# Asia Now

2020

INSIDE



ILLUSTRATION BY JON REINFURT

Matthews Asia

# ASIA & EMERGING MARKETS

*Connections drive growth. In an increasingly interconnected world, Asia serves as the economic hub of emerging markets. While linguistically and culturally diverse, emerging markets are linked by consumer patterns, trade routes and innovation.*

The economic rise of China has provided a strong tailwind for the regional growth of Asia. Similarly, China's growth is disproportionately benefiting many economies across the larger asset class of emerging markets. The desire of China to maintain its economic growth as wages rise, to find an outlet for its labor-intensive businesses as it moves into services and knowledge-based industries, and to expand its international influence, both economic and political, are the major forces shaping the emerging market economies today.

China's government is pushing to expand the infrastructure of the nation across the world—East, West, and South. As it does so, it brings into the global economy many of the emerging nations of Asia, Europe, Africa, and Latin America. Government-built infrastructure includes roads, railways, air-routes, as well as the virtual and physical infrastructure of telecommunications and

*Continued from Page 1*

online platforms. Surely as night follows day, private enterprise follows. Many businesses and investors see opportunity, too. Opportunity in addressing the many new consumer markets; opportunity in investing in the rising Asian corporate champions; opportunities in investing in the corporations across the emerging markets that will both facilitate and benefit from this new wave of growth.

This new direction from Asia and China is not without its complications, such as international relations, cross-border financing, building the manufacturing bases in emerging economies, dealing with labor issues, and competition with incumbent domestic elites. Change of this sort causes all kinds of friction; each vested interest will try and make change seem a burden. In fact, whereas these interests are not entirely self-serving, change from China's overseas development, like other global investors who have come before it, is likely to be overwhelmingly for the good.

Asia's companies are already crossing borders within emerging markets. Japanese companies are building the modern manufacturing processes to allow Chinese companies to drive productivity gains in an era of higher Chinese wages. As wages continue to rise in China, Chinese companies are also moving their production overseas to ASEAN and Latin America to tap into less expensive labor markets. Asia's internet giants are buying up stakes in online businesses across emerging market economies. As wages rise, consumer companies find new markets and new opportunities to help spread the middle class lifestyle. For their part, other emerging market nations are growing their own business champions and supplying the land, labor and raw materials to partner with Asian and Chinese capital to fund this new growth.

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## A Broader Opportunity Set

**How should investors think about this?**

Well, the first thing to do is to try and step outside of the mindset that the center of the global economy is the U.S. and its allies in Europe. This is no longer a fair or complete view of the world; nor is it a helpful guide as to the future growth in the global economy, nor even as a signpost to the set of opportunities for the global investor. Global benchmarks are belatedly, slowly, but inevitably coming round to the new reality. However, it may still be a long time before the true influence of the Chinese economy, Asian economy and Asian corporates, as it exists today, is finally represented either in emerging markets or international equity benchmarks.

The flow of capital to date has most assuredly been from China across the rest of the world. And yet, it has been remarkably passive in that it has focused on U.S. treasuries. This is already showing signs of change as China starts to ramp up its investments in physical capital and FDI (foreign direct investment) across the world. China's One Belt One Road initiative is building transportation links that look like the arms of the world's poor reaching out across Central Asia to try and link hands with the European Union.

In addition, China is trying to internationalize the role of its currency and its capital markets. China would love to have the luxury enjoyed by the U.S. and the core European markets, where individuals, businesses, and global central banks are happy to hold their treasury bills. The next revolution of Chinese growth is to be virtual: service industries, online platforms, knowledge and intellectual-property-based profits, and financial markets. Whereas it will be the labor on the emerging parts of the world that will take up their opportunity. What the U.S. was to China in the denouement of the Cold War, China may be to the poorer nations of the world. On the face of it, this should generate a remarkable cooperation between capital and labor that should raise wages and help drive the most efficient use of capital. It ought to be an environment where innovation and productivity gains drive increases in standards of living, driven largely by new technologies and ideas coming out of China.

This is not to say that the world and the emerging markets will necessarily have the easiest of relationships with China. But nor should the relationship between China and the rest of the world be as tense and difficult as the one between the U.S. and China. Despite its emergence as an economic superpower, China is seen by many as an economy, the growth of which is beneficial to those nations struggling to achieve capitalistic take-off. Or even, as may be the case in parts of Europe, as a new avenue for dynamism and growth within established capitalist nations.

It is always tempting to invest in the companies that are leading China (and Asia's) outreach to the rest of the world. However, companies building out infrastructure may be doing so via government initiatives and partnerships, and consequently may not necessarily earn strong returns. It is the longer-term effects of infrastructure investment that interest us most at Matthews Asia. Increased productivity drives wages higher, which leads to more consumption. In turn, consumer companies have the chance to build higher-margin business and generate better returns when consumers make decisions based on quality and brand loyalty. This pattern of development is precisely the pattern enjoyed by China over past decades—the growth and development of a richer, service-led, consumer-based economy. Consequently, when we look at emerging markets, we tend to find many good long-term opportunities in precisely these kind of companies.

*By Robert Horrocks, Ph.D.*
*Chief Investment Officer, Matthews Asia*


*Across emerging markets, rising incomes reshape family spending priorities and consumption patterns, spurring increased demand for insurance, wealth management services and higher education.*

# Smaller Families, Bigger Budgets

"Mais feijoada por favor." "Nǐ jīntiān hǎo ma?" "Na zdrowie!"

At dinner tables throughout emerging markets, middle-class families tuck into comfort food, share details about their day and toast each other's successes. Languages and cuisines may differ, but many elements of everyday life are often quite similar.

Common threads unite families in emerging markets from Mexico City to Jakarta and dozens of places in between. As incomes rise, families tend to have fewer children, which spurs a near-universal reshuffle in spending priorities and consumption patterns. Growing financial resources are dedicated to a tighter nuclear household. New goals come into focus, many of which are shared across the diverse range of developing economies.

## Safeguarding Loved Ones with Insurance

Staying healthy, saving for the future and providing for your survivors: These are foundational desires felt by families at all income levels. As purchasing power grows, households in emerging markets are increasingly able to act on the need for protection by buying insurance. Various forms of insurance appeal to such families, including life insurance, health-care plans and coverage for cars, liability and agriculture. Many households also utilize long-term savings and annuity products offered through insurance providers.

Demand for health insurance is particularly robust in China. Members of the fast-growing middle class are purchasing supplementary private medical insurance plans to help safeguard the health of their dependents. As a result, demand for private medical insurance in China grew at a compounded annual growth rate (CAGR) of nearly 40% between 2014 and 2019, according to Swiss Re.[1] Families in China are taking advantage of middle- and high-end products, which extend coverage for medical services, drugs, dental treatments and visits to public and private hospitals. Many of the insurance products combine low premiums, high coverage amounts and a simplified underwriting process—an attractive blend that fits the needs of a wide range of families.

1 Swiss Re Institute, "Sigma," November 2019

Brazilians are acting on the same need to protect their loved ones. OECD data shows that insurance penetration—calculated as the ratio of direct gross premiums to GDP—has increased in the past decade.[2] In addition, individual life insurance plans sold in Latin America's largest economy posted 19% growth between 2016 and 2019, according to Ernst & Young.[3]

Opportunities abound for insurance companies operating in emerging markets. Forward-thinking firms are harnessing technology to make improvements to their top and bottom lines via digitized distribution, pricing and claims administration. Insurance companies are also acutely focused on customer experiences, striving to deliver innovative new products and exceed families' ever-higher expectations.

## Focusing on Wealth Management

As families throughout emerging markets transition toward affluent status, wealth management becomes an important focus. Families share a desire to make smart decisions with their money, calling on professional resources to ensure their carefully built prosperity makes a positive, lasting impact. Older families begin to plan for life events, such as retirement, philanthropy and wealth transfer to the next generation. Younger families often seek out investment management and advice as they accumulate new wealth.

The wealth management industry in Asia is particularly strong, boasting an estimated US$34 trillion of onshore personal financial assets at year-end 2019. The industry has grown at a CAGR of approximately 10% from 2014 to 2019, according to McKinsey & Company—well ahead of the 5–6% growth rates in developed markets. And yet, wealth management advisory and financial planning still have ample room to grow in Asia: Managed assets represent only 15-20% of the region's overall personal financial assets.[4]

Appetite for wealth management is also evident in Latin America, where a large proportion of private companies are family-owned. By some estimates, the figure is roughly 85%.[5] As such, many households feel a deep connection between wealth, business and family. Decades of vibrant growth have created a rising tide of prosperity and substantial wealth for family-owned enterprises—but such growth has also created a host of thorny issues for relatives who are in business together. For many, realizing a shared vision that fosters household harmony alongside financial success is a real challenge. Families often get expert support from traditional wealth management firms, private banks and family offices. Through an array of services, these providers help high net-worth families navigate the complicated cross-section of business demands, succession planning and other multi-generational dynamics.

## Taking Advantage of Private Education Opportunities

Ask almost any parent and he or she will agree: High-quality education is a top priority—so it's no surprise that private education is a trillion-dollar industry globally, according to Ernst & Young.[6] Families across emerging markets feel several of the same forces, which together are fueling increased enrollment in private education. First, the average household size is shrinking, and more families have dual incomes. As a result, fewer households are relying on extended family members for childcare and are instead seeking out early education opportunities. Second, rapid urbanization and rising affluence are concentrating demand for education in major metropolitan areas. Lastly, many public education systems are falling short, unable to meet the growing demand for high-quality education. In emerging markets, families influenced by one or more of these factors are increasingly able to look to private education for solutions.

In emerging Asia, China and India are home to large private education markets. Parents can take advantage of a variety of offerings, ranging from K-12 schools to private colleges and vocational training. International schools are growing in popularity throughout Southeast Asia, boosted by families' desire for global curriculum and English-language instruction. In the Middle East, education consultant L.E.K. estimates that private K-12 education is growing at a rate three times faster on average than GDP, with particularly rapid growth in the UAE.[7] Global education providers, independent operators and local education companies are all part of the boom.

2 OECD.Stat, "Insurance indicators," September 2020

3 EY, "2020 Brazil insurance outlook," 2019

4 McKinsey & Company, "Asia wealth management post-Covid-19," June 2020

5 Vistra.com, "Helping preserve and transfer wealth across multigenerational Latin American families and family businesses," May 2020

6 EY-Parthenon, "Education in Southeast Asia," 2016

7 L.E.K. Consulting, "The private K-12 education opportunity in the Middle East," 2018

Wuhan Yellow Crane Tower Park night and light show scenery

# The Resilience of Cities

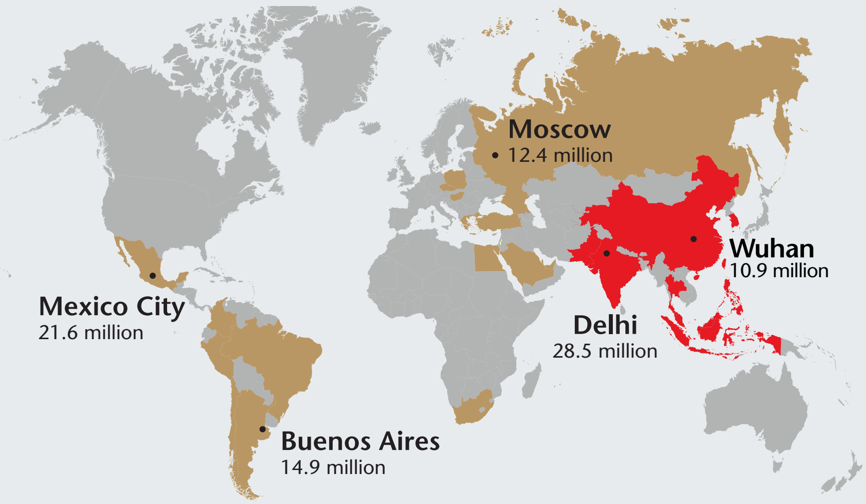
Great cities have proven resilient and adaptable time and again, even when faced with great challenges. As a "new normal" of daily life evolves amid the pandemic, the economic health of emerging market economies remains connected to their largest cities. From everyday necessities to consumer upgrades, we believe understanding consumer behavior within cities is crucial when investing with a long-term view in the emerging markets. The spending power of middle class urbanites provides ballast and stability to a number of sectors and industries across the broader universe of emerging markets.

## Cities Remain Cultural and Economic Powerhouses

Wuhan, a metropolitan area with a population of 11 million people, was thrust into the harsh international spotlight earlier this year. Prior to the pandemic, the city gained little media attention. However, Wuhan is among nine cities exceeding 10 million inhabitants in China alone. The provincial capital was deeply bruised by the coronavirus. However, schools, businesses and government services in Wuhan have opened more quickly than other megacities worldwide. In addition, Wuhan remains a bustling commercial, manufacturing and transportation hub as well as a center for tertiary education. Despite the economic and health care challenges associated with the pandemic, it is unlikely that urban living goes out of style over longer time frames.

## Cities as Economic Engines

Megacities—those with more than 10 million inhabitants—often play outsized economic roles in their broader national economies.



Any assessment of growth opportunities in emerging markets necessarily starts with their largest cities, where the vast majority of their wealth is concentrated. Based on the UN's latest data (2018), 31 of the world's 40 largest cities are located in emerging markets. Megacities are the economic engines of emerging markets. In many cases, they are also political capitals, like Mexico City, Moscow or Manila. Others, like Shanghai, Mumbai or São Paulo, are distinguished as global commercial powerhouses, international or even supra-national in character. Collectively, they represent a trend toward massive urbanization in emerging markets. By 2030, the UN projects that the urban population of the world's frontier and emerging markets will exceed 4 billion, or around 57% of these populations.

## Urban Culture Cuts Across Borders

Although many are separated by oceans and time zones, the world's megacities tend to transcend their linguistic, cultural and political differences. Thanks to the internet, social media and the ubiquity of smartphones, fashion, cultural and consumer trends reverberate around the world at amazing speeds. The key barometer of growth in emerging markets is a rise in discretionary income, which enables a growing consumer class to absorb and assimilate trends and influences from other countries. A woman earning US$25,000 a year in Shanghai may be willing to spend a considerable amount of her disposable income on South Korean cosmetics because it is relevant for how she sees herself and for how her friends see her.

Everyday life in large emerging market cities follows similar patterns and is governed by similar social contracts—whether it is Moscow or Seoul, people are accustomed to living in densely packed, close quarters and making the most of comparatively small spaces. They shop for food daily rather than stocking large freezers, and may rely on scooters, taxis or ride-hailing to get around rather than private cars. The density of emerging market cities is favorable to innovative businesses that can master a combination of technology and "last mile" viability – food and grocery delivery, for example.

## Density Creates Opportunity

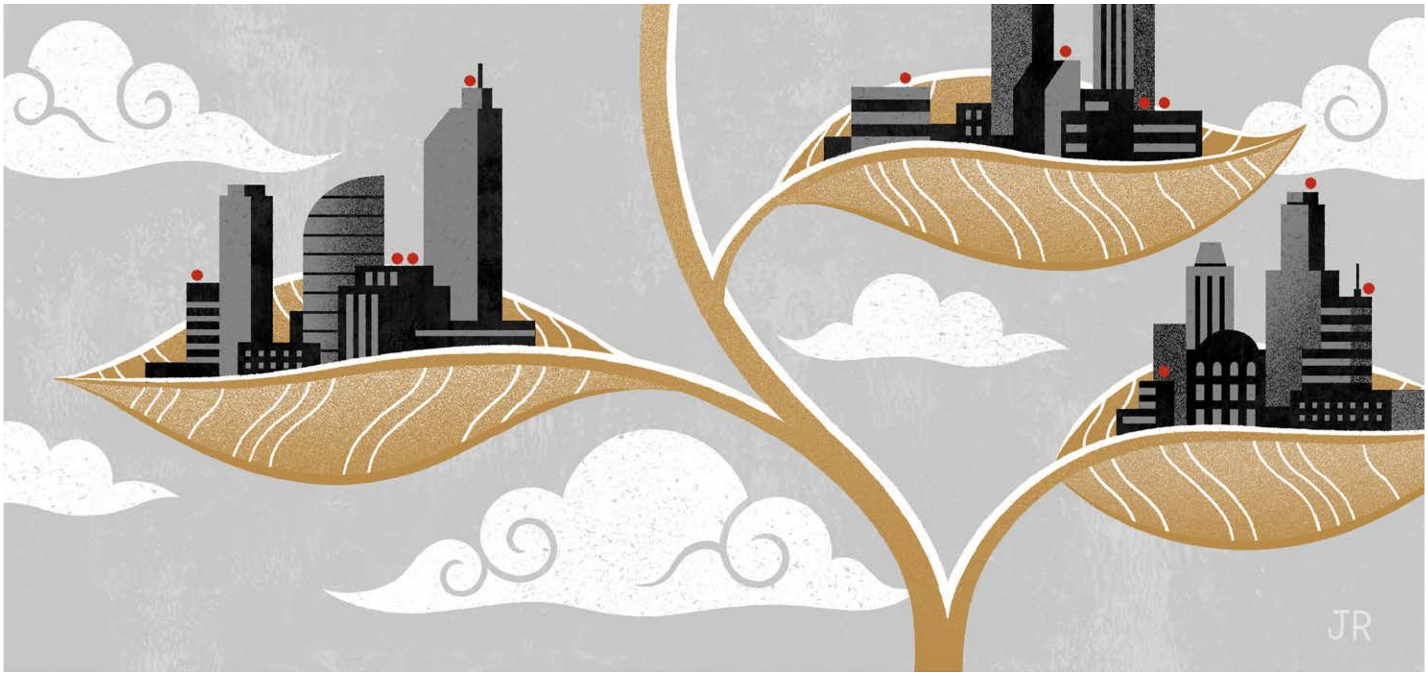
Emerging market megacities are hotbeds of social change and incubators of innovation. They attract young strivers in search of opportunity. Large cities on different continents share a concentration of skills and higher education levels. By many accounts, entrepreneurial activity is more pronounced in emerging markets than in developed economies, largely out of the sheer necessity to find solutions to challenging problems. Growing technological fluency accelerates entrepreneurship. As a 2018 World Economic Forum Report noted, "more pressing needs create better conditions for radical innovation and rapid scale." While the COVID-19 pandemic has presented considerable public health challenges for many of the world's largest and densest cities, cities remain important engines of economic growth and innovation globally.

## Megacities at a Glance

The sheer density of cities in emerging markets requires understanding the economic role of cities when investing with a long-term view.

| China Megacities | Population in millions |
|---|---|
| Chongqing | 30.8 |
| Shanghai | 24.2 |
| Chengdu | 16.3 |
| Tianjin | 15.6 |
| Guangzhou | 14.5 |
| Shenzhen | 12.9 |
| Wuhan | 16.3 |
| Shijiazhuang | 10.8 |
| Suzhou | 10.7 |

| Emerging Market Megacities (Urban Agglomerations) | Population in millions |
|---|---|
| Delhi | 28.5 |
| São Paulo | 21.6 |
| Mexico City | 21.6 |
| Cairo | 20.0 |
| Mumbai | 19.9 |
| Dhaka | 19.6 |
| Karachi | 15.4 |
| Buenos Aires | 14.9 |
| Istanbul | 14.7 |




# ESG's Early Adopters

*In emerging markets, many exchanges and regulators are setting forth enhanced standards, often aimed at bolstering shareholder protections and corporate disclosure requirements.*

Investors often think of emerging markets as taking cues from their developed counterparts—for example, by aiming to boost consumption and to achieve productivity gains. It may come as a surprise that some emerging economies have made an earlier start in adopting environmental, social and governance (ESG) conventions than many of their developed market counterparts. Among the significant ESG developments in emerging markets are the promotion of stronger ESG and corporate governance frameworks by exchanges and regulators. Their progress is particularly timely, given investors' increasing focus on ESG: Signatories to the United Nations-supported Principles for Responsible Investing grew at an annual rate of more than 20% in 2019.[1] In addition, 103 stock exchanges worldwide now participate in the Sustainable Stock Exchanges Initiative, representing over US$88 quadrillion in assets.[2]

## Regulators and Exchanges Encourage Stronger Corporate Governance

In emerging markets, many exchanges and regulators are setting forth enhanced standards, often aimed at bolstering shareholder protections and corporate disclosure requirements. In some cases companies must adopt the standards in order to be listed on the exchange or segment. The results benefit many different stakeholders. Investors benefit from improving access to ESG information and potentially better business performance over the long term. Benefits also accrue to participating companies by way of improved overall corporate accountability and risk management, as well as the possibility of attracting new capital. Exchanges gain increased competitiveness and access to capital.

1 Saa, Lorenzo. "PRI welcomes 500th asset owner signatory." UN PRI blog, 2020.

2 Sustainable Stock Exchanges Initiative, September 2020

One such listing segment is Novo Mercado, part of Brazil's prominent B3 stock exchange. In the years leading up to the launch of Novo Mercado, investors in Brazilian equities faced two major challenges, as identified in a case study by the International Finance Corporation (IFC).[3]

- First was the prevalence of non-voting shares: Companies were legally permitted to issue up to two-thirds of their capital as non-voting shares. As a result, holders of voting shares could control companies by owning as little as 17% of the listed company.
- Second was a change of control law which enabled transfers of controlling shares to be completed at extraordinarily high premiums. At the same time, minority shareholders were left out in the cold, unable to sell their shares alongside the controlling blocks.

In December 2000, Novo Mercado was launched with the intent to achieve equitable treatment of all shareholders by instituting corporate governance requirements that extended well beyond Brazil's legal and regulatory framework. Companies listed on Novo Mercado can only issue common voting shares, and the same conditions provided to controlling shareholders during a change of control are extended to all shareholders, ensuring what are known as "full tag-along rights" for every shareholder. Companies must also adhere to enhanced transparency and monitoring policies.

Listings on Novo Mercado have grown at an impressive rate and now constitute a significant share of the Brazilian market. Encouragingly, exchanges in other emerging markets are following the lead of Novo Mercado. For example, the chairman of Argentine stock exchange BYMA cited Novo Mercado as inspiration for BYMA's special listing segment for companies with high corporate governance standards.[4]

## Top Ten Global Stock Exchanges in Terms of ESG Disclosure

Three of the world's leading stock exchanges for ESG disclosure are found in emerging markets—South Africa, Colombia and Thailand.

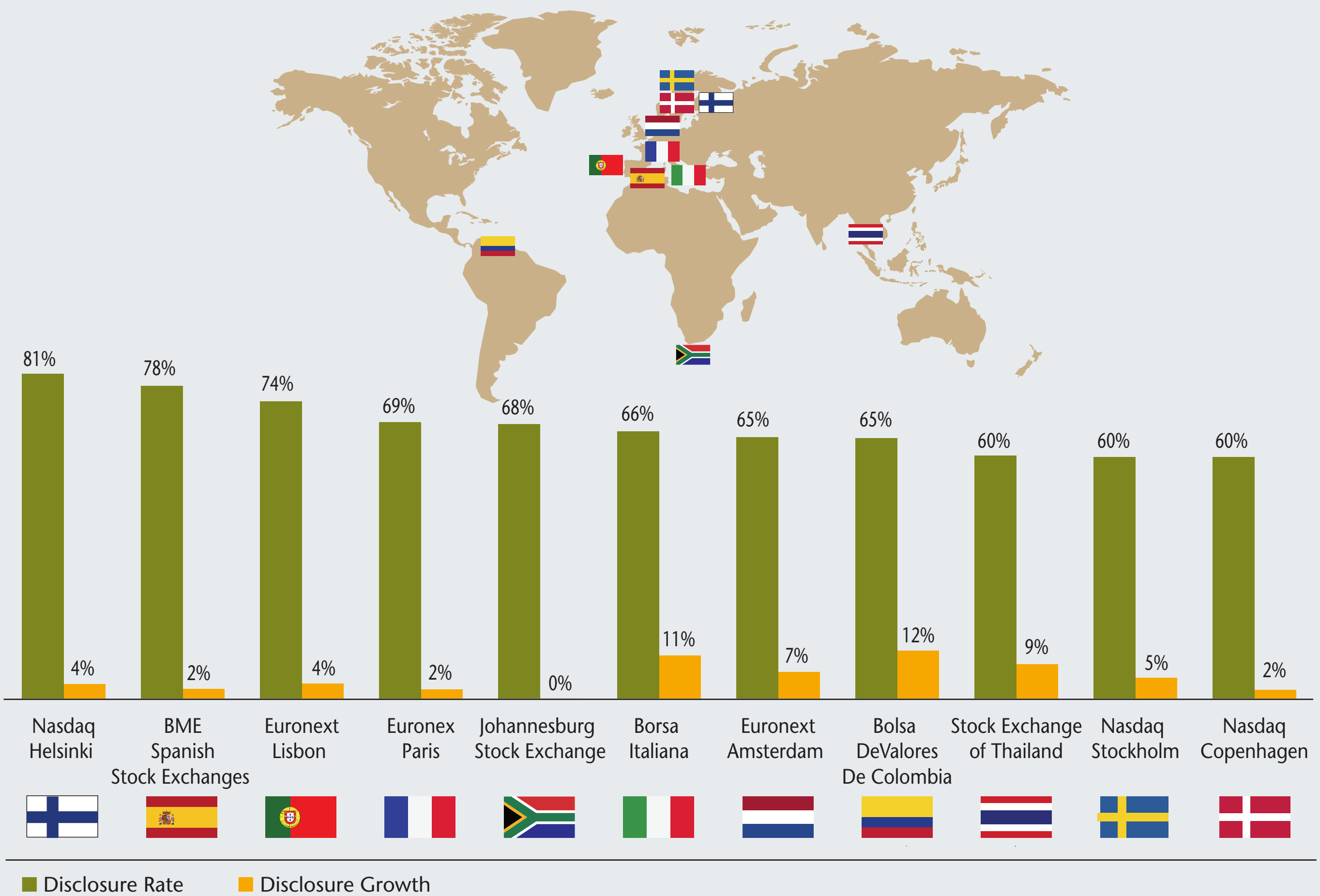



Chart compares and ranks disclosures that are specific to ESG topics. Source: Corporate Knights, 2019

3 Alexandru, Petra; Ararat, Melsa; Santana, Maria Helena; Yurtoglu, Besim Burcin. Novo Mercado and its followers: Case studies in corporate governance reform. IFC

4 Sustainable Stock Exchanges, "Argentina's BYMA joins exchanges committed to sustainability." December 20, 2017.

Sao Paulo, home to Brazil's B3 stock exchange, is a vibrant financial center in the developing world.

The Moscow Exchange (MOEX) has also been taking significant steps towards development of responsible investing. It became a Sustainable Stock Exchange Partner Exchange in 2019 and in the same year launched the daily tracking of Russia's first sustainability indices as well as new MOEX's listing rules providing for the creation of the Sustainability Sector.[5] Higher listing standards among exchanges such as the Novo Mercado and Moscow Exchange are a welcome development for long-term investors, but fundamental research remains important in emerging markets.

## Asia Sets a Strong Example

Research by CFA Institute highlights Thailand as an example of swift progress by an emerging market toward development of a mature ESG disclosure mentality, helped in large part by actions from Stock Exchange of Thailand (SET).[6] In 2019, SET placed ninth on the Corporate Knights ranking of stock exchanges worldwide based on ESG disclosure of issuers, earning it the highest ranking in Asia—even above the developed-market Australian Securities Exchange.[7] This represents a notably rapid evolution for SET, given its low ranking of 31st out of 35 in 2012. The exchange's successes are attributed to multiple efforts, including ongoing ESG training for listed companies, a new Corporate Governance Code in 2017 and annual publishing of a list of companies that meet ESG performance criteria.

China, the region's largest market, has also made considerable progress on the disclosure and transparency front, encouraged by China's exchanges. China has taken many steps to give investors more confidence to invest in the country's capital markets by focusing policy on corporate governance reforms. Policymakers have amended or issued key rules and guidelines over the past years related to financial reporting, disclosure of substantial ownership stakes and director trading. Fair and relevant disclosure of financial and operational information is an important component of good corporate governance. In some respects, A-share listed companies (those that trade in China's domestic markets) are outdoing Chinese companies listed in offshore markets in areas such as comprehensive disclosure requirements. A-share companies also are subject to stricter regulation on potential conflicts of interest (see table on the next page).

Enforcement and engagement also are on the rise. Bloomberg reported that in the first months of 2019, China's stock exchanges stepped up scrutiny of listed companies to address corporate governance concerns, sending 23% more queries to local firms, which was 62% more than in the same period in 2017. The queries focused on irregularities in the firms' financial results, inadequate information disclosure and relations with controlling shareholders with the goal of improving the credibility of China's capital markets for international investors.[8]

5 Sustainable Stock Exchanges, "Exchange in Focus: Moscow Exchange Advancing ESG," May 2020

6 Leung, Mary; Zembrowski, Pitor. ESG disclosures in Asia Pacific: A review of ESG disclosure regimes for listed companies in selected markets. Charlottesville, VA: CFA Institute. 2019.

7 Corporate Knights, Measuring sustainability disclosure: ranking the world's stock exchanges. 2019.

8 Bloomberg, "China Steps Ups Vigilance on Company Disclosures as Market Opens." June 2019.

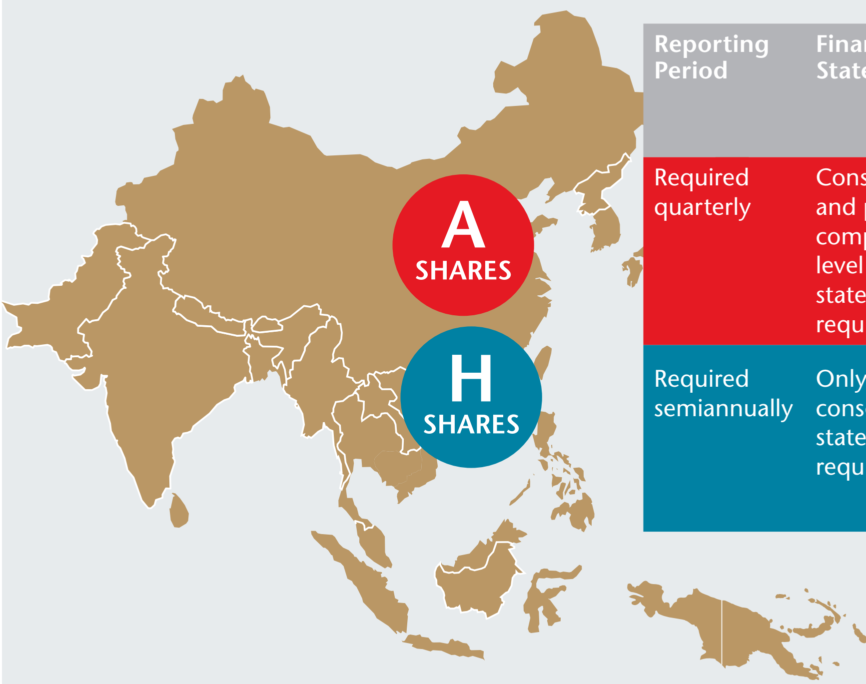
## Integrating ESG into Fundamental Analysis

When investing in emerging markets, ESG considerations may play a key role in fundamental analysis. Helping to identify opportunities and spotlight risks, ESG criteria provide a framework for beginning to evaluating material factors that could create either headwinds or tailwinds for individual companies. For active managers, ESG may play a particularly important function in bottom-up, active stock selection processes.

Investing with a long-term view, we believe ESG factors are highly compatible with the bottom-up, fundamental investment process that we employ at Matthews Asia. In our experience, well run, high-quality companies tend to survive better in times of stress, grow better in times of prosperity, and generate more cash than a company that has a bad character. We adhere to an integrated approach to ESG with an emphasis corporate governance; it is the input we consider most closely. Governance influences social and environmental factors and is near universal in its objective. We seek robust corporate governance that fairly considers the needs of non-control minority investors like ourselves. Companies require strong, ethical management teams and solid board oversight to maximize long-term returns for shareholders. We are also committed to comprehensive risk monitoring, driven by proprietary research and complemented by reputation risk monitoring via multiple research providers. Additionally, our ESG approach includes a consideration of what is material for each industry and sector, and a commitment to communicating concerns directly with company management teams.

Greater ESG adoption with emerging markets economy translates into greater transparency. Qualities that can be measured are qualities that can be improved. For economic growth to be sustainable, it should be inclusive and benefit all stakeholders. We see considerable progress in emerging markets and look forward to continuing to engage with our portfolio companies on key ESG considerations.

## Comparison of A-Shares vs. Hong Kong Counterparts (H-Shares)




| | Reporting Period | Financial Statements | Cash Flow Statements | Dual-Class Shares | Pledge Share Disclosure Threshold | ESG Disclosure |
|---|---|---|---|---|---|---|
| A Shares | Required quarterly | Consolidated and parent-company level statements required | Quarterly reporting required | Not allowed* | Anyone owning more than 5% | Mandatory from 2020 |
| H Shares | Required semiannually | Only consolidated statements required | Available once per year in annual reports | Allowed | Controlling shareholders (i.e. 30%+) | Comply or explain |

Source: Matthews Asia. Analysis as of September 2020. Chart compares general corporate operational and financial disclosures in China. Includes references to Hong Kong Institute of Chartered Secretaries, "A Comparative Study of Continuing Disclosure in Hong Kong and the PRC," September 2008, where regulations remained in place in 2020.

* Dual-Class shares are not allowed on the Shanghai and Shenzen main exchanges. However, dual-class shares are allowed on China's Science and Technology Innovation Board – or STAR Market – operated on the Shanghai exchange.


# E-COMMERCE *Sizzles*

*Across emerging markets, growth in e-commerce accelerates as the pandemic reshapes consumers' shopping patterns.*

A young couple in suburban São Paulo wants a smart TV. During the COVID-19 pandemic, they have become used to buying nearly everything they want or need online. But they are reluctant to buy a television without actually seeing it. So they strap on their masks and head to a large store downtown, where they can compare makes and models, sizes and picture quality, and talk to a salesperson. Then they go home, discuss their options, make their selection, and order it online for delivery. Here's what makes it easy: the store they visited and the online marketplace they bought from are operated by the same company.

In Shanghai, the reverse scenario is taking place. A mother knows exactly what she needs from the grocery. She opens an app on her smartphone that lets her into China's largest e-commerce platform. She orders everything on her list (and then some) and pays for it electronically, using the online platform's payment system, which links directly to her bank debit card. Then she drives to the grocery market—one of China's urban "hypermarkets"—where her entire order is packaged and waiting for her to pick up.

Chinese e-commerce providers can make deliveries to more than half of all urban dwellers in China.

## Online-to-Offline Convergence

These two scenarios on different continents are the flip sides of a major emerging market trend: the convergence of e-commerce and physical retail into a fast-growing "super-sector" referred to as omnichannel. And while the sector has been developing over the past several years, its growth has accelerated dramatically in the wake of COVID-19, as the number of emerging market consumers shopping online has surged.

While the omnichannel model is similar across emerging markets, it has evolved very differently in other parts of the world compared to China. Historically, countries such as Brazil or Mexico already had a number of large, established brick-and-mortar retailers and a shopping mall culture when e-commerce began its ascent in the 21st century. These retailers had to invest aggressively in recent years to build an online presence to complement their physical stores and create a competitive “moat” against the threat from young and agile pure-play e-commerce sites.

In contrast, China had very little in the way of consumer retail stores as it grew out of the Mao era and began liberalizing its markets. Today’s massive online retail platforms in China effectively leapfrogged the physical stage of development, abetted by the rapid proliferation of the smartphone. Unburdened by legacy physical operations, they introduced innovative mobile shopping apps that were far more advanced than those of their Western counterparts. Their move into physical spaces is a comparatively recent development, as they realized that a majority of Chinese consumers still want the choice of an in-person shopping experience.

*Digital payment systems, which have expanded rapidly in China, are starting to take hold in other emerging markets.*

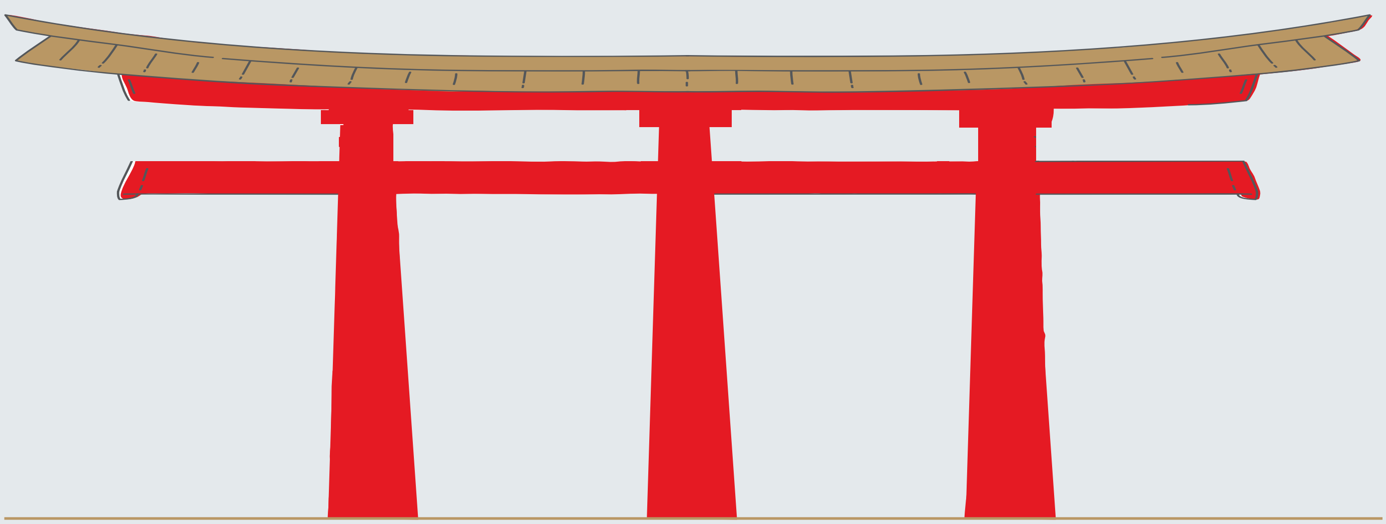
These different evolutionary patterns—online to offline in China, offline to online in Latin American markets—are reflected in the differing economics of omnichannel from market to market. Brazil’s largest omnichannel player, for example, reportedly derives revenue in roughly or nearly equal amounts from its online and offline channels. Among China’s e-commerce giants, no one is approaching such a 50-50 split. Online sales still account for the vast majority of revenues. Meanwhile, China’s prestige shopping districts are dominated by global brand names. Rather than building their own brick-and-mortar stores to compete, China’s leading e-commerce providers partner with these popular brands and feature them prominently on their sites—creating a virtual “high street” of flagship stores within the context of a larger online platform.

Chinese e-commerce sites have also taken partnership stakes in large grocery chains, making possible the online order, in-store pick-up scenario cited earlier. These supermarket and hypermarket networks give the online players a presence in virtually every Chinese municipality, with access to an estimated 65% of the country’s population that lives in or near an urban area. In return, the physical stores can leverage the online providers’ proprietary payment systems to offer added convenience and capture a loyal consumer base.

## The Pillars of Omnichannel Success

To win in e-commerce, players must master the three “pillars” that characterize a well-run business. The first is product. Sites must have the right merchandise that consumers want, and have the supply chain to ensure availability. The second is logistics. Companies must

### Three Pillars of Successful E-Commerce Companies



**PRODUCTS**
Appealing merchandise and strong supply chain

**LOGISTICS**
Ability to deliver products quickly to clients

**PAYMENTS**
Technology solutions to collect payments with ease

have an effective fulfillment and delivery network to get the merchandise to the customer at a reasonable cost and in an acceptable time frame (which increasingly means "free" and "next day"). And the third is payments. The platform must provide a seamless transaction capability.

COVID-19 has put these capabilities to the test. In China, for example, some players own their own distribution networks, which gives them more control over delivery vehicles and schedules. But others rely on third-party carriers with a mix of last-mile delivery modes, from trucks and vans to taxis and scooters. In the early days of the pandemic, when drivers were not allowed to leave their homes or travel across provincial boundaries, delivery times suffered. The merchandise mix shifted as well. Where consumers previously shopped online primarily for discretionary items, such as electronics or apparel, they were now looking for household essentials and hard goods, such as appliances.

The omnichannel model is likely to see growth in emerging markets that have the infrastructure to support the three pillars of success. In countries that lack efficient road networks between major population centers, for example, e-commerce platforms will be hard pressed to meet the delivery expectations that consumers in other countries have become accustomed to. Companies that have invested heavily in getting the logistics, warehousing and last-mile routes right have gained a significant advantage during the pandemic as others have not kept pace.

A reliable and trustworthy payment system is also essential. Brazil's top omnichannel platform offers a branded affinity credit card in conjunction with a leading global payment processor with features that encourage usage on the site. In China, where credit card penetration is low and consumers are generally averse to personal debt, the e-commerce players themselves have filled the void by building their own electronic payments networks to facilitate seamless transactions. Digital payment systems, which have expanded rapidly in China, are starting to take hold in other emerging markets, enabling merchants of all stripes and sizes to take advantage of the trend toward online ordering and on-site pick-up.

## Consumers Vote with Their Digital Wallets

Ultimately, of course, it is the customer who decides the fate of an omnichannel venture. Companies that can deliver a satisfying customer experience, whether online, in-store or in combination, stand to benefit the most from the growing demand for omnichannel buying solutions. In emerging markets, where discretionary incomes are rising and consumer buying behavior has permanently changed, the omnichannel sector—encompassing not only retailers but also logistics and payments providers—represents some of the most compelling long-term investment opportunities.

**In Jiangsu, China, a logistics company's picking line shop.**

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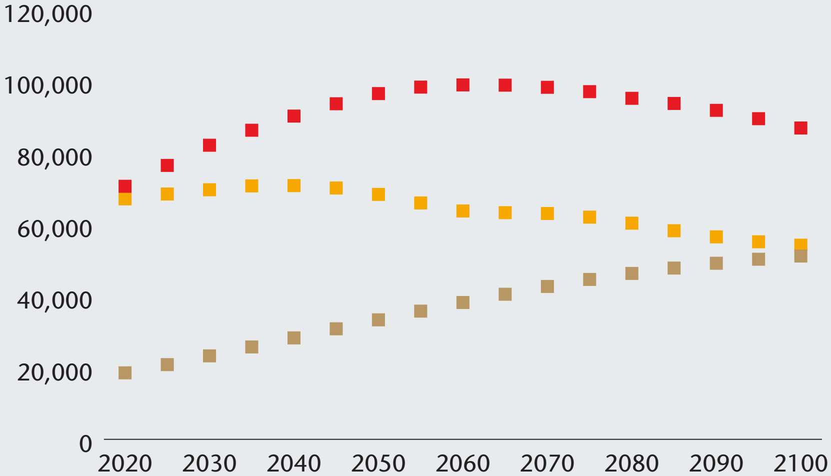
# Youth Quakes and Elder States

Demographics aren't destiny, but they matter. Whether driven by surging youth populations or growing cohorts of elderly citizens, demographic trends in emerging economies create opportunities for investors to capture the benefits of changing consumption patterns.

## Youth Quakes: A large young population can grow the workforce, drive down poverty rates and bolster economic growth.

Working age population, ages 15–64




Source: United Nations Population Division. Data and projections as of 2019. All data shown are estimates. There is no guarantee any estimates or projections will be realized.

**PHILIPPINES**

30 million young people between the ages of 10–24 account for 28% of the population, representing the largest generation of young people in the country's history.[1]

**VIETNAM**

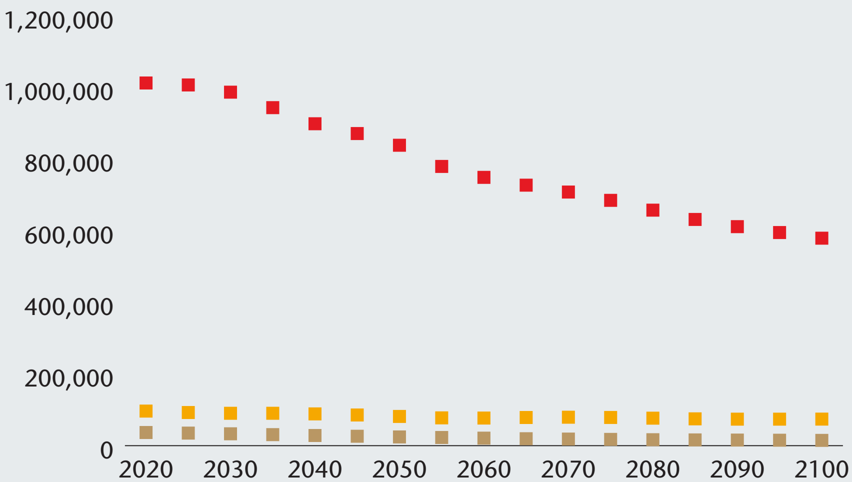
As investors aim to capitalize on the country's young population, Vietnam attracted FDI of US$38 billion in 2019, a 10-year high.[2]

**GHANA**

19 of the world's 20 youngest countries are in Africa.[3] In Ghana, approximately 57% of the population is under age 25.[4]

## Elder States: Emerging markets will be home to more than two-thirds of the world's elderly population by 2050.[5] Aging populations drive demand for chronic disease management, automation capabilities, software and workforce productivity enhancers.

Working age population, ages 15–64

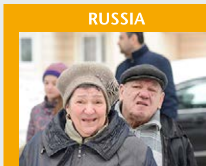



Source: United Nations Population Division. Data and projections as of 2019. All data shown are estimates. There is no guarantee any estimates or projections will be realized.

**CHINA**

Home to the largest number of elderly people in the world, China has its own "silver economy." For example, 2018 saw 17% year-over-year increase in the number of private nursing homes.[6]

**RUSSIA**



Increased life expectancies are poised to steeply increase the age of Russia's population in coming decades.

**SOUTH KOREA**

Between 2019 and 2050, South Korea is expected to have the largest percentage-point increase in the share of older persons (+23 pp).[7]

1 Philippines.unfpa.org, "Young people," September 2020
2 Vietnamnews.vn, "Viet Nam's FDI capital hits 10-year record in 2019," December 2019
3 WEForum.org, "19 of the world's 20 youngest countries are in Africa," August 2019
4 CIA.gov, "World factbook: Ghana," September 2020
5 United Nations, "World Population Ageing 2019," 2019
6 FT.com, "China's private nursing homes out of reach for most of elderly," January 2020
7 United Nations, "World Population Ageing 2019," 2019