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# Supply chain diversification: Europe's investment patterns in Asia

## #PositiveImpact


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The diversification of supply chains is becoming an increasingly important theme for corporates. A series of economic and geopolitical shocks in recent years have exposed the vulnerabilities of concentrated supply chains, and are prompting conversations around the option set for corporates, particularly around China Plus One strategies.

We find that corporates from the US and Japan appear to be further along in their diversification journey than corporates from Europe, which appear to have thus far kept a more balanced approach to where they invest. Last year, US ODI to ASEAN ex Vietnam reached a record $40bn and was four times of that to China. Japanese ODI to ASEAN has tripled from $10.5bn to $27.9bn in the last 10 years, while that to China has stagnated at around $10bn per year. Meanwhile, EU ODI to ASEAN and China have largely tracked each other, with $37bn worth of net inflows going to both ASEAN and China in 2021.

Why has Europe been slower in diversifying away from China compared with the US and Japan? Europe is more export-oriented and has a higher degree of export exposure to China, hence is more reliant on China for growth. In 2022, Germany's exports to China as a % of GDP was 2.8%, Netherlands' was 1.9%, while the US' was just 0.6%. Secondly, a diversity of views within Europe may have also made it more challenging for the bloc to form a cohesive plan on supply-chain diversification. But with the EU now seeking to start discussions on having a common approach toward China, we could begin to see greater focus in Europe's ODI to the theme of diversification. We note that European corporates have been more vocal about China's strengths not being easily overlooked, such as the presence of complete supply chains within the country, skilled labour, and infrastructure.

Given varying policies and levels of infrastructure within ASEAN, how can corporates looking to more actively diversify their supply chains differentiate within the region? We have developed a scorecard to assess the relative strengths of ASEAN economies by using the following key drivers of investment: labour laws, demographics, investment incentives, and infrastructure.

Singapore scores the best on all parameters, but high costs limit FDI to capital-intensive and high-skilled sectors to leverage on its skilled workforce. It primarily functions as a place for regional headquarters and to test-bed innovative solutions, rather than capture broader fundamental shifts in supply chains out of China. Malaysia also scores relatively well across the categories. Corporates looking for a developed economy to build a manufacturing facility in a moderately-skilled sector, and requiring costs to be relatively low, could find it an attractive investment destination. Again, corporates can leverage on Vietnam, Indonesia and Thailand's large working populations and invest in low- to moderately-skilled manufacturing sectors there. Country-specific industry strengths include textiles and electronics for Vietnam, auto manufacturing for Thailand, and natural resources for Indonesia. The advantage for Philippines is its recent liberalisation of FDI rules, high English proficiency, and low costs, which could lead to increased investment in the future.

### Our ASEAN Investment Attractiveness Scorecard

| | SG | MY | VN | TH | ID | PH |
|---|---|---|---|---|---|---|
| Labour laws | 1 | 3 | 4 | 6 | 5 | 2 |
| Demographics | 1 | 3 | 5 | 6 | 2 | 4 |
| Investment Incentives | 1 | 4 | 3 | 2 | 5 | 6 |
| Infrastructure | 1 | 3 | 2 | 5 | 6 | 4 |

Source: Deutsche Bank, CEIC, World Bank, United Nations, WTO, OECD, INSEAD

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