KCS Group Europe

Made in China: Is ‘China Plus One’ Working?

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As multinationals adapt to the shifting challenges of global manufacturing, the ‘China plus one’ strategy was devised to facilitate such change. This approach promoted the diversification of supply chains away from China to neighbouring states to mitigate risks amid geopolitical upheaval. Unfavourable political exchanges aside, foreign business operating in China were also facing rising labour costs and insecure supply chains.

Some say moving from China was not merely to do with reducing dependency considering tensions, but more about becoming increasingly efficient and identifying new markets with favourable trade conditions and operational costs. Vietnam and India were the first identified as viable manufacturing locations, offering advantages such as low-cost labour and growing local markets.

Apple Inc. is known to have been actively diversifying manufacturing locations since 2023 from China to both Vietnam and India, driven by political pressure and a need to enhance supply chain resilience.

The dynamics of diversification

The ‘China plus one’ reorientation was instigated by a need for not having all one’s eggs in one basket and mitigating risks associated with an over reliance on a single market.

In contrast, while most multinational firms have sought to relocate to alternative ‘plus one countries’ as a consequence of tensions, political pressure and supply chain risk, German businesses have been going against the grain.

Companies like SEW-Eurodrive and leading optics maker Zeiss are increasing their investment in China and exploiting newfound market potential and supportive government policies. The strategy has been referred to as “in China for China” which looks to compete by leveraging improved technology and product quality.

This trend reveals a newfound commitment to the Chinese market, regardless of the broader decoupling actions of foreign businesses previously operating in China, irrespective of supply chain, rising labour and US applied tariff cost concerns.

Strategic implementations and outcomes

Vietnam's diminishing appeal

Vietnam has been one of the main benefactors taking advantage of the ‘China plus one’ diversification having attracted many multinational firms. The move was largely instigated by rising labour costs and tariff charges applied by the US on all goods exported from China following ongoing political differences. Labour costs are reported to be 20 per cent lower than in China, with pay as low as US$150 a month.

However, Vietnam itself is now experiencing escalating costs. It is interesting to note that Vietnam’s lost cost lure has, for years, attracted thousands of foreign investments from Japan, Singapore, South Korea, Taiwan and even mainland China.

Many Chinese firms moved manufacturing operations to Vietnam as a workaround to also avoid US tariffs, a move that the US government has accepted. Chinese power tools manufacturer, Chervon, set up a small factory in Vietnam three years ago with a view to avoiding US tariffs and reducing costs. Chervon generates two-thirds of its revenue from the US and has reported that it is making less than expected. This has been apportioned to a 10 per cent increase in raw materials and operational costs. These rises coupled have made operations 7 per cent higher than when in China, which is on a par with the 7.5 per cent US tariff. It must also be noted that Vietnam’s labour force is considerably smaller than China’s, which means that scaling up production is a concern, as has been reported by Apple inc.

Land prices are said to be more expensive in places than China as a result of an influx of investment from South Korea (Vietnam's top foreign investor), China and Japan. Some experts believe that operating costs in Vietnam are now 10-20 per cent more expensive than China. The changing landscape in Vietnam suggests that it might no longer be the anticipated solution to replace Chinese operations.

Has India benefited from the 'China plus one' strategy?

Despite increasing foreign investment following supply chain diversification from China, data reveals that the dragon's dominance in global exports has increased. During 2018 and 2023, China's global exports grew from 12.9 per cent to 14.9 per cent, with mainstay exporting nations Germany, Japan, South Korea, France and the UK losing share. India's share in world exports was modestly up from 1.7 per cent to 1.9 per cent over the same term. This means that to date, India has not benefitted significantly from the 'China plus one' agenda.

One of the key reasons for these limited results is the difference in the exports from India and China. China's top exports consist of high-value industrial matter like electrical machinery, nuclear reactors, and vehicles, where India's include mineral fuels, jewellery and organic chemicals. The difference in these export profiles explains why India is not really directly competing with China in a lot of key sectors and that is where China has the stronger comparative advantage.

Paris Olympics case study

At the Paris Olympics, Chinese manufacturers were able to demonstrate their strength in manufacturing and global distribution by establishing contracts with a variety of suppliers, from high performance equipment to Olympics souvenirs. Despite diversification, China's mass production capability remains unparalleled, as seen in their supply of equipment for the iQFoil windsurfing events. Chinese company, Sonic Composite Technology, demonstrated their advanced manufacturing processes which has made them leaders in innovation and production. This presence at a prestigious event such as the Olympic Games, underscores the limitations of the 'China plus one' strategy, as other nations struggle to compete. Any envisaged dislocation of Chinese manufacturing prowess is far from materialising anytime soon.

Evaluating market responses and future directions

In the process of evaluating the ‘China plus one’ strategy, it is plain to see that while the initiative sought to offer alternatives to China, the economic impacts and operational challenges have been abundant.

Rising costs in Vietnam show that these substitutes might not be able to accommodate the China’s manufacturing exodus without significant infrastructure investment and local training. China’s dominance, as witnessed at the Paris Olympic games earlier this year, suggests that the nation’s prominent position in manufacturing remains intact.

Peering into the future, the long-term effects of the ‘China plus one’ strategy will see a more subtle manufacturing landscape. Businesses will have to weigh the benefits of diversification over the efficiencies of existing operations in China. Boardroom decisions will not just consider geographics, but also an in-depth analysis of trade policies and possibly labour dynamics across myriad manufacturing hubs.

Conclusion and strategic recommendations

The ‘China plus one’ initiative that looked to present alternative manufacturing opportunities to China, shows mixed results. While countries like Vietnam and India have welcomed the attention, operational challenges and cost increases have hindered effectiveness.

Multinational corporations would do well to continuously assess and adjust strategies focussing on cost, efficiency, scalability and geopolitical risk. It is recommended to explore local partnerships in new markets and conduct thorough risk assessments. This will go some way toward firms being able to stay agile and responsive to these volatile conditions.

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