OBG Global CEO Survey

Race for Returns:

CEOs chart the risks and rewards emerging markets face in 2020

OXFORD BUSINESS GROUP

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I. INTRODUCTION

Oxford Business Group (OBG) began its CEO Survey in 2016 with the aim of giving our clients a handle on sentiment in the various markets we cover.

Sentiment is of course intangible, but it is an all-important factor in the decisions businesspeople and investors make when they weigh up their risk appetite. In turn, sentiment informs the level of confidence with which they view a market.

It is also acutely sensitive, something clearly demonstrated by the way global markets have been impacted by the spread of covid-19.

The fast-growth markets we specialise in – what we call the “Yellow Slice”, in reference to our corporate colour – have in many senses inherently higher levels of risk than those in the developed world, but the possible returns can be much higher too.

With moribund growth in many established markets, the Yellow Slice countries in Asia, Latin America, Africa and the Middle East, when viewed as a bloc, with their strong economic fundamentals, youthful populations and positive average GDP figures, present a compelling picture.

That’s not to say there’s a straight divergence – it’s much more complicated than that. While as a group their average growth rates are higher, much still needs to be done in terms of economic and social reform to ensure an equitable spread of the fruits of growth. Many suffer from the commodities curse, whether in the form of agriculture, hydrocarbons or mining, as well as opaque political systems and bureaucratic red tape.

However, we live in an increasingly interconnected and interdependent world. The differences between what used to be termed developed and developing are blurred. Take the supply chains surrounding the Apple iPhone as a prime example of this. Each handset is made up of hundreds of components, sourced from about 43 countries on six continents. To take the smartphone analogy even further, these devices are increasingly enabling people to watch the same things, share the same fashions and ideas, and transact and do business with each other more easily than ever before.

As a result, what happens in one market can – and increasingly does – have a direct impact on others, often on the other side of the world.

Globalisation has come under major scrutiny in the years since the financial crisis, but it seems to be here to stay; how to equitably spread its benefits is actually the question that should be exercising us.

Enabling an understanding of how businesspeople in these markets view their own environments from the standpoint of growth, taxation, regulation, access to credit and availability of labour is what the OBG CEO Survey does, providing important insights for our clients and informing their decisions.

The survey is undertaken on an anonymous basis, allowing for candid answers. We do, however, categorise companies by industry, sector and headcount, and can therefore extrapolate broader trends. We publish the results annually on both a national and regional basis, and now we do so for the first time globally.

It is worth noting that the survey was undertaken before the wider spread of covid-19 and that the results do not therefore reflect the inevitable changes in businesspeople’s current outlook. While it is too early to predict how the virus will develop, the impact is clearly rattling investors. What is clear, though, is that it will be quite some time before the full impact can be assessed, and will therefore make the coming iteration of the CEO Survey interesting and instructive reading.

II. GLOBAL INVESTMENT OUTLOOK

Against a backdrop of heightened geopolitical tensions, commodity price volatility and the US-China trade war, global growth has unsurprisingly slowed. Indeed, IMF forecasts show most regions' GDP growth decelerating in 2019, even if there are some notable exceptions at the country level.

Furthermore, disruption from new technologies and the Fourth Industrial Revolution is transforming the very nature of business. Failure to keep pace with these changing dynamics could prove fatal for a business or investor. Yet, if sentiment is weak, there is no appetite for commercial adventure.

Unsurprisingly, therefore, our respondents were more negative about the prospects of their respective business environments than in previous years, with the percentage of CEOs with positive or very positive outlooks falling by 18%. However, that figure was still over half, at 57%. OBG's Latin American and Asian markets saw the biggest shift downwards.

In Latin America, 45% of CEOs had positive or very positive outlooks for the coming year, down from 82% in 2018. In large part this decline can be attributed to political uncertainty – not least in Mexico, where the president has seemingly rolled back business-friendly reforms, and where the renegotiation of the North American Free Trade Agreement was under way for much of the year.

In other markets such as Argentina, the local currency suffered against the US dollar, while in Colombia and Chile, inequality and dissatisfaction with government fuelled civil unrest. Immigration flows from troubled Venezuela, interestingly, had a broadly positive impact on neighbouring economies.

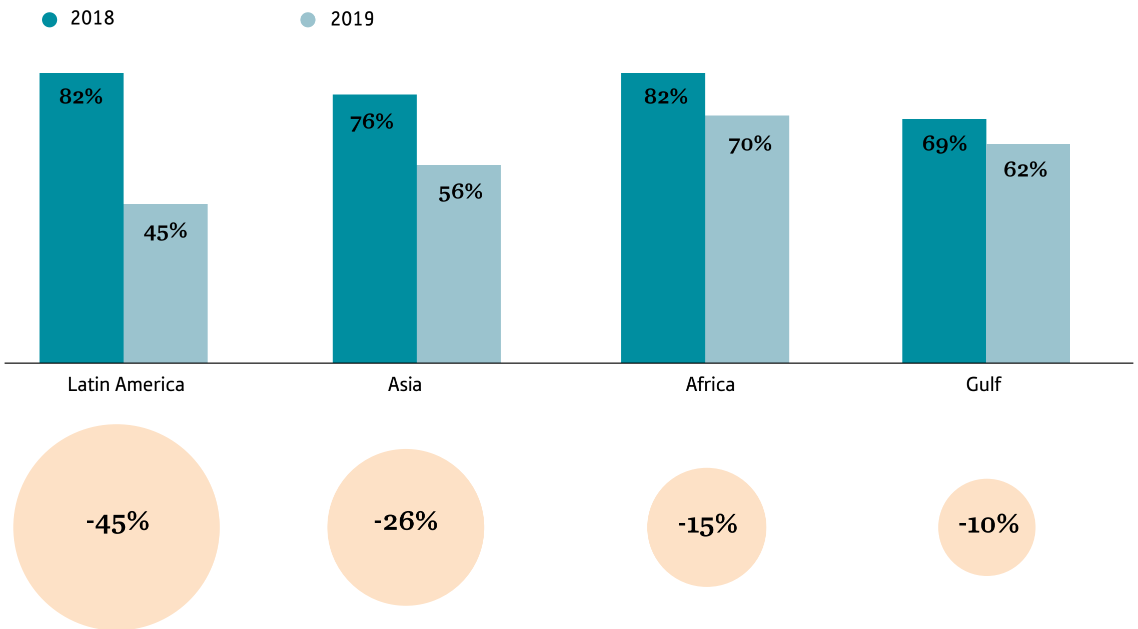
Meanwhile, in Asia, 56% of CEOs held positive or very positive outlooks, down from 76% in 2018. Perhaps the largest influence here was a fall in demand from China, the dominant regional influence, and the uncertainty created by its trade war with the US.

While there was a breakthrough in trade negotiations between the world's two largest players in January, as the so-called phase one of a trade deal was signed, with President Donald Trump facing both a looming election and recently concluded impeachment proceedings, the ability to crank up the trade war to his domestic advantage may mean it is electorally useful that the spat continues, to the detriment of growth. This is to say nothing of recent stock market tremors over fears of the spread of covid-19. It therefore seems unlikely the "China factor" will be eliminated in 2020.

On the whole, CEOs are less optimistic about growth in 2020, with this trend especially pronounced in markets we cover in Latin America and Asia

What are your expectations of local business conditions in the coming 12 months?

% of respondents answering positive or very positive



IS THERE A SILVER LINING IN LATIN AMERICA?

Unsurprisingly, the decline in GDP growth figures across Latin America and the Caribbean in 2019 has been accompanied by less positive business sentiment regarding both the economic outlook and business transparency. Interestingly, however, tax is one area where there seems to have been steady progress towards a more competitive environment region-wide.

Colombia stands out as an example; it passed a comprehensive package of tax reforms in 2019 that reduces the rate of corporate tax from 33% to 30% by 2022, in turn boosting investor confidence in the region's best-performing large economy. Although Mexico's leftist leader, Andrés Manuel López Obrador (known as AMLO), is unlikely to implement such measures, the fiscal autonomy of state-level administrations means foreign investors can be gifted a one-off tax respite through different proposals and sweeteners offered by investor-friendly state governments. Peru – one of the few countries in the world to go over two decades without a recession – passed its tax reform in 2016, which came into force in 2017. Designed to stimulate growth, simplify procedures and help smaller enterprises, it has likely contributed to the positive tax outlook.

On other indicators, such as the labour market, another interesting picture emerges. Argentina, Colombia, and above all, Mexico, all have solid manufacturing bases. However, the success of the broader drive in all three countries towards higher-value-added export goods does not necessarily depend on technical engineering skills, according to the survey's participants.

Rather, they underscore the importance of research and development. This implies that business leaders want to foster economic value added along the entire production chain, starting at the very root. This is exemplified by Colombia's Economía Naranja (Orange Economy) policy, which looks to nurture innovation across a plethora of sectors. This concept has been so well received internationally that in February 2019 the country's second-largest city, Medellín, was designated a Fourth Industrial Revolution Network affiliate centre by the World Economic Forum, part of a network of global innovation clusters that includes Tokyo, San Francisco and Beijing.

Harry Van Schaick, Regional Editor - Latin America

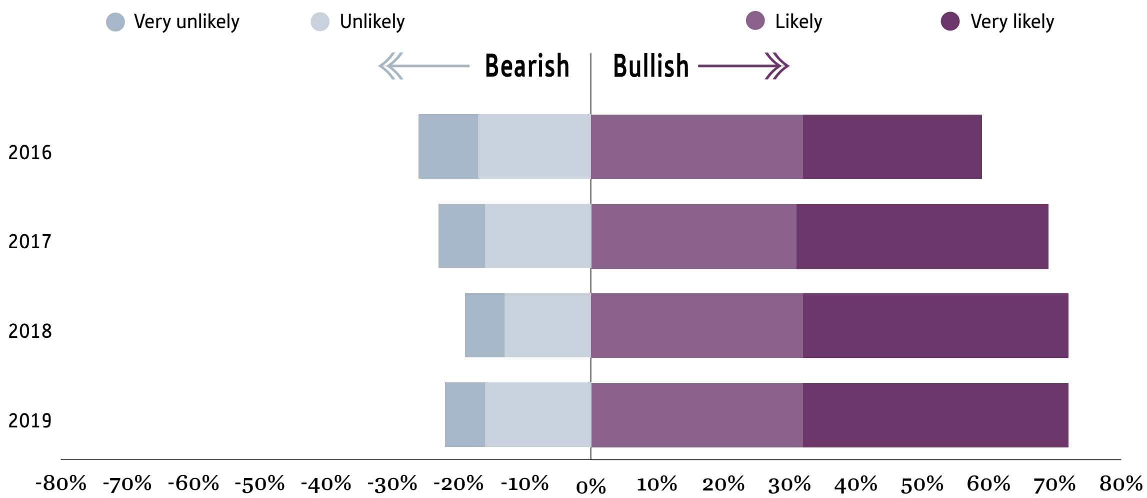
When it comes to making decisions on whether to make a significant capital investment over the next 12 months, globally our respondents have become more positive over the past four years.

The percentage of CEOs who say their companies are likely or very likely to make a significant investment has risen from 59% in 2016 to 62% in 2019. Interestingly, though, this figure was unchanged from the 2018 result.

Despite waning global business sentiment, executives are increasing willing to take risks and make big investments in pursuit of earnings growth

How likely is your company to make a significant capital investment within the next 12 months?

% of respondents answering unlikely or very unlikely characterised as bearish; % answering likely or very likely characterised as bullish



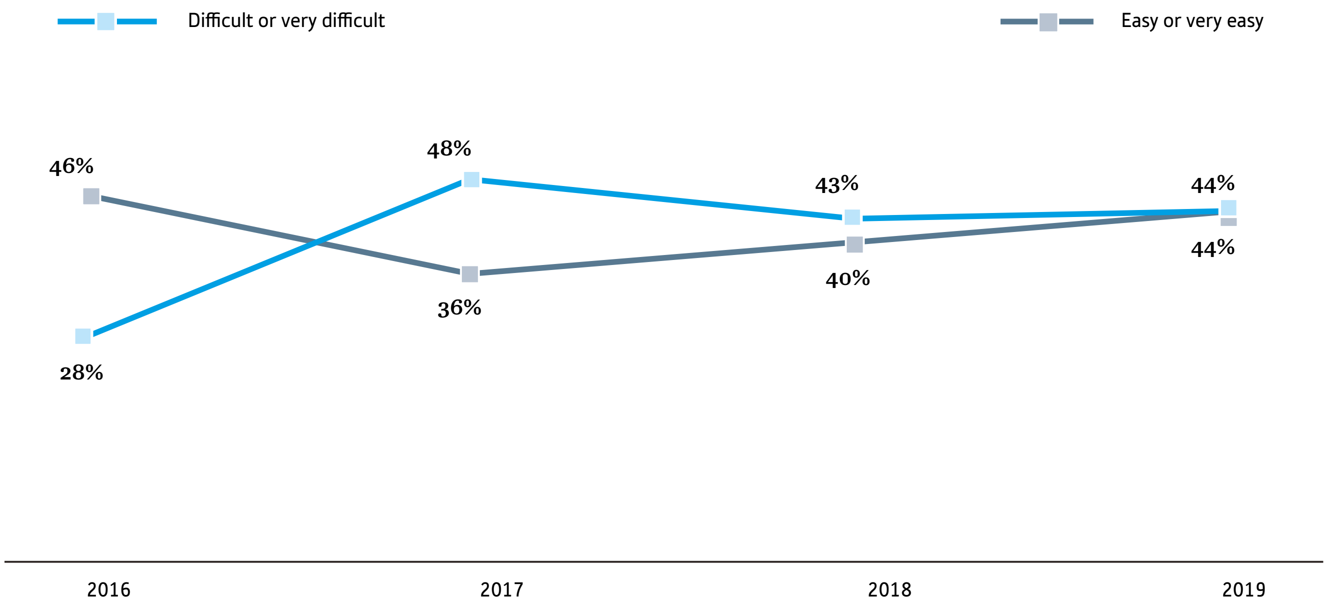
Investment often requires raising capital, so we ask CEOs to characterise the ease of access to credit in their market. The percentage who say it is difficult or very difficult has on average risen, though it is in decline from a peak of 48% in 2017 (up from 28% in 2016) and sat at 44% in 2019 – very near the level in 2018.

The willingness of banks to extend credit is of course based on a number of factors, but the broadest is confidence in the company to repay. One would therefore expect sentiment to be correlated with confidence – the local economic outlook and business conditions presenting important endogenous factors.

With many central banks looking to exploit every opportunity to engage in monetary tightening, business leaders are facing a more constrained lending environment

How would you characterise the ease of access to credit in your market?

% of respondents



THE INFLUENCE OF CHINA AND DEMOGRAPHICS IN AFRICA

The slight deterioration in sentiment in Africa can be explained by upcoming presidential elections leading to a slowdown in business in some of the countries that make up the Yellow Slice – namely Côte d'Ivoire and Ghana – and the impact the US-China trade war could have on capital inflows to the region. The importance of China in Africa has waxed in recent years, with total investment in the region estimated to have increased from £13bn in 2010 to £35bn in 2018, channelled primarily into infrastructure and natural resources.

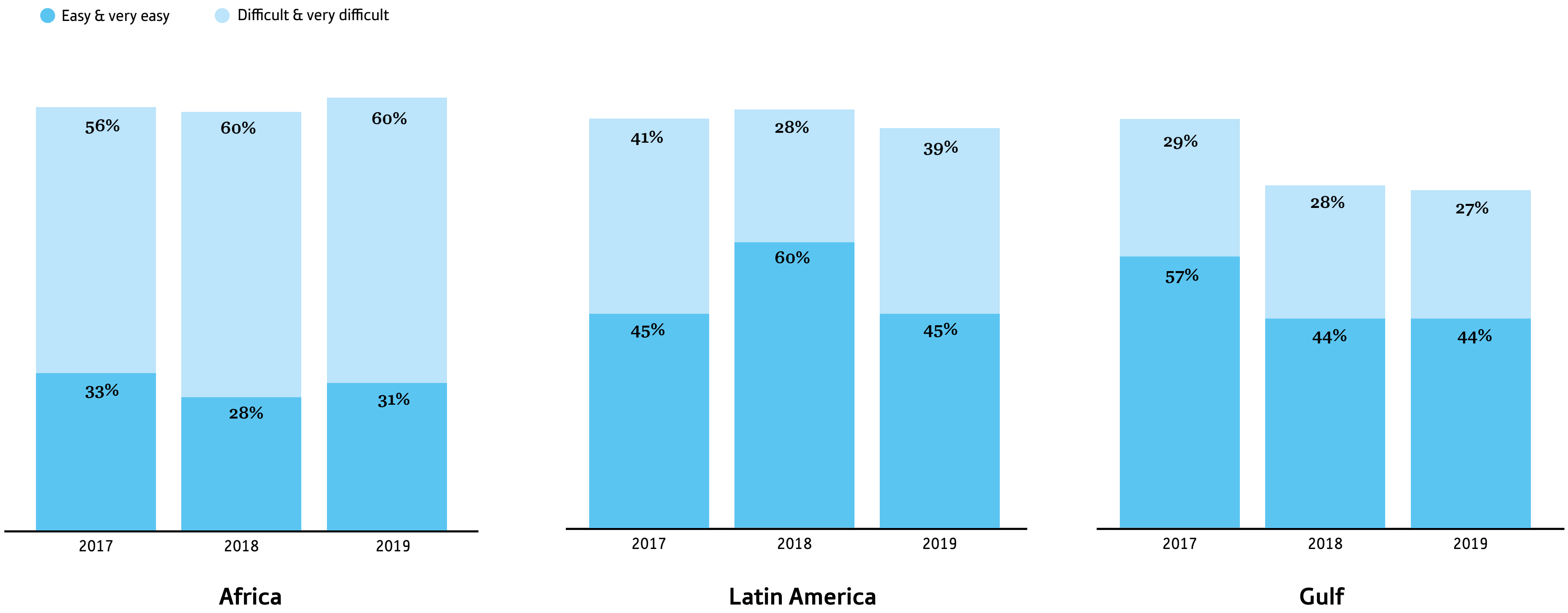
As promising as these prospects may appear, Africa – and China – have a bigger challenge to contend with: job creation. With the world's fastest demographic growth and a working population slated to increase by 900m people over the next 35 years, for Africa, accelerating job creation has become more pressing than ever.

Views on the labour market have been consistent over the past three years, with leadership, engineering, and research and development topping the list of skills in demand. For businesses to thrive in Africa, the focus should therefore shift to aligning skills with market needs and creating more labour-intensive industries such as manufacturing. The ratification of the Africa Continental Free Trade Area agreement in 2019 bodes well in that regard, bringing with it the promise to boost intra-regional trade, allowing for a modern and competitive manufacturing base to emerge.

Souhir Mzali, **Regional Editor - Africa**

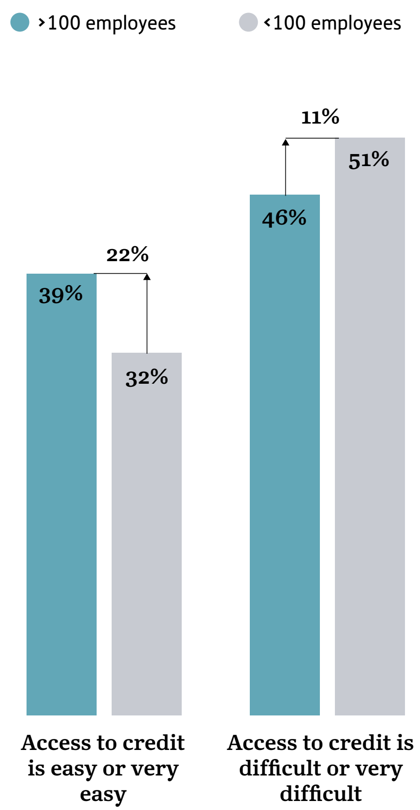
By some margin, the region where CEOs find it most difficult to access credit is Africa, where this perception has generally trended upwards

In both Latin America and the Middle East, the largest percentage found it easy or very easy to access credit, though this has declined since 2017



Strength in numbers?

Companies that employ more people find it easier to access credit



There are a wide range of factors at play here. Interest rates remain historically low, though they are almost always higher in faster-growth markets, as they are a key tool for central banks to manage inflationary pressure. This in turn means that these countries have more room to stimulate their economies with a rate cut than their developed counterparts. Indeed, in real terms, most major developed economies have been in negative real interest rate territory for several years.

So, it is not necessarily interest rates that are the issue.

In a number of Yellow Slice markets, the prominent role of both state and state-owned enterprises has meant that raising capital has not really been an issue until recently.

In the Gulf this is particularly true, where the drive to generate autonomous private sector growth is a key policy goal. As a result, corporate loans, debt and equity issuance, and private equity are all relatively underdeveloped.

UNPACKING TRADE AND TAXES IN ASIA

With China established as the top trade partner for the Association of South-East Asian Nations (ASEAN), and external demand a key driver of economic activity in many member states, the disruption to global trade flows as a result of the US-China tariff war is undoubtedly the number-one reason for a decline in business sentiment across the region in 2019. Following the signing of the so-called phase one trade deal in mid-January, there are reasons to be cautiously optimistic about a more stable trade environment in 2020. However, the deal still leaves many of the tariffs imposed by both sides in place, and fails to address long-standing issues such as Chinese support for state-owned enterprises. We should also note that if China is going to import $200bn more in US goods at a time when its economy is decelerating, it will naturally import less from elsewhere, which could have a negative impact on regional supply chains. Under the leadership of Vietnam in 2020, ASEAN could benefit from concrete actions to strengthen intra-ASEAN trade as a means to mitigate external shocks, including addressing non-tariff barriers.

At the same time, CEOs are growing increasingly dissatisfied with the tax environment. Tax-to-GDP ratios in countries such as Indonesia, Malaysia, Papua New Guinea and the Philippines are notably below averages in Africa and Latin America. Policymakers must walk a tightrope between generating sufficient revenue to channel into much-needed infrastructure and social development projects to meet the demands of their aspirational populations, without dampening private investment or consumption. While tax reform has been high on the agenda of all Yellow Slice countries in Asia Pacific, the Philippines has pursued the most ambitious and wide-ranging recent action. President Rodrigo Duterte's initial Tax Reform for Acceleration and Inclusion package was passed by Congress relatively easily, but it was held responsible for a spike in inflation in 2018 – somewhat unfairly considering the numerous other supply-side factors at work. Nevertheless, negative headlines likely fed into declining sentiment, while the next major package of proposed reforms – aimed at streamlining incentives in special economic zones in tandem with a gradual lowering of corporate tax – has been blamed in some quarters for falling foreign direct investment pledges. While the Philippines' experience does not exactly mirror that of its Yellow Slice neighbours, it is a useful example of the difficulties faced in securing the consent of the private sector and the general public for wide-ranging fiscal reforms that produce short-term pains but long-terms gains.

Patrick Cooke, **Regional Editor - Asia**

III. EASE OF DOING BUSINESS

Another factor banks and financial institutions consider when extending credit to a business is corporate governance. Here again, in many Yellow Slice countries this is a relatively new concept, with transparency a notable issue in some.

In all but one of the past four years (2017) over 50% of CEOs described business transparency in their market as high or very high. However, on average, the percentage of those who were neutral declined and the number saying it was low or very low rose to top 32% in 2019.

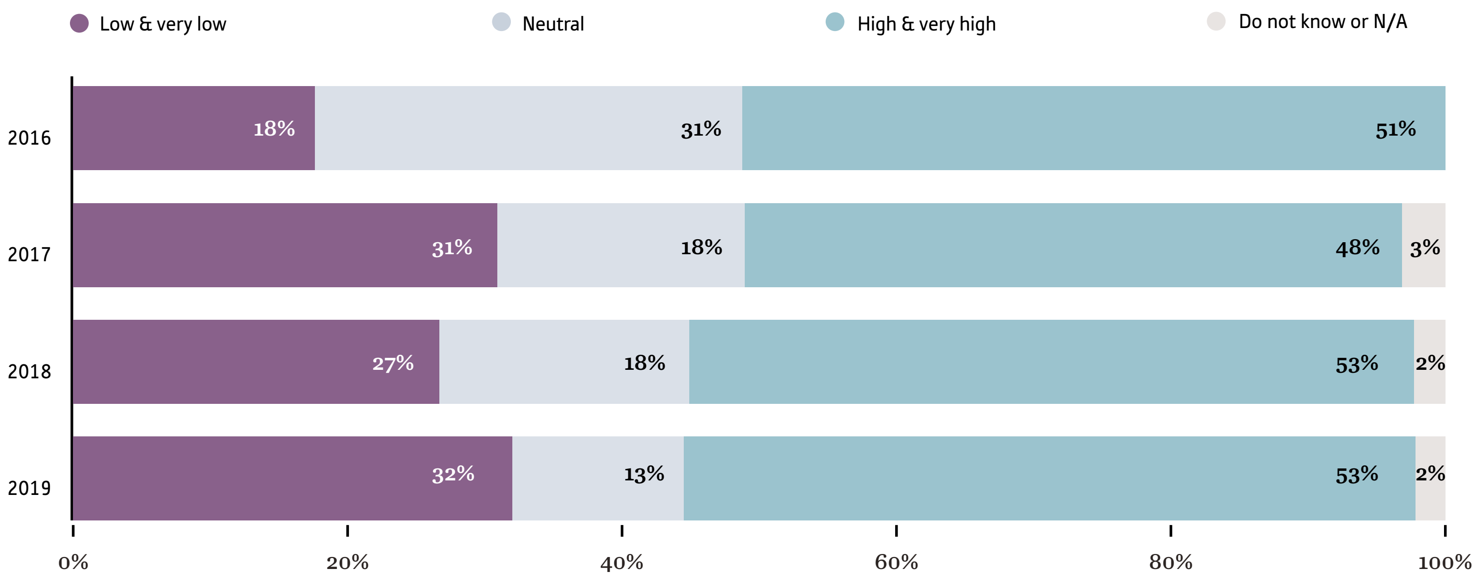
Data from a number of sources suggest that perceptions of corruption are actually moderately increasing in most of the regions we cover, and it is certainly a topic that frequently appears in analysis of fast-growth developing markets. So there could be a simple awareness factor here.

Regardless, the conclusion has to be that there is still a ways to go in this arena – and that's true of so-called developed economies too. It would be a bold banker who claimed that what happened in 2008 couldn't happen again, and the developed world was very much the patient zero of that financial contagion.

Creeping pessimism about business transparency suggests that Yellow Slice markets, like their developed counterparts in North America and Europe, still have some work to do

What is the level of transparency for conducting business in the country relative to the region?

% of respondents



Supposed wits like to say there are only two certainties in life: death and taxes. Just how much tax, personal and corporate, CEOs pay is a major factor, though.

On average, CEOs say that their local tax environments have become increasingly uncompetitive on a global basis over the last four years. In 2016 nearly 70% of respondents said that they felt the environment was competitive. This slipped in 2017 and has held steady at 49%, while the share choosing neutral has steadily fallen.

On a regional basis, CEOs in Asia seem to view their tax environment as the least competitive, and in Africa there is a near equal split between those who view it as competitive and uncompetitive. In Latin America, the figures show sentiment is shifting towards greater competitiveness, while the Middle East remains broadly well disposed toward current levels of taxation.

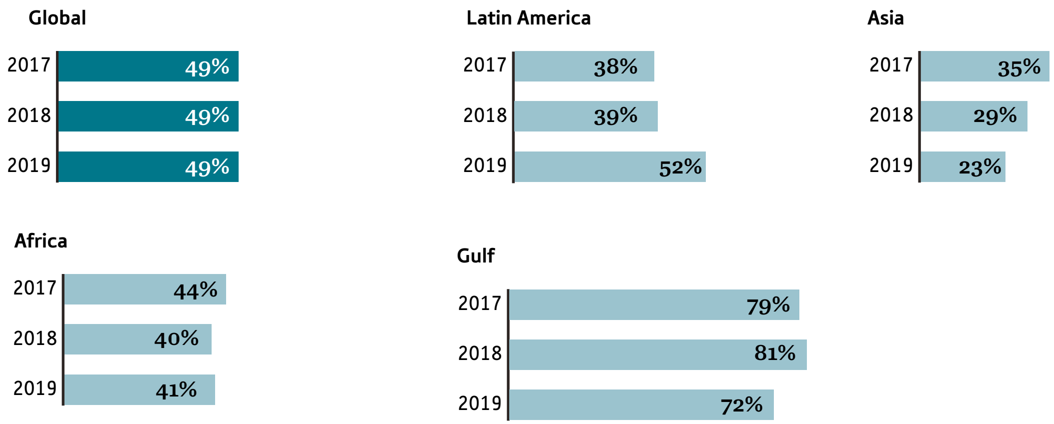
The introduction of a 5% value-added tax (VAT) in the countries that make up the Gulf Cooperation Council in 2018 was a significant change in a region famous for very low to non-existent levies. However, after the initial shock, the impact of VAT seems to have been minimal: the vast majority of respondents still view the environment as competitive or very competitive.

This also speaks to the fact that most businesspeople recognise that taxation, as long as it is reasonable and not punitive, is acceptable, and can oil the wheels of local infrastructure and public services which enable businesses to grow.

Even with the historic introduction of 5% VAT, the CEOs surveyed in the Gulf remain the most positive about the competitiveness of their tax frameworks

How competitive is the current tax environment (business and personal) on a global scale?

% of respondents answering competitive or very competitive



RISK PROFILES IN THE GULF

While in Africa and Asia the slowdown of the Chinese economy has been the main drag on sentiment, in the Gulf concerns have been closer to home. CEOs unsurprisingly consistently cite regional tension as the factor most likely to negatively impact growth, and with 2019 witnessing several flashpoints in the region, it would be astonishing if sentiment had not taken a hit.

Starting with the attack in June on two tankers in the Gulf of Oman, through the September attacks on Saudi Aramco's facilities at Abqaiq and Khurais, and ending with the January 3 assassination of the Iranian major general Qasem Soleimani, in what many commentators consider a rash move on the part of the US, the past year saw a string of significant, sometimes deadly incidents in the region. All of this against a backdrop of ongoing civil wars in Yemen and Syria, and worrying signs of re-emerging civil strife in Iraq, despite US President Donald Trump's early 2019 declaration that ISIS had been defeated.

This is not of course to suggest that a Chinese slowdown does not concern the region's CEOs, however. Recent years have seen a significant deepening of commercial ties with China – which remains the biggest destination for the region's energy exports – while several of the major infrastructure investments across the countries of the Gulf Cooperation Council have links with China's Belt and Road Initiative.

Looking ahead, and as is the case in virtually all Yellow Slice economies, the onus must remain on creating regulatory and fiscal frameworks capable of attracting international capital and investment. However, more crucial still will be the provision of the highly skilled and educated human capital needed to staff the future global economy, whether this be in the application of green energy solutions or the development of Industry 4.0 technologies. With core skills such as leadership, engineering, and research and development consistently identified as lacking across the Yellow Slice, business leaders (in the Gulf at least) will be hoping that the region's bulging youth cohort, coupled with the billions of dollars allocated to education over the past two decades, will stand their economies in good stead as they race to close the skills gap.

Billy FitzHerbert, **Regional Editor - Middle East**

But if, as a business leader, you cannot find the skills you require in a market, then you arguably have a rather bigger problem than taxation.

CEOs consistently identified leadership as the skill most in need, and this held true on both a global and regional level.

This can be attributed to the nascent nature of some sectors in these markets, but also to relatively underdeveloped management training, continuous professional development and, on an intuitive level, the fact that executives naturally place a higher value on managerial prowess.

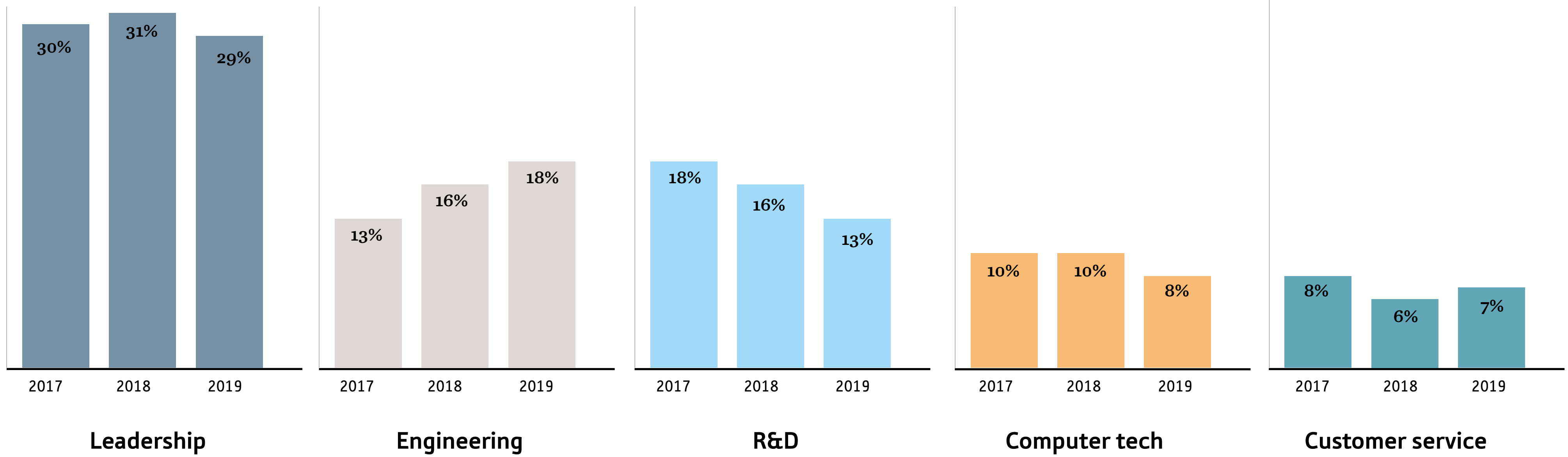
In a number of markets, the private sector still remains relatively small, so there is an experience factor at play too.

But perhaps the more interesting regional divergence is in what ranks second: Latin America and the Middle East both highlighted a lack of research and development skills, while CEOs in Asia and Africa were more concerned with the availability of skilled engineers. This is perhaps unsurprising, given the focus on innovation and knowledge-led diversification in the Gulf, as well as burgeoning industrial value addition and the emphasis on creative industries in Latin America.

While leadership consistently ranks as the most in-demand skill, CEOs in Latin America and the Middle East also highlight a lack of R&D competency, while those in Asia and Africa are more focused on recruiting engineers

What type of skill is in greatest need?

% of respondents, top-five choices displayed



About OBG CEO Surveys

This survey has been designed to assess business sentiment among business leaders (Chief Executives or equivalent) and their outlook for the next 12 months.

Unlike many surveys, the OBG CEO Survey is conducted by OBG staff on a face-to-face basis, across the full range of industries, company sizes and functional specialties. The results are anonymous.

This Global CEO Survey is based on nearly 7000 responses from companies within the following parameters, among others:

- 80% of companies surveyed were private
- 39% of companies surveyed were international
- 45% of companies surveyed were local
- 16% of companies surveyed were regional

The data generated allows for analysis of sentiment within an individual country, as well as regionally and globally. Additionally, comparisons can be drawn between both individual countries and regionally. The results are presented statistically within infographics and discussed in articles written by OBG Managing Editors. OBG provides this survey, infographics and accompanying analysis from sources believed to be reliable, for information purposes only. OBG accepts no responsibility for any loss, financial or otherwise, sustained by any person or organisation using it.

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