



CHINA'S GLOBAL COMPETITIVE ADVANTAGE

The beginning of the end, or the end of the beginning?

By Bill Fischer - July 2010

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For three decades, China has grown into a world economic presence, if not powerhouse – slowly, at first, and now full-fledged – in an unprecedented, consistent, monotonic, success story. It is, to be sure, an extraordinary achievement – but it's also time for a change!

We are at a major transition point in the China growth story. In fact, I am reminded of the metaphor of “shifting gears in a moving vehicle in order to adjust to a change in the road conditions.” Now is the time that the traditional engine of China's growth requires a “shifting of gears.”

Let's be sure that we understand what is happening on the path to continued Chinese growth and why it matters. If we are sober and honest, China's wildly successful [re-] debut onto the world economic stage over the past three decades has been all about cheaper labor and lower costs. No doubt there is an extraordinarily attractive domestic market as well, but China's real advantage in the global economy has been low-wage manufacturing labor. It has not been innovation! It has not been services! It has been single-focused on the advantages of making existing products cheaper – full stop!

If we follow Deng Xiaoping's admonition to “learn truth from facts,” we can answer a series of probing questions with the same response. Has there been a Chinese enterprise which has created a noteworthy new product innovation, such as Xerox's PARC personal computer, Kodak's digital camera, Boeing's 747, Philips' CD or Sony's walkman? Has China ever come up with a process innovation as noteworthy as Toyota's production system or IKEA's shopping-maze design? Or how about an internet offering as noteworthy as Amazon or Facebook? A business model innovation à la iTunes' rewiring of the customer listening experience, or Zara's reinvention of the frequency of fashion offerings, or eBay's community of members? The answer to all these questions is no. In truth, China's growth has been powered by not by doing things – anything – differently but by doing existing things less expensively and that takes cheap labor.

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And why is now a critical juncture? 2010 is the year in which China's "working age" population has reached its highest level. This year, 71.9% of the Chinese population is between the ages of 15 to 64 which has been depicted by statisticians as the ages at which people make a net-positive contribution to economic value-creation. After this year, that proportion of the population will decline and after 2015 the actual number of Chinese working-age people (15-64) will also begin to decline. As long-time China watcher Philip Bowring recently observed in *The International Herald Tribune*: "For China as a whole there are currently only 106 million workers in the 15-19 age group compared with 122 million in the 20-24 group. China now has 378 million in their 40s and 50s but only 273 million under 20. The decline, which is continuing, in the number of the young and mobile has been greatest in rural areas. So China will have to find other ways of sustaining economic growth and gains in worker productivity." The obvious way for that to happen is through innovation, but here we have no reason to argue why the past (no innovation) will suddenly change.

The conundrum underlying all of this is that you will find a great amount of creativity in China today. From the art scene, fashion, sculpture, music and cinema, China is awash with creativity. But, if you look closely, you will notice that this is individual innovation, not organizational innovation. What sets the eBays and Amazons and Apples apart is that they are all examples of "organizational" innovation. The iPod, iPhone and iPad experiences could not have been designed by one person; it needed a team, and a diverse team at that. Same is true behind most of the big innovations of recent times.

Yet, what is it about Chinese organizations that they turn out to be so much less innovative than the sum of the people who are brought together under that organizational structure? Is it

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that the command and control approach to management which has characterized thousands of years of Chinese history is still hard to break? Or, is it Confucian respect for hierarchy and relational prerogatives? Is it not enough trust or too much trust? Is it not enough diversity? Or is it something else? These are such relevant questions in such a critical location that IMD will be sending me to Hong Kong later this year to run a program for leading executives in the region faced with the task of achieving more effective innovation.

This is China's time to address the innovation issue so that its prior successes represent the "end of the beginning" – a period of time when China will move from being the factory of the world into a world-class innovator. If this does not happen, then we are likely looking at the "beginning of the end" of China's distinctive competitive advantage and a movement into a time when China is just another low-wage producer, bigger than most, but no longer either the biggest or the lowest priced.

Bill Fischer is Professor of Technology Management at IMD. He directs IMD's Mastering Innovation Globally program which will take place in Hong Kong from October 25-27, 2010.

· Bowring, Philip. "China's Dwindling Resource." International Herald Tribune, June 3, 2010
<http://www.nytimes.com/2010/06/04/opinion/04iht-edbowring.html>

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