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Brace for Impact

The AEC presents opportunities, challenges and changes for SMEs

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On Nov 22 2015, Asean leaders established the Asean Economic Community (AEC), which came into effect on Dec 31. One of its aims is to promote freer movement of trade and capital in the region. In practice, this means that tariff barriers between the 10 Asean countries will be eliminated while non-tariff barriers will be phased out.

Restrictions on cross-border investment and the movement of labour within the region will also be progressively lifted.

The impact on enterprises will be significant. Consumer businesses will gain access to a combined market of approximately 625 million customers at a time when the middle class is growing in size and affluence. B2B businesses will gain access to an equally wide customer base that is also taking advantage of the AEC to expand around the region.

Small and medium-sized enterprises (SMEs) stand to benefit greatly from the upside of new markets, cheaper resources and more sources of capital. But they are also particularly vulnerable to the downside of steeper competition and market volatility, as they may not have the capital or experience to adjust their strategies.

Demand boost

The AEC presents SMEs with many opportunities to increase their competitiveness. They will have fewer transactional costs and immigration requirements to address, while enjoying access to far more resources at lower cost, including a wider range of raw materials and talent.

Manufacturing and service costs will drop. SMEs will be able to access new business models and new forms of technology, which may help them to improve their operations and strategies. All of these will help them improve their supply chains.

Sources of funding for SMEs should also increase, as capital flows are expected to increase with the liberalisation of capital markets, improvements to market access and linkages, and the reduction or removal of restrictions on foreign investment.

At the same time, regional integration will offer investors the prospect of getting the best of both worlds: the capital and skilled labour of Asean's more developed countries, together with the resources and competitive costing of its developing economies.

Over the short and medium term, real estate and construction will see increased demand for industrial, office and retail space as businesses expand into new markets. In the longer term, logistics and professional services are expected to benefit from increased trade and capital flows. Tourism will also grow on the back of improvements to air and land transport infrastructure.

Increased competition

Even as SMEs improve their competitiveness under the AEC, they will face increased competition. They can expand into new markets, but their foreign counterparts can also enter their own home markets. These new competitors may have more funding, more experience and better resources. They may even have the support of their governments.

The competition will extend to resources, including human capital, and funding. With cross-border labour movements becoming easier, the best talent will become even more mobile. SMEs may find it increasingly challenging to retain good human capital, with knowledge-based and high-value industries being particularly affected.

At the same time, some domestic difficulties may become exacerbated over the short and medium term. For instance, an influx of cross-border talent gives rise to the potential for miscommunication as businesses adjust to having different cultures in the workplace. Capital inflows may also cause significant volatility in sectors such as real estate, where commercial and industrial rents may be affected.

Defence plan

Singapore enterprises must understand that domestic organic growth alone will no longer suffice to defend them against competition.

Capitalising on the AEC will require a regional strategy. Mergers and acquisitions (M&As) should increasingly become an option for growth and expansion, and to consolidate a company's market position. Acquiring attractive targets also helps to prevent competitors from gaining a similar foothold.

However, companies should not enter M&As without any preparation. This is especially so if they plan to venture across borders. Cross-border M&As carry heightened risk and can be difficult to achieve due to various factors, including poor communication and lack of local market knowledge.
To reap the full benefits of M&As, companies need to plan well in advance and ensure that they have the correct resources at hand. This includes conducting thorough due diligence before an acquisition and building a sound strategy or framework to determine whether the M&A is right for the company.

Going through changes

As the market changes, SMEs will need to keep their eyes out for opportunities such as new technology, new supply chains, and partnerships both inside and across the industry. For example, in some of the sectors that will benefit from AEC - such as manufacturing and professional services - businesses may be able to collaborate for economies of scale.

If they expand, they also need to be aware of issues such as non-tariff barriers, non-transparent practices and facilitation payments. Political risk also remains a factor in certain markets. Some may even wish to rethink their business models and strategies, drawing examples from successful counterparts and industry leaders around the region.

Most importantly, SMEs need to embrace the mindset that it can be not only possible, but measurably beneficial to leave their comfort zones and explore new avenues of growth. They need to be open to change and prepare themselves to adapt to the environment.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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