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Industrial Relocation of Foxconn (East → West)

Enar lazcano
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China Europe International Business School
699, Hong Feng Road
Pudong, Shanghai
People's Republic of China



After two prosperous decades, manufacturing industries in China's coastal cities, which employ millions of migrant workers, have started moving from traditional hubs like the Yangtze and Pearl River deltas toward central and western China, due to lower production costs inland.

Foxconn, the Taiwanese electronics giant that assembles iPhones and other Apple products, is among the latest batch of manufacturers that are relocating inland. Other businesses on the move include Flextronics, a Singaporean competitor of Foxconn, which announced on May 31 2010 plans to build a new power plant in Ganzhou, Jiangxi. Other business groups also will migrate to less expensive cities in China, including Tianjin, Yantai and Wuhan, like HP.

Vice director of the Institute of Population and Labor Economics *Zhang Yi* said that China's coastal boom was fueled by cheap labor supplied from the economically backward central and western regions of the country. *Zhang* predicts that China's next boom will be led by businesses that relocate inland according to the cost of labor.

In the particular case of Foxconn, the cost of labor has increased more than the average. The firm has taken a bad publicity hit this year for a rash of employee suicides in its Shenzhen factories, and as a result, Foxconn has pledged to increase pay in the Shenzhen factory. The company has attempted to resolve the situation by relocating its main manufacturing sites to northern and inland cities where it can find cheaper labor and benefit from local governments' industrial incentives. Since Foxconn's move from Taiwan to Shenzhen has been a great success, the company intends to continue this profitable relocation strategy. In light of the recent internal crisis, its plans to relocate once again have been given absolute priority. However, suspicious minds could infer that Foxconn wants to find places with less-intense media coverage and more people

willing to work long hours for little compensation. Meanwhile, Foxconn's relocation strategy raises eyebrows because the company already decided to pass on the expense of the wage increases to customers such as Apple.

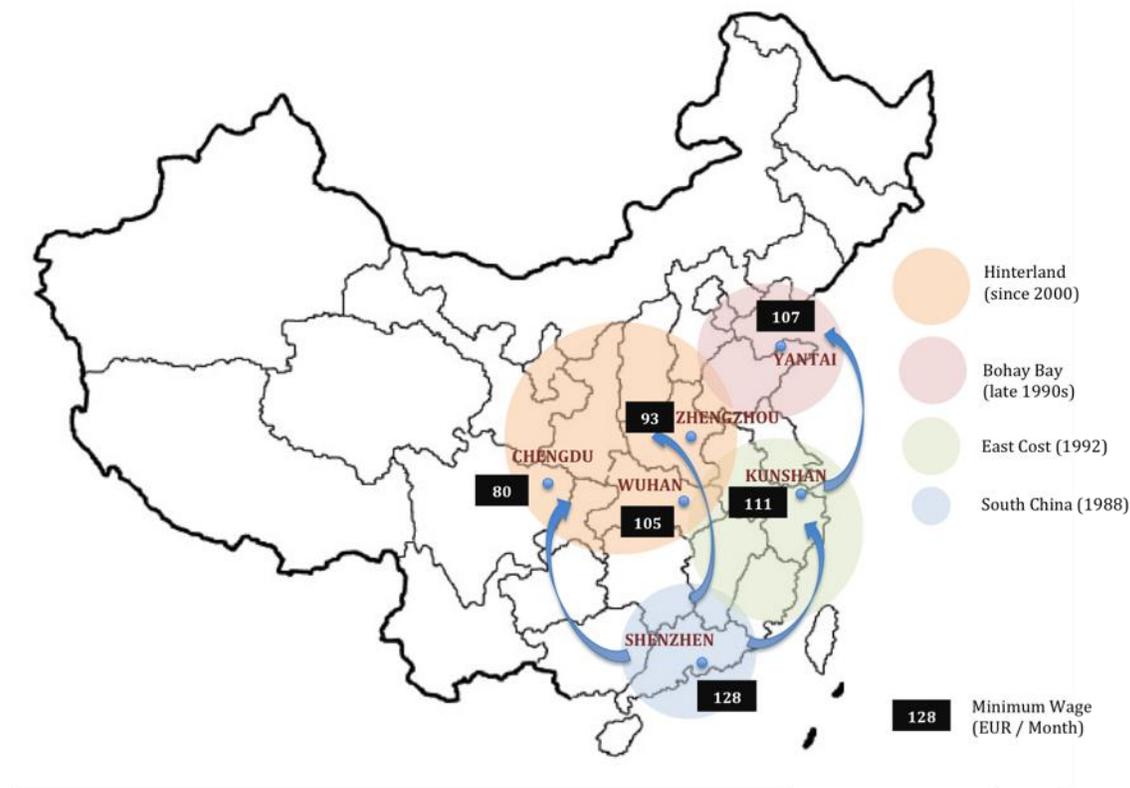
New Hosts

China has seen more and more manufacturing companies moving their plants to or setting new plants in the country's interior from coastal provinces as factory owners try to cut costs. Higher labor prices made China's traditional manufacturing bases, like the mainland's top exporting province of Guangdong, less advantaged than before. However, inland provinces and cities that offered improved transportation capacities and preferential policies shine as new investment destinations.

As this changes, a new chapter is being written in the inspiring story of economic development in Asia. Starting with Japan, country after country grew rich by following the same playbook: step on to the lowest and most labor intensive rung of industrialization and gradually move up the value chain as you build up skills and capital, letting poorer countries take on the tasks you leave. This is how the Asian countries copied Japan, and how successive generations, including China itself, followed. The current relocations are no less momentous for happening within a single country.

Business relocation is understandably welcomed by local governments in central and western China, where economic growth has lagged far behind coastal areas. Last year, the board of Foxconn approved an investment plan of EUR 50 million in Chengdu and Zhengzhou, being the first time for Foxconn to invest in those places. By far, the domestic dispute over the relocation of Foxconn settled. Foxconn explained that Chengdu and Zhengzhou will hopefully become the "key areas" in the Chinese Mainland. The Chengdu production base will focus on manufacturing tablet computers and set-top

boxes (STBs), while Zhengzhou cell phones.



Foxconn's Relocation Strategy

In the eyes of local officials, Foxconn's large-scale recruitment in these places will be a boost to local employment and GDP. Labor and education officials of Zhengzhou, the provincial capital of Henan, are the most eager participants in the Foxconn recruitment drive, papering residential areas with advertisements for the company. Many high schools in Zhengzhou are required by local authorities to make arrangements for their students to intern at Foxconn factories in Shenzhen. These internships may be seen as part of the Zhengzhou government's efforts to convince locals into Foxconn's planned Zhengzhou factories.

Despite its high status, Foxconn is struggling to recruit new workers due to rumors of

bad working conditions and a rash of suicides among its workforce this year. Even with a promised basic monthly salary of no less than 1,200 yuan (EUR 140), rising to 2,000 yuan (EUR 230) after completion of a three-month internship, many vocational high students are reluctant to work for Foxconn due to the cloud of negative press surrounding the company. Others are waiting for Foxconn to formally set up in Zhengzhou to avoid the expense and trouble of moving to Shenzhen. Regarding to this, a teacher at the Zhengzhou College told *NewsChina* that he had difficulty talking students into going to Shenzhen and was worried that he might not fulfill this *important task* assigned to him by authorities eager to accommodate Foxconn. Quotas have been set for tech related colleges requiring them to contribute a certain number of interns to Foxconn.

Before Zhengzhou was chosen as the host city of Foxconn's new factories, other provincial cities such as Hebi, Kaifeng and Nanyang, as well as a handful of cities in other regions including Tianjin, Langfang and Wuhan were all reportedly lobbying the Taiwanese firm for relocation contracts.

Relocaton and Relocation

Taking operations inland was always part of Foxconn's long-term strategy in China, before the company began to attract negative press. According to company officials, Foxconn began to transform its Shenzhen manufacturing base into R&D center as early as 2003 like in its similar centers in Taiwan, Japan and the US. The number of its Shenzhen employees will be gradually reduced from the current 400,000 to between 100,000 and 150,000, relocating its manufacturing to inland cities.

This industrial relocation is not happening just with Foxconn. Since the outbreak of the financial crisis and economic downturn in late 2008, many businesses have accelerated their plans to move inland to cut their operational and labor costs.

For instance, in 2009, Intel closes down an assembly line and testing factory in Shanghai and moved operations to Chengdu, making Sichuan Province the new export base for the international microchip giant. In 2010, Hewlett-Packard started operations at a new laptop manufacturing and export base in Chongqing. Moreover, a number of Chinese home appliance makers such as Haier, TCL and Gree are all planning to set up factories in the hinterland.

The main appeal of China's poorer regions lies in their lower labor costs. For example, the minimum monthly wage in Shenzhen in 2010 was around 1,100 yuan (128 EUR). By contrast, minimum monthly wages are 800 yuan (93 EUR) in Zhengzhou, 625 yuan (80 EUR) in Chengdu and 900 yuan (105 EUR) in Wuhan.

In addition to cheaper labor due to current income inequality, the cost of running a factory in the west is lower than in the east and south. For example, in Chongqing electricity costs 0.55 yuan a kWh; in Shenzhen in southern China, it is 0.88 yuan a kWh.

Land Grab

In the wake of the implementation of China's new Labor Contract Law from January 2008, many economists predicted that many overseas manufacturers in China would relocate to cheap labor pools in countries such as Vietnam. However, there is no sign so far of a large-scale exodus. Compared to the old contract law issued in 1994, the new law provides greater job security and employers feared the new law would have meant bigger severance payments and higher operational costs. Nevertheless, in the long run,

the new labor contract law did not negatively impact China's competitiveness and appeal as a destination for foreign investment.

Experts say it is land, rather than the cost of labor, that constitutes the decisive factor in industrial relocation. The salary gap throughout Asia is likely to narrow in the years to come, and another mayor attraction to investors is the fact that local officials in inland China can provide plenty of viable land as well as tax breaks.

There remains a huge price difference between land designated for commercial and industrial use, which may lead to a redefinition of policy. Foxconn has already acquired 230 hectares of industrial use land in Shenzhen, and more than 650 hectares in other parts of the country. Such huge land reserves are a huge asset, and Foxconn's subsequent establishment of a real estate arm to operate along side its factories has come as no surprise. For example, the main economic planning agency in the province of Zhengzhou, Henan, has already allocated 133 hectares of land to Foxconn, and not just this, also some basic water and power facilities are already under construction lobbying the firm as much as possible.

In order to attract outside investment, a local government will usually provide industrial land to a potential investor at low price or even at no cost at all. More often than not, basic infrastructure is also built at the expense of local taxpayers as part of the deal. To local officials, the success of bringing in new investment, particularly Fortune 500 companies like Foxconn and Intel, boosts the image of the local business environment and looks favorable on official performance assessments.

As the first mainland Chinese city to take over the bulk of Asia's manufacturing industry after companies moved in mass from Taiwan and Hong Kong in the 1990's , Shenzhen is

now shifting its focus to value added hi-tech products, rather than industrial scale mass production.

Land has become a scarce resource in China's coastal cities, with prices skyrocketing after the government implemented prohibitive taxation on land reclamation projects. Local officials in Shenzhen, as most of the coastal cities, publicly acknowledged that the city is now constrained on four fronts, namely: "land, energy, environment and population". It is for these limitations, inland cities such as Zhengzhou or Chengdu are gaining prominence in the new economy of China.

China's "Go West" effort

China's Communist Party, knowledge of the coastal industrial saturation, launched in 2000 its "Go West" plan to develop and modernize the west, from the Tibetan plateau to the deserts of Xinjiang, and beyond to address inequalities between China's western hinterlands and coastal east.

Western China's GDP per capita has increased in recent years from 489 EUR to 1,600 EUR, but the gap with the rest of China remains wide. The west's GDP was only 17.8% of China's total in 2009 and its average GDP per capita was only 41.09% that of the east says a 2010 report by the Center for Studies of China Western Economic Development at North-west University in Xi'an, Shaanxi province.

The main components of the strategy include developing infrastructure, attracting foreign investment, increasing environmental protection, education promotion, and the retention of high-skilled labor from flowing to richer provinces. That's one of the reasons why firms like Foxconn are moving to inland cities, in order to take advantage of all incentives offered by local governments in central and western China. Authorities has

such power that, as I mentioned before, they can be influenced in education to convince students to join a firm or build basic infrastructure at the expense of local taxpayers. Also, the central government offers favorable deals over land and tax, such as 10 percent tax reduction to companies operating in certain western areas. The ultimate goal is to attract outside investment to the west either way.

However, the go-west movement focuses also on the future consumption power of the west. China produces one-third of the world's computers, with 27.6 percent going to the domestic market last year, jumping from 20.4 percent in 2008. The next consumer market of PC will be in the western China. The annual growth of western China's demand for PCs will reach 21 percent by 2014, thanks to further development and rising incomes.

A recent survey by the American Chamber of Commerce in Shanghai shows that 28 percent of all multinational corporations that responded to its questions are considering relocating or expanding some operations from the south and east of China, up from 17 percent in 2008. All these data confirm that apparently "go west" policy is starting to work. A decade after Beijing launched its "go west" campaign to develop backward western provinces, but the hinterland remains poor. However, now that much of the infrastructure is in place, with better roads, faster railways and bigger airports, cost of moving goods around inland has fallen considerably. Having said all these, over the next decade it is expected an increase of manufacturers opening production facilities in the west and center of China.