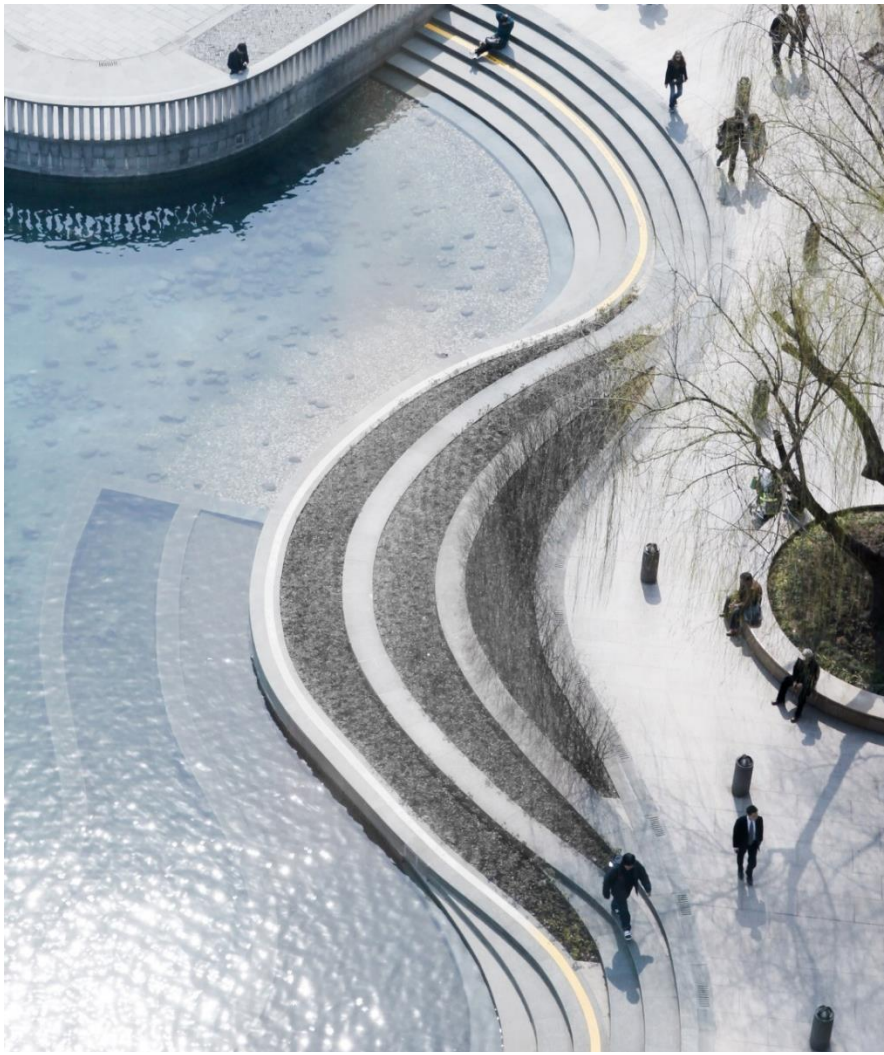
Riding on the shoulder of China's new economic strength

A private company view



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Executive Summary

The private sector is key to China's ongoing economic transformation. Since the country's economic reforms in the 1980s, private businesses have assumed a catalytic role in driving growth. The sector now contributes more than 60% of national GDP growth and employs over 80% of workers. This report sheds light on the views of private companies in Mainland China and Hong Kong in the context of business opportunities and challenges brought by the global trade environment, domestic market dynamics, as well as digital transition in the workplace.

Some of the key insights include:

35% (China Overall: 37%) of the private company executives in China reported being "very confident" about their company's prospects for revenue growth in the next 12 months, compared to 30% and 29% in 2016 and 2015 respectively.

82% of private company executives in China (China overall: 81%) reported being "more confident or just as confident" than a year ago about launching new products or services or entering a new line of business, and 59% of respondents (China overall: 57%) in China considered developing new products and services for domestic market as a top strategy for their organisation to undertake over the next three years.

Businesses are exploring new ways to stay competitive in the face of digital transformation, and even turn the tide in their favour. The percentage of private company executives "automating certain functions in their organisation" is expected to increase from 62% today to 83% in three years.

Private sector leaders in China also recognise the importance of an educated and well-trained workforce as the percentage of those willing to invest in training of workforce will increase from 30% today to 59% in three years. In addition, 44% of them will move to new structures of employment including more 'gig' talent and outsourced labour in three years compared to 28% today.

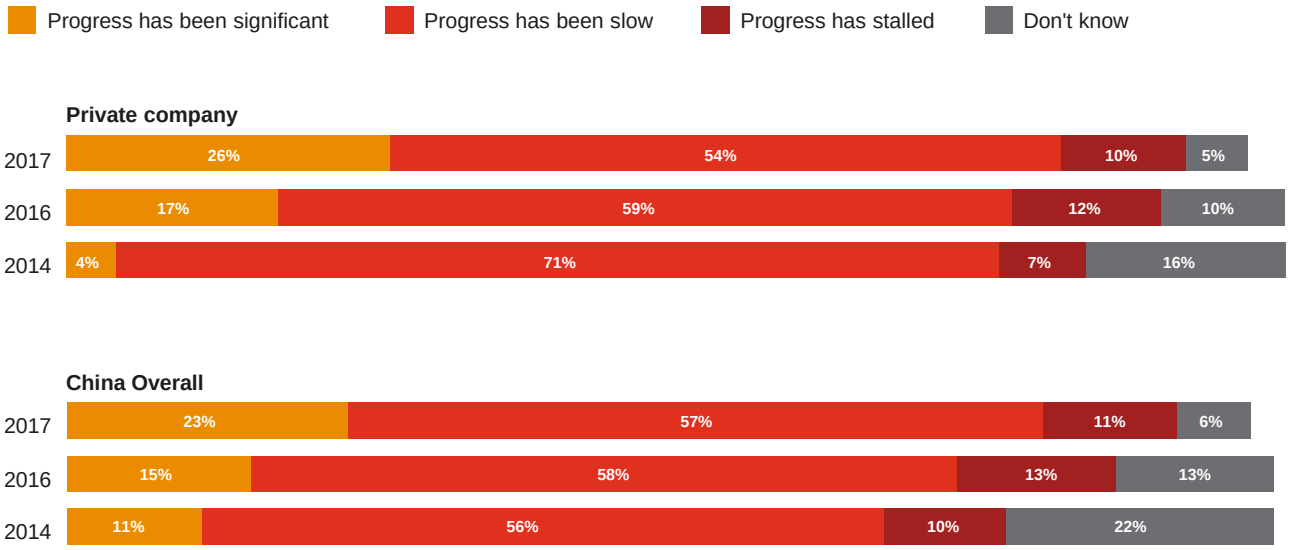
A fluid global trade orientation and the BRI initiative led by China have unveiled new investment opportunities. Survey results found that 78% of the private sector executives in China (China overall: 74%) feel "more confident or just as confident" in expanding their existing operations in Asia Pacific economies outside of China.

Greater trade openness benefiting private firms despite short-term jitters

China's enthusiasm in global trade is apparent and ever-growing, and private companies who have embraced trade openness are poised to benefit in the long term.

Although Chinese local firms are facing a more ambiguous global trade atmosphere, precipitated by escalating tension in Sino-US trade relationship in recent months, the bullishness in global trade benefiting businesses is still reflected through the private sector's perception in trade progress. When asked about the pace of progress towards free trade across the Asia Pacific region in the last 12 months, a higher proportion (26%) of Chinese private company executives assessed that progress has been significant, compared to 23% of China overall executives with the same view.

Figure 1: Higher proportion of executives in China are optimistic about trade progress in Asia Pacific, while there are fewer executives who feel that progress has been slow



Proportion won't add up to 100% as respondents who did not answer are not shown

In particular, the BRI initiatives, which have paved the road for greater connection between China and member countries through infrastructure development, will unleash unprecedented opportunities for the private sector in areas such as railways and energy – which were previously dominated by state enterprises. [1]

At the time of the survey (May to July 2017), private business leaders reported that they expect to experience the following challenges in the global trade environment in the next 12 months: the increased barriers to moving data across borders (36%; China overall: 31%), followed by employing foreign labour (31%; China overall:33%); Nevertheless they also recognise an increase in revenue opportunities due to a new trade agreement (30%; China overall:33%).

Private companies increasingly found themselves embracing for greater trade openness, and with it both market access and competition.

The trend towards greater trade openness is echoed in China's 13th Five Year Plan (FYP) emphasising on overseas collaboration and Chinese outbound investment to promote greater use of Chinese equipment, technology, standards and services in the international markets and help Chinese brands gain wider international recognition.

President Xi's address at the 19th Party Congress also announced easing market access, expansion of foreign trade, lowering entry barriers for foreign companies and protecting the legitimate rights and interests of foreign investors treating all businesses registered in China equally. Li Keqiang's government work report also confirmed the country's move towards removing foreign ownership caps on financial institutions. Therefore, we expect to see a more leveled playing field accompanied by rising competition from foreign businesses.

1. As of end of September 2017, 6,778 projects under public-private partnership (PPP) mandate entered the development stage with a total investment of about RMB 10.1 trillion, of which 2,388 projects have been carried out with total investment of RMB 4.1 trillion.[i] China has become the largest and most influential PPP market in the world. The Chinese government has spearheaded initiatives aimed at ensuring reasonable returns for private investment in public-private partnership (PPP) projects, as well as improving credit rating mechanism for easy access to loan.

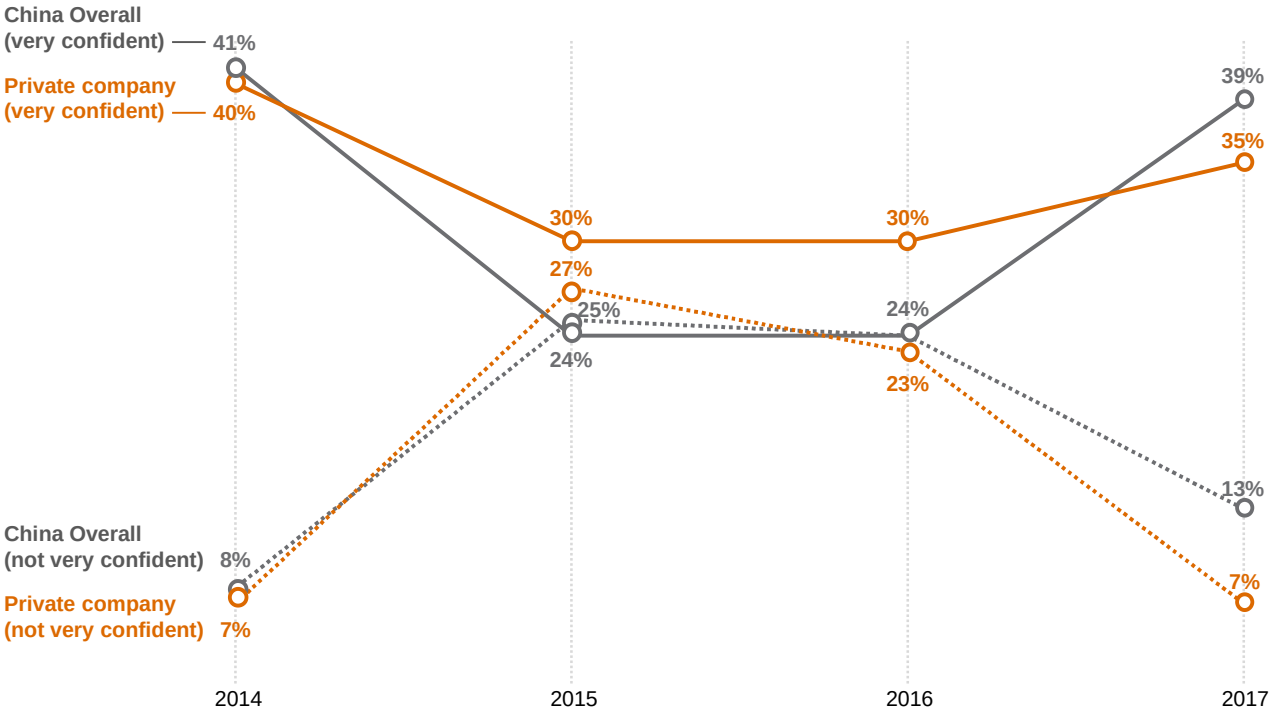
Business outlook, growth sectors, and strategies to drive competitiveness

The ecosystem of start-ups and small and medium enterprises are at the forefront of the country's economic transformation from manufacturing and fixed asset investments, towards domestic consumption, services, and innovation.

In fact, the fastest-growing companies in China over the last few decades have arguably been the entrepreneurial firms in the private sector. According to tech-sector funding research company CB Insights, China is now home to 70 unicorns – unlisted companies with valuation of 1 billion or more – quickly becoming world's second largest in ranking only after the US.[ii] New-born Chinese unicorns, the likes of Jinri Toutiao, United Imaging Healthcare, and NIO, have benefited from a more mature startup ecosystem funded and nurtured by Chinese venture capital and tech giants.

The private sector is prudently optimistic about the commercial environment. PwC's *2017 APEC CEO Survey* found that 35% of private company executives in China are "very confident" about their company's prospects for revenue growth in the next 12 months, lower than 39% of China executives with the same view. However it is still a considerable upswing of business sentiment compared to 2016 (30%: very confident) and 2015 (30%: very confident).

Figure 2: Percentage of executives who are "very confident" about their company's prospects for revenue growth in the next 12 months



From the sectoral perspective, more than 49% of business leaders from the financial services sector estimate the industry will grow by 8% or more per annum over the next 3 years, outpacing the country's GDP growth, followed by 30% of business leaders in the consumer and retail sector and 23% in the industrial sector who share the same prediction about their industry growth (i.e. 8% or more per annum over the next 3 years).[2]

To drive their growth strategy, 82% of private company executives in China were "just as confident or more confident" about launching a new product or service or entering a new line of business, 78% were confident about expanding operations in Asia Pacific economies and 68% were confident about securing the talent and skills needed to perform globally. The sentiment of private firms towards these strategies is consistent with that of the overall sample.

However, there was a decline in the proportion of private company executives in China feeling "more confident" about forecasting compliance costs and tax liabilities from 16% in 2014 to 9% in 2017.

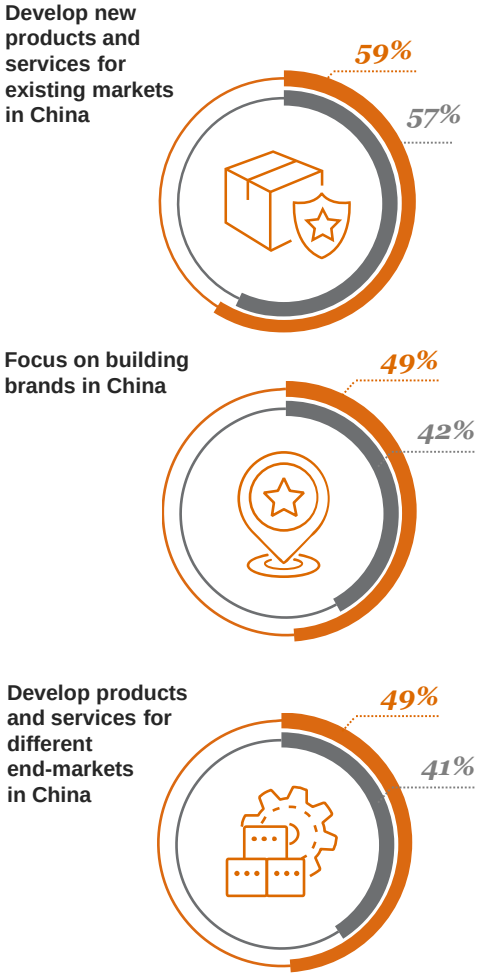
The Chinese leadership is aware of this challenge and trying to ease the cost of doing business for private firms. Recently it extended the value-added tax exemption policy for three more years targeted at companies with monthly sales revenue of less than 30,000 yuan (US$4,520). The State Council also cut reserve requirement ratios for commercial banks and it will strengthen financing guarantee agencies – following the establishment of a national loans guarantee fund – to help small businesses obtain loans at a lower cost.

China will continue to streamline administrative approvals and cut red tape to improve business environment. A pilot reform will be carried out in Shanghai's Pudong New Area to cut or simplify another 47 approval items. Earlier, China's free trade zones have separated operation permits from business licenses and cleared 116 approval items, according to statement released by State Council in January.[iii] These efforts are being recognised as China climbed up the rankings to 78th place in ease of doing business, according to a 2017 report by the World Bank, up from the 96th place in 2013.

Given greater complexity – and unpredictability in certain aspects – of the commercial environment, private business executives are reorganising themselves to navigate into new growth frontier.

Considering the optimistic outlook for domestic demand in China, 59% of private business executives (China overall: 57%) consider developing new products and services for existing markets in China as a top strategy for their organisation to undertake over the next three years. 49% respondents (China overall: 41%) plan to adopt market expansion strategy to sell products and services to different end-markets, while the same proportion (China overall: 42%) considered building their brand in China a top strategy.

Figure 3: Percentage of executives who are pursuing the following strategies in the next 3 years to tap into growth opportunities in China



The urge for growth of private companies beyond national borders has increased. The proportion of private company executives in China feeling "more confident" than a year ago in increasing profit margins in international operations, recovered from 17% in 2016 to 23% in 2017. It is worthwhile to note that there is considerable jump in the proportion of private companies (34%) planning to diversify outside of China than seen in the previous year (27%), a sign that the private sector is willing and ready to deploy resources to expand internationally and to diversify business risks associated with their domestic portfolio.

2. In particular, FinTech was identified as one of the focused areas to generate momentum for Hong Kong's economic development and raise its competiveness, as outlined in the city's Smart City Blueprint released last December 2017. A new alliance under a public-private partnership (PPP) - comprising of Cyberport, the Smart City Consortium (SCC) and IBM China/Hong Kong - was set up in January 2018 to help support local start-ups in the FinTech sector.

PwC's 2017 Global FinTech survey has found that the expansion of products and services, increased customer base, and leveraging of existing data and analytics are top three opportunities arising from the rapid development of the flourishing Fintech space in China. Meanwhile, Chinese financial institutions regard themselves as amenable to disruption, and are keen to adopt emerging technologies such as data analytics, artificial intelligence (AI), mobile technologies, robotic process automation (RPA) and Blockchain.

Private firms to seek new opportunities and diversify risk across borders

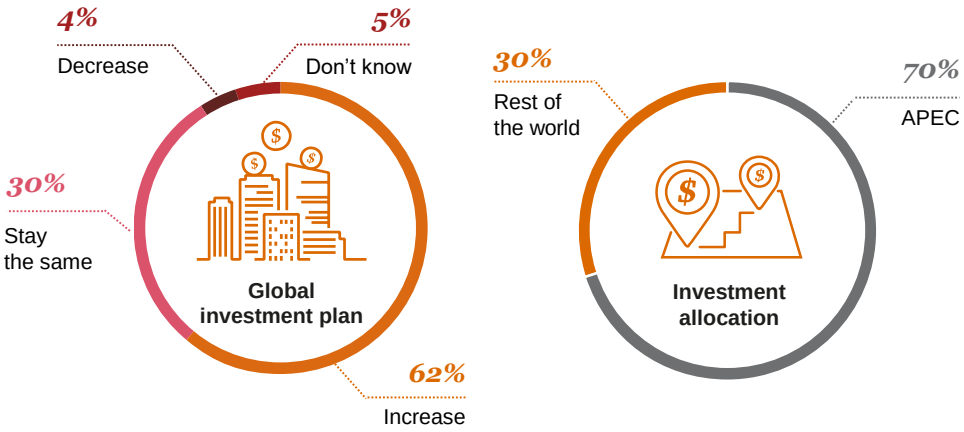
China's M&A activity in 2017 was down by 11% to US$671bn in valuation terms compared to the record highs of 2016, partly due to a reduction in mega deals reflecting the tightening and rationalisation of outbound activities by government authorities.

Looking forward, some increase in M&A activity shall be expected in 2018, bringing the level close to – or possibly exceeding – 2016. With greater policy clarity, outbound M&A is expected to resume its growth trend, according to PwC's M&A 2017 Review and 2018 Outlook.

Nevertheless, the private sector demonstrates greater readiness towards expanding their global footprints via outbound investment. There has been an increase in the proportion of private company executives who said they plan to increase their global investments in the next 12 months from 57% in 2016 to 62% in 2017, exceeding the level of enthusiasm shown of their China overall counterparts in three consecutive years, according to PwC's 2017 APEC CEO Survey.

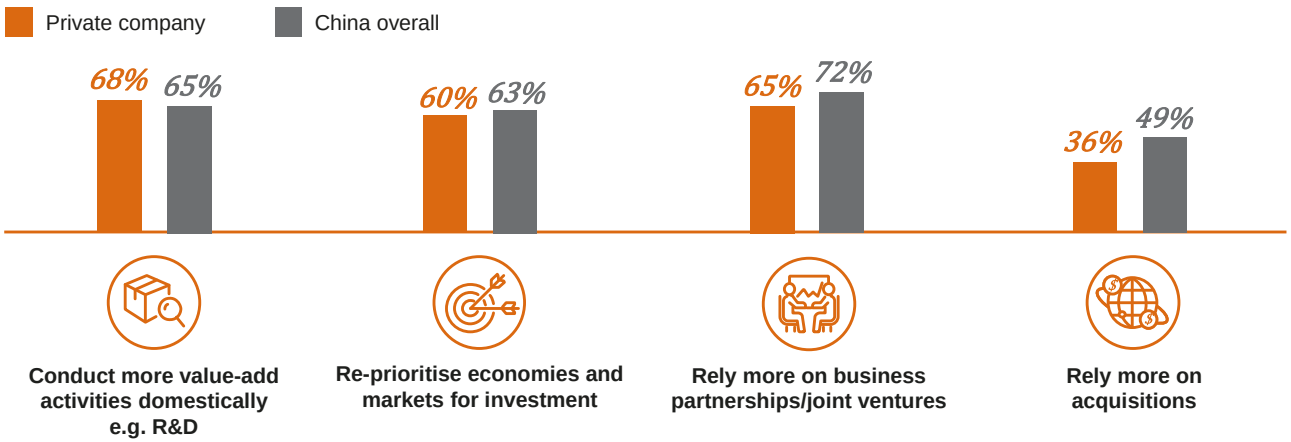
APEC economies are attracting a significant share of that new investment. 70% of them are planning to invest in APEC region and 30% in rest of the world, sharing the same investment intent as their China counterparts.

Figure 4: Future investment intents and allocation of new investment to APEC and Rest of the World, by private company executives



To drive their competiveness beyond national borders , 68% of the private company executives in China (China overall: 65%) said they conduct, to a “great extent” or “some extent” more value-add activities domestically such as R&D to secure growth in overseas markets; 65% of private company executives surveyed in China (China overall: 72%) said they rely, to a “great extent” or “some extent”, on business partnerships/joint ventures to secure growth in overseas markets; Moreover, 60% said they re-prioritise, to a “great extent” or “some extent” economies and markets for investment to secure growth in overseas markets, while 63% of their China counterparts said the same.

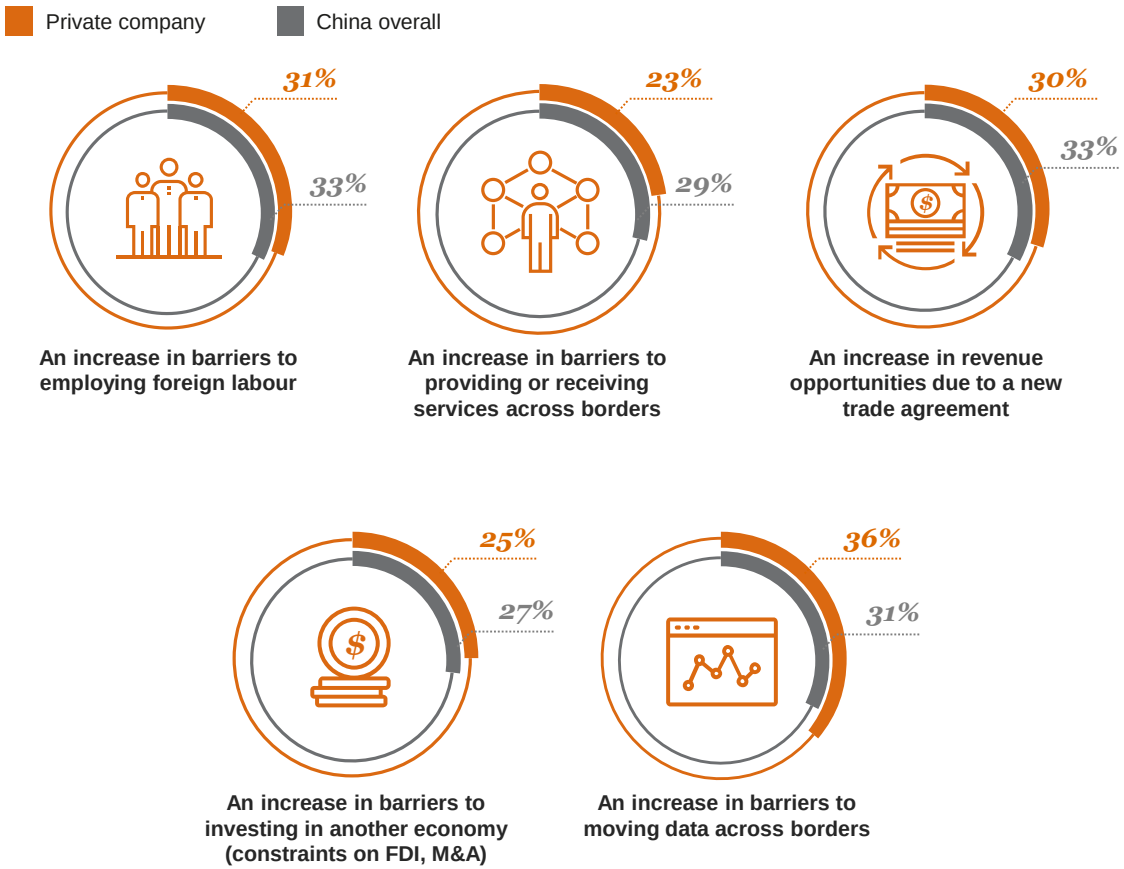
Figure 5: Percentage of executives who will rely, to some or a great extent, on the following strategies to secure growth in overseas markets



While 49% of the executives surveyed in China rely more on acquisitions to a "great extent" or "some extent" to secure growth in overseas markets, only 36% of private company executives reported the same. Adding to that, 25% of private company executives in China said that they expected to experience increased constraints on overseas direct investment (ODI) and M&A to invest in another economy in the next 12 months – considerably higher than those (19%) who said they encountered such barrier in the past 12 months.[3]

Apart from perceived difficulty in outbound investments, private firms also face obstacles in cross border data flow. 36% of private company executives in China anticipated an increase in barriers to moving data across borders in the coming year compared to overall average of 31%.

Figure 6: Percentage of executives in China who expect to experience the following in the global trade environment in the next 12 months



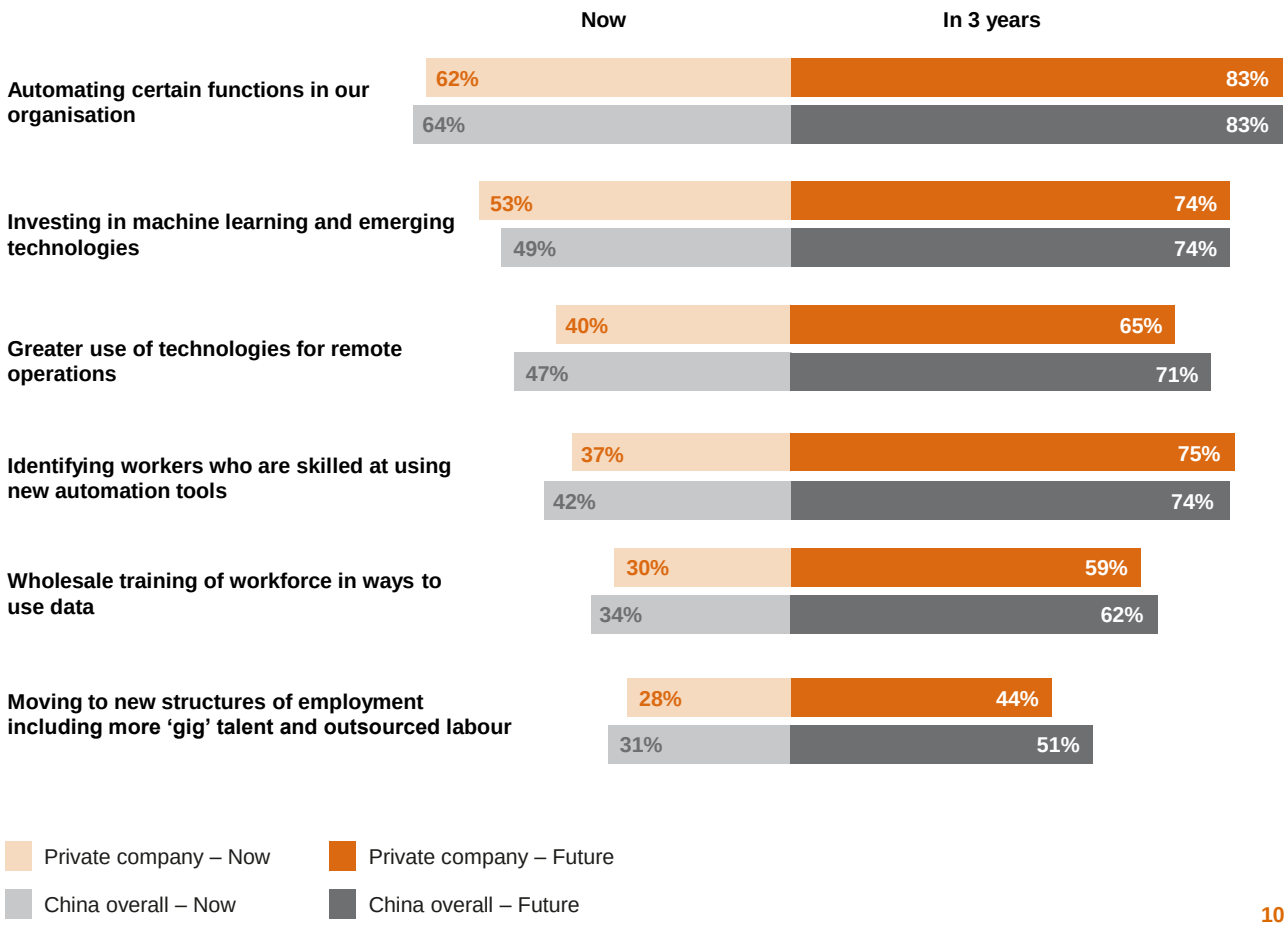
3. This can be partly explained by the Chinese government's continued stance in curbing speculative overseas investment in overheated sectors such as real estate, hotels, entertainment, sports clubs, and movie industries - as a means to restrict capital outflow and ease pressure off the Chinese yuan. Although, overseas investments in long term projects aligned with State's directives are still being encouraged and supported in 'Belt and Road' countries.

Staying relevant in the age of automation and workplace digitisation

AI, robotics, and automation are not only changing products and services but also transforming the workplace. Smart manufacturing and digital transformation are key components of the Made in China 2025 strategic mandate, and automation is the first step in raising productivity for Chinese businesses, both in manufacturing and services.

According to PwC's 2017 APEC CEO Survey, the percentage of private company executives in China "automating certain functions in their organisation" will increase from 62% today to 83% in three years (China overall: 64% today vs 83% in three years). Currently, 53% of private company executives in China (China overall: 49%) are "investing in machine learning and emerging technologies" and in the next three years, that proportion will rise to 74% (China overall: 74%).

Figure 7: Percentage of executives in China who will adjust their workforce strategies in the next 3 years to adapt to and profit in the digital age



The pace of automation aimed at optimising the production process is accelerating in the private sector. For example, Ash Cloud, a private manufacturer of affordable mobile phone plastic cases, has widely adopted cameras and sensors in its production plant in Shenzhen to track real time manufacturing data. Combined with sophisticated cost control, this practice has empowered the firm to stay competitive on profit margins.[iv]

In Dongguan city where automation is strongly encouraged as part of the local government's strategy to upgrade manufacturing, mobile phone producer Changying Precision Technology has recently replaced up to 90% of its human workforce with machines and robots, and reported a staggering 250% improvement in productivity and a significant 80% drop in defects. [v]

On the service front, online retailer JD.com has opened up its first fully unmanned and automated supermarket in Beijing in Dec 2017, effectively connecting the virtual customer and product data, and offline brick-and-mortar experience through its new retail model. [vi]

The proportion of private company executives in China "identifying workers who are skilled at using new automation tools" is expected to increase from 37% (China overall: 42%) today to 75% (China overall: 74%) in three years. While 40% (China overall: 47%) of private company executives surveyed in China are adopting "greater use of technologies for remote operations" today, 65% (China overall: 71%) of them will be adopting the same in three years. Those willing to invest in wholesale training of workforce in ways to use data will increase from 30% (China overall: 34%) today to 59% (China overall: 62%) in three years.

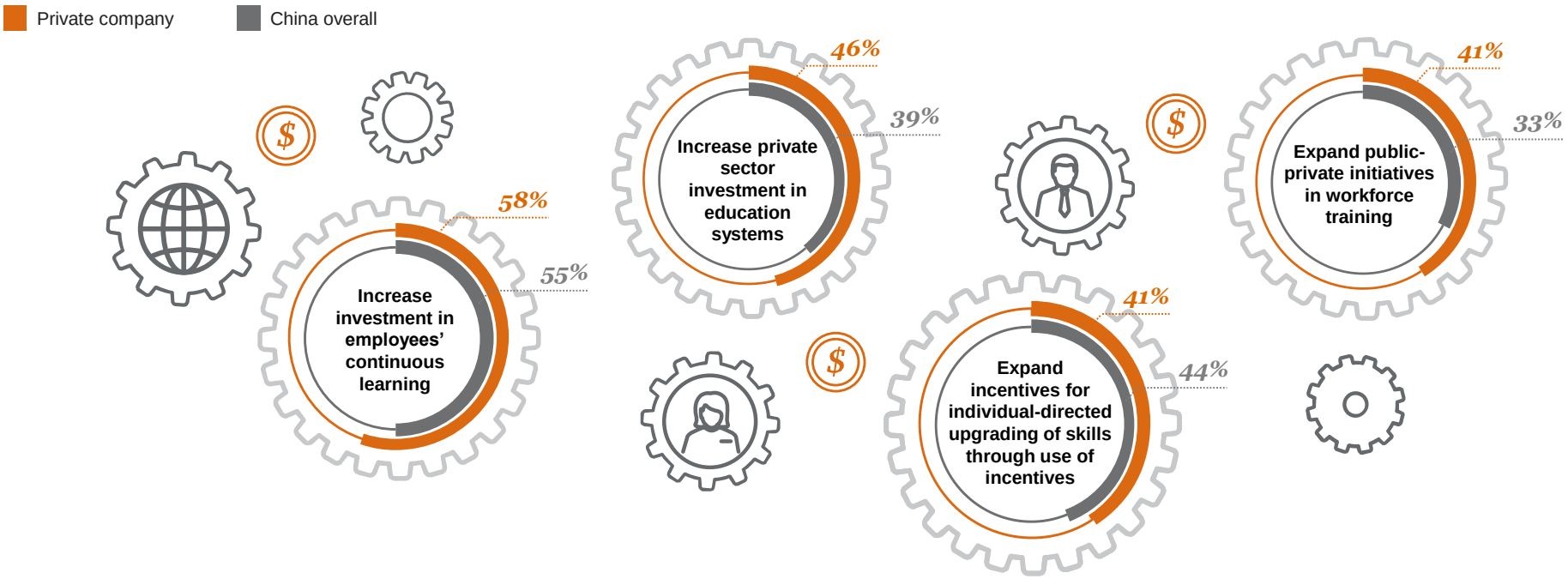
Executives are also exploring new employment structures. About 44% (China overall: 51%) of private company executives in China expect to move to new structures of employment including more 'gig' talent and outsourced labour in three years from 28% (China overall: 31%) of the executives today.

In fact, enterprise's need for greater agility and flexibility to respond to changing market conditions has given rise to the gig economy, characterised by short term contracts and freelance work. It has grown in popularity as alternative solution for skill sourcing, and has benefited companies like WeWork and Naked Hub who have taken advantage of the demand for co-working space driven by rapidly-growing number of start-ups in China.

To help workers adapt to an era of greater automation and jobs rebalancing, 58% of private company executives (China overall:55%) recognise that increasing business investment in employees' continuous learning is the most effective way. Increasing private sector investment in education systems (46%; China overall: 39%), expanding incentives for individual-directed upgrading of skills (41%; China overall: 44%), as well as expanding public-private initiatives in workforce training (41%; China overall: 33%) are the other ways that can help workers to retool and reskill.[4]

4. China's 13th Five-Year Plan aims to modernise the entire education system in a bid to prepare its young population for the digital workplace. One of the primary emphases is on the growth of online education. The Chinese government invested a record $1.07 billion in EdTech startups in 2015 alone, with a further investment of an overall $30 billion in EdTech by 2020. It is also working to provide all K-12 schools with resources to upgrade their IT systems and create an overall student to computer ratio of 6:1 in the next three years.

Figure 8: Jobs reskilling, continuous learning, and new employment structures are key to developing the workforce of the future



Conclusion

While the private companies in China are confident and competitive, there are undoubtedly significant challenges ahead. Outcome of the 19th Party Congress in October 2017 has reiterated China's intentions to expand foreign trade, lower entry barriers for foreign companies, spur innovation driven growth – which means startups and private firms - with their innate agility and entrepreneurship - are now in better position to compete effectively with multinationals.

It is reasonable to foresee that with the recent proactive reforms announced on boosting the private sector's competitiveness, and with better implementation, there will be real improvement in the business climate for companies, both domestically and internationally.

Methodology

The eighth edition of PwC's 2017 APEC CEO Survey explores the theme of "A World in Transition". We surveyed more than 1,400 business leaders in 21 APEC economies between May and July 2017 for the PwC's 2017 APEC CEO Survey. This report is based on the views of 81 private sector leaders from Mainland China and Hong Kong.

For the purposes of this report, "China" refers to the People's Republic of China, including Hong Kong survey respondents. "Private companies" are defined as business firms operating in the private non-public sector of an economy, with shares controlled by private individuals and not offered to the public. They can exist in many forms including family business, sole proprietorship, limited partnership, and limited liability corporations, and so on.

The main sectors in the private company sample were Industrial Products (35%), Consumer and Retail (27%), Financial Services (9%), Technology (12%) and Professional Services (10%).

In terms of revenue composition, 33% of the overall sample companies earned up to USD 100 million; 26% of the overall sample firms earned between USD 100 million – USD 500 million; 7% of the overall sample earned between USD 500 million – USD I billion; 23% of the overall sample earned between USD 1 billion – USD 10 billion; 7% of the overall sample firms earned greater than USD 10 billion.

Figure 9: Distribution of China sample by sector, 2017

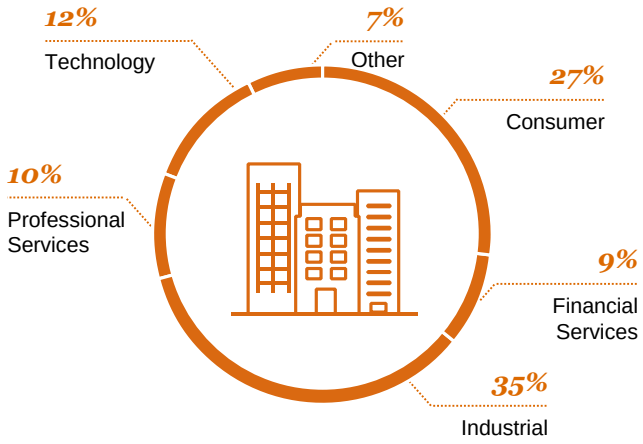
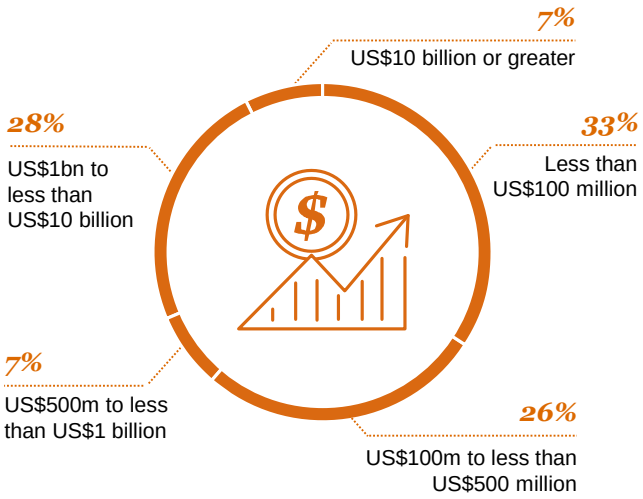


Figure 10: Distribution of China sample by firm revenue, 2017



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