BERITA ONLINE

THE EDGE MARKETS

TARIKH: 02 JANUARI 2023 (ISNIN)

THE EDGE MARKETS
MAKE BETTER DECISIONS

DigitalEdge

Stepping into an uncertain 2023

Pathma Subramaniam and Kiran Jacob / The Edge Malaysia
January 02, 2023 00:00 am +08

This article first appeared in Digital Edge, The Edge Malaysia Weekly, on December 26, 2022 - January 08, 2023.

From the ashes, there will be leaders emerging in 2023. Technocrats and industry observers believe that an economic downturn might just turn into the catalyst needed to revitalise the local technology landscape.

For instance, some of the current tech leaders had emerged from the 2007/08 global financial crisis. Enterprises that provide transparent value will thrive; lower availability of capital and less competition will drive innovation while resilience and persistence will be key differentiating factors, they concur.

As the threat of recession looms in Southeast Asia, local tech companies have been tightening their belts and resorting to mass layoffs. Tech giants such as Indonesia's GoTo Group — a joint venture between ride-hailing start-up Gojek and e-commerce marketplace Tokopedia — slashed close to 12% of its headcount, or 1,300 jobs, in November.

ngapore's internet behemoth Sea Group has cut more than 7,000 jobs (out of nearly 68,000 jobs) in the last six months while online marketplace Carousell has retrenched 110, citing challenging macroeconomic conditions. The respective retrenchment numbers made up more than 10% of the companies' workforce. In contrast, Malaysia's first unicorn, Carsome, started an "employee base optimisation" exercise in September, which saw fewer than 10% of its employees being laid off.

"Corporations have continued to lean into technology and digital transformation solutions, data and analytics, and creative talent investment as ways to help insulate and even leverage elements of a recession into potential growth opportunities."
Jaffri

While the move is largely seen as a consolidation measure for the high-growth tech companies — which hired too aggressively during the Covid-19 pandemic to meet record demand for services and goods — to recalibrate themselves, there is trepidation about tech companies' ability to raise capital on the back of rising interest rates amid high inflation.

However, despite widespread retrenchment jitters and doubts about the resilience of the sector, the tech industry continues to be "recession-proof", say observers.

"From the standpoint of entrepreneurs, this is arguably a great opportunity to start a business. Many great start-ups were founded during economic downturns, many of which most of us use today, such as Instagram, Airbnb, Grab and Slack," says Aaron Sarma, general partner at ScaleUp Malaysia.

"In Malaysia, we saw several new solutions launch and grow during the pandemic such as the AirAsia Super app, Beep by Storehub, along with a plethora of other fintech products."

Although the increasingly recessionary environment adds pressure on the global economy, analysts remain bullish on their outlook for the tech space, says Jaffri Ibrahim, CEO of the Collaborative Research in Engineering, Science and Technology Centre (CREST).

"I am of the same belief as this sector has shown its mettle by being resilient during the pandemic. Corporations have continued to lean into technology and digital transformation solutions, data and analytics, and creative talent investment as ways to help insulate and even leverage elements of a recession into potential growth opportunities," adds Jaffri.

Funding is another matter

“We are in an interesting pivot in the global economy. I don’t think anyone knows with any certainty what is going to happen in 2023. What we do know is several challenges will increase that volatility next year,” says Udhay Furtado, managing director and head of Asia equity capital markets at Citigroup Global Markets Asia Ltd, at the “Outlook 2023: Challenges and Impact on Southeast Asia’s SMEs & Start-ups During Global Recession” organised by Malaysia Venture Capital Management Bhd.

There will be substantial challenges globally as well as in the future, after coming out of the Covid-19 pandemic and following a decade of easier financial conditions, observes Udhay.

Disruption is going to continue happening over the next few years, and small and medium enterprises (SMEs) and start-ups will need to get themselves ready to navigate the funding ecosystem to remain competitive.

Most of the SMEs and start-ups were not in operation the last time there was the same sort of economic climate, which was around 20 years ago, Udhay points out.

“We are at levels of inflation that are at record highs. I think there are some glimmers of hope in what we are seeing in the markets right now, with some of the data in the US pointing to an easing of inflation,” he says.

Regardless, inflation remains high. The annual inflation rate in the US accelerated to 9.1% in June 2022, the highest since December 1981.

Significant increases in rates have impacted the equity and fixed-income markets and overall funding markets. The abrupt rate hikes are an attempt to tame inflation.

“This has a direct impact on tech, high growth and disruptive companies because it does impact how people perceive an evaluation because of the underlying cost of capital,” says Udhay.

ScaleUp’s Sarma concurs. Although it is a great time to invest in start-ups — especially those in the early stages of growth — it may be a bit more challenging to invest in later-stage companies that could see some sluggish growth next year, he tells Digital Edge.

From the standpoint of entrepreneurs, this is arguably a great opportunity to start a business. Many great start-ups were founded during economic downturns.”

Sarma

“This is why we are seeing layoffs in major tech firms around the world. It’s a recognition that capital will not come as easily as before and responsible firms are making hard choices to prepare themselves for the difficult times ahead.

“For founders, the pressure point will be around ensuring that their unit metrics are strong and that they can demonstrate an attractive growth story,” says Sarma.

Citigroup’s Udhay adds that the pace of private capital investments, while slower than last year, remains robust and is likely to exceed public market activity.

“What happens in Google (Alphabet) and Alibaba does have a knock-on effect, particularly if you’re running tech start-ups. It has an impact in terms of valuations and in terms of the returns that people are making,” says Udhay.

The tech-heavy Nasdaq has lost almost 30% of its value this year, the third largest drop in two decades. A lot of this has to do with the US’ highest inflation in 40 years, rising interest rates and the strong US dollar, which affects multinational companies as they would record a lower revenue once it is converted into dollars.

“What’s happened in 2022 is a significant correction in the public equity markets and a lot of that has been tech-focused. If you look at what’s happened in the Nasdaq, these sorts of drops are reminiscent of what happened during the dotcom crash,” says Udhay.

The dotcom bubble refers to the rapid rise in equity valuations of US technology stocks, fuelled by investments in internet-based companies following the use and adoption of the internet in the late 1990s.

The current economic conditions will also highlight the underlying issues that were previously hidden. The market is starting to focus on productivity and profitability.

But inflation serves as an external factor that will drive the pace and rate of innovation as it causes stress on businesses, adds Peter Wee, the honorary secretary of Malaysian Business Angel Network (MBAN) and partner at NEXEA Angels Sdn Bhd.

"There will be greater opportunities for greater investment in technology in a downturn as many businesses will be forced to change and adapt."
Wee

"With the risk of inflation, coupled with the significant impact of economic risk (both externally and internally), businesses cannot leave it to chance and must take action to survive and maybe thrive.

"Without investment, there would be no economic growth. Businesses must innovate and invest. Whether it is their products, services or business model innovation, these have to be done," says Wee.

And, technology is the means to drive innovation, he adds. "In a recession, only the strong will survive and innovation is key. I see that there will be greater opportunities for greater investment in technology in a downturn as many businesses will be forced to change and adapt. Digital transformation in this day and age is highly relevant. Very few businesses have not been touched by the digitalisation wave."

Digitalisation is key to turning things around

Investment in digital technologies is expected to continue as a strategy to weather the storms of disruption brought about by uncertainties in the business environment, talent gaps and the risk of recession.

The International Data Corp (IDC) predicts that spending on digital technology by organisations will grow at 3.5 times the economy in 2023.

Digitalisation can place businesses in a competitive position, says CREST’s Jaffri.

“For example, automating processes enable companies to permanently reduce the cost of doing business. Augmenting and automating activities with technology such as artificial intelligence (AI) or robotics can lead to a reduction in labour costs, shore up production and free up scarce, high-cost talent to focus on value-creating activities.

“Additionally, producing more relevant digital products and services that will improve customer and employee experience will ultimately bring value back to businesses as this will likely grant them a place among the winning companies that can survive through downturns and eventually thrive,” he says.

Digital transformation is also necessary to withstand the uncertainties, says Alvin Gan, head of technology consulting at KPMG Malaysia.

“Businesses are looking to expand their ecosystem by partnering with start-ups such as fintech companies to help them become more agile as well as to drive growth for their organisations.”
Gan

“The returns and performance improvements [of digital transformation] have branded customer-centric technology strategies as lifesaving tools in any business’ survival kit. Hence, digital transformation during a recession would still be relevant, albeit very focused and strategic.”

As digital transformation is expensive, Gan says investments need to be impactful, measurable and prioritised in areas that will help drive growth.

KPMG foresees that these investments will be focused on narrowing the gap between digital transformation and the workforce, with CEOs prioritising investments in new technologies to support their operations, ensuring that their people are more productive.

“Advancing digitalisation and connectivity across the business is tied to attracting and retaining talent as the top operational priority to achieve growth over the next three years. This focus on digital transformation may be driven by the increasingly flexible working arrangements and heightened awareness of cybersecurity threats, exacerbated by geopolitical uncertainty.

“Additionally, in meeting customers’ needs in the most effective way possible, we foresee organisations investing in creating customer-centric experiences, which may involve designing workflows, services and products,” says Gan.

This also includes investments needed to build partnerships. “With 71% of CEOs surveyed by KPMG globally viewing partnerships as an important means to continue the pace of digital transformation, businesses are looking to expand their ecosystem by partnering with start-ups such as fintech companies to help them become more agile as well as to drive growth for their organisations.”

Cybersecurity will continue to be a high-priority investment as well, given the rapid increase in cyberattacks and the increasing difficulty of detecting them in time, he says.

“We may see more targeted investments in automation and innovation in dealing with cyber incidents. This is because organisations are now more aware of the cyber environment, with 76% of CEOs seeing information security as a strategic function and a potential source of competitive advantage.”

KPMG also observes that there is a widespread appetite for emerging and disruptive technologies — even if they are untested.

“Approximately 67% of those surveyed expect to embrace emerging platforms within two years, including the metaverse, non-fungible tokens (NFTs) and Web3; 72% expect to have invested in quantum computing within the same timeframe,” says Gan.

AI, fintech, logistics and sustainable tech hold great promise

While companies work on beefing up their business to withstand global and local inflationary pressures, investors should take advantage of opportunities that have yet to take off on a large scale in Malaysia, say veterans of the tech and tech-funding sectors.

Factoring in macro changes such as a rise in financial market volatility, food shortages, energy transitions and security issues, including inflation, CREST’s Jaffri says tech sectors that are likely to thrive in 2023 and beyond are digital health, logistics, cybersecurity and remote work.

“People need healthcare, even when incomes decline. Healthtech companies that could do well are those that add productivity to existing infrastructure and allow for robust patient monitoring and tracking. Additionally, by innovating in healthcare delivery through telehealth and other digital options, companies can lower costs and attract budget-conscious consumers.

“The logistics and supply chain segment never fully recovered from 2020 [and continues to] remain under stress. Therefore, I see particular potential around productivity, including mapping tools, route planning, resource management and seamless APIs for connectivity. Supply chain optimisation will be essential in building protective measures into supply chains to manage shortages, rising costs and reduce exposure to volatile market pricing commodities,” he continues.

Amid the ongoing economic and geopolitical challenges, the cybersecurity sector remains strong, adds Jaffri.

“Thus far, the sector is proving to be recession-proof and remains a growth area, defying current troubling macroeconomic headwinds. With the increase in threat complexities and frequency, coupled with the rising cost of cybersecurity breaches, it is without a doubt that businesses will shift funds from elsewhere towards protecting their organisations.

“And, finally, 2020 permanently changed the future of work leading to more companies hiring remote teams in lower-cost-base markets to maintain productivity and increase profitability. Therefore, I believe that companies that help identify, hire, onboard, pay, handle taxes or train remote staff will likely benefit,” says Jaffri.

Additionally, companies need to leverage research and development to ensure their future competitiveness. “High-value R&D activity is critical for a faster economic recovery. Companies that are smart in R&D efforts now can use this disruption to explore new ways of operating, improving products and gaining a competitive advantage when the global economy recovers.”

Significant progress will be made in segments such as the metaverse where virtual simulations of real-world products, processes and operations can be used by organisations to test and prototype new ideas in the safe environment of the digital domain, Jaffri adds.

Headway will also be made as 5G becomes more widely available. “This has broad implications for organisations as it supports the creation of new services and business models linked to sensor-enabled intelligent products, yields new value-chain offerings (for example, predictive services and augmented-intelligence services) and creates the potential for companies to more seamlessly personalise offerings across channels and create heightened customer experiences.

“In mobility, for example, Internet of Things (IoT) sensors and near-global coverage can help manufacturers capture vehicle signals, monitor the condition of each system in the car and notify the owner to schedule repairs before a breakdown occurs, improving the vehicle’s durability and lifespan,” says Jaffri.

The turbulent economic environment notwithstanding, the present situation is also a chance for Malaysia “to get back to the basics”, reminds Sivavenayakam Velayutham, co-founder and managing director of 25 Startups, a Penang-based incubator.

“Malaysia is still an electrical and electronics (E&E) giant. While there is a correction in the market, the other big wave which hasn’t hit us yet is in 5G, even 6G. Malaysia, and in particular Penang, should capture these opportunities.”

Moreover, Sivavenayakam expects tools like AI to likely become more mainstream next year.

“The impact of 5G [will] become more apparent, especially when married with Industry 4.0 and the IoT. Blockchain will develop and reach the level where AI was at more than five years ago. And more of our transport and logistics will be smarter.”

CREST’s Jaffri says, “One of the top trends in 2023 for SMEs will be the adoption of AI as a service at relatively low costs. Some examples include recruiting tools such as Spark Hire, which will replace phone interviews. In manufacturing, IBM has reported that AI use in commercial manufacturing is expected to see a 40% to 80% rise within the next few years.”

"Within the fintech space, we see that financial literacy will be helpful to educate the lower-income population to save and invest."
Lau

Rachel Lau, managing partner and co-founder of RHL Ventures, says the firm is bullish on the growth of fintech, education, food and agriculture, as well as healthtech. RHL is a Southeast Asia-based private investment firm that focuses on growth capital investments in the region and the US.

"Within the fintech space, we see that financial literacy will be helpful to educate the lower-income population to save and invest. For instance, in Versa, we allow daily withdrawals of savings that have interest rates that are similar to a 12-month fixed deposit in the banks. Versa has also launched Versa REIT to encourage fractional shares investment and yield-based investments," says Lau.

Hibiscus Fund, a venture capital fund managed by RHL and South Korean financial services conglomerate KB Investment, invested in Versa — a provider of digital wealth management services — in September.

However, Lau is against patronising offerings such as the buy now, pay later (BNPL) solution and earned wage access. "[These] are not the right place to be in [currently] as this only encourages bad behaviour of discretionary spending."

ScaleUp’s Sarma, too, believes that companies focusing on financial inclusion, especially fintech companies that offer services to help the unbanked gain access to financial tools, will do well.

“We are also going to see a trend in initiatives that support food security and sustainability. Finally, I’m really bullish on the opportunities in AI, which will change the game in a lot of ways,” he says.

While Malaysia continues to be on a path to recovery in 2022 on the back of improved external demand and the reopening of the domestic economy after the pandemic, it is imperative to remember the need for continued innovation.

“Innovation should continue to be the centrepiece to promote sustainable growth and for businesses to be more agile to respond quickly to market challenges and opportunities,” says CREST’s Jaffri.

ScaleUp’s Sarma takes a less effusive view: “Never take things for granted. We had assumed 2022 would be a rebound year and now we are bracing for a challenging 2023.”