The Insight Bureau

From the Desk of...

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Chinese whispers: getting headquarters to understand the real challenges of doing business in Asia should be a top priority for regional CEOs.

It is a familiar tale; as the US economy slows, the difficulty of maintaining margins is rising. And so multinationals are putting ever more pressure on their Asian subsidiaries -- too much pressure, in fact. They are often forcing companies to invest too much, too fast and too recklessly. They are being foolhardy, forgetting one of the principles of business - that risk and reward are linked. Asia promises plenty of reward. But it is foolish to ignore the risks.

Regional CEOs know this only to well. “Sometimes, they just don’t listen”, they tell me, “but can *you* tell them?” So I spend an increasing amount of my time giving talks in Europe and the US to boards who are too keen to grow too quickly in Asia, too happy to ignore the risks, too far away from the markets to really understand them.

I frequently find executives are too willing to believe what they *want* to believe, not what is actually true or what their regional heads are telling them. Take China’s consumer market; I often hear talk about ‘the 1.3 billion consumers in China’ and quickly point out that this is wrong. There are 1.3 billion *people* in China. Not 1.3 billion *consumers*. More than 10% of China’s population earns less than $82 a year. The next 400 million have seen their real incomes, which are very low, drop in the last two years. And even Unilever, one of the largest producers of consumer goods, thinks of China as a market of just 300 million people. Their CEO in China told me that he thinks the next billion have too little money and are already well enough served by very low cost local producers. Targeting this group increases the chance that products will be copied, he says. “Besides, a market for 300 million is big enough for us right now.”

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A similar story emerges when you talk about local competition. Many international telecoms companies moved into China in the early 1990s expecting an easy ride. With their high tech products and oodles of cash, the world’s fastest growing phone market was ripe for picking. Yet, a decade on, they have found the networks are controlled by domestic Chinese firms, as is a huge chunk of the handset market.

Similarly, the world’s biggest carmakers moved into China and India with deep pockets and technology that had taken a hundred years to develop. Yet domestic car makers in China, companies that didn’t even exist a decade ago, now control a third of the market. The two dominant car makers in India control almost the same share as they did a decade ago too. Much the same is true when you look at white-goods, pharmaceuticals, computers and packaged foods.

Asia is not only misunderstood, it is also riddled with hidden costs

Asia is not only misunderstood, it is also riddled with hidden costs. I could count on one hand the number of multinational business heads I have met over the last ten years who have not had a problem with counterfeiters. Everyone knows about fake DVDs and handbags. But what about counterfeit blood plasma? Or copied cosmetics which cause skin problems, bottles of Pepsi filled with soy sauce and fizzy water, aircraft brakes made from compressed cardboard and even old oranges injected with chemicals to make them swell and look fresh again? All exist. There is even an expression in Shanghai; ‘we can copy everything except your mother’. Believe me, it is true.

Add to this the problems of corruption in much of South East Asia, theft of stock and equipment, high staff turnover (commonly 30% these days in much of Asia) rising wages (the going rate for a personnel chief in Shanghai is now RMB 2 million - roughly $250,000), higher logistics costs (typically 15% more than in Europe) and the troubles with tax authorities, provincial governments and the courts and it is easy to see why there are reasons for caution.

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Most companies even seem to think that political risk is something they can safely ignore. But with a coup in Thailand last year, instability in Indonesia and the Philippines and 87,000 government-recorded demonstrations in China in 2006, complacency is dangerous.

The opportunities in Asia are very substantial. But the challenges of doing business in the region are to be ignored at your peril. Risk and return go hand-in-hand. So let's hear no more of this, 'we're here for the long term' nonsense! If a market is risky, be cautious. Don't rush in just because everyone else is. First -mover advantages are often a mirage. And expect a higher return as well as a faster one. If you can't find a way to do that, wait till the risk is manageable.

This is not just what they teach you in the first year of a business studies course -- it is common sense.

About Graeme Maxton

Mr. Maxton is an independent writer and commentator on Asian economies and doing business in Asia. He is also a leading authority on the global automotive industry. He is a freelance writer for *The Economist* on Asia and automotive issues as well as a contributor to various other publications and articles.

Until recently, Mr. Maxton worked for the Economist Intelligence Unit and headed its Asia Pacific business intelligence programme called *Corporate Network.* He led the team which serviced over 700 multinational clients based in Hong Kong, Singapore, Beijing, Shanghai and Tokyo.

Mr. Maxton chaired and moderated discussion of these Corporate Network meetings as well as many of Economist Conferences' scheduled Roundtables. He has chaired conferences on various industries, including automotive, aviation, energy, financial services and manufacturing.

Mr. Maxton was the co-founder of *auto*POLIS, a strategy consultancy dedicated to the automotive industry. With Dr. John Wormald, Mr. Maxton has written two globally acclaimed books about the industry; the most recent of which was a highly influential work entitled "*Time for a model change*". He was previously with Booz Allen & Hamilton, American Express International and Citibank.

Mr. Maxton recently left The Economist Group and now operates from offices in Hong Kong and Vienna in order to fulfill assignments in Asia as well as Europe and North America.

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