The Economist Corporate Network

INVESTING INTO ASIA'S REFORM LANDSCAPE

Asia Business Outlook Survey 2015

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Preface

Investing into Asia's reform landscape: Asia Business Outlook Survey 2015 is an Economist Corporate Network (ECN) report. It is based on a survey of more than 700 business leaders from across the Asia Pacific region. We would like to thank all respondents to this annual Asia Business Outlook Survey.

January 2015

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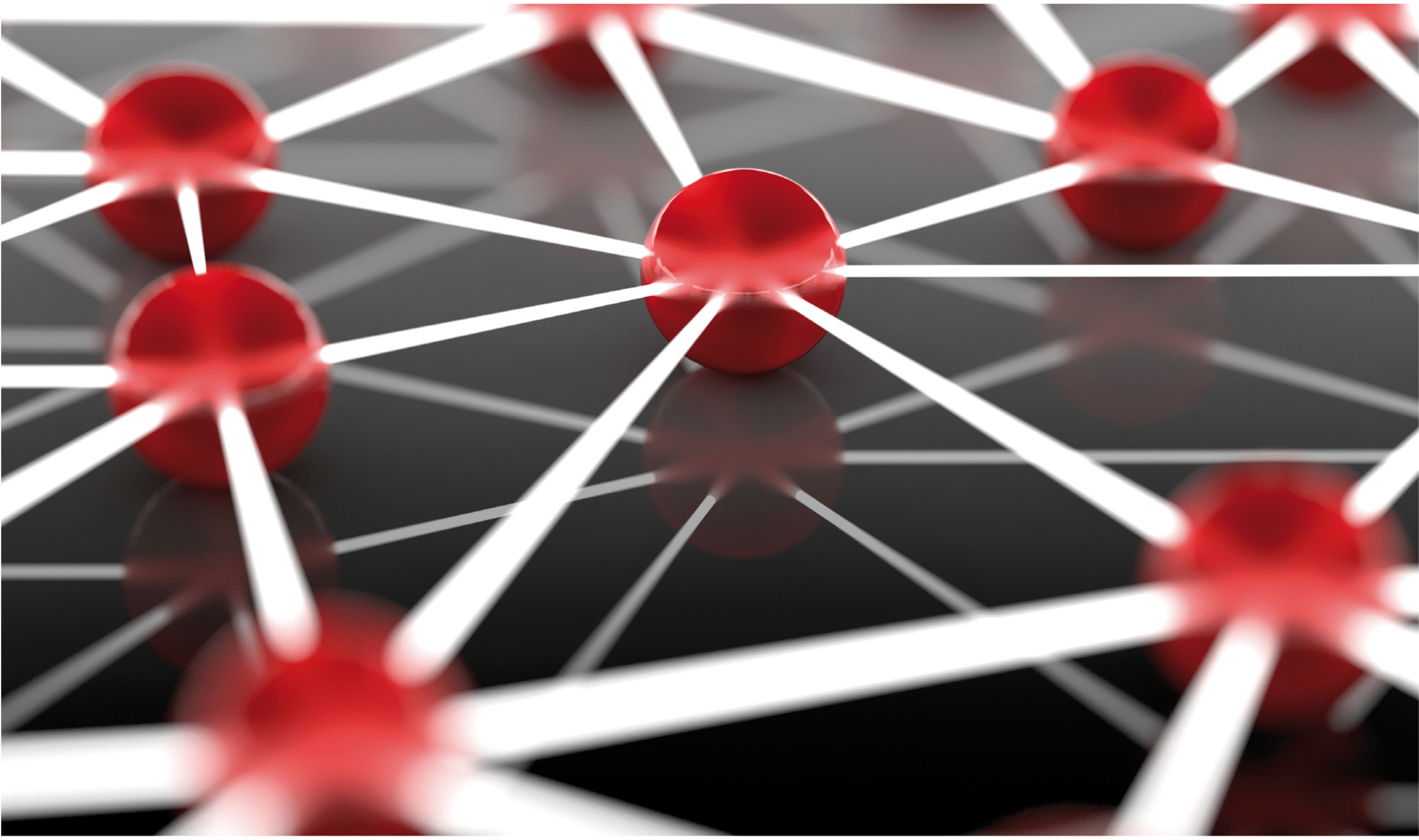
Intelligence. Insight. Interaction. In Asia



“High-quality opinions and discussions, shared in an open and informal setting, make this a uniquely valuable senior-level experience.”

- Andrew Steel, Regional Managing Director, Head of Asia Pacific, Fitch

The Economist Corporate Network (ECN) is the Economist Group's membership-based executive networking and briefing service, which caters to more than 2,500 senior executives and more than 500 firms in Asia.

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1. Introduction

Asia’s business leaders share their views on the region

Every year, the Economist Corporate Network—the business advisory service of The Economist Group—surveys the 2,500 C-level executives with whom it works in Asia Pacific. The collective views of these business leaders 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 2014 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 704 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, 23% 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 32 for more details about the survey respondents.)

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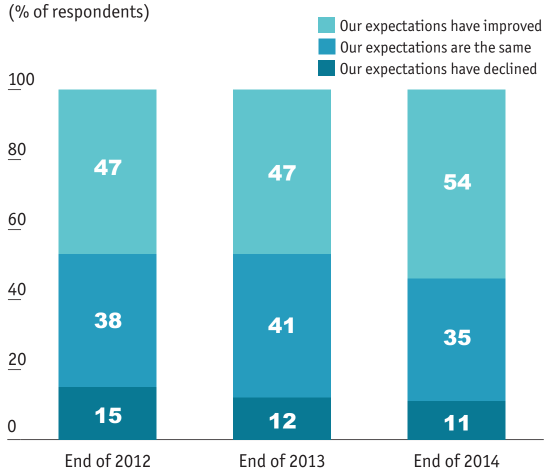
2. Asia gathering steam?

Sentiment about Asia's prospects is broadly positive, with expectations improving

Standing on the cusp of 2015 and looking ahead, the economic outlook is deeply uncertain. America is enjoying a robust recovery. But while that bodes well for Asia's exporters, it threatens an era of rising interest rates, and the risk of instability as capital flows out of emerging markets. In Europe, the economic picture is bleak, with growth stalling and deflation looking ever more likely. Concerns about the viability of the euro currency are once more stalking the headlines. In Asia, the primary growth engine, China, is also slowing as authorities try to rebalance the economy. Meanwhile, oil prices have tumbled, with markets uncertain whether this is a positive sign, thanks to over-supply, or negative, reflecting weak demand.

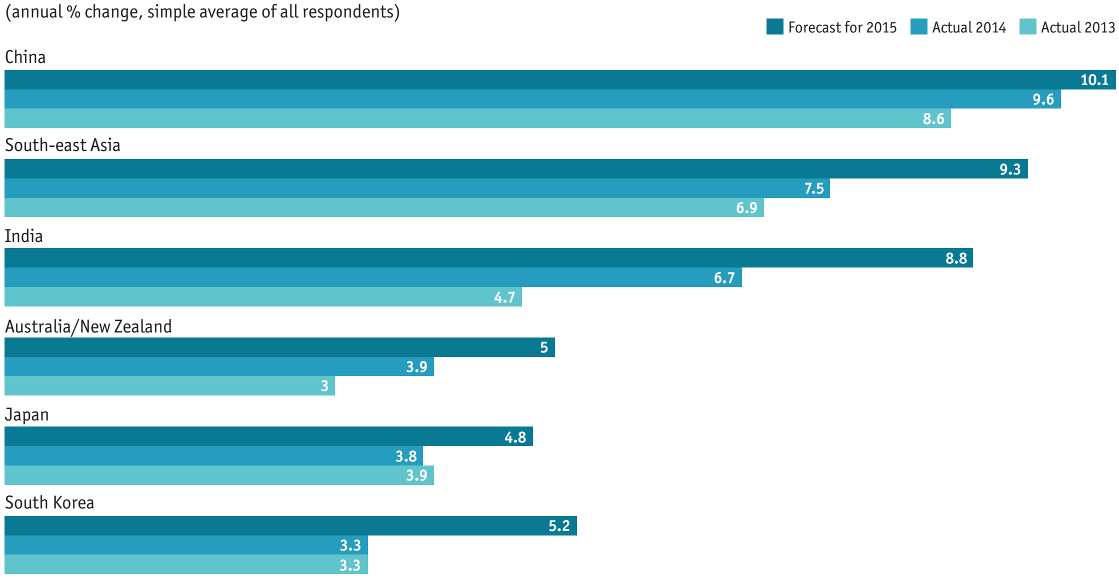
Across Asia, however, business leaders responding to our survey are looking through such concerns and projecting confidence in the future. At a very macro level, some 54% of executives say their expectations for Asia have improved over the past year. Only 11% say they have declined. This makes the balance of opinion more optimistic at the start of 2015 than at the same time during the previous two years. (See chart 1.)

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



Source: *Economist Corporate Network ABOS 2015*

Chart 2: How did your revenue grow (or decline) in 2014, and what do you expect in 2015?
(annual % change, simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

What's more, our survey shows that companies expect their sales to grow more rapidly in 2015 in Asia than they did in 2014. Indeed, for every territory across the region, executives expect growth rates to pick up in the year ahead. (See chart 2.)

As would be expected, China is forecast to deliver the fastest rates of sales growth, at 10.1%. That is above our own view of China's nominal GDP growth in 2015 of 9.2% (real growth rate of 7%). Is this optimism deserved? The administration of president Xi Jinping is overseeing major structural reforms to China's economy. After years of growth fuelled by debt and over-investment, the government wants to forge an economy powered by private consumption, with productivity improvements pushing up incomes, and a liberalised financial system improving the allocation of capital. Companies that are well-placed to benefit from such reforms should prosper, but there will be headwinds, particularly for sectors centred on the property market. In the course of implementing these reforms, growth will keep trending down, reaching around 5.5% (in real terms) by 2019.

South-east Asia is close on the heels of China in terms of the growth that executives are expecting for their companies. The region has much to support high structural growth, not least supportive demographics, rising investment into fixed assets such as infrastructure and factories, ongoing urbanisation, deepening regional integration, and competitive cost structures relative to China. The political scene in 2015 may well be more stable than last year too, with no elections on the immediate horizon, and the turbulence in Thailand more contained than a year ago. However, weak commodity prices will hurt some parts, notably Malaysia and Indonesia, while rising interest rates in the US could cause problems.

The picture in India is brightening, in part thanks to the election of Narendra Modi as prime minister in 2014. It would be foolish to expect Mr Modi to turn India around immediately, but with a rare majority in the lower house of parliament, he is well-placed to implement meaningful reforms. The appointment of a highly competent central bank governor in Raghurajam Rajan has also improved the outlook by bringing stability to the rupee and the welcome prospect of falling inflation. Executives clearly expect India to deliver better results in 2015 than in the recent past.

Japan's economy faltered in 2014, largely due to a hike in the sales tax in April that tipped the economy into recession. Many also felt a growing concern that the whole Abenomics experiment was running out of steam. This weakness was clearly felt by executives in our survey, with the rate of sales growth falling during 2014, albeit marginally. Yet expectations are more bullish for 2015. Why the optimism? Crucially, the second stage of the sales tax hike, originally planned for October 2015, has been postponed until at least 2017 which should allow consumer confidence to recover. The year ahead should also see wages climb as the labour market tightens and pressure mounts on corporate Japan to release some of its record—yet largely idle—cash holdings (estimated at US$2.1 trillion or 44% of GDP).

Naturally, the growth story varies by industry as well as by geography. Table 3 shows the breakdown for revenue growth by industry as well as by geography in 2014, and reveals how executives expect that to change in 2015.

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Table 3: What was your revenue in 2014 and what do you expect it to be in 2015?
(%, simple average of all respondents)

2014	China	India	Japan	South-east Asia	Australia/ New Zealand	South Korea
Automotive	16.7	-3.6	7.1	2.5	0.3	8.6
Chemicals	7.2	7.3	2.9	5.8	1.5	1.6
Commodities	3.5	5.6	-0.8	4.6	2.8	0.2
Consumer goods & retail	6.4	6.6	3.1	6.3	3.6	2.0
Engineering	5.2	0.3	5.4	4.0	-0.5	6.3
Financial services	10.2	6.5	5.0	9.0	5.0	3.4
Hotels & leisure	10.0	6.7	2.5	7.5	8.1	13.1
IT & software	11.6	8.9	5.4	10.5	6.9	4.9
Manufacturing	8.2	6.6	2.7	3.8	-0.1	1.6
Media & marketing	10.0	6.6	1.8	9.7	5.9	3.4
Pharmaceutical & healthcare	14.6	12.3	6.4	11.1	3.5	6.8
Professional services	11.4	6.8	5.3	9.6	2.7	1.8
Property & construction	7.6	4.4	4.9	6.6	6.1	3.8
Transport & logistics	8.8	6.6	1.7	3.6	3.2	4.0

2015	China	India	Japan	South-east Asia	Australia/ New Zealand	South Korea
Automotive	12.4	5.0	2.5	4.7	2.2	6.3
Chemicals	7.6	8.9	0.9	6.4	0.8	2.1
Commodities	5.6	6.3	0.7	5.8	2.1	1.5
Consumer goods & retail	8.1	8.4	2.4	9.3	3.6	4.0
Engineering	6.9	7.0	0.7	5.6	0.0	2.8
Financial services	11.0	8.8	5.8	10.8	6.0	6.5
Hotels & leisure	8.9	7.5	3.9	9.0	7.5	10.1
IT & software	12.8	12.4	10.2	12.1	8.6	7.6
Manufacturing	8.6	7.5	3.6	6.3	3.1	2.6
Media & marketing	10.2	9.5	3.9	11.3	6.1	4.4
Pharmaceutical & healthcare	13.6	11.5	7.0	10.4	5.0	8.3
Professional services	12.7	8.9	7.7	11.8	7.2	8.0
Property & construction	7.4	6.4	3.9	8.4	3.8	3.8
Transport & logistics	7.6	8.2	3.1	6.6	5.5	5.3

Green = accelerating rate of sales growth
Red = falling rate of sales growth

Source: *Economist Corporate Network ABOS 2015*

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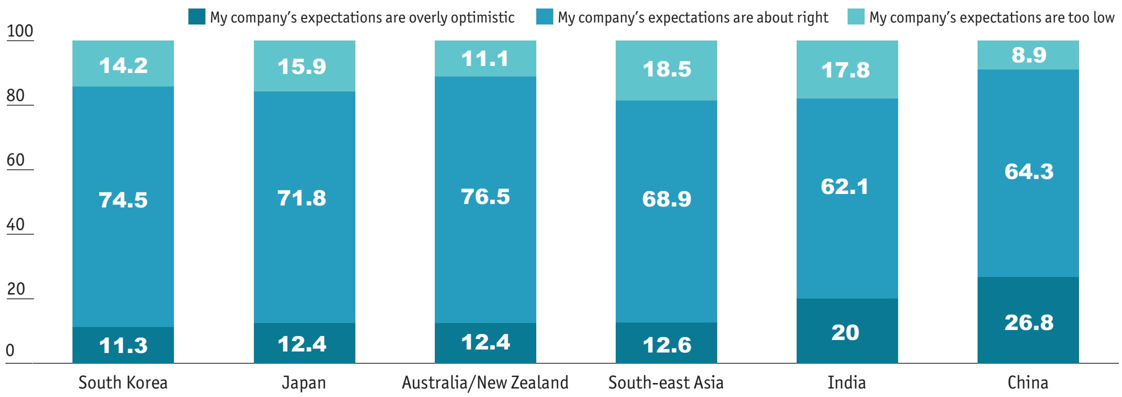
3. Are expectations for Asia realistic?

Are the leaders of Asia operations successfully managing the expectations of their bosses at HQ? And are they making their investment case strongly enough?

The majority of executives in this year's survey feel that, in general, their company's expectations for Asia are about right. (See chart 4.) However, their views on specific markets produce some outliers.

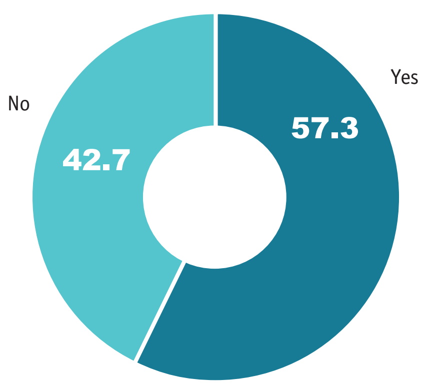
More than a quarter think their companies are expecting too much of their China business. Over-optimistic assessments of China's potential from HQ have long been a headache for decision-makers in the region. Importantly, however, this over-optimism has not blinded China managers to the realities of a market that is slowing and changing, and most are successfully preventing overblown expectations from their HQ from becoming unobtainable targets. (See chapter 5 on page 11.)

Chart 4: 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 2015*

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



Source: *Economist Corporate Network ABOS 2015*

In South-east Asia, the balance of opinion is the opposite, where nearly a fifth of respondents feel their companies should be more ambitious. India (as is often the case) presents a more complicated case, with roughly a fifth of respondents reporting overblown expectations, but an equal number reporting too little enthusiasm for the market.

Interestingly, while most executives feel their firms have a reasonably accurate view of Asia's potential, a significant minority (43%) feel their firms are under-investing in the region. (See chart 5.) There is a disconnect here. While expectations for revenue growth (chart 4) are broadly accurate, the potential in the region may not be achieved because of under-investment (chart 5).

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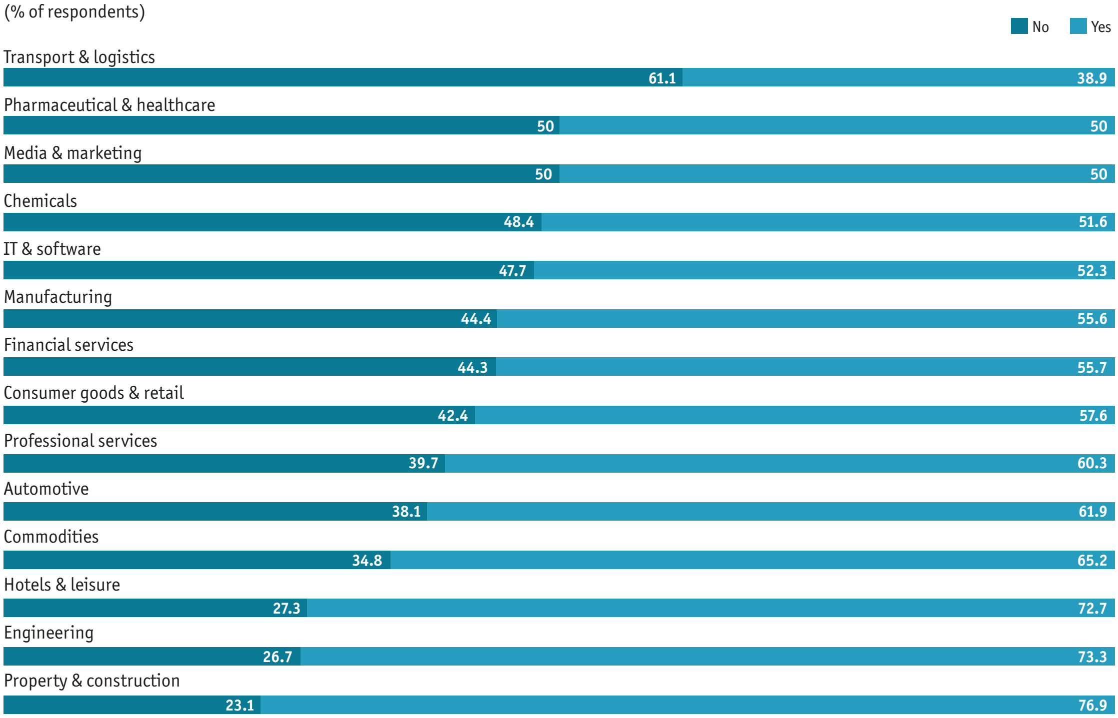
These worries about under-investment vary by sector. (See chart 6.) Easily the most pessimistic industry is transport and logistics, where 61% of companies feel they are under-investing in Asia. Several issues might explain these concerns. In much of Asia, notably India and South-east Asia, infrastructure is poor, and this may well prevent transport firms and logistics providers from investing at a rate they feel is appropriate to Asia's growth rates. In other markets such as China and Korea, where roads, ports and airports are in place, it could be that the tremendous growth of e-commerce is putting strains on express delivery and distribution networks.

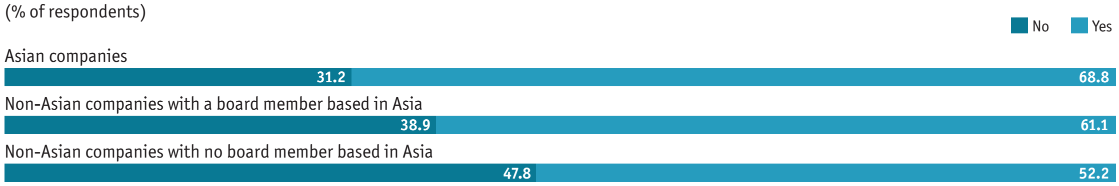
Chart 6: Is your company investing at the right rate in Asia Pacific to achieve its revenue expectations?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

Importantly, the sense of under-investment appears to be correlated with the seniority of leadership committed to the region. Respondents from Asian companies (with board members and global business heads based in the region) have the lowest level of concern. Those from non-Asian firms with at least one board member in the region are slightly more concerned about under-investment. But respondents from non-Asian firms with no board member in Asia show the greatest worry. (See chart 7.)

Chart 7: Is your company investing at the right rate in Asia Pacific to achieve its revenue expectations?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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4. How impressive is the growth?

Headline rates of sales growth in Asia look strong, but are they less impressive than they seem?

When compared to other parts of the world, headline rates of sales growth in Asia look impressive. But how do they compare to growth in the underlying economy?

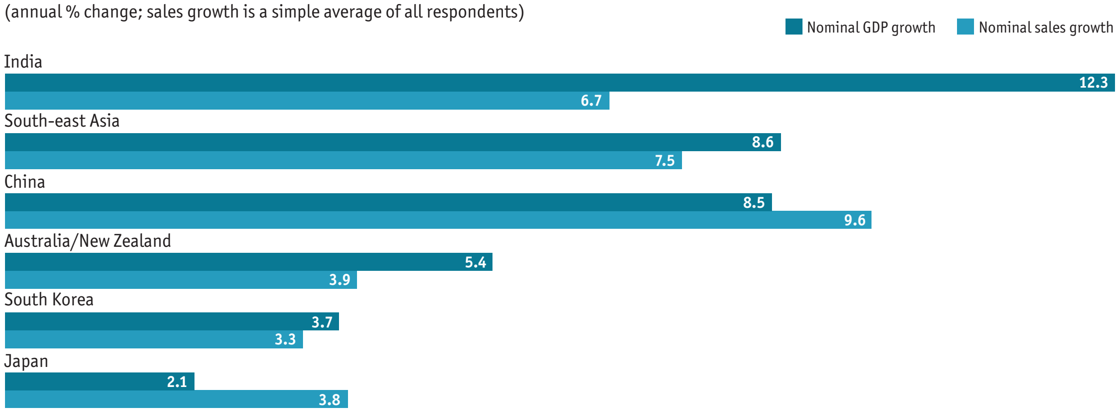
Chart 8 plots nominal sales growth at respondents' companies against nominal GDP (we use nominal growth to reflect both changes in the volume of business as well as changes in the prices charged). As such, it offers a rough gauge of whether companies are growing more quickly or more slowly than the broad economic backdrop.

In much of Asia, sales growth is roughly in line with GDP growth. This means that performance is not necessarily cause for celebration. Take South-east Asia. Sales at the companies in our survey grew there by 7.5% last year. But the underlying economy grew by 8.6%. While managers in Europe would kill for sales growth of 7.5%, it arguably represents under-performance in the context of South-east Asia.

The biggest under-performer in our survey was India. There, nominal GDP grew by a rapid 12.3% in 2014 (thanks to high inflation), but respondents say their nominal sales grew by only about half that rate (6.7%).

Conversely, managers in China and Japan are doing better than might be expected. In Japan, sales growth of 3.8% looks paltry by Asian standards. But given the economic context of Japan, the performance was good.

Chart 8: Nominal GDP growth and nominal sales growth in 2014
(annual % change; sales growth is a simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

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5. Planning supremos

Executives proved adept at forecasting their businesses during 2014

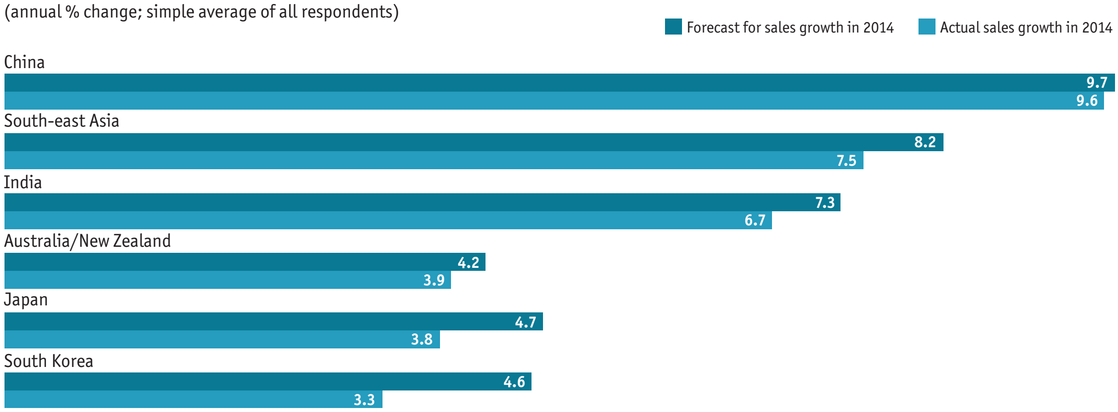
How good are business leaders in the Economist Corporate Network at forecasting sales for their business? To find out, we looked back at our ABOS survey a year ago, conducted in December 2013. We wanted to see what executives were forecasting for their business at the start of 2014, and then to compare that with their actual performance at the end of 2014.

It turns out that forecasts were pretty accurate. (See chart 9.) While forecasts everywhere were a little over-optimistic, companies missed their targets by only a small amount.

Executives were most accurate in their forecasting in China, where actual performance was almost exactly what was targeted. This is interesting, because the Chinese economy is undergoing tremendous change. Under Xi Jinping, the president, the government there is trying to re-balance its economy away from an over-reliance on fixed asset investment, credit growth, and low-value manufacturing towards consumer spending, financial stability, and services. Clean behavior and clean air are just as important.

Growth rates are trending down as a result. But the companies in our survey seem to have the measure of these changes and are re-calibrating their expectations accordingly. Companies have also responded to the increased complexity of their operations in China, deploying their most experienced managers and taking care to localise supply chains and marketing, making it a priority to stay close to their suppliers and customers.

Chart 9: How do forecasts for revenue growth made at the start of 2014 compare with actual performance?
(annual % change; simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

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6. Investment priorities in 2015

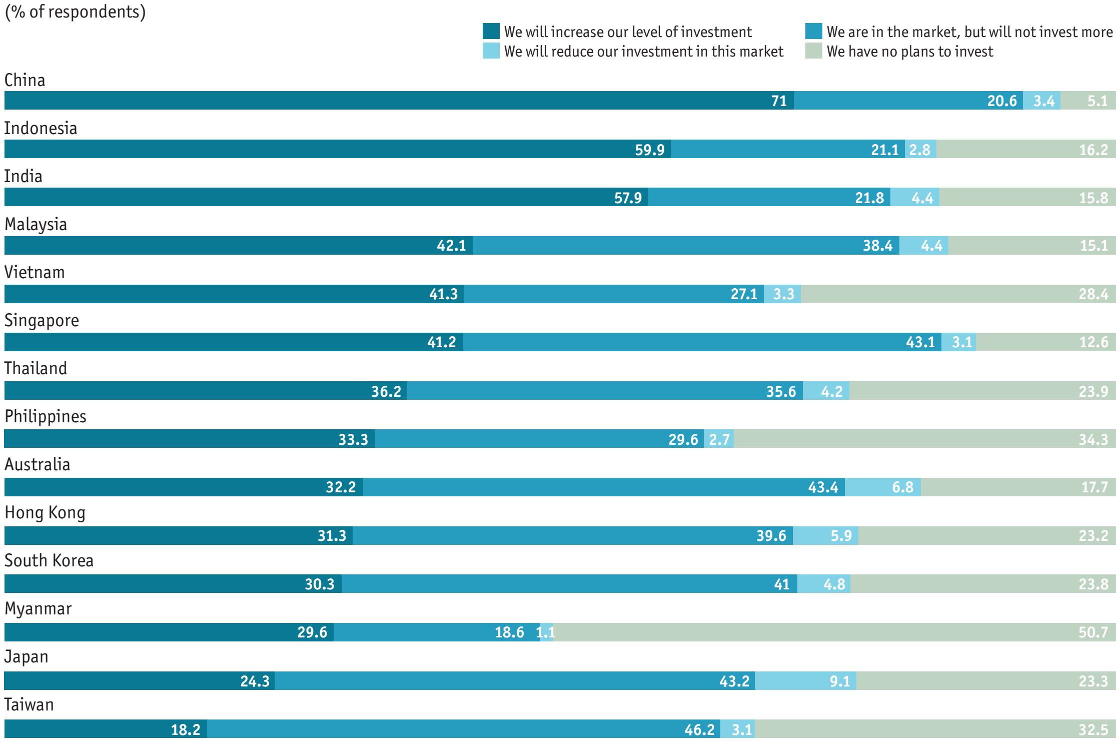
Companies are investing ever more heavily in China, Indonesia and India, but Japan and Myanmar have lost their lustre

On almost every measure of investment, Asia stands out as the world leader. Consider Asia's share of global fixed asset investment: in 2014, the region accounted for 45% of the global total. Or consider foreign direct investment: in 2014, Asia attracted 33% of the global total. Clearly, the region is an attractive place for the world's companies to deploy their capital.

But where will companies be investing their money in 2015? Chart 10 shows the investment intentions of the firms in our survey. As is the case every year, China is the standout leader in attracting new investment. The economy there is slowing, and the environment is becoming more uncertain, but no company of any size can afford to ignore China. What's more, while the current round of reforms may be challenging for companies as they adjust to a "new normal", companies in our survey are optimistic that the outcome of the reform programme will be positive. (See chapter 7 on page 15.)

Second in the rankings of investment destinations sits Indonesia. While the country has had a somewhat turbulent time over the past two years, what with falling commodity prices, a bruising

Chart 10: How will your level of investment change in the following markets during 2015?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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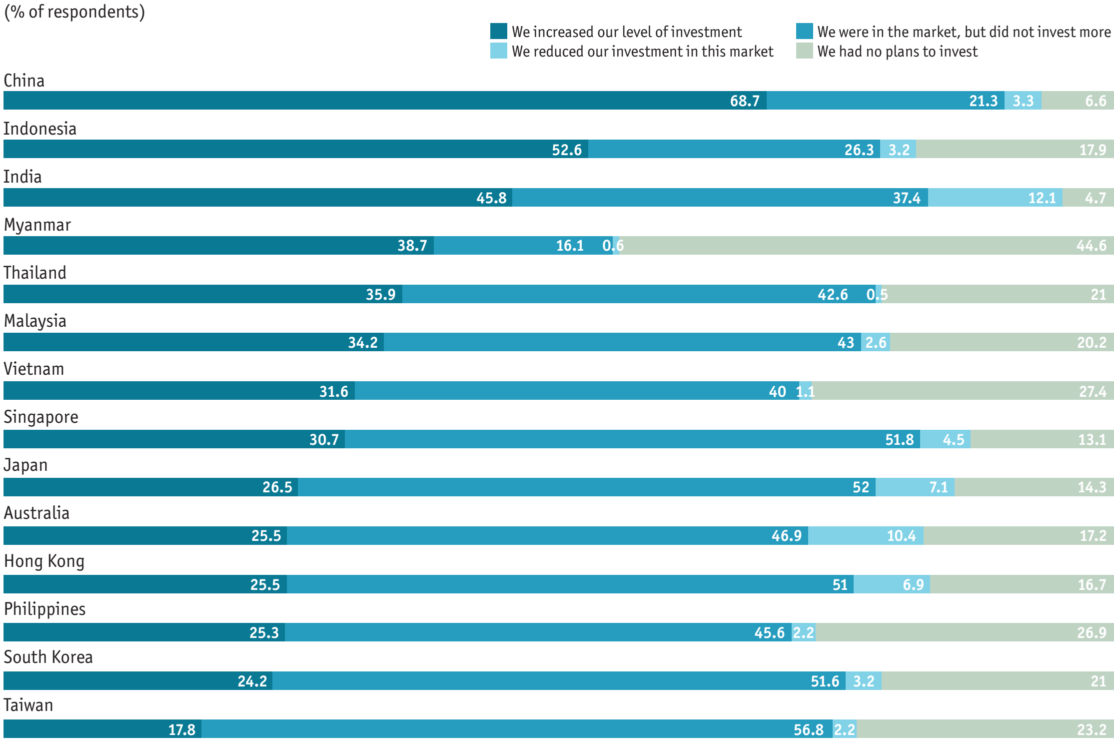
election, and major currency volatility, few companies can afford to ignore South-east Asia's economic engine, and the fourth most populous country in the world.

India sits third in the rankings, marginally behind Indonesia. The election of Narendra Modi as prime minister in 2014 will surely improve the outlook for the country, and help to address some of the issues that have put off investors in recent years. But it remains a difficult market. And while India has a much larger population than Indonesia, and has higher growth rates, it remains a harder country to navigate successfully as a foreign investor.

Behind these three giants, sit a whole set of much smaller markets in South-east Asia, such as Malaysia and Vietnam. While the markets may be relatively small, growth rates are attractive, and opportunities significant.

Comparing the investment intentions in 2015 (chart 10), with the intentions shared in our ABOS survey last year (chart 11), reveals how companies have changed their views on different markets. Of note is the position of Myanmar. While it is still of great interest to many firms, its ranking has fallen from fourth to 12th. Quite possibly the initial euphoria around the nation opening up has given way to the reality that Myanmar is extremely poor, with weak institutions and a difficult business climate. While players in areas such as infrastructure and low-value consumer goods are doing well, the market remains too early-stage for many firms.

Chart 11: How did your level of investment change in the following markets during 2014?
(% of respondents)



Source: *Economist Corporate Network ABOS 2014*

Also of note is the position of Japan. Last year it ranked 9th, but this year has fallen to 13th. The number of companies planning to raise their investment in Japan has fallen, while those intending to reduce their investment has risen. Undoubtedly part of this change of heart centres on perceptions of president Shinzo Abe and his programme of Abenomics. Many companies are keen to see his "third arrow" structural reforms take hold, but little of substance has been implemented so far.

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7. Weathering the reform storm

Companies have confidence that reform in India, Indonesia and China will bring meaningful improvements, but are less certain about Japan and Thailand

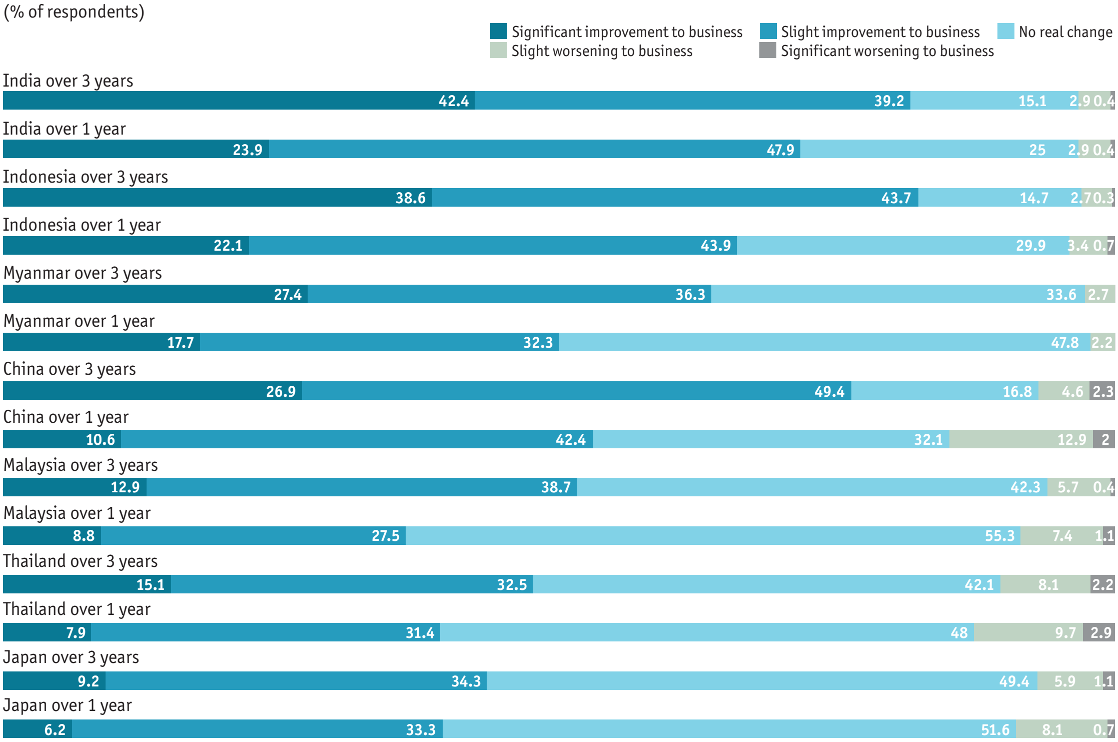
Many Asian countries have unleashed major economic and political reforms over the past year or so. Are these making a meaningful difference to business? We asked respondents to gauge the impact of ongoing reform programmes on their business in seven countries across Asia where the reform efforts are most ambitious. (See chart 12.)

Overall, companies do not expect great changes to occur over the coming year. However, over three years executives are much more confident that positive change will arrive.

Executives are most confident of positive change in India and Indonesia. Respondents are also positive that China will deliver major improvements for business over a three-year timeframe, although over a one-year horizon some 15% say reforms will make things worse before they get better.

At the other end of the scale, executives are largely skeptical that reforms in Thailand and Japan will make much difference to the outlook for their business. Both nations face deep structural challenges,

Chart 12: Many parts of Asia have launched major economic and political reform programmes in recent times. What impact do you expect these efforts to have on your business in the next 1 year and next 3 years?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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from ageing demographics and protectionist policy in Japan to divisive politics in Thailand, and many business leaders feel that reforms are unlikely to address these issues in a meaningful way.

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8. Profitable growth?

How do profits vary by industry and by geography across Asia? And how will margins change in 2015?

Asia has decent topline growth. But what does the bottom line look like? In aggregate, all regions offer decent profitability. But some parts of Asia offer better profits than others. No surprise, India is bottom, followed by China. These are difficult markets, with major uncertainties and strong local competitors. The mature markets of Australia and New Zealand, with their reliable business climate, offer the best profits, although relatively low growth. (See chart 13.)

Chart 13: What were your operating profit margins in 2014 and what do you expect them to be in 2015?
(%, simple average of all respondents)

Source: *Economist Corporate Network ABOS 2015*

The profit picture varies by sector as well as geography. The pharmaceutical and IT/software sectors are most profitable, while the transport and logistics and automotive sectors are least. (See table 14.)

Looking ahead to 2015, how do companies expect their profitability to change? Unsurprisingly, the outlook for commodities is poor, with declining margins forecast for every part of the region except China. The retail sector is also set to see margins fall in many parts of the region.

In terms of geographies, Japan stands out as having the greatest number of sectors where the outlook for 2015 is worse than 2014. Digging a little deeper, the sectors that did well during the initial burst of optimism surrounding Abenomics (financial services and retail in particular) are less confident about 2015. On the other hand, the weak yen is improving profitability for some sectors. For example, the yen is boosting inbound tourism which reached a record level in 2014 and supported the hospitality sector. Just as clearly, the weak yen is helping the manufacturing sector. Given the improving margins that the sector expects in 2015, this may be the year that yen weakness translates into export strength.

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The most positive geography is China, where every sector is expecting margins to improve in 2015. This finding plays into one of the themes of this year's ABOS report, namely that companies remain confident about China and its economic outlook despite the challenging reforms that lie ahead.

Table 14: What were your operating profit margins in 2014 and what do you expect them to be in 2015?
(%, simple average of all respondents)

2014

	China	India	Japan	South-east Asia	Australia/ New Zealand	South Korea
Automotive	9.5	4.2	8.4	8.5	8.5	9.6
Chemicals	13.1	9.8	13.5	13.9	11.8	11.9
Commodities	8.9	11.3	10.5	15.2	10.7	12.8
Consumer goods & retail	12.0	11.3	17.5	13.9	18.9	17.8
Engineering	9.2	9.0	13.3	13.0	11.9	14.4
Financial services	12.1	11.2	12.2	13.4	16.4	10.3
Hotels & leisure	15.8	14.3	14.3	18.1	18.4	16.3
IT & software	13.0	16.5	17.3	19.8	17.6	15.8
Manufacturing	10.8	9.5	11.9	12.4	12.8	11.1
Media & marketing	16.5	17.1	13.8	17.1	19.5	15.5
Pharmaceutical & healthcare	13.2	13.5	19.7	15.2	19.1	18.8
Professional services	13.6	12.9	12.9	14.5	13.5	11.3
Property & construction	14.7	12.1	13.9	13.1	15.3	12.8
Transport & logistics	9.5	8.8	9.4	7.5	9.4	11.0

2015

	China	India	Japan	South-east Asia	Australia/ New Zealand	South Korea
Automotive	9.8	6.2	8.4	8.1	8.5	9.6
Chemicals	13.3	9.9	13.3	13.5	11.8	12.6
Commodities	9.6	10.8	10.4	14.3	9.9	11.9
Consumer goods & retail	12.1	13.1	17.2	13.8	18.6	17.5
Engineering	10.8	10.0	12.8	13.4	13.1	16.6
Financial services	13.2	13.0	12.1	14.2	15.4	12.3
Hotels & leisure	16.9	15.7	15.7	19.2	18.4	17.9
IT & software	16.3	16.8	15.9	20.2	18.5	16.1
Manufacturing	12.2	11.5	12.9	12.9	13.5	11.8
Media & marketing	17.6	15.8	14.4	16.1	18.8	16.2
Pharmaceutical & healthcare	14.1	14.6	20.5	17.8	19.1	20.4
Professional services	13.8	14.3	13.8	16.3	14.7	13.2
Property & construction	15.3	13.7	14.5	13.6	14.3	13.1
Transport & logistics	10.5	10.9	9.2	9.3	10.6	10.8

Green = improving profit margins
Red = falling profit margins

Source: *Economist Corporate Network ABOS 2015*

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9. Driving profitability up and down

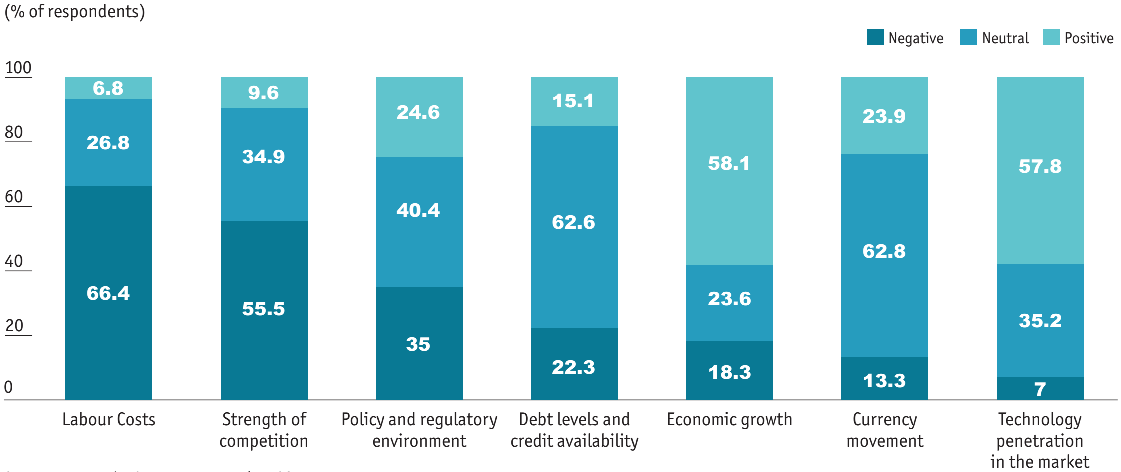
Rising labour costs and strengthening competition are the two biggest headaches affecting corporate profitability

A company's profitability is impacted by many things, some of them specific to a company, others to the industry in which it works, and yet others to the economic and political context. In this year's ABOS survey, we asked companies to rate how different issues in the broad economic and political backdrop in different parts of Asia are impacting profit margins.

In China, companies say the biggest challenge to profitability is rising labour costs. (See chart 15.) This is a perennial isssue in China, with a penchant for blooming early in the year, lunar new year bonuses are expected and new labour contracts are signed. The size of the workforce in China has now peaked, which means steady pressure on wage rates. In addition, the government's directive to increase minimum wage rates within the current 12th Five Year Plan, has resulted in wage growth that is well above inflation and GDP growth levels.

In second place is the strong growth of local companies. This trend is clear to see in many sectors, from the rise of China's internet giants such as Alibaba and Tencent, to the fact that the biggest smartphone maker in China, Xiaomi, is now local. Foreign companies have long complained about non-tariff protectionist barriers, as well as the theft of intellectual property (IP), but the Chinese giants of today are incresingly competing with their own IP, and without state support. In third place, companies are worried about policy uncertainty. As China shifts to a new economic model, companies are exposed to new rules and new government aspirations. While this creates opportunities for some firms, it undermines old certainties for other companies.

Chart 15: In China, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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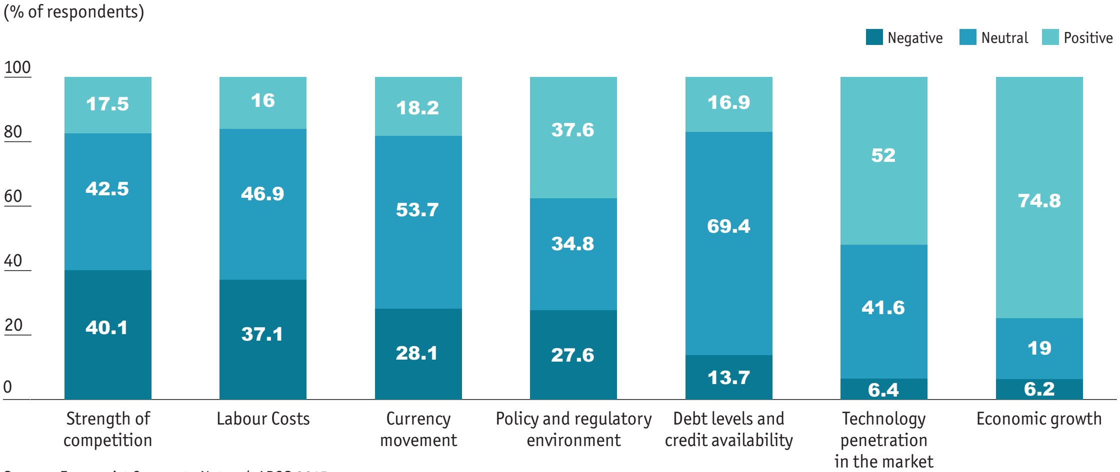
Our survey this year reveals that, of all markets in Asia Pacific, India is the place where firms have the lowest profit margins. (See chapter 8 on page 17.) What cost issues are companies most concerned about? The number one struggle is the strength of competition. (See chart 16.) Foreign companies, which make up the majority of companies in this survey, face many challenges from local rivals. For a start, ownership restrictions discriminate against foreigners, preventing them from making the right levels of investment needed to compete. What's more, India is a difficult market, with uncertain rules, poor infrastructure, and murky business practices. While local companies have many years of experience learning how to cope, foreign firms are not so sharp.

Companies operating in India are also highly concerned about rising labour costs. Some 40% of firms say the issue is having a major negative impact on their operating margins. Given India's growth rates, the education system is clearly not providing enough workers with the right skills, leading to sharp wage inflation.

In third place in the ranking of profit concerns sits currency volatility. The rupee has tumbled sharply over the past year and a half. However, it now looks to have stabilised, so perhaps this concern will be less acute in the year ahead.

Chart 16: In India, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

The biggest issue impacting profitability in Japan is currency movement. (See chart 17.) With the yen being driven down by the Bank of Japan's huge quantitative easing programme, this is positive for many Japanese companies, who are enjoying a boost not only to export competitiveness but also to the value of repatriated foreign earnings. However, most of the respondents to our survey are non-Japanese companies for whom a weak yen is bad news in that it makes imports less competitive and reduces the value of profits being sent back to head office. Sadly for foreign firms, currency volatility is likely to continue with interest rates expected to rise in the US this year and no end in sight for Japan's continued loose monetary policy.

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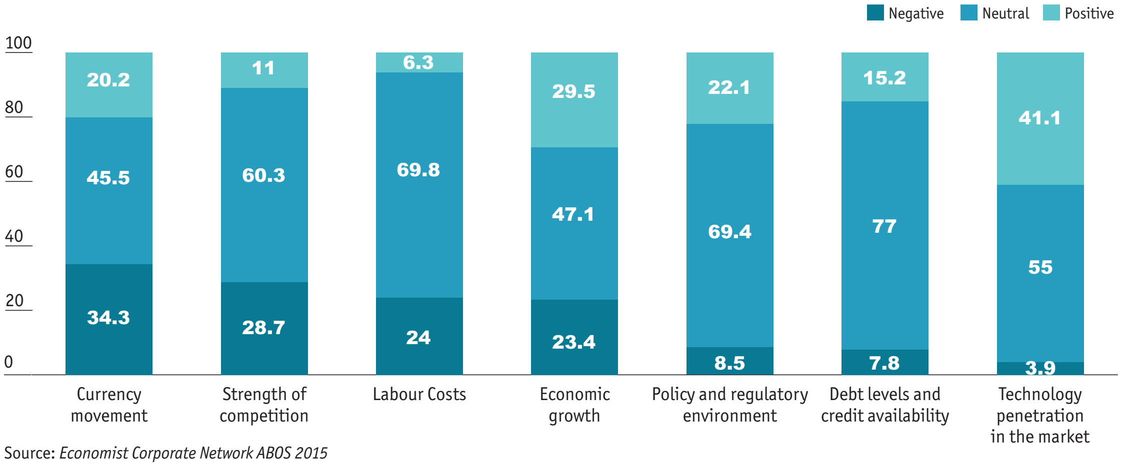
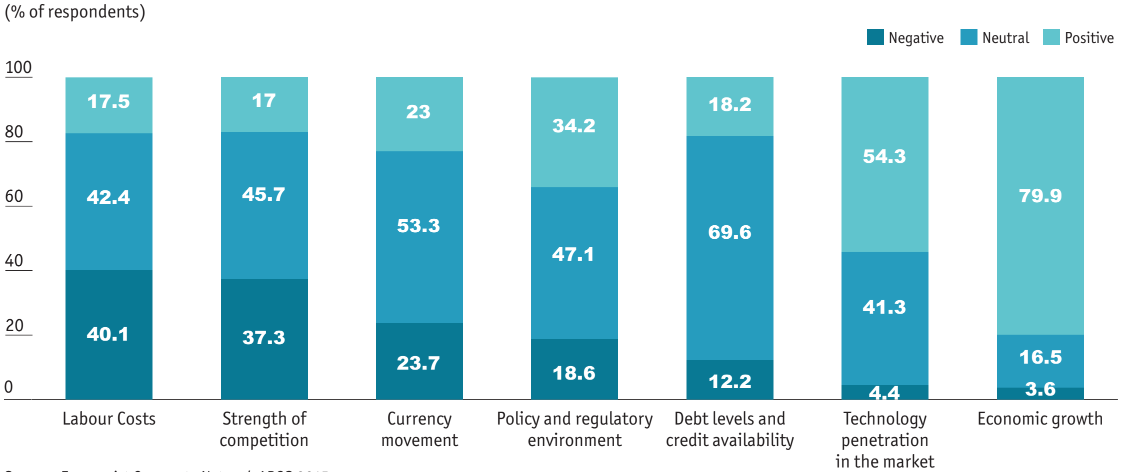
Chart 17: In Japan, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

In South-east Asia, rising labour costs are the biggest challenge to profitability. (See chart 18.) High structural growth means demand for labour generally outstrips supply, forcing up wages. However, many nations, including Thailand, Indonesia and Malaysia have all raised minimum wages in recent years, adding to the problem. Even in Singapore, with its highly educated workforce, new government restrictions on foreign workers are putting upward pressure on wages. The second biggest challenge is strengthening local competition. In almost every sector, from banking to retail to software to chemicals, a new generation of regional giants is rising up and challenging the established global multinationals. The launch this year of the ASEAN Economic Community is likely to see competition within the region get even stronger.

Chart 18: In South-east Asia, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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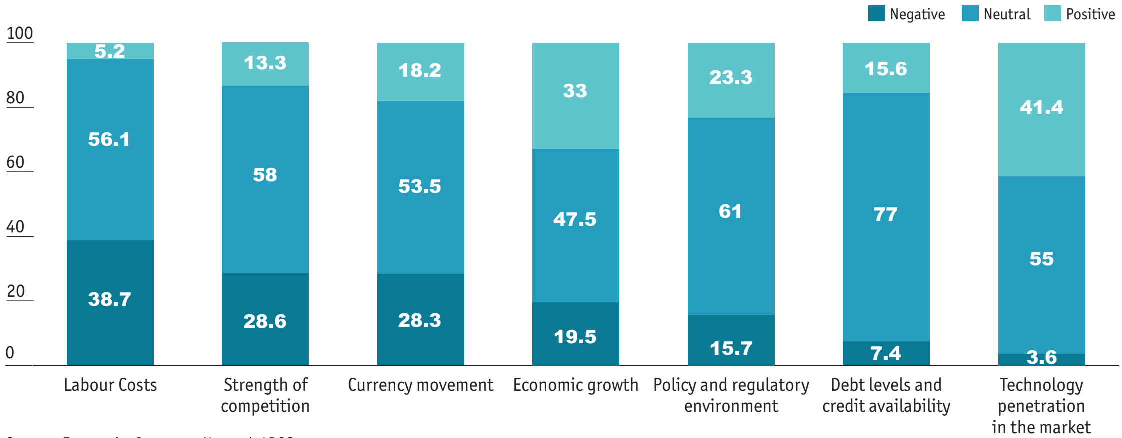
In Australia and New Zealand, companies say the number one challenge to profitability is rising labour costs. (See chart 19.) Almost 40% of companies cite this issue as having a negative impact on profit margins. Had we asked this question two years ago, respondents in Australia might well have listed currency movements as being the number one challenge, given that the strong dollar had not only hurt exporters, but had also made many imports cheaper than locally-produced goods and services. Today, however, with the dollar much weaker, the issue ranks only third as a challenge to profits. Nonetheless, for foreign firms sending profits home, a weaker dollar isn't necessarily good news.

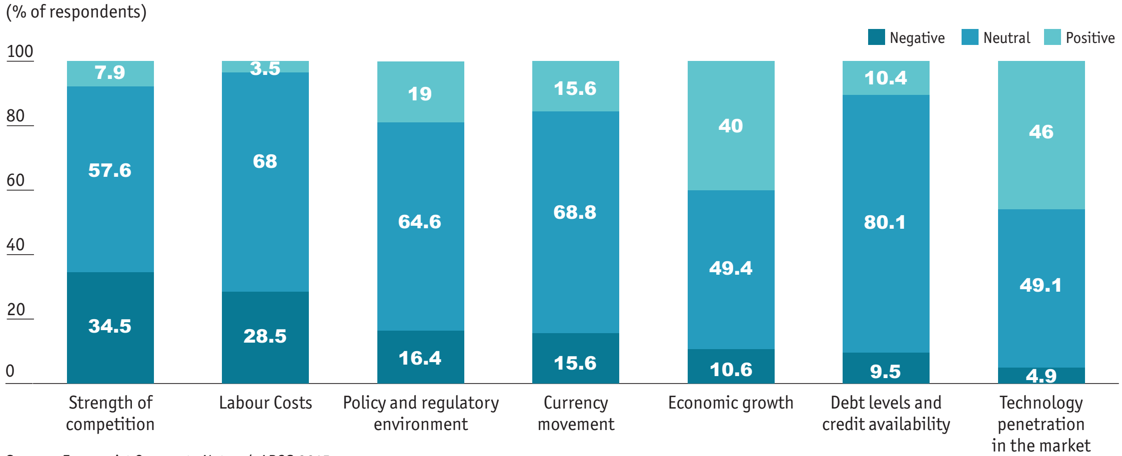
Chart 19: In Australia and New Zealand, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

The strength of domestic competition is the biggest challenge for firms operating in South Korea, although the issue of rising labour costs is not far behind. (See chart 20.) Indeed, labour costs have increased by around 27% since 2010 leading to significant downward pressure on profitability. Interestingly, although much is made of the potential risk of high levels of consumer debt in South Korea, this is overwhelmingly regarded as a non-issue by almost 90% of respondents. This may bode well for a return of private consumption in the coming months.

Chart 20: In South Korea, how are changes in these issues impacting your profitability?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

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10. Worker woes

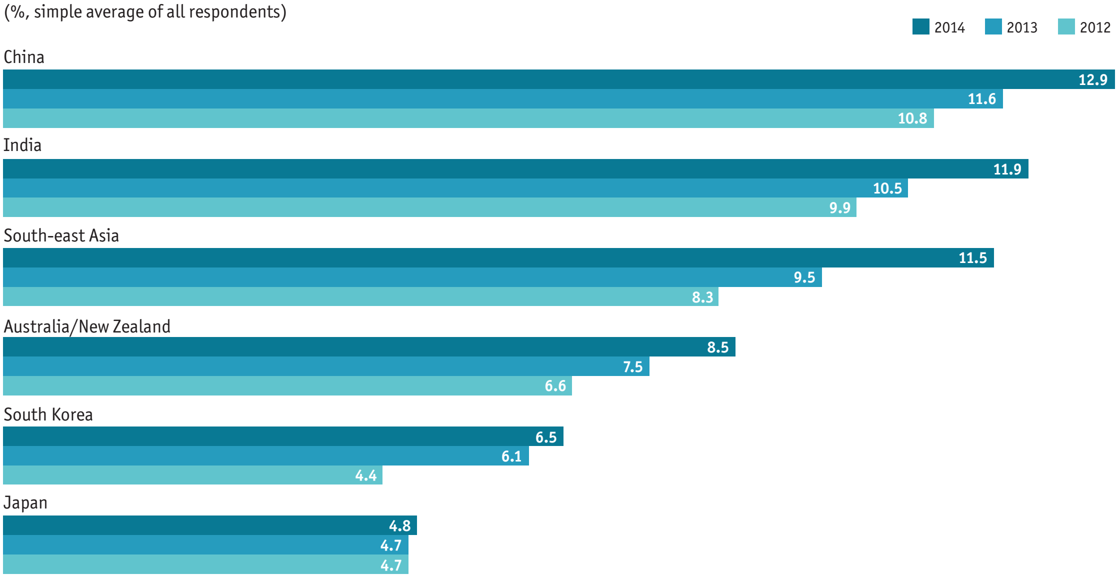
Rates of staff turnover appear to be edging up across Asia

One issue impacting profitability is staff turnover (the percentage of workers that must be replaced each year). Finding and retaining staff is a perennial problem in the high-growth parts of Asia. In 2014, the picture appeared to worsen, albeit modestly. (See chart 21.)

Companies operating in the fastest-growing economies, notably China, India and South-east Asia, had to cope with double-digit staff turnover rates. South-east Asia saw its churn in workers accelerate most rapidly in 2014 compared to the year before. This perhaps reflects rising foreign investment—inflows of FDI into ASEAN are at record levels. What's more, as the costs of doing business in China have risen, some companies have looked to South-east Asia as an alternative, which has in turn led to a more intense struggle for talent to manage the growing operations there.

Conversely, the relatively mature, low-growth markets of Japan, South Korea and Australasia appear easier to manage. Unsurprisingly, turnover rates in Japan are again the lowest in Asia, attributable in part to Japan's inflexible hiring and firing regulations.

Chart 21: What is your staff turnover in these territories?
(%, simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

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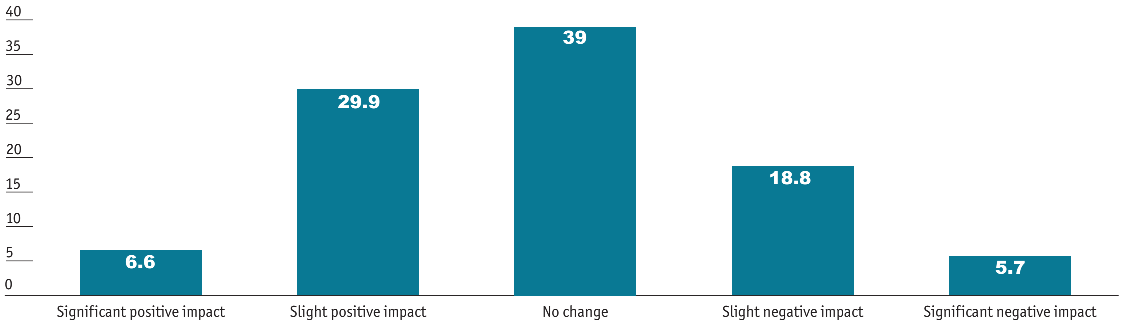
11. Will sunlight help China grow?

Executives take a broadly positive view of the country's anti-corruption drive

Another issue that has the potential to hurt profitability is China's ongoing anti-corruption drive. For some sectors, such as luxury goods, the austerity and anti-corruption measures have hurt sales as lavish gift-giving is curtailed. For other sectors, investigations and fines have had a big impact.

Interestingly, however, most executives in our survey take a positive view of the anti-corruption efforts. They believe that ultimately it will improve the business climate by creating a more level, transparent playing field. (See chart 22.)

Chart 22: In China, what impact is the ongoing anti-corruption campaign having on your business?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

However, while anti-corruption efforts are generally seen in a favourable light, many in our survey do sense that the motivations behind some of the investigations might not be entirely pure. For example, almost half of respondents feel that the anti-corruption efforts are being targeted most vigorously against foreign firms, especially the pricing and anti-monopoly probes. (See chart 23.)

Chart 23: In China, do you feel the anti-corruption campaign is targeted more at local companies or foreign companies?
(% of respondents)

Source: *Economist Corporate Network ABOS 2015*

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And yet, while these concerns are very real, and while they come against a backdrop of rising uncertainty thanks to president Xi Jinping's efforts to re-set China's economy onto a more sustainable footing, foreign investors have not dimmed their enthusiasm. As Chapter 6 shows, foreign investment continues to grow. (See page 12.)

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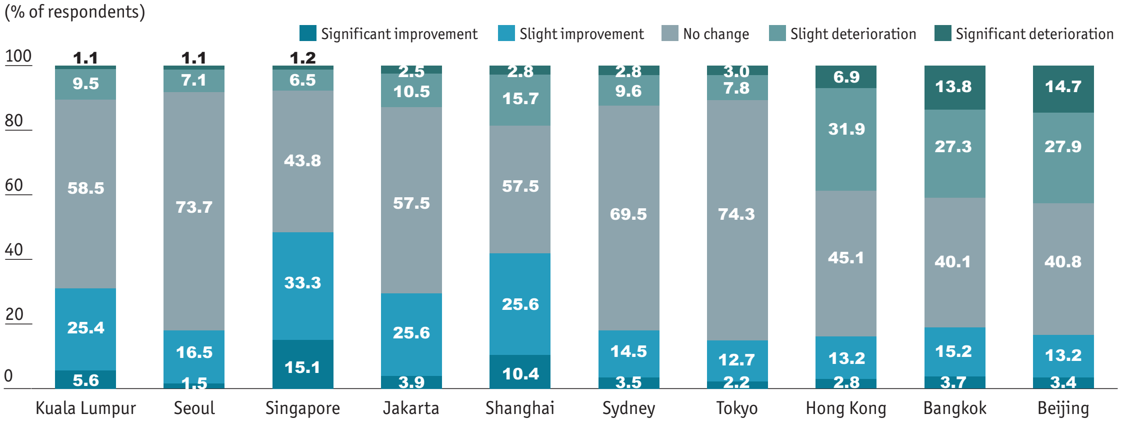
12. Hub bubble and trouble

Which cities are becoming more attractive as regional management hubs in Asia?

How are perceptions changing around the relative attractiveness of different cities in Asia as hubs for putting management talent and operations? Moving up the ranks are cities that have worked hard to improve business-friendly infrastructure and regulations: Singapore is the clear leader here, followed strongly by Shanghai. More than a quarter of respondents felt that both Jakarta and Kuala Lumpur were also improving as business hubs. (See chart 24.)

At the other end of the spectrum, several cities saw their operating environments deteriorate in 2014. Well over a third of respondents said Beijing, Bangkok and Hong Kong have all worsened. Negative headlines—from Beijing's choking air, to Thailand's long-roiling political turmoil, to the disruptions caused by the Occupy Central movement in Hong Kong—served to dent the perceptions of these three cities.

Chart 24: Over the past year, how have your views about the following cities changed as centres for running regional management operations?
(% of respondents)



Source: *Economist Corporate Network ABOS 2015*

What are the factors that people cite as being cause for concern? Chart 25 outlines which operational challenges would motivate managers to move out of a hub. (The chart shows the number of times that respondents identified each issue as being significant.)

In this analysis, certain "pan-Asian" operational headaches emerge; the lack of talent is a nearly uniform challenge across all the region's hubs. Outside of these, there are different challenges in "rich hubs" versus "emerging hubs". Unsurprisingly, rising costs are the primary concern for managers in the "rich hubs", particularly in Singapore. "Emerging hubs" have both more diverse, and more numerous, complaints: least-loved Beijing, in particular, had numerous complaints about pollution, congestion and its overall quality of life. Interestingly, despite perceptions that Shanghai is improving

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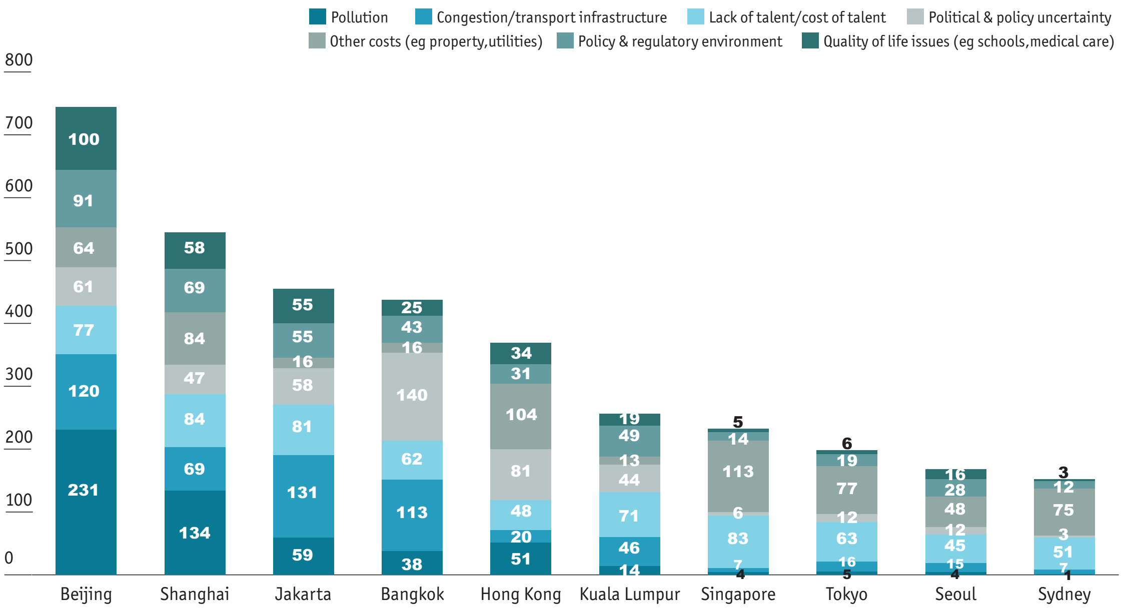
as a regional hub, it still ranked second in the number of concerns that respondents raised about the city.

Somewhat worrying for Hong Kong, respondents believe it suffers from both "rich hub" problems like costs, as well as copious "emerging hub" challenges. It ranked just after Jakarta in terms of pollution (though far lower than Beijing or Shanghai), and second in terms of congestion, possibly due to the impact of the Occupy Central movement's closure of key roads during a two-month period in 2014.

Hong Kong was also found to have the region's highest degree of political uncertainty, after Bangkok. The pragmatic view would say that managers are accurately gauging the impact that the Occupy movement has had on Hong Kong's efficacy as a place to run regional operations: if Hong Kong continues to bristle under China, this cannot be helpful for businesses still trying to manage China-centric businesses there. An optimistic view would see the opposite: that there is danger in conflating the Umbrella Revolution's disruptions with eroding efficiency, when its longer-term impacts could possibly result in increased political transparency and government responsiveness.

Chart 25: Would any of these issues cause you to consider relocating staff away from these cities?
(Number of respondents)

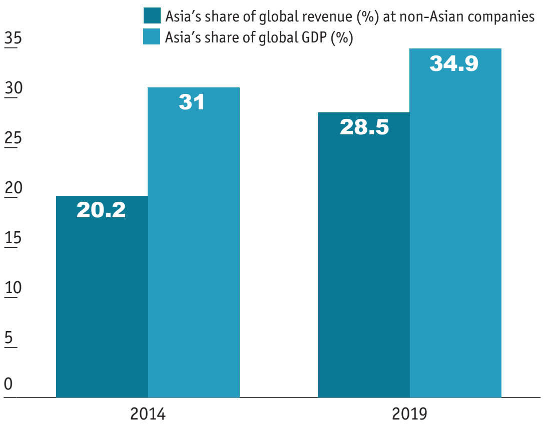


Source: *Economist Corporate Network ABOS 2015*

13. Asia's heavy-weight status (I)

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

Chart 26: What share of your global revenue came from Asia Pacific in 2014 and how will that change by 2019?
(%, simple average of all respondents)



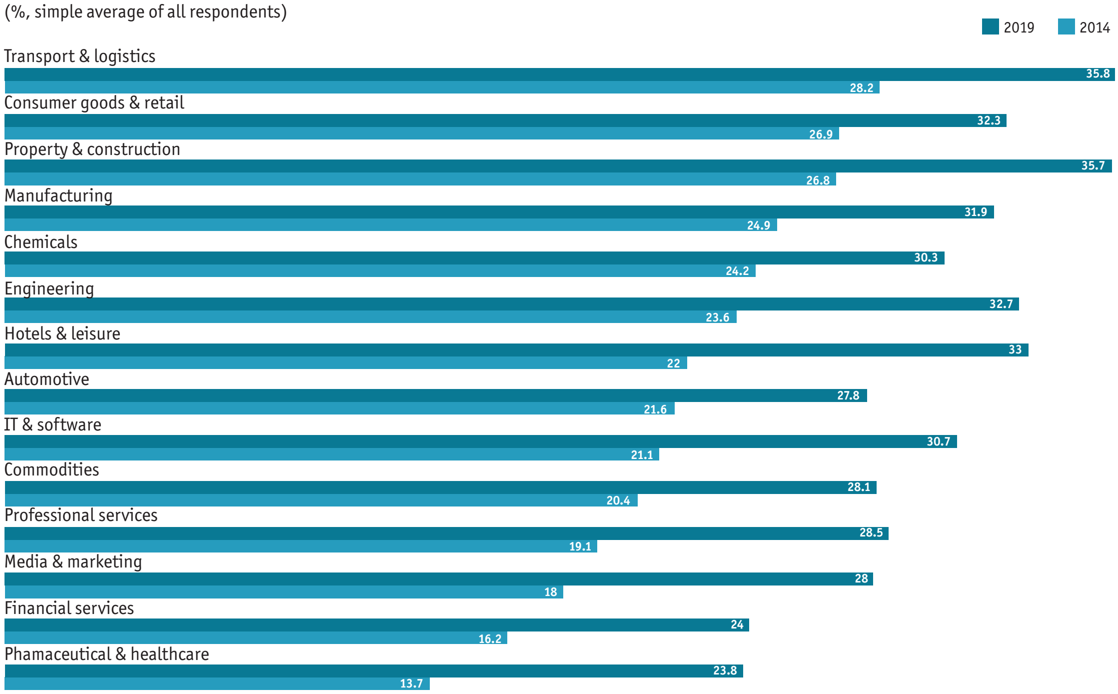
Note: Data is only for non-Asian firms
Source: *Economist Corporate Network ABOS 2015*

Asia's importance to global MNCs continues to rise, as does their expectations of the region's future worth to their business. Considering only the 542 non-Asian companies in our survey, such firms estimate that 20% of their global revenue came from Asia in 2014. By 2019, they expect that share to rise to 29%. (See chart 26.) Only 30% of our MNC respondents make more than a quarter of their global revenue out of Asia—but more than half believe this will be the case in five years' time.

When compared to Asia's share of global GDP, managers at these companies clearly have some catching up to do. But, as our results suggest, managers are confident that they will keep closing that gap in the years ahead.

When these responses are parsed by industry sectors, we see a tendency for higher value-added verticals, such as healthcare and financial services, to report a lower share of their global revenue coming from Asia. Doubtless as incomes rise across the continent, as service sectors expand, and as middle class spending patterns develop—such as investing more heavily in the future through health, education and financial services—this picture will change. (See chart 27.)

Chart 27: What share of your global revenue came from Asia Pacific in 2014 and how will that change by 2019?
(%, simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

Note: Data is only for non-Asian firms

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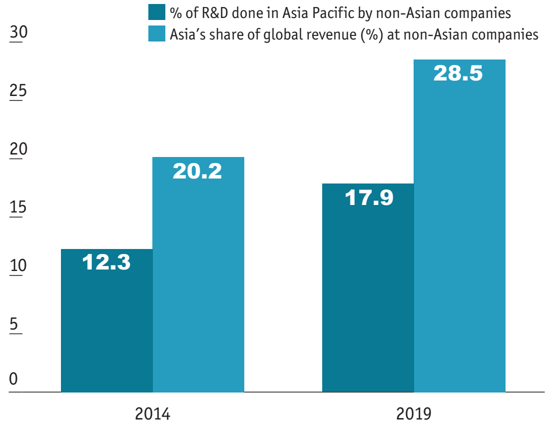
14. Asia's heavy-weight status (II)

Asia's share of global R&D spending is set to rise, but will lag behind its share of global revenue for the world's MNCs

The share of R&D that global, non-Asian, companies conduct in Asia is rising. However, it still lags behind the share of global revenue coming out of Asia for these firms. (See chart 28.) This disconnect will surely change, although respondents do not expect it to change in the next five years.

One reason might be that some global firms are conducting R&D in Asia as part of their global manufacturing processes. In the lingua franca of sourcing managers, this is not part of the "revenue side" of their Asian operations, and not directly correlated with their regional sales performance. As supply chains designed to service world-wide markets evolve to be more Asian market-centric (again, reflecting Asia's growing proportion of global market demand), this will change.

Chart 28: What share of your global R&D was conducted in Asia Pacific in 2014 and how will that change by 2019?
(%, simple average of all respondents)



Source: *Economist Corporate Network ABOS 2015*

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15. Asia's heavy-weight status (III)

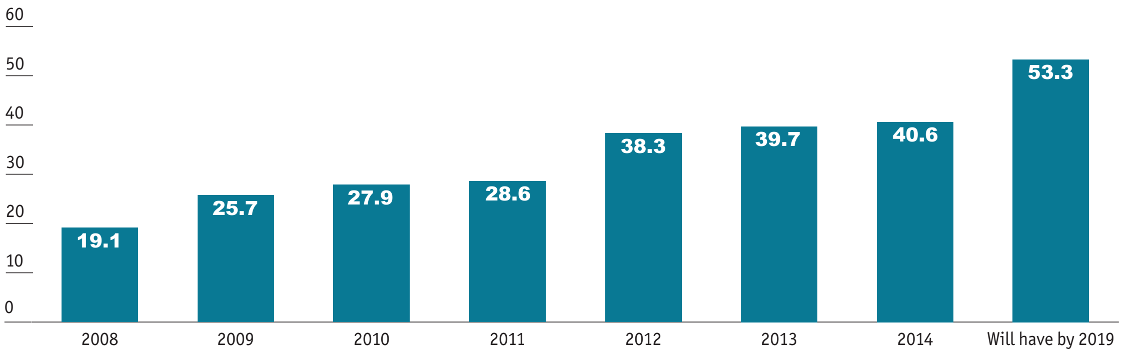
Global companies are transferring ever more decision-making power to Asia

Global companies are committing ever more of their leadership team to Asia in response to the region's rising importance. This has been a trend that the ABOS project has been tracking for many years, and this year sees the trend continue, with the number of non-Asian companies posting a board member to the region rising to 40.6%. (See chart 29.)

The increase during 2014—a rise of one percentage point over a year earlier—is meagre compared to some recent years. In 2012, with Western markets in disarray following the Global Financial Crisis, the number of non-Asian companies posting a board member to Asia rose from 28.6% to 38.3%. The jump was driven by the need to put senior decision-makers closer to the epicentre of global growth. However, looking to the future, respondents expect board representation to keep rising, and indeed for the trend to pick up speed.

The same trend holds broadly true for companies re-locating the global heads of business units to Asia rather than leaving them in their traditional home markets. (See chart 30.)

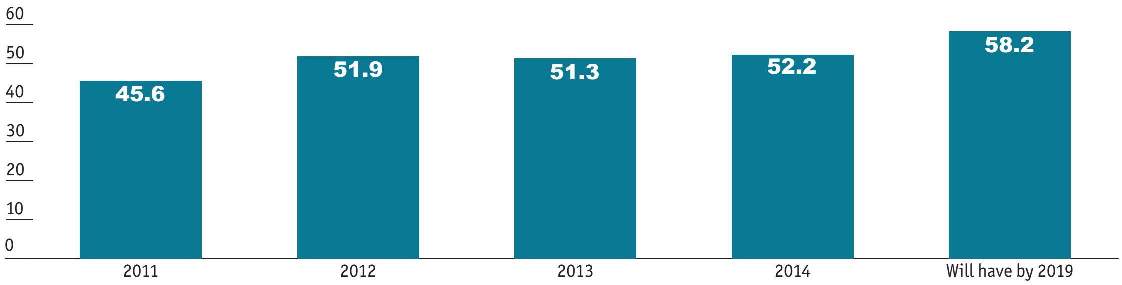
Chart 29: Are any members of your main board of directors based in Asia Pacific?
(% of respondents answering yes)



Source: *Economist Corporate Network ABOS 2015*

Note: Data is only for non-Asian companies

Chart 30: Are any of your firm's global business unit heads based in Asia Pacific?
(% of respondents answering yes)



Source: *Economist Corporate Network ABOS 2015*

Note: Data is only for non-Asian companies

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16. Asia's giants go their separate ways

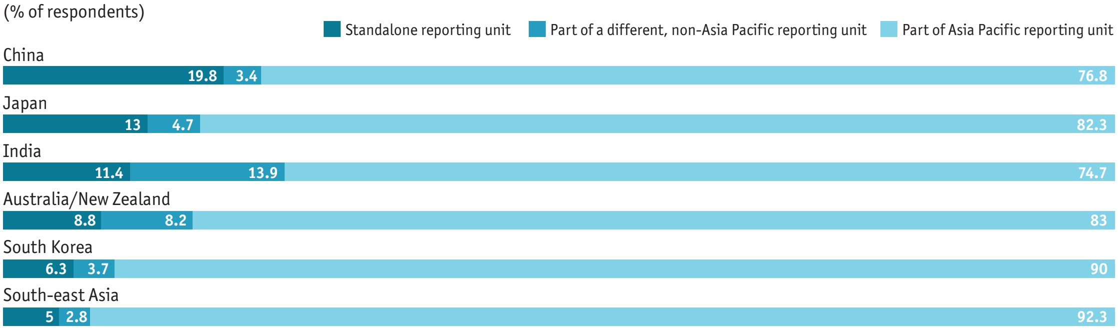
Is Asia too big and too diverse to run as one management unit?

How are the reporting structures at multinational companies in Asia changing? As the regional economy gets ever bigger (now almost a third of global GDP), it makes sense for companies to carve up Asia into smaller units for the purposes of reporting and more effective management. The giant diversity in Asia is an equally important consideration. What works in China may not work in India. Having different management teams can help firms to cope with diversity.

At present, most companies still manage Asia under a single reporting structure. But this is slowly changing. Given the size and importance of the China market, a significant minority of companies (about one-fifth) already manage the country as a standalone reporting unit. (See chart 31.)

India, the other regional giant, is also increasingly not part of the Asia reporting unit. At many companies India is now managed as a standalone unit. But equally many companies bundle it together with the Middle East, with the regional management hub located in a place like Dubai. Not only does Dubai have a rich seam of Indian managerial talent, but the trading and cultural links between India and the Middle East are historically deep and continue to deepen.

Chart 31: Do these countries report into an Asia Pacific reporting unit, a different non-Asia unit, or are they a standalone reporting unit?
(% of respondents)



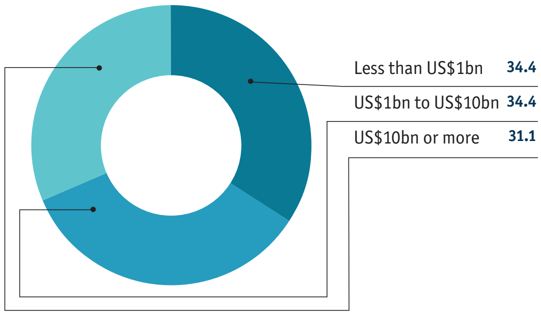
Source: *Economist Corporate Network ABOS 2015*

Note: Data is only for non-Asian companies

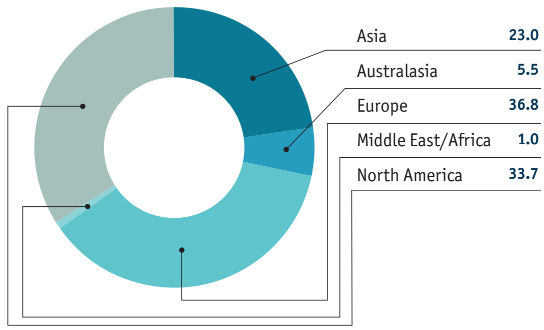
Appendix: Survey firmographics

A total of 704 companies took part in the 2015 Asia Business Outlook Survey, conducted in December 2014

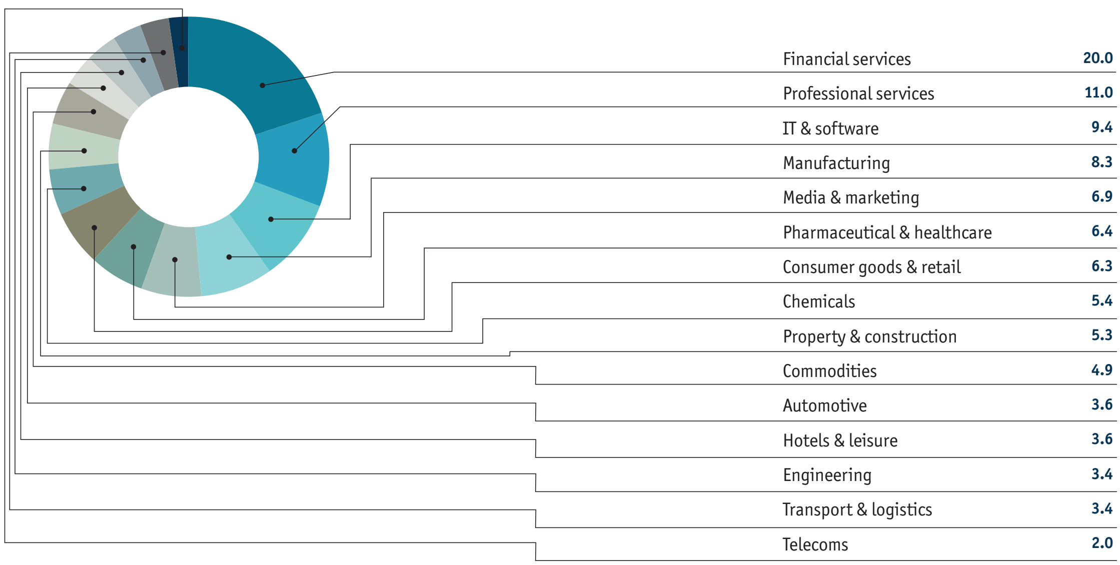
Survey respondents by global revenue
(% of respondents)



Survey respondents by location of global HQ
(% of respondents)



Survey respondents by industry sector
(% of respondents)



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