Member Survey

The US-China Business Council | 2023

THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

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Executive Summary

The US-China Business Council conducted its annual Member Survey in summer 2023. The data in this report reflect responses from leading American companies' senior executives based in the United States and China. Most respondents are large US-headquartered multinationals that have operated in China for several decades, and nearly half generated more than $1 billion in revenue in China last year. This report seeks to measure business sentiment and benchmark challenges and opportunities in the China market.

Geopolitics is the single largest issue weighing down business sentiment over the long term. Continued deterioration in the US-China relationship over the last 12 months has led to uncertainty, lost sales, and rising costs for more USCBC member companies than ever before. Bilateral tensions, among other factors, are contributing to delayed or canceled investments in China. While very few firms plan to fully exit the China market, many companies are adjusting their China-specific business operations, strategies, and supply chains to mitigate the impact of increasing tension.

Long-standing domestic policy issues in China are impacting American firms' competitiveness. American companies that conduct business in China continue to encounter systemic challenges around market access and barriers to investment, opaque rules and uneven regulatory enforcement, and rising compliance requirements, particularly around data security and privacy. Industrial policies aimed at developing domestic innovation and national champions, policies that companies have raised concern about for many years, are giving rise to worries over lost market share in China and globally. While China reopened its borders in 2023, a significant majority of respondents report few tangible improvements in the business environment.

The trajectory of US-China relations will dictate future investment trends. Most companies remain profitable in China and recognize the China market's importance to their global competitiveness. However, the challenging domestic operating and geopolitical environments have cut into company profits and revenues, fueling record-high pessimism and causing companies to take a more cautious approach regarding future investments. The pace with which US business sentiment and future investments rebound will depend on the decisions of policymakers in China and the United States.

2023 Top-10 Challenges	2022
#1 US-China relations: Geopolitics or domestic politics	2
#2 Data, personal information, and cybersecurity rules	4
#3 Export controls, sanctions, and investment screenings	6
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Introduction

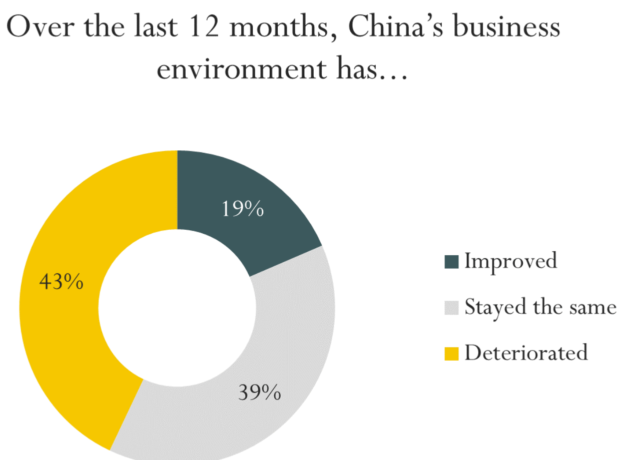
For most US companies in China, this year has not proceeded according to expectations. While the Chinese government's decision to lift COVID-19 restrictions in late 2022 eliminated real obstacles to conducting business, growth in the domestic economy has been stubbornly slow, and many familiar policy and operating challenges in China have not improved. On the global stage, the deteriorating US-China bilateral relationship is creating greater uncertainty as both countries continue to levy export and investment restrictions against each other. Consequently, the level of optimism among US companies operating in China is at a historic low.

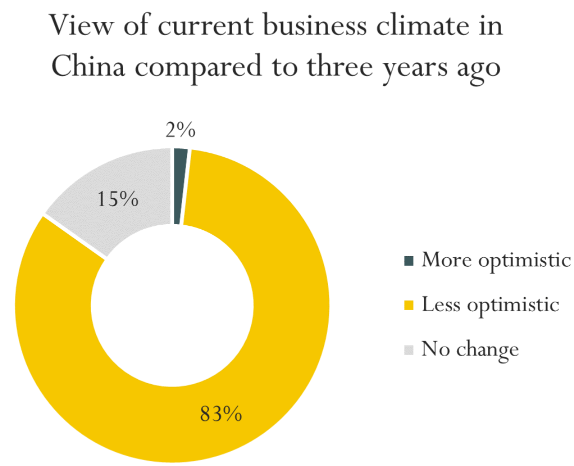
The list of top-10 challenges from this year's member survey provides a view of the contours of the business environment for American companies in China today. Two of the top-three challenges are related to geopolitics. US-China relations have regained their place as the top challenge, replacing COVID-19 lockdowns, while export controls, sanctions, and investment restrictions have risen to the third spot from sixth last year. Notably, China's data policies are now the second-biggest challenge—their highest-ever level on the list—reflecting the pace, complexity, and costs of new policies. Other challenges relate to Chinese policies that put American companies at a competitive disadvantage, such as industrial policy, and issues that were previously lower in priority cracked the top-10 list, including licenses and approvals, uneven enforcement of laws and regulations, international travel, and transparency.

Business Sentiment

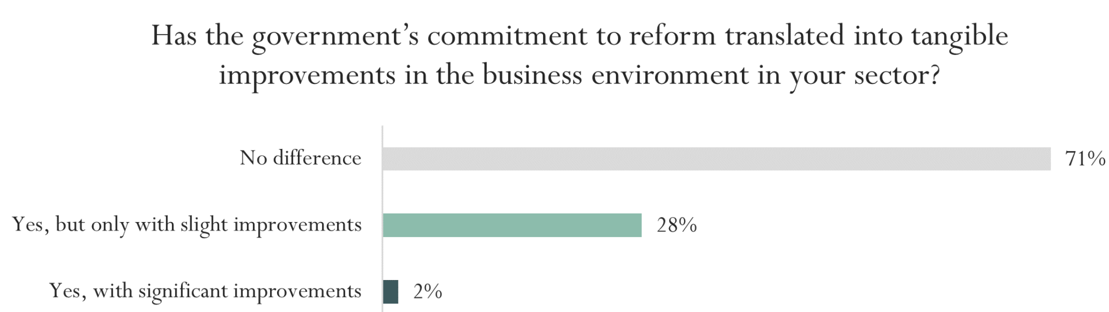
Companies are waiting for the post-COVID business environment to improve

The Chinese government's decision to dismantle its zero-COVID strategy in December 2022 removed a major source of uncertainty for companies that conduct business with China and generated an expectation that business conditions would improve. In large part, those expectations have not yet been met. While this is undoubtedly related to China's economic slowdown, this year's survey also indicates that most companies perceive the business environment as a contributing factor to unmet expectations. Survey respondents indicate that China's business environment is either deteriorating (43 percent) or not improving (39 percent), while less than one-fifth (19 percent) of companies see an improvement.



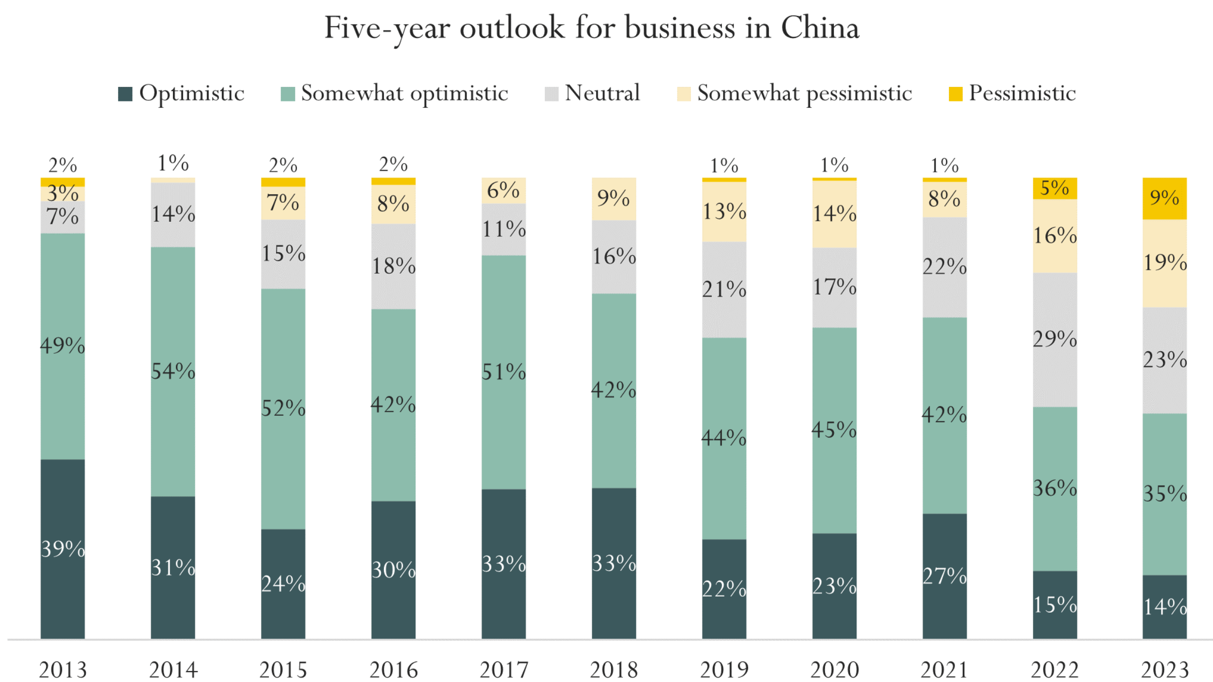


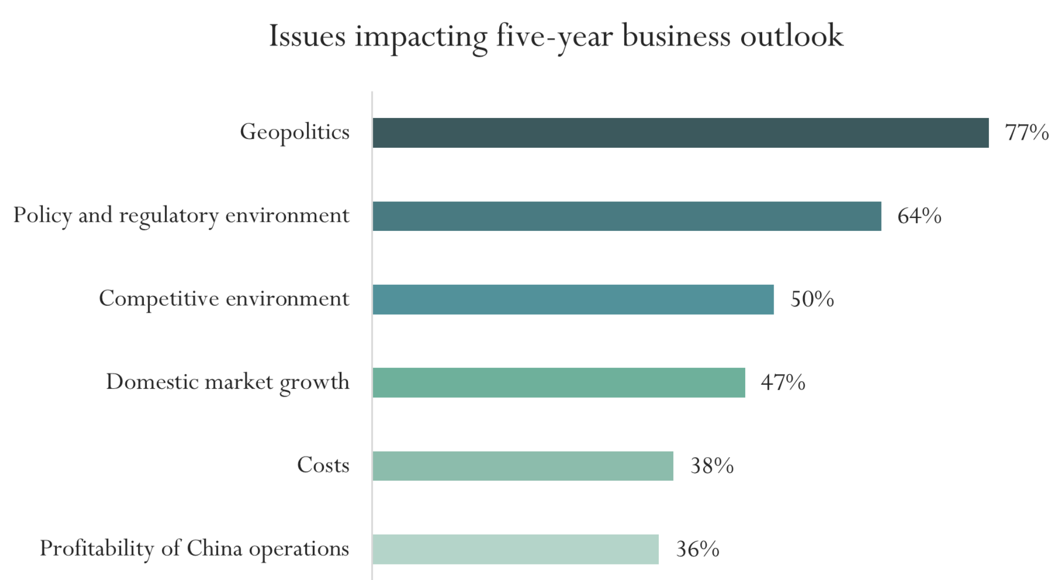
Despite the Chinese government's efforts to attract more foreign investment, a sentiment that was conveyed by senior ranking Chinese policymakers at Davos and the China Development Forum in early 2023, 71 percent of companies say that the government's commitment to reform has not translated into tangible improvements in the business environment for their sector. Only 2 percent of respondents are more optimistic about the current business climate in China compared to three years ago, while 83 percent say they are less optimistic.



Optimism hits an all-time low for second consecutive year

This year, companies' five-year business outlooks have continued a downward trajectory. About half of companies surveyed have expressed an "optimistic" or "somewhat optimistic" outlook—a new all-time low for the second consecutive year. At the same time, pessimism has reached an all-time high of 28 percent, up seven percentage points from last year and over triple the figure from 2021. Companies attribute their five-year outlooks to concerns about geopolitics (77 percent), China's policy and regulatory environment (64 percent), and competition (50 percent), among other issues.

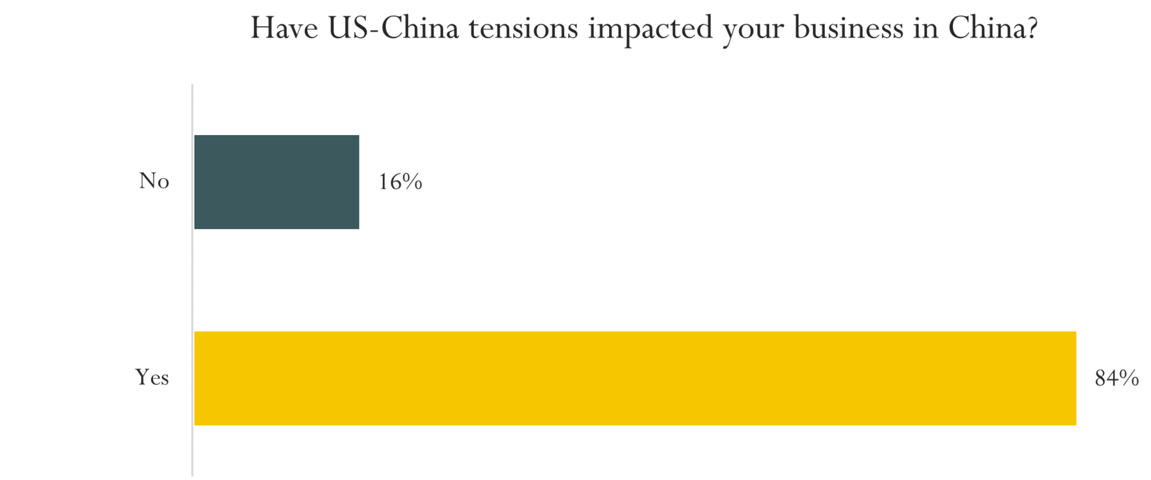




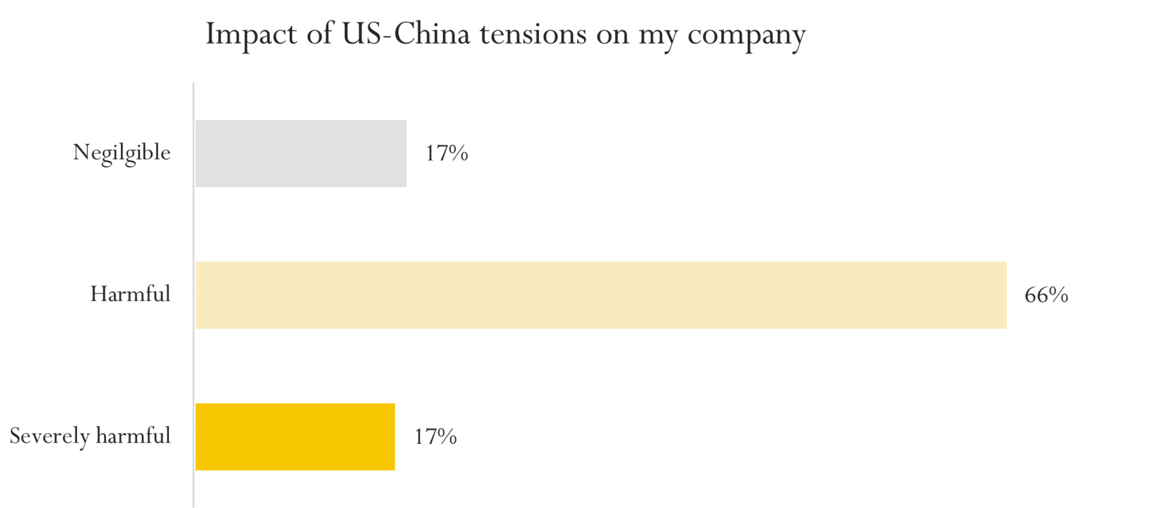
Key Challenges

US-China relations and geopolitics weigh on business sentiment and investment plans

Two of this year's top-three challenges were related to US-China relations. With China now moving past the pandemic, US-China relations have supplanted COVID-19 lockdowns to once again rank as this year's top challenge, while export controls, sanctions, and investment screenings are third. Excluding last year, US-China relations have taken the top place since 2018, when tariff escalations first began.

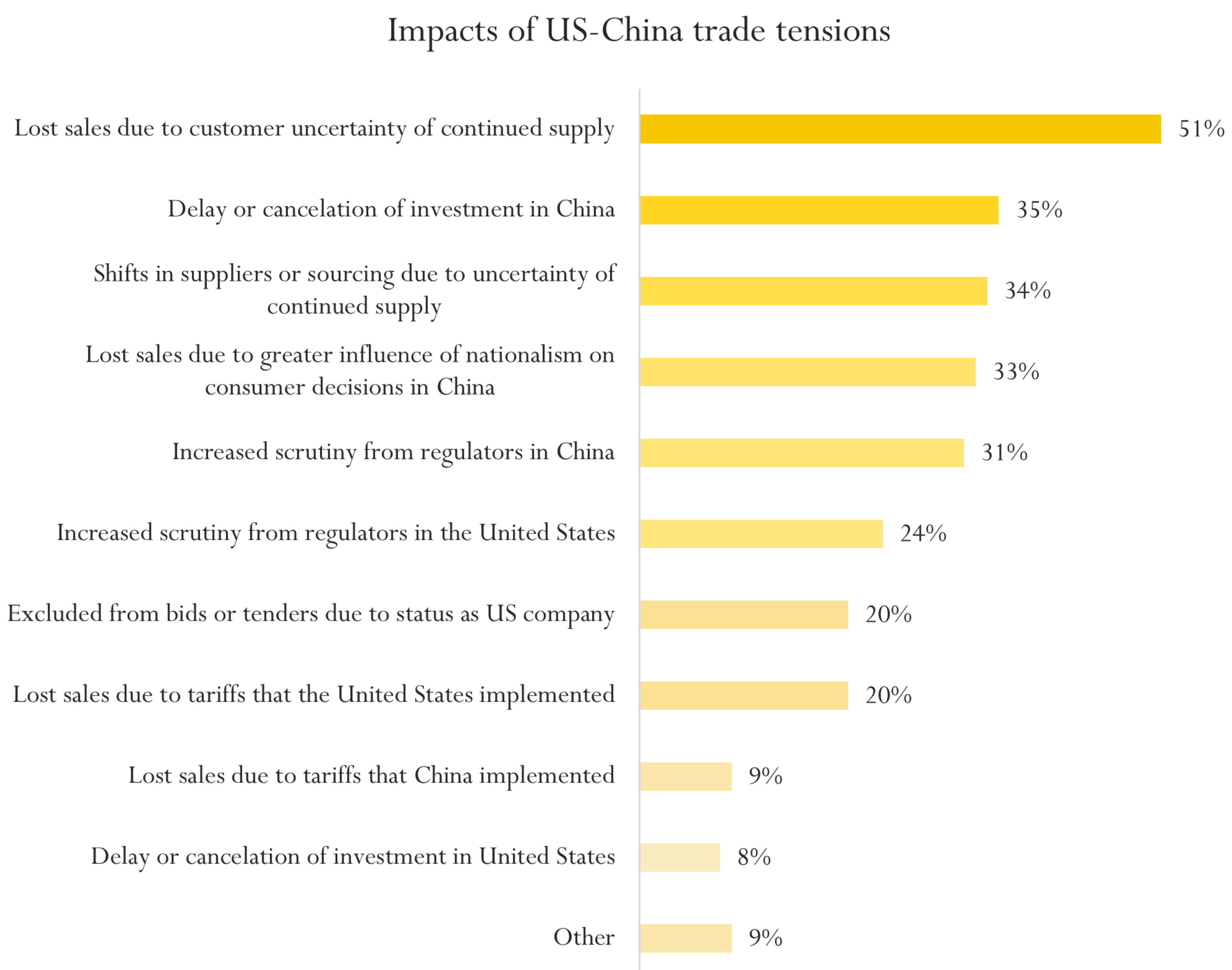


Negative impacts from US-China relations have affected 84 percent of respondents, with 66 percent of affected companies experiencing harmful impacts and nearly 20 percent reporting severely harmful impacts.

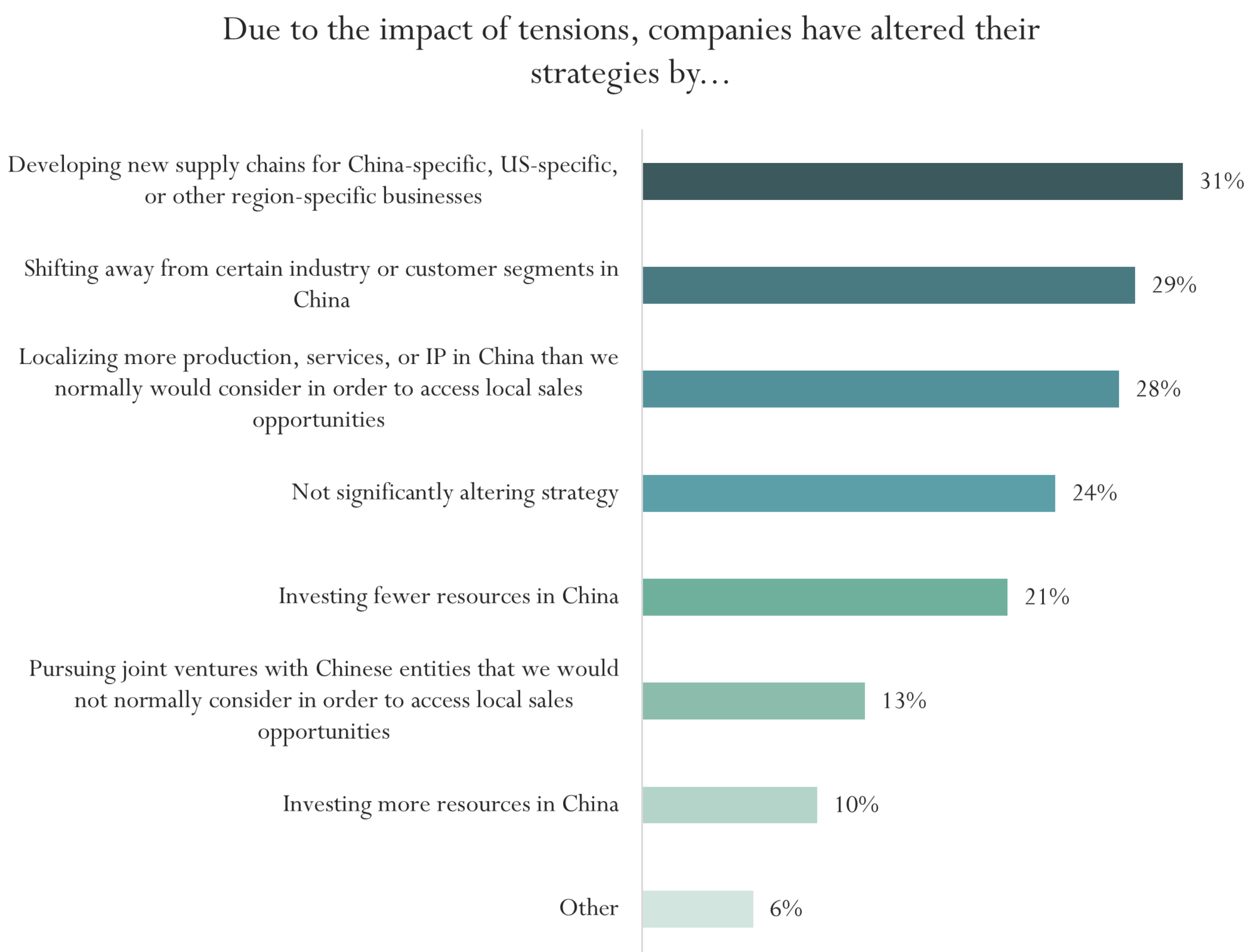


Rising US-China tensions are resulting in lost commercial opportunities for US companies. A record high of one-half of respondents report lost sales due to customer uncertainty of continued supply, while one-third of respondents have lost sales due to rising nationalism among Chinese consumers. Twenty percent of those impacted report lost sales due to tariffs imposed by the United States, and 9 percent report lost sales due to tariffs imposed by China.

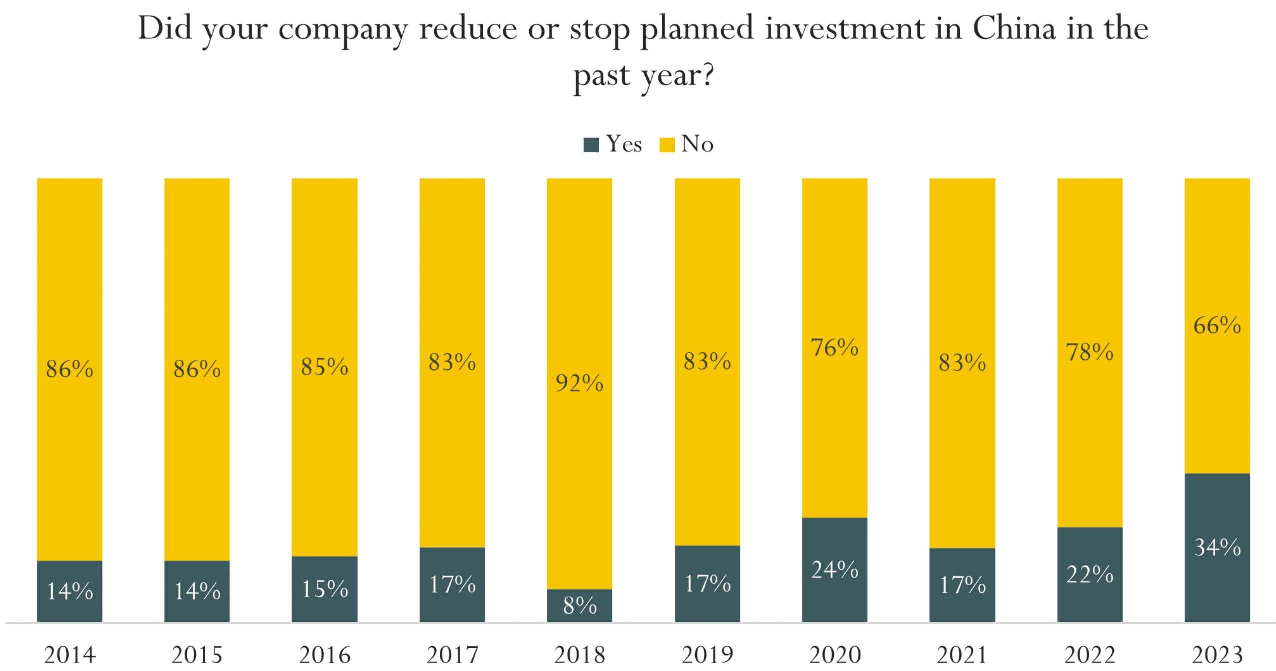
Rising US-China tensions are also impacting companies' commercial decisions. More than one-third of respondents say that the impact of US-China tensions has resulted in delayed or canceled investments in China, the same proportion as last year, while 34 percent have changed their own suppliers to mitigate uncertainty around continued supply.



Facing increased pressure from both sides of the Pacific, companies are undertaking a range of business strategies to ensure continued access to the China market and diversify supply chains. About a third of companies report developing separate supply chains for their US-, China-, or other region-specific businesses, continuing a trend that has been underway for several years. In addition, nearly one-third of companies are localizing more production, services, or intellectual property (IP) in China. At the same time, some companies are choosing to shift away from certain industry or customer segments (29 percent) and invest fewer resources in China (21 percent) because of uncertainty stemming from the bilateral relationship.



More than one-third of respondents have reduced or paused planned investments in China over the past year —another record high and a noticeable increase from 22 percent in last year's survey. Companies point to increased costs or uncertainties from US-China tensions, increasing market access restrictions, and the need for supply chain resilience as the top reasons for pausing or canceling investment plans over the past year.


Did your company reduce or stop planned investment in China in the past year?
Yes
No
86%
86%
85%
83%
92%
83%
76%
83%
78%
66%
14%
14%
15%
17%
8%
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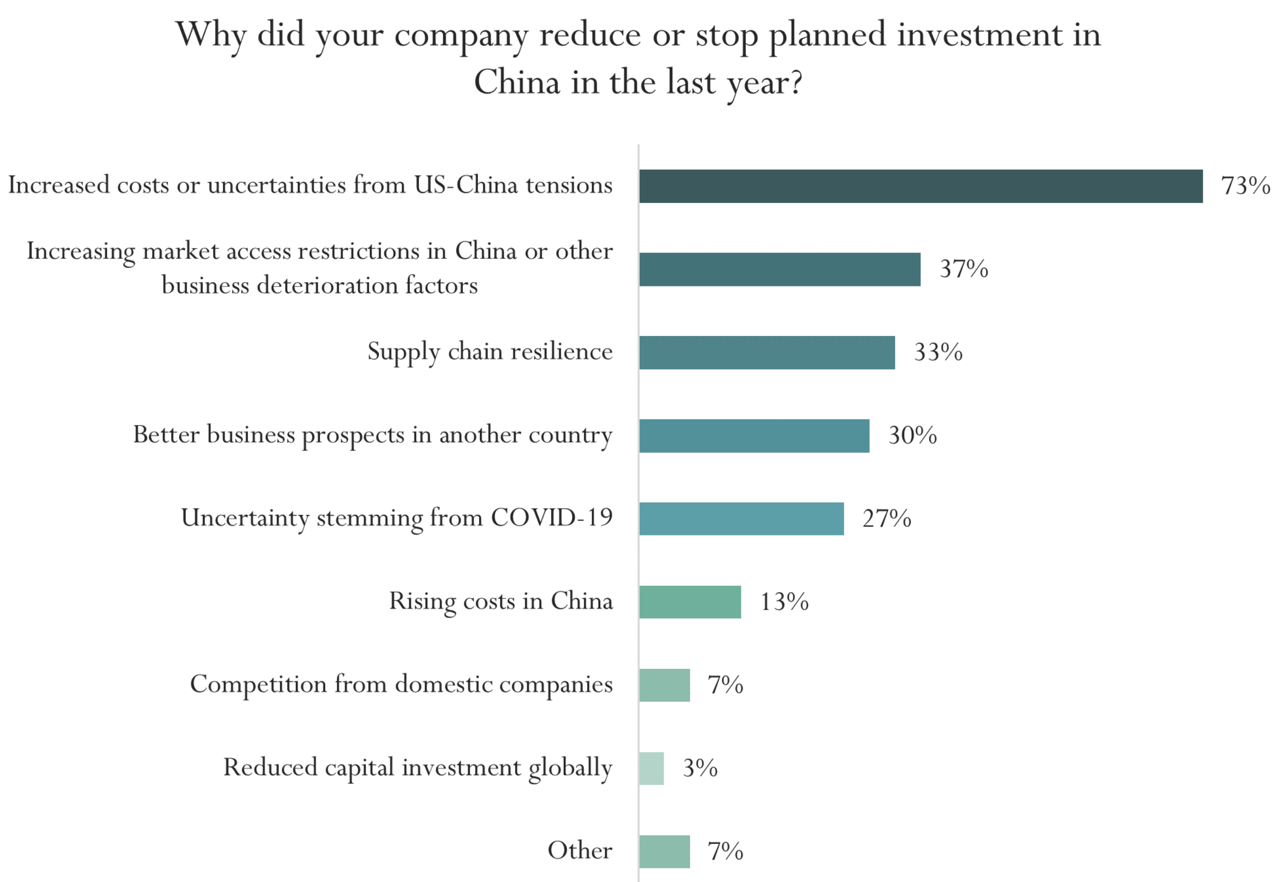
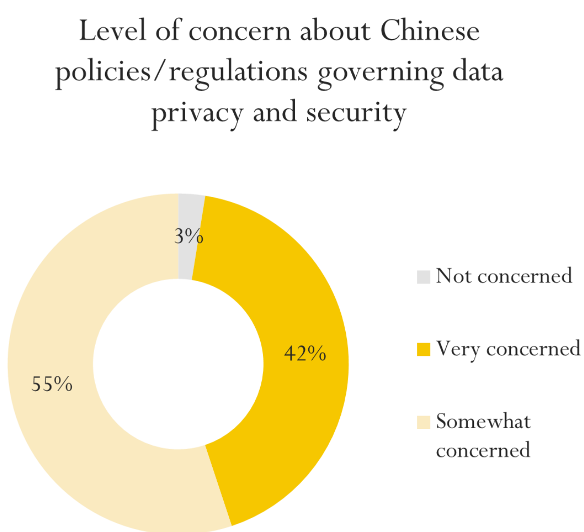

Why did your company reduce or stop planned investment in China in the last year?
Increased costs or uncertainties from US-China tensions
73%
Increasing market access restrictions in China or other business deterioration factors
37%
Supply chain resilience
33%
Better business prospects in another country
30%
Uncertainty stemming from COVID-19
27%
Rising costs in China
13%
Competition from domestic companies
7%
Reduced capital investment globally
3%
Other
7%

Rising compliance requirements propel data, personal information, and cybersecurity rules to number-two challenge

In recent years, the Chinese government has placed a higher priority on regulating data, protecting personal information, and addressing its perceived national security concerns. The Cybersecurity Law, originally implemented in 2017, and subsequent Data Security Law and Personal Information Protection Law provide the foundation for a more onerous framework for governing companies' management of the data they collect, but many of the practical implementing details are imprecise and costly. Companies that invest in China leverage their global scale to enhance their competitive advantage. Restrictions on cross-border data transfers and overly broad data security concerns have impacted companies' investment plans, as China's data policies inhibit the integration of local operations into global businesses.

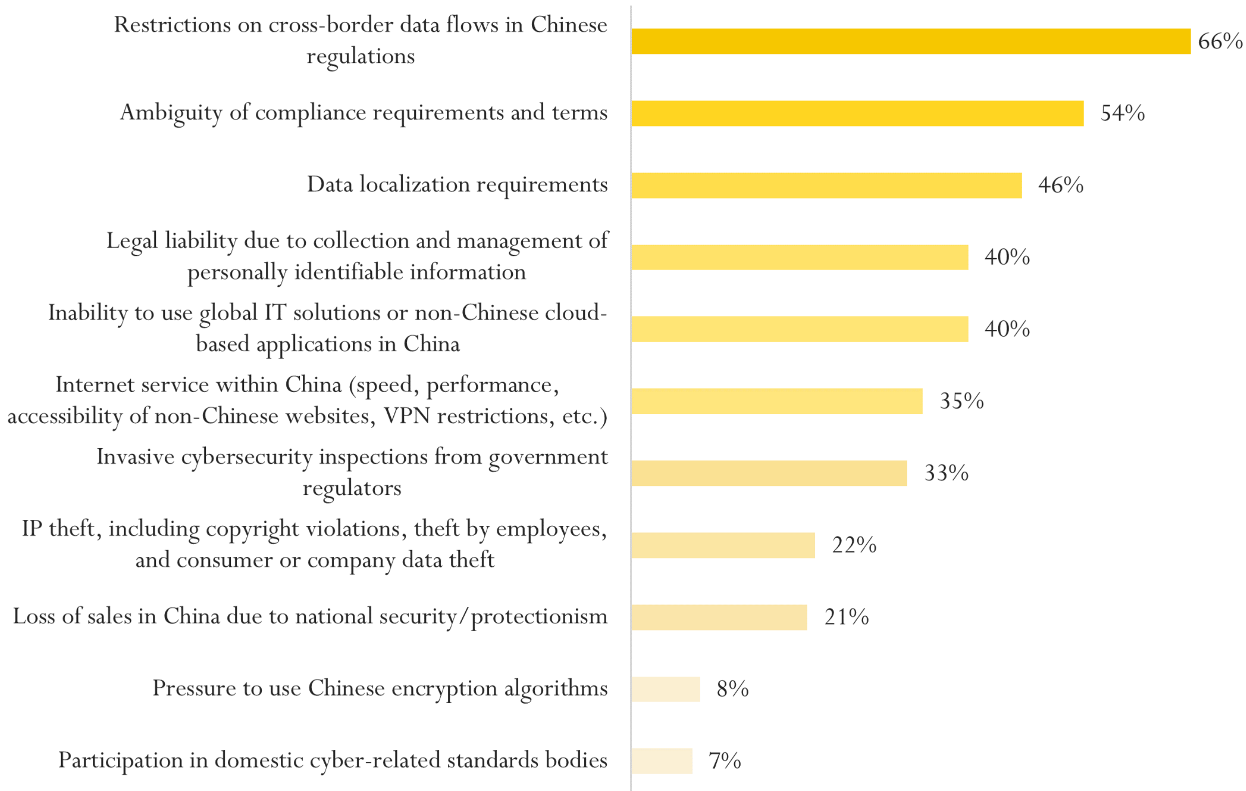


Companies are more concerned about China's data, privacy, and cybersecurity policies than ever before, indicated by its rank as number two on the list of companies' top issues, a jump from fourth place last year. Respondents have also expressed the highest level of concern about data and cybersecurity policies since their inclusion in this survey, with 97 percent either "very" or "somewhat" concerned.

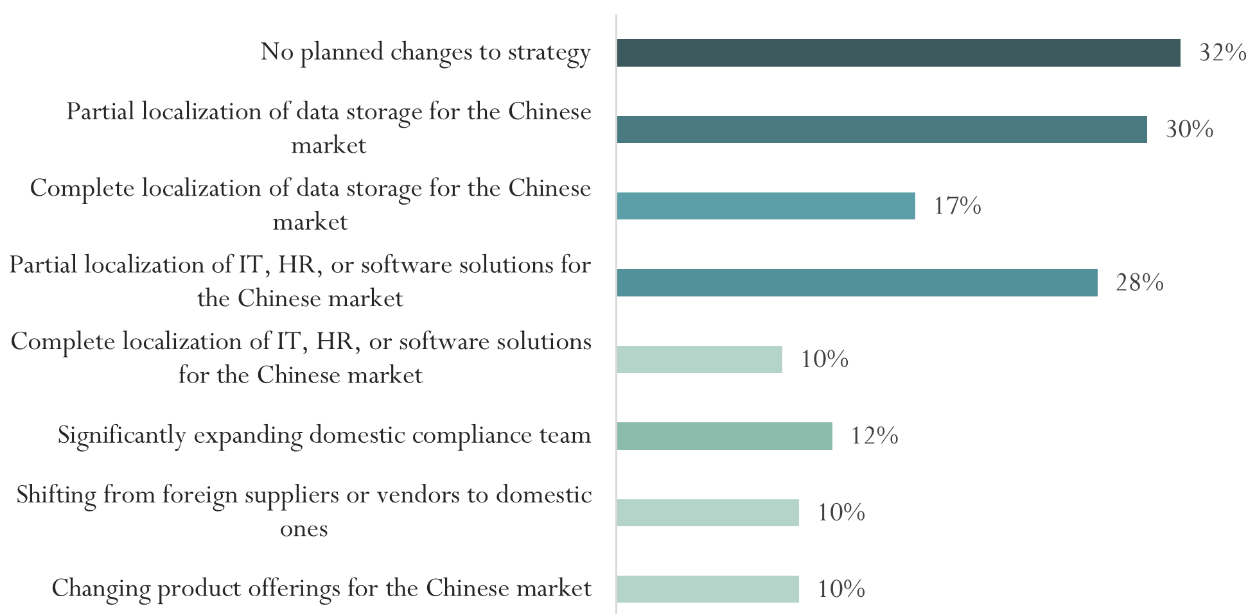
For the third consecutive year, companies cite cross-border data transfers as their most challenging cyber-related issue, with 66 percent indicating concern. Companies are likely to experience greater impacts as more apply for government security reviews to transfer data overseas, a new requirement. Consistent with last year, over half of respondents express concern about ambiguous cyber and data security compliance requirements, while 46 percent cite concerns about China's data localization requirements.

As Chinese regulators issue more measures to clarify compliance requirements around data security and privacy, companies are incrementally adapting their data-handling and processing practices. At this juncture, nearly one-half of respondents have already localized their data storage partially or completely, while nearly 40 percent of companies have localized at least some software solutions for the China market. Further, about a third of companies indicate that they currently do not have plans to change their data strategies. The wide range of responses may reflect companies' efforts to comply with China's data regulations while also using global systems and practices when possible.

Concerns about data security-related issues



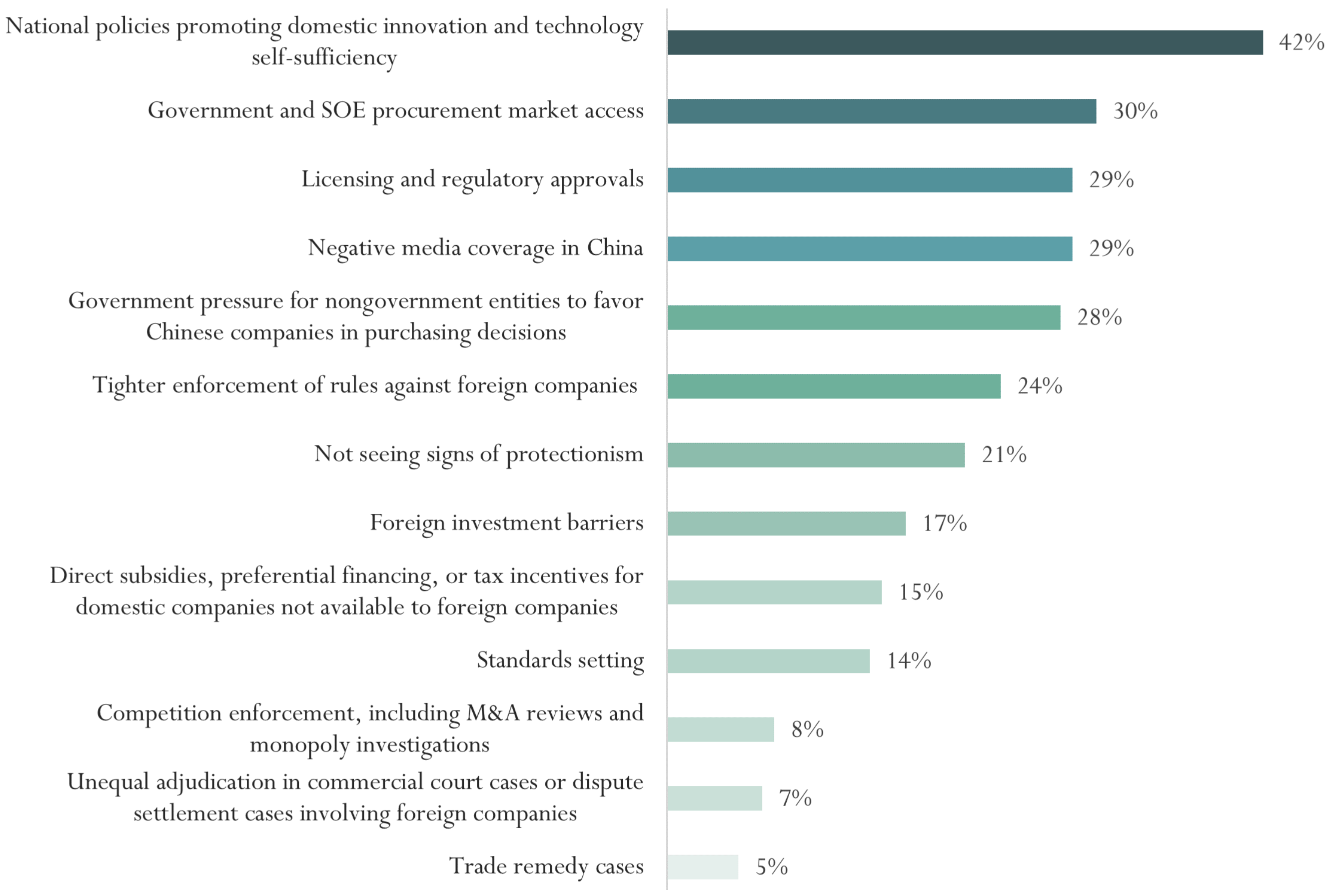
How is your company adapting its strategy based on cyber-related concerns?



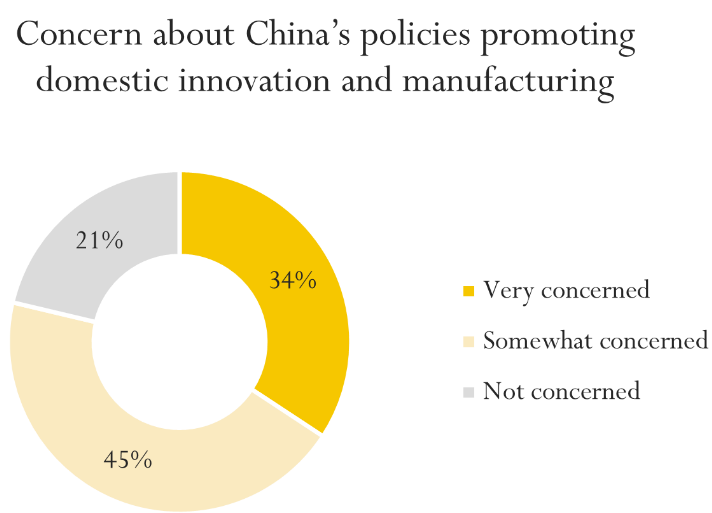
Protectionism exacerbates competition concerns

Protectionism can take many forms. For the fourth consecutive year, national policies promoting domestic innovation and technology self-sufficiency are the most prevalent forms of protectionism that respondents report. Member company concerns about China's policies promoting domestic innovation and technology self-sufficiency have retained similarly high levels since 2017, when the survey first posed the question. Other familiar policy tools, such as procurement market access barriers, foreign investment restrictions, licensing and approvals mechanisms, and uneven implementation of rules, also limit the ability of foreign companies to compete in the China market.

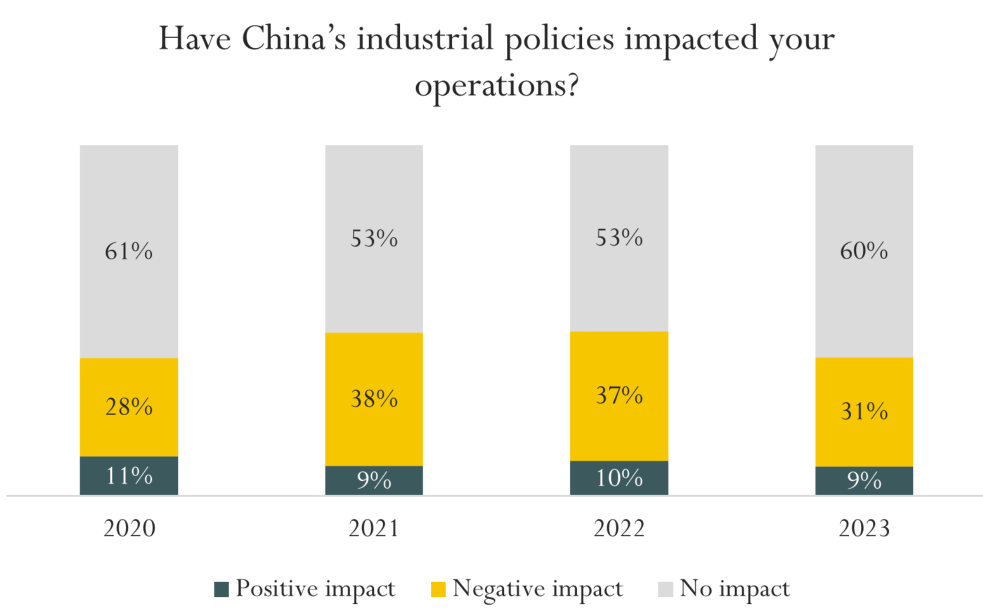
In what areas, if any, is your company seeing signs of protectionism in China?



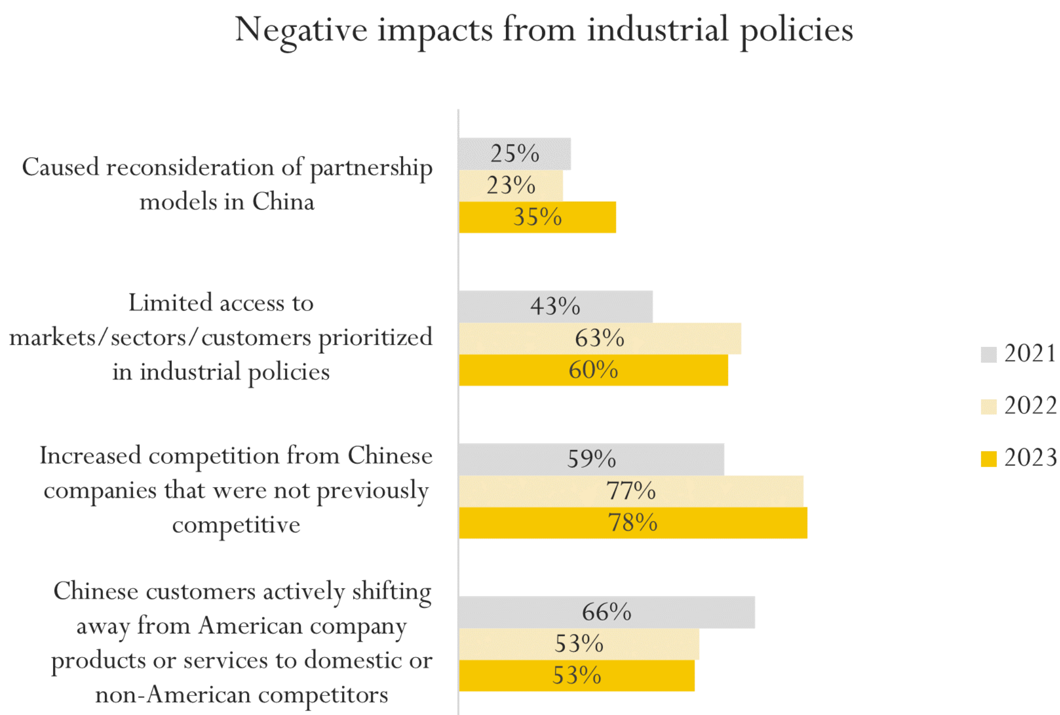
China employs a range of industrial policies aimed at strengthening domestic technological capabilities and reducing its reliance on foreign technologies, trade, and investment. These policies can become problematic when they are used to protect domestic industries from competition with foreign companies or when they lead to overcapacity. In this year's survey, competition with Chinese companies ranked fourth in the list of top-10 operating challenges—an all-time high. Companies attribute the rise in domestic competition to broad support from China's industrial policies. Some industrial policies carry specific localization and domestic content requirements, which have the intended effect of boosting market share for domestic companies.



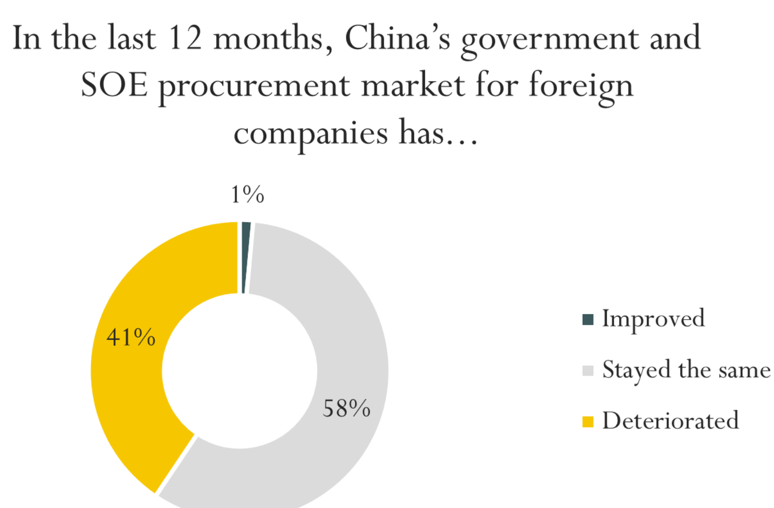
Roughly 80 percent of respondents are concerned about China's policies promoting domestic manufacturing and innovation. Going beyond concern, 31 percent of companies say that China's industrial policies have negatively impacted their operations.



Consistent with last year's survey, companies cite increased competition from Chinese companies as the top negative impact of China's industrial policies. Compared with two years ago, the share of respondents who believe China's industrial policies are resulting in stronger domestic competition has increased by nearly 20 percentage points. At 60 percent, limited access to markets, sectors, or customers is the second-biggest impact.

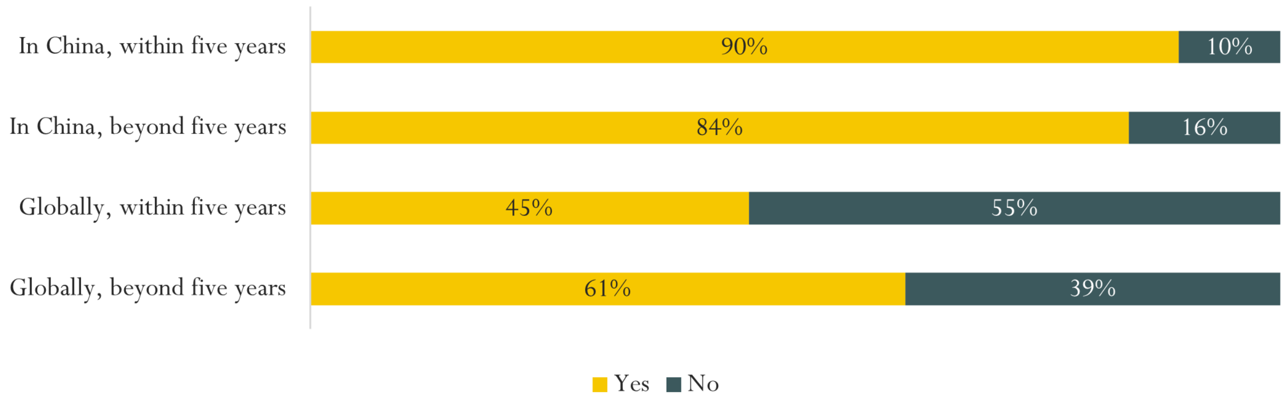


Companies' perceptions of China's public procurement markets have largely stayed the same or deteriorated over the last 12 months. Procurement markets are subject to a wide range of protectionist measures and serve as a key instrument of China's industrial policy tool kit.



As the government pursues long-term strategies to promote domestic champions, US companies are expressing greater urgency about the potential for lost market share. The overwhelming majority of respondents (90 percent) believe that China's industrial policies will erode US market shares in China within five years, a dramatic increase from the 59 percent who indicated the same in last year's survey. Additionally, nearly half of companies are concerned about losing market share to Chinese competitors globally in the short term.

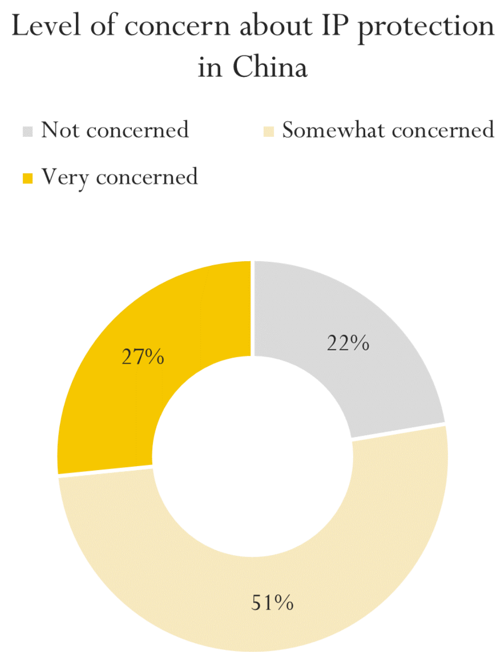
Are you concerned that Chinese industrial policies will negatively impact your market share?



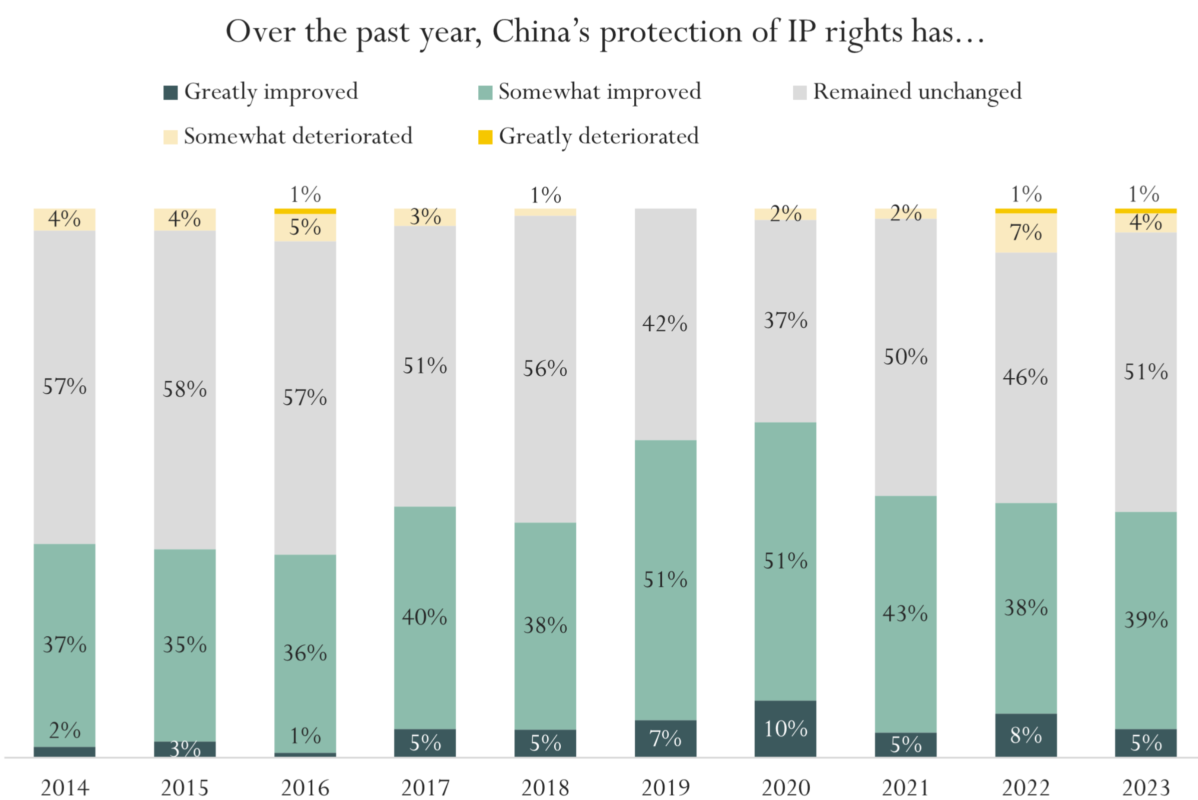
Other operating and regulatory issues

IP protection

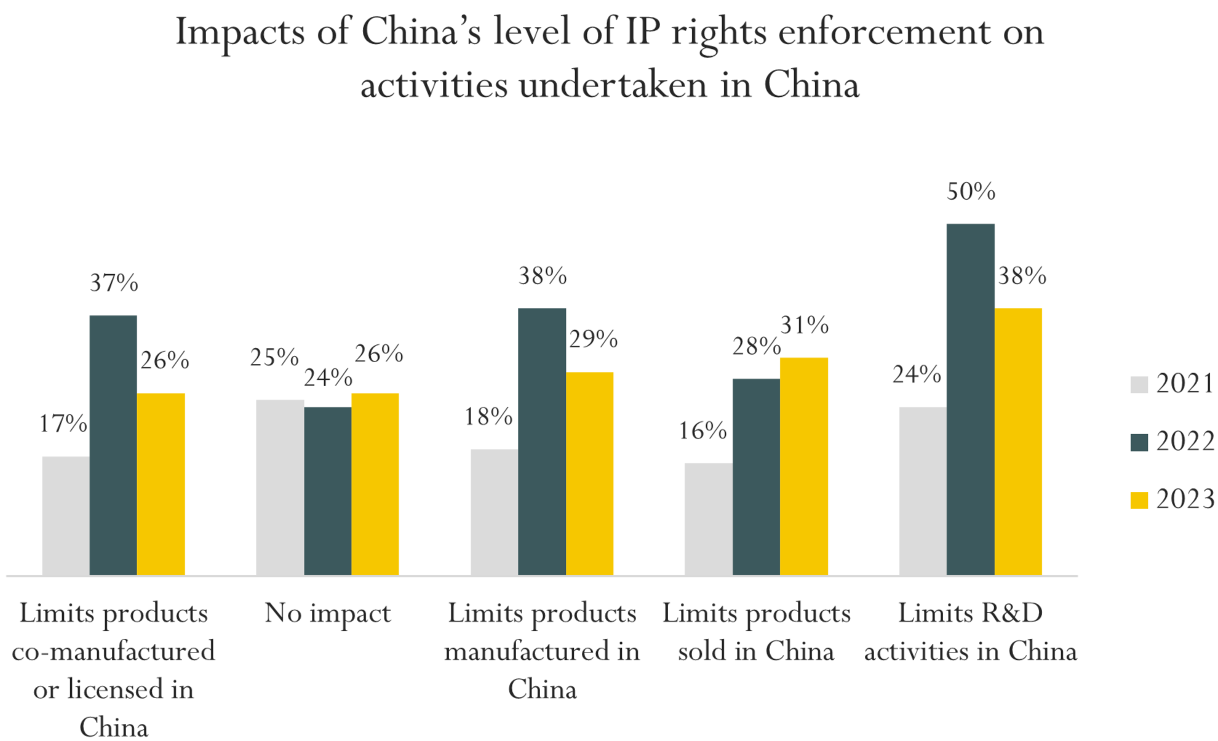
A perennial issue for most companies in China, IP protection ranks ninth on the list of member companies' top-10 challenges. As in previous years, most companies (78 percent) are concerned about the level of IP protection in China, and patents and trade secrets are cited as the IP infringements of greatest concern. Although the level of professionalism and specialization of China's IP courts has risen in recent years, companies continue to report challenges with local authorities enforcing judicial decisions.



After reaching record-high levels of optimism in 2020, owing to bilateral commitments from the US-China Phase One Trade Agreement, companies' perceptions of China's protection and enforcement of IP rights have stagnated. Meanwhile, anecdotally, companies report that IP infringers are becoming more sophisticated.

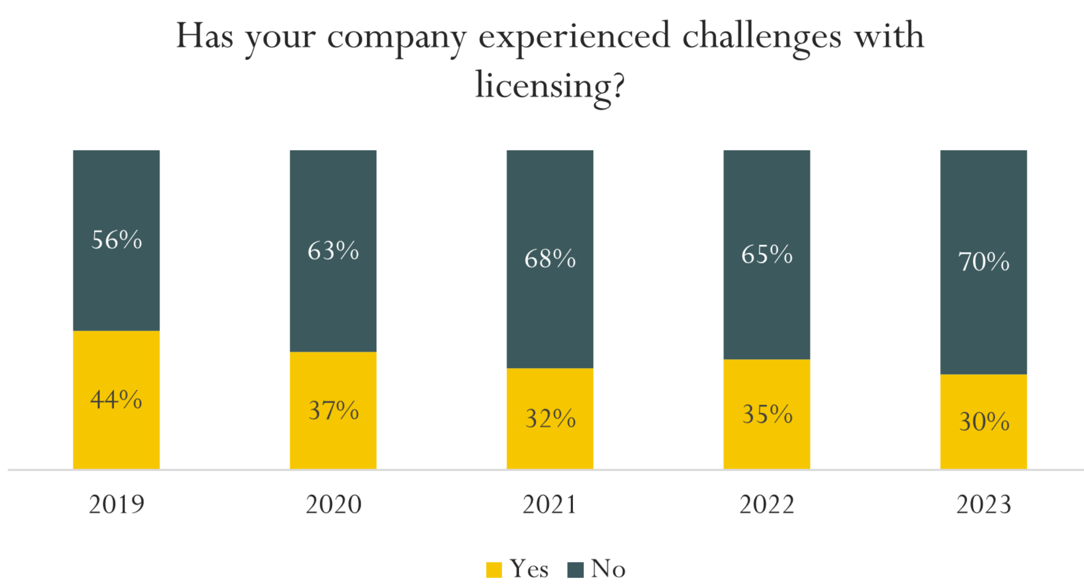


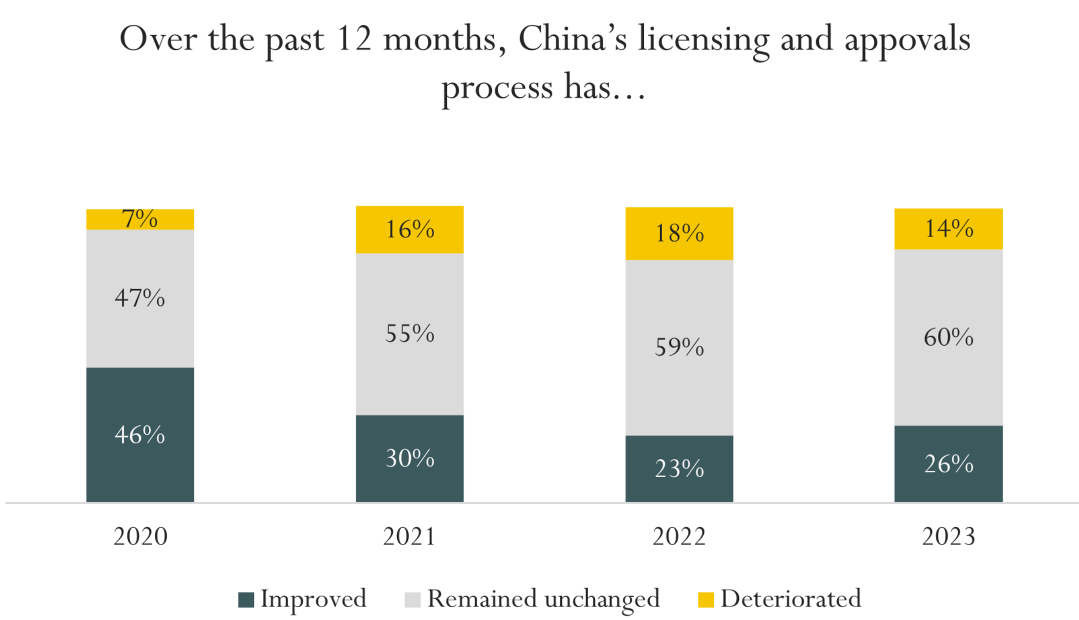
Concerns about IP protection and enforcement influence the types of commercial activities and investments that companies undertake in China. Over one-third of respondents limit their research and development activities in China due to IP protection concerns, while a similar proportion of companies report a reluctance to sell certain types of products in China. Despite the United States and China agreeing to specific commitments to protect IP under the US-China Phase One deal in 2020, the proportion of companies reporting negative impacts has grown over time.



Licensing and approvals

Another area where progress has seemingly stalled is licensing and approvals, which ranks as a top-five challenge for companies for the first time since 2019. While fewer companies are reporting specific challenges in obtaining licenses compared to previous years, only about one-quarter of respondents perceive an improvement in China's licensing and approvals process in the past year. This is noticeably down from three years ago, when nearly one-half of respondents saw improvements. As in previous years, the vast majority of companies report challenges with securing approvals from central government regulators, while about one-third encountered challenges with provincial-level regulators.



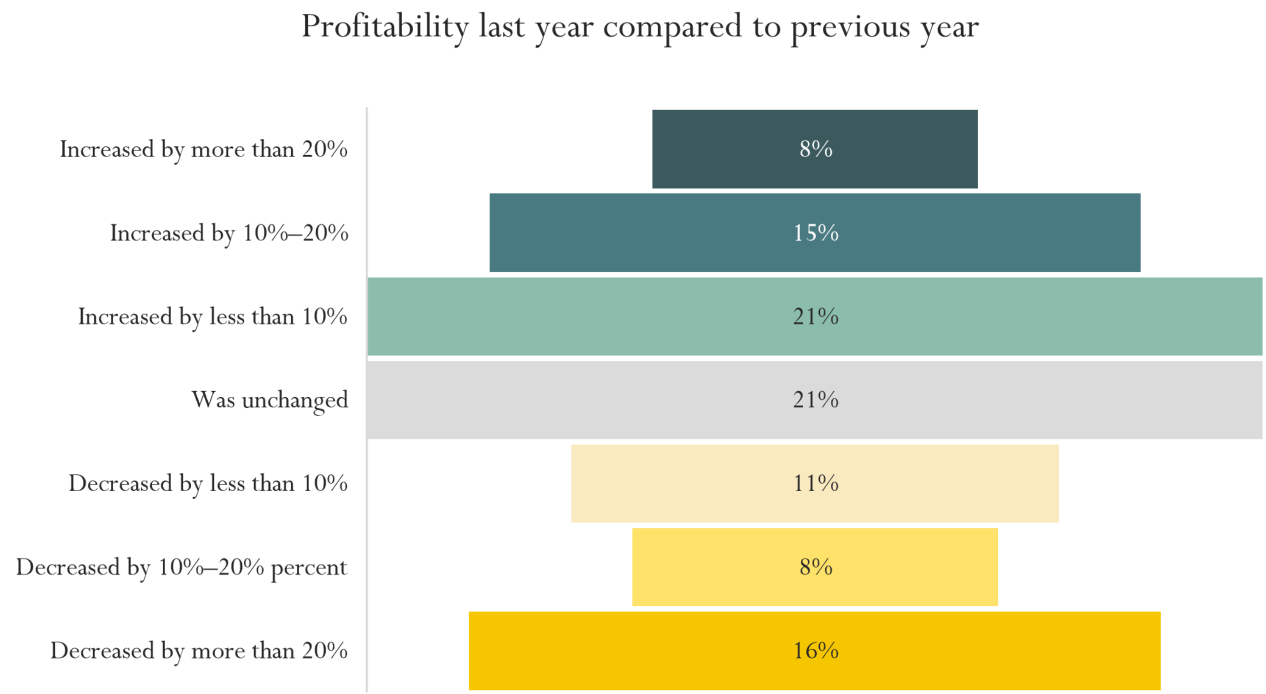


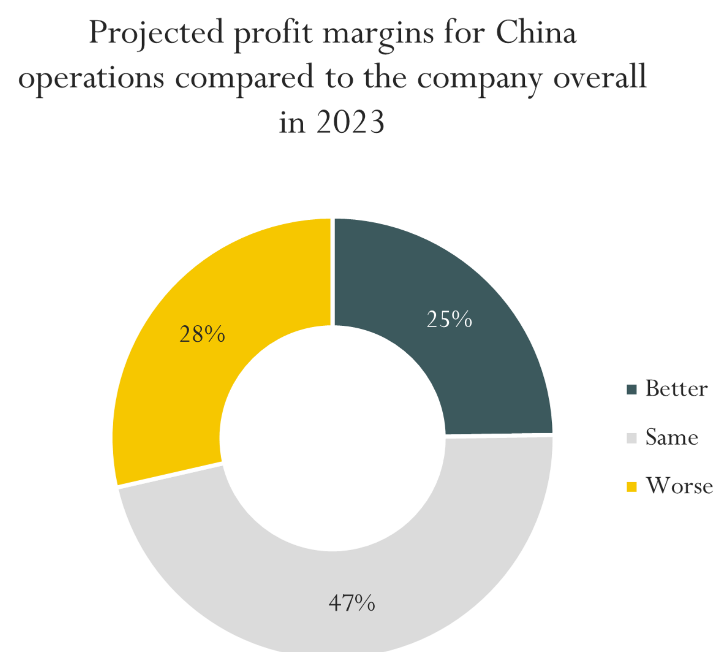
Company Performance and Future Planning

Companies were profitable in 2022, but margins were under pressure

Overall, companies' financial performance in China remains healthy despite being weaker than in recent years. Eighty percent are profitable, but this is a decrease of nine percentage points from the year prior, and profit margins are growing more slowly year over year.

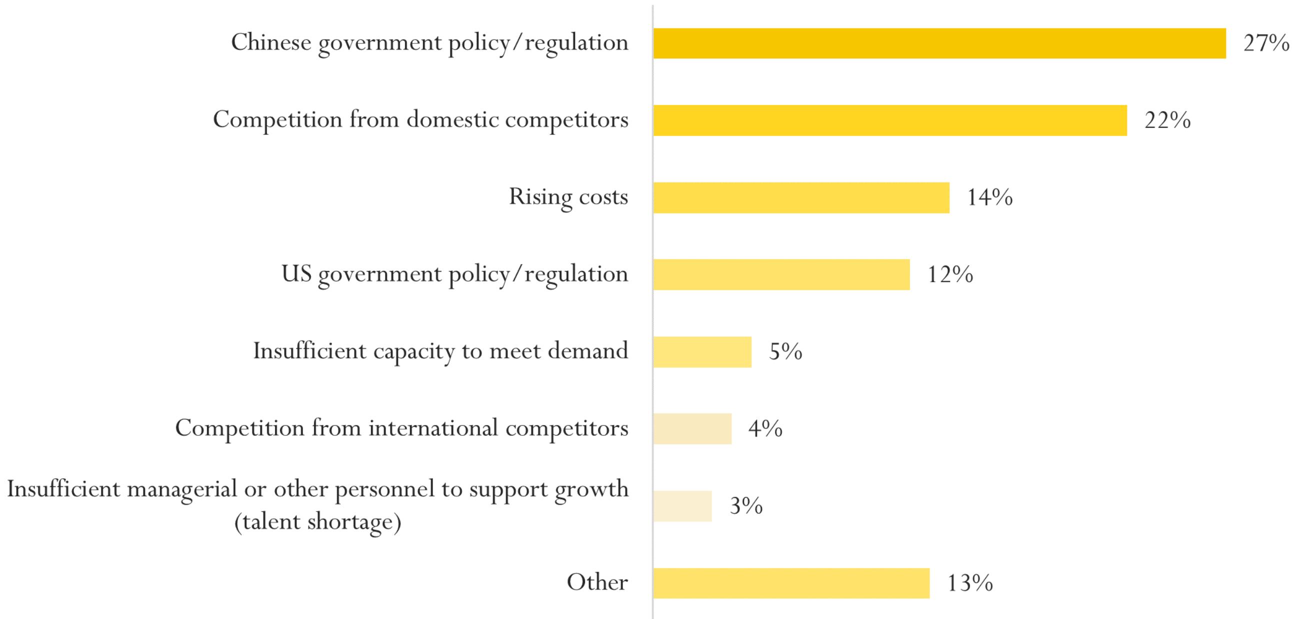
Less than half of respondents reported higher profit margins in 2022 than in the previous year, slightly below the trailing five-year average of 48 percent. Over one-third of companies saw their profit margin growth rates decrease in 2022, nearly double the number of respondents who reported decreases in last year's survey. Lower profits likely reflected the impacts of China's COVID-related restrictions and shutdowns in 2022, among other factors. Companies anticipate incremental improvements in their profit margins this year, with 72 percent of respondents predicting that the profit margins of their China operations will be equal to or greater than their global average, up from 60 percent in last year's survey.



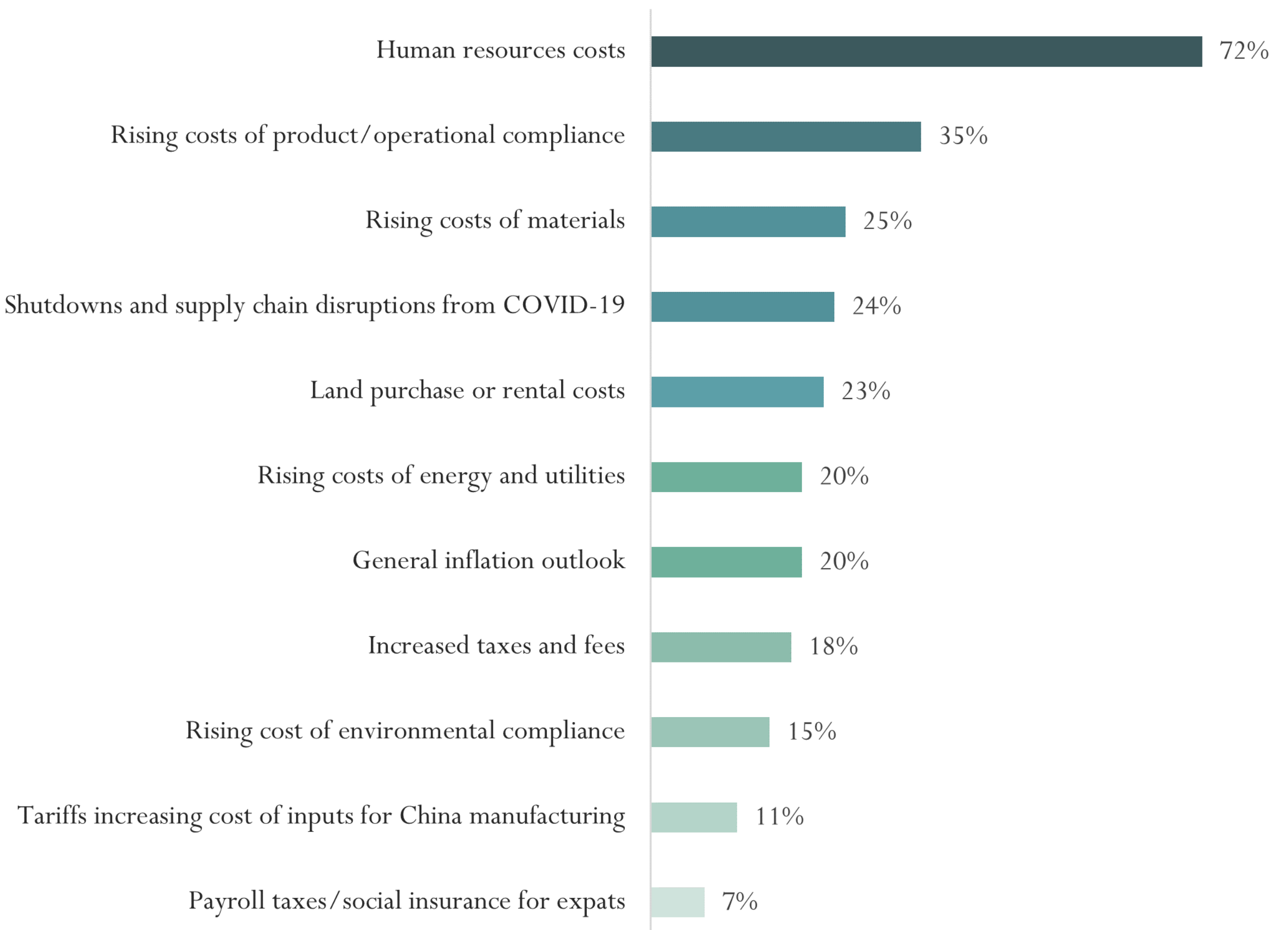


US companies continue to encounter a mix of market and policy factors that restrain profitability in the China market. Chinese government policies and regulations, competition from domestic competitors, and rising costs are the top-three restraints on increased profitability. Companies indicate that human resources costs are by far the largest cost concern, followed by the rising costs of product/operational compliance and materials, respectively.

Primary restraint on increased profitability in China



Top-three cost concerns

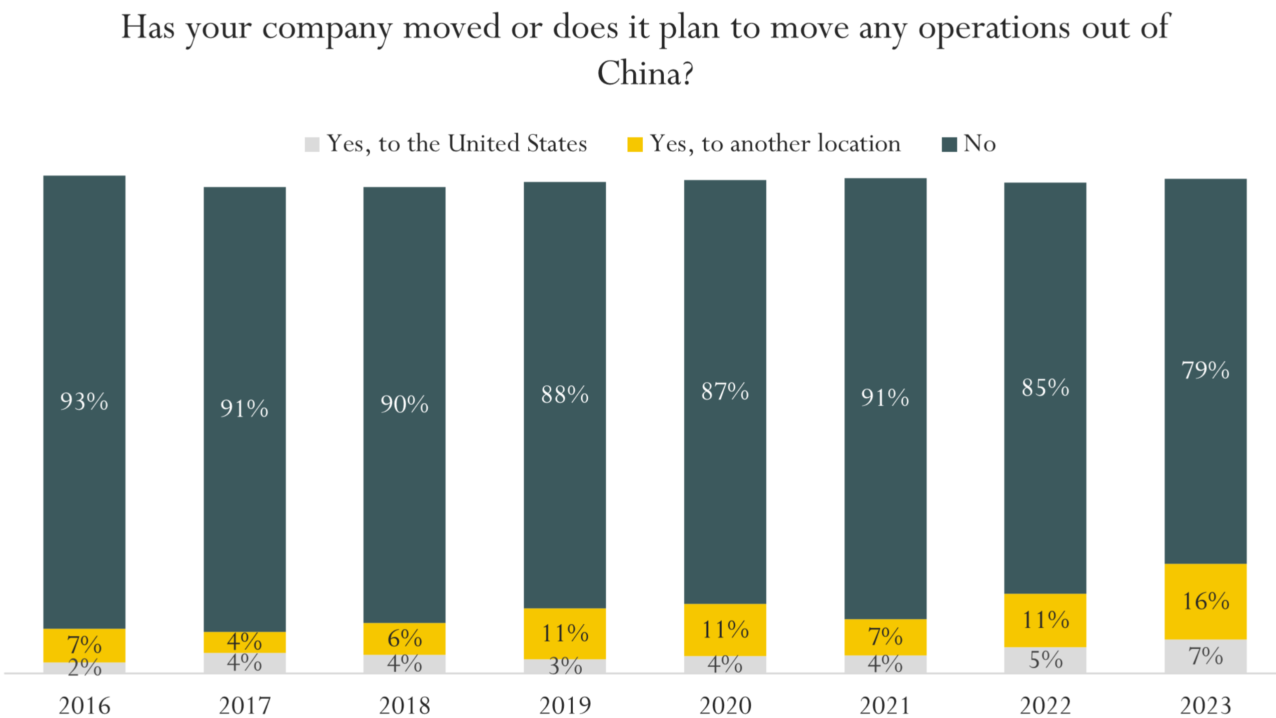


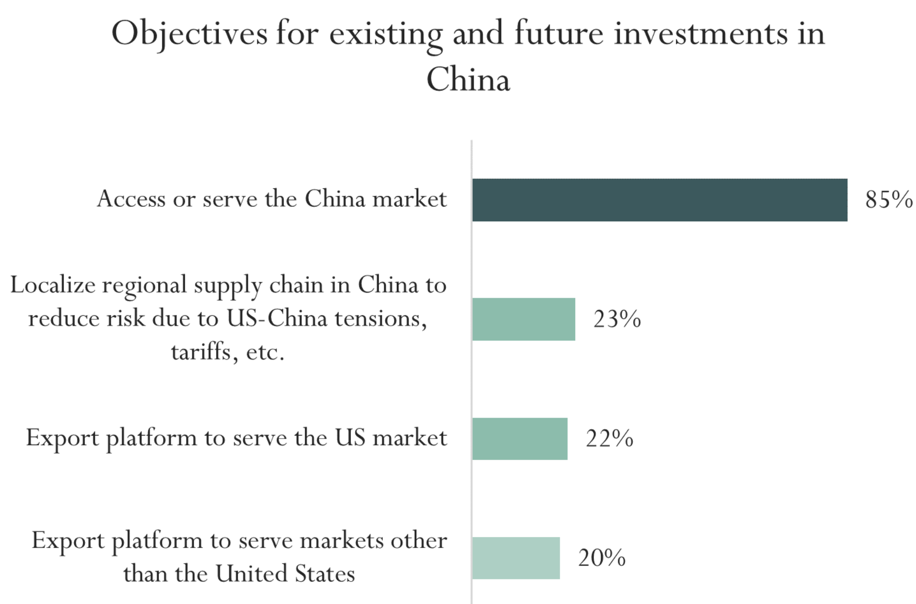
Companies adjust investment plans

Amid record-low levels of optimism, companies are evaluating resource commitments and investment plans in China. While a quarter of respondents plan to accelerate their resource commitments to the China market over the next year, this is half the proportion from five years ago. The percentage of respondents planning to curtail their resource commitment has more than quadrupled over the same time frame, from 4 percent to 18 percent. More than half of respondents are in wait-and-see mode, choosing to delay decisions about resource commitments over the next 12 months.

Companies stay in China to access the domestic market

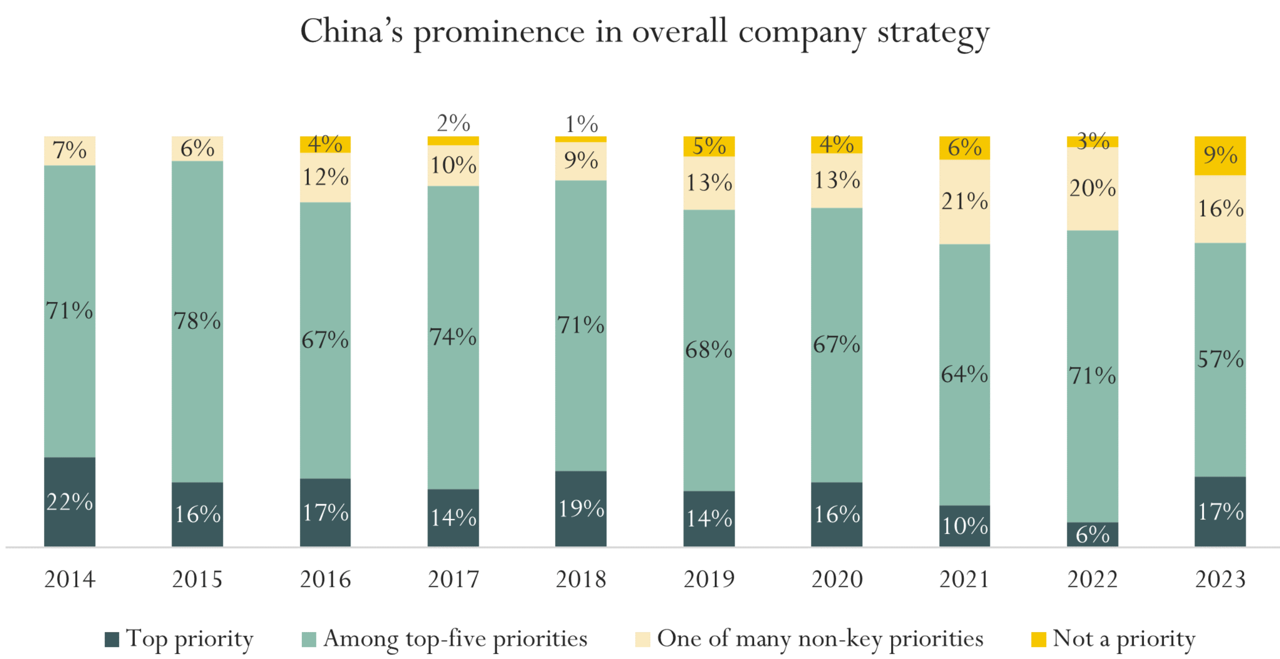
Even as some companies reduce or pause planned investments, most remain committed to the China market. Less than one-quarter of respondents have relocated or plan to relocate certain operations outside China, though this is up from 16 percent last year. More than four-fifths of respondents report being in China to access and serve the China market as opposed to manufacturing in China and selling into the United States or a third market.

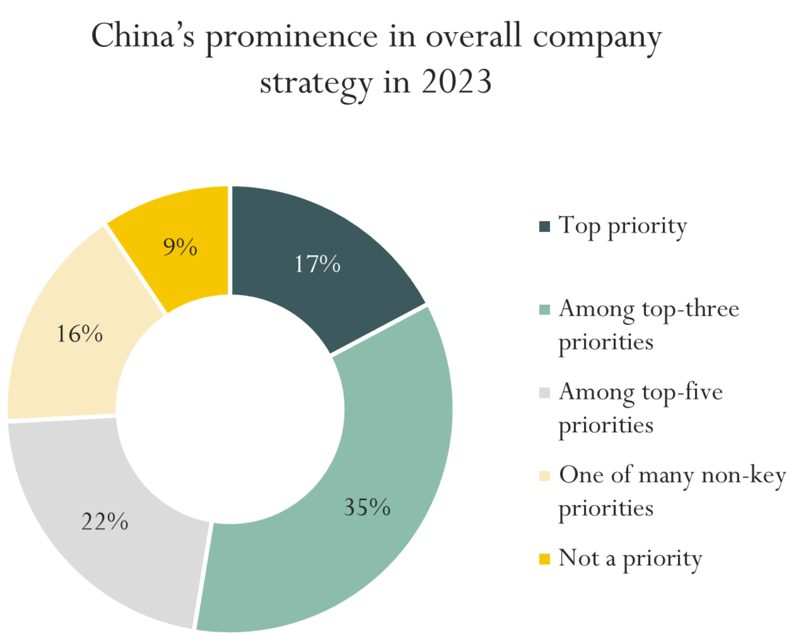




China remains a top market for companies

Compared to other markets where US companies conduct business, China remains a top-five priority for 74 percent of companies. Nearly one-fifth of companies designate China as the top priority market globally, while another third report that it is a top-three priority. However, this figure is low compared to a decade ago, when China was a top-five priority market for 93 percent of respondents. The number of companies indicating that China is not a priority market has risen to nearly 10 percent, an all-time high.





Conclusion

The data presented in this year's member survey underscore heightened anxiety about the worsening geopolitical situation and challenging domestic operating environment in China. However, there are reasons to be guardedly optimistic.

First, since the survey closed in early July, the two governments have stepped up diplomatic engagements and agreed to establish an information exchange on export controls, create a working group on trade and investment issues, and convene technical discussions on strengthening trade secret protection during licensing processes. Looking ahead, USCBC will be watching for commercial outcomes around these new mechanisms as well as during the Asia-Pacific Economic Cooperation Leaders' Meeting in November, when President Joe Biden and President Xi Jinping could meet. Expanding bilateral discussions could reduce uncertainty, set the stage for positive outcomes at the meeting, and give way to a stronger impetus for addressing commercial issues important to USCBC member companies.

Second, both the United States and China are gradually increasing the number of direct flights between the two countries, albeit slowly. International travel ranks seventh among the top issues faced by member companies this year. Easing obstacles to two-way travel will be vital to improving commercial links between the two countries. USCBC urges both governments to continue negotiations on this fundamental issue.

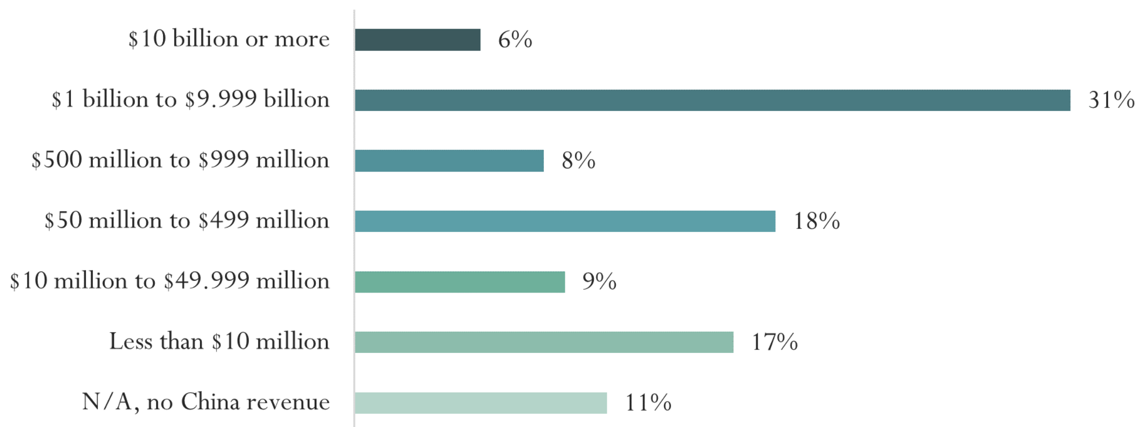
Finally, there are signs that Chinese policymakers understand foreign companies' concerns about market access and regulatory compliance issues. The State Council's "24 measures," published in August of this year, call for granting national treatment to foreign enterprises in government procurement and standard-setting initiatives as well as for expediting security reviews necessary for cross-border data transfers. This is a positive signal, but caution is warranted. USCBC urges Chinese policymakers to ensure that implementation and enforcement of these pledges is timely, fair, and consistent across jurisdictions in China.

Methodology

This year's survey was conducted between June and July of 2023 and draws from a pool of 117 member companies. Respondents have significant experience and presence in the China market—two-thirds have operated in China for more than 20 years, and more than one-third generate revenue in China exceeding $1 billion.

Respondents' top-10 challenges were ranked using a weighted system to reflect the most significant issues they encounter while doing business in China. To ensure consistent analysis over time, the same methodology was used in previous years. Due to rounding, some chart totals may add up to slightly more or less than 100 percent.

What is the China revenue of your company?



Years doing business in China