

Retail in China: a fragmented landscape

Nobody should need reminding of how important China is likely to be to 21st century multinationals. But is a lack of understanding of the Chinese retail chain holding global brands back? Gilbert Lee and Karen Que take a closer look.

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

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

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

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

International brands initially secured a lion's share of the emergent mobile market in China. In 2000, the big global players such as Motorola and Nokia enjoyed a 90% market share, but by early 2004 about half the mobile phones sold in China were local brands. As the overall market expanded the big brands lost ground, particularly in the smaller cities and rural areas. Our experience at Research International China suggests, however, that even in these cities global brands are still seen as being higher quality and have higher overall preference. But consumers' familiarity with and knowledge of local competitors is higher. If this lies behind the big players' dwindling Chinese market share it must be a sign that preferred brands are simply not reaching local retailers in big enough numbers. The global

manufacturers need to understand the differences in channel structure between larger and smaller cities.

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

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

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

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

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

Target audiences in China are open to global brands, and can be effectively marketed to

via advertising, but unfortunately you cannot take it for granted that your brands will actually be available to their potentially huge audience. You need to work hard and smart to make it happen.

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

The second part of the strategy should involve a greater focus on “push” marketing to build up a brand presence at point of sale in small regional markets. This inevitably means a larger investment in the sales force, and also smart thinking in terms of sales promotions, range management and product placement. This might mean training salespeople to have more of a ‘street market’ mentality in terms of promotions – a classic example being a mobile phone customer who switches brands on the promise of a free badminton racquet worth less than 5% of the phone! The aim should be not only to increase sales but to build up brand knowledge among the consumer base – hard information that an aspirational advertising strategy cannot deliver. So in-store information packs and tailored brochures and leaflets will also play a part.

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

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