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The Pros and Cons of Offshore Production

Eased trade restrictions are luring more and more American manufacturers to distant shores, where low wages promise the chance to meet global competition.

Mexican assembly plants, known as maquiladoras, got a big boost from the 1994 North American Free Trade Agreement. Now, a year after China's entry into the World Trade Organization, that country is the site of choice for many U.S. manufacturing companies. Manufacturers also find attractive incentives in other nations in Asia, the Caribbean, and Central America.

But the opportunities come with substantial risks requiring careful evaluation.

Opportunities

The opportunities are undeniable.

Impressive advantages flow from reduced labor costs in developing countries. Mexican factory workers make about \$2.50 an hour, including wages and benefits. Figures in China are hard to nail down, but informed estimates peg wages at somewhere between 50 cents and \$1 an hour. In the United States, on the other hand, manufacturing workers average \$15.41 an hour.

Also, some companies are drawn offshore by less restrictive government policies — particularly environmental rules. Access to new markets is another plus, along with proximity to sources of less costly parts and supplies.

Risks

But the risks can be substantial.

To begin, the sheer distance from headquarters makes it more difficult to exercise the careful supervision required to maintain control over product quality.

Costs connected with the physical move of assets and personnel can be very high, especially when the new operation is in Asia. And once you're there, expensive surprises may continue, in the guise of unexpected infrastructure problems. Inadequate roads, rail lines, and utilities, for example, can impede efficient supply flow and product distribution.

You also are likely to encounter water shortages and insufficient sewage treatment facilities, affecting not only production capacity but also the human needs of your work force.

Culture Shock

Differences in language and culture may present the greatest adjustment challenge.

The informal culture of the United States has bred a work force responsive to a light hand of supervision that encourages them to recognize and solve many minor production problems without specific instructions. In the more regimented developing world, workers are likely to await clear orders from authorities for each step, creating a need for more intense supervision.

Other differences in experience may show up in specific work habits, for example in worker attitudes toward preventive maintenance.

American workers accustomed to maintaining household appliances and automobiles know the value of taking care of equipment. But employees in countries where spare parts are hard to get may find it strange to fix something before it's broken.

Likewise, record-keeping requirements in a modern factory may bewilder workers who've never had a bank account or a credit card.

Safety

Overseas wages may be lower, but some labor costs may approximate those at home. For example, following lower overseas standards on questions such as child labor and employee safety can damage the reputation of a U.S. company and create legal problems.

In one recent Texas case involving the deaths of 14 workers in its Mexican operation, a U.S. garment manufacturer faced a \$30 million lawsuit. The workers were killed when a company bus ran off the road. Plaintiffs in *Rodriguez-Olivera v. Salant Corp.* accused the company of skimping on bus safety and driver training.

Tax and currency questions present another area of uncertainty. Maquiladoras have lost some of their cost edge with the expiration of many of their early tax exemptions. In the two-tiered Chinese tax system, domestic producers have an advantage over foreign investors.

Margins are subject to sharp changes with unpredictable sudden shifts in currency value, like the 1999 rise in the Mexican peso.

Even more troubling is the possibility of political disruptions. In extreme cases, upheavals may result in governmental expropriation of foreign investments.

With this complex set of variables, offshore ventures require thorough planning. Substantial financial resources are required for such projects, along with cultural understanding, patience, and flexibility.