk-greater-china

Weibo
weibo.com/germanchamber

Disclaimer

While every reasonable effort is made to ensure that the information provided is accurate, no guarantees for the currency or accuracy of information are made. All material relating to information, products, and services (or to third party information, products and services), is provided 'as is', without any representation or endorsement made and without warranty of any kind, including the implied warranties of satisfactory quality, fitness for a particular purpose, non-infringement, compatibility, security and accuracy. The contributors are solely responsible for the content thereof. Views expressed do not necessarily represent those of the China German Chamber of Commerce and/or the Delegation of German Industry and Commerce Beijing and/or the Delegation of German Industry and Commerce Shanghai and/or the Delegation of German Industry and Commerce Guangzhou and/or the German Industry and Commerce (Taicang) Co., Ltd. and its branches in China, and these entities will not be liable for any loss or damage whatsoever arising from infringement or any defect of rights of the content.

This information includes links to other websites. These links are provided for your convenience to provide further information. They do not signify that we endorse the website(s). We have no responsibility for the content of the linked website(s).