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The Exodus Of Chinese Manufacturing: Shutting Down ‘The World’s Factory’

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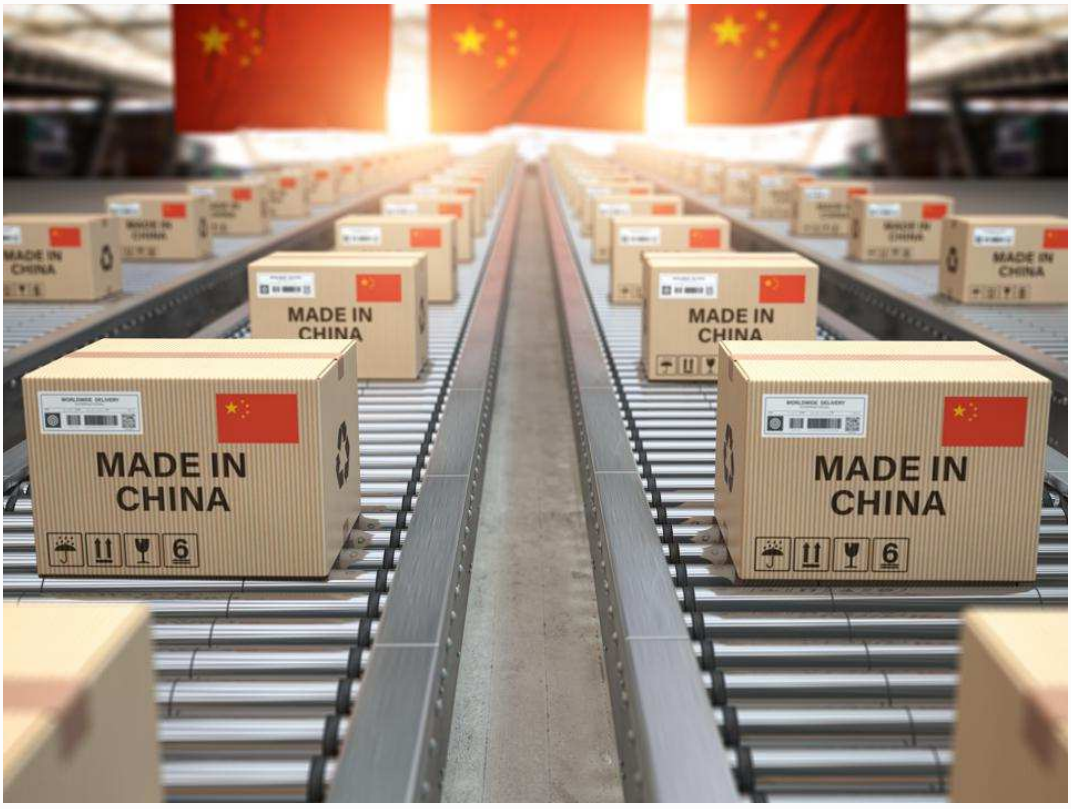

Made in China. Cardboard boxes with text made in China and chinese flag on the roller conveyor. 3d ... [+] GETTY

It's not breaking news that manufacturing is leaving China.

Over the last twenty years, Chinese manufacturing has dominated over the rest of the world. This was driven primarily from optimized shipping lanes and extremely cheap labor rates by way

of government subsidies. These two benefits made enough sense financially for brands to withstand quality issues, shipping timelines, communication barriers, and annual production delays during the Lunar New Year timeline.

However, in the last 3 months, Chinese manufacturing got hit by what can only be described as "a perfect storm" of incidents. A mixture of longstanding issues and new challenges such as high tariffs, Covid-19, and increased geopolitical tensions have resulted in a mass exodus from Chinese manufacturing, and triggered the start of the downfall of the country's manufacturing dominance.

To understand what might make China fail however requires an understanding of what made China's manufacturing economy so successful in the first place.

The rise of Chinese manufacturing

China grew to become the "world's factory" over the course of the last 40 years. This started with former president Deng Xiaoping ordering an economic reform in the late 1970s and introducing the concept of a free market to China for the first time.

All of a sudden, a mixture of loosened state regulations and access to the world's largest, youngest, workforce in the world made China the perfect place to outsource manufacturing. Cheap labor rates and proximal access to quickly growing consumer populations in Southeast Asia made China one of the most lucrative business hubs in the world. It quickly overtook the United States in 2011 to become the world's largest manufacturer driving growth in the nation's GDP by 40%.

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Over the course of these forty years, the world around China also underwent an enormous digital transformation. Consumer electronics proliferated homes and workplaces with paper and pens replaced by phones, tablets, and computers for nearly every knowledge worker.

Through quick planning, China was able to quickly adapt its manufacturing capabilities and develop specialized industries like electronics and PCB manufacturing. Entire cities like Shenzhen were constructed for the sole purpose of enabling more rapid manufacturing of consumer electronics.

This maturation point in China's exponential growth curve however, led to a few unforeseen circumstances.

The price and speed at which China was able to produce goods started to slow as the country's population grew and its presence on a global stage drew attention around environmental and wage regulations. Specialization drove labor rates up, resulting in the average manufacturing hourly labor rate settling at about $6.50 an hour, up almost 20% from previous years.

trade war between USA and China GETTY

A global trade war with the US spurred by the Trump administration also dealt a fatal blow towards Chinese manufacturing. This has resulted in not only decreased export volume to the US, but also to other countries facing American pressures to reduce global dependency on Chinese manufacturing. Analysis reports that Chinese exports globally have estimated to drop by $25 Billion since the tariffs were first implemented.

And amidst geopolitical uncertainty, Covid-19 has pushed Chinese manufacturing to the brink of shut downs. The lunar new year, followed by immediate Covid-19 shut downs, created bottlenecks throughout the supply chain. Raw materials weren't sourced fast enough from upstream suppliers, creating delayed lead times and choked end customer deliveries.

For modern US companies, both startups and giants alike, supply chain risk has been top of mind. Companies are diversifying their supply chains to mitigate risks earlier and earlier in their production cycles, leaving no risk of being caught empty handed for the next global pandemic.

Where is manufacturing going?

This raises an interesting question: if manufacturing is leaving China, where is it going next?

Amidst numerous attempts to drive re-shoring efforts, US manufacturing still suffers from problems of labor skills and wage costs. Tariffs have succeeded in lowering global dependency on Chinese manufacturing, but they have failed in driving manufacturing back to the US.

USA and China trade war. US of America and chinese flags crashed containers on sky at sunset ...
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Global consulting firm Deloitte recently ran a report around expansion and optimization of US companies manufacturing bases. Upon surveying hundreds of manufacturing executives about decision making post Covid-19, the report highlighted top goals for brand executives when deciding where to expand new manufacturing bases. These included:

New market opportunities

Proximity to existing accounts

Talent availability, educational infrastructure

Business disruption risk

State technology advances.

Therefore, given proximity to a ballooning population base and relatively lower wage rates, Southeast Asia still remains a lucrative opportunity for brands looking to outsource manufacturing.

Conveniently, as Chinese manufacturing began its decline, other Southeast Asian countries nearby started quickly gearing up to take over some of Chinese business.

Individual countries started eating up niche specialities. Vietnam, for example, made massive efforts to grab everyday apparel manufacturing. Popular sportswear brands like Nike NKE and Adidas have rapidly re-allocated a vast majority of manufacturing and footwear base to Vietnam, from China.

Thailand has seen an increase of about 19.7% export volume from the US, specializing in automotive, food and beverage, and natural rubber manufacturing. Thailand also offers some competition to China in electronics manufacturing.

Indonesia has also emerged to be a new player in the space - appearing particularly attractive for companies seeking to relocate from China. President Joko Widodo of Indonesia has been incredibly keen to jump on the Chinese manufacturing exodus by presenting close to $1 Bil in federal investments through the creation of an industrials park in Java, Indonesia.

India, another global superpower with a quickly expanding consumer base and previous manufacturing know-how, is also attempting to reclaim a spot as a world exporter. India already has a massive auto, food, and apparel manufacturing base. Apple AAPL recently released an intent to start manufacturing the iPhone 11 at a Foxconn owned CM plant in Chennai. There's also talk of assembly of an iPhone SE 2020 at a Wistron plant near Bangalore. Pharmaceutical companies are also turning towards Indian

manufacturers for a more reliable production base. Most notably, AstraZeneca will be utilizing Indian contract manufacturer, the Serum Institute, to manufacture its newest Covid-19 drug.

Mexico and Brazil have also grabbed the spotlight and gained huge manufacturing market shares in the automotive space for both internal country production as well as export purposes.

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Can China save its presence?

Amidst the stagnation in Chinese production, it's critical to recognize China's success in manufacturing, as well as its potential to retain its role in some portion of the world's supply chain.

Manufacturing executives globally still look to Shenzen for supplying micro-electronics (from Peloton components to phone chargers), and if properly handled, China might be able to save itself from a manufacturing driven economic free fall by cementing

itself in as not necessarily the "world's everything factory", but the "world's electronics factory".

Shenzen still retains the ability to be the world's leader in electronics development specifically for post fabrication and assembly portions of the supply chain. Through investment in operational efficiency, customer satisfaction, and supply chain transparency and simplicity, China has the ability to continue to serve as a preferred partner for global companies.

China went from being a low income nation to enduring a period of enormous growth through specialized manufacturing. As the world became more dependent on software and robotics to automate every part of our homes and workspaces, China ramped up production to deliver on that dependency.

Developing strategic trade corridors, investing in maritime safety to guarantee a US-China shipping lane, and pouring massive amounts of infrastructure into port systems enabled China to quickly rise to power as the world's preferred manufacturing partner.

But at the end of the day, rise in labor rates and more globalized calls for regulations have driven up prices of Chinese manufacturing, forcing not only international companies, but also Chinese based ones, to turn elsewhere for their supply chains.

guangdong GETTY

Over time, China developed a niche in electronics manufacturing - effectively constructing and scaling the city of Shenzhen to greater than 20 million in population between 1998 and 2017. As the worlds desire for electronics grew, China specialized to meet demand by cutting new tooling and developing a new workforce specializing in lower end electronics production. But with this came downsides - a more specialized labor workforce pushed up wage rates - driving companies to move manufacturing bases out of China to other Southeast Asian countries.

All eyes will be on China over the next few months, and years, to see if they can continue to remain their global manufacturing presence in the post-Covid 19 economy.

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Prince Ghosh

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