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Restoring Business Through Reshoring

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Restoring Business through Reshoring

Offshoring has been a common practice for many years in some manufacturing sectors, providing companies with the ability to send production overseas for lower costs. However, with competing countries experiencing increased labor costs, many U.S. companies are looking for new ways to decrease this expense. **Reshoring** has become a great alternative, restoring manufacturing jobs in the U.S. while also supporting local sourcing and production, lowering costs, improving customer service, and increasing efficiency and time management. This whitepaper examines some of the benefits and costs that should be considered by U.S. companies in deciding to reshore manufacturing operations. Juxtaposed against these factors is also a discussion on the continuing viability of using China as an offshore alternative.

In recent decades, many companies pursuing the offshore manufacturing strategy have sent production to China, due to the country's historically low labor costs. Now this trend has changed. This article examines some of the key issues for U.S. companies in determining whether to reshore some or all of their manufacturing to the U.S., as compared to continuing to outsource to China.



Recent studies have shown that [more than half](#) of CEOs at U.S. based manufacturing companies with revenues exceeding \$1 billion are returning some production activities back to the United States, or are seriously contemplating it. With notable cost, quality, safety, and employment benefits, reshoring has become an attractive option for many business owners. While there are still countries around the world that offer lower labor costs, we have been seeing an increasing number of companies in our practice who have brought back at least some of the manufacturing process to the US to maintain better control over quality, just-in-time delivery, and reduction of waste, to name a few reasons. What US companies seem to have discovered is that cheap labor isn't the only thing to consider in deciding where to establish manufacturing operations.

3 Reasons you should consider reshoring for your business.

1.) Offshoring can be costly.

Companies can no longer make the argument that business overseas is far superior, largely due to [rising wages](#) in competing countries.

As an example, manufacturing wages in China have risen extraordinarily fast, at more than 10 percent per year on average over the last decade. While the cost of living is keeping relative pace with wage increases, the Chinese government is under considerable pressure to ensure this trend continues and thereby ensure social stability.

Similar to wage differences among the U.S. states, China does not actually stipulate a single minimum wage. Rather, local governments in the country's provincial-level administrative units determine their own minimum wage levels based on prevailing socio-economic conditions. Unlike other countries, Chinese law requires that the minimum wage in all regions be increased at least once every two years - ideally at an average rate of 13 percent annually, according to the latest state policy plan. This legal mandate has been a key factor in the reduced global competitiveness of manufacturing in China in recent years.

Minimum wage, however, provides only part of the overall picture for labor costs in China. Mandatory social insurance contributions can present huge, often unanticipated costs for employers, and strongly differentiate China's labor environment from those of lower-cost competitors like Vietnam. With social welfare contributions factored in, real wages in China can amount to twice those of Vietnam and five times those of India.

When U.S. companies look at their total cost of operations (TCO), it becomes clear that reshoring often makes the more economic sense if their customer base is located on North America. Though Indonesia currently has the lowest manufacturing costs, this is often not the single most important factor that goes into the decision to reshore. Studies have shown that savings obtained from outsourcing will decrease to the single digits for multiple products in the near future. It has become much more cost effective to create a product in the U.S. rather than make it in a foreign country and ship it back. When a quality control issue arises, it is important for companies to be able to quickly respond to customer demands and it is much easier and cost effective to do this in the U.S. The alternative, sending a group overseas to analyze such issues, is extremely costly.

Lengthy Turnaround Times

Having business operations abroad can mean putting up with **lengthy turnaround times**. Dealing with lengthy lead times is an inconvenience and pain point for any business. Many foreign manufacturers only ship products and parts that are paid for in full beforehand. This can severely diminish the cash flow for a company, adding more time and stress for a manufacturer to replenish cash for production.

Work Environment

To add to the labor cost and time issues with offshoring, the work environment in foreign countries is much different than in the U.S. Many countries cannot guarantee their workers **safety**.

Considering the potential for unsafe buildings overseas, and recent riots in Vietnam, worker safety is often times questionable abroad. Workers expect and deserve a safe workplace that they can depend on.

In addition to this, repairs following workplace disasters can be extremely costly and can severely damage a company's reputation. Many disasters overseas are recurrent, so companies need to spend more money preparing and planning for these disasters in some cases.

Lower Fuel Prices

The price of energy for many U.S. companies has decreased dramatically because of the extraction of natural gas from shale. In less than two years, it has been projected that the price for natural gas in the U.S. will likely be [60-70%](#) lower than in Europe or Japan. Lower fuel prices allow U.S. companies to operate more efficiently than their overseas counterparts which allows room for new factories and job creation. The shale gas "boom" that the U.S. is currently experiencing and enjoying makes it substantially easier to support domestic operations.



2.) Intellectual Property

By keeping production in America, companies can also better protect their intellectual property. It is one thing to keep tangible property protected, but keeping intellectual property safeguarded abroad is a daunting task. A shorter supply chain helps keep intellectual property notably more secure.

A shorter supply chain also means that there is more opportunity for innovation because of a better connection to research and development departments. The proximity to the product is vital for the success of the company, and moreover proximity to the customer so that manufacturers can enhance their products according to customer demands. Reshoring contributes to a shorter supply chain and a shorter supply chain contributes to the ultimate ease of doing business.

3.) Made in the U.S.A.

The "Made in the U.S.A." tag also presents a lucrative branding opportunity for any manufacturer, given the right marketing. Consumers have responded to reshoring in a positive way largely due to the perceived quality of American made products. Wal-Mart has plans to buy \$250 million more American made products over the next ten years as a testament to this. After price, customers are most likely to consider a product's origin when they are deciding on a [purchase](#). Labelling one's products as "Made in the USA" can incentivize consumers to pay more and carry an impression of added product quality. This positive brand and media exposure can then be leveraged by the company in subsequent negotiations for grants, abatements and tax credits.

Case Study: [Mei Xu](#) of the **Chesapeake Bay Candle Co.** opened a U.S. factory in 2011. She ran into problems with set up costs and employment issues, but nevertheless, she did not regret her decision. When she saw the amount of U.S. candles added to her assortment, she knew she had made the right decision. Consumers have found that it is [not about the cheapest product](#), but the best quality product. With local operations that cut the supply chain substantially, Chesapeake was able to concentrate on quality more easily and effectively.

Are There Still Benefits to Offshoring in China?

Despite the rising costs of manufacturing in China, it should be noted that certain regions within the country continue to present significant advantages for offshoring. China now hosts over 200 Economic and Technological Development Zones (ETDZs), the majority of which are concentrated along its eastern seaboard, and often targeting specific types of industries such as technology, exports and logistics. Zones are divided between various administrative levels (e.g., national, provincial, municipal), which vary according to the level of autonomy granted to their management, e.g., for approving tenants in the zone. This greater autonomy, in turn, can translate into less red tape, more governmental support, and better developed infrastructure – all bonuses to foreign investment projects.



Additionally, in an effort to narrow the development gap between China's prosperous eastern region and lagging inland provinces, tax incentives are offered to companies choosing to locate in the country's less-developed western and inland provinces. A reduced corporate income tax (CIT) rate of 15 percent – down from a standard rate of 20 percent - is available to enterprises located in Guizhou, Sichuan, Shanxi, and Yunnan provinces, among others. Meanwhile, China has been investing heavily in the logistical networks and industry specializations of these regions to ensure that investors are able to recoup the added shipping costs of locating further away from China's seaboard.

These efforts indicate that business in China does have its benefits. However, a more balanced approach in assessing all costs, not just chasing cheap labor, seems to be what is prevailing among business leaders.

Challenges involved in Reshoring

Supporting reshoring is easy when you consider all the advantages for your company but it also helps to be aware of the current challenges.

1. **Lack of suppliers-** There is a much wider range of suppliers in China than in the U.S. [Wal-Mart](#) alone has 80% of their suppliers located in this area. Companies involved in reshoring have found that moving operations back means finding American made components to create their products, and it's not always an easy task. Finding the right suppliers is necessary for production yet could be a very costly venture with some prices increasing by 50% when made entirely in the U.S.
2. **Inexperienced workforce/ Shortage of skilled labor-** This is perhaps the greatest concern among manufacturers considering the move back home. Many products require the attention of tool makers and precision machinists, jobs that require experience and training. Thus, reshoring means that more time must be spent on training workers. [Experienced workers](#), like tool makers and those with high level computer skills are usually already employed. Although reshoring does create job opportunities, finding qualified workers needed to fill positions can be difficult. The availability of a workforce in the skilled trades has greatly declined and a shortage of workers will mean higher salaries for existing employees, resulting in increased costs for employers.
3. **Changing Operations-** Changing operations that have been done one way for a long time can be a costly and difficult process. Companies have found it tricky to navigate complex regulatory systems, and to add to that, many U.S. companies often have very outdated machinery. Many products are in constant demand, so a halt in operations for machinery updates could be fatal to a business.

Based on China's complex regulatory environment, closing up shop in the country can be a prohibitively costly venture. The high compliance costs of deregistering in China mean that most investors would rather scale down their operations in China and relocate a portion elsewhere, rather than pull out of the country completely.

The procedural complexity of deregistering even the simplest of investment vehicles (i.e., a representative office) in China can often dissuade companies from doing so. This entails a multi-step process of applying for deregistration with the tax bureau, State Administration of Foreign Exchange (SAFE), Customs, State Administration of Industry and Commerce (AIC), Quality and Technical Supervision Bureau and the Statistics Bureau – and can take more than two years from start to finish. Because the repatriation of corporate bank holdings is the final step in this process, companies can be left waiting to receive their funds from China, which constitutes a drag on cash flow.

Besides the challenges posed on the China side of reshoring, several problems exist on the U.S. side of the arrangement. For example, selecting the proper site for reshoring to the U.S. can be a complicated decision. As many places in the U.S. are now offering preferential policies to incoming manufacturers, businesses are advised to do careful research before deciding on the optimal site for reshoring. In contrast to Chinese state policy, which is formulated in consecutive Five-Year Plans, the comparative changeability of U.S. politics can amount to added risk for corporate tax liability.

Lastly, depending on one's industry, the differential availability of certain raw materials in China versus North America can also put a damper on a reshoring plan. U.S.-based companies needing to import materials from China face the risk of import restrictions imposed by the latter, as well as the added costs of shipping and import duties.



It is difficult to deny that the cost benefits associated with offshoring continue to be the driving force behind keeping operations abroad. Some companies have invested a great deal of money in new equipment only to result in sales below expectations and in some cases even having to shut down operations.

The U.S. is still considered a high cost manufacturer when compared to Latin America, Asia, and Europe. Though countries like China have increased their wages, some companies are looking to create a product for the lowest price possible in order to keep their target market interested in purchasing their products. For companies following this business model, China may still be the lower cost option.

Is reshoring worth the risk?

Nevertheless, companies are still making the move back. Though businesses involved in the reshoring process will inevitably experience difficulty, there is a significant amount of companies taking the risk. In the business world, nothing is ever certain, so taking risks is sometimes necessary for the growth and prosperity of the company. Exports from the U.S. have reached their highest point in 50 years and since 2005, American exports have been rising [seven times faster](#). Though operations could be slow and difficult at the beginning of the process, the decision could be entirely favorable in the long run.

Further hesitancy to leave China is fueled by the country's massive and increasingly important middle-class consumer market, estimated to be 600 million by 2020. Long before then, China is predicted to become the world's largest retail market, at a value of roughly U.S. \$4.2 trillion, by 2016. From luxury cars, to cosmetics, to electronics, selling to China is becoming more and more critical in the global strategy of multinational companies. Sacrificing this lucrative opportunity needs to be carefully considered against any potential savings of scaling down operations.

One viable option available to investors with China-based manufacturing operations is to expand or modify their registered business scope to include the distribution of products to the domestic consumer market. Using this method to maintain a low-level retail profile can give businesses the time they need to plan a China marketing strategy and ensure that later investments don't get caught up in bureaucratic limbo at a critical stage in market opportunity.

In the end, the success of your company could rest on whether or not you have American made products on your shelves. The trend has driven numerous companies to make the move back. If your customers yearn for American made products, reshoring could be the answer. With better cost, time, and safety management, as well as quality control, a reshored company could potentially do better than it has ever done before. By whole-heartedly restoring operations back to the U.S., companies will inevitably face challenges with employment and supply demands, but business owners have often found it to be worth the risk. The simple ease of business that comes along with the move back to the U.S. is luring many manufacturers to reconsider their offshoring practices.

For more information on deciding if reshoring is a practical option for your company, [contact us](#).

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