Doing Business in China

Experiences and opinions of Australian companies operating in China

November 2018

KPMG.com.au
UniMelb.edu.au
AustCham.org
ACBC.com.au

Chairs' message

Sometimes it seems there are two stories about the Australia-China relationship. One is a story of promise and opportunity; the other a narrative of challenge and suspicion. The results of this survey indicate that members of the China-Australia Chamber of Commerce (AustCham) and Australia China Business Council (ACBC) believe that the opportunity story should be the predominant pathway, while being sensitive to learning and adapting to current and emerging issues.

Australia has benefited enormously from China's rise. In 2017 our two way trade was A$183.4 billion, accounting for almost a quarter of our total trade. China is our largest source of high-spending tourists and international students, and our services exports to China continue to grow at an impressive 15 percent each year.

Both believe the best intelligence about the Chinese economy comes from the people on the ground. That's why the 2018 *Doing business in China* report is so important. It surveys 165 AustCham and ACBC members who are working every day to grow their businesses in and with China, and who know first-hand the challenges and opportunities in the world's biggest developing economy. This report examines the intentions and attitudes of those in the best position to gauge the real life impacts of shifts in the Australia-China relationship.

Last year's inaugural report showed a high level of optimism. This year we see a mix of optimism and concern. The word respondents use most often to describe working in China is 'challenging' — but it's closely followed by 'opportunity'. 75 percent of respondents think recent media reporting had a negative impact on the bilateral relationship. But at the same time, two thirds plan to increase their investments in China.

There are lessons here for policymakers. As the US continues to prosecute a damaging trade war, Australia should continue to advocate for the benefits of free trade and closer engagement — both in words and deeds. In doing so we should listen carefully to the voices of business. We thank the survey participants, KPMG Australia and the University of Melbourne for another important report.

Vaughn Barber
Chairman, AustCham Beijing

John Brumby
National President, ACBC

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Foreword

Last year's inaugural survey of Australian companies doing business in / with China suggested optimism and opportunity. But time has passed, and circumstances have changed. In 2017, AustCham and the ACBC recognised the need for a longitudinal survey of Australian businesses to better evaluate the impact of trade liberalisation and specific trade agreements, as well as the general business conditions in doing business in / with China. This 2018 survey allows us to verify the robustness of last year's responses to give a better understanding of why Australian companies continue to engage in business with China, and whether that engagement continues to deliver the business objectives.

A decade has passed since the Global Financial Crisis (GFC) fundamentally disrupted free trade, globalisation and capitalism. It left its marks on Australia's ranking of trading partners. In 2009, China overtook Japan to become Australia's premier export market. Following the GFC, Australia's exports to its major trading partners (Japan, the US and Korea) declined, yet exports to China increased by 31 percent.

It is hard to grasp today how quickly that trade partnership with China evolved and grew. A decade before the GFC, then Minister for Trade, The Honourable Tim Fischer addressed the launch of the book *Australian Trade Policy 1965-1997*. It seems impossible to imagine a speech on Australian trade that is not dominated by references to China, but there it was. Not a single mention (apart from invoking an old Chinese curse) in a speech framed by the Asian Financial Crisis and how it affected regional trade with Indonesia and Korea.

No longer so, as Australia's trade and business investment in China continues to thrive at double digit growth rates. The recognition of China's dominant impact on Australian trade (and economy) is reflected in the Reserve Bank of Australia's September 2018 statistical chart pack. Six of the twelve graphs describing the World Economy are about China!

It is clear that China has become the next global economic and trading powerhouse, yet that very position is now challenged by increased trade tensions with the United States. The threat to free trade undermines business confidence in further trade liberalisation in China. This report shows continued optimism about the (potential) benefits of the China Australia Free Trade Agreement (ChAFTA), yet also recognises the challenges in maintaining a positive bilateral relationship as well as the impact of broader geo-political uncertainties.

Despite these emerging challenges, doing business with China has lost little of its lustre and opportunity for Australian companies.

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Key findings

Overall, the 2018 survey results are consistent with 2017 in describing a business environment in China which is challenging for Australian companies, but affords ample opportunities. While the predominant strategy is expansionary and the attitude continues to be upbeat, a fast evolving market-place has ensured that there have been significant shifts in the nature of the challenges, opportunities, concerns and risks faced by businesses operating in China. From a business perspective, China's Belt and Road Initiative remains an important opportunity. Notably, the survey highlights the importance for companies of Sino-Australian bilateral relations as well as the impact of media reporting of those relations and the collateral effects of Sino-US trade disputes.

Investment environment

81 percent of respondents indicated that China is in their top three destinations for short-term global investment plans. In addition, two in every three companies continue to increase their investment in China, highlighting that Australian businesses in China continue to expand their operations. This is further underlined with over 60 percent of businesses expecting to increase headcount in 2018. Three quarters of the increase in investment is cited as a response to future growth opportunities.

Despite the vote in confidence for the future of the Chinese market, changed market demands, unclear laws, rising labour costs and market access are still of concern to business. Local partner requirements have dropped significantly as a primary concern.

When asked about challenges, there was consistency with labour costs being among the highest priorities. Payment issues have emerged as a much more significant hurdle than last year.

Conditions in China's inbound investment environment have stabilised with 39 percent of businesses seeing no change in the investment environment. Those seeing improvement were 37 percent, while 24 percent considered the environment had deteriorated, a marginal increase year on year by 2 percentage points.

China's business climate

There is a notable increase in the rating of China being difficult for doing business (72 percent). This could be the result of having a larger set of survey respondents operating out of Australia. There remains a bias that doing business in China is challenging. However, education and resources continue to be among the sectors that consider doing business to be easier.

With regards to profitability, the surveyed companies continue to perform well with more than two thirds being profitable or breaking even, while another one-fifth could not answer due to statutory obligations. Education and finance appear to be the most profitable sectors. Businesses in the healthcare sector reported mixed profitability results.

Tensions in Sino-Australian relations emerged as the largest risk that businesses faced in China. This was followed by increased protectionism and the risk from an overall Chinese economic slowdown. Almost a third of Australian companies reported a negative impact as collateral effects from the bilateral US-China trade sanctions.

Just under half of respondents have seen an increase in attention or engagement by Chinese authorities. A notable minority saw a decrease in engagement.

Unsurprisingly companies have continued to report rising operating costs, of which human resources, payroll, tax and general inflation are reported as the top concerns.

Of those concerned by intellectual property (IP) protection, three quarters have seen no change, although the ratio of those who have seen an improvement to those that see deterioration are running at a ratio of over 6 to 1.

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Economic and policy conditions

There was a significant reshuffling of perceived risks since 2017. Low consumer demand has risen to be the highest risk, followed by new asset bubbles and insufficient government policy support having much higher priorities. Increased economic volatility is no longer viewed as the highest risk. Significant drops in perceived risk were recorded in geopolitical instability, overcapacity in certain industries and debt in the public sector.

Two-thirds of surveyed businesses were positive about profitability potential for domestic market growth in China. Key growth opportunities in the China market remain the rise of middle class and sustained economic growth. Also notable was that half of respondents saw the Belt & Road Initiative as either the first or second greatest business opportunity.

The advantages of the ChAFTA have seemingly already been factored into the business environment with over two-thirds believing it has had a positive impact on Australian business in China. Nearly 80 percent believe our government has an important role to review and assist Australians to overcome a wide range of non-tariff barriers being faced in market.

Bilateral relations

Over four-fifths of companies believe the Australia-China relationship has an impact on business. Tellingly 56 percent believe that the recent turbulence has had a direct negative impact on their business.

75 percent of companies believe that media reporting has had an adverse effect on bilateral relations and over half of Australian companies consider there to be a negative impact from that reporting on their business. These effects have been compounded by the negative collateral effects of Sino-US trade disputes.

Other key findings of this year's survey are:

28%

believe that the US/China trade sanctions have negatively impacted their business whilst 12 percent believe it has had a positive impact on their business.

45%

of respondents in 2018 flagged tensions in Sino-Australian relations as a top business risk.

44%

of respondents viewed the rise of the middle class is as the key business opportunity.

66%

of businesses believe that ChAFTA has had a positive impact on Australian businesses in China.

83%

of respondents flagged human resources a top cost concern when doing business in or with China.

37%

of respondents see China's investment environment to be improving.

Bureaucracy is perceived to be less of a challenge for business in China in 2018, whilst Chinese Government engagement with business is seen to have increased.

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About the survey

The survey for *Doing Business in China* was conducted with the membership of the China-Australia Chamber of Commerce (AustCham) and the Australia China Business Council (ACBC) in the third quarter of 2018. In the second year of the *Doing Business in China* report, executives from 165 Australian companies that are operating in or doing business with China have provided valuable source data to inform Australian policy makers, business sector leaders and the media community.

Last year, we had 100 respondents who were largely operating in China and since then, 65 more companies have come forward to contribute their views and opinions. Many of the new respondents are not permanently located in China but are actively trading with Chinese suppliers, distributors and customers.

We should all pay close attention to their views and the detailed findings of the report. These are not journalists, academics, advisors or bureaucrats — they are Australian business people, leading Australian companies, large medium and small, across most sectors and investment structures in rapidly changing Chinese markets.

They employ and manage around 43,000 Chinese employees and create many more indirect jobs both in China and Australia. More than half have been operating in China for more than 10 years.

Note - charts are subject to rounding errors and may not equal one hundred percent.

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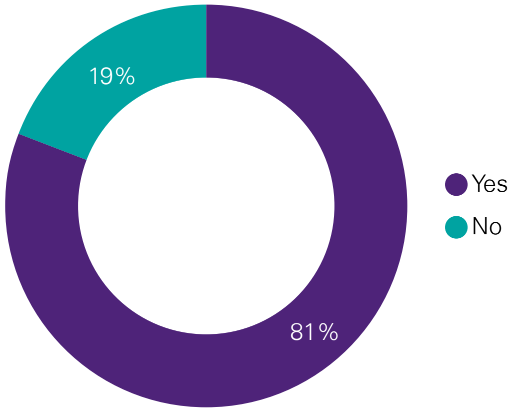
Figure 1

Does your organisation hold an Australian Business Number (ABN)?



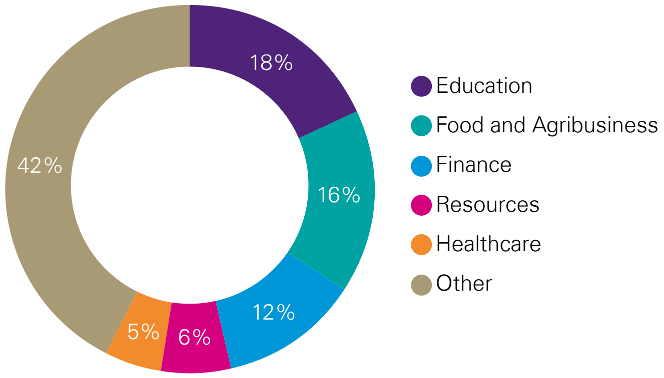
Four in five of the survey respondents are registered in Australia with an Australian Business Number.

Figure 2

Which best describes the main industry you work in?

Figure 3

Which best describes the main industry you work in? Aggregated



The responding companies cover a broad range of industries, dominated by service providers (in particular education, finance and tourism) followed by food and agribusiness producers, and resources companies. Notably, but perhaps not surprisingly, is a dearth of manufacturing companies. The composition of industries in the survey is very similar to last year's survey, although a much larger representation of education sector respondents compared to last year (9 percent).

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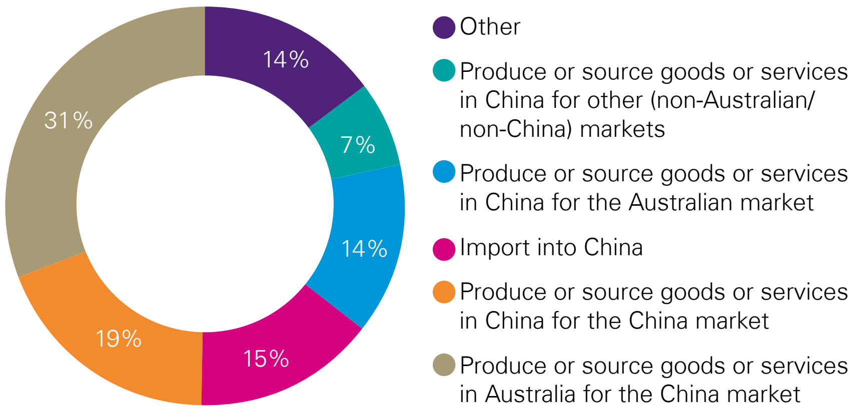
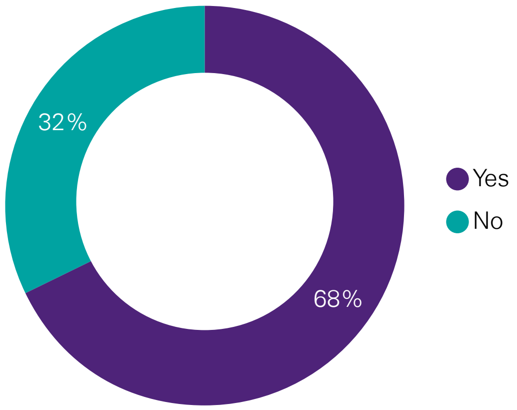
Figure 4
What is your company's primary strategy in China?



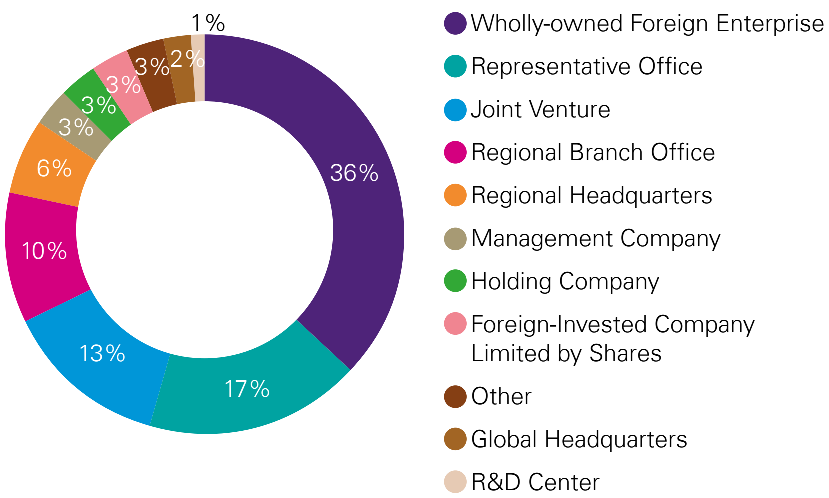
When asked about their primary strategy in China, 40 percent of the respondents replied that they pursue the production or sourcing of goods and services in China — either for the Chinese (19 percent), Australian (14 percent) or other markets (7 percent). That proportion is down by more than 10 percent on last year. The drop in 2018 is offset by a similar increase in the production or sourcing of goods and services in Australia for the China market — both of these statistics are likely attributed to the increase in respondents based out of Australia. Imports into China are also slightly up, and overall strategic activity by Australian companies indicates continued targeting of China's strong (and increasing) demand for goods and services.

Figure 5
Do you have a legal entity or presence in China?



In last year's survey, 11 percent of respondents did not have a presence in China. This year's survey includes 32 percent of respondents without a China presence.

Figure 6
What type of legal presence do you have in China?



The survey respondents cover a variety of legal (and organisational) presences in China. Most common presence is the wholly-owned foreign enterprise at 36 percent (up from 28 percent in 2017), followed by the representative office at 17 percent. Joint ventures are third most common in the survey sample at 13 percent. Regional headquarters are becoming more common, but global headquarters remain a rarity.

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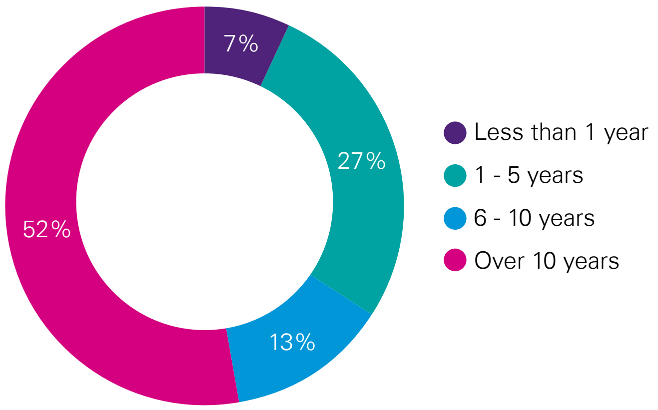
Figure 7

How long has your company been operating in China?

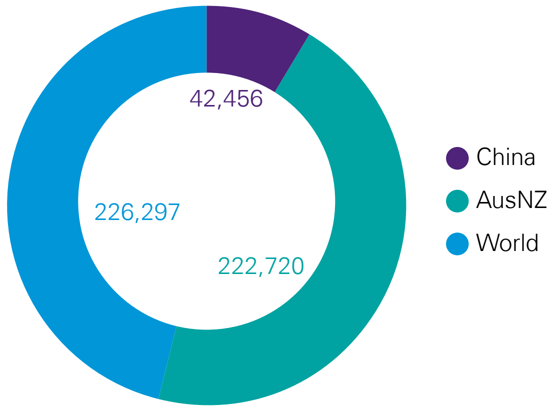


The survey sample has further matured since 2017. More than half (52 percent) of company respondents have now been operating in China for over a decade. A further 13 percent has operated in China between 6 and 10 years. Newcomers (that is, arrivals in the last year) dropped from 8 to 7 percent of the sample.

To investigate the impact (benefit or otherwise) of longevity on business in China, the survey distinguishes the 'young' (less than six years of operation in China) from the 'mature' (with more than six years of operation in China).

Figure 8

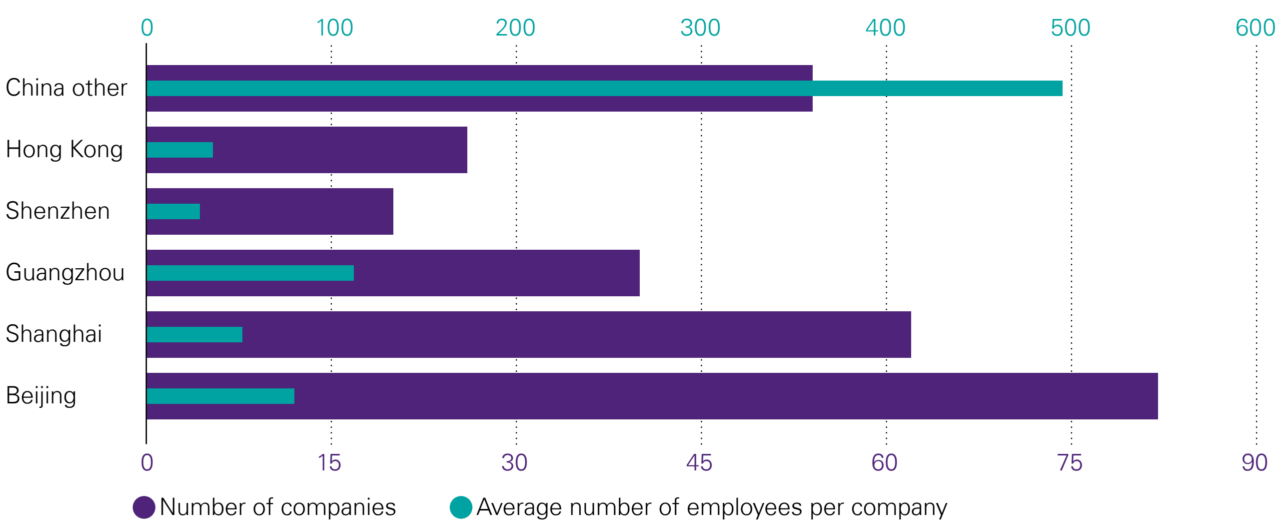
How many employees work for your organisation? Aggregated



The combined 165 company respondents employ 491,473 people worldwide. Of these, 42,456 are employed in China, most of these in Beijing (6,552) and Guangzhou (4,466), followed by Shanghai (3,197). If we look at the distribution of Australian companies across China, then again most are located in Beijing followed by Shanghai and then Guangzhou.

Figure 9

How many employees work for your organisation in China?



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The investment environment

One year on from the first *Doing Business in China* survey the investment environment continues to offer ample opportunities for Australian business. Two-way trade between Australia and China is at record levels and, in dollar value, China is now two and a half times as large an export destination for Australia as the next largest, Japan. Imports from China have also grown considerably, yet not to the same extent, with China now being the second largest import source for Australia.

While growth opportunities for Australian resources companies may have diminished since the GFC, exports of minerals remain a significant cornerstone of Australia's export earnings. But it is China's transition to services and domestic consumption — from export-focused manufacturing — which provides an increasingly attractive proposition for Australian businesses operating in China.

Australian service exports to China have grown at 15 percent per annum, with no sign of this momentum abating. Education and tourism lead the way, with healthcare the next major services export sector. But the prospects for business with China is not restricted to services and resources. The still relatively untapped Australian food and agribusiness sector is rapidly finding its way to China through exports of certified, clean, healthy and environmentally friendly produce.

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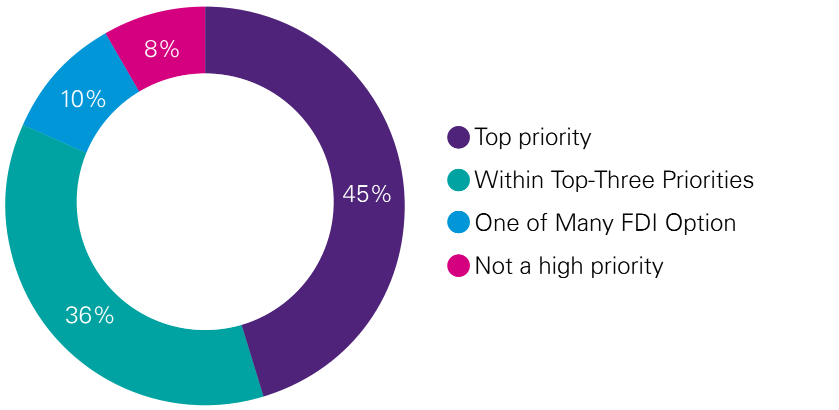
Figure 10

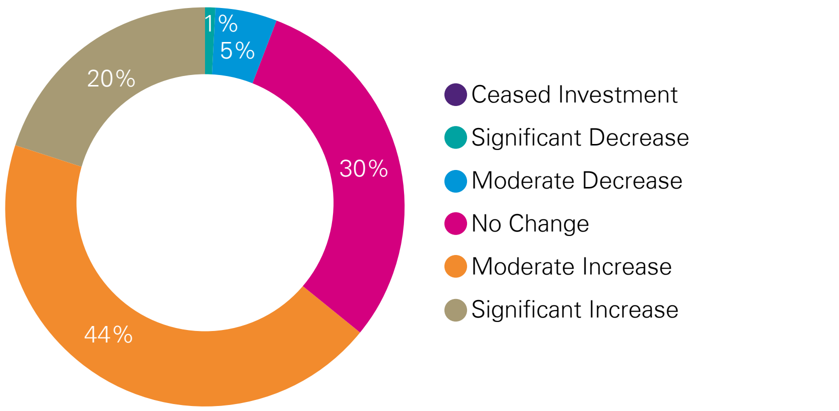
How does China rank in your company's short-term global investment plans?



When asked how important China is in our respondents' global investment plan, 81 percent indicate that it is in their top three priorities, with 45 percent stating China as their top priority. The survey respondents are not a random sample of Australian businesses, but companies that have already invested to do business with China.

Figure 11

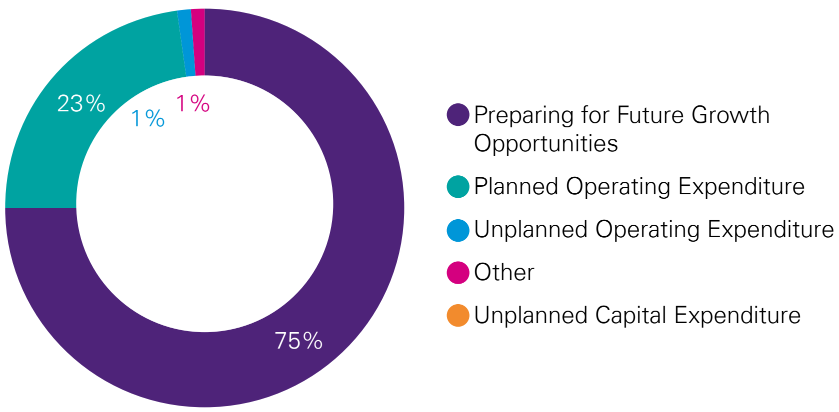
Last financial year, did your company increase or decrease the level of investment in its China operations?



Two in every three companies continue to increase their investment in China. Only 6 percent have decreased their investment.

Figure 12

What were the reasons for the increase?



The increase in investment primarily reflects the respondents' need to prepare for future growth opportunities. Investing for operating expenditure accounted for 23 percent of responses.

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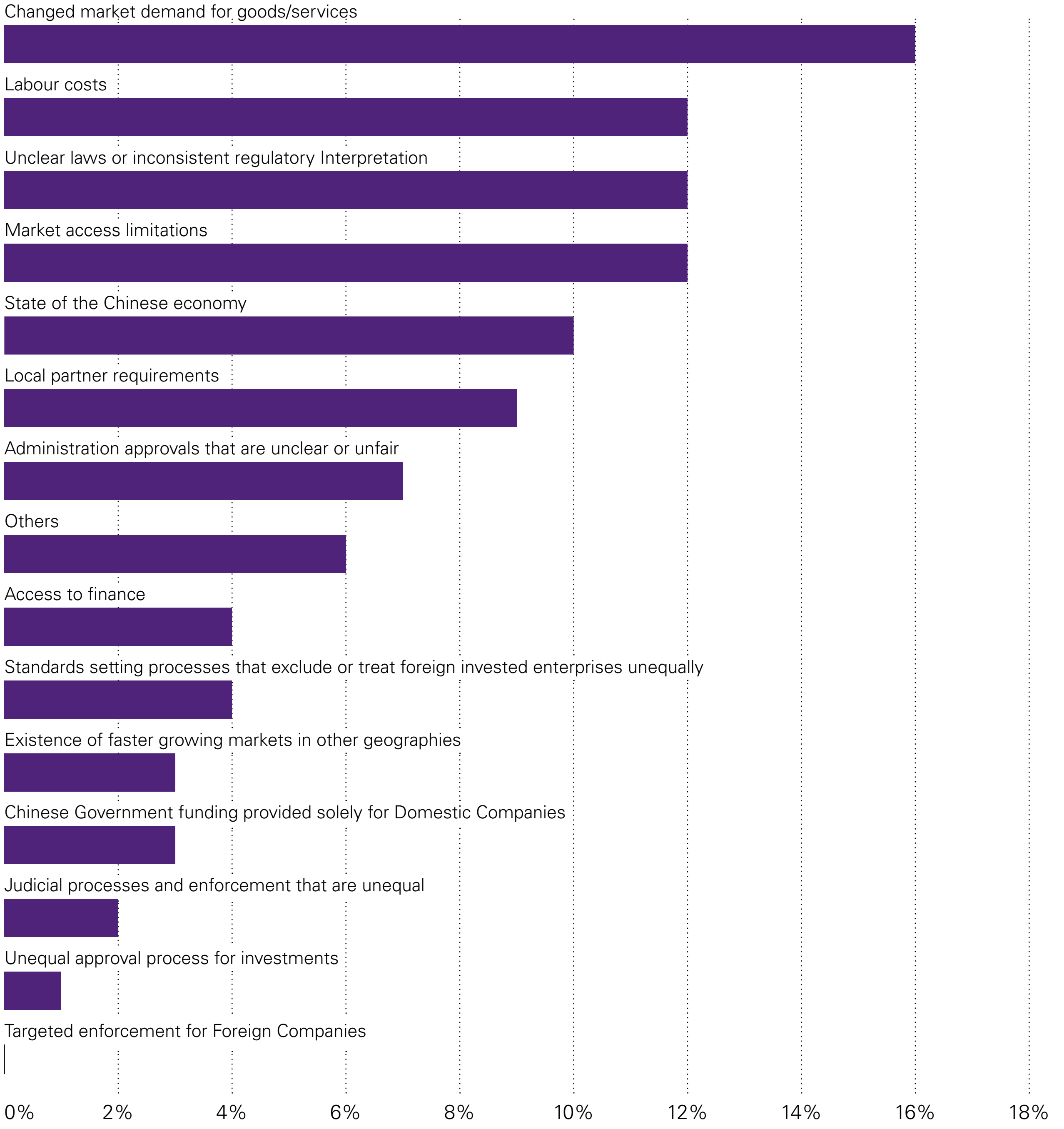
Figure 13
Which measures below had a limiting impact on your company's investment in China?



Despite the priority to invest in China, there are many concerns that have limited investment. Over 15 percent of the responses suggested changed market demand concerns, with a further 10 percent indicating the state of the Chinese economy. Labour costs, regulatory or legal uncertainty and market access concerns also feature prominently as limiting factors. Local partner requirements last year featured as the second most limiting factor, this year falling to rank sixth.

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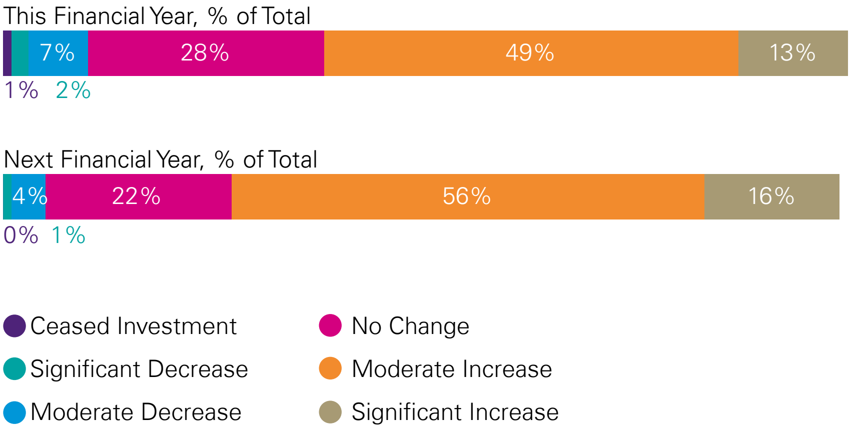
Figure 14

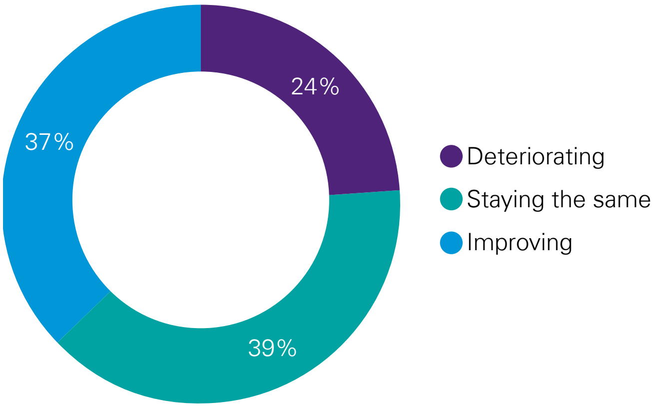
Do you estimate your company will increase or decrease its level of investment in its China operations?



In the most recent financial year, 62 percent of companies increased investment (at least moderately). We can compare that figure to last year's survey that forecast 80 percent of companies to increase investment. This suggests that expectations may be higher than reality. For the next financial year, the proportion of companies forecast to increase investment rises to 72 percent.

Figure 15

How do you feel about China's inbound investment environment?



When asked how respondents felt about China's investment environment, the responses were to an extent at odds with investment behaviour. 24 percent see the environment to be deteriorating despite only 5 percent of respondents expecting decrease their investment in China. This disparity may be accounted for by respondents: being able to overcome these obstacles (by off-shoring labour away from China); thinking the deterioration affects other Australian businesses but not their own; or, operating with sufficient margins to withstand the worsening conditions.

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China's business climate

Another year of robust economic growth in China and ongoing transition to a services and domestic consumption-oriented economy continues to provide opportunity and attract Australian interest in doing business with or in China. But nobody is under any illusion that doing business in China is easy. This survey teases out the challenges and pain points for new Australian entrants.

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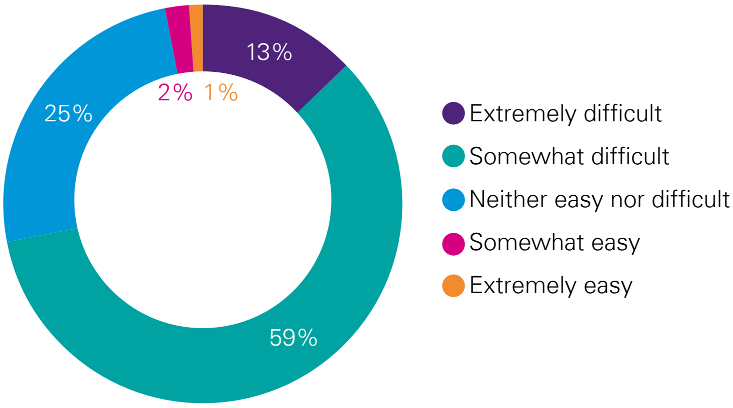
Figure 16

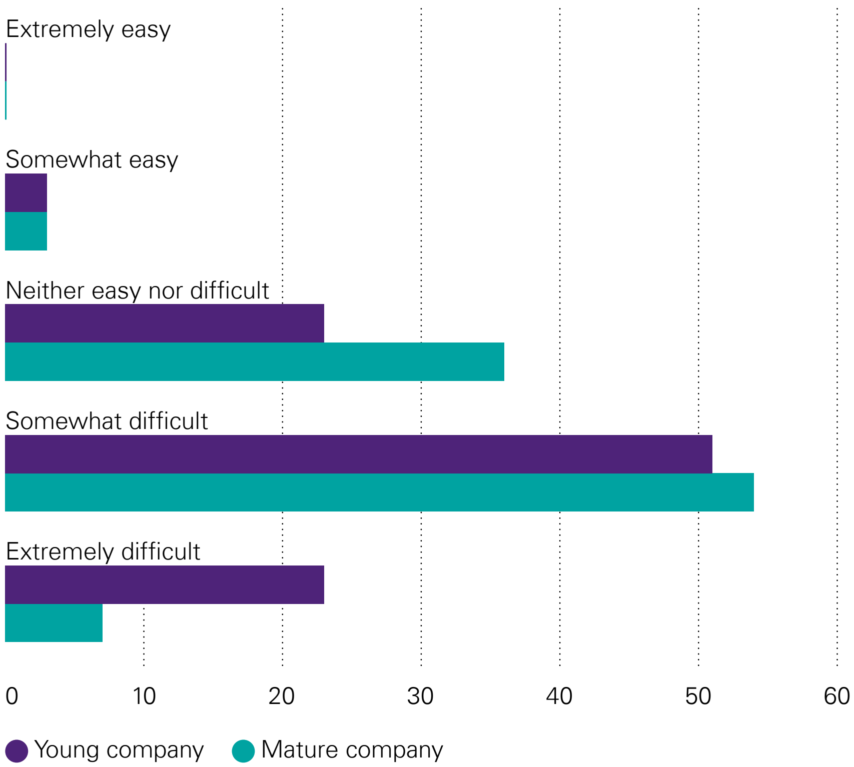
How would you rate the ease of doing business in China?



It doesn't get any easier doing business in China, as the respondents rank the degree of difficulty similar to last year. Almost three in four respondents perceive doing business in China as difficult. This time only 3 percent (10 percent in 2017) of respondents find doing business in China (extremely or somewhat) easy.

Figure 17

How would you rate the ease of doing business in China? By age of operations



Does it get easier with age (of operations in China)? When comparing the young companies with the mature cohort, we only observe a clear difference for the extremely difficult answer, where young companies are three times more likely to give that answer than mature companies.

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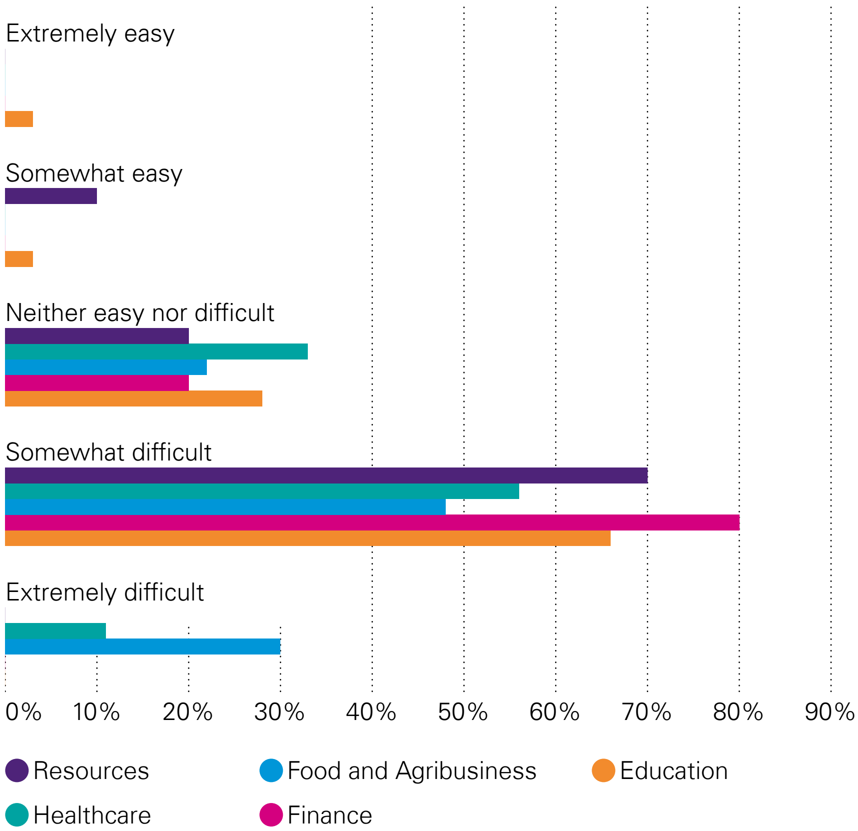
Figure 18

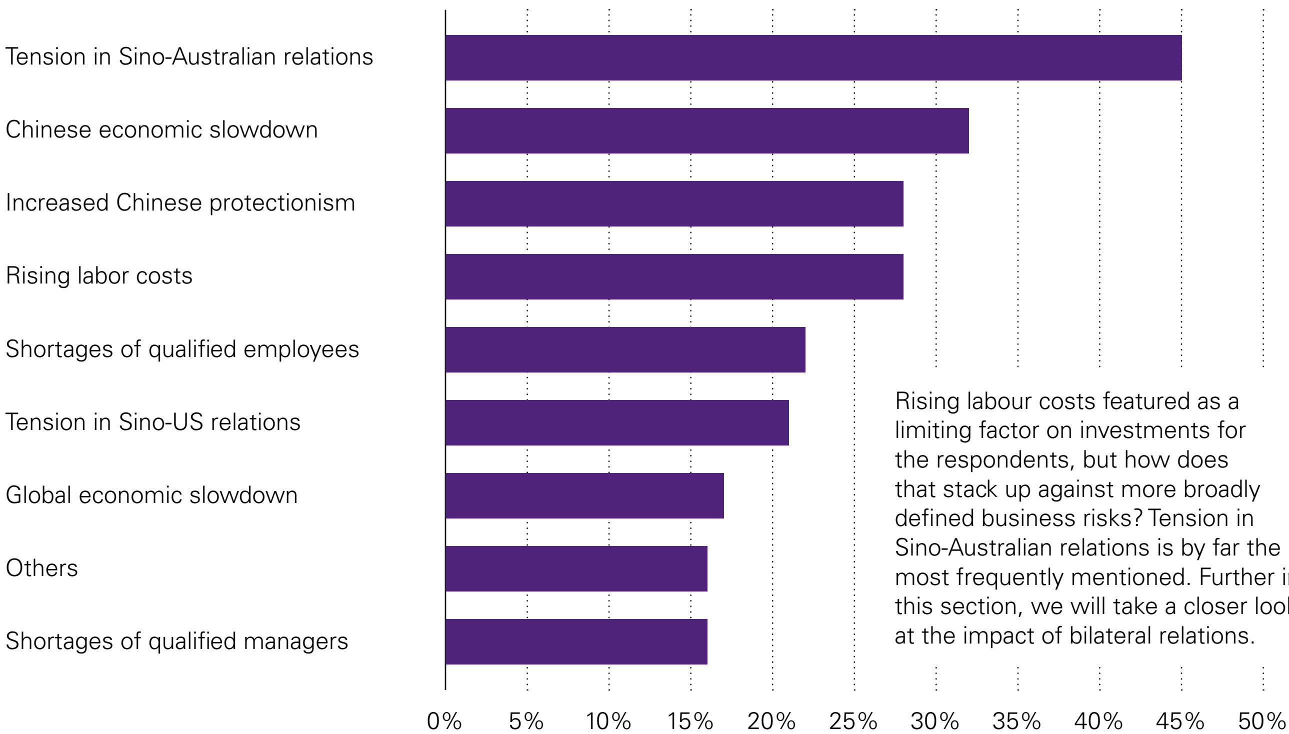
How would you rate the ease of doing business in China? By industry



Could it be that some industries encounter more problems than others? It seems that food and agribusiness and healthcare struggle more than education — possibly due to ongoing regulatory requirements in those sectors.

Figure 19

What are the top business risks facing your business in China?



Rising labour costs featured as a limiting factor on investments for the respondents, but how does that stack up against more broadly defined business risks? Tension in Sino-Australian relations is by far the most frequently mentioned. Further in this section, we will take a closer look at the impact of bilateral relations.

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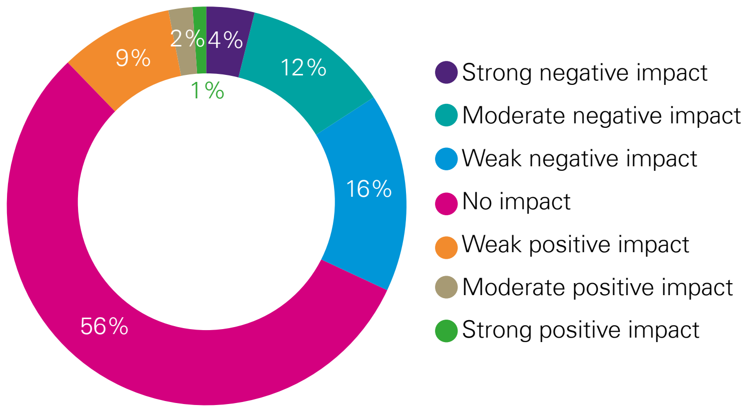
Figure 21

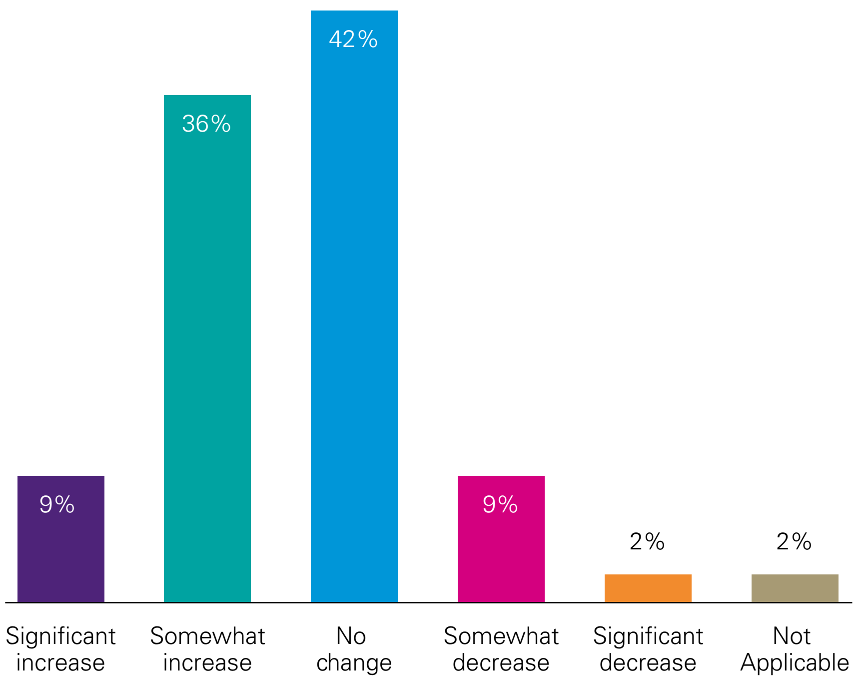
To what degree have the recent US/China trade sanctions on China impacted your business?



When asked about the impact of the US proposed trade sanctions on China, one-third of companies indicate that they have been negatively impacted. 12 percent suggest a positive impact.

Figure 22

Have you noticed any change in attention or engagement of your firm from Chinese authorities, including Chinese industry-wide regulatory change in the last year?



Compared to last year's survey regulatory/legal oversight is again perceived to have somewhat increased.

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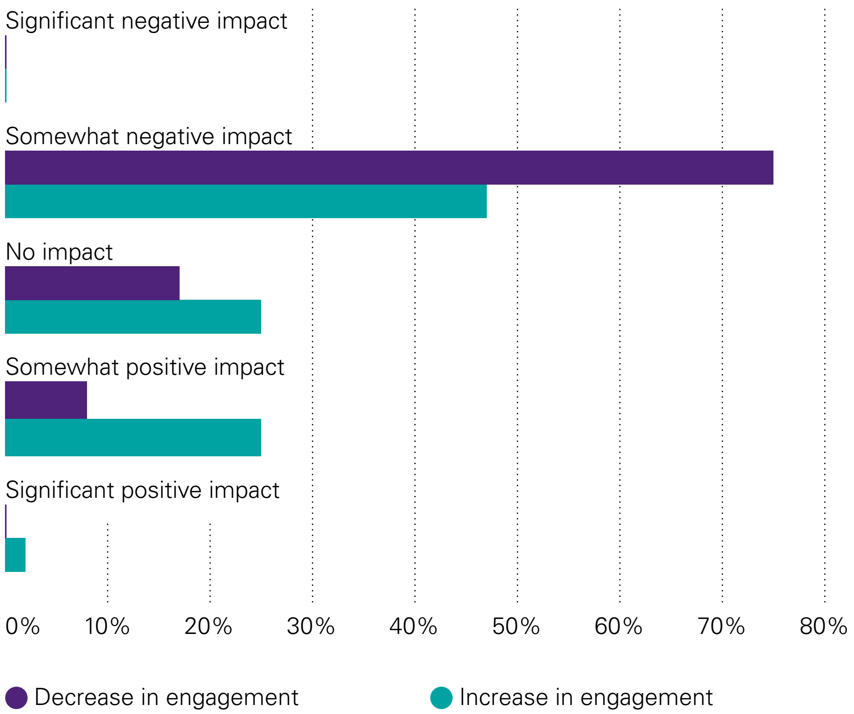
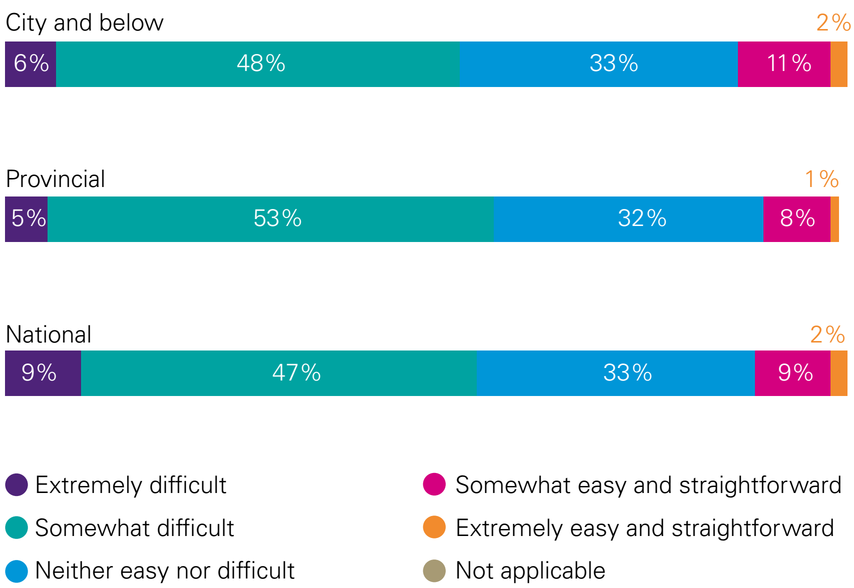
Figure 24
How has that impacted your business? By decrease/increase in attention/engagement



To verify whether business impact is negatively correlated with the change in oversight, we split the cohort into those that attracted more attention and those that attracted less attention. Surprisingly, we find the opposite correlation. More attention has had a positive impact.

Figure 25
If your organisation had experience with Chinese government approvals processes, how would you rate the experience at different levels of the Chinese government?



As China's regulatory regime varies by level of government, we also asked how business approvals processes were experienced at the city, provincial and national levels. While there is not much difference between jurisdictions, national approval processes were slightly more often considered to be extremely difficult.

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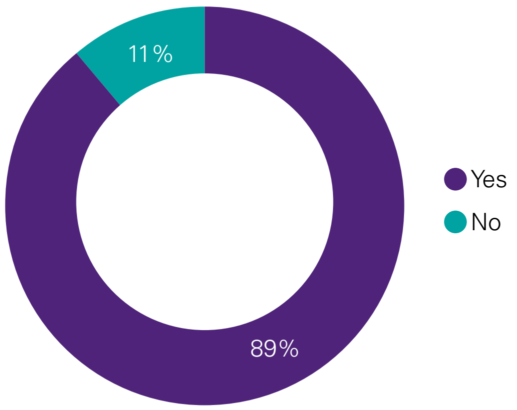
Figure 26

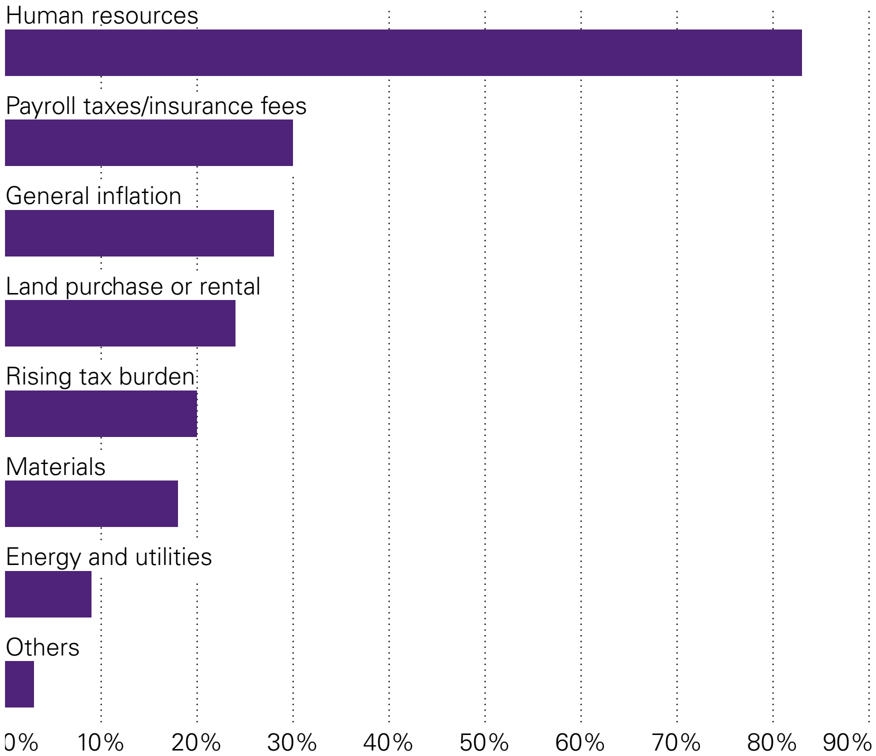
Are your company's operating costs in China increasing?



While the question was slightly differently framed in last year's survey (which asked about cost concerns), the respondents do indicate overwhelmingly that their Chinese operating costs are in fact increasing. Assuming that rising costs are a concern, the proportion of concerned companies has increased from 66 percent last year to 89 percent this year.

Figure 27

What are your top cost concerns?



83 percent of responses indicated concern for human resources expense — reflecting the increasing labour cost in China. It is somewhat remarkable that the many other cost components are of much less concern — probably reflecting the dominance of labour cost in the services industries.

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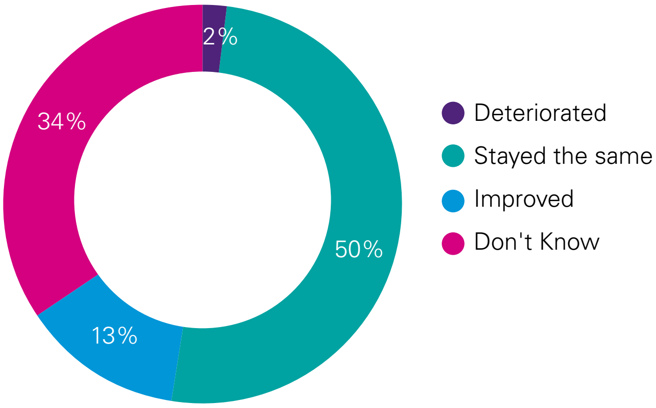
Figure 28

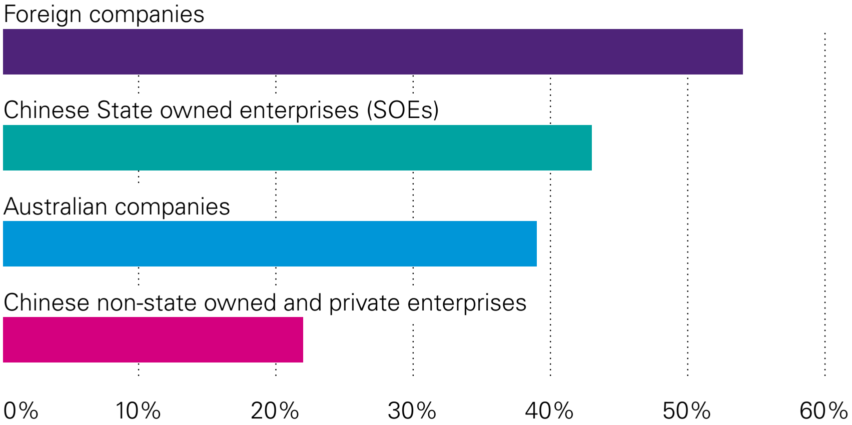
During the last year, how has China's protection of your company's IP changed?



For those respondents who see IP as an issue, the proportion of respondents that saw an improvement in China's protection of their IP reduced to 13 percent (from 26 percent last year). While IP protection has not deteriorated, the increase (from 34 percent later year) in respondents indicating that China's protection has stayed the same perhaps shows a maturation of IP regulations.

Figure 29

Who are your key competitors in China?



The competition facing Australian companies in China comes from multiple directions with most respondents indicating foreign, Chinese non-SOEs, and other Australian companies competing for market share. Some responding companies still see China's SOEs as their main competitors.

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Economic and policy outlook in China

News of another year of robust economic growth in China has been interrupted by trade disputes with the US. The next section will address the impact on free trade agreements in some detail. To assess the mood among Australian companies in this changed geo-political environment, this survey includes questions on the importance of strong bilateral relations and the impact of media reporting, more generally.

China's real GDP growth may have tapered (from 7.8 percent in 2013 to an anticipated 6.6 percent in 2018). The slowdown is in fact quite moderate and seems carefully managed to control domestic economic policy variables — in particular inflation and unemployment. It also suggests that China's transition in economic focus — from exporting manufactured goods, to producing services for domestic consumption — avoids excessive volatility. That evolution of the economy suits China's trading partners, by avoiding speculative bubbles and trade flow volatility.

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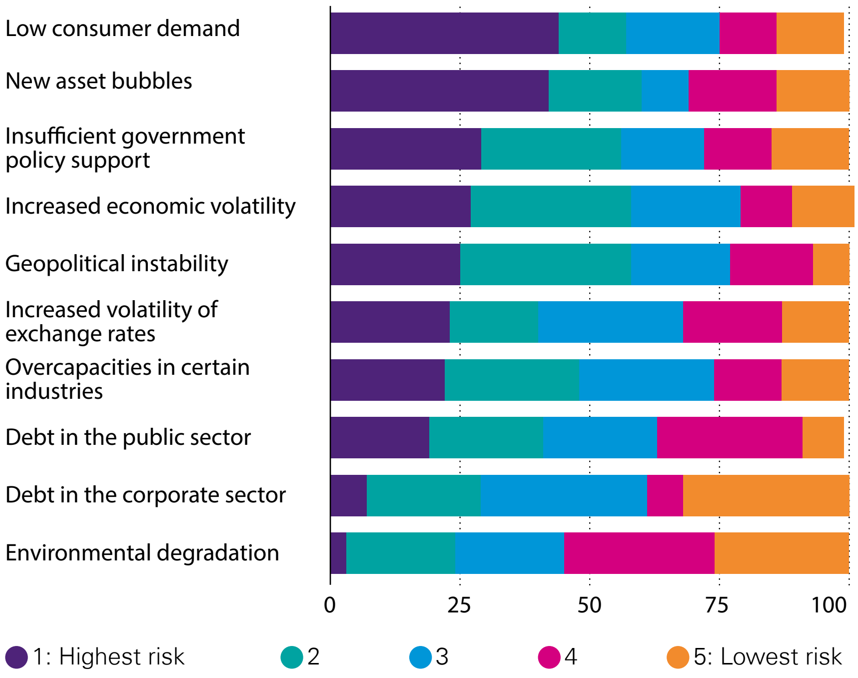
Figure 30

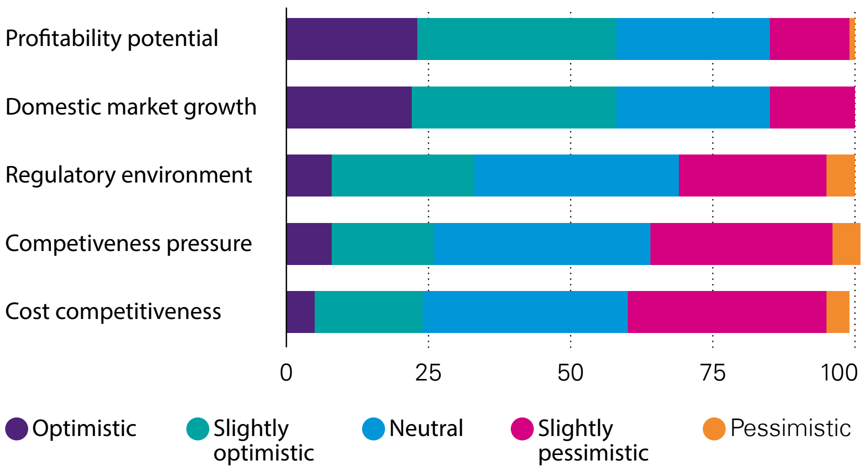
What do you view as potential risks to China's economic growth? (1 = highest risk)



Low consumer demand and asset bubbles are singled out as the most significant risk factors to China's economic growth. That suggests increasing concerns about China's ability to manage these risks in an increasingly complex geopolitical environment.

Figure 31

How would you describe your business outlook in China on the following aspects over the next two years?



The revealed risk exposures do not prevent an overall optimistic outlook on profitability and domestic market growth — albeit slightly less optimistic than in last year's survey. The respondents are much less optimistic about the competitive pressures and cost concerns.

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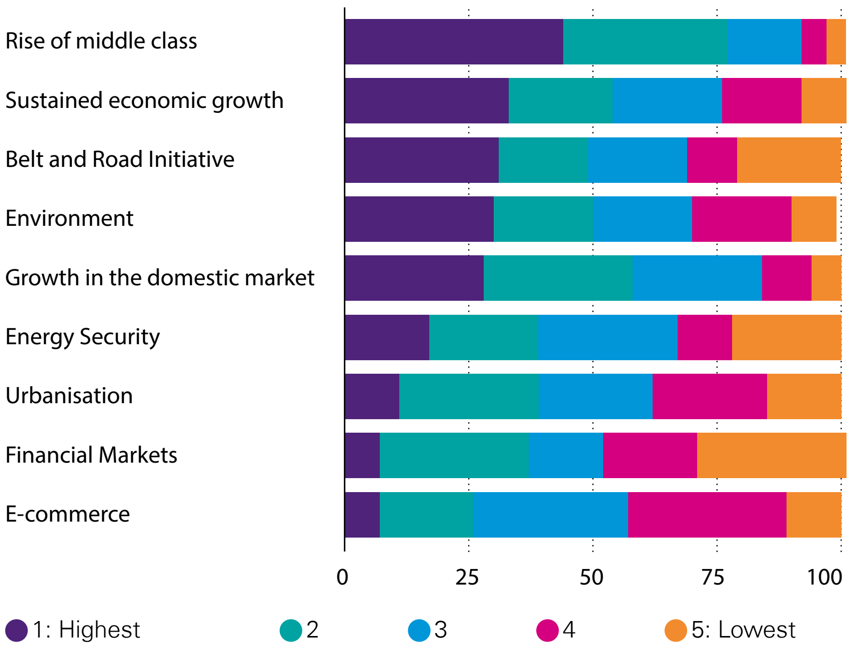
Figure 32

Which of the following do you think are the key opportunities for your business in China? (ranking 1 being the highest priority)



China's middle class continues to emerge as an economic powerhouse. With sustained economic and domestic market growth, those are the three key opportunities. Our respondents don't see much potential in energy security, urbanisation, financial markets and particularly e-commerce. Sectors where China has a distinct (or at least comparative) business advantage over Australia.

Figure 33

Do you expect headcount to increase or decrease in 2018?

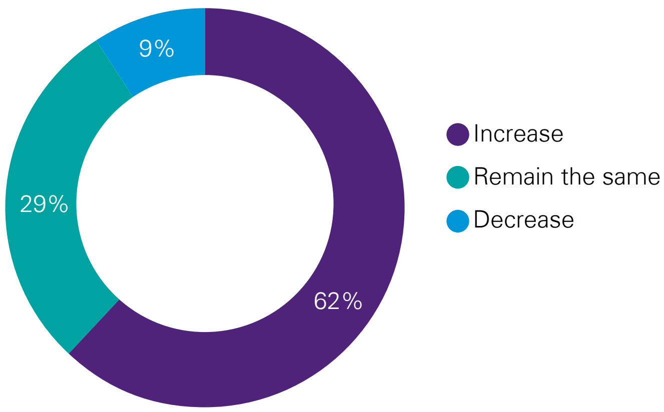


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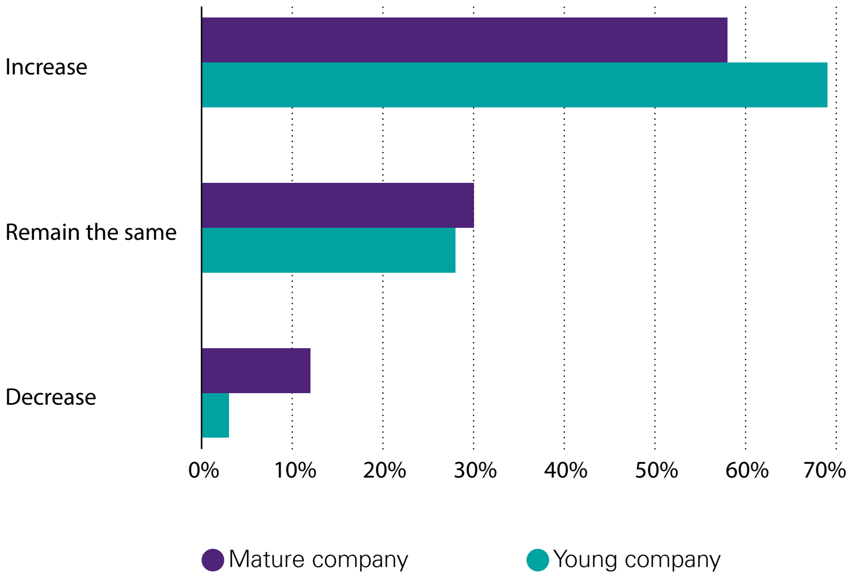
Figure 34

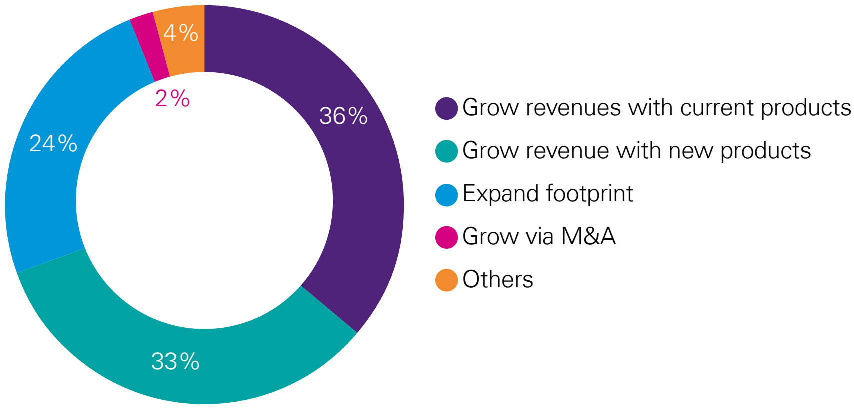
Do you expect headcount to increase or decrease in 2018? By age of operations



Young companies are more optimistic about increasing headcount than mature companies, possibly reflective of their current growth trajectory.

Figure 35

Which of the following most accurately describe your company's primary growth strategy for China for 2018?



Despite ongoing concerns about cost and business conditions in China, the respondents continue to see profit opportunities. They invest and expect to grow their workforce. Growth strategies differ, with 36 percent growing revenue from existing products and a further 33 percent selling new products. The third option is to expand footprint by accessing new Chinese markets. Growth through mergers and acquisitions remains unpopular.

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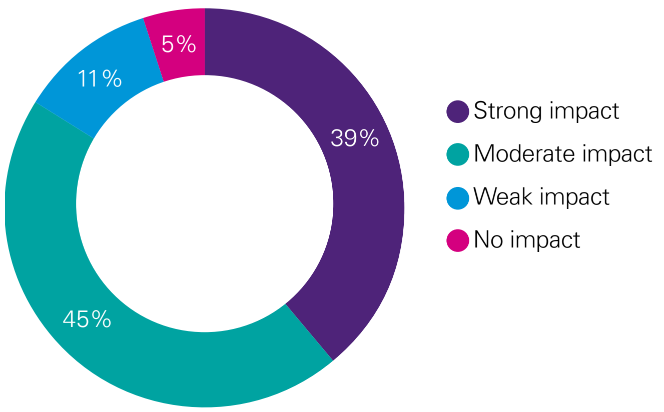
Figure 36

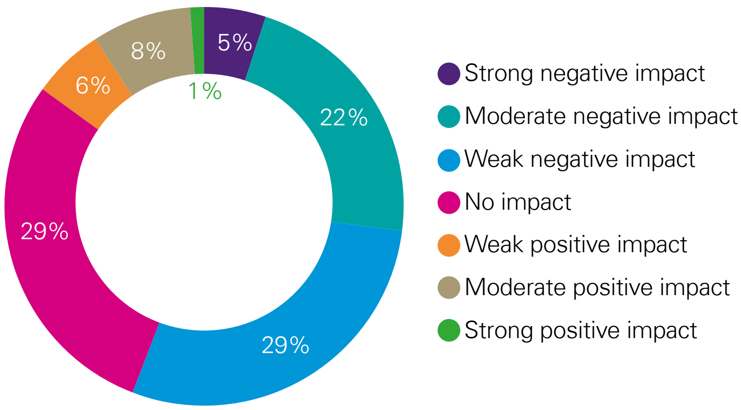
To what extent do you think Australia-China governmental relations impact business between the two countries?



The year past has focused on the impact of bilateral relations between Australia and China. Last year's survey indicated that respondents rated positive bilateral relations as very important for business growth. Not surprisingly, 84 percent of respondents now identified a strong or moderate impact of bilateral relations on business.

Figure 37

To what extent do you think the recent bilateral Australia-China relationship has impacted your business?



When asked more specifically about the impact of the recent bilateral relationship on their business, 56 percent of respondents mentioned a negative impact, against 15 percent mentioning a positive impact.

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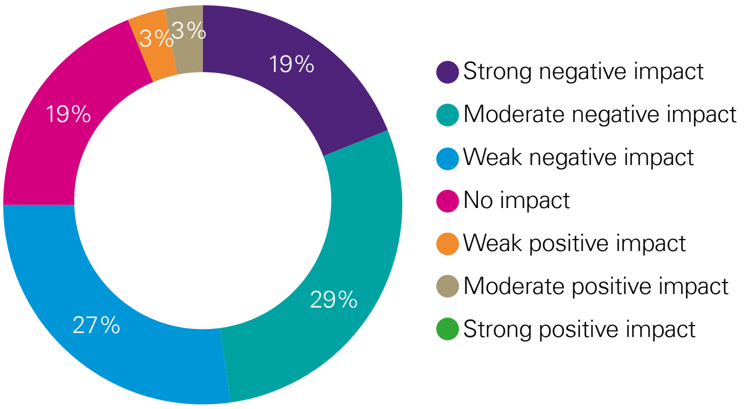
Figure 38

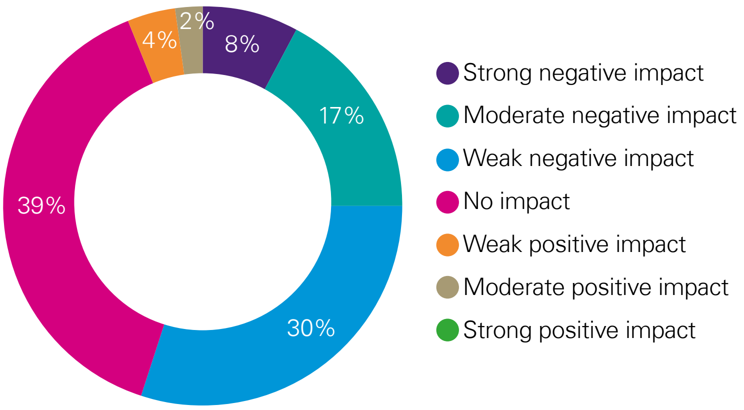
To what degree do you think recent media reporting on the Australia-China relationship has impacted bilateral relations?



The media is clearly an important driver of the mood in bilateral relations. Much more than mere reporting the facts of trade, the media provides comment and opinions. Recent media reporting (both Australian and Chinese media) has been less than complimentary and that is reflected in the survey. As the importance of the bilateral relationship between China and Australia was recognised by the survey respondents, anything that sours or threatens that relationship potentially affects business with and in China. And indeed, 75 percent of respondents think that media reports had a negative impact against just 6 percent claiming a positive impact.

Figure 39

To what degree do you think recent media reporting on the Australia-China relationship has impacted your business?



When asked whether those media reports impacted their business, the respondents were not as negative (at 55 percent), and many (40 percent) concluded that it did not impact them. When comparing the split between those without legal entities in China and those with legal entities, 66 percent of companies without legal entity in China considered negative impacts, while 51 percent of those in market considered themselves to be negatively impacted. This may have a demotivating effect for Australian businesses engaging into the China market.

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ChAFTA impacts and improvements

What a difference a year makes to free trade!

Last year's survey focused on the benefits from ChAFTA and further progress in bilateral free trade negotiations between Australia and China. ChAFTA came into effect in December 2015, and last year's survey revealed positive impacts on business in or with China and expressed hopes for further trade liberalisation.

With US administration focusing on the direct impact of free trade on US manufacturing, the landscape has shifted dramatically. Following a series of escalating US tariff announcements on imports from China, free trade deals are challenged. While Australian businesses have upheld their free trade stance, the public (and not just in the US) has started to question the benefits of free trade.

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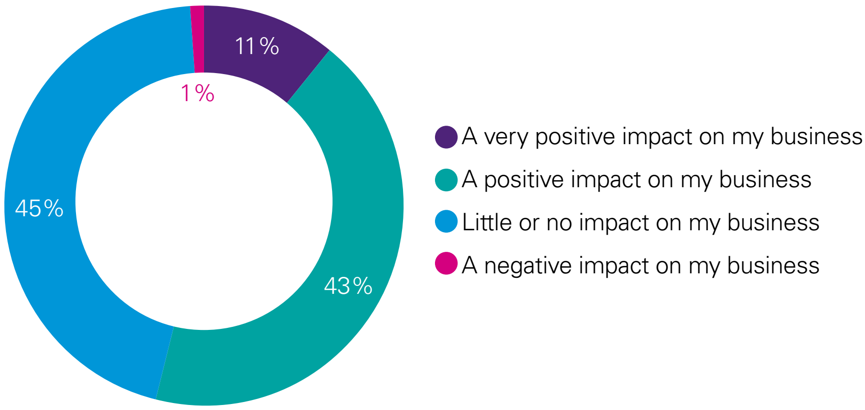
Figure 40

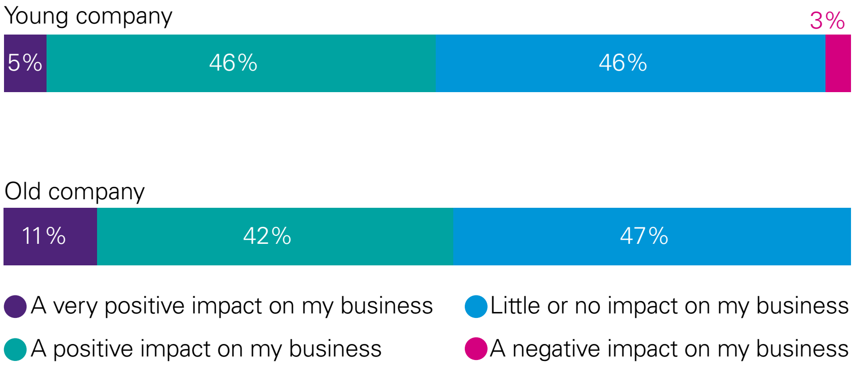
Which of these statements do you most agree with? The China Australia Free Trade Agreement (ChAFTA) has had



The benefits of free trade are clearly appreciated by the respondents, with 54 percent claiming a positive impact — similar to last year. It is, however, interesting to note that a further 45 percent experienced little or no impact from ChAFTA — after three years of operation.

Figure 41

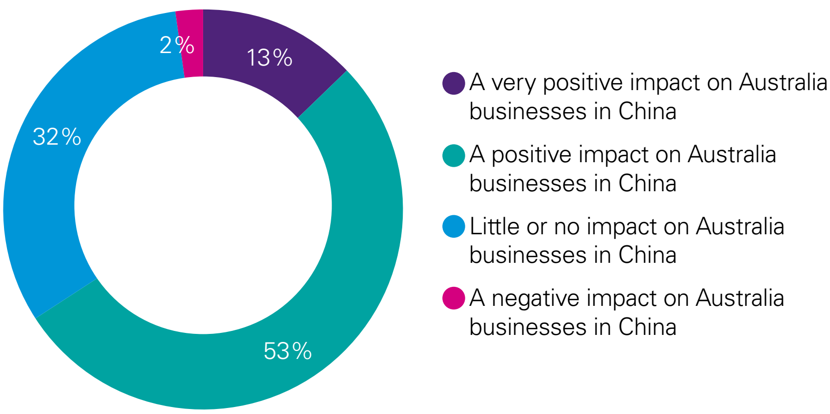
By age of operations



Could it be that young companies have been more likely to benefit? Not according to the survey, where the appreciation of a positive impact is very similar for young and mature companies. Interestingly a small number of young companies claim a negative impact. Could it be that ChAFTA made it easier for their Australian competitors to also enter China and compete for business?

Figure 42

Which of these statements do you most agree with? The China Australia Free Trade Agreement (ChAFTA) has had



When asked whether ChAFTA was positive for Australian businesses operating in China generally, the respondents are more optimistic (66 percent) than for their own business' impact.

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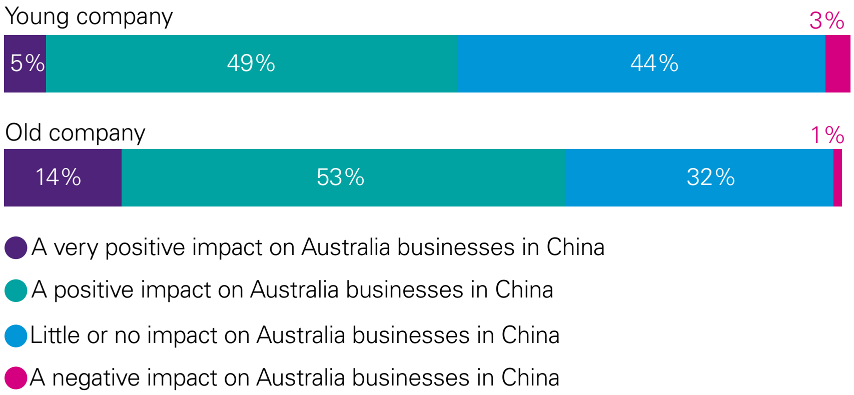
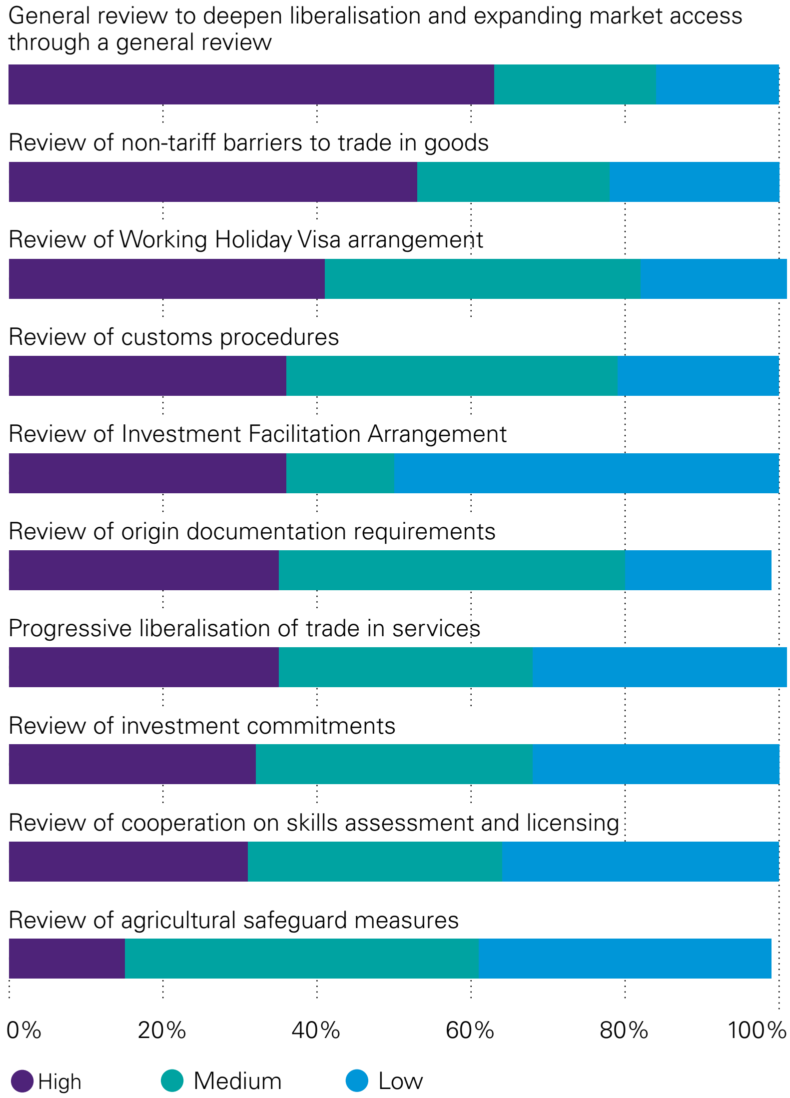
Figure 43
Which of these statements do you most agree with? By age of operations: The China Australia Free Trade Agreement (ChAFTA) has had



That more positive perception for business in general is driven by respondents from mature companies. In all likelihood, they think that ChAFTA made it easier for new entrants (young companies). The young companies themselves do not experience that.

Figure 44
What priority would your business attach to the following future review mechanisms under ChAFTA?



Australian businesses attach the highest priorities for further ChAFTA review to a more general trade liberalisation approach, followed by a review of non-tariff barriers (NTBs). Those priorities have not changed much since last year, with a relatively low priority to skills assessment/ licensing and a relaxation of agricultural safeguard measures.

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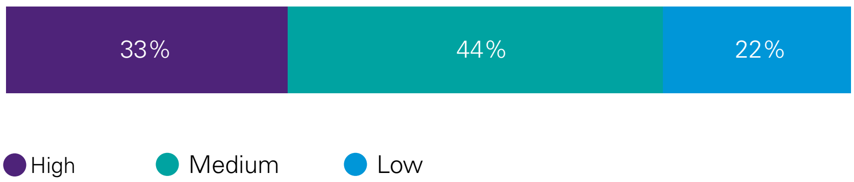
Figure 45

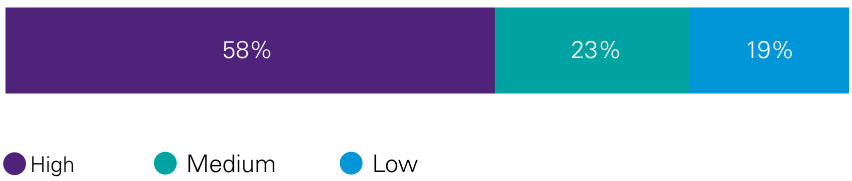
What priority would your business attach to the future review of Agricultural Safeguard Measures under ChAFTA? — Agribusiness respondents only



Of course, different industries will have different priorities. So if we only ask the agribusiness respondents to prioritise, then it is not surprising to see one in three attaching highest priority to a review of agricultural safeguard measures. Nonetheless, Australia's reputation for high quality, safe agricultural produce might well benefit from tight agricultural safeguards on imports into China, as reflected in the low priority.

Figure 46

What priority would your business attach to the future review of Non-Tariff Barriers under ChAFTA? — Import into China and Exporting to China respondents only



And likewise, Australian exporters to China, and importers into China would stand to benefit significantly from reductions in Non-Tariff Barriers on trade in goods.

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Figure 47

What priority would your business attach to the following future review mechanisms under ChAFTA?

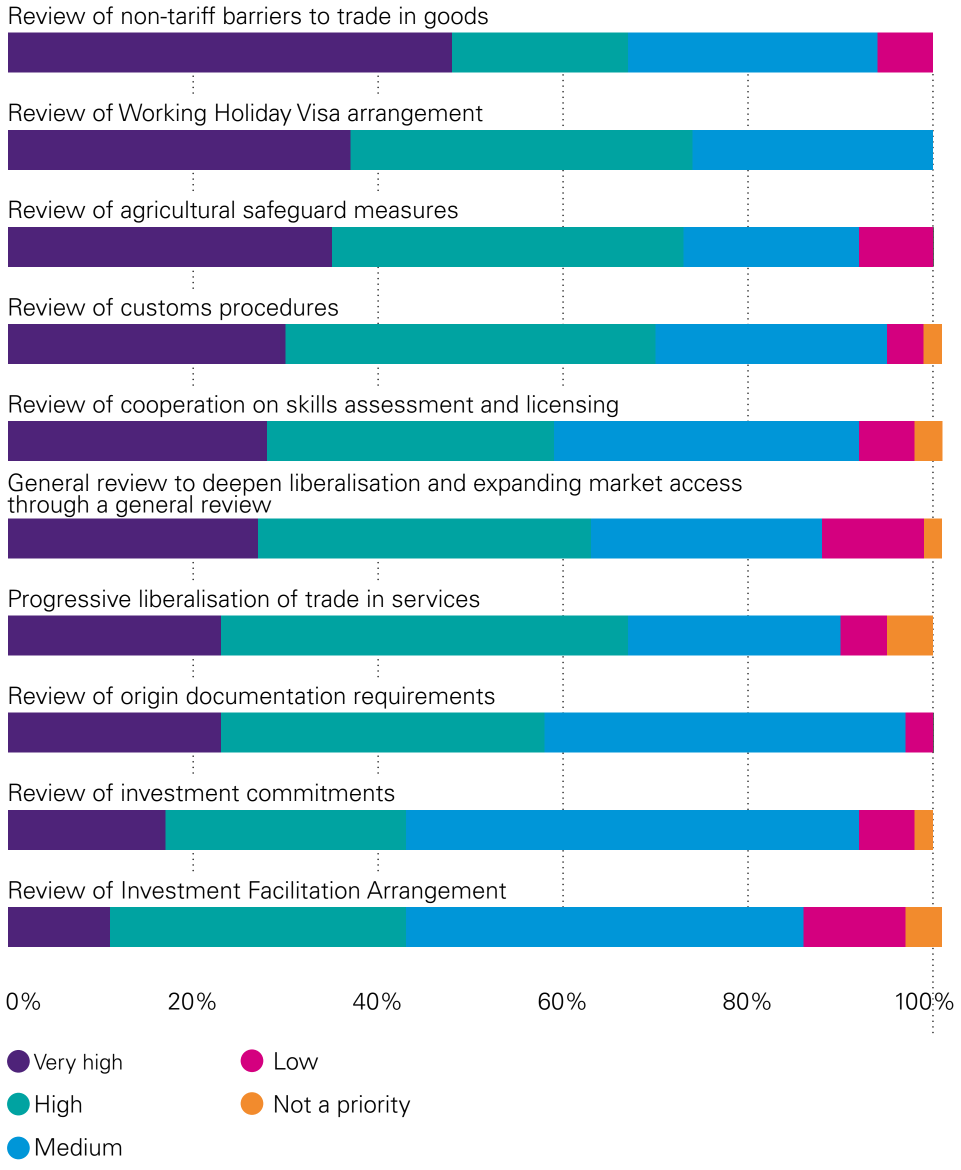

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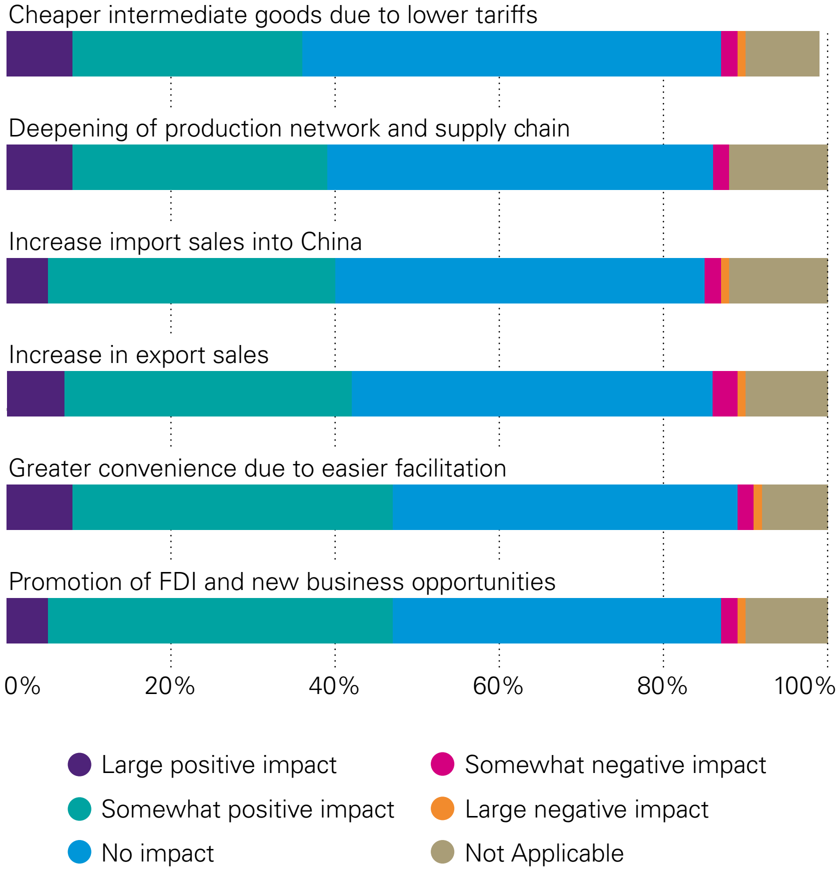
Figure 48

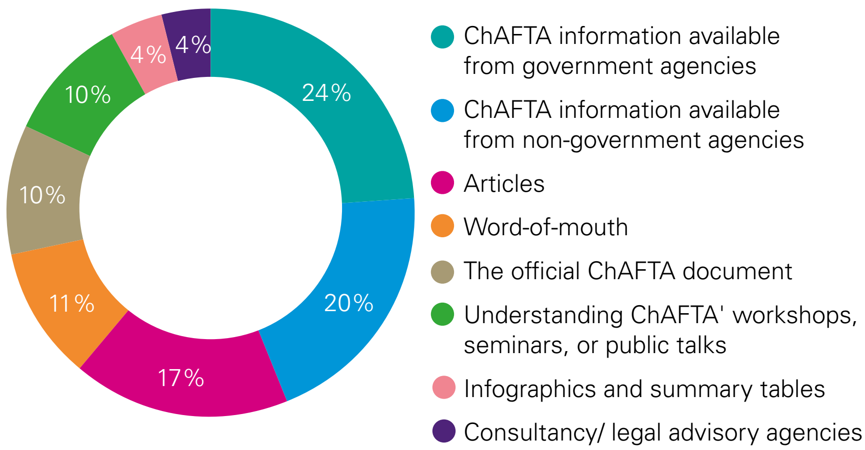
What are the impacts on your business as a result of ChAFTA?



When asked what specific business activity has benefitted from ChAFTA, the most positive impact was experienced in the ability to establish business in China, through Foreign Direct Investment and new business opportunities. Easier facilitation was similarly mentioned as positively impacted. Less positively impacted were the supply chain and intermediate goods procurement.

Figure 49

Which channels have provided the most beneficial source of information about ChAFTA?



Preferred sources of information on ChAFTA are predominantly the government agencies, AustCham, ACBC and other sources. Although there are many other sources used by the respondents (including word-of-mouth), most of them rely on the "direct" sources.

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Challenges of doing business in China

Doing business with or in China comes with its challenges. Accessing and operating in emerging economies is always daunting and requires businesses to be agile, adaptable, but most of all, persistent. Challenges come in many shapes and forms and test the best prepared. What are the key challenges for Australia's companies?

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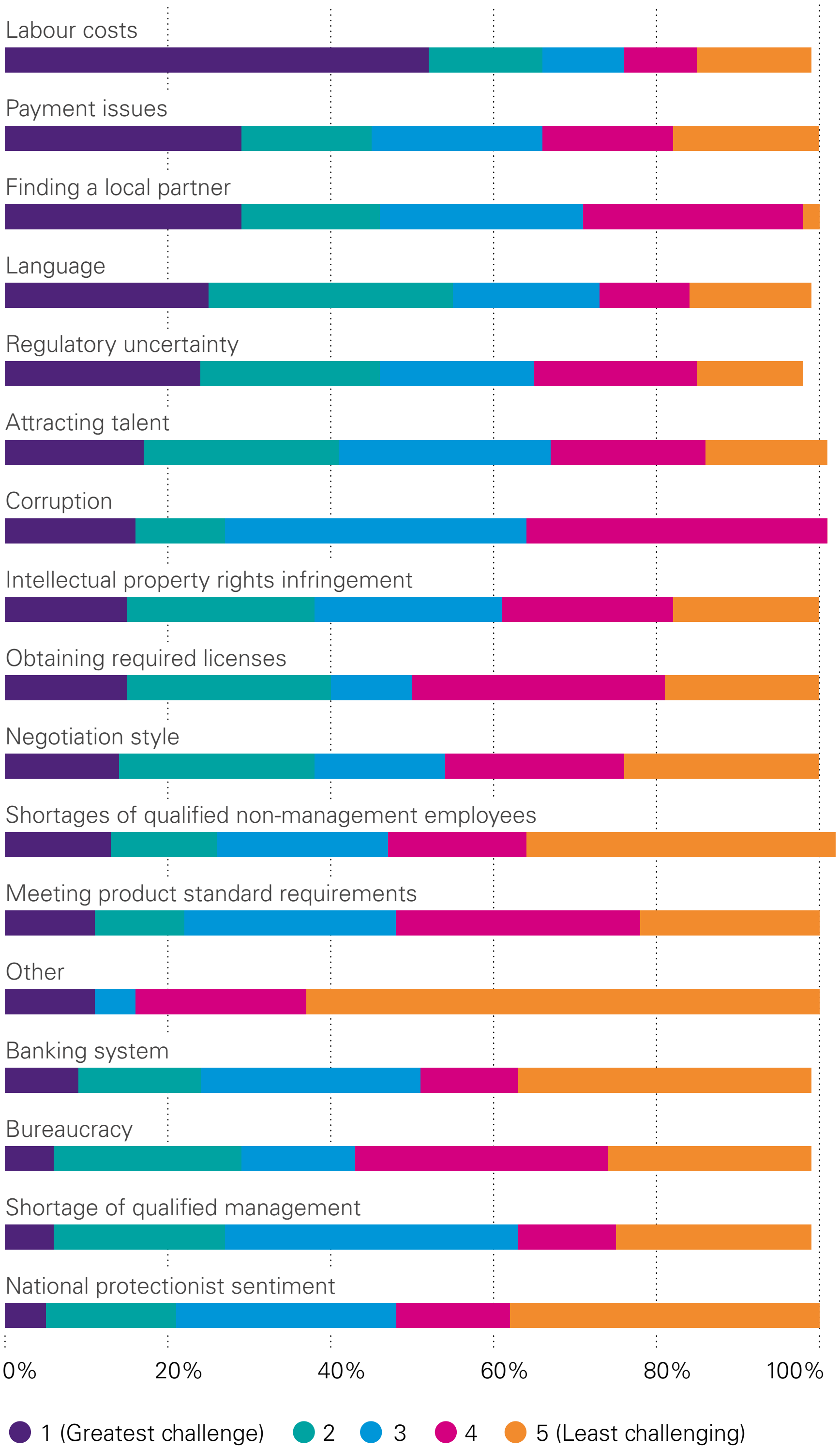
Figure 50
What are your top five business challenges in China?



While economic and business conditions challenge Australian companies doing business with or in China, there are many more cultural, regulatory, political and environmental factors to deal with. Payment issues, finding a Chinese partner, language and regulatory uncertainty feature in the top 5 concerns.

Corruption has become a lesser challenge compared with last year. Labour costs, on the other hand, is now clearly the leading concern. Payment issues have surfaced as the second most important concern — not ranking high in last year's survey and reflective of the increase in respondents based in Australia that are engaging with China. Noteworthy in the opposite direction is bureaucracy, now considered much less challenging than last year.

Perhaps reassuring is the bottom ranked national protectionist sentiment. Despite escalating rhetoric in the US-China trade sanctions, Australian companies do not see a major concern.

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Market entry and support

With China's trade liberalisation came easier access to its domestic markets. But is market entry any easier now for a China novice? And how are Australian companies supported in their foray into China?

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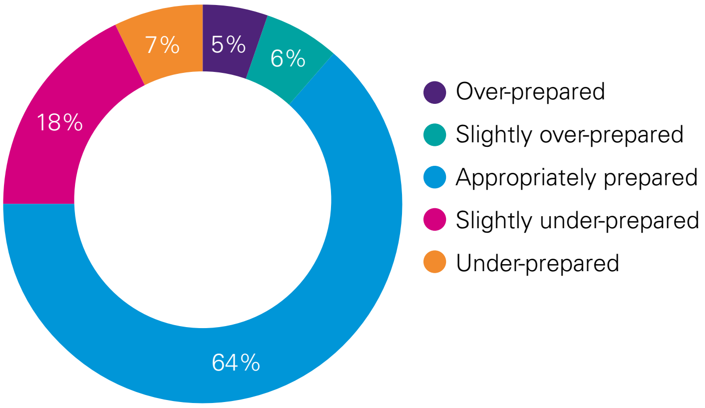
Figure 51

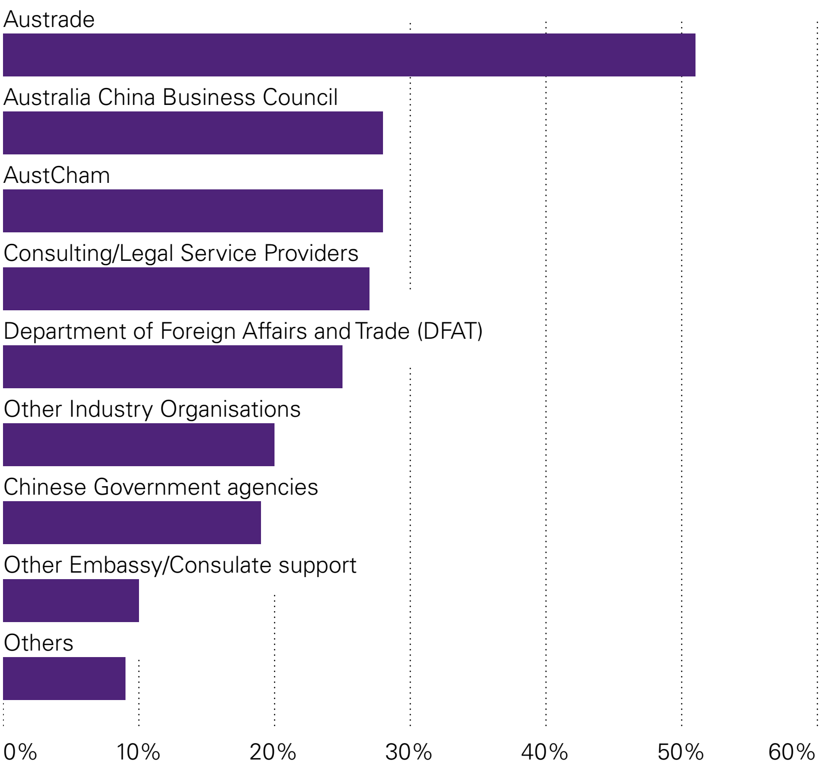
How would you rate your business preparedness on entering the Chinese market?



As in last year's survey, three out of four respondents state that they were appropriately (or over) prepared. That still leaves 25 percent who felt underprepared for the strategic move. Testing whether young firms (operating in China for less than 6 years) were better prepared than the mature firms, reveals no significant difference.

Figure 52

Which services or agencies did you engage as part of your market entry strategy?



The first port of call for the survey respondents aiming to enter China is Austrade. ACBC and AustCham feature as the next two sources for support, followed by consulting/legal services for specific regulatory and legal advice.

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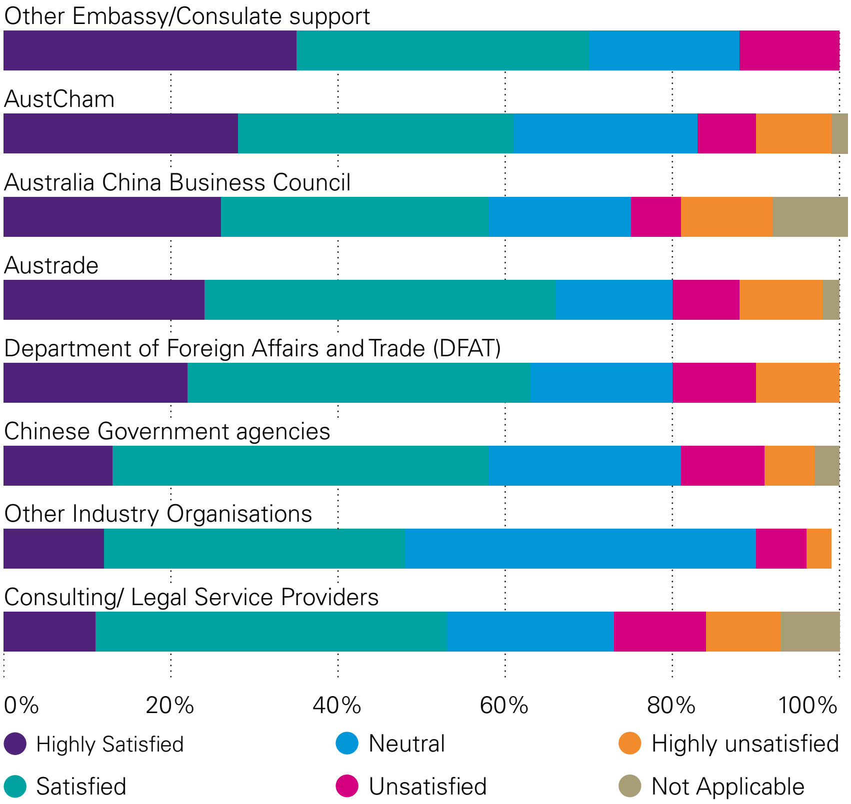
Figure 53

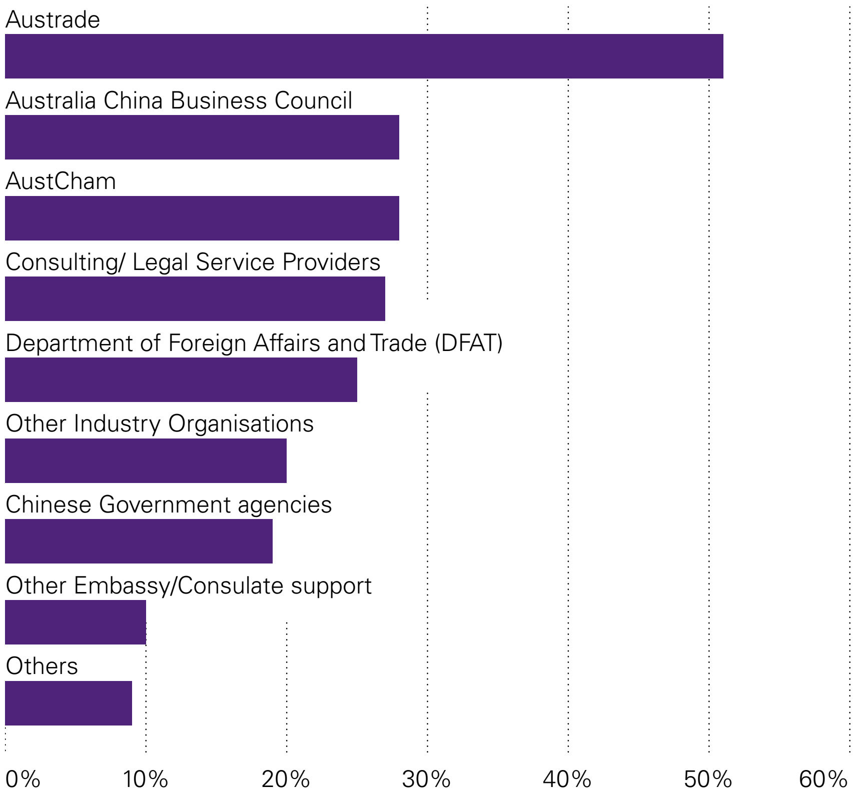
How satisfied were you with the services or agencies you engaged as part of your market entry strategy?



Satisfaction levels with the support services and agencies used were generally quite high (60 percent satisfied) with less than 20 percent being unsatisfied. Lowest satisfaction ratings applied to the consulting/legal services.

Figure 54

Which services or agencies did you engage in the past year?



Services accessed in the past year were very similar to services first provided upon access into China. Austrade was most commonly used by the respondents followed by AustCham and the ACBC. Once doing business in or with China, the need for consulting/legal services diminishes, while Chinese government agencies are becoming more important for business conduct in China.

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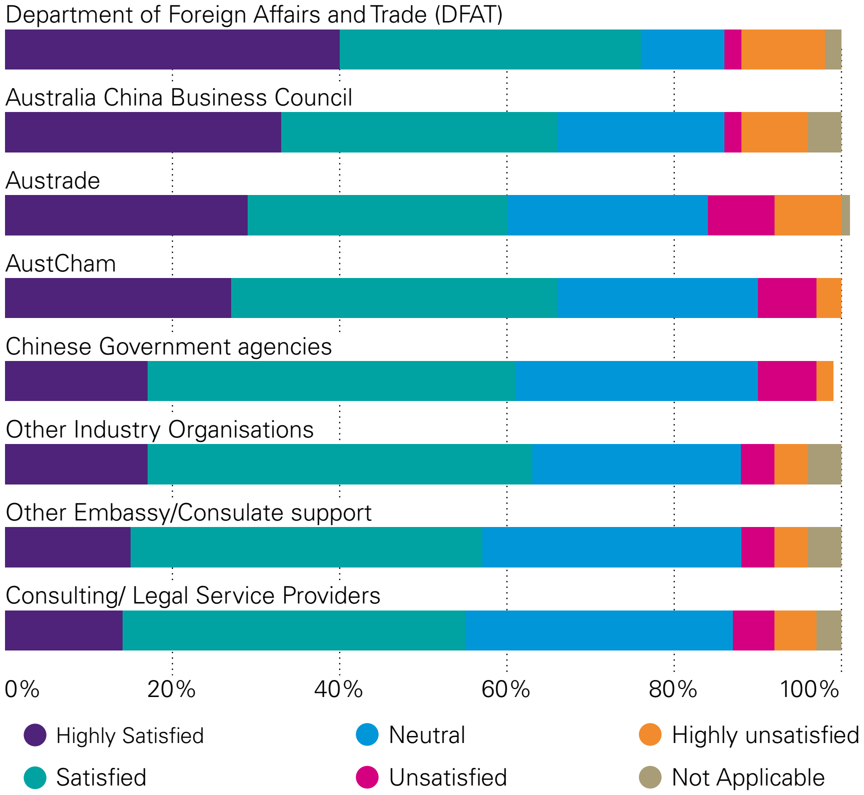
Figure 55

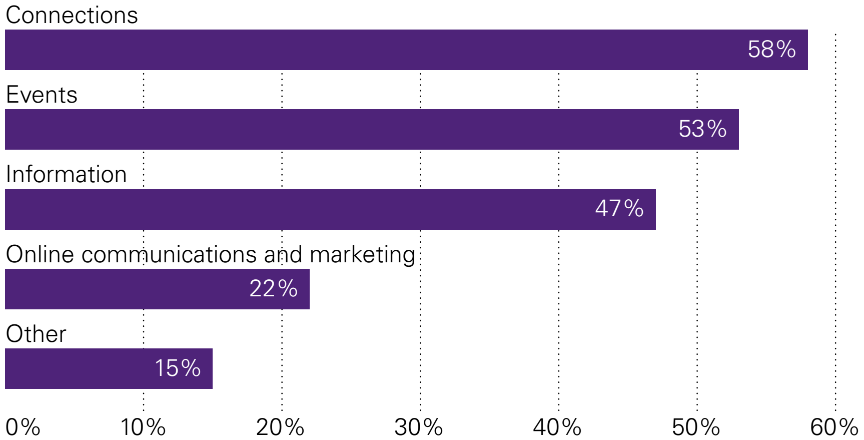
How satisfied were you with the services or agencies you engaged in the past year?



Again, services provided were generally satisfying the respondents, mostly so for DFAT, ACBC, Austrade and AustCham services. On the low end of the satisfaction scale features consulting/legal service providers. Of course, it may be that the cost of advice/service influences the respondents' expectation of the quality of that service.

Figure 56

If applicable, what services provided by AustCham add the most value to your business?



AustCham's facilitation of connections (access to networks) and hosting of events (where these connections meet face to face) are most valued by Australian businesses. Basic and specific information is the next highest valued service.

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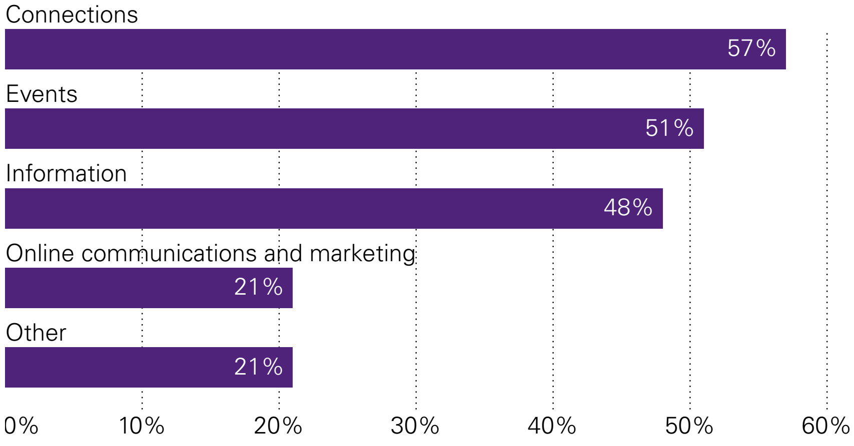
Figure 57

If applicable, what services provided by the Australia China Business Council add the most value to your business?



ACBC's connections and events are likewise most valued by the respondents. Online and marketing communications are not very highly valued. Networking and building relationships are clearly perceived to be the key to unlock business success in China.

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Business performance

Ultimately, business success in China is measured by the bottom line. Of course, international diversification of operations and establishing a foothold in Asia may, among other objectives, play a role in the China business strategy. But profitability seems to be the main driver behind the surveyed companies' China operations. Have Australian companies realised the expected return on investment in China? Are the opportunities indeed paying handsome dividends — despite the risks and cost concerns? And is that expected to continue?

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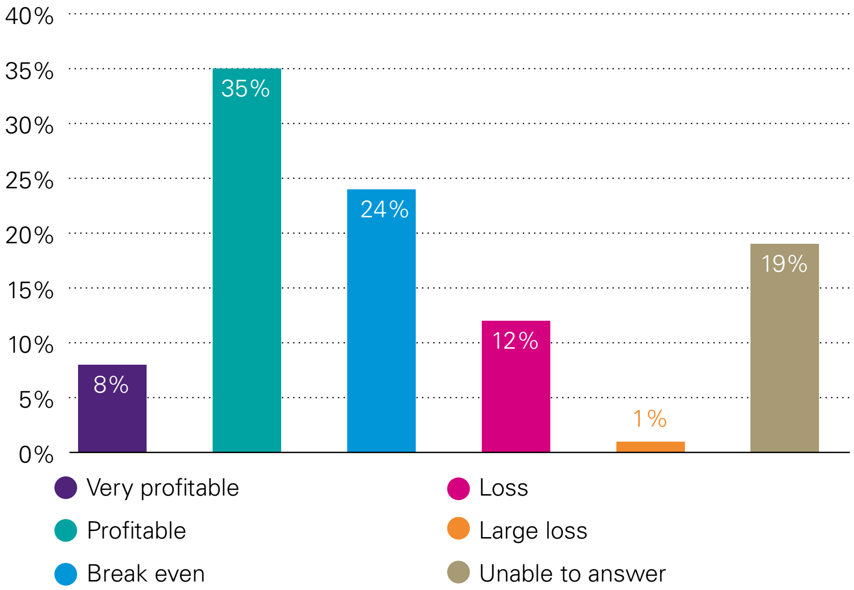
Figure 58

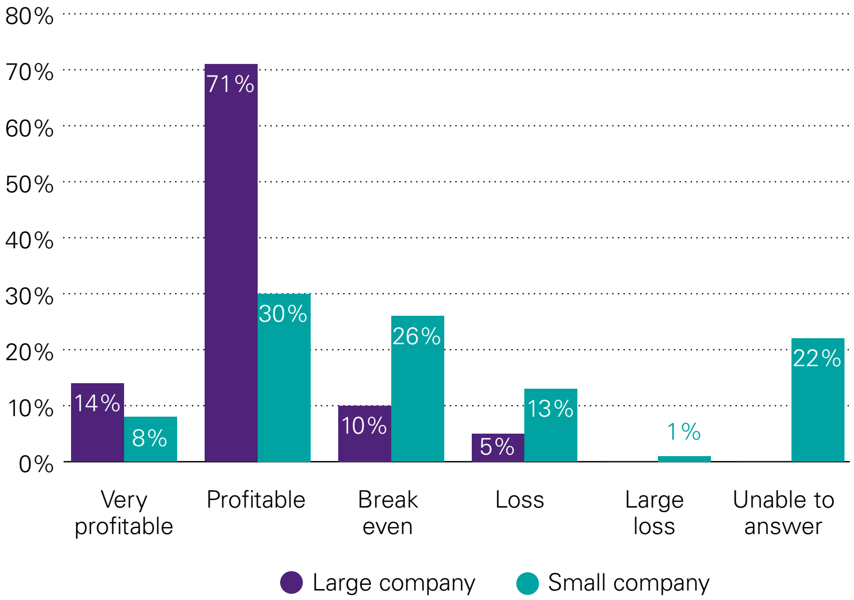
How would you characterise your company's financial performance in China in the past financial year?



The surveyed companies continue to perform well, with 8 percent being very profitable, 35 percent being profitable and 24 percent breaking even. 12 percent made a loss, and 1 percent made a large loss. Despite the overall healthy financial performance with 43 percent doing better than break even, this is a decline of almost 10 percentage points compared with last year when 52 percent of surveyed companies were (very) profitable.

Figure 59

How would you characterise your company's financial performance in China in the past financial year? By size



When comparing profitability by size of operations, large companies (with more than 120 employees in China) did considerably better than small companies. 85 percent of large companies were profitable, against 38 percent of small companies. Losses were also concentrated among small companies.

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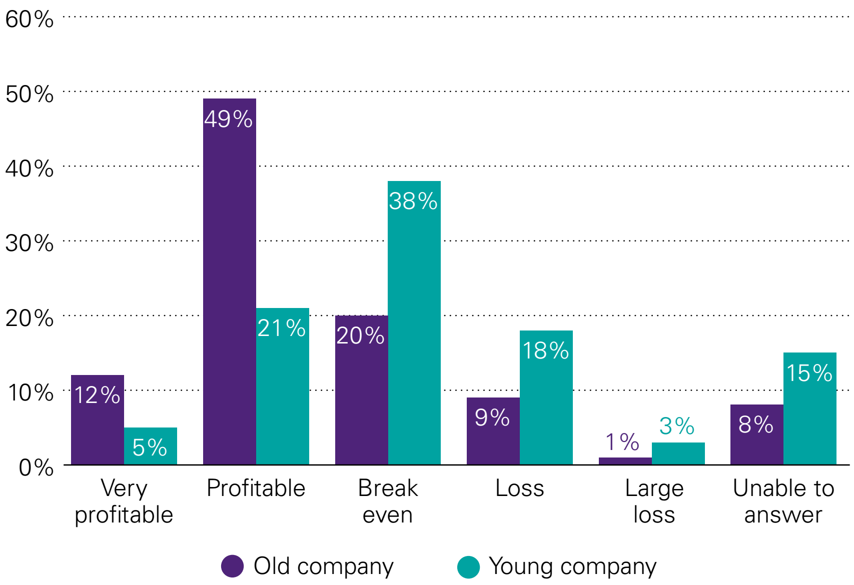
Figure 60

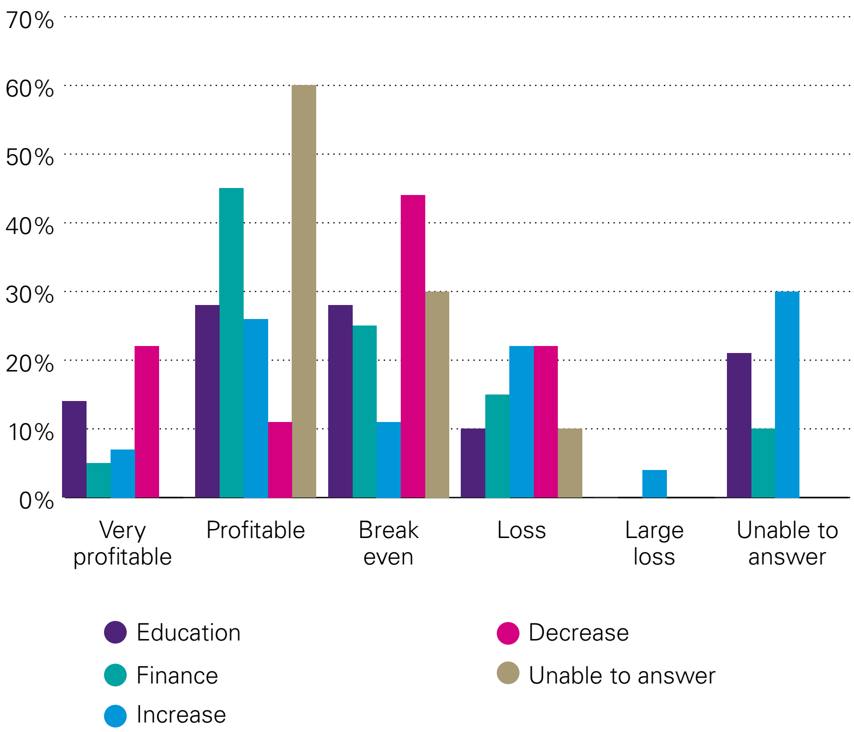
How would you characterise your company's financial performance in China in the past financial year? By age of operations



Age of operations may have something to do with the two-speed profitability. 61 percent of mature companies are (very) profitable compared with 26 percent of young companies. Losses are concentrated among young companies.
Young and small companies are somewhat correlated. The cause of the distinction in profitability might therefore lie in the increased competitive pressures — particularly for young companies.

Figure 61

How would you characterise your company's financial performance in China in the past financial year? By industry



When comparing profitability by broadly defined industry, we see that resources and education are still highly profitable. The profitability of food and agribusiness, and healthcare is more dispersed — both sectors having 22 percent of companies making a loss, yet similar numbers of companies being highly profitable.

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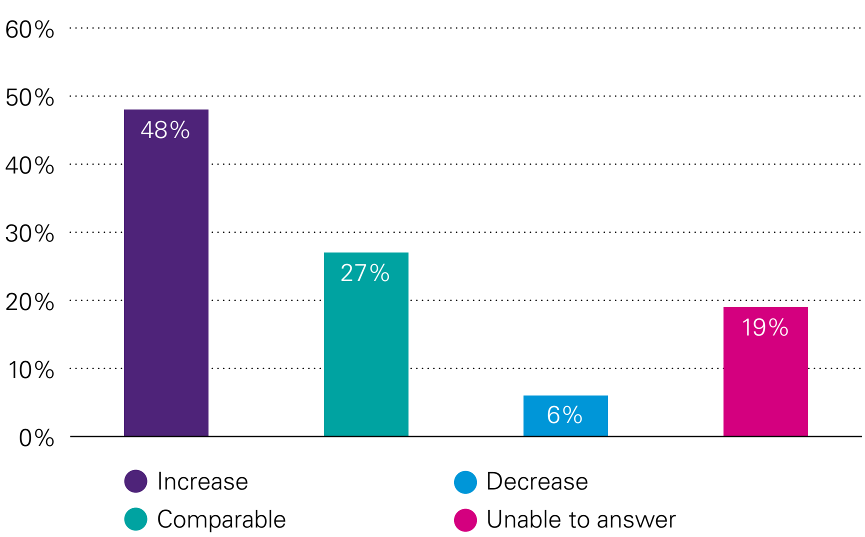
Figure 62

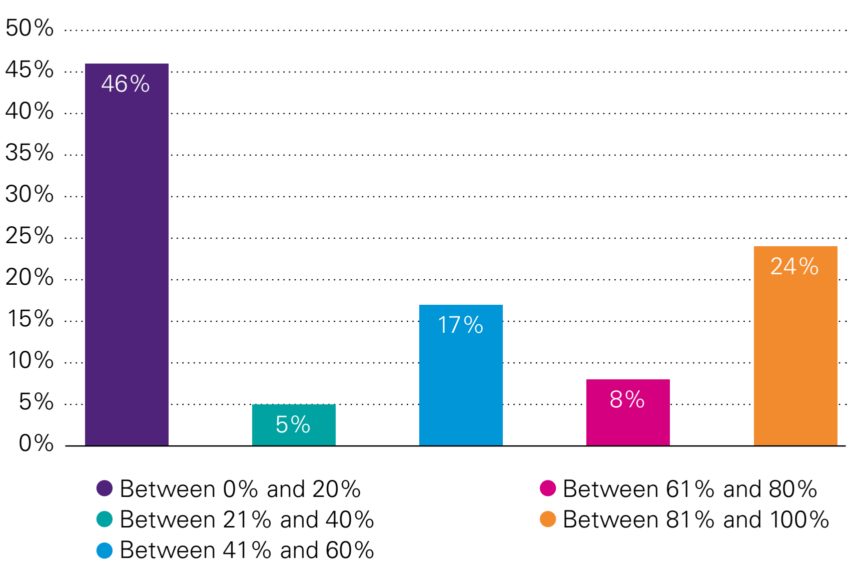
How do you expect this financial year's performance in China to compare with last year's?



Optimism still reigns. Looking forward on this financial year's expected profitability, almost one in two respondents expect an increase in profitability and a further 27 percent expect comparable profits. Only 6 percent expect lower profitability.

Figure 63

In the previous financial year, what was the revenue from your company's China operations as a percentage of your company's worldwide operations revenue?



The contribution of China operations to the companies' global operations revenue is somewhat bi-modal. For 46 percent of companies, China revenue is up to 20 percent of their total revenue. For 23 percent of companies, China revenue exceeds 80 percent of their total revenue. At least half of our sample companies depend significantly on Chinese revenue and profitability.

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Top tips for business success for Australian companies operating in China

KPMG's top tips for successfully doing business in China are:

1. Recognise that China is the big show:

no other market compares now or in the future. Make China a strategic long term priority, dedicate appropriate senior resources, invest with a medium-to-long-term view, and do your homework.

2. Understand that China is not an "easy" market:

it is a complex, fast changing and highly competitive market. There are also aspects of the business environment which can be challenging for foreign companies. All of this means that to establish a profitable China business requires careful planning and disciplined execution. This is also why it is important to work with strong partners including reputable advisors with a good track record of relevant in-market experience.

3. Develop a compelling China strategy:

not based on "over-quoted" macro statistics about China's economy or demography, but very niche and independently tested growth strategies about markets, customers and positioning. Spend the time and money to identify, qualify and prioritise growth opportunities; develop a robust market entry strategy to capture them; and make an implementation plan for launching your new China business.

4. Localise:

foreign companies need to consider what unique contribution they can make to China's social and economic development priorities and align their value proposition and business strategies appropriately. Consider establishing a local presence, partnering with local companies, and using local talent to ensure your business operates effectively and adapts appropriately to local conditions.

5. Be prepared for frequent regulatory changes:

implement processes to ensure your company considers the implications of all new laws, regulations and practices affecting your business and makes timely changes to ensure full compliance.

6. Build understanding and support:

especially with your Board and shareholders and avoid setting overly optimistic expectations too early. Based on this survey, the majority of Australian companies are profitable or at least breaking even, but at least 10 percent of respondents are currently incurring losses.

7. Understand that atmospherics really matter:

the impact of ChAFTA has been overwhelmingly positive in creating opportunities, but positive bilateral relations are also seen as important for trade and business growth. Assistance in solving a multitude of non-tariff barriers are the biggest priority areas for government and Austrade attention and support.

8. Utilise communities of Australians to help each other:

leverage the information, connectivity and support provided by AustCham, the Australia China Business Council, government-led delegations and various other networking and knowledge sharing platforms.

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10 boardroom questions to consider in your planning[1]

Based on key finding and our collective experience, 10 questions that Boards should consider asking executives operating in China:

1. How will the ongoing economic transition impact our existing China business: positively and negatively?
2. Which sectors and regions will provide the greatest opportunities and where are we best placed to take advantage of them?
3. What strategy review have we undertaken to assess the opportunities under China's 13th Five-Year Plan?
4. How does the value proposition for our China business align with the social and economic development goals in the 13th Five-Year Plan?
5. What disruptions — technological, regulatory, competitors — could take place in my industry in China and how would they impact our business? How will my business in China be transformed over the next three years — new technologies, new business/operating models, new processes, new products and services, disruption from existing competitors?
6. How will the globalisation of Chinese companies — who might be our suppliers, competitors and/or customers — affect our business in China and in our top markets outside China?
7. What are the opportunities for co-operation between Chinese companies and us in China, our home market and/or third countries?
8. What does the 'Belt and Road' Initiative mean for our company? Are there opportunities for us to supply goods and/or services to 'Belt and Road' infrastructure projects? How do we access these opportunities?
9. Which 'Belt and Road' markets would be attractive for our group to sell goods and/or services? How and when would we enter these new markets, and what would the role be for our Chinese business to manage sales and production operations in 'Belt and Road' regions?
10. How would various potential geopolitical outcomes affect our business in China? What steps have we taken or should we take to mitigate potential business impact of these risks?

1 Adapted from KPMG publication: Boardroom Questions - China's Development Roadmap 2016-2020

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Case studies

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CASE STUDY 1

George Institute for Global Health

Growth Story

The George Institute for Global Health (GIGH) was established in Sydney in 1999 and soon realised there was a need to have a presence in China. It soon formed an alliance with Peking University Health Science Center and in 2007 GIGH set up in China as an independent Wholly Owned Foreign Enterprise (WOFE). With their China headquarters in Beijing, GIGH now employs over 100 staff across Beijing, Shanghai and Chengdu, and are exploring expansion to southern China in Guangzhou.

Challenges

GIGH found that when hiring locally, staff prefer to work with Chinese Government organisations. This has resulted in difficulty of hiring staff, with over two-thirds of respondents also citing attracting talent as one of their top three business challenges. In terms of brand awareness, GIGH is small and relatively unknown, which can make it hard to work within the Chinese system. Similarly, GIGH has often found it difficult to attract local funding and conduct philanthropic activities.

Success Factors

GIGH places a strong emphasis on company values and been rewarded with tremendous loyalty from staff. People in China resonate with GIGH's core mission of helping China, which gets more compelling as GIGH expands its programs and presence across China. An excellent operations and finance team has helped the company navigate bureaucracy, including the recent change to Representative Office status. Persistence and patience have paid off for GIGH, so much that it's cited as a shining light for compliance by regulators. Key to GIGH's ongoing success is their academic professors with significant global experience and their ability to collaborate with world-class experts. GIGH recognises the value that the China's healthcare industry places on engaging global experts who are published in world journals, such as Executive Director Professor Craig Anderson.

Outlook

The outlook for GIGH will be to continue to assist China with its growing health challenges, specifically chronic diseases, common to an ageing population, bad diets and obesity. Just for type 2 diabetes, over 100 million people in China suffer from this condition. China's healthcare expenditure is expected to grow from 6 percent of GDP to over 9 percent in 2035(cite), compared with 9 percent in Australia and 19 percent in the United States, so the economic impact is high. Health is a fast developing sector where Australian companies can benefit by the opportunities from ChAFTA. Also to GIGH's advantage is that China has a high uptake of digital technology and digital health apps. This has the potential to feed back into the Australian healthcare industry, which makes it so important for GIGH to continue to be active in this market.

http://www.worldbank.org/en/country/china/publication/healthy-china-deepening-health-reform-in-china

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CASE STUDY 2

King & Wood Mallesons

The top international law firm in China is also an Australian firm — underlining the rapid inroads being made by Australia's vibrant services sector into that fastest-growing area of the Chinese economy.

King & Wood Mallesons (KWM) was formed by a merger six years ago of leading firms in each country — Mallesons Stephen Jaques, which had first opened a Beijing office in the pioneering days of 1993, and King & Wood, one of China's oldest and most established private law partnerships.

Today KWM has 12 offices in China including in Hong Kong, and 27 in total around the world. It has 2,300 lawyers, 550 of whom are partners. It handles the China business of about 350 of the Fortune 500 global corporations.

The firm supports Australian clients eager to participate in the massive Chinese economy but lacking the local knowledge, relationships or experience required to navigate the often complex regulatory challenges. It has also been ideally placed to help Chinese state owned and private companies to invest in Australia, which remains one of the top three targets for Chinese foreign investment — a position it has held for a couple of decades.

KWM's role in facilitating Australian involvement in China includes working with the ASX in establishing a joint project with Bank of China to develop new market architecture to enable real-time settlements in RMB, with Telstra on its US$1.6 billion sale of its Autohome stake to Ping An, and CBA on its China investments.

In the other direction, it has advised Humanwell Healthcare on its US$600 million acquisition of Ansell's sexual health business, a Cheung Kong led consortium on the proposed A$7.3 billion purchase of the DUET energy group, China Merchants and Hastings Fund Management on their A$3 billion bid for the Port of Newcastle, and a range of big resource and energy deals including Yancoal's acquisition of Rio Tinto's Hunter Valley coal operations, BG Group on selling its Queensland Curtis LNG stake to CNOOC for US$1.9 billion, and PetroChina's US$1.6 billion Browse Basin gas investments, bought from BHP.

Scott Gardiner, leader of the New Energy Future team, says KWM stands out as "the only top tier firm headquartered here in Asia" — with the firm's Global Chairman Wang Junfeng based in Beijing and the firm's Global Chief Executive Partner based in Hong Kong.

KWM is not some loose association of individual firms, he stresses, but a combination of firms across Australia, China, Singapore, Europe and the USA. "We operate as a single firm."

Jonathan Grant, also an international partner who comes from Australia, and is based in Beijing, says: "We are at the epicentre of global transactions — M & A activity, the Belt & Road Initiative, and Chinese companies eager to go global." The Greater Bay Area bringing Hong Kong together with its dynamic Pearl River neighbours presents further opportunities.

Australia, he says, is in the neighbourhood, "it's a natural relationship, and we are tapping in to this nexus seamlessly." The Australian connection is a positive, with the country viewed in Asia as "neutral" — without the big-power or colonial histories of countries like the US or UK.

The two countries, says Gardiner, bring complementary skills — "a deep familiarity respectively with Western style transactions, and with the way Asia does transactions. We know the way business is done globally."

Grant says that the Chinese commercial law environment has become highly sophisticated, so that even purely domestic deals are fully documented, "And a lot of cross-border deals are conducted in English today."

He emphasises that KWM is not only a corporate firm, but a full-service firm, "covering everything our clients may need."

That means, says Gardiner, "we are the gorilla in the room," and it also means that "you are always under pressure to retain the best staff — we must constantly look after them, and ensure they are professionally both satisfied and stimulated as our competitors are constantly seeking to hire the lawyers from the no. 1 firm in the region"

But that isn't too hard, since especially for young lawyers, says Grant, "what we're doing together at KWM is simply exciting, it's a great adventure. I feel that I am living the China dream, with my young family here with me in Beijing" — which one of Gardiner's young Aussie Chinese colleagues last saw when she was six, collecting her visa to emigrate to Australia with her family. Now she is back 20 years later, working in the KWM Beijing HQ as an up-and-coming lawyer.

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CASE STUDY 3

Servcorp

Servcorp is a great example of the new wave of Australian companies that succeed by helping other businesses succeed — including, especially, in places where firms dream of operating but fear to tread because of the practical challenges.

China is a classic case. With a surprise twist.

Servcorp is today playing a substantial role in aiding Australian businesspeople to operate in China's five most important business centres, as well as in Hong Kong and in 22 other countries, as well as in helping Chinese businesspeople find their way into Australian opportunities, in 23 locations.

An ASX-listed company, Servcorp was founded 40 years ago by Alf Moufarrige. He had established a real estate business but battled to win the support of fresh investors because he lacked a blue-chip, credible address. He encountered peers in a similar position, and they shared the costs involved in taking out the top floor of the iconic MLC Centre in Sydney when it opened.

He has since diversified into a range of other activities, such as restaurants and gyms, as well, but Moufarrige rebuilt his core business around that "light-bulb moment" — and retains that great MLC Centre location.

Servcorp's China & Singapore senior manager Anna Chavez says that while competitors have naturally joined the market, her company's point of difference is that "we are focused on the service element. We have a highly trained team to help our clients do well in their markets."

They book appropriate accommodation, arrange drivers to pick up managers, provide quotes, organise meetings, send invitations, translate documents, WeChat clients, and offer office space in central locations that is of a seamless standard anywhere in the world.

In China, the team is fluently bilingual — a crucial qualification that keeps Chavez busy as she works to ensure the staff stay loyal in a hugely competitive space.

The system works the same in all the cities where Servcorp provides premises — including, in China, Beijing, Shanghai, Guangzhou, Hangzhou and Chengdu. "It's always such a buzz" in those office, Chavez says, "there's such a lot going on."

The surprise twist in China is that while at first, the company's main clients were from Australia, Europe and the US, today they are from… China.

"Now they are 90 percent Chinese firms," Chavez says — "a massive switch."

Some are using those central Chinese city locations to do business with foreign entities seamlessly. Some need, as did Moufarrige in his own founding days, a prestigious address from which to operate from time to time alongside other Chinese corporations.

"We can also offer scaleability," says Chavez. Servcorp's spaces are flexible, and new workstations can be added if business demands step up — including for seasonal reasons.

Clients can operate year-round from their Servcorp spaces too — or can use them temporarily, or use Servcorp as a virtual office.

Chavez is well aware that "appointments can be quite fluid in China, so having a physical location that is central, attractive and well managed — where clients are greeted by name and offered a refreshment as they arrive from the lift — makes a great impression," and makes it more likely that the client will keep that appointment, and will come again.

Each floor of a Servcorp office is staffed by a receptionist, two secretaries and two managers.

Their communication skills are especially important, says Chavez, since "China runs on its own marketing and communication platforms" — for instance, Baidu not Google, and WeChat not Facebook.

And Servcorp provides direct fibre connections to its server in Hong Kong, ensuring seamless connections with clients' own favoured platforms, as well as through Servcorp's own internal platform names Community, through which all clients can communicate freely and easily.

In Australia, Chavez says, "Chinese clients are especially attracted to locations with spectacular views — such as in Sydney, the Gateway Tower overlooking the Opera House and the harbour views from Barangaroo.

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