ON BALANCE

Recalibrating Markets, Firms, Society and People

DAY 1 SESSION SUMMARIES

Day 1 of KMF 2018, themed “On Balance: Recalibrating Markets, Firms, Society and People” kicked off with an Opening Address by the Minister of Economic Affairs, YB Dato’ Seri Azmin Ali who discussed the external headwinds facing Malaysia as well as the steps that the government, particularly the Ministry of Economic Affairs would take to face those headwinds. In particular, YB Dato’ Seri Azmin spoke about the need for a new economic logic for Malaysia towards a more balanced development path.

This was then followed by Professor Joseph Stiglitz who gave a holistic perspective of the concept of Balance in today’s politics, economics and society, covering topics as far-ranging as climate change, inequality, multilateral trade agreements and fractioning politics. The first Core Session of the Forum on Macro & Markets dived into the Im-Balance of the markets, particularly in Emerging Markets as US interest rate hikes, the US-China Trade War and a growth slowdown in China had increased market volatility in EM nations. The question of how to overcome this volatility, especially with a focus towards the medium- to long-term was then provide by Professor Ha-Joon Chang, who gave a detailed presentation on economic diversification, arguing that it is by design, rather than by default, that nations increased their economic diversification.

This led into the Luncheon Address by the Minister of Finance, YB Lim Guan Eng, who stressed that while fiscal consolidation was critical for Malaysia given the liabilities left over by the previous government, the government was not into an austerity drive, but rather into smarter spending. The Minister stressed that if there were initiatives that would greatly increase Malaysia’s productive capacity, particularly in technology driven industries, the government would be more than willing to collaborate with the private sector – still the primary driver of economic growth – as an ‘Entrepreneurial State.’ Ultimately, however, the main objective of growth should be to maximise societal well-being which remains a top priority of the government.

Having discussed external challenges and the need for economic diversification, the Forum then went from macro to micro, discussing the issues and challenges faced by Firms. In particular, the Forum discussed the fallacy of maximising shareholder value, arguing instead for a broader view on maximising stakeholder value. Firms needed to also move away from a deep focus on quarterly earnings, rebalancing towards a more long-term perspective. This is especially true given the exponential rise of technology which increases the threat of obsolescence of firms should they fail to innovate.

But even if firms know what to do, how are they incentivized to do so? The conversation, moderated by Hisham Hamdan, between Dominic Barton and Mark Wiseman touched on crucial points surrounding the various incentives for the Boards and Management of corporates. The discussion was far-ranging, covering topics such as the right structuring of Boards and how Boards must play a more active role in the operations of the business, as well as the right ways to incentivize Boards and Management to think long-term and Balance more ‘passive’ styles of management with more active ones.

Finally, while the Firm is key to value creation and re-balancing the economy away from short-term priorities towards long-term ones, society still remains in a state of Imbalance. Of course, institutions matter, but at the heart of institutions are simply, people. And the way that people impact change in society and re-Balance the existing Imbalances are via Social Movements. Social movements are collective, bottom-up, and regenerative. Compared to the traditional form of power that is top-down, hierarchical and coercive, social movements carry a different power where it is collective, bottom-up and regenerative. Social movements can serve as checks on institutions to secure and build a sustainable future for the next generation.

OPENING ADDRESS

YB Dato’ Seri Mohamed Azmin Ali

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The Global Economic Landscape Brings Tough Challenges

- **EMs face tightening monetary conditions.** EMs are being severely hit with their currencies declining and some countries raising interest rates to unprecedented levels to stem capital outflows.
- **The US-China trade war hurts the rest of the world.** The US and China are locked in a full-blown trade war, underscoring the repercussions of a breakdown in globalisation and the myth of free trade. This, in turn, particularly hurts developing countries.
- **The trade war could morph into a geopolitical dispute.** The trade war could escalate into a geopolitical dispute with military implications. This is especially for South East Asian nations who share a common border along the South China Sea.

Malaysia Faces A Number Of Structural Issues

- **GDP per capita, as measured in nominal USD, has fallen.** Malaysia remains stuck in a middle income trap as GDP per capita in 2017 is USD 9,944 from a peak of USD 11,183 in 2014.
- **Electrical and Electronics exports have declined compared to rising commodities exports.** E&E went from a peak share of 60% of total exports in the early 2000s to about 40% as of 2017 while commodities rose from about 13% of exports to about 20% in 2017.
- **GDP growth is incomplete measure of economic performance.** Headline indictors are somewhat positive with moderate GDP growth, stable and low inflation but the situation behind the headline paints a different picture. Besides massive debt because of 1MDB – debt to GDP is now at 80% of GDP, there is also a problem of youth unemployment which stands at 13.2%.

A New Economic Logic For Malaysia Towards A Balanced Development Path

- **Boost productivity by creating new industries adapted to global technology landscape.** There is a need to diversify to new industries by adapting to the global technology landscape and establishing Malaysia as experts of the application of cutting age technologies that will boost economic productivity.
- **Boosting economic complexity via export-led growth to diversify the economy.** This is because exporting to the world requires goods or services produced to be globally competitive. With the escalating trade war, intra-regional trade, particularly with ASEAN, must also be enhanced.
- **Development policy must become more inclusive to benefit the rakyat.** Growth in terms of GDP alone is not enough. Policies must enhance the purchasing power of the people and address disparity across states and income inequities. Structural issues must also be addressed such as raising productivity, ensuring quality investments and innovation as well as pushing industries to move up the value chain.

SPECIAL ADDRESS

Striving for Balance in Economics, Politics, and Society

Prof Joseph E. Stiglitz

A World Out Of Balance

- **Balance across the board.** Any talk of Balance must begin with Environmental Balance, but also critical in the discussion of Balance include Balance between Man and Nature, Intergenerational Equity, the Present and Future, Balance between Individuals, Society, the State and Globalisation.
- **These imbalances were the result of how we've structured our economy and society**. Economic ideas have shaped people to become more selfish and materialistic thus resulting in the loss of balance between altruism and materialism.

Navigating An Out Of Balanced Reality

- **GDP is not a good measure of economic and social progress.** GDP "fetish-ism" and the pursuit of materialism has resulted in companies risking future generations for short-term gains.
- **Need to balance collective action and individual behavior as economic and societal systems change over time.** Today's challenges require more collective action, especially when individual decisions can have a disproportionate effect on others.
- **Market forces have created instabilities, and we cannot expect the market to fix itself.** The nature of interventions has to change as markets do not exist in a vacuum. It needs to be restructured to not promote inequality and rent-seeking behaviour.

Rebalancing Policies

- **Tax policy to promote greater Balance**. Taxes such as carbon taxes, property taxes and CPGT, can be targeted at correcting pollution or distortions in the social fabric of a country, rather than on productive inputs such as work or savings.
- **International trade agreements today tend to disproportionately benefit developed countries.** Countries should engage in a new form of Multilateralism where its terms are mutually beneficial for all signatories. While Malaysia has signed the CPTPP, Malaysia does not need to ratify it.
- **Moving forward requires young visionary leaders.** The way forward starts with young people with different visions, who recognise the importance of the rule of law, the need to be in a symbiotic relationship with our planet, and a global community which desires a life beyond materialism.

CORE SESSION 1: MACRO AND MARKETS

EM: Escaping the Lost Decade

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ON BALANCE

Emerging Markets Are Confronted With Headwinds Of Rising US Nationalism, Increasing US Interest Rates And Chinese Growth Downturn

- **Trade war impacts China, impacts the world –** The US-China trade war is, in part, a tool to pressure China to change its government-led growth model**.** The fallout from trade war would inevitably hurt global economies.
- **Global capital inflows and loose monetary policies a problem.** Massive global capital inflow and loose monetary policies since the global financial crisis have contributed to elevated debt levels and perhaps asset bubbles in emerging markets.
- **Notable headwinds still prevalent in emerging markets.** Notable structural headwinds to emerging markets include global monetary tightening cycle and rising militarisation.

EM Regulators Have To Be Conscientious About The Type Of FDI Flows They Seek To Attract And Prevent Crowding Out Of Private Sector Investments

- **When playing EMs, new strategies must be adopted.** The EM growth playbook (export-led growth model to move up the value chain) is fast becoming obsolete, in light of rising trade protectionism, which challenges the structure of global supply chains.
- **EMs can learn from China.** EMs should take a leaf out of China's recent experience of rebalancing away from state owned enterprise growth, which historically crowded out private investments.
- **Labour, not just Capital, for Industry 4.0**. Technological disruption will be a game changer to the nature of investment flows, but simply investing capital is insufficient to achieving success. Highly skilled labour will be necessary to adapt to Industry 4.0.

Malaysia Has The Potential To Achieve Developed Nation Status, If The Policy Setup Is Correct

- **Malaysian firms have demonstrated its abilities to nurture global champion firms**. The key is to balance between public and private participation in the market.
- **The right policy conditions should be in place to enable SMEs growth to scale to a global reach**. Products and services should cater to a global consumer market because the Malaysian market is relatively small at approximately 30 million people.
- **New opportunities for FDI into China lie in the services sector**. EMs will benefit from technology transfer and management know how from China. Most new FDI to China is small but largely going to the service sector. Hence, the service sector represents future opportunity for FDI investments into China.

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SPECIAL ADDRESS

Economic Diversification and Economic Development

Dr Ha-Joon Chang

Diversifying The Economy Is Needed

- **A more diversified economic structure allows countries to spread risk.** If a country is too reliant on a small number of products, then that country will experience big negative shocks if prices or demand fall by a large margin.
- **Diversifying the economy reduces vulnerability to technological changes**. The values of primary commodities can change dramatically due to technological changes, originating from the technologically superior countries. Malaysia knows this problem well, from its experience with synthetic rubber.
- **Diversification is needed for upgrading an economy's productive capabilities** – Horizontal diversification (Chile's diversification away from copper into salmon, fruits and wine) does not necessarily mean upgrading of productive capabilities. Countries need to focus on capabilities that upgrade productive capabilities, which is the ultimate source of economic development in the long-run.

Diversification Need Not Be Based On Countries' Comparative Advantage Or Natural Resources

- **Adjacencies as the prevailing view.** Today's prevailing views is that countries need to diversify into activities related to what they are already doing, especially activities that are related to the natural resources they have; however, this is not necessarily the case.
- **A country's natural endowments are more or less irrelevant when it comes to high-technology, high-productivity industries**. For example, in industries like electronics, raw materials account for very little of the cost. In industries like automobile, so many different types of raw materials are required that no country can be said to have a 'natural' advantage for it.
- **Principle of 'related' diversification is not a very useful guideline**. For example, if one is an oil-producing country, diversifying into petrochemicals, may be obvious, but from petrochemicals one can diversify along a number of different routes, which can in very different directions.

Diversification Is Deliberate; A Balanced Diversification Strategy Is Needed Going Forward

- **Countries can diversify so long as they have the will and desire to do so.** Countries become good at certain industries only because they decide to become so and make the necessary investments into machines, research, and worker skills, not because they are somehow destined to do so.
- **Countries should support both new and existing industries.** For countries to continuously develop, there needs to be a balance between support for new industries and support for existing industries (needed to fund new industries).
- **Even among the newly-promoted industries, a country needs to build a balanced portfolio in terms of the 'difficulty' involved**. What is needed is a balanced portfolio of industries with different risk/return portfolios – a few high-risk/high-return new industries, a good number of medium-risk/medium-return industries, and a significant but (over-time) declining number of existing industries.

LUNCHEON ADDRESS

YB Lim Guan Eng

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Fiscal Consolidation For Fiscal Sustainability

- **No austerity, just smarter spending**. Fiscal consolidation by the government does not imply austerity, but rather on smarter spending in projects that lead to long-term sustainable growth and wellbeing for the people.
- **Government review of existing projects.** Projects which have already been agreed by the previous administration are under review to allow for further savings and also to leave no space for financial abuses. A large number of public-private partnership projects are also currently under review.
- **Institutional checks-and-balances as part of the government's overall institutional reforms**. These include the Public Finance Committee, which is tasked to outline medium-term fiscal plans to balance out needs for fiscal consolidation and economic growth, as well as the Tax Reform Committee to ensure the nation's tax system is more efficient and progressive.

The Entrepreneurial State To Drive Malaysian Growth

- **Fiscal sustainability is also supported by stronger private sector driven growth.** Given the fiscal restraint posed by the RM1 trillion debt, the government's balance sheet to drive growth is limited; private sector must lead the way.
- **Malaysian companies must pursue diversification and move towards higher value added industries**. In the case of successful developed nations, governments often lead the charge, but change is inevitably driven by the private sector, e.g. Nokia in Finland. The old ways of "build and they will come" has proven to be unsuccessful in driving economic growth.
- **Malaysian corporates have capacity to invest for economic growth**. Malaysia corporate debt-to-GDP currently stands at only 20% while its net debt-to-EBITDA is 2x, which is lower than most Emerging economies. Firms need to constantly evolve and not remain idle if they are to survive and drive economic growth.

Ensuring Wellbeing For All Malaysians

- **Fiscal consolidation and private-sector led growth in turn should be towards increasing the wellbeing of the people**. Savings from fiscal consolidation should be reinvested for the people. Further, government should not pursue an industry simply because it is new, but rather because they improve Malaysia's economic future.
- **The government is focused on creating opportunities that are fair for all Malaysians**. One aspect of this is the new government's aims to ensure no Malaysian is penalized by their life circumstances. For example, the low-income segment of society should not be burdened by regressive taxes and thus, the removal of GST.

CORE SESSION 2: FIRMS AND TRANSFORMATION

To Explore and to Exploit: Trials and Tribulations in an Era of Rapid Disruption

The End Of The Primacy Of Maximising Shareholder Value?

- **The mission of increasing shareholder value has only been here since the 1990s.** Maximising shareholder value can lead to short-term manipulation of stock prices. Building long-term strategic business value will naturally add to long-term shareholder value, so that should be the focus.
- **Manage for the entire system of stakeholders, not just shareholders.** Employees, the local community, the local environment, the government, and society at large are wider stakeholders. The outcomes of all stakeholders must matter.
- **Responsible investing is important**. Companies increasingly need to incorporate responsible investment metrics. Companies that perform well, in material, environmental, and good governance, also outperform financially and economically.

Companies Now Have To Be Managed For The Long-Term, In Concert With Long-Term Shareholders

- **Level of engagement has become a lot shorter, so more depth of engagement is required with shareholders.** Good, long-term strategic plans should be discussed with good, long-term shareholders. Corporates should look to have 25% of shareholder base as good, long-term institutional shareholders.
- **Management, Board, and members of the executive committee all have roles to play.** If you are CEO, board member, or member of an executive committee, think of what is unique to your role, so that you can make the organisational change from short-term to long-term.
- **There are other benefits to including diversified metrics such as social contribution** – For instance, in environmentally conscious firms, staff morale improves. Further, firms that operate with purpose do better financially and have higher staff attraction and retention.

The Impact Of Technology Is Changing Product And Service Delivery Quickly And Enabling New Business Models

- **Today's corporate and business world requires speed, since profit pools are shifting very fast.** When growth stagnates, one must relook core capabilities and assets, and look for adjacencies. There is a lot of optionality in learning even if some ventures fail, provided no bets are too big.
- **Technology evolves at an exponential rate, companies must respond in kind.** Ping An moved from 3,000 developers 6 years ago to some 25,000 developers today.
- **Companies must also invest when times are good and not just when profit growth stagnates**. Ping An reinvests 10% of profits in R&D, but knowing where to invest and knowing where one's adjacencies are, is key. In Ping An's case, it looked at the entire ecosystem, decided what was needed, and kept pivoting.

SPECIAL SESSION

Active vs Passive – The Paradox of Long Term Capital

Dominic Barton and Mark Wiseman

Incentive For Every Stakeholder Must Be Aligned To Focus Capital For Long-Term Investing

- **Bring in the right investors who are aligned with your long-term strategy**. Asset owners must be more proactive in asset stewardship by getting actively involved in their investee companies. Research has shown that 25-30% minority investor stake, i.e. single shareholders such as family owners or Private Equity funds, are ideal for investors to actively manage boards.
- **Directors and management must also be incentivized accordingly**. Compensation via shares can help align the interests of the directors and management with those of the owners. When all stakeholders have skin-in-the-game, everyone will be incentivized to work towards the longevity and survival of the company.
- **There is a greater need for more Private Equity firms and activist investors in Malaysia**. The local investment landscape is mostly dominated by large institutional investors, whose activist capacity might be limited. Local entrepreneurs should venture into this space with the support from the large funds.

Active Vs. Passive Investing Is A False Dichotomy

- **Choosing between investment strategies introduces an element of choice**. All investors are active investors as they face a choice in how to deploy capital via alternative investment strategies. Hence, the dichotomy between active investing and passive investing is false.
- **Quant strategies need to be paired with human judgment to enhance returns**. Investors should not ignore quantitative investment strategies. They should utilise passive strategies to enhance alpha strategies.
- **Boards need to be ready to deal with short term investors and give a voice to the long term ones**. Most "passive" investment flows are less than 5% of company ownership but have a louder voice compared to longer term investors who hold larger stakes. Boards need to give a voice to long-term investors.

Getting The Right Structure At The Board

- **Boards need to spend more time focused on strategy rather than reporting requirements**. Board members should spend more time crafting long-term strategy for their companies and regularly reviewing these strategies rather than focusing on reporting requirements of developments that happened over the previous quarter.
- **Diverse boards with the right culture make for better boards.** Boards should have a diverse composition, be it along the lines of race, gender, background, and thinking style. Boards also need to build relationships with senior management beyond CEOs and create a safe environment for management to engage on strategy issues despite not having all the answers.

SPECIAL SESSION: SOCIAL MOVEMENT

A New Balance of Power? When Institutions Meet Movements

Institutions Should See Themselves As Custodians For Future Generations, Otherwise They Face Being Toppled By Social Movements

- **Social movements are collective, bottom-up, and regenerative.** Compared to the traditional form of power that is top-down, hierarchical and coercive, social movements carry a different power where it is collective, bottom-up and regenerative.
- **Social movements as a means of achieving a sustainable future for the next generation.** Social movements can serve as checks on institutions to secure and build a sustainable future for the next generation.
- **The success of social movements depends on existing institutions.** However, the effectiveness of social movements may ultimately depend on existing institutions to create lasting change.

Technology And Social Media Have Proven To Be Powerful At Connecting And Mobilizing People, But With That Power Comes The Responsibility Of Managing Fallout

- **Social media is imperfect and problematic.** While technology such as social media has been the mobilising medium that is both cheap and inclusive, Anya Schiffrin argues that it is an imperfect and problematic means to bring people together with no current viable and lasting solutions.
- **Social movements enabled by technology are now seen as the new currency of power**. This is because they have successfully toppled oppressive establishments. However, in recent times, they have paved the way for demagogues to take over and have resulted in the current wave of populism.

Different Cultural Manifestations (E.G. Music And Stories) Revive A Sense Of Community And Belonging; Thereby, Providing The Possibility Of Imagination And Freedom

- **Stories matter more than facts.** Brexit came about because Leavers told a powerful story about refugees coming in and stealing jobs whereas Remainers didn't tell a story. People who lead movements have stories.
- **The power of culture in affecting change**. The arts give community members a safe outlet to share their emotions. Historically, arts have also been the means of resistance.
- **The arts can healing communities that have suffered from traumatic experiences.** Arts have also been used as a healing process for communities that have been through traumatic experiences, which is the first step to community consolidation and later empowerment.