

Serve the People:


The Importance of the Service Industry to China's Economic Growth

By **Laurie Young**, author of *'From Products to Services'*

Activity aimed at stimulating the Chinese service economy is one of the many actions taken by the mainland government in the current worldwide economic troubles. This focus on the service industry in fact began long before the current global crisis. Nearly three years ago the administration announced a massive investment in incentives and financial aid to boost its service sector and lessen its reliance on manufacturing. The State Council said that its intentions were to increase the contribution of services to 50% of the country's economy by 2020. Land approvals and capital bailouts would be given to companies engaged in logistics, information technology, software, electronic commerce, industrial design, law and accounting. These firms would also be encouraged to list their shares in the domestic and overseas stock markets to raise funds for future development. Since then, many Chinese manufacturing companies have suffered badly from the slump in international demand, giving greater urgency to the need to stimulate service growth.

Yet, this interest in a service economy is a sign of success, not recession. It is a normal phase in the development of sophisticated modern economies, prompted by the needs of a growing, more educated and more urbane population. As people grow richer they want better education and housing, improved healthcare, more restaurants, bars, car dealerships and shops that carry goods far beyond the mere basic amenities of life. Increasing prosperity unleashes a creative explosion in new service concepts, which successful businesses want to exploit.

The Chinese service industry is catching up fast. In December 2005, for example, official figures showed the economy to be worth 16 trillion yuan in 2004, 17% more than expected. Interestingly, 93% of the increase was due to the service sector. As the Economist magazine said: "The world's factory, it turns out, has a sizeable canteen attached, not to mention an office block and shopping mall."



As people grow richer they want better education, and housing, improved healthcare, more restaurants, bars, car dealerships and shops that carry goods far beyond the mere basic amenities of life. Increasing prosperity unleashes a creative explosion in new service concepts, which successful businesses want to exploit.

The service sector jumped to 41% of the economy compared with 46% for manufacturing and 13% for primary industries such as agriculture and mining; an increase of 9%. Admittedly, some of this increase was due to the fact that the National Bureau of Statistics had started to track the service sector more closely after its previous emphasis on factories and manufacturing. Yet it reported that growth came from a number of sub-sectors: wholesale, retail, catering, transport, storage, post, telecommunications, real estate, architecture and building services.

So, the Chinese service sector is on course to become as well rounded, varied and large as that in any developed economy. As economies develop, service sector employment becomes more dominant. Before the recent economic catastrophe, approximately 10% of American workers were employed in manufacturing as opposed to 25% in 1970 (employment in services was 80%). The estimates for Britain (14% compared to 35% in 1970), France (15%) and Canada (14%) were similar; with other big economies, like Japan, at 18%. Since a number of workers within manufacturing com-

panies still occupy service roles (like marketing, design and facilities management) the actual employment in manufacturing roles among the developed economies could be much less. The story in agriculture is the same. About two percent of the current American population works in agriculture (as opposed to 90% in 1790) but produces more than at any time in history.

Despite its emphasis on growth and manufacturing, China shed 15 million manufacturing jobs between 1995 and 2005, indicating the start of these trends. As Time magazine said:

“China needs to start creating new jobs by boosting its underdeveloped service sector. In that way, the country can reduce its dependence on exports and continue to grow, thereby increasing its role as an outlet for the goods and services produced by the rest of the world.”

So, Chinese manufacturers are likely to experience the same pressures and strategic decisions as those in the developed economies. There are now very few sectors within the Western economies where service is not important to profit, customer relationships and growth. For instance, suppliers of domestic appliances and electronic entertainment products have learnt to increase profits through guarantees, extended warranty and maintenance. In retail, supermarkets now offer a range of services (such as insurance and legal help) in addition to consumer products. The car industry, on the other hand, having offered associated financial services for many years, has had to take the effect of “after care” on repeat purchase much more seriously. In telecommunications, massive suppliers, like Ericsson, have adopted more of a service orientation; with new services, such as systems integration or charging customers for advice, called in the trade “from fee to fee”.

Many famous manufacturers (such as Nokia, IBM, Unisys and GE) have changed into service providers over the past twenty years. Despite working in very different industries and being of very different size and culture, all have had to re-assess the importance of service to their business. With a product manufacturing heritage, most had seen service as a cost. For them it used to mean either the repair or support of equipment that had been sold to customers (“operational services”) or advising them on how to use that equipment more effectively (“professional services”). Yet, the transition from products to services involves changes to business operations, management, finance, sales, distribution and marketing. Some have accomplished

it through strong leadership from the top and others through gradual steps, prompted by those lower down. Many, though, have not done it well. Research suggests that, although a lot of Western business leaders claim to garner vast revenues from service, a number do not yet make good profits there. This has been caused by a lack of clear strategy, a poor understanding of service business and poor change management. So, although product companies in Western economies have been moving into services for nearly thirty years, many have secretly experienced years of depressed margins as a result. Businesses on the Chinese mainland that take this course will need help if they are to avoid the same damaging mistakes.

Another aspect of this trend towards services opens up large opportunities for businesses on the mainland and in Hong Kong. It is the increasing international service trade between countries. According to the United Nations, world trade in services grew 17% in 2004 and 14% in 2003. This followed a spell of annual growth at around 6% per annum between 1990 and 2003. A number of companies in nations like India been able to succeed at exporting service. They have started, with the help of their government, to offer cheap services to western companies. As they have gained experience, though, they have improved the quality of their offers and gained more sophisticated customers. Now they are able to offer cheaper but higher quality services to customers in Europe, Australia and America. If Chinese business leaders can take similar, progressive steps, they should be able to enter these large service markets, dominate them and succeed against stodgy, Western service businesses.

The Hong Kong economy is, of course, already dominated by service businesses. They are familiar with the dynamics of a wide range of services; from financial, professional and business services through to retail and hospitality. They are positioned well to help and advise Chinese manufacturers on the nature of service business and might also act as a gateway into the vast service markets of the West.

Laurie Young has held senior positions with BT, Unisys and PricewaterhouseCoopers. He also founded, built and sold a company. He now divides his time between writing, teaching and consulting, setting aside a limited number of days to advise on business issues. Over the years, clients have included: Deloitte, Ericsson, Microsoft and American Express. His fifth book “From Products To Services: Insights and Experience from Companies which have Embraced the Service Economy” was published by Wiley last year and is now available in a Chinese translation.

Contact: www.lauriedyoung.com