

ASEAN Connected



Foreword



Tony Cripps
CEO, HSBC Australia

It gives me pleasure to introduce *ASEAN Connected* – a report highlighting the opportunities offered to Australian businesses by the maturing markets of Southeast Asia.

Following decades of consistent economic growth and increased connectivity across the region, the ASEAN market is on course to become the world's fourth largest economy by 2050.¹

Supported by new trade agreements and initiatives such as China's Belt and Road Initiative, ASEAN will continue to carve its powerful economic identity alongside neighbouring China and India.

While some Australian businesses have enjoyed a competitive advantage over rivals by harnessing opportunities offered by ASEAN, more can be done to deepen ASEAN trade links to leverage our nation's position in the region.

As the relationship between Australia and our ASEAN neighbours continues to grow, domestic companies should capitalise on their existing strengths in areas such as education and advanced manufacturing.

In doing so, Australia can leverage the changing consumer demand of a more affluent, active and inter-connected region to reinforce its competitive place globally.

As the leading international bank in Australia, HSBC is committed to helping our clients explore ASEAN's dynamic markets, enabling businesses to meet new customers and tap into the region's unrealised potential.

ASEAN's cultural, political and economic diversity means that there is no one-size-fits-all approach to doing business in the region.

However, HSBC's roots in the development of this region and our footprint across Asia will help our Australian clients to capture available opportunities.

This report – developed in partnership with the Export Council of Australia (ECA) – identifies the diverse qualities of six key ASEAN markets and should spark a conversation among Australian corporates looking to expand there.

Through its observations of the region, HSBC hopes to inspire and encourage Australian investment in ASEAN, supporting new and existing customers through our financial services when they embark on this adventure.

Tony Cripps,
CEO, HSBC Australia



Lisa McAuley
CEO, Export Council
of Australia

Trade and investment are key drivers of innovation and long-term prosperity for Australia. At the Export Council of Australia, we believe that Australian jobs are best created and protected over the long term through an open and competitive economic system.

Australia is home to around 50,000 exporters who collectively send around \$320 billion worth of goods and services to the rest of the world.² Growing this number, and increasing our international trade and investment, is crucial to unlocking Australia's future economic potential.

Australian firms enjoy more overseas opportunities than ever before. This is in the context of international demand for what this country produces, and a growing array of liberalising trade agreements – particularly across ASEAN, home to many of our largest trading partners.

ASEAN economies are becoming increasingly connected thanks to trade and integration initiatives like the ASEAN Economic Community, Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership agreement, as well as the Chinese-led Asian Infrastructure Investment Bank and the Belt and Road Initiative.

These initiatives, as well as the sheer potential and size of these ASEAN markets, are attracting companies from around the world seeking a slice of this growth opportunity.

The challenge for Australia is to capitalise on these opportunities as well, and to reinforce

our competitive position in this potential-rich region sitting right on our doorstep.

To meet this challenge, we need to encourage more export-capable companies to engage with opportunity, as well as grow our skills base to succeed internationally.

I am therefore pleased to launch the *ASEAN Connected* report to highlight regional opportunity for Australian companies, together with our partner HSBC Australia.

This report is aimed at assisting Australian exporters in navigating the region by highlighting a small slice of the opportunity available, as well as provide a practical resource in how to access it.

To support the release of the ASEAN Connected report, the ECA and HSBC Australia have also developed the ASEAN Connected Toolkit: a series of practical resources for accessing opportunities under the various free trade agreements in the region.

I would like to thank our partners HSBC Australia for their support in this initiative, as well as our Head Research Manager, Niels Strazdins.

We hope these resources will encourage more Australian companies to seriously consider and actively engage in the vast opportunity available to us in the ASEAN region.

Lisa McAuley,
CEO, Export Council of Australia

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Executive Summary

The Association of Southeast Asian Nations (ASEAN), with a collective GDP of USD 2.5 trillion, a population exceeding 600 million, and a strategic location at the crossroads of Australia, China and India, is a AUD 100 billion trading market for Australia.³

Increasing regional connectivity is gradually lowering what barriers remain to trade and investment in the region, and allows Australia to build on the already strong commercial foundation we have in place with ASEAN.

This report discusses the opportunities that Australian companies can leverage today, keeping our focus practical while also highlighting emerging trends which are building the more connected ASEAN of tomorrow.

Broad opportunity exists for Australian companies across the region, although for the purposes of practical illustration we have chosen to limit our discussion to select opportunities from each focus market in this report.

The opportunities we have chosen to focus on either are either areas of strength for Australia – like education and advanced manufacturing – or have the potential to facilitate Australian trade with the region and/or improve efficiencies for Australian companies – such as business process management outsourcing, or establishing regional treasury centres.

We pair these opportunities with the six largest ASEAN economies: Singapore, Malaysia, the Philippines, Indonesia, Thailand and Vietnam. These are either the most mature or the fastest-maturing markets for Australian goods and services, as well as the most developed operating environments in the region.

Singapore offers an easy, low-risk ASEAN entry point for Australian companies, and is an ideal location in which to establish a regional treasury centre as part of a pan-ASEAN proposition.

Malaysia represents an opportunity to match Australia's highly-regarded education and advanced manufacturing expertise with the country's need to further up-skill its workforce, as the Malaysian manufacturing

sector climbs the value chain in a more connected ASEAN.

The **Philippines** offers Australian companies possible cost savings and efficiency gains by integrating the country's strengths as a business process management hub into their own value chains.

Indonesia presents a massive opportunity for Australian companies in infrastructure development and supporting services, but with this comes a complex set of challenges to capitalising on development in Australia's closest ASEAN neighbour.

Thailand provides a strategic gateway to the Cambodia-Laos-Myanmar-Vietnam subregion, allowing Australian companies to leverage a more established and comfortable operating base to access ASEAN's fastest-growing markets.

Finally, in **Vietnam** Australian education service providers can tap a fast-growing market, hungry for knowledge and expertise.

ASEAN opportunity is of course not limited to these sectors or markets. Enterprising Australian companies are sure to also find rewards in the four ASEAN countries not directly covered by this report: Brunei, Cambodia, Laos and Myanmar.

Supporting this report was a survey commissioned of 83 mid-market Australian companies from a variety of sectors, all with annual turnover in excess of AUD 30 million. Their responses appear throughout this report, and the survey is henceforth referenced as the ASEAN Connected survey.

This report is intended to inform and inspire, though we also recognise the need to provide practical guides to opportunity. As part of our wider ASEAN Connected project, the ECA and HSBC Australia will therefore be launching a series of ASEAN toolkits which focus on practical information for accessing ASEAN opportunity.

We hope this report and wider project become useful resources and stepping stones on the path toward greater Australian engagement with ASEAN, today and tomorrow.

Increasing regional connectivity is gradually lowering what barriers remain to trade and investment in the region, and allows Australia to build on the already strong commercial foundation we have in place with ASEAN.

Background

ASEAN is a crucial trading partner for Australia. At nearly AUD 100 billion, Australia's collective two-way goods and services trade with the region is larger than that with the United States (US) or European Union (EU).⁴

ASEAN's competitive landscape is tightening, however. The region's high economic growth and maturing economies are attracting more and more of the world's best and brightest, while local firms are improving their own capacities, moving up value chains and becoming formidable competitors in their own right.

It is therefore crucial for Australia's future prosperity that we reinforce and grow our competitive position in ASEAN, especially as the region becomes more interconnected and opens new opportunities for foreign businesses to capitalise on its dynamic growth.

Collectively, Australia's trade with ASEAN is growing, albeit at a pace that does not necessarily reflect the size of the ASEAN opportunity.

Overall, Australia-ASEAN trade has grown by around AUD 8 billion between 2011 and 2014.⁵ This is less than half of the AUD 34 billion growth in Australia's two-way trade with China⁶ – perhaps the only market of comparable development and opportunity to the ten ASEAN countries when taken as a whole – over this period.

There is clear opportunity for Australia to grow our ASEAN trade. Some of it is still low-hanging fruit, while some of it is more challenging to access. Some of it stems from satisfying new or existing demand, and some of it lies in leveraging ASEAN's existing strengths to facilitate increased trade not only between Australia and the region, but with the wider world as well.

Individual ASEAN members are already amongst our largest trading partners – led by Singapore, Malaysia and Thailand (see Figure 1). Australian companies have enjoyed many successes and are welcomed across the region. The proximity, experience and soft ties that Australia enjoys with ASEAN cannot easily be matched by our competitors from Europe or North America.

The ASEAN-Australia story is therefore a very positive one, and will continue to be, so long as Australian companies are proactive in their outlook and quick to capitalise on emerging opportunity.

This report is not intended as a comprehensive study of the ASEAN opportunity for Australia. It instead aims to inform and spark discussion on the fundamentals of Australia's trading links with the region, as well as the impact various trade and connectivity initiatives will have on opportunities.



Figure 1: Australia-ASEAN two-way trade in goods and services, in AUD millions, 2014 (Source: DFAT)

This report focuses on five of these regional initiatives. These five can lower remaining barriers to regional trade in ASEAN, and open new opportunities for cross-border commercial linkages. They are the Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP) mega-regional trade agreements, the China-led Belt and Road Initiative (BRI) and Asian Infrastructure Investment Bank (AIIB), and the ASEAN Economic Community (AEC) regional integration initiative.

These initiatives are largely in their formative stages, and it is therefore still early days. But the prospects are bright and the potential for new and innovative approaches to Australian commercial engagement with ASEAN is immense. The groundwork for capitalising on this can and should be laid today.

TPP

- A mega-regional trade agreement consisting of 12 states ringing the Pacific Ocean, from Chile to Australia, that will eliminate tariffs on 90% of traded goods, harmonise rules of origin and allow self-certification of origin, harmonise other benefits.
- Allows for “cumulation”, which is key to facilitating greater supply chain integration. This allows all TPP members to treat materials from one TPP country the same way as those from all TPP countries when these are used to produce a TPP good. A product manufactured in Malaysia can therefore incorporate components from Australia and Japan, and then count these components in the overall rule of origin for export to the US, for example.
- Yet to come into force and largely dependent on ratification by the US Congress, a prospect widely seen as doubtful as of the middle of 2016.

BRI

- An ambitious undertaking by China to build trade, infrastructure and soft ties along a land-bridge connecting China and Europe over the Eurasian landmass, and along a maritime route doing the same across the South China Sea, Indian Ocean and Mediterranean Sea.
- Best thought of as a collection of projects along these roughly-defined routes, rather than as a strictly defined structure. As such, the BRI does not have any official start or end dates beyond when official pronouncements are made.
- Impacts around 65 countries, including Australia and all of ASEAN, who are likely to have a large role to play in the BRI’s maritime component.

AIIB

- A China-led initiative to develop an alternative financing pool for infrastructure development in Asia. It includes 57 member states from most regions of the world, including Australia and all of ASEAN.
- Though still in its infancy, the AIIB launched its first four projects in June 2016.⁷ Three of these are led by other multilateral institutions, signaling the AIIBs potential as a cooperative and welcome addition to the funding pool available to fill the large infrastructure investment deficit across Asia.

RCEP

- A mega-regional trade initiative, less ambitious than the TPP, centred on ASEAN and aimed at harmonising trade between it and the six countries with which ASEAN collectively has trade agreements in place: Australia, China, India, Japan, New Zealand and South Korea.
- Still in the negotiations phase with a goal to conclude talks by the end of 2016, though opinions are mixed on whether this will be achieved and what sort of outcome can be expected.
- Likely to have fewer commitments in services, food, food safety, and agricultural market access than the TPP, as well as fewer standards and regulations – though less ambitious, this may render the agreement more achievable.
- Should go some way toward harmonising and simplifying trade between its 16 member countries – who together account for 60% of Australia’s two-way trade⁸ – and thereby increase the ease and efficiency of conducting cross-border business between Australia, ASEAN and the wider region.

AEC

- Aimed at creating an integrated economic community amongst the ten ASEAN member states, including a single market and production base to allow and facilitate the free flow of goods, services, investments, and skilled labour across ASEAN.
- Officially launched on December 31, 2015, but full realisation of its promise may not be seen until 2025 or later, with gradual implementation of reform and liberalisation in the interim.
- Not an EU for Southeast Asia, being far less ambitious than the European project. Differing histories, cultures, societies and levels of economic development across the ASEAN region mean it will not approach the degree of integration achieved in Europe.
- Though officially less than a year old, the AEC’s underlying integration process began many years ago and has already achieved a few successes: the establishment of a Single Aviation Market to eliminate barriers and restrictions on regional market access to carriers within ASEAN, as well as the 2012 launch of the ASEAN Trading Link between the stock exchanges of Malaysia, Singapore and Thailand to facilitate cross-border trading.

Singapore

- An ideal ASEAN entry point for more risk-averse Australian businesses
- Australia's largest trade and investment partner in ASEAN, with a solid framework in place to further strengthen our commercial relationship
- A true ASEAN hub, offering the best network of extra-regional agreements in Southeast Asia, including 76 double tax agreements, 41 investment guarantee agreements and 21 free trade/economic partnership agreements
- An ideal regional treasury centre to centralise currency and liquidity management, standardise and optimise processes, and mitigate risk

AN IDEAL ASEAN ENTRY POINT

Singapore is an ideal ASEAN entry point for Australian businesses, especially those who are more risk averse or cautious about establishing operations in less developed regional markets. It is sophisticated and stable, and one of the most free and well-connected economies to Australia, ASEAN and the wider world.

Australia and Singapore are both open economies, sharing a common language and strong legal systems based on English common law. This makes communication easier, decreases uncertainty and potential risks, and reinforces Singapore's attractiveness to companies looking for a first step into the region.

Singapore's deep and well-developed financial markets make scale easier to achieve for Australian companies looking to overcome the restrictive size of our domestic market, while its investment attraction schemes offer advantageous incentives to lure foreign businesses to the city-state.

Singapore has leveraged these strengths to overtake Hong Kong as Asia's leading financial services hub in 2016.⁹ It now trails just London and New York globally, and is ranked far ahead of Kuala Lumpur (36th globally) and Bangkok (47th) among ASEAN financial centres (see Figure 2).

The city-state has been the easiest place in the world to do business for over a decade, and has ranked as the world's second most competitive economy each of the past five years.

Looking forward, Singapore's strengths and competencies in finance and professional services, education and logistics mean the city-state is likely to emerge as the heart of the nascent AEC, as well as an important cog in Chinese-led regional connectivity initiatives.

Australian companies using Singapore as an entry point are therefore also plugging into the ASEAN of tomorrow, and creating a base from which to capitalise on future connectivity.

This includes the ability to spread different functions across the region to leverage the strengths of different markets, and manage costs accordingly. "R&D and design can be done in Malaysia, sales and service in Singapore and manufacturing in Vietnam," notes Aizah Abdullah, Australia Director at the Malaysian Investment and Development Authority.

Australia-Singapore Fact Box

Singapore GDP, PPP (global ranking)	\$471.8 billion (41)
Singapore GDP per capita, PPP (global ranking)	\$85,253 (3)
Singapore real GDP growth	2.2%
Global competitiveness ranking	2/140
Ease of doing business ranking	1/189
Australia goods exports (global ranking)	\$6.9 billion (7)
Australia goods imports (global ranking)	\$9.3 billion (8)
Australia service exports (global ranking)	\$4.1 billion (5)
Australia service imports (global ranking)	\$5.3 billion (3)
Australia investment in Singapore	\$67 billion
Singapore investment in Australia	\$98.5 billion

Australia-Singapore trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

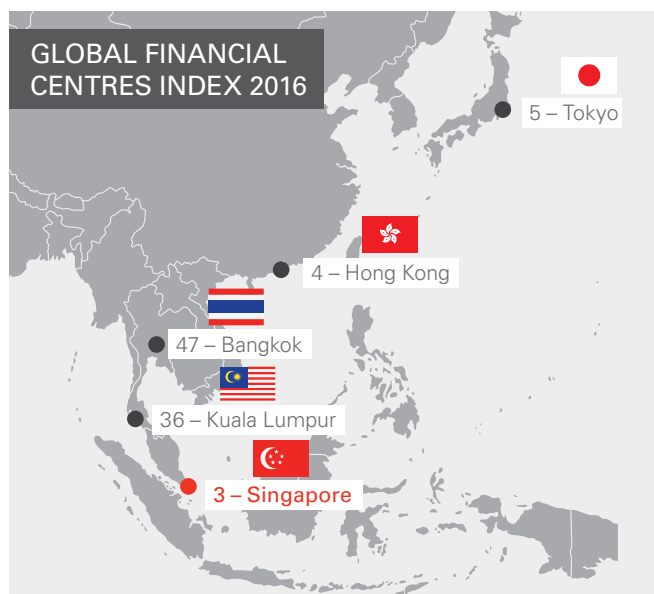


Figure 2: Global financial centre rankings (Source: Z/Yen Group)

A CLOSE TRADING PARTNER

Singapore is Australia's largest trade and investment partner in ASEAN. We share a very strong and long-standing commercial and strategic relationship that is gradually being deepened as we update existing agreements and negotiate new ones.

Most recently, Australia and Singapore have agreed to a Comprehensive Strategic Partnership Agreement, a ten-year road map toward enhancing trade and economic linkages. It aims to facilitate private-sector partnerships through information sharing and collaboration in areas like infrastructure, food and agribusiness opportunities, as well as promote mutual recognition of standards and qualifications, among other measures.

Singapore is an especially important services trading partner for Australia: our third largest services import source (primarily transport) and fifth largest services export destination (primarily professional services).

Australia and Singapore enjoy an open and largely barrier-free commercial relationship thanks to the two free trade agreements we have in place: the Singapore-Australia Free Trade Agreement (SAFTA) and ASEAN-Australia-New Zealand Free Trade Agreement (AANZFTA).

SAFTA not only eliminates virtually all tariffs on trade between Singapore and Australia, but also reduces

restrictions in a number of areas pertinent to Australian service providers – such as easing the establishment of joint venture law firms, and reducing restrictions on Australian financial service providers operating in Singapore.

A third review of SAFTA has just been completed to reflect contemporary business issues and further reduce red tape. As a result, Australia now enjoys better access to the Singapore market than any of the country's other trading partners in areas like labour mobility, professional qualification recognition, and access to government procurement contracts.

AANZFTA provides an additional avenue for Australian businesses to access opportunity in Singapore, and in the wider region.

In addition to tariff reductions, the agreement offers regional rules of origin to assist Australian companies in tapping regional supply chains, as well as legal protection for Australian investment in the region.

Despite its benefits, AANZFTA is the second-least understood trade agreement by Australian businesses, according to Australia's International Business Survey (AIBS) results.

On average across all sectors, 50% of Australian businesses responding to AIBS did not understand how or whether AANZFTA applies to their business. (see Figure 3).

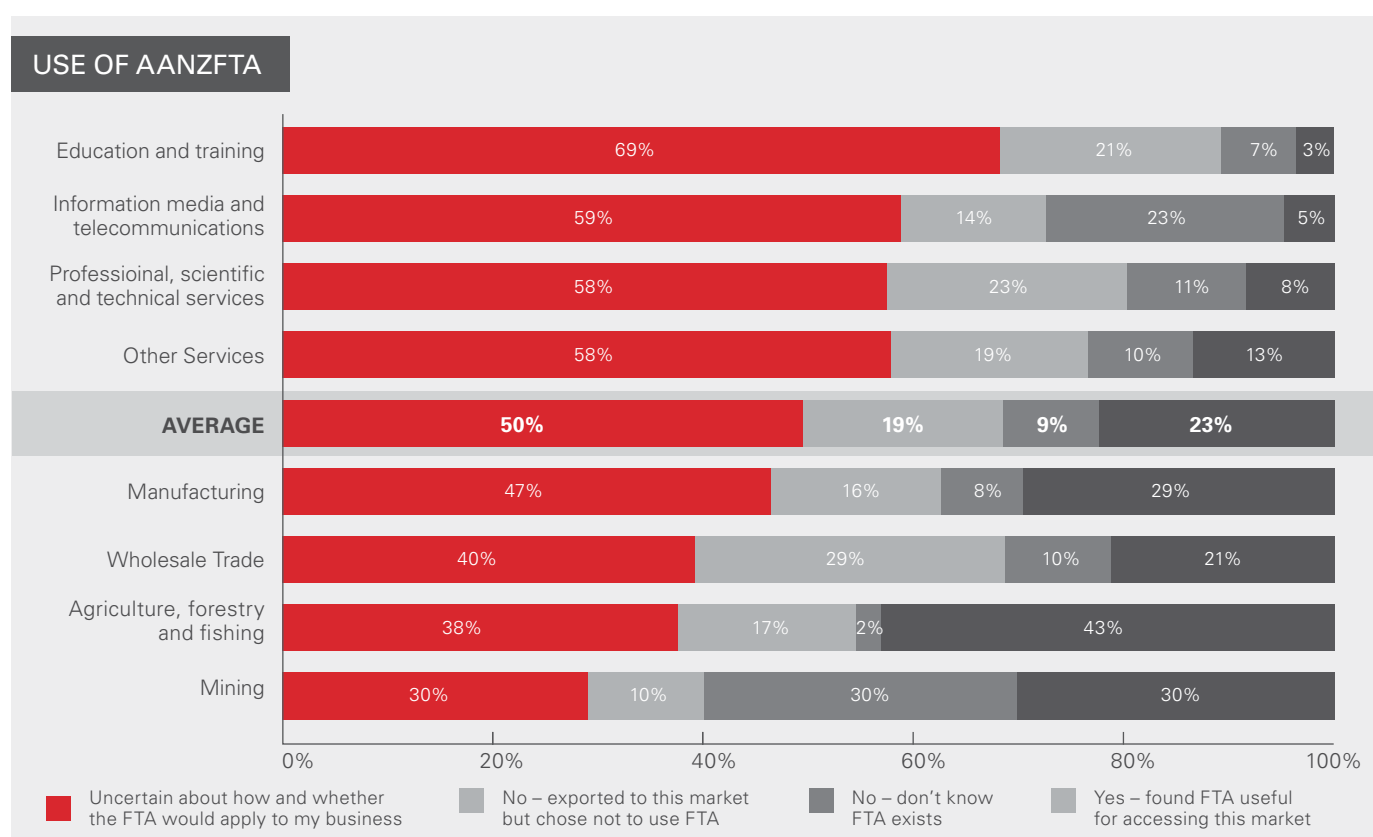


Figure 3: Use of AANZFTA (Source: Australia's International Business Survey 2015)

However, trade agreements are inherently complex, and many businesses find themselves benefiting from these agreements without realising it.

A GATEWAY AT THE HEART OF REGIONAL CONNECTIVITY

Singapore sits at the heart of ASEAN regional connectivity. It attracts over half of all foreign direct investment (FDI) into ASEAN and is a destination of choice for international companies seeking a regional hub.¹⁰ Its excellent network of regional and extra-regional international agreements is the best in Southeast Asia, bolstering Singapore's case as a very attractive regional base for Australian businesses seeking access to ASEAN opportunity.

This network benefits all Singapore-incorporated companies, and includes 76 double-tax agreements, 41 investment guarantee agreements and 21 free trade/economic partnership agreements (see Figure 4).

Australian companies in Singapore can take advantage of this network in number of ways. For example, Singapore's large network of double tax agreements (DTAs) can be leveraged when remitting profits back to Australia. This is particularly useful for companies operating in less developed ASEAN markets, as Australia itself only has DTAs in place with six of ASEAN's ten member states.

When it comes to regional connectivity initiatives, both the BRI and the AIIB are likely to capitalise on Singapore's

strengths as Southeast Asia's leading finance and logistics hub, its deep investment linkages, and its strong legal system.

Singapore has already begun positioning itself as a financial centre for the BRI. For example, International Enterprise (IE) Singapore – the country's trade promotion agency – and China Construction Bank signed an MoU which will see the CCB provide USD 22 billion in funding for BRI projects in Singapore.¹¹

The country is well-placed to be Asia's infrastructure hub, IE Singapore notes, considering the strengths of Singaporean financial institutions in infrastructure project structuring and financing, as well as non-financial capabilities in areas like engineering and design.¹²

"Singapore has strengths along the entire infrastructure value chain, from detailed planning, effective product development and engineering, to stringent procurement processing and efficient construction and operations," says IE Singapore's China group director Ho Chee Hin.¹³

On the AIIB front, Singapore has committed itself to "build up the AIIB as a first-class multilateral financial institution", according to Minister of State for Finance and Transport Josephine Teo, as it was a beneficiary of similar lending schemes by the World Bank and Asian Development Bank during the early years of its development.¹⁴

"Singapore, as a regional hub, will benefit from the AEC and TPP", HSBC Singapore Head of International

SINGAPORE'S INTERNATIONAL AGREEMENTS

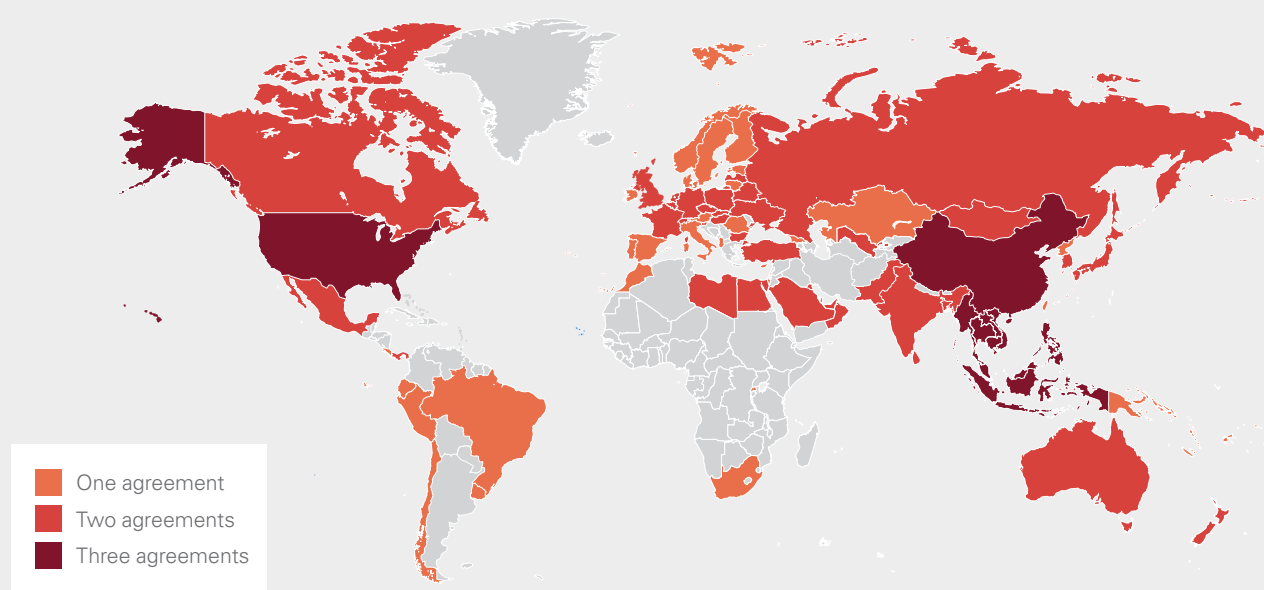


Figure 4: Singapore's International Agreements (map excludes Barbados, Bermuda, Fiji, Guernsey, Isle of Man, Jersey, Liechtenstein, San Marino, Seychelles (one agreement each) and Mauritius (two agreements)). Source: Inland Revenue Authority of Singapore, Ministry of Trade and Industry Singapore, IE Singapore).

Subsidiaries Harish Venkatesan says. He adds that these benefits “will depend upon the speed of implementation and execution” of the initiatives.

The longer-term potential is certainly there, especially when it comes to the AEC. HSBC Singapore CEO Guy Harvey-Samuel says the city-state could see a GDP boost of 9.5% by 2030 as a result of the AEC, on the back of expanded investment and service provision across the more liberalised region.¹⁵

Considering how open and connected Singapore’s economy already is, it mostly stands to benefit indirectly from the TPP.

For example, Singapore’s logistics and transport sectors may be tapped to facilitate any increased trade that results between TPP countries. Benefits would also likely accrue from the large gains expected for lesser developed ASEAN TPP members, such as Vietnam, considering Singapore’s existing linkages to these markets.

What this means for fellow TPP member Australia is also likely to be indirect gain on the back of increased trade flows between TPP countries, as well as potential for collaboration with Singapore in new opportunities.

AN IDEAL REGIONAL TREASURY CENTRE FOR AUSTRALIAN BUSINESSES

As ASEAN’s leading financial centre, Singapore is an ideal regional treasury centre (RTC) location for Australia.

A well-placed RTC allows companies to efficiently manage borrowing and lending, optimise funding costs, and hedge and mitigate risk.

“Over the last two decades, Singapore has clearly established a very reliable framework to attract companies, and to help them use Singapore as a regional hub,” Venkatesan notes. “This is thanks to strong legal, tax and physical infrastructure, as well as talent,”

The future looks bright as well. ASEAN’s increasing cost advantages over locales like China are attracting manufacturing and other businesses to the region, reinforcing demand for treasury services as companies operate across multiple jurisdictions.

Regional competitors in other ASEAN capitals – such as Bangkok and Kuala Lumpur – have also launched incentive programs to attract treasury business, but Singapore clearly stands out as the favoured regional treasury destination for Australian companies (see Figure 5).

According to the survey, Singapore is the leading jurisdiction in which Australian companies already operating in ASEAN have established an RTC, with one-third of respondents

RTC BENEFITS

- Significant tax advantages and incentives
- Increased efficiency by centralising and streamlining operations with standard processes and protocols
- Increased visibility over overall cash positions, creating potential to free working capital to support other business areas or additional investment
- Improved regional/global fund mobility through centralised operations, potentially lowering loan amounts required to support daily operations
- Increased risk mitigation capability when operating across multiple markets and currencies, by alleviating a degree of foreign exchange and interest rate risk

centralising their treasury operations in the city-state. It is also the most attractive jurisdiction in which to establish an RTC for Australian companies that are interested but not yet doing business in ASEAN.

Among non-ASEAN jurisdictions, Hong Kong and Shanghai are popular choices for businesses with significant China exposure, but they still trail Singapore in terms of their attractiveness for treasury operations, HSBC’s Venkatesan notes.

“You do see companies setting up regional hubs in Shanghai, but these tend to be ones where a much bigger share of their Asia business comes from China and North Asia,” he says.

While technology allows many activities to be conducted from anywhere in the world, a physical presence in ASEAN provides proximity to local markets, and the better quality information and market intelligence this provides.

The tax advantages of operating an RTC from Singapore are also a compelling advantage, and are difficult for other centres to compete with.

Corporate tax in Singapore is 17%, which can be lowered to 10% by utilising incentives schemes offered by the Singaporean government to attract treasury centres. No withholding or capital gains tax is levied.

Singapore’s Economic Development Board (EDB) offers a Finance and Treasury Centre Incentive Award (FTC Award), with a reduced corporate tax rate of 8% on fees, interest and gains from qualifying treasury services and related activities. The FTC Award also provides a withholding

ASEAN RTC ATTRACTIVENESS TO AUSTRALIA

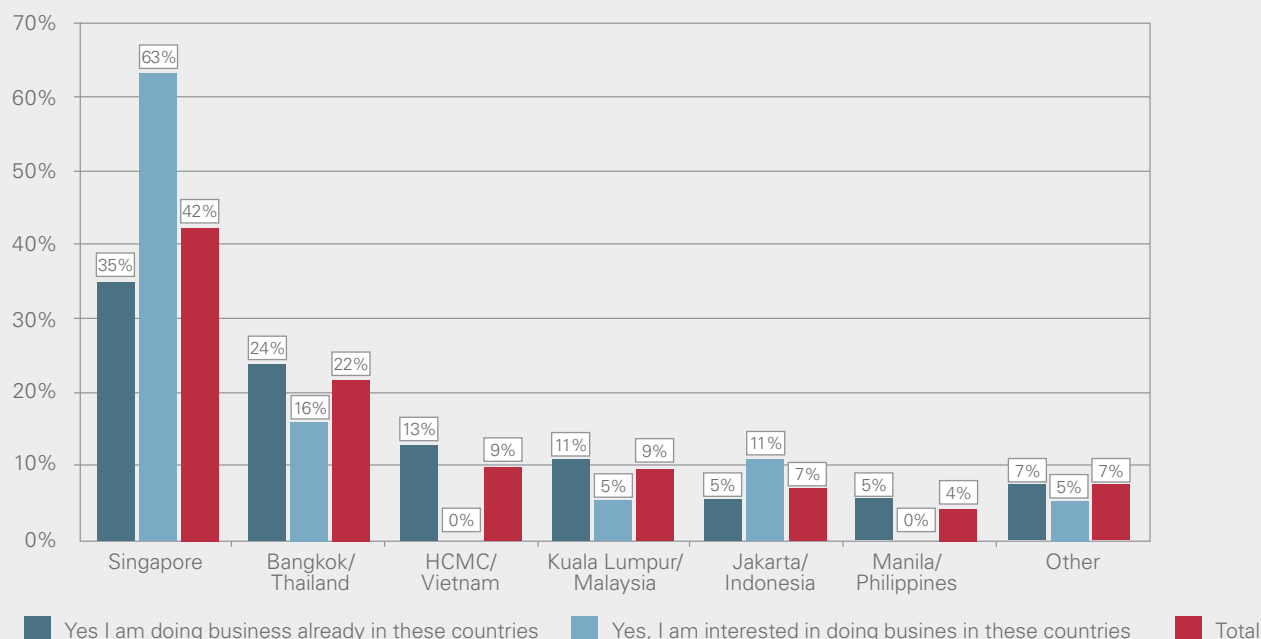


Figure 5: RTC locations/most attractive locations for Australian companies already in/interested in doing business in ASEAN (Source: ASEAN Connected Survey, RFI Group)

tax exemption for interest payments on loans from non-resident banks for treasury activities, as well as on loans and deposits from non-resident approved network companies.

All of this is not to say that Singapore doesn't have its challenges. It is an expensive city to live and do business in, a factor that lower cost regional competitors can use to their advantage. But the outlook is very strong for the city-state, and its position as the RTC of choice for ASEAN is safe in the short and medium terms, according to Venkatesan.

"There are some challenges, but I think the Singapore government is being very proactive in the space, and given that there is a whole [legal, regulatory, infrastructure] system in place, I don't see many challenges to Singapore's position, at least in the next five-to-seven years," says Venkatesan.

SINGAPORE RTC OPPORTUNITY: NEXT STEPS

The RTC concept is not right for every company, and smaller businesses especially should ask some hard questions about themselves before taking the plunge, Venkatesan cautions.

Companies should consider what they are looking for when setting up an RTC, and whether they are confident in living up to commitments made to relevant authorities, he says.

"You need to have some scale of operations, some complexity, which then makes the RTC a very useful tool along a company's evolution," Venkatesan notes.

This is especially true once Australian companies are operating in more than two or three countries in ASEAN or wider Asia, at which point "Singapore becomes a very attractive proposition for liquidity consolidation, operating in a time zone that spans a number of countries, and to draw on the talent and expertise that Singapore offers," he says.

An alternative for companies without the scale and complexity required to fully benefit from an RTC is a hybrid model. For example, this could involve hiring a regional representative in Singapore who is able to make strategic decisions, while leaving the execution with the home country team.

"Typically, we see bigger companies with fully-fledged RTCs. The slightly smaller and growing companies usually have a hybrid model. That's where your discussion with the EDB and your understanding of your company's scale and complexity really comes into the picture," Venkatesan says.

CALL TO ACTION

Singapore should be a first port of call or entry point into the ASEAN region for Australian companies. Its well-developed legal, tax, infrastructure and talent advantages can mitigate some of the initial risk or hesitancy of expanding into the region. As a strong and established services hub, Singapore is an ideal location in which to establish a regional treasury centre as part of a larger pan-ASEAN proposition.

“Singapore has built a significant track record, to the extent that companies all over the world consider Singapore their number one option when they look at Asia from a regional treasury centre standpoint.”

*– Harish Venkatesan, HSBC
Head of International
Subsidiaries, Singapore*

Malaysia

- An ideal ASEAN hub for Australia's advanced manufacturers to access regional value chains and production ecosystems
- An opportunity for Australian vocational education and training (VET) providers to leverage demand for up-skilling as Malaysia moves up value chains
- Well-connected with Australia, with two FTAs in place, and potentially one of the biggest beneficiaries of regional connectivity across the initiatives
- Australian companies can leverage investment attraction incentives to establish a regional hub to access Malaysian and ASEAN-wide opportunity

AN IDEAL ASEAN HUB FOR LEVERAGING REGIONAL VALUE CHAIN AND ECOSYSTEM OPPORTUNITY

Malaysia is one of ASEAN's most mature and connected economies, both regionally and globally. It is a big beneficiary of regional connectivity, considering the degree to which the country has extended its value and supply chains across the region.

In the manufacturing space, Malaysia has long been known as a hub for electronics and semiconductor manufacturing, but this is now changing as the economy matures.

"We are now focusing on high value-added sectors like advanced electronics, medical devices and the aerospace industry," Malaysia Investment Development Authority (MIDA) Australia Director Aizah Abdullah says. "We want the economy to move up the value chain."

For Australia, this creates opportunity to not only tap into demand in Malaysia for our advanced-level manufacturing and expertise, but also plug into ASEAN-wide value and supply chains through establishing a base in the country.

Malaysia's approach to advanced manufacturing is centred around building ecosystems to attract foreign expertise in areas where this is lacking in the country. This includes core manufacturing processes, as well as the supporting and surrounding processes and services.

Involvement in these ecosystems is an opportunity-rich proposition for Australian companies, and a potential gateway into regional value chains. It helps that of the six main ASEAN economies, Australian companies rank Malaysia as the third most attractive market in the region, after Singapore and Indonesia (see Figure 6).

Moreover, as a fast-maturing economy, education is prominent in the Malaysian story. A growing middle class is driving demand for the higher quality education and skills training that Australian institutions excel at providing.

Australia-Malaysia Fact Box

Malaysia GDP, PPP (global ranking)	\$803 billion (29)
Malaysia GDP per capita, PPP (global ranking)	\$26,215 (34)
Malaysia real GDP growth	4.7%
Global competitiveness ranking	18/140
Ease of doing business ranking	18/189
Australia goods exports (global ranking)	\$6 billion (9)
Australia goods imports (global ranking)	\$10.3 billion (8)
Australia service exports (global ranking)	\$1.8 billion (9)
Australia service imports (global ranking)	\$1.2 billion (15)
Australia investment in Malaysia	\$9.6 billion
Malaysia investment in Australia	\$20.9 billion

Australia-Malaysia trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

MOST ATTRACTIVE ASEAN MARKETS FOR AUSTRALIA

	Singapore	Indonesia	Malaysia	Philippines	Vietnam	Thailand
1 – Most attractive	39%	20%	15%	12%	9%	4%
2	14%	16%	24%	12%	16%	18%
3	15%	16%	19%	27%	7%	16%
4	19%	14%	12%	19%	22%	15%
5	8%	9%	19%	15%	16%	32%
6 – Least Attractive	5%	24%	11%	15%	30%	15%

Figure 6: Most and least attractive current/potential ASEAN markets for Australian companies (Source: ASEAN Connected Survey, RFI Group)

Education has pride of place in the Eleventh Malaysia Plan (11MP), the latest five-year iteration of an industrial master plan that aims to transform Malaysia into a developed country by 2020.

The 11MP focuses on the need for innovative approaches to accelerate Malaysia's development, including education reform, boosting productivity and focusing on high value-added activities. It sees a big role for the VET sector in supporting this, as an estimated 60% of jobs created under the Plan will require VET skills.

The Plan also acknowledges that the VET sector in Malaysia is fragmented, with over 1,000 public and private institutions offering similar programs in the country, to varying quality standards.

A QUIET BUT STRONG AND CONNECTED TRADING PARTNER

Malaysia may not be the highest profile Australian trading partner, but it is a very important one. The country is our third largest trading partner in ASEAN, after Singapore and Thailand, and in our top ten overall.¹⁶

It is a particularly important export market for Australian service providers, especially in

education. The country is our ninth largest service export destination overall, and Australian education exports are the single biggest item in our trading relationship¹⁷.

It is a very accessible market for Australian companies, with two FTAs to be leveraged: the Malaysia-Australia Free Trade Agreement (MAFTA) and AANZFTA.

MAFTA builds on the liberalisation introduced by its broader cousin, offering "AANZFTA-plus" elements that improve access to the Malaysian market for Australian companies.

It is also the Australian FTA with the most certainty in its applicability to individual Australian companies (See Figure 7).

As a key ASEAN economy, Malaysia is very much plugged into regional trade and connectivity initiatives. Most will have a longer rather than shorter-term impact, but Australian companies can lay the foundation now in order to capitalise on future opportunities they create.

Regarding the AEC, MIDA's Abdullah says its practical impact has been limited so far, but notes the initiative has promoted a more cooperative and complementary

"All these trade agreements are aimed at promoting ASEAN as a single unit, one community where each country can play its own unique role."

– Debbie Mak, HSBC Head of Global Trade and Receivables Finance, Malaysia

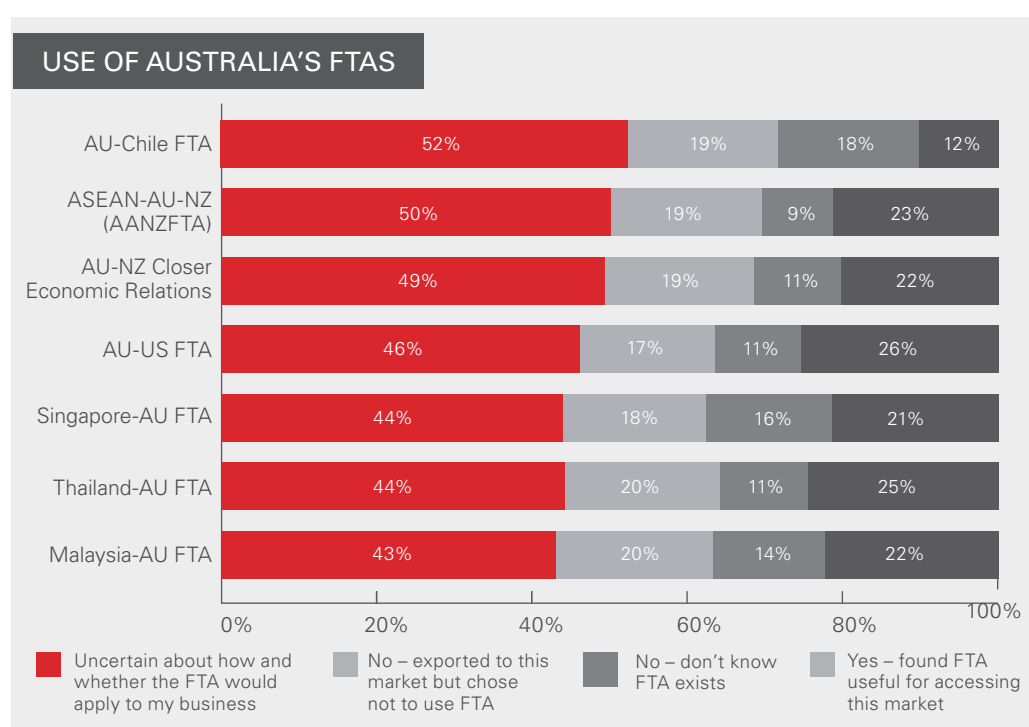


Figure 7: Use of Australia's FTAs (Source: Australia's International Business Survey 2015)

perspective on intra-ASEAN trade between member countries.

Local circumstances and domestic regulation are a drag on AEC liberalisation efforts, but discussions are taking place to move its ambitious goals forward in Malaysia.

“We have seen some impact in terms of allowing skilled labour movement between these countries, for example, but there are still restrictions and quotas involved,” HSBC’s Head of Global Trade and Receivables Finance in Malaysia Debbie Mak notes.

When it comes to trade initiatives like the TPP and RCEP, these are expected to benefit Malaysia more than a developed economy like Singapore, because it has more room to grow and therefore more to gain through greater trade liberalisation.

For example, one study projects growth of around 1% in Malaysia’s overall exports by 2027 as a result of the TPP, with automotive exports and foreign investment in the automotive sector projected to grow around 1–2% over this period.¹⁸

RCEP is less far along, but Malaysia’s Ministry of International Trade and Industry expects similar benefits, such as increased market opportunity as countries like China and India are brought into the fold, and better FTA utilisation as ASEAN’s current regional agreements are harmonised.¹⁹

As a strong Chinese trading partner, Malaysia is also likely to play a leading role in Chinese-led connectivity initiatives in the region.

This is already taking shape in a number of sectors, including the listing of the world’s first “21st Century Maritime Silk Road” bond in the country to support the BRI, as well as recent statements of interest in high speed rail projects in Malaysia.

Though early, such projects may present opportunities for Australian participation, either through direct involvement in the projects themselves, or in providing the services and other functions necessary to see them to fruition.

EDUCATION, SKILLS AND ADVANCED MANUFACTURING: A RECIPE FOR VALUE-CHAIN INCLUSION

Malaysia is an education-hungry economy and is eager to attract the education services and training necessary to further up-skill its workforce.

Higher value-added activities require a more skilled workforce, and therefore the education and skills necessary to create this skilled labour. Malaysia’s movement up value

chains and the demand this creates for appropriate training and education is therefore a mutually reinforcing opportunity for Australia.

Virtually every sector in Malaysia is looking at how to raise the availability of skilled workers, HSBC Head of International Subsidiaries in Malaysia Ian McElwain notes.

“The challenge remains to move further up the value chain, and there is a need for Malaysia to continue to improve the skill-set required to do that, both from an educational and vocational training perspective,” McElwain says.

Australian education institutions already have a strong presence in the tertiary sector in Malaysia – Curtin University, Monash University and Swinburne University all operate offshore campuses in the country – but we are not alone.

While Australian education service exports to Malaysia are the single biggest traded item in our commercial relationship, we are being increasingly challenged by international competitors.

American universities are now adopting Australia’s pioneering strategy of employing agents in source countries to enrol students, for example.²⁰ However, HSBC’s McElwain notes our strong reputation in the market gives Australian institutions a competitive advantage.

“Australia is the first place a lot of Malaysians look to when considering educational opportunity, because the perception of Australian academic institutions is very strong here,” he says. “There’s certainly more opportunity for Australian institutions to explore, whether it’s attracting international students to Australia, or setting up campuses here in Malaysia.”

This strong reputation extends to Australian capabilities in technical areas like advanced manufacturing as well.

“Australia has top-of-mind recall when it comes to education, as well as a fairly strong and well established reputation when it comes to manufacturing expertise,” says Mandeep S, HSBC Head of Global Liquidity and Cash Management in Malaysia.

This expertise and reputation, combined with Malaysia’s aim to attract higher-value activities and functions, can be leveraged by Australian companies to access both local and regional opportunity.

“Malaysia no longer supports labour-intensive and low value-added activities,” MIDA’s Abdullah says. “Instead, we are more targeted in our investment promotion efforts, aiming to attract quality investments. We introduced the Principal Hub scheme last year as part of this.”

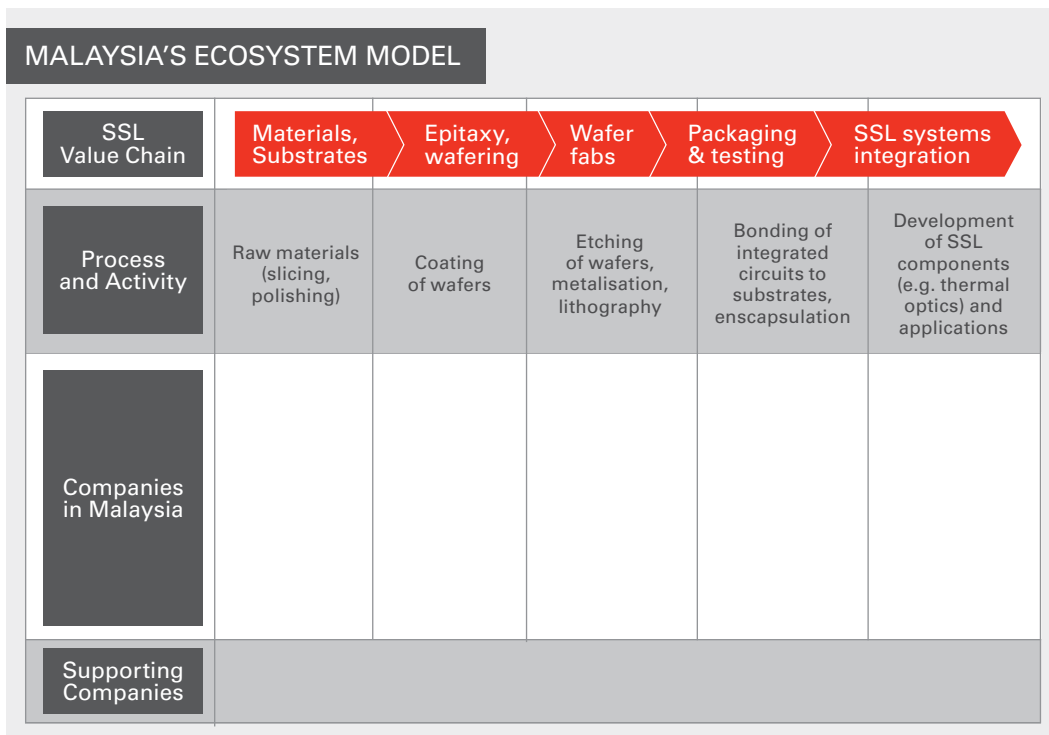


Figure 8: Malaysia ecosystem development template (Source: Malaysia Investment Development Authority)

The Principal Hub scheme is aimed at attracting and incentivising foreign companies to use Malaysia as a base for regional and global business operations. We discuss some of these incentives in the next section.

In moving up value chains to more advanced activities, Malaysia aims to attract entire ecosystems that sit around specific industries or sectors, including all core and supporting functions. Under this comprehensive approach, certain sectors are targeted, and their value chains broken down into their constituent activities. Companies with strengths in each segment of the chain are then targeted in order to attract them to Malaysia.

For example, Figure 8 features a sample investment attraction and ecosystem development template for the LED sector. It breaks the value chain down into five core processes and activities, under which the companies in Malaysia conducting these activities – as well as supporting functions – would be identified to determine where gaps lie and where the ecosystem could be strengthened.

Australian companies with niche skills and capabilities in specialised areas may thus enjoy significant advantage in Malaysia.

Australia can therefore fill two complementary and mutually reinforcing demand gaps in Malaysia, and capitalise on our recognised expertise in each: the need for advanced manufacturing technology and expertise as the country moves up value chains to higher-level activities, and the need for the education and skills training to get them there.

After all, “the perception of Australia is strong in technical, strong in engineering, and strong in expertise-heavy areas,” McElwain says.

Easier and more cost effective access to component and supplier networks are the main factors encouraging Australian supply chain expansion into or across ASEAN (see Figure 9).

Malaysia is therefore an attractive base from which Australian companies can access component and supplier networks, both locally and across ASEAN, thanks to many of the factors we have discussed here.

“Australia is the first place a lot of Malaysians look to when considering educational opportunity, because the perception of Australian academic institutions is very strong.”

– Ian McElwain, HSBC Head of International Subsidiaries, Malaysia

EDUCATION AND ADVANCED VALUE CHAIN OPPORTUNITY IN MALAYSIA: NEXT STEPS

Australian offerings have a premium reputation in Malaysia, MIDA's Abdullah says, echoing earlier comments on our brand reputation in the education and technical spaces. This can and should be leveraged by Australian companies pursuing opportunity in Malaysia.

Our FTAs can help.

For example, MAFTA allows majority ownership in companies in a wide range of sectors supplying services to Malaysia, including 70-100% ownership in higher education and other education services.²¹

In pursuing education opportunity, Australian service providers and VET institutions can capitalise on the aforementioned priority the Malaysia government is placing on the sector, as well as the good reputation for quality and standards Australia already enjoys in the market.

An up-skilling Malaysian workforce increases the country's attractiveness as a base for Australian companies to access both local and ASEAN-wide opportunity. As in education, Australian manufacturers can leverage our strong reputation for quality and expertise in the field to into this opportunity.

"Australian companies should leverage the Principal Hub scheme's benefits, and consider Malaysia an optimal location to cater for Asia-Pacific and global markets," says Abdullah, encouraging joint ventures and collaboration in the technology space in particular.

For Australian companies who find the prospect of a Malaysian hub attractive, MIDA's Principal Hub incentive scheme should be a first port-of-call.

A Principal Hub is defined as a locally-incorporated company that uses Malaysia as its base for regional or global operations to manage, control and support key functions - such as risk management, decision making and other strategic business activities like human resources.

The benefits on offer include customs duty exemptions in various special economic zones, relaxation of equity ownership restrictions and more flexibility in hiring expatriate labour, among others.

The scheme also offers tax advantages, such as a reduced tax rate of 0-10% over a 5-year period, with the potential for extension, dependent on business expenditure and the number of skilled jobs created.

As a condition of these incentives, Principal Hubs must "serve and control" network companies in at least three countries outside Malaysia, and must offer at least three specified qualifying services.

"The scheme is not confined to a specific area, but provides locational flexibility whereby companies can choose to establish their principal hub at any preferred location in Malaysia that best aligns with their strategic objectives," MIDA CEO Dato' Azman Mahmud says.²² "The scheme also fits the current trend of the way businesses manage their operations globally as MNCs are increasingly centralising key strategic value-adding functions to maximise value and be more cost efficient."²³

FACTORS ENCOURAGING ASEAN SUPPLY CHAIN EXPANSION

	Total
Cheaper access to component/supplier networks	50%
Easier access to component/supplier networks	41%
Proximity to end user markets	35%
Less restrictive regulatory environment	32%
To take advantage of greater regional integration	24%
Proximity to suppliers	22%
Other	11%

Figure 9: Main factors encouraging supply chain expansion across ASEAN for Australian companies (Source: ASEAN Connected Survey, RFI Group)

CALL TO ACTION

Australian education service providers can capitalise on Malaysia's maturing economy, and the demand this is driving to up-skill the country's workforce and move up production value chains. Australia's high-quality education services are well-regarded in Malaysia, and the need for VET skills is recognised. Australian advanced manufacturers should leverage incentives like the Principal Hub scheme, and plug into manufacturing ecosystems in the country. This could be a boon to niche and smaller companies, allowing them to tap into regional value chain opportunity.



Philippines

- A progressive, English-speaking and service-oriented economy offering efficiency gains and cost savings as a leading business process management destination for Australian companies
- An easily accessible market through AANZFTA, mutual membership of TPP and RCEP negotiations, strong people-to-people links and common language
- More than just call centres, with higher value services in finance, engineering, design and web-based solutions waiting to be leveraged through business process management outsourcing
- Generous incentives can be leveraged by Australian companies interested in the opportunity

A SERVICE-ORIENTED ECONOMY WITH EFFICIENCY GAINS AND COST SAVINGS TO OFFER

The Philippines is a case in point that service sector opportunity can be found across ASEAN, and is not just limited to the region's more mature economies.

"We are a service-based economy like Australia, which is quite impressive for an emerging economy," notes Philippines Commercial Consul to Australia, Kenneth Yap.

The country was able to jump from agriculture to services by capitalising on developing strengths in areas like electronics

and component manufacturing off the back of North Asian investment, Yap notes. The legacy of which is now a strong IT services sector.

With strong English language ability, a culture based on friendliness and hospitality, and comparatively low labour costs, the Philippines has emerged as a strong hub for business process outsourcing (BPO).

While call centres are still among the first areas to come to mind when considering BPO in the Philippines, the story is not there anymore. BPO has become business process management (BPM) in the Philippines, as the sector has developed beyond voice-based services to higher value-added activities like design, engineering, finance and accounting.

For Australia, the Philippines' experience and maturing BPM capabilities are an excellent cost-saving and efficiency gaining proposition. The challenge is building awareness of its benefits, as well as awareness of opportunity in the Philippines in general.

When it comes to outsourcing either front or back-end services, Australian companies ranked the Philippines fifth among a select group of typical outsourcing destinations – and third in ASEAN (see Figure 10).

ATTRACTIVENESS OF ASEAN OUTSOURCING DESTINATIONS

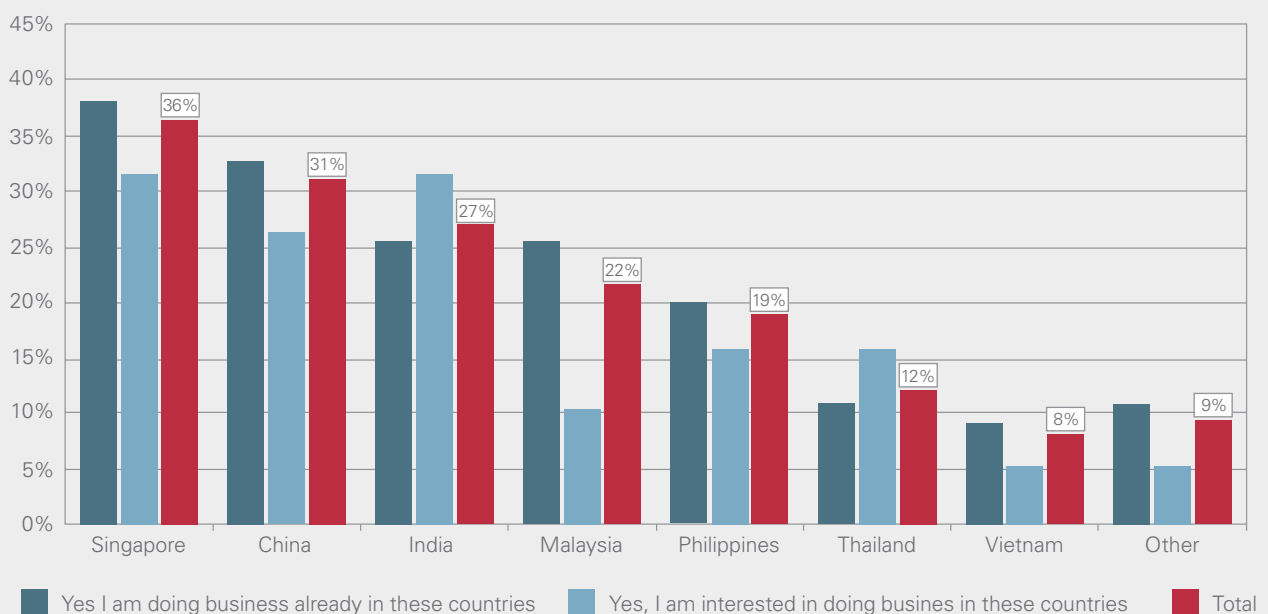


Figure 10: Attractiveness/popularity of select outsourcing destinations for Australian companies (Source: ASEAN Connected Survey, RFI Group)

Australia-Philippines Fact Box

Philippines GDP, PPP (global ranking)	\$860.6 billion (27)
Philippines GDP per capita, PPP (global ranking)	\$7,254 (118)
Philippines real GDP growth	6%
Global competitiveness ranking	47/140
Ease of doing business ranking	103/189
Australia goods exports (global ranking)	\$1.5 billion (20)
Australia goods imports (global ranking)	\$744 million (38)
Australia service exports (global ranking)	\$702 million (19)
Australia service imports (global ranking)	\$757 million (24)
Australia investment in Philippines	\$10 billion
Philippines investment in Australia	\$473 million

Australia-Philippines trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

A GROWING AUSTRALIAN TRADING PARTNER, WITH SERVICES LEADING THE WAY

The Philippines is our smallest trading partner among ASEAN's six biggest economies. Australia's total trade with the Philippines is less than one-third of our trade with Vietnam, for example.

Though we are starting from a small base, the Australia-Philippines commercial relationship is a fast-growing one, with services leading the way.

Australia exports over AUD 700 million in services to the Philippines, exports which grew around 11% in 2015, and the country is now amongst our 20 largest service export destinations worldwide.²² Education and travel are the largest items, reflective of strong people-to-people links between our two countries.

Comparatively speaking, the Philippines is not an easy place to do business, ranking 103rd in the world for ease of doing business, and 47th in terms of competitiveness.²⁵ This is respectable for an economy at its stage of development, ranking above countries like South Africa and Turkey.

Australian companies interested in the Philippines market can take advantage of preferential access through AANZFTA. It provides for substantial tariff reductions, locks in regulatory provisions and investment protection, and facilitates regional rules of origin, among other benefits.

Australia and the Philippines also share mutual membership of the TPP and RCEP negotiations. These agreements, if concluded and ratified, can open doors to new opportunity in each other's markets.

The challenge for the Philippines is to prepare itself for the more liberalised trading environment connectivity initiatives like these and the AEC will introduce.

Preparations for liberalisation under the AEC are helping pave the way for mega-regional agreements like the TPP, former National Economic Development Authority Director-General Cielito Habito says, and the country is now more than halfway toward making the adjustment necessary to join the TPP, should it come to fruition.²⁶ He notes foreign ownership and constitutional restrictions remain the biggest obstacles.

One of the main benefits to Australia from trade agreements like these lies in the reform they will require and catalyse in the Philippines. This liberalisation will foster a more open and competitive operating environment, and strengthen legal and intellectual property protection.

They will introduce new opportunities in the Philippines as well, as the AEC for example should benefit the country's people-centric economy when it comes to freer movement of skilled labour.

"If a certain company wants to outsource to the Philippines primarily because of English capabilities, but also would like to outsource operations that include communicating in another language, some vendors in the country would be open to exploring this arrangement," says Rona David, HSBC Philippines Head of Payments and Cash Management.

The impact the BRI and AIIB initiatives will have on the Philippines is likely to hinge on the future political relationship between the Philippines and China, especially as a new government takes over in Manila, and Beijing prepares to revamp its top leadership in 2017.

China is the Philippines' second-largest trading partner overall and third-largest export market²⁷, so it can be assumed that with good political relations, the economic benefits from both BRI and the AIIB should accrue to China's close neighbour.

For example, manufacturing in the Philippines is seeing a resurgence partially thanks to Chinese companies shifting operations away from higher labour costs in South China, Commercial Consul Yap points out.

For Australia, positive developments will create new opportunities for involvement in BRI-linked or AIIB-financed infrastructure projects in the Philippines, considering the abundance of projects required to modernise infrastructure in the country.

Australia has provided aid to the Philippine Public-Private Partnership program, such as technical assistance and funding for feasibility studies to prepare projects for bidding, Yap notes.

"Australia companies should capitalise on this by hopefully winning some of the bids for the projects," he says. The Philippine government plans to increase public infrastructure spending to 7% of GDP in 2016 and the years to come, according to Yap.

"More and more we are seeing that industry growth prospects are in information technology, such as software development, game development, engineering and design."

– Trish Ramos, HSBC Head of Trade, Philippines

In the shorter-term, Australian companies can realise immediate benefits from leveraging the Philippines' strong service sector, in particular its strengths in BPM.

BPM: OUTSOURCING ANYTHING THAT CAN BE TRANSMITTED ONLINE

The BPM industry in the Philippines has branched far beyond voice-based services, and will soon overtake remittances in terms of revenue generated.

"In terms of expectations, the IT and Business Process Association of the Philippines projects 2016 revenues at USD 25 billion, while in 2015 it was USD 21 billion, so with a 15% to 18% compounded annual growth rate in the past 10 years, the expectation for the BPM industry is definitely very positive overall," says HSBC's David.

"We are getting such investments because the number one asset of the Philippines is our trainable and efficient workforce, which more than one million people join each year, including 585,000 college graduates" Commercial Consul Yap says. "Companies are spoilt for choice in terms of the high quality workforce and number of college graduates we churn out every year."

"For the Department of Trade and Industry, we want the BPM industry move up the value chain to higher value types of services, and have put policies in place to incentivise this" Yap adds. "Lower-value services are good for Filipinos that are fresh out of college and going into their first jobs, but

they then need higher pay and to build their skills, and that's where the higher value services come in."

"More and more we are seeing that industry growth prospects are in information technology, such as software development, game development, engineering and design," HSBC Head of Trade in the Philippines Trish Ramos notes.

Yap concurs, noting the country has been successful in attracting software development and design companies, including Hollywood studios like Disney, who do digital animation in the Philippines.

"We want to move from voice-based services to higher value non-voice ones, like software development, animation, engineering and architectural design, web development and management, and financial services, among others," he says.

Virtually any type of process which can be transmitted via the internet can now be outsourced to the country, Yap adds.

Many Australian companies are already taking advantage of BPM in the Philippines. These include Macquarie and QBE, as well as many smaller companies.

As in other countries, Australian companies enjoy a strong reputation in the Philippines, and a perception that our motivations go beyond profit and extend to the welfare of employees.

"The good thing about Australian companies from a Filipino perspective is they care for their workers, they care about creating a good working environment here," Yap says, which in-turn generates goodwill that can then be leveraged for competitive advantage.

In all, Australian companies currently employ around 30,000 staff in the Philippines and collectively generate around AUD 2 billion in annual output.

Larger companies run the gamut in terms of what they outsource to the Philippines. Smaller Australian companies are setting up graphic design, accounting, finance and engineering operations, as well as web-based design and support services. Some look to employ just five people, others 120-150, and many would start small and then scale-up as their business grows, Yap says.

Companies from across Europe, North America and North Asia are very active in capitalising on the BPM opportunity in the Philippines, and Yap notes Australian companies should be just as proactive.

"Australian companies should be bolder and more aggressive like their Asian counterparts, who are very aggressive and aren't afraid to venture out of their

comfort zone for growth opportunities,” Yap remarks.

“It is a challenge for Australian companies to venture into countries with different cultures from their own, but in the Philippines, the big ones are at least leading the way.”

“The good thing about Australian companies from a Filipino perspective is they care for their workers, they care about creating a good working environment here.”

– Kenneth Yap, Philippines Commercial Consul to Australia

“What we want is not to take jobs from Australians, but rather to get them to look at the Philippines as a base to expand to bigger and growing markets in ASEAN and across Asia,” Yap says.

BPM OPPORTUNITY IN THE PHILIPPINES: NEXT STEPS

Recognising the crucial importance of BPM to the Philippines economy, the government has been offering a variety of incentives in the sector for over a decade.

“Knowing that BPM companies in the Philippines cater to foreign clients, we have reduced red tape in the industry to make the process of setting-up as smooth as possible,” Yap notes.

The Philippine Economic Zone Authority (PEZA) is the government agency under the Department of Trade and Industry that facilitates the establishment and operation of foreign businesses in the Philippines. It also administers fiscal incentive programs.

Australian companies interested in operating in the Philippines can register with PEZA and take advantage of a generous tax regime in the country. This includes tax holidays of 4-6 years, to be determined by PEZA depending on the size of the company, as well as a preferential 5% tax rate on gross income.

Recognising the size of the industry in the Philippines, and the fact that entire buildings can be devoted solely to BPM activities,

many of these buildings themselves are designated by PEZA as export processing zones – a novel approach that reflects the way digital commerce and business processes are conducted in the 21st century.

This allows for tailored business incentives to be applied to these buildings and the companies housed within them, such as the removal of requirements to renew businesses licenses, easy visa renewal processes and a dedicated PEZA staff member for each building to service registered companies.

“If you’re in an export processing zone, establishment is a walk in the park. You can be sure you’ll get world class service. You only talk to one government person and get all of the requirements taken care of,” says HSBC’s Ramos.

For Australian companies interested in this opportunity, size doesn’t matter, and there are BPM service providers that can tailor to specific business needs. Smaller companies can be more flexible and may be better able to service Australian companies that are only looking for just one or two dedicated people, Yap points out.

Turnkey solutions are also available. For example, some BPM providers can train 150 staff members in a certain process or activity related to finance, accounting or design, and then turn over the entire operation to the Australian company years later with fully trained staff.

When it comes to quality concerns, Yap notes the Philippines is a party to conventions that safeguard electronic data, which is especially important when dealing with sensitive information such as payments.

“In terms of data security, much of it comes down to choosing the right Philippine partner with a good track record,” he says. “You can’t simply be looking at reducing costs at the expense of security.”

Finally, when it comes to location, there is plenty of opportunity outside of metro Manila, and agencies such as PEZA or the Philippines Trade Centre in Australia can assist in selecting an appropriate location.

“Australian companies should be bolder and more aggressive like their Asian counterparts, who are very aggressive and aren’t afraid to venture out of their comfort zone for growth opportunities.”

– Kenneth Yap, Philippines Commercial Consul to Australia

“There has been a dispersal of this business away from Manila, away from Cebu and other urban centres, creating opportunity for secondary and even tertiary cities,” says Ramos.

“You would get to pick the best students from the best universities in these areas, many of which would be encouraged by the prospect of getting to work closer to home, while you enjoy the cost savings,” Yap adds, while noting there are a number of Australian companies already in many of these areas, like the Visayas, Mindanao and Davao.

CALL TO ACTION

Integrating the Philippines into regional value chains can benefit Australian companies in all sectors. There are cost savings and efficiency gains to be had and generous incentives to be leveraged by capitalising on the Philippines’ business process management strengths. Despite the fact that Australian companies enjoy a very strong reputation in the Philippines, not enough are exploring opportunity there. This is to Australia’s detriment, as aggressive competitors from around the world and within Asia itself are capitalising on the Philippines’ growing sophistication.





Indonesia

- A vast country presenting vast opportunity for Australian involvement in infrastructure development
- A very accessible market for Australian companies through AANZFTA and a Closer Economic Partnership Agreement on the horizon
- Across-the-board demand for infrastructure development and modernisation, from road and rail, to maritime and tourism-related projects
- A prime opportunity for service providers that support infrastructure development, from contracting to project supervision and finance

A VAST COUNTRY, WHOSE INFRASTRUCTURE NEEDS EXEMPLIFY BOTH THE CHALLENGE AND OPPORTUNITY OF ASEAN

To call Indonesia a vast country is nearly an understatement. Its 258 million people make Indonesia the world's fifth most populous country, and its 13,000 islands make it the world's largest archipelagic nation.²⁸

Indonesia is the economic giant of ASEAN. Measured by GDP on a PPP basis, its economy is more than triple the size of the second largest in ASEAN, Thailand, and accounts for over 50% of the combined GDP (PPP) of all six countries we focus on in this report.²⁹

It is a developing economy – Indonesia's per capita GDP (PPP) is one-eighth that of Singapore's³⁰, for example – and faces all of the challenges that come along with this: an urgent need for infrastructure development and modernisation, better quality education and upskilling, and economic reform in general.

Infrastructure is arguably at the heart of both the developmental challenges facing Indonesia, as well as market opportunity.

Australia-Indonesia Fact Box

Indonesia GDP, PPP (global ranking)	\$3 trillion (8)
Indonesia GDP per capita, PPP (global ranking)	\$11,126 (99)
Indonesia real GDP growth	4.7%
Global competitiveness ranking	37/140
Ease of doing business ranking	109/189
Australia goods exports (global ranking)	\$5.5 billion (10)
Australia goods imports (global ranking)	\$5.6 billion (12)
Australia service exports (global ranking)	\$1.2 billion (12)
Australia service imports (global ranking)	\$2.6 million (8)
Australia investment in Indonesia	\$8.4 billion
Indonesia investment in Australia	\$1.4 billion

Australia-Indonesia trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

A TOP-15 AUSTRALIAN TRADING PARTNER, BUT PLENTY OF ROOM FOR GROWTH

The Australia-Indonesia trading relationship is large, but we have plenty of room to grow as our trade does not yet reflect the potential in our relationship, especially considering Indonesia's size, needs and proximity to Australia.

Indonesia is our closest ASEAN neighbour but sits outside our top ten trading partners, ranking 12th overall.³¹ It is only Australia's fourth largest trading partner in ASEAN³², despite dwarfing the rest of the region in terms of market size and – some say – potential.

"Australia businesses are definitely interested in Indonesia, despite some commentary to the contrary," Australian Ambassador to Indonesia Paul Grigson says. "Some Australian businesses decide not to invest in Indonesia after doing their due diligence, but often this is because they didn't seek advice in the first place."

Primary products dominate Australian goods exports to Indonesia, around a third of which is comprised of wheat and live animals, while our major imports are crude petroleum and machinery equipment.³³ On the services side, education is our biggest export, and personal travel – by a wide margin – is our biggest service import.³⁴

Australian companies benefit from access to the Indonesian market created by the AANZFTA, and in the future are sure to benefit from a prospective Closer Economic Partnership Agreement, negotiations over which were relaunched in March 2016.

AANZFTA has significantly reduced tariffs on Australian exports to Indonesia, which were as high as 56% as recently as 2011.³⁵ These have since been reduced to zero on 92% of all tariff lines, increasing to 94% by 2025.³⁶

On the services side, AANZFTA has allowed 51% Australian equity in existing local banks, 55% in joint venture construction services, and 49% in educational institutions established with a local partner.³⁷ The door is left open to further liberalisation in services in the future.

From a regional perspective, Indonesia is party to the AEC as well as RCEP negotiations, but not the TPP. It is a member of the AIIB and hosts what some consider a highlight BRI project: A China-backed high speed rail line between Jakarta and Bandung.

These regional trade and connectivity initiatives should collectively motivate and drive domestic reform efforts to better align Indonesia with international best practice and standards.

However, reform faces a number of challenges in Indonesia, as concerns over the competitiveness of Indonesian products and services in a more barrier-free ASEAN can encourage protectionist tendencies.

For example, Indonesia's expansive and complex geography, coupled with poor infrastructure, burden Indonesian exporters with some of the highest logistics costs in ASEAN.³⁸

Issues such as these lead to questions of whether greater liberalisation will be beneficial or harmful to Indonesia at this stage of its development.

The impact of the BRI and AIIB initiatives is challenging to assess. In principal, Indonesia is a prime candidate to benefit from these schemes, considering it is a developing country with urgent infrastructure development needs and already a large beneficiary of Chinese investment (when indirect investment is considered).

However, if the under-development Jakarta-Bandung high speed rail line is any indication, the road ahead will be bumpy. The project has been hailed by observers as an example of what the BRI can offer the region, but has been hampered by controversy since China bested Japan to win the bidding process with its Indonesian partners. Difficulties have included permit issues, local opposition and concerns over the project's budget and time frame.

Nevertheless, Indonesia's immense infrastructure needs mean any and all investment is likely to be welcome.

To the extent that these initiatives encourage greater infrastructure development in Indonesia, this will be positive for Australia and create opportunity to not only participate in the projects directly, but also to benefit from the knock-on effects that improved infrastructure in Indonesia will create.

VAST DEMAND FOR INFRASTRUCTURE DEVELOPMENT

More than half of Indonesia's massive population is located on Java alone, an island smaller than New Zealand's South Island and not much bigger than its North Island. At 31 million people, metropolitan Jakarta is the world's second largest urban area.³⁹

The sheer numbers and density illustrates the scale of the infrastructure needed to modernise the Indonesian economy, reduce bottlenecks and inefficiencies, and improve the living standards of the Indonesian people.

"Under President Jokowi, the key sector of focus has been infrastructure, particularly maritime logistics. We've also seen a lot of roads being built recently, as well as infrastructure in inner-cities and the eastern parts of the country."

– Rosalina Lazuardi, HSBC Head of International Subsidiaries, Indonesia

At less than 4% of GDP, the Indonesian government has invested less than half of what is necessary to escape the middle-income trap and become a high-income economy by 2030, according to the World Bank.⁴⁰

This insufficient infrastructure investment has cost the economy around 1% of lost economic growth each year over the past decade.⁴¹ Recognising its investment shortfall, Indonesia's 2016 State Budget earmarks nearly USD 23 billion for infrastructure investment, the highest ever allocation for infrastructure spending.⁴²

The private sector has picked up some of the slack in lieu of public spending as well, HSBC Head of International Subsidiaries Rosalina Lazuardi notes.

"Under President Jokowi, the key sector of focus has been infrastructure, particularly maritime logistics. We've also seen a lot of roads being built recently, as well as infrastructure in inner-cities and in the eastern parts of the country," she adds.

Insufficient revenue collection – Indonesia has only been able to collect around 30% of its tax revenue target during the first five months of 2016⁴³ – coupled with inefficient past spending allocations, means the government will be largely reliant on foreign and private assistance for infrastructure development and financing.

Australia's role in Indonesian infrastructure development is likely to be in infrastructure development and delivery: contracting, engineering and technical supervision, among other areas.

In contracting for example, no standard template exists for projects in Indonesia. Instead, a new contract is written for each individual project.

"Australia is working to try to standardise this, we are good at it," Ambassador Grigson notes, while adding that Australia's strengths in supervision and project oversight could also be put to good use in Indonesia.

"Australia has developed very good, very sound project financing models around motorway projects which have worked very well," Lazuardi notes. "This is the kind of best practice that I think Australian companies can share with Indonesia."

Maritime infrastructure is a big opportunity for Australia.

As an archipelagic nation, seaborne transport is the lifeblood of the Indonesian economy, considering most of Indonesia's resource wealth reaches domestic and world markets by sea.

Regional economic growth can vary substantially, with GDP per person in resource-rich provinces such as Riau up to

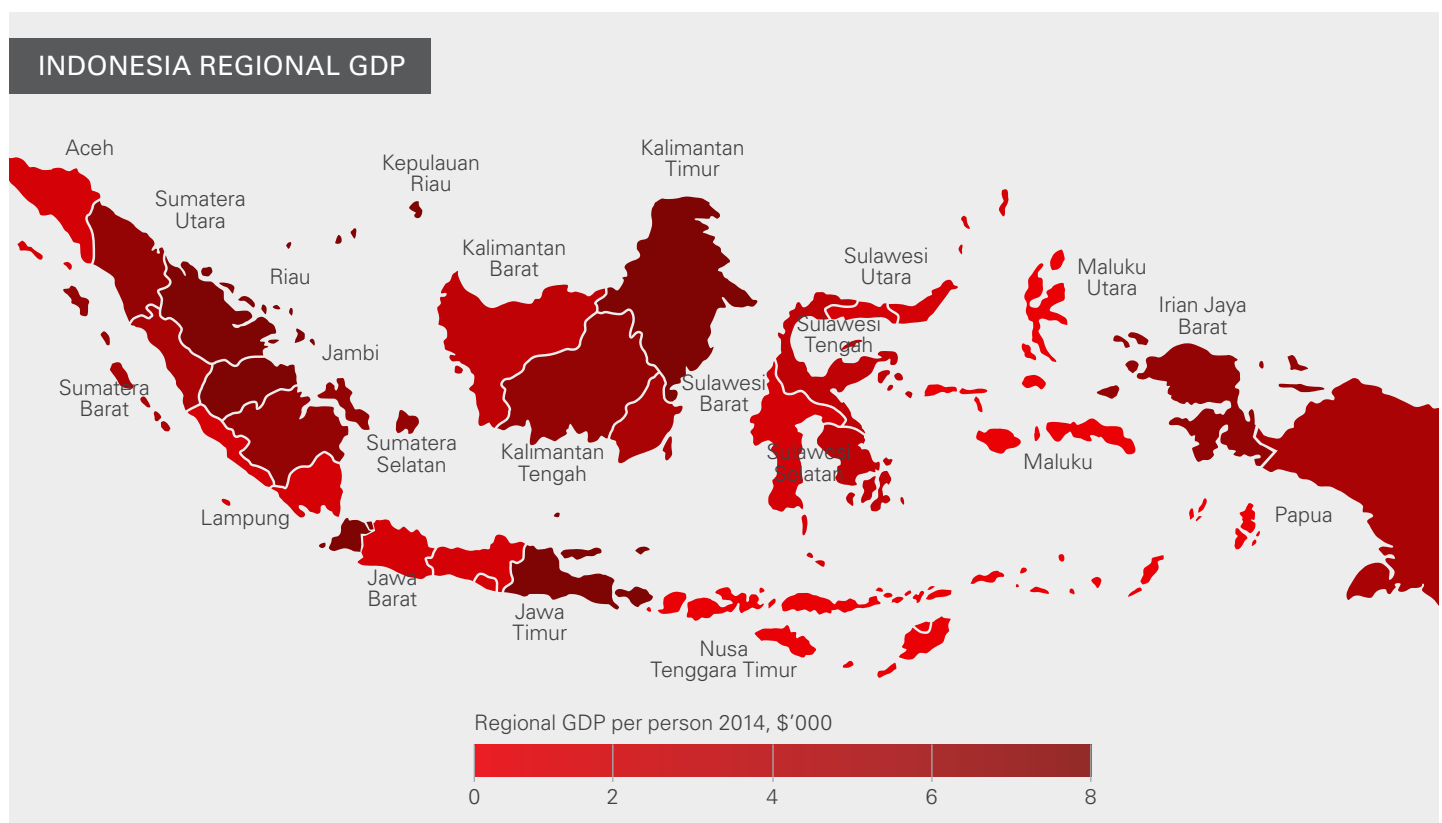


Figure 11: Indonesia regional GDP per person, 2014 (Source: The Economist)

three times higher than that in farther-flung and resource-poor southern and eastern islands (see Figure 11). Indonesia's major islands all have at least one sizeable port city, and maritime access is a significant priority for the Indonesian government.

Australia can capitalise on this demand and top-level encouragement by providing not only physical vessels like ferries, but also the services that surround maritime transport.

Australian companies should keep an eye on the leisure side of the maritime equation. Demand for quality marinas is increasing as yacht ownership increases, Ambassador Grigson notes, and is an example of a less conventional maritime infrastructure opportunity in the country.

More broadly, Indonesia's existing leisure and tourism infrastructure is under increasing stress as Indonesia aims to increase tourism arrivals. It has been successful in doing so, having exceeded its tourism target for 2015.

Makassar, the biggest city on Sulawesi island, is a good example, Ambassador Grigson notes. "It is beautiful and growing, which is creating a great opportunity for infrastructure there, particularly in hotels where they need facilities that are up to international standards."

INFRASTRUCTURE OPPORTUNITY IN INDONESIA: NEXT STEPS

"Get advice," is one of the biggest pieces of advice offered by Ambassador Grigson. "Companies often make simple mistakes that could have been avoided if they had gotten advice. Indonesia is a unique country with unique challenges."

Indonesia is one of the most complex countries in the world in which to start a business, and is on a downward rather than upward trajectory.⁴⁴ The country has dropped ten places in the World Bank's annual rankings for the ease of starting a business for example, from 163rd out of 189 countries, to 173rd.⁴⁵

To alleviate some of the burden on foreign businesses, President Jokowi in late 2014 announced a one-stop shop would be created to combine the dozens of licenses required from different departments into a single service for foreign investors, under Indonesia's Investment Coordinating Board (BKPM).

"A one-stop shop has been set up and it has had some impact, but more is necessary," Ambassador Grigson says. "It is still a work-in-progress, but businesses say it has made a difference. The right conversations are happening."

Leveraging strong people-to-people linkages between Australia and Indonesia can provide Australian companies with an advantage over international competitors, considering the crucial role local knowledge and expertise can have in a country like Indonesia.

Stuart Page, CEO of Evolution Hospitality Institute – an Australian company specialising in hospitality training – says finding the right partner in Indonesia is vital.

"You have to find a partner to work with in Indonesia, which is not easy," he says. "It comes down to trust, how they trust you and you trust them. Everyone also has to make money out of the partnership, and everyone has to contribute to the partnership, otherwise it doesn't work."

"There are a lot of opportunities in Indonesia, and you'll find one if you are willing to spend the time looking for partners," Page adds.

Ambassador Grigson advises Australian companies to leverage our sister state relationships with Indonesia. While easy to discount from an Australian perspective, "these mean something in Indonesia", he says.

Sister state relationships are in place between Queensland and Central Java, and New South Wales and Jakarta, for example.

"Get advice. Companies often make simple mistakes that could have been avoided had they gotten advice. Indonesia is a unique country with unique challenges."

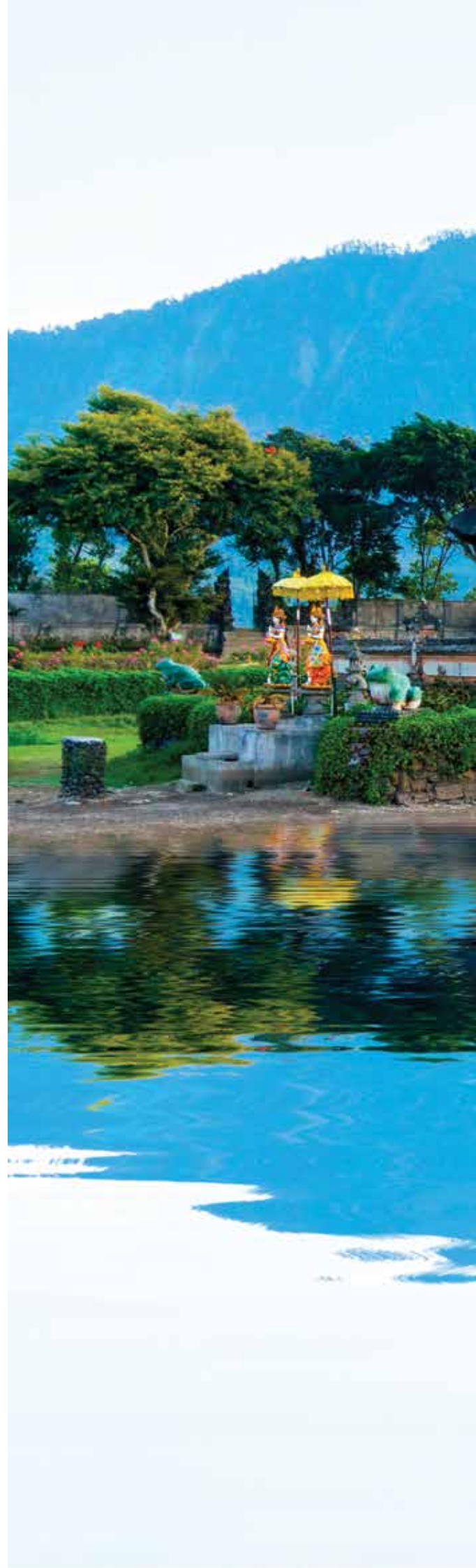
– Paul Grigson, Australian Ambassador to Indonesia

“You have to find a partner to work with in Indonesia, which is not easy. It comes down to trust, how much they trust you and you trust them.”

– Stuart Page, CEO, Evolution Hospitality Management

CALL TO ACTION

Indonesia’s vast infrastructure opportunity should be closely evaluated by Australian companies, and how this aligns with the investments, expertise or services they can provide. The expertise and services required by these projects create demand for even the most specialised Australian provider. Indonesia is not an easy place to do business, and being well-advised of both the opportunity and the challenges from day one are crucial to success in the market.





Thailand

- A hub through which to plug into regional value chains, such as in mid-level manufacturing
- A gateway to regional opportunity in the fast growing Cambodia-Laos-Myanmar-Vietnam region
- An easily-accessible market for Australian companies through two FTAs, as well as mutual membership of RCEP negotiations
- A range of fiscal and non-fiscal incentives can be leveraged by Australian companies to establish or expand operations in Thailand, as can a series of border-hugging special economic zones

A WELL-CONNECTED REGIONAL HUB FOR MID-LEVEL VALUE CHAIN ACCESS, AND GATEWAY TO THE CLMV REGION

We previously highlighted Singapore as an ideal entry point and treasury hub for the region, as well as Malaysia's strengths in production ecosystems and potential as an ASEAN hub for Australian advanced manufacturers.

In Thailand's case, the country offers strong potential as a mid-level manufacturing hub for Australian companies, as well as a gateway to the neighbouring CLMV region.

Strategically located at the heart of mainland Southeast Asia and strongly linked with its neighbours, Thailand can be a more comfortable and reliable base from which to operate to tap into demand in this region.

Thailand is also a strong mid-level manufacturing base which is well-connected with regional and global value chains. Its particular strengths in auto manufacturing are already being leveraged by Australian component manufacturers, and are an example of how Australia can leverage manufacturing bases in the region to take part in these cross-border trade flows.

A SLEEPING GIANT AMONG AUSTRALIA'S TRADING PARTNERS

Thailand is the second largest economy in ASEAN and we enjoy a very strong, if somewhat unheralded, trading relationship.

Thailand is Australia's second largest trading partner in ASEAN and eighth largest trading partner overall, ahead of countries like India and Germany.⁴⁶

At 11.2%, our total trade in goods and services is growing faster with Thailand than with any other major trading partner, with the exceptions of India and the US.⁴⁷

Australian companies enjoy the liberalisation benefits offered by two FTAs when accessing the Thai market: the Thailand-Australia Free Trade Agreement (TAFTA) and AANZFTA.

Australia-Thailand Fact Box

Thailand GDP, PPP (global ranking)	\$1.1 trillion (20)
Thailand GDP per capita, PPP (global ranking)	\$16,097 (75)
Thailand real GDP growth	2.5%
Global competitiveness ranking	32/140
Ease of doing business ranking	49/189
Australia goods exports (global ranking)	\$4.3 billion (11)
Australia goods imports (global ranking)	\$13.5 billion (5)
Australia service exports (global ranking)	\$996 million (14)
Australia service imports (global ranking)	\$1.8 million (11)
Australia investment in Thailand	\$3.3 billion
Thailand investment in Australia	\$4.1 billion

Australia-Thailand trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

TAFTA is one of Australia's longer-standing FTAs, having been in-force since 2005. The agreement introduced substantial tariff reductions, which previously reached 200% in some cases.⁴⁸ It lowered barriers to Australian ownership in a number of sectors, allowing majority stakes in construction services, specialised tertiary education institutions, and more.

The agreement has mostly benefited Australian companies in agriculture, manufacturing and wholesale trade, according to the latest results from AIBS (see Figure 12).

AANZFTA built on this foundation by locking in provisions in services and investment protection, while providing for regional rules of origin to be applied. In Thailand's case this last point is particularly useful, as regional rules of origin can be leveraged by Australian component manufacturers to plug into regional value chains through Thailand.

Turning to regional connectivity initiatives, Thailand is a party to the AEC and the negotiations over RCEP. It is not currently party to the TPP but would likely sign up if the agreement comes to fruition.

If it does join, HSBC Thailand notes this may force regulated sectors like telecommunications to open further, as well as provide bigger market opportunity for Thai firms, especially those who are more innovative.

Business opportunities in general could suffer from production shifting to other locales to take advantage of tariff and tax changes, as well as from potential lags in the innovation space and technology transfers, says HSBC Thailand Head of Commercial Banking Krisda Phatcharoen.

Regarding the AEC, Thai commentary has been mixed on its overall benefit to the economy, as well as on Thailand's overall preparedness for deeper regional integration.

For example, local regulations and standards stand in the way of freer movement of skilled labour in cases when professionals must still meet Thai qualification standards in order to practice their trade in the country. Thailand's poor English language capabilities are another issue frequently raised, considering the barriers this creates for companies seeking to do business in Thailand, and to Thai companies seeking to do business abroad.

Nevertheless, Thailand is a very integrated economy. It sits at the centre of ASEAN and worldwide supply and value chains, while initiatives like establishing ten special economic zones along its borders with Cambodia, Laos and Myanmar are aimed at fostering further AEC-led connectivity with neighbouring countries.

When it comes to the Chinese-led initiatives, it is important to note that China and Thailand already enjoy very strong trade links, as China

is Thailand's largest import source and its second-largest export destination.⁴⁹

China is involved in a number of high-profile infrastructure projects in Thailand, including a USD 23 billion plan to build and link two high speed rail projects in the country with China by 2021, as part of an ambitious Kunming-Singapore rail line. Though the Thai portion of the project has been slightly hampered by some back-and-forth over its financing, it is indicative of China's infrastructure ambitions for the region and how they can benefit local ASEAN economies.

For Australia, these projects open opportunities to benefit from direct involvement in their physical construction, or in providing the services that help bring them to fruition. They also indirectly create opportunity to leverage commercial ties between Thailand and China to our advantage.

In all, Thailand is a sleeping giant because of its relatively low profile despite the strength of our trading relationship, and potential to do more. This starts with increasing awareness of the opportunity available.

"When Australians think of Thailand, they don't have an accurate perception of the country as a business hub. You don't get this until you visit Thailand, and really visit manufacturing sites."

– Wirat Tatsaringkansakul,
Australia Director, Thailand Board
of Investment

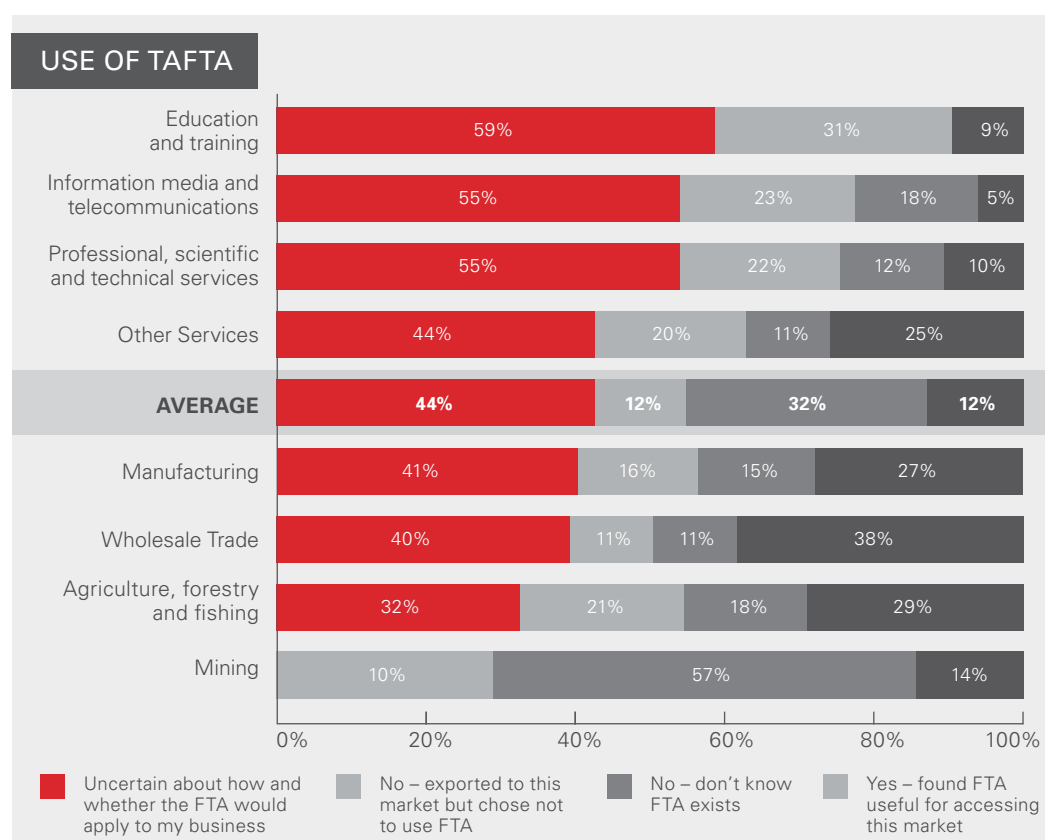


Figure 12: Use of TAFTA (Source: Australia's International Business Survey)

MOST ATTRACTIVE ASEAN MARKETS FOR AUSTRALIA

	Singapore	Indonesia	Malaysia	Philippines	Vietnam	Thailand
1 – Most attractive	39%	20%	15%	12%	9%	4%
2	14%	16%	24%	12%	16%	18%
3	15%	16%	19%	27%	7%	16%
4	19%	14%	12%	19%	22%	15%
5	8%	9%	19%	15%	16%	32%
6 – Least Attractive	5%	24%	11%	15%	30%	15%

Figure 13: Most and least attractive current/potential ASEAN markets for Australian companies (Source: ASEAN Connected Survey, RFI Group)

Indeed, Thailand was ranked as the least attractive current or potential ASEAN market among the region's biggest economies by respondents to the *ASEAN Connected* survey (see Figure 13). It ranked just below Vietnam, with 47% of respondents ranking the country 5th or 6th in the region for attractiveness, compared to 46% for Vietnam.

PLUGGING INTO REGIONAL SUPPLY CHAINS THROUGH THAILAND

"Thailand's focus is on the CLMV region," notes Bhuthong Thongyai, Thailand Trade Commissioner to Australia. "These countries view Thai products and services as premium offerings, and they are close to us which reduces transport costs significantly."

He notes this is also why Thailand has been promoting a series of special economic development zones (SEDZs) around its vast borders with Cambodia, Laos and Myanmar. There are now ten of these zones in all: four along Thailand's eastern border, three along its north and western border, and two along its southern border (see Figure 14).

The stated goal of these zones is to "create economic connectivity with neighbouring countries and support integration of the ASEAN Economic Community".⁵⁰

Australian companies benefit from significant fiscal and non-fiscal incentives by operating in these zones. Depending on the activities performed, companies are able to enjoy exemptions from corporate income tax for up to eight years, as well as an additional 50% reduction for five years after that.

These zones also act as one-stop service shops, with customs checkpoints, licensing and issuance procedures offered and conducted through them, thus streamlining the investment and establishment process for foreign companies.

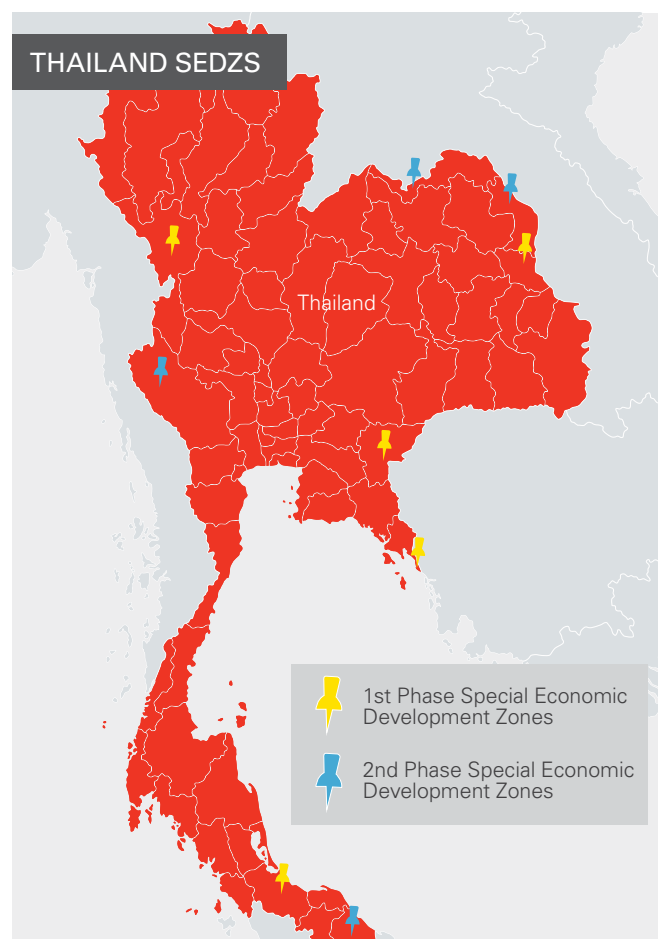


Figure 14: Thailand's Special Economic Development Zones (Source: Thailand Board of Investment)

"We took some businesses and officials from Western Australia up to see opportunities in Thailand. They could not believe how well developed the facilities and supply chains were."

– Wirat Tatsaringkansakul, Australia Director, Thailand Board of Investment

There is not much Australian activity in these zones yet, the Thailand Board of Investment's (BOI) Australia Director Wirat Tatsaringkansakul says, though he notes half of them are still just one year old.

The zones offer more certainty and stability for Australian companies seeking access to neighbouring markets as well, and can be a gateway to them.

Japanese companies leverage them for access to the Myanmar and Laos markets, for example, taking advantage of the better-developed legal and institutional infrastructure in Thailand.

This connectivity with the wider CLMV region, and also with mainland China, are some of Thailand's most attractive points as a manufacturing hub according to HSBC Thailand. The country enjoys infrastructure advantages over its neighbours, and cost advantages over regional hubs like Singapore when it comes to doing business in general.

HSBC sees many companies in Thailand strategically positioning themselves to access regional opportunity in ASEAN and China. They take advantage of incentives offered by the BOI, as well as the readiness of Thailand's infrastructure to receive inward FDI.

Indeed, many of the benefits Thailand offers as a regional hub align with the factors that encourage Australian companies to expand their supply chains into or across ASEAN in the first place: cheaper and easier access to component or supplier networks, and proximity to end users (see Figure 15).

These benefits extend beyond regional goods flows and into services as well.

In education for example, foreign universities service students not only from the domestic market but also from neighbouring countries like Cambodia and Myanmar as well. These students are particularly attracted to Thailand for professional and technical training opportunities.

Australian education providers can therefore tap into regional demand for their services from a more comfortable and developed operating base in Thailand.

The ability to access regional opportunity from the country is not limited to the CLMV countries, nor even to ASEAN, but includes wider Asia as well.

"Thailand is an excellent first step before going to China," Tatsaringkansakul notes. "Because we have very close business connections with China, once you're in Thailand you can tap into these networks. ASEAN depends on connections like these."

FACTORS ENCOURAGING ASEAN SUPPLY CHAIN EXPANSION	
	Total
Cheaper access to component/supplier networks	50%
Easier access to component/supplier networks	41%
Proximity to end user markets	35%
Less restrictive regulatory environment	32%
To take advantage of greater regional integration	24%
Proximity to suppliers	22%
Other	11%

Figure 15: Main factors encouraging supply chain expansion across ASEAN for Australian companies (Source: ASEAN Connected Survey, RFI Group)

REGIONAL CONNECTIVITY AND SUPPLY CHAIN OPPORTUNITY IN THAILAND: NEXT STEPS

As we have mentioned, AANZFTA can be particularly useful to Australian companies tapping into regional value chains through Thailand, thanks to regional rules of origin it introduced.

The unique value of this AANZFTA provision should be leveraged by any Australian component manufacturer or producer eyeing regional opportunity.

Thailand's border-hugging special economic zones should be investigated as efficient entry or expansion points for Australian companies in Thailand, as well as gateways to the wider CLMV region.

In addition to the aforementioned concession on corporate income tax, the zones offer further deductions in areas like import duties, transport, and equipment installation costs. Non-fiscal incentives are on offer as well, including relaxed entry for foreign experts and the ability to own land.

Each zone targets certain activities, such as electronics in the Mukdahan SEDZ, or automotive components in the Tak and Sa Kaew SEDZs.

Thailand's soft people-to-people connections with the wider region can be leveraged as well, complementing the harder benefits the country offers.

Finding good local partners can help in this regard, and can also assist in overcoming language and culture barriers. Finding good partners is not usually a problem, Tatsaringkansakul says.

CALL TO ACTION

Australian companies should consider Thailand as a gateway and operating base from which to access opportunity in the wider CLMV region. The country's strategic geography and the wealth of incentive schemes on offer makes this an enticing proposition. These include a variety of fiscal and non-fiscal measures, as well as ten special economic zones located along the country's vast borders with its neighbours. Operating from these areas can offer an advantageous base to not only reach Thai consumers and suppliers, but also those from the wider region.



Vietnam

- A fast-growing opportunity for Australian education service providers, from tertiary education to professional development offerings
- Australia's fastest growing ASEAN trading partner, accessible through AANZFTA and mutual membership of RCEP and TPP negotiations
- Rapid economic growth is increasing demand for executive and professional education
- A growing destination for students from other ASEAN countries, creating opportunity for Australian providers to tap into regional demand from a single location

A FAST-GROWING AND INCREASINGLY SOPHISTICATED EDUCATION OPPORTUNITY

Vietnam's rapid economic growth is creating a leading opportunity for Australian education services, particularly in the tertiary and professional areas.

At 6.3%, Vietnam is the fastest-growing market we have explored in this report.⁵¹ It is the fourth fastest-growing economy in ASEAN, bested only by the least developed countries in the region – Cambodia, Laos and Myanmar.⁵²

Education is now a record AUD 20 billion industry for Australia, thanks to 13% growth in 2015 which solidified its place as our third largest export after coal and iron ore.⁵³

Vietnam is a prime example of the opportunity available to sustain and catalyse further growth in Australian education exports, and in turn our ASEAN engagement.

Over 100,000 Vietnamese per year elect to pursue studies overseas, while at home an average of eight new universities and 12 colleges were established each year during the past decade.⁵⁴

Vietnam's tertiary enrolment rate is expected to increase from 162 students per 10,000 persons in 2001, to over 400 students per 10,000 persons by 2020.⁵⁵ Total tertiary enrolment tripled from 2000 to 2013, to 2.25 million students.⁵⁶

Accompanying this rapid growth have been concerns over the quality of education delivered, as well as over standards and graduate employability.

There are strong opportunities for Australia to capture some of this growth, and provide Vietnamese students with high quality Australian education, either here in Australia or in Vietnam.

Australia-Vietnam Fact Box

Vietnam GDP, PPP (global ranking)	\$552.2 billion (35)
Vietnam GDP per capita, PPP (global ranking)	\$6,024 (125)
Vietnam real GDP growth	6.5%
Global competitiveness ranking	56/140
Ease of doing business ranking	90/189
Australia goods exports (global ranking)	\$3.4 billion (13)
Australia goods imports (global ranking)	\$4.4 billion (16)
Australia service exports (global ranking)	\$1.2 billion (13)
Australia service imports (global ranking)	\$890 million (22)
Australia investment in Vietnam	\$1.4 billion
Vietnam investment in Australia	\$468 million

Australia-Vietnam trade and economic highlights, GDP figures in USD, Australia figures in AUD (Source: DFAT, IMF, World Bank, World Economic Forum)

AUSTRALIA'S FASTEST-GROWING ASEAN TRADING PARTNER

Vietnam is Australia's second smallest trading partner among the six ASEAN countries explored in this report, with total two-way trade standing at just over AUD 10 billion in 2015.⁵⁷ This is around one-third of our trade with Singapore, and half of our trade with Thailand and Malaysia.

Our relationship is nevertheless a fast-growing one. Vietnam is in fact our fastest-growing trading partner in ASEAN, with overall trade increasing 12% year-on-year in 2015.⁵⁸

Australian companies can benefit from Vietnam market access provided by AANZFTA, an agreement especially useful in Vietnam's case considering Australia lacks a bilateral FTA with the country.

Vietnam is party to both the TPP and RCEP negotiations, and, as a developing country in need of numerous reforms, stands to be one of the biggest beneficiaries of further economic liberalisation through these initiatives. The AEC is likely to have a similar reform-boosting effect.

"There is positivity toward the AEC, because it will allow local markets access to broader goods and services," says HSBC Vietnam Country Head of Wholesale Banking Winfield Wong. "You would also expect more investment, especially from developed countries like Korea, Japan, Thailand, Singapore and Hong Kong."

Greater openness to regional and global markets is already manifesting itself in positive ways in Vietnam, such as through the introduction of new investment and enterprise laws in 2014 that reduce trade-hampering bureaucracy and red tape.

FDI in Vietnam has increased nearly 50% in the first seven months of 2016 alone, with South Korea alone accounting for around 40% of total FDI into the country.⁵⁹

Foreign interest and investment is benefiting from the potential of the TPP, which Wong notes has created a lot of positive sentiment around Vietnam. Investments are increasing in higher-value added areas as well.

“We have seen more upscale production starting to move to Vietnam. Some of the internationally well-known electronics firms are not just looking at manufacturing and chip plants, but also R&D centres, which are being set up this year,” Wong says.

The BRI and AIIB initiatives may further facilitate investment flows into Vietnam, though to what degree may depend on the political climate between the two countries. Vietnam has been one of the biggest beneficiaries of Chinese manufacturing and production shifting to lower-cost jurisdictions, and China is now Vietnam’s largest import source and second-largest export destination.⁶⁰

Chinese officials have noted the BRI’s potential to provide “new momentum” to the bilateral relationship, and that both countries are exploring potential collaboration in energy infrastructure as well as inland and sea transport.⁶¹

As with other cases, Australian companies can broadly benefit from the new opportunity created by BRI projects in Vietnam through the provision of the services required to bring them to fruition. Developing Vietnam’s energy potential as well as its transport and logistics networks are candidates for high profile projects, and are areas where Australia possesses a wealth of expertise and strengths in supporting services.

A FAST-GROWING COUNTRY, HUNGRY FOR THE EDUCATION SERVICES AUSTRALIA EXCELS AT PROVIDING

Education is Australia’s largest export to Vietnam and a key component of our bilateral relationship⁶², but there is plenty of room for further growth. This is being fuelled by favourable demographics, rapid economic development and a fast-growing middle class that demands – and can increasingly afford – high-quality education for their children.

Vietnam’s 90 million people now reside in a middle-income economy. Its middle class is the fastest growing in ASEAN, and is expected to grow from 12 million in 2012 to 33 million by 2020.⁶³

Australia is already the leading study destination for Vietnamese students, almost 30,000 of whom were enrolled in Australian institutions in 2015.⁶⁴ This makes Vietnam the third largest source of overseas students in Australia, after China and India.⁶⁵

The education opportunity lies not only in attracting Vietnamese students to Australia’s shores, but extends to serving them in their own country as well. Vietnam’s education sector is lagging behind regional and global standards (see Figure 16), making high-quality Australian education an attractive proposition.

“When I arrived here, I saw that we are getting the cream of the crop,” says a program director at a leading Australian university in Vietnam. “We get students that are unbelievably dedicated, committed, hard-working, highly intelligent, very numerate, and extremely willing to learn. If you give them a reading, they do it. If you ask them to present, they put their heart and soul into it. If you give them feedback, they’re hanging onto every word.”

Visiting professors to the university’s campus note the students attracted to its programs “are as good as anywhere in the world”, he adds.

“We have seen more upscale production starting to move to Vietnam. For example, Samsung are not just looking at manufacturing and chip plants, but also R&D centres, which are being set up this year.”

– Winfield Wong, HSBC Head of Global Banking, Vietnam

Higher Education and Training Competitiveness Rankings				
Country	Overall	Quantity of education	Quality of education	On-the-job training
Singapore	1	9	1	5
Australia	8	1	14	18
Thailand	56	54	68	53
Vietnam	95	99	78	94

Figure 16: Higher education and training competitiveness rankings, Global Competitiveness Report, 140 countries (Source: World Economic Forum)

He says the university has seen real benefit to being physically present in Vietnam and making a long-term investment in the country.

“Being based here has allowed us to develop programs in response to particular local needs,” he notes.

Australia, though well-regarded as an education provider, is still competing with other countries for Vietnamese students’ investments.

As a starting point, Australian institutions compete on an even keel with education providers from the US and Europe in Vietnam. “They certainly like Australia, but I think they like Europe and America equally well,” the program director notes.

As Vietnam’s economy continues to grow and integrates regionally and globally, the expertise required to tap into international opportunity is driving demand for education and up-skilling in a number of areas, from English language training to business and management courses.

For example, a number of foreign companies are shifting their manufacturing processes from higher-cost jurisdictions to Vietnam. With this comes an influx of senior managers to the country, thereby increasing demand for business education offerings.

The country is also beginning to attract more students from across ASEAN, as opportunities increase and education standards improve.

“We get quite a few students from Singapore, Laos, Cambodia, Thailand and Indonesia. Every year is slightly more than the year before,” the program director notes.

“Being based here has allowed us to develop programs in response to particular local needs.”

– Program director at a leading Australian university in Vietnam

EDUCATION OPPORTUNITY IN VIETNAM: NEXT STEPS

The education opportunity in Vietnam is large, growing, and multi-faceted. Australia is in a strong position to capitalise on this, considering our well-known education strengths and expertise, but the international market is competitive. Australian education service providers compete on relatively even footing with American and European offerings in Vietnam.

It therefore pays to recognise that Vietnamese students are well-informed about their choices in the market, as well as the value they receive from various offerings.

“The students here are well-informed and they do their research,” the program director notes. “They ask us questions on standards and accreditations, because it’s becoming more important to Vietnamese students that their degrees are internationally recognised.”

A physical presence in the market allows for a better understanding of local conditions so that programs can then be designed to meet local demands, increasing the program’s value proposition.

“Our advantage is that we grant an internationally accredited degree, taught in English, in Vietnam, tailored to the needs of Vietnam,” the program director says.

A physical in-country presence is perhaps the riskiest approach to tapping education opportunity in Vietnam, but can unlock otherwise inaccessible opportunity, or increase the size of existing opportunity.

“The students that we have here are in addition to the Vietnamese students that have gone directly to Australia,” the program director points out. “So the fact that we are here means we have these additional students.”

As with any sector, local knowledge can be crucial to establishing a successful presence in Vietnam, as can regular communication with government. Programs can then be tailored to meet local conditions, thereby increasing their value in the local market.

“The wheels turn differently from our home countries, so you have to be very cautious of that,” the program director notes.

Intended program offerings should therefore be researched so that they are a fit for Vietnam, and tailored to local conditions. Open communication channels with government and relevant bodies can ensure the process runs smoothly on the Vietnamese side.

CALL TO ACTION

Australian education service providers should recognise the opportunity that rapid economic growth and a fast-rising middle class is creating for high-quality education in Vietnam. The opportunity is more than just attracting Vietnamese students to Australia, but extends to establishing a physical presence in Vietnam too. A physical presence allows access to students who are very eager to learn, as well as to a growing pool of professional talent in Vietnam. It can also allow access to a pan-ASEAN student body, as more students from across the region look to study in Vietnam.

“The students here are very discerning and they do their research. They ask us questions on standards and accreditations, because it’s becoming more important to Vietnamese students that their degrees are internationally recognised.”

– Program director at a leading Australian university in Vietnam

What's Next

With an economy set to become the world's fourth largest by 2050, ASEAN will only become more attractive to businesses around the world.

As the region becomes a more competitive place to do business, Australian companies need to become increasingly proactive in capitalising on the dynamic and fast-growing opportunity sitting on our doorstep.

As this report has noted, the policy and institutional infrastructure is in place to facilitate this.

We have bilateral FTAs with our three most important ASEAN trading partners, and a fourth with Indonesia on the way. AANZFTA not only complements these, but provides preferential access to the remaining seven ASEAN countries with whom we currently lack trade agreements. This means Australian companies enjoy better market access to Southeast Asia than most of their competitors.

Organisations like Austrade and the trade promotion and investment attraction agencies of various ASEAN countries stand ready to assist Australian companies evaluate and capitalise on opportunity in these markets.

It is therefore up to Australian companies to be proactive and seize this opportunity, which will allow us to maintain and grow our place in an increasingly connected and competitive region. The alternative, to sit back and watch as our international competition capitalises on this opportunity, is a worrying prospect for Australia's trade and our future prosperity.

In concluding this report, we offer some notes on what's next for Australia in going forward and capitalising on an increasingly connected ASEAN.

"The problem is that Australia has always seen itself as different. The idea that we are a part of Asia is only around 15 years old, and there is still a lack of trust in many of these ASEAN markets that stems from our differences."

– Rohit Garg, HSBC Head of Global Trade and Receivables Finance, Australia

A CHANGE OF MINDSET AND ATTITUDE IS NEEDED, AS ASEAN IS NOT ONLY A GROWTH OPPORTUNITY BUT INCREASINGLY A GROWTH NECESSITY

To increase our engagement with ASEAN, Australian companies need to accept the fact that high-growth developing markets, like many of those in ASEAN, come with the need for a bigger risk appetite, an openness to

different business cultures and an emphasis on trust that can sometimes only be gained through engagement.

"The problem is Australia has always seen itself as different," HSBC Australia's Head of Global Trade and Receivables Finance Rohit Garg notes. "The idea that we are a part of Asia is only around 15 years old, and there is still a lack of trust in many of these ASEAN markets that stems from our differences."

"For example, in Australia we have a well-defined, safe legal and regulatory environment. You don't have that in many of these markets," he adds.

"The prospect of increased economic integration is a sweetener, but the ASEAN opportunity would still be there regardless."

– Rohit Garg, HSBC Head of Global Trade and Receivables Finance, Australia

One of the best ways to build trust and familiarity is through engagement, which is a learning opportunity as much as it is a business opportunity.

Opportunity is a word frequently used in this report, as Australia certainly stands to benefit from ASEAN's growth story. But considering the small size of our domestic economy, this growth opportunity should increasingly be viewed as a growth necessity.

"Our firms have had huge opportunities for domestic investment and there has largely been enough development for them in Australia," Garg notes, "Australian companies now largely need to look outside the country for further growth."

This applies to many different sectors, whether it's our universities, infrastructure developers or financial service providers. ASEAN provides Australian companies with these growth opportunities, but accessing it will require a shift in mindset to be more accommodating of risk and different business practices from our own.

EVALUATING OPPORTUNITY IS NOT A BLACK AND WHITE PROPOSITION; LOOK OUTSIDE THE BOX TO UNDERSTAND WHAT'S HAPPENING AND WHERE THE LINKAGES ARE

If there are plans on the table for a large infrastructure project in Indonesia, the opportunity is not just a project financing proposition, but also an opening to provide the ancillary activities and services that go into delivering it as well.

Likewise, a manufacturing play in Malaysia is not just about production, but can involve the research, design and services that surround it.

“Look at the services that surround the physical act of manufacturing something, in the same way that we have developed our strength in mining services,” Garg suggests. “Look at the services component that goes into manufacturing and manufacturing supply chains, like high-end design.”

Such outside-the-box thinking could open a new world of opportunity for Australian companies in ASEAN, especially considering the growing complexity and maturity of these economies.

Understanding what’s happening in the region and where the linkages are is part-and-parcel of this thinking.

For example, when it comes to opportunity created by the BRI initiative, the key is in understanding the aims and objectives of a particular project and how your company can assist in achieving them, notes Jean Dong, Executive Director of the Australia China One Belt One Road Initiative (ACOBORI).

Dong adds that Australian companies need to be proactive in understanding the opportunity, and in profiling their own capabilities. For example, when thinking of advanced manufacturing, Germany and Japan come to mind, but not necessarily Australia.

“Australia often waits for other people to come and tell us about opportunities, but we need to profile what we do well in order to attract opportunities in the first place,” Dong says.

IT’S STILL EARLY DAYS FOR MANY OF THE CONNECTIVITY INITIATIVES, BUT ANY INCREASED ATTENTION AND INVESTMENT IN THE REGION CREATES OPPORTUNITIES FOR AUSTRALIA TO CAPITALISE ON

At the time of writing, many of the trade and connectivity initiatives discussed in this report are still in their formative or prospective stages. New opportunity will present itself as they are gradually implemented, but this is just the icing on

the cake. The ASEAN opportunity is already there for Australian companies, and some are already capitalising on it.

“The prospect of increased economic integration is a sweetener, but the ASEAN opportunity would still be there regardless,” notes HSBC’s Garg. “There is a lot to be done from an infrastructure and demand satisfaction perspective, for example.”

Nevertheless, there is consensus that all these initiatives create a buzz about the region, and any increased foreign interest and investment in ASEAN – whether it is linked to these initiatives or not – creates ancillary opportunities for Australia, especially when it comes to service provision.

Services are of course a key Australian strength, while our knowledge and expertise in a number of areas is not only acknowledged in the region, but welcomed as well.

For example, Australian companies can leverage these strengths and reputation to capitalise on infrastructure development and the opportunities these projects create for contractors, surveyors and project management firms.

Australian companies of all sizes should be aggressive in taking advantage of such opportunities by examining projects and needs, and determining where they can play a part.

As countries like Malaysia or Vietnam move up regional value chains to higher level processes, their demand for education and training to up-skill their workforce increases.

Who better to provide the advanced skills and western-style education required than Australia, a close neighbour where long-standing hard and soft links have already been established?

Australian companies should therefore keep an open mind to developments and connectivity initiatives in the region. Even in cases where there is no obvious benefit to Australia, these can often create indirect opportunities for companies to capitalise on.

“Look at the services that surround the physical act of manufacturing something, in the same way that we have developed our strength in mining services. Look at the services component that goes into manufacturing and manufacturing supply chains, like high-end design.”

– Rohit Garg, HSBC Head of Global Trade and Receivables Finance, Australia

HELP IS AVAILABLE IN SEEKING OUT ASEAN OPPORTUNITY

Our aim with this report has been to highlight a small portion of the wealth of opportunity available to Australian companies in an increasingly connected ASEAN.

This is only a starting point toward understanding and capitalising on the ASEAN opportunity, and there is plenty of assistance available for Australian companies to take the next step.

Austrade and the trade promotion and investment attraction agencies of the various ASEAN countries can be approached to identify specific in-market opportunities and incentives relevant to your business. HSBC can assist in evaluating market opportunity, making connections and facilitating the entry or expansion process. ACOBORI, and organisations like them, can help with clarifying what initiatives like the BRI mean for your business. The ECA's education services and membership offerings can assist Australian companies develop the skills necessary to access international opportunity.

Considering the benefits and advantages Australia enjoys with the ASEAN region, such as physical proximity, strong people-to-people links and world-leading market access advantages, we as a nation and our companies should have a sustainable and leading place in ASEAN's growth story.

"Australia often waits for other people to come and tell us about opportunities, but we need to profile what we do well in order to attract opportunities in the first place."

— Jean Dong, Executive Director, Australia China One Belt One Road Initiative





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FOR MORE INFORMATION AND SUPPORT:

Austrade can provide services and on-the-ground assistance to assist Australian businesses expand across ASEAN. Please see www.austrade.gov.au for more information.

HSBC can provide products and solutions which may assist you in your expansion into ASEAN. Please see business.hsbc.com.au/ASEAN for more information.

The ECA can provide the education and skills training necessary to understand and access international market opportunity. Please see www.export.org.au for more information.

FOR MARKET-SPECIFIC SUPPORT, THE FOLLOWING ORGANISATIONS MENTIONED IN THIS REPORT CAN HELP.

The Singapore Economic Development Board can assist Australian businesses interested in accessing opportunity in Singapore. Please see www.edb.gov.sg for more information.

The Malaysian Investment and Development Authority can assist Australian businesses interested in accessing opportunity in Malaysia. Please see www.mida.gov.my for more information.

The Philippine Trade & Investment Centre can assist Australian businesses interested in accessing opportunity in the Philippines. Please see investphilippines.gov.ph for more information.

The Indonesia Investment Coordinating Board can assist Australian businesses interested in accessing opportunity in Indonesia. Please see www.bkpm.go.id for more information.

The Thailand Board of Investment can assist Australian businesses interested in accessing opportunity in Thailand. Please see www.boi.go.th for more information.

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