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# A new era for manufacturing in China

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**Four challenges**

For years, China’s low salaries; strong supply base; high investment in port, road, and rail infrastructure; and solid engineering and technical skills provided a strong platform for manufacturing exports. Meanwhile, a vast domestic market helped fuel China’s continuing transition to a consumption-based economy. Today’s outlook is more mixed. Here, we review four core challenges and the types of players particularly affected by each of them. In doing so, we draw on a set of global manufacturing archetypes established recently by the McKinsey Global Institute (see sidebar “The makeup of Chinese manufacturing”).

**Rising factor costs**

Rising wages and the appreciation of the renminbi have dampened China’s exports in recent years and focused global attention on its future viability as a low-cost manufacturing center. Most multinationals that produce labor-intensive goods, like textiles and apparel, are actively seeking to diversify beyond China to reduce costs and mitigate political and supply-chain risks. China-based processors of goods such as beverages, fabricated metals, food, and tobacco are also concerned about rising costs, including those for packaging. Yet their regional focus makes this less a global competitive issue and more a question of which players in the value chain will create the most value.

上升因素的成本

近些年来，工资的上涨以及人民币的升值抑制了中国的出口业，这也使得全球的关注点转移到了中国未来成为低成本手工业中心的可能性上去，像大多数纺织业以及服装业这一类的跨国公司目前正在积极寻求除中国外的其他公司合作，用以减少成本并规避政治和供应链的风险。中国的其他一些饮料，金属，视频，烟草等制造商也注意到了在包装等方面上成本的上升。如今，这些制造商的区域注意点以及不再是全球竞争问题了，而是在这样的一个价值链中，哪些参与者能够创造最多的价值，

**Rising consumer sophistication**

McKinsey research suggests that by 2020, the income of more than half of China’s urban households, calculated on a purchasing- power-parity basis, will catapult them into the upper middle class— a category that barely existed in China in 2000. The members of this group already demand innovative products that require engineering and manufacturing capabilities many local producers do not yet adequately possess. An executive of a Chinese television-panel maker, for example, recently confessed that his company cannot fully meet the requirements of high-end customers and that the quality of his company’s flat-screen panels is exceeded by that of products from fast-moving South Korean competitors. China’s automakers face a similar challenge: consumers perceive their brands as lower in quality, even compared with foreign brands assembled in nearby Chinese factories.

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这一阶级的人们已经开始寻求具有创新性的产品，这些产品需要一定的工程和手工业能力，这一能力是许多当地的制造商们现在所不具备的。例如，最近一位中国电视面板制造商的执行官就说抱怨到这样两件事，一个是他们公司的产品完全不能满足这群手高眼低的顾客的需求，另一件事是他们公司的平板显示器已经被他们的竞争对手-韩国的快速移动公司超越了，中国的汽车制造商们也面临着这样的一系列挑战：顾客认为他们的品牌在质量上较低，甚至还不如在中国附近拼装的外国名牌。

These issues confront players in a range of other sectors—from appliances and chemicals to electrical and office machinery, pharmaceuticals, telecommunications gear, and transportation equipment. What they have in common is that they compete on the strength of their R&D, technology, and ability to bring customers a steady stream of new products and services. Rising consumer expectations will require even food and beverage players to raise their game on freshness and regulatory compliance, areas where China’s standards still lag behind Western ones.

**Rising value-chain complexity**

Another big challenge is coping with the rising value-chain complexity that accompanies consumer growth. Greater affluence and rapid urbanization require product makers to manage, make, and deliver an array of increasingly diverse and customized products to increasingly remote locations. Between now and 2015, for example, almost two-thirds of the growth in demand for fast-moving consumer goods will come from smaller (Tier-three and Tier-four) cities, which outnumber their Tier-one counterparts, such as Beijing or Shanghai, by a factor of 20.

Product proliferation and booming e-commerce also contribute to value-chain complexity. Business-to-consumer online sales in China are expected to grow by 45 percent a year from 2010 to 2015. For product makers, this means smaller and smaller lot sizes and deliveries to households farther and farther “out there.” During Chinese festival periods, the supply chains of many companies already creak under the strain of online orders. Demanding consumers contribute to supply-chain headaches, as well. Since many retailers in China accept cash-on-delivery payments, it’s not uncommon for shoppers to pit online retailers against one another by ordering, say, three identical products from three retailers—and refusing delivery to all but the first to arrive.

Such issues are relevant for technology companies and others responding to the Chinese consumer’s increasingly sophisticated tastes. But rising value-chain complexity is also a worry for manufacturers of more labor-intensive goods, given the sheer variety of products they make, and for regional processors, whose logistics networks are affected by urbanization and booming infrastructure development.

**Heightened volatility**

The uncertain global economic environment since 2008 has complicated life for manufacturers everywhere. Those in China have arguably been the most severely affected, given the country’s status as the workshop of the world.

In China’s steel industry, for example, annual demand growth slowed to 3 percent in 2012, after a decade of double-digit increases. The result has been lower capacity utilization, cutthroat competition, and a 56 percent decline in average profit margins for the industry from 2010 to 2012. Similarly, in China’s massive auto industry, annual growth rates over the past five years have varied from 7 percent to 52 percent.[4](http://www.mckinsey.com/insights/manufacturing/a_new_era_for_manufacturing_in_china) Appliance and electrical-machinery producers have also experienced strong demand fluctuations, exacerbated by gyrating overseas demand.

Volatility at such levels makes planning difficult for China’s manufacturers. This is problematic for companies that routinely make large, long-lived capital expenditures whose returns are crucial determinants of performance.