




Succeeding in a brave new world:
A CEO guide to strategic positioning
for the recovery

ADVISORY



The sharp contraction in the global economy during 2008 and early 2009 has forced many organisations in Asia Pacific to focus unexpectedly on short-term survival and the stability of their balance sheets. While executives have struggled to make longer-term strategic plans in such an uncertain environment, many have wisely taken the opportunity to conduct some rigorous house cleaning.

The worst may be over.

Growth opportunities are now emerging once again, but the environment remains volatile and the prospects for a deep and sustained recovery are still uncertain. Capital injections by governments around the world have maintained liquidity in some key areas, but not necessarily assured us greater stability.

In this climate, some companies will succeed, but others will continue to fail. We are at a point in the economic cycle where chief executives need to consider the following questions:

What is the new context?

How should my business model adapt?

Where are the new markets?

How do I fund my new business model?

What is the way forward?

This guide, drawing together the views KPMG Advisory partners and professionals from across the Asia Pacific Region, is intended as a starting point to help the CEO address these important discussions.



The new context

The events of 2008 and early 2009 produced the biggest shock to the global economy in decades. For many organisations, the result has been a decline in orders, pressure from longstanding customers to cut prices, pressure from investors and stakeholders to cut overheads, or an inability to secure new lines of credit or collect receivables.

Almost overnight, existing strategic plans and forecasts were rendered irrelevant, and many companies found themselves fighting to survive. Many companies are still coming to terms with a serious and lasting erosion of their profit margins and a need to shore up cash positions.

Over the second half of 2009, there was no shortage of comment about

the march out of recession and who may lead that march. Talk of recovery gathered momentum in September, when the U.S. Federal Reserve chairman Ben Bernanke claimed "the U.S. recession is very likely over", at least "from a technical perspective", while ceding that the economy will have to accept a slow recovery and high unemployment as the price to guard against inflation. Since then, we

¹ In December 2009, KPMG's Global Business Outlook Survey, produced in association with Markit Economics, indicated a strong improvement in sentiment among executives in manufacturing and services industries, when compared to the previous surveys conducted in January and May 2009.

have seen lead economic indicators from manufacturing and service industries indicating a recovery in orders and improved optimism around capital expenditure and even hiring.¹

Do executives in the Asia Pacific Region feel the same way about their business environment? Have they seen “green shoots” emerging from the markets in which they operate? Around the region, the mood of corporates is still cautious and prudent, with survival and viability of business models remaining the key concern.

We do not expect to see a sharp economic rebound in 2010 given that unemployment in the region’s main export markets is likely to remain high and certain key sectors continue to struggle with an overhang of debt and surplus capacity. There may be periods or pockets of quite rapid growth around the Asia Pacific Region, but these should not be mistaken for a return to conditions where struggling businesses are quickly refinanced and where growth can hide poor management and governance practices. The fallout of a global recession will be a market with less liquidity, continued downward pressure on costs, erosion in profit margins and cash positions, and reticence in both corporate and consumer spending.

This is a business climate in which well-run organisations can achieve long-term success, but to do so they must be clear now about their market positioning, at the board level, at a strategic level and at an industry level. Organisations need to take a fresh look at their competitive environment, the stability of customers and business

partners, and reliability of funding sources, all of which have been shaken by the extent of the economic volatility.

For many organisations, this means the risk environment has also changed fundamentally. Economic pressures may have placed a strain on business relationships, increased the risk of fraud or non-payment and threaten the survival of key suppliers or customers. Volatility in commodity prices has raised concern about valuation issues and the ability to hedge risks effectively. Cost-cutting and streamlining implemented in response to the downturn may have weakened internal controls and undermined the integrity of key processes. These efforts can have implications in terms of regulatory compliance, or can undermine the quality and reliability of end products and services. Protection of corporate brand and value propositions are key to maintaining the trust of business partners and financial stakeholders.

Risk assessments need to identify the risks in relying on specific customers and business partners as well as the impacts of supply chain disruptions. Re-evaluating existing risk management processes means assessing the adequacy of the resources allocated to addressing changing risk profiles.

CEO checklist

- Have you altered your business model for a post-crisis environment and redefined your strategy in terms of market share and positioning?
- Is your business model positioned to withstand a gradual recovery, characterised by continued market austerity and potentially some further economic shocks?
- Do you understand how your risks have been affected and how the strategies of key customers, suppliers and partners may have changed as a result of the downturn?



The new business model

The economic downturn has given executives the opportunity to dispose of underperforming, non-core assets and generate cash to support the core businesses. It can also be an opportunity to get back to basics and implement changes that improve operational effectiveness and break down silos within a business.

In times of growth, it is all too easy for organisations to break into unwieldy silos, get diverted by non-core business opportunities, and lose track of the broad strategic vision behind the organisation. Different silos may have defined strategies that address market share, market penetration, product range (for example rationalisation or expansion), supply chain, procurement and systems. The critical thing for the CEO is to make sure these all contribute to a broader vision.

Only with such a shared vision in place do CEOs have any chance of instilling

a culture of shared responsibility across senior management and across business functions. Organisations are confronting a more competitive environment in which operational effectiveness is no longer a competitive advantage but a key to survival.

For many organisations, the focus on revenue growth during the boom times created a heavy legacy of infrastructure. IT platforms have become far too complex and fragmented, and without taking rapid steps towards standardisation they



will not be effective in providing corporate management with the right information. Finance functions spend too much time re-hashing non-standard data and not enough time anticipating and understanding future business needs.

In hindsight, many organisations now recognise that their numbers were telling them there were problems in their businesses. But as their systems had become so complex or fragmented, it took too long to consolidate and meaningfully interpret that information.

True operational effectiveness means having end-to-end processes where the whole organisation is aligned and attuned to changes in demand at the front end. One example of this is to align supply and demand through more effective collaboration between the marketing/sales and operations functions. This is still all too rare across the region, but leading organisations are now embedding a collaborative approach to operational planning and budgeting processes, with the CEO playing a central role.

Integrated budgeting sets the foundations for every department within an organisation to do what they need to do. Effective cost reduction, in response to the economic crisis, and cost optimisation on an ongoing basis, are not possible without operational discipline.

The need for shared responsibility and strategic vision extends to the critical issue of managing people. As the economy picks up and the labour market stirs to life, CEOs need to ask whether they have done the right things to retain and reward their best people and whether the right incentives are in place to support future growth. Any misalignment

between incentives and wider strategy will inherently create risk, as the events of 2008 painfully proved for a number of organisations.

The downturn has not stemmed the appetite for services outsourcing around Asia. This strategy can also be critical as companies seek to develop more agile business models focused on their core competencies. IT outsourcing has traditionally led the way as a means to extract financial gains from labour arbitrage, standardisation and scale. Increasingly companies are outsourcing business-critical IT functions to external parties, such as customer relationship management (CRM), network security software, analytics, application maintenance and development.

Outsourcing is not without its risks, and like any decision entailing a change to the business model, different choices of locations or partners need to be considered closely. Yet there are a growing number of examples of companies outsourcing to gain quick access to skills that are not available internally, or to transfer the risk involved in managing and deploying certain resources.

As with budgetary and risk concerns, responsibility for human resource management also needs to be shared across an organisation and not just confined to the Human Resources department. While the HR departments should be empowered to bring out the potential growth of people in the organisations, CEOs should make people management, training and retention the responsibility of every department. CEOs need to build a platform for each department to deliver, integrating the companies' strategic goals in its key performance indicators.

CEO checklist

- Are different divisions of your business all working towards a common strategic vision?
- Have you fully addressed legacy infrastructure issues in your organisation, possibly arising from strong growth prior to the financial crisis?
- Have you considered strategies such as outsourcing as a way to create a lighter and more agile business model?



The new markets

While many organisations remain cautious about entering new markets, many do recognise Asia's continued importance as a region of opportunity that will shape developments in the global economy. Many organisations may wish to shift their strategic focus away from the more developed markets, where growth is likely to be slower than they previously forecast.

CEOs need to ask if they are operating in the right locations for their businesses, where their future growth markets are, and how they are going to get there. For the multinationals seeking to develop their businesses in stronger and more profitable markets, now is the right time for boards to get past cultural barriers and inertia to redeploy resources, including key senior management, to the areas of strongest growth.

Expanding into new markets is never an easy ride and many organisations have not found Asia's emerging markets to be as easy to enter and exploit as they originally thought. Operations distant from head office usually need more monitoring as they have a higher-than-average degree of risk.

Nevertheless, it is critical to understand the goodwill, cultural and market understanding that have been



built up in a particular market. This understanding represents real value, even if the market is failing to deliver the profits that were hoped for.

Many organisations in the region are still concerned that they will miss out on opportunities if they don't expand. Mergers and acquisitions (M&As), joint ventures (JVs) and greenfield investments all have risks and benefits attached, so it is important to assess all the options and identify which is the most appropriate method of expansion to pursue.

As companies cannot rely on bull markets to create value for them from M&A deals, they need to get smarter and identify the real strategic fits before jumping into a deal. Executives need to distinguish between over-gear businesses that face distress but remain operationally strong and attractive, and businesses that have a more fundamentally weak market position, requiring operational turnaround, re-branding or repositioning.

Markets in Asia are less homogenous than those in other parts of the world, so organisations should scan the entire spectrum of available deals and partnering opportunities, including within the portfolio companies under a private equity group, private companies, public companies and spin-offs from public companies.

For those taking a JV route to grow revenues, building trust and establishing strategic compatibility between partners are key. It is also important to establish clear common goals, governance structures and operating agreements, along with break-up clauses to address diverging goals between partners over time. In

practice, a lack of control over the JVs created and cultural clashes between management often deter CEOs from using JVs more frequently.

Nevertheless, JVs offer a very credible route for expansion in these tough times. Activity has been increasing over the past few years and the downturn and contraction of credit could be catalysts for further activity. Joint ventures can be a cost-effective way to access specific capabilities and intellectual property, get closer to the customer and win contracts in new markets.

A key consideration to succeed in new markets is the sourcing of talent. The downturn can be a useful justification to redeploy your best people to those markets. But leaders also need to be clear about the skills available on the ground in different locations and understand the benefits of international versus domestic experience. Somewhat unexpectedly, the growth of new outsourcing and offshoring centres has led to new pockets of talent well away from more established markets.

As companies increasingly turn to outsourcing to blend flexible capabilities from a range of service providers in diverse locations, effective management and co-ordination of these activities and locations has become a key business task in its own right. Inevitably, different markets and business locations will present their own risks to be managed, along with opportunities that can be harnessed.

CEO checklist

- Have you used the downturn as an opportunity to take difficult decisions and refocus towards new growth markets?
- Is your strategy for growth through M&A or JVs based on real strategic parameters or just a quest for market share?
- Have you a definition of the value of your business in different emerging markets and do you know where the skills and talent that you need for your business reside?



Funding the new business model

Where previously there was ample capital available, now it is critical to consider whether capital is being allocated appropriately, efficiently and competently. In the new environment, the CEO cannot just rely on the CFO to answer this question and should seek to understand capital management issues more thoroughly.

It is ironic that as many companies fail on the way out of a downturn as do on the down slope. It is when things start picking up and their order books fill up that working capital requirements are critical to address.

Typically, businesses with high business volumes, low margins, high fixed costs, high costs for premises and staff, high operating gearing and highly volatile cash flows have been hit fastest in the recent crisis. At the other end of the spectrum, companies with low volumes and high margins have been better placed as they have more

capacity to cut margins and continue selling.

The CEO should be challenging whether the organisation has the right capital structure to match its business model. This may seem obvious, but there are many painful examples of crisis-hit companies that have failed to realise just how fundamentally their business environment has changed and how that has affected their overall capital structure and accompanying risks. Many companies operating in Asia have complex corporate and debt structures due to the use of offshore



holding companies as listing vehicles, and many debt instruments may actually have risk characteristics akin to traditional equity.

Good housekeeping on the company's debt and equity structure is absolutely necessary. This enables the corporate executives to understand how continued weakness in business activities will affect their business revenues, and potentially risk the breach of a covenant. When bank funding was freely available, many organisations became overly reliant on cheaper uncommitted funding, relative to longer term debt, as a way to fund long-term assets. This mismatch created problems when banks withdrew their short term lines.

CEOs should be looking at their cost of funds and their net (not gross) operating margins to match pre-interest earnings to meet their debt obligations. Scenario analysis and cash flow assessments should be run to test how robust their corporate financial structures really are.

While there are signs of a recovery, executives must continue to ask themselves how continued weak performance could affect their financial positions. In cases where debt covenants risk being breached, they need to know how close they are to the thresholds. This is another reason why executives must understand what activity drives what line in the company's profits and loss (P&L) and to make a realistic estimate as to how this might lead to a "cash crunch".

Financial risk detection should start with the long-term forecasting of a company's pre-tax earnings. This means examining the company's back-end to understand a company's

business activities and sales records to realistically assess the firm's P&L accounts. This allows companies to set achievable targets, rather than relying solely on the "nice-to-have" predictions that CFOs may have derived from past data alone. In these uncertain times, it is more critical than ever to conduct a critical or independent review of the reasonableness of the assumptions behind P&L forecasts.

To gain the maximum visibility, the cash forecasting process should involve all key business managers who are most able to influence those business activities and outcomes, such as the heads of sales and procurement, or the general managers of particular operating units.

Funding thresholds should be established, and well in advance, to enable companies to tap into various funding sources well before credit bottlenecks occur. While there is liquidity available in the current market environment, banks are no longer prepared to lend until they have completed their due diligence, providing them with an appropriate level of confidence in the business model and the strength of the management team. They need to be convinced that their borrowers are able to service their principal and interest obligations and can withstand a level of continued market deterioration in the case the current market optimism proves to be premature. The notion that "success breeds success" certainly holds true in Asia's funding world.

CEO checklist

- Do you understand your capital structure and capital management structure as clearly as your CFO?
- Are you clear how close you are to debt covenant levels and about the risks associated with specific debt instruments?
- Are you continuing to instill a culture of responsibility for cash flows and working capital management, even as there are signs of recovery?



The way forward

For many organisations, 2009 was a challenging year where previous plans and strategies were cast aside and a new set of rules had to be understood. The crisis threw into sharper relief many strategic issues that organisations were already confronting after many years of expansion.

While many CEOs talk optimistically about 2010, a recovery is by no means assured. As economic stimulus packages draw to a close, government debt levels remain high and consumer confidence low. This is not a time to return to pre-crisis patterns of behaviour.

Rather, now is the time for CEOs to gain greater visibility over the risks facing the organisation in light of the downturn. With companies undergoing

massive upheaval and change – adjusting strategies, restructuring, reducing costs, transforming business models – the task of maintaining these critical alignments, ensuring that everyone is pulling in the right direction, becomes even greater. Failure to correctly align such aspects of a business can represent a very real risk in its own right.

It is also the time to create a culture of cash management and cost control.



To extract the right information for robust decision making, it is essential for organisations to standardise, consolidate and remove excesses from their business processes. These disciplines need to endure since they will help to prevent costs rising in parallel with revenue as economic conditions improve.

The days of easy credit are over so companies need to fully justify their capital structures and their allocation of capital, giving the balance sheet issues at least as much consideration as income issues, if not more. No one can be sure if the economy is going to bounce back strongly or remain subdued. Debt profile and working capital levels need to be managed to be able to handle either scenario. Banking

relationships are as important as ever. The more comprehensively your bankers understand your business, the better placed you are in seeking their continued support.

As we come out of the recession, the ability for CEOs to hire, motivate and retain good people, including the right local talent, is important to take advantage of growth opportunities and maintain a competitive edge over industry peers. To succeed, companies need to have the right products, the right people and the right processes in place – and then ruthlessly execute their strategies.

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