Member Survey

US-China Business Council | 2022

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

Executive Summary

The US-China Business Council's 2022 Member Survey was conducted in June 2022, shortly after a period of widespread COVID-19 lockdowns across China, most prominently in Shanghai. This report is based on responses from 117 member companies, a similar participation rate to past years. Most respondents are large, US-headquartered multinational companies that have operated in China for more than 20 years. The findings in this report are meant to measure business sentiment and benchmark challenges and opportunities in the China market.

Key takeaways

- **China's COVID-19 policies are the top challenge:** China's COVID-19 strategy now poses the top challenge to US companies, displacing US-China relations, which ranked as the top concern for four consecutive years. The looming possibility that companies will again be forced to partially halt operations due to lockdowns and the impacts of local controls on consumer demand have undermined confidence in the business environment.
- **Bilateral tensions continue to hurt American companies:** Respondents report record-high concern with US-China relations, which continue to deteriorate. Geopolitical pressures are bleeding into the commercial realm, leaving companies—which depend on a stable and predictable trade environment—in increasingly challenging positions. Chinese customers' real and perceived concerns about ongoing access to US technology due to US-China tensions continue to threaten US companies' competitiveness in the market, an alarming trend that could be difficult to reverse.
- **Little progress on long-standing issues as new barriers emerge:** Significant market access barriers remain, even as China assures foreign companies that they will receive equal treatment. Intellectual property (IP) protection has seen limited improvement. Chinese economic planners have expanded industrial policies to bolster Chinese companies, and localization requirements to qualify for state-affiliated procurement are increasing. At the same time, new Chinese data security and privacy rules threaten to disproportionately increase costs for multinational companies.
- **Trajectory of commercial relations at another inflection point:** The difficult operating and geopolitical environment has impacted company performance, leading to record levels of pessimism and affecting companies' decisions about their supply chains and future investments. At the same time, companies overwhelmingly remain profitable in China and they continue to recognize China's importance to their global competitiveness. Whether business sentiment and the pace of future investment rebound or continue to falter will depend on decisions by US and Chinese policymakers in the coming months and years.

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Introduction

The past year has brought immense challenges to US companies doing business with China. Around the time that this survey was conducted, Chinese cities were emerging from extended periods of lockdown in an effort to stem the spread of COVID-19, grinding normal business operations in China to a halt. Escalating geopolitical tensions globally, including between the United States and China, are disrupting supply chains that have yet to recover from the initial shock the virus sent through the world in 2020. Both countries maintain tariffs on each other's imports, and there appears to be little appetite in either government to make concessions during what is a politically sensitive year in both countries.

The list of top 10 challenges facing US companies in China in 2022 reflects this challenging reality. While companies remain frustrated by a lack of progress on long-standing issues, other more immediate challenges have moved to the forefront. For example, rapidly evolving challenges such as those related to China's COVID-19 strategy, US-China relations, and data feature prominently in members' perceptions of their future in China. The challenge of US-China technological decoupling ranks highly as a result of US and Chinese national security–based restrictions that many consider overly broad.

Top 10 Challenges

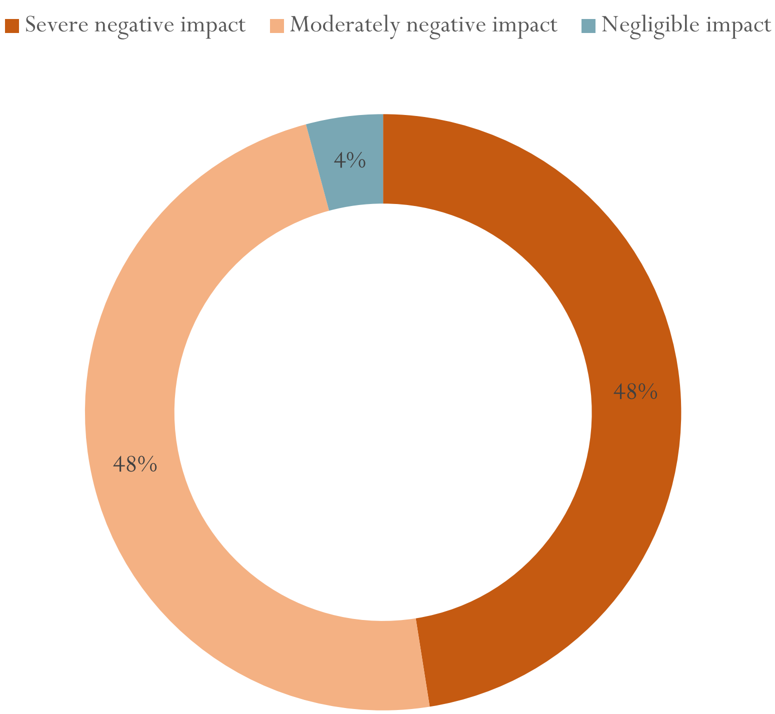
1. COVID-19: Shutdowns
2. US-China relations
3. COVID-19: Travel
4. Data, personal information, and cybersecurity rules
5. Cost increases
6. US-China technology decoupling
7. Competition with Chinese companies in China
8. Industrial policy
9. Procurement policies in China
10. IP protection

COVID-19 lockdowns rock business confidence

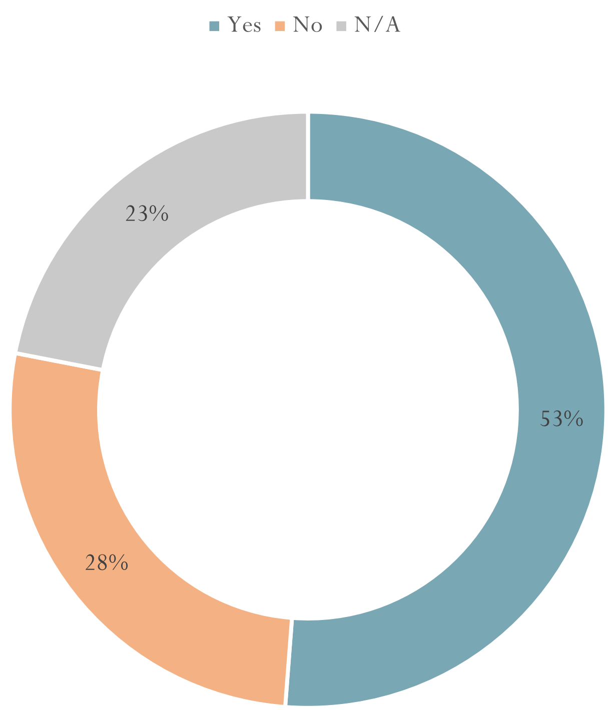
Two of this year's top three challenges are related to China's COVID-19 control policies. Lockdowns have supplanted US-China relations as this year's top challenge, whereas bilateral relations were in the top place since 2018, when tariff escalations first began. COVID-19-related travel restrictions placed third. Most US-based executives have not been able to travel to China to see their business, employees, and customers for two and a half years, further compounding concerns with market conditions.

Ninety-six percent of respondents have experienced negative impacts on their China business because of the control measures, with nearly half reporting severe negative impacts. The control measures have also impacted more than half of companies' future business and investment plans.

What impact have China's COVID control measures had on your company's existing China business?

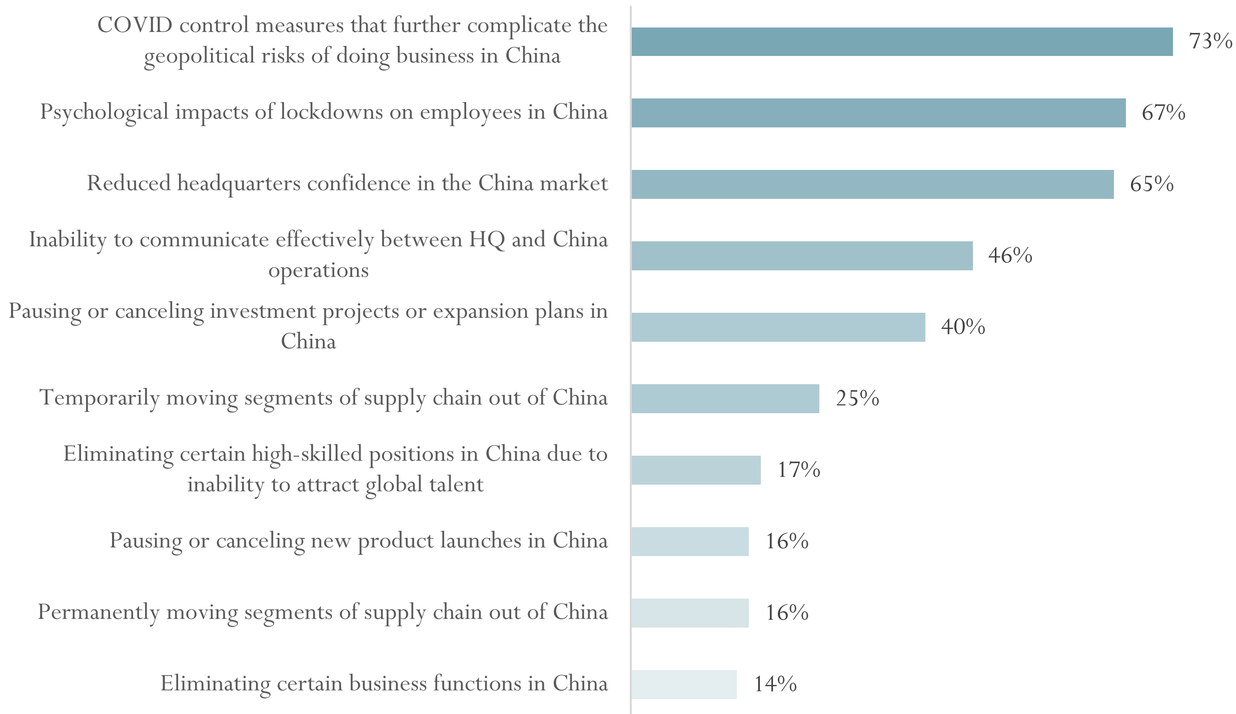


Have China's COVID control measures impacted your future business and investment plans in China?



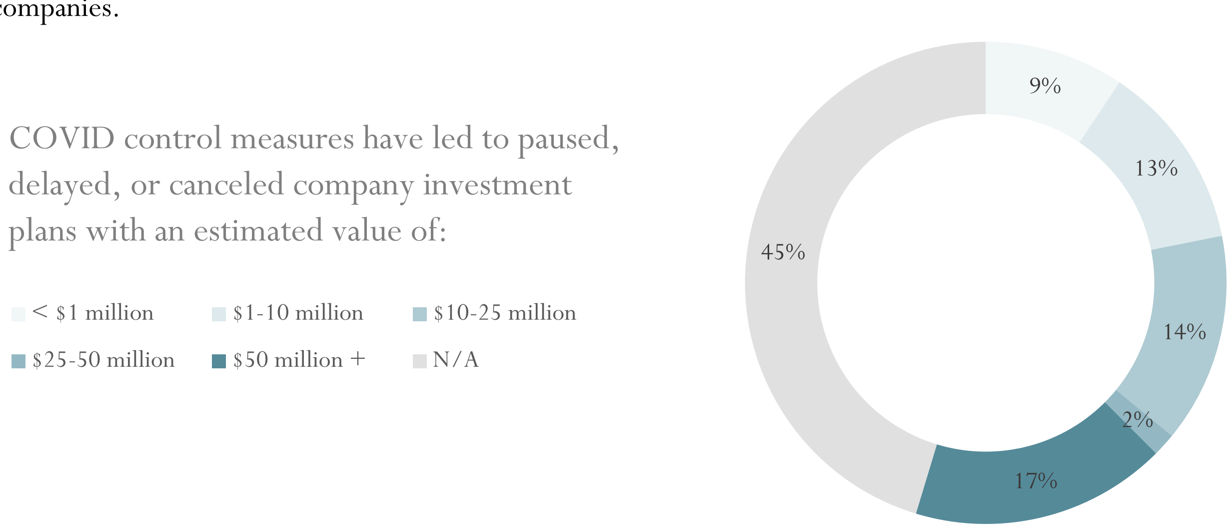
The most-reported impact is a perception of increased political risk from doing business in China, indicating a high level of concern about the direction of the country's policy decisions that affect the business environment as well as the balance between political objectives and economic pragmatism. Other top impacts were the psychological effects of lockdowns on employees and reduced headquarters' confidence in the China market.

What are the top impacts to your business and investment plans?

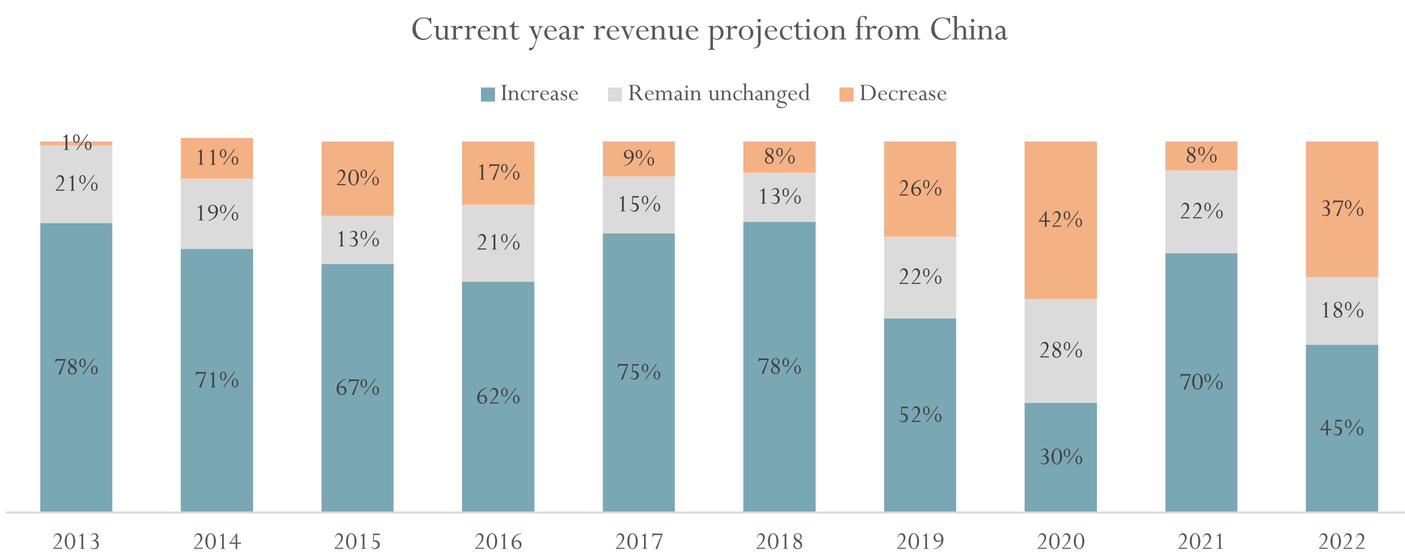


Over half of respondents paused, delayed, or canceled investment plans in China as a result of the country's COVID-19 strategy. These measures impacted plans for over $50 million in investment for 17 percent of companies.

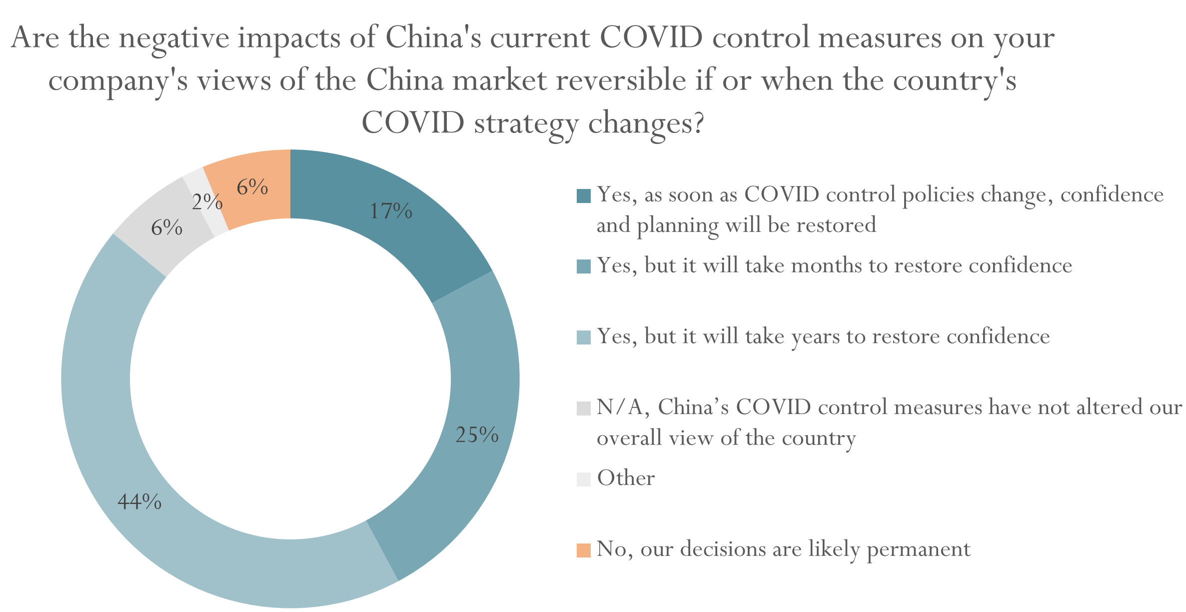
COVID control measures have led to paused, delayed, or canceled company investment plans with an estimated value of:



These concerns can clearly be seen in companies' revenue projections for the year. The number of respondents expecting an increase in revenue is 25 percentage points less than last year. Revenue projections took a similar dip in 2019 after unprecedented tariff escalations and again in 2020 at the beginning of the COVID-19 pandemic before rebounding to historic levels in 2021.



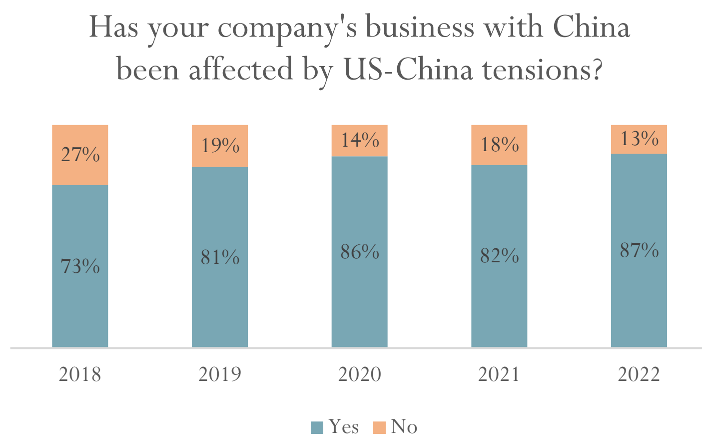
While 6 percent of respondents indicate that the impacts of control measures on their views of the China market are irreversible, 86 percent believe the damage is reversible. However, 44 percent say it will take years to restore business confidence, even if China's strategy changes.



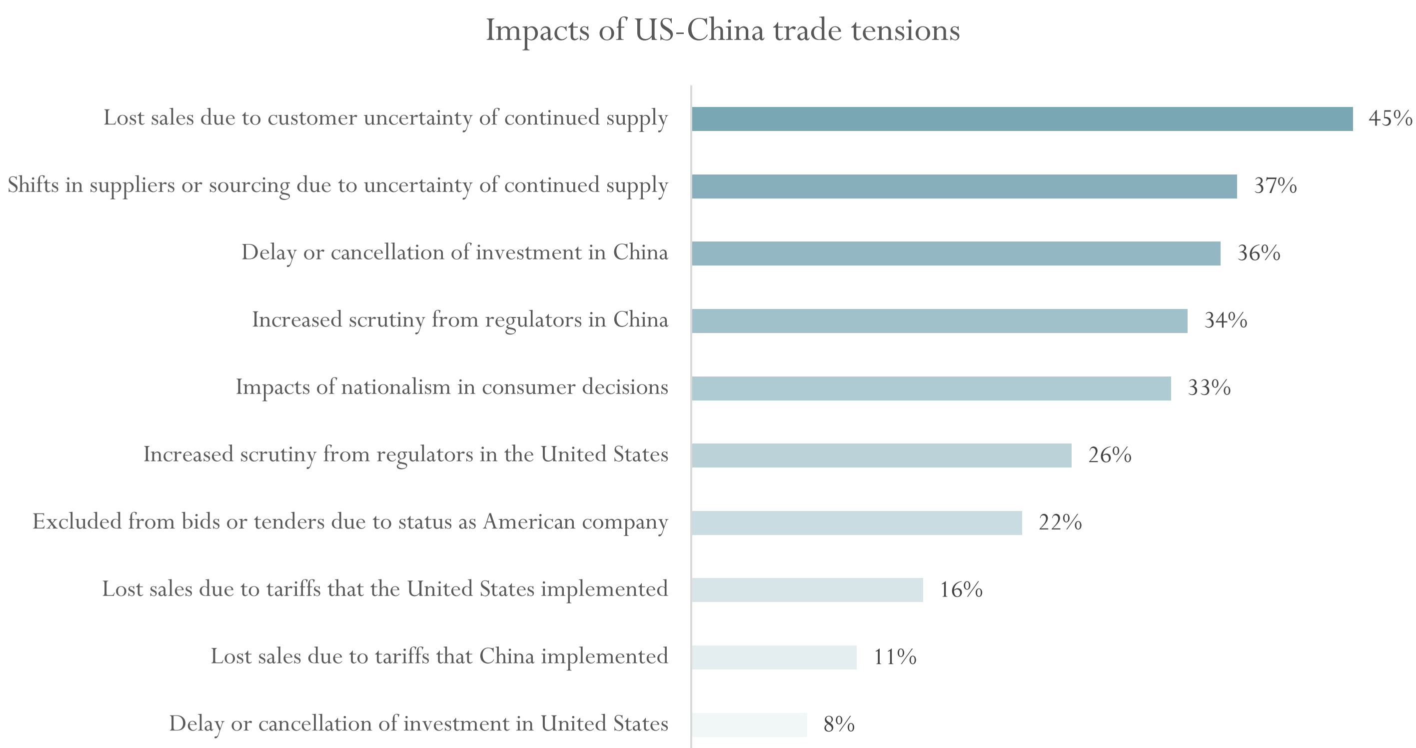
US-China tensions continue to weigh on companies

Respondents are highlighting tensions in US-China relations as their number two challenge this year, indicating relations remain a top issue for US companies doing business in China. US-China technology decoupling is sixth among top challenges, demonstrating concern around issues like US export controls, sanctions, and proposed outbound-investment screening measures as well as China's technology self-reliance efforts and nascent sanctions and export control regimes. And while tariffs fell off the top 10 list, they remain a significant concern, ranking 11th among top challenges in 2022.

At 87 percent, the number of companies reporting business impacts from US-China tensions is at a record high. This trend has continued across different US administrations, indicating that tensions are enduring and will be difficult to reverse.

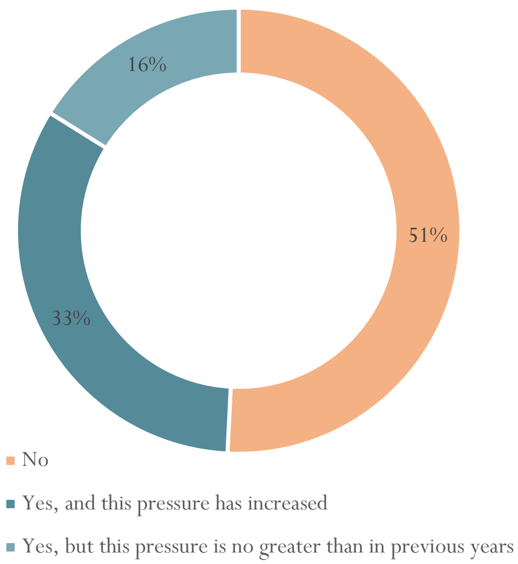


As in past years, the top impact of US-China tensions is lost sales due to uncertainty of continued supply, which is impacting nearly half of respondents. One-third of companies are concerned about impacts of nationalism on consumer decisions, also similar to last year.

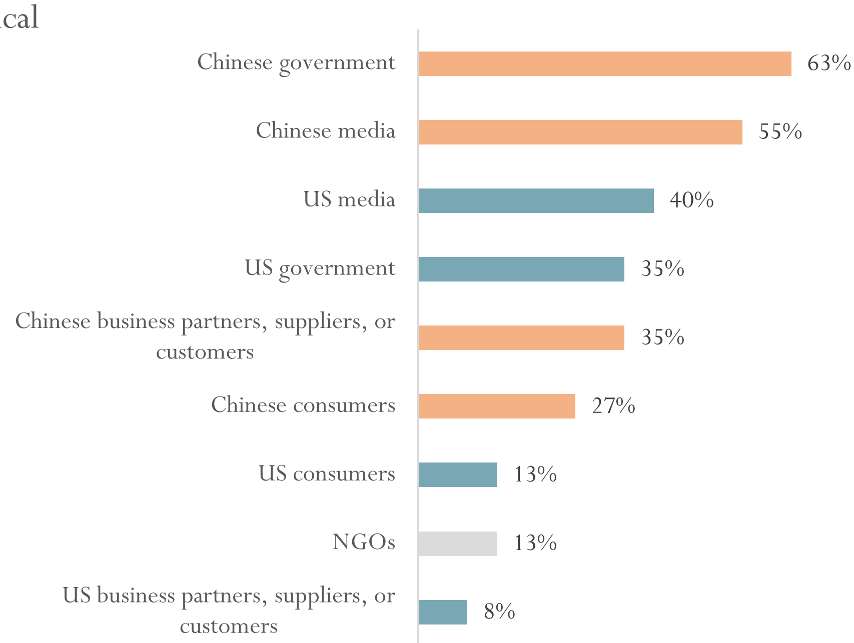


About half of respondents feel pressure to make political statements, with most of that pressure coming from the Chinese government and media, though a significant amount comes from the US government and media as well. One-third of respondents say such pressure is greater than in past years.

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



If yes, where is the pressure coming from?

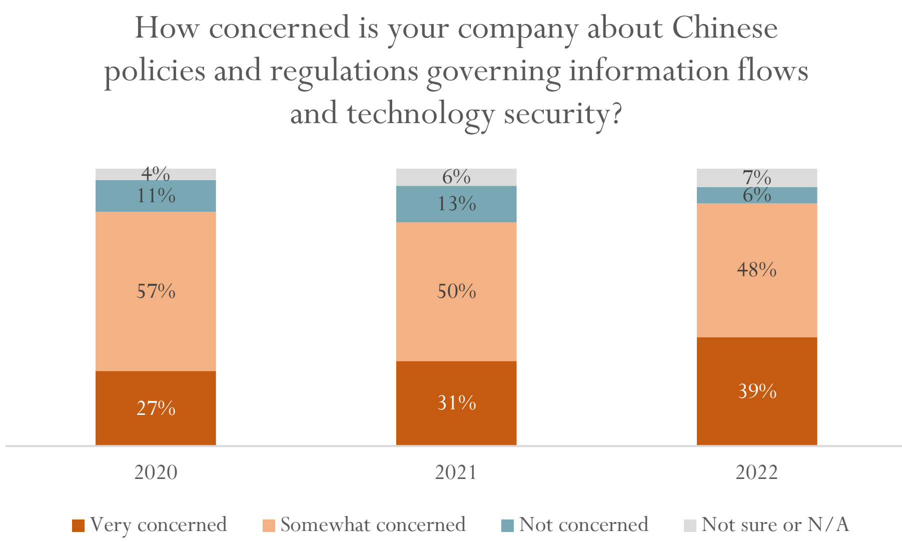


As companies face increased pressure from both sides, they are adapting their strategies to make their US and Chinese businesses increasingly separate. About a third note that this involves their increased localization in China, which makes sense considering 83 percent report being there to access the China market. However, adaptation also involves separating their supply chains (29 percent), shifting away from industry segments (26 percent), and investing less in China (24 percent). Should China use anti-sanctions measures against a foreign company, 59 percent of companies indicate that would reduce their headquarters' confidence in the China market.

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

New data and privacy rules lead to record levels of concern

Amid the roll out of new key legislation in China, respondents rank data, privacy, and cybersecurity concerns as their number four challenge this year. This is the highest level of concern for these issues since their inclusion in this survey, with 87 percent of respondents either very or somewhat concerned. Respondents have consistently expressed high levels of concern since 2015, when the first draft of China's Cybersecurity Law was published.

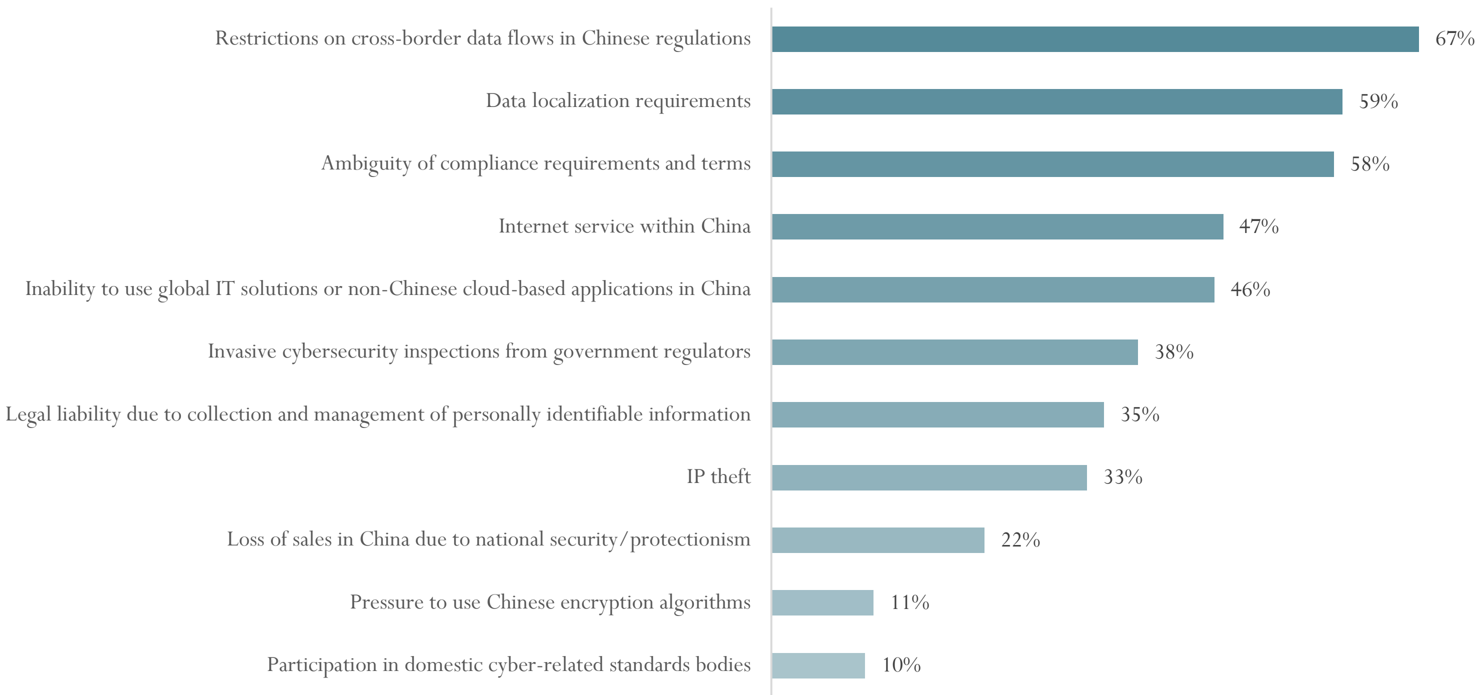


Cross-border data flow restrictions once again top the list of cyber-related issues facing companies, with 67 percent indicating concern. As new cross-border data security reviews come online in the coming months, impacts on business operations could further intensify. Data localization and ambiguous compliance requirements also rank highly as concerns.

Example: Data localization costs

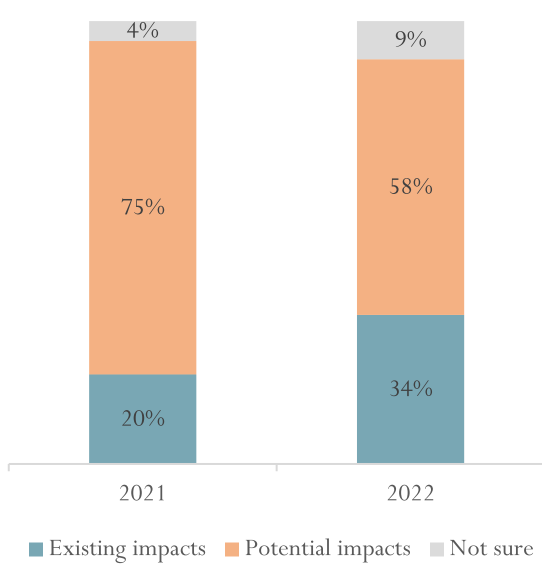
One company shared that data localization not only creates an upfront cost of several million dollars but also carries costs for annual maintenance, repair, and improvements. In addition, they indicated that establishing a data center in China would take between 6 to 12 months—disrupting business efficiency and normal operations.

Concerns about cyber-related issues



There is also a jump in companies experiencing tangible impacts of China's data policies in 2022, as those companies have started incurring costs for mapping data and developing compliance regimes in preparation for implementation. A record high of respondents indicate that their concerns are based on the existing impacts of China's information flow and technology security policies (34 percent) as opposed to potential impacts (58 percent).

Are concerns based on existing or potential impacts?

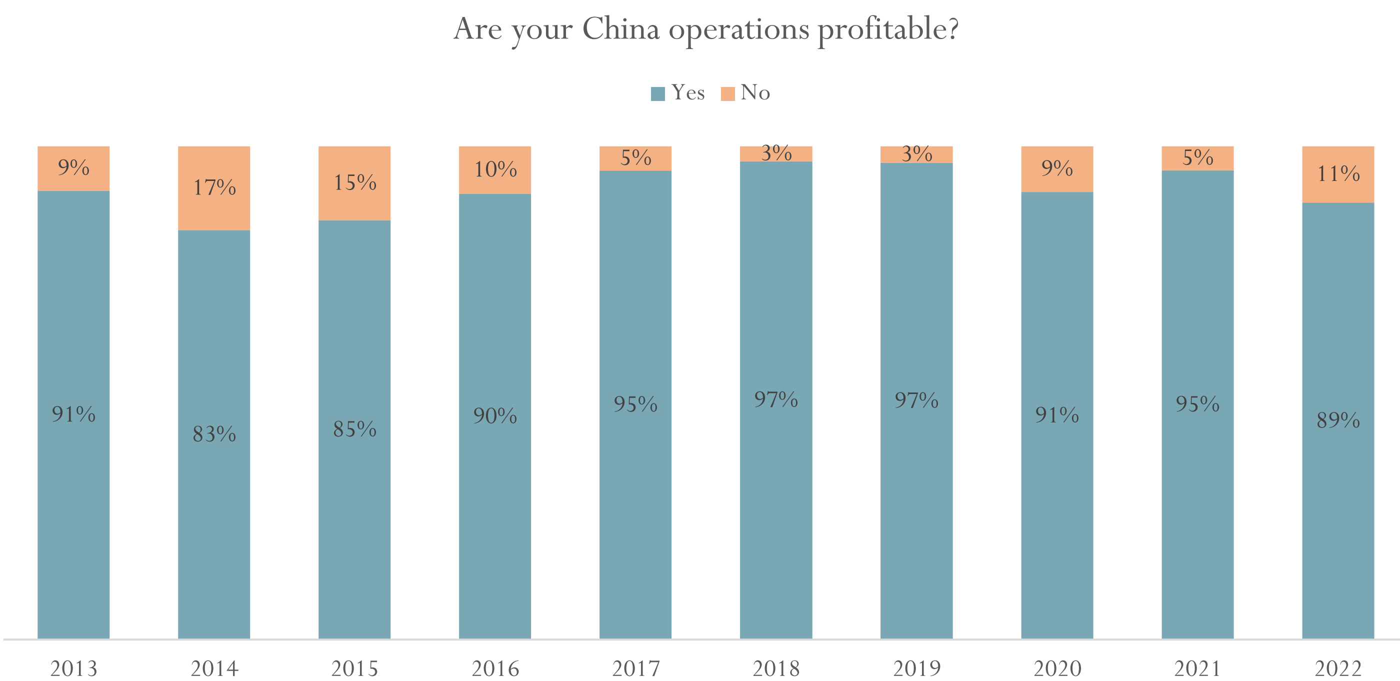


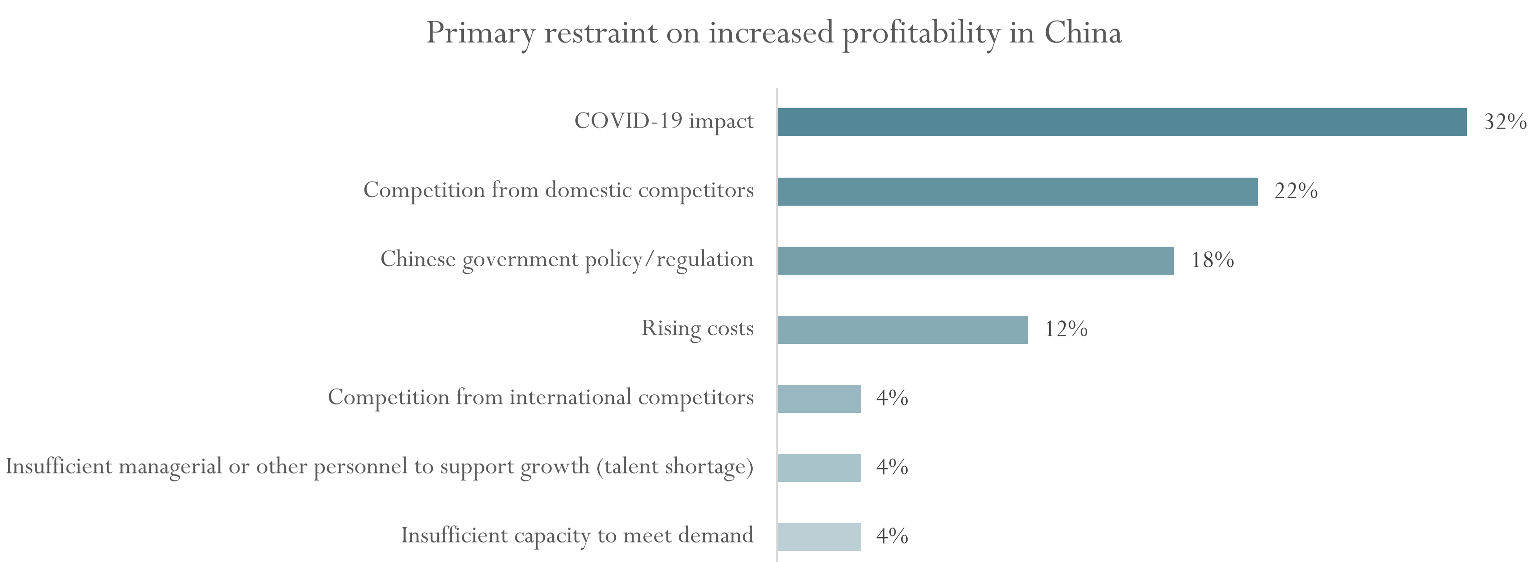
Example: Impact on product offerings for China market

China's data and privacy policies can impact the types of products members are able to offer in the China market. One company shared how, due to increased sensitivities of data collection and the potential risk of noncompliance, they are increasingly separating product packages with trimmed down versions for the China market and full-feature versions for the non-China global market. The main consideration for this move is uncertainty surrounding future regulatory actions by the Chinese government on issues such as data and personal information.

Performance weakens slightly after a strong 2021

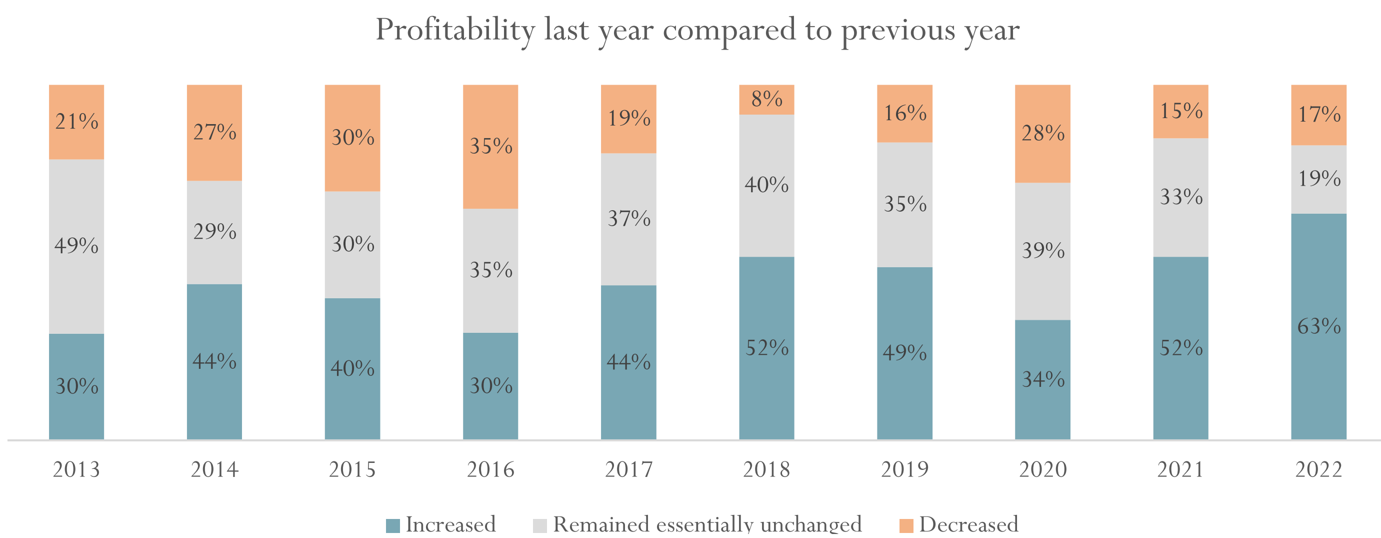
In the face of challenges, respondents' economic performance in China remains strong. However, while 89 percent of respondents remain profitable, this is the lowest percentage of profitable respondents recorded in USCBC's survey in seven years. Companies list COVID-19 impacts as their top restraint on increased profitability, followed by competition with domestic competitors and Chinese regulations.

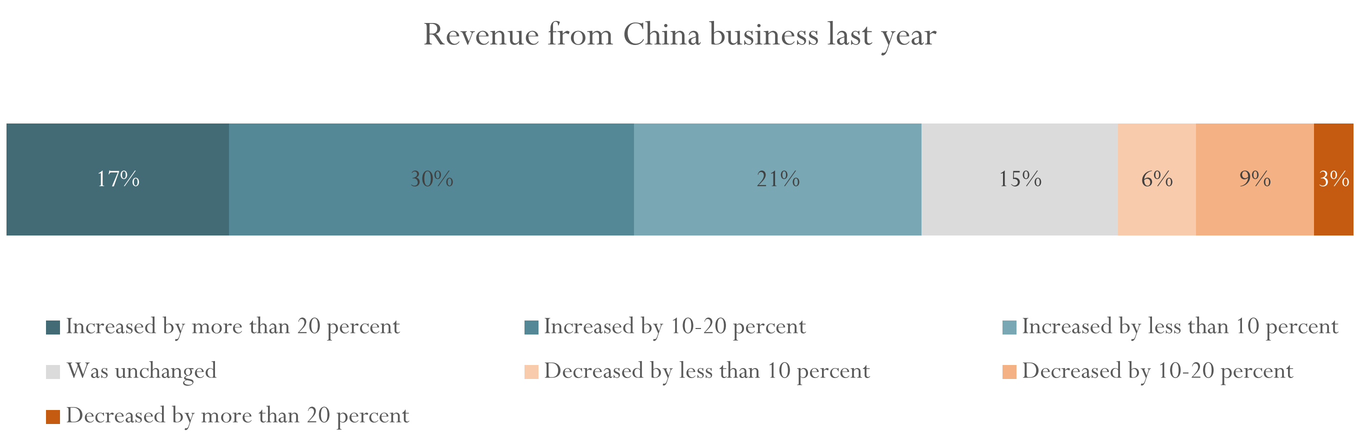




Despite challenges this year, 63 percent of respondents indicate that their profitability increased last year—a proportion unseen in more than a decade. Four-fifths of respondents report their China profit margins were the same or better than overall operations last year, another decade high. China business revenue increased for 68 percent of respondents last year, with nearly half reporting increases of over 10 percent.

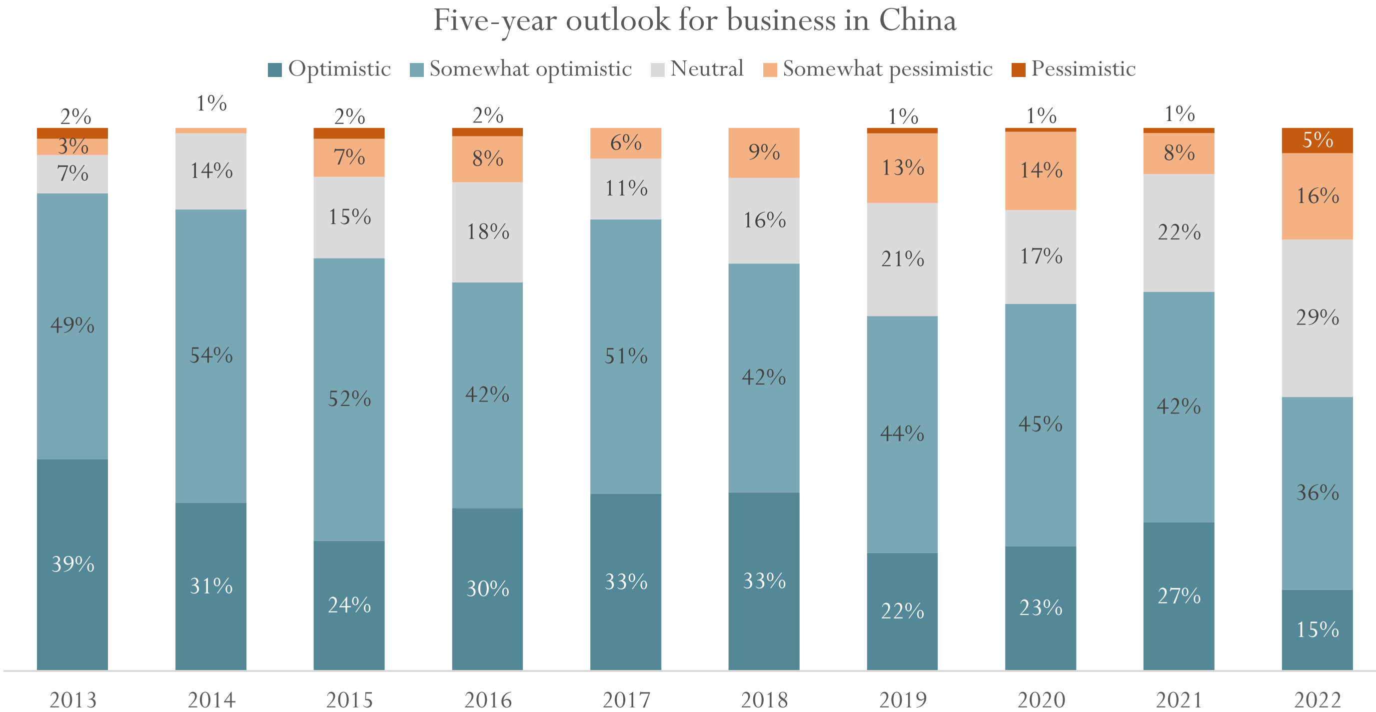
These performance figures show the potential that the China market holds for American companies. If they are not able to participate in the China market and reap these benefits, they are at a global disadvantage compared to competitors who are.



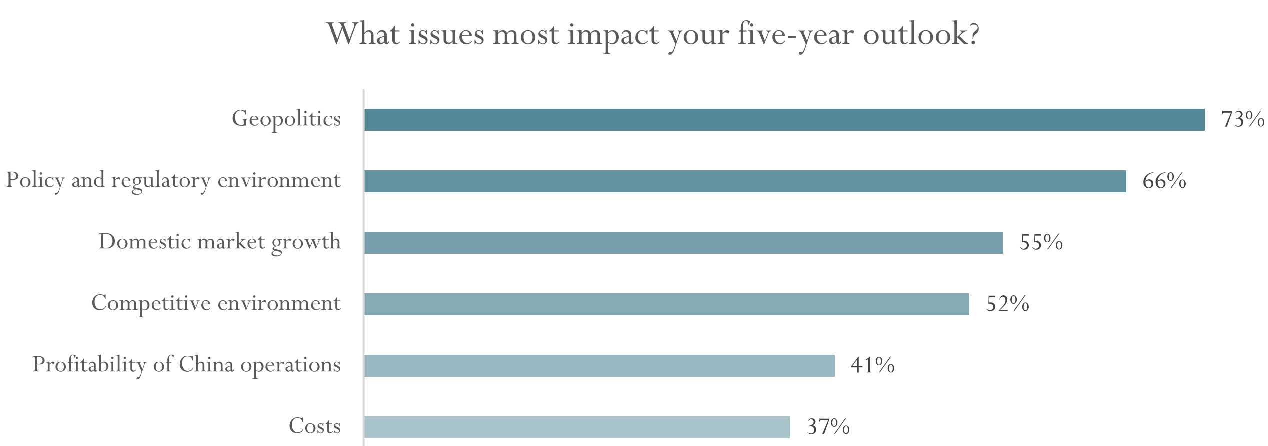


Optimism hits an all-time low

Respondents' optimism regarding their five-year business outlook has taken a sharp dive this year, with companies expressing an optimistic or somewhat optimistic outlook falling 18 percentage points from last year to a record low of 51 percent. At the same time, pessimism is at an all-time high of 21 percent of respondents, more than double last year's figure. Over a decade, optimism in five-year outlooks has dropped from nearly 90 percent to just over 50 percent, and pessimism has increased from 5 percent to over 20 percent.

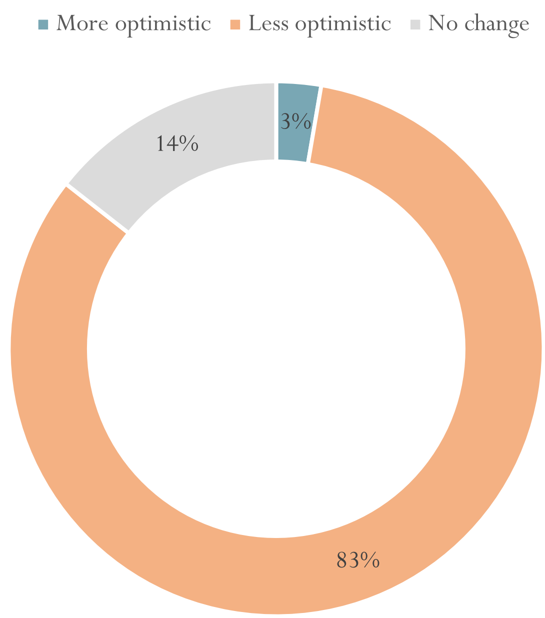


Amid uncertainty surrounding the long-term implications of protracted US-China tensions, respondents cite geopolitics as the top issue impacting their outlook. China's policy and regulatory environment also ranks highly as a consideration as new challenges emerge and longstanding issues see little progress.



When comparing the current business climate in China to the one just three years ago, respondents also report record levels of pessimism, with 83 percent indicating they are less optimistic today. This is a 24 percent increase from last year and a 42 percent increase from a decade ago.

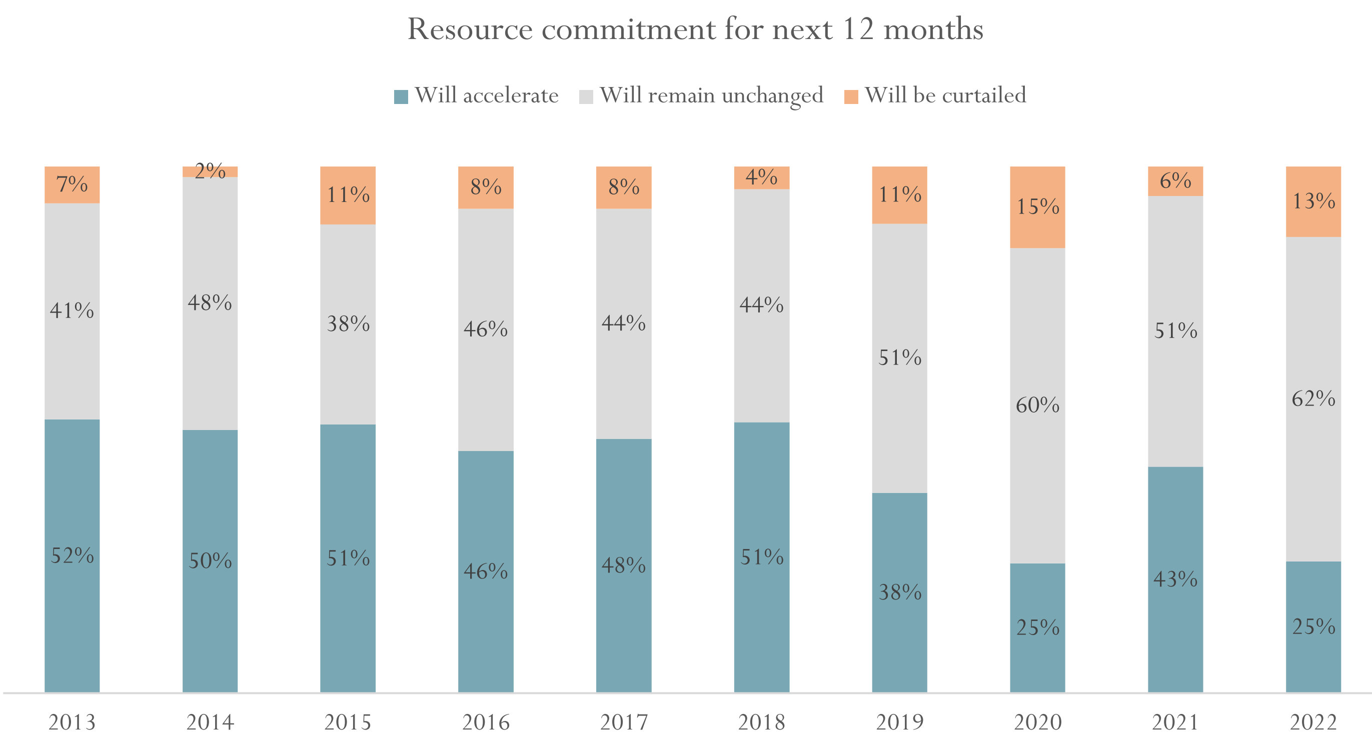
View of current business climate in China compared to three years ago



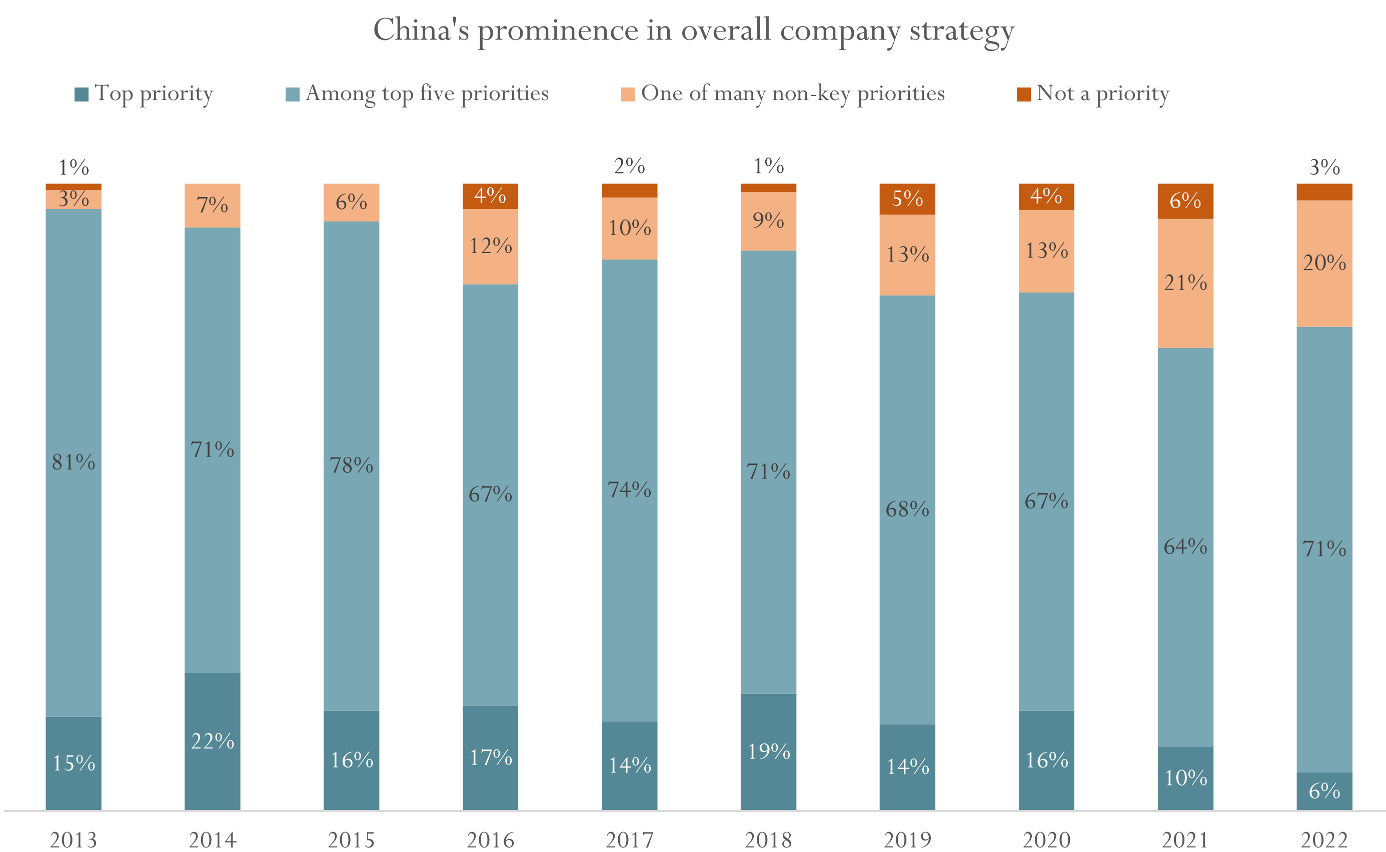
Companies sit tight on investment plans in uncertain times

Increased challenges and souring optimism have impacted company plans to invest more in China. One-quarter of respondents plan to accelerate resource commitment to the China market over the next year, just half the proportion of five years ago. Respondents planning to curtail their resource commitment have more than tripled over the same time frame, rising from 4 percent to 13 percent.

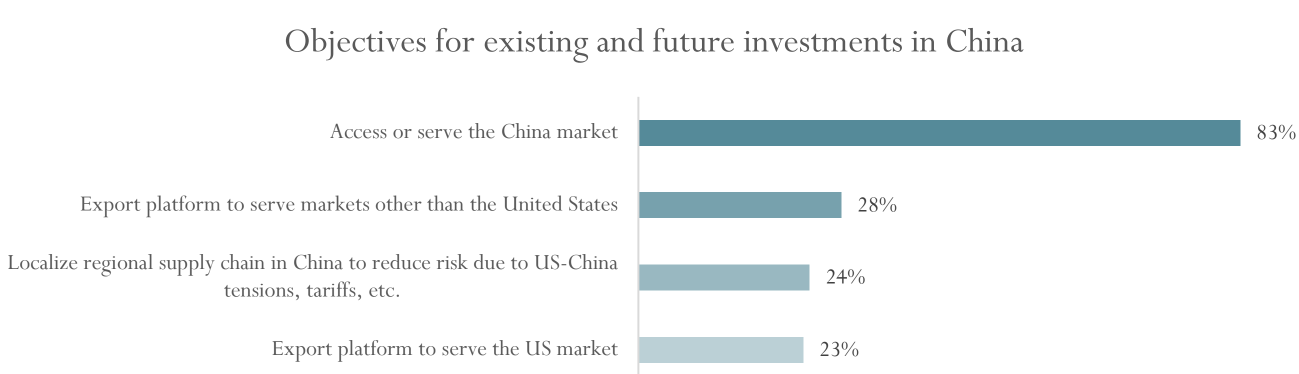
A majority of respondents are in wait-and-see mode, not planning to make any changes to resource commitment over the next 12 months amid significant uncertainty around China's COVID-19 policies, bilateral tensions, and geopolitics. Companies had a similar reaction in 2020 at the outset of the pandemic, and company resource commitment bounced back in 2021, when China's COVID-19 policy was able to contain the virus without yet requiring mass lockdowns. How foreign companies invest in China moving forward will likely depend on China's policy choices through the end of this year.



Compared to other countries where companies do business, China remains a top five priority for 77 percent of respondents. However, this figure has declined consistently over the last decade, at the beginning of which China was a top five priority for 96 percent of respondents. And companies indicating that China is their top priority market have fallen to an all-time low of 6 percent.



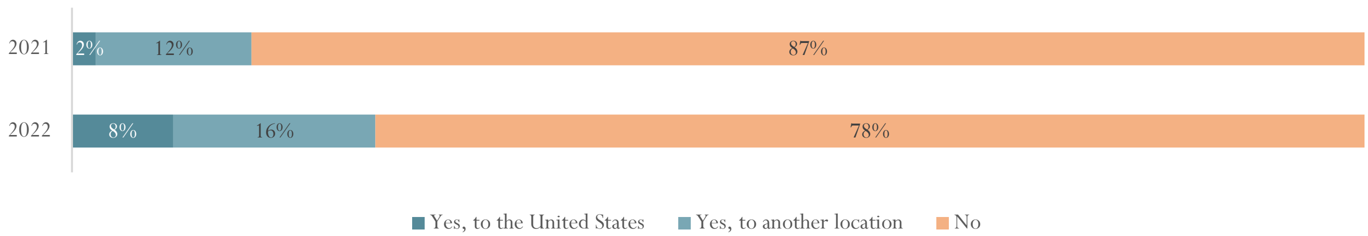
In terms of the reasons companies invest in China, 83 percent of members are there to serve the China market. Despite COVID-19 and economic pressures, China's large and growing middle class still represents an important opportunity for companies over the long term, and to be competitive in the China market, it is important to be close to suppliers and customers.



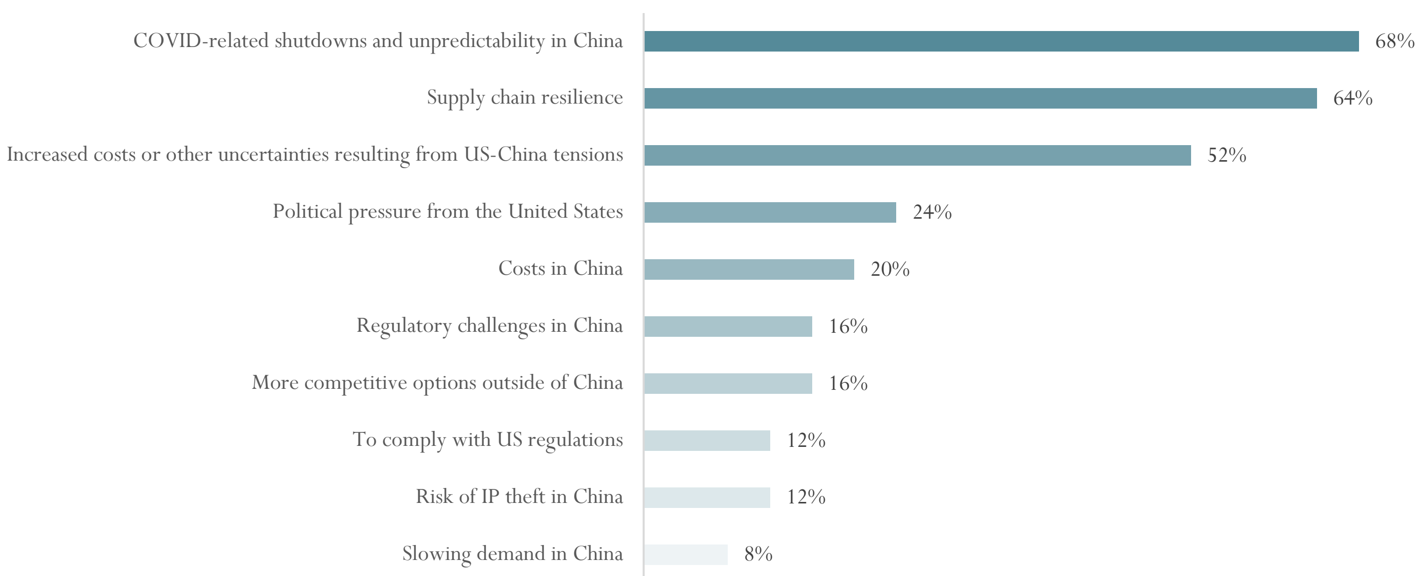
China remains prominent in supply chains

Most respondents are not moving segments of their supply chains out of China. This speaks to the country's competitiveness in speed, quantity, quality, and cost of manufacturing, despite lockdowns and tariffs. However, the increasingly challenging environment has also caused companies to reconsider supply chains. Over the past 12 months, nearly a quarter of respondents have moved segments of their supply chains out of China—a significant jump from last year—and the majority doing so are moving them to locations other than the United States. The top reasons cited are COVID-19 shutdowns in China and supply chain resilience.

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



What were the reasons for moving supply chains to another location?



While the vast majority of respondents (85 percent) have no plans to move their own operations out of China, the percentage of companies that do have such plans (15 percent) has reached its highest level since USCBC began asking this question in 2015.

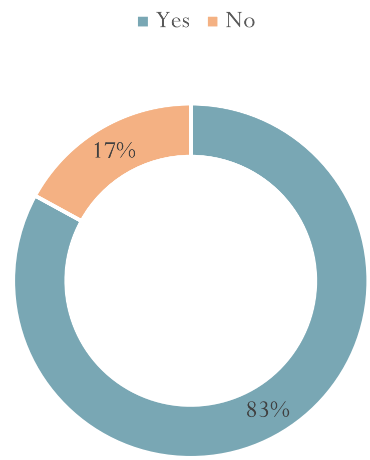
Rising costs weigh on companies

Rising costs constitute the fifth largest problem facing companies and factor prominently in their outlooks for profitability, future investment, and supply chain plans. Eighty-three percent of respondents express concern about rising costs.

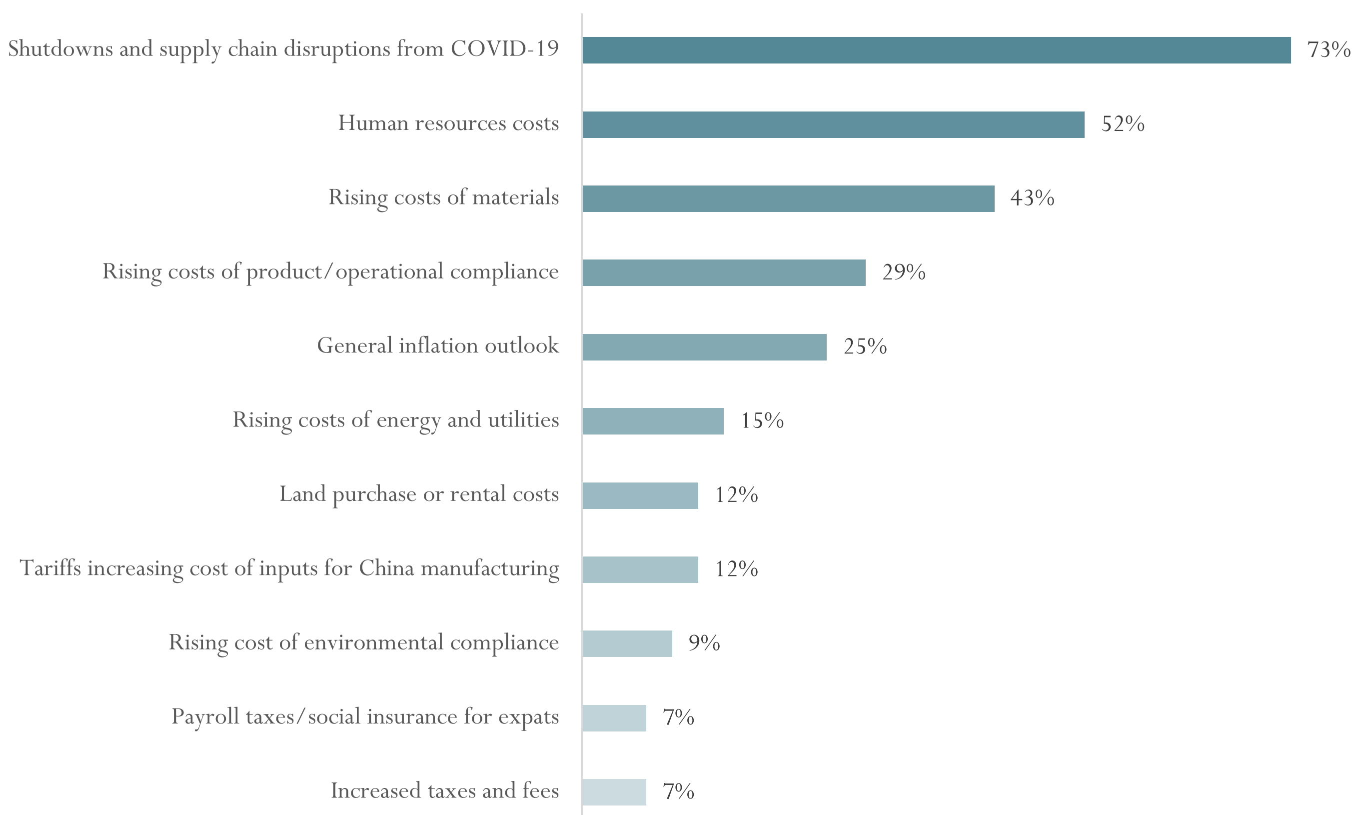
Unsurprisingly, shutdowns and supply disruptions from COVID-19 rank top among cost concerns, jumping from 20 percent of respondents indicating concern last year to 73 percent this year. Logistics costs dramatically increased as disruptions to logistics from port shutdowns in China cascaded across the global shipping industry. Abrupt factory shutdowns led to lost revenue and/or lost supply, and companies that were able to institute closed-loop operations to reopen did so at a steep additional price.

Human resources costs also rank high among concerns, though less so than last year.

Are rising costs in China a concern?



Top cost concerns

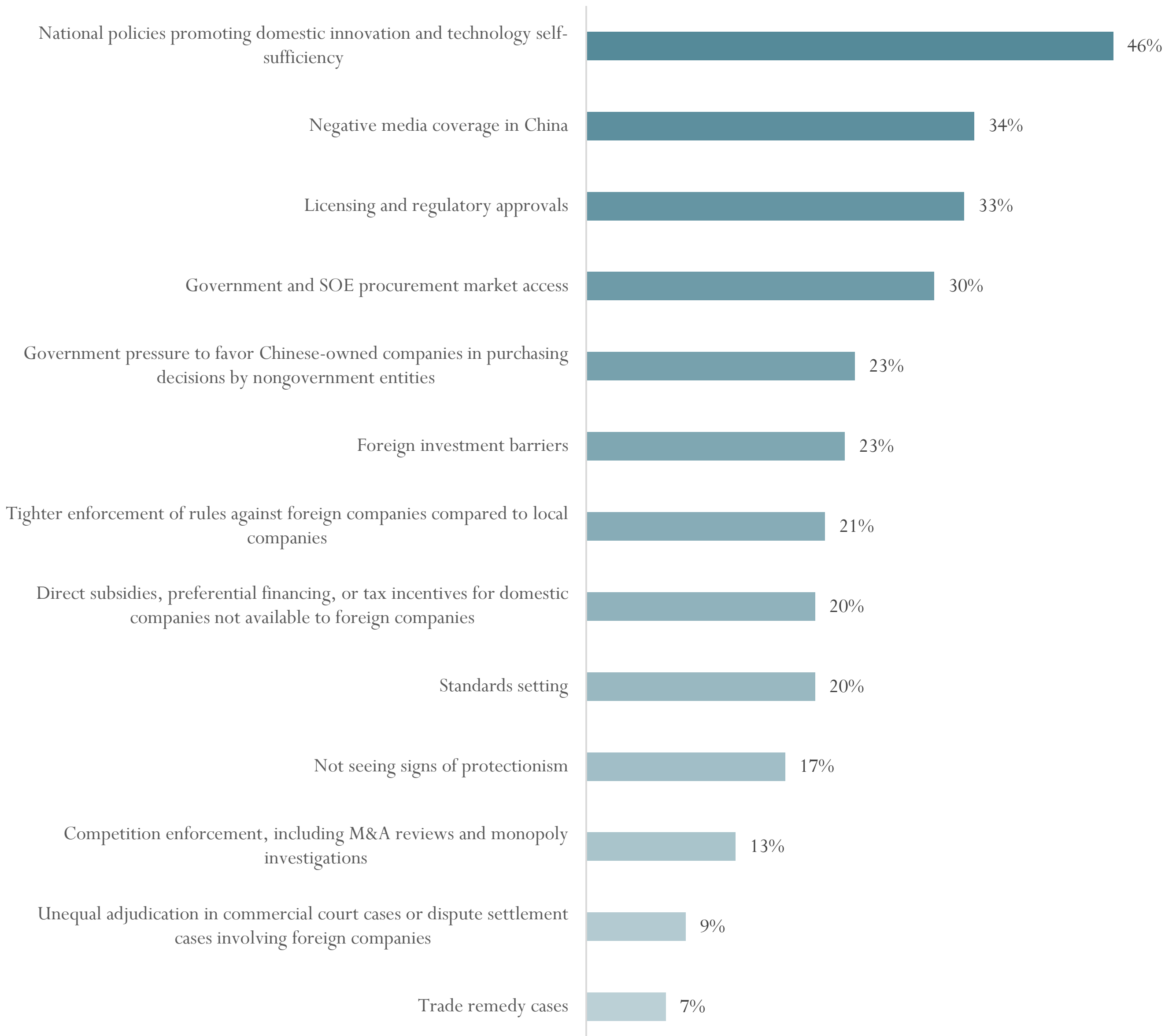


Industrial policy tools used to protect domestic players

China employs a suite of policies to stimulate industrial development, which can become problematic when used to protect domestic players from competition with foreign companies. A number of industrial policy tools are reflected in the protectionism concerns outlined by respondents. While domestic innovation and technology self-sufficiency policies have topped protectionism concerns for the third year in a row, many other tools associated with industrial policy have also made the list, including procurement market access, foreign investment barriers, subsidies, and standards.

Amid increasing US-China tensions and nationalist sentiment, a third of respondents also note that being targeted by negative media coverage in China is a concern.

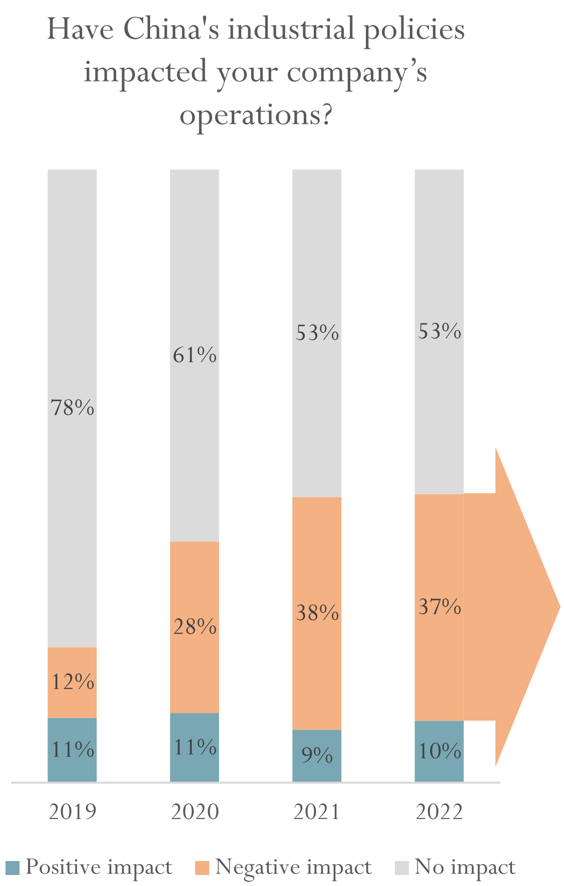
Signs of protectionism in China

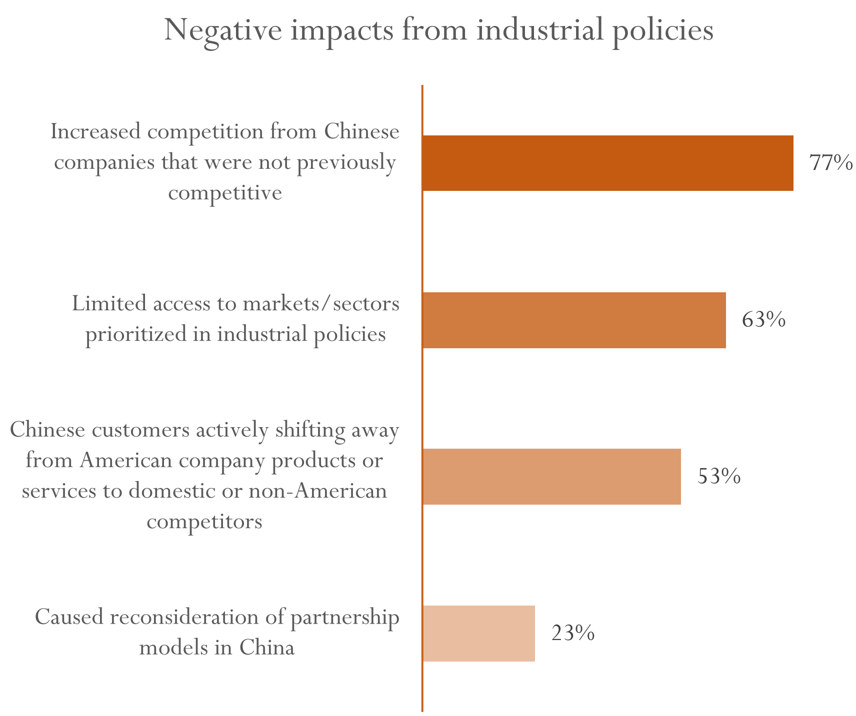


Industrial policies tilt the playing field

Three-quarters of respondents are concerned about China's policies promoting domestic manufacturing and innovation, which have only expanded in recent years amid efforts to achieve technology self-sufficiency and develop national champions.

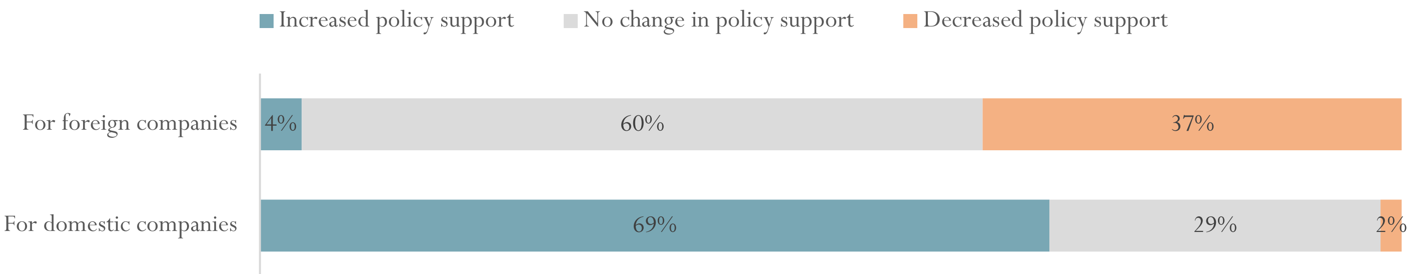
While more than half of respondents have yet to see an impact from China's industrial policies on current operations, the percentage of companies reporting negative impacts has tripled since 2019. The top negative impact from industrial policies is increased competition from Chinese companies that were not previously competitive.





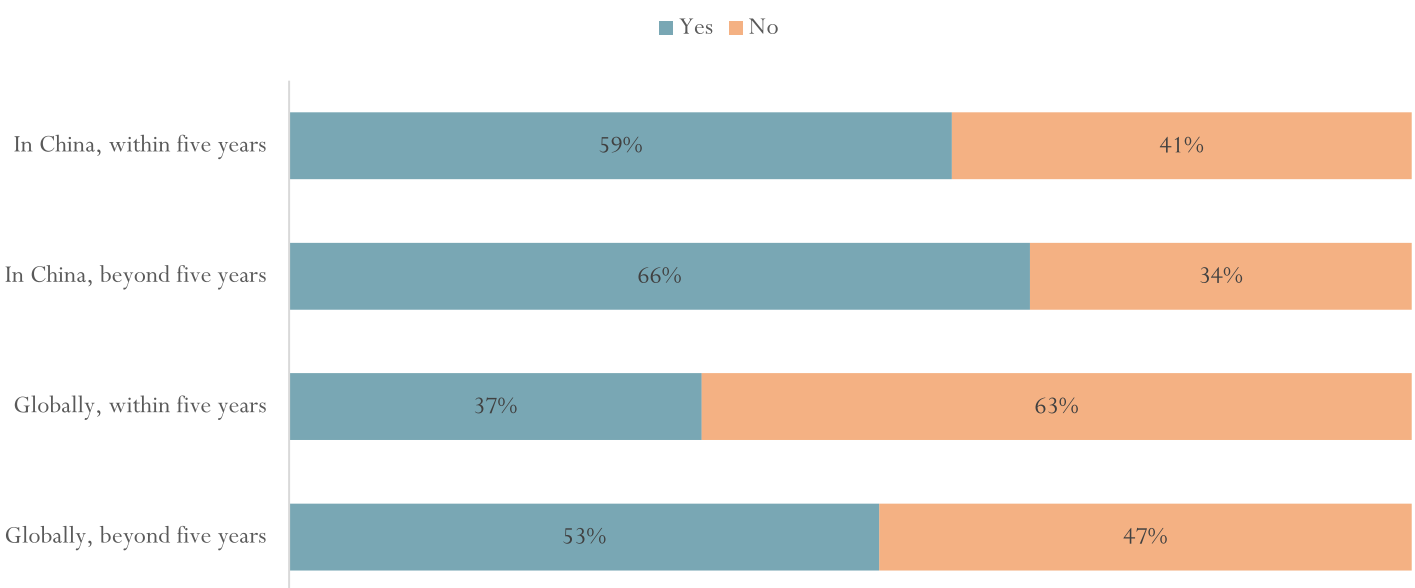
Respondents have observed that US-China trade frictions are leading to diverging trends in policy support for foreign and domestic companies. Respondents estimate domestic companies received increased policy support or similar levels of support as in the past, while foreign companies either saw no change in support or decreased support. Concern about continued access to US technology is a key motivator for industrial policies aimed at technology self-sufficiency.

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



It takes time for industrial policies to foster domestic competitors and even longer for them to reach global scale. It is not surprising, then, that respondents feel that Chinese industrial policy will have a greater impact on their market share both in China and globally over time. Within China, companies see a greater impact of industrial policy on market share, though long-term impacts are expected to be only marginally greater than short-term ones. Globally, though, 37 percent of companies believe Chinese industrial policy will impact their market share within five years, and over half believe it will impact them beyond five years.

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

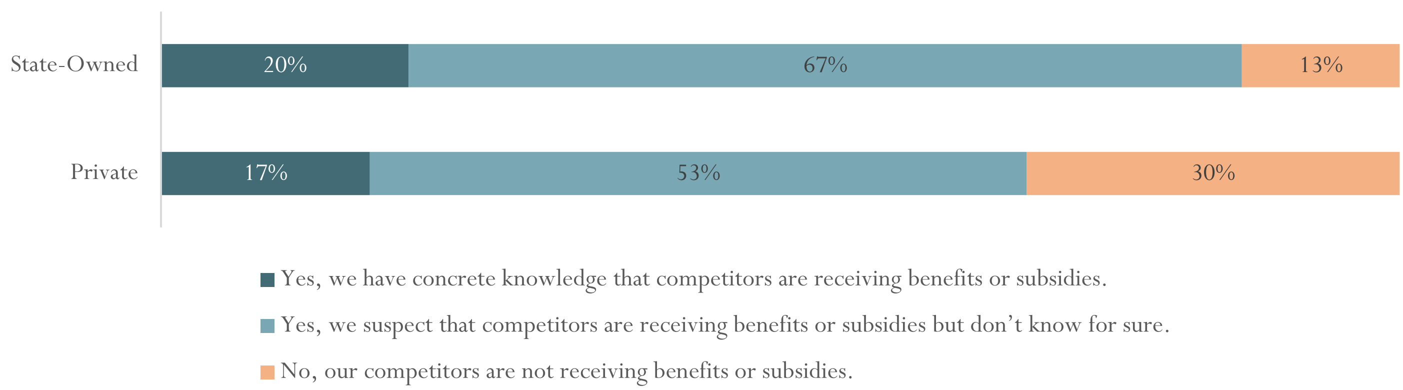


Increasingly competitive Chinese firms continue receiving state support

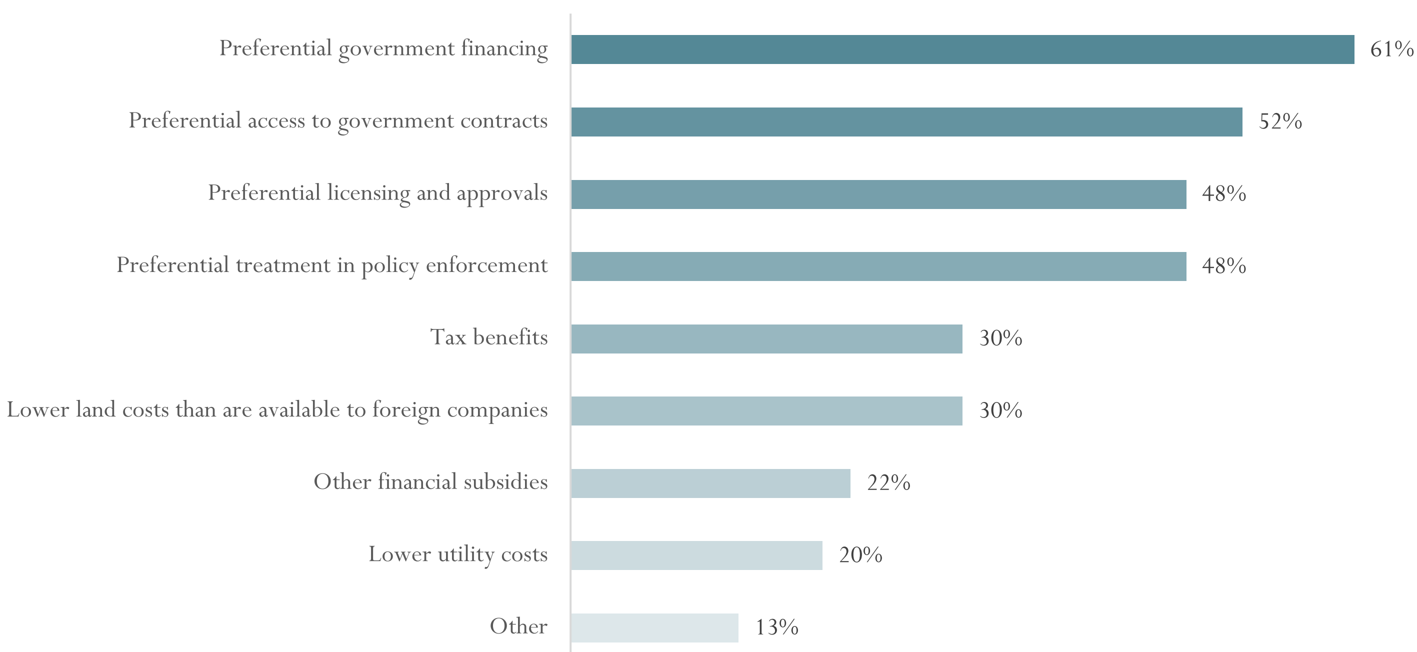
Competition with Chinese companies is seventh among this year's top challenges. Chinese companies have become increasingly competitive as the market matures while at the same time continuing to receive state support, such as preferential government financing and access to government contracts.

US companies in China compete with both state-owned enterprises (SOEs) and private Chinese companies, although more respondents compete with private Chinese companies (86 percent) than SOEs (55 percent). A majority of respondents believe that both their SOE and non-SOE competitors are receiving such support, though estimates are lower for non-SOE competitors. In many cases, companies suspect that their competitors receive state support, but this can be difficult to confirm and even harder to quantify.

Are competitors receiving tangible benefits?



What kinds of benefits do SOE competitors receive?

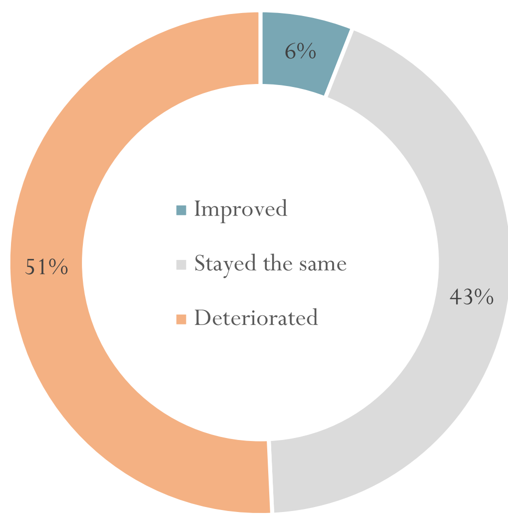


Increased difficulties participating in procurement opportunities

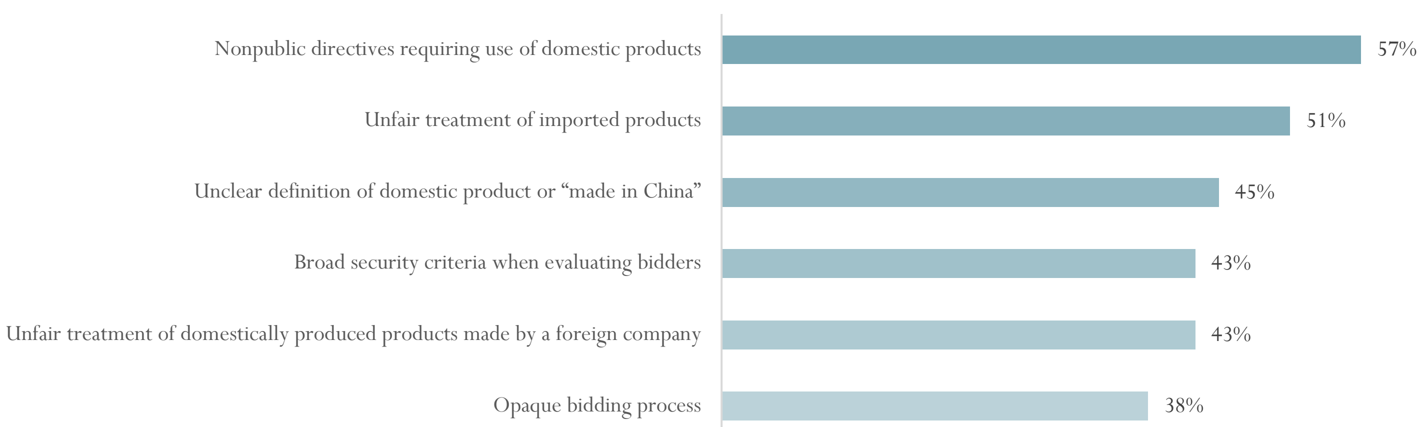
Despite a directive last year to treat foreign-invested companies as equal to their Chinese-owned competitors in government procurement, buy China policies are creating more difficulties for US companies. Last year, authorities issued a list of nonpublic domestic content targets for life sciences equipment, and opaque security requirements in tenders have disadvantaged foreign technology products for years. This effort is hard to reverse, undermines confidence in the market, and cuts against the government's commitments to equal treatment.

It is not surprising, then, that China's procurement policies rank ninth in this year's list of top challenges, making it into the top 10 for the first time in over a decade. Half of respondents report the environment for Chinese government and SOE procurement is deteriorating for foreign companies.

In the last 12 months, China's government and SOE procurement market (including public institutions) for foreign companies has:

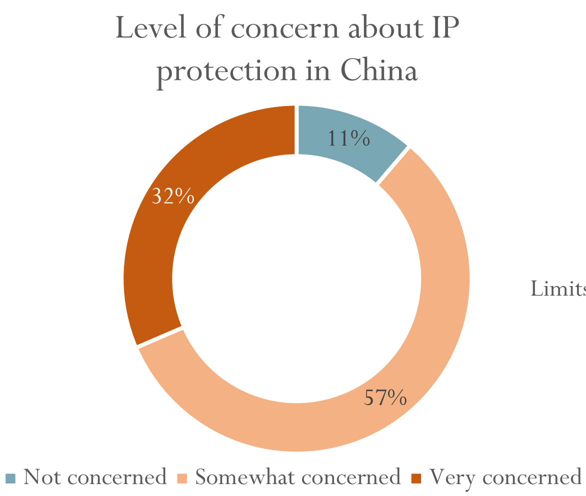


What challenges does your company face in government and SOE procurement in China?



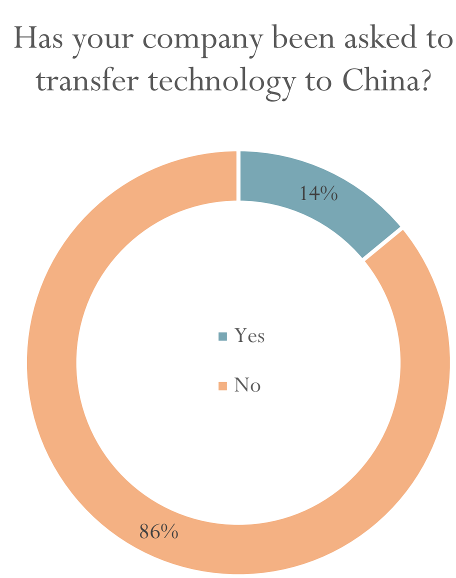
Intellectual property protection remains a persistent concern

IP protection has been a longstanding issue for US companies in China with few recent groundbreaking developments. While IP protection has dropped from the 6th to the 10th top concern of respondents this year in the overall ranking, the percentage of companies concerned with China's IP practices remains consistent with past years, indicating that companies are not becoming less concerned about IP protection, but rather, other emerging and urgent issues have taken priority.



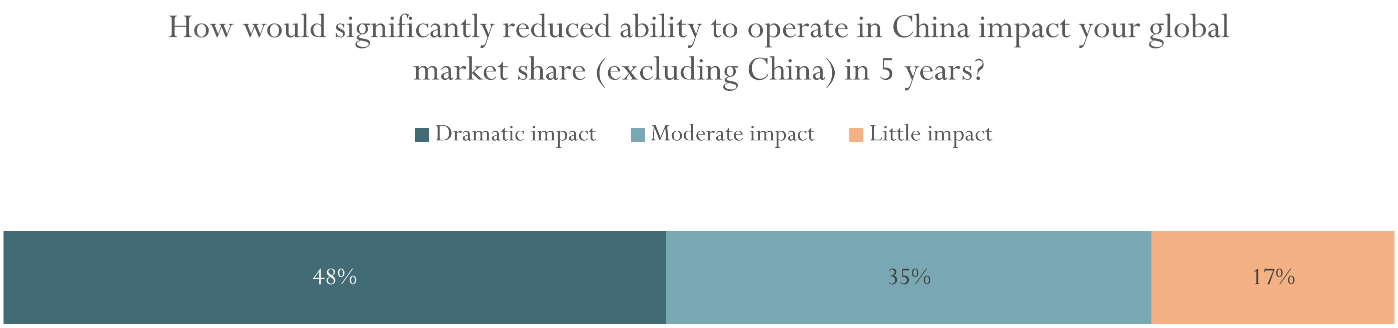
While most respondents note that China's protection of IP has either improved (46 percent) or remained the same (46 percent), 54 percent of respondents feel that its IP environment provides less protection compared to other countries where they operate. IP protection concerns influence what activities companies pursue in China—half of companies surveyed indicated that IP protection concerns limit their R&D activities in China, and nearly two-fifths report that this limits products manufactured there.

While the majority of respondents say they have not experienced requests for technology transfers, such requests can be an acute issue for affected companies. In this year's survey, 14 percent of respondents report that they have been asked to transfer technology. In some cases, such requests come as part of normal commercial negotiations, but other times, they come from government entities as conditions for market access, compelling companies to weigh the relative values of both their technology and access to the China market.



Conclusion

The data in this year's survey foreshadow major headwinds for US companies operating in China. But this hardly means these trends are set in stone. Business sentiment and investment plans have bounced back from challenges before. Despite flagging optimism and companies' more cautious approach to future investments, China remains vital to US companies' global competitiveness. Many companies report that if their ability to operate in China was reduced significantly, their global market share would be dramatically impacted.



The future trajectory of US-China commercial relations depends on the choices of US and Chinese policy makers over the rest of this year and beyond. USCBC urges China to take bolder steps to balance pandemic control with economic growth. We encourage China to move proactively to level the playing field for foreign businesses by improving market access and limiting distortive industrial policies. USCBC hopes both governments can adequately but narrowly scope security issues to avoid unintended consequences to trade and investment activities. Both governments should also look for areas of cooperation around global public goods such as climate and public health.

Making progress on this range of issues is even more difficult with today's limited channels of communication between both governments. USCBC recommends both governments immediately begin exploring expanded opportunities for constructive, results-oriented dialogue on commercial issues and global public goods while continuing to manage geopolitical and bilateral tensions.

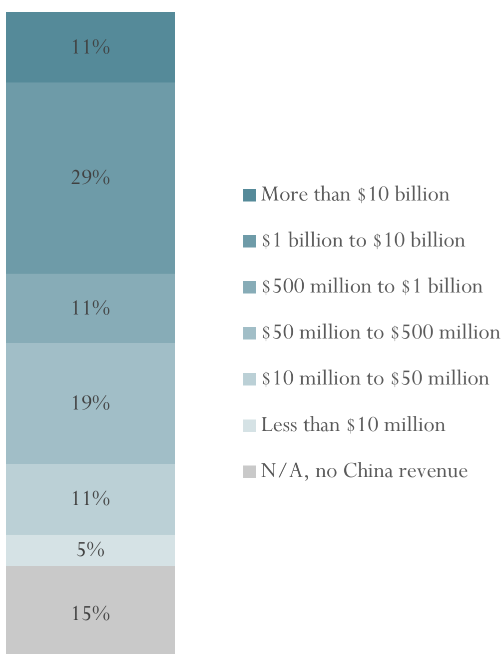
Methodology

This year's survey was conducted in June 2022, and this report draws from the responses of 117 member companies, a level of participation similar to past years. Respondent companies have significant experience and presence in the China market—nearly 70 percent have operated in China for more than 20 years, and 40 percent report generating $1 billion or more in revenue in China.

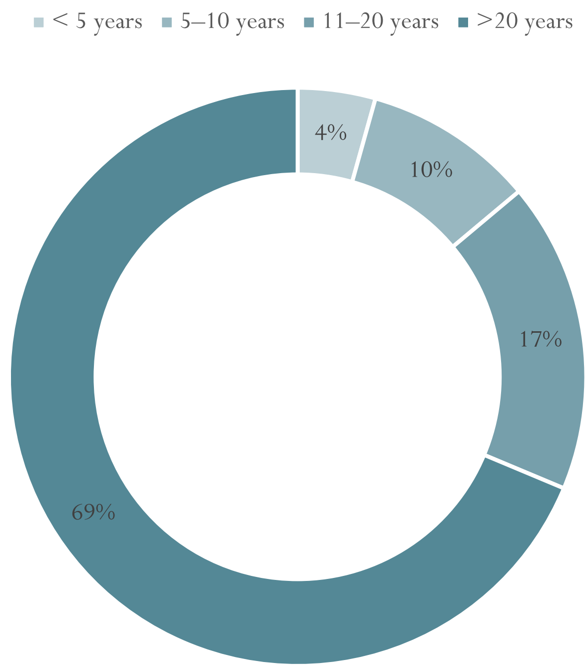
Respondents' top 10 challenges were ranked using a weighted system to reflect the most significant issues they encounter while doing business in China. The same methodology has been used in previous years to ensure consistent analysis over time.

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

What is the China revenue of your company?



Years doing business in China



Type of Operations in China