

'Finance and New Economy'

Prepared for Chula Radio FM 101.5 Interview
by Dr. Pongsak Hoontrakul [March 14, 2001]

1. What is the 'New Economy' s definition ? What is it related to in real life ?

Normally, a new economy is thought of as internet related business such as e-Commerce [e.g. B2C, B2B, B2E, B2G, etc.], eBusiness [e.g. eFinance, eMarketing, eLearning, etc.], etc. This is understandable since it is a closest thing to every day life.

However, I would like to define the 'new economy' in boarder sense. The 'new economy' is defined as an economy based on **'knowledge'**. In a nutshell, it is a **business of technology** leveraging on our knowledge.

For an example, if you are expert in 'Corporate Finance' training, you can physically teach your students in a class room or write a book on how to train the 'Corporate Finance' course. You are challenged by **physical constraint and scarcity**. The availability of your time, class room, your physical book and your distributed channel are limited. This follows a classical law of **'diminishing return'**.

In a new economy concept, you can transform your knowledge into **digital capital** – information products or intangible services which can be sold or traded over the internet or other electronic media across frontier, 24 x 7 – at all time. Information or your digital knowledge – (string of zeros and ones) on Corporate Finance is expensive to produce, particularly on the first workable set, but it is cheap to reproduce. High fixed cost and almost zero variable costs make this industry very different from the 'old economy'. This follows a law of **'increasing return to scale'**.

For another example is far away from our every life – say Bio tech. If you have an innovative idea to produce a wonder fruit – apple which is ever fresh, variety of tastes and vivid appearance, you can patent your invention. This becomes your intellectual property. Consequently, you can leverage on your intellectual property by licensing this patent to other producers. The more they produce, the more you make money without additional variable cost.

Knowledge is power !!!

2. It sounds very complicated. Let's to digest one by one. What is the digital capital exactly meant ?

Due to time limitation, I would like to focus our discussion on internet related business or eBusiness. Regarding to your questions, digital capital is a direct result from the internetworking of three types of knowledge assets :

2.1 Human Capital : What our people know,

2.2. Customer Capital : Who you know, and who knows and values you and

2.3 Structural Capital : How what you know is built into your business system.

The key success is how to form and build reserves of such digital capital by harnessing the power of business webs.

3. Please, kindly give more fundamental different examples between 'old' and 'new' economy

| | <u>Old Economy</u> | <u>New Economy</u> |
|-----------------------------------|--|--|
| Business Model | Asset based Model | Intellectual based Model |
| Product Production | Goods/service Mass | Innovation Customerized |
| Asset Factor Asset Form | Capital and Land Tangible | Digital and Human Capital Intangible |
| Fixed Cost Variable Cost | Land, Machinery Labour/Material/Factor Cost | R & D Almost Zero |
| Distribution Process Economics | Physical Scarcity | Virtual Abundance |
| Profitability | Marginal Cost = Marginal Benefit | Value Proposition x Networking Effect |

4. How is the role of 'new economy' affecting the financial economic situation ?

There are really at least three issues embedded in this big questions.

4.1 Dot Bomb : We have to separate three issues – 'Old' Economy, 'New' Economy and 'Nasdaq' bubble burst. The initial utopia of 'new' economy was oversold in USA. The stock price was overvalued and now plunged for nearly 50% from peak. Surely, there is temporarily a negative wealth effect on US and the world economy.

Having said all these, we can not deny the fact that new paradigm of new economy existence. Many companies [e.g. Cisco, Oracle, etc.] in this 'new economy' still make profit and prosper. Some 'old' economy firms [e.g. WalMart, our local banks, etc.] are now learning a new way to adapt and to deploy 'new' economy concept into their business model. In short, 'new economy' driven by IT revolution will produce long-term economic gains in productivity improvement despite of short term volatile stock market.

4.2 Lower Price Pressure : Deflation would continue for most of all products and services. In essence, the 'new' economy concept capitalizes on the inefficiency in 'old' economy concept. Bank and finance, for example, are being reintermediated by new software or web based services. All the paper works and process by human that can be digitalized will be digitalized to improve productivity and services.

4.3 Labour Pains : Digital divide will be widen between information rich and information poor citizen of the world. Those who can adapt and have accessed to IT and information would prevail. Those who do not have this privileged would be left out in low wage paying job. Wage inequality between IT literate/better educated person and high school graduate will be widen significantly in the coming decades.

4.4 Human Capital Development would increasing be the only major driven force in well being of people in knowledge based world. Demand for IT literate/skill labour would continue to outstrip the supply of high QUALITY workforce.

Human capital is our last resource and a key factor in knowledge based economy.

5. What are the implications to Thailand ?

These are enormous. From optimistic points of view, the East Asia countries including Thailand are likely to benefit from IT than Africa or Latin America. Africa lacks of many of economic and legal institutions. Latin American is well behind Asia on educational standards. Asia has young and educated population though the IT adoption is still not up to a satisfactory pace. [There is no doubt much reform is needed to improve Asian or Thai education system which is not our topic today.] For example, in Thailand, all importer and exporters are now able to be on-line because Thai government has passed a law requiring all trade document to be provided on the web.

On the pessimistic view, Thailand is lagging behind our neighbor in term of human development, legal infrastructure for eBusiness related and telecom liberalization. The result would be Thai manufacturers may be left behind the supply chain of OEM [original equipment manufacture] from large conglomerates like WalMart, Siemens, Cisco, Dell, etc. Malaysia and Philipine is already moving up the high value product chain, while Greater China is catching up with us very rapidly.

If we do not differentiate ourselves in term of high value proposition, then our economy would remain far below our long term sustainable growth.

6. How can our financial manager in corporation prepare themselves for 'new economy' era ?

This is a very good question, indeed. There are many ways which we have to prepare ourselves for this, but most of them would start with the changing of our mind set to the 'new' economy project or eProject related vital issues as follows :

6.1 Starting with accounting process, we have to treat people – not as expense but as a human capital. Research & Development, training and human development programs which should be regular and up-to-date must be treated as investment – asset or

goodwill. Explicit work contract and incentive compatibility for knowledge workforce which can not be overemphasized can be valued, even in market price.

6.2 Feasibility of digital capital development or eProject should encompass the real option value of networking effect and 'lock in' effect on the top of the traditional cash flow projection.

6.3 The financial manager should balance the intellectual asset portfolios similar to other business units. Some would be 'cash cow' and a few would be 'problem child' to develop or to liquidate, for instance.

6.4 Financing the 'eProject' is very different from 'old' economy – traditional manufacturers or real estate development. Most of eProjects can not be funded by traditional fund providers like banks or finance. eProjects are likely funded by equity only from specialists – like business angel, eBusiness Incubator, Tech based venture capitalist or other non-traditional fund providers.

6.5 The trickiest question is : 'Is your eProject financeable ?' The answers normally lie in qualitative rather than quantitative. Management team, large market size, market readiness and estimated margin on value proposition are among key subjective evaluation. You have to understand each individual fund provider very well and their needs to add your eProject exposure to their existing eProjects portfolios.

7. What is your assertion on the stage of Thailand development in 'new economy' ?

For eBusiness, I believe we still have plenty of room to develop. We already passed the 1st generation of portal site driven and the 2nd generation of store front driven. We are in a stage of web enable business processes. B2B or business to business, payment gateway and eGovernment are among the fine examples.

A few urgent needs to further develop eThailand are as follows :

1. To increase the internet usage and number of users for average Thai citizen by further deepen telcom liberalization,
2. To push IT technology awareness and usage to middle and high income population by creating tax benefit and soft loan to IT investment,
3. To promote further competition to reduce the price and to upgrade their service among telecom service providers – state owned and private enterprise,
4. To privatize more government services in digital ways as a top priority to improve government service and cost efficiency and,
5. To pass more comprehensive digital legal infrastructure to protect intellectual property and to promote eBusiness atmosphere.

There are a lot more than to cover, but I shall stop at this point.

I would be more than happy to entertain a few questions by telephone.

8. For further information on this topic, I would strongly recommend to

- a) to attend the upcoming 'Finance and New Economy' seminar by www.taipan123.com in April 2001,
- b) to attend the international conference – www.apfa2001.com organized by Sasin and the Faculty of Commerce and Accountancy of Chulalongkorn University.
- c) To visit my website www.hoontrakul.com for more related articles and publications or email to me at pongsak@hoontrakul.com if you have any further questions.