Business Theory

Best Practices in Operations Management

China's Supply Chain Rocked by 13.6% Labor Cost Increase

Posted by Tim Filed Under: Supply Chain Management 4 Comments

Park jobs being brought back because of lower labor costs? Or, are political factors affecting the decision?

As discussed in an interview with a U.S. manufacturing executive who lived in China for 13 years, global manufacturers who are looking to minimize their labor costs are locating factories in Viet Nam, not China**.** This strategy—chasing every cent of labor savings—requires rejiggering the supply chain every few years. Vietnam's minimum wage is only US$85 per month (or $1,020 per year). Thus, **Chinese workers are paid 282% more than Vietnamese workers.**

Although the labor differential gap between the U.S. and Asian countries is narrowing, it is still significant. Offshoring will continue to be attractive to firms with products that have

- High labor content
- Large Production volumes
- Low variety
- Low transportation costs

Products that meet these criteria—such as electronics assembly—will most likely never return to the U.S. Furthermore, in certain industries—for example, in computer and cell phone production—most of the companies that comprise the supply chain are situated in Asia. Given this reality, moving production to the U.S. would be uneconomical. In these industries, hoping for backsourcing to happen is like waiting for an airplane to touch down that is simply not going to land [on U.S. shores].

In conclusion, the key determinant in terms of where to produce is based on total cost, not just labor cost. One must begin by looking at the manufacturing process to determine where the most economical location is. Although China's increase in its minimum wage is significant, it is just one of many factors to consider.

What do you think? Is there a future for manufacturing in the U.S.? Given the labor differential between China and the U.S., do you think that we can still compete?

Comments

Chris says:

February 14, 2012 at 2:12 pm

Good Article.

Re: your comparison of labor costs at GE vs China – there are a few other factors to consider into the equation:

Freight costs – that is getting the finished goods from China to the US.
Duty/Tariff fees – the tax the Fed Govt puts on different types of imported products.

For small appliances – eg toasters – freight might cost $2 per unit. On larger appliances like a refrigerator – it might be $20.

Duty varies but could be 5% of the product value. If a toaster costs $10 in China that adds $.50. If a fridge costs $300, that adds $15.

I'm sure there are other govt incentives – tax breaks or credits – that are also sweetening the pot to add the jobs here.

And while these costs don't fully make up the dramatic labor cost difference, they do narrow the gap – and make it economically viable for a large co. like GE to make a "political" choice to bring a smattering of jobs back to the US.

Where these rising Chinese labor costs will make a bigger impact is in lower cost/retail goods. Manufacturers and importers will look to pass these cost increases along to the retailers and ultimately the consumers. If however, Walmart or other large retailers resist these cost increases, manufacturers will instead start cutting corners on the materials and/or quality control of these goods.

So while you may still get a pair of scissors of a small toy for $3, don't expect it to last very long before breaking.

Welcome to the New America!

Reply

Timothy Mojonnier says:
February 15, 2012 at 12:55 pm

Thanks for you comments. You are absolutely right in pointing out that there are many factors to consider beyond direct labors costs. The information that you provide regarding actual transportation costs for various categories of appliances is interesting.

I also agree with your statement that the gap is narrowing. In some cases—when looking at total costs—the argument for back sourcing work to the U.S. does makes economic sense. Also, you make a compelling argument about the possibility that offshore suppliers will cut corners if the big box retailers push pack on price increases.

Reply

Trevor says:
April 27, 2012 at 6:17 am

Our company is located in Sydney, Australia. Our chinese suppliers have this month increased pricing by 15-20%, citing increased labour costs. It is the latest in a steady stream of price increases. The product I am buying from China cost USD$0.61 in 2006; it now costs USD$3.00. This is roughly a 500% price increase.

I do not know of anywhere except China that gets away with a 500% price increase through the Global Financial Crisis and beyond. In our case, air freight adds an additional

USD$0.70 per unit. So the argument for local production gets stronger. I would like nothing more than to manufacture locally, but we won't help anyone by going broke because we cannot compete. Maybe in 5-10 years.

Reply

Raymond YUEN says:
July 1, 2012 at 9:00 am

Positive Printing may change the world about labor cost competitive edge.

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