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## Global Sourcing's Growing Pains

'Some ask what's next? There is no real next. There is no alternative in the scale of China', BruceRockowitz of Li & Fung, quoted in the South China Morning Post (1st June)'

Companies the world over are currently looking at China's export manufacturing sector and assessing what the implications of inflation and socio-economic development will be. Global supply chains really are becoming 'global' in nature, especially in certain low value add product categories. But it is a stark statement by the Chief Executive of the largest trading company in the world that there is currently no real alternative to China on account of its scale (Li & Fung manufactured just shy of two thirds of their products in China last year). It would, however, be wrong to simply look at the quotation in isolation. He went on to argue that the huge reverse from a long deflationary period would further force low value add manufacturing to move further inland and to other South East Asian countries. Nothing unexpected with that logic, but his sentiment is clear; China will remain an important strategic sourcing location.

Of course, the current internal pressures with in China are well documented and consistently appear across various media channels. The most recent data released in June underlines the inflationary pressures that the Central Government is facing. The CPI (Consumer Price Index) for May was 5.5%, predominately due to food price inflation of 11.7%. The significance of the increase in the price of food should not be underestimated. With increasing food prices, especially the staples, the Government will become more wary of the possibility of social unrest, which will tie in with their strategy of minimum wage increases. Food aside, the PPI (Producer Price Index) was up to 6.8% year-on-year showing that increases were also present at the factory gate. However, some of the economic data shines a more positive light - the PMI (Purchasing Manager's Index) dropped to 52 in May from 52.9 the previous month which, although still shows an expansion in output, is the lowest rate for 9 months. Of particular note is one of the sub-indices, the 'input price', which dropped to 60 from 66 the month before.



There is actually a degree of correlation between the CPI and the input price of the PMI, which is seen as an indicator for future movement in headline inflation. Some economists are concluding that China will in fact be in for a soft-landing as a result with inflation beginning to slow over the summer as interest rates rise, with an annual 9.5% GDP growth now a realistic possibility.

### A Factory Perspective

Speaking to factory managers across our vendor base, although there are slight variations across industry and location, the main concern that they have spoken of is the Government's stance on employees whether it be the labour law or the minimum wage increase. This is no more documented than in the Pearl River Delta where the Governor included, in his most recent 5 year plan, an acceleration to wage hikes with a view to force the manufacturing base up the value chain at a faster pace. Wage rises and, ultimately, an increased standard of living are part of any economy's development and after decades of low wages, such readdress can only be fair. This has and will change the dynamic within the migrant labour force though. Already, the migrant force has been depleted due to the availability of work closer to home for similar wages. The traditional manufacturing base around the Pearl River Delta has suffered most with rumours that some factory managers having to offer signing on bonuses to attract staff after Chinese New Year.

There have been increasingly fractious confrontations between these migrant workers and the local residents as well, which further underlines the growing disquiet within the manufacturing communities. In Xintang town, central Guangdong, there were a couple of days of sustained rioting by 1,000 migrant workers earlier this month due to an alleged manhandling of a pregnant women by a security guard at a supermarket.

These are not only China-centric issues though. At the end of 2010 were there riots by 4,000 garment factory workers over the proposed increase in the minimum wage in Bangladesh. And that is in a year when the minimum wage increased 87%. In Vietnam, through our own discussions with factory managers, it is clear that similar migrant labour is increasingly able to find work nearer home in the provinces North of HCMC; and this is a country of only 90 million people albeit with a lower average age compared with China (China's average worker is 32; Vietnam approximately 25).



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Asia as a whole is developing rapidly and with this growth there are going to be growing pains along the way. The point is that with the global macro-economic landscape shifting as quickly as it is doing, it is essential to understand the dynamics and how these relate to your supply chains. If there is one significant lesson that can be derived from past sourcing decisions, it is that the decision making process will become much more reliant on a range of factors rather than labour costs alone. These already include quality, lead times, access to raw materials, speed of internal delivery, port efficiency, road networks and others such as automation, supply chain strategy and operational efficiencies will become undoubtedly more prominent going forward. In that sense, China, regardless of its current upheavals, is not so badly positioned.



## ET2C India

In accordance with our belief that clients will need to base their decision on a wider range of factors and as part of our strategy to broaden our reach across export manufacturing bases and provide our clients with more options, we are now in the final stages of due diligence on opening an India Office for the last quarter of 2011. This will allow our clients to have access (whether buying office or trading) to another jurisdiction. We will provide a further update once all the details have been finalised.



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