Coping with the global economic slowdown

A survey of China's leading entrepreneurs
An annual event in the business community, the Ernst & Young Entrepreneur Of The Year China awards program is in its sixth year. In addition to recognizing the extraordinary achievements of Chinese entrepreneurs, we wish for the Ernst & Young Entrepreneur Of The Year awards to bring together the great insights of these entrepreneurs to find new ways to stand out in a challenging market environment.

We have recorded in this white paper the ideas of 100 well known private business leaders and a number of the past winners of the Entrepreneur Of The Year China awards. These entrepreneurs have shared their valuable thoughts and experiences regarding business positioning, human capital, investment consideration and industry policy.

In the shadow of the global economic slowdown, it's a good sign to see that the majority of the entrepreneurs surveyed are cautiously optimistic about the future. There are problems to be tackled, such as the pending resolution of Europe's debt crisis, rising operating costs, and limited access to financing. These are real and pressing challenges. However, it's always true in the business world that a crisis can be turned into an opportunity. The theme of this year's Ernst & Young Entrepreneur of the Year China awards program was “Achieving Growth Through Innovation”. Businesses should embrace innovation whether in good times or bad, just like those award-winning entrepreneurs who have demonstrated entrepreneurial vitality in their ongoing efforts to achieve outstanding performance.

I am particularly grateful to the Cheung Kong Graduate School Of Business (CKGSB) for their great support to this year’s Ernst & Young Entrepreneur of the Year China awards program. Both Ernst & Young and CKGSB value entrepreneurship. We are reliable professional advisors of many successful entrepreneurs. We do what we can to encourage entrepreneurs to become the global business leaders of tomorrow.

The purpose of this white paper is to inspire our readers by providing an overview of how successful entrepreneurs think and do. Your opinions and comments would be greatly appreciated.
2011 marks the tenth year of China's accession into the WTO. In a global business environment where changes, strategy redefinition and innovation are inevitable, for those Chinese enterprises pursuing globalization and sustainable growth, what's the right way to go? At the end of 2011, CKGSB joined Ernst & Young in a survey of 100 top business leaders in China, hoping to find out the latest developments and ideas in China's business community. The goal is to share strategic thinking and approaches to cope with the global economic slowdown from business visionaries in various sectors.

A slowdown is a state or process rather than an outcome. I hope this report will give rise to more serious thinking among leading entrepreneurs as to how to build lasting success driven by innovation, globalization and accountability. China is in a critical stage of economic transition and modernization. Chinese entrepreneurs need to focus on self-improvement as well as corporate social responsibility in order to win respect and play a greater role in the game. It's important to understand how wealth cycles work in the wealth creation process. Entrepreneurs should work together to create successful business establishments and build China's new business culture in an enlightened manner.

Vision, Strategy and Competence: As one of the leading business schools in China, CKGSB's mission is to create and disseminate world-class insights on management theory and practice and to develop leaders for a new era of global business in China and beyond. We continue to inspire innovative thinking and shape new ideas and values to guide the globalization process of Chinese enterprises. We encourage proactive thinking and decisive action of entrepreneurs in making their own business dreams come true in an era of global change.

Again, I would like to thank you for participation. Let's work together for a growing economy and thriving businesses in 2012!
Coping with the global economic slowdown

With the sovereign debt crisis in Europe continuing to deepen, the impact of the global economic slowdown is increasingly felt. In December 2011, China’s top leaders met for the Central Economic Work Conference – considered a bellwether for the Chinese economy. The leaders predicted that for 2012, in light of the global challenges, instabilities and uncertainties, it will be difficult for the Chinese economy to entirely escape the effects of the global economic slowdown.

Past experience shows that market leaders tend to identify opportunities and strengthen their competitive advantage in economic downturns. The questions are: how private businesses – the backbone of the Chinese economy – plan to cope with the global slowdown; what challenges and opportunities they are facing; how to develop strategy and improve operation; and what’s the role of the government in this process?

We wanted to exchange ideas with China’s leading private entrepreneurs to find out their answers to these questions. For this purpose, Ernst & Young and Cheung Kong Graduate School of Business (CKGSB) jointly held the first Entrepreneur Of The Year (EOY) Academy roundtable on November 4, 2011 and the first Chinese CEO Survey was kicked off in December. The survey was designed for 100 top private entrepreneurs in China, including 2006-2011 EOY winners and finalists, CEOs of the most promising companies and the students of CKGSB’s CEO class. The roundtable conference was presided over by Prof. Liu Jing, a CKGSB Associate Dean, and more than 30 EOY winners and judges were present.

This report is based on the information gathered from the survey and the roundtable discussion. We would like to thank the respondents for sharing their valuable time and insights. We are looking forward to further exploring the ways to cope with the global economic slowdown.
Challenges in the global economic slowdown

The deepening debt crisis in the Eurozone has given rise to a systemic risk in global capital markets. The Eurozone manufacturing PMI fell to 46.4 in November - the lowest since July 2009. In the United States, despite the November PMI rising to a 7-month high, core demand is weak and the future remains uncertain. In Japan, the November PMI recorded the lowest index reading of 49.1 since April, with a bleak economic outlook, highlighting high levels of unemployment and fluctuations in consumer spending.

The Chinese PMI dropped below the threshold value to a 32-month low of 47.7 in November, indicating a slowdown in China’s manufacturing sector and signaling a contraction in manufacturing activities. Although domestic inflationary pressures have eased, fixed asset investment seems to be losing momentum, local debt risks could increase and the issues in SME financing remain unsolved.

However, survey responses show that a majority of the leading private enterprises in China have managed to maintain growth momentum in 2011 amidst global economic turbulence. 67% of respondents report an increase in operating profit and 33% report no change or a decrease in operating profit in the last 12 months (fig.1). Most of the respondents have experienced significant (35%) or modest (47%) increase in demand for their products while 20% report no change or a decline (fig.2). Listed and non-listed companies show similar growth trends in operating profit and product demand (fig.3 and fig.4).

Fig. 1: What change has there been in your operating profit over the past 12 months?

Fig. 2: What change has there been in the demand for your products over the past 12 months?

Fig. 3: Comparison of operating profit over the past 12 months between listed and non-listed companies

Fig. 4: Comparison of product demand over the past 12 months between listed and non-listed companies
Most respondents are cautiously optimistic about a significant (28%) or slight (51%) improvement in business over the next 12 months. But 21% of respondents expect no improvement or even deterioration over the same period (fig.5). In particular, 77% of the listed companies are positive about some improvement over the next 12 months and 80% of the non-listed companies feel the same way (fig.6).

Although the fundamentals of most respondents’ businesses remain healthy, challenges are on the rise. Of particular note are intensified competition and rising costs. 23% of the entrepreneurs surveyed consider strong competition as a major challenge while 22% and 17% respectively believe labor costs and material costs are the key issues in running a business (fig.7).

“Food safety is now a widespread concern in the community and the production cost is increasing to ensure food quality,” said Mr. Liu Yonghao, President of New Hope Group, in the roundtable discussion. “In addition, the prices of raw materials are going up, leading to a rise in our overall costs.”

> Encouraging innovation and reducing cost - that’s what we do to tide over the crisis.

Cao Dewang
Chairman, Fuyao Glass Industry Group

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1 Source: Markit Eurozone PMI
2 Source: The U.S. Manufacturing ISM report
3 Source: Markit / Jmma Japan Manufacturing PMI
4 Source: The HSBC Manufacturing PMI for China
Strategic positioning: Is a change necessary?

All the roundtable participants agree that, in the context of global economic slowdown, a business’s core competency is of top priority. In our survey, 20% of the respondents deem the current strategic position as a core advantage while 17% consider innovation and brand building as their core advantages (fig.8).

“This is not a good time for redefining the strategic position, although it would be helpful to do some tactical adjustment,” said Mr. Yao Gongda, Chief Executive Officer of Daqo New Energy, expressing his opinion on how to cope with the economic slowdown. “M&A opportunities emerge in an economic crisis and you can’t be too prudent before making any move.” Mr. Hugo Shong, Founding General Partner of IDG Capital Partners, agreed that tactical adjustment was the right way to go in the downturn. “A big picture is important. Set your eyes on the international market and start to build an international brand instead of concentrating on the domestic market,” said Mr. Shong. “The business strategy is not Play-Doh. Think outside the box and do something from a tactical perspective. A better opportunity will come up.”

However, an unchanging strategic position is not the answer to every problem. Whether a change is necessary depends on one’s resources, capabilities and conditions. One-size-fits-all does not apply here. For instance, at New Hope Group, business transformation has not been impeded by the downturn. Over the years, the company, as one of China’s largest feed manufacturers, has been planning a transformation into a technology-driven agricultural conglomerate. In addition to introducing state-of-the-art breeding techniques, Mr. Liu Yonghao has formed marketing and technical service entities for the farmers. A technical support team of about 10,000 employees is in place. “From a pilot program to a large-scale transformation, products are creating more and more value and the industry chain is extended,” said Mr. Liu. “No matter how successful you have been, you need to find the way out.”

Entrepreneurs believe that strategic positioning is the cornerstone of corporate strategy, something that can stand the test of time even in a changing environment. 94% of the respondents reported no change or a slight change in their business models over the past 12 months. 82% expect no change or a slight change in their business models over the next 12 months. Only 18% anticipate significant change (fig.9).
Besides understanding the big picture, optimizing operations is essential to coping with the global economic slowdown. According to Mr. Cao Dewang, Chairman of Fuyao Glass Industry Group, the company has never cut back its investment on operational improvement despite the global financial crisis in recent years. “We saw a global economic crisis coming and took action in 2007. Loss-making plants were closed and innovative and cost-saving measures were introduced,” said Mr. Cao. “In addition, we re-identified inventory limits. That’s what we did to tide over the crisis.” In the early stage of the financial crisis, he shut down four plants in the red at a loss of nearly RMB 600 million to receive a streamlined production structure and enhanced profitability. Meanwhile, innovative ideas from the employees helped reduce sales costs by 23%.

Human resources are critical to coping with the economic slowdown, too. In our survey, 20% of the respondents find it a major operational challenge to get the right people in key seats (fig. 7). Entrepreneurs emphasize the importance of maintaining a stable management team in the slowdown. “It’s understandable that employees may not get big raises in a downturn,” said Mr. Vincent Lo, Chairman of Shui On Group. “However, it’s important to retain the key employees because a high-performance team is the hope of a sustainable business.” Second, an appraisal mechanism shall be in place for employee motivation. “My experience tells me rules and regulations are inadequate,” said Mr. Cao Dewang. “Performance should be evaluated and rewarded systematically.” Third, the channels of communication between management and employees should be provided to facilitate internal communication. “Internal communication is a core element of corporate culture,” said Mr. Thomas Woo, President of City Super Group. “Without an effective internal communication mechanism, the decisions of management may fail to get understood and supported by the employees, resulting in waste of time and energy and making it difficult to get what we want.”

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Vincent Lo
Chairman, Shui On Group
Our survey reveals that 7% of the entrepreneurs find their access to debt financing or equity financing very limited (fig.7). Meanwhile, there is an increasing demand for capital expenditures. 73% of the respondents have experienced an increase in capital spending over the past 12 months (fig.10). In view of this, it is critical to maintain a healthy cash flow. Mr. Vincent Lo pointed out that after the bankruptcy of Lehman Brothers, many companies got in trouble due to their cash flow problems. Therefore, businesses should prepare for the worst by keeping the liquidity risks under control.

As for investment, most entrepreneurs are in favor of a prudent strategy. Mr. Woo argued that investments should be selective in order to strengthen core advantages. “In a market downturn, it makes good sense to prioritize investment plans,” said Mr. Woo. “We need to take a look inside. What are our core values? Can we create value for our customers? Then, strategic plans will be developed accordingly.”

Mr. Ren Yuanlin, Chairman of Yangzijiang Shipbuilding Group, suggested prudence in making cross-sector investment decisions. “There are two ground rules of M&A, i.e. building profitability of the core business and fueling future growth,” said Mr. Ren. “Think it through before making a cross-sector M&A decision. Your company could end up in crisis due to an acquisition or merger in a sector that you know nothing about.” However, if the M&A opportunity comes from the sector that the company is operating in, Mr. Ren would, “seize the opportunity before it was too late”, provided that the acquisition / merger could fuel the company’s future growth. In 2009, he successfully acquired a stake in a Singapore-listed shipbuilding company. The total consideration for the acquisition was twice the investee’s net assets. The deal had been deemed disadvantageous. However, Mr. Ren was positive it would help improve the company’s management and technology capabilities. The acquisition proved to be a great buy and the company received more than US$ 20 million in dividends in the second year.

"Think it through before making a cross-sector M&A decision. Your company could end up in crisis due to an acquisition or merger in a sector that you know nothing about. If the M&A opportunity comes from the same sector, seize the opportunity before it’s too late."

Ren Yuanlin
Chairman, Yangzijiang Shipbuilding Group Limited
The Chinese government tided over the 2008 financial tsunami with a RMB 4 trillion stimulus package to boost domestic demand and ensure steady economic growth. Facing a new global economic slowdown, is there another stimulus program on the way? Respondents are divided on this issue, but they all agree that the government is playing an essential role in coping with the global economic slowdown. In our survey, entrepreneurs express their expectations for effective government assistance. 24% of the respondents would like a lower corporate tax rate and 21% of the respondents wish easier access to credit and equity financing (fig.11), with a similarity between the desires of both listed and non-listed companies (fig.12).

In addition, entrepreneurs wish to see increases in impartial and free market competition. In our survey, 13% of the respondents call for less government intervention and more free market competition (fig.11). They affirm the general openness of trade policies in China, but claim to be treated unfairly in various circumstances. For instance, an open policy has been adopted since 1982 in the shipbuilding sector and China is one of the leading shipbuilders in the world. However, state-owned enterprises and private businesses in this sector are still treated differently with respect to VAT refunds. Respondents say China needs to increase the development of an impartial and transparent market environment before the international community would be “convinced” to recognize its market economy status.

Zhou Haijiang, Chief Executive Officer, Hongdou Group Co., Ltd.

“Public scrutiny and administrative supervision should be strengthened to monitor government officials effectively and improve managerial accountability.”

Clearly-defined policy and stepped-up supervision

Fig. 10: What change has there been in your capital expenditure over the past 12 months?

Fig. 11: What initiative(s) taken by the government will help your company the most?
Coping with the global economic slowdown

Core competence, preparedness and an excellent team are what you need to ride out the storm. Some make money in bad times. Some lose money in good times.

Wang Hung Roger, Chairman, Golden Eagle International Group

What is required for a fair market environment? In our survey, 12% of the respondents want stronger government guidance in making industry policies (fig.11). Meanwhile, the roundtable participants made it clear that regulations should be developed in a discreet and explicit manner. “In a slowdown, frequent changes in policy should be avoided,” said Mrs. Wang Jingbo, Chief Executive Officer of Noah Holdings Limited. “A policy must be carefully studied before its release. Law and regulations must be clearly and correctly defined.” In addition, 4% of the respondents call for anti-corruption and clean government measures (fig.11). Mr. Cao also pointed out the need for the government to further intensify its law enforcement efforts in building the market economy.

Fig. 12: Expectations of the government from listed and non-listed companies

- Lower corporate tax: 27% listed, 14% non-listed
- Less intervention and free competition: 16% listed, 10% non-listed
- Government guidance in making industry policies: 15% listed, 10% non-listed
- Reform of the stock market for easier access to equity financing: 14% listed, 10% non-listed
- Reform of the banking system for easier access to credit: 13% listed, 11% non-listed
- More R&D spending: 9% listed, 6% non-listed
- More healthcare and pension spending: 7% listed, 4% non-listed
- Anti-corruption: 5% listed, 5% non-listed
- More education spending: 3% listed, 2% non-listed
- Others: 4% listed, 1% non-listed

Mr. Zhou Haijiang, Chief Executive Officer of Hongdou Group, stressed the importance of faith and integrity from an ethical perspective. He argued these ethical concepts were not appreciated enough in Chinese society, even though they were supposed to provide the basis for the legal system. “Building faith and integrity along with an independent judicial system would bring about a remarkable improvement in a broad sense.” As a member of the standing committee of Jiangsu People’s Congress, Mr. Zhou advocated public scrutiny and administrative supervision for effective monitoring of government officials and improvement of managerial accountability.
Conclusion

In the results of this CEO survey and roundtable discussion, we can see the top private companies in China are looking for the right way to stand out in coping with the global economic slowdown. They put forth a multi-faceted approach to address business management, policymaking and ethical issues. With respect to business management, they place emphasis on strategic adjustment and tactical improvement in a responsive manner, especially in increasing operational efficiency. Meanwhile, they focus on financial risk management, healthy cash flow and highly promising M&A deals. In the policy and regulation area, they call for increased legal system support for the market economy, including stepped-up enforcement efforts supporting the development of free market competition. In their opinion, the global economic slowdown is not an excuse to call a halt to China’s economic reform. And last but not least, these foresighted business leaders pointed out the importance of building faith and integrity for the long-term development of the Chinese economy. In short, in its appeal for impartial competition and integrity, this approach goes far beyond practical skills for survival and growth.

When talking about the future, entrepreneurs expect challenges to come from two main sources – policymaking and the economic environment – over the next three years. 32% of the respondents are concerned about new challenges from risks in the international and domestic financial systems. 21% see policymaking and regulatory risks as the main challenges for their businesses (fig.13). From a global perspective, despite increasing uncertainties in the economic outlook, China is still one of the few bright spots. As Mr. Wang Hung Roger, Chairman of Golden Eagle International Group put it “Core competence, preparedness and an excellent team are what you need to ride out the storm. Some make money in bad times. Some lose money in good times.” Looking ahead, China is set to improve its development model to ensure steady and healthy growth. The wisdom of the entrepreneur community combined with a government determined to extend reforms will turn the global economic slowdown into an opportunity for business growth.

Fig. 13: The main challenge(s) for your company over the next three years
Commitment to entrepreneurship

We value leading entrepreneurs

At Ernst & Young, we cherish entrepreneurship. Created in 1986, the Ernst & Young Entrepreneur Of The Year (EOY) awards program has grown to more than 140 cities in 50 countries and territories, with awards presented to hundreds of the world's most successful and innovative entrepreneurs. Each year, Entrepreneur of the Year country winners from around the world come together and vie for the coveted World Entrepreneur Of The Year title in Monte Carlo, Monaco. We pride ourselves on being able to recognize the achievements of these leading entrepreneurs and will continue to encourage and honor the most outstanding entrepreneurs who inspire others with their vision, leadership and achievement.

The EOY Academy is a forum for its members (all past awards winners) to build relationships, share ideas and generate new business opportunities through an unrivaled network of the world's business elite.

We encourage in-depth discussion on entrepreneurship

At Ernst & Young, we work together with people of creative thinking at all levels, including opinion leaders from established multinationals, visionaries from prelisted companies as well as those who are dealing with the toughest issues in our community. We learn a lot from these people and understand entrepreneurship is about insight and wisdom rather than running a sizeable business. We believe the entrepreneurial spirit is the one to be celebrated.

Therefore, we would like to share our ideas with business leaders, economists, politicians and policymakers around the world to encourage their involvement in the valuable dialogue on the importance of entrepreneurship and innovation. We are planning to launch a series of white papers, webcasts and events to ensure the insights of these exceptional entrepreneurs are communicated, and to encourage people to think about what qualities make a great entrepreneur and how to create an idea-inspiring environment. This dialogue is open to businesses of all sizes and types, no matter where they are from or which sector they are operating in.

For more information about the EOY program, please visit: www.ey.com/china/eoy

Coping with the global economic slowdown
The Cheung Kong Graduate School of Business (CKGSB) is China's first independent, faculty-governed, not-for-profit business school. Founded in Beijing in 2002, CKGSB has grown to become a global business school with satellite campuses in Shanghai and Shenzhen and a network of overseas offices in Hong Kong, New York and London. CKGSB was established through the generous financial support of the Li Ka Shing Foundation.

World-Class Faculty
CKGSB faculty members are authorities in their fields and regularly publish in leading peer-reviewed journals. They come to CKGSB from top business schools in the U.S. and Europe. CKGSB’s faculty concentrates on how China’s economic growth influences not only developed markets, but also emerging economies such as those of the BRIC nations and ASEAN bloc.

Insight
CKGSB’s emphasis on research and knowledge creation has opened a unique bridge between the East and West. While the insights generated by faculty members are international in nature, they are characterized by the growing influence of China and emerging markets. Faculty research areas cover the implications of China’s economic rise on the world stage, the globalization strategies of Chinese companies and competition and collaboration among multinational, state-owned, private and family-owned companies. These research insights are complemented by the on-the-ground experience of practitioners and the school’s extensive alumni network.

Alumni Network
CKGSB alumni are some of the most entrepreneurial and successful businesspeople in China. With over 5,000 alumni across China and the globe, CKGSB’s alumni network is among the most influential in the world.

Commitment to Responsibility
CKGSB’s business education programs promote humanism and social responsibility. CKGSB believes these attributes to be crucial to the sustainable success of the next generation of global business leaders.

CKGSB’s website: http://www.ckgsb.edu.cn