The Swiss Business in China Survey 2022

Edited by Tomas Casas-Klett | Nicolas Musy | Zhen Xiao | with Romain Barrabas
Niwen Chen | Kuno Gschwend | Yong Zhou | Guangli Zhu | Patrick Ziltener

Research partners

Research Institute for International Management
University of St.Gallen

SWISS CENTERS
瑞士中心

Integrated China

Partners

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Embassy of Switzerland in China
瑞士驻华大使馆

swisscham.org

swissnex

economiesuisse

SWITZERLAND GLOBAL ENTERPRISE
enabling new business

Swiss Chinese Chamber of Commerce
瑞中经济协会

This report is the result of a collective research and writing effort by its editors, authors and the production team. Individual contributions are recognized in the corresponding sections of the report. Each named author is responsible for his or her own article.

If you wish to reference the report, please use the following citation format:
Casas-Klett, T., Musy, N., & Xiao, Z. (2022). The ***Swiss Business in China Survey 2022***.
Zurich: Seismo. doi: 10.33058/seismo.30877

Published by Seismo Press AG, Zurich and Geneva

ISBN: 978-3-03777-269-0 (Print)

ISBN: 978-3-03777-877-7 (E-Book)

https://doi.org.10.33058/seismo.30877

The Swiss Business in China Survey 2022

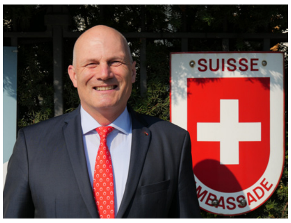
2022年度瑞士在华企业调查

Methodological note

The *Swiss Business in China Survey 2022* is the first such inquiry carried out since the start of the pandemic and follows previous editions published between 2006 and 2019. The survey instrument has been updated this year after many years of development, with many news questions negotiated by its numerous institutional stakeholders and then tested on respondents. The team intends to continue to improve the survey instrument, in both its English and Chinese versions. While the comparatively low number of respondents associates with statistical validation issues, the report undeniably provides unique insights of strategic and operational relevance. Beyond its practical relevance, the report also provides the Swiss public with a description of doing business in China during a critical juncture, and possibly the most challenging year for Swiss companies in over two decades. The collection of data for the 2023 survey will start in October 2022 with the intention of contrasting and contextualizing the findings of this report and assessing future trends.

Table of Contents

Preface



It is a great pleasure for me, as Ambassador of Switzerland to China since only September 2022, to read this survey and to write the preface for it. By taking the pulse of Swiss businesses in China, the survey offers key insights on the challenges and opportunities faced by our entrepreneurs and executives here on the ground. Conducted for the first time in 2006, date which coincides with my first arrival in China as the Deputy Head of Mission of the Embassy of Switzerland, it is the result of coordinated efforts of many Swiss institutions, China experts, and academics working in unison.

To say that China has changed between these two periods is an understatement. On one hand, relationship between Switzerland and China has strengthened considerably, especially in the economic field, with the Sino-Swiss Free Trade Agreement coming into force in 2014, the signature of an Innovative Strategic Partnership two years later and the implementation of a Strategic Dialogue in April 2018. This coming together is not surprising, as more than 1,000 Swiss companies are established in China. The country has been our main trading partner in Asia since 2010 and is presently our third largest global trading partner after the EU and the US.

We should not forget that our relationship with China was forged by business people as early as the 18^{th} century, initially through the watchmaking industry. Mutual interest deepened and led Swiss diplomatic services to establish early contacts with post-war China, Switzerland being, on January 17 1950, one of the first Western European countries to officially establish relations with the People's Republic of China.

On the other hand, the business environment in China today is far more challenging than in previous years: The 2022 edition of this survey is particularly interesting as it highlights the differing perceptions of the Swiss business community on China pre and post the Shanghai lockdown. Thus, while in the first months of the year, Swiss firms expressed historically high levels of confidence in their Chinese businesses, the subsequent strict confinement and geopolitical tensions have had an important impact, as you will be able to read in this survey and see in the charts.

Nevertheless, business confidence remains positive and the transformations underway in the Chinese economy, particularly its growing need for advanced technologies, are likely to offer new opportunities for our most innovative companies, whether they are multinationals, SMEs, or start-ups.

It remains for me to assure that the Embassy of Switzerland, the Consulate Generals and myself will continue to be on the spot for the the Swiss business community in China as well as for all other Swiss interests. We will use our best efforts to facilitate exchanges with Chinese officials and to support the interests of Switzerland and of the Swiss economy as vigorously as possible.

Jürg Burri, Ambassador of Switzerland to the People's Republic of China

Executive Summary

This *Swiss Business in China Survey 2022* reflects the tumultuous events of this year. This is the first time that we have needed to conduct a follow-up mid-year flash survey to re-evaluate the level of business sentiment recorded at the start of the year. We felt that this was essential in order to understand how war in Europe, growing geopolitical tensions in Asia, and the ongoing Omicron lockdowns in China have impacted the expectations of Swiss companies for 2022 and beyond.

The **dramatic collapse in business confidence** that this survey reports is **unprecedented.**

Part I of the survey shows that early in the year, although the key challenges for Swiss companies were intensifying, with ever-fiercer competition and problems in finding and retaining the right talent, plans to invest in China were at their highest ever levels on the back of high profit and revenue growth expectations for 2022. The comparison with the 2019 data illustrates that all of the growth lost due to the pandemic had been fully recovered, and so **executives of Swiss companies viewed 2022 with broad optimism.**

Yet within 6 months, Swiss business confidence went from its highest recorded level to its lowest, on a par with expectations for 2016 which were hit by the 2015 Chinese stock market crash and the lifting of the Swiss peg to the Euro. These radically different results are detailed in Part II of the survey.

The analysis and opinion pieces presented in Part III of this report discuss and provide novel perspectives on a number of crucial topics for doing business in China today. First, the **possibility that the current dynamic zero-Covid policy may be lifted** is considered and it is concluded that this is highly unlikely in the short term for a variety of reasons (Section 3.1). Second, the **effects of the Omicron wave and growing geopolitical tensions on China's economic outlook** are evaluated for their impact on Swiss companies (Section 3.2). Next, the comparison with a parallel EU survey detailed in Section 3.3 shows that while the Swiss responses are generally consistent with their EU counterparts, they are somewhat more optimistic. This pattern is consistent with previous surveys and gives us confidence that the relatively small number of respondents to our survey provides a reasonably representative sample.

The **two very different business environments** for foreign companies in China are discussed in Section 3.4, highlighting the specific problems faced by firms working in sectors where China has prioritized local capacity. A closing piece makes the case that **deglobalization is not an option** for future international business and global prosperity (Section 3.5).

Importantly, the 2022 survey also provides **new insights** by asking participants a wider range of questions, many of which have a strong practical bearing. For instance, **difficulties in managing relationships with headquarters**, one of the key internal challenges identified in the survey, appears to be mostly linked to the slow speed of communication and the overly centralized management of R&D by HQ (Section 1.4).

Moreover, Swiss firms reported that the following **four issues** were **important for the positive development of their business** over the next 5 years: China's national and industrial policies, growth in domestic consumption, the relationship between China and Western countries (especially the US), and further reforms to open up the economy (Section 1.6).

We hope that this work will be useful in benchmarking your business activities and providing useful facts and analysis to facilitate decision making, while at the same time increasing the overall level of understanding about China in your company.

The Editors and Contributors to the *Swiss Business in China Survey 2022*

1. Outlook, pre-lockdown

PART I

This year's survey of Swiss firms conducting business in China was concluded in March 2022, just weeks before there were widespread outbreaks of the Omicron COVID-19 variant and a lockdown in Shanghai. The timing undoubtedly had a significant impact on the business outlook. To understand the magnitude of this impact, the research team undertook an additional flash survey in June 2022 to get updated responses on key questions and the level of confidence of Swiss businesses working in China. Part I of this report focuses on the results of the pre-lockdown responses, while the post-lockdown update is provided in Part II.

1.1 Sales growth, profitability and investment intentions

Sales

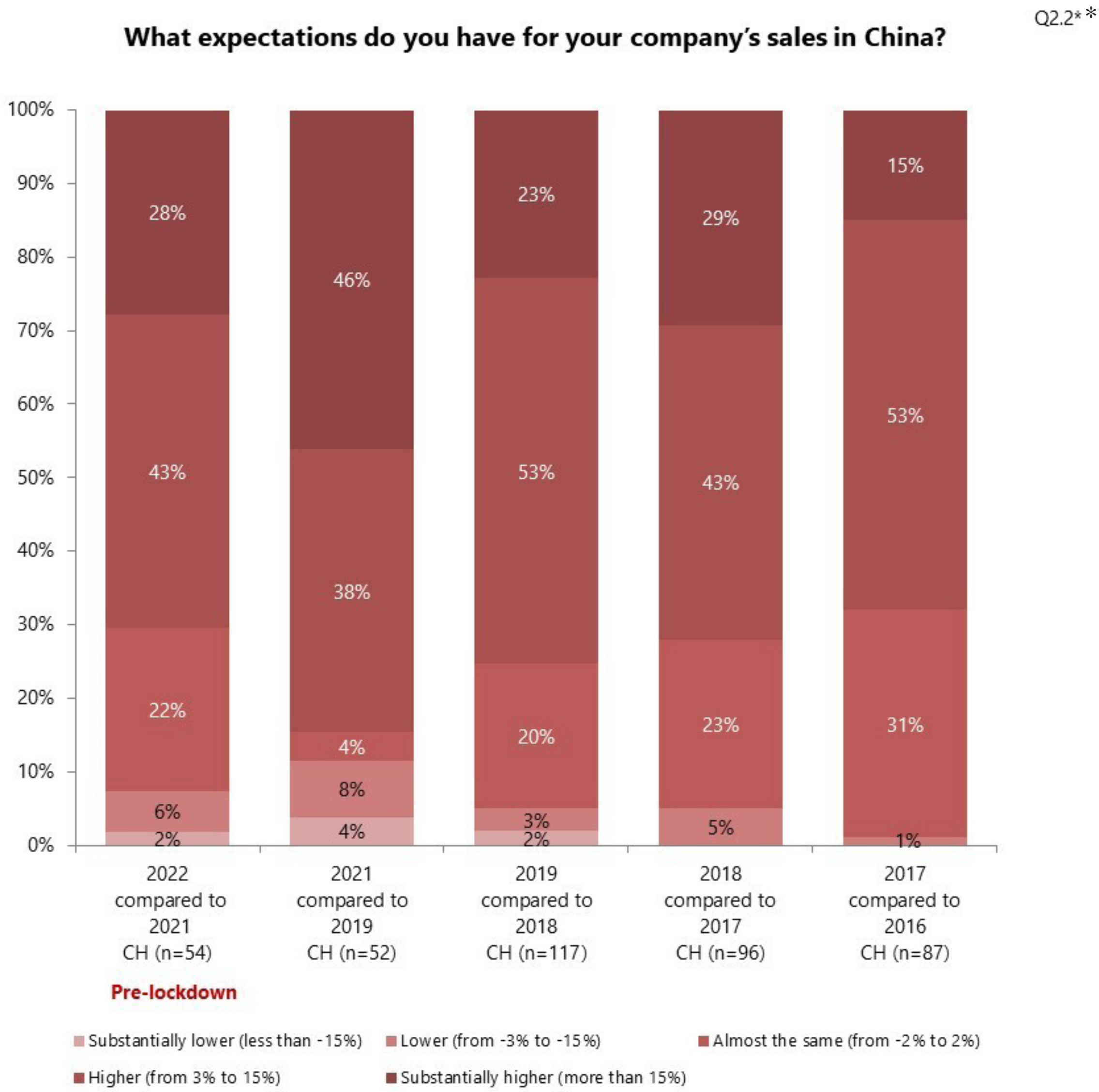


Figure 1.1: Sales growth expectations

A large proportion of Swiss companies reported sales growth in China. This year we asked the companies to benchmark their 2021 sales against 2019, since the figures for 2020 were largely distorted by the affects of the COVID-19 outbreak in Wuhan. 84% of the respondents reported "substantially higher" or "higher" sales, clearly indicating that the ground lost as a result of the pandemic has been recovered.

Figure 1.1 shows that when asked about their predicted 2022 sales as compared to 2021, 71% of the respondents expected "substantially higher" or "higher" sales, a growth figure in line with previous (non-pandemic) years. In other words, in March 2022, Swiss companies expected their sales growth in the Chinese market to continue at the same pace as in the (pre-pandemic) past.

*The top right corner of all applicable figures references the question number in the survey instrument.

Profitability

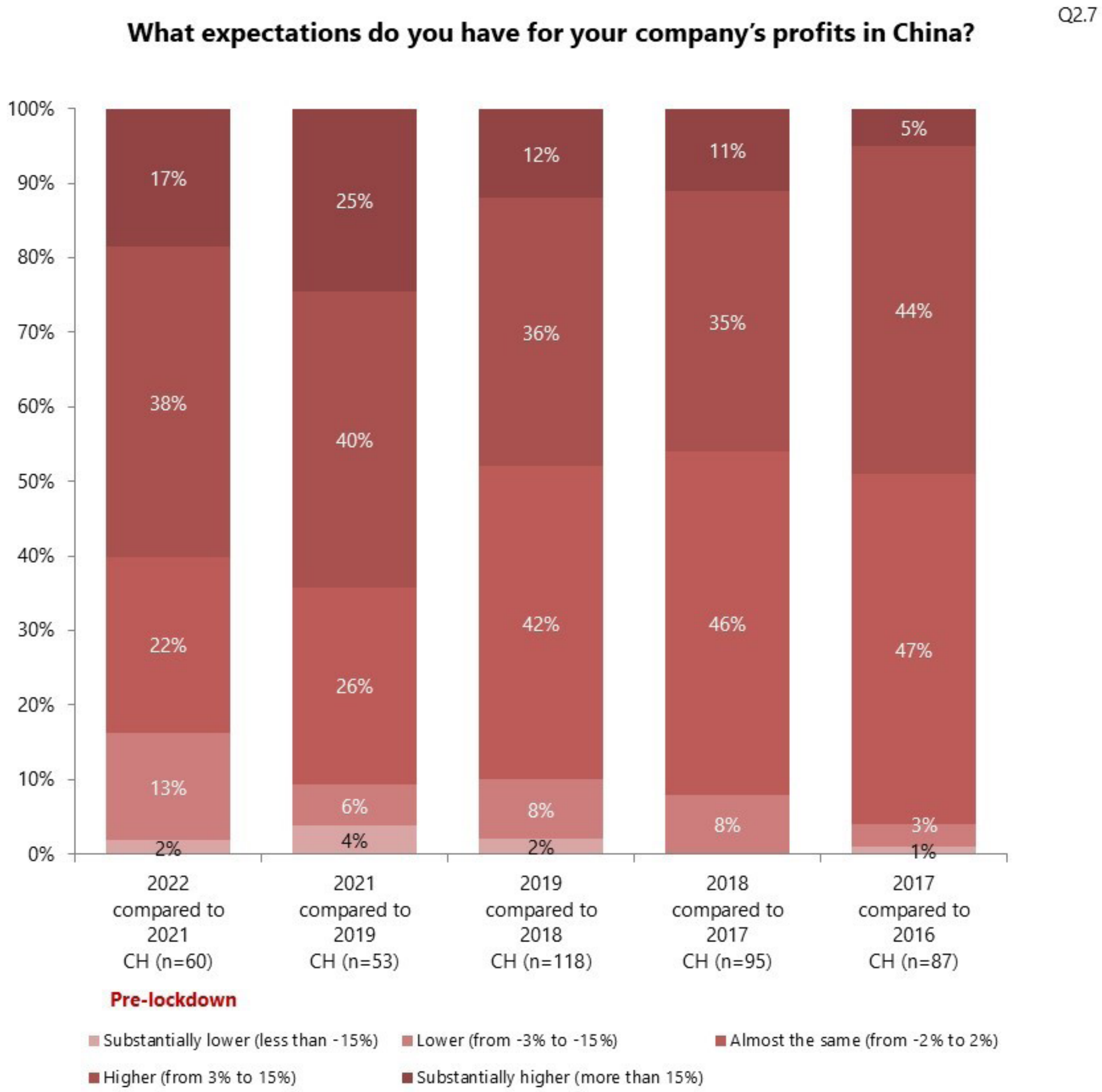


Figure 1.2: Profitability expectations

Swiss companies also reported very good performance in terms of profitability. Almost two-thirds of the respondents reported "substantially higher" or "higher" profits in 2021 as compared to 2019. In addition, 55% of respondents expected their profits to be "substantially higher" or "higher" in 2022 as compared to 2021, which demonstrates a higher level of business confidence than in the years 2017 to 2019, when the average percentage of respondents expecting "higher" or "substantially higher" profits was 47.7%.

2022 was therefore looking particularly positive for Swiss companies in terms of increasing profits for their businesses in China, highlighting the fact that the pandemic was viewed as now being in the past and that business confidence was increasing.

Investment

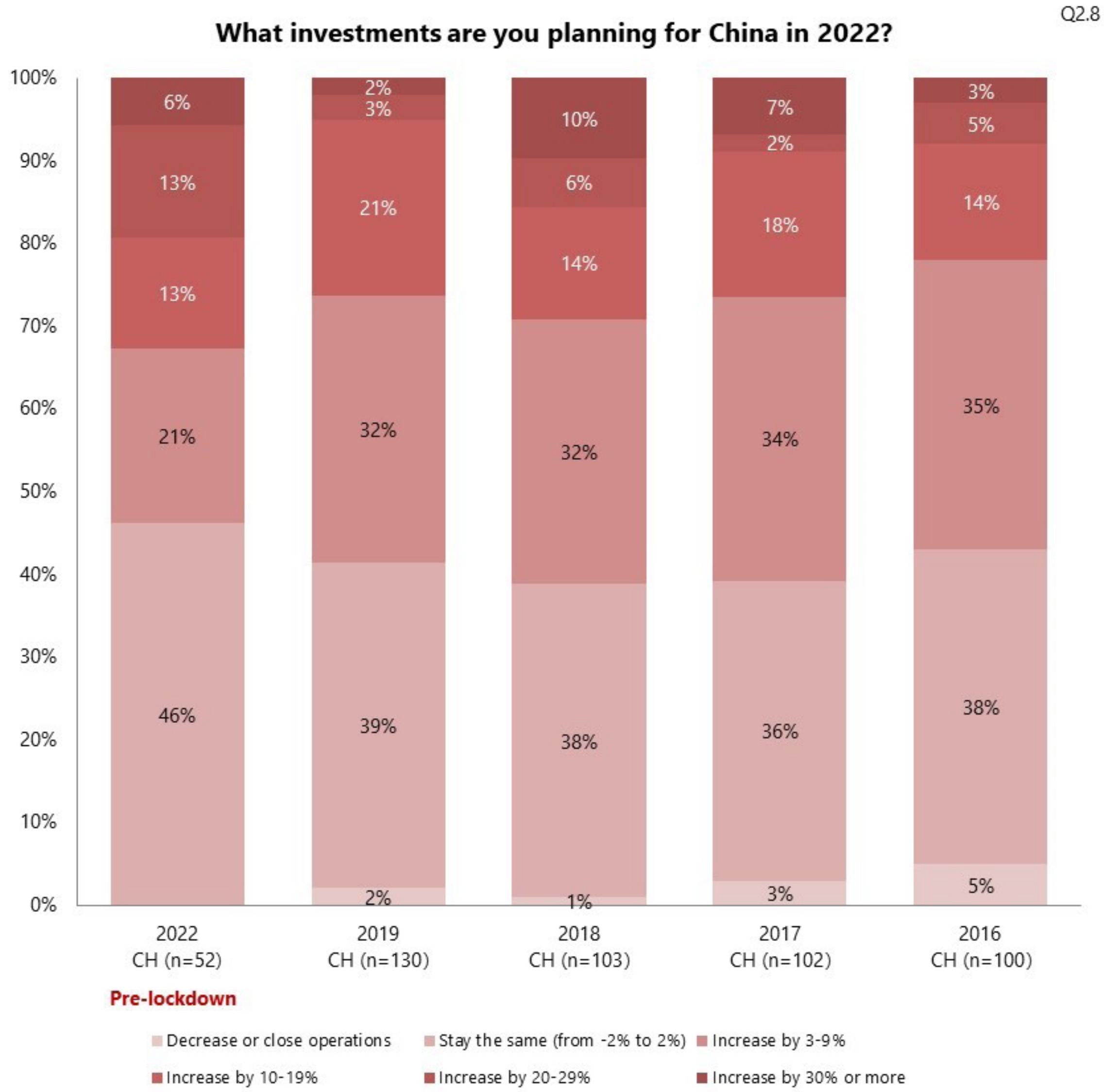


Figure 1.3: China investment plans

Investment plans generally confirm the positive pre-lockdown survey results. For 2022, 32% of Swiss firms planned to increase their investments by 10% or more, whereas an average of only 26.3% of them had planned to invest at these levels in 2016, 2017, 2018 and 2019.

Overall, we can conclude—albeit that this may be a surprising finding to many—that up until March 2022, Swiss companies had a much more positive outlook on their business performance and development in the Chinese market than in the pre-pandemic years.

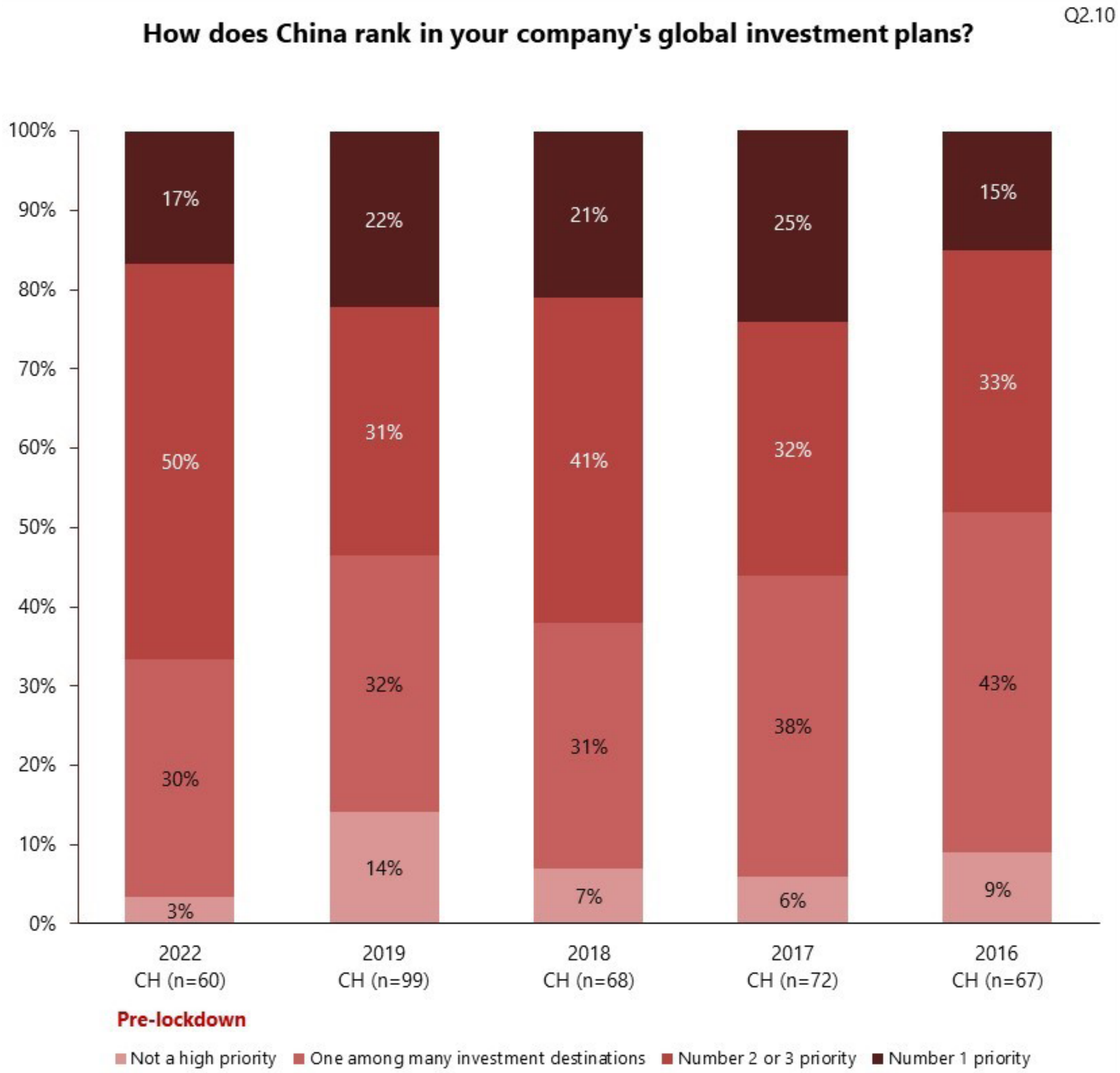


Figure 1.4: China rank in global investment plans

In March 2022, about 67% of Swiss firms saw China as one of their top 3 investment priorities, markedly higher than the average of 55% found in the pre-COVID years of 2016 to 2019.

Top investment locations in China

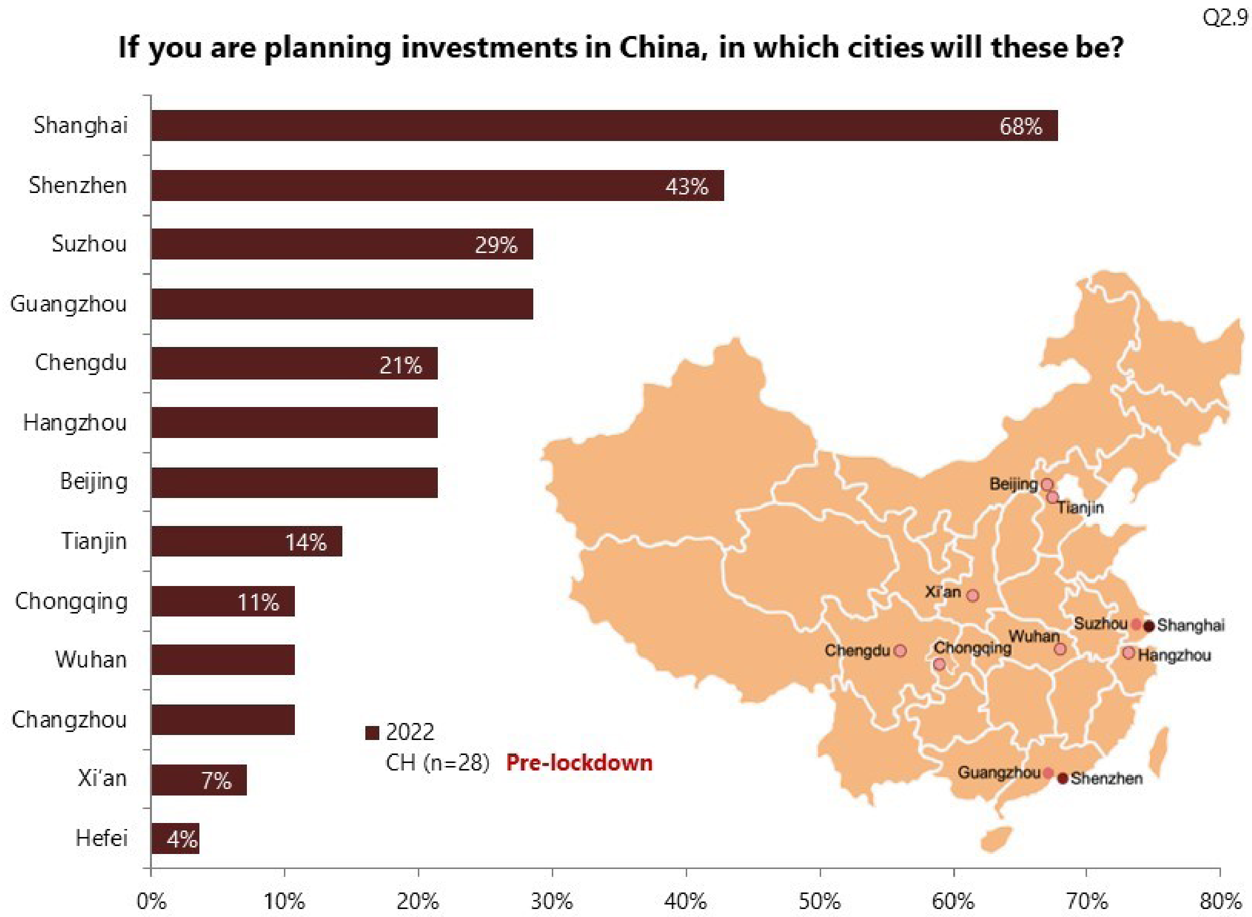


Figure 1.5: China investment plans by target city

The survey asked those that responded positively to the investment plan question where they were planning to invest. The top-ranking destinations for investment in 2022 are Shanghai, Shenzhen, Guangzhou, Suzhou, Beijing, Hangzhou and Chengdu—-all of which were mentioned by more than 20% of the respondents.

It is important to note that Shanghai is the city with the largest concentration of Swiss companies in China.

1.2 Success and competitive advantage in China

Key success factors

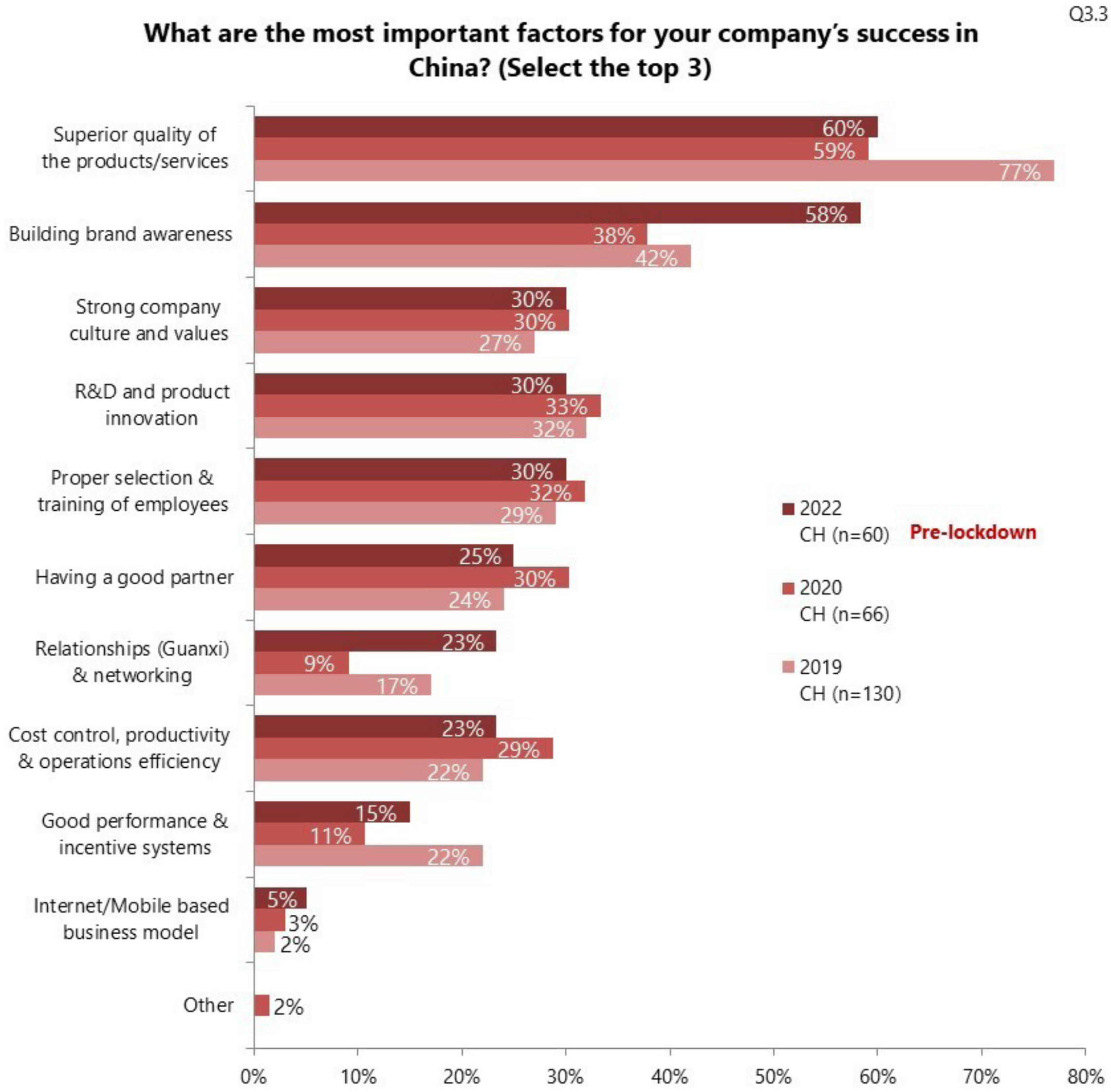


Figure 1.6: Key success factors in the Chinese market

As always, Swiss companies see the superior quality of their products and services as the primary factor for their success in China. Building brand awareness is also seen as a key success factor, but it is perceived as being significantly more important when compared to previous surveys, which may indicate that competition in China is further intensifying. An explanation for this could be that a growing number of the companies surveyed are active in areas where brand recognition is essential.

Sales success factors

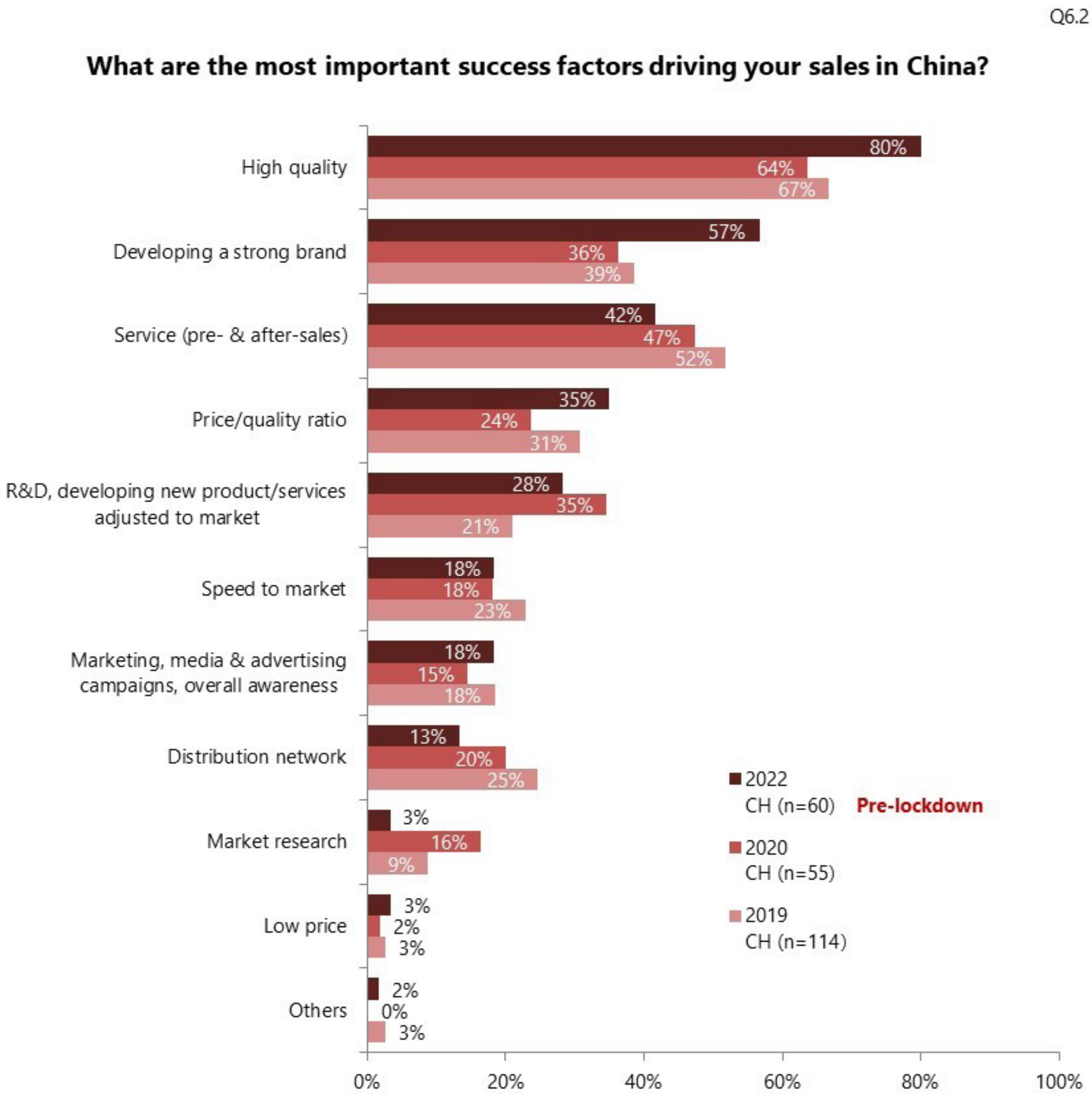


Figure 1.7: The most important success factors driving sales in China

High quality products and having a strong brand are, unsurprisingly, also the two factors perceived as being the most important for sales success in China by 2022 respondents.

Marketing success factors

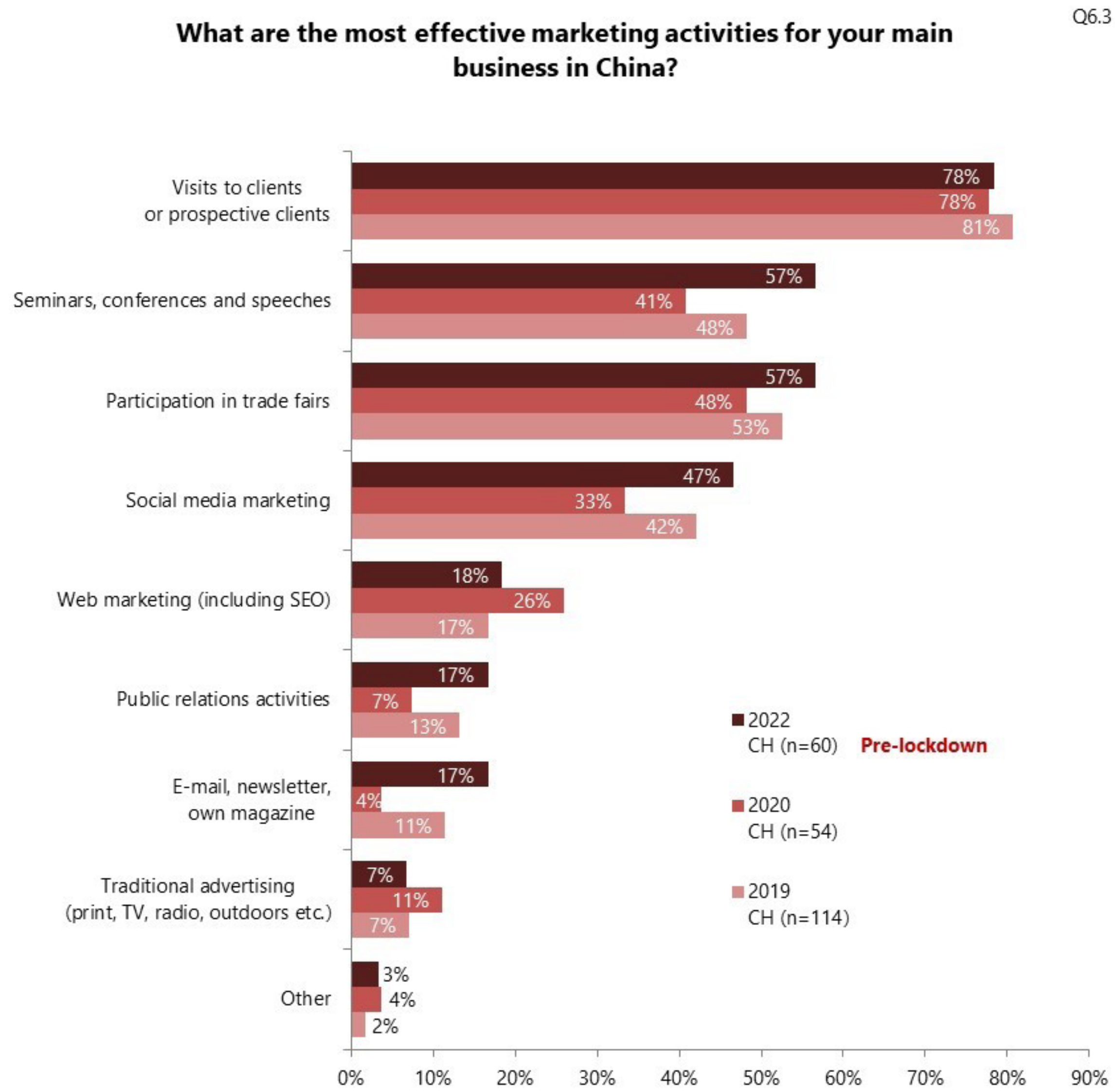


Figure 1.8: The most effective marketing activities in China

In terms of the value attributed to different marketing activities for doing business in China, the 3 most effective activities chosen by Swiss companies are: "Visits to clients" (78%), "Seminars, conferences and speeches" (57%), and "Participation in trade fairs" (57%). These remain very similar to responses recorded before COVID-19 and again confirm the importance of personal interactions for doing business in China.

The fourth most effective activity, "Social media marketing" is, however, becoming more prominent, with 47% of respondents selecting it as one of their top three marketing strategies.

1.3 External challenges: Competition, rising costs, regulation and more

The most significant external challenges

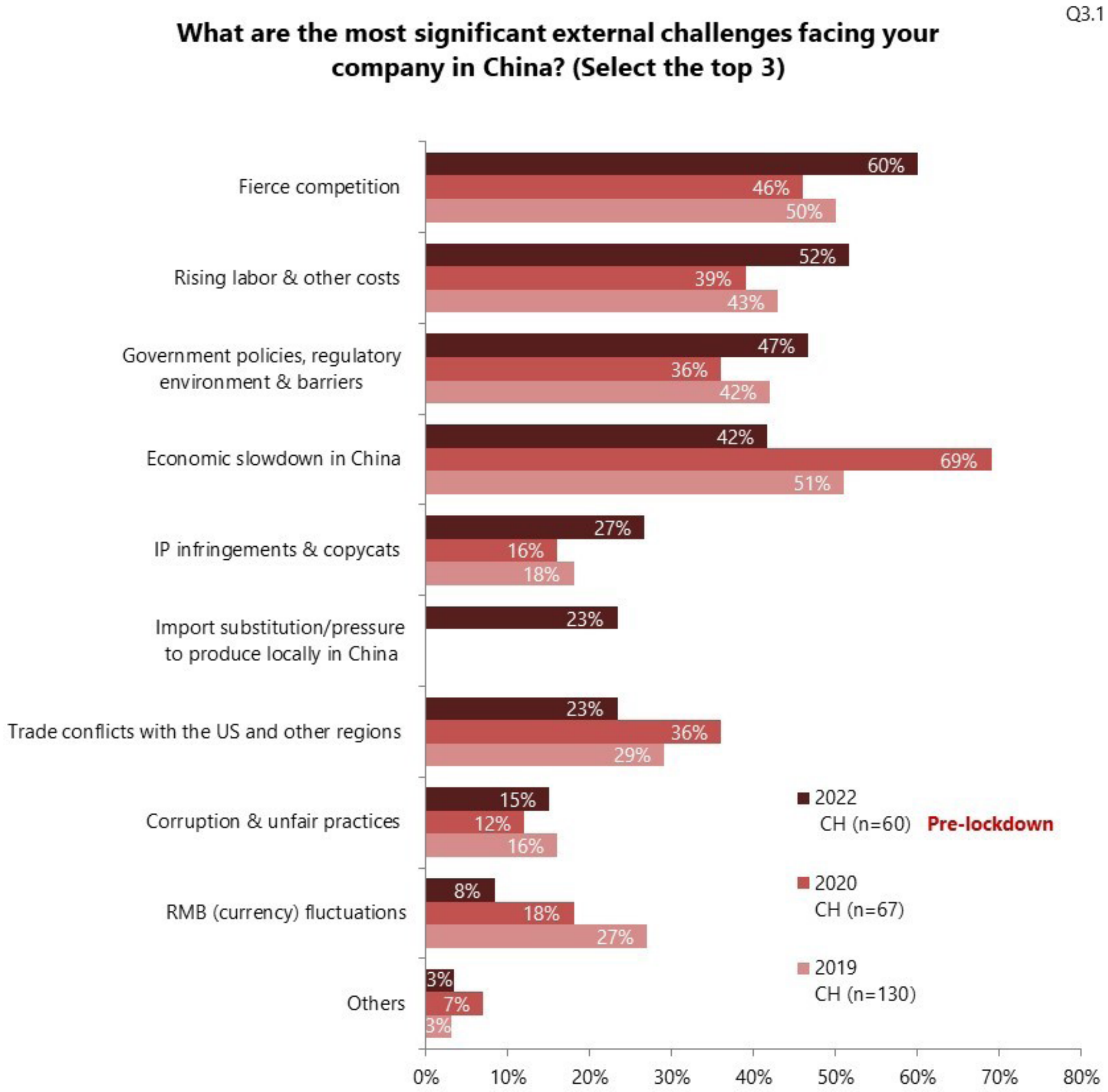


Figure 1.9: The most significant external challenges facing companies in China

A slowing Chinese economy was the primary concern voiced by Swiss businesses prior to the pandemic. By March, 2022, "Fierce competition" had become the most significant external challenge that Swiss companies face when doing business in China. "Rising labor and other costs", "Government policies, regulatory environment & barriers" and "IP infringement & copycats" are also perceived as challenges that are intensifying.

Intensifying competition

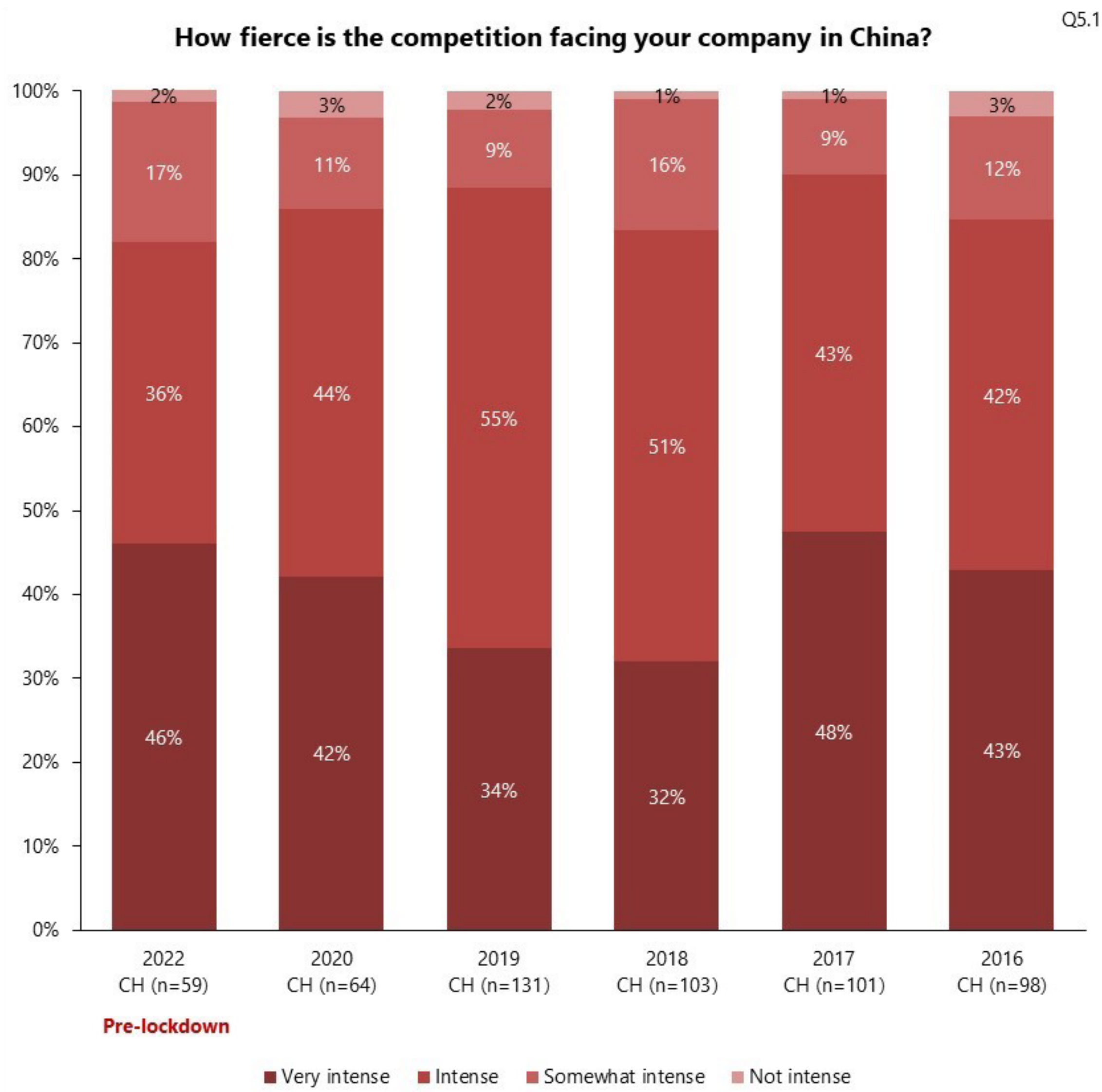


Figure 1.10: Competition intensity in China

Figure 1.10 illustrates that competition in China is intensifying, with a near record percentage of respondents (45%) deeming it to be "very intense", the highest proportion recorded in this survey since 2017.

Who are the competitors?

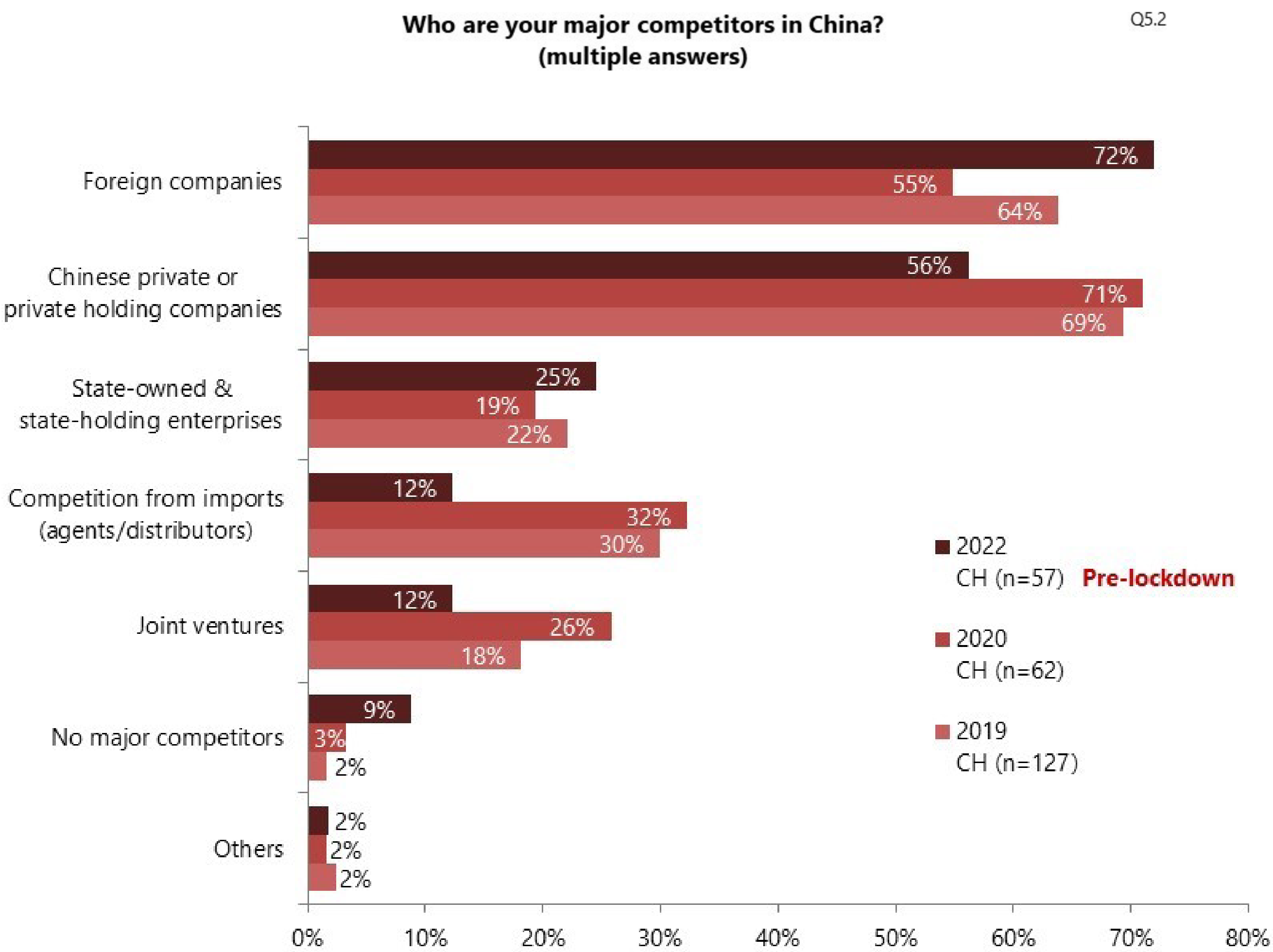


Figure 1.11: The national origin of competitors to Swiss companies in China

In contrast to findings from the previous two years, the Swiss companies that responded to the 2022 survey saw their main competitors as, more often than not, other foreign companies rather than private Chinese entities. It is open to debate whether this is a sign that Chinese companies have been weakened by the pandemic more than their foreign counterparts, or simply a statistical anomaly. Future surveys may or may not confirm if this signals a reversal of a trend that has seen Chinese private companies becoming ever more competitive.

The R&D and innovation capabilities of Chinese competitors

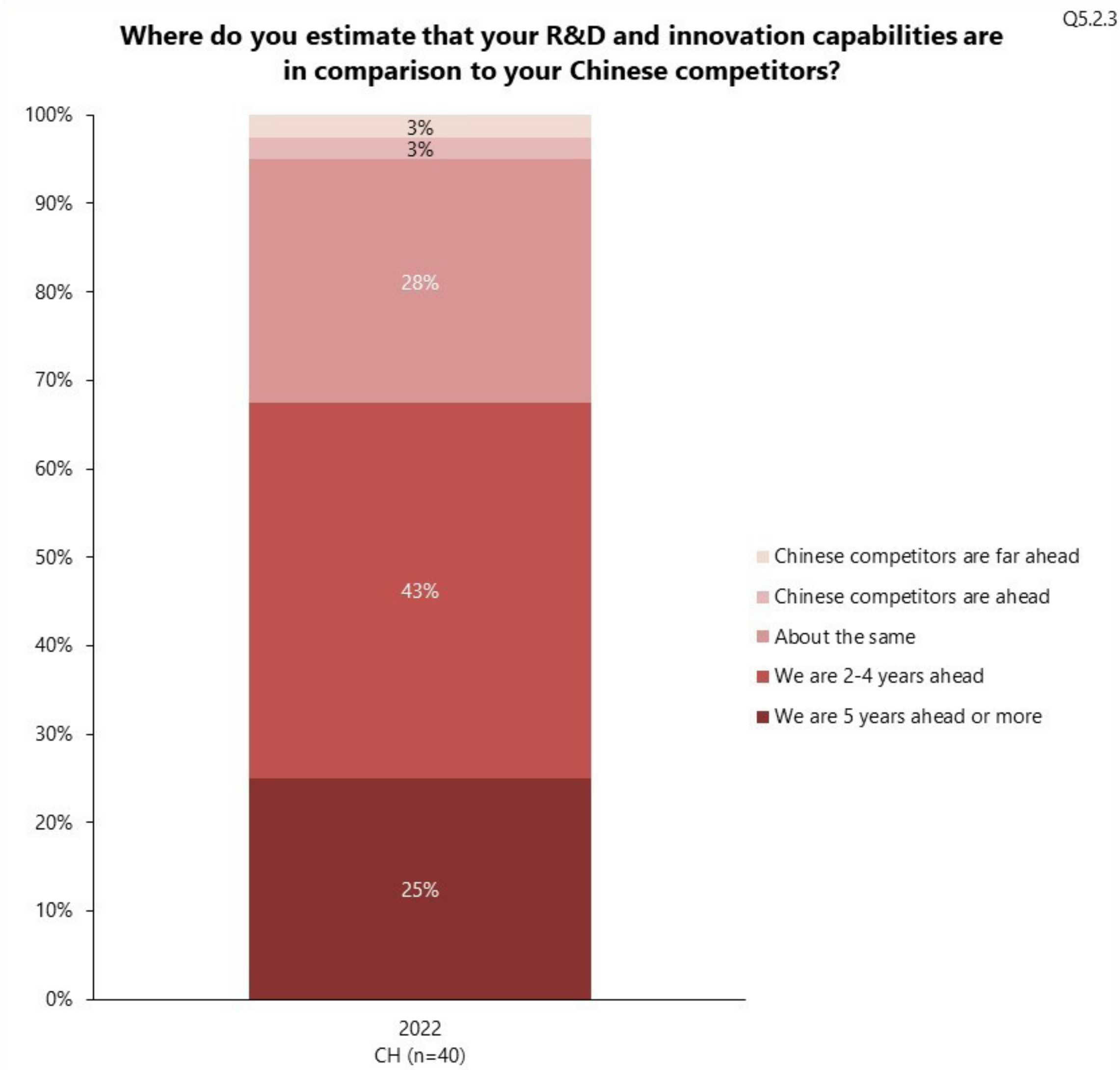


Figure 1.12: Swiss firms' perceptions of their R&D capabilities in relation to Chinese competitors

The survey also considered how Swiss companies perceived the research and innovation capacity of their Chinese competitors. This has been a policy priority for Beijing for some years as evidenced by the 2015 launch of the strategic program 'Made in China 2025', as well as by the dual circulation strategy, mentioned for the first time in May 2020 at a meeting of the Standing Committee of the Political Bureau of the Communist Party of China Central Committee.

Despite these Chinese initiatives, 68% of Swiss companies estimated that they were ahead of their Chinese competitors by 2 years or more, showing that they still maintain a clear advantage in terms of R&D and innovation. Since this is the first time that we have included this question in the survey, it is not possible to determine a trend, but future surveys will provide additional insight on this critical aspect for competitive advantage.

Source of foreign competitor's competitive advantage

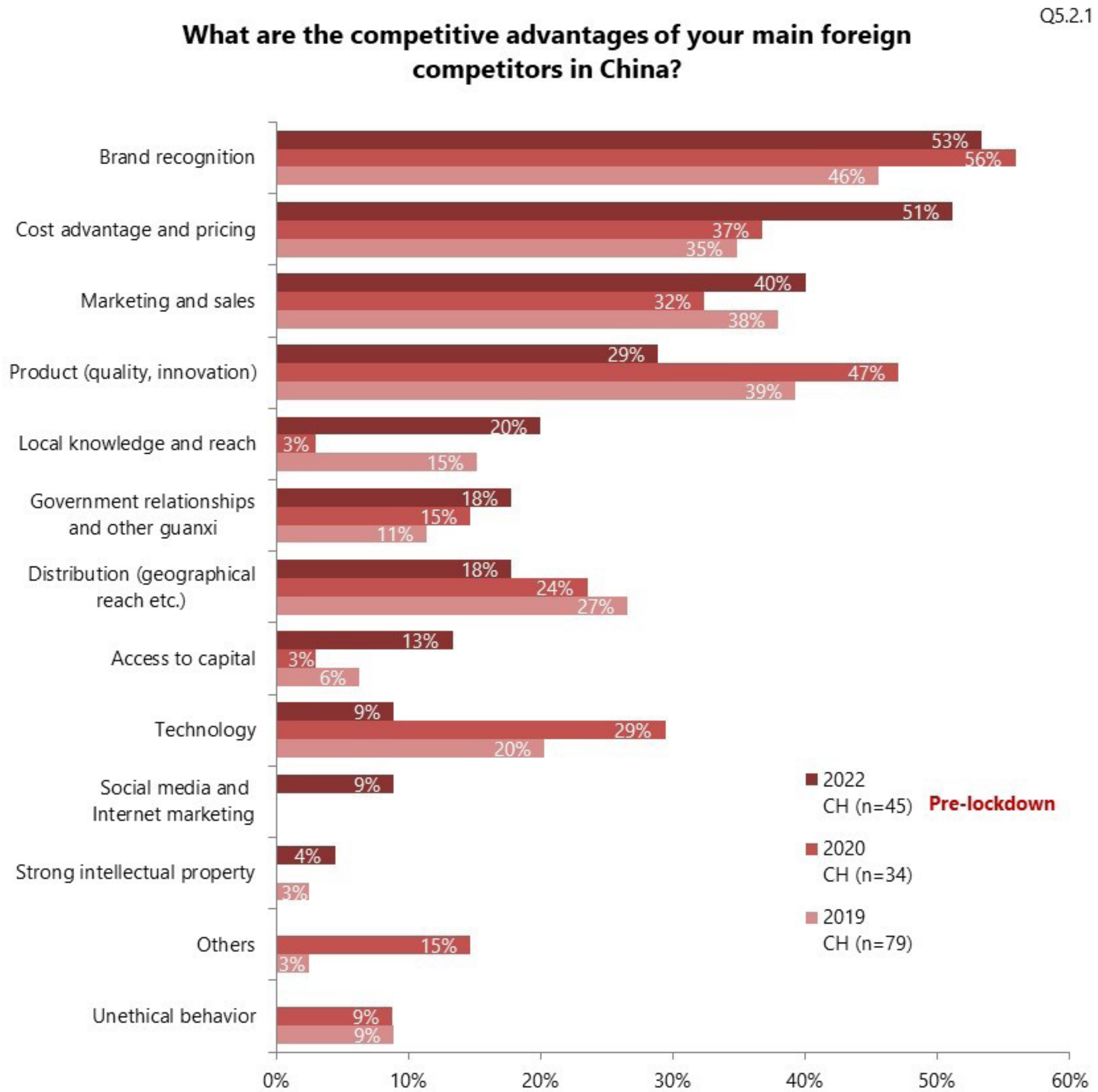


Figure 1.13: Foreign firms' competitive advantage in China

When looking at the respective advantages of foreign rivals, Swiss companies see the cost advantage clearly taking more precedence than has previously been the case. This indicates that Swiss companies may need to increasingly focus on cost management to remain competitive.

Source of Chinese competitor's competitive advantage

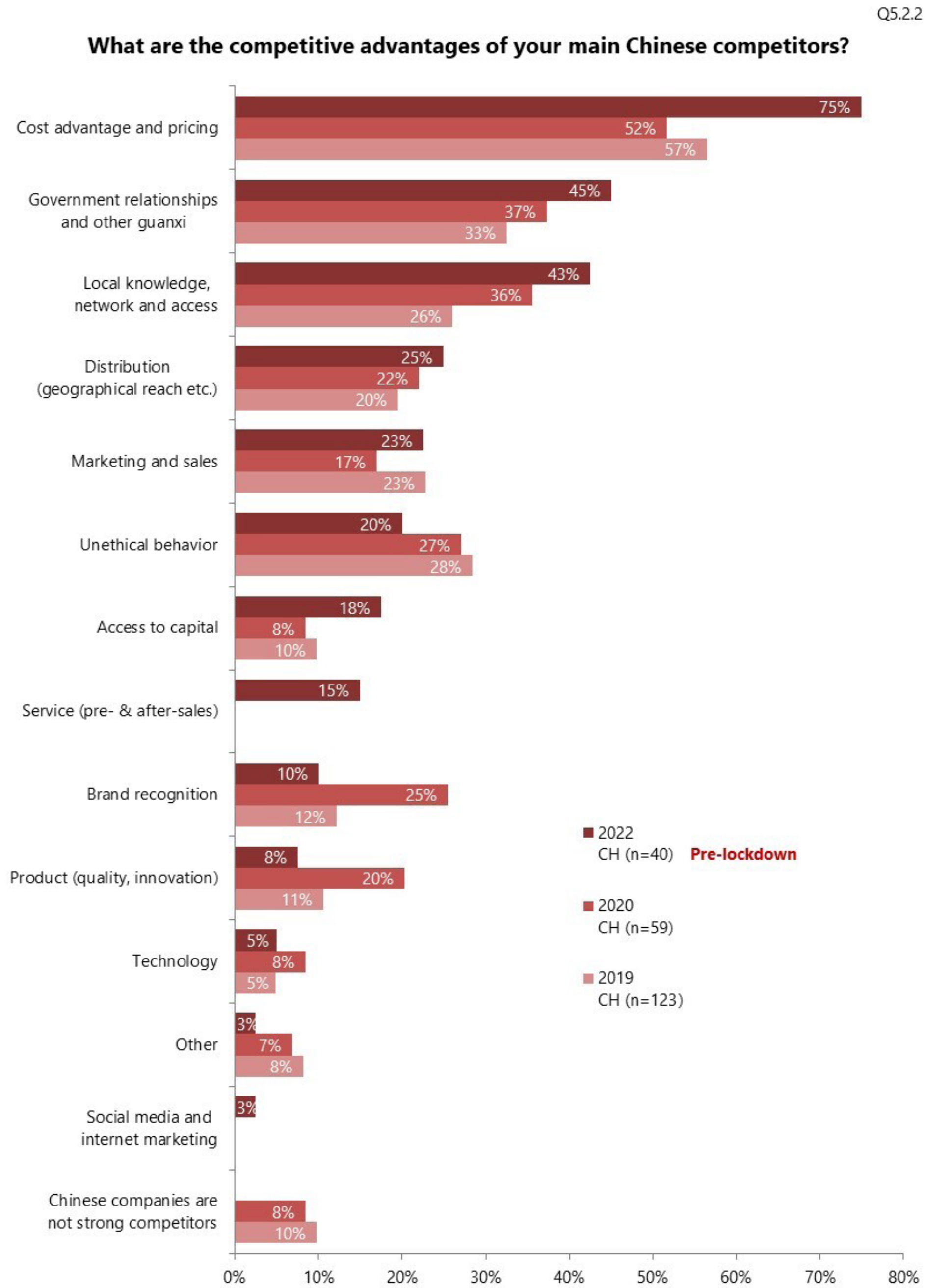


Figure 1.14: Chinese firms' competitive advantage in China

In addition to citing the cost and pricing advantages enjoyed by their Chinese competitors, the respondents also perceived local companies to be increasingly using their government relationships, local networks, and other *guanxi* to boost their competitiveness.

Regulatory challenges

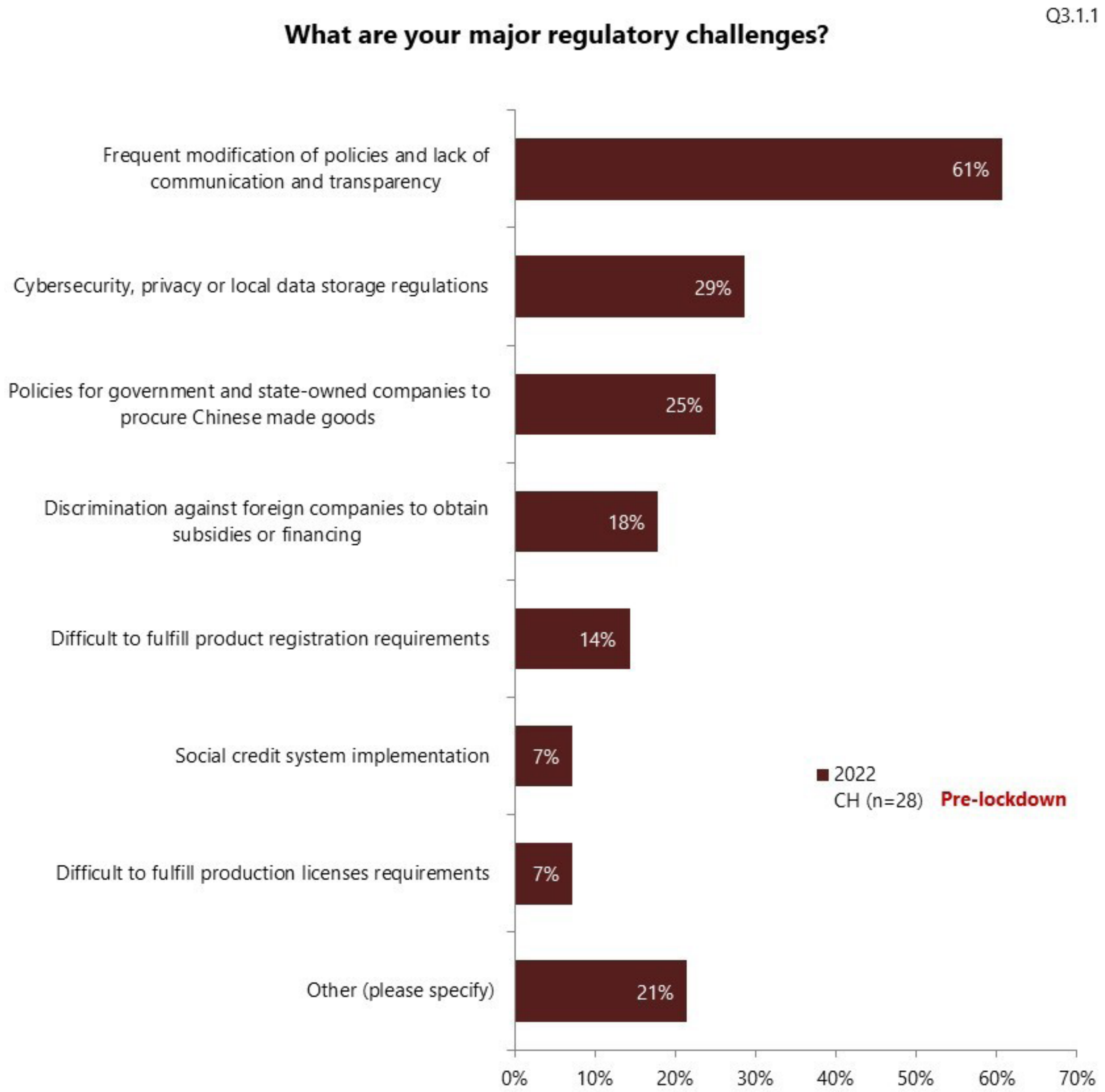


Figure 1.15: Major regulatory challenges in China

Since the regulatory environment has become more challenging over the last few years, the survey asked for the first time an additional question on this aspect.

A clear majority of companies highlight the frequent changes and updates to the regulatory environment, and especially the lack of communication and transparency on such issues as an important challenge.

Regulations on data and cyber security are cited by nearly 30% of respondents as problematic, indicating that a whole new set of regulatory issues are now relevant for businesses following the introduction of new Chinese privacy and data laws.

Policies aimed at encouraging local procurement by the government or state-owned enterprises are also of concern for nearly a quarter of the respondents. This is also the first time that this question has been asked in our survey, and the answers given by Swiss firms in coming years will be particularly useful in identifying trends.

1.4 Internal challenges: Human resources becomes an ever more critical factor

The most significant internal challenges

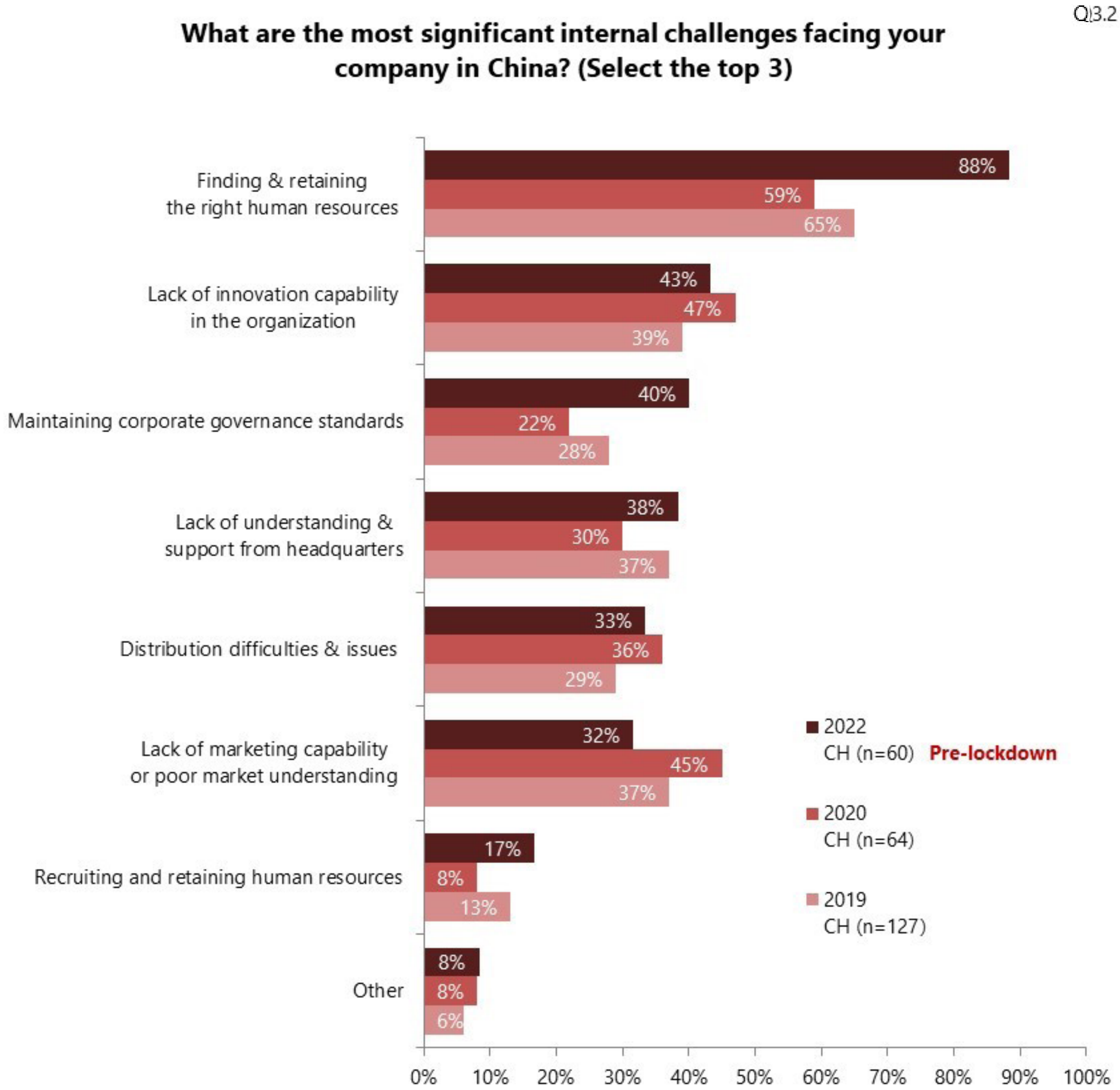


Figure 1.16: The most significant internal challenges facing foreign companies in China

The top internal challenge for Swiss companies doing business in China remains personnel. It has ranked consistently highly in recent surveys but has become even more critical in 2022, with 88% of the respondents selecting the recruitment and retention of human resources as a significant problem. As a result of its importance over time, this year's survey has been extended to go into more granular detail on the human resources problem, with the findings shown on the next pages.

"Lack of innovation capability in the organization" and "Maintaining corporate governance standards" are also deemed to be important and point to another human resources related challenge: organization and organizational development.

Major human resource issues

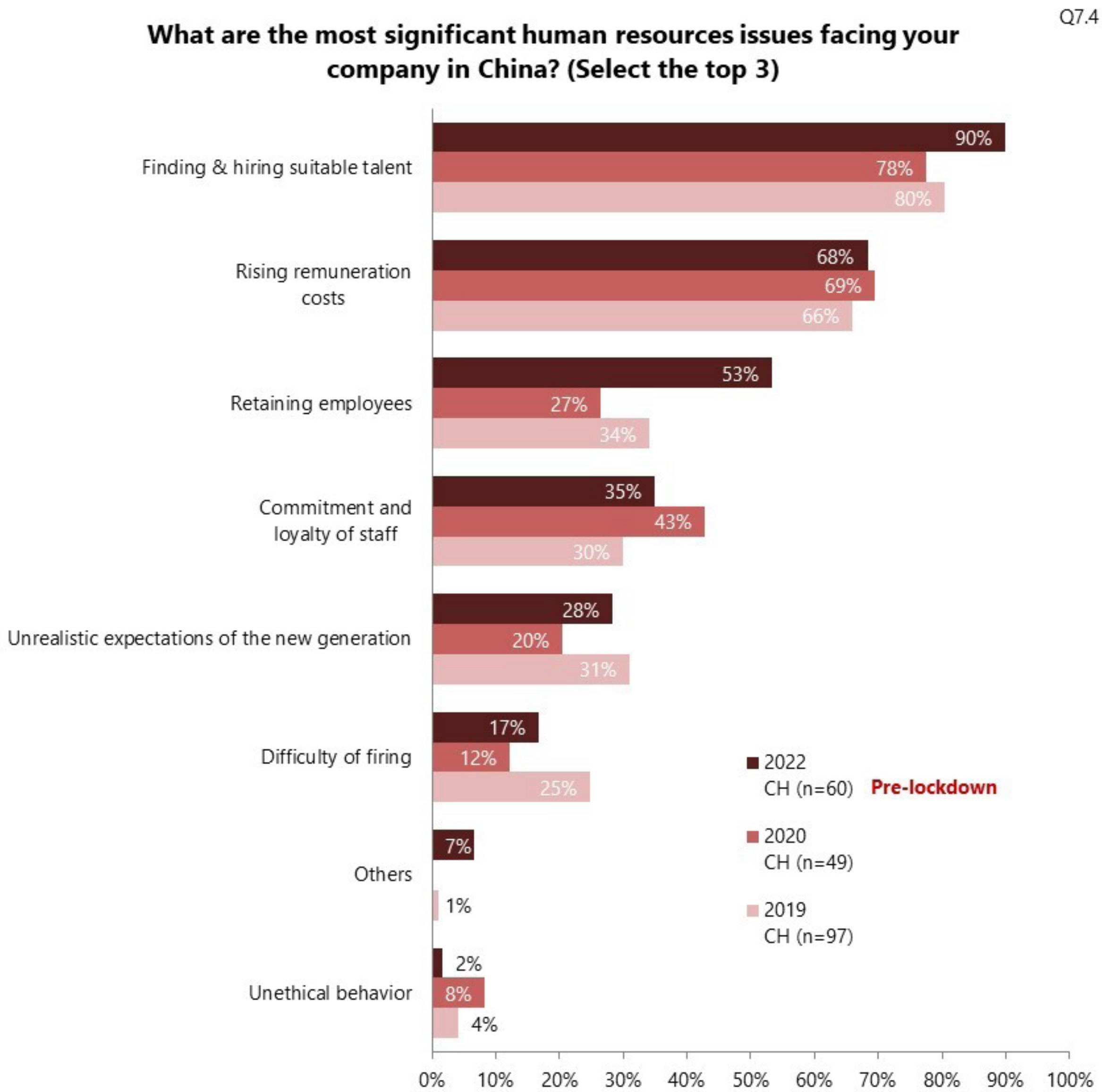


Figure 1.17: Major human resources issues facing Swiss companies in China

By digging deeper into human resources related challenges, one factor is predominant: "Finding and hiring suitable talent", as highlighted by 90% of respondents. Unsurprisingly, "Rising remuneration costs" is also seen as important and selected by 68% of companies, though this is at a level similar to previous years. "Retaining employees" is, on the other hand, seen as increasingly difficult, confirming again that the primary human resources concern for Swiss companies in China is recruiting and retaining the right talent.

It should also be noted that while "Commitment and loyalty of staff", the "Unrealistic expectations of the new generation" and "Difficulty of firing" rank lower, these are still concerns for 20%-35% of the respondents.

Headquarter challenges

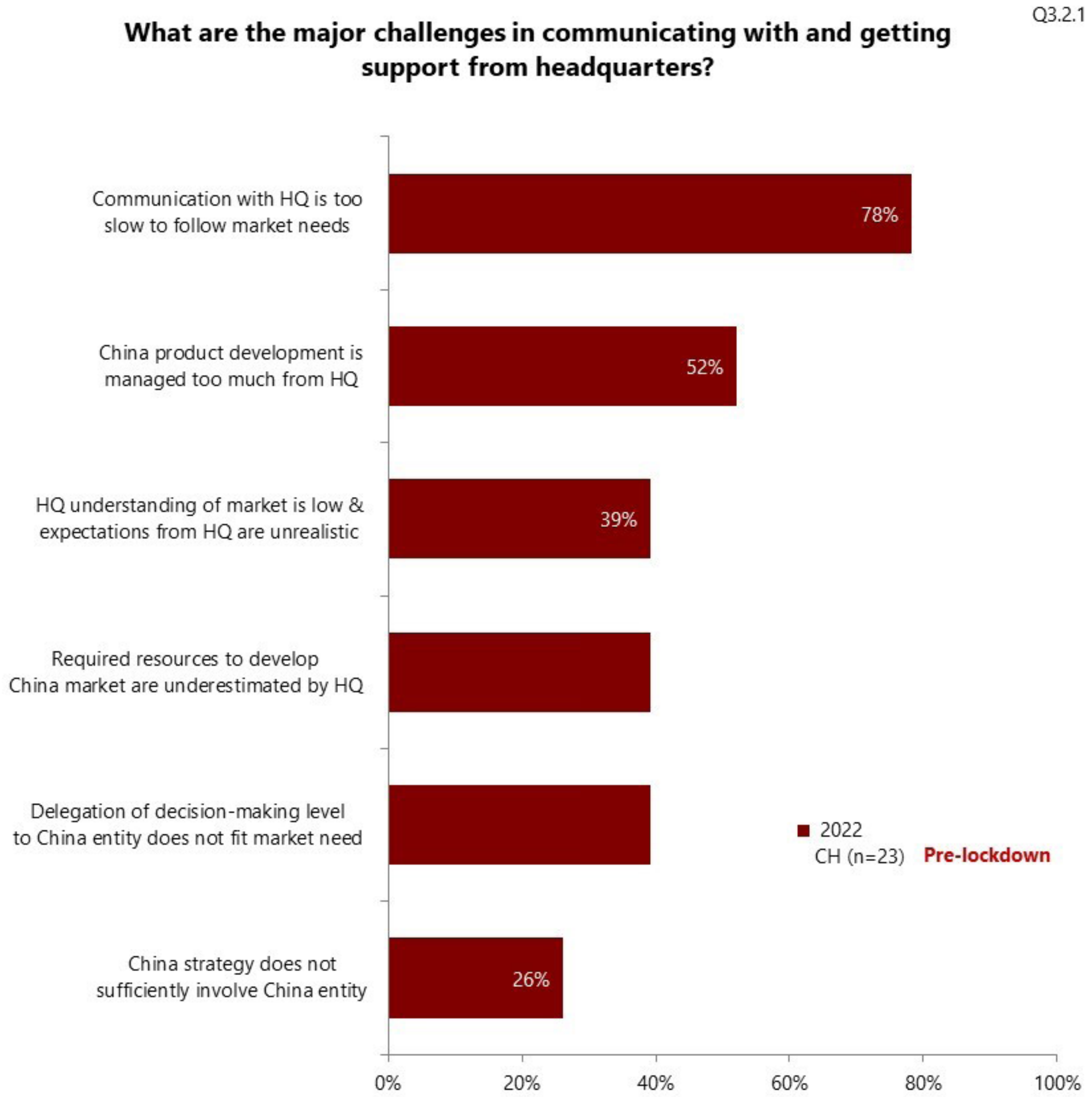


Figure 1.18: Major challenges in the relationship with headquarters

A new question was designed concerning challenges in managing the relationship between headquarters and foreign subsidiaries in China. This is an issue regularly mentioned in informal conversations. It is now confirmed by the survey as a key challenge and specific issues are identified. These insights ought to be of practical relevance to headquarters and subsidiaries alike.

Salary increases

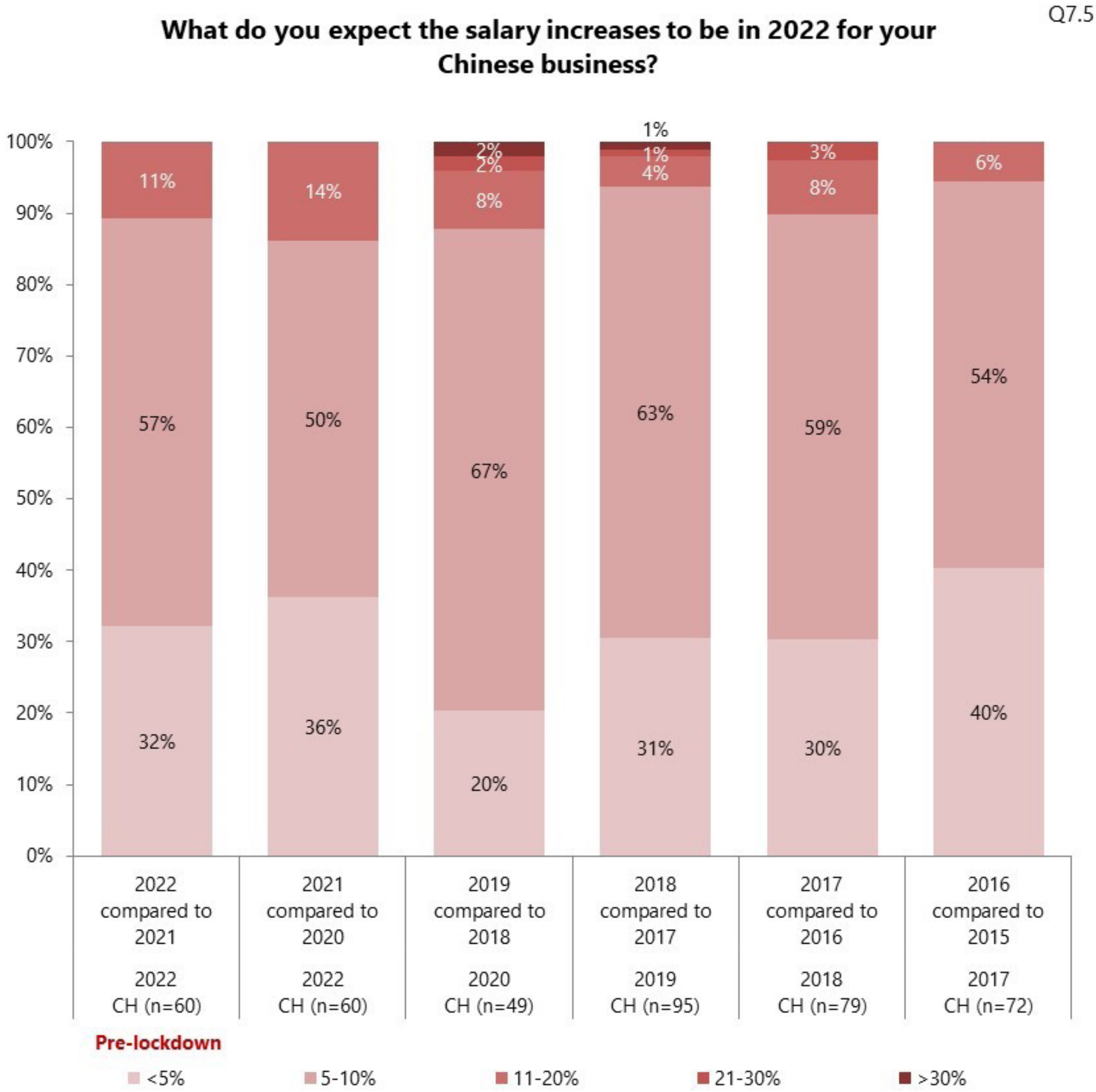


Figure 1.19: Expected salary increases in 2022 for the Chinese business

In terms of increases in remuneration, Swiss companies in the 2022 survey intend to offer smaller salary rises than in pre-pandemic years. Still, more than two-thirds of respondents are increasing employee salaries by between 5% and 20%.

Unwanted employee turnover

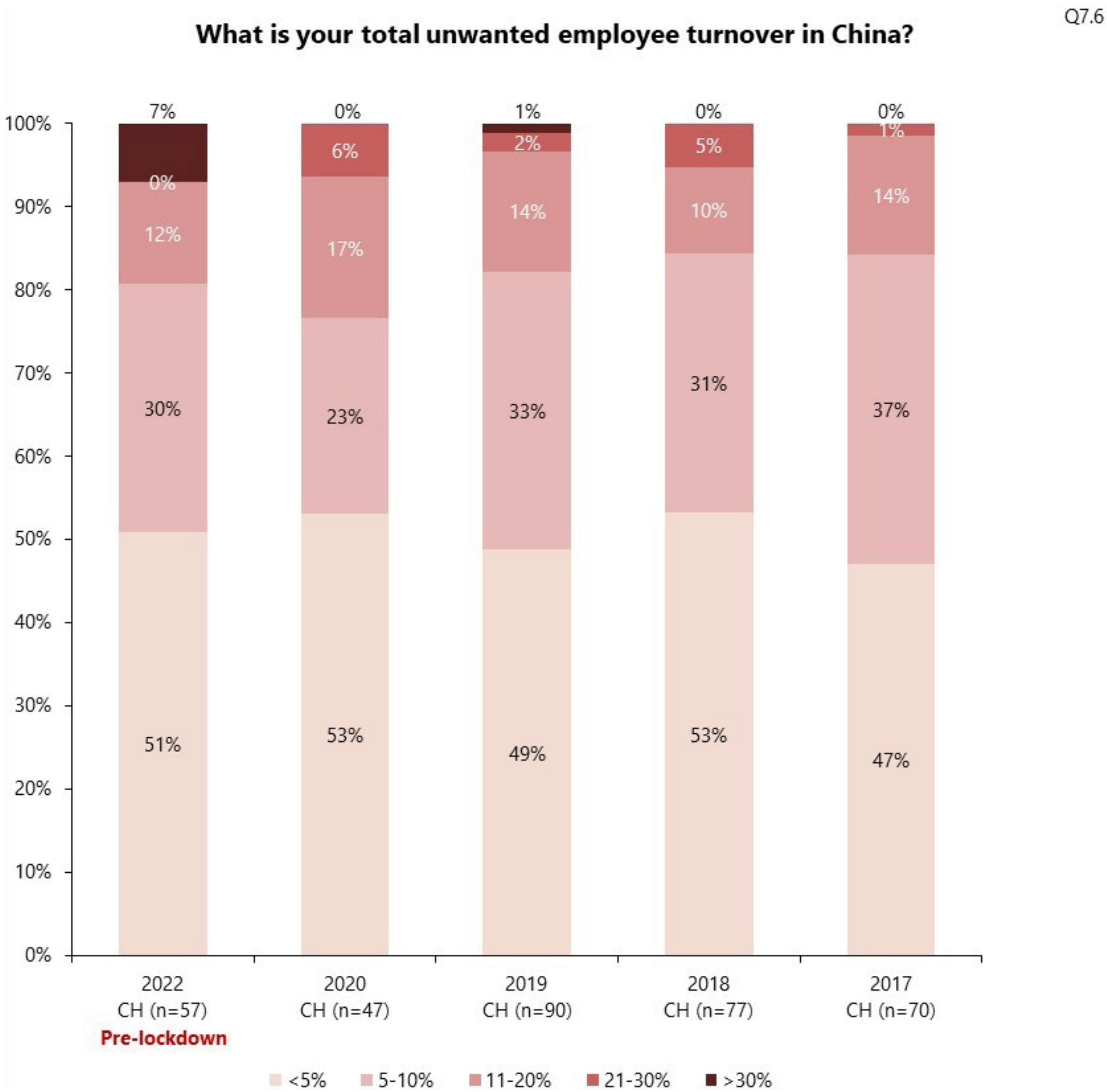


Figure 1.20: Total unwanted employee turnover in China

Since the 2017 survey, and despite the employee retention problem, around half of Swiss companies have managed to keep unwanted employee turnover below 5%. This is evidence of successfully mastering an important challenge in China.

Strategies to retain employees

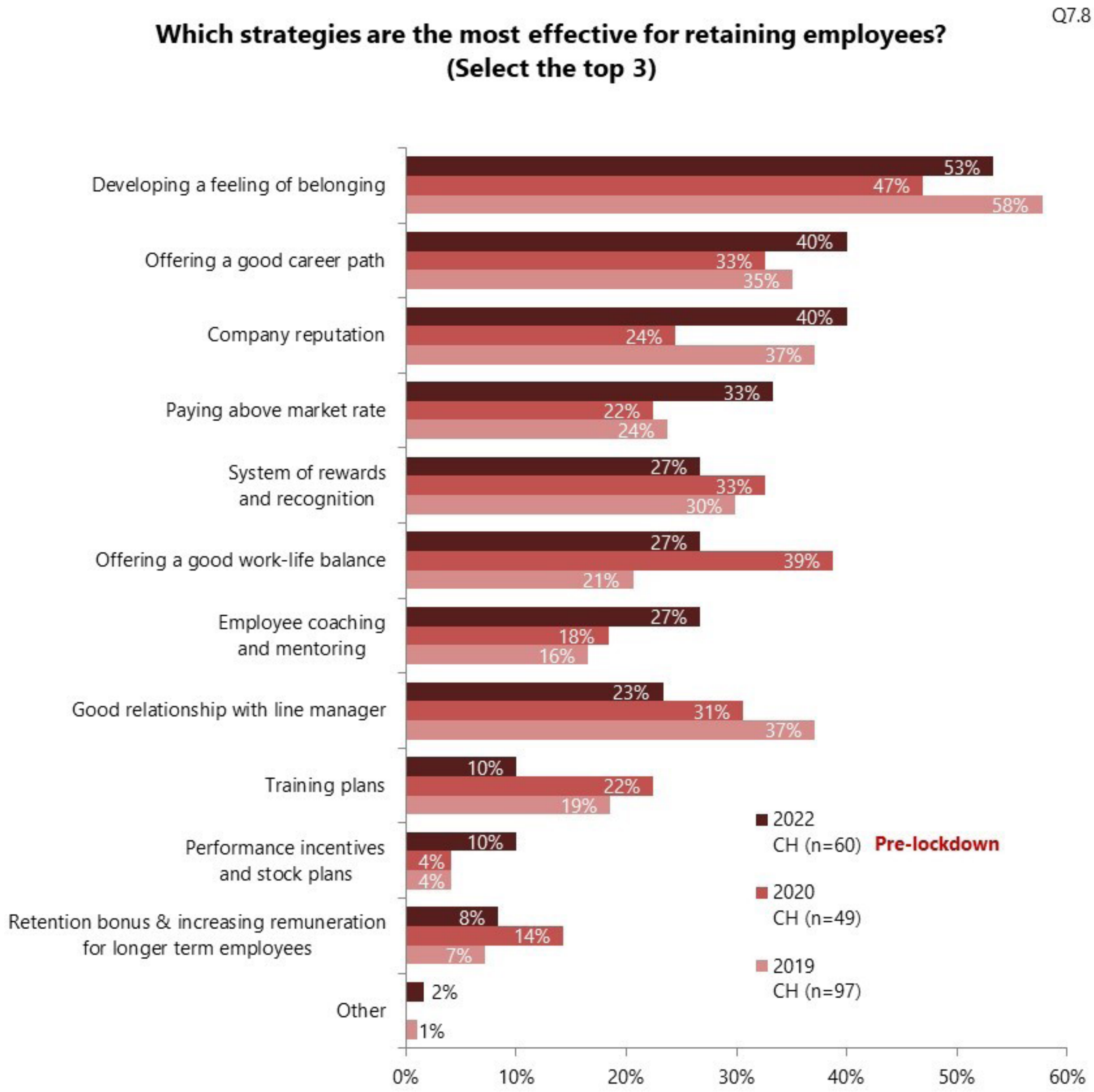


Figure 1.21: Most effective strategies for retaining employees

To retain personnel, managers of Swiss companies have consistently ranked "Developing a feeling of belonging" as the most important factor in the last three surveys.

"Offering a good career path" is the second most important strategy, but this year, "paying above market rate" has jumped in terms of significance (from 22% to 33%). This is consistent with the rise in labor costs, since progressing in ones' career includes promotion and receiving a higher salary. "Company reputation" has also increased in importance in this survey.

1.5 Perceptions of corruption

How serious is corruption?

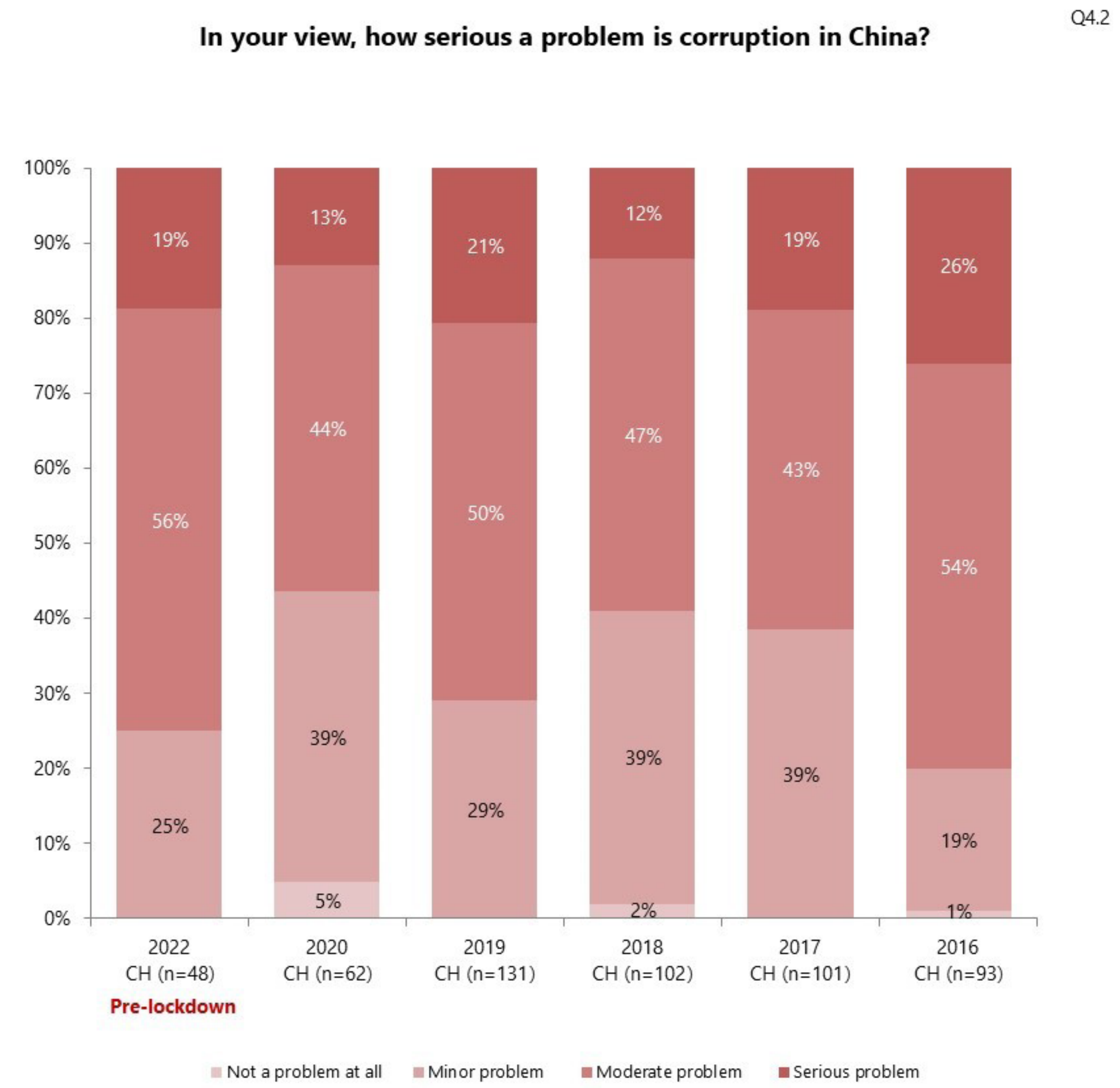


Figure 1.22: Perceptions of corruption in China

The overall perception of Swiss managers to corruption in China has been generally stable over the years, though in 2022 it has become an issue of growing importance. In fact, the percentage of respondents that viewed it as a serious or moderate problem are at the highest level seen since 2016.

Corruption within your industry in China

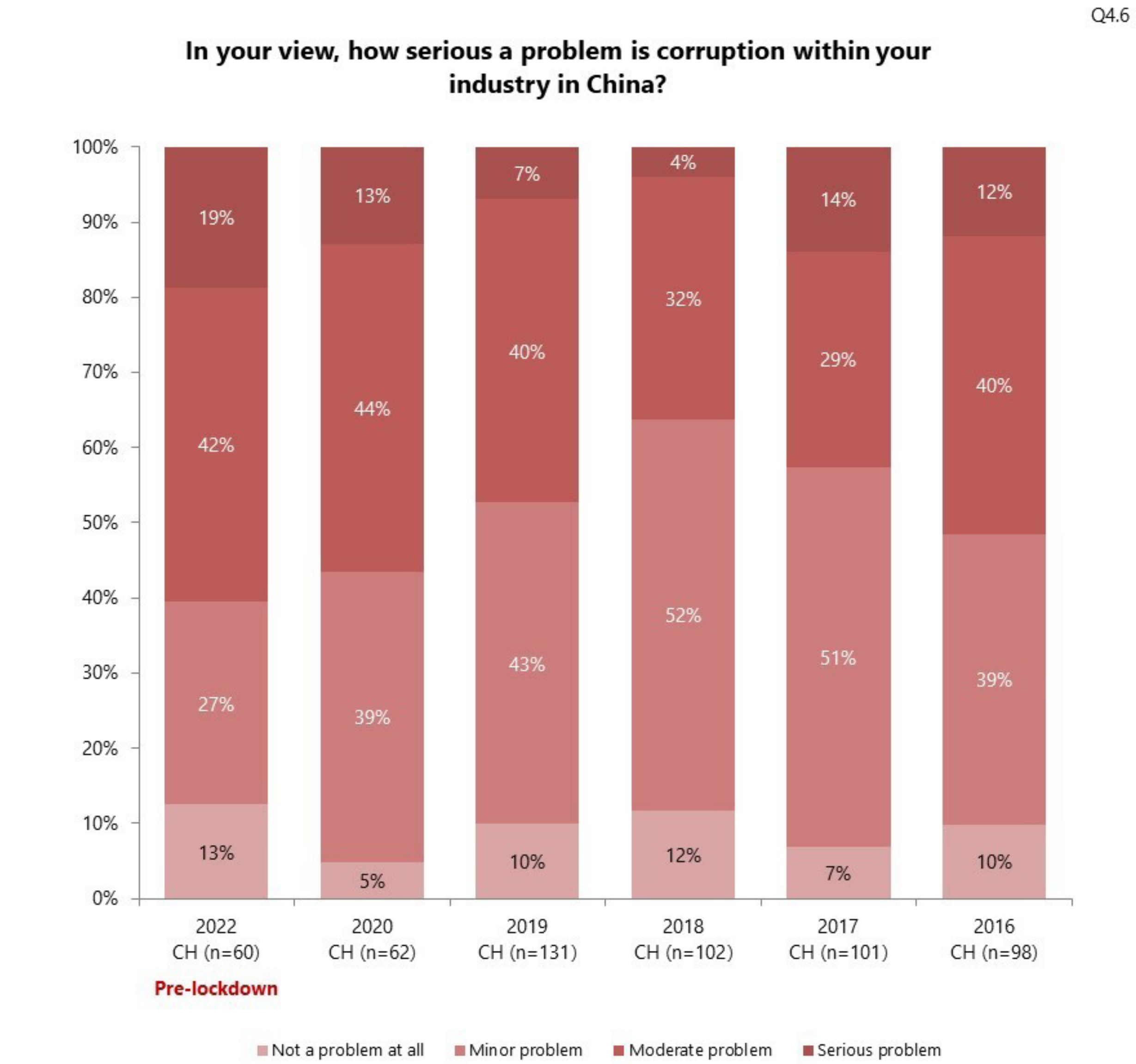


Figure 1.23: Perceptions of corruption in my industry

When respondents consider corruption in their industry, a clear picture appears to emerge. The 2022 responses show that perceptions of corruption as a serious issue are at an all time high. Taking into consideration the fact that respondents may have a more objective perception of what happens in their industry, this might indicate a reversal of the previous trend towards decreasing concern over corruption.

1.6 Business confidence

Confidence in operational success

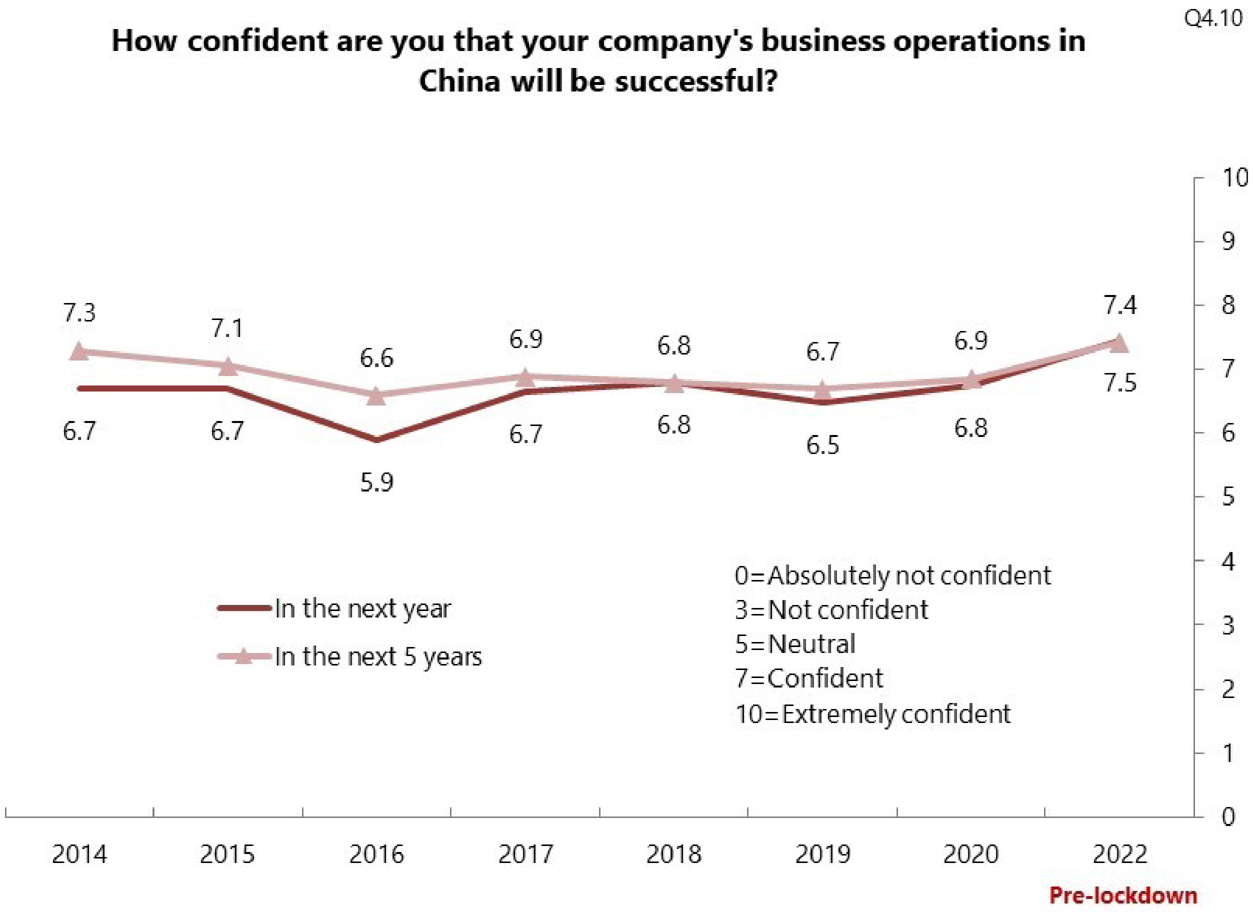


Figure 1.24: Confidence in China business operations success

As of March 2022, Swiss companies expressed historically high levels of confidence in their Chinese business. On a scale of 0 to 10, with 10 being "Extremely confident", the average confidence of the 60 respondents was 7.5 "in the next year", and 7.4 "in the next 5 years".

Key business environment factors

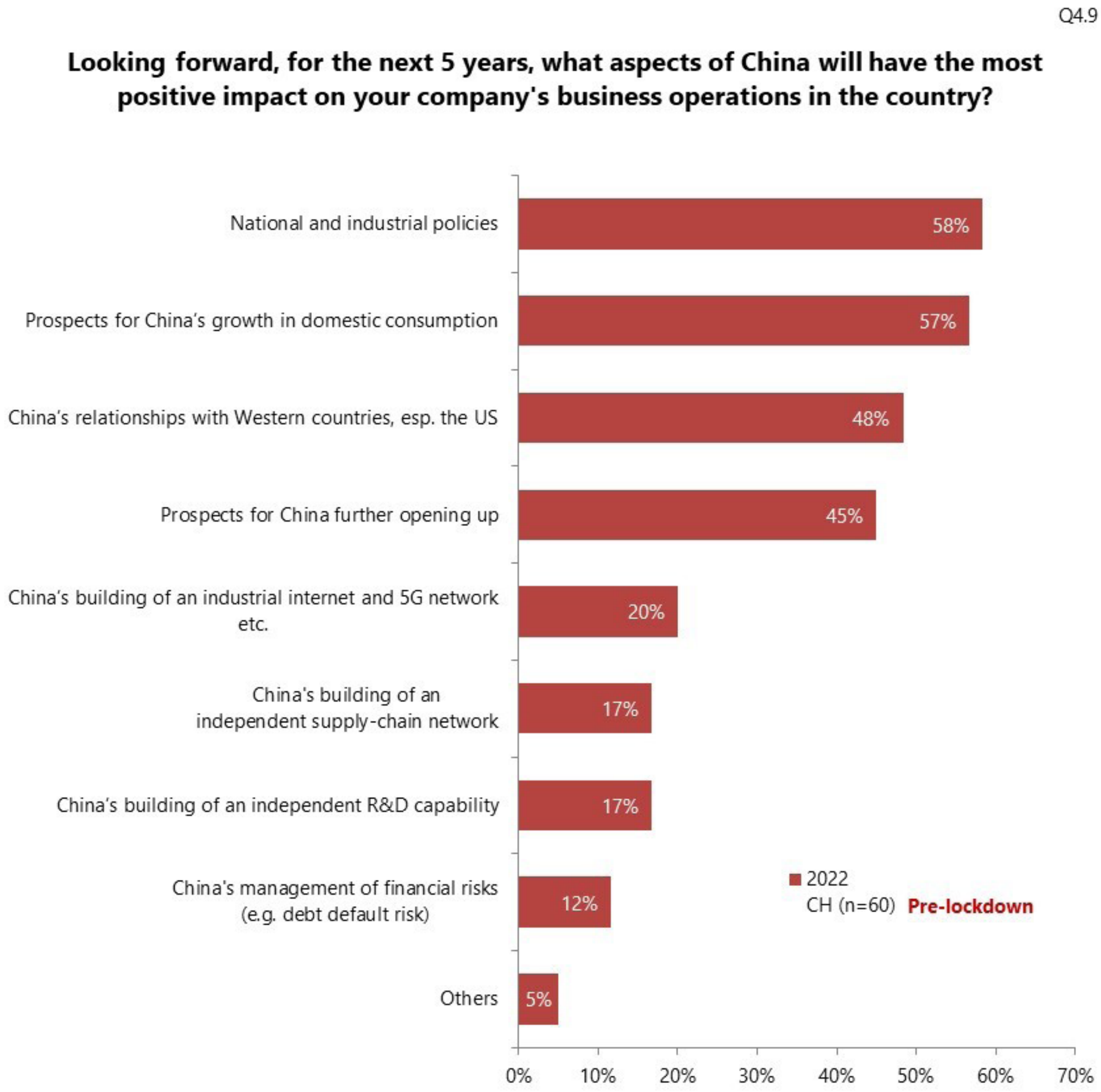


Figure 1.25: Positive business environment impact factors, next five years

Confidence in operational success may not be a surprise given the accelerating sales growth and profits reported by the companies. When respondents were asked for the factors in the Chinese business environment that would have a positive impact on their operations over the next 5 years, they highlighted "National and industrial policies" and "Domestic consumption" as key issues. Taken together, these responses may provide some clues to better understand the increasingly good results of Swiss companies in China.

Regarding national development policies, it must be noted that many aim at reducing China's dependence on foreign technologies, the best-known example of which is semi-conductors. However, at least as a first step, Chinese companies need to upgrade their production capabilities with high-level machinery and equipment. Swiss companies are particularly famous for such high-end equipment, having developed strong knowledge and competitive advantages. Most of them also benefit from the import duty exemption provided by the Sino-Swiss Free Trade Agreement.

In addition, the large number of Chinese middle-class families that now enjoy an increase in their purchasing power are looking for the best quality products that they can afford, while the affluent class increasingly looks for exclusive offers and customized experiences. Swiss consumer brands are also, traditionally, very well positioned to provide such high-quality and exclusive products.

It is also interesting to note that the next most important issues identified by Swiss companies that make them confident of a positive outlook for their businesses over the next 5 years are: "China's relationships with Western countries, especially the US", and the "Prospects for China further opening up". Much may depend on geopolitical developments in this regard.

2. Business sentiment flash survey, post-lockdown

PART II

While the results of the *Swiss Business in China Survey 2022* were being compiled, the Omicron variant of COVID-19 reached China and Shanghai experienced an unexpected lockdown lasting 2 months, from the end of March until June 1st. At the same time, partial lockdowns were implemented in Beijing and a range of restrictions also applied to many lower tier cities (including a complete 2-month lockdown of Jilin). All of this had a huge impact on people and companies in China and the resulting supply chain disruptions were felt worldwide.

To evaluate this impact, we decided to initiate a flash survey of 6 key questions that ran from June 6th to June 20th 2022, to allow us to present an updated, and in many aspects a very different, picture of Swiss companies in China and their business expectations.

2.1 Sales expectations for 2022 plummet

Company sales post-lockdown

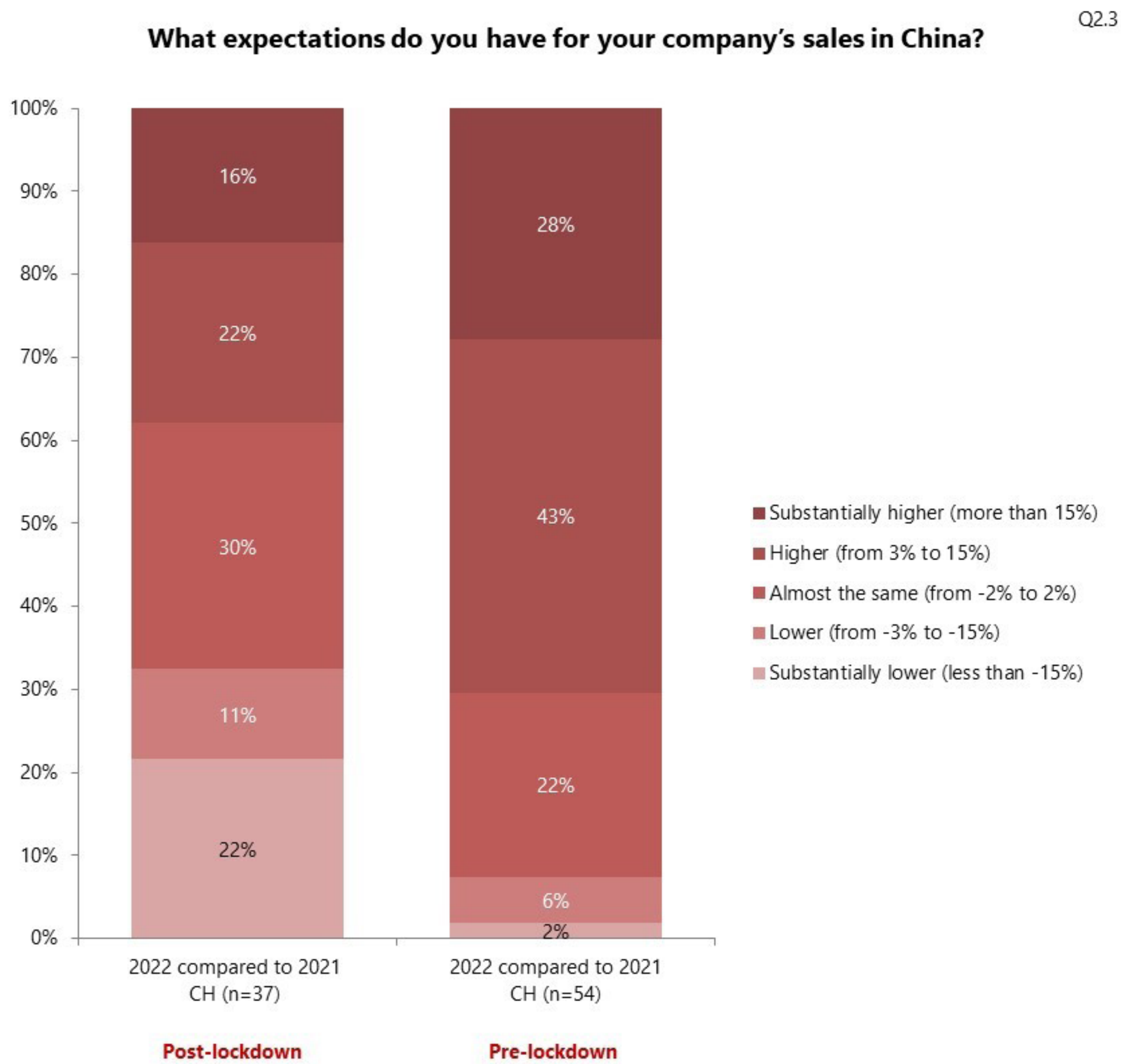


Figure 2.1: Sales growth expectations, post-lockdown

While 71% of respondents expected "Substantially higher" or "Higher" sales as of March 2022, only 38% answered in the same way post-lockdown. In addition, the proportion of companies that expected "Substantially lower" sales jumped to 22%, after being practically negligible in all previous surveys.

Impact of lockdown on sales

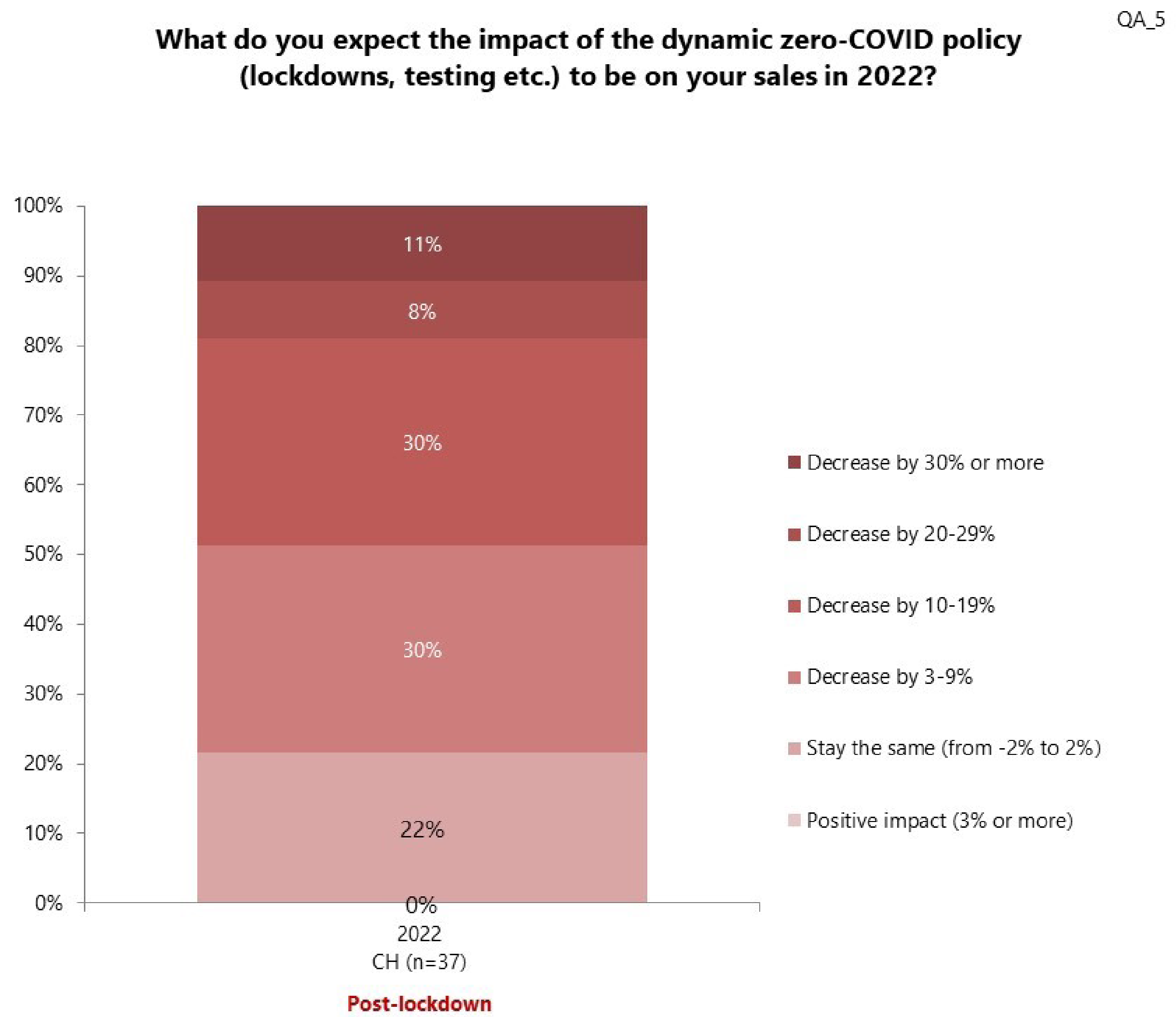


Figure 2.2: Impact of lockdown on sales

China's dynamic zero-COVID policy is clearly the cause of a change in business sentiment. There is a bleaker outlook overall, with nearly 80% of respondents expecting a negative impact on their sales due to the pandemic prevention measures.

2.2 Investment post-lockdown

Halting investments

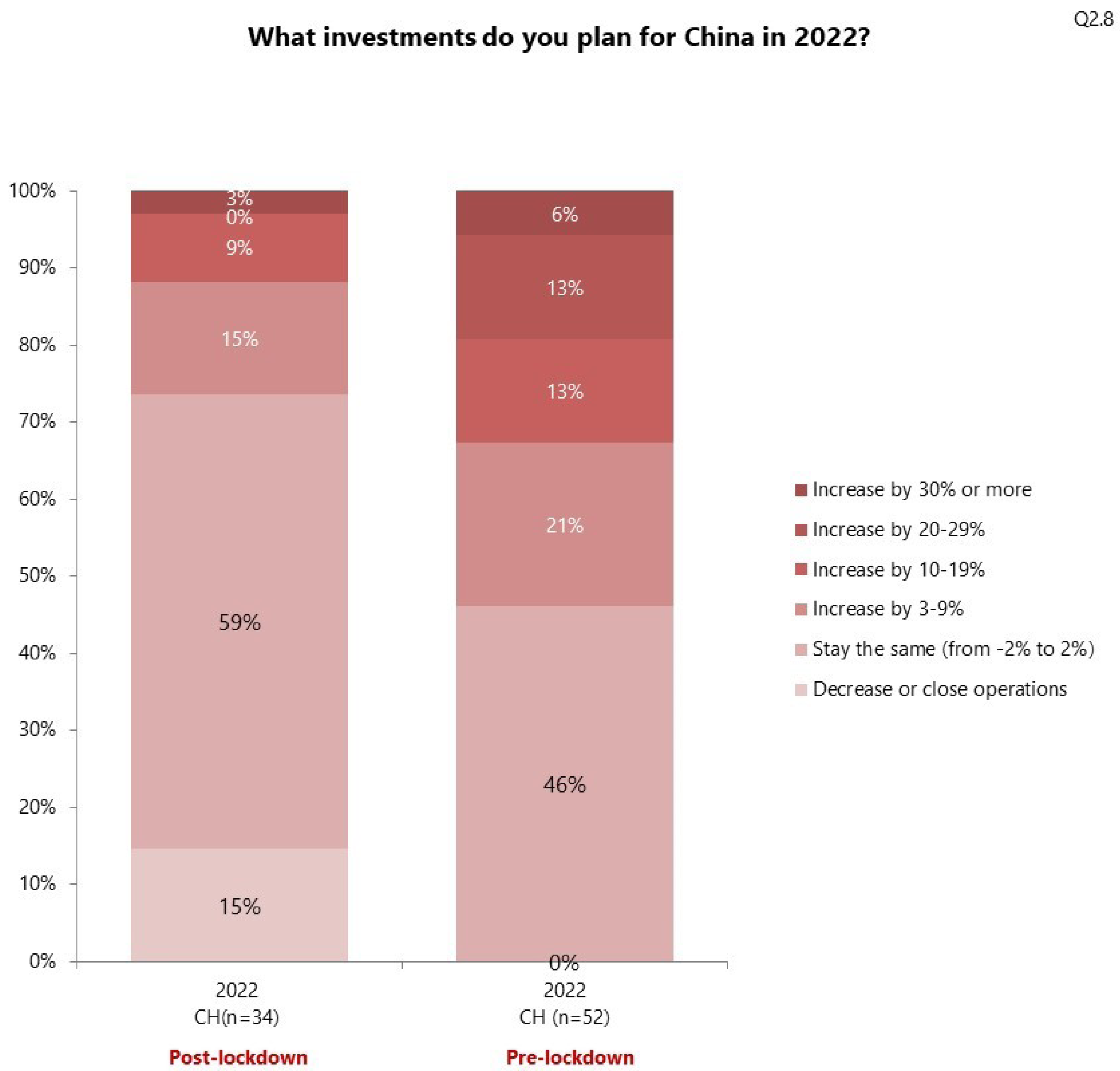


Figure 2.3: China investment plans, post-lockdown

For the first time since the *Swiss Business in China Survey* was conducted, a significant proportion of companies (15%) plan to decrease their investments or close operations.

While the plans of Swiss companies are still to increase investment overall, only about 27% of respondents are still planning to do so post-lockdown. This figure contrasts with the 54% that where planning to do so before the Shanghai lockdown.

2.3 Business confidence

Confidence drops post-lockdown

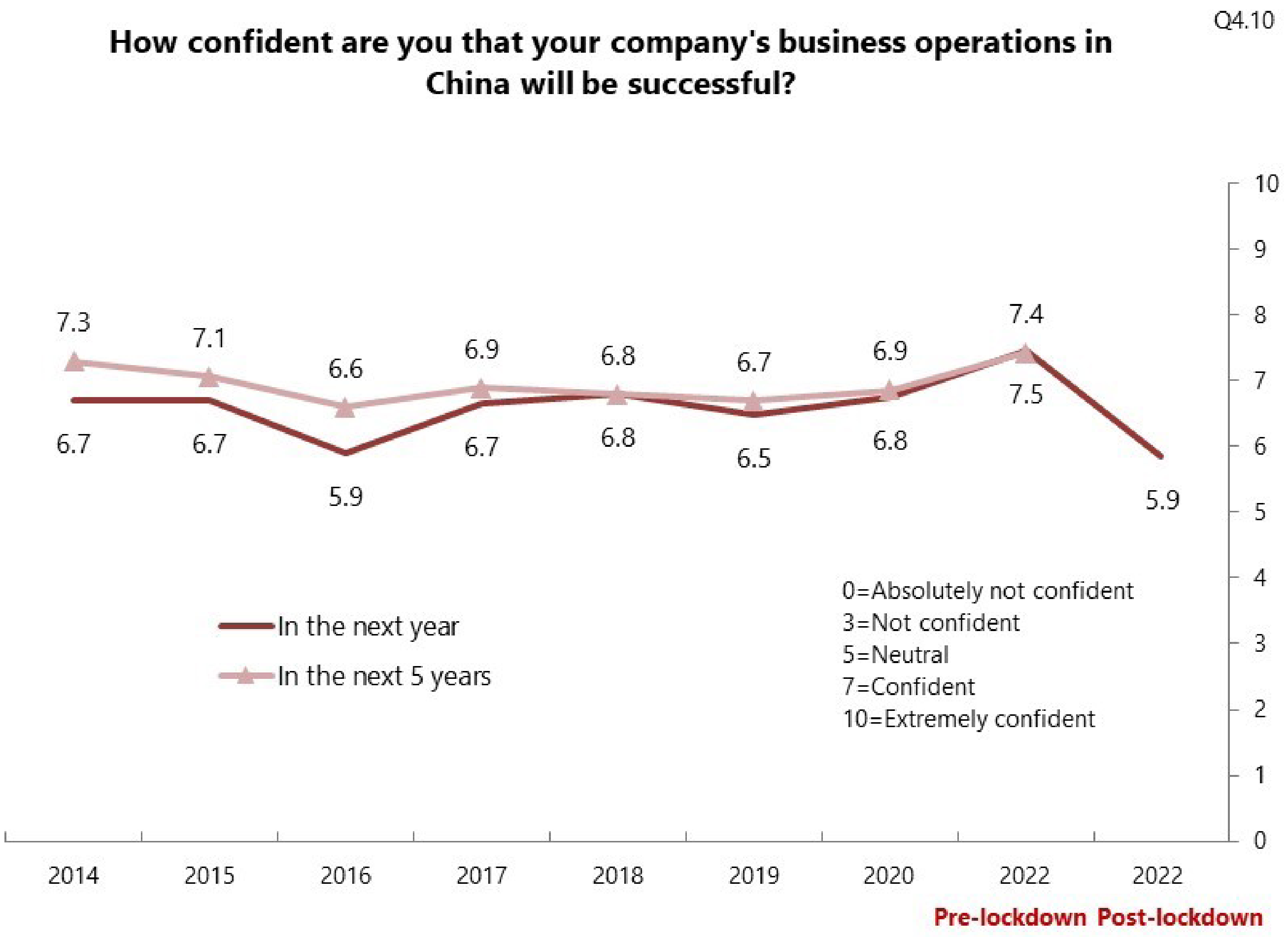


Figure 2.4: Confidence in the success of China business operations, post-lockdown

The business confidence level dropped significantly in the space of 3 months, following the record high-level reported in March 2022. That is, a confidence level of 7.4 (out of 10) plummeted to 5.9. This is as low as in the 2016 survey when there was great concern about an economic slowdown.

Geopolitical tensions

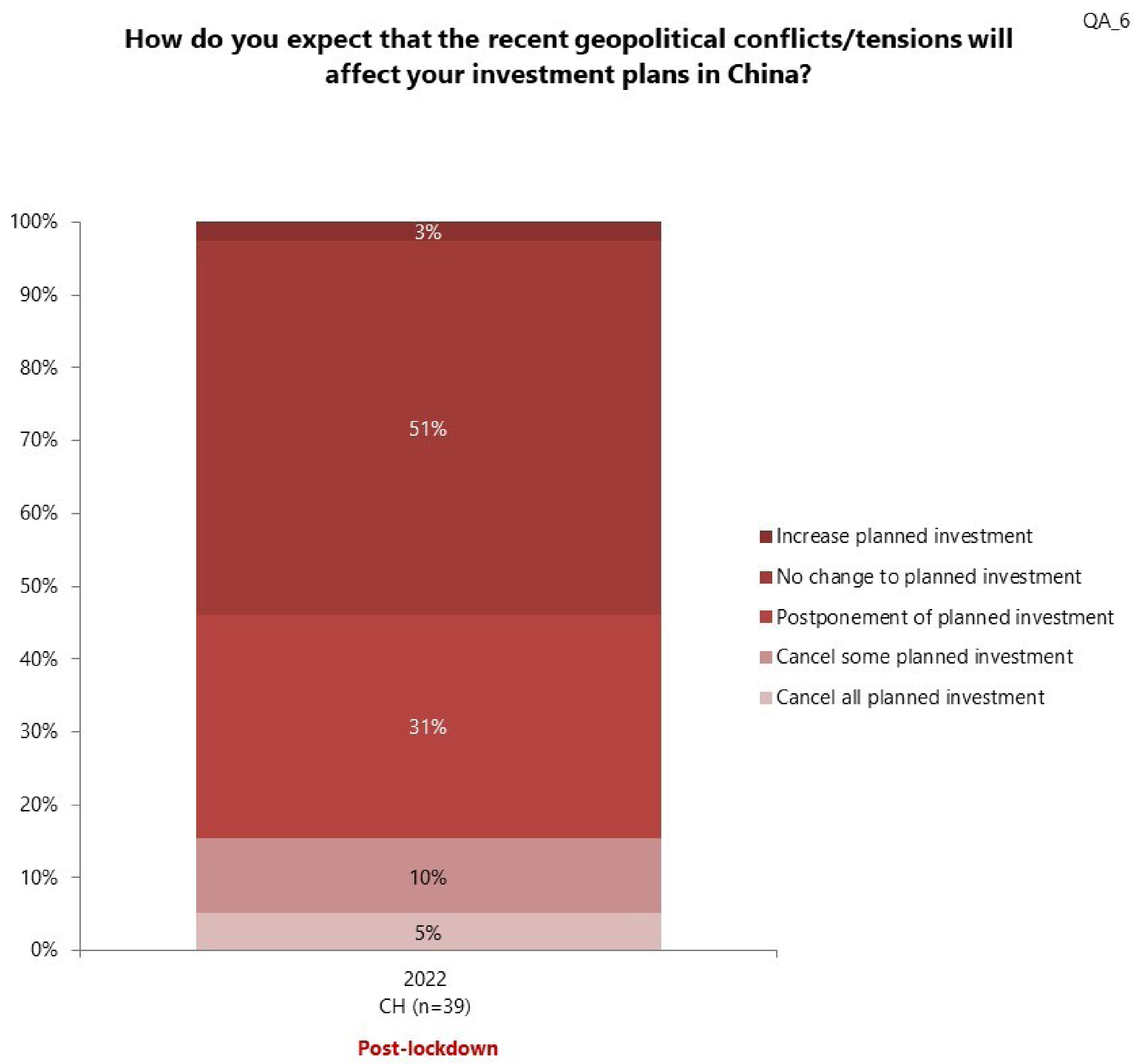


Figure 2.5: The impact of geopolitical events on China investment plans

The precipitous fall in business confidence is certainly the explanation for the drop in investment intentions. However, the Omicron outbreak and subsequent lockdowns may be only partly responsible for this lower level of confidence. Indeed, when asked about the impact of geopolitical tensions, 15% of respondents stated that this was a cause for their cancellation of all or part of their planned investments. In addition, 31% of respondents planned to postpone investments.

Satisfaction with the Chinese policy response to Omicron

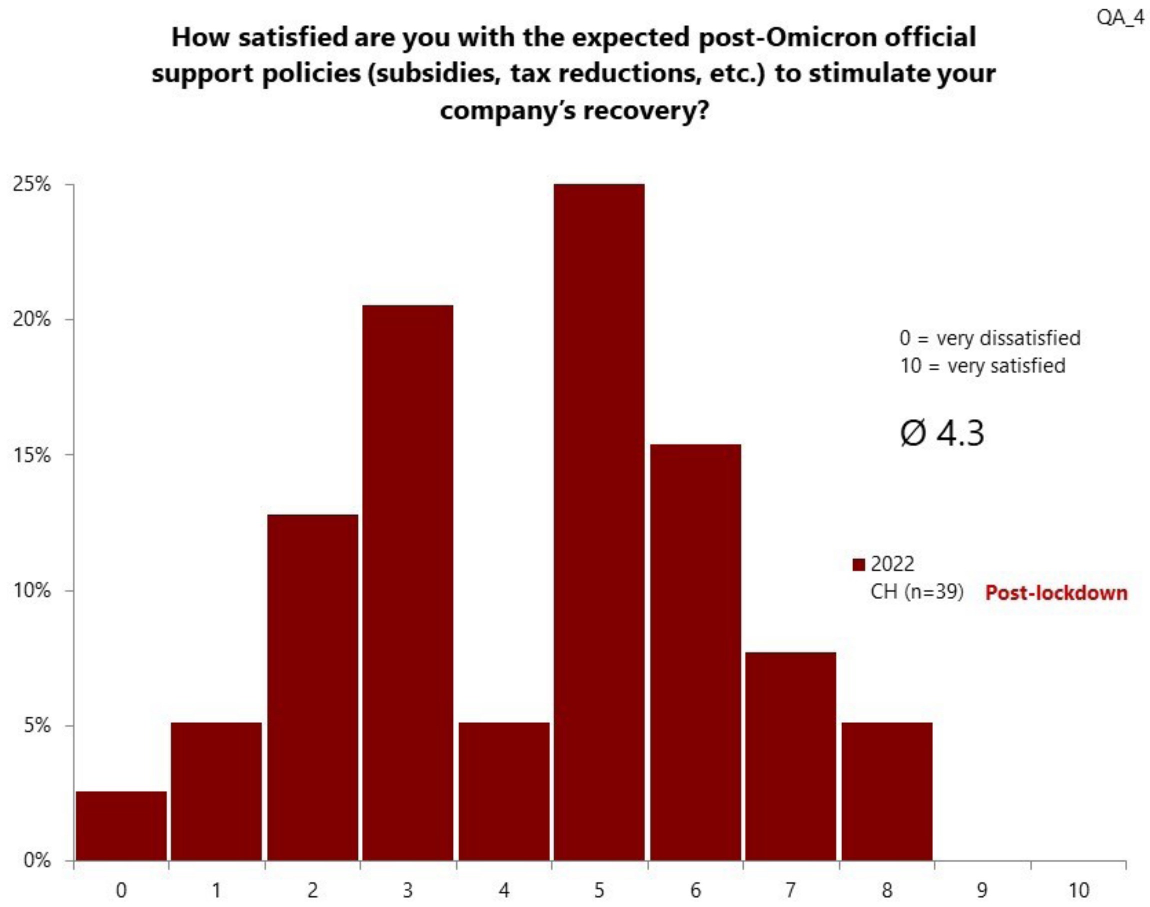


Figure 2.6: Satisfaction with post-Omicron support policies

When asked the question: "How satisfied are you with the expected post-Omicron official support policies (subsidies, tax reductions, etc.) to stimulate your company's recovery?", the responses were lukewarm at best, with an average score of 4.3 on a scale from 0 ("totally dissatisfied") to 10 ("completely satisfied").

All in all, the post-lockdown survey paints one of the bleakest pictures ever seen by Swiss businesses in China. We did not include a flash survey question on the expected confidence level over the next 5 years, as we intend to undertake the usual full survey from the end of 2022 to early 2023.

How the perceptions of managers of Swiss firms look at the end of this year will be critical in determining whether the current negative outlook is set to continue or there is a trend reversal.

PART III

3. Analysis and opinion

This closing part of the report provides analysis and opinion covering a range of different perspectives on doing business in China.

3.1 When will China re-open (if ever)?

Nicolas Musy, Founder of the Swiss Centers and CEO of China Integrated

On August 3, 2021, the well-known French magazine *Le Point* published an article entitled 'And if China stayed closed for ever'[1]. At the time, such an idea seemed very far-fetched. Today, despite the evolution of the zero-Covid policy into its current dynamic zero-Covid version, China's top leadership has left the world in no doubt that it is sticking to its intention of stamping out local transmission of the virus at, apparently, any cost.

Many, including the Director-General of the WHO, have voiced the opinion that this is not a sustainable policy. Indeed, it is rumored that Shanghai has spent RMB 300 million (over US$ 40 million) per day on PCR testing during its lockdown. Total economic costs have been estimated at US$ 46 billion per month, or up to 3.1% of China's GDP[2], which is almost double the official military expenditure of 1.7% of GDP[3].

This appears to exhibit a stubbornness that those that have watched or experienced the past decades of China's pragmatic, often very innovative, and mostly successful policy approaches have not been used to. Yet there are practical reasons and precedents that have influenced this decision.

As of January 23, 2022, the four waves of the pandemic that Hong Kong experienced before the appearance of the Omicron variant resulted in only 13,286 cases and 213 Covid-related deaths[4]. Less than 3 months later, on April 17, Hong Kong announced 1,197,825 cases and 9,139 fatalities[5].

This incredible hecatomb had two key causes: first, Omicron could not be contained and spread like wild fire through Hong Kong; and second, many elderly people were not vaccinated resulting in a fatality rate of almost 10% in people over 80 years old who were infected[6]. The reason for the high death rate among the elderly is itself two-fold: many did not get a vaccine at all, while the Chinese vaccines used in Hong Kong were not as effective as the Western mRNA vaccines. Indeed, the 0.31% death rate for those vaccinated with two doses of the Chinese Sinovac was 8 times higher than the 0.04% that died after receiving two doses of the BioNtech/Pfizer vaccine[7].

The situation in China is unfortunately very similar to Hong Kong. Only Chinese vaccines have been given to the population and many old people did not take them. The reason for this is counter-intuitive but simple to understand. When China started to vaccinate its population, the Wuhan lockdown had ended successfully and the pre-Omicron variants of the virus were practically eradicated in China. Local cases and infections were all traced to imported cases, which were also successfully eradicated.

As a result, the Chinese government decided to vaccinate younger, healthier age groups first to confirm that the vaccines were safe, beginning with 19-59-year-old citizens. However, seniors (and their children) concluded from this that there must be a risk for older people to take the vaccine. As there was no propagation of the virus in China, many decided that it was not worth taking such a risk.

In May of this year, a simulation of an unchecked Omicron outbreak in China concluded that 1.5 million Chinese citizens would die within 3 months, with a peak of 1 million emergency room beds needed while China has just 64,000[8].

While this number of Covid deaths in proportion to the size of the population would be a fraction of the rate of many developed countries (and particularly of the US), the stress on emergency rooms would replicate what happened in Wuhan in Spring, 2020 all over the country. In addition, the absolute number of deaths would completely negate the narrative of better pandemic management that China has communicated, both to its own population and to the rest of the world.

Under the circumstances, there is no other alternative than enforcing a strict zero-Covid approach to the pandemic, at least until the projected related deaths can be brought down to numbers similar to those of a typical flu season (about 88,000)[8], which could potentially be managed by the healthcare system.

Indeed, with the very high transmissibility of Omicron, it is difficult to imagine a 'half zero-Covid' policy. The only way to avoid an exponentially propagating wave, similar to the one experienced in Hong Kong, is to stop every transmission as early as possible.

Paradoxically, the higher transmissibility and lower mortality rate of Omicron led most of the rest of the world to abandon their Covid-related restrictions altogether, while forcing China to impose ever stronger ones. Abandoning the zero-Covid policy in an orderly way is therefore very problematic for China.

Some have argued that the leadership has no will to do so, both for political and economic reasons. It is implied that the government favors the current situation where the Chinese no longer travel abroad due to high international travel costs and strict quarantine requirements when returning. As a result, they go on vacation and shop exclusively in China, re-directing this part of their spending locally. At the same time, they are not exposed to Western information and ideas, allegedly allowing the government to better control the population's opinions.

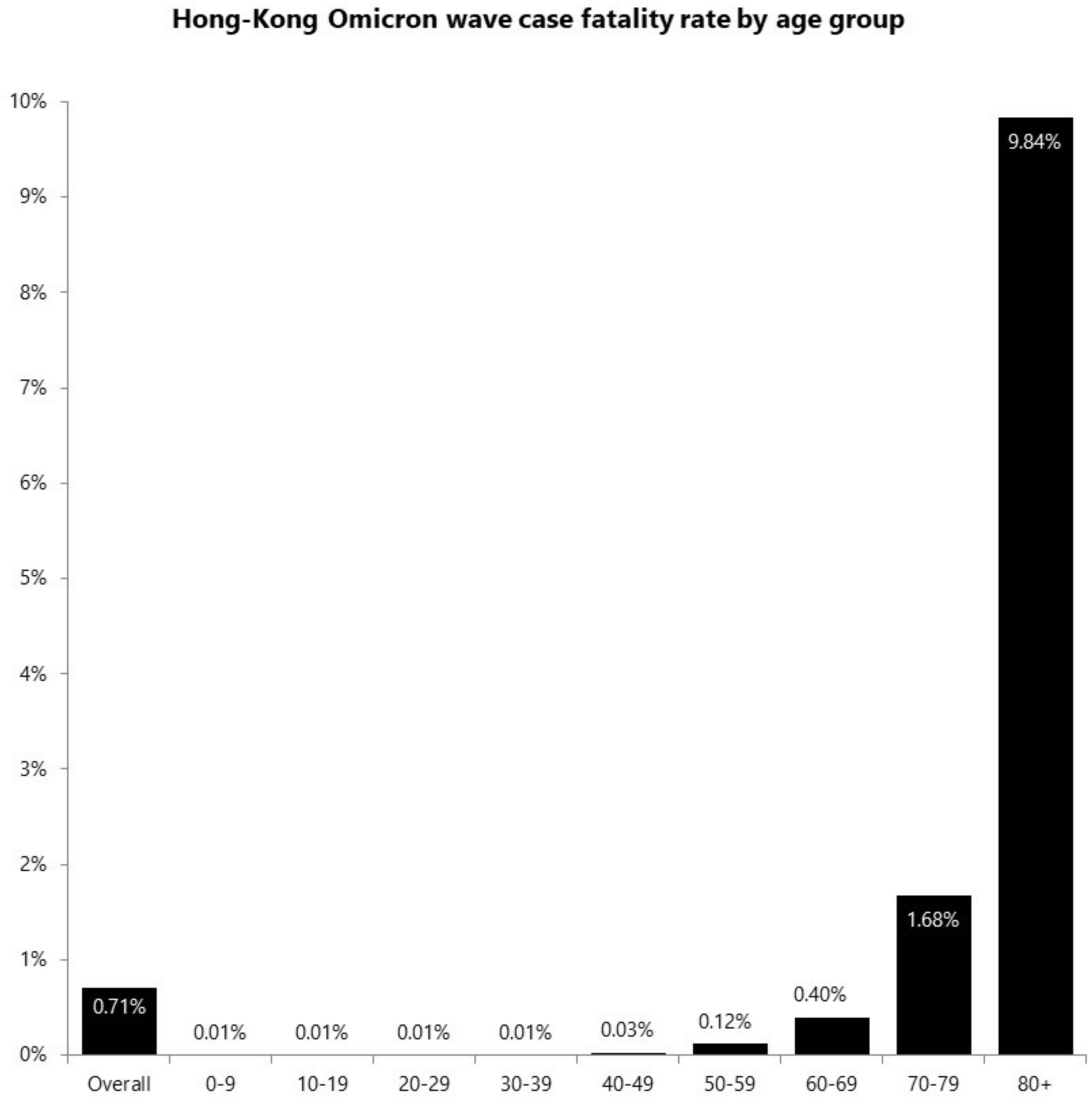


Figure 3.1: Hong Kong Omicron wave case fatality rate by age group (data based on Centre for Health Protection, infections and deaths from December 31, 2021 to April 6, 2022)

Yet, with constant lockdowns and local travel restrictions, it is more and more obvious that the economic costs of the policy are higher than its benefits. Besides, China had little difficulty in managing its population's ideas successfully before the pandemic began. Therefore, it is reasonable to believe that the practical challenges of breaking free from the current policy is the key reason for maintaining it.

So, how and when could China get out of its pandemic conundrum and re-open, as most of the rest of the world is doing?

I believe that it will depend on two key elements: the evolution of the virus itself, which should be more and more transmissible but could also become more or less fatal over time, and the speed with which China develops its own mRNA vaccines and anti-Covid medications. Should the virus become more dangerous, China will certainly increase restrictions. If not, the way out is through the development of effective vaccination and treatment capabilities, unless the virus weakens so much that the fatality rate becomes negligible.

A number of Chinese anti-Covid medicines are under clinical trial, though at the moment they are only intravenous and would need a hospital setting. Pfizer's Paxlovid anti-Covid pills have also now been approved for use in China, though there are no reports of widespread use and the drug's availability is still limited.

Most importantly, and for reasons not yet clear (though these are rumored to be political), China has not approved the BioNtech vaccine, despite a licensing agreement to produce and distribute it locally with the Fosun Group, a reputed Chinese pharma company. Should approval be given and the elderly population be strongly encouraged to take it, this will be a clear sign that China is moving towards an exit from the zero-Covid policy.

Of course, a vaccination drive to reduce the vulnerability of old people will take quite some time to complete, so it is difficult to imagine that the current approach will be abandoned in the next 12 months, at least. This does not mean that China will not loosen travel restrictions, but it is difficult to expect quarantine to be eliminated in the short term.

In summary, China is likely to remain caught between a rock and a hard place for some time. This will have a significant impact on the development of local consumption as well as on the willingness of businesspeople to travel to China. It will also probably have a negative impact on foreign investment, particularly if geopolitical tensions also remain high.

The next section aims to consider the consequences of the very particular and complex situation in which China finds itself.

References:

[1] André, J. (2021, August 3). Et si la Chine restait fermée pour toujours. *Le Point.* Retrieved from https://www.lepoint.fr/monde/et-si-la-chine-restait-fermee-pour-toujours-03-08-2021-2437723_24.php

[2] A paper by researchers from Tsinghua and Zhejiang universities on the mainland, Princeton University in the United States, and the Chinese University of Hong Kong, found that China's strict pandemic response is likely to cost at least US$ 46 billion per month (3.1 per cent of GDP) in lost economic output. Source: Zhuang, P. (2002, April 13). Shanghai lockdown tests limits of China's dynamic zero Covid-19 policy. *South China Morning Post.* Retrieved from https://www.scmp.com/news/people-culture/social-welfare/article/3173882/shanghai-lockdown-residents-fear-false-positive?module=perpetual_scroll_1&pgtype=article&campaign=3173882

[3] The World Bank. (2020). Military expenditure (% of GDP) – China. Retrieved from https://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS?locations=CN

[4] Yeo, R. (2022, January 23). Coronavirus: Hong Kong health expert warns of 'very high risk' to unvaccinated, seniors after cases detected at hospitals, homes for elderly. *South China Morning Post.* Retrieved from https://www.scmp.com/coronavirus/article/3164454/coronavirus-hong-kong-health-expert-warns-very-high-risk-unvaccinated

[5] Choy, G., & Yeo, R. (2022, April 17). Coronavirus: Hong Kong reports 747 new infections, fewest Covid-linked deaths in nearly 2 months, as residents enjoy Easter break. *South China Morning Post.* Retrieved from https://www.scmp.com/news/hong-kong/health-environment/article/3174572/coronavirus-hong-kong-confirms-747-new-covid

[6] Cheung, E. (2022, April 9). Why is Hong Kong's coronavirus death rate so high? Breaking down fatalities by age and vaccination status. *South China Morning Post.* Retrieved from https://www.scmp.com/news/hong-kong/health-environment/article/3173698/why-hong-kongs-coronavirus-death-rate-so-high

[7] Cheung, E. (2022, April 9). Why is Hong Kong's coronavirus death rate so high? Breaking down fatalities by age and vaccination status. *South China Morning Post.* Retrieved from https://www.scmp.com/news/hong-kong/health-environment/article/3173698/why-hong-kongs-coronavirus-death-rate-so-high

[8] Chik, H. (2002, May 11). Removing China's Covid controls could result in 1.5 million deaths, study warns. *South China Morning Post.* Retrieved from https://www.scmp.com/news/china/science/article/3177236/removing-chinas-covid-controls-could-result-15-million-deaths

3.2 Should I rethink my China strategy?

Nicolas Musy, Founder of the Swiss Centers and CEO of China Integrated

Unpredictability and risk hits business confidence and puts a hold on foreign investment

2022 has seen the largest drop in business confidence of international companies—whether they are Swiss, EU or US firms—working in China since the Asian financial crisis of 20 years ago. There is remarkable consistency among investors from these countries and regions in terms of reduced business confidence as is highlighted in the comparison between the EU and Swiss surveys (see Figures 3.4 and 3.5) and the US-China Business Council survey conducted in June, 2022 (see Figure 3.2).[1]

While China's zero-Covid policy has had a strong impact on sales expectations for 2022, it is geopolitical tensions that appear to weigh most heavily on the future investment strategies for Swiss companies, with 46% postponing or canceling their plans (see Figure 2.5). Unsurprisingly, US companies rank geopolitical tensions as the most impactful issue shaping their five-year outlook on business in China.

As for EU companies, the Flash Survey undertaken at the end of April shows that one third of companies felt that China was a less attractive destination for investment after the war in Ukraine broke out (EUCCC, 2022b, p. 9). It is also worth noting that this sentiment was recorded before tensions flared across the Taiwan Strait.

The diplomatic alignment between China and Russia and an unsuccessful EU-China summit on April 1st, 2022, characterized as a "dialogue of the deaf" by the top EU diplomat[2], were followed by increased military exercises and a hardening of China's policy on Taiwan before and after the early August visit of US House Speaker, Nancy Pelosi, to the island. China's policy changes included declaring that the Taiwan Strait can no longer be seen as international waters as well as omitting from an updated Taiwan policy that it would not station its own troops or civil servants on the island under its 'one country, two systems' reunification concept.

On the multilateral front, the United Nations Human Rights Office issued its assessment of "human rights concerns in Xinjiang", referring to potential crimes against humanity[3], unavoidably increasing negative perceptions of China in developed economies.

In Switzerland, the NZZ (Neue Zürcher Zeitung) reported that the country may also impose sanctions on China in the case of forced reunification with Taiwan.[4]

All in all, the zero-Covid policy and its repeated lockdowns, combined with the possibility of international sanctions against China due to a geopolitical crisis in Asia have injected a considerable dose of unpredictability into international business sentiment, both in terms of the sales potential of the Chinese market and the security of Chinese supply chains.

China is running on only two out of its four growth engines

On the economic side, China has been losing two of its key sources of growth. The real estate sector, generally considered to account for 25% of China's GDP, is in a latent crisis. In the first half of 2022, sales for China's 100 largest property developers fell by 50%, while a growing number of buyers who did not receive their pre-paid apartments on schedule are deciding to go on "mortgage strike".[5]

The other stalling engine of China's growth is domestic consumption. In the first half of 2022, retail sales were down by 0.7% on a yearly basis, and rose by only 2.7% year-on-year in the subsequent month of July[6]. In pre-pandemic years, retail sales have regularly grown by 8-10% a year.

This leaves China's GDP running on only two out of its four traditional engines: large government infrastructure projects, which increase the country's total debt, and exports, which grew strongly in June and July (by about 18% year-on-year).

While infrastructure projects are firmly in the government's hand, they are fueled by borrowing. China's total debt as a percentage of GDP is on a par with (if not higher than) the debt levels of developed economies[7].

As a consequence, the central leadership is pushing local governments to generate growth by their own means at a time when they are already burdened with extraordinary expenses to ensure a zero-Covid environment (see Section 3.1 above). This puts a limit on further debt-fueled government-generated infrastructure projects.

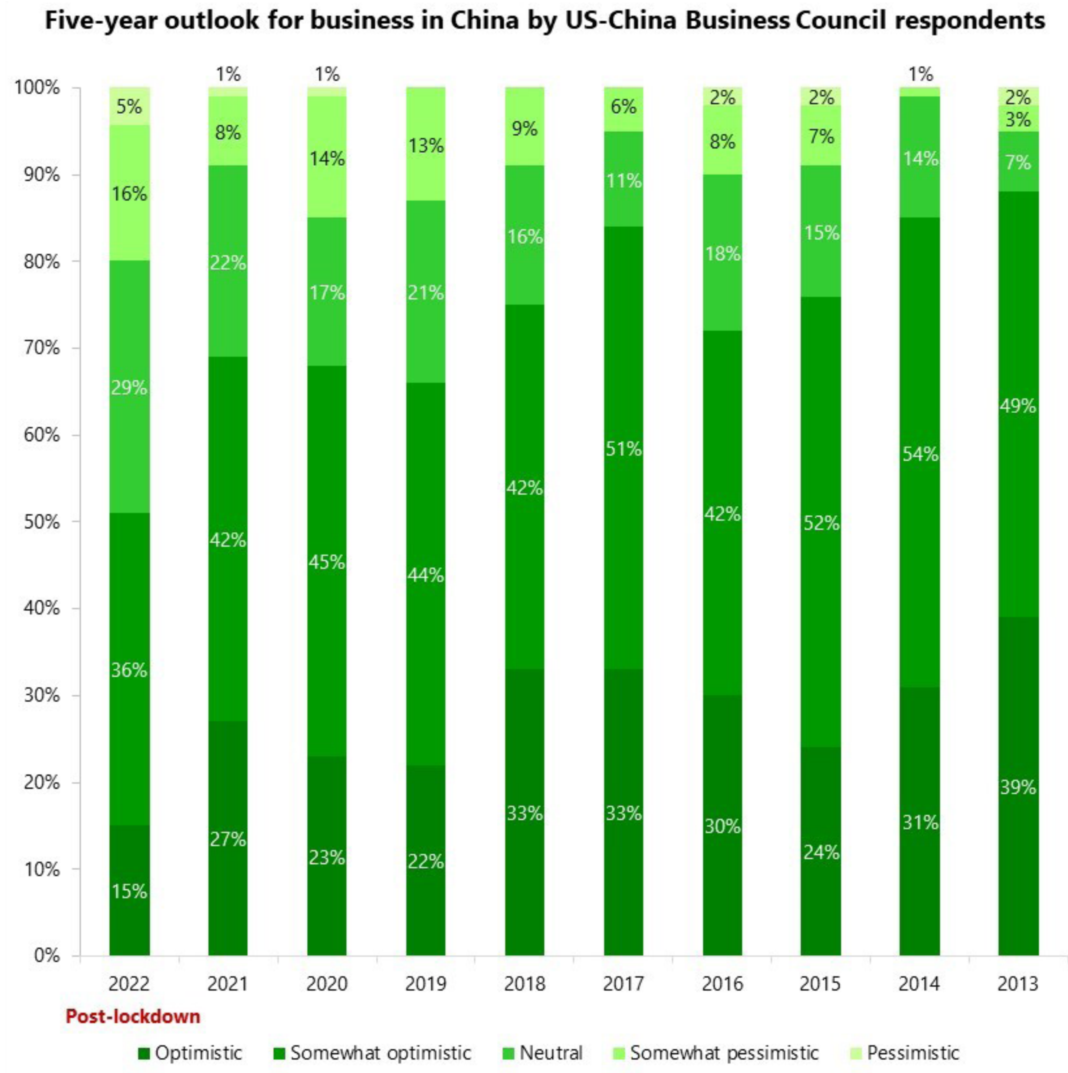


Figure 3.2: Five-year outlook for business in China by US-China Business Council respondents (data based on USCBS 2022 member survey, p. 11)

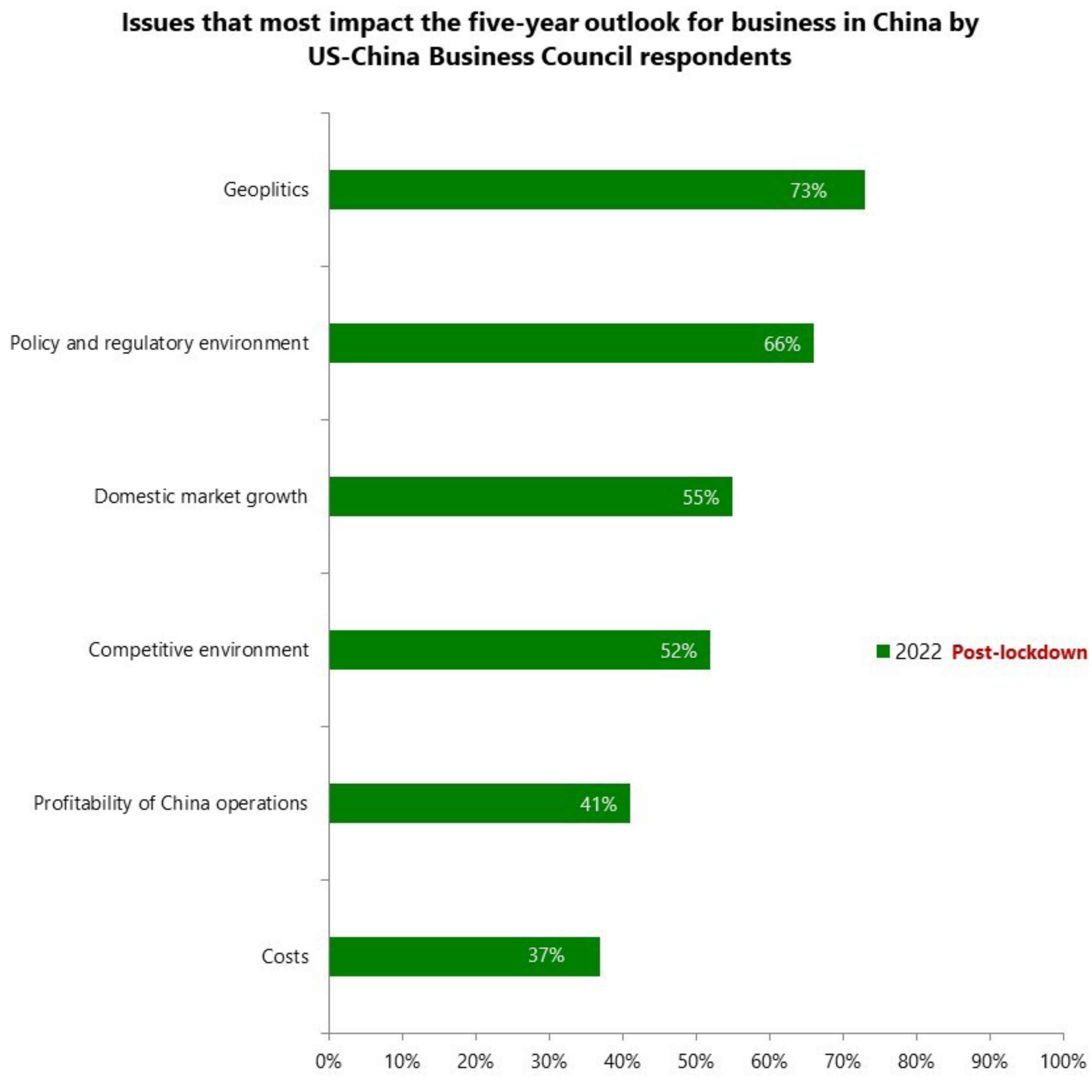


Figure 3.3: Issues that most impact the five-year outlook for business in China by US-China Business Council respondents (data based on USCBS 2022 member survey, p. 11)

A perfect economic storm

In a video speech to 100,000 government officials at the end of May 2022, China's Prime Minister, Li Keqiang, stated that: "The 8.1 per cent growth of China's economy last year was largely driven by foreign trade" and "we must recognize that 70 per cent of our manufacturing relies on imported parts, and that foreign trade generates direct and indirect jobs for 180 million people".[8]

Indeed, international firms generate about 36% of China's exports. Clearly, should the current negative business sentiment persist among foreign investors and international supply chains be diverted out of China, exports will be affected and growth will stall. China's economy would then be forced to run on the single engine of its infrastructure investments at a time when these are reaching their limits. The result could be that a perfect storm hits China's economy.

Under such circumstances, China's government is likely to make renewed efforts to support foreign investment and pay greater attention to avoid raising geopolitical tensions and being sanctioned by developed economies. Still, one should not expect the zero-Covid, Taiwan, or the technology self-reliance dual circulation policies to fundamentally change in the short term.

Facing new risks and opportunities, now appears to be the right time for foreign firms to review their China strategy!

References:

[1] The US-China Business Council. (2022). *USCBS 2022 member survey.* Retrieved from https://www.uschina.org/reports/uscbc-2022-member-survey

[2] Bermingham, F. (2022, April 6). EU-China summit was a 'dialogue of the deaf', says top Brussels diplomat. *South China Morning Post.* Retrieved from https://www.scmp.com/news/china/article/3173188/eu-china-summit-was-dialogue-deaf-says-top-brussels-diplomat

[3] UN Human Rights Office. (2022, August 31). UN Human Rights Office issues assessment of human rights concerns in Xinjiang, China. *Office of the High Commissioner for Human Rights (OHCHR)*. Retrieved from https://www.ohchr.org/en/press-releases/2022/08/un-human-rights-office-issues-assessment-human-rights-concerns-xinjiang

[4] Swissinfo.ch. (2022, July 30). Swiss set to match EU sanctions if China invades Taiwan - agency chief. *Swissinfo.ch.* Retrieved from https://www.swissinfo.ch/eng/swiss-set-to-match-eu-sanctions-if-china-invades-taiwan---agency-chief/47791976

[5] Wakabayashi, D. (2022, August 17). As China's economy stumbles, homeowners boycott mortgage payments. *The New York Times*. Retrieved from https://www.nytimes.com/2022/08/17/business/china-economy-real-estate-crisis.html

[6] China Internet Watch. (2022, August 15). China retail sales growth slowed to 2.7% in July 2022. *China Internet Watch.* Retrieved from https://www.chinainternetwatch.com/30910/retail-sales/#:~:text=In%20July%2C%20the%20total%20retail,billion%20yuan%2C%20up%201.9%25.

[7] Bloomberg News. (2022, July 6). China's debt to climb to record in 2022, government adviser says. *Bloomberg*. Retrieved from https://www.bloomberg.com/news/articles/2022-07-06/china-s-debt-to-climb-to-record-in-2022-government-adviser-says

[8] Luna, S. (2022, May 26). China aims to stabilise foreign trade, allay investor fears as Premier Li issues call to action. *South China Morning Post.* Retrieved from https://www.scmp.com/economy/china-economy/article/3179318/china-aims-stabilise-foreign-trade-allay-investor-fears

[9] Statistica. (2022, February 7). China: foreign companies share in import and export 1986-2020. *Statista.* Retrieved from https://www.statista.com/statistics/1288326/china-foreign-invested-companies-share-in-total-import-and-export/

3.3 How do Swiss businesses in China compare to their EU counterparts? Pre- and post-lockdown survey comparison

Tomas Casas-Klett, Director of the China Competence Center (FIM-HSG) and Wei Lin (FIM-HSG), University of St.Gallen

Foreign businesses surveyed by the European Union Chamber of Commerce in China and the *Swiss Business in China Survey*[*] in early 2022 were very optimistic about the prospects for their Chinese operations. About 60% of EU businesses expected improved sales compared to 2021 (EUCCC, 2022a, Figure 4), while over 70% of Swiss firms (Figure 1.1) did so.[**] These figures represented some of the most positive business sentiment of the last decade.

This positivity took a sharp turn for the worse when Omicron lockdowns were announced by the Chinese authorities in late March, as evidenced in two flash surveys carried out to measure their effects. The proportion of Swiss firms that expected revenue growth fell to below 40% (Figure 2.1), while almost 60% of EU businesses decreased their sales projections (EUCCC, 2022b, p. 4).

When asked to review 2021 in terms of profitability, both Swiss and EU businesses reported a positive balance. About 65% of Swiss enterprises reported increased profitability in 2021 (compared to 2019), as is depicted in Figure 1.2. In the EU survey, the question was formulated slightly differently, but the overall conclusion was similar with 79% of EU businesses reporting positive EBIT (EUCCC, 2022a, Figure 7). The surveys demonstrated regained confidence in China after a problematic 2020, blighted for both Swiss and EU businesses by COVID-19 (EUCCC, 2022a, Figure 9; Figure 1.24). However, it is clear that business confidence has now substantially deteriorated due to the recent rounds of lockdowns in China. Will that affect investment?

Pre-lockdown, Swiss firms in China were eyeing expansion, with more than half planning to increase investment, while no firm wished to decrease investment or close operations (Figure 1.3). Traditionally a little less enthusiastic than the Swiss, EU businesses still shared this basic optimism with only a modest 11% considering shifting investments out of China (EUCCC, 2022a, Figure 11). Post-lockdown, this positive outlook on FDI faltered drastically in the case of Swiss businesses, with only 27% still considering increasing investment (Figure 2.3). This post-lockdown chill is also evident in EU businesses that now view China as a less attractive investment destination. A quarter of EU firms (more than double the previous number) are now considering shifting investments out of China (EUCCC, 2022b, p. 5).

In terms of external challenges, both Swiss and EU businesses ranked rising labor costs and a tightening regulatory environment as top concerns. Swiss firms saw increased challenges from fierce competition while their EU peers were more concerned with the economic slowdown (EUCCC, 2022a, Figures 3 and 20; Figure 1.15). Questions were also posed on likely impacts of recent geopolitical tensions. Here, a small proportion of companies plan to shift their investments out of China; that is, 7% of EU companies (EUCCC, 2022b, p. 9) and 5% of Swiss companies (Figure 2.5). When asked about the ease of doing business, which might also be construed as having a geopolitical connection, the results differ. About 20% of Swiss companies feel that it has become more difficult to do business in China, a percentage that has been fairly stable over the past four years. In contrast, almost three times as many EU companies reported that it has become more difficult for them to do business in China in 2022 (see Figure 3.6).

In terms of the internal challenges that firms face, both Swiss and EU enterprises identified soaring labor costs and difficulties in finding and retaining the right talent as a universal concern (EUCCC, 2022a, Figure 20; Figure 1.16). The Swiss survey revealed that employee retention has become a major HR issue for over 50% of Swiss firms, similar to the percentage reported by EU businesses in China (EUCCC, 2022a, Figures 23, 24; Figure 1.17). Moreover, EU firms emphasized that the conundrum of finding and retaining the right talent is in part attributable to work permit restrictions exacerbated by COVID-induced entry restrictions (EUCCC, 2022a; Figures 23, 24).

In summary, the surveys show that the impact of strict zero-COVID policies, the increasingly grave geopolitical situation, and the general macroeconomic environment, have reversed the very promising level of business confidence at the start of the year. The *Swiss Business in China Survey* shows that, by the middle this year, about 70% of Swiss businesses expected negative sales growth for 2022, with almost 50% of Swiss firms anticipating revenue decreases of over 10%. These are unprecedentedly low estimates for Swiss businesses in China. In a similar vein, almost 60% of EU firms are cutting their revenue projections by over 10% (EUCCC, 2022b, p. 4). As business confidence is an essential indicator, what is the ultimate signal sent by the surveys?

As Figure 3.4 on the next page shows, as the year progressed, Swiss businesses lost confidence, but not precipitously. For EU businesses, the drop is more severe (our interpolation is made on the basis of EUCCC, 2022a, Figure 9, 2022b, p. 4). However, despite all of the challenges, it is important to note that China remains one of the top three FDI destinations for a majority of Swiss and EU companies (EUCCC, 2022a, p. 12; Figure 1.4 and Figure 3.5). Thus, the big question ahead is: will business sentiment quickly recover this lost ground when COVID-19 policies loosen up and the geopolitical and general global business environment improves?

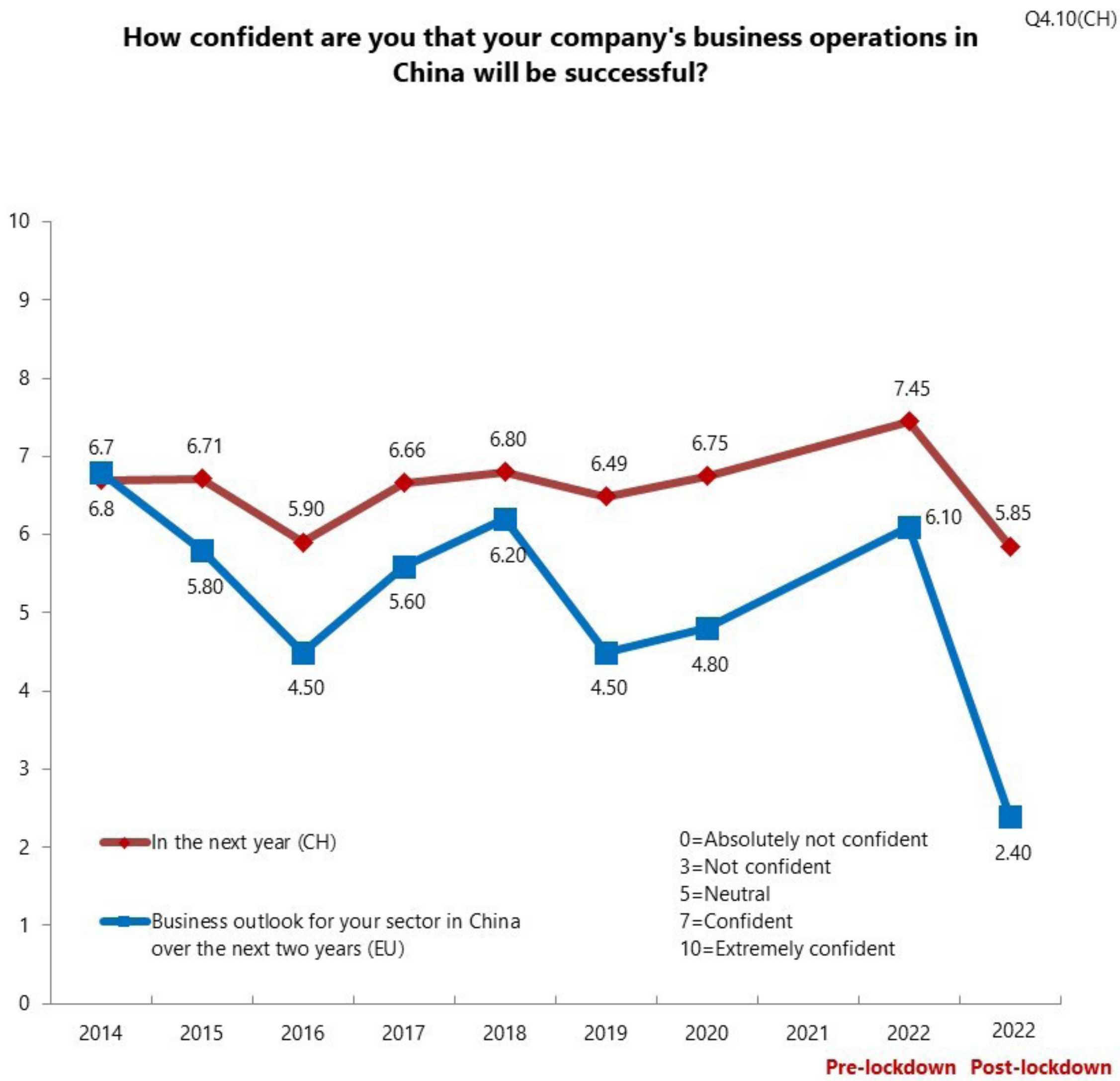


Figure 3.4: Confidence of Swiss and EU businesses in China

* The EU Chamber of Commerce in China Survey 2022 took place from February to March 2022, with 620 European corporations participating (EUCCC, 2022a, p.46). The Flash Survey was conducted in April 2022, with 372 companies responding, to incorporate opinions on how recent geo-political events (e.g., the Omicron lockdowns, the Russia-Ukraine conflict) may have affected the business confidence of EU corporations doing business in China (EUCCC, 2022b, p.11). In comparison, the Swiss dataset contains responses from between 30 and 60 companies depending on the specific survey question.

** Note that the survey questions underlying these results and comparisons were similar but not equivalent, with the EU survey asking for realized changes in revenue and the Swiss survey for estimated projections.

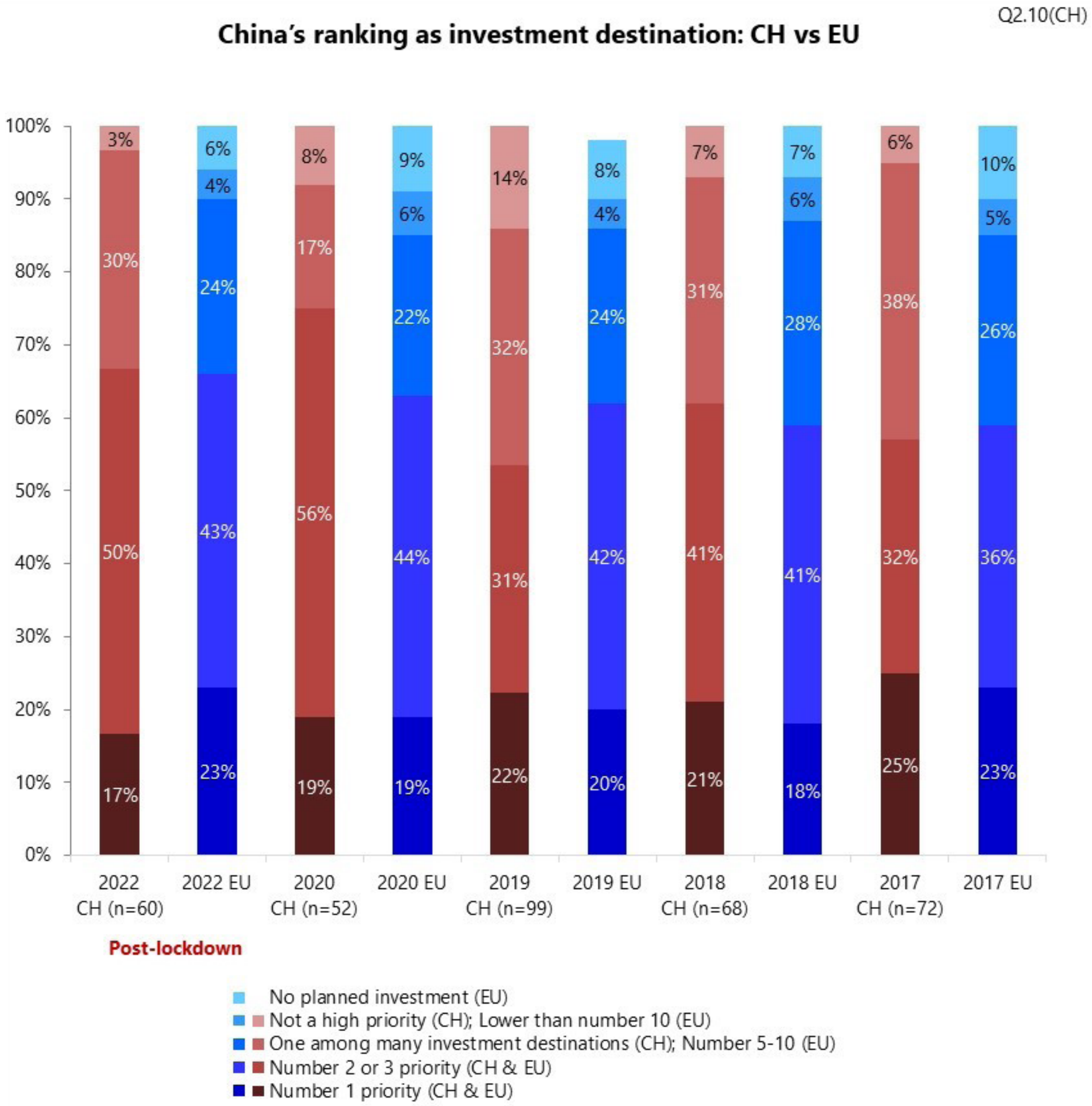


Figure 3.5 China's ranking as investment destination: CH vs EU. Sources: EUCCC, 2022a, p. 12 and Figure 1.4

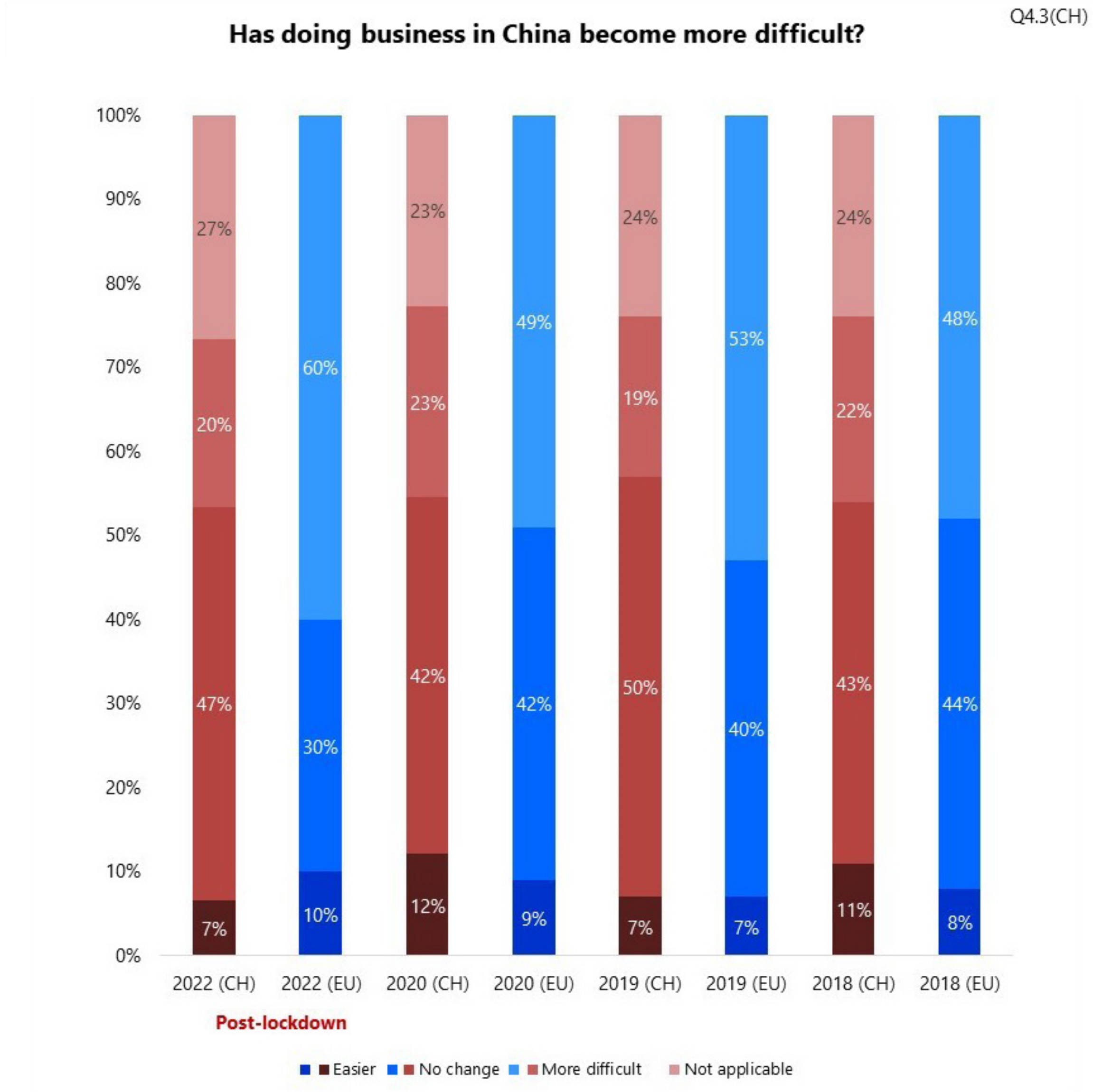


Figure 3.6: Has doing business in China become more difficult? Sources: EUCCC, 2022a, p. 12 and survey question Q4.3

References:

- European Union Chamber of Commerce in China (2022a, May). Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China. Retrieved from: https://www.europeanchamber.com.cn/en/publications-archive/973/Flash_Survey_COVID_19_and_the_War_in_Ukraine_The_Impact_on_European_Business_in_China

- European Union Chamber of Commerce in China (2022b, June). European Business in China Business Confidence Survey 2022. Retrieved from: https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022

3.4 The two different business environments in China: Impact on Swiss companies

Patrick Ziltener, Professor, University of Zurich

Almost half of the Swiss companies in this survey identified "Government policies, regulatory environment & barriers" as a significant challenge (Figure 1.9) to doing business in China. When they were asked about their experiences concerning major regulatory challenges, 61% mentioned "Frequent modification of policies and lack of communication and transparency" as a key problem (Figure 1.15). What exactly should Western companies in China be concerned about when it comes to Chinese government policies?

In an analysis of the state of China's current innovation ecosystem conducted between September 2021 and April 2022, the European Union Chamber of Commerce in China and the Mercator Institute of China Studies (Groenwegen-Lau & Gunter, 2022) identify two diverging sets of conditions under which Western companies do business in China. On the one hand, there are companies that enjoy more or less unfettered access to a basically open market, some even receiving 'red-carpet treatment' for their activities in China. On the other hand, companies active in sectors that are under increasing pressure from China's state-planners find themselves in an unwelcoming business environment that makes them feel they are no longer wanted as competitors to national champions. An example of such a sector is information and communications technology, where foreign companies are the most pessimistic about their outlook. These two different business environments impact the behavior of the Western companies, especially with regard to their research & development strategies and the protection of intellectual property, with some even keeping core technologies and innovations in their home markets to limit leakage.

This situation, of course, is related to the 'Made in China 2025' initiative, launched in 2015, the Chinese government's industrial policy aimed at rapidly developing its advanced manufacturing base and expanding its high-tech sectors. It was drafted by the Ministry of Industry and Information Technology (MIIT) over a two and a half year period and with inputs from 150 experts at the China Academy of Engineering (Kennedy, 2015). The policy includes a wide range of measures and tools, from government subsidies (with some estimates putting these in the range of the hundreds of billions of dollars), mobilizing and guiding state-owned enterprises, and pursuing intellectual property acquisitions from Western companies, not only in China, but also in their host countries. The main focus is on sectors that are considered to be crucial in the ongoing '4th Industrial Revolution'. The plan lists 10 priority areas:

1) New advanced information technology;
2) Automated machine tools & robotics;
3) Aerospace and aeronautical equipment;
4) Maritime equipment and high-tech shipping;
5) Modern rail transport equipment;
6) New-energy vehicles and equipment;
7) Power equipment;
8) Agricultural equipment;
9) New materials; and
10) Biopharma and advanced medical products.

'Made in China 2025' set specific targets: by 2025, China aims to achieve 70% self-sufficiency in high-tech industries, and by 2049—the 100th anniversary of the People's Republic—Chinese companies active in these areas should have achieved leading positions in the global market.

The initiative was neither completely new, nor will it be the last program of its kind, but 'Made in China 2025' significantly accelerated pre-existing efforts by the Chinese government to invest more resources and intensify centralized policy planning to coordinate actions across government, private companies, and academia. As a result, complaints by Western companies (that pre-date 2015) about the asymmetry of a system in which China is largely free to invest in foreign countries and take over foreign companies, but foreign companies selling to and operating in China are highly constrained by investment requirements and other regulations, have intensified. These complaints have led to a downplaying of the initiative by the Chinese government and more self-restraints in company take-overs, but not to a significant change in the level of ambition or the measures applied. Wübbeke and his co-authors suggested in 2016 that depending on the degree to which China's own smart manufacturing capabilities mature, it will be "more likely that the Chinese state will further step up its discriminatory practices and restrictions of market access in the field of smart manufacturing" (Wübbeke, et al., 2016, p. 7).

What does this all mean? Western firms will continue to operate under two diverging sets of conditions when doing business in China and it is clear that Swiss companies must understand the shifting terrain they are playing on. After all, this will determine both their strategy and performance in the years to come.

References:

- Groenwegen-Lau, J., & Gunter, J. (2022). *China's innovation ecosystem: Right for many, but not for all.* Beijing/Berlin: European Union Chamber of Commerce in China/Mercator Institute of China Studies (MERICS). Available at https://merics.org/en/report/chinas-innovation-ecosystem-right-many-not-all

- Kennedy, S. (2015, June 1). Made in China 2025. *Center for Strategic and International Studies (CSIS).* Retrieved from www.csis.org/analysis/made-china-2025

- McBride, J., & Chatzky, A. (2019, May 13). Is 'Made in China 2025' a threat to global trade? *Council on Foreign Relations (CFR).* Retrieved from www.cfr.org/backgrounder/made-china-2025-threat-global-trade

-Wübbeke, J., Meissner, M., Zenglein, M.J., Ives, J. & Conrad B. (2016). *MADE IN CHINA 2025: The making of a high-tech superpower and the consequences for industrial countries.* MERICS Papers on China No. 2, Berlin.

3.5 Deglobalization is not an option: International business is a global public good in a time of critical junctures

Tomas Casas-Klett, Director of the China Competence Center (FIM-HSG), University of St.Gallen

Taking a step back from the survey the reader might well ask a key strategic question of international business: whether now is a time to intensify or halt investments and business expansion in the Chinese market. This question will invariably be mediated by the elephant in the room, the possibility of a progressive decoupling between the West and China. Given the four earlier articles of this section, few would disagree that we have entered a critical juncture where two divergent paths lie ahead. One leads to a world that fragments and splits into antagonistic blocks. The opposite path sees efforts to stabilize the global political economy, anchored by credible international institutions and a doubling down of globalization by value-maximizing business interests.

The practical business question

The practical question for the Swiss businessperson is whether to increase or decrease their commitment to China, which links to the question posed at the end of Section 3.3. Answering this question will depend on two criteria. The first is strictly business orientated and requires an assessment of China's economic vitality and the intrinsic opportunity set it provides for foreign firms. The second is political and geopolitical, and requires consideration of the decoupling issue. With regard to the first criteria, and consistent with the outcomes of the flash survey presented in this work, many will ask whether an inflection point was reached in 2022 and the eternal Chinese growth story has now been relegated to the past. Contextualizing this sentiment in terms of hard GDP growth might be helpful. As shown in Figure 3.6, the IMF expects China to record growth of 3.3% for 2022, lower than the original goal of 5.5%, while the actual numbers might end up being even lower. What should Swiss businesses expect after the *annus horribilis* of 2022?

All that is good starts with reform

Those waiting to see whether China will bounce back to the 4.6% growth rate for 2023 predicted by the IMF will watch next year with trepidation (see data in Figure 3.7). Chinese economists often emphasize that with the lockdowns and the turbulent international waters of this year, a growth rate between 2% and 3%, while certainly disappointing, is also a testimony to the resilience of China's economy, not of its weakness. In this view, the glass is half full. Moreover, China's economy has already recently proven that it is able to bounce back from adversity; the first pandemic year of 2020 saw record low growth of 2.2%, quickly followed by an extraordinary 8.1% growth rate in 2021. This stellar showing also accounts for the highest ever confidence levels recorded by Swiss firms in China that are evident in the pre-lockdown 2022 survey of this report (see, for instance, Figure 1.24). Looking forward, what must happen to realize China's economic promise?

According to both foreign and Chinese experts, a post-Omicron opening up and structural reform are essential. For context, China's nominal GDP per capita (US$ 19,338) is about a quarter of that of Switzerland (US$ 77,324)[1], while in terms of purchasing power parity (ppp) China stands at about one eighth of Switzerland (US$ 12,556 vs US$ 93,457)[2]. Hence, robust growth is possible, if, and only if, there is change. Jörg Wuttke, The President of the European Union Chamber of Commerce in China (EUCCC), shares his thoughts on the matter in the European Business in China Position Paper 2021/2022: "[we used] the expertise of our member companies in the form of 930 constructive recommendations, made by our 35 working groups and sub-working groups, and stand ready to engage in discussions with the Chinese authorities at all levels to help turn China's ambitions into reality".[3] Zhang Jun, Dean of the School of Economics at Fudan University in Shanghai, referenced the HSG's Elite Quality Index (EQx) in a recent article[4], noting that:

> For us to realize the second hundred-year objective, in addition to the continuous modernization of political governing elites, increasing the size of the market economy remains the only viable path with great potential. As long as we continue to firmly promote transparent policy and reform, we can boost the extent of the market economy and hence the ability of capital to discover entrepreneurs and promote creativity. The result will be the sustained increase of productivity[5].

Foreign investors will eagerly await signals of reform along the lines of the 930 EUCCC recommendations. Ambitious initiatives will also be welcomed, such as the institutional changes and opening of markets that would accrue from the hypothetical accession to The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a geographically vast and deep free trade agreement. How much China's future hinges on reform is clear from the different trajectories mapped for countries by the World Bank and outlined in Figure 3.7.

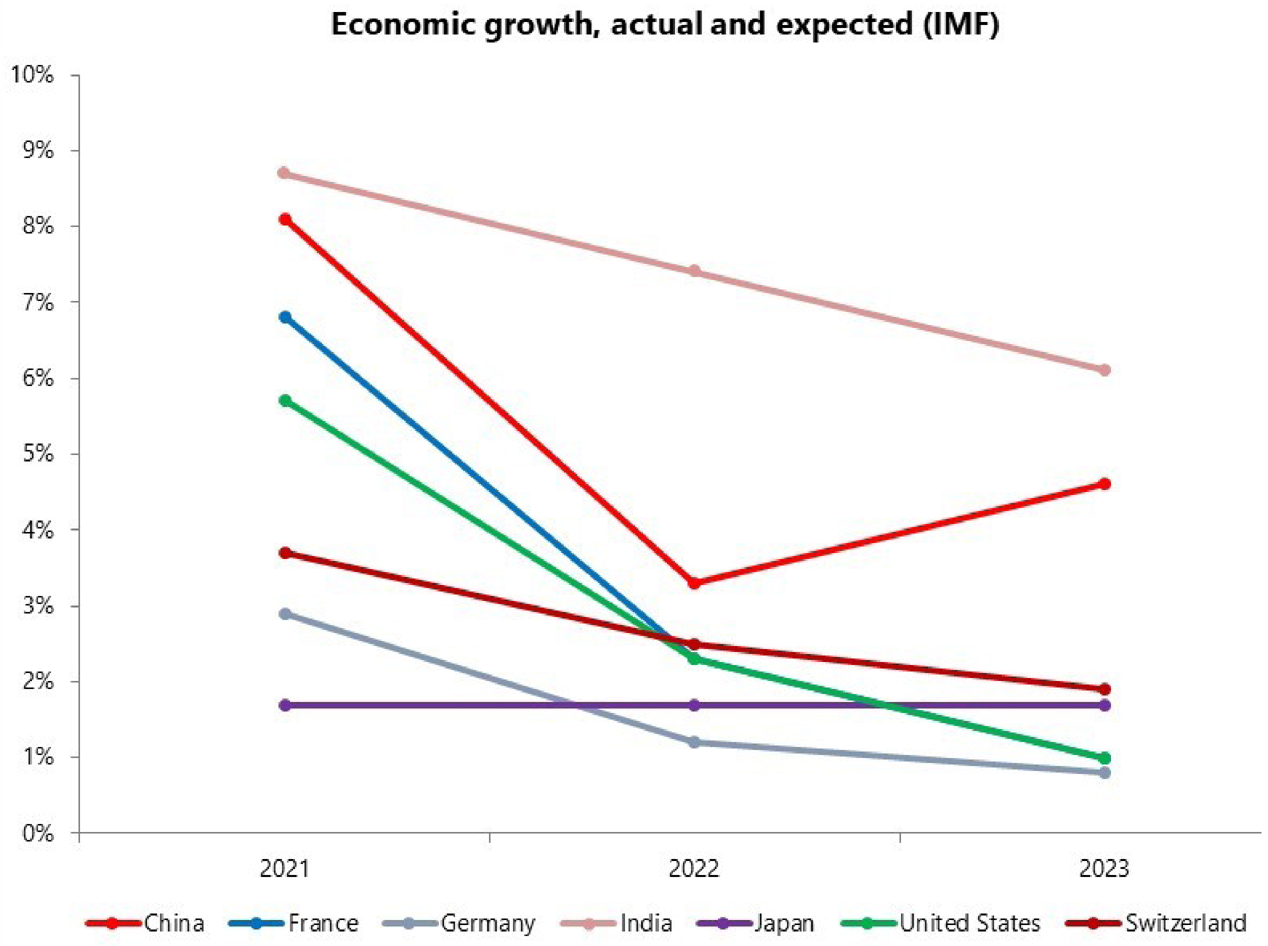


Figure 3.7: Growth forecast of selected countries by the IMF (July, 2022)

Shall we dance?

The second criteria for the concerned Swiss businessperson to consider when doing business in China relates to decoupling, which is intimately related to the future growth prospects of the first criteria. The future of decoupling could be ascertained by imagining a global scenario without China. The pandemic and war in Europe have made it painfully obvious that the global economy is an extremely complex web of business relationships, long and sophisticated supply chains, mutual dependencies, distributed risk taking across geographies, and the need for highly specialized firms. The last 30 years have seen an unprecedented and pervasive general increase in prosperity, largely attributable to three factors: technological progress, an increase in economic complexity and specialization enabled by China's rapid development and integration in the global economy, and, to a lesser but not insignificant extent, the availability of cheap energy based on bold risk-taking. Cheap energy now seems to be a thing of the past, but so might increases in productivity, especially in a world that is fragmented by duplicated supply chains or technology standards. What if China retreats from the global economy?

For the West it would mean the allocation of unimaginable amounts of capital to duplicate what China already offers to the world. That is, risky multi-billion dollar industrial policy initiatives—such as the American CHIPS (Creating Helpful Incentives to Produce Semiconductors for America) Act. A de facto "tech arms race"[6] would need to be undertaken in countless areas from solar panel manufacturing capacity to rare earth mining. In plain language, decoupling probably means two decades of heavy investment efforts, sprinkled with substantial amounts of inflation, and the heroic sacrifices of ordinary citizens who would see their consumption, state services and quality of life reduced. At the end of day, it is uncertain to what degree such industrial bets would succeed in replicating China's industrial capacity and current contributions to the global economy. An idealist would say that decoupling is a lose-lose scenario, that no rational decision makers would accept such a hit to global prosperity and conclude that this will not come to pass.

In terms of how to navigate choppy geopolitical waters, Israel, now working on the first free trade deal between China and the Middle East, offers lessons that Switzerland might learn from[7]. The director-general of Foreign Trade and International Relations at the Manufacturers Association of Israel is well aware of decoupling in the context of the US-China rivalry and notes: "Israel is a small country that is very dependent on trade. The US is its most important ally but it also needs to look out for its own interests"[8]. Swiss firms have to assess what China can offer, what can be gained from having a strategic presence in China in terms of becoming more internationally competitive, and whether 2022 was an exceptional year that will be followed by a recovery or an inflection point that signals a downward spiral.

What does this mean in practical terms? In preparation for the visit of the University of St.Gallen's EMBAs to the Port of Haifa and its highly visible cooperation with China's state-owned Shanghai International Port Group (SIPG), we asked for the advice of our hosts at Tel-Aviv University. The reply was to the point: "You must learn how to dance in two weddings at the same time". This may not be an easy skill to acquire but one that the leaders of firms around the world might need to master for doing international business.

The fact of the matter is that securing win-win business deals and good relationships with China makes the global economic system more prosperous and decreases the chances of conflict. In essence, this makes international business a de facto public global good. As for the immediate future, assuming that the IMF's July forecast comes to pass (see Figure 3.9), the added economic output of China will be slightly over US$ 800 billion in 2023, an amount equivalent to Switzerland's total GDP.

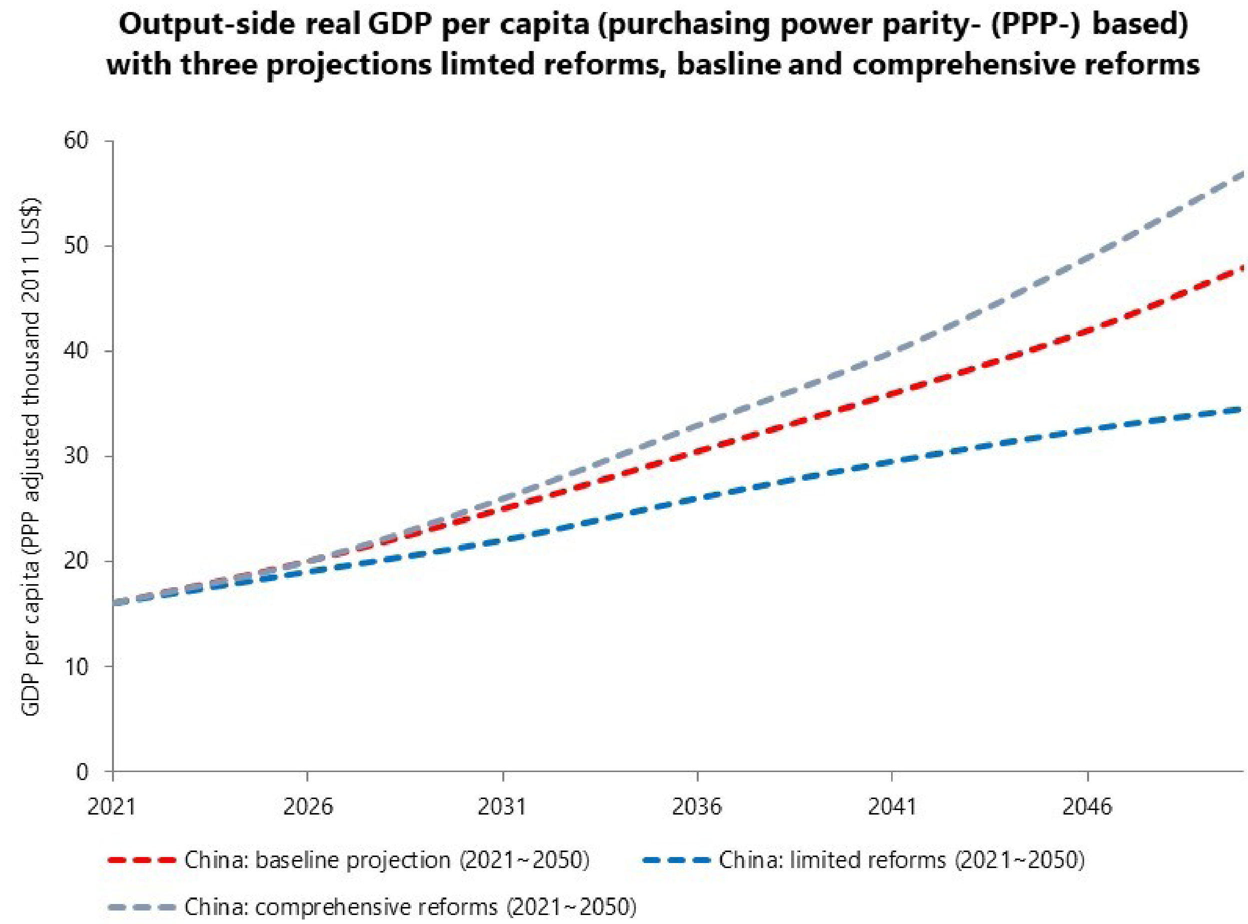


Figure 3.8: China's long-term growth paths contingent on reforms (EUCCC, European Business in China Position Paper 2021/2022 p. 5, original data from the World Bank)

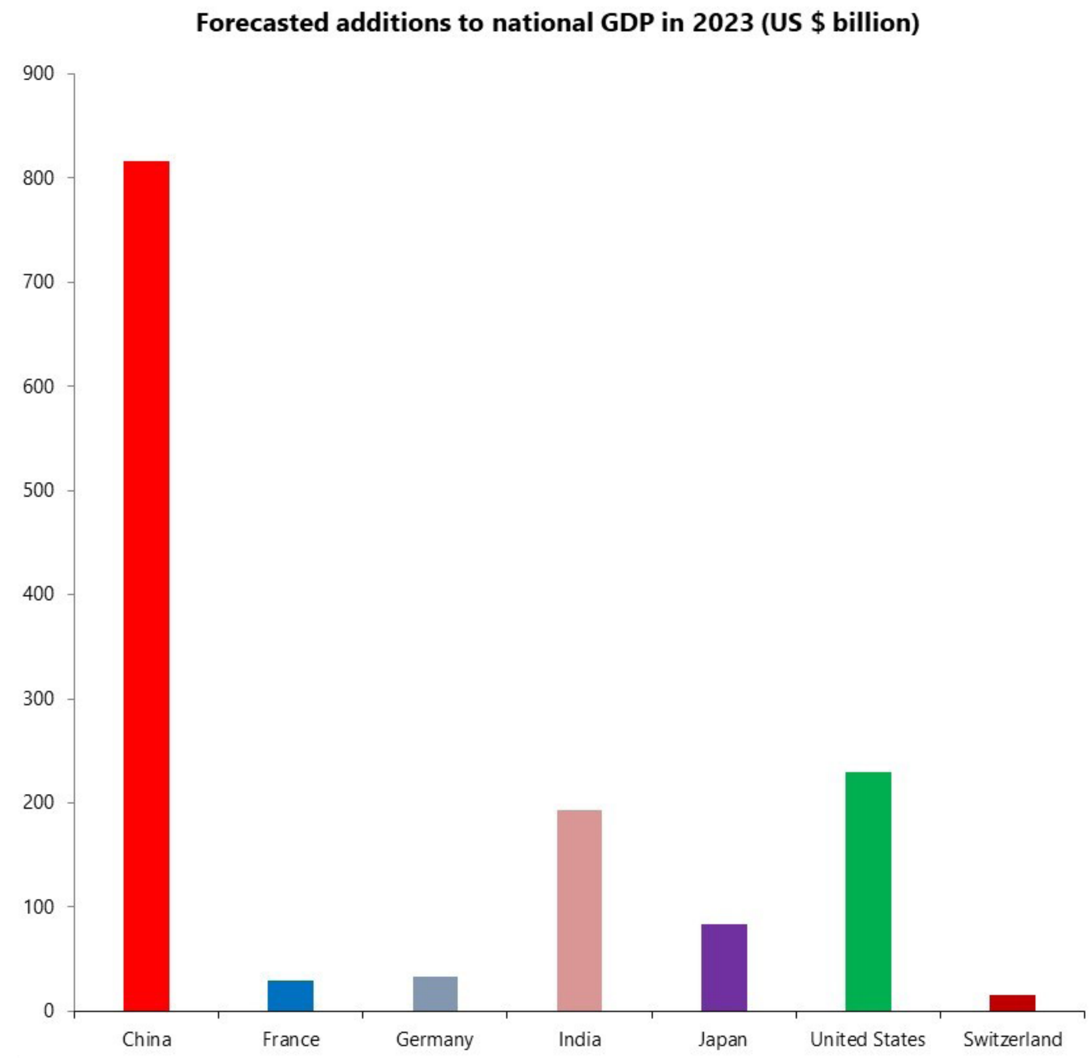


Figure 3.9: Additions to GDP forecasted for selected countries in 2023 (based on World Bank data and IMF July, 2022 growth forecast)

References:

[1] The World Bank. (2021). GDP per capita, PPP (current international $) – Switzerland, China. Retrieved from https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD?locations=CH-CN

[2] The World Bank. (2021). GDP per capita, PPP (current US$) – China, Switzerland. Retrieved from https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=CN-CH

[3] European Union Chamber of Commerce in China (EUCCC). (2021). *European Business in China Position Paper 2021/2022.* p. 2. Available at: https://europeanchamber.oss-cn-beijing.aliyuncs.com/upload/documents/documents/European_Business_in_China_Position_Paper_2021_2022[964].pdf

[4] Casas-Klett T., & Cozzi, G. (2022). *Elite quality report 2022: Country scores and global rankings*. Zurich: Seismo. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4085752

[5] Zhang, J. (2022, August 22). 如何更好地利用资本，对未来30年的中国经济至关重要 [How better utilized capital is crucial to China's economy in the next 30 years]. *Guancha.* https://www.guancha.cn/ZhangJun/2022_08_27_655383_2.shtml#comment

[6] Stone Truitt, J. (2022, August 9). Biden signs CHIPS Act into law as tech arms race with China heats up. *NIKKEI Asia.* Retrieved from https://asia.nikkei.com/Business/Tech/Semiconductors/Biden-signs-CHIPS-Act-into-law-as-tech-arms-race-with-China-heats-up

[7] Jennings, R. (2022, Sepember 8). China, Israel free-trade deal, Beijing's first in the Middle East, in 'last stages' amid troubles with the US. *South China Morning Post.* Retrieved from https://www.scmp.com/economy/china-economy/article/3191828/china-israel-free-trade-deal-beijings-first-middle-east-last

[8] Ben-David, R. (2021, September 2). Israel inaugurates Chinese-run Haifa port terminal, in likely boost for economy. *The Times of Israel.* Retrieved from https://www.timesofisrael.com/israel-inaugurates-new-haifa-port-terminal-in-expected-boost-for-economy/

PART IV
APPENDIX

4. Additional China business insight and descriptive statistics

4.1 Further China business insight

Institutional relations

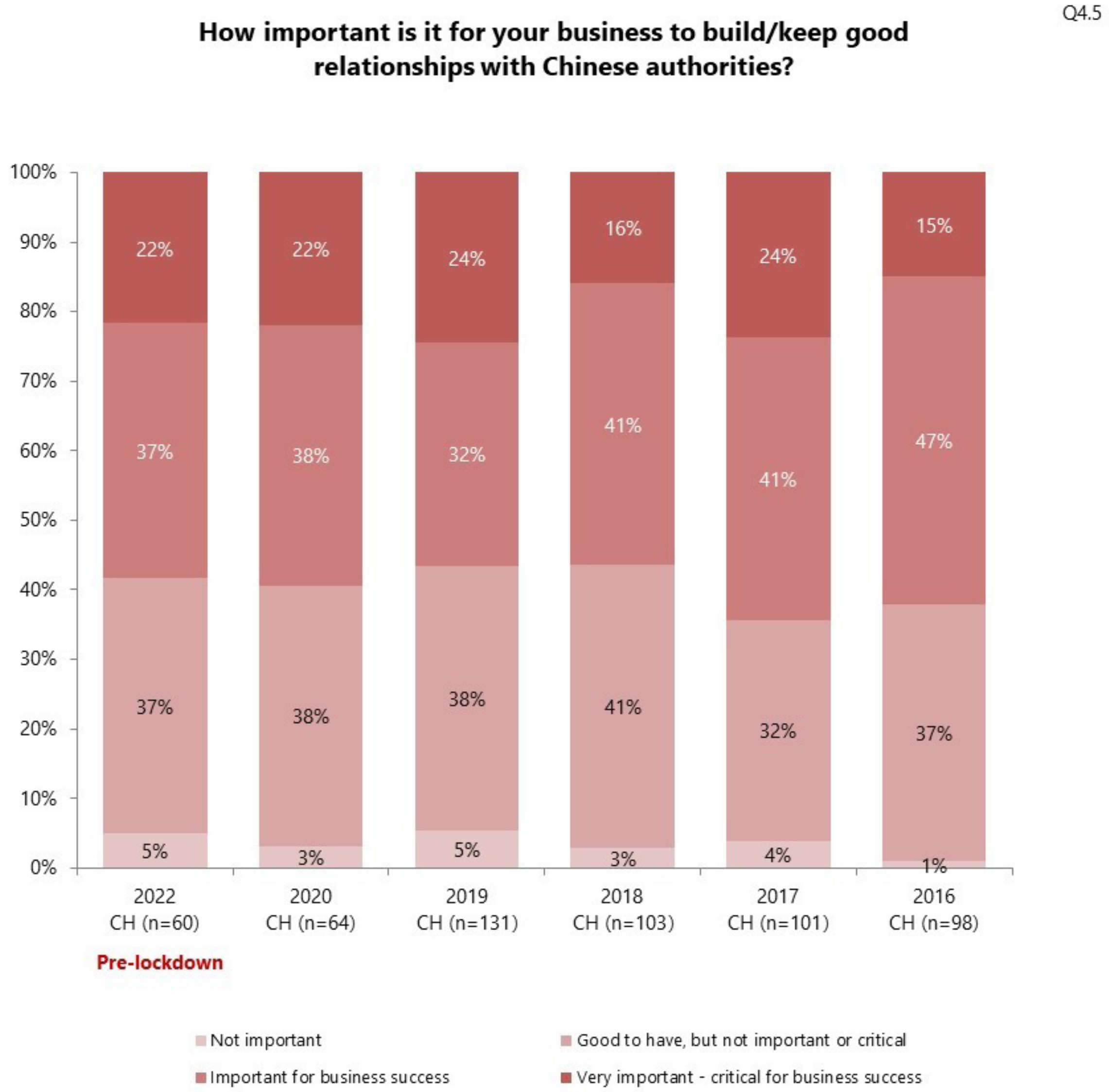


Figure 4.1: Importance of relationships with Chinese authorities

The importance that Swiss companies give to maintaining good relationships with Chinese authorities has remained stable over the years. For 40%, such relationships are not important, whereas for slightly more than 20% of firms they are critical, highlighting two very different approaches to doing business in China.

R&D in China

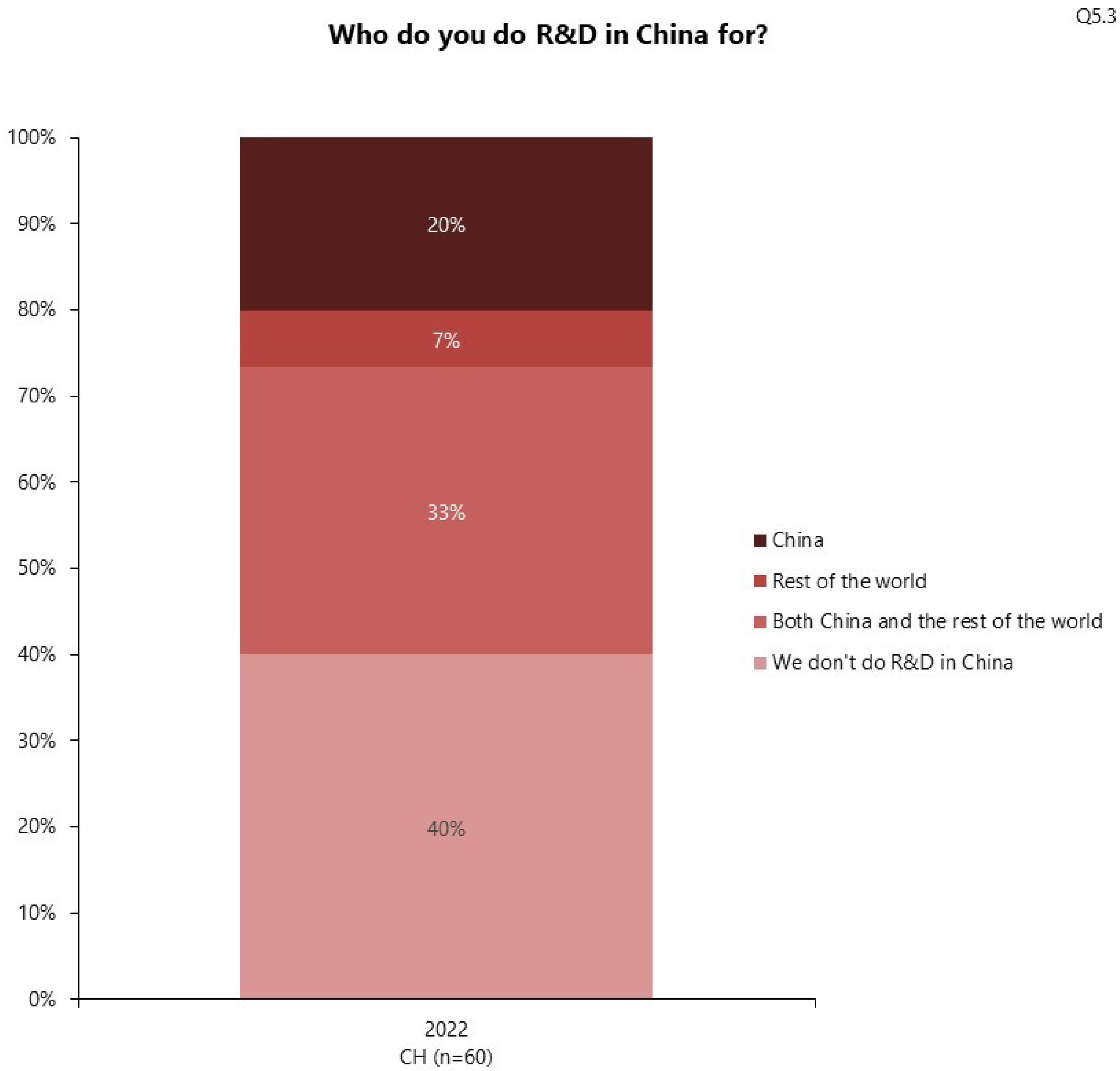


Figure 4.2: Users of the Chinese R&D of foreign firms

R&D has become a strategic activity in China, undertaken by 60% of respondents. Of these, 55% (or 33% of all respondents) do R&D for international clients, illustrating the technological capabilities and human capital that China possesses.

Market positioning of Swiss firms

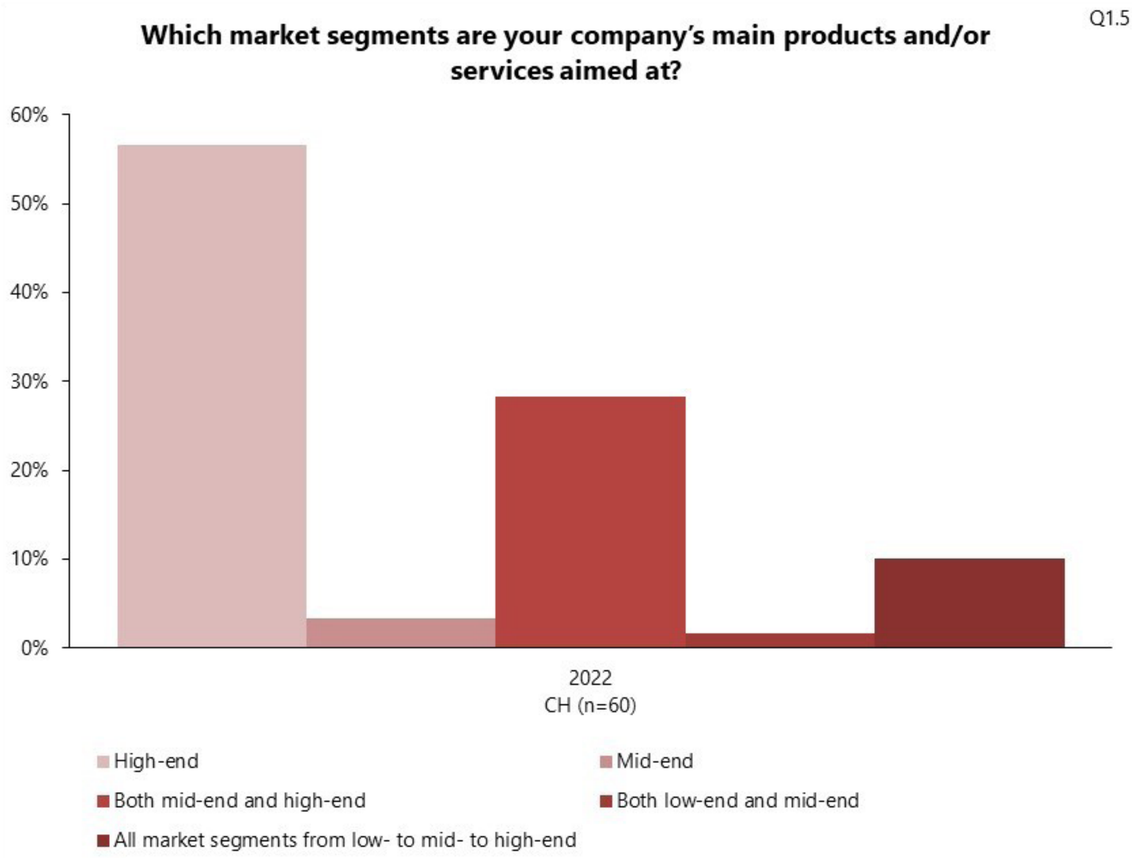


Figure 4.3: Positioning of products and services in the Chinese market by responding Swiss companies

The market positioning of Swiss companies in China is notable, with most selling to the premium and high-end segments. The strategic question for these firms is whether it is wise not to target the mid-market segment given its enormous size.

4.2 Descriptive statistics for the 2022 survey respondents

Ownership structure in China

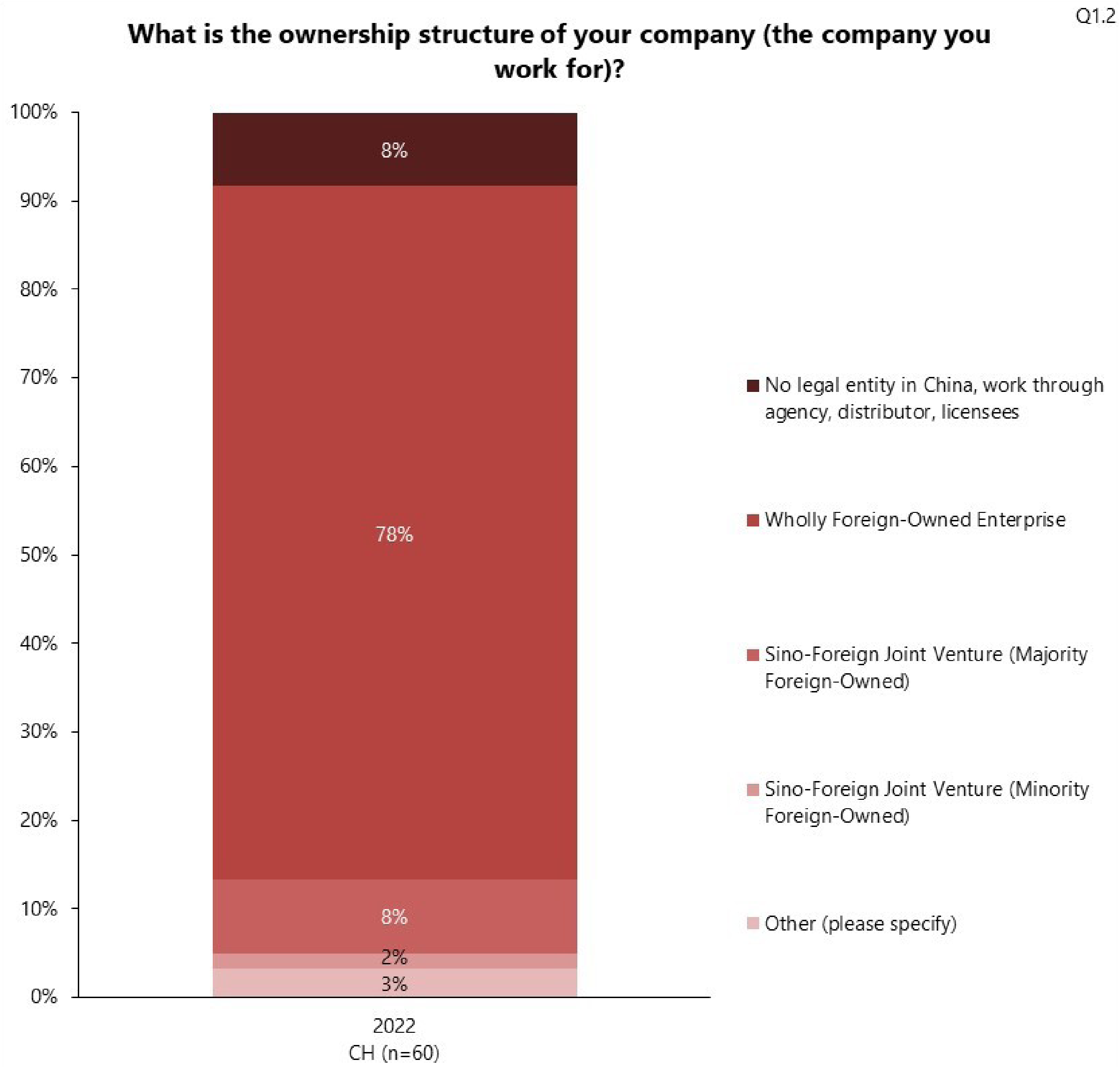


Figure 4.4: Company ownership structure of the survey respondents

Most Swiss firms in China are Wholly Foreign Owned Enterprises (WFOEs), with 10% engaged in joint ventures (JVs) and a similar number working through partners.

Public vs private company type

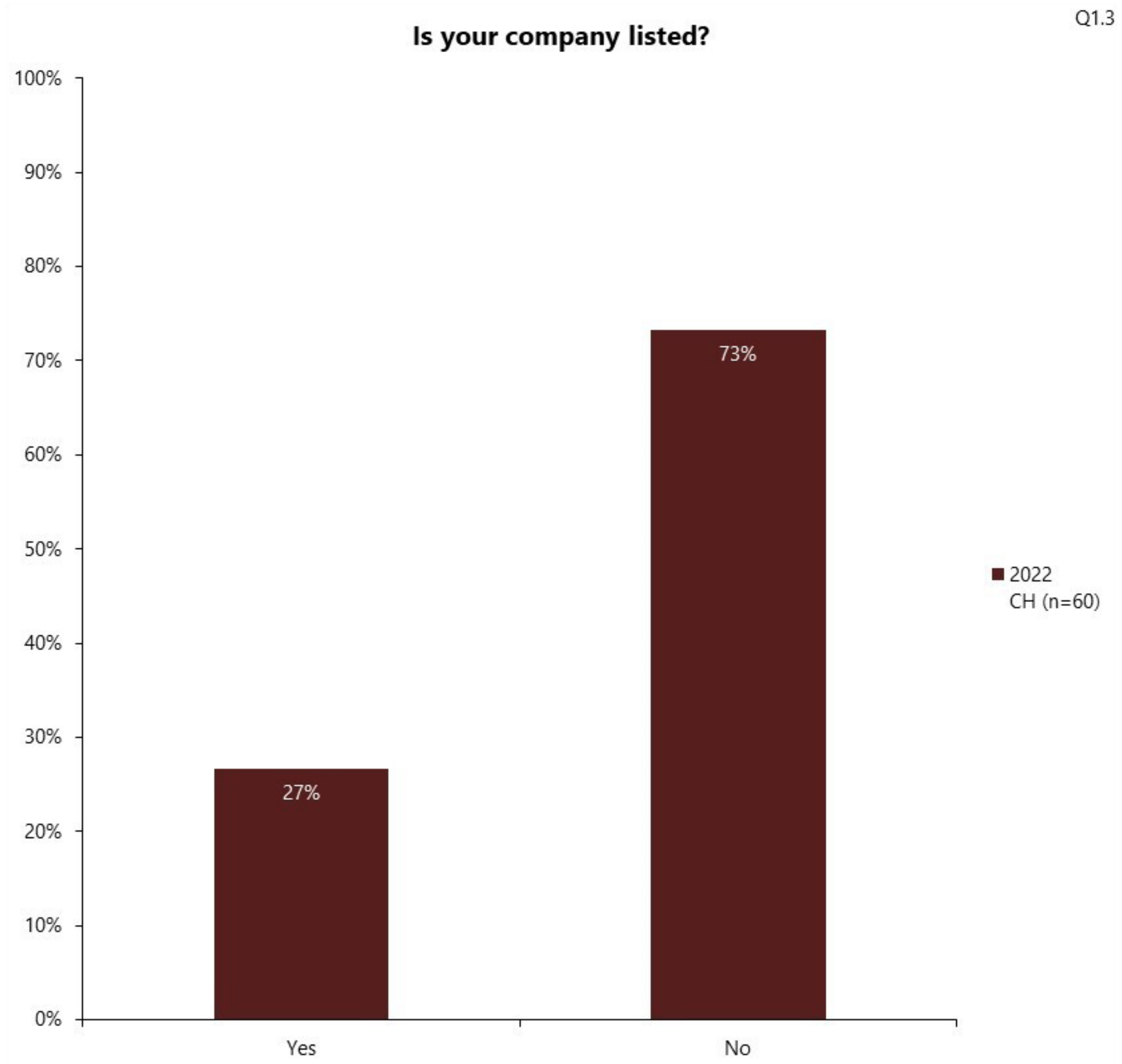


Figure 4.5: Public vs private company type of survey respondents

The majority of Swiss firms doing business in China—almost three quarters of the companies surveyed—are non-listed private firms.

Manufacturing vs services sector

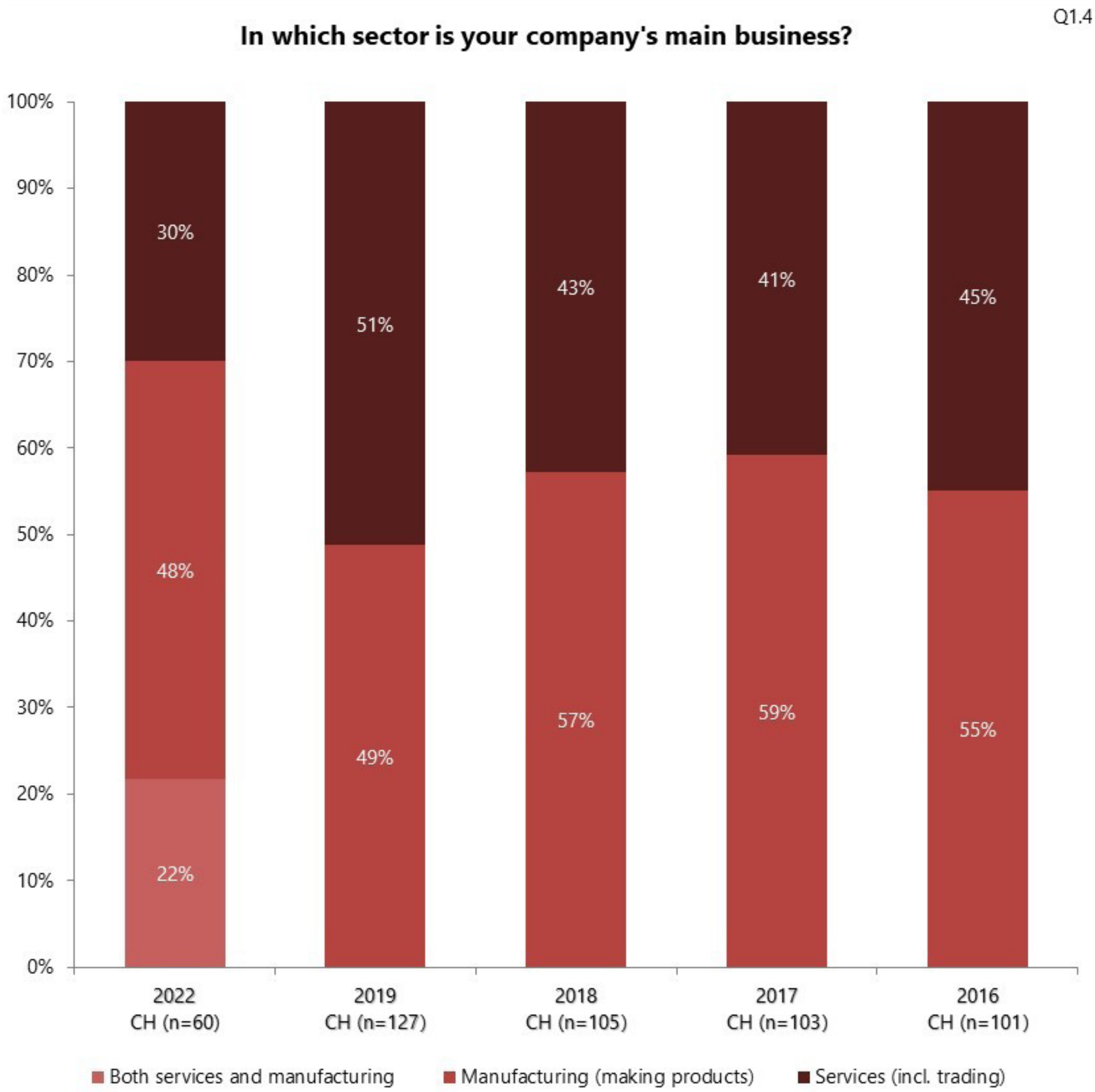


Figure 4.6: Manufacturing or services company type of survey respondents

Investments in China have now moved away from the traditional focus on manufacturing with many Swiss firms now engaged in the services sector. Firms providing services are more likely to be focused on the domestic market, while manufacturing goods will serve both China and the international market.

Client type

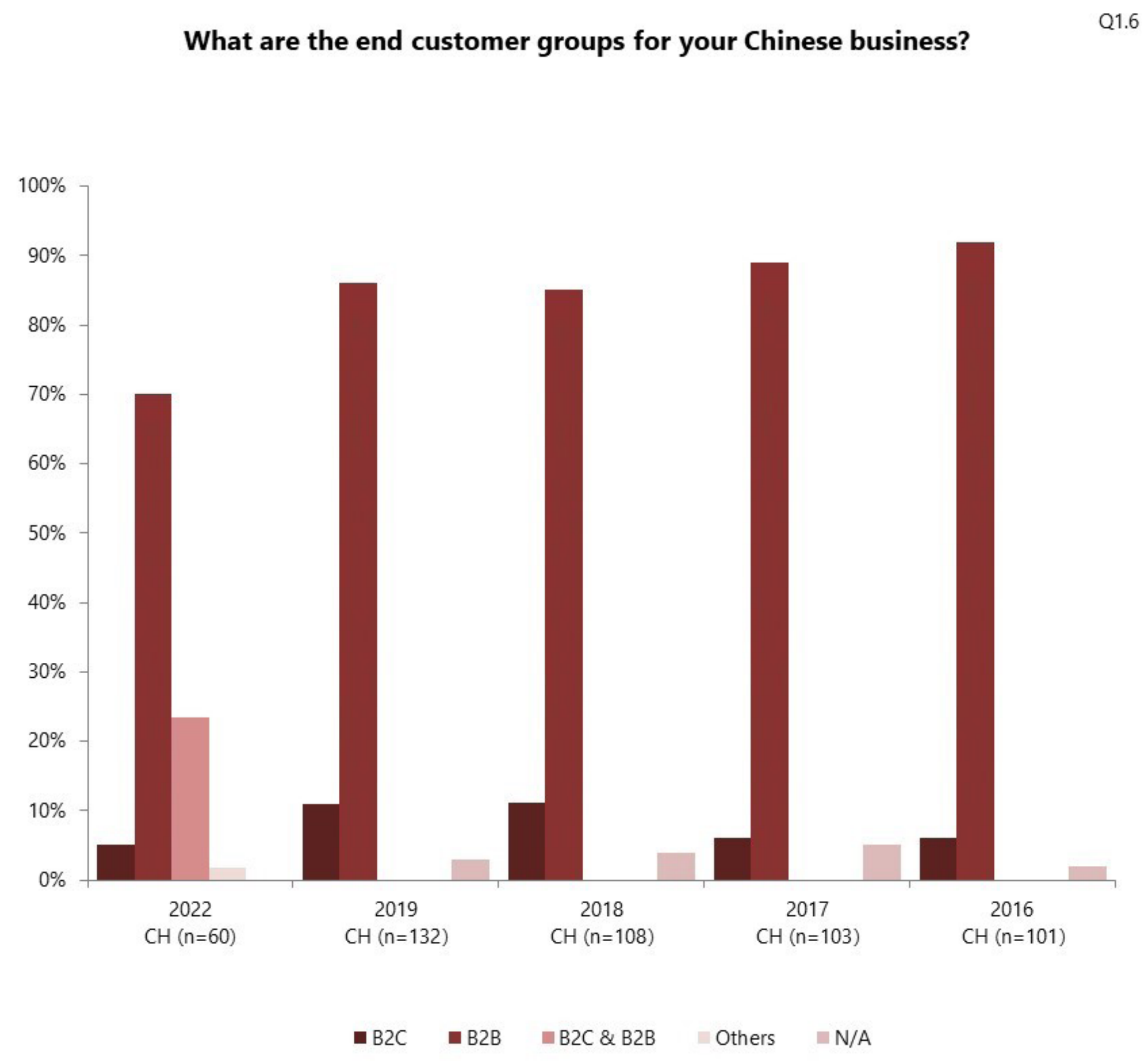


Figure 4.7: End customer groups for the Chinese business

The traditional dominance of B2B still persists, but now to a lesser degree, as some Swiss firms in China are starting to incorporate B2C customers into their business models.

China management experience

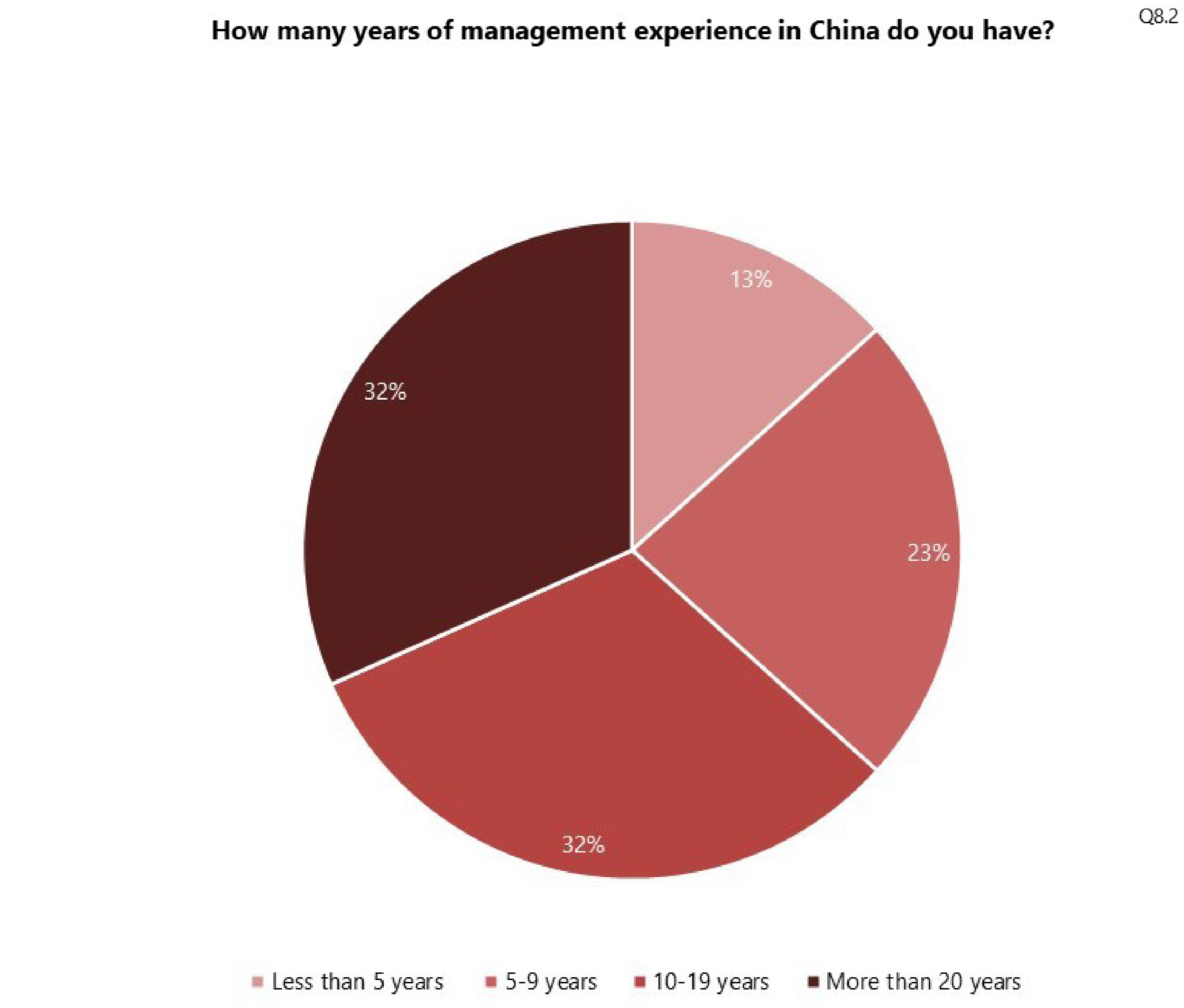


Figure 4.8: China management experience of survey respondents

Respondents to the *Swiss Business in China Survey 2022* are generally very experienced managers. This confers additional credibility to the survey's results.

Nationality

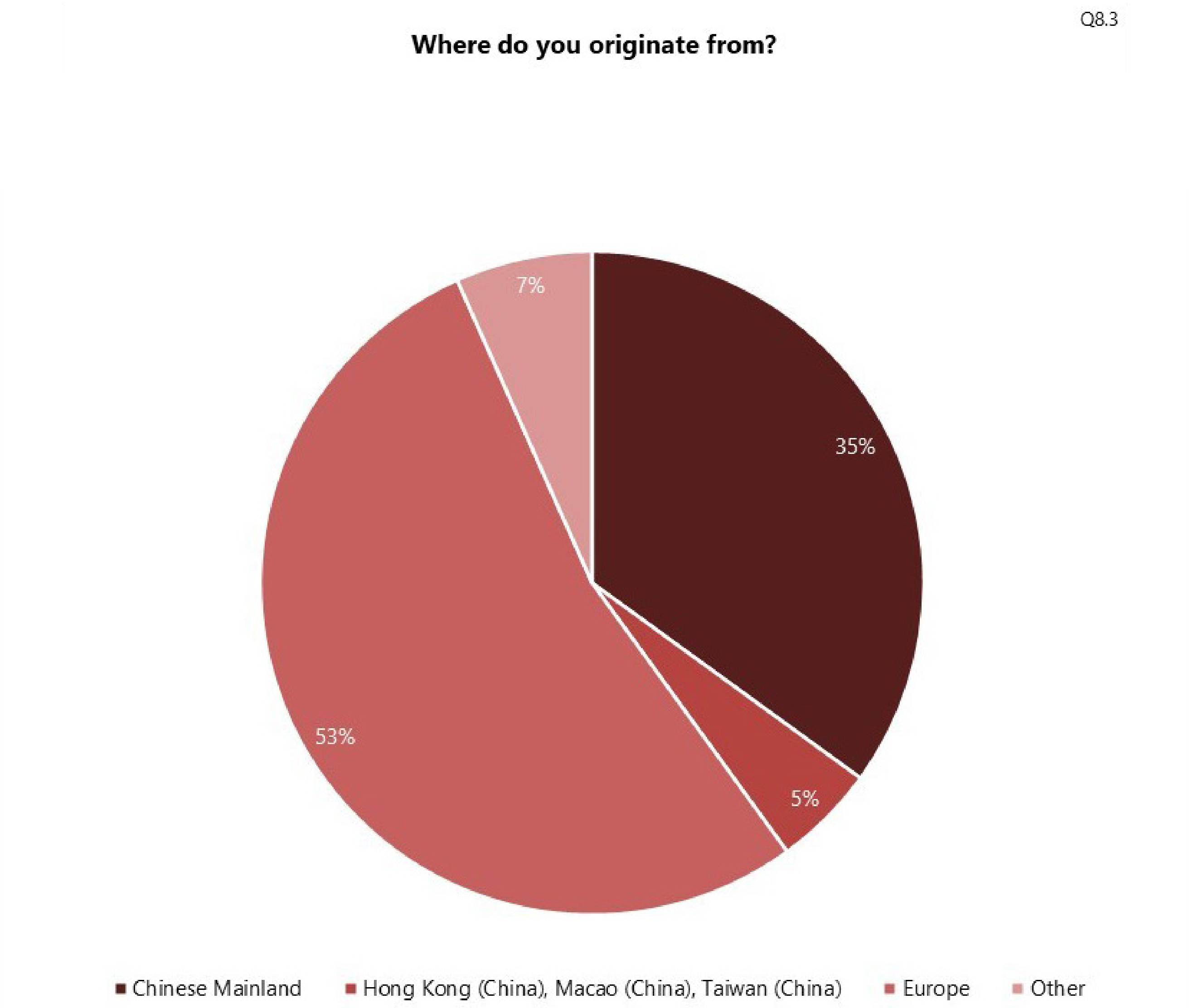


Figure 4.9: Nationality of survey respondents

More than 50% of the respondents to the survey were from Europe, while almost 40% originated from the Chinese mainland. (Note that this survey was conducted and is available in both Chinese and English).

China sales volume

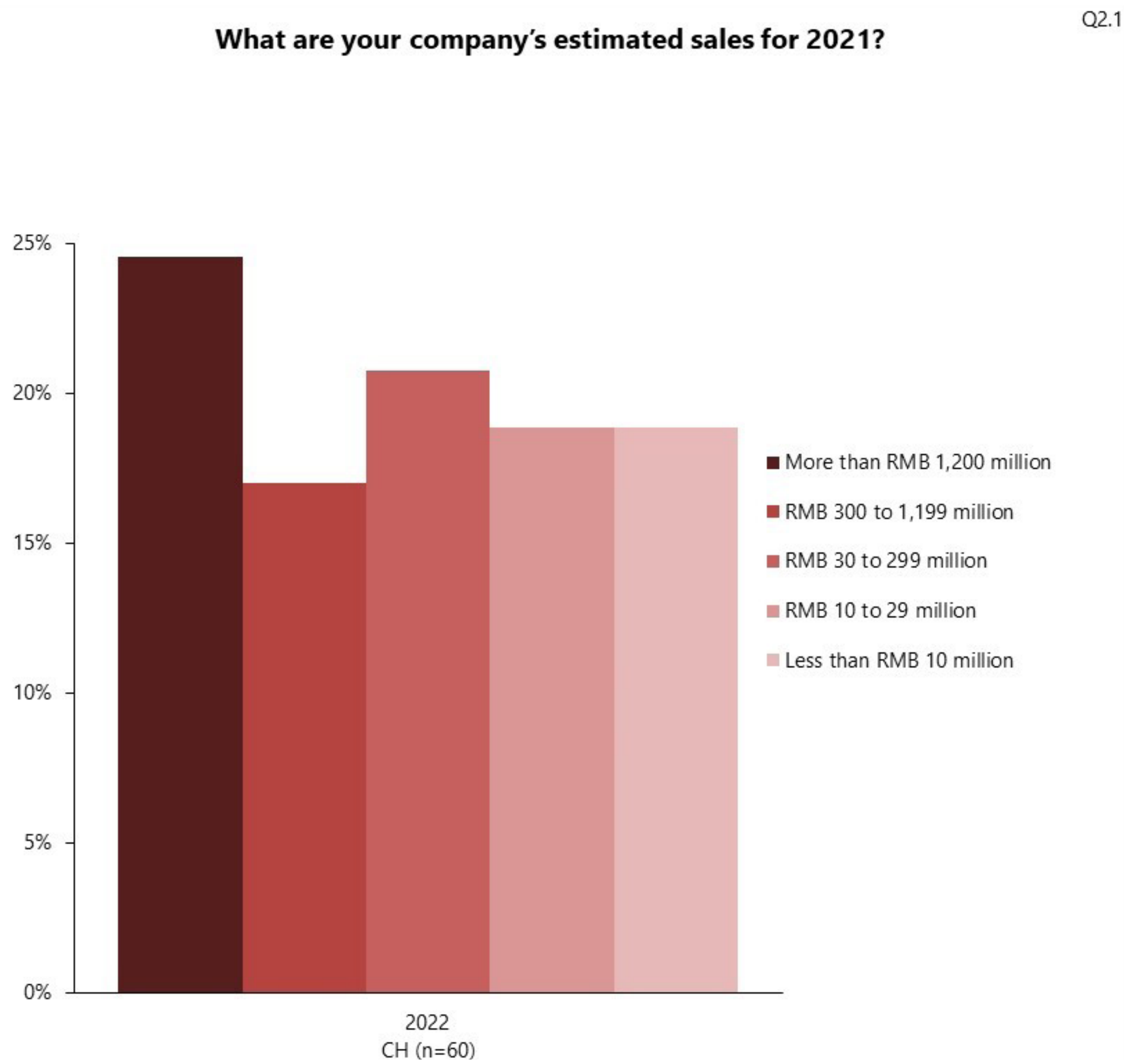


Figure 4.10: Estimated China sales for the survey respondents' companies

The expected sales volumes of the companies surveyed reflect a wide diversity of firm sizes, from SMEs to large multinational corporations, highlighting the many opportunities that the Chinese market offers and the variety of respondents answering the survey.

Acknowledgments

First and foremost, the The *Swiss Business in China Survey 2022* team extends its thanks to the survey respondents; the leaders and managers of Swiss companies doing business in, or with, China. During a difficult and extraordinary year they took the time to share their views and experiences with our team. It is our hope that this report meets their expectations, provides them with valuable intelligence, and helps them gauge the sentiment of the Swiss business community engaged with doing business in China.

This report enjoyed the committed support of many individuals and organizations who shape the Sino-Swiss relationship. Their assistance includes helping in the data collection process, both in Switzerland and China, sending out survey questionnaires and following up with respondents, and advising us on how to improve the survey questions, while providing the team with insights and guidance on the report's content. We wish to specifically recognize the support of the Swiss Embassy in China and the Swiss Consulate General in Shanghai. We are also very grateful to Swissnex Shanghai, SwissCham in China; Switzerland Global Enterprise, the Swiss Business Hub, the Swiss-Chinese Chamber of Commerce; and economiesuisse. Without the generous help of these institutions and their representatives this report would not have been possible.

At the University of St.Gallen, the directors of the Research Institute for International Management (FIM-HSG), Winfried Ruigrok and Gudrun Sanders, contributed through their long-term support for the China Competence Center (CCC) and its activities, as did Patrick Ziltener, member of the board of governors of the university. Post-doctoral researchers and students provided research support, and are already preparing for the forthcoming 2023 survey and report: Wei Lin, Kieran-Lee Russell, and Lisa Gao. The report could not have been published without the professional and effective work of Francizka Dörig, Christine Hirzel and Stefanie Keller at Seismo Verlag in Zurich. Chloé Dikötter supported us by designing the report and John Stuart's patient and methodical editing ensured that the written quality of this work provides phenomenal added value to the project.

The project team looks forward to their continued support for future editions of *The Swiss Business in China Survey.*

The *Swiss Business in China Survey 2022* is the first such inquiry carried out since the start of the pandemic and follows previous editions published between 2006 and 2019. This is the first time that we have needed to conduct a follow-up mid-year flash survey to re-evaluate the very positive business sentiment expressed by Swiss businesses at the start of the year. We felt that this was essential in order to understand how war in Europe, growing geopolitical tensions in Asia, and the ongoing Omicron lockdowns in China have impacted the expectations of Swiss companies for 2022 and beyond.

The editors, authors and survey team hope that the results will be useful in benchmarking the activities of Swiss and other foreign businesses in China. Moreover, the analyses may assist business decision making and increase the overall level of understanding of the Chinese market and its opportunities and challenges.

Seismo

ISBN: 978-3-03777-269-0 (Print)
ISBN: 978-3-03777-877-7 (E-Book)
https://doi.org.10.33058/seismo.30877