EDITORIAL

THE RISE OF CHINA

To the casual observer, the recently concluded NAMM show looked pretty much like every other show of the past five years. Manufacturers enthusiastically hawked their latest wares to semi-skeptical dealers against a backdrop of slick displays and the din of endless demos. In fact, cruising up and down the aisles, it was hard to avoid the feeling of déjà vu. However, beneath this comfortable veneer of similarity a major upheaval was underway that promises to reshape much of the industry. Specifically, we're referring to the flood of Chinese-manufactured product on display.

At *Music Trades* we began chronicling the migration to lower-cost manufacturing environments with our first issue in 1890. Back then the hot story was whether Chicago-based piano makers, with their cheap labor and better access to raw materials, would threaten more established New York firms. In the years following World War II, we reported on factories being moved from Northern states to places like Arkansas, Mississippi, and Tennessee. In the '60s and early '70s we charted the rise of Japan as a major producer of guitars, pianos, and all forms of electronics. The '80s was the decade of Korea and Taiwan as the two nations shared the mantle of the world's low-cost producer, with Korea specializing in pianos and guitars and Taiwan turning out drums, wind instruments, and electronics. As we begin the new millennium, China has emerged as the new force to be reckoned with.

The rise of China as a source of supply differs from the rise of Japan, Korea, and Taiwan for two significant reasons. First and foremost, by virtue of its immense size China has the indigenous talent and resources to participate in every segment of the industry. At this year's NAMM show Chinese-made goods were available in every product category: pianos, guitars, band instruments, pro-audio, and even electronic keyboards. While the Chinese have yet to acquire digital engineering skills, Chinese factories already assemble hi-tech gear for a significant number of prominent manufacturers.

The second reason for the rapid rise of China has to do with contemporary manufacturing methods. Thanks to readily available digital production machinery, it no longer takes years to develop the human skills necessary to achieve the requisite level of productivity and quality. More specifically, a machine that can carve violin tops or piano bridges with absolute precision reduces the need to train a large workforce capable of executing these tasks by hand. To get an idea how this technology speeds the process of launching a factory, just compare the experience of Japan and China. Yamaha began building pianos in the 1890s, but more than 70 years would elapse before the company began exporting to the U.S. Large-scale piano production in China didn't get started until the mid-1980s, yet today Chinese manufacturers have a significant share of the U.S. market. The difference in time frame can be traced directly to the quality of the tools on the factory floor. We cite only pianos, but similar scenarios are playing out in every other segment of the industry.

As Chinese production expands, manufacturers around the world have to rethink their entire structure. An American factory worker earns about $10 an hour. His counterpart in China makes less than a tenth of that. Given this reality, there is no way a U.S. production facility can win in a price war. Thus, American firms are scrambling for other ways to compete, typically with some combination of brand prestige and technological innovation. Needless to say, this isn't an easy task.

Down the line, retailers will face challenges, too. Eye-popping price reductions from Chinese factories will probably force selling prices down to below current levels. Economists like to talk about the "elasticity of demand," which in layman's terms means that when you cut prices people buy more. Unfortunately, experience suggests that a 20 percent price reduction on an entry-level guitar, from say $119 to $95, will not attract 20 percent more customers. Do retailers face the unpleasant prospect of selling more units just to produce the same dollar volume?

As the year begins, we face something of a good news/bad news situation. The good news is that consumer demand remains far stronger than many expected. The bad news is that finding a way to profitably fill that demand is getting harder.

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