



Matthews Asia

## Riding the Innovation Wave in Asia

Asia is riding a wave of homegrown innovation with long-term investment implications.



### NEW REALITY

Asia is riding a wave of innovation that extends beyond technology to new business models, education and economic reforms.

*No longer a place where everything is produced but nothing is invented, Asia is riding a wave of homegrown innovation with long-term investment implications.*

Innovation is a beguiling concept for investors. It promises great change and great profit opportunities, yet often at the cost of increased risk and uncertainty. Sometimes it requires a leap of faith. Understanding innovation, however, gives committed active investors a potential advantage over passive or systematic investors. Many of the issues that innovation brings to the forefront are inherently unquantifiable. We have to make use of our best judgment, our knowledge of history and perhaps just good old common sense to navigate the opportunities and the risks involved.

Asia used to be viewed, with some justification, as a region that did not innovate. Imitation was rife. Some companies would watch, learn and imitate the best. Copying better ways of doing things helped to propel productivity and wage increases across the region in past decades. But, as Asia has grown and its populations have become richer and its citizens have witnessed what wealth creation can do for living standards, scientists, business leaders and politicians alike can see the value of true innovation—giving rise to the region's own brands, intellectual property and market structures.

Now, we are starting to see advances across different areas, particularly in technology and health care, but also in the way developing countries initiate reform programs and improve on the ways in which other Asian countries reformed in the past. Banks in India, looking to serve millions in rural areas, are skipping brick-and-mortar local branches in favor of smartphones. South Korea is doubling down on R&D spending to boost its battery cell and semiconductor businesses. Japan, with its aging population, has long been at the forefront of mechanization and the robotization of manufacturing. Researchers in China are mapping genomes of entire populations to expedite cancer research and drug development. Novel business models are arising based on the different ways in which Asians live their lives compared with Americans and Europeans. Access to financial markets and the desire of governments to democratize credit have led to new solutions. The increased spending power of Asia's workers has led to a rise in domestic brand names. Multinationals can no longer rely on a halo of quality or exclusivity around their technology or brands when domestic businesses are emerging as true competitors, better attuned to the preferences of the consumer—even sometimes with better technology. The excitement is infectious! And as these new industries arise, traditional businesses fall by the wayside.

Rapid innovation can bring challenges, of course. Regulation often lags behind technology. We have seen the issues around data privacy with some of the online giants in the U.S. How will Asia deal with these issues? As innovation evolves,

just how real are the opportunities? Exciting as they may seem, huge amounts of money may be invested on the basis of little more than speculation. This excitement may be good for the overall speed and direction of research and development, but as investors, are we going to benefit? The population of Asia as a whole may benefit, but will we profit?

Although innovation may hurt many traditional companies, other companies may not be as vulnerable to new markets. They may be able to adapt. There may still be much value in traditional sectors in tandem with the advances. Win or lose, it's a complex environment of new and old industries interacting often in stark ways but also sometimes in more subtle ways that can be win-win. We try to sort through the landscape of innovation and reform in Asia. How do we think about some of the new opportunities at Matthews Asia? Which are more established businesses? Which are more speculative? As active investors focused on Asia, we have always believed that the benchmarks are too backward-looking. And many of the exciting trends we see today will be reflected in the major regional benchmarks only in years or decades to come. In the meantime, we must temper any excitement with a level-headed investigation of the various types of innovation happening in Asia today and try to find the best investment opportunities.

**Robert Horrocks, PhD**

Chief Investment Officer and Portfolio Manager  
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