Doing business in China: A McKinsey Survey of executives in Asia

Jean-François Martin

Less than two-thirds of executives in Asia who responded to a recent McKinsey survey say their company currently has operations in China or trades with the country, but the vast majority say they'll be doing business there within five years.

Executives identify several potential threats to China's continued economic growth; many say that even if China does not address those threats sufficiently there will be little effect on their companies' revenue.

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Surprisingly few companies have any operations in China today, but the vast majority expect to be doing business with the country within five years.

China is an increasingly important player in the world economy. However, nearly 40 percent of executives in Asia say their companies do no business in China today, according to a McKinsey survey, and a third say that even if the country's growth rate fell to zero their company's revenue would not be affected.

Executives also see significant threats to China's continued growth; these include a shortage of talent and weak enforcement of commercial laws and regulations. But many respondents say that the country can address its challenges sufficiently.[1]

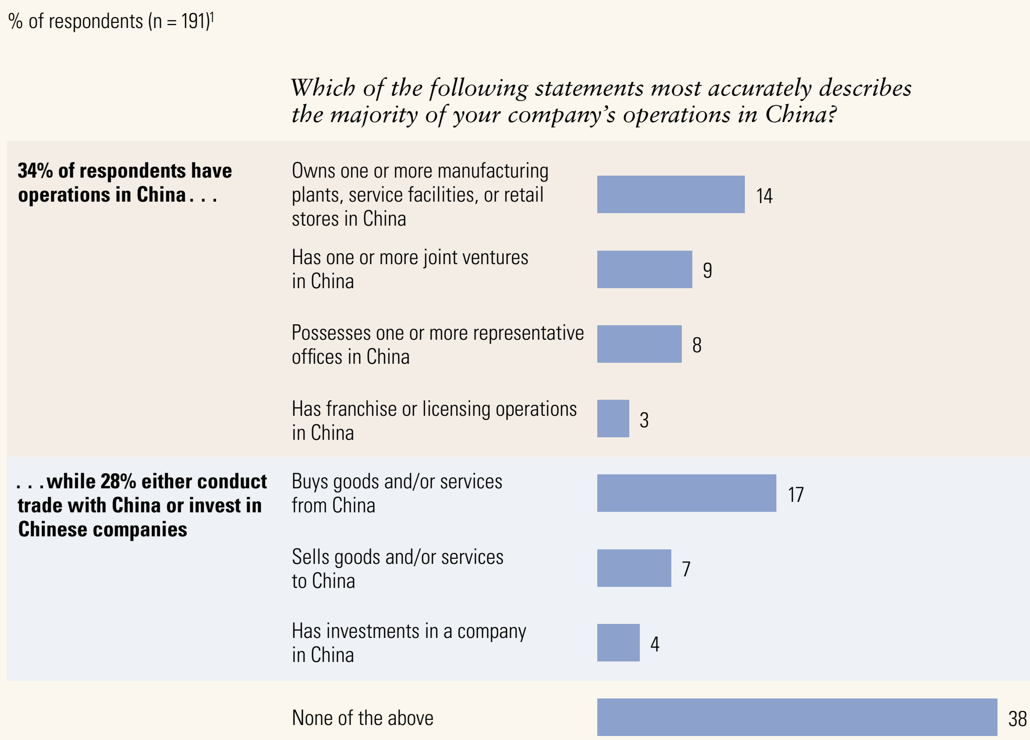
[1] *The McKinsey Quarterly* conducted the online survey in January 2007 and received 253 responses from C-level executives in Asia.

The China market

Just over a third of the survey's respondents report that their companies have operations in China, and almost 30 percent trade with the country (Exhibit 1). Just over half say their companies earn some revenue from China. Two-thirds of larger companies—those with annual revenues of $1 billion or more—currently operate in China, and 81 percent generate revenues from the country. Perhaps most interesting, at a time when many companies are assessing whether they have concentrated too much of their operations in China, only 14 percent of all survey respondents say their companies own one or more manufacturing plants, service facilities, or retail stores there. Even among companies in the production sectors (as opposed to service firms), the figure is only 21 percent.

Exhibit 1

Doing business in China



[1]Includes respondents whose office locations are in Asia but not in China.

Source: January 2007 *McKinsey Quarterly* survey of executives in Asia

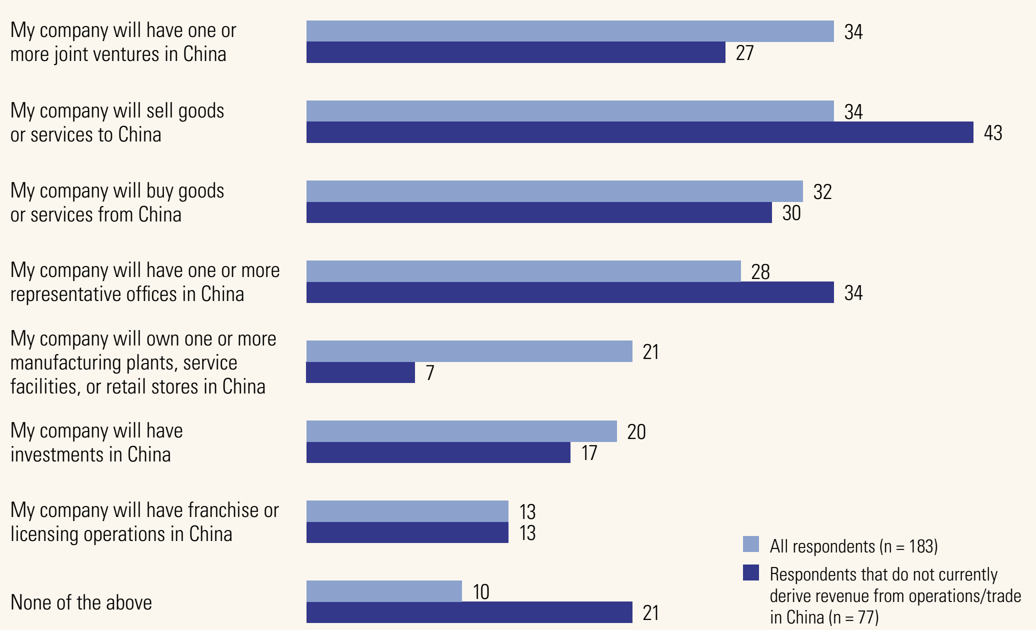
That relatively low presence won't last long, executives say. Overall, 90 percent of respondents expect their companies to be doing business of some kind in China within five years. Executives' views on where their companies can grow in China focus on its huge market: only 7 percent say their companies currently sell goods or services there, yet 34 percent of all respondents—and 43 percent of those whose companies currently earn no revenue from China—expect to be selling there within five years (Exhibit 2). Indeed, executives may think a presence in China is all but inevitable: 83 percent of respondents who say it's unlikely that China can sufficiently address the threats to its growth still expect their companies to have some operations there within five years.

Exhibit 2

More business ahead

% of respondents (n = 183)[1]

Thinking of your company 5 years from now, which of these statements do you think will most accurately describe the majority of your operations in China?



[1] Includes respondents whose office locations are in Asia but not in China; excludes respondents who answered "don't know"; respondents could select more than one answer.

Source: January 2007 *McKinsey Quarterly* survey of executives in Asia

China as competitor

Companies based in China are seen as strong, but not overwhelming, competitors; a significant majority of respondents see the basis for that competition as the low cost base that Chinese companies enjoy (Exhibit 3). Their low production costs may help explain why 27 percent of respondents in production industries rate Chinese competitors as either overwhelmingly stronger or stronger than most, compared with only 11 percent of respondents in service industries. (Indeed, 27 percent of those in service industries say their China-based competitors are weaker than most—yet even they were far likelier to say the basis of competition is low costs rather than any other factor.)

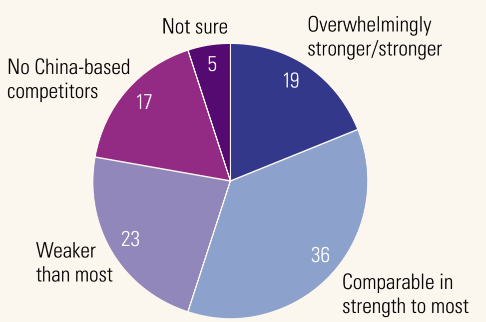
Interestingly, 36 percent of executives in China rate China-based competitors as weaker than most, far more than respondents in any other country. Thirteen percent of respondents in China also say that, should the country's growth rate fall to zero, their company's revenues would be unaffected.

Exhibit 3

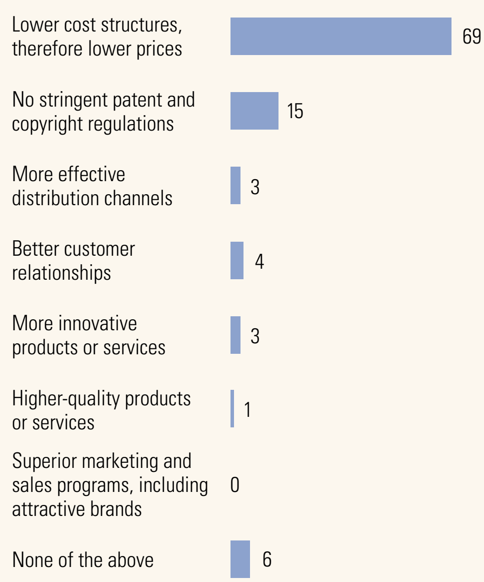
Strong Chinese competitors

% of respondents (n = 253)

Considering all the markets in which your company operates, how strong are your China-based competitors compared with competitors from other countries?



Which of these statements best describes the basis of the competition you face from companies based in China compared with competitors based in other countries?[1]



[1] Excludes companies that do not have China-based competitors; n = 197; figures do not sum to 100%, because of rounding.

Source: January 2007 *McKinsey Quarterly* survey of executives in Asia

Threats to growth

Executives see a variety of social, economic, and environmental threats to China's continued growth and development (Exhibit 4). They indicate that economic and social issues are far more important than environmental ones. For instance, though 63 percent of respondents cite pollution as a threat to growth, when asked to weigh it against economic and social issues, 80 percent choose a threat other than pollution as the most significant.

Across all issues, pollution is the only health or environmental issue among the top five. The others are rising income inequality, poor enforcement of commercial laws and regulations, a shortage of qualified talent, and weak financial institutions.

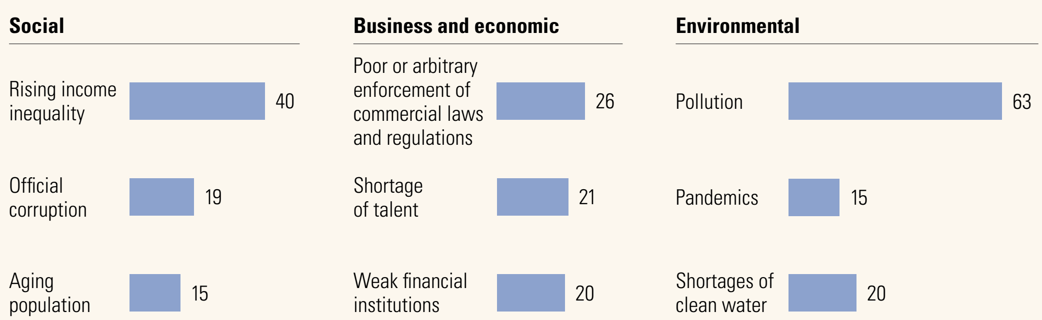
Some issues that are significant concerns in other regions—such as the renminbi's exchange rate against the US dollar and rising energy prices—are, surprisingly, of very little concern to the executives in Asia who responded to this survey.

Exhibit 4

Potential threats

Top three threats, % of respondents (n = 253)

Which of the following issues poses the greatest threat to China's continued growth and development?



Source: January 2007 *McKinsey Quarterly* survey of executives in Asia

Assessing and addressing the threats

When respondents are asked to consider how quickly China should respond to the threats to its continued growth, more than 80 percent say China must address those threats within five years. The majority (60 percent) say China is likely to be able to do so, although only 12 percent see it as "very likely" (Exhibit 5). Respondents in China are the least likely to be optimistic; less than half say the country is very or somewhat likely to be able to address the problems sufficiently. Executives whose companies are currently generating revenue in China but whose offices are located elsewhere are somewhat more optimistic: 69 percent see it as very or somewhat likely that China will sufficiently address the threats it faces.

Exhibit 5

Addressing the threats

% of respondents

Over the next 5 years, how likely is it that China will be able to address sufficiently the economic, social, and environmental threats it faces?

	Total[1] (n = 253)	**China** (n = 62)	**India** (n = 97)	**Rest of Asia**[2] (n = 94)
Very/somewhat likely	60	47	69	56
Somewhat/very unlikely	24	27	18	29
Neither	12	23	9	7
Not sure	5	3	4	7

[1]Figures do not sum to 100%, because of rounding.
[2]Includes Japan and South Korea; figures do not sum to 100%, because of rounding.

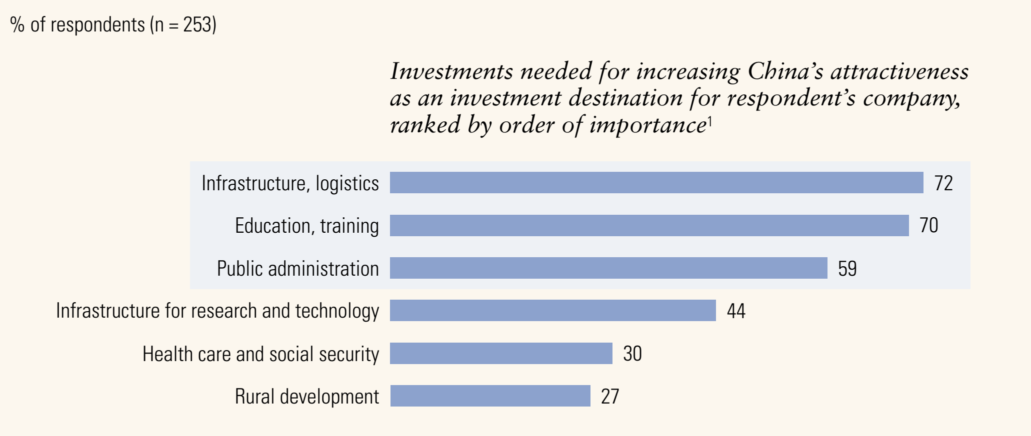
Source: January 2007 *McKinsey Quarterly* survey of executives in Asia

What will happen to these companies if China fails to address these threats and growth slows or stops? Surprisingly little, given executives' view that China is quite influential economically. Just over half of all respondents say they would see no effect on the revenue of their companies if the growth rate of China's GDP fell by half during the next five years; 47 percent of those currently generating revenue in the country say the same. Even if growth stopped entirely, a third of all respondents say their companies' revenue would be unaffected, as do a quarter of executives whose companies are currently generating revenue in China.

When asked where China should invest to make itself a more attractive destination for corporations, executives do not focus their priorities solely on the biggest threats to the country's growth. Investments in infrastructure and logistics top executives' wish lists, regardless of sector or company size; 72 percent of executives make this category their first, second, or third priority (Exhibit 6). Education is close behind. Despite the deep concern about income inequality, investments in health care, social security, and rural development are the lowest priorities, even among respondents in China.

Exhibit 6

Attracting more investment



[1] Respondents ranked investments as first, second, or third priority.

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This survey is a joint effort by the McKinsey Global Institute and the Lee Kuan Yew School of Public Policy at the National University of Singapore. Contributors to the development and analysis of the survey include Janamitra Devan, an associate principal in McKinsey's Shanghai office, Earl Carr and Isabel Ho, consultants based in Shanghai, and Stavros Yiannouka and Joval A. Pantangco, of the Lee Kuan Yew School of Public Policy.

Source: January 2007 *McKinsey Quarterly* survey of executives in Asia