There Isn't a 'Next China'

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Prices of products made in China are rising. In the short term, this is bad news for consumers and businesses that buy products made in China (read: everyone). As a result, a lot of people in the manufacturing world are asking, "Where's the 'Next China?'"

The answer to this question is vitally important, but not particularly uplifting. Unfortunately, there is no "Next China." Sourcing executives would do well to spread the word — and fast.

The Rise of China

China is not the first country to dominate manufacturing. (In reverse chronological order, think: South Korea, Taiwan, Japan, America, and England). However, the speed of China's rise — and the scope of its manufacturing dominance — has been staggering. There have been three ingredients to China's success: pro-trade government policy, solid infrastructure, and a huge, underemployed labor pool.

It is this last ingredient — China's huge labor pool — that has kept manufacturing costs so low for so long. Typically, you would expect wages to rise as more and more companies start manufacturing in a particular region and demand for labor increases. However, in the case of China, there were so many people that needed jobs that it seemed companies would always be able to find more people that were willing to work for very little.

But, as we now realize, it only seemed that way.

Rising Prices in China

In the last few months, we have seen the landscape change very quickly in China. In the wake of several suicides, high tech powerhouse Foxconn raised wages dramatically [1]. In response to multiple strikes, Honda also offered workers significant pay increases [2]. While the speed of change is breathtaking, the fact that things are changing is not a surprise to most sourcing executives, who have seen the writing on the wall for years.

Prior to the Great Recession, wage rates were already increasing, particularly in coastal China, leading many companies to move inland or to begin the search for the "Next China." However, the Great Recession forced many suppliers into survival mode and enabled buyers to get low prices for a little while longer. But this was a temporary state of affairs.

As the global recovery picks up steam, wages are again increasing. And China's recent decision to move to a more flexible currency — while good for China and the global economy in the long run — only compounds the effect of wage increases.

There is now little doubt of what the future holds: prices of products made in China will rise. And so companies are again asking, "Where's the 'Next China?'"

Where's the Next China?

In attempting to identify China's successor, it's worth revisiting the ingredients to China's success: pro-trade government policy, solid infrastructure, and a huge, underemployed labor pool. Doing so brings us to the bad news: there is no "Next China," because there is no country in the world that has these three key ingredients.

To be sure, there are countries that have these first two (the United States, virtually all of Europe, and many ASEAN countries). But there isn't a country in the world that has as many underemployed people as China did when it began its march to manufacturing dominance.

India comes close, and frankly should be the "Next China." In fact, India should have been China before China was China. However, India lacks the first two ingredients — pro-trade government policy and solid infrastructure — and shows no signs of remedying things in the near future.

Does this mean that there aren't low-cost alternatives to China? No. In fact, many companies have found success by sourcing from places like Vietnam, Bangladesh, Thailand, and Indonesia. However, none of these countries has a large enough underemployed population to keep wages low if companies pour in for as long, and in such numbers, as they did in China. Therefore, any gains from moving to new geographies are likely to be short-lived.

Only the most nimble sourcing organizations — the ones that can stomach shifting geographies on a regular basis — will be able to stay a step ahead of wage increases; everyone else is going to have to cope with rising manufacturing costs.

Spread the Word

If there isn't a "Next China," what should sourcing executives do? First, spread the word. For a long time, sourcing organizations have been known for being able to reliably deliver low manufacturing costs. This is about to change. Telling your colleagues this will take courage, but it's essential. What's worse than rising costs?

Being surprised by rising costs. At least if your colleagues know that rising costs are on the horizon, they can plan accordingly.

It's worth acknowledging the argument being made by some that the days of cheap labor in China are not yet over. Those making this argument point to the possibility that China is in the midst of a bubble that will soon burst, ultimately resulting in a renewed willingness of workers to accept low wages. Others counter that China's young workers, having tasted higher wages and white collar opportunities, will never tolerate a return to the old order, even if China is in the midst of a bubble that will soon burst. In any event, wouldn't you rather your colleagues be surprised by lower-than-expected costs, rather than by higher-than-expected costs?

Second, invest in being nimble. Sourcing organizations need to excel at working flexibly across multiple geographies. Technology and information can help, but only if your team recognizes that, in today's world, only the nimble survive. Presuming your team is up to the challenge, arm them with information that allows them to get up to speed in new geographies as quickly as possible. Alternatively, if you don't think your organization is up to the challenge, consider partnering with organizations that already know how to work flexibly across geographies.

Finally, recognize that, in the long run, innovation is the only reliable way to consistently keep costs down. High technology companies have already figured this out; technological innovation is a key reason that the price of iPhones will go down, even as the wages of Foxconn workers go up. However, beyond the world of high tech, abundant, cheap labor has traditionally been the key to keeping manufacturing costs down. As Tom Nelson, VF Corporation's VP of Global Product Procurement, notes: "In the past, factories in Asia tended to throw more people at a tough job. However, I believe that with good engineering the Asian factories could offset many of the current cost increases we are seeing today."

For the last decade, we've had China to thank for low costs. In the medium term, we will have flexible supply chains to thank. In the long term, as wages rise across the globe, innovation will be the key to cost-containment. But, in the short term, manufacturing costs are likely to rise — because there isn't a "Next China."

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Links:
[1] http://www.manufacturing.net/News-Foxconn-Doubles-Workers-Wages-060710.aspx?menuid=
[2] http://www.manufacturing.net/News-Honda-Says-China-Plants-To-Return-To-Work-061010.aspx
[3] http://panjiva.com/