

High-tech companies grapple with rising costs in China

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The price to make Silicon Valley gadgets and computers in China - the assembly line for the global tech industry - is going up, forcing tech companies to rejigger supply chains to contain costs and to consider charging more for electronic devices.

With millions of Americans out of work, some hope the soaring salaries and other rising costs across the Pacific will trigger a renaissance in low-cost manufacturing in the United States. That is not expected to happen any time soon, experts say. But there is mounting concern among tech executives in the fiercely competitive gadget and PC markets.

"Costs are rising across the board," said Sung Won Sohn, an economics professor at California State University-Channel Islands.

Prices of imports from [China](#) rose 3.6 percent in 2011, the highest uptick on record, according to the U.S. [Bureau of Labor Statistics](#).

"This is a long-term shift, and it's going to continue," said Shaun Rein, managing director of Shanghai-based China Market Research Group, who just published a new book, "The End of Cheap China."

"Last year, 21 of China's 31 provinces increased the [minimum wage](#) on average 22 percent," he said. "Americans will have to pay more when they shop at [Best Buy](#), or companies like HP will have to squeeze margins and become less profitable. So what's happening is companies are trying to change their [supply chain](#)."

Foxconn Technology Group, which assembles [iPads](#), Hewlett-Packard laptops and many other devices in China, recently announced [wage increases](#) of as much as 25 percent for its workers. That will raise the monthly salary of many workers to about \$400, not including overtime. It was the third pay increase since 2010, though assembly-line workers in China still make a fraction of the \$2,200 a month typically paid for similar work in the United States.

The pay increases in China came as the nonprofit Fair Labor Association performed on-the-ground inspections of Apple supplier Foxconn at Apple's request. Foxconn, which employs more than 1 million workers in China, has come under pressure after a number of employee suicides in 2010 and a plant explosion that killed four employees last year.

HP Chief Executive Meg Whitman recently said rising wages in China, in particular, could affect the global electronics industry.

"If Foxconn's labor costs go up, their product cost to us will go up," she told Reuters. "But that will be an industrywide phenomenon, and then we have to decide how much do we pass on to our customers versus how much cost do we absorb."

Wages, which remain a relatively small piece of the total cost of computing devices, are merely one of the rising costs in China.

Foreign companies with operations there are also getting squeezed by the rising value of China's currency. Although the United States and other Western countries complain that China has traditionally held down the value of the yuan to make its exports cheaper and Chinese companies more competitive against foreign companies, the currency has nonetheless appreciated about 35 percent since 2005, Sohn noted.

"This year, I expect appreciation of the yuan to be up about 2.5 to 3

percent," he said.

Also contributing to rising costs is the Chinese government's new requirement that multinationals provide pensions for workers. And the prices of some metals are increasing, as well as fees tied to regulations. Meanwhile, hard-disk drives have become more expensive because of floods in Thailand, which devastated many factories.

Increasing costs "could be a big deal" for companies like HP and Dell, said Shaw Wu, analyst at Sterne Agee & Leach.

During its most recent quarterly financial report, Hewlett-Packard reported a decline in sales and a sharp drop in profit. About 30 percent of its business is "exposed" to the cutthroat global PC industry, Wu said. So increased costs could further pinch profits. Dell, which relies on computer sales for about 70 percent of its business, faces even more pressure, he said.

Apple, though, could sidestep much of the pain because it's not competing solely on price, Wu said.

"If you look at Apple's products, they are priced at premium," he said. "They have higher margins. The other (competitors') products are more commodity products. They are more price-sensitive."

Jim Handy, principal analyst at Objective Analysis, said Apple can use its market dominance in certain products to drive down costs.

"They have phenomenal clout," he said.

If the company were to pass along increased costs, it would probably result in slightly diminished upgrades of next-generation products rather than price hikes, Handy said.

For now, China retains its position at the epicenter of tech manufacturing. Foxconn, which has opened a factory in Vietnam, maintains the bulk of its operations in China but is shifting operations from the pricey southeastern region of the country to inland locations, such as Chengdu, where wages are much lower.

"If you want to ship something from Chengdu, it's the same as if you were shipping it from Shanghai," said Lester Lee, CEO of Sunnyvale, Calif.-based Recortec, which makes high-end computers used to operate factories and has extensive ties to Asia. "That little extra distance doesn't make much of a difference in airfreight costs."

"If you are a Nike or an apparel company, you are moving out of China," Rein said. "But if you are a computer- or iPhone-maker - anything higher up on the assembly difficulty level - you can't shift production outside of China. The other (Asian) countries just don't have the worker productivity and world-class infrastructure that is needed."

There have been a few examples of low-end manufacturing returning to the United States, Sohn said, particularly in the apparel industry.

Nonetheless, constructing acres of factory floors for low-end manufacturing in the [United States](#) doesn't make economic sense, said Oded Shenkar, a professor of business management at the Ohio State University and author of "Copycats: How Smart Companies Use Imitation to Gain a Strategic Edge," and who visits China regularly.

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