

A CASE STUDY

Rise of China as a manufacturing hub

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China as an economy has grown leaps and bounds in the past years. Few of the factors which have contributed to this fast growth has been attributed to:-

- Large working population of the country
- Almost non existent labour laws
- Culture of hard work in China
- Government support for enhanced export
- Largely pegged currency

The figures depicting growth of China are as presented below:-

- Exports:- US\$1.506 trillion (2010)
- Imports:- US\$1.307 trillion (2010)
- FDI Stock:- US\$ 100 billion (2010)
- Public Debt:- 17.5% of GDP (2010)
- Revenues:- US\$ 1.149trillion (2010)
- Expenses:- US\$ 1.27 trillion (2010)
- Foreign Reserves:- US\$ 3.05 trillion (Ist Qtr, 2011)

China is a market oriented country located in Asia with a population of 1.3 billion people. It is a country with a mixture of many cultures and religions. China is country that booming up in modern technology. Even though the country's population is of great number but the people are very hard working. China has its own languages as any other country but English is well spoken now in the country so as to ease communication with foreign people mostly tourists and foreign business people that visit China.

China has many industries such as tourism, agriculture, manufacturing, technology industries. So if SMEs are looking to invest in foreign countries than China is the right place to do so.

The future of the country is determined by decisions made by the Communist Party of China (CPC). SMEs in China are estimated that they are responsible for 60% of the country's industrial output and should employ 75% of the workforce in the country's cities and towns. SMEs are suppose to create urban jobs since the Chinese government is aware that SMEs are job creators. "Flexible SMEs are generally well positioned to take advantage of opportunities created by China's entry to the WTO" (Embassy of the United States united states of Beijing, China, 2002)

Pest analysis :

Political :

Political environment includes factors in government, level of political stability, the law and regulatory system that affects an organization when operating.

Government type and political stability :

Even if China has changed from a planned economy to a market oriented country the political economy stays the same. The CPC (Communist Party of China) take the decision which determines the future of the country. The power centers in China are:

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- Conservatives
- Liberals
- President Hu Jintao
- Former president Jiang Zemin
- Military

Rules and regulations doing business in China :

Starting a business in China :

A permit is needed so as to do business in China, so your agent or distributor will put all documents needed together and provide them to Chinese custom agents. "Documents that may be required include import permits and quality supervision, inspection and quarantine inspection (AQSIQ) clearance.

Most imports to China do not need an import license if they are registered with China's Ministry of Commerce (New Zealand Trade and Enterprise, 2008). Just few items come across licensing or permit procedures, such as drugs, chemicals, weapons.

If a local agent is being used then it is important to make sure they have an import license. If not, the importer will have to look for links which will lead to higher costs in delivery.

So as for the case of shoe manufacturing in China a license or permit is needed so as to start the business. By having connections before starting the business than it is made a lot easier and less expensive.

Forms of investment in China :

Investment is divided to direct investment and indirect investment. In China there are three main types of direct investment:

Equity joint venture :

Equity joint venture refers to working together between two individuals a local individual and a foreign individual in other words a Chinese and an overseas individual, they share mutual rewards and risks. Here is where the Chinese government and businesses are concerned. "Overseas parties are only allowed to invest at most 25 per cent of the entire registered capital in the form of cash or trade property rights etc. The parties to the joint venture shall share the rewards, risks and losses according to the ratio of investment." (Starmass International, 2001)

Contractual joint venture :

Rights and responsibilities and all liabilities are agreed on a contract before joint venture. This is when the parties will agree on the form of administration and profit division.

"The major difference between an equity joint venture and a contractual joint venture as means in China market entry is that the latter neither necessarily calculates the shares in the form of currency nor distributes profit in proportion to

their share, but share profit according to the form of investment and the ration of profit sharing as per the contract." (Starmass International, 2001).

Wholly foreign -owned enterprise :

This refers to the established enterprises by foreign investors with their own capital according to the law of China. Since China offers joint ventures with other countries than SMEs should use this chance to enter in the manufacturing industry in China due to reasons such as:

- Cheap labour
- Availability of raw materials
- High technology

Taxes :

There are different kinds of taxes in China which SMEs have to know. The kinds of taxes available are as follows:

Kinds of tax description :

Business tax:

This is a tax payable against turnover by all enterprises and individuals doing business of construction, finance and insurance, selling immovable properties. It varies from 3 per cent to 20 per cent of the sales turnover.

Value added tax (VAT) :

VAT is applied if your company is selling, manufacturing, processing or repairing tangible goods. VAT Rate for "general taxpayers" is 17 per cent, or 13 per cent for some goods. "small scale tax payers get lower rates of about 4 per cent for trading enterprises and 6 per cent for other production and other enterprises.

Foreign enterprise income tax :

It is calculated against the net income in a financial year after deducting reasonable business costs and losses; *i.e.* profits.

Withholding tax :

Withholding tax is a PRC tax levied on overseas companies providing services to China based business. If you are based outside the PRC but are supplying services to clients in China, your invoices are in effect.

Individual income tax :

If you are sent to China and your salary is being paid elsewhere not in China and spend more than 183 days in China then you would have to pay IIT in China based on the number of days you effectively spent in the country.

(Source from: <http://www.agn.org/regions/ap/MainlandChinaTaxationOverview.pdf>)

Economic environment :**Gross domestic product (GDP):**

Gross domestic product is an essential part of gross national income. It is the total value of goods and services produced within the country in one year. GDP is used to access countries whose multinational sector is significant share of activity.

During the reform period China's GDP has risen from Rmb 362.4 billion in the year 1978 to Rmb 13.7 trillion in 2004.

The share of primary industry in GDP has fallen from 28 per cent in 1978, at the beginning of the reform period, to 15 per cent in 2004. This fall occurred because agricultural output grew more slowly than output of other economic sectors. (China Statistical Yearbook, 2004)

Manufacturing industry grew faster than the GDP over that period from 48 per cent to 53 per cent during the manufacturing boom.

Individuals have also become richer, with annual GDP per head rising during that time from Rmb 379 to Rmb 10,502 (China Statistical Yearbook, 2004)

China's phenomenal economic growth in recent years was primarily due to growth in the secondary and tertiary sector of the economy (Heilig, 2009).

Agriculture in China which is the primary sector only grew a little since 1996.

Currency and foreign exchange rate :

The currency of China is known as Renminbi which means people's money. China's monetary authority issues the money in China.

During the previous decade, Mainland China's currency was pegged to the U.S. dollar at 8.28 RMB. On July 21, 2005, it was revalued to 8.11 per U.S. dollar, following the removal of the peg to the U.S. dollar. The revaluation resulted from pressure from the United States and the World Economic Council (Danwei, 2002).

In 2003 the value of dollar dropped causing value of Renminbi to fall also making exports more competitive in China mainland. This led to some pressure on the PRC from the United States to increase the value of the RMB in order to encourage imports and decrease exports (Danwei, 2002).

Leading industries :

China is a fast growing country and the industries have changed the economic status in the country especially foreign direct investment. Manufacturing industry is the leading industry in China as stated in the diagram below. So SMEs can consider investing in manufacturing industry by choosing to joint venture with local investors in the country.

Social and cultural environment :**Demography and population growth :**

The decline of dependency ratio has created a

productive population age structure with an affluent supply of labour force. Empirical results illustrate that the Chinese demographic transition has contributed to 15-25 per cent of economic growth and 5-21 per cent of savings rate in the reform era. With the acceleration of population aging, demographic dividend will be depleted at the end of 2013 (Fang and Dewen, 2001).

Since mid 1960s China has been able to harvest its demographic dividend due to changes in population age structure. So the reduction of working age population will cause rise in wages.

The Chinese are hard working people and are very healthy. So if wanting to join ventures with China to start a manufacturing company then China is the right place to do so.

China has a population that exceeds 1.25 billion people in the country and it increases approximately 12-13 million people each year.

Religious beliefs :

The Chinese are not very religious people. "Chinese culture was perhaps the first to develop an intellectual skepticism concerning the gods" (SACU, 2001).

Religions practiced in China include:

- Daoism (Taoism)
- Islam
- Buddhism
- Christianity
- Popular folk religion (village religion)
- Spirituality

Language :

Every country has its own language, so does China. Mandarin Chinese is the official language and is difficult for foreigners to learn and understand. "As one of the six official languages used by UN (United Nations), Chinese now has earned itself greater status in the World." (TravelChinaGuide, 2009).

Many Chinese speak basic English especially the youth which makes more better for SMEs to start a business in that certain country because communication won't be a problem when working together. But it is still a problem in certain areas in China where language is a barrier in communication, so it gets difficult for foreigners to communicate with the locals. Even though China is growing fast in technology language is still a problem in some areas.

Technological environment :**Transportation infrastructure:**

China is in the middle of a massive upgrade of its transportation. China has realised so as to keep their economy growing they are going to need efficient system so as to move

goods and people around the country. According to World Bank statistics, goods lost due to poor or obsolete transportation infrastructure amounted to one per cent of China's GDP (US commercial service, 2001-2009).

Ports are being improved for more use of the country's waterways and even airports.

China is about to open a 36km six lane highway across Hazngzhou Bay which will reduce travel time between the two busiest ports in China in about two hours. So transportation is being made easier for doing business in China.

Internet usage :

Internet in China is growing fast according to China Internet Network Information Center (CNNIC) the country's online population has grown 41.9% in 2008 to 298 million users. Even though China's internet penetration is still fairly low even if it exceeds the world's average.

Access of internet through mobile phones is very popular, it is said that the number of internet users through mobile phones in China went up to 133 per cent from 2007.

Recommendations :

According to the PEST analysis in China technology industry, tourism industry, manufacturing industry and agriculture industry are the fast growing industries in China. SMEs are recommended to enter into manufacturing industry because it is the leading sector of industries in China. SMEs should invest since there is availability of cheap labour, raw materials and modern technology.

Mode of energy :

When starting a new business large capital is needed, since SMEs have limited capital so it is suggested mode of entry is to joint venture with local manufacturing industries. Joint-venture has medium control as it has more than two companies involve in management (Daniels *et al.*, 2007).

SMEs benefit in this country through joint-venture method whereby they don't have to start a company from the bottom, the company's image is established by current companies in the country.

Benefits :

China is now given the title end of cheap China because many have started business in China due to cheap labour and availability of resources. SMEs benefit from China because of:

- Currency
- Quality
- Natural resources
- VAT rebate cuts

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