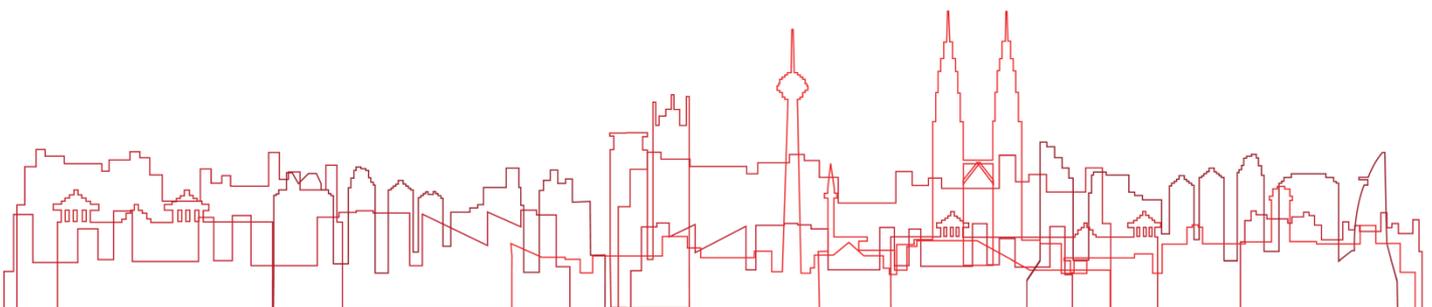


# MEETING TODAY'S SUPPLY CHAIN TRENDS AND CHALLENGES

**Part 2:** STRATEGIES FOR  
DRIVING GROWTH IN  
EMERGING MARKETS



*June 2015*



## PREFACE

In the previous article, we covered how best-in-class companies are redesigning their supply chains to manage costs to protect shareholders value in a challenging economic climate. With increased mobility in today's globalised world, the competitive landscape and environment is far more challenging. Thus, locating strategic supply chain functions in a cost and tax efficient jurisdictions location would provide a competitive edge for the company to undertake various value-add and growth activities across the region.

With an efficient supply chain in place where cost is managed well, this ensures future access to capital which will be required to drive future growth strategies.

However cost is only one side of the equation. When economic growth rates are declining, the issue at hand is; when and how to utilize ones capital to invest in areas that would continue to deliver growth. Companies who have a clear strategy to address this would be in a position to attract greater levels of investments.

As such, in this article we look into:

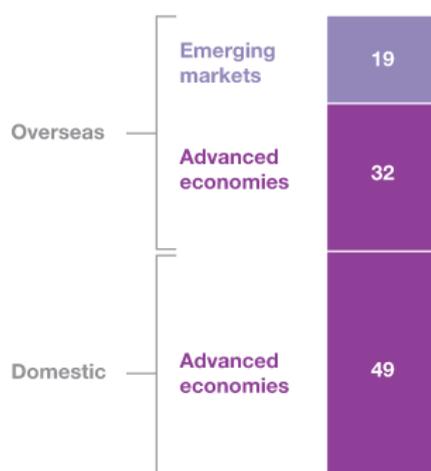
- The next geographies for economic growth;
- The channels that are dominating the distribution of goods; and
- The supply chain strategies being employed by Best-in-class companies to grow their market share in new emerging markets

## PART 2: STRATEGIES FOR DRIVING GROWTH IN EMERGING MARKETS

### Growth Driven by Global Shift in Flows

In a recent McKinsey's Quarterly publication - [Harnessing the Power of Shifting Global Flows](#), it forecasts a change in flow of trade and finances driven by increased consumption in emerging markets. While companies from advanced economies have expanded their markets globally, the major source of revenue is still derived from their home country and trade with other advanced economies. Only 19% of revenue is realized from emerging markets.

Share of overseas and domestic revenues for multinational corporations,<sup>1</sup> 2013, % of total



<sup>1</sup>For companies with headquarters in advanced economies; largest 100 companies from the 2013 Fortune Global 500 list that reported revenue by geographic segment in that year and had revenue from overseas markets.

Source: Annual reports; Fortune 500; McKinsey Global Institute analysis

**Figure 1: Multinational companies in advanced economies are missing out on the opportunities arising in emerging markets\***

However, trade in developing economies is predicted to continue to swell and by 2025, it will represent 47% of global consumption. Best in class companies employ a growth strategy to address this gap and position their supply chains to adequately address this opportunity.

Stefan M. Selig, Under Secretary of Commerce and International Trade recently stated "With 2.7 billion middle class consumers by 2030, the Asia-Pacific region is essential to economic growth".

\*Source: McKinsey quarterly report – *Harnessing the power of shifting global flows*, Bughin, Lund & Manyika, 2015



**Figure 2: The growth of middle class consumer spending by 2030<sup>^</sup>**

The growth in emerging economies will be mainly driven by the Asia Pacific markets increased consumption where the forecasted growth of 571% will outpace projections for all other regions. Besides the usual suspects of China and India, the ASEAN economy of a US\$ 2.5 trillion GDP, growing at a rate of 5-7% and a combined population of 633 million present a formidable market for companies seeking to expand globally.

The ASEAN economy is projected to strengthen further due to the progress made on ASEAN Economic Community (AEC) which aims to create an integrated regional economic hub. The AEC aspires to create a single market and production base across its 10 member countries by removing inter-region trade barriers. This creates future opportunities for multinational companies to establish their regional supply chain centres to manage activities from procurement right up to distribution and returns from one single location which will also be able to serve the needs across the region.

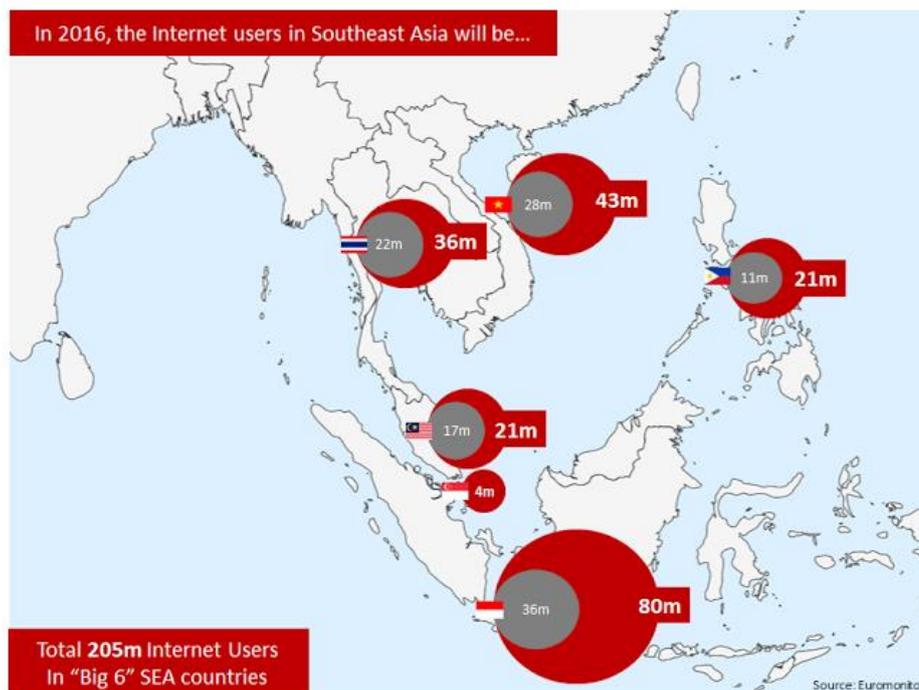
<sup>^</sup>Source: Star Management- [Under Secretary Selig: "With 2.7 billion middle class consumers by 2030, the Asia-Pacific region is essential to economic growth"](#)

## Growth Driven by Digital Channels

From the McKinsey quarterly report, cross border internet traffic has grown by nearly 1,600% since 2005 and could increase almost eight times further by 2025. In tandem with this growth, we see similar trends with the digital economy.

According to [eMarketer](#), worldwide business to consumer e-commerce sales will increase by 20.1% in 2014 to reach US\$1.5 trillion and this growth will come primarily from the online and mobile users which are rapidly expanding in emerging markets. It also states that Asia Pacific will leapfrog North America to become the world's largest regional e-commerce market with sales reaching US\$525.2 billion in the region compared with US\$482.6 billion in North America. The potential for the digital economy in Asia Pacific has yet to be fully realized although it accounts for 46% of digital buyers worldwide, with only 16.9% being the actual users out of the region's population.

In the big six SEA countries – Indonesia, Singapore, Malaysia, Thailand, Vietnam and Philippines, the internet penetration and subsequent digital commerce reach is projected to grow from 114 million users in 2011 to 205 million users in 2016 according to Euromonitor<sup>#</sup>.



**Figure 3: Internet and E-commerce penetration in South East Asia<sup>#</sup>**

What this means for businesses seeking to grow in ASEAN, especially in the consumer goods industry, is to incorporate digital channels into their overall growth and supply chain strategy.

<sup>#</sup>Source: [The ultimate guide to e-commerce statistics of Southeast Asia & Malaysia](#), Milo & Wong, 2013

## Supply Chain Priorities for Growth

Given the growth potential that Asia Pacific and ASEAN would experience in the next 10-15 years and also the untapped potential of digital commerce channels in the region, most companies would redesign their market penetration strategies and further develop their digital capabilities.

The supply chain function is not just an effective avenue to manage overall delivered costs for a business but also a strategic tool which can be used to break into new markets and expand new channels. Let us look at the areas of interests these supply chain companies are investing in, to further their agenda in these new markets.

In May 2015, the Economist Intelligence Unit gathered insights from 400 executives in eight emerging markets on the intention to strengthen their supply chains. Three out of the eight emerging market economies reside in ASEAN which includes Vietnam, Indonesia and Thailand.

One of the key questions was; *In the next three years, where do you expect to see growth in your emerging market supply chains?*

### 24. In what areas of your company’s supply chain(s) in emerging markets do you expect to see the most growth over the next three years?

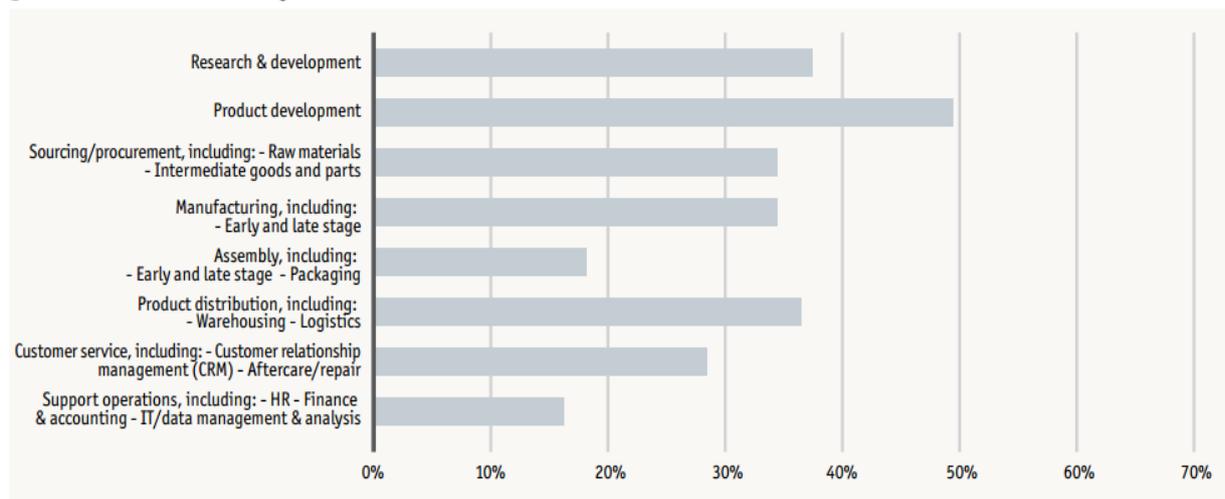


Figure 4: Areas of growth in emerging markets supply chain<sup>Ω</sup>

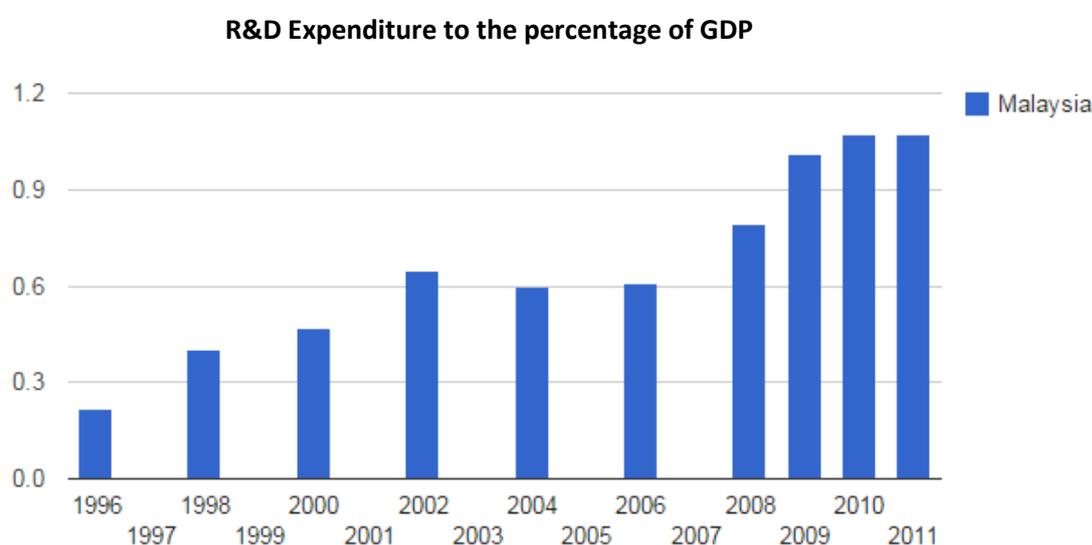
The result from that question showed five top areas these companies are focusing on growing, which are Product Development, Research & Development (R&D), Product Distribution & Logistics, Sourcing/Procurement and Manufacturing.

<sup>Ω</sup>Source: EIU, “[Chain Reactions – How trade between emerging markets is shaping global supply chain](#)”, pg 33, 2015

It is not surprising that Product Development and R&D which go hand in hand, topping the list. Breaking into the emerging markets consist of more than just establishing sales and business development functions in cities while relying on technologies and product specifications which work back in the home countries. Tastes and preferences change by region and are being influenced more and more by millennials in those regions. As such, to remain relevant, products and services would need to be tailored for the regional markets, hence companies are investing in regional R&D and product development outfits to cater for regional needs.

One of the key destinations for R&D activities in ASEAN is Malaysia. In a WorldBank report, Malaysia’s R&D spending as a percentage of GDP has risen steadily from 0.22% in 1996 to 1.07% in 2011<sup>17</sup>.

Global MNCs such as Panasonic, Sony, Shell Global, Ingress Katayama, and Agilent Technologies are undertaking R&D activities in Malaysia and Honda has recently announced to establish a R&D centre in Malaysia by end of 2015.



**Figure 5: Malaysia’s R&D spending has grown rapidly in recent years<sup>17</sup>**

Product Distribution and Logistics, Sourcing, Procurement and Manufacturing came with almost equal emphasis. These are major cost drivers and will have a large impact on the profitability of the companies’ operations in ASEAN. These are some of the factors which we have covered in the [first article](#) of this series.

Since most countries in ASEAN are still developing, operational costs comprising of labour, utilities and raw materials are still competitive. As such it would make sense for MNCs to undertake both sourcing and/or manufacturing activities through subsequent distribution within the region and optimize their logistics costs by having all their key supply chain activities regionalized.

A case in point for regionalised location for supply chain activities is Malaysia where the strategically located country in ASEAN is home to several regional distribution centres such as Vale, Amway, BMW Parts, Xiaomi-managed by CEVA and Hoover Container Solutions.

<sup>17</sup> Source: TheGlobalEconomy.com, [Malaysia’s R&D expenditure](#)

## KEY TAKEAWAYS

- Emerging economies including ASEAN and Asia Pacific will represent 47% of global consumption by 2025. However, multinational companies from advanced nations which are leading the globalization trend only generate 19% of their revenues from these markets today.
- The Asia Pacific region is projected to be the fastest growing consumer spending market with a forecast increment of 571% growth from 2009 through 2030.
- Asia Pacific will leapfrog North America to become the world's largest e-commerce market but the potential is far realized as only 16.9% of the region's population are digital buyers today.
- Best in class companies seeking to grow would consider redesigning their supply chains to capture the potential of Asia Pacific and ASEAN's market and incorporate a digital commerce channel strategy.
- Best in class companies are increasing their supply chain scope to undertake key business functions such as Product Development, R&D, Procurement, Distribution and Manufacturing within the emerging markets they seek to grow in.

InvestKL, a special purpose investment promotion agency by the government of Malaysia provides end-to-end facilitation services to multinational companies looking to establish regional headquarters in Greater Kuala Lumpur for the ASEAN market. InvestKL has facilitated many corporations to establish regional outfits in Greater Kuala Lumpur including Schlumberger, SC Johnson, Colas Rail, Oleon, Turner, International SOS and Epson.

Should you wish to explore establishing a footprint in ASEAN to grow your business, do get in touch with any of InvestKL's Investor Relations directors or visit [InvestKL's website](#) for further details on our services and testimonials from some of our clients.

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