

# ASIA MONTHLY

## May 2017

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## Topics Collaboration with local startups in Southeast Asia

As a strategy to get into Southeast Asian markets through localization and digitization, Japanese companies should consider collaborating with local startups that have been emerging in recent years.

### ■ The growing importance of localization and digitization in market development

Japanese firms have long continued to enjoy business superiority in Southeast Asia. However, in recent years, the region has begun to attract global attention as a market with high growth potential, and firms from Europe and the US, and also China and South Korea, are beginning to make full-scale inroads into Southeast Asia. For this reason, coupled with the fact that local firms are steadily growing in strength, the relative presence of Japanese companies in the region has begun to wane, and the days when products would sell simply on the strength of having been made in Japan, or having a Japanese brand name, are already coming to an end. Under these conditions, in order for Japanese companies to develop markets in the region, it will be more important than ever before for them to localize their businesses by going on-site to local areas, carefully identifying local needs and linking them to business opportunities.

At the same time, digitization is currently progressing in Southeast Asia, with Internet and smartphone usage spreading rapidly. However, there are significant discrepancies among the different fields of digitization, with, for example, many countries having a higher usage of social media than most industrialized nations, but lower rates of electronic settlement. In addition, various types of infrastructure are still not as developed as would be expected from the level of digitization, and the progress of development in digital and other fields is not as consistent as it is in the industrialized nations. As a result, Japanese firms will be unable to respond in the same ways as they have done at home, and will need to develop ways that match local circumstances. Localization is important in these cases too.

### ■ Startup collaborations as a strategy

One strategy that Japanese companies have at their disposal as they attempt to develop markets in Southeast Asia under such difficult circumstances is to collaborate with local startups.

The purpose of companies collaborating with startups is to gain access to the innovation that the startups create, and to make contact with the talent that is responsible for producing it. The expectation is that this will allow them to participate in new markets and to complement their own research and development activities. In a survey (by Accenture) of large companies in major countries on the merits of collaborations with startups, among the top responses were “access to particular skills and people”, “participation in new markets” and “improved returns on own R&D investment”.

As regards methods of collaboration with startups, various options are available, depending on the degree of commitment, starting from the light end with one-off purchases of the startup’s products, to welcoming them as a supplier, and from purchasing their products on a regular and continuous basis, to carrying out joint development and marketing, or even buying out the startup.

Currently, startups have been founded throughout Southeast Asia, leveraging the latest digital technology in order to develop businesses that closely fit local circumstances. By cooperating with these local startups, and incorporating their innovations, Japanese companies can overcome the handicaps of lack of information and know-how relating to localization and digitization, enabling them to conduct various types of business experiments more easily. This may be expected to be a tool with which Japanese companies can develop markets in

#### <Large Companies’ Benefits of Collaborating with Startups>

Q: What are the top benefits to collaborating with startups/entrepreneurs on innovation?

(Ranked within the top three)

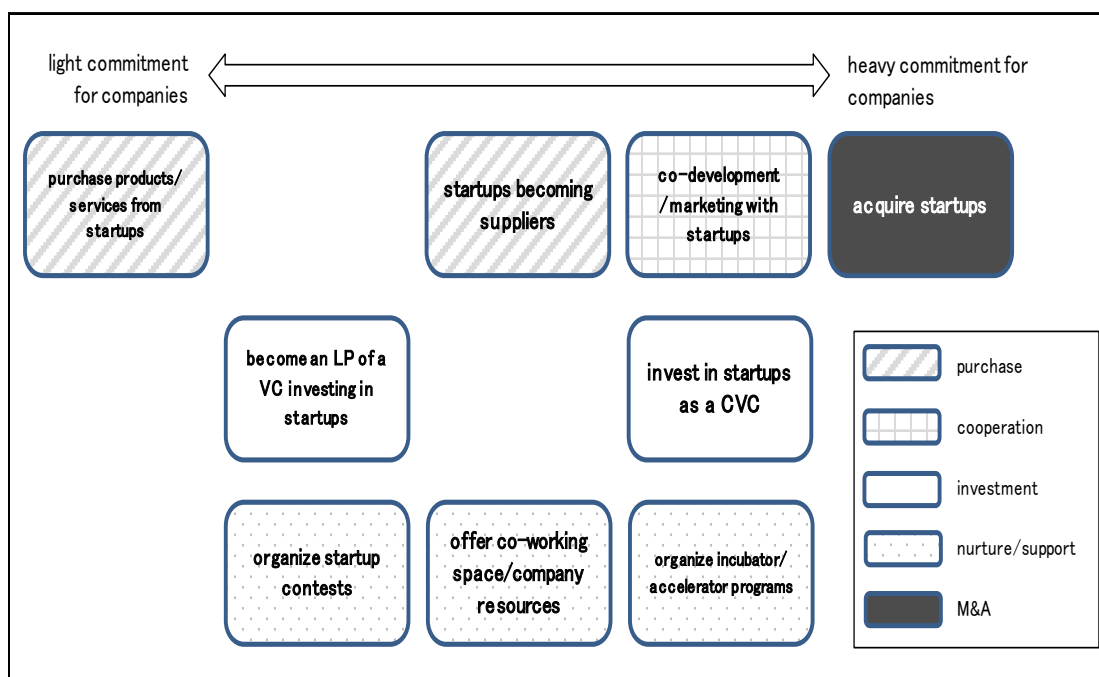
	(%)
Accessing specific skills and talent	53
Entering new markets	50
Improving return on in-house R&D investment	48
Accelerating disruptive innovation in your company	42
Designing new products and services	40
Enhancing company’s brand/image	39
Enhancing the entrepreneurial culture of your company	17

Note: Survey on 1,000 large companies across the G20 economies.  
Source: Accenture, *Harnessing the Power of Entrepreneurs to Open Innovation*, 2015

Southeast Asia, leading in turn to the maintaining and improvement of Japanese companies' presence in the region.

For example, if a Japanese fashion brand plans to enter the Indonesian market, they could collaborate with a startup managing an electronic commerce (EC) site in the country, selling their products there. Then, being able to contact consumers throughout Indonesia's vast land-mass, they will have opportunities to conduct a range of business experiments, such as analyzing the sales performance of their products, and identifying the tastes and acceptable price ranges of the Indonesian consumer through comparison with competitors' products. Again, a Japanese cosmetics manufacturer aiming to promote sales in Thailand could collaborate with a startup doing marketing using social media. This would allow them to make more direct and effective contact with their target audience than they could expect through mass advertising.

<Examples of Companies Collaborating with Startups>



Note: VC: Venture Capital, CVC: Corporate Venture Capital, LP: Limited Partner  
Source: Japan Research Institute. Ltd.

### ■ Collaboration with Japanese startups

Among Japanese companies in recent years, the importance of open innovation is being recognized, and, as part of this, there are examples of major companies establishing collaboration with startups. However, there are still very few examples of Japanese collaborations with startups overseas, especially in the new emerging economies. For Japanese companies unfamiliar with this kind of collaboration, there is the option of establishing collaboration with startups that have been launched by Japanese entrepreneurs in Southeast Asia, which have been increasing in recent years. The merits of this approach include 1) easier communication of ideas and feelings since top management on both sides speak Japanese and understand Japanese thinking patterns, 2) attentive support to ensure that the Japanese company's products are accepted in local markets, and 3) explanation from the startup on local business practices that may be difficult for Japanese companies to understand, as well as advice on related points to be paid attention to. After gaining a foothold to localization through collaboration with a Japanese startup, an effective strategy would be to then expand candidates for collaboration to include startups operated by local business people.

(Kaori Iwasaki)

## Hong Kong Chief Executive-designate chosen

### Domestic and external demand both improving

Hong Kong's economy is continuing on its recovery trend. The real GDP growth rate for the October to December quarter of 2016 was 3.1% compared to the same period in the previous year (and the same hereafter), improving on the July to September quarter (2.0%). Part of the background to this has been a rally in domestic demand as a result of a healthy employment and incomes situation, and receding concerns over economic deceleration in mainland China.

Encouraged by economic recovery, Hong Kong's unemployment rate was 3.0% in February, 2017, falling to its lowest level since February, 2014. Real wages continue to increase, growing 2.6% in the October to December quarter of 2016, and the employment and incomes environment is continuing to improve.

In response to these circumstances, the decline in retail sales is beginning to contract. The consumer confidence index continues to improve, after bottoming out in the April to June quarter of 2016, and private consumption is expected to continue to improve in the future. In addition, the asset effect is expected to contribute to the recovery of consumption, due to the higher prices of assets such as housing and shares. Though housing prices fell sharply from October, 2015, due to concerns over possible higher US interest rates and economic deceleration, now that the sense of overpricing has been cleared and the economy is beginning to recover again, prices are beginning to trend upwards again. Share prices are also rising due to the recovery in corporate earnings, mainly as a result of improved export performance.

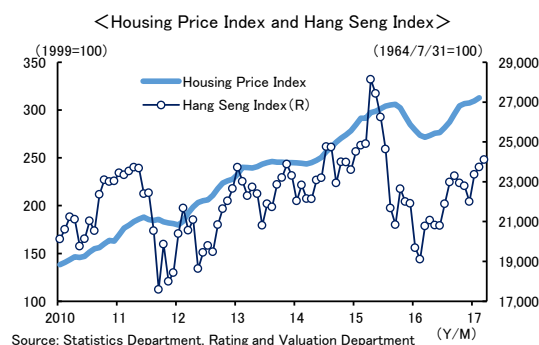
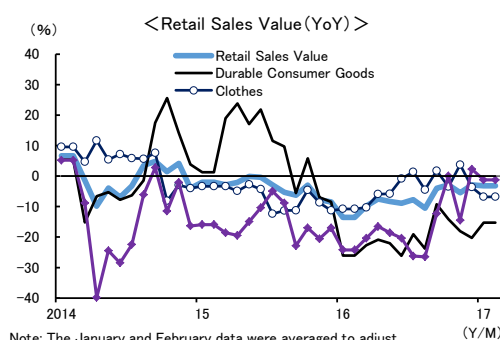
Turning to external demand, February's exports to China, which account for about 50% of Hong Kong's exports, grew at 35.9% compared to the same period in the previous year, a significant margin, while those to ASEAN, where economic recovery continues, grew at a robust 12.6%. In addition, service exports are recovering, with the number of overseas visitors, which had been falling below the previous years' levels, returning to positive growth in December, 2016, and January, 2017, mainly due to the recovery in the numbers of visitors from mainland China.

Looking ahead to the future, the outlook is that the economy will continue to improve, supported by the recovery in both domestic and external demand. However, it will still be necessary to pay attention to the trend of interest rate hikes, following suit of US interest rate hikes. Since December, 2015, the policy interest rate has been raised three times (0.25% each time), and now stands at 1.25%. While there are no signs at the moment of increases in the lending rates of the major banks, there is a possibility that these will go up in the future, due to the expectation of further US interest rate hikes. In that case, there is a danger that the real estate market may cool suddenly.

### Lam Cheng Yuet-ngor wins Chief Executive election

The election for the post of Hong Kong's Chief Executive was held on March 26, 2017. The pro-Beijing candidate, Lam Cheng Yuet-ngor (Carrie Lam) won by gaining 777 votes, more than the 600 vote majority. It is expected that, after she takes office on July 1, she will begin to promote harmonization policies within Hong Kong. However, given that she has maintained a strong stance against student movements demanding ordinary elections, and that she has served as the Chief Secretary, the Number Two position of the current administration, which is losing its influence, there is a possibility that dissatisfaction among the citizens of Hong Kong will intensify in the future. In addition to repairing Hong Kong's rifts, the new Chief Executive-designate will face the task of improving the people's confidence in the new administration, while grappling with a mountain of issues such as the reforms of the real estate market, social welfare and the electoral system.

(Kentarō Matsuda)



## Philippines Upward pressure on interest rates intensifying

### ■ Inflation rate rising

Inflationary pressure in the Philippines is growing. The consumer price index for March, 2017, was 3.4% compared to the same period in the previous year, the highest growth level in 28 months. Among the reasons for the increase in the inflation rate, the following three may be mentioned.

The first is the progressive depreciation of the peso. The Philippines, whose manufacturing industry lags somewhat behind in terms of its development, depends on imports for many of its goods, and has an economic structure that is vulnerable to import inflation due to the depreciation of its currency. Against this backdrop, the exchange rate has continued with the peso trending weak against the dollar since the latter half of 2016, due in part to a growing sense of distrust over the extreme behavior of President Duterte, and expected US interest rate hikes. At the end of March, 2017, the exchange rate was 50.2 pesos to the dollar, with the dollar strengthening 9.2% against the peso compared with the end of March, 2016.

The second reason is rising electricity charges. Manila Electric Company, which produces and supplies electricity in Metro Manila and other areas, had to switch to an expensive alternative fuel in order to generate power, due to a temporary shutdown of the Malampaya gas field, and this caused an increase in power generation costs, as a result of which electricity charges have been going up continuously since the start of 2017.

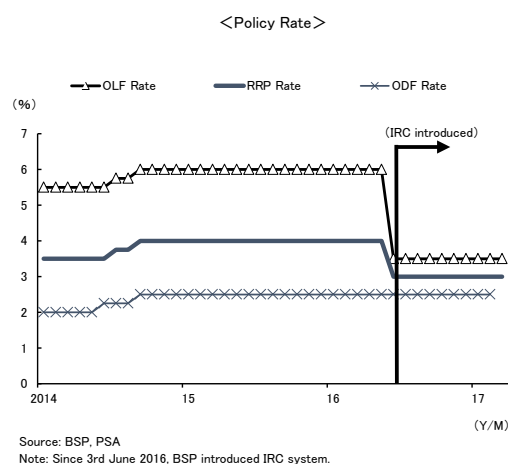
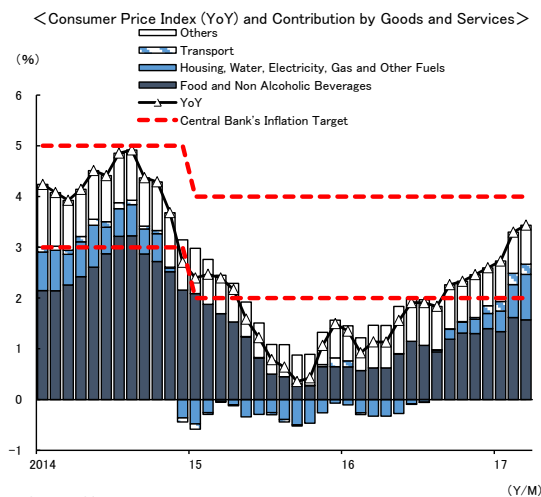
The third is the rise in crude oil prices. Due to expectations of the production cuts agreed between OPEC and non-OPEC countries, crude oil prices, which had been falling until the early spring of 2016, recovered from the latter half of 2016 onwards reaching \$51 per barrel in March, 2017, rising just over 30% compared to the same period in the previous year.

### ■ Even if interest rates are raised, significant economic slowdown can be avoided

In the future also, it is expected that upward pressure on consumer prices will intensify due to the continuing strength of the dollar against a weak peso as US interest rates continue to rise. For this reason, it is very likely that Banko Sentral ng Pilipinas will embark upon interest rate hikes within the year, with the aim of curbing inflation. In fact, examination of the inflationary phases of 2014 shows that BSP implemented interest rate hikes whenever the inflation rate was getting close to the upper limit of the target range.

Although inflationary pressure may be expected to settle gradually if BSP implements interest rate hikes, there are concerns over a possible negative effect on the economy due to the suppression of private investment, automobile sales and so on. However, given that support will be provided by the progress of various types of infrastructure projects under the Duterte administration, the growth in exports as a result of an improvement in the global economy, and healthy growth in the amounts of money remitted home by Oversea Filipinos Workers due to the recovery of the US and other economies, it is likely that a major deceleration of the Philippine economy as the result of interest rate hikes can be avoided.

(Yuta Tsukada)



## China Economic stays within a flat range

### ■ 6.9% growth in Q1

China's real GDP growth rate in the January to March quarter of 2017 was 6.9%, compared to the same period in the previous year, accelerating slightly from the October to December quarter of 2016 (6.8%, similarly).

In terms of individual demand items, investment is gradually picking up momentum. Fixed asset investments (excluding rural households) in the January to March quarter grew 9.2% compared to the same period in the previous year, growing faster than the performance for the whole year 2016 (8.1% compared to the previous year). The main factors behind the recovery have been rapid growth in infrastructure investment and an improvement in real estate development investment. The authorities did introduce measures to restrain housing prices, but their effect was limited, with capital pouring into those cities that did not actually implement the measures, for example, and this appears to have accelerated the pace of increase in real estate development.

The pace of consumption growth is blunting slowly. The nominal retail sales growth rate for the January to March quarter was 10.0%, compared to the same period in the previous year, coming in 0.4% points below the figure for the whole year 2016. Two of the reasons behind this are 1) the slowing pace of growth in wages, and 2) the waning of the booster effect of consumption stimulus measures. In the case of automobiles, a representative example of the latter, as a result of the contraction of tax reduction measures, sales fell from double digit growth in 2016 to just 4.2% growth in March, 2017, compared to the same period in the previous year.

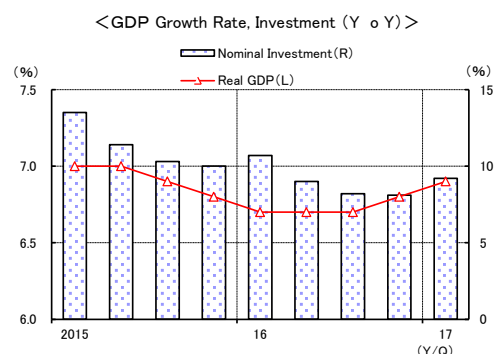
Looking at external demand, encouraged by the recovery trend in the US and new emerging economies, exports changed to positive growth in March, compared to the same period in the previous year. Imports are continuing to enjoy high growth levels, as a result of the expansion in infrastructure investment and improved industrial production.

### ■ Trade friction with the US poses economic downswing risk

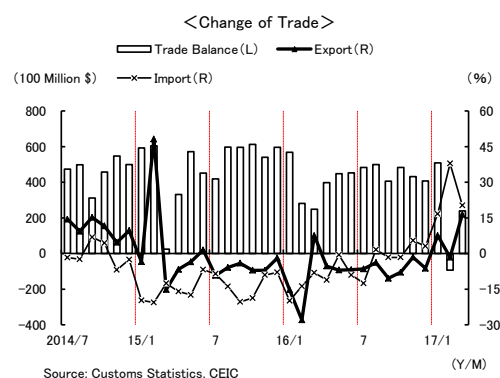
With regard to the future economic outlook, taking into consideration the fact that the Xi Jinping ruling circle is in agreement in wanting to push ahead smoothly with structural reform, and to avoid upset in the run up to the National Congress of the Communist Party of China, slated for the autumn of this year, it is assumed that there will be a continuation of mainly financial measures designed to ward off economic downswings, such as increased infrastructure development and tax reductions. Domestic demand will likely maintain expansion within a generally flat range over the latter half of the year.

With regard to external demand, a look at the recent real economic front shows that exports are expected to make a solid recovery. Of course, it is necessary to be aware that economic friction with the US still poses a risk of economic downswing. At the Trump administration's first US – China summit meeting, held on April 6 and 7, the enactment of a "100 day plan" to correct US – China trade imbalances was agreed upon. Negotiations will continue in the future, centered mainly on expanding imports from the US, but, depending on the direction of these negotiations, it is possible that the US may impose stern measures, such as slapping high customs tariffs on Chinese products, or labelling China a foreign exchange manipulator. If high customs tariffs are imposed, it is not impossible that a tit-for-tat battle could ensue, with China introducing retaliatory measures, and the concern being that this would not only hurt trade between the US and China, but could also have a significant negative impact on world trade. The appropriate handling of trade issues with the US is one of the most important economic management challenges for the Xi Jinping administration, and one which will test their mettle.

(Junya Sano)



Source: National Statics of Bureau  
Note: Investment figures and year-to-data excluding rural households.



Source: Customs Statistics, CEIC