

# Should I Stay or Should I Go?

Rising prices are driving some companies away from China's traditional manufacturing hubs. But not everyone wants to go

By Katrina Hamlin

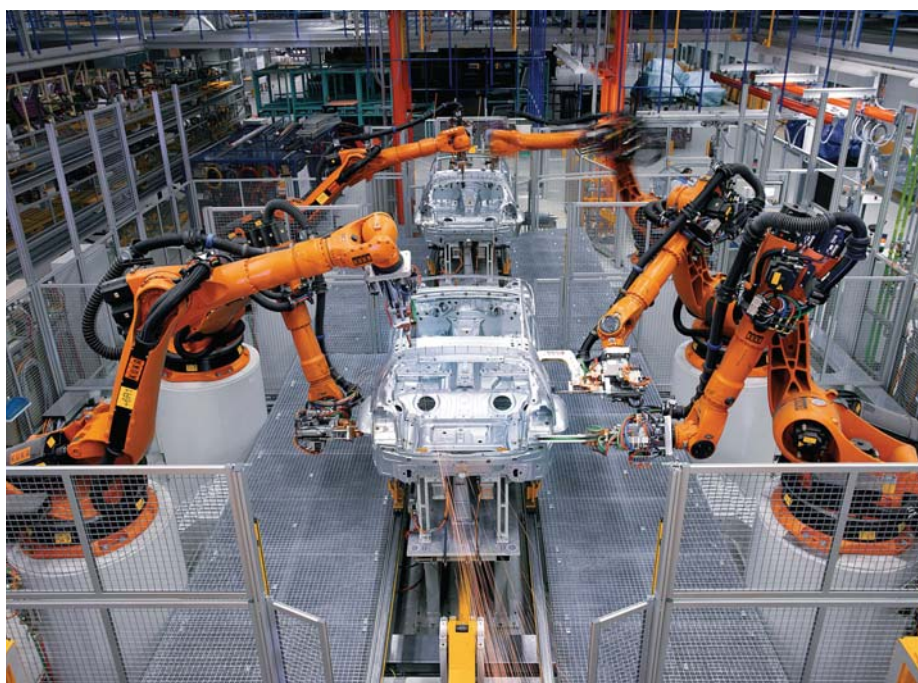
**C**HINA'S MANUFACTURERS are facing double-digit salary increases on top of rising commodity prices and escalating rent. "In March, Li and Fung, a Hong Kong-based consumer sourcing group, suggested that 'a new era in sourcing with higher prices' had come to China," says Alistair Thornton, a China analyst and economist at IHS

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Beijing. "The company's president, Bruce Rockowitz, said, 'The biggest topic on the minds of everyone in this business is that higher prices are really here to stay.'"

In the face of this unattractive change, many manufacturers have chosen to go elsewhere. Factories have migrated to inland provinces, or to alternative manufacturing hubs in south east Asia. "For some manufacturers, a cheaper location is the only solution," says Sergio Zamudio, business development director at SBE International, a China-based consulting company that advises both MNCs and local suppliers on quality improvement projects.

But what if they don't want to go? China's traditional manufacturing



Automation is already widely used in the auto sector in China.

centres on the east coast — especially south east Guangdong — retain a special charm, boasting the know-how and infrastructure necessary to support supply chains and manufacturing processes. At other locations, these systems are still maturing.

"We have buyers moving from the eastern seaboard to inland regions such as Henan and Hubei," says Sébastien Breteau, CEO of AsiaInspection, which provides quality inspection services and factory audits across China and in India. "These regions offer cheaper labour and therefore cheaper products, but

definitely do not have the same maturity of quality offered by Guangdong and areas outside of Shanghai."

"There is a certain stickiness, because manufacturers would like to stay in Guangdong for multiple reasons — the supply chain, infrastructure, set-up, and the economy. India and other developing alternatives don't compare," says Thornton.

This means that manufacturers have to be even more focused on cutting costs and shoring up the competitive advantages of their products. Relocation alone is not enough — rethinking entire

processes will be essential.

## Man Vs. Machine

As early as 2010, the executive vice president of giant manufacturer, Foxconn, which produces electronics for the likes of Nokia and Apple, announced that the company would need to look for new ways to cut costs in the face of rising wages, and suggested that increased automation could be one possible solution.

In July 2011 although some of their processes had already been relocated to cheaper areas in western China the company confirmed that they still saw huge potential in automation. It was announced that the group would increase the number of robots used in their production systems from the current 10,000 to a million by 2013.

In more mature industries, such as the automobile industry, automation is already relatively well established; now it has become increasingly attractive for other manufacturers. “There is a broad trend towards automation,” says Thornton, “Foxconn acts as a leading indicator because of the scale of its operations. If Foxconn does something like this, it could be a sign that this trend is taking root.”

“The continuous development of robot and control technology is establishing robotics across a broad spectrum of different markets. Cooperating robots are optimising and making production processes more flexible, not just in the automotive industry,” says Stefanie Senft, corporate communications executive at KUKA Roboter GmbH (KUKA), a manufacturer of industrial robots. KUKA works with many sectors besides auto, including logistics, plastics, metalworking, foundry, medical technology and entertainment. Senft also points out that there are opportunities developing in other areas, for instance, in the medical sector and the solar industry.

Senft is a great advocate of robotics and its role in the development of China-based industry, and says that manufacturers stand to “benefit from high quality and throughput, as robots never lack in concentration and can

work without breaks. Furthermore, the robots’ great flexibility can be quickly adapted to new and modified cell concepts. Processes are reproducible and quality is improved. Programmes can be written offline in the office while the robot is working. All these allow for the inexpensive production of countless product variants in small batches.”

## Man Power

“You typically use automation when you cannot achieve the same results using manual labour,” says Dr Frank Henze, CEO of IMIG China, a subsidiary of the International Management and Innovation Group (IMIG), a German-based management consulting company providing support to manufacturing companies in China and overseas. He explains that for products such as mobile phones made by Foxconn, there are processes that machines can do more efficiently; “Look at a printed circuit board assembly; you cannot do this with precision, at speed, in quantity, by hand. A machine does it better.”

However, he is very clear that manual labour may be more suitable in other cases. “For instance, after the circuit board has been assembled later in the process, people will be needed to put the body of the phone together,” he says. “Machines are not well suited to perform this particular function. Also, as phone models change so frequently, you will need the flexibility of human workers, who are more adaptable. Automation can make such change difficult.”

In addition, Henze emphasises the need for human talent to maximise the benefit from any system, including automation. “These automated processes will require skilled and well-trained foremen.” Henze sees great potential to increase manufacturing efficiency by developing these operators and managers. “The operators for automated processes need to be trained - there are not enough of them available at present in China,” says Henze.

Whether or not a company opts for automation, Henze adds that human input remains invaluable when it comes to implementing improvements

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and innovations. He stresses the value of constantly thinking through and improving processes, a human function that machines cannot replicate. In particular, Henze describes how a Kaizen or a Lean approach — the continuous assessment of a process to find and implement innovations for improvement — plays a valuable role in the development of operational excellence. “In any process, automated or manual, workers and managers can innovate and improve the system,” he says.

Zamudio also points out that management could be developed to further improve these processes. “The downstream of information can be difficult, because middle managers have



More adaptable robots are bringing automation into different sectors.

▶▶▶ little power. It is necessary to empower them so that they are able to figure out the issues and control the problem.”

To make the most of the potential benefits, companies turning to automation or considering the Lean approach may also need to consider the reactions provoked by any attempt at down-sizing the workforce. Henze compares this point in China’s industrialisation to a similar period 20 years ago in Germany, when a need for cost-cutting drove enterprises to shrink their teams and lay off many employees. “That was the time when the phrase ‘Lean is Mean’ became very popular,” he says.

Foxconn has been careful to sidestep this issue. The announcement that 990,000 robots would join the team was not accompanied by any suggestion that human workers would lose out; instead Foxconn emphasised their desire to prepare their people for more sophisticated roles in research or as operators.

**Quality Assured**

Another way to stay competitive amid rising prices is to increase the emphasis on quality. “We all know why everyone is sourcing from China: lower prices.



Quality is becoming more important as prices rise.

**We see China playing the ‘mature supply’ and ‘quality’ cards. This is not something we saw ten years ago**

But as the supply chain has matured and there is growing competition from other countries, such as Vietnam and Bangladesh, we see China playing the ‘mature supply’ and ‘quality’ cards. This is not something we saw ten years ago when it was all about the lowest price. Importers are more than ever measuring the risks associated with poor quality,

and industry veterans are well aware of the quality to price ratio,” says Breteau from AsiaInspection.

Pressure from overseas regulations may push that forward. “We are seeing stricter regulations on consumer products in Europe and the United States. We’ve seen clients post-production with 50,000 units, which they have had to recycle because these couldn’t be exported to Europe,” says Breteau.

However, Zamudio notes that among local manufacturers, attitudes towards quality control are still developing, and while some may recognise the value of ensuring quality, their current approach could be ineffective. “They may be aware of the problem, but they don’t yet know how to resolve it.”

“Not everyone is comfortable with these processes yet, which are still quite new to

China,” says Henze, “but manufacturers are gradually adjusting. They must. They can’t just wait until their people are prepared for these changes — they have to get ready now.”

**Going Up**

Costs are likely to continue escalating as time goes on. “With China’s developing demographics, wages will rise more rapidly as the labour force changes. Increasing consumption will also require an even higher income, and therefore higher wages,” says Thornton.

He concludes, “China is moving up the value chain, and it will be good for the economy, and for the Chinese worker.” But manufacturing companies will have to keep an even sharper eye on costs on quality if they want to benefit. **SBR**