Industrial Clustering in China:
with Special Reference to Wenzhou Footwear Cluster

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Outline

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2. Local clustering in China
3. Wenzhou footwear cluster
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1. Introduction

Clusters: Successful organization forms (?)

- (Innovative) districts and clusters have proved successful organization forms for firms, institutions and communities, representing important arenas for the traditional local vs. global contest.
- They emerged or established in both industrialized and developing countries, relating to old-and new-economy secondary and tertiary industries.
1.1 Topical issue

- Economic activities in varieties of industrial sectors and localities are embedded in a complex relations between local and global networks, developing across a multiplicity of socio-cultural and institutional contexts.
- The global linkages generating the local clusters do not always concord with the local context.
- What is needed is developing core competencies through radical innovation and embedded localization.

1.2 Cluster definition, effects and categories

- **Industrial cluster referred to a group of proximate and inter-related firms and associated institutions.**
  - **Local linkages:** Firms in the group must be linked by traded interdependence (input-output relationships) and/or untraded (social and cultural) interdependence around a core activity.
  - **Proximity:** The group located in a geographical proximity to one another. The group basically generates external economies and may or may not further create opportunities for mutual learning, enhances the levels of trusted co-operation and fosters innovation.
The effects of cluster/agglomeration

■ The basic effect:
  - Cost reduction
    ■ Generate advantages of scale and scope, e.g. development of general labor markets and specialized skills
    ■ Enhanced linkages between suppliers and customers.

■ A further effect:
  - Facilitate the “learning economy”.
    ■ Industrialization is a territorial process
    ■ Innovation as a social process.

The Difference between clusters in developed and developing countries

■ The kind of market niches are different.
■ The trust atmosphere is different.
■ Contrasting growth paths:
  - Innovative/creative clusters: synonymous with innovation, high quality, functional flexibility and good working conditions
  - Survival clusters: based on competing on the basis of low prices, cheap materials, labour flexibility and cheap labour.
1.3 Cluster formation in developing countries: concentrated dispersion

Global dispersion

Local concentration

Concentrated dispersion

Global outsourcing

Local Manufacturing

Clustering effect
(Positive-negative)

Actors: Local Entrepreneurship, Government, Industrial association

Actors: MNC flagships

Power Imbalance?

industrial clusters may only be considered as facilitating factor for subsequent developments (which may or may not occur).

1.4 Substitutable parks vs. territorialized innovative clusters

- Industrial parks generally are substitutable locations, even cheap-labor platforms, but not territorialized innovative clusters.

- There is a trend of investment shift toward clusters in locational choices.

- When activities are located in places isolated from other firms in the same field, the challenge is to build a cluster.
1.5 China's clusters: toward innovation

- China's global advantages are moving well beyond cheap labor and land. A fine geographical division of labor exists among industrial clusters.

- Industrial clusters do not automatically lead to innovation; in contrast, they would act well as supply-chain cities for multinationals, where the knowledge hide in the fixed products.

- To define the circumstances in which local upgrading strategies can be expected to succeed or fail is necessary.

Policy towards clusters

- Supporting existing and emerging clusters rather than trying to create them from scratch.

- A policy aimed at developing entirely new groups of firms in selected sectors can entail high costs and high risks.
A need for tailor-made policies

- Current global trends pose a challenge for policy-makers in general, and for cluster policy in particular.
- Since different territories display different organisational features, e.g. clusters/industrial districts and industrial parks, there is a need for industrial policies to be tailor-made for each environment.

2. Local clustering in China
2.1 Distribution

Along the pathway to China’s export-oriented industrialization there are two types of agglomerations:
- Industrial parks, or “induced” by top-down intervention and created by government (urbanization-based).
- “Natural” clusters formed from the bottom up (localization-based and created by market).

China’s industrial clusters:
distribution in different sectors and different activities

From low-tech to high-tech
From weak creative to strong creative

Textile and garment
Footwear
Furniture
Bicycle
Jewelry
Eyeglasses
Cigarette lighter
Umbrellas
Lamps
watches and clocks
...

E-equipment
Auto parts
Notebook computers
...

Software
Animation
...

Low value added

From manufacturing to design and R&D
Industrial clusters/districts in China's selected provinces

Remarkable specialization

- These days, buyers from New York to Tokyo want to be able to buy 500,000 pairs of socks all at once, or 300,000 neckties, 100,000 children's jackets, or 50,000 size 36B bras.

- Increasingly, the places that best accommodate those kinds of orders are China's giant new specialty cities.

Formation of clusters: Local forces

- **Industrial cluster/districts formed in those regions**
  - high efficient market environment, law system is good
  - entrepreneur climate is good
  - culture respecting knowledge and talent, stressing credit, encouraging individuality development and creation
  - social capital – trust
  - incorruptible, self-discipline, honest and high efficient government service
  - industrial association is active

- **No industrial districts in those regions**
  - no clearly defined and secured property rights
  - imperfect market environment
  - over heavy intervention of the state
  - Bureaucratic networks sometimes have only one-way, top-down links.

2.2 Challenge and Dilemma for China

- **Challenge:** how to meet intense global competitive pressure while avoiding the “low road” based on cost reduction

- **Dilemma:** the independence of innovative action and reaping the benefits that could come from the technological advancement of developed countries. Multinational companies can choose to locate activities anywhere, including innovation-related activities.
New challenge since 2007

- The rise in business failures
- Weaker demand from the developed countries
- Stronger Chinese currency
- Tougher safety standards
- ......

2.3 Relocation/upgrading in situ

- Soaring costs of raw materials, land and labor......

- Relocation
  - Many clusters are highly efficient and unique in the world. Production costs can be kept at low levels due to clustering, and buyers stand to benefit.
  - Collective relocation is happened

  - Any relocation of factories from these clusters without careful planning will not be able to benefit from the clustering effect and may result in higher but not lower costs.
2.4 Cluster learning and upgrading

- Local clustering and global production networks are not only compatible but mutually reinforcing.
- Latecomer firms in developing countries can vertically integrated in global value chain and horizontally integrated in local cluster.
- China's clusters are engaged in learning and upgrading.

3. The case:
Wenzhou footwear cluster, Zhejiang Province
3.1 Co-located industrial districts/clusters

- A cigarette lighter making district, nursing 260 companies accounts for 70 per cent of world production;
- A district of eyeglasses-making, nursing 500 companies, 90 per cent of its eyeglass products are exported every year;
- A district of pen making of more than 100 companies, supplying one-third of China’s domestic market;
- A town named Liushi, where 3 thousands of companies produces one third of Chinese low-tension electrical machinery.
- A town named Yongjia has the reputation as “the world capital of fastener”.

3.2 Entrepreneurship: “Wenzhou Spirit”

- Wenzhou: remote location and poor resource endowment
- Historically, there are two ways for most of the local peasants to make a living - fishing on the sea or doing small business throughout the country.
- Thanks to the more liberal attitudes of late 1970s towards entrepreneurship, the SMEs in Wenzhou developed in an amazing speed.
- The second momentum was the founding of the Wenzhou Lucheng Association of Footwear Industry in 1988.
3.3 Wenzhou Footwear Industrial Cluster

- Wenzhou’s footwear products account for 1/4 of China and 1/8 of the world.
- More than 300,000 people in Wenzhou are employed in the footwear sector.
- Half of Wenzhou’s total product value are concentrated in Lucheng District, a central part of Wenzhou city.

Export Value of Main Export Commodities

- Shoes Made of Cloth and Rubber
- Leather Shoes

[Chart showing export values for different commodities from 2004 to 2007]
3.3.1 Local division of labor

- Suppliers:
  - specialized products at short notice;
  - raw materials and components;
  - second hand machinery and spare parts;

- Producer services in technical, financial and accounting matters;
  - Sell to distant national and international markets by agents

- Associations providing services and lobbying for its members.
The distribution of shoes production areas in Wenzhou

- Industrial park in central Shoes-polis
- Industrial parks for shoes
- Soles production area
- Accouterment production area
- Tanning industrial area
- Shoes material market or Shoes market
- Major shoes enterprise

Wenzhou dummy shoes cremation event (1987)

- Wenzhou has its 500-year-history of shoe production.
- In the 1980s when shoes in short supply in China, many dummy shoes came out from black factories of Wenzhou.
- The angry customers cremated Wenzhou-made dummy shoes in the Hangzhou City Gate of Wulin in 1987.
- Since then, the shoes makers in Wenzhou have realized the products should meet quality standards.
3.3.2 Wenzhou Association of Footwear Industry

- Act as the bridge between the government and its members, the association influencing the cluster greatly and enhancing the reputation of the Wenzhou shoes products.
- The Association has made great efforts to improve the shoes' quality, helps the members to open up the markets both at home and abroad, build and strengthen the electronic information facilities etc.
- The collective efficiency and the synergy of local production network are achieved.

3.3.3 Local government

- At the beginning the governments of Wenzhou have simply told people to do any legal business to get rid of poverty and to be enriched. Under such kind of laissez-faire institutional environment, the private-owned township firms in the rural area of Wenzhou boomed.
- The government has promoted firms to implement the strategic plan to upgrade their capacity of technology and management and to build their trust capital. This has greatly stimulated the shoe companies.
- Brands have been rising among the top ten in China and penetrated the national market.
3.3.4 The role of Specialized Market

- The specialized market, a unique space in most of the important industrial clusters in China. The growing production also contributed to the establishment of local specialized markets which, given the general shortage of consumer goods in the country, soon became national distribution centers of specialized goods.

- Compared to transaction markets in other developing countries, the high intervention of the public sector can be pointed out as the most characteristic feature of the specialized market.

The Number of Stalls and Annual Transaction Value of the Shoe-Material Market in Wenzhou

<table>
<thead>
<tr>
<th>Commodity Exchange Markets</th>
<th>The North Zhejiang Shoe-Material Market</th>
<th>Wenzhou Shoe-Material Market</th>
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<tr>
<td></td>
<td>Number of Stalls</td>
<td>Annual Transaction Value (RMB 1 million yuan)</td>
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<tr>
<td>2007</td>
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<tr>
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<td>675</td>
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<td>2004</td>
<td>675</td>
<td>26.34</td>
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</tbody>
</table>

Data Source: The Statistic Year Book of Wenzhou
3.4 The challenges for a sustainable and upgrading cluster

- The barrier of anti-dumping
- The barrier of eco-standard
- The problem of low-tech
- The lack of the awareness of innovation
  - Call for a further joint action

4. Implication for developing countries
Implications of China’s industrial clusters

- Industrial clusters in China benefit both MNCs and NIS.
- The key task facing China should be to foster innovative industrial districts instead of building more “low road” ones.
- Developing countries need to learn as quickly as possible not only in adopting lessons from other industrial districts but also in seeking to position local industries in the global value chain and in strengthening their competitiveness in the global market.
- Policies need to differ for different sectors.

Towards innovative and creative clusters

- The shift from world factory to world studio, from low cost manufacturing to design specialization capability, from production to services is now a key policy platform.
- Clustering had become a policy panacea for economic development commissions and local governments looking to create new enterprise and wealth.
Thank you.