FOCUS ON SOUTHEAST ASIA:

Cultural Nuances Factor into Supply-Chain Success

As an incumbent and major force within the supply chain and manufacturing industry, China has witnessed rapid change in growth as a result of its governmental push to boost its economy. As a result, the country has in recent times experienced a rise in the middle-income class, and inevitably, rising labor costs.

> In the wake of the recent U.S.-China tariff war, there has inevitably been supply-chain disruptions and significant challenges within the manufacturing industry, leading companies to increasingly explore options to diversify their value chain and find ways to minimize the cost of bringing products to market.

The tariff war increasingly puts products made in China at a pricing disadvantage for many U.S. firms. Therefore, many have made the move or are now looking to establish or transfer operations elsewhere, whilst others simply want to spread their supply chain risk across geographies.

A Glimpse into the Changing Southeast Asia Landscape

As a result of recent changes in the geographic landscape, many companies are looking to Southeast Asia as a strong alternative. Many manufacturers have targeted Vietnam, Malaysia and other countries in the region as the trade war and pandemic-related supply chain disruptions affect their ability to stay financially competitive.

In the 1980s, it was Southeast Asia that represented the epicenter for manufacturing of electronics and apparel products, but that shifted to China over time. However, the pendulum seems to be swinging back toward Southeast Asia as a solid option for its improving capability and perceived lower costs.

And while opportunities abound in the region, the diversity of cultures, varying capabilities and disparate governance all require a nuanced approach ahead of investing in any one country. Firms that lack on-the-ground understanding of the complexities of each nation may find that expected savings or benefits gained through relocation may be eroded as they navigate steep learning curves.

Value chain leaders will make better decisions and benefit from looking at the region's economic profile, the experience of some manufacturers who made the switch and the key steps needed to successfully move manufacturing operations into the region.

An Economic Snapshot of Southeast Asia

Manufacturers have good reason to turn to Southeast Asia. The 11-country region has experienced substantial growth in local and foreign investment as well as an improved educational status over the past decade. This culturally diverse region, with a growing population of more than 680 million people, is the third most populous in the world and is fast becoming a bridge between the Western world and Asia.

Southeast Asia's manufacturing capabilities and the demand for local and global end-to-end value chain infrastructure have also increased. Signs of health in the region are capturing the attention of companies looking to expand or relocate manufacturing in Southeast Asia. Among them are:

- Rising local and regional demand for goods
- Increasing availability of manufacturing labor skill sets
- Improving sources of raw materials
- Cost-effective wages in manufacturing

Many companies are choosing the region because they perceive the area as a less expensive wage environment compared to the west, and in some instances, China.

Each country in the region can play an increasingly significant role within the manufacturing value chain in its sub-sector domains. Below is a snapshot of six countries in the region with their industry focus and a few comparable economic data points.

	Malaysia	Vietnam	Thailand	Indonesia	Philippines	Singapore
Industries	Electronic Appliances, Apparels	Electronic Appliances, Apparels	Automobiles, Packaged Goods	Machinery, Electronic Appliances,	Packaged Goods, Apparel	Semiconductors, IT-digital hardware /
Population	34.4M	97.3M	70M	274M	110M	5.6M
GDP per capita	10.4K	2.8K	7.2K	3.9K	3.3K	59.8K
Education spending % of GDP	18%	14.5%	19.1%	20.5%	13.2%	28.8%

Sources: United Nations Development Programme, The World Bank, Macrotrends

In addition, a couple of notable highlights for four of the countries show improving workforce capabilities, a desirable trend for potential foreign investors.

Vietnam's young population is benefiting from better standards of education and increased workforce participation. The number of Vietnamese active in the workforce has grown by 40 percent in 20 years.[1]

Education in **Malaysia** is highly subsidized with free public education; however, private education spend has been growing as a percentage of total spending mainly driven by the government's effort to make Malaysia the regional hub of higher education.[2]

With **Singapore's** focus on strategic sectors such as precision engineering and semiconductors, the contribution for net export of goods and services increased 10.1 percent of GDP in 1990 to 27.9 percent of GDP in 2019.[3]

From 2000 to 2019, the percentage of **Indonesia's** workforce engaged in agriculture, fishing and forestry decreased from 45 percent to 29 percent, as the workforce shifted towards higher-paying services and manufacturing jobs.[4]

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[1] *CEPII: Projections*
[2] *BMCC – Education sector report 2018/2019*
[3] *Source: ASEAN Statistical Yearbook 2019 and Singstat*
[4] *https://wageindicator-data-academy.org/countries/data-academy-garment-indonesia-english/labour-regulations-english/minimum-wage-setting-in-indonesia-a-history*

Need for Localized Strategies in a Culturally Diverse Region

The examples above hint at the diversity and complexity within each country and illustrate the necessity for localized strategies. This can be illustrated by comparing the electronic appliance sector in Indonesia and Vietnam.

The electric and home appliance sector in both countries has benefited from increased spending power, brand perception and consumer sophistication. Yet, each country poses a different set of challenges for companies looking to establish an end-to-end manufacturing footprint.

In Indonesia, companies typically manufacture sub-components in the country and ship them to countries such as Singapore or Malaysia for assembly and testing. In Vietnam, companies often conduct end-to-end manufacturing and assembly locally.

That's a simple example of how efficient operations can differ between countries. Add in labor protectionism laws, local regulations and workforce education levels and the decision to choose one over the other becomes much more difficult.

A&M Case Studies

Partnering with Local Resources:

A Consumer Electronics Company's Experience

To illustrate the complexity and nuance of operating in Southeast Asia, consider the experience of a global consumer electronics company faced with challenges from tariffs imposed due to the U.S.-China trade war. The company began relocating its production from China to a Southeast Asian country and expected to be up and running in a short amount of time.

> However, the organization had misjudged the length of the ramp up of its manufacturing operations, the COVID-19 pandemic and local complexities extended the timeframe.

The company reached out to A&M, and with A&M's local resources were able to ensure the readiness of its local partners to take on the additional manufacturing requirements and highlighted bottlenecks.

In a short timeframe, the team was able to assist in alleviating timeline bottlenecks derived from communication challenges by developing efficient governance structures between the company and the local Southeast Asia partner through specific cadence and channels. The A&M team also helped align the company's goals and process requirements with the local Southeast Asia landscape, including the area's regulatory requirements, approval timelines and labor skill availability — all of which were initially tailored to a Chinese operating methodology and mindset.

A&M Case Studies Cont.

Breaking Down Communications Barriers:

An Oil and Gas Products Company's Experience

Sometimes, it takes more than on-the-ground know-how to execute a successful relocation of operations. Recently a leading oil and gas components company faced operational issues with regards to on-time delivery, primarily as a result of ineffective communications with its local workforce. Malaysia has a wide diversity of ethnic cultures and workers and relies heavily on foreign labor, which introduces a wide variety of working behavior, language and cultural challenges. In this particular example, the company had a labor workforce spanning more than seven nationalities — in the same workshop. The company had failed to overcome the complex challenge of getting the entire workforce to move in one direction.

> After the organization sought help, A&M resources in the region, including a professional serving as interim Head of Manufacturing, developed an efficient communications channel by leveraging various visual systems, breaking down silos and getting the workforce to pull together to achieve improvement targets, across workgroups.

Over and above this, A&M had also provided the needed leadership and implemented best operational practices. The result? Delivery time improved four-fold and drove the manufacturing backlog to zero in two months.

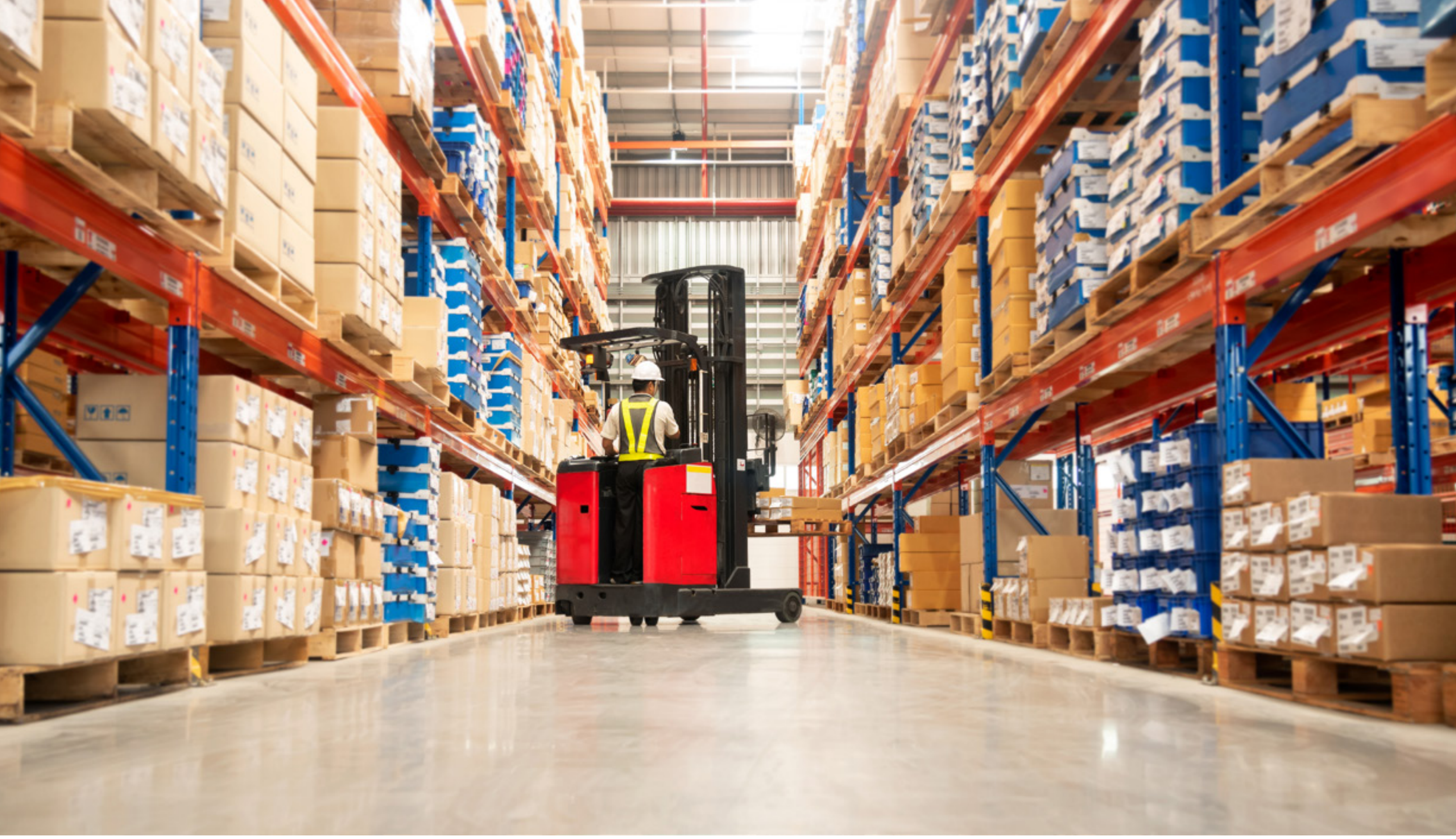
Embarking on a Transformation:

A FMCG Company's Experience

There are key differences in executing improvement in Southeast Asia, as opposed to in the West. A leading global fast-moving consumer goods (FMCG) company headquartered in a European country was under pressure from investors to deliver higher returns on capital and close the gap to its competitors on its cost trajectory.

> The company had successfully leveraged A&M for corporate transformation work in Europe and tried extending the scope to Southeast Asia region without A&M's help, but they faced difficulties.

With A&M's Southeast Asia country-specific experience, the team was able to help the company through collaborating closely with regional and multi-country management teams to develop projects to deliver a cost and value program, as well as develop a governance process across the countries in Southeast Asia.



Must-Do's Before Investing in Southeast Asia

As more global corporations consider establishing or expanding operations in Southeast Asia, it's crucial that leaders have a plan in place to dissect key issues before acting. Companies are best advised to:

- **Tap resources to local landscape, market and governance:** Too often, foreign investors expect Southeast Asia as a region to be on the same level as they have been used to in their home country, or the level of operational efficiency they've come to expect. However, since Southeast Asia is a diverse region consisting of various countries and cultures, processes may vary and offer different levels of efficiency. This will inevitably require companies to deal with differing labor markets, unforeseen risks, and layers of bureaucracy, depending on each target country.

- **Calculate time needed to navigate and implement plans in light of cultural nuances:** Relocating operations means companies will face risk, and they should calculate the amount they're willing to accept before moving forward. Will a cultural difference in working styles mean longer lag times to full operation? If so, companies may need to build in time for training and other mitigating efforts. If the company transfers top talent from their home country or from countries such as China, companies will require time for success as the need to assimilate common best practices are required. The big questions: Is the company prepared to work and navigate through these nuances to achieve its ultimate goals and objectives?

- **Conduct operational due diligence to create value from investments:** If companies relocate into the region through an acquisition of a Southeast Asia-based company or a strategic partnership, can they leverage that local presence to meet performance and EBITDA goals? Companies should conduct proper operational due diligence on the ground to find synergies, looking for opportunities to optimize processes and best practices. As companies discover foundational issues or inefficiencies, they can plan to leverage solutions to create opportunities.

How Can A&M Help?

Companies need on-the-ground insight, especially in times of market turmoil and changing conditions.

What do the next 20 years hold for global supply chain management? Whilst China has, and still is, the epicenter of manufacturing, the countries of Southeast Asia are in the sights of multinational manufacturers, as a viable alternative in light of the continuous development of China's economy, the COVID pandemic, geopolitical impacts, raw material shortages and freight system challenges.

Investors need a holistic understanding of Southeast Asia, its manufacturing capabilities and how it can best add to an organization's value chain. It requires local knowledge and operational expertise to take advantage of a healthy supply-demand trajectory for business growth.

A&M's multi-disciplined approach and global footprint — from private equity, corporate transformation, and operational expertise, and its success across several sectors in manufacturing, can help companies drive value in a complex region.

Contact Our A&M Southeast Asia Operational Leaders to Learn More:

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With over 5,500 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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