

Press release

Study by Roland Berger Strategy Consultants: **The end of the China cycle**

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New study by Roland Berger Strategy Consultants analyzes the socio-political transformation in China. The Chinese "low-cost" manufacturing cycle is coming to an end

- **In terms of gross domestic product, China will be the world's second largest economy by 2025**
- **The rapid growth of the recent decades will not last forever, though: Certain industries have already passed the tipping point and China is now losing market share**
- **Aging population: By 2030, the labor force will shrink by 100 million, leading to a lack of workers and higher production costs**
- **China is losing its cost advantage because of rising wages, inflation and increasing rising export and transportation costs**
- **Foreign companies should rethink their manufacturing strategy in China**

After three decades of rapid growth, China has become an economic superpower and is poised to become the second largest economy in terms of GDP by 2025. Yet signs are pointing to a reversal of fortune: China's one-child policy, rapidly aging population and shrinking labor force could result in tight bottlenecks in various sectors and higher manufacturing costs. Other factors, such as inflation and high export and transportation costs, also play a key role. Many industries, such as the textile sector, are experiencing a clear reversal. Here, the Chinese share of the global market is already declining. These are the results of the study "The end of the China cycle" by Roland Berger Strategy Consultants.

Foreign companies that have outsourced some of their production to China would be well-advised to re-evaluate their manufacturing strategy. "Right now, the value proposition for many firms in China is disappearing as rising costs are eroding China's competitive cost advantage.", observe Roland Berger consultants.

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Shrinking workforce, higher production costs

Over the past few decades, China has emerged as one of the world's economic powerhouses. By 2025, it could even become the second largest economy in the world: "China's GDP would then amount to EUR 7.6 billion – twice as much as the GDP of Germany and India combined," explain the consultants. At the same time, China is faced with a new challenge: the study also revealed a rapidly aging and shrinking workforce that has resulted from China's one-child policy. One in every four people in China will be older than 60 by 2030. China is moving toward a big demographics problem. While the number of retirees steadily increases, the workforce will shrink 10% by 2030. This means 100 million fewer workers.

In addition, actions by the Chinese government to improve conditions in the interior parts of the country are slowing migration to urban areas. The resulting labor shortage will put increased pressure on wages. Wages in China have climbed by 258% since 1999. Other factors such as labor unrest and strikes have also contributed to this increase.

Tipping point in several industry sectors

Although rising wages are the main driver for increasing costs, the combined effect of inflation and pressure to ease the exchange rate are further accelerating the loss of competitiveness. Added to that are rising export and transportation costs. Since 2006, export costs in China have grown considerably more than in other countries – 49% vs. a global average of just 13%. Transportation costs have also gone up, reflecting higher oil prices and increasing global energy consumption. As a result, Roland Berger experts expect that manufacturing costs in China will grow by 75% between 2010 and 2015 alone.

Even the fact that the Chinese government continues to focus on economic development is a challenge for the traditional low-cost model. Looking at China's economy, we are observing a move away from labor-intensive industries with low value-add. China's manufacturing environment is therefore already in a state of flux: Key industries, such as textiles, have already reached the tipping point and are on the brink of a decline in market share.

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Many companies are therefore looking at neighboring countries, such as Vietnam, for a younger, more reliable workforce, more favorable trade relations and lower production costs. There are still opportunities for expansion within China, but only in industries such as semiconductors, circuit boards and automotive.

Companies should review their Chinese footprint

Although the low-cost cycle is coming to an end, there are many other opportunities in China for companies to save costs. For example, China is increasingly offering tax incentives and land purchase discounts to benefit its central and western regions, as well as high- and green-tech projects. The creation of industrial parks with favorable policies in these provinces is already attracting major investors. International high-tech companies have recently unveiled plans to invest more than USD 3 billion in research and development centers and high-tech manufacturing plants in China.

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For further information, please visit our website www.rolandberger.ro / Publications or contact:

Roland Berger Strategy Consultants
Codrut Pascu
Managing Partner

Str. Dr. Burghelea nr. 5
Tel. +40 21 306 05 00

Andreea Stan
Marketing Advisor

Str. Dr. Burghelea nr. 5
Tel. +40 21 306 05 54
andreea_stan@ro.rolandberger.com