Synovate Talk to

The American Chamber of Commerce in Singapore

The American Chamber of Commerce in Singapore

ASEAN: GOLDMINE OR MINEFIELD?

Prepared for: AMCHAM Singapore

Date: 2nd September 2011

Prepared by: Synovate Business Consulting

Blue – For Peace & Stability

Red – For Courage & Dynamism

White – For Purity

Yellow – For Prosperity

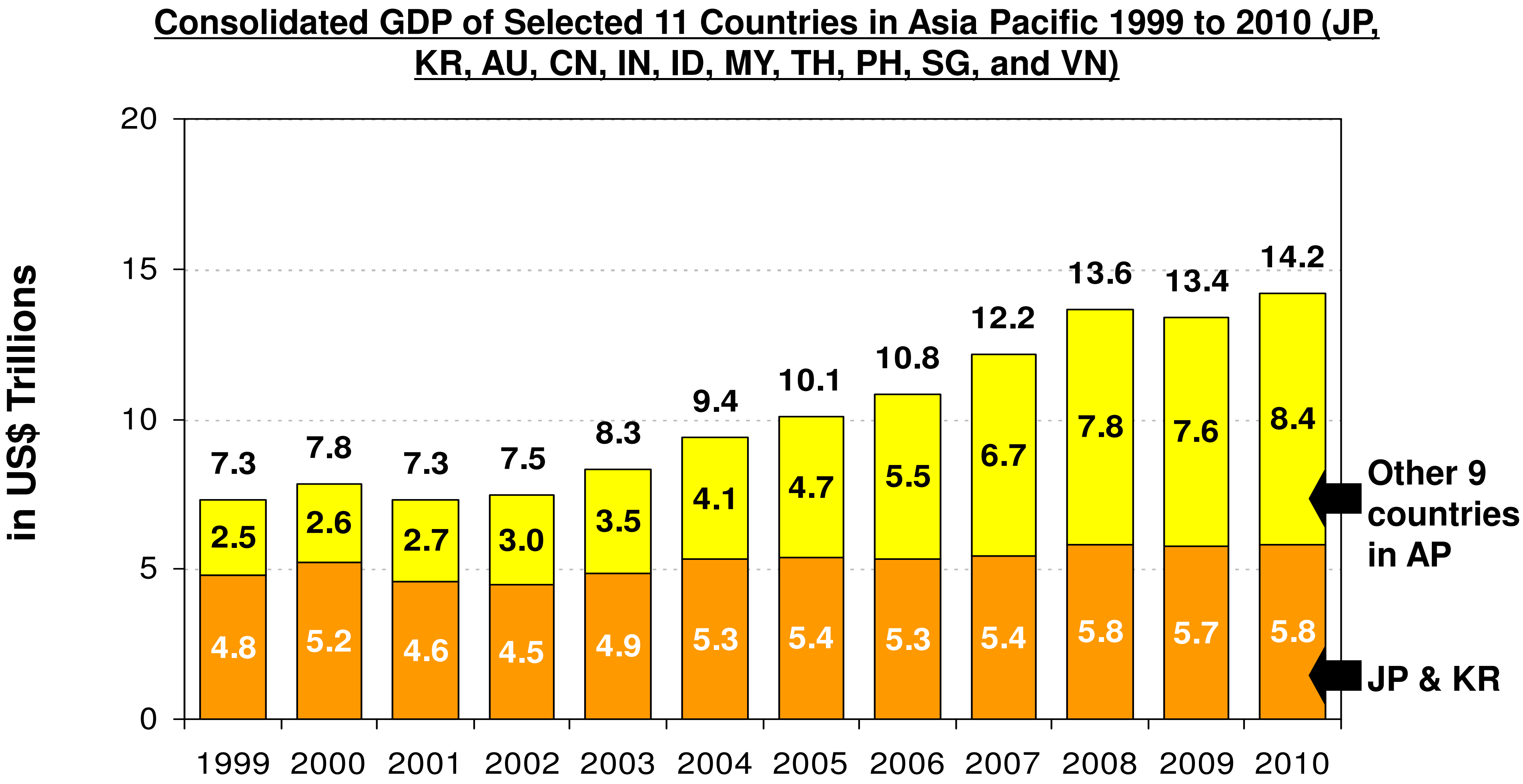
Ten Stalks of Rice (“Padi”) to represent the 10 nations of ASEAN bonded together

The Context & Key Questions

- With the growing clout of China, and the significant growth in India, what is the relevance of ASEAN in terms of growth markets? Is ASEAN on anybody's radar?
- What could ASEAN be considered for? As a demand centre, or as an alternate low-cost supply centre/manufacturing location?
- If we were to look at ASEAN, which are the countries that are attracting the highest amount of attention from multinationals?
- Is there a standard process/methodology we can use to assess these countries?
- Are there industries or markets where we can address the whole of the ASEAN group together (ONE size fits ALL)? Or are ALL industries too diverse to have a common strategy?

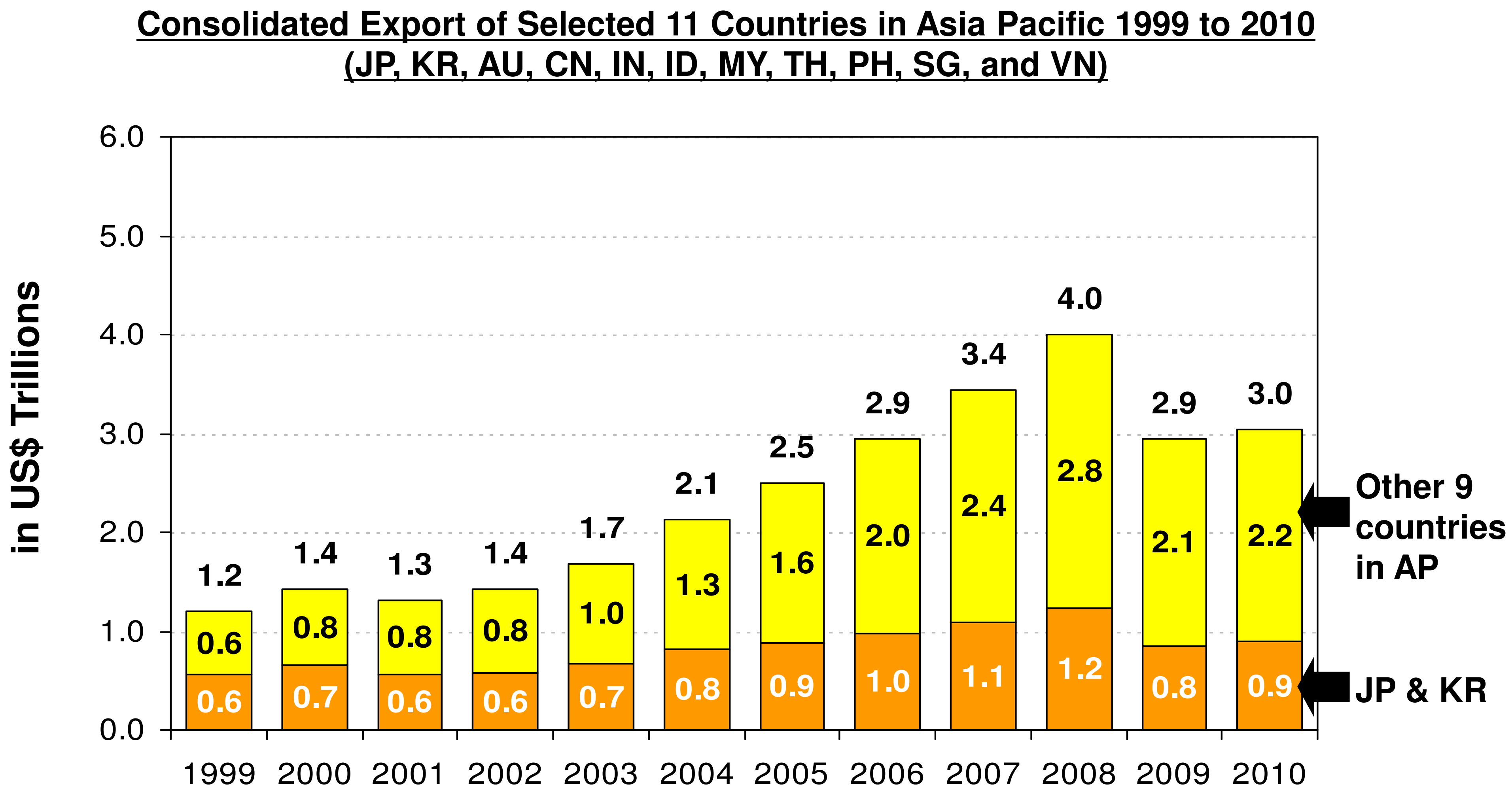
Asia Macroeconomic Stats

The traditional export powerhouses of JP & KR are slowing , but the contribution from other selected countries has led the growth in Asia Pacific.



Asia Exports

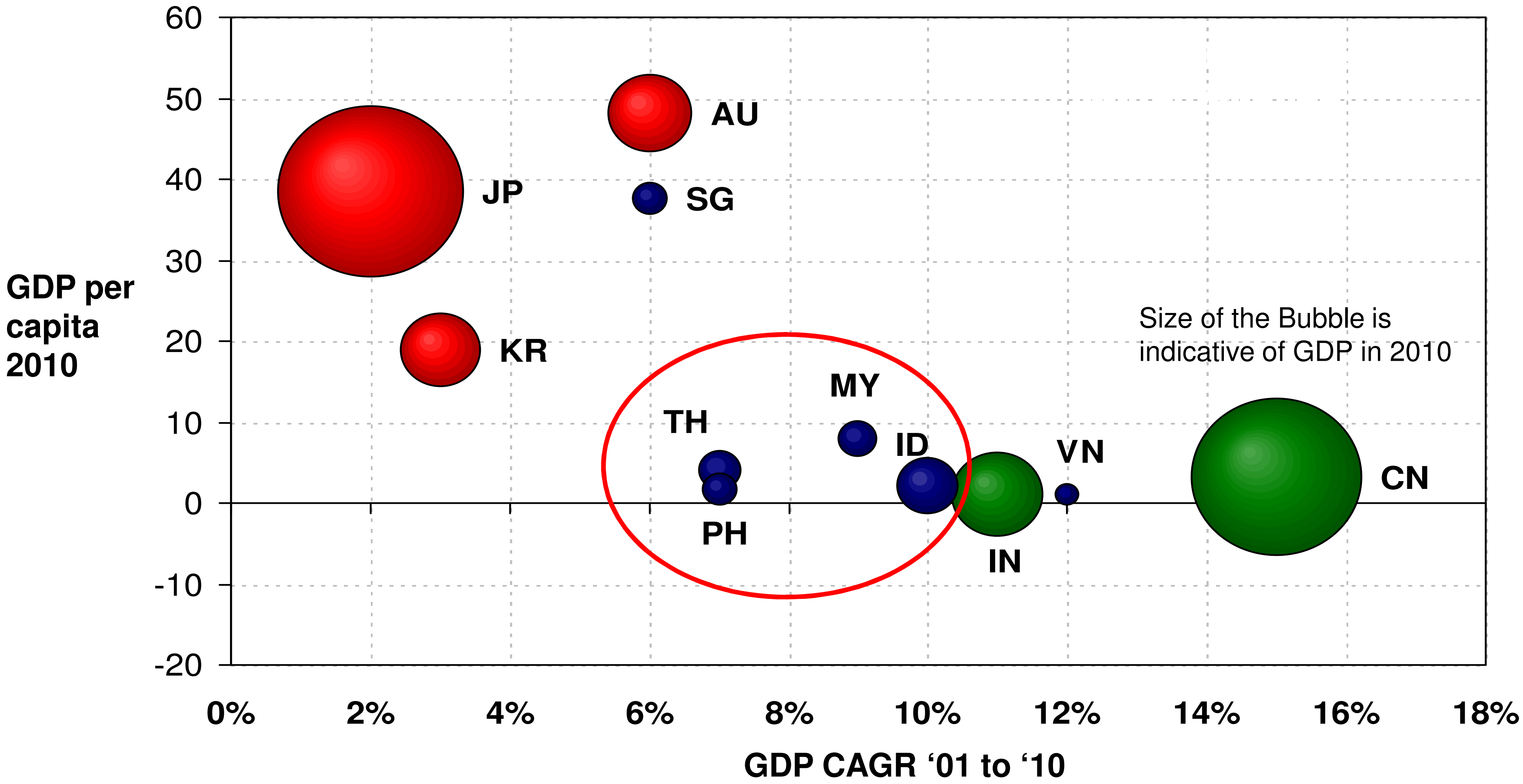
Exports have been growing significantly over the past ten years, though not from the traditional export powerhouses of JP & KR.



The big picture – is ASEAN on the radar at all?

Compared to the larger economies in Asia Pac, ASEAN is a grouping of relatively smaller countries. ASEAN has definitely taken a back seat with the rise of the Asian giants – China & India.

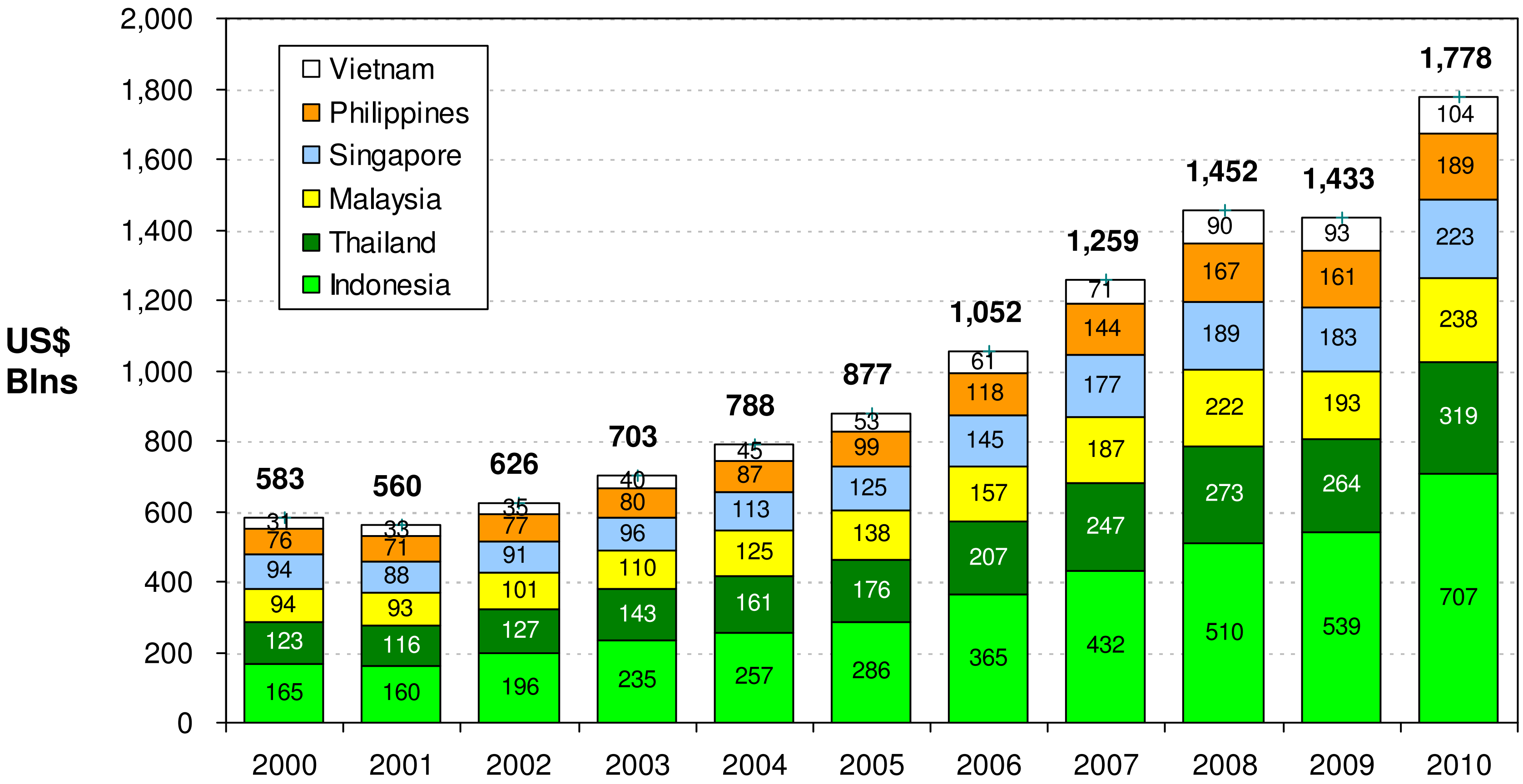
GDP 2010 & Growth Rates of Selected 11 Countries in Asia Pacific (JP, KR, AU, CN, IN, ID, MY, TH, PH, SG, and VN) in US$ Trillions



Within ASEAN

The ASEAN 6 grouping has grown significantly in 2010, counter balancing the recession in 2009. Indonesia accounts for ~40% of total ASEAN GDP, and is the most sought after destination for FDI.

Consolidated Nominal GDP of Selected ASEAN 6 Countries 2000 to 2010 (ID, MY, TH, PH, SG, and VN)



Asia, in Summary

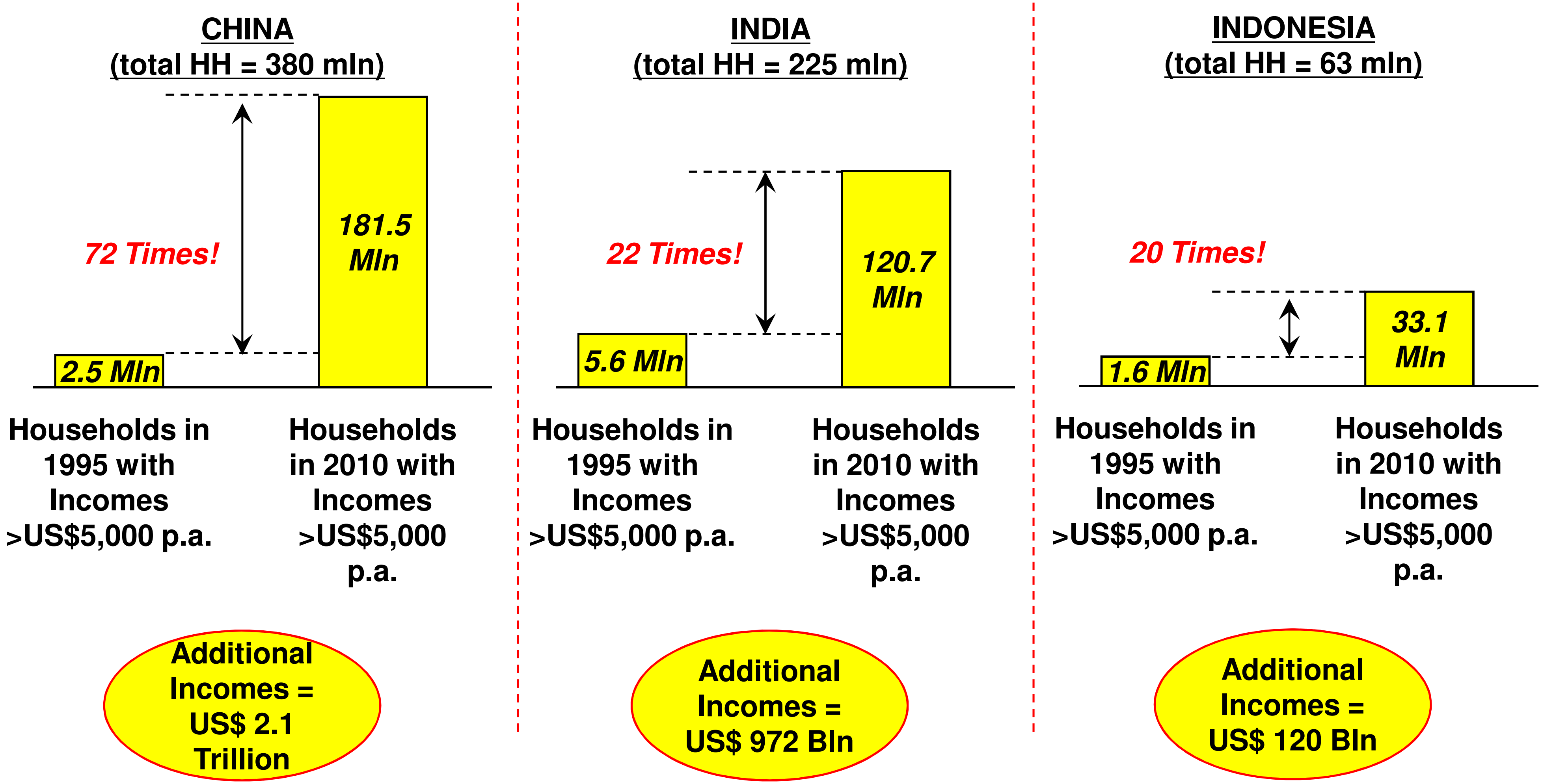
Asia could become the engine of global growth provided the consumer demand picks up where stimulus spending left off in 2010.

- Domestic/Organic Economic Growth:
  - Recovery is suspect, as it is partly driven by government stimulus programs, and partly by regional growth.
  - Consumer demand needs to pick up (many Asian consumers)
  - Key Countries: China, India, and ASEAN (remember AFTA?)

- Export Economy:
  - Asia partly decoupled from developed economies of US & EU, but still reliant on balancing act from China. The developed economies need to start growing again
  - China as the workshop of the world: has it outlived that tag?

The rise of the Middle Class

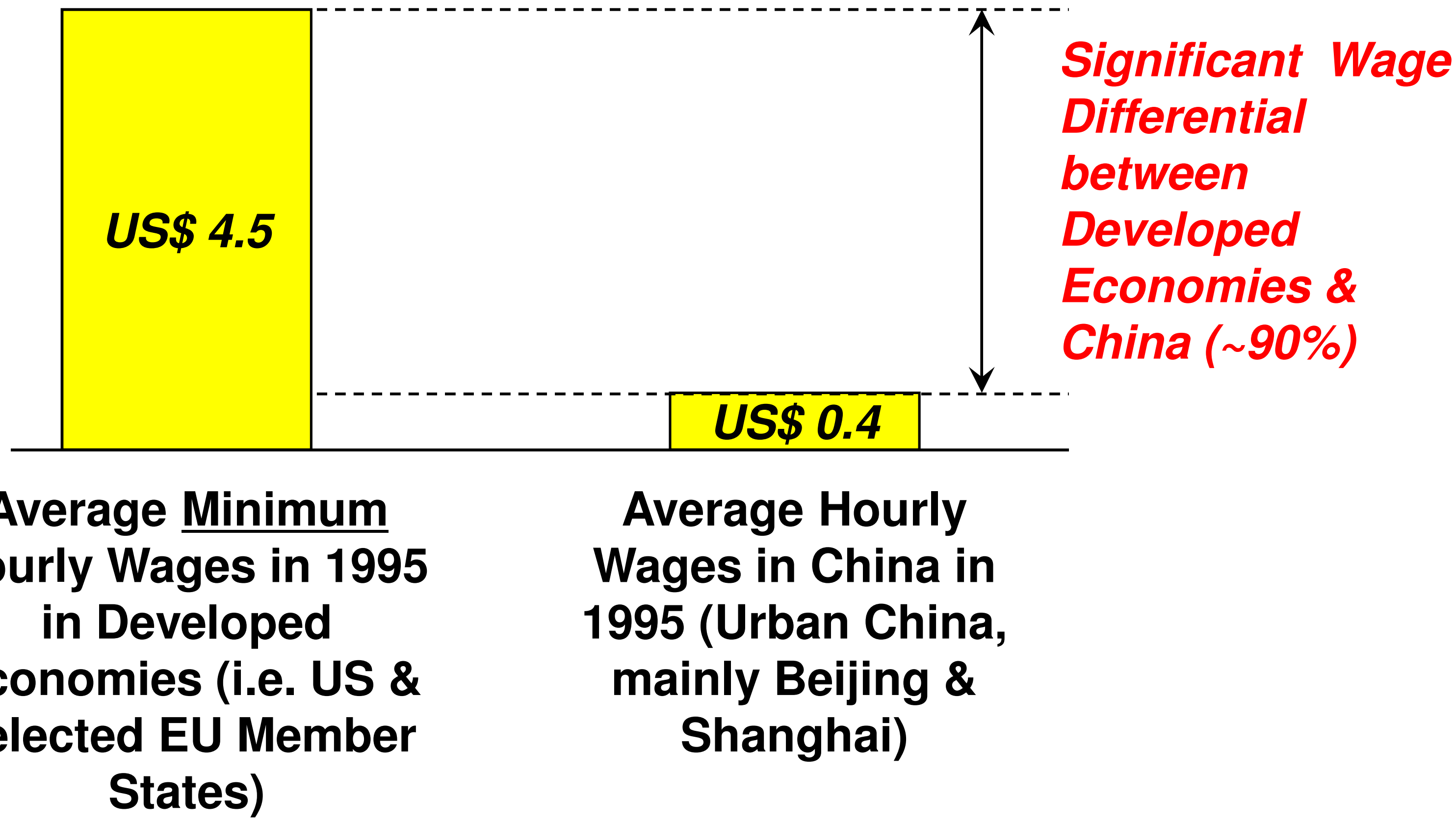
The key difference with income growth among the emerging economies of China, India, and Indonesia is that more consumers/households are entering the famed Middle Income Class - giving rise to consumers with high levels of disposable incomes.



Cost Pressures in CHINA - The Base Case

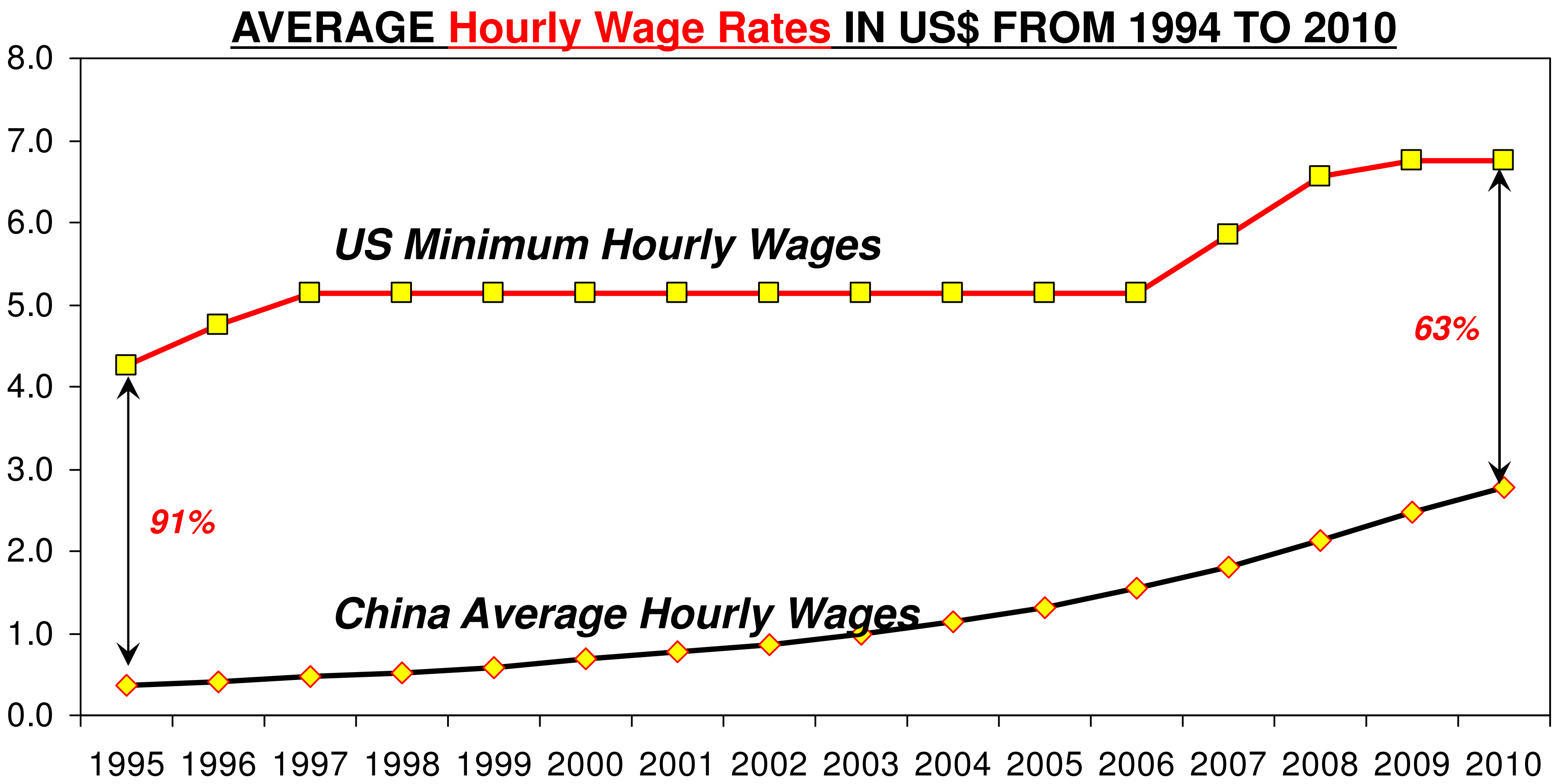
China - huge opportunity in a cheaper manufacturing location (wage arbitrage and lower cost of manufacturing) resulting in lower cost of goods sold, and consequently, incremental profits.

THE CHINA Differential EQUATION in 1995



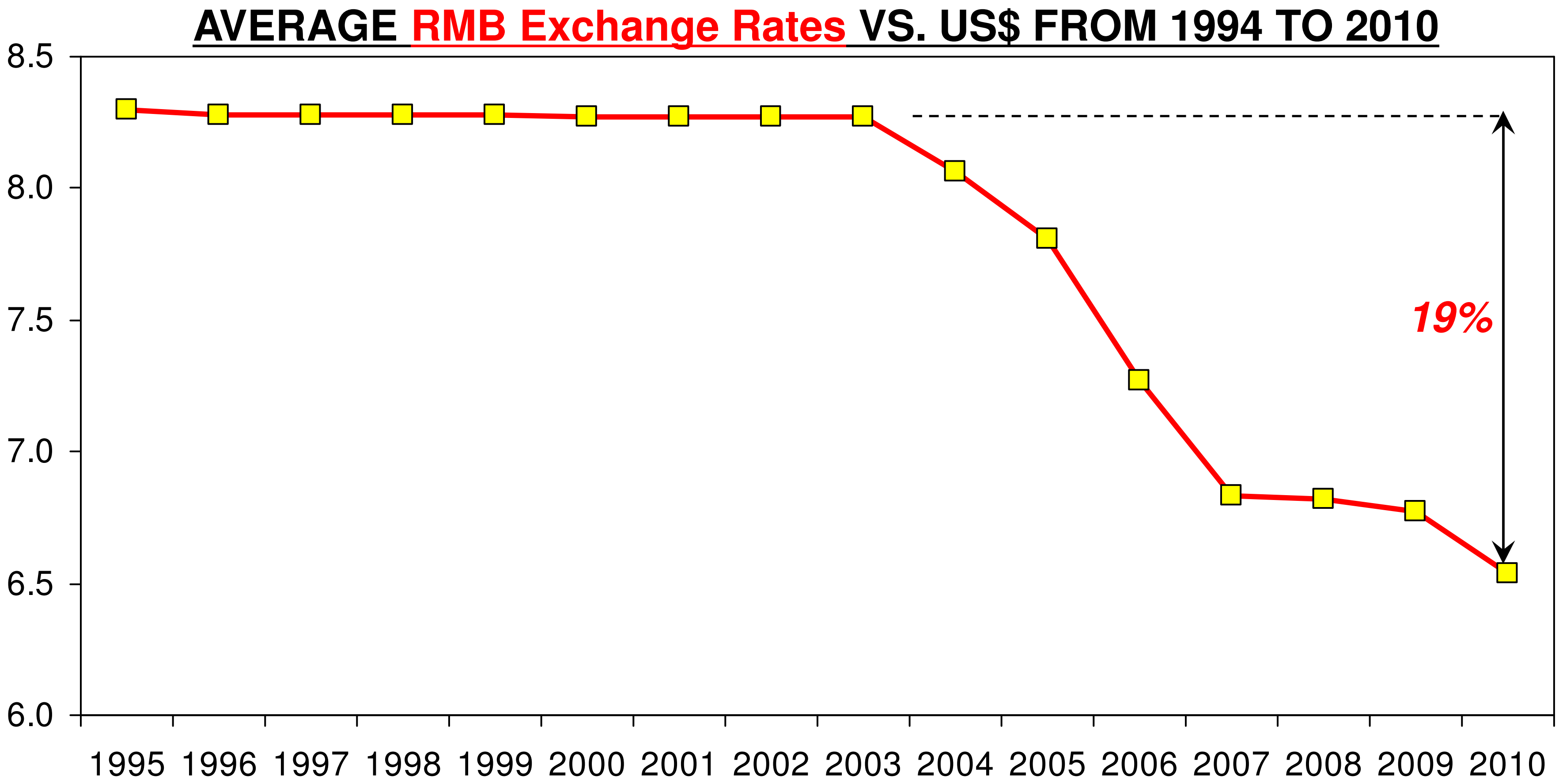
Cost Pressures - Historical Wage Increases

Wages in China have increased over the past 15 years narrowing the differential quite significantly - from 90%+ in 1994, to less than 65% in 2010.



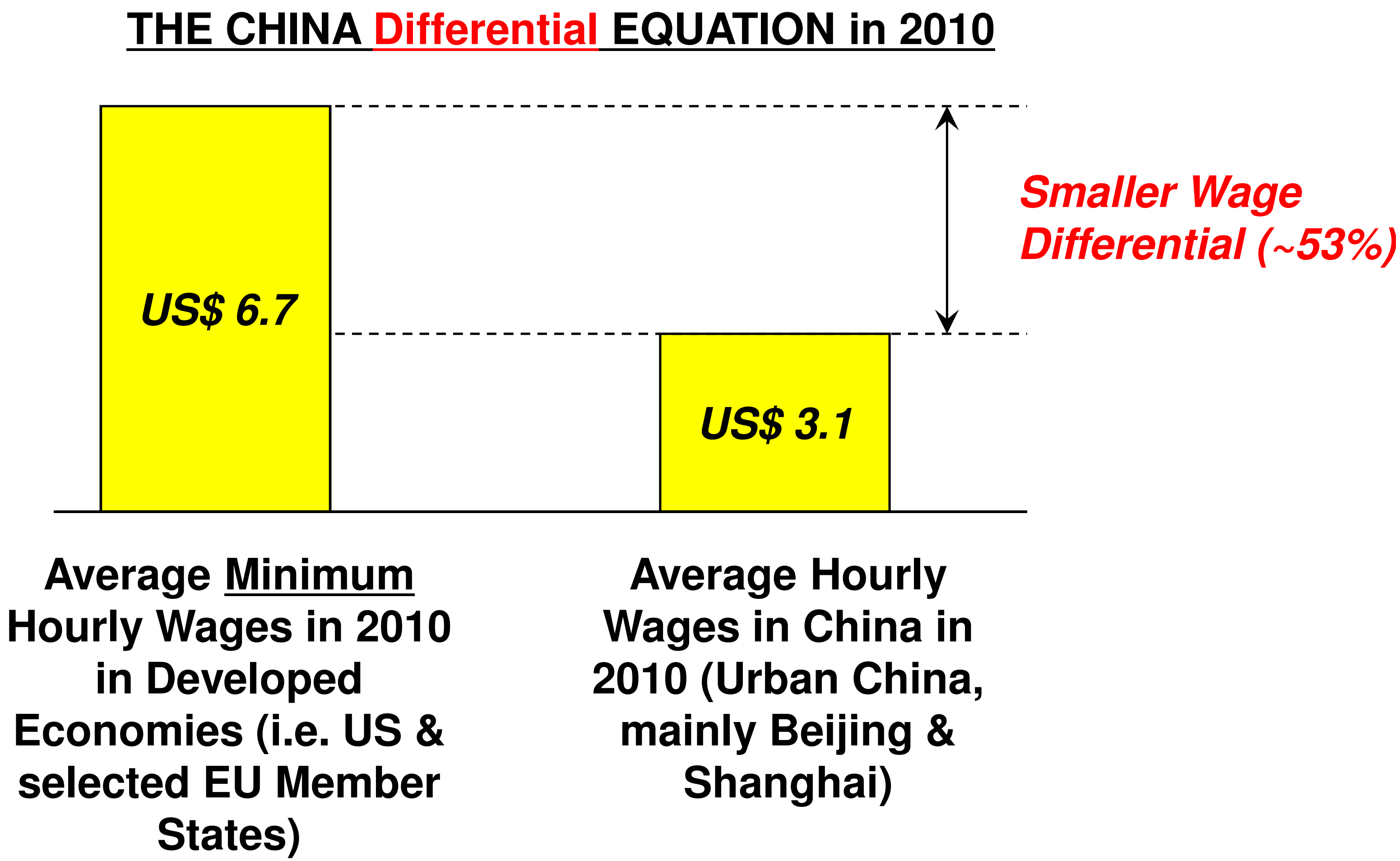
Cost Pressures - RMB Revaluation

Other significant macroeconomic move is the potential revaluation of the Renmimbi (appreciation by ~19% in the past 7 years) which has significant impact.



Cost Pressures - The REVISED Base Case

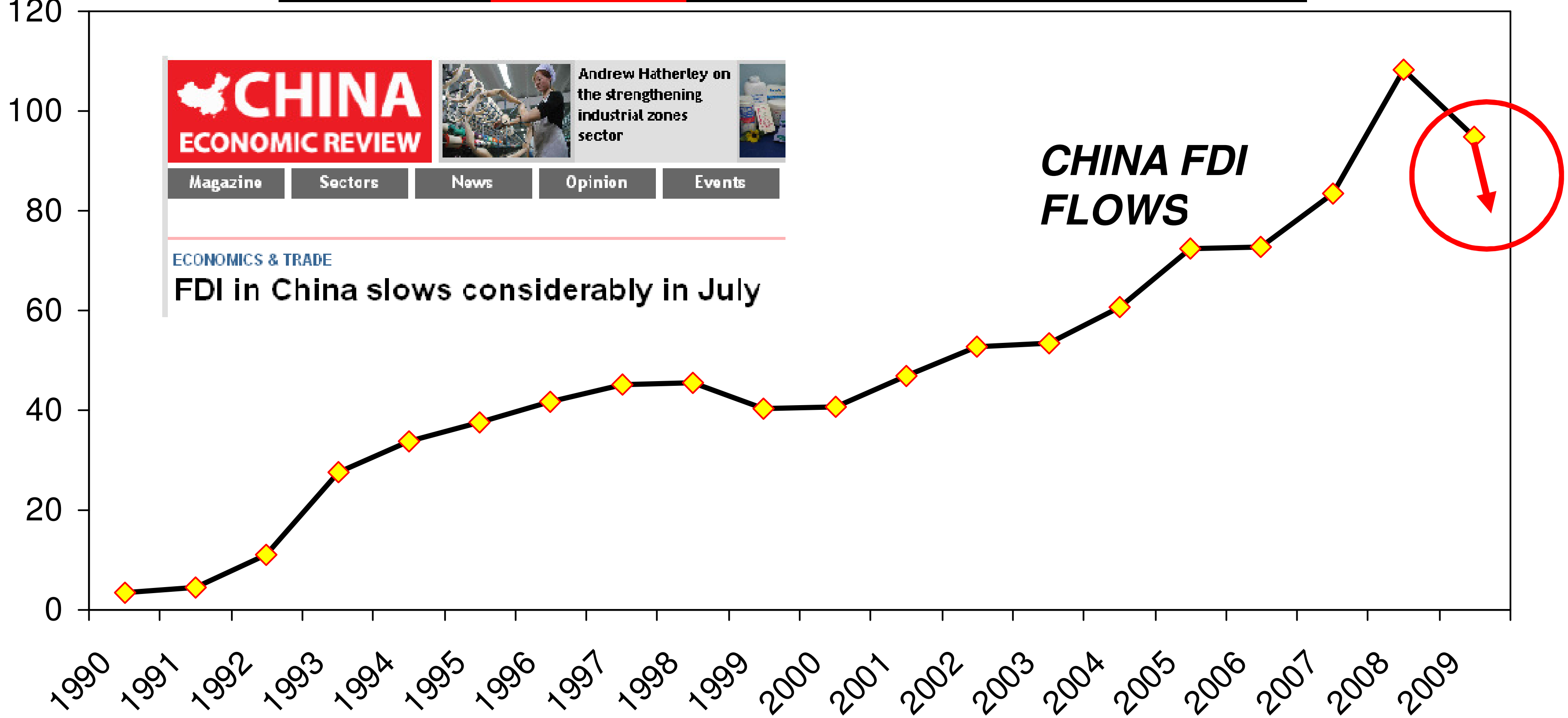
Historical wage increments, and the revaluation of the RMB, has eroded the cost advantage that China enjoyed ~15 years ago - the wage arbitrage has reduced to a little more than half in 2010…



Cost Pressures on China - What's next?

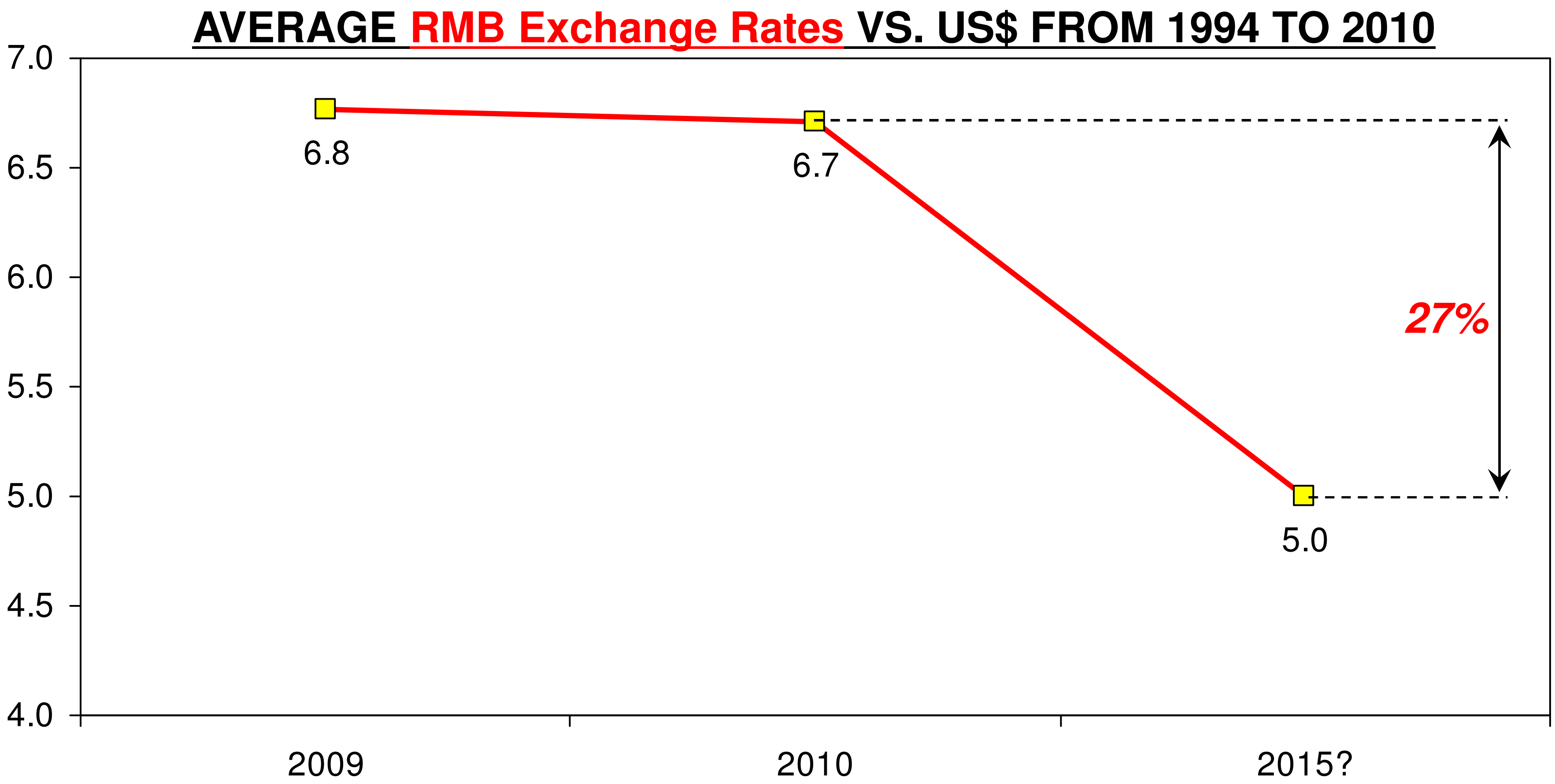
2011 could be the turning point for China in terms of its role in the world - It can no longer lay claim to new foreign direct investments as the "workshop of the world"…

AVERAGE FDI Flows IN US$ BLN ROM 1990 TO 2010



Forecasts - RMB Revaluation

True value of the RMB, by consensus among several economists, seems to be that RMB will appreciate another 27% to ~5 RMB: 1 US$ in ~ 5 years.



Forecasts - Wage Increments

There are several instances where wages have been increased quite significantly in 2010. On average, private sector wages need to increase by 20%+ to manage attrition.

China's Jiangsu Province Hikes Minimum Wage In Hopes Of Luring Back Freaked-Out Coastal Workers

China's Biggest Exporting Province To Raise Minimum Wage

MINIMUM WAGE TO RISE BY 21% IN SOUTH CHINA PROVINCE

Source: Various Press Articles

FT.com FINANCIAL TIMES

COMPANIES

Automobiles

FT Home > Companies > Industrials > Automobiles

Honda 24% pay offer fails to appease workers

By Tom Mitchell in Hong Kong and Jonathan Soble in Tokyo

Published: June 1 2010 04:59 | Last updated: June 1 2010 16:58

Production at a Honda components factory in China remained stalled on Tuesday, in spite of the company's offer of a 24 per cent wage increase to striking workers.

Foxconn China Workers' Salaries Jump 70%

After Suicides, Electronics Firm Foxconn Raises Pay to Preserve 'Dignity of Workers'

By CLARISSA WARD

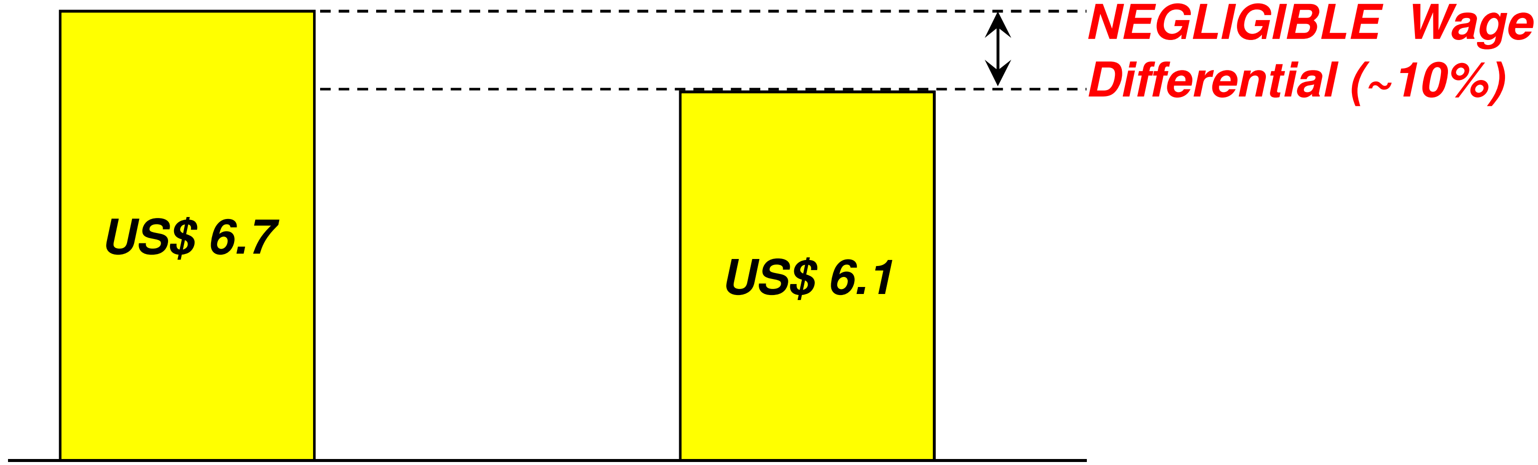
SHENZHEN, China, June 7, 2010

abc NEWS

The FORECASTED Case for 2015

We forecast that there will no longer be a wage differential between China vs. the developed economies in 2015.

THE CHINA Differential EQUATION in 2015



Average Minimum Hourly Wages in 2010 in Developed Economies (i.e. US & selected EU Member States)

Average Hourly Wages in China in 2010 (Urban China, mainly Beijing & Shanghai)

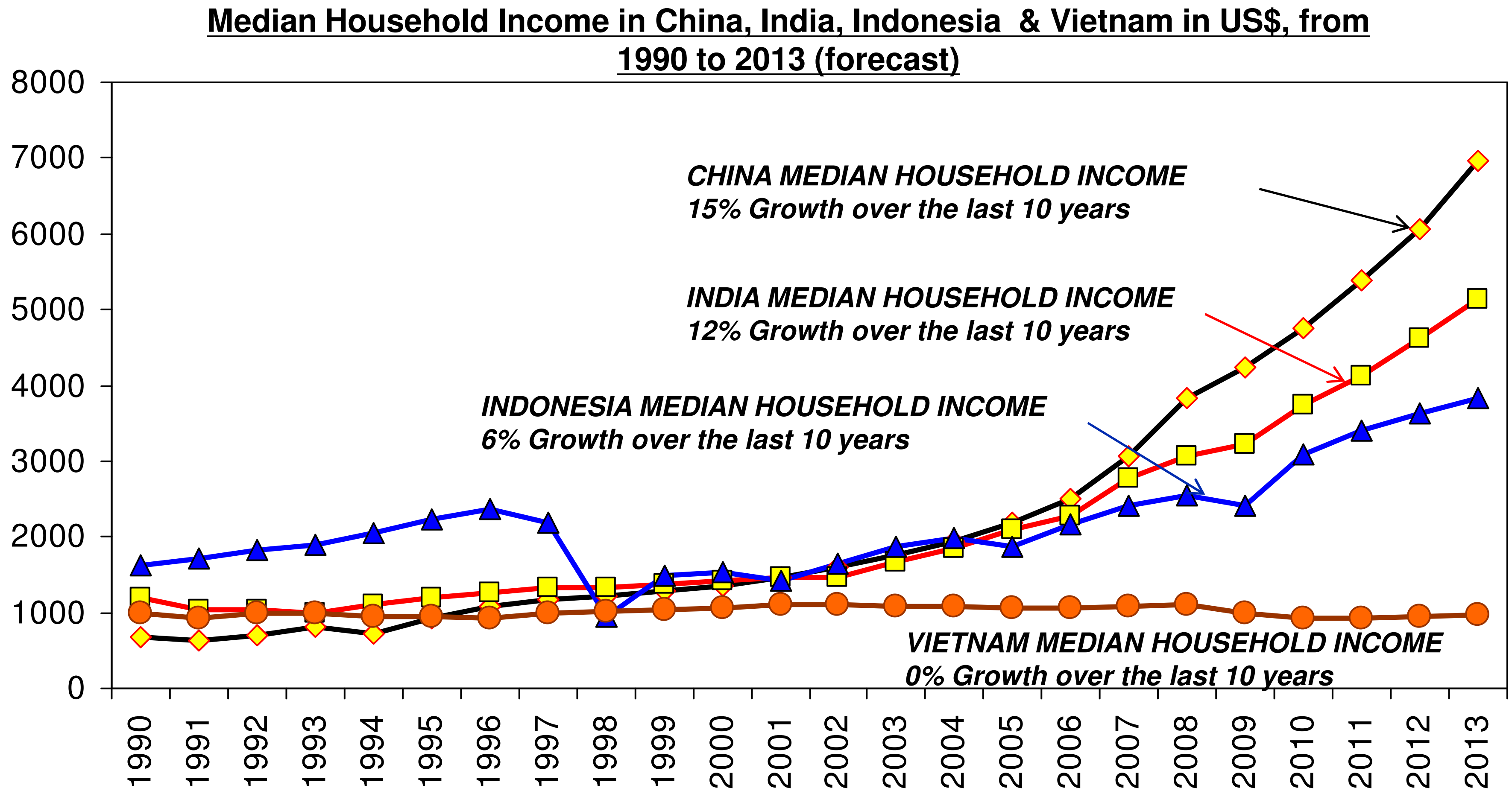
In Summary

If China is no longer the workshop of the world, then who is going to step up to be considered for that role?

- Significant demand from the Asia powerhouses
  - China
  - India
  - Selected countries in ASEAN
- Alternates to China as a low-cost location:
  - India?
  - ASEAN member nations?

Alternate Low-Cost Countries

Vietnam has kept its wages constant over the last 10 years, but mainly due to inflation and currency devaluation. In local currency terms, the wages have skyrocketed.



The ASEAN Situation

Given that India has significant wage pressures, selected countries in ASEAN could step up to be the next low-cost location due to their proximity to the new demand centers in Asia – China, India, and Indonesia

ASEAN

- Covers an area of 4.46 million km²
- Population of approximately 600 million (8.8% of the world population)
- In 2010, its combined nominal GDP had grown to US$1.8 trillion

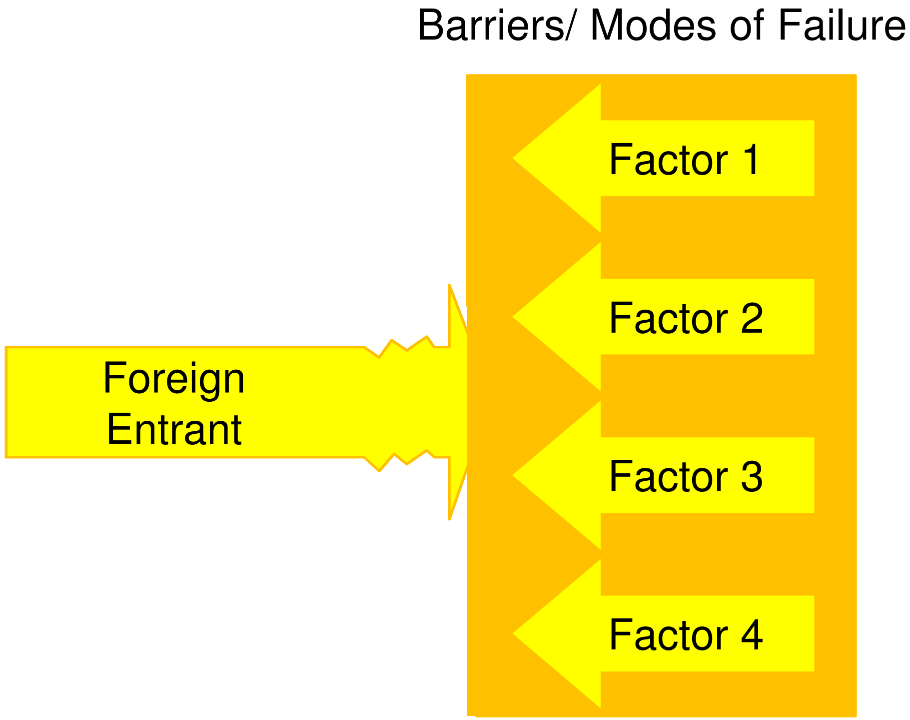
The ASEAN Complication

The potential opportunities in ASEAN do not come without a set of unique challenges – there have been multiple cases of failure with foreign entry.

Country	Outlook
INDONESIA	Growing and sizable markets, with opportunity for low-cost manufacturing too… but "The Devil is in the Details".
THAILAND	Maybe a "Spent Force", and definitely needs political stability.
MALAYSIA	Needs political maturity, and is relatively small to be considered as an independent market.
SINGAPORE	Local market? What local market? Relatively small to be considered as an independent market.
PHILIPPINES	Has gained well with political stability, and needs to grow as a market.
VIETNAM	Reliance on FDI, with low cost due to high inflation & currency devaluation. Note: Profits will also be subject to high inflation & currency devaluation.

Reasons for Failure

There are several areas of failure with entry into selected ASEAN markets.



The common causes of failure are difficult to pinpoint, but could be attributed to selected reasons, including

1) bad governance model
2) (il)legal contracts
3) partner misfit or wrong mode of entry
4) incorrect understanding of the demand characteristics, and
5) strategic misalignment

Key Questions

There are certain fundamental questions that need to be addressed - How do we invest in a growing market with tremendous potential, and mitigate the inherent risks of this investment?

Opportunities	What parts of my core business are best positioned for growth? What adjacent markets present growth opportunities for our business? How can we leverage existing capabilities for value creation in new businesses?
Selection of Opportunities	How do we balance high potential opportunities with the investment required for each opportunity area? What is the ability of my current organization to capitalize on these opportunities? What organizational and capability changes would be required? **What testing is required for each potential opportunity**?
Model for Implementation	What is the optimal growth portfolio for the organization? What is the value impact of these potential growth efforts? What is the action plan and required investment for pursuing this opportunity?

The standard solution

The standard solution seems to make the assumption that data is readily available in the developing markets of ASEAN. We strongly believe that this is not the case.

Competitive Approach Shortfalls

Our preferred solution

We advocate a holistic approach with assessment of all risk areas to uncover any challenges/ roadblocks to the investment. We recommend to conduct a market entry due diligence, with sufficient focus on the details, to ensure that your investment is protected.

<u>Competitive Approach Shortfalls vs. Our Preferred Solution</u>

1. Too Narrowly Focused
   - Depth in one growth area/topic
   - Narrow scope

2. Insufficient Research & Testing
   - Reliant on secondary research
   - Rarely test concepts in market

3. Naïve Operational Understanding
   - No incorporation of risk
   - Weak link to implementation barriers

Proposed Synovate Solution

- Portfolio approach, looking broadly at multiple opportunities
- **Primary research and testing are key with significant research among trade, regulators, competitors, and other relevant industry participants**
- Incorporation of Synovate Business Consulting' operational knowledge for uncovering risks in investments

Preferred Approach

- **Industry Analysis**
- **Opportunity Identification**
- **Route-to-Market Strategy**
- **Operational Strategy Development including Partner Identification**

Industry Analysis

Our fact based approach will aid industry analysis, which is critical for development of entry strategy into an emerging country market.

Industry Analysis - Forces At Work

Preferred Approach

- **Industry Analysis**
- Opportunity Identification
- Route-to-Market Strategy
- Operational Strategy Development including Partner Identification

1 Threat of New Entrants

- Economies of scale
- Proprietary differences (e.g., patents, exclusive products)
- Brand identity
- Switching costs
- Capital requirements
- Access to distribution
- Government policy
- Expected retaliation

2 Buyer Power

- Buyer v. industry concentration
- Buyer volume
- Buyer switching costs
- Ability to backward integrate
- Linkages with government/ state-owned enterprises

3 Power of Distribution/Channels

- Power is high if:
- Few channels are available
- Channel members offer buyers unique value-added services (e.g., inventory management)
- Buyers strongly prefer specific channel or channel type

4 Threat of Substitutes

- Relative price performance of substitutes
- Switching costs
- Buyer propensity to switch

5 Supplier Power

- Differentiation of inputs
- Switching costs
- Concentration
- Importance of volume to supplier
- Cost relative to total purchases in the industry
- Impact of inputs on cost or differentiation
- Threat of forward integration

6 Legal/Regulatory Impact

- Impact is high if:
- Span of enforced government authority is wide
- Many unresolved, highly publicized issues affect the industry

Industry Implications

- Industry growth
- Fixed costs
- Intermittent overcapacity
- Exit barriers
- Corporate stakes
- Degree of commoditization
- Switching costs
- Concentration

Opportunity Identification

Opportunities will be prioritized based on both subjective and objective factors as the reality in the market will need to be reflected in the final selection of opportunities.

Preferred Approach

- Industry Analysis
- **Opportunity Identification**
- Route-to-Market Strategy
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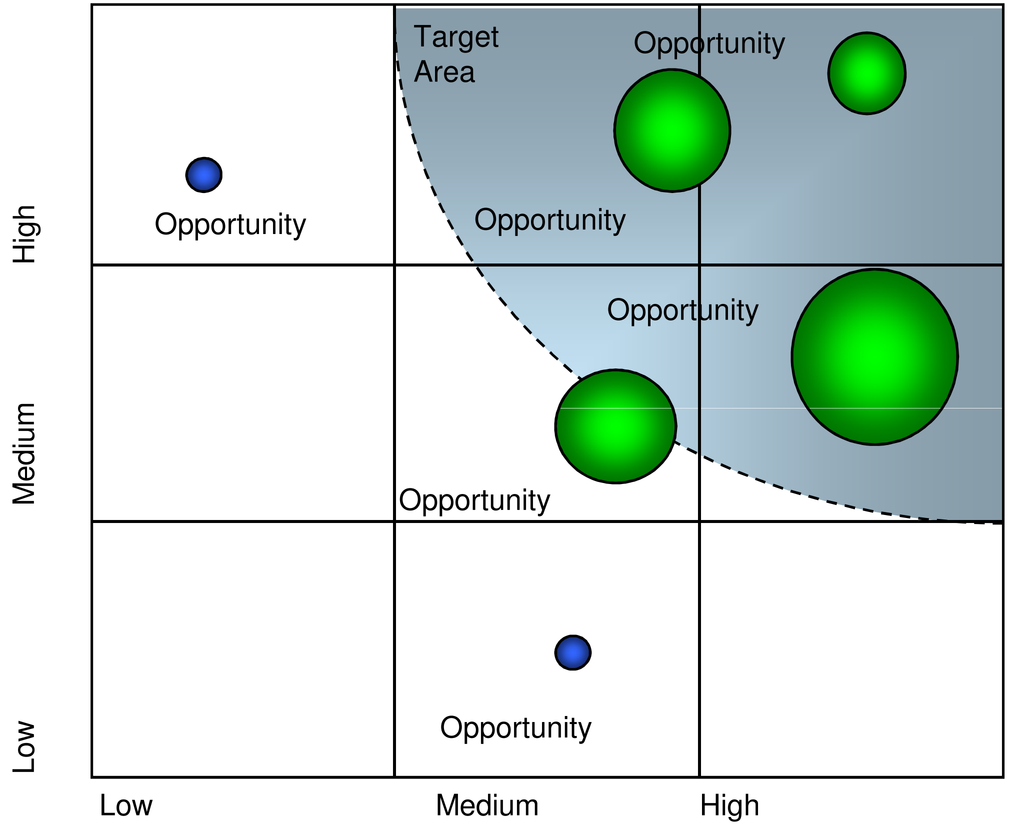
Attractiveness of Opportunity

1. Size and Growth Potential of Identified Opportunity
2. Fit with Intended Strategy
3. Profitability



Sub-sectors

Note : Size of Bubble Represents Potential Contribution to the Business by 2015

Ability to Compete

1. Strength of Current Operations (if any)
2. Ability to provide relevant infrastructure, satisfy customer needs, and create a differentiated positioning
3. Strength of relevant, competitive capabilities when compared to main competitors

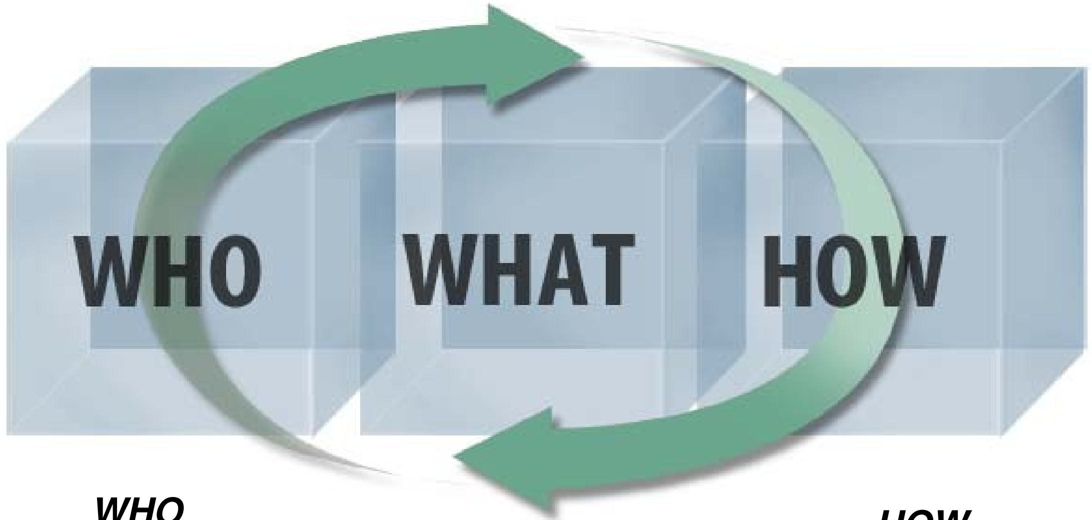
Route-to-Market Strategy

Route-to-Market will be closely aligned with the opportunity being targeted.

Preferred Approach

- Industry Analysis
- Opportunity Identification
- **Route-to-Market Strategy**
- Operational Strategy Development including Partner Identification

Market Entry Considerations



WHO
- ***Segments***
- ***Needs***
- ***Perceptions***

WHAT
- ***Channels***
- ***Product/Services***
- ***Total Experience***

HOW
- ***Resources***
- ***Activities***
- ***Partners***

A company's business model can be defined by its collective choices regarding: WHO its customers are, WHAT is offered, and HOW the business operates

Partner Identification

Not all market entries require acquisitions or joint ventures to address competency gaps. There could be more partnership options that could hedge risks, and be more cost effective

Preferred Approach

- Industry Analysis
- Opportunity Identification
- Route-to-Market Strategy
- **Operational Strategy Development including Partner Identification**

Partner Fit Assessment

OPTIONAL

Parameter setting for partner evaluation	Market scan and broad list development	Screening and initial filtering of broadlist	In-depth Understanding of Shortlisted candidates	Partner evaluation and recommendation	Partnership facilitation and negotiation (OPTIONAL)

Market scan for potential partner broad list

Filter

Broad list qualification

Based on partnership qualification criteria provided by client with advice from Synovate

Filter

Due diligence assessment and prioritisation

Based on in-depth investigation into each qualified company for best fit with client's objectives of the partnership

Recommendation and partnership facilitation

The ASEAN Complication

The potential opportunities in ASEAN do not come without a set of unique challenges – there have been multiple cases of failure with foreign entry.

Country		Outlook
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Indonesia – Devil is in the Details

Indonesia presents a huge opportunity, but the risks are uncovered only by performing detailed on-the-ground research - The "Devil is in the Details"

Industry Analysis - Forces At Work

1 Threat of New Entrants

- Huge threat of government backed local companies entering profitable markets

2 Buyer Power

- Linkages with government/ state-owned enterprises
- Understanding the consumer thoroughly

3 Power of Distribution/Channels

- Buyers strongly prefer specific channel or channel type

4 Threat of Substitutes

- Switching costs has to be well understood to bring in new products to Indonesia

5 Supplier Power

- Threat of forward integration

6 Legal/Regulatory Impact

- Expect frequent policy changes

Industry Implications

- Corporate stakes is a huge area of concern especially when choosing the mode of entry through joint ventures or acquisitions

Harvey Nichols

Basing the market strategy only on desk researched demand factors, and neglecting in-depth understanding of Indonesian consumer behavior, resulted in a flawed market entry

Buyer characteristics

- Harvey Nichols is a leading retailer for luxury brands in fashion, beauty and food. In 2010, Harvey Nichols had to wind down its operations in Indonesia as unexpected low revenues were unable to sustain high rental costs in Jakarta
- This occurred against the backdrop of fairly robust private consumption (positive growth rates between 2006 - 2010) in Indonesia, and high propensity for luxury items
- Despite high consumption demand in Indonesia, Harvey Nichols suffered low turnover because target customers preferred purchasing original luxury branded products from abroad (Singapore, Malaysia, Hong Kong and Europe) due to assurance of no fakes, prestige factor and diversity of options
- This case suggests that looking at the market opportunity alone is not enough but a deeper look what creates value for the end consumer is required

Carrefour

Carrefour's experience helps us understand how mitigating risk by partnering with a "well-connected" local partner is a key success factor in politically sensitive markets.

Regulations / Political risk

- In 2010 Carrefour confirmed that it had sold 40% stake in its Indonesian operations to local conglomerate Para group
- Carrefour had entered Indonesia in the backdrop of the Asian Financial crisis through a joint venture with a local partner and steadily built its business organically. In 2004, Carrefour decided to buy the stake of its local partner and become a wholly owned subsidiary
- Carrefour had always been a target of political groups drawing their clout from traders at traditional markets. However with the removal of the local partner and aggressive expansion policies including a high profile acquisition of Alfa mart resulted in a public relations and legal nightmare*
- Carrefour realized the importance of having a local partner with significant political clout as a part of its venture and entered into a partnership again

*The Competitition Commisson of Indonesia (KPPU)fined Carrefour and ordered it to divest its stake in Alfamart due to monopolistic considerations

Mandala Airlines

The experience of Mandala airlines shows us that selection of right partners with strategic alignment in priorities is critical for success.

Competitive Rivalry/ Strategic Misalignment

- In February 2011, Mandala airlines announced the ceasing of its operations indefinitely till the end of restructuring talks with the creditors
- Mandala was one of the oldest domestic airlines in Indonesia that had been privatized in 2006 with local logistics group Cardig International and US based Indigo partners becoming the new owners
- Mandala initially had a great turnaround in 2007 – 2008 with high yields and loads as the competition in the space was yet to heat up.
- A dispute among the partners over the positioning of Mandala as a frills/ no frills low cost carrier resulted in mismanagement of the business, and delays in investment in the business
- The strategic misalignment allowed competitors like Air Asia , Lion Air, and others to expand their fleets, were able to serve more destination, and achieve economies of scale, while Mandala ran into cash flow problems

*The Competitition Commisson of Indonesia (KPPU)fined Carrefour and ordered it to divest its stake in Alfamart due to monopolistic considerations

Research in motion

First hand knowledge and adapting to local needs led RIM to be successful in Indonesia

Brand building / local adaptation

- Blackberry has been one of the most successful international brands in Indonesia selling over 1.2 million units Though RIM entered Indonesia in 2004 through a partnership with Indosat, it has experienced tremendous growth only in the last 4 - 5 years
- RIM's success in the Indonesian market can be attributed to three major factors:
  - first mover advantage
  - the digital infrastructure network
  - rise of Indonesian middle class
- The years spent in Indonesia have helped RIM establish key relationships with distributors, and corporate customers leading to Blackberry being regarded as essential "status symbol" for corporate executives
- In recent years Blackberry identified the need for Indonesians to stay connected to internet on the move. It devised various packages with its alliance partners to be cost effective

In conclusion…

- ASEAN is a grouping of disparate nations, and each could be a goldmine
- Each country in ASEAN is in a unique state of development, and presents its own challenges (i.e. minefield)
- The trick is to do DETAILED RESEARCH with industry, regulatory, and trade participation
- Test each identified opportunity to ensure it really exists, and to uncover the "hidden" risks
- Not all market entries require acquisitions or joint ventures to address competency gaps. There could be more partnership options that could hedge risks, and be more cost effective

Thank you for your Interest.

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Location:	Synovate Business Consulting, Singapore
Consulting and Research Experience:	12 Years
Research Specialties:	Regional Growth Strategies, Market Entry Strategies, Competitive Intelligence studies, Supply Chain Optimization programs, Mergers & Acquisitions, Financial Evaluation
Sector Specialities:	Industrial Machinery & Equipment, Consumer Products, Logistics/Transportation, and others

Profile:

- Anand is an experienced associate director in Synovate Business Consulting and has more than 12 years of experience, of which 8 years has been in management consulting in the area of Strategy and Operations. He has previously worked for Deloitte Consulting Strategy Practice & Accenture Strategy Practice, and has worked with clients such as Cummins, Daikin, Kraft, DHL, Nike, British American Tobacco, Whirlpool
- Anand’s qualifications comprise MBA, General Management & Finance, Asian Institute of Management, Philippines with an exhange program at Tuck School of Business, Dartmouth; B.Tech, IIT Mumbai