THE R. PAY
COMPANY, LLC
503-780-2014 www.rpaycompany.com rickp@rpaycompany.com

# You Better Watch Out! China is Coming to Town!

By Rick Pay

A May 24, 2010 article in *Fortune Magazine* cites the fact that Chinese companies are buying up American based manufacturing plants. Wait, how can that be? Isn't it cheaper to make products in China than the USA? Not by Chinese standards! There are a number of reasons that Chinese companies are swimming against the current and opening US based operations: land is as much as four times cheaper in the US, and electricity is less expensive by a factor of three and is far more reliable. While US labor is five to ten times more expensive than in China, the gap in costs is shrinking, and the potential devaluation of the Yuan has prompted many Chinese companies to consider moving to the US to reduce their costs and to better serve their customers.

Therein lies the key to contending with China made products. Being close to your customer offers the advantage of physical proximity, which enables a quick response to unforeseen requirements. With distance reduced from a 30-day trans-Pacific boat ride to a couple hour truck ride, companies maintain the competitive advantage of flexibility when facing changes in demand.

Being closer to the customer presents other benefits as well. For example, nearness allows JIT delivery systems, which provide smaller, more frequent deliveries. These not only reduce inventory at the customer and improve their turns, they allow the supplier to produce in smaller quantities with level flow, two main ingredients of Lean production. In addition, being in or near the same time zone makes it easier

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*Rick Pay is president of The R. PAY COMPANY, LCC, a Portland-based management consulting firm that helps manufacturers and distributors achieve peak operational performance.*

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for the supplier to participate in customer product design, which can considerably reduce product cost.

Chinese companies moving to the US can also have a total cost impact on the products. Import duties can be reduced or eliminated altogether, and exporting to Canada and Latin American countries is easier and can take advantage of NAFTA, CAFTA and other agreements. With the lower costs of inventory, logistics, and designed-in cost reductions, the total cost of ownership decreases, making US made products more competitive with those imported from China.

Most companies focus on labor as the reason to go to China, but Chinese companies are coming to the US partly because of overhead costs. In looking at Business Models and Lean Accounting in my clients, I find that overhead and materials both represent much larger portions of the overall model than labor. In addition to the energy savings and lower land costs I mentioned earlier, Chinese companies reap the benefits of tax incentives from state and local governments designed to bring jobs to their areas.

Off-shoring and overall supply chain design should consider a much broader scope of costs than just labor. In order to contend with Chinese companies who move to the US you should consider customer service, total cost of ownership, and overhead as essential competitive factors. Take a look at your supply chain, total cost of ownership and business model to see if you have room for more competitive and profitable operations. Visit my website or contact me for additional information.

**Contact The R. PAY COMPANY, LLC:**
**Phone: 503-780-2014**
**Email:** [rickp@rpaycompany.com](mailto:rickp@rpaycompany.com)
**Web:** [www.rpaycompany.com](http://www.rpaycompany.com)
**Blog:** [http://operationspayoff.wordpress.com](http://operationspayoff.wordpress.com)