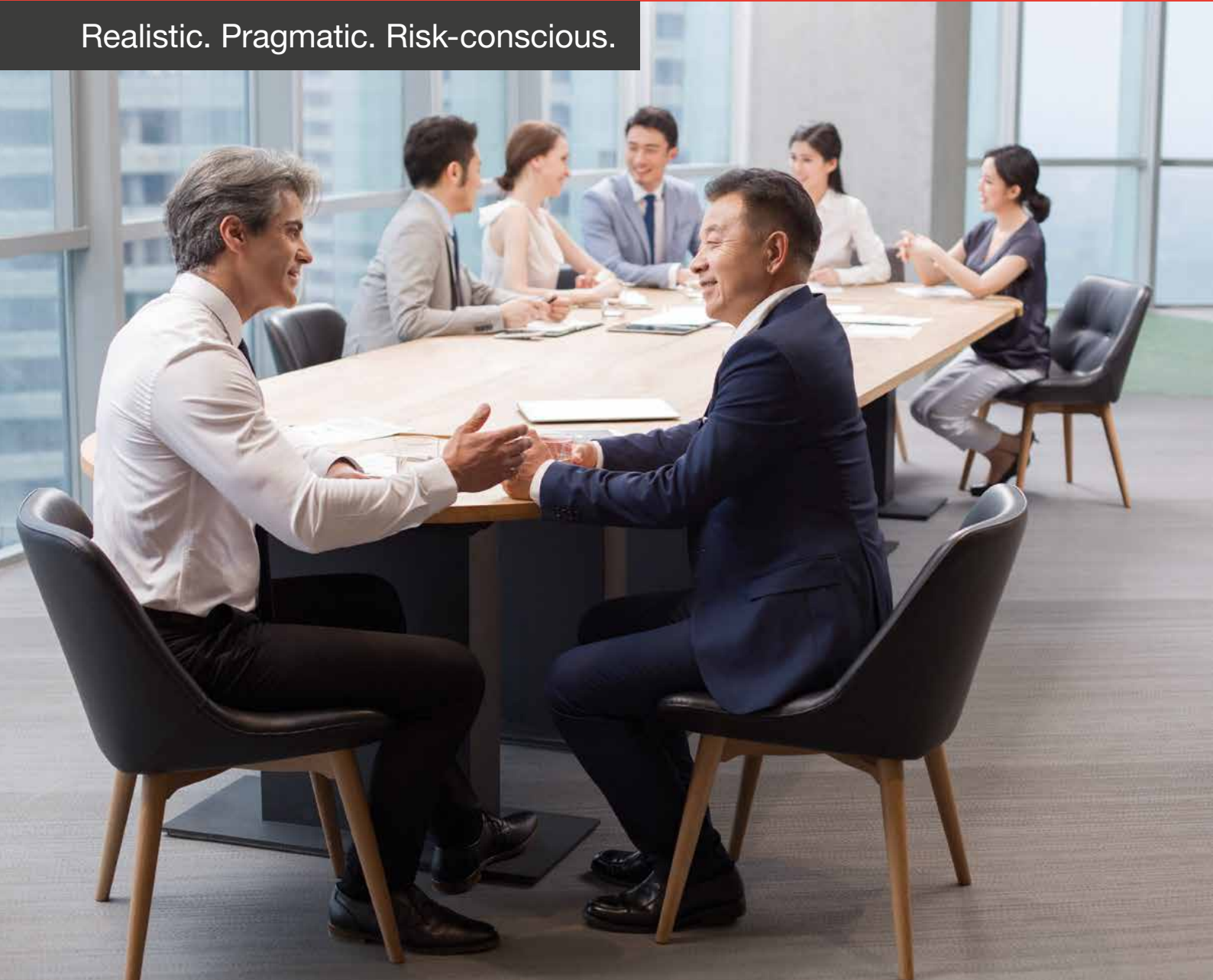


The New China Business of German Companies

Realistic. Pragmatic. Risk-conscious.



The New China Business of German Companies

Published by PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft

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November 2023, 28 Pages, 14 Figures, Soft cover

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Foreword

China is one of Germany's most important trading partners, and the country has had a strong influence on our economic growth for years. However, pandemic-related disruptions and geopolitical influences on supply chains have highlighted the risks of dependencies in recent years.

The growth of the Chinese economy has slowed just as much as the global economy is currently slowing down overall. The rapid return to consistently high growth that China had hoped for does not appear to be on the horizon, even after the end of the zero Covid policy.

Under the current framework conditions, the question arises as to what influence geopolitical and economic developments have on the involvement of German companies in China. How do they deal with the risks associated with their involvement there? How do they adapt their activities in order to continue to benefit from China as an important sales and procurement market?

We already surveyed German companies on China as a business location in 2011 and 2018. In this study, we are once again asking German companies that are active in China about their sentiment. Where possible, we draw comparisons with the results

from previous years, but have also integrated new strategic aspects into the interviews. For example, we shed light on experiences from the past few years as well as their influence on future decisions.

A key finding of our analysis: German companies are reacting pragmatically to the current situation in China, as well as possible regulations from their own country. In principle, German companies are committed to their activities in China and want to continue their involvement there. However, there are also industry-specific differences in planning and implementation depending on the focus of the risks, such as the topics currently in the spotlight and the approach of companies when adapting to these changing conditions to mitigate risks and at the same time exploit opportunities. In this analysis, you can read about how companies are adapting to the changing conditions.

We hope you find this information useful. If you have any questions or comments, please contact us. We will be happy to present the results for your sector in detail during a personal meeting.

Düsseldorf,
November 2023



J. Bauer

Ingo Bauer

Leader Transport and Logistics at
PwC Germany

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Summary of the highlights

Economic power China, world power China. The People's Republic is already playing a decisive role in determining the fate of world affairs. Not a day goes by without the international press reporting on developments in China, making it evident that the People's Republic is a global sphere of influence on a political, geopolitical and economic level. With our survey focusing on strategies and processes relating to the involvement of German companies in China, we wanted to gauge the mood, discern which topics are on the agenda and identify the goals being pursued. What do decision-makers think about the future in regard to China? Will they continue to invest or are they already planning to withdraw from the Chinese market?

- **Realism:** China will remain an indispensable and important supplier of raw materials in the future (88%) and can gain in importance as a sales market for companies in its own sector, even in difficult times (53%). Procurement in China, however, has reached its zenith – under the keyword “Glocalization”, every second company (57%) is rethinking its approach.

- **Pragmatism:** There are no plans for a large-scale exodus, because China has always been a challenging economic partner; minimal, planned partial reductions (6%) are only intended to minimize risks. Companies want to stay, although federal government regulations are seen as a restriction (65%). The majority (63%) of the companies surveyed are aware that projects such as the “Belt and Road Initiative” (BRI) are jeopardized by geopolitical conflicts, while only 33% see the EU's Global Gateway Initiative as an attractive offer. In addition, 56% of respondents view the application of the “Environmental, Social and Governance” standards (ESG standards) as an obstacle. The pragmatism of German companies is also reflected in the fact that almost half (44%) of them have not formulated a China strategy, but are addressing important issues strategically.

- **Risk management:** risks are being focused on more closely and form an integral part of every corporate strategy. 84% of respondents see geopolitical developments as the greatest challenges. 77% consider location options in other countries as an indispensable risk precaution. German businesses have started to take measures to future-proof their activities in China – 51% have increased their cybersecurity activities and 37% have concrete contingency strategies in the event of a pandemic or geopolitical crisis.
- **This all shows that** things will remain positive for at least the next three years, even if the benefits of doing business in China will be reduced for six out of ten companies (58%) due to rising costs. Just as many companies (59%) also complain about increased cyberattacks. In the short term, German companies (67%) do not see any sales migrating to other countries.

Companies from six different sectors were surveyed for the study. There were industry-specific deviations for most topics. Some of these were very clear and differed fundamentally from the statements of the majority.

For example, around two-thirds of companies in all sectors do not consider the labor situation to be a limiting factor. Only in **mechanical and plant engineering** do the majority have staffing problems. An above-average number of companies have difficulties finding qualified staff. In addition, with regard to poaching in China and secondment from Germany, the assessment of this economic sector differs greatly from the assessment of other industries.

Achieving an increase in cyber security activities and adaptation of IT strategies to the new legislation have both been below average within the **automotive industry**. This could indicate that they are outsourcing this part through alliances with competitors, as this type of strategic cooperation is only relevant in this sector.

An above-average number of companies in the **pharmaceutical industry** claim that they have been victims of cyberattacks in the last three years. Pharmaceutical companies continue to fear an above-average deterioration in the handling of sensitive data and are expanding the “Local First” strategy further.

More than any other industry, **the trade sector** sees China and its partner countries as continuing to be important suppliers of raw materials, and writes that they are becoming increasingly important as a sales market.

When selecting logistics service providers, the **consumer goods industry** places above-average demands on punctuality and reliability and leans more heavily than others on flexibility.

Further results and the assessment of our industry experts can be found on our website: www.pwc.de/China-Studie



A The golden years
are over

Economic power China, world power China. China is already playing a decisive role in shaping the fate of world affairs.

Not a day goes by without the international press reporting on developments in China. The People's Republic has expanded its global spheres of influence at a political, geopolitical and economic level.

China exported goods worth around USD 3.6 trillion in 2022. Compared to the previous year, this is an increase in the value of goods of USD 786 billion. Ten years earlier, the value amounted to USD 2.1 trillion, which represents an increase of 66%.

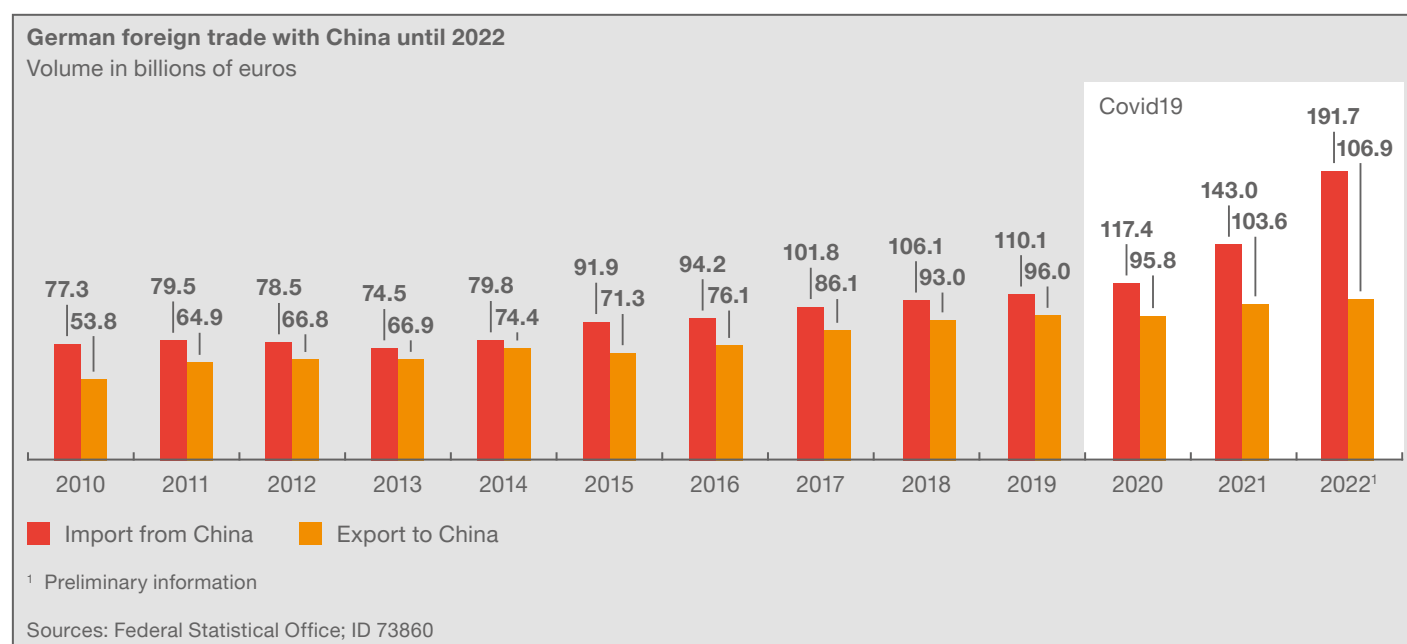
In 2021, the WTO recorded the highest increase in Chinese exports over the past ten years: the value of Chinese exports rose by around USD 800 billion between 2020 and 2021 – from around USD 2.589 trillion to USD 3.593 trillion.¹

China is now the most important trading partner for many countries, and the People's Republic of China also ranks first for Germany, followed by the USA and the Netherlands. In 2012, Germany imported goods worth 78.5 billion euros from China, followed by France in 4th place.; in 2022, the value rose to 191.7 billion euros.

The value of German exports to China in 2012 amounted to 66.8 billion euros; in 2022, the figure was already 106.9 billion euros.

Since reunification, Germany has continuously recorded a trade deficit with China: in 1991, this amounted to 3.83 billion euros; in 2022, it was 85.1 billion euros.²

Fig. 1 Value of German imports from and exports to China from 2010 to 2022 (in billion euros)



¹ Statista.com, <https://de.statista.com/themen/9267/handelsbeziehungenzwischendeutschlandundchina/#topicOverview>.

² <https://de.statista.com/statistik/daten/studie/250757/umfrage/deutschehandelsbilanzmitchina/>.

High hopes are followed by big disappointments

However, China's economic upturn, which has lasted for over 30 years, now appears to be reaching its limits. Many had hoped that the Chinese economy would experience a strong upturn following the end of the strict **zero Covid policy** and corona lockdowns. However, this has yet to materialize, as recently published data shows.

According to the report, exports fell by 14% year-on-year – the sharpest decline since February 2020. Imports fell even more sharply than expected with a drop of 12%.³

The Chinese capital traffic control authority even reported a slump of over 80% in foreign direct investment. These figures are in line with the mediocre economic data of recent months. In short: expectations have been disappointing. The political leadership in Beijing remains vague in its statements. Drastic measures to boost economic growth are not expected.

China's economic upturn is therefore a long time coming: the “Chinese century” seems to be over before it has even really begun.⁴ In addition to the economic problems, China is struggling with a structural problem: its drastically ageing population.

Although the **“one-child policy”** officially ended long ago, it remains the norm for Chinese families to have only one child.⁵

Another problem is the sharp rise in public debt. Municipalities are in the red with over 50% of gross domestic product; in Germany this figure is below 10%. There is also the threat of gigantic insolvencies in the real estate sector: the real estate group “Evergrande”, for example, has debts of almost 300 billion euros; “Country Garden” with USD 150 billion. Around 30 other companies from the real estate sector are in a similar predicament.

Adjustment: the gold-rush mood is over

China has always been a complex trading partner, which on the one hand was able to advertise itself with high growth rates at low costs and good infrastructure, but was also plagued by issues such as corruption, excessive regulation and legal uncertainty.

China is no longer an “Eldorado” where you can earn money easily and quickly, take advantage of the huge sales market and benefit from low production costs.

China appears to be developing into a normal foreign market; the adjustment phase has begun.

Globalization and the associated economic interdependencies between the German and Chinese economies are causing increasing unease among the German government. In the official EU mindset, China is classified as a partner, competitor and systemic rival. On this basis, the German government has formulated the first China strategy for Germany.⁶

This attempts a balancing act of classifying China as both a partner and a competitor. The Strategy should reduce risks, but not aim for decoupling, i.e., derisking (minimizing risks) instead of decoupling.

After all, how realistic would a possible decoupling be if China were Germany's most important trading partner and is very likely to remain so for the foreseeable future?

Can Germany or the German economy really afford this risk? Following the drastic effects on the German economy of the sanctions against Russia, a decoupling from China would be a further factor jeopardizing Germany as a business location and thus forcing an increasing exodus of German industry.

To be and remain globally competitive, German companies continue to source many primary products from China.

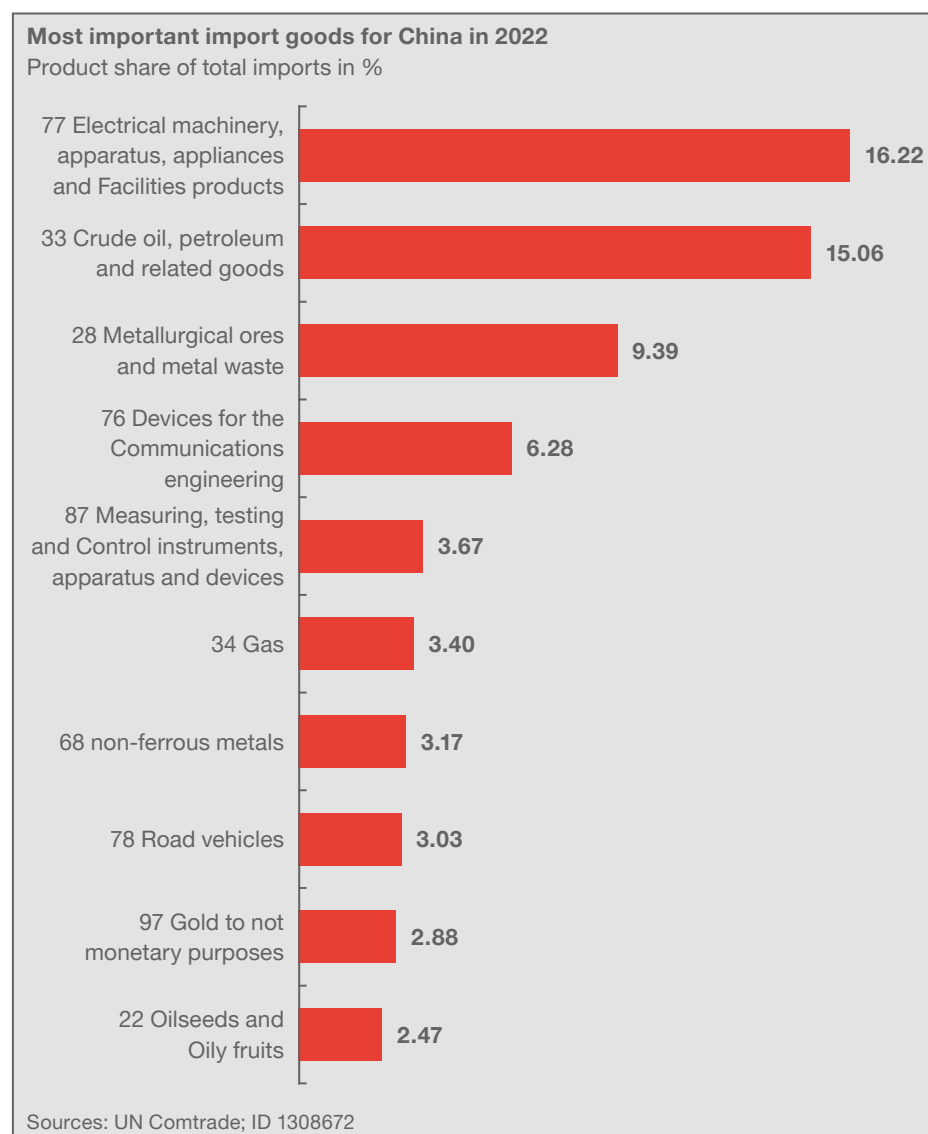
³ Merics 2023.

⁴ <https://www.japantimes.co.jp/opinion/2023/03/10/commentary/world-commentary/china-population-decline/>.

⁵ <https://www.nzz.ch/meinung/china-stirbt-aus-viel-schneller-als-prognostiziert-ld.1726915>.

⁶ <https://www.auswaertiges-amt.de/blob/2608578/810fdade376b1467f20bdb697b2acd58/china-strategie-data.pdf>.

Fig. 2 China: Shares of the most important imported goods in total import trade in 2022, broken down by SITC Revision 4 goods section



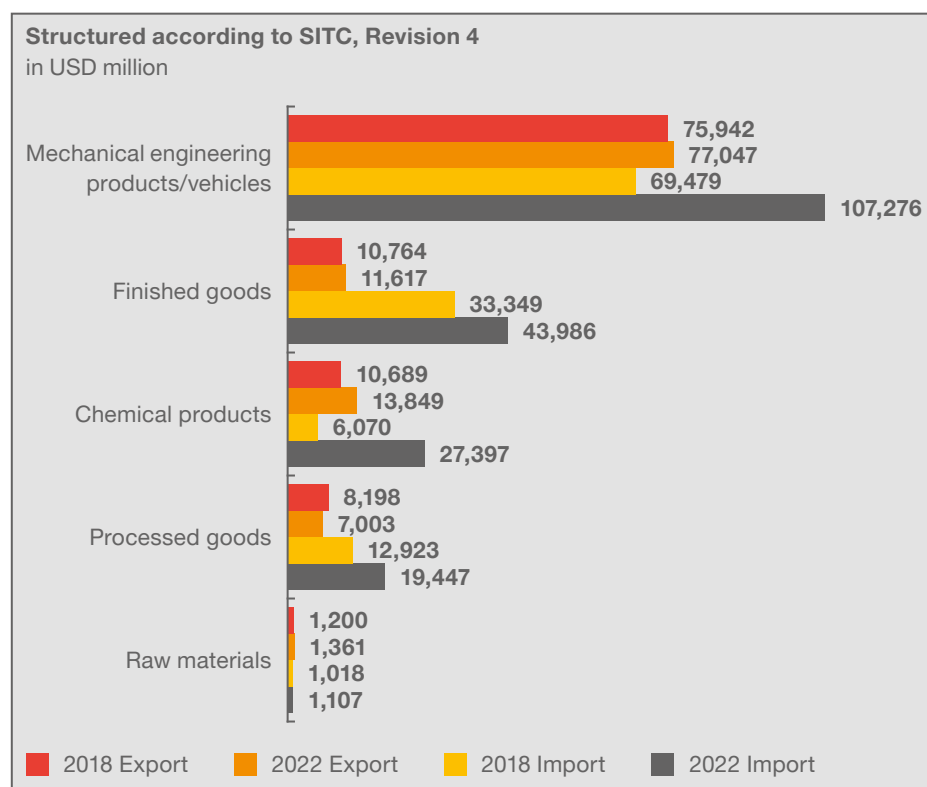
A complete demolition of economic relations with China would jeopardize not least the ambitious plans for the energy transition in Germany and the EU.

Chinese companies are not only leaders in e-cars; China also has the highest deposits of rare earths, which are crucial for both battery and wind turbine production.

China is also the global market leader in the production of solar cells.

A complete decoupling from China would not only be counterproductive for the ambitious energy transition in Germany, it is also unrealistic in the short term. However, a realistic scenario could be exactly the opposite: – namely that China will have a decoupling phase, putting the German economy under pressure.

Fig. 3 Imports to Germany from China and exports from Germany to China



German economy takes a pragmatic approach to China

The fact is that a lot has changed since the long and strict lockdowns in China and the sudden opening at the beginning of the year, and not just in China.

Our study concludes that the German economy is taking a thoroughly pragmatic and realistic approach to post-Covid China.

The economic involvement of German companies in China was also characterized by many challenges before Covid19. The German economy must adapt again and its companies become future-oriented.

This also includes realizing alternative procurement or sales markets as well as production sites outside of China.

However, China is and will remain an important building block in the global economy in the long term – as a sales, procurement and production market as well as a supplier of raw materials.

German companies will remain active in China. An exodus is not planned. However, companies are certainly considering partial withdrawals or relocations in order to cushion against geopolitical risks.

Top 5 challenges for your own industry over the next three years

1. In the long term, China will continue to play a major role as a supplier of raw materials (88% of respondents).
2. In the short term, there will be no sales distribution in other countries (67%).
3. Federal government regulations will make involvement in China more difficult (65%).
4. Geopolitical conflicts will jeopardize projects such as the Belt and Road Initiative (BRI) (63%) and 57% of respondents believe that “Glocalization” will affect the procurement market for German companies.
5. 56% of respondents see the application of ESG standards as an obstacle.

All of this shows that things will continue to be positive and realistic for at least the next three years, as 53% of those surveyed consider China to be a growing sales market.

Nevertheless, companies are increasingly focusing on risk management, which has become an indispensable part of corporate culture and strategy.

Top 5 aspects for your own company looking back over the past three years

1. 84% of those surveyed view unpredictable geopolitical developments as the biggest challenges.
2. 77% of respondents rate the concepts for alternative production and procurement as the biggest stumbling block in the event of a crisis.
3. 59% assess the increasing threat of cyberattacks as strongly increasing.
4. 58% cite rising costs as outweighing the benefits of reducing exposure to China.
5. Pandemic-related problems (48%) as well as the shrinking technological advantage (47%) are a problem for almost every second company.



B Results of the study in detail

1 Company locations, realized value chain

Main regions: still attractive for German companies

The eastern coastal region (66%) around Shanghai and the northeast of China (47%) are still the main regions for the establishment of German companies. This has remained unchanged over the last five years. The southern coastal region, where 39% of companies have settled, takes third place.

The eastern coastal region is strongly characterized by companies from the mechanical and plant engineering sector (77%), while the northeast of China is strongly characterized by the consumer goods industry (53%).

Fig. 4 Manufacturing locations today compared to 2018

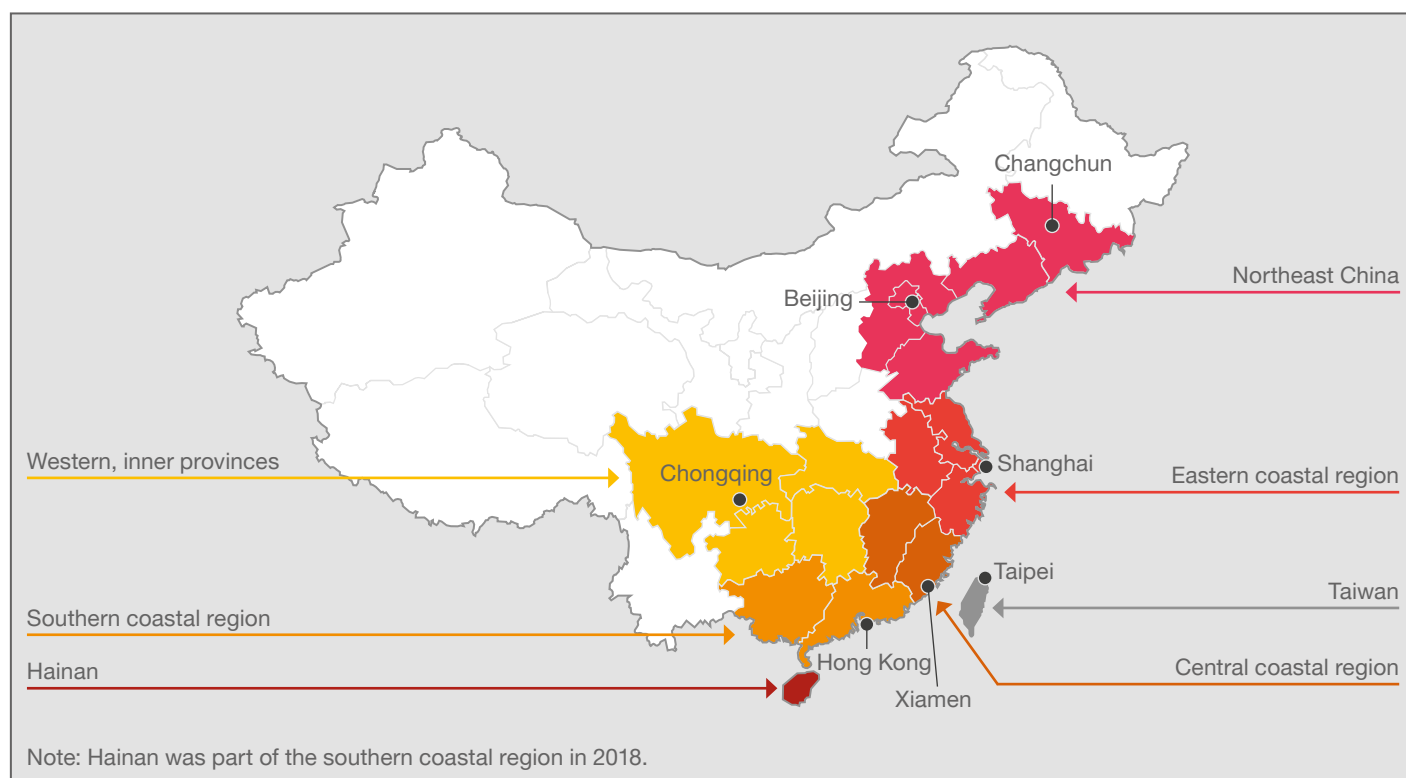
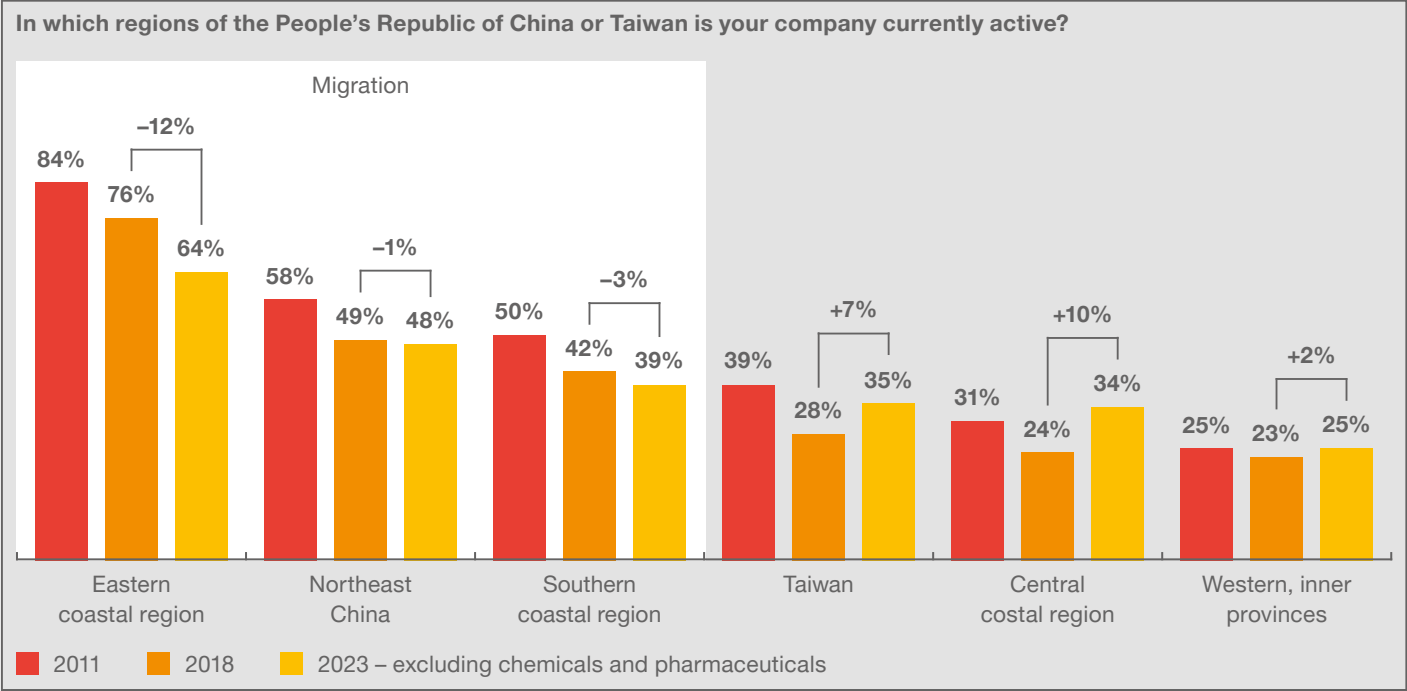


Fig. 5 Manufacturing locations today compared to 2018



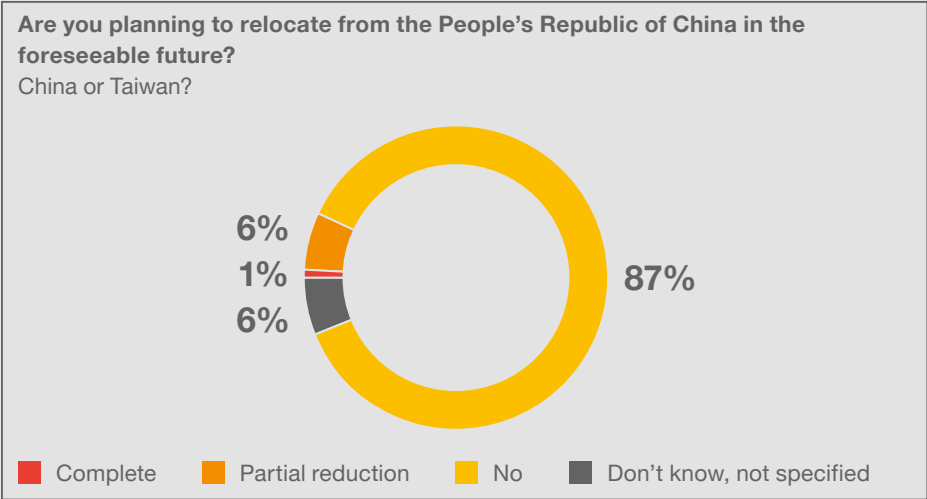
The eastern regions around Shanghai have become much less attractive for German companies.

Significant migration in the main region around Shanghai

The eastern coastal region is becoming significantly less attractive (-12%). Compared to 2018, the central coastal region – the region around Xiamen – saw a large increase of 10 percentage points for manufacturing industries.

The trend in the western inner provinces is stable in terms of new business (+2 percentage points industry-adjusted growth), despite criticism of China’s handling of the Uyghurs. Similarly, despite a possible Taiwan-China conflict, there is currently no discernible trend of withdrawal from Taiwan (+7%) – the opposite is the case.

Fig. 6 Relocation out of China



German companies are not putting China up for discussion as a location – even a partial withdrawal is only an option to a limited extent.

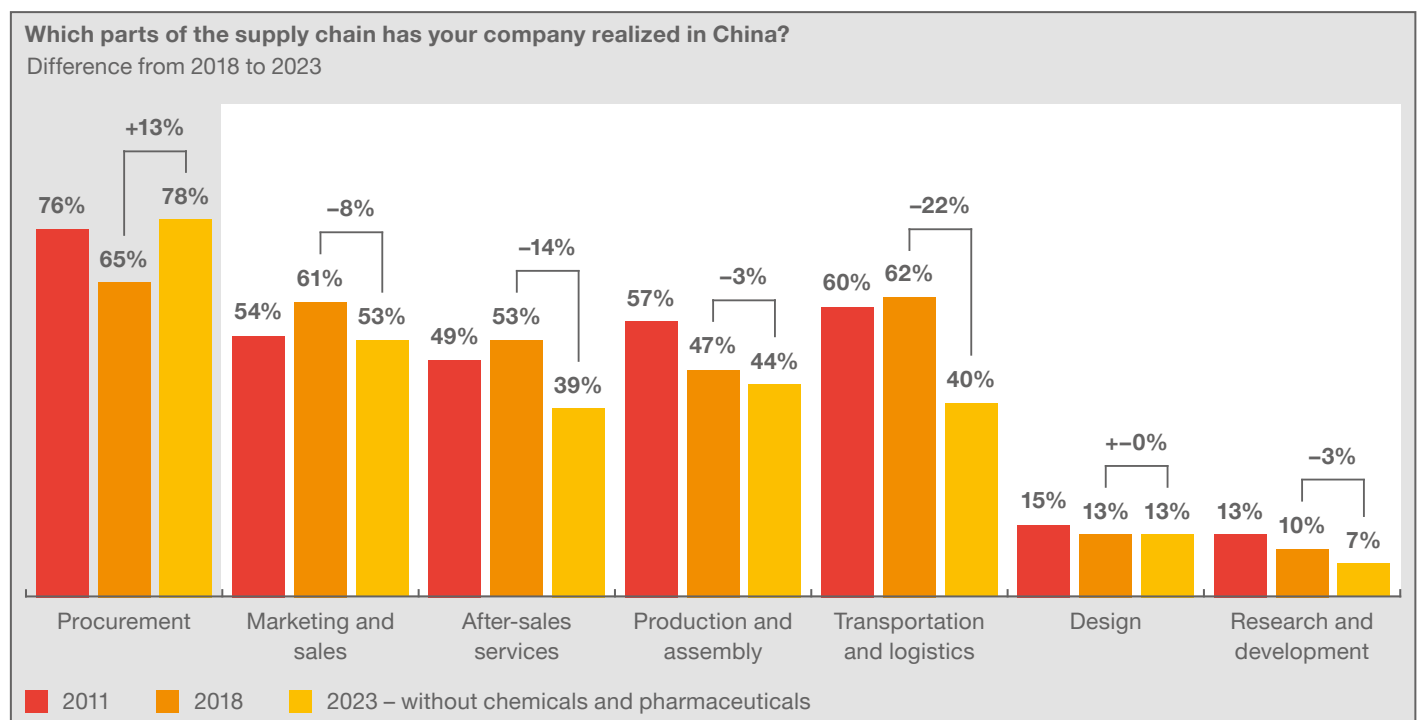


Only 1% of German companies want to leave China. At 6%, only a few companies are also planning a partial exit. At 11%, the automotive and consumer goods industries are above average in this respect. 92% of the companies surveyed are not planning to relocate within China either. Further relocations within China, as have taken place in the past, are also not on the agenda. Only 4% are planning additional branches in other regions.

Despite the existing risks, the importance of China as a procurement market for German companies in the manufacturing industry rose by 13 percentage points since 2018. A sharp reduction in the double-digit range can be seen in the transportation and logistics sectors (-22%) and after-sales services (-14%). As part of the local value chain, design within the manufacturing industry remains unchanged over 2018.

Procurement activities in China have grown significantly over the past five years.

Fig. 7 Realized value chain compared to 2018

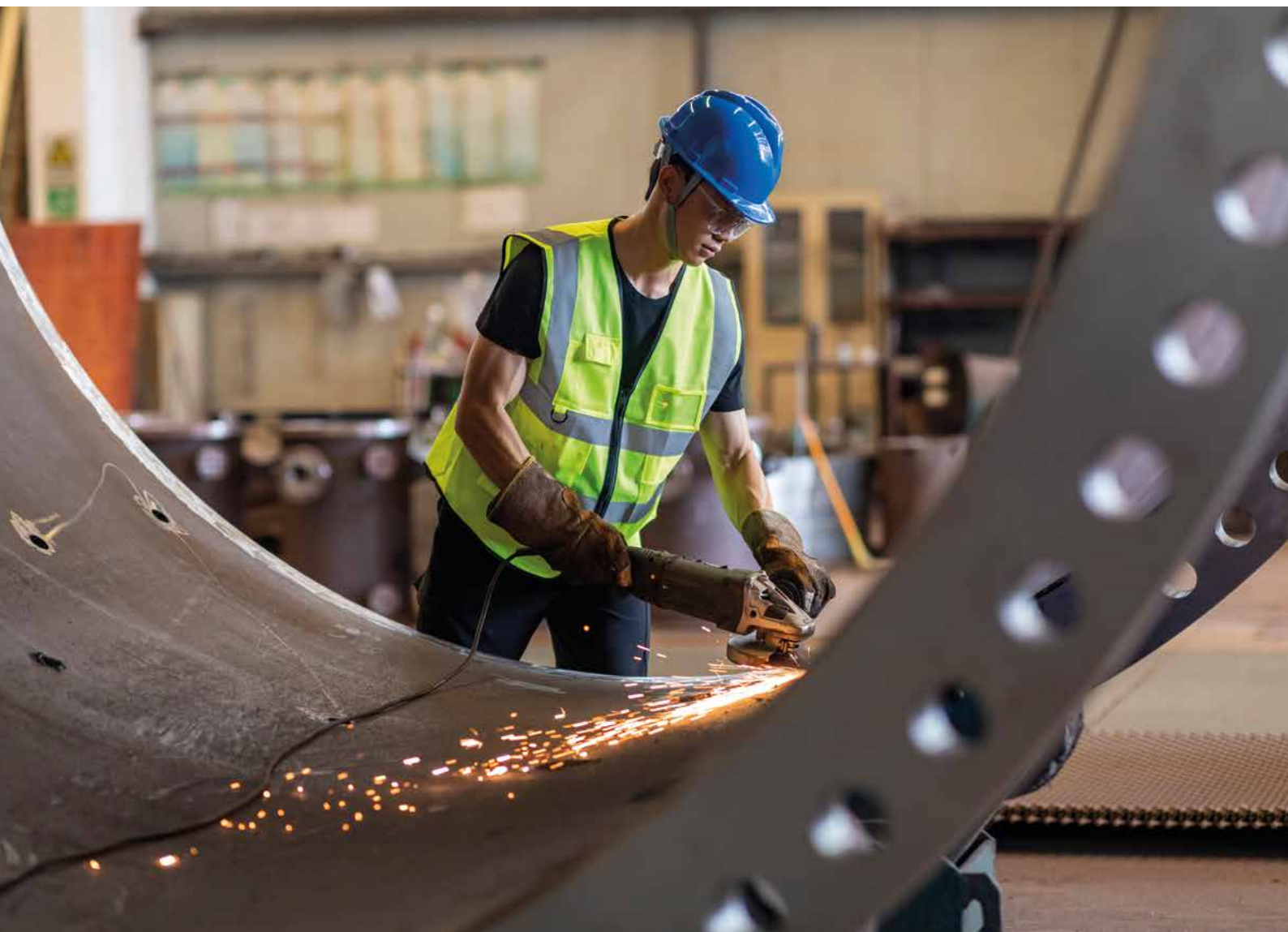


2 Strategic plans, implementation status

Only 29% of the companies surveyed operate with a formulated China strategy – 44% do not have a strategy and have no plans to develop one. In the chemical industry, on the other hand, the implementation of a strategy is above average at 37%. The retail sector is below average here (23%).

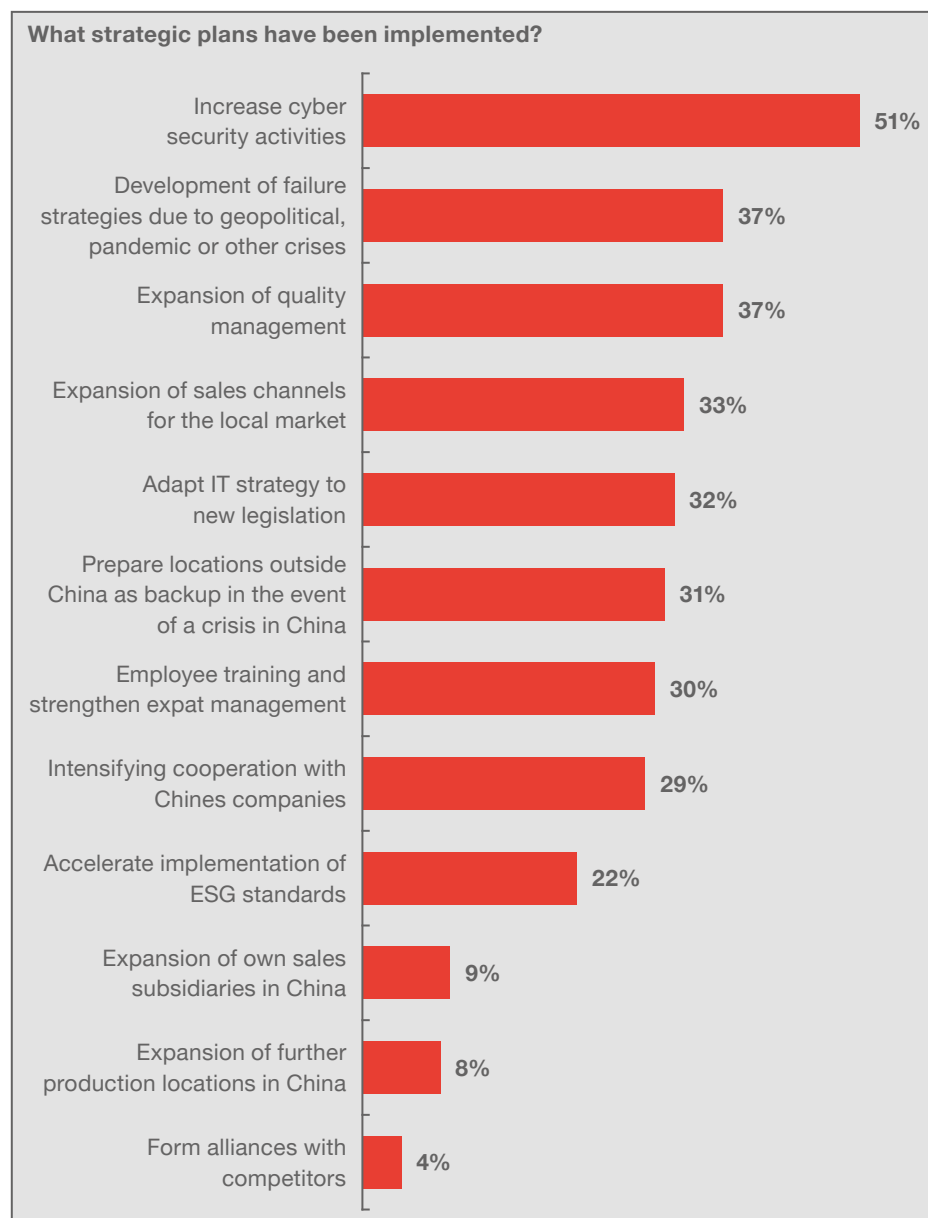
The majority of companies have already increased their cyber security activities.

Fig. 8 China strategy of German companies



Most German companies in China have already increased their cyber security activities in country. Only a third of respondents have prepared contingency strategies for geopolitical crises and replacement locations in other countries, as well as an IT strategy adapted to the current regulations in China. Retail and consumer goods companies want to expand their production sites at an above-average rate (13%). The automotive sector is looking for partners in alliances with competitors with above-average frequency.

Fig. 9 Measures implemented by German companies in business with China



3 Assessments and forecasts

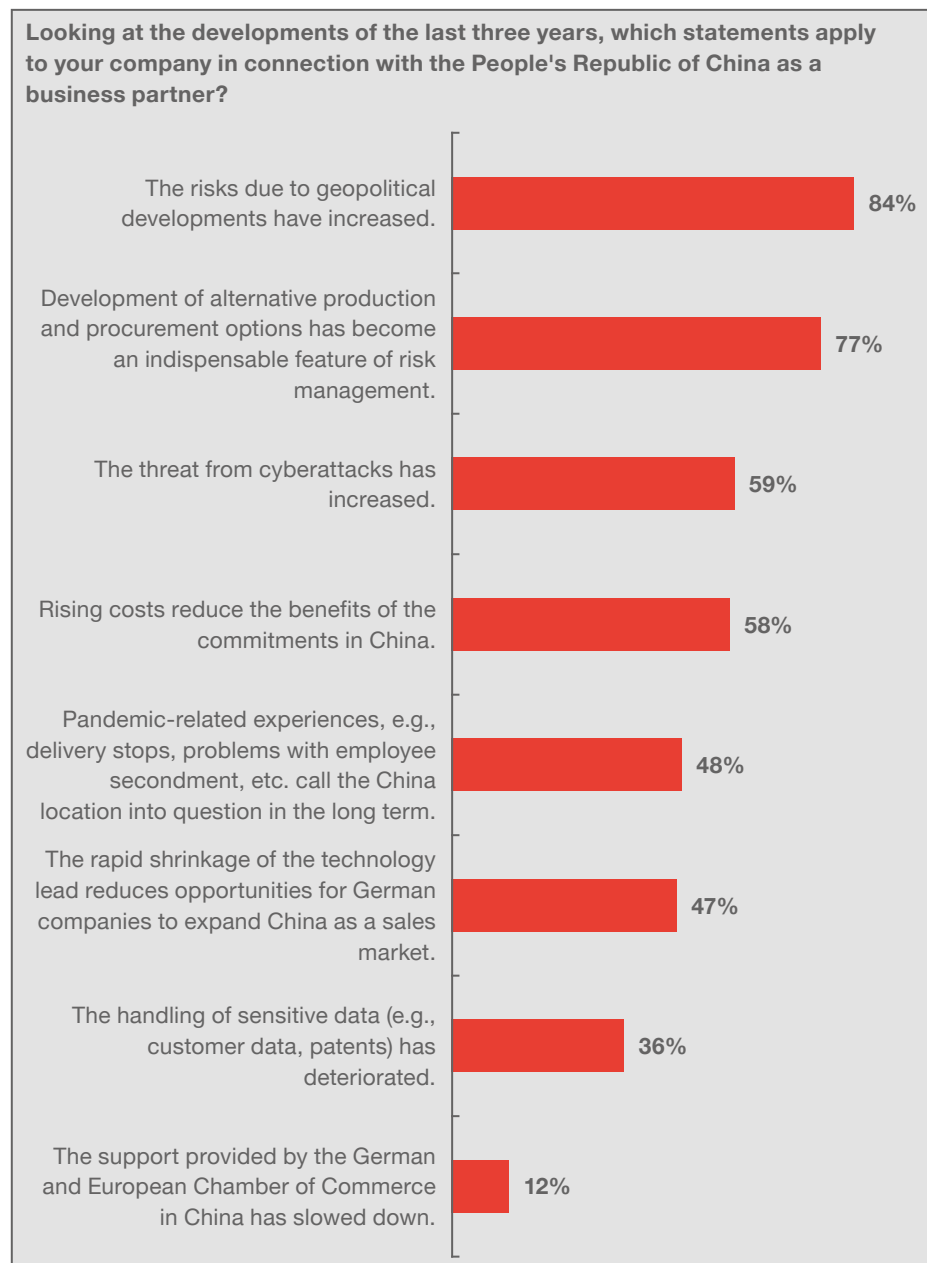
Most respondents see a growing danger of risky geopolitical developments for their own company (84%). Consequently, alternative concepts for production and procurement in the event of a crisis (77%) are also seen as an indispensable part of the company's risk management. Companies in the mechanical and plant engineering sector, in particular, show above average concern in this respect (97%).

Response options to geopolitical crises have become an indispensable part of corporate risk management.

The increasing threat of cyberattacks (59%) and the risk of rising costs (58%) reducing the benefits of engagement are almost part of everyday life for many companies and rank well behind the first two places. The exceptions here are companies in the pharmaceutical industry, which rate the threat of hacker attacks significantly higher at 70%.

Pandemic-related problems (63%) as well as the shrinking, technological lead (70%), but also the deteriorating handling of sensitive data (47%) are criticized more than average by mechanical engineering companies.

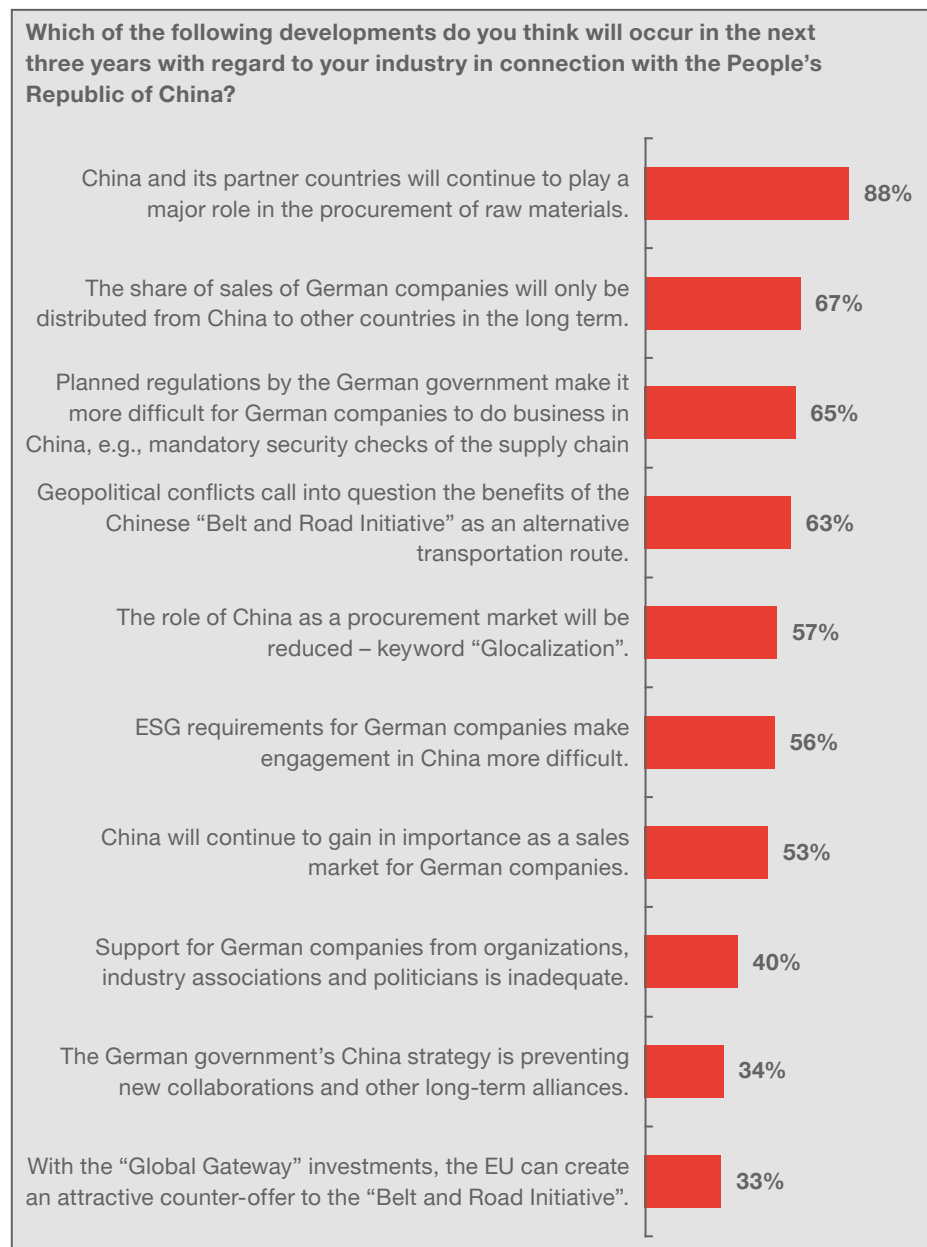
Fig. 10 Assessment of the situation with a review of the last 3 years



China's role as a raw material supplier is rated above average by retailers (97%). Despite the mechanical engineering sector (80%) only forecasting a relocation of sales from China to other countries in the long term, it rates the reduction in procurement activities due to "Glocalization" highest (77%). They believe that the federal government's regulations for companies in the chemical industry are affected more frequently than average (80%).

There is no alternative to China as a supplier of raw materials for production, in procurement and as a sales market (for German companies).

Fig. 11 Challenges for the next three years



4 Logistics and personnel situation

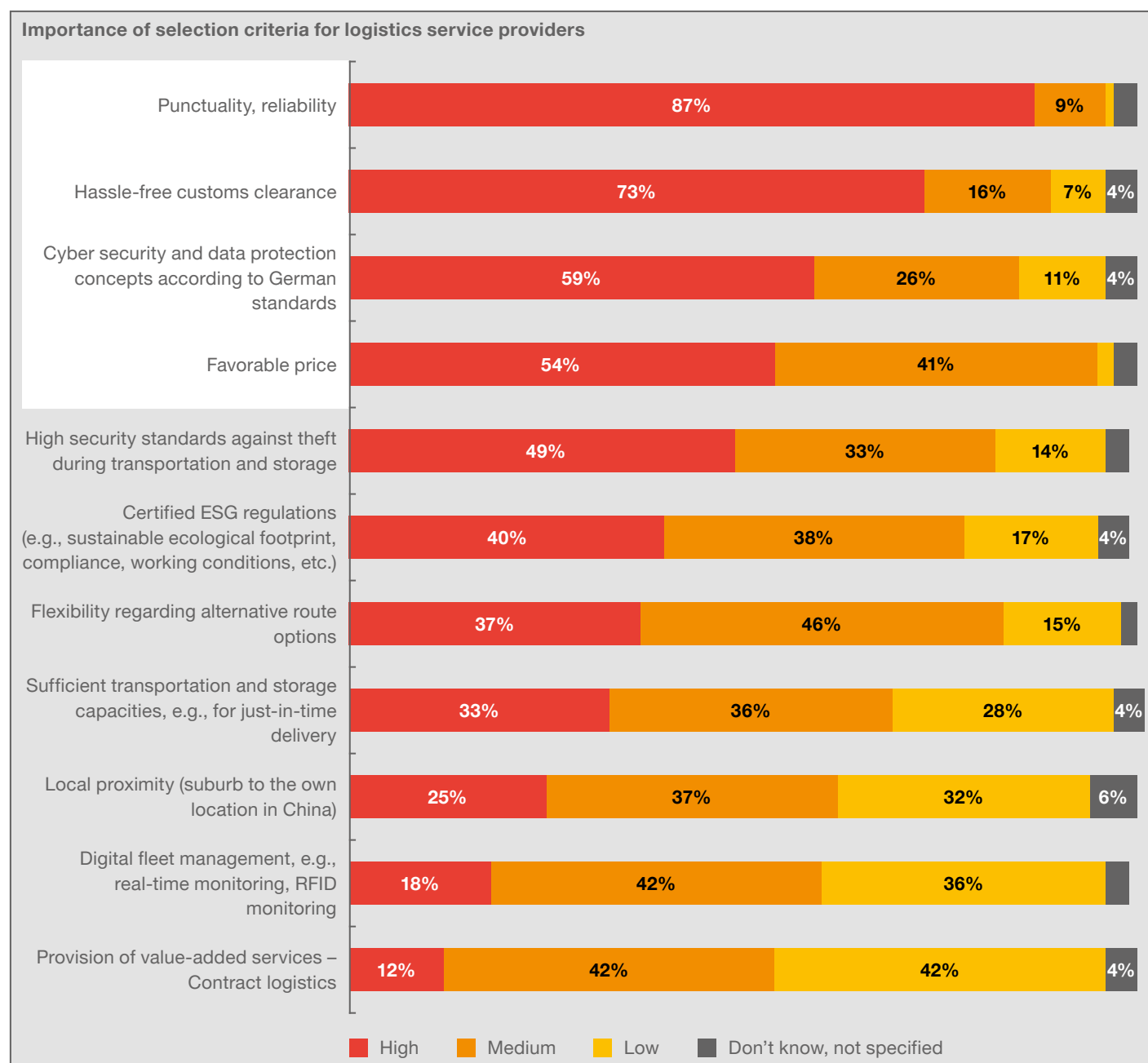
Punctuality and reliability have remained top criteria for awarding contracts to logistics companies for years.

Problem-free customs clearance is also a priority. Poorly positioned service providers can result in high costs for companies, if, for example,

spare parts are not delivered to the customer and production downtimes are imminent. Sufficient transport and storage capacities have lost importance as an awarding criterion, as have digital fleet management and the local proximity of the service provider. The lowest price has remained as important as ever.

Punctuality, reliability and customs clearance are the top criteria when choosing logistics service providers.

Fig. 12 Selection criteria for logistics service providers



The mechanical engineering sector, in particular, experiences above-average personnel problems in China (37%) – 47% have problems motivating employees to go to China, 27% lack the necessary qualifications and for 37%, poaching is a limiting factor. Only less than a third of the industry has no problem with personnel development. In the other sectors, almost two-thirds do not report any deficits – despite the much-discussed shortage of skilled workers.

The majority of German companies in China have no problem with recruiting, headhunting and qualifying staff.



Fig. 13 Statements on personnel development

	We have problems finding staff that we can send to China.	Applicants on the Chinese labor market often lack necessary qualifications.	For the Chinese employees on site, enticement is a problem.	We have problems finding employees in China.	None of these applies.
2023	25%	18%	18%	17%	61%
Machinery and plant engineering	47%	27%	37%	37%	30%
Automotive industry	30%	17%	10%	7%	63%
Trade	17%	13%	7%	7%	77%
Consumer goods industry	17%	17%	23%	23%	63%
Pharmaceuticals	17%	20%	17%	20%	67%
Chemicals	23%	17%	17%	7%	67%



C Recommendations for action and outlook

China Business Group

Chinese economy fails to recover, problems are increasing

Hopes were high that the Chinese economy would recover quickly after the end of the zero-Covid policy. So far, however, the figures indicate that these expectations have been disappointing.

China's economic growth is lower than hoped, imports and exports are declining. The country is currently struggling with many problems: the population is getting older; consumption is declining, and over-indebtedness is growing. At the same time, trouble is looming from the ailing real estate and banking sector. Finally, geopolitical upheavals and the Taiwan issue are creating a high degree of uncertainty.

German companies pursue a pragmatic China policy

Nevertheless, the German economy is maintaining its commitment to China. Fears that this would lead to a complete decoupling have proven to be unfounded. Germany could not afford such a strategy, as it would jeopardize Germany as business location and further accelerate deindustrialization.

This is also the conclusion of the study: it shows that the German economy is taking a pragmatic and realistic approach to post-Covid China. German companies remain committed to China as a business location; a withdrawal on a large scale is not planned. Only a few companies are considering partial withdrawals or relocations to mitigate geopolitical risks. At least in the medium term, China's importance for the German economy remains high: more than half of those surveyed even see China's importance as a sales market increasing. In short: China is and will remain an important part of today's global economy in the long term – as an export market, procurement and production market and as a supplier of raw materials.

The time of adjustment has begun – on both sides

However, it is also clear that a time of adjustment has begun – both for the German economy and for China. In any case, the gold-rush mood for the German economy in China is a thing of the past. China must also get used to moderate growth figures.

German economy is now faced with the task of adapting to the new situation in China to make their companies fit for the future. This also includes rethinking the topic of risk management and finding alternative procurement and sales markets or production locations to tap.

There is reason to be optimistic that this balancing act will succeed. Even before the pandemic, German companies had to overcome numerous hurdles in China. German companies have been active in China for more than 100 years. Their wealth of experience and **expertise in China** is correspondingly large. Coupled with the positive mood surrounding their own **involvement in China** and a reflective self-assessment of their strengths and weaknesses, the chances are good that German companies will continue to take advantage of the Chinese market in the future.

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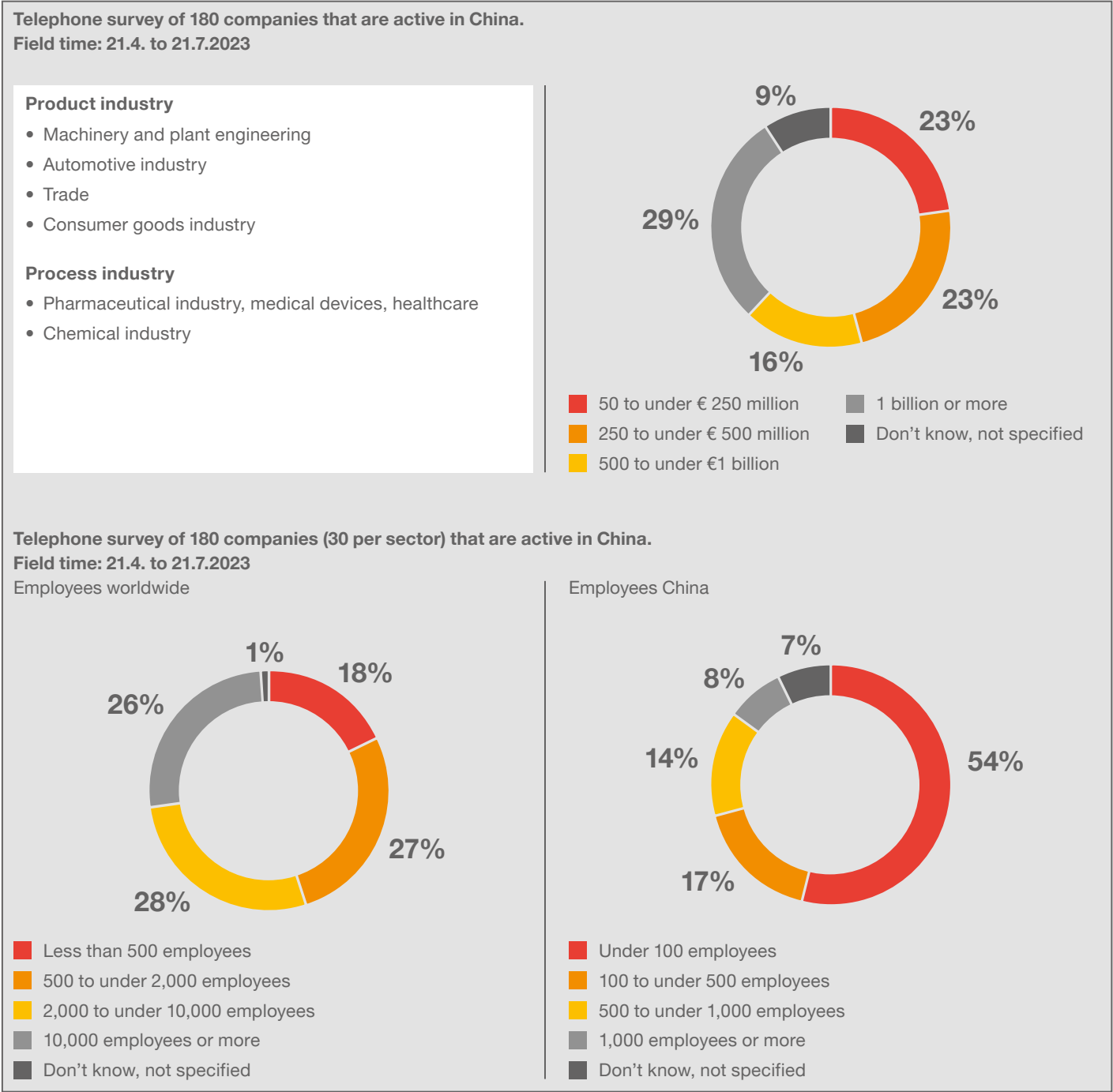
The boom years are over, for both sides: China must get used to moderate growth figures and for Germany, China is no longer the Eldorado it once was. The country is developing into a normal foreign market for the German economy. This adjustment process has already begun – now German companies must take action to remain economically successful.

Thomas Heck, Head of the PwC China Business Group Germany/Europe

Appendix

Methodology

Fig. 14 German companies in China



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