MADE IN CHINA

Doing business with China presents more than just a language barrier. We sent **RICHARD CHIRGWIN** *to investigate how other companies have overcome the various challenges of manufacturing in a foreign land...*

Manufacturing in China is a sensitive topic. So sensitive, in fact, that several companies *iStart* approached to discuss their strategies considered the topic to be a brand risk.

That's understandable: 'disaster stories' about Chinese manufacturing are easy to find. Suntech's troubles are rocking the world's solar power business; last year, three Rio Tinto executives including Stern Hu were jailed. Companies such as Pacific Brands have seen both their share price and public reputation battered by the decision to move manufacturing to China (its recovery and the long haul back to profitability were far less well reported).

Manufacturing in China can even have political implications, especially if it goes wrong: the Reliance Rail contract for new rolling stock for the state of New South Wales has involved delays, production problems and an expensive bail-out. Even investments in China can carry both financial and brand risk, as Fonterra experienced when its subsidiary Sanlu dragged the dairy giant into China's milk contamination scandals.

Yet manufacturing in China can be done successfully – and for any company that wants to maintain its place in a competitive world, it's often a commercial necessity. *iStart* spoke to three businesses for their impressions and advice on what it takes.

Paul Russell of New Zealand company Global Design and Production says that over many years of dealing with Chinese manufacturers, he has developed methodologies for identifying and assessing new manufacturers.

Even so, he says that the concept of guānxì or relationship-building is central to ensuring that outsourced manufacturing will work: both the client and the supplier need to be comfortable with the close contact needed to ensure delivery and maintain quality.

"The minefield is the relationships – that's where things come unstuck," he said. Since you can't know what relationships will prove fruitful, there is inevitably a degree of "flying blind" at the beginning. "You have to start relationships, and hope they turn into good ones," Russell says.

That's a challenge, though, due to the sheer scale of the market: anybody arriving in China for the first time will quickly learn that for any given product, there are thousands of manufacturing facilities to choose from, making distinguishing the good from the bad the first challenge.

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It's vital to match the scale of your business with that of the supplier, he said. It's easy to look at China and characterise its production capabilities in terms of companies whose names we already know – Foxconn, for example, because of its high profile as supplier to Apple, Amazon, Sony, Nintendo and others.

All of these, however, are relationships between peers – and therein lies a catch for the unwary. Put simply, a small Australian or New Zealand company arriving in China will not be of interest to Foxconn. At best, the giants will ignore you, Russell believes, at worst, they will take on the business, but won't give you either the attention or resources needed for you to get what you need.

The same, he says, applies across the board: find a company whose scale is comparable to your own. That way, your business will be important to them – and you'll be more likely to have access to, and form relationships with, the key executives of your supplier company, rather than being relegated to a third-tier sales manager.

David Stewart, CEO of Sydney-based telecommunications manufacturer Netcomm, agrees. "Look for a factory size that's geared to your business – there are very big factories that do huge volume, but are not interested in our business. The »

THE VETERAN

NETCOMM – SYDNEY

Netcomm is a veteran technology supplier that began life manufacturing analogue modems in the 1980s, when (among other things) the peculiarities of national telecommunications networks encouraged product localisation. Having spent more than ten years supplying the ADSL and wifi router markets, the company is now focusing on the emerging machine-to-machine communications market.

While design and engineering remain in Australia, the company now has more than a decade's experience in offshore manufacturing.

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THE STARTUP

COMPOSITE PRODUCTS – ADELAIDE

Composite Products has spent three years working on its ModPod. The ModPod uses a honeycomb carbon composite material to create a lightweight, re-deployable and completely self-contained housing unit. While its initial market is Australia's resources sector, where it hopes the ModPod can displace the container-shed accommodation common in remote mines, the company also believes the unit can be deployed to disaster-prone locations as stackable pre-built emergency accommodation.

Australian production is used for pre-production units, but Composite Products has used offshore manufacturing from its inception.

THE OUTSOURCER

GLOBAL DESIGN AND PRODUCTION – NEW ZEALAND

Global Design and Production (GDP) acts as a "manufacturing plug-and-play" operation, taking a position within its customers' design, manufacturing and logistics departments. Paul Russell, CEO, is an industrial engineer and production designer.

With manufacturing in New Zealand, Australia, China, Taiwan and Cambodia, it's able to follow the complex relationship between supply chain, production process and manufacturing facility to get the best mix for a customer's product. GDP also helps its customers "design for commercialisation".

HOW TO GET IT MADE IN CHINA

- **Get local** - All interviewees agree: for any serious, long-term manufacturing relationship, local personnel are vital. Not only will it smooth the tortuous paths through another country's legal and bureaucratic processes, it demonstrates a commitment to the market.
- **JV** – Joint ventures likewise demonstrate a commitment to a long-term relationship. They also align the interests of both parties.
- **Legals** – Don't skimp the legal support needed to establish contracts to support the business relationship.
- **Building a relationship is incremental** – expect to make many, many trips to support the business relationship.

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volume you're offering has to be interesting to the supplier or you will get no attention."

And without that attention, there won't be the opportunity to build the personal relationships that make the manufacturing relationships work.

CULTURE AND BUSINESS

Many of the assumptions and expectations carried by western businesses are the result of a century of corporate culture. China's extremely rapid development, urbanisation and industrialisation means that there's an awful lot of learn-as-you-go happening. In a single generation, hundreds of millions of people have been lifted out of their formerly-rural lives and plunged into the world of urban business.

Some things that seem obvious to those steeped in a longer business culture are not yet part of peoples' assumptions, Russell explains.

"If I take you on as a client, I want to be selling to you for ten years or more. Similarly, Chinese suppliers may say that it's all about long-term business, but often it's not. The understanding that it's cheaper to do more business with an existing customer than to find a new customer can be missing in China.

"Of course, that understanding can also be missing in Australia or New Zealand!"

Even simple matters like payment terms can catch the unwary by surprise. Russell explains that, "In Australia or New Zealand, you'd expect to set up an account relationship with a manufacturer. So you're paying, say, 50 percent up front and the remainder after the product is shipped and accepted."

It doesn't work the same in China, he says – the unwary might not even see a product before they're liable to pay for it. "If you can't check the product before it leaves, you may as well throw money on the roulette wheel."

And, as Simon Modra, CEO of Composite Products, notes, a business that takes that risk unawares only has itself to blame if it gets caught out.

"It's up to you to honour that deal, so make sure that you prime the pump before you start it. Get your manufacturer to make one before you order 1000."

It's a lot cheaper, he says, to go through many iterations before committing to volume, than to try and short-cut the process.

THE OVERHEAD IS UNDER YOUR FEET

If there is a 'process', it starts with wearing out the shoe leather. You can't arrive in China, spend a week on the ground, and return home with contracts signed, ready to go.

"If you send an executive to China, hire a translator for a week, come back and expect things to go smoothly, you're very naïve," Modra says.

"From when we started – it took a full year to get first products delivered."

That year, he says, included setting up the joint venture, disseminating the intellectual property, working through the manufacturing processes and systems, setting up the factory, setting up the bank accounts and the customs processing.

It's about expectations: a year sounds like a long time to someone expecting to be swamped with suppliers at the airport, but "if I set up a factory from scratch in Sydney or in Auckland, it wouldn't move much faster than that."

Establishing and maintaining relationships costs money, which is probably why so many companies get their forecasts wrong when they first move to China.

A company that set its sights on getting its product for two dollars instead of ten dollars is going to be burned, Russell says, as soon as it turns back its first batch of unsatisfactory product and starts down the much longer – and more expensive – road of forming relationships and shepherding the manufacturing production.

"I spend well in excess of US$100,000 a year for my travel – and there's an opportunity cost of lost business here," Russell says. "The total impact could be US$250,000 per year, but we have over 40 clients that we supply products to.

"Unless you're buying more than US$500,000 worth of product per annum, off-shoring to China won't make sense. And if you're planning to sub-contract, it will go over a million."

Stewart says Netcomm's experience is similar to Russell's. "I'm in Asia regularly. We've used a number of factories, and I have a close relationship from the president down in those organisations.

"You have to be there, look at the factory, the people, the process – you measure that in thousands of dollars, an airfare and accommodation and time. It's not a fortune, but... if you think you can do it remotely, you'll lose everything."

GETTING THE TECH LINKS

In a world in which connectivity is assumed, it may come as a surprise that everybody contacted by *iStart* put such a premium on face-to-face interpersonal contact as the basis of building and maintaining successful business relationship.

However, successfully creating the technological links that support the business relationship remains vital. For Netcomm, Stewart said, the experience of years has taught the company to build and maintain a large number of systematic links between staff and systems, covering the supply chain, finance, engineering functions, test systems, and logistics.

In particular, Stewart nominates supply chain software and quality control systems as key points of interactions between the different businesses that finally deliver a Netcomm product. "The personal one-to-one relationship does not replace electronic interchange, but rather builds the trust and relationship," he says.

Russell cites similar effort and experience for GDP. "Offshore production is built on systematic structure. We invest in a host of components." For example, he says, his company has created a "Globalproduction" system that plugs into the Xero accounting software suite, which went live during April 2013 and allows management of suppliers in Cambodian, Chinese and English. »

OVER THE FENCE

In spite of the differences in their products, Stewart, Modra and Russell all agree that the most common customer mistake is when people believe they can hand over a design and deadline and collect a finished product.

Even with long standing relationships behind the Netcomm products, Stewart says, “you can't just send a product over to a factory, tell them to do it, and expect it to be correct when you get it back.

“You have to provide lots of detail and lots of support to the people you're working with. The documentation, the manufacturing processes, the test scripts – they all have to be right. And the supplier has to understand what it is you're looking for. Not just the product – the quality, the performance and the functionality you're looking for,” Stewart says.

“We send engineering people to China continually to work through the process, the testing and the debugging. For any new product, we send engineers over to work with the supplier on how to make it and how to test it.”

The aim of that investment in people, travel and relationships, Stewart says, is to make every transaction “as seamless as possible”.

“It has to be a partnership,” he emphasises.

BARTER, DON'T BATTER

The most cautionary note Stewart sounds for someone looking at offshore manufacturing is “be careful what you ask for”.

“I've seen people who act like if you wish hard enough, or if you're belligerent enough, you can get any price you ask for,” Stewart says.

“If the price you want is unrealistic, you're just encouraging people to cut corners. If someone agrees to meet it, you won't get what you want.”

There is also a desire to say “yes”, driven by culture and competition. With the thousands of potential competitors available, if a supplier wants your business it's likely to try and accommodate even unreasonable pricing demands – “yes, sure, we can do that” – and only with the delivered product in hand does it become clear that unreasonable demands are only going to be met with unacceptable product quality.

There is, Modra suspects, a cultural component to this. Australians and New Zealanders don't bring the same legal, structural and procedural habits and assumptions to the table in their business dealings. The cross-cultural challenge – hardly unique to Australasian-China business dealings – is this: how does a supplier learn when and more importantly how to say ‘no’ to a customer.

“In Australia or New Zealand,” Modra said, “we'll hammer a supplier down to the bones, and then he'll stop trying. He'll tell you what can't be done.

“They won't say that in China – and you'll get just what you deserve. So we have to change our attitude [...] when we go over there.”

The suppliers need to make a profit, need to pay their staff, have their own mouths to feed – and if you don't care about those things, he said, the relationship will fail.

“If the price you want is unrealistic, you're just encouraging people to cut corners. If someone agrees to meet it, you won't get what you want.”