

KHAZANAH MEGATRENDS FORUM

Shifting Sands: Threats & Opportunities

20 - 21 OCTOBER 2008 • Grand Ballroom, Level 1, Mandarin Oriental Hotel, Kuala Lumpur

Introduction

The financial world in the US and Europe is collapsing, bringing with it the contagion effects in the real sectors of those markets and economies around the world. What purportedly started with sub-prime US mortgages has translated into major upheavals in the global credit markets that have shaken the financial community, threatened the global financial architecture and have destroyed major investment banking institutions in a breathtakingly short period of time. The depth and extent of the crisis are deceptively masked by the swiftness of its unfolding. Indeed, many among those who have been affected are still trying to make sense of what has happened. There is, however, a larger segment of the population that has not felt its effects as yet.

The global economy up to this crisis has been robust. However, rapid and large movements of capital across borders, unprecedented liquidity, changes in trade flow directions, as well as new investors and frontiers of investments are re-shaping the world and emphasising how inter-related this world really is.

The unprecedented demand for infrastructure and commodities from China, the rising prominence of Indian global companies, the astronomical rise of oil prices and corresponding liquidity and wealth accumulation by oil rich countries across the world from Abu Dhabi and Saudi Arabia to Norway, Russia, Venezuela and Nigeria have shifted the financial world's focus, and diffused its attention geographically, and towards different ways of doing business. State investors with large forex reserves like China and Singapore can influence market movements by injecting massive liquidity into markets and shaping new markets like Africa.

Meanwhile, the sub-prime US mortgages, insurance products and credit instruments have affected the global credit markets and the world's perception of what constitutes financial strength, quality and safety. The US and European government bailouts have also raised questions on their clout and moral authority to set financial standards and remain dominant in determining the global financial architecture in the near future. Comparisons to the Asian

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financial crisis in 1997-98 and even to the Great Depression in the 1930s are being made, as people look for lessons of history to predict the future.

The failure of some financial instruments and systems has raised the attractiveness of alternatives. Supporters of Islamic finance, which system promotes less gearing and speculation, and emphasises tangible assets and economic activities argue that Islamic finance is the more sustainable and healthy financial system of the future. Does this spell an opportunity for the Islamic banking and financing model, or is the sustainability yet to be tested?

The liquidity in Asia and the Middle East remains high. Will Asia and the Middle East be in a position to transform the threats to and weaknesses in the global financial system into opportunities? Will these regions stay the course on growth and global competitiveness? In times of shifting landscapes and volatility in the markets, the need for the right leadership, talent and strategy becomes more crucial than ever for companies, nations and regions.

In light of these developments, the Khazanah Megatrends Forum 2008 seeks to answer three broad questions.

- How do we make sense of the ongoing financial turmoil and the overall volatility of the global economy? Do we have a framework to analyse it? How do we identify the trigger points and opportunities?
- What are the implications of this financial turmoil to the real economy? Is there a regional or sectoral bias? What does this mean for Asia and Malaysia, in particular?
- How do we manage this? How do we survive in the short term and remain focused on longer term objectives? What should be the new business model? What are the imperatives of leadership?

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The two-day forum is divided into four main sessions as follows:

1 Macro & Markets

Markets and the world economy are arguably at their most dangerous points. Macro-economic developments across the globe have been colored by high inflation. Emerging economies have been plagued by cost-push inflation mainly due to fluctuating global oil prices and are pressured to increase interest rates - Vietnam and Sri Lanka for example, posted inflation at above 20% and many ASEAN economies have embarked on contractionary fiscal measures. Market performance across the globe was poor as high oil prices resulted in shrinking corporate profits and valuations.

Compounding the gloomy outlook, the tight credit environment resulting from the sub-prime crisis in the US is now exacerbated by the collapse of what previously seemed to be invincible investment banking institutions like Bear Stearns and Lehman Brothers, and the financial rescue of large banks like Merrill Lynch, UBS and Citibank. These series of events have thrown severe doubts on the sustainability of the investment banking model as practiced in most developed economies like in the US, Japan and Europe. One of the more severe reactions to this loss of confidence in the system was nothing less than a complete U-turn towards conventional banking, i.e. a banking system backed by tangible deposits, higher control by regulations and Government support, as displayed by the hasty retreat of Goldman Sachs and Morgan Stanley from their long history of investment banking.

Massive bail outs and restructuring plans by developed countries reminiscent of some Asian governments' responses to the Asian financial crisis have compounded the panic and nervousness in the markets. Short term market cheers for government interventions may not sustain the financial health of institutions like AIG, Freddie Mac and Fannie Mae. The US sub-prime spill-over effects and consequent, deeper credit crunches have dried up liquidity in the global market despite the ever-increasing demand for liquidity to face the high inflation environment.

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The parallel upside trend in other commodities' prices namely steel, coal, and gas is seen as closely tracking up the oil prices. China had been driving global demand on a phenomenal scale for many commodities including oil, gas, steel, and coal especially in their preparation for the Olympic Games from 2001 to 2008. Meanwhile, panic looms large across continents on food insufficiency. Apart from the sluggish macro-economic development, the unpredictable weather conditions contributed to the drop in crop yields, reducing overall food production and supply. Food crisis may continue to be real given the current bad weather conditions that cause flood and hurricane in regions where food production mainly takes place.

- What are the major changes in the markets and movements in commodities pricing and what can we infer from these changes for the world economy?
- What will change further in these conditions? How do we rate the current policy responses and what more can we expect?
- How should the Asian region react and prepare for these changes? How can Malaysia position itself as a commodity exporter and a major trading nation, and
- How can companies and leaders prepare for the inevitable, far ranging effects of significant, systemic changes that we are seeing in the financial world? What are the threats and opportunities?

2 Leadership and Culture

In turbulent times, leadership and talent have to shift focus to manage conflicts, re-set priorities, sustain performance, navigate downturns and identify imminent threats and opportunities and to react quickly. What kind of leadership and talent are required in crisis situations and how can leaders adapt to a rapidly changing environment?

The global war for talent has become even more intense, as demand for talent is rising in the face of business growth in Asia and the Middle East. The talent war has induced changes in other policy areas namely immigration and labour. Countries like Canada, Singapore and Ireland have comprehensive policies to attract foreign talent due to demographic constraints and the need

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to have a competitive edge. How will the current economic climate change this war for talent? What is the outlook for global employment and movement of skilled labour?

There is a progressive movement to transform the human resource function and establish a Human Capital Management (HCM) environment that leverages the workforce as a competitive weapon. Organisations are looking at talent management as strategic issues that can radically improve workforce productivity to drive higher value for the organisation.

- What are the challenges for managing human resources in times of economic turbulence and uncertainty?
- How do leaders and senior management execute changes, build trust and harness a winning corporate culture at a time of great stress, democratisation of information and increasing and often unrealistic expectations?
- Will firms see market driven sentiments of greed and fear replaced by more responsible and principled managerial behaviour? What would be the effects of this behavioural change, if any?
- What are the specific lessons and insights which we can gain from these situations for Malaysia and Malaysian companies?

3 Competitiveness and Development

In the Asian region, a troubled US, Europe and Japan, three large markets, will inevitably affect the roles of the new twin economic powerhouses of China and India as well as export-driven economies in Asia like Taiwan, Singapore, Malaysia, Thailand and Indonesia. With the expected slowing down of activities in the major export markets, how will this affect competitiveness of companies, countries and regions?

While the world is focusing on short term market and economic data how will current market conditions and global economic upheavals affect the competitiveness of companies and countries in the long run? What are the medium to long term factors of competitiveness? What

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can companies, countries and regions need to focus on to sustain competitiveness and learn from the crisis?

How do we reconcile market failures and the seeming revival in statism (including the rise of sovereign wealth funds and government intervention) against the neo-liberal order of the last 30-odd years? Is this a pendulum swing in global economic history? What are the roles of multilateral organisations in steering new policy directions and address weaknesses in the global economy?

- Has the global financial crisis spelt the end of the purported separation between the real and financial economy? Will this signal the revival of the "real economy" like agriculture, infrastructure, mining and manufacturing? Will terms of trades and commodity pricing change as a result?
- What is the outlook for regions with different levels of development and types of economy?
- What are distributional effects of the financial crisis and governments' bailouts of financial institutions? What are the economic, social and political repercussions?
- Malaysia's economic corridor development models aim to reduce disparities in income and growth – will these models and accompanying initiatives have to be re-looked at in times of economic uncertainty and focus shifted to sustain national economic growth?

4 Firms and Transformation

If one were to assume that the environment in which companies operate is an ecosystem, the survival of firms is dependent on their adaptability to change and the demands that come from outside. We are no longer in the age of the conglomerate, and companies must learn to accept their impermanence and devise ways in which to self-preserve in the face of fierce competition from across the world. What do the recent changes in the global economy and financial world mean to individual firms? Will firms be forced to transform in response and how? Related to this is the connected specialisation of firms and issues of geographic dispersal and relocating to where it makes the most sense, specifically in terms of cost and resources.

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In the face of bankruptcies and stories of financial mismanagement and excesses, there will be expected backlash against corporate greed by the public and stakeholders. Will companies be forced to take a closer look at their "organisational DNA" - the ethical framework within which a firm operates? Do Syariah-compliant companies have stronger ethical frameworks? Some navel-gazing by firms may have to occur to reflect on how to sustain the integrity of an organisation as it evolves, expands and contracts. An ethical DNA framework guides the actions of the company although at the management level there might only be an imperfect understanding of how the actions of the company reflect it.

The failure to identify the organisational framework and actively define and manage it makes the company susceptible to mutation, or the undermining from within. When the company leadership does things which go against what the company espouses, it is jeopardising the firm's survival. For example, Enron suspended its Board of Ethics twice to allow related party transactions to proceed.

This example though is not reflective of the many threats to organisational DNA committed by companies. Instead, it is usually more a question of not making ethical considerations as important a feature of decision making. It is about simply overlooking the need to ask "is this right?"

- What do the recent changes in the global economy and financial world mean to individual firms? Will firms be forced to transform in response and how?
- Will current business models have to change in light of the shifting structures of the global economy?
- Will there be geographic shifts in different types of company operations to the East and Middle East where there are larger pools of funds to support firm-level activities and human resources?
- Will firms have to face increased regulation and protectionism?