Offshore Competition

North American springmakers struggle as OEMs court low-cost countries. What's the solution?

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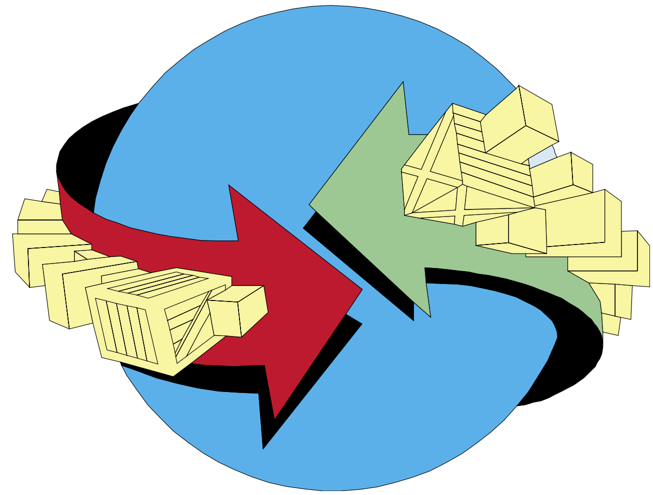

Springmakers have always had to stay one step ahead of cross-town rivals, making sure prices are competitive, machinery is up-to-date and engineering re ects the hot new trends. Because our parts are metal, air, engineered and low cost, we have been able to escape the push to China longer than other component suppliers and mostly worry just about the guy down the street undercutting price.

Being made of metal ensures the parts are heavy enough to drive up long-distance shipping costs. In addition, the shape of most springs means that a certain amount of air (dead space) will always take up room in the shipping cartons. As an engineered component, OEM manufacturers have always relied on springmakers to work with them closely in design areas. Finally, because springs are not high-ticket items, they were further down the list for sourcing to low-cost countries (LCCs) than other, pricier components. Now, however, the buyers have shopped so many of their other components in LCCs, and the only items left are the small formed-metal products. The heat is on for buyers to take even the springs overseas now. The mandate coming from the top at American OEMs is that all components are to be sourced in LCCs post haste and without fear.

Part of this initiative is because entire operations are closing their North American plants and moving all manufacturing to LCCs. While Mexico became a good, low cost alternative to manufacturing in the U.S., it barely makes the list of LCCs, which now primarily include Eastern European and Asian countries (see sidebar, page 13).

Roy Vinderine, joint CEO of the HS Spring Group, with manufacturing facilities in Canada and the U.S., says he personally is less worried about competition from LCCs where it involves the importation of springs into North America. What is far more worrisome to him is the relocation of so many North American manufacturing facilities to these countries.

"Competition, where the playing field is even, has never bothered us," says Vinderine who is also the president of the Spring Manufacturers Institute (SMI). Free Trade and NAFTA have, he believes, been very positive in opening up markets for all who choose to pursue these opportunities.

Regarding imports from LCCs and China in particular, his view is that this offshore competition is a reality and, no matter how efficient we are, we will never be able to compete on price alone where there is such a disparity in wage rates, benefits and so forth. Some customers have said they are, or will be, purchasing springs from China and other LCCs simply because of the lower costs. Given the distances, and all the service and quality requirements that have become our daily way of life, Vinderine questions how effective such imports will be ultimately, or whether compromises will be made by the OEMs and others when it comes to quality standards, JIT, PPAP submissions and all the other requirements on top of extended credit terms. If the LCCs have to set up organizations within North America to warehouse products, and have spring engineers and QA people available, the customer and the overseas supplier may find the exercise more problematic than it's worth.

Vinderine's company is itself an exporter to Europe and Mexico, and he is fully aware of the difficulties that can, and do, face both customer and manufacturer who are continents apart from one another and where the products in question are springs and components.

A recent visit to China opened Vinderine's eyes: "I was extremely impressed with what I saw, particularly the dedication of the Chinese labor force. I visited six different factories and was struck by their work ethic. I never saw any workers lift their eyes from their work, yet they only earn around $2 per day."

As with all springmakers today, Vinderine's group is continually faced with "cost down" demands and, in some instances, they have sought quotations from Chinese companies in an endeavor to retain business. "All the quotes we've received so far have been at prices pretty close to our own, and we have not placed one order for offshore supplies. This is very surprising to me, and perhaps a great deal of negotiation is necessary before the best price is agreed."

What worries Vinderine and his partners far more is the migration of manufacturing to LCCs such that companies have significantly down-sized or shut down entire manufacturing plants in North America in favor of low-cost opportunities elsewhere. "Because of the nature of springs, it is obvious that our 'bread and butter' will largely be purchased where the product itself is being made to eliminate the very problems mentioned earlier. Companies such as Xerox, Black and Decker and GE are but a few who have made this move, and recently Ford announced plans to purchase billions of dollars of components offshore."

This trend seems to be nearing avalanche proportions, which may be the result of macro-economic realities. "I'm hopeful," says Vinderine, "that the burgeoning middle classes in the LCCs (there are 30 million Chinese already who can afford to buy a car) will account for a larger and larger proportion of the products manufactured in those LCCs. Otherwise, I foresee terrible times ahead for North American industry and, of course, its work force. What will happen to our economies when so many will be in lower paying service jobs or have no jobs at all?"

What do we do about this situation? Some spring companies have already opened manufacturing facilities in the LCCs and others have made, or are contemplating, joint ventures and other arrangements.

"I believe absolutely that the only way to control the situation is within the legal framework of the World Trade Organization and other such bodies. If the playing field is even and all countries are made to play by the rules, fair trade should be the result. This is probably all we can hope for other than making our politicians and governments aware of what is happening day to day. I personally don't think sanctions, tariffs or trade embargos are a good idea, except where there is non-compliance with regulations. Enacted to assist the steel manufacturers, the current steel tariffs in the U.S. have had a very serious opposite effect on steel users, whose costs have escalated at a time when we all face price-lowering demands and massive competition from elsewhere. Rightly, there is a lobbying effort, in which many of our members are involved, to have this tariff removed. It would be a little strange to try and get a new tariff imposed on imported spring products at the same time."

There are a number of countries, and China is one, that control their currency exchange rates such that they are always at the same percentage discount to the U.S. dollar. Consequently, even in times like these – where the dollar has lost significant value against the other major currencies, making U.S. products cheaper and more saleable on the one hand and resulting in higher prices for imports into the U.S. – there is no effect what-

The LCC Initiative is in the News

The "LCC Initiative" is the latest sinister buzzword. It is a now common mandate from major North American manufacturers, directing buyers to shop for components and assemblies in low cost countries. While Mexico was once considered a low cost country, it now barely makes the list. Rather, the hot countries to shop include India, China, Korea, Vietnam, Brazil, the Philippines, Ghana and Eastern European countries, like Bulgaria and Romania.

The first industries to feel the pain of LCCs were the call centers and computer operators. To some extent, manufacturing was protected by high tariffs and shipping costs, not to mention engineering and quality concerns. The major manufacturers at first tried to protect themselves by asking their current spring suppliers to be the front-line outsourcers, shouldering any burden for testing and ensuring good products. The quality-assurance fear factor kept manufacturers from cutting American and Canadian springmakers out of the picture completely.

Now, the spring industry is discovering the hard truth that other industries discovered over the past few years: The brainwork can be done almost anywhere. Beyond simply manufacturing components, these LCCs are developing an educated work force that can give extensive design assistance. According to a recent *BusinessWeek* article: "You will see an explosion of work going overseas," says Forrester Research Inc. analyst John C. McCarthy. He goes so far as to predict at least 3.3 million white-collar jobs and $136 billion in wages will shift from the U.S. to low-cost countries by 2015. Europe is joining the trend, too.

The list of companies moving operations out of Mexico reads like a Who's Who of American manufacturing. Economist Paul Craig Roberts, in his series on America's Periled Future, recalls that last year, Emerson Electric made a bold statement that it would move at least half its engineering work to China and India by the end of the year. Emerson CEO David Farr was quoted as saying, "When we finish this calendar year 2002, 70 percent of our manufacturing will be in low-cost countries." Roberts also lists Black & Decker, battery maker Evercel, and auto parts maker Lear Corp. as companies that have recently announced closures of U.S. operations and moves to China.

Things could get worse. According to a recent *Kiplinger Forecast* article, "U.S. exports to China have increased an average of 12 percent per year over the past 20 years, while imports from China have increased an average of 20 percent annually. If this trend continues for another five years, our trade deficit with China will reach $330 billion by 2008, up from $103 billion in 2002."

Valeo, the French automotive equipment supplier, has a substantial investment in LCCs. Not content to source from these countries, Valeo has set up complete operations, beginning with green grass sites. In March, Valeo announced that it would open a new plant in Poland, bringing the number of Polish plants to five. In keeping with trends toward hiring local management, rather than bringing in management from the manufacturer's home country, this plant will have a primarily Polish management team.

Valeo has been in China for 10 years and plans to expand by opening several new manufacturing facilities in China for different product lines over the next few years. Valeo credits process standardization for keeping quality high, regardless of production origin. Part of their commitment to LCCs is to source components for assemblies within these countries. Major manufacturers, like Valeo, have the money and resources to develop their own sources within these countries. Where there is a deficit of component suppliers, these major manufacturers are working to develop their own sources and investing in new manufacturing equipment to support the ventures.

As the OEMs continue to push their LCC initiatives, we will continue to see an erosion of the manufacturing base in North America. There are two hot business topics being played out in the news on a daily basis. The first is the exodus of basic manufacturing from the U.S. and Canada. The second continually overshadows the dismal exodus story: the success of the move toward manufacturing in low cost countries. While lower costs for goods may delight the consumer, they are cause for concern – even panic – for North American suppliers.

What the public and many politicians do not understand are the serious economic repercussions of the LLC initiative. According to a National Association of Manufacturers (NAM) study conducted by Joe Popkin and Co., manufacturing spawns more additional economic activity and jobs than any other economic sector. Every $1 of final demand for manufactured goods generates an additional $0.67 in other manufactured products and $0.76 in products and services from non-manufacturing sectors.

Another indication of the current pressure on U.S. employment is the growing number of discouraged jobseekers who have dropped out of the labor force. The 5.8 percent unemployment rate statistic does not include those too discouraged to seek jobs.

According to U.S. Labor Department figures reported in the *New York Times* on April 27, four million Americans have dropped out of the labor force since March 2001. Some of these dropouts are 30-year-olds formerly making $150,000 per year. The *Times* also reported on April 26 that the real earnings of those in the top 10 percent fell 1.4 percent over the last year, while the real weekly pay for the median worker fell 1.5 percent.

"Pay cuts and a growing number of discouraged jobseekers are the inevitable consequences of U.S. firms substituting lower-cost foreign labor for American employees," concludes Roberts. ❖

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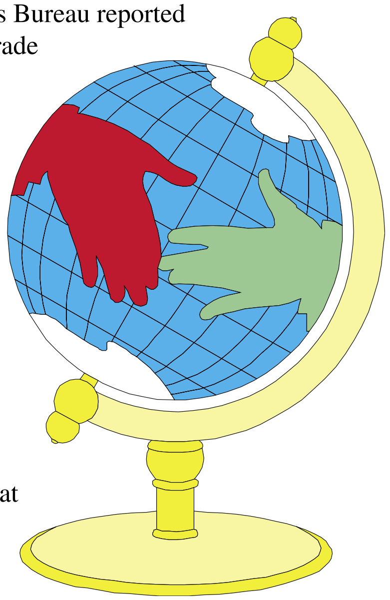
ever on those countries who "peg" their conversion rates against the dollar. "This is where we should be exercising our efforts to the maximum," says Vinderine.

Fred Tedesco, president of Pa-Ted Spring Co. in Bristol, CT, has taken an activist role in combating the exodus of American manufacturing to LCCs. He has had some remarkable successes in getting his message heard on the local, state and national level. "It started for me when I combined efforts with Rich Larkin of the Brown & Larkin Accounting Firm. Now, we are talking to the Bristol Chamber of Commerce, SMI, Manufacturing Association of Connecticut, Connecticut Business and Industrial Association and the NAM [National Association of Manufacturers]."

Tedesco and group have had heartening success in gaining the attention of legislators. They have met with Congresswoman Nancy Johnson and Senator Christopher Dodd, both from Connecticut. "Nancy and Chris told us to do more than just tell them our problems. They asked us to present solutions, and we have taken up that challenge."

Tedesco has extensively researched U.S. trading partner status. According to Tedesco, China has become our most troublesome trading partner by far. "We are expecting a $133 billion trade deficit by the end of 2003, and the numbers we have seen so far are right on target to meet this projection." (For January through April 2003, the U.S. Census Bureau reported a $34,121.8 million trade deficit with China.)

Tedesco is concerned that most of the American transplants do not, or are not allowed to, sell their products in China. "What I have been told by many people is that the government becomes a part owner in their business and tells them that they must export their product. In



that way, China gets the trade dollars. It is not a pleasant negotiation process," he says. "We have to recognize that the Chinese have no intention of taking our products for sale in China, but they'll take our money."

"The effect is compounded because American companies are taking their money out of the U.S. and using it to build manufacturing operations in China. Large companies have fostered this marketing ploy of making everything cheaper, which has forced companies in the U.S., Canada and Mexico to close and move to China. Our NAFTA partners are being killed here," he says.

For Tedesco, the numbers tell an alarming story: According to the Coalition for a Sound Dollar, a group of 60 trade and business associations, the U.S. has lost 2.2 million manufacturing jobs since March 2001. Tedesco and his group project the U.S. will lose an additional 1.1 million jobs in 2003. These job losses are due to numerous issues; however, he asserts that the move to Chinese-based manufacturing is a major contributor to the problem.

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Furthermore, Tedesco believes there is an actual plan on the part of the Chinese government to pursue our manufacturing base. "I have seen Chinese delegations in Mexico and the U.S. go after certain industries with a vengeance," he says.

"There are U.S. security issues arising over this move to China," he continues. "Small to medium manufacturing in the United States is crumbling. It is shocking that components for our defense systems are being made in China. We are at risk of being so dependent on China for equipment and parts that we will not be able to properly defend ourselves in the future." Part of his yet-unnamed coalition's platform is a proposal that all defense-related components must be sourced within the U.S.

As Chinese manufacturing eats away at our high-dollar manufacturing jobs, Tedesco says, we are losing our ability to be a world power. "Who do you suppose will be able to step into that role?" he asks. "We are dumping hundreds of billions of dollars into a communist country. It is frightening to know that companies like GE and Pratt Whitney are making airplane engines that run on Chinese parts."

Tedesco feels it is time for Americans to evaluate the amount of technology we are sharing with the Chinese. "We are transferring technology to China for free every time we work with them to engineer manufactured parts. Once it is there and they see it, they own it.

"We want major retailers to accept and recognize that they have a stake in not destroying the American manufacturing base," says Tedesco. "The majority of the business we are losing is not because the Chinese are sending springs here, but because entire companies are moving operations to China, which destroys NAFTA."

Small appliance manufacturers are a good example, says Tedesco. His knowledge comes from experience with his own customer, a major manufacturer of small appliances. A short time ago, his customer had six plants in the U.S. and three in Mexico. Today, that same manufacturer has one plant in Mexico and none in the U.S. All products are now purchased in China. It cost Pa-Ted Spring over a million dollars a year in sales. According to Tedesco, this same scenario is being played out in spring manufacturing houses throughout North America. The flight to China in 2003 is shaping up to be the highest manufacturing exodus in 10 years.

Tedesco attributes part of the problem to the nature of the spring industry. "In our business, we don't have big margins, our equipment is expensive and we have costly overhead expenses, like insurance and OSHA costs – never mind the wage issue. At least if I'm competing against an American company, I have an opportunity to make the sale. But, Chinese costs don't begin to compare to ours. Benefits there are non-existent, which reduces their costs substantially. People say American manufacturers have to re-invent themselves, but I can't re-invent myself to the point where I can tell people they have to work for $2 a day without benefits." That is why Tedesco was driven to political action.

The next step for his coalition is to choose a name for the organization. Then, over the summer, they will develop a national platform and a Web site, focusing on the goal suggested to them by Dodd and Johnson of making a plan for change, and for stopping and reversing the flight to China.

Tedesco is paving the way for the coalition platform. "The way I've attacked this is through a broad base of action items. I can see that tariffs don't work in the World Trade Organization. So, we would propose that no country should make up more than 10 percent of the trade deficit. If they were in excess of this, they would have to reduce their deficit by 20 percent annually until they hit the 10-percent target."

Fairness in trade is at the heart of Tedesco's developing platform. "We wouldn't have this kind of deficit if there were fairness in trade, and that's what I'm trying to promote. I think the Chinese have a plan for the destruction of American business, and we are falling into it because of greed," he says. "We have plenty of customers who say they can buy products from China, delivered, for less than the cost of materials in the U.S. How can we compete with that?"

"I just want to fix this," says Tedesco. "I don't care about being a big hero and, in fact, I want to make it clear that everything I have done has been the combined efforts of many people and organizations. The question is: How do we approach the Home Depots and Wal-Marts? How do we go

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at them? Then, how do we reach consumers to make them understand that buying Chinese undermines the economy?" asks Tedesco. "Personally, I think we have 'right' on our side. It sounds corny, but this is important to America. The next steps will be in the hands of the American people."

The Spring Manufacturers Institute, on behalf of North American springmakers, is taking an active role in this issue. It is in the midst of implementing a political action plan to address the problem on several fronts. Because its membership is small compared with big lobbying organizations, SMI has joined forces with other national metalworking associations to garner more political clout and media attention.

Though the plan is not yet fully developed, SMI is currently focusing on two areas. First, says Ken Boyce, SMI executive vice president, "Our government needs to enforce World Trade Organization rules against the currency manipulations that go on in Asia, especially in China. Because their currency is artificially held below the dollar, U.S. products automatically become more expensive in those countries, while their products are discounted accordingly." China, for example, pegs the value of its Yuan at 40 percent below the U.S. dollar. "The U.S. needs to adopt policies that forbid that kind of market manipulation, while creating incentives for companies that invest in modernization of equipment, facilities and job creation."

SMI also believes that small and medium manufacturers need a representative in the Administration. "Agriculture accounted for only 1.4 percent of the GDP in 2001, while manufacturing contributed 14.1 percent. Yet Agriculture has its own cabinet-level department to distribute billions in incentives while manufacturing has no representation," says Boyce. "Congress needs to support H.R. 2172 and establish the position of Under Secretary of Commerce for Manufacturing."

"Unfortunately, our own government's failure to understand manufacturing is at the core of many of our problems," he concludes.

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