DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

MANUFACTURING IN ASIA

9 Crucial Factors for Country Selection

Introduction

Are you ready to diversify, but unsure where to relocate your supply chain to? How do you even begin to make that decision?

The past few years have challenged the manufacturing and trade sectors.

Natural disasters, geopolitical tensions, trade disputes, pandemics, or economic downturns in a market can disrupt the supply chain and lead to production delays or shortages. While challenging to anticipate unexpected shifts, diversifying your operations can reduce the impact such disruptions may have on your business.

One of the top questions that naturally arises is: Where in the world do we relocate to?

South Asia or Southeast Asia stand out as compelling options. The proximity to China, relatively low costs, and preferential policies can make these regions particularly attractive, especially if you are coming from the more established Chinese market or setting up a China-complementary (i.e. China plus-one) facility.

Those familiar with manufacturing in China, however, will find major differences in the neighboring regions – differences that may surprise even experienced multi-national corporations. Each country's political system, labor market, infrastructure, and regulatory environment for example, is very different. This complexity makes it considerably challenging to decide which market best aligns with your business needs and will help your business thrive.

To make that decision, it is incredibly important to do your research. Embarking on a facility relocation without the right information can lead to costly mistakes, missed opportunities, and unnecessary roadblocks.

But what information should you collect, where can you find/access it, and how should you evaluate it to make that right decision for your business?

The following checklist outlines nine essential elements you should collect information or data about to fully understand your options and their feasibility. These elements are crucial factors we thoroughly investigate for companies when comparing countries, economic zones, or industrial clusters.

As you engage in your research, you have the flexibility to select and prioritize the items or parameters that will have the most significant impact on your decision-making process. Not all items may be relevant to your unique situation, and this list is not exhaustive. In a case study, you will see how one manufacturer utilized this research framework to lower their costs and risk exposure.

Checklist

- ☑ Political Climate
- ☑ Economic Environment
- ☑ Legal and Regulatory Environment
- ☑ Structuring Analysis
- ☑ Locations for Manufacturing
- ☑ General Operating Costs
- ☑ Labor Review
- ☑ Logistics Review
- ☑ Tax and Tariff Review

The 9 Crucial Factors to Assess

1 | Political Climate

Why: A country's political environment and stability can significantly impact the ease of doing business, investment opportunities, and overall business growth. For example, a stable government with a strong, dominant party can mean a long-term commitment to certain investment attitudes and priorities. Meanwhile, any tendency for domestic unrest can negatively affect your operations. Additionally, it can be valuable to investigate non-tariff barriers that exist and make operations more difficult, such as red-tape measures, domestic subsidies linked to populist policies, etc.

For this parameter, you will want to look for potential risks of operating in the country.

What to look at:

- Government structure and leadership
- Potential future changes and risks of instability
- Operational risks that include official/non-official red tape, violent crime, terrorism, labor activism, union power, etc.

2 | Economic Environment

Why: Exploring the economic environment and key economic indicators will help you understand the current and future potential of a market. These factors will directly impact the opportunities and challenges your business could face. For example, currency volatility may make it difficult to accurately predict cash flow because sudden price drops can decrease your profit margin while your costs stay the same.

What to look at:

- Past and projected GDP
- Past and projected FDI (foreign direct investment) growth
- Import/export trends
- Currency volatility

3 | Legal and Regulatory Environment

Why: A favorable legal and regulatory framework can make a tremendous difference to your ability to operate smoothly and minimize risks. Analyzing current frameworks provides a big-picture overview of the regulatory and administrative procedures in different countries. This understanding will help you assess how your operations will be treated and the extent of regulatory risks you may encounter in the target markets.

Here are some examples of how the legal and regulatory environment can vary between countries in Southeast Asia:

Indonesia

Indonesia has a relatively complex legal system, which can be difficult for businesses to navigate. However, the government is trying to simplify the system and improve the enforcement of laws

Thailand

Thailand has a more favorable tax regime than some other countries in Southeast Asia. For example, the corporate tax rate is 20%, and there are tax incentives available for businesses investing in certain industries.

Vietnam

Vietnam has a relatively strong labor force, but its labor laws are strict. Businesses must comply with more regulations, including those that govern working hours, overtime pay, and severance pay

What to look at:

- Negative/positive investment lists
- Incentive schemes or special economic zones/free trade zones
- Laws that regulate foreign investment and your sector
- IP protection remedies
- Environmental laws
- Historical support for your industry or follow-through on promoted policies
- Which government bodies are involved in trade/foreign investment/your sector

4 | Structuring Analysis

Why: This analysis explores how you can take advantage of the ideal options for setting up. Research what options are available, the processes involved, what special licensing you may need, and how to repatriate profits back to headquarters. These details will provide a good understanding of a potential set-up timeline and the feasibility of establishing in your target country. You do not want to be blindsided by an unexpected requirement derailing your plans and other operations dependent on those. Additionally, you want to ensure you select the right entity for your business needs that both allows you to operate legally and is structured to minimize costs.

What to look at:

- Entity options, characteristics, and requirements
- Any permits or licenses needed for your business line
- Process of establishing an entity
- Profit repatriation options and processes
- Land acquisition rights and processes

5 | Locations for Manufacturing

Why: Significant regional variations exist within each country, with specific locales or areas better suited for particular industries. For this parameter, you should compare manufacturing areas within the target countries that fit your sector. You will want to gather and analyze data to assess the country's overall suitability in comparison to others. You may even opt for a more granular approach, comparing selected economic zones or regions in one country against those in another for a deeper analysis.

What to look at:

- Existing and future-planned infrastructure
- Availability and cost of commercial real estate
- Supplier and consumer markets (depending on if you will sell domestically or not)
- Labor quality

6 | General Operating Costs

Why: To better grasp your overall costs operating in a certain country, you must explore the cost of various utilities you will use.

What to look at:

- Utility costs such as electricity, natural gas, and water
- Internet fees

7 | Labor Review

Why: The labor laws in each country vary significantly, and companies must carefully consider which laws and regulations may apply. It is also important to ensure you can find enough (or the right) skilled labor for your sector and investigate best practices to protect yourself and your employees, while encouraging retention.

What to look at:

- Wages (minimum, average, etc.)
- Employee attrition and turnover
- Labor laws around overtime, working hours, termination, unions, contracts, etc.
- National holidays
- Social insurance contributions
- Common benefits such as meals, accommodation, etc.
- Availability of skilled/unskilled labor
- Visa options and quotas for foreign employees

8 | Logistics Review

Why: The logistical infrastructure in each country can vary significantly. Businesses must carefully assess logistic costs and capabilities. A logistics review looks at existing networks and associated costs within target countries to help you understand the costs and time required to transport goods within and between markets.

What to look at:

- Logistical networks by sea, road, rail, and air
    - Check for proximity between the target zone and infrastructure or, if looking more broadly, their presence and distance between major transport hubs;
    - Check for capacity, traffic/congestion, and turnaround times;
    - FTZ access, if needed
- Shipping costs

9 | Tax and Tariff Review

Why: Tax regimes can be complex and vary significantly from country-to-country. You will want to examine existing policies to understand the extent of your tax exposure in various countries.

While many countries in South/Southeast Asia have adopted appealing tax regimes to attract foreign investment, you will still need to understand if the tax environment will allow you to run and grow your business. Reviewing the tax regimes can also help you grasp how to structure your entity to minimize your tax burden.

Commentary on the application of tax policy can greatly help. It is advisable, however, to speak to a tax professional to fully understand how to structure your investment before market entry and take advantage of all available tax efficiencies.

What to look at:

- Applicable free trade agreements
- Corporate tax rates
- Value-added tax
- Transfer pricing requirements
- Withholding taxes
- Double taxation treaties
- Tax incentives
- Import/export tariff and duties
- Personal income tax implications for foreign employees

Case Study

How an American Hydraulics Manufacturer Lowered their Costs and Tariff Exposure by Assessing 9 Factors

Challenge: An American hydraulics manufacturer faced challenges during the US-China trade war, with escalating risks and tariffs impacting their business in China. To stay competitive and lower production costs, they sought a more US-trade friendly location elsewhere in Asia. However, due to the complexity of the South / Southeast Asian environment the manufacturer had no idea where to set up operations, let alone the time to dedicate internal staff to extensively research a wide variety of parameters they needed to evaluate.

Solution: Teaming up with our business intelligence (BI) experts, the manufacturer identified the nine key parameters crucial to their decision, and together we narrowed the focus to five potential countries.

Our BI team then conducted meticulous research using local government and intergovernmental databases, market and consumer data sources, resources from international financial and research institutes, as well as feedback from local government officials, existing businesses, and professional bodies.

Impact: The manufacturer received a comprehensive multi-country benchmark report that detailed specifics of each country according to the set parameters. To make it easier for decision-makers to effortlessly assess the strengths and weaknesses of each location, the manufacturer also received a visual comparative matrix and a compilation of graphs comparing the countries by each parameter.

The decision-makers observed, for example, that Vietnam was comparatively stronger in certain strategic parameters such as labor productivity and cost. They could also see a side-by-side comparison of tax rates in Vietnam compared to other countries. If they needed more details on specific parameters, they could refer to the comprehensive report for further information.

Based on the supplied information, the manufacturer decided to relocate manufacturing operations to Vietnam.

Our assistance did not end there, however. To figure out the best place to set up in Vietnam, the manufacturer also required a more detailed location analysis of ideal industrial areas. They also needed to find alternate suppliers for inputs and raw materials. Our BI experts were able to help with both an in-depth Location Study and matchmaking services. Additionally, our legal and tax professionals provided support by setting up the manufacturer's legal entity.

Conclusion: Through data-driven analysis and strategic guidance, the manufacturer reduced costs, mitigated tariff risks, and secured a competitive edge in a dynamic trade landscape.

Other companies facing a similar question of where to relocate can use similar steps by first identifying the parameters, or factors, that will affect your decision, researching those factors thoroughly, assessing the information, and lastly, making a country selection.