RISK ANALISYS OF SETTING UP MANUFACTURING PLANT IN CHINA

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The China is still most attractive option when sourcing manufacturing offshore . Even if duties on many products are increased, there are still significant advantages in manufacturing in the Peoples Republic of China. With a population of 1.3 billion, the China display huge capacity to manufacture consumer and industrial products. Labor is relatively inexpensive, although rising, by the standards of the developed world and competitive with those in many other low-cost countries.

But for companies that still don't have a presence in China , there are a number of issues that must be considered in order to establish and operate manufacturing plant in that country. As a China based observer I like to share my observations on the cost of labor, form of ownership, plant location, building a plant, staffing a plant, patents and copyrights, and getting paid.

Cost of labor of most manufacturing workers in China are less than a 1/4 of what their counterparts in the Australia earn. But that advantage is quickly diminishing as wage rises regularly and businesses loaded up to provide benefits to the workers.

One factor is that China is in the focus of implementing a social safety system that will combine the functions performed by Social Security, Medicare. The Chinese Social Security would be financed by contributions from employers and employees alike.

The other factor is that production workers wages are rising faster in China than they are in the rest of the world. As expected, the most rapid growth in labor costs is in metropolitan areas.

Foreign company can own 100 percent of a venture it establishes in China. However majority of the businesses making their presence in China prefer to do so via a joint venture. Joint ventures are attractive because the government gives them tax incentives. They require a minimum of investment (the foreign company need own only 25 percent of the business), and the Chinese partner often can help negotiate the maze of regulations the government imposes on business. It's worth knowing that tax advantages might be revoked and careful selection of the joint venture partner are required like in any other country.

Checking out about the track record of Chinese companies or the background of their executives can be a tiresome task. There's no law requiring Chinese companies to report their financial results, and no incentive for them to do so because only a very small percentage of them have access to capital in the public markets as majority go to the bank. That's where Chinese companies usually go when they need capital. And the banks closely monitor the performance of the companies they lend to, and they are usually well aware of the background of these companies' managers.

Because labor costs are lower in the inner provinces of China, companies may be tempted to build plants in one of these remote areas. There are at least two negative factors. It's hard to lockate competent management in the inner provinces, and it's difficult and expensive to recruit the necessary expertise from the metropolitan areas in the coastal provinces. The other downside is that they don't provide the same degree of legal protection and government cooperation that is enjoyed by companies in the metropolitan areas of the coastal provinces. The provinces that are most hospitable are those along the coast: Shangdong, Jiangsu, Guangdon and Zhejiang.

Remember that foreign companies can't buy land anywhere in China; a plant site must be leased, for terms ranging from fifty to seventy years. Companies that want to manufacture in foreign countries usually prefer to have their plants build by the contractors they're accustomed to working with. But it may not be economical to bring a major western construction firm into China to build anything less than a large factory. That leaves a choice of contractors domiciled in mainland China and those based in Taiwan and Hong Kong. The better choice will usually be a contractor from Taiwan or Hong Kong that is licensed to build on the mainland. Some of these companies have good quality control, better technology and can get projects done on time, on budget. Here again, it will pay to do extensive due diligence to find a good contractor.

There are two positives in working with the Chinese. Most employees are willing to put in long hours, and there is only minor union interference.

On the negative side, Chinese workers in general have a lack of initiative. Typically, a foreign company finds it must put Chinese workers through a long training process before they are able to do their jobs and learn to come up with solutions to problems on their own.

Company can make all the right moves in building a plant in China, manufacturing its products and getting them into efficient distribution channels, but can they get paid for products sold and delivered?

It would be nice if China had a credit ratings agency, but no such entity exists. What, then, can a company do to avoid this problem?

First off companies must accept as a fact of life that the percentage of their receivables that are not collectible in China will almost always be higher.

The way to hold uncollectible receivables to a minimum: Check with the banks that are familiar with prospective customers. As noted earlier in the discussion on joint ventures, the banks know the financial condition and the creditworthiness of Chinese better than any other organization in the country. There will always be one or more banks that know any potential customer of a foreign company.

Company should also differentiate between different types of customers, and be leery of selling to state-owned companies. It's not that these companies deliberately cheat their suppliers; rather, they simply may not be able to pay their bills.

Extreme caution is warranted if a prospective customer is a state-owned manufacturer, because many such companies have obsolete technology and therefore have trouble selling their products.

China subscribes to international treaties and conventions on patents, copyrights and other intellectual property, and the government is sincere in its vow to catch and prosecute infringers. Still, the country is so huge and the profits to made from infringements so great that some infringement does go on.

This does not mean that companies should not manufacture any of its proprietary products in China. But they would be well advised to confine the manufacturing of components containing their core technologies in the country of origin, and have the less proprietary parts of their products made in China.

Tags: Manufacturing in China , outsourcing to China , plant set up in China