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Velong: Rethinking “Made in China”

All of our customers have come to the conclusion that they have to get some part of production out of China, and 30% is the number we hear most.

— Jacob Rothman, Founder and Co-CEO, Velong Enterprises Co.

On January 19, 2023, right before the Chinese New Year, Jacob Rothman and Iven Chen, founders and co-CEOs of Velong Enterprises Co., arrived in Mexico City. They would be in Mexico for 10 days to identify manufacturing sites for their future operation. Headquartered in Guangdong province, Southern China, Velong specialized in designing, developing, and manufacturing grilling and kitchen products for brands such as Joseph and Joseph, Taylor, Blackstone, Weber, Charbroil and retailers such as Canadian Tire, Metro, and Walmart. With \$170 million in revenue in 2022, Velong and a myriad of Chinese companies represented the backbone of multinational companies (MNCs)' supply chains that offered goods to consumers globally. Due to escalating geopolitical and trade tensions between Western countries and China and supply chain disruptions under China's zero-Covid policy, MNCs were reassessing the risk of relying on China as a single or major supply source. As a result, Velong and many Chinese companies in the global supply chain had to respond to customers' request to diversify manufacturing outside of China.

Velong had 11 factories in 4 manufacturing bases (China, Cambodia, India, and Vietnam) with 1,800 workers and staff, but overseas capacity accounted for only 5% of its total capacity, far behind the 30% target customers expected. Coincidentally Rothman and Chen received an invitation from the ambassador of Mexico to China to visit Mexico after the *Wall Street Journal* published a story about Velong in October 2022. During this trip, Rothman and Chen would meet the Foreign Minister, the Minister of Finance, and possibly the President of Mexico. Zhuyao Zhang, another co-founder of Velong and Guohui Huang, Chen's university classmate and President of Prowealth Group, also joined this trip. Huang wanted to learn what opportunities Mexico could provide for Prowealth's portfolio companies in construction materials, furniture, fabric, and food processing. (See **Exhibit 1** for comparison of countries' competitiveness for foreign direct investment.)

As they landed in Mexico, Rothman and Chen wondered what they could achieve out of this trip and more overseas trips in 2023. Would they be able to find manufacturing sites where they could produce goods that met their customers' high standards? Would overseas companies be willing to

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work with Chinese companies or regard them as competitors? How could Velong build up its capability fast enough to support the operation of multiple overseas production sites? And could they increase overseas capacity to 30% by the end of 2023 as customers requested and they planned?

Evolution of Velong

“Velong has a good culture and soul because of the relationship between Iven and myself: it is mutual respect. We can’t run the factory without each other.”

— Jacob Rothman

A second-generation entrepreneur, Chen started Velong with Yushu Cao as a small grilling accessories manufacturer in the coastal city of Yangjiang, Guangdong province in 2003, right after he graduated from Guangdong Business School. (See **Exhibit 2** for Velong milestones.) Jacob Rothman, who grew up in California and studied religion at Bowdoin College, came to China in early 2000s to open a trading company to source products for his family business in the U.S. Rothman learned to speak Mandarin, and got to know Chen as a supplier. They decided to work together after discovering they were chasing the same customer, Canadian Tire, integrating Chen’s manufacturing expertise with Rothman’s customer and product knowledge and communication skill. “I was taught by my father: You can’t go see a buyer if you have never gone to their store. It is disrespectful,” Rothman said. He educated Velong staff about who Canadian Tire, Home Depot, Costco and other customers were, and how they differed from each other in needs and pricing. Later Rothman married Yushu Cao. Iven Chen, his wife Jing Chen, and Cao owned Velong. Rothman was in charge of planning, strategy, key customers and product decision while Iven Chen managed operation and ran the factories. Cao and Jing Chen managed company finances.

Acquiring Customers

Weber, a leading outdoor cooking company headquartered in Palatine, Illinois, was the first brand name customer Velong acquired. To meet their quality standard, Velong had to adjust its equipment. Other customers were easier to get afterwards. In addition to delivering products with the right quality at the right price, manufacturers also had to pass social audit required by their Western customers. (See **Exhibit 3** for examples of customers whose social audits Velong passed.) IKEA was the most difficult retail customer for Velong to acquire. On top of all the requirements other customers had, IKEA cared about the lives of workers, including benefits like paternity leave. Rothman elaborated, “They want to have a northern European culture of respecting workers’ rights in a very ethical way within your factory. Before you are allowed into IKEA, they ask you very specific questions about your background, your goals and future plans. Meeting my wife’s parents was easier than meeting the IKEA team! It took us two years to get accepted by IKEA.” In 2022, Velong delivered 40 million sets of products to approximately 200 customers, with 60% of them brand owners and 40% retailers and distributors. About 50% of its customers were based in North America, 30% in Europe, and 20% in Australia and other countries. (See **Exhibit 4** for Velong’s main product categories.) Rothman expected to have more business from retailers in the next three to five years. He explained, “Amazon, Shopify and other e-commerce platforms have disrupted the value of brands. Emerging brands that nobody knew before could become as popular as brands on TikTok.”

Developing Competencies

The first capability Velong developed was common among Yangjiang factories: metal stamping, a manufacturing process used to convert flat metal sheets into specific shapes.¹ So Velong tried to

differentiate by making better products for demanding customers. Then Velong acquired the capability to design, develop, and manufacture electronics by merging with Shuanghe Electronics, which specialized in thermometers, timers, and other electronic products. Zhuyao Zhang, the founder of Shuanghe, became Velong’s co-founder. “We invite people to be co-founders to show respect to their contribution,” said Rothman. (See **Exhibit 5** for Velong’s co-founders.) When crowdfunding became popular, Velong co-founded a product accelerator called Platform88 in 2015. Michael Wang joined Velong as a co-founder, bringing his expertise in consumer electronics and Internet of Things (IoT) gained from serving brands like HP, Lenovo, IBM, and Best Buy. Platform88 helped over 200 startups to design, engineer, manufacture, and distribute innovative products. Since then, Velong had also strived to be a leader in the sustainable products movement through its efforts in design innovation, material selection, recyclable and compostable packaging, end of life optimization, and company culture. (See **Exhibit 6** for its sustainable products.)

In 2019, Velong and Richard Smiedt, a Red Dot and Edison Awards winner, founded Puzzle, a design agency, in Sydney, Australia. Built on the fusion of design, engineering, and manufacturing, Puzzle helped customers to minimize product development time.² The next idea was to leverage all their competencies to extend beyond grilling and kitchen products and help customers design, manufacture, accelerate, and distribute various types of consumer products through Brand Factory.³ Platform88, Puzzle, and Brand Factory recorded revenues of about \$20 million, \$5 million, and \$10 million respectively in 2022. “We do these mostly to differentiate ourselves and to be flexible to iterate if something happens to our core business,” Rothman explained. After 20 years of development, Velong built a professional team to do product and packaging design and manage merchandise, supply chain and operation and developed all types of production lines and warehouse facilities.

Venturing Overseas

Customers want options outside China. If they are in North America, they want Mexico. If they are in Europe, Turkey looks good. But, what customers also want is Chinese knowledge, engineering, equipment, quality and pricing.

— Jacob Rothman

We are not only good at manufacturing, but also strong in R&D. Every week we discuss with customers to design and develop new products. We call it fast fashion.

- Iven Chen

When the trade war started after Donald Trump became the President of the U.S. in 2017, Velong’s customers started to feel uneasy about the risk of over-reliance on China and pushed for diversification outside of China. Rothman took the lead to explore overseas manufacturing options. Later Velong built a team with over 20 employees from supply chain and manufacturing departments to support its overseas expansion. Rothman explained, “It is easier if I go to these countries. People don’t welcome Chinese manufacturers because they are worried they will compete with them. So you need somebody who looks like me to open the door.” But once Velong got its foot in the door, local manufacturers became more open. Chen explained, “We want to achieve win-win, and they want to learn from our advantages in technology and raw material supply.” Sherry Lee, Velong’s supply chain manager with 15 years experience in this area, added, “When I communicate with Mexican manufacturers, I would ask them to share why their manufacturing cost is so high and how we can help solve the issue, so they are open to discuss with us and import low cost materials from China to Mexico.”

In 2019, Velong set up three joint ventures in Vietnam and one joint venture in India. In 2021, Velong started to build a fully-owned factory in Cambodia with \$5 million investment. (See **Exhibit 7** for Velong’s factories.) To support the operation in Cambodia, it took about a year to prepare. Chen

explained, “We need to set up a team to transfer technical knowhow from China to Cambodia, hire local employees, talk to customers to plan for delivery of products a year later, buy, test, and ship equipment and also ship some building materials to Cambodia, and prepare funding in local currency.”

All the countries that Velong looked at had their own set of issues. Rothman elaborated,

The population in Vietnam and Cambodia can only support so much manufacturing activity. And Vietnamese like to enjoy their lives when their shift is over while Chinese workers are willing to endure hardships. Turkey has an unstable currency, so it makes financial planning very difficult. The world has always wanted India as a second option to China because of the population size and demographics, but it is hard there. You have a stable government, but not stable supply chain. Mexico is a whole other story with huge corruption, politics, supply, and cultural issues.

Cost, lack of production capability, and raw material supply posed challenges for Velong. Sherry Lee said, “Some kitchenware can be easily made overseas, but the manufacturing cost of aluminum pots is 60% higher than in China. Our grilling products involve complicated production processes and techniques, and many countries have little production experience.” Meanwhile, Velong had to communicate with some of its more than 500 suppliers in China to see if they would follow Velong to go overseas. It would also take time for overseas manufacturers to catch up in quality. Rothman explained, “It is like a sports team. If you play baseball since the time you are a little child in the U.S., it is more likely the best baseball players come from the U.S. The competition to be the best and the ecosystem of having to work hard to get the orders creates the best factories in China.”

Despite all the efforts, overseas factories only accounted for about 5% of Velong’s total capacity. Rothman explained,

Due to Covid, our ability to travel has been limited and everything was on Zoom. I was also locked down in Shanghai for two months. Until zero-Covid ends, we can’t go to overseas locations, move equipment, and train our partners. And orders slowed down. Everyone has excess inventory in the U.S. and around the world, and the war in Ukraine caused severe inflation and slowed down sales in Europe. Despite these challenges, by Q3 or Q4 of 2023, we hope to have 30% of our total manufacturing capacity outside China.

The Changing Landscape of Global Supply Chain

“We are at a crossroads in the evaluation of global supply chains that pits just-in-time systems designed to improve operational efficiency against just-in-case plans that emphasize planning and preparing for a range of plausible scenarios. To find balance, supply chain leaders must engage in risk management to assess their organization’s willingness to take risk onboard and decide how to quantify that risk against other network objectives such as cost effectiveness.”

— Kamala Raman, senior director analyst of Gartner Supply Chain Practice, a consulting firm⁴

“Made in China”

Amidst rapid economic growth since its reform and opening in 1978, China became the largest manufacturing economy contributing 30% of the world’s manufacturing output in 2021.⁵ China also became the second largest consumer market in the world with a middle-income group of over 400 million people.⁶ (See **Exhibit 8** for the top 10 manufacturing countries in the world and **Exhibit 9** for China’s share of world demand.) A number of factors fueled the rise of China as the World’s Factory:

policy support to develop economy and attract foreign investment, well-developed infrastructure, a large supply of low-cost and hard-working labor, an enormous domestic market, and intense competition. Over time, it built competitive advantages that were hard to replicate elsewhere: an industrial base unparalleled in breadth and depth,⁷ economies of scale, and a production experience curve that gave China substantial cost advantages in sectors like auto parts, batteries, appliances, electronic components, and flat panel displays.⁸

In the electric vehicle (EV) sector, for example, Tesla set up a plant in Shanghai in 2019 to be close to its supply chain and its second-largest market. To grow the EV supply chain and domestic EV makers, the Chinese government offered Tesla cheap land, loans, tax benefits, and subsidies.⁹ China also allowed Tesla to solely own its factory without a local partner, the first time for a foreign automaker in China. Tesla’s CEO Elon Musk commented that the Shanghai factory was “the best quality, lowest cost and also low drama.”¹⁰

China’s high-volume manufacturing model featured “factory cities,” self-contained campuses that included facilities that met employees’ work and life needs.¹¹ First created with the help of managers from Hong Kong and Taiwan,¹² these “factory cities” mushroomed in the 1990s in coastal provinces like Guangdong, Zhejiang, and Jiangsu and recruited workers from inland provinces and rural areas.¹³ Hon Hai Technology Group (Foxconn), the world’s largest contract manufacturer with revenue of \$206 billion and net profit margin of 2.32% in 2021,¹⁴ had set up over 40 production sites in coastal and inland areas of mainland China since 1988.¹⁵ It operated the world’s largest assembly sites for iPhones, PCs and laptops in mainland China.¹⁶ Its Zhengzhou campus, for example, was the world’s largest iPhone assembly site with about 200,000 workers.¹⁷

However, China’s growth model based on investment, low-cost manufacturing, and exports had limitations and resulted in economic, social, and environmental imbalances.¹⁸ When Xi Jinping became the new leader of the Communist Party of China (CPC) in 2012 and the Chinese President in 2013, he pushed for “accelerating the adjustment of China’s economic structure and the transformation of its mode of economic development.”¹⁹ He felt that China must implement an innovation-driven strategy for future development focused on growth quality and performance.²⁰

In the manufacturing sector, China hoped to address many challenges: the rising cost of labor and other production factors, slowdown in exports, weak innovative capability, high dependence on foreign countries in core technologies and high-end equipment, low efficiency in resource and energy utilization, environment pollution, and the lack of ability for companies to operate globally.²¹ Besides, China’s demographic dividend was diminishing: from 2010 to 2020, population in the age group of 15-59 decreased by 6.79% and reached 894 million in 2020, while the population over 60 increased by 5.44% and reached 264 million.^{22,23} And as the education level improved and new employment opportunities emerged in other industries, young people became less interested in working on assembly lines that demanded longer working time, more intense work, but offered uncompetitive compensation and developmental opportunities.²⁴ Realizing the old development model was not sustainable, the Chinese government released “Made in China 2025,” an action plan to transform China from a big manufacturing power into a leading manufacturing power by 2049.²⁵

With rising geopolitical and trade tensions, a gloomy global economic outlook after the outbreak of the pandemic, and a super-large domestic market with consumers demanding a better life, the Chinese government articulated a “dual circulation” model in 2020, urging the “gradual formation of a new development pattern with the domestic cycle as the main body and the domestic and international dual cycles mutually promoting each other.”²⁶ In December 2022, the Chinese government released a guideline on expanding domestic demand during 2022-2035.²⁷ For export-oriented Chinese

manufacturers, serving Chinese consumers and companies required new capabilities in product development, brand building, sales, and distribution channel management.²⁸

Rising Trade and Geopolitical Tensions

The trade war between the U.S. and China started in 2017 with a Section 301 investigation by the Trump administration into China's practices related to "forced technology transfer, unfair licensing, and intellectual property policies."²⁹ The purported theft of intellectual properties alone by China had cost the U.S. an estimated \$225 billion to \$600 billion a year, according to the Commission on the Theft of American Intellectual Property.³⁰ Upon completing the Section 301 probe, the U.S. decided to impose unilateral tariffs on a range of Chinese imports and follow with several rounds of tariff hikes on some \$370 billion worth of goods, taxing at between 7.5% and 25%.³¹ China retaliated by raising tariffs on \$75 billion worth of U.S. imports at an average rate of 20.3% and filing against the U.S. to the World Trade Organization (WTO). The sentiment of U.S. consumers toward Chinese products also changed under the shadow of the trade war, with 40% adults rejecting such purchase in a survey conducted in 2020.³²

The trade war soon developed into a tech war between the two superpowers, with the U.S. targeting several large Chinese tech companies, especially Huawei, which was a telecommunication equipment maker with leading 5G network technology that the U.S. described as a major threat to national security. U.S. allies in the Five Eyes intelligence alliance, including the UK, Canada, Australia, and New Zealand, subsequently prohibited or rejected Huawei's technology. The U.S. Congress also passed new laws to increase scrutiny on foreign investment, mainly from China, in U.S. companies and to tighten export control by extending the Entity List of foreign companies and entities for which Americans must obtain a license to do business with. As of August 2022, about 600 Chinese companies were on the Entity List, and more than 110 of which were added by the Biden administration.³³ The U.S. also widened the ban on doing business with Chinese companies on the list by including goods that used U.S. technologies and inputs by non-U.S. firms, such as equipment for making advanced computer chips. To maintain its lead over China in what the news media dubbed the "chip war," the U.S. proposed a "Chip 4" alliance by engaging Japan, South Korea, and Taiwan, all of which owned all or some of the key technologies for producing the fastest computer chips possible.³⁴

China's relationship with other trade partners such as the European Union and Australia also deteriorated. At a WTO review in 2021, Australia, whose exports to China including barley, coal, sugar, wine, and beef had faced tighter restrictions since 2020, argued that "China has increasingly tested global trade rules and norms by engaging in practices that are inconsistent with its WTO commitments."³⁵ The EU in 2021 froze a major investment agreement with China that had undergone seven years of negotiations, after both sides imposed tit-for-tat sanctions triggered by the United Nations' findings of the use of forced labor in China's Xinjiang region.³⁶ In China, resentment against Western brands spiked among young consumers after the Xinjiang labor right dispute, with many of them turning to local Chinese brands from foreign labels when making purchases.³⁷

In November 2022, the presidents of the U.S. and China met during the G20 Summit in Bali, the first in-person meeting since Biden took office. President Biden stated that the U.S. would continue to compete with China "vigorously," but acknowledged that the two countries "must work together to address transnational challenges," such as global warming and global macroeconomic stability.³⁸ President Xi asserted that U.S.-China relations was not a "zero-sum game" and that "the world is big enough for the two countries to develop themselves and prosper together."³⁹

The U.S. efforts to win in the “extreme competition”⁴⁰ with China by forming partnerships with countries or economies had added uncertainties to the already tense geopolitical situation in Asia Pacific. For example, some U.S. government and defense officials had warned of the likelihood of a war between China and Taiwan,⁴¹ as Beijing felt that the U.S. no longer upheld the longstanding “One China” policy. At one point in 2021, *The Economist* even labeled Taiwan as “the most dangerous place on Earth.”⁴² Chinese military encounters with the U.S. and its allies in the South China Sea, which China claimed to control but the U.S. challenged by citing freedom of navigation, had also increased in frequency. On the other front, in 2020, Chinese and Indian soldiers clashed in a border valley, resulting in the deadliest conflict between the countries in 40 years.⁴³

In a 2022 survey of 44 executives mostly from the world’s largest corporations with revenues of at least \$10 billion, 95% said they were concerned about political risk in Asia Pacific, compared with 62% in 2020 and 80% in 2021.⁴⁴ A separate survey by the American Chamber of Commerce in Shanghai (AmCham Shanghai) showed that data localization requirements, a lack of intellectual property right protection, and procurement practices favoring domestic Chinese competitors remained the three biggest regulatory challenges facing U.S. firms in China.⁴⁵

The Impact of Covid

Since the first cases of novel coronavirus were detected in Wuhan, China in December 2019, Coronavirus disease (COVID-19) had led to over 600 million infections and over 6 million reported deaths globally by December 2022.⁴⁶ After the World Health Organization characterized the COVID outbreak as a pandemic on March 11, 2020,⁴⁷ governments worldwide adopted a series of measures to limit the spread of the pandemic including severe travel restrictions.

China implemented a zero-Covid policy for almost three years to achieve “timely detection of cases, preventing mass infections, severe illness and deaths and avoiding straining medical resources to meet people’s daily medical needs better.”⁴⁸ Such a policy required mass testing, centralized quarantine requirements for those in close contact with infected people, residential or office buildings lockdowns, and international travel restrictions. In 2020 and 2021, these measures helped to contain the spread of the pandemic, minimize severe cases and deaths, and to sustain China’s economic growth while the rest of the world struggled under the pandemic. In 2021, China grew its economy and export of goods by 8.1% and 21.2% respectively, and the foreign direct investment went up by 20% and reached \$173.5 billion.⁴⁹

However, 2022 was a turning point. When the more contagious Omicron variant spread to China, China adopted even more stringent Covid restrictions, including a two-month lockdown of Shanghai, China’s economic and financial center with a population of over 20 million. These measures caused disruptions to daily life and business operations and dragged down the economy. Economic growth fell to 3.9% in the first three quarters, below the government target of 5.5% for 2022.⁵⁰

The zero-Covid policy significantly impacted the sentiment of global business executives towards China. For example, a survey of 307 member organizations of AmCham Shanghai in July-August 2022 showed that only 30% (versus 38% in the 2021 survey) were planning on increasing their investment in China in 2022 while 19% reported plans to decrease their investment.⁵¹ The top three reasons that the AmCham members gave for their change in investment plans were all Covid-related: shutdowns, travel restrictions, and supply chain disruptions.⁵² Only 55% of the AmCham reported that they were optimistic or slightly optimistic about the five-year outlook (the lowest in its survey’s history since 1999 and 23% down from the 2021 survey).⁵³ One-third of respondents redirected

planned China investments to other destinations in the past year, almost doubling the number of companies that did so in 2021.⁵⁴ (See **Exhibit 10** for a summary of AmCham survey results.)

Released in June 2022, the European Business in China Business Confidence Survey 2022 showed a similar sentiment.⁵⁵ “The only thing predictable about China today is its unpredictability, and that is poisonous for the business environment,” said Bettina Schoen-Behanzin, Vice President of the European Union Chamber of Commerce in China. “Increasing numbers of European businesses are putting China investments on hold and re-evaluating their positions in the market as they wait to see how long this uncertainty will continue, and many are looking towards other destinations for future projects.”⁵⁶

On November 11, 2022, the Chinese government issued more measures to optimize Covid prevention and control. While people expected a gradual easing of control, rising infections led to tighter controls in multiple cities. On November 24, 10 people were killed and 9 were injured after a fire broke out in an apartment building in Urumqi, Xinjiang.⁵⁷ Claims that the door to the building was sealed due to epidemic control went viral on social media, triggering outrage from the public, even though local government later confirmed pandemic control measures did not affect the evacuation of residents.⁵⁸ Demonstrations broke out in Urumqi and then in cities like Shanghai, Beijing, and on university campuses as people expressed their frustration over the zero-Covid policy.⁵⁹

In December, China abruptly pivoted from its zero-Covid policy. On December 6, China’s Politburo, the top decision-making body of the Communist Party, set the tone for 2023 to “push for overall improvement of the economy, focus on stabilizing growth, employment and prices, significantly boost market confidence, make a stronger push to attract foreign investment and focus on expanding domestic demand.”⁶⁰ On December 7, the State Council released a new 10-point plan to ease Covid controls, ending mass testing, allowing infected people with mild or no symptoms to quarantine at home, and accelerating the vaccination of people over the age of 60. At the annual Central Economic Work Conference on December 15 and 16, Chinese leaders made economic stability a top priority for 2023, rolling out a series of policies to support growth and coordinate the pandemic control with economic and social development better.⁶¹ The sudden relaxation of Covid restrictions led to a surge in infections and shortage of healthcare resources. On December 26, China downgraded Covid-19 from a “Class A” infectious disease, which demanded stringent control measures, to “Class B,” which required more basic treatment and prevention, and removed quarantine requirements for inbound travelers and other restrictions for international travel beginning January 8, 2023.⁶²

Rethinking “Made in China” Strategy

For businesses that had significant exposure to China and were contemplating the future of their China strategy, they generally faced three options: diversification, decoupling, or increasing investment.

Diversification

Shifting operations in various degrees away from China to other locations had long been an option for some foreign multinationals wary of over-dependence on a single country. One of the diversification strategies was known as “China-plus-one,” which Japanese multinationals were probably the first to adopt in 2003 in the wake of the market disruptions due to the SARS pandemic.⁶³ The idea was to invest in an alternative location outside China to reduce concentration risk.⁶⁴ It was also a response to the continuous wage hikes in China; in fact, in 2022 average salaries of manufacturing workers in China stood at around \$13,000, surpassing those in Brazil, Thailand, Malaysia, Vietnam,

Mexico, and India.⁶⁵ For that reason, international brands such as Nike and Adidas had been reducing their production in China over the past decade.⁶⁶

Asian countries in two different groups had emerged as a preferred alternative base. The first group included countries that paid lower wages than China and had competitive advantages in clothing and consumer goods industries, such as Bangladesh, Cambodia, Laos, Myanmar, and Vietnam.⁶⁷ The second group comprised countries that could offer high-skilled labor and well-developed infrastructure, paid the same or even higher prevailing wages than China, and had competitive advantages in electric appliance and general machinery industries, such as Indonesia, Thailand, and Malaysia.⁶⁸ With a large and young population, India had ascended to become a favorite manufacturing hub among multinationals; the GDP contribution from manufacturing was projected to rise in India from 15.6% to 21% by 2031.⁶⁹

The U.S.-China trade tension was an “accelerator” for multinationals to adopt China-plus-one.⁷⁰ An example was U.S. toy maker Hasbro in 2019, when it revealed plan to lower the percentage of China-made goods for its U.S. market from 50% to one-third in 2023.⁷¹ Globally, Hasbro had already relied less on China, which contributed to 66% of the company’s total capacity in 2019 versus 90% in 2012.⁷² Even Chinese multinationals diversified. The computer maker Lenovo produced in Mexico, India, Japan, Brazil, Europe, and the U.S. in addition to its home market China.⁷³ Given its global footprint, Lenovo executive said in 2019 that the company could increase capacity outside China to alleviate the impact from the U.S. tariffs on Chinese products.⁷⁴

The prolonged business disruptions from China’s “zero-Covid” policy pushed companies to rethink their China operations and investments. According to AmCham Shanghai’s survey, 44% of the technology hardware, software, and services respondents were planning to move out of China, followed by 20% in the retail and consumer sectors, and 17% in the automotive sector.⁷⁵ Even companies that had relied heavily on China’s skilled workforce and comprehensive supply chain were seeking alternative locations. For example, the three major suppliers of Apple, which counted on China to assemble about 98% of its iPhones,⁷⁶ shifted an estimated 7% to 8% of their capacity from China to India and were looking to increase the percentage to 18% by 2024.⁷⁷ A continuous capacity shift by Apple would be a catalyst to raise India’s manufacturing expertise and benefit local Indian suppliers who could win the orders. While India had been churning out some older models of iPhones for a few years, China remained as Apple’s primary choice for assembling the high-end iPhone 14 Pro. Some analysts had estimated that it could take about eight years to move 10% of Apple’s production capacity out of China.⁷⁸ Difficult as it might be, Apple had already achieved some levels of China-plus-one for its flagship products—with iPhones in India, MacBooks, the Apple Watch, and iPads in Vietnam.⁷⁹ Other U.S. tech companies including Google, Microsoft, and Amazon had also shifted the production of their flagship hardware products—namely the Pixel smartphone, Xbox game console, and FireTV—partially out of China to India or Vietnam.⁸⁰

But completion of diversifying from China did not mean over-dependence vanished overnight; as Siemens’ CEO Roland Busch said, “Without China, diversification is not possible.”⁸¹ A study found that Japanese manufacturers that had been operating in ASEAN since 2016 still sourced 13.5% of raw materials and parts from China in 2021, making them vulnerable to the adverse impact from China’s Covid-19 lockdowns.⁸² It was a wake-up call as these companies “learned that moving final production assembly from China would not cut dependence if they did not diversify their sourcing of input components at the same time.”⁸³

Decoupling

Decoupling differed from diversifying in that the foreign company not only relocated but wound down its China exposure, sometimes completely. In the AmCham survey, 7% of the respondents intended to move all operations out of China; by sectors, the percentage reached 20% for those in retail, followed by 6% in manufacturing.⁸⁴ While a full exit from China might be inconceivable to some companies, others—notably Korean multinationals—had opted for that for different reasons. For example, in 2019, Samsung Electronics, which had seen its smartphone market share in China falling from about 20% in 2013 to less than 1% in six years amidst competition from local Chinese brands,⁸⁵ closed its last smartphone factory in China that once had a capacity of 70 million handsets.⁸⁶ Lotte Group, South Korea’s largest retailer that had operated in China since 2004 and once set a sales target of 200 trillion won (\$157 billion) there, had begun to withdraw from China in 2018, two years after the Korean government deployed the U.S. THAAD missile defense system, a decision that riled China and subsequently sparked a boycott against the retail brand by Chinese customers. By 2022, Lotte’s exit was completed except for the “paperwork” to cancel the business license.⁸⁷ Amorepacific, a South Korean cosmetics maker whose biggest overseas market was China, downsized its brick-and-mortar business by permanently closing hundreds of stores and department store counters between 2020 and 2022 when Covid-19 swept across the country.⁸⁸

Some trade observers argued that China was no longer “the land of opportunity” for Korean companies. As a former Korean trade ministry official said, the “zero-Covid policy is too much, and Chinese companies are catching up with Korean companies. It would be better for Korean companies to abandon their fantasy about making money in China.”⁸⁹

Increasing Investment

Some multinationals chose to expand their footprints in China despite the headwinds from trade, geopolitical tensions, and Covid-19. For companies such as Siemens, the decision to “double down” — as some news media called it — was driven by using China to power the development of other markets; as Busch said, “If you want more growth in new, emerging markets, you first have to generate this through profitable growth in existing markets.”⁹⁰ Moreover, for many foreign companies, China had become “an important source of knowledge, inspiration, and innovativeness,” particularly in emerging industries “such as new energy vehicles, renewables, sustainability, intelligent manufacturing, advanced medical equipment, and fintech.”⁹¹

For example, China exported 2.2 million electric passenger cars, trucks, and buses in the first nine months of 2022, surpassing the full-year total of 2021.⁹² Among foreign brands churning out EVs and shipping them worldwide was Tesla, whose Gigafactory in Shanghai exported nearly 165,000 units in the nine-month period after undergoing a major expansion in 2022,⁹³ and it was reportedly considering shipping China-made cars to the U.S.⁹⁴ Many EV makers were attracted by the price advantage in China, where lithium-ion battery packs were 33% and 24% cheaper than in Europe and the U.S., respectively.⁹⁵ BMW in November 2022 earmarked RMB 10 billion (\$1.4 billion) to expand battery production in China.⁹⁶ Other carmakers raised their stake in China in the hope of developing next-generation technologies faster, such as Volkswagen’s plan to invest 2.4 billion euros (\$2.3 billion) in an autonomous driving joint venture in October 2022.⁹⁷

Velong’s Dilemma

For 30 years, we have had this great supply chain. Then all of a sudden in the last 3 to 5 years, everyone’s got to change. Nobody is ready for it. Customers want to move 30% manufacturing outside of China, but unwilling to sacrifice high pricing.

— Jacob Rothman

We have to learn global operation from scratch and build new information systems, new communication models, and new capabilities in every aspect because every country is different in legal system, financial and taxation requirements, culture, and even holidays.

— Iven Chen

China developed its manufacturing capabilities and ecosystem in four decades, so Velong was unlikely to find a perfect overseas alternative in the short term. However, the geopolitical and trade tensions would continue to persist, so the company had to adapt to meet customers’ concerns and carve out a plan for survival and growth. Rothman elaborated:

I can predict a few different futures for Velong. One where we retain 60-70% of our manufacturing in China and slowly move production to other countries. I can also see us using our current business model to help other factories. We are international, have design capabilities, and know how to work with brands and chain stores. As supply chains shift, there will be a lot of businesses in China that need help making a transition. There’s only so much we can do on our own. If we tap into the resources that we see around us, I think we can develop a very exciting business model.

Rothman and Chen had been exploring and experimenting in different countries and hoped that they would settle on a strategy in the near future. They had people in Turkey, Vietnam, India, and Cambodia running bills of materials against other manufacturers and see where the problems were. Rothman explained:

Mexico couldn’t get FDA and LFGB^a approved stainless steel. They couldn’t get pieces that we need to make thermometers, timers and scales, so we are talking to the government about opening a tax-free zone where we can import these things. The manufacturers in Turkey are quite good, but maybe they need a little push. So maybe a joint venture in Turkey. We did spend quite a bit of money on Cambodia. We were about to spend another \$2 million on factory expansion. We will wait until we go to Mexico and see what Mexico can do.

As Rothman, Chen and their companions got off the plane after a very long trip, they were curious to find out what the Mexico trip would bring. Should they make bigger bets in countries like Cambodia, India, and Vietnam where Velong already established a presence? Or should they experiment in Mexico and Turkey? And how could they bridge the capability gap in managing multiple overseas operations? They had limited capital and experience to pursue all opportunities, but they had to move fast and do well in relocating their production capacity. On the other hand, they wondered: Did the global economic prospects support their pace of expansion overseas?

^a FDA is the U.S. Food and Drug Administration. LFGB is the German abbreviation for the German Food and Commodities Act.

Exhibit 1 Comparison of Countries' Competitiveness for Foreign Direct Investment

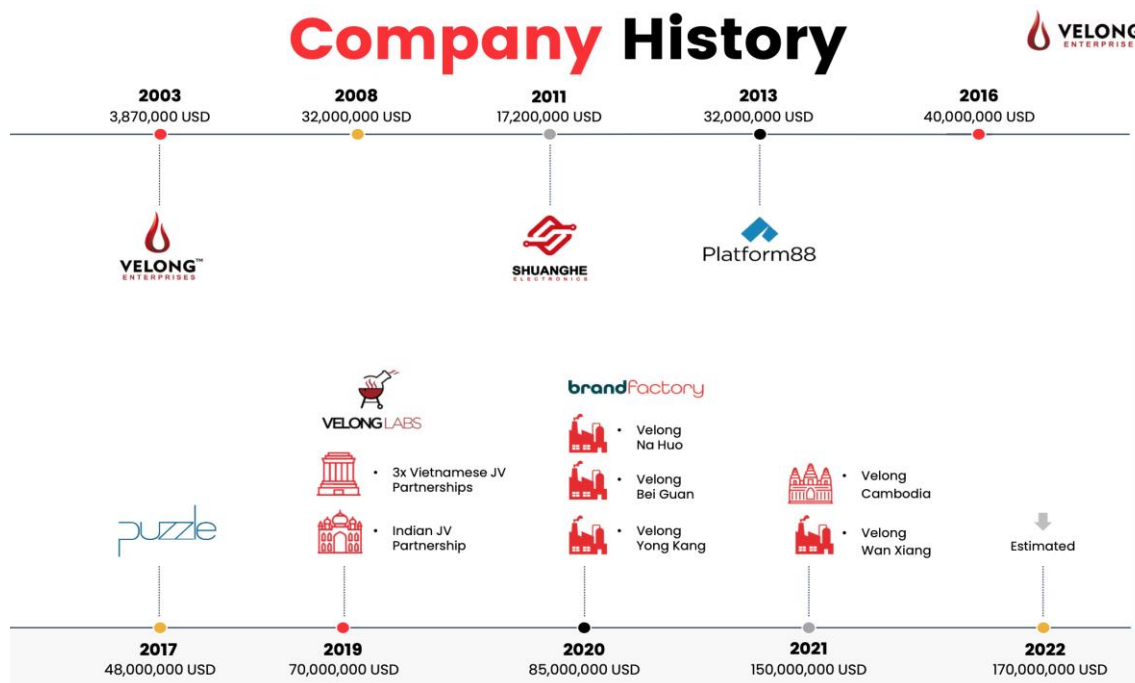
Country/ Region	Economic Freedom of the World Index (rank)	Global Innovation Index (rank)	Credit (rank)	Ease of Doing Business (rank)	Getting Electricity (rank)	Freedom to Trade Internationally (score out of 10)	Trade, Competition , and Market Scale (rank)	Legal System and Property Rights (score out of 10)	Rule of Law (rank)	Corruption Perceptions Index (rank)
Cambodia	63	97	--	144	146	6.94	115	3.70	117	157
China	116	11	25	31	12	6.56	3	5.12	63	66
India	89	40	68	63	22	5.90	9	5.57	60	85
Malaysia	49	36	10	12	4	6.97	33	5.88	39	62
Mexico	64	58	84	60	106	7.65	12	4.72	104	124
Taiwan	24	--	--	15	9	6.31	--	7.16	--	25
Thailand	86	43	11	21	6	6.47	21	4.96	57	110
Turkey	112	37	39	33	42	6.92	11	4.84	83	96
U.S.	7	2	3	6	65	7.77	1	7.56	21	27
Vietnam	113	48	47	70	27	6.13	19	5.14	70	87

Source: Compiled by casewriters using data from <https://www.fraserinstitute.org/economic-freedom/dataset?geozone=world&year=2020&page=dataset&min-year=2&max-year=0&filter=1>; <https://www.globalinnovationindex.org/analysis-economy>; <https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf>; <https://www.transparency.org/en/cpi/2021>.

Note 1: A country's credit considers 1. finance for startups and scaleups, 2. domestic credit to private sector as percentage of GDP, and 3. loans from microfinance institutions as percentage of GDP.

Note 2: Smaller number indicates a higher ranking.

Exhibit 2 Velong Milestones

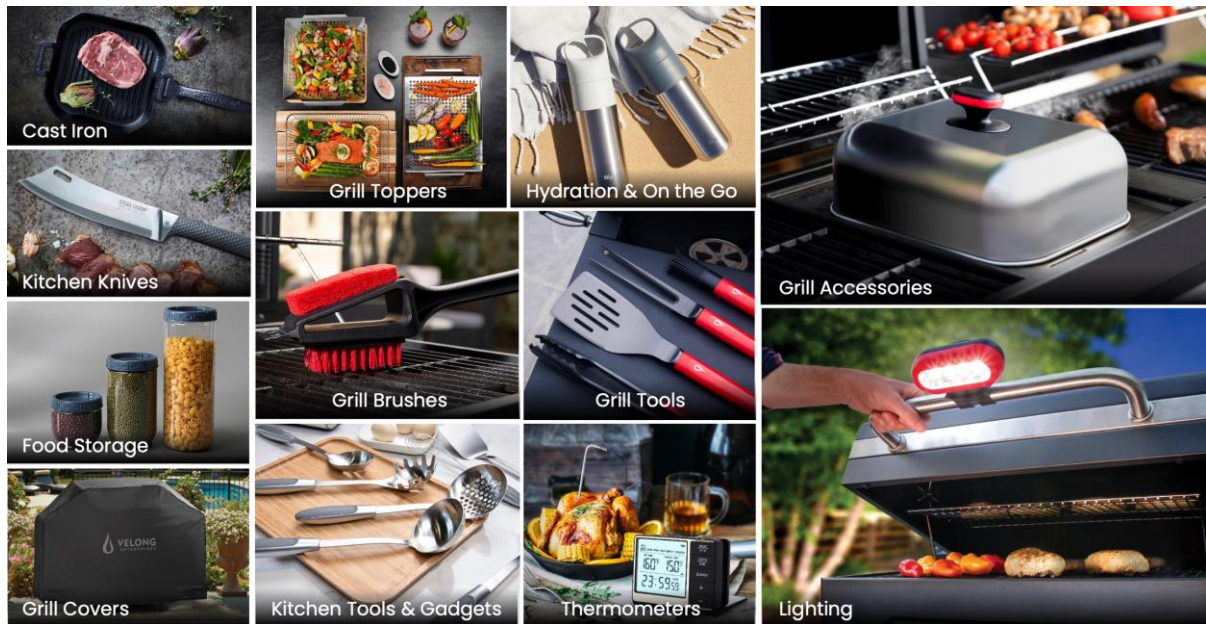


Source: Company presentation.

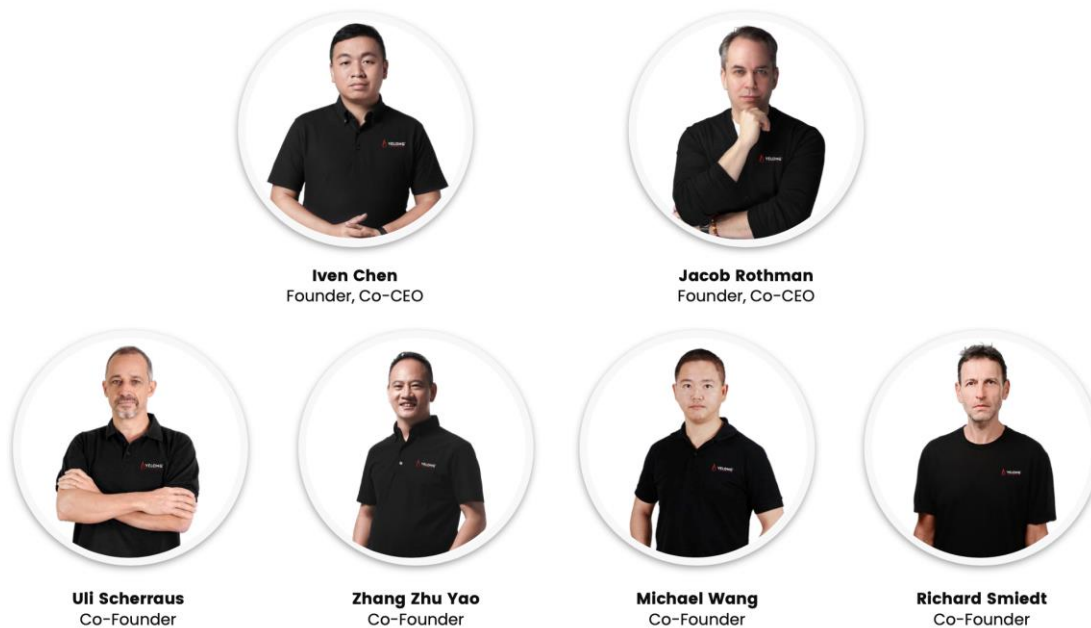
Exhibit 3 Examples of Customers Whose Social Audits Velong Passed



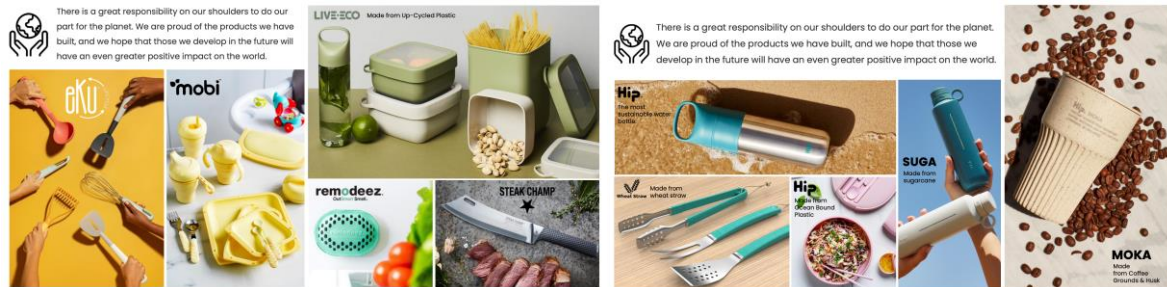
Source: Company presentation.

Exhibit 4 Velong’s Main Product Categories

Source: Company presentation.

Exhibit 5 Velong’s Co-Founders

Source: Company presentation.

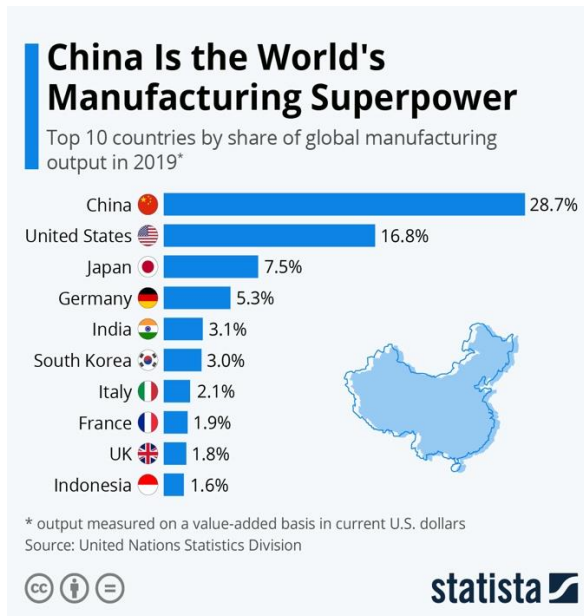
Exhibit 6 Velong’s Sustainable Products

Source: Company presentation.

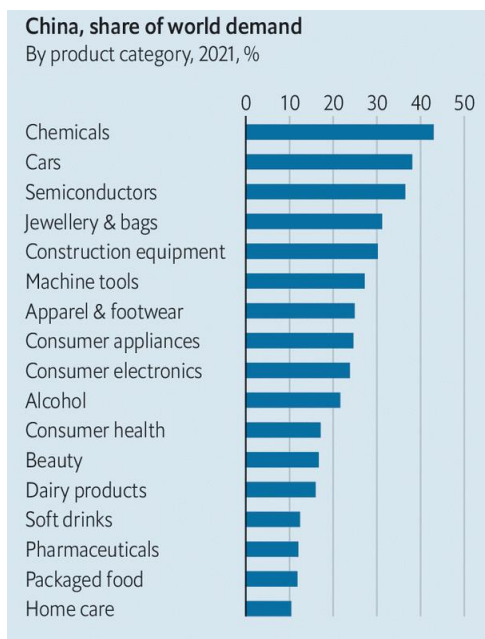
Exhibit 7 Velong’s Factories

Country	Factory	Specialization
China	Velong Yang Dong	BBQ tools, cleaning brush, and grill accessories. This is Velong’s first factory and main headquarters, with production facilities, warehousing, design center, merchandising, and test kitchen. Core competencies include metal stamping, injection molding, brush making, and silicone production. Over 300 workers and staff.
	Velong Na Huo	BBQ tools and grill accessories. Core competencies include injection molding, metal stamping, and brush making. Over 200 workers.
	Velong Bei Guan	Kitchen tools and accessories. Core competencies include injection molding, metal stamping, and silicone production. 200 workers.
	Velong Shuanghe	Electronics and pool accessories including timers, thermometers, scales, pool accessories, and small electronics. Own its own SMT line and can work on products with WIFI and Bluetooth capabilities. Over 200 staff.
	Velong Wanxiang	Drinkware accessories and food storage accessories. Fully automated and have over 500 workers and staff. Core focus is on the use of sustainable materials.
	Velong Yong Kang	Drinkware accessories and food storage accessories. Capabilities in stainless steel and plastic production. Over 200 employees and equipment.
Cambodia	Velong Cambodia (fully owned)	BBQ tools, grill covers and furniture covers. Core competencies include cut and sew products, injection molding, metal stamping, and small electronics. Over 250 staff members.
Vietnam	Velong Enterprises (JV Partner)	Wooden products for the home and kitchen space with a core competency in surface spraying and printing. Over 300 workers and staff.
	Velong Enterprises (JV Partner)	Plastic household products. Over 600 workers and merchandisers, and over 100 injection molding machines ranging from 90 tons to 1,300 tons.
	Velong Enterprises (JV Partner)	Electronics, including chargers, phone cables, power banks, wireless chargers, and headphones. Capable of working on multi-protocol platforms including Bluetooth, Z-Wave, Zigbee, NB-IoT, BLE Mesh, and WIFI solution for Alexa & Google home support.
India	Velong Enterprises (JV Partner)	Located outside of New Delhi in Moradabad. Specializes in brassware, galvanized, wrought iron, aluminum, and stainless-steel items for the home décor and housewares industries.

Source: Company presentation.

Exhibit 8 Top 10 Manufacturing Countries in the World

Source: <https://www.statista.com/chart/20858/top-10-countries-by-share-of-global-manufacturing-output/>, accessed December 21, 2022.

Exhibit 9 China's Share of World Demand

Source: "Multinational firms are finding it hard to let go of China," The Economist, November 24, 2022, © Reproduced with permission of the Economist Intelligence Unit, accessed December 23, 2022.

Exhibit 10 Executive Summary of AmCham Shanghai 2022 China Business Report

2021 profits stable: Exactly 75% of respondents reported being profitable in 2021, marginally below the profitability rates observed over the past several years. The result reflects the robustness observed in several industries, even though intermittent closures of factories and cities due to Covid were a feature of China's 2021 operating environment.

2022 revenue expectations lower: Even with Covid lockdowns in the first half of 2022 undoubtedly dragging on performance, 47% of respondents expect this year's revenue to be higher than last year's. This is a 29 pp drop from the reported rate of year-on-year increases in 2021 and the lowest expectation in at least 10 years. Meanwhile, 47% of respondents expect their revenue growth in China to outpace their companies' worldwide growth, a 22 pp drop from last year.

Investment increase is lower: Only 30% of companies are increasing investment in 2022 compared to last year, lower than in 2021's survey (38%). The top reasons for those increasing investment were growth potential of the Chinese market, China's skilled talent pool and taking advantage of efficient and cost-effective supply chains. For the 19% of respondents decreasing investment, the top reasons were all Covid-related: shutdowns, travel restrictions and supply chain disruptions.

Five-year optimism plummets: Only 55% of companies described themselves as optimistic or slightly optimistic about the five-year business outlook, compared to 78% in 2021. This year's figure is the lowest in the survey's history, worse than either 2020 (Covid) or 2019 (trade war). The percentage of companies that were pessimistic or slightly pessimistic (21%) matched the 2019 figure, when the imposition of tariffs hit companies particularly hard.

China falls out of favor: Just 18% of companies ranked China as number one in their company's global investment plans, down from 27% in 2021 and 2019. Unless China harmonizes its Covid policies with the rest of the world, this fall from favor may be repeated next year. Onerous travel restrictions and lengthy quarantines have dulled the desire of headquarters' executives to travel to China, with knock-on effects on investment.

Investment redirection: One-third of respondents have redirected planned China investments to other destinations in the past year. This is almost double the number of companies that did so in 2021. Among these companies, Southeast Asia was the most popular destination, followed by the US, which surpassed Mexico and the Indian sub-continent this year.

Confidence in economic management weak: 52% of respondents reported that their headquarters' confidence in China's economic management worsened in the past year, and just 8% believed it had improved. This negative perception led many headquarters to delay, cut or divert investments planned for China.

Transparency clouds: With zero-Covid policies upending business and life in Shanghai since early March, members unsurprisingly reported a significant drop in transparency. Only 37% described the regulatory environment in their industry as transparent, a 10 pp drop from last year. The manufacturing sector saw the biggest drop in transparency (down 14 pp to 42%).

Localization proceeds at speed: 12% of businesses accelerated their localization plans due to Covid. But a more prosaic reason explained why a total of 29% were localizing: cost savings. Meanwhile, 20% of companies said they are not localizing, but another 20% are doing so to take advantage of language and cultural skills.

Some are shipping out: Only 53 companies (17%) indicated that they are considering moving operations or footprint out of China in the next one to three years. Of those, just 19% are planning to reshore to US locations. Industries where a very small percentage of respondents expect to move operations/footprint out of China included chemicals (4%) and the pharmaceutical, medical devices and life sciences industries (9%). Conversely, 44% of technology, hardware and software services companies anticipate moving operations/footprint.

Macro challenges ranked: Out of several long-term macro challenges facing China, members ranked a complete decoupling from the US (65%), governance overreach (64%), a property market collapse (60%) and population decline (48%) as the most important.

Source: Excerpted from AmCham Shanghai 2022 China Business Report, p.4.

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