The Economist Corporate Network

RETHINKING PROFITABLE GROWTH

Insights from Asia's business leaders on their outlook for 2014

Asia Business Outlook Survey 2014

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Preface

Rethinking Profitable Growth is an Economist Corporate Network (ECN) report. It is based on a survey of the 500 clients of ECN based in the Asia Pacific region. The report was sponsored across the region by Hays, HP, Jones Lang LaSalle and Carlson Wagonlit Travel. The ECN performed the research and wrote the report independently. The findings and views expressed in this report are those of the ECN alone and do not necessarily reflect the views of the sponsors.

We would like to thank all respondents to our annual Asia Business Outlook Survey for their time.

January 2014.

Contents and Executive Summary

1. Introduction

Asia's business leaders share their perspectives on the region

Every year, the Economist Corporate Network—the business advisory service of The Economist Group—surveys its 500 clients in Asia Pacific. The collective views of these 500 companies provide critical feedback from the frontlines of doing business in the world's fastest growing region.

The latest Asia Business Outlook Survey (ABOS) was carried out in December 2013 and gives a detailed perspective on how businesses are performing, what they expect in the year ahead, where they are investing, and the challenges they face.

Some 334 respondents completed the survey, with an even spread from India in the west to Japan in the east, and from China in the north, to Australia in the south. Respondents were all senior executives, many of them with overall responsibility for the Asia Pacific region. They work in a wide range of industries, from oil and gas to healthcare and pharmaceuticals, and from IT and telecoms to banking and insurance. Of the respondents, 22% work at Asian multinational companies, while the rest work for non-Asian companies. All of them are based in the region and run businesses here. (See Appendix on page 36 for more details about the survey respondents.)

2. An improving Asia?

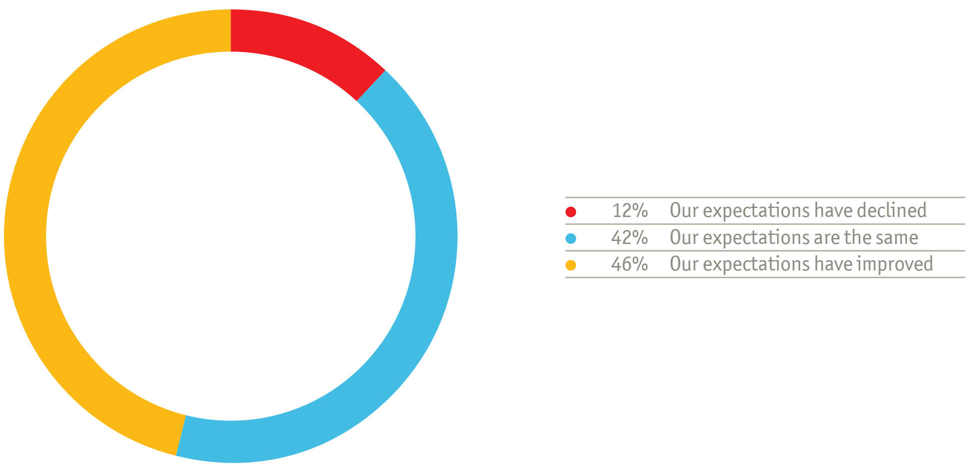
Sentiment is improving, with executives budgeting for higher growth in 2014

For many executives in Asia, the year 2013 was one of unexpected turbulence. The world's two biggest economic engines—the US and China—both caused concern. In America, threats by the Federal Reserve to end its ultra-loose monetary policy of recent years sent shockwaves through emerging markets. Hot capital flows that had once poured into Asia, retreated back to the US, causing currencies and stockmarkets to tumble and confidence to waver. Meanwhile, China also threatened a tighter policy environment, spurred by worries about an unsustainable build-up of debt.

Today, both risks—of an end to quantitative easing in the US, and a slowdown in China's debt-driven growth—still hang over the region. But respondents to our latest ABOS survey are feeling optimistic. At a high level, 46% of executives say their expectations for Asia have improved today compared to a year ago. Only 12% say they have fallen. (See chart 1.)

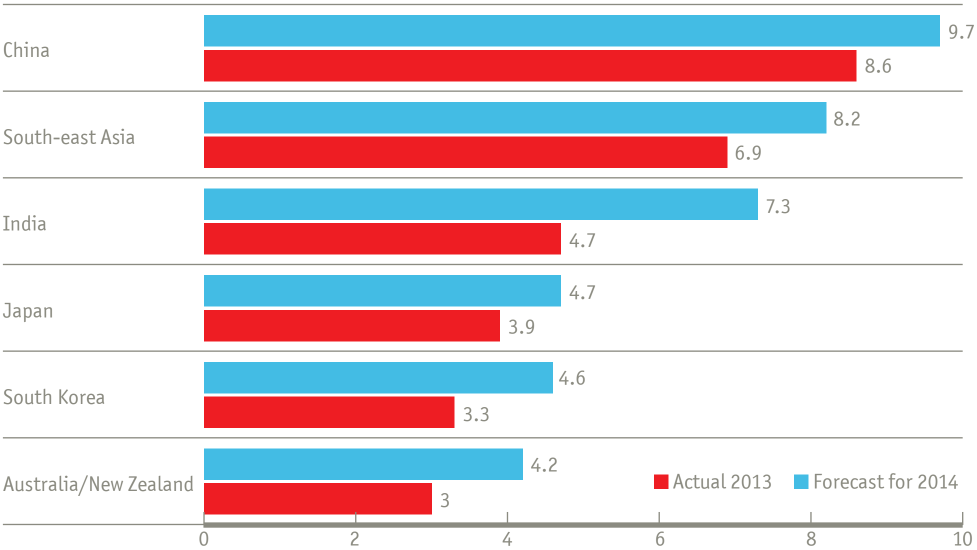
Equally, our survey shows that companies expect their sales to grow more rapidly in

Chart 1: Have your business expectations for Asia Pacific changed over the past year? (% of respondents)



Source: Economist Corporate Network ABOS 2014

Chart 2: How did your revenues grow (or decline) in 2013, and what do you expect in 2014? (annual % change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

2014 than they did in 2013. Indeed, for every territory, executives expect growth rates to pick up in the year ahead. (See chart 2.)

Unsurprisingly, China is expected to deliver the highest rate of sales growth, at 9.7%. The mature economies of Japan, South Korea, Australia and New Zealand will deliver the slowest rate of sales growth, but nonetheless, all are expected to do better in 2014.

Japan is particularly interesting. Throughout this survey, executives express confidence that the new economic policies of Shinzo Abe, the prime minister, are feeding through into a more exciting era for the country. Japan will certainly face challenges, notably when the country raises its consumption tax in April. Similar tax rises in the past have been deeply negative for the economy. But companies appear confident that the new backdrop of extreme monetary expansion coupled with fiscal stimulus will offset any negative impact. In the medium-term, it is hoped that structural reforms to the economy will pick up the baton of driving growth.

India also stands out. Executives have high hopes that their rate of sales growth will pick up sharply, from 4.7% last year to 7.3% in 2014. India's economy has lost momentum in the past couple of years thanks to political and policy mismanagement, entrenched inflation, and a less supportive global economy. In 2014, a general election could see a new, more effective government enter office. What's more, a raft of investor-friendly policies introduced in the past 18 months may start to have an impact.

3. Is the optimism justified?

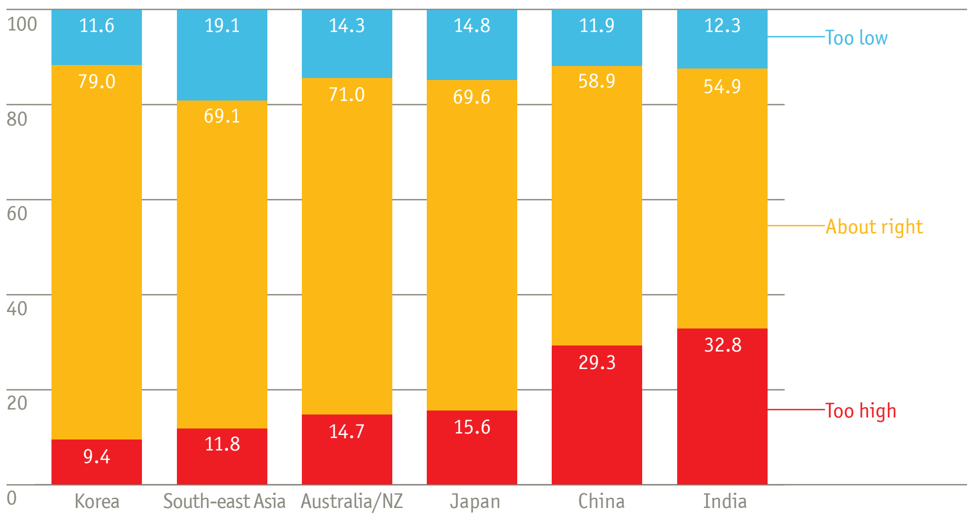
Many executives feel corporate expectations for Asia are too high, and that their companies are under-investing in the region

When asked to assess whether their company's growth expectations for Asia Pacific are realistic, many respondents to our survey said no. In India, for example, a third of executives feel their expectations are unrealistically high. In China, 30% feel the same way. (See chart 3.)

For executives at Western companies, one oft-cited reason for overblown expectations in Asia stems from the weakness in their home markets. Given the recessionary conditions of recent years in the US and Europe, Western multinationals have come to rely on emerging markets, and especially on Asia, as the engine of their sales growth. For many firms, Asia has delivered.

But have these companies become overly reliant on Asia's economies to produce their growth? And have they become overly confident in Asia's continuing strength? Much of the growth in Asia Pacific over the past five years has been driven by rising debt, and this engine is now starting to run out of steam. As we stand on the cusp of 2014,

Chart 3: Are expectations for revenue growth at your company too high, too low or about right for the following territories? (% of respondents)



Source: Economist Corporate Network ABOS 2014

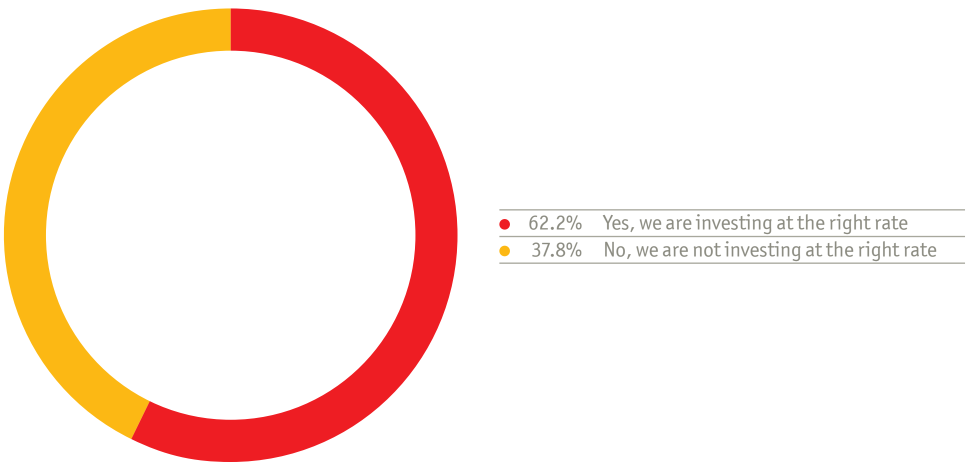
the rich world looks increasingly buoyant. Indeed, Japan, Europe and the US are all showing a synchronised recovery. As demand in these countries grows, it may stimulate export industries in emerging Asia to take the place of domestic debt as an economic engine for the region. But this is by no means guaranteed.

Importantly, many executives feel that expectations are too high because they are under-investing relative to their targets. Some 38% of respondents feel their companies are not committing resources to the region at the pace required to hit their revenue targets. (See chart 4.)

When viewed by sector, the greatest sense of under-investment is found in sectors that serve more mature market segments, the sort that flourish as economies get richer. This includes professional services (such as accountants and lawyers), healthcare and pharmaceuticals, and financial services. By contrast, respondents from more established sectors in Asia, such as those linked to core economic infrastructure (construction, logistics) or first-order market opportunities (consumer and retail), are most likely to feel they have got their investment mix right. It could be that markets for higher-end goods and services in Asia Pacific are developing more rapidly than companies had anticipated, hence a sense of under-investment to keep up with the opportunity. (See chart 5.)

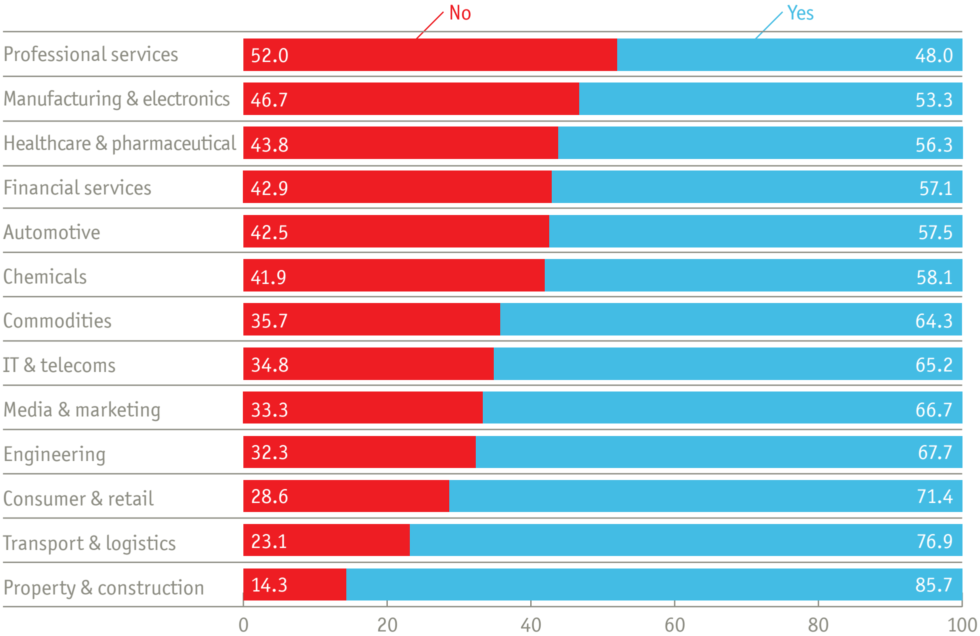
The exception to this thesis is the manufacturing and electronics sector. These industries have been well-established in Asia for many years, and yet executives feel

Chart 4: Is your company investing at the right rate in Asia Pacific to achieve its revenue expectations? (% of respondents)



Source: Economist Corporate Network ABOS 2014

Chart 5: Is your company investing at the right rate in Asia Pacific to achieve its revenue expectations? (% of respondents)



Source: Economist Corporate Network ABOS 2014

they are significantly under-investing. Possibly this situation is linked to the slowdown in global trade of recent years, whereby lacklustre export growth has caused companies to hold back on new investment. Equally, however, it could be due to rapidly rising labour costs. Much of Asia's manufacturing landscape grew up on the back of cheap workers. But wages are rising sharply. It could be that manufacturers feel the need to invest in more capital-intensive production in order to offset labour pains, and that this transition is not happening quickly enough.

4. Losing share of wallet?

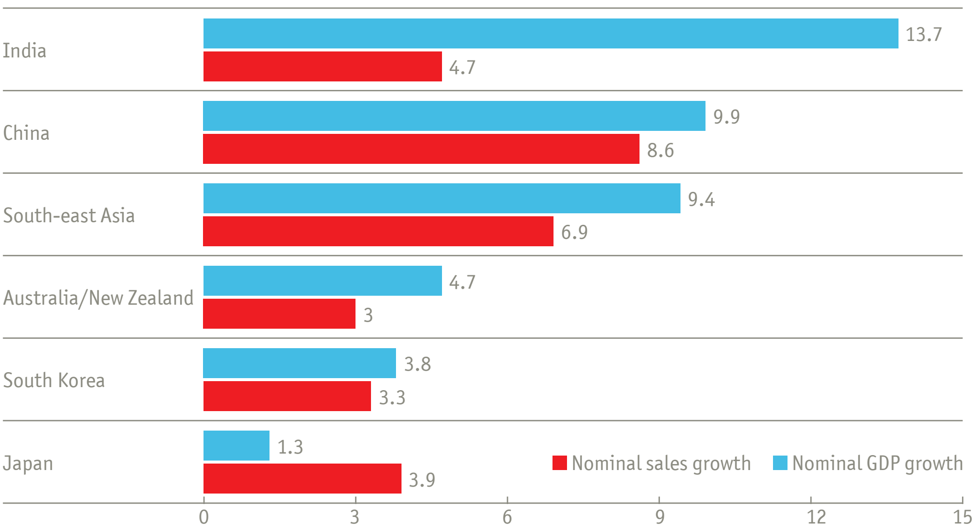
Companies in our survey are growing more slowly than the underlying economies in which they operate—except in Japan

Japan emerges as one of the brightest spots in our survey this year. One of the more intriguing findings, for example, is that Japan is the only country in Asia where respondents say they are growing their businesses more quickly than the underlying economy.

Chart 6 plots nominal sales growth at respondents' companies (which reflects both increasing volumes and price rises) against nominal GDP growth (which includes inflation). As such, it offers a rough proxy for whether companies are growing more quickly or more slowly than the broad economic backdrop.

For most of the region, companies in our survey report that they are growing more slowly than the broader economy. In India, for example, nominal GDP grew by 13.7% in 2013, but respondents say their nominal sales only grew by 4.7%. Companies in China, South-east Asia and Australia also under-performed, although the growth gap was less striking than in India.

Chart 6: Nominal GDP growth and nominal sales growth in 2013
(annual % change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

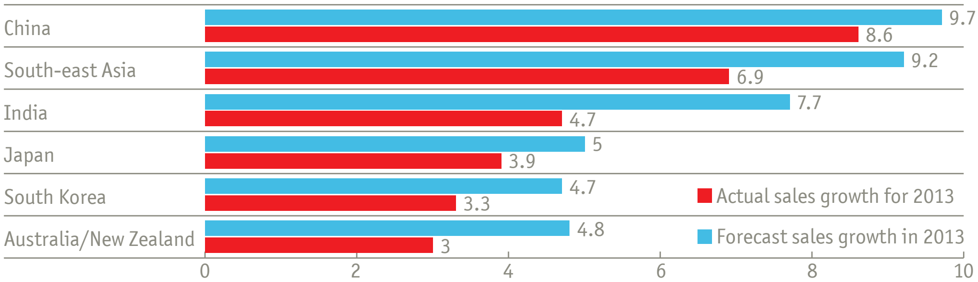
Why might this be the case? It could be because 80% of survey respondents come from non-Asian companies. In the past, when many of these firms first entered the region, they enjoyed relatively uncluttered markets, with low levels of competition. Today, however, local Asian firms are rising rapidly, and many of them enjoy domestic advantages, possibly through better cultural understanding, more appropriate business models, better relationships with government, entrenched protectionism, or perhaps less restrictions around how they win new business.

The exception to this general picture of underperformance by foreign firms is Japan. This might reflect a lack of dynamism at local Japanese competitors, where protectionism may have bred a certain lethargy. The meagre performance of Japan's economy in recent decades may have further contributed to a sense of stasis at Japanese firms. By contrast, foreign competitors may be less imbued with the status quo, and hungrier at scratching out hard-to-reach growth opportunities.

5. Planning in turbulent times

Executives had mixed success in forecasting how their businesses would perform in 2013

Chart 7: Sales growth forecast made at start of 2013 vs actual sales growth
(% annual change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

Forecasting the future is often a fool's errand. Unexpected events can change the economic landscape beyond recognition. Nonetheless, companies need to have a view of where their business is going. So how good are the 500 companies in the Economist Corporate Network at predicting the future?

To find out, we looked back at our ABOS survey a year ago, conducted in December 2012. We wanted to see what executives were forecasting for their sales growth at the start of 2013, and then to compare those forecasts with the actual sales performance at the end of 2013. The results are shown in chart 7.

Managers were reasonably accurate about their performance in China and Japan, undershooting their forecasts by only a percentage point in each. Both economies are experiencing deep shifts in their domestic economic stories (throttling down in China, and upwards in Japan) which are much more significant than the external global environment. Executives have shown good skills at translating these shifts into forecasts for their own companies.

But other parts of Asia, notably South-east Asia and India, are far more exposed to external global forces. In 2013, those forces came in the shape of suggestions from Ben Bernanke at the US Federal Reserve that he was considering scaling back his policy of ultra-loose money. Global capital flows switched direction sharply, rushing out of emerging Asia, causing currencies and stockmarkets to fall in places such as India and Indonesia. Economic confidence was hurt, causing sales to fall short of forecasts.

6. Investment priorities in 2014

China remains the top investment destination, but Indonesia has overtaken India in second place

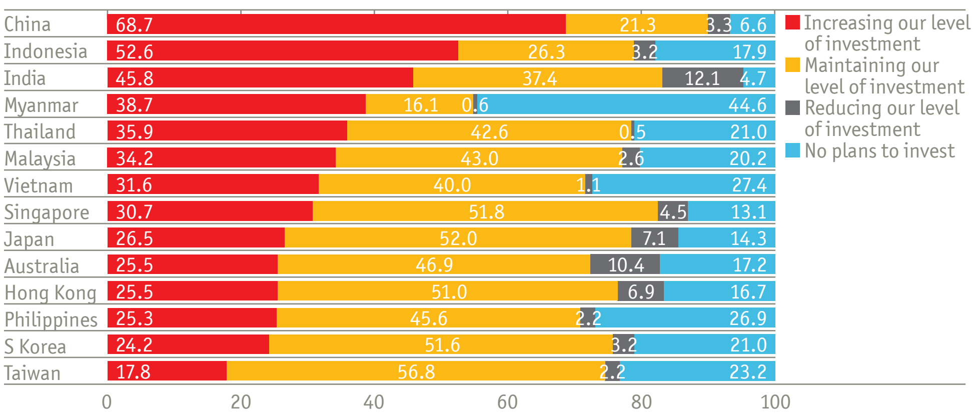
In 2012, the Asia Pacific region made up 31% of the global economy, yet managed to attract 36% of global foreign direct investment (FDI). Asia is clearly outperforming in its ability to attract investment. Given the size of the region, and its superior growth rates, most observers expect this outperformance to continue. But where is the money going?

Top of the list of investment priorities for 2014 is China. In our survey, almost 70% of companies plan to increase their investment in the country. (See chart 8.) The economy may be slowing somewhat, but China does make up almost 13% of the global economy. And growth in 2013 of around 7.7% is nonetheless impressive.

What's more, even if growth does keep slowing, the underlying size of the economy today is much larger. Back in 2007, China grew at 14% and contributed US$350bn of new GDP to the world. In 2013, with the economy expanding by less than 8%, China will contribute another US$350bn of new GDP.

China is clearly a country that few companies can afford to ignore. But where comes next in the list of investment priorities? In past surveys, the second most-favoured option was always India. But this year, India gives way to a new runner-up: Indonesia. Some 53% of companies plan to raise their investment there in 2014. As South-east Asia's largest economy, with a

Chart 8: How will your level of investment change in the following markets during 2014? (% of respondents)



Source: Economist Corporate Network ABOS 2014

population of 250m people, and growth running at close to 6% a year, Indonesia is today attracting record levels of FDI. Indeed, the country attracted more FDI in the first nine months of 2013 than in the whole of 2012, which was itself a record year.

India, by contrast, is struggling to increase its flows of FDI. What's more, in our survey, 12% of companies said they planned to reduce their level of investment in India—a dire testimony not only to the weak state of the economy, but also to the poor job that policymakers have done in managing their investment landscape. In numerous conversations with clients of the Economist Corporate Network, it is clear that Western companies looking at Asia are increasingly picking Indonesia—and not India—as their second big bet in the region after China.

Behind the three big population centres of China, India and Indonesia, a whole set of South-east Asian countries are also popular investment destinations. Myanmar sits in fourth place in the list of investment priorities. This is perhaps to be expected, given the rapid opening up of the country. Many companies are excited about the potential for extracting natural resources, for low-cost manufacturing, for building infrastructure, and for tapping into a population of more than 60m consumers. Importantly, though, Myanmar is still at an early stage of development. Incomes are the lowest in Asia, institutional and physical infrastructure is sorely lacking, and the emergence of the economy from under the shadow of the military junta has a long way to go. For these reasons, Myanmar is also the country where the greatest number of companies (45%) have no plans to invest at all.

Elsewhere, Vietnam is notable for its fall from grace. In a similar survey three years ago, Vietnam ranked as the fourth most attractive investment destination, with 55% of companies planning to raise their investment there during 2012. Today, it has fallen to seventh, and only 32% of firms are raising investment in the next 12 months. The Vietnamese economy has undergone significant troubles with a deflating property bubble, a banking sector crippled with bad debt, the failure to reform state-owned enterprises, and policy mismanagement that has stoked high inflation.

Arguably, Vietnam is now heading in a more positive direction. The authorities appear to be more willing to accept lower economic growth in return for greater economic stability. Certainly many companies feel more encouraged today than during the past two years, and are increasingly excited by the consumer opportunity there as well as the deepening manufacturing ecosystem, especially in electronics, that is starting to offer an alternative to China.

Among the developed nations, Australia is interesting because more than 10% of companies plan to reduce their investment during 2014. Possibly this is a reflection of the mining boom, which is now reaching a more mature stage. Over the past few years, many of the mines drew heavy investment as they were dug and developed, but they are now reaching a stage where investment is giving way to production. Equally, the mining boom has caused the Aussie dollar to appreciate markedly, so undermining the country's competitiveness in sectors such as manufacturing. This might be causing some companies in non-mining sectors to reduce their investment.

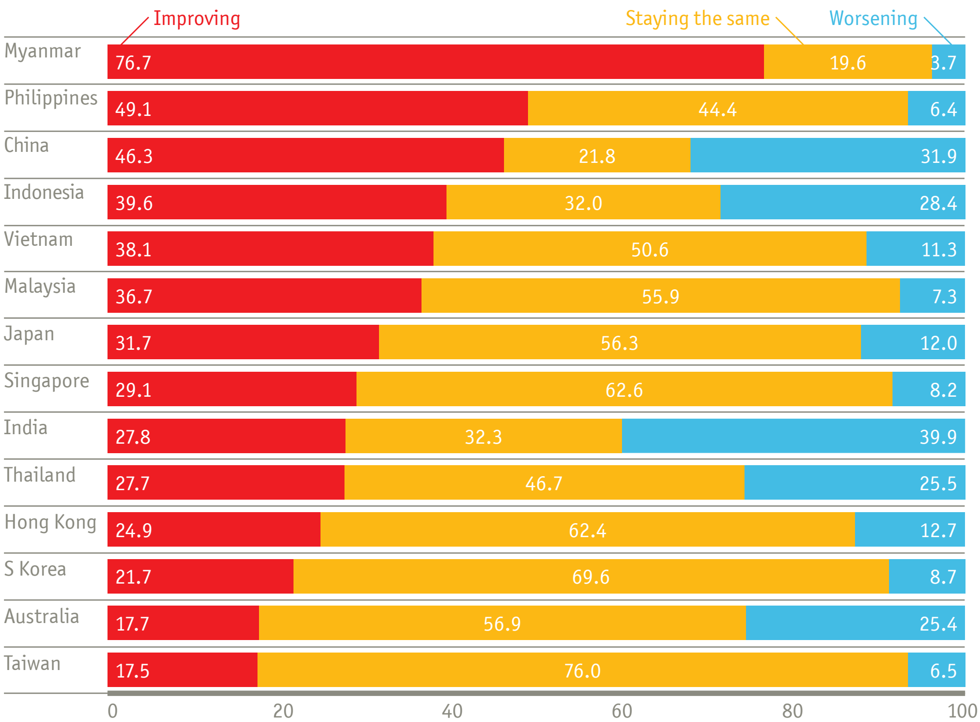
7. Assessing the investment landscape

On balance, executives feel the investment climate is improving in most countries in Asia Pacific, the exceptions being India, Australia and Thailand

Asia is clearly a region attracting significant amounts of business investment. But how is the investment climate across the region changing? Respondents say that, on balance, they see it improving in most of Asia. In particular, Myanmar and the Philippines are perceived to have sharply improving business environments. (See chart 9.)

Over the past two years, Myanmar has taken bold steps to open up, reform and modernise its economy. The pace and depth of change has been breathtaking, and clearly these efforts are paying off. But there is still a long way to go. According to the World Bank's "Doing Business" survey, which ranks countries on the quality of

Chart 9: Is the investment climate improving or worsening in the following countries? (% of respondents)



Source: Economist Corporate Network ABOS 2014

their business environment, Myanmar is ranked 182nd out of 189 nations—only seven countries are considered worse. Nonetheless, executives feel the picture is improving.

The Philippines is also perceived to be improving markedly, driven by the leadership of president Benigno Aquino. The country's macroeconomic fundamentals have strengthened, with the Philippines now enjoying one of the highest growth rates in the region, with low and stable inflation, as well as healthy government finances and positive trade balances. President Aquino has also made progress in tackling corruption, and promoting transparency and open government, which have traditionally been big deterrents for investment. Once again, however, the improvement is coming off a low base—the World Bank estimates the Philippines has the 108th worst business environment in the world.

The picture is not so rosy in India. With a business climate that ranks a lowly 134th in the world, India desperately needs to clean up its act in order to attract much-needed foreign investment. And yet, according to our survey, executives perceive the picture to be deteriorating. Excessive regulation, endemic corruption, weak infrastructure, poor policy-making, deep uncertainty around tax, and onerous restrictions on foreign investment continue to prevent India from achieving its potential.

Surprisingly, respondents have a net positive view on the investment climate in China and Indonesia. Both places have introduced policies that discriminate against foreign investors in certain sectors, and many executives say life is getting tougher. However, a higher number say that things are getting better.

8. Does the investment climate matter?

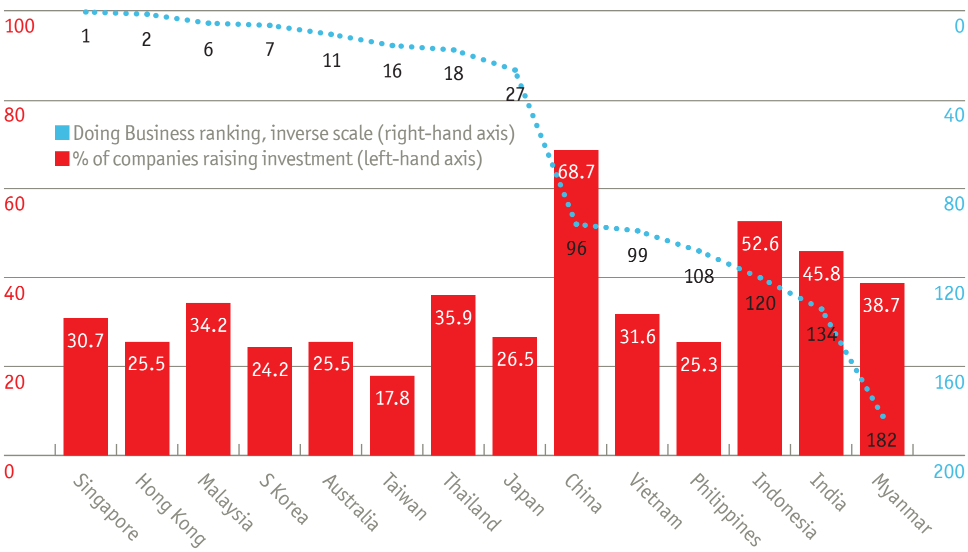
Companies appear to make investment choices based more on the size a market and its potential for growth, and less on the quality of the local investment climate

When executives make an investment, they naturally prefer countries with economic and political stability, and with policies that support business. In general, that includes having a reliable legal system, policies that promote fair and open competition, an environment of transparency, limited bureaucracy, and a degree of certainty around taxation and regulation.

The World Bank's "Doing Business" rankings each year give a good measure of how countries compare on these issues. Some Asian countries do extremely well. Singapore, for example, is ranked first in the world, with Hong Kong in second place. Others do less well. China is ranked 96th in the world, while Indonesia is ranked 120th.

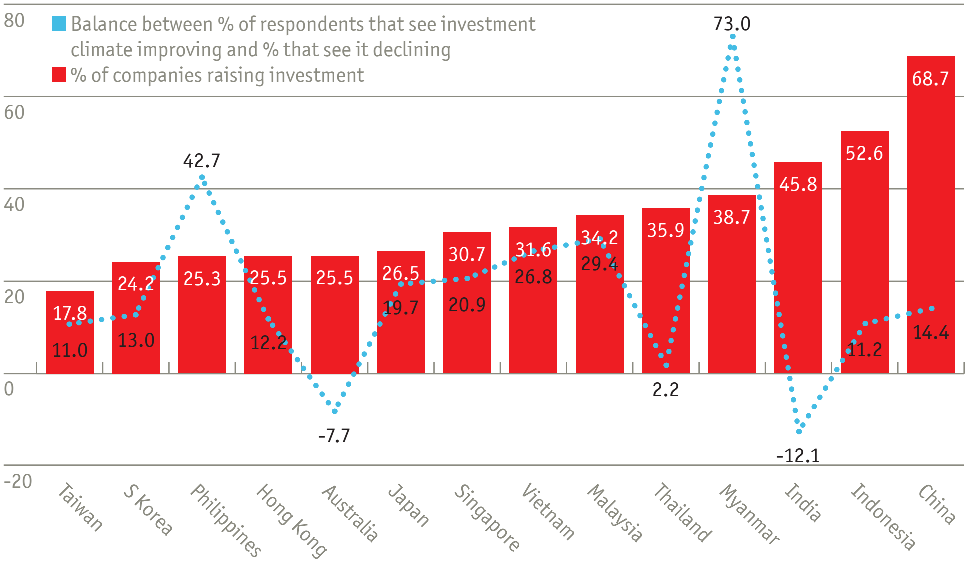
By looking at these rankings, and comparing them with the investment intentions of our survey respondents, we get a sense of how important the quality of the business climate is for foreign investors. (See chart 10.) It turns out that the quality of the

Chart 10: The relationship between investment intentions and the quality of the investment climate



Source: Economist Corporate Network ABOS 2014, World Bank

Chart 11: The relationship between investment intentions and improvement in the investment climate



Source: Economist Corporate Network ABOS 2014

business climate is a secondary condition for most firms. Countries such as Myanmar, India, Indonesia and China have relatively poor rankings from the World Bank, yet companies in our survey are prioritising these nations for new investments. Doubtless this is because of the sheer size of the market. China, India and Indonesia have around 2.8bn people between them and are too big to ignore, no matter how weak the investment environment might be.

What about perceptions of improvement or deterioration? Is there a relationship between perceptions of an improving business climate and the willingness of firms to invest? Chart 11 documents this relationship. Once again, the link between the two is weak.

9. In pursuit of productivity

Companies in Asia Pacific are expecting sales to grow faster than the size of their workforce, but productivity gains are proving elusive for many firms

Companies are expecting to grow the size of their workforce in every part of Asia Pacific in 2014. Firms will be hiring most aggressively in China, South-east Asia and India.

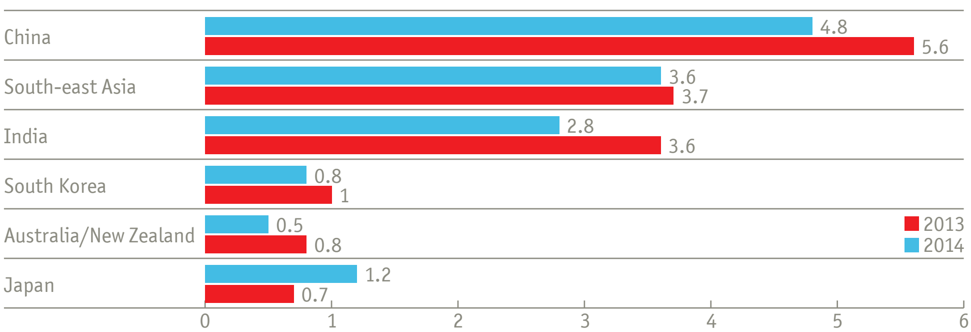
Compared to 2013, however, the rate of workforce expansion is expected to be slower for almost all countries. (See chart 12.) The one exception is Japan, where hiring intentions in 2014 look stronger than last year. This is doubtless due to growing optimism as Japan embarks on the most ambitious economic reform programme it has seen in decades.

Looking at expectations for revenue growth (See "An improving Asia", on page 5) and comparing them to expectations for workforce growth, it's clear that companies expect sales to increase at a faster rate than the size of their workforce in 2014. Across Asia, the expected growth rate for revenues in 2014 is at least twice the expected growth rate for staff numbers (see chart 13). In countries like Japan, South Korea and Australia, companies are expected to grow their revenues more than four times faster than their workforce.

This implies that companies expect their revenue per worker to increase significantly in 2014. There are two ways that companies can achieve this. One way is for firms to increase their revenue by raising the prices of their products and services. The other way is for firms to improve the productivity of their workers. Quite possibly, companies will be looking to do a combination of both.

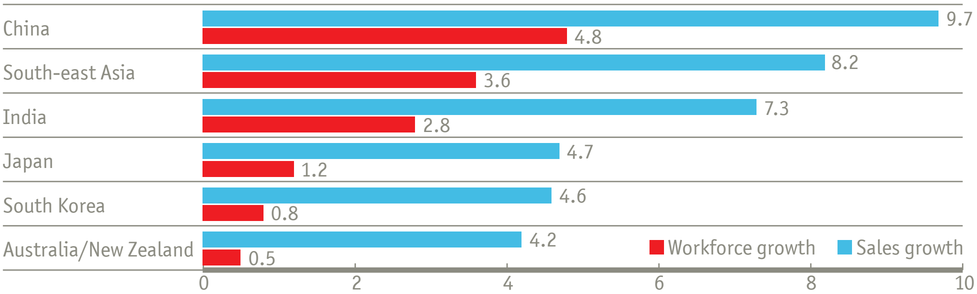
However, raising worker productivity is easier said than done. In Asia the task

Chart 12: How did the size of your workforce grow (or decline) in 2013, and what do you expect in 2014? (% change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

Chart 13: Expectations for sales growth and workforce growth in 2014
(% change, simple average of all respondents)



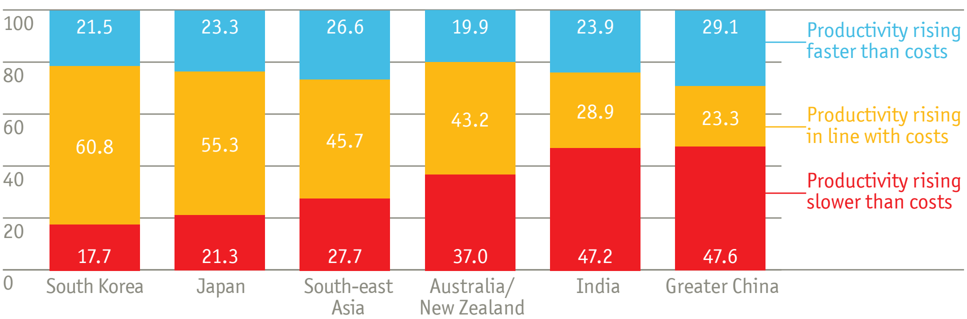
Source: Economist Corporate Network ABOS 2014

is doubly challenging because wages are rising sharply. Indeed, for many companies, productivity improvements are not keeping pace with cost increases (see chart 14). This is especially the case in China and India. For example, nominal average wages per worker in China rose by a spectacular 278% between 2003 and 2012. Other costs such as property prices and regulatory burdens have also increased substantially. Raising productivity fast enough to keep abreast with these growing costs is a tough challenge.

One response from companies in Asia is to increase automation. However, this isn't a panacea for all industries or companies. Automation can raise productivity in factories, but is less effective for front-line sales and service operations.

The picture in Japan and South Korea is slightly more encouraging. On balance, companies say that productivity is rising in line with costs in these two markets. In general, inflation—including wage inflation—has been low and steady, and so perhaps the productivity challenge for companies has been less daunting. Having said that, only a handful of companies (about 20%) have managed to raise productivity faster than costs.

Chart 14: Is labour productivity for your company rising more quickly or more slowly than labour costs in the following territories? (% of respondents)



Source: Economist Corporate Network ABOS 2014

10. Rules rule as consumers get richer

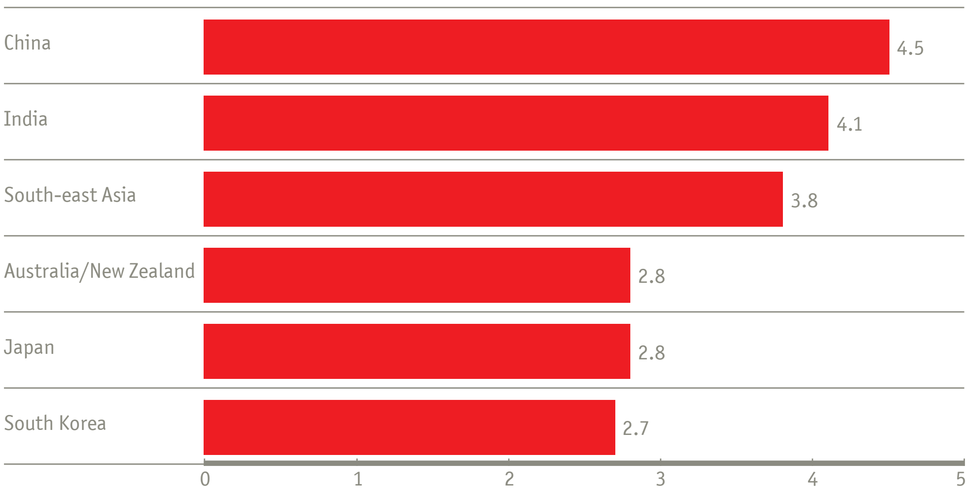
The cost of regulation is rising for companies right across Asia Pacific

As well as labour costs that are rising faster than productivity, companies in our survey also say the cost of regulation is growing. The picture varies by territory, but in general the mature economies like South Korea are seeing slower cost increases than developing ones like China. (See chart 15.) In part, this is because many of Asia's emerging markets are introducing business regulations for the first time. Where such regulations already exist, enforcement efforts are picking up swiftly.

Such issues are to be expected as incomes rise and consumers get more vocal about safety, security and fairness. Governments are responding to their electorates and clamping down on issues such as environmental pollution and food standards. China is notable in this regard, and it is no surprise to see the country ranked as having the fastest rate of regulatory cost increases.

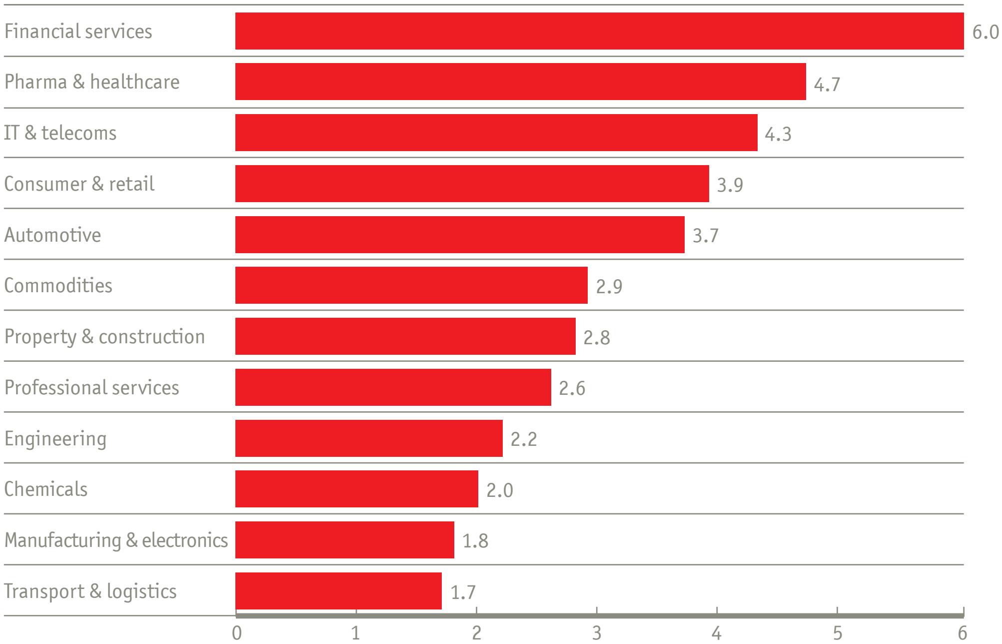
Naturally, different industries experience differing rates of regulatory cost increases. The financial services industry is enduring the biggest change. (See chart 16.) This is a feature of the banking industry the world over, as authorities strengthen

Chart 15: By how much did the cost of regulation change for your company in the following territories? (% change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

Chart 16: By how much did the cost of regulation change for your company in Asia Pacific in 2013? (% change, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

a huge number of regulations covering everything from money laundering and tax evasion, to capital adequacy ratios and market manipulation.

Only a short distance behind financial services is the pharmaceutical and healthcare sector. Recent calls for consumer protection, most notably in China, have seen tighter rules around product safety, as well as efforts to rein in prices and improve affordability. Anti-corruption efforts are also forcing firms to re-think their sales organisations and incentive structures.

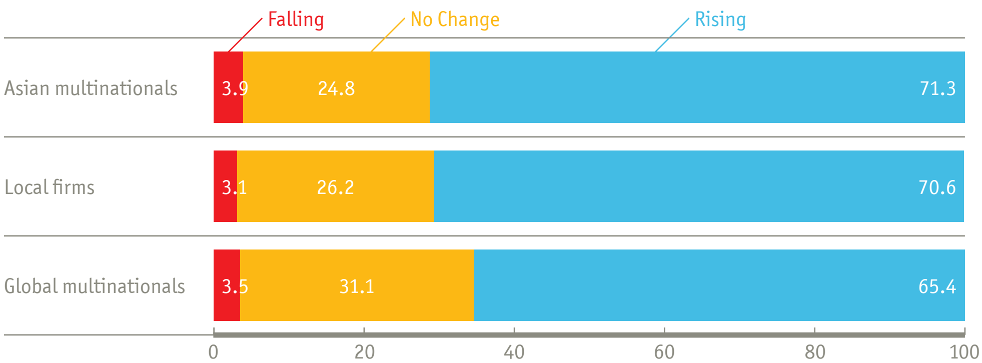
11. Competition attrition

Rising cost pressures for companies in Asia Pacific are compounded by rising competition

Against this backdrop of generally rising costs, companies also say that levels of competition are rising. (See chart 17.) This competition is rising equally from global multinationals, from Asian multinationals and from domestic players within individual countries.

On the part of Western companies, weak economies in home markets of Europe and North America have seen a shift of focus towards emerging markets, especially Asia. At the same time, Asian companies have grown on the back of the region's economic strength. What's more, many are moving up the value chain at incredible speed. Whereas once they tended to compete on cost, by being the lowest-cost producer, increasingly they compete through technology and R&D, and by building brands. It all points to an ever fiercer battle for the Asia opportunity.

Chart 17: How is the level of competition in your sector changing from the following types of company? (% of respondents)



Source: Economist Corporate Network ABOS 2014

12. Margins rising

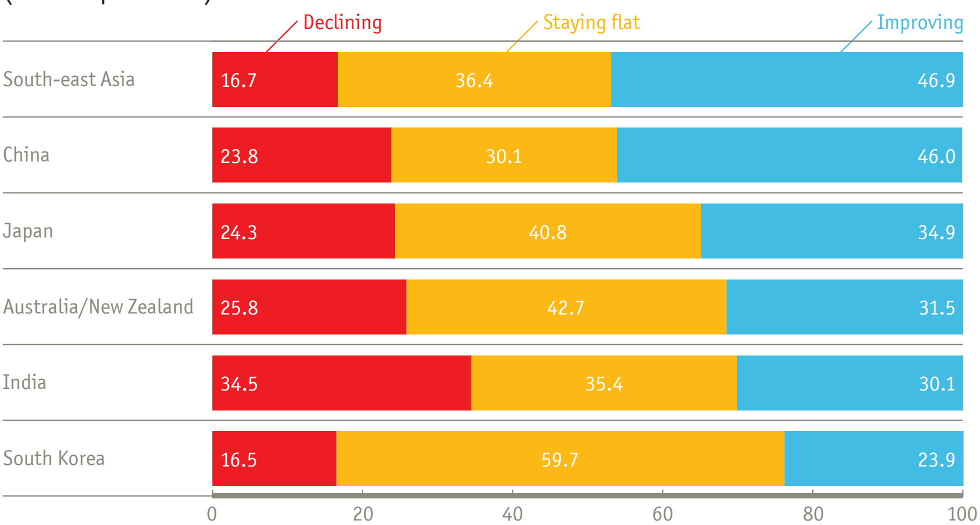
Despite rising costs and stiffening competition, executives say that profit margins in Asia Pacific are improving

Given the rising costs revealed by the survey, and given the increasing competition that makes it hard to pass on these costs to customers, it's logical to expect profit margins to be squeezed. Yet this is not the case. Executives say that their companies are, on balance, enjoying improving margins in most parts of the region.

In South-east Asia, for example, while 17% of firms say margins are declining, some 47% say they are rising. It is a similarly positive picture for China and Japan. Only India has a different story. (See chart 18.)

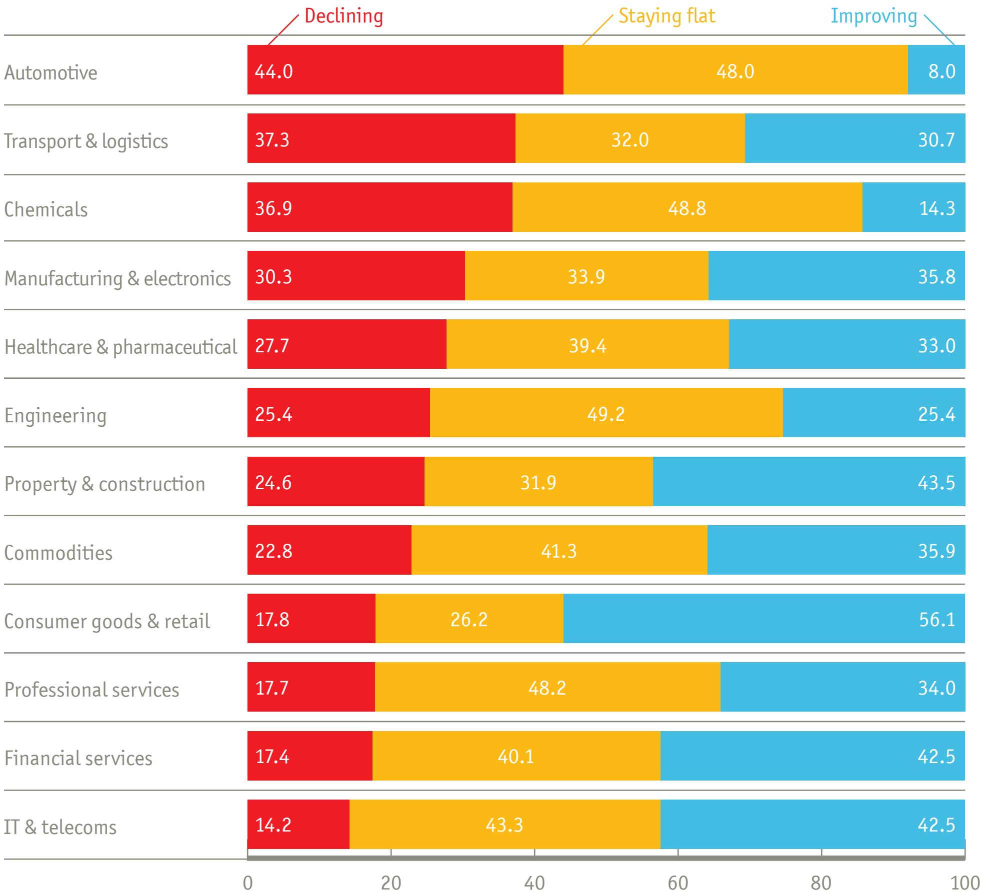
Digging a little deeper, chart 19 shows the margin picture in different industries. Firms in the retail and consumer goods sector are most buoyant about their profitability—56% say margins are improving, whereas only 18% say they are falling. Rising wealth and the dramatic emergence of a middle class are clearly fuelling healthy profit growth. The same observations can be made about companies in property and construction, IT and telecoms, and financial services.

Chart 18: Are your profit margins in the following territories improving or declining? (% of respondents)



Source: Economist Corporate Network ABOS 2014

Chart 19: Are your profit margins in Asia Pacific improving or declining?
(% of respondents)



Source: Economist Corporate Network ABOS 2014

But not all companies are enjoying such a healthy performance. Margins in the automotive, transport and logistics, and chemical sectors, for example, are falling. Part of the story here may well be the weak export environment of recent years. Overcapacity in certain sectors, notably shipping, is certainly hurting many firms. But domestic issues within Asia are also a consideration. In the automotive sector, for example, new rules about auto loans in Indonesia have taken the shine off what was until recently an exciting market.

13. Is Asia the world's most profitable region?

Executives say that profit margins at their companies are higher in Asia Pacific than in other parts of the world

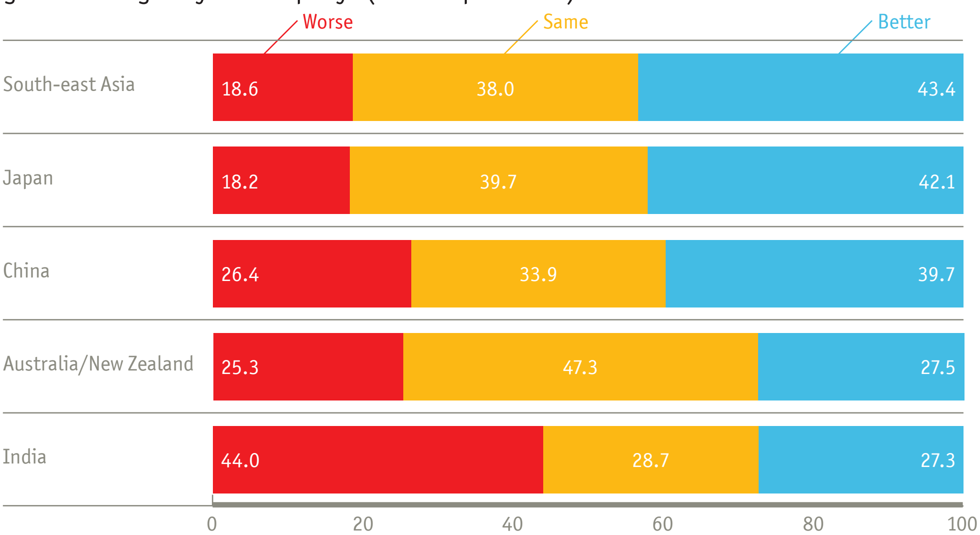
The previous section showed that profit margins in Asia Pacific are largely improving. Intriguingly, executives also say that margins are now higher than in other parts of the world.

Take South-east Asia. While 19% of executives say the region has lower margins than the global average at their companies, a further 43% say the region has better profitability. Japan is equally notable for its superior margins. Only in India does the balance of responses suggest margins are worse than the global average. (See chart 20.)

Yet the picture becomes more clouded when broken down by industry sector. (See chart 21.) Fully half of the respondents in the consumer goods and retail sector report that profits in the region are better than their firm's global average, which again speaks to the growing strength of domestic demand.

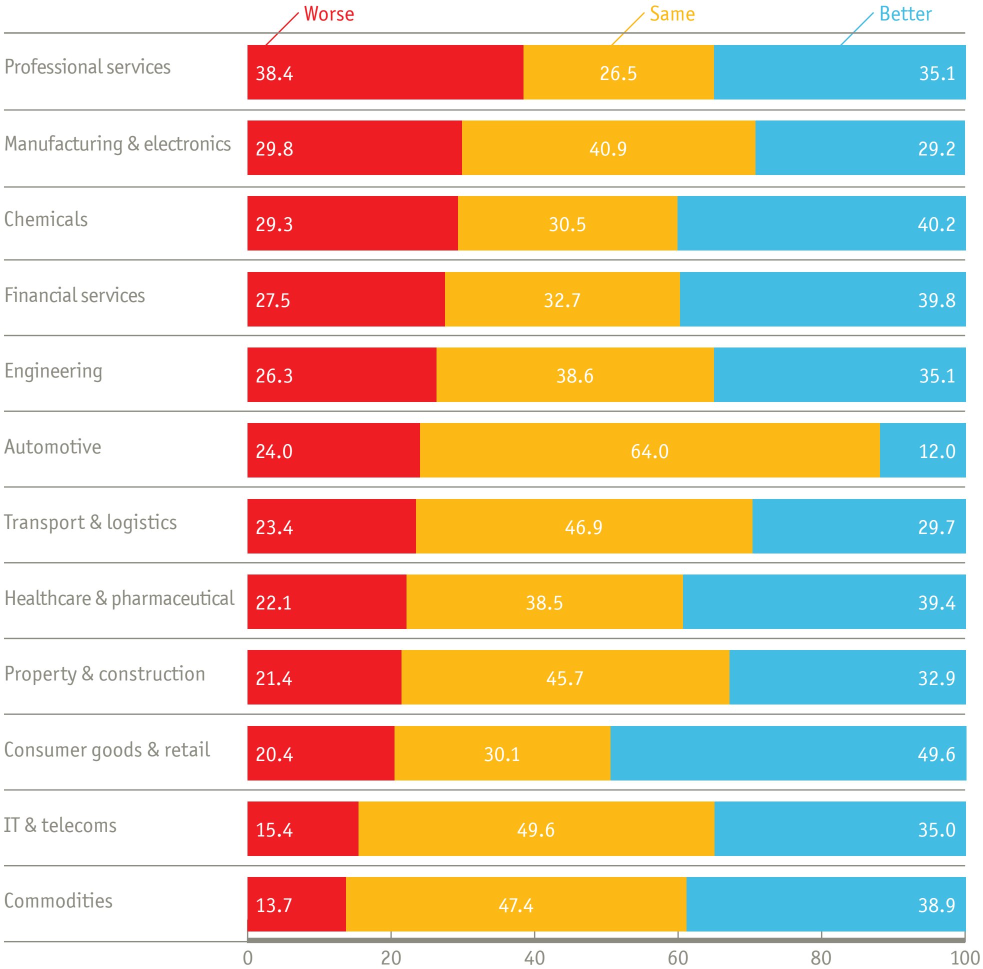
Two sectors stand out for their inferior margins in Asia: automotive and professional

Chart 20: Are your profit margins in the following territories better or worse than the global average at your company? (% of respondents)



Source: Economist Corporate Network ABOS 2014

Chart 21: Are your profit margins in Asia Pacific better or worse than the global average at your company? (% of respondents)



Source: Economist Corporate Network ABOS 2014

services. The weak picture in Asia's auto industry might lie in issues of competition and overcapacity. In the professional services sector, many executives report difficulties selling intangible services such as consulting and advice to Asian clients, although this gripe is starting to ease as markets develop and grow in sophistication.

14. Asia's growing gravity (part I)

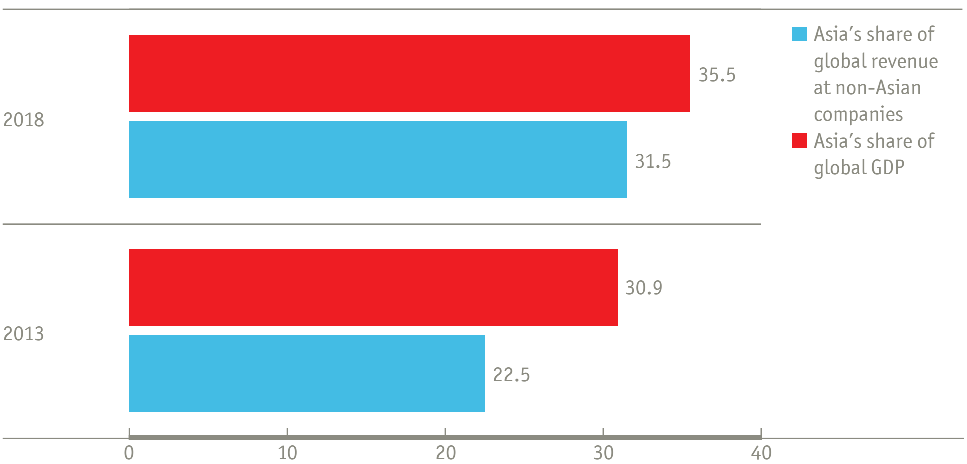
The share of global revenue coming from Asia Pacific for multinational companies keeps rising

As in years past, the share of revenues coming from Asia Pacific at non-Asian companies has again risen year-on-year. In 2012 the average ABOS respondent at a non-Asian company said the percentage of global revenue derived from the region was 22%. In 2013 it was 22.4%.

However, as chart 22 shows, Asia's share of global GDP is substantially higher than Asia's share of global revenues for non-Asian firms. But in five years' time, respondents say they expect this gap to close. By 2018, executives expect Asia Pacific to contribute 32% of their global revenues (compared to the region's 36% share of the global economy).

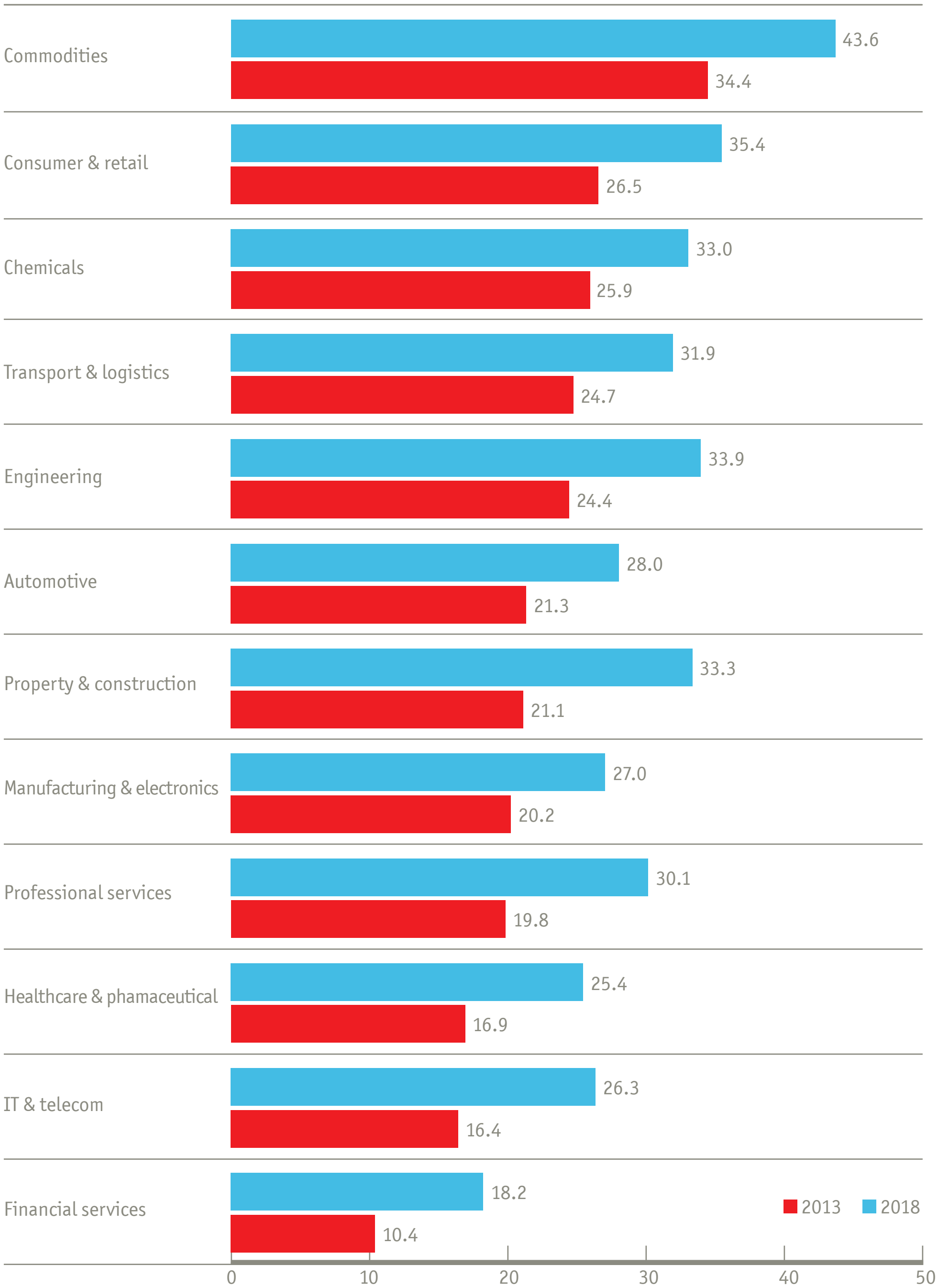
Every sector in our survey has big expectations for the region. (See chart 23.) Most bullish is the property and construction sector, where Asia's share of global revenues is expected to climb by 12.2 percentage points (from 21.1% today to 33.3% in 2018). Least bullish is the manufacturing sector, where Asia's share of global revenue will rise by just 6.8 percentage points (from 20.2% today to 27% by 2018).

Chart 22: What percentage of your global revenues came from Asia Pacific in 2013 and what will it be in 2018? (%, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014
Note: Data is only for non-Asian companies

Chart 23: What percentage of your global revenues came from Asia Pacific in 2013 and what will it be in 2018? (%, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014
Note: Data is only for non-Asian companies

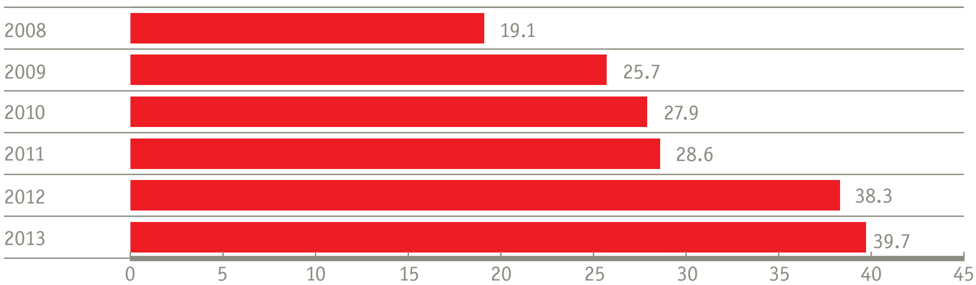
15. Asia's growing gravity (part II)

Global companies are committing ever more of their leadership teams to Asia Pacific in a bid to capture the region's opportunities

Given the growing importance of Asia Pacific to non-Asian companies, it's no surprise to see such companies relocating ever more of their senior managers to the region. As Chart 24 shows, every year more and more firms say they have a member of their main board of directors living and working in Asia.

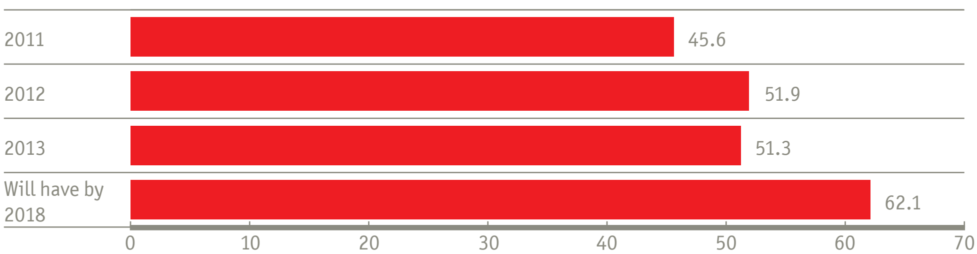
It's a similar story for the global heads of individual business units. Year-on-year, the trend is for more of these positions to be based in Asia where they are closer to their key growth markets. (See Chart 25.) The rate at which such positions are moving to Asia slowed in 2013, but forecasts out to 2018 suggest the trend will continue for some time to come.

Chart 24: Are any members of your firm's main board of directors based in Asia? (% of respondents answering yes)



Source: Economist Corporate Network ABOS 2014
Note: Data is only for non-Asian companies

Chart 25: Are any of your firm's global business unit heads based in Asia? (% of respondents answering yes)



Source: Economist Corporate Network ABOS 2014
Note: Data is only for non-Asian companies

16. The Middle Kingdom pulls away

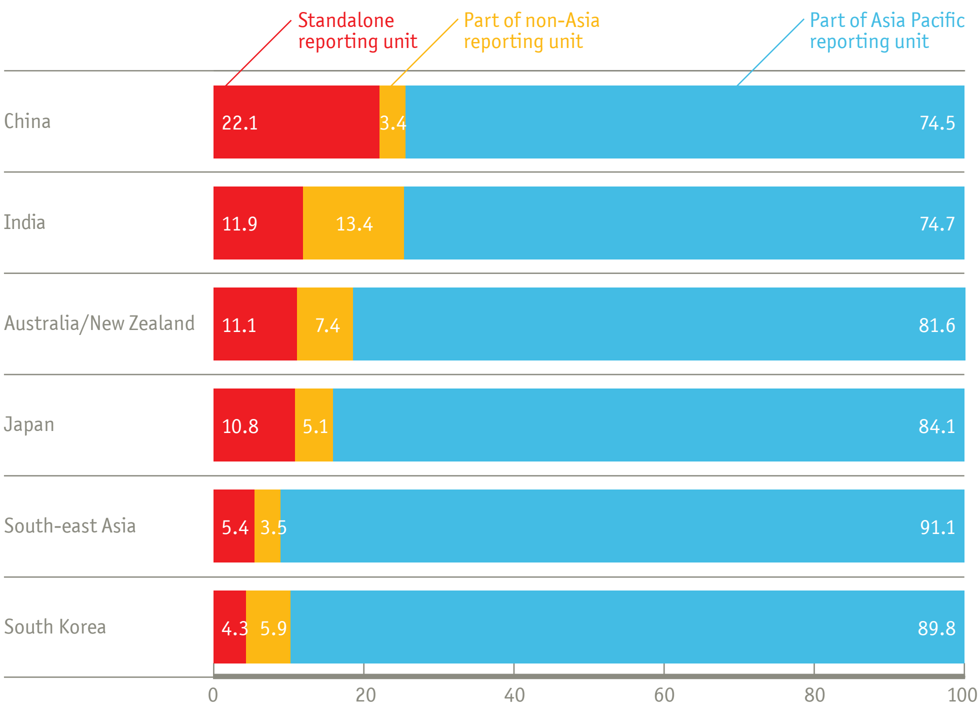
Global companies are re-organising their operations in Asia Pacific, with China becoming a standalone management unit

For a large multinational company, it makes sense to divide up the world into smaller chunks for the purposes of management and reporting. Often that means clustering together countries that are geographically close to each other into a distinct management unit.

In Asia Pacific, the challenge of deciding how to carve up the region into meaningful units is especially hard. For one, the region is huge. The area from Pakistan in the west to Australia in the east represents more than a third of the global economy and more than half of its population. For another, Asia is incredibly diverse. What works in China doesn't work in India.

In the recent past, many firms ran the region as one single management unit. But today

Chart 26: Do these countries report into an Asia Pacific reporting unit, a different non-Asia unit, or are they are a standalone reporting unit? (% of respondents)



Source: Economist Corporate Network ABOS 2014
Note: Data is only for non-Asian companies

this is changing. As the Asia Pacific region becomes an ever bigger part of the global economy, so companies are breaking up their Asia Pacific management units.

Our survey shows that non-Asian companies are increasingly carving out China (often including Hong Kong and Taiwan too) from the rest of the region and setting it up as a standalone management and reporting unit. Some 22% of companies now do this, doubtless because China has become such a big part of their global business that it demands a team devoted solely to the market. Anecdotally, some companies also report that China is now so large and time-consuming, that executives find themselves ignoring other parts of Asia if they have to manage the whole region together. (See chart 26.)

India also stands out, not only because 12% of companies manage the country as a standalone unit, but also because a further 13% of firms consider it to be part of a different, non-Asia reporting unit. In such cases, India is often lumped into a territory that includes the Middle East and Africa, with the regional management hub located in a place like Dubai.

17. Operational insight: Human capital

After falling in 2013, staff turnover ratios appear to be edging back up again

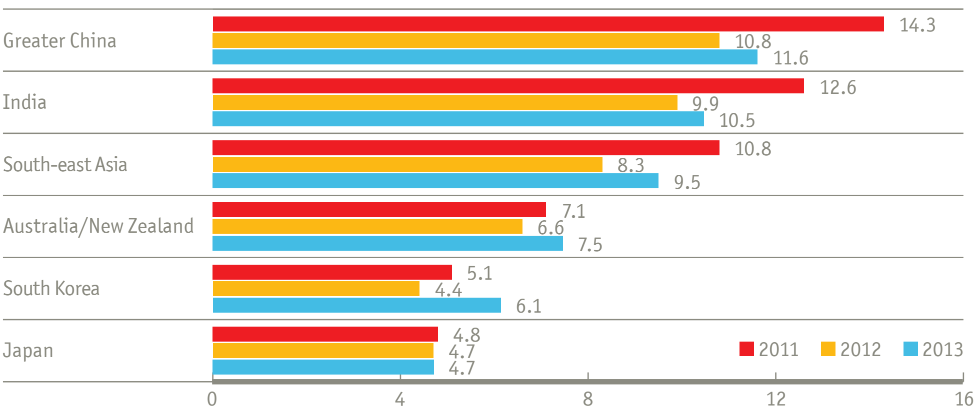
One of the greatest challenges for companies in Asia is finding and retaining qualified staff. Because of the region's high growth rates, the supply of workers with the right skills and experience tends to run behind demand. As a result, competition for talent is ever present, leading to wage inflation and high levels of staff turnover.

In 2012 staff turnover rates fell across Asia as the regional economy slowed amid an uncertain outlook. (See Chart 27.) Companies were reluctant to offer generous pay packages to lure talent from rival companies, and workers prioritised the security of their jobs rather than seeking out new opportunities.

In 2013, however, staff turnover rates have inched up once again. One possible explanation is that workers who had delayed looking for new opportunities in the previous year have now done so in 2013. As the global economy bottomed-out towards the end of 2013 and started to improve, companies are also feeling more confident about the future, which may be feeding through into stiffer competition for leadership talent.

Nevertheless, turnover rates in 2013 were still lower than they were in 2011 in many Asian markets, including China, India and South-east Asia. The supply/demand imbalance for workers is not yet as bad as it has been in the past.

Chart 27: What is your staff turnover in these territories?
(%, simple average of all respondents)



Source: Economist Corporate Network ABOS 2014

18. Operational insight: Real estate

Many companies are looking to real estate strategy as a way to improve their management of human capital and productivity

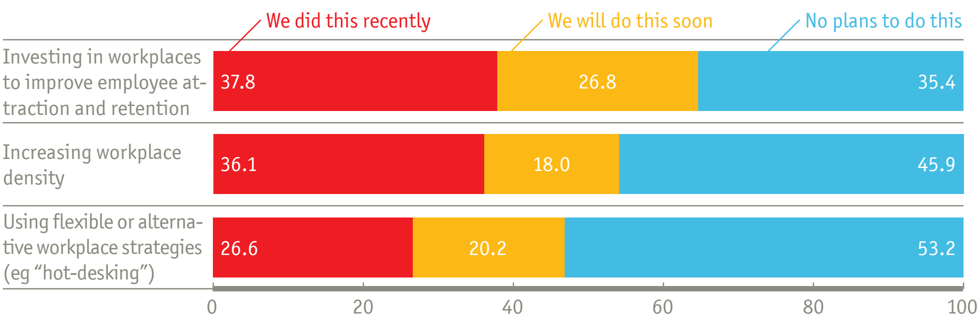
As discussed in previous sections, managing human capital in Asia is a challenge. Not only are labour costs rising faster than productivity, but supply/demand imbalances are causing wages to raise and staff turnover levels to be troublesome.

One often overlooked aspect to tackling these issues is real estate policy. For example, by increasing workplace density, companies can reduce their real estate cost per worker. Similarly, by recognising that many workers spend little time in the office, and by implementing flexible work environments such as "hot-desking", companies can again reduce real estate costs per worker, and thereby boost productivity.

But perhaps the most interesting area of real estate policy is not about reducing costs. Rather it is about creating productive workspaces. By upgrading work environments, companies can potentially reduce staff turnover rates. Just as important, by making workplaces more conducive to collaboration and creativity and the generation of ideas, companies can grow their revenues.

In the past, such ideas were often considered the preserve of internet start-ups where staff gatherings took place around their table tennis table or while playing foosball. Today, however, even relatively staid and traditional businesses, such as oil and gas firms, are recognising the benefits for revenue growth and idea creation that come from a better designed office space. So are companies deploying any of these ideas? Chart 28 shows the results.

Chart 28: How does real estate policy feed into your worker productivity strategies? (% of respondents)

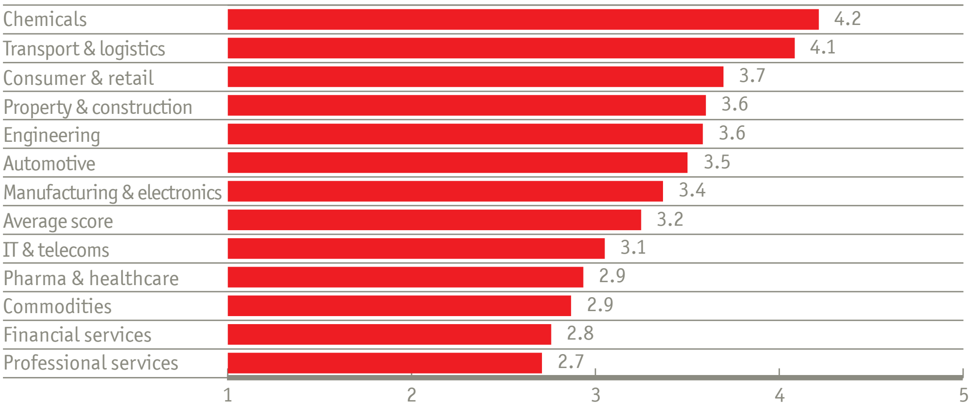


Source: Economist Corporate Network ABOS 2014

19. Operational insight: Sustainability

"Dirty" industries in Asia Pacific appear more committed to sustainability than "clean" ones

Chart 29: On a scale of 1 to 5, how committed is your firm to the idea of "sustainability"? (1 = sustainability targets do not factor into our strategic planning; 5 = achieving precise sustainability targets is vital to our business objectives)



Source: Economist Corporate Network ABOS 2014

As has been discussed several times in this report, Asia's markets are maturing rapidly. Increasingly sophisticated and wealthy consumers are becoming more discerning about the quality and sustainability of the products and services they select. Additionally, as China's urban dwellers labour through more and more toxic air days, and the effects of climate change are felt throughout the region, sustainability is an increasingly important talking point.

It's clear from our ABOS responses that these sensibilities are filtering into the decision-making processes of global business leaders in the region. When asked to rank their firm's commitment to sustainability targets on a scale from 1 (sustainability targets play no role in strategic planning) to 5 (achieving precise sustainability targets is core to the firm's business objectives), the average score came out at 3.25.

Tellingly, business leaders at energy- and resource-intensive sectors, such as chemical production, construction, and manufacturing, are much more likely to indicate that they have worked specific 'green' measures into their strategic planning process. (See chart 29.)

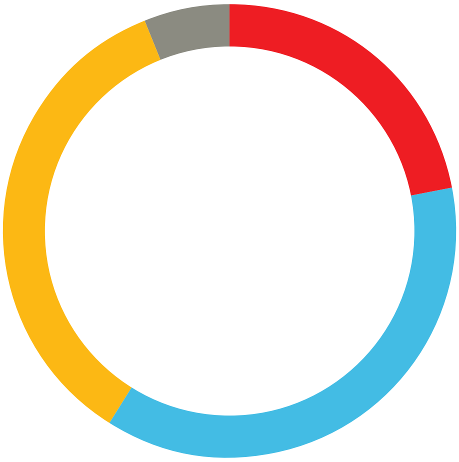
20. Appendix: Survey firmographics

Survey respondents by global revenue

●	31%	Less than US$1bn
●	31%	US$1bn to US$10bn
●	38%	More than US$10bn

Source: Economist Corporate Network ABOS 2014

Survey respondents by location of global HQ



●	22%	Asia
●	37%	Europe
●	35%	N America
●	6%	Other

Source: Economist Corporate Network ABOS 2014

About Economist Corporate Network

Economist Corporate Network is The Economist Group's advisory service for senior executives seeking insight into economic and business trends in their key growth markets.

Independent and thought-provoking, Economist Corporate Network provides clients with the information, insight and interaction they need to succeed. It is led by experts who share a profound knowledge and understanding of business issues. It has regional business groups across Asia Pacific, Central and Eastern Europe, the Middle East and Africa.

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