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Asean: Long on optimism

By Jeremy Grant [Author alerts](#)

Foreign investors and a growing consumer class are driving the rise of southeast Asian nations



Just add water: a worker in Indonesia hangs traditional long noodles out to dry in the sun

When online travel search company Skyscanner wanted to expand in Asia, its management decided not to try China first, even though it may have offered the biggest prospects.

Instead, the Edinburgh-based group set up an office in Singapore in 2011, sensing that the time was right to focus on southeast Asia. A presence in Beijing and Shenzhen followed, but Skyscanner now employs 80 people in Singapore overseeing a part of Asia that is one of its fastest growing: the countries that form the Association of Southeast Asian Nations (Asean).

Monthly visits to Skyscanner's Asian sites grew 140 per cent last year, with a quarter of that from Asean, a 10-member bloc that includes Indonesia, Thailand, Malaysia, Singapore, Vietnam and the Philippines.

For a region where credit card use is low and most people still book trips through small travel agents, that may seem surprising. But Filip Filipov, Skyscanner's chief executive, says the company spotted that young, tech-savvy consumers in the region were driving rapid use of search sites on mobile devices or tablets. "We believe that southeast Asia's time has come and we wanted to get ahead of the curve in terms of the shift to a lot more online purchasing," he says.

The rise of a young, travel-conscious class of consumer is just one factor that is attracting investor attention to Asean. Its economies, across countries with a combined population of 630m, have averaged real gross domestic product growth of 6 per cent a year for the past 15 years. If it were a single country, Asean would rank as the world's seventh largest economy – ahead of India – with a combined GDP of \$2.4tn in 2013.

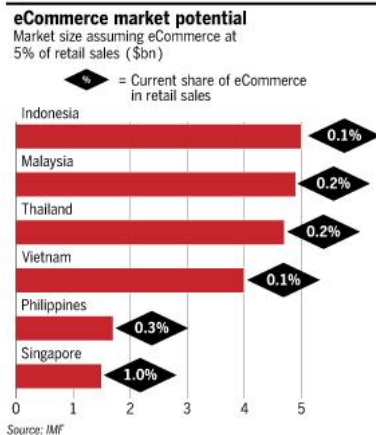
The region has weathered the fallout from the 2008 financial crisis better than many. Government debt is less than 50 per cent of GDP, compared with 90 per cent in Britain. It is also heavily driven by robust domestic demand as people have escaped from lower-paid rural jobs to urban areas, creating a middle class with disposable income for the first time.

Yet amid the optimism, Asean is beset by an escalation in geopolitical tensions, centred on the sea lanes of the South China Sea that are critical to the region's trade.

Anti-Chinese riots in May in Vietnam destroyed that country's reputation for political stability. A military coup in Thailand has frayed investor nerves, and while there is no sign of companies pulling back yet, many executives say this bout of upheaval is the most worrying in years. This month in neighbouring Cambodia, a magnet for foreign garment manufacturers, police and protesters clashed over a disputed election last year.

Even before the escalation in political tension, China's economic slowdown had also put a brake on growth in the Asean region.

For companies looking to expand in Asia, the question is whether Asean is a bankable, long-term concept or, like other economic blocs before – such as Mercosur in Latin America – longer on promise than delivery?



There is agreement among foreign and local businesses that, although it is politically enfeebled, Asean is an economic concept whose time has come. ANZ bank says the region should be thought of as the “third pillar of Asia's growth”, with China and India. “There's a consciousness among those of us who are investing that this is a real thing, not something that's just talked about,” says Michael Zink, Citibank's Asean head.

The scale of US investment in Asean speaks volumes: the country commits a third of its investments in Asia to the bloc – more than US investment in China, India, South Korea, Hong Kong, Taiwan and New Zealand combined. General Electric, which installed street lights in Manila in 1890, says its business in southeast Asia doubled between 2012 and 2013. GE says the growth was fuelled by demand for jet engines, healthcare equipment and energy.

Much of the rhetoric over the bloc's promise centres on plans for an Asean Economic Community. It envisages creating a community marked by the free flow of goods, services, foreign direct investment and skilled labour and the “freer flow of capital”.

But few believe much will be achieved by a target date of December 2015. Part of the reason lies in the competing interests of a grouping that includes Indonesia, which represents 40 per cent of the region's economic output, and, at the other end of the scale, Myanmar, which is emerging from decades of isolation.

“While the Asean vision of [an economic community] is far-sighted, courageous and ambitious, too much political opposition and inadequate institutional infrastructure lie in the way of their effective implementation,” says Tan Chin Tiong, director of the Singapore-based Institute of Southeast Asian Studies, in a book charting the AEC's progress.

Six Asean members – Brunei, Indonesia, Malaysia, Singapore, the Philippines and Thailand – have cut tariffs in line with an Asean Trade in Goods Agreement, but non-tariff barriers remain a serious obstacle to the free flow of goods and services.

Importers remain at the mercy of arbitrary application of a tariff classification system in some countries, effectively denying businesses the tariff reduction, according to consultancy EY. Customs clearance is another obstacle: it takes on average four days to clear goods being imported into Singapore, 14 days in Malaysia and 23 in the case of Indonesia, says the World Bank.

Free flow of services is an even more distant prospect owing to protectionist measures. In a business sentiment survey by the American Chamber of Commerce in Singapore, only 23 per cent of respondents believed that the AEC's goals would be met by 2015, yet 77 per cent said Asean integration was helping their companies do business in the region.

“If you look at the history of Asean it has been a pretty steady path towards harmonisation. The absence of a ‘big bang’ in 2015 will not stop people,” says Judith Fergin, AmCham's executive director.

DHL, the logistics company, plans to double its size in the region by next year through investing in warehousing, transport and information technology facilities. Last year General Motors reopened an assembly plant outside Jakarta that produces minivans, even though the local market has been dominated by Japanese carmakers for years.

“There are broader dynamics going on with fragmentation of supply chains and the emerging consumer opportunities that are driving much of the trade in Asean,” says Fraser Thompson, an economist at the McKinsey Global Institute.

Definitions of “consumer class” and “middle class” are notoriously slippery. Nielsen, a market research company, predicts that the current middle class of 190m in the Asean region – defined as people with disposable income of \$16-\$100 a day – will more than double to 400m by 2020.

There's a consciousness among those investing that this is a real thing, not something that's just talked about

- Michael Zink, Citibank

“With urbanisation, these consumers have a salary for the first time in a generation and are stepping into the ‘white goods’ space for the first time too,” says Regan Leggett, Nielsen’s regional client service director.

McKinsey believes there are 67m households in an Asean consuming class, where households have more than \$7,500 in terms of purchasing power parity. That number could reach 125m households by 2015.

Such predictions appear to be supported by a shift in Asean’s trading patterns since 2008. Before the crisis, the region mainly exported intermediate goods to other Asian countries, whereas since then there has been a shift to the export of finished products within the region.

“That’s a key point because it is a reflection of strong domestic demand,” says Iwan Azis from the Asian Development Bank.



Entrepreneurs have already made their moves, such as Tony Fernandes, who has built up [AirAsia](#) into the region’s largest low-cost airline. Powerful regional conglomerates are also emerging, driving record levels of mergers and acquisitions.

Perhaps the most significant indicator of confidence in Asean is Japanese interest. Companies such as trading conglomerate [Marubeni](#) and [Rakuten](#), Japan’s largest online retailer, are making their biggest push in the region since an initial wave of investment in 1988. In 2012 they invested \$6.4bn into Asean, almost 50 per cent more than in 2005, according to the Japan External Trade Organisation.

Malcolm Cook, a senior fellow at the Institute of Southeast Asian Studies in Singapore, says this fresh wave of Japanese investment could be as transformative as the first, which built supply chains, production networks and installed much-needed power, energy and urban rail infrastructure. “Southeast Asia is benefiting from what appears to be the early stages of another major wave of Japanese inflows,” he says.

While this is being driven by a need to find new growth markets outside Japan, it also has a geopolitical impetus. Japanese companies are looking to Asean as an alternative to China, where labour costs are increasing there and amid political tension between Japan and China. says Tetsuo Tomino, president of the Japanese Chamber of Commerce and Industry of the Philippines.

Still, threats remain. The first is that of a possible sharp slowdown in China. Moody’s, the rating agency, points out that the Asean bloc exported 12.2 per cent of its total shipments to China last year, significantly more than the 7.3 per cent a decade earlier. China is now Asean’s largest trading partner, whereas a decade ago it was third behind the US and Japan.

Lack of structural reforms in the region, especially measures to boost productivity, will probably be exposed when the supply of cheap credit runs dry as the US Federal Reserve eventually completes its “taper”.

Mr Thompson of McKinsey points out another downside: while wages have risen in southern China, productivity growth has been faster there than in Asean nations. This differential means that Asean “won’t capture any displaced manufacturing from China any time soon unless there is a step-change in [its] productivity”.

Creaking infrastructure also poses a huge challenge to growth. But the darkest clouds over the region remain political. After 16 years of peaceful democracy, Indonesia faces a test of its ability to manage the aftermath of a closely fought presidential election.

In the Philippines, lack of an obvious successor to President Benigno “Noynoy” Aquino when his term ends in 2016 is making investors question the future of his reforms, which have turned one of the region’s economic laggards into Asean’s top economic performer this year.

But none of this seems to have dented the case for Asean – yet. This month the EU mission in Singapore announced plans for the first “business missions” to southeast Asia funded by the European Commission for 120 small- and medium-sized enterprises. “Many companies are looking at the Asean growth story for the first time while Europe is in relative decline,” says Hans Vriens, managing partner of Vriens & Associates, a Singapore-based consultancy. “And that doesn’t get derailed by something like political risk.”

Indonesia: A losing fight against regional integration

With Indonesia accounting for about 40 per cent of Asean’s population and economic activity, there can be no meaningful economic community without its proactive participation.

Yet Indonesia is ambivalent about integration. In international forums, Indonesian ministers talk liberally of the new opportunities for inward and outward investment that will arise from the Asean Economic Community.

But, at home, they sing a different tune, warning of the threats from foreign competition, pledging to implement more protectionist measures and reject further trade liberalisation measures.

Both candidates for the presidency, Joko Widodo and Prabowo Subianto, promised to protect Indonesians from the vicissitudes of the AEC.

But, says Fauzi Ichsan of Standard Chartered in Jakarta, Indonesia's large current account deficit, which he forecasts could reach close to 3 per cent of gross domestic product this year, will force the country to open up to investment from Asean and beyond.

"The vested interests in the Indonesian economy are not going to go down without a fight, but in the end it's a losing fight, simply because of the current account deficit and the emerging middle class, who want access to cheaper goods," he says.

It is not just politically connected tycoons who are resisting the AEC.

Natali Ardianto, a young Indonesian internet entrepreneur and angel investor, worries that Indonesia's nascent tech scene will be swamped by an influx of skilled professionals from the Philippines. Many young workers in the financial services sector have similar fears. But Mr Ichsan believes that protecting Indonesia's professionals from regional integration will only make it harder for them to compete in the long run.

The bigger blocks to Asean integration for Indonesia are the same problems that are holding back domestic growth: inadequate infrastructure, endemic corruption and an inefficient bureaucracy.

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