



China PCR Industry 2013

Insights from EUCC China Business Confidence Survey

Roland Berger
Strategy Consultants



European Chamber
中国欧盟商会

Shanghai, July 4, 2013

Our team here today



Jennifer Wilson
Principal
Roland Berger Strategy Consultants
Hong Kong

- > Columbia University (MBA)
- > Over 10 years experience in consulting & strategic planning
- > Extensive experience in growth strategy, market entry, operational improvement, and efficiency programs for both local and multinational firms

Key focus areas

- > In addition to managing the China Business Confidence Survey, Jennifer works with industry leaders, PE funds and governments, across the chemicals/pharmaceutical, financial services, and consumer goods industries. Her expertise includes improvement, organizational design and China market entry/expansion for multinational companies



Christian Kaas
Consultant
Roland Berger Strategy Consultants
Shanghai

- > Carleton College (BA Economics)
- > 5 years professional experience
- > Specialization in energy economics. Extensive experience in electricity market modeling, system planning and power asset valuation in China and SEA

Key focus areas

- > Christian has worked with a broad range of government, oil and gas companies, power producers, financial institutions, and private investors on issues such as competition policy, investment due diligence, economic industry modeling, energy price forecasting, and market entry strategy for new technologies

Roland Berger Strategy Consultants is a top level strategy advisor with a strong understanding of global markets



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Roland Berger was a first-mover into Asia and has been active in the region for 30 years

Roland Berger's presence in Asia-Pacific



RB ASIA IN NUMBERS

1st major consulting firm to establish a presence in China, in 1983

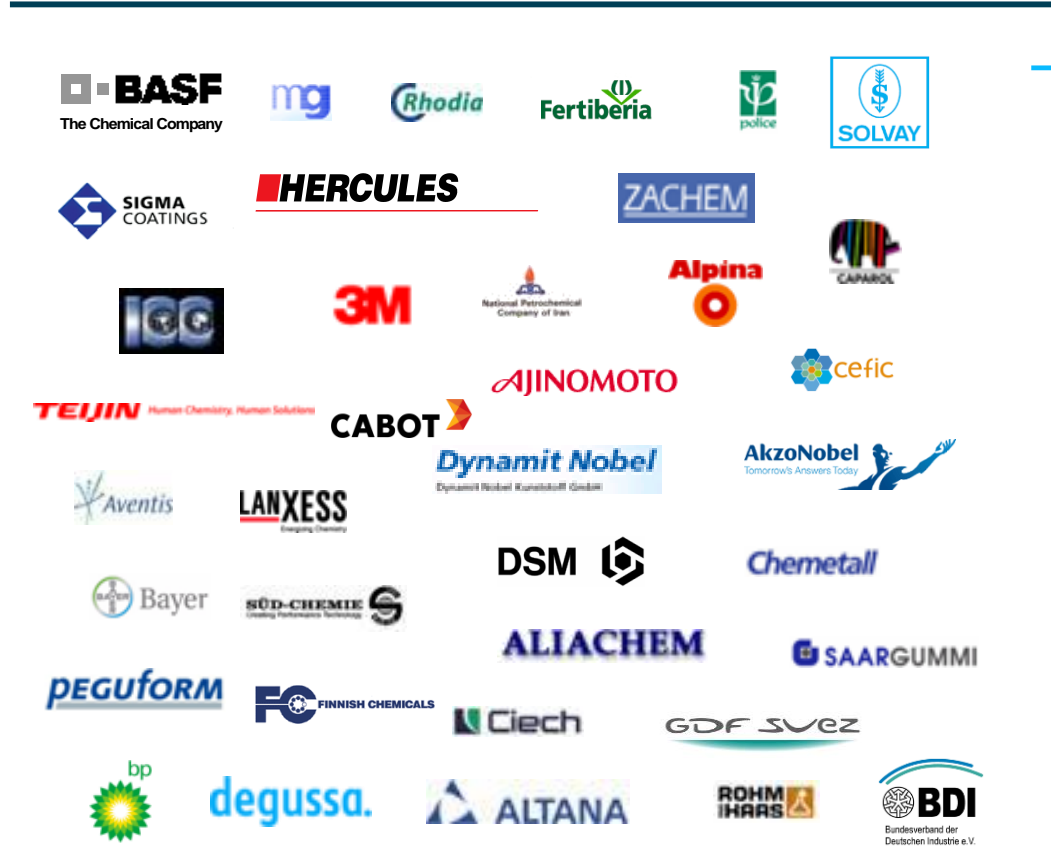
600 consultants in China, India, Japan, Korea, Malaysia and Singapore

75% of our work comes from repeat clients

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Our long track record in chemicals and energy has seen us support a wide range of industry leaders, both internationally and in China

SELECTED INTERNATIONAL ENERGY & CHEMICAL CLIENTS



SELECTED CLIENTS IN CHINA

1 Chinese private and state-owned leaders



2 International energy & chemical majors



3 Specialty chemical leaders



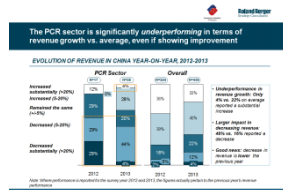
The China Business Confidence Survey (BCS) monitors business trends and outlook over time, across a wide range of industries

China Business Confidence Survey - 2013 Edition

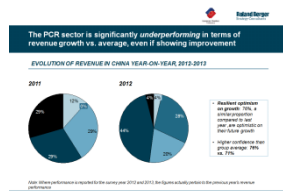
SCOPE OF SURVEY AND KEY DATAPOINTS



47 questions, covering financial and operational metrics, business outlooks, human resources and company profiles



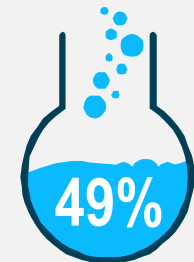
526 EUCCC member companies across 10 major sectors, from retail to automotive to professional services



An **annual survey** that tracks changes in business trends and outlook over time

CHEMICAL & PETROCHEMICALS

- > Covers a wide range of European chemical companies active in China, from small and medium firms, to international chemical leaders



COVERAGE¹⁾

- > 35 PCR companies participated in the 2013 edition of the survey, roughly half of the European Chamber's chemical/petrochemical company membership
- > Respondents are primarily at the senior management level (President, CEO, General Manager...)

1) Scope of the inquiry covers 35 of 72 chemical/petrochemical companies listed in the European Chamber of Commerce

Disclaimer: The BCS provides insight, but isn't the whole story – we look forward to your insights to help complete the picture

BCS IS NOT...



An exhaustive look at all companies or views in industry



A useful tool for gaining insight into companies' thoughts and concerns

A crystal-ball forecast of future developments in industry



A starting point to guide further discussion or investigation



...BUT BCS IS

Summary of 2013 BCS results for PCR sector

- 1 2012: A YEAR OF SLOWER GROWTH AND NARROWING MARGINS**
 - > In 2012, **lower macroeconomic growth**, both globally and in China, **weighed on petrochemical margins** in China, an effect **exacerbated by continued overcapacity** for many petrochemical products
 - > The 2012 picture may become business-as-usual. Companies **reported sustained optimism for future growth**, but the industry's **outlook on profitability has deteriorated** significantly since 2011

- 2 DOMESTIC CHALLENGES ARE SIGNIFICANT**
 - > Key **concerns and challenges for the future are chiefly domestic** in 2012, as the industry's concerns in 2011 surrounding global commodity prices subsided. Companies' primary domestic concerns are: **slowing growth in China, rising labor costs, increasing competition and continued regulatory obstacles**

- 3 CHINA REMAINS A MUST-WIN MARKET**
 - > The forward picture is a more conservative and prudent one: **fewer companies will seek to divest** their assets in China, while **regional expansion will be more limited**, primarily driven by a **need for proximity to customers and cost control**
 - > To overcome challenges ahead, companies **will focus primarily on developing marketing and sales capabilities**, followed by improving **product quality, talent management and innovation**

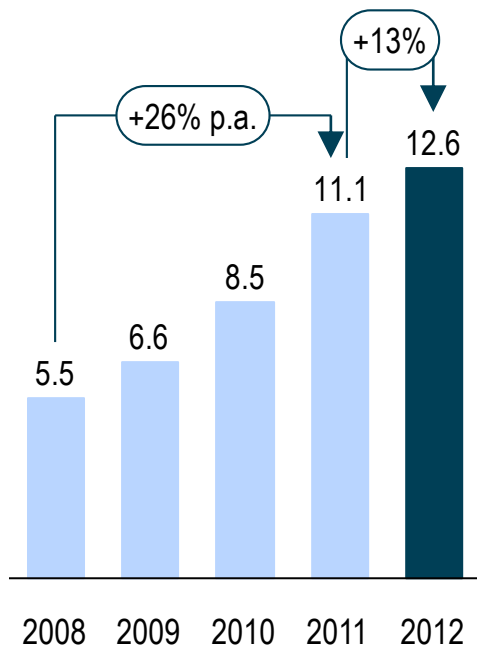
1. How did European PCR companies perform in 2012?

In 2012, a protracted low growth environment and continued overcapacity problems weighed on petrochemical margins in China

Revenues and profit for the Chinese petrochemical industry

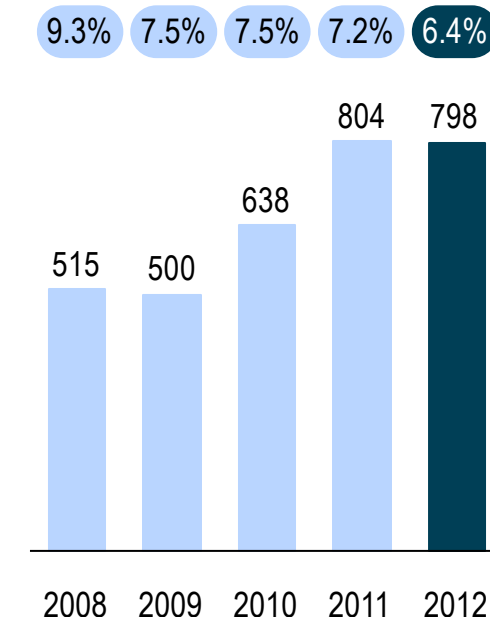
WHOLE CHINA VIEW

REVENUE [RMB tln]



GROSS PROFIT [RMB bln]

% of revenue



COMMENTS

- > Weaker profitability of the industry in 2012 is part cyclical, part structural:
 - A protracted low-growth environment: in 2012: global and Chinese growth were at their lowest since 2010¹⁾
 - Significant overcapacity has put pressure on margins in China

DISCUSSION QUESTION

- > Is slowing demand the whole story, or is there a cost aspect as well? What is putting pressure on margins?

1) 3.3% world GDP growth was lowest since 2010; in China, Q3-13 was the seventh consecutive quarter of slowing growth

European PCR companies were not spared – while more companies reported rising revenues, margins also appeared to fall

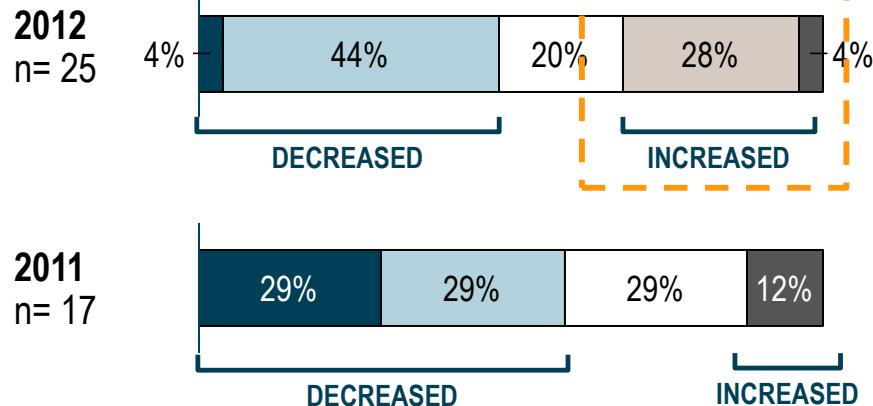
Revenue and margin evolution for PCR companies in China

BCS PCR VIEW

YEAR-ON-YEAR EVOLUTION OF REVENUE IN CHINA

How did your company's **revenue** in China compare with the previous year?

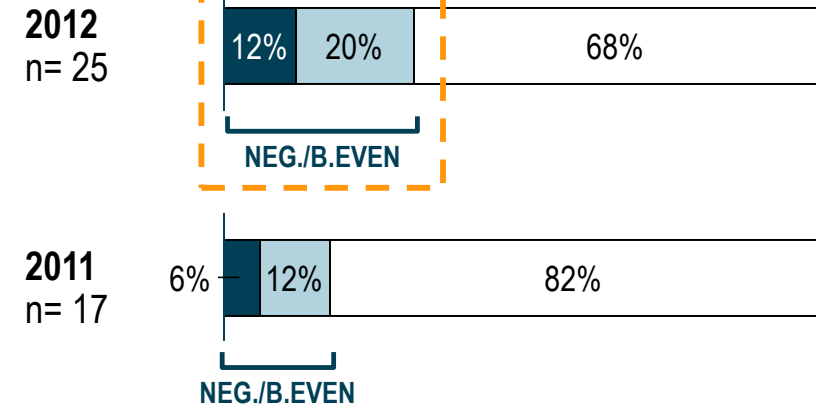
- Decreased >20%
- Stayed the same
- Increased >20%
- Decreased 5-20%
- Increased 5-20%



COMPANY EBIT IN MAINLAND CHINA

Was your **company EBIT margin** positive, break-even or negative this year?

- Negative
- Break-Even
- Positive



Companies are more optimistic about future growth than profitability - shrinking margins may become part of business-as-usual

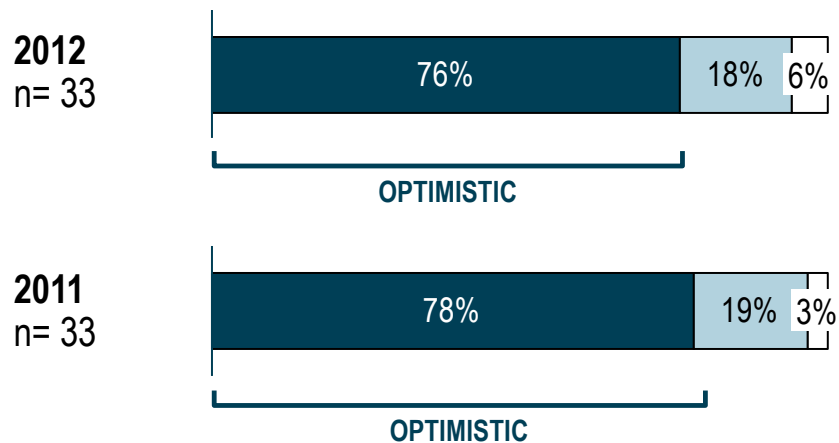
Optimism for growth, not necessarily for profits

BCS PCR VIEW

OUTLOOK FOR BUSINESS GROWTH

Do you characterize your **outlook on your business growth** for the next two years as optimistic, neutral or pessimistic?

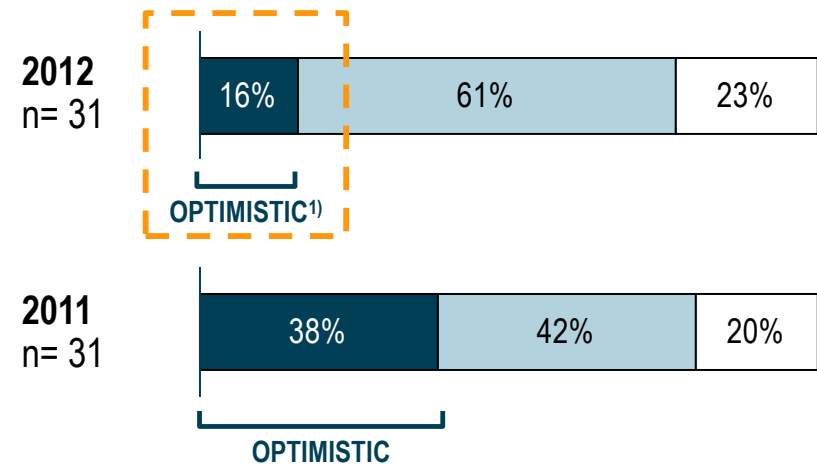
■ Optimistic ■ Neutral □ Pessimistic



OUTLOOK FOR PROFITABILITY

Do you characterize your **outlook on your profitability** for the next two years as optimistic, neutral or pessimistic?

■ Optimistic ■ Neutral □ Pessimistic



1) Optimism is significantly lower among PCR companies than for the average (30%)

2. What are European PCR challenges in China?

Key concerns and challenges are chiefly domestic, as worries surrounding global commodity prices subside



Key concerns and challenges for future business growth

BCS PCR VIEW

What are the **most significant challenges** to your future business in mainland China?

KEY CHALLENGES IN 2011	KEY CHALLENGES IN 2012	RANKING
Increasing global commodity prices	1 An economic slowdown in China ↑	#1
An economic slowdown in China	2 Increasing Chinese labor costs ↑	#2
Increasing Chinese labor costs	A global economic slowdown ↑	#3
A global economic slowdown	3 Competition from private companies ↑	#4
Competition from private companies	3 Competition from state enterprises ↑	#5

Key domestic challenges

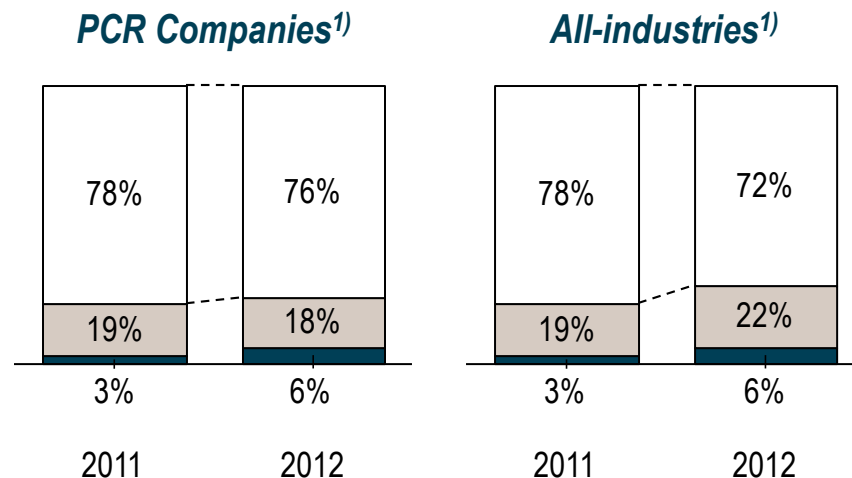
Optimism surrounding short-term growth remains high, but the long-term may bring additional challenges

Companies remain confident in short-term growth

OUTLOOK ON BUSINESS GROWTH

Do you characterize your **outlook on your business growth** for the next two years as optimistic, neutral or pessimistic?

Optimistic
 Neutral
 Pessimistic



1) n= 33 (PCR 2011), 33 (PCR 2012), 540 (ALL 2011), 594 (ALL 2012)

COMMENTS

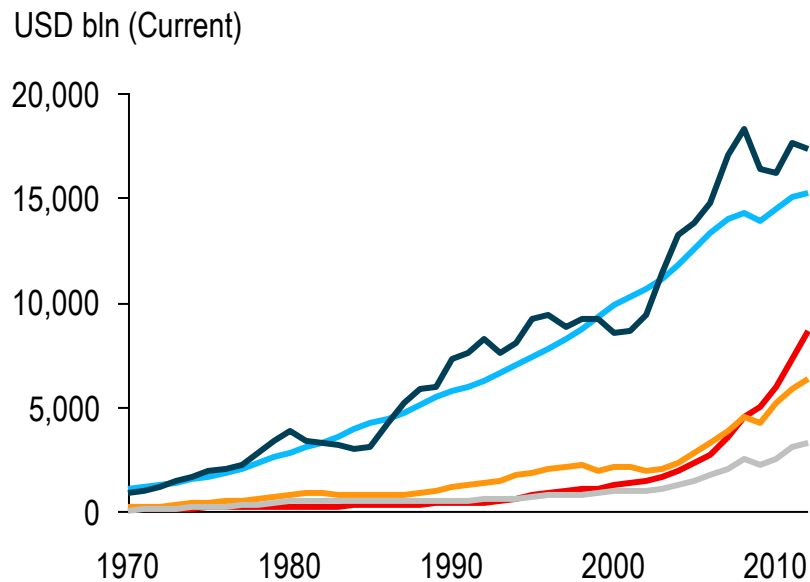
- > In the short-run, companies across a wide range of industries remain optimistic about 2-year growth prospects for their business in China
- > In the longer-term, however, the PCR industry may be challenged by changing growth patterns:

- a** There is little question that China's era of peak growth is over. Macroeconomic growth is projected to slow
- b** Regional growth patterns will shift. In the future, the largest and fastest-growing regional economies will increasingly be found inland, farther from the petrochemical industry's current manufacturing bases

Chinese GDP growth rates peaked in the 1990s at ~18% p.a. on average – the forward picture is one with China growing <8% p.a.

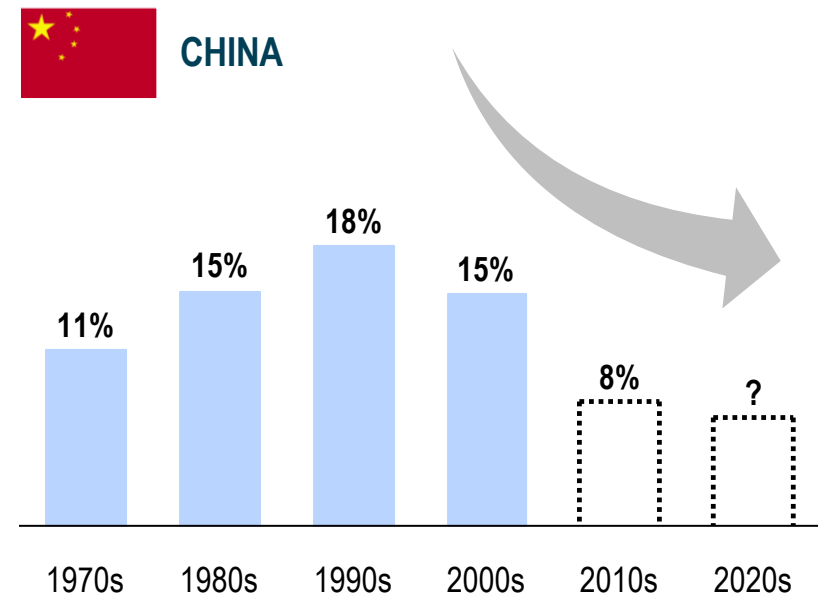
Macro-economic growth is slowing down

GDP GROWTH OF SELECT COUNTRIES [USD bln]¹⁾



— China — European Union — Africa
 — USA — Latin America

AVG. GDP GROWTH BY DECADE [RMB terms]

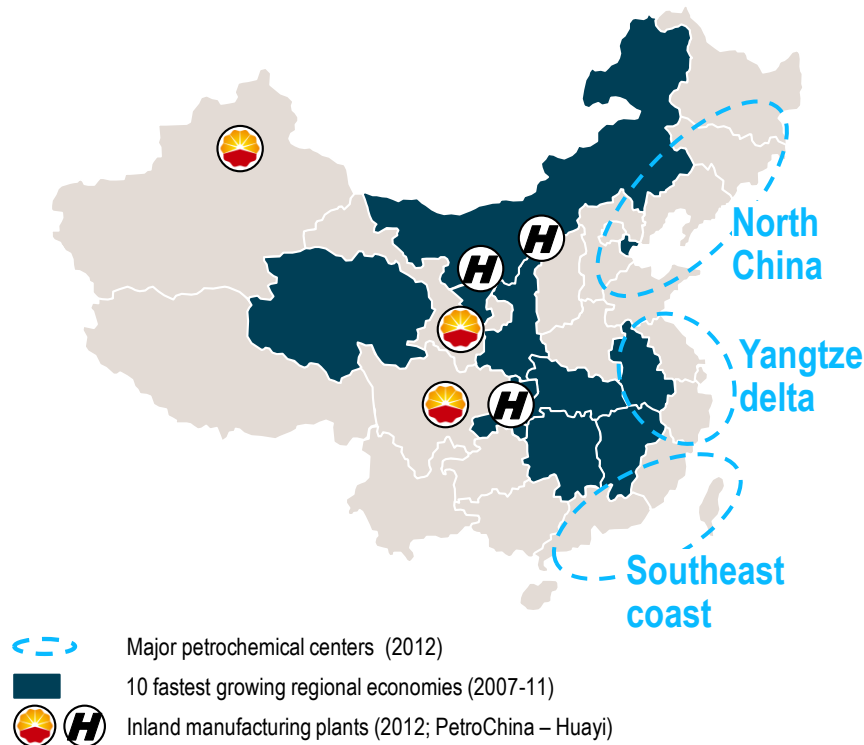


1) Foreign GDP figures, reported in USD, incorporate an exchange rate effect. For China, this effect is most significant between 2000-10 (+22%, compared to +0.9% over previous decade)

The fastest growing regions are increasingly found inland, where local players are already beginning to expand production

New high-growth areas are inland

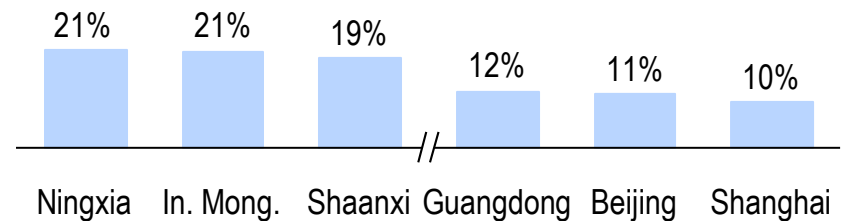
PETROCHEMICAL CENTERS AND GROWTH AREAS



COMMENTS

- > As China's coasts develop and slow, **growth is increasingly moving inland**, where demand for infrastructure and consumer products will drive new opportunities for industrial and specialty chemicals
- > Local players (Huayi, PetroChina) have begun developing production in high-growth regions (incl. Chongqing, Ningxia, Inner Mongolia, Sichuan)

Top/bottom 3 growth differentials (2007-11)

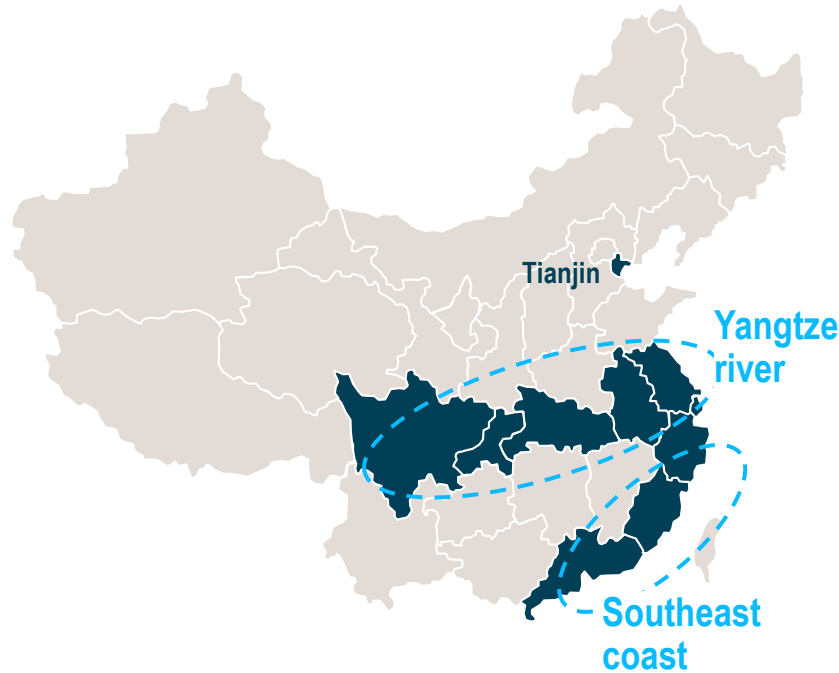


European PCR companies are primarily seeking to expand operations along the southeast coast, and along the Yangtze river

Regional expansion targets for European PCR companies

BCS PCR VIEW

TOP 10 TARGET PROVINCES FOR EXPANSION



Principal target provinces for PCR company expansion

COMMENTS

- > As Chinese companies focus increasingly on inland regions, European companies are primarily interested in developing operations in the south
- > Major regions of interest for European companies are:
 - The southeast coast (Guangdong, Fujian, Zhejiang)
 - Along the Yangtze river (Shanghai, Jiangsu, Anhui, Hubei, Chongqing and Sichuan)
 - Tianjin

DISCUSSION QUESTION

- > To what extent have you already shifted production inland? How are these investments going? What are the major issues you are encountering?

While companies are pessimistic about future labor costs, the biggest challenge today is in identifying and recruiting the right talent

Companies expect labor cost increases to continue

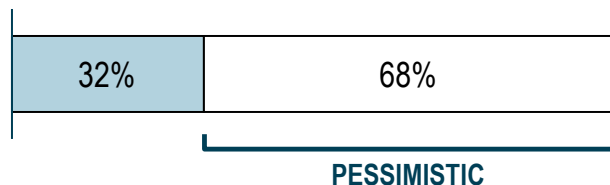
BCS PCR VIEW

OUTLOOK FOR LABOR COSTS

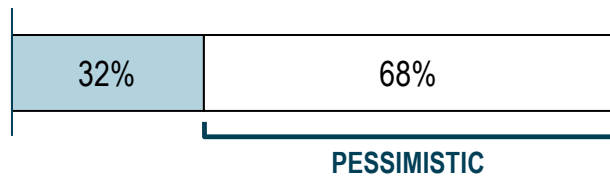
Do you characterize your **outlook on labor costs** for the next two years as optimistic, neutral or pessimistic?

■ Optimistic ■ Neutral □ Pessimistic

2012
n= 31



2011
n= 31



COMMENTS

> Companies' 2012 outlook on labor costs is as pessimistic as it was last year: employers expect costs to rise further

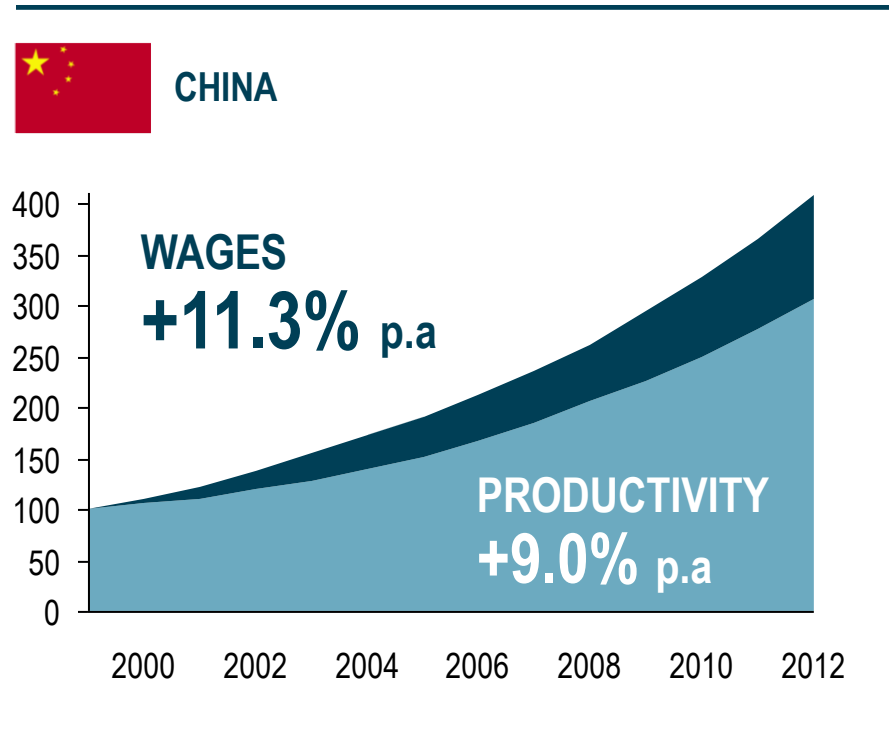
a Chinese labor costs have risen fast and continuously, outpacing productivity growth: employers are bidding up a finite labor pool

b The cost of labor is only part of the story: the greatest challenge facing companies is not one of pure cost, but rather how to recruit and retain the right talent, at the right cost

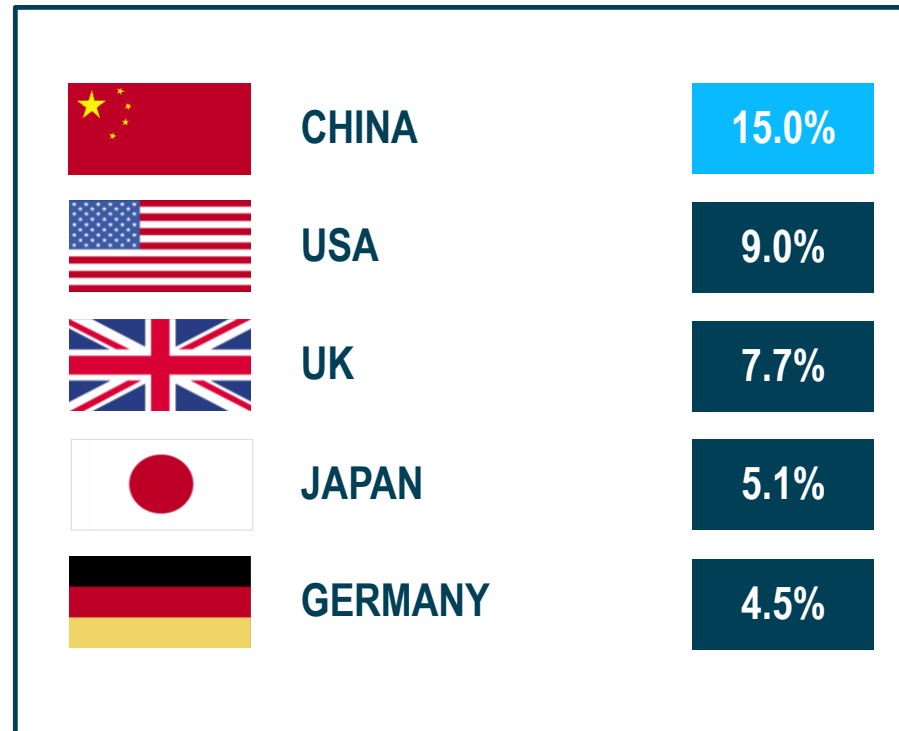
Chinese wages are rising faster than productivity – yet, turnover rates remain higher than in other major economies

Employers are bidding up a tight labor pool

WAGE AND PRODUCTIVITY GROWTH¹⁾



VOLUNTARY ANNUAL TURNOVER RATES²⁾



1) 2011-12 data estimated 2) Various years

For PCR companies, the most significant HR challenge isn't cost - it's the difficulty of recruiting and retaining high-quality talent

Cost is only part of the question: China has a shortage of talent

BCS PCR VIEW

KEY HR CHALLENGES FOR PCR COMPANIES

What is the **most significant HR challenge** your company currently faces in China?

RANK	CHALLENGE	PERCENT
#1	Shortage of talent	46%
#2	High cost of labor	31%
#3	High staff turnover	12%

COMMENTS

- > Despite pessimism about labor costs, companies' most significant HR challenge isn't cost, but rather it's the **difficulty of recruiting and retaining high-quality talent**
- > Shortage of talent is a problem for many industries in China. Some companies are experimenting with HR strategies like **employer branding and retention management**, to differentiate themselves not just on wage, but on intangibles (culture, career development, benefits...)

DISCUSSION QUESTION

- > What strategies are you using to attract and retain talent, in both managerial and technical roles?

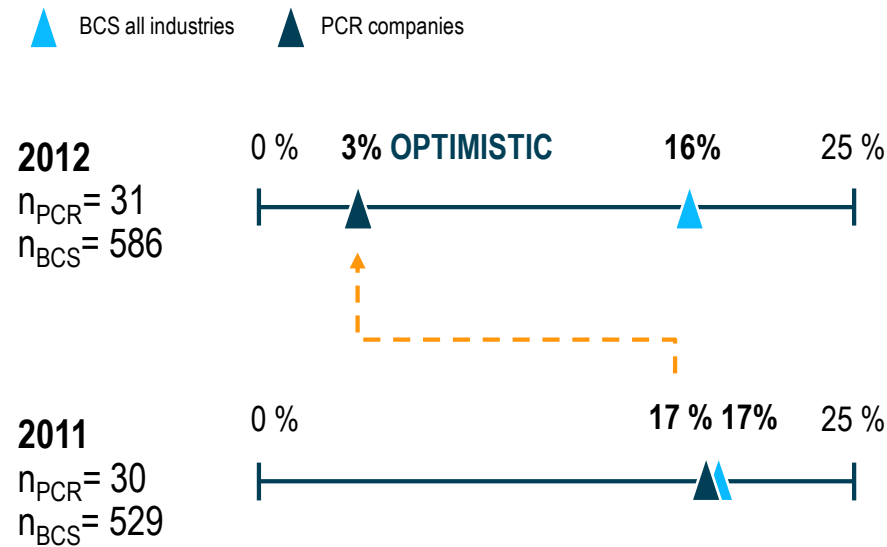
Optimism about future competition fell in 2012, dragged down by a more difficult regulatory environment and stronger local companies

A bleak outlook on competition

BCS PCR VIEW

OUTLOOK ON COMPETITION BY PCR COMPANIES

Percentage of companies characterizing their **outlook on competition as optimistic**



COMMENTS

- > While the all-industry competition outlook was largely stable in 2012, PCR companies' confidence in their future competitive position weakened heavily
 - a The regulatory playing field may not be level for all: a majority of companies say **enforcement of regulation is heavier for foreign companies**, while government policies have become more unfair towards foreign companies
 - b Domestic competition is also strengthening, with **local POEs leveraging significant recent improvements in both pricing, and marketing and sales**

Regulations are seen as having become less fair to FIEs in recent years, while enforcement may also be more lax for local companies

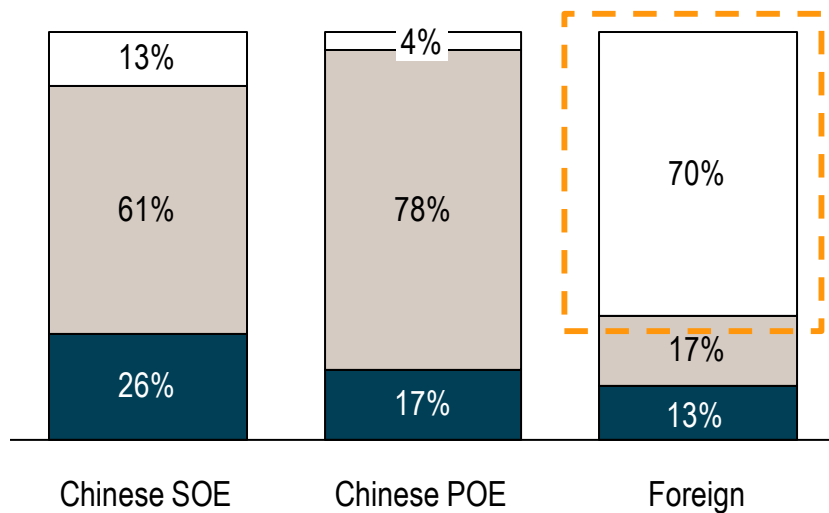
Regulation enforcement and fairness

BCS PCR VIEW

ENVIRONMENTAL REGULATION ENFORCEMENT¹⁾

How would you characterize the **level of enforcement of environmental regulation** on SOE/POE/European companies?

Strong Weak No opinion



1) 2012: n=23

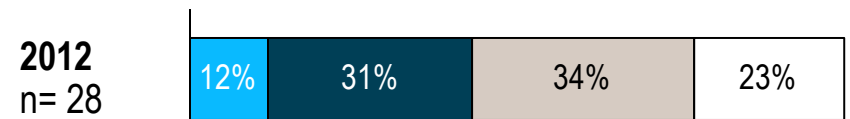
FAIRNESS OF GOVERNMENT POLICIES

How have **government policies affecting FIEs** and their business changed in the past two years?

Have become less fair Are as fair Have become more fair No Opinion



How do you expect **these government policies will evolve** in the coming two years?

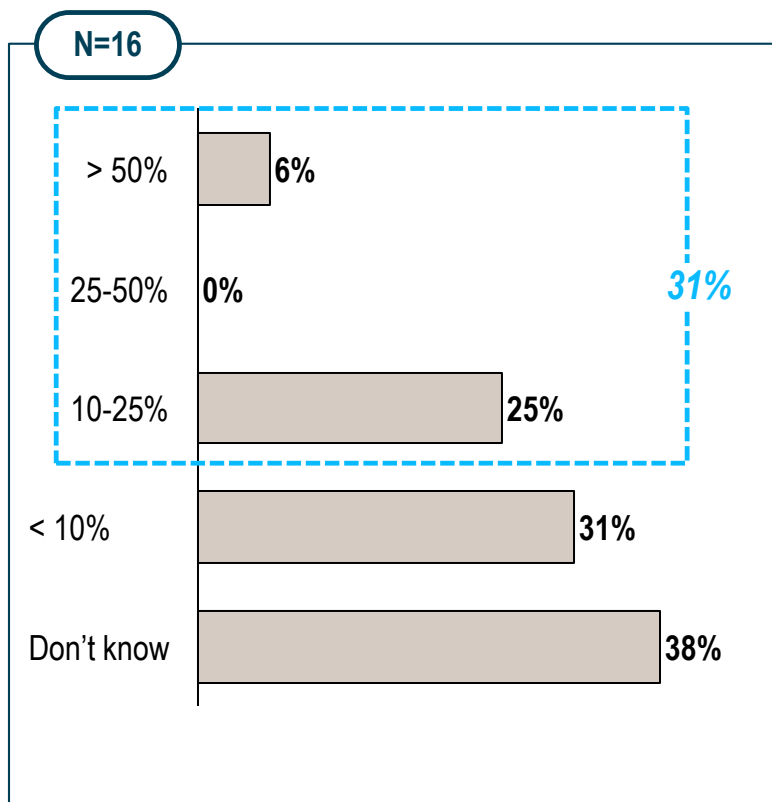
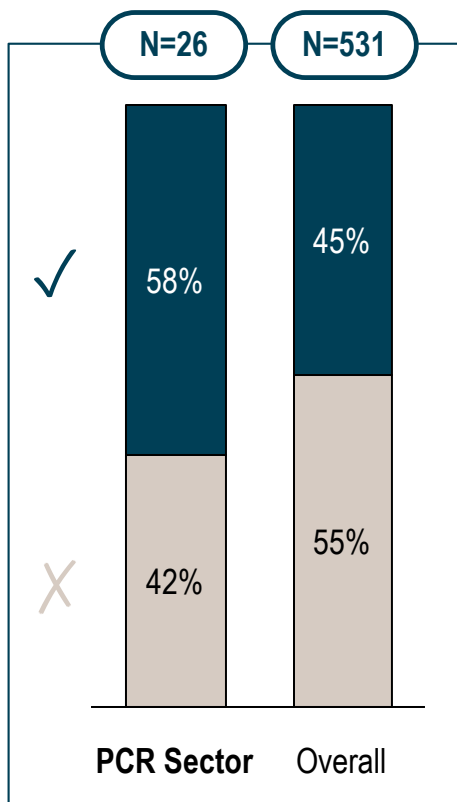


Will be less fair Will be as fair Will be more fair No Opinion

PCR-sector companies appear to have been hit harder than average on missed opportunities due to regulatory barriers

Missed opportunities due to regulatory barriers, 2013

BCS PCR VIEW



Smaller impact, however, on revenue than average:

> 31% vs. 61% on average reported losses higher than 10%

Nonetheless, PCR-sector companies believe the improvement of government policies towards FIEs will soon come

Perception of government policies affecting fies tomorrow, 2013

BCS PCR VIEW

	N=28 PCR SECTOR	N=530 OVERALL
Will increasingly discriminate against FIEs	4%	13%
Will generally much less fair	8%	15%
Will be as fair as now	31%	25%
Will generally be much more fair	35%	21%
Will increasingly discriminate in favour of FIEs	0%	2%
No opinion	23%	24%

> **35% vs. 23%** on average believe government policies towards FIEs will increasingly discriminate in favour of FIEs in the future

> **Only 12%, vs. 28%** on average, believe those policies will increasingly discriminate against FIEs

Against European companies, Chinese POEs are increasingly competitive not only in pricing, but also in marketing and sales

Competitive advantages of different players

BCS PCR VIEW

PRIMARY COMPETITIVE ADVANTAGES

Top 3 **competitive strengths or advantages** in the PCR sector, by company profile/ownership

RANK	CHINESE SOE	CHINESE POE	EUROPEANS
#1	GOVERNMENT RELATIONS	PRICING	QUALITY, VARIETY & INNOVATION
#2	ACCESS TO SUBSIDIES	MARKETING & SALES	BRAND RECOGNITION
#3	ECONOMIES OF SCALE	ACCESS TO FINANCING	TALENT MANAGEMENT

COMMENTS

> The trend continues: in last year's survey, European PCR companies said local POEs had improved the most in pricing and marketing & sales. In 2012, these are local firms' key competitive advantages in the market

DISCUSSION QUESTION

> What have local companies done to develop stronger marketing and sales? How are you countering this?

3. How are European PCR companies meeting these challenges?

Fewer companies are seeking to divest their assets in China, as the strategic importance of the middle kingdom continues to grow

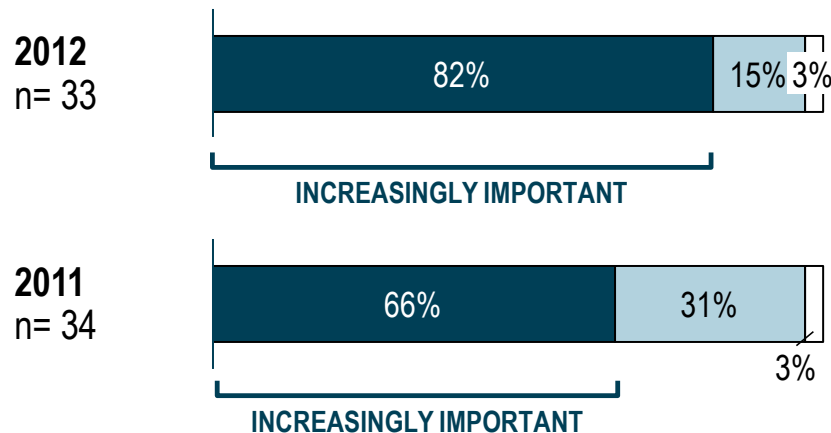
Fewer plans for divestment underline importance of China

BCS PCR VIEW

IMPORTANCE OF CHINA IN OVERALL STRATEGY

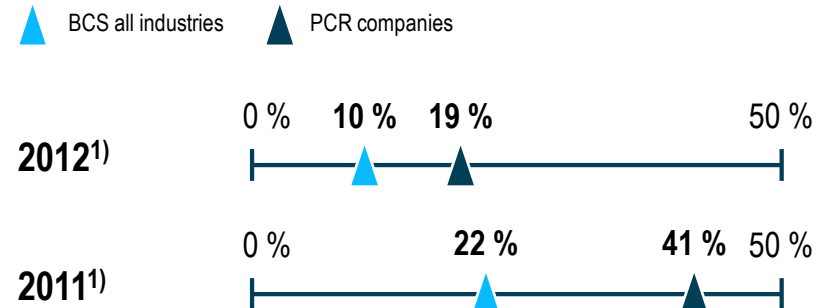
How has the **importance of China** in your overall company strategy changed?

■ Increasing important ■ No change □ Decreasing importance



PLANS TO MOVE INVESTMENTS OUT OF CHINA

Percentage of firms considering **moving investments out of China**



DISCUSSION QUESTION

> Why have PCR companies been more inclined to divest than the average? What can explain lower divestment intentions this year?

1) n= 34 (PCR 2011), 26 (PCR 2012), 557 (ALL 2011), 532 (ALL 2012)

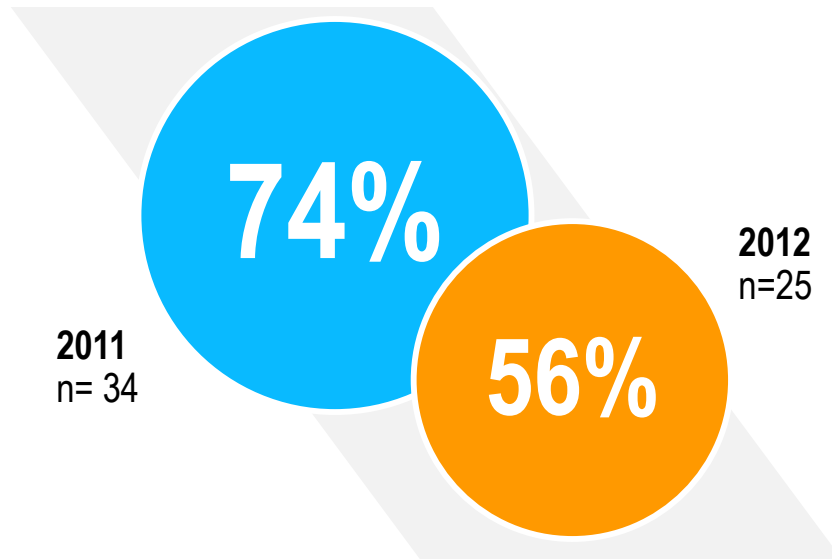
Within China, plans for regional expansion are more limited, but driven by a need for proximity to customers and cost control

Plans and rationale for regional expansion

BCS PCR VIEW

PLANS FOR REGIONAL EXPANSION

Percentage of firms considering **expanding to other provinces in China**



RATIONALE FOR REGIONAL EXPANSION

What is your **primary objective or reason** for considering regional expansion?

MOTIVATION	PERCENT ¹⁾
To be closer to customers	61%
To reduce costs, or take advantage of govt. incentives	28%
All others	11%

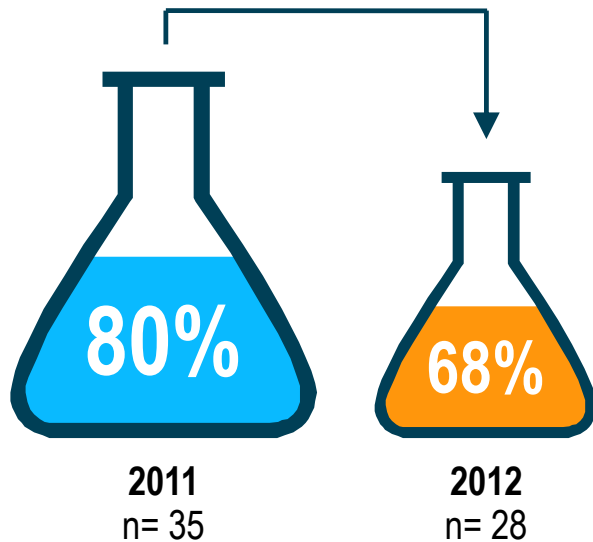
Overall investment strategy will be more prudent, as major investment plans give way to a greater propensity to control costs

Fewer major investments, greater propensity to cut costs

BCS PCR VIEW

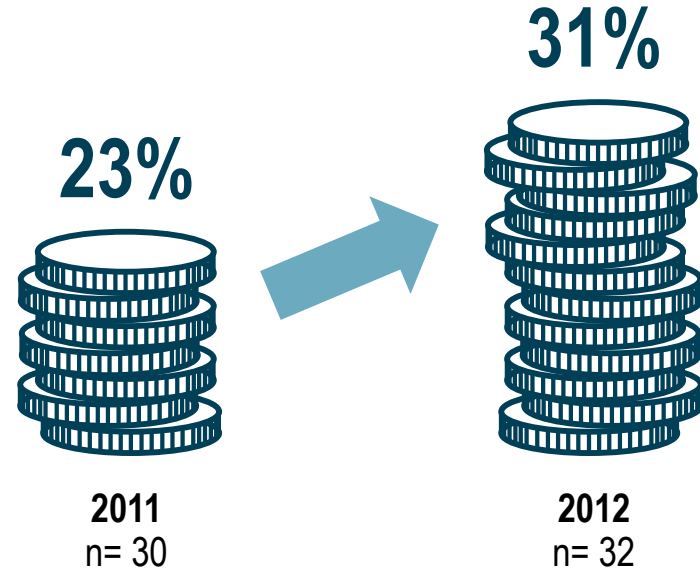
PLANS FOR MAJOR INVESTMENTS

Percentage of firms who say they are considering **major new investments** in China



COST CUTTING PLANS IN CHINA

Percentage of PCR firms who say they are **planning cost cutting** in China



Marketing & sales capabilities will be a primary focus, followed by an emphasis on product quality, talent management and innovation



Key directions for business development (2013-14)

BCS PCR VIEW

What are the **highest priority areas** for your company's **development and improvement** in the next two years?

RANKING	FOCUS AREA	PERCENT ¹⁾	COMMENTS
#1	Marketing and sales	83%	<ul style="list-style-type: none"> > Changing growth patterns and stronger local competitors will challenge incumbents. > Developing stronger marketing and sales channels and capabilities will become increasingly important > Greater competition will challenge companies to differentiate themselves beyond sales and marketing alone by focusing on product quality, and innovation, as well as the talent needed to sustain them
#2	Product quality	63%	
#3	HR/talent management	56%	
#4	Product innovation and design	56%	
#5	Process/operation improvement	54%	

1) Proportion of respondents labeling the focus area as "high priority"

Thank you!

How to get in touch



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**China Business Confidence Survey -
2013 Edition**



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or
www.rolandberger.com/media**