

Asia Strategic Insight Roundtable
Seoul, Republic of Korea**The future of the Asian economy**

Is Japan genuinely reinventing itself? Can China manage a “soft landing” after years of impressive economic growth? These were among the most important questions addressed by 180 business and political leaders gathered in Seoul for the Forum’s recent roundtable. Senior executives and other leaders also debated the pace of Asian economic integration, the consequences of Chinese companies going global, Asia’s security concerns, the transition from rural to urban economies and the region’s growing demands for energy. A number of key themes emerged over the day and a half dedicated to the roundtable. These include:

Business and economics

- High-growth markets such as China and India foster cautious optimism for the entire region, but Japan’s recovery weighs on the minds of most Asia-watchers. Japan’s rise in domestic confidence remains closely linked to the fate of the Chinese and US economies.
- While Asian business leaders are generally confident with the current business climate, they must be prepared for unknown threats. Future growth could be undermined by a “hard landing” in China or a failure to reform Asia’s financial and regulatory regimes. Disaffection with the global trading system could give rise to protectionist and anti-globalization sentiment.
- Individual Asian economies have distinctive competitive advantages based on cost, the ability to innovate and specific expertise. As a result, businesses see substantial advantages to greater regional economic collaboration, but the support of governments is also crucial.
- Consumer markets are growing rapidly, fed by financial liberalization, the availability of credit and media sector development. Brand development in the region is a long-term project requiring a clear understanding of Asian customers and of different national markets.

Geopolitics, security and new risks

- Terrorism remains a potential threat to Asia, as does the recurrence of a SARS pandemic or the spread of other infectious diseases. While governments must develop and integrate effective strategies, companies need to develop their own risk mitigation approaches.
- Continued tensions and uncertainties around the Korean peninsula, Taiwan Straits and India/Pakistan overshadow investment decisions and require careful monitoring.
- Structure is as important as strategy. An operating structure with country or region managers holds advantages over a business-centric structure that operates across regions or countries.

Innovation and reform

- Globalization and technology’s advance have surpassed the ability of Asia’s schools to adapt to market needs. Businesses can compensate for rigid education systems with custom-training programmes that foster creativity and risk-taking, especially among new hires.
- In the process of internationalization (e.g. “going out” by Chinese companies) many Asian companies will strengthen their technology leadership, brands and international profiles as they move beyond competing solely on the basis of domestic cost advantages and focus on creating more value.
- Even though economic conditions have improved, governments should continue regulatory reforms to strengthen credit and risk management practice. Asian companies also require greater transparency and stricter corporate governance in order to attract foreign capital.

Managing opportunity and risk in Asia

Big picture

- Despite the positive trend line with respect to intraregional trade and investment, Asia's integration, unlike Europe's, depends on resolving security issues and managing new threats.
- Asia presents more opportunities than risks as a result of Japan's nascent recovery and China's growth but known and unknown threats to growth are on the rise. Businesses and governments must work together and communicate closely to manage these risks.
- Terrorism, pandemics and protectionism loom as the emerging threats to Asian growth. The Korean peninsula and cross-Strait relations remain the region's dominant security concerns and appear unlikely to be resolved in the short- to medium-term.



Roh Moo-Hyun, President of the Republic of Korea, hosted the World Economic Forum's Asia Strategic Insight Roundtable.

Context

While the mood in Asia is currently upbeat, complacency needs to be avoided. The implementation of global or regional strategies may be slowed or disrupted by threats both known and unknown. These include terrorist attacks, pandemics and the rise of protectionist sentiment caused by disaffection with the multilateral trading system or exasperation over product "dumping".

Geopolitical factors are major risk drivers in Asia. The Korean peninsula and the Taiwan Straits are hotspots. From an economic standpoint, regional or bilateral free trade agreements may help foster greater economic integration and interdependency, but they may slow the progress of multilateral talks.

There are also concerns over contagion and regional instability. The absence of regional mechanisms such as a monetary fund or bond market could make financial crises more destabilizing.

Businesses find geopolitical risks challenging and expect government leadership in their management. At the same time, participants recognized the importance of communication and partnership between businesses and government.

Strategic insights

- Global threats encourage protectionism and isolation when the opposite needs to happen, i.e. global collaboration and dialogues. Governments that have rapid adaptive capacity to pre-empt and respond to crises will be able to better attract businesses.
- Business leaders should make an effort to discover new risks and manage exposure. For example, companies should develop rigorous measures to safeguard premises, staff and transactions to guard against terrorism risks.
- Structure is as important as strategy. An operating structure where country or region managers are appointed holds advantages over a business unit-centric structure that operates across regions or countries. Local managers may better appreciate the local environment, cultivate relationships, identify market opportunities and manage risks.
- The need for enhanced risk management creates new business opportunities. Companies can develop new technologies, products and services to help manage risks (e.g. scanners and Radio Frequency Identification). It is imperative that businesses work in partnership and maintain close communication with governments through appropriate forums.
- Businesses should watch for signs of continued reforms in economies such as Japan, or where complacency has set in to slow the pace of restructuring. These are important lead indicators regarding the sustainability of growth and vulnerability to future shocks.

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Exploring the landscape of reform

Big picture

- Asian and world economies are recovering, offering a new opportunity for needed but difficult restructuring to create a virtuous cycle of sustained growth and reform.
- Greater transparency and stricter corporate governance are required to sustain foreign investment in the corporate and financial sector.
- Serious, long-term obstacles to reform still remain and political will is required.



*Heizo Takenaka,
Minister of State for
Financial Services,
Economic and Fiscal
Policy of Japan*

Context

While Japan's recovery and China's boom auger well for the near future, at least, the sudden onset of both the 1997 Asian financial meltdown and the 2003 SARS crisis demonstrate how fragile good times can be. During the current period of relative calm, Asian governments and firms need to move quickly towards the greater liberalization of markets and industries. Strict financial controls by Beijing have led to what many see as an undervalued Chinese currency which risks stifling profitability and growth among China's neighbours.

Banking and capital market reforms are needed in order to prevent wasteful lending and provide worthy businesses with access to capital through the efficient channelling of savings. The development of small and medium-sized firms is often stifled, as loans are channelled to huge, established and well-connected enterprises that are not necessarily profitable.

Asian companies that successfully tap global capital markets have done so by adopting international accounting standards and improving corporate governance. Foreign investors see bona fide credit and risk ratings, along with the appointment of independent board members, as requisites to investment. The implementation of better management information systems and accounting procedures can yield more productive data for board decisions, investors and stakeholders.

Strategic insights

- With Japan now emerging from a decade of economic stagnation and China posting remarkable growth, the social impact of the liberalization of markets and industries is a key issue that leaders need to address. Action is urgently needed during this economic cycle, yet business leaders are concerned that political pressure or complacency will dampen enthusiasm for reform once again.
- The Japanese government appears resolute in accelerating structural reforms, and business leaders should watch out for any delays and pullbacks in the coming months as an indication as to whether reforms and growth are sustainable. Thus far, indications are positive as the current recovery is driven by the private sector and the reduction in corporate debt levels rather than by government spending. Long-term obstacles include unfavourable demographics, lack of labour flexibility and over-dependence on China's economic growth.
- In the post-restructuring economic environment and with better access to capital, business leaders expect major multinational global corporations to emerge from Asia – not just from Japan and Korea, but also from China and India.

"The world economy is recovering and this has given Asia an opportunity to create a virtuous cycle of growth and reform."

**Sir Martin Sorrell,
Group Chief Executive
WPP, United Kingdom**

Navigating Asia's interconnected marketplace

Big picture

- Individual Asian economies have distinctive competitive advantages based on cost, the ability to innovate and expertise, but intraregional competition and historical issues limit the potential of economic integration.
- Falling barriers to trade and the growth of consumer markets, particularly in China and India, make Asia an attractive region in which to invest and grow business operations.
- Consumer markets in Asia are fragmented and diverse. Success tends to require localized products, strong distribution networks and local expertise.
- The media's unprecedented reach compounds the risk that missteps in one Asian market may have regional or global reverberations.



Victor L. L. Chu,
Chairman and
CEO, First Eastern
Investment Group,
Hong Kong SAR

Context

While Asia's politicians contemplate the need for greater economic integration, the region's business and financial communities are already making it happen. The role of Korea as a regional trading hub provides one obvious example. Intraregional trade and capital flows are already creating a borderless Asian marketplace.

Rather than build identical industries creating needless duplication in different countries, business leaders see advantages in regional specialization. As a result, companies are taking a more sophisticated approach to sourcing their raw materials and support services,

weighing a range of factors from cost to intellectual property rights, from efficiency and skills to data protection standards. This trend helps foster intraregional trade, producing new economies of scale and reducing the region's reliance on exports to the US.

Consumer markets are growing rapidly, fed by financial liberalization, the availability of credit and media sector development. Although this makes them attractive to business, many companies fail because of a lack of necessary due diligence before entering the region's diverse markets. Despite the elimination of some trade barriers, Asia's consumer markets remain nation-specific. Businesses need to understand the local cultural context and build relationships with local officials. The prevalence of global brands has increased competition in many Asian markets.

Strategic insights

- The desire to expand rapidly into local markets creates new pressures inside multinational corporations regarding the protection of brand identity and corporate culture. The training and promotion of locals for top management positions can improve a company's ability to propagate its culture, instil loyalty in local workforces and compensate for the shortage of skilled and reliable employees. Specific attention should be given to adopting appropriate corporate social responsibilities in new operations and avoiding local missteps that can damage a company's reputation.
- Asian governments should develop strategies that promote distinctive competitive strengths to attract foreign investment rather than compete with neighbours on cost.

"Asia needs all of our strengths. The mass markets of China and India, the services of Hong Kong, Taiwan's manufacturing capability and the technology of Japan and Korea."

Victor L. L. Chu

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They should harmonize product standards and be more aggressive about lowering barriers to trade and the movement of capital and skilled labour to ensure their competitiveness within the integrated Asian supply chain. A proliferation of bilateral free trade agreements might reinforce and accelerate regional economic integration, but it could also lead to conflicting trade privileges and regulations.

- Companies, in turn, should critically evaluate the overall attractiveness of possible investment locations such as capable workforce, security and intellectual property protection, and not be driven by tangible factors such as costs, market proximity or government guidance and incentives only.
- Companies operating in Asia must identify an appropriate structure that balances risks across the region while taking advantage of the respective strengths of Asian countries. Getting this right will depend on the regulatory environment, the judicial system, the availability of partners and the local government's attitude towards businesses.
- Companies need to define the niche and product value in order to gain customers and market share. In some cases, success can be derived from selling the lifestyle that a product represents (e.g. Nike and Coca-Cola).



"Asia needs to become a creator and an innovator. It has long been a follower."

*Lim Chee-Onn,
Executive Chairman,
Keppel Corporation,
Singapore*

Growth Competitiveness Index Rankings (Selected Asian Economies: 2003 GCI Results)	
Taiwan	5th Globally
Singapore	6th Globally
Japan	11th Globally
Korea	18th Globally
Malaysia	29th Globally
Thailand	32nd Globally
China	44th Globally
India	56th Globally
Vietnam	60th Globally
Philippines	66th Globally
Indonesia	72nd Globally
Pakistan	73rd Globally



Cartoon by Heng Kim Song, Editorial Cartoonist, Lianhe Zaobao, Singapore

Source: The World Economic Forum,
The Global Competitiveness Report 2003-2004,
Executive Summary, p. xiv

Developing Asia's innovators and entrepreneurs

Big picture

- The emergence of Asian multinational companies (MNCs) will accelerate as the focus shifts from low-cost to high-value production and as a result of China's accession to the WTO.
- The dynamism of Asian entrepreneurship and innovation will largely be dependent on both the pace of government education reforms and the quality of corporate training programmes.



"We have achieved remarkable economic growth but future success will depend on education, science and technology."

*Yun Jong-Yong,
Vice-Chairman and
Chief Executive Officer,
Samsung Electronics,
Republic of Korea*

Context

Technological innovation, entrepreneurial drive, low cost base and a sophisticated, domestic consumer market, as well as proactive government support, may accelerate the emergence of Asian MNCs. Korean companies are gaining global market share in many industry sectors, while Taiwanese, Chinese and Indian companies are fast emerging as global leaders in technology sectors.

The pace of development of Asian MNCs will likely accelerate with "going out" strategies by various Asian governments, but the dynamism of Asian innovation and entrepreneurship will be constrained by rigid educational systems, which are seen as failing to promote creativity or innovation. These systems will require substantial reforms to meet the needs of knowledge-based economies.

Historically, Confucianist influence is widely seen to have reinforced education's central role in Asian society, with Asia leading the world in the number of PhDs. However, Asia's educational systems have been characterized as being based on rote learning and the memorization of facts and do not encourage critical thinking skills, creativity and risk-taking necessary to produce home-grown entrepreneurs and innovators.

Asian companies will have to develop a long-term strategy in internationalization and brand development, and move beyond cost competitiveness. Compliance with international standards (be it in product quality or accounting standards), the projection of cultural values and lifestyle within product branding and design and global human resource development will require sophisticated marketing expertise and management experience.

Strategic insights

- The likely acceleration in the emergence of Asian MNCs will have significant, competitive implications for global MNCs, but there are also potential opportunities for acquisition and collaboration. Global MNCs should develop competitive foresight and position themselves pre-emptively.
- Emerging Asian MNCs should start assessing implications and strategies for internationalization, as well as determining the sequence of markets to enter. Compared to achieving success in their domestic market, Asian MNCs will have to adapt to a more varied, complex and unfamiliar global operating environment that presents new critical uncertainties.
- Technology's rapid advance has surpassed the ability of Asia's schools to adapt to market needs. Business leaders should include the pace and extent of education reforms as leading indicators of future economic competitiveness.
- Progressive education institutions will place greater emphasis on having students develop creative solutions rather than "right" answers, as well as communication and critical thinking skills. Closer relationships with industry in curricula development and internships are needed. Overseas exposure will make Asian graduates more competitive.

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Understanding Asia's energy needs

Big picture

- Asia's fast-growing economies face increasing energy prices in global commodity markets as they consume energy on an unprecedented scale.
- Most countries within the Asia-Pacific region are largely resource poor and require new energy infrastructure. The huge capital investments necessary to match supply with demand require geopolitical security – an area where there is still significant uncertainty.
- Middle Eastern and Russian oil supplies are essential, but pose political and financial risks.
- The diversification of sources and upgrades in infrastructure will span the entire energy chain.



"Connecting energy suppliers and consumers in Asia will be a huge and long-term challenge. Without this, there will be no economic growth."

Andrei Illarionov,
Adviser to Russian
President Vladimir Putin

Context

With China's GDP growth likely to average around 8% per annum over the medium term, Asian energy demands are rising quickly, requiring some US\$150 billion in annual investment. The ongoing conflict in Iraq, OPEC efforts to control oil production and a gradual global recovery all point to continued high oil prices in the short term, absent an economic slowdown.

Natural gas and nuclear power are the preferred energy sources to diversify supply. Successful examples of diversification already exist; France fulfils 75% of electricity needs through nuclear power. Standardized designs could make nuclear power stations safer and more cost effective. Further needs will be fulfilled by renewable energy sources such as wind, hydro and biomass, and, over the longer term, new technologies such as gas from coal and liquids from gas.

Asia requires an extensive network of pipelines, tankers, liquefied natural gas facilities, nuclear reactors, power plants and electricity networks in order to feed business and consumer needs. The immense costs incurred will require public/private partnerships within the region and will also likely require partners from Europe and the Americas.

An expansion of Asia's capital markets, along with greater transparency and improved project and corporate governance can help attract foreign investors.

Without ready access to plentiful and diversified energy sources, sustained high oil prices will cause Asian businesses to lose cost competitiveness. While nuclear power and natural gas may eventually supply much of industry's needs, this will take time. In the interim, coal will continue to play the most important role (particularly in China) and oil will remain a necessity to fuel the region's millions of vehicles.

Strategic insights

- Cooperation between major consumers like China, Korea and Japan could reduce overall costs and help spur further regional integration in the form of free trade agreements, economic unions and increased collaboration.
- Companies and governments need to work together to increase the efficiency of existing grids. Systematic and preventative maintenance of power plants can increase load factors and improve efficiency by 15-25%.
- Firms and governments must not assume a return to the status quo in the Middle East. Despite close political ties with the industrialized world, OPEC continues to attempt to manage oil market prices. As neither Russia nor the Middle East can be relied on for all of Asia's energy needs, other supply options (e.g. West African oil) will be pursued.

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For further information on our Asia Programme, please contact: asia@weforum.org

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