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Special Report

SELLING IN CHINA





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Selling in China

China's 1.3 billion consumers are at a crossroads. They are embracing new economic ideas and habits, and devouring goods that have long been unavailable, unaffordable or forbidden. At the same time, they are part of a culture and an economic system that remain quite different from those of developed countries.

In this special report, experts from Wharton and Boston Consulting Group offer insights on how Chinese consumers are evolving as the market develops; what companies need to know about navigating China's convoluted sales and distribution systems; and the advantages emerging Chinese companies have over Western competitors, even as these firms face their own difficulties in entering the global marketplace. Also, Deepak Advani, chief marketing officer of Lenovo, and Hal Sirkin, senior vice president at BCG, discuss the advantages of tailoring products and messages to local markets in China

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Despite rapid urbanization and the emergence of a strong, status-conscious middle class, experts from Boston Consulting Group and Wharton point out that China is still "a country of extremes," where it pays to understand the differing habits and mindsets of the rich and poor, as well as the subtleties of consumer rationales for trading up and down when making purchases.

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Because it is so difficult to generalize about Chinese consumers, multinational companies using global "one-size-fits-all" marketing strategies seem destined to fail in China. Knowledge@Wharton spoke with Deepak Advani, senior vice president and chief marketing officer of computer manufacturer Lenovo, and Hal Sirkin, senior vice president of BCG and leader of the firm's Global Operations Practice, about strategies for selling to Chinese consumers. The key, they point out, is to tailor products and messages to local markets.



One Billion, Three Hundred Million: The New Chinese Consumer

One Billion, Three Hundred Million

customers: It's a number that has captured the attention of every company in the world that wants to do business in China, hoping to market everything from toothpaste to financial services to luxury cars. But once multinational companies get past the excitement of imagining the opportunities offered by the world's largest consumer market — growing richer and more status conscious with each passing year — there is the sobering thought of figuring out how to go about unlocking the secrets to selling to all of these people. Who are they? How much money do they have? What do they want to buy? What motivates their purchases? What are the peculiarities of the Chinese consumer?

Experts at Wharton, the Boston Consulting Group and elsewhere say China's consumers are at a crossroads. They are embracing new economic ideas and habits, and devouring goods that have long been unavailable, unaffordable or forbidden. At the same time, they are part of a consumer culture and an economic system that remain quite different from those of developed countries. In broad terms, there are multiple Chinas — the old and the new, the urban and rural, dirt-poor peasants and multimillionaires, a land of freedom and authoritarianism whose world outlook and savings and buying preferences reflect the traditions of both East and West.

A Country of Extremes

China is rapidly urbanizing but it is still a "country of extremes," says Hong Kong-based Hubert Hsu, vice president and leader of BCG's consumer goods and retail practice for the Asia Pacific region. China is home to 1.3 billion people, but only about 400 million are in urban areas. In urban areas, incomes have been growing at the same rate as GDP — about 10% annually, adjusted for inflation — in recent years, while incomes of rural people rise only 1% a year. Says Hsu: "It's a land of haves and have-nots."

Wharton marketing professor Z. John Zhang agrees. "The distribution of income is very uneven," he says. "There still is a tremendous difference in wealth between people in the city and the countryside. Even within cities you find huge disparities in income. This is a phenomenon you can't lose sight of if you're selling consumer goods. You have a billion customers, but they're not all the same."

"It's a land of haves and have-nots."

—Hubert Hsu, vice president and leader of BCG's consumer goods and retail practice for the Asia Pacific region

If China is a country of extremes, it is also a "country of contradictions," notes Harjot Singh, ad agency BBDO's strategic planning director for China. Consumers want products that are practical and work well, but they also covet brands that convey images of success. "Functionality of products still commands a premium," he says. "Yet Chinese consumers also want products that make them unique."

"It's difficult to generalize overall about Chinese consumers," says Joseph Wan, director and vice president of BCG in Hong Kong. "Companies are only beginning to realize the differences among consumers. In terms of geographical segmentation, most companies are pretty good at understanding that consumers in the western versus eastern parts of China are different. But there are so many intricate nuances that it's almost impossible to generalize — and things can change so rapidly."

At the same time, a strong middle class is emerging. BCG estimates that there are 25 million to 30 million middle-class households in China, compared with 8 million affluent homes. "More

people are moving into the middle class every year than into the affluent class,” according to Hsu. “In general, the growth in middle-class incomes has been one of the key drivers behind the growth in a lot of consumer categories: color TVs, beer, mobile phones, personal computers. These are categories that enjoy high penetration in China.”

A BCG report published in December 2005 — titled “Wealth Markets in China: Exciting Times Ahead” — shows that wealth in China is highly concentrated. Less than one half of 1% of Chinese households holds more than 60% of the nation’s personal wealth. Among these rich households, about 70% of the wealth is held by households with more than \$500,000 in assets under management.

In all, 1.59 million households have \$500,000 or more in assets under management, according to the report, prepared by BCG consultants Tjun Tang, Thomas Klotz and Thomas Achthorner. Some 250 million households have \$100,000 to \$500,000 in assets under management, and 527 million “non-wealthy” homes have less than \$100,000 in assets under management.

In recent years, the richest Chinese have gotten richer — a trend that shows no sign of abating. “There is a polarization of wealth taking place,” says Tjun. “The Chinese say, ‘the two poles are separating.’”

But, significantly, the report also notes that the non-wealthy households are not getting poorer. Since 1999, households with assets under management of more than \$5 million have grown from a 14.3% share to a 16.6% share of China’s personal wealth. During that same period, non-wealthy households have accounted for a steady 36.6% of all wealth.

“China is going through an economic boom period and that’s driving a lot of consumer behavior changes,” says Hsu. “And this boom has been going on for 25 years now.”

Since 1980, Chinese GDP has been growing 10% a year, on average, after adjusting for inflation. Per capita income in China has grown by a factor of seven during this period, a pace greater than that enjoyed by Japan in the quarter century following World War II. Still, it is important to note that most Chinese are very poor, and even many working couples strain to make ends meet, according to Wharton management professor Marshall Meyer.

“At the top, there’s a lot of wealth,” says Meyer. “Folks engaged in entrepreneurial ventures, particularly ventures where they connect MNCs (multinational corporations) with the large state enterprises,

have been able to make money. But the average family probably feels like the average family in the U.S. — less well off today than a few years ago. Now, people are optimistic in China, but there’s a tremendous squeeze on family budgets, and the squeeze is due to medical and education costs and the skyrocketing cost of housing. Combine these with the need for families to save for retirement. Under the one-child policy, you’ve got an inverted pyramid with one child supporting four grandparents, in principle. People have to sock away a lot of money for retirement. And returns on savings are extremely low in China, so people have to sock away more.”

Middle-Class Growth

Nonetheless, the growth of the middle class is good news for companies selling in China. The Chinese middle class numbers 25 million to 30 million households, according to BCG. BCG defines the “middle class” as those households with an annual income of \$4,300 to \$8,700. “Mass affluent” households are those with incomes of \$8,700 to \$11,600. “Affluent” households earn at least \$11,600 a year.

Middle-class Chinese are both savers and spenders. Since China’s financial-services sector remains relatively primitive, and consumer credit is still virtually non-existent, consumers squirrel away money for long periods of time so that they will have enough to purchase the highest quality products and services they can afford.

Noting that the personal savings rate in China represents a whopping 50% of GDP, BCG’s Hsu calls China “a culture of extremely frugal people. They’ve gone through hard times, starting with the Cultural Revolution [under Mao Zedong] in just the last generation. Most never went to university.”

On the whole, Chinese have more money than ever before. But because the days of harsh poverty are not that far behind them, many middle-class consumers insist that products be practical in nature and function well, according to Hsu.

At the same time, however, people are beginning to look beyond the functionality of goods. Middle-class and affluent consumers spend much of their discretionary income on items that will help them rise in stature compared to their neighbors. “Incomes have increased so much that some people have already taken care of their basic needs,” according to Wharton’s Zhang. “Their aspirational level is much higher now. They’re looking to consume things

that are not entirely necessary. Yet the Chinese are also frugal and will reject products they see as impractical or of low quality.”

Some of the most popular products among the middle class and affluent are color televisions, mobile phones and personal computers, according to BCG consultants. Providing schooling for children is also vital. “Education is always a priority, since Chinese couples can only have one child [by government decree],” Zhang notes. “Parents are always concerned that they don’t spend enough to give their kids a head start.”

People with the means to do so also tend to spend a lot on real estate, an outgrowth of the importance that the Chinese, in what is still a largely agricultural nation, have always placed on land. It is not unusual for wealthier city dwellers to have multiple apartments or houses, Zhang says. Affluent Chinese also enjoy traveling in Asia and around the world. China has become one of the largest tourist-originating countries in the world, adds Zhang.

Eye-Opening Behavior

Hsu says a visit to a middle-class Chinese home can be an eye opener into the idiosyncratic behavior of consumers. “You see amazingly insightful things — where consumers trade up and trade down. Actually, they do both at the same time because there are not enough dollars to go around. A couple with a child will spend a lot on that child. If you go into homes without kids, you see that people spend their money on products that make them feel and look good or give them social status. It can be clothes, mobile phones, fragrances or skin-care products. They don’t spend money on products their friends and neighbors can’t see. They may not be willing to pay premium prices for brands like Windex window cleaner or Kiwi shoe polish.

“It’s important for companies to segment consumers and understand where they’re willing to trade up and trade down,” Hsu says. “Chinese consumers are experimental. They will pay a premium price for a new brand to try it. But if it’s not better, they won’t buy it again.”

Instead, the buyer will go back to using his or her local brand of laundry soap or dish detergent. Brands like Safeguard soap and Tide detergent are national brands, and they are so popular now that they dominate their share of the market. But many local brands exist in China, especially in less cosmopolitan regions where many of today’s city dwellers grew up. In local or regional markets these

homegrown products offer consumers choices that can compete strongly with global brands.

Companies must also pay attention to how the Chinese shop. “For some items they go to the store more often but spend less, and vice versa,” says BCG’s Wan. “It’s a very complicated picture. The rate at which they adopt certain products will also change by demographics, and they have different behaviors across price points and brands.”

By way of further explanation, Wan echoes Hsu’s comments about the unpredictable, ever-changing way in which Chinese consumers trade up and trade down. This is one key difference, by and large, between Chinese and American consumers and it is the kind of behavior that can make life challenging for corporate marketers. Says Wan: “A Chinese consumer may say, ‘I can trade down on my car.’ He may decide that a car is no longer important, even if he is making more money than he ever has before. If he has additional savings or income, he might decide to buy better kinds of wine [to impress other people] and spend less on a car. He is balancing his portfolio, so to speak. This happens all the time, across demographics and incomes.”

Selling to the Affluent

Some MNCs, such as Procter & Gamble, General Motors and Carrefour, have had success in penetrating China’s mass market. But makers of luxury goods have yet to fully exploit China’s growing affluent class.

“There is no way that luxury companies are paving the way in China in terms of penetration,” according to Hsu. “Because luxury-goods companies are not doing a very good job of presenting their products in China, customers go to London or New York to spend money. In China, a lot of these companies give what I call a ‘constrained offer.’ If you go into a store, the amount of merchandise is a third of what you see in same store in New York or Hong Kong. Of course, luxury-goods companies are glad people are spending money in New York, but they can’t target them and get information on them or send them brochures and so forth. They’re missing opportunities.”

Hsu estimates that there are at least one million Chinese with access to \$1 million in cash. He adds that Bentley sold more cars in China than any other country in 2004.

Even though practicality still reigns when it comes to product choice among Chinese consumers, the emotional and social benefits derived from shopping, so well known to Western consumers, are

growing in importance, says Singh, the strategic planning director for China for BBDO. The growth of the economy is changing “the way people look at buying brands and the way they look at themselves as people with money,” he says. Even in the years immediately following the economic liberalization begun by Deng Xiaoping in 1978, people viewed money exclusively as a means of security and a “protector,” giving little thought to luxury. In recent years, however, Chinese have come to see that money can be an “enabler” and that economic freedom means, in part, the “freedom to be wooed by brands.”

Many Chinese citizens, especially the affluent, “have become extremely aggressive, demanding, high-maintenance consumers,” explains Singh. “Instead of controlled consumption restraint and denial, there is much more affluence. There’s this need to seek some form of expression by buying brands and wearing them as a badge.”

But Singh puts a different twist on the need by affluent Chinese to buy brands. Brands are important — not necessarily because people need the esteem and want to stand out, but because they actually want to fit in with everyone else who buys brand-name goods. This has led to a form of anxiety heretofore unknown in China. “It’s been called ‘consumptive anxiety,’” says Singh, who defines the term as the need for people to buy products so as “not to be left behind.”

Citing the work of Helmut Schutte, professor of international management at INSEAD in France, Singh notes that the “hierarchy of acceptance and belonging” is inverted in China when contrasted with the West. “The higher-order needs in China are still collective rather than individualistic. Everyone in China wants to conform to standards in a way that gives them social acceptance. Therefore, symbols become important. People want to subscribe to success. For brands to make a dent over here, it’s no longer a game about creating esteem, it’s a game about creating popularity.”

According to Singh, some of the most popular luxury brands in China — not only in the largest, so-called “tier one” cities like Shanghai and Beijing, but also in tier two cities in the interior of the country — are BMW, Giorgio Armani, Rolex and Louis Vuitton. “Vuitton is trying to open a least three stores a year in China,” says Singh. “The number-one brand of clothing is Armani, and not just in the tier one cities.”

De Beers is another popular brand. Its diamond engagement rings are big sellers, even though the concept of Western-style engagement prior to marriage does not exist in China. A De Beers ring is not a gift from a man to his fiancée; it is a symbol of love and commitment. “People understand that wearing those engagement rings gives them ‘face’ outside [the relationship] — acceptance and validation.”

Another well-known brand with an unusual image in China is Procter & Gamble’s Oil of Olay. Oil of Olay, the top advertiser in China, is an aspirational brand, not a common drug-store brand as in the United States. “In the West, Oil of Olay is about telling women to love their skin,” Singh notes. “Here, the ads say, ‘Oil of Olay will get you a handsome husband.’”

What makes China a complex challenge for marketers is the need to position products so that they are accepted by the largest number of consumers yet are still differentiated, according to Singh. Oil of Olay does just that. “The number-one challenge in this market is to achieve consistency of brand communication, yet permit sufficient flexibility to meet specific needs of individual markets within the bigger China market. For different targets there are different products and for different products there are different tasks.”

Beginning in December 2006, foreign financial services companies will enjoy some of the most exceptional business opportunities in China, and Chinese institutions will be pressed to respond to the competitive pressure. That is when the Chinese banking industry will be fully liberalized, allowing foreign institutions to serve individual customers in businesses using the renminbi.

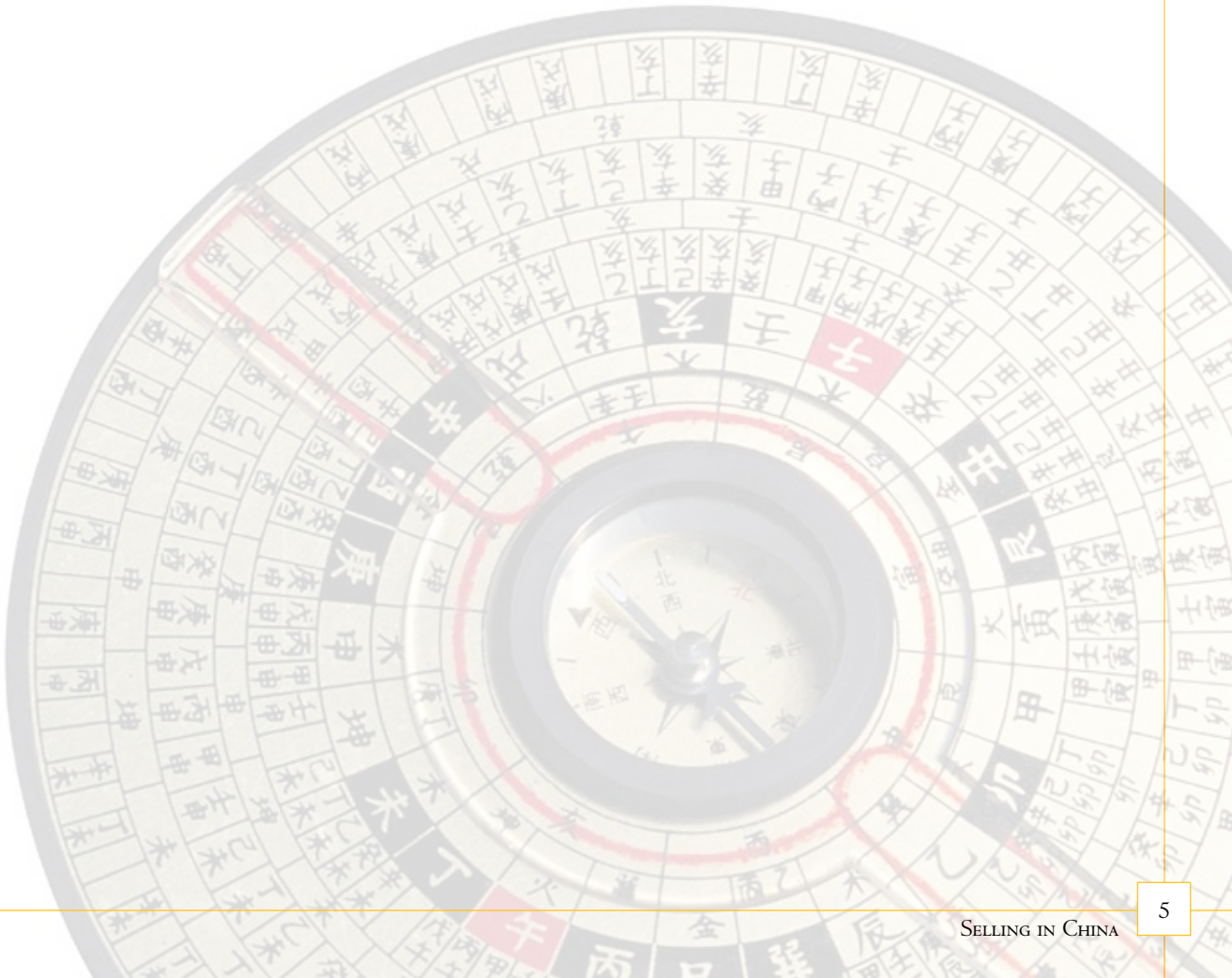
In the report “Wealth Markets in China,” the BCG authors say China represents the second largest wealth market in Asia (after Japan), with \$1.44 trillion in assets being managed for wealthy people. BCG projects annual asset growth among the wealthy of 13% over the next several years, with assets under management reaching \$2.63 trillion by 2009. “BCG expects foreign banks to create some tough competition in the wealth-management market, as they enter the retail market and attempt to cherry pick the most attractive customers,” the report states. “Unless Chinese banks can respond, there is a real and significant threat that many wealthy customers will be lured away by the highly evolved products and services that foreign banks can offer.”

Straddling the Fence

As China's economy continues to grow, consumerism will become more prevalent. But it will not be a smooth transition from communism to capitalism. Wharton's Zhang, who was raised in poverty in China, lived much of his life under an authoritarian regime and says those days are far from completely gone. Chinese citizens today straddle a fence dividing the old times from the new, and are never certain where freedom begins and ends.

Says Zhang: "When I was a boy, [China] was a totally different world. Everybody grew up wearing exactly the same clothes and doing the same things. Now there is more wealth in the country and aspiration is high."

"The country is moving very fast," he adds. "Never in my dreams could I imagine that a country this big with this many people could move so fast. It's astonishing to me, and probably astonishing to most people in the world." ✨



Navigating the Labyrinth: Sales and Distribution in Today's China

For a hundred years or more, Western businesses have dreamed of selling to the vast Chinese market. With sights set on the country's 1.3 billion consumers, they are finally getting their chance, but experts from Wharton and Boston Consulting Group say that firms should not underestimate the skills they will need to develop in order to compete there — particularly as they try to expand outside China's largest 30 or 40 cities into the country's more than 500 other large markets.

“Dealing with the large hypermarkets is more similar than different, but even the hypermarkets have adapted their store formats for China.”

—Jim Hemerling, senior vice president for Boston Consulting Group in Shanghai

The reason: While the big-box retail giants are starting to build modern, recognizable distribution systems in the nation's largest markets, China's goods and services are still mostly supplied via the labyrinthine networks of state-owned distribution companies and small, private wholesalers.

Jim Hemerling, a senior vice president for Boston Consulting Group in Shanghai, says that distribution remains one of the biggest challenges companies face as they try to expand across the country — but also one of the biggest opportunities. “It presents an opportunity for competitive advantage because it's so difficult,” he says.

A Complex, Multi-tier System

Reaching consumers through modern retailers is a somewhat familiar process to Western manufacturers, yet even the more standardized hypermarkets such as Carrefour are not quite the same as they are in other economies. “Dealing with the large hypermarkets is more similar than different, but even the hypermarkets have adapted their store formats for China,” says Hemerling. Carrefour, for instance, has created large “wet markets” in their China stores to cater to the Chinese preference for fresh produce and fish.

The second way goods get to customers is through a complex, multi-tier distribution system that is still emerging from years of state control. Depending on the category, says Hemerling, 30% to 60% of the market is still served by complex tiers of wholesalers, particularly in the smaller, less advanced markets.

David Jin, a partner at BCG in Shanghai, says that distribution in China's old planned economy was historically through a tiered structure in which layers of tightly controlled distributors passed goods from the province, to the city, to the township. While some of these distributors have now privatized, others are still state-owned. State-owned distributors retain important advantages in industries such as pharmaceuticals, where tight regulation has kept distribution somewhat protected, according to Jin.

In less-regulated sectors such as consumer goods distribution, competition is greater. Here, the example of multinationals such as Procter & Gamble is having an impact on the older distributors, notes Jin. “These [companies'] best practices have some spillover effect onto the other distributors, so gradually they're influencing the market,” he says.

Small distributors are also used to moving goods through a third and even fourth tier of distribution, especially to reach into China's smallest 500 cities and its countryside, according to Jin. Goods are either sent through an old official network or through more informal paths. In some categories, small distributors meet in a physical location in some area of a large city, buy a shipment of goods from a larger distributor and then drive their load back to another market in their own city. These distributors will in turn either sell the goods to multi-outlet retailers or to other groups of smaller distributors, who deliver the goods to local stores and "mom and pop" retailers.

Most of these distributors are unlike the value-added distribution firms with which modern manufacturers are familiar. Small and lacking in information technology to manage their inventory, most of these distributors are likely to be passive resellers, intent on passing the goods along from one distribution tier to the next for a very small margin, according to BCG experts.

Not surprisingly, gaining understanding and control in these fragmented networks has proven an easier task for domestic companies than foreign ones. "When Western companies get to tier three or tier four cities [cities of 500,000 to 3 million] they just cannot compete effectively," says Jin. Local firms and companies out of Taiwan and Hong Kong have used this knowledge to their advantage. Chinese consumer electronics companies, for example, have gained market share over foreign rivals by developing distribution through these smaller markets. Lenovo, the Chinese company that bought IBM's ThinkPad unit, has built up a formidable share against Dell in this way as well, by opening local stores even as Dell tried to stick to the direct-sales model that has worked well in more advanced markets.

While most BCG and Wharton experts agree that over time the vestigial wholesale system is likely to be squeezed out through competition, Hemerling says the price of standing aside until that happens may be too high for many Western companies. "Ten years is a long time to wait. You give up a lot of business and you lose the opportunity to establish your brand during that time," he says.

Building a Sales Organization

By all accounts, creating a sales and distribution network in today's China isn't easy. "It's definitely more chaotic, it's definitely more difficult to deal with, and you need to have more people on the

ground because of it," says Z. John Zhang, a marketing professor at Wharton.

One of the biggest challenges is simply mapping the flow of goods through these distribution networks, according to Hemerling. In the past, Chinese manufacturers would often send goods to a distributor with no real idea which customers those goods eventually reached. For a foreign company, Hemerling says, understanding where those goods are flowing is critical because different distribution channels often reach different customer segments.

Creating a sales network is essential in the smaller markets. The tier three and tier four markets are less sophisticated than the largest cities — perhaps five to ten years behind, Wharton and BCG experts say. With a smaller group of modern retailers available, local knowledge is needed to navigate effectively in many categories, and an extensive sales force is often necessary if the supplier wants to retain control of the product. Sales people are needed to identify the best distributors and work closely with them to make sure that products are displayed properly and pricing practices are followed, according to Hemerling.

Controlling product placement and pricing will also involve working with local retailers — which probably won't be easy. "Retailers are very powerful and they are pretty tough to deal with," says Zhang. "They charge back a lot of things to you — so for instance, when they do their price promotions, they let you pay the bill."

The restrictions U.S. companies face against certain kinds of practices may prove an obstacle to expanding through these traditional channels. "Certain things that are proven to be successful practices in China may not be something that many Western companies want to use," Zhang says. For instance, kickbacks are sometimes necessary to get a product through the door.

Sometimes, Zhang notes, these cultural differences can work to the foreign company's advantage. "In some cases you do get respect from these local businesses.... If a retailer knows you can't break a certain rule, they won't squeeze quite as much." Yet there are limits: "I think there is always a balance between the flexibility versus the rigidity, and if you're too flexible, obviously they will try to squeeze you more. But if you are too rigid, of course, then there's going to be a problem there, too," he adds.

According to Zhang, in many cases retailers simply rent store space to a vendor and let the manufacturer

supply its own sales people. Sun Yan, a Beijing-based consultant for Boston Consulting Group, says that this practice began as a way for domestic manufacturers of new products to break into stores, but the stores have extended the model to multinationals. She adds that this practice can be challenging to multinationals, which frequently have strict headcount limits. Although the new sales people are often contract workers employed by a state-owned company, according to Sun, companies face a huge managerial challenge as they try to expand from an organization that may have been only three small offices in the largest cities to a multi-tiered structure with thousands of employees.

For one thing, finding and training capable people is not always easy. Turnover in these fast-growing markets is also likely to be high: “Because of the supply and demand on the talent,” says Jin, “even if you train the people, other companies come in and they just hire them away.”

As difficult as they can be to manage, companies are finding that such large sales organizations do have some benefits. Sun says that a good sales force can do a much better job introducing new features in a product and cross-selling. Such a force can also act as an important source of market data, since sales people can be used to collect consumer and competitor information right in the store.

At present, there seems to be no way around building such an organization. Traditional retailers are still the dominant sales channel in many categories. Western supermarkets such as Carrefour and Wal-Mart are just beginning to expand deeper into China. Sun says that e-commerce and direct mail are still largely a phenomenon of the coastal cities, and Amway-style direct selling remains legally restricted.

Despite the fact that modern retail is growing at 50% per year, BCG analysts estimate that modern retailers reach only one quarter of the 500 million consumers who live in or near the 3,000 largest cities and towns. BCG estimates that 80% to 85% of rice crackers, 75% of soft drinks and 65% to 70% of television sets are still sold through traditional channels.

Reaching the Heartland

Even when agreements between distributors and retailers are all set, the process of moving goods from one place to another remains a daunting task. Marshall Meyer, professor of management at Wharton, says that logistics represent about 20% of China’s gross domestic product — compared to about 10% for

the US. It’s actually cheaper, he says, to ship goods from Shanghai to New York than from Shanghai to one of China’s interior cities or the countryside.

A great deal of the transportation infrastructure is still either in transition from the old state economy or is under construction. The train system is state-owned, according to Zhang, and access often depends on who you know within the system rather than business needs. However, a lot of infrastructure is also still being built. Hemerling says that the country built a strong north-south network about ten years ago, and is now at work on its east-west highways.

Most goods are shipped by smaller trucks. Hemerling says that vehicle sales numbers tell the story of a gradual shift to hub-and-spoke delivery systems as the highway system is extended across the country. Today, the number of large, long-haul trucks being sold is increasing, compared to mid-size trucks. Sales of small trucks and vans, the kind needed to get around in the smaller cities and in the countryside, are also rising, he says. But the closer distribution gets to the village, the more basic it’s still likely to be: When goods reach the countryside, Zhang says, they are often transferred to people on bicycles, motorcycles, or in small cars.

Meyer says that local governments sometimes add their own obstacles to keep goods from reaching a market. Local provinces — many of which have politicians that serve on the boards of local, state-owned companies — may levy internal tariffs on companies trying to move goods from outside the province. Sometimes, too, townships will put up tollgates, almost at random intervals along the highways, simply to boost local revenue, according to Meyer. He adds that when he asks Chinese friends whether this is legal, they laugh and tell him that authorities periodically request that local governments take their gates down; the gates come down, but six months or a year later, they come back.

Impressions from the Past

When it comes to understanding the best options for reaching consumers in today’s China, Western companies are often encumbered by impressions of what doing business in China was like in the recent past.

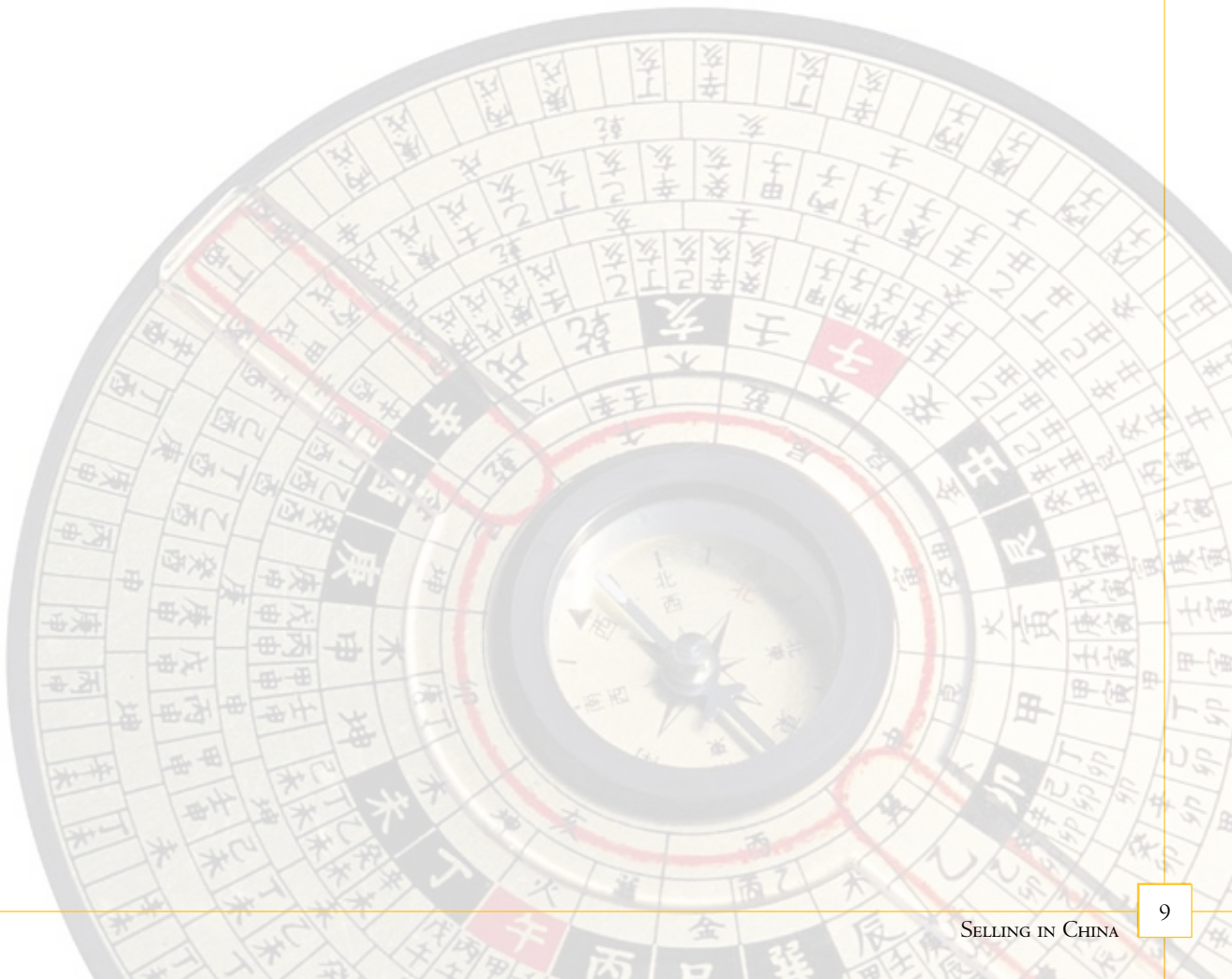
Sun says a number of multinationals already operating in China haven’t realized how quickly the market is growing. “Many companies still ... haven’t realized they need to grow coverage, to increase control. They’re still happy with their coverage of the ten or twenty coastal cities, and oftentimes

the market data is misleading because the market research hasn't reached into these areas," she says.

But companies that try to take advantage of this opportunity without understanding its complexities are also likely to be frustrated, Wharton and BCG experts say.

Over time, distribution around the country will undoubtedly grow more robust. An anticipated growth of third-party logistics providers will likely add more efficiency: China is still underserved by such providers, according to Hemerling, but services such as FedEx and UPS are starting to extend their presence. Logistics management software offered by Manugistics and other leading software developers is also growing more widely available, he says.

And soon, foreign companies will be permitted to operate their own transportation networks. "That will cause a huge change in the distribution landscape," Jin says. "Their distribution model, their know-how, will definitely have an influence on the local distribution market." ✨





'A Crucible of Competition': The Emerging Chinese Company

It's hard to believe today, but private

companies are still a relatively new phenomenon in modern China. In 1988, the Chinese government began breaking up state-owned enterprises into individually directed, but still largely state owned, companies. At around the same time, some private companies began to form, but only in 1993 did the government pass its first comprehensive law permitting private enterprise.

While collectively these firms have already had an outsized impact on economies worldwide, only a few Chinese firms have yet made their presence felt individually. But they're coming, according to John Wong, a senior vice president with Boston Consulting Group in Hong Kong who works primarily with pharmaceutical and consumer goods companies. Wong says that over the next few years, he believes that a number of Chinese companies will begin to emerge from what he calls "a crucible of competition" in the highly competitive, highly fragmented domestic market.

"Any companies that successfully emerge from [China] will be very competitive."

—John Wong, senior vice president for Boston Consulting Group in Hong Kong

What will those firms be like? "Any companies that successfully emerge from [China] will be very competitive," Wong says. While the degree of involvement of Western firms in running these companies is yet unclear, Wong and other experts from BCG and Wharton point out that emerging

Chinese companies will have distinct advantages that many Western competitors are unprepared to deal with, including steep cost savings in wages and safety requirements, and a widespread lack of concern or clear regulation regarding intellectual property protection.

But, the experts note, rising to the level of global competition will not be easy for Chinese companies. Confucius once said that individuals gain wisdom in three ways: "First, by reflection, which is noblest; second, by imitation, which is easiest; and third by experience, which is the bitterest." The same might be said for organizations, and for Chinese companies in particular as they find their way to the global marketplace.

Learning the Hard Way

In the case of the typical Chinese company, experience has so far been the greatest — and true to Confucius's words — perhaps bitterest teacher. The challenges of growing a business in China are pervasive, ranging from the fundamentals of poor infrastructure to the arcane rules that govern competition.

"One challenge is simply that the process of establishing a national presence is not so easy because China is so big and diverse and geographically far-flung," says David Michael, a senior vice president of the Beijing office of BCG. "Many domestic companies emerge out of a certain province or geography in China ... but are challenged in truly growing a national presence and setting up sales and distribution and product coverage nationally."

Fragmentation of sales and distribution has made it extremely difficult to build a brand. Wong says many distributors are still state-owned, and may have their own allied companies to back, making access into particular provinces or cities difficult.

Seventy percent of all retail sales are through local “mom and pop” stores, he says, and even the 30% that is considered “modern retailing” often entails locally controlled licensing of bigger store names.

Not that branding was always seen as desirable until recently: Marshall Meyer, a professor of management at Wharton, says that in the past, low quality led to negative brand equity. “You put a label on something, and they were shoddy goods; the next year, you changed the label so no one would know what they were buying. I don’t think that’s the case today, but a lot of companies operated very short-term — and manufacturers were quite happy to give their brands new names every year,” he says.

Without any brand power, companies have had to compete largely on cost, which has driven them to practices that would be considered out of bounds by Western standards. For example, Oded Shenkar, a professor of international business at the Fisher College of Business of Ohio State University and author of *The Chinese Century* (Wharton School Publishing), notes that this form of competition has led to little investment in safety equipment and salaries of only 60 to 75 cents an hour.

In addition to geographic barriers, Meyer points out that local governments often make it extremely difficult for companies from other provinces to do business in order to favor the products of home-grown companies, where city or provincial government officials often sit on boards of directors. As an example, Meyer recalls that a few ago, “Shanghai threw up tariffs against ‘foreign automakers,’ meaning non-Shanghai automakers.”

“It’s local protectionism,” Meyer explains, “due to a whole set of institutional factors in China, which go back way before communism: big country, difficult communications. Any traditional system of authority looks like that. If you go back to 16th century England, you see the same thing — local nobility ran it. Queen Elizabeth I could govern, but only with the assent of the privy council, which represented the local interests. And that assent was not guaranteed. The situation is the same today in China. It’s a very traditional system.”

Outside Advantages

Private companies face another major challenge from state-owned companies, as well, because of what might be called a sustainable noncompetitive advantage: The state-owned enterprises don’t have to worry about making a profit, because the state won’t let them fail, according to Michael.

Small and mid-size private firms also frequently have a hard time getting financing, unlike state-owned companies. “Over the last 10 to 15 years ... state-owned enterprises and the listed enterprises, which are mostly former state-owned enterprises, have been the recipients of most of the loans of the major banks, and the other firms — the rest of the economy — have gotten relatively little,” notes Wharton finance professor Franklin Allen.

Michael notes, however, that the public-private dichotomy is often not that simple. Many firms exist on both the public and private planes. For example, some may be partly owned by a local or provincial government, but outside the province, receive no special advantages.

Both state-owned and private companies struggle with a variety of managerial challenges. For the state firms, it’s a matter of learning to operate as a profit-driven company. Wong says that among the state companies, some old habits are still common. “Big meetings, unclear handoffs, and lack of clear accountability are still quite pervasive.”

Many local divisions of state-owned firms operate semi-independently of the parent company, according to Meyer. This can lead to tugs-of-war over company control that would be unthinkable in a Western company. “If you look at the airline industry, for example, the software for integrating the system nationally exists, and the software for yield management exists. But look at China Eastern Airlines: They’re based in Shanghai, but they have provincial subsidiaries, and the local folks can say, ‘We want the schedules this way; we want to hold seats for the local officials or their friends, etc.’ So the cost of running an airline over there becomes much higher than here,” he says.

To give the main offices more control, the central government is pressing banks to stop funding locally inspired projects, Meyer says. But local chauvinism remains a problem, and the pet-projects of local boosters have created excess capacity in a variety of different industries. One case in point: Even as the number of major auto manufacturers has decreased to a handful worldwide, Meyers notes that China still has over 150 different car manufacturers.

As state firms struggle to gain greater control over regional fiefdoms, private, entrepreneurial companies, meanwhile, are likely facing the opposite challenge — how to develop a less-centralized organization that doesn’t depend on a charismatic founder for leadership. Michael says

that in the entrepreneurial company, there is likely to be a high degree of centralized decision-making that becomes increasingly difficult to sustain as the company grows.

Winning Through Imitation – But Only for Now

Imitation, Confucius's second mode for gaining wisdom, has been a mixed blessing for many Chinese companies — at least if defined in terms of copying intellectual property.

On the positive side, the near absence of intellectual property laws or enforcement has helped many companies get started: In the absence of patent and trademark protection, what could be a lower-risk strategy than launching a copycat product? Selective copying also provides specific competitive advantages. For example, when a car manufacturer copies designs that a Western company paid to develop, that can be a significant source of cost savings, says Shenkar.

However, the benefits gained may be offset later on when companies are unable to protect their ideas from being stolen by others. Furthermore, some China business experts argue that all this piracy is harming Chinese companies right now, by reducing their incentives to make investments in product innovation and making it more difficult for them to compete globally as anything but suppliers of low-cost goods.

But Shenkar disagrees with economists who see the lack of intellectual property law enforcement as a net cost for Chinese companies at the moment. "I think that these economists are completely wrong because for now it's extremely helpful to them," he says.

Some regional economies are now so addicted to the production of knock-offs that the government is unlikely to tighten enforcement — at least in the short term — even under pressure from the U.S. "Faced with pressure from America against internal pressure that would threaten social stability, guess what they will choose?" Shenkar asks. "...The Chinese will reform when it's in their interests to reform. Right now, I don't think it's in their interests to reform."

When it comes to intellectual property, he says, Western companies need to take a radically new view. "Right now, most companies are chasing after the violators once the product has been copied. I tell them, 'Go back to the drawing board.'" What's necessary, he argues, is nothing less than a completely new way of thinking about intellectual

property. "Instead of hoping that the Chinese will reform, assume — at least for now — that you have no [intellectual property rights] protection."

Some companies have tried to partner with their pirates — Honda, for instance, has a joint venture with a Chinese company that was making imitation Honda motorcycles — but Shenkar is not optimistic about the strategy. Instead, he says, companies from advanced economies will need to rely less on the courts and more on designing products that are difficult to copy.

BCG's Michael predicts that in the short run, the continuing lack of intellectual property rights in China will lead domestic companies themselves to make one of two strategic choices: either to focus their research and development on lower-cost production rather than product innovation, or to make "a business case for innovation which is based on the idea that you'll be pretty quickly copied."

He expects, however, that in the longer term, China's approach to intellectual property will come to align with that of the developed world. He says that as Chinese companies venture abroad, they will need to develop a deeper understanding of intellectual property law, and begin to see the advantages of growing their own portfolio of intellectual property.

This is typical for a developing economy, Michael notes. "In the early 1800s, the United States had a less developed IP system than its European counterparts," he says. More recently, Japan and Korea went through a prolonged period of learning how to use intellectual property strategically. Only in 2003, for example, did Japan collect more in intellectual property royalties than it paid out for IP imports.

Indeed, the Chinese government has at least formally indicated it is beginning to take the situation more seriously. Two major planks in the recently released 11th Five-Year Plan concern intellectual property and the need for more corporate innovation. "I think it's pretty significant," Michael says. "One thing you have to respect about this government is that it has put its reputation on the line on this issue. They've made these public promises. They've publicly stated these priorities and made promises to the West that IP practices will be improved."

But even if he is ultimately optimistic, Michael doesn't minimize the challenge Chinese companies face in the short run. He says that Chinese companies will face some large IP challenges as the system matures. "They will risk having Western markets closed to them if they don't either pay the

licensee or develop their own intellectual property," he says.

Simply learning about patent law is going to take a surprising amount of effort, Michael predicts. Many Chinese companies today, for example, don't realize that a patent filed in China isn't good outside the country, and they don't have a good grasp of all the paperwork and politics involved.

Chinese companies must also work harder to develop intellectual property to give them some negotiating chips as they try to enter new overseas markets. "If you really want to be competitive...you better have some IP in your portfolio as well, otherwise you may be boxed out," he advises.

A New Generation of Managers

Reflection, Confucius's noblest route to wisdom, is becoming an increasingly important source of competitive advantage for Chinese companies, as managers gain more education, sophistication and experience.

Both private and public companies now have younger, better-educated managers than even a few years ago, Wong says. He points out that among the top 50 companies in China, the average age of managers has declined in the past five years from around 55 to 45. Many of the managers of the previous generation had their schooling disrupted by the Cultural Revolution, Wong says; these younger managers have had more opportunities for a sustained education, and more chances to travel abroad.

One typical example of this new breed: 42-year-old China Netcom CEO Edward Tian. Far from parochial, Tian has a Ph.D. in resource management from Texas Tech University, and made his first fortune with AsialInfo, a Delaware-registered telecom software and security products company that Tian took public on NASDAQ in 1999.

Even in state companies where gaining a leadership position once had to do more with party credentials than managerial skills, Wong says, today you seldom see any difference in the quality of managers "except in some egregious situations," such as in banks, many of which are still highly controlled by the state.

But a state company led by executives with Western education and managerial experience still faces challenges quite different from those of a privately owned company. In a recent interview with BusinessWeek, China Netcom's Tian, whose company is half owned by state shareholders, said he found

that surviving in a large, state-owned enterprise is "a 50% business and 50% politics balance."

Often, it's difficult for state companies to reduce headcount to competitive levels. Maintaining a strategic focus can also be difficult because of the haphazard way in which investment often occurred in the past. Tian told BusinessWeek that in Beijing alone, his company owns 2,000 buildings — and even a five-star hotel.

This generation of managers — both public and private — understands its domestic markets perfectly, Wong says, but has a lot more to learn about global markets. That won't always be the case, however. According to Wong, the members of the younger generation of executives are "incessant travelers" who are now intent on absorbing as much knowledge as they can about global markets. He expects, however, that it will take some time for them to gain the kind of understanding they'll need to compete on the global stage. "That's okay for now," Wong argues, noting that most companies have their hands full just trying to win over the huge and growing Chinese market.

Acquiring Knowledge

But companies in some industries don't believe that their competitive situation gives them the luxury of slowly-ripening maturity, and they're using other means to gain the knowledge they need in a hurry — either by hiring new executives with different skill sets, or through acquisitions. While it has been difficult for companies to attract Western executives so far, many firms now see acquisitions as a quick way to integrate Western expertise and, perhaps more importantly, gain greater scale, according to BCG experts.

Michael also notes that acquiring IP is a key driver of M&A work. "Successful developing economies such as Japan have employed it to great effect in the past. During its IP development, Japan completed at least 450 acquisitions of U.S. companies with valuable intellectual property in the computer, biotechnology, advanced materials, chemicals, electronics, semiconductor and other high-tech industries," he says.

However, such acquisitions may be difficult for Chinese companies to execute successfully, experts say. Joseph Wan, a vice president and director for BCG in Hong Kong, says he thinks many companies will be at risk of paying too much for a company. "Deal styles can be very different, and given their lack of experience, Chinese companies will run the risk of not being able to negotiate the best deals for

themselves.” Also, he adds, their very eagerness to close a deal may work against them.

Timing can also be risky, BCG experts say. Move too early, and you risk losing your domestic market share as you integrate with your Western target. Move too late, and your opponents may eventually outflank you before you can make your move, using their global scale to squeeze you out of your own markets.

Even a deal made at the right time and the right price, however, may prove a kind of Pyrrhic victory, for two reasons. First, Wan says that most of the time, a company sells a division because it’s not doing well. As a result, the expertise that comes with the deal may not necessarily be the kind that will help the company get ahead. The team that came up with the deal, after all, is probably made up of “the guys who ran the company into the ground in the first place,” he says.

Second, it may open the door for foreign control. While many pundits have seen the growing presence of Chinese bidders in the global M&A market as a sign that China’s business sector has come of age, Meyer disagrees. In his view, mergers with Western companies, such as Lenovo’s recent purchase of IBM’s PC division, are a sign of weakness rather than strength. “Lenovo, the computer company, is no longer a Chinese company. In fact, the company is controlled by Western investors, at least temporarily. Its management is increasingly Western,” he says. “It took this path because it had no choice. Dell was challenging it severely in its home territory, and it had to play global chess.”

“My guess would be that other companies in China will take the same path, unless the problems of logistics, localism and fragmentation ... can be addressed very, very swiftly,” Meyer says.

For Western companies looking east, opinions vary on the seriousness of the threat Chinese companies may pose. While Meyer believes that many of today’s firms will eventually be controlled by Westerners, Shenkar thinks that the companies that begin to emerge from this market are likely to present a tremendous new source of competition. He argues that the threats are of a magnitude that many U.S. companies are unprepared to face, especially the Chinese cost advantages that come with low wages, lack of requirements for safety equipment, and the general lack of regulation for intellectual property.

Already, he sees U.S. auto parts manufacturer Delphi Corp.’s controversial Chapter 11 bankruptcy proposal

(in late 2005) that its workers take a 60% pay cut as a sign that such cost pressures from China and other emerging markets are beginning to take a toll on companies that can’t adapt quickly enough to the new environment. “When was the last time that you overheard an employer putting on the table, even under Chapter 11, a proposal to workers to take more than a 60% wage cut?” he asks. ✨



Selling to the Local Chinese Market: An Interview with Lenovo Chief Marketing Officer Deepak Advani and BCG Senior Vice President Hal Sirkin

Multinational companies hoping to access China's 1.3 billion consumers face a number of challenges, not the least of which is figuring out how they can market products to a culture that includes poor rural farmers along with urban multi-millionaires, with a range of unique, localized buying preferences and behaviors in between. Because it is so difficult to generalize about Chinese consumers, global “one-size-fits-all” marketing strategies seem destined to fail.

Knowledge@Wharton spoke with Deepak Advani, senior vice president and chief marketing officer of computer manufacturer Lenovo, and Hal Sirkin, senior vice president of BCG and leader of the firm's Global Operations Practice, about strategies for selling to Chinese consumers. The key, they point out, is to tailor products and messages to local markets. They also discuss where consumer growth is taking place, brand perception, and why selling goods and services to China isn't so different from selling to China's neighbor and rival, India.

Knowledge@Wharton: *Treasure Hunt*, a book written by Michael J. Silverstein, Hal's colleague at BCG, makes the point that all around the world, consumers seem to be converging at two pools. One is at the high end of the market, where people are trading up. But there is also a real drive for value, so people want discounted products as well. This means that there is a dent in the middle – and this middle ground of the market is shrinking. Deepak and Hal, are you seeing this in China?

Advani: Yes, I think that's true around the world – we have customers who are looking for value and a bargain price, and others who are seeking a premium branded product. What we've seen in China, though, and what's more relevant to us, is whether they're relationship-driven or transaction-

driven customers. Segmenting the market into these two categories is more useful because these two types of customers have very different needs.

Over the last couple of years, we've created an end-to-end value chain for transactional and relationship customers that enables us not only to build the products, but also take them to market, and that includes the routes, the sales, the marketing – all of which is oriented toward relationship or transactional customers. Our product line includes premium products that are at the higher end of the spectrum, as well as products that are aimed at the cost-conscious or value buyer.

Knowledge@Wharton: Hal, you work with a number of companies in China. Do you see a shrinking middle ground?

Sirkin: Yes. The segmentation in China matches what we're seeing in the West: One segment wants premium products, and another is very cost conscious. A good industry to look at besides the computer business is the automotive business. There are very premium cars and lower-end, entry-level cars sold in China – and not much in between. This may change, but right now we're seeing those two ends of the cost spectrum.

Knowledge@Wharton: Apart from the computer and auto industries, could you give any examples of companies that are doing a good job of Selling in China? Which companies have gotten China right, and why?

Sirkin: Some consumer product companies have done an excellent job selling products such as health and beauty aids. They've done a very good job at segmenting the market, creating both low-end, single-use products and high-end luxury goods that you'd see on Rodeo Drive or the Champs-Élysées.

For health and beauty aids and cosmetics, the segmentation is more extreme than in most Western countries, because companies are offering products at the very low end of the price scale.

Advani: In the PC space, we have a fairly dominant market share in China, hovering around 38%, and one thing we're seeing — and doing ourselves — is partnering with other companies. We've partnered with companies like Oak and Disney very effectively. And to give credit to these other companies, their strategies to succeed in China are very localized. They don't take a global marketing campaign or marketing playbook and just execute in China; they really factor in the needs of Chinese consumers and present their value proposition in localized terms. And that I see as one of the key success factors in China.

Knowledge@Wharton: To turn the question around a little bit, what are some of the most common mistakes you have found companies make when they try to enter China to sell to Chinese consumers? You mentioned the problem of trying to apply the global mindset, without trying to localize, but are there other common mistakes?

Advani: There are a few. One important lesson is to be in it for the long run. You can't expect miracles overnight and expect to become a player in China by having a short-term mindset. You need patience and a sustainable long-term strategy to grow.

As I mentioned earlier, having a localized mindset is critical, and very broad. It's not just about marketing, but also your overall strategy in China. Many multinational companies take globally designed products to China and market them using global campaigns and marketing channels. As in India, the bulk of opportunities for selling PCs — and consumer electronics, cars and the like — in China are in the four or five largest cities — Beijing, Shanghai and so forth. Capturing market share there doesn't require you to have very localized, customized products and go-to-market strategies.

But most of the growth right now and over the next four to five years will be in the tier five and tier six cities. These are smaller cities, and if you are approaching them with global strategies, global products and global go-to-market, it becomes very difficult to penetrate because the needs of this type of consumer are very different. You need to develop products that appeal to them, that factor in their local tastes; you need to speak to them with messaging that is relevant to them. You need channels that are more accessible to them — like storefronts, which are very popular in China. So you

need a very localized strategy if you want to grow in these high-growth areas.

Sirkin: To build on Deepak's point, companies that are relatively new to China often miss the importance of the distribution system, particularly outside of the four or five big cities. You can't do it yourself in the smaller cities; you need distribution partners. The logistics are very different and much more difficult than in most of the more developed countries. These smaller cities are rapidly developing, but they're still very much in the development mode. So getting a product to market — not just the right product, but any product — without the right distribution system can be a nightmare.

Knowledge@Wharton: How do distribution issues interfere with or impact brand-building efforts? Deepak, maybe you could start by addressing that from Lenovo's perspective.

Advani: The distribution networks you have in place can be a very effective way to build your brand. As an example, you sell directly to many of your relationship-type customers, face-to-face. Yet many of the transaction-type customers are in the tier five and tier six cities, and store fronts are the way to reach these consumers. We have 4,000 to 5,000 retail store fronts all across China. This enables us to build our brand in a very direct way, because there are many tactics we can use to convey our brand's value proposition. The best way to build your brand is to have people touch and feel your product. That's what Apple does so well in the United States, and that's what we do in China.

Knowledge@Wharton: Hal, based on your experience with companies outside of China, how do they begin to figure out or break into the distribution system in China to make this kind of store front situation possible?

Sirkin: It's very hard. You've got to begin in the major cities and start building the contacts, which often come from working with other companies. But as Deepak pointed out, it's all very, very local. So you have to bring people on board who understand the local conditions almost market by market.

Advani: Yes, that is exactly right. Many companies start out in the larger cities, which feel, look and act much more like developed markets. But in the tier five and tier six cities, where most of the exciting market growth is, you need a very good understanding of how things work.

For instance, in some of those smaller cities, there are little malls where a vendor may have five store

fronts on the same floor. To a western multinational company, that might seem a complete waste of effort and resources; but that's what it takes to grow, that's the way the psyche works.

Also, the point that was made — that a lot of it is relationships — is spot on. You need to build a network of distributors that you've gotten to know and trust over time. If they see that you are in it for the long run, through patience and sustained efforts you build those relationships over time.

Knowledge@Wharton: It sounds like there's a big effort to push for the tier five and tier six cities now. Deepak, what is the likelihood of a non-urban Chinese citizen owning a computer in, say, five years, or maybe even ten years? What do you predict the penetration will be outside the urban areas of China, where the wealth seems to be concentrated?

Advani: The growth is absolutely tremendous. One of the reasons why China is such an attractive market is the fast-growing middle class with huge purchasing power. Also, we've been working with a lot of our partners to bring value propositions that are very attractive and affordable. We just announced a program with Microsoft that enables consumers to 'pay as you go' for a PC, which significantly reduces the upfront cost of acquisition and allows you to pay for your PC over time. Other companies are focusing on the \$100 PC and the like.

China values education quite a bit. Families spend a disproportionate amount of their disposable income on education. So we also focus a lot on innovating to make desktops, for instance, much more multi-user friendly, particularly for schools with very few IT skills. We design technology that enables people to share a computer very effectively.

Companies like Lenovo, Microsoft, and Intel are focused on making the PC more affordable. The Internet is penetrating quickly as well, which makes the PC much more useful. Schools, universities and some of the smaller towns have a strong interest in breaking technology. So the future looks extremely bright for penetration in some of the non-urban areas.

Knowledge@Wharton: Is education a big thrust of the marketing campaign to get computers out to families in that market?

Advani: Absolutely. In fact, we have a product line that's been designed for the education space, with specific features that we came up with when we did our market research.

In a lot of the schools, especially in small towns, there isn't much IT capability, but there is a desire that multiple students share a desktop PC. We designed a very simple hardware and software solution, a little button that looks like a power button. After a student is done working on the computer, they may have moved around some desktop icons or even deleted some files; by pressing that one button, in less than a minute everything gets re-set exactly to the way the system was before the student started to work on it. This allows [teachers] to get the PC somewhat pristine for the next user.

So, having a product line for the education space is definitely a focus for us.

Knowledge@Wharton: Hal, how do other forms of electronics penetrate that market?

Sirkin: It's critical to meet the local needs. How do I make it affordable? What payment options can I offer? We're seeing more and more pay-as-you-go plans, where the manufacturers finance items over time. And we're seeing this in India, Mexico and many different places, not just China.

In these markets, the credit systems aren't well developed, so sellers need to create financing mechanisms designed for less developed or rapidly developing economies. This is especially true for higher-cost products such as appliances.

Knowledge@Wharton: What product qualities are most attractive to middle-class consumers in China, specifically in terms of electronics? Is quality a key issue, or are there other considerations that middle class buyers tend to have for these kinds of products?

Advani: Although price is clearly a factor, one thing that is somewhat counterintuitive is the importance of brand, particularly in China and India, whose purchasing power is increasing. For the first time, people can afford a car, a TV or a computer, and the brand that they buy is really a reflection of their place in society.

When you interview focus groups or talk to consumers one-on-one, you find a greater appreciation for savings. They want to buy something of good quality, something that will last a while. Brand is very important and relevant, both from a practical perspective of 'I want this thing to last,' and from an emotional perspective as a reflection of a consumer's place in society.

Sirkin: To build on that, Chinese consumers are value buyers, not price buyers. They look at the value/price relationship and won't necessarily buy the lowest-cost item if it won't last long or isn't of good quality. They're informed buyers, and they look at value.

At the same time, some goods in China have the same strong brand value and prestige that we see in the most rapidly developing economies. So quality and prestige are both important aspects of brand in China, but we see a lot of value buying rather than price buying.

Knowledge@Wharton: Both of you mentioned some of the similarities between buying behavior in China and in India. I was wondering if you see differences as well. Are there any ways in which Chinese and Indians buy things differently, because these are the two big markets that most of the world seems to be looking at so closely right now.

Advani: Our experience has been that there are quite a few similarities. In fact, we are in the process of replicating our China business model and go-to-market strategy in India, with very much an Indian flavor. As with China, in India there's a lot of opportunities in the larger cities, but the growth is much stronger in the smaller cities. Also, the importance of education to Indian families is just as high as it is in China.

In India, PC security is more about theft than embedded fingerprint reader encryption subsystems. When people buy a PC, they don't want to lose it. Instead of talking about why you need to upgrade your PC, your messages have to be about why the PC is a good thing, because penetration is down to 1%. You have a lot of first-time buyers. So the low penetration rate, growth in the smaller cities, a lot of first time buyers, the importance of education, the need to speak to consumers in a local language instead of a global language — all these things are common.

In India, we have signed up local celebrities to be our brand ambassadors, so that the messages we are conveying will resonate much more with the Indian consumer. In China we have 5,000 store fronts, but we have fewer — over 100 — in India. In India, the way you go to market with your channel partners is slightly different. In China we have an exclusive distribution network that sells only our products. In India, often you have store fronts that are not exclusive to you, and you'll have other vendors profiled there as well. So there are some differences, but if I step back and look at the macro

view, there are a lot more similarities than there are differences as far as how you market, at least in the PC space.

Sirkin: I would agree that there are a lot of similarities. It comes down to local tailoring to different tastes, and different ways of presenting things — minor differences. But the macro pictures are very similar. These are both markets with a billion people, with very large potential. The companies that succeed will have the ability to look at each market from a macro perspective, and then tailor it from a micro perspective. ✨

Special Report

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