TAL Group plans to close its garment factory in southern China and shift its production to Vietnam. The company says it is unable to cope with rising wages.

China Loses Edge on Labor Costs

As wages rise, some makers of apparel and other low-price goods move factories elsewhere

By Kathy Chu

DONGGUAN, China—When **TAL Group** opened a pants factory in this southern Chinese city in 2007, executives said they expected it to be there for at least two decades.

Instead, the Hong Kong-based apparel maker will close its factory of 2,400 workers next year, unable to keep up with rising wages that are edging out low-cost consumer-goods manufacturers.

"We always knew China was going to be a challenge" because of rising labor costs, said Roger Lee, the chief executive of TAL, one of Asia's largest manufacturers and maker of pants for brands like Banana Republic and J. Crew. "The last two or three years, we've been losing money" at the pants factory, he said.

TAL already has begun transferring pants orders from China to Malaysia, where it has another factory, and is expanding in Vietnam. The manufacturer plans to keep open its other factory in China, a 4,000-employee plant that makes dress shirts. The shirts can be more complicated—and therefore more profitable—to sew than pants, because the fabric is thinner and puckers more easily. TAL says it makes one in every six dress shirts in the U.S.

The apparel maker's experience reflects the difficult decisions that manufacturers in China are making as the world's second-largest economy—once the global factory floor for cheap goods from clothes to toys—pushes through a transition to higher-value manufacturing in industries such as cars, aircraft and electronics.

China's government has championed automation and unveiled a 10-year plan meant to put the nation at the forefront of technologies like 3-D printing and high-end machine tools.

Local governments are also raising minimum wages by double-digit percentages in many cities in China, forcing embattled manufacturers to close factories in more expensive coastal cities and move inland or overseas. Companies from **Coach** Inc. to **Samsung Electronics** Co. have shifted some manufacturing from China to Southeast Asia.

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Labor costs in China are expected to increase 8.6% this year.

Some manufacturers warn that China's slowdown—economic growth fell below 7% in the third quarter for the first time since 2009—could push thousands more factories over the edge, if both domestic and foreign demand for manufactured goods drops.

"The situation won't get better," said Stanley Lau, former chair of the Federation of Hong Kong Industries, a trade group for 3,000 manufacturers, mostly with factories on the mainland. He expects that between 2014 and 2017, 10% of mainland factories owned by Hong Kong-based manufacturers would close.

The number of Guangdong factories owned by Hong Kong companies fell by a third to 32,000 in 2013 from a 2006 peak, partly because of rising wages and difficulty in procuring workers, an analysis by Justina Yung of Hong Kong Polytechnic University for the federation shows.

This year, wages and benefits in China are expected to climb 8.6%, lower than the previous year's 10.3% growth rate, according to the Economist Intelligence Unit.

Still, China's average labor cost of $3.27 an hour in the manufacturing sector is two-thirds higher than Vietnam's and a quarter above Malaysia's, the firm's data show.

The shuttering of factories is starting to change China's Pearl River Delta, the region where Dongguan is. It became

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an economic powerhouse in the 1990s as manufacturers moved their plants from Hong Kong and global companies set up factories.

Now, "for lease" signs cling to deserted factories and worker dormitories inside an industrial park.

In Zhongshan, an industrial city 90 kilometers from Dongguan, Gong Guo Mou, 45, opened a restaurant in September after closing a small shoe factory, which had struggled to win orders from the West.

"Small factories can't survive," said Mr. Gong, sitting inside his restaurant, where ceramic bowls and metal silverware, still covered in plastic, lie on tables. "They're not producing fast and cheap enough to compete with the big guys."

TAL's two-story pants factory sits blocks away, with a goldfish pond in the front, thought in China to bring success and wealth.

The company was founded nearly 70 years ago by Mr. Lee's great uncle, and now has nearly a dozen factories in five countries and Hong Kong, with $850 million in revenue last year.

The year TAL's Dongguan factory opened, wages and benefits skyrocketed 31% in China's manufacturing sector, Economist Intelligence Unit data show. Costs rose 28% in 2008 but have tapered off to low double-digit annual increases since then.

At the same time, countries in Southeast Asia became more appealing as manufacturing destinations as their infrastructure improved and workers became more skilled. It has become much easier to find workers in Southeast Asia than in China, where young people are often reluctant to work on the overnight shift, TAL's Mr. Lee said.

In the pants factory, TAL sees 8% to 10% of its employees leave each month, while turnover at its units in Malaysia and Vietnam runs less than half of that, according to the company.

Over the past few years, TAL realized that even if the pants factory increased its productivity substantially, it would still be more expensive to produce in China than Southeast Asia. "We've done the calculation quite a few times," Mr. Lee said.

—Bob Davis in Washington, D.C., and Mark Magnier in Beijing contributed to this article.

Production Price

Cost of labor as a share of total manufacturing cost, by country

PERCENTAGE POINT CHANGE SINCE 2004: -5, 0, 5, 10, 15, 20

COUNTRY	2015 SHARE
Brazil	30%
Switzerland	41%
Australia	35%
China	**12%**
Belgium	36%
Russia	9%
Canada	24%
Italy	29%
Thailand	5%
Poland	14%
Austria	24%
Sweden	25%
Indonesia	1%
Spain	22%
U.S.	18%
India	4%
South Korea	15%
Taiwan	7%
Mexico	7%
France	29%
Japan	20%
U.K.	22%
Germany	30%
Czech Republic	16%
Netherlands	22%

Note: Data are indexed to the U.S and are adjusted for wages, exchange rates and productivity.

Source: Boston Consulting Group

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