HIGH TECH WEIGHS RISKS & REWARDS OF MOVING BEYOND CHINA

August 19th, 2019 • EPS News • Barbara Jorgensen

Country-of-origin adjustments can help U.S. high-tech companies minimize geographical risks and mitigate the impact of tariffs. But the strategy can be costly, complicated and risky; and a decision that's not easily undone.

Tariffs are not going to just disappear, market experts say. Even with a delay on certain Chinese-import tariffs, the likelihood of a cease fire in the U.S.-China trade war by the end 2019 is diminishing. It's more likely the U.S. will revisit trade issues after the 2020 election.

"Even if we see a new administration come in," said Ted Bauman, a senior research analyst and economist at Banyan Hill Publishing, "they'd have to negotiate through a host of trade issues. That could be three to four years down the road."

Trade uncertainty and tariffs are driving electronics companies with operations in China to consider alternative locations. Additionally, foreign nations, such as Vietnam and Africa, are actively wooing high-tech manufacturers to their shores.

"What we're seeing is that all countries are actively courting foreign investors – this is a perpetual, ongoing phenomenon," said Johan Gott, principal in the Consumer and Retail practice of global management consultant A.T. Kearney and head of its Trade Wargaming initiative.

Typical incentives that governments provide include tax holidays; workforce training; new infrastructure development; subsidized facilities; and tax-free exporting zones, Gott said.

In addition to government incentives, there are attributes that make different countries attractive, he added. "It is basically a balance between costs, people skills, and business environment [red tape and risk]; and what is most compelling depends on the type of operations. For example, in apparel making, low labor costs are the driver, for high-tech manufacturing labor skills will be the most important issue."

Rewards

Carlsbad, CA-based EMS provider Brightworks Technology Inc. has operated in Vietnam since 2007. "We made our original investment [there] and have been very happy with the results in terms of currency stability, worker availability, work ethic, the desire to learn, and the government cooperation with industry," said Brightworks President Robert Carl. "We just recently made a second investment in South Vietnam with a new 10-acre campus."

high tech, Vietnam, Brightworks, risks, rewards
Brightworks Vietnam Facility

The decision to move even a portion of manufacturing should only be made after intensive research and for the long-term, according to business and tax consultancy KPMG. It's about more than tariffs.

Importers have found success in moving portions of Chinese manufacturing operations to another country to effect a change in product origin, according to Doug Zuvich, KPMG partner and global practice leader, Trade & Customs services. However, relocation of simple processes is not sufficient to pass U.S. Customs scrutiny.

"The key to an effective origin adjustment is determining which components or processes are most relevant to the question of product origin, and re-locating those outside of China," said Zuvich on a recent webinar.

Companies are examining a variety of strategies, according to KPMG:

- On-shoring – moving operations in-country to get closer to customers.
- Near-shoring – moving operations closer to end customers with an eye to preserving access to low cost labor and using free trade agreements to enter the end destination market.
- South of China relocation – moving operations out of China but staying in Asia for reasons such as supplier proximity and lower cost labor.
- Multi-origin sourcing – by establishing a source of supply in more than one jurisdiction while ensuring visibility and agility, companies can be ready for quick sourcing changes in the event of new tariffs or other market barriers such as sanctions and quotas.

"We do contract manufacturing and design and manufacturing of AC/DC power conversion products for consumer applications," said Brightworks' Carl. "The most compelling incentives [in Vietnam] are low labor costs, no tariffs back to our U.S. customer base, available/trainable/hardworking/learning eager workforce/seaport access, government cooperation, and utility infrastructure."

Risks

However, warns KPMG, U.S. Customs and Border Protection (CBP) has increased scrutiny on importers declaring abrupt changes to product origin. Businesses need to consider:

- Increased exposure for businesses moving operations into and exporting out of Vietnam and Taiwan.
- CBP requires importers exercise care when making changes to product origin; significant documentation and recordkeeping is recommended.
- Country of origin review is particularly important in cases where finished goods are produced using components from multiple countries and finished/assembled in China, or those that include Chinese components but are finished/assembled outside of China.

Companies intent upon moving have practical considerations as well, said Kevin Beasley, CIO of VAI, an independent supply chain software vendor. "It may sound trivial, but when you are moving operations there are language issues – your systems may have to translate; and then you have networking, your supply chain and, of course, costs."

VAI has acted as a consultant for customers contemplating such moves. "We know their supply chain and their products as we manage their ERP," Beasley explains. "This also extends to their vendors. Companies are concerned about sourcing the products they need – such as minerals – and we can use modeling to determine if their costs go up or perhaps find savings."

Data has also become an issue as nations implement varied data-storage and privacy regulations.

"Different countries have different rules about data storage, and as you move from one country to another, we've found companies that already operate in multiple locations are the best-prepared," Beasley said.

Companies may have leases or contracts in place, so a full-scale move from one country to another is time-consuming, Beasley added. "You need a lot of details, such as logistics – can you easily install equipment? Can you replicate your supply chain? A lot of companies we deal with are concerned with sourcing the products they need – such as certain minerals—so we provide modeling to determine if their costs will go up, or if they can find savings."

ERP, China, electronics, risks
Kevin Beasley, CIO, VAI

Modeling previews business challenges before companies spend any money; allows procurement departments to talk to their suppliers; and estimates supply chain costs. "As an ERP software vendor, VAI has a history of customers' purchasing behavior being very focused on purchasing efficiencies and smart use procurement costs, and has already assisted more than a thousand companies in their expansion efforts," said Beasley.

"Technology can aid relocating," he added. "Companies can consider transferring data to the cloud. Mobile [computing] will make data transfer easier."

Uncertain results

When U.S. manufacturers moved to China, duplicating their supply chains was not always possible. There are similar challenges to relocating even a portion of manufacturing.

"It depends on the product," said A.T. Kearney's Gott, "but in general, geographically concentrated supply chains, or 'clusters' provide 'stickiness' to locations, i.e. they prevent an easy move. However, countries in proximity can benefit, e.g. Vietnam or Taiwan, sitting just next door to Mainland China and able to tap into the supplier network developed in East Asia."

"As an early mover, we've had a supply chain in Vietnam for 12 years," said Brightworks' Carl. "However, for the electronics industry, we were still getting most of our bill of materials from HK, PRC, Taiwan, and Singapore while suppliers in-country were in the developmental phase. Now with the tariff situation, Chinese suppliers are realizing that their business will decline unless they cut costs and can find a way to avoid tariffs. We see them accelerating their exit from PRC and trying to establish a presence in Vietnam."

Brightworks currently serves 50 U.S. customers from Vietnam. That number has grown in the wake of U.S. tariffs.

"In the past, many companies split business between us and Chinese competitors," said Carl. "As of late, they have added to our business and downsized their orders with their Chinese suppliers."

The biggest problem for the electronics supply chain is the uncertainty that accompanies the trade war, said Banyan Hill's Bauman. "If they want to, they can switch manufacturing to Vietnam, but should they?"

Manufacturers of commodity items such as PCBs may be facing such a choice. "They are not breakthrough high-tech product, but they still need factories," said Bauman. "Manufacturers don't know the end-result of the trade war and to spend hundreds of millions of dollars to relocate—it has to be for the long-term and price competitive. It must be a worthwhile investment and these companies must also develop a supporting infrastructure. It's an open question and people will hold off on decisions to see what will happen."