Member Survey

US-China Business Council | 2021

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

Executive Summary

In 2021, an overwhelming majority of USCBC member companies remain commercially successful in China, a trend that has been well documented in USCBC's annual member surveys for more than a decade. Nonetheless, companies still face significant challenges arising from US-China relations, the policy and regulatory environment, residual effects of the COVID-19 pandemic on travel, and rising costs.

Four key themes emerged in this year's survey:

1. **US-China tensions continue to weigh on American companies**

   Conflicting pressures from both the United States and China threaten to put companies in an irreconcilable position, increasing uncertainty and geopolitical risk. For the fourth consecutive year, US-China relations rank as the top challenge for US companies doing business in China. Nearly half of respondents cite concerns about customers perceiving them as unreliable because of US-China tensions. Restrictions on travel between the countries—ranked third among this year's top challenges—are exacerbating both political tensions and operational challenges.

2. **An uneven playing field is making it increasingly hard for US companies to compete**

   State support for Chinese companies and regulatory barriers disproportionately affecting foreign businesses continue to skew the playing field, particularly as China becomes a more mature market and competition intensifies. Challenges related to industrial policy, data and cybersecurity policy, intellectual property, and standards are exacerbated by bilateral tensions.

3. **The Chinese market remains critical to American companies**

   A majority of companies surveyed remain profitable, and more than 40 percent have plans to increase resource commitments in China over the next year. The vast majority of respondents invest in China to serve the Chinese market, where they see strong growth prospects.

4. **Reduced optimism raises questions about US companies' future prospects in China**

   Geopolitical and policy challenges are dampening optimism about China's business environment, and US companies are now prioritizing China less than in years past. While most companies are not moving their business or supply chains out of China, these challenges raise questions about their future competitiveness in China, particularly if perception challenges intensify and the policy environment deteriorates further.

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Introduction

Despite a US presidential transition in 2021 and the beginnings of an economic recovery in both the United States and China, tensions in the bilateral relationship have only intensified since USCBC published its last annual member survey report. US companies operating in China often find themselves in the crossfire, and this year's survey reflects that reality.

Over the last year, each country enacted policies—in the financial, trade, investment, and technology spheres—that run the risk of alienating the other from its market. Over the same period, the pace of China's economic reforms related to intellectual property and market access slowed, while state support for domestic firms and restrictive data policies accelerated. These headwinds are compounded by uncertainty about the future of the US-China relationship, which is now impacting companies' global strategies and investment plans.

This report seeks to take stock of the current business environment in China, unpack the most significant challenges faced by the US companies operating there, and explore the factors shaping their business decisions.

Top 10 Challenges

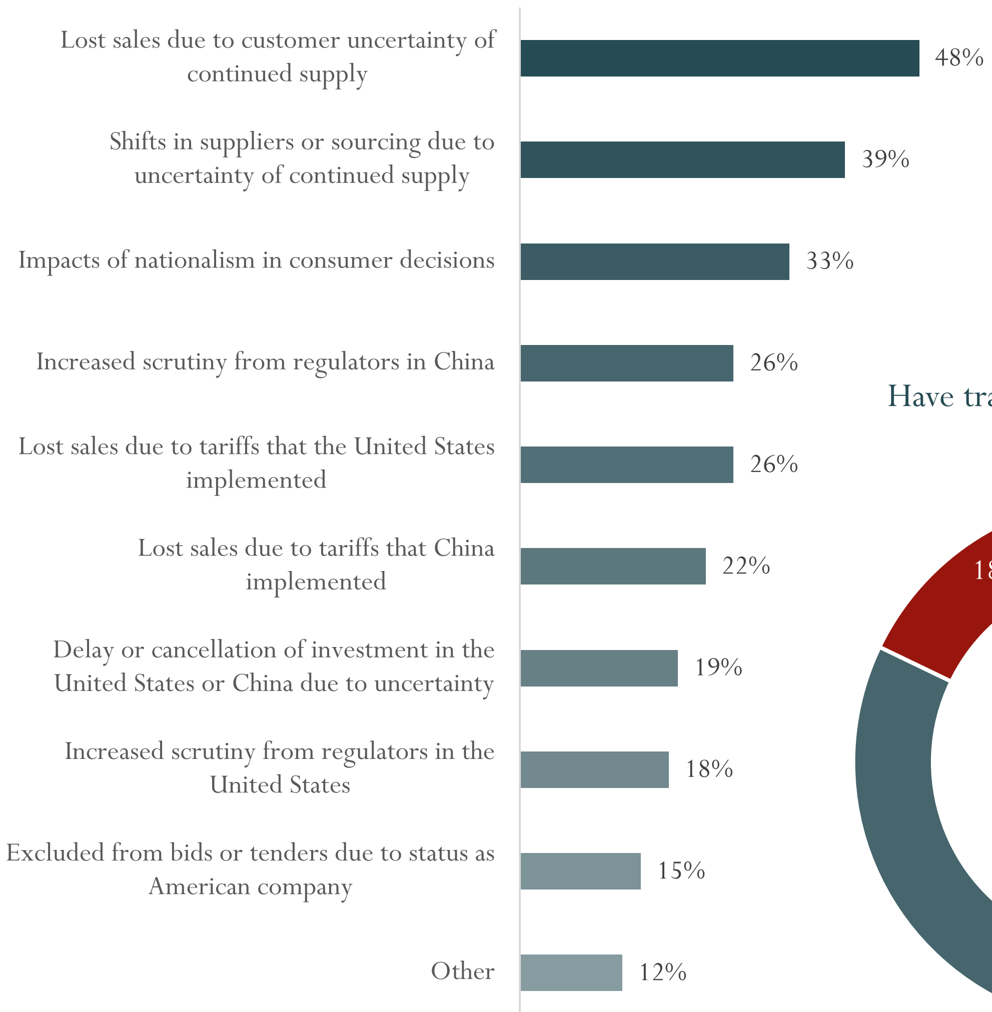
1. US-China relations
2. Competition with Chinese companies
3. International travel and visa restrictions
4. Data flows and personal information rules
5. Tariffs
6. Intellectual property protection
7. Export controls and sanctions
8. Licenses and approvals
9. COVID-19 impacts
10. Cost increases

Elevated US-China tensions are increasing risk and uncertainty

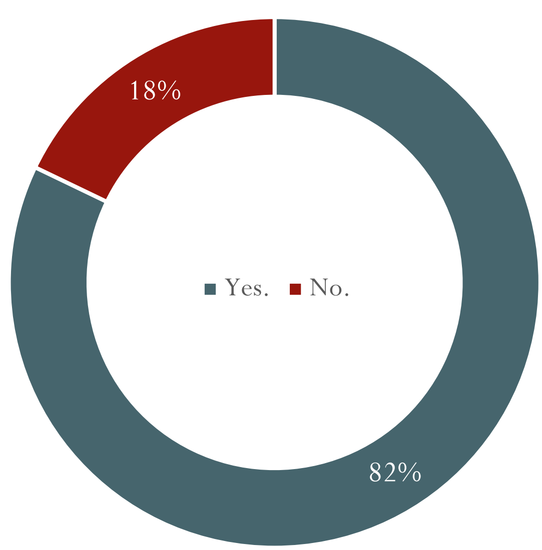
Tense US-China relations have had a detrimental impact on US companies doing business in China. US-China relations are the top challenge faced by survey respondents, as was the case for the past four years. The vast majority of those surveyed have been affected by bilateral trade tensions, with most characterizing the impact as harmful or severely harmful to their businesses.

Several other top challenges identified by companies are linked to friction in the US-China relationship, including tariffs, export controls, and sanctions. Bilateral tensions and subsequent policy efforts are impacting Chinese perceptions about the reliability of US companies, as evidenced by the most commonly reported impact of the trade tensions: lost sales due to customer uncertainty of continued supply.

Impacts of US-China trade tensions



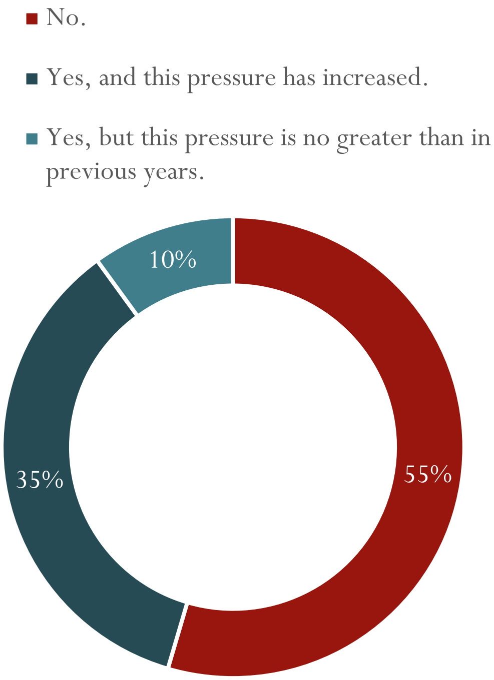
Have trade tensions impacted your business in China?



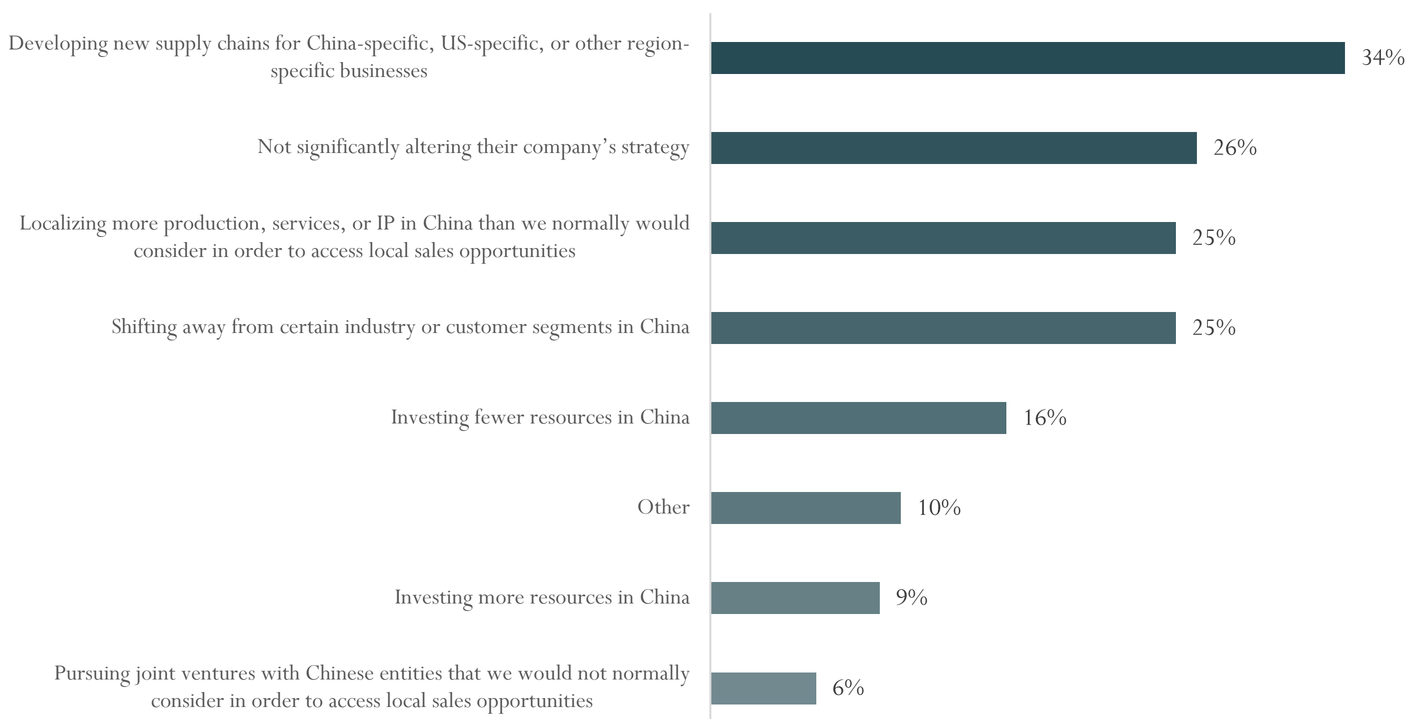
In response to a question asked for the first time this year, 45 percent of companies say they have felt pressure to make statements about political issues, and that the pressure comes from both the US and Chinese governments as well as consumers. One-third of respondents say that nationalism has played a role in consumer decisions as a result of US-China tensions.

While roughly a quarter of companies have not altered their strategy due to the impacts of US-China tensions, many others have had to adapt. Some of these adaptations include adopting a more localized approach to supply chains, production, services, and intellectual property while shifting away from certain industry or customer segments in China.

Has your company felt pressured to make (or not make) statements about sensitive political issues in the US-China relationship?



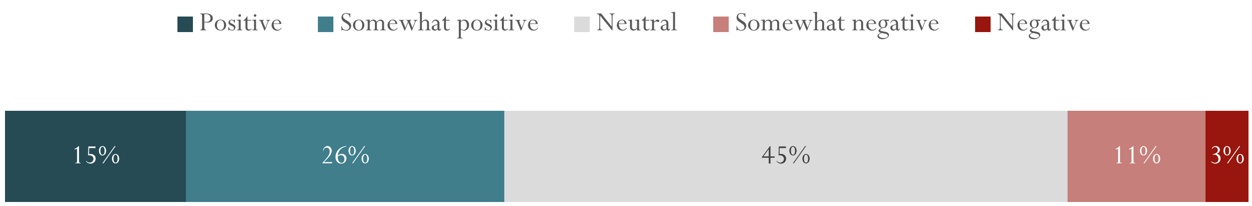
Due to the impact of tensions, companies have altered their strategies by...



The jury is still out on Phase One, but tariffs remain a major concern

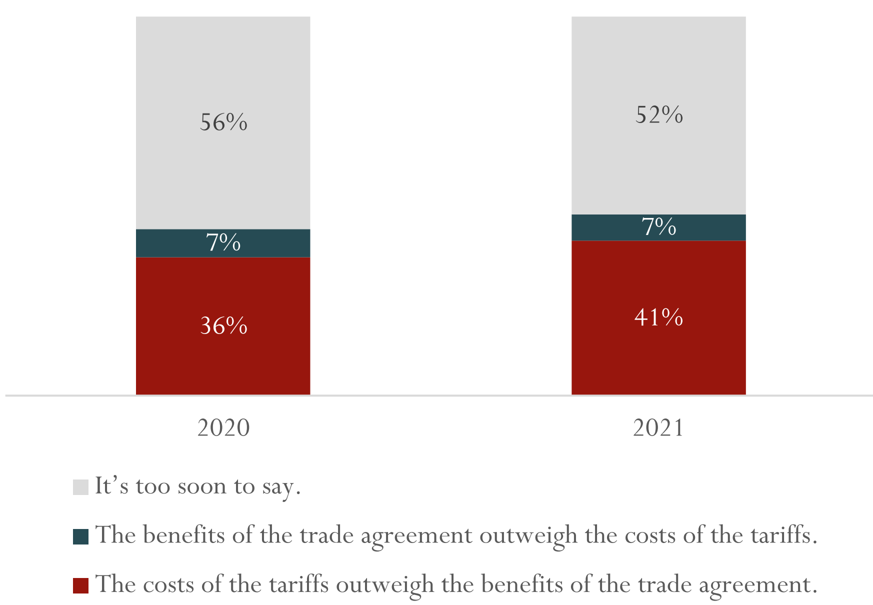
As part of the Phase One trade agreement, China committed to making regulatory reforms and purchasing specific and significant amounts of US goods and services over 2020 and 2021. China has made progress on its commitments but has not fully delivered on promised reforms or purchases. A plurality of respondents have a neutral view of China's implementation of the trade agreement, but a similar portion view implementation either somewhat positively or positively.

Overall views on Phase One implementation so far



Bilateral tariffs rank fifth among the top challenges faced by companies this year. Many had hoped that US tariffs—enacted following a Section 301 investigation into China's trade practices—and Chinese retaliatory tariffs would be lifted upon signing the Phase One deal. However, a year and a half after the agreement went into effect, steep tariffs on both sides remain in place. About half of respondents say it is still too soon to determine whether the costs of the tariffs are worth the benefits of Phase One, while another 41 percent believe that the tariffs are too costly, a camp that grew slightly since the last survey.

Views on Section 301 actions



Travel restrictions are exacerbating operational and political challenges

International travel and visa restrictions—a new option this year—are the third-largest challenge identified by companies in 2021. Due to China's strict COVID-19 control measures, it remains extremely difficult to obtain visas to travel to China, even for critical business matters. Travelers that do manage to obtain a visa are required to endure long quarantines.

How have travel restrictions impacted your operations in China?

The extreme difficulty in traveling between the United States and China has resulted in significant operational challenges for US companies. Additionally, the absence of people-to-people exchanges has challenged diplomatic relations, reducing the already narrow scope of engagements that are necessary to resolve and discuss sensitive political issues.

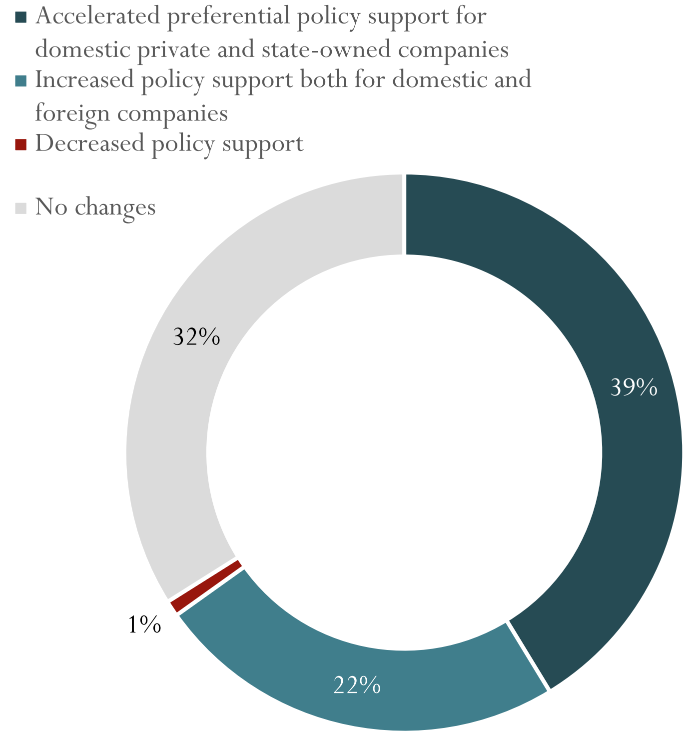
Domestic innovation policies are raising concern amid China's push for technological self-sufficiency

Most respondents expressed some level of concern with China's policies promoting domestic innovation and manufacturing, and 39 percent of companies—a plurality—report that stronger government support for Chinese companies is linked to rising US-China tensions. Companies' concerns are split fairly evenly between existing and potential impacts to business.

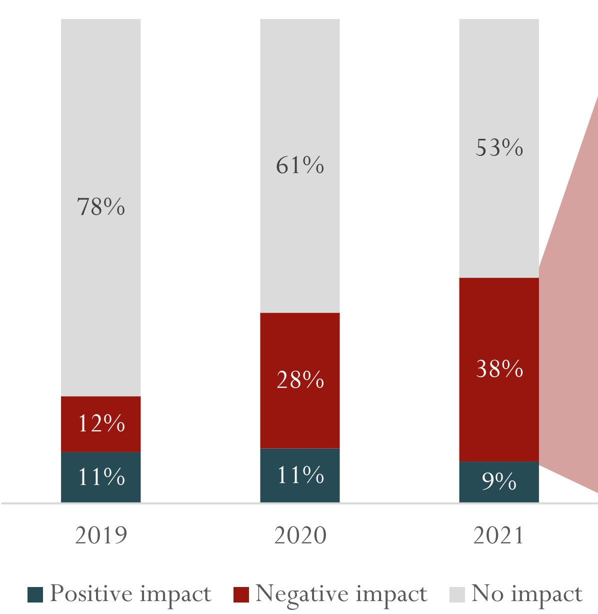
These concerns are in reaction to intensified high-level statements from the Chinese government and new policy plans promoting technological self-sufficiency, which threaten to limit opportunities for foreign companies in the market.

The share of companies negatively affected by China's push to develop high-tech industries and achieve technological self-sufficiency has increased from 12 percent to 38 percent over the last three years. Among the companies negatively affected, the most commonly cited impacts include Chinese customers shifting away from American products and services, increased competition from Chinese companies, and increased barriers to market access in sectors highlighted in industrial policy plans.

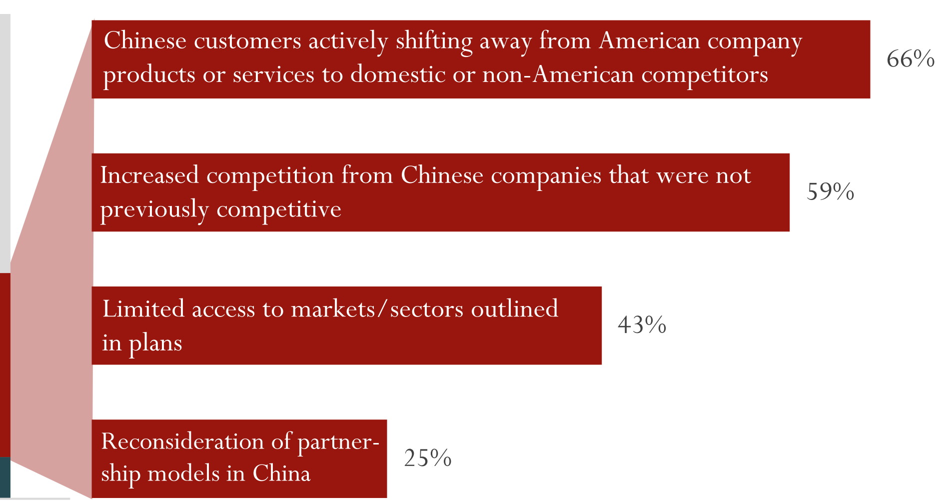
What changes has your company observed in Chinese industrial policies as a result of US-China trade frictions?



Have China's industrial policies impacted your company's operations?



Negative impacts from industrial policies

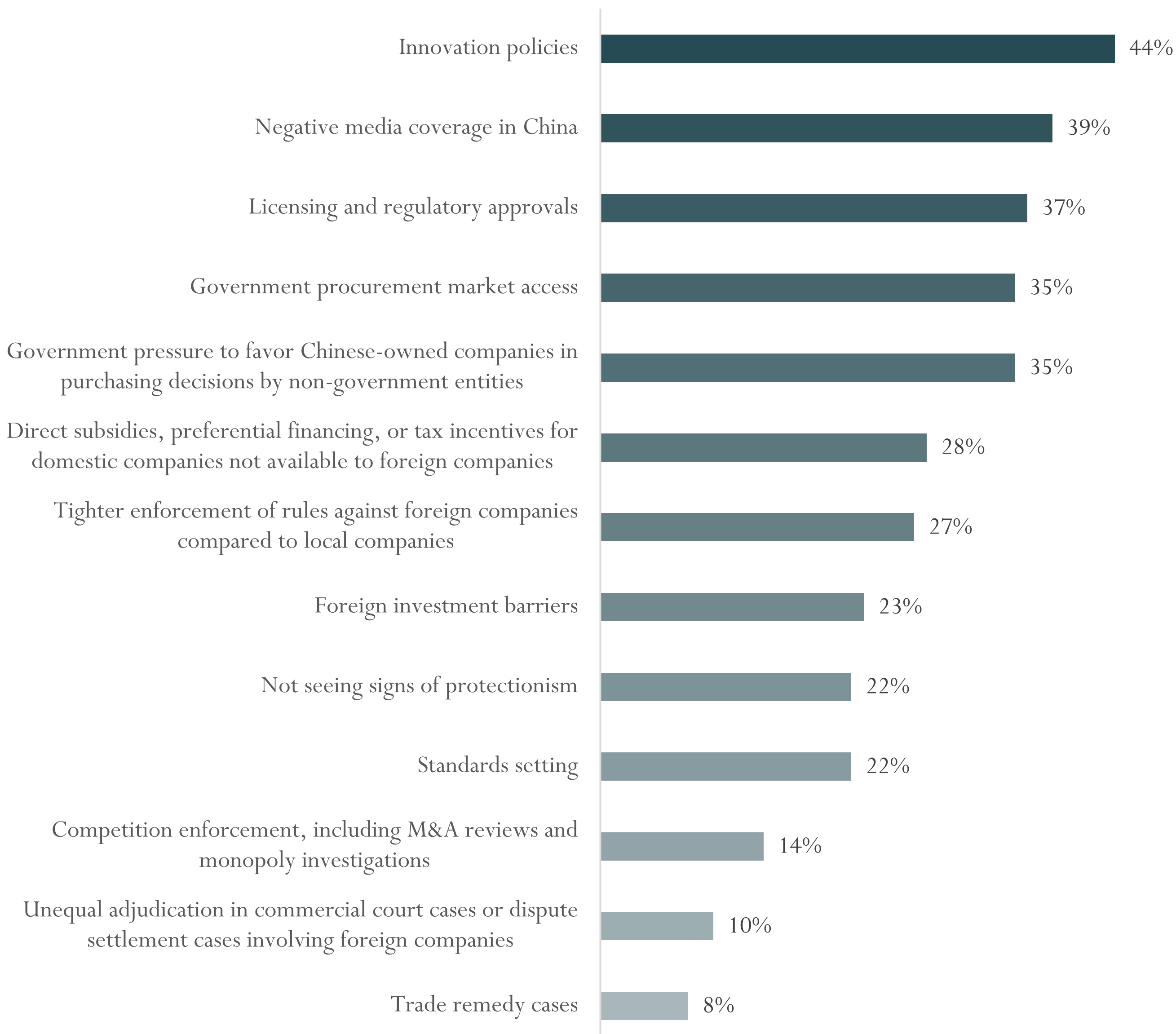


Protectionist policies are skewing the playing field

Companies continue to identify a long list of protectionist policies and behaviors that skew the playing field in favor of their Chinese competitors. National policies promoting domestic innovation are at the top of the list for the second year in a row. Longstanding concerns, such as subsidies, government procurement access, standards setting, and foreign investment barriers are also playing a role in fostering and protecting Chinese national champions. Notably, negative media coverage in China has newly emerged as the second most cited sign of protectionism in the country.

Additionally, 37 percent of respondents are seeing protectionism in licensing and business approvals, an issue that is ranked eighth among respondents' top 10 business concerns.

Signs of protectionism in China

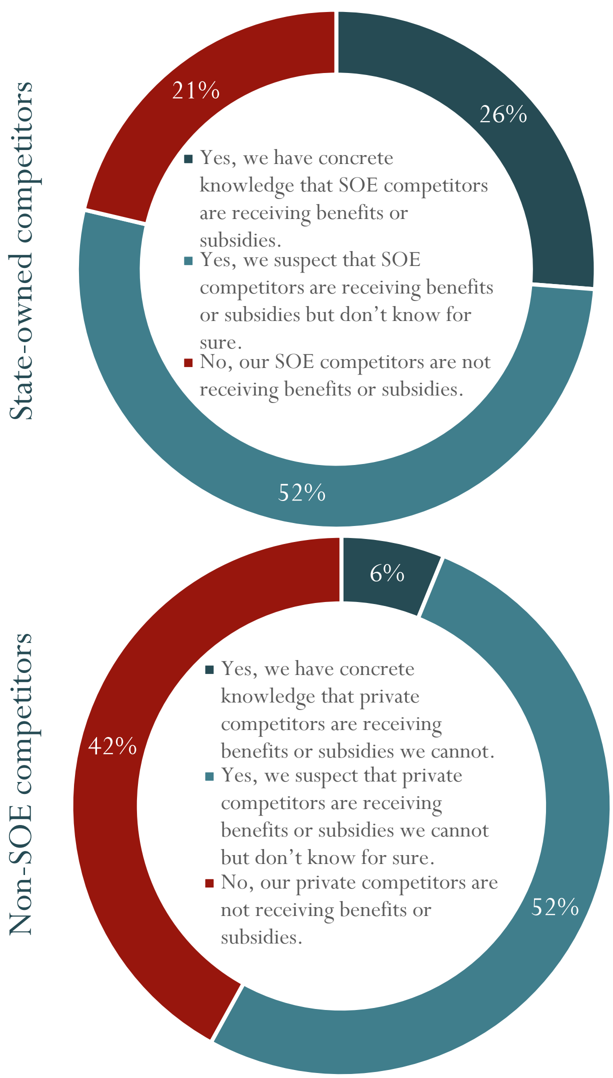


State support for Chinese companies is exacerbating competition concerns

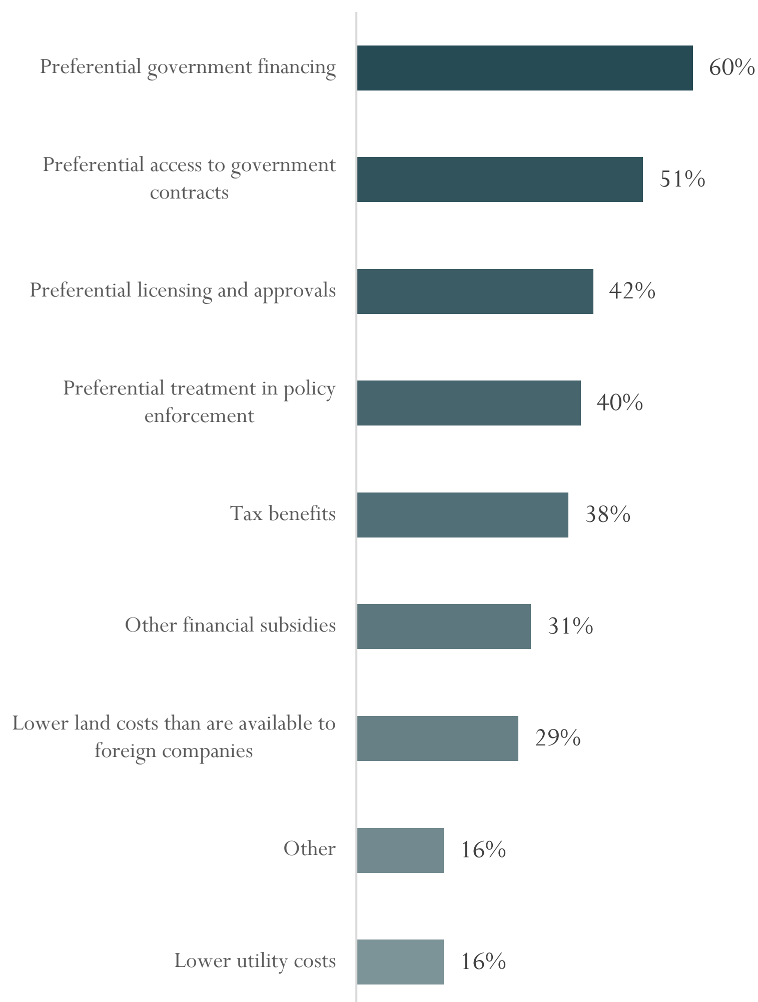
Competition with Chinese companies is the number two challenge for survey respondents. Much of this has been a natural development as China's market and businesses have matured, but state support for Chinese companies still raises the question of how much of the competition is fair. State support for Chinese companies—in the form of preferential government financing, licensing, and access to contracts, to name a few—has provided a significant home-field advantage for increasingly sophisticated Chinese companies, making it difficult for US companies to compete.

Nearly three-quarters of respondents know or suspect that their state-owned enterprise (SOE) competitors receive benefits from the Chinese government that their company does not. This percentage is lower when it comes to respondents' knowledge of their private Chinese competitors receiving state support, but it still represents a majority.

Are your competitors receiving tangible benefits?



What kinds of benefits do SOE competitors receive?



Data flows and privacy rules are stoking widespread concern

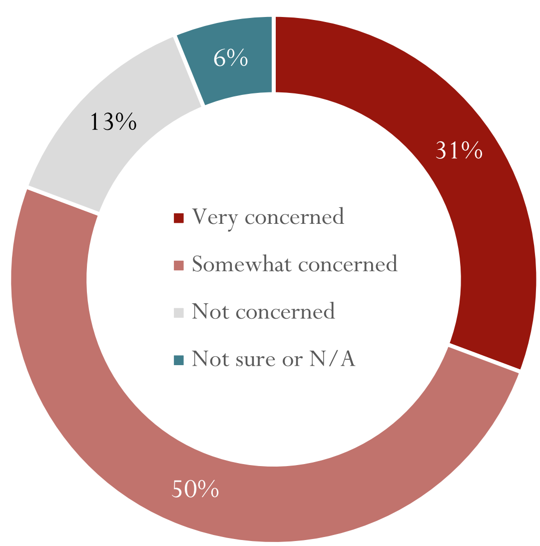
Data flows and privacy rules rank fourth among companies' top challenges, matching the highest level of concern expressed by respondents since this topic's inclusion in the survey. The regulatory environment for data and privacy in China is developing rapidly, with some companies already facing penalties for often unclear violations. Some policies require redundant data storage infrastructure or burdensome and easily politicized security reviews to transfer data abroad. This has put American companies with global scale at a significant disadvantage without providing clear improvements to cybersecurity. Newer laws and regulations include extraterritorial elements, which could further complicate the operating environment for multinational companies.

Companies looking to comply with China's expansive cyber and privacy regime have had to wade through a patchwork of laws, unfinalized implementing regulations, and standards to properly understand their responsibilities. As a result, an average of more than 80 percent of respondents have expressed concern about Chinese policies and regulations on information flows, privacy, data, and cybersecurity since 2015, when the first draft of China's *Cybersecurity Law* was published. This year is no exception, with 81 percent of respondents indicating they are either somewhat concerned or very concerned.

Overarching trends in the Chinese government's approach to data localization, cross-border data transfer reviews, and cybersecurity are coming into focus, but many of the details around compliance with the regime remain murky. As a result, three-quarters of companies are concerned about potential impacts rather than existing ones.

Concerns about cyber-related issues

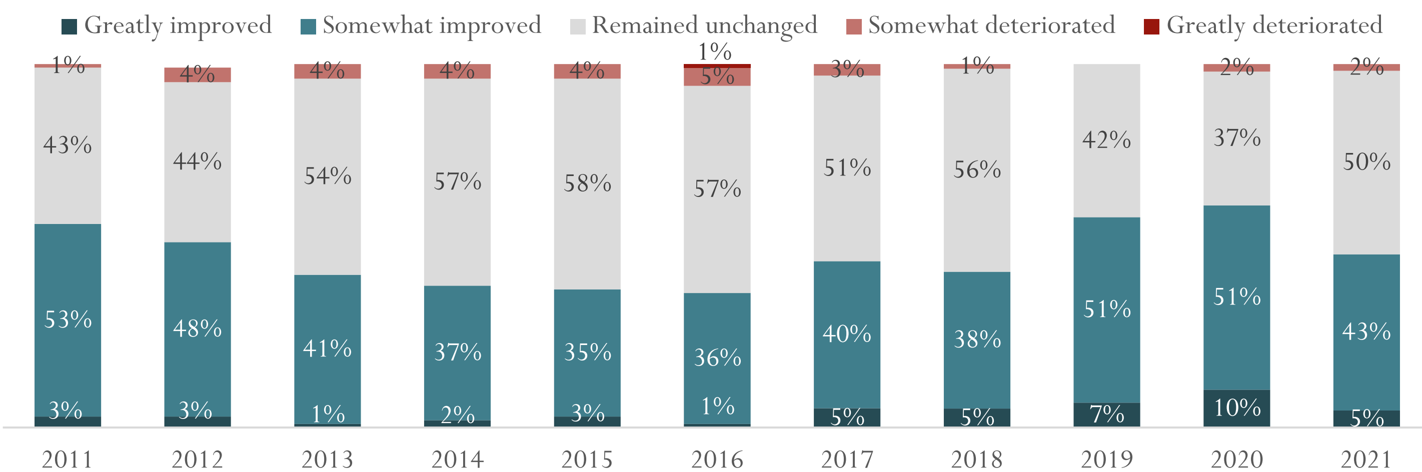
Concern about China's information flow and technology security policies



Longstanding intellectual property concerns persist

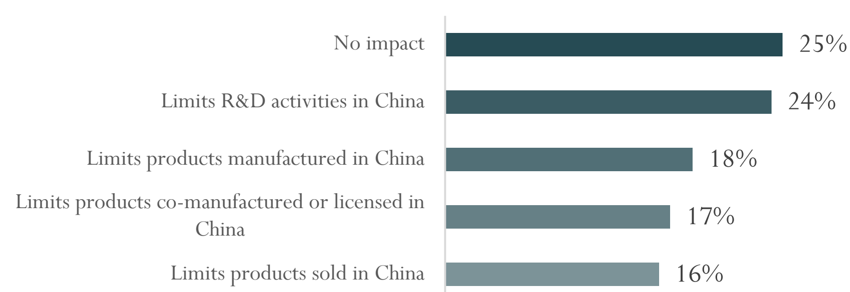
Intellectual property (IP) and technology transfer concerns have been a central issue in bilateral trade tensions and continue to receive significant attention from both governments. Despite a host of regulatory reforms undertaken as part of China's Phase One commitments, half of respondents say that China's protection of IP rights has remained unchanged since 2020. At the same time, perceptions of IP reform have dampened, with the share of respondents reporting improvements in China's protection of IP rights dropping by more than 10 percentage points since last year.

Over the past year, China's protection of IP rights has…

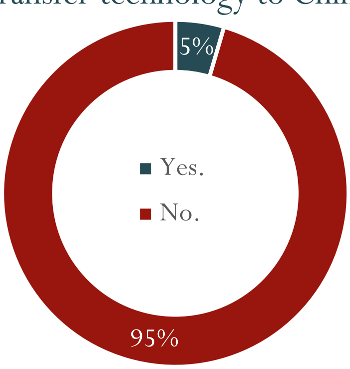


Fifty-nine percent of respondents feel somewhat concerned about the level of IP protection in China, and another 26 percent are very concerned. Concerns around IP protection are limiting the activities companies are willing to undertake in China. This prevents Chinese consumers, researchers, and workers from fully enjoying the benefits of foreign investment and unlocking China's full innovation capacity.

Impacts of China's level of IP rights enforcement on activities undertaken in China



Has your company been asked to transfer technology to China?



Only five percent of respondents have been asked to transfer technology in the last year. While technology transfer has not been a widespread concern of respondents in recent years, it is an acute problem for affected companies. When companies are asked to transfer technology as part of joint venture requirements, administrative licensing requirements, or other regulatory processes as a condition for market entry, they are forced to weigh the value of their IP against access to the Chinese market.

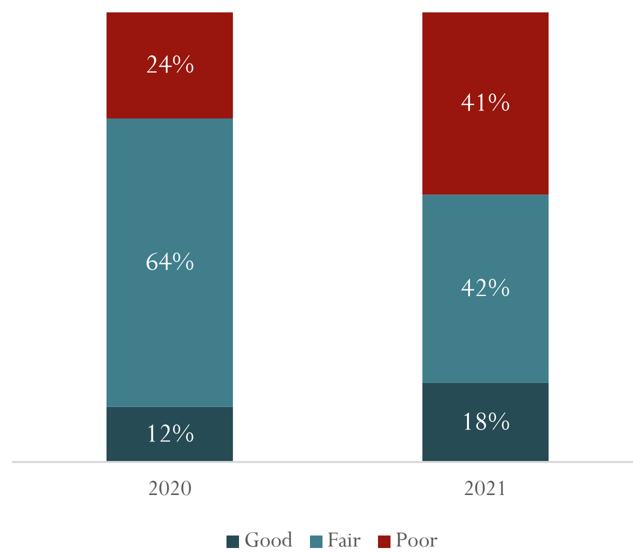
Access to standards setting remains challenging

Technical standards can create opportunities for companies when they align with their product specifications, but standards also erect barriers to opportunity when they do not. The ability to participate in the standards-setting process is especially critical in China, where standards often differ from those used in other international markets.

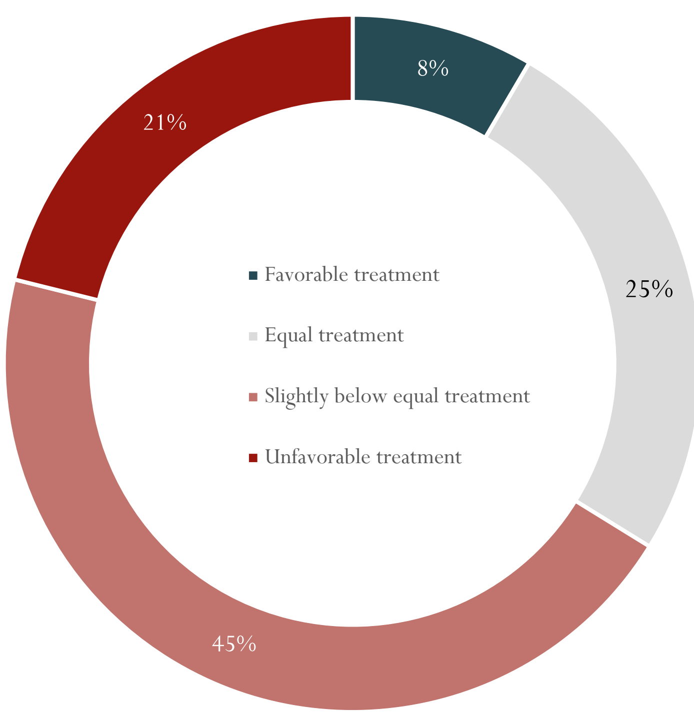
Despite commitments in the 2019 *Foreign Investment Law* to allow the equal participation of foreign-invested enterprises, US companies still report challenges in their access to Chinese standards setting. Although about a third of respondents have not attempted to participate in standards setting in China, of those that have, more than 40 percent rate their ability to do so as poor. This is up from only 24 percent the previous year.

Even when US companies are able to participate in Chinese standards setting, they often still experience challenges with processes and transparency. Of the companies that have attempted to participate, two-thirds say their company receives slightly below equal or unfavorable treatment. A quarter feel they receive equal treatment, and the remainder, eight percent, say they are treated favorably.

Your company's ability to participate in China's standards-setting process is…



Level of treatment compared to local companies

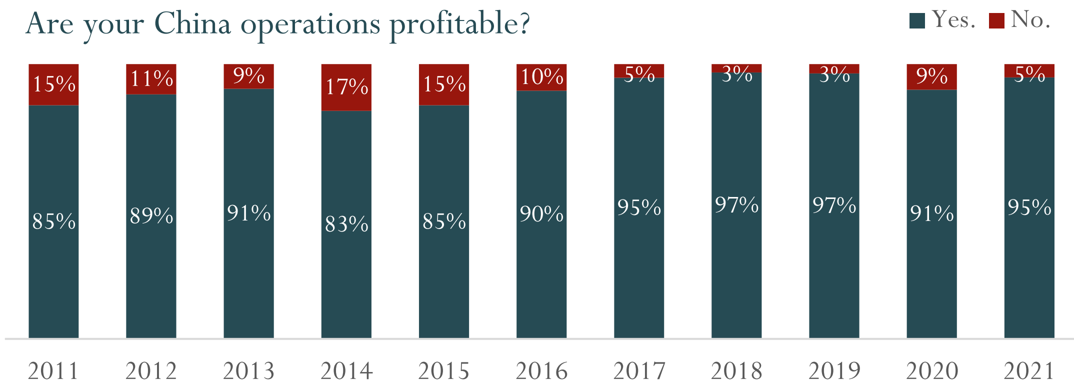


Despite challenges, a vast majority of companies remain profitable and continue to grow

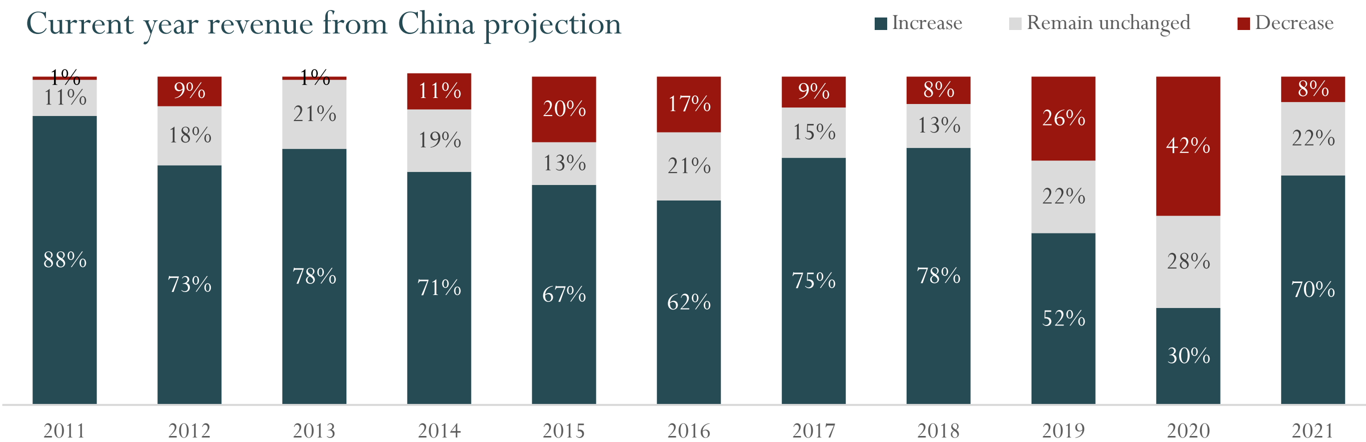
US companies continue to have a strong performance record in China. For more than a decade, an overwhelming majority of respondents have been profitable there, helping to bolster their innovation and competitiveness capabilities in China and globally. Ninety-five percent of respondents report that their China operations were profitable over the last year, and 64 percent saw revenue growth. Profitability in China was the same or better than the company's overall operations for more than three-quarters of respondents.

Most companies expect their revenue in China to increase in 2021, bouncing back to historical levels after the COVID-19 pandemic and trade war distorted outlooks in 2019 and 2020.

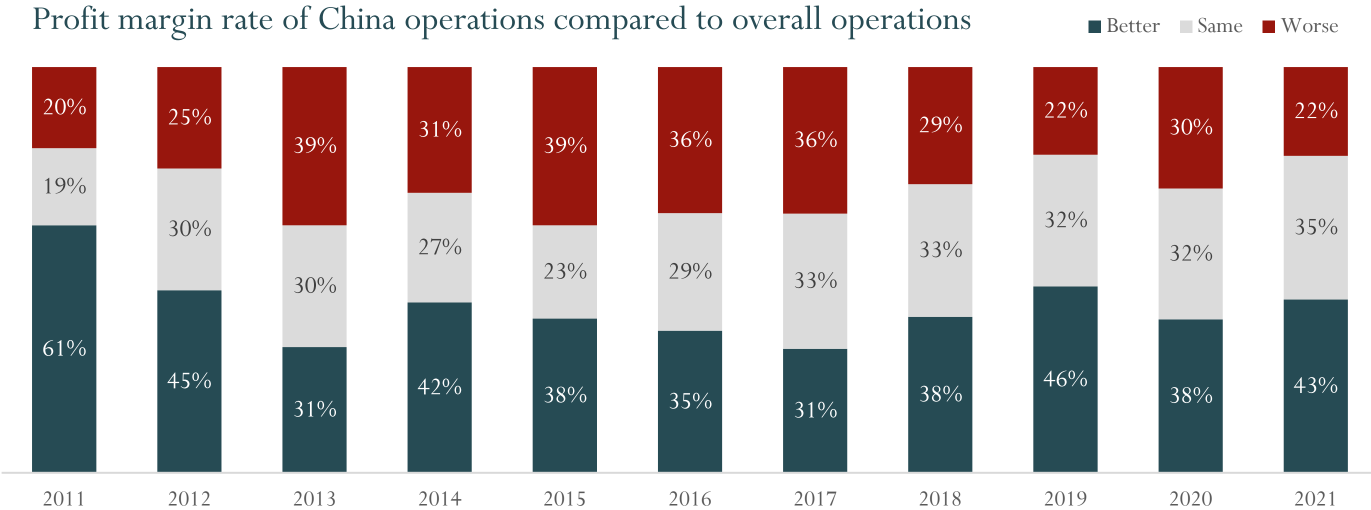
Are your China operations profitable?



Current year revenue from China projection



Profit margin rate of China operations compared to overall operations



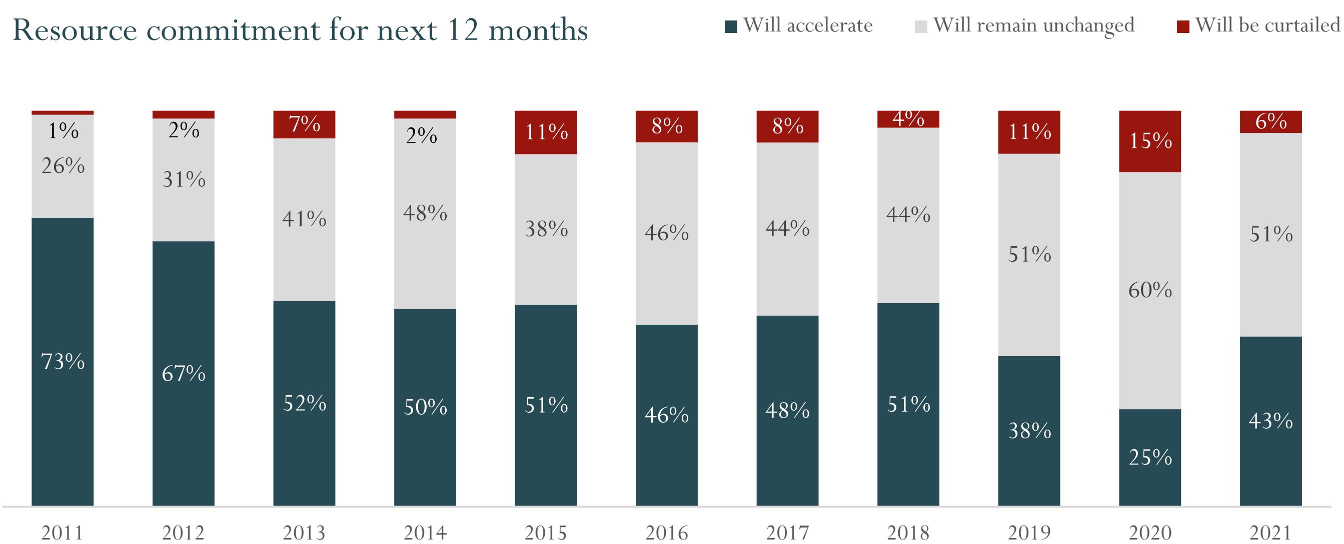
China remains a very important market for US companies

In line with their strong performance, most companies see their resource commitment in China either staying the same or accelerating over the next year.

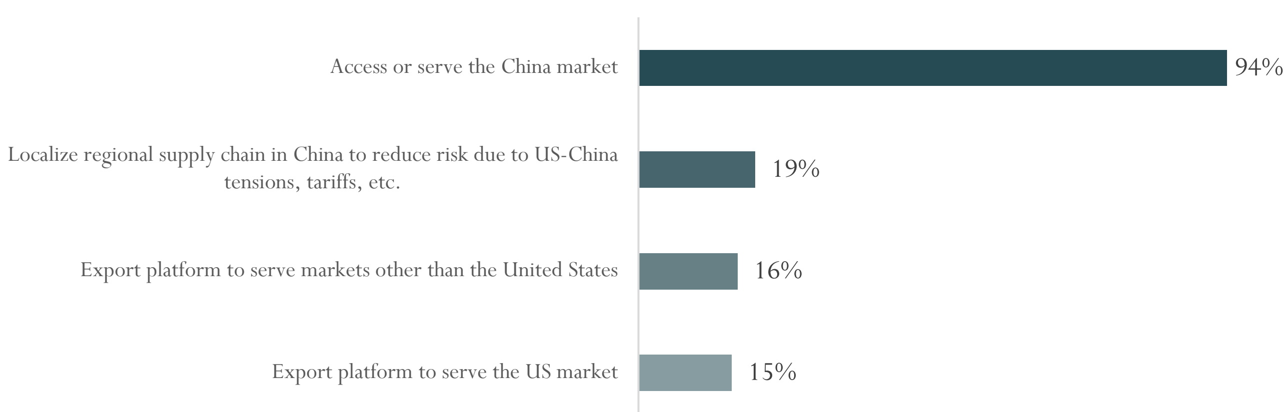
While challenges in the business environment and concerns over bilateral tensions are significant, one of the main reasons companies continue to invest in China is to be competitive in the Chinese market, which is difficult without a presence on the ground. Ninety-four percent of respondents note that their objective for current and future investments in China is to access or serve the Chinese market.

Such "in-China-for-China" investments are likely to continue because of China's expected market growth. Seventy-eight percent of companies view China's growth prospects as better than other emerging markets.

Resource commitment for next 12 months



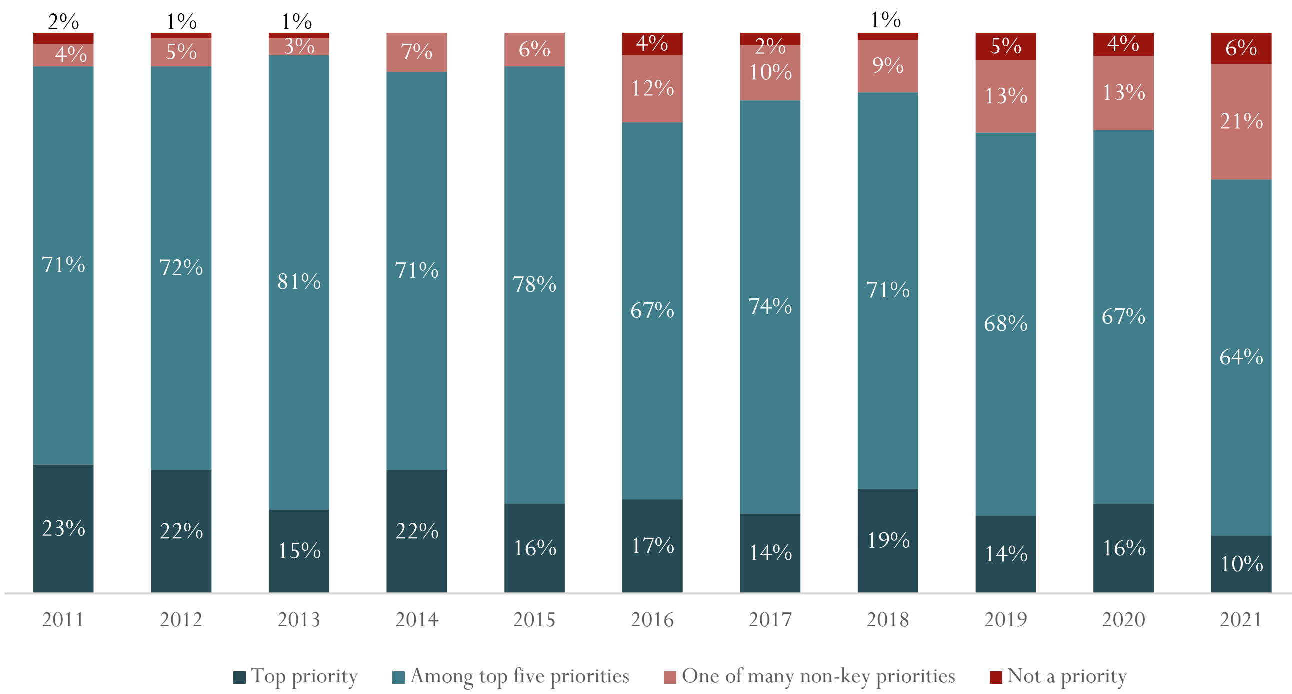
Objectives for existing and future investments in China



China remains a top priority, though less than before

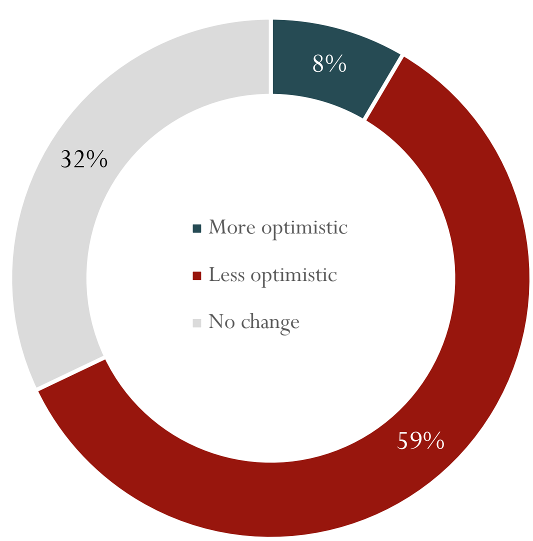
Despite companies' strong performances in the China market, increased geopolitical risk from bilateral tensions and COVID-19 disruptions of supply chains have caused companies to rethink China's role in their business strategies. While China remains a priority compared to other markets (among the top five for 74 percent of respondents), it is considerably lower than in the past. A decade ago, China was a top-five priority market for 94 percent of respondents.

China's prominence in overall company strategy



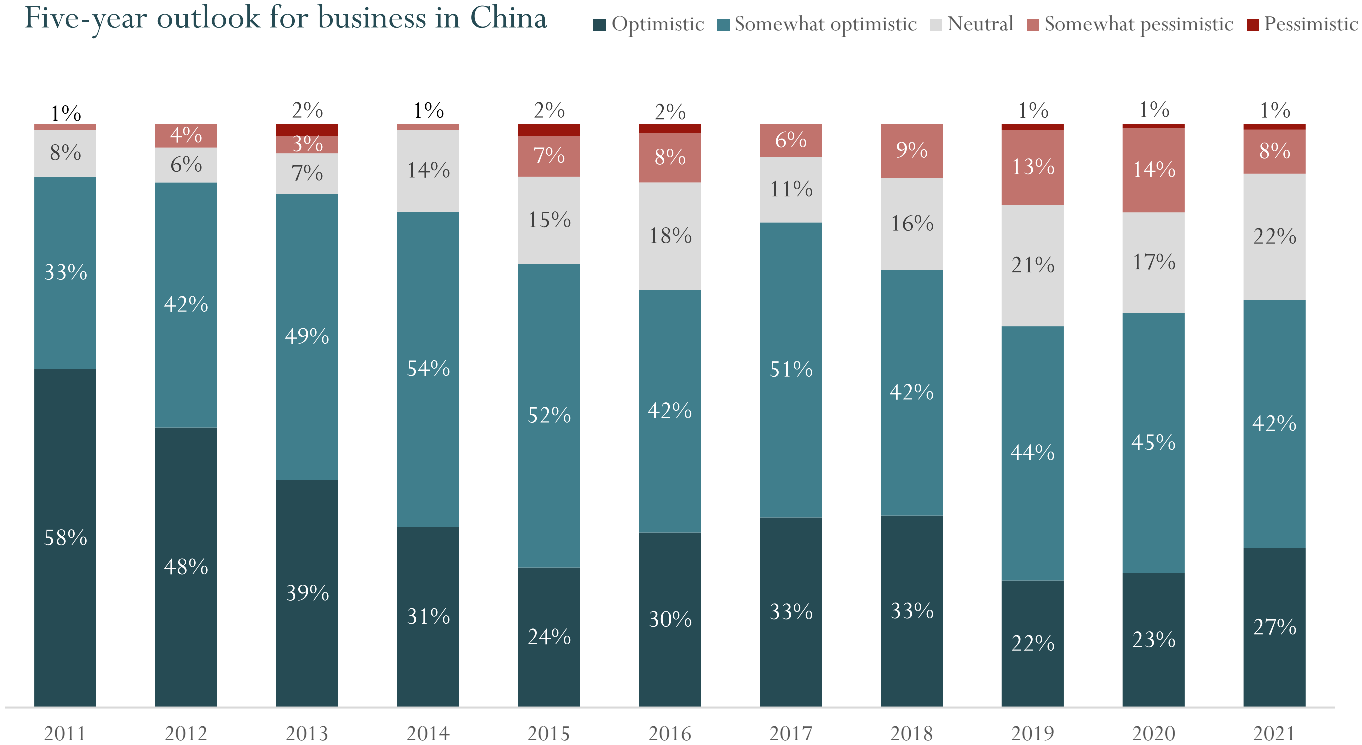
Optimism about the business climate in China has also declined, with a majority of companies less optimistic than three years ago, when trade tensions were just emerging and the COVID-19 pandemic had yet to begin.

View of current business climate in China compared to three years ago

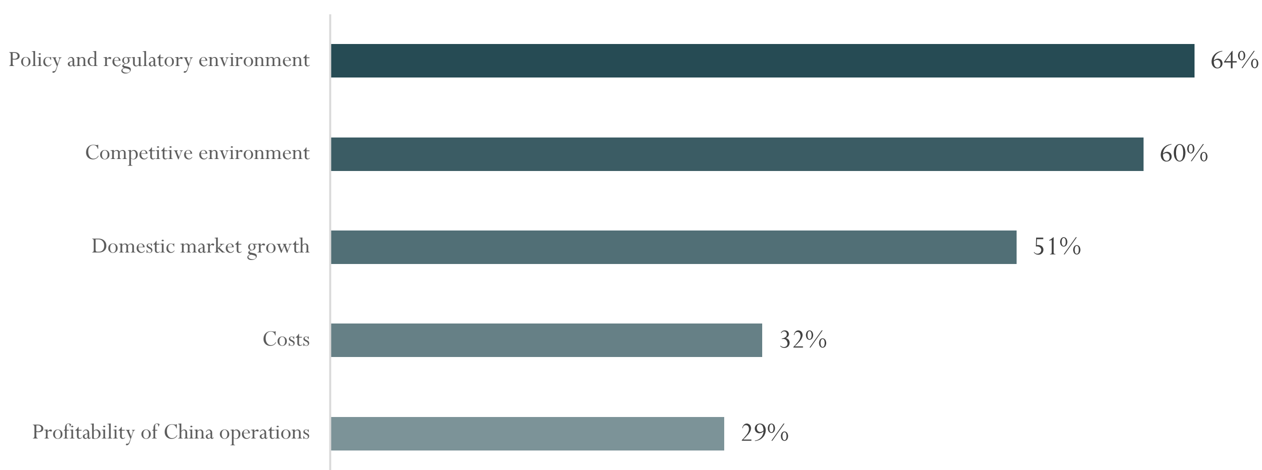


While most companies remain optimistic about their five-year business outlook in China, that attitude has moderated over time; a decade ago, 91 percent of respondents held an optimistic outlook. While the issues impacting respondents' five-year outlooks vary, China's policy and regulatory environment is the top issue cited.

Five-year outlook for business in China



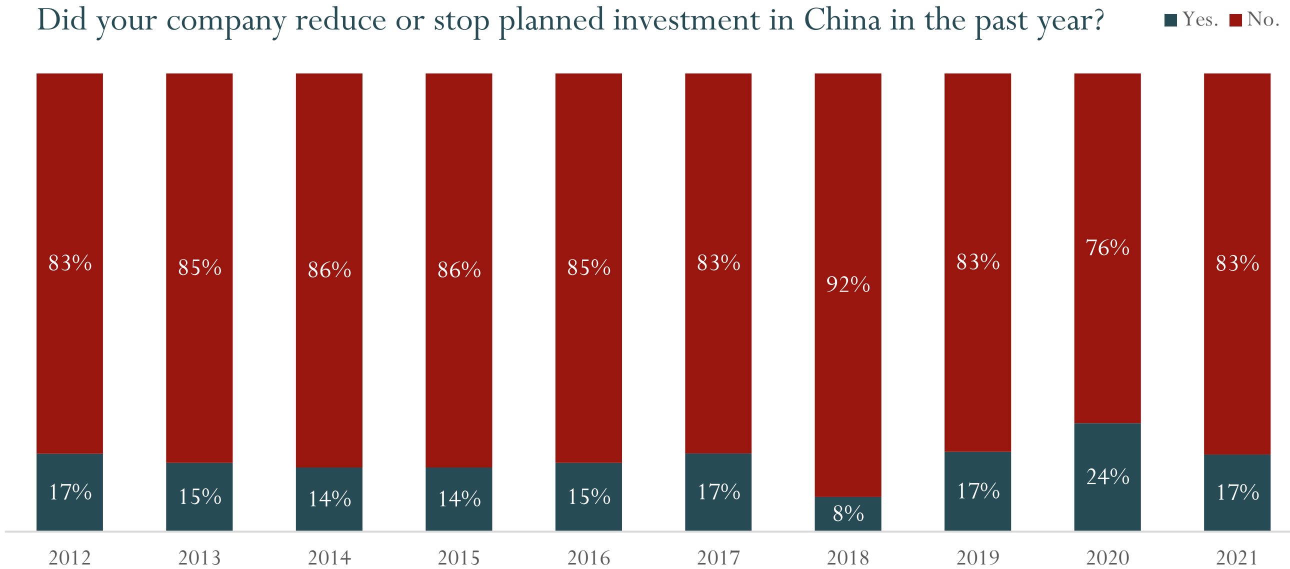
What issues most impact your five-year outlook?



Companies continue reporting that they are staying in China

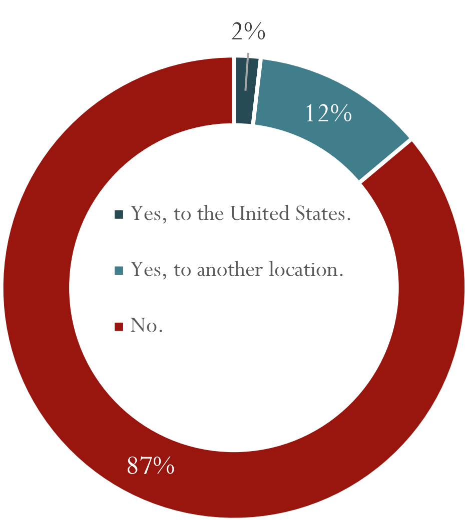
Despite reduced levels of priority and optimism, most respondents report that they did not reduce or stop planned investments in China in the last year. They also report that they are not moving their operations out of China.

Did your company reduce or stop planned investment in China in the past year?

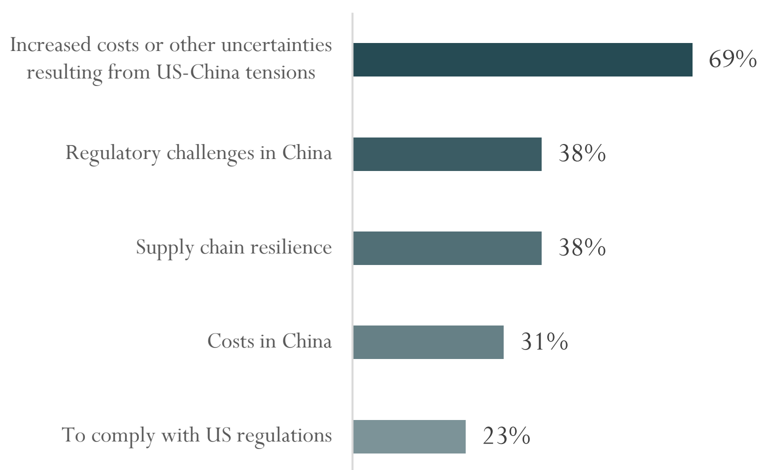


Eighty-seven percent of respondents have not moved any segment of their supply chain out of China in the past year. Of those that have adjusted supply chains, just two percent moved one or more segments to the United States, while 12 percent moved elsewhere. The top reason for supply chain moves was uncertainty resulting from US-China tensions.

Has your company moved any segments of its supply chain out of China in the past 12 months?



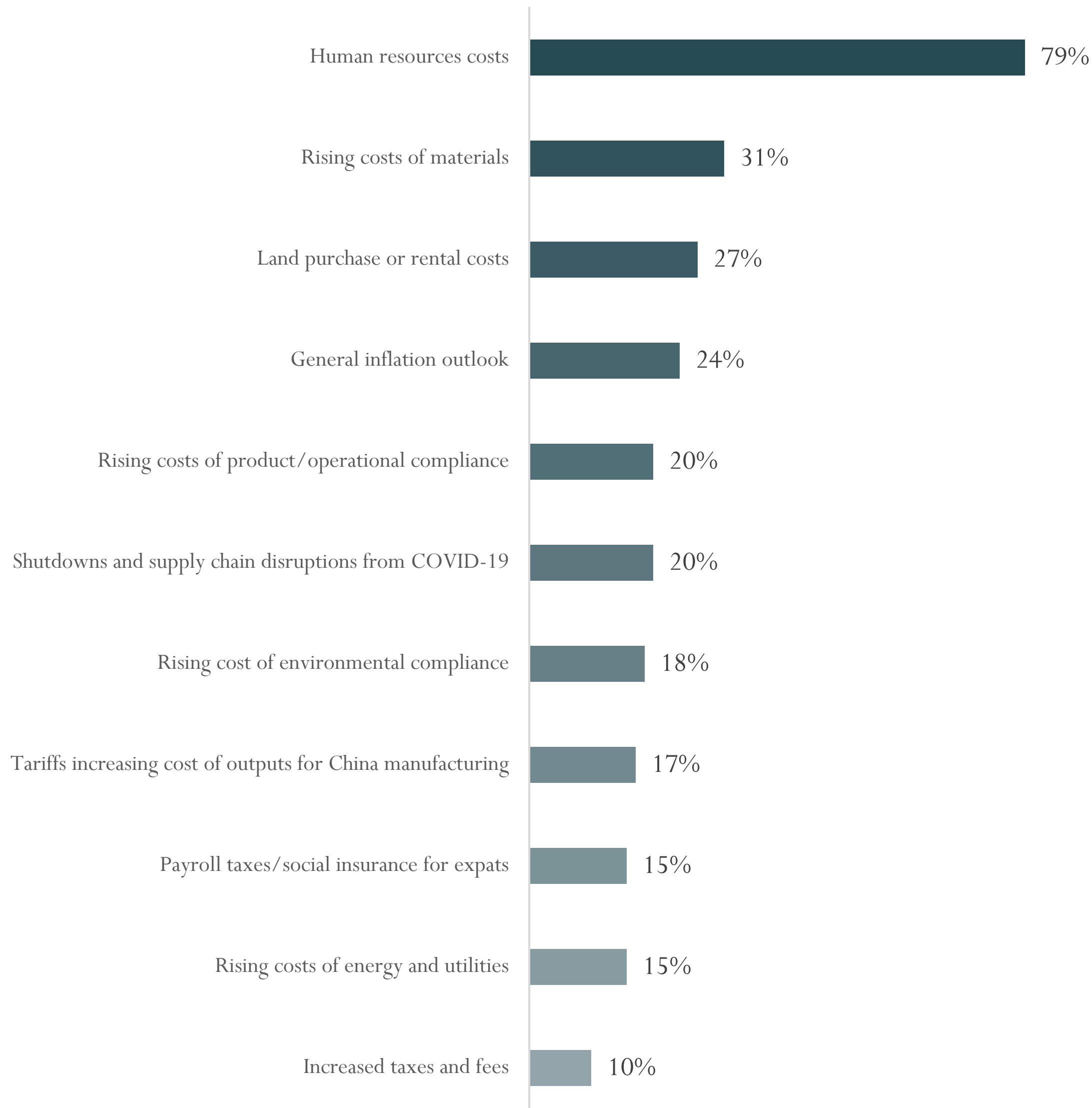
What were the reasons for moving operations to another location?



That a relatively small number of companies shifted supply chains speaks to the strength of China's supply chain ecosystems and to the difficulty of relocating. However, this may not be the case forever. With global efforts to secure critical supply chains on the rise, increasing costs of doing business in China could lead companies to explore options to improve supply chain resilience elsewhere.

One of the contributors to operational moves—rising business costs in China—is ranked tenth among this year's top 10 issues. Costs have been a persistent issue for respondents for more than a decade, with 81 percent indicating cost concerns in 2021. Among specific costs, human resources costs are by far companies' largest concern. Rising material costs come in at a distant second.

Top cost concerns



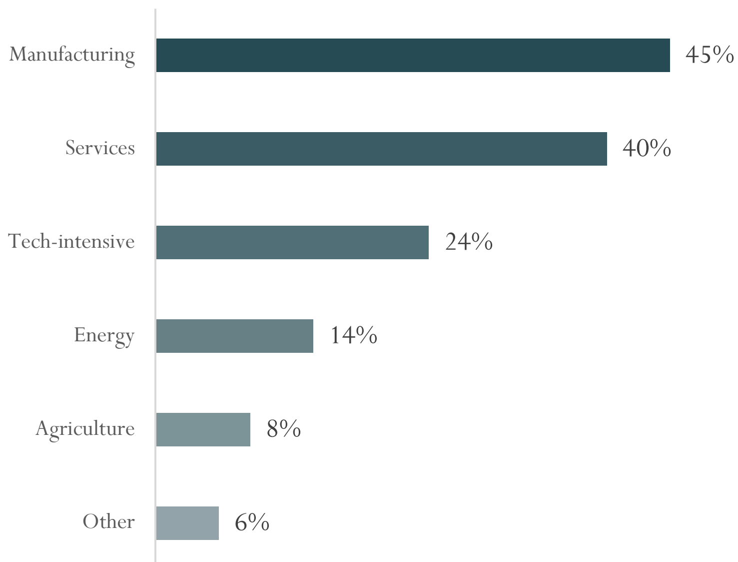
Methodology

For over a decade, USCBC's member survey has captured sentiments from a multitude of US companies operating in China. This year's survey was conducted in June 2021 and draws from a pool of 107 member companies.

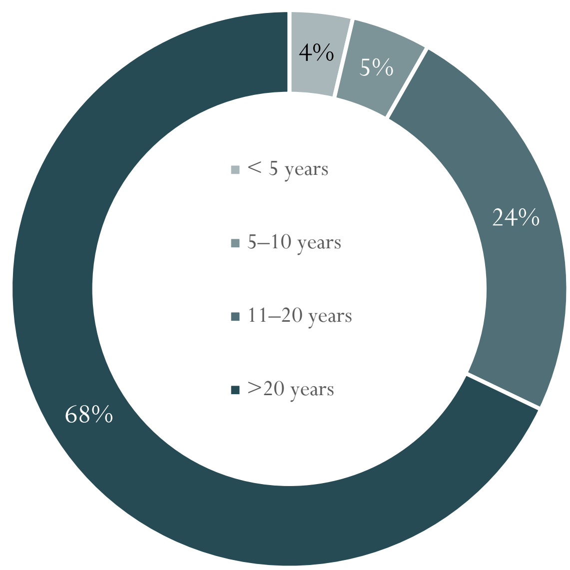
Respondents' top 10 challenges were ranked using a weighted system to reflect the most significant issues they encounter while doing business in China. The same methodology was used in previous years to ensure the analysis is consistent over time.

Due to rounding, some chart totals may add up to more or less than 100 percent.

Type of operations in China



Years doing business in China



Respondent location