17th Annual Global CEO Survey – The view from China

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China's enduring growth: Capitalising on global trends

47%

of CEOs are very confident about their company's growth prospects

See page 1

38%

of CEOs recognise the need to change R&D and innovation capacity

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As the global economy begins to show signs of recovery CEOs around the world are starting to shift their focus from 'how can we survive?' to 'how can we grow?'

But for China's CEOs, who have been in growth mode for much of the last three decades the question at the top of their minds is 'how can growth be sustained'?

The findings from PwC's 17th Annual Global CEO Survey show that China's CEOs are confident about the future growth, but also recognise the challenges that come with a maturing domestic economy. Tax burdens, rising labour costs and over-regulation are key concerns.

China's CEOs are responding by continuing to focus on efficiency, while also adapting their businesses to capitalise on global trends of technological advances and growing urbanisation, as well as major domestic economic reform.

The following is a summary of the views of CEOs from China we collected as part of our 17th global survey of 1,344 CEOS in 68 countries.

Confidence returns

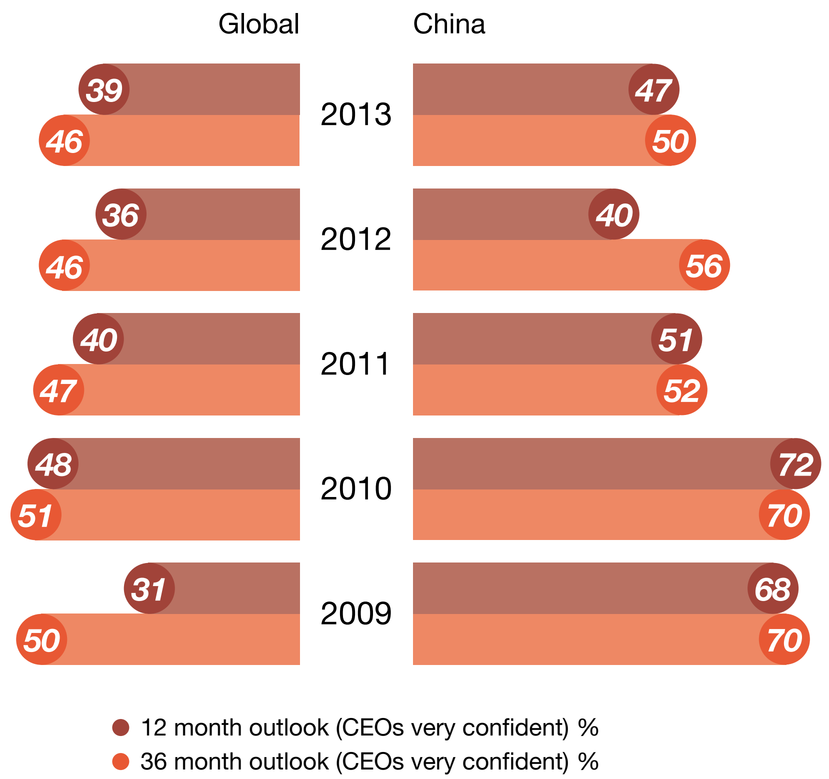
In line with their global peers, short-term confidence among China's CEOs has returned. Almost half (47%) are "very confident" in their company's growth prospects over the next 12 months. This number is up from the record low of only 40% last year.

Whilst this rise is clearly linked to the ongoing global recovery, it is also due to the continued strong performance of the domestic economy. In 2013 China's GDP grew by 7.7%, and 13.1 million new jobs were created. And the outlook is equally strong, with China expected to reach its 7.5% growth target for 2014, according to PwC's latest Global Economic Watch.

When CEOs were asked to look ahead three years, however, the number who were "very confident" of growth was 50%, down from 56% in the previous survey.

This easing, although slight, likely reflects a certain degree of uncertainty caused by the ongoing adjustments and reforms to the Chinese domestic economy. The roadmap released by the Third Plenary Session of the CPC's 18th Central Committee introduces the most significant economic and social reforms in a generation, and whilst the changes will bring significant growth opportunities, many CEOs are understandably working through the implications for their own businesses in the longer-term.

Figure 1 **12 and 36 month outlook for growth by China CEOs and Global CEOs, since 2009**



Growth

Looking close to home

When it comes to more immediate plans for growth, China's CEOs are very clear. And their focus is mostly domestic.

For example, compared to their global peers they are the least likely to be looking for new geographic markets for growth – 5% compared to the global average of 14%. They were also the least likely to have completed a cross border M&A last year – 9% compared to 17% of CEOs globally.

Instead, China's CEOs see their best prospects in new product or service innovations – 52% compared to the global average of 35%.

And when you consider the speed at which China's domestic economy is changing – and the opportunities this presents – it's easy to see why China's CEOs are focused close to home.

In 2013 the services sector overtook the industrial sector for the first time ever as the main contributor to GDP. In the same year the GDP of central and western parts of China grew to 44% of the country's total, opening up significant markets in the vast hinterland areas. By 2020, four in ten people in China will belong to its middle class.

The other reason for a strong domestic focus is the ongoing reform and opening up of the Chinese economy, which will bring both opportunity and risk. The lowering of barriers to entry for foreign investment in key industries outlined in the Roadmap document recently released for example, could lead to greater access to business opportunities. Initiatives such as the China (Shanghai) Pilot Free Trade Zone with its more relaxed administrative and investment controls could potentially benefit both local and foreign businesses.

Figure 2 **Which areas do you see as the main opportunity to grow your business in the next 12 months?**

Innovate and adapt

This strong focus towards adjusting to an evolving domestic economy is reflected in the change programmes China's CEOs are initiating, which are focused on driving efficiencies, improving processes and investment in R&D.

Innovation is a particularly strong theme. When CEOs were asked about the type of change programme they were most likely to have completed or have underway, the most common response (38%) was related to R&D and innovation capacity. And policy makers are thinking along similar lines with the Chinese government identifying the "use of innovation to lead economic structural improvements" as a major task for 2014. In fact, recent research shows China is on track to become the world's number one investor in R&D, and at the current rates of growth and investment could surpass the US by early 2020.[1]

Looking ahead, CEOs are planning change programmes aimed at adapting their businesses to thrive in growing, but also increasingly competitive markets.

The most common included talent strategies (35%), followed by organisational structure & design (32%) and channels to market (30%).

And as we found in the previous CEO Survey, China's CEOs are still very much focused on efficiency. Half plan to implement a cost cutting initiative in the next 12 months.

But increasingly, China CEOs are also looking to do deals. 42% plan to enter a new strategic alliance or joint venture and 30% plan to complete a domestic M&A.

In fact, M&A activity in China last year reached a record high with deal values growing by 28% to US$260 billion. PwC's China M&A Outlook predicts that in 2014 domestic deal activity will continue to grow to new highs, driven by industry consolidation, sector reforms and increased competitive pressures.

"At a time when growth is not as fast as before, we need to pay more attention to internal efficiency."

CHEN Long, Chairman, China Resources Enterprise, Limited

[1] 2014 Global R&D Funding Forecast. Sponsored by Batelle and R&D Mag.

Figure 3 **Changes to business structure and operations**

Q: To what extent are you currently making changes,if any, in the following areas?

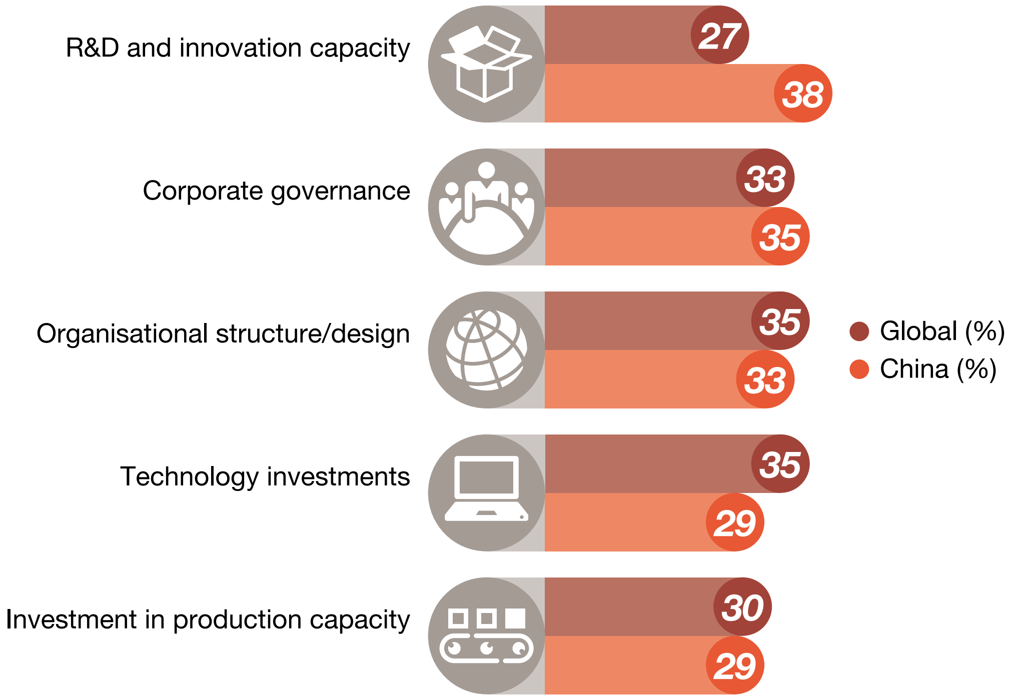
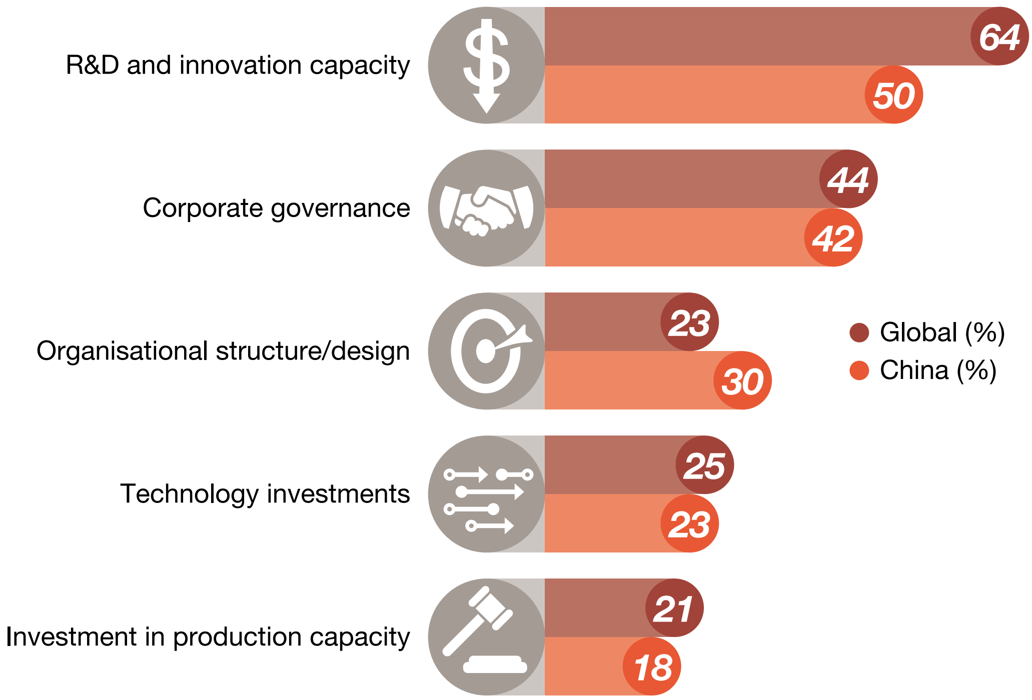


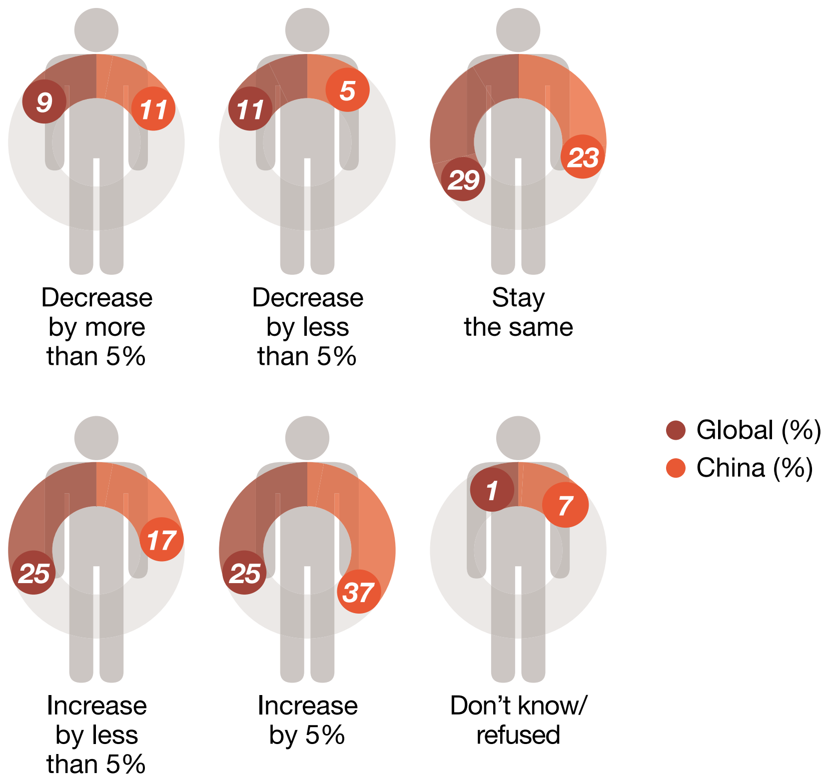
Figure 4 **Changes in approach to driving growth**

Q: Which, if any, of the following restructuring activities do you plan to initiate in the coming 12 months?



37% of China's CEOs plan to increase headcount by more than 5% next year, considerably higher than their global peers, only 25% of whom plan to make similar increases.

Figure 5 What do you expect to happen to headcount in your company globally over the next 12 months? Graph of China vs Global



Offshore opportunities

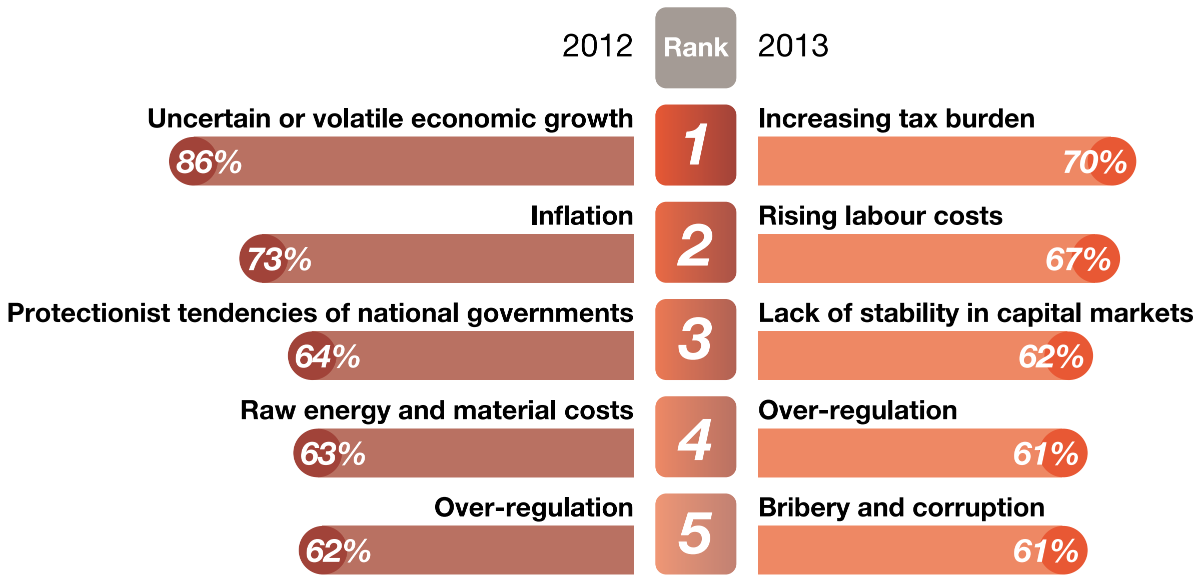
Despite a strong domestic focus, China's CEOs are still looking for offshore growth opportunities. The outlook for outbound deals in 2014 remains steady with 18% expecting to complete a cross border M&A in the next 12 months, similar to the 19% in 2013.

In 2013 Chinese enterprises invested more than US$90 billion offshore, and the Chinese government has said total offshore investment is expected to reach US$500 billion over 5 years.

In addition to being the number one country for inbound investment, China, which had the third largest offshore spend in 2013, is well on target to becoming the world's leading offshore investor.

Risks to growth

Figure 6 **How concerned are you about the following potential threats to your organisation's growth prospects?**



The issues that China's CEOs see as the biggest threats to their organisation's growth prospects have changed substantially since the previous CEO survey.

Whereas last year uncertain growth and inflation topped the list, now CEOs see tax burden as the most significant threat to growth, followed by rising labour costs and lack of stability in capital markets. Over-regulation remains one of the top 5 concerns.

The new prioritisation of concerns to some extent reflects the tentative stabilisation of the global economy, and the continued readjustment of the Chinese economy toward consumption-led growth and away from a reliance on investment and exports. CEOs will be looking to both drive efficiencies and contain costs, without losing sight of growth opportunities. This means staying on top of the major trends currently re-shaping the global business landscape.

The trends transforming business

So what's ahead? When asked to look five years into the future, China's CEOs identified the three major trends that will transform their business.

More than five-sixths of China's CEOs identified technological advances as a major trend; 62% identified urbanisation and 55% say the shift in global economic power.

Technology

The impact of technology is difficult to underestimate. Already nearly one in three people in China have a 3G/4G mobile subscription. By 2020 there will be nearly 50 billion networked devices on the planet – 7 times more than there are people. In 2014 China's government plans to speed up its 4G mobile network programme, build 100 million fibre optic networks in cities and extend broadband connectivity to villages.

An example of the scale of the opportunity presented by the growth in technology uptake in China is Tencent, a home-grown tech company that has become the country's most used internet portal, providing online games, search, instant messaging, software development, and a host of other online offerings. Started only 15 years ago, it now boasts a market cap of US$120 billion, bigger than McDonalds or Boeing, and more users than Twitter.

Technology is also changing the way enterprises operate, disrupting traditional business models and dis-intermediating established markets. Alibaba, China's biggest online retailer, has recently branched into online wealth management, and is on its way to overtaking China Asset Management to become the China's biggest mutual fund manager.

CEOs need to think deeply about how they evolve their companies to compete in an increasingly digitally-enabled world. And not just about how technology changes their relationship to their increasingly mobile, digitally connected customer base, but how technology may impact their business model itself.

Urbanisation

Urbanisation is also having an ongoing and profound impact on the Chinese economy. For example, the chinese government will build 7 million units of subsidised housing this year, over half of which will be in run-down urban areas. It is also taking major steps to deal with pollution, improve health and education programmes and improve general well-being in what it's calling a new form of "people-centred urbanism". The hoped for result will be a more productive, and therefore a wealthier, urban population.

And this impact is being felt beyond the major eastern cities. In 2013, per capita net income of rural residents grew by 9.3% in real terms, and the income gap between urban and rural residents shrank. This ongoing trend signals an increasing easing of regional disparity as well as a maturing opportunity for growth in the vast hinterland areas in China.

"The question of China really is will the country become wealthy before it becomes old? And that's a key economic issue that I know China's looking at and the rest of the world I guess looks at as well."

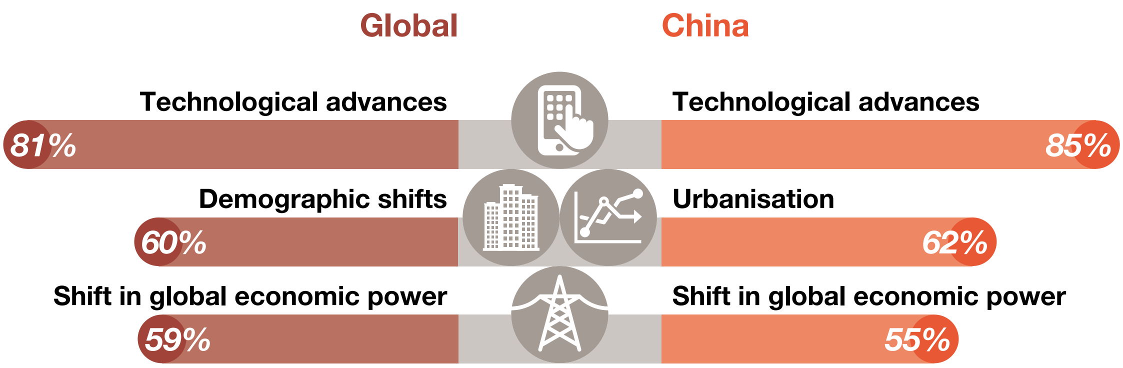
Mark Wilson, Group CEO, Aviva (UK)

Shift in global economic power

The ongoing shift in global economic power towards China is an important trend for both China's and global CEOs and will continue to be a major driver of reform and structural change in the Chinese economy.

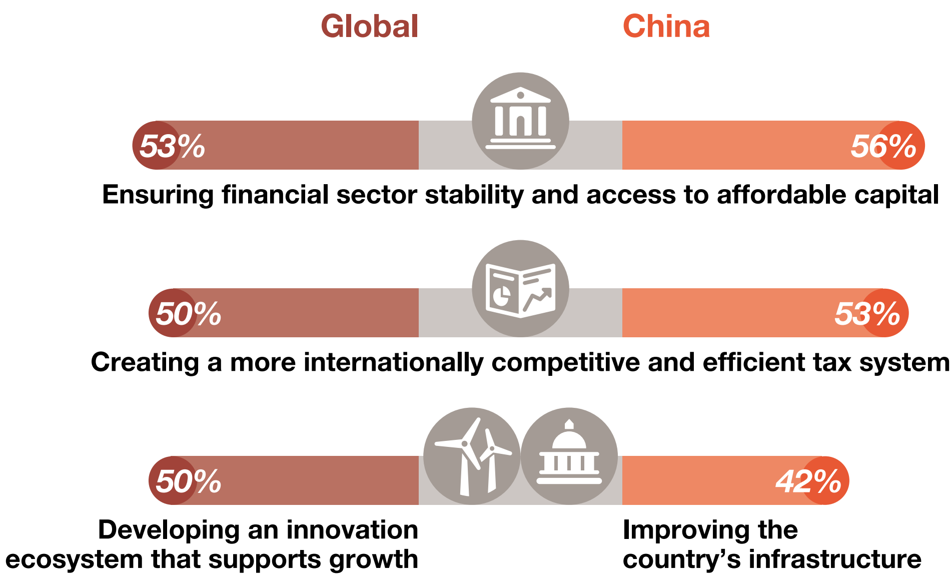
This is reflected in the government's major tasks for 2014, which in addition to making domestic demand the main engine for growth also includes to "usher in a new phase of China's opening to the outside world". This increased interaction with the other economies will create many new opportunities and challenges for China's CEOs as they are exposed to not only new ideas and innovations but to competitive pressures as well. The demand for skills and services will continue to increase as China's economy grows and matures at the centre of global economic power.

Figure 7 Which global trends do you believe will transform your business the most over the next five years?



Government priorities

Figure 8 **Which three areas should be government priorities, in the country in which you are based?**



What do China's CEOs expect from their government? It's largely similar to CEOs everywhere: a stable financial system and a more competitive and efficient tax system.

But unlike many of their peers, however, China's CEOs are not overly concerned about improving the country's infrastructure. This likely reflects the impact of the massive stimulus that the government has injected into the Chinese economy since the global financial crisis, much of which has been targeted at infrastructure projects. More than two-thirds believe the government has been very effective in improving infrastructure, the highest result for any region in the CEO survey.

China's CEOs are, however, more concerned than their global peers about growth, with 42% saying that the government should focus on developing an innovation ecosystem that supports growth.

While the reforms announced in the Roadmap document are squarely targeted at addressing such concerns, CEOs will need to be clear about how the reforms will impact their own company's unique growth prospects.

Initiatives such as the decision to establish a judicial court to protect intellectual property rights, and the equal treatment for foreign enterprises, will have varied impacts on Chinese business depending on their sector and operating model.

Where to now?

It would be fair to say that China's CEOs have a lot on their plate. China itself is undergoing one of the most significant transformations in its modern history – economically and socially. At the same time major trends such as technology and urbanisation are changing the global business landscape in deep, fundamental ways. And even though China's economic growth continues to roll on at an envious pace there are signs that sustaining that growth will be an ongoing challenge for policy makers.

China's CEOs also recognise the challenges ahead. They remain confident – but cautiously so – aware of the need to be diligent about costs and persistent about innovation and growth as both the domestic and global economies transform around them. The ability to not only cope with this change but also adapt and thrive will be critical for China's CEOs to continue to deliver sustained growth over the short to medium term.

And with their strong focus on R&D and innovation, high uptake of new technology, a focus on skills and talent, and recognition of the opportunities presented by reform, the future continues to look bright for China's CEOs.

Methodology

This report was based on a survey of 66 CEOs and senior executives based in Mainland China. It was supplemented by a number of in-depth interviews with business leaders from China and globally.

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