The People's Republic of China: A Fragmented Landscape

RESEARCH INTERNATIONAL

Welcome

Anyone with an interest in business is sure to have heard some impressive facts and predictions about the Chinese economy. It's the largest consumer economy in the world. The country might be the world's largest exporter by 2010, and the world's most popular tourist destination by 2020.

These are fascinating bits of information but do they actually help us understand China? To turn facts into insight you need the experience of working in the country. In 1990 the Chinese government gave my company the first ever license for a commercial market research firm, and I've been working in China ever since, watching its market and its consumer attitudes change as its economy grows.

It may be a cliché, but China is different: to take advantage of its future prosperity you need an experienced perspective on the challenges business faces there. One of the starker challenges is distribution: the sheer size of the Chinese market means that a uniform marketing strategy is almost impossible. Brands that do not take the gap between major and third-tier cities into account, for instance, are far more likely to fail.

These two pieces, which previously appeared in Research International's regular client magazine, focus on two sectors – mobile phones and cosmetics. They offer some insights as to what marketers need to do to succeed in this most complex of markets. I hope you find them interesting.

Gilbert Lee
CEO Research International, China

Retail in China: a

Nobody should need reminding of how important Ch
understanding of the Chinese retail chain holding glo

It has been widely reported that multinational companies are spending a significant proportion of their marketing budgets in China. It is also well known that they are not necessarily winning the battle against their increasingly marketing savvy local rivals. This is particularly true in the third tier and rural cities. Research International believes that in addition to focusing on advertising and new product development, multinationals need to devote more resources to their channel strategies. No matter how successful multinationals are in convincing Chinese consumers that their products are worth buying, if they are not available in the shops then a lot of money will have been spent for minimal returns.

The sheer size of China, in both territory and population, makes marketing there far from simple. The level of economic and social development in different regions and cities varies enormously. This leads to significant differences in the types of retail environment found in different locations, which in turn has extensive influence on consumer shopping habits.

China completely lacks an efficient national distribution system. The channel infrastructure of the country is dominated by regional and provincial players whose level of organization varies hugely. There is no single distributor with national reach so manufacturers are forced to deal with large numbers of intermediaries across different regions. Smaller cities and rural areas are particularly poorly served by the distribution chain. The upshot for multinationals is generally higher costs and a lack of effective control over how their brands are marketed and perceived in the retail chain.

The history of China's mobile phone market shows how in practice this impacts on channel structure and consumer behaviour.

International brands initially secured a lion's share of the emergent mobile market in China. In 2000, the big global players such as Motorola and Nokia enjoyed a 90% market share, but by early 2004 about half the mobile phones sold in China were local brands. As the overall market expanded the big brands lost ground, particularly in the smaller cities and rural areas. Our experience at Research

If the products are not available in the shops then a lot of money will have been spent for minimal returns

International in China suggests, however, that even in these cities global brands are still seen as being higher quality and have higher overall preference. However, consumers' familiarity with, and knowledge of, local competitors is higher. If this lies behind the dwindling Chinese market share of the big players it must be a sign that preferred brands are simply not reaching local retailers in big enough numbers. The global manufacturers need to understand the differences in channel structure between larger and smaller cities.

Mobile phone sales in bigger Chinese cities are concentrated in chain stores and department stores. These offer the consumer the reassurance of a genuine product, wider product ranges, value for money and more after-sales services. Their distribution networks are generally efficient. In the smaller cities the market is typically more fragmented with smaller independent stores and local

a fragmented landscape

THE ISSUE

China is likely to be to 21st century multinationals. But is a lack of global brands back? **Gilbert Lee** and **Karen Que** take a closer look.

marketplaces accounting for a significant amount of phone sales.

So, how do manufacturers deal with these fractured markets? Our surveys suggest that global and local manufacturers approach channel management in small regional cities in very different ways. Local manufacturers have been placing more emphasis on a "push" strategy to local retailers – for example, hiring sales people to approach stores directly and offering better gross margins than the international brands. Their global rivals meanwhile have more often used a "pull" strategy with higher investment in advertising. This works well in larger cities but in smaller ones it is less effective, as the advertised phones are less likely to have actually made it to the shelf.

International brands tend to use advertising to project a modern urban middle-class lifestyle, which works well in establishing an aspirational, premium image for the brand but does not communicate concrete knowledge about the product's advantages. This is a crucial disadvantage – in less developed regions the overall level of product knowledge is low so information and deals offered at point of sale are a lot more important. Consumer behaviour in China's smaller cities is characterized by an unwillingness to 'lose face' by asking too many questions in stores. The local brands, with their "push" techniques, are well placed to take advantage of this.

They also tend to have a price advantage. This is not just because of global brands' premium positioning, but also because international manufacturers are forced to use a multi-level distribution chain thus their costs to get to market tend to be higher than smaller local brands. This makes them less attractive to independent retailers, who therefore respond slowly even when advertising has influenced consumer demand for the global brands.

Problems with distribution can affect everyday consumer goods brands as well. Toothpaste sales, for instance, occur as part of a regular shop and customers are generally store-loyal. Research suggests that while 60% of shoppers choose their toothpaste brand before purchase, a large chunk of the market bases its choice on packaging design and information. This makes in-store visibility a crucial factor for manufacturers, but the same distribution problems plague the supply chain. In larger cities manufacturers can deal with growing supermarket chains, but in smaller cities and regional outlets a multi-tier, disunified distribution network stymies them.

Target audiences in China can be effectively marketed to by global brands. Unfortunately it cannot be taken for granted that these brands will actually be available to their potentially huge audience. Global brands need to work hard and smart to make it happen.

So what do we suggest? The main retail problem facing global brands in China is the uneven and complex distribution networks in smaller cities and less developed regions. Multinationals need to adopt a two-pronged strategy for dealing with this. Firstly, they should support the ongoing efforts of local large retail chains to improve their distribution networks and increase their presence in these local markets. In the past these chains have been very transaction-focused. However as they expand they are looking for partnership with manufacturers. International brands are well-positioned to take advantage of that, and thus cut through some of the local distribution headaches.

The second part of the strategy should involve a greater focus on "push" marketing to build up brand presence at point of sale in small regional markets. This inevitably means a larger investment in the sales force, and also smart thinking in terms of sales promotions,

Consumer behaviour in China's smaller cities is characterized by an unwillingness to 'lose face' by asking too many questions in stores

range management and product placement. This might mean training salespeople to have more of a 'street market' mentality in terms of promotions – a classic example being a mobile phone customer who switches brands on the promise of a free badminton racquet worth less than 5% of the phone!

The aim should be not only to increase sales but to build up brand knowledge among the consumer base i.e. hard information that an aspirational advertising strategy cannot deliver. So, in-store information packs and tailored brochures and leaflets will also play a part.

Retail in China is not an insoluble puzzle, but the country is not yet at a stage where a 'one-size' strategy can work. Multinationals generally have their communications strategy right, but unless they approach regional consumer attitudes and the maze of local distribution systems the battle will remain half won. ■

Gilbert Lee
CEO Research International, China
+86 21 6417 3035 / 3038
gilbert.lee@research-int.com

Karen Que
Marketing and Knowledge Management Manager, China
+86 20 8385 9898
jianping.que@research-int.com

RESEARCH INTERNATIONAL