CHINA: China will 'rise' as a high-end manufacturer

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**Abstract (summary)**

Industrial upgrading in China.

China is no longer just the world’s ‘factory’. While retaining strong positions in low value-added mass-manufacturing, Chinese firms are increasing their presence in global markets for high value-added products too, competing directly with US, European and Japanese firms. China’s growth into a major innovation centre is also changing the global power balance in science and technology. As labour and other production costs rise, China will intensify efforts to upgrade industries ranging from machinery to consumer goods. Within several years, its high-tech production could exceed that of the United States, becoming the largest in the world.

**Full Text**

**SUBJECT:** Industrial upgrading in China.

**SIGNIFICANCE:** China is no longer just the world’s ‘factory’. While retaining strong positions in low value-added mass-manufacturing, Chinese firms are increasing their presence in global markets for high value-added products too, competing directly with US, European and Japanese firms. China's growth into a major innovation centre is also changing the global power balance in science and technology. As labour and other production costs rise, China will intensify efforts to upgrade industries ranging from machinery to consumer goods. Within several years, its high-tech production could exceed that of the United States, becoming the largest in the world.

**ANALYSIS:** Impacts.
Chinese makers are likely to play a leading role in areas such as solar panels, electric vehicles and power equipment.

China's efforts to improve quality control will create demand for foreign products and expertise.

The prestige of Chinese-made products will rise as quality control improves, undermining domestic consumers' preference for foreign brands.

Beijing will better protect intellectual property rights as more Chinese firms become victims of piracy.

Incentives for commercial cyber espionage will grow, and this will assist industrial upgrading.

China's importance as a manufacturing centre for technologically advanced products is growing rapidly:

China's share of global high-tech manufacturing output soared from 8% in 2003 to 24% in 2012. The US share was 27%.

China's high-tech production volume by 2012 was about 30% greater than the EU's and three times Japan's.

Chinese makers are likely to play a leading role in a growing number of high-tech industries:

Solar panels. China is the world's largest producer of solar panels. Six of the top ten manufacturers in 2012 were Chinese. 'Electricity Valley' in Baoding, modelled on Silicon Valley, has become a production platform for wind and solar energy equipment, with more than 200 companies.

Electric vehicles. China has great ambitions for electric vehicle (EV) production, which is currently marginal. The 2015 target is 500,000 units and by 2020 the number is expected to reach 1 million. Manufacturers benefit from a national policy of replacing current public transport vehicles with battery-powered ones. China has become the top producer of lithium-ion batteries, producing some 40% of the world's total.

Power equipment. Chinese manufacturers are growing stronger in production of power equipment. Leading domestic makers Shanghai Electric and Harbin Power Equipment compete directly with GE and other Western giants. Shanghai Electric has a 10 billion dollar contract (probably the world's largest to date) with India's Reliance to supply coal-fired generators.

Quality control.

A growing number of makers enforce strict quality control, challenging the 'poorly made in China' stereotype:

Top manufacturers of lithium-ion batteries BYD, BAK Battery and Tianjin Lishen Battery (now a partner supplier for Samsung and Motorola), have significantly improved safety and reliability.

Chinese machine-tools are starting to compete with the world's leading models. To upgrade faster, makers employ Western designers and use sophisticated imported parts and components. Leading manufacturer Shenyang Machine Tool Group supplies flat CNC machining centres to North American and European customers. European designers and engineers have significantly improved its products. To meet higher quality standards, the company has increased the number of Japanese-made parts (see JAPAN: Firms seek new niche as competitors gain ground - February 7, 2013).

Brand-building.
Chinese companies are increasingly aggressive in brand-building. Initially, this was achieved by buying internationally known brands, along with particular product departments or entire companies:

Lenovo purchased IBM's PC department in 2004, acquiring a name recognisable worldwide as a step towards establishing its own brand.

China's second-largest television maker, TCL, created a joint venture with France's Thomson and became its majority partner, opening the way for producing under the Thompson and RCA brands.

In autos, Geely acquired Volvo.

Pearl River Piano, the world's largest producer of pianos, acquired a UK maker which itself owned the German brand Ritmuller.

However, more Chinese companies are establishing international brands of their own, notably:

telecoms equipment manufacturers ZTE and Huawei (see EUROPEAN UNION: Security concerns may hurt Huawei - December 28, 2012);

domestic appliance manufacturer Haier;

air-conditioner maker Midea; and

clean technology company LDK Solar.

Sports apparel maker Li Ning is competing with Nike and Adidas on design and product selection.

Chinese companies mostly begin by establishing brands in China and then expand to other developing countries. Having acquired brand-building skills and experience, they then enter developed-world economies.

Today, China....

Chinese consumer goods manufacturers are now very active in the high-end niche domestically, where proximity to the marketplace and knowledge of customers' preferences confer advantages.

Although Chinese consumers are often dissatisfied with the quality of domestic products, in markets where differentiation matters, domestic brands often enjoy popularity equalling or exceeding Western counterparts (for instance, the Kurhn doll sells better than Barbie).

The furniture market is a notable example:

Yun Dian Furniture is a popular maker of traditional Chinese-style furniture with a Western flavour.

Foshan Jihao is a high-end sofa manufacturer with several brand names well known in China and independently developed brands in South Korea, Spain, Australia and Poland.

Fu Yi Furniture owns numerous brands in classic and modern styles.

Domestic R&D.
In 2012, China overtook the EU in research and development (R&D) as a percentage of GDP, with 1.98% versus 1.97%, through it still trails the United States (2.8%) and Japan (3.3%). It targets 2.2% by 2015.

China's Medium and Long-Term Plan for the Development of Science and Technology (2006-20) aims to make China a 'technological great power' by developing breakthrough technologies in eight fields:

- biotechnology;
- IT;
- advanced materials;
- advanced manufacturing;
- advanced energy technology;
- marine technology;
- laser technology; and
- aerospace technology.

Beijing is allocating at least 10 billion renminbi (1.6 billion dollars) to each of 16 'megaprojects' in electronic components, software, machinery and pharmaceuticals. These aim to absorb advanced imported technologies so that China can develop its own key products with proprietary intellectual property rights.

**Foreign investment.**

Foreign investment in China increasingly targets high value-added products and R&D. Foreign companies often seek to combine advanced technologies with cost advantages China still provides. Foreign-invested firms produce about 82% of China's high-tech exports.

For example:

- a **Mitsubishi Chemical-Mitsubishi Plastic Engineering** joint venture with Sinopec makes high-end resins used in auto and electronic parts, optical disks and construction materials;

- **LG Electronics** produces advanced models of LCD televisions; and

- **Siemens** has built a plant to manufacture parts for wind energy generation equipment.

The majority of the Fortune Global 500 companies already have R&D facilities in China. By 2013, some 1,800 R&D centres had been established by foreign firms, concentrated in electronics, software, telecommunications, biotechnology and pharmaceuticals, chemicals and autos. They increasingly go beyond product development for the Chinese market, engaging in basic research and development of key technologies.

**CONCLUSION:** Widely recognised Chinese brands will multiply and become major players, first in developing markets and then in developed ones. However, for individual firms, upgrading will require trial and error, and many will lose as they enter fierce competition with developed-market (DM) counterparts. Chinese manufacturers that upgrade will probably retain cost advantage vis-a-vis DM peers for 5-10 years at least, but as production costs rise, those who fail to upgrade will lose competitiveness.
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