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The End of Cheap China

Economic and Cultural Trends that Will Disrupt the World

Shaun Rein • Wiley © 2012 • 240 pages

Management / Doing Business in Asia

Politics / Globalization

Take-Aways

- China was one of the world's cheapest manufacturing locales. Not any more.
- Increasing wages for factory workers and soaring real estate costs will force many foreign manufacturers to move their production facilities elsewhere.
- Manufacturers in China now must compete for workers by raising wages. As Chinese salaries rise, so will the cost of goods worldwide.
- Now that its people are earning money, China is becoming a lucrative retail market.
- Many Politburo members suffered during the Cultural Revolution. That affects how they view government power and reinforces their longing for stability.
- Today, communist China is a champion of capitalism and individual entrepreneurship.
- Women used to be second-class citizens in China, but that is no longer the case.
- China has many internal problems, including a terrible education system, a lack of quality housing and a dangerous, untrustworthy food system.
- For many, China is a vital economic powerhouse and a force for good in the world.
- Others view China with deep mistrust and worry about its sharp global rise.

Recommendation

Think beyond the incorrect stereotypes about China and read Shaun Rein's reality check. This respected China expert takes you behind the scenes to see what is going on in China today. His main message is a cautionary note for Westerners: As Chinese factory wages skyrocket, products made in China and sold around the globe will become more expensive, and China will become the world's most dynamic retail market. Despite its perhaps too-benign view of the Chinese government, *getAbstract* recommends Rein's report to manufacturers, retailers and consumers.

Summary

China: It's Not the Nation You Think It Is

Outsiders wrongly assume that China has millions of poor people who will work for pennies. China does have a vast number of people, 1.3 billion and counting, but pennies won't do anymore. China was known for cheap labor in the past, but no longer. Strong foreign investment in recent years has produced millions of relatively well-paying jobs for Chinese men and women. The upsurge is a wonderful time for China's young people. They have watched their nation's economy soar. They are enthusiastic about the future and excited about their individual prospects.

"The world does not fully comprehend how to deal with a rising China."

This marks a big change. As late as the 1990s, Chinese workers would take any job to feed themselves and their families. Finding a job was terribly difficult, but now plenty of work is available in China, and much of it pays a good wage.

The Impact of Skyrocketing Wages

As Chinese factory wages increase, companies that moved their production facilities to China from the United States and other nations may be forced to move again to countries with lower wages, such as Indonesia or Vietnam. Some American firms may even choose to relocate their manufacturing back to the United States.

"Too many Western observers of China foolishly discount the management and branding abilities of Chinese companies, much as many American companies discounted Japanese firms like Toyota and Sony in the late 1970s."

Laura Furniture manufactures many of its products in Shanghai, in a two-million-square-foot plant staffed with more than 10,000 workers. Several ongoing economic changes, including the rise in labor costs and the appreciation of China's yuan, have severely slashed Laura's margins in recent years. For that reason, the firm recently shifted some manufacturing from China to Indonesia and Vietnam. However, it found that those employees are "less productive" than Chinese workers and that the "transportation infrastructure" is not as good as China's.

“The population of China is five times larger than America’s, but the vast majority live squashed together in a land area roughly the size of America’s Eastern Seaboard.”

Manufacturers in China now must fight each other to get workers, who routinely “job-hop” from one company to another, depending on where they can earn the highest pay. Some companies in China now offer laborers 20% wage increases to leave their current jobs and come work at their factories instead. Additionally, the central government is now pressuring companies to pay better salaries. As a result, factory wages are climbing at a double-digit rate. More than 70% of the respondents to a poll of *Fortune* 500 executives said they faced annual turnover rates of 30% or more in China and named “the ability to recruit and retain talent” as their major challenge.

“Instead of the market to produce in, China has become the market to sell into.”

Western businesses that want to sell in China also find that real estate and rental prices are soaring. Finding a viable location for a new retail establishment in China is becoming increasingly difficult, particularly in Beijing and Shanghai. Western merchants may want to consider setting up new retail stores in second-tier cities that are experiencing rapid growth, such as Changsha.

A Giant Nation of Exuberant Consumers

As wages rapidly increase, the 350 million people in China’s middle class now have money to spend on consumer goods that they never could afford previously. As a result, China has become an incredibly promising retail market for both domestic and foreign companies. In 2010, the Chinese bought more than 17 million automobiles, making China the world’s largest car market.

“China has become the must-win market for consumer product companies.”

Yum! Brands, which owns Kentucky Fried Chicken (KFC), realizes more than 40% of its worldwide sales in China. Nike earned \$1.2 billion in 2011 in China, its “second-largest market.” That year, Chinese consumers spent \$15.6 billion on luxury goods, making China the world’s second-largest market for upscale items. As people in China’s vast middle class buy more cars, homes, clothes and other goods, global commodity prices also will increase, particularly given Earth’s limited natural resources. As a result, the new Chinese dynamic will raise prices on almost everything consumers around the world want to buy.

Angry Voices in the West Against China

Many people worry about the economic and political impact of China’s emergence, and that concern has generated vociferous criticism. A number of well-known Americans use the airwaves and print publications to harangue against China. For instance, celebrity investor and billionaire Donald Trump proselytizes that the US should institute a 25% tariff on imported Chinese goods.

“Chinese consumers tend to prefer local brands if they feel they are as good as the foreign competition.”

Such rhetoric against China is misguided. The United States has a lot to lose if it antagonizes China. Professor Orville Schell of the American-based Asia Society says the US could “lose up to \$2 trillion in Chinese investment” due to hatemongering. And, of course, the people of China naturally resent the fiery rhetoric some polemicists direct against them. Some voices in China advocate pushing back against the US and other Western nations. They want to build China’s military and replace American hegemony across the globe. Poorly informed Americans who clamor angrily against China should at least acknowledge how dangerous it would be to the entire world if the US and China ever engaged in some type of serious armed conflict.

Chinese Manufacturing – in China

China is the world’s primary locale for manufacturing Western companies’ goods, but many Chinese factories also produce goods for Chinese firms. Some Western companies do not respect products manufactured by Chinese companies. In the past, consumers preferred American brands instead of Chinese ones for reasons of quality, but that will not always be the case. In fact, Chinese brands are already gaining great popularity with domestic customers, not just because of price but also because of quality. Some Chinese brands now compete successfully with Western products within China, including Mindray’s medical devices, Wang Lao Ji’s herbal drinks, Mengniu Dairy’s products, Li Ning’s and Anta’s sports clothing, and CTRIP’s travel services. Some of these brands are also penetrating international markets.

Steering China to Prosperity in the 21st Century

China’s Cultural Revolution of 1966 to 1976 deeply affected – and scarred – the Chinese people who lived through it, including some of the older men on the Standing Committee of the Politburo, which runs the Chinese government. During the Cultural Revolution, the radical, student-led Red Guards terrorized, tortured and killed many of the nation’s most prominent people, including some Communist heroes who distinguished themselves during the war against Chiang Kai-shek’s Nationalist forces.

“China’s food supply chain is...a mess that is literally poisoning the Chinese population.”

During the Cultural Revolution, Marshal Ye Jianying was the third most powerful Chinese leader. Deng Xiaoping was also already a leader in the Chinese Communist Party hierarchy. After Mao Zedong’s death, Marshal Ye and Deng led China on its current path to modernization. Both men suffered during the Cultural Revolution. The Red Guards jailed Marshal Ye’s children and threw Deng Xiaoping’s son Deng Pufang out of an upstairs window, paralyzing him for life. Xi Jinping, the next president of China, was exiled to the countryside for a decade.

“Desperation for safe food is so high that gangs are moving away from drugs, pirated DVDs and prostitution to sell baby formula.”

Many Westerners mistakenly believe that the leaders of modern China participated in the Cultural Revolution and approved of its actions. This is a big misconception. While the dangerous chaos that ensued during those years dramatically affected many Politburo members, a number of them now do their best to promote stability as one of China’s primary virtues. Many Westerners also believe that authoritarian rulers tightly control all Chinese citizens. That’s not accurate, either. The “term limits and retirement ages”

that apply to all government leaders, including the men at the top, constrain their power. China also has numerous “provincial, county, municipal and district” governments. The central authority sets national policy, but these local units implement it according to their preferences. However, corruption often taints these regional and local authorities, causing some local leaders simply to ignore directives from the central government.

“The benefits that the central government brings far outweigh any negatives.”

Western businesses opening in China must secure the approval of the central government and the permission of local authorities. Foreign executives are aware of the web of connections – the *guanxi* – that unites local businesspeople and knits them to the central authorities. Experts warn foreigners not to trust intermediaries who offer to sell their *guanxi*. Few Chinese will share this asset, which, though still meaningful, does “not have nearly the importance” it once did.

Communist China Loves Capitalism

After the Cultural Revolution, the Chinese government introduced economic reforms and encouraged the creation of wealth among its citizens. It promoted gender equality and national stability. The emphasis on wealth creation certainly paid dividends: China now boasts hundreds of billionaires and more than one million millionaires, most of whom became rich through entrepreneurial capitalism.

“State-owned newspapers...reported that 4,000 corrupt officials have smuggled \$50 billion in state funds out of the country over the last 30 years.”

Once subservient to men, Chinese women have benefited greatly from the country’s recent changes. Parents now raise their daughters as “little princesses,” teaching them that they should expect only good things to happen in their lives. Women earn more than half the income in China, and they outnumber men in Chinese universities. Companies that plan to market to women in China should focus on the biggest spenders – those “between the ages of 24 and 32.” And in China, localizing your offerings is the best marketing plan.

“Despite the central government’s power to set national directives, it is not quite the monolithic and totalitarian state that many Westerners imagine.”

Young Chinese women love to shop, so global firms with quality products can score big in the retail market. Western food companies also do well. Chinese consumers, particularly young mothers, are deeply suspicious of local food products. They have good reason to be. Chinese newspapers constantly report shocking stories outlining ways Chinese “farmers, restaurants and supermarkets” endanger the public. This includes selling expired meat, pumping additives into pork to make it look like beef and injecting dirty water into watermelons to make them plumper.

“The issue of human rights and how to define them is a major point of contention in US-China relations.”

Since people do not trust Chinese food companies, American fast-food outlets, such as KFC, do extremely well. The Chinese believe Western food companies will not take dangerous shortcuts with their products.

One young woman reflected the attitudes of many other Chinese people when she said, “I love Kentucky Fried Chicken. I go there all the time because it’s healthy.” She understands perfectly that fried food is not a healthful choice, but she trusts KFC to use safe ingredients. “Lots of street vendors use recycled oil from sewers,” she says. “I don’t think KFC would do that.”

“Never forget that most Chinese will always view you as a foreigner who will only be there for the short term.”

Chinese citizens are also coping with a lack of decent housing and a public education system that focuses far too much on rote memorization, test taking and little else.

China in Africa and the Rest of the World

For China to continue to grow, it must secure vast natural resources, including iron ore, oil and copper. For this reason, China has made many inroads in Africa in recent decades. It now spends a great deal of money building infrastructure there and heavily investing in the continent’s nations. China also works hard to secure commodities from other countries, notably Australia and Canada. It also buys the bonds of various nations – not just the US, but also Spain and Greece.

Many nations without democratic governments gravitate to alliances with China. They prefer to deal with China rather than the US, which many consider arrogant. One Pakistani woman said, “All levels of Pakistani society right now like China. They are bringing money without American arrogance. They don’t tell us what to do as if we are children and don’t know any better.”

People around the world hold two contrasting viewpoints about China. One camp, which includes most business leaders, sees China as a hugely beneficial force in the world economy, as well as its “potential savior.” This group does not care about ideology; it just wants to increase profits. Those in the other camp view the rise of China as detrimental to other nations, and some even cast it as a scapegoat for America’s problems. Both factions recognize that China is a bona fide global superpower. Knowledgeable observers understand that China’s internal problems act as a brake to its rise as a “hegemonic” influence with worldwide reach, as the US is today. China’s mammoth economic power, not its ideology, will make it a more dominant global force.

About the Author

Shaun Rein is founder and managing director of the China Market Research Group and the author of a weekly CNBC column on business in China.



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