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by Andrew Cainey, Suvojoy Sengupta, and Steven Veldhoen

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Capturing the Asian Opportunity

Economic recovery in China, India, and elsewhere in the region could be the strongest source of sustained global growth for years to come.

by Andrew Cainey, Suvojoy Sengupta, and Steven Veldhoen

In September 2008, the global financial crisis hit Asia like a tidal wave, flooding in from the U.S. and Europe. Within weeks, Asian GDP growth rates began to tumble: China's annual growth rate dropped from 13 percent in 2007 to about 9 percent in 2008, India's slipped from 9 percent to below 6 percent, and Singapore's plunged from 8 percent to less than 4 percent. Underlying these stark statistics were significant declines in exports. In March 2008, China and India had boasted year-over-year export growth rates of more than 30 percent; nine months later, both were well into negative territory. Foreign direct investment in these countries, and in Korea, Japan, and the nations of Southeast Asia, fell significantly as well.

But by September 2009, it was clear that China, India, and other emerging Asian economies would be the first part of the global economy to rebound. In the second quarter of 2009, China's GDP was up 7.9 percent compared to the same quarter in 2008; India's growth rates began to rise over the same period. This all came as a surprise to many observers, who had overestimated the importance of exports to the largest Asian economies and otherwise underestimated Asia's healthy fundamentals. As it turned out, domestic banking systems in China and India were relatively unaffected by the subprime and securitization crisis, and rapid growth in domestic demand, spurred by government stimulus, compensated for at least some of the drag caused by declining exports. Forecasts call for even better results in 2010. In addition, economic prospects are either stable or rebounding in Pacific Rim nations. In the second quarter of 2009, according to a survey in the *Economist,* Singapore, China, Korea, Japan, and Australia showed quarter-on-quarter annualized GDP growth of 21 percent, 15 percent, 10 percent, 0.9 percent, and 0.6 percent, respectively. The accuracy of specific numbers may be open to debate, but the general direction is undeniable.

This kind of growth, at a time when prospects for the economies of Europe and North America remain ambiguous or moribund, offers substantial opportunities for global businesses. And it also offers a warn-

Illustration by Lars Leetaru

ing: As the recession eases, the shift of global economic activity to Asia is accelerating. This transition had begun well before the collapse, but as recently as 2008 many Western businesses were essentially ignoring it. That is no longer a viable strategy.

Inside the Transition

For hundreds of years prior to the West's Industrial Revolution, China and India together accounted for about half of the world's economic activity. Then, as Western economies industrialized, China and India fell behind — down to only 8 percent in 1970. This trend began to reverse in the 1980s, and today, these two countries account for just over one-fifth of global economic activity. That may seem like a great deal, but not when you consider that they contain more than one-third of the world's population. There are innumerable consumers in India and China seeking to buy products they have never had; an immense amount of financial capital, deployed effectively for growth; many eager and capable entrepreneurs; and a highly favorable business environment for the first time in hundreds of years. All this adds up to a significant shift in the world's economic center of gravity.

Perhaps the most important component of this transition is the growth in Asian consumer markets. When the economic crisis struck, there were fears that weakening consumer spending around the world would spread to Asia. Indeed, more than 20 million Chinese people lost their jobs in the export sector, and the McDonald's Corporation, a bellwether of consumer confidence in emerging markets, reported falling sales in southern China.

But retail sales growth has rebounded sharply in China and India. One force driving this turnaround is consumer credit; younger populations in Asia are more amenable to buying on credit than their parents are, and as aspirations and incomes grow, people recognize the value of credit in allowing them to make purchases they would have otherwise put off for years. Levi Strauss & Company has just announced the first consumer credit program for low-ticket items in India, offering jeans on an interest-free, "buy now, pay later" installment plan. In an experiment conducted over two months in company stores in Bangalore, consumers spent 50 percent more than usual when offered the installment option. The number of credit cards issued annually in China, meanwhile, was about 140 million in 2008, and it's growing more than 50 percent per year.

Another factor affecting spending patterns is the gradual change in government-supported social benefits that is planned in countries such as China. Improvements in health insurance and pensions, although still in their early stages, may free consumers from the need to save as much as they have traditionally saved for their old age.

As global consumer products companies turn to this Asian consumer base, they find themselves welcomed. China is already Adidas's second-largest market after the United States. Mattel's Barbie brand is a big hit in Shanghai. Retailers such as Walmart, Tesco, Carrefour, and Metro, and consumer products companies such as Unilever, Procter & Gamble, PepsiCo, and Coca-Cola have credibly ambitious growth plans for the region. Indonesia, with a population of nearly 240

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million, has generated attractive profits for local companies such as Ramayana and multinationals such as Unilever. In India, government policies still hobble foreign companies, to some extent. But the government is steadily liberalizing, and a 2009 global survey conducted by KPMG International of corporate investment plans predicted that "India will…become the world leader for investment in manufacturing in five years."

Companies based in Asia are finding ample opportunities as well. Because they escaped the economic crisis relatively quickly, many leading Chinese and Indian companies gained prominence on the global stage in 2009. By market value, five of the top 20 banks in the world, including the two largest, are Chinese. (See "What Banking Needs to Become," by Vanessa Wallace and Andrew Herrick, *s+b*, Winter 2009.) As consumers in the U.S. and Europe retrench, Asian companies are looking elsewhere for sales growth. For example, China's trade relations with Latin America, Africa, and the Middle East are growing rapidly; Brazil–China trade alone has shown a 12-fold increase since 2001.

The crisis has also made the connections among Asian companies stronger. Japan and Korea have begun to relocate their manufacturing and customer service sites to lower-cost nations in their backyards. Nissan Motor Company plans to produce the next-generation version of its super-mini, the March, in Thailand in 2010. This will be the first major mass-market Japanese car to be manufactured completely outside Japan; the move will reduce costs for this vehicle by as much as 30 percent. And many Chinese companies have been explicitly mandated to "go out" (*zou chuqu,* in the words of the declared government policy) seeking customers and alliances across Asia.

More than $1.7 trillion in infrastructure investment is required in India in the next 10 years.

Infrastructure: Urban and Rural

Throughout Asia, there is a large need for traditional, "hard" infrastructure: roads, bridges, airports, utilities, and rail networks. Goldman Sachs has estimated that India alone requires more than US$1.7 trillion in infrastructure investment during the next 10 years, particularly in energy, transportation, water, and sewage. China's $600 billion government stimulus package, put into play a few months after the start of the economic crisis, is bringing a new wave of infrastructure investment to that country. The package includes support for thousands of miles of high-speed rail transit and nearly 100 new airports.

Other countries are following suit. In July, the Indian government announced a plan to attract up to $10 billion in foreign investment to help finance toll road construction. These and other infrastructure investments create large-scale business opportunities for multinationals. Siemens AG has announced that it expects to reap orders worth $5.87 billion from the Chinese stimulus alone.

The need for "soft" infrastructure — improvements in health care, education, financial-services infrastructure, and regulatory and legal institutions — is just as compelling. One estimate suggests that India would need to build another 1,500 universities during the next six years to keep up with its ambitious population and its need for skilled human capital. Governments will increasingly turn to the private sector for these types of projects. In India, Apollo Hospitals, founded in 1983, provides an early example. A private company with government sponsorship, Apollo manages 10 major hospitals, including some that have been recognized internationally for their quality; dozens of health-care facilities throughout India; and a variety of innovative institutions, such as Asia's first call center for information on the swine flu virus.

Asia is also likely to adopt leading-edge smart technologies as it builds new energy and transportation systems from scratch. In the U.S. and Europe, the legacy systems built decades or centuries ago are far more difficult to upgrade. For example, adding air conditioning to some lines of the London Underground subway system has proven impossible, because there is no room for ducts to disperse waste heat. In Asia, new technologies such as Cisco's Smart+Connected Communities, which incorporate personalized security, communications, and efficiency into local energy systems, are more easily implemented than in the West.

Finally, governments are placing a high priority on driving economic gains into rural areas. The

Chinese, Indian, and Indonesian governments are all encouraging private companies to serve these markets profitably and sustainably without government subsidies. China's name for its reinvigorated focus on rural development is the New Socialist Countryside, but the plan has many capitalist elements, including incentives for consumers to purchase new appliances. Institutions such as HSBC, Bank of Beijing, and China Life are trying out new banking and insurance services in rural areas. In India, ICICI Bank, after making its name serving the consumer banking needs of the emerging Indian urban middle class, has targeted rural banking with services that include cattle loans, Internet kiosks, and funding for countryside business initiatives.

Rural consumers' purchasing habits are different from those of their city-based counterparts; these consumers expect lower price points and are more dispersed and harder to reach. Companies such as Unilever PLC have already learned to offer products in smaller packaging for rural markets in Indonesia and India. In Malaysia, the telephone manufacturer E-Gal is supplying fixed-line devices to Telekom Malaysia as part of a package for migrant workers who can't afford mobile phones. In China, after observing how rural residents use its products, the appliance maker Haier developed dual-use washing machines that can clean both clothes and vegetables.

Capable Companies

As the growth opportunities have become more evident, the competitive environment in Asia has intensified. This has forced many previously diversified companies to focus on particular businesses. Some Japanese and Korean companies had long maintained widespread and unrelated asset portfolios, influenced in part by government policies that promoted the growth of unwieldy conglomerates, often with interlocking directorates and management. Starting in the mid-2000s, these companies began to exit businesses in which they didn't have a commanding lead or the prospect of developing one.

For example, the Doosan Corporation, an $18 billion Korean conglomerate, has reinvented itself as a high-margin industrial and construction equipment and technology company, minimizing its low-margin consumer business. Doosan disposed of units such as Doosan Kimchi (maker of food products) and Doosan BG (wines and liquors), while acquiring infrastructure equipment firms such as Bobcat and Daewoo Heavy Industries. Other companies have made similar moves in response to the economic crisis; in February 2009, Pioneer (based in Japan) terminated its unprofitable plasma display panel business to focus on automobile electronics and home audio products.

One thing Asian companies are not reducing is their interest in innovation. (See "Profits Down, Spending Steady: The Global Innovation 1000," by Barry Jaruzelski and Kevin Dehoff, *s+b*, Winter 2009.) Asia's emerging economies, particularly India and China, are following the pattern originally set by Japan and Korea. They, too, were once known for low-cost manufacturing and mimicry of Western design. Over the years, Japanese and Korean executives deliberately built up their companies' design and manufacturing skills and became global innovation leaders in everything from cars to mobile phones to plasma televisions. Now, the Chinese government's five-year plan includes a similarly deliberate emphasis on creating an innovation-oriented economy. India's innovators, although they have less government support, are active in such fields as health care, finance, agriculture, and public–private partnerships. (See "The Innovation Sandbox," by C.K. Prahalad, *s+b*, Autumn 2006, and "Not Just for Profit," by Marjorie Kelly, *s+b*, Spring 2009.)

Innovation is usually born of need and opportunity, and Asia has some of the greatest societal challenges in the world.

Innovation is usually born of need and opportunity. And Asia has some of the greatest unmet customer markets and societal challenges in the world, with its vast rural areas, huge demands for natural resources, significant environmental problems, and aging populations. Many Asian governments will rely on private-sector innovation to help meet these challenges. For example, after paying little attention to air quality during its initial burst of industrial development, China has announced a plan to become the leading producer of hybrid and all-electric vehicles by 2012. Companies whose capabilities dovetail with this green strategy could find a lucrative welcome. Meanwhile, Toyota is developing personal-care robots that can perform housekeeping and nursing chores, which it intends to target to Japan's growing senior citizen population. For the same reason, the Japanese pharmaceutical firm Kowa has set up a joint venture with Teva, an innovative Israeli drugmaker, to bring 200 new drugs to market by 2015. If such innovations succeed, other companies may follow.

Risk management is turning out to be another critical capability for many businesses entering Asia, where uncertainty and volatility are often part of the business environment. Consider, for example, the turbulence caused by exchange rate variations. The Korean won fell by 40 percent against the U.S. dollar from January 2008 to March 2009, when it reached its low, and then rose 26 percent in the following five months. Meanwhile, the yen strengthened 21 percent against other currencies throughout 2008 before falling 11 percent in the first eight months of 2009. Even the situation for the Chinese yuan is mixed: Although it has remained stable against (and effectively pegged to) the U.S. dollar throughout the crisis, it has appreciated 11 percent against the euro since January 2009, paralleling the euro's strength against the U.S. dollar during the same period. Swings of this magnitude have a major impact on sourcing, manufacturing, pricing, and M&A decisions.

Policy uncertainties represent another question, especially because governments in Asia have traditionally played a strong role in determining industrial policy. The 2009 election in Japan, which brought the Democratic Party of Japan into power for the first time, and the complexities inherent in the U.S.–Chinese relationship have underlined these uncertainties. Many U.S. and other Western companies will need to improve their skills in working closely with policymakers as the recession gives governments a much greater hand in managing companies, industries, and economic investment.

The Shape of Asia's Industries

As Asia recovers, a new series of mergers, acquisitions, and partnerships will be initiated by Asian companies, which will lead to newly consolidated global industries. No longer will the key economic benchmark for the region be foreign direct investment in China, India, and other parts of Asia. Instead, the future of Asian economies will be determined by an increasingly complex web of investments.

China is already home to many of the world's largest firms. For example, in August 2009, Air China Ltd. had the largest market capitalization of any airline. Some Chinese and Indian companies are coming out of the recession with stronger cash flows and market positions than they had in the past — and are now in stronger positions than their Western competitors. Combined with the profound troubles of many established institutions, particularly in automobiles and financial services, along with greater uncertainty in every global industry, the result is a new set of opportunities for M&A that would have been hard to imagine before the crisis.

Examples include the acquisition of the assets of Australia's Oz Minerals by China's Minmetals for $1.2 billion. (China Nonferrous Metal Mining Group similarly attempted to purchase a majority stake in the Australian rare earths company Lynas Corp. for about $400 million, but the Australian government did not approve the deal.) China's particularly strong business interest in Africa, the Middle East, and Latin America, is evidenced by the Industrial and Commercial Bank of China's purchase of a minority stake in South Africa's Standard Bank; the acquisition by Chinese chemical company Sinopec of the oil and gas company Addax, which has significant assets in Africa and Iraq; and PetroChina's stated interest in acquiring the Latin American assets of Spanish oil company Repsol.

In pursuing these deals, some prospective acquirers are looking for short-term financial returns; others have a longer time horizon. Bank of China and automaker Geely, for example, are concentrating on acquiring capabilities (for businesses in aircraft leasing and engine drive transmissions, respectively).

Success in international mergers and acquisitions always requires a high level of market and cultural understanding. British retailer Marks & Spencer had problems with its store opening in Shanghai in 2008; management had underestimated the impact of variations in shopping habits between consumers in Shanghai and those in Hong Kong, where the company's stores had traditionally done well. The retailer also experienced unexpected supply chain delays involving Chinese customs. Asian companies moving into Africa, Latin America, and other parts of the world are experiencing similar difficulties.

But that won't stop the movement toward Asian mergers. In Japan, for example — a country that has often resisted consolidation — companies with excess capacity, such as those in the paper and computer storage device industries, are reducing factory capacity through mergers. The Lawson convenience store chain recently acquired its insolvent rival am/pm; it can now compete more effectively against market leader 7-Eleven in Japanese metropolitan areas.

In short, the Asian recovery will not represent a return to business as usual. It will lead both to more consolidated industries at home and to a far greater global presence for companies from India, China, and elsewhere on the continent.

The companies that best capture the resulting opportunities will be those with a coherent, focused approach to their markets, combined with a distinctive set of capabilities that give them an edge in reaching those markets. (See "How to Win by Changing the Game," by Cesare Mainardi, Paul Leinwand, and Steffen Lauster, *s+b,* Winter 2008.) For Asian companies, the conventional strategy of moving abroad by acquiring assets will not work. For Western companies, moving established operations into Asia will be equally fruitless. There's only one way for both types of companies to succeed: By determining the capabilities they need to drive operations and investing in those exclusively. If companies' capabilities match their strategic plans, Asia's growth can provide a powerful counterweight to the worldwide recession — and a platform for global expansion afterward. +

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