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## Manufacturing in China: Costs Uncovered

Sean O'Sullivan, owner of Empower Productivity Consultancy, gives AHJ readers valuable insight into the differences between the Australian and Chinese manufacturing and the opportunities in both countries.

His case study is based on real world figures, with costings verified by a manufacturing firm based in Shanghai, China with 25 years experience. The case study reveals how, where and why Chinese manufacturers are so cost and price competitive. The comparative profit and loss statements are presented in this Table.

2008 profit and loss statement samples		
	Australian manufacturers	Chinese manufacturers
<b>Revenue</b>	\$1,000,000	\$1,000,000
<b>Cost of goods sold</b>		
Wages (5 direct & 2 indirects)	259,000	77,500(*1)
Subcontract	37,000	6,290(*2)
Purchases/materials	431,000	215,500(*3)
	\$727,000	\$299,290
<b>Gross profit</b>	\$273,000	\$700,710
<b>Admin/overhead costs</b>		
Admin	40,000	11,900(*4)
ACC	23,000	1,550(*5)
Rent	23,000	5,750(*6)
Depreciation	20,000	20,000
	\$106,000	\$39,200
<b>Net profit (before tax)</b>	\$167,000	\$661,510

### 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 (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 is approximately 83% less than Australian sub contractors' charge out rate of approximately \$60 per hour.

(\*3) Chinese material costs approximate 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.

Other significant cost advantages that Chinese manufacturers have:

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. The \$1.90 per hour factory staff wage rate is comprised of approximately 63c per hour base wage rate (1/3) and

### How Australian Manufacturers can Compete

Seven key initiatives outlined below will help Australian manufacturers maximise their competitiveness and profitability – enabling them to compete with China:

1 Carry out a full 'business audit' of the engineering and manufacturing business. Consider this as a business 'health check'. The 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](http://www.empowersoftware.biz/productivitytemplates.htm) (Template 6).

2 To be as cost competitive as you can, ensure 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](http://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 all factory staff are highly productive (not 'some' factory staff). Use Labour Management software including PCs on the factory floor to time track all jobs and all staff. These systems can be shown to help increase manufacturers' productivity by 15 to 160%. Stop using job cards that factory staff fill out at the end of the day – they are highly inaccurate and misleading. And immediately stop any 'casual approach to business' where the times factory staff take on jobs is not recorded.

4 Job cost (or 'back cost') every job completed. This is critically important to profitability – both at the end of a job and at each stage. This job costing needs to be carried out and determined in time tracking software (not carried out in finance software as the actual labour times, the greatest and most variable cost, in Financial systems are derived from 'cheat sheets' and 'lie sheets' that your factory staff fill in at the end of the day). Ensure all actual labour times on jobs always equals or betters budgeted (ie quoted) labour times on jobs. Only through this review process can continued improvement of core business be achieved – which in manufacturing is managing labour costs.

5 Maximise sales by ensuring all prospective clients, including those jobs which have only recently been quoted 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 products and services to meet the target markets' needs).

7 Ensure the 'unique selling propositions' (USPs) of all products and services are professionally projected – and clearly conveyed.

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*Sean O'Sullivan has been involved in a long term business advisory capacity assisting 250+ manufacturers for over 17 years to date.*

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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.

Many Chinese manufacturers are very large operations which have substantial purchasing power to gain volume discounts on materials costs. Government export incentives are also available up to approx 9% of the export value. And at one stage, companies were costing at zero profit and receiving the Government export incentive as their profit.

A key price advantage for Chinese Manufacturers' is that many are very large operations with substantial production capacity that services both national and worldwide export markets. Their substantial production capacity allows 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.

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