

China Briefing: Sourcing and Manufacturing

What Everyone Needs To Know About China

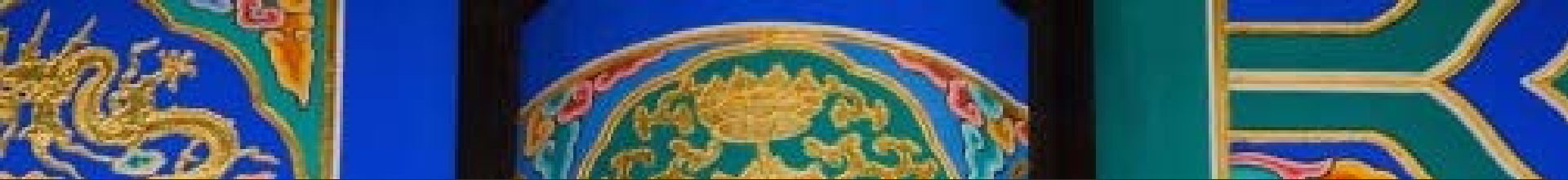
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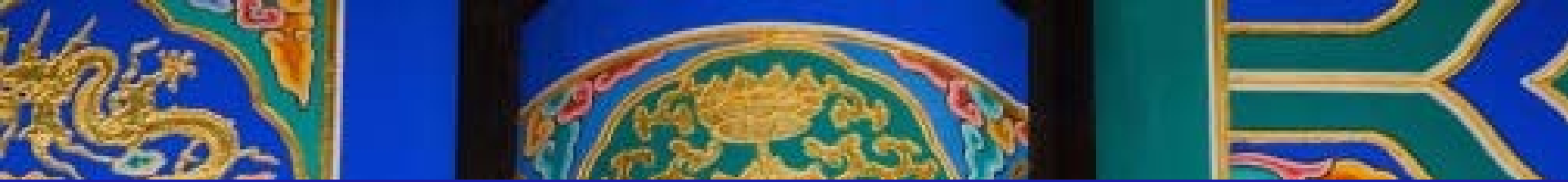
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The logo features a blue curved line above the text.
Blue Silk Consulting
Global Supply Chains



Who is Blue Silk Consulting ?

- **Blue Silk Consulting specializes in Global Supply Chain business processes and technology enablement**
 - **We are a consulting firm, founded by a former KPMG, Answerthink/Hackett and SAP Executive, with 80+ clients and over 20 years of consulting experience**
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- **We provide expertise in**
 - China Sourcing and Manufacturing
 - Global Supply Chain Strategy
 - Information Across the Supply Chain
 - Import/Export Processes
 - SAP Planning and Blueprinting
 - Expert Witness Services
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- **About our name**
 - “**Blue**” color in China symbolizes wisdom, scholarship and trust
 - “**Silk**” is reminiscent of the Silk Road, reflecting our Global Supply Chain expertise and emphasizing China



Some of Our Clients

Key Industries

- High Technology
- Transportation & Logistics
- Industrial Manufacturing
- Oil & Gas
- Retail
- Apparel and Footwear
- Publishing
- Consumer Products
- Aerospace & Defense
- Chemicals
- Automotive

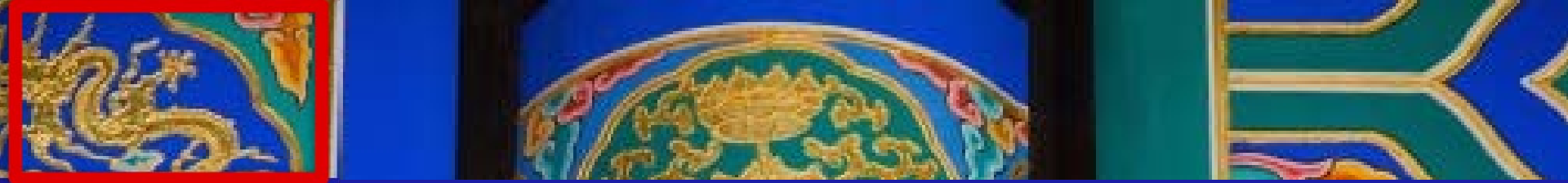


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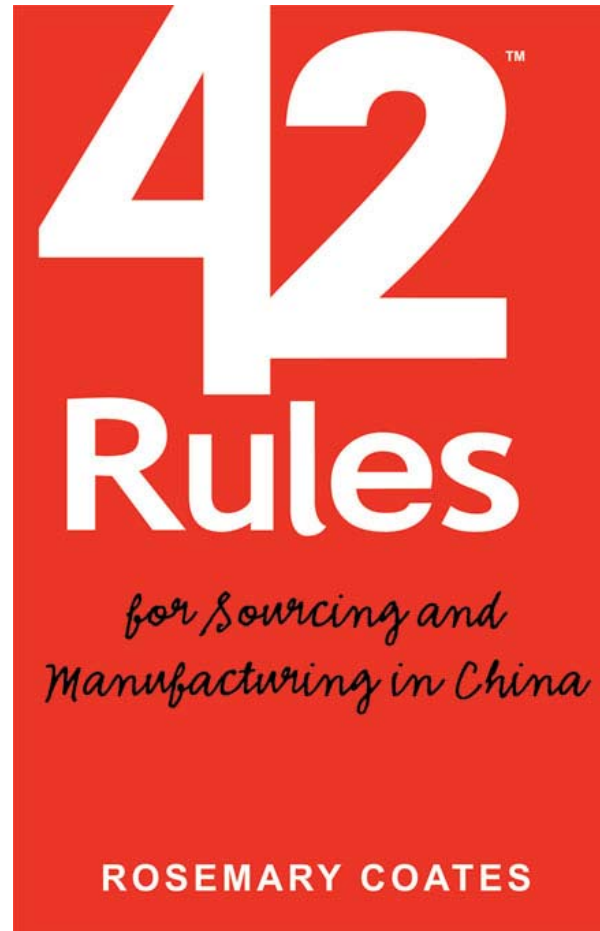
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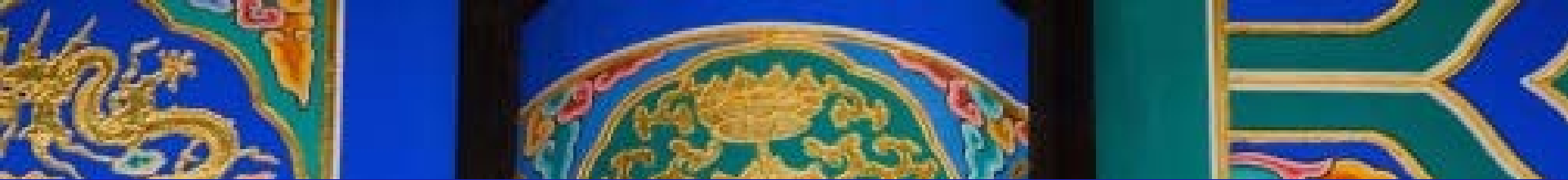


China Expertise

- **Book published in Nov 2009**
- **24 Senior Executives were interviewed for this book**
 - High Tech
 - Retail
 - Apparel
 - Consumer Products
 - Communications
 - Education
 - Green Technology
 - Software
 - Logistics
 - Publishing
 - Automotive – Electric Vehicles



- History
- Economic Development
- Guanxi
- SEZs
- Education
- Communications
- Pollution
- Chinese Firewall
- FCPA
- Supplier Selection
- Contract Mfg
- Plant Tours
- Shadow Factories
- Audits
- Apparel
- Green Initiatives
- Mfg Areas
- Negotiating
- Logistics
- INCOTERMS
- WTO
- Management
- IP
- JVs
- Women in China
- Food
- Chinese New Year
- Safety



Why Learn About China?

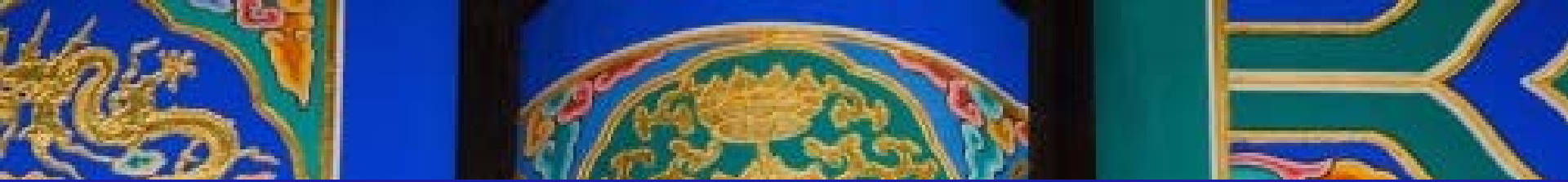
- **Within 10-15 years, China will be the largest economy on earth**
- **China has about 1.5 billion people – 1/6 of the world's population**
- **China sourcing and manufacturing**
 - 35%-40% of the world's production is already in China and this number is growing. The Pearl River Delta is “the world's factory”
 - Significant cost benefits...Chinese vendors can save you 40-70% over US domestic costs
- **Selling to China**
 - Potential market to sell goods and services in China is enormous. The Chinese middle class is rapidly expanding and hungry for western goods
 - Businesses involved in exporting, both large and small, generally weather downturns in the US economy much better than businesses tied solely to the US domestic economy
- **It's inevitable!**

Understanding China Today Takes Some Understanding of China's Background and History



The Empress Dowager Cixi

- **Prehistory**
 - Paleolithic
 - Neolithic
- **Ancient era**
 - Xia Dynasty
 - Shang Dynasty
 - Zhou Dynasty
 - Spring and Autumn Period
 - Warring States Period
- **Imperial era**
 - Qin Dynasty
 - Han Dynasty
 - Jin Period
 - Southern and Northern Dynasties
 - Sui Dynasty
 - Tang Dynasty (AD 618 - 907)
 - Five Dynasties and Ten Kingdoms
 - Song Dynasty and Liao, Jin, Western Xia
 - Yuan Dynasty
 - Ming Dynasty (1368-1644)
 - Qing Dynasty (1644 - 1911)
- **4 Modern era**
 - Republic of China
 - 1949 to Present
- **Imperial Rule**
- **100 Years of Humiliation, Water People, Opium Wars (1840's), Japanese occupation, Invasion of Nanjing in WWII**
- **Ending of Imperial Rule in 1912. Puyi – the Last Emperor of China**
- **Rise of Communism and the Great Leap Forward (1949)**

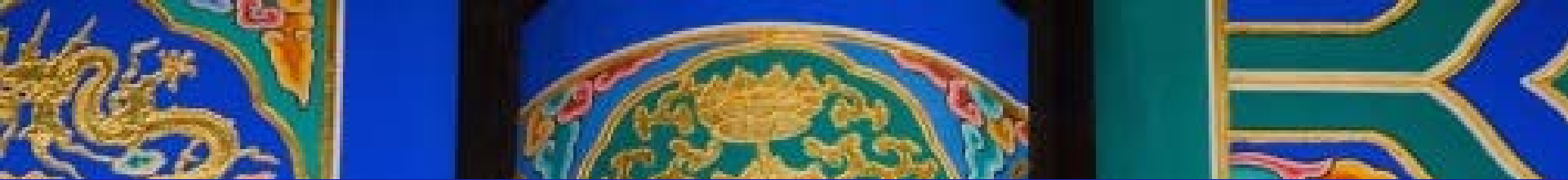


Rise of Communism

- Sun Yat-sen – Father of modern China, over threw the Qing Dynasty in 1912
- Chiang Kai-Shek assumed power after Sun's death then fled to Taiwan after the People's Republic of China was established in 1949.
- Mao Zedong – Great Leap Forward and the Cultural Revolution (1960's)
- Deng Xioping – Economic Reforms (from 1976)
 - Established SEZ's
 - Allowed agricultural productivity improvements
 - Tiananmen Square 1989
- Jiang Zemin – 1990's average annual growth 11.9%, 120 million people lifted out of poverty
- Current President Hu Jintao – focus on growth and the environment

My friend, Ming, in Tiananmen Square 1989



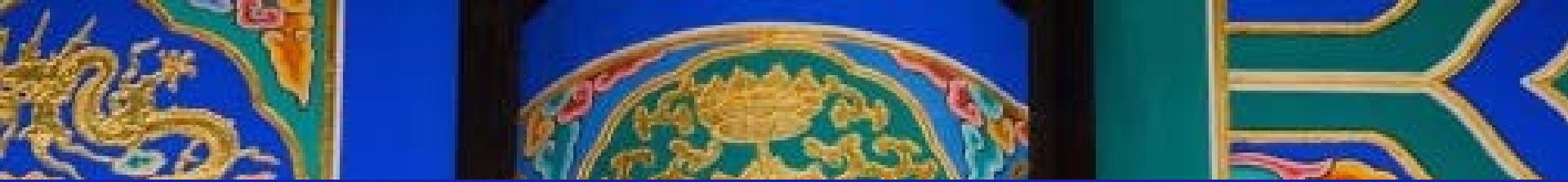


How Does History Influence Doing Business in China?



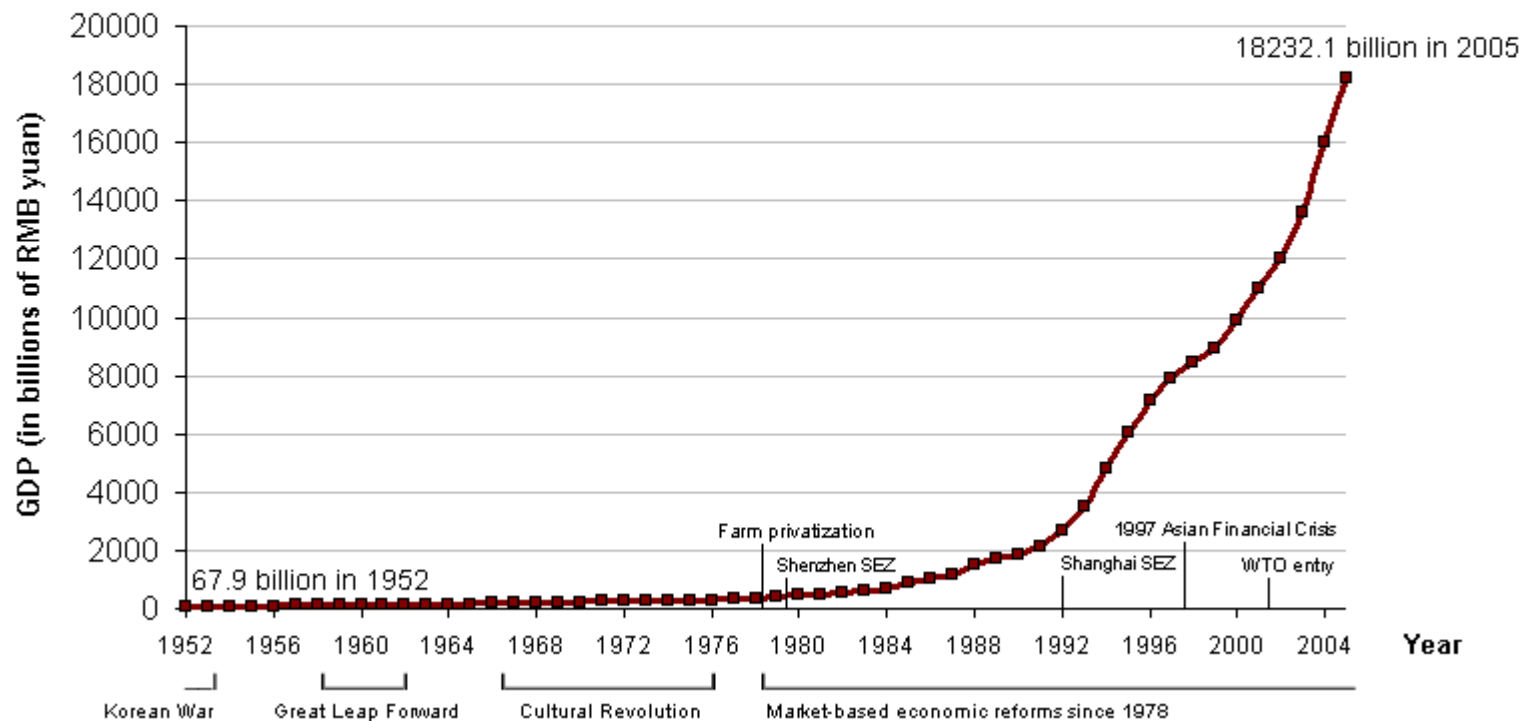
- **Chinese are protective against invaders**
 - Generally, Chinese entities retain 51% ownership of foreign factories
 - Why Guanxi is so important in business
- **Still strong government oversight and policies and stifling of communications**
 - Most Chinese people have no idea what happened in Tiananmen Square in 1989
 - The Great Chinese Firewall
- **There is still both reverence and resentment toward Mao Zedong**
- **Chinese laws are still immature**





Phenomenal Growth Since 1980

People's Republic of China's Nominal Gross Domestic Product (GDP) Between 1952 to 2005



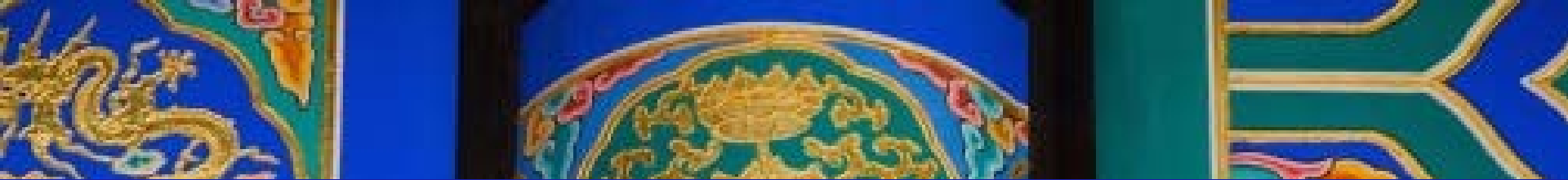
Scatter graph of the People's Republic of China's GDP between years 1952 to 2005, based on publicly available nominal GDP data published by the People's Republic of China and compiled by Hitotsubashi University (Japan) and confirmed by economic indicator statistics from the World Bank

Most of the Industrial Development is on the Eastern Seaboard



- 15 free trade zones
- 32 state-level economic and technological development zones
- 53 new and high-tech industrial development zones have been established in large and medium-sized cities

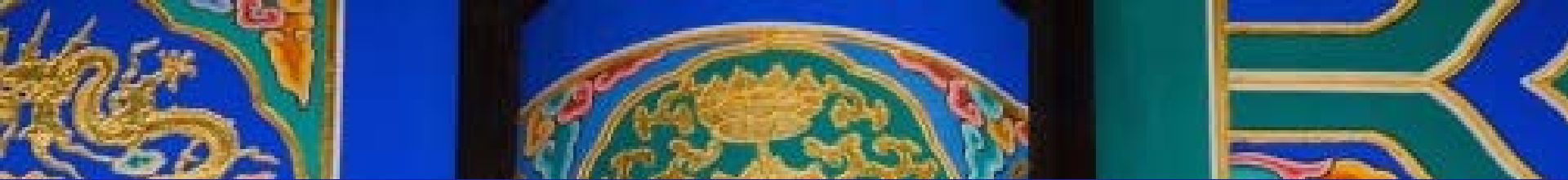
Map of East China



Everything in China is in a “State of Becoming”

- Chinese joke that the crane is the national bird of China

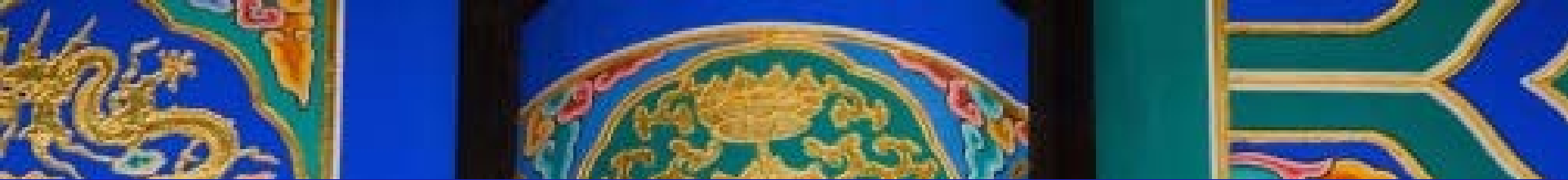




Education System



- **高考, or gaokao, the nationwide college entrance exam**
 - make or break moment for life prospects
- **Students are taught the test material - “Teach to the Test” approach**
 - memorization and repetition are typical throughout Asia
- **Critical thinking and creativity are not taught or encouraged**
- **Written language is difficult to master**
 - up to 5,000 characters must be memorized by school children
- **Even though the Chinese are credited with inventing so many things over time, that creativity was stifled for at least 100 years**
- **China is now graduating 600,000 engineers / year**
 - US graduates 70,000
 - India graduates 350,000

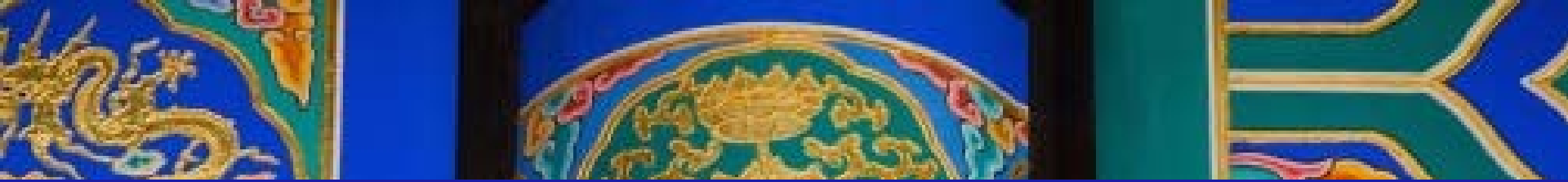


Betty's Story

How Education is Changing China



- Born in northern rural China
- Native language is Mandarin, studied Russian in high school
- After college, she moved to Shenzhen to become a “factory girl” working in an electronics assembly plant
- Studied and learned to speak Cantonese
- After a few job changes, she started working at Peak Plastics
- Learned English to be able to talk with management and customers
- Over 13 years she advanced to Plant Manager, managing all plastics design, production and 200 + employees
- Returned to Shenzhen University and completed an MBA



China is a Dichotomy of Fast Development and Slow Cultural Change

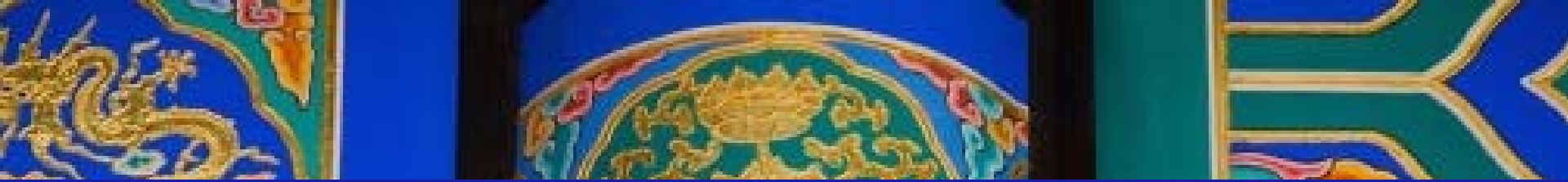




Finding and Qualifying Suppliers and Manufacturing Sites



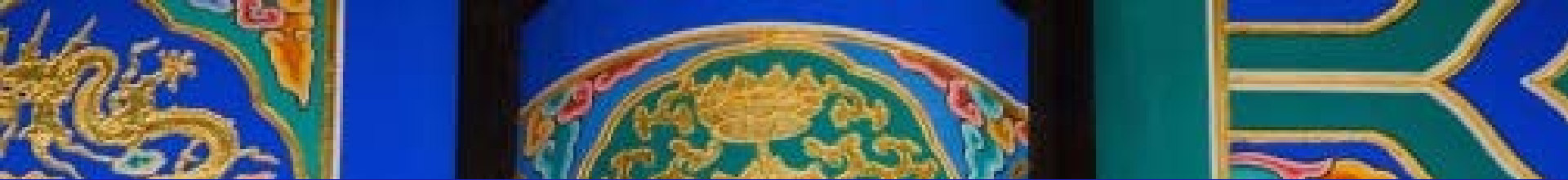
- Do analysis first
- Find multiple suppliers
- Decide on what to source and manufacture
- Use Alibaba.com or [Global Sources.com](http://GlobalSources.com) for small businesses
- Find suppliers at trade fairs
- Use business brokers
- Do reference checks and background searches on sites such as iSafeTrade.com
- Communicate important information in writing, such as standards and component material requirements



Validate the Infrastructure



- Leverage Special Economic Zones
- Hire a driver, hire an interpreter/agent, book your own hotel (the Great Chinese Firewall)
- Consider an industrial park
- Validate the infrastructure (electricity, water, roads, etc)
- Consider the “belly of the chicken”



Negotiations



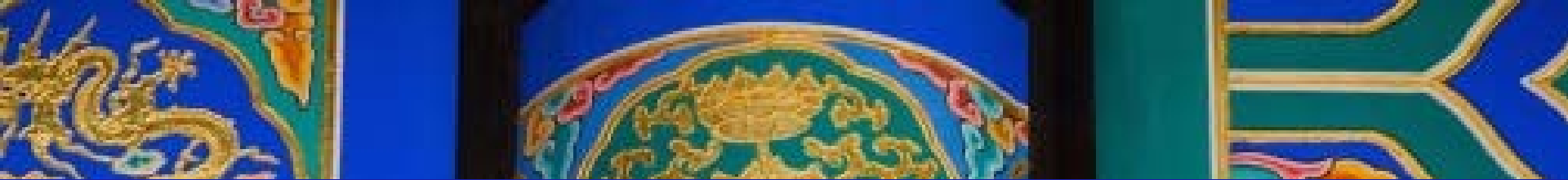
- Prepare for the first meeting – analyze the data
- Be prepared for a different style and path to negotiation
- Expect to spend 2-3 x more time than in a US negotiation
- Observe the room
- Bring a team
- Increase the value of the deal
- The profit motive
- Provide incentives for quality
- Know your terms of sale (INCOTERMS)
- Hire logistics professionals



Starting Up and Managing Operations



- **Tour the plant (all plants)**
- **Validate the Infrastructure**
- **Pay attention to supplier operations. Watch for shadow factories**
- **Be there for first articles**
- **Don't hesitate to give feedback, but always allow Chinese to save face**
- **Be diligent about quality. Watch for "quality fade"**
- **Go to China often and audit the factory**



Shadow Factories



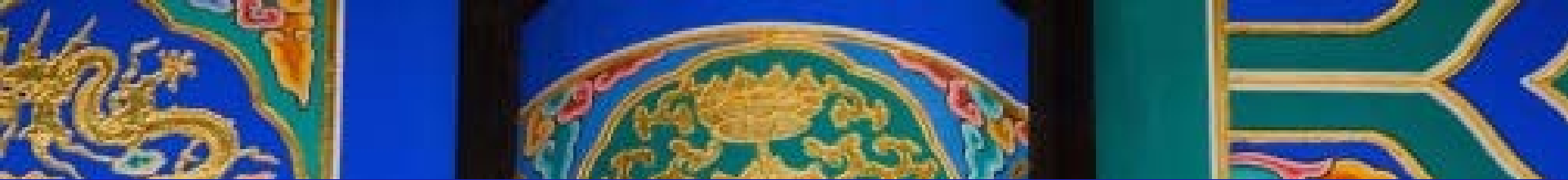
- About 70% of all legal factories in China have shadow factories
- Secondary manufacturing facilities and subcontractors
- Usually near the primary factory and producing the same goods at much cheaper cost
- May violate safety and work conditions
- Avoid paying taxes
- Costs are averaged over the two factories to keep the “China Price” low
- Working conditions may be unsafe, hours are longer, days off are few (16-18 hours/day, 6-7 days/week)
- Workers without work experience may start here

You will be shown the 5-star factory, but never the shadow factory

Quality Fade – The Process of Degradation Over Time



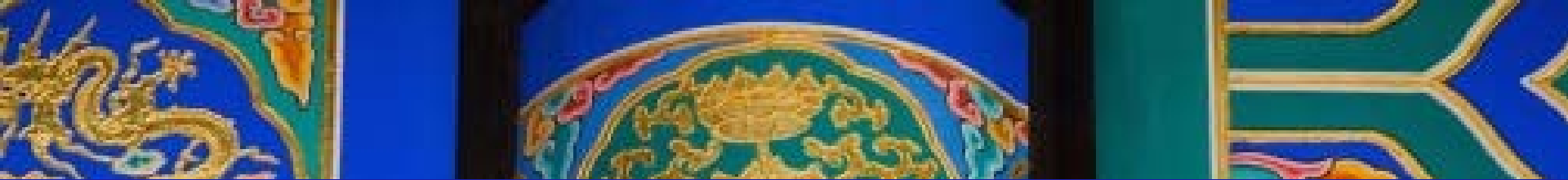
- **Single biggest issue in China manufacturing**
- **Goal is to reduce production costs**
- **In the West, companies would focus on improving efficiency or negotiating better supplier contracts. In China, the focus is on cutting production costs**
- **Your product:**
 - Plastic bottle may get a little thinner
 - 100 ml may become 99 ml
 - Labels may get slightly smaller
 - Wiring may be downgraded
 - Water used to mix product may be impure
- **You must be vigilant and constantly test for quality**



Chinese Management Style

- Initially, Managers had to be imported from Taiwan, Korea, Japan and the US
- Management is very autocratic, not open to suggestion
- Little customer or market-oriented focus
- Lean manufacturing, Six-sigma programs and TQM are unknown concepts
- Lack of understanding of:
 - Pay-for-performance
 - Managing risk
 - Financial management and cost management trade-offs
 - Competitive advantage
 - Marketing activities

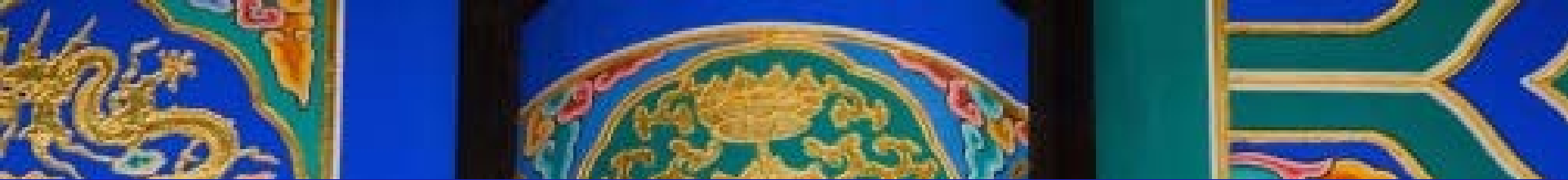
But, as with everything in China...this too, is changing rapidly



Eat, Drink and Build Guanxi



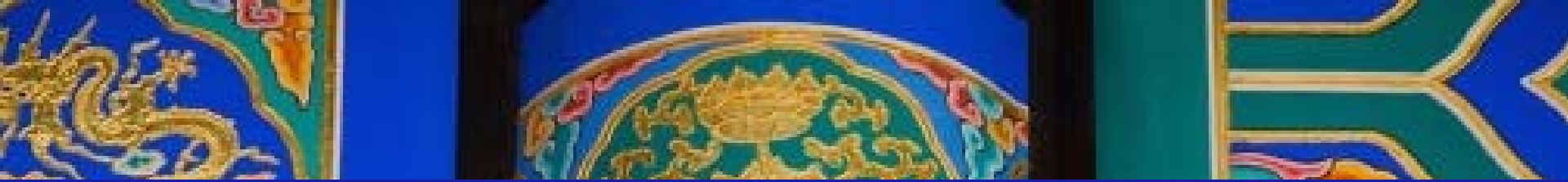
- **Guanxi is important in every interaction you have in China (personal connections, personal responsibility)**
- **Food is a very important part of every culture, especially Chinese culture. Much pride is taken in preparing delicious foods for guests**
 - Eggs symbolize fertility
 - Noodles are a symbol of longevity
 - A fish served whole is a symbol of prosperity
 - Ducks represent fidelity and loyalty
 - Chicken symbolize a good marriage and the coming together of families
 - Seed-filled treats represent bearing many children
 - Words for tangerine and orange sound like luck and wealth
 - Bamboo shoots are a symbol of wealth
- **Eating and Drinking with your Chinese hosts is a must**
 - If you decline, you may insult your hosts
 - Expect lots of drinking and drinking games
 - Chinese eat all parts of animals, so expect the unexpected



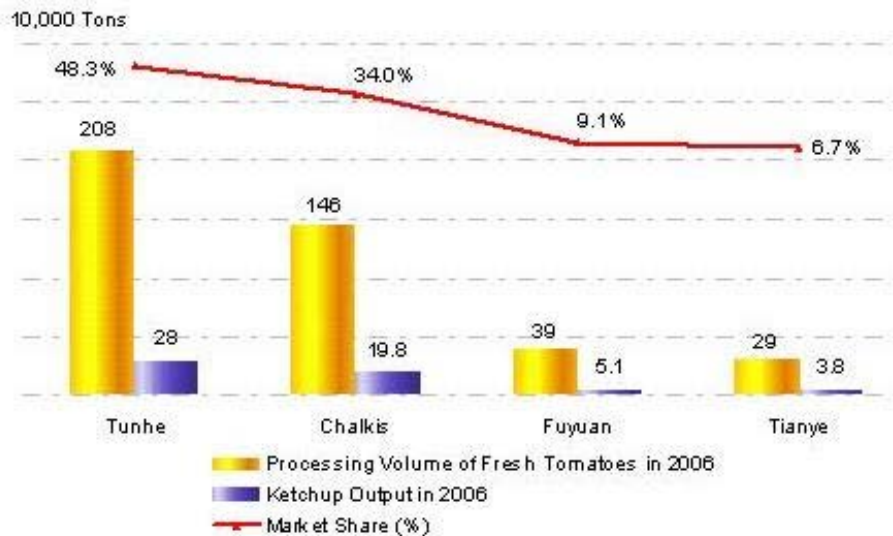
Use Good Manners



- **Good manners are appreciated around the world**
- **Good manners are defined differently by different cultures**
- **For business meetings in China or with Chinese vendors visiting the US:**
- **Addressing Colleagues**
 - The Chinese give their last name first; and last names are usually one syllable
 - Use a title, such as profession (e.g. “Director Wang”) or Mr./Ms. Hu
 - If you know a Chinese person very well, you can use their full name (e.g. “Wang Han”)
 - If you’re meeting in the United States, you can use the western order (e.g. “Han Wang”)
 - If you’re very old friends (20 years of history, say), you can use just a first name (e.g. “Han”)
- **Exchanging Business Cards**
 - Present your card with both hands, your name facing outwards (this is true throughout Asia)
 - Never toss a business card onto a table – this is rude and reflects poor manners
 - Examine any card presented to you for at least 10 seconds. Comment on it; say something nice



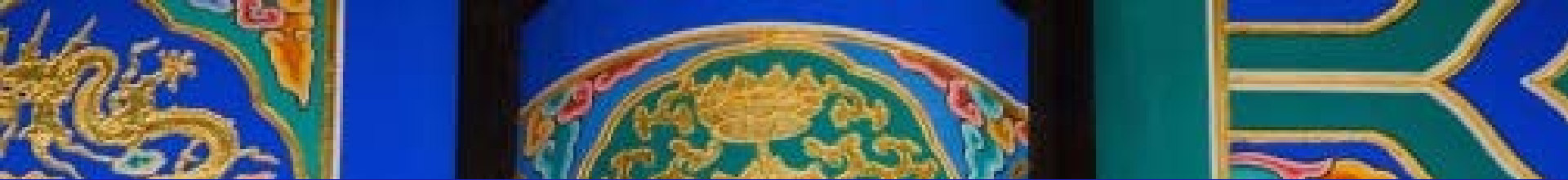
Miscellaneous Facts



Major Chinese Ketchup Manufacturers'

Source:MarketAvenue
Updated: 2007-12-18

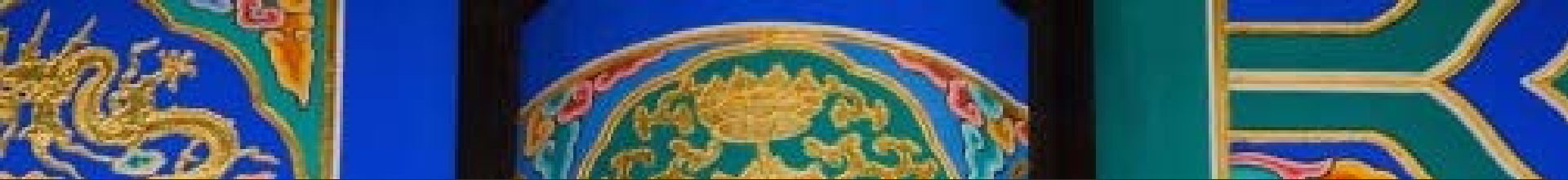
- 60% of the world's ketchup comes from northwestern China
- China Per capita income is approximately \$5400/year vs. the USA which is \$42,000 (World Bank PPP 2009)
- There are 350 million middle-class citizens in China (more than the US)
- Factory girls doing electronic assembly work in the Pearl River Delta (Guangzhou, Shenzhen, Guangdong) China earn about \$100/month, live in factory dorms and send about 1/2 of their earnings home to rural China
- There are 130 million migrant workers from rural China – largest migration in human history
- China has 150 million manufacturing jobs. India has 10 million. The US has about 20 million



More Miscellaneous Facts



- Population of China is 1.3 - 1.5 billion depending on who is counting
- All of China is on 1 time zone
- China has 3% of the world's autos, but 40% of all fatal traffic accidents
- Primary languages are Mandarin, Shanghainese and Cantonese – the written characters are the same, but the pronunciation results in completely different spoken languages
- Translations from Chinese characters into a Romanized phonetics system for Standard Mandarin is called “Pinyin” which is helpful for computer programming and communications
- There are more English speakers in China than any other country in the world
- Surprise! 70% of economic production in China is now (2009) from privately held enterprise



The Future



Benxi, Liaoning Province

- China has 150 million manufacturing jobs and growing
- China supports this growth with unrelenting infrastructure development
- You will inevitably work with Chinese suppliers and manufacturing
- “Comu-capitalism” is the likely form of government for at least the near future
- China is choking on the economy – the air and water pollution problems are horrific. China’s greatest achievement is also its biggest burden
- China relies on coal for 2/3 of its energy needs
- China’s single biggest challenge will be its environmental issues
- Sulfur dioxide and nitrogen oxides spewed by China’s coal-fired power plants fall as acid rain on Seoul and Tokyo. Particulate pollution over the Los Angeles basin originates in China
- Bigger issue is water – aquifers in northern China are being **depleted**. Nearly all of the water from the Yellow River is used for agriculture and industry. Chinese industry uses 4-10 times more water per unit of production than in West Europe and the US. Factories and farms dump waste into the rivers.

Questions?

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