

Developing and Implementing a China Strategy with Newvision Asia Ltd.



Background on Manufacturing in China

In 1980, China was a country rapidly approaching one billion people. The political structure, legal and school systems, and the economy in general had been decimated by political upheaval since World War II. Communism won out as the presiding social structure. Most of the Chinese people lived in what the rest of the world considered to be abject poverty. But change, drastic change, was in the air.

The ruling political body of China, the Central Committee, under the leadership of the progressive Deng Xiaoping began a strategy of cultural building and economic growth. A revolutionary change which came to be known as “Document Number 1”, was issued by the Central Committee in 1984. This document presented policy changes that were significant departures from the traditional Communist Party line. First, small entrepreneurs were allowed to make and keep profits. They could start home businesses or participate in communal endeavors. Secondly, these peasants were encouraged to invest their profits in all manner of enterprises, including private and state run ventures. To assist these people, the government promised to supply necessary social services such as information, marketing support and technical progress. As a result of this new encouragement, the population of China began a slow but ever increasing climb out of poverty.

In order to encourage larger businesses to become competitive in the world market, Deng established specific areas, which were labeled “Special Economic Zones”. Businesses in these geographic areas were allowed to take the gloves off and play by the same rules their world competitors used. In these zones, factory managers were considered autonomous. They were able to pay bonuses to encourage outstanding work. Even more dramatic was their ability to fire incompetent workers; a practice unheard of in the “Iron Rice Bowl” system. Profits could be plowed back into additional business ventures. The government began an era of encouraging foreign factories and joint ventures.

Not all of these progressive efforts worked well. There was always opposition from the “old guard”, but it faded away over time as these aging individuals expired. The new policies required workers to experience a new mobility. It made people harder to keep track of and allowed a new degree of personal freedom from political party policies. Because inland areas were lagging behind the coast, the country experienced a natural migration outward. These immigrants began to overwhelm the resources of the coastal cities. The result of all this was an increase in crime and more specifically, economic crime. Much of this crime impacted foreign businesses and left a negative impression of Chinese business practices. Everyone is familiar with the pirating of video and audio media, which have become common practice in China. All efforts to stop it have been futile.

The process of reverse engineering has flooded many markets with low cost and low quality copies. This quality, however, has been rapidly improving with time. When the U.S. reconnaissance aircraft collided with a fighter aircraft and performed an emergency landing in China, the U.S. government asked for the craft to be returned. Those familiar with the Chinese skill at reverse engineering, ask “Why? They have had it for three days. They will sell you a new one for a third the cost.”

Another shady business practice that has impacted many a foreign investor is the policy of duplicating foreign factories. A U.S. processor of packaged meats entered into a joint venture with a Chinese partner to build a rural factory to sell meat products. (baloney, etc.). After the plant was up and running, sales per month started high and over the course of several months dropped to zero. Upon investigation, it was found that local political officials had actually copied the factory as it was being built and four competing factories were now operating and undercutting prices. The U.S. partner complained to the Commercial Attaché at the U.S. Embassy in Beijing, demanding some sort of satisfaction. After much persistence he was presented with the list of people that had been executed and asked if they would be enough. They had embarrassed the

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government in Beijing and caused people in the ministry in Beijing to “lose face”. Needless to say, the attaché was shocked. Doing business in China requires a deep understanding of the culture and the people.

Despite the problems, the overall trend is positive. More people have disposable income, and a developing world-class standard of living. Many are working on their “Top 10 List” (the top ten items a Chinese family needs to own to feel successful). Even the number of cars sold is on the rise. The balance of trade in China is a huge surplus and will remain so as long as the government manages the currency valuation. That the Chinese people have learned from and imitated western enterprise is obvious by the number of McDonalds billboards in Beijing.

The influence of Document Number 1 is still evident from the manufacturing clusters in China. Manufacturing capability is clustered geographically by raw material component. For example, if you want to buy baskets, you go to Guangxi. For cast iron, the center is Xian, and outdoor furniture is Shanghai, etc.

The scattered nature of these factory clusters has spawned an entrepreneur known as the “middleman”. This is an entrepreneur who represents the factory to foreign clients. It is not unusual for him to lead you to believe that he or his organization owns or controls multiple factories. In truth, they are manufacture reps who markup and resell the factory’s products or are compensated for their services by the factory. It is not unusual for a client to find his proprietary products being copied and remarketed overseas by the same middleman or for a client to receive goods that are not at all like their original sample.

So what is the impact of all this on Western business?

Items that dramatically undercut the competition are flooding many markets. Copying existing products and eliminating the design and development also eliminates that component of the cost. The low cost of labor also impacts the total cost. This labor component not only reduces the final assembly cost but also the labor component of all sub assemblies and piece parts. Hence a product totally

manufactured in China is extremely competitive. This competition has resulted in a loss of Western manufacturing jobs to Asia.

The limited material resources in China are forcing an increase in the price of scrap metal on the world market. This results in Western foundries becoming less competitive. The steel industry is also running scared as idle U.S. steel mills are packed up and moved lock, stock and barrel to locations in China.

What strategic moves will help Western businesses survive this trend? In summary:

- Keep the custom engineering and build of high end and complex products in house.
- Outsource the repetitive manufacturing of standard products and components to third parties in Asia to capitalize on the lower cost.
- Take care to safeguard designs and products to avoid pirating by only working with reputable vendors.
- And most importantly, select a coordinator to represent you in Asia that you can trust. Be sure to check references carefully and know whom you are talking to.

Newvision Asia’s Methodology

NVA prides itself in being a full service provider. NVA maintains a mix of Western and Asian employees, all of whom are fluent in English and multiple Chinese dialects. They have years of experience in both Asian culture and business practices. As part of the pre-production process, NVA seeks out qualified vendors, coordinates the engineering development and QA specifications, negotiates prices, terms and conditions, and in general represents the best interests of NVA’s Client. As part of this full service, NVA arranges travel and lodging, visa requirements and language translation for visitors. Production services include coordination of purchasing documents, monitoring production and quality assurance, shipping coordination and expediting and financial management of the transaction. NVA represents its clients in their business activity in Asia. This client side approach is new to the Asian business community. Although skeptical at first, the vendors (and middlemen) that NVA negotiates with rapidly realize and appreciate that NVA’s objective is a

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successful business experience for all concerned. In a successful transaction, everyone wins.

The first step in the pre-production process defines the goals and objectives of the client. The client may be looking for the best existing product to import and resell. If so, the process is one of product discovery and analysis. Samples are collected and preliminary vendor qualifications are established. If, on the other hand, the client has, or wants, a product manufactured to his specifications, the process is similar but the target vendors are qualified and experienced factories. The list of factories and their preliminary qualifications is assembled for the client. This preliminary qualification process is very economical since there is little or no travel involved.

The preliminary list is then reviewed with the client to determine applicability, capability, capacity and costs. The list is narrowed down to a few viable candidates. Then the serious due diligence begins. An NVA team visits each individual factory to verify the reality of their credentials. Quality assurance procedures are examined. The factory capacity is verified. Factory management is interviewed and ownership is determined. References are obtained and checked. In general, all the initial claims are verified and a prime candidate is selected.

Next comes the second pre-production phase. The factory is provided with the product specifications from the client. These may include drawings, pictures and possibly samples. NVA is careful to review the quality assurance requirements with the factory personnel to guarantee that products shipped will be compliant. The specification process is iterative in nature and NVA assures that the communication between factory and client personnel is clear and concise. When the factory and the client are both comfortable that everyone involved understands the requirements, the pricing is finalized. Although the client contracts are directly with the vendor, NVA is responsible for supporting the negotiation of prices, terms and conditions.

When live production begins, the client sends the purchase orders to NVA first. NVA reviews the purchase documents for pricing, QA requirements, packaging and scheduling. After the NVA review, the client submits the purchase order to the vendor. When the vendor accepts the purchase order NVA begins to monitor the production process and schedule. Any deviations in quantity or schedule requested by the client or the vendor are expedited. Having NVA in the same relative time zone as the vendor, allows many questions to be answered the same day instead of the standard Asian 24-hour e-mail/fax turn around.

NVA has quality assurance procedures that include on site inspections, where digital photos and hard copy reports are transmitted to the client. These procedures include process reviews and continuous process improvement. The product is tracked through packing and scheduling for shipment.

International shipping is a complex process. When a new client comes on board, the first step is to train the client's staff on import procedures and international shipping. The training on shipping logistics includes the freight forwarding process and the Internet tools available for tracking. NVA is responsible for selecting reliable forwarders, the payment structures and the government regulations involved. Getting the product produced is only part of the challenge. Getting it delivered to the clients loading dock on time can be an even bigger challenge. Some of the hazards and considerations are as follows:

- **Missed dates** – Unless the production process is tracked carefully and packed on time, it is not unusual for ships to be missed.
- **Errors in documentation** – These can take weeks to correct when they are sent back and forth between client and vendor. Without correct documentation the shipment will sit and wait at the port of entry. NVA review and same day correction eliminates this problem.
- **Choice of vessel** – Leaving the choice of vessel up to the freight company can be hazardous. Slower transit time and time on the ocean can affect some products.

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- **Ocean warehousing** – On the other hand, selecting the vessel, the port of entry and the route can be a way of warehousing shipments until they are needed at the dock. Rerouting shipments allows this to be done dynamically.
- **Container storage** – Storing container loads in freight yards can also be scheduled.

The first step in eliminating these hazards is to carefully document and follow the shipping procedures so everyone involved understands their responsibilities.

- The vendor notifies NVA that the product has shipped.
- NVA confirms the notice back to the vendor and forwards it to the client with details of route, schedule and cost.
- NVA confirms that the client has made the final payment to the vendor and issues its own debit notice to the client.
- After that NVA continues to track and report on the shipment until it is delivered.

Fees for Services

The client is the exclusive source of funding for NVA's services. NVA has strict policies against the company or any employee receiving compensation from any other source. This policy eliminates any hint of conflict of interest.

The pre-production services are billed at an hourly rate based on the type of task and the skill set required to perform the task. The services are billed to the client monthly.

During the production phase, services are charged as a fixed percentage of the purchase order amount. The percentage is negotiated based on product type and projected client business volumes.

After a production relationship is established with a client, the pre-production research for additional products will normally be performed as part of the overall NVA service and will not be billed separately.

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