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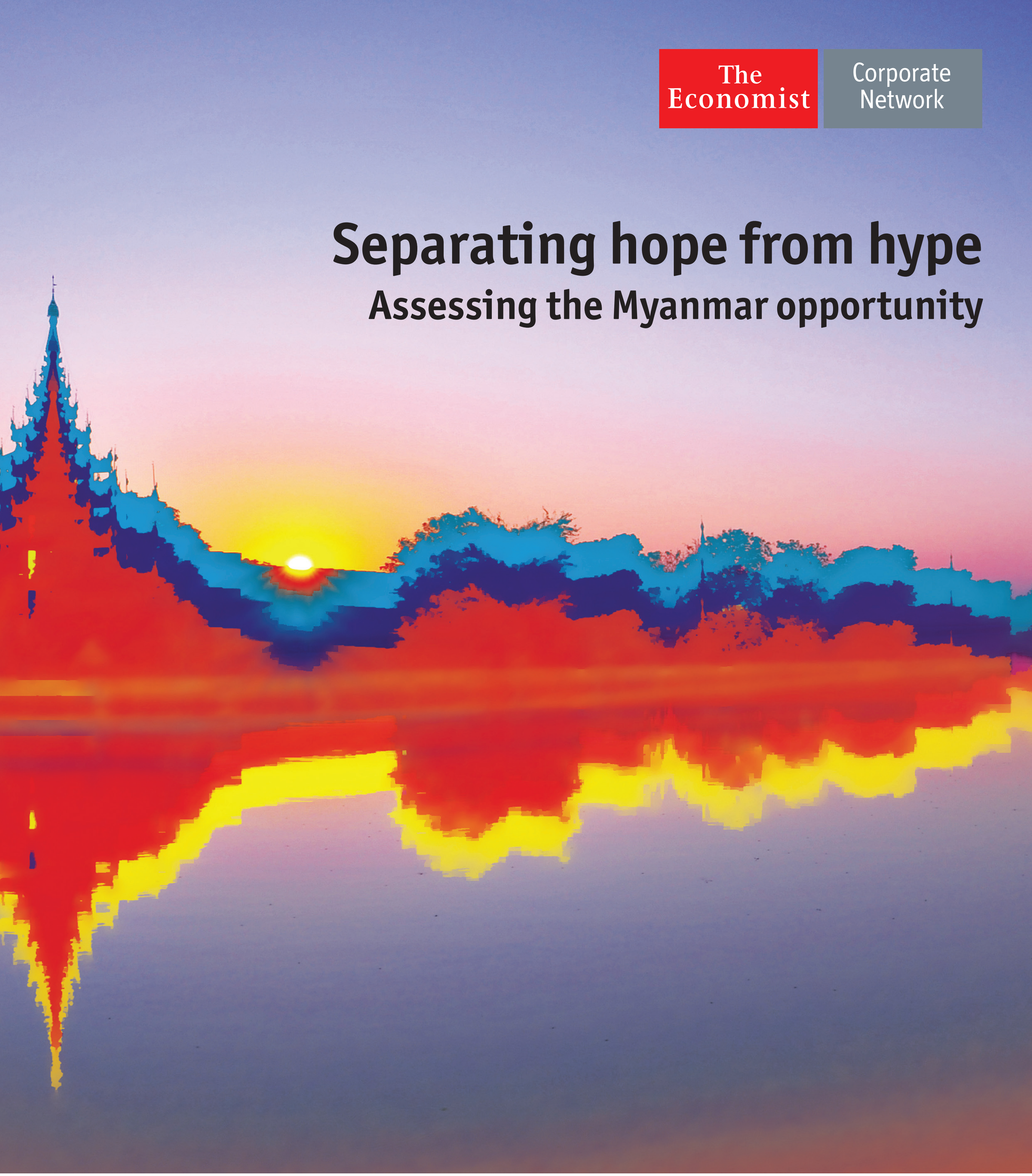

Separating hope from hype
Assessing the Myanmar opportunity

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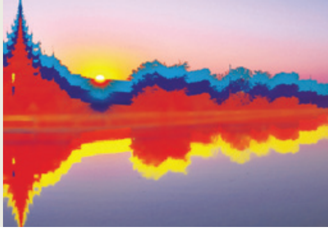


Separating hope from hype:

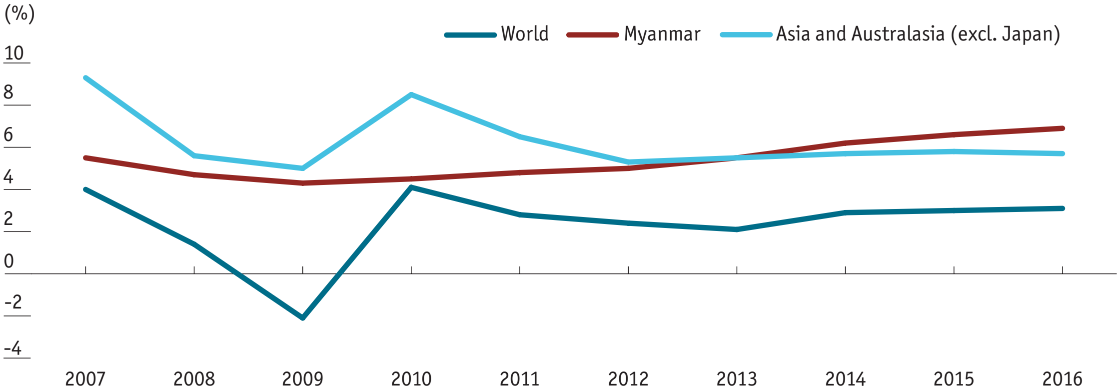
Assessing the Myanmar opportunity

A difficult road to reform

Myanmar's prospects look good on paper, but there are a tremendous amount of obstacles ahead

Panelists and attendees at the ECN's "Separating hope from hype" meeting held on 26 September, 2013 agreed that Myanmar's dramatic political reform and solid consumer growth prospects, which is set to average 5-6% annually in the next two years (see Chart 1), belie a set of very real challenges for investors.

Chart 1
Myanmar promising growth rate



Source: Economist Corporate Network

Alex Travelli, Hong Kong Bureau Chief for the Economist, noted that if the country's growth prospects were the only narrative that captured the headlines, it would be a happier story for investors. Part of its attractiveness lies with its extremely desirable geographic location. The country shares its borders with Bangladesh, China, India, Laos and Thailand, providing investors with a potentially valuable regional transport hub. With approximately 65% of Myanmar's population under the age of 35 years, the country also presents a low-cost manufacturing and export base opportunity. It is a country not only blessed with large oil and gas reserves but also one starting from scratch, presenting vast opportunities for investors from a wide range of product and service sectors.

But as far as Myanmar has come with its domestic policies, there are still many tensions to be ironed out with regards to its great ethnic diversity. Travelli remarked on how "There are a huge number of nationalistic fevers raging still in Myanmar, the kind that more open parts of Southeast Asia pretty much settled in the post-war years." And although Thein Sein's government has signed ceasefire agreements with most of the armed groups, a long-term political solution still appears remote. Far from diffusing, ethnic tensions have only worsened, with the first half of 2013 seeing heavy fighting.

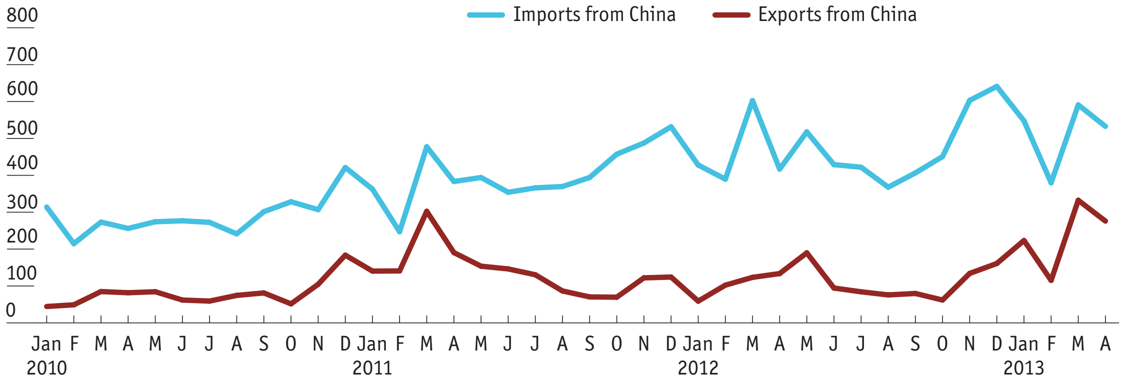
But Travelli observes that it is the fighting in Kachin between the Myanmar army and the Kachin Independence Army (KIA), where a majority of the lucrative investments are taking place that have surprised people the most as it has reached levels of fighting that haven't been seen since long before the reforms began. Like many of the other ethnic minorities that make up about 40% of Myanmar's population, the Kachin have been fighting for autonomy decades. Tensions have been exacerbated given that most of Myanmar's people living outside the centre have enjoyed little of the economic and political progress of the past two years.

While this current period of upheaval spells the greatest ticking time bomb in terms of Myanmar's full integration into the global supply chain, it is also the best possible opportunity to resolve these ethnic disputes. Moreover, Travelli notes that both of the country's big political parties (the military-aligned Union Solidarity and Development Party (USDP) and the main opposition party, the National League for Democracy (NLD), led by Aung San Suu Kyi) know that this is the time to do whatever it takes to garner long-term support from the masses.

Slicing the pie

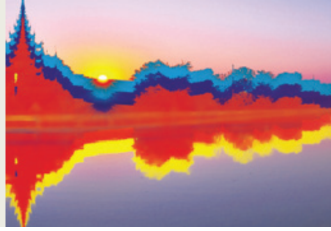
The surge of companies jostling to capture a piece of the country's consumer market, estimated at 62m people, has created an extremely competitive territory. Since 2009, to the chagrin of Chinese officials, Myanmar has looked to lessen its dependence on Chinese investment, turning instead to the US and other Asian neighbours, particularly Japan for foreign direct investment (FDI). As a result, Japanese, Thai, Korean, Indian and US multinationals are becoming key players in the market, while China has scaled back investment from $13m in 2011 to less than a tenth of that amount today. Bilateral trade is also set to slowdown (see Chart 2).

Chart 2
China scales back on trade and investment
(US$m)



Source: Economist Corporate Network

But **Tim Murphy, Partner at McMillan** notes that, of all the multinationals operating in Myanmar today, US firms are probably at the greatest disadvantage, due to the unique legal context that they are facing. As there are still remnants of US sanctions still in place, a fair degree of reporting



obligations persist, obligating US companies to inform the government of their activities and dealings in Myanmar. Moreover, there are still a significant number of people on the Specially Designated Nationals (SDN) list, a list of businesses or individuals that are blocked from making transactions with the US. The outdated SDN list means that American companies need to be very careful of whom they are dealing with to avoid getting into trouble with the government. Companies from other countries do not have to deal with this kind of restriction, placing them at a decided advantage.

Myanmar, a sourcing opportunity

Yasmin Aladad Khan of DHL Express gave a brief overview of Myanmar's supply chain dynamics. She highlighted that since the country opened up in the last 24 months, there has been a huge influx in the number of airline passengers entering Myanmar. And in fact, in the last 12 months, the year-on-year passenger growth rate reached 33%, due to an inflow of not only tourists but also investors exploring the opportunities in the market. As a result, the cargo and passenger terminals have reached their saturation point, causing the government to award contracts to expand both airport and cargo terminals.

On the ground, Myanmar's customs rules require all importers and exporters to register with the Ministry of Commerce, and all importers to open a local currency account. While there are no customs tariffs for exports, customs tariffs for imports range from 5-10% on machinery, and 3-5% on spare parts and general imports. The authorities also levy a commercial tax on all import items, and this tax ranges from 2-10%. But the exact tax rate itself is left at the discretion of the available customs officer (essentially leaving importers at the mercy of customs officers).

Every single imported item requires an import license, which causes extensive delays for importers, and every item worth $50,000 or more has to go through a formal customs process. Aladad Khan notes that "In all the other countries in Southeast Asia, the customs process takes place at the airport, but in Myanmar this process takes place at the customs head office in Yangon, requiring importers to take all the paper work to the head office." But Aladad Khan assured participants that the government's openness to change and dialogue is palpable. She adds that as a result of considering best practice cases and engaging with companies, the government has already removed 300 hundred import items from the import licensing requirements, and expects to remove a further 3,000 items by the end of 2013.

In terms of supply chain infrastructure, Myanmar still has a long way to go before it can provide sufficient access to and use of basic infrastructure and services, such as financial and banking services, roads, electricity, telecommunications, Internet services, and accommodation. Burmese continue to experience poor public utilities with pipe-borne water for example, only available five to six hours a day in Yangon, Myanmar's former capital city. Aladad Khan adds that to cope with this problem, companies that are fortunate to have their offices on landed properties build wells on site. A lack of competition in the aging telecommunications sector is an additional issue. The country's sole telecommunications provider is state-owned, but Khan confirms that the government is finally responding to calls to reform the sector, and assuming they do, the potential for investment and growth is immense. Multinationals are also facing a shortage of local talent, especially in the middle management range. Khan notes

that companies are attempting to resolve this issue by either enticing young Burmese living abroad to return home or working with Myanmar specialty recruitment agencies based in places like Singapore.

According to **James Pitchon of CB Richard Ellis**, another big challenge, especially for manufacturers is power, which is intermittent (with daily outages), and requires companies to acquire an individual generator-set to keep their businesses running. This poses huge challenges for manufacturing, and Pitchon adds that “one of the key determinants of Myanmar’s future as a manufacturing hub would be whether it can offer available power, at a competitive price relative to other regional FDI destinations, and when that power would be available.” Pitchon adds that a benchmark to determine whether Myanmar could become an attractive investment destination would be the Thilawa special industrial zone, a joint Myanmar-Japan project, where a thermal power plant is being planned to distribute electricity to serviced industrial land plots for companies, and the construction of a 25 kilometre port is currently underway.

A tight squeeze

Pitchon gave an overview of the shortages of quality office, apartment and factory space in Myanmar, highlighting that “space is going to continue to be tight for probably the next couple of years.” And although buildings are currently under construction, they would not be ready on time to meet the current needs of companies and individuals setting up in Myanmar. This means that the majority of new market entrants face extreme challenges in finding both office space and residential accommodation, with a very limited number of serviced apartments available that would match Western requirements. Pitchon noted that all of Yangon’s office space could fit into about six office buildings, a size of only about 400,000sq.ft, less than half of Wanchai’s Sun Hung Kai Centre. And within the last 18 months most office spaces have gone from empty to reaching their full capacity, creating severe shortages in the market. In the same time, rents have gone up by 200%, with rents for Grade “C” buildings in Myanmar reaching the same levels of Grade “A” buildings in Singapore, Shanghai and Sydney. Pitchon specifies that the price of one square metre of real estate in a decent property ranges from $80 to $90. Lease contracts are valid for only one year, and after such contracts lapse, landlords can afford to push up the rents even further.

Moving forward

Although the general undercurrent is one of hope, this hope is also tinged with caution

According to Murphy, Myanmar’s 2015 election represents an “inflection point” as it creates a very disruptive possibility. This would be a time as seen in Egypt and former military regimes, when (if constitutional reform goes ahead) the Burmese military suddenly realizes what it is like to no longer have power. It is also a time when Aung San Suu Kyi, who is poised to win the next elections, would need to redirect policy to centre not only on big oil and gas developments but to get development out into the local community, through job creation and skills training. Ceasefire agreements are not a sustainable solution for securing lasting peace in the region, especially given ethnic minorities’ deep mistrust of the government and the military developed over decades of conflict. Burmese, including marginalised people like the Rohingya Muslims, would continue to demand proper citizens' rights and income equality, which all of Myanmar's rulers since independence have so far neglected to do. The government would need to take genuine steps to really secure final peace settlements with all the ethnic groups, as well as install a disarmament process in place.

Although our panelists are in agreement that the best course of action in the case of Myanmar is to hold a-wait-and-see stance, they also agree that the upside for a firm that bares the rising costs and legal uncertainty of waiting for Myanmar's business environment to improve is incredibly high. Travelli adds that the amounts companies would be gaining from investing in Myanmar before the competition does is immense. He notes that "There are already a number of the sectors that are overloaded, such as the retail bank sector, but for example, for the insurance service sector, there's still a lot of room to grow, because a lot will happen within the next two years, and no one wants to be left out."

About Economist Corporate Network Asia

Economist Corporate Network (ECN) is The Economist Group's advisory, briefing and networking service for Asia-based senior executives seeking insight into economic and business trends in key growth markets. Through a tailored blend of interactive meetings, high-calibre research, and private client briefings, ECN Asia delivers country-by-country, regional, global and industry-focused analysis.

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