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McKinsey Asia Consumer and Retail

Winning the Chinese Consumer:

Opportunities for Japanese Companies

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1. Introduction

Japan's consumer-facing companies confront a growth challenge. Until recently, they have been able to sustain modest growth rates by selling their products primarily to Japanese consumers. But with Japan's population simultaneously aging and shrinking—and with consumption falling as a consequence—Japanese companies can no longer count on the home market to drive growth. Projections show that China by 2010 will surpass Japan to become the world's second-largest market in terms of GDP, and by 2014 in terms of consumer spending.

Learning how to appeal to Chinese consumers is a strategic imperative– perhaps even a matter of survival

Even as Japan's consumer market is contracting, Japanese companies must contend with more competition. Multinational corporations (MNCs), in their own quest for growth, are moving more aggressively into Japan. They have recently been joined by Chinese companies, which are testing the waters in Japan through ventures in various sectors including technology and retail. Furthermore, these Chinese contenders are building capabilities and developing a presence in China and globally in industries that have traditionally been Japanese strongholds—automotive and consumer electronics, for example. As Chinese companies become more sophisticated, they could threaten Japan's position not only in Japan but in other global markets as well.

Clearly, Japanese companies must pay close attention to China, both as a consumer market and as a source of competition. Learning how to appeal to Chinese consumers and compete profitably against Chinese companies are strategic imperatives—perhaps even a matter of survival.

Given the geographic proximity, Japanese companies are in theory well positioned not just to use China as a cost-effective production base, as many foreign companies do, but also to sell into the Chinese market. Indeed, Japanese companies were among the first to enter China after it opened its doors to foreigners three decades ago. Japanese brewer Suntory in 1984 became the first foreign company to form a joint venture in China's beer market. Lawson, the second-largest convenience store player in Japan, was the first overseas retailer to obtain a franchise in Shanghai in 1996. But Japanese companies' early experiences in China were full of challenges and failures. They found themselves unable to manage government relationships. Their executives were taken advantage of by business partners and others. And their intellectual property was abused and ignored.

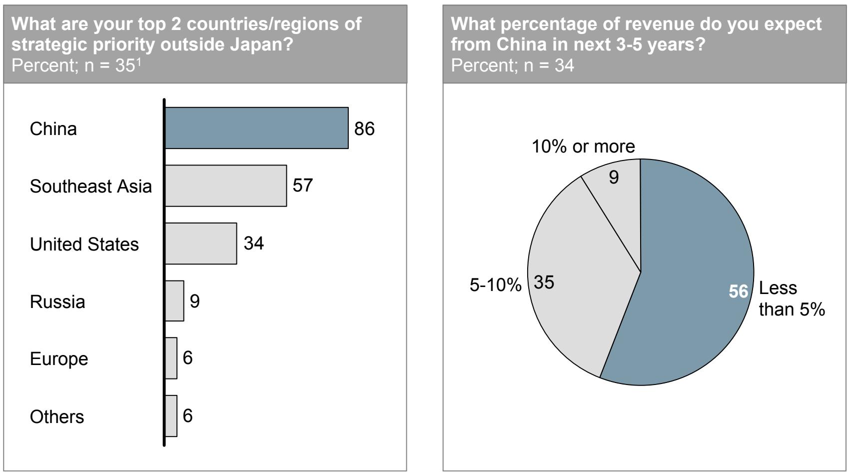
Despite facing many obstacles over the years, however, Japanese companies have never turned their backs on the Chinese market. When China joined the World Trade Organization in 2001, Japan accelerated its investment. In 2008, China overtook the US to become Japan's largest export market and trading partner. Today Japan is the third-biggest source of foreign direct investment in China.

Our research shows that Japan's current success in cracking China's consumer market is mixed. Based on publicly available data and confidential interviews with industry executives and experts in both China and Japan, we have developed a "China scorecard"—a comparative analysis of how Japanese companies are faring in 12 consumer-facing industries in China (see "Japan's China scorecard," pp. 34-43). The scorecard shows that while there are a few sectors—automotive, for one—in which Japanese manufacturers are performing well, there are many more in which Japanese companies lag far behind their Chinese competitors and even their US and European counterparts. These sectors include packaged foods, personal care, household care, PCs, and mobile handsets.

The scorecard conveys Japanese companies' current performance in China, but our research efforts went further—we also sought to understand the factors behind the performance and the outlook for the future. In addition to our data analyses and interviews, in June and July 2009 we conducted a survey of executives from more than 30 leading Japanese companies in consumer-facing industries. Although drawn from a relatively small sample size, we believe the survey results are indicative of the mindsets and experiences of Japanese companies in China to date, and illustrate some of the reasons that Japanese companies have had limited success in China. Among the highlights of the survey:

- Almost all respondents expect less than 10 percent of their revenues to come from China over the next three to five years; more than half of respondents expect less than 5 percent (Exhibit 1)
- While more than 70 percent of respondents believe that now is the right time to invest in China, 21 percent felt it was either too late or were unsure about the timing
- Around 60 percent reported that less than one-tenth of their executives in China are Chinese, and only 25 percent have a mobility program allowing Chinese executives to spend time in Japan
- Only two companies characterized their China operations as "highly independent" from headquarters in Japan
- Survey respondents said the top five challenges they face in China are the country's weak legal and regulatory systems, their own lack of capability in managing government relations, difficulty designing the right products at the right prices, low profitability, and inability to attract talent

Exhibit 1: China is seen as a priority, but growth expectations are low



[1] May not be representative, as survey respondents were attendees at a China conference

SOURCE: McKinsey survey of executives at consumer-facing Japanese companies, July 2009

Most survey respondents concur that China ought to be a top priority, as we argue in the next section of this report, but some of their early, challenging experiences in China have colored their perceptions about the feasibility of winning in that market. Some respondents feel it is too late. We strongly disagree: in most categories consumer preferences in China are evolving rapidly, and smart companies can still shape those preferences. That said, Japanese companies must move quickly. As more companies build strong brands and penetrate China's lower-tier cities, the window of opportunity will begin to close.

Across the consumer-facing industries we analyzed, we see a number of common challenges that, while not unique to Japanese players, are certainly pronounced among them. We discuss these challenges in greater detail in the third chapter. In general, Japanese companies have limited their success in China by failing to tailor their products and business approaches to the specificities of the Chinese market. Yet solid performers like Shiseido are proof that Japanese companies can overcome these barriers. In Chapter 4, we expand on each of these areas and examine the experience of companies that have proved exemplary at them.

2. Why China should be a top priority

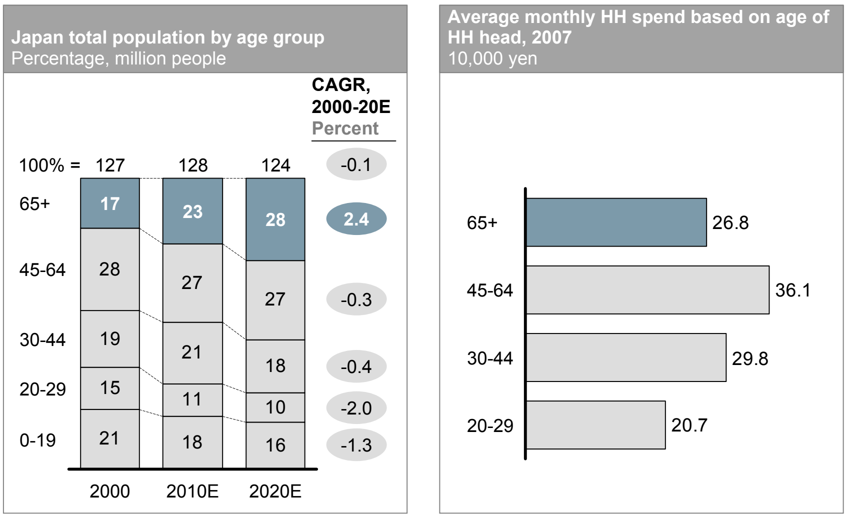
We believe Japanese companies must turn their attention to winning in the Chinese consumer market for two main reasons. First, China represents growing demand for a long time to come—significantly more growth than any other market can offer. Second, it could become a serious competitive threat: with Chinese companies hot on their heels, Japanese companies must be on the offensive. Otherwise, Chinese companies will only get stronger and in due time could threaten Japan's position in other global markets.

With Chinese companies hot on their heels, Japanese companies must be on the offensive

Unparalleled growth in demand

Simply put, demographic and consumption trends are much more favorable in China than in Japan. By the year 2020, Japan's population will be about 3 million people less than it was in the year 2000, with the 65-and-over cohort growing by more than 13 million people to make up 28 percent of the total. Because the 65-and-over demographic group spends less than their younger counterparts, the Japanese consumption market will decline considerably (Exhibit 2).

Exhibit 2: As the 65-and-over cohort grows, overall consumer spending will fall



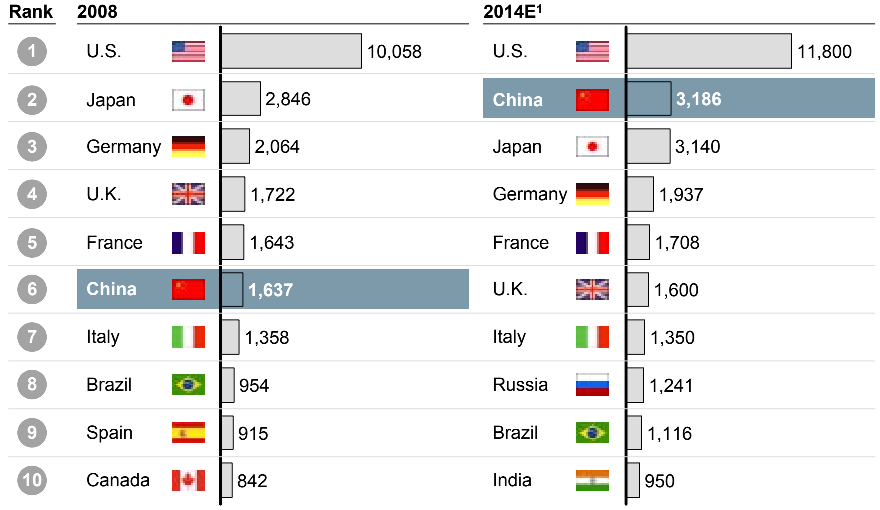
SOURCE: Global Insight (WMM), 2008; Japanese Ministry of Health, Labor, and Welfare, 2008

The story in China is the opposite. With a projected average annual growth rate of 8 percent to 9 percent, China by 2010 will surpass Japan to become the world's second-largest market in terms of GDP, and by 2014 in terms of consumer spending, with urban discretionary spending growing at 9 percent (Exhibit 3). The impact of the global economic downturn on China has been moderate, as consumption remains strong—domestic retail sales are still growing by approximately 15 percent—and China is expected to account for more than one quarter of global GDP growth in 2009.[1] Domestic consumption today represents only 35 percent of total GDP, compared with 70 percent in the US and at least 50 percent in most other markets, suggesting significant room to grow.

In some categories—mobile phones, beer, and automobiles, to name a few—China is already the world's largest consumer market, at least in terms of volume if not sales. Government activism and the expanding middle class make continued long-term growth a near certainty. Upper-middle-class households, a primary target of a wide range of branded consumables, are expected to represent more than half of urban households and to account for 65 percent of total consumption by 2015, compared with 21 percent just four years ago (Exhibit 4). With the rise of China's middle class, more consumers will trade up and be willing to pay more for premium brands. We have found that a growing number of Chinese consumers, not just in Tier 1 cities but also in lower-tier

Exhibit 3: China is projected to become the world's second-largest consumer market by 2014

USD bn; real 2008; private consumption



Rank	2008		2014E[1]	
1	U.S.	10,058	U.S.	11,800
2	Japan	2,846	China	3,186
3	Germany	2,064	Japan	3,140
4	U.K.	1,722	Germany	1,937
5	France	1,643	France	1,708
6	China	1,637	U.K.	1,600
7	Italy	1,358	Italy	1,350
8	Brazil	954	Russia	1,241
9	Spain	915	Brazil	1,116
10	Canada	842	India	950

1 To calculate private consumption, we applied Global Insight's estimate of private consumption as % of GDP (37% in 2014) to IMF World Economic Outlook's April 2009 GDP forecasts

SOURCE: IMF World Economic Outlook Database, April 2009; Global Insight (WMM), 2009; McKinsey analysis

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[1] McKinsey Global Institute, "Preparing for China's urban billion," February 2009.

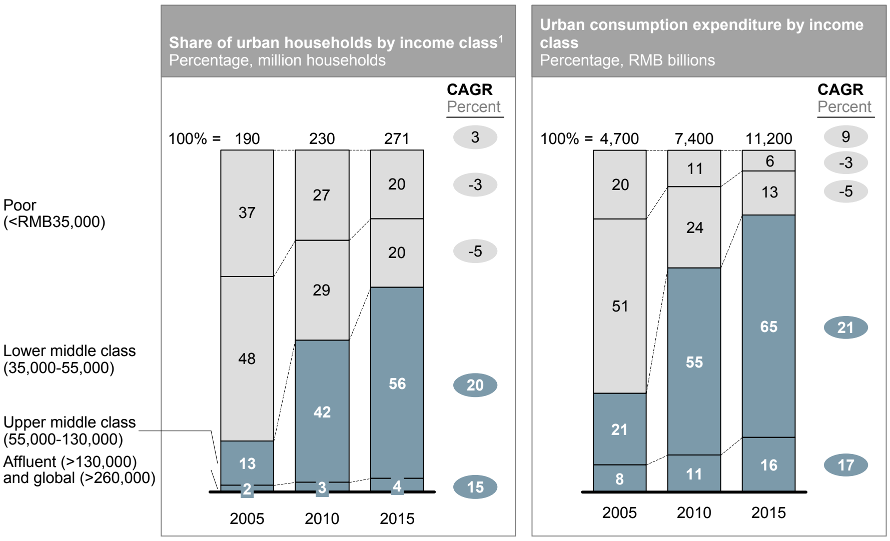
cities across China, are willing to pay significantly higher prices for premium products—up to three times the median category price for premium facial moisturizers, for example.

China is also a profitable market. Although one-third of our survey respondents cite low profitability as one of the challenges they face in China, other MNCs have managed to overcome that challenge. Few companies publish the profitability of their China businesses, but those that do—such as Yum! Brands and General Motors—are highly profitable. In a 2008 survey of 380 US-based MNCs, 70 percent reported that their Chinese businesses were profitable, and a similar percentage said that operating margins in China are at least on par, if not higher, than other global markets.[2]

A serious competitor

Many consumer-facing Chinese companies are building capabilities and beginning to position themselves as global players. A few—including China's top automobile company, Chery Auto; Lenovo, which acquired IBM's PC operations in 2004; and Haier Group, which has become one of the world's five largest appliance manufacturers—already play on the global stage and compete in industries that to date have been dominated by Japanese companies.

Exhibit 4: China's upper middle class is growing fast



1 Annual household income based on nominal value for 2008

SOURCE: McKinsey Global Institute Consumer Demand Model

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[2] American Chamber of Commerce, Shanghai, 2008 China Business Report.

While Chinese companies today have neither the scale nor the experience of other global companies, they have both a steady supply of capital and almost unlimited government support. Moreover, Chinese OEMs can quickly transform themselves from commodity suppliers to fully integrated premium players.[3] Huawei, China's largest telecom equipment company, started as a distributor of foreign imports, but is now the third-largest player in the industry and generates more than 60 percent of its revenue outside China.

* * *

Most of this is not news to Japanese companies. What might give them pause is the realization that, to date, Japanese companies in China are underperforming their potential and lagging behind farther-flung competitors based in the US or Europe. Our research—the first rigorous effort to benchmark how Japanese companies have fared in China—presents a clear picture of the current landscape and some very ripe opportunities that Japanese companies would do well to seize.

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3 That phenomenon has already happened in Taiwan, where high-tech companies like Acer, HTC and Asustek have in the last few years split off their manufacturing arms and chosen to compete directly against the likes of HP and Dell in the PC market with their own brands. The pattern is virtually certain to play out in mainland China as well.

3. How Japanese companies are faring in China

A number of multinationals have established strong positions in China, particularly in sectors such as beverages, personal care, household care, and mobile phones. The retail scene is crowded as well, with Wal-Mart, Carrefour, Tesco, Metro, and a growing number of "category killers" like IKEA, Best Buy, and Zara all competing in China. Even as competition among foreign entrants is intensifying, local incumbents are rapidly becoming more sophisticated.

Amid all this activity, in most consumer-facing categories Japanese companies are barely holding their own (Exhibit 5, see also appendix on pp. 34-43). Why? The industry executives we interviewed—mostly senior marketing and strategy executives based in China and employed by the leading US, European, and Korean MNCs—suggested that one overarching reason is that many Japanese companies regard China as a top priority only in principle, not in practice. Somewhat paradoxically, China is rarely a top five agenda item for many Japanese CEOs. To illustrate: many CEOs of large MNCs make regular trips to China to meet with Chinese government officials, visit with major customers and suppliers, and evaluate partnerships and deals, but Japanese CEOs have been largely absent from the scene, opting to delegate these responsibilities to deputies instead. More broadly speaking, few Japanese companies have taken the steps that other MNCs have taken to make China a priority, such as creating a separate China business unit, sending top-performing executives and managers to China as a training ground for the most senior global positions, or setting high aspirations for the market.

Many Japanese companies regard China as a top priority only in principle, not in practice

Exhibit 5: Japan's "China scorecard"

●●●●● Surpassing other foreign cos. ●●●○○ Competitive with foreign cos. ●○○○○ Far behind other foreign cos.

Category		Market size in China USD bn	Estimated share of Japanese/other foreign players[1] Percent			Current performance of Japanese players	Examples of leading foreign players[2]
Food	Packaged foods	99-112	0	13	13	●○○○○	Danone Nestlé
	Beer	39-43	4	19	23	●●○○○	AB InBev Suntory
	Non-alcoholic ready-to-drink	34-45	1	46	47	●○○○○	Coca-Cola Tingyi (Master Kong)
Non-food packaged goods	Personal care	19-20	3	30	33	●○○○○	P&G Kimberly-Clark
	Skin care and cosmetics	8-10	13	59	72	●●●○○	L'Oréal Shiseido
	Household care	6-7	1	21	22	●○○○○	P&G Unilever
Consumer electronics	White goods	29-38	6	16	22	●●○○○	Philips Bosch-Siemens
	Mobile handsets	24-25	3	69	72	●○○○○	Nokia Samsung
	Flat-panel TV	13-21	20	15	35	●●○○○	Samsung Sharp
	Personal Computers	10-13	2	29	31	●○○○○	HP Dell
Retail		216-311	1	8	9	●○○○○	Wal-Mart Carrefour
Automotive		92-95	31	44	75	●●●●○	Volkswagen Toyota

1 Sum of market share from major foreign players (over 0.1% share) in China; based on volume (not value) for PC, TV, mobile handsets, and automotive
2 Not exhaustive

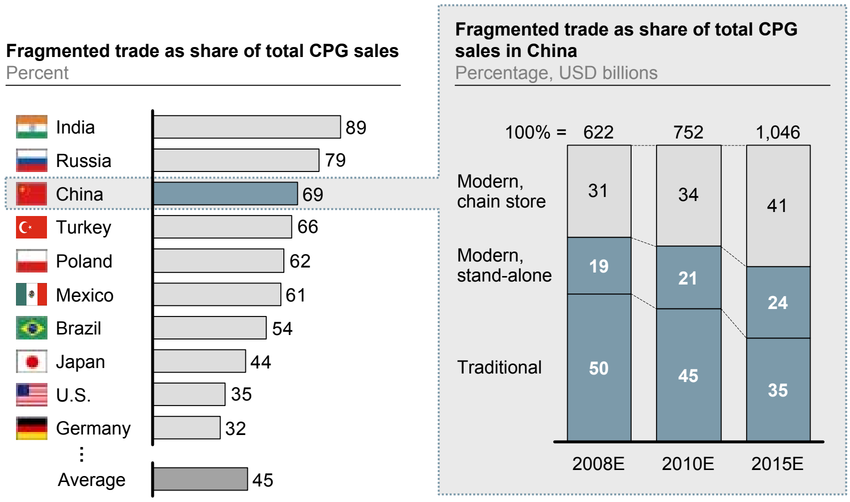
SOURCE: Euromonitor; GfK; Canadean; iSuppli; IDC; Gartner; Planet Retail; Global Insight; CAAM; expert interviews

The MNC executives we interviewed cited the following weaknesses in particular as key reasons for Japanese companies' subpar performance in the Chinese market. Although some of these are broad generalizations, we have found that Japanese executives themselves acknowledge most of these weaknesses:

Simply replicating Japanese products and assortments in the Chinese market. The rise of the Chinese middle class, the rapid emergence of new cities, and intense local competition have put a premium on getting product development right. Catering to local tastes and preferences—and even to expectations about service levels, in categories like consumer electronics—is essential to success. This has not been a strength of the Japanese, who have tended to simply replicate their Japanese assortments and approaches in the Chinese market. As one Chinese chief marketing officer of a successful MNC told us, "Thus far, the product strategies that work in China tend to be premium or deep-value plays—and in either case they are customized for the China market. Midpriced, high-quality products—in other words, the kind of products Japan is known for—tend to be a lot more challenging." Japanese executives acknowledge as much. In our survey, they cited "difficulty designing the right products at the right price" as one of the top challenges they face in China.

Relying too heavily on large retailers. Most Japanese companies are adept at selling their wares through large retail chains, which requires excellence in key account management and in-store execution. But large chains generate only about one-third of China's consumer-goods sales. The "fragmented trade"

Exhibit 6: Fragmented trade will remain important

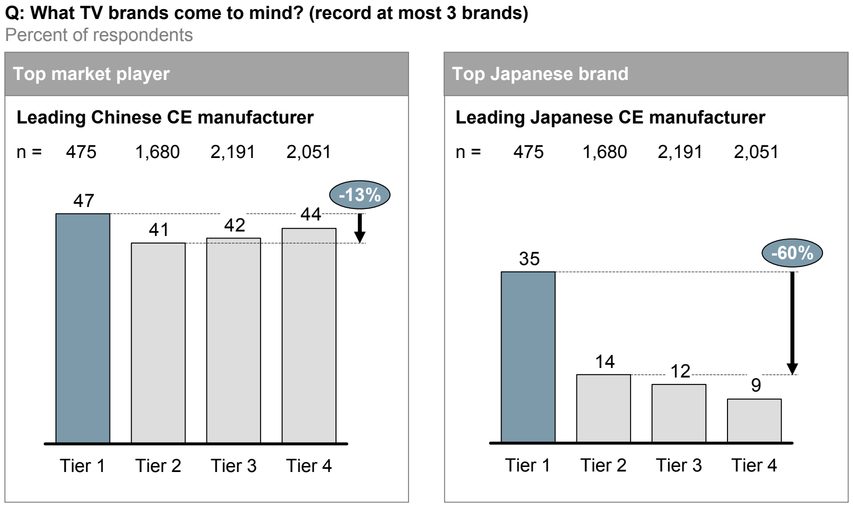


SOURCE: Euromonitor; ACNielsen

channel—consisting of independently owned supermarkets, as well as the millions of small or midsize shopkeepers that run mom-and-pop stores, corner groceries, or local restaurants and bars—can represent 60 percent to 70 percent of sales in certain consumer-goods categories. Even as large retailers make inroads into China, fragmented trade will remain a critical channel for many consumer goods at least until 2015, and probably beyond (Exhibit 6). Those manufacturers that can engage effectively and profitably with distributors, as well as with the owners and operators of these small retail outlets, will gain a significant competitive advantage. Japanese companies, much more accustomed to dealing with big chains and a small number of national distributors, have shown a reluctance to invest in broadening and deepening their relationships with smaller distributors and retailers.

Virtually ignoring consumers in lower-tier cities. Across China's vast expanse are hundreds of millions of consumers with different buying preferences and shopping behavior. Counterintuitively, consumers are more diverse across regions than across socioeconomic segments. The required level of segmentation is therefore very granular; companies clearly cannot adopt a single strategy across various regions, and cannot even group submarkets based on operational convenience rather than consumer insights. Many Japanese companies invest in Tier 1 and 2 cities but virtually ignore Tiers 3 and 4, which have the fastest-growing demand for many consumer-goods categories. In a recent consumer survey, we found that 35 percent of consumers in a Tier 1 city were aware of a Japanese TV brand; awareness drops precipitously in lower-tier cities (Exhibit 7).

Exhibit 7: Awareness of Japanese brands is very low in Tier 2-4 cities



SOURCE: Insights China Consumer Survey, 2009

The most successful companies in China have reached those smaller cities with the right products and marketing approaches.

Failing to attract and retain Chinese talent. Local leadership is critical to success in China, both to build strong local and governmental relations as well as to attract and retain employees. But Japanese companies have had difficulty recruiting and retaining competent Chinese managers. Indeed, more than half of our survey respondents said that fewer than 10 percent of their executives in China are Chinese. One reason may be that many, if not most, Japanese companies use Japanese as their official language even in China; by contrast, most European companies use English, which is taught in Chinese schools. Moreover, the Japanese lifetime employment system—where tenure matters a lot and performance very little—is unappealing to Chinese employees, and the Japanese workplace is typically much more hierarchical than in Chinese or Western companies. In a recent survey by job information site ChinaHR.com asking Chinese college students which companies they most want to work for, the highest-ranking Japanese company was Panasonic, in 27th place—behind MNCs like P&G and IBM (Exhibit 8). Survey respondents cited a lack of good training programs and opportunities to advance their skills as the main reasons for their low ranking of Japanese firms. There is also low awareness of Japanese companies. American and European companies have been more aggressive and creative in recruiting university students, for example through "Meet the CEO" sessions, scholarships, and sponsorships of popular sporting events.

Exhibit 8: Chinese students find some MNCs more appealing than Japanese firms

University students' ranking of most desirable employers, 2008

☐ Japanese companies
▨ Foreign companies

1. China Mobile	16. China Vanke (Real estate)
2. Huawei	17. China Merchants Bank
3. P&G	18. China National Petroleum
4. Lenovo	19. ZTE Corporation
5. Haier	**20. Siemens**
6. IBM	**21. Samsung**
7. Microsoft	22. Inner Mongolia Mengniu Dairy
8. China Guangdong Nuclear Power	23. People's Bank of China
9. Bank of China	24. Midea Group
10. Google	**25. Johnson & Johnson**
11. Alibaba	**26. Nokia**
12. Baidu	27. Panasonic
13. China Telecom	28. Guangzhou Honda
14. Tencent	**29. Mars China**
15. China Petrochemical	30. BYD Auto

SOURCE: ChinaHR.com survey, 2008

Giving insufficient attention to government relations. The Chinese government has at least some level of active involvement in nearly all aspects of business in China—a fact that foreign companies must recognize and deal with if they are to succeed in that market. Companies seeking to succeed in China must treat the Chinese government as a crucial stakeholder. Many Japanese executives are understandably frustrated and baffled by China's complicated regulatory environment, yet what often compounds the problem is that Japanese companies do not invest in the right people and infrastructure to allow them to navigate the political arena and nurture beneficial relationships with Chinese government officials. Either they assign Japanese personnel, who inevitably encounter cultural and language barriers; or they do not identify the key decision makers and political actors most relevant to their business; or they simply lack a strategy for handling governmental affairs.

4. What it will take to win

We believe the challenges that Japanese companies face in China, although considerable, can be overcome. Japanese companies must immediately and seriously act on the following five imperatives if they are to win in China: develop China-specific products, learn how to serve China's large and small retailers, take a granular view of the market, attract and empower local talent, and invest in building government relations capabilities. There are several Japanese companies that have fulfilled these imperatives quite well (for one example, see "Shiseido: Building a billion-dollar business in China," pp. 28-29) and we believe many more can follow suit.

Develop products specifically for China

China's market has been skewed to value for some time, but consumers are steadily trading up. Success in China means advancing beyond "down spec" to a true design-to-value approach, and then continually innovating to follow consumers as they trade up to higher price tiers. Japanese companies need to improve their capabilities in generating and interpreting consumer insights, and then feed these insights back into their product-development teams to launch new products with the right positioning and at the right price points. One large European mobile handset maker sends a product development team to China every quarter to acquaint itself first-hand with customer requirements, key trends, and local competitors. The team then collaborates with global product-development teams to develop China-specific products.

A marketing executive for LG Electronics China said recently, "Chinese customers are loyal to us largely because of our styling. Our product-development team has focused on creating stylish and innovative products that attract Chinese consumers."[4] US-based Kimberly-Clark also attributes its success in China in part to developing China-specific products (see "An interview with Kimberly-Clark's Mei Tong," pp. 30-33).

Another exemplar of customizing products for China is Yum! Brands, which has more than 3,000 KFC and Pizza Hut restaurants in mainland China and opened more than 500 new restaurants there in the last year alone. KFC introduced a number of products to cater to local Chinese tastes, most recently adding *shaobing*, the traditional Chinese sesame seed cake snack, to its menu in several cities. And its Pizza Hut chain is said to sell nearly as many traditional Chinese foods as it does pizzas. Yum! is now testing a new concept called East Dawning, a Chinese quick-service restaurant chain offering affordable Chinese food. Today there are 18 East Dawning stores in China.

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[4] *CMR Business Quarterly*, Sept. 23, 2008.

Learn how to serve China's retailers—both big and small

To win in China, Japanese companies must continue to hone their skills in serving large retail chains as well as develop the skills to serve fragmented trade. For large retailers, key account management and in-store execution are crucial. One handset manufacturer built a powerful IT tool for monitoring the daily performance of 5,000 retail outlets across different regions in China. As a result, the company can see on a daily basis sales and pricing information for each item, inventory data, key trends in cities or regions, and so on, thus allowing the company to adjust accordingly. The company also tests in-store personnel frequently to ensure their selling skills are sharp and their knowledge of product features is detailed. All of this is quite important in the handset category, given that Chinese consumers typically decide which brand of mobile phone to buy while they are in the store.

To make inroads in fragmented trade, Japanese companies must build a stable and well-managed distribution network, optimize sales-force effectiveness, and customize the retailer value proposition.

Building a stable distribution network requires the selection of distributors with solid management capabilities, sufficient capital and financial skills to sustain complicated logistics, a scalable infrastructure, and a collaborative attitude that aims for a win-win outcome with the manufacturer. They must then strive for maximum control at the point of sale—for example, a personal-care products manufacturer must know if its shampoo is placed next to a competitor's brand and priced properly. Companies should then manage and monitor distributors consistently, providing clear performance indicators and incentives. Smart selection and management of distributors are particularly important in China, since partnerships and business agreements tend to be complicated by a lack of rigor in legal enforcement, weak financial reporting, and the potentially conflicting business interests that many Chinese companies and entrepreneurs have.

Recruitment and retention of salespeople is another crucial ingredient for succeeding in fragmented trade. Placing more emphasis on the attitudes and interpersonal skills of candidates for low-level frontline positions—and less on their academic credentials—is one good way to build a more effective sales force and reduce the turnover rate. On-the-job coaching during important new-product launches or special store promotions is a highly effective way to build the capabilities of a large sales force. Companies should also allocate sales-force resources so that the outlets that matter most receive more frequent visits and greater in-store support.

In addition, to win in fragmented trade, manufacturers should understand the levers that drive store owners' decisions and should not assume that profitability and cash incentives top every retailer's wish list. For some, paying their electricity and gas bill may be the gesture that wins their complete loyalty. Other retailers may value ease of ordering or fast delivery. With this knowledge, manufacturers can craft appealing value propositions tailored to retailers' needs.

Take a granular view of the market

Given China's geographic scope, Japanese companies cannot afford to invest indiscriminately. Winners will be those that assess both market potential and competitiveness at a granular level—that is, companies must take a systematic approach to identifying micro-markets with the highest potential. They must then develop their branding strategies, decide how to go to market, and set priorities about where and how to allocate their scarce resources to generate the highest returns. The difference in economic returns generated by "plain" versus "granular" strategies has proven to be substantial— over 40 percent growth in the first year and by a factor of two to three thereafter, with even higher ROIC differentials. As it would be impossible to analyze hundreds of cities and thousands of segments individually, we have developed a method to cluster these micro-markets in a highly tailored way. Our work in China shows that three criteria are helpful in defining China's "city clusters": government initiatives and policies, demographic and economic links (e.g., language, export/import orientation), and consumer profiles (e.g., lifestyle preferences, price sensitivity). Companies that have adjusted their product portfolio, marketing, and distribution strategies to cater to these clusters have demonstrated the power of deploying a granular approach in China.

Consumer attitudes, brand preferences, media preferences, and key buying factors by category vary significantly between clusters, even within the same region or tier. For example, we have found that although TV, word of mouth, and in-store activities (such as in-store ads or displays) are the most effective media vehicles across major products nationwide, the degree of impact varies by cluster. Word of mouth is significantly less effective in the Shenzhen cluster than in the Guangzhou cluster (Exhibit 9).

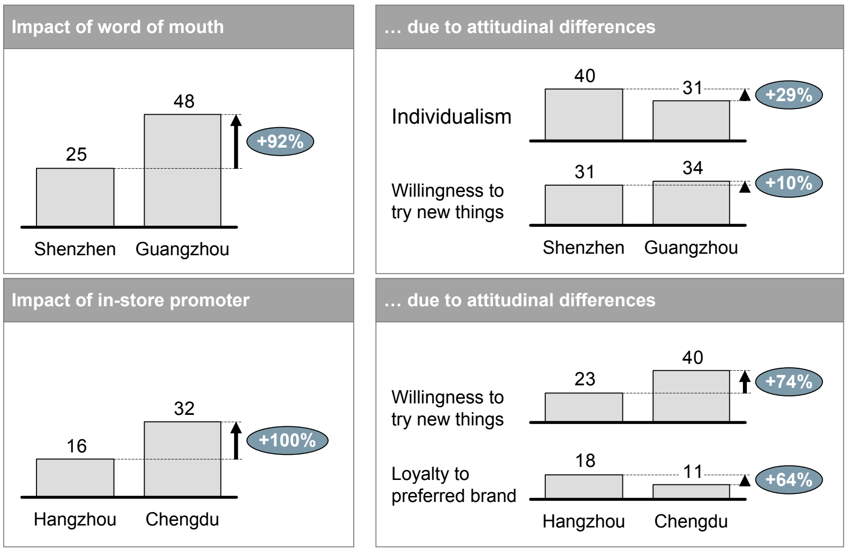
Attract and empower local talent

Many MNCs recognize China as a rich source of talent and innovation. The country is home to approximately 1.1 million research personnel and 1 million science and technology graduates a year—a significantly larger pool than Japan's. To tap into China's talent pool, Japanese companies must make radical changes in their organizational and talent-management practices, including basing compensation and promotions on performance rather than tenure. They must also begin to view China as a training ground for future global leadership, sending their brightest stars to China and investing heavily in recruiting and talent-development programs. The company that has set the standard for talent

Japanese companies must begin to view China as a training ground for future global leadership

Exhibit 9: Consumer attitudes and behaviors differ significantly across regions

Percent of respondents; 2009; n = 2,267



SOURCE: Insights China Consumer Survey, 2009

management in China is global consumer-goods giant P&G, which pioneered on-campus recruiting in China—a tactic that is now used by many MNCs. P&G's early efforts in attracting Chinese talent has yielded a considerable bounty in terms of senior managers: its college recruits in the early 1990s have become its first batch of local senior managers. P&G has also inspired a global vision and aspirations in its Chinese staff. It sends talented employees overseas to help them gain valuable experience. In addition, P&G offers attractive perquisites such as work-from-home options and extensive training programs on business as well as life issues (e.g., team leadership, how to screen and hire household help).[5]

Given China's diverse and fast-changing consumer market, a nimble local decision-making function is essential to success. Japanese companies must localize management, and then give local management the autonomy to take action without necessarily taking the time for the traditional debate and discussion with headquarters in Tokyo or Osaka. A highly empowered, primarily Chinese local management team will not only be better able to keep pace with changing consumer needs; it will also be a powerful force for attracting and retaining Chinese employees.

Build skills in managing government relations

Japanese companies must develop a comprehensive, strategic approach to government relations. This involves mapping out the political and regulatory landscape, identifying the key stakeholders and decision makers at all

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[5] *Global Entrepreneur*, "P&G: West Point," August 13, 2008.

levels of government including the provinces and cities, and coming up with concrete plans for nurturing those critical relationships. Although they vary by industry, important constituents might include the National Development and Reform Commission, the Ministry of Commerce, the Ministry of Industry and Information Technology, and others. Having a presence in Beijing is generally an advantage in building these relationships. In addition, companies should not underestimate the importance of building goodwill with industry associations and media agencies, most of which are closely affiliated with the government and can be instrumental in shaping public opinion. In their dealings with government officials, Japanese companies must clearly articulate the ways their businesses can benefit the Chinese government and China in general.

Foreign companies, once they understand how crucial government relations and regulatory strategies are to their success in China, assemble teams of experienced local hires to manage these functions. These teams are tasked with ensuring that the company's relationship-building initiatives are clear, consistent, and effective at the local, regional, and national levels.

Investments in government relations can pay back handsomely. For example, one large global beverage player worked directly with the Chinese government to agree on the optimal location for a new manufacturing plant, with the promise of creating hundreds of local jobs. As a result, it received favorable tax treatment. Other companies have been able to influence laws and regulations by placing an emphasis on government relations as they conduct their business in China.

* * *

Japanese companies have succeeded in many global markets. Yet the aspirations they have set for China are, in our view, too low: as noted, more than half of Japanese companies in our survey expect China to account for less than 5 percent of their sales in the next three to five years, whereas many MNCs were already generating about 10 percent of their global revenues in China as of 2006.[6] (There are, of course, exceptions. Recently, Japanese restaurant operator Yoshinoya publicized its very high aspirations for China, saying it aims to have 1,000 restaurants in China—almost as many as it has in Japan—by 2015, up from 200 today.) The Chinese consumer market presents some familiar—and some unfamiliar—challenges, but also immense opportunity. The time is now for Japanese companies across all consumer-facing industries to raise their game and become serious contenders in the Chinese market. With their penchant for innovation, their strong execution-focused culture, and their relentless drive, Japanese companies have very good chances of winning in the world's fastest-growing consumer market.

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[6] Survey of 180 consumer-related MNCs conducted by the IBM Institute for Business Value and the Economist Intelligence Unit, 2006.

Shiseido: Building a billion-dollar business in China

Tokyo-based Shiseido, Japan's largest cosmetics manufacturer, first entered China in 1981 by selling a small number of products through department stores and hotel shops in Beijing. In 1994 it launched a China-only brand called Aupres, and in 2002 it opened an R&D center in Beijing, which it expanded three years later.

Shiseido's China sales were $616 million in 2007, and in 2008 its Asia-Pacific sales (primarily China and excluding Japan) amounted to $1.02 billion. The company has said that it expects 20 percent sales growth in China in 2009. It recently announced that it would add 1,700 stores to its sales network in China over the next two years, mainly in inland regions, bringing its total to nearly 5,000 stores.

What has made Shiseido so successful in China? Three factors stand out: it has developed China-specific products, adopted a multichannel distribution strategy, and globalized its organization.

Early on, Shiseido developed a China-only brand. Today its Beijing R&D center develops a steady stream of new products specifically for the Chinese market. Recently Shiseido announced plans to broaden its lineup of locally made products as it expands into regional areas.

Shiseido also recognized the importance of selling to different consumer segments through different channels, and has thus developed differentiated offerings. It sells certain brands in department stores, a different set of brands in thousands of cosmetics specialty stores across China, and yet another set of brands in the ubiquitous Watsons drug stores.

In an acknowledgment of how critical the global marketplace has become for Shiseido, it recently named a foreigner to its board. Shiseido plans to diversify its management team as well. “The need to globalize our organization has come at an accelerated pace,” company president Shinzo Maeda was recently quoted as saying. To that end, Shiseido has introduced a management development program that moves executives around the company’s divisions and across markets. It also has a mobility program through which high-performing Chinese employees can avail themselves of short-term transfers to Japan.

An interview with Kimberly-Clark's Mei Tong

Kimberly-Clark is a US-based health and hygiene company employing nearly 53,000 people worldwide and posting sales of $19.4 billion in 2008. Its brands include Kleenex, Scott, Huggies, Kotex, and Depend, and its products are sold in more than 130 countries. In China, the company has experienced strong revenue and profit growth every year for the past five years.

In July 2009, McKinsey principal Brian Salsberg spoke with Mei Tong, director of corporate development for Kimberly-Clark China, about its prospects for growth in the market. Ms. Tong's perspectives on how Kimberly-Clark has succeeded in China's consumer market offer valuable lessons for Japanese companies. Below are excerpts from the conversation.

McKinsey: *Tell us how Kimberly-Clark started out in China.*

Mei Tong: Kimberly-Clark entered the China market in 1994 via an acquisition of a local feminine-care brand, Comfort & Beauty. In 1995, we introduced the Kleenex brand to China after a merger with Scott Paper. Two years later, we brought the Huggies brand to China. Our first decade in China was challenging, but then we shifted to a more focused, high-end market strategy targeting more affluent and younger consumers in major cities. Since then, our business has seen strong and steady growth.

McKinsey: *Can you describe for us your China business today?*

Mei Tong: We relaunched the Huggies brand in 2004 to position it as a premium product, and today Huggies is the No. 1 premium diaper brand in China, with a 76 percent market share. In feminine care, our growth has outpaced the market. In tissue, we have shifted our product mix toward the premium segment, and as a result we have improved our margins by 9 percent. Overall, our revenues have been growing at very healthy rates, and K-C China is a profitable business unit. In the 2007–2008 timeframe, we saw a 55 percent increase in revenues and a 110 percent increase in gross profits.

McKinsey: *How does Kimberly-Clark plan to sustain that growth?*

Mei Tong: We believe future growth will come primarily from two of the categories we play in—baby care and feminine care. We are confident that Huggies will continue to dominate the premium diaper market. We have built a very solid brand positioning for Huggies, and it has a strong presence in hospitals and baby stores. We plan to increase our investments in advertising and marketing, maintain the strength of our consumer programs, and continue to excel in in-store execution. In feminine care, we are determined to become a significant player in China through increased brand-building investments and product innovation.

The idea that "business is business and government is government" simply does not apply in China

***McKinsey:** K-C has some very well-established global brands. To what extent does the company tailor its products to the local market?*

Mei Tong: All K-C products are 100 percent tailored to or redesigned for Chinese consumers. Our success in feminine care, both to date and in the future, depends very much on being able to launch new products that appeal to Chinese consumers. Having the right products for China involves two different sets of capabilities: one is consumer insights—that is, being able to develop a deep and nuanced understanding of Chinese consumers—and the second is local R&D, or being able to translate these insights into manufacturing the right products. Take diapers as an example: the insight that a large percentage of Chinese mothers use disposable diapers on their babies primarily at night, as opposed to during the day, resulted in our reformulating our diapers for China so that they are much more absorbent than our diapers in other major markets.

***McKinsey:** That's very interesting. Do you have a different approach to different cities and geographies?*

Mei Tong: Yes. Currently we are in more than 100 cities in China, with focused and active coverage of 28 key cities in Tiers 1 and 2. In our tissue business, for instance, our geographic focus has been eastern China. And as we seek to grow our feminine care business, we will concentrate first on very specific geographies. One of the key growth drivers we have identified for our business in China is profitable and disciplined market expansion through an approach that we are calling "key cities + clusters." I am not at liberty to say too much about it.

***McKinsey:** Fair enough. Let's talk about some of the challenges of doing business in China. What would you say are the top challenges Kimberly-Clark is facing?*

Mei Tong: One challenge is that the retail channel is growing very fast. We have to pay careful attention to our geographic expansion, as well as supply-chain expansion, to keep up with this growth. Another challenge is that our key retailer customers—both global and local players—are demanding more in terms of service.

***McKinsey:** Have you found government relations to be a challenge?*

Mei Tong: The idea that "business is business and government is government" simply does not apply in China. To be successful in China, MNCs must recognize that the operating environment is different here. No matter what industry you are in, government agencies are your partner—like it or not. Too often, companies less familiar with China view this as a challenge, but in reality it is more often a benefit. Chinese government agencies need companies like ours and we need them. And they are genuinely willing to support you and help you overcome obstacles along the way. But you need to know how the government works.

***McKinsey:** Our final question is about talent, which is of course critical to success in China. How does K-C attract and develop local Chinese talent?*

Mei Tong: We believe employee engagement is one of the pillars that makes K-C a trusted corporate brand. We take a three-pronged approach to managing our talent: First, we ensure that our brand is strong among current and prospective employees and that we maintain a good reputation as an employer. Second, we invest in on-campus programming, relationship building, and recruiting for new hires. Third, and perhaps most important, we build clear professional development paths for our high-performing employees, which might include rotations both within and outside China. I call this our "pipeline program"; it ensures that we always have a healthy pipeline of local leaders. We provide local employees the opportunity to grow and assume key positions in the organization. We have a fast-track program for promising trainees in which we assign them to a management role within four years.

Although we are a US-based company, our entire management team in China is Chinese. Our head of strategic planning, chief financial officer, and HR director in China are all Chinese. I strongly believe this has been one of our key success factors. In developing our local leadership, we are also focused on globally minded Chinese employees, particularly those who have lived or studied abroad. And I am proud to say we have many women in senior positions in China. We know that we cannot enter a new phase of growth without upgrading our organizational capabilities, and for us that includes expanding and empowering our local leadership team.

5. Appendix: Japan’s “China scorecard”

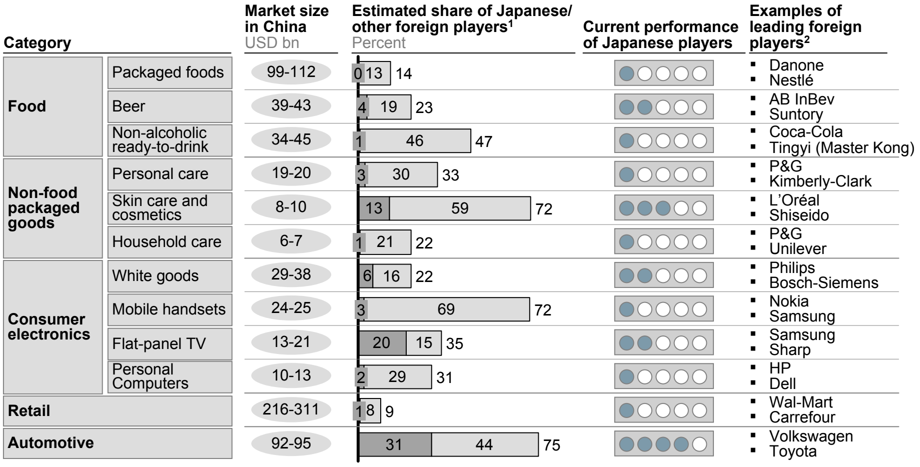
Our inaugural “China scorecard” represents a fact-based assessment of the relative performance of Japanese companies across a broad swath of consumer-facing industries as of the first half of 2009. To calculate the market size, share of foreign companies, and market share of Japanese companies we relied primarily on the following data sources: Canadean, Euromonitor, Gartner, GfK, Global Insight, IDC, iSuppli, and Planet Retail, as well as company annual reports and press searches. To calculate market share, we included only companies with more than 0.1 share in each category. Except where noted, joint ventures and Taiwanese companies are considered foreign players, not Chinese players.

Our estimates of what fraction of foreign players’ total sales are generated in China are based on a sample of the two to five leading players in the relevant category. (A caveat: we believe there is significant room for improvement in the accuracy of available market share and related data. The scorecard represents our best effort, but should be taken as directional rather than definitive.)

In addition, to gather qualitative insights we conducted confidential interviews with industry players and experts—mostly senior marketing and strategy executives based in China and employed by the leading US, European, and Korean MNCs. We asked them for their perspectives on the overall industry as well as on various companies’ performance in several dimensions, including but not limited to profitability, brand and product strategy, channel management, partnerships with local companies and regional government, and talent and organization management.

Here we provide brief summaries of our scoring rationale for 12 consumer-facing industries. We have scored each industry using a five-point scale: a score of 5 means Japanese players are surpassing the performance of other foreign players, while a score of 1 means Japanese players are far behind other foreign players.

Exhibit: Japan’s “China scorecard”



●●●●● Surpassing other foreign cos. ●●●○○ Competitive with foreign cos. ●○○○○ Far behind other foreign cos.

Category		Market size in China USD bn	Estimated share of Japanese/ other foreign players[1] Percent	Current performance of Japanese players	Examples of leading foreign players[2]
Food	Packaged foods	99-112	0 13 14	●○○○○	Danone Nestlé
	Beer	39-43	4 19 23	●●○○○	AB InBev Suntory
	Non-alcoholic ready-to-drink	34-45	1 46 47	●○○○○	Coca-Cola Tingyi (Master Kong)
Non-food packaged goods	Personal care	19-20	3 30 33	●○○○○	P&G Kimberly-Clark
	Skin care and cosmetics	8-10	13 59 72	●●●○○	L’Oréal Shiseido
	Household care	6-7	1 21 22	●○○○○	P&G Unilever
Consumer electronics	White goods	29-38	6 16 22	●●○○○	Philips Bosch-Siemens
	Mobile handsets	24-25	3 69 72	●○○○○	Nokia Samsung
	Flat-panel TV	13-21	20 15 35	●●○○○	Samsung Sharp
	Personal Computers	10-13	2 29 31	●○○○○	HP Dell
Retail		216-311	1 8 9	●○○○○	Wal-Mart Carrefour
Automotive		92-95	31 44 75	●●●●○	Volkswagen Toyota

1 Sum of market share from major foreign players (over 0.1% share) in China; based on volume (not value) for PC, TV, mobile handsets, and automotive
2 Not exhaustive

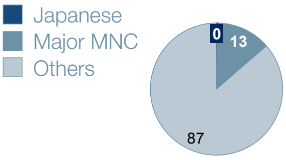
SOURCE: Euromonitor; GfK; Canadean; iSuppli; IDC; Gartner; Planet Retail; Global Insight; CAAM; expert interviews

Packaged foods

Scoring: ●○○○○

Market size:
USD 99-112 billion

Estimated market share (%):



Demand for packaged foods in China is expected to grow approximately 11 percent annually for the next five years[7], driven by population growth, consumers becoming more accustomed to eating packaged foods, and the increasing prevalence of modern retail formats. The leading multinational food manufacturers in China (in terms of sales) include Danone, Nestlé, Kraft Foods, and Unilever, along with Taiwan's Want Want. However, the market is highly fragmented, and by our estimates major foreign players have a combined share across all categories of less than 15 percent of the market.

Japanese players are significantly underrepresented. Instant-noodle manufacturer Nissin has a global presence, but in China it lags behind other competitors despite having partnered with Chinese company Hualong Food. Meiji, the second-largest Japanese confectionery manufacturer, entered China in 1993 but has likewise lagged behind global players. Meiji has recently strengthened its production capacity, perhaps an indication of a renewed focus on the China market.[8] One bright spot is Calbee, Japan's largest manufacturer of crispy snacks, which according to its Web site holds more than 11 percent market share in crispy snacks in Guangdong. Calbee's next challenge is to expand to other regions. Another Japanese success story is Itochu Corporation, a leading trading company that acquired 20 percent of Ting Hsin, China's largest food company. Itochu has established partnerships with Pasco (a Japanese bread maker), Asahi (beer), and Kagome (vegetable juice) to help these brands grow their presence in the region as well. To continue to grow in China, Japanese packaged-foods companies may need to consolidate the market by acquiring players in fast-growing, high-margin categories.

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[7] Just-food.com, "Retail expansion to underpin packaged food growth in China," October 28, 2008.

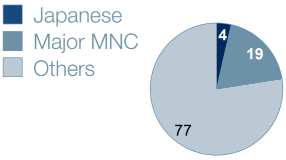
[8] *The Nikkei*, June 22, 2006 and July 17, 2008.

Beer

Scoring: ●●○○○

Market size:
USD 39-43 billion

Estimated market share (%):



China is the world's largest beer market in terms of volume (1.6 times that of the US), but its beer sales equal only 40 percent of US sales. The Chinese beer market is expected to grow at a healthy pace of approximately 6 percent a year through 2012, driven largely by rising urban incomes and increasing per capita beer consumption. The industry has been consolidating over the years, with the share of top ten players rising from 47 percent in 2000 to 74 percent in 2007. China Resources Snow Breweries, which is 49 percent owned by SABMiller, has secured the market leader position through a combination of M&A activity and organic growth.[9] International brewers have managed to capture almost 20 percent volume share. The high-end beer market, dominated by foreign brands such as Budweiser and Heineken, is still relatively small—accounting for a mere 5 percent of the market in 2007—but it is growing at double-digit rates. Attracted by the higher margins, local brands are increasingly trading up into the premium and super-premium segments through brand extensions.

Of Japan's three major players, Suntory and Asahi have a considerable presence in China (Kirin is also in the market, but to a lesser extent), although they are still limited to specific regions and thus lag behind other international players. Suntory was the first foreign beer player to enter the market, acquiring a license in Shanghai in 1984. It has since built a strong brand through aggressive promotions, a focus on the upper-middle-class segment, and a unique product strategy—it has, for instance, developed a "light" beer customized to Chinese tastes. Asahi, in a quest for broader penetration, in January 2009 acquired a 19.9 percent stake in Tsingtao Breweriy from AB InBev. Such alliances could help Japanese companies capture a greater share of the market, if they are able to leverage their Chinese partners' distribution networks and sales forces.

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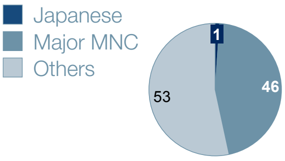
[9] Although a JV, Snow Breweries was included as a Chinese company in our analyses, as it is 51% owned by Chinese players.

Non-alcoholic beverages

Scoring: ●○○○○

Market size:
USD 34-45 billion

Estimated market share (%):



China is the second-largest market in the world (by case volume) for non-alcoholic ready-to-drink (NARTD) beverages, which in China consist primarily of water, carbonated drinks, juices, milks, and teas. Growth is driven by diversifying consumer preferences and foreign players' expansion into lower-tier cities and rural areas. Wahaha (water, yogurt drinks, carbonated drinks) is one of the leading Chinese players. Taiwanese players have a strong presence: Tingyi (whose brands include Master Kong brand of RTD tea and water) and Uni-President (fruit juice and RTD tea) have captured around 15 percent market share. Global giants Coca-Cola and Pepsi, which both ventured into China in the early 1980s, are the dominant foreign brands.

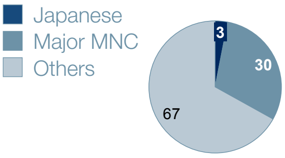
Japan's Asahi Breweries Group established a three-way joint venture with Tingyi and Itochu Corporation in 2004. Asahi, which has a 40 percent stake in the venture, has been providing expertise in production technology and quality assurance technology, and will also bolster the JV's efforts in other areas including marketing and product development. Other leading Japanese players such as Suntory, Kirin, and Ito-En have captured a mere 1 percent of the market, although some of their brands are very strong in specific regions around Shanghai. Japanese players appear to have tried different product strategies, with one localizing its products and focusing on the mass segment and another maintaining its Japanese brand and targeting the high-end segment. In both cases, the challenge is to expand their geographic reach and develop or acquire products to win different consumer segments.

Personal care

Scoring: ●○○○○

Market size:
USD 19-20 billion

Estimated market share (%):



The Chinese personal-care market—predominantly hair care, oral care, and sanitary products—was estimated to be worth approximately $20 billion in 2008. Foreign players like P&G, Unilever, and Colgate-Palmolive have performed relatively well, as have a few local manufacturers that have become leading players (e.g., HengAn International in sanitary products). P&G has captured between 30 percent and 40 percent share in China's hair care market primarily through its "high-low" product strategy—that is, it has both premium and mass offerings.

Japanese players have a 3 percent market share in China. Kao, Japan's largest personal-care products manufacturer, entered China in 1993 and has recently restated its commitment to the region. Unicharm, though its market share remains relatively small, has been aggressive in China, growing sales by 37 percent in 2008. It has carved a niche for itself in high-end sanitary products and is aiming for 20 percent to 30 percent annual revenue growth by penetrating into Tier 2 and Tier 3 cities.[10] Unicharm's success is likely due to its innovative products (for example, it was the first to introduce an extra-long sanitary pad for night use in China) and competitive pricing in the premium market.

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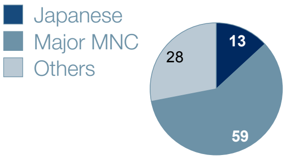
[10] Nikkan Kogyo Shimbun, November 5, 2008; Nikkei Veritus, July 27, 2008.

Skin care and cosmetics

Scoring: ●●●○○

Market size:
USD 8-10 billion

Estimated market share (%):



China's skin care and cosmetics market is worth between $8 billion and $10 billion, with 12 percent revenue growth projected over the next five years. There is intense competition among international players, which have already captured 72 percent of the market. Top players include P&G, L'Oréal, and direct-selling company Amway, which has invested heavily in key city clusters in China and has built a multiformat store network.

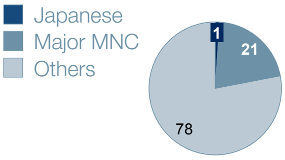
In this competitive market, Japanese brands are regarded as innovators and trendsetters—for example, they have launched popular new skin-lightening and anti-aging products. Shiseido is one of the leading international players. It has protected its premium brands by carefully differentiating its products within each sales channel and as a result has built a large presence in China. Kao is also making aggressive moves in China. This year its subsidiary Kanebo Cosmetics is launching two new brands, and the recent expansion of its manufacturing facility in China will increase production capacity by 150 percent. Japanese cosmetics players are generally good at penetrating modern retail formats but will need to invest more in serving the fragmented trade channel in order to grow in the Chinese market.

Household care

Scoring: ●○○○○

Market size:
USD 6-7 billion

Estimated market share (%):



China's household care market is a highly competitive arena dominated by local players such as Nice Group and Guangzhou Liby Enterprise Group. Laundry care has been growing at about 12 percent and is expected to continue growing by 8 percent. The dishwashing-products market is doing even better, with a growth rate of between 20 percent and 25 percent; growth is expected to accelerate due to penetration into rural markets and urban consumers upgrading to more premium products. Local players WhiteCat, Nice Group, and Liby have captured about 48 percent of the dishwashing-products market. P&G and Unilever have also done well, particularly in laundry; each has a 10 percent market share in the category. SC Johnson has been very aggressive in recent years, and its investments in the Mr. Muscle brand have made it the leader in kitchen cleaning products.

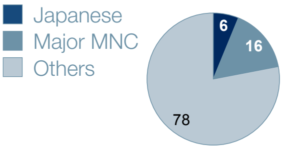
Japanese players have a very small presence in this sector, with a mere 1 percent market share. Japanese company Lion, for one, is focusing not on China but instead on other Asian countries including Thailand and Indonesia. Its sales in China account for less than one percent of its global sales. Kao, Japan's No. 1 player in laundry detergent, has recently acknowledged the need to accelerate its efforts in China. Its efforts to date include conducting rigorous market research to develop products based on Chinese consumers' lifestyles.

White goods

Scoring: ●●○○○

Market size:
USD 29-38 billion

Estimated market share (%):



The white-goods market in China is worth between $29 billion and $38 billion. For the last few years, the market has grown by almost 20 percent, owing in part to government subsidies for rural residents. The top 3 local manufacturers—GD Midea, Haier, and Zhuhai Gree—have captured almost 30 percent of the market, stealing share from MNCs through lower prices and almost equivalent quality. Haier, since its founding in 1984, has achieved significant growth through a series of acquisitions of regional and national appliance companies, including Red Star Electric Appliance. Most recently, Haier acquired a 20 percent stake in New Zealand-based Fisher & Paykel Appliances, giving Haier exclusive marketing and distribution rights for Fisher & Paykel products in China.

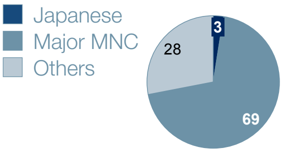
Japanese white-goods players account for approximately one-fourth of foreign companies' share in China, due primarily to the strength of Panasonic, particularly in washing machines and air conditioners. Panasonic has formed successful partnerships with local players, and in 2005 it established R&D centers in Shanghai and Huangzhou to design products tailored to the lifestyles and needs of middle- and upper-class Chinese consumers. Other Japanese white-goods manufacturers, however, have not invested significantly in China. Judging from their dominance in Japan (where their market share exceeds 95 percent), Japanese white-goods companies have the potential to strengthen their performance in China considerably.

Mobile handsets

Scoring: ●○○○○

Market size:
USD 24-25 billion

Estimated market share (volume; %):



China has the largest mobile-phone subscriber base in the world. Not surprisingly, the market is crowded with foreign players—the most successful being Nokia and Samsung—that have leveraged their strong brands and cost competitiveness to beat out domestic competitors. However, Chinese players are increasingly offering cheap handsets and forcing global players to cut prices.

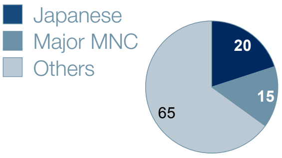
Most of Japan's mobile-handset manufacturers ventured into China, but have left the market over the past few years. Toshiba, for example, set up a joint venture with Nanjing Putian in 2000 and developed a suite of high-end products equipped with video e-mail functions. Sales did not meet expectations, and Toshiba abandoned the joint venture and shifted its focus to 3G handset operations in other regions. The failures of Japanese companies to crack the China mobile-handset market are often blamed purely on technology compatibility issues, but we believe at least some of the obstacles could have been overcome with more thoughtful product development and attention to distribution. Also, building strong partnerships and undertaking joint campaigns with mobile-network operators and retailers—although not easy—is essential to success in the Chinese mobile-handset market. Japanese companies will need to differentiate themselves to attract the right partners; one way would be to develop ideas for value-added data services.

Flat-panel TVs

Scoring: ●●○○○

Market size:
USD 13-21 billion

Estimated market share (volume; %):



China's flat-panel TV market has been growing at the astounding rate of 80 percent per year, surpassing the Japanese market in 2007 and now on track to become bigger than the US and European markets in a few years' time.[11] Flat-panel TVs have replaced CRT TVs as the predominant TV product in China. In 2008, approximately 15 million LCD TV units were sold in the country. Five local companies—HiSense, Skyworth, TCL, Konka, and Changhong—have dominated the market, thanks largely to strong support from regional governments.

Several Japanese players are active in the Chinese TV market—among them Hitachi, Panasonic, Pioneer, Sanyo, Sharp, and Sony—and now account for more than half of volume share among foreign players. However, recently they have struggled to compete profitably as local players have continued to slash prices. Also, Japanese companies have not managed to penetrate lower-tier cities the way their Korean competitors have. Japanese companies tend to prefer dealing with a small number of national distributors; Korean companies, on the other hand, have built farther-reaching distribution networks by becoming closely involved with a broad range of distributors and retailers.

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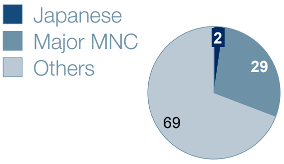
[11] Display Search, 2008

Personal computers

Scoring: ●○○○○

Market size:
USD 10-13 billion

Estimated market share (volume; %):



China's PC market has been growing rapidly, with volumes increasing at a 15 percent clip per year over the last five years. Laptop sales have grown at an even higher rate. The decline in the average selling price and the introduction of very low-cost models have made PCs affordable to many Chinese consumers in both urban and rural areas. The top five players by market share are Lenovo, HP, Dell, Founder, and Acer. Most top players have been expanding into Tier 3 and 4 cities and enhancing their distribution networks; some local players are bundling PCs with local telecom broadband access in rural markets. Dell, for which China is the second-largest market, has recently made a strong push into the small and medium-size business (SMB) markets in Tier 3 and 4 cities, taking advantage of the government's stimulus package.

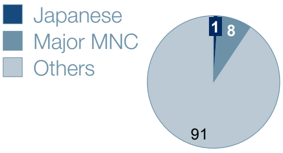
Japanese players significantly lag behind competitors in China's PC market. They have only a 2 percent to 3 percent volume share of the Chinese market, a weak position compared with their global market share of approximately 12 percent. But success is certainly not out of reach if Japanese companies focus on developing the right products at the right prices and getting them to market in a timely manner. Toshiba, for instance, recently released its first low-priced "netbook" in China and has seen a notable rise in sales. Toshiba has said that it aims to increase its share in China's notebook PC market by two percentage points by next year.

Retail

Scoring: ●○○○○

Market size:
USD 216-311 billion

Estimated market share (%):



Despite significant and rapid investment by both local and foreign players, the Chinese retail arena remains highly fragmented. Top local retailers include China Resources and Bailian Group, which operate hypermarkets and supermarkets, and electronics chains GOME and SUNING. Foreign players have captured 9 percent of the market in grocery, but if the scope is broadened to include all retail formats (i.e., department stores, specialty stores, other traditional formats) that figure drops to 3 percent. Building a critical mass of stores and reaching profitability can take a number of years, but early entrants like Carrefour and Metro are believed to be profitable in China. Other retailers have acknowledged growing too quickly; a leading multinational DIY/home improvement player, for example, built a network of more than 60 stores in China, only to close one third of them this year after a slowdown in the housing market.

Japanese convenience-store retailer Lawson, which entered Shanghai in 1996, has nearly 300 stores in China but is clearly playing catch-up to domestic convenience chains such as KEDI and ALLDAYS—both part of Shanghai-based Nonggongshang Group—and QUIK, which has both company-owned stores and franchises. Lawson has yet to expand beyond Shanghai. QUIK, by contrast, has 1,300 outlets in the city and a further 700 across the country, and has been opening 200 outlets a year on average. Neither Yamada Denki nor Yodobashi, Japan's leading consumer electronics retailers, has yet opened a store in China despite announcing plans to do so. Because some of the leading Japanese retailers are accustomed to having a number of different banners and tailoring each store to fit the location, they tend to move more slowly than foreign giants like Wal-Mart or Carrefour when it comes to site selection and store construction. Other challenges include assortments that are not customized to the Chinese market and the dearth of Chinese people in senior management, which results in management not being very effective at influencing the front line.

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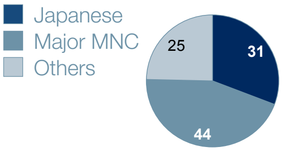
12 *China Daily US edition*, "Lawson's target market keeps chain's expansion slow," March 16, 2009.

Automotive

Scoring: ●●●●○

Market size:
USD 92-95 billion

Estimated market share (volume; %):



Even amid the global downturn, China's automotive landscape holds tremendous promise. Although growth has slowed somewhat, the government has issued a series of policies to spur sales—for example, a reduced sales tax on small passenger vehicles. In addition, many middle-class consumers are trading up, helping to make China a robust market for luxury autos. Indeed, according to some estimates China may pass Germany as the second-largest market for luxury cars within three years. (Our analysis of the automotive market excludes commercial vehicles. We estimated market size by multiplying sales volume by the average retail price per vehicle.)

Japanese auto players Toyota, Honda, and Nissan are all well-established brands in China. Japanese auto companies generate an estimated 12 percent of their global sales volume in China, a much higher percentage than their American and European counterparts, in part because they have rapidly expanded their dealer footprints into the lower-tier cities. Toyota is one of the biggest spenders on advertising in China, and it has successfully established the Lexus brand in the luxury segment. Japanese players also owe some of their success to their strong dealer network. To capture even greater share, Japanese automakers should localize their core functions such as R&D, product planning, and marketing, as Volkswagen has done—it is tailoring its products to Chinese needs and preferences, and has developed a number of "only for China" models.

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