

In the Rebalancing Global Supply Chain, There's No 'Shore' Thing

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Offshoring, reshoring, nearshoring — manufacturing and supply chains around the world are undergoing some seismic locational shifts, many of which the conventional wisdom did not see coming, and for reasons that may surprise you.

Morris Cohen, professor of operations, information and decisions at Wharton, and his colleague, Georgetown professor **Shiliang (John) Cui**, have been tracking those shifts for the past few years. They recently spoke with Knowledge@Wharton about their latest findings — and especially the counter-intuitive results.

An edited transcript of the conversation appears below.

A Benchmarking Study

Morris Cohen: This is a benchmarking study dealing with the issue of the sourcing of manufacturing in a global supply chain network. As you know, most large companies today operate globally. They have factories all over the world. And in recent years, the last 10, 15 years, there have been major shifts in the locations where companies have sourced their production. In particular, there's been a major shift out of the developed economies, the U.S. in particular, to Asia — China in particular. This has, of course, led to a loss of millions of manufacturing jobs and a lot of consternation among the political classes and the commentators, and commentary as to how can we bring these jobs back? How can we revitalize our manufacturing sector? And this political season, these issues have not gone away. In fact, probably, the discussion has become even more heated.

The original purpose of the benchmark study was to gather, objectively, some empirically based information on what companies were actually doing. Not on stated intentions or not on predictions, but on actual decisions that were made.

Last time I was here, I discussed the first phase, which dealt with a benchmark study of about 50 global companies that were operating in China. And we talked about the results we saw. Since that time, we did a second phase with about 75 companies that were much more globally dispersed. And we asked the same questions to see what their current set of decisions was, and what were the drivers of those decisions, what was the expected impact of those decisions.

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Shifting Production

Cohen: Well, in phase one that is true: We did not observe too much of this reshoring or shifting of production into North America, or the U.S. in particular. In phase two, which had a bigger sample, and a much more diverse set of companies, we actually saw a significant amount of shifting production — I have to be careful — not “back,” but into the U.S. What was surprising was where it was coming from. It was not coming from U.S.-based companies, *it was coming from Europe-based and Asia-based companies*. So they are shifting production into the U.S. Not so much American companies. Do you want to add to that, John?

John Cui: Yes. The statement Morris just gave was entirely correct. Part of the reason that we did not observe similar results in phase one was because the respondents that we had in phase one were Chinese divisions of global companies. So they may not have given us the complete picture of the companies’ movement. But when we got to phase two, which involves a lot of U.S. and global companies’ headquarters, we were able to identify this unique shift of non-U.S. companies entering the U.S.

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Decision Drivers

Cohen: As part of our study we ask companies, why are you making these decisions? What are the drivers of those decisions? And the drivers that are driving companies — particularly non-U.S. companies — to come to North America for manufacturing

are market access and access to innovation, not for low labor costs, obviously. This is one of the biggest markets in the world, still — if not the biggest. But I should also say that those are the same reasons that a lot of companies continue to go to China — not for low labor costs, but for access to its huge and growing market.

That raises another point: There was no dominant pattern in what we saw. We saw a very complex set of flows of manufacturing from one location to another. We call that “rebalancing of production.” We also saw what we call “reloading of production,” where some companies would increase their capacity in their domestic country, but not necessarily shift to another market.

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So to answer your question, I don’t know if we have a definitive answer as to why we saw that. But clearly, they claim market access and innovation are what’s driving them to this country. You might argue that the U.S. companies already have that access to the market, and therefore the incremental benefit to them is not as great.

Cui: Yes, I totally agree. We thought that that could explain why the U.S. companies do not benefit as much as foreign companies entering the market. Also, I agree with Morris that cost is no longer the single dominant factor that firms consider when making those reshoring decisions. It used to be dictating their decisions, but these days, we observe much more complexity in their decision-making, and in terms of the outcomes that we observed.

Surprising Conclusions

Cohen: I think that there were a couple of things that we saw in the second phase that reinforced what we saw in the first phase. I think I had already mentioned that there was no one dominant reason, there was not one dominant flow. There seems to be a complex trade-off analysis that companies are undergoing. What’s really interesting to us is that this is pervasive. We are in the midst of a major restructuring of global supply chains. In region after region, company after company, companies are asking the questions: Do we have the right structure? Do

we have the right sourcing locations? Are we bringing our product to market in the most effective way? And they're oftentimes shifting capacity, changing the way in which they produce products, adding technology.

For example, technology and R&D — across the board, everybody's invested in this. So I think that we're in the midst of a period of flux, of change, which is redefining the way the world produces its products.

Two-Way Streets

Cohen: [Offshoring] had been perceived as a one-way flow — a “your loss is my gain” type of thing. But now we see two-way streets. We see movement in both directions. And that's why we call it a rebalancing, which is one of the dominant modes. A lot of companies are making multiple decisions — sometimes offsetting decisions — to gain access to developing economies and their markets, to gain access to their labor, to their suppliers.

So there is no one way to go. But there is a lot of shifting back and forth.

‘The Biggest Flow Was Still *Into* China’

Cui: We found that companies — European companies and non-Chinese companies — are moving to China for market reasons. China is growing to be the largest market in the world. But at the same time, we also observed companies moving out of China, not for market reasons, but this time for cost reasons. For example, in the apparel industry, there were a lot of companies moving out of China and going to South Asia countries like Vietnam, Bangladesh — countries that have even lower costs than China. So I just found it amazing that companies are going in and are going out of China for different reasons.

Cohen: Let me add that what we saw in phase two, consistent with phase one, is that the biggest flow was still *into* China. Even now, in spite of the rising labor costs, in front of the fact that some companies in China are moving out of China, if we asked, “Where are you going, what are you doing?” the biggest observed flow was companies moving into China. Oftentimes, Chinese companies were expanding within China — we call that reloading — or foreign companies were moving into

China. That was still the most popular decision....

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Another thing that we saw very pronouncedly in phase two was that quality was a positive reason to go into China, not a negative.

At some stage, years back, one might have said, “Oh, if you leave the U.S. and go to Asia, you may have quality problems.” But certainly that has not been true in Japan for a long time. And it seems to not be a problem in China. High-quality, complex products — not necessarily labor intensive, but complicated products — are being produced in China at very high quality.

The U.S. and Europe

Cohen: Now, Europe is a very interesting point. In both studies — and I think even more in the second study — Western Europe was the one place that we saw a decline, shifting production. In North America, there was actually stuff coming in from other places. If we add it up, all over the world, we’re gaining. Not at a great speed, but we are gaining ground or recovering.... But Europe is a net loss — except, of course, for Eastern Europe and Russia, which is perceived to be a nearshoring location, just as Mexico is to the U.S. So they’re gaining, but Western Europe is declining.

‘The Global Economy Is Not Flat’

Cohen: I’d say that the global economy is not flat, that there are many possibilities and many opportunities. One thing in particular that we should bear in mind is that *there are opportunities in this country to grow our manufacturing and to grow our economy*. It may be based on innovation, it may be based on different types of technology, but we should recognize that the world will come to our door *as long as we manage that process correctly*.