**From The New York Times – Business Section**
**September 16, 2010 – Page B1**


QILAI SHEN FOR THE NEW YORK TIMES

In Dongguan, China, a factory operated by the TAL Group makes shirts for brands like J Crew and Hugo Boss.

# From Low Cost to High Value

## China's Factories See Their Future As Nimble Suppliers

By DAVID BARBOZA

DONGGUAN, China — Companies here in China's industrial heartland are toiling to reinvent their businesses, fearing that the low-cost manufacturing that helped propel the nation's economic ascent is fast becoming obsolete.

The TAL Group, which operates an immense garment-making plant in this coastal boom town, is moving beyond piecework by helping J. C. Penney electronically manage its inventory of dress shirts, from factory floor to retail shelves as far away as Connecticut.

Chicony, maker of a power device used in the Xbox from Microsoft and a major supplier of computer keyboards to Dell, is diversifying by opening department stores, with three so far around China and seven more planned.

And after years of assembling vacuum cleaners and rechargeable toothbrushes for Philips and other Western companies, Kwonnie Electrical Products is planning its own line of home appliances.

"We want to do more original design and build our own brand," Benjamin Kwok, a company founder, said during a recent tour of a sprawling factory complex that has 3,000 workers, a huge warehouse and labs for testing juice makers, vacuum cleaners and other appliances.

"Many customers won't be happy with the decision to compete with them," Mr. Kwok said. "But we have no choice."

It is too soon to know whether such makeovers will succeed. But economists consider such efforts necessary — and overdue.

For years, factories here in the Pearl

*Continued on Page 4*

# China's Factories Strive To Be Nimble Suppliers

*From First Business Page*

River Delta region have served as the low-cost workshops for global brands, turning this part of China into the nation's biggest export zone. The city of Dongguan, about 35 miles northwest of Hong Kong, has long churned out toys, textiles, furniture and sports shoes — including hundreds of millions of sneakers a year for companies like Nike and Adidas.

But now, with manufacturing costs rising and China looking to create a consumer middle class, experts say the revamping of this region's industries could help reduce the nation's wide income gap and encourage more balanced and sustainable economic growth.

"It is my hope that China's comparative advantage as a low-wage producer does disappear — the sooner the better," Fan Gang, an economics professor at Peking University, wrote in a recent essay, adding that China needed to upgrade and embark on "the next stage of development."

Manufacturing costs have risen rapidly here in response to nagging labor shortages and worker demands for higher wages to help offset soaring food and property prices.

Those pressures were evident a few months ago, when a series of big labor strikes in southern China disrupted several Japanese auto factories and resulted in hefty pay raises.

There is also the looming prospect that China's currency, the renminbi, will strengthen against other world currencies in the coming years. That would make goods produced here even more expensive to export, and further erode what manufacturers say are already thin profit margins.

Seeking lower costs, some Pearl River Delta factories are relocating to poor inland regions of China where wages are as much as 30 percent lower than in coastal provinces. Other factories are moving to lower-wage countries like Bangladesh and Vietnam.

But for companies that have invested billions of dollars in factories here, simply packing up and pulling out is not always financially feasible. That is why many owners of Dongguan factories are experimenting with other solutions.

"We've decided that we're not going to be on the low end," says Roger Lee, the chief operating officer at TAL Apparel, part of the TAL Group.

TAL, which is based in Hong Kong and says it makes one of every six dress shirts sold in the United States, is expanding into supply-chain management for J. C. Penney, one of its big shirt-buyers. Through an extensive computerized system, TAL can stock and restock shirt shelves in all 1,100 of Penney's retail stores in the United States, as demand warrants.

"Too much inventory kills retailers," Mr. Lee said. "Now, we're managing inventory in each store. We gets sales data. We know what's in the warehouse, what's on the boat. We help reduce inventory."

TAL is a fortunate survivor. After the global financial crisis hit, Dongguan's exports plummeted by about 25 percent. Thousands of factories simply closed. Now — even though exports have rebounded to 2008 levels — there are worries that regional growth is slowing drastically.

"Since 2008, the investment environment has worsened in Dongguan," said Lin Jiang, a professor of finance at Sun Yat-sen University in Guangzhou. "A lot of companies don't see a future in Dongguan. And they feel pressure from the government to upgrade."

In Qingxi, an economic zone in the southeastern part of Dongguan, district government officials are trying to help desperate factories adjust to the new realities. If many companies are reluctant to leave, the local government is just as loath to lose the companies and their tax revenue.

PHOTOGRAPHS BY QILAI SHEN FOR THE NEW YORK TIMES

A TAL Group factory, one of many in Dongguan, makes more than 300,000 shirts a day.

A residential development in Qingxi, an economic zone in the southeastern part of Dongguan.

The 56-square-mile Qingxi district is crowded with textile and electronics factories, mostly backed by companies from Hong Kong and Taiwan, that produce for global brands like Burberry, Hewlett-Packard and Sony.

The country's export boom helped Qingxi transform vast tracts of farmland into bustling factories with noisy assembly lines. That created enormous wealth for the country and the local region. But the labor equation is rapidly changing.

Years ago, migrant workers lined up outside factories here hoping to apply for work. As a result, 90 percent of Qingxi's 350,000 residents are migrant workers. Most of them traveled from China's poor interior provinces to find factory jobs that today often pay about 90 cents an hour, which is the typical wage in the Shenzhen-Dongguan area.

But a demographic shift tied to the nation's one-child policy means fewer young people are entering the work force. And government efforts to improve conditions in the interior provinces have lifted growth in those regions and persuaded many young workers to find jobs closer to home.

So companies here can no longer pick and choose among workers.

"We used to prefer women because they are easier to manage," said Frank Chen, a manager at a Qingxi factory called Lite-On Technology, which makes Internet-access cards for Wi-Fi devices. "Before, we wanted three females for every male. But because of the labor shortage, it's hard to get that ratio now."

Chicony, trying to drum up workers, has taken to sending a bus around Dongguan with a loudspeaker blaring, "Chicony is the best."

Because of labor shortages and government efforts to raise the minimum wage to improve the livelihoods of migrant workers, pay rates in the Shenzhen-Dongguan area have nearly doubled in the last five years.

Still, factories here often have to pay middlemen and vocational schools to find migrant labor. The Qingxi government has also tried to step in, organizing recruiting drives into the country's poorest regions.

But longer term, district officials want to encourage innovation.

Zhu Guorong, the vice director of the Qingxi Office of Trade and Economic Cooperation, is among those trying to remake Qingxi. Recently, he drove a sparkling blue Toyota FJ Cruiser — a kind of miniature Hummer — through the city's economic zones, talking about the shift under way.

"Every company now wants to be a high-tech company, and we want to encourage them," Mr. Zhu said, as he headed for an electronics factory, where he would inquire about profitability.

The national government has preferential tax policies to encourage technology companies, and the Qingxi district government has a research and development fund — officials decline to say how much money it has — to support efforts.

One company that has already received government money for research and development is a division of Lite-On Technology, the electronics supplier.

But even for innovators like TAL, the garment maker, success is far from guaranteed.

"The price of a shirt has gone down," Mr. Lee said. "But our costs have gone up."

*Chen Xiaoduan contributed research.*

**ONLINE: WORKERS SPEAK**

*In a video, workers at a Honda plant discuss their predicament after protesting wages.*

**nytimes.com/businessday**