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Opportunities and challenges

In the past two decades, the Association of Southeast Asian Nations (ASEAN) region has become one of the most dynamic growth areas in the world, growing by an average of around 5 per cent annually. Even in the face of massive challenges, such as the Asian and global financial crises, the region has remained resilient, recovering and regaining its positive trajectory.

There are clear indications that this momentum can continue given the favourable economic environment in the region. In 2014, ASEAN ranked as the seventh largest economy in the world and the third largest in Asia, with a gross domestic product (GDP) of US\$2.6 trillion. In addition, it is the third largest market in the world, with 622 million people—around 60 per cent of whom are below the age of 25. The demographic statistics alone bode well for sustained productivity. Higher-skilled workers are also younger, with a median age in the mid-20s, which suggests an increasingly well-educated population.

Within the context of these positive macroeconomic and demographic developments are two key trends. The first is growing urbanisation within the region, and the rise of ASEAN's middle class. ASEAN's cities account for over 65 per cent of regional GDP today. This is projected to grow even further, as more than 90 million people are expected to move to urban centres by 2030. This massive shift is driven by the prospect of higher-paying jobs, which has implications for discretionary income and consumption. Urbanisation is then closely linked to a growing middle-income class. In ASEAN alone, the middle class is expected to double from 81 million households in 2013 to 163 million households in 2030, representing a tremendous consumer base.

The second key development is an increasingly positive trade environment, bolstered by regional integration. Since the beginning of the ASEAN Free Trade Area, total trade has increased sixfold, from US\$430 billion in 1993 to US\$2.5 trillion in 2013. To break down the figures even more: intra-ASEAN trade has seen a massive increase, growing more than seven times, from US\$82 billion to US\$609 billion, in the same period. The same pattern has held in the recent past, with intra-ASEAN trade continuing to account for almost 20 per cent of total foreign direct investments in the region.

Higher trade volumes show that measures towards regional integration have achieved the goal of making ASEAN an attractive place in which to do business. This includes the elimination of tariff and non-tariff barriers, as well as phased sectoral integration.

This pragmatic and outward-looking approach to integration gives Southeast Asia an advantage over other trading blocs. ASEAN has not imposed a common trade policy or legally-binding frameworks, which may not be effective in light of the vast disparities in the region. Instead, the ASEAN Economic Community remains focused on creating a single market and product base—through a consensus-driven process that takes into account market maturity and the readiness of individual nations.

The Philippines: a bright spot in ASEAN

Within such a dynamic region, the Philippines' situation is made even more unique by the fact that the country has experienced sustained economic growth for more than a decade, even amidst external shocks and natural disasters.

Overseas remittances and the growth of the IT Business Process Outsourcing sector have fuelled domestic consumption, which has accounted for over 70 per cent of GDP since the mid-1990s. This strong

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consumer environment has helped the Philippines to remain resilient. Much has also been said about the strength of its human capital, and the demographic dividend the country is experiencing.

In recent years, stronger Philippine growth has been enabled by a stable environment that inspires business and investor optimism. Sound macroeconomic management under recent administrations has led to disciplined fiscal and monetary policy, and a well-managed interest and inflation rate environment. Inflows have increased significantly and the Philippines remains at investment grade status.

Domestic businesses have also grown more confident. With stronger balance sheets, a well-capitalised banking system, and the lowest cost of capital in modern history, companies have been able to look for opportunities to diversify, expand, and deploy their resources—whether locally or on other shores. This has resulted in massive value creation. The largest publicly listed Filipino companies have at least doubled their market capitalisations since 2006. Some have even grown by more than nine times.

Today, Philippine businesses are in a particularly strong position to expand regionally and internationally. From our own experience in the Ayala group, the greater access to capital and stronger valuations in recent years have allowed us to invest in various water infrastructure projects in Vietnam, a real estate company in Malaysia and power assets in Indonesia, as well as expand our electronics manufacturing business in various parts of the world. Philippine banks with sufficient liquidity and internationally-competitive rates have enabled us to pursue these investments.

Similarly, other Philippine companies have been expanding geographically, such as the Aboitiz and Alliance Global groups, retail groups like Bench, and food service chains like Jollibee. Universal Robina Corporation, Liwayway Marketing Corporation, Unilab, and other Philippine businesses with long-established international footprints continue to be similarly bullish about ASEAN's prospects.

ASEAN expansion

There is no doubt that ASEAN economic integration presents a compelling opportunity. While the Ayala group has long had a presence overseas through its manufacturing operations, we have remained on the lookout for regional opportunities. As an example, in 2008 Manila Water started to establish a presence in Vietnam through a non-revenue water reduction

project in Ho Chi Minh City. While this was initially a modest project, it allowed the company to establish a solid footing in Vietnam and become more familiar with the local business landscape. Manila Water was able to leverage the success of this project. Today, Manila Water is arguably the largest foreign investor in Vietnam's water sector. It has, over time, expanded to other Southeast Asian countries, and is currently piloting similar projects in Indonesia and Myanmar.

Our group's experience in cross-border expansion within Southeast Asia has shown us in a concrete way that the trade environment has significantly improved. However, it has also made it clear that there are still a number of practical challenges that businesses must keep in mind when embarking on an ASEAN expansion strategy.

A key hurdle is the great variance in legal and regulatory frameworks. The differences in national policy pose an additional challenge to the cultural and social adjustments that businesses have to make when establishing a presence in ASEAN. Given ASEAN's consensus-building approach, it may take some time before full harmonisation of key policies, such as the ASEAN Banking Integration Framework and the ASEAN Single Window for customs clearance, can take place.

We have learnt that, however exciting opportunities may be, the success or failure of business prospects highly depends on the political-economic environment within member nations, or even specific regions and provinces within those nations.

In addition, we have seen that, in some markets, there are nuances in the policies and regulations, in terms of how they are written and how they translate into actual implementation on the ground. We have learnt that, however exciting opportunities may be, the success or failure of business prospects highly depends on the political-economic environment within member nations, or even specific regions and provinces within

those nations. This has no easy solutions, but maintaining awareness of this can help in crafting strategy and even in amending relevant regulations.

Another challenge for new investors lies in the absence of a local network and professional relationships. The first foray overseas can be daunting to foreign investors. The Ayala group has found it particularly

beneficial to find a local partner with the same governance standards and principles.

Doing this not only helps to navigate the local landscape—it also ensures that we are able to tap local talent and develop a deeper bench for the organisation. The presence of regional business associations, such as the ASEAN Business Advisory Council, with chapters in each country, can be maximised by companies who want an initial point of contact with other business communities.

A final point that must be made about ASEAN is its lack of homogeneity, with great discrepancies in economic development, as well as market and industry maturity. As such, for the majority of businesses, an intra-ASEAN expansion strategy cannot yet accommodate a one-size-fits-all approach. A thorough understanding of the target market and the specific nuances of different sectors is necessary for businesses seeking to establish a regional footprint.

It should be emphasised, however, that this lack of homogeneity is not necessarily negative. The disparities in ASEAN also give rise to opportunities that vary from nation to nation, which can then be matched with the capabilities of businesses. For example, infrastructure is a key growth driver in less-developed ASEAN nations. We recognised this opportunity in Vietnam, which continues to be considered a high potential and high growth area, and requires significant infrastructure development. This need encouraged us to leverage Manila Water's expertise and enter the water sector in Vietnam.

Conclusion

With its dynamic growth, ASEAN represents an exciting proposition for private enterprise. As regional integration continues to progress, and as the sizable market maintains its productivity, grows in strength and becomes increasingly skilled, we believe very strongly that considerable potential remains to be realised within Southeast Asia. In particular, given the sustained growth trajectory of the Philippines, Philippine businesses seem particularly well-positioned to venture overseas—within Southeast Asia and beyond.

Moving forward, expansion strategies require an understanding

of the changing ASEAN landscape and the improvement of the overall investment environment, which can be contrasted with disparities on the ground. Forming local partnerships and understanding specific markets are helpful in this regard.

As a final note, it should be emphasised that achieving full regional integration does not rest on the shoulders of government alone. What public institutions have done is create an enabling environment for intra-ASEAN trade: it is up to businesses to seize the opportunities at hand, and do their part to help realise the full potential of the ASEAN single market and production base.



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The Ayala Corporation is one of the Philippines' largest conglomerates involved in real estate, financial services, telecommunications, water, electronics, automotive, power, transport, education, and healthcare. He is Board Chairman of Ayala Land and Manila Water Company, and sits on the board of various companies in the Ayala group. He is also a member of the INSEAD East Asia Council and the World Presidents' Organization. He holds a liberal arts degree from Harvard College and a CIM from INSEAD, France.