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# Supply Chains

## Re-shoring, near-shoring, right-shoring?

■ Anne Stevenson-Yang

- ▶ **Possible to replace?** Multinational corporations often claim to be diversifying away from China, but sourcing shifts are small-scale, targeted, and industry-specific, failing to mirror the massive shift toward China that came about with offshoring in the 1970-1990s. Companies say it takes them years to find alternative supplier networks on China's scale.
- ▶ **Double sourcing:** Many multinationals are diversifying their components sourcing to protect themselves against surprises like China's Covid lockdowns and chip shortages. Some are also increasing the inventory routinely kept on hand, and some have substituted materials and components obtained outside China for those available only in China.
- ▶ **Bellwethers or special cases?** The most high-profile moves away from China, from Google to Levi Straus, H&M, and Samsung, have been around censorship, products made by forced labor in Xinjiang, and political pressure from central authorities. But so far, investment numbers do not tell a clear story.
- ▶ **Chinese power to compel is dripping away:** For years, the lure of the market conveyed soft power to China's rulers, which they used to force localization of components. That power is disappearing.

China's sudden shifts in policy, the government's opacity, and seemingly capricious lockdowns all have international companies worrying about hedging their bets. Companies want less exposure to sourcing products from and manufacturing in China. Preferred destinations include:

- ▶ **Mexico:** According to a Kearney study of American manufacturing executives, 70% of CEOs have considered moving manufacturing from China to Mexico but only 17% have already done so.
- ▶ **India:** Many U.S. tech companies, including Apple, Amazon and Google, have invested heavily in India in hopes of shifting exposure away from China.
- ▶ **Vietnam:** Vietnam is seen as a high-quality, low-cost destination for manufacturing but lacks China's scale. Sourcing organizations praise Vietnam as a source of apparel, footwear, seafood, wood products, furniture, and other light-industrial goods. Vietnam also competes well in home electronics and electronics

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components. Vietnam is best for price-sensitive items that are not time-sensitive.

Decades ago, the adoption of information technologies made it possible for companies to access distant markets. Most governments also promoted exports. Offshoring became possible and offered such a cost advantage that companies were all but compelled to move. China was the biggest beneficiary. But as both costs and risks in China have risen, companies have been talking about diversification.

China accounts for 28.7% of global manufacturing output, a number that has continued to grow. China offers manufacturing scale, cheap capital, and lax environmental regulations. Global share has grown in every manufacturing industry.

In two years, from 2019-2021, UN procurement from China quadrupled.

## China's share of global gross output, 2000 vs 2017 (%)

	2000	2017
Glass, cement and ceramics	15	48
Textiles and apparel	17	48
Electrical machinery	11	47
Basic metals	14	44
Computers and electronics	7	41
Machinery and equipment	10	36
Chemicals	9	32
Rubber and plastics	10	31
Transport equipment	5	29
Food and beverage	6	29
Fabricated metal products	7	28
Auto	3	28
Furniture and other manufacturing	8	24

Source: World Input-Output Database; McKinsey Global Institute analysis

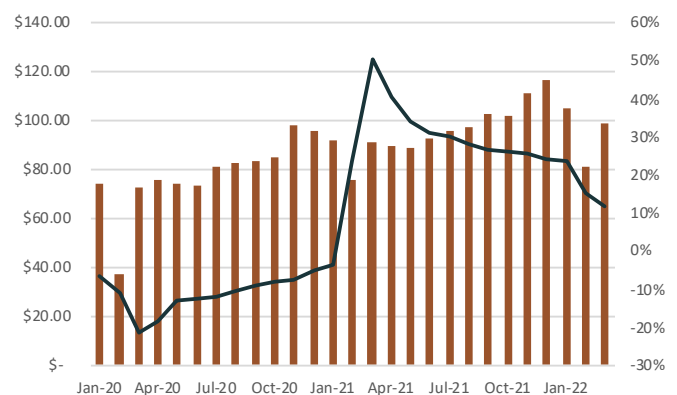
## Diversified sourcing

Shortages have been the story of the post-Covid period. A shortage of chips for automobiles, a shortage of shipping containers, and other supply-chain glitches have MNCs worrying about how to reduce dependence on China for supply. They prefer where possible to diversify manufacturing locales in order to reduce their dependence on any one country. The process, however, is slow.

To diversify, companies need to build clusters of manufacturing partners and suppliers of raw materials. That can be difficult and time-consuming.

Sourcing by foreign companies is extremely difficult to quantify. One measure is exports by foreign-invested enterprises (FIE) in China: those have persistently increased. The biggest exports by far come from Jiangsu Province, followed by Shanghai and Zhejiang. China's tax revenues from FIEs have gone from under 4% of the total in 1992 to over 17% in 2020. FIE taxes as a proportion of the total peaked at 22.9% in 2009, according to the Ministry of Commerce.

## Export Value by Foreign Invested Companies in China (bln USD and YoY)



Source: MOC

## Shifting around

Foreign companies with heavy dependence on procurement from China are all looking at ways to diversify risk.

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- ▶ **Almost a quarter of German companies** operating in China were planning to relocate production from the country in 2019, according to a report by the German Chamber of Commerce in China.
- ▶ **Toyota** mitigated the impact of the semiconductor shortage by investing in two months' spare inventories — a strategy the company picked up after the 2011 tsunami in Japan disrupted production.
- ▶ **Walmart** is moving its procurement headquarters from China to India and has laid out a roadmap that targets \$10 bln in annual procurement from India by 2027.
- ▶ **Walmart, H&M, Adidas,** and other members of the Better Cotton Initiative announced in 2020 they would no longer procure cotton from Xinjiang. Walmart met considerable political repercussions.
- ▶ **Levi Strauss** has been diversifying away from China for a long time, decreasing manufacturing there from 16% in 2017 to less than 2% in 2019. Levi's seeks suppliers that have a multi-country footprint.
- ▶ **Tempur Sealy**, which operates six factories in China, has been working to bolster its U.S. manufacturing base to combat supply-chain constraints.
- ▶ **Intel** sent a letter to suppliers asking them not to procure from Xinjiang (but followed this by making a public apology).
- ▶ **Home Depot** has generated a guide for procurement expansion outside of China.

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## Foreign companies that have left China since 2019

Year	Name	Industry	Country of Domicile	Reasons
2019	Metro AG	Retail	Germany	Sold China business to Wumei Technology Group
	Carrefour	Retail	France	Physical retail shrinking, sold business to Suning
	HTC	Tech	Taiwan	Smartphone market shrinking
	Oracle	Software	US	Market taken by Alibaba, political pressure in the US
	Asos	Ecommerce	UK	Could not compete with Chinese ecommerce
	Amazon	Ecommerce	US	Could not compete with Chinese ecommerce
	Samsung	Electronics	South Korea	Relocated to Vietnam
	2020	Auchan	Retail	France
Philips Home Electronics		Home Electronics	Holland	Sold its appliances arm to Hillhouse
2021	OKI	Electronics	Japan	Shifted manufacturing to Thailand
	Yahoo!	Ecommerce	US	"Increasingly challenging business and legal environment"
	LinkedIn	Ecommerce	US	Censorship concerns
	Toshiba	Electronics	Japan	Political disputes, relocating to Vietnam and Japan
2022	OnSemi	Semiconductors	US	Supply chain disruptions
	Lotte Corp.	Retail	South Korea	Political attacks
	Canon	Consumer electronics	Japan	Contraction in the camera market, cost savings

Source: press reports

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## Foreign companies shifting sourcing from China

Year	Name	Product Line	Country of Domicile	Reasons
2019	Kia	Automobiles	South Korea	Closed one of its plants in China after the 2017 government-led boycott of South Korean firms.
2019	Hyundai	Automobiles	South Korea	Kia's parent. Closed a plant in Beijing. Hyundai Mobis, a parts supplier, also closed a Beijing plant.
2019	Dell	Notebook computers	U.S.	Announced it would shift ~30% of notebook production out of China.
2019	GoPro	Cameras	U.S.	Moved U.S-bound manufacturing from China to Mexico
2019	Sony	Smartphones	Japan	Moved production from Beijing to Thailand and executives from China to Singapore..
2019	Nintendo	Gaming console	Japan	Moved production from China to Vietnam
2019	Quanta	Computer servers	Taiwan	Moved production from China to Taiwan
2020	Stanley Black & Decker	Tools	U.S.	Closed its Shanehen factory after 25 years in business.
2020	Google	Smartphones	U.S.	Set up \$10 bln India Digitization fund for tech companies, beginning with a 4G phone via Jio Platforms.
2020	Amazon	E-commerce	U.S.	Jeff Bezos announced a \$1 bln fund for Indian e-commerce
2020	Microsoft	Notebook computers	U.S.	Reports also suggested Microsoft would move production of its Surface line of notebooks to Vietnam during 2020.
2021	Adidas	sportswear	Germany	Pledged to cut ties with suppliers using forced labor. Has reportedly cut China manufacturing by half since 2010 and moved most to Vietnam.
2021	Puma	sportswear	Germany	Moving manufacturing to Bangladesh, Cambodia, Indonesia and Vietnam
2021	Zoom	Video conferencing	U.S.	Announced an end to direct sales to customers in China.
2021	Steve Madden	Shoes and handbags	U.S.	Moved production of footwear and accessories to Cambodia, Brazil, Mexico, and Vietnam to avoid new U.S. tariffs.
2022	Apple	iPhone 13	U.S.	Moving production to India. Launched production of the iPhone SE in India in 2017, made iPhone 11-12 via Wistron and Foxconn in India.

Source: press reports

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## Localization

China has put in place a number of rules that require foreign-invested manufacturers to localize their components base. This has been particularly acute

in the automobile industry, where prized production licenses were contingent on having the extensive list of components made in China.

## Selection of Localization Policies

Industry	Policy	Source
<b>Innovative domestic technology</b>	1991: The State Council encouraged localities to support domestic production of technologies with a 60% localization rate.	<a href="https://www.66law.cn/tiaoli/142270.aspx">https://www.66law.cn/tiaoli/142270.aspx</a>
<b>Automobiles</b>	1994: the Automotive Industry Policy for the first time encouraged automobile purchases, including by private parties, and required joint ventures to achieve between 60%-80% localization depending on the type of car assembled, in order to receive lower tax and tariff rates.	" <a href="https://www.yoojia.com/article/9820362561074894761.html">https://www.yoojia.com/article/9820362561074894761.html</a> <a href="https://www.docin.com/p-261720621.html">https://www.docin.com/p-261720621.html</a> "
<b>Light passenger vehicles</b>	1997: Tariff reductions on imported components for light passenger vehicles with a 40-60% localization rate and for engine and gearbox manufacturers with localization rates of 60% to 80%.	<a href="https://www.lawtime.cn/zhishi/a1420494.html">https://www.lawtime.cn/zhishi/a1420494.html</a>
<b>Parts for textile machinery</b>	1998-2002: Higher tax rates on any producer of textile machinery who does not achieve 40% localization.	<a href="https://www.lawtime.cn/zhishi/a1420494.html">https://www.lawtime.cn/zhishi/a1420494.html</a>
<b>Urban Rail Transit Equipment</b>	1999: Localization of equipment used in urban rail transit was to be no less than 70%. Foreign-funded enterprises had to form joint ventures with Chinese companies to bid on rail projects.	<a href="https://www.sohu.com/a/149990613_682294">https://www.sohu.com/a/149990613_682294</a>
<b>Wind power</b>	2005: A regulation requires that wind power equipment localization had to reach more than 70% or the equipment could not be installed.	<a href="http://www.chinafastenerinfo.com/gb/news/8967.htm">http://www.chinafastenerinfo.com/gb/news/8967.htm</a>
<b>Processed agricultural products</b>	2006: The 11th FYP set a 2010 target for localization of key equipment to reach 60%. Equipment was also to be internationally competitive.	<a href="http://www.mofcom.gov.cn/article/zcfb/zcwg/200704/20070404540725.shtml">http://www.mofcom.gov.cn/article/zcfb/zcwg/200704/20070404540725.shtml</a>
<b>Ethylene, PTA equipment, and natural gas pipeline equipment</b>	2007: Minimum localization on complete sets of equipment for ethylene and PTA and long-distance natural gas pipelines was set at 75%	<a href="http://paper.ce.cn/jjrb/html/2011-03/29/content_145897.htm">http://paper.ce.cn/jjrb/html/2011-03/29/content_145897.htm</a>
<b>Petroleum and petrochemical equipment</b>	2007: Minimum 75% localization required for large-scale petrochemical equipment, with 100% preferred.	<a href="http://sbgl.jdzj.com/photos/200906/20090630160651_63289.html">http://sbgl.jdzj.com/photos/200906/20090630160651_63289.html</a>
<b>Nuclear power stations</b>	2014: 85% localization required	<a href="https://finance.eastmoney.com/a/20141217458205030.html">https://finance.eastmoney.com/a/20141217458205030.html</a>
<b>Robotics</b>	2015: The 13th Five-Year Development Plan for the Robotics Industry set a 50% localization target, stipulating a certain level of domestic IPR.	<a href="http://m.haiwainet.cn/middle/352345/2015/1120/content_29376261_1.html">http://m.haiwainet.cn/middle/352345/2015/1120/content_29376261_1.html</a>

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Industry	Policy	Source
<b>Camcorders</b>	2019: Localization rates of 10-60% win escalating reductions in tariffs on imported components	<a href="https://www.lawtime.cn/zhishi/a1420494.html">https://www.lawtime.cn/zhishi/a1420494.html</a>
<b>Office computers, systems, software, servers, databases for government and enterprise departments</b>	2020: SASAC reviewed office computers, systems, software, servers, and databases to verify that most provinces had achieved 80% localization. Some provinces require 100% domestic production.	<a href="https://new.qq.com/omn/20200727/20200727A0S5DD00.html">https://new.qq.com/omn/20200727/20200727A0S5DD00.html</a>

Source: press reports

## The end of soft power

Debatably, China's excessive reliance on its market power to achieve narrow political goals has alienated partners worldwide, and many countries are making policies to reduce their dependence on Chinese trade

and investment. MNCs are no longer making splashy announcements about their commitment to the Chinese market.

A few of the policies:

## Policies to Limit Dependence on China

Year	Country	Policy	Source
2020	Japan	Allocated ¥243.5 bln to help Japanese companies exit China in favor of India and Bangladesh	<a href="https://www.japantimes.co.jp/news/2020/04/09/business/japan-sets-aside-%C2%A5243-5-billion-help-firms-shift-production-china/">https://www.japantimes.co.jp/news/2020/04/09/business/japan-sets-aside-%C2%A5243-5-billion-help-firms-shift-production-china/</a>
2022	"U.S.	"	Two senators introduced a bill to require publicly traded companies to report any connection with forced labor from the Xinjiang or with companies and products that may pose a risk to national security.
2022	U.S.	Biden Administration is investigating whether Chinese solar companies have evaded tariffs by shipping from third countries. U.S. solar projects are on hold as a consequence.	<a href="https://www.nytimes.com/2022/04/29/climate/solar-industry-imports.html">https://www.nytimes.com/2022/04/29/climate/solar-industry-imports.html</a>
2020	India	"Any country that shares a land border with India must through a government approval process to invest in India. Only China had significant trade flows with India."	<a href="https://foreignpolicy.com/2020/04/28/india-china-fdi-restrictions-coronavirus/">https://foreignpolicy.com/2020/04/28/india-china-fdi-restrictions-coronavirus/</a>
2022	Australia	Australia will invest more to find new buyers for its exports in an effort to ease trade dependence on China.	<a href="https://www.bloomberg.com/news/articles/2022-03-31/australia-treasurer-plans-trade-outreach-to-slip-china-coercion">https://www.bloomberg.com/news/articles/2022-03-31/australia-treasurer-plans-trade-outreach-to-slip-china-coercion</a>
2022	South Korea	The Moon government signed the Open Societies Statement implicitly targeting China.	<a href="https://www.worldpoliticsreview.com/articles/30219/as-china-south-korea-relations-sour-seoul-aligns-with-the-u-s">https://www.worldpoliticsreview.com/articles/30219/as-china-south-korea-relations-sour-seoul-aligns-with-the-u-s</a>
2020	UK	British Prime Minister Boris Johnson reportedly instructed civil servants to end the UK's reliance on China for strategic imports.	<a href="https://www.mercurynews.com/2020/05/21/british-pm-wants-to-reduce-dependence-on-chinese-imports/">https://www.mercurynews.com/2020/05/21/british-pm-wants-to-reduce-dependence-on-chinese-imports/</a>

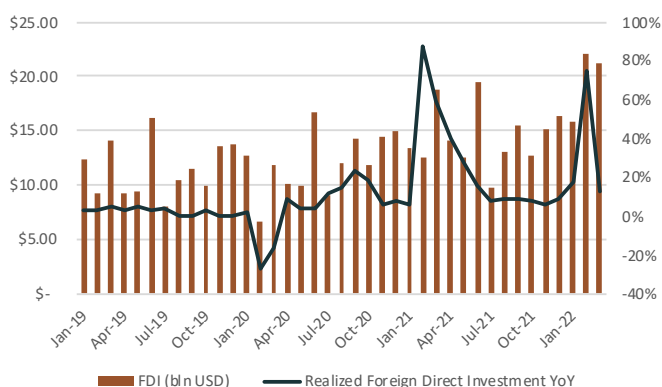
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Year	Country	Policy	Source
2021	UK	UK businesses have been told to stop “selling their soul” by reducing reliance on Chinese investment and trade.	<a href="https://www.export.org.uk/news/575071/UK-warned-to-become-less-economically-dependent-on-China-and-to-put-long-term-interests-first.htm">https://www.export.org.uk/news/575071/UK-warned-to-become-less-economically-dependent-on-China-and-to-put-long-term-interests-first.htm</a>
2021	Germany	German health minister says Germany must reduce dependence on China..	<a href="https://www.reuters.com/world/china/germany-must-reduce-its-dependence-china-health-minister-2021-11-17/">https://www.reuters.com/world/china/germany-must-reduce-its-dependence-china-health-minister-2021-11-17/</a>
2020	Vietnam	Vietnam joined two FTAs providing better access to 37 markets in Asia, Europe, and Latin America. The goal is to reduce trade dependence on China.	<a href="https://www.thinkchina.sg/vietnam-needs-do-more-reduce-trade-dependence-china">https://www.thinkchina.sg/vietnam-needs-do-more-reduce-trade-dependence-china</a>
2021	EU	The European Union unveiled a plan to cut its dependence on Chinese and other foreign suppliers in six strategic areas.	<a href="https://asia.nikkei.com/Politics/International-relations/EU-unveils-plan-to-cut-reliance-on-China-other-foreign-suppliers">https://asia.nikkei.com/Politics/International-relations/EU-unveils-plan-to-cut-reliance-on-China-other-foreign-suppliers</a>
2021	Lithuania	Lithuania’s foreign minister asked European nations to cut their reliance on China.	<a href="https://www.scmp.com/news/china/diplomacy/article/3147582/lithuania-urges-european-union-cut-reliance-china">https://www.scmp.com/news/china/diplomacy/article/3147582/lithuania-urges-european-union-cut-reliance-china</a>
2021	New Zealand	Foreign Minister Nanaia Mahuta said New Zealand must diversify its trade away from China	<a href="https://www.newsroom.co.nz/reducing-reliance-on-worlds-fastest-growing-economy">https://www.newsroom.co.nz/reducing-reliance-on-worlds-fastest-growing-economy</a>
2020	Belgium	Belgium to cut down on Huawei gear	<a href="https://www.politico.eu/article/belgium-huawei-restrictions/">https://www.politico.eu/article/belgium-huawei-restrictions/</a>
2021	Canada	Canada and the EU agreed to reduce reliance on raw materials from China	<a href="https://www.bloomberg.com/news/articles/2021-06-15/canada-eu-in-raw-materials-pact-to-cut-china-reliance">https://www.bloomberg.com/news/articles/2021-06-15/canada-eu-in-raw-materials-pact-to-cut-china-reliance</a>

Source: press reports

Many companies say they plan to reduce their investments in China, but the foreign direct investment numbers continue to rise.

## Foreign Direct Investment in China YoY



Source: MOC

## China’s Overseas Direct Investment YoY



Source: MOC



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