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Asia's Challenge

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Special Report

How can Asia rebound from the crisis? A new, more focused breed of company may lead the way

ASIA'S

The Year of the Meltdown has left most East Asian executives in a state of numbness or desperation. But Morris Chang has other things on his mind besides the region's crashing stock and currency markets. At Chang's Taiwan Semiconductor Manufacturing Co., the world's biggest contract manufacturer of semiconductors, the main obsession is with leading the next revolution in chipmaking.

Inside the labs at TSMC's vast complex at Hsinchu Science-based Industrial Park in Taiwan, TSMC is investing heavily to prepare for the day when all sorts of functions, from memory to microprocessing, will be crammed onto single slivers of silicon. Over the next decade, Chang plans to spend a mind-boggling $20 billion on new capacity.

Considering the corporate carnage stretching from Jakarta to Seoul, one might suspect that TSMC has a touch of irrational exuberance. But TSMC's business of making specialty chips for Silicon Valley has rarely been better. This year, it expects to earn nearly $500 million on sales of $1.5 billion.

"CASH IS KING." A sharp divide is emerging within Corporate Asia. No company will completely escape the effects of plunging asset values, slowing consumption, and skyrocketing interest rates. Many may never again enjoy the rich earnings of the boom years, when high economic growth made every manager look smart. But some companies, such as TSMC, Hong Kong's TAL Apparel, and Taiwan's First International Computer, are still thriving—and could eventually usher in a new era of good fortune in the region. That's because even before the crisis, they were adapting to the demands of the global economy.

Others are riding out the typhoon because of prudent management, a rarity in many Asian boardrooms in the last years of the boom. Companies such as South Korea's Pohang Iron & Steel Co. and Singapore Airlines kept their debts manageable, their operations lean, and their businesses focused. Still others wisely sat on their wallets. "In times like this, cash is king," says Hongkong Resorts International Managing Director Payson Cha, who can now use his $400 million in cash to expand his chain of five luxury hotels.

HONG KONG CUT

TAL's Lee keeps finding new ways to shave costs on dress shirts made for Armani and J.C. Penney

As the well-managed companies pull ahead of rivals that diversified unwisely, overbuilt capacity, and borrowed recklessly, some benefits may emerge. This year's financial shock could prove to be the "watershed event" that forces East Asian companies to take a sounder, more sustainable course, says Victor K. Fung, chairman of Hong Kong-based Prudential Asia Capital Ltd. "You could see the changes in Asian management already coming, but this crisis will initiate very rapid change," Fung says. "[Otherwise,] if things fall in slow motion, like they have in Japan over the last eight years, what we'd get is prolonged agony."

As asset values shrink, the traditional Asian fixation on property as a means of amassing wealth could eventually give way to a focus on assessing new businesses in terms of cash flow and profits, as in the West. The new era of deflation and supply gluts means that Asia's captains of industry will seek their fortunes more in services and information technology than in export-driven, low-tech manufacturing.

SQUEEZED IN CHINA

Strategic adds flashy new features to its bike helmets but can't charge more for them

The financial shock also could spell the end to the acquisition and investment binge of the jack-of-all-trades conglomerates. With positions in everything from telecommunications to toll roads, their strategy has been to snap up any business that could flourish in Asia's rush to modernization, or start one from scratch. But now few can afford to grab every cellular phone franchise, shopping mall, and broadcast license that comes along.

The first signs of this strategic shift are appearing. On Nov. 10, Coca-Cola Co. took over South Korea's biggest Coke bot-

(L TO R) PHOTOGRAPHS BY DAVID MCINTYRE/BLACK STAR; GREG GIRARD/CONTACT

CHALLENGE

DAVID MCINTYRE/BLACK STAR

TOUGH TAIWANESE
Ming's First International ships PCs directly to Compaq dealers and customers

tling operation from the Doosan Group for $430 million. And Thailand's $7 billion Charoen Pokphand Group, whose tentacles reach into agribusiness, telecommunications, retail, and motorcycles, plans to merge its pay-TV operations with those of Shinawatra Computer & Communications PLC. CP Group also wants to exit its oil and gas ventures in China and Thailand.

One factor forcing change is the disappearance of easy money, the ready capital that fueled the rise of Asia's ill-focused conglomerates.

Special Report

From 1986 to 1996, annual investment in the region's factories, real estate, and public works quadrupled, reaching almost a trillion dollars last year. Now Asian companies looking for credit must expect to pay stiff risk premiums until lenders are confident that the money won't be frittered away or that another currency crisis won't destroy a debtor's ability to repay. "It's quite clear that access to capital markets will be very limited" for Asian companies, says HSBC Investment Bank Asia Chairman Kevin A. Westley.

The coming consolidation is likely to spur the rise of a newer breed of Asian company—one that is smaller but more focused. Its forerunners are found among exporters that already have adjusted to the new rules of the global marketplace. Even before the meltdown, global forces had steadily undermined East Asia's traditional strengths of cheap labor, land, and engineers.

On top of all this, U.S. customers, from the big retail chains to the computer giants, have gotten much more demanding. They expect suppliers not only to design products and meet just-in-time delivery schedules but also to assume the responsibility for and cost of managing inventory, quality control, and shipping to the final customer. "Manufacturing is no longer a game of low tech and putting up cinder-block factories in the jungle," says Andersen Consulting supply-chain expert Russell Craig.

This new environment is brutal. To satisfy American buyers, Strategic Sports Ltd.'s helmet factory in Jiangmen, China, keeps adding expensive new bells and whistles—visors, new foams, bright metallic paints, fancier packaging. The required delivery time to the U.S. has shrunk from two months to as little as 15 days. Yet the price the company gets has dropped in half in the past five years, to around $4.

None of this is news to TAL Apparel Ltd., one of the world's biggest makers of dress shirts for labels including Calvin Klein, Giorgio Armani, and L. L. Bean. TAL Managing Director Harry N. S. Lee faces a seemingly impossible task: making money when the prices of his garments stay the same but his costs are rising. The list price of a men's cotton-polyester shirt he makes for J. C. Penney Co., for example, has remained at $24.50 for a decade.

So each year, Lee has to shave another 5% off the cost of getting that shirt to the retail shelf. Lowering production costs won't work because shirt-sewing has defied automation and wages can't get much lower than the $1 a day he pays in China. But he has saved Penney a bundle by cutting the lead time for order-placing from as much as six months to as little as four weeks.

FILIPINO TRAINING GROUND. TAL has also taken on responsibility for managing the retailer's dress-shirt inventory and hooking up to Penney's data network. That way TAL can monitor sales of its shirts at each U.S. store. It now delivers shirts from its Hong Kong warehouse directly to every Penney location in the U.S. And if a particular size or color is running low at that store, TAL can whip up replacements in as little as four hours at a factory in Taiwan. "If they buy from us, they can sleep at night," Lee explains.

Providing such sophisticated service is an enormous challenge for Asian companies. In electronics, for example, this new model is fast becoming a fact of life. Big companies such as Hewlett-Packard, Dell Computer, Ericsson, and Cisco Systems, which outsource the manufacturing of everything from PCs and printers to networking equipment, insist that suppliers have factories and logistical support in the U.S., Europe, and Latin America, as well as Asia.

The growing emphasis on swift, timely delivery gives the home-court advantage to huge U.S.-based manufacturers such as Flextronics International, Solectron, and

ASIA: WHAT COMPANIES MUST DO

GET FOCUSED
Enterprises need to abandon the favored practice of diversifying into a broad range of new industries. They should stay with a few core sectors and sell off the rest.

BUY WISELY
Companies can augment core strengths with timely deals. But they should wait until prices hit bottom and rivals are forced to sell.

SERVE THE CUSTOMER
Instead of relying only on cheap labor, manufacturers must improve logistics, design, and inventory management.

TEAM UP
Strong foreign and local partners can make the business more globally competitive.

DATA: BUSINESS WEEK

SCI Systems, a $5.7 billion giant based in Huntsville, Ala., that has 24 factories in 10 countries. "Asia is losing its relative competitiveness," says SCI Chairman Olin King. "Much of the stuff that was outsourced there now is coming back to the U. S. or Mexico."

Yet Asia's leading contract manufacturers have no intention of rolling over. Take Taiwan's First International Computer Inc., one of the world's biggest makers of personal computers and components. To produce its low-end PCs for Compaq Computer Corp., FIC set up an assembly plant in Austin, Tex., three years ago. It also is building plants in Brazil and the Czech Republic. In addition, FIC delivers the finished PCs to consumers and dealers directly. Assuming such duties "is a big burden and challenge for Taiwan manufacturers," admits Chairman Ming Chien. "But we have the ability to do it." After a rough 1996, FIC has boosted profits 80% through September of this year.

Even Asian manufacturers that don't export can no longer escape this revolution. Many managers in the Philippines, who were put through the wringer by economic stagnation and free-market reforms, are among the best prepared in Southeast Asia. "All of our [domestic] customers are requesting just-in-time delivery," says General Manager Glo Tiongson of Tiongson Industries Inc., a $3 million maker of tin cans for, among others, Royal Dutch/Shell Group and Caltex.

As the new business models spread through the region, investment bankers hope to see a flurry of cross-border deals, with companies building up regional strengths in sectors such as telecommunications and chemicals. Government policies are making such consolidation plausible. Several years ago, for example, the governments of six Southeast Asian nations pledged to slash duties on most goods traded within the region to 5% or less. And partly because of commitments to the International Monetary Fund in recent months, Indonesia and Thailand have sharply reduced legal obstacles to foreign ownership of banks and other businesses.

OBSOLETE STRATEGIES. To be sure, some big companies will resist the trend to slim down: The prospect of a loss of face is still too devastating. Thailand's Siam Cement Group, for example, has incurred huge foreign currency losses and runs the risk of defaulting on some of its $4.2 billion in debt. Creditors would love to see Siam sell off some of its abundant assets, which include steel and petrochemical plants and real estate, or at least bring foreign partners into its core businesses. But Bhanumas Srisukh, managing director of Siam's steel-trading division, says there are no plans to bring in foreign shareholders at its inefficient steel mills.

Yet it would not take much for even the most stubborn executives in Asia to see that many of the strategies that worked during the miracle years are becoming obsolete—and that clinging to them could just mean more disasters. Fortunately, East Asia does have executives who already are demonstrating what must be done. The old Asian model of prosperity is dying. A new one is already emerging to replace it.

By Pete Engardio in Hong Kong, with Jonathan Moore in Taipei, Michael Shari in Bangkok, and bureau reports

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