Avoiding Stalemate in China

Many multinational companies have been blaming their deteriorating performance in China on the country’s economic doldrums. They expect their businesses to improve within a few years, when the economy rebounds. But China’s economic difficulties are masking a more fundamental problem: too many me-too strategies. Succeeding in China requires a more targeted, creative, and differentiated approach than most MNCs are practicing today.

The Stampede for Market Leadership

MNCs have been rushing into China for understandable reasons: it is a potentially huge market for consumer goods. Unlike most emerging markets, China isn’t an option; it’s considered a strategic imperative (see Exhibit 1).

But that perception has created a gold rush mentality. Everyone is trying to get it all by getting there first. What’s more, many MNCs are employing the same or similar strategies in pursuing the same small area of the consumer market: the high end of a segment that is mostly urban (see Exhibit 2).
Nearly every MNC is attempting to control that market by

- introducing global brands at premium prices
- starting on the coast and moving inland
- patching together a network of local wholesalers to cover the many small outlets in China's vast territory and trying to improve that network over time
- relying heavily on TV marketing campaigns to build brand equity

These companies believe that the key to success in China is to obtain the scale advantages that come with a large market share, even if they must tolerate some pain in the short term. In particular, companies whose businesses were growing rapidly before the economy slumped feel this way. They are reluctant to scale back investments this early in the game.

As a result, too many players are chasing too little demand in too many categories. Take beer, for example. Total annual consumption in China is only 15 liters per capita. Although the beer market is growing at an annual rate of about 10 percent, the capacity of foreign brands exceeds demand for their products by as much as 100 percent. Not surprisingly, the prices that such brands command in China are more than 50 percent below the prices they command in other countries. Exhibit 3 illustrates the overcapacity problems of four industries in China. Many others are in a similar predicament.

In addition, because nearly every MNC is targeting the same consumers in the same regions with similar upscale products, building brand loyalty has become very expensive. Add to this the competition from the improved offerings of local players, and the result is even more clutter.

A rebounding economy won’t make the problem disappear. And China’s entry into the World Trade Organization will not be a panacea, since the consumer products sector is already fairly deregulated. Unless companies radically change their strategies, a lot of categories will have only one or two winners and a host of unprofitable also-rans.

**Exhibit 3. When Will Demand Catch Up to Capacity?**

- **Color TVs**
  - Current capacity: 45 million units
  - Projected annual growth: 8%
  - 1998 demand: 21 million units
  - 2008 demand: 45 million units

- **Instant Noodles**
  - Current capacity: 25 billion servings
  - Projected annual growth: 10%
  - 1998 demand: 15 billion servings
  - 2003 demand: 25 billion servings

- **Beer (foreign brands)**
  - Current capacity: 20 million hectoliters
  - Projected annual growth: 10%
  - 1998 demand: 10 million hectoliters
  - 2005 demand: 20 million hectoliters

- **Refrigerators**
  - Current capacity: 20 million units
  - Projected annual growth: 10%
  - 1998 demand: 10 million units
  - 2004 demand: 20 million units

*Foreign brands currently account for about 5% of the total beer market.
Sidestepping a Stalemate

A me-too strategy in a highly desirable and crowded market can result in stalemate. A typical stalemate occurs late in a business cycle after years of competition have lowered the barriers to entry, saturated the market, and turned differentiated products into commodities. Capacity exceeds demand, prices collapse, and profit margins wither. There are too many players, but everyone hopes someone else will blink first and withdraw.

The bad news is that stalemate is already a possibility in China. The good news is that there are ways to avoid it. Understanding the range of strategic options begins with a radical reevaluation of what it would take to establish a defensible long-term position. While scale is clearly an important way to achieve competitive advantage, it is not the only lever.

We have developed a framework that will help companies identify the best strategy for their current competitive position, the underlying category economics, and their degree of category definition—the extent to which purchasing behavior and product use are established (see Exhibit 4).

A few players have already used this framework to set themselves apart from the crowd. For example, a high-end beverage producer with a weak competitive position and low category definition recognized that it was facing both declining sales and loss of market share. So it created and aggressively marketed offerings designed for gift giving and heavy-usage occasions such as weddings—areas that other players had ignored. In that way, the company succeeded in finding new opportunities to grow, improve profitability, and increase brand equity among heavy users.

Another mass-market beverage manufacturer found itself competing on a par with other players at the early stages of category development in China. It responded by lobbying to obtain a structural advantage. This involved an aggressive government-relations campaign to gain access to several attractive markets. That strategy took the company from competing city by city to a position as market leader.

A third MNC found itself in a fragmented category in which low cost and distribution scale are critical to success. The company pursued an acquisition strategy to achieve greater economies of scale and consolidate the industry. That approach required the company to build a strong competence in identifying, integrating, and managing local enterprises without alienating their existing management teams. The company also had to develop and manage local brands, occasionally at the expense of some of its own global brands.

Opportunities for Action

Reprint

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You are the national leader

No players have distinct advantages

Another player dominates

Protect and leverage leadership position to improve profitability

• Reap rewards from both scale and brand leadership

• Invest or acquire to secure leadership or retrace to your niche

• Base decision on anticipated size, timing, and risks of the ultimate payoff

• Reevaluate ambitions in China

• Extend portfolio into less defined categories

• Perhaps lobby for structural advantages

• Acquire, find a niche, or exit

Make your brand the reference for the category (e.g., Kleenex for facial tissues)

• Accelerate category-definition process among target consumers

• Build on the momentum

• Become a trend leader

• Perhaps lobby for structural advantages

Alter the playing field

• Create a trend in the way your product is used or perceived

• Perhaps lobby for structural advantages

High

Low

Category Definition

Competitive Position

Exhibit 4. Strategic Options
Making the Right Decisions

As these examples demonstrate, winning in China requires original strategies. To create them, MNCs first must be sure that the appropriate people are involved. Local managers often don’t have enough time: they have their hands full just handling day-to-day operations. And even if they do have the time, they often need help getting the critical constituents to understand the need for a radical shift in strategy. To that end, many successful companies have brought in managers from their headquarters and regional organizations.

Second, companies usually develop breakthrough strategies by starting with a blank slate rather than by benchmarking the few successful players. The latter approach will produce a me-too strategy, not an original plan.

Third, decision-makers should use the strategic options framework to create customized strategies. To apply the framework and identify the right strategic options, a company must be able to answer some specific questions about its categories and markets:

- How attractive are our category’s economics?
- Is regional scale or national scale more important for increasing profits?
- How important is the breadth of our portfolio in achieving scale?
- Will current prices and costs allow us to make money soon? If not, will there be a shakeout? When? Can we stick it out?
- How profitable and sustainable is a focused strategy?
- Could our product be used in different ways?
- Could we create a trend in how our product is used and perceived?
- What is our competitive position?
- Is a me-too strategy feasible?
- If we can compete, in what regions? What channels? For what kinds of consumers?
- Would we be better off making an acquisition or an alliance? With whom?
- Can we lobby the government for competitive advantage or to improve the economics of the category?

MNCs can avoid a stalemate in China. There are excellent long-term opportunities. Identifying and exploiting them, however, will require deep analysis, original thinking, and the courage to break away from the pack.

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