Asia Insight

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5 Trends Helping Asia's Entrepreneurs Thrive

In fast-growing economies, entrepreneurs play a key role in generating durable and inclusive growth. Asia's entrepreneurs can be found at the helm of start-ups, as well as companies with billions of dollars in market capitalization. Oftentimes, the sources of economic growth are assumed to be driven by top-down factors such as geography, demographics, natural resources or official policies. The role of entrepreneurs and businesses, however, cannot be overstated as they look to invest and innovate, creating growth in the process. Identifying entrepreneurial Asian companies that are true, long-term value creators requires a bottom-up investment process that draws on deep knowledge of local markets and a willingness to ignore the short-term noise and focus on long-term opportunities.

Small and medium-size enterprises (SMEs), in particular, tend to be more entrepreneurial in nature, employing a nimble approach to pursuing and occasionally even creating new markets. Businesses that start small may evolve into mega-cap names with dominant roles in their respective markets. Investment strategies that include companies of all sizes can capture the growth potential of Asia's entrepreneurial businesses at every stage of development, from upstart to market leader.

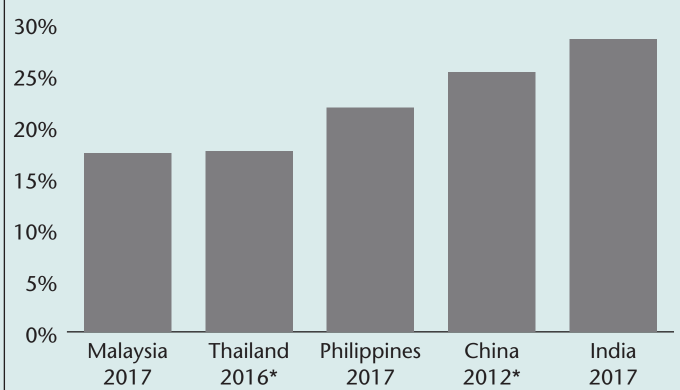
To thrive, entrepreneurs require basic physical infrastructure, such as roads, highways and ports, as well as a regulatory environment that at least tries to address market failures and encourages fair and robust competition. They also require access to capital, talented employees and customers with growing purchasing power. Asia's progress on each of these fronts fuels our belief that Asia is likely to remain a preeminent source of growth over coming years. Here are five secular trends benefiting entrepreneurs that we believe make Asia a compelling destination for growth-oriented investors.

Trend #1: Rise of the Private Sector

Across the region, the continuing trend toward deregulation is supporting entrepreneurs. Deregulation of labor provides SMEs with an opportunity to build more flexible cost structures. Deregulation of ownership structures provides more flexible arrangements for raising capital and bringing on equity partners. Deregulation of natural resources means that commodities now trade in a more open marketplace and are priced based on demand and supply. And the start of liberalization of financial markets means that Asian businesses can attract both local and international capital. Policymakers increasingly recognize that the role of government should be to facilitate a healthy private sector and at times nudge it in the right direction.

Several governments are creating economic policy frameworks designed to foster efficiency-driven and innovation-led growth. With the pace of entrepreneurial activity improving across many parts of Asia, the private sector continues to play a vital role in catalyzing investment activity in the region (see Figure 1). We believe the private sector does a better job of allocating capital than the public sector, so we are encouraged by the rise of the private sector's contribution to capital expenditures. Capital expenditures represent a company's spending to acquire, upgrade and maintain physical assets, which could include property, industrial buildings or equipment.

Figure 1. **PRIVATE SECTOR'S CONTRIBUTION TO CAPEX (% OF GDP)**



*Most recently available data
Sources: Thomson Reuters Datastream, World Bank

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Trend #2: Easier Access to Capital

The onset of the Global Financial Crisis of 2007–2008 was another reminder for policymakers across Asia to build better institutions to manage financial risks. As an example, the Bank of Japan has established collateral agreements with many central banks in the region to avoid liquidity issues. These agreements included Thailand in 2011, Singapore and Indonesia in 2013 and the Philippines in 2015. Several other efforts are underway including the effort by member governments of ASEAN to establish a more integrated regional banking framework. Such initiatives mean that the trend of financial intermediation, particularly for dollar credit, is increasingly diversifying with Asian institutions playing a bigger role (see Figure 2).

The onset of the Global Financial Crisis also highlighted the need for policymakers to continue to enhance the availability of capital for the most productive parts of the economy, including private businesses. This has taken the shape of encouraging banks to focus on SMEs, deregulating capital markets and relaxing foreign ownership norms. One consequence of these efforts is the surge in private equity in Asia over the past few years, which is diversifying the availability of capital for businesses, although it remains a work in progress. The initial surge in private equity inflows into the region was led narrowly by investments in China. Flows now appear more broad-based into South Asia and into sectors beyond simply the internet and information technology but it remains to be seen if this trend sustains.

Trend #3: More Ways to Be Competitive

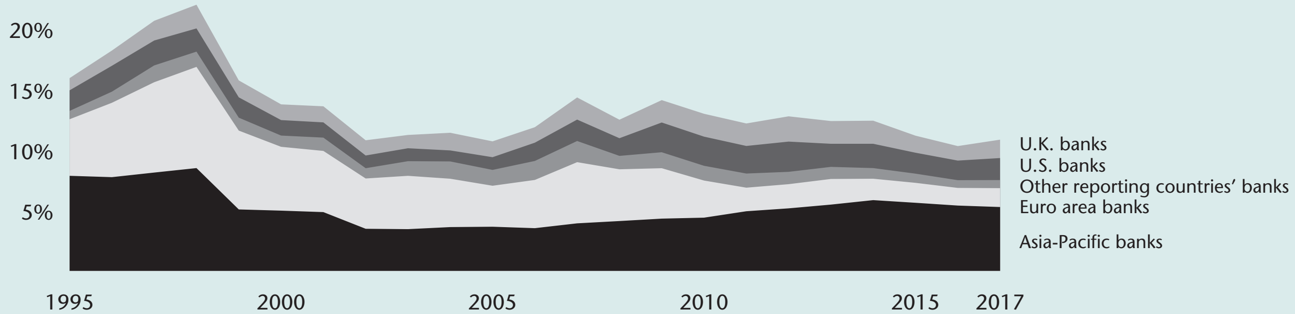
Entrepreneurs in Asia are increasingly competing on more than cost. Factors such as superior intellectual property, quality of product/service offering, trust and convenience help Asian companies enhance competitiveness. The ability to attract and retain skilled workers is a differentiating factor. This is evident in the kinds of skills that are in short supply in many parts of Asia, most notably in China. A leading recruiting company in China said the biggest demand across its site is for managerial and supervisory talent as organizations become more complex and customers more demanding. Skilled talent is becoming scarcer than capital in many respects, and organizations that are able to internalize the solution to this challenge end up creating distinct advantages.

Other intangibles such as business culture and the skill of management teams are also coming to the fore. A recent IPO prospectus for a company in China, for example, reveals how it has converted its culture and core management principles into tangible economic moats that allow it to prosper in a highly competitive consumer services sector. Putting the customer first, empowering employees to handle customer service issues quickly and creating a better overall customer experience have helped the company expand its market share.

Trend #4: Stronger Foundation for Innovation-Led Growth

As Asia's economies move toward greater growth in service-based sectors, new industries and business models are emerging. Across Asia, we see examples of a rising wave of innovation in a broad range of categories. In 2016, Asia outpaced North America in patent filings by more than 3 to 1 (see Figure 3). This flurry of activity signals a larger innovation boom across Asia. Asian businesses are developing products that meet the region's distinctive tastes and needs. Between 2006 and 2016, Asia's share of new patent filings grew to nearly 65% of all new patents worldwide, while North America, Europe and Latin America all saw declines in their share of new patent filings.

Figure 2. **CREDIT TO EMERGING ASIA: INTERNATIONAL CLAIMS AS % OF GDP**

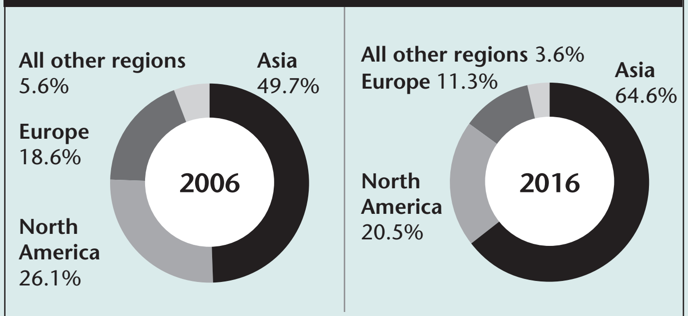


Source: Bank for International Settlements

Emerging Asia represented by countries: India, South Korea, Malaysia, Philippines and Thailand

“Entrepreneurs in Asia are increasingly competing on more than cost. Factors such as superior intellectual property and product quality help Asian companies enhance competitiveness.”

Figure 3. **PATENT APPLICATIONS BY REGION**



Source: World Intellectual Property Indicators 2017

Evidence of innovation-led growth is highly visible in the health care sector. During a recent visit to Songdo, a city in South Korea near Seoul, we learned the area had become home to the world’s largest biomedical facility. Interestingly, the area around Songdo was initially designated as an economic zone to attract foreign investment. However the onset of the Global Financial Crisis crimped any real interest from foreign investors. This paved the way for emerging health care businesses who were able to purchase land at attractive prices from the municipal government in anticipation of future growth especially in the area of biomedicine. While it is still early days for health care-related businesses in South Korea and other parts of Asia, the reemergence of Songdo shows how businesses can capitalize on emerging trends and market opportunities.

Trend #5: Greater Consumer Buying Power

Consumers worldwide have different tastes but remarkably consistent behavior. As incomes grow, consumers buy nicer things. The Brookings Institution estimates Asia will account for half of global middle class consumption by 2030, as nearly 2 billion people enter Asia’s middle class.[1] These trends show why it’s a good time to be an entrepreneur in Asia. Global macro issues will have some impact on Asia, but important trends for successful entrepreneurs are developing in Asia itself. In the past, entrepreneurs had to attract businesses and consumers in the Western world, and this involved a variety of licensing challenges and regulatory risks. With Asian consumption becoming dominant globally, the risks for entrepreneurs are increasingly less about regulation and more about understanding the competitive dynamics and in keeping up with the rising aspirations of the consumer. Having observed the behavior of consumer-oriented businesses across the region for more than two decades, we believe that concepts such as brand, product quality and service standards are starting to matter more than factors such as strength in distribution.

Challenges Facing Entrepreneurs

SMEs contend with a range of risks and challenges. Fluctuations in macroeconomic cycles can interrupt growth but the courage and conviction to pursue a sound business plan can be helpful offsets. The recent trade-related conflicts may test the region’s businesses and entrepreneurs, whom we believe likely able to cope with this new environment and adapt to new realities. As discussed before, policymakers across the region have generally been acting sensibly and responsibly in our view, although the pace of economic reform has been uneven at times. In the recent past, authorities have responded to tough global macroeconomic conditions by attempting to lower the cost of doing business and encouraging the development of private enterprise.

Targeting Durable Growth

One of the most salient aspects about investing in the Asian region has been the steady and nearly uninterrupted growth in household wealth over the past several years. This increase in wealth is increasingly translating into a demand for more sophisticated products, and variety of services. Successfully addressing this need will require different sets of skills and a willingness to take the appropriate risks. Entrepreneurs are well-placed to build businesses that can benefit from this trend, and to drive economic activity leading to job creation and economic growth. This kind of growth tends to be less susceptible to global macroeconomic swings.

It is easy to get lost in the noise emanating from trade-related concerns or other macro headwinds that are looming on Asia’s economic horizon. We find that successful Asian businesses use these challenges as an opportunity to improve the quality of their operations. We aim to stay focused on understanding the prospects for these businesses and investing in those that are capable of delivering steady and durable growth across cycles.

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1 Source: Brookings Institution. “The Unprecedented Expansion of the Global Middle Class,” February 2017

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