Many of us in business in Australia have to face the fact that we have come close to, have reached, or have actually gone past, the limits of business growth in Australia. Many large-scale businesses have found that they are now at a level of maturity where they can successfully leverage the depth of their corporate resources to exploit the high profit growth potential from overseas markets.

The other major strategic parameter is that Australia is close — in spirit and place — to the most dynamic region of the globe, the Asia-Pacific region.

Many years ago I concluded that to be an executive running a global business I had to stop thinking of these places as distant countries. Instead, I had to start thinking of them as just other cities and that visiting them was not fundamentally more difficult than visiting Melbourne, Brisbane or Perth. The major difference is the amount of time spent in the aircraft, and in the past 12 months I have travelled to Singapore more frequently, and just as easily, as I have to Melbourne.

These countries may not be the same, of course, but they work to a logic which yields to patient inquiry, they have goals and aspirations not greatly different from our own, and they are outward-looking in terms of their attitudes to what they can do with international capital, technology...
and management skill.

Getting on terms with our neighbours economically is a worthwhile priority for any significant Australian company with a product or service to sell.

Strategic issues

New regional dynamics dictate new corporate responses.

Management which believes it has already got the answers, got its strategy right, is risking nasty surprises somewhere down the track. This is a risk which is heightened, the larger the enterprise. Size can breed complacency.

The fact is that there are discernible limits to the market power of centralised conglomerates, whether this centralisation is organisational or locational. It is well documented that the generic multinational model has been invalidated by the increasing sophistication and differentiation of the markets of the middle league of nations. Being multi-domestic is the successful model of the 1990.

Why? While technology in transport and telecommunications has made the world relatively homogeneous in many respects, successful economic policies pursued in the middle league, and the consequential affluence of their populations, is defining markets with distinct individuality - especially in regard to branded products.

Being multi-domestic also means being first with the information. And there is no doubt that in a dynamic global environment knowledge is power.

"Being multi-domestic also means being first with the information. And there is no doubt that in a dynamic global environment knowledge is power."

International trade policies: The high moral ground of international trade diplomacy is best left to the government. While governments argue, firms just have to get on with the job! We must take the world as it is, rather than as we would like it to be.

The reality is that constraints to trade are in the making on a continuous basis. Equally, they are just as frequently being taken away. Whole new regimes, such as the ASEAN Free Trade Area, change the economics of these markets and must be reflected in strategic planning.

Scale: Some things can slot conveniently into niches in these markets but many more need a critical mass for business units to accumulate the appropriate functional skills, in the right volume, to be viable. It is important to appreciate the difference.

Marketing: It is a bold, and most likely foolhardy, firm which can assume that because a product or a brand has been successful in one market, it will be successful in another. No-one should discard successful formulas on a whim but, equally, it is sound management to re-interpret locally the successful generic model.

Location economics: The perennial challenge for the management of growing companies is where to locate the marginal unit of capacity. Management effort in understanding the various financial and other incentives offered by governments in this region is time well spent. These can change fundamentally location decisions which were once foregone conclusions.

Practical dimensions

Goodman Fielder has realised that secure market presence must be based on more than just being a seller. The reality is that to be successful in these markets one must become an inside player, not just a seller or importer.

This is true generally, but is especially so in the case of the food industry. Contrary to many conventional wisdoms, only a small proportion of processed food production is traded internationally.

Analysis by the Australian Graduate School of Management has confirmed that while those in the food sector earn a high proportion of their total revenue offshore (41 per cent on average), the overwhelming proportion of this was from in-market production (37 per cent) and only a tiny proportion (4 per cent) from exports.

A number of factors in the food sector indicate strongly in favour of a multi-domestic manufacturing strategy as opposed to a multinational sales strategy. These include tariff and non-tariff protective regimes, the transport economics of high-bulk/low-value product, perishability and market segmentation based on cultural or religious practices.

We were responding to developments in strategic markets which indicated strongly in favour of an investment strategy, rather than merely a
sales strategy, in order to be right on the spot to make the most of emerging opportunities. These included such factors as the process of electrification of rural Indonesia, the privatisation and rationalisation of industry in Vietnam and the rapid transformation of retailing in ASEAN countries as a whole.

And while many people have been observing what they describe as the “westernisation” of Asian tastes, we have seen in the rapid “Asianisation” of “western” tastes an opportunity to locate production facilities in the markets in which these trends originate, and to service an international market from that base.

The outcome is a $200 million investment program in Asia-Pacific markets involving 12 distinct manufacturing businesses in the region, which will swell in number in the next 12 months.

We currently generate 7 per cent of our turnover from our Asian manufacturing operations and expect that to reach 15 per cent ($1 billion) by the end of the decade. To reach this target, we will continue to invest, on average, about $70 million a year in the region.

We have narrowed our immediate focus to China, Hong Kong, Taiwan and ASEAN. But we also look at potentially profitable opportunities in places such as Vietnam.

The lessons

We have realised that the things that let you down are the simple things: like not putting in the right amount of time to get to know your markets, to know your partners, to understand the strengths and weaknesses of your competitors in particular locations.

We have also come to realise the immense value of the work put in over a 20-year period in building up our network of relationships in the region. A number of our recent investments are directly attributable to this.

We could have undertaken more investment if the size of our financial resources had been the only operative factor. But you have to have the settings right in each particular location, and you have to have the people available who can get results by taking the right decisions.

Quite simply, you can’t have all this at once. It takes time to build this sort of expertise. In our case, we set up an Asian Business Development Team specifically to build relationships with other firms, other governments and banks in the region. We have also been building our regional management capabilities through having more promising staff from Asia working alongside colleagues in our Australian operations and vice versa.

We are a big company and we believe there is a “correct” scale. We have decided to start with more projects than we will probably end up with — we have consciously chosen to feel our way in many markets, to grow with the market and to grow with our partners. At the end of the day, we will probably end up with five or six major business units, each with a critical mass appropriate to the market it serves.

In conclusion, no-one can be absolutely certain of success but if you have savvy, you have the best chance. This means being there, having your eyes and ears open, being willing to learn as well as to teach, and never allowing oneself the indulgence of believing that you have, once and for all, got it right.

Can Sydney be a Big Gun?

Kohtaro Miyagi, managing director, Canon Australia Pty Ltd

I believe Australia has great potential in research and development and as the site for regional headquarters. Under Canon’s globalisation program Tokyo is granting more responsibility to areas outside Japan. As far as research and development activities are concerned, Canon has established five major R&D companies. Each of these companies has specific responsibilities. In Australia the purpose is to develop new technology and to commercialise the results here.

Canon Information Systems and Research (CISRA) is responsible for image processing technology.

The reasons we established an R&D company in Australia are:

- Australia is an English-speaking, multicultural country, which allows for easy production of English-language software.
- Australia is a world leader in computer software technology and telecommunications technology.
- There is no time difference between Australia and Japan, which allows for easy communication.
- Australia has a high percentage of highly educated graduates. We are very happy and proud of the quality of staff working for CISRA.

We expect to successfully develop new technology and establish the business headquarters for product development by CISRA in the near future. We are currently spending about $10 million a year.

Under our globalisation program, Canon is looking at establishing a regional headquarters responsible for the Asia-Pacific region. We have already established a regional headquarters for Europe based in Amsterdam, to be responsible for Europe, Africa and the Middle East. We also established an office in New York as the regional headquarters for North Central and South America.

At this stage we are considering Singapore, Tokyo or Sydney as candidates, although we may well postpone our decision for the time being.

The establishment of a regional headquarters would mean taking on the full responsibility of investments, holdings, marketing, personnel etc., and Australia offers a great opportu-
Stepping on the gas

D.C.K. Allen, managing director, Woodside Petroleum Limited

In 1989 the first deliveries of natural gas were made from Australia to Japan. These deliveries represented the culmination of some 20 years of planning since gas was originally discovered off north-west Australia in the early sixties. Since that time, deliveries of LNG from the North-West Shelf Gas Project have risen to five million tonnes a year and will rise to a plateau level of seven million tonnes in 1995/96.

Markets for LNG are expected to expand, particularly in Japan, Korea and Taiwan, over the next 20 years. With large reserves of gas in various locations offshore, there could be significant opportunities for Australian companies to expand this trade. However, many complex factors would have to coincide favourably.

Development costs in Australia are high. Costs for the North-West Shelf project were at least 30 per cent (and possibly 50 per cent) more than an equivalent construction in, say, Indonesia. Part of the reason for this is the remoteness of the location. Further, the extreme climate meant that offshore facilities and onshore plant needed to be able to withstand cyclone conditions.

It was due to rapidly escalating cost estimates during the early eighties, when the initial design was under review, that it was changed from a water-cooled plant to an air-cooled plant. It was also decided not to remove LPG. The two changes reduced the estimated cost of the onshore plant by almost $900 million.

The North-West Shelf project was the last greenfield LNG project to be developed anywhere in the world and it was possible to get it off the ground only because of the relatively high price of oil at the time. In 1985 the price of oil was around $US28 a barrel and the forecast was for a steady increase. The reality, of course, was that in December 1985 the price of oil began to drop rapidly and it has since settled around $US20. Most people expect it to remain around this level for the foreseeable future. The viability of massive upfront investments on gas projects must be considerably lessened because of this significantly diminished potential cashflow.

Another aspect of an LNG scheme is the length of time between the initial decision to invest and the first deliveries. In the case of the North-West Shelf, the decision to go ahead was made in 1983 and the first deliveries were in 1989. With investments by that stage of around $4 billion for the LNG scheme alone, the financial exposure of the participants was immense and would preclude virtually any company other than an extremely large one from participating.

There is no government equity in the project. It is one of only two which are entirely funded by private investment.

Another crucial factor in the LNG business is transport. Not only is it necessary to construct expensive terminal facilities, but the tankers themselves are highly sophisticated. At present a standard 125,000 cubic metre tanker costs around $300 million. In the case of the North-West Shelf project, the fleet will be eight tankers, of which seven are already in service. This fleet represents an investment of the order of $2 billion.

The North-West Shelf project is an excellent example of the magnitude of the capital exposure necessary if a greenfield gas project is to get off the
Understanding Asia

Andrew Hutchings ASIA, investment director, G.T. Management (Australia) Limited

It is very difficult to generalise about the Asia-Pacific region as a single, integrated entity. The stockmarkets of the region vary enormously in terms of size, development and sophistication. In established bourses such as Australia’s, the correlations between returns from particular stocks is relatively low. In many embryonic or emerging markets (and not just in Asia), the correlations are much higher.

In such cases, the key decision for an investor is whether or not to be in the market as a whole. Stock selection, and by extension security analysis, is comparatively less important. Except in Japan, Australia and New Zealand, the absence of liquid and deregulated bond markets often makes “conventional” valuation techniques - based on a notional risk-free rate of return and an equity risk premium - difficult.

Conventional security analysis added little value to understanding the boom and bust in Taiwan, which was one of the most spectacular in the Asia-Pacific region in the 1980s. What were important to market participants and commentators were Taiwan’s macroeconomics and the institutional structure. Large external surpluses combined with a fixed (and often undervalued) exchange rate to generate strong growth in liquidity. Thanks to the country’s high savings rate and the absence of alternative outlets for personal investment, much of the resulting asset price inflation took place in the stockmarket. Ultimately, a change in the tax regime brought the rally to an end. Fundamental valuations were irrelevant.

The Shenzhen and Shanghai markets are more recent examples of situations where fundamental valuations were ignored in a private client stampede.

One of the key features of Japanese investment is, and has been, that an understanding of thematic influences is often just as important as fundamental analysis. From 1982 to 1985, an orientation towards leading stocks which were exporting to the booming United States was critical. From 1985 to 1987, the key themes were Endaka — the astonishing rise of the yen — and latent assets. From 1987 to the end of 1989, when the Nikkei index peaked, counters which benefited from booming domestic demand came to the fore.

Rock-bottom cost of capital was a major factor in both the asset price explosion and the global success of Japanese big business through the 1980s. The corollary of this was that neither earnings per share maximisation nor financial risk reduction was necessarily a prime objective, as they so often are in Anglo-Saxon countries. The challenges for foreign analysts are compounded by significant differences between Japanese and international accounting standards.

Many of the factors which make Asia “different” come together in Korea. The heavily regulated capital market funnels scarce funds towards a small number of Chaebols, and not necessarily at the right price. There is therefore often less pressure on the management of these industrial giants to focus on short-term return on equity or EPS. Accounting standards and investor relations practice favour managers and bankers rather than shareholders. Monetary conditions matter far more than fundamentals in that...
portion of the stockmarket which is closed to foreigners.

The key conclusion has to be that corporate structures, accounting, investor relations, laws and methods of company analysis differ to reflect the varying ways in which capital is sourced. Most companies in the Asia-Pacific region fit one of three general stereotypes.

In the Western Model, typical of Australia and New Zealand and particular industries such as airlines, the structure is simple — local institutions, local private clients and foreign institutions invest in a single business which may or may not have overseas elements. Sometimes one of the major shareholders is a government or foreign corporate.

In the Japanese Model, which is also typical of Korea, a group of companies with different businesses hold shares in each other and maintain other relationships. At least one element may be a bank. Several operations are clearly in capital-intensive or technology-intensive businesses.

Overseas subsidiaries engage in marketing or labour-intensive processing. External shareholders are relatively small and unimportant, but may own shares in virtually all the companies in the group.

The Overseas Chinese Model is common throughout South-East Asia, Hong Kong and Taiwan. In it, a family holds controlling stakes in a range of subsidiaries and joint ventures, spanning several industries and countries. One of the group companies may be a bank. Another is probably in property. Trading is generally accorded a higher priority than capital-intensive or technology-intensive production. As in the Japanese Model, labour-intensive activities tend to take place wherever workers come cheapest. External shareholders often invest in particular subsidiaries or (if corporate rather than institutional) in joint ventures.

However, they invest rather less frequently in the family's own master company. Disclosure of information depends to a great extent on the family's long-term objective. Sometimes non-disclosure is an article of policy.

It is difficult to imagine a homogeneous Asia-Pacific, where a single approach to company analysis can be applied in almost all countries, while so many of the region's markets are still emerging. It is possible that the most exciting bourses of the next 20 years are as yet embryonic (such as Shanghai) or totally undeveloped (such as Vietnam).

Although many of the largest companies in Asia and the Pacific are listed outside the region and may have issued euro-convertibles, few are yet dependent on American or European capital. In some cases, ADR and convertible programs have been heavily influenced by long-term government plans to deregulate capital markets.

Those companies that have needed access to funds on a global basis have tended to be of the Western Model, have generally long outgrown their home countries and have embarked on massive projects. Overseas Chinese and Japanese multinationals have, in the main, been able to finance expansion offshore (including into Europe or America) from traditional sources.

The Asia-Pacific region is the fastest-growing region in the world. It therefore has the greatest capacity to generate capital internally. One or two Asian giants will find that they have to stalk the world for finance, and will change their philosophy (or adopt a different model) in order to do so.

The absolute amount of institutional investment from Europe and America will be huge. Nonetheless, the Asia-Pacific region should retain its separateness for some time. Company analysis will stay different.

The global shockmarket

The new cashflow into long-term mutual funds in the US in the first half of this year was $US120 billion, compared with $171 billion for the whole of last year. Total assets of long-term mutual funds were $1.25 trillion at the end of June, more than a third higher than a year ago.

The sheer volume of funds moving into the hands of professional managers at the expense of the banking system will continue to increase the demand for equities. While I believe that demand will stimulate supply, I do not rely on it to explain the supply side of the expanding equity equation. The explanation also requires a global perspective.

Maximilian Walsh, economic columnist and commentator

The global economy is currently undergoing the largest supply-side shock in history as between three and four billion people gate-crash the market economy. I am talking here about the former communist and mercantilist economies.

By mercantilist I refer to those countries which until recently pursued national policies aimed at creating broad-based self-sufficient economies. These were former colonial possessions which had a deep distrust of external economic forces. In our immediate region Indonesia is the most obvious example but we can include such populous countries as India and Pakistan and all the countries of Latin America.

Their embrace of externally oriented market-based economies and their wooing of foreign investment is every bit as important as the transition of former communist countries to market-based economies.

For reasons of illustrative convenience I will focus on China — but keep in mind that China’s enormous population of 1.2 billion represents between one-quarter and one-third of the total numbers involved in this supply-side shock. And perhaps it is useful to re-
mind you that the total population of the 20-plus members of the OECD, the rich club of advanced economies, is around 1 billion.

In those well-paid OECD economies manufacturing wage costs are, for example, $16.90 an hour in Japan and $16.40 in the US. Manufacturing costs in China are currently 44 cents an hour.

Twenty years ago this huge differential would not have mattered, even if China had been an open, market-oriented economy. Today it is a different story because access to technology and modern management techniques enable emerging economies to leapfrog along the chain of industrial evolution.

If Daimler-Benz wanted to establish a Mercedes factory in Shanghai it could do so and have it up and running with German standards of productivity and quality in two years at the most. You may think this an absurd example — but Nissan is currently establishing a factory in Mexico to export cars back to Japan.

There is, I believe, a very useful analogy between the present situation and what happened during the last quarter of the nineteenth century, when the global economy, like now, enjoyed a condition of free capital flows. In European economic history the period from 1873 to 1896 was known, at least until the 1930s, as the Great Depression. In economic terms, what happened during this period was a supply-side shock as the countries of new settlement, notably Australia, Canada and Argentina, combined with the opening up of the US west with rail transport to suddenly expand the supply of cheap rural and mineral commodities to the then industrialised world of Europe. This supply-side shock came on the tail of a particularly nasty boom-and-bust cycle following the Franco-Prussian war. It also coincided with a long run of very rainy seasons which had a devastating effect on European rural production.

Lower-cost imports and poor production outcomes had a disastrous impact on the rural producers of Europe and Great Britain. Their economic position was exacerbated by what happened in financial markets as the growth prospects in the countries of new settlement caused a diversion of capital flows away from Europe. Precisely the same thing is happening now, although the process is only getting under way. Even so, Barings of London recently estimated that the net equity flow into developing economies last year was $14 billion, up from $1.3 billion in 1988 — a more than tenfold increase in just four years.

An important difference between the supply-side shocks of the nineteenth and twentieth centuries is that the new market economies have large, mature business enterprises that are being transferred from the public sector to the private sector. Domestic capital markets are simply inadequate to digest this process of massive private imperatives which I see as implicit in the changing investment behaviour we are witnessing in the US and to a lesser extent, so far, in other advanced economies.

Post-war political systems, especially in Europe but to a significant extent in the US, Japan and in this country, were built more on the legacy of the "real" Great Depression of the 1930s than they were on the wartime experience.

The post-war world saw the blossoming of the welfare state where the state assumed responsibility for the welfare of its citizens on a cradle-to-grave basis.

Throughout this period we not only had high and continuing economic growth at a level never before experienced; we also had constantly growing workforces where the ratio of dependency — that is, the number dependent on welfare as a proportion of the taxpaying population — was declining.

This period of economic euphoria led many governments, including countries such as Germany which have a reputation for prudent behaviour, to establish high-cost unfunded welfare systems. These were predicated on continued economic growth and a conventional pyramid-shaped demographic structure.

Neither of these two basic assumptions any longer applies. The advanced economies are in the midst of the worst recession they have experienced since the 1930s. By the end of this year unemployment in the OECD countries is estimated to reach 36 million.

Because of the economic downturn we have seen all these countries resort to deficit financing on an unprecedented scale. We see a growing desperation on the part of governments to bring their national balance sheets back into order — to reduce their public debt.

As a result, the next few years will see the privatisation of state business enterprises in Europe on a scale that has no previous parallel. As the Economist magazine noted in its August 21 issue: "Last year, state-owned firms worth $69 billion in nearly 50 countries passed into private hands. That took the running total since 1985 to
We are witnessing a sea-change in the economic order, we are well ahead of change in financial markets which will be a consequence of that transition to underwrite their welfare in retirement. Of the baby-boom generation know in the public-sector transfer payments. In Europe, where state welfare is much advanced and emerging economies before some degree of equilibrium can be restored to all economic systems. Convergence is a two-way concept, but advanced, democratic societies have, in practice, very rigid structures. However, they will have to face up to the reality that the welfare states constructed after the Second World War impose impossible handicaps in the new world economic order. Throughout Europe we now see political debate focusing on ways to cut back public-sector transfer payments.

Of all the advanced economies, the US is the most flexible and most resilient. It has, for example, unemployment of 6.8 per cent compared with double-digit unemployment throughout most of Europe. What is apparent in the US is that the more perceptive of the baby-boom generation know that they cannot look to the government to underwrite their welfare in retirement. While Australia is lagging behind the US in facing up to the new world economic order, we are well ahead of Europe, where state welfare is much more deeply entrenched.

In the 1990s, it is inevitable that welfarism will go into reverse. What we are witnessing in the US is a sea-change in financial markets which will sweep the world. An equity tidal flood is only one of the consequences of that sea-change.

Since 1980, futures exchanges have been established in Hong Kong, Kuala Lumpur, Singapore, Auckland, Osaka, Tokyo and Manila, and futures markets are planned for China, Korea and Taiwan. The Asia-Pacific region is on the threshold of becoming a significant participant in global futures and options trading. Sydney Futures Exchange is acknowledged as the oldest open-outcry-style futures exchange in the region, starting its operations in May 1960. In its early years, SFE established itself as a viable marketplace for hedging purposes in commodity products such as wool, live cattle and gold. By the late 1970s, the Australian futures industry had developed a broad spread of specialist futures broking houses with a large population of experienced floor traders, client advisors, market analysts and back-office staff.

This experience and expertise permitted the Australian futures industry to make the transition from commodity products to financial instruments virtually simultaneously with a similar transition occurring in the United States in the early 1980s. It was during this transition that the Sydney Futures Exchange established a reputation for pioneering innovative futures and options contracts in the Asia-Pacific region.

On deregulation of the Australian financial markets in the 1980s, many international banks and trading houses moved to set up operations in Sydney. This expansion of participants, combined with the volatility of the Australian financial markets and the relatively large size of Australia’s capital markets, resulted in the rapid internationalisation of Australia’s cash and futures markets and led to spectacular growth from the mid-1980s. That growth is continuing to the present day.

L. V. Hosking, chief executive, Sydney Futures Exchange Limited