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SHENZHOU INTERNATIONAL GROUP: sustaining success[[1]](#endnote-1)

Weijiong Zhang, Liman Zhao, and Dimeng (Vicky) Kuai wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In early April 2017, Shenzhou International Group Holdings Limited (Shenzhou International) was ranked first among 10 listed Chinese textile, apparel, and chemical fibre companies, according to the Chinese website business.sohu.com. Each of the 10 companies had a market capitalization of over ¥30[[2]](#endnote-2) billion in the first quarter of 2017. Shenzhou International’s market capitalization was ¥60.9 billion.[[3]](#endnote-3) Financial experts believed that along with increasingly stringent environmental requirements and rising labour costs, small and mid-sized enterprises in the printing and dyeing, spinning, and apparel sectors were facing a shakeout. However, as a market leader, Shenzhou International had seen a huge uptick in sales volumes, market share, and profit margin.

Since its listing on the Main Board of the Hong Kong Stock Exchange in November 2005, Shenzhou International had evolved into the world’s largest knitwear manufacturer, with clients including Uniqlo Co., Ltd. (Uniqlo); Nike, Inc. (Nike); Adidas AG (Adidas); and Puma SE (Puma). The group had set up factories in Ningbo, Quzhou, and Anqing in China, as well as in Phnom Penh (Cambodia) and Ho Chi Minh City (Vietnam), and representative offices in Shanghai, Hong Kong, and Osaka (Japan), with 76,000 employees on its payroll. In 2016, the group turned out over 300 million pieces of apparel, which generated ¥15.1 billion[[4]](#endnote-4) in sales revenue and ¥2,950 million in net profit, up 19.5 per cent and 25.2 per cent, respectively, year on year. Over the previous five years, the group’s gross margin had hovered at 30 per cent and its net margin at 18 per cent.[[5]](#endnote-5)

At the end of 2016, Fuyao Glass Industry Group Co., Ltd. (Fuyao) stepped into the media spotlight, causing quite a stir in the business community, when it opened a factory in the United States. Except for the labour cost, the United States held a considerable edge in terms of taxation, energy, land, market size, and Certificate of Origin. It was widely believed that US President Donald Trump’s comments about commerce and trade, and his speeches on reviving US manufacturing would carry considerable weight with US economic and business communities.

The US market had long been a crucial battleground for world-class brands. History had proven that with their sufficient resources and strong capabilities, leading brand operators were in a position to boost the enterprise value in a certain political climate. Chinese entrepreneurs were enthusiastic about the prospects of opening a factory in the United States to meet the needs of top brand operators like Nike. Executives of US key accounts even approached some Chinese companies and inquired whether they would consider building a plant in the United States.

Shenzhou International’s factories in Vietnam and Cambodia had delivered a remarkable financial performance, contributing to the group’s responsiveness and competence. If Shenzhou International built a factory in the United States, the vast market and enormous reputation of US manufacturing brands could bring the group immeasurable opportunities. The group had to determine whether to establish a factory in the United States as part of its strategic map and how to position it.

Shenzhou International early development

Shenzhou International’s predecessor was Shenzhou Knitting Co., Ltd. (Shenzhou Knitting), founded by Baoxing Ma, who had acted as deputy manager of Technology at Shanghai No.20 Knitting Factory, the largest knitting mill in Shanghai in the 1970s. On March 28, 1990, Baoxing Ma was brought as a top management talent into Shenzhou Knitting, a joint venture set up by Shanghai No.20 Knitting Factory, Ningbo Beilun Foreign Economic Services Co., Ltd., and a US investment company. While concentrating on workshop construction and equipment purchasing, Baoxing Ma set his sights on the Japanese baby clothes market. Shenzhou Knitting received its first order for baby clothes from Japan-based Yagi Tsusho, which was demanding in terms of fabrics, processing, and the production cycle. With a never-say-die attitude, Baoxing Ma stepped up employee training and internal management, and in the end, the company filled the order on schedule. In its very first year, Shenzhou Knitting made ¥15.06 million[[6]](#endnote-6) in sales and ¥100,000 in profit.

As a nascent small Chinese company, Shenzhou Knitting delivered products that measured up to Japanese standards for prices, quality, and lead time, causing quite a stir in the local market. Local media coverage provided a springboard for Shenzhou Knitting to receive more client orders. Soon, Shenzhou Knitting established partnerships with a dozen large corporate clients including Mitsubishi Corporation; Mitsui & Co., Ltd.; and Cecile Co., Ltd. By 1996, the company had earned ¥250 million[[7]](#endnote-7) in annual sales and ¥10.29 million in profit, with 2,300 employees. In the same year, Baoxing Ma handed over the company to his son, Jianrong Ma (hereafter referred to as Ma), who was 33.[[8]](#endnote-8)

After his succession, Ma came up with the slogan “Developing and manufacturing cutting-edge products.” Shenzhou Knitting spent ¥100 million–¥200 million purchasing pieces of advanced equipment from Germany, Italy, and Japan every year to phase out backward equipment, re-moulding the technical processes. By 1998, the company put in place a complete set of efficient and flexible operations mechanisms, which was applauded by clients for reducing the lead time—from placing an order to purchasing raw materials to dyeing and knitting.

By honouring its promise of fulfilling orders well and on time, Shenzhou Knitting attracted many Japanese clients. In 1999, its exports brought in annual sales of US$76 million[[9]](#endnote-9) and total profits of ¥40.72 million.[[10]](#endnote-10)

“Riding on the Coat-tails”

Ma regarded the company’s co-operation with clients as an approach to “riding on their coat-tails,” or benefitting from the success of others. He made a point of establishing partnerships with world-class companies. “In the very beginning, these top brand operators tend to impose onerous requirements according to their standards,” Ma said. “But as long as you conform to their standards and conduct a strategic co-operation with them in procurement, production, and logistics to build a community of common destiny, you’ll likely emerge as their long-term supplier.”[[11]](#endnote-11)

The year 1997 marked a watershed for Shenzhou Knitting. Ma remembered, “When I was doing business in Shanghai, a salesman called me and said a Japanese client inquired whether our circular looms were capable of producing 300,000 sweaters in one month. Yet considering that it was such a great challenge to the company, the salesman gave him a flat refusal. Seeing a potential opportunity, however, I went back to Ningbo that evening to meet that client.” As a matter of fact, the client was seeking an apparel manufacturer for Uniqlo, which used to place orders in Guangdong Province. Uniqlo had placed such an order with a company in Ningbo through a Ningbonese merchant based in Hong Kong. The two sides had agreed on a 90-day delivery. After 50 days, during his site inspection, the client found the products did not meet the required standard. He had no choice but to look for another supplier, with limited time remaining. He made a tentative inquiry to Shenzhen Knitting just to try his luck.[[12]](#endnote-12)

Ma’s negotiations with Uniqlo on the co-operation program ended at 2:30 a.m. the next day. At 5:00 a.m., Ma arrived at the hotel where the client had stayed, and brought the client to the factory to show him around. Though a bit skeptical, the client had no choice but to give the order to Ma. The following month, Ma’s workload was overwhelming, but he finally completed the order. Very satisfied with the order fulfillment, Uniqlo’s production director flew to China to invite Ma for further negotiations on co-operation.

This was just a starting point for Shenzhou Knitting in building a long-term formal partnership with Uniqlo and other international brands such as Nike and Adidas. To do so, Shenzhou Knitting had improved the management process, transformed its factory, and expanded its production capacity, among taking other measures (see Exhibit 1).

full Steam Ahead

In 2002, with the support of Beilun District government, Shenzhou Knitting purchased a 500-*mu* (333,333-square-metre) plot, which laid the groundwork for its sustainable development. The first thing Ma did after acquiring the plot was spend ¥48 million[[13]](#endnote-13) building a 60,000-ton sewage treatment pond.

Many people thought Ma had made the wrong decision in building the pond, but he argued his case. The printing and dyeing technique for apparel fabrics not only consumed a great deal of water and electricity, it also discharged large amounts of sewage. Thanks to the far-sighted measure of building large sewage treatment facilities and purchasing energy-saving and emission-reducing dyeing machines, Shenzhou Knitting was able to conform to the increasingly stringent national environmental standards, proving that Ma’s decision made great sense. Some ill-prepared apparel fabric manufacturers were facing the options of sewage treatment at higher costs, relocation, or even bankruptcy.

In 2005, Shenzhou Knitting was listed on the Main Board of the Hong Kong Stock Exchange as Shenzhou International, by then he was China’s largest, vertically-integrated knitwear original equipment manufacturer (OEM), combining weaving, dyeing and finishing, printing and embroidering, cutting, and sewing techniques through expansion. Before the listing, Shenzhou International had co-operated more with Japanese clients; Uniqlo accounted for more than one half of its operating revenue. The listing delivered a significant boost to its brand influence and financial performance. By virtue of funding, the company sped up technical upgrading and scaled up capacity, winning over top brands like Nike, Adidas, and Puma.

Cunbo Wang, managing director of Shenzhou International, believed the listing served as a lever for the company. Thanks to its co-operation with world-class brand operators, Shenzhou International set up a 6,000-square-metre state-level laboratory and a first-rate fabric engineering research and development (R&D) centre, which was capable of developing more than 1,000 new fabrics annually. Adidas and Nike had even built their design centre in Shenzhou International, reducing the time to market for new products.[[14]](#endnote-14) Shenzhou International was moving full steam ahead. From 2005 to 2016, its net assets rose from ¥1.71 billion[[15]](#endnote-15) to ¥15.09 billion, its sales from ¥2.48 billion to ¥15.1 billion, and its net profits from ¥350 million to ¥2.95 billion (seeExhibit 2).

Gaining a Competitive Advantage

World-renowned brand operators tended to impose a string of requirements on their suppliers. In addition to the product quality, lead time, prices, and flexibility and reliability of the order, most brand operators set specific metrics for suppliers’ compliance (social responsibility, environmental protection), innovative capacity (R&D and design), and capability for vertical integration. Clothing Connect, a London-based consultancy firm, had come up with 15 indicators to evaluate, analyze, and compare suppliers’ competence. The company believed that cost and lead time were the primary considerations for brand operators when selecting suppliers. Another UK consulting firm, Clothesource Ltd., noted that cost accounted for 50 per cent of the supplier assessment criteria, lead time for 30 per cent, and risks for 20 per cent. Brand operators usually gave priority to a supplier with a capability for vertical integration, R&D, and manufacture of high-value-added products.[[16]](#endnote-16)

Compared with brand operators, suppliers—who competed fiercely with each other—were in a weak position in the market (seeExhibit 3). Brand operators could choose among suppliers around the world. They pitted suppliers against each other to prevent them from jointly bargaining with brand operators. For example, Nike had 394 apparel suppliers worldwide in 2016, with 71 in China and 52 in Vietnam. Nike used its Sourcing & Manufacturing Sustainability Index (SMSI) to sort suppliers into five categories by quantifying their capability for lean production, social responsibility, and environmental awareness. Quality, on-time delivery, cost, and sustainability were each given a 25-per-cent weighting.[[17]](#endnote-17)

As for a prevalent purchase pattern, apparel brand operators tended to provide designs, designate a fabric supplier, and commission an OEM to manufacture the apparel. A survey by the United States Fashion Industry Association (USFIA) indicated that a growing proportion of apparel manufacturers had been permitted to participate in product designs and to purchase fabrics independently. For brand operators, the vertical integration of manufacturers could lead to greater efficiency, a lower purchase cost, and quicker responses across the supply chain.

According to the USFIA’s survey, the following abilities would give a supplier a strong competitive edge:

* Helping clients develop and manufacture high-value-added products
* Promoting environmental protection and settling labour disputes so as to maintain sustainable capacity
* Ensuring proper regional distribution that complied with brand operators’ requirement to spread regional risks and make the supply chain more efficient
* Having vertical, integrated, or one-stop production to ensure on-time delivery, lower brand operators’ cost of purchase, and enhance efficiency in procurement[[18]](#endnote-18)

After receiving an order, an apparel manufacturer had to spend about one and a half months sourcing fabrics. Besides this, additional time might be required for any uncertainties that arose over quality control. Knitted apparel manufacturing was a multi-step process. Shenzhou International had been brand operators’ top choice, thanks to its vertical integration strategy, which improved the efficiency of the supply chain and responsiveness to client needs. As part of a community of common destiny, sports and casual clothing brand operators, such as Nike, Uniqlo, Adidas, and Puma, guaranteed the volume of orders they placed with Shenzhou International. In the first half of 2016, Shenzhou International took many rush orders from Uniqlo. As a result, the company’s sales to Uniqlo rose by 25 per cent year on year—the company posted a year-on-year increase of 27 per cent and 23 per cent in revenue from casual clothing and underwear, respectively; the average selling prices of these rose 5 per cent.[[19]](#endnote-19)

While setting top brand operators as key accounts, Shenzhou International had opened an exclusive factory for Nike and Adidas to safeguard their trade secrets. The two factories were completely cut off from each other in terms of personnel management, product R&D, and production. Uniqlo, Nike, Adidas, and Puma had accounted for over 90 per cent of Shenzhou International’s sales for three consecutive years (seeExhibit 4). In addition, Shenzhou International also zoomed in on an information technology (IT)-based, automated factory with over 10,000 employees, whose productivity far exceeded that of most apparel manufacturers with a staff size of around 1,000. Ma summarized the factory’s efficiency as follows:

Compared with most factories in Southeast Asia, our plant lays an emphasis on adaptation to different product categories, as well as lean production and automation. Noted for its flexibility and strong execution, Shenzhou International was in a position to take orders from any client in the apparel sector. Now, it takes us 15 to 20 days to fill Uniqlo orders. Other Uniqlo suppliers feared being squeezed out by us.[[20]](#endnote-20)

Dipping into diversification

Shenzhou International was seeking innovation in line with its vision of “evolving into the world’s best apparel operator.” In 2010, Shenzhou International set up Maxwin (China) Co., Ltd. (Maxwin) in an attempt to create its own brand; Maxwin was aimed at building a Chinese casual wear brand. Maxwin had a team of 40 strong designers, who stuck to the concept of “a simple, modern and new lifestyle.” Maxwin provided apparel that featured quality fabrics, proper cutting, and comfort. The product line ran the gamut of men’s wear, women’s wear, children’s wear, and underwear. Presently, Maxwin ran 25 sales outlets in Jiangsu Province, Zhejiang Province, and Shanghai. In the next few years, the company planned to further tap into the brand retail market to make its stores built-to-last and establish a nationwide retail network.

Some industry insiders argued it did not make business sense for Shenzhou International, a long-time OEM, to build its own brand. Shenzhou International could not compare in core competence with top brand operators. If the company continued to foster its own brand, more resources would have to be channelled into product designs, marketing, advertising, warehousing and logistics, sales models, and commodity planning. According to an announcement by Shenzhou International, Maxwin, a nascent non-core business, was still in the red. To be able to channel more resources into the core business of knitwear production as an OEM, Shenzhou International sold its 49-per-cent stake in Maxwin to NetEase (Hong Kong) Limited on September 1, 2016.[[21]](#endnote-21)

Thanks to Shenzhou International’s growing competence across the world, brand operators placed orders with it for more categories of apparel. In 2012, when the supplier Feng Tay Enterprises Co., Ltd. abandoned the production of Flyknit fabrics for Nike shoes,[[22]](#endnote-22) Nike gave the order to Shenzhou International. Ma spent over US$100 million importing 2,000 pieces of special-purpose equipment to take on this high-tech project. By 2016, Shenzhou International had supplied over 70 per cent of Nike’s Flyknit fabrics, and Flyknit accounted for 6 per cent of Shenzhou International’s total sales, generating considerable economic returns.[[23]](#endnote-23) Flyknit, an innovative high-tech fabric that was popular with runners, had promising prospects—besides Nike, most sports brand operators had set out to apply the fabric to running shoes.

Going Global

At the end of September 2015, Shenzhou International set up an apparel factory in Cambodia. In 2016, with 2,500 employees, the factory turned out more than 850,000 pieces of apparel every month, selling them mainly to European Union member countries.[[24]](#endnote-24) Over the previous few years, the scale of the apparel factory had expanded. In 2016, Shenzhou International ran two subsidiaries with four factories in Cambodia, including eight apparel workshops, two printing workshops, one embroidering workshop, and one rinsing workshop. In 2013, with a staff of nearly 10,000, Shenzhen (Cambodia) Co., Ltd. was the largest Chinese apparel manufacturer in Cambodia.[[25]](#endnote-25)

In Cambodia, Shenzhou International put a premium on compliance with local laws and regulations, labour relationships, environmental protection, and localization of the executive team, granting generous employee benefits and offering a working lunch for free. In addition, the company provided employees, regardless of race or nationality, with equal pay for an equal position. Thanks to all these measures, after the factory was put into operation, its employees neither went on strike nor brought production to a halt. Despite the lower labour cost, Cambodia lagged far behind China in terms of infrastructure, transportation, communications, and the industry supply chain. Thus, Cambodia held no clear advantage in the overall cost of apparel processing.

The soaring labour cost on the Chinese Mainland and major importers’ unfavourable tariff policy against apparel from China brought huge cost pressure to bear on Shenzhou International’s manufacturing facilities in China. Besides this, statistics showed that fabrics required for apparel made in Vietnam were imported from China—in 2015, Vietnam’s fabric imports from China totalled US$8,160 million, up 14.6 per cent year on year. Thus, building a fabric factory in Vietnam would give an apparel manufacturer a competitive edge.[[26]](#endnote-26)

In Quảng Ninh Province, Vietnam, Shenzhou International set up a fabric plant and an apparel factory, which it put into operation in November 2014 and January 2015, respectively. The group had sent some executives and technical experts to these two factories, and provided training for their key employees before the projects came on stream. By 2016, the two projects were off to a flying start. The fabric plant supplied fabrics to the group’s apparel factories in Cambodia and Vietnam, enhancing its market responsiveness and reducing the transportation cost.[[27]](#endnote-27) According to its annual report, along with the expansion of the business in Cambodia and Vietnam, Shenzhou International posted 50-per-cent year-on-year growth in sales from European markets and a 2.5-per-cent increase in gross margin in the first half of 2016. The group planned to increase the number of employees of its factories in Vietnam to 11,000 at the end of 2017 to scale up the annual capacity by 12 to 15 per cent.[[28]](#endnote-28)

While building the two factories, Shenzhou International had set about upgrading the internal operations system, including the production process, quality control, and lead time, to create a production model that integrated fabric production, printing, embroidery, and apparel manufacturing. The group’s IT system laid a solid foundation for its multinational operations. The group adopted a vertically integrated model to manage production planning, finance, human resources, and administration on a consolidated basis. For example, the group’s vice-president of Production in Ningbo oversaw the production in factories in China, Cambodia, and Vietnam; it was up to headquarters to purchase and allocate all raw materials. The vertically integrated management system based on IT brought the group’s processes, quality, efficiency, and costs to the same level. As lean production principles were applied to each manufacturing process in the overseas factories, the group’s productivity markedly improved.

As a global apparel supplier, Shenzhou International made a point of undertaking corporate social responsibility initiatives in order to maintain its competitive advantage around the world. The group was committed to labour law compliance, environmental protection, employee benefits, and community relationships so as to project itself as a responsible company.

Trends for the global knitted sportswear market

The apparel industry was a traditional industry. According to a report from UNCTAD (United Nations Conference on Trade and Development), sales of the global textile and apparel industry totalled US$1.1 trillion in 2012; since 2013, the size of the global apparel market had increased by over 6.6 per cent every year. Based on a conservative estimate of 5-per-cent annual growth, the size of the global apparel market would amount to US$2.1 trillion by 2025;[[29]](#endnote-29) apparel spending per capita in the world was forecast to rise from US$153 to US$247 by 2025. In populous countries, such as India, China, Brazil, and Russia, the demand for apparel per capita would double (see Exhibit 5).

The value chain of the apparel industry—from raw material processing and spinning to apparel manufacture and sales—was not long. The raw materials fell into the categories of natural fibres (cotton, wool, linen, and silk) and chemical fibres. Spun from raw materials, yarns were woven or knitted into fabrics to be dyed, cut, and sewn into apparel, which landed in the market through various channels. Though highly efficient, the weaving technique was generally used for mass production, due to its complicated procedures and long preparation time; despite its high unit cost, the knitting technique was suitable for small-batch production, on account of its short preparation time. Extensively applied in the apparel industry, the knitting technique enabled manufactures to adapt to ever-changing market demand. Soft, kind to the skin, and sweat-absorbent, knitted fabrics were used for underwear or sportswear.

Globally, apparel production was a labour-intensive industry. As the apparel market was highly fragmented, the staff size of most apparel manufacturers worldwide ranged from dozens to hundreds. In recent years, international apparel brand operators had spearheaded an efficient division of labour among thousands of manufacturers in dozens of countries across the industry chain. International apparel brand operators were concentrated on high-value-added activities, such as research, design, marketing, supply chain, and financial services, while outsourcing labour-intensive raw material and apparel production to developing countries and regions for their lower labour costs.

Knitwear made up the bulk of the apparel industry. According to data from US-based Technavio, the size of the knitted sportswear market alone amounted to US$159 billion in 2015 and was projected to increase to US$199.6 billion in 2020 at an annual rate of 4.4 per cent.[[30]](#endnote-30) Market concentration was rather low in the knitted sportswear industry, where even Nike, the world’s largest sports brand, had only a 5-per-cent share. By 2016, competition among brand operators had reached fever pitch (see Exhibit 6).

International brand operators focused on the considerable demand in the global market. When seeking suppliers, these operators needed to take into consideration labour costs, processing technology, differences among countries in trade policy, foreign exchange rate fluctuations, risk control, and lead time. Subject to quotas, apparel products made in China could not be exported to some regions or countries. Some countries, including European Union members, levied stiff tariffs, up to the processing cost, on apparel from China. The rising labour cost was also cause for concern. China’s soaring labour cost had no relative advantages to other countries (see Exhibit 7).

Trade agreements among countries had made a difference to the textile and apparel industry. Over the past few years, the Trans-Pacific Partnership (TPP)[[31]](#endnote-31) had exerted a significant influence on China’s textile and apparel industry. On the one hand, trade among TPP members was duty-free; while bound by the World Trade Organization rules, textiles and apparel exported from China to TPP nations were liable to a 10-per-cent duty. On the other hand, owing to the TPP’s “yarn-forward” rule of origin, TPP members would import fewer fabrics and accessories from China, increasing the imports of similar products from member states. Twelve TPP members, which accounted for 40 per cent of the global gross domestic product, were primary markets for China’s textiles and apparel.[[32]](#endnote-32)

China had once been a major textile and apparel exporter, but its market share of apparel exports had declined in recent years. In October 2013, management consulting firm McKinsey & Company conducted a survey among chief purchasing officers of 29 US and European apparel brand operators, which purchased more than US$39 billion worth of apparel annually, and prepared a report on the global apparel sourcing map. The survey revealed that 70 per cent of respondents would reduce their apparel purchases in China, and instead set their sights on suppliers with lower costs in Southeast Asian and South Asian countries such as Vietnam and Bangladesh.[[33]](#endnote-33)

From the TPP negotiations, Vietnam emerged as the biggest winner. From 2009 to 2015, the average annual growth rate of its textile and apparel exports stood at 18.6 per cent, 6 per cent higher than that of China in the same period.[[34]](#endnote-34) From 2008 to 2012, Vietnam’s textile exports were only 15 per cent of what China was exporting; in 2016, this rose to 23 per cent.[[35]](#endnote-35) According to an estimate by Eurasia Group, the world’s largest political risk consultancy, the TPP would boost Vietnam’s gross domestic product by 11 per cent by 2025, with exports growing by 28 per cent in the same period.[[36]](#endnote-36) Under the TPP’s “yarn-forward” rule of origin, major techniques such as spinning, weaving, dyeing, and finishing had to be undertaken in a member country in exchange for duty-free access. Thus, besides Shenzhou International, other textile manufacturers, such as Texhong Textile Group Ltd.; Huafang Co., Ltd.; Qingdao Hifa Co., Ltd.; and Bros Eastern Co., Ltd., had opened factories in Vietnam.[[37]](#endnote-37)

At the start of 2017, US President Donald Trump’s repeated threats to pull out of the TPP sparked a global outcry. It was widely believed that withdrawal from the agreement by the United States would be detrimental to the TPP.[[38]](#endnote-38) If the TPP was stopped, Vietnam’s advantages in the textile and apparel industry would disappear.

Opportunities for Future Development

Although Shenzhou International had established a presence in various developing countries, venturing into the US market was considered a different situation. Yet, there were three main positive reasons for doing manufacturing in a developed country such as the US market.

First, as Dewang Cao, chairman of Fuyao, noted, the total cost of building a plant was no higher in the United States than in China. The Boston Consulting Group had researched the manufacturing costs for the world’s top 25 export economies, and the findings revealed that China’s manufacturing costs were 96 per cent of the manufacturing costs in the United States in 2014, as opposed to 85.1 per cent in 2004 (see Exhibit 8).[[39]](#endnote-39) Deloitte Touche Tohmatsu Ltd. had rated the manufacturing competitiveness of 40 countries: China was at the top in terms of overall manufacturing competitiveness in 2016; the United States, which ranked second, was predicted to de-throne China in 2020.[[40]](#endnote-40)

Second, the US legal system was solid and stable. Concerned about employment, local governments might provide foreign investors with incentives, as building a factory in the United States could create hundreds of jobs for local communities.

Third, it had been a long time since Shenzhou International had established partnerships with Nike and Adidas. Opening a plant in the United States would facilitate the group’s co-operation with these key accounts, contributing to branding and strategic planning. In the vast US market, the group would undoubtedly see orders stream in.

Nevertheless, there were potential obstacles to Shenzhou International venturing into the US market. The United States differed hugely from Asian countries in terms of legal institutions, business climate, labour policy, and employee competence. Trade unions were a force to be reckoned with, and local governments were environmentally conscious. Shenzhou International was a traditional labour-intensive enterprise and a significant emitter of pollution. Would the group be able to find low-cost technical workers and conform to rigorous US emission standards? In considering opening a plant in the United States, Shenzhou International would need to chart its overall strategic course.

Exhibit 1: How Shenzhou International Built Partnership with Big Brands

Forging formal partnerships with Uniqlo Co., Ltd. (Uniqlo) was typically a long and painful process. A brand-conscious company, Uniqlo attached great importance to building long-term strategic partnership with suppliers. Its supplier network was spread across the world, including over 70 suppliers in Asia. Uniqlo had established a system for order processing, procurement, the production process, quality control, and logistics management so as to better select and manage suppliers. According to Uniqlo, the most efficient approach to quality control was to send out its technicians in charge of product development and quality management to suppliers, to impart the skills for fibre processing, weaving, spinning, dyeing, sewing, and supplying finished apparel so that the suppliers could adopt the same techniques and processes as their Japanese counterparts.

Uniqlo sent five or six senior technicians to Shenzhou International to improve the management process down to every last detail. During their initial factory inspection, these technicians spotted over 100 problems with quality assurance and pressed for prompt improvement. Afterward, they came up with some suggestions for company management, including even updating the restrooms. “We were proud of our efficient execution. On the site, my management team and I spent just two days ironing out all problems on a case-by-case basis. Besides, I engaged a construction firm in the very month to bring restrooms up to the standards of star-rated hotels. I also demanded each factory manager should keep restrooms as clean and tidy as those of three-star hotels,” recalled Jianrong Ma, Shenzhou International’s chairman. “I required all staff bite the bullet to put things right so as to meet the demanding requirements of Uniqlo. I was convinced our client would choose to partner with us as long as we attended to its needs.”

Shenzhou International’s arduous efforts paid dividends. At the end of that year, Uniqlo held a global supplier meeting. Among well-known Chinese textile companies, such as Matsuoka Corporation and Bosideng International Holdings Ltd., Shenzhou International stood out as Uniqlo’s best supplier.

During its co-operation with Nike, Shenzhou International was also committed to improving its production and management. Soon, Shenzhou International was well-equipped to satisfy clients’ varying demands related to the production process, quality assurance, the working environment, cost control, and lead time. Ma said, “The training Nike provided for its global suppliers laid the groundwork for our prominence as a leading supplier. During the training sessions, we were shown around world-class factories and exposed to up-to-date concepts about scientific management, environmental protection, and corporate social responsibility.” Two years later, Shenzhou International received the Best Quality Award from Nike, replacing an apparel manufacturer in Malaysia as Nike’s core supplier.

Shenzhou International also overcame hardships to co-operate with Adidas, a world-renowned brand operator with many suppliers in China. The director of Adidas China asked Ma whether Shenzhou International would be able to build a factory capable of producing 150,000 pieces of apparel per day within one year, to remove the bottleneck in capacity and the price barrier created by the suppliers that had banded together in Taiwan. Given the company’s efficient execution, Ma said it would be. Shenzhou International bought out a factory on the brink of collapse and spent 10 months turning it around. With the number of employees rising from 2,000 to 6,000, the factory met Adidas’s requirements in terms of product quality, production safety, and social responsibility. Shenzhou International emerged as Adidas’ supplier. Two years later, Shenzhou International received the Best Supplier Award and Sustainability Award from Adidas at its headquarters in Nuremberg, Germany.

Source: Summarized by the authors based on a speech delivered by Jianrong Ma at the China Europe International Business School on August 19, 2016.

Exhibit 2: Shenzhou International Historical Financial Data (in ¥ millions)

Consolidated Income Statement

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | **2015** | **2014** | **2013** | **2006** | **2005** |
| Sales revenue | 15,099 | 12,639 | 11,132 | 10,047 | 2,980 | 2,483 |
| Cost of sales | 10,190 | 8,790 | 7,905 | 7,209 | 2,340 | 1,909 |
| Gross profit | 4,909 | 3,849 | 3,227 | 2,839 | 639 | 574 |
| Interest expense | -120 | -99 | -46 | -10 | 12 | 51 |
| Income tax expense | 695 | 532 | 477 | 477 | 19 | 2 |
| Net profit | 2,948 | 2,355 | 2,066 | 1,803 | 390 | 353 |

Consolidated Balance Sheet

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2016** | **2015** | **2014** | **2013** | **2006** | **2005** |
| Assets | 21,816 | 18,362 | 15,943 | 11,317 | 2,794 | 2,541 |
| Including: current assets | 12,835 | 10,912 | 10,309 | 6,993 | 973 | 560 |
| Liabilities | 6,506 | 5,272 | 4,132 | 986 | 719 | 826 |
| Including: current liabilities | 3,094 | 2,155 | 1,265 | 986 | 719 | 826 |
| Net assets | 15,310 | 13,090 | 11,811 | 10,331 | 2,074 | 1,714 |

Note: ¥ = CNY = Chinese yuan renminbi; US$1.00 = ¥ 6.89 on March 31, 2017

Source: Shenzhou International Group Holdings Limited, *Annual Report 2014*, accessed June 4, 2018, [www.shenzhouintl.com/Login/report3/dow/ew\_02313AR-25032015.pdf](http://www.shenzhouintl.com/Login/report3/dow/ew_02313AR-25032015.pdf); Shenzhou International Group Holdings Limited, *Annual Report 2015*, accessed June 3, 2018, [www.shenzhouintl.com/Login/report3/dow/Shenzhou\_B\_AR%20(final).pdf](http://www.shenzhouintl.com/Login/report3/dow/Shenzhou_B_AR%20(final).pdf); Shenzhou International Group Holdings Limited, *Annual Report 2016*, accessed June 3, 2018, www.shenzhouintl.com/Login/report3/dow/Shenzhou\_B\_AR%20(final).pdf.

Exhibit 3: Global Sales of Sports Apparel Brand Operators (2015)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Adidas** | **Nike** | **Puma** | **Under Armour** |
| Global sales | US$7.7 billion | US$8.6 billion | US$1.4 billion | US$2.8 billion |
| US market | 22% | 44.8% | 38.7% | 88% |
| European market | 27% | 25% | 24% | - |
| Chinese market | 15% | 10% | (37%) | - |
| Japanese market | 6% | 2.5% | - | - |

Source: Technavio.com, *Global Sports and Fitness Wear Market* *2016–2020* (Elmhurst, IL: Infinity Research Limited: 2016), accessed July 17, 2018, www.emis.com/php/search/pdf2html?pc=YY&doc\_id=557991480&type=2.

Exhibit 4: Sales Data of Shenzhou International’s Key Accounts (in ¥ millions)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2014** | | **2015** | | **2016E** | |
|  | **Revenue** | **Sales contribution** | **Revenue** | **Sales contribution** | **Revenue** | **Sales contribution** |
| Uniqlo | 3,536 | 31.8% | 3,837 | 30.4% | 4,675 | 30.3% |
| -Coats | 2,332 | 20.9% | 3,137 | 24.8% | 3,765 | 24.4% |
| -Underwear | 1,204 | 10.8% | 700 | 5.5% | 910 | 5.9% |
| Nike | 3,107 | 27.9% | 3,832 | 30.3% | 5,009 | 32.5% |
| -Apparel | 2,610 | 23.5% | 3,137 | 24.8% | 3,827 | 24.8% |
| -Flyknit | 496 | 4.5% | 695 | 5.5% | 1,181 | 7.7% |
| Adidas | 2,367 | 21.3% | 2,738 | 21.7% | 3,231 | 20.9% |
| Puma | 1,000 | 9.0% | 1,092 | 8.6% | 1,365 | 8.8% |
| Others | 1,121 | 10.1% | 1,139 | 9.0% | 1,151 | 7.5% |
| Total | 11,132 | 100.0% | 12,639 | 100.0% | 15,431 | 100.0% |

Note: ¥ = CNY = Chinese yuan renminbi; US$1.00 = ¥ 6.89 on March 31, 2017

Source: *Shenzhou International: Both Productivity and Profitability Increased,* BOC International (China) Limited, accessed December 12, 2016.

Exhibit 5: Apparel Demand Per Capita, trends by Country (in US$)

Note: EU = European Union; US = United States

Source: Bui Van Tot, *Textile & Apparel Industry Report: Opportunities for Breakthrough* (Hanoi, VN: FPT Securities,April 2014), accessed July 17, 2018, www.fpts.com.vn/FileStore2/File/2014/07/01/Textile%20and%20Apparel%20Industry%

20Report%20(latest).pdf.

Exhibit 6: Nike’s Global Apparel Manufacturing Suppliers (2016)

|  |  |  |
| --- | --- | --- |
| **Country** | **Number of Suppliers** | **Largest Supplier’s Number of Employees** |
| China | 71 | 4,300 |
| Vietnam | 52 | 9,000 |
| United States | 43 | 576 |
| Thailand | 26 | 3,200 |
| Sri Lanka | 20 | 6,000 |
| Mexico | 14 | 2,070 |
| Malaysia | 17 | 1,300 |
| Italy | 12 | 93 |
| Indonesia | 16 | 3,700 |
| Brazil | 12 | 600 |

Source: Nike Inc., *FY16/17 Sustainable Business Report: Maximum Performance Minimum Impact*, accessed July 16, 2018, https://sustainability-nike.s3.amazonaws.com/wp-content/uploads/2018/05/18175102/NIKE-FY1617-Sustainable-Business-Report\_FINAL.pdf.

Exhibit 7: PRODUCTION FACTOR COSTS—Comparison of Countries

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **China** | **Vietnam** | **Cambodia** | **Bangladesh** | **Myanmar** | **United States** |
| Total population (100 million) | 13.7 | 0.95 | 0.16 | 1.56 | 0.57 | 3.24 |
| Labour population (100 million) | 8.04 | 0.55 | 0.08 | 0.82 | 0.37 | 1.56 |
| Industrial labour population (100 million) | 2.44 | 0.12 | 0.01 | 0.11 | 0.03 | 0.30 |
| Labour cost (US dollars per month) | 645 | 181 | 121 | 87 | 73 | 4,026 |
| Water price\* (US dollars per ton) | 1.0 | 0.45 | 0.3 | 0.35 | 1.0 | 0.45 |
| Electricity price (US dollars per kilowatt hour) | 0.10 | 0.07 | 0.17 | 0.09 | 0.085 | 0.068 |
| Tariffs on exports to the European Union | Average tariff: 12% | Tariffs will be phased out as per the free trade agreement | Zero tariff | Zero tariff | Zero tariff | Average tariff: 3–5% |
| Tariffs on exports to the United States | Average tariff: 19% | Zero tariff | Zero tariff under the Generalized System of Preferences | Average tariff: 15.6% | Most Favoured Nation treatment | - |
| Tariffs on exports to Japan | Average tariff: 10% | Zero tariff | Zero tariff under the Generalized System of Preferences | Zero tariff under the Generalized System of Preferences | Zero tariff under the Generalized System of Preferences | Average tariff: 2% |

Note: \*Water prices differed dramatically among US states. Owing to abundant water resources, the Great Lakes Region, including Chicago, Detroit, and Milwaukee, set lower water prices; due to its dense population and severe water shortage, California set a higher water price. For example, the water price in Washington, D.C. was US$0.87 per ton, compared with US$0.45 per ton in the State of Ohio.

Source: Central Intelligence Agency, *The World Fact Book*, accessed July 17, 2018, www.cia.gov/library/publications/the-world-factbook/; “Bangladesh Appeals to the United States to for tax Exemption on the Apparel Exported from Bangladesh to the United States [in Chinese],” December 15, 2015, accessed July 17, 2018, http://gpj.mofcom.gov.cn/article/zuixindt/

201512/20151201210502.shtml.

Exhibit 8: Top 25 Export Economies—Manufacturing Costs, 2014

Note: US Manufacturing Cost Index = 100; US = United States; UK = United Kingdom

Source: “The BCG Global Manufacturing Cost-Competitiveness Index,” The Boston Consulting Group, August 19, 2014, accessed February 8, 2017, www.bcg.com/publications/interactives/bcg-global-manufacturing-cost-competitiveness-index.aspx.

endnotes

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Shenzhou International Group Holdings Limited or any of its employees. [↑](#endnote-ref-1)
2. ¥ = CNY = Chinese yuan renminbi; all currency amounts are in ¥ unless otherwise specified; ¥1 = US$0.1451 on March 31, 2017. [↑](#endnote-ref-2)
3. “Among Top 100 Listed Chinese Textile & Apparel Companies by Market Capitalization: Shenzhou International Ranks Top, Followed by Transfer,” business.sohu.com, April 3, 2017, accessed April 18, 2017, http://mt.sohu.com/business/d20170403/

   131849350\_658916.shtml. [↑](#endnote-ref-3)
4. ¥1 = US$0.1440 on December 31, 2016. [↑](#endnote-ref-4)
5. Shenzhou International Group Holdings Limited, *Annual Report 2016* [in Chinese], accessed June 3, 2018, www.shenzhouintl.com/Login/report3/dow/Shenzhou\_B\_AR%20(final).pdf. [↑](#endnote-ref-5)
6. ¥1 = US$0.2092 in 1990. [↑](#endnote-ref-6)
7. ¥1 = US$0.1203 in 1996. [↑](#endnote-ref-7)
8. Zhang Yue, Jiang Hongmei, and Fu Zhiting, “Series of Reports on Shenzhou International: From a Sailing Ship to a Carrier in 17 Years,” *Ningbo Daily*, April 10, 2017, C02 Section. [↑](#endnote-ref-8)
9. US$1.00 = ¥ 8.28 in 1999. [↑](#endnote-ref-9)
10. Zhang Yue, Jiang Hongmei, and Fu Zhiting, op. cit. [↑](#endnote-ref-10)
11. Jianrong Ma, in a speech delivered at the China Europe International Business School, August 19, 2016. [↑](#endnote-ref-11)
12. Ibid. [↑](#endnote-ref-12)
13. ¥1 = US$0.1207 in 2002. [↑](#endnote-ref-13)
14. “Company Listing: Significance and Influence,” Wang Jing, March 18, 2015, accessed April 18, 2017, www.zj123.com/info/detail-d300235.htm. [↑](#endnote-ref-14)
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16. “Shenzhou International: Hidden Champion in Global Apparel Industry: Market Capitalization Grows by a Factor of 30 in 10 Years [in Chinese],” mp.sohu.com, January 4, 2017, accessed January 25, 2017, http://mt.sohu.com/20170104/n477698436.shtml. [↑](#endnote-ref-16)
17. Ibid. [↑](#endnote-ref-17)
18. Ibid. [↑](#endnote-ref-18)
19. “Shenzhou International Posts Net Profit of RMB1,450 Million in First Half of 2016, with Orders Streaming in from Four Key Accounts like Nike and Puma [in Chinese],” China Sspp, November 2, 2016, accessed April 17, 2017, www.chinasspp.com/News/Detail/2016-11-2/360503.htm. [↑](#endnote-ref-19)
20. Jianrong Ma, op. cit. [↑](#endnote-ref-20)
21. Cheng Weixiong, “Shenzhou International Sells Sub-Brand Maxwin: NetEase CEO William Ding Branches out into Selling Apparels after Raising Pigs [in Chinese],” Weixiong’s Comments, September 8, 2016, accessed February 23, 2017, http://news.ef360.com/Articles/2016-9-8/346516.html. [↑](#endnote-ref-21)
22. In 2011, Nike invited its supplier, Feng Tay, to be a manufacturing partner for its Flyknit athletic shoes. A Taiwan-based company, Feng Tay specialized in shoe production. As Nike’s largest and most important original equipment manufacturer and partner, Feng Tay purchased 150 looms for trial production of 700 pairs of Flyknit athletic shoes. In 2012, however, Feng Tay dropped the order from Nike for the mass production of Flyknit athletic shoes, on the grounds that there was too much uncertainty over the extensive application of the complicated Flyknit technique, and that the machine tailor-made for producing Flyknit was incapable of producing other shoes; “Shenzhou International: Hidden Champion in Global Apparel Industry: Market Capitalization Grows by a Factor of 30 in 10 Years,” op. cit. [↑](#endnote-ref-22)
23. Ibid. [↑](#endnote-ref-23)
24. Shenzhou International Group Holdings Limited, *2006 Annual Report*, accessed June 4, 2018, www.shenzhouintl.com/Login/report3/dow/en20074241305311653.pdf. [↑](#endnote-ref-24)
25. Peijuan Ji and Xiaohui Shi, “A Visit to Shenzhou (Cambodia) Co., Ltd., the Largest Chinese Apparel Company in Cambodia [in Chinese],” *China Daily*, September 17, 2013, accessed April 17, 2017, www.chinadaily.com.cn/micro-reading/dzh/2013-09-17/content\_10139013.html. [↑](#endnote-ref-25)
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28. Ding, “Shenzhou International Posts over 20% Increase in Operating Revenue in 2016 and Will Step up Expansion of Apparel Factory in Vietnam [in Chinese],” China Fashion, January 18, 2017, accessed April 17, 2017, www.eeff.net/wechatarticle-9189.html. [↑](#endnote-ref-28)
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30. Technavio.com, *Global Sports and Fitness Wear Market* *2016–2020* (Elmhurst, IL: Infinity Research Limited: 2016), accessed July 17, 2018, www.emis.com/php/search/pdf2html?pc=YY&doc\_id=557991480&type=2. [↑](#endnote-ref-30)
31. The Trans-Pacific Partnership was initiated by Singapore, Brunei Darussalam, Chile, and New Zealand in 2005. When the United States participated in and presided over the negotiations in 2008, the TPP drew worldwide attention. By July 2013, Malaysia, Australia, Peru, Vietnam, Mexico, Canada, and Japan had been granted membership to the TPP. In October 2015, 12 TPP members signed a treaty on the elimination of tariffs among countries, and on investment, competition policy, technological barriers to trade, food safety, intellectual property rights, government procurement, green growth, and labour protection. The TPP represented a “high-quality free trade arrangement in the 21st century” that went further than the World Trade Organization rules, exceeding any other free trade agreement in terms of depth and breadth. [↑](#endnote-ref-31)
32. Xie Shaoan and Fan Xueqian, “Influence of TPP on China’s Textile and Apparel Exports and Countermeasures,” *Modern Business* 4 (2016): 96–97. [↑](#endnote-ref-32)
33. McKinsey & Company, Apparel, Fashion & Luxury Group, *The Global Sourcing Map—Balancing Cost, Compliance, and Capacity: McKinsey’s Apparel CPO Survey 2013*, October 2013, accessed June 4, 2018, www.mckinsey.com/~/media/

    mckinsey/dotcom/client\_service/retail/articles/the\_global\_sourcing\_map\_balancing\_cost\_compliance\_and\_capacity.ashx. [↑](#endnote-ref-33)
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35. “Shenzhou International: Hidden Champion in Global Apparel Industry: Market Capitalization Grows by a Factor of 30 in 10 Years,” op. cit. [↑](#endnote-ref-35)
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