

## *Handout # 1.5*

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### **Inland China Beckons as Hon Hai Seeks Fresh, Cheaper Labor Force**

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SHENZHEN, China—The world's biggest contract manufacturer of electronics, facing rising wages for its huge Chinese work force, is making a big investment in China's hinterland in a bet that the country can retain its role as the world's factory floor for decades.

#### **Hon Hai's Inland Move**

(Foxconn founder and chairman Terry Gou in his office at the Foxconn Shenzhen campus Saturday. Mr. Gou had a bed installed in his office because he has spent much of his time there in the wake of the Foxconn suicides.) Hon Hai Precision Industry Co. plans investments near several inland cities, including two complexes that will together employ half a million people for Hon Hai and its suppliers. In one of those locales, near Chengdu, the capital of Sichuan province, the maker of Apple Inc. iPads and other gadgets is investing \$3.5 billion to build a complex that Chairman Terry Gou hopes will become a model for how big manufacturers operate in China.

The inland investments come amid challenges to manufacturers in China's coastal belt. A spate of worker suicides earlier this year at Hon Hai, the sharp wage increases that Mr. Gou implemented afterward, and recent strikes at other Chinese factories producing cars and parts for [Toyota Motor](#) Corp. and [Honda Motor](#) Co. have highlighted workers' demands for better pay and conditions.

As wages rise in China's coastal regions, Hon Hai is pushing aggressively inland and revising its social contract with employees. Hon Hai's success in managing rising wages could ultimately keep prices down for the Apple iPads, [Nokia](#) Corp. phones and [Hewlett-Packard](#) Co. printers that global consumers buy. And the shift inland by Hon Hai and other companies could help solidify China's dominance as a low-cost exporter, fending off challenges from emerging-market rivals in Asia, Latin America and elsewhere—even as China also makes progress up the value chain in higher-end, more capital-intensive industries.

Mr. Gou, whose company has factories in a dozen other countries, dismisses the idea that any of them could supplant China with its advanced infrastructure, business-friendly policies and still-large pool of surplus labor. In a nearly three-hour interview, he outlined his plans to keep plowing billions into the country. "I think in the next 20 years China won't have a competitor" as the world's main manufacturing center, Mr. Gou said. His response to the challenges he faces lies in two shifts already under way at Hon Hai: one geographic, the other philosophical.

He is rapidly relocating the core manufacturing work of Hon Hai's business away from its historical home in the coastal special economic zone of Shenzhen, where more than half of the company's 920,000 Chinese workers are employed. He is building facilities in less-developed areas further inland: Chengdu, Wuhan and Zhengzhou, second-tier cities that supply most of the laborers for the wealthier coastal provinces. In those areas the typical wage could be two-thirds that of the more-developed coastal provinces, or less. Within two years, Mr. Gou expects 50% of all Hon Hai's workers to be located inland, compared with 20% today. In five years, the inland ratio is likely to rise to 66%, he said.

And Mr. Gou expects his Chinese work force to keep growing during that period, eventually expanding to as many as 1.5 million. Mr. Gou is trying to build industrial centers that hire more local labor. Gone will be the factory towns where Hon Hai runs not only assembly lines but dormitories, cafeterias, security, recreational facilities and hospitals—comprehensive responsibilities that Mr. Gou said his company is ill-suited to handle. Instead, he is enlisting local governments to build towns to house Hon Hai's staff and take over the social functions that the company has long kept in-house.

"We're not just moving a factory from one location to another location," Mr. Gou said in his austere, concrete-floored office at the company's enormous Longhua factory complex in Shenzhen. "We move to a new concept, new ideas."

Mr. Gou's plans have outsized importance in China because of Hon Hai's massive scale. Since Mr. Gou founded the company in Taiwan in 1974, it has come to dominate the business of outsourced electronics manufacturing. Besides iPads and iPhones for Apple, Hon Hai makes personal computers, cellphones and videogame consoles for most of the world's biggest electronics brands, including H-P, [Dell Inc.](#), Nokia, [Sony Corp.](#) and Nintendo Co. In China, Hon Hai and its affiliates are the nation's third-biggest employer, Mr. Gou said, after China's top oil producer and the monopoly electricity-network operator—both state-owned companies.

Mr. Gou said he has cut Hon Hai's long-term minimum growth forecast to 15% a year, from its longstanding goal of 30%, but the company is on track to far exceed that rate this year. Analysts on average expect Hon Hai's revenue to reach nearly \$85 billion this year, up from \$61 billion last year and 30 times its size a decade ago.

Mr. Gou's plans for Hon Hai and its affiliates, known collectively as Foxconn Technology Group, reflect a broader shift in China's economic development toward faster growth in the hinterland. This week, Shenzhen, a boomtown that has one of the highest per-capita income levels in mainland China, is celebrating its 30th anniversary. For more than a decade, China's government has been trying to extend the success of Shenzhen and the rest of the coast inland.

It has created a national highway system tens of thousands of miles long, built scores of airports and constructed the world's biggest high-speed rail network. That has made giant interior provinces more appealing for companies. Last year, the fastest-growing region for foreign investment was Chongqing, which sits next to Sichuan.

That growth is prompting many laborers to want to stay closer to home, rather than move to the coast for work. Last year, the number of migrant workers going to the Pearl River Delta region—the southern manufacturing heartland that includes Shenzhen—shrank by 22.5%, the government said.

The trend is likely to exacerbate a tightening labor supply on China's coast, said Michael Wang, managing partner of McKinsey & Co. in Shanghai. "The migrant workers are always going to do their own math: 'It doesn't make sense for me to go to Guangdong if I can do something in Chongqing,'" he said.

Mr. Gou began investing inland years ago, but the suicides this year prompted him to revise and accelerate his plans. Ten employees at the Longhua campus jumped to their deaths between late January and late May. The deaths triggered the biggest management and public-relations crisis in Hon Hai's history. With world-wide scrutiny intensifying and reporters, officials and customers pressing Hon Hai for explanations and remedies, Mr. Gou moved to Longhua in late May from his home in Taiwan to oversee the response. He had a thin wall built in his office—a long, cement-floored room in a spare one-story building—to create a makeshift bedroom where the billionaire spent most nights for the next three months.

Mr. Gou met with about 200 managers and told them to do whatever they could to stop the suicides, said Louis Woo, one of his senior advisers. He called for safety nets to be installed around all of the buildings on Foxconn's campuses. When he later saw the nets weren't in place, he was furious, yelling so loudly at one of his top lieutenants that she cried, Mr. Woo said. Today, safety nets ring all the buildings on Longhua's nearly one-square-mile campus. The company also has hired counselors, established employee support groups and rolled out a care center with an elaborate computer-database system to help monitor those who call for help. The system alerts top executives to the most serious cases.

Most notably, Hon Hai has sharply increased minimum salary levels to let employees work fewer overtime hours without taking a hit to their incomes. Minimum base pay for assembly-line workers in the Shenzhen operation will rise to 2,000 yuan, or about \$295, a month in October, from as little as 900 yuan earlier this year. Mr. Gou said he was making the move in part because Chinese officials told him they plan to start enforcing a legal cap of 36 monthly overtime hours per employee, compared with the 80 hours Hon Hai and other factories use.

In the interview, Mr. Gou said he had "felt guilty" about the suicides, but he also vehemently denied that the suicides reflected poor working conditions. "I can personally guarantee, nobody commits suicide due to low salary, the workload, too much pressure or

Foxconn management style," he said. He and other Hon Hai officials said many of the suicide attempts appear to have been made on impulse, when workers had difficult personal problems.

But Mr. Gou also acknowledged that his previous business model, oddly enough for China's biggest private-sector employer, has an "old-style Communist Party" flavor to it. Workers labor in Hon Hai factories, live in Hon Hai dorms, eat Hon Hai food and have little reason to leave the campus. "There's social functions in the dormitories that are lacking," he said.

He jumped from his seat to point to a three-dimensional diagram sitting on an easel nearby that showed dozens of buildings in the new Hon Hai complex near Chengdu. "I told the Chengdu government: I'm investing \$3.5 billion [in the factories] and we want you to invest \$7 billion," to create a place for Hon Hai workers to live, he said. It would be a new city for what Mr. Gou calls the "post '90s generation" from Sichuan. "They don't need to go to Shenzhen," he said.

There won't be just young workers, he said, but also older people to mentor and comfort them. "There will be hospitals, there will be other facilities, there will be sources of entertainment," Mr. Gou said. A Hon Hai worker "won't always be living in a dormitory, with that pressure of the dormitory," he said. "And if people still decide to kill themselves, then no one can blame me," he said.

Critics say it is too early to say whether Mr. Gou's planned changes are sufficient. "We have seen Hon Hai's sincerity on improving the working conditions, but none of the measures have borne fruit yet," said Cheng Yiyi of Hong Kong's Students and Scholars Against Corporate Misbehavior, a labor-rights group that has been critical of Hon Hai. Ms. Cheng criticized the use of outside managers in Hon Hai's existing facilities, saying that it merely muddies the issue of who is responsible. "It looks like they're just throwing the problems to somebody else," she said.

Mr. Gou said his plans will enable Hon Hai to continue to make China its base for decades. Hon Hai currently has an additional 100,000 workers in factories around the world, but Mr. Gou said he doesn't see that share of the total increasing on a percentage basis. He rattled off a long list of countries where Hon Hai has factories, among them the Czech Republic, Hungary, Russia, India, Malaysia, the U.S., Mexico and Brazil. None of them, he said, can compete with China's combination of low-cost labor and high-end infrastructure. India's labor problems are more severe than China. Brazil's workers are more expensive and less industrious than China's. Vietnam is good, he said, but it is too small.

And don't mention Russia. "In Chengdu, I signed a deal in July. They'll finish in October" building the first section, which comprises eight buildings, he said. "Three months! In St. Petersburg we're building a factory. You know how long that takes? Two years. And they're not finished yet."

