

Why China Will Innovate

China's development since Deng Xiaoping set the country on the path to economic reform 30 years ago is breaking new ground in the world's economic order. The changes brought by China's rise have been so sudden that perceptions still lag behind reality in many important ways.

by Jack Perkowski



As sourcing from China gained in momentum, for instance, many companies persisted in the belief that their products were not vulnerable to the China price tag. Others doubted that the China market would ever become as large as it has for big ticket items like cars. Conventional wisdom was that China could not manufacture complicated products and income levels were just too low. Yet, as history has shown, China has become both a competitive manufacturer and a large market for almost every product.

"The Chinese can copy, but they can't create" is another commonly held perception that will not stand the test of time; make no mistake about it. China will become an innovative country, for the simple reason that many of the problems it faces will require different solutions than those found in more developed economies. Moreover, the disparity in income levels across the country will force this to happen. Companies seeking to provide solutions to China's problems will have to find ways to satisfy the functional requirements of the marketplace, all the while keeping the price of products within the affordability standards of the majority of the country's population.

When China re-joined the global economy in 1978, it entered a world that had changed dramatically from the one it had left – in every way – but particularly with regard to technology. Led by the rapid post-war economic and industrial development of the United States and the emergence of a reconstructed Japan, gains in technology had changed the landscape of every industry. With no pressures from a competitive market economy to spur development, China was stuck in the 1950s, a 30-year time warp behind the rest of the world. When Deng removed the economic handcuffs from the Chinese, he unleashed a vast wave of entrepreneurialism. Under Deng's new system, it became glorious to be rich, and many Chinese took up his call. By starting new businesses, securing high paying jobs with the thousands of foreign companies eager to gain a share of the China market, and benefiting from the tremendous growth in real estate values across the country, over 400 million people are now making incomes they would

not have dreamt possible 30 years before. In sharp contrast to this group within China, though, are the estimated 900 million people in the country's rural economy who still subsist on annual incomes of approximately USD 500.

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Unlike those in the bottom segment of China's economy, the newly affluent Chinese can afford the higher technology, higher quality and higher priced products found in Western countries. However, having grown up in a much less prosperous China, they have a fundamentally different and lower cost perspective than their Western counterparts: They would prefer not to pay Western prices. When they look at a RMB 100 note, they see the equivalent of what Americans might see when they look at a USD 100 note. Their fundamentally different cost perspective causes them to look at money much more conservatively.

How does this matter? It essentially means that China's lower cost perspective, combined with the large number of Chinese who have much lower income levels, makes it less likely that products that have been designed for other markets will meet the needs of China's market. China's market demands solutions tailored to its own unique set of requirements, a key element of which revolves around the issue of affordability. Take motor cars, for example. Making more transportation available in a country the size of China is fundamental to its continued, sustainable economic growth. Yet, the more vehicles that China puts on its roads, the more acute the issue of fuel availability becomes and the more pressure is placed on the environment. In China, making vehicles more fuel efficient and environmentally friendly isn't a matter of

political correctness or presidential approval ratings; it's a matter of economic life and death. If China is restricted in its ability to move people and goods around the country, it can't continue to grow. It's that simple. For this reason, China has the most to gain from making vehicles that are more fuel efficient and environmentally friendly.

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However, China won't accept solutions that meet the market's functional requirements, but fall outside its affordability standards. Due to its lower cost perspective and the vast disparity of incomes in the country, 1.3 billion Chinese wake up every day and try to discover how to make the products they use in everyday life cheaper, more convenient and simpler to use. In this context, China has become an early developer and adopter of new technologies, particularly those that enable the country to go forward more economically. Just as in telecommunications where the country went from having "no phones" to having cell phones, so is China likely to leap ahead to the latest technologies in industry after industry, including transportation. With little existing infrastructure that has to be rendered obsolete, China can afford to look at any new technology strictly on its own merits.

Innovation occurs when an unsatisfied market demand is combined with a lot of smart people. Somewhere out there are the technological solutions that meet the needs of the China market. Somebody will figure out, for example, how to create more fuel efficient and environmentally friendly vehicles which, at the same time, meet China's affordability requirements. Perhaps the ultimate solution will come from engineers in Detroit, Stuttgart or Toyota City. But it's equally likely that the solution will be developed by Chinese engineers in Beijing, Shanghai, Changchun or Wuhan, engineers who instinctively understand China's lower cost perspective and consequently create designs with that difference in mind. From the vast pool of Chinese companies that sell exclusively to the local transportation market, may emerge the truly elegant solution that satisfies all requirements. Whoever finds these solutions will unlock some of the biggest opportunities of the 21st century. ■

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Product information:

Language:	German
Book:	Hard cover approx. 350 pages
Publication Date:	July 2008
Price:	EUR 48,00 / 480,00 RMB
ISBN:	978-3-940114-01-3

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