2012 EDITION

China Consumer Market Strategies

How MNCs and Chinese companies are competing in the world's fastest growing market

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The China consumer market is forecast to become the second largest in the world by 2015 with enough purchasing power to buy 14 percent of the world's products.

China Consumer Trends Study 2012

The Chinese consumer marketplace is quickly growing more segmented and mature, with an increasing number of consumers looking for high quality products—and willing to pay a premium for them. But are the companies that serve these customers prepared to seize the opportunity and win market share?

This question was the essential backdrop of the second annual "Business Response to Trends in China's Consumer Market" survey of Chinese and multinational companies (MNCs), conducted by The American Chamber of Commerce in Shanghai (AmCham Shanghai) in cooperation with Booz & Company, a leading global management consulting firm. More than 150 companies from nearly two dozen industries, including consumer goods, automotive, consumer electronics, healthcare and financial services, among others, participated in the survey. The results shed light on the evolution of a consumer market that is forecast to become the second largest in the world by

EXHIBIT 1: Description of Nine Trends

	Trend Name	Description
Consumer Attitude Changes	Value as a Differentiator	Importance placed on "value for money"
	Health & Wellness	Awareness of health and wellness
	Work-Life Balance	Quality of life factors into lifestyle choices
External/ Technology Changes	Exposure to & Knowledge of Foreign Markets	Exposure to norms/lifestyles of markets outside of China
	Exponential Growth of Consumer Choice	Number of competing product choices with expanded price points and purchasing channels
	Rise of e-Commerce	Rise of e-Commerce penetration and convenience across categories
	Social Media	Integration of social media into the day-to-day lives of the consumer
	Major Investments in Infrastructure	Major investments in infrastructure (train, road, etc.) across China is creating more flexibility around where people can chose to live, work and shop
Demographics Changes	Evolution of the Family Unit	Increasingly dispersed and ageing demographic

2015—just behind the United States—with ample purchasing power to buy 14 percent of the world's products.

To gain a deeper understanding of this dynamic market, AmCham Shanghai and Booz & Company identified nine disruptive consumer trends, divided into three broad categories, with the greatest potential to influence Chinese consumer behavior *(see Exhibit 1).*

Survey respondents were then asked to rank these trends in order of significance:

1. Value as a differentiator
2. Health and wellness
3. Work–life balance
4. Exposure to and knowledge of foreign markets
5. Exponential growth of consumer choice
6. Rise of e-commerce
7. Social media
8. Major investment in infrastructure
9. Evolution of the family unit

Three noteworthy conclusions emerged from the survey:

• **The Chinese consumer market is beginning to evolve and blossom in ways that could not have been predicted a year ago.** In Tier-1 and Tier-2 cities, an increasing number of consumers are seeking greater value, quality and integrity in the products they purchase. This represents a significant evolution from what has been a price-driven market. In smaller but rapidly expanding Tier 3 and Tier 4 cities (such as Ningbo, Wuxi and Dongguan, as well as rural areas) price consciousness still rules, but the choice of available products has dramatically increased. This is providing consumers with a greater range of purchasing options than ever before, and is creating an increasingly competitive environment for companies. Moreover, and importantly, consumers at the top rungs of Tier-3 and Tier-4 cities are quickly taking on the behavior of their counterparts in Tier-2 cities, and it is only a matter of time before the distinctions in these strata disappear, in at least some regions.

• **In stark contrast to last year's results, Chinese companies and multinationals (MNCs) no longer see the consumer marketplace through different lenses.** The current survey found that in their strategic approaches and the segments they are targeting—as well as in their responses to the challenges they face in developing products, marketing and sales—domestic and international companies have converged in their perceptions of the market's make-up and hurdles. This, in turn, has made virtually every aspect of the Chinese consumer market much more competitive. Thus far, this maturing marketplace appears to be benefiting MNCs the most. The survey found that both multinationals and Chinese companies believe that MNCs—and not Chinese companies—are the strongest competition they face in China.

• **In such a rapidly changing and complex marketplace, it is impossible for a company to be good at everything, but four distinct capabilities are paramount to success in the Chinese consumer market.** Two of them—recruiting and training sufficiently skilled workers to handle everything from product development to marketing communications, and, devising versatile go-to-market strategies—were identified in last year's survey and are still important today. But two additional capabilities gained in significance this year: 1) creative and aggressive product branding, which includes the appropriate mix

> "In Tier-1 and Tier-2 cities an increasing number of consumers are seeking greater value, quality and integrity in the products they purchase"

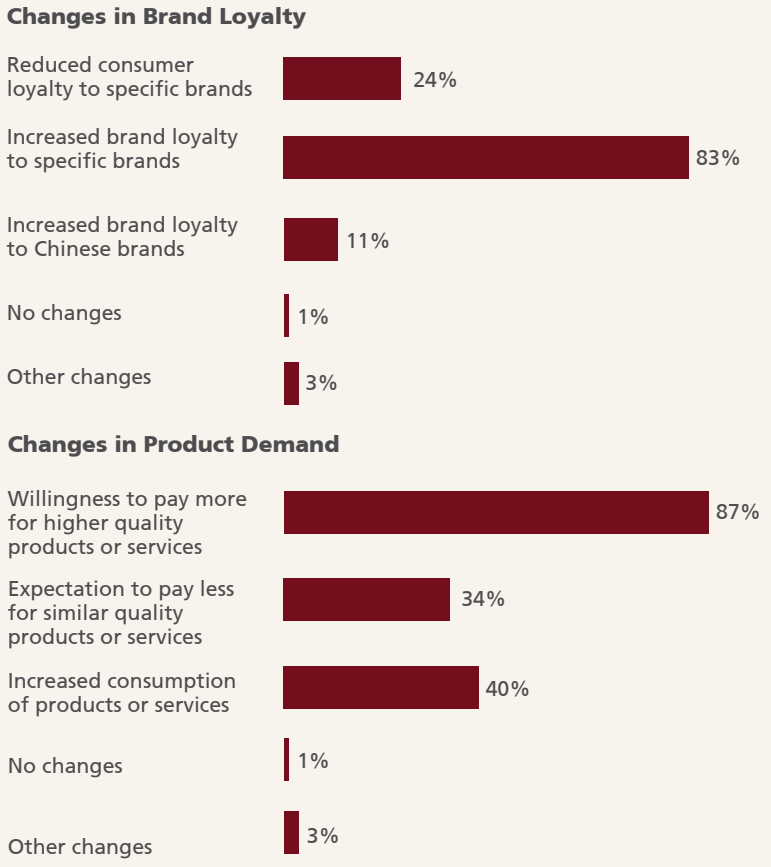
EXHIBIT 2: Overall, how would you rank these nine key trends in terms of their importance for your industry?

High

Low

Key Trends by MNCs	Key Trends by Chinese Companies
Value as a Differentiator	Value as a Differentiator
Exponential Growth of Consumer Choice	Exponential Growth of Consumer Choice
Rise of e-Commerce	Health & Wellness
Social Media	Evolution of the Family Unit
Major Investments in Infrastructure	Major Investments in Infrastructure
Health & Wellness	Exposure to and Knowledge of Foreign Markets
Exposure to and Knowledge of Foreign Markets	Rise of e-Commerce
Work-Life Balance	Social Media
Evolution of the Family Unit	Work-Life Balance

EXHIBIT 3: How is the Value as a Differentiator trend going to affect consumer behavior?



of social media, e-commerce and in-store support, marketing and promotion; and 2) product innovation to provide a sufficiently broad and desirable set of products and product features for the types of consumers being targeted. Results indicate companies are working towards enhancing all four capabilities—but just how they do it, and where they truly differentiate themselves, is an important strategic question. Further, whatever strategies they develop, the strategies must be coherent and flexible to effectively scale operational tools, organizational structure and processes.

THE TOP TREND: VALUE AS A DIFFERENTIATOR

Both Chinese companies and MNCs chose value as a differentiator as the most important consumer trend in China today *(see Exhibit 2)*. Today, more and more consumers in China seek value and are prepared to pay more for products and services that they believe to have greater quality, safety and utility. Importantly, in the Chinese context, "value" consumers are moving upscale, willing to pay a premium for items with integrity, reliability and desirable features and that are made of high quality materials and components *(see Exhibit 3)*. The ascendance of value consumers in China is a sharp departure from the past, when many purchasing decisions were driven primarily by price.

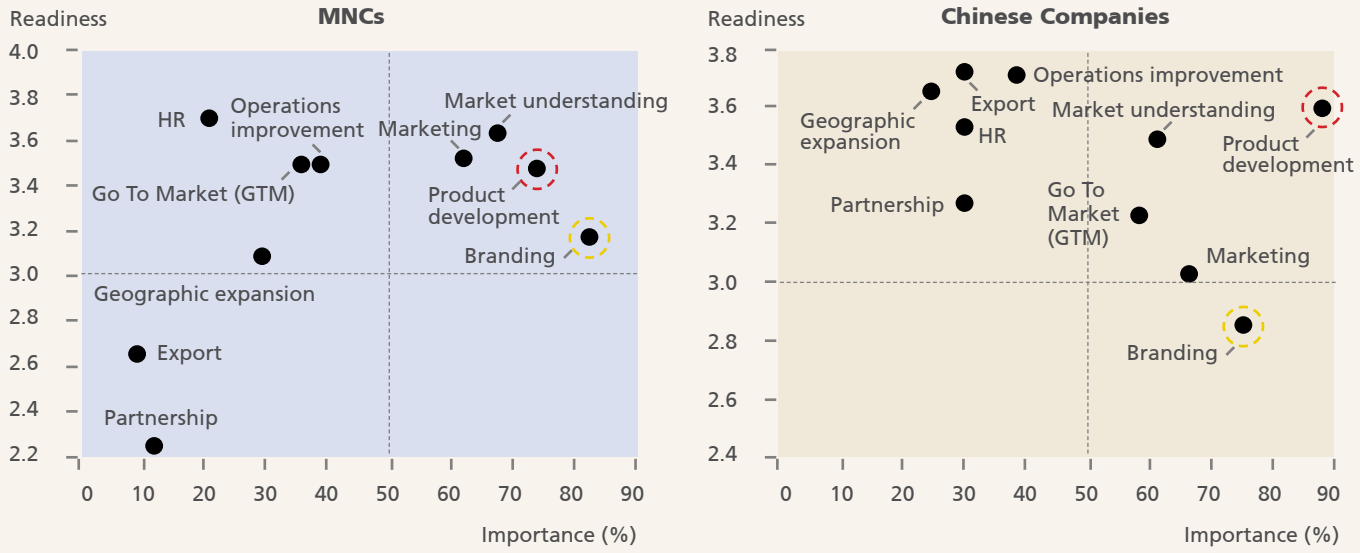
Value consumers are a critical component in the growth of a vibrant consumer base, because their buying behavior—specifically, their focus on quality instead of cost—encourages companies to develop new and better products. The companies are promised a return on their investments if they come up with offerings that are useful, attractive and compelling. And the customers are perceived as repeat purchasers of products they like. Upwards of 83 percent of respondent companies said that the value as a differentiator trend drives increased brand loyalty.

The portrait of the value consumer that surfaces from the survey is of a young to early middle age (21 to 40 years old), middle-income (between 10,000 and 50,000 RMB per month) man or woman who lives in a Tier 1 or Tier 2 city. These cities have growing numbers of young consumers with more disposable income, many with advanced degrees and rapidly rising earnings. In addition, they are not getting married or starting a family as early as prior generations did. In Shanghai, for example, the average marriage age for men and women in 2010 was 32 years and 29 years, respectively—four to five years older than the average ages a decade ago.

But value consumers are not spendthrifts, surveyed companies said: although they are willing to spend for value, they want to be certain they are actually getting what they pay for. As a result, 81 percent of respondents said that Chinese value consumers seek out information—for example, fea-

EXHIBIT 4: Perceived importance of key actions and readiness for "Value As A Differentiator"

Importance: What are the important actions to address the impact of this consumer trend?
Readiness: Has your company taken these actions?



tures and comparative product assessments—before making purchasing decisions. Perhaps not surprisingly, they also want to be treated well if they are paying top dollar, or in this case renminbi; nearly 60 percent of companies noted that these consumers put a premium on the importance of the shopping experience.

About one-third of MNCs claimed that they are fully prepared to respond to value as a differentiator trend, whereas only 19 percent of Chinese company respondents believed that their firms are prepared (75 percent said that they had addressed this trend somewhat, but not to a sufficient degree). However, in the next few years, it is going to be essential for all companies to pay more and more attention to value consumers, particularly as people living in Tier-3 and Tier-4 cities increasingly join this category.

Currently, the gap between MNCs and Chinese companies in responding to value consumers appears to be in branding capabilities. Both MNCs and Chinese companies feel that they have an adequate understanding of the value consumer market and agree that branding is important to reach out and attract these individuals, but Chinese companies feel that they have not gone far enough in giving their best products the cachet needed to entice them *(see Exhibit 4)*.

CONSUMER UNDERCURRENTS IN TIER-3 AND BEYOND

The second most significant trend as selected by both Chinese companies and MNCs, exponential growth of consumer choice, further punctuates how robust the Chinese market is becoming. This trend highlights a vigorous marketplace in which consumers are offered an increasing number of competing products with a variety of features at an accelerating pace. Price points and purchasing channels are also in flux as companies battle to win over consumers, hoping to align their products and services with customer tastes.

The consumer segment most affected by this trend, the "choice" consumer, represents a slightly lower socio-demographic than the value consumer, although this group can nonetheless be extremely lucrative for companies that know how to reach them. Respondents report that, while these consumers are similarly found in Tier-

1 and Tier-2 cities, this trend is having a much bigger impact in Tier-3 cities and beyond (where value consumers are just emerging). In addition, these consumers skew a little younger (predominantly 21 to 30) and their income leans more in the 5,000 to 25,000 RMB per month range *(see Exhibit 5)*.

Consumers most responsive to increase in product choice are also more fickle than value customers, according to survey respondents. They are looking for the lowest possible price for similar quality products and services, and have almost no loyalty to brands that they have chosen before. Moreover, the bricks-and-mortar shopping experience itself does not matter that much to choice consumers; rather, in comparison to value buyers, e-commerce is a favored venue because it is easy to compare prices online.

Although MNCs asserted that they are fully prepared to respond to the exponential growth of the consumer choice trend to the same degree as the value category, only a tiny subsection of Chinese companies, a mere 5 percent, said that they were fully prepared to address choice customers sufficiently. In many cases, Chinese firms have the right products for this trend—at this stage in their development, their brands are often low-priced—and they have relatively well developed Internet strategies (over 90 percent have used social media and/or other digital communication and over 50 percent have sold through an e-commerce site) to drive sales. But they lack marketing communication expertise.

WHAT A DIFFERENCE A YEAR MAKES

In contrast to their divergent responses in last year's survey, MNCs and Chinese companies are now much more in sync about China's consumer market and how they need to address it. Twelve months ago, many more Chinese companies than MNCs placed a premium on the rise of e-commerce (developing e-commerce and other Internet-based sales channels) to tap into the Chinese market. Also in last year's survey, MNCs believed that the

EXHIBIT 5: Which consumers do you think will be most impacted by this consumer trend?

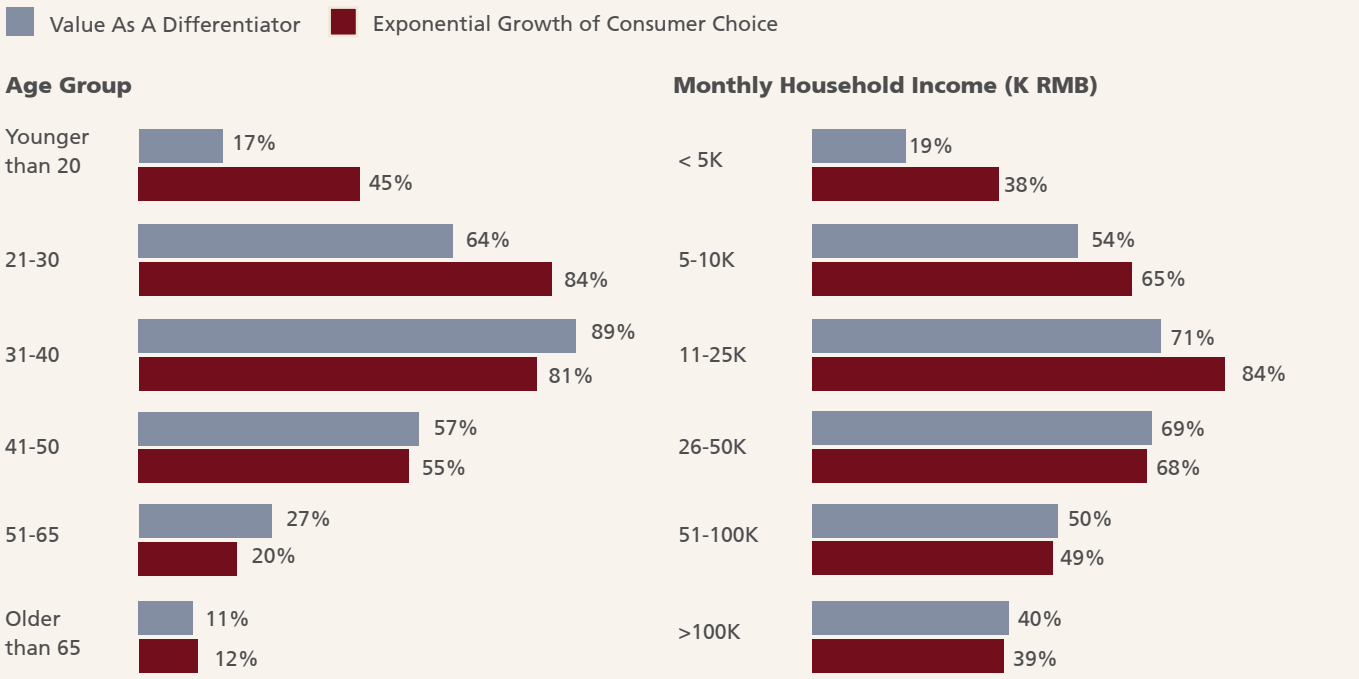
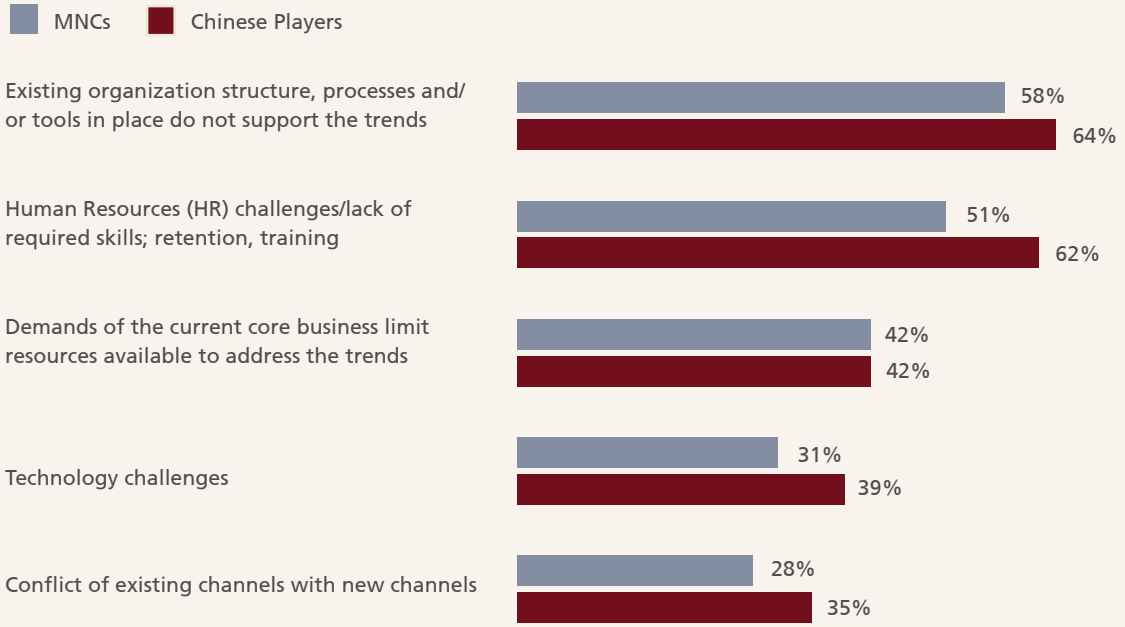


EXHIBIT 6: Top 5 Challenges by MNCs and Chinese Companies



exposure to and knowledge of foreign markets was the key to driving interest in the products produced by their companies.

Both of these trends essentially reflected the first nascent steps toward the consumer market that we see today in China. For the value consumer to emerge, Chinese consumers needed to gain greater appreciation for global products and for higher levels of brand quality. Clearly, based on this year's findings, MNCs, more so than Chinese companies, believe that they have succeeded in finding the right niche for their products among value-seeking consumers in China.

Similarly, e-commerce initiatives are in part responsible for the variety of product choices that Chinese consumers enjoy. This year, an increasing number of MNCs said that they plan to implement e-commerce as a sales channel to reach consumers and to incorporate social media into their branding strategies—two other trends explored. That is a clear indication that MNCs are making a concerted effort to tap into the widening population of Chinese Internet users. It also reflects the fact that Chinese companies and MNCs will increasingly be going head-to-head in the fastest growing consumer segments.

OLD CHALLENGES PERSIST, AND NEW ONES ARISE

One thing hasn't changed in this year's survey: while China offers tremendous opportunity, companies continue to face an intensely competitive and challenging consumer market here. But new this year is the convergence of the top challenges reported by both Chinese and multinational companies.

Both this year and last, MNCs noted that human resources issues—finding people with the required skills (such as communications skills) and developing and retaining talent—were among the top two challenges they faced. Chinese companies, however, were far less worried about these issues last year. This year, by contrast, views on recruitment have converged—as many as 62 percent of Chinese companies and 51 percent of MNCs rate talent issues among their top two challenges. Clearly, Chinese companies are fac-

> Chinese companies are facing rapidly increasing pressure to find more and more skilled workers to design, develop and manufacture higher quality products

ing rapidly increasing pressure to find more and more skilled workers to design, develop and manufacture higher quality products *(Exhibit 6)*.

In both years' surveys, MNCs and their Chinese rivals agreed on the other top challenge: that their organizational structure, processes, and tools are not aligned well enough with the consumer trends that these companies must adapt to. For Chinese companies in particular, shifting from an export-driven model driven by low-cost manufacturing and mass-market product development to a model based on brand innovation and scale for a vast, diverse and growing domestic market in China is akin to turning a battleship, and many large companies feel that they are not nimble enough to achieve this. Chinese companies are a bit

The value consumer: young to early middle age (21 to 40 years old), middle-income (between 10,000 and 50,000 RMB per month) living in a Tier-1 or Tier-2 city.

Coherent Capabilities at Wahaha

Not many companies in China have deftly adopted a coherent capabilities strategy that aligns with the consumer market they are targeting. But in developing and marketing Nutri-express, a milk and juice mix, Wahaha has successfully merged these two elements.

To attract health conscious Chinese consumers, Wahaha has come up with a number of intriguing and attractive product features. Nutri-express is sold in a large, transparent bottle so the consumer can easily see the milk-like, healthy looking liquid, and the bottle features labeling that clearly touts the many vitamins and minerals that the purchaser is about to drink—enough to cover his or her daily needs. In addition, Nutri-express tastes good, according to many consumer surveys.

Equally important, Wahaha's branding campaign has been extremely aggressive and on point; advertising for Nutri-express clearly communicates the message that the product is a mixture of milk and juice, and that one bottle is sufficient for good health and a high level of energy. As importantly, Wahaha is effectively telling consumers through its ads that Nutri-express can be consumed almost anywhere—at home for breakfast, on the train or in the car going to work, at family gatherings, and so on.

But none of this would likely matter if it weren't for Wahaha's robust go-to-market efforts that have placed Nutri-express in retail stores in virtually every part of the country, including cities in all tiers.

more sanguine about this challenge this year (64 percent saw it as a key barrier versus 74 percent 12 months ago), but for MNCs, it is a worsening and looming problem (58 percent versus 49 percent).

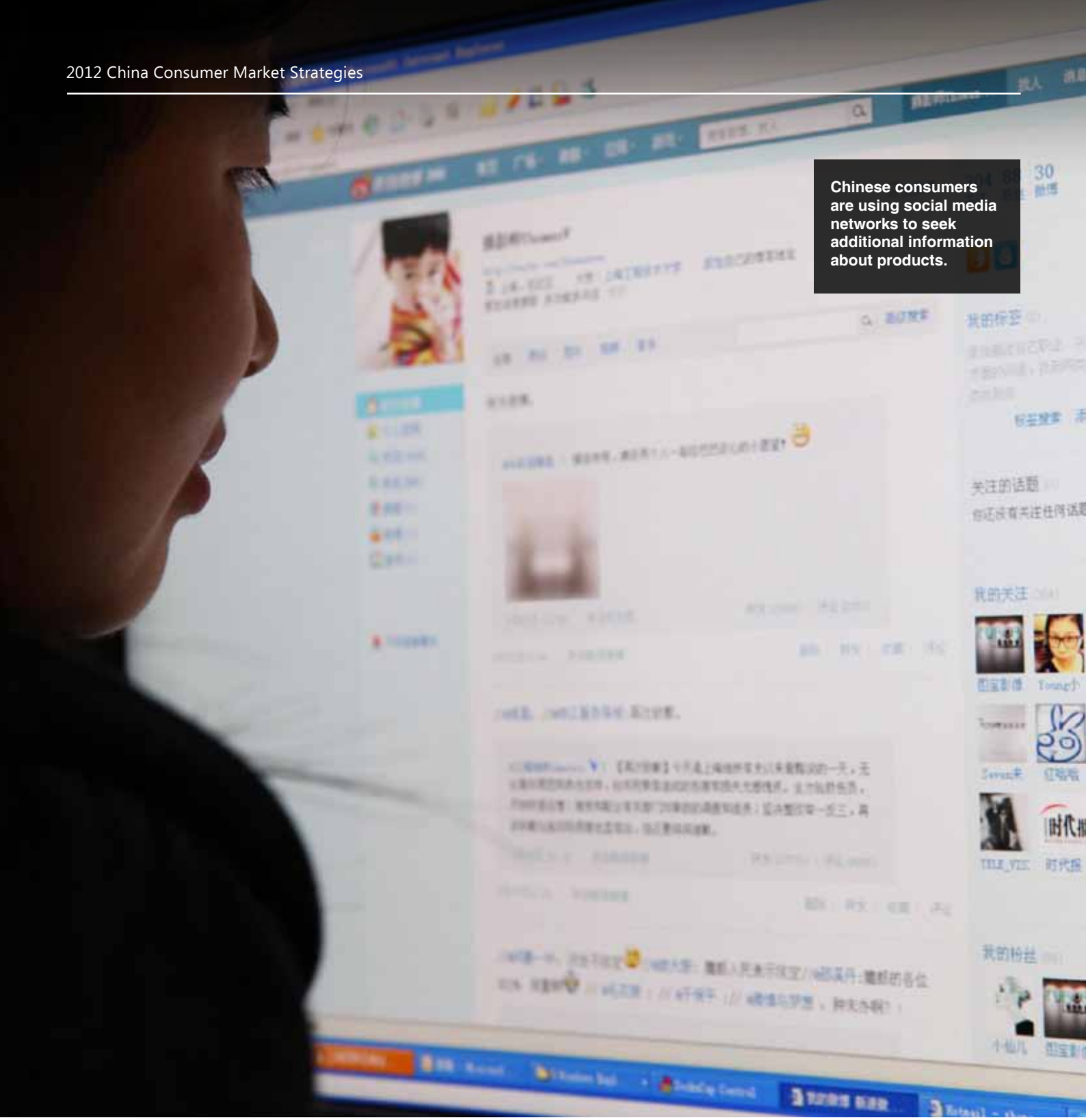
A CAPABILITIES-DRIVEN STRATEGY

Last year, go-to-market skills and better staff performance were the two capabilities that companies identified as competitive necessities for China—must-have essentials for winners in the Chinese consumer market. This year, two more critical capabilities are added to the building blocks that companies must embrace: product innovation as a way to provide more unique items with a range of features and price points for both value- and choice-seeking consumers; and better branding to communicate product features and build an emotional connection with customers in a crowded marketplace encompassing bricks-and-mortar and Internet channels.

1. Product Innovation

The critical challenge in product innovation for both MNCs and Chinese companies is to develop products that appeal uniquely to Chinese tastes. For example, Kraft was only able to muster a modest 3 percent market share for its Oreo brand until the company launched new local versions that grew out of extensive testing. Major changes were made in the product. For example, the new cookie was less sweet and the packaging was reduced to fewer cookies per package. Kraft also launched first to the world new formats in China for Oreo such as Oreo Wafer Sticks. In short order, Oreo's market share in China rose from 3 percent to over 13 percent of the China cookie market.

Most MNCs are quite good at big picture product innovation, but moving nimbly in China to develop items that meet local Chinese preferences has not been their forte. Meanwhile, Chinese companies have been investing heavily in product R&D to quickly respond with products targeted at new market opportunities and popular tastes. About 75 percent of Chinese companies surveyed have R&D facilities in the country to develop products for domestic consumers, whereas only about 50 percent of MNCs do. As a result, 20 percent of Chinese company respondents report that more than 60 percent of their sales come from new products launched in the past 3 years—as compared to only 5 percent for MNC respondents.



Chinese consumers are using social media networks to seek additional information about products.

2. Branding

Brand building is one of China's trickiest business challenges. Traditional media outlets—particularly conventional above-the-line advertising—is now extraordinarily expensive—an onerous cost for companies new to the market or operating in niche or sub-scale markets. In addition, consumer relationships with many brands are highly contradictory. On the one hand, Chinese consumers frequently show minimal loyalty, freely jumping from one brand to another. On the other hand, strong brands tend to influence consumer purchasing behavior, with category champions enjoying preeminent position in most consumers' minds.

The survey found that value shoppers are viewed as repeat buyers for

brands that live up to their promises of quality, safety and features. Once hooked on a brand, they will purchase it again and again as long as it consistently meets expectations. Choice shoppers are viewed to have a much different relationship with brands. They are seeking to pay as little as possible for the product features they want. As a result, the brand itself doesn't matter as much. Nonetheless, companies targeting choice consumers must continue to aggressively promote the facets of their brands that would appeal to these more price-driven shoppers—and they must do so through new channels, such as social media and mobile content. Over 80 percent of respondents said that choice consumers seek additional information about products before making purchasing decisions and 58 percent said that online shopping is a favored activity of this group.

CLOSING CAPABILITIES GAPS

In the past, the vast majority of MNCs and Chinese companies lacked strategic coherence around the core set of capabilities needed to thrive in their targeted consumer markets. Each had strengths in certain aspects of their business but their weaknesses often stood in the way of success. For example, MNCs were generally adept at developing high-level buzz and positive branding messages around key products. But they often missed out on opportunities to sell these products, or offshoots with fewer features, more widely because their sales and distribution capabilities were not developed to address the complex realities of the Chinese multi-tiered retail landscape.

Meanwhile, Chinese companies have been able to reach the many fragmented retail channels in the country using their local insight, but they have often fallen down in developing high-quality products with innovative features. Historically, much of the R&D practiced by Chinese companies was, in effect, to figure out new ways to design already available products more cheaply.

Today, however, with competition intensifying, many companies have found they need to fix their weakest links and build up their strengths—to develop more coherent and aligned capabilities systems. To close these capabilities gaps, MNCs and Chinese companies are increasingly turning to M&A and joint ventures. In particular, Chinese companies are making deals to acquire brands with well-established global pedigrees that require fewer marketing skills to promote. For example, Bright Food recently acquired the British organic cereal maker Weetabix to use these popular products to reach health-conscious value consumers in China.

Taking the opposite tack, MNCs are joining forces with Chinese companies to leverage their go-to-market capabilities. For instance, PepsiCo's sale of its shares of the bottling operations to Tingyi is likely an attempt to tap into Tingyi's strong ready-to-drink beverage sales and distribution capabilities.

CONCLUSION

This year's consumer survey paints a picture of a maturing Chinese consumer market with distinctive segments that will continue to evolve. As Chinese companies and MNCs increasingly view the market and its challenges similarly, and target the same potential customers, competition among the two groups is heating up.

To succeed in the Chinese consumer market today, a company needs to:

- Clearly articulate the role that each of the four core capabilities—product innovation, marketing and branding, sales and distribution and people-—will play in the organization's operating and business model.
- Develop detailed strategies within each of these four capabilities and understand, against the company's strategy, where it is important to be truly great versus acceptable.
- Ensure that these capabilities and underlying strategies are mutually reinforcing and coherent.
- Be nimble and adaptive, and use the company's capabilities to shift strategies as the market transforms.

Survey Background

The 2012 "Trends in China's Consumer Market" survey was conducted by The American Chamber of Commerce in Shanghai (AmCham Shanghai) in cooperation with Booz & Company, a global management-consulting firm that works with many of the world's top businesses, governments and other institutions. A total of 152 companies with extensive sales operations in China were surveyed in April and May 2012. The companies were presented with nine trends impacting the Chinese consumer, and were asked to select the three most important trends for their industry. Then, a series of 12 questions were asked about each of these trends, including who the trend will impact most and how the company itself is responding. Findings were then validated through one-on-one interviews.

Of the companies surveyed, 41 percent were Western multinationals, 24 percent were Chinese state-owned enterprises, 20 percent were private Chinese companies, 13 percent were based in Hong Kong or Taiwan and 3 percent were other Asian companies. Broken down by industry, by far the biggest sectors represented in the survey were automobiles (20 percent) and consumer goods (18 percent). Pharmaceutical, telecommunications, financial services and professional services companies, among numerous other sectors, each represented below 10 percent of respondents. The survey was conducted through online questionnaires and follow-up interviews.

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