Business Trends & Corporate Strategies

CHINA FOCUS

FIDUCIA 德信
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Selling to Chinese Consumers

In this issue:

It might seem paradoxical that, while China's slowing economy makes headlines, many of our international clients selling to China continue to experience and project double-digit growth. But several trends support and help explain their optimism:

Economic: With consumption accounting for 3/4 of GDP growth in 2018, China is leaving behind government investment and exports as its main growth engines, and is on track to becoming a consumption-led economy.

Market: A growing middle-class is driving premiumisation, which favours foreign brands who sell higher-end goods. Average FMCG prices, for instance, are rising faster than inflation, as steeper price tags become a selling point rather than a turn-off.

Social: With a savings rate of 46%, compared to the USA's 18%, China is known for its thrift. But generational change is shaking things up. China's Generation Z, born after 1998 into an already prosperous country, are keen spenders. They already account for 15% of all household spending, versus just 4% in the US.

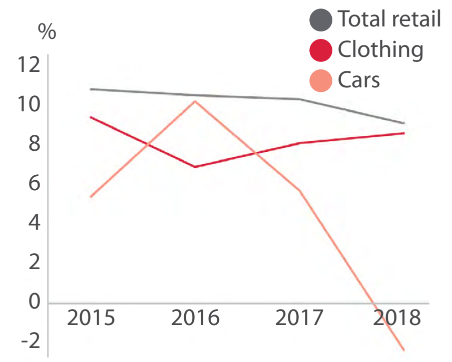
For all its promising signals, China's maturing consumer market also holds new challenges for foreign companies, including a complex digital ecosystem (chart 3) and highly demanding consumers (page 2). In this China Focus, we share a positive outlook for China as a growth market, but we also point out the pains and pitfalls market entrants are likely to face on their path to success. We hope to have the chance to help you get there.

Stefan Kracht

WHAT SLOWDOWN?

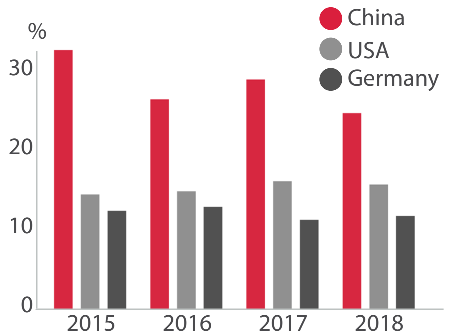
A closer look at consumer goods sales in China (graph 1) shows that the recent woes of the automotive sector don't reflect the general trend: growth in other categories has actually sped up. China's e-commerce market is another cause for optimism: it continues to be the world's fastest-growing (graph 2), offering new and lower-risk avenues for foreign companies to reach consumers. Rather than China's slowing economy, what concerns most foreign companies is its dizzying digital landscape. To stay ahead, being familiar with WeChat, Tmall, and JD is no longer enough. In chart 3, we describe six digital platforms worth looking into for sales and/or marketing purposes.

1.GROWTH IN CHINA'S RETAIL SALES
(% change from previous year)



Source: National Bureau of Statistics (NBS)

2.GROWTH IN ONLINE RETAIL SALES
(% change from previous year)



Sources: NBS, US Census Bureau, BEVH

3. SIX MUST-KNOW E-COMMERCE & SOCIAL MEDIA PLATFORMS

Douyin *(TikTok)*	▶ A social network for sharing short videos ▶ First Chinese app to go global (1b+ downloads worldwide) ▶ 500m monthly active users (MAU), 80% of whom are <29 years old ▶ **Brands using it:** Adidas, Airbnb, Audi
Kaola	▶ One of China's top 3 cross-border e-commerce platforms* ▶ Opened two physical stores in 2018, 15 planned for 2019 ▶ 5m MAU, mostly white-collar consumers aged 20-40 ▶ **Brands using it:** Evian, Hape toys, Orangegarten (by Migros)
Meituan-Dianping	▶ China's #1 e-commerce company for services* (e.g. food delivery) ▶ Named "world's most innovative company 2019" by *Fast Company* ▶ 290m MAU in 2,800 cities; mass market focus ▶ **Brands using it:** KFC, McDonald's, Pizza Hut
Pinduoduo	▶ China's #3 e-commerce site*, specialising in group discounts ▶ Avg. order value: USD6 (vs. USD60 on JD and USD30 on Taobao/Tmall) ▶ 230m MAU, of whom 65% live in third tier cities or smaller ▶ **Brands using it:** Few foreign brands due to low-end focus
Vipshop	▶ China's #4 e-commerce app*, specialising in flash sales model ▶ Tencent and JD invested USD863m in 2017 ▶ 130m MAU, of which 70% are female ▶ **Brands using it:** Calvin Klein, Fendi, Marc Jacobs
Xiaohongshu *(RED)*	▶ Social network + e-commerce, featuring user-generated content ▶ Started as a platform to share overseas shopping experiences ▶ 30m MAU, mostly from the "post-90s generation" ▶ **Brands using it:** Braun, MAC Cosmetics, Philips

** Ranked by sales value*

FAST AND CURIOUS

Five Key Features of Chinese Consumers

China's 1.3 billion consumers have fueled the growth of B2C brands worldwide for decades. Across categories, they now account for a large chunk of multinationals' global revenues: 41% for Volkswagen, 33% for cinema group Imax, and 20% for Apple and Adidas.

But simply taking your brand to China is no guarantee for growth. The retail landscape has become so saturated, mature, and complex, that it's more vital than ever for market entrants to go beyond a superficial understanding of the local market. Here are five features of Chinese consumers that foreign brands should be aware of:

1. THEY'RE SPREAD OUT

Disposable incomes, and thus consumption, have boomed in China's flashy, first-tier coastal cities, sometimes overshadowing the huge potential that still exists in smaller towns.

In 2018, rural consumer spending per capita grew at almost twice the speed of urban spending. The recent rise to fame of e-commerce platform Pinduoduo – which offers good bargains to a mostly rural user base – has revealed just how demographically dispersed China's spending power is. This is even true in the high-end segment: more than half of China's luxury consumers now live outside of the country's 15 top cities.

Reaching China's lower-tier cities has gotten easier thanks to e-commerce. Most foreign players, however, continue to concentrate their offline presence in the main metropoles. This makes sense when first entering the market, especially for high-end players whose glitzy flagship stores in prime locations help cement them as aspirational brands.

2. THEY'RE CURIOUS

China's "open door policy", launched in 1978, gave way to decades of unprecedented economic prosperity. Almost overnight, new products, trends, and aspirations started flourishing. Digital connectivity has only sped up this process. As a result, consumers got used to a brisk pace of change. They expect novelty and tend to be much more experimental than their Western counterparts.

What does this mean for foreign brands? One implication is the need for a broad and frequently updated product assortment. This approach underlies the success of Decathlon in China, its largest market outside of France. The French sports retailer offers all the gear consumers need to try out new sports, releasing more than 3,000 new products per year across 80 sports categories. For experimental shoppers, affordability is also key. Although there is a growing niche of committed Chinese skiers seeking top-notch gear, many more are just looking for "good-enough" outfits for a one-off ski adventure.

3. THEY'RE TECH-THIRSTY

Chinese consumers are not just keen on trying out new hobbies and products; they're also experimental when it comes to shopping habits. This early-adopter mindset is partly what's fueling "new retail", a concept coined by Alibaba to describe the seamless merging of offline, online, data, and logistics along the customer journey – largely achieved through tech.

To stay relevant in a market where the shopping experience is in constant flux, foreign brands need to rethink their traditional retail formats to fit China's tech-thirsty consumers. MAC Cosmetics' augmented reality (AR) mirrors, where shoppers can virtually try on lipsticks in-store without having to worry about hygiene, and the "smart shelves" at INTERSPORT's Beijing megastore, which display information about a certain shoe as soon as a customer grabs it, are some examples of how global brands are adopting "new retail" strategies.

4. THEY LOVE "KOLs"

China's online celebrities – known as key opinion leaders (KOLs) or "wanghong" – steer buying decisions more powerfully than in any other market, especially among millennials and Generation Z.

An A.T. Kearney study found that 68% of Chinese social media users are receptive to brand recommendations by online celebrities, compared to just 34% in Germany. KOLs are so popular, that over half of China's college-age students chose "online celebrity" as their dream job in a recent survey by Tencent.

Many global brands are using KOL marketing effectively. When BMW's Mini Cooper partnered with Becky Li, a fashion and lifestyle influencer, she sold 100 limited edition cars in under five minutes through her WeChat account. But the KOL industry has boomed to the extent of sparking fears of a "bubble". Risks include fake follower profiles and campaigns that backfire because they're perceived as "phoney". Even if others are engaging with KOLs, brands must be cautious when doing the same.

5. THEY'RE GOING LOCAL

Home-grown brands are gaining ground in China's retail space, and foreign players can no longer blame this on cheaper prices. Huawei has eaten into Apple's smartphone market share by positioning itself as more fairly priced *and* more innovative. Its devices offer unique features that are a first in the market – take reverse charging, whereby your handset can be used to wirelessly charge other devices.

Brand consultancy Prophet's annual survey ranks the most relevant brands among Chinese consumers. In 2018, 30 local brands made the top 50, up from just 18 in 2016. Between 2017-18, Chinese players (●) displaced powerful multinationals from the top 10:

2017	2018
1 Alipay	1 Alipay
2 WeChat	2 Android
3 Android	3 WeChat
4 IKEA	4 Huawei
5 Apple	5 Microsoft
6 Nike	6 Taobao
7 Estee Lauder	7 Intel
8 BMW	8 Meituan Dianping
9 Marriott	9 QQ
10 NetEase Cloud	10 Tmall

China's retail landscape evolves at such break-neck speed that no brand is too big to fail. International players can't expect to conquer Chinese consumers and keep them interested with a cookie-cutter approach. A highly localised strategy, based on a nuanced understanding of current market trends, is the only way forward.

CRACKING CHINA'S RETAIL MARKET

A Market Entry and Growth Roadmap

Where to start when looking to enter a market as vast, fast-paced, and unique as China's? Its complex regulations and distinct market conditions can be overwhelming even for experienced executives. As a consultancy that offers end-to-end support in advisory as well as outsourced services, we've accompanied many international companies along their China journey from their very first step. Below, we have summarised a typical roadmap, hoping to help you approach your China entry and expansion in a structured way. In each step, we have included some of the key questions that we commonly advise our clients to consider.

1. Analyse the market

- **Market sizing, segmentation and trends:** Regulations are powerful market drivers in China, but they can change overnight. How far should you base your investment decision on policy?
- **Competitor benchmarking:** What lessons can you learn from rising local contenders (both direct competitors and successful players in related categories/segments)?
- **Customer insights:** In China's "new retail" age, radically customer-centric models win. How can you go beyond a "good-enough" understanding of local customers?

FIRST THINGS FIRST: Trademark Trouble

One of our first questions to clients at this initial stage is: have you registered your trademark in China? Many assume this can be done later on, in the legal setup stage, but that's **a big misconception**. One client, a European sports gear manufacturer, recently won the rights to commercialise their brand in China after a 15 year legal battle against a local **"trademark squatter"**. Chinese law protects the "first to file", regardless of whether they can prove intellectual ownership. So it's never too early to file your trademark in China!

2. Choose your strategy

- **Channels and market entry methods:** Should you "test the waters" by selling on a cross-border e-commerce platform first? When is it time for offline distribution or an own store?
- **Location search:** Where should you open your retail store to ensure the right positioning, and where should you locate your office(s) to access the right talent?
- **Distributor search:** Should you use a broad distributor network or enter into exclusive contracts? Do you need different partners for online and offline?

DISTRIBUTORS: More is More?

When it comes to a distributor strategy, there's no one-size-fits-all solution. We usually recommend a **multi-distributor** approach for reasons such as risk management and geographical coverage. But sometimes, we advise smaller niche brands to choose **fewer, larger partners** who will have the scale and capital needed to push a lesser-known brand.

3. Set up your operations

- **Legal setup:** Is opening a Wholly Foreign Owned Enterprise (WFOE) necessary to carry out your planned activities? Even selling online-only may require it.
- **Hiring and outsourcing:** Local talent is key for effective online sales and marketing. Should you build up an in-house team or fully outsource these functions?
- **Systems and processes:** In an omnichannel "new retail" setup, how can you ensure synergies and seamlessness between online and offline, instead of friction and silos?

ERP: Old-School Omnichannel?

"New retail" sounds complex but it doesn't have to be. Before worrying about AR interfaces to capture customer insights, start by having a solid **ERP system** that synchronises your **online and offline inventory** and gives you **real-time visibility** of sales trends. This alone can ensure on-demand stock availability and tailored product assortments. That's omnichannel seamlessness at its simplest.

4. Expand and optimise

- **Ongoing market analysis:** Are you collecting enough real-time consumer data and regular market insights to inform your R&D, supply chain, and marketing?
- **Organisational transformation:** Could changes in your organisation's culture, structure, processes, or tech help you unlock agility to meet the pace of the Chinese market?
- **M&A and strategic partnerships:** Should you consider new partnerships or M&A to achieve a solid omnichannel strategy more quickly?

SPEED TO MARKET: Finding Shortcuts

By partnering with Tmall, Unilever China leveraged **data** about buyer preferences to co-create a new skin cleansing product, "Purifi", in only six months – a fraction of their usual **product development** cycle of 24-36 months. But data and digital partnerships are not the only fast-track path. We have helped many clients unlock agility internally by performing **"Corporate Healthchecks"** to identify and tackle inefficiencies that hamper their speed to market.

TUNING INTO CHINESE CONSUMERS

> *"China's digital landscape is so advanced that you have to act like a pioneer.*

Sennheiser's high-end headphones and microphones are coveted by audiophiles and discerning buyers around the world – and China is no exception. The German, family-owned company – whose global revenue now exceeds EUR 660m – established a subsidiary there over 10 years ago. Since then, Greater China has become a key growth market. **Pierre Eloy, MD for Sennheiser Greater China**, spoke to us about how the heritage brand is succeeding at luring modern Chinese consumers.

How is Sennheiser's Chinese customer different from its international customers?

I don't think there is a big difference between our Chinese and our international customers. A Chinese Sennheiser customer is educated, sophisticated, and purchases high-end products. For example, China is the biggest market for our legendary product, the HE1 headphone, which costs more than RMB 400,000 (over EUR 52,000).

In general, Chinese consumers are cautious. They research, analyse, and compare options before making a purchase decision, and they tend to seek out advice and recommendations online or on social media.

Chinese consumers are said to be "fickle" in their preferences. Would you agree?

It's true to a certain extent, and understandable because Chinese customers are now offered such a variety of products, so many new things! But we also see brand loyalty here. Trends can change, but great sound quality will always remain great sound quality. Chinese customers increasingly recognise us as a leader in the industry, and our online sales and fanbase on social media are developing at a steady pace.

What has been your experience in channel management?

Chinese consumers are buying everything online. It's no wonder that online channels are our primary growth engine in China. But retail here is quickly becoming an omnichannel world, where online and offline coexist and support each other; where a dealer has an online store and two brick-and-mortar stores. We are adapting to this environment by focusing less on a strict channel separation or channel-specific sales strategies, and more on a holistic approach to customer experience at all touchpoints – social and traditional media, online and offline.

What are the main challenges in consolidating your brand in Greater China?

China's digital landscape is so advanced that you have to act like a pioneer. We are constantly trying out and adopting new methods of personal engagement with our customers. This challenge is a fantastic opportunity for our China business, but also for our global business development plans.

Has the profile of competitors changed in recent years, and how do you stay ahead?

Not really. We compete in China more or less against the same international brands as in other markets, and we do it by focusing on our strategy and our goals, keeping our customer at the heart of all our decisions, and constantly creating premium sound experiences.

Are China's macroeconomic challenges affecting Sennheiser's market outlook?

With a GDP growth of 6%, China remains a promising market for us, like all of Asia to be honest. And looking at the lineup of amazing new products we are launching this year, I am very confident that we will break another sales record!

Sennheiser's top-of-the-line headphones, the HE1, come with an amplifier unit made out of Carrara marble - the luxurious stone used in Michelangelo's Renaissance sculptures.

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