



## About this report

Rapid-growth markets have largely been viewed and studied from the perspective of inbound investment by companies based in the West. *China highlights* and the larger report of which it is a part, *Beyond Asia: strategies to support the quest for growth*, offer rare insights about the strategies of outbound investment from companies based in Asia and provide in-depth perspectives on decision-making for companies from both mature and rapid-growth markets.

*China highlights*, which focuses on mainland China, is based on a survey of 617 business executives based in East and Southeast Asia, conducted by the Economist Intelligence Unit in March and April 2012. Companies were headquartered in mainland China, South Korea, Hong Kong special administrative region (SAR), Indonesia, Malaysia, Singapore, Taiwan, Thailand and Vietnam. The sample included 146 interviews from mainland China. The complete report, *Beyond Asia: strategies to support the quest for*

*growth*, includes the full results from the survey in addition to qualitative interviews with several Ernst & Young sector and country leaders and the viewpoints of senior executives from companies across the region. Oxford Economics provided analysis of current and predicted trade flows among individual Asian markets and between Asia and the rest of the world.

All of the companies surveyed are Asian multinationals that obtain substantial revenues and profits from international markets. Companies with operations limited to East and Southeast Asia were classified as regional; those with operations in two or more markets in the Americas, Europe, the Middle East, Africa, India, Australia, New Zealand or Japan were classified as global. Both groups contained companies from all nine markets surveyed; large and small companies by revenue, a mix of public and private ownership, and a spread of industry sectors.

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## Introduction

In the face of a slow global economic recovery, Asia continues to grow at a rapid pace. Over the next decade, the region's GDP will grow more than 6% a year, according to forecasts by Oxford Economics. In the past ten years, the region has been the world's fastest-growing source of foreign direct investment (FDI). In 2010, FDI outflows from South, East and Southeast Asia totaled US\$230 billion. Although these outflows have not yet reached the level of inflows, clearly the gap is fast narrowing. Regional companies are looking beyond Asia and targeting other regions of the world, whereas Asian companies that are already global are consolidating their investments and competing on a level platform with traditional Western multinationals.

Ernst & Young's in-depth research, featured in *Beyond Asia: strategies to support the quest for growth*, examines the practical issues that both regional and global Asian companies will need to consider to succeed in the next few years. It looks at how, why and where they are expanding, examines the challenges they are likely to face and how they might overcome them. A key component of our analysis compares companies that currently operate only within Asia (regionally focused) and those that have significant operations or investments outside Asia (globally focused). As a result of this analysis, we have developed practical strategies to help businesses focus

on the right rationales for investment, modes of entry and capabilities, as well as forecasts to improve decision-making and planning for future global expansion.

This report compares our overall findings for Asia with those for China and highlights the unique characteristics of Chinese companies that are regionally and globally focused. It contains challenging and thought-provoking insights for Asian companies as they develop their strategies for expansion within and outside the region.

*The China report and Beyond Asia: strategies to support the quest for growth are part of Growing Beyond, our flagship program that explores how companies can grow faster by expanding into new markets, finding new ways to innovate and implementing new approaches to talent management.*

## Lessons from Asia:

# What Chinese companies can learn

As Asian companies grow in stature, the pattern of their overseas investment is changing. Over the next three years, many players that are predominantly regional now will seek to become global players. Our survey found that Asian companies are expanding overseas for six key reasons: growth; diversification; routes to market; access to resources; access to skills; and access to technology. Regional companies emphasize building the capabilities and resources needed to further their ambitions, whereas global companies see expansion first as a means of securing new customers and sales growth.

The Asian business model is also changing. Where once they were renowned for low-cost manufacturing, Asian companies can now rightly boast of the quality of their products and services, and the strength of their technology. When asked about their key strengths and advantages, Asian executives

are most likely to point to those factors as key advantages when targeting overseas markets. Furthermore, Asian companies are becoming more conscious of – and more flexible about – the deal structures they will consider. Regional companies in particular say partnerships and alliances will become more important to them, whereas mergers and acquisitions are a much more viable option for the globally focused companies.

### **Autonomy, profitability pose challenges**

Still, several challenges remain. The farther from home they travel, the more likely Asian companies are to encounter difficulties with understanding the nuances of the local market abroad. Our regionally focused respondents consider themselves more effective than do their global peers at dealing with the challenges of running an international business, but they should not underestimate the complexity ahead. Control is also an issue, as globalization brings with it a need for greater autonomy. Many Asian companies remain tightly controlled from the center, but this raises questions about the effectiveness and agility of their decision-making, particularly in markets that are distant and unfamiliar. In general, companies in the survey tend to become more decentralized as they expand into developed markets.

Another hurdle is that profitability tends to lag investment. Growth may come relatively quickly, but making sure that investments are profitable is much more challenging. Increasing profitability requires companies to focus on efficiency and execution.

### **The need for an international mindset**

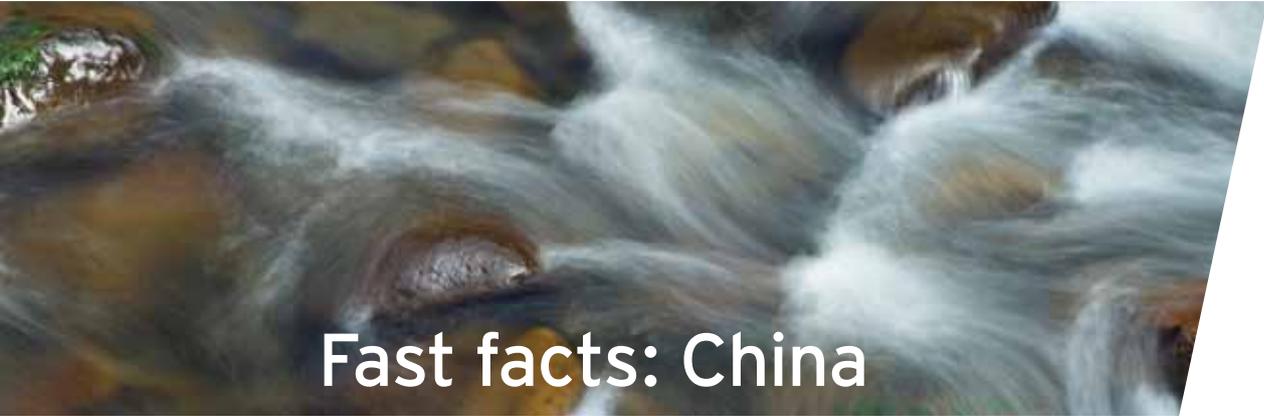
Asian companies with a more diverse geographical footprint readily admit that their management teams need a better understanding of global markets and a more international outlook. Senior managers must have experience of different markets, the ability to understand and reconcile different cultural norms, and the ability to combine local and global talent into one seamless whole.

A step change is also required in talent management. Companies must create the right blend of local and global management and ensure that the right talent is in the right place to achieve key performance objectives. This becomes more difficult as companies broaden their footprint: global companies are less likely than are their regional peers to think that they are effective at many of these key aspects of talent management.



- ▶ Rapid-growth markets from Asia represent the fastest-growing economic region in the world, with annual growth forecast at more than 6% a year.
- ▶ The IMF expects advanced economies to grow by just 1.4% in 2012 and 2% in 2013. The corresponding figure for East and Southeast Asia in 2013 is 7.9%.
- ▶ Since 2000, Asia has been the fastest-growing source of foreign direct investment (FDI). Its businesses currently produce a quarter of the world's exports (US\$3.77 trillion in 2010) and form 87 of the Fortune Global 500 largest firms.
- ▶ FDI outflows from East and Southeast Asia recorded a compound annual growth rate of 22.9% in 2005-2011, jumping from US\$70billion to US\$242 billion.
- ▶ Investors from East and Southeast Asia are major drivers of growth in global foreign direct investment (FDI) outflows, making up 16% of the world's total FDI (up from just 7% in 2005) and driven by increased outflows from mainland China, Hong Kong (SAR), Malaysia, South Korea, Singapore and Taiwan.
- ▶ Intra-regional trade is expanding rapidly, reflecting the shift towards higher consumption in Asia. China leads the way in terms of outflows and destination, with growth for Indonesia, South Korea, Thailand and Vietnam close behind.
- ▶ Trade flows from Asia to the US and Canada, the Middle East, Latin America and Africa are expected to increase by over 10% a year up to 2020.
- ▶ Cross-border M&A purchases are consuming an ever-larger slice of FDI flows, with purchases from Asia reaching a record US\$94 billion in 2010.
- ▶ The China - US trade route is forecast to see the biggest increase in the world, predicted to rise by almost US\$700 billion by 2020.

Sources: UNCTAD, IMF, Oxford Economics



## Fast facts: China

- ▶ China has been the biggest economic growth success story of the last decade, although on a per capita basis China remains a low-income country today. This is changing quickly, though. According to the Economist Intelligence Unit, China's GDP per capita, in purchasing power parity terms, was US\$11,425 in 2011. By 2016, this is expected to rise to nearly US\$19,000, about two and a half times the Chinese average income in 2007.
- ▶ In 2011, China's economy, with a nominal GDP of US\$7.2 trillion, surpassed that of Japan, making China the world's second largest economy after the US.<sup>1</sup> The Economist Intelligence Unit predicts that China's economy will become the biggest in the world in 2018. The country has not held this rank since roughly the 1870s.
- ▶ Although its growth rate has been slowing in recent years, China's GDP is still expected to expand at an average of nearly 8.2% during 2012-16.<sup>2</sup>
- ▶ China is already the world's largest exporter, sending abroad merchandise worth US\$1.9 trillion in 2011.<sup>3</sup> But China's exports are expected to continue growing at over 12% per year until 2020, reaching a total of over US\$5.6 trillion (see Figures 2, 3 and 4).<sup>4</sup>
- ▶ China's biggest market is the US. China's US\$325 billion in exports to the US in 2011 was the world's largest trade flow. Although the two are often cast as rivals, China's fastest trade growth this decade will be with India, with an expected annual rate of increase of nearly 18%. Exports to Korea will also boom at a rate of more than 16%.<sup>5</sup>
- ▶ Manufacturing dominates the Chinese export scene today, and this is not expected to change in the decade ahead. Machinery, transport and other manufactured goods account for three-quarters of all exports today and will remain at about that proportion over the rest of the decade (Figure 5).

### Footnotes

1. Economist Intelligence Unit
2. Ibid.
3. Ibid.
4. Oxford Economics
5. Ibid.

Outward bound:

## The agenda for Chinese companies

China is already the world's biggest exporter. Chinese companies have become major players in markets across the globe as well, while China has also developed into one of the world's largest foreign investors. Despite the scale of Chinese business's internationalization, many of the issues facing its companies are the same as those faced by businesses in the rest of Asia. Much expertise remains to be developed in the country's outbound expansion. In particular, executives from China's global firms are concerned about their need for more international perspective and understanding, while those from regional firms worry about their ability to comply with foreign regulations.

### Internationalization on a grand scale

Sheer size sets China apart from the rest of Asia. Its decades of economic growth come from international commerce. China's exports of goods alone in 2011 were US\$1.9 trillion, a figure that is an order of magnitude larger than the entire GDP of every other country in this study barring South Korea. China's exports will continue to expand rapidly by more than 12% per year, further cementing the country's strength in manufacturing.

China's recent accelerating investment overseas, although similar in pattern to that of many rapid-growth Asian markets, is also dramatic in scale. FDI outflow from China in 2004 was just \$1.8 billion. But by 2011 FDI outflow had grown to US\$50 billion.

The focus of such outbound investments varies depending on the nature of the market. In line with many other Asian competitors, Chinese executives are looking to developed markets for access to technology and innovation. This fits with a widespread desire for firms in China and across the region to move up the value chain. For example, executives see product and service quality as their leading overall competitive advantage for international expansion (see Figure 6). By contrast, Chinese executives overall are looking to rapid-growth markets for potential sales growth. However, there are important distinctions in all this between global Chinese companies and regional Chinese companies.

### Chinese companies face challenges common to many in Asia

The responses of Chinese executives closely followed those of the survey as a whole. Two particular differences, though, reflect how far the Chinese economy has come. On the one hand, Chinese firms are more likely than others to see chances for growth in developed countries (see Figure 7). Thirty-three percent say that the best opportunities are in Western Europe (compared to 29% for the overall survey) and 22% say the same of the US and Canada (compared with 16%). Also, when assessing new markets for expansion, Chinese executives are more likely to look at the issue of protectionism (36%) than are their peers (an average of 28%).

Each of these points reflect – in distinct ways – that the Chinese economy is now of such a size that its businesses will be interacting frequently with firms across the globe. As a group, Chinese executives will inevitably look at a wider range of opportunities and be aware

that their substantial presence globally may cause tensions in some quarters. Already, some proposed acquisitions over the past decade have raised heightened regulatory scrutiny, especially within the US. In many respects, Europe has become a relatively more open environment for Chinese firms' expansion. Furthermore, given Europe's current financial difficulties, many investors are eyeing assets there that may be undervalued.

### Chinese global companies: executives worry about international attitudes and talent

When looking at the survey results, distinctions become more apparent comparing Chinese global and regional companies with their peers in other countries. Perhaps the most striking of these differences is that executives from Chinese global companies are much more likely than their regional counterparts to believe that their corporate leadership lacks an informed international perspective. Only 20% of Chinese global respondents, for example, strongly agree that top management has an international outlook on decision-making, compared with 27% for all global firms (see Figure 8). Similarly, 60% of Chinese respondents say that senior executives need greater understanding of global markets, compared with 55% overall. This may help explain why Chinese global firms are also much less likely than their peers to say that they are very effective at building a rationale for investing abroad (11% compared with 20%).

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“We've been entering overseas markets for more than ten years. You need to be there for a while – you need to know a lot of things, you need to know the language of these countries. After you've been in these countries for several years, the carriers are willing to give you a chance. They won't give you a chance after being there for just one year.”

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Lin Jianyi, Overseas Investor Relations Manager, ZTE, China

To fill this gap, Chinese respondents from global companies say that the most critical change needed to achieve international success is to make the corporate culture more international (49%). This is broadly in line with the sentiment from their peers at other global companies. But there is a much stronger belief among global Chinese executives that it is also critical to make the board more reflective of international markets. Forty-four percent think this necessarily, far more than the 31% who think so among other global executives.

Finding senior executives with international perspectives, though, may be easier said than done. Only 16% of those surveyed from Chinese global companies believe that their firms are very effective at recruiting or retaining key global talent, or at evaluating and rewarding higher performance across different markets (see Figure 9). Meanwhile, just 14% say that they are very good at motivating employees from different cultures. The last issue is particularly challenging: about half (49%) of Chinese global respondents believe that top management needs more insight into incentivizing employees in different markets.

This is noticeably higher than the survey average among global firms (42%). For the moment, Chinese global firms seem to be adopting a second-best solution. They are less likely to recruit members of their international management team in foreign locations (31% compared with 38% for other global companies). On the other hand, Chinese global companies are much more likely to require experience in different international markets as a prerequisite for future management (69% compared with 57% for peer companies outside of China).

**Chinese regional companies: more focused on resources than their peers but concerned about compliance**

Regional company respondents in China also differ in some important ways from their Asian counterparts. Similar to their peers, these firms are clearly seeking to become more global. Their goals, however, differ noticeably, in particular when entering rapid-growth markets. For regional companies across the entire survey, the main benefits of such activity is increasing sales by tapping into gaps in the market (38%), finding improved distribution channels (36%), or simply finding new customers (35%). Although these points are also of interest to Chinese regional executives, they are seen as secondary to other goals (see Figure 10). In particular, more Chinese regional firms are interested in access to raw materials (47%) and new technology or innovation (42%). Access to natural resources is also seen by Chinese regional executives as the leading benefit of expansion into developed markets (45%). This greater focus on resources helps explain why Chinese regional respondents see the Middle

East and North Africa region as the area providing the best growth opportunities over the next three years. Overall, 36% pointed to this region, far more so than other regional companies (28%) or Chinese global companies (27%).

In looking to expand, however, Chinese regional companies lack confidence about their ability to cope with local regulation. Fully 70% say that one of the most important areas in which their top management needs greater knowledge is international taxation and compliance, compared with 56% for regional companies overall (see Figure 11). Similarly, Chinese respondents are noticeably less likely than their Asian counterparts to believe that their companies are very good at understanding the political and regulatory environment of other countries (39% compared with 46% for regional companies overall). As a result, for Chinese regional firms, the function that requires the greatest change is financial management (cited by 45%, compared to 41% for all regional companies).

## International expansion:

# Business implications for Asian companies

Venturing into international markets brings both significant opportunities and significant challenges. As our survey of Asian outbound investment shows, the business implications of growth – and the strategies to manage them – are quite different for global and regional players and need to be explored carefully. The following are some key tactics we have identified:

### For regional companies

**Consider the implications of greater competition.** As companies from both inside and outside Asia continue to target the region, this will increase competition – for assets, talent, resources and customers. Regional companies need to consider the impact of this trend on their prospects.

**Build capabilities for international expansion.** Regional companies seeking to build a global footprint must ensure that they get the basic capabilities in place before making bold moves. They need managers who have an understanding of international markets and core functions, like finance, HR and IT, that can support multiple markets.

**Leverage global resources.** Regional companies will be under greater pressure to ramp up their innovation, product and service mix and talent pipelines. By building partnerships with companies outside Asia, or acquiring companies with the right resources and expertise, regional companies can leverage global resources to ensure that they remain globally competitive.

**Enable greater local autonomy.** Greater geographic scale makes it more difficult to control from the center. Companies should therefore consider devolving greater autonomy to regions, but do so within a set of parameters and risk frameworks.

### For global companies

**Put in place robust risk management.** Enable entrepreneurship and autonomy at a local level but do so within a set of parameters and rules that give business leaders at headquarters comfort that the company's values are being upheld. A robust risk system will also provide early warning of problems on the periphery of the organization.

**Improve profitability.** For many globally focused Asian companies, the priority remains investment and growth. But profits have not kept pace with revenue, as our survey consistently shows. As Asian companies' investments mature, they will need to do more to introduce efficiency and increase productivity.

### Focus on different modes of investment.

There has been a new wave of mergers and acquisitions in developed markets as Asian companies seek brands, know-how, technology and intellectual property. Globally focused companies are bolder than their regional counterparts in conducting mergers and acquisitions or greenfield investments to drive growth, but will still need to identify the right partners and to maximize value.

**Make the corporate culture more international.** By recruiting managers with experience of different markets, reducing reliance on expatriate workers, and putting in place global talent management programs that enable the flow of key talent around the world, companies can disseminate best practice and create a more international workforce.

**Choose where functions should be global or local.** Companies need to think about where they can derive economies of scale without compromising local relevance. Functions such as finance, HR and IT are often good candidates for centralization. It is also possible to create platforms for services that are delivered locally.

# What do these trends mean for Chinese companies?

In addition to implications for Asian companies, our research findings offer a number of implications specific to Chinese businesses seeking to expand internationally. The most important of these are the following:

***The success of Chinese companies can itself become an issue in certain locations.***

Although the current economic doldrums in developed markets have not led to the wave of protectionism that some analysts had feared, Chinese companies are right to keep an eye on this risk.

***Therefore Chinese companies, especially global ones, must enhance their international outlook and understanding of local markets.***

A nuanced understanding of all local political considerations may be even more important for Chinese companies than those from smaller states because China has become such a major economic actor.

***Companies will need to rethink their organizational design and operating models.***

Executives need to consider how to combine local relevance with global scale. Greater autonomy at a local level may require a rethink of how companies are structured. This may be harder for Chinese executives who are used to organizations with centralized control.

***Chinese businesses must give careful consideration to how they can move from investment to profitability.***

As Chinese companies expand rapidly abroad, they will need to be clear about how and when they will achieve a return on investment, not least as overseas expansion can bring complexity and higher costs. Rigorous performance management will be essential to ensuring that managers are clear about what they need to achieve and by when, in terms of both market share and bottom line.

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“Companies here in China, whether state-owned or privately-owned enterprises, are under pressure to have consistent, continuing growth. So on top of doing business in the domestic market, companies are looking into other markets to achieve this revenue growth.”

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Joe Tsang, Asia-Pacific Technology Leader, Ernst & Young, China

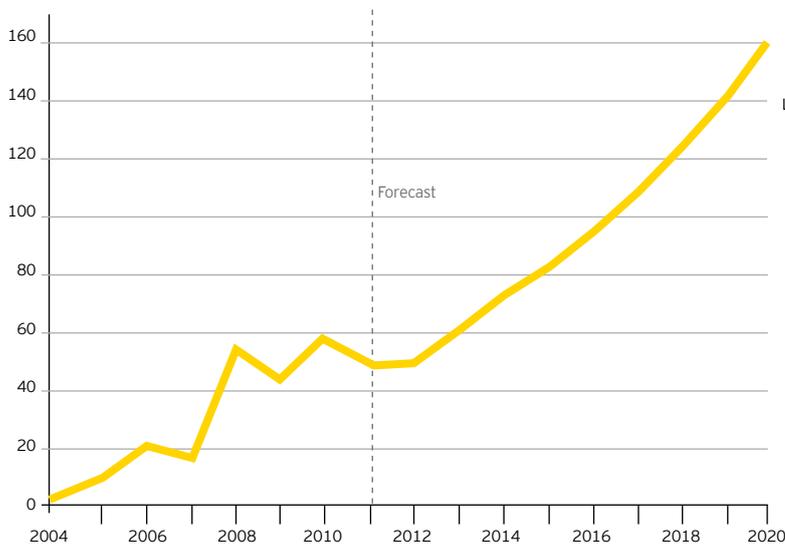
***Chinese regional companies will need to develop the capacity to meet tax and compliance requirements abroad.***

As they seek to become more global, smaller Chinese companies will have to address not just the difficulties of working in foreign cultures, but those of operating in foreign jurisdictions and under different legal systems.



# Figures

**Figure 1: Outward FDI is expected to rise sharply for Chinese companies**



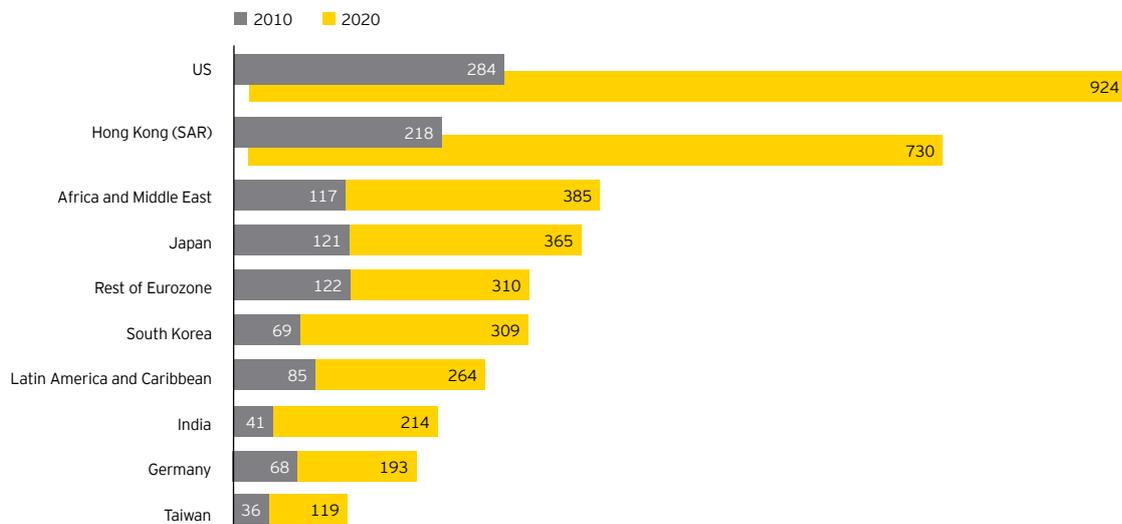
Source: Oxford Economics.  
Shown: Outward FDI, US\$3b.

**Figure 2: Annual growth in China merchandise exports outside of Asia, 2010-2020**



Source: Oxford Economics/IMF.  
Shown: Per annum percentage growth in exports.

**Figure 3: China merchandise exports, 2010-2020**

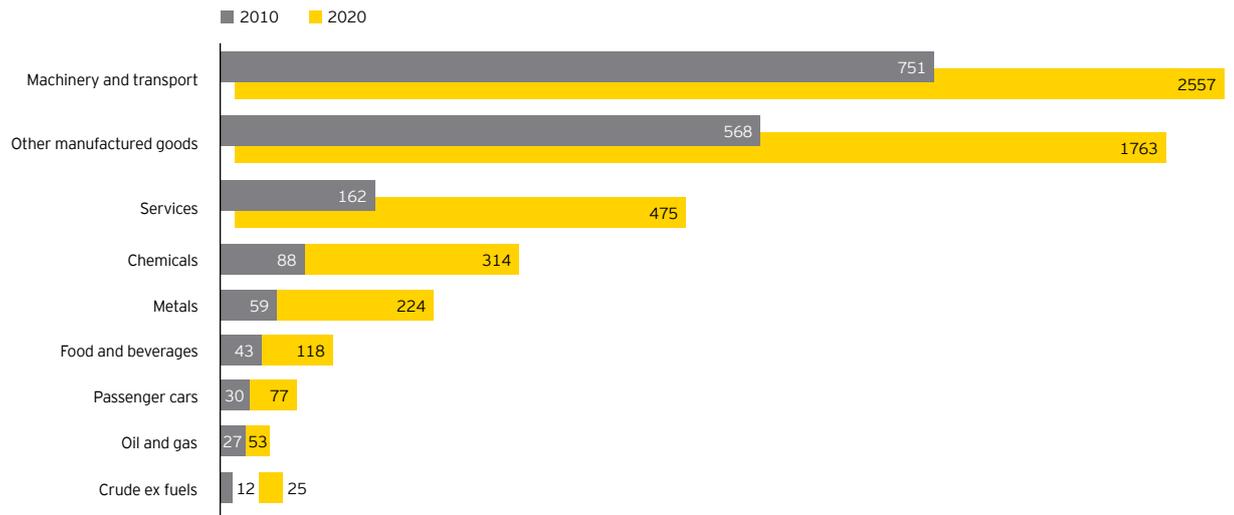


Source: Oxford Economics/UNCOMTRADE.  
Note: Value in US\$3b.

“To date the Chinese banks have been relatively domestically focused, but over the next ten to 15 years we will definitely see more international institutions very similar to the way we see Japanese institutions expand around the world.”

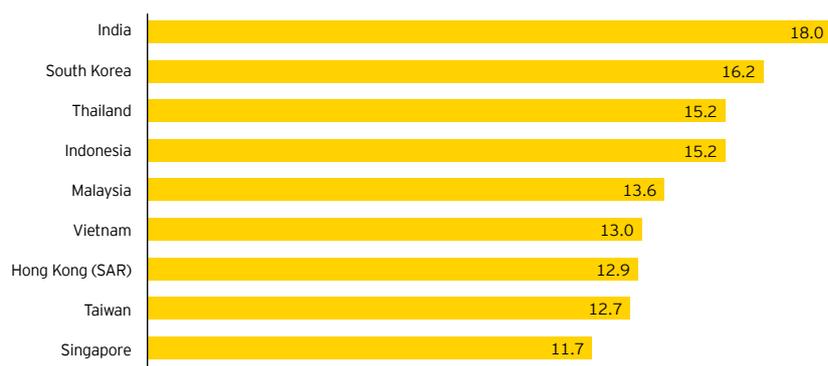
Marc Symons, Transaction Advisory Services,  
Banking & Capital Markets, Financial Services, Ernst & Young

Figure 4: China merchandise exports by sector, 2010-2020



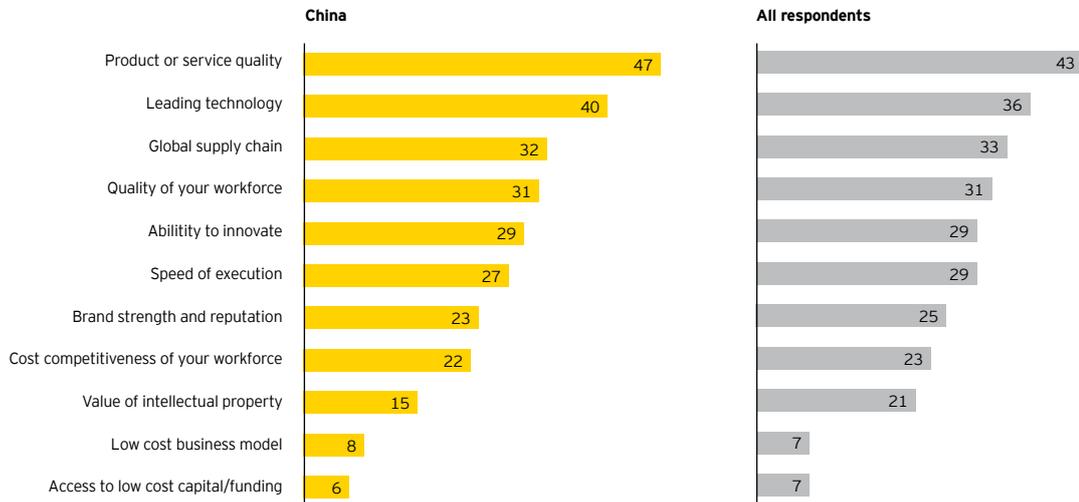
Source: Oxford Economics/UNCOMTRADE.  
Note: Value in US\$b.

Figure 5: Annual growth in China merchandise exports within Asia, 2010-2020



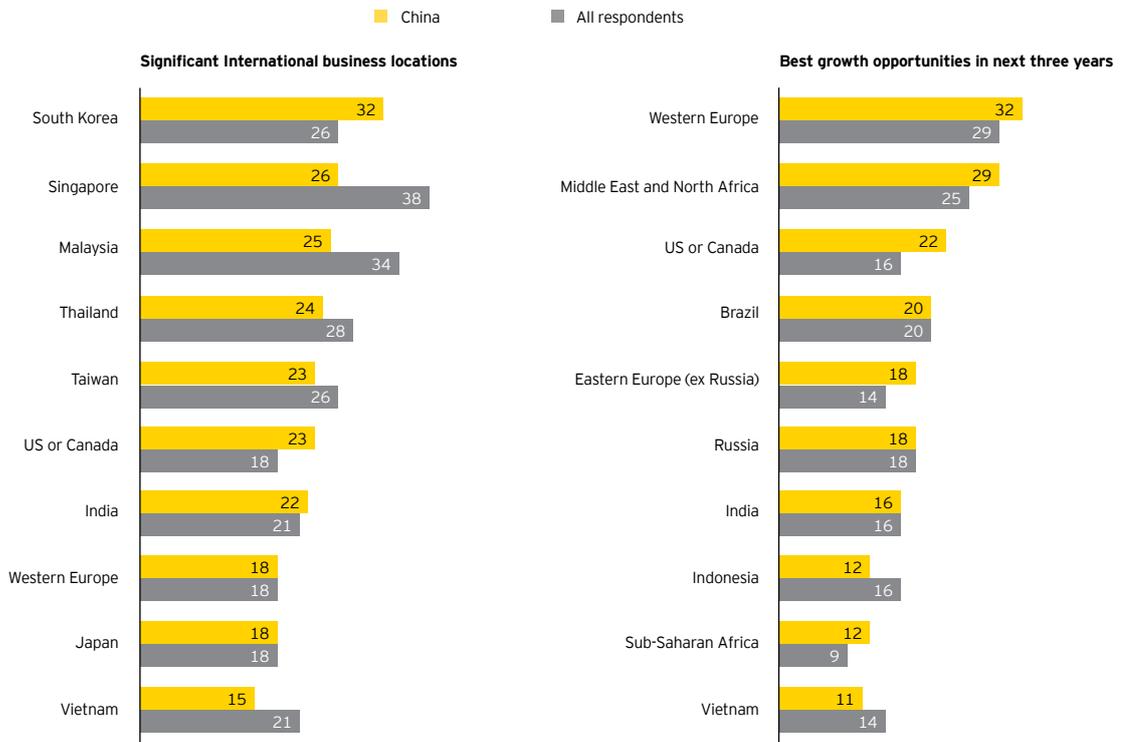
Source: Oxford Economics.  
Shown: Per annum percentage growth in exports.

**Figure 6: Chinese companies are focused on moving up the value chain**  
*What are your company's most relevant strengths and advantages as it targets international markets for sales or investment?*



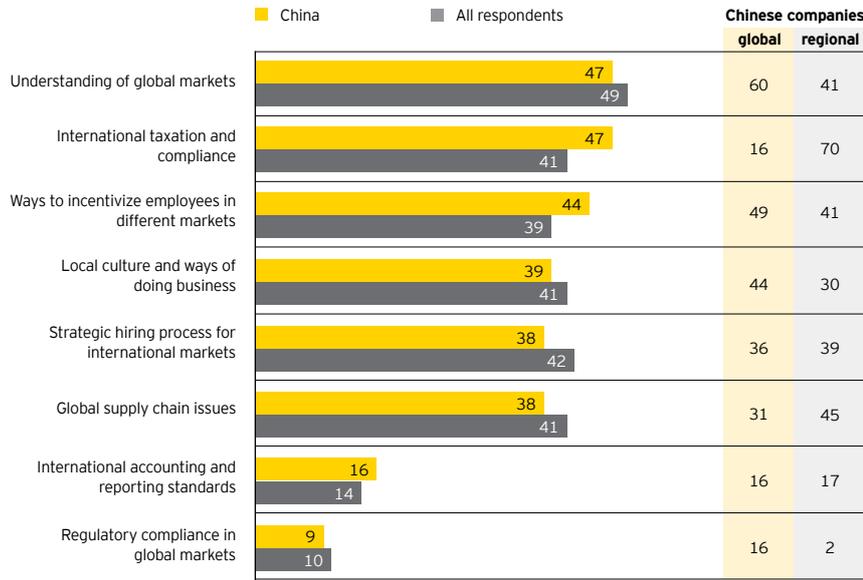
Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617).

**Figure 7: Europe is seen as a key destination for growth**  
*Which of the following countries or regions do you expect will hold the best growth opportunities for your company over the next three years?*



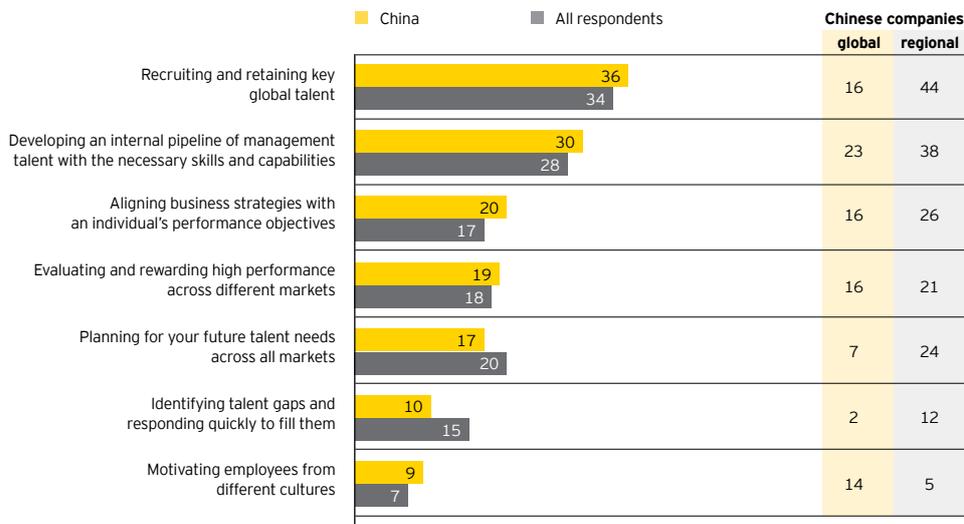
Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617).

**Figure 8: Chinese global companies need a more international perspective**  
*Where does your organization's top management team need more knowledge or insight to be successful in today's global marketplace?*



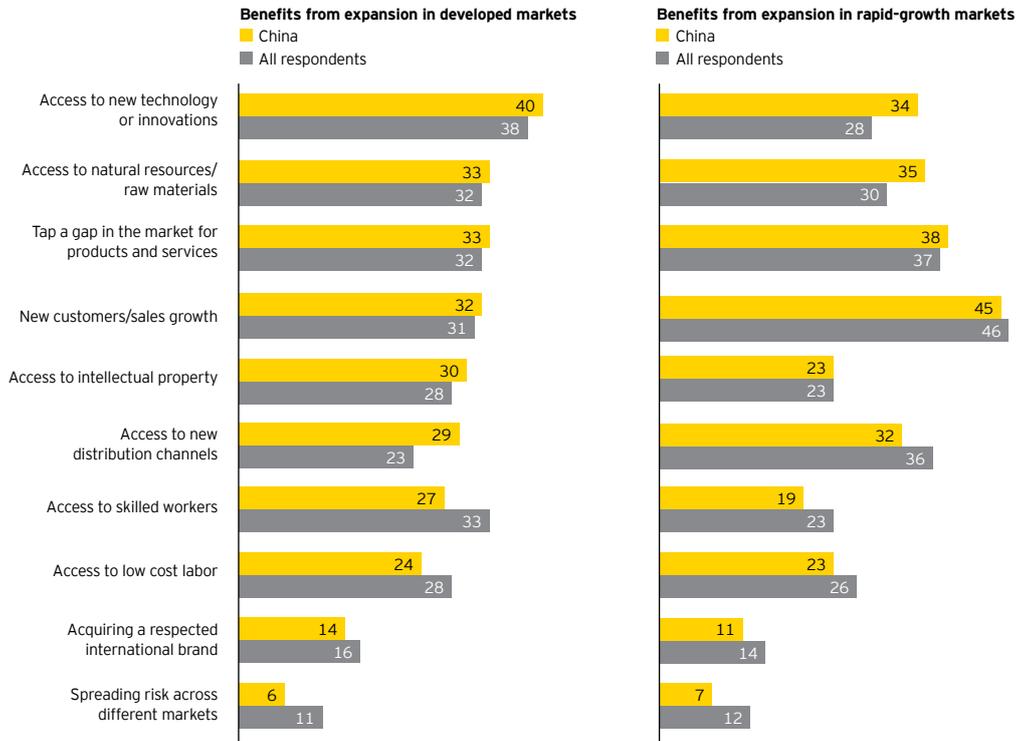
Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617), Chinese globally focused companies (45), Chinese regionally focused companies (66).

**Figure 9: Chinese global companies are not confident about their talent management**  
*How effective is your company at the following aspects of talent management?*



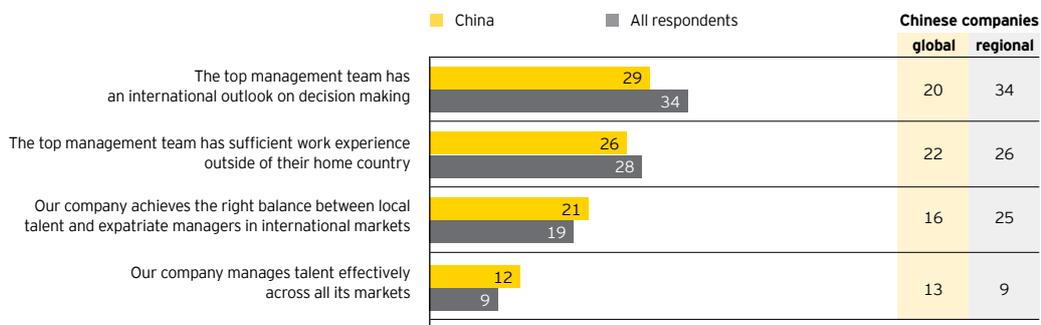
Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617), Chinese globally focused companies (45), Chinese regionally focused companies (66).

**Figure 10: Chinese regional companies are looking to overseas markets for resources**  
*What are the most important benefits you would be looking to achieve through international expansion in developed markets and rapid-growth?*



Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617).

**Figure 11: Chinese regional companies are worried about compliance abroad**  
*Do you agree or disagree that..?*



Source: Ernst & Young *Beyond Asia* survey.  
 Shown: Percentage of respondents. Base: China (146), All respondents (617), Chinese globally focused companies (45), Chinese regionally focused companies (66).

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ED None

#### Growing Beyond

In these challenging economic times, opportunities still exist for growth. In *Growing Beyond*, we're exploring how companies can best exploit these opportunities – by expanding into new markets, finding new ways to innovate and taking new approaches to talent. You'll gain practical insights into what you need to do to grow. Join the debate at [www.ey.com/growingbeyond](http://www.ey.com/growingbeyond).

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Asian companies face major challenges as they expand globally. This report explores these challenges and their business implications.