Passing us by

Why Australian businesses are missing the Asian opportunity. And what they can do about it.

2025

By 2025 Asia will produce half of the world's total economic output

9%

Only 9% of Australian businesses are currently operating in Asia

3.2bn

Asia's growing middle class will reach 3.2 billion people by 2030

65%

Nearly two-thirds of Australian businesses have no intention of changing their stance in the next 2-3 years

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This report refers to ASEAN countries and Asia.

ASEAN is made up of Singapore, Malaysia, Thailand, Brunei, Vietnam, Indonesia, Cambodia, Philippines, Laos and Myanmar. When we talk about Asia we mean the ASEAN countries plus China mainland, Hong Kong, Macau, Taiwan, Japan and South Korea.

About the research

The findings of this report are based on a quantitative survey (n= 1,013) and in depth interviews (n=70) with a representative sample of Australian businesses, conducted by Roy Morgan Research and PwC Australia between August and November 2014.

We wish to thank the many individuals and organisations who contributed their time and countless insights to this research. There are too many to name here but you know who you are and we are deeply grateful.

All $ values are stated in US dollars unless otherwise indicated.

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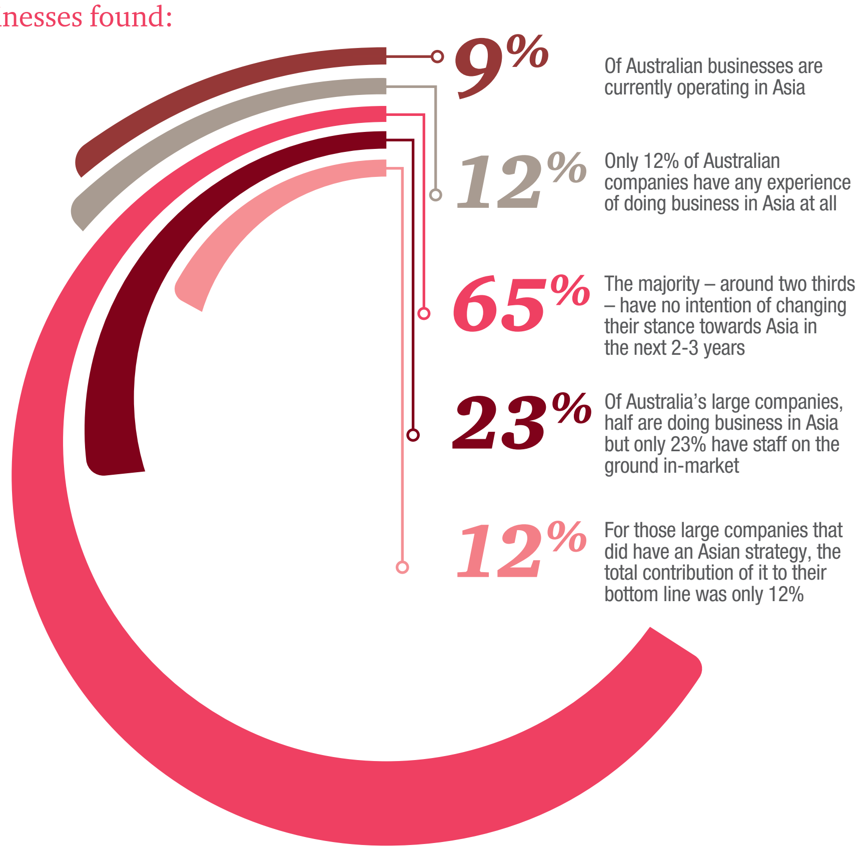


Executive summary

Few would argue that Asia is an economic powerhouse and is growing fast. As a region it's our biggest trading partner. And with the signing of new Free Trade Agreements(FTAs) and the development of the ASEAN Economic Community, it's likely that Australia's trade with Asia will continue to grow.

Whilst this is good news on one level, it masks the fact that the majority of Australian businesses are missing an even greater opportunity – to participate more directly in the growth of the Asia region.

Australia's export trade relationships with Asia are largely built around bulk commodities. Although important for our recent economic prosperity, this kind of bi-lateral relationship does not include direct investment in businesses and markets in the region. If we are to participate in the growing consumer markets in Asia as more than a farm or quarry, we need to actively engage and invest more in Asian countries. We cannot rely on our rich endowment of natural resources for our economic future forever.

But our level of investment in Asia is woeful. Last year, just 5.7 per cent of Australia's foreign direct investment went into ASEAN countries. By contrast, we invested more in New Zealand, a country with less than four and a half million people and Gross Domestic Product (GDP) growth of 2.5 per cent. Australian businesses are looking offshore for growth but are largely ignoring the world's fastest growing region.

We wanted to find out the real extent of Australian business involvement in Asia, as well as identify what was stopping companies from embracing the opportunities on their doorstep. So we surveyed more than 1,000 – across the full spectrum of Australian business – and spoke in-depth to 50 to find out what was driving decision-making.

Our research found:

- Only 9 per cent of Australian businesses are currently operating in Asia and only 12 per cent have any experience of doing business in Asia at all.
- The majority – around two thirds – have no intention of changing their stance towards Asia in the next two to three years.
- Of Australia's large companies, half are doing business in Asia but only 23 per cent have staff on the ground in-market.
- For those large companies that did have an Asian strategy, the total contribution of it to their bottom line was only 12 per cent.

These results clearly show that Australian business is a long way from the level of engagement, investment and commitment needed to secure a long-term share of the region's growth.

Australian companies have struggled to execute in Asia. The biggest issues seem to have at their core, problems in relation to culture, our willingness to deal with change and our ability to manage and operate in an Asian environment. Putting it bluntly, Australian business has operated in a relatively sheltered, comfortable competitive environment. And we have become complacent.

But how much longer can we afford our complacency? Globalisation and technology are tearing down geographic barriers. We are seeing world class competitors emerge in Asia with the scale necessary to support lower cost bases, greater innovation spend and brands that are changing the face of business.

To be sure, there are risks and challenges and these markets are difficult and involve long dated investment cases.

Companies that are now successful in Asia arrived there up to 15 years ago, and they made their business plans and investments work. Along with large local businesses, they are now the competition.

However the biggest risk of all may well be doing nothing. If we want to grow – and defend our home markets – Australian companies need to significantly lift their engagement with Asia, up-skill themselves in doing business there and invest more in the region.

The Asian Century White Paper made a powerful case for Australian business but we have been slow out of the gates.

The opportunity for Australian businesses to get a substantial foothold in Asia is passing us by and we need to act now. This may well be our last chance.

Despite the challenges it certainly is possible to succeed in Asia. For those companies that have done their homework and committed to a long-term plan, Asia is – and will continue to be – an important source of growth. It's now up to the rest of Australia's talented and innovative businesses to embrace the challenge too.

> ***"The scale and pace of Asia's transformation is unprecedented and the implications for Australia are profound."***
>
> Australia in the Asian Century White Paper

Based on our experience, here are eight fundamentals that companies developing their growth strategy for Asia need to get right:

1 *Lead with strategy and take a portfolio approach*

2 *Invest in learning the culture*

3 *Don't be fooled by 'Guanxi'*

4 *Understand 'uniquely Asian' market dynamics*

5 *Keep timelines realistic and be patient*

6 *Proceed with caution*

7 *Triangulate your information*

8 *Go easy on the integration and remember the 80/20 rule*

The state of play

Whilst we trade with Asia, we don't invest in Asia. Australian businesses invest more in New Zealand and only 9 per cent operate in Asia.

The pace of change in Asia of the past few decades has been extraordinary. In 1980, the region accounted for approximately 20 per cent of global GDP. It's now close to 40 per cent. By 2025 Asia will produce half of the world's total economic output.

Asia has, and will continue to be, an important trading partner for Australia. It is home to six of our top 10 global trading partners and, as a region, is our largest trading partner. In 2013 the value of goods and services exported to Asia increased 10.6 per cent to around AU$219 billion, or nearly 70 per cent of Australia's total exports, most of which was concentrated in the resources industry.

Recent Free Trade Agreements (FTAs) with Japan and Korea along with the conclusion of negotiations on the China FTA, the formation of the ASEAN Economic Community and the Trans Pacific Partnership (TPP) will only serve to further facilitate the growth of trade and investment.

But despite the region's tremendous economic growth and despite our trade ties, Australian businesses are still significantly under-invested and under-engaged in Asia.

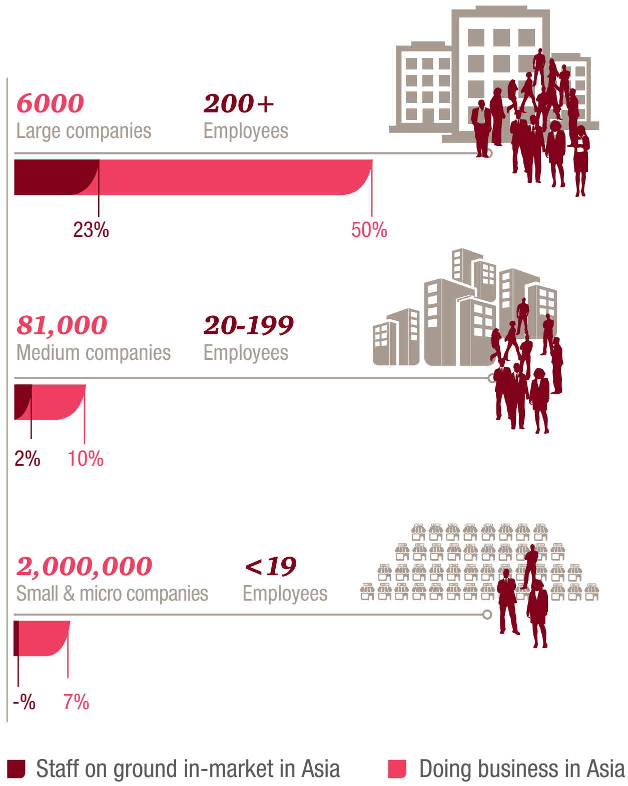
Australia's recent economic prosperity has in part been due to our rich endowment of natural resources, coupled with our close proximity to Asia. These are assets we cannot rely on alone to guarantee prosperity in coming decades.

> *We are already running late in engaging with Asia while so many parts of the world are already there, more than successfully, and well ahead of us."*
>
> Harold Mitchell AC, Founder Mitchell and Partners

Only 9 per cent of Australian businesses operate in Asia

Our survey of over 1,000 Australian businesses found just 9 per cent are currently operating in Asia. Only 12 per cent have any experience of business in Asia at all. And the majority – around two thirds – have no intention of changing their stance towards Asia in the next two to three years.

Figure 1. The Australian marketplace



Of Australia's large companies, half are doing business in Asia but only 23 per cent have staff on the ground in-market. And when we drilled down into what they were actually doing, it was clear that in many instances their business consisted of little more than shop-fronts or offices to source goods, or outsourcing part of their business functions. For those large companies that did have an Asian strategy, the total contribution of it to their bottom line was only 12 per cent.

It's a long way from the investment and commitment needed to secure a long-term share of the region's growth. Such investment could take many forms: partnership, joint venture, alliance, traditional mergers and acquisitions, or starting a greenfield operation.

Figure 2. Types of activities currently undertaken by large Australian businesses in Asia

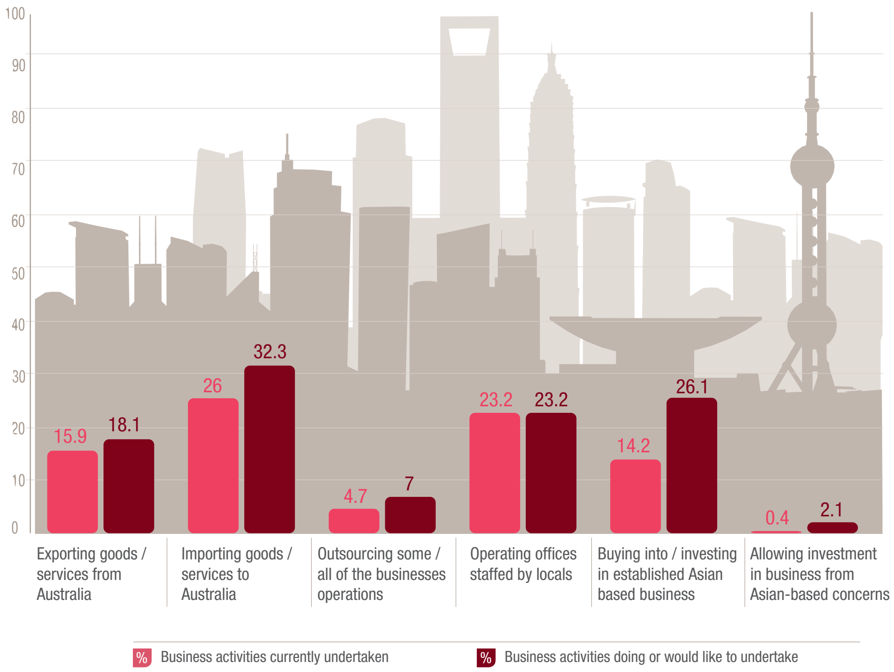
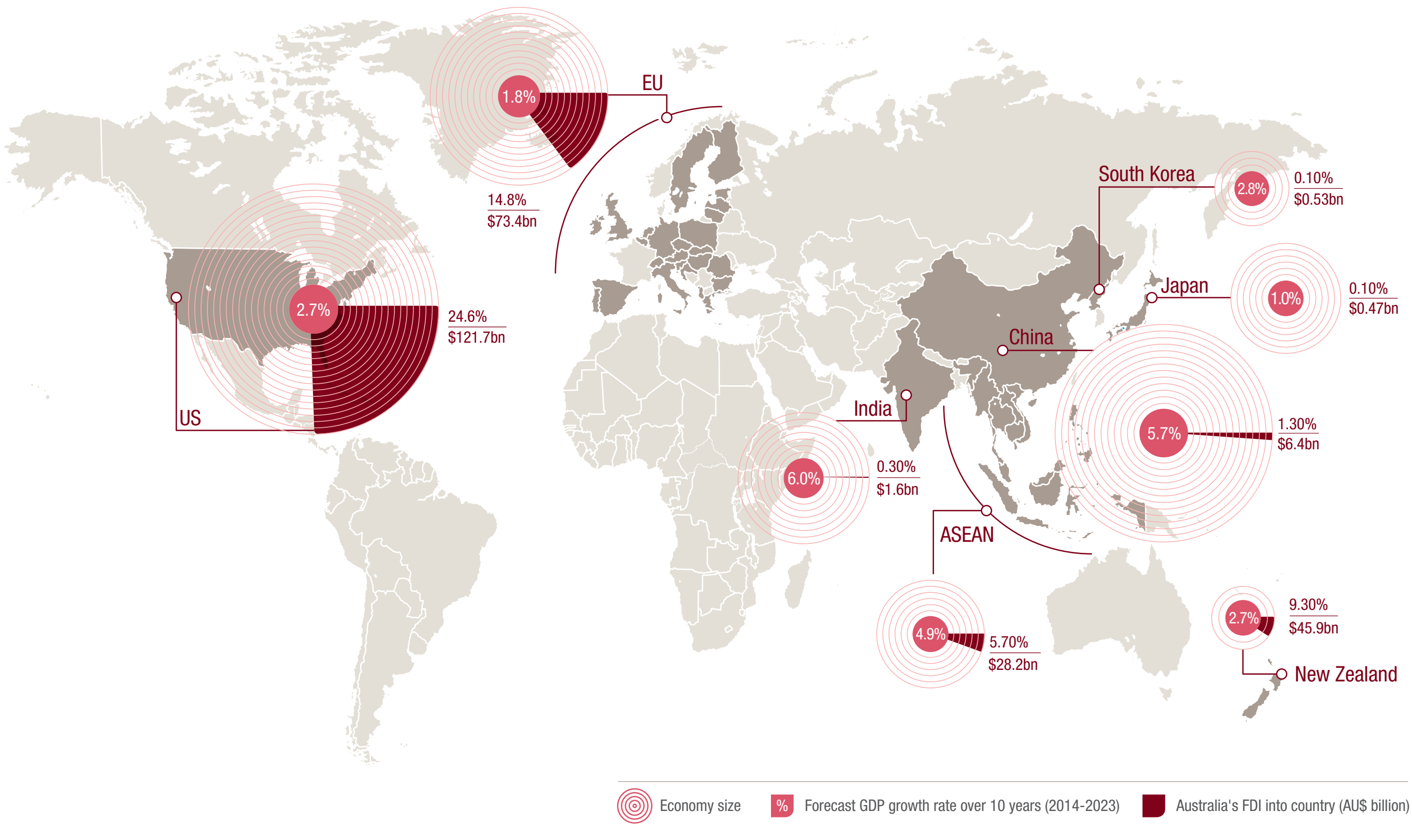


Figure 3. Destinations for Australia's FDI relative to GDP growth and market size



"You say you want to be part of Asia but we don't know what you mean."

Suryo Sulisto, Chairman, KADIN (Indonesian Chambers of Commerce)

We're investing more in New Zealand than Asia

The low level of effective engagement by Australian businesses in Asia is further evidenced by statistics about our foreign direct investment (FDI).

Whilst Asia ranks as Australia's largest export market, just 8.1 per cent of our total FDI stock in 2013 was in the region. This is on par with the EU but behind the US. And it's significantly behind Japan, South Korea and more recently, China, all of which have made much larger Asian bets.

We are also well behind others when it comes to investment in ASEAN countries. Japan has more than doubled and China more than tripled their investments in these countries since 2007. The EU is one of the leading investors, contributing 22.4 per cent of total FDI inflow to ASEAN countries from 2011 to 2013.

Australian businesses on the other hand continue to focus their investment activities in lower growth markets. We invest more in New Zealand – a country of less than four and a half million and 2.5 per cent GDP growth last year – than we do in both China or Indonesia, which have been growing at around 7-8 per cent and 5-6 per cent respectively for the last five years. In fact, we have invested more in New Zealand than all ASEAN countries combined.

The opportunity we're missing

Australian businesses say they are looking offshore for growth, yet they are largely ignoring the world's fastest growing region. The opportunity is right on our doorstep but we need to act now. This may well be our last chance.

“

Europeans are aware the growth for them is in the Asia region and recognise that they have no growth and thus need to access this market for future growth. A valuable lesson for Australia.”

A senior director in a major Australian manufacturing business

Asia’s economic transformation presents a compelling opportunity for Australian businesses. The region is characterised by large population pools and a growing middle class. This middle class, which already numbers around 500 million, approximately half of whom are under the age of 30, is expected to increase more than six-fold in just over 15 years time. That’s a staggering 3.2 billion – or 66 per cent of the world’s middle class – by 2030.

This growth translates into rising demand for a broad range of consumer products and services, including those that Australia does well – food, education, tourism, health and financial services. Compared to more mature global markets, in Asia the demand for these types of goods and services is still relatively under-supplied.

Asia also has immense infrastructure needs. According to the Asian Development Bank, an estimated $8 trillion will need to be spent on infrastructure by Asian countries in the next 10 years to support forecast rates of economic growth.

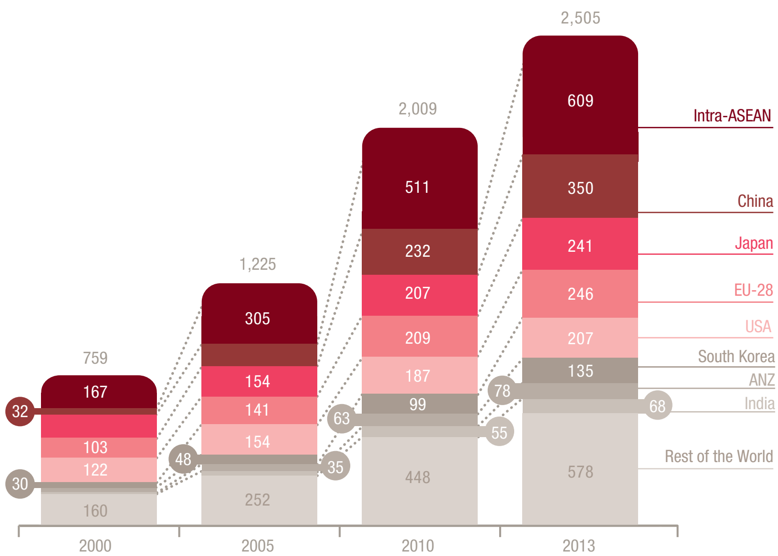
Asian economies are increasingly sophisticated and connected – both globally and within Asia itself. Intra-Asian trade was $3 trillion in 2013 and is predicted to exceed intra-Europe flows to become the world’s largest trading network by 2016. And intra-ASEAN trade topped $600 billion in 2013 up from $167 billion in 2000. The formation of the ASEAN Economic Community, planned for December 2015, will create a $2.4 trillion economy – the seventh largest in the world.

The opportunities are considerable, but so far remain generally overlooked by Australian businesses. Our existing relationships with Asia are largely built around our exports of bulk commodities, which alongside human capital are our predominant sources of competitive advantage. If Australia is to participate in the growing Asian consumer economy as more than just a farm and a quarry, we are going to have to engage and invest more in Asia’s markets and businesses. And this means coming to terms with some hard facts about the region and the changing dynamics of global business.

Much more than a cyclical growth spurt

The industrial and economic landscape of the world has changed irrevocably. And it is more than just a shift from West to East. The rise of Asian economies will lead to nodes of new growth throughout the world – both

Figure 4. Growth of trade flows within ASEAN



Source: ASEAN Community in Figures 2014 Special Edition

> *Those who are successful in growing their Asia business will often be far more successful than their peers who stay local. They will sometimes go through a lot of pain but those who stay the course can often rocket past those who stay at home."*

John Colvin, CEO and Managing Director, Australian Institute of Company Directors (AICD)

between advanced and emerging markets, and within emerging markets themselves. The effect on companies from the developed world will continue to be profound.

Globalisation, fuelled by technology, is changing traditional business models and removing the protections historically offered by geography and borders. Australian companies are not only dealing with traditional competitors from developed markets – they will also face increasing competition from world-class businesses from emerging markets, including those in Asia. These competitors have significant advantages, bringing formidable scale, low cost bases, strong brands and innovation to the market.

Chinese companies are going global

A recent report by Strategy& on the Global Innovation 1000 – a measure of the world's top spenders on R&D – found that only eight China based companies made the list in 2005. But by 2014 that number had jumped to 114. In contrast Australia had two companies in the list in 2005 and five in 2014. The report also found Chinese companies are also increasing their R&D spending much faster than companies in other regions: in 2014 the rate of increase was 46 per cent, compared with rates in the low single digits in Europe, North America and Australia.

China has eight companies in the world's top 100 by market capitalisation, which puts it in equal second place alongside the UK (the US is first with 47 companies). Alibaba Group's September IPO has propelled it into the top 20 companies globally (joining Petro China in the list) with a market capitalisation of around $250 billion, larger than Wal-Mart and nearly double that of Australia's largest company BHP Billiton.

Private Chinese companies have been hugely successful in building global brands like Haier (who acquired Fisher & Paykel in 2012), Lenovo (who acquired IBM's personal computer division in 2005 and in 2014 has acquired Motorola Mobility from Google and IBM's server business) and Huawei, the telecommunications equipment supplier. Few would have heard of these companies before the global financial crises.

Clearly, Chinese companies are going global on an unprecedented scale. To their advantage, they have significantly lower cost bases and higher levels of productivity and they are here now changing the face of industries that are not protected by regulation. One need only look at Australia's own manufacturing industry for evidence of the profound impact of this change.

The opportunity is passing

These business and market dynamics represent a fundamental transformation in the structure of the global economy. It is not simply a cyclical phenomena resulting from the global financial crisis. This is a critical distinction that too few Australian boards, corporate executives and business owners appreciate.

Moreover, many Australian businesses fail to appreciate that the window of opportunity to get a foothold in Asia is fast closing. Companies that are now successful in Asia arrived there approximately 15 years ago, and they made their business plans and investments work. They, along with large local businesses, are now the competition – and they are world class competitors.

Considering the level of investment already made by others, and the time required to get established in Asia, Australian businesses may only have a brief time in which to act if they want to be future contenders in the region.

> *The best time to plant a tree is 20 years ago."*

Chinese proverb

What's holding Australian businesses back?

Our biggest challenges are in relation to culture, our willingness to deal with change and our ability to manage and operate in an Asian environment.

If investing and doing business in Asia were simply 'too hard' then very few countries would be doing it successfully. But that's simply not the case. China, Japan and Korea have all successfully invested across Asia to a much greater extent than Australia. Global brands from Europe and the US are also well established with strong local connections and partners.

This suggests there is something else holding Australian business back. We wanted to know precisely what this was. So we asked them.

We surveyed more than 1,000 directors and owners across the full spectrum of Australian business, from the small to the very large. We also spoke in depth with over 50 senior executives to get a deep understanding of their thinking and decision-making processes.

The biggest issues seem to have at their core, problems in relation to culture, our willingness to deal with change and our ability to manage and operate in an Asian environment. Putting it bluntly, Australian business has operated in a relatively sheltered, comfortable competitive environment. And we have become complacent.

Our investigations show business owners and executives think Asia is 'very different', and for many, uncomfortably so. We identified the following key reasons, which in many cases are no more than excuses, explaining why Australian business is still failing to grasp the opportunity that is Asia.

Perception that there are too many barriers

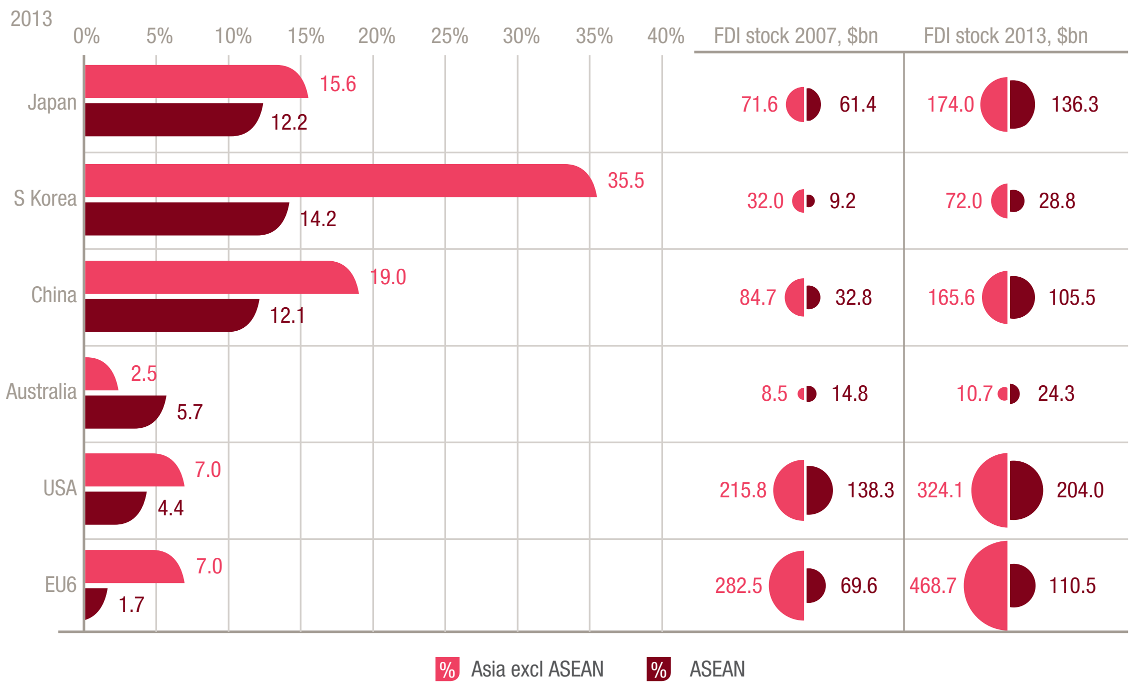
Many Australian business executives have strong preconceived views that it is difficult to do business in Asia. The key barriers cited are: corruption, cultural differences, uneven playing fields, legal barriers and trade barriers. As one respondent said "Corruption is the one we're most aware of. We've got to make sure what we're investing in and who we're investing in is legitimate."

Interestingly, perceived barriers are the same – in terms of the order of importance – whether or not a business has actual experience in Asia or not. This suggests there is a consistent 'folk lore' that circulates in Australian business circles and permeates – and perpetuates – the discourse about the challenges of doing business in Asia.

ANZ's Senior Managing Director Institutional and Corporate Relationships, Mark Monaghan puts it succinctly: "Fear is a great motivator, and can be a motivator to do nothing. There is fear of failure in Australian corporates when it comes to Asia."

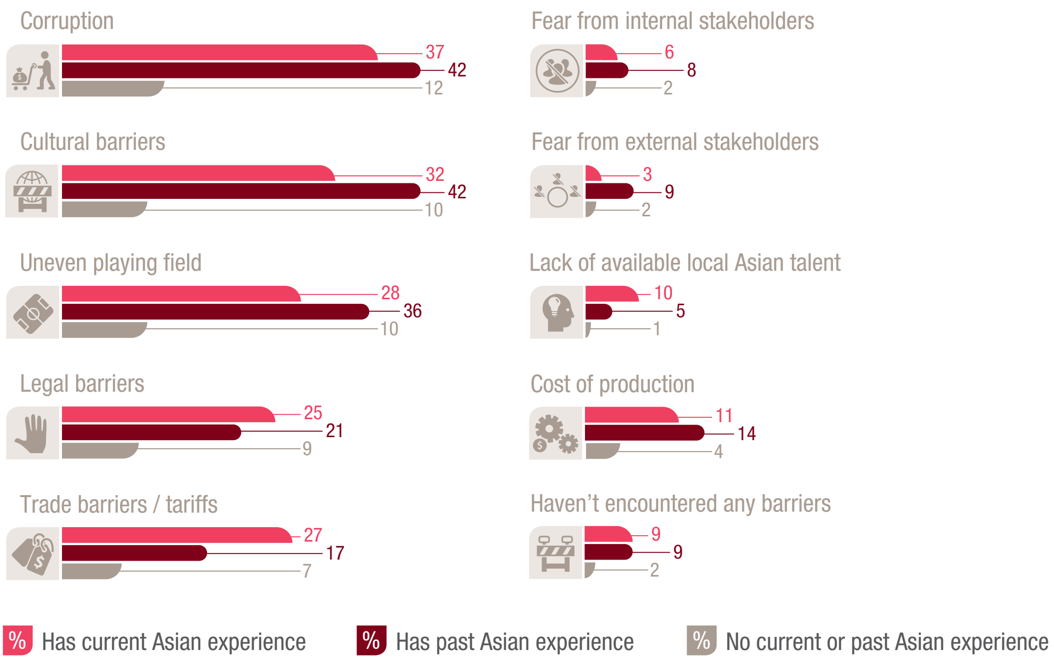
> *"Australian companies are late to the party and this is holding their success back."*
>
> Richard Nunn, General Manager Strategic Development and Performance, NAB

Figure 5. Proportion of total FDI that countries direct towards Asia



Source: DFAT, Bank of Japan, JETRO, Australian Bureau of Statistics, Heritage Foundation, OECD and PwC Analysis

Figure 6. Experienced or perceived barriers to doing business in Asia



> *There is certainly more to be done to raise awareness of opportunities in Asia and we place a high priority on this. Providing Australian businesses with access to networks and quality information are key to the work of our teams across Asia, which account for 60% of our international network."*
>
> Bruce Gosper, Chief Executive Officer, Austrade

Lack of knowledge

We found that it is increasingly common for Boards to hold meetings in Asia, and for directors to travel to overseas operations to build their understanding of local markets. However around 40 per cent of directors and executives surveyed said they had problems finding reliable information, market data or knowledge about doing business in Asia.

And many were unclear about knowing where to go for help. When asked unaided which, if any, government agencies they thought could help them do business in Asia, almost half the respondents (47 per cent) couldn't name any. And more than 80 per cent could not name any sources of help that were non-government.

Richard Nunn, General Manager Strategic Development and Performance, NAB Asia, recognizes the importance of understanding market conditions: "Companies need to get advice prior to their launch, planning or expansion. They need to know the different challenges across the different markets. Industry insight in the region is key."

Satisfaction with status quo

Based on our in-depth interviews there was also a strong sense that those companies not doing business in Asia were often happy with the way things were, and could not see a compelling reason to change. As one respondent said bluntly: "We want to maintain the status quo, and so there's no real reason to [grow in Asia]."

This is a curious finding considering Australian businesses are, in fact, concerned about growth. Another recent survey of Australian CEOs by PwC found one quarter were less confident of margin growth in domestic operations compared to a year ago, and about 40 per cent were unchanged. Only 30 per cent were more confident.

It's almost as if there is a blind spot on the radar of Australian businesses. They are looking for growth yet seem unwilling or unable to engage with the region consistently delivering the strongest rates of growth anywhere in the world.

Belief there is no market for products or services

There was a strong belief among more than a third (35 per cent) of all businesses that there was no market for their products or services in the Asia region.

But this belief does not accord with the facts about the rising middle class in Asia and the level of unmet demand for goods and services in this market. The sorts of things that Asian consumers increasingly demand are the very same that Australian businesses have been offering for decades – high quality food and agricultural produce, health care, financial services, professional services and education.

And according to Hiroshi Fujikawa, Managing Director South East Asia, Kirin Holdings Singapore, Asians like Australian brands, which they see linked to our way of life. “Australians under-estimate the value of brand Australia, which stands for natural, safe, pure and quality.”

Short-termism

Investment requires the outlay of money for capital and operating expenditure that might not produce returns for years. Several respondents felt that their organisation tended to prioritise resources, people and capital around things that will benefit the incumbent CEO and perhaps the successor – but often not those who follow further down the track.

There was a common belief among the business executives we spoke with that this behaviour is driven by market analysts and fund managers, who demand short-term returns. These behaviours are further reinforced by so called ‘long-term’ management remuneration plans that often have three or five-year performance hurdles. With the average tenure of an ASX 200 CEO of about four years, it is hardly surprising that there is often a struggle to get more funds allocated to help with the move into Asia.

As Grant Dooley, Head of Asia at Hastings Funds Management said: “Companies need more patience and need to allocate resources accordingly. The temptation is to bail out when things are not meeting initial, often unrealistic, timelines.”

There was also a strong belief – which is supported to some extent in reality – that market analysts and fund managers deem Asia risky and long-term, and apply a valuation penalty to deals or market plays in the region.

It is right to say that there is risk attached to an Asian investment, and that risk does need to be valued. The question becomes one of whether an Australian management team is better placed to manage the risk, as opposed to the alternative of investing directly. If companies make investments in Asia in a similar way to how they might approach an investment in their own backyard, then the answer is probably ‘no’. So a new approach is required to reconcile strategic intent with market pragmatism.

The fact is that it can take time to become competitive in new markets, so a long-term view is essential. As Bob Seidler AM, Chairman of Hunter Phillip Japan Limited observed: “ It takes at least 10 years or more to build your business in Australia but Australian companies set short term targets for success when establishing a business outside Australia. This is even harder in Asia where language and cultural differences exist.” The important point for companies is that there needs to be a strong conviction to the strategy, a clear articulation of the strategy for investors and complete alignment between the Board, the Chairman, CEO and management team.

> **“**
>
> ***In terms of what is holding businesses back – it is probably the focus on expecting short term pay back on Asian investments. My 20 years living in Asia has taught me that one must choose partners wisely and be patient…”***
>
> Anthony Fasso, CEO International and Head, Global Clients, AMP Capital Investors

> **“**
>
> ***… we continue to see [ANZ’s Asia expansion] as a long term strategy which bears higher risk and potentially higher reward.”***
>
> Nomura analyst Victor German, quoted in the AFR, 30 October 2013

We don't know them. We need to understand them."

Harold Mitchell AC, Founder Mitchell and Partners

There is not a lot of amplification of success stories, we hear a lot of tales of woe though. Maybe it is just the Australian psyche."

Mark Monaghan, Senior Managing Director Institutional and Corporate Relationships, ANZ

Fear of the unknown: culture, language and traditions

A consistent and powerful theme running through all our research was that Australian businesses have a general 'fear of the unknown' when it comes to doing business in Asia.

This is due largely to differences in cultural practices, traditions and, of course, language. As one respondent said: "I just think it's a whole different ball game. If you tap into Asia, you're dealing with corruption, communist countries, and fragile democracies. You'd have to learn the cultural side of things, which is why it is unattractive."

Language is an important window into culture, but unfortunately Australians have relatively low Asian language capabilities. Of the approximately 70,000 students enrolled in the NSW Higher School Certificate in 2014, only 2.2 per cent studied Japanese, 1.3 per cent studied Chinese and 0.3 per cent studied Indonesian. This needs to be addressed in part by Government through our education system, and supported by business.

Our education sector also has a critical role to play in supporting the education needs of a growing Asian middle class. This is not just a business opportunity for the education sector, but also an important component of a national agenda. It would both improve our understanding of Asia through better education opportunities, and improve the talent pools available in Asian markets for Australian companies.

The Australian Government's New Colombo Plan, Asian Literacy Program and the "Economic Diplomacy" program are examples of how Governments can help build two-way trust and better cultural understanding.

Interestingly, the fear of the unknown was not a barrier to those businesses that were actually operating in Asia, or had recent past experience. Their view of Asian culture was largely positive, and they were complimentary about the level of local commitment, expertise, cooperation and willingness to engage and assist, that they experienced in Asian countries.

It seems that fear of the unknown is just that. Once businesses actually take the step and do business in Asia, the experience is very different to what they imagined it would be.

IAG Chief Executive, Asia

Duncan Brain

The decision to go into Asia was essentially around driving long-term growth for the Group, according to the CEO of the IAG's Asia business Duncan Brain.

"Why Asia? Large market shares in IAG's home markets reduces growth prospects, whereas in Asia long-term growth and the right type of metrics around its developing status make it attractive, and of course its low insurance penetration.

"It's also close. Having similar time zones also makes it a much more attractive emerging market than other markets around the world."

IAG had quite a detailed mix of more than a dozen criteria to define which Asian countries were developed enough to enter, but not so advanced they lost some of the attractive metrics.

"For example, we never pursued Laos and we never pursued Japan, but rather looked at the markets in the middle."

In terms of what it takes to be successful in Asia, Duncan says finding the right partner, and then managing that relationship well, is critical.

"You need to find the balance between meeting your own business agenda, and meeting that of your partners'.

"An initial learning for us was getting the pace right and not trying to do too much all at once, nor being too aggressive by pushing our local partners and local management too fast."

And a critical part of managing the relationship well is having an understanding of, and respect for, cultural differences.

"You can build credibility through showing understanding and empathy for local staff, local customs and local culture. These things all contribute to your ability to get things done within a broader agenda," says Duncan.

8 fundamentals for success in Asia

Success in Asia is possible. But businesses need to be aware of the unique risks and challenges the region presents. Above all, they need to plan ahead, do their homework and be patient.

When we asked Australian directors, executives and business owners what they thought were the key characteristics needed for success in Asia, about half identified the following: adaptability, having a long-term view, relationship orientation, open-mindedness.

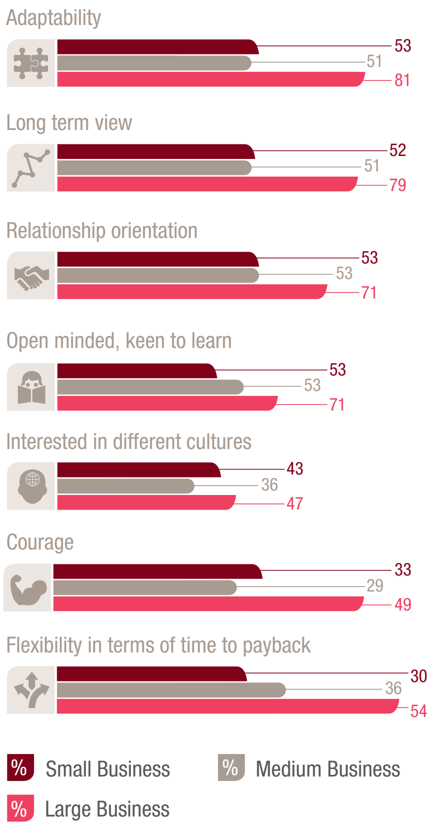
It appears that many Australian businesses have a reasonable idea of what's required – but a majority has failed to translate recognition of key success factors into an ability to execute.

One of the single biggest challenges we see when working with businesses is the systematic need to do something – urgency, for example – to sign the deal. This simply does not work in Asia. Businesses that want to succeed must learn to adjust.

The business environment in Asia is more nuanced and complex than most businesses appreciate. But that just means companies need to invest the time to get a better understanding of what they are facing.

The best way to navigate the risk-opportunity tightrope is to adopt a strategy informed by accurate information and trusted partners with deep local insights and experience. To be sure, the business climate is not straight-forward and the opportunities are not risk free. But the biggest risk in relation to Asian markets could be to continue ignoring them.

Figure 7. Perceived characteristics needed for success in Asia



Australian companies can be successful in Asia and indeed many already are. In seeking out growth in the Asian region, companies require direct in-market insight, corporate strategies and tools that map out and support decision making. Based on our experience, here are eight fundamentals that companies developing their growth strategy for Asia need to get right:

1. *Lead with strategy and take a portfolio approach*
2. *Invest in learning the culture*
3. *Don't be fooled by 'Guanxi'*
4. *Understand 'uniquely Asian' market dynamics*
5. *Keep timelines realistic and be patient*
6. *Proceed with caution*
7. *Triangulate your information*
8. *Go easy on the integration and remember the 80/20 rule*

1. Lead with strategy and take a portfolio approach

Australian companies have strong brands, systems and know-how that can provide significant competitive advantage in Asian markets. On the other hand, local competitors have cost efficient business models and local knowledge. This often places them in a stronger position than a new market entrant.

Companies need to be clear on what it is that makes them unique and what they do better than any other company, and then build a growth plan around it. Start your strategic thinking by asking, "What is our competitive advantage and why will customers be interested in me."

For an investment proposition, the question becomes "What is the strategic hypothesis we have to believe if we are going to invest?" Companies tend to think their own way of doing business or their business model will work in new markets – but all too often it is not the case. Take the time to understand how you will 'win' in a new Asian market then measure how your choices and investments are staying true to that strategy with a laser focus. When we engaged with the fund manager and analyst community on this issue, they emphasised the importance of staying focused.

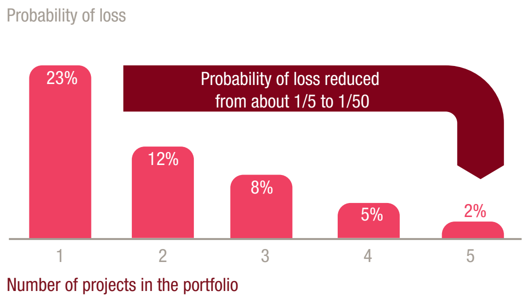
You can't look at an Asian market entry business case through the lens of your organisation's home market. Companies need to adapt their decision-making and valuation models and how they think about risk in the context of these market entry decisions.

Businesses often pick an Asian partner first and then develop their strategy for Asia. Partnerships designed this way are often ill conceived and limit strategy formulation and execution.

We suggest that a capability led approach is more effective. This means businesses should first determine their value proposition, then how they will execute and map the range of capabilities required. Once capability gaps have been identified they can decide how best to fill those gaps and search for the best partner(s) to fill them. Despite fears of the unknown,

Figure 8. How portfolio reduces risk

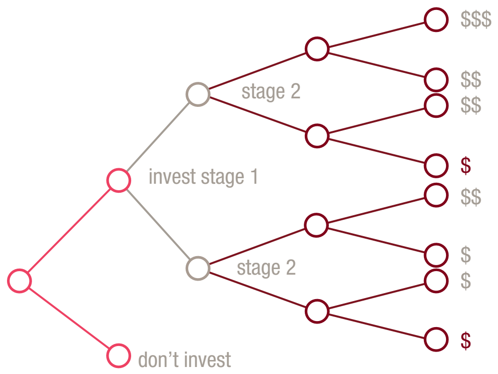
Portfolio effect



Scenario ROI per project: Expect 20%, best 200%, worst -50%.

An organisation can invest in a single large project or a portfolio of projects. Diversifying projects with equal high risk into a limited portfolio can significantly reduce the risk of loss. In this example, the probability of loss is reduced from 23% to 5%, when the number of projects increases from one to five.

Value created by staging investments



Staging investments can create significant value due to the final commitment of capital being delayed until after management can gauge performance against an initial hurdle. This creates flexibility of response which is valuable for risky or marginal projects. In this example, there is an 80% uplift - from 6% to 11%.

NPV as % of invested capital	%
Value proportion if staged	11%
Value proportion single stage	6%
Value created by staging	5%

Although illustrative these examples are based on a proven and scalable approach

don't simply select a partner based on comfort. A thorough partner due diligence is required prior to selection. This means considering prior business dealings and reputations of entities and individuals, their personal and business affiliations, and their assets and liabilities.

And forget the marriage analogy. Companies need to keep their options open. Discussions can collapse quickly. Some ventures will work and others won't. Consider multiple partners based on your capabilities analysis and take a portfolio approach. See Figure 8 for an example of how a portfolio approach reduces overall risk and how staging investments can create value.

> *"The traditional approach of running sensitivities on a +/-10 per cent swing doesn't work when the real risk is that you are entering an emerging market where they could be +/-50 per cent. Similarly with discount rates, load them up with risk and you quickly end up with a negative NPV."*
>
> Andy Penn, CFO and Group Executive International, Telstra

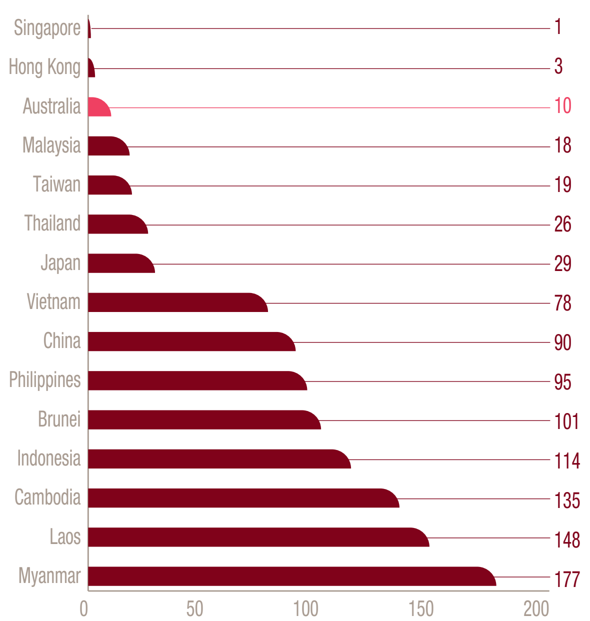
2. Invest in learning the culture

Asia is not a homogenous region. It is culturally and geographically diverse, encompassing a multitude of terrains, languages, governments, histories, religions and traditions. Addressing these variances from country to country requires a keen eye and deep cultural awareness.

On an ease of doing business scale, according to the World Bank, Asia is home to the full spectrum of rankings from Singapore at number one, to Myanmar at number 177 (out of 189 countries) – and everything in between. Australia, by the way, comes in at number 10.

As Ian Buchanan and Edward Clayton of Strategy& noted in their paper *Doing Business Where Governance is Weak*, these rankings make clear that strategies and business models tailored to the regulations and laws of mature markets may not translate well into [Asian markets], many of which are characterised by opaque regulatory climates, weak institutions, and invisible influence networks that may expose companies to unacceptable legal and reputational risks.

Figure 9. Ease of doing business 2014 rankings



Asian culture, and importantly corporate behaviour, is different. Not better or worse – just different."

Geoff Brunsdon, Non-executive Director

Understanding how to manage the complex dynamics of culture and cultural differences as well as the heightened role that relationships play in Asian business is a key skill. The ability to understand and work within the local culture is critical.

Culture and relationships are not new. Everyone says this and whilst it may not sound particularly insightful to say it, there is a reason they are always mentioned – because it's true.

Australian companies wanting to succeed in Asia need to invest far more time and effort in up-skilling themselves on Asia. Anthony Fasso, CEO International and Head, Global Clients at AMP Capital Investors says Asian cultural diversity is important for his business: "We have focussed on getting recruitment right and look for staff who have multiple Asian languages."

For our part, PwC in Australia has publically committed to having 5 per cent of our partners with an Asian cultural background by July 2016. This is part of our commitment to diversity and our belief in the need to develop an Asia ready workforce.

Key cultural differences Australian businesses need to be aware of when doing business in Asia:

Collectivism

The interests of the group are usually put ahead of the interests of the individual. 'Saving face' is more sensitive in Asian societies, which are group-based cultures where relationships have central importance. Avoid embarrassment and maximise respect. If you cause your counterpart to lose too much face, they won't be able to work effectively with you.

Authority

Leadership is often hierarchical in style and autocratic. Employees expect to be told what to do. Be humble and spend a lot of time listening. Take the time to understand who the real decision makers are, and don't assume you know.

Context

Asian cultures rely heavily on non-verbal cues and information drawn from the surrounding context to determine the real meaning of a conversation. Western cultures rely on what's actually verbalised. Westerners tend to get straight to the point whereas Asians will spend more time understanding relationships. Indirect communication is a means to save face or avoid embarrassment.

Harmony

Asian cultures tend to avoid conflict. There is a desire to maintain group harmony and focus on 'win-win'. In Western cultures it is more typical to have clear winners and losers.

Consistency

Asian cultures like consistency in terms of business and cultural norms. So while complicated, once you learn the norms, they often do not change and you can use this to your advantage. It is much more difficult for Asians to learn Western culture and business as our rules constantly change.

Time frames

Australian companies have half yearly earnings targets and tend to think about performance over the short term. Asian companies are often family owned or State Owned Enterprises (SOEs) and have much longer time horizons. Asians do not rush to make decisions as a consequence. You need to be prepared to invest time in meetings over a long period of time to build trust and relationships. Plan for it – your usual company timelines won't work in Asia.

3. Don't be fooled by 'Guanxi'

In the West we often joke it's not what you know but it's who you know. But in Asia it's also what you don't know, or know enough about to ask what you need to know. That's why it makes sense to strive for a real understanding of the local culture and the way business there gets done.

The Chinese even have a word for it, 'Guanxi' (pronounced Gwan-shee), which is the notion that cultural differences can be bridged by building and maintaining relationships. It is particularly important where institutional or regulatory frameworks are not strong. But while personal and business relationships are important, they are often exaggerated and misunderstood by the uninitiated.

The government and other vested interests in Asia are often closely, if not directly, involved in business, often opaquely. Multilateral development banks and non-traditional donors can also influence decision making, particularly on government procurement and privatisations. Identification and understanding of the relative importance of local stakeholders – and their influence on the final outcome – is vital.

So take time early in the process to understand decision-making hierarchies – and who has the final say. This may be clearer in a private or family owned business, but is particularly true for deals involving State Owned Enterprises.

> "
> *Asia is a hard place to make money. You have to get the right people at mid-management levels, not just executive leadership team, who get Asia and can get the culture right. What you do need though is continuity and patience in Asia."*
>
> Ewen Crouch AM, Non-executive Director, BlueScope Steel

4. Appreciate the 'uniquely Asian' market dynamics

> *No doubt corruption and bribery is an issue. You can and must survive without doing it but it can sometimes be expensive in the short-term. You also have to be aware of possible "wash-back" of issues involving a JV partner in Asia who gets caught up in local problems, perhaps politically motivated in the host country, and reputation is tarnished by association. This is very hard to manage but a real risk and concern."*

John Colvin, CEO and Managing Director, AICD

After decades in the making, economic, political, and market factors, combined with a landscape more focused than ever on attracting capital and development, have converged to create a mature environment ripe with opportunity. Asian markets though are still fraught with complexity and challenges and the opportunities are not risk free.

For starters, the region's governments have only recently accelerated liberalised trade and investment policies and introduced transparent regulations to combat corruption and ease the landscape for doing business. Increased progress toward risk reduction will occur over time, not instantly.

In some countries in the region, political stability may be fragile. As such, despite a number of attractive opportunities, companies should be prepared for a range of political, security, bureaucratic, regulatory, rule of law and corruption-related hurdles in these markets, reinforcing the importance of risk monitoring and mitigation.

Business partner pedigrees are at a premium. Engaging good local partners as agents, distributors, franchisees, joint venture partners, or general partners is a common and effective market entry strategy but they also expose the business to the same risks as a local subsidiary.

As well as fines, companies prosecuted for bribery and corruption are at risk of real and lasting damage to their corporate reputation, operations, and profitability. Additionally, concerns regarding labour conditions, worker mistreatment, and wage abuse at local manufacturing facilities in the region also put multinationals at risk of legal and reputational harm not only in the local market but also in the home markets.

In addition to the regulatory and business realities, the region also presents a number of geographic challenges, particularly the threat of natural disasters – such as earthquakes, flooding, and typhoons, which may be quite common in Southeast Asia. A well-developed business continuity plan is essential to meet these risks.

The challenges are myriad, complex, and often interrelated. The government's role in business life looms large – but the lack of separation between government and business is the Asian way.

5. Keep timelines realistic and be patient

Companies tend to prioritise resources, people and capital around things that will benefit the incumbent CEO and the successor, but not the second or third CEO down the track. There is often a temptation to bail out when things are not meeting initial – sometimes unrealistic – timelines.

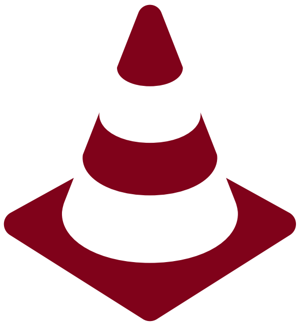
Growth activities in Asia need to be considered over a longer time frame and through a wide strategic lens. Building relationships and getting the commercial settings right take time – so plan for it. Financial targets, and related sensitivities, need to be set and calibrated accordingly.

As John Colvin, CEO and Managing Director, AICD commented, "Companies have to invest time and understand that success won't come easily or quickly. Asia is a 10 to 15 year investment so the mis-match of CEO (and indeed Chairman) tenure and the time required to execute an Asian strategy is very real. You need a strong CEO and Chairman relationship and a commitment to the investment. The Board and executive also needs to be aligned on strategy."

And companies need to have well laid out plans in place to more clearly communicate a coherent Asian strategy to shareholders, fund managers and market analysts if they are to avoid the 'discount' often ascribed to those making an Asian bet.

"In emerging markets, we have primarily adopted an 'attack' strategy. That means we have to pay more attention to market share at the beginning instead of profit."

PwC's 2012 Global CEO Survey



6. Proceed with caution

There are significant misperceptions about both the challenges and rewards of doing business in Asian markets. In many cases, the risks are either highly understated or grossly overstated. The same is true with opportunities. Many executives of large companies believe they should – and can – do business in Asia.

From our experience, the business environment there is far more nuanced and complex than most investors appreciate. The complexities of this new environment call for changes in corporate strategies and the tools to implement them.

Doing business in Asia will require extensive due diligence to vet the reputation, financial stability, and technical capability of local business partners. As Grant Dooley, Head of Asia at Hastings Funds Management commented: "Get this wrong and you are in a world of pain". Such an undertaking may prove to be difficult without appropriate assistance in overcoming the lack of transparency that veils many enterprises in Asia.

Carrying out world-class due diligence is more difficult in emerging markets since, by definition, their institutions are nascent and their information frameworks less developed. The safeguards of a solid risk management framework are vital.

Urgency, the Australian need to 'sign the deal', is a very real risk. Instead, invest sufficient time and money in the due diligence process. Don't cut corners and don't leave your common sense at the border. As Grant Dooley Head of Asia at Hastings Funds Management says "Keep an open mind, be flexible and adaptable but remember what makes your business successful at home. Stay true to your heritage and the organisation's DNA."

Foreign involvement in transactions, especially in privatisation bids, may also stir up nationalistic sentiments. Cultural norms tend to favour domestic companies whenever possible. Should the business overcome this hurdle, post-merger integration is likely to emerge as an additional challenge amid significant cultural sensitivities.

More sophisticated due diligence techniques are required to expose on-the-ground risks and opportunities, and better state the opportunity and risk trade off. Such enhanced pre-deal (whether it be by acquisition, joint venture or alliance) due diligence – incorporating corporate intelligence – assists companies in mitigating their business, reputational, and regulatory risks in a business relationship by providing critical information to help make sharper risk-based decisions. It also serves to demonstrate to regulators that the company is committed to integrity and corporate governance.

To successfully execute a transaction or market entry, the project team should include individuals who can address these risks, in addition to those who have local knowledge and experience in the country where the investment is being contemplated.

> ***"Keep an open mind, be flexible and adaptable but remember what makes your business successful at home. Stay true to your heritage and the organisations DNA."***
>
> Grant Dooley, Head of Asia at Hastings Funds Management

7. Triangulate your information

Due diligence is indispensible, yet elusive. Those in search of transparency often find translucency at best, and the resulting environment can be rife with risk.

An overall lack of transparency heightens the challenges and risks associated with doing business in Asia. The region's tendency toward secrecy and a scarcity of publicly available information tend to hamper cross-border deals involving unlisted target entities. Even when these entities are publicly listed, potential buyers accustomed to Western investor protections will face relatively weak financial transparency and lax corporate disclosure standards, rendering thorough due diligence on potential partners even more critical and challenging.

To assess and mitigate these challenges, it's not enough to ask questions. You need to be creative in accessing data and constantly triangulate your information sources.

Valuing investments in Asia

We know that markets can discount big bets in Asia due to the perception of excessively high risks.

This is exacerbated by traditional investment evaluation in Australia, which is founded on Net Present Value (NPV) analysis and favours big-bang, one shot plays and considers risk and uncertainty 'bad' things.

In making decisions in uncertain situations, the value of learning, flexibility and downside protection are much more important, even though they are ignored in traditional NPV analysis and planning tools.

To successfully navigate investment decisions in Asian markets, new valuation tools – which bring the value of learning, flexibility and downside protection to the fore – are essential.

These tools will tend to reduce up-front pre-committed expenditure into Asia, encourage a portfolio approach to high-risk issues and provide for a more dynamic, iterative investment strategy than is typical in current practice.

As PwC Partner Richard Stewart argues in his book Strategic Value: Value Analysis as a Business Weapon, with these valuation tools and investment strategies in hand, risks will no longer be a bad thing in the investment decision process. In fact, the more risk or uncertainty, the more the important are the elements of value ignored in traditional analysis.

Whilst Asian investments do have risks, the risk of not doing anything is perhaps greater.

80/20

8. Go easy on the integration and remember the 80/20 rule

Execution really matters and don't leave it to your local partner to do it alone. Success will be largely predicated on the ability to fuse business-as-usual with business as-usual in Asia, which can be distinct, but not necessarily mutually exclusive, approaches.

Vietnam, Indonesia, Myanmar, Malaysia, for example, all have very different business practices. Importantly, the employees view point is different. Their education, culture, working and management styles as well as their attitudes to work and company loyalty are different across the region and certainly different to Western styles. Awareness of these differences is crucial.

Strong leadership and a clear sense of direction are also important, as are appropriate incentive programs. Focus on working through the key risks from the beginning. Be 80/20 in things that can be worked out later – for example, being very accurate in long-term projections.

Find quality local managers and staff and empower them to execute within the framework of a well defined governance model.

Though Asian companies may be less sophisticated, don't simply impose your way of working – be deliberate about what to change.

> *"Western organisations bring value through strong processes and know-how but you have to be careful to balance the desire to do things 'our-way' with the experience and market knowledge of your local employees. Getting this balance right is where real value is created."*

Hiroshi Fujikawa, Managing Director South East Asia, Kirin Holdings Singapore

Questions to ask

Here are the top questions that Australian boards, management and business owners should ask themselves in order to ensure their companies are able to engage successfully in Asia.

- What is our Asian strategy, how does it fit with our growth plans and how do we articulate that to stakeholders?
- What is our marketing proposition, does this fit the market and what do I need to do to alter this and gain consumer loyalty?
- Does our track record resonate? What do we need to do to build reputation and brand image?
- Does our 'threats analysis' identify Asian competitors and who they are?
- Is our remuneration plan truly aligned with the strategy?
- What is the business model and how will we 'win' in this new market - how is that different to our 'home' market?
- Do we have the organisational capabilities, people (e.g. management and Board skills) with the right experience to execute our strategy? And if not, do we know how to obtain this?
- What is our execution plan and how does the plan encompass; stakeholder identification, relationship management strategies, own resources versus partner resources on-the-ground, and governance?
- How robust is the valuation model and what sensitivities (upside and downside) have been modelled?
- How will success be measured and are the performance hurdles and timelines realistic for the investment?
- How and why did we identify this business or investment opportunity over others and come to the conclusion that we should go M&A versus JV, alliance or greenfield?
- Have we considered any reputation risk from engaging in this proposed entry model?
- Who has done the due diligence work, and have they done this before in Asia? Does this extend to a review of individuals and business affiliations?
- What work was done to assess the relationship risks and on bribery and corruption risks?
- How much time has the senior management team (and Board) really spent on the ground understanding the local environment, meeting customers, suppliers and local stakeholders?
- What are our plans for integration, who will be responsible and were they involved in the due diligence work?
- What is our risk management framework and how are risks being identified and managed?

Where to now?

Asia is – and will continue to be – the world's growth engine for some time. Growth in key Asian markets like ASEAN and China is expected to be 5-6 per cent over the next 10 years, whilst global growth is unlikely to exceed 3 per cent.

This growth brings both opportunities and threats for Australian businesses. Global supply chains are changing rapidly and technology-driven globalisation is tearing down the barriers of borders and geography that have acted as a protective buffer for many businesses. Asia is already home to innovative world-class consumer brands and they are irreversibly changing the global competitive landscape.

No Australian industry or business is immune.

If Australian businesses want a place in future global supply chains and to participate in the growth of intra-Asian trade – which is expected to top intra-Europe flows to become the largest trade network in the world by 2016 – we will have to dramatically lift our engagement and investment in the region. Continuing to rely on the export of bulk commodities is not enough.

This will require Australian companies to significantly lift their engagement with Asia, up-skill themselves in doing business in Asia and invest more in the region. They will need to invest in learning and understanding Asian cultures, as well as improving Asian business literacy to support their business activities and investments.

The opportunities in Asia are significant – but they are not risk free. Managing these risks requires companies to adopt a more sophisticated and longer-term approach to strategy development, market entry planning, due diligence, valuation and post-deal integration.

The competition arrived in Asia 15 years ago and they have made their investments and business plans work. Unfortunately Australia is way behind. Asia is passing us by and we need to act now. This may well be our last chance.

pwc.com.au/passingusby

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