Consumer products companies and retailers confront a more complex and competitive China

Looking for growth in a slower-growth China

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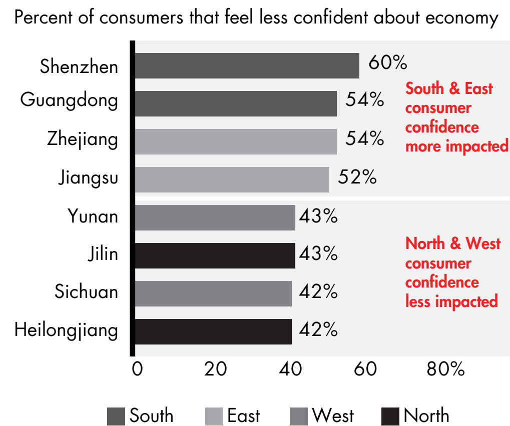
As the financial crisis swept across the globe, China defied recessionary pressures and continued to grow. Although the pace has cooled from explosive double-digit rates, many forecasters are predicting that the emerging market titan may be the first major economy to accelerate out of the downturn. But even if China does rebound, spurred by the government's $586 billion stimulus package, the storm is far from over. Consumer products makers and retailers are confronting a reshaped landscape, one that is both more complex and brutally competitive.

Fast-Moving Consumer Goods (FMCG) companies and the retailers who sell their products have long known that, given the country's vast regional differences, they never could rely on a one-size-fits-all approach to expansion in China. But now, as the dust from the downturn begins to settle, those differences have come into sharper focus. Export-dependent coastal cities like Ningbo and Shenzhen now struggle with consolidation in the once-booming retail sector while those same retailers implement ambitious expansion plans to serve the fast-growing middle class in central and western China. The new environment calls for consumer goods companies and retailers to become far more strategic than ever as they readjust their expansion plans, paying renewed attention to each market's subtleties and potential for profitable growth.

For many companies, China's less impacted regions are the best bet for growth—this includes many of the country's more than 1,500 Tier 2 and Tier 3 cities as well as cities in central and western China, where middle-class consumers now have more discretionary money to spend (See Figure 1). As competition has intensified in the biggest cities, these cities—120 of them with populations over one million—provide a lucrative new arena for well-established multinationals selling necessities like toothpaste, laundry detergent and other household items. But there are a couple of complicating factors. For one thing, while some categories are wide open, others—beer is an example—have become the domain of formidable domestic competitors. And in these cities where much of the growth will occur, domestic companies may have a competitive edge over multinationals when it comes to supplier and distributor networks; they can capitalize on established networks to feed their expansions while foreigners would have to invest heavily to catch up.

Figure 1: Economic impact in China differs by geography



Tsingtao	Sales in **GZ and Eastern** cities declined significantly in Q408 (by as much as 20%–30% in some cities)
Home Inn	Occupancy rates in Q408 **declined** by 4% in SH/BJ/GZ cities, **declined** by 2% in Tier 2 cities but **increased by 6% in smaller cities**
Li-Ning	**Strong same store sales** growth in **Tier 3** cities in West and Central regions, weakening growth in the South

*Home Inn Tier 2 cities include province capital cities and 9 other big cities, e.g., SZ, NB and DL
Source: Millward Brown ACSR and Light Speed survey (N=11,300, Nov-Dec 2008, collected in 23 provinces); Analyst reports

With so many variables in play, knowing where you can head in tomorrow's China starts with knowing where you stand today. Companies that succeed in the post-downturn climate will be those that understand the opportunities created or limited by their competitive position—especially against domestic players—and the implications of how their category is faring. For example, a market leader in a relatively stable category like shampoo would approach expansion quite differently than a weak player in a severely impacted category like luxury watches.

Here's how both retailers and consumer products companies have used their market position to dictate expansion plans for a slower-growth China, making the most of opportunities in the areas of customers, channels, competitors and costs.

Leader in a growing category

Household necessities and affordable indulgences have held up well across the country and are likely to continue growing in the post-downturn market. Leaders like Procter & Gamble, Kraft and L'Oreal have taken advantage of the economic turbulence to grab market share from weaker competitors through aggressive marketing, pursuing untapped customer segments, increasing profits through efficiencies and, where they can, acquiring struggling companies.

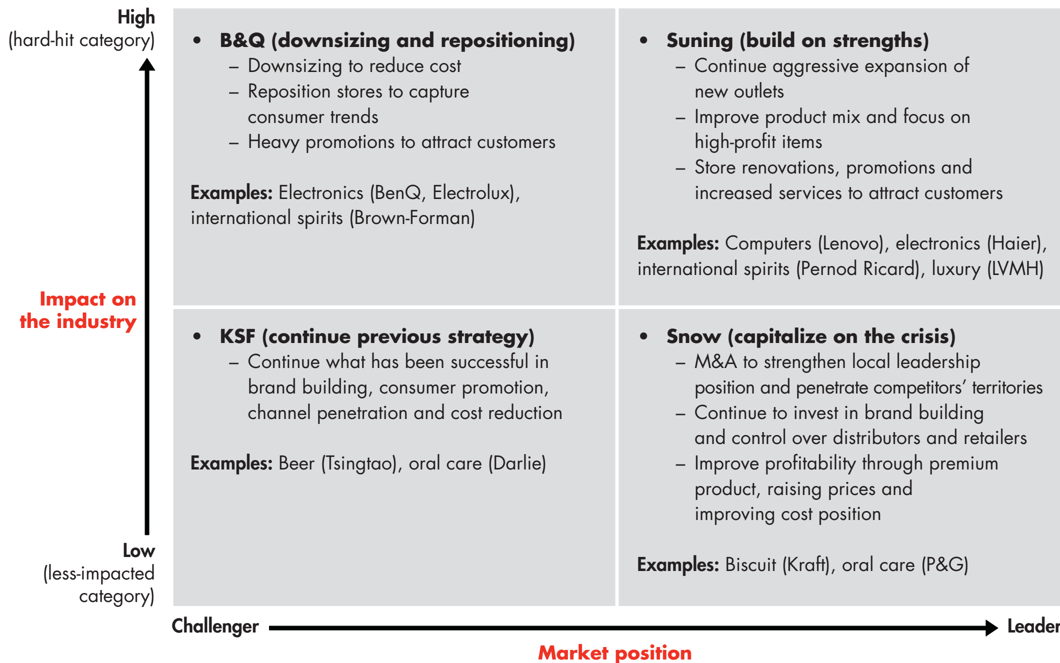
Take Snow, China's number-one selling beer, a joint venture between China Resource Enterprise Ltd and SABMiller. The Chinese brewery has capitalized on the financial crisis by using acquisitions to pick off smaller rivals and expanding into areas that both build on its local leadership position and penetrate competitors' territory. In the spring, Snow acquired four beer makers, including Shandong-based Amber Breweries, a move that gives it a foothold in the province where arch rival Tsingtao dominates. It also has launched a premium draft beer to improve its product mix and continued its national brand-building campaign, outspending Tsingtao's CCTV advertising by three to one. To increase profitability, the company has raised prices and reduced the bottle size in target markets, including Hangzhou, Sichuan and Jilin. Meanwhile, Snow has invested heavily to gain access to important wholesalers and obtain exclusive deals with retailers. To improve its cost position, the brewer has centralized procurement and invested in better inventory management.

These moves have paid off handsomely for Snow, with beer sales volumes increasing 20 percent while revenues have grown 25 percent in the first half of 2009, enabling the company to accelerate out of the downturn stronger than ever.

Challenger in a growing category

In relatively unscathed categories like beer, snack foods and home-care products, challengers to the market leaders are best served by staying the course in their pursuit of new growth. They should continue doing what's proven successful in brand building, consumer promotions, penetrating channels and reducing costs. Companies in this position include Tsingtao, a major competitor to Snow, oral-care product maker Darlie and Kangshifu (KSF), a leader in beverages, instant noodles and biscuits. In biscuits, KSF's strategy is to ratchet up efforts to gain on top-selling Kraft, while at the same time fending off encroaching foreign competitors. To win over customers, KSF is teaming with celebrity endorsers to increase brand awareness among younger consumers as well as sponsoring student music festivals and online games. To grow share, the company has offered value packs and bundled products. KSF is also beefing up its already strong network of suppliers and distributors to help it expand into fast-growing rural areas. And to reduce costs, the tech-savvy

Figure 2: Case study of companies' response to the new environment



company has relied heavily on its information technology system to improve the efficiency of its manufacturing, distribution centers and sales networks. The company's biscuit business saw strong revenue growth of 14.5 percent in the first half of 2009. Operating profit margins have more than doubled from less than 4 percent in the first half of 2008 to more than 9 percent in the first half of 2009.

Leader in a hard-hit category

In severely impacted product categories like consumer electronics and high-end luxury goods, market leaders looking for growth know they must do more than simply hold onto existing customers. They must capitalize on the crisis to grab market share. Companies like Suning, Haier and Pernod Ricard implement strategies that build on the strengths that made them industry leaders, while at the same time exploiting competitors' weaknesses. To boost sales and customer loyalty and at the same time target new customers, they beef up branding and distribution, focus on value offerings that get shoppers in the door, run targeted promotions and discounts, and constantly look for ways to reduce the cost structure.

For Suning Appliances, the good news is that it has established itself as a leading electronics retailer. The bad news is that appliance sales have dropped dramatically in its biggest markets, 9 percent in the first three months of 2009 alone. But while sales in its Tier 1 city stores plunged, Suning was able to increase profits 48 percent in 2008 and 15 percent in the first half of 2009 because the rest of its stores held up. Just as the downturn started to be felt elsewhere in China, the company began mapping

out a strategy to make the most of the changing market: aggressively expand, improve its product mix, renovate stores and use increased services as a lure to attract new customers.

To shift the focus to high-profit items, Suning started prominently displaying high-margin consumer electronics items near store entrances. The maneuver worked, boosting sales of computers alone by 30 percent.

Expansion plans call for opening more than 200 stores in 2009, part of Suning's efforts to undercut the dominance of troubled Gome Electrical Appliances. To cash in on a government rebate program that encourages the purchase of household appliances, Suning is rapidly rolling out stores in rural areas. Over the next five years, Suning's master plan calls for opening at least 1,000 new stores. And Suning is moving into the Japanese market, with plans to purchase a majority stake in Laox, a struggling Japanese electronics retailer, giving it access to Japanese consumer electronics retail experience and to Japanese games and toys suppliers.

Challenger in a hard-hit category

Weak players in hard-hit categories like consumer electronics, premium liquor and home improvement face the fewest options in the post-downturn economy. Among the companies in this position: consumer electronics competitors BenQ and Electrolux, imported spirits maker Brown-Forman and UK-based home improvement giant B&Q. For these and other companies, plotting a future means downsizing to reduce costs, repositioning to capture consumer trends and promoting heavily to attract customers.

B&Q opened its largest store in Shanghai amid great promise on the date 8/8—a lucky number combination in China—in 2001, but now is paying a heavy price for expanding too rapidly in the country. The retailer is burdened with oversized stores selling too many items and sometimes the wrong products for the markets.

To recover, B&Q is taking some dramatic steps. To offset losses in 2008, B&Q plans to close almost a third of its Chinese stores and downsize others. It's cutting costs by scaling back, cashing in on new market trends and increasing sales with heavy promotions featuring discounts of up to 40 percent. From a smaller base, B&Q is pegging its future on a new approach to expansion. Its first "B&Q Next Generation Store," which opened in March in Shanghai, is more modern, more user-friendly and geared to female customers, in recognition of the fact that women often make the decisions about home improvement purchases.

For B&Q, and other retailers and consumer products companies operating in China, capturing one's share of a slower-growth future starts by understanding that competitive position and industry stability dictate how to plot your moves. And as growth accelerates, particularly in the North and West, and in smaller cities throughout China, it requires carefully seeking out the pockets of opportunity that have replaced a booming free-for-all.

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