Succeeding in China
2021

HSBC | Opening up a world of opportunity

Despite the changing nature of international relations, it is clear that international companies will continue to find value in China-centric growth and investment strategies.

Executive Summary

The only major economy to expand in 2020 and forecast to grow by 8.3% in 2021 – significantly higher than G7 economies[1] – China continues to appeal to international companies and investors. Contrary to some media reporting, our latest findings indicate deepening confidence and further investment in China among international firms.

Our survey of 2,174 companies across 10 major economies shows that on average nearly 9 in 10 (87%) of international companies expect an increase in their sales or exports to China in the next 12 months, and more than half (52%) are planning M&A activity in China either now or in the next 12 months. 6 in 10 (59%) are either currently expanding their supply chains in China, or planning to do so in the next 12 months.

Greener is better
Sustainability also stands out in this year's survey – not surprising given climate change sits high on the agenda of governments and corporations worldwide. It is clear that China's march towards carbon neutrality is having a real and positive impact. Our survey finds that over three quarters (76%) of foreign companies feel that China's desire to transition to a net-zero economy makes expanding there more attractive. They also believe business opportunities will arise from the net-zero agenda, with 52% planning to offer greener and more sustainable products for the China market.

At the same time, firms are taking steps to improve the sustainability of their operations and processes in China: 42% report plan to make their operations more sustainable; a further 41% are planning to invest to make their manufacturing facilities or office buildings in the country more energy-efficient or emit less carbon.

Flourishing digital economy
In addition, the fast-changing digital economy – already a growth engine of the Chinese economy – has been further boosted by the pandemic. E-commerce and digital payments in particular have surged. Combined with technologies such as artificial intelligence and the Internet of Things, digitalisation has given foreign companies the opportunity to reach and interact with more customers. As a result, some 92% of foreign companies state that China's rapid digitalisation has improved the growth prospects of their business there.

They are now making investments in their digital capabilities to match. 42% of international companies say they have enhanced or are enhancing their digital channels and platforms. More broadly, 41% say that they have increased their investment in information technology in order to take advantage of China's flourishing digital economy.

1. HSBC Global Research

Eyes on the Prize

International investors scent growth

High hopes and bullish outlook despite headwinds
It is clear that the international business community continues to believe in China's economic promise. Despite ongoing trade tensions and pandemic-related supply-chain challenges, international companies are expanding and investing in China.

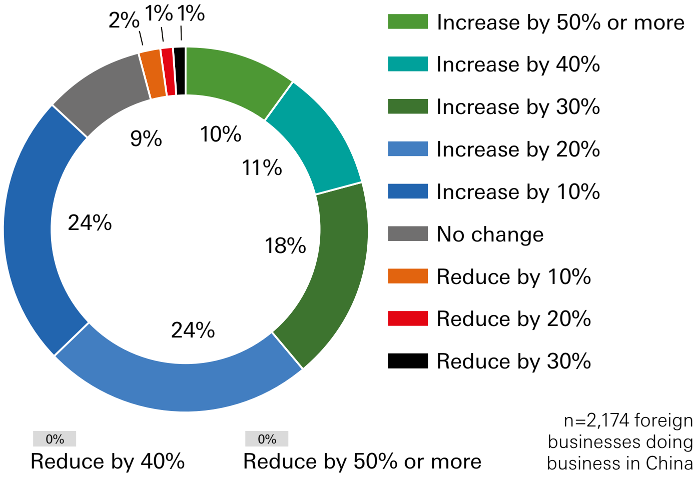
Our survey demonstrates that foreign companies with current or planned investments in China are highly confident about their prospects in this market, 87% of international companies expect an increase in their sales or exports to China in the next 12 months, and 63% believe they will have 20% or more annual organic growth.

For international investors, China remains the country of the present and the future. We investigate the reasons for their ongoing attraction to China below.

China's unique advantages tempt investors
China is predicted to enjoy significantly higher GDP growth in 2021 than the G7 economies, with HSBC Global Research forecasting growth of 8.3% in China, against 5.1% in the developed world. As such, China's economic prospects continue to attract international companies.

Indeed, 1 in 3 respondents cites China's economic prospects as lying behind their decision to invest in the country. Reiterating this observation, a further 41% say its economic growth is one of the most significant opportunities when investing in China – making this the leading reason identified by the respondents.

Figure 1. Annual organic revenue growth (sales and exports) expected in China over the next 12 months

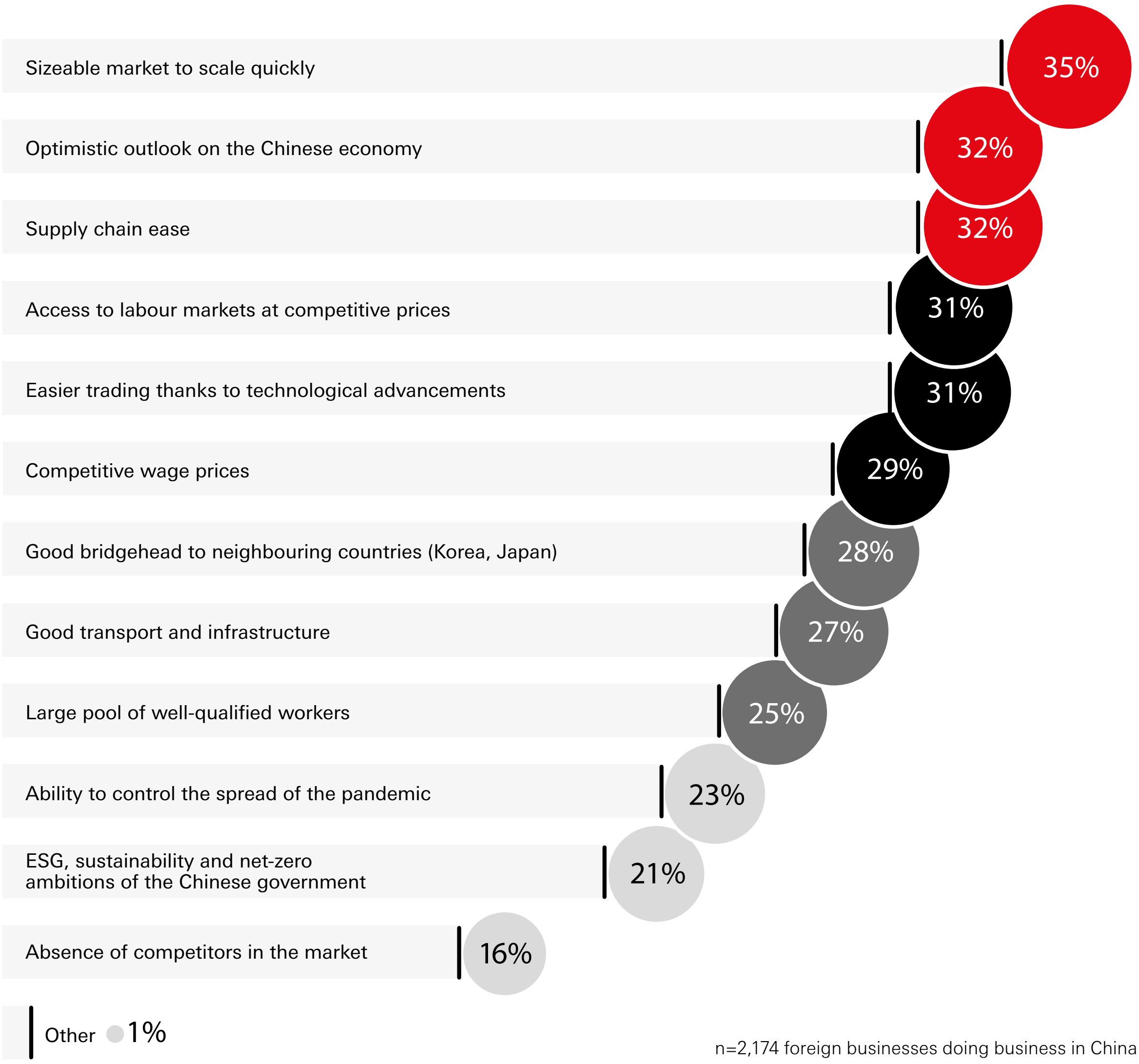


n=2,174 foreign businesses doing business in China

China has fundamental structural advantages. As a country of 1.4 billion people, it provides a huge and unified market for exports. By comparison with the linguistic, economic, and regulatory diversity of Europe or Africa, China's market thus enables rapid and efficient scaling. Indeed, China's status as a 'sizeable market to scale quickly' is the main reason why foreign firms wish to expand in China, with 35% selecting this.

Long the 'workshop of the world', China-based supply chains are well-honed, a fact recognised by 32% of the surveyed companies, who consider China's 'supply chain ease' a reason behind their expansion there. Aligned with superior supply chains is China's good transport and infrastructure – selected by over a quarter (27%) of the respondents as a reason for their Chinese expansion.

Figure 2. Reasons to expand your business in China



n=2,174 foreign businesses doing business in China

Engines of growth: digital technologies and empowered consumers

It is clear that digital technologies have been expanding rapidly in China. Three of the top four industries that are considered by international executives as the fastest growing in China are digital or digital-adjacent – IT (software and services, technology hardware and equipment) (42%), e-commerce (32%), and communication services (telecoms, media, and entertainment) (31%).

Digital economy is thus one of the top two opportunities for investment identified by international firms, with 38% of respondents noting this as one of China's most significant opportunities, second only to the country's economic growth (41%).

Increasingly affluent and digital-savvy, Chinese consumers are major drivers of growth, not just for local companies but also for multinational corporations. Reflecting this is the significance placed by our respondents on the highly consumer-centric industry of e-commerce as a rapidly growing sector. Further demonstrating the importance of Chinese consumers, over a quarter also identifies consumer discretionary (i.e. household durables, apparel, and retailing) (28%) and consumer staples (food, beverage and tobacco, household and personal products) (29%) as the fastest growing sectors in China.

There are some regional variations in perceptions of industry growth, often connected to the economic specialisation of Asia. Executives from Singapore are among the most likely to identify finance (banks, insurance and fintech) as one of the fastest growing sectors, with 32% doing so.

Key consumer trends: e-commerce and digital payments

E-commerce

The development of China's 'mobile-first' consumer technology market has provided it with unparalleled digital penetration and innovation. Both in absolute terms and in proportion to its population, China is the leading country for digital payments and e-commerce. Tightly bound, growth in one facilitates growth in the other.

Recent events have only served to increase this digitalisation. Nearly half of international executives (46%) state that the expansion of e-commerce and video e-commerce is a significant change in Chinese consumer trends after the pandemic.

Wider data support this. While overall consumer spending declined by 3.9% year on year in 2020, online sales in China nevertheless increased by 14.8% during the same period[2]. It is expected that these trends will continue. Market research company eMarketer forecast that in 2021 e-commerce will account for more than 50% of Chinese retail sales.

China is also ahead of the pack when it comes to the use of live commerce – combining live streaming with e-commerce – with two thirds of Chinese consumers having made purchases via live commerce[3].

E-payments

Our survey demonstrates widespread belief that the pandemic has further increased the use of digital payments, with some 44% of the executives considering 'the rise of e-payments and digital transactions' to be a 'significant change' among consumers to have emerged since the pandemic began.

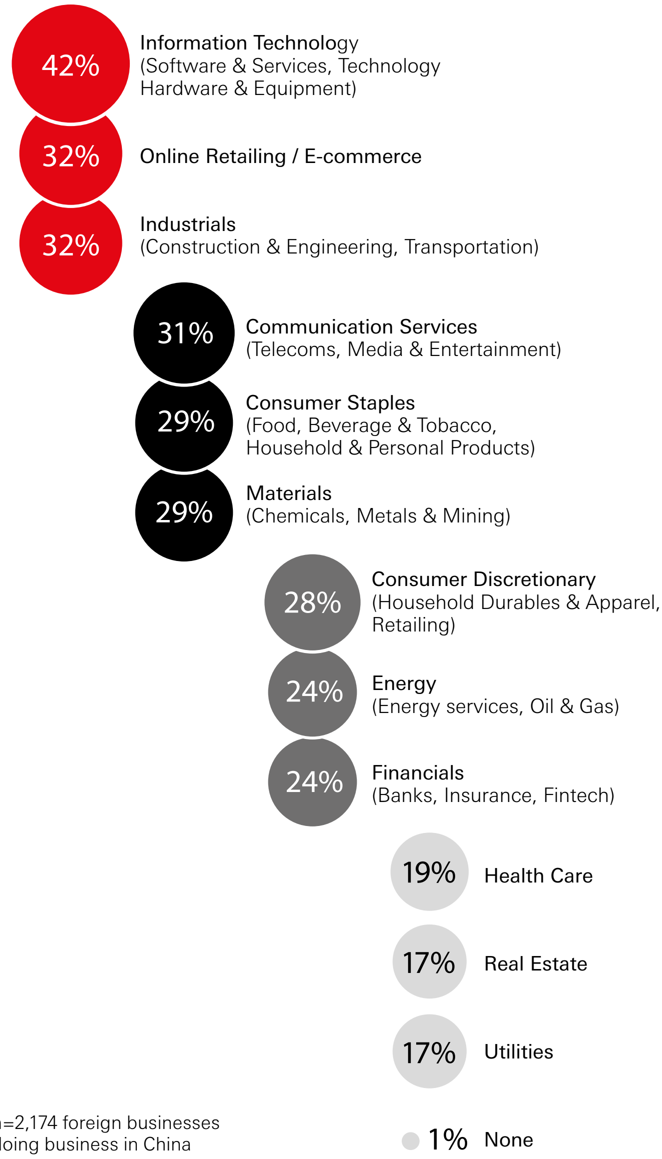
Already growing rapidly pre-pandemic, China's digital payments system, in particular mobile payments, was supercharged by Covid-19. In 2020 the total transaction volume of China's mobile payments increased by 21.5% year-on-year while total transaction value were up by 24.5% annually. Consumers are making more purchases online, and many consider digital transactions more hygienic than handling cash in an in-person interaction.

Digital payments are also supported by the Chinese government. China is taking the lead in developing the digital currency. The country's central bank has been testing the use of digital RMB in pilot programmes in multiple cities across China. It is expected that this will lend further impetus to the country's developing status as a cashless economy.

Fintech companies seem to be embracing the opportunity this provides for expansion – post-pandemic. Half of the fintech executives participating in our survey say they are enhancing their digital channels and platforms in China.

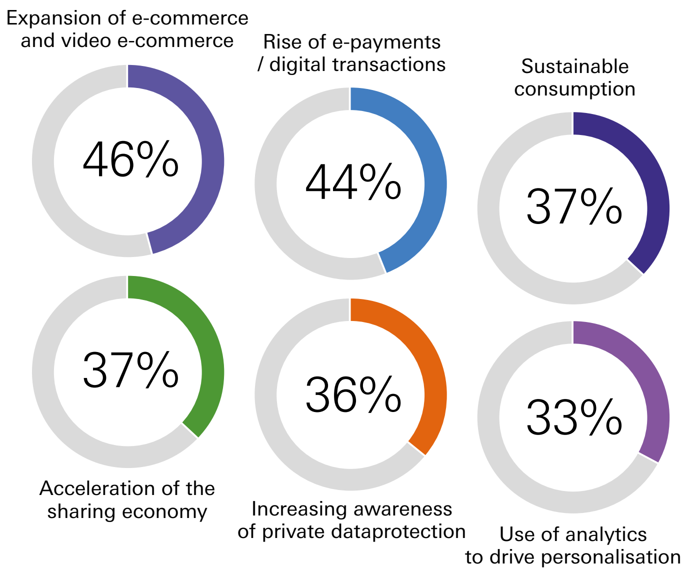
2. National Bureau of Statistics of China, January 2021
3. McKinsey, It's showtime! How live commerce is transforming the shopping experience, July 2021

Figure 3. Fastest growing sectors in China



n=2,174 foreign businesses doing business in China

Figure 4. Most significant consumer trends emerging post pandemic



n=2,174 foreign businesses doing business in China

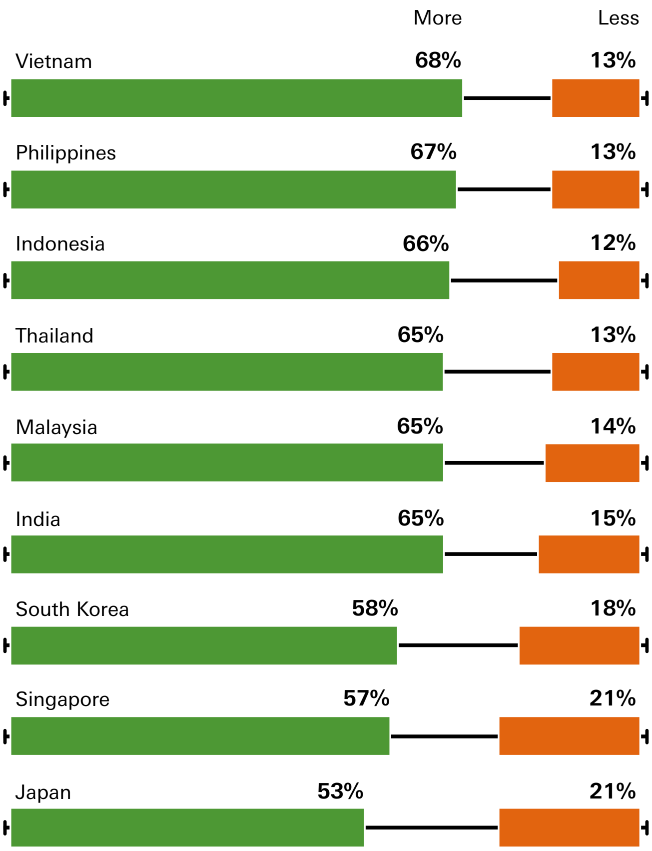
China seen as a superior destination for investment

Some media outlets have reported an ‘exodus’ of foreign firms from China – due to reasons such as increasing international tensions and the appeal of operating in lower-cost markets.

However, our data do not indicate this. When compared to nine other major Asian economies by our executives, China overwhelmingly emerges as the most attractive destination for investment.

Though recent years have seen a developing perception that manufacturing firms are leaving China in favour of lower-cost markets such as India and Vietnam, we find our respondents to be firmly in favour of China.

Figure 5. China is more or less attractive as a manufacturing base



n=614 manufacturing companies doing business in China

China overwhelmingly emerges as the most attractive destination for investment when compared to nine other major Asian economies.

The Greening Dragon

Chinese progress on sustainability provokes opportunities and challenges

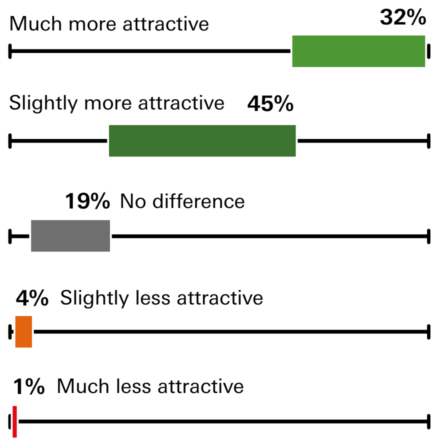
Foreign companies are attracted by sustainability, and improving their green credentials
China is making great strides to reduce carbon emissions and tackle climate change alongside other economies. In September 2020, China announced that it would aim to peak carbon dioxide emissions before 2030 and achieve carbon neutrality before 2060. September 2021 saw a further major climate pledge – that China would no longer fund new coal-fuelled power stations projects overseas.

The commitment for positive environmental change has been positively received by those participating in our survey. Over three quarters (76%) of foreign companies feel that China's desire to transition to a net-zero economy makes expanding there more attractive. This is especially true of Mexican executives, of whom 93% agree with the statement. Companies are planning for greater sustainability.

Our survey finds that over half (52%) of international firms plan to 'offer greener and more sustainable products for the China market'. More than 4 in 10 (42%) report planning to make their operations more sustainable or reduce carbon emissions.

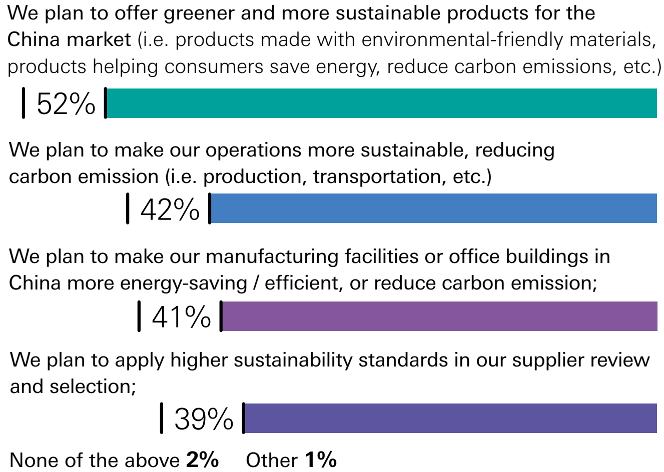
Awareness of sustainability is rising
Survey participants note an increasing emphasis on sustainability. The majority (91%) of our respondents agree that awareness of sustainability issues within China has grown within the last five years, and a further 1 in 3 (37%) sees sustainable consumption as a significant post-pandemic consumer change.

Figure 6. China's desire to transition to a net-zero economy made expanding there more attractive



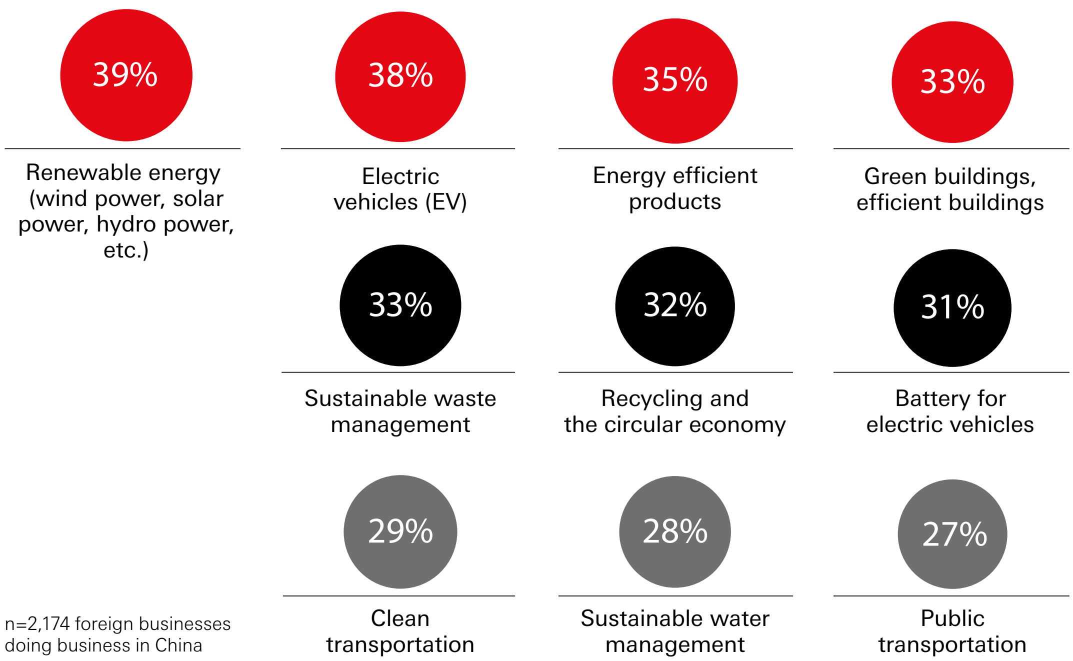
n=2,174 foreign businesses doing business in China

Figure 7. Changes planned by international companies to make their China business more sustainable



n=2,174 foreign businesses doing business in China

Figure 8. Sectors with the greatest growth potential amid China's low-carbon transition



China's low-carbon transition is opening up opportunities for growth and innovation.

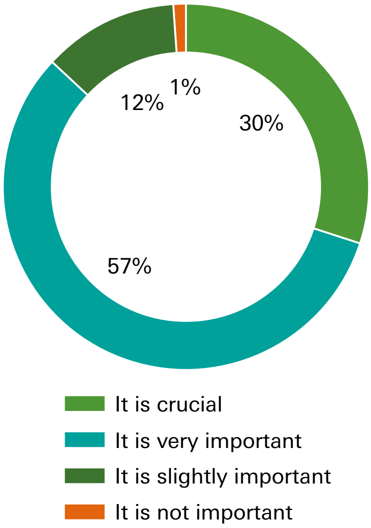
What are the biggest green opportunities seen by foreign firms?

In the eyes of many corporations, the drive to sustainability will provide important opportunities for market growth and innovation. Renewable energy (39%), electric vehicles (38%), and energy efficient products (35%) are seen as having the greatest growth potential within China's low-carbon transition.

Planned investments reflect this assessment, with 27% intending to invest in renewables, 23% in energy-efficient products, and 22% in electric vehicles. It is not hard to see why renewables lead in the attention of the executives participating in our survey. China's consumption of electricity from renewable sources accounted for 28.8% of its total electricity consumption in 2020, according to China's National Energy Administration.

Given the need for new sustainable products, materials, and energy systems to serve the requirements of China's carbon-neutral goals, it is unsurprising that some 86% of international businesses engaged with China agree that the Chinese carbon reduction pledge is an opportunity for them.

Figure 9. How important are ESG/ sustainability credentials of a supply chain partner in China?



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Sustaining expectations: Regulatory pressure and green ESG

In the context of government environmental commitments and rising consumer interest in environmental protection, 4 in 10 of the international executives feel that awareness of sustainability in China has 'considerably grown' in the last 5 years. In all, over 9 in 10 (91%) feel that it has either considerably or slightly grown.

As consumers become more aware of sustainability, and regulators more determined to enforce sustainable practices, international companies must adapt. 87% of international businesses engaging with China find that the ESG and sustainability credentials of their Chinese supply chain partner are either 'very important' or 'crucial'.

When asked about what they would like 'Chinese companies to provide greater disclosure to encourage you to invest in China?', the respondents are most likely to want disclosure of their partners' 'climate action plan' and 'integrated sustainability strategy', with 37% and 35% selecting these, respectively.

Unsurprisingly given the above, international companies are keen to know how the new regulations and rules on carbon reduction could impact their businesses. This is selected by some 3 in 10 international companies as among the top challenges they face when doing business in China.

International companies must adapt to China's changing consumer and regulatory requirements.

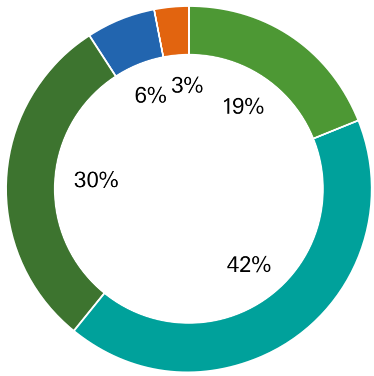
Seizing Their Moment

Foreign firms' near-term investments and operations

Turning on the taps
The expectations held by international companies of continued Chinese growth are reflected in the large investments these firms are intending on making in China. More than 6 in 10 (61%) of the international firms state that they intend on investing more than 10% of their operating profit in China. Specifically, a fifth (19%) say they intend on investing 25% or more, and 42% report intended investment of between 11% and 25% of their operating profit.

The heavy investment in and great expectations of these companies towards China demonstrate that, while international relations continue to evolve, individual businesses and their shareholders continue to identify China as an important place of growth. Indeed, 1 in 4 of US firms is planning to invest a quarter of their operating profit in China next year - behind only Mexican (39%) and UAE (26%) respondents.

Figure 10. The intention to invest resources in China over the next 12 months



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Technology dominates the sectoral investments of foreign companies
Digitally-mediated consumer markets and high-tech innovation dominate perceptions of the Chinese economy among the respondents of our survey.

Unsurprisingly, information technology (IT) investments are by some distance the most likely sector by Chinese-facing foreign firms 'seeking to take advantage of this rapid digitalisation and the rise of the digital economy''. Some 41% of foreign firms say they're investing in IT, 12 points higher than those (29%) increasing investment in industrials, the next most popular sector for investment.

Communications services (telecoms, media and entertainment) is the third-most popular focus of investment, with 28% of respondents investing in this. A natural complement to the IT industry, the investment in communications further shows the importance of the digital economy, as well as the rising needs for entertainment services and products among Chinese consumers.

Most likely to invest in IT are Mexican, Malaysian, and Singaporean executives, of whom 58%, 51% and 50% state their companies are channeling resources into this area. Companies from these three countries are also the most likely to be investing in communications as a part of their plans to take advantage of China's digitalisation.

Deepening engagement; M&A activity, supply chain growth, and hiring plans

M&A plans
Despite the pandemic, China's 2020 M&A value was a 5-year high[4]. Foreign investment also remained strong; China's inbound M&A by foreign strategic investors in 2020 (USD14.6 billion) increased by 31% year-on-year[5].

Our survey reflects that international corporate leaders are continuing to bet on China. More than half (52%) of the international companies are planning to 'significantly increase' M&A activity and takeovers this year or next. Specifically, 1 in 5 (20%) is planning to do so this year, and another 1 in 3 (32%) is planning this next year.

Such planned M&A activity is accompanied by high expectations around organic growth. Over half (54%) of the international firms are significantly increasing this now or next year: with 1 in 5 (20%) doing this already, and a further 1 in 3 (34%) expecting to do this next year.

Supply chain
Some 42% of international companies already have supply chains in China. 40% report that they are increasing their supply chain and securing more supplies from China after the pandemic. This expansion is set to continue with a quarter of these companies expected to see a significant increase in their supply chain footprint in China over the next 24 months.

Headcount
Foreign companies are taking steps to make the most of this growth. Given regulatory and linguistic differences, and the unique nature of China's technological and social media ecosystem, a key step is simply having a larger footprint in the country. Over half (57%) of our respondents plan to increase their headcount in China by 5% or more of their total global headcount.

Partnerships and joint ventures
Building partnerships and joint ventures is also an effective approach to expanding businesses in China. Nearly 4 in 10 international companies with current or planned investments in China (38%) already have partnerships or joint ventures in the country. A further 3 in 10 (27%) are planning on significantly increasing these now; with 1 in 3 (29%) planning on increasing their partnerships and/or joint ventures in one year.

High confidence and strong engagement from Europe and Southeast Asia
Businesses in Europe, one of China's major trading partners, remain confident in the Chinese market. Approximately 3 in 10 of the British, French, and German companies participating in our survey say they are planning to 'significantly increase' their exports to China next year.

French companies are particularly likely to be planning on M&A activity in China this year, with 25% of their executives reporting planned inorganic growth. They are similarly bullish about acquisition plans in a year's time; 34% of both French and German firms report planning inorganic growth for this period.

The pandemic appears to have encouraged Asian engagement with China. Malaysian and Singaporean company executives are most likely to report that following the pandemic they have 'shifted more production to, or increased investment in China', with 48% of Malaysian and 44% of Singaporean executives acknowledging this. On average, 36% of international respondents report this.

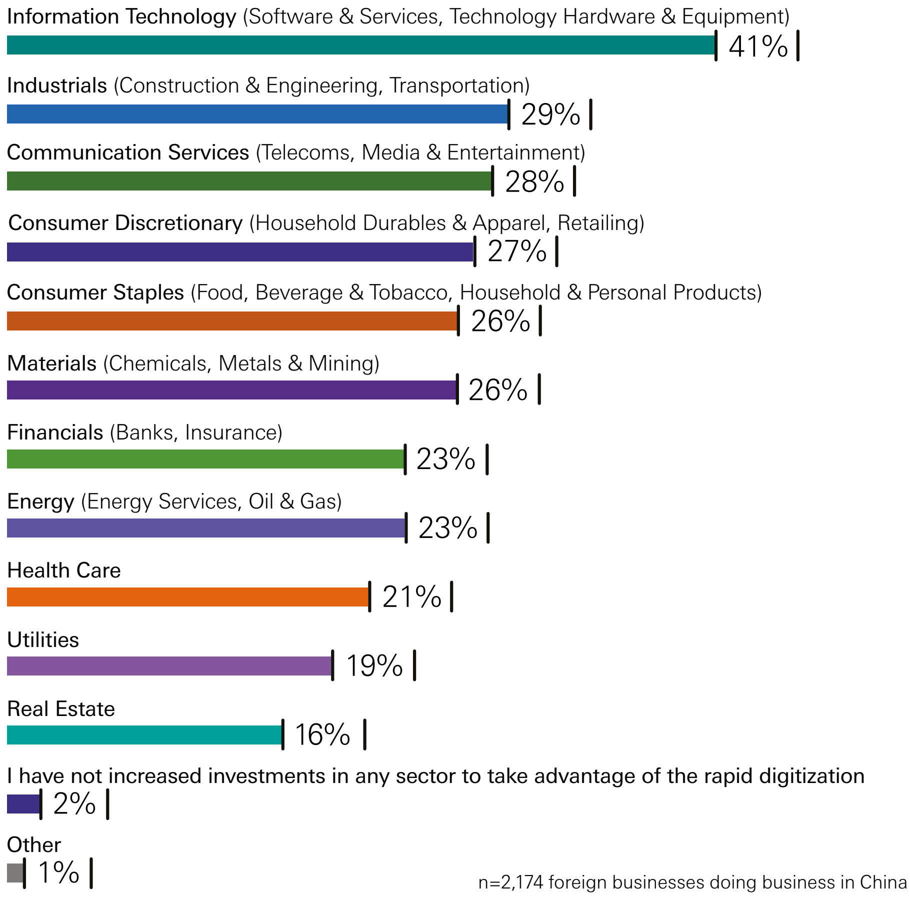
4. PwC, China M&A 2020 review and 2021 outlook, January 2021
5. Chambers and Partners, Corporate M&A 2021, China Trends and Developments, April 2021

A Digital Economy with Chinese Characteristics

Tech investment required for international firms to compete
Throughout our survey data, the emphasis placed by international businesses on Chinese technological innovation is apparent. China is developing a dominant position in digital innovation. Its sheer scale, pervasive digital technology, and relentless market competition make the Chinese market unlike any other. Both private and public forces are at play; in 2017 the Chinese State Council published 'Next Generation Artificial Intelligence Development Plan', a document outlining China's ambition to be the leading AI power by 2030. Immense resources are now being devoted to the pursuit of this goal.

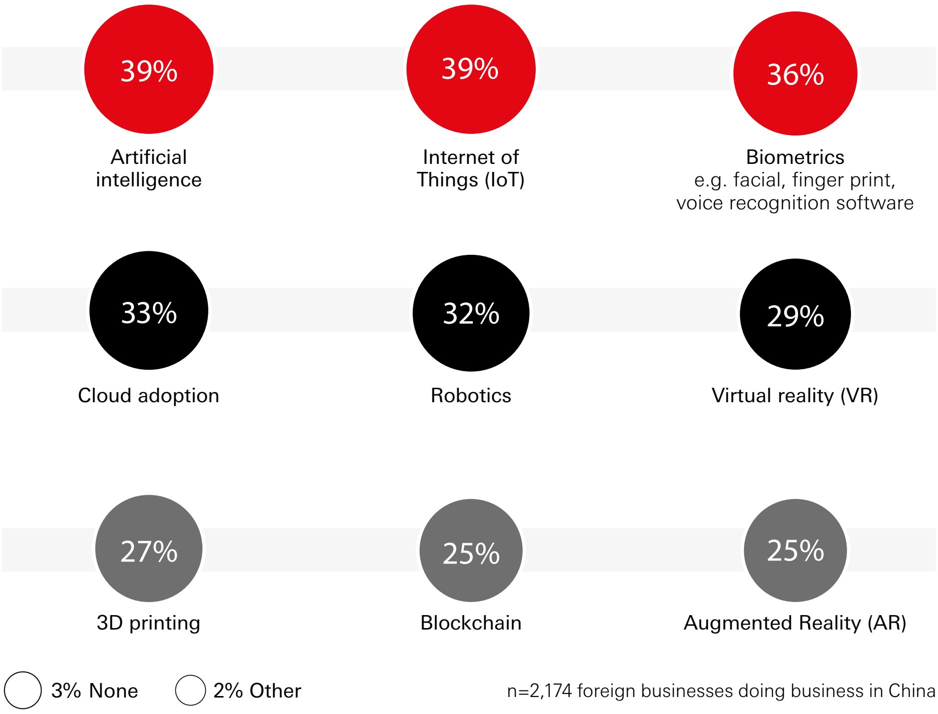
Given these ambitions, not to mention the widespread use of biometrics, and innovations in e-commerce and digital payments technologies, it is no surprise that our respondents demonstrate a widespread belief that China is more technologically advanced than other markets. Some 73% of the international executives who participated in our survey feel that their target market in China is more technologically advanced than their own domestic market, with more than 1 in 3 judging it to be 'much more advanced'. This includes high-tech markets such as Germany, the UK, and the USA - 68%, 64%, and 61% of their respondents respectively state they feel China to be more advanced.

Figure 11. Which sectors have seen increased investments due to the rise of China's 'digital economy'?



To compete in China, international companies must therefore invest in their technological capabilities. IT is the top sector foreign companies have been investing in to take advantage of China's digitalisation, with 41% doing so. A similar proportion (42%) of respondents report increasing investment into their digital platforms and channels to stay competitive in the Chinese market.

Figure 12. Technological developments in China that benefits business growth



n=2,174 foreign businesses doing business in China

Digital channels provide the scale and speed for companies seeking to reach the Chinese consumer.

Digitalisation enabling international businesses to widen their reach
China has nearly one billion mobile internet users. This provides companies with a vast market reachable via digital means, and with more than 400 million Chinese citizens yet to be brought online, this market is due to grow yet further. By investing in digital channels and platforms, domestic and foreign companies can reach these consumers at rapid speed and vast scale.

International businesses clearly consider that digitalisation provides opportunity. In all, 92% agree that the rapid digitalisation has improved the growth prospects of their business in China, of which nearly half (46%) claiming it has 'improved significantly'.

Tech and digital tech enabling energy transition
Artificial intelligence (AI) and the Internet of Things (IoT) are deemed by foreign companies with Chinese investments to be the technological developments that have most significantly benefited their business growth – with 39% of respondents selecting one of these developments.

Systems based on AI and IoT will be core enablers of the energy transition. As physical systems are monitored and optimised to reduce carbon emissions and for other metrics of sustainability, huge investment will be needed in the sensors, algorithms, and platforms required to create data, identify insights, and automate decision making. China's pre-existing investments in computer technologies will thus merge with its sustainability goals, creating opportunities for investors as it does so.

Conclusion

Our survey demonstrates the strong confidence held in China by the international companies who do business there. Our respondents see China as a country of continued promise – a market with a history and future of strong economic growth, a culture of technological innovation, and a proactive and attractive posture towards the challenge of climate change.

Despite the changing nature of international relations, it is clear that international companies will continue to find value in China-centric growth and investment strategies. In our era of global supply chains, and with international collaboration needed on the environment, the logic and benefits of continued engagement with China remain strong.

Methodology
The survey was commissioned by HSBC as part of HSBC Navigator research, and conducted by FTI Consulting online from 9th to 14th September 2021 with 2,174 respondents who are involved in or influence the strategic direction of their company and are currently doing business with China or intending to in the future. The research was conducted across 10 markets: USA, Canada, Mexico, UK, France, Germany, UAE, Malaysia, Singapore, and Australia.

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Note: There may be a slight discrepancy between the sum of individual items and the total as shown in the tables due to rounding.