

Rebooting manufacturing in mainland China



Since the middle of February, manufacturing companies in China have been implementing staged returns to onsite work for their factory employees as the spread of the coronavirus (Covid-19) levels off, with few exceptions beyond the worst-hit areas. Local governments, under state guidance, are acting on instructions to support this return to normalcy by loosening some temporary restrictions put in place to limit the spread of Covid-19. This includes conducting site inspections and providing permits to companies to allow employers to reopen their doors. As workers return, the responsibility for continuing to combat the virus will continue to be increasingly shared with employers and employees themselves. These positive changes are the first steps towards a return to economic growth.

For manufacturing companies, many of these initial steps have already begun. Some manufacturers have been soft starting since the middle of February, and as of early March more than 90 percent have opened. However, “opened” is not well defined, and according to a survey by the American Chamber of Commerce in Shanghai, 78 percent of factories do not have enough workers to resume full production.¹ Cities are posting their back-to-work rates as a percentage of open offices or factories, with some areas already nearly 100 percent back to business. However staffing levels remain low, as some employees are in quarantine, others are hesitant to return to public places, or others are on a limited rotational back-to-work programme. The return to productivity has raised several issues for Chinese management to address, namely: the return of employees to the factory and their ongoing wellbeing, rebuilding the supply chain, prioritising downstream demand, and logistical challenges. While the first wave of challenges are being addressed, a second wave posed by the increased international spread of the virus is just beginning.

For management and office staff, many have been back to work since 10 February and managing the crisis from home. Many are hosting or joining online meetings and webinars, some with their competitors to better understand the daily changes and challenges the virus presents. However, for factory and service workers, returning to work may not be a simple task and as of mid-February fewer than one third of China’s 291 million migrant workers had returned to their jobs,² with this number still remaining at around 70 percent as of early March.³ This ratio is changing rapidly as companies and local governments arrange special transportation to incentivise and accelerate the return to work.

As factory workers return to their city of employment, they may still find themselves in quarantine for up to two weeks. For those who returned immediately after the Lunar New Year, this period will have already elapsed, and they will be permitted to return to work. For those who returned later, or who are still unable to return, their absence will reduce capacity. The impact of this is felt unevenly throughout the country. Guangdong, with a large percentage of migrant workers, is expected to face significant manufacturing capacity challenges for these reasons. However, employers are expected to honour employment contracts and provide regular salaries throughout the crisis period, and part-time or no-pay leave policies continue to be discouraged. Post-quarantine, additional attention will be paid by inspectors and employees to health and safety issues and passing an inspection is a pre-requisite for reopening a factory. This may require changes to the factory floor operations, regular meeting arrangements, and access to the factory. Some manufacturers have allocated a percentage of their manufacturing capacity to the production of face masks, or even machines to produce face masks, for employees to encourage their safe return.

¹ <https://www.amcham-shanghai.org/sites/default/files/2020-02/AmCham%20Shanghai%20Survey%20on%20Supply%20Chains%20and%20Factory%20Openings%20Bilingual.pdf>

² <https://www.scmp.com/economy/china-economy/article/3051175/coronavirus-more-two-thirds-chinas-migrant-labourers-not-yet>

³ <https://www.ft.com/content/1783dd06-6288-11ea-b3f3-fe4680ea68b5>

For some manufacturers, their existing final product supply may suffice to meet downstream demand in the near-term. Manufacturers typically ramp up production in the months leading to the Lunar New Year to compensate for the decrease in productivity during the holiday. In addition, manufacturing often takes time to return to pre-holiday levels as factory workers extend their Lunar New Year holiday for an additional week or two. As a result, some manufacturers may find that their finished products in the channel will continue to meet demand as the restart process continues. However, factories in Hubei are expected to remain shuttered for some time, as the top priority remains the controlling of the disease and the physical wellbeing of the population.

Companies with a long supply chain or who provide products mostly to the export market will need to prioritise which customer orders they fulfil first. As domestic demand is expected to be soft during the recovery, companies may see reduced demand from Chinese customers, allowing for natural prioritisation of international customers. Manufacturers that are part of a global supply chain such as chipset makers and auto part suppliers may find themselves pulled in different directions by their global customers. Companies are reporting business continuity concerns from even captive global customers and are faced with the challenge of providing frequent updates on the local situation to assuage customers' various concerns and convince them to continue to place orders in the future. However, the nature and frequency of those calls may change as the global focus of the virus shifts from China to other parts of the world. Producers may find their production capacity returning to comparable pre-outbreak levels only to find that international orders are declining. China's lowest ever PMI figures will have downstream consequences, and the rush to return to parity may be tempered by lower global demand.

Between points on the supply chain, logistical services providers are facing similar challenges, which are further exacerbated by local and international restrictions on the movement of goods and people. Many provincial borders remain closed or difficult to cross, and even intracity travel remains temporarily limited or discouraged, and the back-to-work ratio for logistical services is one of the lowest when compared to other sectors. Trucks and drivers are temporarily required to have additional documentation to cross borders within China which were not previously required, or at least less scrutinised, however the removal of these requirements has already begun. Some technological aids have been developed to make some of these checks more robust and automated: colour coded QR-codes are generated based on your individual travel history, with a simple "green means go" output for those who are not (or no longer) subject to quarantine.

Additionally, Wuhan is one of the largest logistical hubs in China, and although most manufacturing in Hubei is for domestic use, it is important as a major transit point for products from across western China. For international shipping, most container terminals remain open, however they are facing the same challenges in staffing, and are seeing significant reduction in vessel volume and utilisation, with some vessels only 10 percent loaded when departing.⁴ For air cargo, passenger air traffic has dropped to as low as 20 percent of what it was last year at this time and with large percentages of air cargo being shipped in passenger jets, manufacturers may find their goods delayed regardless of the method of shipment. Management will need to consider these risks in their supply chain as business resumes.

Despite these challenges to business continuity over the past few weeks, the economic engines of the country are beginning to turn again. For the past several weeks, the number of new cases of Covid-19 has declined day on day, and with President Xi's visit to Hubei this week, many see a return to business as inevitable. New daily confirmed cases outside of Hubei have dropped for two weeks. These positive signs are being broadcast to every smartphone in the country, with many citizens waking to check their virus notification app before checking for messages from similarly homebound friends and co-workers. All of us are eagerly preparing for China's inevitable return to economic dynamism.

⁴ <https://www.wsj.com/articles/chinas-shipping-nears-a-standstill-amid-coronavirus-disruption-11581699854>

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