



## Asia Innovators—Creating Value via Innovation

Among the biggest changes to emerge over the past 10 years is the vast consumer market in Asia, which by 2020 is expected to have a middle class of about 1.7 billion—far more than North America and Europe combined. China today has the largest middle class in the world and by 2022, urban household income is still expected to double from 2012 levels. However, it is not just the number of Asia’s middle class consumers that is impressive but their spending power, which is also expected to double that of North America and Europe combined by 2030.

The rise of Asia’s middle class is significant in many aspects—the region has already become the largest market for low, commoditized products, but they are now willing, and able, to pay a premium for innovative, high-quality products. In recent years, we have witnessed many innovative companies rewarded for the products and service ideas that are meeting the new demands of a region of rising wealth. We believe the opportunities being created by improving lifestyles should incentivize even further innovation.

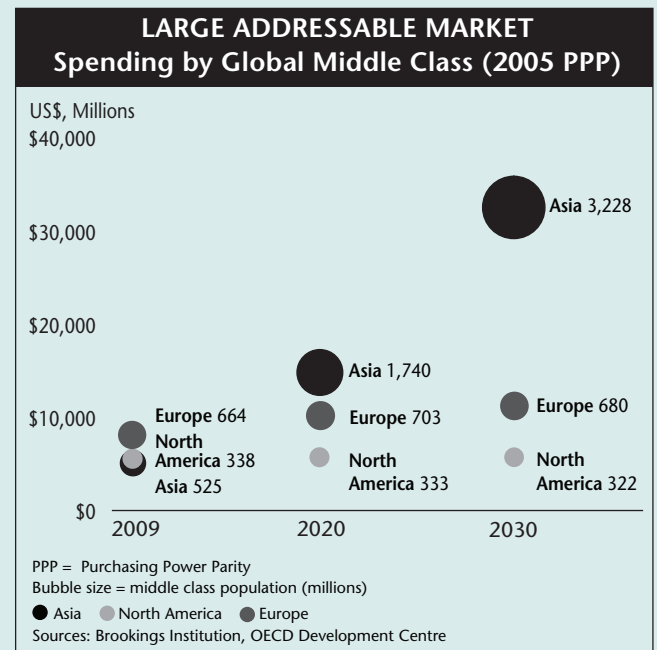
Asia now possesses the four key essentials for innovation: a large addressable market size (as discussed in the July 2015 issue of *Asia Insight*), entrepreneurs, human resources and a vibrant venture capital industry. With these in place, we have already seen the growth of pioneering companies that are able to generate greater value today than in the past.

### Asia is Primed for Innovation

The massive buying power of Asian consumers has far-reaching significance, especially for aspiring entrepreneurs focused on ground-breaking new products. Innovators have existed in every market in Asia, most notably in South Korea, Japan and Taiwan. However, the overall value created has been constrained by their smaller market size since such homegrown inventions have been unique to their domestic markets. Today, this has completely

changed. Key innovators in Asia now target their own regional market—and Asia’s middle class is quite homogeneous in many respects, meaning they may share similar cultural backgrounds, tastes and aspirations. Let’s look at South Korea’s cosmetics industry for example.

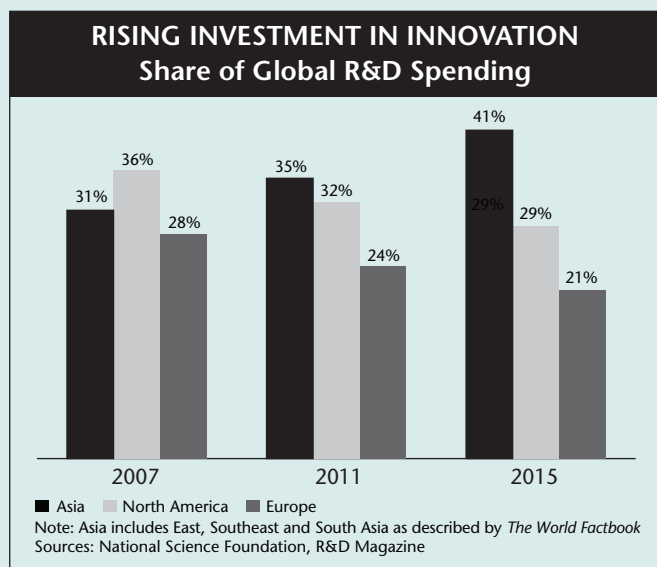
South Korea’s cosmetics companies have developed very unique, innovative products that are well-suited for Asian consumers. But five or 10 years ago, these top notch products did not generate much value because the markets that these products were selling in were relatively small. In recent years, Korean cosmetics makers have found success in China, in part due to the emergence of the country’s middle class and their rising disposable incomes, and they are able to sell their products into a much bigger market—sometimes even much larger than U.S. or European markets—and this has enabled them also to generate solid returns for shareholders.



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### Key Source of Competitiveness

Human resources, another key source of competitiveness for innovators in Asia, is something that tends not to be in short supply in Asia. Each year, a highly educated workforce of millions hails from North Asian countries and India. South Korea’s young population, for example, has a notably high proportion of college graduates and the country has one of the highest ratios of higher education degrees earned among OECD (Organization for Economic Cooperation and Development) countries and the highest in Asia for those aged 25-35, according to the OECD and UNESCO. Asian companies are also increasing spending on research and development. In fact, many policymakers in Asia have made innovation a national, strategic priority. The global share of research and development spending by Asian companies surpassed that of U.S. companies in 2011, and the gap continued to widen in 2015. The effort has given rise to numerous research hubs equipped with good infrastructure and skilled workers. In this way, Asian companies are increasingly laying firm foundations for future innovation.



### Moving from East to West

An important trend we are seeing is innovation moving from East to West. This is most evident in the Internet services and consumer products space. For example, Amazon recently started a one to two-hour delivery service in some key cities in the U.S., and is investing in developing its own logistics as a key competitive advantage. This business

strategy was started by leading Chinese entrepreneurs and companies early on. Initially, many investors had doubts over its potential for success, but the development of one’s own logistics has in fact become a global trend among many e-commerce companies. And most leading e-commerce companies in India and South Korea are making related investments in order to improve customer experience and satisfaction levels. It seems Amazon is also taking a page from this approach.

In another area of prominence, China is leading the world in financial technology and, along with Indonesia, has among the highest levels of mobile banking penetration. In fact, Internet companies in China are penetrating deeper into the everyday lives of Chinese consumers in almost every respect. Internet companies have touched upon just about every major life purchase—from cars to homes to insurance products. Mobile Internet penetration in China is among the highest in the world, and China is often leading the innovation, creating new markets and services in the mobile Internet space.

Asia can also claim to lead in some areas of traditional technology products, including next-generation display technology, known as organic light-emitting diodes (OLED), that will power future mobile devices and TVs, as well as lithium batteries—essential for many mobile devices and electronic vehicles. Almost all lithium batteries used in electronic vehicles today are made by companies based in Asia, and Asian companies are spearheading the development of next-generation batteries to power the global electronic vehicle industry.

### Innovation is Key for Growth and Survival

Innovation can create value even during slower growth environments, which is important at this juncture since Asia in general is likely to transition more gradually. For example, South Korea has long been a pioneer in the e-commerce industry and its market has become relatively mature with among the highest penetration rates in the world. It also has the highest e-commerce penetration rate in the Asia Pacific region with an online shopping reach of approximately 62%. But even in this relatively mature market, new companies with inventive marketing and distribution strategies have been able to grow exponentially—in one instance, one created a market value of approximately US\$5 billion in just five years. This is particularly relevant to Asia today as many parts of the region adjust within a slower growth environment.

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It is also important to note that innovation is not only limited to technology industries. Innovation can happen in any industry—old or new. Let’s look at transportation for example. Transportation is an old industry but a newcomer like the ride-sharing service Uber has completely changed the industry. Uber disrupted the century old industry with new ways of providing transportation services enabled by new mobile technology. Within the tourism industry, companies like Airbnb are doing the same, enabling people to capitalize on under-utilized assets by connecting the supply and demand of accommodation rentals via mobile technology. This is just the beginning for the ways in which technology is reshaping older industries.

Even in the automobile industry we are witnessing tremendous changes brought by electronic vehicles (EV). EV is likely to have far-reaching impacts beyond the automobile industries as it influences energy consumption patterns.

Japan and China, the region’s major auto powerhouses, have been ramping up the competition over the type of technology and power that may be adopted as the global standard for electric cars. China, which has famously been grappling with pollution issues, now has many locally funded EV start-ups that hope to usurp Tesla Motors. Beijing has been pushing for EV autos, offering buyer incentives, compelling global automakers to share their technology, and opening its market to tech firms. Japan, on the other hand, has invested heavily in fuel-cell technology and infrastructure as part of a national policy for the zero-emission fuel to power homes and vehicles.

## Looking Ahead

The explosive growth of China’s emerging middle class brought sweeping economic changes to the global economy and these changes are still ongoing. Asia also has many emerging countries whose middle class has not yet entirely emerged. The ASEAN (Association of Southeast Asian Nations) region, which includes Indonesia, Malaysia, the Philippines, Thailand, Myanmar, Vietnam, is a compelling area of focus for future growth. With an overall population of about 625 million, this region holds exciting potential despite still being relatively poor with an overall middle class that is still relatively underdeveloped.

We believe that Asia innovators can create value for Asian consumers and long-term shareholders on the back of a vast market that has been created in the Asian marketplace. Companies that can create unique products and services that are well-suited to meet the demand created by rising disposable incomes and improving lifestyles should be well rewarded by the market, and we believe this will continue to foster more innovation. This virtuous cycle will be one of the major trends in Asia going forward and be a sustainable value creator for long-term investors.

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