



IS ASIA STILL STANDING?

When the credit crunch started in the United States in 2007, economists and business observers in Asia developed the thesis of decoupling, in which Asian economies were now sufficiently large and independent from their Western counterparts to thrive on their own. Indeed, during the first half of 2008, Asia remained insulated from the deepening liquidity crisis and corporations continued focusing their efforts on acquiring top talent to grow their businesses in Asia. However, in the wake of the Lehman Brothers bankruptcy, the Asian exchanges fell by more than 50 percent off their January 2008 peak, and the decoupling theory was officially pronounced dead.

The mood in Asia is quickly becoming somber as the constant flow of bad news continues, but the recollection from the bull days remains. The question on everyone's mind from Singapore to Shanghai and from Mumbai to Hong Kong is, can Asia drive the world's growth again?

We have asked that question — as well as a related question about the economy's impact on the region's talent pool — to many of the senior financial services and private equity executives we met in the last couple of weeks and three consistent themes have emerged from our discussions.

It will get worse before it gets better

The first theme is that things will get a lot worse in Asia before they get better. Sure enough, the sentiment in Hong Kong and Singapore, the region's financial centers, is directly affected by the events taking place on Wall Street. And it has now become apparent that the region's economic fortunes are more closely connected to the West and Japan through its exports than the decoupling theory assumed. Even though the region was very resilient until October, exports eventually drive a large share of the economy.

Recent studies, in particular one conducted by the Asian Development Bank, show that while intra-Asia trade has grown significantly (thus giving rise to the decoupling theory), Asia is still dependent on exports to the developed world. Once intermediate production stages are netted out, about two-thirds of Asia trade eventually ends up being consumed by the U.S., Europe or Japan. The conclusion is inescapable: the slowdown in the West will drag down the Asian economies significantly. This effect can already be felt in Asia today as domestic demand is falling off a cliff. Singapore, for example, is now planning a GDP contraction of about 2 percent in 2009. Unemployment is on the rise as multinationals and local corporations are striving to reduce their costs in prevision for a difficult year ahead and several quarters of declining revenue. Credit scarcity is threatening many companies, and a

number of bankruptcies — for example, in the real estate sector — can be expected. As a leading economics professor remarked recently, there is no way to predict how deep this crisis will be, but the risk that it turns into a major recession cannot be ignored. Particularly if banks do not resume lending quickly, Asian economies could fall victim to a downward spiral of production cutbacks, unemployment and falling demand.

Trade and political risks could emerge

So the crisis is global and Asia will feel its full effects. But there are additional risks, and this is the second theme that has emerged in our conversations. The erection of trade barriers is a major threat to a rapid recovery. Asian countries are largely powered by exports, which can amount to more than 200 percent of GDP in the case of the open economies of Singapore and Hong Kong. The Western governments have been prompt to resort to protectionism when their economies are under threat. The rise of a strong Democratic majority in the U.S. Congress increases that risk, as President Obama will have to deal with pressures to keep jobs in America.

It would be unfair to blame only the West. Asian governments have historically been nationalistic and protectionist. They may easily pull back on recent liberalization measures to protect their workers and their markets. Countries like India, China and Indonesia particularly have a record of moving back and forth on the liberalization agenda, even though free trade is key to their broader economic development. Newly erected trade barriers would harm the global economic recovery and would particularly hurt Asia.

There are reasons to be optimistic though. At their November summit, the leaders of the Asia-Pacific Economic Cooperation forum (APEC), which includes the

United States, have declared that they fully back free trade and that they should avoid protectionism at all cost.

Nevertheless, some observers also worry about rising political risk. A renowned economist feels that in times of recession, governments in some nations may be under severe stress, and he cites Pakistan, North Korea and Malaysia as major risks. Paradoxically, he is much less concerned about Thailand, Indonesia or India, which cyclically undergo periods of instability but always find a new equilibrium point.

The fundamentals remain strong

Despite the near-term challenges, things will not be as bad in Asia as they may be elsewhere. Our third theme is that the region remains full of opportunities in the medium term because the growth drivers of Asia are healthy.

Strong financial sector. The Asian banking system, destroyed during the 1998 Asian crisis, is fundamentally stronger today. While local banks may see their loan books worsen, particularly in the small and medium enterprise sector, they are well-managed for the most part and are well-capitalized. Banks have a low exposure to toxic credit products and we will only see very limited deleveraging. There is no need for a financial sector restructuring in Asia. We are still seeing selected banks, asset managers and private equity funds hiring new professionals, particularly when there is an opportunity to bring in a top professional who might not have been available, affordable or even interested previously.

Growing middle class. The rise of the Asian consumer has been well-documented and will continue to drive growth. In addition to the giants China and India, which have a combined population of 2.5 billion and a GDP of US\$10 trillion, the ASEAN group has a population of nearly 600

million and a GDP of US\$3.4 trillion (at PPP). Asian populations are often young: India's median age is 25 and Vietnam's is 27 (by comparison, the U.S. is at 37 and Germany at 43). The differential of wealth is significant. GDP per head is US\$5,300 in China and US\$2,600 in Vietnam, compared to US\$46,000 in the United States.

First-class infrastructure. The quality of infrastructure in Asia often surprises foreign visitors who must quickly shed the clichés they have in mind. Although China and even Indonesia and Vietnam have large populations living in poverty, the business infrastructure in urban centers is excellent. Telecommunications are world-class and cell phone and Internet penetration is high. Transport and logistics are efficient, with excellent regional airlines (e.g., Cathay Pacific, Singapore Airlines), ports and airports (China is planning to build more than 20 new airports by 2010). Issues remain, particularly around the enforceability of law and corruption, but progress made in the last 10 years has been astonishingly fast.

Political stability. With the exception of the three markets mentioned earlier, Asian governments have demonstrated remarkable skill in developing economic policies that are business-friendly without jeopardizing stability.

Deepening talent markets. In the last 10 years, Asia has been home to one of the fiercest talent wars as strong economic growth has led to a dramatic imbalance between supply and demand. As the region's education systems struggled to produce enough well-trained, English-speaking, initiative-taking graduates, multinationals operating in the region fought for the same limited talent pool. This led to soaring compensation levels and high employee turnover as individuals jumped from pay hike to pay hike, and frustrated employers who felt they were paying top money for average-quality staff.

We are now optimistic for three reasons. First, the economic slowdown is resetting employee expectations and allowing employers to eliminate the overpaid-underqualified employees they hired in the past. Second, universities, particularly in China, are progressively adapting curriculum to meet the demands of the business world. Finally, there is a large pool of international executives familiar with Asia and capable of operating at senior levels in the region. Many of our placements are foreigners in the country where they work, but most were sourced from within the region. For example, we have placed Singaporeans in Beijing, Malaysians in Singapore, and relocated Westerners from Shanghai to Hong Kong. While fair-weather expatriates return home, a core group of international professionals (who may or may not be Asians by ethnicity, but who all have extensive Asian experience) has emerged and is ready to lead the international institutions of the region tomorrow.

Taken together, these strengths position the region for strong growth in the medium term. Asia alone, however, will not be able to power the world out of the economic crisis. In nominal terms, its economy, excluding Japan, is only about half that of the United States. But growth projections for the region are encouraging. The International Monetary Fund projects that the region will grow by about 7 percent in 2009, and India and China alone should generate half of the world's GDP growth. Observers believe that China will grow in the 7-9 percent range. The rest of the region should grow between 4 percent and 6 percent (with Singapore and Hong Kong potentially growing at a lower rate or even contracting due to the open nature of their economies). Ironically these numbers are disappointing those who were accustomed to witnessing double-digit growth. But realistically, Asia is still where multinationals should look for sustained revenue growth when the U.S. and European economies have started contracting.

Opportunities in financial services

As the saying goes, crises create opportunities and this time is no different. The executives we have spoken to see three main areas on which to focus.

Cheap assets. If you loved the stock at \$50, you should love it even more at \$20. As valuations drop, opportunities for investors to acquire local liquid or illiquid assets (companies, real estate and infrastructure) will appear. Reaching an agreement on the price with the sellers may take a while, as we saw 10 years ago during the Asian crisis, but good bargains eventually materialize.

Distressed situations. This is a corollary of the previous idea. Companies that cannot finance their projects anymore, or cannot roll over their debt, will look for new sources of funds. Providers of high-yield debt, restructuring advisers and acquirers of distressed companies will see unparalleled opportunities in the coming 12 months, and will be able to build market share with limited competition.

Talent acquisition. Until recently, financial institutions struggled to attract and retain talented professionals in Asia as they were all chasing the same limited pool of professionals, fueling salary inflation and contributing to the erosion of loyalty. With the ongoing waves of layoffs at investment banks and hedge funds, institutions that have long-term plans to remain and grow in Asia have a unique and unprecedented opportunity to hire top-notch talent. We have seen this selective upgrading take place as some of our clients have decided to enhance their capabilities in leveraged finance, real estate, commerce, asset management, portfolio management or institutional sales, to name a few recent examples.

A number of moves we expect to see in the next six to 12 months:

- > Private equity houses strengthening their deal teams to actively cultivate a proprietary deal pipeline and to be ready to jump in when valuations on both sides match.
- > Asset managers capturing market share by hiring institutional sales rainmakers from the competition to tap into the large Asian reserves. Asia is the future of asset management as markets are expected to rebound before the end of 2009.
- > Selective upgrading and “re-tooling” in global markets as demand shifts from structured products toward plain-vanilla products. Advisory-focused boutiques will emerge and snap up top dealmakers looking for renewal opportunities.
- > All employers using the slow markets to “put their house in order” and enhancing their support functions — top chief operating officers, finance and risk management executives are still in strong demand.

Conclusion

Across industries, Asia will certainly suffer the impact of the financial crisis, but we anticipate a fast rebound in the second half of 2009. As institutions lack visibility and everyone struggles to advance their best guesses for 2009 budgets, now may not be the right time to hire. But the time will come very soon to initiate selective conversations with top talent, map competitors and select who should be hired to be ready to move when the right time comes.

About the author

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