Grant Thornton

An instinct for growth™

Thailand: *the business growth landscape*

Grant Thornton International Business Report 2015

Contents

Introduction

This is the 10th year we have published our annual focus on the Thai economy from the Grant Thornton International Business Report. So what has the last 10 years brought us in Thailand? 11 Prime Ministers (if we include those that were acting), 10 Finance Ministers, many deadly street protests, two coups, one airport shut-down and a devastating flood of massive proportions. Given this it is almost surprising that Thailand has managed to eke out an annual average growth rate of 3.13% over the last 10 years, albeit the lowest in the region.

Compare this to our neighbours in ASEAN during this same period. Singapore – one Prime Minister and 5.17% growth; the Philippines – two Presidents and 5.43% growth; Malaysia – two Prime Ministers and 4.86% growth; Indonesia – two Presidents and 5.7% growth; and finally Vietnam – one Prime Minister and 6% growth. None of these countries have had a coup during this time although most have had their share of natural and domestic challenges.

Studies have confirmed that 'coup governments' prioritise stability over prosperity. The Economist[1] recently looked at the impact of coups on growth finding that *"growth slows, on average, by 2.1% in the year of a coup, and 1.3% and 0.2% in the two years thereafter."* The article quoted Paul Collier, a professor of economics at Oxford who has *"calculated that the cumulative effect of a coup, tracked over several years, is to reduce incomes by 7%."* Thailand has suffered two coups in the last 10 years each of which was preceded by months of instability and conflict.

Other serious long-term issues exist in Thailand. The population is ageing dramatically, which will have the double negative effect of reducing the working population whilst at the same time incurring higher bills for healthcare. This burden will be absorbed in part by the people and in part by the national and local Thai governments. Two of the systemic fixes for these problems are culturally challenging for Thailand. Radical changes in the education system including greater technical education and a focus on advanced vocational training to promote increasing levels of productivity are not even being discussed. Even if this were to happen now, it would be one or two generations before there would be a measurable enough contribution to efficiency. The second is 'positive' immigration. This means identifying skills gaps and encouraging the hiring of higher-skilled foreign workers.

Income disparity also constrains Thailand's recovery. The World Bank in its recent focus on Thailand stated that *"The rate of recovery and reigniting economic growth will depend on how fast Thailand can overcome factors constraining growth and promote a more inclusive growth model."* However the NESDB has recently said that 0.1% of Thais own nearly 50% of the country's assets. Compare that to America, where 0.1% of the population owns only 20% of that country's assets.

Thailand is trying to move up the manufacturing "value tree" and away from low-cost labour intensive manufacturing. Interestingly, a recent advert for Rolls Royce that was heavily featured by the Thai government showed gleaming new Rolls Royce aeroplane engines being manufactured, giving the impression these were made in Thailand whereas they were actually made in Singapore. However it is at least the right aspiration.

[1] "The high cost of stability" 8 Oct 2014

Other key ingredients of a knowledge-based economy are not present: R&D spending, IP protection, and investment in science and technology. We are even lacking high-speed internet. This absence of digital infrastructure further contributes to even more basic challenges: business, banking and government transactions are still too paper-based thus encouraging a lack of transparency while incurring higher expenses for all involved.

Another factor influencing the lack of growth is the conscious failure of Thailand to liberalise the services sector. Although this is a challenge in many other parts of the world, Thailand is still too beholden to powerful benefactors which prevent liberalisation for fear of competition.

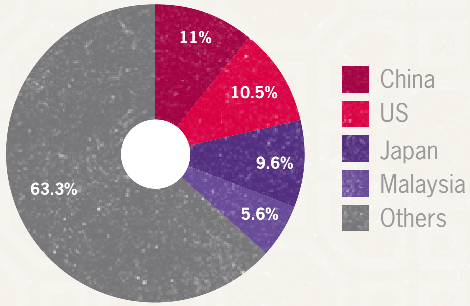
Thailand can accelerate growth using three main levers including more household spending, more exports, and a substantial increase in government spending.

The first two of these levers are already too hot to touch. Household spending has been declining whilst household debt has increased dramatically at the same time. The prognosis for exports is sluggish – the Bank of Thailand expects the worst merchandise exports performance since 2009. Exports – which account for around 60% of GDP – have been hit from two sides: first from the weakness in global commodity prices and also from the economic slowdown in China, which accounts for around 11% of overseas sales for Thailand.

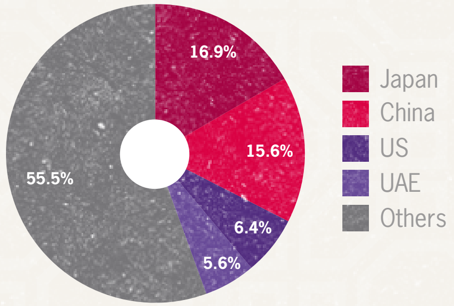
As mentioned earlier, Thailand has not made the necessary adjustments to its education programs to improve productivity but has instead relied upon growth in the global economy and specifically in its major trading partners. That is no longer the case. Our neighbours in the region are also competitive in this area. Thus the halcyon days of strong export growth are no longer sustainable.

Government spending is a possibility and is starting to happen with the large infrastructure projects that have been announced. The government's bank balance can certainly support these projects. However, history has taught us that the government is generally slow to actually spend funds, while fast profligate spending can also encourage corruption, which the government is attempting to prevent. This environment essentially paralyses the government from making any meaningful decisions for on the one hand the bureaucrats are scared of making decisions for major projects and on the other hand, are waiting for an environment better suited to making those decisions.

Export destinations



Import originations



Source: The Economist Intelligence Unit

Thailand's rulers have also unveiled a new strategy to build 'a people's state'. Its aim is to empower local communities and local enterprises through stimulus measures targeted at small and medium enterprises including 100bn baht in soft loans, a 100bn baht credit guarantee to encourage banks to lend to SMEs, a two-year 10% tax rate, a five-year corporate income tax exemption for SME start-ups and 6bn baht in venture capital contributed by state-backed banks.

The net effect of all of this will be continued long term nominal growth in the lower digits, as we are seeing now. There remains a real risk that the actual results will be 'zero' growth or even a shrinkage, especially if there is no ability to have a stable elected government, which is not perennially tied up in constitutional red-tape. Or worse – more street protests and what seems to be their inevitable consequences – a peculiarly Thai version of Groundhog Day.

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68 million inhabitants

Economic outlook

The economy is expected to grow by 2.5% in 2015, up from just 0.9% in 2014. Exports were flat last year and are forecast to contract this year. A gradual recovery in the external sector, a possible weakening in the strength of the baht and increased infrastructure spending should help GDP growth rates increase but will remain around 3.5% to 3.8% with Thailand's Fiscal Policy Office forecasting a projected 3.8% growth rate for 2016 with continued pressure to the downside.

Crucially these forecasts depend on continuing domestic stability. Travel and tourism account for almost a fifth of GDP but despite political uncertainty and the August bombing of the Erawan shrine, tourist numbers are forecast to climb 22% to 30.3m in 2015 according the tourism council – boosted by a sharp increase in visitors from China. While military rule offers social stability in the short-term it remains to be seen whether it can offer real long-term improvement in the complex fractious relationships that exist in Thailand. There is also the always present risk that the current government might introduce fiscally costly populist economic policy measures to keep the economy afloat.

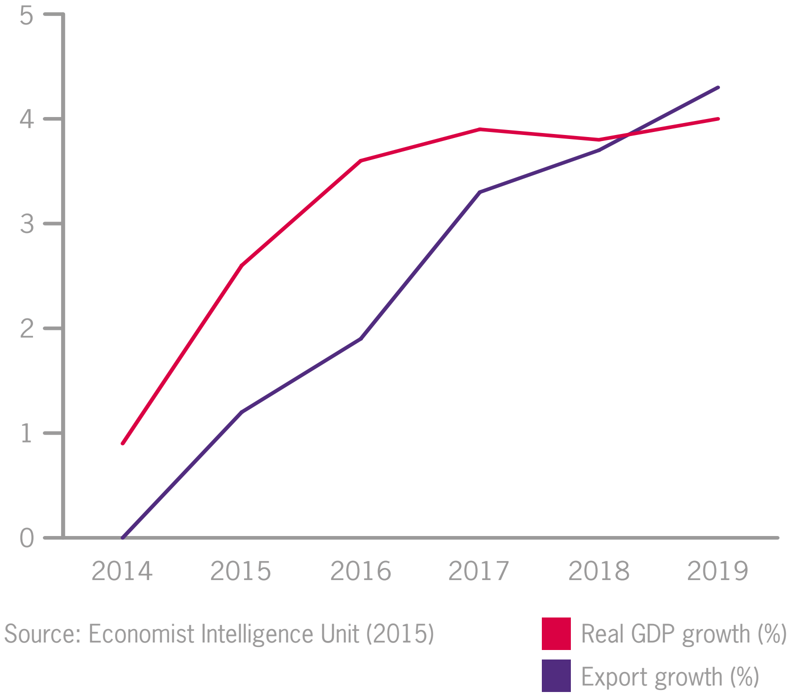
There are also vulnerabilities in the local economy. Thailand – mainland southeast Asia's only upper-middle-income country – is stuck in the so-called 'middle-income trap' where a developing country loses export competitiveness because domestic wages are too high. Business confidence remains low due to the prospect of years of slow growth as well as unexpected changes in government legislation and policy. The Thailand Development Research Institute has called on the government to focus on developing either the manufacturing (like South Korea) or services (like Taiwan) route to escape low growth and raise living standards.

Exports have suffered from low global commodity prices and weak demand while the devaluation of the Chinese renminbi might further undermine the competitiveness of Thai products. However, while competing Vietnam pushes ahead with the Trans Pacific Partnership (TPP) and European Union free trade deals, there seems some aversion to opening up protected Thai sectors such as telecommunications, financial services and agricultural products to outside competition.

Latest economic indicators:

- the economy grew by 0.4% in Q2-2015 with full year expansion for all of 2015 estimated at 2.5%
- the consumer price index (CPI) declined by 1.1% in September from a year earlier, the ninth consecutive month of deflation. However, core inflation, which excludes volatile raw-food and energy prices, rose by 1% from a year earlier
- merchandise exports fell by 6.7% from a year earlier in August to US$17.7bn, the eighth consecutive month of decline in merchandise trade
- the consumer confidence index (CCI) fell to 72.1 points in September from 72.3 in August. This is the lowest level since May 2014.

GDP expected to recover as exports grow



Source: Economist Intelligence Unit (2015)

Business growth

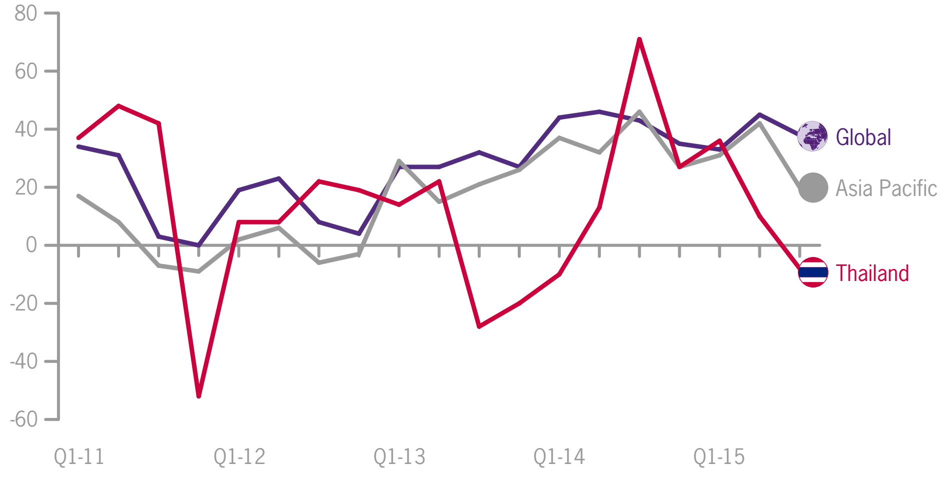
Business confidence across the Asia-Pacific region declined in Q3 as strong global headwinds including a slowdown in global trade and uncertainty over China's growth path in particular weigh on the outlook. In Thailand net optimism in the economic outlook dropped 18 percentage points to -8%. The past 12 month rolling average stands at 16% compared to 26% in 2014.

Across APAC optimism fell from net 42% to just 20%, its lowest level since the second quarter of 2013. The decline in developed markets was most severe (down 30pp to net -8%) but emerging markets also saw a steep decline (down 18pp to net 34%). The global average remains fairly buoyant driven by strong business confidence in both the UK and US.

Thai business confidence has fallen…

…to its lowest level since mid-2013

Net percentage optimism in the economic outlook (next 12 months)



Source: Grant Thornton IBR 2015

Growth indicators

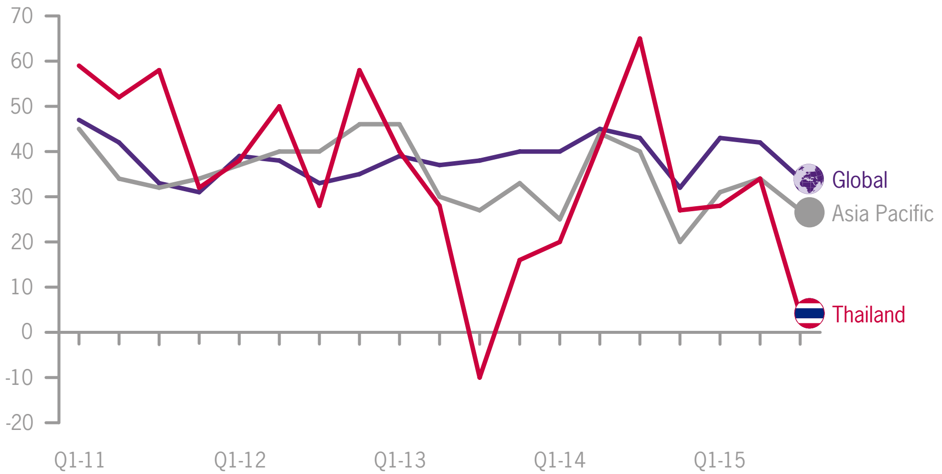
Business growth indicators have also fallen across the past three months. In Thailand, net 8% of businesses expect revenues to rise over the next 12 months, down from 50% in Q2. Expectations for raising revenues dropped to net 38% in APAC, down 10pp from Q2 – the lowest since the second quarter of 2012. Revenue growth expectations in Thailand have averaged 39% in 2015 compared with 49% last year.

Profitability indicators also fell 30pp to just net 4% in Thailand – the rolling 12-month average now stands at 23% compared with 39% in 2014. This compares with a drop of 7pp across APAC to net 27% although the figure for emerging nations remains level with the global average at net 34%.

One reason for this pessimism could be the slowdown in trade, with net 0% of businesses in ASEAN expecting to increase exports over the next 12 months, a 17pp drop from Q2. In Thailand, net -4% of businesses expect to increase overseas sales in the year ahead (meaning a majority expect a contraction). This has driven a fall in the yearly average to 13%, down from 18% in 2014.

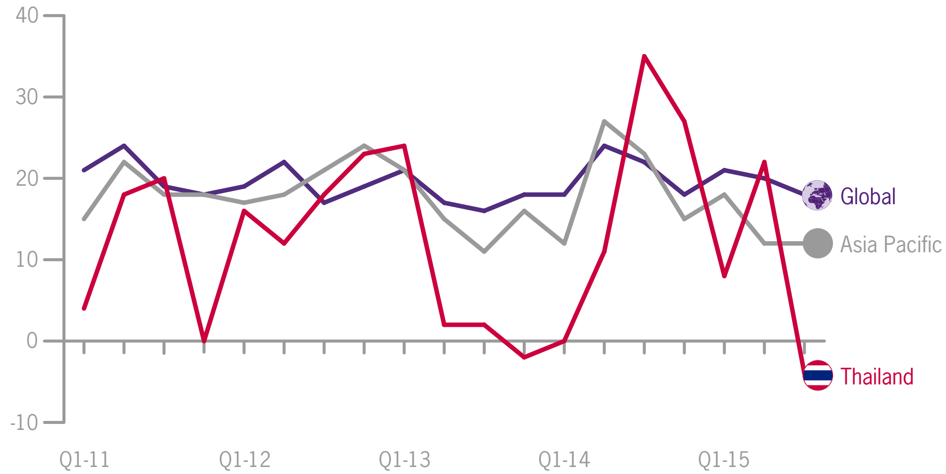
Given the prevailing uncertainty, Thai business leaders are far less likely to expand their workforces over the next 12 months. Net 4% expect to add jobs in the year ahead, down from 42% in Q2 and an average of 28% across the past 12 months. The figures for ASEAN (31%) and APAC (26%) also slipped slightly over the past three months.

Net percentage of businesses expecting to increase profits (next 12 months)



Source: Grant Thornton IBR 2015

Net percentage of businesses expecting to increase exports (next 12 months)



Source: Grant Thornton IBR 2015

Growth constraints

Businesses in Thailand are facing multiple challenges as they try to grow their operations – and are generally more constrained than their southeast Asian neighbours.

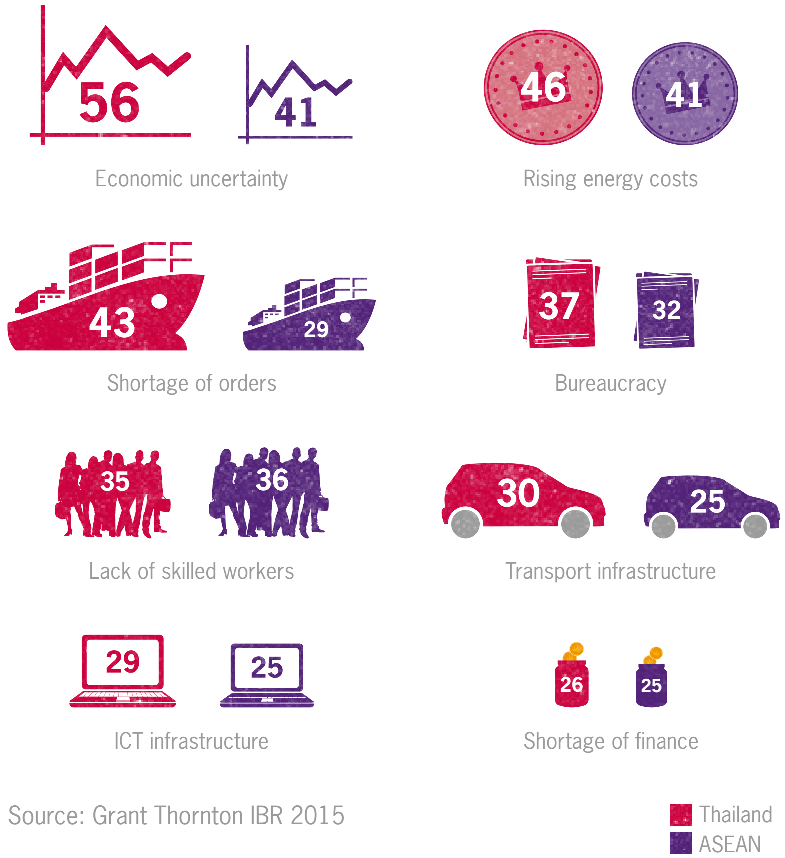
The major constraint they are facing is economic uncertainty (56%) driven by both domestic political and global economic concerns. This is also the principal constraint faced by businesses globally (37%) while more than one in two businesses in advanced APAC economies say uncertainty is constraining their growth prospects (53%), slightly above the figure for the emerging economies (41%).

Rising energy costs are also a concern across the region despite low global oil prices. More than two in five APAC businesses cite energy costs as a growth constraint compared to 30% globally. The figure for Thailand is 46% compared with 41% across ASEAN.

A shortage of orders is also a major concern and ties into the downward trend in exports: 43% of Thai businesses cite low demand for their products and services – well above the global (30%) and ASEAN (29%) averages. The figure for advanced APAC economies is even higher at 54%.

Bureaucracy (37%) and a lack of skilled workers (35%) are also cited by more than a third of businesses in Thailand.

Net percentage of businesses citing constraint (next 12 months)



Source: Grant Thornton IBR 2015

Opportunities and challenges

As discussed in our recent report, 'The future of Asia-Pacific', the APAC region is one of myriad opportunities for business leaders, from low-cost manufacturing to huge and rapidly expanding middle classes. However there are challenges to contend with too, including demographics and rising regional tensions.

Increased ASEAN economic cooperation (72%) is by a long distance viewed as the greatest opportunity for Thai business leaders. Southeast Asian countries are increasingly acting together. The ASEAN economic community covers economies which, taken as a collective unit, would be the seventh largest economy in the world – and the fourth largest by 2050 on current growth forecasts. The figure for APAC as a whole is, perhaps unsurprisingly, much lower (26%) but Thai business leaders are much more excited in this regard than peers in Malaysia (64%), the Philippines (62%), Indonesia (58%) and Singapore (50%).

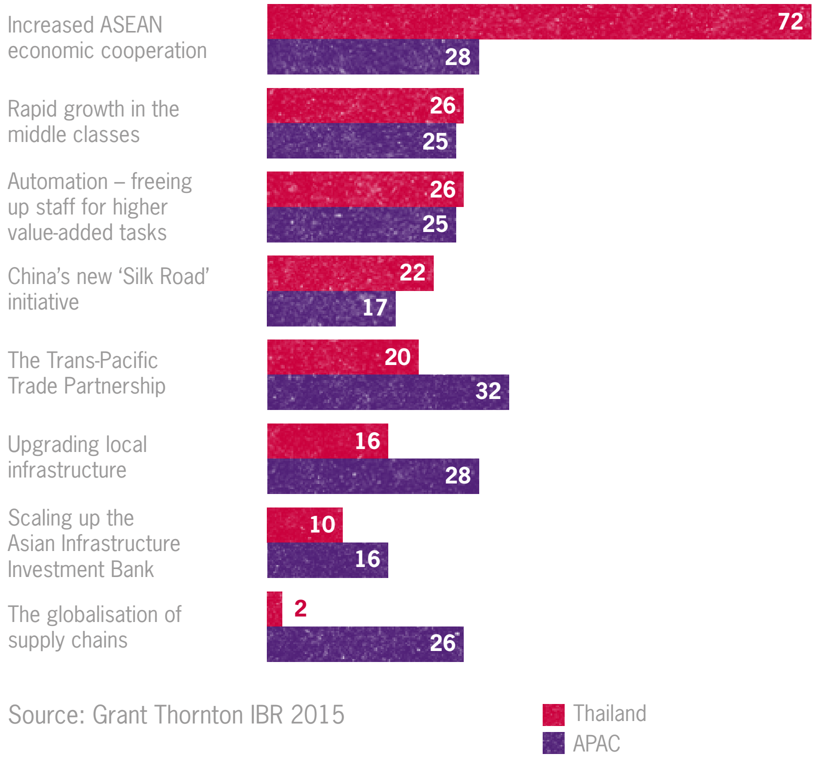
Rapid growth in the middle classes (26%) is cited as the second greatest opportunity. Thailand is well integrated into global automotive supply chains in particular but future middle-class demand from major regional markets such as China and India is likely to be for services.

The automation of simple business processes freeing up staff to execute higher value-add tasks is also cited by a quarter of business leaders (26%) – similar to the APAC average (25%).

In terms of other trade deals, Thailand is relatively more interested in China's new 'Silk Road' initiative (22% compared with 17% across APAC) than the TPP (20% compared with 32% across the region).

businesses hoping for increased ASEAN cooperation

Biggest opportunities for APAC over the next five years



Source: Grant Thornton IBR 2015

Opportunities and challenges (cont.)

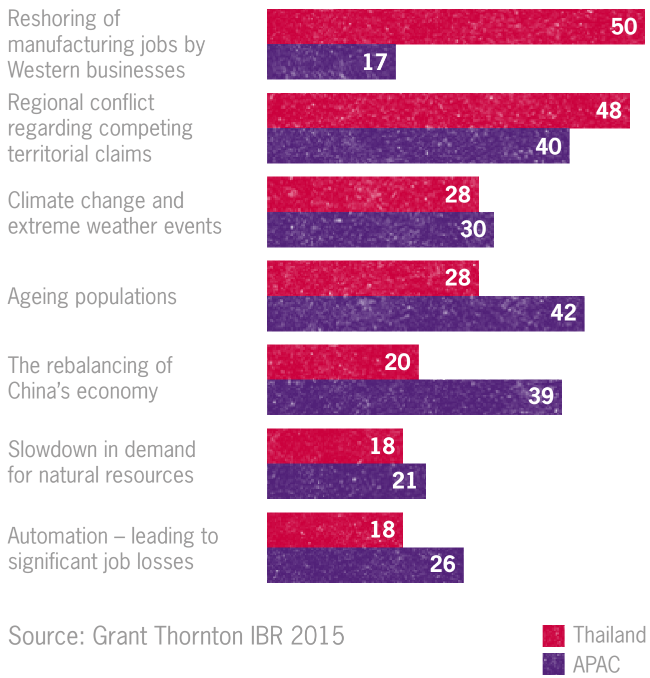
Thai business leaders also see a range of threats to regional growth prospects. Half are concerned about the reshoring of manufacturing jobs by Western businesses (50%) compared with just 17% across APAC. Only Australia (49%) is as concerned. Rising APAC wages, automation and political pressure are all forcing manufacturing businesses in Europe and North America to think again about the wider costs of overseas production.

A further 48% of Thai businesses are worried about regional conflict regarding competing territorial claims, slightly above the APAC average (40%). There are a number of live border disputes in the region – most noticeably in the South China Sea – and business leaders in the Philippines (66%), Japan (59%), India and Indonesia (both 58%) are even more concerned.

Climate change and extreme weather events is the third most cited threat to the region in Thailand (28%), broadly level with the APAC average (30%). Business leaders in the Philippines (80%) which frequently has to cope with devastating typhoons see this as the biggest threat.

Thai business leaders are comparatively unconcerned with either the threat posed by ageing populations (28% compared with 42% in APAC) – even though dependency ratios are forecast to begin rising by 2020 – or the slowdown in China's economy (20% compared with 39%).

Biggest threats for APAC over the next five years



Source: Grant Thornton IBR 2015

Automation

Business leaders in Thailand are split as to whether automation represents an opportunity or a challenge to regional growth prospects (see previous section).

The last decade has seen some rapid advances in technology: 3D printing is now a reality and driverless cars will soon be on our roads, threatening many job categories, from factory workers to lorry drivers. A recent study[2] from Oxford University suggested that 47% of jobs in the United States are under threat from computerisation.

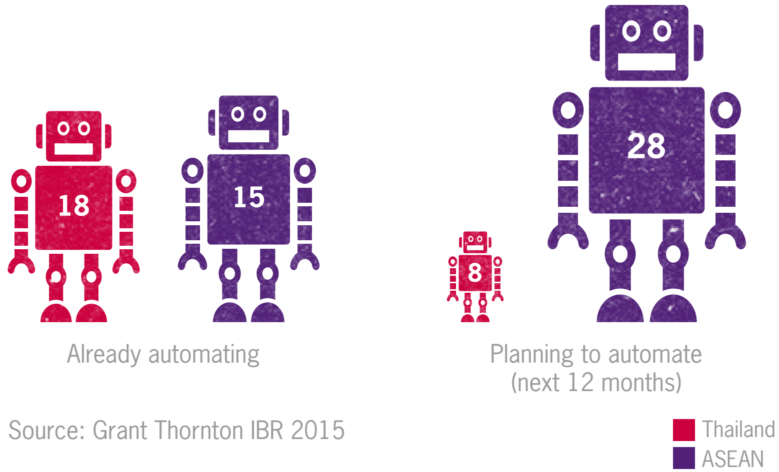
How Thai businesses react will be crucial to long-term growth prospects. On the one hand, automation could free up key staff for higher value-add tasks helping to mitigate declining employment growth. But there is also a risk that Western companies will pull back from low-cost APAC production if automation allows them to perform the same tasks at home.

Our research shows that a quarter of Thai businesses are currently automating processes (24%) only slightly behind the ASEAN average (29%). However, 64% of Thai businesses have no future plans to automate, compared to 42% of ASEAN peers.

The key motivations for automating Thai businesses are greater accuracy in production (47%), freeing up key staff and to lower long-term costs (both 35%). Just over half of these businesses expect to reduce headcount (53%) compared to 61% across ASEAN.

35%
of businesses want to free up key staff

Business attitudes to automating (percentage of respondents)



Source: Grant Thornton IBR 2015

[2] 'The future of employment: how susceptible are jobs to computerisation?' Frey, Osborne (2013)

Cybersecurity

Businesses are losing over US$300bn a year to cyber attacks according to IBR research earlier this year. The figure for APAC alone is US$81bn.

Almost one in six Thai businesses faced a cyber attack over the past 12 months (16%) compared with 12% across ASEAN and 9% in APAC. Further analysis of the results at the global level reveals that the average cyber attack costs businesses 1.2% of revenues. Despite this, just 24% of Thai business view cyber attacks as a major threat. This compares to 30% across ASEAN and 37% in APAC.

The relevant optimism of Thai businesses as regards cyber attacks may be driven by sound preparation. More than half of Thai businesses say they have a cyber strategy in place (56%), above both the APAC (47%) and ASEAN (39%) averages.

A third of local businesses also have a Chief Information Officer or CIO specifically tasked with cybersecurity compared with 21% in APAC and 18% in ASEAN. However 42% of Thai businesses have no one in charge of cyber, higher than the average for APAC (33%) but lower than that for ASEAN (52%).

16%
of businesses have faced a cyber attack

Business attitudes to cybersecurity (percentage of respondents)

Source: Grant Thornton IBR 2015

Thailand
ASEAN

IBR 2015 methodology

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held businesses all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 business leaders in 36 economies on an annual basis, providing insights on the economic and commercial issues affecting companies globally.

The data in this report are drawn from interviews with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses. The definition of mid-market varies between countries: for example in China we interview businesses with 100-1000 employees and in Thailand those with 20-599 employees. Q3 data is drawn from 2,500+ interviews globally (700 in APAC, 50 in Thailand) conducted in September 2015.

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