



### What are the major questions to be answered in selecting the most appropriate manufacturing site in China?

- Why the decision is important?
- What is a regular selection process?
- What are the major criteria to be considered and how to prioritize them?
- What are the clues in dealing with Chinese officials?

## Why the decision is important?

# Incorrect site selection has brought foreign companies an unexpected tougher life in China

### Selected failure cases of site selection decisions by foreign investors in China

#### Overview:

DELL China production and headquarters are both located in the very Southern China, which is Xiamen, Fujian province.



#### Consequences:

Due to the remote location of Xiamen as compared to Shanghai and Beijing for instance, the turnover of management people at DELL is very high, since people are not willing to settle down in Xiamen for a long period.

#### Going forward:

Dell is moving part of the marketing department to Shanghai. They have signed agreement with Microsoft, Intel, Oracle, EMC, and etc, who are not allowed to hunt staff from Dell.

#### Overview:

The JV between Ford and Changan Automotive in Chongqing started in 2001 was proved to bring tough life for Ford in China.



Chongqing is not only located in the middle of China, but it is also a city surrounded by mountains.

#### Consequences:

Ford is moving their production to the Eastern China, Nanjing, Jiangsu province to gain good market and logistics benefits.

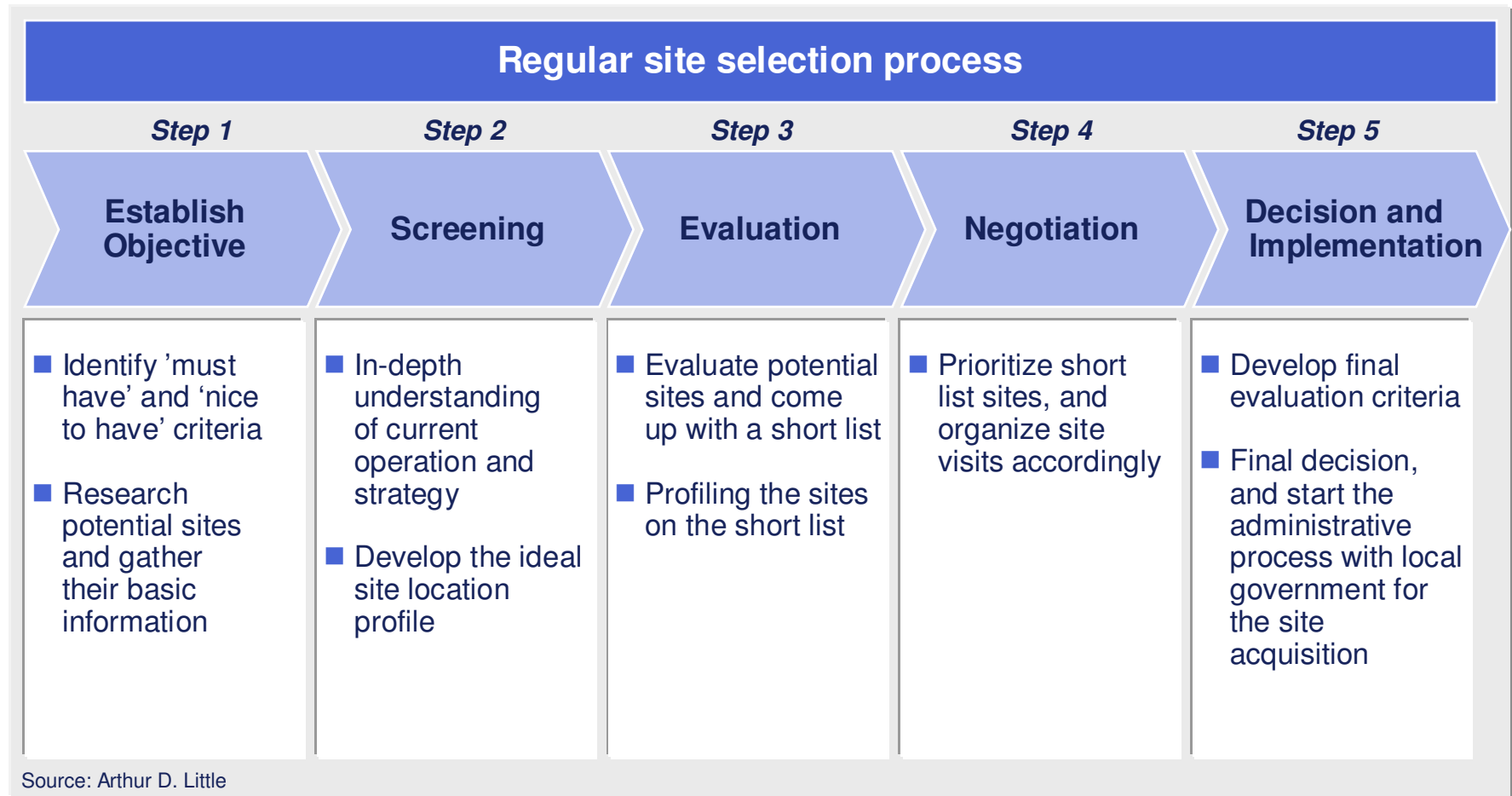
#### Going forward:

Further expansion to the Yangtze River Delta by moving headquarter and procurement centre to Shanghai.

Sources: Arthur D. Little; First Financial Daily, 2005

## What is a regular selection process?

### A regular site selection process in China consists of mainly five steps



## What are the major criteria for a GO or NO-go decision?

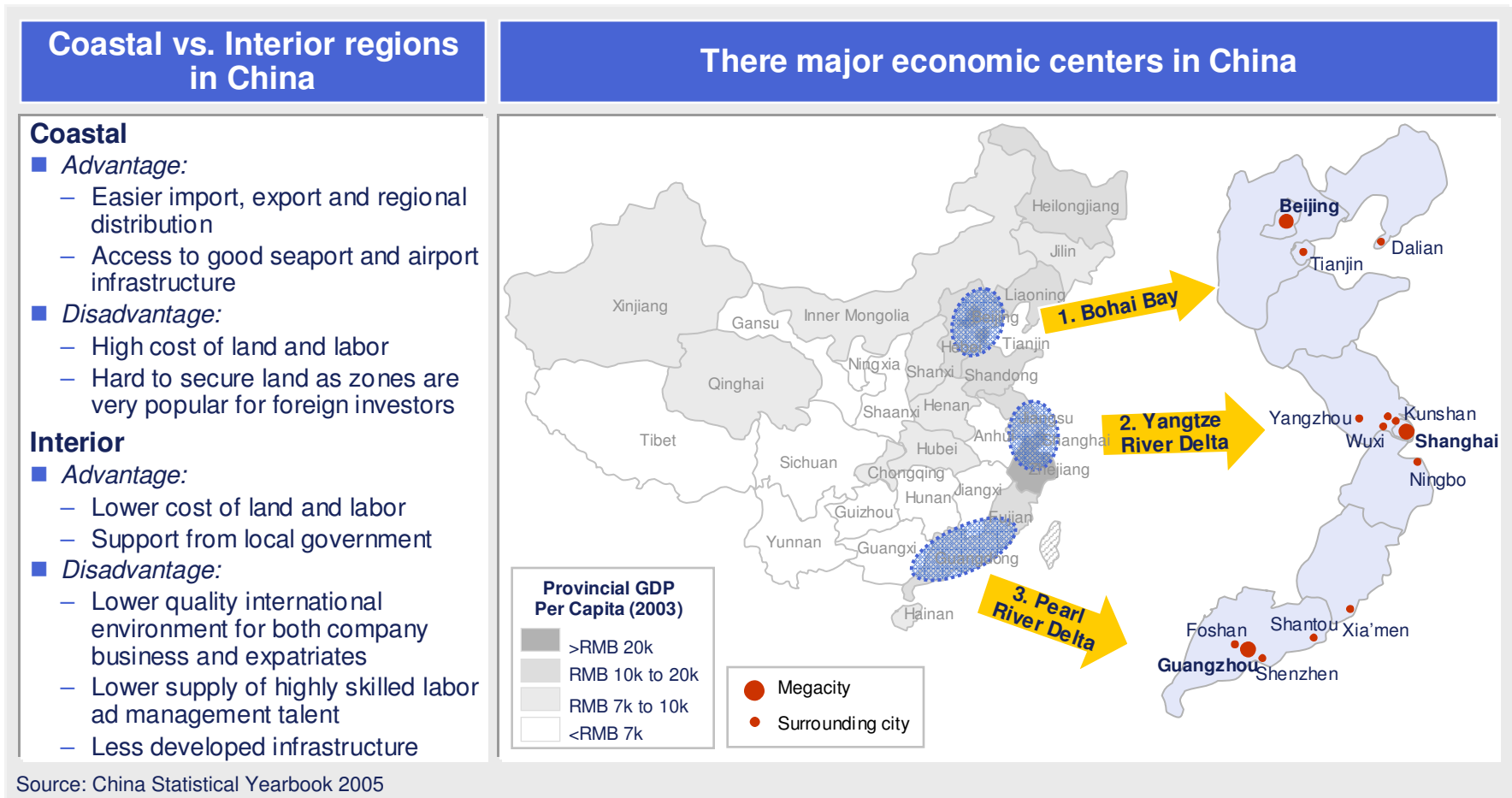
Generally three major aspects for site selection in China need to be analyzed: HR, logistics and tax incentives

Major criteria for a Go decision						No-go Criteria
HR MANAGEMENT		LOGISTICS		TAX AND INCENTIVES		
<p><b>Cost of labour</b></p> <p>The cost is relatively higher in coastal areas as compared to other regions</p>	<p><b>Access to skilled labour</b></p> <p>Labor in coastal regions tend to be better educated and skilled</p> <p>Feasible for expats</p>	<p><b>Access to suppliers and customers</b></p> <p>Effective reach suppliers and customer by referencing parameters in specific industry</p>	<p><b>Access to logistics</b></p> <ul style="list-style-type: none"> <li>■ Access to major rivers and sea</li> <li>■ Truck transport inefficient and costly</li> </ul>	<p><b>Local government support</b></p> <p>Good relation required in case of bureaucratic matters and expansion requirement</p>	<p><b>Tax regime and incentives</b></p> <p>It may vary among different type of industrial parks and land</p>	
						<p><b>2</b></p> <p>Avoid areas with high utility cost</p>
						<p><b>3</b></p> <p>Avoid areas without guarantee of energy supply</p>

Source: Arthur D. Little

What needs to be considered in respect to coastal vs. interior locations?

## Bohai Bay, Yangtze River Delta and Pearl River Delta are the three most developed regions in China



What needs to be considered in respect to various type of land?

Different business models require and can benefit from different type of land use in China

- Different business models require different type of land
- Depending on the mix of import & export, and manufacturing activities, more than a single location may be required to gain profit and efficiency

Selected business models vs. land use			
Business model	Land type	Rational	Availability
<ul style="list-style-type: none"> <li>■ Local sourcing of raw material</li> <li>■ Exporting final product</li> </ul>	China land	<ul style="list-style-type: none"> <li>■ Ordinary land in China, which is commonly available</li> <li>■ Customer clearance is needed for goods from/to oversees</li> </ul>	Mostly available
<ul style="list-style-type: none"> <li>■ Local sourcing of raw material</li> <li>■ Exporting and local sales of final product</li> </ul>			
<ul style="list-style-type: none"> <li>■ Import raw materials</li> <li>■ Local sales of final products</li> </ul>	Bonded warehouse	<ul style="list-style-type: none"> <li>■ No need for clearance</li> <li>■ Significant importation can apply for bonded warehouse with local customs</li> <li>■ Major benefit is the possibility to defer import tax</li> </ul>	Available upon approval by customs
<ul style="list-style-type: none"> <li>■ Import raw materials</li> <li>■ Exporting final product</li> </ul>	Bonded area – EPZ	<ul style="list-style-type: none"> <li>■ EPZ is designated for export oriented company (over 70% production for export)</li> <li>■ FTZ is designated with the purpose to promote international trading and foreign investment</li> </ul>	Available in coastal area
<ul style="list-style-type: none"> <li>■ Regional distribution centre</li> </ul>	Bonded area – FTZ		

Source: Arthur D. Little

## What needs to be considered in respect to HR management?

### Foreign investor should establish effective controlling system to monitor the local staff

Human Resource Management	
<b>Cost</b>	<ul style="list-style-type: none"><li>■ Cost of labor is higher in south and east coastal China. For example, salary levels in Guangdong province are often 1 - 2 times higher than in other coastal areas</li></ul>
<b>Travel distance from site to home</b>	<ul style="list-style-type: none"><li>■ Travel distance from living place to manufacturing sites should be managed</li><li>■ Remote sites may generate difficulties to secure experts, require higher pay, or both</li></ul>
<b>Job-hopping and retention strategy</b>	<ul style="list-style-type: none"><li>■ Job hopping is common if not severe in some locations of China</li><li>■ It results in disruption of operation, negative impacts on intellectual property and competition</li><li>■ Top talents in China are mostly found in Beijing and Shanghai, and there are several channels to locate them:<ul style="list-style-type: none"><li>– Head hunting</li><li>– Recommendation from people</li><li>– Attend Chinese universities and directly recruit graduates</li><li>– Through JV or M&amp;A with Chinese firms</li></ul></li><li>■ Competitive pay, attractive benefits, company reputation and international exposure opportunities are popular retention strategies in China</li></ul>

Source: Arthur D. Little



## What needs to be considered in respect to physical infrastructure and logistics?

**Generally transportation and logistics are most developed in coastal areas, where utility and land are more expensive and lacking**

Physical Infrastructure and Logistics	
<b>Transportation</b>	<ul style="list-style-type: none"><li>■ Physical infrastructure, i.e., highway, railway and airport is almost the same in all key economic regions</li><li>■ However, coastal areas usually have better access to ports</li></ul>
<b>Logistics</b>	<ul style="list-style-type: none"><li>■ Coastal areas of China, especially Yangtze River Delta, Pearl River Delta and Bohai Bay offer both good transportation network as well as customer and suppliers base</li></ul>
<b>Utilities</b>	<ul style="list-style-type: none"><li>■ 80% of China experienced power shortages in 2004, with Zhejiang, Jiangsu, Anhui and Fujian as the most severe areas</li><li>■ Cost of water in northern China is 2 - 3 times more expensive as compared to southern China due to the shortage</li></ul>
<b>Land</b>	<ul style="list-style-type: none"><li>■ Land transfer cost in close-to-Shanghai area is typically around US\$ 20-35 per sq.m, while in other areas is generally US\$ 15-25</li></ul>

Source: Arthur D. Little

## What needs to be considered in respect to tax and incentives?

### Favorable tax policy and functional service offering are another characteristics of a attractive industrial park

Tax and Incentives offered by the industrial parks	
<b>Land availability for future expansion</b>	<ul style="list-style-type: none"><li>■ Normally it is very difficult in popular industrial parks, however, an attractive investment plan and relationship with local government leadership would be helpful</li><li>■ If adequate land for future expansion can not be secured initially, a land plot should be sought that borders future expansion parcels of the park. In this case, the company is in a good position to ask for additional land connected to its current base when industrial park begins its expansion</li></ul>
<b>Functional service</b>	<ul style="list-style-type: none"><li>■ Availability of bonded warehouse or any other incumbents at the industrial park needs to be investigated</li><li>■ Be aware and clear with industrial park's plan and strategy</li></ul>
<b>Tax policy</b>	<ul style="list-style-type: none"><li>■ Tax incentives by the government is the reduction in the corporate income tax, which is 33% in China (30% is for the national government, while the 3% is for the local government)</li><li>■ China has set up various types of zones at state, provincial and local level, who provide 10%-15% corporate income tax rate and 5 year tax holiday to attract foreign investors</li><li>■ Various zones provide similar preferential policies</li><li>■ However, the Chinese government is considering unifying the corporate income tax for both foreign companies and domestic companies, and the rate is expected to be 20%-24%</li></ul>

Source: Arthur D. Little

## How should European middle-size investors prioritize the criteria?

### Foreign investors should prioritize all criteria based on their business model for the site selection

#### Case study: an European middle-sized supplier with predefined business model assumptions

##### Business model assumptions

1. Middle sized European manufacturer
2. Engaged in B2B business (a supplier)
3. Manufacturing in China for both local and overseas market
4. Raw materials and parts are sourced both locally as well as from overseas
5. Equipments are purchased locally, as well as imported from abroad

##### Prioritized major criteria and issues under consideration

- Site close to, not only a single customer, but more importantly, a broad customer base
- Site close to various mode of transportation, i.e., highway, railway, water and air, as well as ports
- Custom and logistics companies within the industrial park
- Access to both local management personals and skilled workers due to possibly inability to sent European staff permanently to China
- Establish the effective controlling system to monitor the local management force
- Possibility to start with a short-term business plan, and a flexible business model
- Formulate tax strategy or other financial control system/strategy to control investment, due to capital constrains
- Be aware of the land availability for possibly next stage expansion
- Good relationship with local government and industrial park

Source: Arthur D. Little

## What are the clues in dealing with Chinese officials?

### ADL experience summarize the DO's and DONT's in dealing with Chinese officials



#### DO's in dealing with Chinese officials

- Gather internal information through agents or colleagues – know what is happening to you
- Understand various interests the Officials have, e.g. their performance/promotion measures, their pressure from other governmental organizations, their personal interest (e.g. they might have committed before you come and need to get back to other people)
- Double check information with as many sources as possible



#### DONT's in dealing with Chinese officials

- As a general rule in China, do not trust the system 100% (they need to follow some rules, but not all)
- Don't assume they will put your interests before theirs
- Don't assume information from Officials is always exactly the "real" situation

Source: Arthur D. Little

Contact for further information

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We would be happy to discuss your experience in China and offer you our support



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