Why Chinese manufacturers' prices approximate being 75% less than Australian manufacturers' prices

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Part 1

A business consultancy firm based in Shanghai, China with 25 years manufacturing experience, confirms Chinese manufacturers' operating costs, which form the basis of this article.

To enable you to see and appreciate "how, where and why" Chinese manufacturers are so cost competitive and price competitive, comparative 'Profit and Loss Statements' are presented below.

Notes

1. Chinese manufacturers' Cost of Goods Sold is 2.5 times less expensive – than Australian manufacturers

2. Chinese manufacturers' Profit is approximately four times higher – than Australian manufacturers.

Chinese manufacturers Costs expanded on (all costs outlined in Australian dollars)*

(*1) Chinese wages approximate the following:
Factory staff - $1.90 per hour (including productivity bonus)
Administration staff - $2.50 per hour
Middle Management - $12.50 per hour

(*2) Chinese manufacturers pay their subcontractors a charge out rate that approximates $10.00 per hour. This approximates 83% less than Australian sub contractors' charge out rate of approximately $60 per hour.

(*3) Chinese material costs approximates 50% to 66% less than Australian material costs. The conservative "50% less" is allowed for in the Chinese P and L above.

(*4) Chinese administration costs approximate 15% of their wage costs, which is $11,900. Chinese administration cost is low because their wage cost is low.

(*5) Chinese ACC equivalent cost approximates 2% of their low wage, which is $1,550 per year. Chinese ACC equivalent costs are low because their wage costs are low.

(*6) Chinese factory rent costs approximate 75% less than Australian factory rent costs. "The Chinese Government determines the geographical areas in which they require their manufacturing and population to expand - and as a consequence the Chinese Government has been building factories for manufacturers free of charge". The conservative "75% less" has been allowed for in the Chinese P and L above.

2008 - Profit and Loss Statements

	Australian Manufacturers	Chinese Manufacturers
Revenue	$1,000,000	$1,000,000
Cost of Goods Sold		
Wages (5 direct & 2 indirects)	259,000	**77,500(*1)**
Subcontract	37,000	**6,290(*2)**
Purchases/Materials	431,000	**215,000(*3)**
	$727,000	$299,290
Gross Profit	**$273,000**	**$700,710**
Admin/Overhead Costs		
Admin	40,000	**11,900(*4)**
ACC	23,000	**1,500(*5)**
Rent	23,000	**5,750(*6)**
Depreciation	20,000	20,000
	106,000	$39,200
Net Profit (b4 tax)	**$167,000**	**$661,510**

Other significant cost advantages that Chinese manufacturers have:

1. "When factory orders "drop off" factory staff are told not to come in for a given period. And no wages are paid to factory staff for that period".

2. "Of the $1.90 per hour factory staff wage rate this can comprises approximately 63c per hour base wage rate (1/3) and approximately $1.27 per hour productivity bonus.

(2/3). So when productivity is not achieved bonus is not paid and the wage cost drops from $1.90 per hour to 63 cents per hour".

3. Many Chinese manufacturers are very large operations, which have substantial purchasing power to gain volume discounts on materials costs.

4. Government export incentives are available up to approximately 9% of the export value. "At one stage companies were costing at zero profit and receiving the Government export incentive as their profit."

One key Price Advantage that Chinese Manufacturers' have:

1. As many Chinese manufacturers are very large operations they have substantial production capacity servicing both national and worldwide export markets. Their substantial production capacity allow them to operate on low profit margins per product and per order and as a direct result of this they are able to capture new markets and maintain a competitive edge through significantly lower prices.

Part 2 – "How Australian manufacturers can compete with China"

Seven key initiatives outlined below will help you maximise your competitiveness and profitability – and therefore enable you to compete with China:

1. Carry out a full "business audit" of your engineering and manufacturing business. Consider this a "health check" of your business or a "warrant of fitness". This audit should ideally be carried out with the assistance of a professional advisor. A template form of key issues manufacturers need to audit can be downloaded free of charge from www.empowersoftware.biz/productivitytemplates.htm (Template 6).

2. To be as cost competitive as you possibly can ensure that your labour rate and overhead cost is current and highly accurate. Use a manufacturers overhead cost calculation template form free of charge from www.empowersoftware.biz/productivitytemplates.htm (Template 4). Also use professional costing and quoting software to ensure that you are thorough in listing all your costs. Stop using spreadsheets, which have significant limitations when costing and quoting.

3. Ensure that all your factory staff are highly productive (not "some" of your factory staff). Use Labour Management software including PCs on your factory floor to time track all your jobs and all your staff. History of significant numbers of manufacturers in Australia over the last ten years has shown that Labour Management systems have helped increase manufacturers' productivity by 15 to 160%. Stop using job cards that your factory staff fill out at the end of the day – as they are highly inaccurate and are misleading. And immediately stop any "casual approach to business" where you don't even record times your factory staff take on jobs.

4. Job Cost (or "Back Cost") every job you complete. Critically important to your profitability is that you "Job Cost" every job - both "the complete job" and at "each stage of the job". This Job Costing needs to be carried out and determined in your Time Tracking Software (not carried out in your Finance Software as the actual labour times, your greatest and most variable cost, in your Financial system are derived from "cheat sheets" and "lie sheets" that your factory staff fill in at the end of the day). Ensure that all your Actual Labour Times on jobs always equals or betters your Budgeted (ie Quoted) Labour Times on jobs. It is only through this "review process" do you thoroughly and properly employ 'Continuous Improvement' of your core business – which in manufacturing is Managing Labour Costs'. And immediately stop any "casual approach to business" where you don't even job cost (ie back cost) every job.

5. Maximise your sales by ensuring all your prospective clients, including those you have recently quoted work for, are always followed up proficiently. Use only professional Contact Database and Quote management Software. Stop using manual systems and listing of prospective customers solely on Word or Excel as these methods have significant limitations.

6. Target your marketing. Know your "target market" well - and truly tailor your product and service offer to meet your target markets' needs).

7. Ensure your "Unique Selling Propositions" (USPs) of your products and services are professionally and well projected - and clearly conveyed. -S-