ASIAN MANAGEMENT INSIGHTS

SMU
SINGAPORE MANAGEMENT UNIVERSITY

ASIAN MANAGEMENT INSIGHTS

Leveraging Market-Based Assets
To de-risk the firm's operations

Singapore's Growth Story
An interview with Singapore's sixth president S.R. Nathan

Mind the Liquidity Gap
Impact of safeguards after the Lehman crisis

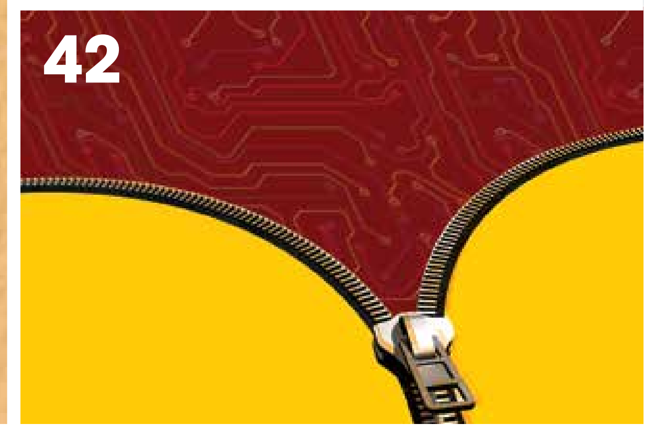
Re-visioning the Silk Road
The converging economies of India and China

Singapore Management University

Vol. 1, Issue 2 (November 2014)

VOL.1 S$16.00
ISSN 2315-4284

CONTENTS



One way to manage uncertainty is to create your own destiny, and do the right things right.

- S.R. Nathan, sixth President of Singapore

AT THE HELM

INDUSTRY WATCH

VANTAGE POINT

CASE IN POINT

EXECUTIVE BRIEF

Uncertainty, volatility and risk are a part of life in the global economy. In this day and age, the ability to embrace these aspects is the difference between surviving and thriving.

– Philip Zerrillo, Editor-in-Chief, Asian Management Insights

PARTING SHOT

ASIAN MANAGEMENT INSIGHTS

Asian Management Insights (ISSN 2315-4284) is published biannually at a recommended retail price of S$16 by the Centre for Management Practice, Singapore Management University, 81 Victoria Street, Singapore 188065.

We welcome comments and letters to the editor should be sent with the writer's name, address, and phone number via email to editorami@smu.edu.sg. Letters may be edited for length and clarity, and may be published in any medium and at the Editor's discretion. All letters become the property of Asian Management Insights and will not be returned.

Submissions: We encourage submissions. Proposals for articles should be addressed to editorami@smu.edu.sg. Unsolicited manuscripts will be returned only if accompanied by a self-addressed stamped envelope.

Subscriptions: Please email enquiry to subscriptionsami@smu.edu.sg.

For further information, to advertise or request reprints, please contact: enquiryami@smu.edu.sg.

FROM THE EDITOR

Uncertainty. Volatility. Risk. The mere mention of these words can unnerve the most stoic of corporate leaders to assume a defensive posture and ready themselves for the inevitable storm ahead. The way they choose to manage these factors is often dependent on the type of risk preferences they are willing to assume, and their ability to employ the skills, knowledge and insights available to them. Unfortunately, many firms lose sight of their vision in a reactionary grasp at survival, and soon find themselves battling crisis after crisis.

The reality of the matter is that uncertainty, volatility and risk are a part of life in the global economy. In this day and age, the ability to embrace these aspects is the difference between surviving and thriving. Asian Management Insights explores this topic further. Our distinguished authors' insights and observations on how firms are reshaping their markets will provide stimulating reading for anyone interested in running a successful business–even under these onerous conditions.

Sustained competitive advantage requires leadership and innovation. In this issue, the former President of Singapore, Mr S. R. Nathan, shares his thoughts on how newly independent Singapore navigated through its extremely fragile and uncertain future. The city-state's success, he argues, was in large part due to a strong, competent leadership that maintained a long-term vision and commitment to investing in human capital. In an interesting aside, he also tells Asian Management Insights that collaboration between the regulators and the private sector does not necessarily have to be at odds with one another.

If risk and uncertainty are inherent in all complex business relationships, how can firms succeed in volatile markets? As one of our contributors notes, leveraging a firm's more intangible market-based assets, such as its ecosystem and networks, is essential to succeeding in rockier markets. But even the term 'rocky' often reflects ambiguity bias and unfamiliarity with a market–and investors, wherever they are located, often overlook many opportunities. Indeed, as one of our authors argues, Asian conglomerates are significantly undervalued, which raises thought-provoking questions on unrealised opportunities within the region.

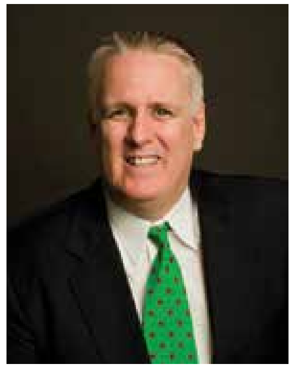
Our authors also explore how firms will have to rethink conventional strategies to manage cross-border talent, wealth and reputation.

These are exciting times. The formation of the ASEAN Economic Community, now just months away, will become the sixth largest economy in the world, creating new business frontiers.

China–now the world's largest economy–together with India, is once again travelling the Silk Road. This journey sees Indian firms adapting and redefining their own manufacturing and service models as they enter China, and modifying them yet again as they re-examine the future of their home markets. It is the ability of firms to learn from one market and bring those insights into another that is imperative to developing dynamic capabilities to thrive in the face of uncertainty.

As our authors also point out, in the years since the 2008 global financial crisis, we have witnessed a rush of money from quantitative easing in the developed markets flow into emerging market bonds. Emerging market debt is now five times higher than the debt levels witnessed prior to the collapse of Lehman Brothers, and while market volatility has been at an all time low, it is now showing signs of returning.

Managing uncertainty is never an easy task. But strong leadership and innovation continue to be timeless advice for governments and corporate policy makers alike. Successful businesses need to be adaptive and resilient, and must embrace change constantly. Inertia is not an option.



DR PHILIP C ZERRILLO
Editor-in-Chief
Asian Management Insights
pzerrillo@smu.edu.sg

Singapore's growth story: LEADERSHIP AND INNOVATION

The sixth president of the Republic of Singapore, **S.R. Nathan**, talks about leadership and innovation as the key foundation stones in Singapore's growth story in this interview with Rajendra Srivastava.

I think it is very important to remember that leaders have got to do the right thing, given the circumstances, and prioritise what is important for society.

The Singapore you see today is very different from the harsh and difficult environment you grew up in. You witnessed the war and the Japanese Occupation. Looking back, what do you think are some of the key factors that worked for Singapore once it gained independence from Malaysia in 1965? What is it that saw the country truly 'take off'?

When the British left, there was total uncertainty. One way to manage that uncertainty was to create your own destiny, and do the right things right.

When the British decided to grant the right to 'Internal Self Government' in 1959, there was great doubt as to how Singapore was going to manage. Unemployment was high, and no new jobs were being created to absorb the thousands coming out of school and into the employment market. Labour unrest was high and political agitation was becoming increasingly prominent.

How to create our own destiny by doing the right things right was the pre-occupation of the leadership.

In 1965, following Independence and our separation from Malaysia we faced many serious challenges, and Singapore was left plagued with doubts if it could survive. There was the loss of the hinterland, which Malaysia had retained, and we were also racked with financial issues and resources held in pound sterling that were plummeting in value. At that point, we could have either caved in, or 'thought positively'. Our leaders chose to do the latter, and a decision was made to prioritise Singapore's industrialisation. JTC, formerly known as the Jurong Town Corporation, was set up soon after to develop industrial sites beyond Jurong, which was our first industrial site. The Government also took over the shipyard in the naval bases left by the British and converted it to a government shipyard, which was later privatised. Likewise, the shipyard belonging to the Port Authority transformed the swampland of Jurong into our first thriving industrial estate.

Basically, society has to look forward. And Singapore believes in being forward-looking. In fact, we are always thinking of what to do next and there has been a continuous transition from an economy based on raw materials trade (rubber and tin), to higher value products such as palm oil, and then on to manufacturing, services, and now technology. Innovation has been a cornerstone of our growth, together with a disciplined societal leadership.

Can you elaborate on the role leadership has played in developing Singapore? Why does 'thinking positively' seem to have worked in Singapore and not in most other places?

In India, for example, as well as in some other nations, one day the British were in charge, and the next day they were in charge. Perhaps those who took over chose not to do anything differently compared to the British. For instance, India handled its economic uncertainty differently. It chose to close itself off from uncertainty.

Singapore believes in being forward looking. Innovation has been a cornerstone of our growth, together with a disciplined societal leadership.

Somehow our leaders in Singapore were more willing to take a path that was different. They realised early on about the reality of our political and economic circumstances that saw us without adequate means to feed three million people and a (shrinking) economy. I think it is very important to remember that leaders have got to do the right thing, given the circumstances, and prioritise what is important for society as well as realistically deliverable. They may be unpopular, they may not be good solutions, but they are things that need to be done and you have to be brave enough to see them through, taking the necessary risks and managing the transition.

We had as leaders a core group of men seized with a sense of mission, supported by able administrators who saw to it that there was collaboration across all sectors in the translation of policies into reality. They recognised that there was a need for the government to drive growth, especially as it was faced with limited capital and skills as well as a shrinking market. This was admittedly quite contrary to Western philosophy, which is usually opposed to government intervention in the economy, but Singapore did not have the luxury of adopting the free market mechanisms advanced by others, and had to push for planned growth in its own way. We tried our best to learn from others, but ultimately decided to take approaches that were modified to suit our own circumstances, needs, and our limited resources and capabilities.

What were some of the specific actions that Singapore's leaders took with regard to the external world in order to set up a platform for growth?

There were many things we did. We recognised our dire circumstances, and focused on seriously addressing our economic problems—thinking about what we needed to do to overcome the problems it might generate in the long-term, should they remain unresolved.

We also took a pragmatic approach to our neighbours in the region. Take our relationship with Japan. At that time, there was a lot of turbulence in the region, and several countries wanted to extract their economic revenge against Japan. This was much like what Western Europe did to the Germans after World War I, when they made it so painful for Germany that it was almost impossible for the country to pay off all that it owed. Several people held that same sentiment here. However, our first prime minister, Lee Kuan Yew, stepped in and took steps to settle the issue. He reminded the people that no amount of money could ever resolve the pain that they had suffered. Through his efforts the matter was put to rest, with Japan agreeing to pay S$50 million in compensation, half of which was a grant and the rest a loan. This was taken as both a gesture of atonement and as a gesture to put the past behind us. It helped make a new start for the Japanese and our own people to find a way to work together. This helped us build our economy with Japanese investments; and was in contrast to other countries that were still demanding reparations. Subsequently, as a result of the improved political relations, large companies like Mitsubishi, Ishikawajima-Harima and Sumitomo began to step in and invest in Singapore's economy, as well as take part in our industrialisation effort.

And then, as I mentioned earlier, we also realised we had very little in the way of resources—with no hinterland, no agriculture and no minerals. We were just a small island, but nevertheless still a very important trade and maritime centre for the region. This was an asset we chose to build on. Clearly we had to find ways to attract financial capital. As there was limited human capital available, we had to be very open to bringing in people with skills while at the same time ensuring that we were also focused on developing our own people. Priority was accorded to education to meet the demands of an economy that was beginning to need trained manpower that went beyond schooling.

And we were always looking for ways to improve, or what I call 'learning how to learn'. We looked at what was successful in Asia and beyond. Initially we looked to Hong Kong and Taiwan for industries to absorb our unemployed. We then concentrated on investment promotions in Europe and the U.S.—always seeking to try and get ideas, but ultimately recognising that we had to focus on what we possessed in Singapore and decide for ourselves about how to best adapt or adopt their ideas.

Could you elaborate on some of the internal policy innovations that took place?

With independence in 1965 and the permanent loss of our hinterland, the urgency to attract foreign direct investment became more than urgent. The pro-Communist labour organisations were still agitating and disrupting the industrial peace. Singapore faced a daunting challenge to get those supporting the governing party to tone down their militancy and opposition in order to attract the multinational corporations that were prepared to come and invest in Singapore, bringing with them capital, know-how, skills and markets.

Faced with such challenges from within, I remember the Prime Minister confronting some prominent leaders of the Labour Movement and saying that he had the moral duty to find jobs for the growing number of unemployed, and that was his priority—and not to protect those who already had jobs and wanted more benefits, at the expense of those without work. He reminded them that if he had to fight them, he would do so. However, if they appreciated our circumstances and helped the coming of the MNCs, he would ensure that their jobs were secure and that they would be assured of fair treatment and reasonable wage increases in line with national economic performance.Out of that debate sprang the seeds of tripartism and orderly annual wage increases as determined by the tripartite National Wages Council—which continues to this day.

To the credit of organised labour, it saw a way of co-operating, after holding its own 'Modernisation Seminar' to discuss and determine what it had to do in the circumstances.

With an improved labour relations climate, efforts were made to attract MNCs looking for production locations to consider Singapore as a venue for their operations. Singapore's policy of focusing on English in our schools and an emphasis on science and technology made us attractive as a source of workers for such investors. With MNCs entering, and the economic growth that came with oil explorations in Southeast Asia, our employment picked up and within two to three years, we had wiped out our unemployment.

At the same time and through the investment promotion efforts of our Economic Development Board (EDB), foreign investment in manufacturing and services was beginning to bear fruit.

Government efforts thus provided the boost for various industries and services that are prominent in our economy today. DBS Bank, for example, came out of an EDB service to support investors with funding to facilitate their growth. Industries like ST Engineering, and other defence-related industries that are now prominent in the market, came out of industries established to support our defence effort and become self-reliant in critical areas of military application.

To ensure that we were perceived as business-friendly, we kept our tax structure very close to that of an economic free trade zone (Hong Kong is our closest competitor), but safeguarded this with strong regulations and policies to steer and guide the development, as well as phased out sunset sectors.

And all the while, we went out of our way to ensure that there was clear transparency in everything we did. Even today, for example, if you visit the Urban Redevelopment Authority (URA) office, you will find a three-dimensional model that shows what Singapore is going to look like ten years from now. The URA has clearly identified the regions that are going to be developed, and those that are going to be preserved. And when it comes to selling land, the government auctions every square metre of land in this country, ensuring that the opportunity to buy is transparent and open to competitive bidding on an equal basis. These are just a few examples of the innovations that took place.

What do you think are some of the lessons that policy-makers, leaders and managers in other developing countries can learn from Singapore's journey?

To begin with, these countries need to recognise that being open to importing capital and human capital is not a negative. This is especially so for those without capital, skills and markets: there is no other option than to import foreign capital that brings with it what one does not have. However, it is even more important to have a clean and arm's length dealing with such foreign capital, without placing oneself hostage through corrupt practices.

And pointing to colonialism and its exploitive side will also not solve today's problems. Nowadays, it is you who are in control. We need to understand that if people are coming into the country, seeking to invest, then it's a business transaction. They are here for no other reason than to earn an income, not to love us. In our experience, every time someone from the EDB went around the world seeking to attract investment, not just from the MNCs, but even from small entrepreneurs who were doing potentially exciting work, the emphasis was always on learning from them or partnering them in some form of joint economic endeavour.

The second point to remember is that government intervention can be a great positive. And in this context, I want to emphasise that there are no hand-outs. Citizens need to be given the fishing rod to fish, as opposed to soup lines.

The third element that we learnt very quickly in Singapore is how critical it is for us to develop our own human capital. And this is particularly important for countries with a large unskilled workforce that needs jobs—after all, what is the point of some having tertiary education, if the majority of our young people lack skills or a job-related education?

Finally, these countries must remember that for multinationals to come in and help you, you must offer them transparent opportunities to succeed. After all, they have a primary responsibility to their shareholders, not to your country. But above all, you must stand by your word, both written and unwritten.

This has a lot to do with setting in place a culture that pushes to develop your own people. I see a tendency in some developing countries for its people to behave like crabs in a fisherman's basket. If one crab is trying to get out, the others will pull it back. They do not want to see the other succeed.

To conclude, what would you like to see for Singapore, now that it has travelled from 'underdog to top dog'?

Perhaps humility. Are we humble enough to recognise that we still have weaknesses and faults despite our high per capita income and good quality of life? To recognise that not everything is hunky-dory on the island? Singapore is at a crossroads once again, and it must again use its strong leadership and innovation to navigate the changing currents. And I certainly hope that we continue to interact with the rest of the world, learning from them, seizing opportunities, surmounting constraints, and always staying ahead of emerging competition.

S.R. Nathan
is the sixth President of Singapore for two terms, spanning 12 years from 1999-2011

Rajendra Srivastava
is Provost and Deputy President (Academic Affairs), Singapore Management University

MIND THE LIQUIDITY GAP

Six years on, what has been the impact of the safeguards that were put in place since the Lehman crisis of 2008?

By Kaushik Rudra

Certain events leave an indelible mark on our lives. For people working in the area of finance, Lehman Brothers going into Chapter 11 on 15 September, 2008 clearly falls into this category. The global financial crisis was a watershed moment, dramatically changing the operating environment for financial markets, with the authorities tightening the regulatory framework appreciably since then. This has affected financial markets profoundly, and perhaps in ways unintended by policy makers. The new regulations, for example, aim to reduce market volatility and risks to intermediaries. However I would argue that not only are these safeguards yet to be tested, it remains unclear whether or not the current regime could dampen the negative impact of the next financial crisis–when it happens.

This article focuses on some of the key changes introduced since the Lehman crisis and the impact they are having on economies and financial markets, particularly in Asia. It also discusses the potential pitfalls and unintended consequences of some of these changes, as well as offers broad solutions to combat the challenges arising from the evolving financial landscape.

> Asian banks in most jurisdictions are currently more than adequately capitalised with respect to Basel III. However, as they are called upon to support the region's economic growth over the next decade, they are likely to run up against capital constraints.

Bonds will grow at the expense of loans

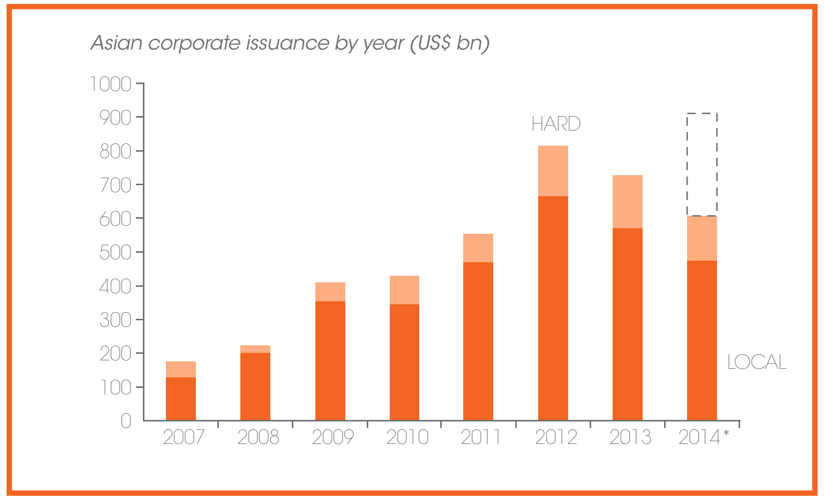
The Basel III regulations were introduced with a view to shoring up banks' capital to ensure an adequate cushion against economic shocks and a potential deterioration in bank portfolios. This was meant to reduce contingent liabilities on governments and taxpayers, and to reduce pressure points in the economies where banks operate. These regulations may be more relevant to (and perhaps designed for) developed markets (DM), where banks on average had lower capital levels relative to those in emerging markets (EM) prior to the Lehman crisis. However, their impact is being felt in both markets. The introduction of Basel III in various jurisdictions–and its anticipated introduction in others–has prompted banks to preserve scarce capital by reducing leverage and shedding risk assets. As a result, lending has come under pressure. This is particularly true for European banks, whose capital levels were low to start with.

While EM banks (and Asian banks in particular) are well capitalised, they are also likely to see an impact on their loan markets over time. Asian banks in most jurisdictions are currently more than adequately capitalised with respect to Basel III. However, as they are called upon to support the region's economic growth over the next decade, they are likely to run up against capital constraints. This will force them to make a tough choice between preserving capital (and thereby reducing lending) or continuing to lend but risking running short of capital. I believe banks are likely to choose the former option, causing them to scale back (or at least not increase) their loan exposure. A clear unintended consequence of this reform is the crowding out of corporates, particularly small- and medium-sized enterprises, from the loan markets. I expect many of these companies to turn instead to the corporate bond markets, a shift that is already evident in record issuance levels in both local-currency and hard-currency corporate credit markets (refer to Figure 1). This is likely to increase the size of the region's corporate bond markets over the medium-term as corporates seek longer-term (and arguably, less covenant-heavy) funding. Basel III implementation is likely to accelerate this transition towards corporate bond-market financing and push more corporates, especially higher-rated ones, to access bond markets directly rather than borrow from banks. Within Asia, I expect the biggest growth in China and India; the former is likely to represent more than 50 percent of the Asian corporate credit market over the next few years (refer to Figure 2).

Disappearing market liquidity

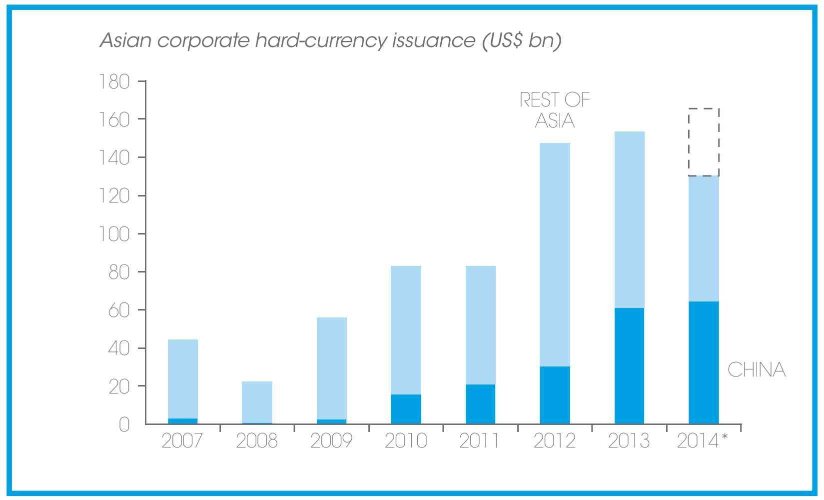
The Dodd-Frank Wall Street Reform and Consumer Protection Act—better known as Dodd-Frank—was a response to the global financial crisis of 2008. Its intention was to prevent another collapse of a major financial institution like Lehman Brothers. Dodd-Frank includes major areas of reform and hundreds of pages of regulations and rules. The law subjects banks to a number of regulations, with the possibility of breaking up banks if they are deemed to be 'too big to fail'. The Volcker Rule, part of Dodd-Frank, prohibits banks from owning, investing in or sponsoring hedge funds or any proprietary trading operations for their own profit. The rule on proprietary trading has had a profound impact on secondary-market

FIGURE 1: CORPORATE CREDIT ISSUANCE HAS SURGED SINCE 2009



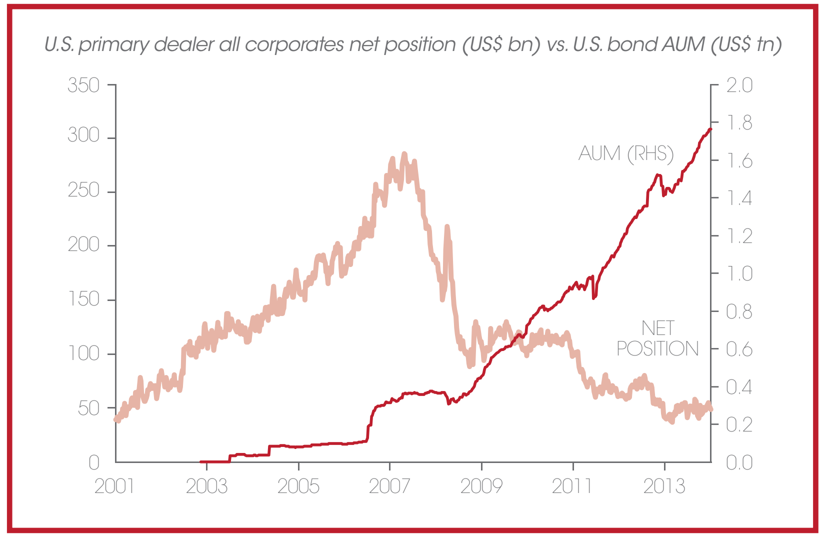
*As of August 2014; Source: Dealogic, Standard Chartered Research

FIGURE 2: CHINA INC. HAS BEEN RESPONSIBLE FOR HALF THE ISSUANCE



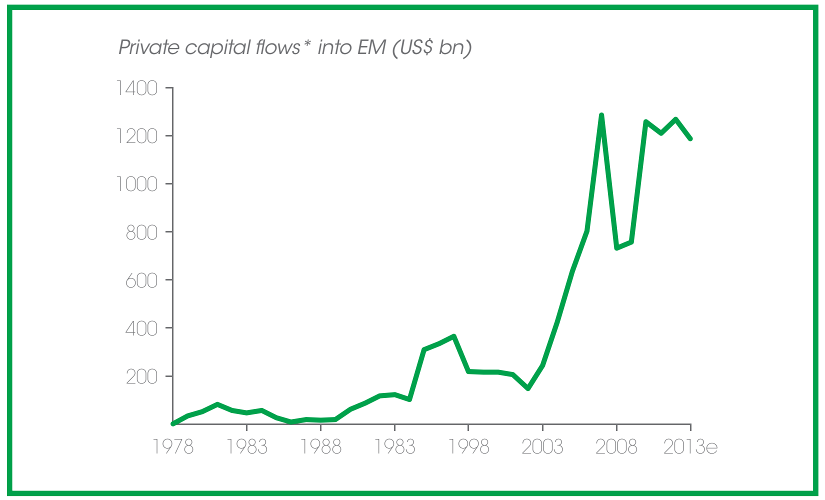
*As of August 2014; Source: Dealogic, Standard Chartered Research

FIGURE 3: SELL-SIDE INVENTORY IS NOT IN SYNC WITH GROWING BUY-SIDE AUM



Source: NY Fed, EPFR Global, Standard Chartered Research

FIGURE 4: CAPITAL INFLOWS TO EM HAVE SURGED IN THE PAST DECADE



Includes FDI, equity and debt flows; Source: IIF, Standard Chartered Research

liquidity. With regulations severely restricting how long trading desks can hold securities, bank trading desks have become much less willing to hold securities, even for market-making purposes. With little or no inventory, it is unsurprising that secondary-market liquidity is a shadow of its former self. New York Fed data suggests that U.S. primary dealers' net position in corporate debt has declined by more than half since the Lehman crisis (refer to Figure 3).

Too much money chasing too few assets

The global financial crisis changed the way investors view emerging markets. Investors globally recognised that they had arguably mispriced risk, assigning too little risk to DM and too much to EM. This mispricing of risk resulted in an under-allocation of portfolios to EM. After the Lehman crisis, global investors tried to correct this misallocation, and increasingly directed funds towards EM.

The surfeit of easy money owing to quantitative easing and accommodative monetary policies around the world accentuated the reallocation of funds in favour of EM (refer to Figure 4). The resulting search for yield unleashed a rush for EM assets, and EM bonds, in particular, benefited from these fund flows. In the five years since the Lehman crisis, inflows to EM debt have far exceeded the levels witnessed prior to the global financial crisis (refer to Figure 5). There have been periods when the size of the inflows has exceeded the size of the tradable markets.

Market implications: sidestepping secondary markets

The confluence of regulatory changes and easy money has created three most interesting (and potentially challenging) dynamics in EM financial markets.

Firstly, Basel III will likely cause banks to withdraw (at the margin) from

loan markets, consequently increasing corporates' reliance on bond markets. This will result in much faster growth in corporate bond markets. While reliance on bond markets is already prevalent in the developed world, I expect it to accelerate growth in EM bond markets, particularly Asia.

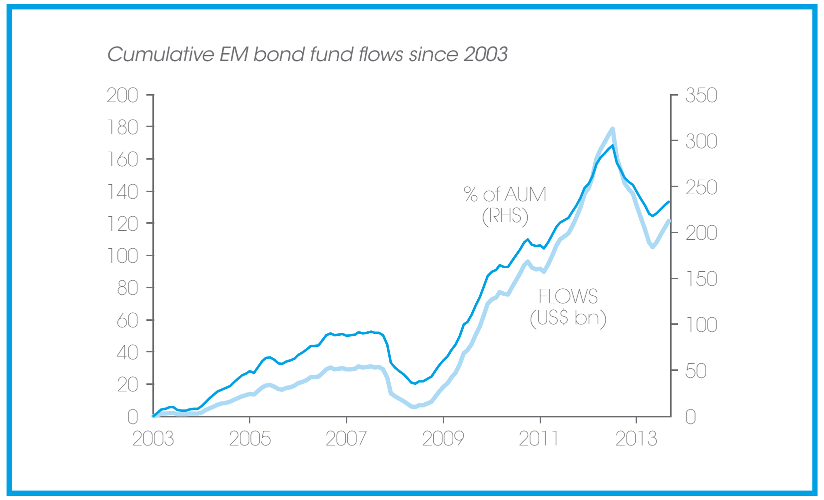
However not all Asian banks are equally well positioned to embark on this Basel III journey. While banking sectors in Southeast Asia are extremely well capitalised, India's public-sector banks and China's banks will need additional capital in order to support the financing needs of domestic corporates; and with capital becoming an increasingly scarce commodity, I expect banks to be more selective in lending to corporates. Banks are likely to favour larger corporates; this could potentially crowd out small- and medium-sized enterprises, resulting in potentially higher levels of stress and defaults in this segment.

Meanwhile raising capital (via government injections or the equity markets) would allow banks to preserve their lending to corporates. However, if they are unable to increase their capital in line with financing requirements, economic growth in their jurisdictions will likely be lower.

Growth in corporate bond markets is a clear consequence of tighter lending conditions. Corporate bond markets in Asia excluding Japan could grow to around US$10 trillion and represent around 40 percent of the overall financing mix toward the end of this decade (refer to Figure 6).

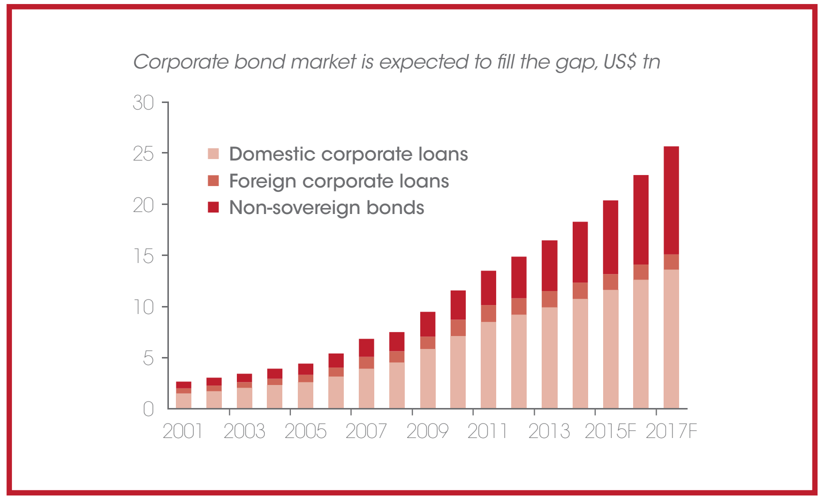
Secondly, Dodd-Frank and the Volcker Rule have presaged declining secondary-market liquidity. With banks unable to take proprietary positions, their need and willingness to hold bond inventory is negligible. This means that the trading desks making markets on these are also shrinking in size. This is forcing investors to rely largely on primary bond markets

FIGURE 5: ASSET ALLOCATION TO EM DEBT HAS RISEN NEARLY THREE-FOLD SINCE 2008



Source: EPFR Global, Standard Chartered Research

FIGURE 6: ASIAN CORPORATE FUNDING MARKET



Source: Standard Chartered Research

(new issues) to meet their requirements.

Sell-side banks are much smaller now than they were before the global financial crisis. Trading operations have been trimmed, particularly on the fixed income side, with significant headcount reductions. While this has played out more clearly in the West, it has been a global phenomenon.

As these operations generate lower income, bank income pools have been reduced. This has increased cost pressure on banks, resulting in lower compensation and reduced hiring by the sector, making the sector a less attractive destination for fresh graduates entering the job market.

Declining secondary-market liquidity is also forcing investors to rely largely on the primary markets to meet their portfolio needs.

Thirdly, the readjustment of EM risk premiums and the surfeit of easy money after the Lehman crisis have resulted in a surge of fund flows to EM, particularly EM debt. As a result, EM debt portfolios have grown manifold in the five-year period since the crisis (refer to Figure 5). With global asset managers continuing to increase their Assets Under Management (AUM) allocation to EM debt, the buy-side is likely to continue to grow.

Buy-side AUM, particularly for EM and Asian portfolio managers, continues to grow, and is significantly larger than that of sell-side institution trading desks. This means that secondary-market liquidity cannot fully support the trading flows of the buy-side. As highlighted above, buy-side firms have to rely on primary issuance to meet most of their portfolio needs. Given their size and relatively poor secondary-market liquidity, it is very difficult for the buy-side to accumulate meaningful positions (in terms of portfolio returns) via the secondary markets.

Decreased liquidity from sell-side banks in the secondary markets is giving rise to a new breed of 'buy-side to buy-side' brokers. These new intermediaries are linking buy-side institutions to each other and bypassing sell-side banks altogether. While this is helping buy-side institutions to bypass secondary-market liquidity constraints, the rise of a new breed of unregulated institutions servicing the buy side could also pose new challenges.

Buy-side firms are starting to use credit default swaps (CDS) to express more tactical views. CDS liquidity tends to be better, allowing these investors to get in and out of trades much more easily. CDS are generally less balance sheet-intensive than cash bonds, and therefore more palliative for sell-side banks. While buy-side brokers and CDS trading are being used fairly extensively in other jurisdictions, their use in Asia has been limited to date.

Thin liquidity has made markets one-dimensional

Growth in EM portfolios dovetails well with the surge in issuance over the past few years. However, with sharply reduced secondary-market liquidity and bank trading unable to support these investors' increased positions, there is potentially no exit for these EM bond portfolios. While EM is a legitimate asset class that is here to stay, it is unhealthy for markets to have no exit. In my conversations with global investors, I repeatedly hear that market liquidity is significantly worse today, even more than the post-Lehman crisis 'dark days' of late 2008 and early 2009. If investors want to reduce their positions, there is limited scope for them to do so via the secondary markets. This is unhealthy, and could result in a serious market crisis should investors need to get out of their positions. It increases the risk of a disorderly sell-off.

How do we mind the liquidity gap?

Market participants have recognised these issues for some time. The key question is whether regulators are also thinking of these issues. They appear to be. The European Central Bank and the

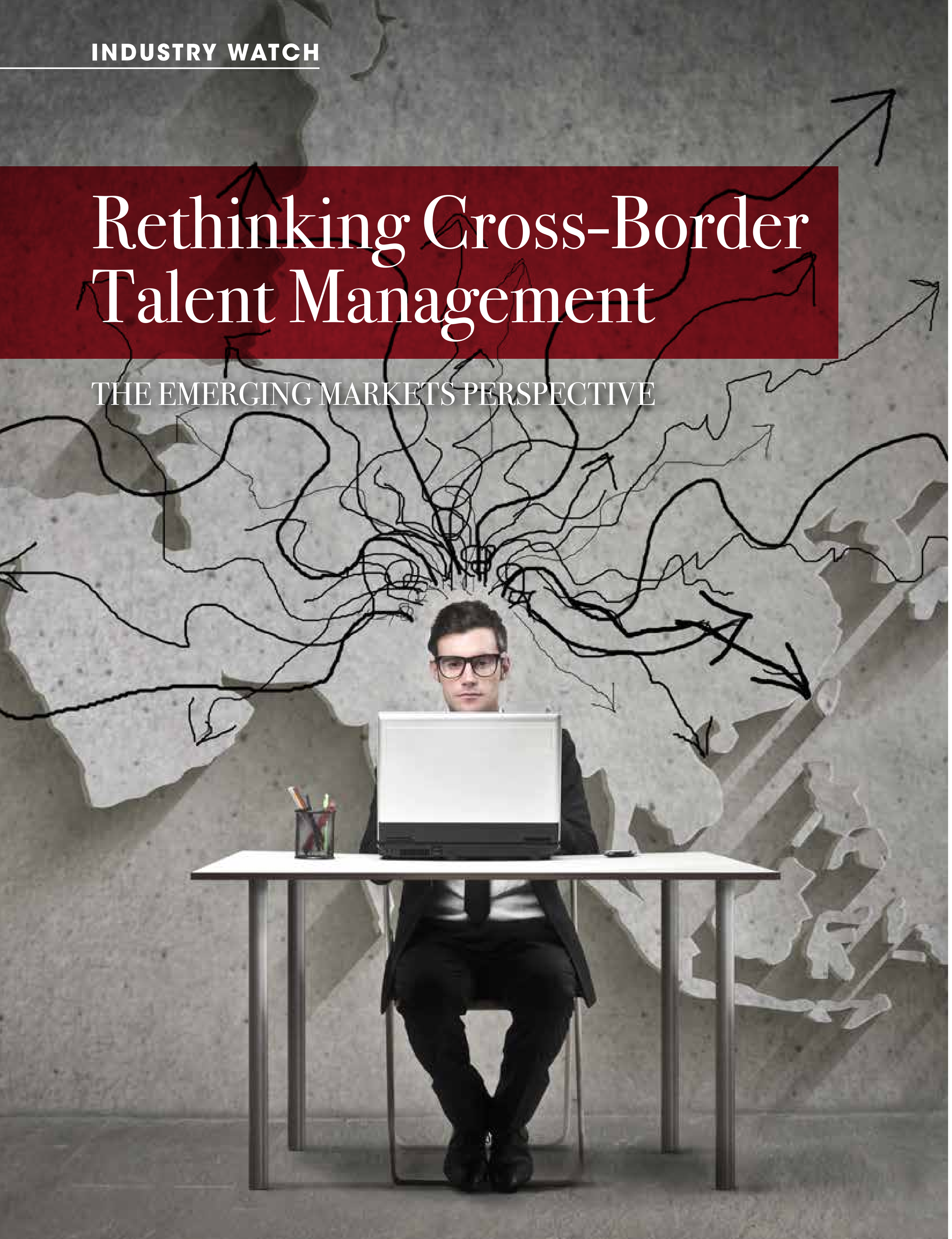
Sell-side institutions need to manage scarce market liquidity very carefully so as to limit potential damage to the P&L and capital. This means secondary liquidity is unlikely to improve soon. Given these regulations and the asymmetric risk-reward for sell-side institutions, these institutions have no incentive to step in and provide ample liquidity during periods of market stress.

Bank of England have both cited lack of secondary-market liquidity in bond markets as a source of potential concern in their latest financial stability reports. The hope is that the authorities will look into the unintended consequences of these changes and take steps to address some of the challenges emanating from poor secondary-market liquidity across different markets.

Meanwhile, market makers must deal with the impact of these measures in their own ways. Sell-side institutions must manage scarce market liquidity very carefully so as to limit potential damage to the P&L and capital. This means secondary liquidity is unlikely to improve soon. Given these regulations and the asymmetric risk-reward for sell-side institutions, these institutions have no incentive to step in and provide ample liquidity during periods of market stress.

Buy-side institutions are managing this new environment with measures of their own. Portfolio managers are maintaining higher cash balances and are largely staying close to their respective benchmarks. Moreover, given poor secondary-market liquidity, their ability to build meaningful positions via the secondary markets is limited. Instead, they are using the rapidly growing primary markets to deploy their cash. Given the size of buy-side firms (AUMs have grown rapidly at a time when the net position of the sell-side has decreased markedly) and poor secondary-market liquidity, they have a limited ability to make significant portfolio changes via the secondary markets. That said, buy-side firms are starting to turn firstly to non-traditional providers of liquidity (as highlighted above), and secondly, do more CDS trades (relative to cash trades) to express tactical views, in an attempt to bypass the secondary-market liquidity constraints of the sell-side.

Kaushik Rudra
is a Managing Director and Head of Rates & Credit Research at Standard Chartered Bank. The views expressed in this article are the author's own and do not represent those of his organisation.



Rethinking Cross-Border Talent Management

THE EMERGING MARKETS PERSPECTIVE

A closer look at the relatively little understood issue of *how* and *why* emerging market MNCs manage their senior talent for international growth leads us to question the conventional wisdom on talent management practices.

By Tejpavan Singh Gandhok and Richard R. Smith

Markets are grappling with volatility and unpredictability, and becoming increasingly reactive to economic conditions surrounding them. At the same time, organisations are struggling to redefine their business models, operating structures and people practices to do what they can to protect their future.

Yet despite rising unemployment in some regions, many organisations are still unable to find the right talent with the necessary skills and expertise to meet their strategic and operational goals. According to the Mckinsey Global Institute, there will be a 13 percent shortage of high-skill professionals globally by 2020. The overall shortage of skilled professionals is estimated to be around 85 million.[i]

Getting the right cross-border talent management approach is thus a must for the health, prosperity and long term viability of many organisations and their ambitious business plans.

While there is plenty of conventional wisdom on the practices relating to international talent management of multi-national corporations (MNCs) from developed markets, little has been done to understand these practices for emerging market MNCs. As a result, little is understood about how emerging market MNCs manage their senior talent across international borders.

We studied a sample of 14 Indian origin MNCs across a variety of sectors, including information technology, pharmaceuticals, consumer and industrial (see Table 1). All these companies satisfied the following criteria: they were publicly-listed, had recorded over 25 percent sales outside India with operations in more than four countries, and had revenues exceeding US$500 million per annum.

The key questions we asked during our qualitative and inductive research included: Where does the top talent come from? Where does the top talent go next in terms of posting, and when? Why do organisations choose a particular approach? And how do organisations enhance their effectiveness in managing senior talent across borders?

Through this research, we sought to understand how these MNCs managed their senior talent across borders, and thereafter offer insights and implications for MNCs in other emerging markets, as well as MNCs originating from the West.

TABLE 1: PROFILES OF COMPANIES INCLUDED IN THE RESEARCH

Sector	Companies in the sample	Sample significance	No. of senior roles in sample	No. of countries/ geographies	Percent of Indian talent in sample
IT	Infosys, Tata Consultancy Services, Wipro	These top three IT companies command more than a 60% market share of the Indian software industry	31	All six key continents	87%
Pharmaceuticals	Ranbaxy, Sun Pharma, Dr Reddy's	These three are amongst the largest pharmaceutical companies by revenue and market capitalisation. They command more than 15% market share of the Indian pharmaceutical industry which is fairly fragmented: the next seven companies have 25% market share, and the balance (60%) is spread over another 30+ companies	20	14 countries	67%
Consumer	Godrej Consumer Products Ltd, Marico, Fortis Healthcare*, Tata Global Beverages	These are four of the largest seven to eight consumer players that fulfil our criteria (*Fortis Healthcare has subsequently significantly divested its international operations and is moving to an India-focused strategy)	15	All six key continents	53%
Industrial Goods	Tata Motors, Mahindra & Mahindra, Tata Steel, Hindalco	These are four of the largest private sector industrial companies. They have also done large international M&A deals totalling over US$500 million invested for each of these companies	10	Several countries in Western Europe, North America and Asia	50%

While there is plenty of conventional wisdom on the practices related to international talent management of multi-national corporations (MNCs) from the developed markets, little has been done to understand these practices for the emerging market MNCs.

A classification of cross-border talent management approaches

We classified the senior cross-border talent management approaches used generally by organisations into five categories:

Ad-hoc: A one-time custom solution for the position in hand. It generally signifies a solution designed for a specific problem or task, and is non-generalisable or not intended to be merely replicated in other situations.

Home Market or Country of Origin: Talent hired from the country where the organisation is headquartered.

Local Talent: Hiring talent from the country that the firm is planning to enter or expand to.

Regional Development: Talent is chosen or groomed into the role as he/she has done well in a similar or neighbouring market.

Global Rotation: Talent is regularly rotated across borders, the typical practice is to rotate people every two to three years across a very broad range of countries across the globe, in an attempt to create a 'global plug-in and play' cadre.

The above five approaches can be considered along a continuum starting from Ad-hoc and proceeding all the way to Global Rotation.

We observed that the MNCs in our sample mainly use two cross-border talent management styles. The IT sector MNCs use mainly 'Home Market' talent, while the other three sector MNCs balance this evenly with 'Local Talent', especially when they grow through mergers and acquisitions (M&A).

"Our talent mix historically has been 'India-centric', although in the past five years or so we have started to develop local talent—especially in Delivery, Project Management and even Sales roles—as we've moved to diversify delivery centres across the globe, as well as moved further down the value chain in key developed markets. However, interestingly, our senior leadership pattern remains 'Indian-centric'— although this is not by any grand design—it is merely an end outcome in which individuals have been fit for the right role at the right time".

IT major

"...although we have tried local hires to head many of our key markets, surprisingly we haven't always found these moves to be more successful when compared to home market talent in that job. In our business, the issues are beyond citizenship, it's much more about relevant domain knowledge, skills, networks and relationship management..."

IT major

"...the bulk of our international growth has been through acquisitions, and in each of these, initially, we prefer to take control through local teams to ensure no trust deficit, and put in processes and frameworks for visibility at corporate headquarters (a key finance function person is usually a trusted home market placement) ... Over time, we fill key gaps as required, but usually still ensure that the consumer facing roles are suitably local talent..."

FMCG major

Key factors that help in choosing the right talent management approach

Based on our interaction with organisations, and observation and experience as consultants, we have distilled five underlying factors that seem to have a significant bearing in choosing the appropriate talent management approach from the above-mentioned choices (refer to Table 2). In order, these are *first*, the international business strategy and the balance between home market advantage vis-à-vis the role of local market insights/capability; *second*, an organisation's maturity level of operating internationally and in the target market; *third*, the degrees of dynamism and complexity of the market; *fourth*, target market talent availability; and *fifth*, expatriate talent suitability, which comprises capability of talent under consideration, his/her cultural adaptability, acceptability and cost of availability.

An objective understanding of these factors and their dynamics can also help organisations understand how to move along the continuum of talent management approaches that we mention above.

TABLE 2: KEY FACTORS THAT HELP GUIDE THE CHOICE

International business strategy and the balance between home market advantage vis-ā-vis local market insights

Organisation's maturity level of operating internationally and in the target market being considered

Degrees of dynamism and complexity of the market in which the organisation operates

Target market talent availability

Expatriate talent suitability, capability, cultural adaptability and cost

OBSERVED CHOICES

INITIAL

- Ad-hoc
- Home-culture dominated leadership
- Local Talent

OVER TIME

- Regional development
- Global rotation

The following cases illustrate the relevance of our proposed framework in helping to understand the underlying rationale for why the observed players have chosen their range of cross-border talent management approaches. It is especially interesting to note the contrast in their approaches, and we argue that this is because of their unique contextual realities and business needs.

TATA GLOBAL BEVERAGES (TGB)

A Local Talent approach for international growth

TGB is the world's second-largest manufacturer and distributor of tea and a major producer of coffee. Key brands include: Tata Tea, Tetley, Good Earth, Eight O'Clock, JEMCA, Tata Coffee and Himalayan mineral water. It has key alliances with PepsiCo and Starbucks, and over 3,000 employees. TGB has achieved this remarkable transformation from being a plantations-based India-centric focus to becoming a renowned international and consumer brand as well as a healthy beverages player in just over a decade. The company has grown rapidly through international acquisitions (mainly in western developed markets), and has by and large retained the key local management of its acquisitions. Hence around half of its key senior management pool is Local Talent.

Rationale for using Local Talent strategy

International business strategy: TGB's international growth strategy is multi-local, that is, it has largely acquired local/regional brands in various key markets. Hence, given that its mode of entry and growth has predominantly been M&A with a focus on business-to-consumer(B2C), local market insights are of key importance.

Organisation's level of maturity in operating internationally and in that target market: TGB is in the early stages of growth, and its internationalisation strategy is only a little over a decade old.

Degrees of dynamism and complexity: The B2C and local/regional brand strategy requires a stronger appreciation of local consumer preferences.

Target market talent availability: The most significant part of TGB's M&A growth has been in the developed markets of the West, such as the U.S., U.K. and Europe, where local talent is readily available.

Appropriateness of home market talent for the target market: This is low in TGB's case as it brings relatively little home market advantage to its international businesses.

We observe that the MNCs in our sample use two main cross-border talent management styles. The IT sector MNCs use mainly 'Home Market' talent, while the other three sector MNCs balance this evenly with 'Local Talent', especially when they grow through mergers and acquisitions (M&A).

TATA CONSULTANCY SERVICES (TCS)

A mainly Home Market Talent approach

TCS is the largest Indian-born IT company by revenue and market capitalisation. It operates in over 40 countries and has around 200 branches across the world. The company employs nearly 300,000 people. Its rapid growth has predominantly been organic, with M&A activity so far consisting of relatively small but strategic deals. TCS, as is the case with other key players in this sector like Infosys and Wipro, uses a predominantly 'home market' cross-border talent management approach, with nearly two thirds of its senior cadre being Indian. Contrary to popular perception, TCS has relatively more 'local hires' than Infosys and Wipro in its senior cadre (this incorrect perception stems mainly from the fact that Wipro has, in the past, and Infosys has recently appointed 'Local' talent in CEO roles).[ii]

Rationale for using mainly Home Market or Country of Origin Talent and Local Talent

International business strategy: TCS' international growth strategy is 'global', given the technical nature of its IT Services offering. The balance is in favour of home market advantage. This is further reinforced by the off-shoring model of Indian IT players to undertake cost arbitrage due to the availability of relatively cheap and abundant technical talent in India—and over time, Indian software capability has developed a positive brand perception that also seems to help. Whereas the role of local market insights has been relatively low as the mode of entry/growth in most markets has been predominantly organic, the business-to-business (B2B) segment focus is on large global key accounts and hence the key success factors include technical capability, industry context understanding, key account relationships, etc.

Organisation's level of maturity in operating internationally and in that target market: This is relatively high, as TCS (as is the case with most Indian IT majors) was 'born global' in the sense that the bulk of its business has always been from outside India, and predominantly in Western developed markets.

Degrees of dynamism/complexity: This is fairly high both in terms of technology and client contextual knowledge—which favours a paradoxical fluid rotation of project level staff, yet seeks stability for key accounts, industry verticals and regional senior managers, given the strategic relevance of key account relationships to maintain the high sales growth rates.

Target market talent availability: This remains a challenge in most markets, given the above complexities.

Appropriateness of home market talent for the target market: In markets which are culturally more homogenous, such as China, Japan and Latin America, TCS relies on local hires to run their businesses. However, 'home market' talent runs their key regions, North America and Western Europe, and industry verticals (which happen to be the major portion of their business) as TCS' key global accounts in these markets are culturally much more open and heterogeneous.

Our observations suggest that, "all players need not at all times" avoid the home-market dominated leadership, because the success of this approach depends on context specific factors such as home market advantage versus local insights, the ability of home market managers to cope with target market needs and heterogeneities, as well as their acceptability in the target market.

GODREJ CONSUMER PRODUCTS (GCPL)

A Local Talent approach for international growth

GCPL is among one of the leading home-grown FMCG players in India, with strong positions in personal care, household insecticides and hair colour categories. It has achieved a remarkable transformation from a predominantly India-based business that responded to liberalisation of the Indian economy in the mid-1990s with a strategy of forging joint ventures (JVs) with western MNCs such as P&G and Sara Lee for its home market; to subsequently exiting these JVs in the late 1990s. In the past decade, GCPL has grown via a string of international M&A to achieve 40 percent of its revenue from international operations in mainly emerging market countries, such as Indonesia, Nigeria, Kenya, Argentina; and the U.K. GCPL has by and large retained the key local management of its international acquisitions.

Rationale for using Local Talent strategy

International business strategy: GCPL's international growth strategy is multi-local in that is it has predominantly acquired local/regional brands in emerging markets, and then grown selectively in contiguous geographies and/or categories. The balance is largely in favour of local market insights, given that its mode of entry and growth has been primarily M&A, with a focus on B2C trade.

Organisation's level of maturity in operating internationally and in that target market: GCPL is in the early stages of growth mode and its internationalisation strategy is only a little over a decade old.

Degrees of dynamism and complexity: The B2C and local/regional brand strategy requires a stronger appreciation of local consumer preferences and local trade practices.

Target market talent availability: The most significant part of GCPL's M&A growth has been in the emerging markets, where finding and retaining local talent is a challenge.

Appropriateness of home market talent for the target market: GCPL tries to leverage home market talent to supplement the local market talent gaps mainly in up-stream functions (such as Manufacturing and Finance), but prefers where possible—at least in the early stages of acquisition and/or presence in that market—to rely on local talent for the 'local context decisions' in consumer facing roles in its international businesses.

As shown in the above examples, these players may prima facie be wrongly perceived as preferring home market talent or local talent. However most of them in reality have a well thought out plan that is in line with their strategic context. We must also keep in mind that these firms are still maturing as MNCs, and even after a decade or so, their underlying processes and policies are dynamic and evolving.

While most of our research has been India-centric, we have also seen many Chinese, Korean and Japanese MNCs tending to favour a home market talent approach. Some like the Chinese MNC, Huawei, appear to choose a variety of approaches, including 'Home Market' and 'Local Talent', based on their business priorities and local market needs.

This strengthens our belief that the five-factor framework can help with decision-making on cross-border postings in a more holistic context; and provide a useful tool kit to evaluate which cross-border talent approach would be best suited for the business environment. While our point of view stems from a sample of Indian-born MNCs, our findings lead us to question the prevailing conventional wisdom.

HOME MARKET TALENT SOURCING IS OKAY

Use of 'Home Market' or 'Country of Origin' talent is often regarded as an inferior approach for cross-border talent management, lacking in sophistication and doomed to fail. However, our observations suggest that, 'all players need not at all times' avoid the home-market dominated leadership, because the success of this approach depends on context specific factors such as home market advantage versus local insights, the ability of home market managers to cope with target market needs and heterogeneities, as well as their acceptability in the target market.

For the Indian IT MNCs in our sample, this 'Home Market' talent approach appears to have served them well for over two decades, with no apparent adverse impact on performance or valuation. Also it is worth noting, that since Indian executives are making it to the C-suites of established Western MNCs, they should also be well suited to drive the ambitions of Indian MNCs.

> An organisation's cross-border talent approach should be well grounded in the context of the strength of its people, business and local market priorities, and corporate strategy.

GLOBAL ROTATION MAY BE LIMITING

The practice by many Western MNCs of a regular two to three years 'Global Rotation' approach is often regarded as aspirational best practice and a mark of sophistication. On the contrary, our observations suggest that, especially for emerging markets, having suitably longer stints for business unit heads ranging over five years allows for a better and stronger understanding of the local market and relationship building–which go a long way in most emerging markets. The shorter one to three years' rotations should instead be focused on hi-potential middle management talent. As one IT major pointed out, "We find that longer-term postings (typically five to six years) work very well–not only for the business and the individual–but also for their family life, which is equally important to us in a more holistic work-life balance context. As long as the business unit and the individual running it are performing well, we are happy to maintain status quo and now no longer look at a longer stint as a negative or question mark…"

TALENT STRATEGIES SHOULD FOLLOW BUSINESS STRATEGIES

Firms should avoid following a particular talent management approach merely out of imitation or aspiration. Instead, an organisation's cross-border talent approach should be well grounded in the context of the strength of its people, business and local market priorities, and corporate strategy.

GLOBAL AND LOCAL BUSINESS NEEDS CAN BE ALIGNED

Finally, rather than focusing on 'where the talent comes from' and 'moves to next', what matters more is how effectively MNCs can integrate local and global issues, and align these issues with the strategic context of their organisation and the nature of their business.

It would be interesting to see how well the key takeaways mentioned above fit into MNCs from other emerging markets, and Western MNCs expanding within emerging markets. We see a potential here for future research.

Tejpavan Singh Gandhok
is a practitioner, academic and entrepreneur based in New Delhi. He was a former Senior Partner with private equity and strategy consulting firms including BCG, Stern Stewart & Co. and AT Kearney; and an affiliate faculty member at Singapore Management University

Richard R. Smith
is a former Partner and Managing Director of Accenture; and Senior Lecturer at Singapore Management University

Reference

[i] McKinsey Global Institute Research Paper, June 2012, "The world at work: Jobs, pay, and skills for 3.5 billion people".

[ii] For the purposes of this study, Indian origin leaders (such as Satya Nadella, the chief executive officer of Microsoft), who have completed most of their education and professional career in western developed markets are classified as 'Local Talent' and not 'Home Market'.

[iii] Black, J. S., & Morrison, A. J., 2010, "A cautionary tale for emerging market giants", Harvard Business Review, 88(9), 99-103; which exhorts BRICs MNCs to avoid the Japanese MNCs 'mistake' of an overly 'Home Market' focused leadership approach.

[iv] For example, the Indian IT majors such as TCS, Infosys and Wipro have higher operating margins and sales growth rates as well as PE and Sales to Market Cap valuation multiples than their western competitors such as IBM and Accenture.

Transforming wealth management THROUGH Technology

Wealth managers can see the potential benefits of rapidly evolving mobile technology and are taking steps to significantly enhance interaction with their clients and transform the way information is presented and shared.

By Vineet Malhotra

Global private financial wealth grew by 15 percent in 2013 to reach a total of US$152 trillion, compared to a growth of 8.7 percent in 2012.[i] The Asia Pacific region (excluding Japan) represented the fastest growing region worldwide, continuing the trend of high growth in the 'New World'; and it is estimated that its 'New Wealth' will account for about half of global growth by 2018.[ii]

Technology today is providing opportunities for investors to make it more convenient and efficient to manage wealth. It is not uncommon to see people speculate about stock markets and property prices, more often than not using a mobile phone to instantly check prices, indices and the like. They manage their investment portfolio online and have Skype sessions with their relationship manager—but the digital wave has not yet swept through the wealth management space. Although computers have been around for many years, it is the smartphones and tablets that are having a real impact in the way clients interact with advisors and brokers, as well as how information is shared. The combination of Big Data and increased storage capacity, along with the ability to deliver information rapidly to smartphones, has provided a great platform for firms to enhance the experience of their clients. The paradigm for mobile is changing from 'always on the go' to 'always active', which means that the phone is not just for receiving and making calls, but a device being actively used to see alerts and take action instantly.

> Although computers have been around for many years, it is the smartphones and tablets that are having a real impact in the way clients interact with advisors and brokers, as well as how information is shared.

The use of mobile technology in service industries has been growing rapidly over the past five to six years—in retail, travel and entertainment—and more recently in health, education and financial services. The lines between the physical and digital worlds are blurring with the availability of 'augmented reality'—a live, direct or indirect, view of a physical, real-world environment whose elements are enhanced by computer-generated sensory input such as sound, video, graphics or global positioning system (GPS) data. Though still in its incipient stages, the trend is clear: these smart devices will continue to get smarter.

In Asia, the emergence of next generation investors—the Millennials (also known as the Millennial Generation or Generation Y)—have created the demand for sophisticated mobile-based tools to manage wealth. Low-cost online brokers (for trade execution) and specialised firms that manage money online are targeting a demographic segment of households with liquid assets of US$100,000 to US$1,000,000. At the same time, high net worth individuals are also reacting positively to changes in technology and the prospect of online client servicing. Whilst consumers are spoilt with the choices available, mobile technology businesses are competing fiercely for a share of the market. Customisation and personalisation of mobile solutions have gained importance and are seen as a competitive advantage.

Whilst the focus of this article is on the use of technology in wealth management, I often compare and contrast this with trends in the world of banking. Among financial institutions, banks have been the early adopters of mobile technology, and wealth managers can glean important lessons and best practices from their experiences. When looking back over the last 10 years in banking, I see that 2004 was all about managing customers, knowing them better and segmenting broadly to identify a suitable pricing model. Five years later in 2009, the focus was on optimising the channel mix between online and high touch branches/relationship managers with a clear focus on maximising profitability. The next five years leading up to 2014 have been about deeper customer analytics (Big Data), investment in technology and attempting to personalise and customise the client experience. Will the wealth management function follow the same trends? What new developments and what changes do we anticipate in the mobile wealth management space over the next five years?

Trends

There are some interesting trends to keep in mind. First, multi-tasking is a reality (for example 50 percent of users who watch TV also look at their mobile phones) and attention spans are short—so financial information that is used for decision-making needs to be succinct and targeted. Second, emails continue to be important. The question often asked is whether or not emails are breathing their last gasp in the face of social media. Not really... Analysis of data from 2013 on emails, with a focus on mobile preference and consumer purchase behaviour, shows that the number of mobile orders went up by 58 percent from Q3 to Q4 2013. Mobile revenue increased by 52 percent, whilst desktop/laptop revenue grew by just 18 percent. Half of subscribers interact with emails exclusively on a mobile device.[iv] Third, a potential disruption in distribution models is taking place at a rapid pace today, as seen by some of the online players such as Alibaba (refer to the box story below). A large number of online money managers have emerged in recent years, such as Personalcapital, Wealthfront, Betterment, Mint and Nutmeg, to name a few. These are in addition to online brokers like eTrade, Charles Schwab and others that have been in existence for decades. For Internet-based sellers who have established scale (think Amazon), it is also tempting to progress from eCommerce to ePayments to eFinance.

ALIBABA'S FORAY INTO ONLINE WEALTH MANAGEMENT PLATFORMS

In 2013, Alipay launched an online money market fund, Tu'E Bao that now makes Tianhong Asset Management Co. the second largest asset management company in China. It was successful, in part, due to the strong trust of the general public, to being an affiliate of a technology company and in providing a tailored product. Assets gathered ballooned to approximately US$95 billion within a year.[v]

Alibaba has also launched an online wealth management platform using an online app called Zhaocai Bao that pairs tailor-made wealth products with individual investors. It believes investors' demand will grow transactions to the RMB1 trillion mark (US$162.49 billion) within the next two to three years. Five fund managers are involved in the development of the platform, and this points to a very important trend of strategic partnerships being formed between technology firms and fund managers. While most products sold at banks and insurance companies require an investment of at least RMB 50,000 (US$8,125), Zhaocai Bao has a minimum investment of just RMB100 (US$16).

Challenges in a highly regulated industry

The regulatory framework in banking and asset management may be a barrier for some technology companies seeking to enter the wealth management and fund distribution space. After all, selling music on iTunes is not the same as selling a fund on iTunes.

A report this year from Pricewaterhouse Coopers (PWC) warned that fund managers could face competition from social media or tech companies. It went on to say:

"More than a quarter of asset managers were not sure whether the use of mobile technology for distribution or communication would play a critical role in their business. We believe that the expectation gap between customer needs and asset managers' slow take-up of technology could provide opportunities for further new entrants to come into the industry. The most likely source of disruption will come from social media or technology companies, which may combine their reach, knowledge and influence with banking alliances to provide compelling asset management (AM) propositions. A social media firm such as Google, Facebook and Twitter or product providers like Apple (through iTunes) or Amazon could, for example, provide front-office services, and partner with, or even buy, a back-office servicing firm to create an integrated AM."[vi]

Given this direction, the regulatory framework will also need to evolve. A regular dialogue with regulators can build an environment that creates pragmatic regulations to manage risks effectively. With the rapid adoption and rise of social media, data privacy and reputational concerns will need to be addressed through a practical and reasonable legal framework. I do not expect rapid transformation on the regulatory front—but as success is demonstrated in some markets, regulators will talk to one another and there will be lessons learnt before we see widespread evolution of regulations over the medium to long term.

In the short term, we should expect specific opportunistic moves to get the first movers advantage in some markets in Asia, and Alibaba is a case in point here.

Ultimately the consumer will see cheaper, faster, better delivery of information and products; and tech companies will have to get used to higher costs of regulation—more than they have been used to before. With such huge amounts of information about customers available to tech giants, they can play a critical role in using this collective knowledge to provide better solutions for their clients. Over the years, banks and payments companies have sought to understand spending and saving habits and the like in order to develop customer profiles, which can then be targeted with tailor-made solutions. There may, however, be some scepticism about the feasibility of sharing data relating to personal investments and wealth obtained from peer groups, and creating greater transparency and validation through a social community. Again I think, over time the benefits of this approach will be something that will influence regulators to facilitate such interaction. Regular dialogue between the industry and regulators is essential in the short term if we are to create a suitable regulatory environment in the medium to long term.

> Ultimately the consumer will see cheaper, faster and better delivery of information and products; and tech companies will have to get used to higher costs of regulation—more than they have been used to before.

There are other risks like cyber security and data privacy that continue to present challenges across companies and industries. Recognising these challenges from the start (irrespective of the scale of the organisation), having robust procedures, frequent penetration tests, and use of specialists to certify readiness is important.

What is the 'secret sauce for success'?

There is no a silver bullet here but there are a number of areas to focus on. With the explosion of information on the Internet, digital clutter frustrates users just like physical clutter. Hence the more successful companies know that the **quality of content**

As the impact of technology shifts from improving efficiency to enabling transformation of business operations and the client experience, there is a blurring of lines between technology and marketing functions in organisations.

is absolutely critical, irrespective of the technology used. There does not seem to be a single golden source for people to find information on mutual funds they wish to purchase. Investors resort to all types of searches on the Internet and get confused with lots of information about performance, size of the fund, fund manager's track record and so on. They often seek an independent source to compare funds across a standard set of parameters, which is not always available. Some investors focus too much on returns in the past without considering the underlying securities in the product and associated risks. Hence one of the important ingredients to success is to have 'elevator pitch' style sales material that is factual, short and objective. Providing tools that show the impact of adding a fund to an existing portfolio are well received by financial advisors, but are not easy for individual investors to understand and use.

Adhering to a **core set of objectives that include solving the existing problems of clients** rather than going for the latest fad to create a new experience is another factor to keep in mind. While avoiding the 'me too' bandwagon of apps and offerings and creating a differentiated offering is stating the obvious, in practice that is not the case. For example, companies launch apps with some form of a 'game' because they see it as a good way to engage prospects and clients. Some digital agencies have also created a gaming platform and want to generate revenue by bringing as many clients as possible to the gaming platform. Such games have a finite life and are expensive to maintain and enhance, which means the value generated is questionable in the absence of clear calls to action. A good mobile app is one that solves a real need, for example providing regular fund price updates on request; or alerts when new thought leadership material, or events with far-reaching implications like a downgrade of a country rating, is posted on the app.

We have to look at the Internet and mobile transformation in the context of an organisation's **overall contact strategy**. Companies should grab opportunities to transform the customer engagement model given the unique functionality offered via mobile. For example, with travel within Asia Pacific being high, seamless interaction across locations for employees and synched-up data across all devices are very useful. Sounds simple—but not all companies can offer this to their sales staff who interact with customers across the region. Typically, financial advisors who travel across the region should have the ability to see data in real time, as well as create portfolios and simulations for their clients using mobile-enabled tools like a searchable repository of fund data and thought leadership along with a modelling tool on a tablet. I have seen some companies provide iPads to sales staff, but few of them have a programme to centrally create content and tools in an efficient and scalable manner. Often it is left to each sales person to use a tablet the way he/she deems fit and the experience of their clients can vary. Insurance companies across Asia have been active in providing tablet-based tools to their sales-force to assist with client interaction whilst they are on the move. There may be a lesson for wealth managers here.

Benchmarking your offering against non-financial services best in class offerings provides a refreshingly different perspective. I am fascinated by the connection between mobile and health, using sensors in phones that record movement and physical activity. There is an opportunity to connect mobile devices with financial health too. Understanding the characteristics of each market and creating solutions that are suitable for each market is better than implementing the same solution across all markets in Asia Pacific. For example, some markets are highly intermediated and advisor-led whilst customers in others may be more self-directed. Finding this next generation of advisors and creating a

The key is to use technology to offer targeted and personalised client solutions.

connection with them is a winning strategy over the medium to long term.

Millennials are the demographic cohort following Generation X. Whilst there are no precise dates as to when the generation starts and ends, researchers and commentators use birth years ranging from the early 1980s to the early 2000s. These Millennials want to work with innovative firms that can **personalise their experience** with them. Collecting information about advisors from a variety of sources, including tracking social media activity to create targeted marketing content and tools to assist them, will go a long way. A recent report from Kasina on 'What Advisors Do Online' states that three out of five financial advisors in the U.S. say the digital capabilities of asset managers affect how they perceive the brands, hence asset managers must increasingly focus on their Web presence.[vii] Financial Advisors seek a customised experience with their asset managers.

As the impact of technology shifts from improving efficiency to enabling transformation of business operations and the client experience, there is a **blurring of lines between technology and marketing functions in organisations**. What I mean by this is that the way technologists deliver solutions is different today—they think in an integrated manner and look at the client experience as well, sometimes creating and adhering to high standards of usability and design. Traditionally this has been a marketing domain.

In any solution development there ought to be a significant amount of time and money invested in **user experience and design**. Social input on beta versions of solutions is often a good way to get some early input and test ideas in a very cost effective manner. The trick for large organisations is to build once and deploy many times across the world by creating scalable solutions across markets, whilst maintaining local relevance. Mobile applications and websites are being built as a collection of components by technologists and these components can be assembled to create a journey with input from marketers.

I have been involved in many test-and-learn type projects and having the **courage to determine a failed project** is also very important. There is more of a test-and-learn approach when developing mobile applications and more willingness to change offerings rapidly. For example, a mobile application developed for retail clients was adapted for use by commercial, small or medium enterprise clients, and the usage pattern was very different. Commercial organisations often need multi-layered authorisation, large transaction limits, etc.—which

were not really built for retail clients, and the application had to be re-created from scratch. Constant optimisation accompanied by a drive for greater return on investment (ROI) should be part of the implementation philosophy. Most innovative organisations have a tolerance for failure as long as the learning is applied in future projects. I have also seen wealth management and fund price-tracking apps removed from the App Store as they failed to achieve any critical mass in terms of the number of users, and so did not justify the cost of maintaining the app. Thus, the principles of managing a product range (for example, any consumer goods like television sets) also applies to wealth management tools, and firms are looking for real ROI on their technology spend.

Lastly, I would say there is sometimes a **fear of technology** amongst non-technology functions. Here, increasing technology awareness of staff across the organisation also helps. There are many free courses available, and today, children are writing code and developing applications the way some of us solve crossword puzzles or Sudoku.

Wealth managers are now on the cusp of further innovation, where they can glimpse the potential benefits of mobile technology. Some early adopters are taking the lead. The key is to use technology to offer targeted and personalised client solutions. Finally, acting fast is important, as the cost of waiting is too high.

Vineet Malhotra
is a Managing Director at BlackRock, based in Hong Kong

Views expressed by the author are his own and do not represent those of his organisation.

Reference

[i] The Boston Consulting Group, bcg perspectives, 2014, "Global Wealth 2014: Riding a Wave of Growth".
[ii] Ibid.
[iii] "Augmented Reality", Mashable, http://mashable.com/category/augmented-reality/.
[iv] Yesmail Interactive, "Yesmail Study: Half of Consumers Now Read Emails Only on Mobile Devices", February 2014.
[v] PwC, 2014, "Asset Management 2020: A Brave New World".
[vi] Ibid.
[vii] Kasina, 2013 "What Advisors Do Online".

Leveraging market-based assets

TO DE-RISK THE FIRM'S OPERATIONS

In times of uncertainty and volatility, the active management of market-based assets, such as brands and channel relationships, take on a new significance in managing risk.

By Rajendra Srivastava

Today's dynamic and ultra-competitive environments require managers to deal with volatile markets and minimise vulnerability to competitor inroads. Volatility has been defined as an indication of how much and how quickly a value, such as the price of a product, changes over time. It is governed by both variability and uncertainty, with variability describing the overall movement, and uncertainty referring to the unpredictability of the movement. The levels of volatility vary widely across countries, and it is essentially on account of these two elements—variability and uncertainty—that there is far more scope for volatility in the growing, emerging markets of Asia, as compared to say the developed markets of the West.

For example, when the U.S. began tapering off its quantitative easing programme, many emerging markets in Asia were at major risk. With interest rates remaining low, domestic private debt in the region had surged, as there had been an increase in foreign currency denominated external borrowing.[i] With the appeal of relatively high interest rates waning, these countries were no longer flush with foreign direct investment, and their fortunes changed dramatically, creating havoc in their currency and equity markets.

Secondly, many sectors of developing Asian markets are not as well known as those in the developed markets. When there is no previous comparison point, it becomes far more difficult to predict demand, thereby increasing uncertainty. This is particularly true for firms operating in sectors such as technology. BlackBerry, for example, was a market leader that did not heed the threat of rapidly emerging low-cost competition coming out of Asia, and went on to witness its product become steadily irrelevant within a decade.

> Volatility varies widely across all countries, and it is essentially on account of two elements—variability and uncertainty.

A third reason for demand uncertainty is because income growth in the middle class has fuelled increased consumption of consumer goods. Growth in consumer goods can therefore be twice as much or more than overall GDP growth. Even when these economies slow down, growth in consumer goods–though decreased–is still quite high by developed market standards. However, capacity development spurred by previously higher growth has resulted in short-term excess capacity. This puts considerable downward pressure on price trends that further erodes revenues and profits at the product category level.

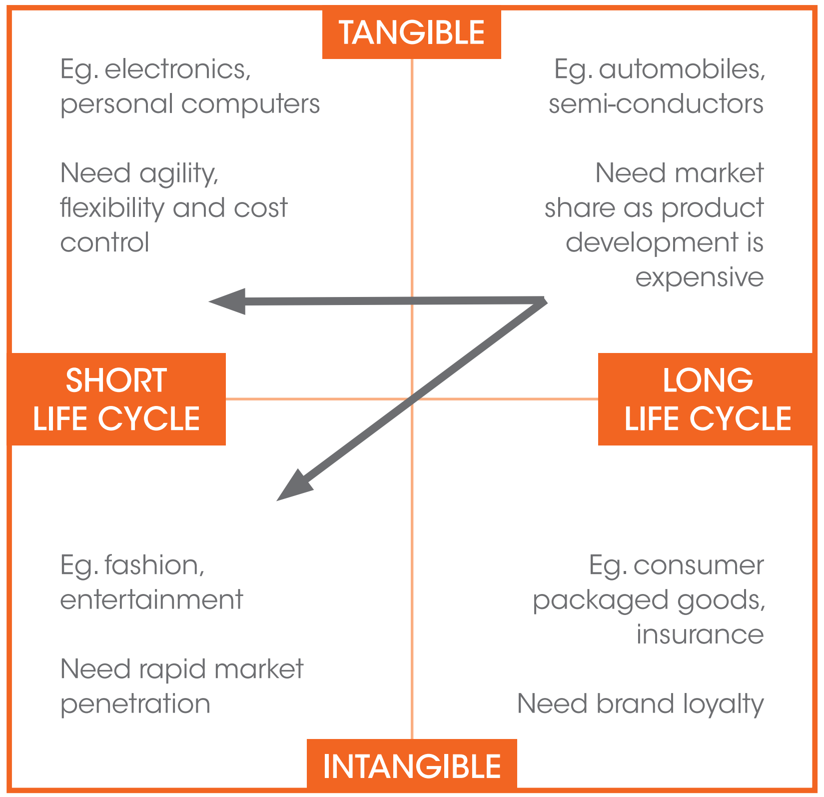
Finally, many companies in Asia are further back in the value chain. Typically, they have far fewer customers than those that are 'customer facing', such as in retail businesses. In such oligopsonic markets, the slowing down of purchases by even one customer can cause a huge setback to the business. This was seen earlier this year when Samsung lost the monopoly it held as the producer of Apple's microprocessor, to the Taiwanese firm, TSMC, which began supplying chips for iOS devices like the iPhone and iPad. The further back we go in the channel, the greater is this problem. In Asian markets, this in an important factor to consider as many Asian companies are involved in business-to-business (B2B) manufacturing–relying on big contracts from oligopsonic buyers–and thus intrinsically carry a far greater risk of volatility.

Volatility is contextual

In the last few years, there has been a shift from manufacturing to information- and knowledge-driven services, where the world is moving in a direction of progressively more value coming from intangibles. Product life cycles are getting shorter, and as they develop, economies are becoming more service oriented (refer to Figure 1).

Nonetheless, many Asian businesses are becoming further embedded in the top left quadrant, that is, of tangible, short cycle industries–which goes against the trend and adds to the risk– because for firms to succeed in the manufacture of tangibles, new product development is critical. However, new product development is itself becoming a riskier proposition with product development cycles becoming shorter, parallel development taking place (resulting in fewer go/no-go gates) and many low-cost global competitors quickly replicating new products. But while continuous innovation and differentiation is a must to reduce volatility in the West, in Asia, countries such as China, India and Indonesia are fortunately big markets, and so firms can operate more on scale rather than margins. And that may require product simplification as well as process improvement, rather than product innovation.

FIGURE 1: SHIFT TOWARD INTANGIBLES AND SHORTER PRODUCT LIFE CYCLES



Risk and management controls

Risk can be of several types, from a systematic risk that affects the macro-environment, to idiosyncratic firm-specific risk (refer to Figure 2). Systematic risk relates to where you compete, and consequently, the strategy to manage this risk is largely in the selection of the right product markets. Even then, as the 2008 global financial crisis has shown, sometimes it does not matter how well behaved the organisation is, a meltdown in the environment results in mayhem in all firms' markets.

Moreover, what might be considered a safe position today may well change in the future, because external factors such as technology can bring about industry evolution. For example, in the space of five years, Li & Fung has gone from a position of a dominant global supply chain manager and the darling of this part of the world to witnessing troubled times. This is partly on account of disintermediation, which has resulted in supply chain shrinkage and firms bypassing Li & Fung's intermediary role.

But while it may be harder to manage the systematic risk, firms can indeed manage the idiosyncratic risks at the industry as well as at the firm level. Asian emerging markets are especially prone to industry level risks due to competitive zeal: all too often, there is an abundance of companies rushing to enter a limited space. Hence while the Chinese automotive market has increased manyfold–China is now the world's second largest automotive market–so too have the number of competitors. This constant tussle for market share greatly increases uncertainty at the firm level.

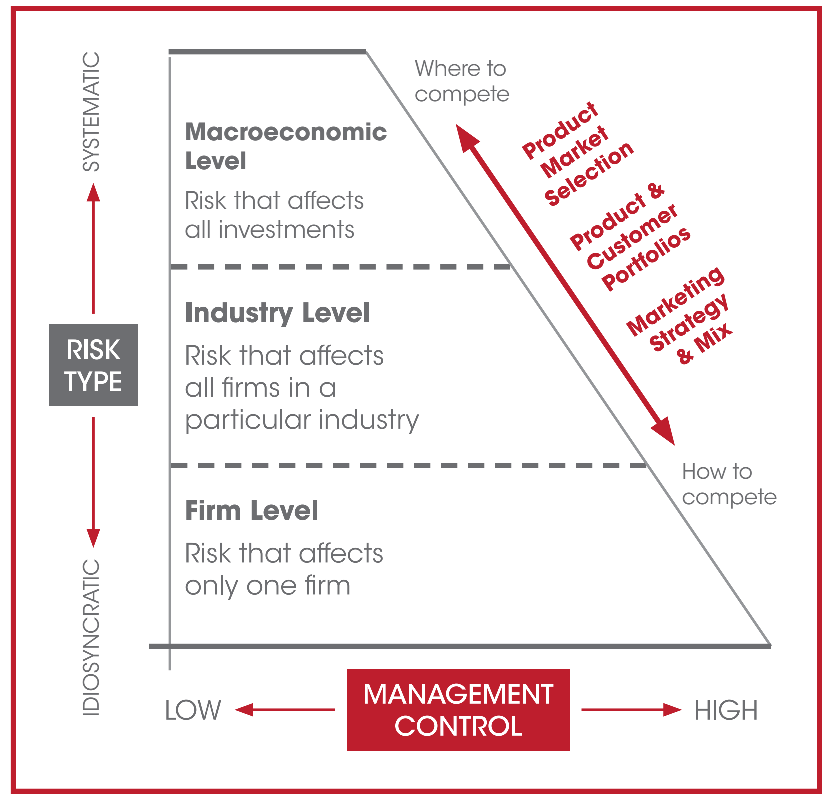
In other cases, uncertainty and risk may be self-inflicted. So while risk in financial markets may be higher than that for say, consumer goods (people do have to eat, before they invest), some financial institutions may elevate their risk further by serving 'sub-prime' credit customers in the pursuit of higher revenues and margins.

Similarly, many companies which operate in relatively stable consumer markets such as food and beverage rely on price-promotion to elevate demand. But this simultaneously increases demand variance, which might be mitigated by other companies using every-day-low-price (EDLP) strategies.

THE OPTIONS APPROACH TO MANAGING RISK AND UNCERTAINTY

There are many approaches to managing uncertainty and risk. Firstly, uncertain

FIGURE 2: TYPES OF RISK MANAGEMENT CONTROL



times demand insight. Anticipation of change enables the potential for an appropriate response. For example, it can be safely predicted that with ageing becoming an issue in many Asian countries, there will be an increase in demand for healthcare. So adding capacity and growing the business would be a safe bet for companies operating in this industry. Secondly, exploration of ways to reduce uncertainty and volatility, such as the EDLP strategies mentioned above. Thirdly, preparation for volatility by perhaps holding enough inventory to manage demand uncertainty. Hence, by and large, uncertainty demands flexibility and actions contingent on information. This is termed the options approach.

Put simply, the options approach suggests that, depending on the level of uncertainties, a firm may choose to either defer or exit from an investment (and the option captures the value of postponing the investment decision relative to investing today), or then exercise a growth option by making initial investments in an asset such that follow-up investments could be made at a later date.

In my view, under options thinking, uncertainty is an opportunity rather than a threat. For any outcome, there is an upside potential (performance above expectations) and downside risk (performance below expectations). The trick is to avail of the upside potential and sidestep downside risk–and while uncertainty clearly adds to the risk, it is also undoubtedly the best time for a firm to gain competitive advantage by managing that risk better than its competitors.

Using market-based assets to manage risk in volatile times

Amongst other strategies, such as improving agility and becoming a better sensing organisation, one of the most effective ways for marketers to manage risk is by actively developing 'market-based assets'.

Market-based assets are essentially the firm's connections in the value chain ecosystem. These assets are predominantly of two types: intellectual and relational. Intellectual market-based assets reflect the knowledge the firm possesses about its external environment, such as facts, perceptions and projections. The greater the knowledge, the better would be the firm's speed and accuracy of response.

Relational market-based assets refer to the interface of the firm with its key external stakeholders, and include both–customer relationships such as brands and installed customer base; and partner relationships including channels, co-brands and networks. By entering into such relationships, a firm would have greater knowledge of market conditions, lower inventories and several other advantages that can enable it to better manage its activities and ensure that the cash flows become more stable and less unpredictable.

Below are some of the key strategies suggested to reduce risk, specifically in the Asian context, by actively managing market-based assets.

INVEST IN CREATING A STRONG BRAND

In times of volatility, market cycles get shorter and more pronounced, and under such conditions, trust and strong customer relationships are important factors for survival. But in Asia, while customers may have awareness, preferences are not as well-developed as say, in the U.S. Still, a great brand addresses that challenge by creating strong market imperfections, providing opportunities for pricing flexibility, and

> One of the most valuable ways for a firm to deal with multiple uncertainties is by creating shared product and customer platforms.

generating a powerful attachment for the product. By creating differentiation, the brand ensures that commoditisation is overcome, which leads to a period of competitive advantage. High equity brands witness higher customer loyalty, and a lower churn. And in times of volatility, this is an invaluable asset.

CREATE A LOYAL CUSTOMER BASE

One of the best ways to deal with uncertainty is to create customer inertia, which slows market churn, and along with creating a well-established installed customer base, not only protects the firm's market, but also prevents competitors from attacking it. Back in the early 1970s, research showed that the churn rate of customers that had only a bank checking account was substantially higher than those who had a checking and savings account. And if the customers had three or more accounts, they could be considered to be effectively locked in. Similarly, free online bill payment services was another way that banks have retained retail customers.

Marketers have invested in a variety of programmes aimed at enhancing customer loyalty and switching costs by increasing benefits (e.g., Singapore Airlines' loyalty programme) and reducing risks (e.g., through unconditional money-back guarantees) to more loyal customers. Larger retailers often offer programmes where consumers collect stamps or points which are redeemable throughout a network. This provides a significant advantage compared to the single store retailer and enhances both desired loyalty and inertia. In addition, cross-selling and up-selling are two key market strategies that have been used by firms to retain customers—as has been seen in the case of Apple, which has migrated and moved its customer base from the iPod to the iPhone and on to the iPad.

Finally, as many of these companies are in the B2B space, there should be a strong value attached to long-term contracts—even if these are offered at a price concession. After all, the experience curve states that the more experience a firm has in producing a particular product, the lower are its costs. Hence, given that long term contracts are expected to lock in customers, they would provide a hedge against volatile demand, and reduce production costs.

BUILD CUSTOMER AND PRODUCT PLATFORMS

One of the most valuable ways for a firm to deal with multiple uncertainties is by creating shared product and customer platforms. Modular designs can enable this strategy, as the firm can design its products in such a way that they can be used in multiple end-use products. Honda, for example, deploys a small engine technology that supports multiple products such as cars, motorcycles, generators and lawn mowers. By doing so, Honda can better manage its risks and costs, by spreading it across several items in its product range. It can also help increase sales and enable quicker adoption of new innovations. Moreover, by using the same technology, it can out-spend competition even if it is a late entrant. This is particularly important for Asian companies that operate in the B2B space.

Firms can also take advantage of multiple product lines by creating unique product/service bundles, such as Microsoft's Office Suite, that others cannot easily duplicate.[ii]

SHIFT TO CUSTOMER SOLUTIONS AND BUSINESS OPTIONS

In the manufacturing space, offering services helps reduce volatility and vulnerability. This is one of the key reasons that the Finnish company, Konecranes, which had traditionally focused on manufacturing cranes, is now progressively moving to grow its revenue from services. This is also why a company like General Electric chooses to install its MRI machine at no upfront cost to the radiologist, and instead charges for maintenance based on its use—because it recognises that this results in a much longer term relationship with the customer than what would have been achieved by merely selling the product along with a warranty.

Thus, along with loyalty programmes, services are another valuable way to foster customer loyalty. It enhances customer 'stickiness' by taking advantage of synergies in providing a complete customer solution. This is why it is preferable to be an Original Design Manufacturer (ODM) rather than an Original Equipment Manufacturer (OEM)—as the latter simply manufactures to specifications provided—while the ODM has consciously moved up the value chain, and made the customer reliant for design capability too.

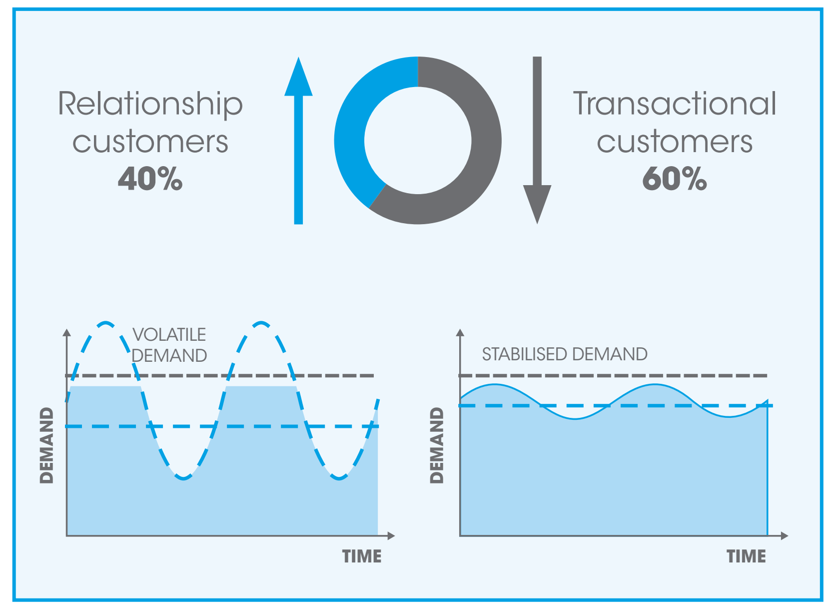
GET THE RIGHT CUSTOMER MIX

Firms should focus on not just the 'largest' customers, but those who would have the most to gain from their products. And typically, it is those firms that are not the largest that are hungry for differentiation. The other significant issue with focusing on very large customers is that it can result in very high dependency on that customer's fortunes, and whims.

Getting the right customer mix also means that firms need to move towards replacing transaction-based exchanges with relationship-based customer intimacy—and this is a great tool for the firm to de-risk.

For instance, suppose a steel mill, which is subject to customer cycles, supplies to an automotive OEM. Because it is very difficult for it to halt production and restart; even when there is a slowdown in the automotive industry, it has to continue with its operations. This results in excess inventory, which it sells to the distributor. And when the economy improves, the distributors start competing. In this example, the distributors are what we would call transactional customers, and the OEM would be a relationship customer. If the steel mill can consciously work toward increasing the proportion of its relationship customers, say from 40 percent to 60 percent, it would find that it has far more steady and strategic customer relationships to manage, as compared to dealing with the distributors who are transactional customers and more opportunistic in nature. The relationship customers thus tend to have a more stable demand, and are also far more loyal to the firm. Stabilisation of demand enables more efficient capacity utilisation (refer to Figure 3).

FIGURE 3: RELATIONSHIP CUSTOMERS VERSUS TRANSACTIONAL CUSTOMERS



While the strategies prescribed for Asian companies to hedge against volatility and uncertainty are much the same as in western countries, the context is different. Asia is growing at a much faster rate.

However, it must be noted that transactional customers may have low loyalty, even if they are satisfied with the product. This anomaly tends to typically be found in commodity markets, or where there is low differentiation among the products and many substitutes have lowered the switching cost. An example would be the PC market, where despite being satisfied with one brand, the customer may not hesitate to replace with another brand. Hence, firms operating in such markets need to recognise that even though they have a strong product, they may not be in a position to retain a large proportion of customers. Thus creating differentiated products are a key means to reduce volatility. But referring back to the earlier discussion, sometimes it is a differentiated solution (such as the billing method, collections, delivery, service warranties, etc.) rather than the simple product that offers a tremendous opportunity to erect a competitive barrier to entry.

On a related note, some firms may choose to cement their relationships with particular customers by granting price concessions in exchange for longer-term purchase contracts. While this may work in the short-run, it must be noted that both the vulnerability and volatility of cash flows are undervalued when a short-term transaction perspective displaces a longer-term relationship mentality.[iii]

DEVELOP STRONG CHANNEL MARKET-BASED ASSETS

Managing relationships well in the distribution network goes a long way in reducing risk. Firms can increase switching costs with 'entanglement programmes', such as incentives or offering services.

The volatility of cash flows is also reduced when manufacturers reduce cash flow uncertainty by demand-driven flexible manufacturing. The logic is that the firm uses internal capacity to meet steady, repeatable demand; and outsources production to cover uncertain demand. Firms can also shift the risk to their partners where appropriate, and Li & Fung has done that very well with vendor-managed inventories. It has kept its core business model asset-light and flexible, by not owning any part of its production facilities. Moreover, the company decided that they would contribute between only 30 percent and 70 percent of a factory's production. This ensured that, while at 30 percent, the factories appreciated the importance of a contract with Li & Fung, by not taking on 100 percent of the production, Li & Fung did not become responsible for having the suppliers completely dependent on its order.[iv] Similarly, in April 2013, e-commerce player Flipkart operating in India launched Flipkart Marketplace, where buyers could deal with sellers directly. This way, Flipkart would be responsible for delivering the product but would no longer have its own inventory.[v]

It also helps when a firm is vertically integrated, particularly in adverse economic times. This gives it more control, flexibility and greater ability to absorb external shocks. However, it must be noted that this is a double-edged sword, as it may also increase the concentration of risk.

Firms in Asia must work towards bringing the consumer to the channel partner. This sends a strong statement that "not only will we give you the product to sell, but also give you the customer to buy it". The second half of this statement is very powerful, because it is only when customers start asking for the product that strong branding and customer loyalty takes place. And while most Asian companies manage the 'pull' side well, they are not very good at 'pushing' the consumer side (with the notable exceptions of some like Lenovo and Haier, which are getting better at managing the overall channel relationship).

RETIRE CAPACITY

Yet another way to reduce volatility is to retire capacity. The PC market, for example, was shrinking as low-end users migrated to tablets, resulting in unused manufacturing capacity. PC manufacturers began to heavily discount their products, which led to further price cutting. In this case, it would have been better if the capacity had been altogether closed out, or at least shifted to some other category. Of course, in some industries this cannot be done. For instance, in the hotel business, if a property is not profitable and is sold, chances are that it would be bought and used for the same purpose. It would be the same in the shipping and airlines industries. Hence, in some industries, capacity never disappears, and it is these industries that are far more risky whenever over-supply becomes a huge issue.

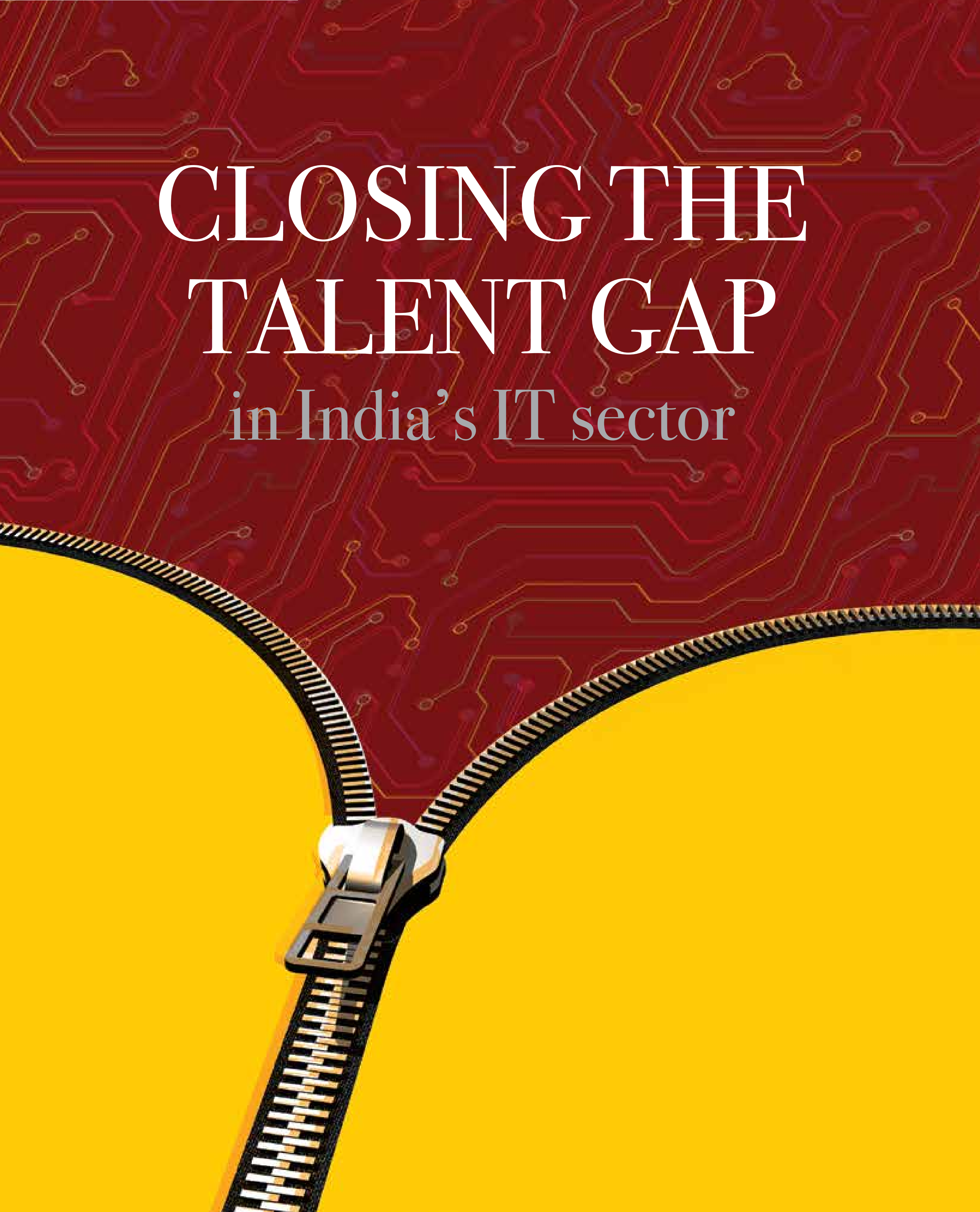
And in Asia, there is clearly excess capacity in a number of industries. For instance, the steel sector is straining under the pressure caused by years of excess steelmaking capacity, despite the Chinese government mandating that 80 million tonnes of capacity should be removed by 2018.[vi] Thus firms would need to take a close look at how they can close out or re-deploy their excess manufacturing capacity.

Learn how to defend your position in the marketplace

While the strategies prescribed for Asian companies to hedge against volatility and uncertainty are much the same as in western countries, the context is different. Asia is growing at a much faster rate. It is also subject to greater fluctuations, with large amounts of money moving in and out. Meanwhile many Asian companies are lower down in the value chain and engaged in B2B marketing. For these reasons, flexibility and market knowledge become critical. Effective management of the firm's market-based assets would be great enablers to achieving this.

Rajendra Srivastava
is Provost and Deputy President at Singapore Management University

Reference
[i] Ansuya Harjani, Here's how QE Tapering could hurt Asia, CNBC Asia, May 28, 2013.
[ii] Srivastava, R., Shervani, T. A. and Fahey, L., "Marketing, Business Processes, and Shareholder Value: An Organizationally Embedded View of Marketing Activities and the Discipline of Marketing", Journal of Marketing, 1999.
[iii] Ibid.
[iv] Magretta, J., 1998, "Fast Global, and Entrepreneurial: Supply Chain Management, Hong Kong Style – An Interview with Victor Fung", Harvard Business Review.
[v] Shinde, S., April 6, 2013, "Flipkart changes business model, launches Flipkart Marketplace", Business Standard.
[vi] Ernst & Young, 2014, "Global Steel 2014".



CLOSING THE TALENT GAP in India's IT sector

By Arnoud De Meyer and Peter Williamson

How Infosys reduces partnership risk through ecosystem management

What is especially remarkable about the Campus Connect programme is that by virtue of its design, it is able to significantly reduce principal-agent risks within large-scale, multi-organisational collaborations.

Infosys, one of India's largest information technology (IT) consulting firms, developed the Campus Connect programme in response to the growing belief among India's IT industry majors that fresh graduates being recruited from the country's engineering colleges were neither readily employable, nor sufficiently industry-ready. The programme was designed to address this problem through an industry-academia initiative to revamp the education experience of engineering students. The goal was to build a sustainable partnership between Infosys and engineering education institutions for mutual benefit, producing high quality talent for the IT industry. This would be carried out through a range of programme components that Infosys would collaborate on, and develop with, academic institutions.

The programme was launched in May 2004 with 70 Indian colleges. By 2013, it had been scaled-up to cover 400 colleges, where more than 180,000 students and 8,300 faculty members across India had benefited from the programme's technical and soft-skills training and exposure to industry practices.

In the programme's first eight years, the number of Infosys recruits increased from 8,000 to over 20,000. Moreover, the recruitment conversion and yield from participating Campus Connect colleges were higher than non-partner colleges. These new cohorts demonstrated marked improvements in applying engineering principles to practical situations, along with better teamwork, project experience, cross-function networking and communication skills.

What is especially remarkable about the Campus Connect programme is that by virtue of its design, it is able to significantly reduce principal-agent risks within large-scale, multi-organisational collaborations. For instance, the internal mechanisms and structure of the programme contain certain key elements that encourage organisations to partner in the programme, share costs, ensure compliance and create synergies.

In this respect, Campus Connect has become more than the sum of its parts. Essential to achieving this is a framework that creates a talent ecosystem, which is scalable, sustainable and measurable. The various elements of the programme all fit together such that Infosys captures a competitive advantage, improves partner capabilities and successfully nurtures a talent pool that benefits the entire IT industry.

INFOSYS MILESTONES

1981 :	Infosys is founded by six engineers in Pune with an initial capital of US$250
1993 :	Infosys goes public
1999 :	Revenue reaches US$100 million, lists on NASDAQ
2006 :	Revenue reaches US$2 billion
2008 :	Revenue exceeds US$4 billion, net profit of US$1 billion
2011 :	Employee count reaches 130,000
2012 :	Revenue hits US$7 billion, company ranked as one of the most innovative in the world by Forbes

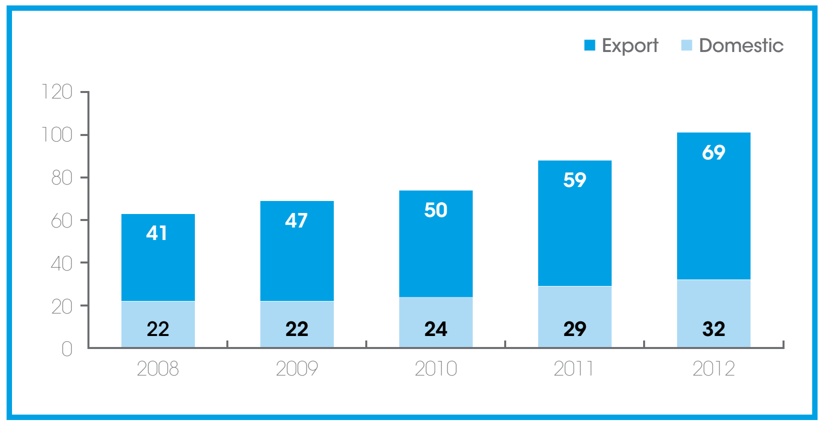
> At a quantitative level, there was a growing chasm between the needs of India's high-growth IT industry and the availability of a group of skilled, employable engineering graduates.

Infosys

Infosys was founded in 1981 for a meagre US$250 by seven people. Today it is recognised as a global leader in the IT industry—reporting revenues in excess of US$7 billion and a workforce of more than 155,000 employees in 69 offices and 87 development centres throughout the world. It provides business consulting; technology, engineering and outsourcing services to help world-class clients in over 30 countries.

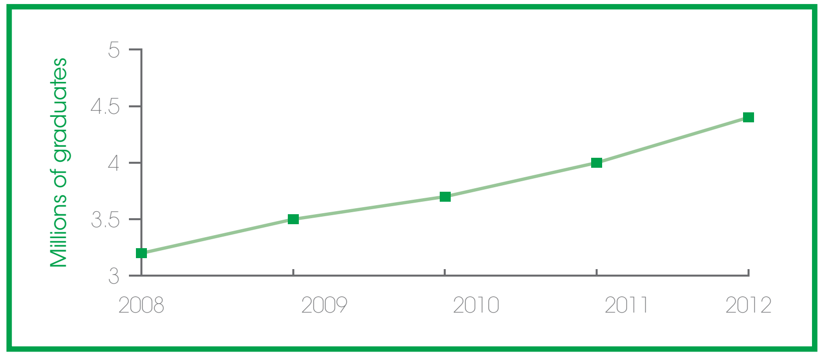
These services require more than technology and engineering expertise. Infosys employees must understand the nuanced needs of clients along with the intricate complexities of their businesses. Building a strong relationship with clients and working with them on collaborative problem solving is thus an important aspect of Infosys's success, where as much as 97.8 percent of Infosys revenues come from existing repeat customers. In this industry, talent is key.

MARKET SIZE OF THE IT INDUSTRY IN INDIA (US$ BILLIONS), 2008-2012



Source: India Brand Equity Foundation. IT & ITeS, NASSCOM, March 2013

GRADUATE ADDITIONS TO TALENT POOL IN INDIA (MILLIONS)



Source: India Brand Equity Foundation. IT & ITeS, NASSCOM, March 2013

India's IT industry

In the mid 1990s, U.S. companies began to outsource back-office operations to India, which had an abundance of cheap, but skilled, labour in the IT field. By the 2000s, the sector was booming and becoming increasingly competitive. Large investments into IT infrastructure and research and development soon paved the way for more advanced products and service offerings well beyond back-office operations like call centres.

From the mid-2000s, India's IT sector firms had established themselves as large multinational companies with global reach, often making cross-border acquisitions. By the 2010s, these firms collectively boasted 560 centres spread across 70 countries, directly employed 2.8 million people and indirectly employed another 8.9 million.[i]

But despite India's large number of engineering graduates and substantial investments in training and development, the industry's spectacular demand-driven growth continued to outpace the IT sector's capacity to source and develop adequate new talent.

The talent gap

At a quantitative level, there was a growing chasm between the needs of India's high-growth IT industry and the availability of a group of skilled, employable engineering graduates. At a qualitative level, fresh recruits from the engineering colleges displayed a real lack of industry-readiness in terms of industry orientation and the ability to apply their theoretical knowledge to practical use and problem solving. There was also a clear competency gap with regards to soft skills, process awareness and English language proficiency.

Infosys was hesitant to address this gap solely through in-house training and development. Not only would such an option be expensive, it would also put Infosys at risk of talent poaching before it could recover its human resources investment. Moreover, it would not address the root cause of the talent shortage.

Campus Connect

It was with the intent to address this talent gap, that in May 2004 Infosys launched the Campus Connect programme. The key objective behind the programme was to evolve a scalable, measurable and sustainable model through which Infosys and academia could partner together to enhance the quality of IT education in India, thereby improving the employment prospects and industry-readiness of the students, as well as augmenting the overall talent pool available to meet the growing demand in the IT space. The programme was designed as an industry-academia collaboration to align the competencies and capabilities of the overall engineering graduate workforce with the industry's needs. Irrespective of where graduates were sourced—from a metro or a rural area—there needed to be consistent quality throughout the talent pipeline.

This ambitious goal required Infosys to work with a wide spectrum of stakeholders. This included the management, faculty and students of partnered academic institutions; as well as practitioners in the IT industry and regulatory bodies. With such massive collaboration, creating stakeholder alignment could be problematic given the potential for principal-agent risk. Infosys therefore needed a comprehensive solution to reconcile potential conflict amongst so many competing interests and create an ecosystem that delivered worthwhile benefit to all stakeholders.

Key elements of collaborative alignment

ADDING CLEAR VALUE TO PARTICIPANTS

As the lead organisation in the Campus Connect programme, Infosys needed to entice the engineering institutions into joining the partnership, especially since these schools must contribute significant resources to develop curricula that answer the call for more IT industry-ready graduates. Infosys addressed this challenge by taking a holistic approach, first by assessing stakeholder expectations, and then by developing programmes that catered to partners' needs.

The benefits of such programmes are clear: an institution's partnership

CAMPUS CONNECT: KEY STATISTICS

Campus Connect Top Level Information				
Item	FY10	FY11	FY12	FY13
# Partnering institutions	411	435	474	395
# Campus Connect Conclaves	2	8	1	0
# Technical Workshops conducted for the faculty	16	19	19	15
# Faculty enabled through Technical Workshops	696	744	887	709
# Soft Skills Workshops	24	9	20	9
# Faculty enabled through Soft Skills Workshops	919	292	613	320
# Road shows	142	124	141	111
# Seminars in Institutions (Technical/Soft Skills)	26	47	80	60
Foundation Program (FP) Rollout-Technical				
# Batches completed	373	307	339	304
# Institutions that completed at least one batch	189	142	173	152
# Students completed FP	24333	19551	21665	19700
Soft Skills (SS) Program Rollout				
# Batches completed	162	240	194	200
# Institutions that completed at least one batch	72	95	56	58
# Students completed SS	8167	13496	12240	11962
Technical Electives				
# Batches completed	11	63	141	133
# Students completed	2319	8857	19845	15288
Soft Skills Electives				
# Batches completed	NA	28	19	26
# Students completed	NA	1830	1017	1690

enhances the employability of its graduates by facilitating a closer relationship with industry. The faculty also benefits as involvement in the programme gives them the opportunity to take part in sponsored sabbaticals at Infosys, and to collaborate on research papers. By providing students with more exposure to the industry through field trips and internships at Infosys, the employability and industry readiness of this group is further enhanced. Finally, Infosys, and the IT industry in general, benefit from the reduced training time that results from industry-aligned curricula and the soft skills training gained through internships and industry exposure.

DEFINING DISTINCT PARTNER ROLES

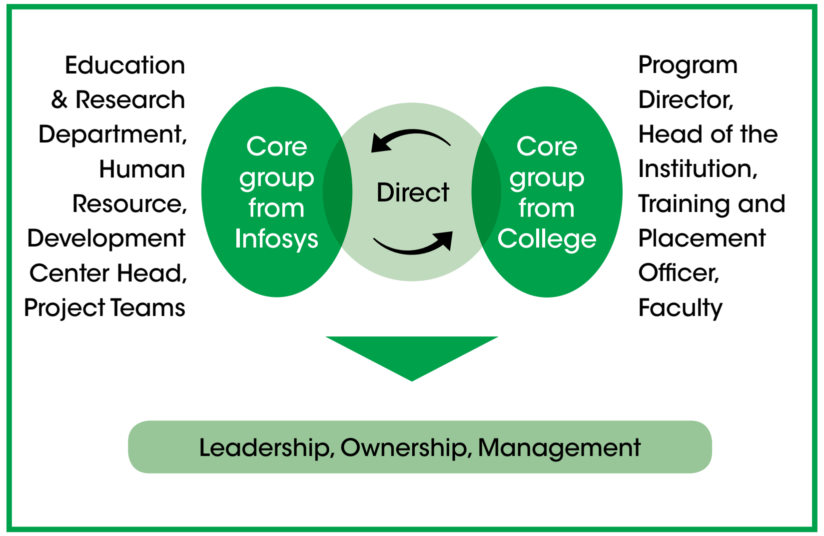
Campus Connect is essentially a relationship between two core groups: Infosys and partnered institutions. This relationship is officiated during a conclave in which these organisations come together and share expectations about one another as to what Campus Connect can offer. During the conclave, a Memorandum of Understanding (MoU) is signed whereby roles, responsibilities and resource commitments are secured, and an action plan is drawn up to initiate programme rollout.

The actual operations of the programme are then managed by a dedicated group of 15 Infosys staff that builds and maintains relationships between the core groups, facilitates and implements action plans, reviews the programmes, and evaluates the performance of partnered institutions.

Infosys also segments the partnered institutions as either member colleges or advanced colleges. Member colleges are those that have recently joined Campus Connect and have since commenced conducting joint programmes and satisfied the objectives set during the conclave. Advanced colleges are former member colleges that have significantly progressed and integrated programmes into their curriculum. These colleges could also be those that have effectively implemented co-created industry electives that have significantly impacted the partnership. These institutions are recognised as best in class amongst partner institutions and have exceeded their action plans and stated deliverables. They show continuous and consistent improvements in student performance, graduate employability, and have often demonstrated innovative initiatives. Only colleges in the advanced category are offered Infosys-sponsored sabbaticals, joint prototype development and additional research sponsorship support.

In the event of failed objectives, a partnered institution may be dropped from the programme.

GOVERNANCE MODEL



ENCOURAGING PARTNER INVESTMENT AND GAINING EFFICIENCIES

The conclave deliberations establish governance to the relationship by defining roles, responsibilities and core processes. At first this relationship was largely unidirectional, with most of the responsibility with Infosys. But as the programme evolved, the responsibilities and costs of Campus Connect are now much more evenly distributed and the relationship has become better balanced.

A COMMITMENT TO FLEXIBILITY

The structure of Campus Connect is designed to be highly adaptable and capable of evolving to meet new challenges. This is important given the unique qualities of the different regions in India and the distinct characteristics of the hundreds of partnered institutions, which include different academic calendars. A centralised programme would have been inadequate.

A distributed model is also more scalable than a centralised system, another important consideration given that there are some 5,000 engineering institutions in India. It further ensures that every institution receives a uniform Infosys experience, irrespective of where they are located. This hub-and-spoke model succeeds in forging lasting relationships with alumni and provides a solid emotional connection between people within the partnership, thereby creating more vibrant institutions.

CAPTURING THE VALUE OF THE ECOSYSTEM

Campus Connect also deploys an online Campus Connect Portal to facilitate transparency and communication within the programme. It provides easy access to courseware, information and collaboration on student projects, campus news and events, business English lessons and a variety of other programme-oriented services. It has proved exceedingly popular, with about 11,000 faculty and 250,000 student registrations from 2004 to 2012.

The portal also includes a programme management scorecard that evaluates the institution's Campus Connect programme offerings within the context of the action plan and deliverables to stakeholders as specified in the MoU. The scorecard enables the Campus Connect management team to plot the performance of the overall programme and work with stakeholders on strategising future direction. In this respect, the portal is more than a communication and content sharing tool–it is a management tool, a reporting tool, and a decision-making tool critical to driving continuous improvement and vibrancy.

Infosys also evaluates the effectiveness of the Campus Connect programme internally by regularly reviewing its recruitment impact to ensure that it maximises quality new hire yield, monitors high performers and minimises attrition.

In addition, Infosys conducts surveys among partner institutions to measure how well Campus Connect benefits them as well. For instance, in a 2012 survey, the partner institutions reported that graduate employability had increased, on average, by 40 percent. These institutions also experienced better-ranked students in their intake and decreased faculty attrition.

The ecosystem advantage

It is through elements such as clear added value for stakeholders, structured

KEY MECHANISMS USED TO CREATE ALIGNMENT AND REDUCE PARTNERSHIP RISKS IN THE INFOSYS ECOSYSTEM AND CAMPUS CONNECT PROGRAMME[ii]

Objective	Criticality	Implementation and Campus Connect
Pinpointing added value	Pre-requisite to cover inevitably higher costs than vertically-integrated structures	Campus Connect has a clear value proposition for stakeholders
Structuring differentiated partner roles	Essential to achieving the benefits of specialisation and focus for individual partners, and promoting cooperation over competition	Campus Connect explicitly delineates roles between partner groups
Stimulating complementary investments	Enables the lead firm to amplify the impact of its investment and create potential for increasing returns to scale	Campus Connect aligns the costs with partner roles and the value proposition
Reducing transaction costs	Key to minimising an important cost disadvantage relative to vertically integrated structures	Infosys provides technological capabilities that reduce transaction costs, such as the Campus Connect web portal and webinar capability
Enabling flexibility and co-learning	Flexibility and accelerated co-learning are important potential advantages relative to vertically integrated structures	The Campus Connect programme model is highly decentralised and distributed. This allows for flexibility in both location and offerings
Engineering value capture mechanisms	Ecosystems have a risk of 'free-rider' problems where the network architecture established by the lead firm creates value for participants but fails to capture value for itself	Partnership in Campus Connect works through specified deliverables stated in an MoU. In addition, the Campus Connect programme portal uses a scorecard to rate partner institutions and also measures the performance of programme offerings

and differentiated partner roles, co-investment, reduced transaction costs, flexibility, and value capture mechanisms, that Infosys is able to secure a successful ecosystem advantage through its holistic approach to collaborative alignment.

Moreover, effective ecosystem management has become increasingly important in addressing the challenges inherent in a progressively complex and connected world. Problems more often exist in multiple dimensions where collaborative action has become essential. Organisations that succeed in this endeavour will strengthen their competitive advantage and be better able to adapt to rapidly changing circumstances and uncertainty, especially if they seek to take on greater leadership and align stakeholder interests. However, there needs to exist a robust set of properties, mechanisms or rules to maintain collaborative alignment and enhance adaptability.

Arnoud De Meyer
is President of Singapore Management University

Peter Williamson
is Honorary Professor of International Management at Cambridge Judge Business School

The authors acknowledge the support provided by the Singapore Human Capital Leadership Institute for sponsoring this study.

Reference

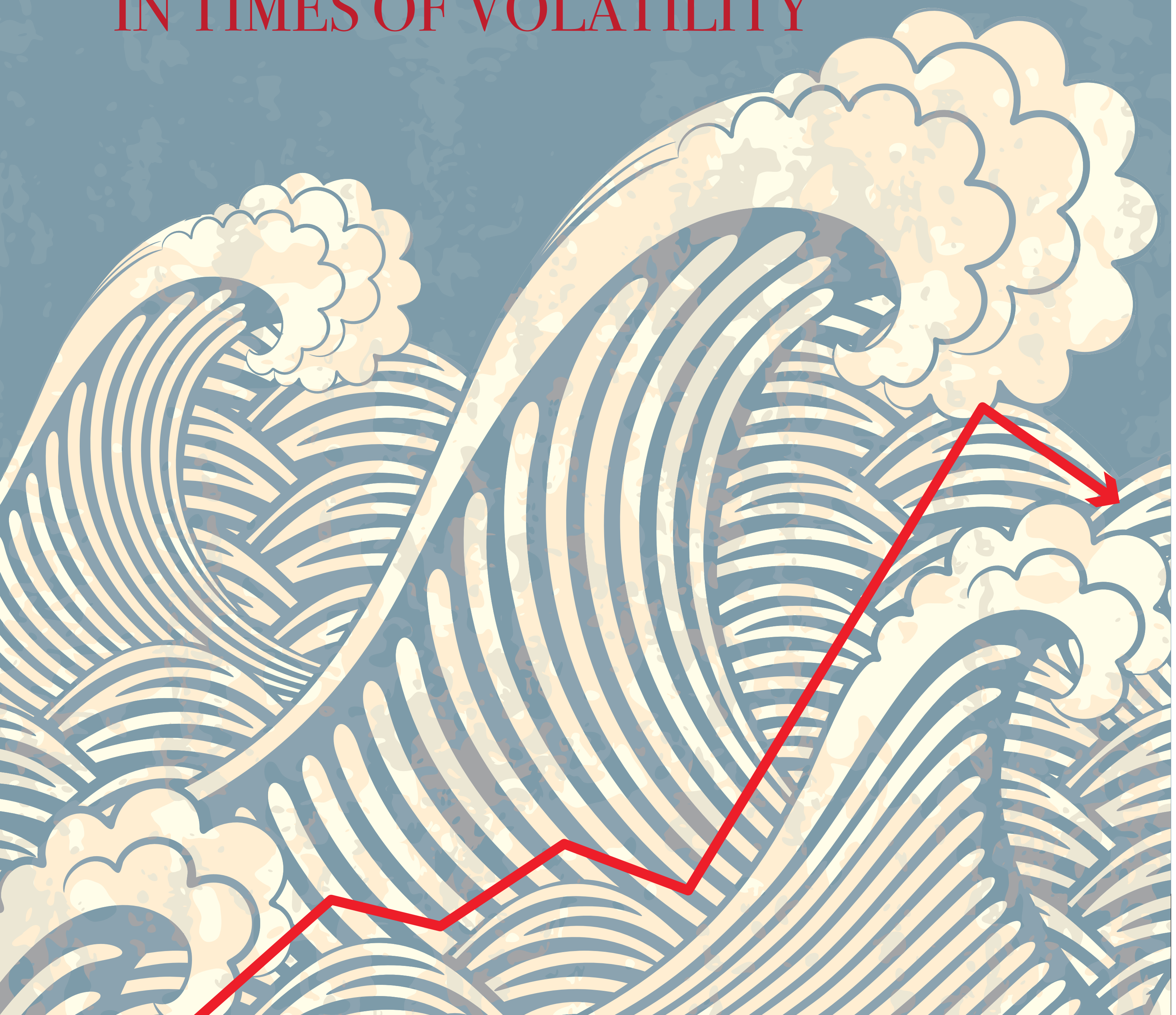
[i] India Brand Equity Foundation, IT & ITeS, NASSCOM, March 2013.

[ii] Williamson, P.J. and De Meyer, A., 2012, "Ecosystem advantage: how to successfully harness the power of partners", California Management Review, 55(1): 24-46.

SINGAPORE EXCHANGE

Managing investment risk

IN TIMES OF VOLATILITY



Growing Asian stock exchanges, such as the Singapore Exchange, create economic value for businesses and investors, while helping to reduce volatility by offering a diversified basket of investment choices and equity derivative products.

By Geoff Howie

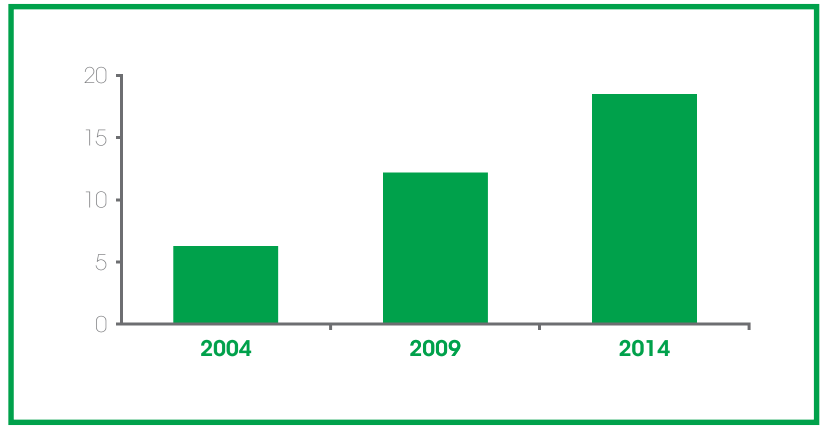
The wide milieu of participants, prices and scenarios making up present day equity markets all originate from simple, common socio-economic needs. They existed before merchant banks and before Shakespeare's Merchant of Venice engaged the public with a comedic take on their uncomplicated practicalities. Then and now, markets still make economic sense and create economic value.

Since the production of the most basic food staples, someone has had a sustainable business idea that required the help of another person. That help–economically termed as a capital input–could be in the form of labour, fixed assets or money, to which an entitlement would be received in return. These foundations remain much the same today. The exchange of some ownership of the business for funding is a modern day part of capital formation and stock exchanges are the institutions through which such efficient allocations take place.

Growing from 3,000 to 12,000 stocks

Let us take the example of a privately owned business considering listing on the stock market. The business might have an exciting plan that is yet to achieve fruition because, quite simply, the plan needs more capital. The business owners could go to the bank or issue a bond or sell some equity in the business, or do all three.

FIGURE 1:
ASIA MARKET CAPITALISATION (US$ TRILLION)



Source: Bloomberg, SGX My Gateway

Unlike a bank loan or debt issuance, creating new equity will directly relinquish some ownership in the business. Moreover, equity enables the potentially new capital backers to be more aligned with the opportunities and challenges of the business. Equity builds stakeholders and can bring both institutional and individual investors into the plans and purpose of the business. For young companies, a successful Initial Public Offering (IPO) is a validation of the business by the markets.

In Asia, businesses are continuing to list, exchanging equity for capital. Alongside physical trade and direct investment, some significant milestones in the number of listings in Asia have brought about greater economic integration with the world. Twenty years ago, there were about 3,000 stocks listed across the current exchanges of Emerging Asia. [i] This has grown four-fold to the present, with over 12,000 primary listings, significantly outstripping the growth rate of the number of new primary listed stocks in North America and Western Europe, as well as the developed parts of Asia Pacific.

This has also helped shape the face of Asia's international financial centres (IFCs). As illustrated in Figure 1, Asia's major economies have seen their combined market capitalisation almost triple over the past decade. The total current market capitalisation of 14 Asian economies, including China, Hong Kong, India, Indonesia, Japan, Malaysia, Pakistan, the Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand and Vietnam, is worth US$18.5 trillion. Their combined gross domestic product (GDP) stood at US$20.6 trillion at the end of 2013.

All these Asian economies, with the exception of Japan, saw their market capitalisation growth well outpace that of the United States. The economies that saw the greatest increase in their stock market capitalisation, compared to ten years ago, were China, India, Indonesia, the Philippines and Thailand.

For the ASEAN region, Bloomberg data indicates that the combined market capitalisation of the region has grown from US$430 billion in 1994 to US$510 billion in 2004 to US$2.4 trillion in 2014. This is based on data for eight countries with the exception of Myanmar and Brunei.

> The higher or wider the economic goals of the developing economy, the higher the potential for swings in sentiment.

Despite the expansion of capitalisation in recent years, there is still scope and scale for more. This is particularly evident for listed businesses involved in infrastructure construction. Asia has an enormous pipeline of projects comprising road, rail, as well as electricity and water requirements. Yet currently, the Financial Times and the London Stock Exchange (FTSE) Emerging Infrastructure Opportunities Index is only one-sixth the size of the net market capitalisation of the FTSE Developed Infrastructure Opportunities Index.

Facilitating efficient equity

The potential return to equity owners is largely in the form of income and asset appreciation. Equity owners have a share in the income of the business, generally through dividends. They also own a ticket in the asset value of the business, generally reflected in the price of a share in the business.

Exchanges help to facilitate the trading of equity in listed companies and provide ongoing listing requirements that establish the trust of the businesses and their investors. This sets the stage for a fair, efficient, competitive, transparent and orderly mechanism to determine the share price of the business.

A public listing does not mean that businesses and investors are immune to failure, volatility or speculation in share prices. Microeconomics has historically shown that some businesses can succeed and others will still fail. As such, the challenges to the exchanges are firstly, to ensure the business investors are well informed on the risks, and secondly, to provide an adequate means of protecting these investments.

In Asia, exchanges and regulators have made significant progress along the experience curve in bringing together investors and businesses to facilitate efficient capital formation, predominantly through prescribing ongoing listing and trading requirements. Enabling secondary fund raising by businesses has also been instrumental in creating value for the businesses and investors. When the global stock markets were at record lows amidst high volatility five years ago, the Singapore Exchange (SGX) also saw a record set in the amount of secondary fund raisings by its listed businesses.

The establishment of investable stock indices has also helped investors manage their exposures over time—while stocks can join or leave a benchmark index, it is the index and its representation that becomes the investment.

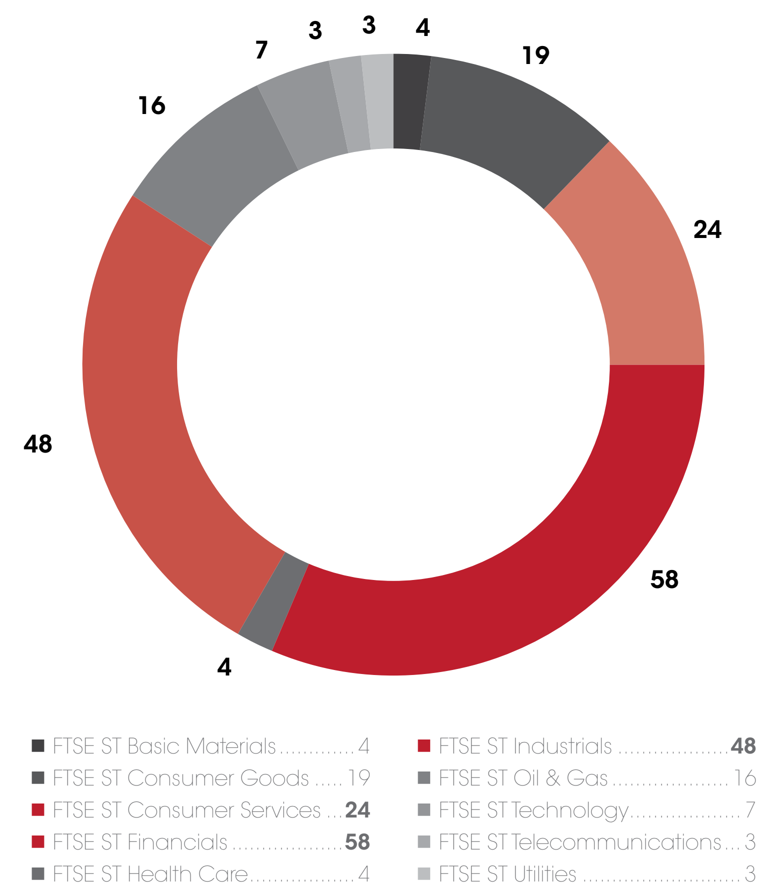
Stability in the sum of the parts

Unlike businesses listed on exchanges in the developed world, those in the heart of Emerging Asia can be more prone to volatility. These emerging economies are on a developmental curve that, if led by exports, can provide added sensitivity to global conditions, or if led by domestic demand, can add to political stress. These conditions can affect revenue and operational outlooks, and the smaller the business, the potentially more volatile the share price.

This was exemplified in the five years ending June 2014, where the annualised volatility based on US dollar monthly log returns of the FTSE Emerging Asia Pacific Small Cap Index amounted to 19.5 percent compared to 14.7 percent for the FTSE Developed Asia Pacific Small Cap Index. Nevertheless, by bundling the businesses of Emerging Asia together, investors experienced a smoother ride than would have been experienced with the FTSE China 'A' Small Cap Index and its comparative annualised volatility of 27.6 percent, or with the FTSE India Small Cap Index and its comparative annualised volatility of 23.8 percent.

In a similar vein, SGX provides investors with a highly diversified range of listed businesses whose operations and sales are spread throughout the Asia-Pacific region. This unique attribute of SGX enables portfolio managers to diffuse portfolio volatility by embracing this differentiation with stocks based on geography and industry. The Straits Times Index (STI) is made up of 30 businesses with approximately half of the combined revenue generated outside of Singapore and almost every second business representing a different business sector. The result of these two levels of diversification means that the comparative annualised volatility of the STI was 13.2% over the five years.

FIGURE 2: FTSE ST ALL-SHARE INDEX BY INDUSTRY (AS OF 30 JUNE 2014)



Source: FTSE Group

While the sum of different parts means the benchmark has a recent history of stability, Singapore has also served investors with business segments that were comparatively more volatile. Sector indices such as utilities, basic materials, oil and gas, and maritime that have focused on Emerging Asia have generated a five-year annualised volatility that are significantly higher than the STI. In multiple cases these sectors have also generated some of the most active plays in terms of turnover velocity.

The combination of having volatile plays and enough differentiation in the market to diffuse the volatility at a broad or benchmark level has helped to serve both retail and tactical institutional investors. This has also helped shape the development of investment products. Figure 2 illustrates an industry breakdown of the stocks of Singapore's broader benchmark, the FTSE ST All-Share Index.

Continuing to augment capital formation

In its continuing efforts to grow capital formation beyond the primary and secondary stock markets, SGX has also brought to the marketplace numerous start-up businesses through the Catalist board. These businesses would have otherwise been most likely funded through private equity had they not been brought to list on the market through a sponsor.

Catalist caters to the needs of fast-growing enterprises and 2014 represents its sixth year of operation. Companies seeking a primary listing on the Catalist must be brought to list by approved sponsors via an initial public offering. There are no quantitative entry criteria required by SGX. Instead, the sponsors decide if the listing applicant is suitable to be listed using their house criteria. The quotation, trading and settlement of a stock listed on Catalist works the same way as a stock listed on the SGX Mainboard.

Moreover, retail and institutional

investors alike are able to invest in the potential high growth stage of a start-up company. Although these boards come with more risks to investors, they do provide accessibility in the capital formation process for new businesses. There are now more than 140 businesses listed on the Catalist board.

It is clear that Emerging Asia has also become an important part of the IFCs—from providing commercial opportunities for the world's biggest listed companies to using those IFCs to raise capital.

As a result of SGX establishing its bourse with stocks that have revenue reach throughout both Emerging and Developed Asia, Singapore's share in global market capitalisation of US$66 trillion exceeds its share in global GDP of US$74 trillion. Over the past 20 years, investors have been exchanging their capital for the potential return and risks of these business ventures in Emerging Asia. They will continue to do so in the years to come.

At the same time, SGX has expanded the number of equity derivative products, particularly in those emerging countries where the higher volatility was seen, to enable investors to better manage their investments and risk exposures. Investors and portfolio managers are consequently better poised to hedge and manage market risks. Meanwhile, as savings rates remained low in banks in recent years, products such as Exchange Traded Funds and Regular Shares Saving Plans have enabled retail investors to turn savings into investments that track the STI benchmark.

Regional risk management

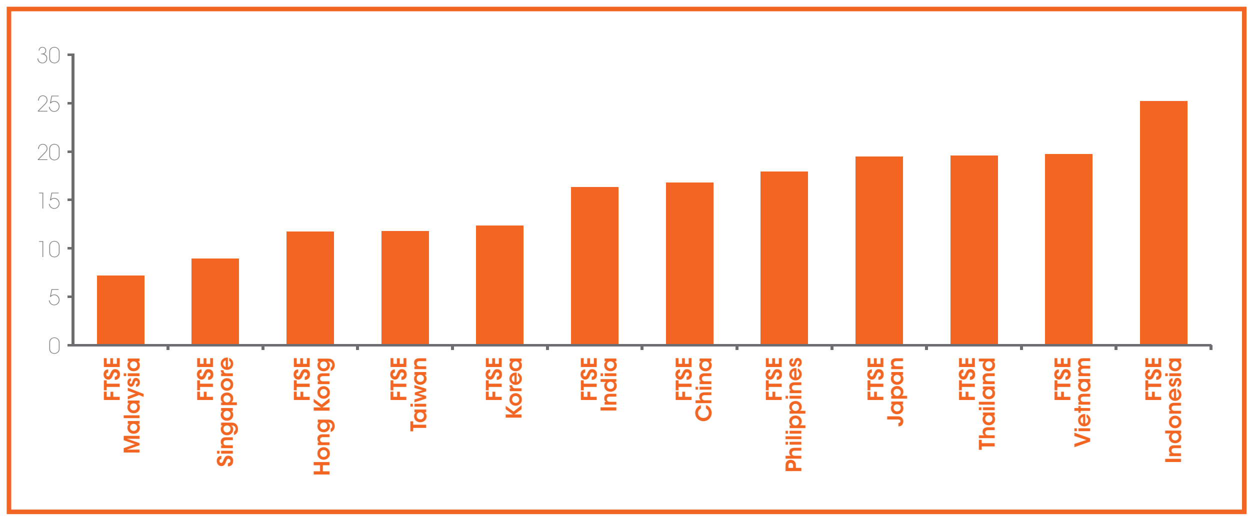
The creation of primary markets in debt or equities for small start-ups on the growth board or large mature businesses on the SGX Mainboard is just one end of an exchange's capital formation spectrum. On the other end, exchanges can list derivatives, which are more sophisticated portfolio management products that construct their value from pre-existing securities.

As discussed above, the more negatively correlated segments exist within a stock market index, the potentially less volatile the index. As emerging stock market indices are part of emerging economies, they are less likely to possess constituents with a wide range of geographical revenue reach, or less likely to possess constituents that have reached a level of maturity in the lifecycle. Hence these emerging stock markets can be more sensitive or volatile to changes in sentiment.

It is natural that economic development should see more stabilising mechanisms to an economy and its broad stock market. However, the higher or wider the economic goals of the developing economy, the higher the potential for swings in sentiment. This will have an effect on the volatility of the stock market of the emerging economy, with the volatility becoming an efficient function of sentiment in the capital market.

This means that emerging stock market indices can be more volatile than those that represent advanced economies. As illustrated in Figure 3 below, with the exception of Malaysia and Japan, over the 12-month period from June 2013, the annualised daily log returns of stock market indices of Emerging Asia were higher than those of Developed Asia. In many instances for Emerging Asia, this 12-month period

FIGURE 3: ANNUALISED VOLATILITY OF REGIONAL INDICES



Source: FTSE Group – 12 months to end of June 2014 – volatility based on annualised daily log returns

Studies show investors have, in the past, received benefits of global diversification by devoting 20 to 40 percent of their portfolio to equities listed outside the United States.

coincided with a mix of at-home events in addition to global inferences from the Federal Reserve agenda in exiting unconventional monetary policy.

Of the seven most volatile stock markets across Asia over the 12-month period ending June 2014, SGX provides six futures contracts that are based on similar indices to the FTSE series. The use of these contracts saw a number of records in turnover and open interest in the futures contracts based on FTSE China A50 Index, the S&P CNX Nifty Index and the MSCI Indonesia Index.

Over the period, futures contracts on the MSCI Thailand Index and the MSCI Philippines Index were introduced. The ability to short and maintain a leveraged position with a futures contract makes it relevant to investors who wish to hedge against volatility or returns from market swings. Assuming there is little home-bias of investors to these contracts, simple dissections of participation trends can provide an insight into investor attitude towards risk within Asia.

By offering a pan-Asian suite of equity index derivatives, an exchange can cumulate investments into the region, enabling market participants to break down and make objective assessments of regional investor sentiment.

A pan-Asian suite of investment products is also a key to enriched risk management. Macro market development in line with the region's economies brings more diversified choices to investors, less participation in proxy products and thus a more efficient investment proposition.

Historically, globally diversified portfolios have dominated domestic-only ones on the efficiency frontier. As long as there is no perfect positive correlation, a global portfolios should earn a higher return for the same level of risk and take less risk for the same level of return. Studies show investors have, in the past, received benefits of global diversification by devoting 20 to 40 percent of their portfolio to equities listed outside the United States.

Executives presiding over a business that has either direct or indirect revenue exposure to the region can seek to protect the capital funding of the establishment. There are hundreds of companies listed on SGX and tens of thousands across the world with similar operational circumstances.

Exchanges are creating economic value by connecting businesses with investors while continuing to roll out products and procedures to help investors alleviate risks associated with their investment. Yet they must offer some degree of volatility to ensure that capital markets clear efficiently. Hence the ultimate axiom of investing: a potentially new return will always be accompanied by risk.

Geoff Howie

is the market strategist for SGX

Reference

[1] Bloomberg defines Emerging Asia as Bangladesh, Cambodia, China, Fiji, India, Indonesia, Kazakhstan, Kyrgyzstan, Laos, Malaysia, Mongolia, Nepal, Pakistan, Papua New Guinea, Philippines, Sri Lanka, Thailand and Vietnam. Note the list does not include South Korea or Taiwan.

UNLEASHING

ASEAN's potential through AEC

Rising affluence and an expanding middle class, accompanied by a demographic dividend and an abundance of resources, will see ASEAN become one of the world's largest integrated economic communities.

By Michael Zink

The Association of Southeast Asian Nations (ASEAN) has set an ambitious goal to integrate the economies of its ten members by 2015, a move that is aimed at boosting the bloc's competitiveness and creating development across the region that is more equitable. With the target date for Southeast Asia's countries to create a single economic market just months away, increasing attention is being paid to the region's vast economic potential.

If successful, the formation of the ASEAN Economic Community (AEC) will not only create one of the world's largest integrated economic spheres, but will add vastly to the appeal of a region that is already benefiting from a trio of powerful global trends: globalisation, urbanisation and digitisation.

In an increasingly connected world, multinational companies are flocking to set up manufacturing and service hubs in Southeast Asian countries in an effort to better service Asia and the rest of the world. A case in point: in its annual ranking of the top 2000 public companies in the world, Forbes reported that the number of Global 2000 companies with headquarters in ASEAN increased from 49 in 2006 to 74 in 2013, a gain of just over 50 percent in seven years.

McKinsey also stated in its 2014 report, "Understanding ASEAN: Seven Things You Need to Know" that 227 businesses with more than US$1 billion in revenues, or three percent of the world's total, are located in this part of the world. These numbers all point to ASEAN's attractiveness as a place to conduct business on a global scale.

Meanwhile, growing urbanisation is leading to rising consumption—and hence economic growth—as more people in Southeast Asia start to seek their fortunes in the region's booming urban centres. The McKinsey report observes that roughly 22 percent of ASEAN's population currently lives in cities of more than 200,000 inhabitants, accounting for more than 54 percent of the region's GDP. This trend is expected to continue, with McKinsey expecting another 54 million people to migrate by 2025.

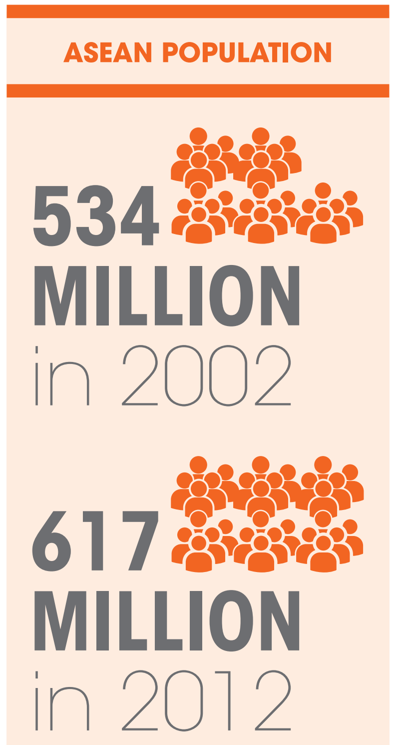
The region's consumers have also adopted digital technologies at a rapid pace, helping to fuel consumption and growth. According to the McKinsey report, mobile penetration in ASEAN stands at 110 percent with Internet population at around 25 percent. Advanced Singapore is the front-runner in this area, boasting the fourth-highest smartphone penetration in the world: almost three in four Singaporeans are connected to the Internet.

With the target date for Southeast Asia's countries to create a single economic market just months away, increasing attention is being paid to the region's vast economic potential.

If viewed by sheer numbers alone, Indonesia is poised to become a digital powerhouse. It is Southeast Asia's most populous country and its largest economy. It already has 282 million mobile subscriptions with 100 million Internet users forecast by 2016. Internet users in the region are also actively engaging with one another on social media platforms like Facebook, where they make up the second-largest community after the United States.

A region brimming with potential

ASEAN's economic potential is linked to, among other factors, its size, the potential of its capital markets and a robust credit environment. According to the ASEAN Economic Community (AEC) Chartbook 2013, the region's collective population grew from 534 million in 2002 to 617 million in 2012, making it the third largest in the world after China and India. The population grew at an average annual rate of 1.45 percent over the same period, faster than China's 0.53 percent and India's 1.44 percent.



Southeast Asia's sizeable youth population is also producing a 'demographic dividend', a situation where fertility rates fall, which in turn results in a labour force that is temporarily growing faster than the population dependent on it, and frees up resources that can boost future economic growth. This is most evident in Indonesia, where more than half of its 240 million people are under the age of 30.[i]

When viewed as a single economic entity, ASEAN last year ranked as the seventh largest economy in the world with a combined GDP of US$2.4 trillion, according to a 2014 report by UNCTAD. It is expected to grow to become the fourth largest by 2050, according to global consultants IHS.

The region's biggest economies—Indonesia, Malaysia, the Philippines, Singapore and Thailand—have seen their per capita GDP expand two to four times, according to Citi Research. The combined GDP of the ASEAN-5, which includes the Philippines, Indonesia, Malaysia, Thailand and Vietnam, is US$2.1 trillion.

This GDP growth has also been accompanied by rising affluence as more people work their way into the middle class. Research firm Nielsen estimates that there were over 190 million people in Southeast Asia who could be defined as middle class in 2012, with this number expected to double to 400 million by 2020.[ii] This shift bodes well for the region's future prospects.

ASEAN's capital markets have also grown rapidly in the past decade, providing a platform for businesses here to fuel their growth. The number of mergers and acquisitions has more than quadrupled over the past ten years, while other barometers such as stock market capitalisation, local currency debt outstanding and foreign portfolio investment have all risen faster than the rest of the world. Market capitalisation of the ASEAN-5 stock exchanges has quintupled to US$2.5 trillion since 2000, representing more than 100 percent of their combined GDP.

Reflecting this trend, Singapore overtook Japan last year for the first time as Asia's biggest foreign exchange centre. In April 2013, the Bank for International Settlements Triennial Central Bank Survey released statistics showing that the city-state's average daily foreign exchange volume increased 44 percent to US$383 billion in April 2013, compared to the same period in 2010. Moreover, in an encouraging sign of co-operation among member nations, the Monetary Authority of Singapore, the Securities Commission of Malaysia and the Securities and Exchange Commission of Thailand, jointly rolled out the ASEAN Collective Investment Scheme (CIS) Framework in August this year.

This initiative gives retail investors from these countries a wider choice of funds to invest in, while fund managers will have better access to investors in other ASEAN countries. The move is expected to deepen the region's capital markets and boost liquidity.

Banks are also keen to lend to companies in Southeast Asia, drawn by robust demand for credit as well as the improved credit worthiness of borrowers here. The region's bank credit to GDP percentage remains relatively low, while non-performing loans as a percentage of total loans in ASEAN banks have been declining.

Taken together, these factors are leading to a more sanguine outlook for the region compared to many parts of the world. According to the 2015 ASEAN Business Outlook Survey, two-thirds of the 588 respondents expect ASEAN markets to become more important in terms of their companies' worldwide revenue over the next two years. Nine out of ten respondents also expect their company's level of trade and investment in Southeast Asia to increase over the next five years. Meanwhile, the survey also revealed that 81 percent of executives across the region expect an increase in profits in 2015. With US$204 billion invested in ASEAN, U.S. companies are collectively the largest direct foreign investor in the region.

The AEC game changer

Looking ahead, the formation of the AEC is a major milestone in ASEAN's development as an economic community, and one that will create synergies and generate new opportunities for regional businesses.

CITI'S STRATEGIC POSITIONING IN ASEAN

Having a large and established franchise in the region, Citi is an example of a company that is well positioned to capitalise on ASEAN's future growth, and to contribute to the development of the region. The bank has been operating in Southeast Asia since 1902 and is deeply entrenched in its various markets.

Over the years, Citi has built a number of strategically important hubs and Centers of Excellence for its various businesses, including an Operations and Technology support centre in Singapore that serves more than 60 countries around the world, and a trade processing centre in Malaysia that offers its services to Citi Asia. Reflecting its importance, around 30 percent of Citi Asia employees live and work in Southeast Asia. On the client-facing side, the bank has extended its reach by serving the local and regional offices of its multinational clients in ASEAN markets. Meanwhile, specialised divisions such as Citi Private Bank Asia and Citi Commercial Bank Hub have been bolstered with the necessary resources and talent to serve their respective customer segments.

Citi is also playing a role in banking innovation in ASEAN. For instance, the Consumer Innovation Lab that is housed in Singapore played a key role in the development of Citi's Smart Banking branches and the new generation of ATMs called Citibank Express. On the corporate side, the Citi Innovation Lab, which has been operational since 2011, leverages analytics and interactive technologies to engage with Citi's corporate and institutional clients and create effective solutions and products for them. At the time of the launch, the lab in Singapore was the first of its kind in Asia Pacific.

Specifically, implementation of the AEC by December 2015 will liberalise and facilitate trade in goods and services, as well as allow for a smoother flow of labour and capital across borders. The lifting of trade barriers will also reduce the costs of production and attract manufacturing foreign direct investment (FDI).

An integrated AEC is also forecast to add an extra 14 million new jobs and boost the region's annual growth to 7.1 percent by 2025, according to a joint study by the UN's International Labor Organization and the Asian Development Bank.

The bottom line is that a single Southeast Asian market will become an even more formidable economic competitor than it already is today. This comes as at a time when China's wage cost advantage is eroding. Partly as a result of labour cost advantage, returns on FDI for multinational companies operating in ASEAN have been superior to those in China, especially for U.S. manufacturing firms.

Indeed, Chinese companies are themselves investing more in Southeast Asia. According to Citi research, while the country's outward direct investment (ODI) remains small in absolute terms, ASEAN's share of China's ODI has more than doubled from 1.9 percent to 5.1 percent since 2002.

So what progress has ASEAN made towards its goal of creating an integrated economic bloc by end 2015? Quite a lot it seems. According to a scorecard mechanism to track the implementation of measures in the AEC blueprint, over 80 percent of the measures have been implemented to date.[iii]

Capitalising on opportunities in ASEAN

Despite the optimism, there are multiple challenges to making the AEC a reality.

An integrated AEC is also forecast to add an extra 14 million new jobs and boost the region's annual growth to 7.1 percent by 2025.

Integrating the capital markets of the 10-nation bloc, for one, means having to adjust domestic currencies, capital accounts and taxation policies, as well as different levels of capital market maturity.

Policy makers in some member countries will also be hard pressed to eliminate obstacles to investment. This is reflected in the World Bank's 2013 Ease of Doing Business Index that ranked the Philippines 138th and Indonesia 128th out of 185 countries.[iv] However, we do see that there are efforts to close the gap. In the Philippines for example, the Senate recently approved a bill to expand the participation of foreign banks in its financial sector. This is expected to pave the way for greater foreign participation in the banking industry in the Philippines, boost trade and create more jobs.

There are also concerns that integration could worsen income equality across the region if the process is not well managed. Meanwhile, ongoing territorial disputes in the South China Sea could adversely impact efforts towards regional cooperation.

That said, even if the AEC does not achieve all its goals by the 2015 deadline, the synergies generated over time by efforts to integrate across borders are likely to generate new opportunities for regional businesses. More importantly, the proliferation of cross-border networks has already driven tighter ASEAN economic integration since the 1980s.

Simply put, the process of working towards a single market, even if it is not fully realised, is already generating benefits for businesses in Southeast Asia. The AEC is a potential game changer that can transform the economic and commercial landscapes of member nations, opening up vast opportunities for businesses. Leading companies are already positioning themselves to leverage the potential of this dynamic region and tap the opportunities presented by the AEC; while companies that adopt a 'wait and see' approach risk losing a first mover advantage in this huge market.

Michael Zink
is Head of ASEAN and Citi Country Officer, Singapore

Reference

i Newley Purnell, "Twitter to Open Indonesia Office: Social Networking Firm Hopes to Tap into Fast-Growing Emerging Markets" The Wall Street Journal, August 28, 2014.

ii Regan James Leggett, "ASEAN 2015: Seeing Around the Corner in a New Asian Landscape", Nielsen, 2014.

iii "ASEAN Annual Report 2012 – 2013", ASEAN Secretariat, July 11, 2013.

iv "Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises", The World Bank, 2013.

DYNAMIC ADVANTAGE

Building sustainable competitive advantage for global firms

Reaping the advantages of a global resource network

By Stephen Wyatt

How do leading firms with global operations extend their success in today's context of business environments, geo-political uncertainty and demanding customers that threaten to switch loyalty at the swipe of a smart phone screen? Many global firms may have expanded internationally, yet still continue to operate in geographical or functional silos. These firms have not reaped the advantages of their global resource network.

Frankly, global firms need to do more to stay ahead of the curve. They have to share and leverage knowledge and resources available to them from across their global operating networks, and efficiently adapt and apply these insights in other markets and across their organisation. This ability to learn and adapt across a network of territories can create value and sustainable competitive advantage for the firm, a characteristic that I call Dynamic Advantage.

Leading firms have altered their strategies, organisation, governance, products and even branding to enable them to act seamlessly across their geographically dispersed markets. Based on the experience of such companies, this article outlines how the tenets of Dynamic Advantage can be used to ensure successful globalisation strategies.

> This ability to learn and adapt across a network of territories can create value and sustainable competitive advantage for the firm, a characteristic that I call Dynamic Advantage.

Why Dynamic Advantage?

Jack Welch, the former chairman and chief executive officer of General Electric, commented, "Market success is only part of globalisation. We must globalise every activity in the company....our challenge is to capitalise on the vast intellectual capital available around the world."[i]

Firms pursue international expansion to improve business performance–seeking advantages of scale, access to new markets and the consequent sales they provide– while being able to better serve key clients and extend their market power. But globalisation can offer many more advantages: it can be a means to tap into know-how, talent and other scarce resources, as well as to exploit opportunities for reducing costs, minimising fiscal burdens or accessing incentives.

There are three mechanisms through which Dynamic Advantage heightens the ability of the firm to create and capture value. The first, **replication and reconfiguration**, refers to the set of processes that enables a firm to apply learning from one market directly to another; leveraging the benefits of experience of external market actions and reactions, together with learning about internal processes for effective implementation that will enable competitive advantage in other markets.

For example, Unilever continuously

works at improving the firm's ability to share and apply experience and learning between markets—be it fine-tuning relationship management with channel partners across markets in Asia, or then rolling out major social campaigns across geographies such as the Lifebuoy handwashing drive that targets reducing diarrhoea through hand-hygiene in developing countries.

The second, **business innovation**, emphasises that firms with Dynamic Advantage are particularly adept at drawing on insights from multiple markets to see new possibilities for extending and creating new product categories; simplifying and/or enriching the offer; or building a product experience. They also innovate across the global value chain, minimising the complexity in any one stage or location and fluidly adjusting activities across borders.

Syngenta, the Swiss agribusiness corporation, is a case in point. The company successfully leverages the diversity of the markets in which it operates by testing different innovations in different markets, learning from each 'live experiment'. The combined learning from these experiments helps to develop new solutions, such as new techniques to increase the productivity of rice farming through pre-germination, reducing the time the crop is in the ground, and new go-to-market strategies that help to deter the overuse of chemicals.

The third mechanism, **portfolio transformation**, offers firms the opportunity to shift their business focus. Few firms are as famous as IBM for having demonstrated their ability to transform themselves, entering new areas of business and harvesting, or even exiting, businesses that had previously 'defined' them. More often than not, the notion of entry and exit of businesses is associated with the portfolio management activities of conglomerates and investment funds. Firms exhibiting high Dynamic Advantage are able to shift their business focus in a timely manner as they sense the changes in the industries and markets in which they compete.

Honeywell has transformed itself over the past ten years from a struggling industrial giant to a dynamic diversified conglomerate, significantly reshaping its portfolio of businesses, making over 80 acquisitions and divesting more than 50 businesses. Honeywell's chief executive officer, Dave Cote, calls the new operational model 'Diversity of Opportunity', whereby the corporate centre is responsible for growth and risk management across the global portfolio, and has built core competencies in the timing and execution of mergers, acquisitions and divestments.[ii]

How can a firm achieve Dynamic Advantage?

Business leaders need to focus on the three critical drivers that create Dynamic Advantage: organisation systems and structures; leadership practices, policies and characteristics; and diversity of market and competitive contexts.

ORGANISATION SYSTEMS AND STRUCTURES

Firms that are pursuing a strategy of Dynamic Advantage have the ability to draw on and leverage knowledge sources from outside and across the organisation to enable informed decisions, and the translation thereof into timely action. This ability goes beyond just insight seeking—these firms have invested in systems and structures that enhance knowledge sharing across internal boundaries and transform the knowledge into actionable learning. They work hard to overcome the structural inhibitors to knowledge flow.

> Common to firms with a high level of Dynamic Advantage is a sense of mission or journey of discovery for the members of the Top Management Team.

At IBM, knowledge acquisition and sharing is not only a priority—it is mandatory and enabled with continuous investment in infrastructure, as well as social media. Executives are expected to be active participants in several online communities via the company intranet, discussing and sharing topics of interest. They are also required to prioritise updating their skills and knowledge regularly, and to participate in external communities and forums. Selected executives are positioned as thought leaders responsible for insight collection, integration and dissemination from both within the firm and externally with customers and partners. As one executive observed, "We are industry leaders in knowledge creation and sharing, this has a very positive impact and is a key source of competitive advantage, enabling us to behave dynamically."

Firms, whose senior-most executives are located remotely from one another, yet collectively provide leadership to the organisation, exhibit a greater capacity to absorb and share knowledge across the network. Such polycentric firms have a heightened ability to sense insight from markets globally, and are able to bring a diversity of perspectives into Top Management Team (TMT) decision making. These polycentric structures are visible at Unilever, where both the global chief operating officer and global talent officer are based in Singapore, while the chief executive officer and other corporate leaders are located in Europe. Similarly, senior-most officers of Standard Chartered Bank are based in Hong Kong and Singapore as well as in London.

Dispersed decision-makers and remote management of operations are increasingly feasible (and practiced) due to technologies enabling real-time coordination of operations

globally. However trust must be explicitly nurtured through shared experience and familiarity between the individuals, which may imply a premium on tenure and the social networks that develop between members of the TMT. As the talent officer for a global oil company stated, "We know that our Asian talent serves us best by being in the region, but they are required to do multi-year postings [to global headquarters] if they are going to move into top executive leadership. It is like a 'rite of passage', building relationships and trust whilst being taken out of the region where they are most effective."

LEADERSHIP PRACTICES, POLICIES AND CHARACTERISTICS

At the core of Dynamic Advantage is the mindset of senior management—the management philosophy—that permeates the culture of the firm. Common to firms with a high level of Dynamic Advantage is a sense of mission or journey of discovery for the members of the TMT. Such a sense of purpose enables the members of the TMT to work remotely from one another, but as though on a common 'quest'. For example, Syngenta describes the senior-most stakeholders as having come together to identify a new 'breakthrough question': How to feed the world's growing population while safeguarding the natural resources in the process? Subsequently, the TMT adopted a charter of six goals in a 'good growth plan' that has helped to motivate and give direction to all activities in the organisation.

Firms with Dynamic Advantage invest heavily in developing the skills and mindset of their executives, perhaps even tending to over-invest, with an expectation that this enables greater adaptability as well as allows them to be better able to make sense of the evolving context. They design and rollout development programmes across the globe that combine learning skills and competencies, while also strengthening values such as integrity, trust and professionalism. In this way, they help to increase the executives' ability to sense and respond to the dynamic context, whilst not only being aligned with the values of the firm, but also with a broad network of colleagues who can enhance collaboration and knowledge sharing.

When firms with high Dynamic Advantage confront a difficult challenge or a particularly exciting and relevant market opportunity, they quickly determine 'who' should be deployed to lead the team or organisation to address that situation, rather

Firms with a higher Dynamic Advantage invest and rely on exploration, that is, the pursuit of new knowledge and discovery, from their activities throughout their networks.

than establishing a committee or taskforce that will report-in progress to the existing power structure and reporting lines. This helps to minimise the risks of the 'important' being subjugated to the 'urgent'. Addressing the issue with a 'who' instead of a 'how' requires that a leader with sufficient stature, skill and energy is appointed—one who is also able to obtain and command all the resources that are required to get the job done. Thus the length of tenure of the senior executives becomes very important, as well as the depth of trust between the executive and the rest of the TMT.

The Tata Group has achieved an enviable record of success in integrating acquired companies, relying on a formula of complementing the insight and energy of the leadership of the acquired company with the resources, capabilities and perspectives of the Tata Group. By deploying a key executive to work with the leadership of the acquired company, it has achieved success even in notoriously difficult contexts such as Daewoo Commercial Vehicles in Korea.

DIVERSITY OF MARKET AND COMPETITIVE CONTEXTS

Firms with a higher Dynamic Advantage invest and rely on exploration, that is, the pursuit of new knowledge and discovery, from their activities throughout their networks. New markets bring new challenges, and leading firms look inward for knowledge and experience from successfully established markets. As one executive from McCann Worldgroup reported, "We seek ideas everywhere, continuously, no matter who you are, in whichever division, in whichever part of the world—if you see something that you think is relevant and important, you are encouraged to share it."

Sourcing knowledge globally through participation in diverse markets is a key driver of Dynamic Advantage of a firm. As researchers Doz, Santos and Williamson state, "Innovate by learning from the world. Tomorrow's winners will be companies that create value by searching out and mobilising untapped pockets of technology and market intelligence that are scattered across the globe".[iii]

The key attributes here are the willingness to share, and receive, knowledge and insight, as well as the ability to transform the knowledge shared into actionable learning. Sune Karlsson, a vice-president of ABB Power Transformers describes this capability: "Our most important strength is that we have 25 factories around the world, each with its own president, design manager, marketing manager and production manager. These people are working on the same problems and opportunities day after day, year after year and learning a tremendous amount. We want to create a process of continuous expertise transfer. If we do that, it is a source of advantage none of our rivals can match."[iv]

A learning journey

Globalisation can reap tremendous value for a firm if its operations across geographies are well integrated, and draw on information, activities and resources across the corporate network. Companies need Dynamic Advantage to compete in a dynamic business environment. Therefore, this capability to seamlessly integrate across geographies, functions and business units is one that firms need to continuously review, revise and reinvest in order to stay competitive in the global marketplace. Stressing the unceasing learning journey of every successful global firm, Ginni Rometty, chief executive officer of IBM, concludes, "A constant change, test, change, test [in] real time… I think all businesses are going to move into that: experiment, learn, try."[v]

Stephen Wyatt
is the Head of Executive Development at Singapore Management University and former global leader at Monitor Group

Reference

[i] Yves L. Doz, José Santos, Peter Williamson, "From Global to Metanational: How Companies Win in the Knowledge Economy", Harvard Business Press, 2001.

[ii] Nin-Hai Tseng, "Honeywell CEO: How I'd Fix the Economy", Fortune, January 25, 2012.

[iii] Yves L. Doz, José Santos, Peter Williamson, "From Global to Metanational: How Companies Win in the Knowledge Economy", Harvard Business Press, 2001.

[iv] William Taylor, "The Logic of Global Business: An Interview with ABB's Percy Barnevik", article in "Fast Forward: The Best Ideas on Managing Business Change", edited by James Champy, Nitin Nohria, Harvard Business Press, 1996.

[v] Richard Waters and Martin Dickson, "FT Interview: Big Blues", The Financial Times, May 13, 2014.

DO ASIAN CONGLOMERATES OFFER Attractive risk-adjusted returns?

Research on a sample of seven Asian conglomerates shows that stocks of some of these companies not only outperformed the S&P 500, but also exhibited lower volatility.

By Nandini Vijayaraghavan

Equity markets typically ascribe a discount to the valuation of conglomerates, where the market value of a conglomerate is lower than the sum of the values of the individual businesses, due to lower synergy among component businesses and, in certain cases, a complex organisation structure. But debt markets, especially in Asia, view conglomerates favourably, with the debt issuances of these entities frequently being over-subscribed and credit rating agencies ranking these issuances as investment grade.

The intrinsic strength of Asian conglomerates and the fact that their businesses are focused on high growth economies outside the United States, implies that their stocks ought to generate robust medium- to long-term returns and the correlation of returns with the S&P 500 returns must be low. If this premise is correct, then fund managers managing USD-denominated portfolios that are geography and sector agnostic should be able to enhance the return and diversity of their portfolios by investing in Asian conglomerate stocks. Surprisingly, my research shows that this is not the case.

TABLE 1: KEY FINANCIAL INDICATORS AND BUSINESS-WISE OPERATING PROFITS

	Year End	Market Capitalisation as of 9-Sep-14 (US$M)	Assets (US$M)	Revenues (US$M)	EBITDA Margin	Lease-Adjusted Debt (US$M)	Cash (US$M)	Net Debt/ EBITDA (Times)	Key Businesses (as % of EBITDA)	Geographic Exposure
HWL	31-Dec-13	56,354.74	105,169	33,044	37.3%	31,933	13,255	1.51	Cheung Kong Infrastructure: 24%, Ports, Property & Hotels: 15%, Retail & Husky Energy: 15%, 3G Europe: 13%, Others: 3%	Europe: 39% of EBITDA, Mainland China, Canada & Rest of Asia & Australia: 15% each aggregating 45%, Hong Kong 14%, Others 2%
RIL	31-Mar-14	56,062.61	71,763	66,445	8.8%	14,800	6,129	1.48	Refining: 47%, Petrochemicals: 28%, Oil & Gas: 18%, Others: 7%	India: 32% of revenues & 88% of assets. Outside India: 68% of revenues & 12% of assets
JMH	31-Dec-13	42,824.89	63,835	39,465	11.5%	11,652	5,214	1.42	Astra: 56% of EBIT, Hong Kong Land: 26%, Dairy Farm: 15%, Others: 3%	Southeast Asia: 53% of net income, Greater China 43%, UK & Others 4%
SMC	31-Dec-13	4,170.67	26,428	16,888	10.3%	11,929	4,346	4.34	Power: 34%, Beverage: 27.4%, Petron: 19.4%, Food: 9.7%, Packaging: 3.9%, Others: 5.6%	Not reported, predominantly in the Philippines
KC	31-Dec-13	15,472.87	23,699	9,762	16.3%	6,213	4,388	1.15	Off-Shore & Marine: 50%, Property: 42%, Infrastructure: 6%, Others: 2%	Singapore: 75% of external sales, Americas: 11%, Far East & ASEAN: 9%, Others: 5%
CRE	31-Dec-13	6,611.74	20,026	18,856	6.0%	7,612	2,776	4.31	Beer: 50%, Retail: 42%, Food: 5%, Beverage: 3%	Mainland China: 94%, Hong Kong: 5%, Others: 1%
SIME	30-Jun-13	18,194.43	15,353	14,831	12.7%	3,226	1,297	1.03	Plantation: 39%, Industrial: 27%, Motors: 14%, Property: 9%, Energy & Utilities: 5%, Others: 6%	Malaysia: 50% of EBIT, Australasia: 21%, Indonesia: 16%, China: 7%, Singapore: 6%, Others: Less than 1%

Source: Bloomberg, Company Annual Reports, Author's analysis

To test the proposition whether Asian conglomerate stocks offer superior risk-adjusted returns, I first compared the **stock performance** of seven of the largest Asian conglomerates against the S&P 500. Second, in order to measure stock volatility, the **standard deviations** of stock returns were benchmarked against that of the S&P 500. Third, to understand the dispersion of returns relative to the average, I also looked at the **co-efficient of variation** (CV) of individual stocks. Finally, the historical and projected **price earnings ratios** (P/E) of the companies were compared with those of the S&P 500 and American and European conglomerates to ascertain whether the stocks were priced attractively.

Based on the various indicators, my results show that despite the superior performance and lower volatility of Asian conglomerates, some of these stocks continue to be undervalued and hence potentially present an attractive investment opportunity.

Performance and volatility of Asian conglomerates

The seven short-listed conglomerates include Hutchsion Whampoa Limited (HWL), Reliance Industries Limited (RIL), Jardine Matheson Holdings (JMH), San Miguel Corporation (SMC), Keppel Corporation (KC), China Resources Enterprises (CRE) and Sime Darby Berhad (SIME).[i] These conglomerates have well-established businesses that span developed and emerging economies. They also have a long track record of generating robust operating cash flows, and possess strong and liquid balance sheets. Many of them have forged deep relationships with capital markets that translate into a diversified funding profile with competitive funding costs. Table 1 provides the key financial characteristics and business-wise operating profits of the seven conglomerates.

The reason for benchmarking individual stock performance to the S&P 500 is twofold. First, the index may be regarded as a conglomerate/diversified company with exposure to multiple businesses. Second, there exists no index to track the performance of conglomerates. Country-wise equity investment data indicates that the U.S. continues to be the preferred destination for non-domestic equity investments. According to the International Monetary Fund's 2012 Coordinated Portfolio Investment Survey, the U.S. has the highest quantum of outstanding non-domestic equity investments, accounting for 16.14 percent of the US$16.95 trillion of global equity assets, followed by the U.K. (10 percent), Luxembourg (9.8 percent), Cayman Islands (6.45 percent) and Japan (4.71 percent).

TABLE 2: STOCK PERFORMANCE OF ASIAN CONGLOMERATES AND THE S&P 500

	1 year (July 1, 2013 to June 30, 2014)	3 years (July 1, 2011 to June 30, 2014)	5 years (July 1, 2009 to June 30, 2014)	10 years (July 1, 2004 to June 30, 2014)	14.5 years (January 1, 2000 to June 30, 2014)
HWL	31.4%	-49.5%	-16.3%	-19.7%	-63.6%
RIL	15.3%	-8.6%	-15.7%	280.1%	524.9%
JMH	-3.3%	6.0%	111.8%	434.3%	1452.6%
SMC	-6.9%	-30.3%	67.4%	46.2%	38.2%
KC	4.3%	0.7%	60.3%	n.a.	n.a.
CRE	-12.0%	-33.3%	n.a.	n.a.	n.a.
SIME	-2.4%	-3.7%	70.0%	n.a.	n.a.
S&P 500	21.7%	46.8%	118.5%	74.4%	36.1%

Source: Yahoo Finance, Author's analysis

TABLE 3: STANDARD DEVIATION OF STOCK RETURNS OF ASIAN CONGLOMERATES AND THE S&P 500

	1 year (1 July 2013 to 30 June 2014)	3 years (1 July 2011 to 30 June 2014)	5 years (1 July 2009 to 30 June 2014)	10 years (1 July 2004 to 30 June 2014)	14.5 years (1 January 2000 to 30 June 2014)
HWL	0.7%	0.5%	1.0%	0.5%	0.4%
RIL	0.6%	0.2%	0.3%	0.3%	0.2%
JMH	1.4%	0.7%	0.8%	0.6%	0.5%
SMC	0.8%	0.7%	0.6%	0.3%	0.2%
KC	0.1%	0.1%	0.1%	n.a.	n.a.
CRE	0.2%	0.1%	n.a.	n.a.	n.a.
SIME	0.1%	0.03%	0.03%	n.a.	n.a.
S&P 500	36.3%	30.3%	20.7%	9.5%	6.6%

Source: Yahoo Finance, Author's analysis

The stock prices considered are the closing prices with dividends. The USD-denominated returns of the stocks are considered in order to facilitate comparison among the short-listed stocks, as well as the S&P 500. The USD-denominated returns of the stocks would also be more relevant to overseas institutional investors and asset managers than local currency returns. The data analysis runs from January 1, 2000 to June 30, 2014, except in cases where the companies were not listed for the entire 14.5 year period.[ii]

My results indicate that three companies from the sample—JMH, RIL and SMC—outperformed the S&P 500, which registered an aggregate return of 36.1 percent during the 14.5-year period. The returns generated by RIL and SMC are particularly impressive considering the fact that the Indian Rupee and the Philippine Peso are weak currencies that have almost consistently depreciated against the US$ during the period under consideration. Comparable data was not available for KC, CRE and SIME. HWL was the only company that generated negative 64 percent returns (refer to Table 2 for detailed results).

The standard deviations of stock returns, a measure of stock volatility, point to a counter-intuitive trend.[iii] The S&P 500 is the most volatile of the sample during the period January 1, 2000 to June 30, 2014. The standard deviation of all stock returns denominated in US$ was significantly lower than the S&P 500 standard deviation (refer to Table 3). This is despite the SARS outbreak that occurred in Asia during 2002-03. As the S&P companies were most affected by the 2008 global financial crisis, it is understandable that the 10-year and 14.5- year volatility of the S&P 500 exceeds those of the Asian conglomerate stocks.

But what is striking is that Asian conglomerate stocks were more stable than

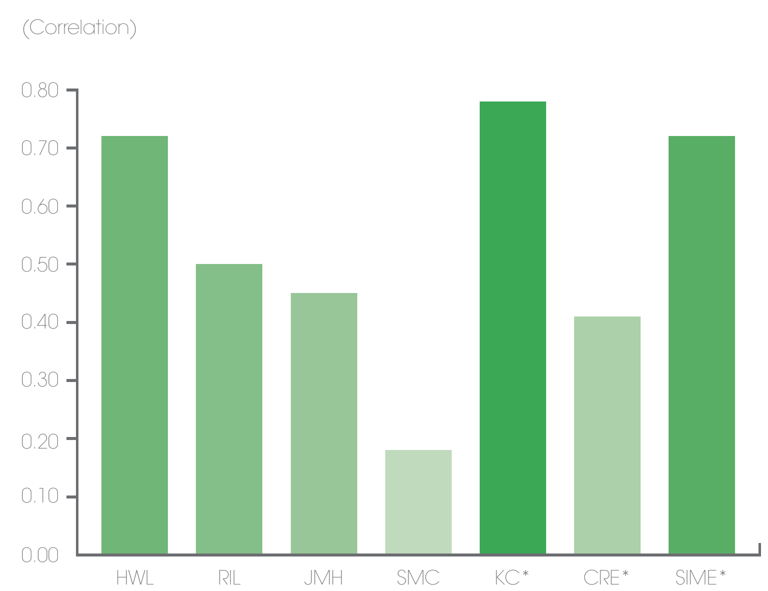
Asian conglomerate stocks were found to be more stable than the S&P 500 even during the five-year period after the global financial crisis.

the S&P 500 even during the five year period after the global financial crisis. More research is required in this area to identify the contributory factors.

To interpret the standard deviation of returns in relation to the mean return, the co-efficient of variation (CV) i.e. the ratio of the period standard deviation to the period mean is calculated. This parameter indicates the dispersion of returns relative to the mean. A lower ratio indicates greater stability of returns. RIL and JMH, with a CV of 1.56% and 1.66%, respectively, were the most attractive stocks on a risk-adjusted basis during the period under consideration.[iv] The two companies' geographically diversified businesses in countries with growing affordability and their strong market positions underpin their robust historical performance and favourable prospects. SMC (3.22%) and KC (3.37%) also registered significantly lower volatility than that of the S&P 500, which was 11.05%.

Another interesting observation is that with the exceptions of KC (bulk of whose business is Singapore-centric), HWL (operates predominantly in investment grade economies including Hong Kong, Europe, Singapore, China, and Australia) and SIME (which mostly operates in Malaysia, Singapore, Australia and China), all other stocks exhibit low to medium correlation with the S&P 500.[v] A significant contributory factor is that these companies' businesses are all non-U.S. centric (refer to Figure 1). The low CV and correlation of Asian conglomerate stocks with the S&P 500 supports the hypothesis that fund managers managing geography agnostic portfolios could invest in Asian conglomerate stocks to enhance portfolio return and stability.

FIGURE 1: CORRELATION OF INDIVIDUAL STOCKS WITH THE S&P 500



* Correlation is computed from 2007 for Keppel Corporation, 2009 for China Resources Enterprises and 2008 for Sime Darby

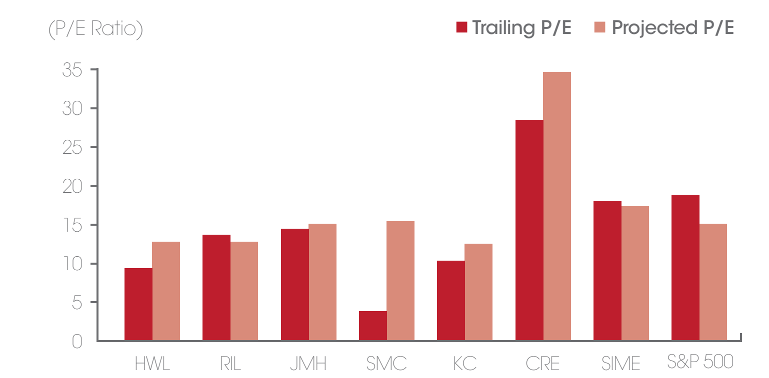
Source: Yahoo Finance, Author's analysis

The historical and projected price earnings (P/E) ratios of the companies were compared with those of the S&P 500 to ascertain that the stocks were priced attractively (refer to Figure 2).[vi] The trailing and projected P/E ratios support the return-volatility analysis presented above. Barring CRE (that has had a prolonged run of poor earnings), SMC and SIME, the trailing and projected P/E ratios of all other stocks are lower than the S&P 500.

Next, the P/E ratios of the Asian conglomerates were benchmarked against the P/E ratios of four of the largest global conglomerates–two U.S.-based and two European conglomerates, details of which are provided below in Table 4.

It is evident that the largest Asian conglomerates are of smaller size (in terms of total assets) than their American and European counterparts. However, it must be noted that

FIGURE 2: PRICE EARNINGS RATIO OF CONGLOMERATES COMPARED WITH S&P 500



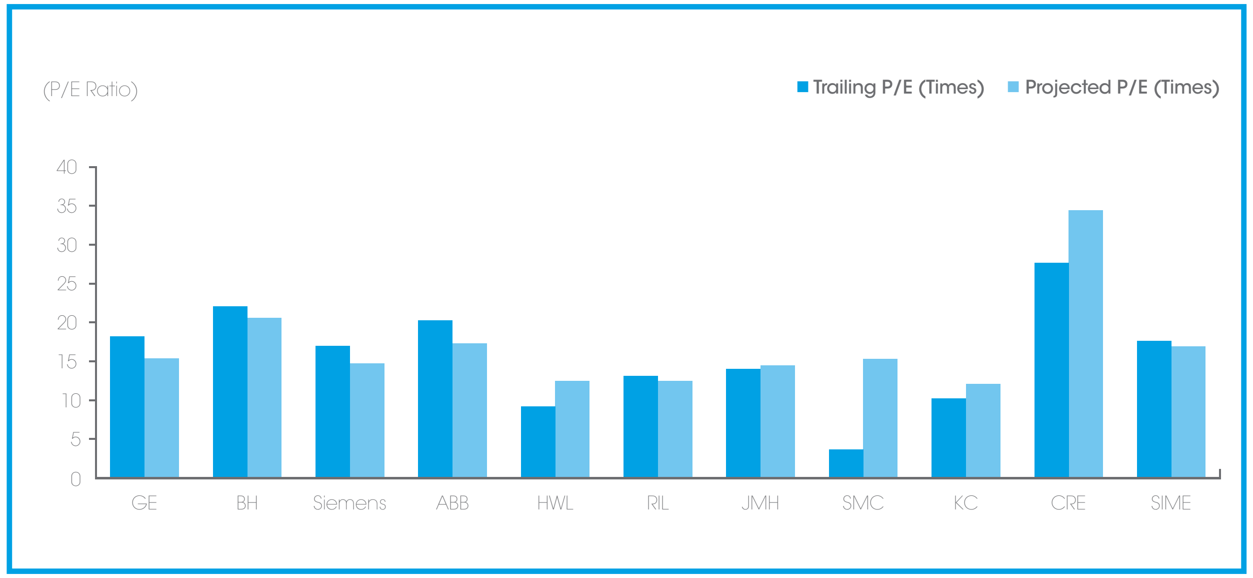
Source: Bloomberg

TABLE 4: PRICE EARNINGS RATIO OF NON-ASIAN CONGLOMERATES

	Headquarters	Year End	Total Assets (US$M)	Market Capitalisation as of 9-Sep-14 (US$M)	Trailing P/E as of 9-Sep-14 (Times)	Projected P/E as of 9-Sep-14 (Times)
General Electric (GE)	US	31-Dec-13	656,560.00	261,884.89	18.45	15.55
Berkshire Hathaway (BH)	US	31-Dec-13	484,931.00	339,803.26	22.21	20.87
Siemens	Germany	31-Sep-13	131,985.71	112,371.34	17.16	14.94
ABB	Switzerland	31-Dec-13	48,064.00	53,140.52	20.48	17.71

Source: Bloomberg, Company Annual Reports, Author's analysis

FIGURE 3: PRICE EARNINGS RATIO OF ASIAN VS. NON-ASIAN CONGLOMERATES (AS OF 9 SEPTEMBER 2014)



Source: Bloomberg

asset values tend to be lower in Asia, and the operating currencies of Asian conglomerates like RIL and SMC tend to be weak. But what is striking is that the trailing and projected P/E ratios of the Asian conglomerates, barring CRE and SIME, are lower than those of the selected U.S.-based and European conglomerates (refer to Figure 3). This could be due to two reasons. First, portfolio managers managing USD-denominated portfolios probably display familiarity and hindsight biases—they tend to be more familiar with companies that are located in the regions where they operate, and hence allocate a greater share of investments to the stocks with which they are familiar. U.S.-based and European stocks' trailing P/Es are higher than those of Asian conglomerate stocks. This leads the fund managers to believe that the trend will be sustained in the future. Fund managers who are willing to familiarise themselves with the intricacies and risks of Asian markets can greatly benefit from investing in these stocks.

Second, awareness of the performance and potential of Asian conglomerate stocks is limited. Asian conglomerates must showcase their USD-denominated stock performance and their suitability as constituents of various investment themes, such as a global large cap portfolio and a global diversified portfolio, to attract higher equity investments. In short, Asian conglomerates should raise their visibility and 'market' themselves to global investors.

Another factor that supports the case for higher investments in Asian conglomerate equities is that as most of their business is focused on high growth areas outside the U.S., the correlation between the individual stock and S&P 500 is low to medium. Hence, these stocks may be used to enhance returns, impart stability and diversify a U.S.-focused or USD-denominated equity portfolio. ASEAN alone comprises a US$625 million market with a growth rate that is several multiples that of the U.S. or Europe. Astute investors will see the upside in investing in these companies due to the huge economic potential offered by the region. This has yet to be priced into their investment strategies.

An opportunity for investment

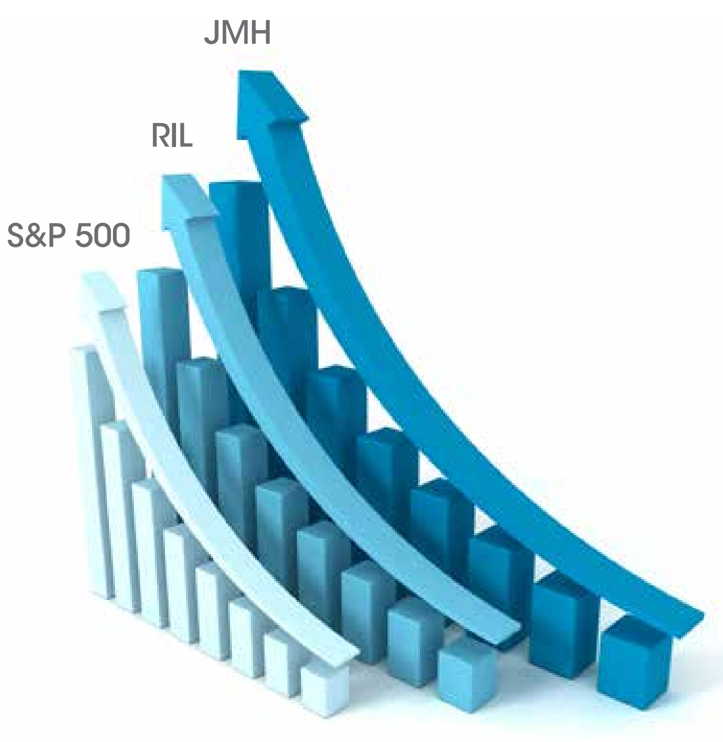
The research implies that Asian conglomerate stocks—especially JMH and RIL that have delivered higher and more stable returns than S&P 500 and have demonstrated lower correlation with S&P 500—are undervalued, that is, the equity markets value a dollar of earnings of U.S.-based and European conglomerates more than a dollar of earnings of Asian conglomerates. This indicates that there exist attractive investment options in the Asian conglomerate equities space.

The current research can be developed further. First, it opens up ideas and opportunities to look at a larger sample of conglomerates in Asia Pacific and other regions outside the U.S., whose risk-adjusted return would enable portfolio managers to generate an alpha return (excess return of a stock over the benchmark index return) in the medium-to long-term. Second, this study has looked at conglomerates as they are representative of a macro attitude toward the region. In the future, research needs to be extended to pure play industries such as energy, telecommunications, consumer durables, banks and the like. The leading stocks of each of these industries can be benchmarked against the respective U.S. and global index to identify other attractive investment opportunities and determine if Asian equities as a whole have attracted the quantum of investment that is in line with their performance and prospects.

Nandini Vijayaraghavan

is Director in the Corporate Ratings division of Fitch Ratings, based in Singapore

The information and data for this article is drawn from the public domain and has been obtained from the annual reports of the companies covered, Yahoo Finance and Bloomberg. The views expressed in this article are the author's own views and do not represent those of her organisation.



Reference

[i] South Korean chaebols like Samsung, Hyundai and LG are not included because only specific subsidiaries such as Samsung Electronics, Hyundai Motors and LG Electronics are listed. Frequently, the chaebol's holding company is unlisted and consolidated financials are not available.

[ii] These companies are Keppel Corporation, China Resources Enterprises and Sime Darby Berhad.

[iii] Standard deviation is a measure of the dispersion of set of data from its mean. The more spread apart the data, the higher the standard deviation.

[iv] Coefficient of variation was calculated for the period January 1, 2000 to June 30, 2014 for RIL, JMH, SMC and S&P 500. For KC, the time period under consideration was May 2, 2007 to June 30, 2014.

[v] Correlation is a statistical measure that determines the degree to which the movement of two variables are associated. Correlation values range from -1 to +1. A correlation of -1 indicates that two variables are perfectly negatively correlated i.e., they move almost always in opposite directions. A correlation of +1 indicates that the variables are perfectly positively correlated. A zero correlation indicates that the variables are not correlated. Correlation does not imply causation.

[vi] Price earnings (P/E) ratio is a valuation ratio of a company's current share price compared to its per-share earnings. In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. The P/E ratio, on a standalone basis, is of limited utility. It is usually more useful to compare the P/E ratios of one company to other companies in the same industry, to the market in general or against the company's own historical P/E.

START-UP reputations in Asian markets

Do strategies for building reputation differ between Western and Asian start-ups?

By Mark Chong & Gregor Halff

Many studies have shown that organisational reputation and performance have a strong and positive correlation. When an organisation's reputation grows, it not only reduces the stakeholders' uncertainty about its future, but also increases the organisation's access to stakeholder resources (such as money and influence)—thereby improving its chances for economic success.

Start-ups though encounter several additional challenges, as compared to established firms, in communicating their potential to generate wealth and gain access to the resources needed to commercialise their technologies. More specifically, start-ups typically do not have a track record of financial performance to guide stakeholders; they lack the resources to invest in costly signals such as advertising and branding; and their offerings are yet to be tested and validated by the markets. Thus, the way they develop their reputations would differ from that of established firms.

New, entrepreneurial firms in the West have been known to develop their corporate reputations through three distinct mechanisms: reputation borrowing, reputation by endowment, and reputation building.

REPUTATION BORROWING

When established/prestigious actors decide to enter into a transactional relationship with the start-up, it serves as an endorsement of the start-up's quality and potential. For the start-up, such an affiliation with prestigious venture capitalists and underwriters attracts attention, and subsequently enhances the credibility of the new venture.

REPUTATION BY ENDOWMENT

By virtue of personally possessing the relevant management and technical expertise, experienced founders and top managers transfer some of their personal reputations to their start-ups. Hence, this is an internal reputation building model, where these start-ups may be said to be endowed with their founders' and top managers' reputational capital, which can boost their access to venture capital.

REPUTATION BUILDING

Despite their resource constraints, start-ups can build their reputation through a number of tactics, such as new product introduction, winning product awards and competitions, and symbolic actions and communication. Amazon.com, in its early years, invited celebrity writers to book

New, entrepreneurial firms in the West have been known to develop their corporate reputations through three distinct mechanisms: reputation borrowing, reputation by endowment, and reputation building.

launches and held poetry contests to attract the interest and attention of stakeholders. Such tactics can help the start-up attract the attention of key stakeholders and establish its credibility as a firm.

And this leads us to the key question posed by this article: what strategies do start-ups in emerging Asian markets use to develop their reputation? While research posits that start-ups in the West use one or more of the above three strategies to develop their corporate reputation, does the same hold true for young companies in Asia?

The role of business reporting

It would not be possible to answer this question without discussing the role of the media, which typically acts as the greatest link between start-ups and their audiences. Over 50 years ago, the renowned sociologist Bernard Cohen argued that the "press may not be successful much of the time in telling people what to think, but it is stunningly successful in telling its readers what to think about... The world will look different to different people depending on the map that is drawn for them by writers, editors, and publishers of the paper they read."[i]

As stakeholders are rarely able to experience the performance and identity dimensions of a firm in person, they often resort to third-party sources such as the news media for information. This is particularly true for start-ups, that is, new entities without a distinctive identity. By magnifying the relatively weak signals coming from a start-up's actions, the media can increase a firm's visibility to a larger number of stakeholders and attract broad market attention. By selecting which features of a firm are included in business reporting, journalists increase the salience of these features. Accordingly, the features included in business reporting determine a start-up's reputation to a large extent.

However, is the media equally active and effective in drawing attention to start-ups in every part of the world? Or do we see regional differences?

To understand the applicability for reputation building for start-ups in Asia, we took a sample of four top-tier, English-language newspapers in Southeast and East Asia: The Straits Times (Singapore), South China Morning Post (Hong Kong), Bangkok Post (Thailand), and Jakarta Post (Indonesia), and searched for articles that contained the word 'startup' or 'start-up' in the headline and/or lead paragraph using the Factiva database. Our analysis covered all articles over the ten-year period between January 1, 2003 and December 31, 2012. We excluded stories that were not focused on a specific company. We also excluded stories that focused on disruptive events over which the start-ups had little control (e.g. lawsuits) and newswire reports, blogs, and corrections. This process resulted in a final set of 106 articles: 65 from The Straits Times, 30 from South China Morning Post, six from Bangkok Post, and five from Jakarta Post.[ii]

We used media content analysis to identify the specific reputational features most prevalent in these four countries. Two coders, oblivious to the research question and independent of each other, coded the articles and obtained inter-coder reliability scores of 0.849 (Krippendorff's Alpha) and 94.4% (percent agreement). Their unit of analysis was the entire article for the existence of the following three features: reputation borrowing, reputation by endowment and reputation building (which included innovation, new product introduction, awards and competitions, symbolic actions such as presenting papers or publishing studies, etc.). Where two or more features were present, the coders chose the most dominant feature. The results of this analysis are shown in Table 1.

TABLE 1: RESULTS OF MEDIA CONTENT ANALYSIS

	The Straits Times	South China Morning Post	Bangkok Post	Jakarta Post	Total
Reputation Borrowing	14	1	0	0	15
Reputation by Endowment	11	2	0	1	14
Reputation Building	40	27	6	4	77
Total	65	30	6	5	106

Is the media equally active and effective in drawing attention to start-ups in every part of the world? Or do we see regional differences?

Asian start-ups have less to gain from mainstream media

Given the extremely low sample size that was generated in the search, our first key finding was that mainstream newspapers may not be a good tool for building reputation for start-ups in Asia after all. And that in itself is a distinct difference between the western and Asian models, and suggests that start-ups in emerging Asian markets may be better off not targeting the major English-language newspapers in their countries, but instead invest their scarce resources elsewhere to build their nascent reputations.

Thereafter, our exploratory study indicated that the 'reputation building' strategy was most frequently featured in business news reporting. It was also the most commonly reported reputational feature in each of the four newspapers. It seems that media is drawn in by original ideas and (symbolic) actions of new companies, while stories of founders, senior managers and financiers rarely made it into the news.

But if the mainstream English-language media does not play a key role in start-up reputation building, then what are young entrepreneurs in Asia doing to enhance their credibility in the market? To answer this question, we continued with our research and held a focus group discussion with six Singapore-based start-up founders.[iii]

Our first key finding was that mainstream newspapers may not be a good tool for building reputation for start-ups in Asia after all. And that in itself is a distinct difference between the western and Asian models.

FROM MAINSTREAM TO NICHE MEDIA

According to the respondents, the paucity of newspaper stories on how Asian start-ups build reputation could be attributed to Asian mainstream media's interest in 'success' stories. As one focus group member said, "The mainstream media wants to pick up success stories, and by success, I mean 'successful' in terms of dollar revenue. But for each successful start-up, there are many failed cases that will go unreported as Asians cannot accept failure. To be frank, how many successful stories can be found in Singapore?"

Two respondents also attributed the paucity of newspaper coverage to the nature of newspaper audiences, "The only people who actually care about early-stage start-ups are the people who run start-ups themselves, ex-entrepreneurs or the investors. Nobody else cares." Thus, the founders we spoke to looked instead to trade media for coverage (for example, Tech in Asia for technology start-ups), as they perceived editors of trade publications to be more supportive of start-ups.

Five of the six respondents said that while print and social media could help build initial awareness of a company and provide social proof (which could subsequently open up new opportunities such as industry connections), the awareness alone does not necessarily translate into reputational advantage.

In particular, for start-ups introducing a new technology, it is also crucial to raise awareness about the technology itself, and articulate the value proposition of the business: "In our case, it boils down to the accuracy of the data. You have to let them test the product either very cheaply or for free. So once they see positive results, they will publish in scientific journals. Once your name is in the scientific journals, the word will spread." Some entrepreneurs even contribute thought provoking articles to trade publications, sharing with readers their personal experiences and learning as an entrepreneur. This strategy had worked well for one respondent, "An angel investor read it [my article] and thought it was interesting. He ended up giving me free office space for a couple of months."

FROM PRINT TO SOCIAL MEDIA

Unsurprisingly, most respondents were focusing their efforts on social media as a means to build awareness and establish a reputation in the market. Social media helps tap into a wider audience cost effectively and creates a multi-dimensional communication channel through which the start-up can engage with its investors, customers and other channel partners. Print media, in contrast, is one-dimensional.

Yet another benefit of social media is that the results are (partially) measurable. As one respondent pointed out, "It is very hard to track the return on investment for a newspaper article...it is easier to track it if it is online, such as the number of re-tweets on Twitter and the number of 'likes' on Facebook. I do guest blogging as well, as it builds my reputation, although not so much for my start-up. It is indirect reputation building."

FROM FOUNDER-CENTRIC TO COMPANY-CENTRIC

Cultural factors also come into play in explaining an Asian start-up's lack of success in gaining newspaper coverage. Characteristically, many Asian societies tend to equate expertise and knowledge with age, whereas many founders of start-ups are young. One respondent, who ran entrepreneurial ventures in the U.S. and Singapore, explained, "Talking about cultural differences, yes, it's really different here [in Singapore]. It is very important to have people with a few grey hair. That is exactly why I chose a co-founder who is 15 years older than me and is an ex-professor. Every single person we hired eventually turned out to be 10-12 years older than me. That really helped because their personal background, their personal reputation, and their experience added this huge legitimacy factor."

Experience and maturity bring obvious benefits to a fledgling business. It is also true that, at the earlier stage of setting up a business, a start-up investment is an investment in the entrepreneur. Hence the personality of the founders, their commitment and capabilities often drive the decision making of investors and other stakeholders. However, as an 'idea or concept' flourishes into a tangible 'offering', be it a product, service or solution, the reputation of the founder gradually gets decoupled from that of the company.

Awareness does not guarantee reputation

Five of the six respondents in our focus group said that while print and social media could help build initial awareness of a company and provide social proof (which could subsequently open up new opportunities such as industry connections), the awareness alone does not necessarily translate into reputational advantage.

Some start-ups proactively adopt a communication strategy to build market reputation, engaging and involving key stakeholders in understanding the business value proposition. As one respondent mentioned, "From day one, we hired a communication graduate. Our employee 'zero' was not a business guy or tech guy, but a corporate communication guy."

THE END GAME: THE PRODUCT MATTERS

Ultimately, the respondents emphasised that if start-ups focus on getting a good product, service or solution out and on gaining traction in the marketplace, a good reputation will follow. Sharing from personal experience, one respondent further added, "[Our] reputation was built from the quality of the service we provide."

The importance of a good offering resonated with all members of the focus group, "Focus on customer acquisition, because at the end of the day, if you can't acquire customers, then you have a product problem or a market problem, and no amount of public relations (PR) can help you—so you're just spinning your PR wheels and you're not getting anything out of it."

Thus, a key takeaway here is that word of mouth is more important than word of media. Or, to take it one step further, the product speaks for itself. If your offering has proved itself in the market, then you have already begun to build a good reputation in the market. Focus on the core of your business. Reputation is just one part of it. Getting the product out and gaining traction should still be the core of the business. As one respondent put it succinctly, "Do the real stuff and forget the fluff."

VIKI: BUILDING A REPUTATION THROUGH AN INNOVATIVE BUSINESS MODEL

In September 2013, Singapore-based start-up Viki was acquired for allegedly US$200 million by Japan's e-commerce giant Rakuten, making it the most successful Internet start-up in Singapore's history. Described as 'Hulu for the rest of the world', Viki was co-founded in December 2010 by former NBC Universal executive Razmig Hovaghimian and his two friends as a joint class project between Harvard and Stanford graduate students. Developed as a platform for real-time crowdsourced subtitling and sharing of video over the Internet, Viki's features drew several high-profile investors such as Greylock and Neoteny Labs who provided the start-up with initial funding. As the company's business model continued to get validated through its stellar performance, it secured additional funding from more investors. Viki's growing reputation enabled it to license more shows from content providers, and attract a greater number of viewers, advertisers, and members for its fan-subbing community. Thus the valuation of the start-up was enhanced with each successive activity that it engaged in, and most of its early reputation was based on the innovativeness of its business model and software.

Focus on the core of your business. Reputation is just one part of it. Getting the product out and gaining traction, these should still be the core of the business.

Mark Chong

is Associate Professor of Corporate Communication, Academic Director (MSc in Communication Management), and Area Coordinator Corporate Communication at Singapore Management University

Gregor Halff

is Associate Professor of Corporate Communication, Associate Dean (General Management Programmes) and Academic Director MBA/EMBA at Singapore Management University

The authors wish to thank Desai Arcot Narasimhalu, Willis Wee, Ivan Chang, Elisha Tan, Pulkit Jaiswal, Jaryl Sim, Fan Mingwei, and Natalie Ip for their assistance in the study.

Reference

[i] Bernard Cohen (1963), The press and foreign policy, New York: Harcourt.

[ii] The difference in the coverage of start-ups between the four countries in the sample did not surprise us, as it reflects the differences in their respective business environments. Based on the Global Innovation Index (http://www.globalinnovationindex.org). Singapore and Hong Kong have almost always been ranked among the top 10 most innovative countries in the world since 2007. Thailand and Indonesia, on the other hand, have never made it into the top 30.

[iii] The start-ups were recommended by Professor Desai Arcot Narasimhalu, Director of the Institute of Innovation and Entrepreneurship at Singapore Management University, and Willis Wee, founder of technology portal Tech in Asia.

Protecting an Asian treasure in America

The impact of Japanese cars on the American auto industry is well known. Not so well known are the regulatory and intellectual property issues faced by beef producers in the introduction of Japan's esteemed Wagyu beef herd to U.S. pastures and tables.

By Jeffrey Andrien

Japan is known globally for its meticulous attention to quality standards and consumer standards, often offering the most differentiated and intricate products. In no industry is this more apparent than in the cattle industry in the U.S., where Japanese brands are considered to be the gold standard for the world's finest meats, and where beef producers are now continuing the trail-blazing branding efforts of Toyota and Honda that commenced more than four decades ago.

In 2014, it is Japanese cattle breeders that are poised to have a profound impact on the American beef industry. However, distribution agreements, partnerships and legal challenges threaten to derail American efforts to fully adopt Japanese cattle-raising methods, and protect the genetic and intellectual property that serves as its very basis of distinction.

In 2014, it is the Japanese cattle breeders that are poised to have a profound impact on the American beef industry, However, distribution agreements, partnerships and legal challenges threaten to derail American efforts to fully adopt Japanese cattle-raising methods, and protect the genetic and intellectual property that serves as its very basis of distinction.

When one thinks about the best beef in the world, Wagyu beef invariably comes to mind. The word, Wagyu, is made up of two parts 'wa' and 'gyu', which refer to 'Japanese' and 'cattle', respectively. Wagyu can refer to any of four indigenous Japanese breeds of cattle, Kuroushi (Japanese Black), Akaushi (Japanese Brown or Japanese Red), the Japanese Polled and the Japanese Shorthorn.[i] The distinctions among the four breeds of cattle are important because they produce beef with different characteristics and quality.

Wagyu are considered to be national treasures of Japan, with the Kuroushi and Akaushi strains reputed to produce the highest quality beef. While it is Kuroushi cattle that produce the world renowned Kobe beef,[ii] it is the Akaushi breed, from the Kumamoto prefecture in Japan, that is currently struggling to maintain its pure lineage and unique

Japan's success in developing two breeds of cattle that produce superior quality beef is based, in large part, on the adoption of a 'closed system'.

identity in the U.S.[iii] Like Kuroushi, Akaushi (pronounced 'akka-ooshē'), produce some of the world's best beef; typically grading two to three levels above U.S. Department of Agriculture (USDA) Prime.[iv] This is exceptional as only from one to three percent of U.S. beef grades out at USDA Prime and above. And because Akaushi cattle are considered national treasures, the Japanese government has banned their export, making authentic Akaushi beef virtually impossible to find outside of Japan, and when one can find it, the retail price of the product is often three or more times that of prime beef.

The Japanese way to building a treasure

Japan's success in developing two breeds of cattle that produce superior quality beef is based, in large part, on the adoption of a 'closed system'. In contrast to the West, where breed development is left to individual ranchers and breeders, the Japanese have established a central authority that collects and analyses data, and regulates breed development. For example, the Japanese Akaushi Association (JAA) was created over 50 years ago in order to 'collect, manage and process all Akaushi data', and JAA has collected 'carcass performance, breeding pedigrees and economic data for every animal in the entire breed'.[v] Master geneticists and scientists have analysed the data for multiple traits, such as maternal, structural, fertility, carcass and palatability, and used them to develop a breed that is uniform to the extreme and consistent throughout its genetic lines.[vi] New bloodlines are only released for general production after they have 'been proven meritorious by extensive and accurate statistical analysis, using a sophisticated progeny-testing model'.[vii] The Japanese data tracking system is so rigorous that for Kobe beef, which has the most stringent requirements, a consumer ordering a steak can request a certificate of authenticity that provides, among other things, the lineage of the animal that the steak comes from, the date of slaughter of the animal, and the weight of the animal at slaughter.[viii] This data-driven approach is what helps make Akaushi cattle superior to Western breeds in virtually every aspect.

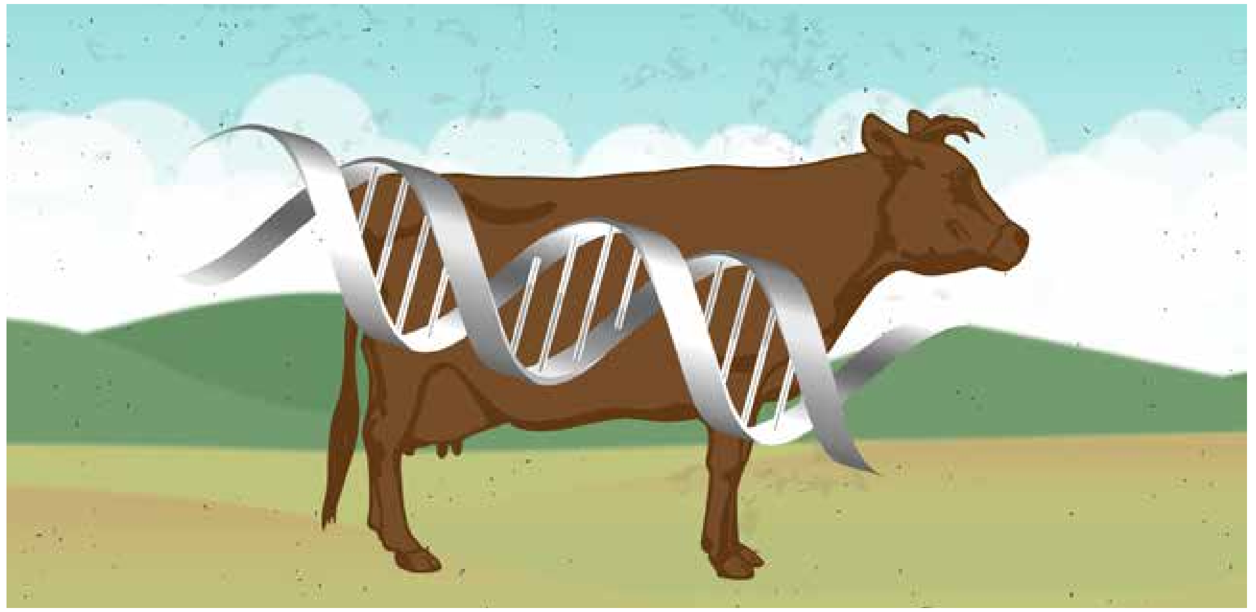
As a national treasure of Japan, the Japanese government forbids the exporting of live animals and other genetic material such as bull semen or embryos for transplant. However, as the result of a loophole (which has since been closed) in the Trade Act of 1992 between the U.S. and Japan, a breeding nucleus of 11 Akaushi cattle was brought to Texas in a custom-designed Boeing 747 in 1994.[ix] Perhaps even more fortunately, the importers of these 11 prized cattle recognised the benefits of the Japanese method of developing and protecting the breed. They resisted the urge to exploit the cattle for short-term profit, which would have come at the expense of diluting the breed's genetic characteristics. Instead, with a focus on maintaining the distinctiveness and integrity of the breed, HeartBrand and its producer partners have bred the Akaushi herd in America to approximately 10,000 head of cattle over the past 20 years.

Remarkable results and health benefits

From a consumer's standpoint, the most celebrated trait of Akaushi is that it produces extremely flavourful, tender and juicy beef with high intramuscular fat or marbling. And in one of those rare win-win situations, where something that tastes better is actually good for you, Akaushi beef has an extremely high ratio of monounsaturated fat to saturated fat and cholesterol, as well as a high amount of Conjugated Linoleic Acid (CLA). HeartBrand reports that studies have shown CLA to help control insulin levels (thereby reducing diabetes), help increase weight loss, and slow the growth of a wide variety of tumours, including some kinds of cancerous tumours. Additionally, the high ratio of monounsaturated fat to saturated fat has been demonstrated to lower levels of low-density lipoprotein (LDL), which is the harmful cholesterol, without decreasing high-density lipoprotein (HDL), which is the good cholesterol, thus lowering the risk of heart disease.[x]

From a rancher's perspective, however, health benefits are only one of the many attributes of Akaushi. Amazingly, the cattle have better carcass yield and transfer their genetic components significantly faster than their Western counterparts. Moreover, Akaushi require no special feed or care compared to Western breeds, have fertility rates that are comparable to or better than western breeds, and can adapt to different climates better than most other cattle (Akaushi are being raised throughout the U.S., in disparate climates such as Texas, Colorado, Montana and Florida).[xi]

While the cost and complexity of raising Akaushi are low compared to the best American breeds, it is the grade and potential yield that is of greater interest. According to HeartBrand, full-blood Akaushi yield over 95 percent of USDA Prime grade beef on a typical carcass. In contrast, Angus, a widely popular and distinguished cattle breed in the U.S. and Europe, yields from six to eight percent USDA Prime beef. These high-grade yields command significant premiums at slaughter. In fact, even half-blooded Akaushi, when crossed with domestic U.S. breeds, yield over 50 percent USDA Prime beef, and do so after only one generation of crossbreeding. This type of genetic transfer, in which ranchers attempt to increase yields or improve genetic characteristics by introducing new bloodlines into their herds, typically takes 10 to 12 years (three to four generations) with other breeds.



Following in Japanese footsteps

Since receiving the original 11 cattle in 1994, HeartBrand has carefully and diligently built and protected the Akaushi brand and avoided the short-term oriented decisions that could irreparably harm the distinction of the Akaushi product.

Dr. Antonio Calles, a master geneticist and former executive at HeartBrand, is perhaps the most authoritative figure in the U.S. on Akaushi cattle. It was through his devotion to the breed and to the Japanese methods of raising cattle and protecting Akaushi genetics that the U.S. Akaushi herd grew to a self-sustaining size of approximately 10,000 head of cattle.

From the beginning, Calles and HeartBrand have strived to follow the Japanese model to protect and maintain the integrity of the Akaushi breed. For example, they established the American Akaushi Association (AAA) to perform a role similar to the one the JAA performs in Japan. The AAA's mission is 'to change beef production through tracking, maintaining and verifying the purity of the breed, the performance of the offspring and the

The fact that HeartBrand does not have (and cannot acquire) a trademark on the term, 'Akaushi', further complicates its development of the Akaushi brand in the U.S., and strengthens its need to maintain a closed, Japanese-style production system.

quality of the final retail product'.[xii] To this end, the AAA has adopted a whole-herd reporting system, which collects DNA data, carcass performance, breeding pedigrees and economic data for every Akaushi animal in the U.S. that registers with the association.[xiii] HeartBrand, in turn, requires ranchers that purchase its Akaushi cattle ('Producers') to become members of the AAA and to participate in the whole-herd reporting system. The ability to track progeny performance across different climates and geographies is essential in evaluating and improving the yield of herds.

Additionally, HeartBrand maintains a closed system, similar to that in Japan, by placing certain restrictions on its Producers. One such restriction is that Producers can only sell live Akaushi cattle to HeartBrand or to other Producers, thus ensuring that the supply of Akaushi cattle is kept within the HeartBrand network. Such customer resale restrictions are generally used when the good or service needs to be protected to maintain the distinctiveness of the offering. This distinction serves as a basis of differentiation and allows the product to avoid being commoditised. Further restrictions involve how Producers can market beef derived from Akaushi cattle and what portion of their harvested cattle must be sold back to HeartBrand for sale to the public. Much like a bottling relationship with a carbonated soft drink producer, the cattle producers have contracted margins and known purchase arrangements. This type of contract is referred to as a vertical restriction in which a producer or the owner of a mark specifies the manner, territory, types of customers or prices, etc. that those who wish to deal with them must abide by; in some cases it might be all of these managerial actions. Such vertical restraints have been a cornerstone in developing brands and protecting intellectual property.

Together with these restrictions and requirements, HeartBrand's closed system of growing the Akaushi herd in the U.S. enables tracing of the lineage of every animal within the system back to its Japanese ancestors, thereby authenticating it as full-blood Akaushi. This attention to process has earned some goodwill within the Japanese cattle industry. While initially HeartBrand and the AAA had a strained relationship with the JAA, primarily because the JAA was unhappy that the 11 animals were exported from Japan and was concerned about stewardship of its national treasure, the relationship has improved over time. By fully embracing Japanese methods and protecting the integrity of the Akaushi breed, these organisations now share an excellent relationship and work cooperatively with one another.[xiv] One advantage of this cooperation is that it creates redundancy. Having herds in different locations ensures that independent bloodlines can be established and used to rebuild either herd—in the event that disease or some other natural disaster decimates the Akaushi population in one country. This has happened in other agricultural sectors, as was the case with some popular European wines, crops of which were killed by disease. Eventually, Californian vines needed to be re-imported to rebuild the diseased vineyards of Europe.

Litigation

HeartBrand's closed system has recently come under attack, facing legal challenges from one of its producing partners, Bear Ranch. Owned by billionaire Bill Koch of the high profile Koch family, Bear Ranch became a Producer in HeartBrand's system when it purchased 400 Akaushi cows and 24 Akaushi bulls from HeartBrand in 2010. Duly impressed with the quality of the cattle, Bear Ranch management continued purchasing additional Akaushi cattle from other HeartBrand's Producers between 2010 and 2013, and grew its herd through purchases and breeding to approximately 4,000 head of cattle.

However, Bear Ranch soon found the restrictions and requirements of HeartBrand's full-blood contract onerous and sued HeartBrand, claiming the contract was anti-competitive and, therefore, illegal. Flouting of any of the precepts that ensured the integrity of the cattle would mean dramatically reducing the authenticity and distinction of the brand not just in the U.S. but on the global stage.

HeartBrand countersued Bear Ranch claiming that the latter engaged in fraud when purchasing its Akaushi cattle and that Bear Ranch had breached the contractual obligations of a HeartBrand Producer. The lawsuit has been ongoing for more than two years now, and although HeartBrand won a major victory during a recent jury trial, the verdict still faces judicial review and potential appeal. In short, HeartBrand's ability to continue employing the Japanese systems that are designed to protect the integrity of the Akaushi breed is at high risk.

The challenges ahead

Despite winning a jury verdict in its litigation with Bear Ranch, HeartBrand did not emerge completely unscathed, and the company still faces some difficult hurdles enroute to achieving its goal of transforming the U.S. cattle and beef business and delivering the highest quality beef to the market. Most notably, one of the court's rulings in the litigation eliminates HeartBrand's ability to control inter-Producer purchases. In other words, the court ruled that while the contract restrictions apply for the purchases a Producer makes from HeartBrand, if a Producer purchases cattle from another Producer, the HeartBrand restrictions no longer apply. One can only imagine the potential for intra-firm sales via cross-holdings, which would circumvent the spirit of the initial agreement.

Depending on how this plays out in practice, this ruling could devastate HeartBrand, as well as its ability to control the Akaushi genetics outside of Japan and apply the Japanese principles that are the foundation for building the Akaushi brand in the United States. Producers could potentially circumvent the DNA testing and whole-herd reporting that enables authentication, data collection and optimal genetic performance of Akaushi cattle. Moreover, they could sell live Akaushi cattle to ranchers outside of the current system without restrictions, which would undoubtedly result in the proliferation of cross-bred animals that are marketed under the term Akaushi, thus diluting the breed's brand. The fact that HeartBrand does not have (and cannot acquire) a trademark on the term, 'Akaushi', further complicates its development of the Akaushi brand in the U.S., and strengthens its need to maintain a closed, Japanese-style production system. In conclusion, the prospects of another Japanese revolution in a quintessential American industry, although off to a strong start, remain (for the time being) at the mercy of the U.S. legal system. Stay tuned.

Jeffrey Andrien

is a Managing Director at The Claro Group, a financial advisory and management consulting firm in the United States. He is also a visiting professor at Thammasat University, Bangkok and frequently lectures at other academic institutions

Reference

[i] Kobe beef, "FAQ", http://www.kobe-niku.jp.
[ii] Much like the term 'Champagne', a designation for sparkling wine that is produced from grapes grown in the Champagne region in France, the term 'Kobe' is a designation for beef produced from Kuroushi cattle born and raised in the Hyogo prefecture in Japan. In order to be classified as Kobe, the beef must also satisfy a number of additional requirements.
[iii] HeartBrand Beef, http://heartbrandbeef.com.
[iv] Sarah Harris, "A Breed all its Own", Farm Credit Bank of Texas, Summer 2007.
[v] HeartBrand Beef, http://heartbrandbeef.com.
[vi] Ibid.
[vii] Ibid.
[viii] Olmsted, Larry, "The New Truth About Kobe Beef: Scarce Amounts Now Available In The U.S., But Not In Europe", Forbes, July 1, 2014.
[ix] HeartBrand Beef, http://heartbrandbeef.com.
[x] Ibid.
[xi] American Akaushi Association, http://www.akaushi.com/.
[xii] Ibid.
[xiii] American Akaushi Association, Whole Herd Reporting system, http://static.squarespace.com/static...Whole-Herd-Reporting-II-1.pdf.
[xiv] Sarah Harris, "A Breed all its Own", Farm Credit Bank of Texas, Summer 2007.

It's not will you succeed? but can you afford to fail?

The re-visioning of the Silk Road in the 21st Century

With India and China's economic ties no longer defined only by trade, the countries' convergence is opening up new opportunities and challenges for businesses on either side seeking to cross the Sino-Indian border.

By Girija Pande

The China-India relationship is set to become one of the most significant economic ties of the coming decades. Bilateral trade between the two countries has jumped from US$3 billion in 2000 to US$69 billion in 2012. In the same year, China became India's second-largest trading partner, after the United Arab Emirates. In turn, India was China's twelfth-largest and fastest-growing trading partner. Yet, direct investment remained minimal. However, for adventurous corporates seeking to do business in either country, the question for their strategists, advisors and investors becomes not, "Will you succeed?" but "Can you afford to fail?"

In many cases, pioneering companies from India entering into China and vice versa, are operating outside their comfort zones and are being forced to innovate and adapt their processes and strategies to succeed. The lessons learned, many of which have been identified in The Silk Road Rediscovered, a book I co-wrote together with Professor Anil K Gupta and Haiyan Wang,[1] can help pave the way for others and encourage multi-national enterprises (MNEs) in the U.S., Europe, Japan and other countries to brave the waters in these economies which, to date, have been negotiated with trepidation.

> China is changing substantively, and the evolving structure of the Chinese economy along with its growing consumer movement will result in the country becoming much stronger in the services sector.

I believe that the biggest stumbling block in the relationship between the two countries developing further is the current mind-set—particularly on the part of Indian executives.

The economies will converge

I do believe that Indian companies can succeed in China, and conversely—and they must. While India still lags in infrastructure, the country does, of late, boast of strong leadership. If Indian firms decide to enter China, they would no longer be inhibited by the infrastructure weaknesses of India. Similarly, the Chinese would love to build their business in India. Their leaders recognise that the Indian economy is growing rapidly, and have publicly accepted that the trade ties in China's favour need to be more balanced. We therefore forecast that Chinese investments in India will hit US$30 billion in 10 years' time.

But while it is commonly said that there is complementarity between the two economies—with China being the manufacturing capital of the world and India acting as the back office of the world—we argue in the book that this is not the way it will continue in the future. China is changing substantively, and the evolving structure of the Chinese economy along with its growing consumer movement will result in the country becoming much stronger in the services sector. Moreover the fast increasing cost structures and slowdown in the size of the labour force will require China to vacate certain areas in manufacturing. As for India, I expect that once its infrastructure investment takes root, the well-educated and low-cost labour force, along with the growing scale of market, will result in a strengthening of its manufacturing sector—more so for exports.

Hence, over a ten year time frame, both countries will go into manufacturing and services—and that represents convergence, not complementarity.

Although the challenges and strategies are similar, and most of our argument is symmetrical and applies to companies in both countries, I will focus here largely on one side: that is about Indian companies entering China.

Challenges and strategies for Indian companies to operate in China

I believe that the biggest stumbling block in the relationship between the two countries developing further is the current mind-set—particularly on the part of Indian executives. Let me elaborate. If you look at China, it has historically had varying degrees of border issues with its neighbours—Korea, Japan, Taiwan, Vietnam, Mongolia, Russia, Hong Kong and India. (And that's not a surprise—so does India—big countries do have this challenge). But these East Asian countries, other than in South Asia—including India, have managed to deftly separate political issues from business issues, and remain large trading partners with China. While I do not expect the Indians to forget the boundary and other disputes with China, I argue that this should not come in the way of sound economic cooperation. The age-old geopolitical tensions between China and India are not likely to be resolved in a hurry, but the economic relationship between the two countries needs to take centre stage. Over the next decade, cross-border investments between China and in India are likely to grow even faster, both organically and indirectly through third-country acquisitions.

The other major issue with the Indian mind-set is the lack of confidence in the corporate headquarters of Indian companies, which do not believe that they can really build a large and sustainable business in China, given factors such as its size, diversity and language barriers. Hence the first step an Indian company would need to take would be to ensure that they 'Think Global', not just 'In-China-For-China' when entering China. Potential investors need to look carefully at how the move will fit into their global strategy. Besides looking at the competitive advantages they can gain by leveraging their distinctive competencies (whether it is technology, organisational capabilities, corporate reputation or global relationships) in the new market, business leaders need to consider the ways in which a move into China will bring added benefits to the company outside the host country.

Companies can reduce the risk of failure by first targeting a very clear and narrow beachhead market segment.

CHINA: VAST AND DIVERSE, AND CHANGING RAPIDLY

I always advise Indian companies not to say that they are building a business in China, but that they are building a business in a specific province such as Guangdong or Shanghai because China is not only an extremely large country in terms of geography, population and economy, it is also very diverse. You have to look at it regionally. For instance, the per capita income on average in say Shanghai or Beijing is seven to eight times that of those residing in the poorer western parts. This wide income disparity means that the customer profile will also vary widely, and adds complexity to an already unknown environment. The company thus has to be very flexible and adapt its products and services not just for 'China', but also for its different provinces and cities.

At about US$9.3 trillion, not only is the size of the Chinese economy substantially larger than the Indian economy at around US$1.6 trillion (2013), it is also growing more rapidly. And this gap only continues to increase. The rate of change is much more rapid in China than that to which Indian firms are accustomed. This means that consumer behaviour and industry structure are changing constantly, and represents an unstable situation where the economy is growing at a rate that the world has never seen, and where businesses must adapt to this rapid change in an incredibly vast country.

Companies can reduce the risk of failure by first targeting a very clear and narrow beachhead market segment. For instance, when the Mahindra group ventured into China, it did not go into a broad automotive sector, but instead focused on small farm machinery recognising that China, like India, had small land holdings. The product mix was thus adapted to the social and business climate of small farms.

Another way of reducing the uncertainty is to learn as much as possible about China before entering the market, by say, attending relevant seminars, and learning from others and their mistakes. It can also be extremely helpful to ensure that the team that goes in—particularly the leaders—is well experienced in China. At Tata Consultancy Services (TCS), for instance, only expatriates with China or Taiwan experience were sent in as senior managers. Similarly, Mahindra hired someone from Unilever, who had worked several years in China, to set up and lead their business.

Almost every multinational company in the world is in China—though not as yet in India.

Chinese economy (2013)

US$9.3 trillion

Indian economy (2013)

US$1.6 trillion

BRUTAL COMPETITION

Almost every multinational company in the world is in China—though not as yet in India. China has a rather pragmatic view that these companies will, at the very minimum, contribute to building the infrastructure and creating jobs, but the Indians tend to get more nationalistic and bogged down by the concerns of having a foreign company on their land. As a result, competition in China is generally far more intense than what the Indian companies would have faced. And it is not only the multinationals, but also the booming Chinese private sector with its host of small and medium enterprises (SMEs) with which foreign firms must contend. And finally, there are the state-owned enterprises (SOEs), many of which do not look at margins, but go for volume. Typically, SOEs are not listed, and have a much longer horizon for returns on investment than the Indian companies, which look at capital very differently with quarter-to-quarter targets. Hence, the company needs to have a very clear strategy: looking at China with a global lens and recognising the global capabilities that it brings and which will differentiate it from these competitors.

Provinces too, are often competing fiercely with one another to bring in investment—and this can prove to be a great boon to firms ahead of deciding where to establish operations.

SAFEGUARDING INTELLECTUAL PROPERTY WHILE INNOVATING

Historically there have been concerns about the protection of intellectual property (IP) in China. While laws do exist, enforcement has not been consistent and in line with best practices. But we argue that this will soon lessen as a key concern. Since China became a member of the World Trade Organization in 2001, and particularly over the past four to five years, Chinese companies and the Chinese government have realised that the days of low-cost mass production are over. They can no longer compete on those grounds given the changing cost structure and the strengthening currency. They have understood the significance of competing through the creation of new ideas and therefore recognise the need to respect IP. Today, Chinese companies such as Huawei are some of the biggest filers of patents. And to safeguard those patents, they are now suing one another; the end result being that some of the most heated discussions in the IP arena are now between the Chinese themselves.

But cross-border investments are not just about growth. Companies moving into China get a chance to share knowledge and to adapt and innovate—creating unexpected products and opportunities along the way—and at least some of these innovations are likely to be globally relevant. This type of benefit is illustrated well by the case of NIIT in China (refer to Box 1).

TALENT MANAGEMENT: ACQUISITION, ENGAGEMENT AND DEVELOPMENT

A major worry of doing business in China is the high levels of attrition. Turnover rates among professional staff can be as high as 20 to 40 percent a year. There are two key reasons for this. First, the kind of growth rate that China is witnessing has resulted in huge opportunities across industries and services. And second, the average Chinese worker has changed over the past couple of decades: China's one child policy has created princelings, who are far more individualistic and demanding than previous generations. Hence, retaining these individuals and managing their careers becomes a real challenge. In TCS, if employees did not get a promotion every 18 months, they typically started looking elsewhere for other options.

It is therefore important for managers to make sure that employees are well-compensated and in line with the market. Deferred compensation, such as stock options and employee loans, are some other ways that could work to effectively retain employees.

BOX 1: INDIA'S NIIT IN CHINA

Global IT learning and out-sourcing company NIIT's unique "Inside" business model was incubated in China after the company's journey into the country took a surprising path. NIIT entered China in 1997, when information technology was still a nascent industry. After some difficulty getting a license, the Shanghai Education Bureau agreed to a 10-year contract teaching at just one centre in Shanghai under tightly controlled conditions. The interest from potential participants was immediate and unexpected, with newspaper advertisements prompting more than 2,000 applications for the company's first two- to three-year courses.

For NIIT's leadership team in China, this was a period of massive learning on all fronts, not least on how to protect their intellectual property. They hired 14 professors to translate the textbooks, breaking each into 14 parts and giving a different part to each professor. Innocuous but deliberate mistakes were made in course materials so that copies could be easily identified, and the marketplace was policed closely to keep track of pirated logos, text material or even fake NIIT centres that showed up. Adaptions were also made in teaching techniques and for remunerating staff.

After a successful first year, NIIT was given permission to expand. However, difficulty obtaining licences from other city governments forced them to rethink their usual models. Instead of going it alone, the company began signing up universities and colleges as franchisees, which meant that as well as having the necessary licences, the universities had existing infrastructure, so no new investments were necessary. It didn't take long before the universities came up with the idea of embedding the NIIT curriculum in their bachelor's degree programmes—a win-win situation—which eventually became the NIIT Inside model, an idea they have since taken back to India.

NIIT has thrived in China, and as of 2013, it was training over 30,000 IT professionals a year at more than 140 centres, and had signed a memorandum of understanding with the Hainan Government for a multi-year large-scale talent development project.

Above all, rapid learning and familiarisation is critical as is recognition that internally, India is far more diverse than China on a host of dimensions—income levels, language, religion, climate, and political leanings—and like China, India too is changing rapidly.

BRAND RECOGNITION

For an Indian company wishing to enter or expand in China, brand recognition will be a challenge. Hence the choice is either to acquire a well-known third-party brand, like Tata Motors did when they acquired Jaguar Land Rover, or build it. A key difference is that when a brand is built in India, it is essentially being done for the firm's customers and its employees; but in China, the brand has to be built for the government as well. Because in China, the government is omnipresent–and if it believes that the firm has a strong reputation and is socially responsible–then brand-building becomes far easier.

UNDERSTANDING GOVERNMENT RELATIONSHIPS

It follows that any firm operating in China must understand the importance of the government at every level. While the state (particularly at the province level) heavily promotes investment, the fact is policies do tend to change. The mayors typically enjoy considerable autonomy in decision-making–but this does not mean that approval at their level implies unanimous agreement across other states and government functionaries. Hence the company has to keep abreast of developments and understand these nuances while navigating the political landscape.

DECIDING WHETHER TO PARTNER OR NOT

My view is that while a firm may still manage 'China for the world and China for the region' on its own, 'China for China' is another issue altogether. There is almost no hope of making any headway into the Chinese domestic market without a partner. Of course this depends very much on the firm's existing capabilities and relationships in the target market. The Mahindra Group's entry into China via joint ventures is a case in point (refer to Box 2).

The Silk Road ahead

While this article has focused largely on the challenges, opportunities and strategies that Indian companies can adopt to succeed in China, it is interesting to note that there are similar lessons emerging from the journeys of Chinese companies into India–which we have outlined in our book.

BOX 2: MAHINDRA & MAHINDRA GROUP

Mahindra Tractors, a unit of India's Mahindra & Mahindra Group, took time to explore China's marketplace before making a move. As a result, it is now the fifth largest tractor manufacturer in China, while selling 240,000 tractors annually in more than 40 countries, with manufacturing operations in India, China, the U.S. and Australia.

Mahindra's first foray into China was to explore the potential for exporting tractors from India. They soon realised their Indian-made tractors were far too expensive, and the design was not compatible with Chinese farmers' requirements. The only way they could compete would be to design and manufacture the vehicles locally. Instead of rushing in full tilt, they started small, forming a US$10 million, 80:20 joint venture with the financially troubled, state-owned enterprise, Jiangling Tractor Company (JTC). It didn't take long before Mahindra identified areas of concern. The company's manufacturing locations were far away from markets, there was a capacity constraint, and a majority of the dealers were ineffective. But all was not lost. For Mahindra, the JTC commitment had been a learning move, through which they were able to get people into China to study the market and figure out possible entry and follow-on strategies.

After four years, Mahindra felt ready to make a bigger move, and signed their second Chinese joint venture, this time with Jiangsu Yueda Yancheng Group, one of China's top 100 business groups with revenues of about US$7 billion. In November 2009, another US$40 million was added to the venture to create an R&D centre and a new engine manufacturing plant.

Like China, India too often suffers from not just unpredictable government policies, but also the fact that it is a low-income country open to players from every other country. Thus companies often face brutal competition and thin margins. Moreover, the Chinese find the chaos in India rather difficult to manage, as the new generation of Chinese in particular has not experienced such a lack of infrastructure. Yet if they are to have any hope of emerging as successful players over the next five to 10 years, they must make investments now, and see India as part of the company's global strategy.

They too must be very cautious and selective when entering into a joint venture, for joint ventures can be disastrous and costly, as the example of Haier shows (refer to Box 3).

Finally, Chinese companies must not forget that the media and the government in India are important stakeholders–and they have to build their trust with them. Above all, rapid learning and familiarisation is critical, as well as recognition that internally, India is equally or even more diverse than China on a host of dimensions–income levels, language, religion, climate, and political leanings–and like China, India too is changing rapidly.

Chinese companies must not forget that the media and the government in India are important stakeholders—and they have to build their trust with them.

BOX 3: HAIER

Chinese home appliance multinational, Haier's first push into the Indian market began in 1999 when it set up a joint venture with Hotline, a Kolkata-based company. Hotline Haier Alliances Ltd. ran into trouble from the very beginning as the partners differed profoundly in strategy. The move set Haier's China plans back at least two years. By 2003, the company's management decided to go it alone, setting up Haier India as a wholly owned subsidiary, importing white goods from China and later Thailand. Later agreements saw it sourcing from Indian companies Whirlpool and Voltas, hoping to build up sales before starting its own manufacturing. The company focused on premium brands but in mid-2006 changed course to focus on rural India and the bottom-of-the-pyramid market. A year later they acquired their first company-owned manufacturing facility in India.

Girija Pande
is Executive Chairman, Apex Avalon Consulting, Singapore, and was previously Chairman, Asia-Pacific, for Tata Consultancy Services

The material in this article is derived from the author's recently published book: "The Silk Road Rediscovered - How Indian and Chinese Companies Are Becoming Stronger by Winning in Each Other's Markets"; co-authored with Anil K. Gupta and Haiyan Wang.

Reference

[i] Anil K. Gupta, Girija Pande and Haiyan Wang, 2014, "The Silk Road Rediscovered - How Indian and Chinese Companies Are Becoming Stronger by Winning in Each Other's Markets", John Wiley and Sons.