

ASEAN 2016 and beyond:

New markets, new bases



Building a better
working world



Embassy
of the Federal Republic of Germany
Jakarta



ASEAN 2016 and beyond: New markets, new bases



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Forewords

ASEAN 2016 and beyond: New markets, new bases



Dr. Georg Witschel

Ambassador of the Federal Republic of Germany to Indonesia, Timor-Leste and ASEAN

ASEAN moves in the right direction

“Aim for the moon: even if you miss, you are still among the stars.” This proverb could be one way to describe the ASEAN Economic Community (AEC). When on 31 December 2015 the New Year’s Eve fireworks went off, few people thought about the establishment of the AEC on that day.

And indeed many people would argue that the aim of free flows of trade, services, capital and labor within ASEAN has not yet been achieved. But maybe this is not so surprising in a region with huge disparities of size, wealth and development.

In my past four years as German Ambassador to Indonesia, Timor-Leste and ASEAN I have had the chance to travel extensively. What impressed and struck me again and again was the diversity of the region and its biggest member, Indonesia – geographically, culturally and also ethnically. Diversity is a founding principle of ASEAN; its challenge is to find the common ground.

The formulation of the AEC as a single market and production base was a bold and ambitious goal. Even if this has not been completely achieved, ASEAN is going in the right direction. *“Two steps forward and one step back”* still makes for progress. The recent apparent proliferation of non-tariff barriers to trade certainly was a step back from the abolishment of intra-ASEAN tariffs, and political considerations are always present. Economic figures, however, speak for themselves: ASEAN GDP is at two-thirds of Germany’s GDP and bigger than India’s, and foreign direct investment into ASEAN is approaching China’s.

In a worldwide context, ASEAN is among the economic stars. It has been remarkably stable amid the global slowdown and even its commodity exporters have, in the face of falling prices, held up much better than their emerging-market peers in other regions. ASEAN as a low-cost manufacturing base increasingly provides an alternative to the previous *“workshop of the world”*: China.

At the same time, its huge domestic market of 600 million people and a growing middle class presents obvious potential for German companies. However, recent investment figures from Germany show that our companies have not yet fully realized this potential.

I hope this report, like its predecessor, will help to attract attention to the possibilities here. One of the obvious challenges in the region is the lacking infrastructure – especially for transport – but that also offers opportunities for companies to invest. Our German embassies in the region are happy to support these companies on their way to the stars of the ASEAN economy.

Leaving this region, as my term comes to an end, I will certainly miss the economic dynamics and the diversity I was able to experience during my tenure. I will not, however, miss the regular traffic jams in Jakarta and roads that occasionally resemble the surface of the moon. But, despite some shortcomings, ASEAN has a huge potential to reach the stars – perhaps even the moon.

I wish you an interesting read.



Jan Rönnfeld
Managing Director,
AHK Indonesien on
behalf of AHK ASEAN

ASEAN: a bright spot in a volatile world

With last year's publication of ASEAN 2015 and beyond, we wanted to introduce the region and its economic potential to an audience not yet active here, as well as learn about the expectations that German companies have of the AEC 2015 – the ASEAN Economic Community – which has just come into effect. This year's publication expands on where and how these expectations have been fulfilled, and investigates how the region and the companies are doing economically. Our findings are as follows:

Over the past year, the stability of the ASEAN market has rewarded those German businesses that have already made a push

into the region. Large parts of the developed world are battling with aging populations and decreasing consumer-spending rates, and most emerging markets are struggling to cope with the collapse in global oil and other natural resource prices, while ASEAN's more balanced economies continue to notch up healthy growth rates. In our survey, 91% of respondents noted the importance of the region's economic stability to their aspirations there, while 86% pointed to strong and resilient market growth rates.

ASEAN's rising appeal is driven by two main factors: its rapidly growing consumer market and its increasing attractiveness as a production base.

The region is home to more than 633 million people, and the population is expected to rise to almost 720 million by 2030. Its GDP per capita growth rates (in purchasing power parity terms) annually are between 5.5% and 6.5%, and its middle class will grow from today's 250 million consumers to 400 million consumers by 2020.

ASEAN's attractiveness as a production base is also rising. This owes much to increasing costs in China, while at the same time ASEAN countries are starting to take a more proactive approach to attracting foreign investments, offering a wide range of attractive incentive packages. New investments and expansion from foreign companies in sectors such as automotive, electronics,

clothing and footwear are now increasingly going into ASEAN, ahead of other alternatives.

Our survey shows that expectations for launch of the AEC at the end of 2015 may have turned to disappointment for many. On the other hand, companies are developing increasing awareness of viewing ASEAN as a region, rather than as a collection of isolated countries, and have greater knowledge that ASEAN is moving toward deeper integration. The region's economic scale is just too hard to ignore, meaning that developing a strategy for ASEAN is as important as having one for China, India and Northeast Asia.

My advice for firms looking to enter this dynamic region is to be open-minded, learn to understand the local markets and cultures, patiently establish a network and brand and seek local partnerships. Finding the right partners in the region can arm a new entrant with the market knowledge needed to become an ASEAN success story, and we are here to help with that.



Forewords



Thomas Wirtz

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Embracing ASEAN

When we published *ASEAN 2015 and beyond* in April last year it was unclear whether there would be enough interest from readers to justify a second edition. But then the enquiries started coming in – from investors both in Germany and all over the world – and we were encouraged to continue. Another sign of strong interest in our study was the number of respondents to our survey, which has almost doubled from last year – to 254. So we continued the journey.

And I continued a journey of my own, relocating from Indonesia back to Germany. Here in the volatile eurozone, what has surprised me most is the fact that, despite emerging ASEAN markets also experiencing

volatile market conditions, the business outlook of German investors in ASEAN remains strong. In fact, our survey shows that it has even improved since last year, even while concern over the outlook for growth in Europe continues to grow.

Monetary tightening in the US has put upward pressure on interest rates and downward pressure on currencies across the world, including in ASEAN. And commodities have been subject to heavy price fluctuations, which adversely impacts the export revenues of countries such as Indonesia. All of this would typically drive investors to lower their expectations and slow down their investment.

Yet ASEAN is defying these headwinds and continues to be a compelling region for investors. Perhaps its volatility is less daunting for investors from a region that is learning to grow accustomed to its own unpredictability. But as this report explores, the region also has solid prospects for economic growth. First, an ever-rising middle class – which Nielsen expects to comprise around 400 million people by 2020. And second, an attractive manufacturing environment with competitive labor costs, and the hope that non-tariff barriers will be significantly reduced in the coming years.

However, while many large German companies are already present in the region, the German *Mittelstand* (SMEs) is lagging behind – due largely to a lack of

resources. But they also need answers to their questions of “*Where do we start?*” and “*How?*”

Every business is unique, so this study cannot offer one-size-fits-all advice. The answers to the SMEs’ questions are abundant, ranging from “*Start with Singapore, with its excellent infrastructure and access to talent*” to “*Head for the largest market for your products or services*” and “*Keep costs low by partnering with other investors and sharing human resources.*” We find that there is even the possibility of looking beyond ASEAN for unconventional entry routes, for example by considering Japan as a gateway to the region.

The strategies for participating in the growth of ASEAN are numerous and nuanced; organizations big and small can choose to be creative or more traditional, to play it safe or be bold.

I would welcome the opportunity to talk you through the report and ASEAN investment options in more detail.



Executive summary

The ASEAN region has established itself as a major consumer market in its own right, with much potential for growth ahead.

German companies see ASEAN as an exciting consumer market, with the region's market size topping the list of pull factors for potential investors. It is a major market in its own right – now the eighth largest in the world – with lots of potential for growth, especially in terms of middle class spending. This will continue to rise rapidly: over the next five years, the IMF expects GDP per capita to rise by 6.5% in purchasing power parity (PPP) terms across ASEAN as a whole, which is slightly below China and India.

But much work remains to be done on bringing down ASEAN's barriers to trade.

The survey shows that the launch of the ASEAN Economic Community failed to live up to expectations. In our 2015 study, 84% of respondents said they had high expectations that the AEC would deliver strongly simplified market access and inter-regional trade, but only 20% of those polled this year agree that those expectations have been met. One trend has been the rise of non-tariff barriers, even as official trade tariffs have come down. That said, ASEAN is aware of these problems and reducing non-tariff barriers is a key part of ASEAN Economic Community Blueprint 2025, which aims to create over the next decade a highly integrated regional economy with more seamless movement of investment, skilled labor, business people, and capital. In addition, the ASEAN Economic Community Blueprint 2025 pledges to bolster the use of science and technology, skills, better governance and connectivity.

Germany's foreign direct investment (FDI) into ASEAN continues to grow, but there is a risk that investment is lagging behind the scale of the region's potential.

German investment into the region is still fairly low, considering the size of ASEAN's economy and the opportunities it presents. In 2015, the most recent year available, German outbound FDI into ASEAN totaled US\$1,287m – well below the peak years of 2010-11. There is a risk that businesses are missing out, not least as the proportion of FDI from Germany into ASEAN (1.6%) lags the level of economic growth derived from the region (3%).

ASEAN's competitive wages are a major draw for manufacturers seeking a low-cost base.

Low wages were second on the list of factors attracting German companies to the region – not least as rising wages in China are also making ASEAN more competitive. Last year, the monthly salary of a Chinese factory worker was US\$424 – comfortably higher than in any ASEAN economy except Singapore and more than double the salary in Vietnam, for example. The region's diversity also adds to its appeal. Treated as a single production base it offers advanced manufacturing sectors, with skilled labor and extensive supply networks in places like Malaysia and Thailand, along with low labor costs in the less-developed economies such as Vietnam and Cambodia. This means that companies can split their high-end and low-end operations between countries.



About the study

ASEAN 2016 and beyond: New markets, new bases builds on a company survey that was conducted in May and June 2016 by the AHK ASEAN and EY, with kind support from the German embassies.

This study focuses on the ASEAN region, and provides insight targeted in particular at German investors, building on an initial study released in April 2015 and the annual business confidence survey by the German chambers in the region. Its findings are based on an analysis of the current reality regarding German FDI into the region as well as a snapshot of perceptions drawn from a survey of 254 German companies.

The respondent base represents a diverse set of 13 industries, including automotive, chemicals and pharmaceuticals, engineering, extractives, consulting, and other services. About nine in ten (88%) respondents that participated currently have operations in the ASEAN region. All respondents occupy senior management roles. Company sizes vary widely: 31% are from organizations with less than €50m in annual revenue while, at the other extreme, 34% are from organizations with more than €1.5bn in revenue. (Note: due to rounding, not all charts may total 100.)

Our thanks are due to the following for their time and insights in compiling this study (in alphabetical order, by surname):

- **Lee Cheong Chee**, Managing Director, Infineon Technologies (Malaysia) Sdn Bhd
- **Kimjin Gan**, Partner-Advisory, Asia Pacific Operating Model Effectiveness Leader, EY Solutions
- **Tobias Gruemmer**, Managing Director, Rhenus Logistics
- **Hartmut Heckermann**, Director, Bilstein
- **Dr. An Wee Moo**, Regional Director (Europe), Singapore Economic Development Board
- **Petrus Ng**, Managing Director, BASF Thailand
- **Mikael Sami**, First Secretary, Trade and Economic Section, Delegation of the European Union to Indonesia and Brunei Darussalam – EU Mission to ASEAN
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- **Dr. Georg Witschel**, Ambassador of the Federal Republic of Germany to Indonesia, ASEAN and Timor-Leste

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- **Daniel Bernbeck**, Executive Director, Malaysian-German Chamber of Commerce and Industry
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- **Dr. Roland Wein**, Executive Director, German-Thai Chamber of Commerce
- **Thomas Wirtz**, Executive Director, Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Germany

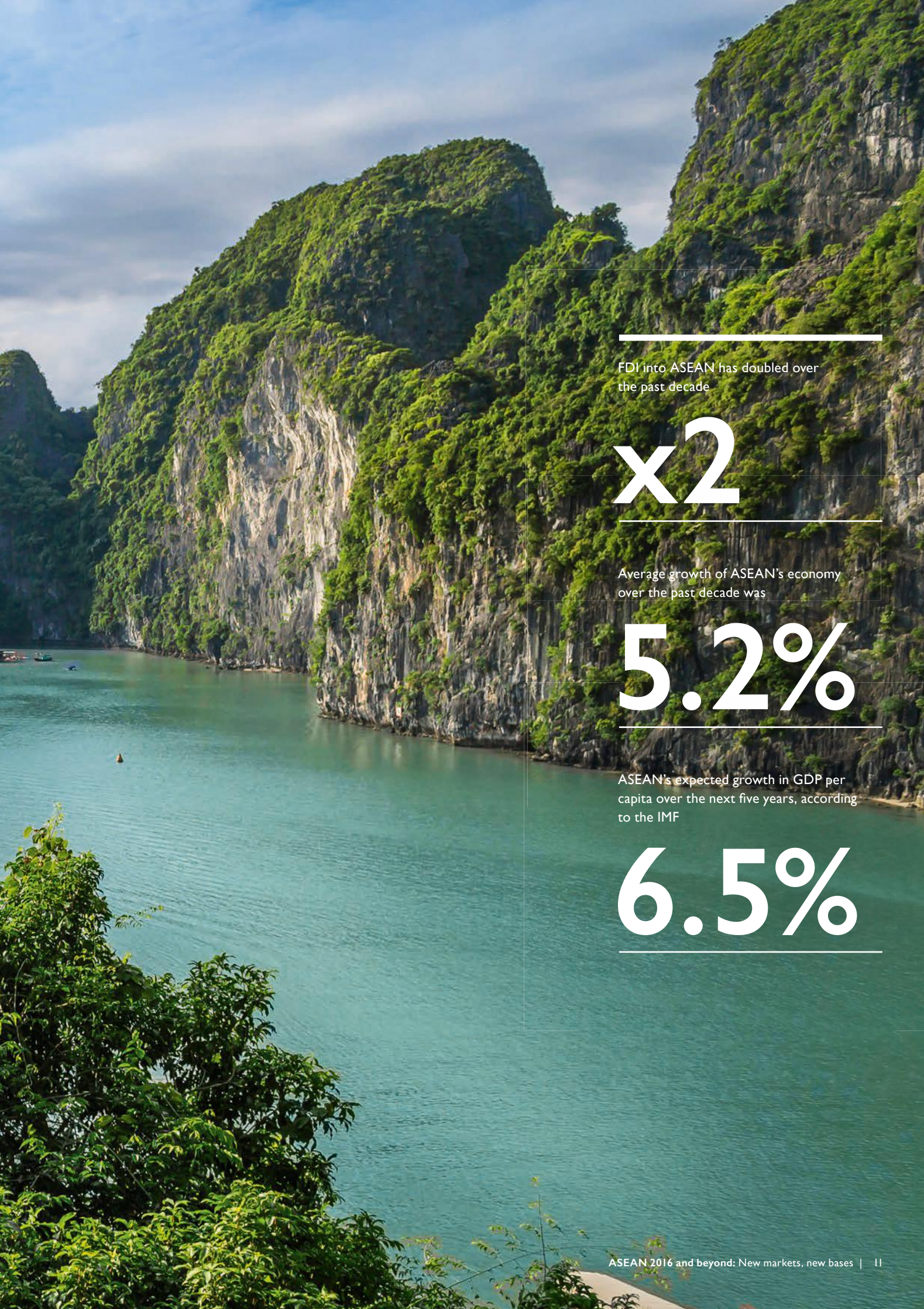
German investors are planning to expand their presence in ASEAN, given its good prospects.

Our survey suggests that those German businesses already on the ground are excited about prospects for ASEAN. Most expect their business outlook to improve over the next year, and almost half are planning to expand their headcounts over the next 12 months.





Introduction: ASEAN — a global bright spot



FDI into ASEAN has doubled over the past decade

x2

Average growth of ASEAN's economy over the past decade was

5.2%

ASEAN's expected growth in GDP per capita over the next five years, according to the IMF

6.5%



Introduction: ASEAN – a global bright spot

ASEAN is becoming one of the most attractive regions in the world for international businesses. Foreign direct investment (FDI) into the region has doubled over the past decade, and last year was worth over 5% of regional GDP. To put that into context, FDI into China was only 2.5% of GDP.

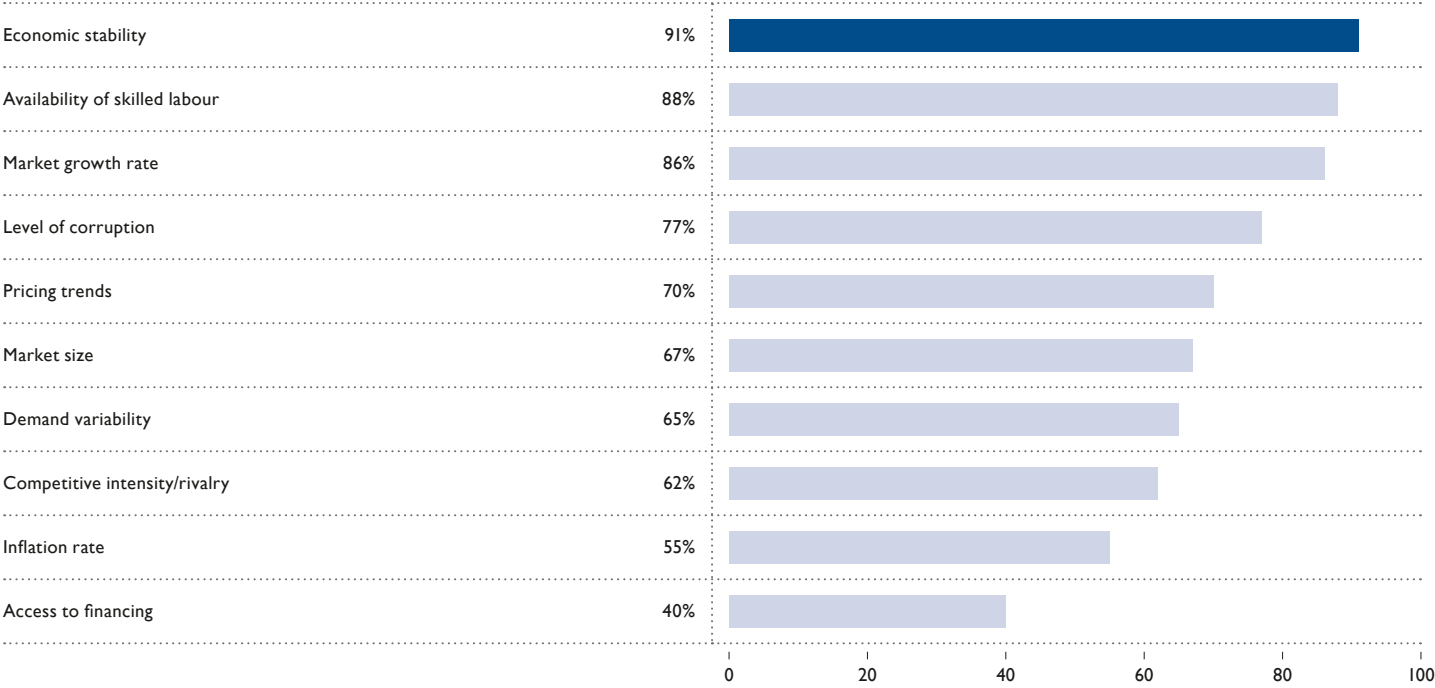
There are two key reasons why companies choose ASEAN: first, it is itself a large and expanding market; and second, it offers low costs for companies looking to set up production operations.

As Tobias Gruemmer, Managing Director of Rhenus Logistics, puts it: *“Foreign firms see ASEAN as an attractive destination, as the AEC’s development promises a highly dynamic market with an approximately 6% share of the world trade, which isn’t far off China’s 10%. In addition,*

ASEAN economies are relatively stable and competitive in the international arena – even if, from a supply-chain view, there are still obstacles to be removed to ease cross-border trade.”

These advantages are becoming harder to find in the rest of the world. The emerging-market slowdown of recent years means that businesses looking for opportunities to expand into a large, growing and stable market are running short of options. Brazil, Russia and South Africa all slipped into recession in 2015, and the uncertain outlook for China’s economy has become a source of global concern. Viewed alongside problems around the rest of the emerging world, ASEAN’s performance over the past year has been impressive: its economy grew by 4.5% in 2015, and has now expanded by an average of 5.2% over the past decade.

Chart 1
The relative importance of key market factors when assessing ASEAN countries (% respondents)



Source: AHK ASEAN/EY survey, June-July 2016

Key takeaways:

- German investors are mainly attracted to the ASEAN region for two reasons: access to a market of more than 600 million consumers, and a manufacturing base where wages are often more competitive than in China.
- The region's continued growth and economic stability are key factors for investors. However, greater stability in policy-making would be a major help.
- There is some disappointment about limited progress after the introduction of the ASEAN Economic Community (AEC), but investors remain positive about the outlook and plan to expand their investments.

Our survey suggests that ASEAN's resilience has not gone unappreciated on the ground. As many as 91% of respondents note the importance of the region's economic stability to their aspirations there, while 86% point to rapid market growth. Prospects also look strong. The majority of respondents expect their situation to improve over the next 12 months, and the IMF is forecasting GDP growth of 5% over the next five years.

Given that ASEAN is a collection of highly diverse economies, it is inevitable that there will be both growth stars and laggards in the region. Malaysia, Singapore and Thailand, for example, have all had their turns in the spotlight, but the Philippines and Vietnam are currently shining brighter than the others, with the former enjoying the benefits of six years under a president who pushed a positive reform agenda and the latter benefiting from rising costs in China.

These stars aside, most ASEAN economies can be said to have outperformed in the past year. Singapore's days as a trail-blazing tiger economy are well behind it, but it benefits from its role as a financial and logistics hub at the heart of ASEAN and remains more dynamic than most other advanced economies.

Brunei is struggling to cope with the drop in oil prices, but the region's two bigger commodity-producing economies, Indonesia and Malaysia, have held up much better than their counterparts in other regions: both expanded by almost 5% last year. The main reason for their success is that they have more than one string to their bows. Despite Malaysia's oil riches, manufactured goods make up almost two-thirds of its exports. And in Indonesia, a large domestic consumer market has helped to make up for a loss of export revenue.



“Asia has moved past its traditional role as a supplier of components, and the region is fast becoming a driving force for the global economic demand,” says Dr. An Wee Moo, Regional Director (Europe), Singapore Economic Development Board.

Nevertheless, the worldwide economic slowdown did not bypass the ASEAN region altogether – although its negative impacts seem to have been much less severe there. Our survey shows that concern over various economic and political issues in the ASEAN region has risen from a year ago (see chart 2).

The most notable change in factors inhibiting the attractiveness of the ASEAN region for German investors, though, concerns pressures in the labor market. Although second on the list after worries over corruption, this factor showed by far the biggest increase from last year (from 5% to 18%).

Ongoing economic growth, rising inflows of FDI and a lack of effective vocational training schemes have clearly intensified competition for qualified employees. As in other rapidly expanding economies, this has led to greater demand for skills and higher salaries. In cities such as Singapore, Bangkok and Jakarta, in particular, leverage has shifted to employees rather than employers. Nevertheless, one qualifying factor to note is the weighting in this survey toward service-oriented businesses: there remains plenty of capacity for lower-skilled workers, such as for basic manufacturing processes.

Political uncertainty on the rise

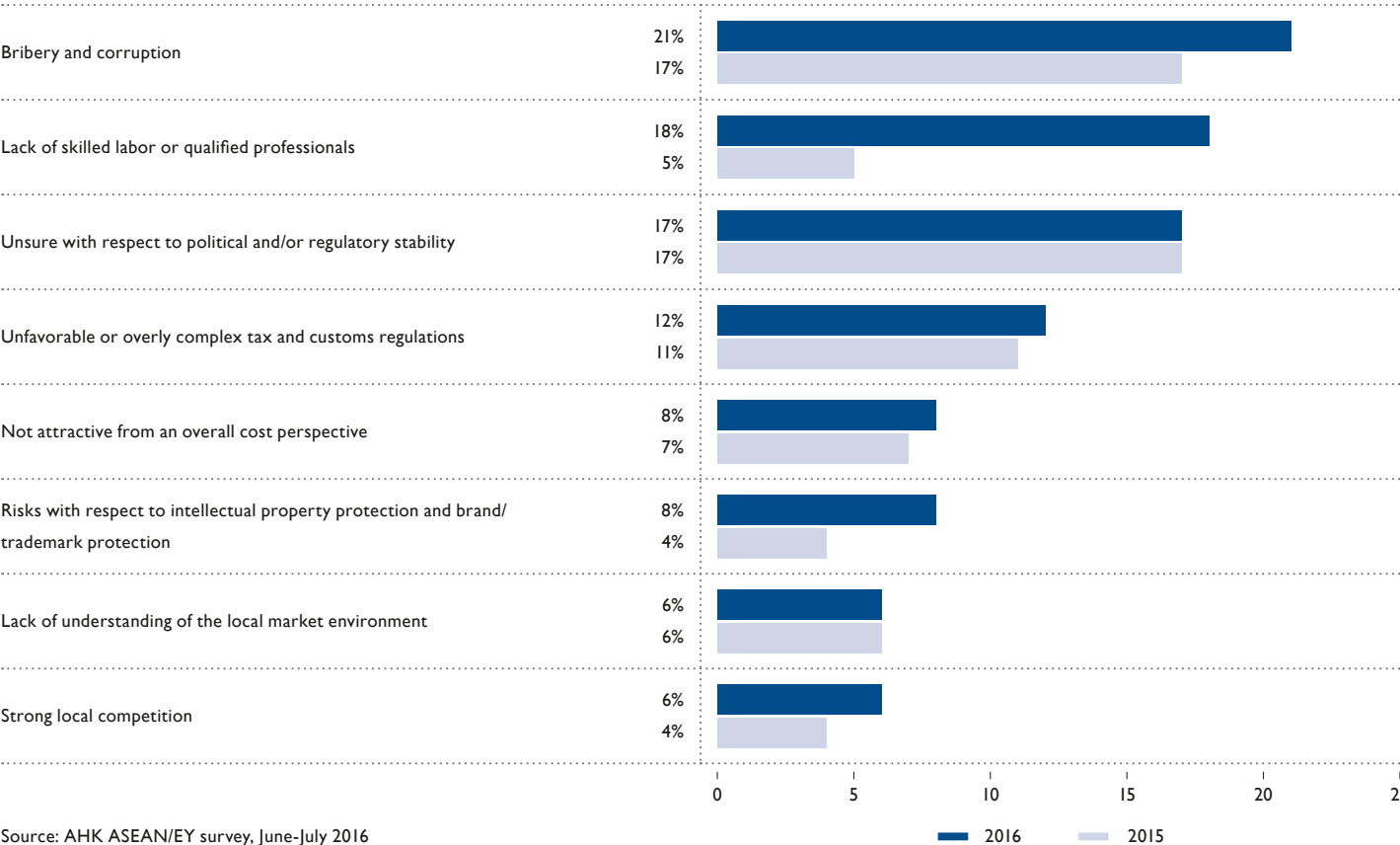
In addition to skills shortages and fears over corruption, our survey shows that concerns about political and regulatory instability around the rest of ASEAN have increased since last year. It was the third most common answer given by companies when they were asked what is holding them back from increasing their engagement in the region.

The main disappointment in recent years has been Thailand, which has been held back by a decade-long period of political crisis. The military government has held power since 2014, and it recently strengthened its grip with a new constitution – approved by voters in a referendum – that introduces an appointed senate and other unelected positions. The military says it is planning a return to democracy in 2017, but previous elections have been delayed and even if a vote goes ahead there is no guarantee that an elected government would bring stability.

On a positive note, the first free elections in Myanmar for decades and transition to a civilian government have proceeded smoothly, far exceeding expectations.

The most obvious new problems are found in Malaysia, where the government has been embroiled in a corruption scandal at a state-owned investment fund, 1MDB. In the Philippines, meanwhile, the election of an outspoken new president, Rodrigo Duterte, also initially caused some jitters after six years of sound policy-making under Benigno Aquino III.

Chart 2
Factors inhibiting further investment or engagement in the ASEAN region (% respondents)



However, businesses do not appear to be too put off. Indeed, Thailand tops the list of countries in which our respondents were planning to establish business operations, despite it being the country with arguably the most uncertain political environment. This could reflect the long history of Thailand's economy shrugging off political turmoil. This resilience has given confidence to many multinationals to continue investing or setting up regional headquarters in the country, as seen with Robert Bosch, Covestro and Kellogg Company, among others. The Philippines and Malaysia are also being targeted by more than 20% of respondents. In the Philippines, more encouragingly, Duterte's policies are mostly continuing in the same vein as his predecessor's, albeit with tweaks such as relaxation of the constitutional restrictions on foreign ownership and accelerating annual infrastructure spending to further boost growth.

“The president’s 10-point economic agenda includes simpler and reduced taxes, a more efficient public administration, increased competitiveness, and better communication infrastructure,” says Peter Kompalla, Executive Director, German-Philippine Chamber of Commerce. *“Negotiations with the EU about a free trade agreement will continue.”* In addition, the public and private modernization of infrastructure will offer many business opportunities for German companies, says Kompalla.

The reality is that flip-flops on regulation are probably a bigger concern for most businesses than outright political turmoil. As an example of the frustrations that policy-makers can create, Lee Cheong Chee, Managing Director of Infineon Technologies (Malaysia), points to the Malaysian government’s recent changes to rules on the employment of foreign workers. In February, the government told companies that they would no longer be allowed to hire foreign workers. In May, under pressure from businesses that were struggling to meet orders because of labor shortages, it lifted the ban in several sectors, including manufacturing. According to Lee, *“One of the advantages of being in Malaysia is that if we cannot find workers locally, we can hire from abroad. That isn’t an option that businesses in China have.”* But after this year’s ban, however brief, Malaysian manufacturers can no longer be sure that they will always have that option. *“Policy needs to be more consistent,”* says Lee.

Still, the region must be getting something right. Most of its economies rose up the rankings in the World Bank’s Doing Business report this year, most notably Brunei, Indonesia and Myanmar, while Singapore retained its place at the top of the list. Singapore, Malaysia, Thailand and Brunei all rank higher than China, and Vietnam is right behind China, having moved quickly up the ranks. Indonesia’s jump up the rankings is striking, and has been achieved by streamlining the bureaucracy involved in starting a business and paying taxes. Smaller countries such as Brunei have also made impressive gains. The Indonesian president, Joko Widodo, has once again started to show a more welcoming approach toward international businesses by slashing the list of sectors in which foreign investment is limited.

Most of the improvements in ASEAN’s business environment are taking place at the country level, and that is likely to remain the case. There is no powerful central bureaucracy, and ASEAN has a tradition of non-intervention into the affairs of member countries. The upside of that approach is

that it reduces the chances of ASEAN becoming a source of tension in the region, and there is little reason to think that an ASEAN country would feel a need to leave the trade bloc. But it also helps to explain why regulations vary so much, and why efforts at integration have not moved as quickly as many had hoped.



Table 1
World Bank Doing Business rankings
(Out of 189 countries)

Country	2016 ranking	2015 ranking	Change
Singapore	1	1	0
Malaysia	18	17	-1
Thailand	49	46	-3
Brunei Darussalam	84	105	21
Vietnam	90	93	3
Philippines	103	97	-6
Indonesia	109	120	11
Cambodia	127	133	6
Laos	134	139	5
Myanmar	167	177	10
Benchmark countries			
China	84	83	-1
India	130	134	4

Source: World Bank

Slow integration

One of the region’s headline events of the past year – and the driver for our first survey on this issue – was the official launch of the AEC at the end of 2015. The AEC aimed to establish ASEAN as a single market and production base, breaking down barriers to trade and investment and freeing up the movement of skilled workers.

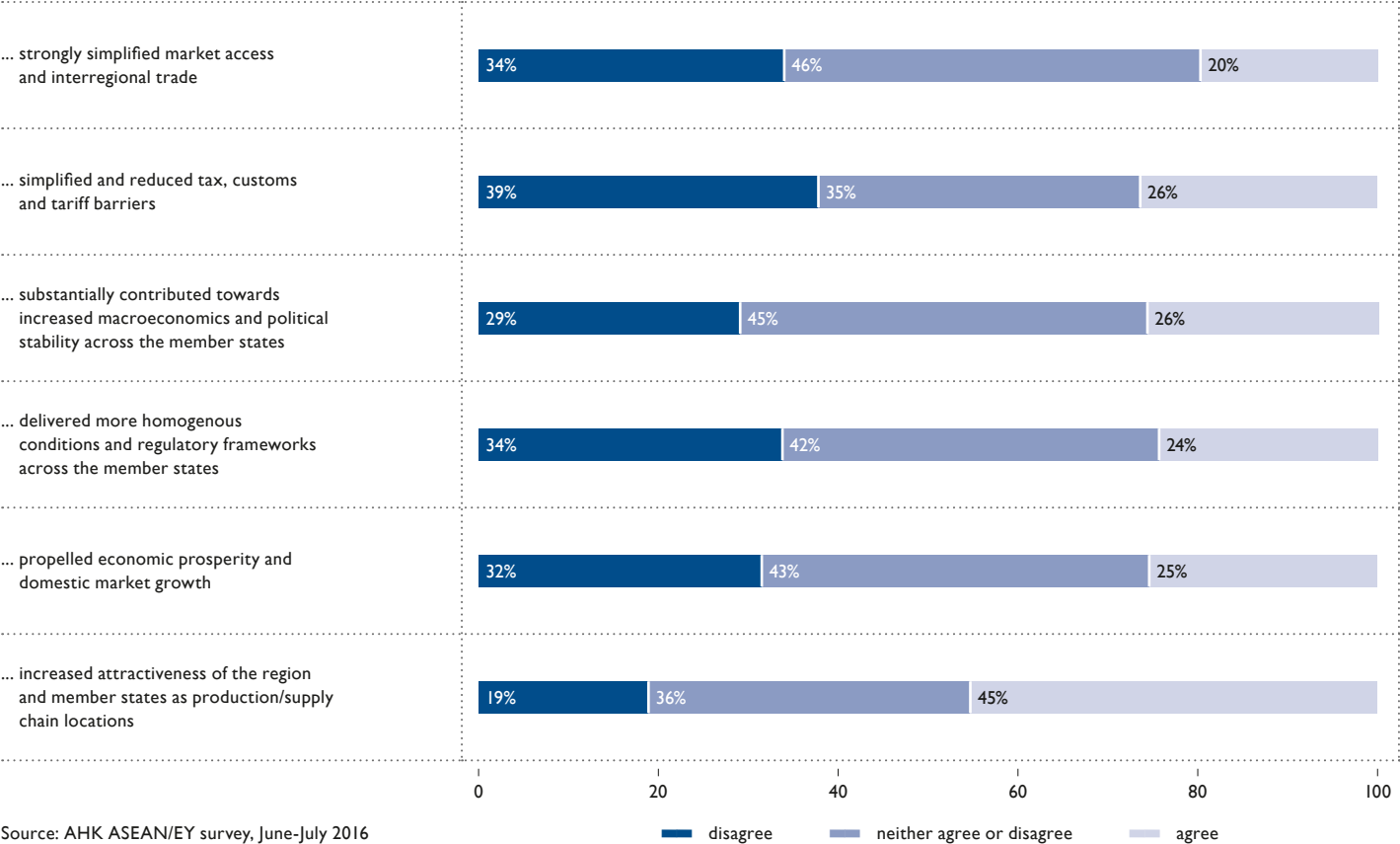
Last year, our survey showed that businesses were very optimistic about the potential effects of AEC 2015. For example, 84% of respondents said they had high expectations that the AEC would deliver strongly simplified market access and inter-regional trade. Unfortunately, one year on, only 20% agree that those expectations have been met, and 33% disagree.

But while the AEC has so far been something of a disappointment on the ground, it has helped to draw attention to the benefits of ASEAN. More generally, there has been a sharp increase in forums and dialogs organized by EU member states, many of them inaugural events, to raise awareness of the “new” ASEAN market. These are especially aimed at getting small and medium-sized enterprises, such as within Germany’s Mittelstand, to catch up on investment in the region. “There is a manifesting greater interest from the business community to have a stronger regional presence in light of the establishment of the ASEAN Economic Community,” says Ratchanee Wattanawisitporn, Deputy Consul-General, Investment Section, Royal Thai Consulate-General.

Hartmut Heckermann, Director, Bilstein Group is one person who sees rising potential in ASEAN as a result of the AEC. “We know we need new markets to grow our business,” he says. “After China and India, ASEAN was the next obvious market, especially as we became aware of the ASEAN Economic Community. We have chosen to go to Indonesia first. It has a large population, healthy growth and stable politics. The country has already overtaken Thailand for car production, and we see a lot more potential there. We have already had our first trial orders from an Indonesian stamping company and a tier-one Japanese firm.”

Moreover, Rhenus Logistics’ Tobias Gruemmer says that trade barriers are already low enough for ASEAN to almost be considered as a single production base. After all, even before the launch of the AEC, tariff rates were already close to zero on 99% of goods traded among the ASEAN-6 countries. “Despite some non-tariff barriers that have been set up since the reduction of duties between the member countries, ASEAN can now be used as a single production base, with labor-intensive production steps moving toward the region’s production-focused economies while other more R&D and service-focused economies are rising up the value chain,” says Gruemmer. “The new situation also allows for optimizing the existing production set-up that companies may already have in place, together with a re-engineering of the supply chain to reach customers throughout this single market.”

Chart 3
Across which of the following factors have expectations of the AEC 2015 been met? (% respondents)



Opportunities missed?

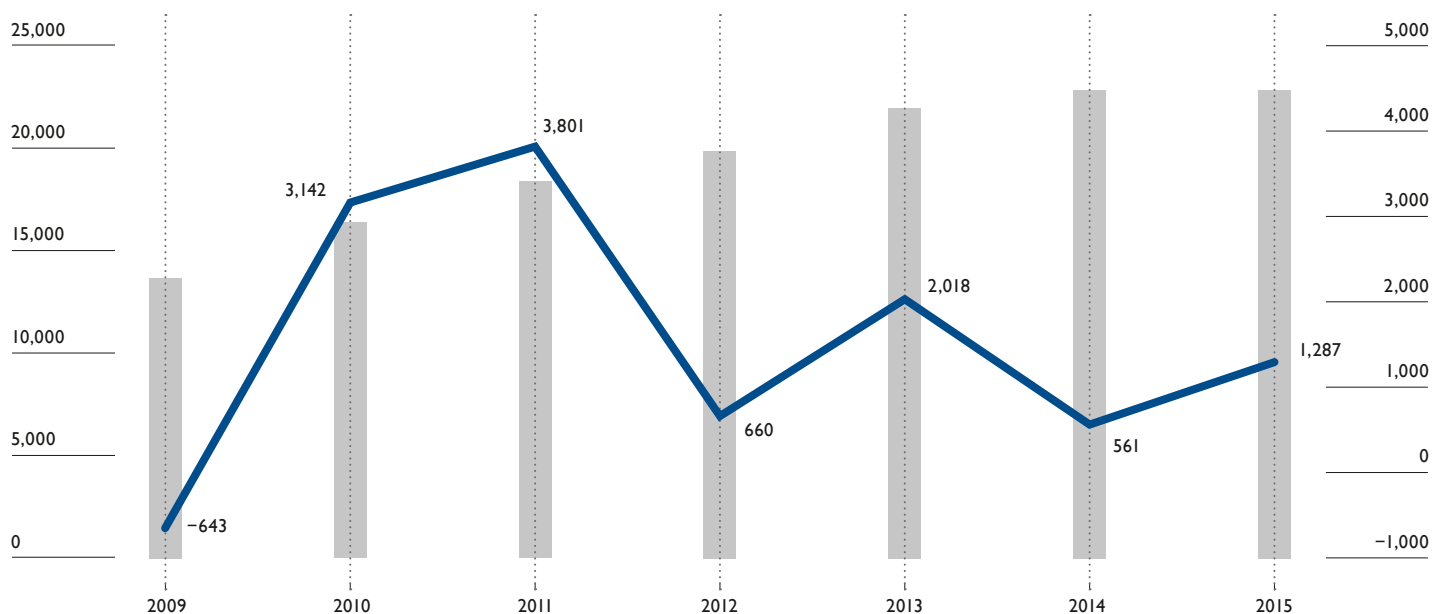
Despite the buzz around ASEAN, German investment has hardly been rushing into the region in recent years. In 2011-15, net FDI outflows from Germany into ASEAN amounted to €6.3bn, which was 1.6% of total German FDI net outflows. Given that ASEAN accounts for 3% of the global economy, this looks to be on the low side, especially since ASEAN is a region that is heavily reliant on FDI – no other developing region receives more FDI relative to its GDP. In addition, Germany's FDI total is dwarfed by the amounts seen from other countries. In 2015 alone, for example, Japan invested US\$17bn, the US US\$12bn, and China US\$8bn.

However, our survey suggests that those German businesses already on the ground are excited about prospects for ASEAN. Many (53%) expect the overall business outlook to improve over the next year, and even more expect sales to rise (60%). In addition, almost half are planning to expand their headcounts over the next 12 months. Even more noteworthy is that 77% of respondents plan to expand their business operations to other ASEAN countries over the next five years. There is a clear risk that others are missing out.



Chart 4

German outbound FDI flows and positions to ASEAN region (US\$)



Sources: OECD, Deutsche Bundesbank, EY estimate¹

— German-ASEAN FDI position (left axis)

— German-ASEAN FDI flow (right axis)

1) Note 1: FDI position data for 2014 and 2015 is an EY estimate because this has not yet been officially reported. It is based on using actual FDI flow data from the Deutsche Bundesbank in those years. Note 2: Variations to German-ASEAN FDI positions and flows, when compared with our 2015 report, are caused by a change by the Deutsche Bundesbank to its methodology for calculating FDI data.

Getting the operating model right

To make the most of the opportunities in ASEAN, businesses will need to operate across very diverse countries. And to do this effectively, they will have to get their operating structures right.

There are three options that companies generally employ in order to manage operations that are spread across a large, eclectic region such as ASEAN:

- **The “center of excellence” model.** This involves having an expert team located in one country – a country that offers an attractive standard of living and tax benefits. This team of project managers, engineers, researchers, etc then travels the region, looking after operations.
- **The “shared services” model.** This places transactional-type workers in one place, and they perform defined processes, such as call-center services and book-keeping, for all of the business’s operations in the region. There are also operations that benefit from scale – it makes sense for operations across countries to share financial and shipping services, for example, to leverage that scale. There is little benefit to spreading these operations across countries.
- **The “fulcrum” model.** In this structure, everything is brought into the hub – even those activities that could be achieved outside of the center.

The third option is problematic when it comes to ASEAN: each country ideally has its own sales team, with the capability to negotiate with distributors and interpret changes in the market. A lot of business in ASEAN is still relationship-based, and it is easier for an organization to build those relationships if it is located within the country. Working out these complexities is a common question for investors. For example, at the growing number of EU-hosted forums on investing into ASEAN, attendees are often looking for local partners to help with market entry, government assistance to reduce costs and experienced advisors to help navigate the local regulatory, legal and commercial environment.

And when it comes to centralizing R&D, Kimjin Gan, Partner, Asia Pacific Operating Model Effectiveness Leader, EY, who helps businesses to set up operations in the region, sounds a note of caution: *“There are advantages to locating R&D in a hub, where it is easiest to find the skilled labor and to make the most of tax incentives offered by some governments. But the needs of consumers are very different across countries. In the food industry, for example, flavor profiles will be different, and some markets require food to be halal. There is a need to localize the product. Maybe that can be done by having researchers regularly flying around the region, but it is probably easier to understand the market if you are on the ground – especially since these markets are changing so quickly.”*

Companies pursuing success in ASEAN must develop an operating model that allows them to turn the region’s diversity to their advantage. They can also consider an innovative approach to establishing an operating hub – whether that means splitting personnel across two or three ASEAN countries or turning received wisdom on its head and establishing the hub outside ASEAN. *“An alternative route to ASEAN could also be through the large Japanese trading houses or corporations for which ASEAN has been a ‘backyard’ for many decades,”* says Thomas Wirtz, Executive Director, Transaction Advisory Services, Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft. *“These firms not only offer distribution platforms in ASEAN but could also help finance expansion – even for SMEs.”*





Chapter I

Should manufacturers see ASEAN as a viable alternative to China?



The rate at which the Philippines' manufacturing sector grew in Q2 2016

10.8%

Average salary of a Chinese manufacturing worker

US\$ 424

Average salary of a Vietnamese manufacturing worker

US\$ 185

Chapter I

Should manufacturers see ASEAN as a viable alternative to China?

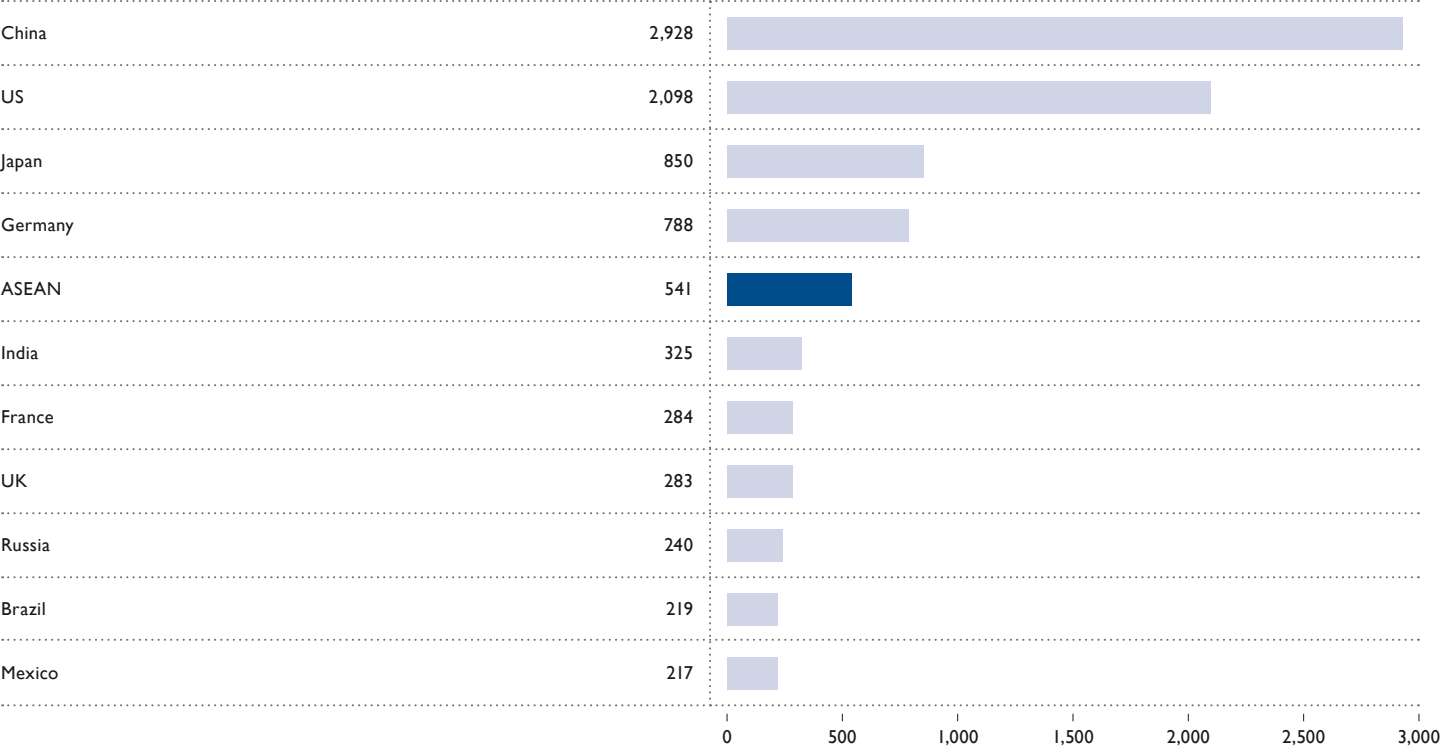
China's status as the "workshop of the world" is unquestionable. Its manufacturing output is worth almost US\$3t a year, making it by far the biggest manufacturer in the world. ASEAN certainly won't be challenging that position any time soon: its manufacturing sector is worth a much smaller US\$540bn a year. Still, that is more than Brazil and Russia put together, more than India and the UK, and not too far off Germany.

What's more, recent data suggest that the tide has started to turn away from China and toward ASEAN. China's manufacturing sector expanded by 10% a year over the past decade, but in Q2 2016 it grew by just 5.4% year-on-year. Meanwhile, Vietnam and

the Philippines had two of Asia's fastest-growing manufacturing sectors, expanding by 10.1% and 10.8% in Q2 2016, respectively, and manufacturing sectors in Indonesia, Malaysia and Thailand are all growing at a similar rate to China's. In the Philippines, which has long focused on business process outsourcing and continues to prioritize this, manufacturing is also a key plank of its economic development plan.

Two factors are starting to work in ASEAN's favor. First, rising costs in China are giving manufacturers a reason to look for other locations for their factories. Second, ASEAN is making efforts to present itself as a single, large-scale production base.

Chart 5
Total value added generated by manufacturing (US\$m, 2014)



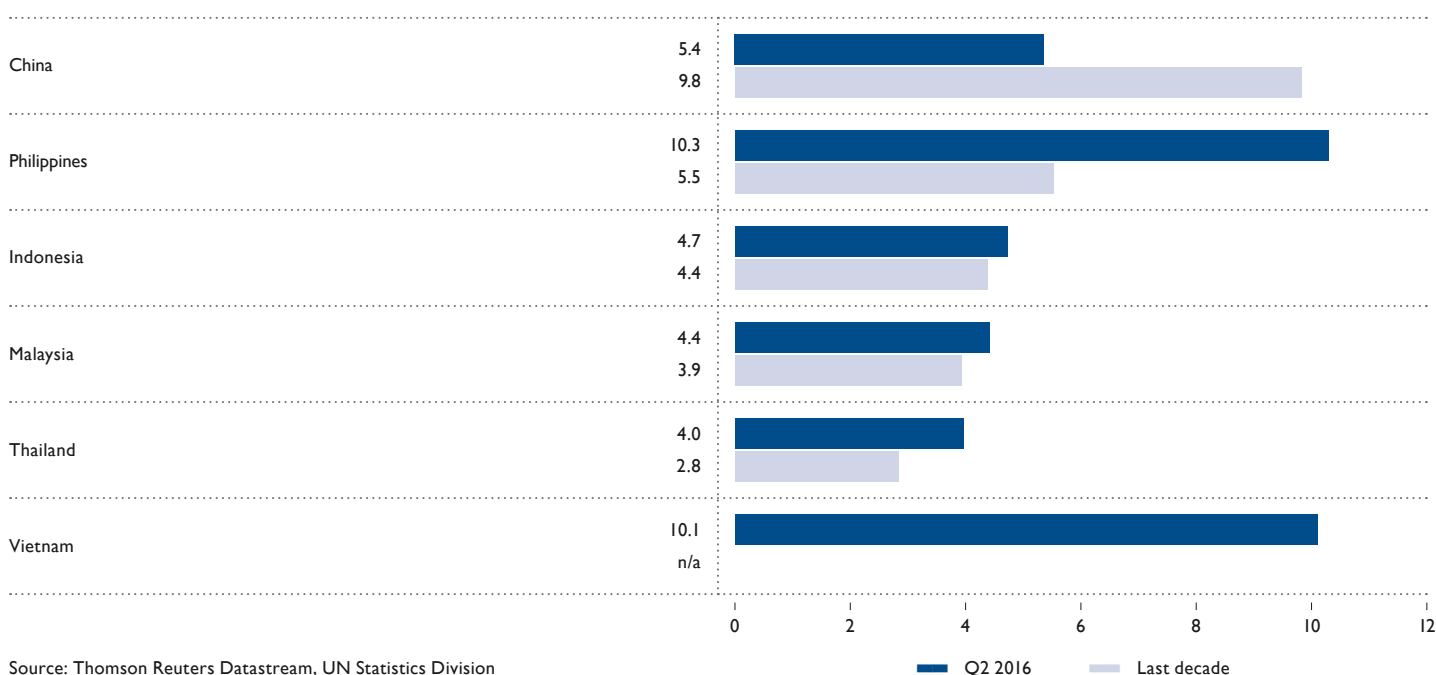
Source: UN Statistics Division

Key takeaways:

- Although China remains the dominant global manufacturing base, ASEAN is looking increasingly attractive as a target for investment. The growth of manufacturing has been especially high in Vietnam, although other countries are expanding this sector rapidly too.
- Low wages are a key draw. In Vietnam, manufacturing wages are now half the amount of China's workers, although productivity rates will no doubt vary. However, skills shortages can be a problem.
- More concerning is cross-border red tape, which hinders trade. While tariffs have fallen, non-tariff barriers often remain high.

Chart 6

Changing growth rates: Q2 2016, year-on-year manufacturing growth versus the prior decade's average



The draw of low wages

So far, the first of these changes appears to have been more important. Put simply, China is no longer a cheap place to have a labor-intensive factory. According to survey data from the Japanese External Trade Organization, the average monthly salary for a factory worker in China has risen by around 40% in the past five years, outstripping increases in all but ASEAN's least developed economies. Last year, the monthly salary of a Chinese factory worker was US\$424 – significantly higher than in any ASEAN economy except Singapore, and more than double the salary in Vietnam, for example.

Rising wages are only part of the problem. According to Petrus Ng, Managing Director, BASF Thailand, *“Rising wages in China are only one factor pushing businesses to consider other locations for their factories. Regulatory changes, especially*

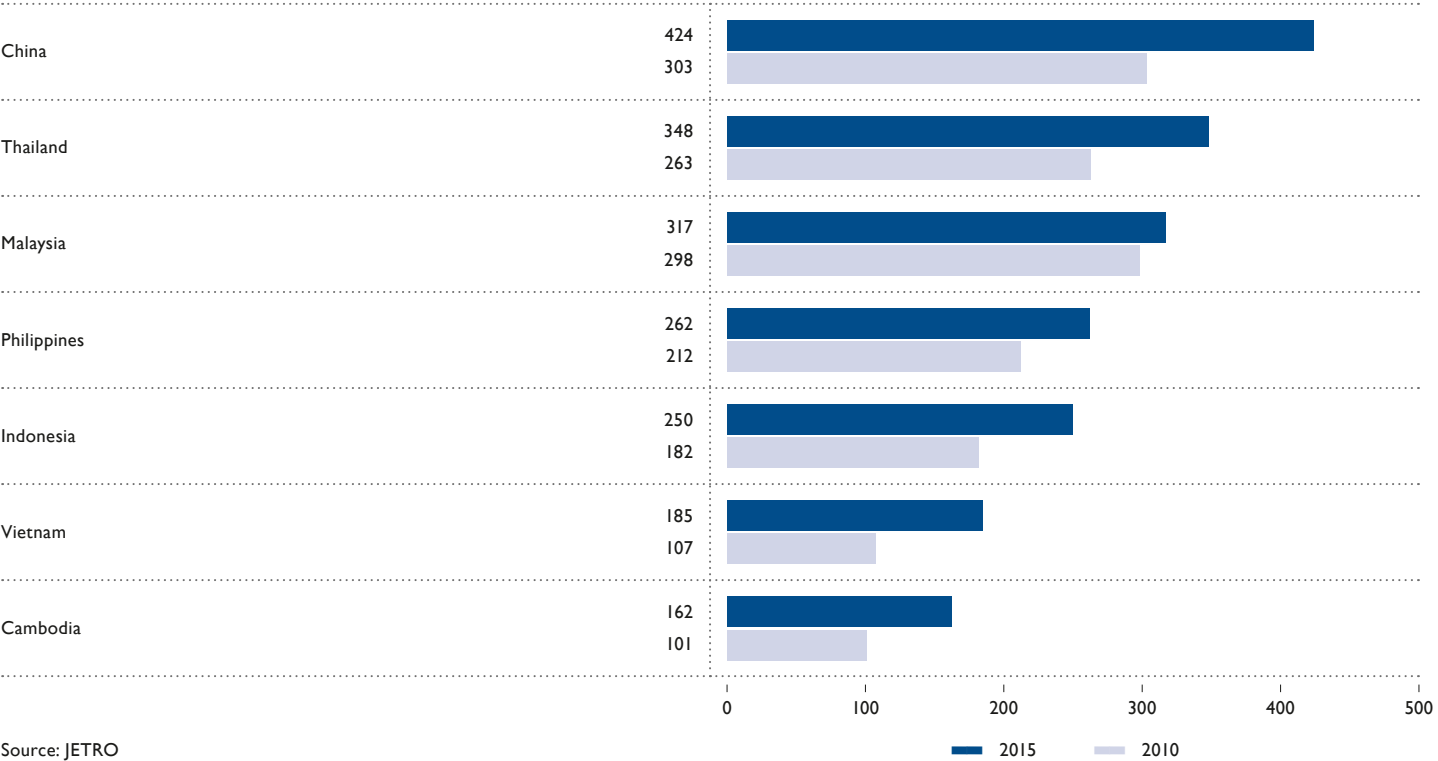
environmental control measures, are also making it more costly and difficult to do business in China. However, China is still an attractive location due to the huge domestic demand as well as the established and extensive supply-chain network.”

Our survey shows that low labor costs are the second most important factor that makes ASEAN attractive as a location to establish new business activities, with 78% of respondents saying that they are a plus.

Less positively, 54% of companies say that a lack of skilled labor is holding them back from increasing their engagement in ASEAN; only corruption is more commonly reported as a drawback.



Chart 7
Average monthly salary of a manufacturing worker (US\$)



Source: JETRO

However, the availability of skilled labor varies considerably across the region. Malaysia and Thailand, for example, have had large manufacturing sectors for decades, and have built up a pool of expertise, along with extensive support industries. The less-developed economies are some way behind.

Infineon Technologies has factories across Asia – in Malaysia, Indonesia, Singapore and China – but has found it easier to grow in Malaysia because of the availability of skilled labor. *“Wages for factory workers in Malaysia are competitive, even if they are rising quickly,”* says Managing Director Lee Cheong Chee. *“But the country’s big advantage is that it is relatively easy to hire the skilled engineers that we need for our overall front-end and back-end operations, even beyond some global functions such as R&D and IT services.”*



Toward integration

The combination of advanced manufacturing networks in some countries with low costs in others adds to ASEAN's appeal. Many companies exploit this diversity by splitting their high-end operations from their labor-intensive activities, even if there are some challenges in treating ASEAN as a single production base.

And there have been strong efforts to bring down trade barriers and integrate the region more closely in recent decades – efforts that have come partly out of necessity.

“The experience of competing for investment against the emerging giant of China in the mid-2000s was sobering to many,” says Ratchanee Wattanawisitporn, Deputy Consul-General, Investment Section, Royal Thai Consulate-General. *“While China is a single production base with national laws and regulations which – at least in principle – apply countrywide, Southeast Asia was a loose grouping of diverse economies characterized by differences in customs policies, tariff regimes, regulations, industrial structures and legal systems, with inadequate connections between national infrastructures. Clearly, there was a need for change to prevent a continued and permanent shift northward of economic power within Asia.”*

Tariff rates are now close to zero on 99% of goods traded among the ASEAN-6 countries – the remaining four countries need to adjust their tariffs to that level within the next three years – and more than 70% of total trade between ASEAN countries is now conducted with zero tariffs, while only 5% of goods are subject to tariffs above 10%.

Obstacles to trade

Nevertheless, various barriers to trade remain. *“ASEAN's borders are still facing the problem of high costs and long delays. The reasons include poor infrastructure, multiple checkpoints and the cumbersome administrative process of trading,”* says Wattanawisitporn.

Excessive paperwork when it comes to trading within ASEAN is a common complaint. *“The biggest frustration in ASEAN is red tape, especially when it comes to trade,”* says BASF Thailand's Petrus Ng. *“Moving goods between countries is physically easy, but it requires so much paperwork with different regulations/requirements in each country to enjoy preferential rates on import/export duty under the ASEAN FTA [free trade agreement]. I haven't seen much improvement since the AEC was launched. Hopefully over the next few years that will change. Standardizing regulation and moving more paperwork online would be a big help.”*

Meanwhile, non-tariff barriers are, if anything, a growing problem. Tobias Gruemmer, Managing Director at Rhenus Logistics, helps businesses transport their goods around ASEAN, which gives him first-hand experience of the challenges. He says that as tariff barriers have come down around ASEAN, governments have found other ways to protect their markets. *“Customs surcharges are the most common barrier, but price controls and financial measures, such as advanced import deposits and cash requirements, are also used,”* he explains. *“There are technical measures that require products to meet different, often arbitrary, standards across countries. Some countries use monopolistic measures, such as requiring goods to be imported through a government agency.”*



The statistics back up Gruemmer's observations. According to data from the United Nations Conference on Trade and Development (UNCTAD), the number of non-tariff barriers applied between ASEAN economies rose from around 1,800 in 2000 to 6,000 in 2015.

One of the main goals of the ASEAN Economic Community (AEC) was to bring down these non-tariff barriers, but our survey suggests that there has not been much of an impact so far. That said, even if ASEAN's lack of a strong central bureaucracy means that the AEC is liable to miss deadlines, there is at least an awareness in the region that non-tariff barriers need to be reduced. Gruemmer points to plans for an online self-certification system for country of origin as the next step that will make life easier for exporters. More ambitious is ASEAN's intention to set up an ASEAN Single Window, which will bring the region's customs clearance processes online.

Over the longer term, the ASEAN Economic Community Blueprint 2025 will aim to create a highly integrated regional economy with more seamless movement of investment, skilled labor, business people and capital. Reducing non-tariff barriers is a key part of that vision, as are improvements to transport links. The plan also shows an awareness of the other problems that businesses currently face in the region, pledging to foster a more predictable, market-driven environment that supports SMEs.

ASEAN might not be about to challenge China as the world's workshop, but it is an increasingly attractive alternative. And if the bloc can deliver on its promise of greater integration, even more manufacturers will shift their sights south.



Is Thailand shr

For a decade, Thailand has been lurching from one political crisis to another. The military government, which has been in power since 2014, will hope that its recent changes to the constitution deliver more stability, but elections planned for May 2017 could be the trigger for another bout of unrest. Despite this uncertainty, however, Thailand was the country that the most respondents to our survey (35%) said they are looking to expand into.

For many businesses, Thailand offers the best of both worlds: it has a large population with rising spending power, while offering labor costs that are low enough for the country to serve as a competitive production base for export-oriented companies.

Thailand tops our survey when it comes to expectations for growth of middle class spending. As Petrus Ng, Managing Director of BASF Thailand, explains: *"There is a large number of consumers in Thailand, with the population at above 60 million and another 20+ million tourists visiting the country every year, demand for value-added and mid-high-end products is sizable. Most of the industries related to the consumer market are very established and there are many local and multinational producers active in those industries. We are serving the producers with products from our local production, as well as products imported from neighboring countries."*

Labor costs are higher than in the region's poorest economies, but they are still relatively cheap compared with developed economies and China. Thailand also offers well-established supply chains and a pool of skilled labor in a number of industries that have a long history in the country. Ng highlights another advantage: *"Intellectual property [IP] rights are important to us, because R&D is a key focus of our business. Thailand has good IP protection, and we're more comfortable here than we would be in China, for example. We don't have to worry about competitors copying our ideas."*

It is no surprise, then, that our survey shows that businesses in a wide range of sectors are looking to expand in Thailand. For example, 39% of the machinery and equipment companies

ugging off its political risks?

that we surveyed say they are expanding there, while on the consumer side 54% of healthcare companies are doing so.

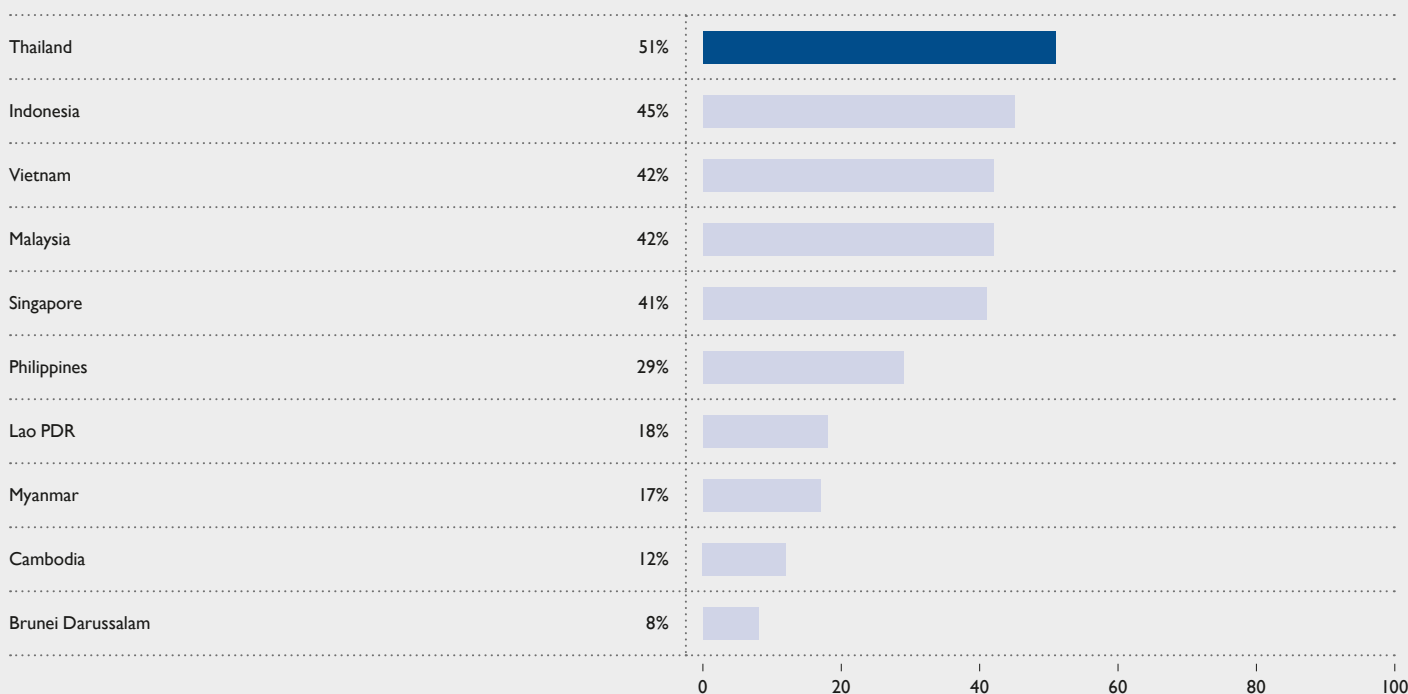
However, the political situation is undoubtedly creating some nervousness among the business community. *"We are concerned about the political situation in Thailand, as it has negatively impacted on business environment in the past few years,"* says Ng. *"We have a big production footprint in Thailand, and turmoil would disrupt our business."*

But unless things get out of control, we won't be moving, because it would be costly and difficult to start from scratch in another country. Besides, Thailand is an important market for us."

It seems that, for most businesses, Thailand's advantages make it worth the risk.

Chart 8

Which countries do you believe have good prospects as regards growth of the middle class? (% respondents)



Source: AHK ASEAN/EY survey, June-July 2016

Chapter 2

In focus: The ASEAN consumer



Spending by ASEAN households rose by more than 30% between 2009 and 2014

30%

As a single country, ASEAN would be the eighth largest consumer market in the world

8th

The collective population of ASEAN member states is more than

633 million people

The predicted size of the ASEAN middle class by 2020

400 million people

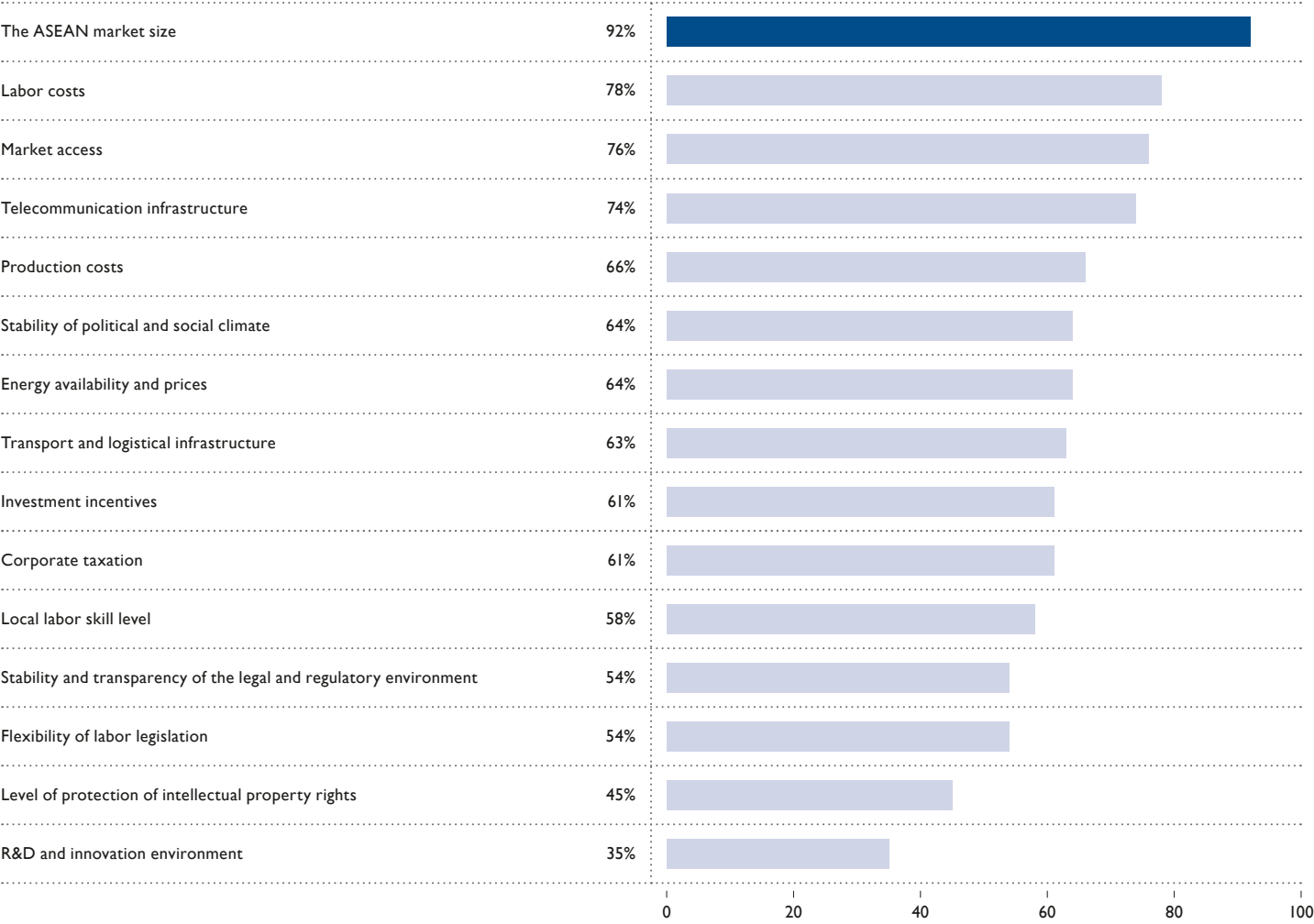
Chapter 2

In focus: The ASEAN consumer

ASEAN’s consumer market is generating plenty of interest. Our survey shows that 92% of business leaders see the size of ASEAN’s market as a factor that makes it an attractive place to establish new business activities – higher than anything else.

A look at the numbers makes it easy to see why this is. The region’s households spent US\$1.4t in 2014. That would have made ASEAN the eighth largest consumer market in the world if it were a single country – larger than India, Russia and Mexico, and in

Chart 9
Key factors driving the attractiveness of the ASEAN region for investment (% respondents)



Source: AHK ASEAN/EY survey, June-July 2016

Key takeaways:

- Nine in ten German investors consider ASEAN's rapidly expanding pool of consumers as a draw for investment. In the five years to 2014, the region more than tripled its proportion of global consumer spending to 3.2%.
- The key challenge is choosing between more developed markets, where competition can be fierce, and less mature ones with more severe infrastructure limitations.
- Much like in Europe, each country needs to be considered with a distinct approach and strategy, as opposed to a homogeneous market like the US or China.

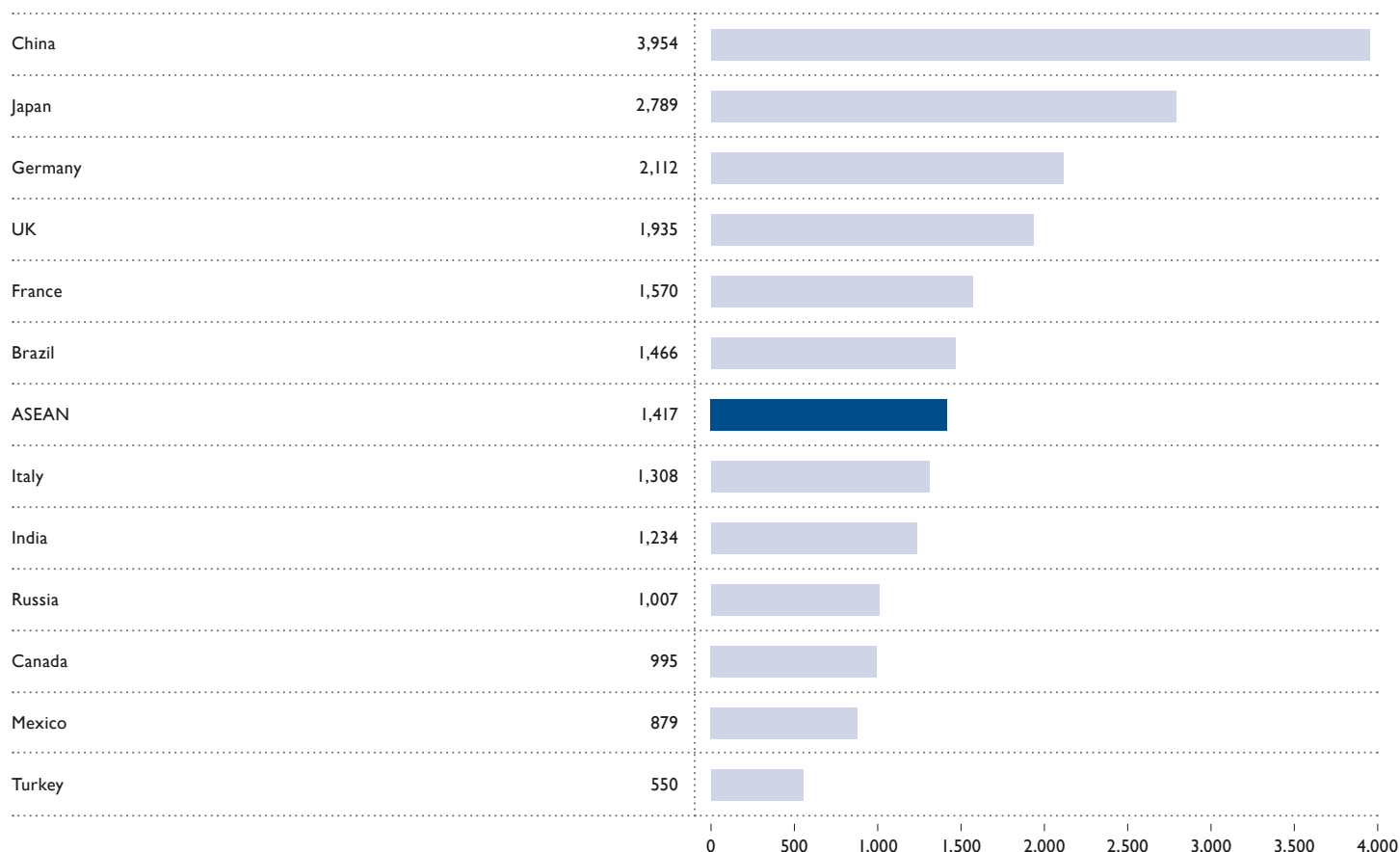
the same league as Brazil. Spending is also rising quickly. Over the five years to 2014, spending rose by more than 30% at a rate of 5.6% a year. Over that period, ASEAN's share of global consumer spending rose from 1% to 3.2%. It is becoming much harder to ignore, especially since the prospects are also promising.

At the moment, ASEAN is home to more than 630 million people, comfortably more than the EU and almost double the US. And the UN estimates that the population will rise to almost 720 million by 2030, making this an increasingly significant region to target. Demographics will work in ASEAN's favor.



Chart 10

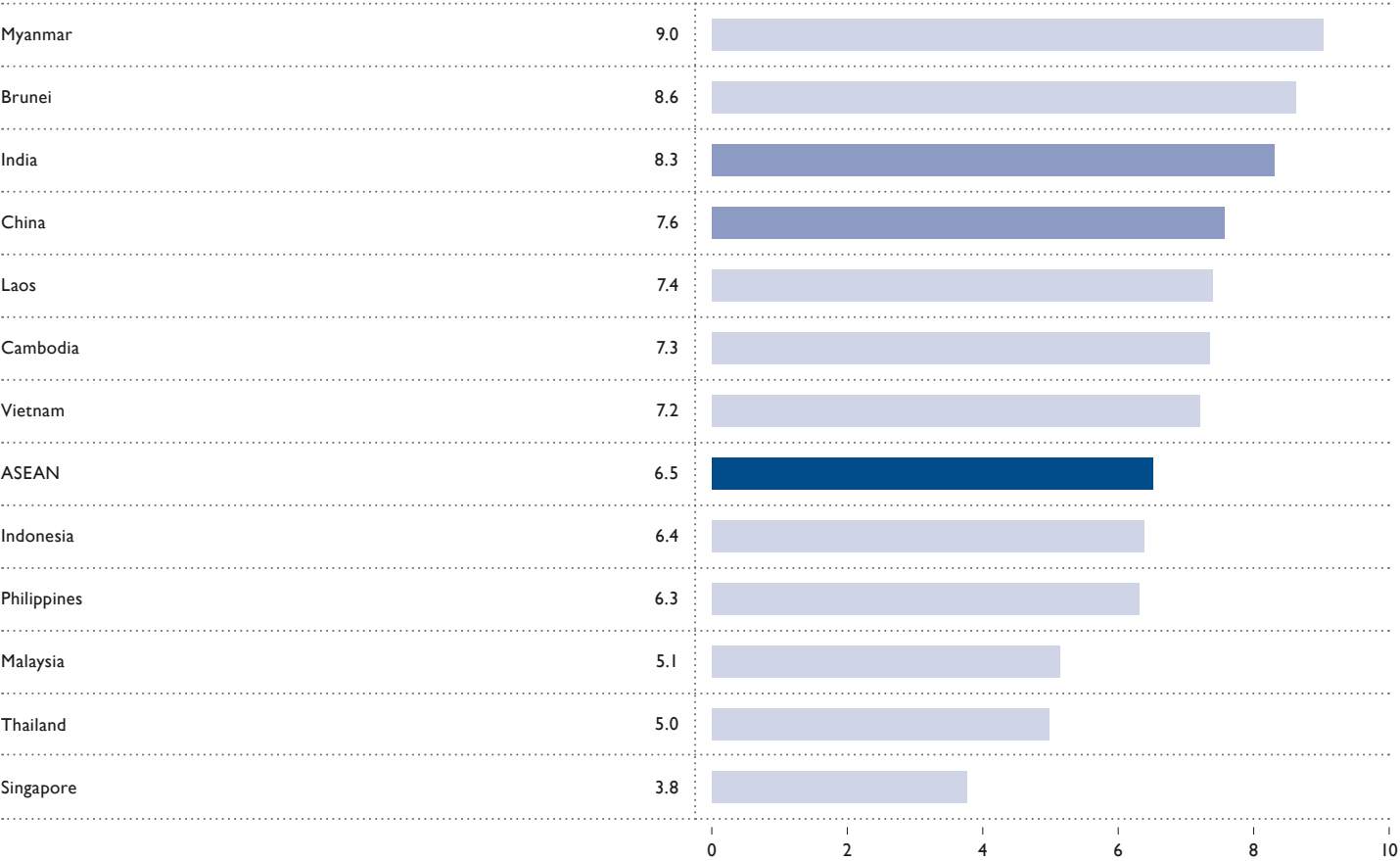
Big spenders: Total household consumer spending, ASEAN vs select countries, 2014 (US\$bn)



Source: UN Statistics Division

Chart 11

On the rise: Expected growth in GDP per capita in PPP terms, 5-year average (% , 2017–2021)



Source: IMF World Economic Outlook



Not only is the population set to rise, but households should also see their spending power increase sharply. Over the next five years, the IMF expects GDP per capita to rise by 6.5% in PPP terms across ASEAN as a whole, which is not far off China and India.

Of course, this income growth will not be spread evenly across ASEAN. A highly developed economy such as Singapore, where incomes are among the highest in the world and technologies and business practices are already at the global cutting edge, has far less scope to raise living standards than countries such as Vietnam and Myanmar. This potential in new markets has not gone unnoticed: Myanmar was cited as the top investment destination for German companies last year.

“In the mid-long term I think prospects for growth in ASEAN’s consumer market are very good, but I’d split the region into two groups of countries,” says Petrus Ng, Managing Director, BASF Thailand. “In the first group you have the less-developed economies – Cambodia, Myanmar, Laos, Vietnam and the Philippines – that are coming from a low base, racking up rapid growth. Buying power in these economies will continue to rise strongly. In the other economies, the prospects are not quite as strong in the short term. But I still think they will pick up when the global and Chinese economies turn around. Thailand is also still recovering from its recession.”

Case study

Rocket Internet cracks new markets in ASEAN

Rocket Internet in brief

Date founded: 2007
Headquarters: Berlin, Germany
Net revenue: €2.4bn

Number of people including ventures: 36,000+

Key ASEAN brand: Lazada, founded in 2012, which now operates in Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam

Key deal: A US\$1bn sale in April 2016, to Alibaba Group, of a controlling stake in Lazada, valuing the brand at US\$1.5bn

For a business like Rocket Internet, ASEAN is filled with promise. The company identifies internet start-ups that it thinks can work on an international scale, and helps to take them to that level. In Asia it already has a fund of US\$200bn invested in 16 companies operating across 15 countries.

Hanno Stegmann, Rocket Internet's CEO for Asia Pacific, says there are four factors that make ASEAN exciting for digital companies. First, it has a large population that is young and attracted to innovative service providers. Second, the region's economy is growing quickly while others are slowing. Third, digital penetration is soaring. In some of the less-developed economies, in particular, the rate of growth in cellphone and internet usage is astonishing. And finally, the market is not yet crowded.

"China is super-interesting, especially for innovative new businesses," says Stegmann. "But it is competitive, with lots of local firms already in most markets. And to break China, very specific local knowledge is needed. Of course you need local knowledge in ASEAN as well, but the market is not as dense and tight as China's."

One example he gives is that of taking Lazada, the e-commerce brand, to Indonesia and other Southeast Asian markets five years ago: *"Many people told us that Southeast Asia would be too difficult, but those concerns meant that we were able to roll out Lazada without facing significant, well-financed competitors."*

In his view, while it is a risk going to a market early, waiting for that market to become more mature often means that the opportunity is lost. Rocket Internet's latest attempt to get in early is in Myanmar, with Shop.com. The consumer market is still small and the difficulties of doing business in the country are a big deterrent for services and consumer goods companies, but in Stegmann's view, *"If we don't build a presence there now, we might be too late. A local or Chinese firm will have cornered the market."*

Stegmann acknowledges that ASEAN's consumers cannot quite be considered as a *"single market"*, and that moving into different countries requires dealing with different tastes, cultures and legal systems. *"I like to compare ASEAN to Europe rather than somewhere like the US," he explains. "It is a collection of countries with different cultures and systems. If you don't look at each country as a separate piece of a puzzle, you will fail."*

But he also points out that there are a lot of commonalities, which brings opportunities to leverage a local presence. *"If your infrastructure and supply chain are established in the region, it is much easier to expand," he says. "We found it quite simple, for example, to set up in Kuala Lumpur having already had operations in Singapore. It is important to look at markets individually but to work with a regional perspective."*

In overcoming the problems associated with operating in very different markets, Stegmann emphasizes the advantages that come from working with a local partner. Sometimes this means teaming up with an established company, as Rocket Internet has with Indosat in Indonesia. But it can also mean bringing on board a local entrepreneur.

Stegmann is clear that ASEAN's challenges should not be a reason to hold back. *"An agile approach suits this dynamic region," he says. "Instead of taking years to evaluate whether to make a big commitment to a country, we think it is better to find a local partner and act quickly. Sometimes that means failing quickly, too, but we know that if we are a success we will be in the market early and well positioned for the long term. I think bigger firms could learn from this. In ASEAN it can pay off to try something fast."*

The burgeoning middle class

Not only do ASEAN’s middle-income countries still boast relatively healthy growth prospects, they are also at an interesting stage of their development where large numbers of households are entering the middle class.

Nielsen estimates that, by 2020, around 400 million people in the region will be able to spend US\$16-100 a day – up from 190 million people in 2012. Once they reach this spending bracket, consumers are able to buy cars, televisions, and other higher-end products. They start to use financial services and their demand for healthcare services rises. They eat in restaurants and buy their groceries from modern stores. All of this brings them onto the radar of multinational companies.

“The growing middle class in Asia is increasingly demanding higher-end and better-quality products” says Dr. Au Wee Moo, Regional Director (Europe), Singapore Economic Development Board. *“Many global leaders, including German Mittelstand, have hence anchored manufacturing and research development activities in Asia.”*

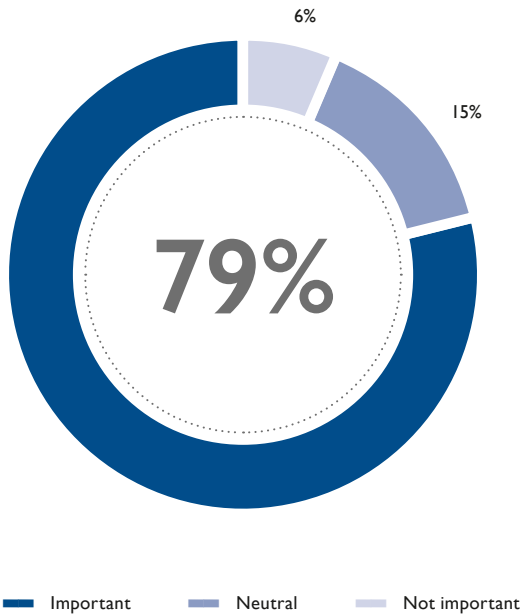
Dr. Tim Philippi, Executive Director, Singaporean-German Chamber of Commerce, is also optimistic about the growth of the middle class in the region – particularly in Singapore. *“Regarding middle class development, Singapore can be seen as role model or ‘vision’ for the whole ASEAN region,”* he says. *“The middle class in Singapore has grown steadily and is now a major contributor to the economy. Customers are consumption-oriented and aware of trends and brands. The widespread availability of the internet speeds up processes nowadays and also educates the customer. I see many opportunities for international companies to participate in the growth of the middle class in all ASEAN countries.”*

Excitement about this growing middle class comes across in our survey. Almost 80% of respondents with a business-to-consumer focus say that the rising middle class is important to their business strategy in ASEAN. And it is two industries that most rely on middle class spending – the automotive and services sectors – that feel most positive about their situation.

Expectations for middle class growth are highest for Thailand and Indonesia, with Malaysia and Vietnam not far behind. Despite their prospects for strong income growth, in Cambodia, Laos and Myanmar most of the population is still well below the middle-class income bracket.



Chart 12
How important is the growing middle class to your overall business strategy? (% respondents)



Source: AHK ASEAN/EY survey, June-July 2016

Diversity as an opportunity – and a drawback

One factor that adds to the opportunities available in ASEAN is that much of it is still relatively untapped. Only 6% of respondents to our survey say that strong competition would hold them back from increasing their engagement in the region. Obviously there are mature markets in ASEAN; Competition is particularly fierce in Singapore and the region’s other major cities. In ASEAN’s less-developed regions, meanwhile, consumer-facing companies have the opportunity to pursue different strategies.

“The typical strategy for consumer-related firms expanding into Indonesia is to do Java first,” explains Sahala T Situmorang, Partner M&A and Infrastructure Advisory, PT Ernst & Young Indonesia. *“But Java is a mature market. If you want fast growth, you can target the country’s second- and third-tier cities in outer islands like Sulawesi and Kalimantan. These are more niche, and untapped. The infrastructure is not as good, but there is also less competition. Adventurous firms can become kings in these areas.”*

The problem for companies looking to conquer the whole of ASEAN is that it still cannot be treated as a single market. In part, this is unavoidable. Linguistic and cultural differences across the region will always require companies to adapt their products for each market – just as they do in the EU, NAFTA and almost any other trade bloc – but ASEAN’s infrastructure and regulation shortcomings add to this problem.

Nevertheless, as companies such as Rocket Internet (see case study on page 33) are showing, there is clear potential in entering early to build mindshare, find strong local partners, and develop direct access to end customers. Beverage brand Asahi partnering with Indofood to enter the Indonesian market is another example of this.

Big consumer opportunities in Indonesia

Indonesia's consumer market is the largest in ASEAN, worth around US\$420bn and accounting for 40% of the region's total consumer spending. But what makes it more exciting is that it could potentially become much larger.

The IMF expects income per head to rise by around 6.5% a year over the next five years, and given the country's low level of development there is no reason why it could not keep up that pace for much longer with the right policies.

Demographics are also in the country's favor. Half of the population is under the age of 29, and the UN expects the population to hit 295 million by 2030 – up from 258 million in 2015. In our own survey, 45% of respondents say that they see good prospects for growth in the middle class. Clearly, the Indonesian consumer market warrants plenty of attention.

The trouble is that conquering Indonesia is far from simple. Claus Weidner led Mercedes-Benz to the top of the luxury-car marketplace during his time as Managing Director of Mercedes-Benz Indonesia. His advice to companies looking to break into Indonesia is to make sure they understand the market. *"It is important to do the market research,"* he says. *"The large population is attractive: firms get lured by the potential. But not all of the country is at the same level of development. In the cities, there are the very rich, the middle class and the poor. In the countryside, there generally isn't that full strata of consumers. Different regions can be culturally different. And of course the logistical difficulties are high in many regions. Companies need to work out whether they want to go countrywide, or just focus on certain areas."*

More than anything, however, Weidner cautions that patience will be needed. *"Look at the details,"* he says. *"There will be initial frustrations. Indonesia will not be a short-term win. But if you have a long-term view and take time to establish a brand, there are big opportunities in Indonesia."*

Challenging logistics

Logistical problems are a common complaint in Indonesia. They make it difficult for businesses to scale up once they have established themselves in the major cities. It helps that, of the country's 17,000 islands, the two largest, Java and Sumatra, are home to 70% of the economy. But even concentrating on those two comes with problems. *"Indonesia is a large and exciting market, but every client we work with finds it difficult,"* says Kimjin Gan, Partner, Asia Pacific Operating Model Effectiveness Leader, EY. *"It can take 12 months to get a product approved for import. The ports are often clogged due to clearance problems, which makes things especially difficult for businesses importing goods with a short shelf life. A product can be ruined by the time it gets through customs clearance."*

According to Jan Rönnfeld, Managing Director of the German-Indonesian Chamber of Commerce and Industry, the regulatory environment has been changing for the better since Joko Widodo took over as president in October 2014. *"We've seen a strong push for improvements in the past year,"* he says. *"A number of deregulation packages marked a change in direction toward making it easier to do business."*

He advises companies to look at Indonesia and ASEAN as a strategic market, rather than as a normal one. *"There are not many countries or regions left in the world that have comparable growth perspectives and a similar healthy risk-profit ratio,"* he says. *"But don't wait too long!"*

Conclusion

Making the
most of
the ASEAN
opportunity

1. How should businesses view ASEAN?

As an increasingly integrated, large and dynamic region. Although our survey shows that few companies feel the AEC 2015 is living up to expectations in terms of simplifying trade, almost half of them do say that it has increased the attractiveness of the region as a consumer market and production base – and nearly eight in ten (77%) plan to expand their business operations to other ASEAN countries within the next five years. The experts we spoke to say that this is because ASEAN is showing a commitment to integration. Deadlines may be missed, but the goal is clear and there is an understanding of the problems that must be addressed. What's more, the ASEAN Economic Community Blueprint 2025 lays out a framework for how the region intends to move forward.

ASEAN offers a large consumer market – the eighth largest in the world if it were a single country. It has proven very stable in recent years, providing sustainable growth when other emerging economies have struggled. It is notable that in our study there was not a negative shift in businesses' views of their current situations or the outlook for the next 12 months compared with a year ago, despite today's economic uncertainty in nearly every other global region. And there is every reason to think that ASEAN's solid economic outlook will hold firm, given that the region's governments have strong finances and most economies are well diversified, providing a competitive production base.

Greater integration also means that businesses are increasingly able to use ASEAN as a single production base while making the most of the region's diversity and the different opportunities offered by individual countries.

2. How should businesses organize?

To capitalize on what ASEAN has to offer, businesses will need to spread their operations across countries. The region's less-developed economies offer the potential for rapid growth and low production costs. But the logistics are more difficult than in the more developed countries, and it can be harder to find skilled labor. Getting the balance right is crucial. Each of ASEAN's markets is different and they are all changing quickly; to understand them properly, local teams of researchers and sales strategists are invaluable.

3. What should businesses expect on the ground?

Only 6% of the businesses we surveyed say that high competition is a problem in ASEAN. While that may be the case in some markets for some products, many companies are caught unaware by the need to localize products to help fight off rivals – be they domestic or from other Asian economies. As with any new market, relevant local research will be important, not least in adapting to what is typically a more relationship-driven commercial environment.

And despite ASEAN efforts, regulation still varies enormously across the region – and it is susceptible to change or interpretation. Businesses should expect initial frustrations, especially when they venture away from the most developed economies. Local partners can help to navigate these issues, but patience will be necessary for the long road to becoming a success in ASEAN.

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