

# CKGSB BCI

May 2015

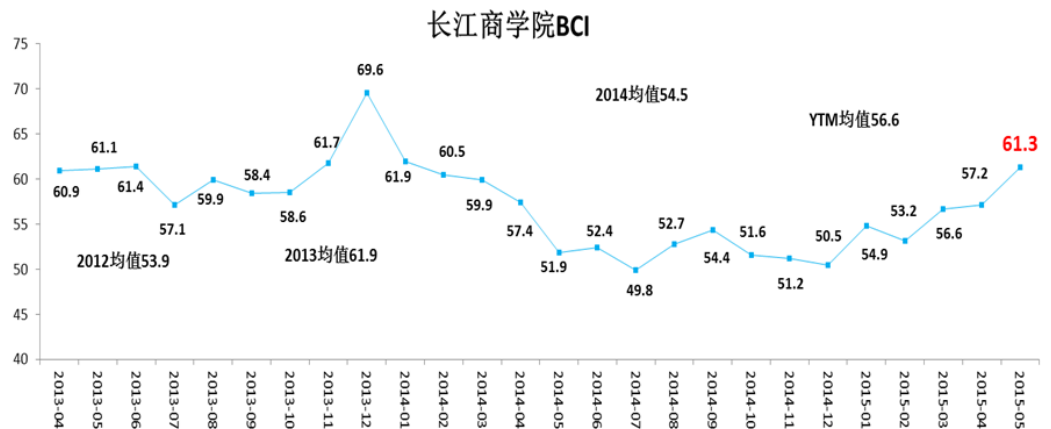
26 May 2015

CKGSB Case Center and Center for Economic Research

In May 2015, the CKGSB Business Conditions Index (BCI) registered 61.3, up slightly on April's index of 57.2, and above the confidence threshold of 50. This shows that the majority of relatively successful firms sampled have a positive outlook on business prospects in the next six months and have plans to expand operations.

July 2014 marked the BCI's low point, with the overall index dropping below the confidence threshold of 50. Since then, the index has begun, by twists and turns, to turn positive. That the forward-looking BCI now registers above 60 means companies are more confident in business conditions over the next six months. The Chinese economy appears to have left its recent slump behind. Moreover, we can look forward to economic growth in the second half of 2015.

**Figure 1 CKGSB BCI**

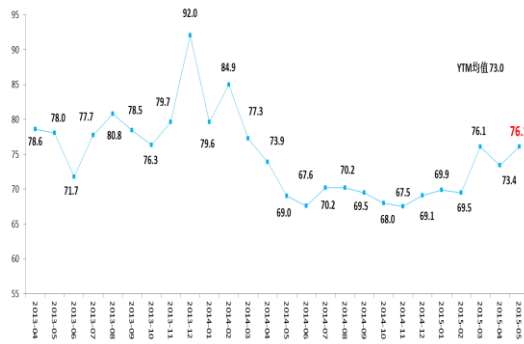


Source: CKGSB Case Center and Center for Economic Research

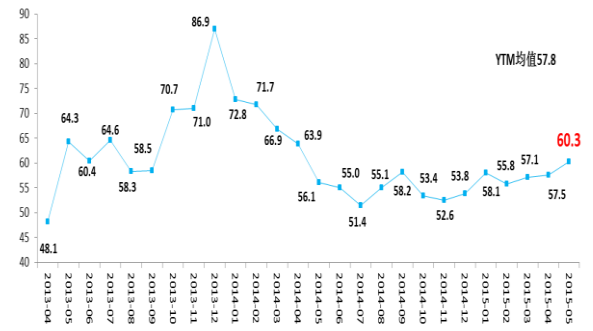
The CKGSB BCI comprises four sub-indices that are forwarding-looking indicators for corporate sales, corporate profits, corporate financing environment and inventory levels. Of these, only the financing index is a measure of the current situation. In May, these sub-indices individually read as follows:

**Figure 2. Sales**

**Figure 3. Profit**



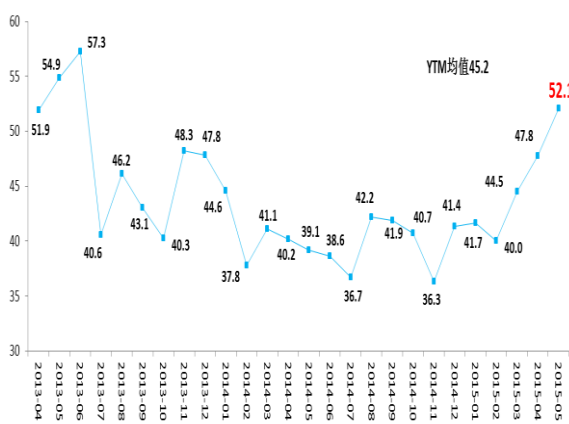
Source: CKGSB Case Center and Center for Economic Research



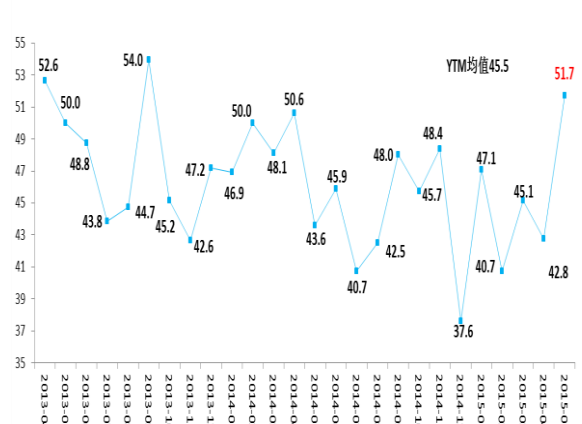
Source: CKGSB Case Center and Center for Economic Research

The corporate sales index remained high in May, indicating that businesses expect healthy sales in the upcoming period. Sales are the foundation of a company, and profits and cash flow all spring from healthy sales. If we look at a company as a pyramid, sales form the bottom layer. When sales are strong and reliable, companies have favorable conditions for development. From Figure 2 we can see that overall sales growth, although volatile in recent months, remains a cause for optimism. From the sales perspective, business conditions are not too bad, or at least not a major cause for concern.

Corporate profits boosted this month's forward-looking index, rising from 57.5 in April to 60.3 this month. This keeps profit forecasts in line with overall BCI trends. Profit expectations in the first half of 2014 fell almost to 50 (51.4 in July 2014), before recovering in the second half of the year. Compared with sales, profit forecasts have fluctuated more. While a lot of companies are experiencing healthy sales, cost pressures and profit adjustments mean that increasing profitability relies most on developing business scale.

**Figure 4. Financing**


Source: CKGSB Case Center and Center for Economic Research

**Figure 5. Inventory**


Source: CKGSB Case Center and Center for Economic Research

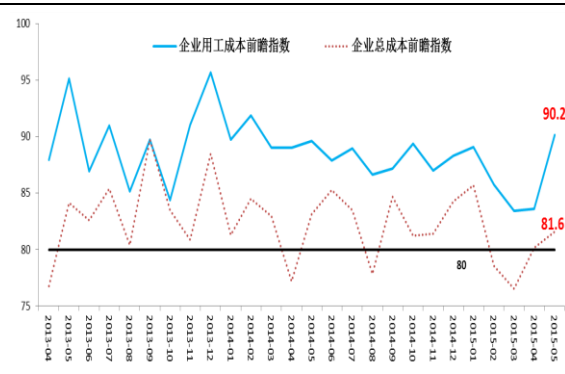
The corporate financing environment index saw good news in May, pushing past the threshold of 50 for the first time since June 2013. At 52.1, the financing environment index has surpassed its long held sub-50 position (July 2013 to April 2015), even dipping below 40 on five occasions and reaching as low as 36.3 in November 2014. Since our sample consists of mainly small- and medium-sized private firms, this data specifically points to challenging financial pressures and high costs in the sector.

In recent months, due to concerns about an economic downturn, the government has adopted a series of economic stimuli. Interest rate cuts have been introduced with the aim of cutting the cost of financing. Some believe that, at a time of economic downturn, banks will become increasingly concerned about bad loans on their books, resulting in a credit crunch. They worry that the cost of capital may not even reach the real economy, especially troubled, smaller, private firms. Others think that lower financing costs will encourage speculation, on the stock market for example, which would completely undermine government policy.

However, the results of this month's index suggest that private SMEs have felt the benefits of government policies. The various concerns expressed above do exist, but the situation is nowhere near as bad as expected.

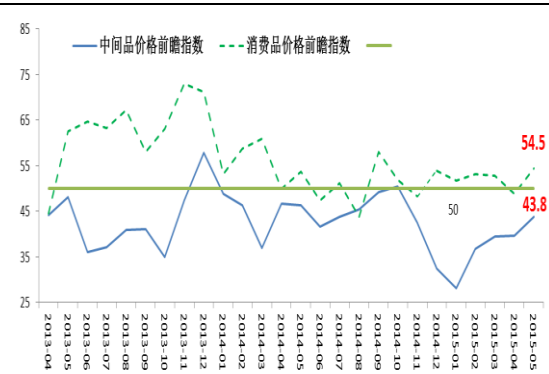
Related to the financing environment, this month's index measuring inventory levels also gave out positive signals, rising from April's 42.8 to 51.7 in May. Although inventory has tended not to register as weak figures as the rest of the BCI, inventory turnover has been sluggish for a long time. The last time that the inventory index rose above 50 was in April 2014 (50.6). From this index, respondents to the BCI survey expressed mildly positive sentiments in this area, but inventory remains an area of concern and further investigation is necessary to determine whether or not inventory levels are sustainable.

Besides the main indices, we also surveyed respondents on predicted costs, prices, investment plans and employment conditions, to form a supplementary set of indices.

**Figure 6. Costs**


Source: CKGSB Case Center and Center for Economic Research

Blue: Labor; Dotted: Overall

**Figure 7. Prices**


Source: CKGSB Case Center and Center for Economic Research

Blue: Producer; Dotted: Consumer

In May, both costs indices rose: labor costs rose from 83.6 to 90.2 and overall costs rose from 80.2 to 81.6. It must be noted that both have risen from an already high level of confidence, with the labor costs forecast at over 90. Long-term high costs show that Chinese firms' costs pressures are structural rather than cyclical.

As with costs, the consumer prices index has also risen. It registered 54.5 in May, up from 48.8 in April. Producer prices are also forecast to rise, with the index up from 39.7 to 43.8. Since January 2014, prices have been stuck in the doldrums with consumer prices doing fairly well, and mostly

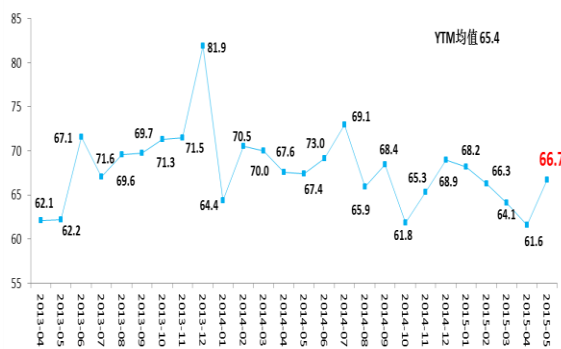
above the confidence threshold of 50. However, producer prices indices have been consistently bad, above 50 in only one month (October 2014, 50.5), and dropping as low as 28.1 in January 2015.

Our data show that firms have a degree of confidence about future consumer prices, but remain pessimistic about producer prices. This is also reflected by official data: CPI figures are low but have yet to reach zero. PPI data has been negative in the long run, only rising above zero in February 2012 (0.03%). Whether looking at the CKGSB BCI or official statistics, both clearly show the same phenomenon – serious overcapacity in industry – and yet this overcapacity has not been satisfactorily addressed to date. Low producer prices and PPI figures indicate that loss-making factories have kept producing. If market competition is strong, such factories would be subject to mergers and acquisitions or go bankrupt. Instead, they appear resistant to the tough conditions. This seems to be related to local government policies. So as to avoid heavy unemployment and other undesirable byproducts of economic trouble, local governments have been conditioned to bail out companies that should perhaps not be saved, using up valuable social resources in the process and redirecting resources from more efficient enterprises. Such a system impedes economic efficiency and harms welfare generally, dampening the growth of living standards for everyone. How to change this requires reflection on all sides.

Having discussed costs and prices, issues concerning investment and labor demand should be considered. Both rose in May, the former from 61.6 to 66.7 and the latter from 64.3 to 69.5. These two indices are interesting because while many indices have fluctuated dramatically since the start of the BCI project in September 2011, such as profits, inventory and the overall BCI, some have remained relatively stable, including costs and the two indices to be discussed next: investment and labor demand.

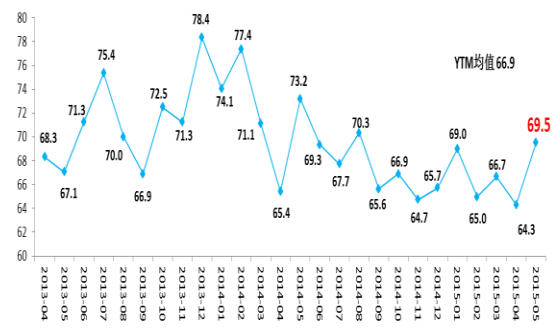
Corporate investment and labor demand indices have stayed above 50 over the long term, and figures remain high. Taking investment forecasts as an example, since September 2011, the index has been between 50 and 60 on three occasions, and above 60 for the rest of the time. For four months, the index has registered above 80. As for the labor demand index, for only one month has the index been between 50 and 60 and the rest of the time it has been above 60, with two months above 80.

**Figure 8. Corporate Investment**



Source: CKGSB Case Center and Center for Economic Research

**Figure 9. Labor Demand**



Source: CKGSB Case Center and Center for Economic Research

Overall, good sales expectations, cost pressures, a poor long-term financing environment and weak prices combine to mean unsatisfactory profit levels. But, despite this, companies continue to expand, invest and make new hires. Government stimuli to promote growth aim to leverage private investments. But our figures show that firms continue to expand, whether or not the government is engaged in stimuli policies. What is their logic?

We believe there are two explanations: the first is that company efficiency is continuously improving and can help them withstand the pressure. However, this conflicts with profit performance. Another explanation is that companies are convinced that in the case of an economic downturn, the government will step in to maintain strong growth. Regarding the second explanation, logically speaking, business practices are not only understandable, but also rational. The problem is that if most companies act in this way, what will happen to the overall business landscape?

### **CKGSB BCI Introduction**

In June 2011, the CKGSB Case Center and Center for Economic Research initiated a project to gauge the business sentiment of executives about the macro-economic environment in China – called an index of business conditions.

Under the direction of Professor Li Wei, in July 2011, the two research centers designed and tested the BCI survey. In September 2011, the first surveys were distributed and results computed. Since May 2012, the research team has published monthly BCI survey reports.

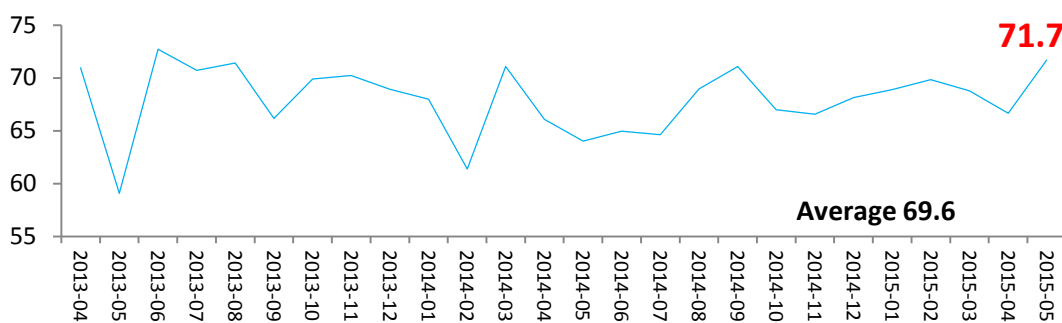
### **Explanation of the Index**

The CKGSB Business Conditions Index (CKBCI) is a set of forward-looking, diffusion indices. The index takes 50 as its threshold, so an index value above 50 means that the variable that the index measures is expected to increase, while an index value below 50 means that the variable is expected to fall. The CKGSB BCI thus uses the same methodology as the PMI index.

The survey asks senior executives of companies whether their main products are for consumers or non-consumers, and then asks how they think product prices will change in the next six months. Based on survey responses, we have been able to report expectant changes in consumer and producer prices.

The BCI is generated wholly on the basis of statistics gathered from leading enterprises, whose executives have studied, or are currently studying, at Cheung Kong Graduate School of Business. In the questionnaire, we ask respondents to indicate whether their firm is more, the same, or less competitive than the industry average (50), and from this we derive a sample competitiveness index (Figure 10). Consequently, as our sample firms are in a relatively strong competitive position in their respective industries (71.7 in May), the CKGSB BCI indices are higher than government and industry PMI indices, and, put another way, China's overall situation is worse than shown in this report.

### **Industry Competitiveness**



Source: CKGSB Case Center and Center for Economic Research

### Method of Calculation

During each survey, respondents are asked to indicate whether certain aspects of their business (e.g. sales) are expected to increase, remain unchanged, or decrease over the forthcoming six months as compared to the same time period last year. The diffusion index is calculated by summing the percentage of “increase” responses and half of the “remain unchanged” responses.

Of all the indices measured for the CKGSB BCI, the overall business conditions index is an aggregate index, which has been calculated, since December 2012, by averaging its four constituent indices of sales, profit, financing environment and inventory. The aggregate BCI index before December 2012 uses a different composition of constituent indices, and is therefore not directly comparable to the current BCI index.

### About Cheung Kong Graduate School of Business

Established in Beijing in November, 2002 with generous support from the Li Ka Shing Foundation, CKGSB is a private, non-profit, independent educational institution and the only business school in China with faculty governance. The school offers innovative MBA, Finance MBA, Executive MBA and Executive Education programs. In addition to its main campus in the center of Beijing, it has campuses in Shanghai and Shenzhen and offices in Hong Kong, London and New York.

CKGSB faculty, through their on-the-ground research and close relationships with leading domestic executives, provide global thought leadership on both the theory and the practical reality of real-life business in China. They consistently generate important insights into areas that are poorly understood outside of China, such as the globalization strategies of Chinese companies and competition and collaboration among state-owned enterprises, private businesses and multinationals.

CKGSB is the only business school in China with the reputation and resources to attract faculty from top business schools such as Wharton, Stanford, NYU, and INSEAD. The majority of CKGSB faculty members were born and raised in China before leaving to study and teach abroad. Their bicultural backgrounds have endowed them with a valuable capacity to interpret global business in the context of both China and the West.

### The Research Team

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