



MNCs in Southeast Asia

– The view of
multinationals
in ASEAN



Contents

3 / Foreword

5 / Introduction

7 / The New ASEAN Opportunity

11 / Point of View: Shell

13 / The AEC and its Practical Implications

17 / Point of View: Caterpillar

19 / The Region's New Champions

23 / Point of View: Nestlé Indochina

25 / Point of View: Lazada Group

27 / ASEAN's Changing Taxation and Regulatory Climate

31 / Point of View: HP



33 / Strategic Corridors

35 / Point of View: DHL Express

37 / China's Commercial Shadow Looms Large

41 / Point of View: Artesyn Embedded Technologies

43 / Looking Forward

45 / About KPMG

46 / About Silk Road Associates

47 / Contact Us

KPMG and Silk Road Associates have jointly produced the publication "Multi National Corporations (MNCs) in ASEAN". MNCs were contacted and interviewed by Silk Road Associates writer, Ben Simpendorfer, ahead of the publication being developed with KPMG.

“ MULTINATIONALS ARE
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BUSINESS. ”



FOREWORD

We are virtually at the doorstep of the ASEAN Economic Community (AEC) 2015. Its creation will likely be a significant moment in Southeast Asia's history, binding - the region's commercial fortunes more tightly together than ever. When the idea of an AEC was first proposed, it - is difficult to imagine we would have come so far today. -

Yet, even as we take pride in our achievements, we must also recognise that there is still much left to be done in order to make sure the AEC is fully implemented. It is a task worth finishing as it promises to change not just the region's economic fortunes for the better, but lift the lives of the many people within ASEAN (the Association of Southeast Asia Nations).

Multinationals (MNCs) are rightly excited by the opportunity. ASEAN has long been a focus for the world's leading firms and the AEC's successes so far allow for the building of more integrated regional business. CEOs talk most positively of having more investment choices, as a result of the region's commitment to free trade and as evidenced by the fall in tariff barriers and the ongoing harmonisation of national regulations. However, those interviewed for this report

also identify areas where more work is needed, such as the dismantling of non-tariff barriers or the free movement of labour.

KPMG has also responded to the AEC and its impact on the business environment. We are operating more regionally than ever; we have more people delivering solutions across ASEAN, rather than just within in a single country; we are bringing some of the network's leading expertise to ASEAN in order to help member firm clients understand how they can make the most of the region's emerging opportunities. In this, we are behaving much the same as the world's leading multinationals, including those interviewed in this report, as we look to provide an integrated ASEAN solution.

Looking ahead, KPMG see the importance of having a national consensus on economic reform

at a time when many countries in the region are experiencing political transition. Opinion polls will go up and down over short periods. But it is critical for the region's leaders to build support for reforms that will last well beyond their own time in office; reforms that will strengthen political stability, raise living standards and leave foreign investors feeling confident about the region's future.

In sum, we are encouraged by the AEC's successes so far and excited about ASEAN's commercial future. This report offers a practical view of how multinationals are responding and we would like to thank all those who contributed, especially the executives who were interviewed for their insights.

THAM SAI CHOY

Chairman, KPMG's Asia Pacific Region
Managing Partner, KPMG in Singapore & Brunei

INTRODUCTION

ASEAN is enjoying a golden period as the region's robust growth rates and 600 million consumers capture the world's attention, and multinationals are rightly recalibrating their regional strategies.

But how should we think about the ASEAN opportunity? The prospect of a single market, as promised by the arrival of the ASEAN Economic Community (AEC) later this year, is certainly compelling. And while the AEC may still only be partially implemented, the region is now firmly on the path of greater integration. But CEOs also talk about the region's fragmentation and need for country-specific strategies.

So trying to strike a balance between local insights and regional platforms in ASEAN will be the critical challenge for multinationals over the coming years. But that's harder than it may appear as demand in the region's smaller cities expands; nimble local companies look to expand regionally; and digital technologies challenge established business practices, to name just a few of the challenges.

And that's what makes the interviews in this report so invaluable. Faced with these opportunities and challenges, CEOs from some of the world's leading multinationals have shared their insights into how to successfully execute in such a fast-changing environment; where to centralise operations and where to localise; where the AEC is likely to provide immediate gains; and where obstacles remain.

The report also follows our recently published MNCs in China report where CEOs face a different challenge as China's economy enters a period of transition. Yet there are also striking similarities around finding the right trade-off between local knowledge and global assets. ASEAN's rise has also further complicated the challenge for leadership teams trying to identify where better regional coordination is a benefit.

What then is next for multinationals in ASEAN? Leading CEOs are focused on those global and local competitors quietly taking advantage of even partial integration. These are the firms that are likely to gain first mover advantage and so capture significant market share by the time the AEC is complete. That means establishing regional teams to join the dots between countries, not just staying alert to single-market opportunities.

In short, it is an exciting time to operate in ASEAN and to take part in what promises to be one of world's most dynamic growth stories. This report offers a guide to the way forward.

BEN SIMPFENDORFER
Founder & Managing Director,
Silk Road Associates



THE NEW ASEAN OPPORTUNITY

“ FINDING REGIONALLY INTEGRATED SOLUTIONS WILL BE A DIFFERENTIATOR FOR LEADING MULTINATIONALS AND SO IT IS CRITICAL TO BUILD TEAMS LOOKING AT REGIONAL OPPORTUNITIES, RATHER THAN JUST COUNTRY-SPECIFIC. SINGAPORE REMAINS THE NATURAL HUB FOR THESE ACTIVITIES. ”

THAM SAI CHOY
CHAIRMAN, KPMG'S ASIA PACIFIC REGION
MANAGING PARTNER,
KPMG IN SINGAPORE & BRUNEI





Striking a balance between regional platforms and local insights

What does the future hold for multinationals in the ASEAN region? CEOs say they are increasingly bullish on the region's opportunities even as they recognise the challenges. ASEAN is enjoying a high-growth period at a time when China's growth rates are slowing and prices rising. The arrival of the ASEAN Economic Community (AEC) in 2015 meanwhile promises a more integrated market, and so there is good reason for multinationals to be reassessing their regional opportunities and rebalancing their investments.

There is little doubt that ASEAN's \$2,460 billion economy, similar in size to Brazil, is a compelling prospect. And yet it is an opportunity spread across ten countries, each separated by culture, language, and even ocean. The level of fragmentation leaves CEOs trying to understand where it is best to replicate a global strategy or where to localise a product or operating model. The pressure is especially acute where multinationals face competition from nimble local companies that may be closer to their

customers. For this reason, the region's fast-changing economies often defy simple data analysis. Figures on GDP, income, and population are a helpful start, but they are no guarantee of being able to execute successfully.

And so we have spoken with CEOs at some of the world's leading multinationals to understand how they are responding to emerging opportunities and challenges in the ASEAN region. Their insights offer a practical guide to grappling with ASEAN's fast-developing economies and the implications of the AEC. It is, in short, an opportunity to look beyond the numbers and to identify where business conditions are changing at the ground level.

The need to localise is one of the clearest messages from these conversations. Caterpillar's regional head talks of a lack of consistency between markets and the need to develop country-specific strategies where the opportunity is large enough; DHL Express' Regional Director for Southeast Asia notes that most of the firm's expertise sits at the country level in order to respond rapidly to changes in the local market; Nestlé's CEO for Indochina refers to the company's four sub-regional clusters that cater to the differences in ASEAN's many markets.

The pay-offs of localisation are significant in a market where income per capita can range from just \$2,000 in Laos to \$56,000 in Singapore; where single cities such as Bangkok and its nine million inhabitants has a larger population than Laos' six million; where median ages range from 23 years in the Philippines to 38 years in Thailand; and all are overseen by the region's multiple government regulators. It is understandable then that many multinationals might struggle to replicate strategies across countries.

How then is the rise of a more integrated market shaping regional strategies? The most common response from CEOs is the need to centralise functional lines and share best practice wherever possible: Artesyn's COO specifically notes how the company has moved many back office functions to the Philippines; Lazada's CEO argues the case for centralising relationships with major brand owners; HP Enterprise Services' regional General Manager talks about how firms will need to use technology more effectively.

In the end, multinationals are more likely to localise product lines, but retain regional functional lines.

In this, Singapore remains the region's functional headquarters and that will likely remain given the city's favourable business climate. But it was striking in conversations conducted for this publication that for all the growing attention on the regional opportunity, multinationals are generally more focused on developing country-specific strategies, suggesting that regional strategies are more likely to be tactical rather than all-encompassing.

The tendency to distinguish between Indonesia and the rest of the region was also striking. The country is clearly the region's giant, with its \$859 billion economy accounting for 35 percent of the region's total in 2014 and its 252 million population an even larger 40 percent. Yet, given the size of these domestic opportunities, many felt that Indonesian companies are more focused on home markets and local regulators are understandably protective of those opportunities. This in turn will likely shape the way multinationals integrate Indonesia into their regional platforms.

Meanwhile, the re-emergence of Myanmar is a popular topic, but most CEOs are generally cautious about the opportunities there and view it as a long-term play. Infrastructure and policy stability are key concerns. And that means finding the right partner or acquiring companies for their distribution networks rather than their brands. "It's still early days" is the most common remark with most CEOs seeing more accessible and larger opportunities in countries such as Indonesia and Vietnam.

Where does all this leave multinationals? The leaders are likely to be those that can strike the right balance between local insights and regional platforms; they are likely to be those that can find the right tactical regional opportunities; and they are also likely to be those that are nimble enough to keep pace with local competitors. In short, multinationals are moving into a more uncertain world in which strategies will need to be regularly adapted, but where the gains will be significant for those who get the right mix.

Significant differences in ASEAN average age

MEDIAN AGE

38.7 SINGAPORE

23.4 PHILIPPINES

29.1 ASEAN'S AVERAGE



Source: UN Population & Projection Division

KEY FIGURES

Significant differences in income per capita across ASEAN



GDP PER CAPITA

\$ 56,000

SINGAPORE

\$ 1,270

MYANMAR

\$ 3,159

ASEAN AVERAGE

Source: IMF, World Economic Outlook Database (2014 estimates)

11

LAOS

17

CAMBODIA

17

BRUNEI

60

MYANMAR

188

VIETNAM

292

PHILIPPINES

304

SINGAPORE

343

MALAYSIA

374

THAILAND

859

GDP
(USD BILLIONS)

INDONESIA

Source: International Monetary Fund, World Economic Outlook Database, October 2014

POPULATION (MILLIONS)

626

ASEAN

622

LATIN AMERICA

917

SUB-SAHARAN AFRICA



9%

OF THE WORLD'S POPULATION ARE IN ASEAN COUNTRIES

Source: UN Population & Projection Division



Mark Gainsborough is Executive Vice President – Global Commercial for Shell, one of the world's leading energy companies.

"For Shell, ASEAN has always been a big part of our business. We've been in the region for more than 100 years; in fact, next year we are celebrating our 125th anniversary in Singapore. Today, we employ 17,000 people across ASEAN and have seen employee growth rise by about 13 percent annually over the past three years," Gainsborough says. "We see the AEC as having the potential to be a real economic powerhouse with its combined population of 600 million. And so we really support the AEC's aims."

When asked where ASEAN sits with respect Shell's China strategy, Gainsborough says, "I think we have a good balance between the two. China is a growth opportunity, but so is ASEAN;

we actually have more resources in ASEAN. We tend to organise our business globally and also have strategies for each local market, especially in ASEAN where markets are heterogeneous. And so our ability to understand the different market dynamics and tailor products accordingly is key."

The preference to work globally has also impacted the company's regional organisational structure. "We don't have a regional ASEAN office. But we do use Singapore as a hub for a number of senior positions," he says. "In fact, we have deliberately based a number of our global positions in Singapore and so brought key decision makers to the region. The global integrated gas business, for instance, is based out of Singapore. Much of the global lubricants business is also based out of Singapore."

ASEAN's rapid growth and the arrival of the AEC will meanwhile influence Shell's regional business. "In the oil business, your supply chain is critical to your success. And we do think that having low trade barriers between each market is a massive advantage, so anything that

accelerates that change is a major positive," he says. Still he also notes that the region's growth is pushing Shell to invest in larger single country facilities, such as the company's lubricants facility in Indonesia, which will be the country's largest operated by an international oil company.

"The growth in ASEAN is also an opportunity for the region to broaden its energy mix," Gainsborough adds. "ASEAN will grow at twice the rate of the rest of the world over the next 20 years. And having a more efficient energy mix and more reliable supply will be a key competitive driver for the region and individual countries. We see gas in particular playing a bigger role in ASEAN, and that's why we have located our global gas business in Singapore."

When asked if he sees local competitors as a growing threat, Gainsborough says, "In the oil business, your competitors are also your partners. However, what we see are the national oil companies becoming more professional over time and they are already quite formidable competitors. In all markets, the trend is towards increased competition. But we don't overly worry about that on the basis that we are a top quality supplier with a good grip on customer needs. The most important thing is that we can compete on a level playing field."

Gainsborough also talks about the need to have a good grasp on local customer's needs and understanding when to localise the product offering or business model. "Our marketing

strategy is a mix of global and local. Like many multinationals we have increasingly globalised our business. But we perhaps put too much weight on global marketing programs and so are now looking to make sure our propositions are more tailored for the local market. What works for a customer in Singapore might not work in China. And it's critical to get the balance right," he says.

"Big data and social media have had a big impact on our retail business where we have about 9,400 outlets in ASEAN," Gainsborough says when asked about the importance of digital technologies. Social media is especially important. If you look at our Facebook presence, we have more followers in Indonesia of our lubricants business than anywhere else in the world. E-commerce is also important with 80 percent of our global lubricant orders made online, as against 20 percent five years ago. The figures are much the same for ASEAN," he says.

Meanwhile, Gainsborough has mixed views on the region's labour challenges. "For Shell, it's not a big issue though, as we are an internationally mobile and diverse workforce. We don't find it super difficult to move people around the region." He then adds that many of the company's contractors have been impacted by labour restrictions, echoing others in this report. "They are finding it more challenging to get employment permits for their staff in a number of countries with labour policies mainly driven by domestic issues."



THE AEC AND ITS PRACTICAL IMPLICATIONS

“ THE GLOBAL BANKS ARE VERY MUCH FOCUSED ON INVESTING IN RISK AND REGULATION AS WELL AS COST AND EFFICIENCY. REGIONAL BANKS ARE ALSO FOCUSING ON THESE AREAS, BUT ALSO LOOKING TO IMPROVE THEIR MULTI-CHANNEL CLIENT EXPERIENCE AND INORGANIC GROWTH STRATEGIES. ”

ANDREW TINNEY
CEO, MANAGEMENT CONSULTING,
KPMG ASEAN

The AEC has achieved much already, but there is still work to be done



There is good reason to be excited about the arrival of the ASEAN Economic Community (AEC) in 2015. CEOs talk of the AEC as providing further momentum to the region's ongoing integration, building on the already robust gains achieved by the region's Free Trade Agreements. The AEC also provides a blueprint to focus governments' attention on where reforms must be made to ensure that the region continues its progress towards a single market.

But CEOs are equally pragmatic about the complexity of the AEC. To this end, it is critical to not just outline the AEC's blueprint, but also detail how the agreement is expected to work in practice.

To start, it matters that the economic community is built on a consensus-based approach, rather than the rules-based approach that is associated with the European Community. In short, the ASEAN member states are not transferring their sovereign power to a higher authority and each has significant latitude over the extent to which they implement and enforce the AEC's rules. Not surprisingly, this creates a dilemma for governments as they balance national interest against what is good for the region's future.

In interviews conducted for this publication, CEOs talk most positively about the emergence of a single production base as tariff barriers continue to fall: average tariff rates on trade between ASEAN's six main economies are near zero percent; the rollout of an ASEAN Single Window that facilitates cargo clearance and the exchange of data between countries is another positive. Evidence of change is in the data with

intra-regional trade flows rising by \$232 billion since 2009 to account for some 24 percent of the region's total share.

However, senior executives equally worry that tariff cuts are low-hanging fruit and attention must now shift to the harder subject of non-tariff measures. In the food & beverage sector, for instance, faster alignment and stricter enforcement of regulatory frameworks would boost confidence towards the safety of imported food products. Local food & beverage brand owners could then compete more aggressively on innovation and local insight, rather than dealing with non-tariff obstacles or consumer mistrust.

Multinationals are especially cautious about the prospects for the free movement of labour. Most CEOs state that labour is still highly regulated and that, in some cases, labour restrictions are in fact tightening.

Asked whether they hoped this might change in the future, most replied in the negative. But this creates inefficiencies as companies must establish specialist teams in each country rather than a single regional team with the result that multinationals are duplicating teams across the region.

These obstacles matter a great deal in a region where skills shortages are already severe and there is a mismatch of skills between countries.



Vietnam has very good welders, for example, but by contrast, it's tough to find good welders in Malaysia and Indonesia, as noted by one of the interviewees. In the European Community, however, it is simple enough to fly Polish welders to fill skills gaps at English factories. This will not be a reality in ASEAN yet, where governments are still relatively protective of their labour markets.

There are similar modest hopes for the free movement of capital. The idea of a single regional financial market is certainly compelling; an environment in which a Thai broker might arrange deals for a Malaysian issuer funded by a Singaporean investor, for instance, would help to both lower transaction costs and raise overall liquidity. It would also support the further integration of the region's production base and the rise of truly regional players.

And yet many countries remain cautious about giving up too much ground, in part worried about their competitiveness relative to Singapore. The list of issues to be dealt with is also not small: the lack of a central tracking system; overlapping tax codes; and limited name recognition for many local financial players are all obstacles. Given the challenges, local financial institutions might instead find it easier to initially bank on their own country's corporate sector as it expands into the rest of the region.

While progress has been disappointing, multinational banks have nevertheless made the most of incremental gains. Based on our

conversations, the banks are leveraging their regional platforms and relationships with regulators to capture deal-specific opportunities. In this, multinationals have a competitive edge that may equally apply to other issues, such as non-tariff barriers or labour, as they use their regional capabilities to navigate an only partially implemented AEC.

A favourable assessment of the AEC so far is that it's still too early to tell. The fact that so much has already been achieved should be seen positively. Moreover, it would be wrong to expect too much too soon; the income disparities between the member states will remain a strong incentive to protect certain industries, meaning that the AEC will likely only be fully implemented at a pace consistent with the region's economic development and the narrowing of growth gaps. In short, 2015 is just a beginning.

The pace of change will also likely accelerate once local companies, especially mid-sized companies, see the benefit of regional integration and lobby their governments for deeper reform.

What's holding these companies back? Most local companies are simply unaware of the AEC and its commercial implications. The experience of course differs by country with many large-sized corporates in Malaysia, Singapore, and Thailand well advanced in their AEC strategies. But the intensity of debate is seen as generally relatively low. This is a gap multinationals can fill by encouraging ASEAN partners, especially critical local suppliers, to develop regional strategies.

KEY FIGURES

44%
ARE
AWARE
OF AEC

ASEAN firms
are more
aware of the
region's FTA
with China
than the AEC

67%
ARE AWARE OF THE REGION'S
FTA WITH CHINA

Source: Institute for Southeast Asian Studies (2012)

ASEAN
received
more FDI
than China
in 2013

FDI INFLOW
(USD BILLIONS)
124 CHINA
125 ASEAN

Source: UNCTAD

Japan invests
twice as much
in ASEAN
relative to
China

JAPAN OUTBOUND FDI
(USD BILLIONS)
9 CHINA
23 ASEAN

Source: JETRO

INTRA-ASEAN EXPORTS (PERCENT SHARE OF TOTAL)



49
MYANMAR

48
LAOS

31
SINGAPORE

28
MALAYSIA

26
THAILAND

23
BRUNEI

22
INDONESIA

16
PHILIPPINES

14
CAMBODIA

14
VIETNAM

Source: ASEAN Merchandise Trade Statistics Database compiled by Association of Southeast Asian Nations



Steve Lancot is Regional Manager, ASEAN and India for Caterpillar, the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives.

The company principally operates through its three product segments - Construction Industries, Resource Industries and Energy & Transportation - and also provides financing and related services through its Financial Products segment.

Lancot has a unique perspective on the AEC having previously worked in Europe during the creation of the EU and the arrival of the euro.

"It was such a big deal at the time. Everyone was talking about it and everyone had an opinion," he recalls. "I don't see that same level of engagement for the AEC. There are some exceptions, of course. I've met many Thai business leaders, for instance, who are genuinely excited about the AEC and are making specific business plans for it. But I'm not seeing that same level of enthusiasm in other parts of the region."

"Unless we see every country embracing the spirit of an ASEAN FTA, I don't think the AEC can achieve the same level of success as the EC. For instance we are seeing some Nationalistic policies such as requiring domestic content and this goes against the grain of an FTA. We are also hearing about situations in at least one market where end users are almost being forced to purchase locally made products where possible."

Lancot has particularly strong views on the potential benefits of labour mobility that should result from stronger economic integration. "Free movement of labour as required by the EU had the biggest impact on our business in Europe," he

“ UNLESS WE SEE EVERY COUNTRY EMBRACING THE SPIRIT OF AN ASEAN FTA, I DON'T THINK THE AEC CAN ACHIEVE THE SAME LEVEL OF SUCCESS AS THE EC. FOR INSTANCE WE ARE SEEING SOME NATIONALISTIC POLICIES SUCH AS REQUIRING DOMESTIC CONTENT AND THIS GOES AGAINST THE GRAIN OF AN FTA. ”

STEVE LANCTOT
REGIONAL MANAGER ASEAN AND INDIA, CATERPILLAR

recalls. “Take the northern U.K., for instance. There was a good supply of skilled local labour. But when we did suffer a shortage, we were able to tap the supply of Polish labour, especially welders. That allowed us to flex through the cycles. It's not an insignificant advantage.”

“It should be a similar story in ASEAN,” he continues. “Vietnam has very good heavy welders, for example. By contrast, while it's tough to find good welders in Malaysia and Indonesia, you do find good machinists.”

Yet, while Lanctot argues that labour stability has improved, he adds that there is still some way to go. “Caterpillar still faces challenges renewing work visas for our expatriate workers in some places, it should not so difficult to move talent around.”

Caterpillar meanwhile has a regional ASEAN strategy, but with a focus on specific parts of the business. “We exchange best practices between countries all the time,” Lanctot explains. “But it's more in terms of operational efficiencies, which can be similar from one place to another. For example, we have been heavily focused on China for the past 10-15 years and so have learnt a great deal, such as in terms of distribution development. We have since replicated many of the same lessons to our operations in India and even Thailand.”

He continues “We manage Asia-Pacific Distribution as one large organisation, based in Singapore. Asia-Pacific is then divided up into four regions, specifically China, Japan, Australia & New Zealand, and ASEAN & India, and I am regularly meeting

with my peers around the same table where there is a chance to share experiences. We also have a conference in the United States each year at which the entire region is represented and we spend two days sharing best practices.”

But Lanctot also cautions on the benefits of relying solely on a regional or global strategy to drive growth. “We aren't finding a lot of consistency across the individual ASEAN markets and so are having to develop country-specific strategies, especially where the market opportunity is significant enough, such as in Indonesia and India.”

Lanctot meanwhile talks of more visible Chinese competition in the region. “There's certainly more of them and they are getting better. Their product has improved. Their distribution has improved. Their understanding of markets has improved. However, in most products, they aren't quite in the same league. Perhaps the biggest impact is to our rental fleet, which are typically two to three-year-old machines; some customers might use a new Chinese machine over these older rental roll-out units.”

However, Lanctot emphasises that the company's Chinese competitors are very much focused on a different trade-off between price and performance with prices still generally low. “They are not yet able to offer our life-cycle cost proposition and are instead still very much focused on selling at a low price. They also have to work hard at improving their after-sales service support, such as their parts distribution. They will improve though over time. They clearly have the ambition.”

THE REGION'S NEW CHAMPIONS

“ THE AEC WILL CHANGE PHILIPPINE COMPANIES' APPROACH TO DOING BUSINESS IN THE REGION. PHILIPPINE COMPANIES, FLUSH WITH CASH AND BENEFITTING FROM A LIQUID CAPITAL MARKET, ARE LOOKING FURTHER AFIELD TO EXPAND THEIR PORTFOLIOS. IN THE LOCAL SCENE INFRASTRUCTURE, ENERGY, CONSUMER MARKETS, AND THE FINANCIAL SECTOR PRESENT MANY OPPORTUNITIES FOR OUR MULTINATIONAL CLIENTS TO POTENTIALLY BENEFIT FROM THE PHILIPPINES' GROWING ECONOMY. ”

EMMANUEL BONOAN
HEAD OF MARKETS & TAX,
KPMG IN THE PHILIPPINES





A more integrated ASEAN will result in stronger local competitors

Whether because of ASEAN's economic rise or the arrival of the AEC, new regional players are emerging to compete with foreign incumbents. The ASEAN region accounts for a little more than one quarter of Asia's biggest global companies with the largest share in Malaysia, Singapore, and Thailand, but this share is expected to grow as regional champions take advantage of opportunities to build out large regional platforms even as multinationals seek to consolidate their own gains.

In our conversations, CEOs are clearly aware that tomorrow's competitors are most likely to be local. And responding to that challenge is a key part of strategic long-term planning.

CEOs are most impressed by the speed at which nimble local competitors are responding to fast-changing markets. Family-owned businesses in particular have the capacity to change their strategic focus rapidly. They are often closer to their customers and spot emerging trends early. Nestlé's Chairman & CEO for Indochina argues that competition in the FMCG sector will intensify around who best understands the local consumers and that this process will inevitably make regional companies more competitive.

But can local companies translate that agility to the regional stage? Those surveyed for this report argue that leading local companies are already building regional businesses: Thai retail conglomerates in Vietnam; Malaysian banking groups in Indonesia; and Singaporean property developers in the Philippines, to name just a few. For those firms, their ability to spot emerging opportunities and their understanding of local markets is a key reason for success.

And yet it is not a new trend. In our conversations conducted for this publication, CEOs argued that this select group of leading local companies has been building regional businesses for many years irrespective of the AEC. Indeed, many are operating globally and investing in even bigger deals in China, Europe, the United States, and Latin America.

Moreover, other local companies often find opportunities in their national markets more compelling. Indeed, many interviewed for this report noted a lack of awareness among mid-sized companies about opportunities elsewhere in ASEAN and those specifically related to the AEC. They also noted a tendency for local capital



to stick close to home markets where companies believe they have the strongest competitive advantage, especially in sectors where ties to the local establishment are important.

To this end, the biggest impact of the AEC may yet be psychological.

By raising awareness among mid-sized companies towards their regional opportunities, the AEC could encourage some to expand gradually into neighbouring markets.

But this is a slow process and unlikely to result in new regional champions overnight. That means multinationals should focus more on their country-specific competitors, in addition to the current list of regional names.

Nevertheless, our interviews indicated a number of areas where local companies may yet surprise, taking advantage of incremental changes resulting from the AEC.

For a start, some argued that local mid-sized suppliers will quietly expand regionally alongside their multinational clients. The Japanese auto sector is a popularly cited example with mid-sized Thai suppliers looking to follow their Japanese partners into neighbouring low-cost countries, such as Vietnam. There is also a widely-shared view that mid-sized local suppliers to internationally competitive sectors, such as the auto sector, tend to more aware of the AEC.

There are also financial players looking to build regional businesses. Private equity funds, for instance, are acquiring small-sized companies across multiple countries to create a single

regional company. In many cases, they are taking advantage of multinationals wanting to divest non-core assets. In this, the private equity funds are acting as a bridge for the aggregation of ASEAN's many small-sized businesses into sizes that are attractive to regional players.

Indeed, this ability to stitch together five or 10 companies across multiple geographies will be a clear differentiator in the coming years and perhaps why many firms have been slow to move.

The online sector may also provide surprises as local brand owners are able to tap regional markets without having to invest in physical stores or traditional media. Lazada's CEO talks of how a respectable share of the company's business is driven by such local brand owners, many operating in smaller cities and hoping to reach a larger regional audience. Just consider the opportunities for a furniture manufacturer and brand owner in Sumatra once selling to clients within a 100 kilometre radius but now able to sell to Malaysia.

How are multinationals responding? The challenge is that large organisations may be less nimble than their local competitors and more influenced by the global boardroom than local dynamics. The key will be making use of global platforms to draw on best practices and products from around the region and world. And in our conversations, many CEOs specifically cited the proven ability of multinationals to manage businesses across multiple countries as being a major competitive advantage.

"The key is matching global learnings with local insights," noted one of our interviewees. And striking this balance in ASEAN's fragmented markets will be critical for multinationals facing greater local competition.

KEY FIGURES

TOP 100 NON-FINANCIAL MNCs FROM DEVELOPING AND TRANSITION ECONOMIES (RANKED BY FOREIGN ASSETS)

12

CHINA

6

KOREA

7

INDIA

18

HONG KONG

10

TAIWAN

14

ASEAN

Source: UNCTAD



Wayne England is Thailand-based Chairman & CEO for Nestlé Indochina, a division of the global food and beverage company with 15,000 employees in ASEAN and 330,000 globally.

England expects Nestlé to enjoy strong growth as a result of the AEC. However, he also emphasises the importance of pushing ahead with further market integration. "We are seeing greater competition within sectors and that will fuel future growth prospects for ASEAN as a whole. However, there is always the risk that people turn more protective as they start to feel the effects of such internal competition, so it is critical for the region to view competition as healthy and level playing fields as beneficial to growth."

When asked where he would like to see change, England says, "There are only limited opportunities for tariff reductions, as tariffs are already low. Instead, we would like to encourage a faster alignment of regulatory frameworks among ASEAN countries as well as a reduction of non-tariff measures. These are important to trade facilitation. Having a consumer-centric regulatory framework, strictly enforced, will also benefit consumers and companies. Confidence on issues like food safety will grow and fuel further economic activity."

England explains that with aligned regulations combined with good enforcement, countries will feel more confident about moving their investments across borders. "There are countries that will benefit from regulatory advancements by having better food-safety regulations and increasingly compliant and strong governance systems in societies," he says. The end result is that sustainable and value-adding competition will intensify around who best understands the local consumers. This is where the regional players will become more competitive," he adds.

“ THAILAND’S LOCATION AND DEVELOPED LOGISTICS NETWORKS MEAN MULTINATIONALS BASED IN THE COUNTRY ARE IN A POSITION TO USE THAILAND AS A HUB WHEN EXPANDING INTO NEARBY COUNTRIES. ”

KAISRI NUENGSIKAIPIAN
CEO,
KPMG IN THAILAND

The fact that Nestlé has a 120-year history in the Indochina region means the company is a ‘local player’. But that also requires balancing a global platform with local insight. “It’s not about being local versus global. All our activities are based on local insights as a result of our local research and local partnerships,” England says. “However, the key is matching global learnings and leveraging global strategies with local insights and execution. There is always the risk that large multinationals struggle to remain nimble in complex markets, such as those in ASEAN.”

He continues, “Local firms are certainly becoming much more competitive. They might be offering a unique product, or expanding regionally, or even doing both. They sometimes also have different, more entrepreneurial, KPI’s and greater agility responding to environment shifts,” he says. “Competitors in general have greater access to off-the-shelf technologies, which together with the rapid spread of digitally shared information, sees barriers to entry reduced and a narrowing of the competitive gap between global and local players. For this reason, increasing big innovations is becoming more important to drive growth in ASEAN.”

“There’s definitely a strength being a global player and leveraging your global technology, product platforms, and scale. But you need to stay nimble. You can’t just cut and paste, finishing the job with local insight and strong capabilities in execution is critical,” England adds. “At Nestlé, we are committed to our global strategy in ASEAN. However, we emphasise different elements of that strategy depending on the region with an aim to delight consumers in all localities and create shared value in each country of operation. For instance, Nescafé doesn’t taste the same in every country in ASEAN.”

How does the need to remain nimble impact your organisational structure? “We have four ASEAN clusters and each cluster reports directly to an Executive Vice President responsible for the Zone of Asia, Africa, and Oceania, in Switzerland. The Head of the Zone, with the Cluster Market Heads, is assisted by an ASEAN-focused regional assistant who travels extensively in the ASEAN region which enables Nestlé to execute globally aligned strategies effectively in ASEAN,” says England. “My own cluster includes Myanmar, Thailand, Cambodia, Laos, and Vietnam, the core of the Greater Mekong. The other three clusters are Malaysia /Singapore, Indonesia, and the Philippines.”

England also talks about emerging clusters. He predicts trade flows between southern China and the Greater Mekong region will expand. “It’s still an informal conversation we’re having around the subject, but the regions are important to each other, especially as Myanmar returns to the game. I imagine a lot of people will also take it more seriously once Myanmar holds elections and we have greater clarity on the country’s investment environment.”

Finally, England comments on how the region’s rising domestic demand will impact distribution models. “The change in models depends on the advancement and connectivity of trade infrastructure, economy of scale, ability to establish a network of relevant hubs – all of these will help improve the efficiency in the value chain of goods. Rising domestic demand will certainly help attract investment in these areas. The demand, completion, and mobility of skilled and unskilled labour will also intensify and pace change within clusters and for ASEAN as a region.”



Max Bittner is CEO of Lazada Group, Southeast Asia's leading online shopping mall, with operations in Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, and offices in Hong Kong, Korea, and Russia.

Lazada was created in 2012 by Rocket Internet, a Berlin-based investor and incubator. Lazada has since raised more than \$600m from investors including Tesco and Temasek with Rocket still holding a minority stake. Lazada has now established itself as the leading online destination site across Southeast Asia for customers and brands.

How do you balance the need to localise your product offering with your regional capabilities? "Lazada's success as a one-stop online shopping mall in Southeast Asia has been due to our ability to give consumers in each market access to the widest range of international and local brands. We are able to achieve this because we have local operations and teams on-the-ground. Our teams are integrated into the local landscape and close to the consumers and brands," says Max.

"Regionally, we offer 13 product categories, ranging from health and beauty to fashion, computers, home appliances, watches, and toys, among many others. Within each market, our product assortments are matched to local consumer demands and culture. We also tweak product promotions to cater to festival shopping demands such as Christmas and Ramadan."

Lazada is also tapping into the region's growing number of local brand owners. "Local brands account for a big part of our product offering with share varying by country," says Max. A local brand could be a furniture maker based in a small city in Sumatra, Indonesia, to an Android phone

manufacturer in Manila, the Philippines. The cost and complexity of shipping and customs tend to be prohibitive for intra-regional trade; however this also makes AEC a big future opportunity."

"But we also try to centralise our operations wherever possible, especially where we find synergies between markets, for functions such as back office, IT, and marketing."

"More significantly, we centralise our relationships with our biggest brand owners. These brands see Southeast Asia as an exciting but fragmented opportunity, and our value is the ability to provide them with simple, fast, and direct access to 600 million consumers across six countries through one retail channel. We are solving the challenge for the brand owners and enterprising suppliers to tap the Southeast Asia e-commerce opportunity."

In spite of the company's regional presence, the differences between Lazada's customers by nationality is less than might be popularly perceived. "Apart from some minor differences, we generally find consumers are very similar. Many are part of the burgeoning middle class who are using their disposable income to buy their first discretionary item, such as a mobile phone," Max says.

"The difference is in the consumer choice of products within a category, mainly because of income disparity. In Vietnam, for instance, consumers will buy mobile phones that have on average lower price points than of those sold in Malaysia."

He adds, "There are also differences in the way consumers make their purchase decision. Malaysian consumers are more transactional and seek the best deals, while Indonesian consumers are more social and read product reviews on social media."

"With an on-the-ground understanding of what our consumers want, we are in a strong position to be the best matchmakers for the brands and the consumers."

Payment is among the more challenging processes to centralise and Lazada has unique insights into how to manage the process. "We offer a wide spectrum of payment methods across the region and get the right payment solutions in each market to make the shopping experience easy for our consumers."

"We have the same payment toolbox across the region, with each market choosing a different mix of tools. In Vietnam and Thailand, it's predominantly cash-on-delivery while in Indonesia, it's offline bank transfers."

When asked how the competitive landscape may change in the coming years, Max says, "It has not been easy, particularly for local players, to build regional scale where there's also a scarcity of capital and talent. However, I expect this to change as the extent of the opportunity becomes simply undeniable."

"Our strategy to keep our lead is to continue investing in the building blocks of our e-commerce business -- logistics infrastructure, IT systems, and payment solutions."

Max also has strong views on China's role in Lazada's business. "From our sourcing hub in Hong Kong and Shenzhen, we have spent the past two years recruiting merchants and sourcing products in China for sale on our marketplace platforms in Southeast Asia."

"I would say there's still supply imbalance in Southeast Asia and the opportunity remains huge to fill this gap. Hence, China will continue to be play a strategic role as a supply base to our Southeast Asia online shopping business," he concludes.



ASEAN'S CHANGING TAXATION AND REGULATORY CLIMATE

“YOUR STRATEGY NEEDS TO CONSIDER VIETNAM'S YOUNGER LABOUR FORCE AND NEWER FACILITIES AS A MORE EFFICIENT MEANS OF PRODUCING FOR THE ENTIRE REGION. BUT BE AWARE OF A DEVELOPED LOGISTICS INFRASTRUCTURE AND THE STRONG STANCE OF LOCAL TAX AUTHORITIES.”

WARRICK CLEINE
CHAIRMAN & CEO,
KPMG IN VIETNAM & CAMBODIA



It is critical for MNCs to take a more strategic approach to the region

It is little surprise that in a region with 10 countries, taxation and regulations are major issues for regional businesses. CEOs share widely divergent experiences depending on their industry and geographical focus. But change is happening fast and not always in a predictable manner as governments jostle for position ahead of the AEC's introduction. The fact that eight countries have a GDP per capita of less than \$15,000 also means governments are keenly aware of how taxation and regulations impact domestic social priorities.

Taxation is not included as part of the AEC framework, but it is nevertheless fiercely contested, as the region's governments look to attract foreign investment. The average corporate tax rate is currently 24 percent, ranging from 17 percent in Singapore to 30 percent in the Philippines, and will likely converge at around 20 percent judging by similar developments in the European Union. This coupled with a variety

of tax holidays, specific tax incentives, and international treaties on double taxation will be transformative.

It also suggests that taxes must rise elsewhere to compensate for the erosion of national tax bases. And given the region's rising middle class and its growing spending power, governments may be tempted to hike indirect taxes, such as VAT. While lower corporate taxes are a benefit to companies, there are risks should consumers change their spending patterns in response to rising taxes on middle-class goods and services, such as substituting foreign brands for cheaper local products.

Multinationals must respond strategically to these developments as they look to locate parts of their value chain in the most advantageous regions, whether that means a factory in Vietnam, shared services in Malaysia, or a regional headquarters in Singapore. Indeed, changes in taxation may be a source of greater immediate opportunity than the AEC, especially should governments seek to compensate for falling tax revenues by stalling on reforms in more sensitive areas, such as those tied to agriculture or services.

“ IT’S GENERALLY A GREAT TIME TO ACCUMULATE A PLATFORM. HOWEVER, MULTINATIONALS OFTEN LACK THE CAPACITY TO TRANSACT MULTIPLE SINGLE-COUNTRY DEALS. PRIVATE EQUITY WILL STEP INTO THE GAP AS THEY ROLL UP SMALL SINGLE COUNTRY FIRMS INTO A REGIONAL PLATFORM COMPANY. ”

ANDREW THOMPSON
ASIA PACIFIC HEAD OF PRIVATE EQUITY,
KPMG

Tax efficiencies are especially relevant for the supply chain. In the ASEAN region, supply chains are often overly complex, as companies have segmented their market by country, city, and even customer depending on national regulations. But the approach has only added to overall costs. And while the AEC will not be implemented overnight, even incremental regulatory change will allow regional players to find new efficiencies, especially for companies producing in multiple locations and selling across the region.

These efficiencies are not limited to ASEAN. The region’s FTA with China offers multinationals opportunities to further align their local production with their regional production capacity. For instance, where a company might be producing fruit juice for sale across the region, the opportunities to consolidate production in a single country and so tap on a nearly two billion-person market is compelling, especially as companies are increasingly producing for local sale rather than export.

Meanwhile, the fact that laws and business regulations are not yet fully harmonised is a major obstacle to regional integration. The specific challenges differ widely by industry and company.

CEOs talk of Indonesia as a huge opportunity, for instance, but the country has made slower progress towards standardising complex laws and regulations as required by the AEC framework, with those related to land and foreign ownership cited as particular issues. Labour permits are another key concern with some CEOs arguing that the challenges of hiring foreign professionals in these markets, including C-level managers, have intensified over the past years.

How to explain the different stances? Many interviewed for this report explained the difference as driven by national interest. Indonesia has more to lose than gain given the country’s large domestic market and still maturing industries, so is more resistant to opening up. Singapore has much to gain and so has been a strong proponent of the AEC.

Thailand lies in the middle, recognising the risks of greater foreign participation, but also the opportunities to position Bangkok as a hub for the Greater Mekong.

The commitment to non-discrimination is a particularly critical test of each country’s national interest. The agreement as detailed by the ASEAN Comprehensive Investment Agreement (ACIA) allows for stronger foreign investor protection and non-discrimination. This taken together with the agreement to allow ASEAN investors to own up to 70 percent of a service-related business in another ASEAN country is already proving a major challenge for governments where they are concerned about the impact on local business.

And therein lies the greatest risk for the idea of an integrated market with CEOs generally worried that governments will turn more protectionist should greater integration result in job losses.

It’s no wonder that multinationals continue to rely on different business models for each of the region’s countries. As indicated in Issue 18 of KPMG’s ConsumerCurrents Magazine, brand owners are still relying on local partners with their local consumer insights and, critically, ability to navigate local regulations. And the region’s integration isn’t going to change the importance of such partners overnight. Indeed, to judge by China’s experience and our latest MNCs in China report, local partners may become more important, not less.

Nevertheless, this combination of lower taxation and mixed progress on regulatory harmonisation offers opportunities for multinationals to optimise their regional operations. CEOs argue that multinationals are more familiar in dealing with multiple authorities and so more capable in finding efficient ways to navigate such complexities. In this, the simple fact that taxation and regulatory policies are changing rapidly should be seen as a reason to act even if achieving regional integration will take longer than planned.

Softcopy of KPMG’s ConsumerCurrents Magazine, Issue 18 is available online

KEY FIGURES

EASE OF DOING BUSINESS (GLOBAL RANKING AMONG 189 COUNTRIES)



	GLOBAL RANKING	TRADING ACROSS BORDERS RANKING
SINGAPORE	1	1
MALAYSIA	18	11
THAILAND	26	36
VIETNAM	78	75
PHILIPPINES	95	65
BRUNEI	101	46
INDONESIA	114	62
CAMBODIA	135	124
LAOS	148	156
MYANMAR	177	103
CHINA	90	98

Source: World Bank

2015 CORPORATE TAX RATES (PERCENT)



25

CHINA

34

INDIA

24

ASEAN

20

CAMBODIA

25

INDONESIA

24

LAOS

25

MALAYSIA

25

MYANMAR

30

PHILIPPINES

17

SINGAPORE

20

THAILAND

22

VIETNAM

Source: Singapore Tax Facts 2015 - Corporate Tax



Sandeep Bhargava is General Manager, Southeast Asia and Taiwan, for HP Enterprise Services, one of the largest global providers of infrastructure, applications, and business process services to more than 1,000 clients in 90 countries, including all 10 ASEAN members.

Looking forward, ASEAN will be a key focus for HP Enterprise Services as it helps businesses and governments to drive value in their technology investments and overcome the challenges involved in managing dynamic data centers and

updating existing applications, says Bhargava. "Looking at the ASEAN region over a three-year timeframe, we expect to meet, if not exceed, our commercial expectations during this time. Our strategy is to help organisations in the region to cross the bridge from traditional IT to new, more effective ways of using technology - a 'New Style of IT' for businesses - so they can better serve their customers and citizens," he says.

HP Enterprise Services has meanwhile developed a nuanced approach for engaging strategically with the ASEAN region. "As one of the largest global players in the enterprise services sector, we have a multi-layered strategy. Our ASEAN management team is largely based in Singapore, and works closely with our Asia Pacific leadership, most of whom are also based in this location."

"However, as our presence in certain countries has expanded in recent years, and continues to do so, we have put in place local management teams in specific markets, such as Thailand and the Philippines. This trend is likely to continue,

“ALONG WITH MANY OTHER COMPANIES OPERATING IN ASEAN, OUR HOPE IS THAT REGIONAL ECONOMIC INTEGRATION COULD FACILITATE INCREASED TRADE BETWEEN COUNTRIES WITHIN THIS BLOC. THIS WILL HAVE A POSITIVE IMPACT ON COMPANIES FOCUSED ON INTERNATIONAL TRADE, WHICH IS LIKELY TO LEAD TO A GREATER EMPHASIS ON ENHANCED ENTERPRISE SERVICES.”

SANDEEP BHARGAVA
GENERAL MANAGER SOUTHEAST ASIA AND TAIWAN FOR HP ENTERPRISE SERVICES

based on further growth in individual countries,” he says.

The emergence of digital technologies and e-commerce applications looks set to continue as an ongoing trend in the ASEAN countries. When asked about the potential impact on HP’s operations in ASEAN over the coming two to three years, Bhargava says “These trends have already affected the way our clients address their businesses. Our role is to help our clients navigate these changes and take advantages of the opportunities that they raise.”

“E-commerce is well established in ASEAN and digital technologies are also becoming more advanced, especially in countries such as Indonesia. Big data, however, is still at a relatively early phase and we find that our clients, in ASEAN and elsewhere, are looking to harness big data by analysing social media sentiment or using social media ‘listening’ tools. Again, our role is to advise organisations on how to capitalise on these trends,” says Bhargava.

Bhargava meanwhile points to regulatory change as a key challenge for customers in ASEAN over the coming few years. “Regulatory systems, especially those governing technology companies, vary country by country, and it’s essential for us to remain wholly compliant with changing regulatory infrastructures, especially in the larger, fast evolving markets, such as Indonesia and the Philippines.”

“Along with many other companies operating in ASEAN, our hope is that regional economic integration could facilitate increased trade between countries within this bloc. This will have

a positive impact on companies focused on international trade, which is likely to lead to a greater emphasis on enhanced enterprise services. This is where we hope to capitalise,” says Bhargava.

Bhargava also highlights some potential IT challenges for HP Enterprise Services’ customers over the remainder of 2015 and beyond. “One major barrier to success that we see in many organisations are legacy IT systems and disconnect between the IT department and those leading the customer experience. This can lead to significant roadblocks.”

“There has to be a merging of minds across the C-suite with IT professionals learning to speak the language of those in charge of customer experience. Rather than recruiting staff simply to maintain IT systems, CIOs need to be considering skills beyond IT expertise, and thinking about hiring professionals based on their ability to contribute in an agile environment,” he says.

When asked about the potential difficulties of hiring personnel in key ASEAN markets, Bhargava says “Developments like cloud, security, big data, mobility, and social networking are not only causing disruptions in the consumer space, they are also affecting business models.

Our need is for personnel who can advise our clients on how to manage enterprise IT landscapes and who are familiar with these trends. We are working closely with our country management teams in our key markets, such as Indonesia, Vietnam, and the Philippines, to recruit executives with the right skillset to support our projected growth plans.”

An aerial photograph of a city skyline, featuring a prominent dark glass skyscraper with the 'BCA' logo on its side. The building is surrounded by other high-rise structures and a dense urban landscape with lower residential buildings and greenery. The sky is blue with some clouds. Large, semi-transparent blue geometric shapes are overlaid on the top left and right sides of the image, framing the text.

STRATEGIC CORRIDORS

“ NAVIGATING ENTRY TO THESE
PROMISING MARKETS CAN BE
DIFFICULT FOR COMPANIES OF ALL SIZES,
AS HGM CHALLENGES AND RISKS
ARE BECOMING MORE COMPLEX
THAN EVER BEFORE. ”

MARK BARNES
GLOBAL HEAD OF HIGH GROWTH MARKETS,
KPMG IN THE UNITED STATES



MARK BARNES
GLOBAL HEAD OF HIGH GROWTH
MARKETS,
KPMG IN THE UNITED STATES

There has been a significant shift in the balance of economic power from mature markets to high growth emerging markets. We have seen this shift become an integral part of organisations' strategy for achieving profitable growth.

KPMG's 2014 survey of 100 senior U.S. business executives shows that high growth markets (HGMs) are now at the top of the corporate agenda, with an overwhelming majority, 84 percent, indicating that HGMs are important to their company's strategy and growth, an increase of 37 points from the previous year. Another significant majority, 83 percent, cited geographic expansion as the top investment area over the next 12 months.

Executives are also looking to a broader range of HGMs than ever before. Executives are realising that they must enter new frontier markets now or risk being left out of the economic gains. There is an increasing appetite to invest in the dynamic economies of the Association of Southeast Asian Nations (ASEAN) such as Indonesia, Malaysia, and Myanmar as well as other frontier markets across the globe.

However, navigating entry to these promising markets can be difficult for companies of all sizes, as HGM challenges and risks are becoming more complex than ever before. Our survey showed that cultural challenges, infrastructure problems, strong government influence, bribery and corruption, vague and changing regulations, are all significant barriers to success in these markets.

Savvy companies have developed strategies to navigate and overcome these HGM challenges, and have identified top drivers of success for operating in HGM countries. These include cultural adeptness, blending local and head office leadership, adapting the business model, focusing on talent acquisition and retention and other success features.

Softcopy of HGM Outlook survey is available on the internet



Yasmin Aladad Khan is Regional Director of Southeast Asia and South Asia for DHL Express, the international express freight company with 21,000 employees in the Asia Pacific region and 77,000 globally.

Khan has responsibility for Southeast Asia and South Asian countries and so has unique insights into multinationals and their regional supply chain strategies. "We do have customers who are developing ASEAN strategies in response to the AEC. However, most customers have been working on their regional strategies for years, well before the AEC. It is the growing strength of the ASEAN economies that is really driving strategic planning, rather than regionalisation efforts such as the AEC."

Khan points to customs barriers as one of the obstacles to full regionalisation. "It's still challenging to move goods across borders, as customs procedures are complex and vary greatly between ASEAN countries. So we continue to work closely with local governments to help them simplify and harmonise procedures. The ASEAN single window is an example where some countries have made gains, but there is still much to be done. Having a single window would ultimately benefit the region's SMEs as they could submit documents in a more simplified and efficient way. DHL actively works with governments and customs administrations across the region, sharing best practices and supporting reform. For example, we recently held a workshop with senior Myanmar officials sharing our experiences on trade facilitation from other parts of the globe. Our local and global knowledge as trade facilitator is unsurpassed, so we feel we can work closely with governments as a thought leader."

"We really want to see more effective implementation on the ground." There needs to be a mechanism to address outstanding issues in

the event that the region's governments don't live up to their commitments. It's of course important for the big multinationals, but the region also needs to understand that the primary benefits of harmonisation of rules and procedures for trading between countries are for SMEs. If governments can make these changes, then ASEAN will really stand out as a cohesive regional bloc."

Khan views the region's lowest-cost countries as being the most progressive in implementing the agreements liberalising trade and investment so far, albeit facing capacity constraints in other areas. "I've seen Cambodia, Laos, and Vietnam as the most progressive reformers which are more open to international trade and more welcoming of foreign investment. These countries ultimately believe that a high level of foreign investment will help boost their economic growth and competitiveness, and so they are more willing to liberalise trade and investment regimes."

The growth of e-commerce is meanwhile also shaping DHL's regional business. "For us, much depends on the capability of the region's SMEs to trade regionally, rather than just domestically, so we are investing a lot of time to help them venture abroad. We are also tying up with local logistics players, especially in the region's more remote areas where we don't have an extensive presence, and so we work with local postal agencies to enable delivery. I would imagine we will start to see more opportunities in these more remote areas as the e-commerce business expands."

ASEAN's SMEs are clearly a significant long-term opportunity, but Khan also points to the rise of the region's own multinationals as a more immediate opportunity for companies such as DHL.

"We call them regional nationals – that's where we see real opportunities for growth. Malaysian banks, such as CIMB, are good examples, as they look to expand across ASEAN. Companies within the food and beverage industry are where we also see opportunity for partnership, with emerging regional nationals such as Jollibee and F&N."

Khan also has talks about striking a balance between the company's global, regional, and country specific strategies. "At DHL Express, we have a relatively flat structure. My regional team members are mainly in HR and finance. Most of our expertise sits at the country level. That's important if we are going to respond rapidly to changes in the local market. However, our service quality is the same globally, as we apply global standard operating processes in every country. With standardisation and global best practices in place, that's how we win customers," she explains.

Khan meanwhile observes how China's rising costs have had an impact on regional trade flows. "Vietnam is the biggest beneficiary of low-end manufacturing leaving China. We see also see a lot of activity in Myanmar. We aren't seeing the same level of activity in Indonesia, although it's likely only a matter of time. For instance, a growing number of textile and garment manufacturers are moving outside of Jakarta into other lower-cost areas like Semarang in Central Java in order to reduce their costs," she says.

"The change is coming slowly," says Khan when asked about the threat from local competitors. There are certainly a number of local logistics companies emerging, but we also have slightly different target groups for our services, considering our global network ensuring connections to over 220 countries and territories," Khan says. And what about the threat from Chinese competitors? "We've not seen much in the way of Chinese logistics companies. There has been some activity in Malaysia, but for the most part they have not been very aggressive in our markets."

DHL has meanwhile faced fewer labour challenges than some companies. "Our retention rate is relatively stable across almost all countries. That said, in the fast emerging markets like Myanmar, competition for labour is fierce," Khan says. "It helps that we train our employees to raise their standards to international levels; whether you are a courier or senior manager there's an opportunity to earn international certification and develop your career. We also reinforce the importance of balancing achieving results with respect for others. That's something we share and communicate actively with our people."



CHINA'S COMMERCIAL SHADOW LOOMS LARGE

“ MNCS WILL CONTINUE TO INVEST
IN BOTH CHINA AND ASEAN OVER THE
LONG TERM. THE CHALLENGE FOR CEOS
WILL BE THE ESTABLISHMENT OF OPTIMAL
OPERATIONS ACROSS BOTH REGIONS. ”

HONSON TO
CHAIRMAN,
KPMG IN CHINA



China's rising costs and demand are helping to fuel ASEAN's rise

No discussion of ASEAN's commercial future can overlook China's role. CEOs recognise that China is four times the size of ASEAN's combined economies and is expanding at a rate equivalent to Indonesia's annual output. Economic growth is slowing, but CEOs remain committed to the world's second largest market. "We need to be in China to stay globally competitive" was a common comment by CEOs in our recently published MNCs in China report.

But China is also increasingly expensive. Rapid economic development is partly to blame. However, it is the country's demographic changes that are most important for ASEAN's low-cost manufacturers, as China's youth population is expected to fall by around 90 million during the coming 10 years, a figure comparable to Vietnam's entire population. And it is no surprise then that wages in Cambodia and Laos are just one-third of wages in China's export producing regions.

This trend isn't new and global sourcing executives have already increased their buying from ASEAN over the past five years. It is a shift that is evident in the region's apparel exports to

the world, which have jumped an impressive 42 percent during the past five years. But this is no simple substitution story. China is too big to replace and that's why sourcing executives talk about still buying the bulk of their products from China, but reducing the country's overall share and looking to ASEAN for diversification.

It is this dispersion of the region's production that creates new complexities for CEOs as they must consider how to rebalance their regional operations. Artesyn Embedded Technologies' regional COO notes how the firm has sharply reduced the number of its China-based employees even as it adds in the Philippines, but he also points to ASEAN's tight labour regulations and the gradual automation of China's factories as complicating his decision.

And so multinationals are no longer able to see China and ASEAN as two distinct opportunities, but are instead having to assess the relative opportunities of buying from a factory in Hanoi rather than Dongguan, or setting up a shared services centre in Dalian or Manila. That's no easy task.

**ASEAN
APPAREL
EXPORTS**
(USD BILLIONS)



2008

24

ASEAN

2013

35

113

CHINA

165

Source: UN Comtrade

So do CEOs view China and ASEAN as the same or separate parts of their global strategy? We have asked this question to over 25 senior executives working for multinationals in China and ASEAN. The simple conclusion is that market size dictates and whereas most multinationals have a specific China-strategy to deal with the country's vast opportunities, far fewer have a specific or combined strategy for the smaller and more fragmented ASEAN region.

Practical concerns are partly to blame. With comments on how China can be 'all consuming' for senior executives dealing with the country's scale and complexity. CEOs talk of this being a particular challenge when a multinational's regional leadership team is based in China; it is too easy for senior executives to focus on fast growing opportunities in a nearby province, rather than those a 4-hour flight away in the ASEAN region.

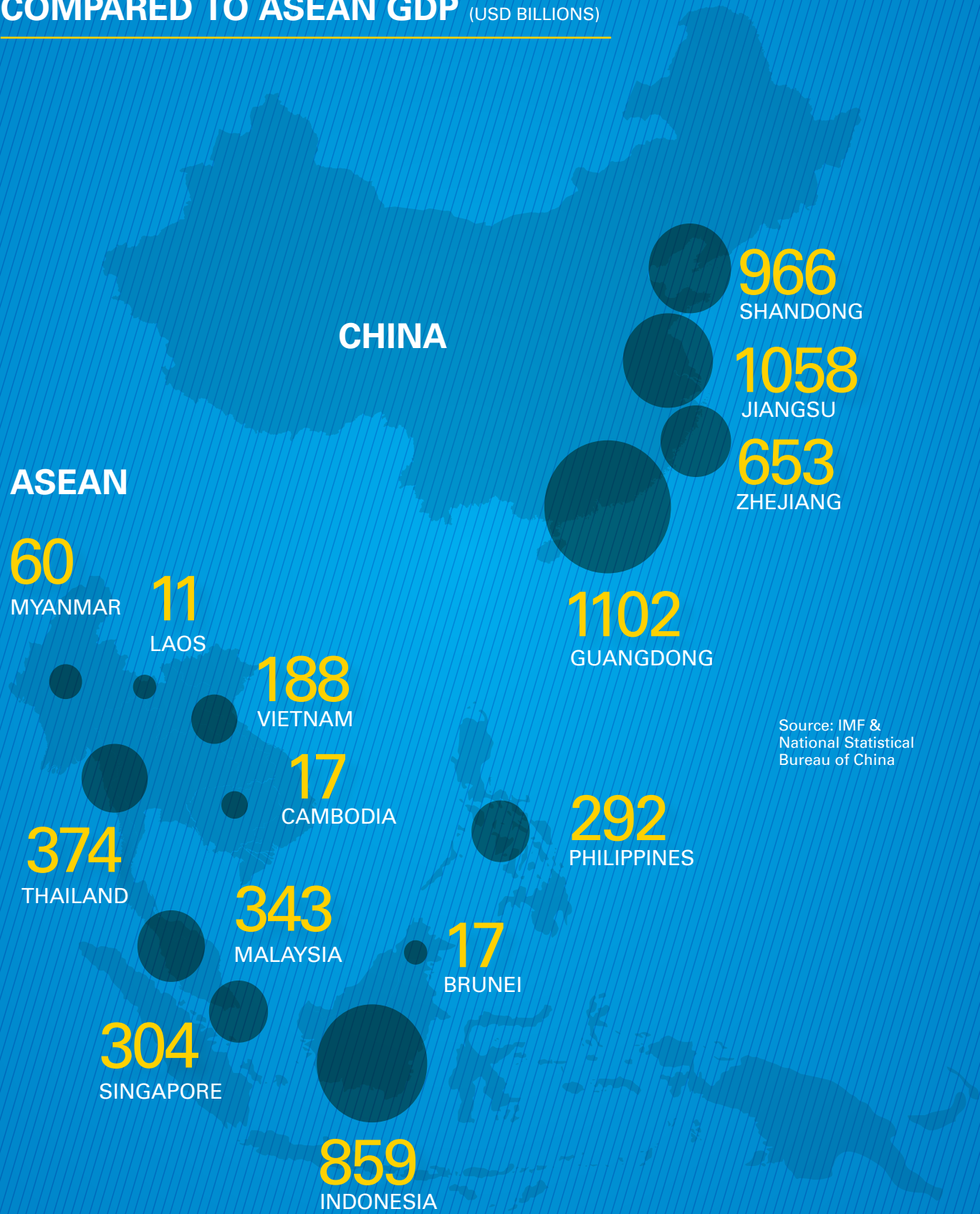
Sharing experiences within the regional organisation will however be critical should multinationals in ASEAN start to face threats from Chinese competitors. For now, senior executives in ASEAN tell us that Chinese companies are only just appearing on their radar screens; Korean and Japanese firms, by contrast, still dominate. And where there is stronger activity, it tends to be Chinese construction companies building infrastructure in Cambodia, Laos, and Vietnam, or manufacturers opening up facilities in those same countries.

But there are signs of change, such as in the industrial equipment sector. Caterpillar's Southeast Asia CEO notes that Chinese companies have made gains in the refurbished rental fleet where local customers may choose to buy a new Chinese product rather than a refurbished high-end product. That said, he emphasises that Chinese competitors are focused on a very different trade-off between trade and performance. "They are not yet able to offer our life cycle cost proposition," he says.

What is clear from these changes is that ASEAN's growing opportunities have created a new set of challenges for multinationals as they broaden their focus beyond China.

CEOs will need to respond in turn by aligning organisations across a greater number of countries and identifying value propositions among a more complex set of opportunities. In short, the rise of ASEAN and the region's growing engagement with China should push multinationals to rethink their regional and global strategies. After all, China and ASEAN account for some 27 percent of the world's population, a share greater than Europe and the United States combined, making more strategic planning critical.

CHINA'S LARGEST PROVINCES GDP
COMPARED TO ASEAN GDP (USD BILLIONS)



Source: IMF &
National Statistical
Bureau of China

ARTESYN EMBEDDED TECHNOLOGIES



George Foo is the Hong Kong-based COO for Artesyn Embedded Technologies, a global power conversion MNC, and formerly part of Emerson Electric, with 15,000 employees in ASEAN and 22,000 globally.

Foo explains that Artesyn's entry into ASEAN was partly driven by China's rising costs. "Today, we have 9,000 employees in the Philippines and the number is growing, especially among our production workers," he says. "We have also moved our back office functions from the U.S. to the Philippines as well as established a strong R&D center in Manila. We also have two manufacturing facilities in the Filipino cities of Laguna and Cavite. I used to think Chinese workers were more productive, but my views have changed as a result of my experience in the Philippines."

Today, China accounts for only 40 percent of Artesyn's Asia-based employees, down from an original 85 percent, a change indicative of the shift in manufacturing around the region.

Artesyn also has experience in other Southeast Asian countries. "We set up a plant in Vietnam about five years ago and were initially quite successful," Foo says. "But then we started producing more products with a lower labour content, so it made less sense over time to stay in the country. We also found it challenging to find skilled professionals and deal with a more radical labour force. Logistics costs were also relatively high because all the material had to be imported from China. Facilities costs are also surprisingly higher when compared to China."

The fact Artesyn is building factories with a 10-year view is also key to the company's decision. "We need to make large capital investments in order to build our products. We also need to invest in training and developing. So we have to view our opportunities from a long-term perspective. And when I look at the region's other low-cost countries, such as Indonesia or Vietnam, labour costs might be low today but inflation

“ FINANCIAL BARRIERS AND UNCERTAIN POLICY ENVIRONMENTS REMAIN A CHALLENGE FOR ENERGY COMPANIES LOOKING TO BUILD REGIONAL PLATFORMS. BUT AS GOVERNMENTS RECOGNISE THE NEED FOR BETTER INFRASTRUCTURE AND CONNECTIVITY, THE OPPORTUNITIES FOR MULTINATIONALS WILL GROW. ”

PEK HAK BIN
REGIONAL HEAD OF ENERGY & NATURAL RESOURCES
KPMG

rates are relatively high. If I look at the change in costs over a 10-year period, I would expect wages in these countries to be higher than those in the Philippines.”

Artesyn is not alone in its decision to relocate to ASEAN. “I do see a growing number of competitors moving to the Philippines from China. It’s not a flood yet. But there’s a gradual increase in the number of companies, and customers, looking to exit as a result of rising costs.” Foo also points to Malaysia as another possibility. “I do see, perhaps, a possible shift of higher end electronics manufacturing from China to Malaysia if inflation in China continues to remain at double digits. In fact, some of my top people in China are Malaysian and finding excellent professionals will not be an issue.”

However, he cautions that supply chain costs are still higher in the Philippines or Malaysia relative to China whose supply chain remains exceptional by comparison. “It’s also expensive to close a factory in China and move it to another country. The big issue is severance costs owing to changes in employee regulations in recent years. They can be prohibitive. There are also a growing number of automation companies in China and I see that as making China more competitive in the future. The country has an uncanny ability to reinvent itself,” he adds.

Foo also had a unique view on the region’s labour challenges. “We haven’t had any issue moving our Filipino engineers around the region. If anything, we are losing people to other ASEAN countries. And we are not unique in the industry. It appears to be simply part of the culture for Filipinos to work abroad and repatriate funds back to home. In fact, further reducing the barriers to labour would probably be even worse for me and others in the Philippines. Other than at the senior management level, it’s not like I’ll be

taking someone from Singapore or Thailand and moving them to the Philippines,” he says.

Artesyn’s end-users have meanwhile shaped the company’s ASEAN strategy. “Our end customers are outside the region, such as in Europe or the United States. They aren’t in Malaysia or Singapore. We might ship to a contract manufacturer in those countries but the end user is still non-Asian. For that reason, it’s not particularly critical for us to have a regional ASEAN strategy. We have sales staff around the region to manage relationships with those contract manufacturers. But our Asia leadership team is in Hong Kong and that isn’t likely to change anytime soon,” says Foo.

“I do see many of our major customers who used to have decision making in the U.S. and Europe are moving more of that responsibility to Asia. However, most are moving to Hong Kong/ China and Taiwan. There are a few moving to Singapore,” he adds.

“ I DO SEE A GROWING NUMBER OF COMPETITORS MOVING TO THE PHILIPPINES FROM CHINA. IT’S NOT A FLOOD YET. BUT THERE’S A GRADUAL INCREASE IN THE NUMBER OF COMPANIES, AND CUSTOMERS, LOOKING TO EXIT AS A RESULT OF RISING COSTS. ”

GEORGE FOO
COO,
ARTESYN EMBEDDED TECHNOLOGIES





LOOKING FORWARD

This report provides a practical view of how multinationals are viewing their opportunities and challenges in ASEAN.

There's no doubt the region is one of the world's great commercial opportunities. But there are also challenges in building regional strategies given the differences between individual markets, whether they relate to consumer preferences or regulatory imperatives. The report identifies that striking a balance between regional and individual country strategies will be critical for multinationals.

The opportunities for the ASEAN countries are immense. The region's combined efforts to drive greater efficiency, productivity, and living standards are already creating a more attractive destination for foreign capital. And that is an important message for companies looking to invest in this region. There is an opportunity to engage not only with the economic story, but also with the incredible social change which will transform the region. KPMG member firms are keen to work with those looking to invest and contribute to this emerging and rapidly expanding market.

GEOFF WILSON
COO, KPMG's Asia Pacific Region
Hong Kong

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In Southeast Asia, KPMG member firms are taking the lead in serving the varied and growing needs of this region while leveraging the benefits brought about by ASEAN integration. KPMG member firms support clients in their pursuit of business growth, enhanced performance, sound governance and compliance objectives.

KPMG member firms are present in all 10 countries across ASEAN. We have 24 offices staffed by 8,600 professionals and 290 partners, serving all major industry sectors in the region.



cutting through complexity

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Silk Road Associates is a trusted advisor for multinationals and mid-market firms looking to grow their commercial footprint across China, Southeast Asia and the Middle East.

We provide a range of services from business strategy and market studies to executive programs and boardroom briefings. Our team of consultants, business strategists,

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Led by Ben Simpfendorfer, a world-leading specialist in the commercial rise of Asia and the Middle East, we also understand the challenges of operating across multiple countries and grappling with a fast-changing region. Our team partners with clients to provide multi-country solutions and strategies as companies assess their regional business propositions.

CONTACT

BEN SIMPFENDORFER
Founder & Managing Director,
Silk Road Associates

1801 Wheelock House,
20 Pedder Street, Central
Tel: +852 2293 2236
Email: ben@silkroadassoc.com

SILK ROAD
ASSOCIATES

CONTACT US

COUNTRY LEADERS

THAM Sai Choy

Chairman, KPMG's Asia Pacific Region
Managing Partner, KPMG in Singapore
& Brunei

Tel: +65 6213 2500

Email: saichoytham@kpmg.com.sg

Tohana WIDJAJA

Managing Partner, KPMG in Indonesia

Tel: +62 (21) 574 2333

Email: Tohana.Widjaja@kpmg.co.id

Johan IDRIS

Managing Partner, KPMG in Malaysia

Tel: +60 (3) 7721 3388

Email: jidris@kpmg.com.my

Roberto G MANABAT

Managing Partner, KPMG in the
Philippines

Tel: +63 (2) 885 7000

Email: rgmanabat@kpmg.com

Kaisri NUENG SIGKAPIAN

CEO, KPMG in Thailand,
Myanmar & Laos

Tel: +66 (2) 677 2989

Email: kaisri@kpmg.co.th

Warrick CLEINE

Chairman & CEO, KPMG in Vietnam
& Cambodia

Tel: +84 (8) 3821 9266

Email: warrickcleine@kpmg.com.vn

Honson TO

Chairman, KPMG in China

Tel: +86 108 508 7055

Email: honson.to@kpmg.com

PARTNERS AND DIRECTORS

Geoff WILSON

COO, KPMG's Asia Pacific Region
Hong Kong
Tel: +852 2826 7210
Email: gwilson@kpmg.com

Mark GODSON

Head of Markets, KPMG in Indonesia
Tel: +62 (21) 570 4888
Email: Mark.Godson@kpmg.co.id

ABDULLAH Abusamah

Head of Markets, KPMG in Malaysia
Tel: +60 (3) 7721 3388
Email: aabusamah@kpmg.com.my

Emmanuel BONOAN

Head of Markets & Tax, KPMG in the Philippines
Tel: +63 2885 7000
Email: ebonoan@kpmg.com

TAN Wah Yeow

Head of Markets, KPMG in Singapore & Brunei
Tel: +65 6411 8338
Email: wahyeowtan@kpmg.com.sg

Sean SEVERN

Head of Markets, KPMG in Thailand, Myanmar & Laos
Tel: +66 (2) 677 2787
Email: ssevern@kpmg.co.th

Mark BARNES

Global Head of High Growth Markets, KPMG in the United States
Tel: +1 212 872 3199
Email: mbarnes1@kpmg.com

Andrew TINNEY

CEO, Management Consulting, KPMG ASEAN
Tel: +65 6411 8026
Email: andrewtinney@kpmg.com.sg

PEK Hak Bin

Regional Head of Energy & Natural Resources, KPMG in Singapore
Tel: +65 6411 8138
Email: pekhb@kpmg.com.sg

Andrew THOMPSON

Regional Head of Private Equity, KPMG in Singapore
Tel: +65 6213 2929
Email: andrewthompson8@kpmg.com.sg

Vinod KALLOE

Head of International Tax Policy, KPMG in the Netherlands
Tel: +31 8 8909 1657
Email: Kalloe.Vinod@kpmg.com

Dan RADLEY

Director, Markets, KPMG's Asia Pacific Region
Tel: +65 6597 5592
Email: danradley@kpmg.com

Dawn WESTERHOUT

Director, Markets, KPMG in Singapore
Tel: +65 6507 1538
Email: dwesterhout@kpmg.com.sg

KPMG ASEAN

Email: asean@kpmg.com.sg
www.ASEANconnections.com

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