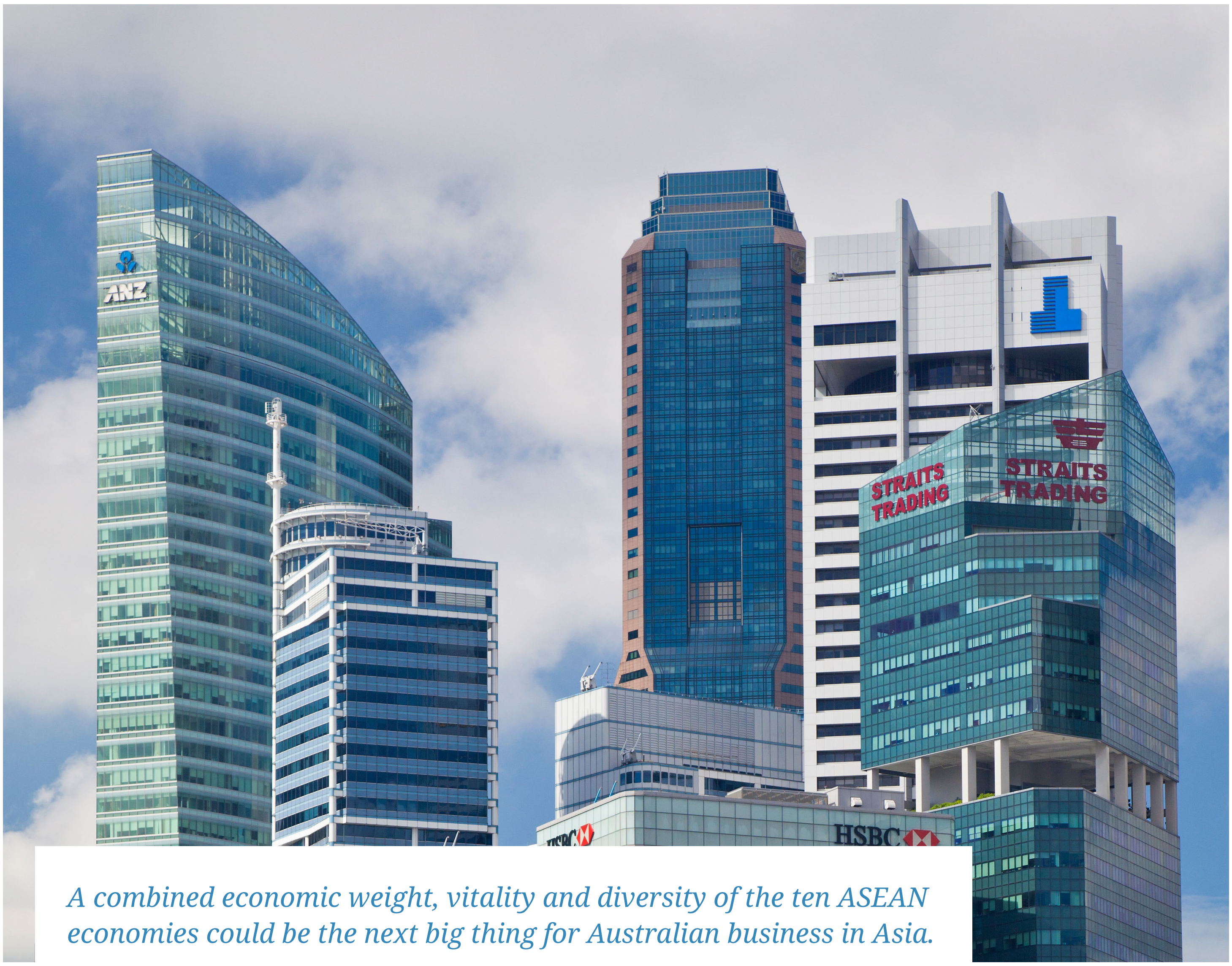
ANNA GREEN

The new frontier: Can ASEAN be this decade's China?



A combined economic weight, vitality and diversity of the ten ASEAN economies could be the next big thing for Australian business in Asia.

Ten years ago, boardrooms across Australia were absorbed in answering "The China Question". It had become – more and more so – a critical strategic decision. China was growing, enticing, financially lucrative but complex, fraught and unfamiliar. But few doubted we were entering an Asian century, with the Asian region destined to become more important than the developed markets of Europe and the US for business opportunity and growth. And China was at its centre.

A decade later, Australian businesses are in China, willing and inevitably navigating the

changing political landscapes, evolving regulatory environments and complex and nuanced cultural dynamics associated with entry into China. Many have seen significant returns and the path to entry for Australian business in China has now become more familiar territory.

Today's question – and whilst it shouldn't be a new one, it seems that it is – is whether ASEAN can be this decade's China. ASEAN, or the Association of Southeast Asian Nations, is a coalition of 10 nations: Brunei, Cambodia, Indonesia, Laos, Myanmar, the Philippines, Singapore, Thailand, Vietnam and Malaysia. With a population of over 637 million, many of whom represent an expanding and affluent middle class, a GDP that comprises 3.4 per cent of the world's GDP and growth expected to remain above 5% in the near term, the opportunity is great.

But despite trade flows increasing, Australian business remains hesitant in engaging. The question must surely be asked – if Australian business was prepared to enter China, why not ASEAN?

In reflecting on this question, we should first consider whether the comparison is fitting: are there useful similarities or is it a neat but shallow analogy?

China 2006 VS ASEAN today

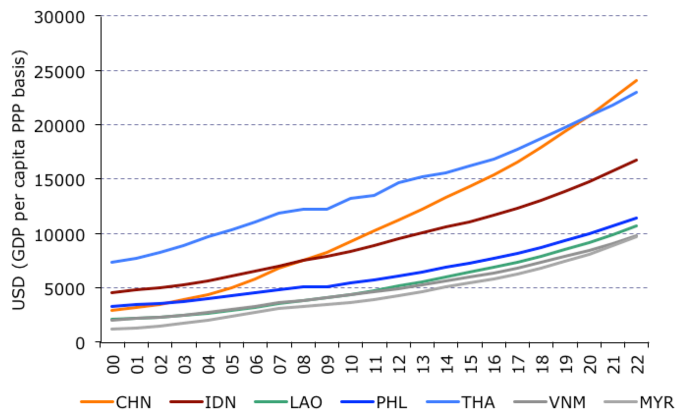
In 2006, the China story was a compelling one for Australian business. China's real GDP growth was over 12%. Its demographics were favourable to an export economy with an expanding middle class and affluent population establishing the basis for strong consumer demand. For Australia, that meant demand for products and commodities. China's exports, meanwhile, amounted to 35% of its GDP.[11]

The Chinese government was opening up to international trade and companies like IKEA, Apple and IBM were growing their presence in the market with Google launching its Chinese branch Google.cn in January 2006.

The ASEAN bloc today looks much the same on many of these measures. And while at a country level, and even at a provincial level across individual ASEAN countries, metrics relating to economic growth are incredibly diverse, and the "cross border" nature of doing business in the ASEAN region make comparisons with doing business in China tangibly different on many measures, there is still some instructive data to consider:

- Whilst not matching Chinese double digit growth at its peak, the median GDP growth in ASEAN countries in 2016 hit 4.6% which easily outstripped world GDP growth figures in the same year of 3.2%.

ASEAN and China - Past and Projected GDP per capita income[2]



Source: DFAT Australia

- China's growth over the last decade was unprecedented but it is interesting to note the median PPP GDP of China 10 years ago matches that of ASEAN economies today (excluding Thailand).

Granted the projected economic growth of the ASEAN economies does not reflect the explosive double digit experience of China over the past 10 years but the story of economic growth in ASEAN will be driven by similar variables.

Like China 10 years ago, ASEAN demographics favour Australian exports, with consumer spending from the growing educated middle class who possess a healthy disposable income per capita and a fervent appetite for consumables sourced from Australian based agricultural food and mining commodities.

With the official creation of the ASEAN Economic Community (AEC) in 2015, ASEAN governments have become increasingly invested in reducing barriers to inter-ASEAN trade. With total annual inflows of foreign direct investment now outstripping those of China and a market that comprises the equivalent of about 50% of China's population, the AEC seeks to become an integrated market promoting seamless cross border trade both within ASEAN and internationally.[3]

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[1] *This is how China's Economy has changed in the last 10 years*, Andrew Wright, World Economic Forum, June 2016

[2] ASEAN Now Insights for Australian Business, Australian Government, November 2017

[3] *ASEAN is Looking like a China 2.0 Play*, Forbes Magazine, April 2016

In line with this objective, ASEAN governments have increased their engagement with Australia and other countries on reducing barriers to cross border trade in the region via the TPP and RCEP trade agreements as well as growing existing bilateral relationships and agreements.

Challenges

If at a high level the market similarities are notable, so too are the challenges.

Notwithstanding the introduction of the AEC, ASEAN is by no means a heterogeneous market. However, China in 2006 was similarly characterised as a fractured market for international business wishing to enter, with no single point of reference on the application of the myriad of different rules and regulations administered by the various state and provincial authorities in China. ASEAN with its 10 member states, each with their own cultures, differing regulatory environments and diverse social, political and religious operating environments, present similar challenges for new entrants.

Issues relating tocompliance, opaqueness of the legal framework, challenges with consistency in application of laws relating to trade and customs and geographically disparate populations are also common across the two markets.

Achieving Success in China

Are there lessons then from international companies that were successful in setting up in China when it was at a similar stage in its development? The evidence suggests there are common themes which contribute to a company's overall success, which include:

- a long term strategy and commitment to the market
- thorough due diligence of their entry points
- being open to using wholly owned subsidiary structures
- being willing to engage with Chinese government contacts in a meaningful and culturally appropriate manner
- seeking out the right local advice in establishing joint venture partnerships

Procter and Gamble, a long time player in the Chinese market invested in significant market research before entering the market with analysts attributing P&G's success in China to its localisation strategies. The company spent significant time customising its product packaging, product formulas and advertising campaigns to cater to the Chinese market.[4]

DHL's success in establishing its operation in China has, in part, been achieved by its longstanding relationship with Sinotrans-National Foreign Trade Transportation Group, a state owned logistics company. Jerry Hsu, president of Greater China DHL Express Asia Pacific commented in 2006 that:

> *"DHL-Sinotrans has built up its position in China by leveraging DHL's global expertise and the local advantages of [the partnership with] Sinotrans has led to a market leadership position, with 40% market share in China and an annual growth rate of 35% to 45%."*[5]

Massive Swiss-Swedish multinational engineering corporation ABB took the approach "Think Global, Act Local" in its entry to the Chinese market choosing to create joint ventures with numerous state owned entities from the outset and rapidly building out these joint ventures across China so that it had 17 production and manufacturing facilities throughout eastern China and five wholly owned subsidiaries in China by the end of 2004.[6]

But the journey for multinationals in forming these partnerships, navigating the numerous cultural and regulatory nuances of the Chinese markets and implementing the "Think Local, Act Global" mantra, has not been without its headaches. Some global multinationals have ran afoul of Chinese cultural norms when the advertising run on television and in print was considered offensive and insulting by Chinese viewers, requiring, in some instances, a full public apology for their missteps.

In most instances, companies that have seen success in China have acknowledged that these types of mistakes, while costly, are part of the landscape of doing business in the country. They have had to reshape their corporate thinking along these lines in order to survive noting that:

> *"The key to success is to have fully assessed your markets and risks, and be invested – really invested – in knowing your customers and partners, your government touch points and stakeholders."*[7]

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[4] *How Procter and Gamble Cultivates Customers In China*, Forbes Magazine, April 2010

[5] *Determinants of MNC's entry mode strategies in China*, Shuang Wang Uppsala University Press, May 2011

[6] Ibid.

[7] *Doing Business and Investing in China*, PWC, 2013

Australian business in ASEAN now

Australian business experience in ASEAN to this point would suggest similar maxims for success can and should be applied to approaching business in ASEAN.

"The key to success is to have fully assessed your markets and risks, and be invested – really invested – in knowing your customers and partners, your government touch points and stakeholders."

Anecdotally it can be seen that businesses that hav invested in longer term "ride it out" strategies across the ASEAN region have seen most success.

Australia's logistics giant, Linfox, has been in the ASEAN region since 1992 and has carefully invested time on the ground in each of the countries in which they operate to properly understand the operating environment before entering.

International CEO for Linfox Greg Thomas notes the company's plans for expansion in the ASEAN region in 2018 include:

> *"Investigating strategic acquisition opportunities and joint ventures as well as building capabilities internally...and committing resources to gain a better understanding of the logistics requirements in these countries."*[8]

Similarly Blackmores who, having recently weathered a substantial drop in their share price as a result of the changing regulatory landscape in the ever shifting Chinese consumer market, continues to pursue opportunities to expand their footprint across ASEAN.

Peter Osborne, Blackmores Managing Director Asia, notes that the company views its key to success in the region as being driven by three factors:

> *"We employ very good country managers, typically from a multinational fast-moving consumer goods background, and build very strong local teams because they understand the market. Furthermore, we're a brand that focuses on quality and we believe you have to educate your consumers and your partners about that."*[9]

Missing the opportunity

Whilst these two examples of Australian success in the region highlight these companies' commitment, strategic planning and corporate resilience, the reality of Australia's engagement with the ASEAN region and in Asia more generally appears to be far less rosy.

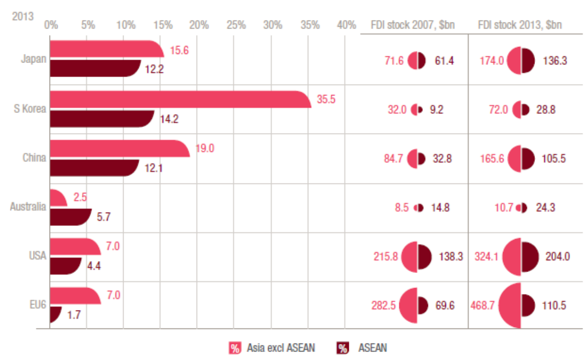
PWC's recent report "*Passing Us By: Why Australian businesses are missing the Asian opportunity*" presents a stark view of Australia's lack of engagement with the region, which policy makers and business leaders have noted with increasing unease.

It states that as at 2015, only 9 per cent of Australian businesses were operating in Asia and only 12 per cent had any experience of doing business in Asia at all.[10]

And perhaps more worryingly. the majority – around two thirds – of Australian business have no intention of changing their stance to doing business in the region in the next two to three years.

Australia's hesitancy to engage means we are also falling behind other countries in our investment in the region. Japan has more than doubled and China more than tripled their investments in Asian countries since 2007. And the EU contributed 22.4 per cent of total FDI inflow to ASEAN countries from 2011 to 2013.[11]

Whilst Australian business has stepped up its engagement, its lack of "on the ground" presence in many ASEAN countries and preference for investment in lower growth markets like New Zealand, indicates a general reluctance to commit to the differing way of doing business that the region requires for success.



Source: DFAT, Bank of Japan, JETRO, Australian Bureau of Statistics, Heritage Foundation, OECD and PwC Analysis

New opportunity – the digital journey

This difference is perhaps even more marked when we consider how China and ASEAN are likely to do business in the future. Both China and ASEAN share compelling metrics with respect to the opportunities for Australian business with their burgeoning digital economies. China has well and truly edged ahead of other markets as the innovator with respect to online business, with companies like TenCent and Alibaba

[8] *Solutions Magazine*, Linfox, Dec/Jan 2018
[9] *ASEAN Now Insights for Australian Business*, Australian Government, November 2017

[10] *Passing Us By: What Australian businesses are missing the Asian Opportunity and what they can do about it*, PwC, December 2014
[11] Ibid.

investing early and heavily on infrastructure, market research and network incentives to grow this lucrative market both locally and internationally.

The Chinese economy has been on a digital journey in the past 10 years that has taken it from a population with a relatively small digital presence (only 1 in 10 people were online) to one in which almost every person has a mobile phone, over half of whom use that phone for accessing the internet to shop. China has become the world's largest and most dynamic e-commerce market and today over 21% of the world's internet usage now occurs in China.[12]

To put this in perspective in terms of business opportunity, according to China's National Bureau of Statistics online retail sales in China reached 5.16 trillion yuan (752 billion US dollars) in 2016. And China's innovations in online payment systems via WeChat and Alipay are providing international business with a vehicle in which to enter the online market.

Australian companies like Blackmores and Capilano Honey have recognised the opportunity that the Australian "brand" of health and wellbeing presents with Chinese consumers and have found a voracious online market for their products.

A recent McKinsey and Company report estimated that the value of cross-border e-commerce transactions with China was valued at more than 50 billion Australian dollars in 2015.[13] And an Australian Government business update noted that whilst there were no official trade statistics on the volume of Australian products sold to China through e-commerce, Australia is estimated to be the fourth most popular source of products behind the United States, Japan and Korea.

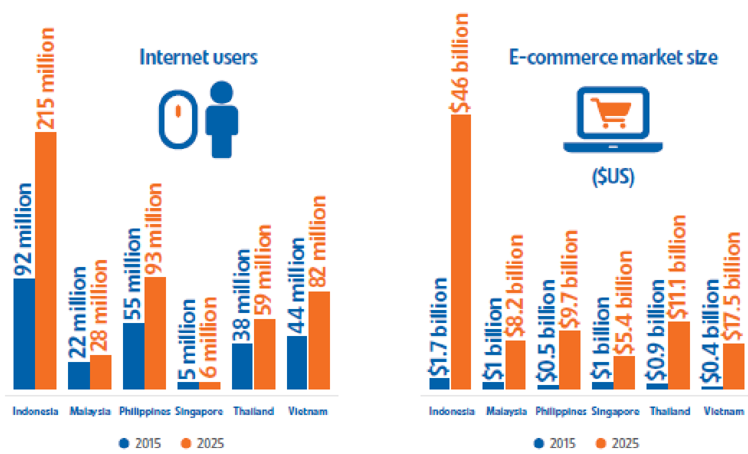
Speaking with the Australian Financial Review recently, Chief Executive of Wine Australia, Andreas Clark noted:

> *"We've just done a deal with Ali Baba to get Australian wine online in China. They have this incredible culture of jumping on the internet and ordering a few things, and these couriers bring it straight over. To succeed in this market will mean accepting the online channel."*[14]

[12] www.Internetlivestats.com
[13] *Cross border e-commerce is luring Chinese shoppers*, McKinsey & Company, December 2015
[14] *Australia China Business Council says integration of economies entering intense phase*, Australian Financial Review, September 2016

By comparison, the ASEAN markets remain relatively untapped where it comes to e-commerce. Consistency of digital platforms, regulations, infrastructure and internet speed remain a challenge for development of the e-commerce market across the region. But the statistics on the potential for growth are powerful, with DFAT noting that e-commerce in ASEAN is expected to grow at 14 per cent over the next five years whilst China is expected to grow at only 5 percent over the same period, with the value of the e-commerce market in ASEAN predicted to reach over 97 billion US dollars in the 6 major ASEAN economies by 2025.[15]

Figure 14 – Forecast Internet and e-commerce growth in six ASEAN countries



Source: Google and Temasek, 'e-conomy SEA: Unlocking the $200 billion digital opportunity in Southeast Asia', May 2016[16]

Lessons for success in ASEAN – act now

There is no doubt ASEAN presents Australian business with similar opportunities for growth that the now more developed Chinese market offered in its earlier years. The statistics in terms of opportunity speak for themselves. Whilst differences in the geopolitical, cultural and regulatory environments make any such approach to entrance necessarily different, Australian companies should be entering and engaging with ASEAN with the same vigour – indeed more given the (with hindsight) slow approach until now– they did a decade ago in China.

For this reason alone, Australian business cannot afford to continue to see ASEAN as "all too hard". What makes the need for immediate action even more important is the practical reality that companies which have made the Chinese market a success for their business have done so after, in most instances, significant time. An entry to China, and, it can be

[15] *ASEAN Now Insights for Australian Business*, Australian Government, November 2017

argued ASEAN is not a short-term play.

Adding to the urgency is the reality that the economic growth countries across ASEAN are seeing now is not cyclical. It is a function of the dynamics of the growth in consumer demand across the region, driven by the expanding middle class with access to an increasing disposable income. This too, is finite.

So, as with China ten years ago, the need to engage with and have a strategy for growth in ASEAN to take advantage of the opportunities the region has to offer for Australian business is real and immediate. The challenge for Australian business remains how to implement a strategy that allows it to operationalise the significant scale that the ASEAN markets have to offer over the longer term - not an easy feat but one that ultimately will pay significant dividends.

As foreshadowed in the *Australia the in the Asian Century White Paper* in 2012:

> *"The scale and pace of Asia's transformation is unprecedented and the implications for Australia are profound."*

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