The Economist Corporate Network

Responding to Asia's new normal

Asia Business Outlook Survey 2016

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Preface

Responding to Asia's new normal: Asia Business Outlook Survey 2016 is a publication of The Economist Corporate Network (ECN). It reports the findings from an annual survey of Asian-based executives about their current and anticipated business operating environments.

ECN gratefully acknowledges the participation of all respondents who took time to anonymously contribute their views and also the support of Hays, the regional sponsor of this report. Irrespective of participation and sponsorship, ECN has conducted and reported on this survey independently. Rob Koepp, director of ECN in Beijing, analysed the data and authored this publication. He particularly appreciates the editorial assistance of Pamela Qiu, associate director of ECN South-east Asia, and graphic and layout design work of Wai Lam, Asia-Pacific art director at The Economist Group.

January 2016

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Executive summary

This year's survey finds that almost 30% of respondents indicated their outlook for revenue growth in Asia has declined compared to the view held when heading into the previous year. This represents a marked deterioration from the high-level expectations expressed in past surveys. Yet within this "new normal" of lowered expectations, most respondents still anticipated growth of some kind. Prospects for Asia overall are viewed positively with the economies of India, China, and South-east Asia attracting the greatest proportion of bullish sentiments.

Among the industries surveyed, financial services and the IT and software sectors both have over one-fifth of respondents anticipating high levels of sales growth. Respondents from the pharmaceutical and healthcare, transportation and logistics, and consumer goods and retail industries also expected significant double-digit gains.

Further reason to cheer: this year's survey participants anticipated a drop in operating losses compared to 2015. While most also expected a squeeze in the upper bracket (above 30%) of profit margins, respondents looked forward to earning more at profit levels of 5-10% and 20-30%. Across the majority of Asian economies, respondents highlighted economic growth and technology penetration rates as key factors impacting profitability.

Close to one-half of respondents predicted Asia will account for 21-40% of their firms' worldwide revenues by 2020. This presents a potential new normal of the near future. Yet the degree to which firms are basing their research and development (R&D) activities and senior leadership positions in Asia suggests that many foreign companies are probably underprepared to capitalise on this shifting economic tide. Over one-third of respondents felt that companies are failing to invest at a rate necessary to match growth expectations.

In an assessment of leading Asian cities as magnets for regional management operations, survey participants rated Singapore and Shanghai as exerting the greatest forces of attraction and Bangkok, Kuala Lumpur and Beijing as offering the least desirable environments.

In most of the Asian economies surveyed, annual staff turnover averaged 6-10%. Asia's fastest growing economies demonstrated even more volatility with staff turnover.

One of the survey's most surprising findings came from the way respondents evaluated China's ongoing anti-corruption drive. Many viewed it as biased against foreign companies but also saw it as effective in creating better operating conditions for everyone's benefit.

1. Introduction

Looking forward from inside the world economy's fastest-growing region

At the end of every year The Economist Corporate Network—the executive advisory, briefing, and networking service of The Economist Group—gathers confidential input from organisational executives throughout Asia on their views about existing and anticipated business conditions. Results from this *Asia Business Outlook Survey* (ABOS) provide unique, first-hand assessments across a range of topics about doing business in the fastest-growing region of the global economy.

Survey respondents, who at the end of 2015 completed this outlook for 2016, manage operations in corporations active throughout Greater China, India, Japan, South Korea, South-east Asia, Australia and New Zealand. Their scope of business spans 16 industries. Nearly one-third (31.7%) of respondents work at Asia-headquartered companies, with the rest at firms headquartered outside of the region. Regardless of corporate domicile, all survey respondents are based in Asia and run operations in the region. All respondents contributed to the survey with complete anonymity. Although emphasising perspectives for the coming months of 2016, the survey's time horizon extends to 2020. (An Appendix on page 37 provides "firmographic" details about the survey respondent base.)

2. Revenue outlook

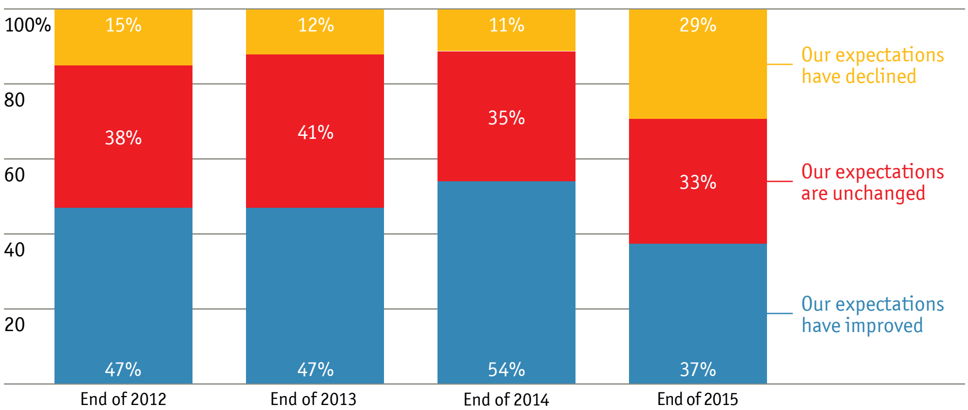
Where growth is expected in a year of diminished expectations

Compared to previous survey participants, respondents to the *Asia Business Outlook Survey 2016* finished the preceding year observing a marked reduction in their firms' expectations for revenue growth.

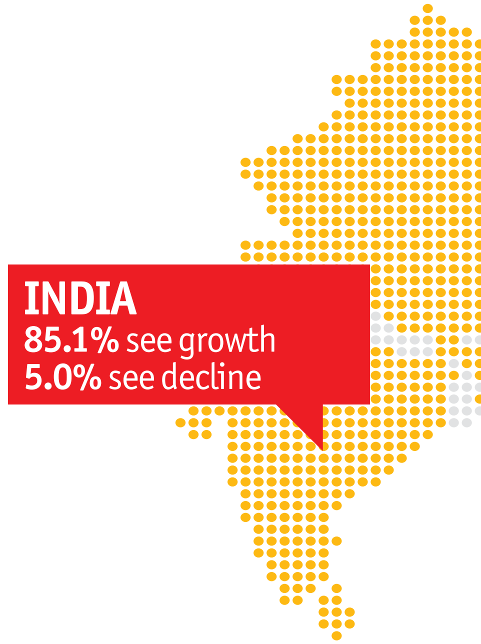
Whereas 2014 ended with only 11% of respondents stating that expectations have declined, 2015 finished with almost three times that number seeing diminished expectations for Asian markets. (See figure 1.) During 2010-14, Asia's largest economy, China, enjoyed GDP growth of 7-10%. The Economist Corporate Network (ECN) estimates that after having slipped to slightly below 7% in 2015, China's rate of growth will drop to 6.4% in 2016 and to 5.9% by 2017. The deceleration is not surprising given the country's accumulated economic mass and it is a long way off from what would qualify as a "hard landing". Yet uncertainty about China's future growth undeniably affects sentiment for the region and, indeed, for the entire global economy.

However, despite this decline in expectations, it is important to bear in mind that an even larger portion of survey respondents reported that their expectations have improved or remained unchanged. This group, representing more than two-thirds of all respondents, still views Asia as an appealing opportunity to grow their business.

Figure 1: How have your firm's expectations for revenue growth in Asia changed over the past year? (respondents surveyed)



Source: The Economist Corporate Network.



As shown in the adjacent map and figure 2 (opposite), India stands out for attracting the highest expectations for sales growth. An overwhelming proportion of respondents (85.1%) anticipate higher sales for India in 2016 over 2015, with approximately one-fifth estimating an increase of 20% or greater.

South-east Asia ranks second for growth expectations, with 77.8% of respondents looking forward to revenue increases in 2016 and only 3.7% expecting revenue declines.

Despite frequently observed headwinds for China, the majority of executives (74.1% of those surveyed) still expect their business to grow in the Middle Kingdom in 2016. A good proportion of them (13.4%) even expect expansion to surpass 20%. But China also has its pessimists—another 10.3% are less optimistic and are bracing for revenue declines.

Slight majorities (ranging between approximately 55% and 59%) anticipate growth for Australia and New Zealand, South Korea, and Japan. Unsurprisingly, the lowest level of growth expectations overall is for the Japanese market: only 54.8% of those polled are confident of growing their sales there. What is somewhat surprising is that more executives expect double-digit growth rates in Japan than in South Korea: while nearly 16% of respondents expect their sales in Japan to rise by 10% or more, only 11.3% expressed the same optimism for South Korea.

These findings reflect how market momentum has been shifting throughout the region. Although China remains the standout major economy of Asia, uncertainties about its future direction—coupled with encouraging developments in the markets of India and South-east Asia—are driving growth expectations to these latter areas.

INDIA

ECN predicts that India will achieve about 7% GDP growth annually up to 2018. The nation's economic expansion would be even higher if New Delhi could manage deeper structural reforms and further eliminate barriers to investment. The government of the prime minister, Narendra Modi, still lacks a majority in the upper house of India's bicameral legislature. Its reformist agenda will be constrained until it obtains a broader political mandate (a likely possibility within the next three years). The Reserve Bank of India (the central bank) is led by a hawkish governor, Raghuram Rajan, who probably will be re-appointed in September 2016. Mr Rajan's term has been characterised by lower inflation and a more stable currency, both of which have provided a positive climate for investment and boosted consumer purchasing power.

SOUTH-EAST ASIA

Respondents indicate overall bullishness about South-east Asia's business environment, especially in the areas of economic growth and technology penetration. (See page 18.)

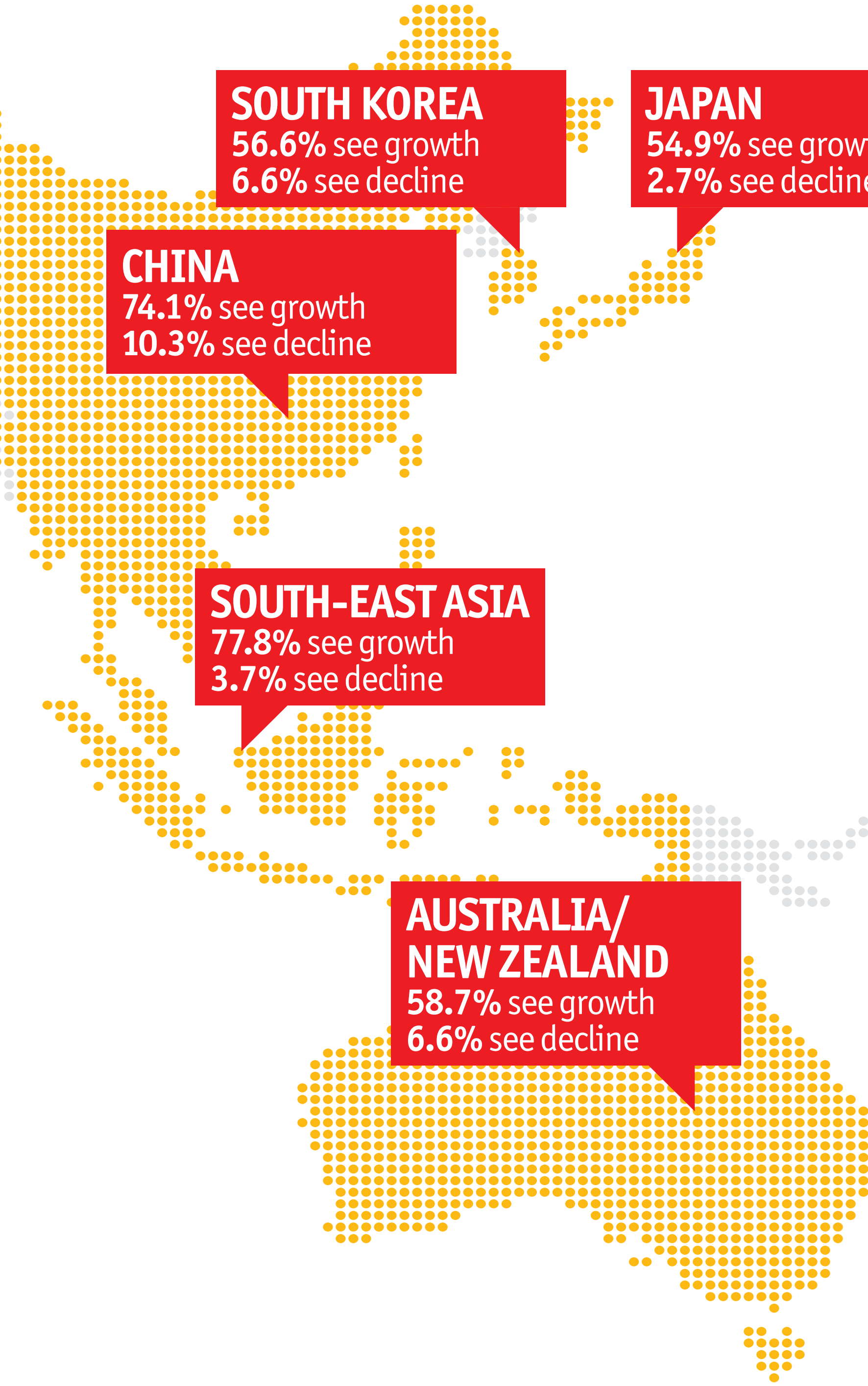
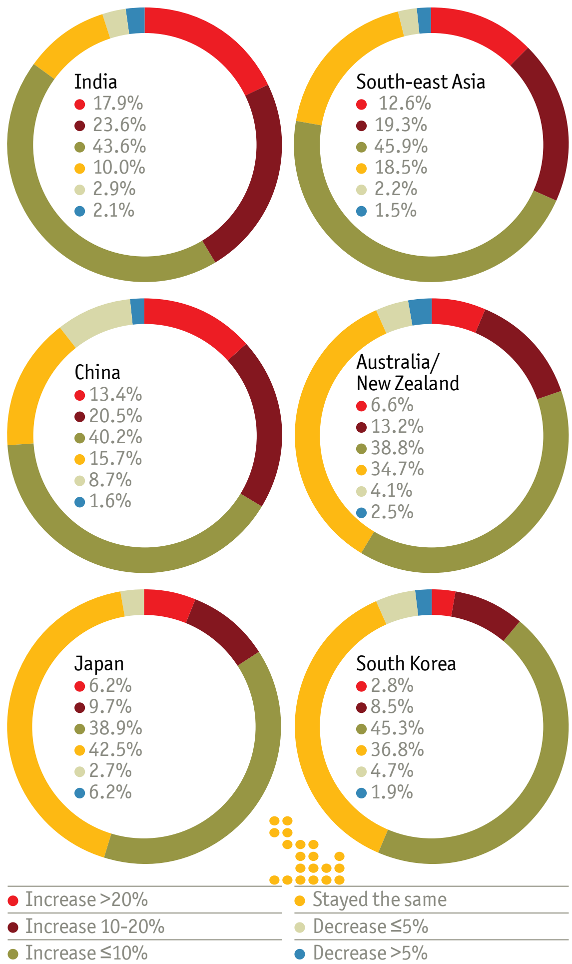


Figure 2: What are you expecting for your company's Asia sales performance in 2016 relative to 2015? (respondents surveyed)



Source: The Economist Corporate Network.

ECN expects the subregion's largest economy, Indonesia, to recover from a dip in GDP growth under 5% in 2015 to average 5.3% annually for 2016-19. The rate of GDP growth in economies like the Philippines and Vietnam will average more than 6% over the same period, with private consumption being a major contributor to the growth story in these countries. We predict expansion in Vietnam's private consumption to be above 7% and imports to rise by about 12%. For Malaysia, where services already account for 53% of the economy, we see growth in services averaging 6.6% between 2015 and 2019. Especially active services subsectors in Malaysia include retail trade and IT.

CHINA

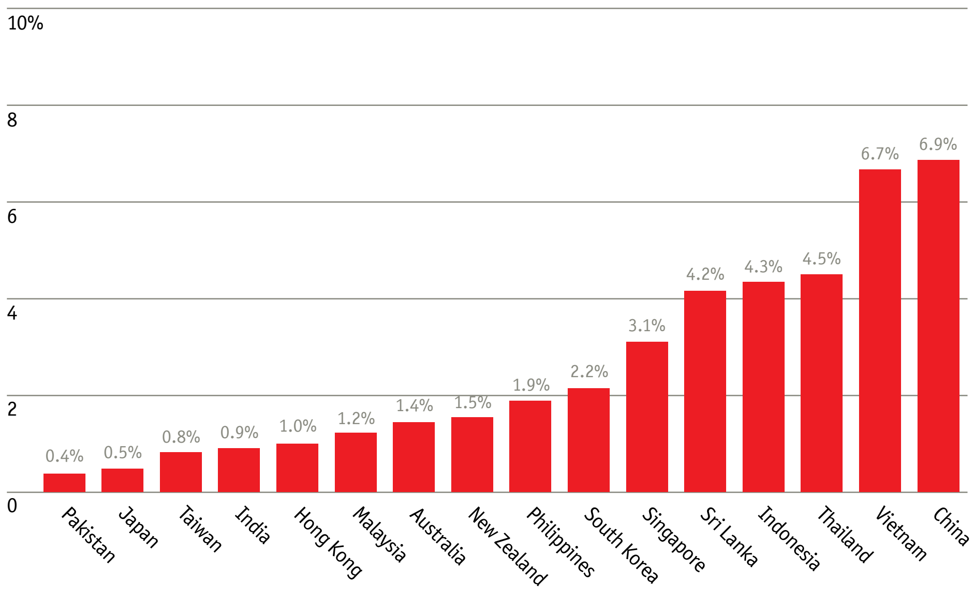
Although it may have lost some lustre with slowing GDP growth and turmoil in its currency and stockmarkets in 2015, China can hardly be considered marginalised in any objective assessment of Asia's macroeconomic outlook. ECN predicts China's GDP growth to slow to under 5% by 2020, as part of a gradual deceleration from 2016's predicted rate of 6.5%. Yet by 2020, China's GDP will account for more than US$14trn in output, whereas India's economy will generate just one-quarter of that, or approximately US$3.6trn. China shows little sign of being eclipsed in terms of sheer economic size.

At the same time, China also stands out for various negative conditions, including achieving the highest rate of rising wages within Asia. (See figure 3.) This aspect of China's business environment along with increased market competition is cited as among the most undesirable dimensions of doing business in the country by surveyed executives. (See page 16.)

SOUTH KOREA

In the middle of 2015, South Korea's economy was buffeted by the outbreak of Middle East Respiratory Syndrome (MERS), which sent consumer and business sentiment plummeting. ECN estimates that GDP growth dropped from 3.3% in 2014 to 2.5% in 2015 and will not again see a rate of 3% until 2018. Household debt has swollen in recent years and the burdens of repayment are limiting private consumption. Nearly 7% of survey respondents

Figure 3: Growth in annual real wages, 2015- 19



Source: The Economist Corporate Network, *Asia Country Briefing*.

reflect this gloom, anticipating sales to decline in 2016. South Korea is likely to continue to present challenges until structural improvements take shape.

In the nation's favour, South Korea's consumer electronics giants are operating at the forefront of global technology. Indicators point to increasing investment in research and development (R&D) and productive capital which will help the country's globally exporting brands.

JAPAN

Economic prospects for Japan—Asia's second-largest economy—are the most challenging in the region. ECN predicts growth of 1.2% for the Japanese economy in 2016 and we do not see it breaking into a 2% pace of growth for the foreseeable future. (By comparison, we anticipate growth of about 2.5% for the US in 2016–2018.) Yet Japan's plodding rate of expansion should be seen in light of a 0.1% GDP contraction in 2014 and a declining population. The nation is in fact in the middle of an economic recovery fuelled by ultra-loose monetary policy to support private consumption and investment. The postponement until April 2017 of a controversial consumption tax hike seems to have stabilised consumer sentiment, at least in the short term. Meanwhile, a longer-term boost to consumption is expected with events leading up to Tokyo's hosting of the 2020 Olympic Games. Japan's sports industry is second only to the US in size and its inbound tourism industry has been growing impressively, especially with visitors from China (the latter a feat even more remarkable considering Tokyo's prickly diplomatic relations with Beijing). The prime minister, Shinzo Abe, is expected to maintain political leadership until 2018, allowing his namesake reform agenda, "Abenomics", the opportunity to prove whether or not it can substantively deliver on Japan's rejuvenation through synchronised monetary, fiscal, and structural initiatives.

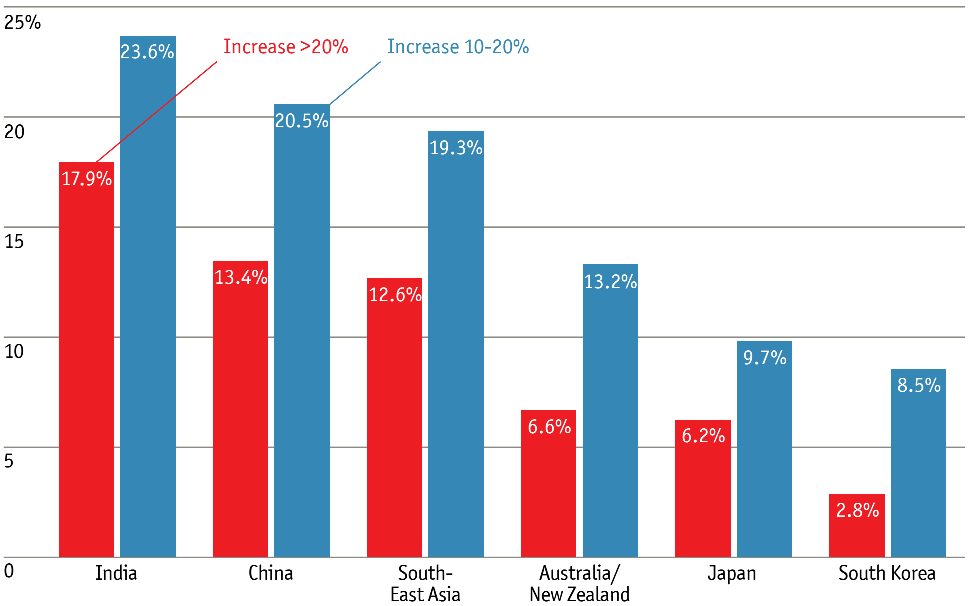
3. Double-digit dynamics

Places and sectors expecting big changes in sales growth

A new normal of relatively diminished expectations does not mean that the outlook for fast-paced growth in Asia has gone away. For each of what respondents have indicated are Asia's three leading growth zones—India, China, and South-east Asia—more than 30% of participating executives see sales growth of 10% and higher in 2016.

As shown in figure 4, more than 40% of survey participants expect sales growth of 10% and higher in India, with nearly 18% expecting their sales growth rates to exceed 20%. China, for all of its uncertainty, is still promising enough for slightly more than one-third of respondents to look forward to double-digit sales growth there in 2016. South-east Asia commands a similar level of confidence as China, with about 13% looking forward to growth exceeding 20% and another one-fifth of respondents expecting growth of 10-20%. Even South Korea, despite recent setbacks, has more than 11% of respondents estimating revenue growth of 10% and greater in 2016.

Figure 4: Outlook for sales growth of 10% and higher in 2016 (respondents surveyed)



Source: The Economist Corporate Network.

INDUSTRY-BASED GROWTH

The outlook from executives representing a range of sectors points to additional areas for notable growth and, in some cases, decline.

Executives in financial services are the most bullish among survey participants in their level of sales growth expectations, slightly edging out their counterparts in IT and software for anticipated revenue increases that will exceed 20% in 2016. (See figure 5.) Altogether 65.4% of surveyed financial managers are looking forward to growth of some kind. There are those who are less optimistic. Almost one-quarter expect growth to be largely unchanged from 2015, while nearly another 9% are bracing for sales to actually decline. As the sector provides services to a wide range of countries and industries, its outlook—whether positive or negative—will be influenced by a diverse range of factors. The Asian financial industry's largely optimistic outlook for 2016 bodes well for leading regional centres of finance: Hong Kong, Singapore, Shanghai, Tokyo and Mumbai.

The IT and software industry has the broadest expectations for growth overall. An impressive proportion of almost 80% of IT sector respondents view 2016 as a year of growth. IT optimists far outnumber pessimists with less than 5% of this industry's respondents expecting sales to decrease. As we detailed in a 2015 report, *Asia's digital disruption*, ECN sees trends with mobile communications, social media, and e-commerce to be underpinning a shift in the economic gravity of these three IT subsectors away from

Figure 5: Outlook for sales growth in 2016, select industries
(respondents surveyed)

	Increase >20%	Increase 10-20%	Increase ≤10%	Stay the same	Decrease ≤5%	Decrease >5%
Financial services	22.2%	17.3%	**25.9%**	**25.9%**	7.4%	1.2%
IT & software	**20.2%**	15.5%	**44.0%**	15.5%	2.4%	2.4%
Pharmaceutical & healthcare	14.7%	**19.1%**	**55.9%**	7.4%	2.9%	0.0%
Transport & logistics	11.1%	11.1%	**40.7%**	**37.0%**	0.0%	0.0%
Consumer goods & retail	10.1%	15.9%	**36.2%**	**31.9%**	4.3%	1.4%
Manufacturing	7.7%	17.3%	**50.0%**	**19.2%**	5.8%	0.0%
Property & construction	6.3%	**25.0%**	**50.0%**	12.5%	6.3%	0.0%
Professional services	2.8%	**38.0%**	**42.3%**	12.7%	0.0%	4.2%
Chemicals	1.5%	2.9%	**55.9%**	36.8%	1.5%	1.5%
Commodities	0.0%	11.5%	**34.6%**	**38.5%**	11.5%	3.8%

Shading indicates expectations for *changing* sales rates among at least 10% of surveyed respondents.

Red bold percentages indicate the predominant (50%+) range in which industry respondents expected to achieve sales rates in 2016.

Source: The Economist Corporate Network.

the West and towards Asia. The expectations recorded by IT and software representatives in this 2016 survey lead further credence to that earlier assessment.

The pharmaceutical and healthcare, transportation and logistics, and consumer goods and retail industries all have at least 10% of their executives anticipating growth at levels of above 20%. In many ways growth patterns in these three industries interrelate. The increasing wealth of Asia's populations allows people to spend more not only on goods (which underpins growth in transportation and logistics services), but on key services too (such as healthcare). In addition, ageing populations in many Asian countries—especially in China, Japan and South Korea—means that the demand for increased healthcare products and services will accelerate over the long term.

Executives from the commodities sector registered the greatest level of pessimism. A combined 15.3% of commodities respondents anticipate declines of some order compared to 2015 sales performance. Considering that 38.5% see growth likely to "stay the same" (the highest proportion for all surveyed) and that 2015 was largely a down year for the industry, this purportedly neutral assessment here can probably be seen as a bearish indicator as well. China's slowdown, especially in its property sector and resource-consuming heavy industries, has principally contributed to declining fortunes in commodities. In Asia and around the world there is a movement to boost efficiencies and increase economies of scale in commodity supply chains. On-going capacity consolidation and corporate rationalisation are likely to continue to feature in the sector's future.

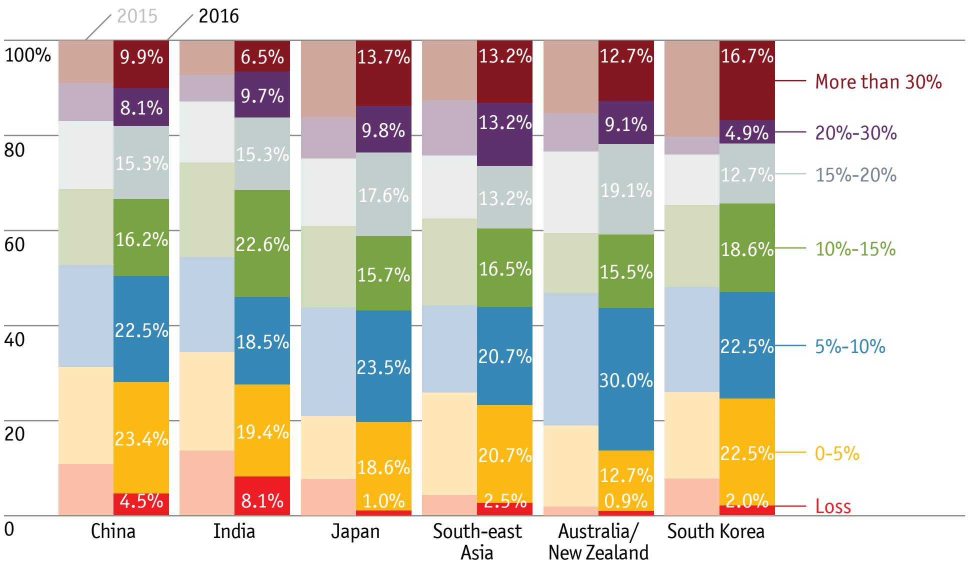
4. Regional profitability

Narrowing losses and greater earnings overall

This year's survey results point to an across-the-board drop in the proportion of companies registering losses. Even more encouragingly, respondents in a number of markets are anticipating growth at the highest profit margin rates of above 30%. (See figure 6.) Although not all expect to see growth at the highest rates compared to 2015, all respondents see their companies likely to be earning more at profit levels ranging between 5-10% and 20-30%. All in all, survey respondents have painted a generally optimistic profit picture for 2016.

Even for markets in the slowing giant of China, fewer companies anticipate losses in 2016 (4.5% compared to 2015's proportion of 10.7%). Respondents expecting China to offer earnings of 30% and greater have also increased, from 8.9% for 2015 to 9.9% for 2016. Although respondents see slightly less high-end profit margin opportunities for India (6.8% in 2016 from 7.2% in 2015), the outlook for a reduction of loss-making business

Figure 6: What were your operating profit margins for 2015/expected to be in 2016?
(respondents surveyed)



Source: The Economist Corporate Network.

activity India is noteworthy. The proportion of companies suffering red ink in India will drop from 2015's share of 13.6% to 8.1% in 2016 if survey predictions hold true.

It is not all unmitigated good news for India. Its 8.1% loss rate will be the highest in Asia in 2016. For all other markets, respondents from fewer than 5% of companies expect to lose money. The GDP growth laggards of Japan and South Korea somewhat conversely offer bullish prospects regarding the share of companies anticipating profit margins of 30% and greater. Slightly more than 13% of respondents expect this level of earnings for Japan, and 16.7% (the highest proportion among all surveyed) expect this for South Korea. Only 1% and 2% of respondents anticipate losing money in these North Asian markets respectively, whereas almost 8% of respondents reported losses for both markets in 2015.

The comparatively large portion of respondents expecting operating profit margins of above 30% for Japan, South-east Asia, Australia and New Zealand stem from varying favourable economic conditions. Markets in Japan and South Korea offer the sort of high-margin opportunities found during economic recovery from contraction (Japan) and downturn (South Korea). A number of Australian markets are enjoying positive spillovers from an economic rebalancing that has followed a severe slowdown in Australia's resource sector. South-east Asia continues to offer growth opportunities expected in well-performing emerging markets. A number of countries in the subregion are augmenting this baseline advantage by upgrading strategically important sectors, such as IT, while also providing relatively favourable policy environments. The next section explores this and related topics in greater detail.

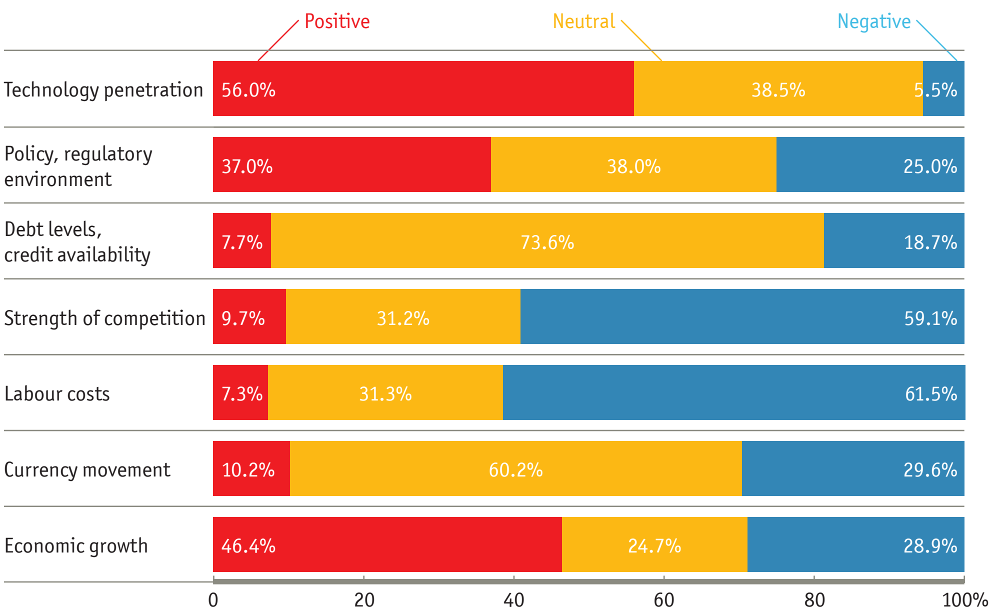
5. Profit and operations

Assessing the factors impacting profitability outlooks

To drill further into the macro conditions that influence business environments, the *Asia Business Outlook Survey* probed respondents about their views on positive, neutral, or negative effects on profitability according to changes across seven key dimensions of economic activity:

1. Economic growth
2. Currency movement
3. Labour costs
4. Strength of competition
5. Debt levels and credit availability
6. Policy and regulatory environment
7. Technology penetration in the market

Figure 7: Impact of changing economic factors on profitability, China
(respondents surveyed)



Source: The Economist Corporate Network.

CHINA PROFITABILITY FACTORS

For China, respondents rated technology penetration, economic growth, and the policy environment most favourably. (See figure 7.) The nation's technology penetration, the factor with a clear majority favourable assessment, is evident in it being home to the world's largest online and mobile populations. China's tech-enabled consumers patronise fast-growing, highly profitable sectors relating to e-commerce, mobile transactions (m-commerce), financial technology (fintech), and various novel forms of entertainment content delivery. China's most influential—and by some accounts, only—global brands hail from its IT sector.

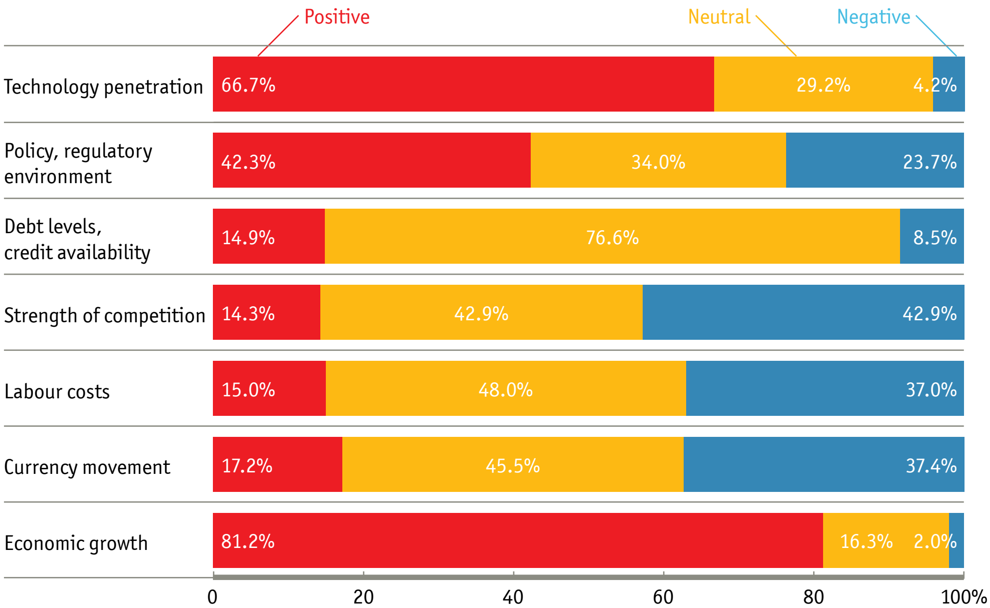
Foreign—and for that matter, most private Chinese—corporations do not usually sing the praises of China's regulatory environment. Nevertheless, for the changes under way in China's policy regime to receive a mainly positive or neutral review by survey respondents is not that surprising either. The government recently has bolstered professed commitment to "reform and opening up" and Beijing's much-touted efforts against corruption, a cornerstone of the reform strategy led by the president, Xi Jinping, have received generally favourably appraisals by the business community. (See page 35 for more detailed assessments.)

China fares much less positively in the categories of rising labour costs and strength of competition. The mainland's competitive environment is influenced by both structural factors and market forces. Structural matters the government could improve on if it wishes, but market forces represent part of the new-normal in marketplace reality whereby companies will need to develop appropriate strategies. Labour costs in China have been rising at the highest rate in Asia for the last ten years; ECN predicts continued record-setting rates for at least the next five. This is tough news for employers hoping for an attractive cost base but good news for companies hoping for increased spending power among Asia's largest population of consumers.

INDIA PROFITABILITY FACTORS

India's most positive characteristic to survey participants is its regionally top-performing rate of economic growth. This is ranked as a favourable contributor to conditions for profitability by 81.2% of respondents. (See figure 8.) India's technology base (positively rated by 66.7% of respondents), while not as advanced as Japan's or China's, is highly developed for an emerging economy. Mr Modi's policy objective of *Sabka Saath Sabka Vikas* ("Together with all, development for all") includes innovative applications of high-tech (biometric-identity numbers, for example) to help economically enfranchise India's underclass. Outstanding private schools, institutions of higher education, and technical training programs also bequeath the nation with a large pool of technologically skilled workers. A rapidly expanding economy and positive technology environment are seen as clearly beneficial to realising profit opportunities in the Indian marketplace.

Figure 8: Impact of changing economic factors on profitability, India
(respondents surveyed)



Source: The Economist Corporate Network.

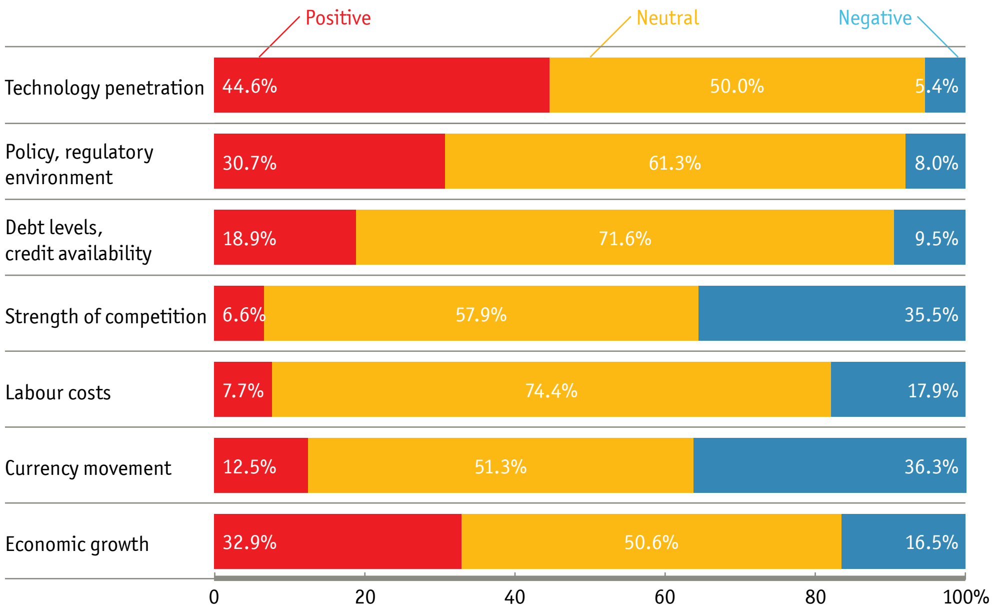
India's policy and regulatory conditions also earn a favourable review among 42.3% of respondents. This endorsement comes in some 5% higher than the proportion of respondents who positively rate China's policy environment. By the same token, about a quarter of respondents hold a negative view of policy conditions in India as well as in China—an indication of how much room remains for policy and regulatory improvements if either country hopes to meaningfully increase the appeal of their business environments.

In comparison with China, India also fares better with a relatively lower proportion of negative assessments in key areas like strength of competition (42.9% respondents viewing this negatively versus 59.1% for China) and labour costs (37% versus 61.5%). Yet these are hardly stable comparative advantages and could easily erode as markets mature and wage inflation sets in. As noted in the previous section on margin profitability, India distinguishes itself for having the largest proportion of respondents anticipating a loss with business activities there in 2016. India is entering 2016 with high expectations for its economic and business prospects but still confronts challenges for sustainable modernisation of its economy.

JAPAN PROFITABILITY FACTORS

Respondents view profitability factors in Japan more ambivalently than those in China, India, or South-east Asia. Japan's technology penetration attracted the highest

Figure 9: Impact of changing economic factors on profitability, Japan
(respondents surveyed)



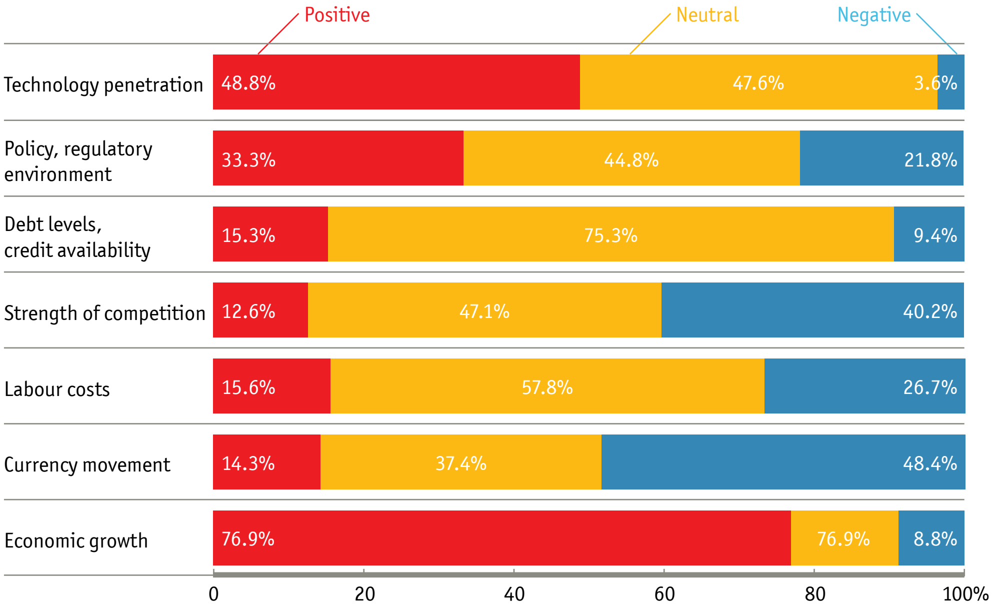
Source: The Economist Corporate Network.

proportion of any qualitative assessments, in this case a 44.6% positive rating. (See figure 9.) The next highest percentage of respondents, 36.3%, negatively rated Japan's depressed currency, the yen, as a factor working against profitability. The Abe administration has made weakening of the yen—which has depreciated from less than ¥80 to the US dollar in 2012 to a level hovering around ¥120 by 2015—a central component of Japan's economic strategy. The policy helps boost Japanese exports and drive inward investment but disadvantages imports. Competition, seen as negative by 35.5% of respondents, is followed by a 32.9% positive assessment of Japan's economic growth. Although still sluggish, the country's economy is on a rebounding trajectory.

SOUTH-EAST ASIA PROFITABILITY FACTORS

As illustrated in figure 10, economic growth throughout the ASEAN countries rates positively among a visibly large 76.9% of respondents. This favourable assessment for the impact of economic growth on the bottom line ranks at nearly as high as how respondents viewed the effect of India's fast-growing economy on profits. South-east Asia's technology penetration also attracts a proportionally high positive assessment by 48.8% of respondents. On the negative side, currency volatility was faulted by 48.4% of those surveyed. Strength of competition also garnered slightly more than 40% of

Figure 10: Impact of changing economic factors on profitability, South-east Asia
(respondents surveyed)



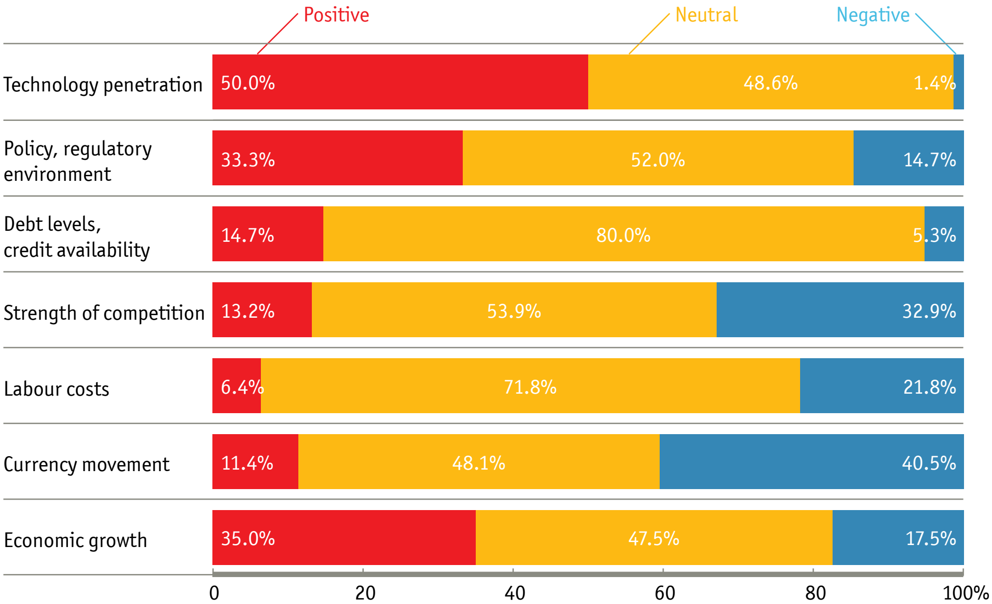
Source: The Economist Corporate Network.

respondents with an unfavourable view. On balance, policy and regulatory environment factors fared well with 33.3% of respondents seeing them as having a positive impact against 21.8% interpreting them negatively. The newly-formulated but yet-to-be-implemented multilateral trade agreement known as the Trans-Pacific Partnership (TPP) has among its signatories the subregion's countries of Malaysia, Vietnam, Singapore, and Brunei. With the TPP's intent to further open markets and eliminate regulatory barriers, it might offer one of the more tangible means to further enhance South-east Asia's policy and regulatory environments over time.

AUSTRALIA AND NEW ZEALAND PROFITABILITY FACTORS

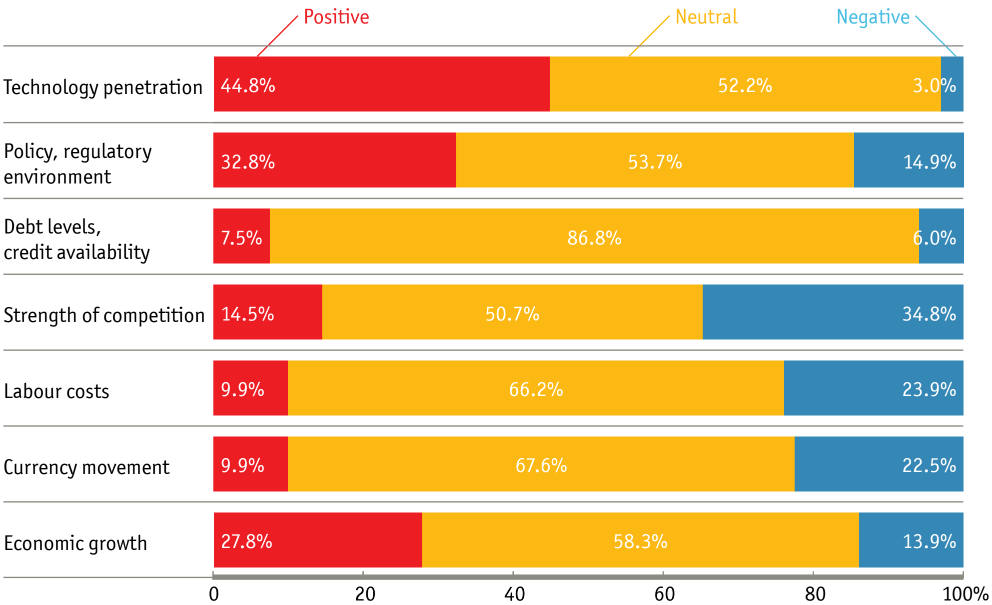
Australia and New Zealand score similarly to Japan with moderately positive views on economic growth and technology penetration, which were cited as conducive to profits by 35% and 50% of respondents respectively. (See figure 11.) The area generates predominantly neutral views on economic conditions such as labour costs and debt levels and credit availability. Considering that Australia and New Zealand are not only Westernised in an economic sense but also in terms of having developed within a Western liberal democratic political mould, it is somewhat unexpected that only 33.3% respondents favourably rated both countries policy and regulatory framework (a majority

Figure 11: Impact of changing economic factors on profitability, Australia/New Zealand
(respondents surveyed)



Source: The Economist Corporate Network.

Figure 12: Impact of changing economic factors on profitability, South Korea
(respondents surveyed)



Source: The Economist Corporate Network.

favourable view would have seemed more likely). Another 14.7% of respondents flatly consider the policy environment to be a drag on profits. Interestingly, on a net basis Japan outperforms Australia and New Zealand in this category: 30.7% of respondents favourably viewed Japan's policy and regulatory environment with only 8% giving a negative assessment.

SOUTH KOREA PROFITABILITY FACTORS

Technology penetration was the category that respondents most clearly cited as a positive factor for profitability in South Korea, earning high marks by 44.8% of those surveyed. (See figure 12.) South Korea's technology industry base, led by companies such as Samsung, LG, and SK Telecom, is undeniably impressive; so too is the nation's wired infrastructure which boasts the fastest average download data rate in the world. For respondents to not see technology as an outright (50% or greater) positive influence on profits, however, does point to this dimension of the economy being less crucial to business operations than would normally be expected. For example, neighbouring China—which provides a far slower, government-controlled Internet backbone and has not developed globally prominent IT brands to the degree that South Korea has—nevertheless has an evolving technology environment that rates positively by an outright majority (56%) of respondents. This reflects China's success at developing technology platforms that are noticeably contributing to the bottom line of firms. If South Korea were to undertake reforms to liberalise its markets and welcome more foreign participation in its economy, it could realise broader application of as well as perceived benefits from its superlative technological base.

6. Investing in Asia

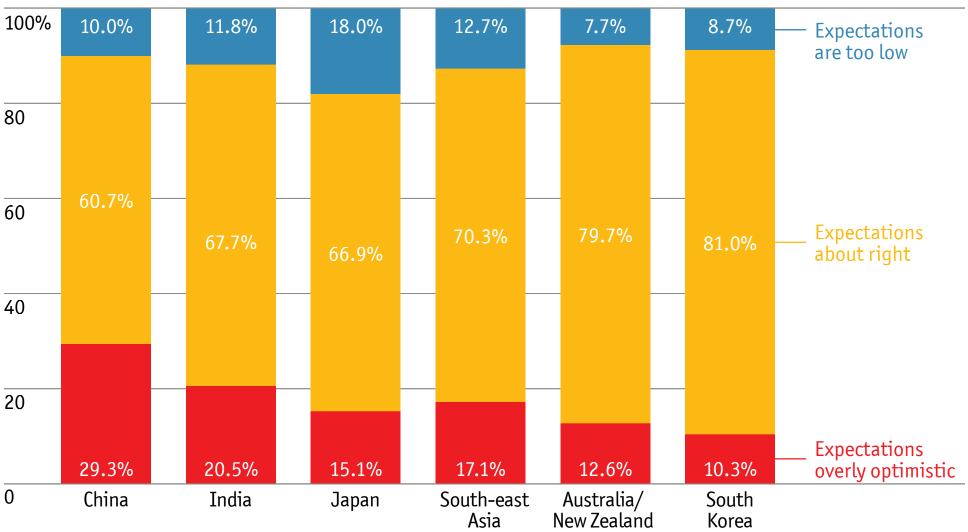
Matching ambitions with money

This year's survey revealed that managers of Chinese operations will be comparatively challenged by their firms' ambitious goals. When asked to assess whether their company's growth expectations for Asia Pacific are realistic, some 29.3% of respondents, the highest proportion for any assessment of mismatched expectations, felt that hopes for growth in China were "overly optimistic". (See figure 13.) Other markets that respondents notably felt have kindled unwarranted enthusiasm are India (20.5%) and South-east Asia (17.1%).

As a further demonstration of how hard it can be to convince senior leadership about market realities, a smaller but still meaningful percentage of managers felt that firms' expectations were "too low" for the same three markets, South-east Asia (12.7% of respondents), India (11.8%) and China (10%). If respondents are in fact seeing things accurately, then corporate-level expectations for these key territories are off some 30-40% of the time.

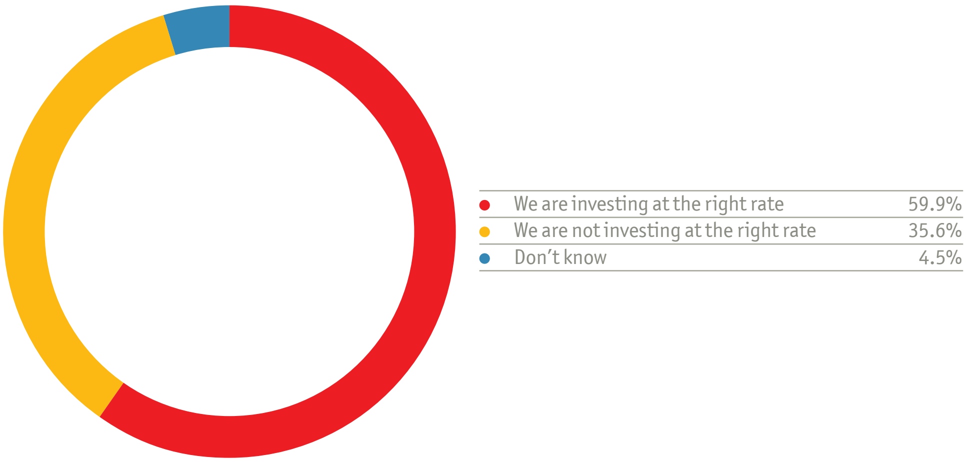
Living up to its image as a perplexing enigma to most outsiders, Japan was seen as misunderstood by survey participants in terms of overly pessimistic and overly optimistic

Figure 13: How do you assess your firm's expectations for growth in Asia?
(respondents surveyed)



Source: The Economist Corporate Network.

Figure 14: Is your firm investing in Asia at the right rate to achieve growth expectations?
(respondents surveyed)



Source: The Economist Corporate Network.

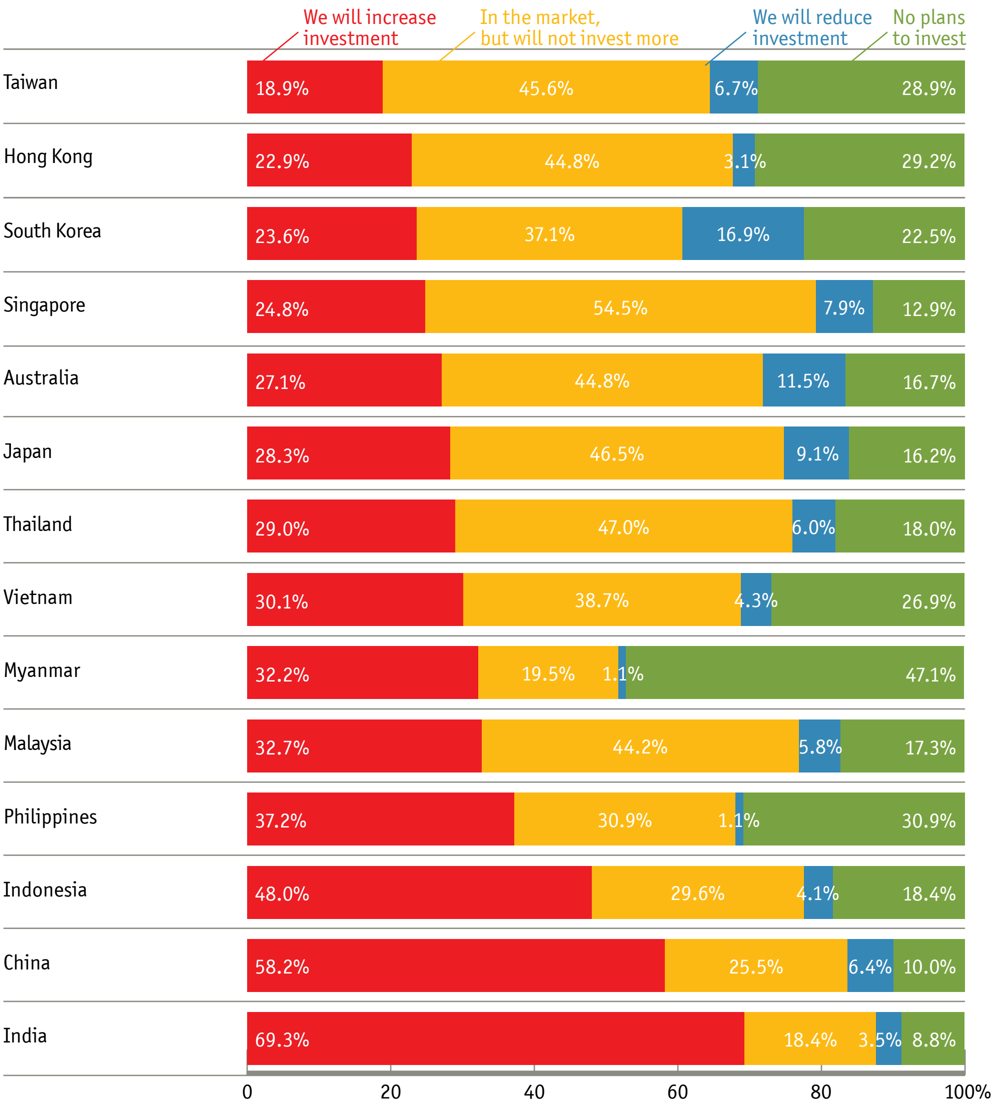
expectations in roughly equal measure. Some 18% of respondents feel corporate assessments of that market are too negative, while 15.1% feel they are too positive.

Consistent with the suggestion that expectations for business growth in Asia's leading economies are missing the mark some 30-40% of the time, 35.6% of respondents felt that companies are failing to invest at a rate necessary to match expectations. (See figure 14.) This is hardly a comforting result, but it also should be considered in the context that nearly 60% of respondents felt investment levels to be appropriate. Regardless, based on our survey's findings, companies should consider ways to better align funding with the true nature of opportunities in Asian marketplaces if they wish to optimise their potential for growth.

To add more insight on the 2016 outlook for investment in key Asian markets, we also asked respondents how they expect their firm's investments to change. Top destinations for attracting investors are India, China, and Indonesia, where respectively 69.3%, 58.2%, and 48.0% of respondents foresee an acceleration in investment. Illustrating Asia's enduring appeal as a target for investment, even the relative laggards in this part of the survey—Taiwan, Hong Kong, South Korea, and Singapore—are still viewed by between 18.9% and 24.8% of respondents as likely to pull in new funding. (See figure 15.)

The only markets where significant retrenchment of investment is anticipated are South Korea and Australia. Respectively 16.9% and 11.5% of those surveyed revealed that they expect a cut in funding commitments. Myanmar, which until recently has been largely shunned by the global business community, stands out for an unusually high percentage of respondents (47.1%) indicating that their companies still have no plans to invest there. Other countries being avoided for investment are the Philippines, Hong Kong, Taiwan, and Vietnam (between 30.9% and 26.9% of respondents). Asian economies suffering from a reduction in investment or being disproportionally passed over as investment destinations will need to build recognition as deserving markets if they want to take greater advantage of Asia's appeal for allocation of corporate funding.

Figure 15: How do you expect your firms investments in key Asian territories to change in 2016? (respondents surveyed)



Source: The Economist Corporate Network.

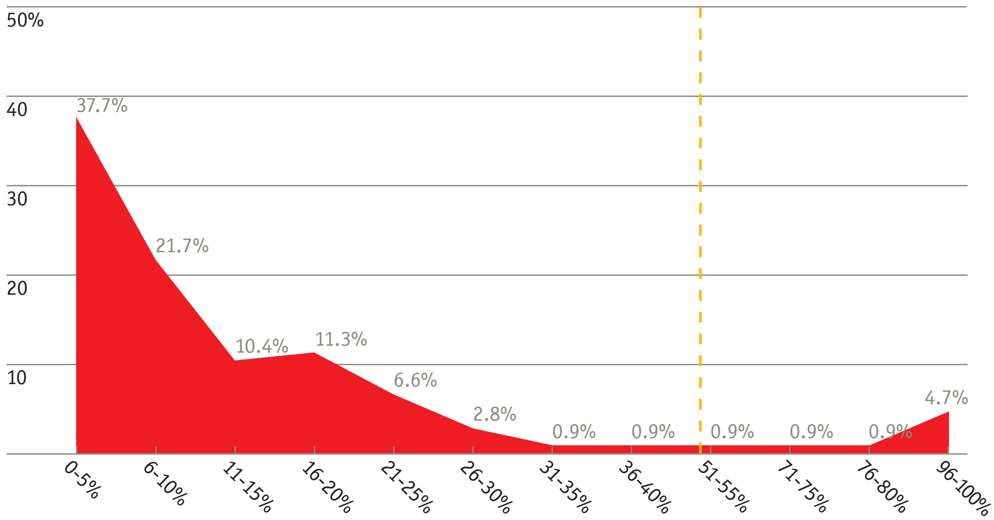
7. A growing R&D edge?

Asia's prospects in the world of innovation

Asia's role as a platform for sourcing and sales of products originally developed in the West has been gradually supplanted by a growing recognition of Asia-originated products and contributions to global innovation value chains. Japan's rise as a technology powerhouse in the 1980s was followed by world-leading advances in high-tech sectors from newly industrialised Asian economies such as South Korea and Taiwan. Recently China has emerged as a prolific investor in R&D, and by some measures has achieved levels of R&D activity that rival the United States.

To gain insight into what survey respondents are themselves observing with the changing role of R&D in Asia, we first asked what share of their firms' global R&D output currently comes from the region. (See figure 16.) The results showed that Asia's contribution to corporate R&D activity remains proportionally small. The majority of respondents (75.6%) noted that their firms have only up to 25% of their global R&D sourced from Asia. Slightly more than half of those surveyed (51.2%) indicated that the

Figure 16: What percentage of your firm's global R&D currently comes from Asia?
(respondents surveyed)



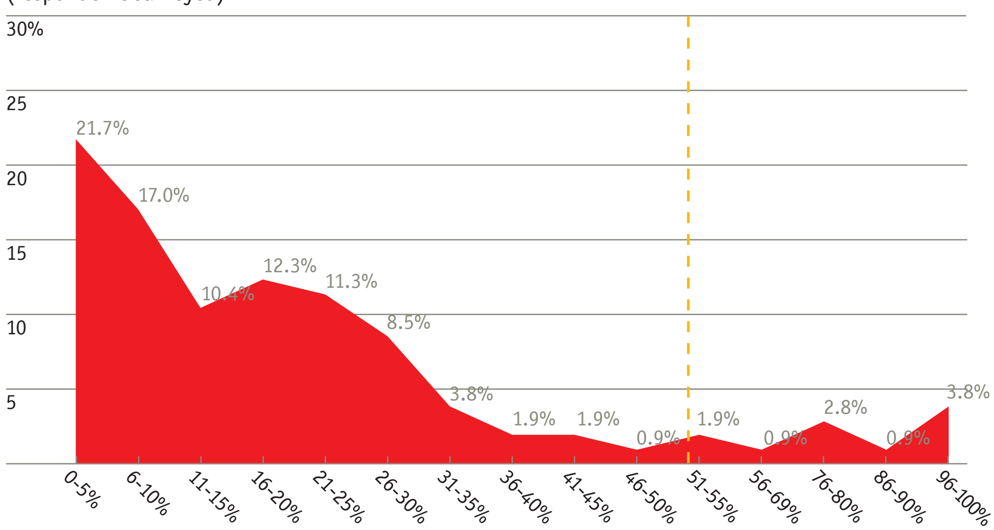
Source: The Economist Corporate Network.

sourcing amounts to 10% or less. Only 6.5% reported having more than 50% of their R&D coming from the area.

The future outlook for Asian R&D is far more encouraging. When asked what percentage of R&D they expect to come from the region by 2020, nearly three-quarters of respondents (74.8%) believe that up to 40% of global R&D will originate in the region by that time. (See figure 17.) A slight majority of 52.8% of respondents estimate that Asia's share of their firms' global R&D will be within the range of 0-20%—twice the amount estimated at present. While this represents a significant migration of commercial innovation towards Asia, the region is perceived to likely maintain a role more of support than dominance in the field of R&D. Only a small portion, 9.4%, of respondents estimate that the major share (50% or more) of their global R&D activity will be coming from Asian economies by 2020.

Asia's political, academic, and industrial leaders could facilitate an increase in Asia's worldwide R&D participation through enhancing education and management systems that foster inquisitive learning and creative thinking. For foreign multinationals, the figures also point to an opportunity/challenge for their leaders to better use their firms' Asian talent pool and other resources so that Asia-based contributions to global innovation more closely align with Asian contributions to global revenues. The following section further explores this broader context of Asia's growing importance as a source of corporate global revenues.

Figure 17: What percentage of your firm's R&D do you expect will come from Asia by 2020?
(respondents surveyed)



Source: The Economist Corporate Network.

8. An easterly swell

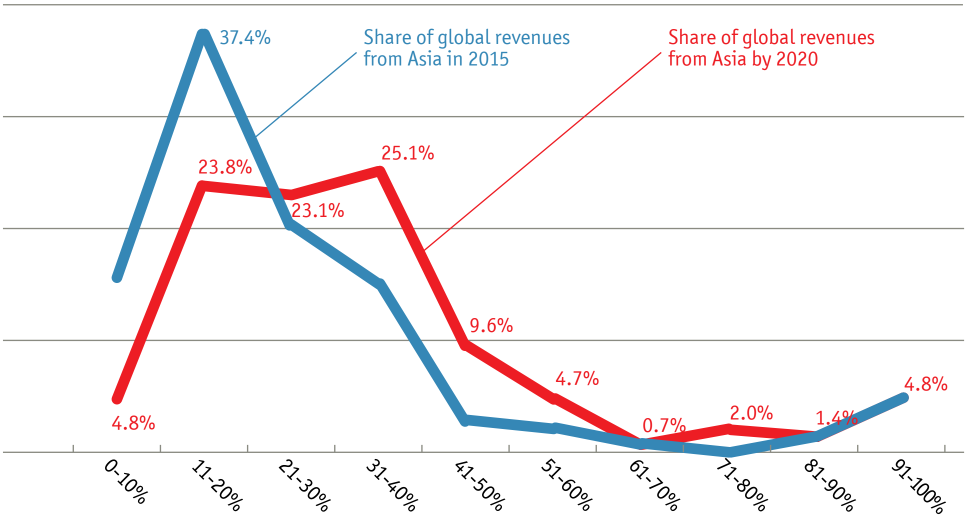
Is senior management positioned to follow the money?

Asia's importance as a source for global revenues is on the rise. A proportional majority of 37.4% of survey respondents observed the region accounting for 11-20% of sales for 2015. (See figure 18.) Yet 48.2% (close to an absolute majority) anticipate Asia to account for between 21-40% of their worldwide revenues by 2020. Corporate revenue streams are in an eastward swell.

The coming tide of revenue flows offers tremendous promise for companies positioned to capitalise on the shift. How well is the senior leadership of companies situated to respond?

Among the respondents who work for companies headquartered outside Asia, 37% indicated having at least one main-board director based in Asia presently. (See figure 19.) Within that group, 12.8% reported having two or more directors based in the region. An additional 16.8% foresee likely having at least one director based in Asia by 2020. This implies that slightly over one-half of non-Asian companies will have one board member based in Asia by the end of this decade.

Figure 18: Asia's contribution to respondents' global revenues (respondents surveyed)



Source: The Economist Corporate Network.

Figure 19: Are any members of your company's main board of directors based in Asia?
(respondents whose companies are not headquartered in Asia)

Yes, two or more already	12.8%
Yes, one already	24.2%
No, but there likely to be one by 2020	16.8%
No, and unlikely to be one by 2020	46.3%

Source: The Economist Corporate Network.

These responses suggest that companies based outside Asia do appreciate its swelling influence to some degree. But looking ahead, can companies benefit even more by building a stronger presence with board members based in Asia?

Assuming an average board comprises of seven directors*, then two or (more preferably) three board members should be expected to have reasonable familiarity with Asia for any firm receiving as much as 40% of its revenues from the region. As noted above, almost one-half of respondents surveyed anticipate Asia to contribute between 21-40% of their firm's worldwide revenue base by 2020. However, less than 15% of respondents from companies headquartered outside Asia affirmed having two or more directors in the region currently. Many companies could find themselves ill prepared to benefit from the swelling tide of Asia-originated sales unless the average number of Asia-based—or, in any case, Asia-*experienced*—directors increases accordingly.

The picture for the heads of business units based in Asia is slightly stronger. Some 22% of respondents from firms headquartered in non-Asian territories reported having two or more such top executives in the region already. (See figure 20.) A significant majority of 62.3% expect to have at least one such person by 2020. The numbers, functions, and sizes of business units differ so widely between companies that any categorical statement about how many heads of business units on average should be located in Asia is difficult to make. Yet here again a crucial question emerges regarding adequacy. As the chiefs of business divisions typically represent the senior-most direct contributors to a firm's revenue-generating capacity, their increased exposure to Asia

*Audra L. Boone, Laura Casares Field, Jonathan M. Karpoff, and Charu G. Raheja, "The Determinants of Corporate Board Size and Composition: An Empirical Analysis," *Journal of Financial Economics* 85 (2007): 66–101.

Figure 20: Are any global heads of your firm's business units based in Asia?
(respondents whose companies are not headquartered in Asia)

Yes, two or more already	22.0%
Yes, one already	24.5%
No, but there likely to be one by 2020	15.7%
No, and unlikely to be one by 2020	37.7%

Source: The Economist Corporate Network.

would be expected to support a firm's ability to respond to the increasing opportunities in the region.

Accordingly, to have less than one-quarter—only 22%—of non-Asian company respondents indicate that two or more heads of business units are based in Asia points to a potential area of corporate weakness. Many foreign companies might be unprepared for the region's growing role as a contributor to global sales. For those companies that already have or plan to add business unit leaders to their Asia operations by 2020, time will tell if these senior management configurations prove adequate to address Asia's anticipated rise as a major revenue source.

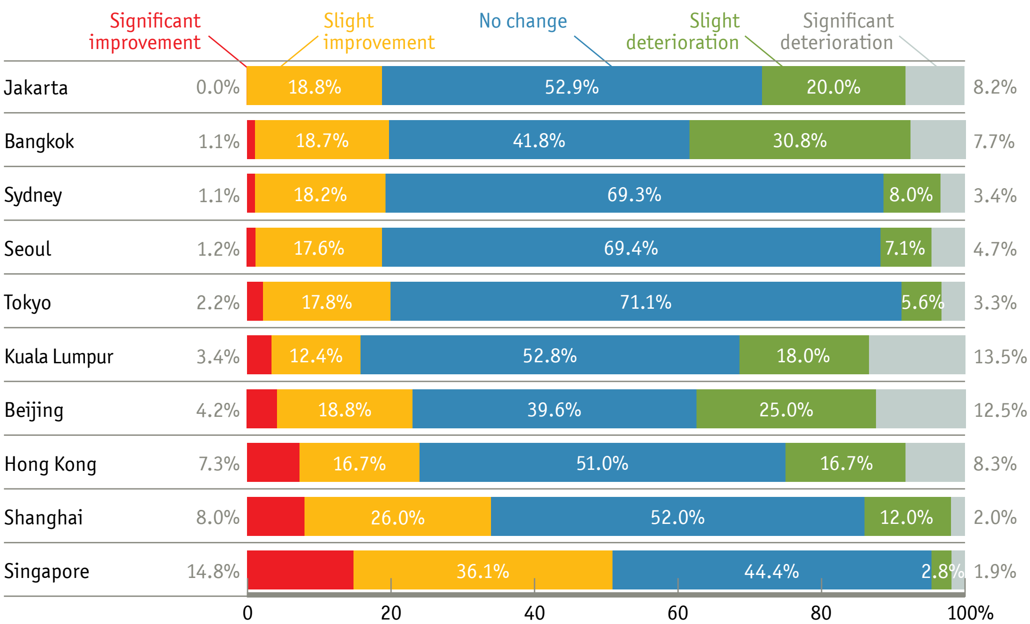
9. Urban magnets

Asian cities and the forces of attraction and repulsion

Just as globally operating companies should be prepared for the rise of Asia, Asian cities also should be prepared to support such enterprises with world-class environments for doing business.

Regarding the site selection of a firm's Asia regional management operations, Asian cities in effective compete with one another to draw in companies and their staff. For businesses operating in Greater China, the main choices for basing regional operations are typically Shanghai, Beijing or Hong Kong. For South-east Asia, Singapore tends to dominate the selection of regional headquarters but Kuala Lumpur, Jakarta, and Bangkok are also options. For covering all of Asia, Hong Kong or Singapore are popular choices for more widely scoped regional headquarters, but locations like Shanghai, Beijing, and Tokyo (among others) also sometimes play this role.

Figure 21: Throughout 2015 how have your views about various Asian cities changed as regards centres for regional management operations? (respondents surveyed)



Source: The Economist Corporate Network.

MOST IMPROVED, MOST DETERIORATED

We asked survey participants how their views on the various Asian cities as bases for regional management centres have changed throughout 2015. Only three cities rated as having significantly improved by more than 5% of respondents: Singapore, at 14.8%, followed by Shanghai, 8%, and Hong Kong, 7.3%. (See figure 21.)

If including cities that merited recognition for both significant and slight improvement by at least one-fifth of respondents the cities that make the list are Singapore (50.9%) followed by Shanghai, Hong Kong, Beijing and Tokyo (which in descending order were mentioned by between 34% and 20% of respondents).

Beijing and Hong Kong unfortunately also rank among those cities deemed to have significantly deteriorated, a grouping led by Kuala Lumpur followed by Beijing, Hong Kong, Jakarta and Bangkok (cited by between at 13.5% and 7.7% of respondents).

The cities that exceeded one-fifth of respondents considering them as slightly or seriously deteriorated are Bangkok (38.5%) followed by Beijing, Kuala Lumpur, Jakarta and Hong Kong (mentioned by 37.5% to 25% of respondents).

FORCES OF ATTRACTION AND REPULSION

We factored in the two extremes to understand how these cities perform as magnets for regional centres of management in the eyes of the entire survey base. Our analysis reveals that two cities are perceived as notably more improved than deteriorated: Singapore, whose view for overall improvement minus overall deterioration was 46.3%, and Shanghai, whose overall improved perception was 20%.

Conversely, none of the cities had a net proportion of more than one-fifth of respondents who consider them to have deteriorated more than improved. Nonetheless, three cities—Bangkok, Kuala Lumpur, and Beijing—clustered in a comparatively high grouping of locations that on balance are viewed negatively. These three capitals respectively saw 18.7%, 15.7%, and 14.6% in terms of net responses rating them to have worsened more than improved.

As magnets for basing regional operations, Singapore and Shanghai thus exert the greatest forces of attraction. Bangkok, Kuala Lumpur and Beijing conversely exert the greatest forces of repulsion.

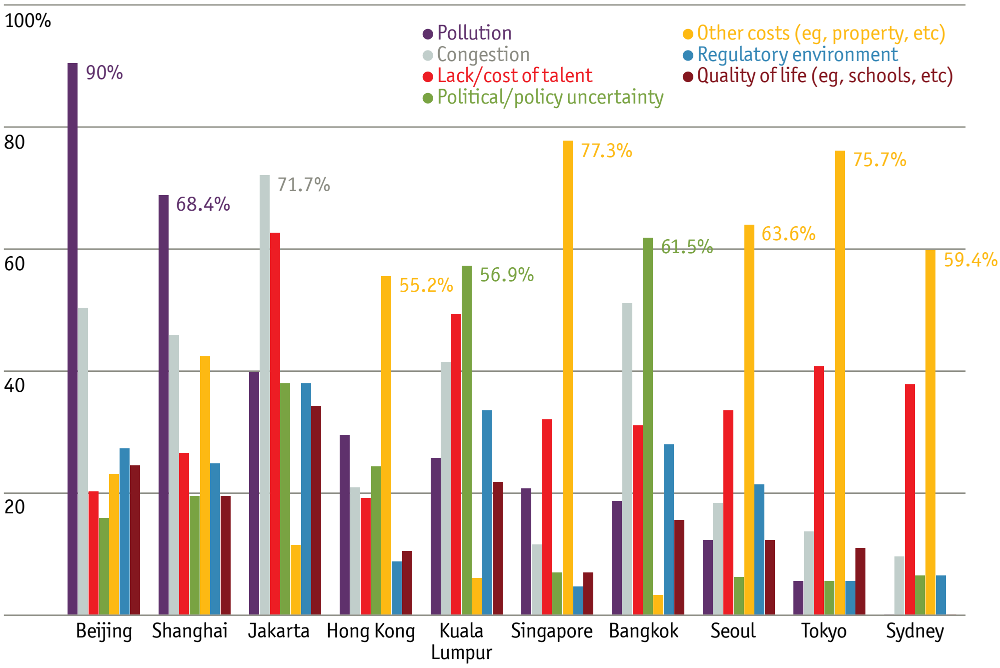
ISSUES DRIVING RELOCATION

Despite ranking as Asia's most attractive city, Singapore also scored highest among respondents who unfavourably rated its high cost base excluding human resource (HR) costs (a category that incudes items such as property prices). The Lion City's non-HR costs were rated as problematic by 77.3% of respondents, the second highest of all scores in this evaluation of negative factors. (See figure 22.) Only Beijing performed worse with a massively high 90% of respondents citing the capital's notorious pollution as a motivating factor to relocate operations.

Like Singapore, Tokyo, Seoul, Sydney and Hong Kong all had non-HR costs receiving mention by over one-half of respondents as a reason to consider relocation. Congestion in Jakarta (faulted by 71.7%), pollution in Shanghai (68.4%), and political uncertainties in Bangkok (61.5%) and Kuala Lumpur (56.9%) rounded out the picture detailing undesirably factors.

These survey results indicate that even for well-regarded cities such as Singapore and Shanghai, their comparative advantages are far from absolute. For the likes of Bangkok, Beijing, and Kuala Lumpur—where many respondents cited unfavourable conditions—their political and commercial leaderships have that much more motivation to exert efforts at improvement.

Figure 22: What issues might cause you to consider relocating operations or moving headcount away from any of these locations in the next two years (2016-2017)?



Source: The Economist Corporate Network.

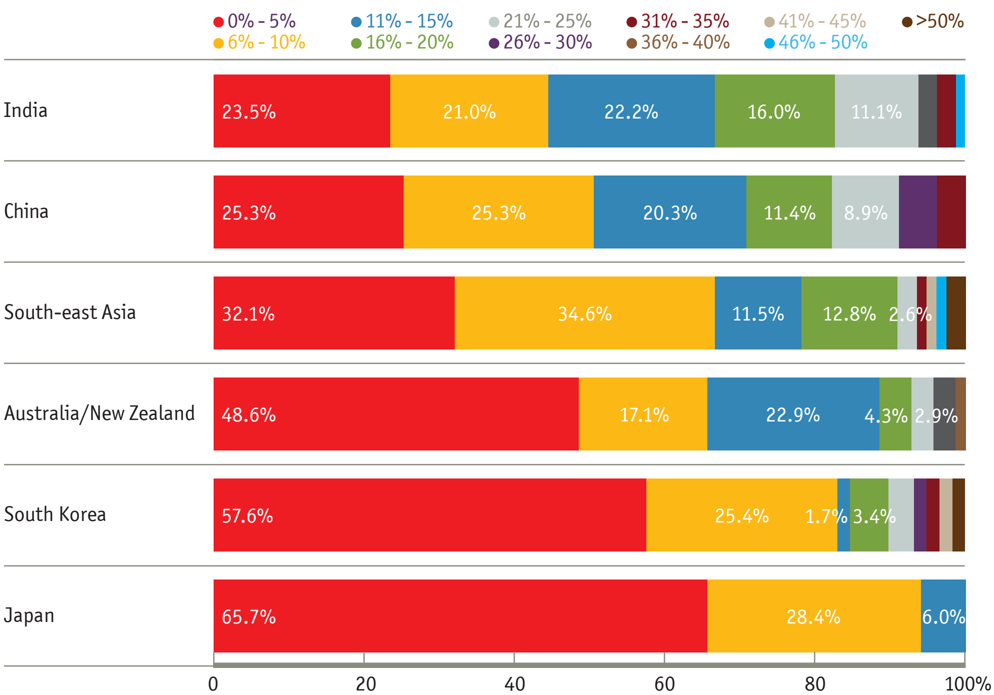
10. Human resources

The challenge to retain talent in Asia

For most corporations the ability to integrate and retain human resources across marketplaces represents a vital competitive asset. Workforce development is ultimately in the hands of individual firms but local operating environments also play a critical role in providing talent pools receptive to staying with an employer.

Respondent answers showed Asian markets to coalesce around a norm of 6-10% in annual staff turnover. As depicted in figure 23, the observed 6-10% rate of turnover ranges from a low of 17.1% for Australia/New Zealand to a high of 34.6% for South-east Asia.

Figure 23: What is your company's annual staff turnover ratio in Asia?
(respondents surveyed)



Source: The Economist Corporate Network.

LOW-TURNOVER ECONOMIES

The more mature economies of Japan, South Korea, Australia and New Zealand fare well for employers in search of workforces with a tendency to stay put. Some 48.6% of those surveyed indicated that staff turnover at their companies is less than 5% for Australia and New Zealand; 57.6% said the same for South Korea. For Japan that low rate of turnover was observed by 65.7% of respondents, the highest level of workforce stability recorded by the survey. Nearly all respondents (94%) put their company's annual turnover rate in Japan at within 10%. Japan is the only market covered in our survey where no more than 15% of employees were observed to leave a firm annually.

HIGH-TURNOVER ECONOMIES

Asia's fastest-growing economies are also the most volatile with staff turnover. Some 54.3% cited India and 49.4% cited China as markets where they expect annual turnover rates of between 11% and 35%, with large proportions of these groups (about 50% for India and 40% for China) seeing turnover within the range of 11-25%. China's slightly better performance likely can be attributed to the nation's lengthier experience with opening markets to foreign companies and its more developed urban labour force.

Australia and New Zealand and South-east Asia ranked as the next most frequently mentioned economic areas for employee turnover. Australia has been contending with worsening rates of unemployment—from less than 5.2% in 2012 to over 6.2% in 2015—and disruptions that come from economically restructuring away from reliance on a once-high-flying mining industry towards other sectors such as services. These factors likely contributed to 32.9% of respondents observing staff turnover rates in Australia of 11-30% (which would include involuntary as well as voluntary moves by workers). More than one-quarter of respondents (28.2%) witnessed annual turnover in South-east Asian markets of 11-35%, with most (about 24%) seeing it at the lower end of that range, 11-20%.

As intimated by the relatively low rates of staff turnover recorded for companies operating in more mature Asian markets, employee retention to a large degree can be attributed to a wider economy's stage of development. When operating in Asia's fast-growing emerging markets, employers need to be prepared for tendencies—and geographically varying tendencies at that—towards staff turnover and strategise accordingly.

11. China's crackdown on corruption

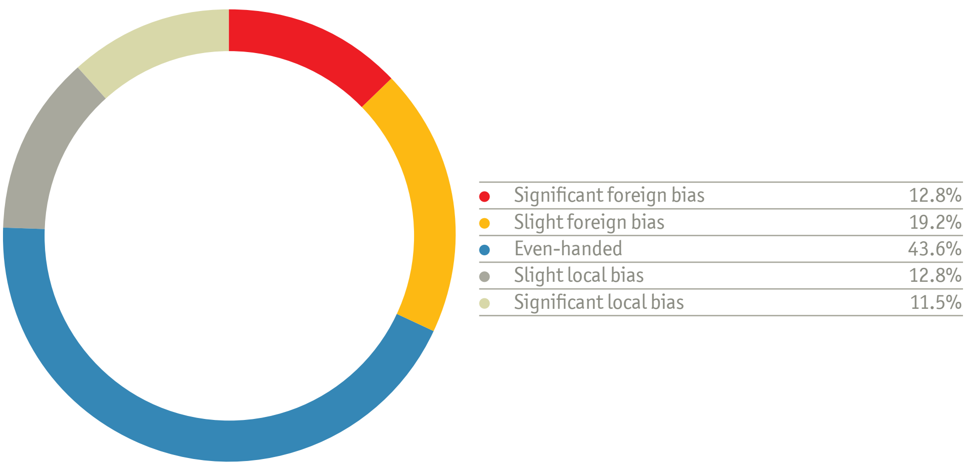
Are foreign firms unjustly targeted?

Since Xi Jinping assumed the general secretaryship of the Chinese Communist Party in 2012, he has initiated a program to root out corruption within the party, government institutions, and business interests. Among foreign individuals and companies doing business in China, one frequently hears the contention that the anti-corruption campaign also serves protectionist aims, intending to restrict the ability of foreign firms to compete fairly in China.

We therefore asked survey participants about their perceptions of bias in China's anti-corruption efforts and the impact the campaign is having on their business. In line with common perceptions, more respondents, 32%, saw the efforts as biased against foreign firms to some degree. As illustrated in figure 24, most of the respondents who saw bias against overseas enterprises viewed this as more in terms of a "slight" than a "significant" unfairness. Notably, the highest proportion of respondents (43.6%) considered the effort to be even-handed.

On the basis of the campaign's perceived biases, what was rather surprising was how the same respondent group (which mainly consists of foreign company executives)

Figure 24: Does China's anti-corruption campaign seem targeted more at local companies or foreign companies? (respondents surveyed)



Source: The Economist Corporate Network.

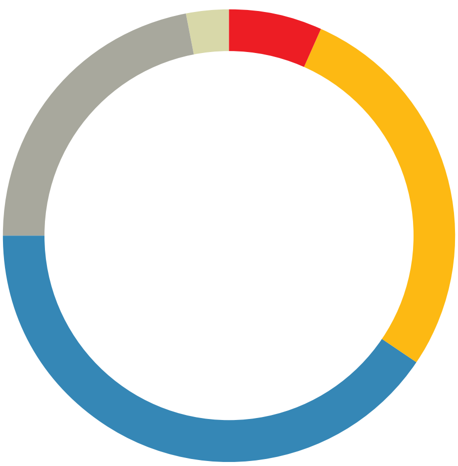
nevertheless saw the effect on their operations as more beneficial than detrimental.

A total of 34.6% of respondents rated the campaign as significantly or slightly positive for business (figure 25). This compares to 25% who judged it significantly or slightly negative. Interestingly, twice as many saw the impact as "significantly positive" compared to those who saw it as "significantly negative". Considering the perceived anti-foreign bias and the larger proportion of foreign company executives surveyed, one naturally would expect more of a negative impact on business.

If taken at face value, these seemingly contradictory results suggest that although China's anti-corruption campaign is somewhat biased against foreign companies, it has all the same served its intention to clean up the business environment. This would have the effect of improving market efficiencies and increasing opportunities for legitimately competing enterprises, including foreign ones. Put another way, survey responses indicate that while the anti-corruption campaign might be *unfair* (ie, biased against foreign companies) it is perhaps *not unjust* (ie, effectively producing better operating conditions for everyone's benefit).

A robust measure of true impartiality and the quality of economic justice delivered through China's anti-corruption campaign would represent a complex undertaking, certainly one that lies beyond the scope of our survey. Regardless, these basic results do provide a useful view on the net effect that one of China's most talked about political initiatives is having on Asia's largest economy. Foreign companies that can manage to accommodate the campaign's biases can also expect to reap the rewards of an improving Chinese business environment.

Figure 25: What impact is China's ongoing anti-corruption campaign having on your business? (respondents surveyed)



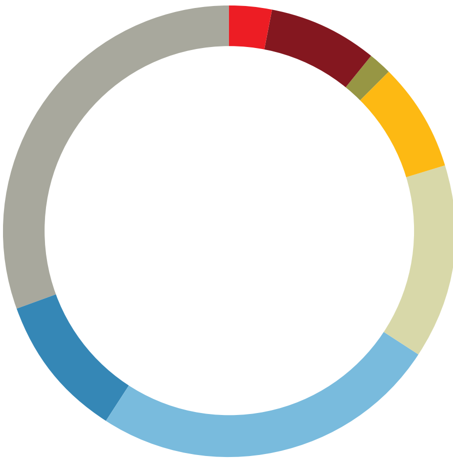
Significantly positive	6.7%
Slightly positive	27.9%
No change	40.4%
Slightly negative	22.1%
Significantly negative	2.9%

Source: The Economist Corporate Network.

Appendix

Firmographics of 223 survey respondents

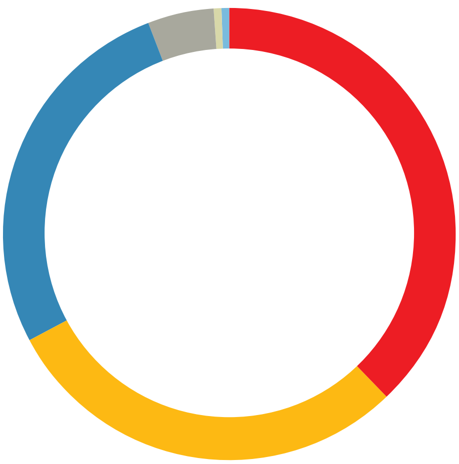
Figure 26: Survey respondents by global revenue



Less than US$10m	3.2%
US$10m to US$50m	7.7%
US$50m to US$100m	1.8%
US$100m to US$500m	7.7%
US$500m to US$1bn	14.0%
US$1bn to US$5bn	24.9%
US$5bn to US$10bn	10.4%
US$10bn or more	30.3%

Source: The Economist Corporate Network.

Figure 27: Survey respondents by location of global headquarters



Europe	37.9%
North America	29.5%
Asia	26.9%
Australasia	4.8%
Latin America	0.4%
Middle East/Africa	0.4%

Source: The Economist Corporate Network.

Figure 28: Survey respondents by industry sector

Financial services	20.6%
Other	10.8%
Consumer goods & retail	9.9%
IT & software	9.9%
Professional services	8.5%
Pharmaceutical & healthcare	6.7%
Chemicals	6.3%
Manufacturing	5.4%
Property & construction	4.9%
Automotive	3.6%
Commodities	3.1%
Engineering	2.7%
Transport & logistics	2.7%
Media & marketing	2.2%
Hotels & leisure	1.8%
Government	0.9%

Source: The Economist Corporate Network.

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