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State of Play — Supply Chains and Trade Realignment

Asia Pacific Business Renewal Series

Foreword

Supply chain renewal is being driven by transformative geopolitical change.

COVID-19 has amplified both the geopolitical and economic challenges that were present before the health crisis erupted in 2020. Now, business leaders must consider what further changes to make to their organizations to meet the needs of a vastly changed business landscape — and where legal expertise may be needed most to manage disruption and soften risks.

With the global rollout of vaccine programs, sentiment is strong among corporate executives and their management teams across Asia Pacific that business will rebound sharply in 2021. Research surveying 800 respondents in the region shows that more than half (58%) say that revenues will be back to 2019 levels by the end of 2021 — and 14% say they are already back in line with pre-pandemic sales volumes. Sentiment within individual markets across Asia Pacific follows this pattern: roughly half of respondents in most jurisdictions see a recovery to top-line growth within 2021.

Across various industries, much starker differences are apparent. Business leaders in the Technology Media and Telecomms (TMT), Healthcare and Life Sciences (HLS), and Consumer Goods and Retail (CGR) industries see a recovery within the short-term. Conversely, Industrial, Manufacturing and Transport (IMT) companies and the region's Energy, Mining and Infrastructure (EMI) corporations say they may struggle for the next two to three years before they see a return to growth.

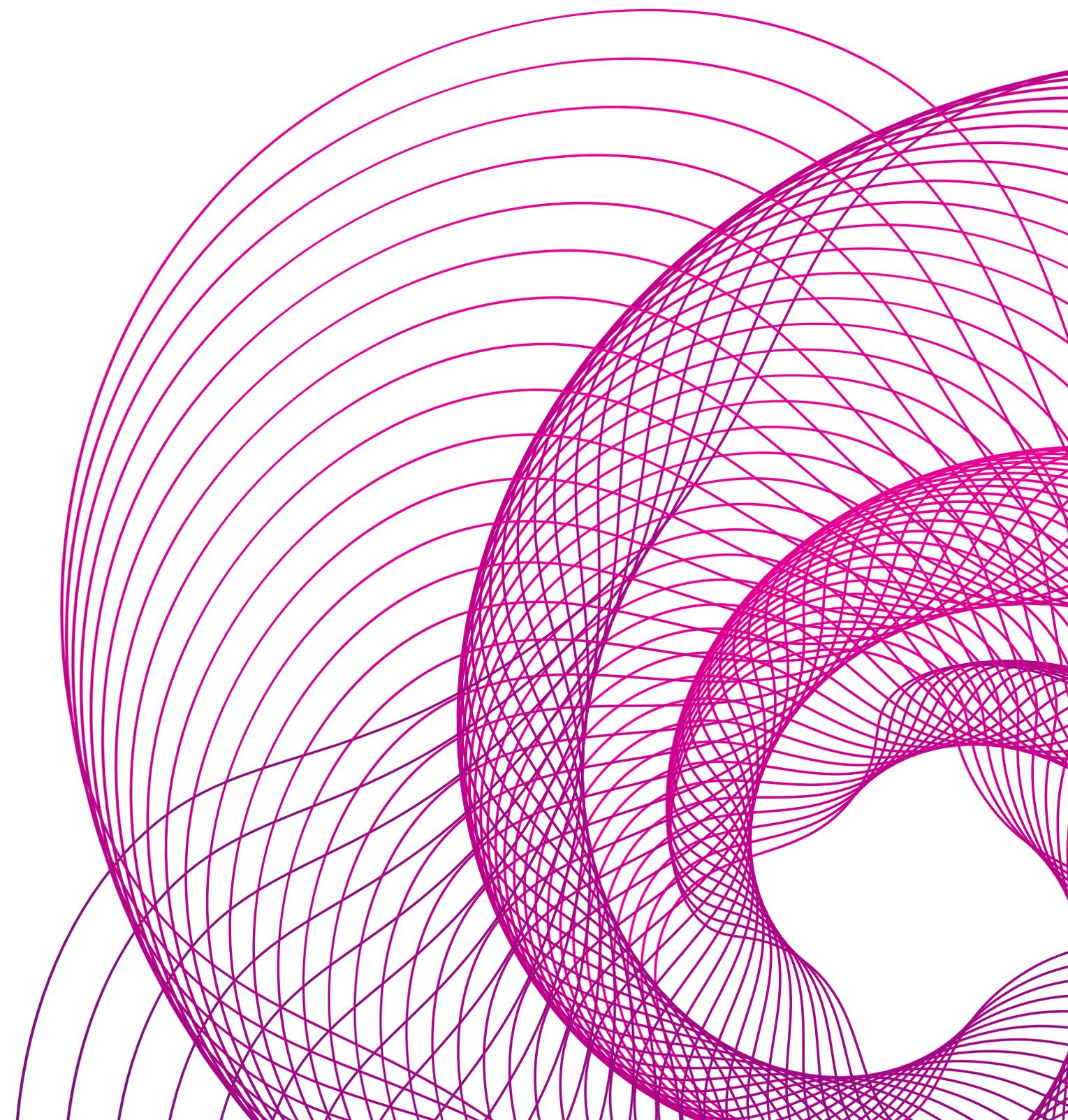
Regardless of jurisdiction or sector, respondents tend to agree on one thing: this is no time to ease off their plans for transformation. Intertwining complexities that have arisen in recent years have been amplified by the pandemic, making it crucial now more than ever for corporate leaders to rethink their businesses to remain competitive.



Anne Petterd
Head of International Commercial & Trade
Asia Pacific

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1 About the Asia Pacific Business Renewal Series

Unpacking the hypercomplex nature of business in 2021, the Asia Pacific Business Renewal Series sheds light on the momentum and mindset of business leaders and decision-makers in the region as they navigate challenges relating to four main areas of business: Supply Chains, New M&A Landscape, Digital Transformation and Sustainability.

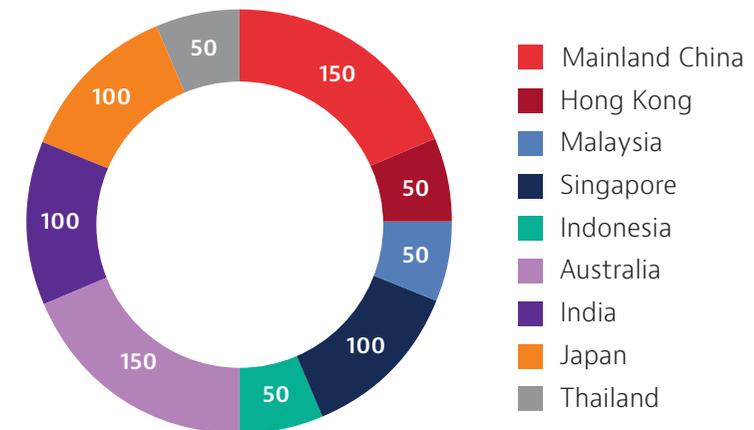
Each report features key considerations and action points to helping businesses to understand the horizon ahead as they make strategic decisions, pursue growth and secure lasting success.

About the Research

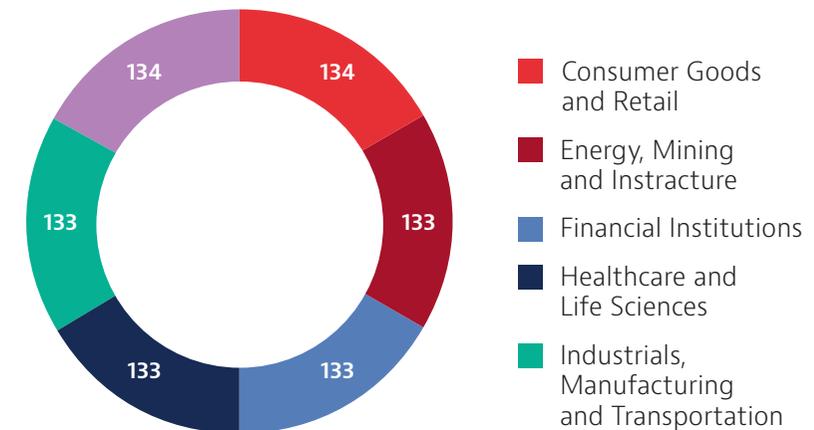
Findings from this report and others within the series were conducted in Q1 2021 in partnership with Acuris.

800 respondents were surveyed across nine jurisdictions and six sectors, including Technology Media and Telecomms (TMT), Healthcare and Life Sciences (HLS), Consumer Goods and Retail (CGR), Industrial, Manufacturing and Transport (IMT), Financial Institutions (FI) and Energy, Mining and Infrastructure (EMI). This Asia Pacific business and legal issues research has been run every two years since 2016 by Baker McKenzie in Asia Pacific.

By Jurisdiction



By Sector



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Key Challenges Facing Business Leaders in Asia Pacific



Trade Disputes and Rising Protectionism



of respondents cite trade disputes and rising protectionism as a major risk area for their business and **more than half** of respondents are actively seeking legal support or advice to mitigate this risk.



of IMT respondents and **64%** of EMI respondents rank this as a major risk area from a sectoral view.



Supply Chain Disruption



of respondents cite supply chain disruption as a major risk area for their business, yet **only 15%** are actively seeking legal support or advice to mitigate this risk.



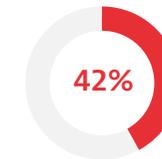
of CGR respondents and **43%** of EMI respondents rank this as a major risk area from a sectoral view.



Compliance and Regulatory Scrutiny



of respondents cite compliance and regulatory scrutiny as a major risk area.



Accordingly, **42%** of respondents are seeking legal support in this area.



of HLS respondents and **37%** of Financial Institutions rank this as a top 3 area of risk.



2



“Trade disputes and protectionism have increased in many of our markets. After the pandemic, governments may put more emphasis on internal development and giving higher priority to local businesses.”

**Chief Strategy Officer,
Australian infrastructure company**

2.1 Trade disputes and protectionism rank as a top concern

Executives and their teams see trade disputes and increasing protectionism as the greatest macro risk for their business in the year ahead, according to 44% of respondents. This is a notable jump when compared to our previous business complexities study in 2019, when trade disputes ranked in the bottom half of perceived challenges.

Respondents have been particularly vocal in this area, with the Managing Director of a Singaporean bank saying that ongoing trade tensions “create considerable uncertainty regarding any sudden policy changes. The political impact on our business could increase.”

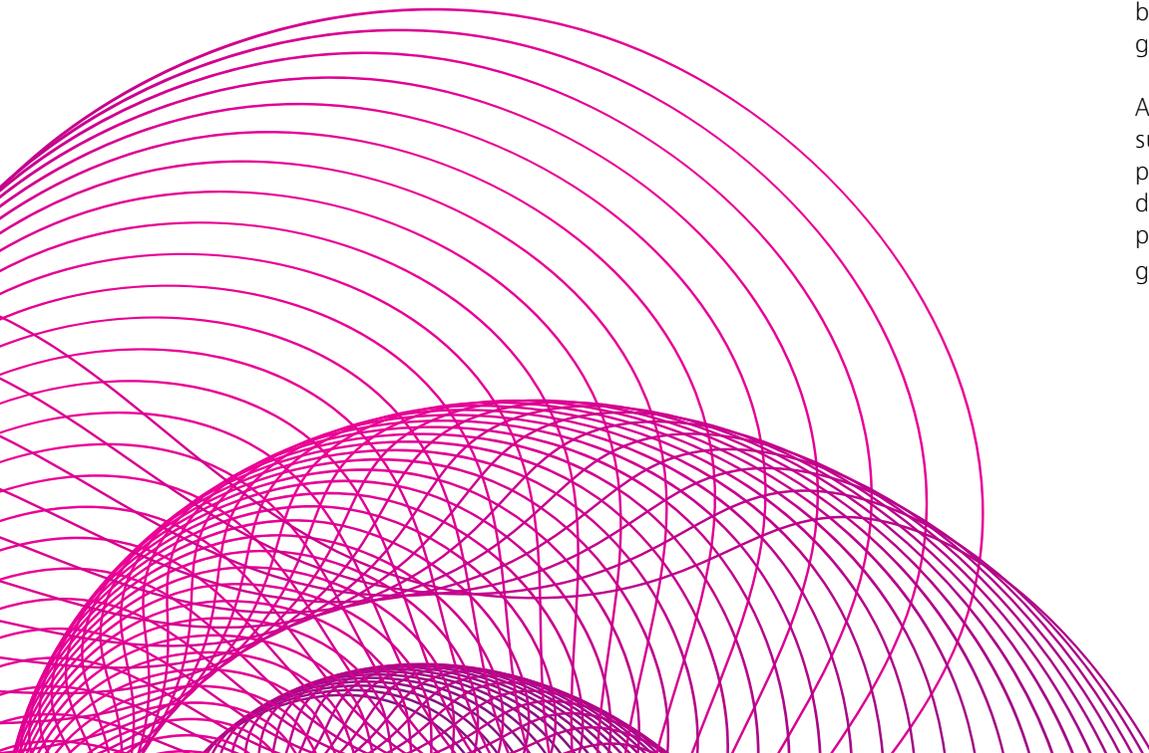
Anne Petterd, Head of International Commercial & Trade, Asia Pacific notes, “Countries in the region have diverse geographies, cultures and economies. This means that the response by governments to rising protectionism and global trade tensions will vary. One way for the region to tackle these hurdles is to find common ground and collaborate. Initiatives like the Regional Comprehensive Economic Partnership (RCEP) which include mechanisms to tackle non-tariff barriers to trade can help to facilitate trade and mitigate some of the wider global risks.”

Additionally, the Chief Strategy Officer of an Australian infrastructure company suggests that while trade disputes and protectionism were issues before the pandemic, the global health crisis may in fact be making matters worse. “Trade disputes and protectionism have increased in many of our markets. After the pandemic, governments may put more emphasis on internal development and giving higher priority to local businesses,” says the respondent.

2.2 Supply chain disruption is a motivating force for change

Similar concerns are driving sentiment regarding supply chain disruption as a major risk. Many respondents (33%) recognize this as a problem they will face even as the pandemic subsides as protectionism continues to spread, possibly intensified by the global health crisis.

According to the Chief Operating Officer of an Australian shipping manufacturer, “Over the next 12 months, we will have to be careful in restoring supply chain feasibility. With the changing political scene in the US, we have to watch out for new political decisions that would affect businesses.” Another respondent, the Head of Operations at a Japanese beverage maker, says that, “The supply chain disruptions during COVID-19 could be problematic in the next 12 months as well. We have to seek new vendors to secure the key ingredients for our products.”





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“We will bring legal advisors in for compliance management. The regulations for healthcare product manufacturing and distribution are changing and we want to be free of any legal issues.”

Chief Financial Officer Officer, Mainland Chinese pharmaceutical company

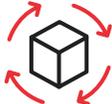
2.3 Compliance and shifting regulatory goal posts

Respondent commentary shows a recognition of challenges with regard to compliance and shifting regulations on a regional and global scale — 42% of respondents say they will require legal support in this domain. Among them, the Head of Risk at a Chinese insurance provider shares that compliance and regulatory scrutiny will be a major risk as it relates to restrictions on the application and use of customer data. As supply chains and data management are increasingly interlinked, this is becoming a major factor in supply chain reorganization.

Concern over compliance and regulation is particularly true of businesses pursuing growth through cross-border investments. The Chief Operating Officer of a Thai manufacturing company emphasized that the business intends to “[...] bring in external advisors to assess the compliance and regulatory framework in case of new market entry [to] ... provide us [with] detailed reports and environmental analysis data.”

3 Transformative Changes Abound

Across geographies and industries, business leaders in Asia Pacific are taking various measures — from minor to transformative — to address trade barriers and disruptions to their supply chains.

 <h3>Shifting Investment</h3>  <p>24% of respondents intend to move major investment to jurisdictions where barriers to investments remain lower.</p> <p>38% of respondents intend to move some investment to jurisdictions where barriers to investments remain lower.</p> <p>34% of respondents are now focusing primarily on investing domestically.</p>	 <h3>Supply Chain Disruption</h3>  <p>73% of respondents are diversifying their supply chain geographies.</p> <p>46% are on-shoring</p> <p>78% are near-shoring</p> <p>67% are insourcing</p> <p>42% are pursuing a Mainland China + 1 strategy</p>	 <h3>Supply Chain Resilience</h3>  <p>91% are building in greater flexibility and contingencies to switch supply lines if needed.</p>	 <h3>Responses to Rising Protectionism</h3> <p>In response to increased protectionism:</p>  <p>35% of respondents say they have already transformed their production, sourcing and supply chain.</p> <p>32% of respondents say they are currently transforming their production, sourcing and supply chain.</p> <p>15% say they are making small changes.</p> <p>Only 19% say they do not see a need to respond or change in response to increased protectionism.</p>
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“Domestic investments would be far more favourable. We can get revenue numbers back up to the 2019 levels if we are focused on domestic investments. We can think about global investment targets after the business has stabilized.”

Chief Financial Officer, Mainland Chinese pharmaceutical company

3.1 Investors are looking inward

Foreign investment restrictions and trade tensions are causing business leaders to move quickly to secure supply chains and almost all respondents are taking action today. More than half (62%) have already redirected investments toward jurisdictions with lower barriers to entry — and of these, 24% say such diverted investments have already been substantive.

A third of business leaders (34%) are rethinking their investment strategies completely, emphasizing a focus on domestic markets rather than those offshore. These sentiments are most prominent among Thai and Mainland Chinese business leaders, more than half of whom think their businesses will have greater success by focusing on the home front. The Head of Strategy from a Mainland Chinese bank shares that “[their] main focus will be domestic investments. At least for the next three to five year period, we will invest in growing companies. Overseas investments have become more risky.”





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“We have already transformed our production and sourcing. We do not rely on the regions that pose higher risks amid the increased protectionism. We are sourcing some materials from new regions.”

**Head of Finance,
Japanese manufacturing company**



“Diversifying is one of the best options to mitigate risks to some extent. For instance, if protectionist policies are introduced in one region, we can lower our market presence through mergers or divestments and concentrate on more feasible opportunities.”

**Chief Financial Officer,
Indonesian insurance provider**

3.2 Adjusting to the rise of protectionism

The increasing spectre of protectionism, is prompting transformative change toward supply chain management at companies across Asia Pacific. Two-thirds of respondents (67%) say they have already or are currently transforming their production, sourcing and supply chains. Another 15% are prepared to make small changes to protect these aspects of their businesses.

Respondents from Japan and Australia expect the most drastic change, with large numbers of respondents in both jurisdictions saying that transformative change will happen to their supply chains somewhere in the near-term future. According to the Chief Strategy Officer of an Australian infrastructure company, “The necessary transformation strategies have already been implemented. As we saw that protectionism was changing the business atmosphere and decisions of global companies, we also made changes to our supply chain.”

Perhaps due to their focus on their enormous domestic market, Mainland Chinese respondents (and subsequently those from Hong Kong SAR) had some of the lowest numbers citing expected transformations to their supply chains.

Regardless of jurisdiction, most respondents (91%) say building in greater flexibility and contingencies to switch supply lines if needed is the best course to take in the current environment. Large numbers of respondents are also near-shoring (78%) or insourcing (67%) portions of their supply chains as they bring these closer to home.

Still, 73% say diversifying geographies presents the best bet to safeguarding supply lines. “Diversifying geographies will work towards building the flexibility of operations. Supply chains will become stronger. Providing for the demands of the end users would be easier,” says the Chief Executive Officer of a Japanese manufacturing company.

“Despite the combined large population of countries in the region, the challenges for supply chain diversification, particularly in South East Asia, center on diversity of geographies, political conditions, legal certainties, ease of doing business and investment incentives for foreign investors.

These conditions do not provide a level playing field across the region, which enables foreign manufacturers to consider this region as the unified market. On-shoring or near-shoring can be feasible in the region, but benefits are more obvious for industries which can operate under automation and digitalization such as IT and tech sectors.

In general, due to the array of different business languages in the region, as well as the fact that individual countries do not operate as one single market or a single supply chain hub, the key challenge ahead is to streamline different legal and licensing requirements, and national standardization between countries.”

**Cahyani Endahayu (Icay)
Partner, Jakarta**



4 Spotlight on Australia



Australia on the Radar



of respondents expect Australia to have far greater or somewhat greater influence in the region.

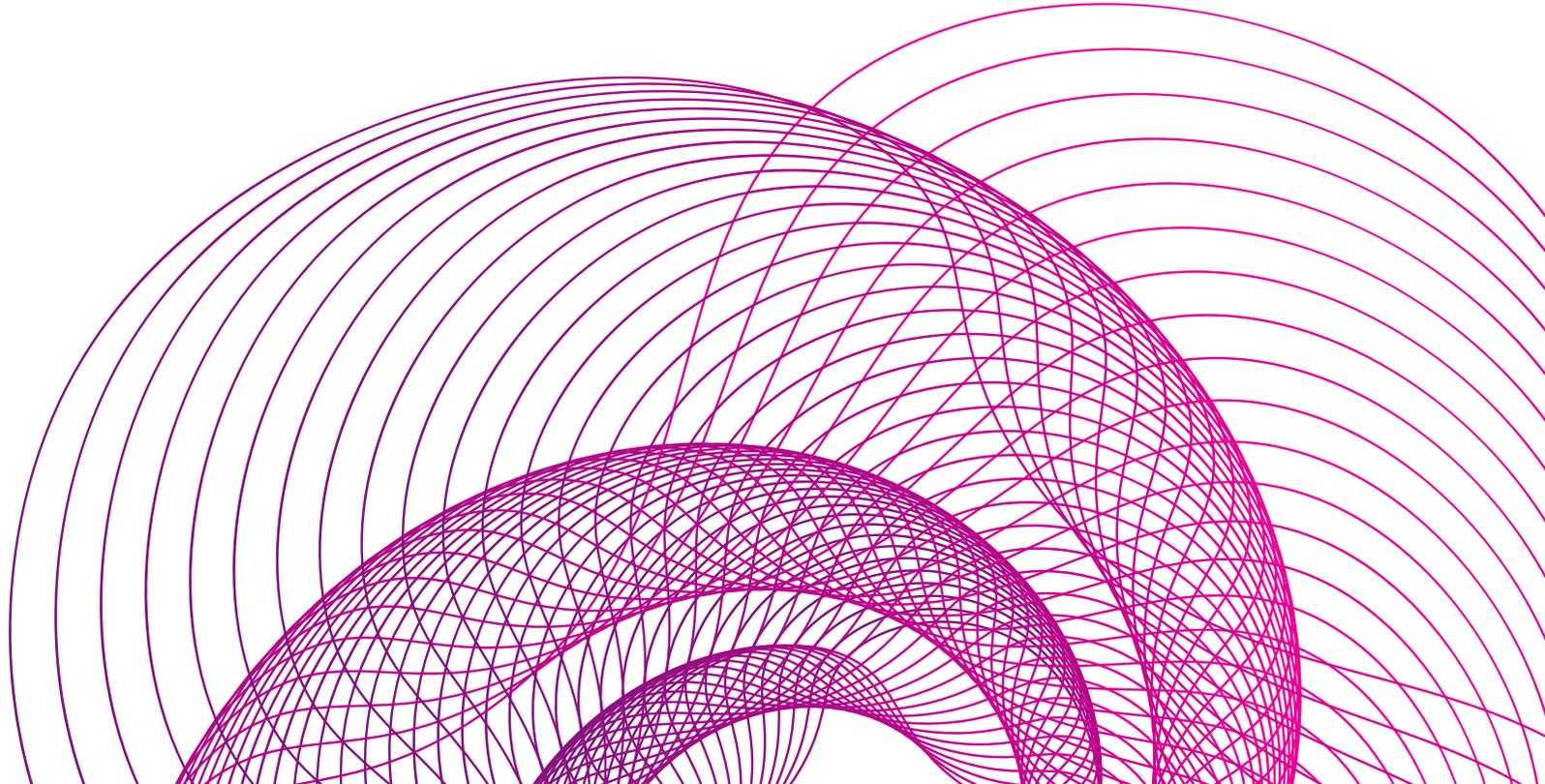


of respondents list Australia as the top new supply destination, followed by Europe excluding the UK (**66%**) and North America (**62%**), UK (**62%**).

Respondents cite that Australia’s economic resilience and strong fundamentals will allow it to see expanded economic influence. Indeed, 89% see Australia’s rising influence and potential as a plus for the region. Highlighting Australia’s advantages, the Head of Risk at an Australian manufacturing company says that “Australia is showing more development in niche sectors. The renewables industry is being given more focus, and there are more investors as well.”

Petterd notes that “Australia’s V-shaped recovery is an indication of economic rebound, which could be a contributing factor to the country being cited as a top destination for select new supply in the region. Recovery was bolstered by increased household spending toward the end of 2020 and government support through the pandemic. Another key area of focus is the positive sentiment towards investment in renewables in the country.”

In addition, a remarkable three quarters of respondents (76%) across the region say Australia is now a primary market for new sources of supply, markedly above other key markets like Europe (66%), North America (62%) and Mainland China (54%).





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Conclusion: Forward-looking Perspectives

As businesses navigate business renewal and pursue opportunities for growth through strategic change, much will be dictated by the ongoing roll-out of COVID-19 vaccinations. This will set the pace for the easing of border controls and other restrictions related to the movement of goods and people.

Chung Seck, Partner, Ho Chi Minh, considers the factors of consideration for business transformation, “Whilst labor costs have been and will remain a key consideration for large scale manufacturing, other important factors will be weighed too — this includes the skill level and productivity of the workforce, the level of efficiency that can be achieved with Fourth Industrial Revolution (IR4.0) tools that leverage on digitalization, AI, and IoT, as well as ESG considerations, in particular, the impact on environment and involvement of slavery. The adequacy of infrastructure is another important component, and apart from road and port access, power supply and connectivity would be paramount, in particular if producers are pursuing IR4.0 solutions. Additionally, socio-political stability is another key factor that will drive shifts in supply chains as well as the relocation of regional HQs and talent.”

With supply chain complexities remaining at the crux of trade realignment, businesses will need to carve out competitive advantage in both the nearer and longer term landscape. To do so, businesses will need to assess current risks, focus on key drivers of renewal and take action now, rather than later.

Crucially, key decisions that lie at the intersection of legal and business issues must take precedence in order to balance buffering against future shocks and paving a roadmap for sustained success in the future.

How will regional efforts shape the road ahead?

“We expect to see multilateral trade and investment agreements, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership (RCEP), compel shifts in supply chains and relocation of production hubs, and opening of new market and investment opportunities for the member states.”

Chung Seck
Partner, Ho Chi Minh

Where does the US feature in AP supply chains and trade?

“The US is still one of the biggest investors in ASEAN. US President Biden’s Executive Order (EO) called for federal agencies to conduct a review of supply chains for critical goods, including pharmaceuticals and large capacity batteries, and continued US investment in Asia Pacific will be crucial to secure US supply chains.”

Continued US investment will provide opportunities for Asia Pacific countries to supply semi-finished products and to be involved in the larger multi-jurisdictional supply chain activities.”

Riza Buditomo
Partner, Jakarta

What roles does sustainability play?

“Given the momentum of wide-scale supply chain remodelling in the region, businesses are looking to become more agile by innovating, automating and implementing more technology throughout their operations. As more businesses pivot to an e-commerce model, “green” packaging, waste reduction and smart management of vehicle loads may feature more prominently in sustainable supply chain strategies.”

Kana Itabashi
Partner, Tokyo

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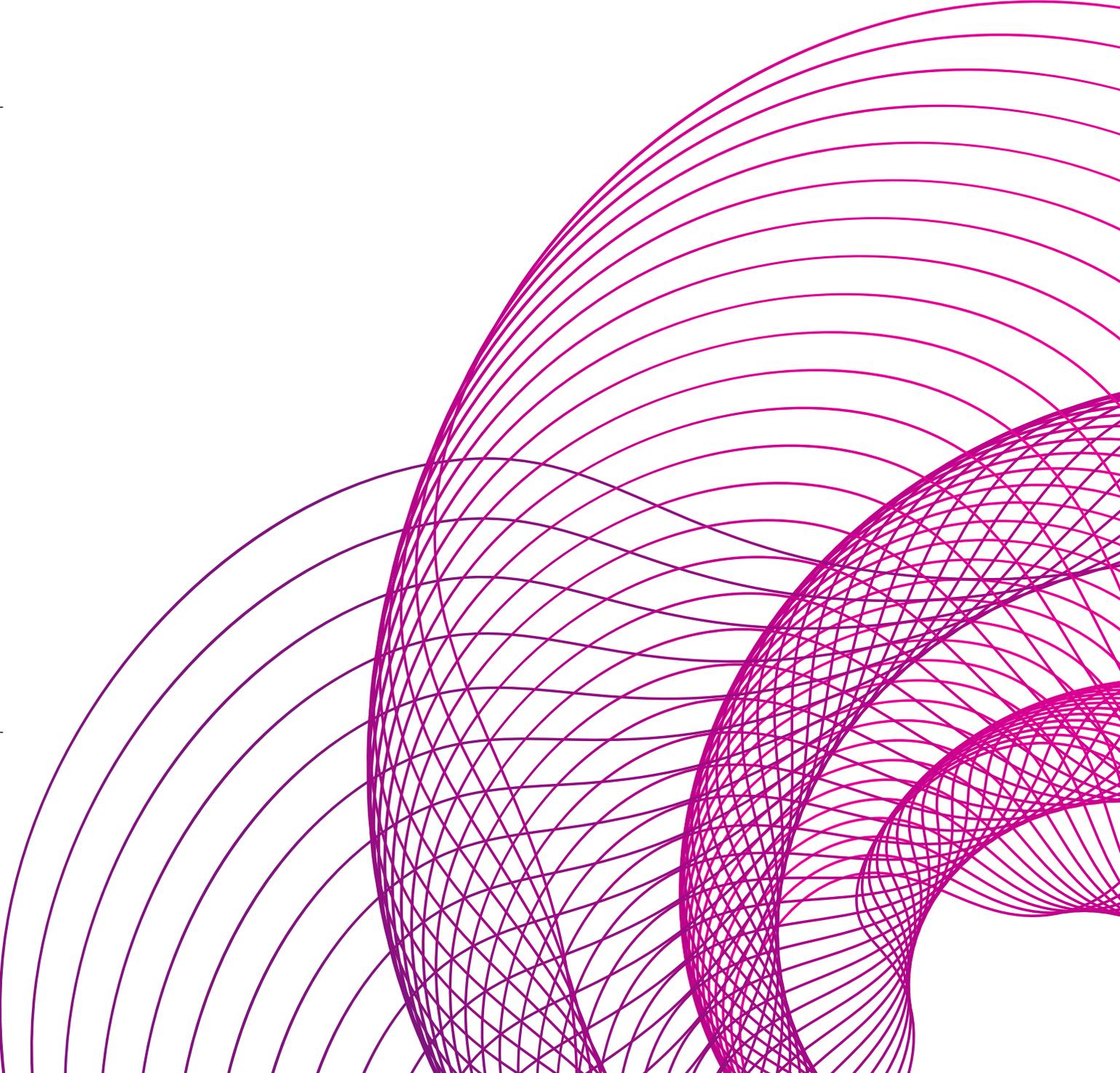
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Appendix of Charts

All chart data derived from research conducted in partnership with Acuris in Q1 2021.

FIGURE 1. WHEN BUSINESSES EXPECT TO REACH 2019 REVENUE LEVELS (BY SECTOR)

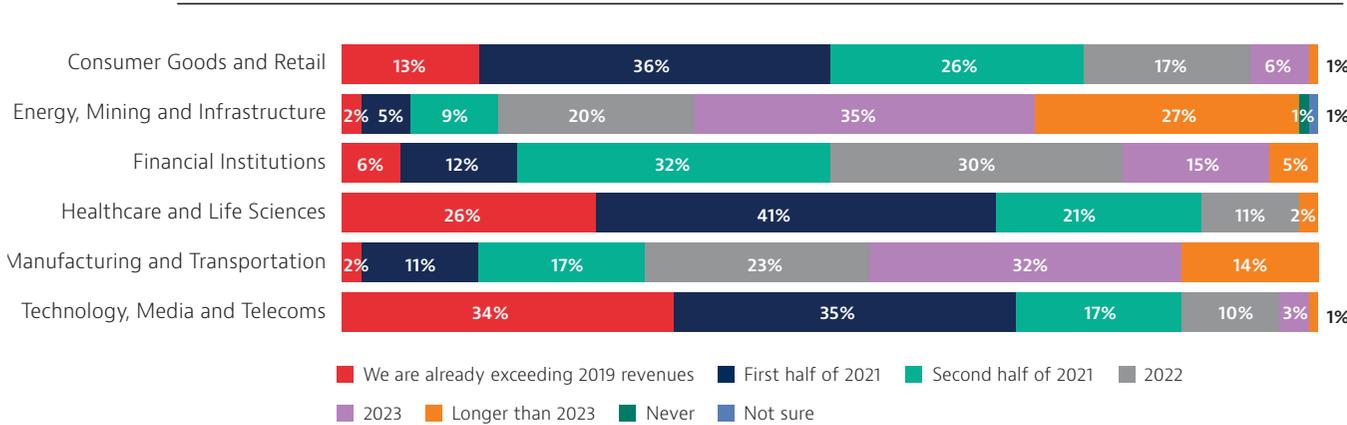
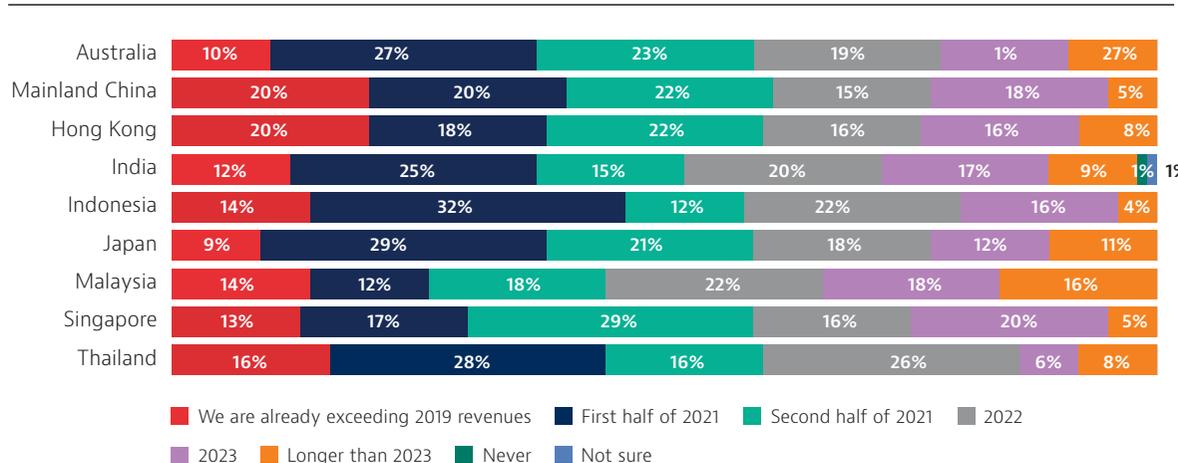


FIGURE 2. WHEN BUSINESSES EXPECT TO REACH 2019 REVENUE LEVELS (BY JURISDICTION)



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FIGURE 3. IMPACT OF INCREASED PROTECTIONISM AND TRADE TENSIONS ON MANAGEMENT OF PRODUCTION AND SUPPLY CHAIN

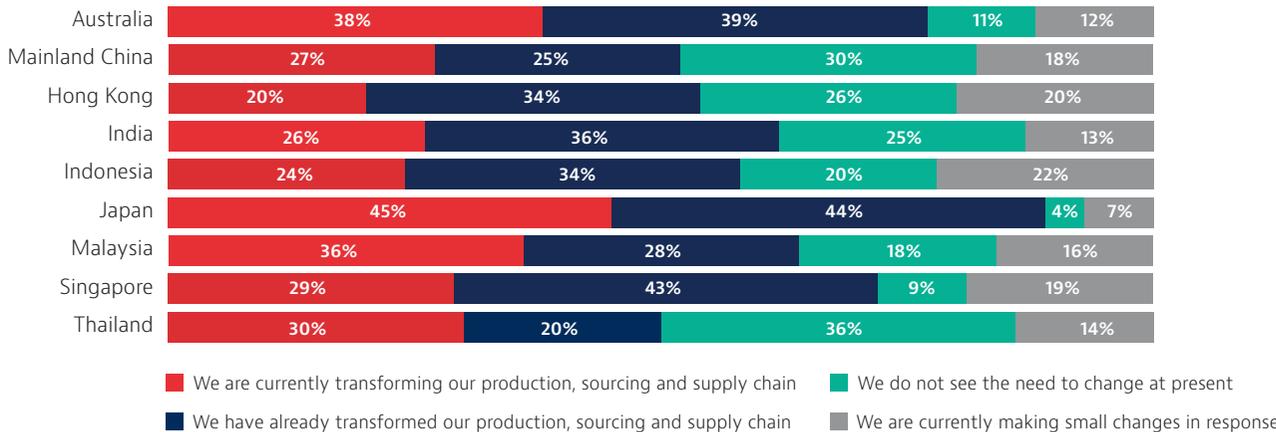


FIGURE 4. IMPACT OF INCREASING FOREIGN INVESTMENT RESTRICTIONS ON SOURCING AND INVESTMENT STRATEGY

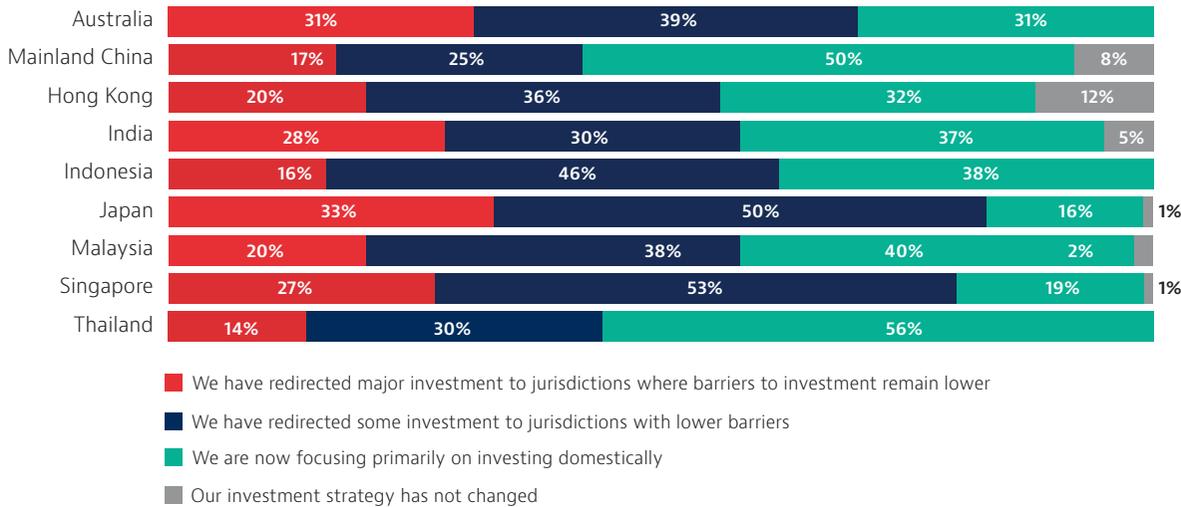
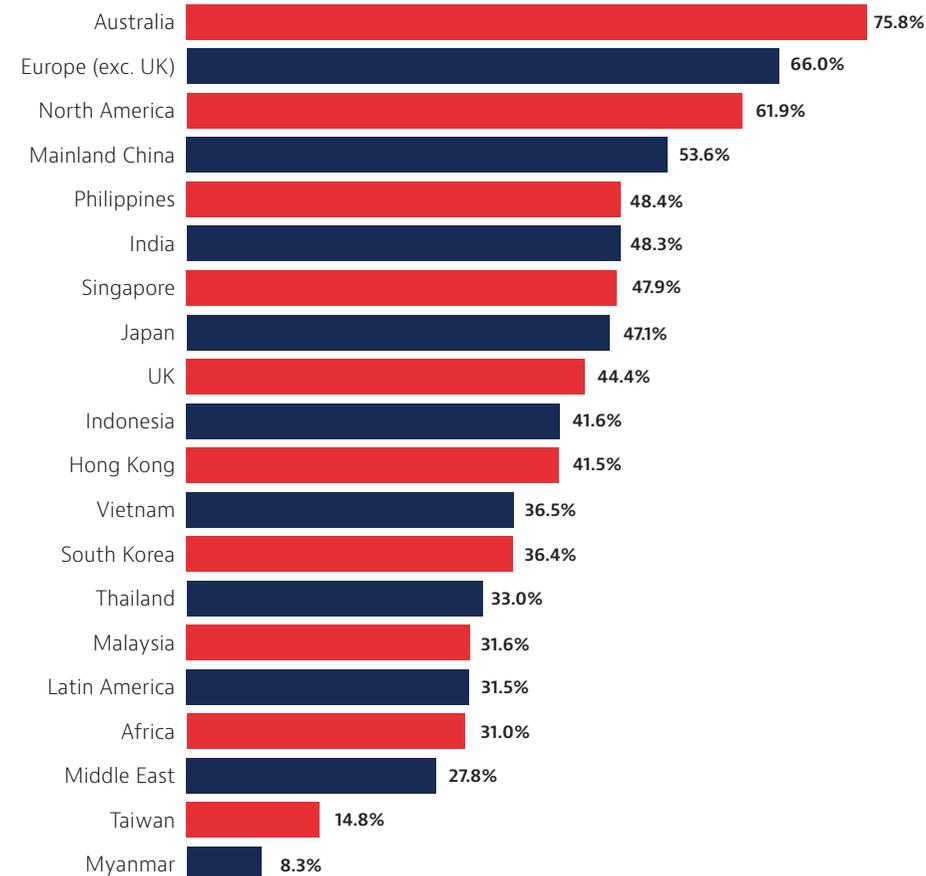


FIGURE 5. NEW SUPPLY DESTINATIONS



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