

The New Era of Post-Chinese Sourcing

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Boston Strategies' 2008 State of Supply Chain study found that four factors contributed to the extraordinary boom in Chinese sourcing over the last 15 years. The main motivation for off-shoring was low cost and availability of labor. The average cost of Chinese labor was recently as low as 10% of the cost of US labor. Given that about 20% of the product cost was dedicated to transport,¹ Western manufacturers recently enjoyed as much as a 70% cost advantage by sourcing from China. Second, lenient regulatory controls made low-cost countries attractive sourcing platforms by lowering their costs relative to their Western counterparts. Third, China put unprecedented investment into its infrastructure, thereby reducing some of the conditions that had previously made it unattractive from a logistical point of view. Finally, it joined the World Trade Organization, established accepted legal frameworks that moved toward protecting intellectual property, and trained workers.

The report, which can be downloaded at www.bostonstrategies.com, also concluded that, although the price differential between Western manufacturers and low-cost country sources was huge, a "perfect storm" of the China sourcing boom could come to a close if five developments occurred. These factors were: 1) if Chinese labor costs continued to increase; 2) if the Chinese RMB revalued versus the Euro and the US dollar, thereby making Chinese goods more expensive; 3) if shipping costs from Asia to Europe and/or the US rose; 4) if protectionist policies drove goods back to their domestic locations; and 5) if environmental concerns gave a bad name to thoughtless consumption of low-cost

goods that were shipped halfway around the world.

Well, aside from shipping costs, which have fallen instead of risen, the extraordinary economic circumstances over the last six months have conspired to vastly reduce the economic benefit of sourcing from China.

- Labor cost nearly doubled in urban areas like Shanghai, eliminating about half of the cost advantage of sourcing from China (it went from 10% to 20% of US costs, leaving only a 60% cost advantage for US-based companies to source from China).
- The Chinese RMB has revalued vs. the US dollar and the Euro to the tune of 15-20% since 2005. In the case of the dollar, most of the change has occurred in the last 12 months. This narrowed the Chinese cost advantage to only 40-45%.
- Chinese authorities raised export taxes on certain raw materials by about 12% by eliminating an export credit. This further reduced the cost advantage to about 30-35% for these items.
- Increasing environmental legislation has increased the cost of Chinese-sourced products. For sake of argument, let's assume it is 5% - which leaves only a 25-30% cost benefit from still sourcing from China for most Western companies, depending on whether they are affected by the export credit.
- In addition, the economic crisis has forced some sourcing back onshore as governments worldwide have provided economic stimulus (subsidies) to local producers.
- Finally, the Chinese RMB is forecast to revalue by another 10% over the next

four years, which could narrow the remaining advantage of sourcing from China to 15-20%, which would put it in line with a wide range of other emerging economies.

Moving forward, the emerging economies of India, Brazil, and Russia present increasingly attractive sourcing locations for importers in the Middle East, North America and Western Europe. In addition, the growth of the next tier of emerging economies such as Vietnam, Thailand, Hungary, and Turkey offer long-term alternatives to Chinese sourcing.

So the good news is that there is unbounded opportunity for realizing benefits from terms of trade. Today, however, most Western companies are unfamiliar with sourcing from these new locations, and it will take time to establish viable sourcing relationships. To position yourself for the post-China trading environment, it will be essential to establish supply lines to qualified partners in the next tier of emerging economies. This morning our sourcing team is headed to Day 2 of the Hannover Fair in Germany to talk to companies from these countries who are making their pitch to buyers worldwide. Hannover is one of three dozen trade fairs we have canvassed over the last 12 months in search of qualified supply chain partners that can serve our clients cost-effectively. The potential of global supply chain management is worth the effort, since staying on top of global supply chain opportunities can yield a 30% improvement in corporate performance. 

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¹ Based on Boston Strategies International's 2005 study "The Asian Sourcing Boom: How Long Will it Last?"