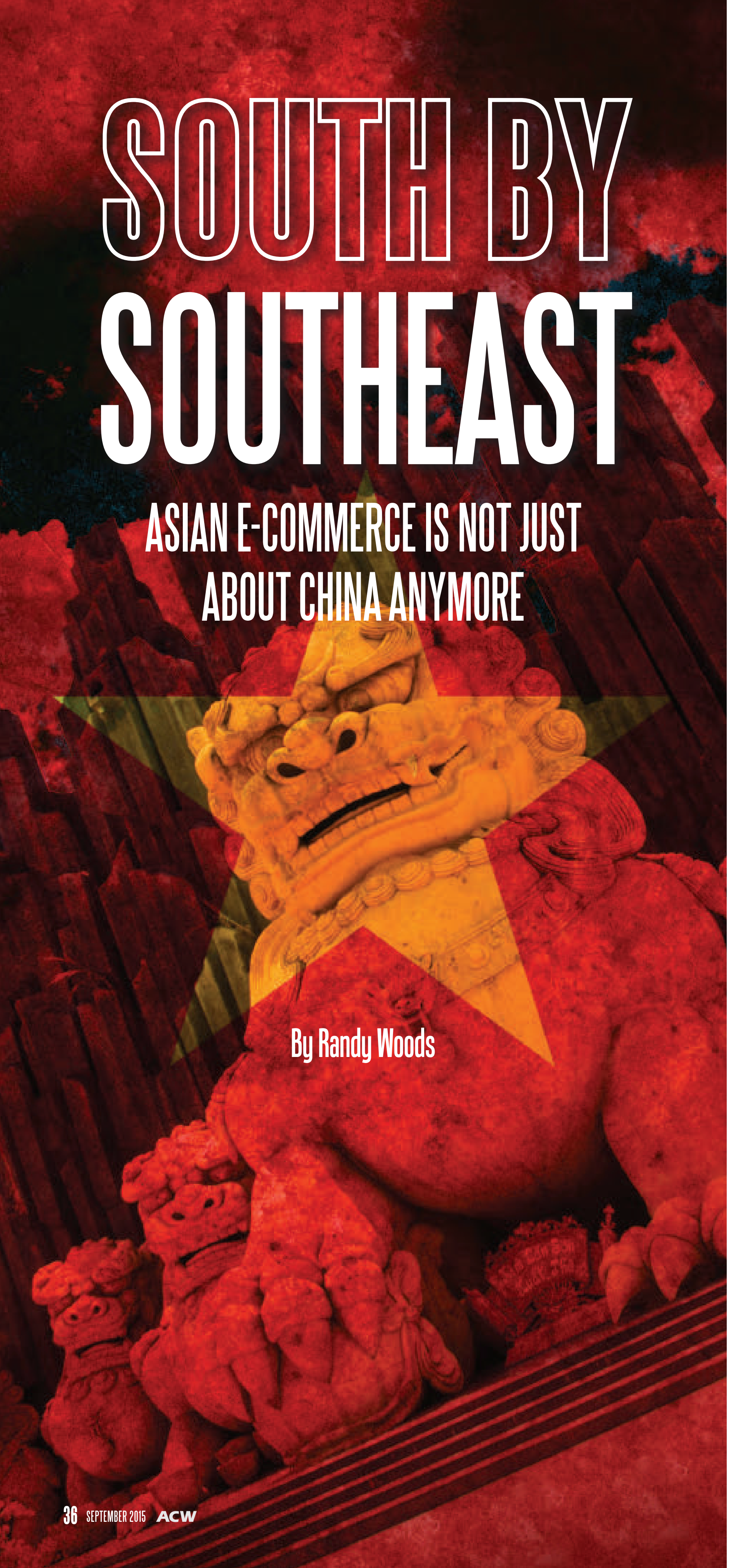
SOUTH BY SOUTHEAST

ASIAN E-COMMERCE IS NOT JUST ABOUT CHINA ANYMORE

By Randy Woods



The cavernous factory might be the size of several football pitches and hold more than 90,000 workers, but it's hardly unique. Each year, the plant produces high-end running shoes for Adidas, Asics and Nike for export around to the world. It is just one of dozens of plants that make more than a million pairs of shoes every month.

Just another day inside the awe-inspiring economic engine that is China, right? Wrong.

The factory is located not in China but just outside Ho Chi Minh City in Vietnam, China's upstart neighbor to the south. The company that owns the plant is actually a Taiwanese firm called Pou Chen Group, which is the largest shoe manufacturer in the world. This factory, and many others that produce garments for Western consumers, have recently moved to countries like Vietnam because China has become too rich to find the kind of cheap labor it takes to make affordable clothing.

This case of mistaken manufacturing identity can be found in several other nations across Southeast Asia, including Indonesia, Malaysia, Thailand, the Philippines and others. The e-commerce boom kicked off by China has spilled over its borders and ignited a new online logistics land rush. The movement is starting to have consequences. According to a report from the Footwear Distributors and Retailers of America (FDRA), although China increased footwear production volume to 470 million pairs of shoes from 300 million in 2014, its market share fell by 3 percent. Meanwhile, Vietnam has seen a double-digit rise in market share for two consecutive years, partially due to labor shortages in China.

"E-commerce is undoubtedly adding to demand for airfreight, as it has opened up markets across the globe and is one of the fastest growing segments. We expect e-commerce to continue growing strongly in the years to come," said Morten Damgaard, CEO for the South East Asia region at forwarder Agility Global Integrated Logistics. Although freight forwarders are traditionally not set up to provide e-commerce solutions, they are playing a part in this online revolution, he said, by providing services such as warehousing and contract logistics services in certain areas.

While China led the e-commerce charge in Asia – both as a manufacturing center to support Western demand and also in the growth of domestic demand – the torch is being carried by Vietnam and other Southeast Asian countries, often at China's expense. Perhaps it's time for China, and the rest of the logistics industry, to sit up and take notice.

Leading the charge

While there are many Southeast Asian countries emerging as serious logistics markets, Vietnam is at the tip of the spear. Forty years after American troops left the war-torn country to its Communist government, Vietnam has been reborn as one of the fastest-rising economic powers in the region, ironically attracting another foreign "invasion" in the form of manufacturers and logistics firms. Companies such as Converse, Gap, H&M, Lacoste, Reebok, and Zara all have factories there, producing $20.8 billion in garments and $10.2 billion in footwear, boosting the country's annual export growth by 15.8 percent in 2014.

And that's just the apparel industry. Vietnam is not only one of Apple's fastest-growing consumer markets in the world, it is also becoming one of the leading manufacturing centers. Other high-tech companies like LG, Microsoft and Samsung Electronics have invested billions of dollars in Vietnamese factories to build smartphones, tablets and various appliances.

U.S.-based forwarder and trucking firm C.H. Robinson recently opened an office in Ho Chi Minh City – the city through which more than 70 percent of the country's cargo volume is shipped – to be near the center of the action in the region. "Several companies are beginning to explore manufacturing options throughout Southeast Asian countries as a result of the region's increasingly affordable and high-quality labor options," said Matt Castle, director of global airfreight services at C.H. Robinson. "Vietnam, in particular, has experienced steady economic growth due to its strategic location and growing population. Vietnam's total volumes, along the U.S. trans-Pacific eastbound trade lane, are second only to China."

Agility's Damgaard says interest in Vietnam is only going to increase for the next few years, at least. "Vietnam has also seen strong growth in its airfreight market as high-tech manufacturers and retailers have expanded into the country to take advantage of its relatively low-cost production base."

Next in line

While Vietnam is getting attention for its manufacturing potential, many other countries in the area are showing just as much promise, not just as sources of inexpensive labor, but as a consumer block.

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>
> –Matt Castle, director of global airfreight services, C.H. Robinson

"We are seeing growth across the region, with specifically the Philippines and Indonesia looking stronger," Damgaard said. "Based on its demographics, Indonesia has a lot of potential for airfreight growth due to its fast-growing middle class consumers and large domestic market."

Agility has a well-established presence in Southeast Asia that has been built up over the years, starting with a Singapore operation in 1975. In recent years, the forwarder has opened its doors to much more restrictive regimes, such as Myanmar, in response in demand from customers. "In the last few years, we have expanded contract logistics and domestic distribution capabilities in Indonesia and Malaysia and are constantly assessing the need for additional facilities," he said.

Indonesia, he added, "stands out as a 'next-tier' emerging country," in terms of its technology, pharma/life sciences, retail, and perishables sectors, as well as its "huge consumer base" of 250 million people. "While some [Indonesian] companies have moved parts of their supply chain to ocean freight, there will still be demand from these sectors."

There is also growing domestic demand in Malaysia, a strong manufacturing base in Thailand, and robust economic growth in Philippines, Damgaard added, all of which "position the region well for continued growth."

Samsung may help make the case that Indonesia could be the next most promising market. The world's largest cell-phone maker opened a plant there earlier this year capable of producing 1.5 million phones per month, using labor that is less than half as expensive as it is currently in China, and a large consumer base that is more interested in Samsung's lower-cost phone – a shrinking demographic in China, with its growing middle class.

If Samsung builds more factories in Indonesia, there will be a greater demand to ship the most sought-after new releases via air. "As the world clamors for new technology, electronic products, such as televisions, laptops, tablets and smartphones, continue to drive demand in the global air freight market," said Castle, of C.H. Robinson. "Although more expensive than other methods of shipment, airfreight is by far the fastest, and potentially the most reliable, method of transportation."

The infrastructure barrier

But regardless of how much demand there is within any particular emerging market, the lack of infrastructure tends to get in the way. The draw of manufacturing in this region is strong, but many logistics firms also must face the reality that much of Southeast Asia, with inadequate roads, rail lines, ports and airstrips, is still woefully unprepared for the interest it is now receiving from the global forwarding and shipping community.

In some ways, Indonesia, with its vast population and relatively high wealth, is leading the infrastructure race. However, there are still hardships to overcome because the country is spread out among so many outlying islands, making it hard to maintain flexibility during demand spikes.

"From world-class facilities in Singapore to the challenges faced in Cambodia or Indonesia, there is a great difference," Damgaard said. "The infrastructure is in good shape

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with Singapore and Malaysia offering best-in-class capabilities, followed, in no particular order, by Thailand, Indonesia, Philippines, and Vietnam, while countries such as Cambodia and Myanmar present challenges."

Another challenge, he said, is the complex regulatory environment in Southeast Asia. Countries have vastly different customs regulations, making it especially challenging for cross-border transportation. "Countries in the region have made progress in developing the infrastructure required, such as ports, airports and roads, but progress still needs to be made in the 'softer' side of logistics, with bureaucracy still causing delays and problems."

Castle calls the infrastructure problem "one of the biggest challenges for freight forwarding in the region today. With the exception of Singapore, most of the countries within this region are only considered secondary ports and feed into a larger hub port, such as Hong Kong and Taipei. As a result, countries such as Vietnam and Indonesia are competing for carrier capacity in both their local markets and large regional markets."

Global connections

The proximity to hubs such as Hong Kong, Taipei, Seoul and Tokyo, however, give the region another selling point: access to global markets.

Speaking in defense of Hong Kong's third runway plan, DHL Express Asia Pacific CEO Jerry Hsu described how the express carrier felt the need to expand its air network across Southeast Asia to boost their connectivity and shorten transit times in response to the surge in e-commerce traffic. "We have launched a new intra-Asia flight that connects Bangkok, Hanoi and Hong Kong five times per week and increased the frequency of a service connecting Penang, Ho Chi Minh City and Hong Kong from five to six days per week, thereby increasing capacity on the route by 20 percent," he said.

Vietnamese exports to the United States are some of the key issues being discussed in the proposed Trans-Pacific Partnership (TPP), which would remove trade barriers for more than a dozen Pacific Rim countries and, at press time, was still being hotly debated. "There is potential growth opportunity in exporting frozen seafood, as well as fresh fruits and vegetables, from Vietnam," Castle said.

According to Castle, the TPP, if ratified, would have a huge positive effect on the Vietnamese economy, since it would slash major trade protections against its exports to the U.S., one of Vietnam's largest trading partners. Annual seafood shipments to the U.S. are worth US$1.5 billion, or 22 percent of Vietnam's total seafood exports.

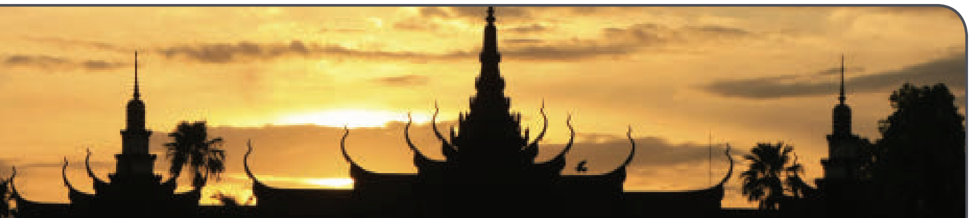
"In Southeast Asia, declining air freight yields and growing competition are some of the challenges that freight forwarders face," Damgaard said. "Despite the growth opportunities in Asia, the air cargo industry continues to face a tough operating environment due to the global economic uncertainty and reduced demand for airfreight."

Changing trade patterns are also causing challenges in Southeast Asia, he added. "Where before, most production was for export to the developed markets, an increasing proportion is now staying within Asia. This means that forwarders also have to provide solutions at a [national] and regional level. Increasing levels of income and the rise of a consuming middle-class are driving domestic consumption, and forwarders need to overcome the challenges that come with domestic distribution in countries such as Indonesia and the Philippines."

Who'll be next?

Just as trading patterns can change, so can labor patterns. Right now, Vietnam may seem like the world's cheap labor capital, but forwarders would be wise to pay attention to what the workers say. At that very same Pou Chen Group factory in Ho Chi Minh City, a massive strike was held last spring – an action practically unheard of in the tightly controlled country – to protest a possible change in plans.

The strike was resolved peacefully after six days and the workers were reassured that a new law would not affect their retirement payments. But if labor unrest spreads to the other mega-factories, another "It Country" may be needed to fuel the massive global logistics engine. And there are only so many emerging countries left untapped. ACW



ASEAN TAKES ON THE BRICS

For many decades, the countries in the Association of Southeast Asian Nations (ASEAN) have taken a back seat to the five emerging economies known as the BRICS (Brazil, Russia, India, China and South Africa), as the economies in the latter group have skyrocketed to super-power status. In logistics, however, the ASEANs are striking back, according to the latest "Emerging Markets Logistics Index," a survey of the opinions of 1,000 supply chain execs, plus a data-driven ranking of 45 economies, released each year by Agility Logistics.

Now in its sixth year, the rankings are based on each economy's size, business conditions, infrastructure and other factors relevant to the freight forwarding industry. This year, seven of the top 20 economies are located in Asia, and five of them are ASEAN member states. Here are some highlights about how they stacked up:

- While China is a perennial No. 1, Malaysia came in at No. 2 in "market connectivity," meaning it has one of the best infrastructures and transport links among the emerging markets.
- The Philippines rose by three spots over last year to reach No. 4, among countries with GDP below US$300 billion, thanks to an improved standing among supply chain executives surveyed.
- Vietnam jumped two spots to No. 7 among countries with GDP under $300 billion, as strong growth in its apparel and high-tech goods spurred higher exports and foreign direct investment.
- For logistics and supply chain executives in the survey, Indonesia was the highest ranked Southeast Asian country as a major logistics market, at No. 4.
- The fastest-growing trade lanes linking emerging Southeast Asia and developed markets in 2014 were U.S.-Vietnam (up 42.7 percent by volume); and Cambodia-EU (up 41.9 percent) for air cargo.
- Out of the top 10 potential investment markets cited by logistics executives, three are in Southeast Asia: Vietnam (No. 4), Indonesia (7) and Thailand (10).