ASIA MONTHLY

September 2023

株式会社日本総合研究所

https://www.jri.co.jp/en/reports/asia/

This report is the revised English version of the September 2023 issue of the original Japanese version (published 28th Aug.).

Topics *Chinese IT firms driving digitalization in Southeast Asia*

Chinese IT companies are contributing significantly to the digitalization of Southeast Asia. Leveraging the technological strength and know-how they have accumulated in their home market, they are now supplying a variety of digital products and services as well as digital infrastructure.

■ Digitalization in Southeast Asia and the role of Chinese IT firms

In Southeast Asia, digitalization is progressing in many areas of society, from shopping to payments and communication, and the COVID-19 pandemic has accelerated this trend. Alongside local startups, Chinese IT companies are driving this digitalization.

First, Chinese-branded budget smartphones began to be sold in Southeast Asia in the 2010s, and this was a major factor in the proliferation of smartphones in the region. At the same time, it spurred the emergence of various Internet services, such as electronic commerce (EC), that were designed specifically with smartphones in mind. Although the Chinese-branded smartphones were initially inferior to those from developed countries, their manufacturers gradually improved their performance and functionality while keeping their prices low, and they continue to sell well in Southeast Asia today.

In the EC space, a major Chinese IT firm acquired a local startup in 2016. This startup held the top market share at the time and has continued to operate under the same brand name since then. While competition is fierce with numerous companies entering the Southeast Asian EC market, this Chinese brand has maintained the leading market share thanks to multiple infusions of capital from its parent company. Recently, another big Chinese IT company has entered the Southeast Asian EC market, triggering a new wave of battle for market share.

In addition to operating their own digital-related businesses in Southeast Asia, Chinese IT firms have also been enthusiastic investors in local startups. Most major local startups have received investment funding from Chinese IT companies. Local startups perceive advantages from accepting cash from Chinese IT firms, as not only do they benefit from the funding, but also from the provision of various technologies and know-how.

More and more Southeast Asian governments are also seeking the cooperation of Chinese IT companies to advance digitalization in their countries. A prime example of this is that since 5G (5th generation mobile communication systems) became available for commercial services worldwide in the late 2010s, Chinese telecom equipment giants have been developing base stations and networks in partnership with Southeast Asian governments. The Chinese companies are also using this as a springboard to provide a variety of 5G services.

In addition, Chinese IT firms now often collaborate with Southeast Asian governments in the construction of data centers and the development of smart cities. In the past, low prices were generally the primary source of Chinese IT firms' competitiveness, but the level of their technologies has gradually increased, and in some fields, they have reached par with or even gone beyond the tech level of IT companies from developed countries. Reflecting this, collaborations now extend to giving advice on digitalization policies, developing IT talent, and providing cross-border EC support to small and medium-sized enterprises (SMEs).

■ Popularity of Chinese digital brands among consumers

Chinese IT companies are playing a major role in digitalization in Southeast Asia, and this can be seen in the results of surveys of which brands are highly regarded by consumers. According to a survey of consumers in six major Southeast Asian countries conducted by advertising industry media Campaign Asia-Pacific, 16 of the top 50 brands for customer experience were digital-related (see figure on next page). And out of the top 10, six are digital-related. The line-up includes EC, ride-share apps, social media, and smartphone firms, most of which were founded after 2000. This suggests that digital-related startups are on the rise in Southeast Asia.

Six Chinese firms are in the list of the top 50 brands, and five of them are digital-related, so tech companies dominate. This confirms that up-and-coming Chinese brands are in demand among consumers. The results for U.S. and European companies are quite different. While there are large numbers of U.S. and European firms in the list (16 and 14, respectively), only four and two, respectively, are digital-related companies, with non-digital firms making up the majority. As for Japanese companies, four are ranked among the top 50, but none of them are digital-related.

■ Chinese firms' strengths: Financial clout as well as technology and know-how accumulated in China

How have Chinese companies been able to become the key players in the digitalization of Southeast Asia? The first reason is that Chinese IT firms, which had already achieved success and swelled to massive sizes in their home market, were able to pour huge sums of money into their forays in Southeast Asian markets. Their deep pockets have been particularly useful in acquiring or investing in local startups. Another factor has been their ability to deploy the advanced technology and know-how they have accumulated in their home market to expand their operations in Southeast Asian markets. In the background to this is the fact that an expansive virtuous cycle has been realized whereby China has digitalized and the IT companies that have played the leading role in this process have grown large, which in turn has further propelled digitalization in both China and its neighboring countries.

On the other hand, the reasons that Chinese IT firms are focusing on Southeast Asia include not only the region's high potential, but also their need to find avenues for growth overseas as China's domestic market is maturing and room for further growth is shrinking. As more countries become difficult to expand into due to the U.S.-China and India-China rivalries, Southeast Asia is attracting attention as a region that is relatively unaffected by these geopolitical confrontations. Given these circumstances, Chinese IT companies are expected to further expand into Southeast Asia going forward.

＜Breakdown of Top 50 Brands for Customer Experience in Southeast Asia by Head Office Location＞

(Companies)

Date of Foundatin	No. of companies						
		U.S.	Europe	China	Southeast Asia	Japan	Other
Total <of which digital>	50 <16>	16 < 4>	14 < 2>	6 < 5>	5 < 4>	4 < 0>	5 < 1>
1980s or earlier <of which digital>	35 < 2>	13 < 1>	12 < 0>	1 < 0>	1 < 0>	4 < 0>	4 < 1>
1990s <of which digital>	2 < 2>	1 < 1>	1 < 1>	0 < 0>	0 < 0>	0 < 0>	0 < 0>
2000s <of which digital>	5 < 4>	2 < 2>	0 < 0>	2 < 2>	0 < 0>	0 < 0>	1 < 0>
2010s <of which digital>	8 < 8>	0 < 0>	1 < 1>	3 < 3>	4 < 4>	0 < 0>	0 < 0>

Source: Prepared by JRI based on Campaign Asia-Pacific, "Top 50 Brands for Customer Experience," May 18, 2023 (https://campaignasia.com/article/southeast-asia-top-50-brands-for-customer-experience/484506)
Note 1: The survey targeted consumers aged 16 or over in Singapore, Malaysia, Thailand, Indonesia, the Philippines, and Vietnam. The brands were ranked after a process comprising three stages:
1) Consumers were asked to name a brand they believe offers the best customer experience (CX).
2) From the names that came up, brands operating in at least three of the six countries surveyed were selected.
3) Consumers were asked to rate the brands selected based on five dimensions of CX: quality, buying experience, customer service, advocacy (support/protection), and brand touchpoints.
Note 2: The table shows the number of brand-providing companies whose head office or parent company's head office is in each country/region. China includes Hong Kong.
Note 3: <of which digital> refers to companies providing digital-related product/service brands.

(Kaori Iwasaki)

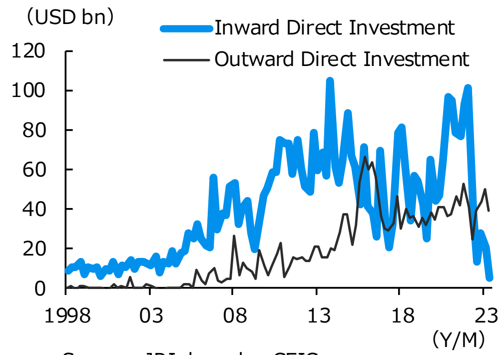
Topics The U.S.-China conflict is making business into China riskier

Tighter U.S. regulation relating to China and retaliatory moves by China have heightened the risks posed to foreign companies entering the Chinese market. This elevated risk level could prolong the downturn in direct investment into China.

■ The Chinese government is proactively trying to attract foreign firms, but direct investment has plummeted

Inward direct investment (flow) into China declined sharply in the April-June quarter, plunging 87% year on year. The increase of foreign direct investment has been the driving force in elevating China to the status of "the world's factory," but has been slowing, with this downward trend becoming more pronounced from the second half of 2022. According to a survey by the American Chamber of Commerce in China (released in March 2023), 45% of U.S. companies (60% in the previous year) ranked China as a top-three investment priority in their near-term global investment plan. This was the first time since these surveys began that the figure had fallen below 50%. Similarly, a survey carried out by the European Union Chamber of Commerce in China (released in June 2023) found that 48% of European firms are considering expanding their business in China (previous year: 62%), dipping below 50% for the first time in seven years. Foreign investment remains an important source of growth for China's economy, which has expanded rapidly through increased trade since the country joined the WTO in 2001. The Chinese government has indicated that its policy is to support foreign investment in China. At the Boao Forum in March this year, for example, Premier Li Qiang stressed that the government will assist foreign firms expanding into China. However, little effect has been seen so far.

<Direct Investment in China>



Source: JRI, basedon CEIC

■ More stringent U.S. regulation relating to China has prompted retaliation by China and the business environment there has deteriorated significantly

One factor contributing to the stalling of investment in China by foreign companies has been growing uncertainty about the outlook for the Chinese economy. In 2022, with China still pursuing its zero-COVID policy, activity restrictions, most notably a lockdown in Shanghai, were imposed one after another, and this significantly worsened the business environment for foreign firms operating in China. The Chinese government's decision to scrap the zero-COVID policy at the end of 2022 marked an about-turn, and eased the anxiety felt by foreign companies. However, the economic recovery quickly ran out of steam, and China's economy has stalled again recently due to such factors as the real estate market correction becoming more serious. As a result, foreign companies are reluctant to expand their business in China.

In addition to these economic factors, the protracted U.S.-China confrontation has also contributed to the uncertain outlook. Notably, 1) the U.S.-led containment of China and 2) the strengthening of retaliatory measures by the Chinese government seem to have played a part in the sharp decline in direct investment into China.

First, the U.S.-led containment of China has made doing business in China difficult not only for Chinese firms, but also for non-Chinese companies, including those from the U.S. The U.S.-China rivalry started heating up in around 2018, and the U.S. raised tariffs on Chinese imports and tightened trade regulations in the high-tech sector, targeting semiconductors in particular. The U.S. has also been expanding controls on investment. In August 2023, U.S. President Biden signed an executive order to restrict investment in China in areas such as semiconductors and artificial intelligence (AI). Although the tightening of regulations by the U.S. primarily targets Chinese companies, the export ban on such products as advanced semiconductor manufacturing equipment will affect non-Chinese firms as well. Furthermore, the scope of regulation in the high-tech sector may be expanded beyond semiconductors to other areas in the future. To avoid sanctions for regulatory violations, foreign companies have had to be cautious about entering China, and many of the firms already there are now seeking to bring production back home or relocate it to countries other than

China.

The U.S. is also looking to restructure its supply chains to reduce its dependence on China. This can be seen in its increasing efforts to promote "friendshoring," the aim of which is to complete transactions within friendly countries. In May 2023, the 14 countries participating in the IPEF (Indo-Pacific Economic Framework for Prosperity) signed a deal called the Supply Chains Agreement. Semiconductor supply chains outside China are also being strengthened through the "Chip 4" semiconductor alliance comprising Japan, the U.S., South Korea, and Taiwan. Moreover, discussions are underway as part of other frameworks such as the APEP (Americas Partnership for Economic Prosperity), the QUAD (the U.S.-Japan-Australia-India Quadrilateral Security Dialogue), and AUKUS (a trilateral security pact involving the U.S., the U.K., and Australia). It is difficult for firms from countries participating in these frameworks to ignore these discussions and step up their expansion into China.

<Friendshoring-related Frameworks>

IPEF	APEP	Chip 4
Australia	Barbados	Japan
Brunei	Canada	South Korea
Fiji	Chile	Taiwan
India	Colombia	U.S.
Indonesia	Costa Rica	QUAD
Japan	Dominican Republic	Australia
South Korea	Ecuador	India
Malaysia	Mexico	Japan
New Zealand	Panama	U.S.
Philippines	Peru	AUKUS
Singapore	Uruguay	Australia
Thailand	U.S.	U.K.
U.S.		U.S.
Vietnam		

Source: JRI based on various media reports

Second, the Chinese government is strengthening its economic security policies as a countermeasure against the U.S., and becoming more aggressive in terms of retaliation. In the semiconductor field, in May 2023 it banned domestic critical infrastructure providers from procuring products from major U.S. semiconductor memory companies. And in July it announced the imposition of export controls for gallium and germanium, which are used in the manufacture of semiconductors and other products, under the country's Export Control Law and Foreign Trade Law. Outside of semiconductors, it has redoubled efforts to protect China's own critical information, with the enactment of the Data Security Law in 2021. Furthermore, in response to the U.S.'s and other Western countries' imposition of sanctions against China for human rights abuses and other issues, China enacted the Anti-Foreign Sanctions Law in the same year. In addition, the Chinese government is also nervous about confidential information leaking out of the country, and in May 2023 it carried out a raid on a Western consulting firm under the Counter-espionage Law. In July, amendments to the Counter-espionage Law expanded the definition of espionage, increasing the risk that ordinary corporate activities could be construed as spying.

Such developments have inevitably put many foreign companies on guard about the risk of getting entangled in retaliatory measures and tighter controls. The Chinese government has emphasized that it is continuing to implement reform and open up its economy, and it is supporting the entry of foreign firms, but its current moves to beef up economic security are arousing increased suspicion of the Chinese government among foreign companies, and are having the effect of keeping foreign firms away.

■ As U.S.-China clashes continue, it will be even more important for companies to control risks related to their China business

The U.S. had once hoped that bringing China into the international community would lead to democracy there, but it now views that "policy of engagement" as a failure, and at present there is no sign of it rolling back on its confrontational stance toward China. Regulations relating to advanced technologies such as semiconductors could be further strengthened, and the scope of controls may be expanded to encompass critical resources. If that happens, the Chinese government would likely step up retaliation and regulatory tightening, prolonging the slump in direct investment in China.

However, although companies are being forced to scale back their Chinese business, drastically reducing their dependence on the Chinese economy is not a realistic option for them. Given that completely exiting China will be difficult for them, firms will continue to keep an eye on risks and develop their business in ways that minimize negative impacts from the exacerbation of the U.S.-China rivalry.

(Minoru Nogimori)