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Topics Partnering of Japanese companies and Southeast Asian startups

In Southeast Asia, an increasing number of Japanese companies have been forming partnerships with local startups to develop markets and acquire the latest technologies. The types of Japanese companies collaborating with local startups have also expanded from emerging companies to traditional large enterprises.

■ Japanese companies are forming partnerships with Southeast Asian startups

In the past, many Japanese companies have collaborated with large companies, mainly local conglomerates, in Southeast Asia. But in recent years, with the rise of startups in Southeast Asia, more and more Japanese companies are choosing to partner with them. A review of the 73 major partnerships between Japanese companies and startups in Southeast Asia since 2010 shows that those in 2018 and 2019 accounted for 50% of the total, indicating rapid growth in the past few years.

By business segment, electronic commerce (e-commerce) was the main field at first, but the movement for cooperation paused around 2017, probably because the number of new entrants to e-commerce website operation in Southeast Asia had almost run its course. On the other hand, fintech partnerships continue to persist. One reason for this is that Japanese companies believe that there are still many opportunities for startups to play an active role in Southeast Asia, where there are many financial issues such as low bank account ownership.

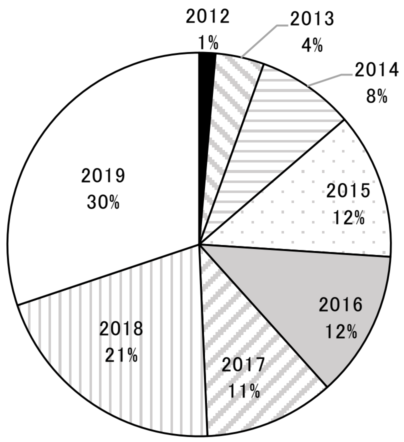
What is growing rapidly is collaboration in the fields of the latest digital technologies and mobility that we rarely saw before. In the latest digital space, Japanese companies have been forming partnerships with blockchain, big data analytics, and RPA (robotic process automation) startups. The same startups work with several Japanese companies, and most of them are based in Singapore. Quite a few were founded by Indians. In the mobility space, on the other hand, partnerships with two giant ride-hailing startups dominate.

The lineup of Japanese companies forming partnerships with Southeast Asian startups is also changing. In the beginning, there were many Japanese emerging companies mainly in the e-commerce field, as those companies reacted quickly to the startup boom in Southeast Asia. Since then, traditional large Japanese enterprises have joined the movement to form partnerships, as the recognition of these startups has grown, thanks to the expansion of the types of businesses that startups engage in as well as the rise of Unicorns (unlisted companies with an estimated valuation of 1.0 billion dollars or more).

■ Two objectives behind partnerships

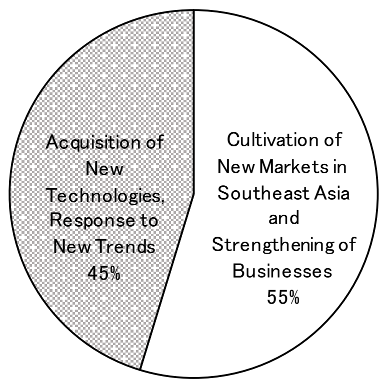
What are the reasons why Japanese companies are forming partnerships with Southeast Asian startups? According to press releases from 53 Japanese companies that formed partnerships, 55% of them wanted to “develop new markets and strengthen business operations in Southeast Asia” while 45%

<Partnerships Between Japanese Companies and Startups in Southeast Asia: Share by Year of Partnership>



Source: Prepared by The Japan Research Institute, Ltd.
Note: 73 partnerships between Japanese companies and startups in Southeast Asia are covered.

<Partnerships Between Japanese Companies and Startups in Southeast Asia: Share by Purpose of Partnership>



Source: Prepared by The Japan Research Institute, Ltd.
Note: 53 Japanese companies which have formed partnerships with startups in Southeast Asia are classified by the purpose of their partnerships based on information from press releases, etc. When there are two or more purposes, the assumed main purpose is selected.

wanted to "acquire the latest technologies and respond to new trends."

The first objective of "developing new markets and strengthening business operations in Southeast Asia" means that Japanese companies aim to use these startups as a springboard to expand and strengthen their existing businesses in Southeast Asia, where digital startups such as e-commerce and fintech are popping up one after another. Since the business environment is different in Southeast Asia compared to Japan, Japanese companies want to make use of the local knowledge and data of startups.

As for the second objective of "acquiring the latest technologies and responding to new trends," businesses using the latest digital technologies and businesses based on new concepts such as the sharing economy are now emerging around the world. Japanese companies are trying to absorb their knowledge and technology by working with startups that are key players in these businesses. In the past, most of these startups came from the United States, but since then startups have originated from China, Israel, and, more recently, Southeast Asia. Accordingly, Japanese companies have been shifting their focus on partnerships in Southeast Asia.

■ How to support startups to grow is the key

There are two main ways for Japanese companies to find startup partners: by themselves or by outsourcing. To find a partner on their own, employees of local subsidiaries of Japanese companies in Southeast Asia can attend local startup events regularly, organize their own startup events, or enter the startup communities by becoming more intimate with the founders of startups and their surrounding organizations. On the other hand, in the case of outsourcing the search for startup partners, there are ways including (i) becoming a limited partner of a venture capital investing in startups in Southeast Asia and collecting information via the venture capital, (ii) collecting information from research companies, etc., and (iii) using matching services between Japanese companies and startups in Southeast Asia.

The potential of startups in Southeast Asia is drawing attention from all over the world, and there is an increasing demand towards partnership for promising startups. In the case of Silicon Valley in the United States, it is said that the initiative in the collaboration between companies and startups is on the startup side, and that rather than companies choosing a startup, a startup chooses a company in forming a partnership. A similar situation applies to promising startups in Southeast Asia. What influences the startup in choosing a partner is whether the partner can contribute to its growth. Japanese companies' strengths in providing support to startups may include (i) opening up their own technologies, (ii) providing their own sales and other networks, and (iii) supporting their entry into Japan. For Japanese companies to be chosen as partners, the key is how to support the growth of startups through utilizing these unique strengths.

(Kaori Iwasaki)

Topics *"Guo jin, min tui" will further slow the Chinese economy*

The Chinese economy is under unprecedented downward pressure. The environment surrounding China is severe even from a medium- to long-term perspective, and the Xi Jinping administration may face a further slowdown due to the "guo jin, min tui (the state advances, the private sector retreats)" policy that favors state-owned enterprises.

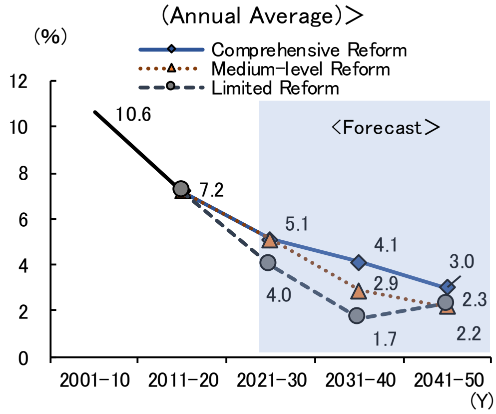
■ There is unprecedented deceleration pressure

The real economic growth rate in 2019 was 6.1%, the lowest in 21 years. The target growth rate for 2020 was expected to be lowered from the previous year's 6.0%-6.5% to around 6% at the National People's Congress in March, but the convention was postponed due to the spread of the novel coronavirus. The target growth rate may be further lowered. Some Chinese economists estimate 2020 growth at 4.5%.

The environment surrounding China is also severe in the medium to long term. This is because the potential growth rate continues to decline as the working population diminishes and productivity growth slows. The population aged between 15 and 64, which peaked at 1,005,820,000 in 2013, is expected to fall to 760 million by 2050. Productivity, which was once easily raised through the introduction of foreign investment and the promotion of urbanization, cannot be expected to grow as the developmental stage advances.

In addition, China faces unprecedented downward pressure on its economy due to sluggish exports caused by worsening relation with the United States. While the next round of trade talks with the United States will focus on China's ambition to become the world's strongest manufacturing power through "Made in China 2025," negotiations are expected to be tough, and exports are unlikely to be revived. The administration of President Xi Jinping has pledged to increase the growth rate through reforms, but the effect will be limited.

<China's Declining Potential Growth Rate (Annual Average)>



Source: Prepared by The Japan Research Institute, Ltd. based on materials of the IMF and the World Bank

The Development Research Center of the State Council (DRC) and World Bank predicts that even if the Chinese government works on "comprehensive reform," the potential growth rate will fall to 5.1% between 2021 and 2030, 4.1% between 2031 and 2040, and 3.0% between 2041 and 2050. In the case of "limited reform" with passive initiatives, the growth rate will be 4.0%, 1.7%, and 2.3%, respectively. Even if the Xi Jinping administration implements reforms, it can only slow the pace of China's economic downturn.

■ State-owned enterprises have been a drag on economic growth

Since its inception, the Xi Jinping administration has stressed that China is in a "new normal" and that it can no longer expect the high growth it had in the past. In China, at the time, it was considered that a growth rate of between 8.5% and 11.5% was "ultrafast" and that it would shift to "medium-to-high speed" growth of between 6.5% and 8.5% due to the new normal. While China's "medium-to-high speed" growth period was initially expected to continue for 10 to 15 years, it ended in just seven years. The growth rate, which was 9.6% in 2011, decreased to 7.9% in 2012, shifting to "medium-to-high speed" growth but dropped to 6.1% in 2019, below the lower limit of "medium-to-high speed" growth.

The decline in the potential growth rate of countries that have graduated from low-income country status is well known as the "middle-income trap." In the case of China, the slowdown has been amplified by the postponement of reforms. This is symbolized by a decline in investment efficiency. China needed 6.9 yuan of investment to produce 1 yuan of GDP in 2017, which was significantly more than the 5.7 yuan of investment required on average for the period between 2008 and 2017 and the 4.0 yuan of investment required for the period between 1998 and 2007.

State-owned enterprises (SOEs) are at the root of the decline in efficiency. The rate of return on total assets, which shows how much profit was generated by the assets of SOEs, including those in the service sector, peaked in 2007 and has been declining since then. On the other hand, the asset-liability ratio has hardly changed. SOEs can be said to symbolize the Chinese economy, whose growth is slowing under excessive debt.

■ “Guo jin, min tui” has been affecting investment

A more serious problem is that private sector, which have played the role of filling the holes in SOEs, are also suffering. There are a variety of private sector, including limited liability enterprises and stock limited, but the stagnation of private enterprises is particularly noticeable. Private enterprises, whose sales grew by more than 40% due to the explosion in the number of companies, drove economic growth in the 2000s, but that momentum is no longer there. This suggests the progress of “guo jin, min tui” in which private enterprises are forced to exit the market while state-owned enterprises are making great strides.

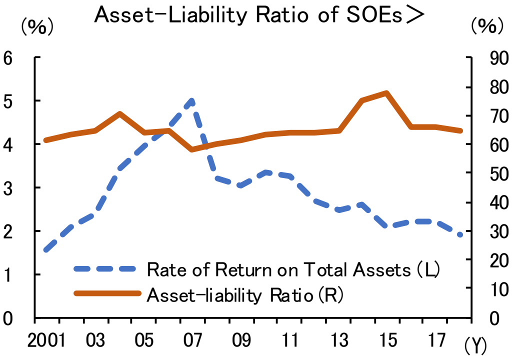
In China, it has been thought that “a decline in the ratio of SOEs in the economy” equals “advance of market economy.” In fact, industrial statistics show that SOEs have declined significantly over the past 20 years, accounting for only 4.9% of the total number of enterprises and 23.4% of sales in 2018. Based on this, there is no evidence of “guo jin, min tui” in which private sector are forced out of the market.

When you look at investment, however, it doesn't seem that is the case. The ratio of SOEs to fixed asset investment has been rising since 2016. The same phenomenon occurred in 2009, when the economic stimulus package resulting from the collapse of Lehman Brothers was launched, but this is the first time in history that the proportion of SOEs has risen over such a long period of time in the absence of an emergency. Behind this was the fact that private companies faced difficulty in raising funds as a result of the government, which was wary of excessive debt, limiting the supply of funds to companies including shadow banking. The net amount of funds procured in the bond market (bond issuance amount minus bond redemption amount) in 2019 remained positive for SOEs, while it was negative for private enterprises.

Although there are opinions within the government that funds should be provided to private enterprises, there are few that call for a review of the mechanism by which funds are provided preferentially to inefficient SOEs. Therefore, the proportion of investment directed to SOEs is expected to increase in the future. Since “guo jin, min tui” in investment will depress the economy for longer than the spread of coronavirus and sluggish exports, China’s potential growth rate is likely to approach that of the “limited reform” pattern shown in the diagram on the previous page.

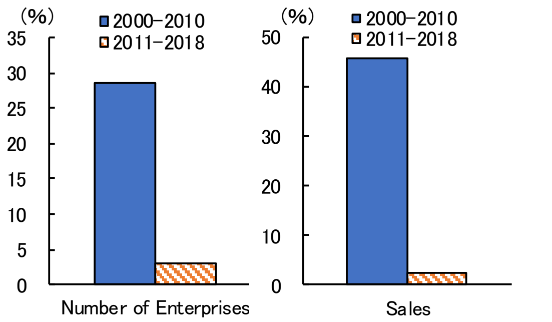
(Yuji Miura)

＜Rate of Return on Total Assets and Asset-Liability Ratio of SOEs＞



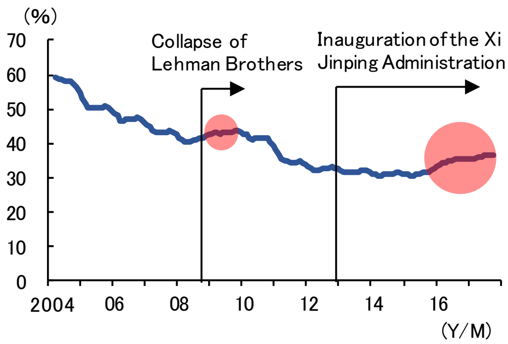
Source: Prepared by The Japan Research Institute, Ltd. based on materials of Ministry of Finance of the People's Republic of China
Note: SOEs are state-owned enterprises and limited liability enterprises and stock limited enterprises whose largest investor is the Chinese government.

＜Growth in Number of Private Industrial Enterprises and Their Sales (Annual Average)＞



Source: Prepared by The Japan Research Institute, Ltd. based on materials of the National Bureau of Statistics of China
Note: Only enterprises with a certain level of sales are counted.

＜Share of SOEs in Fixed-Asset Investment＞



Source: Prepared by The Japan Research Institute, Ltd. based on materials of the National Bureau of Statistics of China
Note: Monthly data are cumulative figures, with a 5-month moving average.