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The untapped business opportunity in Southeast Asia – productivity improvement

Reddal Insights — 30 March 2016
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Low productivity is the main challenge facing Southeast Asian economies. There is a macroeconomic imperative to boost productivity but implementation is difficult. In this article, we address automation, efficiency and human capital development as key new business development areas in the region.

Southeast Asia, considering the countries part of The Association of Southeast Asian Nations (ASEAN); Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam, represents an economy of over 600 million people and a GDP of 2.4 trillion USD. If it were a single country, it would be the seventh largest economy in the world today and the fourth largest by 2050, according to projections. The economy has grown at the pace of 5.1% per annum in 2003-2013 and is expected to grow at the annual pace of around 5% in the near future. [1]

Much of the region's growth has been driven by an increasing labor force partly due to a shift of workers from agriculture to manufacturing. This dynamic will eventually dampen, creating a need for addressing the region’s low levels of productivity.

The Southeast Asian countries are expected to see a rapid economic development also going forward. As a region it offers opportunities for both market entrants from abroad and local businesses. While companies in industries such as consumer goods and services, real estate and infrastructure will have opportunities given the region’s attractive fundamentals, there is also untapped potential and need for solutions improving efficiency and labor productivity in both private and public sectors, given the sizeable productivity gap in the region.

ASEAN region has great fundamentals for rapid economic development

A growing, urban consumer base with increasing purchasing power will drive private consumption in Southeast Asian markets. Standards of living and disposable income within all social classes are expected to rise rapidly, although (in the case of some countries in the region) the starting point is low. The rapid pace of urbanization is estimated to double the consuming class to 163 million households by 2030. This drives growth in consumer goods, retail and consumer services sectors, and creates a need for investments into infrastructure and real estate. An estimated USD $7 trillion in investments into infrastructure, housing and commercial space will be required. [2]

In addition to an attractive domestic market, the region has potential to become a manufacturing hub for the future. Although the ASEAN countries represent multiple ethnicities, languages and cultures, at different levels of economic maturity, the ASEAN integration is expected to bring down trade barriers to support capital, goods and labor movement within the countries, making the region more competitive. Furthermore, the Chinese economy, with its rising labor costs and target to decrease dependence on exports, is providing Southeast Asian countries with an opportunity to capture a bigger proportion of global manufacturing operations. While this is especially true for multinationals seeking a low cost-base, or those afraid or tired of the challenges of doing business in China, it is also enabling local companies to grow and expand.

Productivity improvement is a key challenge to enable economic development

Low productivity is the main challenge facing Southeast Asian economies. While productivity growth has improved dramatically it has been the result of a large scale shift of labor from agriculture into more efficient sectors, rather than productivity improvements within the sectors themselves.

The demographics are still favorable but the boost to economic growth from an expanding workforce will eventually begin to slow down. To maintain economic growth, many ASEAN countries will need to speed up productivity improvement, in some cases doubling their current development pace [2]. While low-cost labor is considered a competitive advantage in the region, this benefit is undermined by weak output per worker. The low productivity is an even more severe issue in the SME sector (companies with less than 500 people), representing 95% of the companies, up to 97% of employees but only in the range of 23-58% of gross domestic product [2]. As the ASEAN region becomes a more integrated market and global trade barriers are lowered with trade agreements, these companies will be facing increasing competition from more productive multinationals and larger local companies. With the Trans-Pacific Partnership Agreement (TPPA) signed on February 4th, 2016 by 12 countries including Singapore, Malaysia, Vietnam and Brunei of the ASEAN countries, this threat of increased competition is now stronger than ever. Southeast Asia’s lower-income countries will have to solve the productivity challenges in order to remain competitive, especially as pressure for wage increases builds up.

Despite a macroeconomic imperative to boost productivity, severe implementation challenges remain

Southeast Asian governments have acknowledged the productivity challenge and many programs have been implemented to incentivize and support productivity improvement by offering financing, training, education and tax benefits. Organizations such as the Malaysia Productivity Development Corporation or Vietnam Productivity Centre seek to guide and coordinate the productivity development on a national level. Regional differences are also big. For example in Vietnam the productivity level is exceptionally low, one fifth of that of Malaysia and two fifths of that of Thailand.

The government efforts would benefit from centralized coordination, instead of having multiple entities in each country solving the problem independently. However, due to a fundamental lack of productivity improvement culture in private enterprises the macroeconomic imperative does not necessarily translate into a real microeconomic improvement. Dato' Dr. Ir. Andy Seo Kian Haw, former General Manager of the General Electric Company Malaysia, former Managing Director of Kone Malaysia and currently the Vice Chairman of Federation of Malaysian Manufacturers comments: "Supply of low cost labor offers the quickest and cheapest solution to increase output. Many companies choose this easy route, rather than looking into how relative productivity could be improved. The general mindset is to solve challenges simply by adding more labor. This is evident in companies employing full time tea-ladies to offer drinks at the workplace, but also at home where it is common to employ multiple domestic helpers. The market is used to low cost labor and this mindset is difficult to change."

Automation, efficiency and human capital development are key business opportunities

The need for productivity improvement is creating opportunities for new companies to enter the market. Across the Southeast Asian economies there will emerge a distinct need for production automation, process efficiency solutions and human capital development.

Production automation solutions include any solutions geared at improving output per labor unit. In addition to the private sector automation investments, there is a dire need for productivity improvement through automation in the public sector, which today is highly ineffective. There are significant opportunities to develop various e-government solutions for most Southeast Asian governments. With 1.6 million civil servants and a population of 30 million, Malaysia has one of the highest civil servants-to-population ratio (5,3%) globally and much higher compared to neighboring Singapore where the ratio is 2,5% [4, 5]. Approximately 10% of the workforce is in civil service. Productivity solutions, in addition to making the public sector more productive, would help private sector companies by improving ease of doing business. Process efficiency solutions such as software technologies for more effective operations, lean manufacturing and streamlined processes provide opportunities for both software companies and professional service companies that provide training and implementation support.

Human capital development through training and education of the labor force is another important element to improve total factor productivity, but still largely overlooked. This driven by the fast economic development and rapid employee turnover in Southeast Asian

countries. In most cases, the immediate focus needs to be on process efficiency and the way of working, followed by training and focused investments into automation. Automation investments are easily wasted, if no adequate training for the machinery or system operators is provided. Human capital development will rapidly rise into the forefront as efforts to improve productivity commence.

Adjusting offerings and investing time in relationship building is required for success

In the long run, Southeast Asia is a solid opportunity for companies offering solutions for productivity improvement. In many ways the region is also an easier place to conduct business compared to China, and the relative productivity gap – and thus the opportunity – is larger. Given the availability of government support, including financing offered through various government grants and loans, the key question is not so much "what" the opportunities are but "how" to capture them and how to develop an attractive value proposition.

Successful market entrants will have to adjust their go-to-market strategies, value propositions and offerings, while preparing to invest in developing long-term relationships. In spite of the potential, the region is no place for quick wins. There is in-built caution for investing into productivity enhancing solutions and a tendency towards short-term thinking, largely driven by the rapid economic development in recent years.

Solution providers entering the market need to consider customer short term financial benefits and how to make an investment attractive, while also including elements for sustainable long-term benefit. This requires a thorough understanding of the current way of working and existing skill gaps. A solution roadmap should address these in a balanced way to ensure both quick wins and long-term success. Innovative pricing/financing solutions should accompany the solution, especially for the SME sector where productivity challenge is the biggest. Companies capable of adjusting their value proposition to the local characteristics will have a considerable advantage.

Long-term relationship building is important in Southeast Asia, just like in Asia generally. There is no tradition of using third party service providers to develop productivity. Andy Seo stresses the cultural mistrust towards externals and the importance of senior relationships: "Local companies are often not willing to engage external professional support even though it is badly needed. This is due to a lack of trust for third parties and an unwillingness to share information. It is also difficult to convince companies to pay for development initiatives, as the benefits are considered 'intangible', the value of which is not immediately obvious. One should always approach the owners and top management with an offering. The gap between the top and the lower organizational levels is large, and a proper understanding of the owner's needs and mindset is critical. Relationships are extremely important and there is also certain preference for age seniority which may also be easily overlooked by the potential market entrants."

Southeast Asia is not an easy market to enter, but there is a clear underlying trend that is

building up demand. Understanding the local challenges, mindset and cultural heritage is key. For the systematic market entrant who has developed a clear strategy, there is nevertheless a clear opportunity for business, and a market that can be expected to develop considerably going forward.

A Korean translation of this article was published on the Korea Trade-Investment Promotion Agency (KOTRA) website: [전문가 기고] '기회의 땅' 동남아시아에서의 미개척 사업 기회 - 생산성 향상.

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