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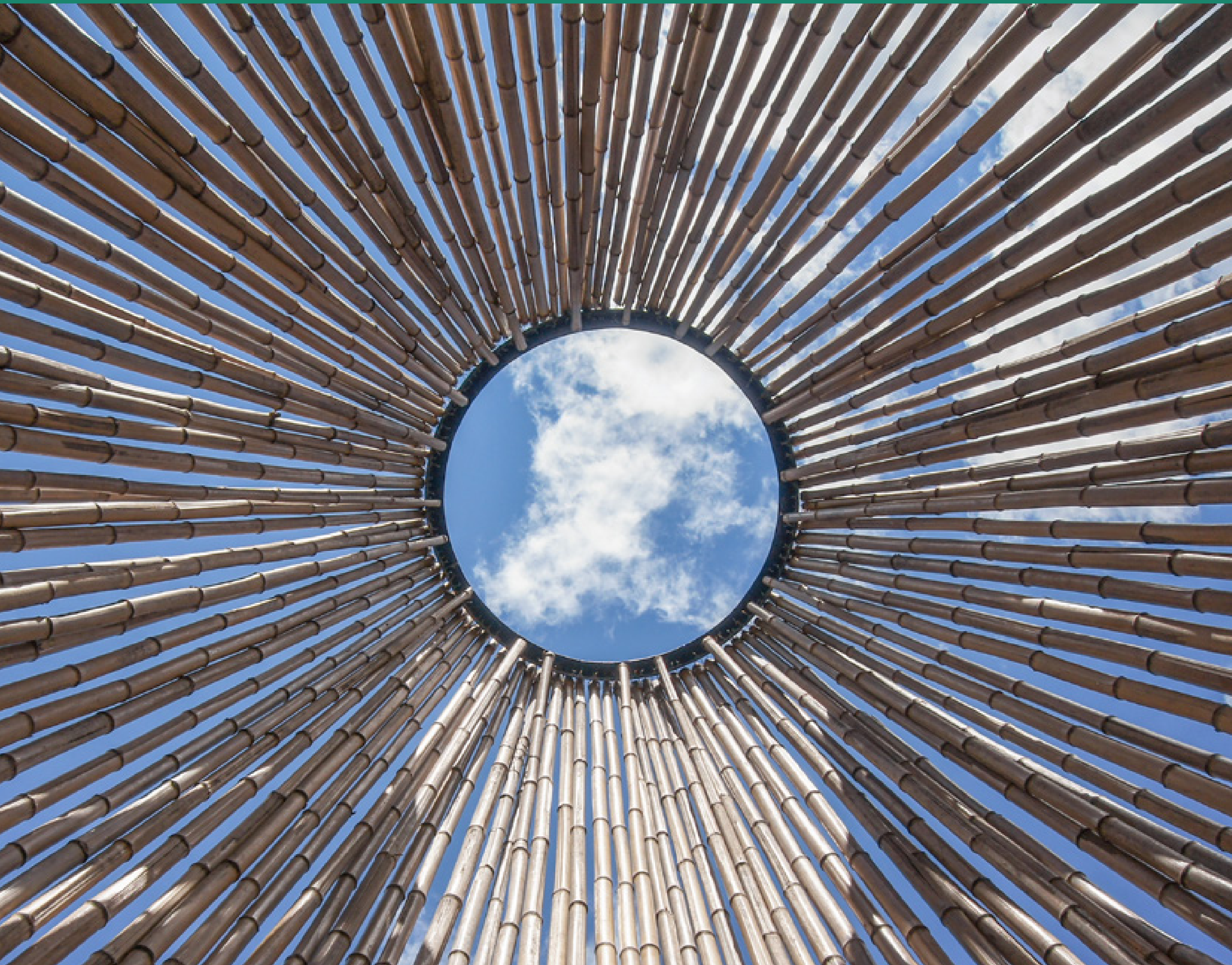
THE NEW GLOBALIZATION

How Asia Can Win in the New Global Era



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How Asia Can Win in the New Global Era

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AT A GLANCE

Rising economic nationalism and rapid digitalization are radically redefining globalization, with profound implications for Asian businesses and economies. With effective leadership, the region will be in a strong position to make the transition needed to confront the challenges—and capitalize on new opportunities.

SHIFT THE FOCUS FROM GOODS TO DIGITAL SERVICES

Exports of manufactured goods have long been the catalyst of growth in Asia, but under the new globalization framework, services will also make a large contribution. Invisible data highways and cloud storage, rather than the supply chains of multinational companies, will become increasingly important in delivering services to vast, borderless communities of digitally connected consumers.

DEVELOP THE NEW SOURCES OF COMPETITIVENESS

National competitiveness will have less to do with abundant cheap labor and more to do with leveraging technology and the skills required to enhance operating efficiency and excel in advanced manufacturing and digital services. Countries must improve their business environments and ensure that the latest technologies and infrastructure are widely accessible so that small enterprises can participate in global value chains.

This publication is the third in a series exploring the profound changes in globalization and how to navigate this new world.

ONCE EVERY GENERATION OR so for the past century, the global business environment has undergone a fundamental restructuring triggered by an international crisis or a major geopolitical shift and shaped by a confluence of technological and societal megatrends. It happened after both world wars, after the oil shocks of the 1970s, and after the emerging-market debt crisis and the fall of the Berlin Wall in the 1980s.

The global economy is currently undergoing a similar historic reset—and this time it is particularly disorienting for business leaders. The twin forces of rising economic nationalism and the rapid adoption of digital technologies are radically redefining globalization as we have long known it.

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The global economy is decentralizing in many ways as a result of growing protectionism, a decade-long stagnation in the growth of world trade and foreign direct investment, and the weakening role of multilateral institutions that set the rules and provided governance for much of the postwar era. Yet in other ways, the world's people and businesses continue to integrate rapidly through data networks, connected devices, and social media. (See "The New Globalization: Going Beyond the Rhetoric," BCG article, April 2017.) The number of internet users, for example, has soared from 900,000 to more than 3 billion since 2005, and should surpass 4 billion by 2020. The number of connected digital devices is projected to triple, to nearly 21 billion. Global data flows, which have exploded tenfold over the past decade to 20,000 gigabits per second, are projected to triple by 2020.

The previous era of globalization brought unprecedented prosperity to Asia. Powered by a dramatic rise in world trade and by economic models that focused on export manufacturing, Japan—and eventually Asia's developing economies—enjoyed explosive economic growth and industrialization that vaulted hundreds of millions of households into the ranks of the middle class and the affluent. This most recent tectonic shift has similarly enormous implications for the region's business and government leaders.

The New Globalization and Asia

The combination of economic nationalism and digital integration poses several major challenges. On the geopolitical front, Asian leaders must continue to advance an agenda promoting the free movement of products, capital, and people. They must also agree on common regulations and standards that will make digital systems interoperable and help entrepreneurs benefit from the tremendous opportunities created by the new globalization.

At the same time, business and government leaders must adjust to the realities of a transforming economic, business, and political landscape. Executives must navigate a world in which growth is slower, multipolar, and more fragmented. Instead of assuming that the global economy is converging on a single system of governance, companies must adapt to a multiplicity of shifting regulatory and rule-making regimes. They will have to cope with tougher trade and investment rules, "buy local" campaigns, increasing state capitalism, and new institutions.

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Under the new globalization framework, domestic demand and the ability to deliver services to vast, borderless communities of digitally connected consumers will become just as important to generating growth as the export of goods, if not more so. Invisible data highways and cloud storage, rather than the supply chains of multinational companies, will be the integrating forces of the global economy. The adoption of Industry 4.0's advanced manufacturing systems and powerful analytical platforms will compel companies to rethink the way they deploy assets, business functions, and capabilities locally and globally. And companies will have to overhaul their traditional business models to capture—and create—new growth markets by delivering goods and services that are enabled by new technologies and affordable to lower-income customers.

The implications for government leaders are equally profound. National competitiveness will have less to do with low wages and more to do with the skills and talent required to excel in advanced manufacturing technologies and digital services and solutions. Economic-development models that focus on export manufacturing will have to become more balanced, with a greater emphasis on promoting growth in services and domestic consumption. Countries will need to ensure that the latest digital technologies and infrastructure are widely available, so that citizens and businesses—particularly small and midsize enterprises—can participate in global value chains. Efficient business environments will also be critical for competing in the new environment.

Business and government leaders must find ways to ensure that this new era of globalization is more equitable than the previous one. Despite the tremendous benefits that it brought to Asia, the old globalization framework exacerbated economic inequality and uncertainty elsewhere in the world. Income disparities between those at the top and those at the bottom of the economic ladder widened in most countries—to the point where only around 1% of the world's population now controls half of its assets—while many middle-class households saw their incomes stagnate or even decline as good-paying jobs went offshore. This was especially true in the US.

By dividing societies into winners and losers, the old globalization became unsustainable. It triggered a political backlash against free trade and immigration and fueled the rise of economic nationalism, with Britain's pending withdrawal from the European Union, the US withdrawal from the Trans-Pacific Partnership (TPP), and moves to renegotiate the North American Free Trade Agreement being its most dramatic manifestations.

The new globalization presents steep challenges for Asia. But with effective leadership, the region is in a strong position to make the needed transition and capitalize on the new opportunities.

Moving Beyond Export-Led Models

As Western nations gradually opened their markets to imports in the decades following World War II, Asia's economies were able to achieve rapid economic growth by exploiting their abundant, growing pools of young labor and wide wage gaps with developed economies. As US, Japanese, and European companies outsourced product assembly, components, and some engineering functions to low-cost locations, Asian economies positioned themselves as essential cogs in the global supply chains of multinational companies. Starting with light manufacturing of such products as garments, shoes, and toys, Singapore, Taiwan, Malaysia, and other economies ultimately grew into global production hubs for computer peripherals and microelectronics. Thailand became a major outsourcing partner of Japanese automotive and consumer appliance manufacturers, while China, upon entry into the World Trade Organization (WTO), became the world's workshop in a broad range of industries. More recently, Vietnam and Bangladesh have targeted export manufacturing as the first rung on their ladder of economic development.

As some of the greatest beneficiaries of globalization, Asian economies have the most at stake under the evolving new framework. Manufacturing will remain an important contributor to growth in Asia, but export-led economic models are now under pressure in most of the region. In China, exports as a percentage of GDP have declined from 37% in 2006 to less than 20%. In Indonesia, exports have dropped from 31% of GDP to 19% and are projected to account for just 11% in 2030. One reason for the decline is that trade, whose contribution to global GDP grew from around 25% in the 1960s to more than 60% in 2008, has since stalled. Another is that Asia's previously enormous manufacturing cost advantages have shrunk as wage growth has outpaced productivity. In the case of many goods produced in China for North American markets, for example, the cost advantage over manufacturing in the US has declined dramatically over the past decade. The cost gap between the US and Thailand and Malaysia has also narrowed.

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The specter of rising protectionism, too, compels Asian policymakers and companies to ensure that they do not rely excessively on export manufacturing. According to the WTO, the number of trade-restrictive measures in force in the G20 leapt by 16%, to 1,263, from October 2015 to October 2016. According to a recent BCG analysis, proposed changes to US trade policy—which could include the imposition of higher tariffs on goods from certain trading partners or "border-adjustment taxes" on imports—would severely affect many manufacturers that have concentrated their production and sourcing in a handful of low-cost economies. Such risks are likely to force many companies to consider shifting more production closer to consumers at home. (See "How to Thrive in an Era of Shifting Trade Policy," BCG article, June 2017.)

As discussed below, the advent of Industry 4.0 technologies will further redraw the map of global manufacturing by making it more cost effective to produce more goods in smaller facilities closer to customers. Even in Asian nations where wages remain very low and labor is plentiful, development strategies that focus on export manufacturing will be less effective.

Asia is very well positioned to benefit from the digitalization of global business and the shift to services and domestic consumption.

Redefining Asia's Advantages

The good news is that much of Asia is very well positioned to benefit from the digitalization of global business and the shift to services and domestic consumption. China is a case in point. Even though annual GDP growth has slowed from around 10% in the 1990s and the early years of the 2000s to around 7% today, growth in personal consumption has been significantly higher. Even if China's GDP growth slows to 5.5%, personal consumption is projected to reach $6.5 trillion annually by 2020, an increase of roughly 50% since 2015. Spending on services, meanwhile, is growing significantly faster than spending on goods and now accounts for more than half of GDP. (See *The New China Playbook: Young, Affluent, E-savvy Consumers Will Fuel Growth*, BCG Focus, December 2015.) The contribution of services to GDP has surpassed that of manufacturing in Indonesia, Malaysia, the Philippines, and Thailand as well.

The rising affluence of Asian households suggests that the region will continue to be the world's biggest growth market for health care, education, financial services, entertainment, and other services. China's middle class is projected to expand by 36 million households and to represent 40% of the country's population by 2020, while another 20% will be living in upper-middle-class and affluent households. Vietnam is projected to add 5 million upper-middle-class households by 2020, India 11 million, and Indonesia 29 million, according to BCG's Center for Customer Insight.

Asian consumers and businesses are among the world's most digital savvy, making them prime targets for business models tailored to the new globalization. E-commerce already accounts for 15% of private consumption in China, compared with 3% in 2010, and is projected to account for more than 40% of consumption growth through 2020. Fifty-three percent of Southeast Asians—340 million people—are connected to the internet, according to the International Telecommunications Union. Their ranks have increased by more than 30% just since January 2016. An estimated 42% of Southeast Asians actively use mobile social media, with 73 million new users added over the same period, according to data compiled by Hootsuite, a social media platform.

The region's entrepreneurs are developing new ways of making digital connectivity more affordable to low-income Asians. These innovations will help broaden digital's reach even further. India's Reliance Industries, for example, announced that it has developed an inexpensive web-enabled handset with high-speed 4G access. Voice and text messaging will be free, while unlimited mobile data on the network will cost less than $3 a month.

The Need for International Collaboration

For the economic opportunities and gains of the new globalization to be shared widely among Asian citizens and businesses of all sizes, it remains as urgent as ever for governments to maintain progress in integrating their markets and to develop common rules and norms. Many of the rules set forth in multilateral agreements are out of date, especially when it comes to digital trade. When the WTO was established in 1995, cloud computing didn't exist; e-commerce accounted for a miniscule fraction of the $22 trillion in annual global revenue that, according to UN Conference on Trade and Development data, it had generated as of 2015.

New international agreements and standards are critical if global e-commerce is to function securely, efficiently, and reliably. Cooperation is needed to protect consumers, facilitate payments and authentication, establish rules on the taxation of digital trade, and guard against the growing danger of cybercrime. Common standards are also important in order for digitally connected devices, platforms, and machines to operate seamlessly with one another.

There is no substitute for truly global multilateral agreements. But with global trade talks stalled for more than a decade and agreements such as the TPP severely undermined by the withdrawal of the US, it will likely be up to the Asia-Pacific nations to pioneer multilateralism in the years ahead. The region accounts for 40% of world trade—and trade within the region is growing faster than anywhere else in the world—so Asia has perhaps the most to gain from cross-border cooperation. Asia-Pacific is also a driver of the global economy and an important location for any business in pursuit of growth: the region's 4.5 billion people account for nearly 60% of the world's population, and it includes many of the world's fastest-growing economies.

Finally, the ten member states of the Association of Southeast Asian Nations need to make a concerted effort to integrate their economies further. Asian governments should also press to negotiate agreements covering trade, investment, economic and technical cooperation, and intellectual property rights within the Regional Comprehensive Economic Partnership—a group that includes the ASEAN nations as well as Australia, China, India, Japan, New Zealand, and South Korea. Other initiatives should accelerate as well. For example, Singapore's central bank is working with a UN agency to help digitalize ASEAN cooperatives, microfinance providers, and banks in order to provide better financial access to the region's economically marginalized population.

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How Digital Is Changing Asian Business

As the legal framework of the new global economy evolves, Asian business leaders must adapt to digital technologies and to rapidly increasing connectivity, which are changing every industry, sector, company, and society. We see three major forces at work that must be at the top of these leaders' agendas: the shift to Industry 4.0, the development of digital platforms, and the rise of digitally enabled services.

Industry 4.0. In addition to reducing labor costs and boosting productivity by as much as 30%, next-generation manufacturing systems, which include advanced robotics, additive manufacturing, and digital simulation of factories—collectively known as Industry 4.0—have the potential to radically redraw the map of global manufacturing. Under the traditional mass-production system, most manufacturers have focused on standardized products and processes and have tended to concentrate production in large factories in a handful of low-cost locations in order to capitalize on economies of scale. The more flexible digital factories of the future will make it increasingly economical and practical to fabricate small batches of customized products closer to end markets. (See *Man and Machine in Industry 4.0: How Will Technology Tranform the Industrial Workforce Through 2025?*, BCG report, September 2015.)

Rather than offer themselves to multinational companies as havens of low-cost labor, Asian countries will have to compete on the basis of skills.

A number of leading manufacturers are already beginning to adopt "multilocal" manufacturing footprints. Adidas, for example, has traditionally concentrated its global production in giant factories in low-cost countries. Now, thanks to advanced manufacturing technologies, the company is moving some customized production to Germany and other nations. A similar trend is underway in electronics. Foxconn, which is aggressively deploying robotics, used to manufacture all of its electronics products in southern China. Now it does assembly in Mexico and has announced plans to manufacture in the US as well.

Several Asian nations are at the forefront of Industry 4.0 systems. (See *The Robotics Revolution: The Next Great Leap in Manufacturing*, BCG report, September 2015.) But the economic policies and development strategies in most of the region need to be updated in order to support and keep pace with this trend.

Industry 4.0 will compel Asian countries to change their value proposition when competing for manufacturing investments. Rather than offer themselves to multinational companies as havens of low-cost labor, these countries will have to compete on the basis of skills. And they will have to position themselves as locations where companies can reach important new markets and enhance their efficiency by leveraging the latest technologies at every point in the value chain.

Digital Platforms. One way that Asian companies can reach borderless, digitally connected global markets is by investing in their digital platforms and developing ecosystems of local partners around the world. The size of these borderless markets is staggering. Goods worth $700 billion are traded each year through Alibaba and Amazon alone, a volume that has been growing at a compound annual rate of more than 30% since 2012.

The remarkable success of companies such as Uber, Airbnb, and China's Alipay in rapidly building multibillion-dollar global businesses with relatively little physical capital investment in target markets testifies to the power of digital platforms to make national borders and country-based business models nearly irrelevant. Asia has more than 60 platform companies with a combined market capitalization exceeding $1 trillion, according to the Center for Global Enterprise.

Around half of Asia's platform-based companies are Chinese; others are dispersed across the region. South Korea's KakaoTaxi dominates that nation's on-demand ride-sharing market. Grab—founded in Malaysia in 2012 and now based in Singapore—has established ride-sharing services across Southeast Asia, with more than 1.1 million drivers who provided nearly 3 million rides daily as of July 2017. Downloads of Grab's mobile app have tripled, to over 50 million, since 2016. Indonesia's

Go-Jek, which began as a ride-hailing service, has branched out into food and prescription drug delivery, online payment, and car maintenance services. It has built a network of 300,000 motorcycle, car, and truck drivers and 100,000 small and midsize enterprises. Singapore-based Sea—Southeast Asia's most valuable tech startup—has expanded well beyond its Garena games brand to include the e-commerce company Shopee, the digital payments service Airpay, and BeeTalk, Southeast Asia's first indigenous mobile social network.

China's Alipay is building a global business by providing services to digitally connected tourists. It offers a mobile payment platform that has 450 million active subscribers, who use it as an alternative to credit cards. The company has been targeting the fast-growing market of Chinese travelers, who are projected to spend $1.75 trillion by 2030, up from $500 billion in 2012. To reach this market, Alipay has partnered with global payment providers such as Verifone and First Data. Luxury department stores, retailers, and such global brands as Body Shop also accept Alipay, as does Uber.

Digital Services. Advances in digital technologies and platforms are enabling the rapid growth of cross-border digital services, such as online travel booking, entertainment sites, and asset performance management, as well as end-to-end solutions. Digitally enabled services accounted for 25% of the exports from OECD countries in 2014, compared with 17% in 1980.

Digitally enabled services offer opportunities for companies to achieve growth even in countries with rising trade barriers or limited financial resources. Because the economics of delivering services are entirely different from the economics of selling physical goods, companies can reach new markets with relatively little investment in local assets. Using a strategy known as servitization, hardware manufacturers can drive growth even in low-growth markets by lowering the "access cost" of their products and creating value for customers.

Some servitization pioneers are developing new business models that combine local and global capabilities. By centralizing a function such as data analytics in a location where they have the greatest capabilities, companies can capture the benefits of scale in high-skill functions. And by locating other functions locally, they can serve customers effectively.

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Philips illustrates how servitization can be deployed. The company has joined forces with the tech nonprofit Imaging the World and the governments of Kenya and Uganda to provide cost-effective, easy-to-use telemedicine services, such as ultrasound screening in remote hospitals. Data from scans are transmitted to the cloud and analyzed by radiologists elsewhere in the world. Health care companies in markets with well-developed telemedicine industries, such as India, Thailand, and Singapore, are in a strong position to develop such businesses.

An Agenda for Asian Business

Many Asian entrepreneurs have been in the global vanguard in terms of embracing digitalization and developing innovative business models that allow them to leapfrog competitors and seize the opportunities that emerge. But businesses in much of the region have been relatively slow to adapt.

Asian companies will need nimble and aggressive corporate cultures that permit rapid decision making and significant risk taking. And they will need business models that allow them to penetrate low-income markets or developing economies with more affordable goods and services. Rather than focusing only on driving down costs, Asian companies must find ways to deliver new forms of value by leveraging digital platforms to address unmet needs.

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Business leaders should assess their organizations and find the balance between centralization and decentralization that will enable them to win under the new globalization. In general, they should consider aggressively standardizing purely internal processes while giving local operations the flexibility to customize external-facing ones. Likewise, companies should develop the capability to offer certain services on a global scale and at the same time customize them to the regulations and needs of specific markets. For example, they can explore providing cloud-based services that give young companies the cost benefits of scale that were previously unavailable to them.

Asian companies will also need to invest in human capital to build up the local capabilities needed to thrive in the new environment. To attract and retain talent, they should invest more in continuing training so that workers can upgrade their skills and remain effective. Companies might consider programs such as one offered by Starbucks, which pays for employees' college tuition—an investment not usually associated with the fast-food and beverage business. They should also consider offering more career mobility and merit-based recognition.

Companies will have to take a new look at how to integrate their workforces with technology in order to unlock the value of Industry 4.0. It will be critical to figure out which tasks humans and machines, respectively, do better and to design processes that leverage the strengths of each to create competitive advantage.

Asian business has a valuable role to play in ensuring that the new globalization is more equitable. Leaders can learn from the adverse consequences of the previous era of globalization and contribute to the creation of a virtuous cycle of trust and shared prosperity. They should look beyond short-term interests and appreciate that broad-based prosperity is good for the long-term health of their economies and businesses. Asian companies can do more to confront economic inequality and dislocation by working with governments and other institutions on sustainable-development initiatives.

Finally, companies can strengthen linkages among Asian economies by supporting multilateral institutions and initiatives that ease friction in trade and cross-border transactions.

The risks and opportunities created by the emerging globalization framework present a daunting agenda for both business and government. But few entrepreneurial cultures and governments have proved more adaptive to change than those of Asia. The region has successfully navigated every major economic shift over the past seven decades and come out ahead. By working together, business and government leaders can ensure that Asia continues to succeed in the coming new era of globalization.

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