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# China Plus One in ASEAN – The How and Why

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# China Plus One

## ❖ Diversification

- China +1 is an international business strategy that consists of the expansion of one company's current operations in China
- There are two types of alternative locations: low-wage countries in Asia (Bangladesh, India..) and Association of Southeast Asian Countries (ASEAN) countries



# China Plus One

## ❖ Benefits

- Cost control: Workers in Southeast Asia generally are less expensive to hire than Chinese employees
- Risk Diversification: Spreading production across several markets hedges future investment in China by leaving producers less vulnerable to supply chain disruptions, currency fluctuations and tariff risks in any individual market
- New Market Access – burgeoning middle class in ASEAN

China vs Southeast Asia	
How China compares to 'China Plus One' countries	
	<b>China</b> Ease of doing business ranking: 90 Monthly minimum wage: \$136-296 October manufacturing PMI: 50.4
	<b>Vietnam</b> Ease of doing business ranking: 78 Monthly minimum wage: \$89-127 October manufacturing PMI: 51.0
	<b>Malaysia</b> Ease of doing business ranking: 18 Monthly minimum wage: \$240-270 October manufacturing PMI: N/A
	<b>Indonesia</b> Ease of doing business ranking: 114 Monthly minimum wage: \$75-202 October manufacturing PMI: 49.2

Note: Minimum wage varies by region  
Source: World Bank Group, WageIndicator Foundation, Malaysia Ministry of Human Resources, HSBC/Markit

PMI: Purchasing Managers Index

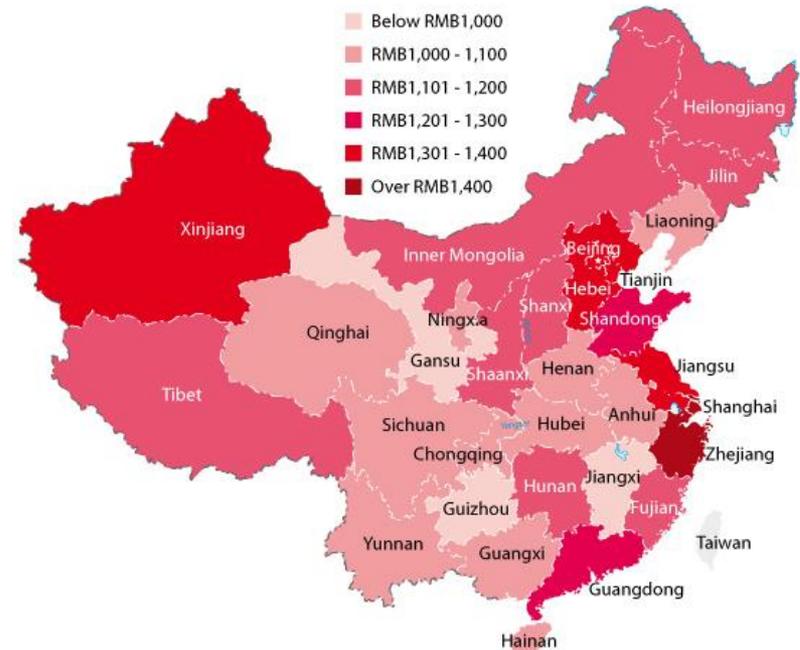
# The Problem — a Maturing Economy, Rising Wages and Disappearing Tax Incentives

## ❖ Rising labor cost

- A hike in wage structure- approximately 25% a year in major industry sectors.
- Minimum wages in Chinese regions increased above 30% (2010 to 2016)
- Other regions: Jiangxi: doubled the nominal wage
- Beijing: an increase in the nominal minimum wage of 63%

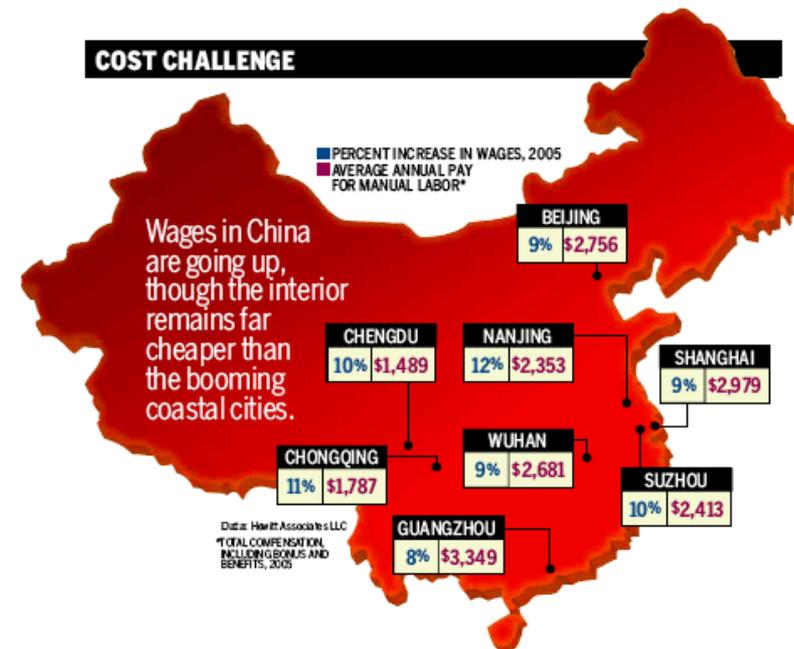
## Minimum Wages Across China

(Based on monthly minimum wage levels in Class A districts of each region as of January 1, 2013)



# The Problem — a Maturing Economy, Rising Wages and Disappearing Tax Incentives

- China's base salaries across all job grades are between 5% and 44% higher than in Indonesia and other labor market among the emerging ASEAN economies
- According to ECA International, the average real wage increase of 4.7% forecast for Chinese workers in 2017 is considerably higher than the global average forecast of 1.5% and the Asia-Pacific forecast of 2.6%



# The Problem — a Maturing Economy, Rising Wages and Disappearing Tax Incentives

## ❖ Shortage of qualified workers

- Increasingly severe shortage of labor, especially in urban areas
- A shortage of qualified workers has led to wage inflation (10% in 2012)
- During the coming years, forecasts suggest that Chinese labor shortages could grow, in part, as a result of China's one-child policy.



# The Problem — a Maturing Economy, Rising Wages and Disappearing Tax Incentives

## ❖ Structural reforms

- Since 2009, most of the tax privileges for foreign invested enterprises have expired.
- China unified its corporate income tax system last year, leading to an effective increase in tax rates for some WFOEs operating in the country



# The Problem — a Maturing Economy, Rising Wages and Disappearing Tax Incentives

## ❖ Political risks

- Anti-Japanese protests throughout the streets of big Chinese cities in 2012 intensified Japanese investment in ASEAN
- Japanese FDIs into ASEAN in 2015 were worth more than \$20bn, according to government data, and exceeded FDIs into China and Hong Kong for the third year running
- Some Western, especially US, companies are increasingly concerned about an unfair competitive environment, fueled by political prerogatives



# China+1 Strategy: Where to go ?

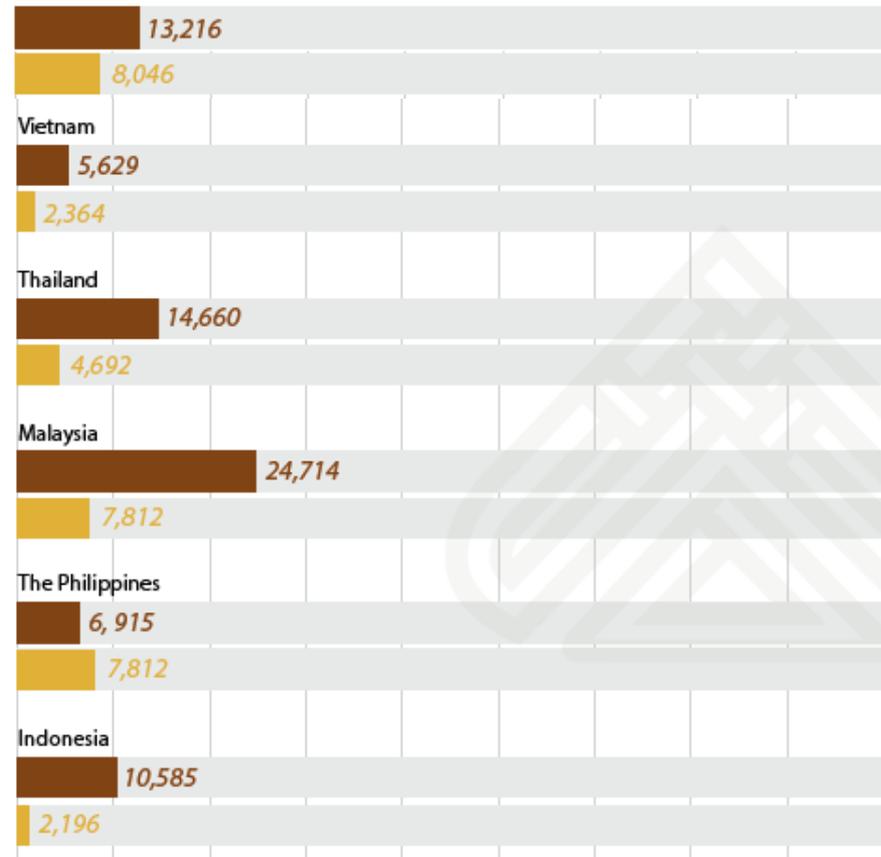
## Vietnam, Indonesia or Thailand are top destinations for China+ 1 Strategy

- **Labor Costs:** Average labor costs are similar in China and Thailand but are significantly lower in countries such as Vietnam, Indonesia.
- ASEAN countries also offer young and dynamic workforce

■ GDP Per Capita (PPP) ■ Cost of Labor (Average Annual Income)

Unit: USD

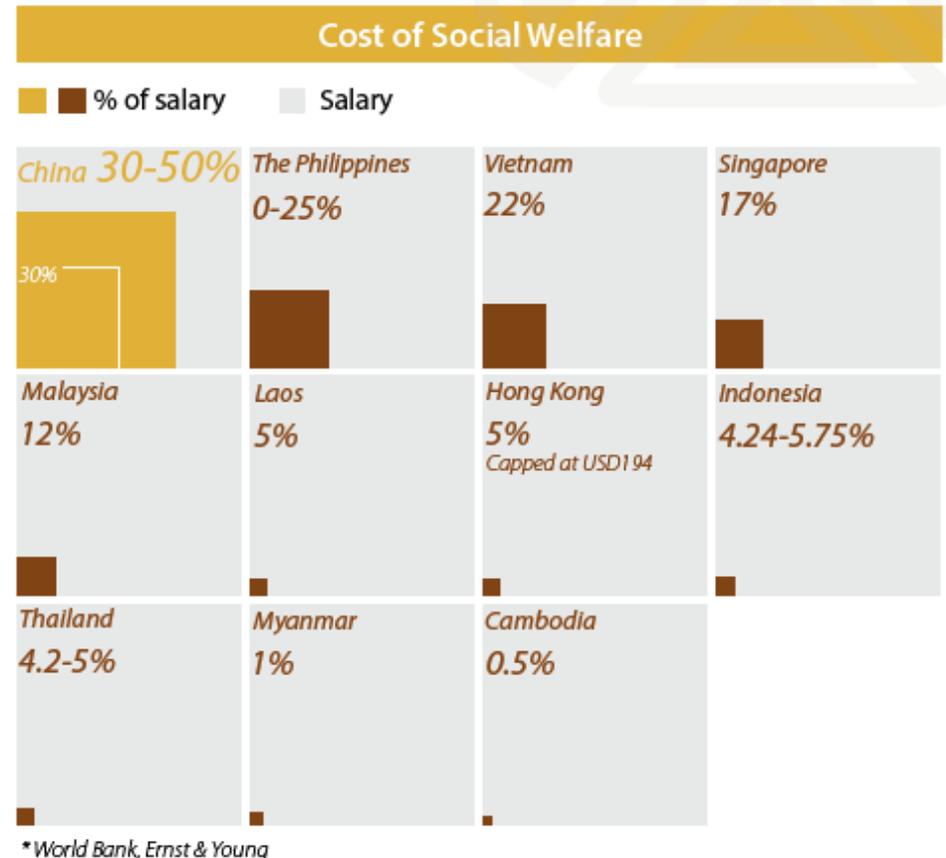
### China



# China+1 Strategy: Where to go ?

## Social Welfare

- In China, the cost of social welfare is relatively high. The rate is 30 to 50% of employee's salary
- In Vietnam, the rate for social welfare that employer have to pay is 21.5% (latest update from June 2017)
- The rates are even lower in Thailand and Indonesia (4.2% to 5% and 4.24% to 5.75%)



# China+1 Strategy: Where to go ?

Country	CIT	Goods/Services
Vietnam	20%	Up to 10%
China	25%	Up to 17%
Hong Kong	15, 16.5%	-
Singapore	17%	7%
Indonesia	25%	10%
Thailand	20%	10% (7% till 9/16)
Malaysia	19, 24%	6%
Philippines	30%	12%

# China+1 Strategy: Where to go ?

Global manufacturing competitiveness index rankings:

Country	Rank	Index Score
China	1	100
India	11	67.2
Thailand	14	60.4
Malaysia	17	59
Vietnam	18	56.5
Indonesia	19	55.8

2016

Country	Rank	Index Score
China	2 (▼-1)	93.5
India	5 (▲+6)	77.5
Thailand	14	62
Malaysia	13 (▲+4)	62.1
Vietnam	12 (▲+6)	65.5
Indonesia	15 (▲+4)	61.9

2020 (Projected)

# China+1 Strategy: Where to go ?

## Infrastructure

China and Thailand in the middle group for infrastructure attainment, Vietnam, Indonesia and Myanmar were among the bottom six countries in East Asia

### VIETNAM

- Vietnam's public & private sector infrastructure investment averaged 5.7% of gross domestic product -> highest in Southeast Asia
- Total length of roads: 220,000km (90 national highways: 17,300km)
- 7,440 bridges
- 3,142.7 km of railway:
- Main lines: Hanoi-HCM, Hanoi- Hai Phong: connect almost all major economic centres.
- 20 airports
- 100 seaports, major ports have advanced and sufficient facilities including EDI systems and ample handling capacity against the present demand



# China+1 Strategy: Where to go ?

## Infrastructure

### THAILAND

- Ports: Good - Total: 400 ships (1000 GRT or over) 2,808,509 GRT/4,317,320 DWT
- Airports: Good
- Roads: Good - Road conditions as a whole is in favorable condition, Asian Highway is all completed, connection to neighboring Burma, Laos, Cambodia, and Malaysia. More than 60% of all Asian Highway sections meet high standards, with more than 4 lanes.
- Railways: Good - Total: 4,071 km



# China+1 Strategy: Where to go ?

## INDONESIA

- 391 thousand kilometers of roads, 6.5 thousand kilometers of railways, and 21.5 kilometers of waterways
- Ports: Poor  
Operation of Tanjung Priok is less efficient compared to other major ASEAN Ports, with small handling capacity for vehicle cargo.
- Airports: Developed air transport network that encompasses 652 airports connecting all islands



Tanjung Priok- Indonesia

→ Weak infrastructure development, need more investment

# China+1 Strategy: Where to go ?

## Industrial land prices and average office rent

### Industrial Land Prices

Unit: per sqm

<b>China</b>	<b>\$177</b>	<b>\$144</b>	<b>\$132.7</b>	<b>\$98-112</b>	<b>\$80</b>	<b>\$70</b>	<b>\$70</b>	<b>\$60-100</b>
<b>Pearl River Delta</b>	Thailand Bangkok	Indonesia Serang	The Philippines Manila	Vietnam Ho Chi Minh City	Malaysia Penang	Cambodia Veng Sreng Road	Myanmar Yangon	

### Average Office Rent

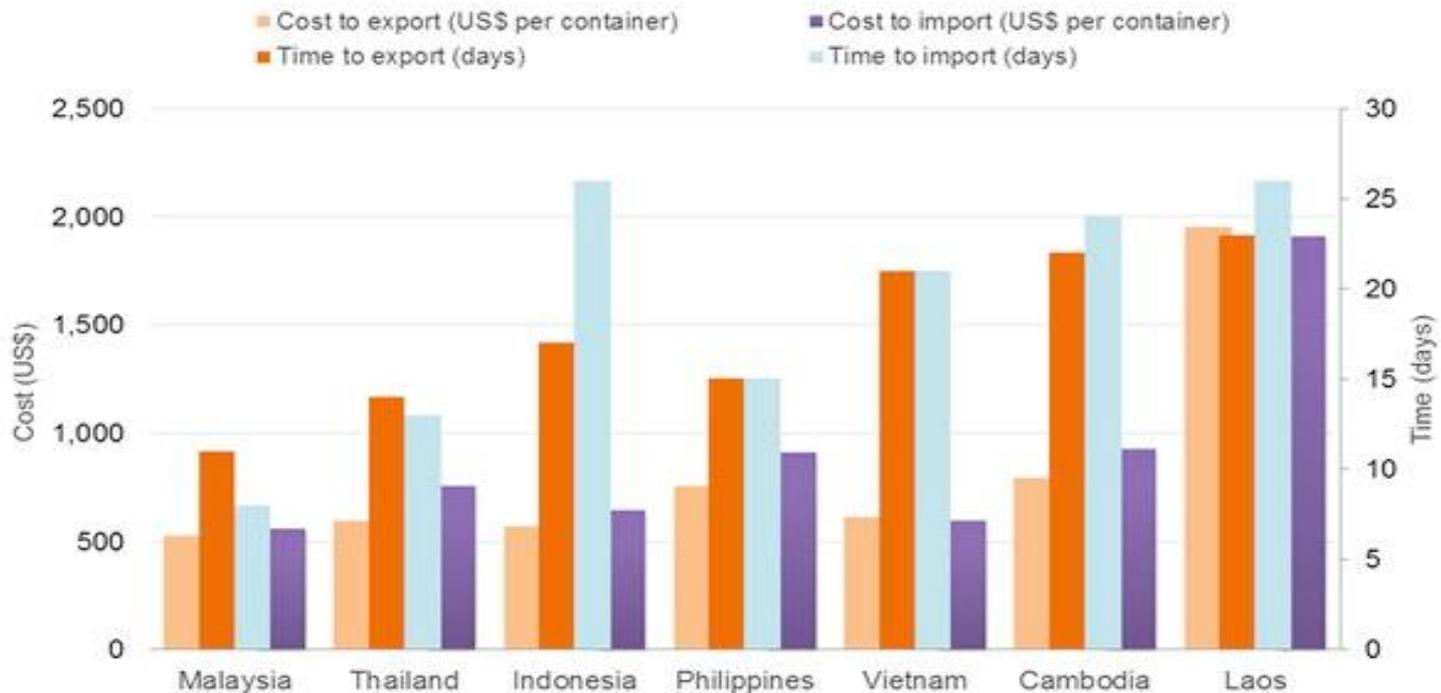
Unit: per sqm

<b>China</b>	<b>\$94</b>	<b>\$126</b>	<b>\$93</b>	<b>\$72</b>	<b>\$47</b>	<b>\$46</b>	<b>\$33</b>	<b>\$26</b>	<b>\$22</b>
<b>Shanghai</b>	Hong Kong Causeway Bay	Singapore Raffles Place	India New Delhi	Indonesia Jakarta	Vietnam Ho Chi Minh City	Malaysia Penang	Thailand Bankok	The Philippines Manila	

\* Cushman & Wakefield, Colliers International, Cambodian Investment Bureau, CapitalVue

# China+1 Strategy: Where to go ?

## Time and Costs of Trading Across Borders (Selected ASEAN countries)



Source: Doing Business report 2015, World Bank

# China+1 Strategy: Where to go ?

## Free Trade Agreements

### VIETNAM

- RCEP
- EVFTA
- Vietnam- Israel FTA
- AEC
- ASEAN- Hong Kong, China FTA
- ASEAN- Australia & New Zealand FTA
- ASEAN- Korea FTA
- ASEAN- Japan FTA
- ASEAN- India FTA
- ASEAN- China FTA
- Vietnam-Chile FTA

### THAILAND

- Thailand- Bahrain FTA
- ASEAN- Hong Kong, China FTA
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) FTA
- India- Thailand FTA
- Pakistan- Thailand FTA
- RCEP
- Thailand- EU FTA
- Thailand- US FTA
- AEC
- ASEAN- Australia & New Zealand FTA
- ASEAN- Korea FTA
- ASEAN- Japan FTA
- ASEAN- India FTA
- ASEAN- China FTA
- Thailand- Chile FTA
- Thailand- Peru FTA

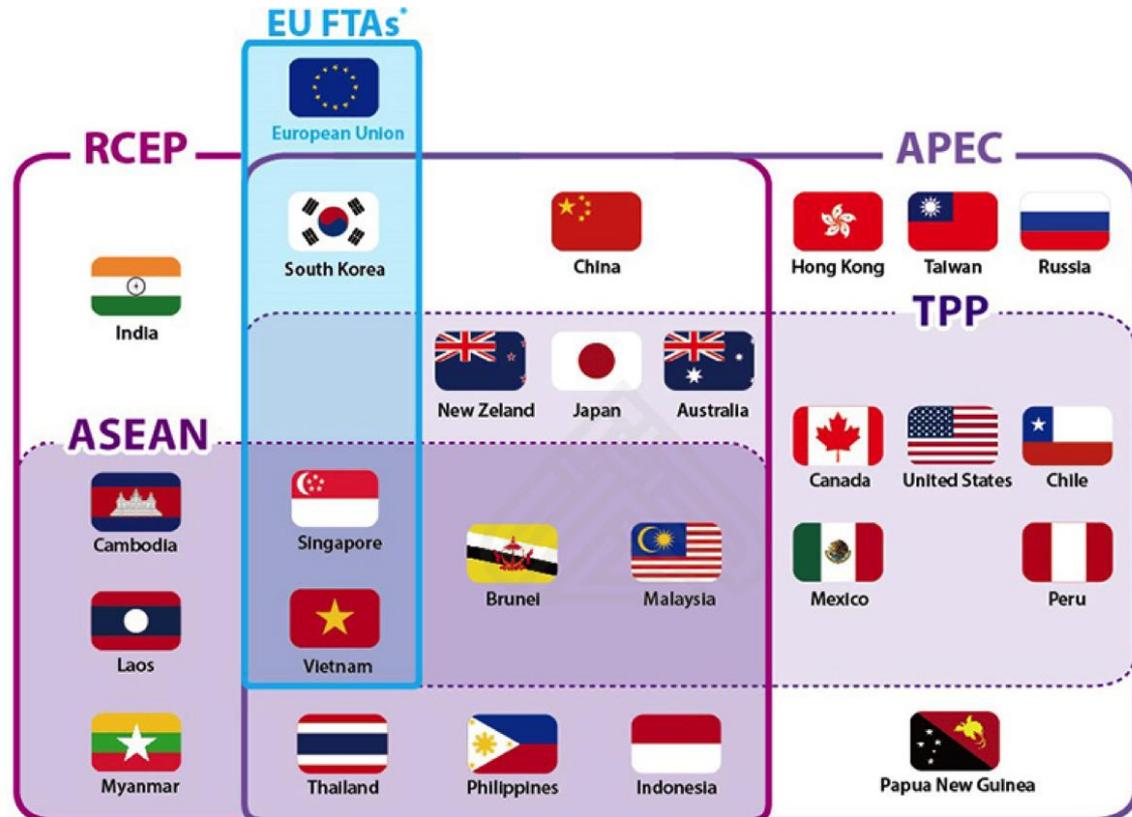
### INDONESIA

- ASEAN- Hong Kong, China FTA
- ASEAN- Australia & New Zealand FTA
- ASEAN- Korea FTA
- ASEAN- Japan FTA
- ASEAN- India FTA
- ASEAN- China FTA
- AEC
- Indonesia- Chile FTA
- RCEP
- Indonesia- EU FTA
- Indonesia- Pakistan FTA
- Preferential Tariff Arrangement- Group of Eight Developing Countries
- Trade Preferential System of the Organization of the Islamic Conference

# China+1 Strategy: Where to go ?

## Free Trade Agreements

VIETNAM



APEC (Asia-Pacific Economic Cooperation); TPP (Trans-Pacific Partnership); RCEP (Regional Comprehensive Economic Partnership); ASEAN (Association of Southeast Asian Nations).

\* The EU's FTA with South Korea has been finalized; Its FTAs with Vietnam and Singapore have been concluded, but not yet entered into force

# China+1 Strategy: Where to go ?

## Free Trade Agreements

INDONESIA



# China+1 Strategy: Where to go ?

## Free Trade Agreements

### Thailand's FTA Networks



Source: Department of Trade Negotiations of Thailand

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# Case Study – Vietnam (Manufacturing)

- **Company X** in the electronics sector is based in Europe
- In 2005 it locates manufacturing in Guangzhou, in the Pearl River Delta, where it outsources the production and assembly of its machines' components
- In 2017, China is losing its cost advantage and Company X finds manufacturing more expensive because of shortages of workers, appreciating currency, restrictive government policies, inflation and political risks
- Trend in the electronics sector in considering Vietnam the ideal manufacturing export hub for China + 1 strategy
- Company X decides to relocate the assembly of its components in Ho Chi Minh City, where it enjoys:
  - Low wages
  - Developing supply chain for electronics
  - Tax incentives
  - EVFTA

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# Case Study – Vietnam (Supply Chain)

- **Company Y-** one of Japan's largest and oldest shipping company
- Company Y signed contract with Guangzhou Port Group Co., Ltd. of China to provide the port of Xinsha with highly sophisticated techniques in 2004. However, the dispute between China and Japan made the company ready to leave Chinese port, following the move of many Japanese companies in 2014.
- Rising labor costs in China are really changing the Japanese corporate perceptions of the role of ASEAN in their global supply chain
- According the President, the company's decision was a response to the rising number of Japanese manufacturers closing factories in southern China and moving production to the lower-cost hubs of Vietnam.
- Company decides to invest in a \$1.2 billion container port expansion in the Vietnamese northern coastal city of Hai Phong.
- The port project, which is being jointly undertaken by the Vietnamese government and others, will start operations in 2018 and double the capacity of the existing port that serves the growing electronics hub near Hanoi

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# Case Study – Thailand (Automotive)

- **Company Z-** a famous American multinational automaker who has its manufacturing center based in Nanjing, China and North America . It also has a big Japanese partner.
- Company Z acquired its shareholdings of 33.4% in its Japanese partner
- In 2010, Company Z said it was building a \$450 million plant in Rayong Province in eastern Thailand. The new plant has a capacity of 200,000 units a year. Z and also its Japanese would spend \$350 million revamping their joint venture that builds pick-up trucks in Thailand (All investments are through the Japanese Partner)
- Reason for this China+1 strategy:
  - Z wants to expand to ASEAN market
  - Z wants to export their products to Australia and New Zealand
  - Cheaper labor cost as China is getting more expensive
  - Z is going to close its factories in North America and put more focus on Asia
  - Political issues between China and Japan
  - Z is following others famous Japanese carmakers
  - Thailand is one of the leading destination for stamping industry
  - Z wants to increase its manufacturing capacity

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# I'm sold – so what next?

## How to execute a China Plus One play in ASEAN:

- Very important to perform a comparative analysis between the different countries in ASEAN in regards to your industry and precise activities, considering:
  - Wages
  - Market size
  - Level of competition
  - Regulatory environment
  - Ease of doing business
  - Other country specific considerations
- If it makes sense to open a new company in your selected ASEAN country, how will you structure this? Do the benefits offered by a SG holding company help you?

# I'm sold – so what next?

## How to execute a China Plus One play in ASEAN:

- Get help obtaining the right licenses – many ASEAN countries are very strict on business lines...you don't want your hands tied later on!
- Engage with local stakeholders...partnering with local firms or working through consultants can be an important way to get your foot in the door!



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# Key Takeaways

- Companies are **NOT** leaving China, but they **ARE** moving lower value-add, lower tech, and more labor intensive activities out of China and into Southeast Asia
- ASEAN is in **excellent position** both in terms of physical infrastructure and the less tangible infrastructure of trade facilitation agreements and FTAs to **integrate seamlessly into a China based supply chain**
- As **China becomes a more and more difficult** place for foreign companies to operate, ASEAN is generally moving in the opposite direction and is **more welcoming to FDI**
- ASEAN's internal **consumer markets are growing and cannot be ignored** – starting in the region by focusing on exports is a great first step towards setting up a business to sell to the region's burgeoning consumer classes

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# Potential Roadblocks

- The region is **diverse and complex**
- **Regulatory frameworks are patchy and not uniform**, they are a work in progress
- **Physical infrastructure** in some countries is also difficult and a work in progress
- We need to understand **Rules of Origin** and other requirements to benefit from the excellent “trade infrastructure”
- The CLMV countries in particular are **still “frontier” markets** with ample ambiguity and opportunities for missteps – tread carefully and don’t jump into a new market alone!



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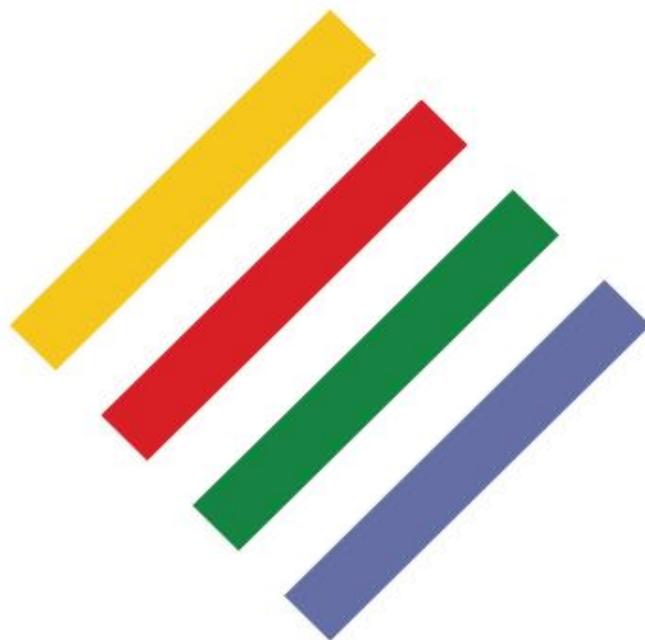
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