

## China – First pass Option for Gaining Global Advantage

Edited by Frank Zhang

According to the new report of “Capturing Global Advantage” by The Boston Consulting Group (BCG), China has become the first pass option for companies looking to gain global advantage by implementing Low Cost Country (LCC) strategy. China’s advantages in cost, market size and manufacturing capabilities make China the most favored country for leading western companies to move sourcing, manufacturing, R&D, and service operations from High Cost Countries (HCCs) to LCCs.

### China’s Cost Advantage

The report shows that a company can realize savings of 20 to 40 percent in the landed cost of its products by relocation of sourcing or manufacturing to China. China’s cost advantage mainly comes from lower labor cost, lower capital investment cost and government incentives.

*Lower Labor Cost.* A factory worker in the United States or Europe costs \$15 to \$30 or even more per hour. In contrast, a Chinese worker earns well below \$1 per hour – a twenty fold cost advantage. Wages in Mexico or Eastern Europe are two to eight times the level in China. Actual costs vary widely around the averages, but the magnitude of the difference between West and China – a ratio of 20 to 1 cannot be ignored. Compared with India, the availability of large numbers of highly educated English-speaking workers and managers is still limited in China. For this reason, China has become a major and fast growing source of industrial goods while India has become a powerhouse for outsourced services.

*Lower Capital Investment Cost.* Factor costs are very low in China compared with those in the west. For example, stamping presses, CNC machines and power tools cost 50% less than in the West. China also offers the opportunity to use a higher portion of manual labor that can reduce capital investment cost significantly. Companies that have been operating in China report that, in the aggregate, they can drive their investment requirements to as low as 30 to 40 percent of what would be required in their home countries.

*Government Incentives.* Besides providing tax incentives and lowering import duties, the central

Chinese government has set up more than 500 special economic zones that attract foreign investment. Local governments have followed the suit and created several thousands of their own. For example, Tianjin has set up more than one hundred economic zones. One BCG client claim that it received so many incentives for one of his factories that its construction is virtually free of charge.

*China’s Cost Advantage will persist.* Many observers have suggested that China’s cost advantage will evaporate in the foreseeable future. But BCG believes that the advantage will exist for the next 20 years. The growth of wages in China will be limited because of the enormous reservoir of underemployed in China. Although there will be more pressures on higher-skilled positions, the supply of candidates for such positions are also very large. Furthermore, the current differential in labor rates between China and the West is so big that the gap remains substantial for the foreseeable future, even if there are double-digit differences in the rates at which they grow.

### China’s Market Advantage

For many industrial goods, as well as for consumer goods, China is already the world’s largest market – as well as the world’s largest producer. For instance, China is already the largest market for machine tools, the second largest market for transmission and distribution equipment, and the fourth largest market for automobiles (for passenger cars and trucks). The leading companies are starting to generate a large portion of their global sales in China. A specialty metals producer told BCG that he expects half of his company’s global growth to come from China. China’s domestic markets are so huge and fast growing that companies can not afford not to serve them.

### China’s Capabilities Advantage

A large pool of talented, trainable and loyal skilled workers as well as a large pool of highly educated engineers and researchers is available in China. Migration of sourcing, manufacturing, and R&D operations to China enable a company gain non-cost advantages in flexibilities, quality, R&D speed and productivity.

**Five levels of LCC Strategy**

BCG thinks that there are five levels or stages for industrial companies to derive advantages from LCC sourcing and manufacturing: testing the water; purchasing components or complete products; developing comprehensive sourcing; adopting an integrated LCC strategy; and capturing global advantage. BCG believes that there is little competitive advantage to the testing water level.

Although the implementation of LCC strategy is complex and challenging, the report concludes that

companies hesitate to implement it are at their peril. Globalizing company's cost structure and business model, with China and India as first pass options, is rapidly becoming not merely a strategic alternative but a competitive imperative.

**Notes:**

This article is edited based on the BCG report with a focus on China. The original report of "Capturing Global Advantage" is available at BCG website [www.bcg.com](http://www.bcg.com).