The Economist Corporate Network

Navigating Asia's risks and rewards

Asia Business Outlook Survey 2017

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Acknowledgements

Navigating Asia’s risks and rewards: Asia Business Outlook Survey 2017 is a publication of The Economist Corporate Network (ECN). It reports on and analyses the findings from an annual survey of Asian-based executives about their current and anticipated business operating environments.

ECN gratefully acknowledges the participation of all respondents who took time to anonymously contribute their views that provided this year’s data. We also appreciate the support of Hays, the regional sponsor of this report. Irrespective of participation and sponsorship, we have conducted and reported on this survey independently. Rob Koepp, director of ECN in Beijing and Hong Kong, and Pamela Qiu, associate director of ECN South-east Asia, developed the survey questionnaire. Sam Charlton, director of sponsorship at ECN, managed survey distribution. Rob Koepp compiled and modeled survey results and wrote the report with contributions from Firat Unlu, analyst at The Economist Intelligence Unit (The EIU). The supervising editor was Robert Ward, global editorial director of The EIU. Gaddi Tam, graphic artist at The EIU in Hong Kong,managed report graphics and typesetting.

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Contents

Executive summary

- Firms' expectations for revenue growth in Asia are looking up. Over one-half of respondents have indicated that their firms' expectations for revenue growth in 2017 have improved over the past year. This optimistic outlook was held by less than 40% of respondents in our 2016 survey.
- South-east Asia ranks first for revenue growth expectations in 2017, overtaking the top-ranked spot held by India in our 2016 survey. This year's standout areas for expected revenue growth are South-east Asia, India and China.
- In assessing the developed economies of South Korea, Japan and Australia and New Zealand, executives also are anticipating growth, albeit at much lower rates than in developing Asian markets.
- Respondents viewed government responses to political and economic risks in Indonesia, Myanmar, Vietnam and India as most likely to positively impact business prospects in 2017.
- Conversely, government policies in China, Hong Kong, Malaysia and the Philippines in the face of rising geopolitical and economic risks were seen as more likely to negatively affect business conditions.
- Views on the impact of China's response to risk greatly improve further out over a three-year horizon, 2017-19. India has attracted the largest percentage of executives who express bullishness about its prospects for handling risk over the same period.
- This year's survey has registered a drop-off in expectations for high rates of revenue growth. Despite this, for China, India and South-east Asia at least one in five respondents expects sales growth to surpass 10%.
- Our findings indicate that in 2017, the percentage of firms earning profit margins of 20% or greater in Asia will decline. The silver lining to this situation is that expectations for losses also have diminished too, resulting in a "bulging middle" for profit levels of 0-20%.

- About 20% of respondents felt their firm's expectations were "overly optimistic" for China. The same proportion believed that corporate expectations were too low for India.
- A significant proportion, about 40%, of respondents felt that companies are failing to invest at a rate necessary to match expectations for growth in Asia.
- A strong majority, 60.7%, of respondents indicated that Asia is considered important or very important as a source of R&D for their firms. Looking out to 2021, respondents anticipate a notable shift towards more R&D being conducted in Asia.
- One-half of respondents anticipate Asia to contribute between 21-40% of their firm's worldwide revenues by 2021. Yet less than 20% of respondents affirmed having two or more directors in the region currently. Many companies could find themselves ill prepared to benefit from the swelling tide of Asia-originated sales unless the number of Asia-based directors and business unit heads increases.
- Hong Kong, Beijing, Bangkok, Dehli, Kuala Lumpur and Jakarta were all regarded by 20% or more respondents as having deteriorated conditions for basing regional operations. For Shanghai and Singapore, at least one-fifth of respondents saw conditions as having improved.
- The most frequently cited issue for basing regional operations in Asian cities was non-labour costs (such as property and utilities). Such costs particularly affect well developed, cosmopolitan cities such as Hong Kong, Sydney, Singapore and Tokyo.
- More than three-quarters of executives observed staff turnover rates of 6-30% in China, a similar proportion described turnover rates of 6-20% in India. Japan tops our list as Asia's most stable labour market, with 87% of those surveyed noting turnover ratios of 5% and less.

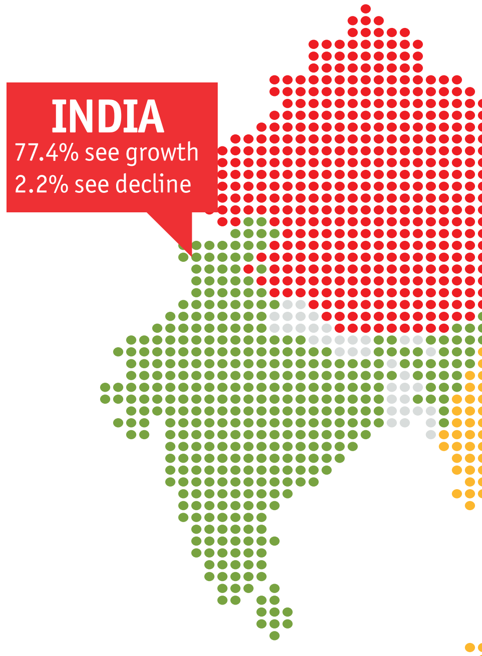
1. Introduction

Informed views on the risks and rewards that lie ahead

At the end of each year, The Economist Corporate Network (ECN)—the advisory, briefing, and executive dialogue service of The Economist Group—gathers input from organisational executives throughout Asia on their views about existing and anticipated business conditions. Recognising the pattern of surprising geopolitical developments and new uncertainties that have arisen in the region and around the world, the theme of this year's Asia Business Outlook Survey (ABOS 2017) is "navigating Asia's risks and rewards".

Survey respondents, who at the end of 2016 provided feedback that went into this ABOS 2017 report, are active throughout Greater China, India, Japan, South Korea, South-east Asia, Australia and New Zealand. Their scope of business spans 21 industries. Nearly one-quarter manage operations at East Asia-headquartered companies, with the rest at firms headquartered in Western economies. This provides survey with a mixture of insights on Asian markets that reflect organisational perspectives from Western multinational corporations along with those whose origins lie within Asian cultural spheres. Regardless of corporate domicile, all survey respondents are based inside Asia and understand the area from direct experience. Augmenting the raw data that the survey generated, expert analysis and commentary has been contributed by editors and writers of ECN and The Economist Intelligence Unit.

All respondents participated in the survey with complete anonymity. This allowed for frank, unencumbered input from business leaders with first-hand knowledge about doing business in the fastest-growing region of the global economy. Moreover, although emphasising the outlook for 2017, parts of the survey's time horizon extend to 2021, allowing readers to glean views that span near- and longer- term horizons. As with everything we do at ECN, our objective with this installment of ABOS is to enhance organisational leaders' grasp of challenging economic and business topics that impact the bottom line.



2. Revenue outlook

Defying risks, revenue expectations have rebounded

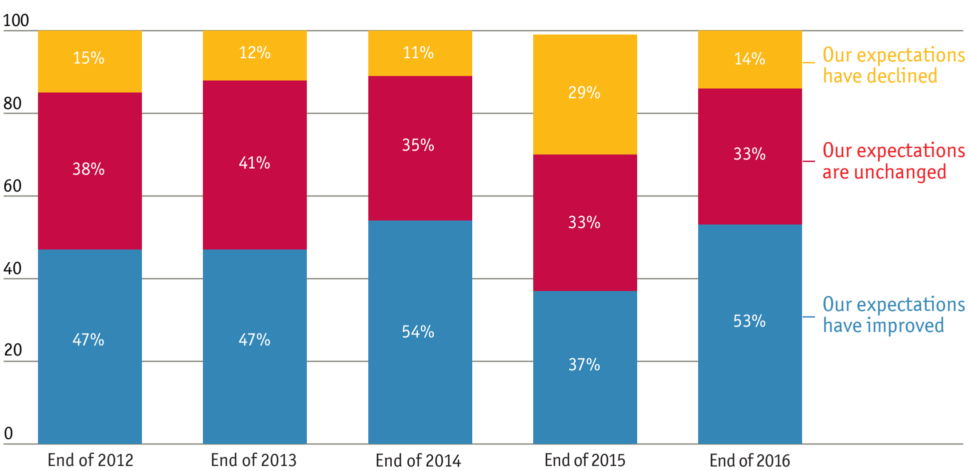
Strong economic growth across most of Asia's major economies means that 2016 marked a positive year for firms operating in Asia, lifting sentiment among participants in ABOS 2017. Whereas at the end of 2015 only 37% of respondents stated that their firms' expectations for revenue growth had improved, this figure had risen to 53% at end-2016, close to the five-year high of 54% recorded in late 2014 (see Figure 1).

Consistent with this trend, the share of companies expecting a decline in revenues halved compared with the ABOS 2016 survey, falling to 14%. Around one-third of all respondents reported that their firms' expectations had not changed, slightly lower than the five-year average.

MAPPING OUT GROWTH

As shown in the adjacent map and Figure 2, South-east Asia, India and Greater China once again stand out for attracting the highest expectations for sales growth. In contrast to last year, South-east Asia is now ranked first in revenue growth expectations

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



Source: The Economist Corporate Network.

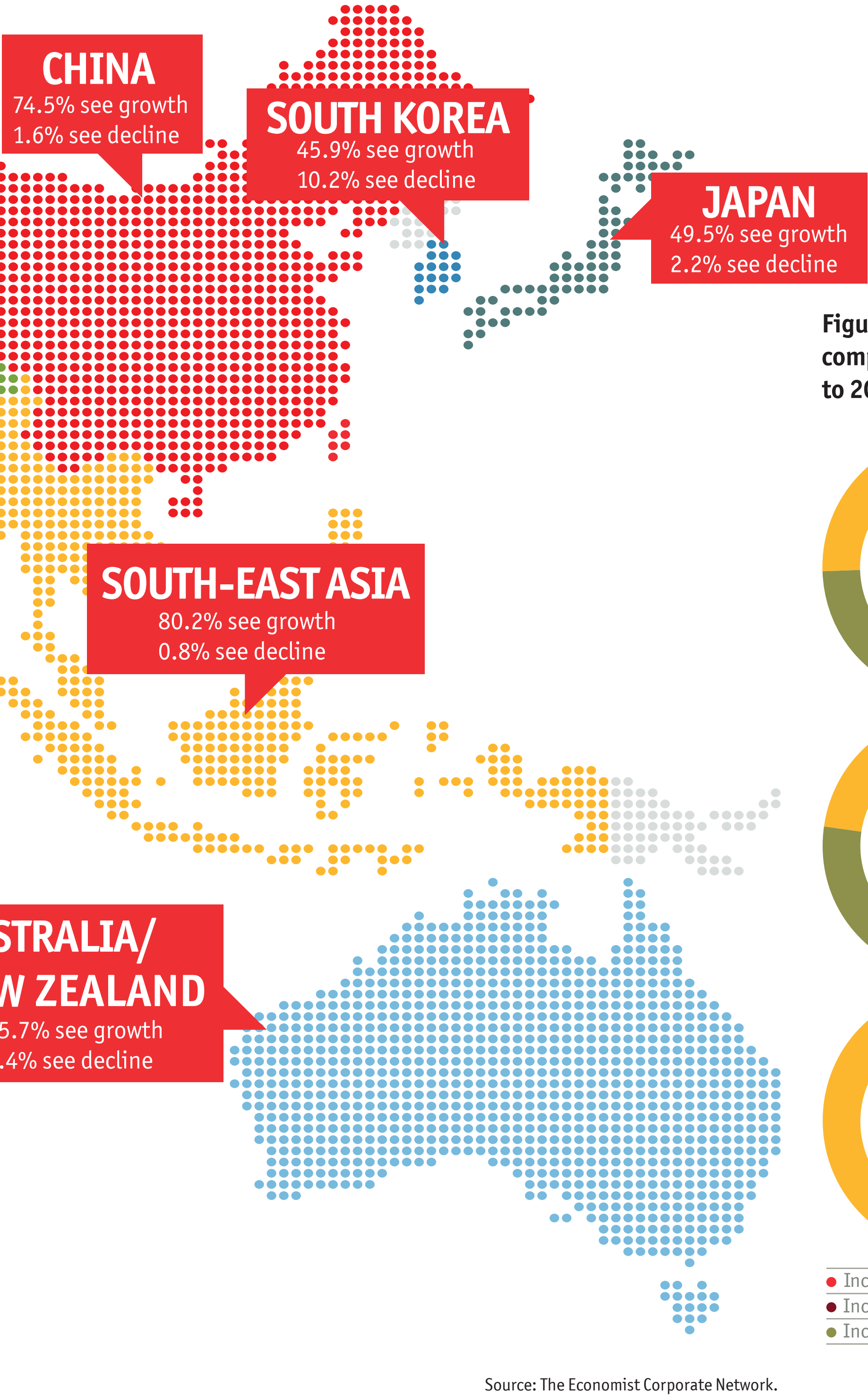
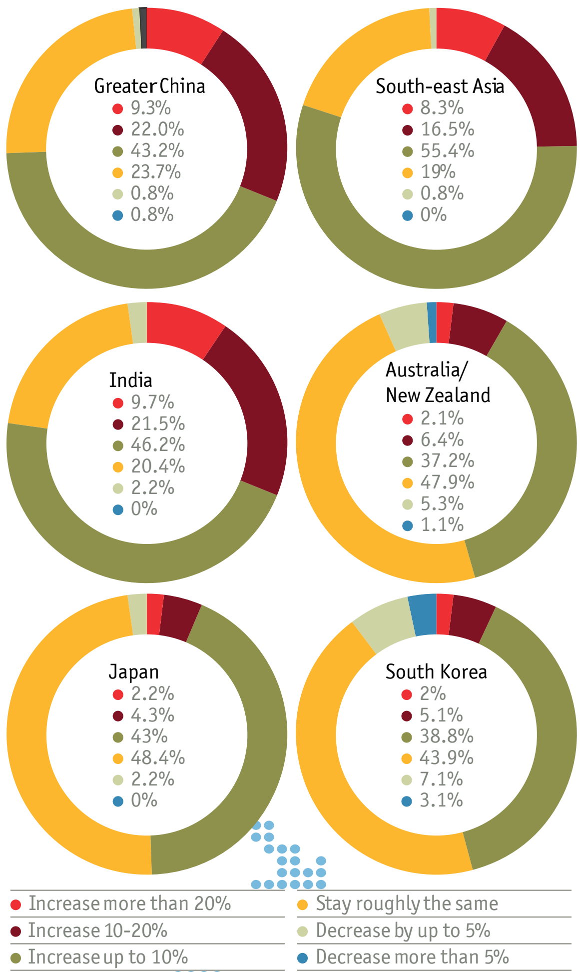


Figure 2: What are you expecting for your company's Asia sales performance in 2017 relative to 2016? (respondents surveyed)



Source: The Economist Corporate Network.

pushing India to the second spot. An overwhelming proportion of respondents, 80.2%, indicated that they see South-east Asia headed for higher sales in 2017. As many as one in twelve are forecasting increases of 20% or greater.

With a combined population of more than 2.6bn, India and China are positioned to remain the world’s fastest-growing, large-scale economies throughout 2017 and beyond. Private consumption and investment will be fueling demand for goods and services, a secular trend once again reflected in our survey results. For India, 77.4% of respondents stated they look forward to revenue increases; a mere 2.2% expect a drop. Despite an increasingly challenging business environment and rising macroeconomic risks in Greater China, roughly three-quarters of survey participants believe that revenues there will increase. A smaller percentage than that for India, 1.6%, are braced for revenue declines—an indicator that firms have become accustomed to rising revenues irrespective of business uncertainties.

Surveyed executives estimated that in the developed economies of South Korea, Japan and Australia and New Zealand, their operations also are on course for revenue expansion in 2017. As markets in these regions are typically at a mature stage with less potential for rapid growth, respondents not surprisingly have set their sights lower. Only about 2% of survey participants anticipate high revenue growth in excess of 20% for these territories and only one in two expect a revenue increase of some kind. Such steady-state revenue growth outlooks are in line with our own economic forecasts for these countries.

The basic composite picture for 2017 is thus one of strong expectations for growth in South-east Asia, India and China and more tempered expectations for growth in Japan, South Korea, and Australia and New Zealand.

In an otherwise positive outlook, survey results reveal a stark decrease across all regions in 2017 in expectations for revenue growth above 20%, reflecting concerns over the global and regional economic environment as well as local business conditions. The drop was most notable in India, where only 9.7% of respondents stated they expect revenue growth to surpass 20% (compared with 17.9% at end-2015). The over-expectations seen in ABOS 2016 might in some measure be attributable to India’s official economic growth data, which were revised upward in 2015.

SOUTH-EAST ASIA

We believe that South-east Asia will benefit from macroeconomic stability in the near term, but forecast that economic growth will be unexciting. In 2017, real GDP in the economies of the Association of South-East Asian Nations (ASEAN) will expand by 4.6%, slightly higher than our estimate of 4.4% in 2016. Indonesia will comfortably remain the bloc’s largest economy, with a GDP in cash terms around two-and-a-half times that of Thailand, ASEAN’s next-largest economy. Yet we remain skeptical about the ability of Indonesia’s president, Joko Widodo, to enact significant business reforms although robust private demand will lift corporate revenue streams. Thailand's shopping malls will see more traffic thanks to improved consumer sentiment in 2017, even as rising levels of private debt are acting to constrain household spending. Vietnam will remain a bright spot in ASEAN, particularly as its exports will continue to grow strongly in the years ahead. In the Philippines, the erratic policies of the president, Rodrigo Duterte, will cause some uncertainty but we do not expect this to undermine the country's solid macroeconomic fundamentals.

INDIA

India will remain among the world's fastest-growing economies for the foreseeable future. Nevertheless, in the short term the botched handling of the government's demonetisation campaign (launched in November 2016) will weigh on the outlook. We forecast growth of 7% in 2017/18 (April-March), a slight downgrade from our pre-demonetisation expectation, as it will take several months for economic activity to normalise. A lack of cash in the economy as a result of this policy has added significant stress in rural areas and could even result in a poor harvest in early 2017, driving up food prices. Weakness in rural India will constrain consumer spending and affect companies in sectors such as FMCG particularly strongly. The legislative reform agenda of the prime minister, Narendra Modi, is unlikely to make much progress over the coming years as the National Democratic Alliance coalition that generally supports his policies will continue to lack a majority in the upper house of parliament. Nevertheless, our expectation is that individual states will make solid progress in enhancing the business environment and attracting foreign capital.

CHINA

Economic activity in 2017 for the region's dominant economy will remain strong even as GDP growth slows and stresses in the financial sector build. We forecast that China's economic growth will decelerate from an estimated 6.7% in 2016 to 6.2% in 2017. The government will be keen to ensure steady economic growth in the run-up to the five-yearly National Congress of the Chinese Communist Party in October-November 2017, at which the party will make wide-ranging personnel changes. This political transition will strengthen the president, Xi Jinping, and should enable the government to take action to deal with the bad loan problems. We then expect GDP growth to decelerate further in 2018, to just 4.2%. However, this will still be a relatively benign scenario as we expect private consumption, supported by rising incomes, to hold up well. The reduction in industrial overcapacity triggered by the government's tackling of the bad debt overhang could even reduce pressure on firms' profit margins, particularly in sectors in which Chinese stateowned enterprises compete heavily. At the same time, while China takes aim at bad loans, government-led efforts to ensure that Chinese companies move up the value chain are likely to result in stronger competition for foreign firms, particularly in sectors such as manufacturing.

JAPAN

Economic prospects for Japan, Asia's second-largest economy, will remain challenging. We forecast GDP growth of just 0.7% for the Japanese economy in 2017 and believe that expansion will remain under 1% into the next decade. Yet Japan's plodding rate of growth should be seen in light of a declining population and rising levels of per capita income. Moreover, despite tepid economic growth, our survey results indicate that Japan offers comparatively high profit margins for Asia—a sign that markets in mature economies can still be lucrative. We expect the prime minister, Shinzo Abe, to stay in office over the coming years, providing political stability. Should Mr Abe be re-elected at the next party election, which is due in late 2018, he could serve as prime minister until 2021, thus becoming Japan's longest-serving premier since the end of the second world war.

SOUTH KOREA

2016 marked an *annus horribilis* for South Korea's corporates, consumers and politicians. Unfortunately, no respite is in sight. Although we believe that political stability will improve once the current president, Park Geun-hye, leaves office, we also forecast that real GDP growth in 2017 will remain broadly unchanged from 2016, at 2.7%. In the absence of stronger global trade growth, South Korea's export engine is unlikely to take off and high levels of household debt will increasingly limit private consumption growth. The likely sharp slowdown in China in 2018 will further dampen growth prospects for South Korea.

3. Risky business

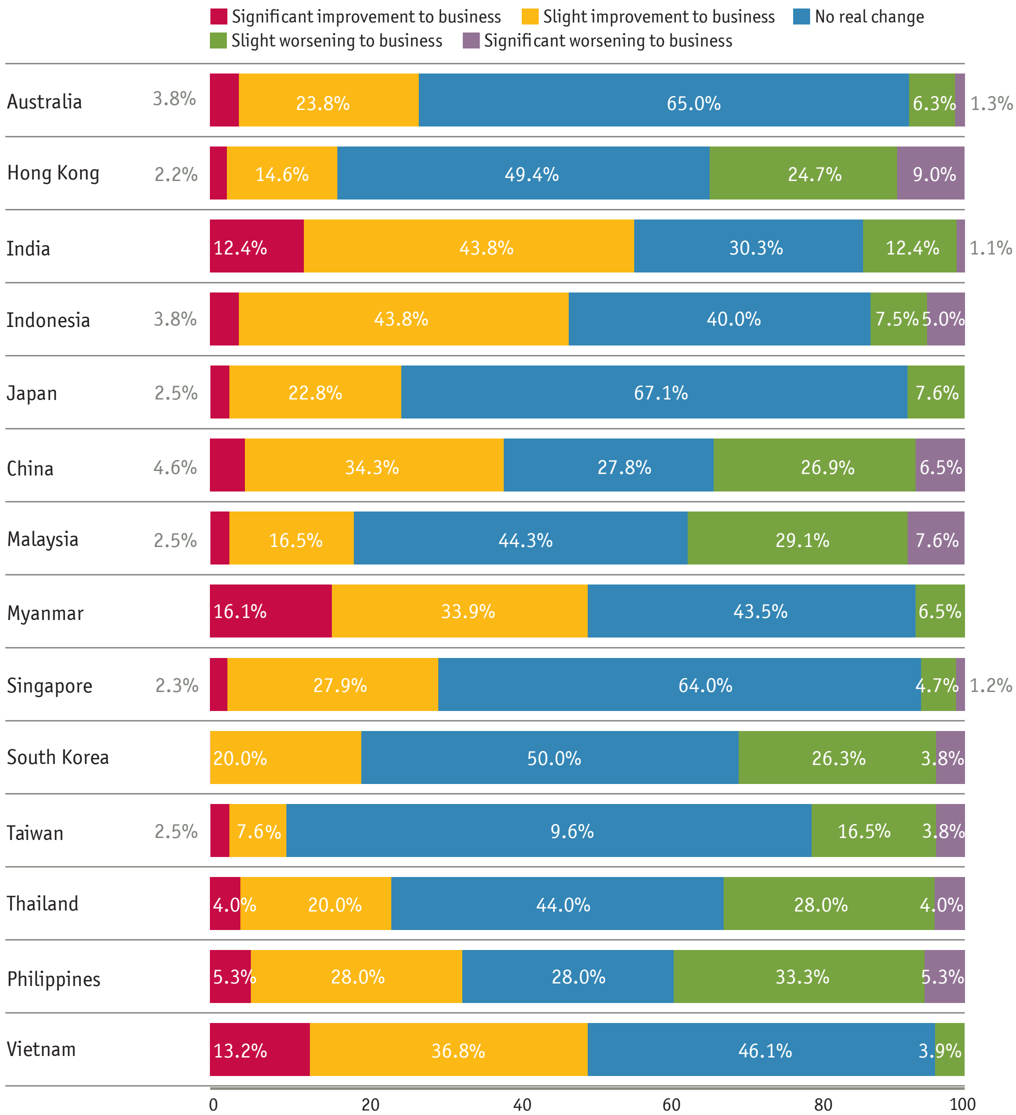
Navigating Asia's risks and rewards

Last year saw the emergence of geopolitical and economic risks with enormous potential impact on the operating environments and business prospects of firms active in Asia. In particular, the election of Donald Trump as US president in November 2016 could mark a turn towards greater protectionism in the global economy. This would notably hurt Asian economies, which disproportionately rely on trade to fuel growth. Western, especially American, multinational corporations could also be exposed to retaliatory actions by aggrieved Asian governments. Outside the political arena, developments such as slumping global commodity prices have highlighted risks related to economic governance, the tax environment and macroeconomic stability across many developing world economies. The ways affected governments address these risks will determine not only the competitiveness of individual countries but also affect firms' revenue and profit opportunities.

Our 2017 survey asked participants to assess how the response of Asian governments to political and economic risks will likely affect their business outlook. As shown in Figure 3, executives were most optimistic about Indonesia, Myanmar, Vietnam and India. These countries were ranked by around 50-60% of those surveyed as having responded to risks in ways that will result in some kind of improvements for business. Conversely, countries that stood out for responding in ways that will result some degree of worsening conditions for business were Thailand, China, Hong Kong, Malaysia and the Philippines. These countries were cited by 30-40% of respondents as having reacted to risks in ways that bode less positively for 2017.

The range of negative assessments for China, Hong Kong, Malaysia and the Philippines is lower than the range of positive views towards Indonesia, Myanmar, Vietnam and India. This suggests a generally more positive view about the overall impact of risks on the region. Just under 40% of surveyed executives think China's response to risk will result in improvements for business. This proportion of those holding a positive outlook on the country's response to risk actually is slightly larger than the 33.4% of those surveyed who foresee a negative impact from Chinese policies. As with many things relating to China, the outlook for threats and opportunities in this measure is a mixed bag.

Figure 3: How do you view the way governments in the following countries are responding to political and economic risks in terms of the likely impact on your business in 2017? (respondents surveyed)

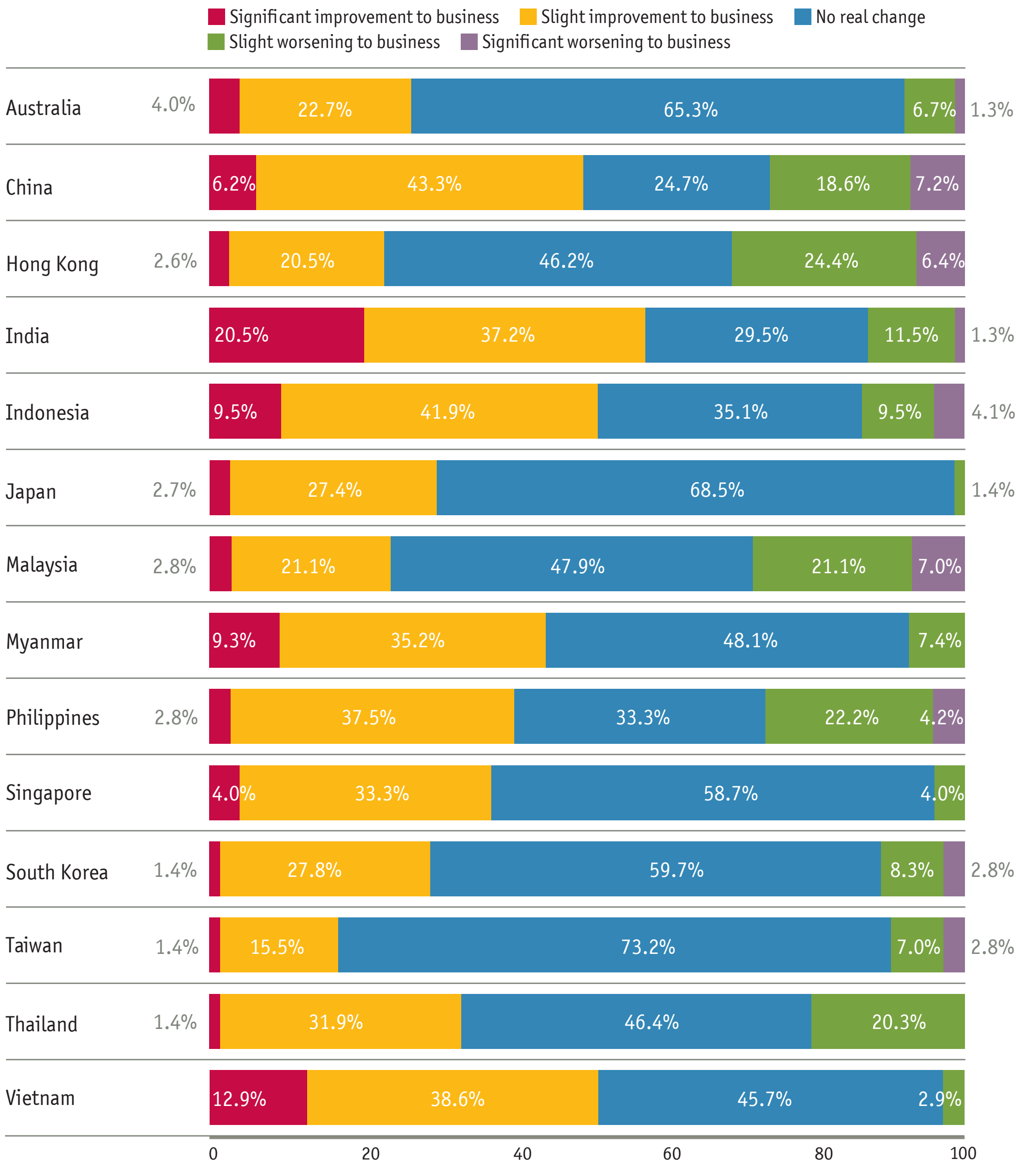


Source: The Economist Corporate Network.

Views on the impact of China's response to risk greatly improve further out over the three-year horizon, 2017-19. As Figure 4 shows, around one-half of respondents feel their firms will witness some sort of improvement to business based on how Beijing manages risks over this broader time span. The implication is that firms that can weather any upcoming turbulence from risk in 2017 are likely to reap rewards further out.

Over the same time period, India retains its top spot as the Asian country where largest percentage of executives expressed bullishness about its prospects for handling risk. A total of 57.7% expect some kind of improvement for business in India. Of that, an

Figure 4: What about government response to risks in terms of the likely impact on your business over the next three years (2017-19)? (respondents surveyed)



Source: The Economist Corporate Network.

impressive 20.5% are looking forward to a “significant improvement to business”—the highest proportion of such a positive view expressed towards any country measured. Indonesia and Vietnam also stand out as countries where more than one-half of respondents expect an improved business climate in the face of heightened political and economic risks.

The degree of expectations for negative fallout from risks is also lower for 2017-19. Whereas some 30-40% of respondents expected worsening conditions in Thailand, China, Hong Kong, Malaysia and the Philippines during 2017, when looking out to 2019, most of these countries were cited by only around 20-30% of respondents as likely worsening. Hong Kong has the dubious distinction of being a slight outlier in this trend. Although improved somewhat over its assessed outlook for 2017, slightly over 30% of respondents expect worsening conditions in Hong Kong out to 2019. How leaders in Beijing and Hong Kong work to further political and economic harmonisation while also addressing populist tendencies that have sprung up in the Special Administrative Region will be key to improving on expectations for tough times ahead.

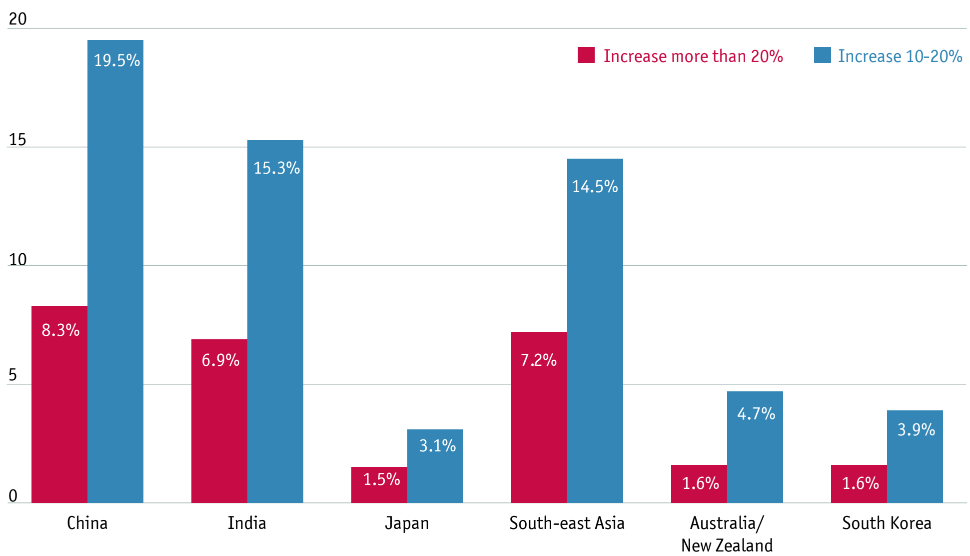
4. Double-digit sales growth

China, India and South-east Asia take the lead

Although in the face of new risks executives have remained optimistic about growth prospects in Asia generally, ABOS 2017 has registered a drop-off in expectations for high rates of growth. Compared to ABOS 2016 data, the ratio of participants expecting sales growth to exceed 20% fell by one-half in the region's fastest-growing economy, India. Despite such diminished expectations, China, India and South-east Asia have maintained their ranking as the three most promising regions for double-digit percentage sales growth. For each, at least one in five participants expects sales growth to surpass 10%. China has the highest proportion of respondents, 8.3%, expecting sales to grow more than 20%. This again underscores how China retains attractive potential even in the midst of painful economic rebalancing and geopolitical uncertainties.

The maturer economies of Australia and New Zealand, Japan and South Korea demonstrate the lowest expectations for double-digit revenue growth. This is perhaps not surprising, especially relative to the fast growing economies of China, India and

Figure 5: Outlook for sales growth of 10% and higher in 2017 (respondents surveyed)



Source: The Economist Corporate Network.

South-east Asia. Nevertheless, for maturer Asian economies to continue engendering expectations for high levels of growth of some kind is noteworthy in itself. On top of myriad risks affecting their trade pictures, in light of the recent political turmoil that has convulsed South Korea and demographic and currency headwinds that have been constraining GDP growth in Japan, to still be perceived to offer double-digit growth opportunities for businesses in these economies at all signifies an ongoing resilience in these countries' growth dynamics.

5. Regional profitability

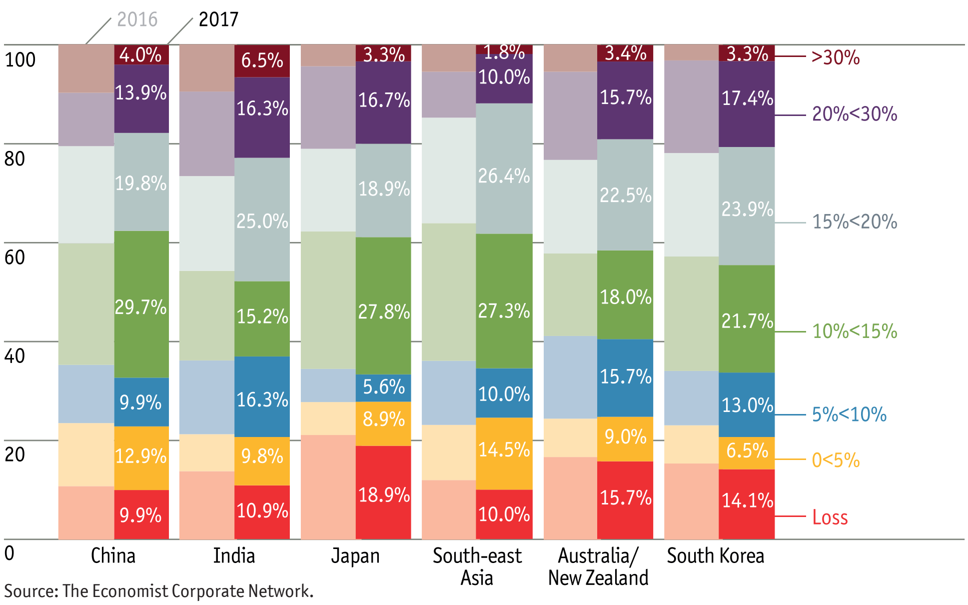
A "bulging middle" profit outlook

Along with reduced expectations for high-level sales growth, survey respondents are anticipating a squeeze on higher margin profits. According to 2017 outlook data, the percentage of firms earning profit margins of 20% or greater in Asia will decline. The silver lining to this situation is that expectations for losses have also diminished. The net result is a "bulging middle" for profit levels of 0-20%.

As illustrated by Figure 6, among the high-growth Asian economies, India attracted the largest proportion of respondents looking forward to profit margins of within 15-20%. China holds the highest percentage of those expecting profit margins of within 10-15%. South-east Asia is a close second to China with surveyed executives counting on that level of profitability.

Most respondents in their evaluation of Japan expect mid-range profit margins of 10-15%. Australia and New Zealand and South Korea fare reasonably well in this measure, with

Figure 6: What were your operating profit margins for 2016/expected to be in 2017?
(respondents surveyed)



Source: The Economist Corporate Network.

views coalescing around a higher level of profit expectations. Despite also being low-growth economies, the outlook by the largest proportion of respondents is for profitability in range of 15-20%. This probably reflects the results of companies that have a more established presence in these markets and are better experienced at extracting value from their operations.

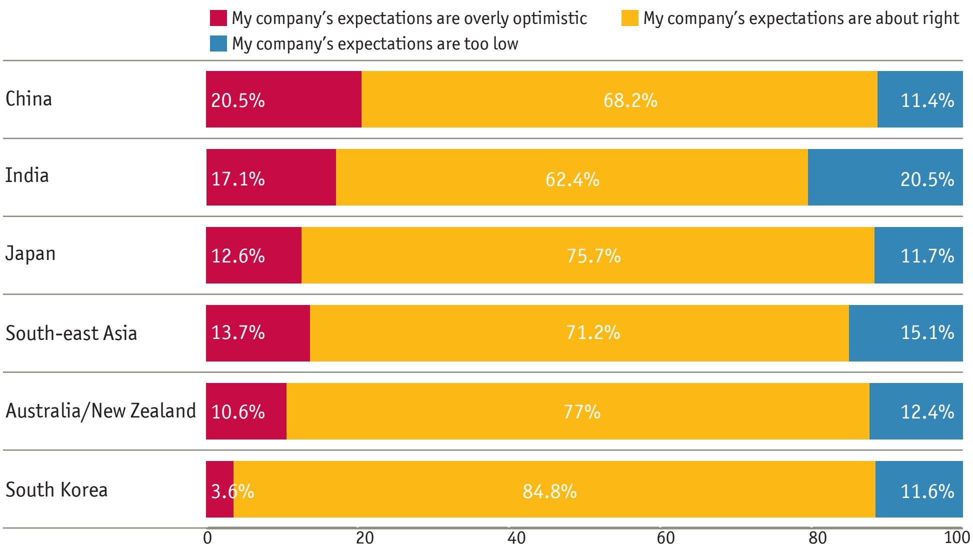
6. Investing in Asia

Matching ambitions with money

In terms of delivering growth in line with corporate expectations, our survey indicates that executives in Greater China will face the biggest difficulties in meeting their firms' targets. Just over 20% of respondents observed that their companies' growth expectations were "overly optimistic" (Figure 7). Even as economic growth in China decelerates, the Greater China region represents a key source of revenues and profits at many companies, often persuading headquarters to set ambitious goals and thereby putting executives in a challenging position.

Opinions about India tend towards the opposite direction, with the exact same proportion observing that "my company's expectations are too low". In the category of properly aligned growth expectations, India is remarkable for having a relatively large proportion, 17.1%, of respondents also claiming that company goals are set too high. This means that nearly 40% of surveyed executives active in India will contend with mismatched corporate expectations on either end of the spectrum.

Figure 7: How do you assess your firm's expectations for growth in Asia?
(respondents surveyed)

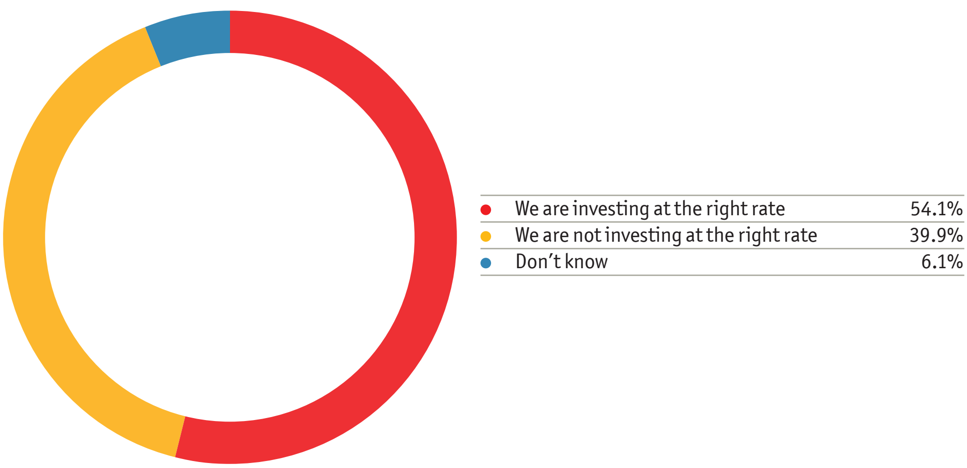


Source: The Economist Corporate Network.

The South Korean market stands out as one territory where corporate expectations are considered accurate—nearly 85% % of survey participants thought this. Possibly a sign that pessimism caused by export weakness and political turmoil may have become too strong, only 3.6% of respondents believe that expectations are overly optimistic. We note that the number of executives believing that their firms' hopes for growth were "too low" is up across all markets (with the exception of Japan) compared with last year.

A measure closely related to how corporate expectations match up with reality is the assessment on whether firms are investing at the correct rate to achieve growth expectations (Figure 8). In this metric, 39.9% of respondents felt that companies are failing to invest at a rate consistent with their objectives. Based on our survey's

Figure 8: Is your firm investing in Asia at the right rate to achieve growth expectations (respondents surveyed)



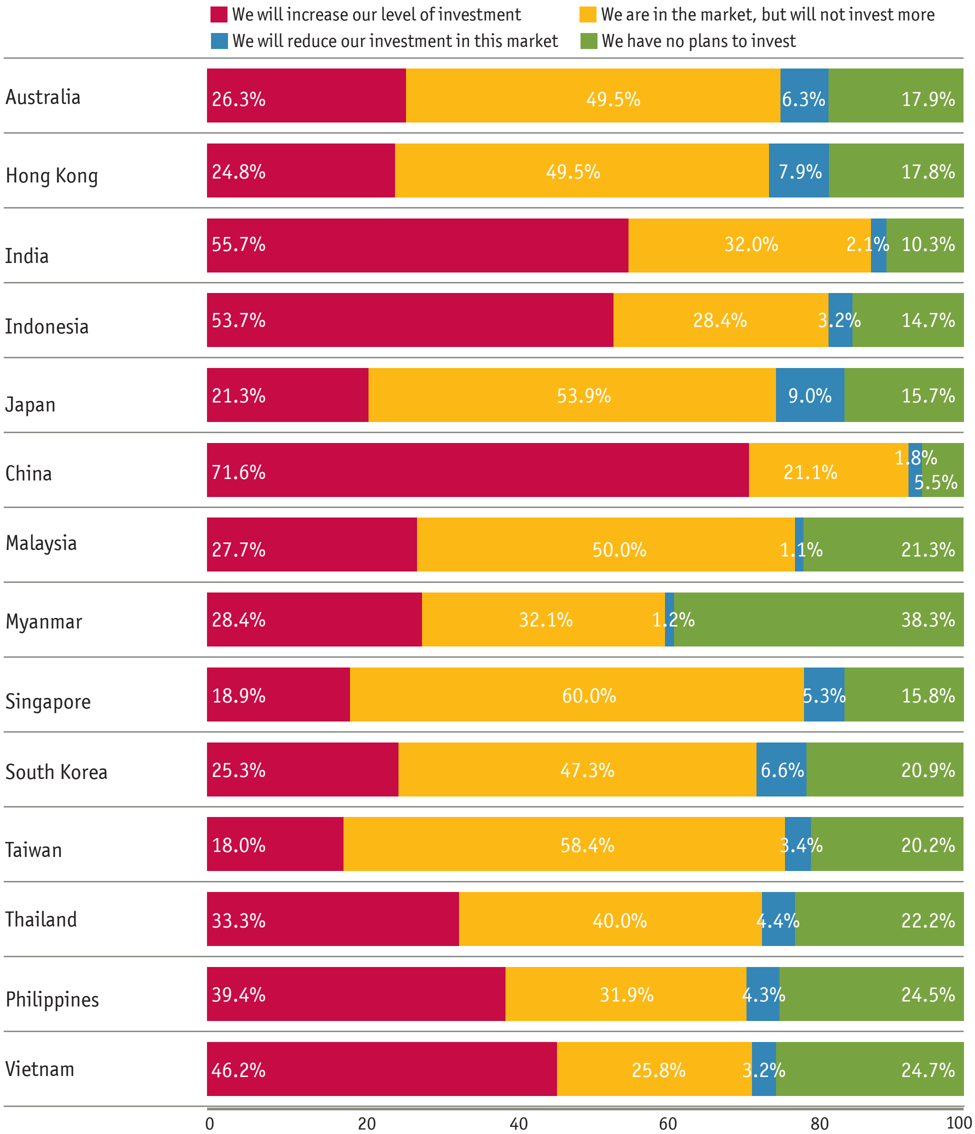
Source: The Economist Corporate Network.

findings, a significant portion of companies should consider ways to better align funding with the true nature of opportunities in Asian marketplaces to optimise growth potential.

We also asked respondents how they expect their firm's investments to change. Top destinations for attracting investors are China, India and Indonesia, where respectively 71.6%, 55.7%, and 53.7% of respondents foresee increases in investment. Such is the strength and appeal of China's market that despite significant regulatory and political risks, only 1.8% of firms actually plan to reduce investment.

Owing to strong export-led growth, Vietnam has also gained in prominence among investors, with 46.2% of survey participants stating that their firms will expand investment. Based on the survey results, any negative fallout from the Philippines' tough-talking, nationalistic president, Rodrigo Duterte, on investor appetite is limited. Close to 40% of respondents anticipate an increase—versus a paltry 4.3% that foresee a reduction—in investment in the Philippines.

Figure 9: How do you expect your firms investments in key Asian territories to change in 2016? (respondents surveyed)



Source: The Economist Corporate Network.

The most inactive markets for investment or divestment are Taiwan and Singapore, both of which have a large majority of respondents indicating that their firms "in the market, but will not invest more". For Japan, the highest proportion of respondents (9%) stated that their firms will reduce investment. Consistent with what our 2016 survey revealed about Myanmar, the country remains the most avoided in terms of percentage of respondents who indicated "no plans to invest". Myanmar is improving in this regard, however. The percentage of respondents that indicated no plans to invest in 2017, 38.3%, is down from the 47.1% who indicated avoidance in 2016.

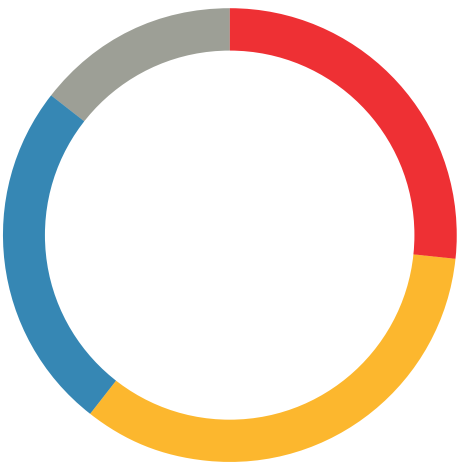
7. R&D in Asia

Asia's prospects with corporate innovation

As Asia becomes an increasingly important source of revenues, firms are tailoring products and services according to local demand. Moreover, a rise in technological capabilities and strong government-led investment in knowledge-intensive industries means that Asia-based companies often operate at the cutting edge in some technology sectors. Apart from the high-tech powerhouses of Japan and South Korea, China in particular has emerged as a technology producer and is a prolific investor in R&D. India, Singapore and Hong Kong have also drawn attention for efforts at fostering their high-tech industries.

A strong majority, 60.7%, of respondents indicated that Asia is considered important or very important as a source of R&D or innovation generally for their firm. An even one quarter stated that the region will likely be at least somewhat important for R&D by 2021. The perceived importance of Asia as a global source for not only for manufacturing and sales but also new products and ideas is on the rise.

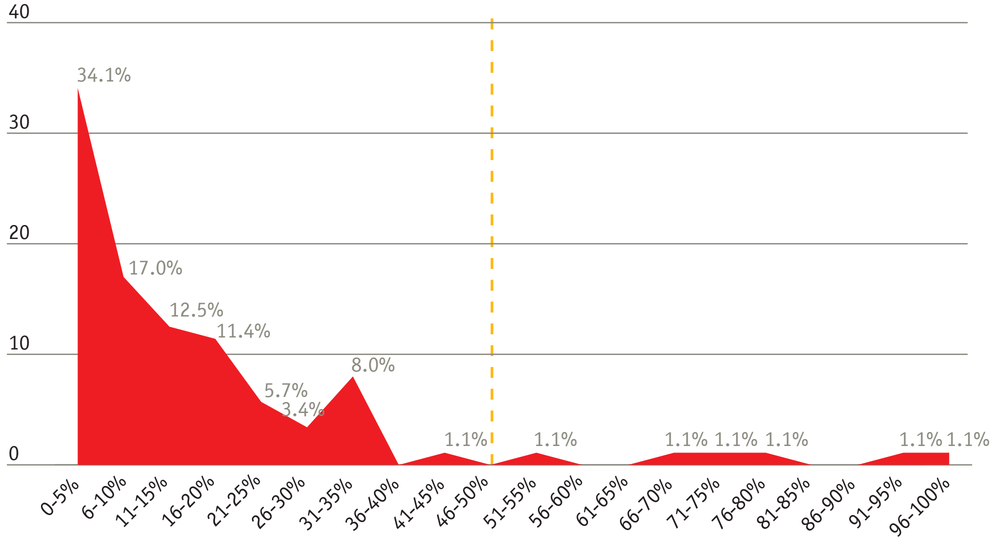
Figure 10: How important is Asia as a source of R&D or innovation generally for your firm? (respondents surveyed)



Very important	26.8%
Important`	33.9%
Not important now but likely to be at least somewhat important by 2021	25.0%
No, and unlikely to be one by 2020	14.3%

Source: The Economist Corporate Network.

Figure 11: What percentage of your firm's global R&D currently comes from Asia?
(respondents surveyed)



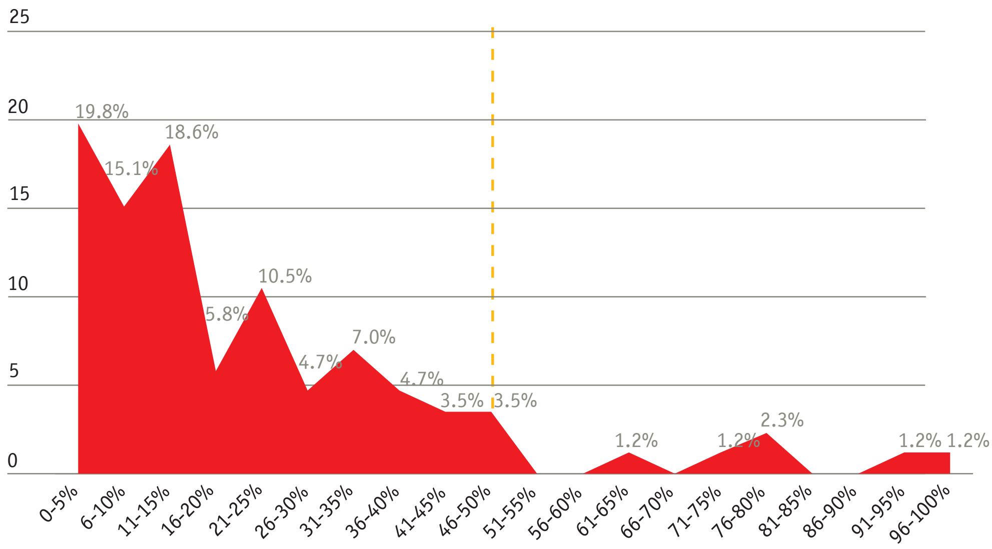
Source: The Economist Corporate Network.

As with the previous section on revenue growth expectations, we wanted to check how much perceptions and actions are aligned with R&D activities. When asked what share of their firms' global R&D output currently comes from the region, the largest portion of respondents, 34.1%, indicated that Asia's contribution to global R&D output is in the range of 0-5% (Figure 11). A dominant majority of respondents, 80.7%, noted that their firms have up to 25% of their global R&D sourced from Asia. Just under 7% reported having more than 50% of their R&D coming from the area. These results can seem at odds with the perceived importance of Asia as a source of R&D and innovation. However, within the context of most respondents being from Western multinationals where traditionally nearly all their R&D would have been done outside the region, this is not necessarily the case.

Indeed, in reply to the survey's follow-on question, "What percentage of your firm's global R&D expenditure will be in Asia by 2021?", respondents indicated more R&D activities will be migrating to Asia. Whereas currently the greatest proportion of companies R&D expenditures in Asia cluster around the 0-5% range, in five years time, survey data indicates that R&D expenditures will cluster around higher expenditure levels of 11-15% and 21-25% (Figure 12). Although about 80% of surveyed firms have up to 25% of their global R&D sourced from Asia today, by 2021, a similarly dominant share, 81.5%, will have up to 35% of R&D taking place in the region.

Figure 12 shows this change as a rightward shift towards greater amounts of R&D expenditures. The shape of this graph compares to the leftward concave shape of Figure 11's depiction of current R&D expenditures, which skew towards lower expenditure levels on the left side of that graph.

Figure 12: What percentage of your firm's global R&D expenditure will be in Asia by 2021? (respondents surveyed)



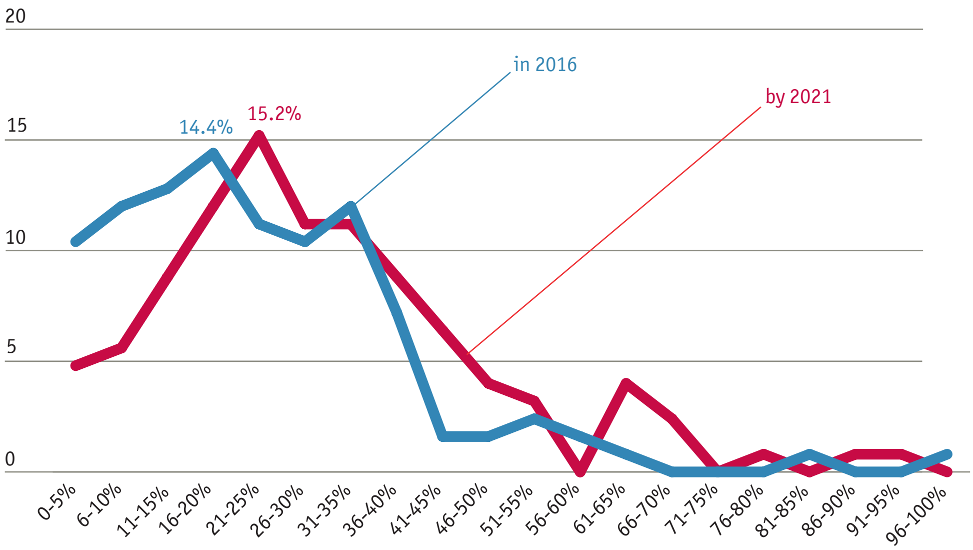
Source: The Economist Corporate Network.

8. Eastern tide

Is senior management positioned to follow the money?

The results from ABOS 2017 once again underscore Asia's importance in global business. The greatest proportion of respondents indicated that Asia contributed 16-20% of their firms' 2016 global revenues. Looking out to 2021, an even higher proportion indicated that they expect Asia to contribute 21-25% to global sales. The data indicate that the share of companies that derive one-half or more of their revenues from Asia will almost double over the next five years.

Figure 13: Asia's contribution to respondents' global revenues (respondents surveyed)

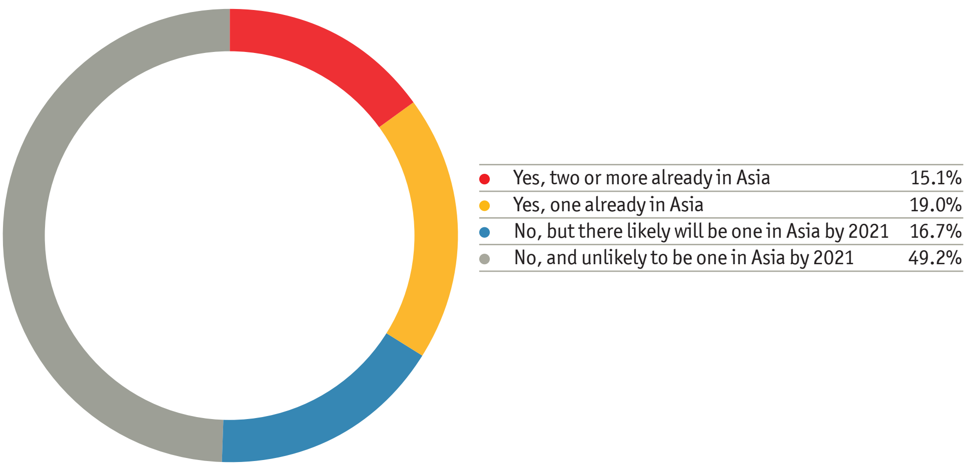


Source: The Economist Corporate Network.

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

Over one-third, 34.1%, of respondents indicated having at least one main-board director based in the region (Figure 14). Within that group, 15.1% reported having two or more directors based in the region. An additional 16.7% foresee having at least one director based in Asia by 2021. This means that slightly over one half of companies will have one board member based in Asia by the start of the next decade. As less than one quarter of survey responses came from executives in East Asian headquartered companies (where Asia-based board members would be a matter of course), the measure can be seen as a broader indicator of positioning by Western multinational corporations. As such, the results offer mixed signals on corporate preparedness.

Figure 14: Are any members of your company's main board of directors based in Asia? (respondents surveyed)



Source: The Economist Corporate Network.

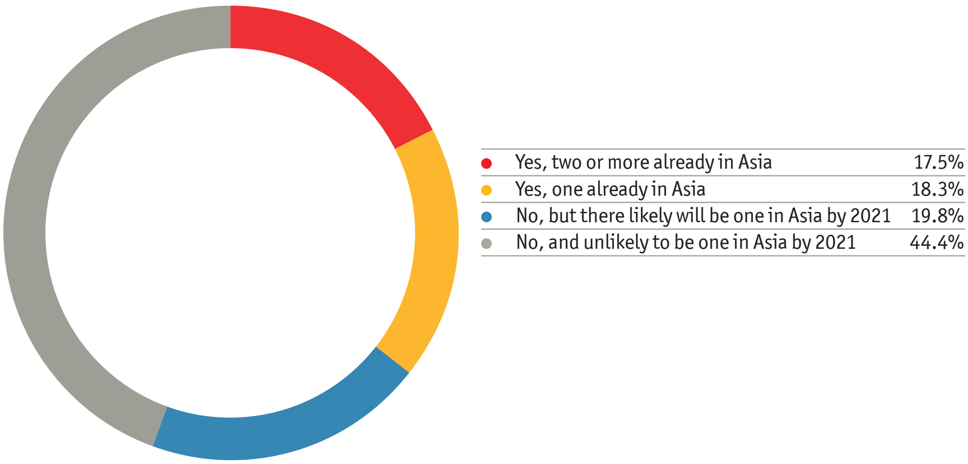
Assuming an average board comprises of seven directors*, then two or (more preferably) three board members should be expected to have reasonable familiarity with Asia for any firm receiving as much as 40% of its revenues from the region. The survey indicates that one-half of respondents anticipate Asia to contribute 21-40% of their firm's worldwide revenues by 2021. However, less than 20% of respondents affirmed having two or more directors in the region currently. Many companies could, therefore, find themselves ill prepared to benefit from the swelling tide of Asia-originated sales unless the average number of Asia-based—or, in any case, Asia-experienced—directors increases accordingly.

The picture for the heads of business units based in Asia is slightly more encouraging. A total of 17.5% of respondents reported having two or more such top executives in the region already (Figure 15). An outright majority, 55.6%, expect to have at least one such person by 2021. The numbers, functions, and sizes of business units differ so widely between companies that any categorical statement about how many heads of business units on average should be located in Asia is difficult to make. Yet here again a crucial question emerges regarding adequacy.

As the chiefs of business divisions typically represent the senior-most direct

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

Figure 15: Are any global heads of your firm's business units based in Asia?
(respondents surveyed)



Source: The Economist Corporate Network.

contributors to a firm's revenue-generating capacity, their increased exposure to Asia would be expected to support a firm's ability to respond to the increasing opportunities in the region. To have significantly fewer than one-fifth—only 17.5%—of respondents indicating that two or more heads of business units are based in Asia thus points to a potential area of structural corporate weakness.

9. Urban magnets

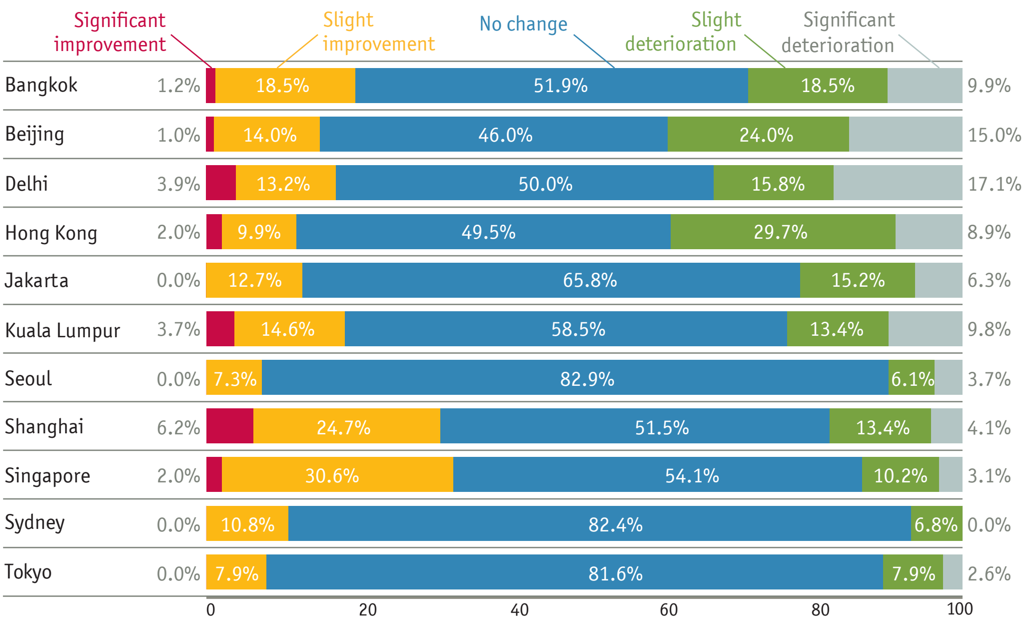
How Asian cities rate as bases for regional operations

Just as globally operating companies need to be positioned to respond to the risks and rewards posed by ongoing developments in Asia, Asian cities need to position themselves with world-class business operating environments to effectively draw in and foster globally leading industries, companies and talent.

IMPROVEMENT AND DETERIORATION

We asked survey participants how their views on various Asian cities as bases for regional management centres have changed throughout 2016. The tough news: Hong Kong, Beijing, Bangkok, Dehli, Kuala Lumpur and Jakarta all registered 20% or more respondents indicating that conditions for basing regional operations have deteriorated (Figure 16). The tougher news for companies and the region overall: far

Figure 16: Throughout 2016, how have your views about various Asian cities changed as regards centres for regional management operations? (respondents surveyed)



Source: The Economist Corporate Network.

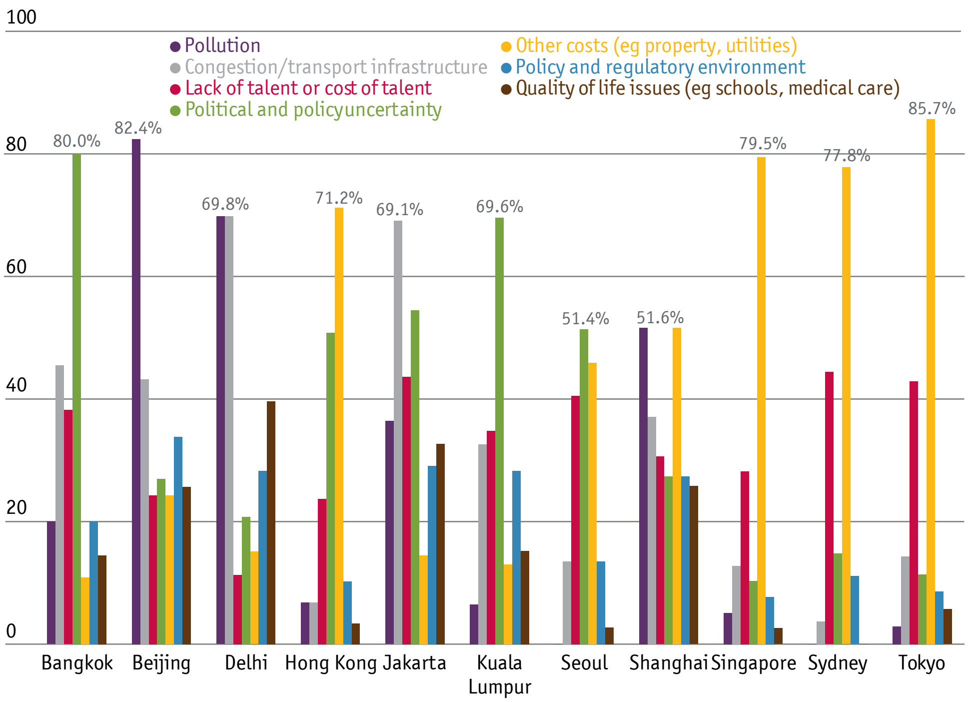
fewer cities have registered noticeable improvement. Only one city rated as having significantly improved by more than 5% of respondents: Shanghai, at 6.2%. If including cities that merited recognition for both significant and slight improvement, Shanghai was joined by just one other city, Singapore, where at least one fifth of respondents saw conditions as having improved.

Seoul, Sydney and Tokyo registered the greatest stability with perceptions. More than 80% of respondents indicated that their views on these cities as bases for regional operations were unchanged.

RISKS TO REGIONAL OPERATIONS

Delving deeper to understand what issues pose risks to Asian cities serving as regional bases, we asked survey participants what issues might cause them to consider relocating operations or moving headcount. The most frequent issue to emerge was non-labour costs (property, utilities, etc.), which particularly affect well developed, cosmopolitan cities such as Hong Kong, Sydney, Singapore and Tokyo. In

Figure 17: What issues might cause you to consider relocating operations or moving headcount away from any of these locations in the next two years (2017-2018)
(respondents surveyed)



Source: The Economist Corporate Network.

those locations, such costs were cited by 71.2-85.7% of respondents as a reason for relocating.

Other issues that stood out as a leading reason to leave a city were pollution (82.4% of respondents cited this as an issue for Beijing and for 69.8% for Dehli), political uncertainty (80% for Bangkok and 69.6% for Kuala Lumpur) and congestion (69.8% for Dehli and 69.1% for Jakarta).

Shanghai and Seoul fare relatively well in terms of not having any issues cited by an overwhelming majority of respondents, although they still were noted for problems. Just slightly over half of executives gave pollution and non-labour costs as the leading reasons to leave Shanghai. Political uncertainty was cited by a similarly slim majority as the major cause for executives to bid goodbye to Seoul. Although negative indicators, those percentages compare well to the problems cited by about 70-85% of respondents as reasons to abandon other Asian cities.

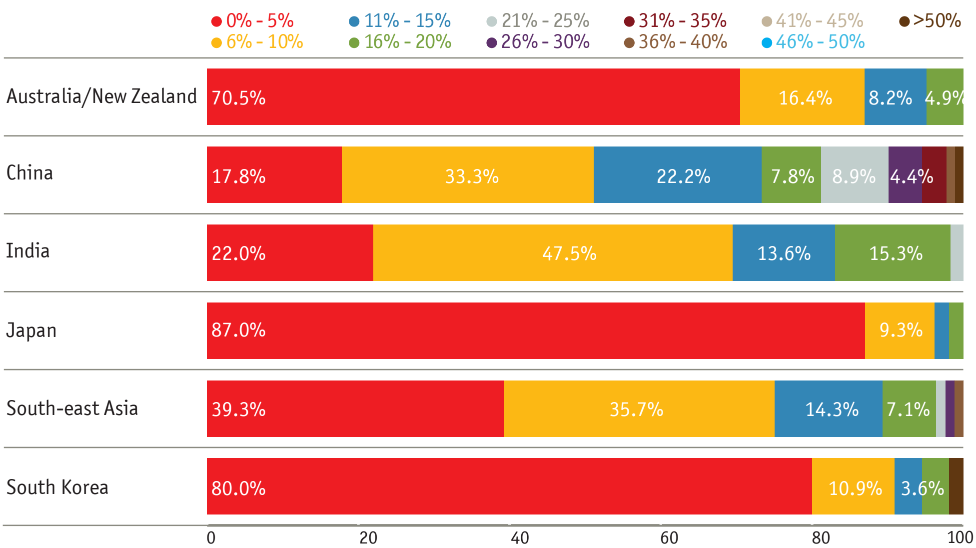
10. Turnover economics

Challenges with talent in Asia

The ability to attract and retain talent in local markets represents a vital competitive asset for companies active in Asia. Workforce development is ultimately in the hands of individual firms, but local operating environments also play a critical role in providing labour pools that are willing to stay with an employer.

Respondents again called out the fast-growing economies of China, South-east Asia and India as leading pack, here in a less positive measure of employee turnover rates (Figure 18). The statistical mode (the value that appears most often in the data set) for the turnover ratio in still developing Asian markets is 6-10%. China is remarkable for having more than three quarters (76.6%) of executives observing staff turnover rates of 6-30%. India falls in a similar bracket with 76.4% who described rates of 6-20%.

Figure 18: What is your company's annual staff turnover ratio in Asia?
(respondents surveyed)



Source: The Economist Corporate Network.

Japan tops our list as Asia's most stable labour market. A massive 87% of executives surveyed indicated turnover ratios of 5% and less. Nearly all (96.3%) respondents observed churn rates of no more than 10% in their Japan operations. South Korea places a close second, with 80% of respondents relating that only 5% or less of their staff leave annually.

This final metric of our 2017 report offers varying implications for risk and benefits to companies active in Asia. Volatility is the most basic measure of risk. In that sense, China, India and South-east Asia qualify as being especially risky labour markets. Costs associated with losing talented staff and the expense of recruiting and training replacements can be considerable.

At the same, more fluid labour markets can provide an easier environment for trying out new employees and, when necessary, removing underperformers. On the other hand, markets with highly stable labour forces offer the advantage of a better environment to retain talent, but with the downside of making it harder to remove staff. As with the other measures covered by this year's survey report, companies that can adapt their strategies to any of the features of Asia's varied economic landscape will be best positioned to reap potential rewards.

Appendix

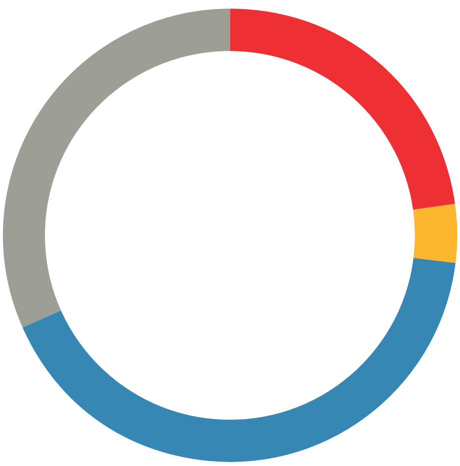
Firmographics of 223 survey respondents

Figure 19: Survey respondents by global revenues

Less than US$10m	5.3%
US$10m to US$50m	4.3%
US$50m to US$100m	4.8%
US$100m to US$500m	12.2%
US$500m to US$1bn	4.8%
US$1bn to US$5bn	19.7%
US$5bn to US$10bn	11.2%
US$10bn or more	37.8%

Source: The Economist Corporate Network.

Figure 20: Survey respondents by location of global headquarters



Asia	23.0%
Australasia	4.2%
Europe	41.4%
North America	31.4%

Source: The Economist Corporate Network.

Figure 21: Survey respondents by industry sector
(respondents specifying an industry affiliation)

Financial services	20.6%
Manufacturing	10.8%
Professional services	9.9%
Consumer goods	9.9%
Retail	8.5%
Transport & logistics	6.7%
Automotive	6.3%
IT & software	5.4%
Property & construction	4.9%
Chemicals	3.6%
Media & marketing	3.1%
Agriculture/food	2.7%
Healthcare	2.7%
Hotels & leisure	2.2%
Pharmaceutical	1.8%
Engineering	0.9%
Oil & gas	0.9%
Electronics	0.9%
Government	0.9%
Telecoms	0.9%
Mining, metals & minerals	0.9%

Source: The Economist Corporate Network.

The Economist Corporate Network

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