INSIGHT.

The Journal of the American Chamber of Commerce in Shanghai - Insight November/December 2021

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(86 21) 6169-3000
Story ideas, questions or comments on Insight: Please contact Kate Magill
kate.magill@amcham-shanghai.org

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27F Infinitus Tower
168 Hubin Road
Shanghai, 200021 China
tel: (86 21) 6169-3000
www.amcham-shanghai.org

FEATURES

TECHNOLOGY

POLICY PERSPECTIVES

MEMBER NEWS

PRESIDENT'S LETTER

KER GIBBS

President of The American Chamber of Commerce in Shanghai

The annual China Business Report is one of the most important things we do at AmCham Shanghai. We refer to the data constantly throughout the year, as people from Washington DC to Beijing are interested in knowing what our members are doing in the China market.

Members will want to read the summary available in this edition of *Insight*, or they can view the full report on our website. I would like to highlight a few things that surprised us in the report or that bear special mention.

As we designed the survey questions we were particularly interested in the relationship between managers in China and their global headquarters, including how well the challenges and opportunities of the China market are understood by colleagues at the home office. To our surprise, only 21.9% said they were not confident that headquarters understands the challenges of operating here. Regarding business opportunities, only 17.5% complained that headquarters does not fully appreciate the China market. We added these questions because travel restrictions have almost completely eliminated visits from headquarters to China offices. While some managers are relieved to be free of the chore of entertaining visitors, one might think this would reduce the flow of information. Apparently that's not the case for the majority of our members.

We also asked members if their global boards are looking to "rebalance" away from China. Just over three-quarters who chose to answer the question said that yes, they are looking to rebalance. When asked why, they reported US-China relations as the number one issue, followed by domestic competition. Keep in mind that rebalancing is not the same as moving production or abandoning the market. Rebalancing can reflect concern about becoming overly dependent on a single source of revenue or a question of asset allocation.

We also wanted to know how concerned members are about the threat of consumer boycotts. Only 6.5% said it's an issue at their headquarters. On the one hand, nobody thinks they have a problem like this until it's on their doorstep. Facing a boycott is often a surprise to executives since if they had seen it coming, they likely would have done something to head it off. Also, many of our members are industrial or sell business-to-business, so they are less exposed to consumer sentiments. Our members in technology and retail were most concerned, with 30% of retailers saying consumer boycotts are a top concern at their headquarters. In fact, 13% of retailers said they have reduced planned investments because of Chinese consumer boycotts.

Two survey questions were added specifically to support our advocacy discussions in Washington, DC. Production in China has been a topic of much interest in Washington, especially in the context of Covid-related supply chain disruptions, decoupling and tariffs. Our survey puts this question to rest—72% of our members with manufacturing in China say they have no plans to move any production out of China within the next three years. There are some companies making production adjustments, especially around non-consumer electronics, where some production will leave China. However, of those who are making adjustments, none of them will re-shore to the US.

The topic that may be of most interest to people in Washington is the impact of China operations on employment in the US. For years we have tried to counter the outdated and incorrect perception that US companies in China are outsourcing American jobs. The Biden administration has been clear that they will look at the China trade relationship through the lens of what is best for American workers. Here at AmCham, we have always believed that our business success in China brings benefits to the US and adds jobs to the US economy. Our survey confirms this. Nearly 30% of respondents said China operations add to US employment.

Lastly, the China Business Report addresses the question of foreigners leaving China. Over 70% of our members said they are having trouble attracting and retaining foreign talent. The Covid-related travel restrictions are of course a major factor, but there are many other reasons why so many of our friends and colleagues are leaving China.

Sadly, I will be joining this group myself next month. We are in the last weeks of my tenure as president of the American Chamber and to some degree my time in China. I look forward to rejoining my family in the US, who never expected me to be gone so long when I accepted a two-year expat assignment in 2002. The years have flown by. With a heavy heart, I'm saying goodbye to the Chamber and to Shanghai, but I know for sure that I will be back. Let's keep in touch on WeChat, and hope that changes to the travel restrictions will make the return to China easier for all of us in the very near future. I

2021
CHINA BUSINESS REPORT

THE AMERICAN CHAMBER OF COMMERCE IN SHANGHAI

Highlights of The Amcham Shanghai Annual China Business Survey

This year's China business survey was conducted between June 15 and July 15, 2021, and 338 companies responded. Among the many metrics we measured were company performance, investment, domestic competition, mobility, and offshoring of production. As always, we also gauged members' sentiment toward the regulatory environment.

Despite the shadow of Covid-19 on the economy in 2020 and its continuing negative impact on domestic consumption in 2021, the majority of our members not only did well last year but were optimistic about their 2021 performance and the years ahead.

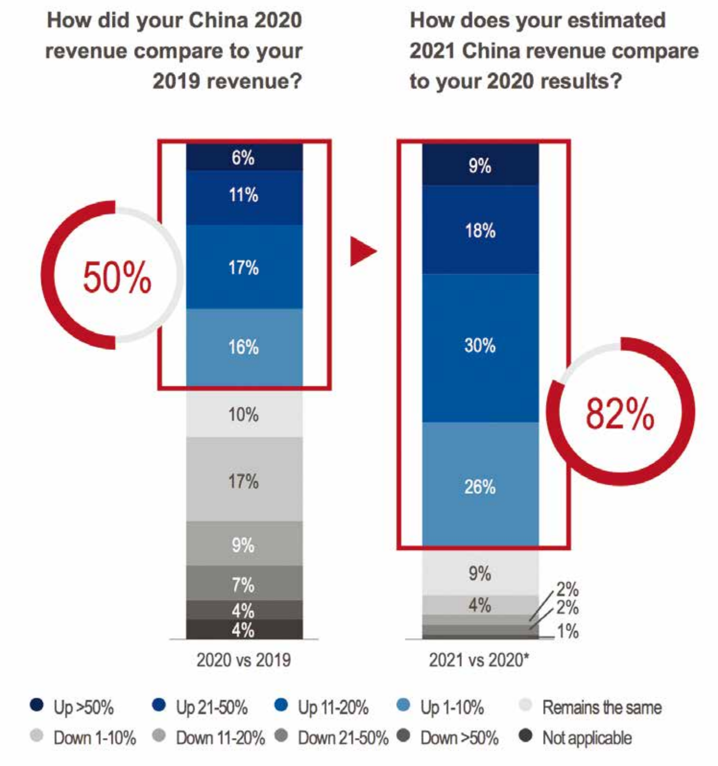
2020 Profits

Contrary to early 2020 expectations when Covid briefly closed a large part of China's economy, 77.1% of members reported profits last year, in line with the past several years. China's swift recovery from Covid was helped by the government's supply-side stimulus. The speed with which our manufacturing members reopened their factories clearly contributed to the 84.7% that reported profits. Less fortunate were retailers, with only 70% profitable in 2020, against 85.4% in 2019. In services, 68% members were profitable, versus 65.4% in 2019.

2021 Revenues set to rebound

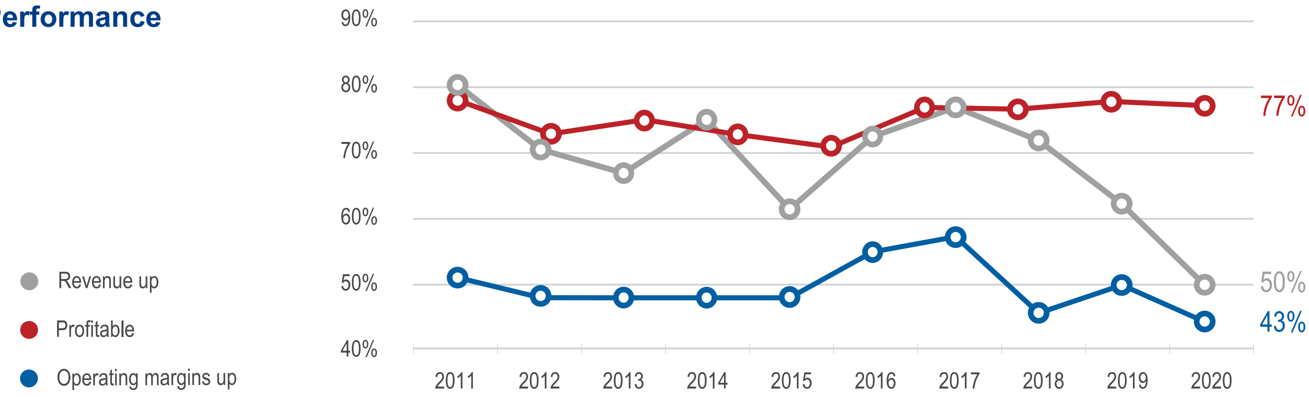
Exactly 82.2% of companies projected they will earn higher revenues in 2021 than in 2020, a return to growth levels last seen before the US-China trade war. The most confident industries expecting revenue growth included pharmaceuticals, medical devices and life sciences (91.3%), automotive (91.3%), non-consumer electronics (90%) and industrial manufacturers (88.6%).

Many more companies expect China-based revenues to grow in 2021



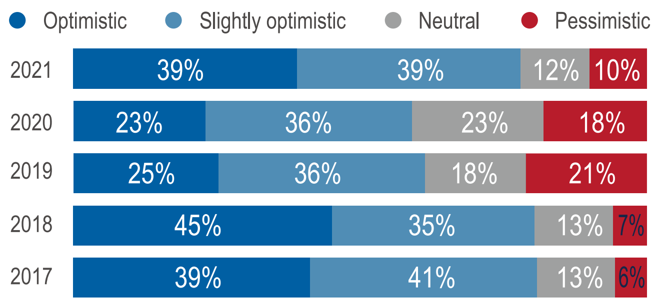
** 2021 data does not include a 'Not applicable' option.*

Performance



Five-year business outlook

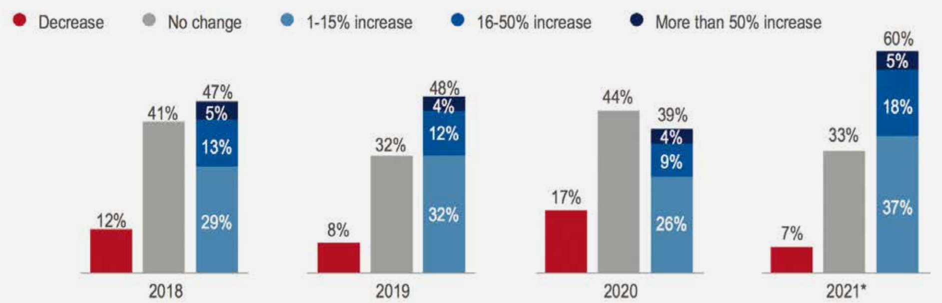
This year, 77.9% of businesses were either optimistic or slightly optimistic, akin to the 80% figure observed from 2015-2018. Only 9.8% of companies were pessimistic, versus 18.5% in 2020 and 21.1% in 2019, the iciest point of the US-China trade war. The retail sector was cheery, with 85% of companies optimistic or slightly optimistic, versus 79.4% in manufacturing and 73.4% in services.



Investment in 2021

After two years of lower investment during the trade war and the pandemic, confidence in the China market rebounded this year. The majority of companies (59.5%) reported an expected increase in investment for 2021 compared to 2020, up 30.9 percentage points from last year, and near 2018's pre-trade war level of 62%.

Investment change in China



* Projected investment change

Why some companies are not investing

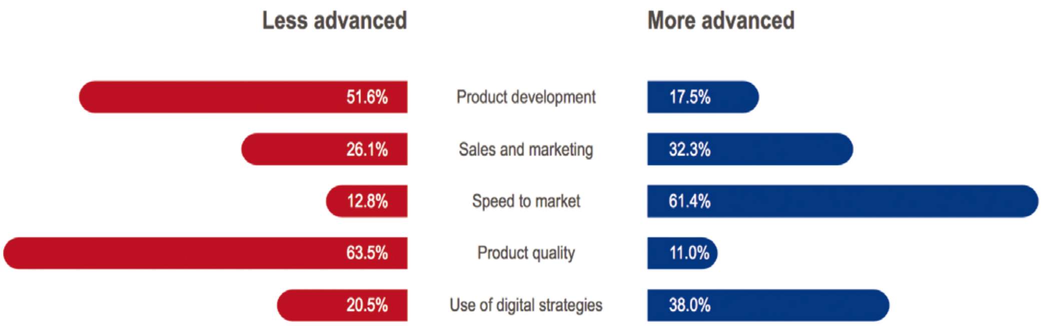
Of those respondents that planned to lower their China investments in 2021, 47.1% cited uncertainty about US-China trade policy, followed by the impact of the coronavirus (33.7%). Among companies that said they are decreasing investment, 66.7% of industrial manufacturers and all technology hardware, software and services cited uncertainty over US-China trade relations as one reason to decrease investment, unsurprising given their focus on goods and technologies that have been subject to US trade restrictions.

Top 4 reasons why 2021 China investment plans are lower than in 2020

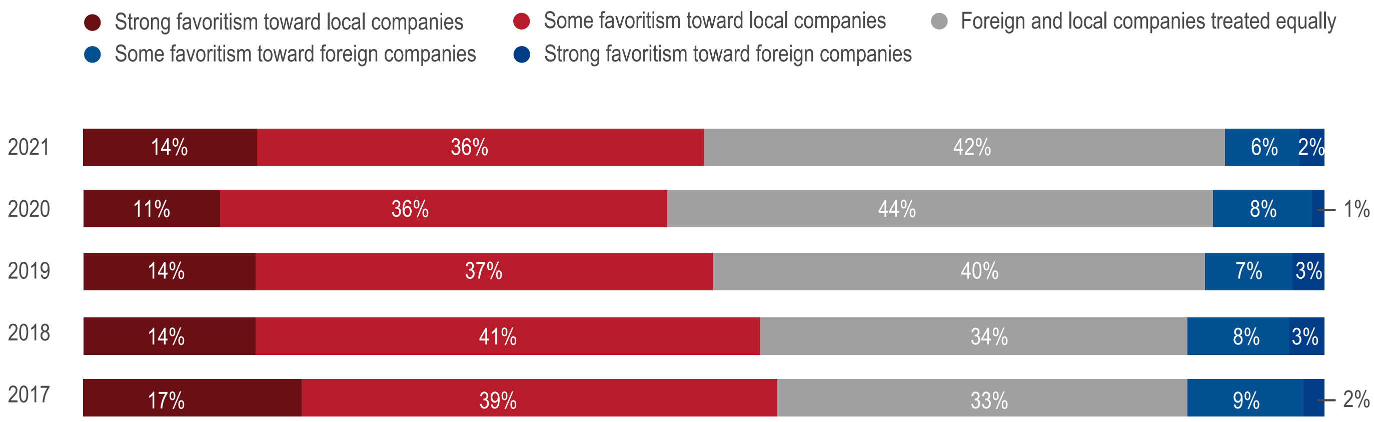
How are your products and services in China impacted by China's IP enforcement regime?

In high technology industries such as chemicals (31.6%), non-consumer electronics (30%) and technology hardware, software and services (30%) almost a third of companies limited their research and development activities because of China's IP enforcement regime.

How do you rate your Chinese competitors in these business areas?



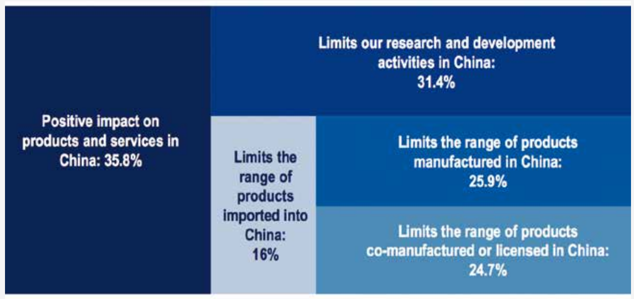
Chinese government policy toward your industry



Government policies still favor local firms

The percentage of respondents that believed China's government treated foreign and local companies equally slipped this year to 41.7%, against 43.9% last year. The number of companies that believed government policy strongly favored local companies was 14.2%, a level last seen in 2018 and 2019. Bias toward local companies was felt most in the services sector (57%), followed by manufacturing at 46.5%, 8.2 percentage points more than last year.

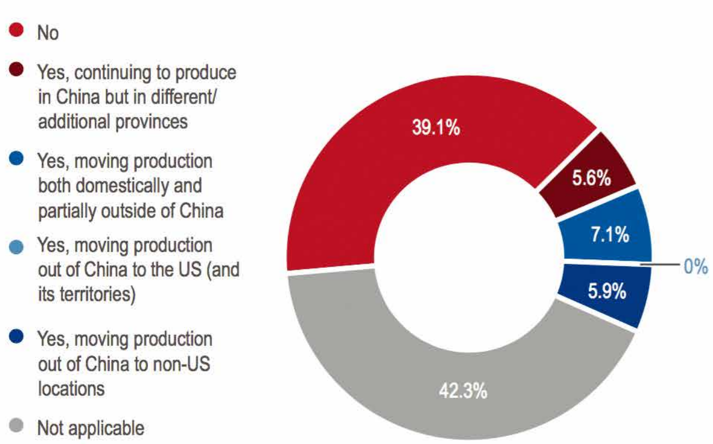
How are your products and services in China impacted by China's IP enforcement regime?



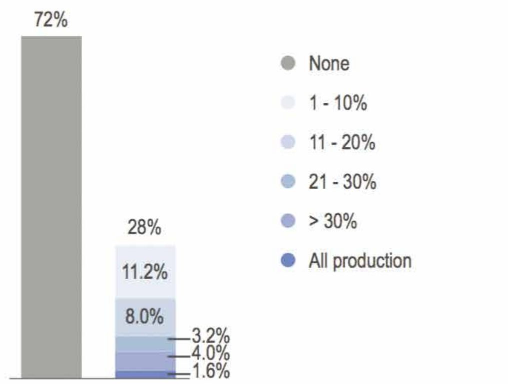
Do you plan to move some or all of your production to other regions of China or outside China?

In a blow to those calling for American companies to reshore, no businesses were relocating their production from China to the US. Of companies that reported having production facilities in China, 10.3% were moving some or all of production from China to non-US locations. Two thirds of companies (67.7%) will keep their production where it is today. Among the 110 companies with an "in China, for China" strategy that responded to the question, 9.1% will relocate some production to other regions in China.

Do you plan to move some or all of your production to other regions of China or outside China?



If your company manufactures in China, what percentage of production will you move out of China over the next three years?

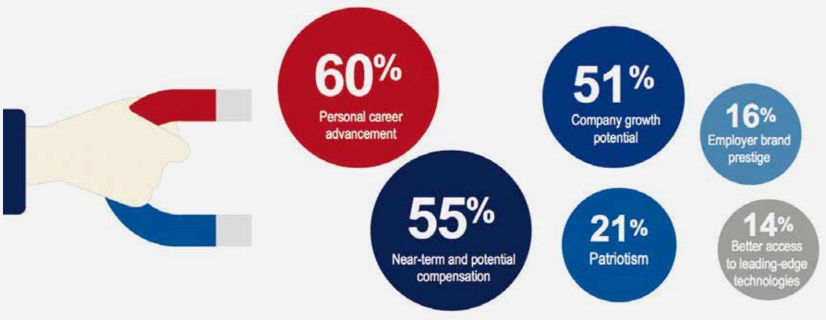


** Among 125 companies*

Talent & Mobility

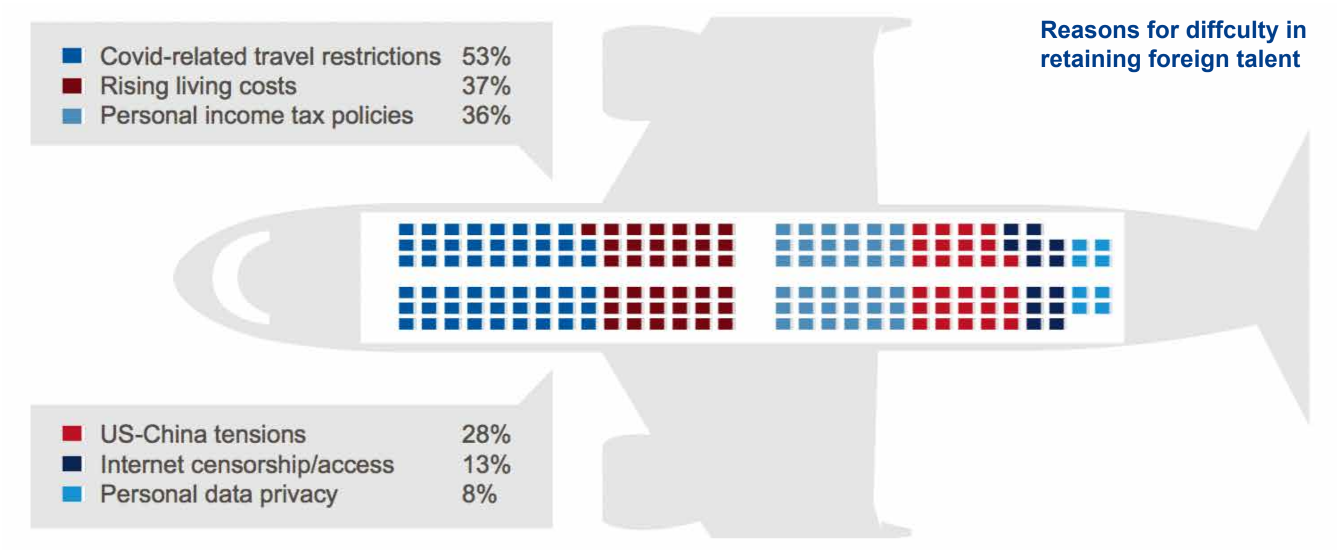
Losing out to local firms

A belief that Chinese companies offer better compensation and career advancement has made it more difficult to retain local staff. Some 54.9% of respondents said that near-term and potential compensation at local firms was luring away Chinese talent, while 59.6% agreed that Chinese workers were opting for local firms to seek better "personal career advancement."



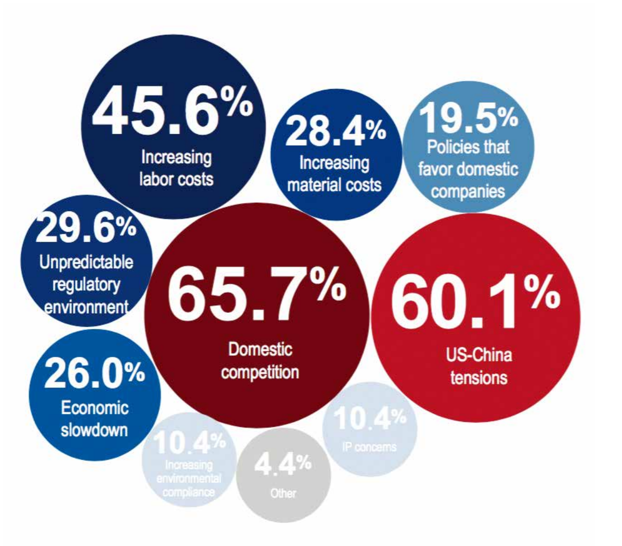
An empty boarding gate

Only 29.3% of respondents had no problem attracting and retaining foreign talent. More than half of companies (53.4%) said Covid-related travel restrictions hurt this ability, as tight border controls hindered many foreigners from easily entering China or bringing their families. More than a third (36.5%) of respondents said that hiring foreign staff was impeded by rising living costs in China. A similar percentage (35.6%) cited personal income tax policies, which include the expected cancellation of non-taxable allowances for foreign employees.



Over the next 3-5 years, what do you expect to be the top three challenges facing your company in China?

More than two-thirds (65.7%) of our members cited domestic competition as a top challenge, followed by US-China tensions at 60.1% and increasing labor costs at 45.6%. Amid continued distrust between the US and China over the threat of technology decoupling, almost all non-consumer electronics (90%) and many technology, hardware, software and services companies (85%) listed US-China tensions as a top concern.



Q&A

AN ECONOMY IN TRANSITION

China economy expert Michael Pettis on how the country can push its economy into a new phase

Interview by Ian Driscoll

Michael Pettis is a professor of finance at Peking University's Guanghua School of Management, where he specializes in Chinese financial markets, and a nonresident senior fellow in the Carnegie–Tsinghua Center for Global Policy. He has also taught at Tsinghua University's School of Economics and Management and at Columbia University's Graduate School of Business. He is the author of several books, including *The Great Rebalancing: Trade, Conflict, and the Perilous Road Ahead for the World Economy* (Princeton University Press, 2013).

Do you see Evergrande as a parable for the economic transition that China wants to make, or can't make or has not yet made?

There are two problems with Evergrande. One is specific to Evergrande or any other company that finds itself in this problem, which in finance theory is referred to as indirect financial distress costs. Significant changes occur in the behavior of the various stakeholders and we're seeing that in Evergrande: employees are worried about their job prospects; they're worried about their savings – they were the big buyers of the wealth management products. Suppliers are demanding to get paid upfront; they no longer treat Evergrande as a valuable client. Homebuyers are reluctant to buy homes from Evergrande unless they are at incredible discounts. The net effect is to make revenues much lower than expected, expenses higher than expected and balance sheets more fragile than expected.

That's how, typically, companies go bankrupt. Once you've reached this point there's no way you can save yourself with internal resources. Unless a credible external agent steps up, it's game over.

The other problem with Evergrande is a more general one, and that is that without the kind of moral hazard that allows companies like Evergrande to keep growing, it would be impossible for Beijing to make its GDP growth targets.

What does the moral hazard issue imply for elsewhere in the Chinese economy?

If you want to eliminate moral hazard, then you have to let companies like Evergrande go under and let the creditors take their losses. That is the only way you enforce lending discipline on the market. This is where Evergrande becomes symptomatic of a bigger problem for China, with so much growth in the past decade or more requiring investment in nonproductive property and nonproductive infrastructure.

You can't have that activity without moral hazard; you need moral hazard, otherwise banks simply won't lend to local governments and to property developers. Those are the engines of Chinese economic growth, and without them China's growth rates drop sharply because consumption isn't replacing it nearly fast enough. Beijing wants to get rid of moral hazard but if they do there's no way that they can maintain high growth rates. My suspicion is that we will see some sort of bailout because Beijing is not willing yet to tolerate the lower growth rates.

If Chinese policymakers want to drive the economy further towards a consumption-based model, then don't they have to let some of these companies perish?

There is a Keynesian problem which we saw in the United States, for example, in the 1930s. If these companies do go under then they fire workers and if the workers are fired then their consumption goes down, and if consumption goes down then more companies get into trouble and you have to allow them to go under. So, you get a downward spiral. That's what they want to avoid.

Common prosperity is an attempt to solve the problem at the heart of dual circulation. Dual circulation talks about both strengthening exports and domestic demand, and domestic demand really being driven by consumption. But the contradiction is that Chinese export prowess, like that of Germany, Japan and all the surplus countries, depends on wages being low relative to productivity.

In all of these countries, the household share of income is lower than that of their trading partners because wages are lower relative to productivity. But the fact that wages are low relative to productivity is why consumption is so low. When you argue that you are going to both strengthen exports and strengthen consumption, you face a conundrum: if you raise wages, you strengthen consumption but weaken exports, and if you lower wages, it's vice versa.

> “If you want to eliminate moral hazard, then you have to let companies like Evergrande go under and let the creditors take their losses. That is the only way you enforce lending discipline on the market”

Common prosperity attempts to get around that by raising household income not by raising wages, but by raising what we call secondary and tertiary distribution. Wages are primary distribution; secondary distribution is through taxes. Some talk about tax reform but the main form of redistribution is tertiary distribution, which is donations from the wealthy, out of excess profits from the wealthy and businesses. I'm not sure that will work in the long term; it will help in the margin.

But there are two big problems with common prosperity. One is that if you add up all of the existing and promised donations, it comes to three hundredths of 1% of China's GDP, or three basis points. Multiply it by ten, that's about a third of a percentage of GDP. That's not enough for rebalancing. We need two to three percentage points of GDP. So, the first problem is that it's a very, very low number.

The second problem is that you are transferring money from the wealthy and businesses to ordinary households. That would work in the United States or in Europe, where 70-80% of GDP is household income. When there are problems in the distribution of income in the US, UK or Germany, it tends to be in the household sector. The rich have too big a share of household income.

In China the rich also have a very high share of household income but the problem is that household income is a low share of GDP. It's not 70-80%, it's a little under 55%. In China, governments retain a disproportionately large share of GDP. That's why households have such a low share. Solving these problems must involve a transfer from the government sector.

Which companies do you save, and which do you let die? To upend a cliché, do you kill a monkey to save the chickens?

It's an unresolvable problem. As long as you have target GDP growth rates above whatever the real growth rate is, which I think is below 2-3%, the only way to achieve it is through nonproductive investment in the property sector and the infrastructure sector. You can let companies go under as long as they don't threaten the funding of the property sector or the local governments, but that's where most of the bad lending is. You can clean up bad lending as long as you don't touch most of the bad lending, which is sort of meaningless.

What does China do when it's caught in this trap where property and associated investment is too much of GDP? If you let firms die it will impact consumption, which is what the government wants to raise.

There are only five paths that China can follow. One is to do nothing and continue growing at this rate and allow debt to grow much faster than GDP. Already China has the highest debt-to-GDP ratio that we've seen for a developing country and it's growing very rapidly. If you keep doing that, then your hope is that there is no debt constraint, that

you have infinite debt capacity. Logically that's not possible, but we don't know when you reach your debt capacity, so one possibility is that you keep doing this and hope nothing bad happens. China did this for a long time, but people – those around the PBOC, the CBIRC, the CSRC, the academic economists – all believe that we can't continue on this path.

> "In China, the total amount of wealth is much less than the perceived amount of wealth. Which means that economic activity is much brisker than it should be. We all think we're richer than we are so we're all spending this money"

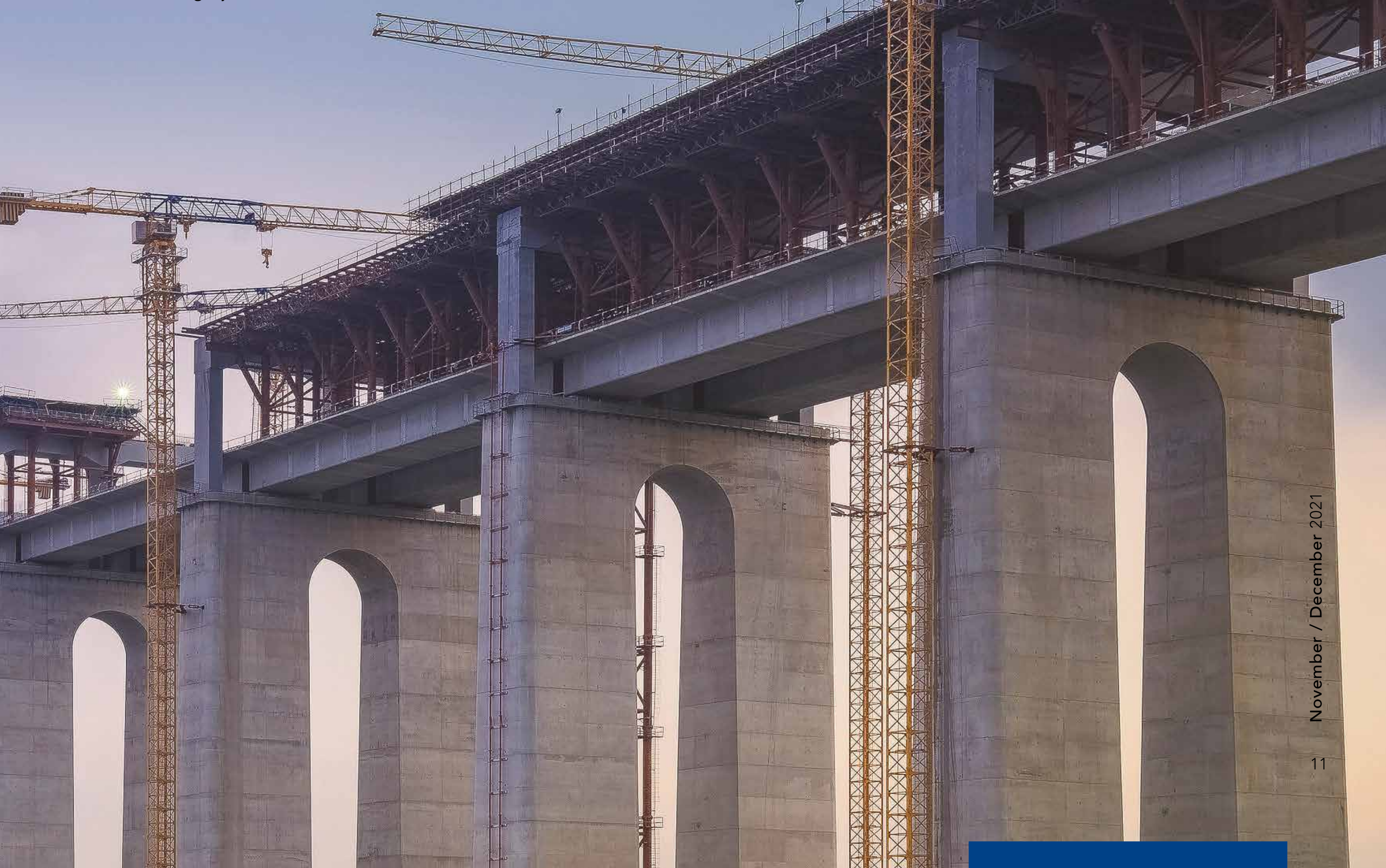
The second path is to solve the problem of misallocated investment or malinvestment. One way to solve it is by turning bad investment into good investment. Stop investing in empty apartments and unnecessary infrastructure and invest in the high-tech sector, etc. But it's hard to do. One reason is that as a developing country, China's ability to absorb high levels of productive investment is lower than in other countries for institutional and legal reasons.

What's more, the amount of investment that you have to shift is enormous. China invests roughly 45% of GDP, which is a huge amount of investment. If half of that is good and half is not so good, which is probably conservative, then you need to take 20-25 percentage points of GDP worth of investment and direct it into other parts of the economy. You need not just some good investment opportunities, but huge investment opportunities. In theory it's possible, but so far, they haven't pulled it off and the private sector doesn't look desperate for capital.

If you have too much bad investment you can reduce investment. But if you reduce investment, then you have to increase some other demand or growth slows. How can you increase other demand? [The third path] is to increase your trade surplus. If you're Singapore it could be a viable strategy, but if you're China you have to increase your trade surplus by 2-3 percentage points of GDP every year, which the world clearly can't absorb. That's a [third] possibility, but it's unlikely.

The fourth path is to increase consumption. But to increase consumption you have to increase household income, which means you have to reduce the income share of local governments, which is politically very tough to do. That's the path that China seems most determined to follow, but it's very hard to pull it off.

The fifth possible path is you reduce investment and don't increase anything else, in which case growth slows sharply, either in the form of a crisis or in the form of lost



decades like Japan.

My prediction is that they choose the fifth path. And if they don't choose it, they are forced into path number five – much, much slower growth. The great choices are the second and the fourth, the increased good investment or the increased consumption, it's just that no one's done it because it's really tough to do.

Looking at the broader Chinese economy, what do you see as good versus bad?

There's a lot of dynamism and efficiency in the private sector. Mind you, they have had quite a lot of subsidies, including rising real estate prices, which are a subsidy for those who own real estate. We have to see what happens in a slower growing economy. The bad part is that it's vastly overinvested.

In my most recent Carnegie essay, I re-introduced Kenneth Galbraith's concept of 'the bezzle.' For Galbraith, the bezzle – it comes from the word embezzlement – is what happens in a Ponzi scheme. If I defraud you of $100, I feel $100 richer, and you don't know yet that you are a hundred dollars poorer. Collectively, we act as if we are $100 richer than we really are. What Charlie Munger pointed out is that it just doesn't only occur with embezzlement. Whenever the price of assets exceeds their real value, and their real value is the future value generated by those assets, then you temporarily feel much richer than you really are.

What I added is a third form of bezzle, and that is a bridge to nowhere. If you spend $100 building a bridge that generates $20 of growth for your economy, then your wealth went up by $20, but you paid $100 for it. You're actually poorer by $80. But if you don't record that loss, for example if you're a government and you carried at cost, you feel $80 wealthier than you really are.

When you add up all these types of bezzle, you would argue that during periods in which bezzle is being created, which is true throughout the world, but especially in China, the total amount of wealth is much less than the perceived amount of wealth. Which means that economic activity is much brisker than it should be. We all think we're richer than we are so we're all spending this money. But as Galbraith, Munger and I point out, that bezzle doesn't last forever, it's eventually amortized – reality always kicks in. And when that happens it has a real negative impact on growth. So, in China we have tons of bezzle, but we will eventually amortize it and that's going to affect the long-term growth rate. For me, that's the big problem. The perception of wealth, a lot of that is fictitious.

So does the bezzle idea apply to Shanghai property prices and yield?

A quarter of apartments in China are empty. What's the value of an empty apartment? Zero. It has no value to the economy. But if you own an empty apartment and it's worth a million dollars, you feel you are a million dollars richer. China isn't a million dollars richer, but you think you are. If you believe American real estate is correctly valued, and it's not, it's probably overvalued, but if you believe it is correctly valued, then Chinese real estate should be roughly two-thirds of the value of American real estate because the Chinese economy is roughly two-thirds of the size. But Chinese real estate is worth twice as much as American real estate, which means if you believe that American real estate is correctly valued, Chinese real estate's value is probably three times its real economic value. That doesn't last forever.

“Chinese real estate's value is probably three times its real economic value. That doesn't last forever”

When prices overshoot one way, then they tend to adjust by overshooting the other way. We saw that in Japan, where real estate prices dropped by 85% in the 1990s. But here is the problem, 80% of household wealth in China consists of real estate. Imagine if real estate dropped by 50% to the same value of American real estate, which is still overvalued. If it drops by 50% it means that 40% of your wealth, if you are the average Chinese household, disappears.

A sobering afternoon we're having here!

Yeah, well, I'm always doom and gloom.

You have previously said that China needs

to direct money from local government pockets to consumers, to help transition to a more consumption-based model. What are the mechanisms to achieve that? Will the central government push provincial governments in that direction?

There are dozens of such mechanisms. You could eliminate the hukou, in which case migrant workers would immediately be richer and the popular city governments would immediately be poorer. Instead of selling real estate to build luxury apartments, you could use the real estate to build really cheap apartments and give them to the poor. Immediately their income, their wealth goes up, but of course local government wealth goes down. You could strengthen the social safety net and cut back on consumption taxes. You could spend more money on schools for the poor. You could spend more money on the health of the poor. All those things increase the wealth of the poor, but they reduce the wealth for whoever does the spending, which should be the local government. But there will be opposition from local governments.

The press often speculates that China's ambition is to see the RMB on par with the dollar or become the global trading currency of choice. What do you think?

It's not going to happen. Look at the flow of excess savings globally, nearly half goes to the United States. And of what's left, nearly half goes to the UK. A big chunk of the remainder goes to Canada and Australia, and a part goes to Switzerland. What's going on here?

The reason is not the English language – the Swiss don't speak English. The reason is straightforward: In all of those countries you have incredibly strong property rights, and you have very little government interference in the inflow and outflow of capital. If a foreigner buys an apartment in New York, he has the same rights as an American who buys an apartment in New York.

Money flows to countries with very deep, flexible financial markets, very strong protections of private property and very strong governance. And if that's the case, is money going to flow into China? No. None of those things exist here, you have capital controls, you have lots of government intervention, you have a clear distinction between foreigners and Chinese, you have weak property rights, etc.

> "If China is going to be a net recipient of foreign inflows, it must give up its current account surplus and turn it into a deficit"

The question is: Is that what the Chinese government wants? I think people who don't understand, you know, provincial governments, military people, foreign affairs people, they want it because they see that it gives the US and the UK disproportionate geopolitical power. But people at the PBOC are much more skeptical because they also recognize that it is highly costly.

The US and the UK have run permanent deficits since the 1970s, which trade theory tells us is impossible, but they've done it. The reason is because those deficits are the balancing part of those inflows. The US and the UK don't need foreign savings. Interest rates are so low, companies sit on huge piles of cash, so they don't really need foreign savings, but they have no choice.

Foreign money comes into these countries because that's where you keep excess savings. As a result, their currencies are probably too high, [because of] all these other adjustments that the economy has to make in which they are forced to run current account deficits. You can't have net inflows and a surplus, if you have net inflows then you must have a deficit because it always balances to zero. If China is going to be a net recipient of foreign inflows, it must give up its current account surplus and turn it into a deficit. But then if you go through the current impact on the economy, that's almost impossible. It'll take decades until China can do that. And the PBOC understands this. I

▲ A solution to the property problem

MITIGATING RISK:

HOW TO CRAFT A WHISTLEBLOWER STRATEGY

By Dr. Tim Klatte

Dr. Tim Klatte is a partner and head of the Shanghai Forensic Advisory Services practice of Grant Thornton China. With 27 years of China-related experience, Klatte has conducted over 600 investigations across multiple industries and in all regions of China. He holds both an MBA and DBA and serves as the Chairman of AmCham Shanghai's Ethics and Compliance Committee. To confidentially discuss the article or ask further questions, contact Tim at tim.klatte@cn.gt.com.

Detecting fraud in a company has never been a matter of if it will happen, but when. Forty-three percent of occupational fraud is reported via a tip – of which 50% come from current employees and 22% from customers, according to the Association of Certified Fraud Examiners. These findings reinforce the necessity of a strong global whistleblower program, available to both internal and external stakeholders. Anonymity and protection remain the top priorities for whistleblowers, and in China, technology facilitates these factors, allowing more professionals to apply the "see something, say something" principle and encourage people to safely speak up against fraud.

In the US Securities & Exchange Commission's (SEC) latest annual report, whistleblowers from China ranked fourth behind the US, Canada and the UK for number of whistleblowing calls made, at 67 calls to the SEC's hotline. The number of allegations (and rewards) from across the globe increases year on year, with over 6,900 tips in 2020 that represent a 130% increase since the SEC's whistleblowing program began in 2011. This article aims to share not only the benefits of having a local whistleblowing program, but also best practices for how it should be established and maintained to elevate your organization to a new ethically driven level.

Enforcing a culture of protection & rewards

Whistleblower protection has moved beyond a handshake and a promise, as governments worldwide have implemented robust protection and rewards programs for whistleblowers. In the United States, the SEC whistleblower program continues to build trust around the globe, and in China, the laws are clear and enforceable. In addition to the SEC reporting outlet, whistleblowers have other options, such as reporting anonymously to the company (the local branch or headquarters) or even to the Chinese government to solicit an investigation.

The Supreme People's Procuratorate,

Ministry of Public Security and Ministry of Finance in April 2016 issued provisions to protect and encourage whistleblowing by strictly prohibiting the disclosure of information relating to whistleblowers. The provisions include a guarantee of confidentiality for corruption reports provided to the People's Procuratorates. The personal safety of informers and their close relatives is also guaranteed and the provisions provide a reward mechanism for whistleblowers who report crimes to the government. Awards are based on case facts and circumstances, and retaliation protection is a focus for all countries' programs.

Benefits (and concerns) of blowing the whistle

A China-based whistleblowing system is crucial for any company. The most obvious benefit is the potential money saved from early detection of misconduct. Even relatively minor transgressions that go unchecked can become severe issues. An effective whistleblowing system will reinforce a "speak-up" atmosphere that creates employee trust and confidence in management. The program should ensure management decisions are based upon reality and the best interests of the organization – a transparent touchpoint to actual business operations. Whistleblowing channels can ensure that crucial information will quickly reach those who can act upon it. The channel should be entirely open inside the organization, protecting the rights and interests of whistleblowers and their relatives.

From the company's perspective, a sturdy whistleblowing system can prevent unethical behavior, safeguard company assets, improve financial performance and enhance stakeholders' confidence. Or as former US Deputy Attorney General Paul McNulty explained, "If you think compliance is expensive, try non-compliance." Building an effective whistleblower system can protect company performance and improvement. From the whistleblower's perspective, a system clearly provides them with a channel to report unethical misconduct.

However numerous concerns remain on the whistleblower's mind. Investigators may question the relationships of the whistleblower, lawsuits against the company can feel never-ending, and, of course, retaliation is a possibility. Retaliation is one of the most significant barriers to promoting and sustaining a sound whistleblowing system. Research shows that whistleblowers who lack company confidence typically do not proactively report misconduct.

Implementing an effective whistleblowing system

When developing a sustainable whistleblower program, the following four elements should serve as the cornerstones for your strategy.

1. Airtight written policies: Refine all written policies to address how to report unethical behavior. This includes proper reporting channels, justification to report, and the required details when reporting. The company should also provide feasible channels for whistleblowers to report wrongdoings, such as email and phone channels, as well as walk-in visits and standard mail sent to a secure location, with all reporting done in the local language.

2. Access to reporting: Publicize the whistleblowing channels (hotline details should be posted around the facility and on the intranet landing page), and proactively raise the importance of reporting unethical behavior. Once reporting access is clear, make sure the benefits of reporting are publicized.

3. Real-name reporting: When vetting the allegations, knowing the whistleblower's access to the information is much more helpful for the investigative team. Clear communication between the whistleblower and the team will increase investigative efficiency. Real-name reporting can also prevent falsehood reporting to some extent, which unfortunately, is common in China.

4. Diverse investigation team: The team investigating the allegations should have separate duties in the company and have enough authorization and professional knowledge to conduct the work. For example, if allegations involve inventory theft, the warehouse manager could not be a member of the team. If the allegation is related to a senior executive, the investigation should report directly to the Board of Directors and also take guidance from them. An independent review is critical to a successful outcome.

A violation is revealed – now what?

Now, it is time to test the executives. If your company leadership has received an allegation, these four steps should be taken immediately:

1. Investigate promptly and thoroughly: Please take all complaints seriously. A prompt and thorough investigation into the allegation, even if it appears unfounded, sends a much-needed signal to all stakeholders that there is zero tolerance for unethical behavior. Quite often, inaction sends a louder signal to employees than taking action. Retaining a third-party investigator to ensure objectivity and secure the right resources to do the job is necessary, especially if claims are directed to senior management or someone in your direct reporting line.

2. Protect from retaliation: The most significant mistake employers make is failing to protect a whistleblower from retaliation. The employee must be protected from adverse employment action, such as an overlooked promotion, a poor performance evaluation or a minimal or non-existent annual salary increase – all in an effort to push them out for being labeled as an inside troublemaker. If possible, follow-up with the whistleblower and keep him/her updated on the investigation's progress. This may allow for the collection of more helpful information. If disciplinary action is required for the wrongdoers, determine what information is best to communicate to the whistleblower.

3. Remain proactive: If the whistleblower is an employee who may have performance issues, the documentation related to the employee's poor performance (i.e., customer complaints, supervisor's notes of coaching sessions, formal discipline) preceding the date the employee "blew the whistle" will help to avoid the perception of retaliation and reduce the risk of a retaliation claim. Proper documentation throughout all steps will ensure a higher chance of success for the organization during complicated and sensitive compliance investigations.

4. Review adverse employment action decisions: Discipline, termination and other forms of adverse employment action against the whistleblower (if they are identified) should be vetted to ensure legitimate business reasons support the effort. Ensure that the whistleblower treatment is consistent with how the company has handled similar past situations. Include at least one decisionmaker in the investigation who does not know the employee's complaint to avoid a bias decision.

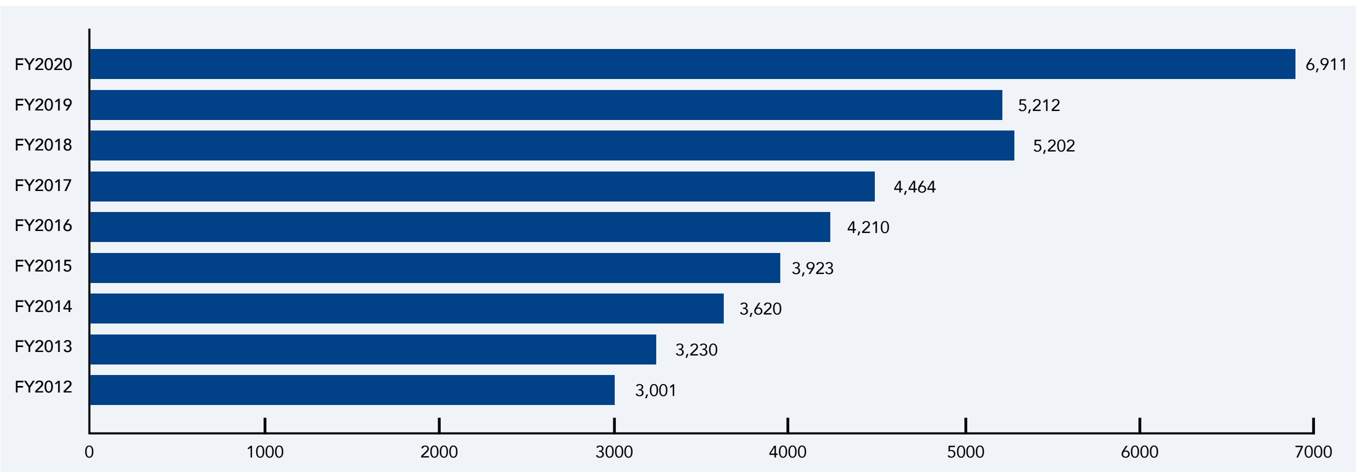
A new age of accountability

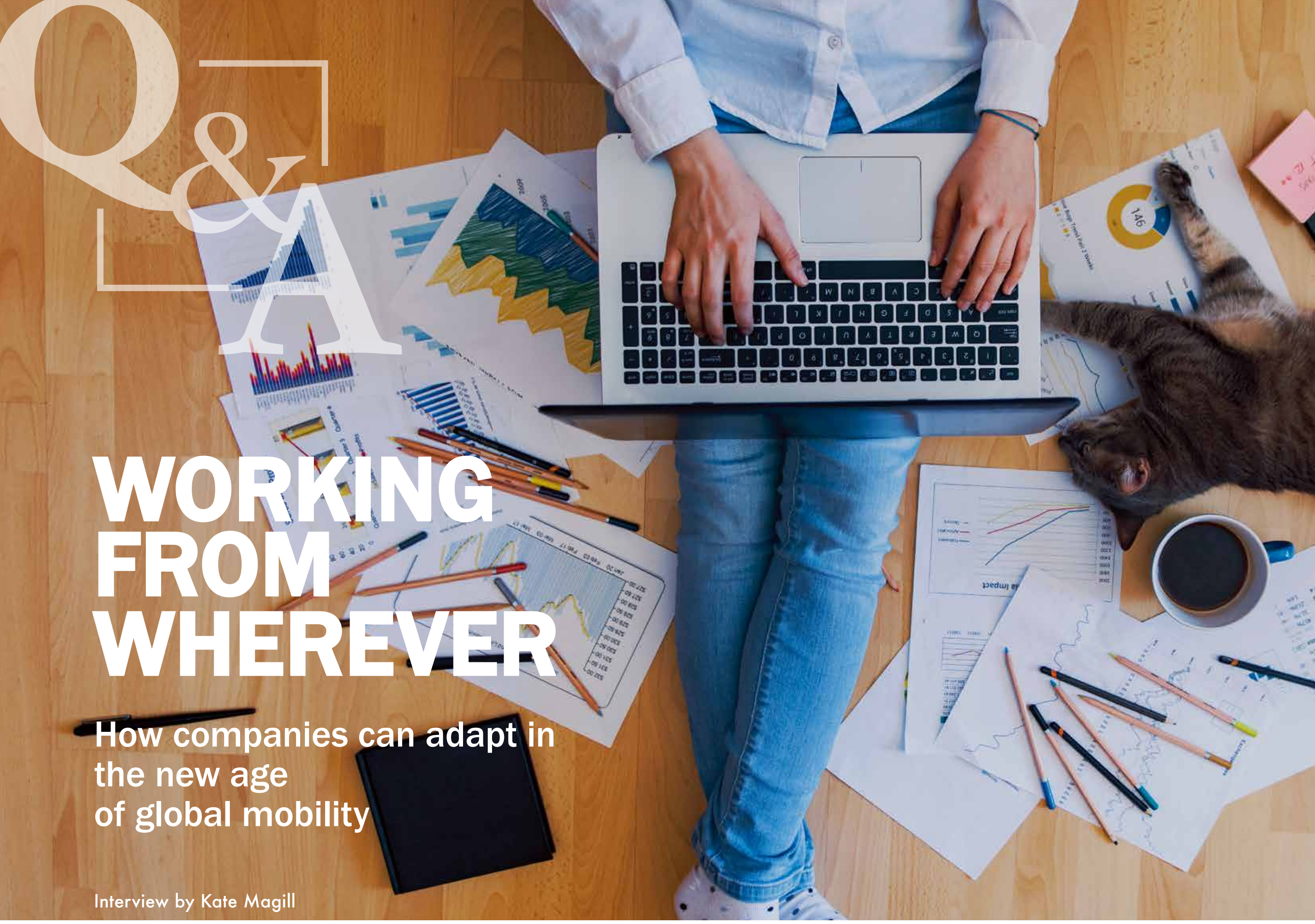
Whistleblowing is on the rise across the globe. The EU Directive on Whistleblower Protection is significant new legislation that will shake up the European business landscape, starting this year. The laws will elevate the status of whistleblowers and the role organizations play in bringing unethical behavior and criminal activities to light. The directives set minimum requirements that can significantly affect organizations. For instance, the directive requires organizations with 50 or more employees or an annual turnover or total assets of more than €10 million to have a secure and confidential internal reporting channel.

In 2020, countries such as Japan and Australia implemented penalties for companies that do not have compliant whistleblower programs. Japan passed amendments to its Whistleblower Protection Act such that companies that fail to establish a reporting system are subjected to administration. In Australia, the failure of an in-scope company to have a compliance whistleblowing policy can attract fines of over 125,000 AUD. No company is beyond the long arm of compliance and as our society becomes more globalized, accountability through transparent reporting channels will become increasingly more important to corporate success.

Transparency has become the expected standard for organizations with subsidiaries in China, and it is essential to recognize corporate accountability in order to have a strong whistleblowing program. As China offices gain more prominence within corporate headquarters, so does the need to tighten internal controls and give all stakeholders a local outlet for sharing information that could impact the company's performance. Now is the time to enhance your company's local whistleblower strategy. I

The growth of whistleblower allegations reported to the US SEC since the start of its program in 2011





Q&A

WORKING FROM WHEREVER

How companies can adapt in the new age of global mobility

Interview by Kate Magill

Joyce Wang is the Director of People Services at KPMG China. Joyce joined the KPMG GMS practice in Shanghai in 2006 and has more than ten years of experience in providing individual income tax compliance and advisory services to multinational clients and in assisting clients with relocating international assignees globally.

Angus Leung is the Director of Executive Recruitment at KPMG China. Angus has more than 20 years of working experience in executive recruitment and technology management consulting in the supply chain domain. Other than senior executive recruitment, Angus also has solid track records in advancing the market position of his clients through new technology deployment and realizing business turnaround through process innovation.

What are three key recent trends in global mobility?

JOYCE: The first one is the integration between mobility and talent management. The second could be the flexibility in work approaches due to Covid. Many companies need a more flexible approach or arrangement for their mobility because of barriers getting in and out of countries. Third would be the use of technology in analyzing and assessing global mobility and whether it is for the benefit of the business or employees.

Even with the end of Covid, we will continue to hold some meetings online; there's no need to go onsite for every meeting, every seminar. But of course, for some work we need people to be onsite, like manufacturing. There will be more travel across the region with the end of Covid, but less than before [the pandemic] and for more specific roles.

ANGUS: [In talent management], we see more short-term placement opportunities because of the lack of workforce mobility, management needs to rethink or regroup the workforce in different locations. Employees are assigned a specific task or project and will work with the local people there for three or six months.

What is the most popular format right now in China for work (onsite, remote, hybrid, etc.), and how do you expect that to evolve? Is there a lean towards flexibility or a hybrid model?

ANGUS: It depends on the company culture. For private clients that we work with in Hangzhou or Suzhou, they are more local-

ized and manufacturing intensive, so they prefer to work onsite. But for professional services firms like us, we are very familiar with working on project-based tasks and being mobilized in different locations. At the same time, we have well-established systems to track and recognize the efforts of our team no matter where they are. So it depends – we have to make work flexible and be ready for the impact of a [future pandemic] and have to have enough mechanisms to track and allow employees to work from anywhere.

How has remote work impacted companies when it comes to compliance for tax, immigration, labor, etc., especially for cross-border work?

JOYCE: Many companies are seeking legal advice for compliance requirements not only for tax, but labor law and around social security concerns. If the employee is working in a different location from the company in Shanghai for example, there could be some obstacles to the company making social security contributions for the employee in his or her home location. From a labor law perspective, if a work injury happens when working from home, how does the company deal with it?

From a cost perspective, if a company bears all the relevant additional employee-related costs [of allowing employees to work remotely in another city], including insurance, salary and social security, then they need to be sure they can absorb those costs. Some key individuals at a company may be approved for remote work, but those who are not key employees may be required to work in the Shanghai office.

What do companies need to be aware of when it comes to data security and data compliance and cross-border remote work?

ANGUS: Firms need to be aware of cyber security concerns around hacking. Working in a different location, you bear the risk of exposure. If your laptop is stolen and is not properly password protected, or if the employee is not aware of data security that they have an obligation to protect, that is a big problem. [Companies should protect themselves by installing] technology solutions to tackle stealth malware. Employees also need to be knowledgeable about the data privacy laws where they are working, especially if they transferring or exchanging sensitive personal data across borders. Companies should offer training that makes employees aware of the issue.

What kinds of remote working policies do you recommend companies implement?

ANGUS: When it comes to evaluating effort, we have tools that recognize employee performance, such as through the use of different apps. It's not that we have to adopt new practices in China for establishing remote mobility, it's more about how employers will use data analytics to motivate and retain employees. Another angle is how the team leader manages remote work; it will require more creativity to bring people together in this format. Finally, companies should encourage employees to manage interruptions, like kids disrupting tasks, etc. It's more about employee judgement and a sense of awareness, rather than having a very complicated mechanism of track and trace; I don't think anyone wants to do that.

How can companies in China deal with onboarding new employees from overseas amid strict visa controls and long quarantines? Approximately how long is it taking companies to bring new employees into China right now?

JOYCE: Most of our clients have set up relevant procedures or updated internal SOPs for the process. We need to estimate the time not only to get the visa but for the employee and company to consider the offer. It could be a half year from the time of the candidate assessment to onboarding the individual in China. After the individual accepts the offer, they need to go through the visa procedure, which takes at least three months (up from two pre-pandemic). Right now, companies in China are recruiting senior executives to relocate to China, but midlevel employees may not be asked to come to China at the current stage. Companies will look for local talent, which is more stable.

What kinds of globality mobility businesses have seen a bump in opportunity as a result of the recent environment changes?

JOYCE: Business for relocation companies may be better than before because visa applications have become very complicated. Outside consultants and lawyers are also doing well; companies need external advice on whether to recruit or not, to work remotely or not and how to stay compliant.

ANGUS: Payroll outsourcing has seen growth. MNCs here will have more local employment, so the ability for payroll companies to support a global network is vital. Further, as Chinese companies extend their footprint globally, the professional service companies like payroll that work with them will also extend their global reach. Cost allocation, effective task payment, that will all be tracked under the payroll system. I

Major Upcoming Events

Nov 12 AmCham Shanghai's 2021 Fall Education Fair

Nov 17 2021 Government Affairs Conference

Nov 19 2021 Government Affairs Conference

Nov 23 AmCham Shanghai Suzhou Center Annual Government Dialogue: Meeting with Suzhou Municipal Government & SIPAC Government

See all upcoming events and register at:
https://www.amcham-shanghai.org/en/events/Upcoming

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SMART & GREEN

The latest structural trends in China's autonomous and new energy vehicle markets

By Nick Lai

Nick Lai is Head of J.P. Morgan's Asia Autos Research and Head of China Equity Research. He joined J.P. Morgan in 2004 as the SMid-Cap analyst for the Greater China market. Nick has been consistently ranked by Institutional Investor and AsiaMoney since 2003. Nick became Head of Taiwan Research in 2008 and moved to Hong Kong in 2013 after he assumed responsibility for Asia Autos. In 2019, he further assumed his Head of China Research role following his relocation to Shanghai. Nick has an MBA from the University of Cambridge and an M.S. in Finance from the University of Illinois at Urbana-Champaign.

The past and the future

China's NEV market has developed from the stage of slow adoption, driven by push factors, to a new stage of accelerated growth, supported by pull factors:

Stage 1 (2014-2019): In 2019, approximately 1.2 million NEV units (including pure EVs and plug-in hybrid EVs) were sold in China. NEV market penetration increased steadily and slowly from 0.4% in 2014 to 5.5% in 2019 because of state incentives that offset the high purchase cost. People were pushed to purchase NEVs via government subsidies and a free license plate in cities with purchase quotas, such as Beijing and Shanghai.

For automakers, such push factors came from increasingly strict emissions requirements under the government's two-credit policy; as a result, carmakers had to produce a certain number of NEVs to meet the requirements. Failure to comply resulted in credit deficit.

Stage 2 (2020-2025): NEV penetration is expected to reach 20% by 2025, according to the State Council. We have a more optimistic forecast of 35% by 2025, with a sales volume of approximately 10 million units.

This is supported by three pull factors:

1.) A reduction in costs, especially on the battery side. Battery vehicle production costs are expected to reach parity with internal combustion engine (ICE) vehicles by 2025. 2.) A shift in customer to include direct to consumer sales (e.g., from corporates such as leasing companies or taxi operators to individuals) and a shift in customer preference from ICE to EV. 3.) Young buyers (who account for nearly half of all NEV purchases) look for technology content and a connected experience. A vehicle is increasingly perceived by young buyers as a smart device with four wheels. We believe the transition from ICE to smart EV is similar to that of feature phones to smartphones in the past decade.

Against this supportive backdrop, the Chinese government aims to have 0% ICE vehicle sales by 2035, with pure EVs accounting for 47.5% of total auto sales. This is supported by the more stringent two-credit policy and the effect will likely persist.

Our observations of a changing market

Cars are now a smart device with four wheels for young buyers. The average age of car buyers in China is 10 years younger than in the US or EU. The 25 to 35-year-old group accounts for nearly half of all NEV purchases in China. Young buyers exhibit two distinct characteristics in China: 1.) They embrace technology, including autonomous driving (AD), in-car connectivity features and interface through voice and touch panels (vs. buttons on a dashboard in conventional ICE cars). 2.) They have low brand loyalty and are open to new brands. This presents a window of opportunity for Chinese OEMs, including start-ups. We forecast Chinese brands will dominate with a 60-70% share of the NEV market, the opposite of ICE cars, where foreign brands capture 60% of the market.

> "We forecast Chinese brands will dominate with a 60-70% share of the NEV market, the opposite of ICE cars, where foreign brands capture 60% of the market"

Crowds are shifting. During our visit to the annual Shanghai Auto Show in April, we saw strong interest and fierce competition in the smart EV market:

- We had an entirely new experience this year. There were huge crowds at the smart EV booths across Chinese and foreign brands, including Geely's Zeekr, Great Wall's Ora, BYD's new EV platform, GAC's Aion, Benz's EQS, Ford's Mustang and BMW's iNext. In previous years, the German premium brands' booths would have attracted the crowds.
- Technology giants, such as "Huawei Inside," Baidu's Apollo, Horizon Robotics and DJI, also had a significant presence at the show, demonstrating their autonomous driving (AD) capabilities, in-car connectivity solutions and most importantly, their ambition to enter the smart EV business.

We are also seeing an increasing vertical integration trend in the industry. While EV start-ups such as XPeng, NIO and Li Auto have already launched or have started to focus on full-stack, self-developed AD solutions, traditional original equipment manufacturers (OEMs) tend to seek turnkey solutions from technology companies.

Challenges

Charging networks operated by national power players, e.g., the State Grid, OEMs and private operators, a lack of demand for EVs and lack of charging infrastructure are intertwined problems:

- A common issue for consumers is range anxiety, if an EV's designed range is less than 300-400km.
- The Chinese government has targeted 150 million units of slow charging posts and 1.5 million public fast charging port units by 2035, compared to the existing 1.9 million charging posts established by the end of the first half of 2021.
- If charging networks develop in line with targets, combined with an increasing range for most EV products (now up to at least 450-500 km), EVs should see strong growth.

Two-credit policy: In June 2020, the Chinese government updated the two-credit policy for corporate average fuel consumption (CAFC) and NEVs for 2021-2023:

- CAFC: Like the CAFE (corporate average fuel economy) in the US, China introduced a target and regulations for CAFC, where OEMs collectively need to reduce fuel consumption to an average of 4.0 liters per 100km driving range by 2025.
- The NEV credit program, or the so-called carbon emissions trading scheme: OEMs need to meet a certain level of NEV credit, and the credit "quota" is set at 14-18% of total traditional energy car production (not sales) volume in 2021-2023, respectively.

Given the tighter regulations ahead, we believe automakers will push more aggressively for NEVs, driving continued acceleration of NEV credit value and thus helping to mitigate the shortfall of subsidies for EV makers.

Subsidies: In April 2020, the Chinese government announced the NEV subsidy plan for 2020-2022, which included 10-30%

subsidy cuts for passenger vehicles and buses in 2020-2022, respectively.

Clear guidance until 2022 sets a good operating framework for the industry. EVs have also become more affordable with much lower subsidies than in the past. We believe the subsidy policy is positive for the industry as players including OEMs and the battery supply chain can set appropriate strategies for pricing and volume.

Entry of technology companies: Technology companies will inevitably enter the market, but they are likely to embrace different business models compared to the OEMs.

Their focus in the smart EV business is most likely to be on 1.) providing AD and connectivity solutions and 2.) assessing the potentially sizeable business opportunity of content monetization in the future. Technology giants are effectively using vehicles to extend their digital service beyond phone or consumer electronic products. Opportunities could be enormous if we advance to a semi or full-autonomous driving environment.

Hence, we believe technology companies are more likely to outsource manufacturing to OEMs, given the sophistication of the car production process and its low-margin nature.

> "We think Chinese battery material suppliers will benefit directly or indirectly from the US stimulus package, given their exposure to Korean and Japanese battery makers"

Opportunities

Overseas opportunities: On June 24, 2021 President Biden announced his Bipartisan Infrastructure Framework plan. The plan mentions the building of a national network of EV chargers along highways and in rural and disadvantaged communities. The network would be the largest EV infrastructure investment in history. The total budget for EVs is $15 billion, with half for constructing EV infrastructure and the rest to electrify buses and transit. We think Chinese battery material suppliers will benefit directly or indirectly from the US stimulus package, given their exposure to Korean and Japanese battery makers. Meanwhile, Chinese battery makers may also be able to export to the North America market.

Outside the US, Europe announced detailed proposals for the "Fit for 55" policy, which includes a 100% emissions reduction by 2035 (only zero emission vehicles e.g., BEVs and FCEVs can be sold post-2035). The plan implies a significant upside for long-term EV penetration in Europe. Relevant suppliers along the EV and battery supply chain in China could benefit from this development too.

Smarter vehicles

Autonomous driving: This segment is poised for strong growth. We estimate that ADAS (advanced driver assistance systems) and AD vehicle sales will increase from 4.9 million units in 2019 to 19.3 million in 2030 (CAGR at 18%). We also expect the total addressable market for China ADAS to rise from $1.3 billion in 2019 to $17.7 billion by 2030 (CAGR at 27%).

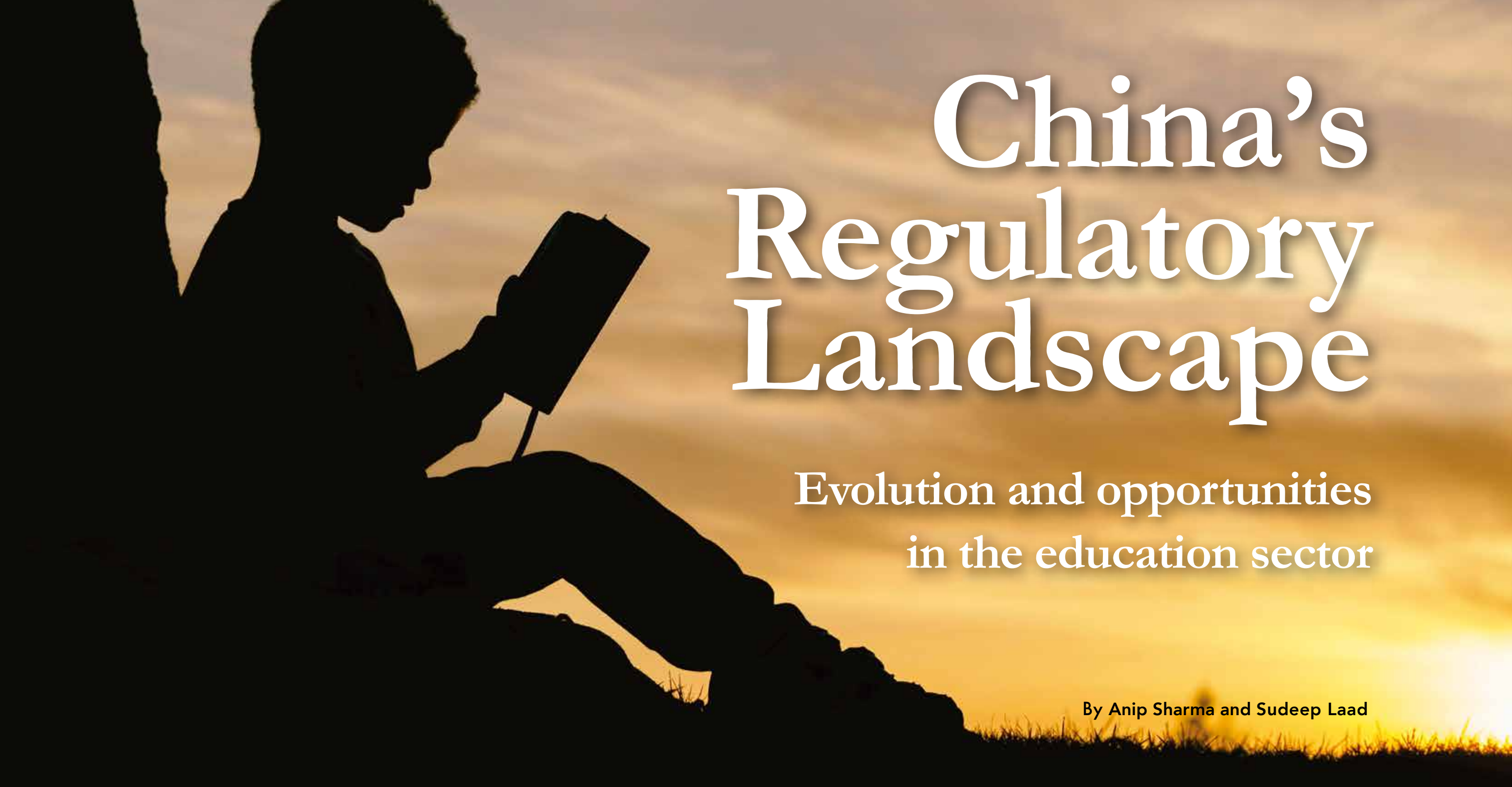
Key reasons for the increasing penetration of ADAS in China include:

- Government support: According to "Made in China 2025," the Chinese government regards ADAS as a key development area.
- Consumer preference: AD technology brings freedom to drivers and transforms their driving experience.

Smart EVs: By drawing an analogy between smartphones and smart EVs, we predict a strong adoption trend:

- Similar to the transition from feature phones to smartphones, we expect customers to shift quickly from ICE vehicles to smart EVs because 1.) A younger customer base will favor a large content base (e.g., ADAS, interconnectivity and infotainment features) and 2.) Touch screen and voice control holds more appeal than a dashboard full of buttons.
- Content monetization could become another source of income for OEMs in the future.

We expect the competitive dynamics to be similar to the battery market, with numerous new entrants in the beginning but many exiting by the end of the early growth stage due to inability to deliver or to continue investing. Longer term, we are bullish on the development and growth of the smart EV market in China and project over 40% CAGR through 2025. I



China's Regulatory Landscape

Evolution and opportunities in the education sector

By Anip Sharma and Sudeep Laad

Anip Sharma is a Partner in L.E.K. Consulting's Singapore office. He is a founding member and leader of the Education Practice at L.E.K. He has over 15 years of advisory experience, of which 10 years have been dedicated education sector experience – he has led and advised over 600 cases across all education segments in 50+ countries globally, and heads all of L.E.K.'s work in China. Anip has vast on-ground experience in helping investors and operators navigate the country's complex education landscape. Anip's area of expertise is in growth strategy, innovation in education and education technology.

Sudeep Laad is a Partner and founding member of L.E.K. Consulting's Global Education Practice. He advises education companies and investors across all education segments including K-12, Higher and Vocational Education, Transnational Education, English Language Learning, Corporate Training and Education Technology. He has extensive experience across global and Chinese education sectors, and has advised C-suite clients on market potential, growth and market-entry strategy, investment decisions and pricing strategies.

China's education sector is one of the largest, deepest and fastest growing in the world. However, overnight regulatory changes are impacting stakeholders in significant ways. Is this the end of the road for investment opportunities in Chinese education? Or are there segments that offer potential for new investors and existing operators with legacy investments in the sector?

Background

China has one of the largest education markets in the world, with an estimated $300 billion in annual revenue. The landscape broadly includes three sectors: formal education, supplementary education and education services. **Formal education** covers kindergarten, primary and secondary school, high school, secondary vocational education and training and higher education focused on adults. **Supplementary education** covers early childhood enrichment and care, K-12 academic tutoring, K-12 enrichment, junior English language training (ELT), foreign counselling and test prep, skill-based vocational training, white collar professional development, adult tertiary programs and corporate training. Finally, **education services** include education software (including LMS, SaaS, etc.), education content, education supplies and online program management.

Education spending in China is driven by a large population with parents who are increasingly pursuing an agenda of premium and high-quality education *(Figure 1)*.

In addition to growing K-12 spending, parents are also spending on upskilling, vocational training, corporate training and continuous learning. This has created massive demand for high-quality private education offerings (all recent sectoral growth has been in the private rather than public education sector). As of 2019, approximately 19 million children in China were enrolled in K-12 private education, 10% of the total K-12 student population.

Thematically, the three important and dominant trends in the Chinese education sector are:

Internationalization: Overseas education continues to be a priority for Chinese parents, with the US as a top destination choice. This is driving demand for English language and test prep training. Even young Chinese who remain at home for higher studies and work regard English as a "must have" skill. They're also increasingly seeking international professional certifications from foreign universities and content providers, which they believe can improve career prospects.

Premiumization: Rising per capita disposable income in urban China and the emergence of education as "the ultimate

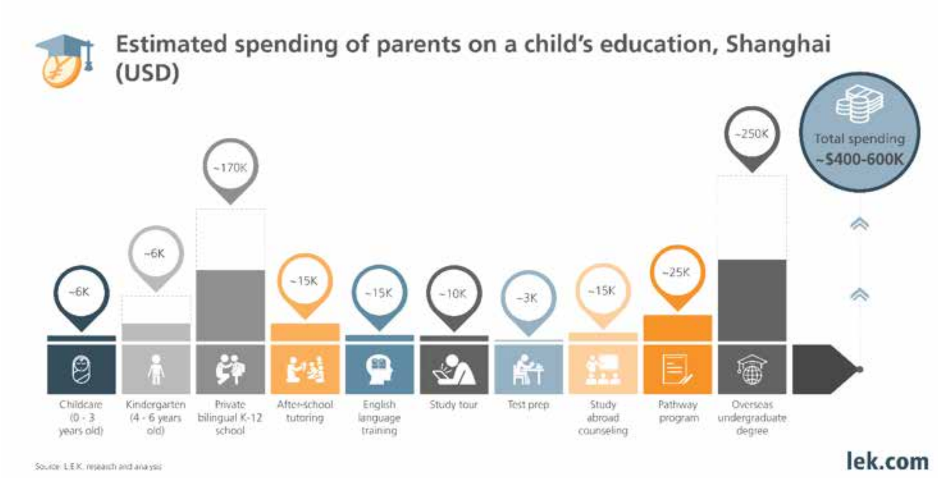


Figure 1

consumer good" has driven demand for premium education. Bilingual schools are growing at 15-20%, with the premium segment growing the fastest. This willingness to spend more for higher quality is driven by perception of value, success rate for outcomes including acceptance to top-tier foreign universities, expectations on outcomes and brand reputation, especially in English proficiency, where legacy brands like Harrow International School, Dulwich College and Westminster School are in demand.

Digitization: Chinese consumers, who traditionally display an "online first" eagerness, are willing to engage with digital education, driving the proliferation of online models. China has 250 million school-age children and an internet penetration level of approximately 60%. These 150 million 'online children' collectively consume nearly 280 million hours of screen time daily and, of this, almost 45% — or 120 million hours a day — is educational. Additionally, growing device proliferation plus internet penetration means that a large pool of untapped learners in tier three to five tier Chinese cities are skipping offline training centers and going directly online. A growing integration of online and offline learning methods has been observed, which represents a substantial opportunity for providers offering tutoring and enrichment programs in either mode.

Regulatory headwinds

Current regulatory conditions have called into question investable opportunities in China's compulsory education space, where regulatory intervention was already high. Recent regulations however have made even the afterschool and ELT segments a challenging space for both investors and operators *(Figure 2)*. The challenge for investors centers around the inability to invest in key, high growth sectors of Chinese education while for operators in segments with high regulatory overhang, the main challenge is access to growth capital.

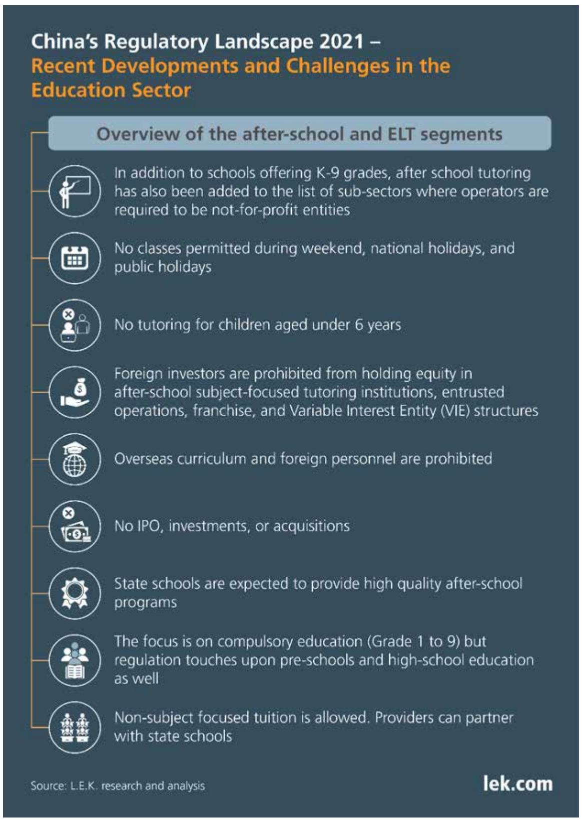


Figure 2

The impact of these regulatory headwinds is evident in the stock price performance of listed education companies, particularly those in afterschool tutoring and some K-12 players, such as Tianli Education and Lixiang Education. Continued regulatory tightening is creating downward pressure on stock prices in these segments, on top of already softening Chinese equity markets. Of the 30 largest listed global education companies, only seven are Chinese – down from nine in 2019. In contrast, post-IPO stock prices for higher education and vocational training space players have been more resilient.

Historically, the story of the regulatory environment in China has been one of overreach (tightening) and subsequent relaxation (loosening). This is evidenced by:

- The Chinese higher education sector grew rapidly through private participation for over two decades after the economy opened, until a crackdown in the last decade, primarily to weed out low quality operators and unaccredited foreign institutions.
- Similarly, the international student counselling market has seen the progressive tightening and loosening of requirements for study abroad agencies, resulting in an alternating cycle of consolidation and fragmentation. The ELT sector has witnessed a similar pattern.

Implications and opportunities going forward

Despite these regulatory burdens, China remains one of the world's most vibrant education markets and presents a range of opportunities for investors *(Figure 3)*. While demand-side drivers will remain strong, regulatory headwinds will be greater for operators and investors in some segments, some others will be relatively immune and yet others may even see tailwinds. The fast-growing ELT industry, for example, may bear some of the most negative impacts, especially due to restrictions on recruitment of foreign teachers, since most premium online and offline providers rely on native English-speaking tutors. The ideal opportunities for investors will lie in the following areas.

Areas outside regulatory purview

Early years enrichment and care

Early Childhood Education (ECE) is likely to sustain its current growth. This is driven by multiple factors, including the relaxations of China's one child policy, growing ECE affordability and the growing popularity of more holistic and well-rounded ECE beyond just childcare. Given these factors, leading providers are in a position to further consolidate the market. Childcare offers higher margins and slightly better growth prospects than the enrichment segment. Critical success factors for ECE players will be market coverage, brand impact, innovation and cost effectiveness. Major players include children's fitness center chain MyGym and clothing store brand Gymboree (both offering enrichment products), as well as RYB (offering childcare + enrichment). While the childcare sector has lower rates per hour and enrollments compared to enrichment, its average margins are much higher (30-40% EBITDA margins, versus 20-25% for enrichment).

White collar professional development and upskilling

Increased competition in the domestic job market and growing demand for professional upskilling across industries will continue to drive high growth rates in this segment. Barring civil service test prep, other segments are fragmented and offer consolidation opportunities. Critical success factors include increasing teacher utilization/reducing teacher churn, reducing customer acquisition cost (CAC), and upselling/cross-selling. Globally, this is a fast-growing segment and it has emerged as a large industry in itself with providers like Great Learning, Emeritus and Upgrad all securing multiple rounds of funding. These and other local providers are showing great traction in Asia, Europe and Latin America in high demand areas like IT, data science, leadership and analytics. Major players in China include ITCast, Tarena (both IT focused) and Golden Finance (certification test prep for courses like CPA, CFA, CMA, ACCA).

Education software and services

At-home consumption of educational content is likely to see growth given recent regulatory changes. With this, the education software market in China is expected to grow at more than 20% annually for the next few years; large system integrators, such as Jia Fa IE, with their higher profit margins, and vertical providers, such as Seentao, with strong product advantages are likely to win. Impetus from Covid-19, industry consolidation, wider service offerings (K-12 players such as Yuanfudao and Zhangmen are expanding into the logic and coding tutoring business), and growth opportunities in third to fifth tier cities will drive growth. Critical success factors for companies will be end-to-end offerings that can capture a larger market share, the ability to develop and tailor products that cater to a larger consumer base and strong partner distribution networks that lower CAC and widen the user base.

Figure 3

Tutoring in non-subject areas

Tailwinds exist for non-subject focused enrichment providers in areas such as art, coding, music and sports and other supplementary education products. Besides these, opportunities exist in Technical and Vocational Education and Training (TVET), lifelong learning and adult education. Subject-oriented sectors including logic, coding, Chinese and arts and music are also very popular. Top firms such as Huohua, VipThink and Zhangmen have taken over 80% of market share in this segment and have raised multiple rounds of funding.

Outbound opportunities

Incumbents can look at regional and international expansion and focus on outbound opportunities, while leveraging the infrastructure and capabilities they have developed in China.

Overseas education demand is likely to grow rapidly. In response, some K-12 providers such as Maple Leaf, which acquired CIS in Singapore, as well as Bright Scholar, are increasingly looking at acquisition and expansion opportunities outside China. Tutoring and ELT companies could potentially look at adjacent markets in Southeast Asia, India and beyond where demand for similar products is robust. ELT companies could also diversify into teaching Mandarin outside China, given the huge global interest in China. Lingo Bus (a part of VIPKID) is an online learning platform that has enrolled 4-to-15-year-olds from several countries in its Mandarin learning programs.

Conclusion

The current regulatory conditions are painful and will likely persist. This calls for a shift in focus by existing operators and investors. In the early childhood and K-12 space, operators will need to consider global or regional expansion owing to greater regulatory overhang. Service providers would do well to review their offerings and disengage their better protected enrichment offerings from school performance. Instead, they should develop more 'at home' digital learning products, with a focus on online higher education and continuous education. Meanwhile, the most attractive segments from regulatory and economic opportunity points of view are likely to be early childhood enrichment and care, higher education, TVET and the continuing education space. I

A talk with AmCham Shanghai's 2021 Future Leaders of the Year

Ivy Wong

Co-founder, Diversity and Inclusion Consulting

Ivy Wong, originally from Hong Kong, has been a strong ally on diversity, equity and inclusion in Greater China and Asia for more than six years and is the co-founder of Diversity and Inclusion Consulting. She is the winner of AmCham Shanghai's 2021 Future Leader Award. She was also selected as the Future Leader of Tatler's Gen T Asia List 2021.

Interview by Kate Magill

What made you want to get involved in diversity and inclusion work?

I first learned about diversity and inclusion while I was in university. Growing up, LGBT+ was not a topic discussed at home. At university I had the chance to join an LGBT+ leader training camp, where many of the participants were part of the LGBT+ community. That was the first time where I, as a heterosexual person, was in the minority and had to explain my sexual orientation to others, which made me realize how vulnerable one can feel when doing so. This experience made me realize that people who are LGBT+ face this anxiety in their everyday lives, in family settings, at school and especially at the workplace. Whenever they enter a job or prepare for an interview, they must struggle with whether to come out to their HR or to their boss. This experience of being in the minority made me realize my privilege and helped me develop empathy.

The turning point for me was that a few months before I graduated from university, I organized a student job fair, and many companies talked about [their diversity and inclusion programs] and why they are important, especially for LGBT+ inclusion.

I realized that companies can actually make an impact by taking care of their people. The combination of social impact and business was fascinating to me, and that's why when I graduated, I immediately took a job at an organization that focused on diversity and inclusion in Hong Kong and greater Asia.

Why did you decide to establish Diversity and Inclusion Consulting?

I was invited to Shanghai in June 2017 to present my work at an event hosted by ShanghaiPRIDE. When I walked into the conference room, I realized there were over 200 attendees. The scale and impact of it just blew my mind. At the same time, I realized that not many companies here were aware of diversity and inclusion work, let alone LGBT+ inclusion. I saw the gap that if no one was doing it, then there was an opportunity to tap into this niche market.

In September 2017, I decided to relocate here. Initially, I didn't plan to start a company. Instead, I thought I would get involved with ShanghaiPRIDE to develop its workplace initiatives and work with companies on their internal programs. However, in 2020 ShanghaiPRIDE ceased operations after 12 years due to the challenging environment. When that happened, [co-founder] Charlene Liu and I were thinking, 'How can we continue this legacy?' We heard from a lot of companies that were really interested [in diversity and inclusion programs], but they did not know how to talk about it. So last year, we decided to establish Diversity and Inclusion Consulting (DNIC) to support companies in China and Asia on their diversity and inclusion journeys.

Initially we started with LGBT+ issues, because that is where our strength lies from our background in ShanghaiPRIDE. However, we found that many companies do not know what diversity and inclusion means. Gradually, we started to give presentations and workshops on general diversity and inclusion, how to identify unconscious bias and microaggressions, how companies can be more inclusive and how colleagues can be allies in the workplace. This year, especially after the pandemic, more companies have become aware of the importance of diversity and inclusion in China, especially to retain talent.

How does diversity and inclusion work differ in China vs. the West?

In China, diversity and inclusion is different from in the West and the US. In Chinese companies, 90% of the workforce is Chinese, so the concept of diversity is not obvious. However, in recent years, there is more awareness on gender diversity, as it is an easier topic to discuss and tackle. We have seen both public and private entities focus on gender diversity in science, technology, engineering and mathematics (STEM) in the workplace. Companies are also now working on disability inclusion in the workplace, as well as generational diversity. There are more young people in the workforce, management is getting younger, and now people over 40 are worried that they can't stay in their company. I think LGBT+ is the last issue that companies want to deal with. Generally, it is considered a sensitive issue in China as there are still a lot of myths and misconceptions around being LGBT+ in China.

What misconceptions do people often have about diversity and inclusion training, and how do you approach clearing up those misunderstandings?

There are several misconceptions. The first is that it takes a long time to establish an initiative and to see the impact, especially in China where things are fast moving and corporations want quick wins. When you mention a diversity and inclusion strategy, people will think, 'Oh it's such a large topic, we need to take time to tackle it.' But there are actually small steps you can take that can create results. For example, you can start implementing gender neutral language. This is such a small step, but it can create a large impact. It starts conversations, it makes people think about why this is needed and can get people talking about sexual orientation, gender identities, etc. For MNCs that run employee engagement surveys every three or six months, you can capture this kind of change by asking diversity and inclusion-related questions. 'Do you feel that you are more included, do you feel that you are more respected, that your differences are appreciated in the workplace?' These small things can be reflected in employee surveys to gauge changes from initiatives.

Matthew Spriegel

Chief Executive Officer & Founder, Atiom

Interview by Royce Shey

Matt Spriegel is the founder and CEO of Atiom, a mobile-first workplace solution that empowers businesses to learn and grow every day. Prior to Atiom, Matt was the VP of Operations (APAC) for STEM Marketing, a healthcare consulting company. He also worked in business intelligence at Boehringer Ingelheim where he discovered the need to address gaps in modern workplace training. Matt has been living and working in Asia for over 10 years and is fluent in Mandarin.

What inspired you to create Atiom?

I was working in the healthcare industry before Atiom, and the idea came when I was sitting in a classroom setting for eight hours a day, six days in a row [for professional training]. I did this kind of training twice while I was at the company and my thinking was 'For companies that require employees to stay up to date and up to standard on critical information, why are we only doing this type of training once or twice a year? If it's relevant training content we should really be doing it every day.'

If there's relevant training, especially around standards, product knowledge or safety, then we should be learning it forever while we're working at the company, not just doing one-offs, because learning has a compound interest. Through building Atiom, we never intended to replace in-person training; it's meant to be a complementary tool that gets people up to speed quickly. By giving people something to learn or engage with every day it builds a much stronger connection between the managers and the frontline staff.

What other platforms inspired you as you developed Atiom?

The two key ones were Duolingo – one of the largest bite-sized language learning platforms in the world – and an app called Elevate, which is for general learning and memory games like spelling, math [and] grammar. Those inspired us around the idea of bite-sized content delivery and everyday learning. Five minutes every day is far more effective than one hour or two hours once a month.

How can Atiom help companies create a healthier work culture and improve company performance?

You can teach or inspire your team every day to grow and learn; it's definitely going to benefit the company culture. On a more practical level, we do a lot of compliance, service standards and safety training on Atiom. Delivery of bite-sized training and engagement everyday helps keep people up to standard and on their toes to perform on the job. It's not just about increasing revenue but also making sure that people are safe on the job and mitigating risks for the company.

What has feedback been like from clients?

During Covid it helped managers stay in touch with their remote workforce. It's a whole new era of communication and engagement with frontline teams – it's a newly distributed workforce, so the teams and the companies we've worked with have been very happy with Atiom. Not as a replacement for HR or training, but as a complement, because it's hard to get frontline teams to do everything every day.

How has Covid and the subsequent movement to remote work impacted Atiom?

When Covid came, we, like many other businesses, struggled to find new clients and new business, but our existing customers leaned into Atiom during that time. We're a mobile-first platform, so it was easy to keep everyone connected and to deliver critical updates, which is being done to this day even as the dust is settling in China. As people are adjusting to this re-distributed workforce, I think they see a big need to digitize and we're a very easy solution to help managers communicate and train their frontline teams.

How does Atiom's gamification framework improve employee training and engagement?

Number one is bite-sized content delivery. Whenever an employee goes onto Atiom, they're not going to spend more than five to ten minutes on the app during a session. Number two is a spaced repetition learning algorithm. Every person's account is personalized, so they're only going to get content that is relevant to themselves.

The third part is that we have different algorithms to get people to go back every day to create a habit for training and communication. Atiom's framework starts with Gamification 1.0, which includes leaderboards, point systems [and] badges. And then we have Gamification 2.0, which comes with a customized rewards wheel, interactive items and daily quests – rewards that you get for frequent learning. If you go back every day you get point boosts and more chances to win prizes in exchange for company rewards, rather than just completing activities one or two times a week.

What have been some of your biggest challenges since founding Atiom?

Definitely Covid. When we were going into Covid we were growing very fast on new business and that was halted.

Also, being first-time founders. When we first started, we worked with lots of different companies like Chanel, Porsche [and] Mandarin Oriental, and I think we spread ourselves too thin across the different industries; we probably should have been more targeted. Now we've done well in facility services, hospitality [and] real estate and it's a bit easier to expand from there.

What is it about those industries that makes it appealing to expand in those areas?

The main appeal for us and for them is that they are compliance-first organizations. Whereas training, development and standards are nice to have in some industries, these are must-haves in industries where people's lives are at risk. In manufacturing, shipping and real estate, safety is number one. They're going for zero risk, zero errors, zero fatalities on the job, so these organizations are a good fit for our service.

What are your goals for Atiom in the future?

The short and medium-term goal is to be the leading software solution and service for frontline teams in training and engagement in Asia. I

Member-Exclusive Services

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Corporate Visa Program

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Member Briefing on September 7 with US Consul General James Heller

AmCham Shanghai and BritCham Shanghai Fall Mixer on September 22 at Paulaner at the North Bund & Käferby the Binjiang One

"The Impact of the Evergrande Crisis on China's Economy" panel on October 19

September & October

Release of AmCham Shanghai's 2021 China Business Report on September 23

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