

Why US Technology vendors should increase investment in Asia now

Over the last few months there has been a media assault of conflicting information about the US downturn and its potential impact on the global economy. In Asia though, it's business as usual. Companies continue to report double digit growth. What does this mean for your company?

by Mark Braithwaite & Mark Pretty

The dilemma for many US tech companies is that they know Asia will continue to grow, but they may have to shore up US profitability through worldwide cost cuts. Extending the cost cutting indiscriminately to Asia may help this quarter, but is very short sighted.

We all have access to public domain information. The problem with this data however, is that the facts are historical, and predictions are either conflicting or self serving spin. In writing this report, we accessed two distinct sources of information to get a clear picture of what is really happening in Asia:

- ▶ On the record sources – Including, The IMF, China Statistics Bureau, IDC, Gartner, The Economist.
- ▶ Off the record sources – One-on-one interviews with the Asia Pacific/Japan SVP's of 34 global technology vendors.

Firstly, let's summarise what the "On the record" sources say is happening in Asia.....

10 years ago, a US economic downturn would have seriously affected every country in the world. Things have changed though. Simon Johnson, the Economic Counsellor and Director of Research at the IMF delivered the IMF's spring 2008 World Economic Outlook Report on April 9. He said, "For emerging and developing economies, direct effects from the US downturn and financial strains have been much less pronounced than in previous episodes."

There are some fundamental reasons for the decreased influence the US economy has on the fate of emerging economies. Economists can't agree on what to call this phenomenon and for want of a better word, "decoupling" is

now the common term. Here are some the relevant extracts from their research:

- ▶ China's exports to the US slowed 5% last year
- ▶ More than 95% of China's 11.2% GDP growth in 2007 was from domestic demand
- ▶ China's exports to India, Russia, Brazil were up 60% and to OPEC countries 45%
- ▶ Half of China's exports now go to other emerging economies

The same kind of trend has unfolded in many emerging economies. They are trading with each other and have huge domestic demand. The "decoupling" theory means that these countries are less reliant on the US and therefore somewhat immune to significant impact from a US recession.

Last year, the average growth of the emerging economies in Asia was four times that of the developed world. China has acknowledged a slowdown in GDP growth this year from 11.2% to 9.4%. There are conflicting numbers about China's growth but they are all over 9% and that is after the downgrade! The IMF has stated that a worst case scenario for China this year, if there is global financial chaos, is 7% growth.

This story is mirrored across the region.

- ▶ **India** offers a similar story to China.
- ▶ **Australia** keeps hiking interest rates to slow an overheating economy riding on a wave of unending commodity sales to China.
- ▶ **South Korea's** exports to the US dropped 20% last year but overall exports grew by 20% as it traded more with other developing countries. All of the other smaller economies in Asia are growing way beyond the developed nation growth rates.

Japan though, is different to the rest of Asia as it is a developed nation which has been through a protracted period of very slow growth. The IMF is predicting that Japan will grow at 1.4% this year. Having said this, Japan is a huge economy and is a significant market for MNC's.

And what do the industry analysts have to say?

- ▶ Gartner recently surveyed 1011 CIO's worldwide and stated that in Asia, budgets had increased almost 6% in 2008 over 2007.
- ▶ IDC predicts a global slowdown in IT spending growth by around 1% and recommends, "Vendor companies should be aggressively hedging their bets through accelerated activity in high growth emerging markets". They predict that China, India, Russia and Brazil will grow IT spend by 16% in aggregate during 2008. SMB in Japan will grow 5-6% but enterprise spend there will remain flat.

So, what are the SVP's in Asia saying?

As executives of public quoted companies, on the record comments are constrained by governance issues. However, we have been able to engage in a series of "off the record" discussions, which has allowed much greater candour to the sharing of the SVP's experience of what is currently happening in the region. This brings greater depth of meaning to the content of this report.

These off the record discussions were all with the APJ SVP's of major brand global ICT vendor companies who have a significant existing presence in APJ. We looked for a wide yet balanced view, so chose companies that covered the bulk of the ICT market. They include companies in Application Software, Software Infrastructure, Virtualisation, Storage, PC's & Peripherals, Telecommunications, IT Services & Outsourcing. The companies we spoke with sell to Government, Enterprise, SMB and consumer. They sell direct, channel and retail.

As you would expect, we received many varied opinions which can be influenced by the particular circumstances of the interviewed executive and the current issues he or she faces at that moment. We looked for the common, relevant themes and have listed every opinion/statement that was

raised by more than four people. These interviews were one-on-one between each SVP and Mark Braithwaite. Some face to face, some by telephone. We began with one open question.....

"Considering the turmoil in the US financial markets and the confirmed global economic slowdown, what are you experiencing in your market and how do you see things unfolding for you in Asia?"

..... We then probed the first response and engaged the SVP in dialogue lasting between 15 and 30 minutes.

In summary, these were the common themes :

- ▶ No impact to sales in Asia Pacific at this stage
- ▶ No softening of pipeline
- ▶ US MNC's as customers will be impacted as they receive cost cutting directives from the US
- ▶ No impact on local company buying behaviours
- ▶ No impact on government buying behaviours, this area is very strong
- ▶ Have not seen deal delays, but CFO's are using cautious language
- ▶ India, China and Japan are self fuelled markets
- ▶ Asia is where our company will see top line growth in 2008
- ▶ Consumer demand is driving Asian growth
- ▶ A US recession will mean a 1-2% growth loss in Asia
- ▶ Of course there will be impact, but not like 10 years ago
- ▶ Expect a minor downturn in Australia
- ▶ The devaluation of the US dollar will have a bigger impact on us than a US recession because of the increased cost of new offshore investment for US companies and customer perception of current discount levels due to the weak dollar

- ▶ The constraint is not lack of opportunity but lack of talent leading to inability to deliver
- ▶ Have not backed off expansion plans
- ▶ We are seeing positive development in the Japanese market for the first time

During our interviews, there were a few bold statements worth quoting:

- ▶ "Every time we hire another rep, we sell more software. How can we be constrained by the market?"
- ▶ "Centralised companies may find it hard to make investment decisions."
- ▶ "US companies have a view of the world that is dominated by what is happening on their doorstep."
- ▶ "If your strategy is to sell to MNC's, you need to pull back. If your target is local markets, then no change is needed."
- ▶ "The general growth in our markets has nothing to do with the US."
- ▶ "If a US recession lasts more than 3 quarters, then Japan, Singapore, Taiwan and Korea will be hit. Less so for China, India and Australia."
- ▶ "Chinese and Korean companies are acquiring global companies and the need for technology for integration is driving new business for us."

There was one other major theme that can't be summarised in a one line quote. Let's call it "Planned Hyper-growth". Two of the interviewed VP's are targeting a growth rate of five times the market in Asia. In both cases, they have significant and mature presence in the region with revenues in excess of US\$2bn. Their view is that they need to grow at this rate for the next two years before they have effective market coverage. To achieve this kind of ambition takes a mix of aggressive investment in hiring and acquisitions.

The majority of companies don't have an appetite for the Planned Hyper-Growth strategy, but in the main, the positive sentiment is keeping most growing at more than 20%.

So, how can you use this?

On balance, the mood of the economists and the APJ SVP's is very positive about the regional economic outlook, despite a grim couple of years ahead for the US. Commodity prices, oil, food prices and inflation are all wildcards. Nobody has quite digested what effect this will have.

So, here is our advice. We see three kinds of US ICT vendors in Asia:

1. **Companies with a large, mature presence in Asia** – Costs in terms of talent and real estate will increasingly impact your margins. Operational efficiency must be high on the list of priorities. At the same time, the talent shortage will make you a target for other companies as they try to grow their regional presence. They will offer salaries that will cause havoc with your operational efficiency efforts.
2. **Companies with an existing presence in Asia but not achieved full market coverage yet** – It's time to invest now. The US is quiet, so turn your attention to growth markets. "The Street" will love the story. You are not alone. Most US MNC's fall into this category. Companies with single digit growth in Asia will struggle to balance margins with the increasing cost of doing business. Acquiring these companies and rationalising the exec team and back office has proven to be a successful route to market share for many players.
3. **Companies not yet in Asia** – It's not too late yet. This is not a short term boom. Get help though as there are lots of things you don't know. Trial and error in Asia is a very expensive game.

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