



# THE NUTS AND BOLTS OF CHINA'S COMPETITIVENESS

The story of a country's rise and the challenges ahead

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China's competitiveness<sup>1</sup> has surged up through the rankings in recent years, surpassing all precedents, and is currently one of the world's first economies to rebound from our current recession.

First covered in 1995, the nation ranked 34<sup>th</sup> out of 41 economies, alongside the likes of Indonesia, the Philippines and Colombia. China moved into the top 20 in 2006 and since then has maintained a ranking between 15<sup>th</sup> and 20<sup>th</sup> place out of an average of 55 nations. In the recently published 2009 ranking, China came 20<sup>th</sup> out of a selection of the 57 most competitive countries in the world. Let's break down the country's competitiveness profile.

## Competitiveness today

Competitiveness, as defined by IMD, measures how nations manage the totality of their competencies in order to improve overall prosperity for their people. This year, among the 57 countries studied, China fell in three of the four major factors that we use to measure competitiveness: *Economic performance*, *Government efficiency*, *Business efficiency* and *Infrastructure*. Despite an extraordinary ranking for *Economic performance* (second place), the country ranks only 37<sup>th</sup> for the *Efficiency* of its business sector. This measures the extent to which the national business environment encourages enterprises to perform in an innovative, profitable and responsible manner. Using international governance standards as benchmarks, Chinese companies on average do not yet meet this definition.

China also suffers a skills gap. The shortage of competent managers and their lack of international experience (ranking last in 57<sup>th</sup> place) are huge operational problems for multinationals and locally-owned companies. But companies also complain about the scarcity of finance and IT skills and the difficulty in finding competent and well-rounded managers with the ability to build teams and take initiatives. China ranks 51<sup>st</sup> for *Management practices*, meaning that there is a real need that Chinese managers acquire more leadership qualifications and develop soft skills.

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<sup>1</sup> As measured by IMD's World Competitiveness Yearbook.

### Competitiveness policy framework

Besides business competencies, the rankings reflect the efficiency of a nation's government sector. A country's policies are compared with the best practices of the most competitive nations to identify strengths and weaknesses. Are the country's policies conducive to creating an environment that supports the ability of enterprises to compete in world markets? What could be improved to help move the country to a higher stage of development? Here China ranks 15<sup>th</sup>, on par with Chile and Thailand.

Competitive economies show resilience (China ranks 10<sup>th</sup>) and sound government actions as well as the ability to adapt. A policy framework that is open, adaptive, transparent and predictable remains a strong factor of competitiveness. This is particularly true with regard to attracting investments into a country, a strategy for which China has been especially successful, ranking fifth worldwide for *Inward foreign direct investment*. But the long-term prosperity of the country depends on how people directly benefit from increased economic success.

### Socio-economic balance

The long-term goal remains the transformation of China's economy to reduce over-dependence on exports and investment. The recent growth recovery in China has been mainly driven by policy stimulus and financed by aggressive bank lending, helping to offset the negative impact from falling exports. There is an imperative need to shift the balance: Less emphasis on investment and low-cost exports and more on consumption, services and innovation. More specifically, the well-being of society requires a greater focus on healthcare reform, education, labor legislation and environmental protection. Out of the 57 countries covered, China only ranks 53<sup>rd</sup> for *Health and environment*, 49<sup>th</sup> for *Education* and 56<sup>th</sup> for *Pollution problems*.

When the country opened up in the 1980s, it dismantled its public healthcare system which basically worked through state-owned enterprises. Today, only about 20 percent of rural residents and about half of urban residents have medical insurance. Education and pensions put similarly serious financial burdens on people's lives. Beijing says it will extend basic health care to 90 percent of the population by 2011 and spending on education and healthcare is slated to rise. With a better social safety net in place, people will feel more secure and willing to spend, which will thus spur economic growth.

To guarantee competitiveness, the concept of justice must permeate all of society. Nations need to ensure that the people get a tangible return on the economic success of the country. Chinese authorities have started to address the inefficiencies in the nation's institutions and continue to tackle corruption, but they are still far from attaining a first-rate rule of law, ranking 43<sup>rd</sup> for *Justice*. The major hurdle remains law enforcement, although local governments have started monitoring factories' environmental impact and creating new regulations to better protect workers' rights.

### Other challenges ahead

One of China's major challenges is the urgency to create more employment opportunities for the growing labor force, especially college graduates and migrant workers, many of whom are unemployed. The current crisis offers a unique opportunity to encourage more labor-intensive service industries, (which would move the economy towards higher value-added and innovative activities), reduce the over-capacity in many low-cost manufacturing industries and boost job creation.

China's financial system also requires further reform. Improved governance and transparency risk being put on the back burner against the need to stimulate credit and lending - some of the green shoots that are spurring current growth. This is especially critical for the small and medium-sized enterprises that may not survive without sufficient and affordable access to capital. The key areas which could be targeted to improve the financial system, in which China ranks poorly, are the following: *Accessibility to and affordability of credit* (43<sup>rd</sup>), *Shareholders' rights* (54<sup>th</sup>) and *Financial institutions' transparency* (54<sup>th</sup>).

Lastly, public infrastructure calls for enhancement of its quality and efficiency, and to halt environmental degradation. The stimulus package aims primarily at investment in new infrastructure projects (railways, roads and power grids). In addition, China is heavily dependent on foreign energy and is strongly pursuing outward investment to secure additional energy sources. But a more ambitious goal would be targeting government funding to provide incentives to make clean and renewable energy projects a long-term priority.

### Short-term sacrifice for long-term gain

An active debate about labor legislation and the environment is currently posing many dilemmas in China. New labor laws passed in June 2007 and stricter compliance concerning protection of the environment are seen by the business community as burdensome and restricting their ability to compete. These laws are forcing manufacturers either up the value

chain or out the door, especially low-cost manufacturers that can no longer offer the “China price” and survive. China’s objective – in line with the direction towards a more mature society – is to encourage more foreign investment in value-added industries and services. In this way, it hopes to harness foreign expertise and technology, create better jobs and slow investment into low-end sectors. This strategy has often proved successful in contributing to improved competitiveness of nations, enabling them to move up into a higher league in the rankings.

The fact that the new laws are perceived as negatively impacting business partly explains the decline in China’s overall competitiveness ranking from 17<sup>th</sup> position last year to 20<sup>th</sup> today. In the long run, laying the foundation for future competitiveness will imply some short-term sacrifices. But at the same time it will help move China to a more advanced and modern economy and ensure the sustainability of future growth.

### The future

There it is – China’s competitiveness in a nutshell. Where does the country go from here? The authorities could grasp new opportunities arising from the global crisis to address the structural problems that may hold China back from moving further up the competitiveness ladder. Meeting the challenges described above should help steer the country towards greater prosperity and a more mature economy.

*The IMD World Competitiveness Yearbook (WCY) is perhaps the most renowned and comprehensive annual report on the competitiveness of nations. It analyzes how nations and enterprises manage the totality of their competencies to achieve increased prosperity based on 329 different criteria, split up into four categories: economic performance, government efficiency, business efficiency and infrastructure.*

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