Navigator

Growing with China

HSBC

Together we thrive

If we are to both maintain progress and tackle global issues like climate change, inequality, and the threat of future pandemics, we have to encourage stronger international ties between nations.

"The vision of an interconnected global economy is undoubtedly under great pressure, but this survey indicates that the business case for both international trade and globalised supply chains remains as strong as ever despite Covid-19 and the rise in protectionist sentiment.

It shows that the momentum is still on the side of a globalised production model. It indicates the importance of technology, both in breaking down barriers between markets and in streamlining production. It shows that China is going to remain pivotal to the global economy for the foreseeable future. And it reveals that for international businesses to thrive in China, understanding the needs and habits of increasingly sophisticated and digitally-minded customers will be key to success, suggesting that the next great wave of trade growth might be in service industries.

China's entry into global markets 40 years ago accelerated the realisation of a new era of international economic collaboration, an era that has simultaneously lifted more than a billion people in developing nations out of poverty and assured a consistent flow of affordable, high-quality goods that have immeasurably improved well-being around the world.

This system is now under threat just when we need it most. If we are to both maintain progress and tackle global issues like climate change, inequality, and the threat of future pandemics, we have to encourage stronger international ties between nations.

As this survey shows, the commercial foundations of international collaboration are strong and enduring. This unsettled time is an historic opportunity to build on them, working together across borders to build a new kind of global economy that combines prosperity with sustainability."

Stuart Tait
Group General Manager
Regional Head of Commercial Banking, Asia-Pacific
HSBC

"For international businesses to thrive in China, understanding the needs and habits of increasingly sophisticated and digitally-minded customers will be key to success."

Executive Summary

Neither Covid-19 nor rising geopolitical tensions seem to have dimmed China's attraction as both a destination market and a key player in global supply chains.

Our survey of 1,100 companies[1] across 11 key global markets[2] shows the combination of China's early recovery from the pandemic, its vast market, and its unrivalled manufacturing infrastructure remain compelling reasons not just to maintain business with China, but in many cases to increase it.

Three quarters of the companies surveyed expected their sales in China to grow over the next two years, with one in five saying they expected growth of greater than 20%. More surprisingly given the geopolitical pressures, 75% of all companies, including 70% of US companies, said they expected to increase the proportion of their supply chains based in China over the next two years.

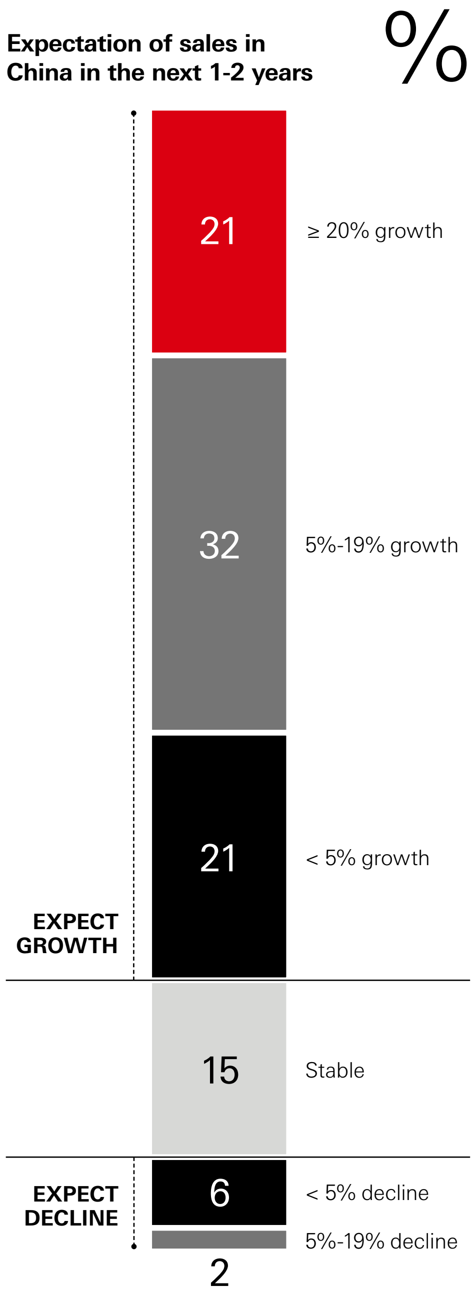
Rising trade protectionism and geopolitics came third and fourth among companies' ranking of the challenges they faced when doing business in China, behind the difficulties of getting to grips with the business culture and the disruptions caused by Covid-19.

Much of the excitement over the Chinese market is down to the country's early recovery from the pandemic and persistent weak demand in Western economies. HSBC expects the global economy to shrink by 4.1% this year, but our China forecast is for growth of 2.4%. The survey hints that as China's economy matures and consumer tastes become more cosmopolitan and sophisticated, more high-end and high-tech players are pushing into the market. Among them, medical device manufacturers are seeing a particularly strong increase in demand, driven by the pandemic.

Adding to the attraction is China's position at the leading edge of the digital revolution, making it easier to reach new customers remotely. More than four in ten companies said they are strengthening their digital presence in China, and there seems to be an emerging trend of firms looking to solve the challenge of understanding the business culture by creating a hybrid local digital presence in partnership with local digital platforms.

Finally, we looked deeper into the stickiness of supply chains, and the potential effect of efforts to encourage companies to move away from China. These efforts seem to be having little tangible impact. Our survey finds that three quarters of companies expected to increase the proportion of their China-based supply chains over the next two years. More than four in ten of all respondents said they intended to increase the proportion by 10% or more.

Expectation of sales in China in the next 1-2 years



Three quarters of the companies surveyed expected their sales in China to grow over the next two years

1 These companies were already selling or exporting to, or manufacturing in mainland China, or considering doing so.
2 Europe: France, Germany, UK; Asia Pacific: Australia, Hong Kong SAR, Malaysia, Singapore; Americas: USA, Canada, Mexico; MENA: UAE

Companies are going into China

Although China is still experiencing sporadic outbreaks of Covid-19, recent strong GDP figures seem to indicate that the the country's economic recovery is gathering pace.

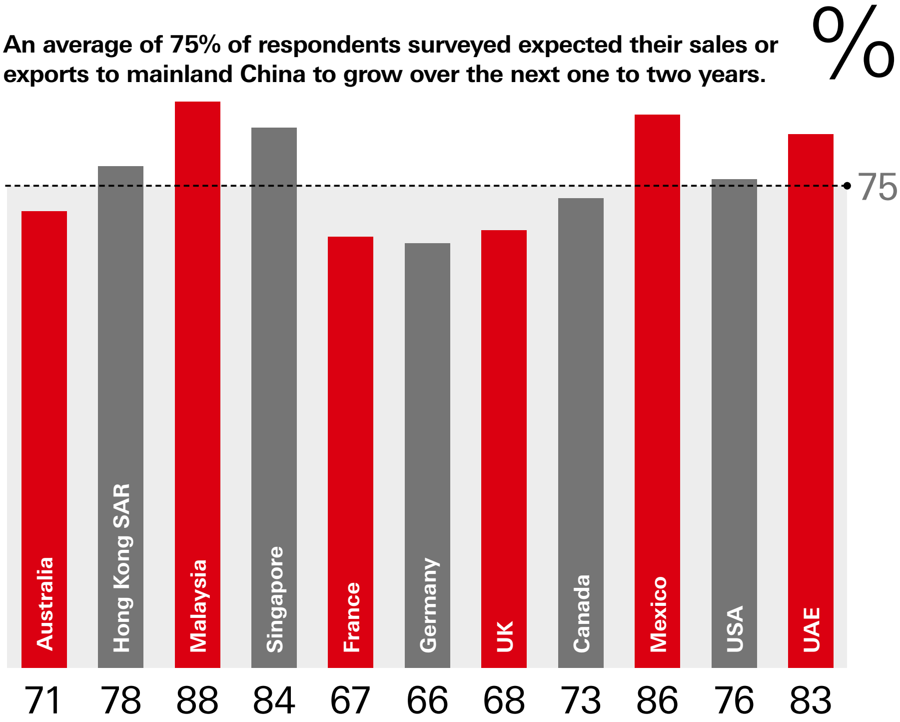
Global companies are responding by focussing on the world's fastest-growing major economy as their best hope for growth over the next few years.

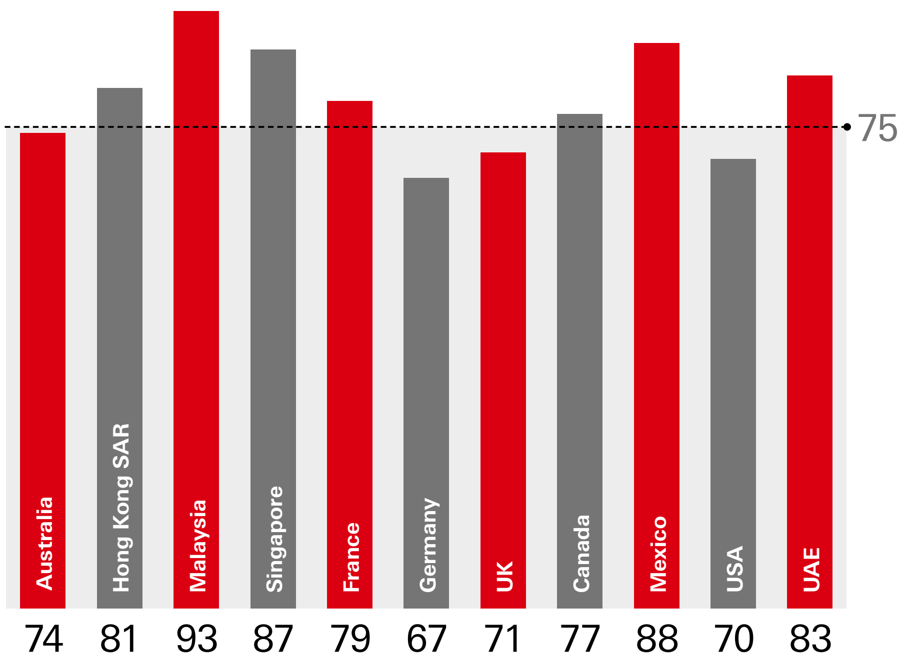
Our September 2020 survey of 1,100 companies across 11 markets found that China already contributes 25% or more to two-thirds of companies' overall international business revenues and that despite the combined pressures of the Covid-19 pandemic and rising economic nationalism, three-quarters expected their sales or exports to China to grow over the next one to two years. This optimism is all the more remarkable because more than half said they had scaled back their international exposure to focus on their domestic business over the past 12 months.

Given the tariff pressures on US companies trading with China, it was interesting to note that they were marginally more optimistic about growing their sales to China than the global average, and 10 percentage points more confident in growth than European companies.

A similarly upbeat picture emerged when we asked about China-based supply chains. Three quarters of all companies said they expected to increase the proportion of their supply chains based in China over the next two years – and 70% of US companies also planned greater Chinese proportion in their supply chains.

An average of 75% of respondents surveyed expected their sales or exports to mainland China to grow over the next one to two years.





An average of 75% of all companies said they expected to increase the proportion of their supply chains based in mainland China over the next two years

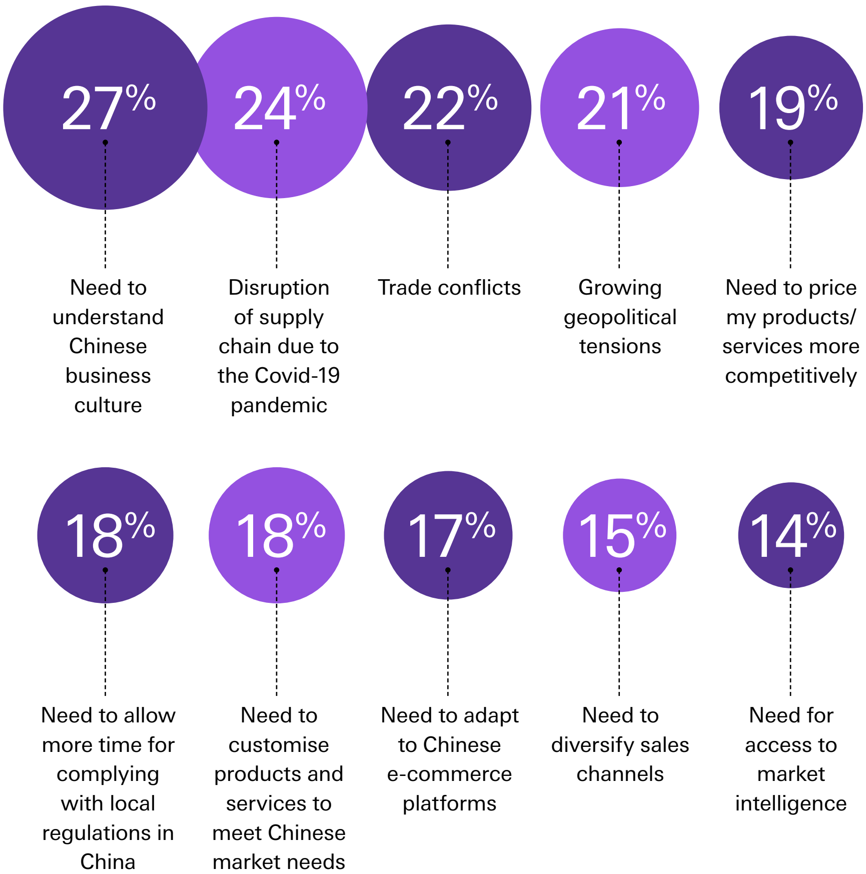
There are bigger challenges than trade conflicts and geopolitics

Neither bilateral tariffs nor geopolitics seem to have had much impact on corporate planning. Only 22% of companies said that the last two years of tit-for-tat trade tariffs were their biggest challenge to doing business in China and just 21% cited geopolitical tensions, although it was notable that the larger the company, the greater the concerns over economic nationalism and geopolitics. Only 25% of US companies cited rising trade conflicts as their biggest challenge, three percentage points fewer than their European counterparts. Globally, the need to understand Chinese business culture and Covid-related business disruptions were both regarded as more substantial challenges than trans-Pacific tension.

25%

Only 25% of US companies cited rising trade conflicts as their biggest challenge

Key challenges to selling/ exporting to China



Why are companies going into China

The overwhelming impression, both from international companies that sell in China and from those for whom it forms part of their supply chain, is that the country's combined attractions outweigh the challenges.

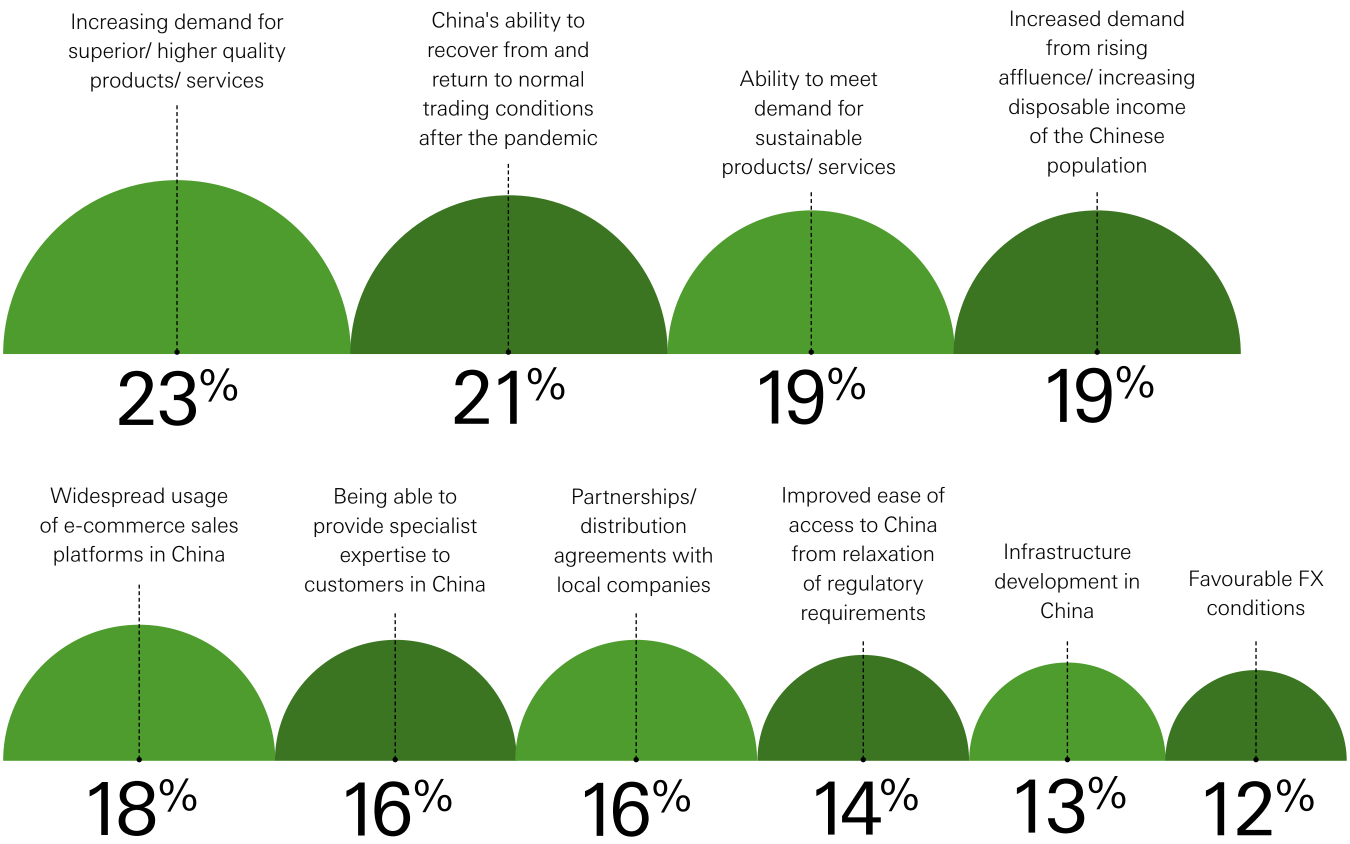
More than two-thirds of all the surveyed companies said that China is among their top three target markets for growth. 65% cite China's business environment as the main attraction. Respondents in Asia Pacific in particular said China's early recovery from the pandemic – HSBC forecasts China's economic growth of 2.4% compared to a global contraction of 4.1% – as a leading growth driver, combined with an increasingly affluent Chinese population, reflecting a renewed focus north and east as they search for new markets while countries in Europe and North America struggle to rebuild demand.

The other attraction was the advanced development of China's digital economy, which facilitates expansion at a time of global isolation. This also explains why 73% of services companies, many of which are better-positioned to take advantage of digital opportunities to expand without the need for physical contact, said China was among their top target markets over the next one to two years, compared to 57% of manufacturers.

73%

of services companies, said China was among their top target markets

Top reasons for selling/ exporting to China

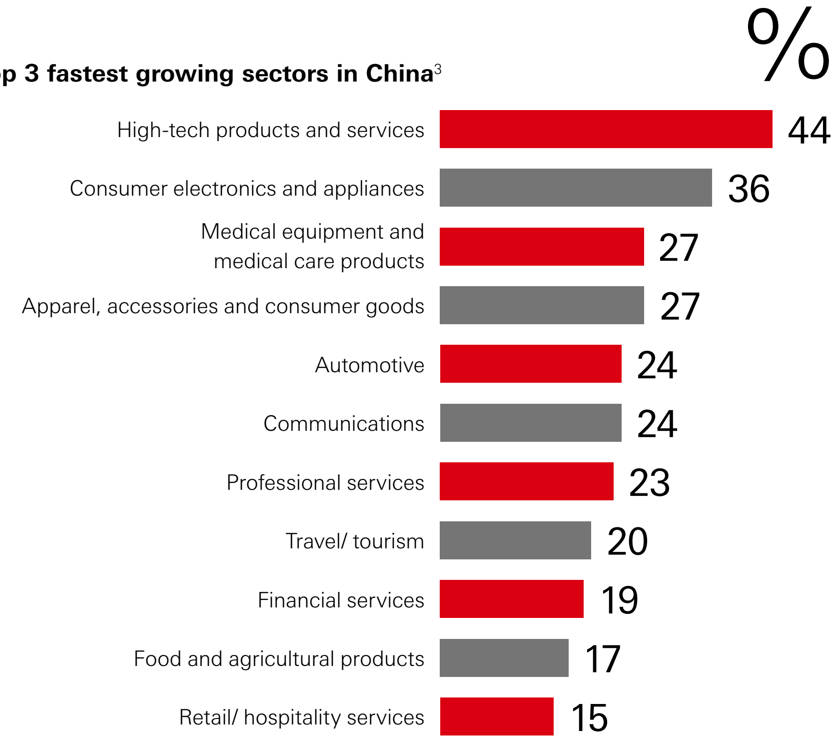


Where's the growth?

Companies foresee a broad-based recovery across the Chinese economy, but are noticeably more optimistic about the outlook for service industries over the next 24 months. Some 54% of all companies ranked services, particularly high-tech services, as the number one growth area over the next two years. While this possibly reflects the increasing challenges of goods trade should tensions continue to rise, it is also testament to the growing ease of delivering many services remotely to one of the world's most digitally savvy populations.

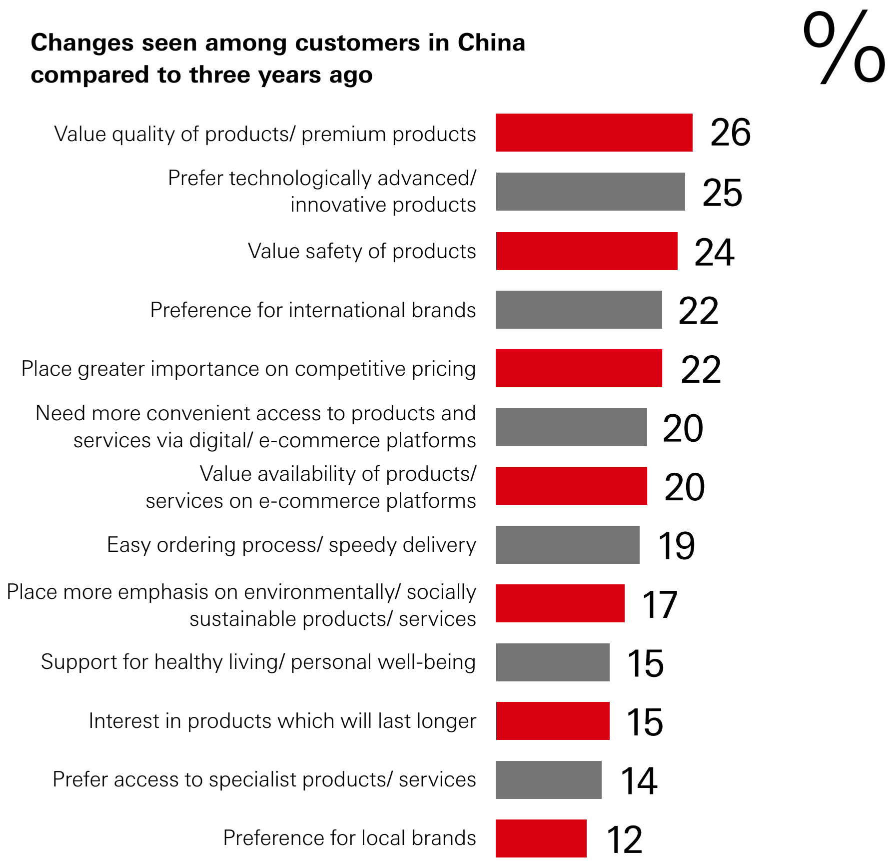
As the Chinese economy matures and consumers increasingly focus on quality of life, services are expected to become a key market for international companies. This is reflected in the changing tastes of Chinese consumers. Companies said they had noticed an increasing interest among buyers in the quality of products, with more and more people placing a premium on advanced technology, safety and longevity of the products.

Top 3 fastest growing sectors in China[3]



[3] Respondents were allowed to choose multiple options.

Changes seen among customers in China compared to three years ago



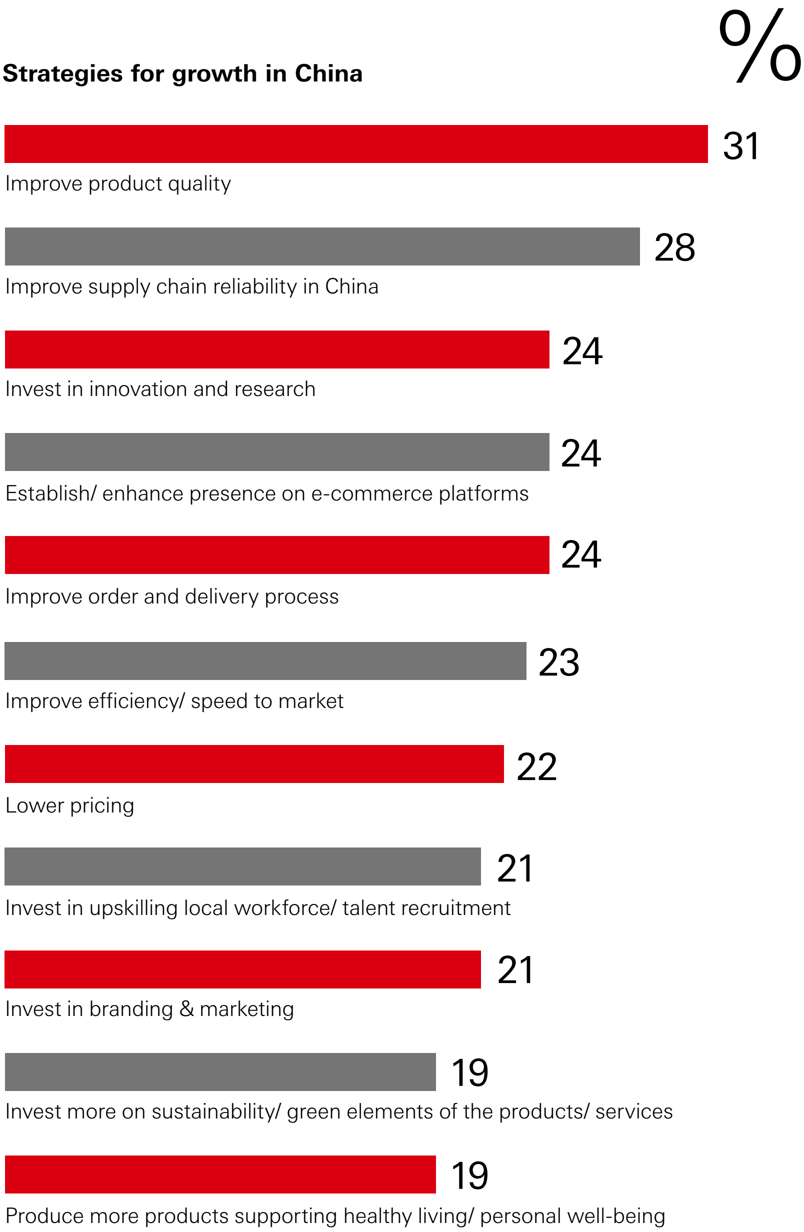
How businesses are preparing for the China market

The survey shows a clear recognition that the changing shape of the post-pandemic Chinese economy calls for an evolution in strategy. Six in ten businesses are looking at ways to improve efficiency/ reliability, notably by improving supply chain reliability, improving their order and delivery processes and increasing their speed to market. Harnessing technology will be crucial to success.

A third of businesses said they are pursuing strategies built around well-being and sustainability, with an equal proportion saying they intend to produce more products supporting healthy living/ personal well-being and invest more to make their products and services more sustainable. When compared to the similar data contained in our 2019 Navigator survey, the good news is that companies do not seem to be cutting environmental corners due to the commercial pressures of Covid-19.

It is noteworthy that a higher proportion of businesses were improving the quality of their products and services than pursuing a strategy of lowering their prices (31% compared to 22%) and this was even more pronounced among large corporates where more than five times as many were improving product quality rather than lowering their prices (27% and 5% respectively).

Strategies for growth in China



The role of technology

The Chinese economy operates at the digital frontier, and businesses recognise that the pandemic has accelerated the pace of technology adoption and that they need to join the race if they are to compete.

More than four in ten businesses are looking to strengthen their digital presence within China by upgrading their technology/ e-commerce platforms. There seems to be an emerging trend of creating a hybrid digital presence, with 63% of respondents saying they intend to use both proprietary platforms and partnering with local digital platforms, rising to 74% of companies which regard China as their most important business partner.

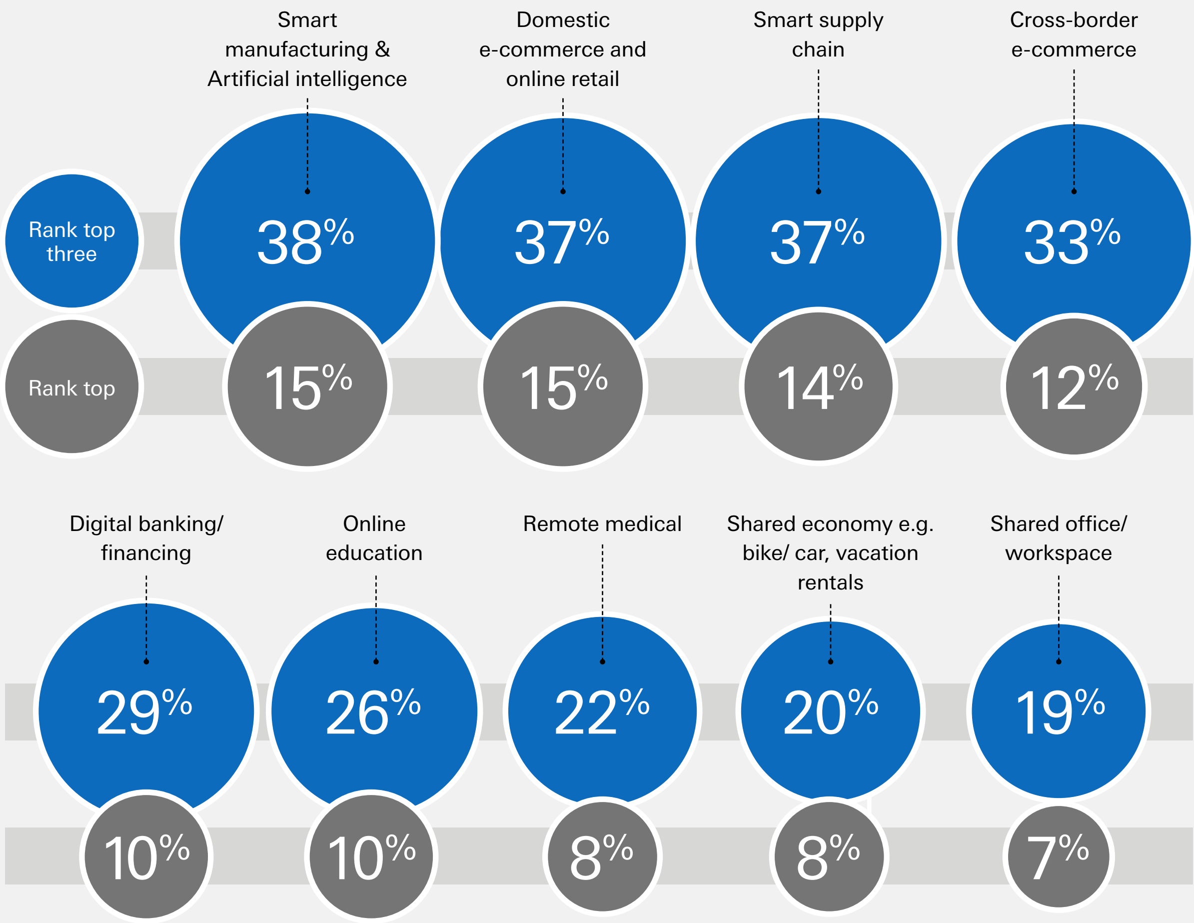
While the survey shows that almost three quarters of businesses currently doing business with China are concentrating their initiatives sales on Tier 1 and Tier 2 cities, strengthening digital platforms will enable them to tap into the huge consumption potential of more areas in the vast Chinese market.

China's New Infrastructure Initiative, which encourages investment into sectors including mobile networks, industrial internet, data centres and artificial intelligence, is expected to further improve its digital infrastructure and facilitate business activities, and offer new opportunities for global companies to grow their business in China.

However, few companies regard China as a pure digital play, with two-thirds saying they believe it is important to have a physical presence on the ground, and that they are planning to invest accordingly.

Looking at more specific (technology enabled) areas of strongest growth in China in the next two years, these are expected to be:

Areas in digital with strongest growth

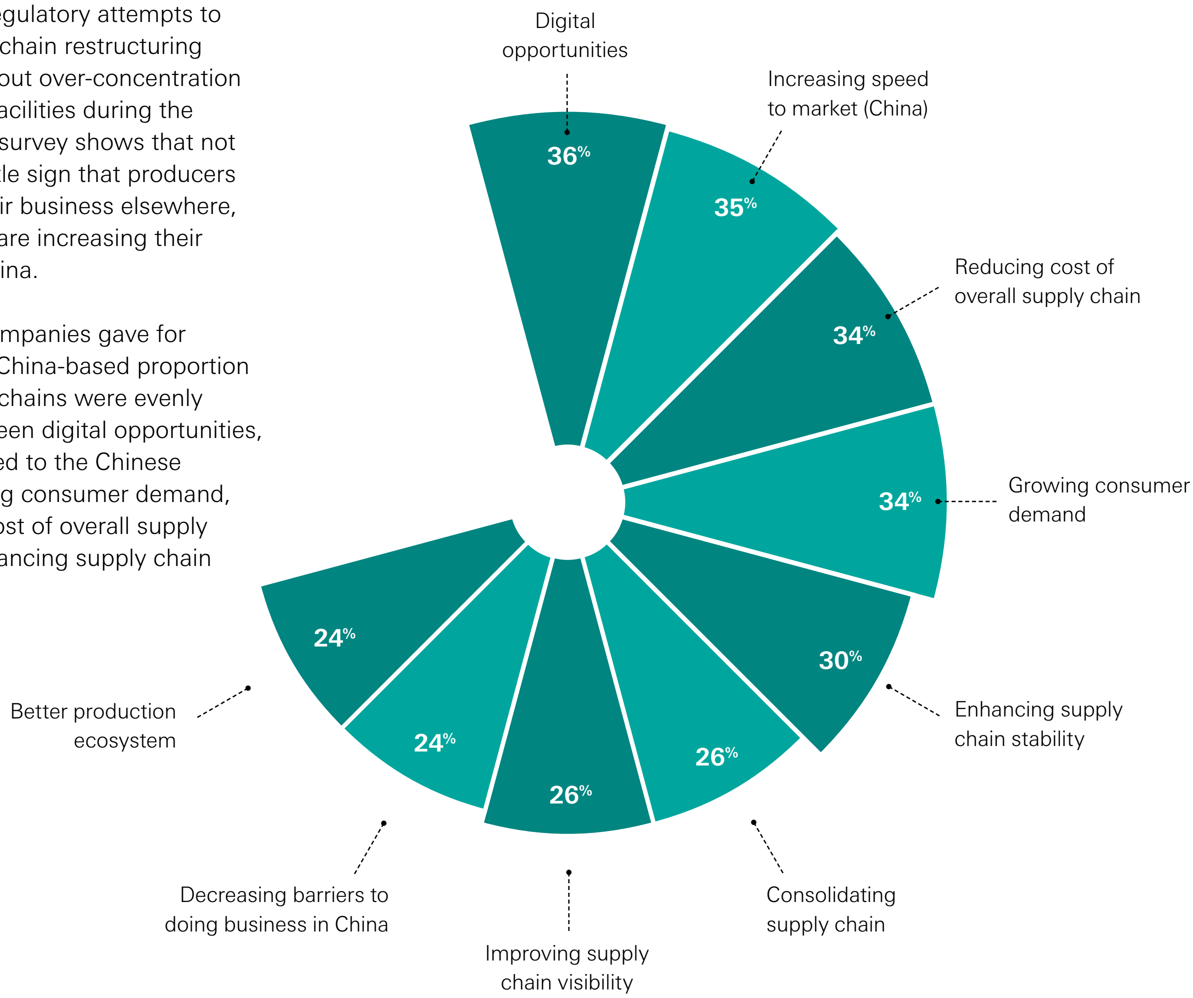


Supply chains

China's pivotal role in global supply chains has proven remarkably durable. Despite both regulatory attempts to promote value chain restructuring and worries about over-concentration of production facilities during the pandemic, the survey shows that not only is there little sign that producers are moving their business elsewhere, but also many are increasing their exposure to China.

The reasons companies gave for increasing the China-based proportion of their supply chains were evenly balanced between digital opportunities, increasing speed to the Chinese market, growing consumer demand, reducing the cost of overall supply chain, and enhancing supply chain stability.

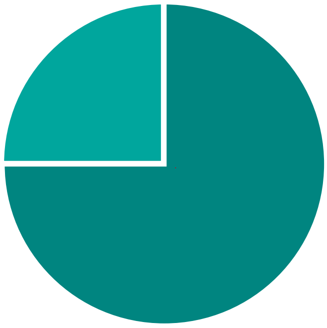
Reasons for increasing supply chain exposure to China



Some 75% of companies said they expected to increase the proportion of their supply chains that were based in China despite economic, political and social pressures to move production.

The United States was an outlier in a number of categories. A fifth of US companies said they intended to increase the China proportion of their supply chains by 20% or more over the next two years.

Surprisingly there was little evidence that Brexit is having a major impact on UK corporate planning. When asked about increasing the proportion of the supply chains based in China, the UK at 71% was bracketed by France at 79% and Germany at 67%.



75%

of companies said they expected to increase the proportion of their supply chains that were based in China

About **Navigator: Growing with China**

HSBC's Navigator: Growing with China surveyed 1,100 businesses with turnover of $5m USD or more from 11 key markets globally, including: Australia, Canada, France, Germany, Hong Kong SAR, Malaysia, Mexico, Singapore, UAE, UK and US.

Survey respondents were key decision makers from businesses already selling/ exporting to or manufacturing in China or those considering doing so. It explores their current perspective and future ambitions in relation to trading with China.

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