Winning in Asia

Opportunities and challenges for business in the COVID-19 era

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Opportunities and challenges for business in the COVID-19 era

Executive summary

Even as the COVID-19 crisis continues, Asia is poised to lead the global recovery. Rapid economic development and dynamism in recent decades have given Asian markets a distinct growth and investment advantage. Although Asian economies face a more challenging economic outlook now, this advantage nevertheless endures as key markets in Asia have been first to chart a path toward economic reopening and recovery.

Governments are driving the economic recovery — and simultaneously reshaping the business environment. Governments have taken unprecedented steps to limit the health and economic impact of the COVID-19 crisis and create a foundation for recovery. Three government policy-driven shifts are currently transforming Asia's business landscape, each of which create both opportunities and challenges for the private sector: intervention to boost domestic growth and national competitiveness; incentives for supply chain reorientation; and escalating geopolitical tensions, principally between China and the US.

Implementing a geostrategy in Asia has never been more important. Companies should re-evaluate and adjust their Asia strategies to incorporate political risk management to capitalize on the opportunities while also mitigating the risks that come with more active government intervention in economies. We identify three strategies that can help companies — both those based in Asia and those based in other regions — mitigate political risks and build enterprise resilience in Asia now and sustain it as the world enters the next phase in the COVID-19 crisis.

Companies should "go local" to help governments boost domestic growth and national competitiveness. In a world where governments are increasingly activist and focused on domestic competitiveness, companies must be willing to invest in local expertise to be successful. Companies that will be most successful in Asian markets will demonstrate to policymakers their long-term commitment to the local economy. Joint ventures with local companies will be key to this strategy.

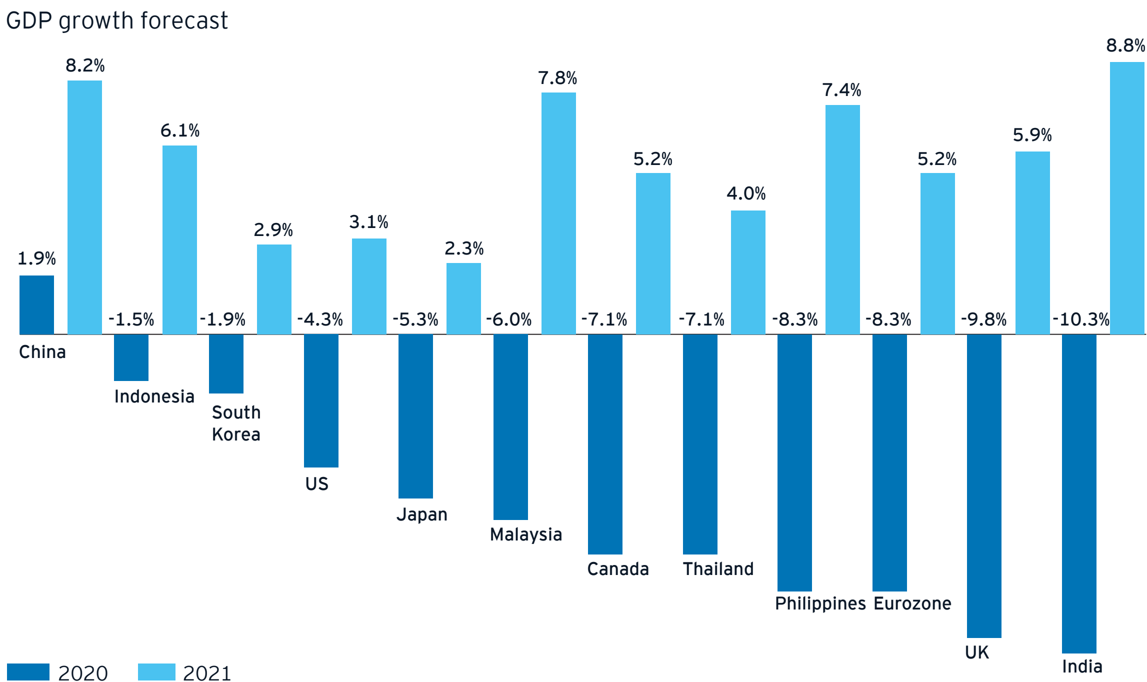
Companies should explore diversifying their supply chains within Asia. Government incentives for the relocation of production activities are proliferating throughout the region. Companies seeking to capitalize on these incentives must balance the importance of enhancing flexibility and redundancy in their supply chains with the added cost and reduced efficiency that these provisions may entail — and the continued ability to serve the Chinese domestic market. The "China Plus" model — where producers expand to low-cost environments while retaining their footprint in China for access to that crucial market — is an effective strategy in this environment.

Companies should target the Asian consumer for future commercial growth. Rising geopolitical tensions, principally between China and the US, raise the risk of a bifurcated global economy. Yet this creates a silver lining for companies operating in Asia as policymakers seek to deepen regional trade, creating a larger, more integrated consumer market. Rapid expansion in the Asian middle class will not only benefit the consumer sector, but also the pharmaceutical, energy, industrial materials and financial services sectors.

The importance of Asia

Having a strategy to win in Asia has never been more important for global business. This is particularly true in the midst of the economic turbulence resulting from the COVID-19 pandemic. In recent decades, rapid economic development and the dynamism of Asian markets have given the region a distinct growth and investment advantage. Today, Asia is home to more Fortune 500 companies than the US and to more than one-third of the world's unicorns. Despite the World Bank forecasting the regional economy's 2020 growth rate will hit its lowest level since 1967, this advantage endures as key markets in Asia have been first to chart a path toward reopening and the region appears poised to lead the global economic recovery from the pandemic. Of course, some Asian markets continue to suffer from COVID-19-induced disruptions, most notably India. And while China is the only major economy forecast to expand this year, many Asian markets are forecast to rebound more dramatically than other major markets in 2021 (see Figure 1).

Figure 1: All major economies except China are forecast to contract this year



Source: International Monetary Fund | Note: Forecasts current as of October 2020.

Early and proactive responses to COVID-19 in a number of key Asian markets were effective. And the dramatic expansion of health care infrastructure in response to COVID-19's initial spread has often prevented additional outbreaks from getting out of control. The region continues to grapple with COVID-19, but on the whole Asia appears to have been spared from the more economically devastating scenarios that parts of Europe and North America have found themselves mired in.

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>
> Asian governments, for the most part, have been world leaders in combating COVID-19, even as additional waves of the virus permeate the region and the world. Resilient health care infrastructure in a number of Asian markets makes the region the best positioned in the world for economic recovery and takeoff.
>
> – Kurt Campbell, Chairman and CEO, The Asia Group

Governments throughout Asia are not only active in combating COVID-19; the pandemic has also made government policy more significant than ever in shaping business outcomes in Asia. Governments took unprecedented steps to limit the fallout from the crisis and create a foundation for recovery. At US$2.2 trillion, the Japanese Government's stimulus package as of May 2020 was equivalent to approximately 40% of its GDP. Singapore, known for its prudent economic policies, also dipped into its reserves — for only the second time in its history — to provide relief for workers and businesses. And South Korea has announced plans to increase fiscal spending over the next year by 8.5% to a record US$468 billion to bolster employment and improve growth.

> "There is no question that the post-COVID-19 world will be a challenging one. The leading policies that China and Asia-Pacific governments have been putting into place enable the region to better cope with those headwinds for now, while preparing to take advantage of opportunities that are the emergent new drivers of global economic growth.
>
> — Walter Tong, Managing Partner, Asia-Pacific Accounts, Ernst & Young (China) Advisory Limited

These short-term stimulus measures are only one part of the story, though. Governments throughout Asia are playing an active role in shaping opportunities and challenges for the private sector. Three government policy-driven shifts are currently transforming Asia's business landscape:

- Increased government intervention to boost domestic growth and national competitiveness
- Policy-driven incentives for supply chain reorientation
- Escalating geopolitical tensions, principally between China and the US

Some of these shifts had already been underway in the region but have now accelerated due to COVID-19. Others are more novel policy trends driven by the pandemic. And each of these policies creates a unique set of opportunities and challenges for companies with operations or commercial interests in Asia.

Boosting domestic growth and national competitiveness

The COVID-19 crisis has demonstrated how far some governments are willing to intervene in private markets to remain economically competitive. China, for example, is spending billions of dollars in capital on "new infrastructure" that includes digital technology such as 5G, big data and artificial intelligence. And other governments, such as in India, have highlighted the importance of supporting local firms amid the economic crisis. Some government-driven efforts to boost domestic growth and national competitiveness are creating opportunities for firms that are agile and strategic enough to capture them, while others are creating geopolitical challenges that companies must carefully navigate.

Opportunities: new government support for strategic sectors — and consumers

Several Asian governments have assumed more prominent roles to craft ambitious economic development goals, intervening heavily to foster new domestic industries, particularly technology and health care, and to support domestic consumers. These efforts are generating opportunities for both domestic and foreign companies.

Technology

Economists expect that local governments in **China** will issue close to US$600 billion in infrastructure projects in 2020, which will undoubtedly benefit state-owned enterprises but also could deliver attractive returns for private equity investors and project financiers. And China's "smart infrastructure" initiative is pouring significant public investment into 5G, internet of things (IoT), AI, cloud computing, blockchain technology and data centers. As of March 2020, 22 local governments in China had set targets to accelerate the construction of 5G base stations, investing RMB3.5 trillion (US$500 billion) over the next five years. These projects have already attracted interest from European and US technology companies and are helping drive an Asia-wide boom in industrial real estate and logistics infrastructure investment.

Japanese policymakers are earmarking funds to support long-term industry research on 6G wireless networks under a new government-sponsored organization that will invite input and experimentation from the private sector. Meanwhile, Seoul's US$133 billion "Korean New Deal" stimulus plan — described by South Korean President Moon Jae-in as "the architect to design the Republic of Korea's new century" — is creating a fund to support companies' R&D in commercial applications for artificial intelligence, data management and robotics. Seoul has also established 10 key projects for the digital and energy industries, including a data infrastructure project that aims to collect and share big data to be used in finance, transportation and renewable energy production.

Amid a continued push by the **Indian** Government to increase the prevalence of digital payments in the country, monthly online retail sales in India are soaring, reaching an all-time high of INR2.6 trillion (US$34 billion) in June. The Indian Government is focusing on this surge and has announced an objective to attain a total of 1 billion transactions per day. While New Delhi's new restrictions on investment from China are presenting challenges for Chinese venture capital companies in the Indian market, the domestic technology scene is still poised to benefit from what some analysts see as a "v-shaped recovery" in venture fundraising from both foreign and domestic firms.

Governments across **Southeast Asia** have recognized the crucial role of financial technology (FinTech) companies in driving innovation and competition in the region. FinTech companies in countries such as Malaysia and Singapore are ramping up efforts to provide micro-lending services to help underserved small businesses struggling with short-term liquidity needs. The FinTech industry is expected to grow over the coming years, benefiting from strong government support in the form of regulatory sandboxes, grants and regulations, as well as licensing regimes to promote innovation.

5G-related industries are another major focus for the **ASEAN-5** countries (Malaysia, Indonesia, the Philippines, Singapore and Thailand). In Singapore, for example, the government aims to roll out nationwide coverage engineered by domestic telecommunications firms by 2025 and drive opportunities across cloud gaming, urban mobility, smart buildings and maritime operations. Some sectors within the region are expected to benefit from this

5G investment. Large plantations in Indonesia are using 5G drones to collect information on soil conditions and moisture levels, for instance. And across the region, small and medium enterprises (SMEs) and startups are set to capitalize on 5G to generate business growth and support digital transformation initiatives.

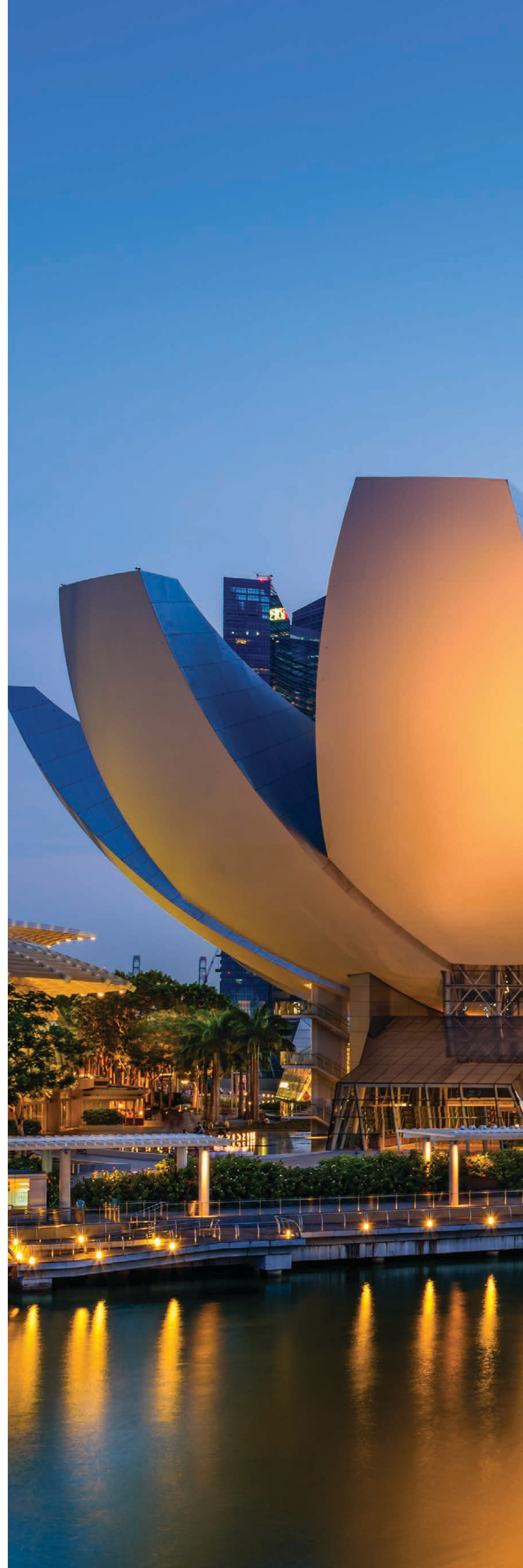
Health care

Health care continues to be at the center of the economic recovery from the pandemic, and rapid adoption of digital health products among Asian consumers suggests that digital health offerings could increasingly become the norm. Governments and market players in Asia have quickly made digital health platforms readily available to the general public. In **India**, the Government has released new guidelines for telemedicine and recently announced a new national health identification system for its citizens, creating a digital infrastructure upon which local health care startups can grow. **China's** largest digital health care platform saw newly registered users grow by a factor of 10 from early January to mid-February, while other platforms reported triple-digit growth during this period. **South Korea** has eased restrictions on telemedicine to treat COVID-19 patients more efficiently, while **Japan** has launched a free government-backed remote digital health service. **Indonesia's** Ministry of Health partnered with ride-hailing giant Gojek and telemedicine provider Halodoc for quick COVID-19 diagnostics in remote areas.

Consumers

Asian governments are also working to ensure that consumer spending power will continue to grow during the COVID-19 crisis. Singapore and Hong Kong announced direct cash payments to individuals as significant parts of their COVID-19 rescue packages, while Japan has launched an ambitious tourism plan that offers coupons and discounted travel costs for domestic travelers.

Government support for consumers in China — a significant economic force — has also been notable. The Government helped to support the distribution of vouchers and coupons mostly through e-payment tools — a significant action given the popularity of mobile payments in China. Fashion and beauty sectors have both benefited from the voucher scheme — one major online retailer's beauty sales reached US$14.1 billion within one minute while another's luxury sales increased 400% within one hour during the country's mid-year shopping season. And the EY Future Consumer Index (FCI) from July 2020 shows that Chinese consumers are far more likely than their global peers to feel comfortable going to restaurants and bars, further supporting consumer spending.



Challenges: downsides of localization

Sustained government intervention across the region also brings about its own set of uncertainties for business, with greater potential regulatory risks for foreign companies in certain Asian markets. A slow macroeconomic recovery could increase the likelihood that policymakers will advance more measures that aim to protect industries at the expense of overseas companies. This risk is especially high in Asian emerging markets that have been particularly hard-hit by COVID-19, such as the Philippines, Indonesia and India.

The COVID-19 pandemic has already amplified calls in New Delhi for **Indian** "self-reliance," with Indian Prime Minister Narendra Modi repeatedly calling on all Indians to "make the 'local' a mantra of our life" and encouraging consumers to "become vocal for local." One notable example of policy action is the Indian Government implementing stringent non-personal data protection measures. This could complicate compliance for multinational technology companies and hinder their ability to compete with local firms.

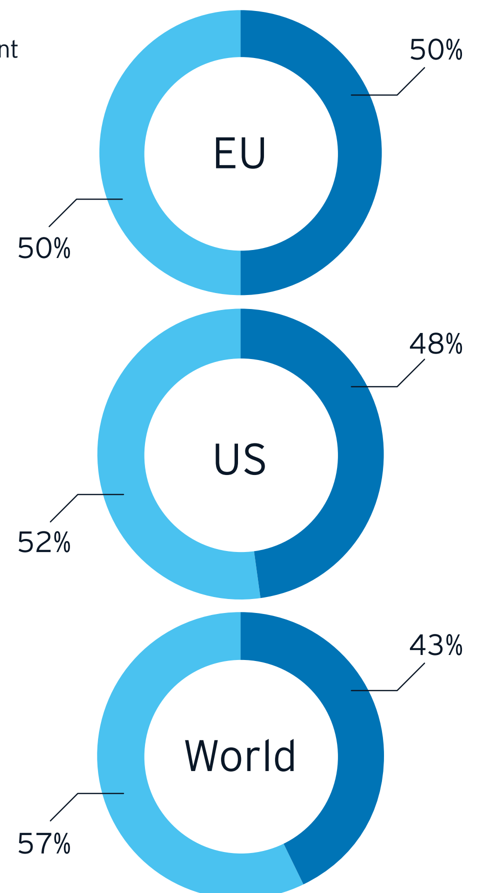
More broadly, lower valuations in global equities markets have generated thoughts of a potential uptick in Chinese overseas M&A activity. In response, governments have taken a series of actions to shield strategic domestic industries from perceived foreign takeover risk. While these measures appear at present to be aimed at Chinese firms, they could have a broader negative effect on other foreign investors as well. In addition, Canberra has made changes to its foreign investment law — the first time it has done so in decades — giving the Australian Government broad authority to curb or unwind foreign investment deals on the basis of national security.

Incentivizing supply chain reorientation

Asia — and in particular China — has become the factory to the world. Companies depend on Asia for everything from palm oil to cell phones. Crucially, the production of medical supplies is heavily concentrated in China (see Figure 2). The COVID-19 pandemic has therefore triggered a reassessment of supply chains — both within Asia and globally. In the years prior to the crisis, Asian governments had been making concerted efforts to deepen cross-border trade and investment flows as a way to boost growth. This trend is continuing but is being supplemented with greater government incentives for relocation of production activities. This poses a number of potential opportunities for companies, although shifts in export-related manufacturing may also present cost challenges.

Figure 2: Vulnerabilities have been exposed in the global medical supply chain

Share of personal protective equipment imports from China



Source: Peterson Institute for International Economics
Note: Blue sections indicate share of imports from China. Gray sections indicate share of imports from the rest of the world.

Opportunities: policy incentives to attract foreign direct investment

The United Nations projects a 45% decline in foreign direct investment (FDI) into Asian emerging and frontier markets in 2020 due to the COVID-19 crisis, making for a particularly competitive environment for governments to woo companies. They are stepping up their policy incentives accordingly.

Indonesian President Joko Widodo underscored this on a recent visit to a new industrial park, asserting that "if other countries are asking 1 million for land, then we can offer it for 500,000." Jakarta is also cutting the corporate tax rate to 22% from 25% in 2020, with a further reduction to 20% in 2022, a year earlier than planned. **Indian** officials are taking a similarly proactive approach in recruiting foreign companies, especially ones with operations in **China**, establishing a US$6.6 billion fund to attract foreign smartphone manufacturers. And in **Vietnam**, lawmakers are using the pandemic as an opportunity to revise existing investment laws, for the first time allowing foreign access into research and development, high-tech manufacturing and energy production.

While there is clearly competition among governments to attract FDI, they are not only working in isolation. **Australia**, **India** and **Japan** are preparing to launch the Supply Chain Resilience Initiative, a joint effort to help companies reduce their manufacturing dependency on China. There are indications that some Association of Southeast Asian Nations (ASEAN) member countries may join the initiative as well.

Financial support from governments to help companies relocate can ease the burden of significant investment outlays associated with reconfiguring supply chains. Executives should explore the incentives on offer throughout the region and price these into their assessments for future production or sourcing locations.

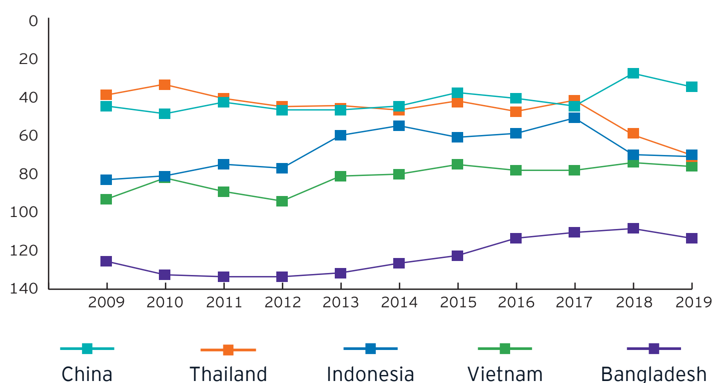
Challenges: "sticky" supply chains and infrastructure deficits

Many of these COVID-19-induced policies to attract FDI involve government pressure on firms to shift some of their production from the China market. But there is a "stickiness" to supply chains that are already in China because the country already has a strong manufacturing ecosystem for many products. And such a move comes with costs — both upfront due to relocation and over the long term due to the competitiveness of operating in the Chinese market. Recent bank research predicted that US and European firms looking to shift manufacturing out of China in the aftermath of COVID-19 could face as much as US$1 trillion in relocation costs.

A key long-term consideration is that **China** continues to boast a higher quality of infrastructure compared with many of its Asian peers (see Figure 3). Electricity coverage in China is on par with developed markets around the world, for instance, and the Government has driven exponential growth in highway and rail system capacity over the past 10 years. Its embrace of smart factories and automated production is replacing traditional assembly lines and allowing manufacturers in China to produce at lower cost compared with other markets. Infrastructure issues continue to create bottleneck risks in **Cambodia**, for instance. And access to reliable energy sourcing remains an issue in some markets. As electricity demand in **Vietnam** outpaces supply, Hanoi has warned that severe power shortages will begin to take effect as early as next year.

Figure 3: China's infrastructure quality has improved relative to key Southeast Asian markets

Annual ranking of overall infrastructure quality



Source: World Economic Forum Global Competitiveness Report

Note: Ranking out of 140 countries

Reducing manufacturing dependency on the Chinese market will take considerable amounts of time to reestablish elements of a viable logistics network and distribution apparatus elsewhere. Some companies will decide to remain in China despite the government incentives to diversify their supply chains. A number of **Japanese** manufacturers have turned down cash incentives offered by Tokyo to diversify away from China because unwinding their production flows are too challenging and costly.

Escalating US-China tensions

There are a variety of geopolitical tensions in Asia — including between Japan and South Korea and between China and India — but US-China tensions are particularly impactful. Accurately assessing the global economic implications of an increase in tensions between the US and China is imperative for all companies — regardless of where they are headquartered — to successfully navigate the business environment in Asia. The most visible manifestations thus far have been escalating trade and technology tensions, which have created sustained challenges and uncertainties for companies. Washington's continued pressure on Chinese technology firms, for instance, has left global semiconductor suppliers scrambling for new customers. Yet rising US-China tensions create a silver lining for companies operating in Asia. Intra-ASEAN trade is projected to continue to grow as policymakers seek to deepen trade, making the region increasingly appealing for companies by creating a larger, more integrated market.

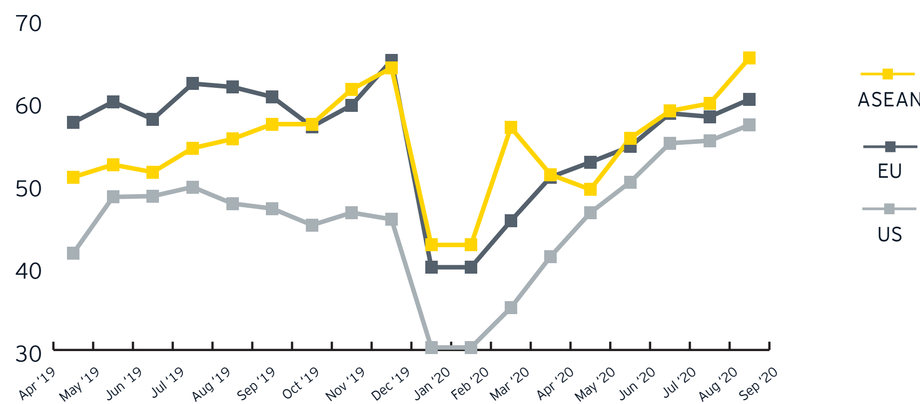
> Integration within ASEAN is key to boosting the region's economic growth in the medium term, and we are already seeing a striking increase in intra-regional trade both within ASEAN and among emerging economies more broadly.
>
> — Walter Tong, Managing Partner, Asia-Pacific Accounts, Ernst & Young (China) Advisory Limited

Opportunities: regionalizing trade and investment

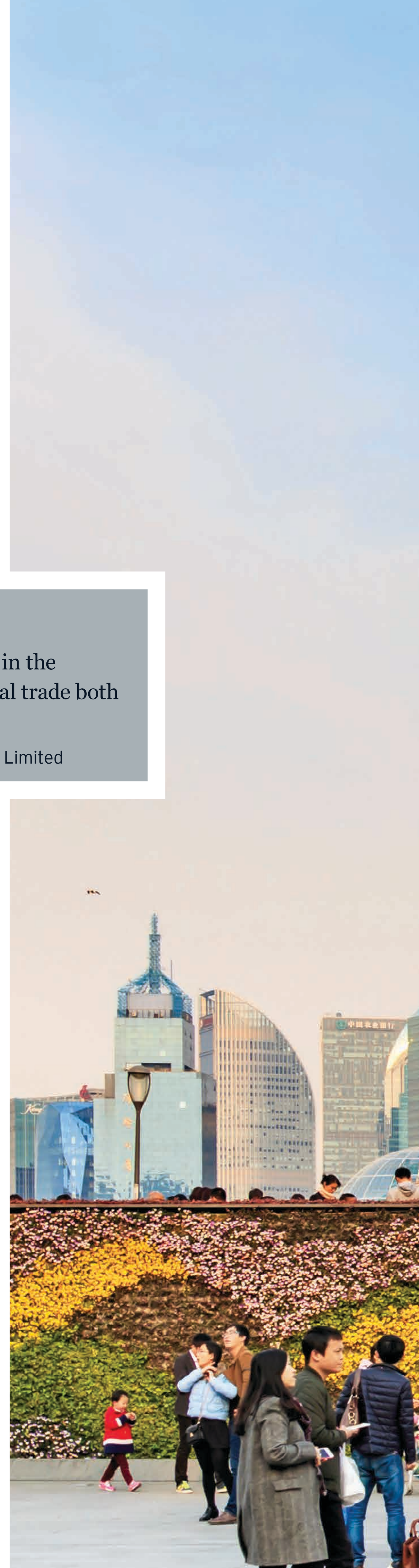
The Asian regional economy is relatively integrated already. And the **ASEAN** bloc stands as potential locus for further deepening trade and investment in Asia. Importantly, ASEAN is increasingly linked to the Chinese economy. The bloc became China's largest trading partner earlier this year, surpassing the EU and the US (see Figure 4). With COVID-19 accelerating friction between Washington and Beijing, ASEAN leaders are actively promoting deeper levels of trade and investment within the region.

Figure 4: ASEAN has become China's largest trade partner

China's bilateral trade value in US$ billions



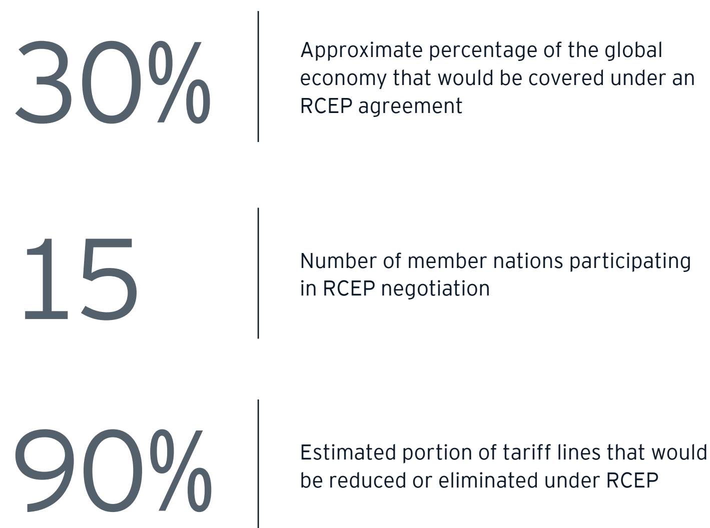
Source: China Customs Office | Note: ASEAN is the Association of Southeast Asian Nations; combined data reported for Jan-Feb 2020 period is halved and split into individual months on graph.



Cambodian Prime Minister Hun Sen has asserted that the pandemic created a new urgency to improve intra-regional trade and eliminate remaining tariff barriers between neighboring trade partners, while **Indonesian** and **Vietnamese** officials have supported the ASEAN Business Advisory Council's plan to establish a new advisory board that ensures enhanced private sector cooperation within the region. Meanwhile, **Japan** is playing a leadership role in driving discussions about a digital trade framework that would more closely connect the digital economies of the region.

Economic disruptions related to the COVID-19 pandemic have also prompted renewed focus on finalizing the Regional Comprehensive Economic Partnership (RCEP) — a bloc of 15 Asian countries that comprise approximately 30% of global trade. **Singaporean** officials are optimistic that the RCEP will be signed as planned by the end of 2020 (see Figure 5). Separately, members of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) have asserted that the current economic climate has made it "more important than ever to counter protectionism and reinforce an open … rules-based trading system to restore economic growth."

Figure 5: RCEP will account for almost one-third of global trade



Sources: Center for Strategic and International Studies, The Diplomat

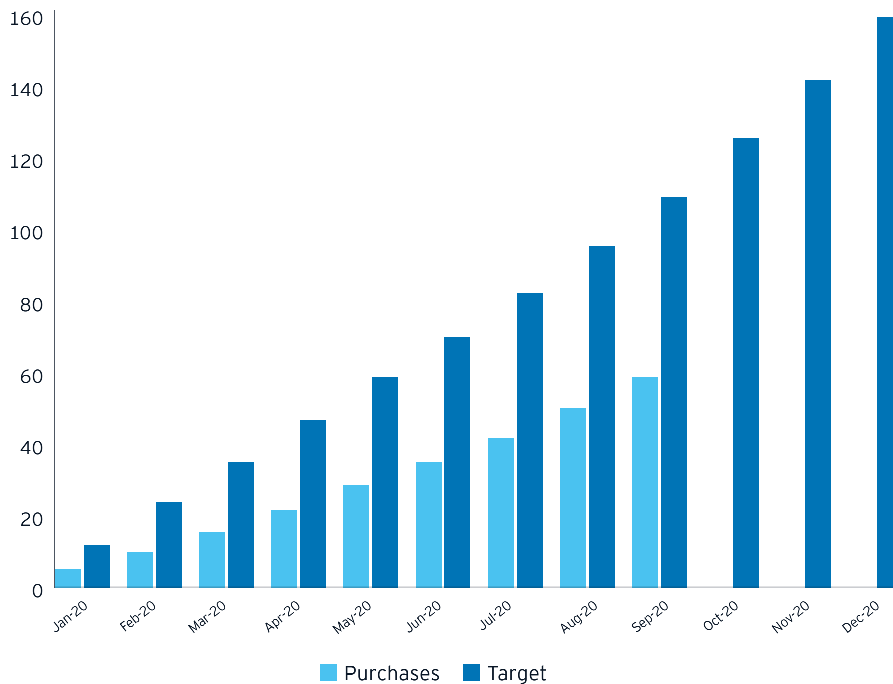
This push for deeper regional economic integration will help companies bring production closer to end users while also supporting economic growth amid a drop-off in external demand in Europe and the US. Companies can also use the opportunity re-evaluate their footprint to capitalize on regional economic integration dynamics and build resiliency.

Challenges: decoupling risks

Instead of providing a respite, the pandemic has hardened US-China relations, exposing the systemic nature of competition between Washington and Beijing. The US-China Phase One Trade Agreement has done little to ease bilateral tensions, but rather has become a potential mechanism for further escalation. The US could use the agreement's terms as an excuse for additional tariff action should China fall short of meeting its formalized purchase targets, a prospect that has grown increasingly likely due to weak macroeconomic conditions in both countries (see Figure 6).

Figure 6: US-China Phase One Trade Agreement purchases are falling short of targets

Cumulative targets and actual purchases, USD billions



Source: Peterson Institute for International Economics

And several US policy announcements in recent months have targeted Chinese political and economic interests. These have included US sanctions on senior officials over the national security law that China implemented in Hong Kong and on certain companies over the situation in Xinjiang, the potential delisting of Chinese corporations on US stock exchanges, expanding export controls, banning some Chinese social media companies in the US, and the ongoing campaign against Chinese 5G technology companies. China has responded in limited ways, with sanctions on US Congressional members and human rights officials, reciprocating the closure of a consulate, and some economic measures, such as releasing new details on its unreliable entities list.

Commercial disruptions related to this ongoing bilateral competition are at risk of becoming a permanent fixture in the region. A US Chamber of Commerce survey found that the proportion of firms that believed that it would be impossible for the US and Chinese markets to decouple fell 22 percentage points from October to 44% in April. The combination of US sanctions and technology export controls, and potential responses from Beijing, are creating a challenging business environment, including how financial transactions between Wall Street and China's largest banks might be conducted in the future.

These tensions do not only affect Chinese and American companies, but also affect other markets around the world. As the third major pillar of the global economy and with deep diplomatic and commercial ties to both China and the US, the

European Union (EU) stands out in this regard. In Germany, the domestic auto industry has been used as a pressure point by both sides over whether to include Chinese components in German 5G networks, and European apparel makers have scrambled to reassess their suppliers in the region in response to pressure from Washington. European policymakers have often resisted choosing sides between the US and China, and they have begun to develop a new strategic outlook that stresses their geopolitical independence, dubbed "strategic autonomy." Underpinned by a push for "digital sovereignty" and more assertive competition, trade and industrial policies to promote European autonomy and competitiveness, this policy shift will significantly impact the global business environment.

More broadly, many global companies will continue to face supply chain cost increases and disruptions from semi-permanent and potentially expanding trade and investment barriers across all three power blocs, as well as policy preferences and incentives that favor domestic companies or production. Manufacturing companies and those that source from them need to determine whether their global supply chain and footprint remain viable. Decisions on new investments should factor in both the heightened political risk associated with doing cross-border business between the US and China and the EU's positioning with regard to these tensions.

Strategies to harness Asia's potential

Executives need to monitor the rapidly changing policy environment in Asia and assess what challenges and opportunities it provides to their company. There is a growing consensus among Asian governments that it is now more important than ever to keep trade doors open to cushion the impact of the pandemic and restart economies effectively. And government policies to foster "indigenous innovation" within the region continue apace, promising opportunities for industry players. Companies should re-evaluate and adjust their Asia strategies to capitalize on the opportunities while also mitigating the risks that come with more active government intervention in economies throughout the region. To win in Asia, companies therefore need a geostrategy – the holistic and cross-functional incorporation of political risk management into broader risk management, strategy and governance.

> "Government relations has never been more important for businesses. Having access to high-quality, full-time government affairs resources that can work across jurisdictions is imperative in the current environment.
>
> – Nirav Patel, President, The Asia Group

Successful geostrategies require adopting a systematic and cross-functional approach to political risk management. This includes an ongoing identification of political risks, assessing their impacts on the business and taking action to mitigate them. We identify three specific strategies that can help companies mitigate political risks and build enterprise resilience in Asia now – and sustain it as the world enters the next phase in the COVID-19 crisis.

> "In this transformative age, companies face a choice – manage geopolitics or be managed by them. COVID-19 has presented companies with the opportunity to design and implement a geostrategy to improve political risk management and enterprise resiliency in both the short term and the long term.
>
> – Mary Karol Cline, EY Geostrategic Business Group Senior Advisor

Going local: importance of on-the-ground partnerships

In a world where governments are increasingly activist and focused on domestic competitiveness, companies must be willing to invest in local expertise to be successful. Companies that have proven to be most successful in Asian markets have been able to demonstrate to policymakers their long-term commitment to the local economy. This process requires deep immersion and collaboration with local entities and involves the slow-and-steady accumulation of political capital that unlocks additional opportunities in the future. Foreign companies should highlight to governments that their local partnerships provide stable employment opportunities, lift up home-grown companies, deliver world-class labor and environmental standards that serve as models to local industry, and promote cutting-edge technologies and infrastructure that have positive spillover effects for the broader economy.

Long-term investment in local partnerships can also improve the ease of doing business in Asian economies where national champions and domestic industries command large market share. After witnessing generations of new entrants into the Indian market, for instance, foreign investors have recognized that teaming up with local partners is often crucial for success. US technology and private equity firms in particular have displayed a growing appetite to purchase equity stakes in domestic conglomerates, choosing to invest strategically and profit off the returns of local players instead of entering the market alone and potentially facing costly bureaucratic hurdles.

And in markets where formal entry barriers exist, the creation of a local subsidiary or local partnership can help new entrants secure access to opportunities that were otherwise inaccessible. For example, a global fast-food giant was able to secure better locations in third- and fourth-tier Chinese cities through a joint venture (JV), allowing it to fulfill its expansion ambitions. While collaborating with a local entity through a JV remains a standard approach for some veterans to the Asia market, the lifting of foreign ownership caps in countries such as Vietnam and China offers greater access to some of the most attractive sectors in these countries.

Supply chain diversification: appeal of "China Plus"

Firms must balance the importance of enhancing flexibility and redundancy in their international supply chains with the added cost and reduced efficiency that these provisions may entail. Rising tensions between the US and China have given greater impetus to these decisions, with COVID-19 providing even more urgency. A prominent technology supplier has recently accelerated its plans to shift production from China to elsewhere in the region due to rising concerns about decoupling, for instance.

This is not new, though. Companies have been exploring the reorientation of supply chains from mainland China for at least a decade. In search of lower labor costs, some foreign manufacturers relocated production to other emerging markets in Asia while still maintaining a presence in mainland China. Taiwanese and Japanese electronics manufacturers, for instance, expanded production in new locations in India and Vietnam. This "China Plus" model — where producers expand to low-cost environments while retaining their footprint in China — offers an effective strategy for building supply chain resilience within Asia.

Even if more regionalized and diversified global supply chains help mitigate risks in production in the future, China remains an irreplaceable partner. Smart supply chain and smart logistics will become indispensable to a functioning economy in the future.

— Ignatius Tong, Asia-Pacific EY-Parthenon Strategy Leader

The Asian consumer: long-term driver of commercial growth

US-China geopolitical tensions are creating rifts within the Asian regional economy — and the broader global economy as well. But this does not diminish the importance of the Asian market in driving future business growth. If anything, it makes the case for developing stronger ties to the Asian consumers even more crucial. As the economic balance of the region continues to tip toward the services and consumption sectors, the Asian consumer is emerging with impressive force.

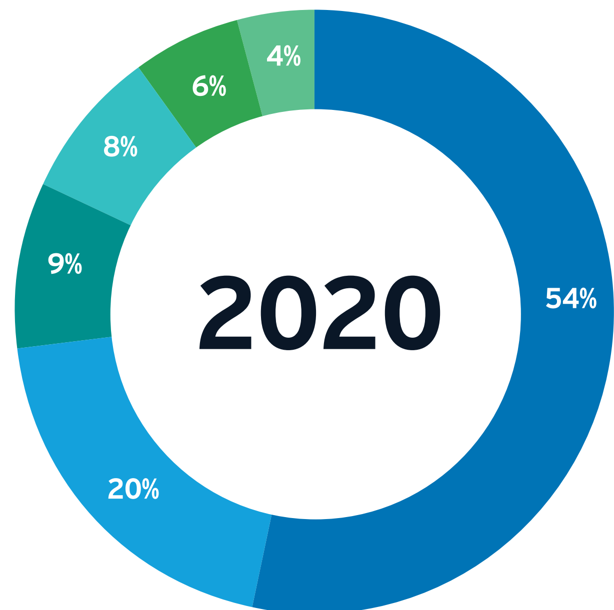
The World Bank estimates that COVID-19 has caused an additional 38 million Asians to live in poverty in 2020. As economic growth returns, though, the Asian consumer is expected to continue to be a long-term driver of commercial growth. The Brookings Institution estimates that there are currently about two billion Asian middle-class consumers, a number that could rise dramatically in the coming years, increasing Asia's share of the global middle class (see Figure 7). This rapid expansion will not only benefit the consumer sector, but will also solidify the emergence of the world's third-largest pharmaceutical market. Asia is also growing its share of the global market for energy and industrial materials. This market growth is likely to continue to drive a surge in M&A activity throughout Asia in the coming years as well.

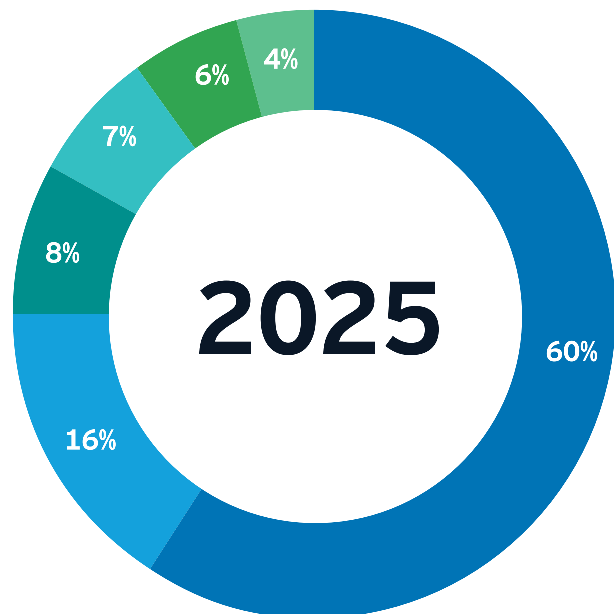
Much of this growth can be attributed to the sustained development of the Chinese consumer. Chinese retail is expected to eclipse that of the US in terms of total market size by next year, while Chinese e-commerce is already almost three times the size of the US and the EU e-commerce markets. Remarkably strong earnings from Chinese technology giants and an increasingly diverse user demographic on digital platforms also highlight how the Asian consumer is growing increasingly digital.

Yet the thrust of Asia's future spending power will be in South and Southeast Asia. The ASEAN bloc boasts 600 million consumers and a nominal GDP of US$2.3 trillion, while retail consumption in India is expected to grow to more than US$1.1 trillion in the next five years (provided the post-COVID-19 recovery is strong). And as ASEAN and Asia more broadly seek to further deepen regional trade and investment ties, the commercial opportunities in an increasingly connected consumer market will expand further. Firms should therefore place the Asian consumer at the center of their strategies for global growth.

Figure 7: Asia already accounts for more than half of the middle class — and is set to grow further

Share of global middle class by region





Source: Brookings Institution

Note: Figures may not add up to 100 due to rounding.

Implementing a geostrategy in Asia has never been more important

Even as the COVID-19 crisis continues, Asia is poised to lead the global recovery. This recovery will largely be shaped by government policy interventions, including most notably intervention to boost domestic growth and national competitiveness; incentives for supply chain reorientation; and escalating geopolitical tensions, principally between China and the US. These policy shifts represent political risks that can have a profound effect on enterprise resilience. The possibility of technological decoupling and changing regulatory landscapes means that implementing a geostrategy in Asia has never been more important. Companies should incorporate political risk management into their Asian strategies to capitalize on the opportunities while also mitigating the risks that come with more active government intervention in economies. In doing so, companies will improve their ability to identify, assess and manage political risks during the COVID-19 crisis and sustain enterprise resilience as the world begins to enter the post-pandemic era.

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The EY Geostrategic Business Group (GBG) helps organizations translate geopolitical insights into business strategy. Geopolitics affects every global organization, from strategy to supply chain. Yet, many companies struggle to assess and manage this disruption and the impacts it has on their business. The GBG harnesses local knowledge and collaborates with third-party firms to bring an added independent political risk perspective. With the breadth of our strategic and operational knowledge, EY teams develop actionable plans to help organizations better monitor, assess and manage political risks.

About The Asia Group

The Asia Group is a strategic consultancy focused on developing comprehensive market entry and expansion strategies for global businesses in Asia. With an experienced team comprised of former senior US and Asian diplomats, business executives, trade lawyers, investment bankers, and industry experts. reaching every key market from Tokyo to Jakarta, Manila to Hong Kong, and Hanoi to Delhi, The Asia Group is uniquely positioned to help the world's leading businesses excel across the Indo-Pacific region.

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