TITLE: MYTHS & SURPRISING TRUTHS ABOUT CHINA

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Around 86% of the world lives in developing markets of which more than 20 % live in one country – China. The population of China is estimated to be between 1.3 and 1.6 billion. In that range of error is the entire population of the US. It has 150 cities with over a million population versus 48 in North America and Europe together. It is the third largest economy growing at around 9.7% and expected to become the second largest by 2015. In the next couple of years 60 airports are planned and the new Beijing airport is the biggest in the world. China is adding 10 million car owners per year and 6 million mobile phone accounts per month. China's scale is daunting, diverse and full of promise.

The scale of China and its diversity makes it the coveted prize not just because of its large consumer base but also because it offers huge cost advantages as a manufacturing base. For any marketer the questions that arise are; is China really different from the developed world? Have the rapid change and forces of globalization changed the values of the society? For a society in transition, what roles do brands play? How much cachet do global brands carry? Are local brands a challenge or can they be harnessed? And so on. This is an attempt to share some insights into the myths and surprising truths surrounding China.

PRODUCTION MYTHS

- **Myth** - China cannot produce global brands – Chinese reputation for producing counterfeit brands is without parallel. The World Customs Organization estimates that 7 percent of world merchandise or more than $500 billion worth of goods in 2004 is from counterfeit products with about two-thirds coming from China. For long, 'Made in China' was associated with poor quality. Perceived inexperience, lack of managerial talent, corporate structures geared to serving single and captive markets have posed hurdles in China becoming successful globally. According to a Mckinsey study, China has the slowest pace of globalization compared to India, South Korea and Taiwan in terms of sales, assets, employees, shareholders and top management outside the country.

  Surprising Truth - Presently the only competitive advantage of companies based in China is seen as low cost production. 'the China price' are the three scariest words in US industry. In general, it means 30% to 50% less than what you can possibly make something for in the US. In the worst case it means below your cost of materials. But according to a McKinsey study that is all going to change in the next three years as Chinese companies are on the threshold of becoming truly global. In fact some are more global than their better known global brands. Lenovo scores over Dell on all the metrics for globalization mentioned above. Haier is making its presence felt as the value brand of choice in developed markets. China International Marine Containers (CIMC) has been a pioneer in Chinese globalization. Chery and Geely are selling Chinese cars to the world. Most Chinese companies are testing the waters by entering developing countries in Eastern Europe and Asia before entering developed markets.

- **Myth** - It is a large shop floor rather than a creative hotshop – There is a belief that while India is the best destination for products at the high end value chain, China offers the best production base.

Surprising Truth – A Chinese Silicon Valley – in the mid 90s the idea would have laughable. China was a place to make sneakers not semiconductors. But to many of Silicon Valley's movers and shakers the specter of Chinese competition is no longer a joke. The assumption has long been that US and other developed economies will keep leading in knowledge-intensive industries while developing nations focus on lower-skill sectors. "What is stunning about China is that for the first time we have a huge poor country that can compete both with very low wages and in high tech," says Harvard University economist Richard B. Freeman. 3Com Corp. in Massachusetts is settling for lower margins and taking advantage of a 1,200 engineer joint venture with China telecom giant Huawei technologies Co. This is the first high-end piece of networking gear sold by a US company that is designed and manufactured in China. Outside Beijing, Semiconductor Manufacturing International Corp. has just opened a chip plant fabricating 12-inch silicon wafers that experts say is just two generations behind Intel Corp.

CONSUMPTION MYTHS

- **Myth** - The consumer is driven by price and price alone – A State controlled economy, a single Party political system and no profit motivation, ensured that the Chinese consumer had no choice, poor quality products at the bare minimum pricing. Conventional consumer mindset leans towards frugality, conservatism and lack of consumerism and consumption.

  Surprising Truth – Over the past 15 years, disposable income in China has risen three to five times faster then income in the developed world, bringing better living conditions and more sophisticated tastes. Consumers are looking upgrade in most categories. In a KPMG study trading up beats trading down – topping the charts are consumer electronics, home appliances, personal care, skin care and cosmetics and home décor (50% and more claimed they would uptrade). Trading down is more prevalent in the West with the popularity of large retailers such as Aldi, Asda, Carrefour and Wal Mart. In China shopping in such supermarkets would be considered uptrading compared to traditional Chinese trade channels and unbranded products. There are three factors driving uptrading; first is the hunger for trying out new and better products with rising affluence. Second the absolute price point of products in the value segment is much lower in China than it is in the West and the value segment has the largest share of the market. Finally, there are always concerns about the quality about mass and value brands and western /global brands enjoy greater trust and loyalty particularly for baby food and dairy products.

- **Myth** - The consumer is seduced by global brands – In a McKinsey study, more than 80% consumers claimed to buy well known names in consumer electronics and food and beverages. And 69% would buy more branded stuff if they had enough money versus 57% in the UK and the US.

  Surprising Truth – Despite these claims, Chinese consumers do not consistently buy the same ones or even those they prefer. Asked to choose among three leading television brands – two foreign and one domestic – 49% of the survey (McKinsey) respondents said they would pick Sony if prices were similar. However, for a Sony 10% premium over Changhong, a leading domestic brand, could have 33% of the Sony would-be-buyers move to the cheaper rival. This is despite consumer electronics enjoying some of the highest brand preference and loyalty scores among all the categories. In the McKinsey Chinese survey loyalty scores in China are about 50% higher for consumer electronics than for fast-moving consumer goods such as soft drinks and personal care items In contrast, US consumers are much more loyal to sodas and other daily purchases than to consumer electronics. One reason is that in China the price of a television set is a very large share of the household income. In daily items they are trying out new offerings whereas in western markets people have settled down over time with what works best with them.

- **Myth –** For most global brands global positioning statements are expressions of universal motivations and emotions. In most markets across the world, brands use cultural connects for the global positioning. For example, Head&Shoulders is sold on the back of the dandruff story or OMO is positioned as 'Dirt is Good'. Chinese, given their proclivity for foreign brands, should have no problem with global platform as in other markets.

Surprising Truth – Interestingly, China is becoming a battleground for global versus local realities. Consumers don't seem to buy into the global promises (even when they are about functional benefits and not just imagery). Head & Shoulders talks about beautiful and shining hair and OMO is struggling with its 'dirt is good' positioning in China. In both cases the dominant logic or the prevalent consumer habit is so contrary to the premise on which the product is based that it is unlikely to work. A reverse case scenario would be to try sell MSG in UK something that is routinely used in Chinese cooking. Popular belief is that MSG is not good for health.