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By the ASQUANCE team in Hong Kong

How to win the recession thanks to China?

Nobody knows exactly how many companies closed in China in the last year. The PRC government is rather quiet on the subject, and happy to deflect attention to the awfulness of things elsewhere. One number often mentioned is 100 000 bankruptcies in the first three quarters of 2008. Official state agency Xinhua once quoted 350 000 bankruptcies. The South China region of Guangdong (Shenzhen, DongGuan and GuangZhou cities) is hardest hit.

For example, out of 5300 toys manufacturers listed by the Hong Kong toy maker trade association in 2007, only 1600 were still operating at the end of December 2008.

PRC exports declined by 3% in December 2008, and imports into the PRC declined 21%. As China is to a large extent a semi finished products transformation platform, it imports a lot of its exports. This bodes ill for future export trends.

Electricity consumption dropped 2% in 2008, the first drop since the Asia crisis of 1997. The crisis had serious consequences on state enterprises stability and the solidity of the banking system. Eventually banks had to be massively recapitalized by the state in 2004-2005.

PRC official GDP statistics are very unreliable. It is notorious that provincial GDP does not add up to national GDP, as each provincial official is paid on GDP growth. Electricity consumption is more difficult to fake and a more reliable indicator. As activity drops, imports of raw materials for energy production, but also for glass,

plastic, steel production drop. As a result sea lanes are less busy both for import and export, freight cost indices also drop.

For example the Baltic Dry index which tracks the cost of shipping raw materials by sea dropped from 11780 points in July 2008 to 785 points last week. Container shipping activity is down drastically also, and costs per TEU on the HK - Rotterdam route have dropped from USD 2500 in 2007 to around USD 800 in the past weeks.

There is now overcapacity in shipping. To compound this most Chinese factories were already closed two weeks ago, i.e. two weeks before the traditional Chinese New Year annual 1 week rest, on weak customer demand. A quick survey of the Shanghai deep sea port last week revealed 2/3 of berths empty. Hong Kong was no better. Singapore is increasingly used as a parking area for decommissioned cargo ships. Air freight operators also report unprecedented spare capacity.

The PRC government figure is that 10 million of the estimated 150 million domestic migrant workers are now without work. A quick look at the number of bankruptcies officially announced reveals how unlikely this figure is. The true figure is probably 3 to 5 times higher, ie 30 to 50 million (and the total number of domestic migrant workers is probably higher too. Most are difficult to track as they are unregistered).

Aside from classic stimulus offers (heavy structural investment announced in October), the government is under

tremendous pressure to deliver growth and jobs. Devaluation of the RMB is tempting but could lead to serious diplomatic sanctions.

More revealing is a series of measures taken since September, such as the reinstatement of VAT deductibility for exporters, sharply increased bank lending at the end of 2008, and large purchases by the state of aluminum and steel to stabilize prices and avoid a complete shutdown of the producers.

Also noteworthy is the new tendency in government and the press to lean over private companies to retain surplus workers, while at the same time being more lenient in implementation of the strict 2008 labor law.

THIS IS ALL VERY WELL, NOW HOW DO I WIN ?

1- Leverage the downturn in your Supplier relationships

Buy better. Do not forget that raw materials costs have seriously crashed, and that pressure on labor costs is down to. Use competition to your full advantage.

Time is on your side: factories have idled for the Chinese New Year, order books are empty. This winter will be difficult for factories with low cash. The COO of a medium sized electronics factory (5000 staff) renowned in the industry for its high quality and conservative approach told us recently: "We are fighting for survival."

Renegotiate all your contracts. Please pay equal attention to the next point.

2- Do not use just any supplier

More than ever, check your partners background, their latest financial situation, and obtain additional information through

trade sources. Watch your competitors cry when their supplier defaults with their down payment. Do not face such problems, perform yearly audits of their accounts, and use frequent factory visits - product quality inspections for example, to keep an eye of staff and inventory conditions.

3- More than ever, check PRODUCT QUALITY.

Any supplier in a tight corner, be they Polish, Mexican or American, will be tempted to cut corners on quality. Avoid suppliers who do not authorize spot quality checks in the factory. Also avoid suppliers who require full payment of the goods before production.

Finally, beware of habit: it is traditionally after the third delivery that quality starts to slip. We talk from experience on the latter, and expect quality will deteriorate even faster in the current climate.

Reasonably you should pay no more than 35 to 50% of an order before having had a chance to verify product quality on site.

4- Do not forget to review your freight agreements.

China and Asia were on the verge of being expensive with petrol at USD 145 per barrel and a wave of ever increasing demand. Things have changed. Asia is again a very competitive solution to buy better and cheaper.

China again leads the way and will help you reach profit targets.

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