

EWA China Plant Closures, Consolidation & Relocation Webinar

Successfully managing the risks of plant closures, consolidations and relocations

**May 25, 2021
1:00 PM EST**

east  **west**[®]

a s s o c i a t e s

DRIVING COMPANY GROWTH IN CHINA, ASIA, MEXICO & CEE

Part 1: Brief Introduction of East West Associates

Part 2: China's Changing Business Environment

Part 3: Consideration Impacting Implementation

Part 4: Operational considerations impacting Closure, Consolidation & Relocation

Part 5: Summary of Recommendations

Part 6: Case Studies

- A leading provider of Corporate Strategy, Commercial, Operational & Risk Management solutions
- Founded in 2005, EWA executives have held senior management positions with P&L responsibilities for western MNCs, including
 - ✓ Briggs & Stratton (NYSE: BGG)
 - ✓ Bechtel Group
 - ✓ Fluor Corporation (NYSE: FLR)
 - ✓ Littelfuse, Inc. (NASDAQ: LFUS)
 - ✓ Eastman Kodak (NYSE: KODK)
 - ✓ Ashland, Inc. (NYSE: ASH)
 - ✓ Barnhardt Manufacturing Company
 - ✓ Hill & Associates

EWA Core Areas of Service

Strategic Business
Planning

Manufacturing
Footprint
Optimization

Supply Chain
Optimization

Performance
Improvement

HR & Executive
Recruiting

Risk Management

M&A Due Diligence

Business
Assessment

Research Services

EWA Executives in 5 Regions



- EWA has extensive global experience in numerous key industries:

Automotive

General Manufacturing

Durable Goods

Metal Fabrication

Consumer Goods

Filtration & Separation

Chemicals

Packaging

Electronics

Semiconductors

Food & Beverage

Medical Devices

Specialty Metals

Laboratory Equipment

Food Technology

Energy & Natural Gas

Industrial Textile & Apparel

Costings & Building Materials

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- Pretariffs, 61% of US companies will expand investments in 2019 (AmCham Shanghai)
- 40% of US firms have moved or are considering moving operations “out of China”
- Some MNC's are reassessing their China expansion plans—“wait and see” and/or restructuring the domestic supply chain for “in China, for China.
- Many purely exporters are leaving China for Southeast Asia
- 76% of US firms are profitable, yet margins are dropping
- Growing economic nationalism, i.e., indigenous innovation, cyber law, tariffs, EP3, Belgrade, China 2025, etc.
- MNCs are not as welcome; greater scrutiny; less incentives
- Increasing pro-labor protection; increasing labor cost across the country
- Growing market maturity—hyper-competition (domestic and foreign)
- Still limited corporate governance, business ethics, intellectual property (IP) theft, market access, etc.

Key Drivers of Closure, Consolidation & Relocation Change

- Seven key drivers of change impacting company strategic decision making are:
 - 1) Urban renewal and infrastructure development forcing relocation
 - 2) Mergers, acquisitions, etc., resulting in redundant or outdated infrastructure
 - 3) Increased government mandates to combat industrial pollution
 - 4) Government-mandated growth of industry-specific business hubs, industrial parks, and FTZs
 - 5) Tariffs—growing exit of foreign exporters to Southeast Asia, Eastern Europe, the United States, and Mexico
 - 6) Migration of customer base, labor force & suppliers
 - 7) Rising domestic and foreign competition

China's environmental protection program has accelerated the relocation process of factories into new industrial parks, which is expected to accelerate the development of new innovation.

(Shanghai Qingyue)

Companies are increasingly being forced to relocate operations due to urban renewal in order to regain proximity to labor force, suppliers & customers

(China Economic Review)

China's new expanded infrastructure will create new local market access opportunities to companies and will play a major role in the continued growth of factory relocations

(Institute of International Economics, Nankai University)

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Part 3: Evolving Challenges of Plant Closures

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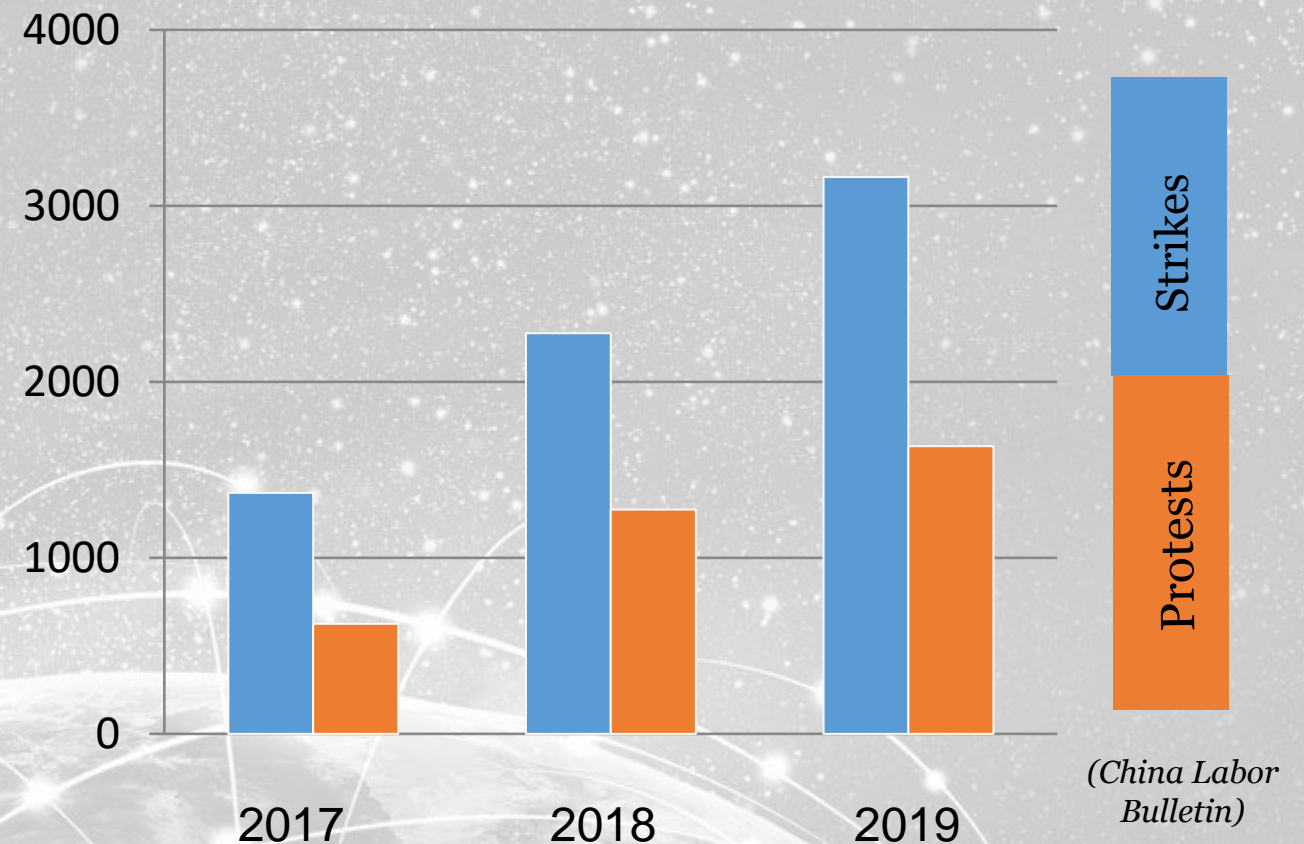
Decision making pertaining to site location, plant closures, and relocation in China is more complex than ever before.

“Teams must recognize and understand the evolving environmental, labor, regulatory, supply chain, incentives, and capital investment risks and develop a structured and disciplined risk mitigation and program implementation plan”

Key Challenges – Closures, Consolidations & Relocations

Company decision making is being impacted by a number of new challenges which increase operational risks during a plant closure, consolidation and relocation

- Increasing severance pay demands
- Pro-labor regulations
- Retroactive HR compliance and tax scrutiny
- Rise in labor militancy before, during and after closure
- Increased incidences of threats, sit-ins, strikes, stalking, kidnapping and theft
- Deeper scrutiny by new permitting & registration authorities
- Typically less tax incentives even for “encouraged” industries



Changing Dynamics

CURRENT DOWNSIZING SITUATION IN CHINA

MNC at greater risk as downsizing precedents set in many locations.

- Previous unethical behavior of some FIE's
- Implied State and ACFTU support
- Inexperience in planning and facilitating downsizing activities.
- Lack of understanding of the intensity of the response
- Unrealistic employee termination expectations
- Labor law making employee terminations more difficult
- MNC's misunderstanding of China's social and cultural aspects
- Mistaken reliance on local government and PSB support



DEMOGRAPHIC, POLITICAL AND SOCIAL CHANGE

Changing work force: older, less mobile, more costly

- Shrinking work force... working age population declining since 2015
- Fewer young workers, but growing numbers of factories

2nd Generation Migrants: Children of Reform Era

- Better educated: exposed to mass media / social media
- More demanding
- More aware of rights: sensitive to inequality
- Different expectations:
- Little experience as farmers
- Not going back to farm
- More acclimated to city life

Threats against company & personnel

- Factory Sit-Ins (“Squatters”)
- Hostage & Management Lock-Ups
- Death & Personal Injury Threats
- HQ Office Disruptions
- Media distortion
- Negative social media campaigns

Threats against company assets

- Work Stoppage & Management Lock-Outs
- Sabotage (Products, Facilities, Equipment)
- Riots & Physical Damage
- Fraud
- Theft (Products, Materials, IP)



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Closure, Consolidation & Relocation Considerations

- **Security first**—Before the closure plan can proceed and address the physical assets, inventory, IP/Trade Secrets (TS) issues, demobilizing, decommissioning, relocation/sale of plant and process equipment, etc., the “on site” plant environment must be safe and secure.
- Labor unrest will delay the decommissioning, put assets at risk, and absorb significant management time.
- A **Closure/Crisis Management Plan** (CMP) must be implemented across all functional areas simultaneously.
- Hire a professional risk consulting and outside legal firm that has rich experience in China closure **planning and execution**.

Closure, Consolidation & Relocation Considerations

- Form a confidential **multifunctional planning team** well in advance. Seek corporate approval and alignment.
- An area **risk assessment** is mandatory to understand the impact on the company, management, employees, assets, and community.
- Follow the current labor laws for terminations, severance pay, retirement, and other provisions. **Review past HR compliance and tax obligations**
- Understand the local severance **compensation precedence**. Communicating with the workforce is important, but a closure plan must be totally confidential and then executed simultaneously.

Closure, Consolidation & Relocation Considerations

- Consider **who** will make the plant closure announcement; explain the reasons, severance packages and termination process "at the meeting." Have employees sign and paid at the meeting.
- Employee demographics—typically 95% of the workforce will accept terms offered if treated fairly.
 - It is the 5% that may cause trouble who often incite others.
- Hold a "town hall" type meeting **off site**, not on company property.
- Consider augmenting or changing the **security vendor** who has strong connections with the local PSB.

Closure, Consolidation & Relocation Considerations

- Depending on the locale, local officials may likely stay away and will not intervene on either side
- Notification to the local and municipal labor bureau and PSB is required; however, do not expect support. Know how much “*guanxi*” you have.
- The PSB will not intervene or get involved until the law is broken. This means a high threshold of physical violence and injury.
- In some jurisdictions, the PSB can overreact causing you considerable PR embarrassment; they must be briefed.

- HR will have to deal with the affected workers, **who need to be properly empowered, well briefed, and protected.**
- If prolonged negotiations—Chinese to Chinese—bring in a respected local individual to lead the announcement or if it extends for more than a week or so.
- Consideration should be given to a reasonably generous offer for the affected workers. Possibly a **“signout” bonus**. Know the local precedents.
- Prior to the announcement, implement the customer, supplier, and government relations notifications plan.
 - **Do not implement before the internal company announcement.**

Closure, Consolidation & Relocation Considerations

- Once the site is secure and stabilized, implement the plant decommissioning, demobilization, and disposition plan for equipment, assets, inventory, and IP/TS.
- The legal, finance and accounting, tax, deregistration, etc., and labor bureau issues can be implemented offsite only during and after the announcement.
- Make sure all plants/other company premises are properly protected, locked down, and secured. Secure the IT systems access.

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RISK MANAGEMENT SUMMARY OF RECOMMENDATIONS

- Engage a multi-functional Closure Team to develop a integrated plan
- Identify the threats and risks and mitigation measures
- Develop an appropriate and actionable compensation plan
- Liaise with Labor Bureau/PSB/Local government “at the right time”
- Negotiate - Chinese to Chinese - bring in a respected individual to lead announcement
- Avoid potential flash points - evening meetings where alcohol may have been consumed - avoid expat management in front of the work force
- Develop a plant decommissioning, demobilization and disposition plan for equipment, assets and IP/TS.
- Inform existing clients/vendors/suppliers of the transition plans
- Develop public/government/media relation plans
- Be fair but firm.....Give employees what they deserve and a “little more”

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EWA Plant Closure & Relocation Project

- US-based manufacturer of automotive parts with manufacturing WOFE in Shanghai. Ordered by the government to relocate operations and close the existing facility within 10 months, due to environmental compliance violations and urban renewal
- Should the 10 month deadline not be met, the company faced a US\$1M fine
- No closure planning was done by the Company
- Following an ill-advised public announcement of the plant closure:
 - An employee strike broke out
 - The Chinese GM resigned
 - No security during the strike

EWA was engaged to manage the turnkey plant relocation & closure project:

- Protect the physical assets
- Resolve the strike
- Within 10 month timeframe
- Within the agreed upon budget
- Without interruption of manufacturing production
- Without disruption of customer product shipments

- EWA Recruited an experienced Interim General Manager (IGM) to take control of operations
- Recruited an Interim Project Manager (IPM) to immediately deal with the strike
 - Gathered background knowledge – local severance comp, previous company labor unrest
 - Developed and implemented a crisis management plan
 - Engaged strike leaders and employees
 - Ended the strike & got people back to work within 26 days

Then IGM/IPM focused on developing a phased operating, relocating & closing strategy:

- Communicated with customers to guarantee timely product deliveries
- Increased plant shifts from 1 to 3 to build inventory stocks
- Relocated inventory to an outside 3rd party warehouse to reduce risk of theft
- Implemented new physical, IP, data & information security safeguards in order to reduce theft
- Maintained quality levels and began preparations to re-certify product in the new facility
- Developed a closure and relocation budget & cash-flow management plan

- Continued to build inventory stock as well as fulfilling orders
- Continued close employee communications to avoid repeat of labor problems
- Closely monitored quality levels, avoided rejected shipments
- Initiated New Facility Project Planning
 - Site Selection and Building Modifications
 - Developed a comprehensive project relocation plan
 - Production area and utility equipment design & layout
 - Relocate production equipment and peripherals
 - Fit out of administrative offices and telecom systems
 - Procure / Relocate support and mobile equipment
 - Coordinated move sequence with building occupancy permit schedule

New Facility Plan

- Qualified and selected design firm
- Qualify and selected construction firm
- Fit out completed & new equipment installations installed
- Offices & employee facilities completed
- New staff hired & trained
- Preparations for re-certification underway
- Initiated “permanent management” recruitment search
- Production commences and ramps up, training continues and results measured

Old Facility

- Concluded negotiations over any government incentives to move
- Obtained liquidation approvals from business zone, governmental authorities, etc.
- Liquidation process (9 months elapsed time)
 - Filing government documentation-registration, business license, board resolutions
 - Filing necessary “close out” financials, bank accounts, tax, VAT rebates, registered capital - and customs documentation
 - Completion of all de-registration and governmental documentation and plant turnover to the landlord

- Timely project competition
 - **No** penalty fines
 - **No** governmental authority repercussions
- Smooth project implementation
 - **No** interruption to production
 - **No** delay in customer shipments
 - **No** quality decline (products from new plant approved under PPAP process)
 - **No** theft of IP or physical assets
 - **No** incidences of physical violence or post-strike labor unrest

EWA Location Strategy and Site Selection Project

Client: A global fine chemical company with sales & manufacturing operations in all major world markets

- Well-established operations in China, with a manufacturing facility located in the Pearl River Delta Region dating from the 1990s
- Network of satellite product distribution warehouses across other regions of China
- Strong history of revenue and earnings growth in China, with growth rates accelerating

EWA was engaged for the following services:

- Overall assessment and development of a future-state country operations strategy including
 - Potential impact of increased regulatory scrutiny over chemical manufacturing operations, and mitigation strategy
 - Major shifts in location of both customer and supplier bases
- Identification of an optimized manufacturing and distribution site required to meet future demands
- Project management support for the new site design and construction phase

Development of future state country operations strategy

- Client's existing chemical operations were in a general-purpose industrial zone
 - EWA researched and confirmed that there will be rapidly increasing operational risk to any chemical manufacturing company operating outside of a formally certified chemical industry zone
 - Land availability within chemical zones will be increasingly limited with land use rights costs expected to increase sharply
- EWA evaluated client's supplier and customer base
 - Vast majority of the client's key component suppliers were now located in the YRD Region
 - Customer base had shifted dramatically since the client established operations in South China
 - *Substantial logistics and inventory savings were available by locating in the YRD region*
- EWA assessed cost difference for operating within YRD vs. South China
 - Land use costs and government investment incentives
 - Basic operating costs (labor, utilities, etc.)

Site Selection:

- Based on customer/distribution and supplier location analysis, EWA focused on potential locations in the Yangzi River Delta Region (YRD).
- Search criteria was focused on:
 - National Level Chemical Industry Parks
 - Availability and cost of land use rights
 - Available investment incentives
 - Reputation of each zone as being supportive and professionally managed
 - Verification of specific properties as being authorized for relevant chemical production (e.g. Class A chemistry)
 - Optimized location for customer and supplier logistics, availability and cost of labor and utilities
 - Search “stretched” to less developed areas (e.g. Anhui) to test for long-term sustainability
 - Identified and interviewed more than 20 potential chemical industry parks
- Selected a site in a National Level Zone ~ 100 km from Shanghai



Site Design, Development and Construction Project Management

- EWA provided a Senior Project Manager with decades of experience managing chemical project design and construction projects, as well as ongoing chemical manufacturing operations in China
 - Managed the overall project scope, schedule, budget, quality and safety criteria
 - Selected the design institutes for both base building and process engineering
 - Provided a project team for all stages of the design, procurement, and construction project
 - Ensured that all necessary approvals are obtained, and design is consistent with local and int'l codes
 - Established professional and transparent processes for contractor and supplier bidding, selection and payment.
 - Managed unforeseen project scope change orders
 - Nearing the completion of the original site design, the client decided to change the overall mission of the site from domestic to international supply site
 - This radically changed the technology to be deployed and the overall site design requirements

Best incentives package

- **RMB 7.5 million plus local VAT refund and other incentives**

Ideal location relative to suppliers, customers and international logistics

- **RMB 1.5 million per year cost reduction for transportation and warehousing costs**
- **RMB 15 million cash from reduced inventories**

Excellent blend of local skilled labor availability and relative costs

- **3% reduction of yearly operating costs**

EWA Plant Closure

Client seeks advice on a closing and mass layoff at a Shanghai “manufacturing” facility due to urban renewal:

- A WOFE having acquired an SOE years ago.
- Company notified 450 employees that a closure was eminent
- HR manager suggested the machinist staff are “very loyal;”
- Company had a history of labor militancy
- The plant and production equipment was to be relocated to another town
- Very few production staff to be offered new positions
- Intended to announce at a “town hall” meeting on Company property
- An expat VP would give the announcement
- Severance package was not yet finalized for the meeting

Met with local, regional and HQ executive management to develop a Closure Plan

- **Closure plan** - stressing who is the client executive in charge?
- **Labor Activism** - Reviewed history of labor activism and militants? A former SOE with a militant history.
- **Security** - Recommended augmenting security - assessed the current in-house security team to deal with unrest? Recommended additional security measures to protect management staff, IP, and assets before, during and after closure?
- **Severance Comp** - What should the compensation package be? Nearby plants have already closed. Recommended prevailing severance of N+3? Distribute severance pay at “town hall” meeting
- **The Press** - Employees had prepared an organized response and notified the press. “Talking points were developed”
- **Closure Meeting** - Where and who should lead the employee notification meeting? Recommended an offsite meeting and announcement given by senior local manager. Security in place at hotel
- **Labor non-compliance** – there were minor issues and itemized for Labor Bureau review
- **Gov Affairs** - recommended notifying the local DZ government, Labor Bureau, PSB in advance?
- **Demobilize** – recommended incentive team who will demobilize and decommission the plant
- **Entity deregistration** – recommended teams for liquidation & deregistration, F&A, tax, customer relations, GR, PR, etc.

What Company Decided to Do

- Declined augmented security – employee relations were “good”
- Decided to make the “town hall” meeting in the cafeteria; save cost
- Decided to have an US expat VP from Singapore make the announcement with translator
- No decision yet on severance package; it was not presented and severance distributed at meeting
- Employees were organized and presented demands; they notified the press.
- PSB was not briefed and put on standby
- Labor Bureau not notified by management; employees notified the Labor Bureau

- The hard core militants locked the doors and held the expat and managers hostage throughout the evening
- They encouraged all employees to stand firm on meeting their severance demands
- Throughout the evening the plant was looted of valuable manufacturing equipment, tools, inventory, and telecom equipment
- The Press was on site reporting the exploitation of Chinese employees
- We were called to extricate the VP and local GM from the hostage situation
 - We mobilized an extraction team and vehicles
 - We mobilized the PSB to secure the plant perimeter
 - We notified the Labor Bureau
 - We notified and Development Zone management and sought PSB support.

For further information as to how East West Associates can improve your business, please contact:

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