

Winning in Asia

Creating long-term value

A SPECIAL REPORT



Australian
Institute of
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Directors



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WINNING IN ASIA IN THE MIDST OF COVID-19 AND BEYOND

THE IMPACT OF THE PANDEMIC ON GLOBAL GROWTH



Global growth has been dramatically impacted by the COVID-19 crisis, projected at an alarming -4.9 per cent in 2020, the worst economic downturn since the Great Depression¹. The multiple waves of the pandemic, the synchronised deep global downturn, depressed consumer spending, mobility restrictions, and contraction in global trade have had an unprecedented impact on the global economy².

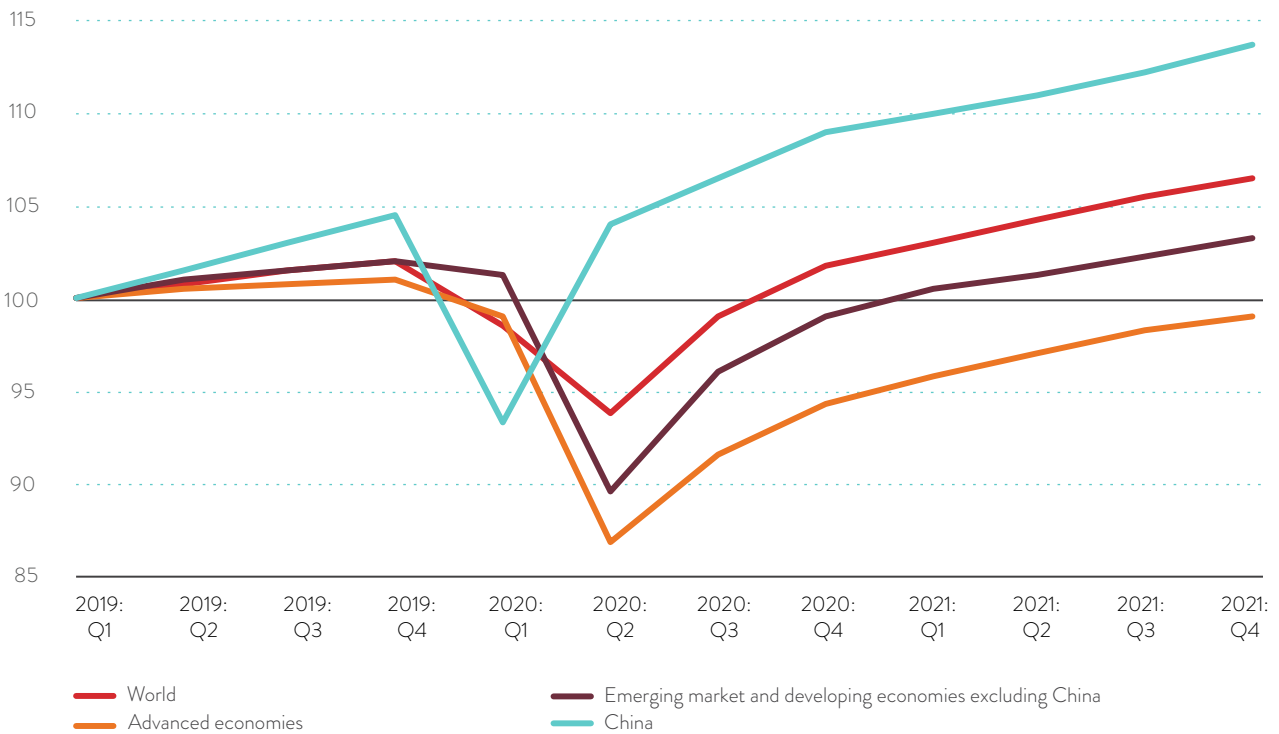
The IMF forecasts that all major advanced economies are projected to record growth worse than -4.9 per cent. China, India and the ASEAN 5³ are all projected to record growth rates better than the major advanced economies and the global growth rate. China is forecast to grow at 1 per cent, India at -4.5 per cent, and the ASEAN 5 at -2 per cent⁴. Australia is now forecast to record

-4.5 per cent growth in 2020, two percentage points better than the April forecast⁵. The successful containment to date of the virus and gradual easing of restrictions on business are amongst the reasons cited for the improvement in Australia. The Australian Government's own forecasts (as part of its Economic and Fiscal Update in July 2020) reveal that the economy is forecast to record -2.5 per cent growth in the current financial year and that unemployment is expected to be -8.75 per cent in the same period. On a calendar year basis, the contraction is expected to be -3.75 per cent in 2020⁶.

The OECD is less positive on the state of the Australian economy, noting a likely contraction of -5 per cent in 2020⁷.

FIGURE 1. Quarterly world GDP

(2019:Q1=100)



Source: IMF staff estimates.

The impact of the pandemic challenges the broadly heralded pre-pandemic view of the Asian Century. Consistently cited projections over the last decade have held that the real GDP of Asian economies are projected to exceed the combined economies of the Americas and Europe by 2030⁸. Asia is also expected to account for over 70 per cent of world capital stock by 2030 and lead capital exports⁹. Even sooner, by as early as 2020, the middle class consumers in Asia were expected to outnumber the middle class consumers in the rest of the world combined¹⁰. These macro-level narratives have influenced national, industry and firm-level agendas in Australia and across the world in respect to the scale of opportunity in Asian markets.

As Prime Minister Lee from Singapore recently highlighted, notwithstanding the extraordinary economic growth in Asia “an Asian Century is neither inevitable nor foreordained”¹¹. While this assessment is a sobering reminder of the impact of geostrategic tensions between China and the US, regional tensions and the impact of the pandemic, it should also be viewed in a relative context. From an economic perspective, projections of the region remain that it will continue to be the growth engine for the global economy and the macro-level narratives of the size of the opportunity in Asia still retain their value¹². Realising the opportunity however, may be more complicated, requiring greater government-to-government engagement, deeper business-to-government engagement, and a recognition that economic, defence and strategic national interests will prove increasingly harder to decouple.

Navigating the new normal: Shocks, tensions and contradictions

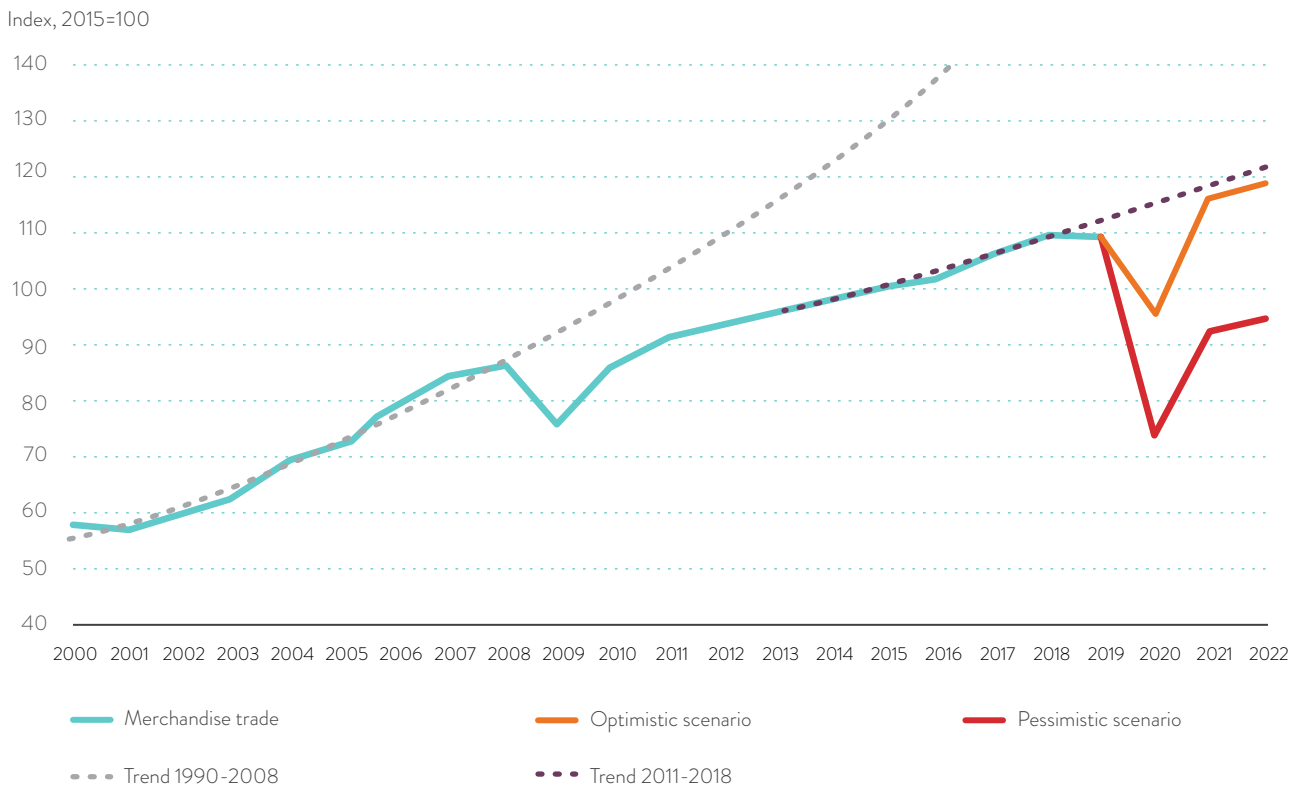
Globalisation has come under sustained attack in 2020. Reshoring to enable supply chain resilience and drive sovereign capability has become a popular rhetoric of governments internationally. Martin Wolf (in referencing Sebastian Miroudot from the OECD) reminds us of the difference between ‘resilience’ and ‘robustness’:

The former refers to the ability to return to normal operations after a disruption; the latter to the ability to maintain operations during a crisis. In a pandemic, the latter is probably the more relevant. The obvious way to achieve robustness is to diversify suppliers across multiple locations¹³.

While a singular focus on sovereign capability may impede the realisation of economies of scale, the cost of maintaining multiple supply chains, while seemingly robust, could actually become a very costly exercise.

Alarming, the impact of the pandemic has gone beyond a desire to ensure resilience. It has seen a precipitous fall in trade and investment. Steven Altman cites the WTO, UNCTAD and ICAO to highlight globally “a 13-32 per cent decline in merchandise trade, a 30-40 per cent reduction in foreign direct investment, and a 44-80 per cent drop in international airline passengers in 2020”¹⁴.

FIGURE 2. *World merchandise trade volume*



Source: WTO/UNCTaD and WTO Secretariat estimates.

There have been significant impacts felt by Australia, most notably on the international education and tourism sectors. Universities Australia forecasts a \$16 billion hit to Australian universities due to COVID-19 by 2023, with revenue losses in 2020 now forecast to be between \$3.1 billion and \$4.8 billion¹⁵. The tourism sector is forecast to take a hit of \$55 billion in 2020 relative to the \$138 billion of expenditure in the sector in 2019¹⁶.

On the other hand, the iron ore sector has had strong demand, prices and uninterrupted supply chains. The agricultural sector has reported minimal impact from COVID-19¹⁷. The Australian Government has played an important role in neutralising the impact of COVID-19 on the sector through targeted support in air, freight and logistics services. Across 11 commodity categories, the Australian Government has attributed the impact of COVID-19 on only two categories, seafood, meat and live animals. The impact on these two sectors is not immaterial. For instance, there is an expected fall of \$200 million in seafood export earnings with China in 2019-2020 attributable to the pandemic¹⁸.

There has also been exponential growth in e-commerce, with Australia Post reporting an 80 per cent increase in year-on-year sales in the eight weeks after the COVID-19 pandemic was declared by the World Health Organization¹⁹.

Australia’s position appears steadfastly in support of globalisation. The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), which came into effect on 5 July, marks yet another free trade agreement by the Australian Government to create preferential market access with a key economic partner. Ongoing significant efforts to engage more deeply with India, in addition to the India Economic Strategy to 2035 (IES), including through the recent virtual summit between prime ministers Morrison and Modi in June 2020, is reflective of the efforts being made to enable trade diversification strategies in both markets.

Australia remains heavily coupled with Asia from a trade and investment perspective. Seven of our top 10 trading partners are in Asia, and an increasing volume and deal value of inbound investments have come from Asia over the last decade, most notably from China, which still remains behind Japan in its stock of foreign direct investment in Australia²⁰. The US remains by far the largest investor in Australia.

Australia has also grown its outbound investments in Asia. Over the last 10 years Australian investment in Asia has grown almost four-fold from \$120 billion in 2009 to \$472 billion in 2019²¹. While it is true that Australia still invests more in New Zealand than it does in China and almost six times more than it invests in India (based on 2019 investment levels), the levels of Australian investment in Asia are steadily rising.



Key drivers of Australian engagement with Asia

Our analysis suggests that there will be five key drivers underpinning Australian engagement with Asia in a COVID-19 and post COVID-19 environment.

1. International cooperation will be ‘more, not less, important’

We believe that rather than a retreat to protectionist measures, Australia will continue to recognise that its future is inextricably linked to Asia. As our consultations have highlighted, in the sensitive area of healthcare, international cooperation will only become more important. For instance, with their large populations, Asian countries will serve as critical for Australian clinical trials in cardiovascular diseases or diabetes. In the midst of COVID-19, with significant rhetoric favouring sovereign capability, Australian researchers have been working with partners from the US, Asia and Europe to find a vaccine for the virus. The need for cooperation on grand challenges will continue to be self-evident.

2. Digital trade

The exponential growth in e-commerce highlighted previously and replicated across the world is highly likely to continue into the future. As McKinsey & Company highlights, consumers are accelerating adoption of digital sales channels and most first-time users are either satisfied or very satisfied with their experience and the majority plan to continue using digital channels in a post COVID-19 environment²².

As recent business performance highlights, Australian health and wellness companies have seen an increase in activity levels in China²³. We expect long-term e-commerce opportunities across China, South-East Asia and India for Australian companies.

3. International diversification for long-term value (China “plus”)

Australia remains one of the few countries in the world with a trade surplus with China. Sectors of the Australian economy, such as the mining sector, have deep long-term relationships with Chinese customers. The size of the Chinese market for Australian miners indicates that there may not be an equivalent alternative market. This suggests a ‘China plus’ strategy²⁴.

Customer diversification is generally well-understood by companies as they have to actively manage the risks of overexposure to one or a few customers. Developing alternative markets and customers is an increasing priority for Australian companies. The size of the domestic market will continue to drive Australian companies – large and small – offshore for growth. This offshore expansion will also increasingly couple trade with outbound investment, that is, investment will be necessary to be close to the end consumer. This will be particularly the case with the services sector.

4. Internationalisation is first about international best practice

The continued rise of Asian multinationals, technology companies and universities is likely to drive technological trends, management practices and leadership approaches going forward. Learning from Asia rather than teaching Asians best practice will increasingly become the norm. With several Chinese, Indian, Japanese and South Korean companies being global leaders across verticals, they are highly likely to be natural partners for Australian companies in third country markets in the region. Strategic alliances and joint ventures with Asian companies could involve significant technology and knowhow spillovers to Australian companies.

5. Regionalism is the new globalism

As McKinsey & Company highlight, a growing level of Asia’s trade is intra-regional as is its cross-border investment²⁵. For instance, 60 per cent of goods traded are within the region, 59 per cent of investment is intra-regional and 74 per cent of Asian travellers travel within the region. This means that Australia will need to increasingly compete for a share of Asian trade, investment and tourists as they increasingly migrate towards integration within their own region.

OUR APPROACH AND METHODOLOGY TO WINNING IN ASIA

The focus of this report is on addressing the various misconceptions Australian boards, senior executives and investors have of the challenges of doing business with the Asian region. We address the perceived challenges with rigorous, evidence-based analysis across four areas:

1. The relationship between offshore expansion and returns

We examine the relationship between market diversification and returns to understand if internationally diversified companies perform better than those that are domestically focused. This is a threshold question essential to influence Australian business leaders of the size, scale and quality of the market opportunities in Asian markets. We compare the ASX 200 to peer companies from other regions, evaluate the total shareholder returns of internationally diversified and domestically focused companies, and assess the factors that support internationalisation.

2. Business models to succeed in Asia

We apply a three-part framework to understand business models, including, criteria for assessing opportunities in Asia, capabilities to execute and modes of entry. We examine case studies of non-Australian and Australian companies that have successfully entered Asian markets. We use a combination of quantitative evidence of market share, performance and returns (with the non-Australian company case studies) and qualitative commentary developed with C-suite executives (with the Australian company case studies) to draw out the specific strategies and business models that have led to success. We cover a mix of public and private companies.

3. Capabilities to execute in Asian markets

We assess the Asia capabilities of the boards and senior executive teams of the ASX 200 to understand if our senior leaders have the capabilities to create and execute strategies in Asian markets. Using a proprietary methodology, we study over 100,000 data points of evidence of Asia capabilities in a pool of 1,705 board members and senior executives. Through extensive stakeholder consultations of senior leaders we identify constraints on our companies engaging effectively with Asian markets and make specific recommendations to overcome the constraints.

4. External engagement for risk mitigation and impact

We assess the critical impact of external affairs to manage stakeholders, brand and reputation in Asian markets. We compare and contrast Australian external affairs functions to their international counterparts, evaluate the optimum size, composition and focus of external affair teams, and present new ideas to foster more effective media and communications engagement by Australian company executives.

Key principles driving our approach:

- 1. Co-development:** The report reflects the collaborative partnerships developed with knowledge partners including the Boston Consulting Group, Cooper Investors and Ellerston Capital. These partners were seen as critical to complementing Asialink Business' strengths in providing rigorous, evidence-based quantitative analysis for the first two sections of the report (on international expansion and returns and business models). Asialink Business ensured a similar rigorous approach to the third and fourth focus areas of the report (on capabilities and external affairs respectively).
- 2. Stakeholder consultations:** Co-development with knowledge partners was complemented with extensive stakeholder consultations with senior leaders, typically board members and C-suite executives of Australian public and private companies. The consultations ensured that there was incisive qualitative commentary to support the quantitative findings.
- 3. Focused data set:** The data set focuses primarily on the ASX 200. The ASX 200 was a focus of the report as a result of significant stakeholder consultations over the last five years indicating that there was a perception that this segment of the Australian workforce was underweight with its engagement with Asian markets. The ingenuity of small and medium enterprises (SMEs) has been recognised in other significant research. For instance, recent research undertaken by Asialink Business with the Commonwealth Bank of Australia has focused heavily on SME engagement with Asia²⁶. In *Winning in Asia*, we selectively complement the analysis on the ASX 200 with analysis of private companies to compare and contrast their orientation, business models, leadership capabilities and mindset.
- 4. Data-driven:** Our analysis in this report includes over 300,000 fresh data points of analysis. An important principle for the project partners was to ensure that the direction, findings and recommendations presented in the report reflect genuinely new, well-researched, and evidence-based analysis.
- 5. Strategies based on evidence:** The final section of the report presents strategies for our corporate sector, government, peak bodies, and the broader workforce to drive a winning formula with Asian markets. Each strategy prescribed is based on evidence-based findings reflected in the report.

Diversification – Markets, services and models

Previous Asialink Business research has highlighted that accessing non-resource sector opportunities in Asia with the right business models and capabilities could add up to \$275 billion to the Australian economy²⁷. Asialink Business' research has also highlighted that driving greater services sector engagement with Asia could add more than one million jobs to the Australian economy by 2030²⁸. Combining the strengths of our resources sector with the potential of our services sector provides us with an exceptional portfolio of companies that can pursue opportunities with Asia.

Our top companies are central to realising these goals. This report focuses on ensuring that they access the right opportunities, execute the right business models, utilise the best capabilities and navigate risks effectively. In the current low to negative growth environment with high levels of unemployment, winning in Asia through the blueprint in this report is essential.

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Printed in Australia.



Australian Government
Department of Industry, Science,
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**THE MYER
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*Asialink Business is supported by the Commonwealth Government Department of Industry, Science,
Energy and Resources, The University of Melbourne and The Myer Foundation.*