



The China Squeeze on U.S. Manufacturing Margins

Low-wage economies in other countries have always challenged U.S. companies, at least since steamships opened large-scale trade. But the price pressures that are squeezing U.S. manufacturing margins today are unprecedented.

The source of these pressures, above all, is the rising industrial giant in China.

An increasing number of U.S. businesses are finding themselves in a place called “commodity hell.” Chinese-made goods can easily undersell those made here by 40 percent or more. Trying to match a Chinese selling price is unthinkable; some companies have tried, and found themselves selling below their cost of production — even below their cost of materials.

It’s not just a few ancient enterprises making obsolete products in outdated plants that face this trans-Pacific squeeze. To the contrary, the *China price* is shaping up as the greatest single threat to most U.S. manufacturers, ahead of health costs, wage demands and compliance. All indications are that this competition will grow and sharpen in the coming decade.

Want To Race?

U.S. companies that have taken up China’s price gauntlet have found themselves in a race to the bottom. Others have opted for offshore operations. Added together, these choices account for thousands of closed plants across the U.S. — apparel, furniture, electronics, plastics and others — and millions of manufacturing jobs lost since 2000.

That’s because the real commodity in question is labor, which costs less along the Yanatze than it does along the Missouri.

How much less? In China, five straight years of 8 percent raises will bring the average factory wage up to *\$1.30 an hour*.

Sure, the United Auto Workers may give up some ground on health care. But what U.S. company can compete with the China wage?

Most of China's new industrial capacity is designed to meet domestic demand from a huge and growing middle class. (By 2007, the four biggest shopping malls in the world will be in China, including one three times larger than Minnesota's Mall of America.) That massive capacity is already turning outward in search of global markets — but the real frenzy is yet to come, if and when the Chinese economy cools.

Virtually no manufacturing operation in an advanced nation can compete with Chinese industry on labor costs or price. So what options remain?

They Also Serve . . .

A manufacturer could step back from the price wars, pursue the higher end and differentiate itself with customer service. This tack takes nerve, and it's not for everyone, but some companies will succeed with it. When the economy loosens up, customers will be less price sensitive — and they'll remember which suppliers took good care of them, and which didn't.

If You Can't Beat Them, Join Them

A company can take its industrial operations offshore in search of lower labor costs. But U.S. firms that move plant to Mexico are now contending with a new and unexpected trend: Chinese industry and infrastructure have reached the level where they can perform what was once thought of as "Mexican" work.

With the cost of labor in Mexico almost double that in China, Mexican-based enterprises are doing the math, too. At the famed Mexicali Industrial Park, more and more chained-up doors say "*Cerrado*" and give a forwarding address in Asia.

The Next Big Thing

Or a firm might come up with something new — a product or a technology that sets it far enough apart that it can stand outside the price wars.

It doesn't really have to be a *big* thing: The company that develops a new-technology portable music *player*, and combines it with a portable music *service* — wait, that's been done. Come up with something comparable, like a patented lightweight engine brace that only you are legally allowed to make, and you'll face less in the way of price pressure.

How to innovate? If it were easy, everyone would do it. Read the current wisdom, study the shining examples, sharpen pencils. And manage the process, because the spark of inspiration is necessary but not sufficient. To be successful, innovation has to integrate with a business model.

Here are some other points to keep in mind:

- Some 54 percent of Chinese companies list innovation among their top objectives, while only 26 percent of U.S. companies do.
- Small to mid-sized companies have historically been more successful at innovation than larger ones.
- Small innovations add up. When a culture of creative and continuous improvement is always at work, up and down the process from design to assembly, small quantitative changes can become qualitative.

Successful innovation is more than science. Our firm can help you survey your operations for opportunity — and help determine if a new idea is practical