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Christiane Prange
Editor

Market Entry in China

Case Studies on Strategy, Marketing, and Branding

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Editor
Christiane Prange
School of Economics and Management
Tongji University
Shanghai, China

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Part I

Introduction

The Promise of China

Christiane Prange

Since opening up to foreign trade in 1979, China has become the land of promise for many Western companies. China has emerged as a major global player and today is the largest economy in the world (on a purchasing power parity basis) (Morrison, 2015). However, the economic crisis in 2008 has also affected China, with exports and foreign direct investment declining and growth slowing down. Real GDP fell from 10.4 % in 2010 to 7.8 % in 2012, to 7.4 % in 2014. The IMF projects that, over the next 6 years, China's real annual GDP growth will average 5.9 % (IMF, 2015). Future growth will largely depend on the government's activities to boost consumer demand, accelerate the transition to a free market economy, and engage in innovation rather than remaining the 'low cost factory of the world'.

Looking back in history, China has become a major economic power within three decades. The World Bank estimates that, from 1981 to 2010, 679 million people in China were raised out of extreme poverty (The World Bank, 2013). Prior to 1979, China, under the leadership of Chairman Mao Zedong, maintained a centrally planned, or command, economy. State control dominated production output and prices. By 1978, nearly three-fourths of industrial production were produced by centrally controlled, state-owned enterprises (SOEs), according to centrally planned output targets. Private enterprises and foreign-invested firms were generally barred (Morrison, 2015). Market mechanisms were basically lacking to allocate resources and to influence the quality of production output. Shortly after the death of Mao in 1976, the government decided to abandon its Soviet-style economic policies to adopt free market principles and open up trade with the West. In 1979, several reforms were launched, including a new Joint Venture law. Starting in 1980, special economic zones were established to attract foreign direct investment (FDI), economic decision-making was decentralized in several sectors, and citizens were encouraged to start their own entrepreneurial

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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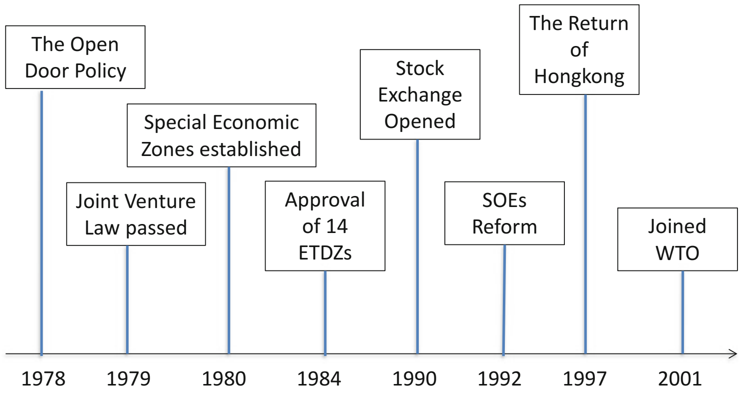

Fig. 1 Some of the key events during China's opening up (1978–2003). *Source*: Adapted from Bauer and Liu (2006)

ventures. At the beginning of 1984, to further open to the outside world, the Chinese government decided to establish economic and technological development zones (ETDZ) by using successful experiences of special economic zones in the previous period. From 1984 to 1988, 14 ETDZs, namely Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Minhang, Hongqiao, Caohejing, Ningbo, Fuzhou, Guangzhou, Zhanjiang, were the first to be established after the approval of the State Council. With the opening and re-establishment of Shanghai and Shenzhen in 1990, alongside Hong Kong, China has three stock exchanges. Reforms of state-owned enterprises in 2001 contributed further to making business decisions free of administrative interference. With the accession to the World Trade Organization in 2001, China reached a major milestone that signified its deeper integration into the world economy (Fig. 1).

From 1979 to 2014, China's annual real GDP averaged nearly 10 %, growth that was mainly explained with increasing productivity and large-scale investment. However, with the country's aspiration to break its dependence on foreign technology and move away from the 'made in China' to the 'innovated in China' model, many Chinese companies have slowed down in productivity. Indeed, the Chinese *zizhu chuangxin* ('homegrown innovation') initiative has become the watchword for the future to transform China into an innovation-driven economy. During the process, China will also have to face a phenomenon called the middle-income trap. This means that several developing (low-income) economies were able to transition to a middle-income economy, but because they were unable to sustain high levels of productivity gains (in part because they could not address structural inefficiencies in the economy), they were unable to transition to a high-income economy. Another reason for the slow-down of the economy may simply result from the shifting of resources from agriculture to industry that has already occurred.

As in the past, the next few years will be preordained by China's Five-Year Plans (FYPs), which have been issued by the government since 1953. The FYP is the major vehicle for the government to establish broad economic and social goals for the period under consideration, to coordinate investments between the central and local governments, and to oversee implementation of policy. Not only does the plan influence investments by government entities, it also provides direction for bank lending and government approvals and regulation of private and semi-private industries. In March 2011, China's National People's Congress approved the 12th Five-Year Plan. The 12th FYP (2011–2015) contains three broad themes: (1) economic restructuring, (2) promoting greater social equality, and (3) protecting the environment (S.R. 2015; Xinhua, 2011).

Economic restructuring involves collaboration with and learning from foreign firms, which were welcomed after Deng Xiaoping's reforms in the early 1990s to instill competition and share knowledge on market orientation, branding, and world-class technological quality. There were reportedly 445,244 foreign-invested enterprises (FIEs) registered in China in 2010, employing 55.2 million workers or 15.9 % of the urban workforce (National Bureau of Statistics of China, 2012). FIEs are responsible for a significant level of China's foreign trade and dominate China's high technology exports. From 2002 to 2010, the share of China's high tech exports by FIEs rose from 79 to 82 %. During the same period, the share of China's high tech exports by wholly owned foreign firms (which excludes foreign joint ventures with Chinese firms) rose from 55 to 67 %.

While competition is on the rise, China's SOEs may still account for up of 50 % of non-agriculture GDP (Szamosszegi & Cole, 2011). In addition, although the number of SOEs has declined sharply, they continue to dominate a number of sectors (such as petroleum and mining, telecommunications, utilities, transportation, and various industrial sectors). Most strikingly, they are shielded from competition, and the main sectors encouraged to invest overseas, and dominate the listings on China's stock indexes. The nature of China's SOEs has become increasingly complex. Many SOEs appear to be run like private companies. For example, a number of SOEs have made initial public offerings in China's stock markets and those of other countries (including the United States), although the Chinese government is usually the largest shareholder (Morrison, 2015).

Going forward, a vibrant private sector will also be very important. Since 2003, the private sector has been expanding and, in particular, many small and medium-sized SOEs have become privately owned. The government encourages entrepreneurship and new venture formation by introducing preferential tax policies, social security subsidies, and easier business registration procedures. "The government is doubling its effort to boost employment by not only lifting burdens for market players, but also injecting vigor into the market," said Zhu Lijia, a professor with the China National School of Administration, a state think tank (Xinhua, 2015). As a result, about 844,000 new companies were registered in the first quarter of 2015, rising to 38.4 % from the same period the previous year, according to data from the State Administration for Industry and Commerce. Between January and March, the number of newly registered firms in tertiary industries rose 41 % to 677,000 accounting for 80.2 % of new companies (Xinhua, 2015). The State Council even issued an opinion to further mass entrepreneurship and innovation, emphasizing the strategy of innovation-driven development, and demanding that institutional obstacles should be removed (The State Council of the People's Republic of China, 2015).

With regards to *social equality*, the role of policy will be to support equality of opportunity through increasing the numbers of skilled works and by rising educational standards. The growing shift to skill-based labor will also increase the pace of innovation and help China to move up the value chain. At the same time, China's existing comparative advantage in low unit labor costs will shrink gradually and enhanced productivity will rapidly increase the middle-class segment, which in turn, will increase consumption rates. Over a period of 20 years, more than 500 million Chinese people have already been lifted out of poverty. However, millions of people are still poor; most of them live in remote or hard to reach areas, particularly in Western China. Many more people are "almost poor"—that is, they live just above the poverty line and are vulnerable to risks and shocks that could push them back under it once again (The World Bank and Development Research Center, 2013). Social disparities are mirrored by large gaps between the richest and poorest citizens, with mean incomes of the richest decile are some 25 times higher than those of the poorest decile (Li, 2012). It is estimated that the richest 10 % of the population could be earning more than 50 times the average income of the lowest 10 %, which manifests itself in increasing household expenditure.

Finally, the *protection of the environment* is a major issue of concern because growth patterns in the past may have been environmentally unsustainable. Thus, Chinese authorities proposed a new approach toward green development in the 12th FYP in which economic growth should be combined with environmental sustainability, with each mutually supporting the other. With the new environmental protection provisions, effective since January 2015, the government's environmental agencies will be allowed to enforce strict penalties and seize property of illegal polluters. Under the new law, local governments will be subject to discipline for failing to enforce environmental laws. Regions will no longer be judged solely on their economic progress, but instead must balance progress with environmental protection. Additionally, local governments will be required to disclose environmental information to the public. Individuals are encouraged to "adopt a low-carbon and frugal lifestyle and perform environmental protection duties" such as recycling their garbage under the law (Duggan, 2014). Continuing along these principles, long-term market incentives will be required to encourage enterprises and households to "go green".

While China has demonstrated a tremendous growth in the past decades that has turned it into an upper-middle-class society, there are different challenges ahead. In order to maintain sustained rapid growth and development for extended periods, the World Bank Commission on Growth and Development (2008) focuses on the following criteria: countries exploit opportunities in the world economy by fostering open trade and investment policies; they maintain economic stability and enjoy high savings and investment rates; they allow markets to allocate resources; and they lead by committed and credible governments—all criteria that China demonstrates. And, as the World Bank (2013) argues, these criteria are the pillars for creating a modern, harmonious, creative and high-income society by 2030.

In a *modern society*, the quality of life is on par with developed countries. There are high degrees of industrialization and society adheres to modern values while conserving the heritage of the past. Social structure exhibits equality with access to state-of-the-art products and technologies, discussed and promoted on a global level.

In a *harmonious society*, people show mutual respect, disputes are resolved justly and peacefully through accepted norms, laws, regulations and practices. This requires a stable institutional system that, at the same time, is quick to adapt to society's changing needs. It also includes living in balance with nature, thus the strong ecological footprint with the preservation of biological capacities and resources. Further, China would like to see itself as an equal, constructive, and accepted partner in the community of nations, working peacefully and cooperatively toward common goals, and engaging constructively on global issues and in global institutions.

As for a *creative society*, China focuses on innovation and individual entrepreneurship, supported by governmental incentives. Its ambition is to move up the value chain, to increase productivity, and to compete on high-level products, services and technologies. With its pressing need to increase environmental quality, for example, China may become a leading innovator in the field of green technology, and then its expertise and knowledge on this subject will likely be sought worldwide. With creativity, society will also benefit in its cultural and intellectual spheres, incentivizing other countries to learn from China.

As a *high-income society*, China aims to be on a par with advanced economies, with a strong middle class to promote further growth. Successfully started in the past, poverty reduction remains a predominant goal by increasing equality of opportunities and by lowering inequality in all its economic and social dimensions. Compared with today, China's economy in 2030 will be more complex, market-driven, knowledge-centered, and oriented toward services. Its trade and financial integration with the global economy will make it more interdependent with other economies and, at the same time, more vulnerable to external shocks.

With these objectives in mind, China's projected growth patterns may be declining; however, assuming steady reforms and no major shocks, they will nonetheless result in a promising market environment for foreign firms.

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Internationalizing to China: Challenges and Pitfalls

Christiane Prange

For companies, the historical development of China has held many promises, but now several conditions are making life more difficult. Competition of local brands is intensifying and profits are shrinking as a result of the economy's slowdown. Several examples illustrate this. For instance, foreign multinational Yum's China division was providing more than half of its global operating profits in 2011. However, sales growth in the most recent quarter was down to a plodding 3 % and, on October 20th, 2015, shortly after cutting its global profit forecast because of weakness in China, Yum said it would spin off the China division into a separate company next year (The Economist, 2015). Several other powerful corporations have gone confidently into the People's Republic, only to stagger out a few years later, battered, confused and defeated. Earlier in 2013, media reported that global retail giants Wal-Mart and Carrefour had big problems. Also, Best Buy, which entered China in 2006 by paying $180 million to take control of Five Star, China's fourth-largest electronics retailer, failed (Riley, 2013). There are many other examples from different sectors.

Of course, no defined formula for unlocking the Chinese market exists. Companies that have been successful in meeting their goals are usually those with a thorough and in-depth market and resource analysis, a clear understanding of entry mode choices, consumer behavior and the need for an adaptive strategy. They are nimble enough to respond to changes in the fluctuating environment and innovative enough to approach China differently. They do not expect to use the same business strategy that had worked in their home markets, or from any other emerging market, even should that strategy be tried and proven.

Taken collectively, an analysis starting with the external environment, e.g., PESTLE (political, economic, sociological, technological, legal and ecological factors) and the company's internal environment (resource audit) should precede

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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any internationalization activity. Both internal and external factors, depicted in a SWOT-analysis = strengths, weaknesses, opportunities and threats, could give a first overview on the expected scenario. However, many companies have overestimated their strengths while ignoring their 'liabilities of foreignness' (Hymer, 1976); that is, the additional costs that firms operating outside their home countries experience above those incurred by local firms. These costs originate in limited local knowledge, local stakeholders' discriminatory attitudes and the difficulties of managing organizations whose subunits are separated by time and distance. These factors influence the choice of entry mode, an important issue for firms entering China. While choices were legally limited only recently, today several options are open to companies.

1 Restricted Industries

Doing business in China is influenced both by the legal restrictions and a firm's risk appetite. For different sectors, there are opportunities and restrictions (LehmanBrown, 2015; PWC, 2012). Foreign investment in China is currently governed by the "*Catalogue for Guiding Foreign Investment in Industries*," a detailed list of industry sectors that are classified as either: (1) encouraged, (2) permitted, (3) restricted, or (4) prohibited (Fig. 1). Industries not listed in the three basic categories of "encouraged," "restricted" and "prohibited" are considered *permitted*, which acts as a default category. These industries are open to foreign investment, unless other PRC regulations state otherwise. The investment only needs to be registered with the government.

Encouraged industries generally are ones in which the investment relates to new and/or advanced technology, projects that meet an international demand not currently being met or increases product quality, projects that will increase exports, projects that can increase the efficiency in which manpower is used, and projects that conserve resources and protect the environment. The Chinese government

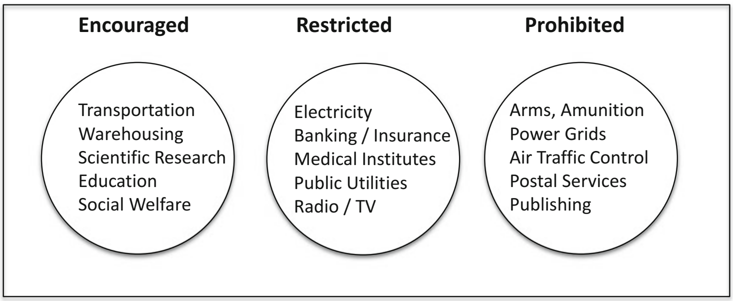

Fig. 1 Examples of encouraged, restricted, and prohibited industries. *Source*: Based on LehmanBrown (2015)

offers preferential tax treatment and other incentives to foreign investors in these growth industries.

Restricted industries face more strict scrutiny from the government or require approval from higher levels of the government. Also, automatic approval of the investment cannot be assumed. Industries may be classified as restricted for a variety of reasons, including where the technology has already been imported into China, where the industry would have an adverse effect on the environment or would not promote energy conservation, and industries that are highly regulated by the State or fall under State central planning. In order to access these restricted industries, multinationals may be required to enter into a joint venture with a Chinese enterprise or other partnership with local shareholders.

Investments in *prohibited industries* are completely off limits to foreign investment because they would endanger state security or harm the public; pollute the environment or endanger human health; endanger the use of military resources; would use manufacturing techniques that are unique to China.

2 Entry Mode Choices

Related to the openness of specific industry sectors and product types, companies can choose between different types of market entry, ranging from "go it alone" to minority engagements dominated by Chinese partners. For a long time, such a minority ownership investment between a Chinese company and a foreign company was the only way for foreign investors to enter the Chinese market, especially before China became a member of the WTO in 2001. Today, there are several other options available that differ with regard to the degree of control and ownership.

Representative Offices This is the easiest and quickest way to enter China and test whether the promises of the business model turn out to be true. There are few regulations and no capital requirements to set up a representative office, thus it incurs fewer risks for foreign companies. However, there are also drawbacks of representative offices because they are no legal entities, but rather a liaison between the headquarters of the foreign enterprise overseas and Chinese government agencies, trade organizations and prospective Chinese business partners. The parent enterprise will be legally responsible for the activities of its representative office, only permitting it to engage in non-direct business activities, such as market research or to promote the brand and better understand the operations side of business in China.

Wholly Foreign-Owned Enterprises (WFOEs) WFOEs give investors 100 % equity and control. Without having to share with a partner company, a WFOE has complete jurisdiction over its internal decisions, operations, human resources and corporate culture. In contrast to representative offices, WFOEs have the ability to do business legally in China. They can conduct sales, issue invoices and receive revenues. No minimum registered capital is required for WFOEs with the objective of business of consulting, trading, retailing, information technology, etc., in China. However, it is advisable to choose registered capital within RMB 100,000–RMB 500,000 (investors could inject the capital within 2 years) as the minimum registered capital for Consulting WFOE, Service WFOE, Hi-Tech WFOE registration in Shanghai, Beijing, Shenzhen, Tianjin, Guangzhou, Hangzhou, Ningbo, Suzhou and many other cities of China (Path to China, 2015a).

Foreign-Invested Commercial Enterprises (FICE) The foreign-invested commercial enterprise (FICE) is a popular variant on the WFOE. The China FICE can distribute either imported or locally manufactured products throughout their wholesale, retail and franchise systems. They can also provide related services such as storage and warehousing, training, and inventory management (PWC, 2012). Before December 11th, 2004, FICEs, i.e., enterprises established by foreign investors in China (including wholly foreign-owned enterprises [WFOEs] or joint ventures [JV]), were only permitted to import raw materials and semi-manufactured products for their own use and to export self-manufactured products directly. Today, FICEs can distribute imported and locally manufactured products through their own wholesale, retail and franchise systems and can provide a host of related services, including storage, warehousing and garage services, inventory management, and repairs.

Joint Ventures (JV) A Joint Venture is a business arrangement in which the participants create a new business entity or official contractual relationship and share investment and operation expenses, management responsibilities, and profits and losses (Path to China, 2015b). The Chinese authorities encourage foreign investors to use this form of company in order to obtain exposure to advanced technology and new management skills. In return, foreign investors can enjoy low labor costs, low production costs and a potentially large Chinese market share. Joint Ventures are sometimes the only way to register in China if a certain business activity is still controlled by the government, e.g., restaurants, bars, building and construction, car production, cosmetics, etc. Companies can decide between two types of Joint Ventures.

An *Equity Joint Venture* is the second most common matter in which foreign companies enter China. Typically, product and technology input comes from the foreign partner, whereas the Chinese partner provides market access and manufacturing capability. After a joint venture is registered, the entity is considered a Chinese legal entity and is free to hire Chinese nationals without the interference from government employment industries as long as they abide by Chinese labor law.

In a Sino-Foreign Cooperative Venture (also known as *Contractual Joint Venture*), the parties involved may operate as separate legal entities and bear liabilities independently rather than as a single entity. There is no minimum foreign contribution required to initiate a cooperative venture, allowing a foreign company to take part in an enterprise where they prefer to remain a minority shareholder.

3 Cultural Challenges

Apart from legal requirements, the most demanding challenges for foreign companies arise from cultural differences, requiring them to learn about the cultural gaps separating the East and the West. Indeed, expanding to China requires deep insights into cultural traditions and their impact on consumer psychology. For instance, what is often difficult to understand for Westerners is the fact that *opposites can coexist*. This understanding goes back to the difference between Aristotle and Confucius: Western societies believe in logic—where something is either 'A' or not 'A'—so dealing with logical inconsistencies causes great discomfort. East Asians are able to accept that something could be both 'A' and not 'A' at the same time.

Another important difference is the *Guanxi* culture or relationship issue, which also derives its meaning from Confucianism. Although the word "guanxi" is not found in Confucian classics, the word *lun* is used instead, which is regarded as the root of guanxi (King, 1991). As Confucius mentioned, in China, in a relation-oriented society, one was a socially dependent being, which made it imperative to know one's social position, to fulfill one's duties and obligations, and to observe the appropriate moral standards. Guanxi can be defined as an informal, particularistic personal connection between two individuals who are bounded by an implicit psychological contract to follow the social norms, such as maintaining a long-term relationship, mutual commitment, loyalty, and obligation (Chen & Chen, 2004).

Guanxi can refer either to the state of two or more parties being connected or the connected parties themselves. As a state of being connected, it is either in existence or not, good or bad, close or distant, deep or shallow, in tension or in harmony. In reference to the actual parties involved, a guanxi can be individual or an organization, as a dyad or as a network. Guanxi also can be described as guanxi-related activities, such as *pull guanxi* referring to actions of initiating and establishing a connection, and *walk guanxi* meaning to use connections to achieve specific purposes. Other frequently used verbs include building, developing, consolidating, maintaining, breaking and so on (Luo, 2009).

Further, there is *mianzi*, which means never losing face, and is a very important issue in China. From a social-psychological point of view, it refers to an individual's value in the eyes of others, or the kind of prestige or reputation achieved through getting on in life through success and ostentation (Hu, 1944). Chinese like to *have Mianzi*. That means they expect others to think them rich, generous, and have good taste, etc., no matter whether they are or not. This culture definitely promoted a luxury consumption tide in China. However, that is an unbalanced consumption. Some research found that the Chinese are seen as having a low level of involvement when purchases are for private consumption, but exhibit a high level of involvement when they are buying products for their social or symbolic value. Since the Chinese greatly value social harmony and smoothness of relationships within the extended family, the social significance of products is highly important, be it to express status, gratitude, approval or even disapproval (Jiang, 2005).

What often makes it difficult to understand Chinese culture is that it is in a constant state of flux. It is anchored in traditional values and torn towards modern ones; inspired by relationship, harmony, family and attracted by entrepreneurial achievement and well-being. The more advanced and modernized values have adapted to laws of nature and society, in accordance with people's interests and the natural development of human society. Integrating elements of Western values is vital for the modern Chinese value system, but preserving traditional Chinese values, such as harmony and cooperation, will extensively reflect China's policy and future success. In fact, China does not adapt to modernity, but uses it as it has always done in the past, as a tool to serve its own purpose. As Faure (2003) put it:

> The 'Macdonaldization' in China is only a superficial phenomenon that should not mislead the interpretation of the true nature of the changes. The process is the following: collection of new elements, sedimentation of those elements within the Chinese system, then digestion and finally re-use within the Chinese metabolism.

While the result may appear to be more modern, or more Westernized, we may all be dramatically mistaken to assume that we can operate with the same business principles and practices. To understand China, one has to consider first the cultural foundations that make the Chinese civilization so unique; this requires exploring the invisible dimension of what often remains hidden when dealing with China on the surface only.

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Marketing Decisions in China: Positioning, Branding, Marketing Mix

Christiane Prange

Twenty years ago, many people in China were buying most of their daily necessities with some sort of coupons, and every family had a little book, which recorded the amount of rice, flour and oil it purchased. Ten years ago, such coupons were already a thing of the past, but there were still many state-owned shops and these shops offered only a limited variety of goods. Now, people go to the supermarkets or hypermarkets, many of them foreign-funded, and they can find whatever products they want, many of which come from abroad. Before the late 1970s, marketing was of no concern to Chinese companies because they took orders from the state and fulfilled predefined production and distribution targets (Schaffmeister, 2015; Zhang, Doorn, & Leeflang, 2012).

1 The Rise of the Middle Market

Alongside economic reforms, consumer income has become higher and the middle-income market has continuously increased, thereby paving the way for foreign products that are more expensive and of higher quality. Currently, the market is rapidly bifurcating between a still large (but less affluent) mass market and a new, even bigger group of upper-middle-class consumers. The people in this more affluent segment enjoy household incomes between 106,000 and 229,000 Renminbi ($16,000–$34,000) a year. By 2022, McKinsey (2013) estimates, the upper middle class will account for 54 % of urban households and 56 % of urban private consumption. The mass middle will dwindle to 22 % of urban households. The evolution of the middle class means that sophisticated and seasoned shoppers—those able and willing to pay a premium for quality and to consider discretionary goods and not just basic necessities—will soon emerge as the dominant force.

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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There are also regional differences. In 2002, 40 % of urban middle-income consumers lived in first-tier cities like Beijing, Shanghai, Guangzhou or Shenzhen, but this will fall to 15 % by 2022. Some 85 % of them lived in the Eastern coastal regions in 2002, but this will also fall to 60 % by 2022. China's income distribution is slowly rebalancing towards the West and North, away from East and South China, and away from the first-tier and second-tier mega cities to the medium and smaller-sized cities. Newcomers often mistakenly see China as one market, rather than multiple markets with a very diverse mix of lifestyles, cultures, languages, tastes and preferences, and consumer behavior. Savings rates also vary considerably. In first-tier cities, people save as much as 60 % of their income, while consumers in second- and third-tier cities are spending more. First- and second-tier city (e.g. Hangzhou, Wuhan, Nanjing) shoppers also tend to be less brand-loyal, choosing from a wider range of brands. Those residing in smaller cities and inland areas are more traditional and conservative in their consumption compared to those in coastal areas, and they tend to be more price-sensitive and focused on functionality and durability. Consumers in coastal cities, on the other hand, care more about brand reliability and consider emotional needs as important in their purchasing decisions (McKinsey, 2012).

In particular, discretionary spending has become larger, which refers to items one likes but does not necessarily need for survival. Chinese citizens are now moving beyond being able to only afford the basics of life, and their discretionary spending is taking off. Growth in spending on annual discretionary categories in China is forecast to exceed 7 % between 2010 and 2020. This category is growing faster than spending on actual necessities, which is expected to grow around 5 % a year, about the same as expected GDP growth (Towson & Woetzel, 2014).

These developments are based on a variety of cultural specifics and lead to concrete insights for marketing strategy. First, the one-child policy in China, the so-called *Dusheng generation* (the only child in a family), has fostered interest in consumerism. Compared with their parents and people who were born earlier, and who had at least one brother or sister, this new generation has a totally different living situation. It builds on a different perception of the world and acts according to different principles that are more self-centered. At the same time, this generation bears a heavy responsibility for fulfilling their parents' expectations. The *Little Emperor Syndrome* is a consequence of China's one-child policy, with children gaining an excessive amount of attention from their parents and grandparents. This is combined with an increased spending power within the family unit and parents' general desire for their child to experience the benefits they themselves were denied (Jing, 2000). Second, there is also a belief among the middle class that they can transform their lives and engage with society for material and social benefit. However, this doesn't mean that China's middle class is becoming more Westernized and materialistic; rather, consumer spending is seen as a tool for social achievement (Doctoroff, 2012). This is important to know, because purchasing behavior is influenced by how much items can be displayed to show and share the wealth the buyer has acquired. Luxury products are bought as a means to an end; they incorporate cultural aspirations, together with the desire for status, image, and self-representation. Naturally, this has several consequences for marketing in general and for positioning in detail.

2 Positioning and Branding

First and foremost, there is an appreciable rise in the number of consumers expressing willingness to pay premium prices for good quality. Close to half of upper-middle-class consumers claimed that they “always pay premium prices for the best product, within the bounds of affordability,” compared with around 40 % of all respondents. This is partly due to the fact that Chinese people tend to associate good quality with well-known brands and high prices, which opens the door for foreign products (McKinsey, 2012). For that reason, consumers seem to be willing to trade-up as soon as they can afford it.

Chinese consumers prefer to purchase global luxury brands more than domestic luxury products, even if this means paying higher prices. Therefore, it is assumed they enhance and maintain their social status and self-concept because global brands rank higher in perception than their domestic counterparts. Those Chinese consumers that have only recently become wealthier engage in almost pathological levels of consumption of foreign luxury fashion goods, emphasizing mianzi. Therefore, many Chinese consumers purchase global-brand products because global brands and/or imported goods symbolize higher social status, prestige, high fashion, and reliability (Wang & Chen, 2004). However, top-end consumption is more important for specific product categories, such as high-tech or consumer electronics, while the choices of Chinese consumers for other product categories are much more varied and nuanced.

However, there are also other companies that have failed with their foreign brands in China because they did not clearly define their brand position, failed to understand and relate to their consumer base and overestimated presumed brand loyalty linked to product sophistication. For instance, L’Oréal, with its cosmetics, both for men and for women, has been very successful in China. However, one of its competitors, Clarins, struggled in targeting the male consumer segment because men have been put off by the metrosex image of campaigns and the branding centered around permanent care, which was seen as unmanly. Clarins was portraying its brand in an odd light to Chinese consumers that did not resonate with them (Rein, 2007).

Apart from unsuccessful positioning, consumers also prefer local products in some categories, for instance food and household items. Studies by The Boston Consulting Group (BCG) in 2008 revealed that consumers sometimes differ in what they buy and what they say they buy. In a survey, consumers were visited at home after interviewing them about their brand preferences. Looking into consumers’ pantries, medicine cabinets, and linen closets, expectations were to find the local brands that many had claimed to prefer strongly and purchase regularly. Instead, products like Safeguard and Lux soaps, Pantene shampoo, and Olay and Avon cosmetics—all international brands—dominated. As an explanation as to why they had purchased so many foreign brands when they claimed to prefer local products, consumers' answers were strikingly similar: they had always assumed that these products were, in fact, local. Based on this, BCG introduced the term *chameleon branding*. Just as a chameleon blends into its surroundings, some foreign brands can appear to be Chinese, even to a native.

Some companies are obviously more able to make their brands relevant to Chinese consumers by adopting a local Chinese name or by using local images in advertising. When these products are available in local stores at reasonable prices, they can become so much a part of the local environment that it's no wonder they are mistaken for Chinese brands. That's particularly true of items that consumers use daily and keep on their bathroom shelves, such as personal-care products. The ubiquity of these brands helps them blend into Chinese consumers' lives. Indeed, foreign companies operating outside the luxury segment often try to make their products seem Chinese to appeal to consumers who might prefer local products.

3 Marketing Mix: Standardization or Adaptation?

Just like the branding examples, questions of local adaptation or global standardization have been around since the early days of doing business in China. Initially, the approach for most companies was standardization because of the huge desire to buy Western brands after long years of scarcity. But this situation has changed and many multinational companies that have tried to penetrate the market with their globally standardized approach have failed, and these failures result invariable from all marketing mix elements.

3.1 Product Policy

When it comes to adaptations in the product policy mix, many international companies operating in China acknowledged that they needed to alter their product specifically for the Chinese market. In most cases, this does not mean creating a completely new product or service, but rather making small adjustments to better suit Chinese culture and preferences. Kraft Foods, upon discovering that some Chinese do not like very sweet flavors, made an alternative Oreo cookie that had less sugar and included local, favorite flavors such as green tea. Western fast food chains, in particular KFC, have had much success in China due to their combination of an extensive chicken menu, a favorite among Chinese, as well as local dishes (Startup China, 2015).

In terms of product policy, one of the main questions asked is what elements of the offer can be standardized and what needs to be adapted (Alon, Jaffe, Prange, & Vianelli, 2016). Physical characteristics, color, shape, style, design, packaging, country of origin, branding, service attributes and, of course, functionality, are all elements of the total product offer that need to be examined accurately before entering a foreign market. Some of these elements—for example, color or style—

can be a physical characteristic and convey a symbolic meaning at the same time. Product attributes that have to be analyzed include the following:

- Regulations and standards
- Physical characteristics
- Style and design, color, and product quality
- Packaging
- Branding
- Country of origin—that is, a product-country-related perception
- Service attributes.

When considering China in particular, the challenge for a company is to take into consideration not only differences between countries, but also diversities within a specific country itself.

3.2 Pricing

When entering foreign markets, a company can set the same price in different markets or adapt pricing policies to local market conditions (Alon et al., 2016). Price standardization implies the same price positioning strategy across different markets. Factors that are potentially important in influencing the price standardization level are the economic and legal environment, distribution infrastructure, customer characteristics and behavior, and product life cycle stage. Basically, a standardization strategy is possible when the company operates in global sectors. It often becomes necessary when the company sells to global retailers. The retailers expect the product to be delivered at the same price in each country. If this does not happen, they would concentrate their purchases in the country where the product is offered at the lowest price.

Price adaptation occurs when a company is compelled to adopt a different price positioning strategy, owing to heterogeneities in consumers' preferences, product perception, the intensity of competition, and country-of-origin effects. Global giants such as IBM and Coca-Cola have been adamant about maintaining consistent pricing for their distributors across the world. However, they and many other large companies have modified their strategy in low-income but emerging markets such as China, much to the dismay of their distributors in developed countries.

Other companies adopt a modified pricing scheme that is not based on direct fees or uses different payment options. For instance, when considering the success of Taobao in China, knowledge about the target audience becomes evident. Taobao has a similar service like eBay, providing a platform through which individuals can sell products to others, yet it is the methods through which Taobao differs. eBay requires purchasers to pay online using a credit card, as is standard in the West. Taobao, understanding that many Chinese do not like to use credit cards online, either because of not owning one or because of security concerns, allows customers to pay with cash on delivery. In addition, Taobao does not require sellers to pay a fee but makes profits through advertisements. As a result, despite its popularity in the United States, eBay lost ground in the market and finally quit operations (Startup China, 2015).

3.3 Place and Distribution

As for place and distribution, consumer preferences also vary. Apart from consumer preferences, distribution in China was also quite difficult in the past due to the lack of sufficient infrastructure. Direct selling was not viable and new entrants were not allowed to engage in foreign exchange. Most foreign companies had to deal with state-owned enterprises in China that were exclusively licensed to operate in certain product areas. In a country dominated by mom-and-pop retailers and sidewalk consumers and where bicycles were sometimes used as delivery "trucks", several multinational companies relied on "grassroots marketing" with some proven effectiveness. Hiring locals as sales associates or franchise dealers to blanket a regional market seemed to work for these companies. The situation changed markedly in 1986, when China began to reform its state distribution system, which kick-started the emergence of private enterprises in retailing. With the new Joint Venture law in 1992, even foreign participation was allowed in the retail channel. The distribution sector in total was opened to foreign investors in 2004. Since then, foreign agents and distributors have been expanding quickly.

Over the last decades, China has also invested in improving infrastructure in interior cities, with a focus on building larger interior cities into major logistics and distribution hubs. For example, Wuhan is becoming the multimodal logistics hub of central China. The city has one of China's largest inland ports, handling up to 40 million tons of cargo annually, with shipping lanes that lead to 14 countries. National highways and railway lines link Wuhan to other major Chinese cities. Many large multinational companies, such as the Coca-Cola Co. and Kimberly-Clark Corp., have made the city a key strategic distribution hub. Other inland cities developing similar hubs include Chengdu, Chongqing, and Zhengzhou (Feuling, 2010). More and more brand owners and retailers are attracted by these booming consumer markets in China's 3rd and 4th-tier cities. The government has launched a series of initiatives such as "household appliances to the countryside" in an effort to boost rural consumption. Looking ahead, inland regions and the rural markets are expected to maintain a better growth momentum. Distributors are responding to these changes. Nonetheless, expansion into these regions is costly for many distributors and does not guarantee immediate returns in the short run (Li Fung Research Centre, 2012).

Given the complexity of the Chinese market, companies in China often adopt a combination of distribution models. Currently, domestic distributors account for a large share of the wholesale trade in China. Many of these distributors come with a state-owned background and have operated since the pre-economic reform era, giving them an edge in terms of established infrastructure, government "guanxi" and network reach. Wholesale markets have also been playing a significant role in channeling products of the country's numerous small- and medium-sized manufacturers into the hands of urban and rural consumers. Facilitated by improving the logistics infrastructure in China, some established brand owners or manufacturers have set up their own wholesale and retail arms to conduct wholesaling and retail activities, leading to a significant shift in power in China's retail supply chains. By contrast, the majority of distributors in China remain fairly small in size with narrow product lines and are serving in limited localities (Li Fung Research Centre, 2012).

3.4 Communication Policy

Among the different instruments, advertising plays a major role and rising communications costs will force advertising budgets to increase. During the cultural revolution (1966–1976), there was an unofficial ban on all advertising, but since this ban was lifted, advertising has become a fashionable tool. Advertising plays a huge role in terms of brand awareness, but is heavily influenced by cultural values and differs significantly from the West (Zhu, 2009). For instance, the relationship-based culture favors personal testimonials from social references, rather than the information provided by companies (Liu et al., 2011). Also, Western beliefs in individual freedom clearly differ from Chinese culture where the individual does not exist outside of her network of familial and communal obligations. Apple's "Think Different" campaign, for example, wouldn't appeal to Chinese consumers, who prefer to "stand out by fitting in" (Gots, 2015). Despite challenges in adaptation, China already one of the largest advertising markets, and it is poised nearly to double, reaching more than $70 billion by 2016. In China—as the United States and Japan—television remains the largest single category (roughly 40 %) of ad spending (Yeh & Zhang, 2013).

Television in China will remain important with big channels such as China Central Television (CCTV), Beijing TV, and Shanghai Media Group wielding tremendous power and influence. Among the different channels, CCTV remains the central government's main media voice and serves social, political, and cultural functions. Advertisers should understand that strategic marketing considerations are often a lower priority for these TV stations. The dominance of TV stations ensures that China's media market will continue to face price inflation in the foreseeable future. In 2009, the Chinese government introduced the tri-play policy (integrating broadcast TV, Internet, and telecom) and a new broadcast advertising rule. The tri-play policy aims to promote digital media development; the broadcast rule restricts the amount of advertising airtime allowed on state-run TV stations (Zhang, 2011).

Digital advertising is also on the rise with WeChat, a mobile marketing application that is widely used in China (IHDigital, 2015). WeChat encourages group categorization, which facilitates targeting and engaging consumers into chat communications. E-coupons, digital scratch cards, payment solutions are all part of today's reality. All this is possible due to the mass-market introduction of the smartphone in China in 2009 that has come to characterize the digital landscape of the country. In 2014, China had a smartphone penetration rate of over 30 % and the total Chinese smartphone population is expected to top half a billion in 2015, and exceed 600 million by 2017 (CNNIC, 2014). Given the growing rates of smartphone adoption, user engagement and benefits to marketers, the Chinese mobile advertising market is expected to grow at a 27 % compound annual growth from over RMB 12bn (US$ 2bn) in 2014 to RMB 25.7bn (US$ 4.1bn) in 2017.

While customer behavior is certainly different, adaptation also requires up-to-date knowledge about legal requirements. In September 2015, the advertising law of China has been amended and implemented in September 2015 (Standing Committee of the National Congress, 2015). For Western companies, even more than for local firms, it is important to understand the intricacies of these regulations that determine content, format, channel, as well as competitive positioning.

The above has only represented a small snapshot of how marketing decisions differs in China. The case studies in this book draw on some of these issues and highlight concrete cases of companies managing foreign market entry and operations.

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Overview of the Book

Christiane Prange

The following case studies in this book deal with different industry sectors, which are very attractive for foreign companies. Case studies highlight a particular market entry or market development scenario and show how companies tackled specific challenges. Each case starts with a case synopsis to introduce the reader to the problem. Several questions, tools, and overall themes help to prepare for case analysis and better understanding. Cases can be used to acquire in-depth knowledge on industries and companies as well as to discuss with interested people.

Following this introduction, *Part II* focuses on the automotive industry in China. Prior to 1978, state-owned automobile manufacturers primarily concentrated on large commercial trucks, with only a small number of passenger cars being produced. In the 1980s and early 1990s, the government began to approve joint ventures with foreign car manufacturers to enhance China's domestic production. One of the major objectives of these joint ventures was directed at technology transfer, learning, and capability development. The government's focus on the consolidation of the sector and the development of the large established state-owned enterprises meant that smaller producers not involved in joint ventures faced restrictions on market entry and product development throughout the 1990s.

In 1994, the Chinese government designated a number of industries as 'Pillar Industries' intended to drive the national economy; the automotive industry was chosen as one of these industries. It was reasoned that the development of an automotive industry would encourage Chinese enterprises in many sectors to specialize and coordinate their efforts better. These conditions provided the background for the Chinese government's Automotive Industry Policy in 1994 with four key objectives: (1) to establish large-scale groups of saloon and light truck

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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producers (to replace the small-scale, scattered manufacturers); (2) to improve the components industry; (3) to create automotive product development capabilities, and (4) to encourage individual car ownership. The policy contained an aggressive schedule for the development of the Chinese automotive industry, and was further amended in 2004 (for an overview: Oliver, Holweg, & Luo, 2009).

The growth of the automotive industry attracted considerable foreign investment with foreign manufacturers seeking to expand operations. In 2005, the vehicle sector was dominated by three types of manufacturers: first, JVs between local Chinese vehicle manufacturers and multi-national foreign companies, which in 2004, accounted for about 90 % of total sales of passenger vehicles. Second, there were large domestic groups that, either in addition to their JVs with foreign firms or independently, manufactured and sold cars (e.g. FAW and Chang'an); third, there was also a substantial base of small manufacturers (e.g. Chery and Geely), which largely produced economy vehicles for the low-end market (Oliver et al., 2009).

Since 2007, China's auto market has grown by 24 % annually. However, the penetration rate of the market is only 5 % and there is still great potential to be unleashed in the future. According to McKinsey's forecast, by 2020, China's new car sales is expected to exceed figures of the European and North American markets to reach 22 million units per year, and to record annual growth of the global auto market of 35 %. In the meantime, urbanization and the emerging middle class will drive the development of China's auto industry (McKinsey, 2012).

The two cases in this book present the German car manufacturer Audi and the French company PSA Peugeot Citroën. Audi (Volkswagen group) has become the leading 'premium' car brand in the Chinese market. The case looks at the key success factors that have allowed Audi to develop in the world's largest automobile market. Audi has chosen to concentrate production facilities in Germany and it is thus necessary to examine major benefits and risks associated with the recent decision to significantly increase production capacities in China. Decisions on market entry choice and positioning (both premium and country-of-origin) will be part of the analysis. The case study of the French company PSA Peugeot Citroën focuses on increasing performance problems in the market and reflects entry speed and marketing mix strategy decisions as well as repositioning.

Part III focuses on the retail industry in China. At first glance, the retail market seems to be a global one. Hypermarket retail formats diffuse throughout the world and names like Tesco, Wal-Mart, or Carrefour seem to be universally known. However, looking at the level of the individual consumer shows that the challenge is much more complex. Especially for food, consumer preferences differ widely as, for example, there are separate shops for fresh food and stores for non-perishables, imported versus local products, wet markets versus hypermarkets.

Indeed, in China, most food-related shopping takes its cue from the wet market: open sides lit with naked light bulbs and cooled with fans in the roof. These markets contain numerous vendors, with products in piles on display trays, delivery baskets and crates. Customers have narrow aisles to ease through past sellers yelling promotions or bargaining (Warden, Stanworth, Chen, & Huang, 2012). As food and traditional medicine are closely tied (Chang, 1977), food is bound to local culture, which can nullify the perceived advantages of a hypermarket even while being acknowledged and appreciated by customers. Similar differences may apply to the meaning of fast food. In the West, it is often considered a cheap alternative but in China it holds appeal for social gatherings, study or dating in a comfortable environment with no pressure to leave (Wirtz & Lovelock, 2005).

As for fashion retail, consumer preferences are also hugely diverging and sales has become increasingly difficult with shoppers complaining that sizes do not fit and the clothes do not suit local tastes. Foreign companies are often seen to offer products on the top price range, which has the effect of reducing volumes sold to each customer. In turn, this requires huge investments in the modernization and design of retail shops to be perceived as high-end retailers with premium quality. This positioning is often in conflict with the one pursued at home and challenges arise with regard to localization and marketing mix adaptation.

Despite cultural adaptation needs, there is a couple of promising retail trends in the country that are emerging on the back of the country's increasing affluence. With pollution of air and ground water, safety concerns of domestically manufactured goods have been fuelling demand for imported goods and there is a likely increase in overall spending. E-commerce is the fastest portion of the retail sector. The industry as a whole is expected to have increased by 25 % annually in terms of total market value, reaching $US 2100bn in 2014 (Business Monitor, 2015). Many retailers are offering online services from B2C to online promotions and advertising, especially using social media, as the public opinion is very important to a brand's image and reputation among peers.

Tier 1 cities such as Beijing and Shanghai attract most of the retail developments, particularly with regard to shopping malls. Two third of the urban population regularly visits malls, and 40 % goes to a mall at least once a week, which equals 54 million visitors to malls every week. The huge numbers of visitors to malls regularly results in massive opportunities for revenue for retailers, with Chinese shoppers spending $US 113bn in 2014, which is expected to rise further (Business Monitor, 2015).

The three cases in this part deal with the British companies Tesco, Marks & Spencer and the Swedish manufacturer IKEA. In 2013, Tesco announced it would partner up with China Resource Enterprise, after the retailer had tried to crack the Chinese retail market for nine consecutive years. The case follows a series of events that led to Tesco's eventual withdrawal from the Chinese retail market. Questions pertain to issues of overall brand building, brand change, awareness, and the orchestration of the local marketing mix. Had Tesco done enough to succeed?

Marks & Spencer entered China in 2008 and failed in many ways. Reasons were partly due to misplacement of (fashion) products, neglect of local customs and tastes, and the failure to understand the Chinese culture. Numerous other problems with the marketing mix strategy provided a hard time for the company that had to decide whether to stay in China or to quit the market.

IKEA, the giant Swedish company, was still struggling to achieve positive financial results after entering the Chinese market. A lack of understanding local peculiarities of the market prevented the company from implementing an adequate targeting strategy and occupying a strong competitive position in the market. The company's global marketing strategy was flawed and as a consequence the company was forced to reconsider not only its marketing strategy but also its overall business proposition.

Part IV deals with fashion, luxury, and play. While these products are also sold in large retail stores, the cases in this section consider individual brands and their presentation.

The luxury market, even more than other market segments, continues to grow, but it has shifted away from purchases in Mainland China and Hong Kong to foreign markets like Europe, Japan, and Korea. According to Bain & Company's 2014 China Luxury Market Study, the region's luxury market is undergoing a fundamental shift, brought on by evolving customer dynamics, an influx of new, emerging luxury labels, and an economic slow-down. As a result, luxury brands in China must step up their game in 2015 by adapting to new market conditions and customer expectations (Bain & Company, 2015).

As more wealthy Chinese consumers choose to shop luxury products abroad, some luxury brands have started to cut their prices in China with a hope to drive part of the overseas spending back to the country. More luxury brands are expected to adjust their pricing strategies in China in the near future. In addition, shopping experience becomes an important purchase criterion. Many luxury retailers now put more focus on creating an exceptional shopping environment and introducing lifestyle experience in their physical stores, hoping to enhance the attractiveness of their stores. In order to better control brand image and overseas expansion, some international luxury brands have started opening more directly-operated stores, buying back franchises from local partners and taking stakes in other China retail partners (Fung Business Intelligence Center, 2014).

Chinese consumers are also more concerned about the history and culture of brands, as well as brand heritage and product quality. This may lead to advantages for Western companies that can capitalize on their country-of-origin, especially if the country is well known for luxury product categories, such as, Swiss watches, French perfume, or German cars. There continues to be a strong association towards European heritage brands in these categories. However, the luxury market is broader, including different product categories, such as, jewelry, arts, entertainment, or cosmetics.

The cases in this part deal with different products, ranging from Giewes & Hawkes, high-end bespoke luxury clothes manufacturer and HTH, a high-end furnishing company to Athlete's Foot, an American footwear company, and Mattel, the toy producer with its famous Barbie-doll brand.

The Gieves & Hawkes case focuses on a luxury company expanding to China. G&H is a time-honored British bespoke gentleman's tailor and the expansion to China marked a turning point in their history—not because it did not work out, but because they were by far more successful as expected. As a market entrance strategy they decided to work with a Chinese distributor. They selected the Hong Kong-based company Trinity Limited, who introduced the brand to the Mainland in

2006. One of the key questions for the company was how to manage the trade-off between high-end positioning and continuous expansion.

HTH was a high-end home furnishing fabrics "editor". HTH is distributing its collections worldwide through building up a well-organized distribution structure composed of showrooms, sales teams, and franchised distributors. As a luxury brand, HTH was esteemed as a luxury brand in the furnishing fabrics sector. The case describes its preparations for market entry in China and the related strategies for developing a luxury brand in an emerging market country.

Athlete's Foot is an American company that made early entry into China using master international franchising, and, consequently, ran into problems indicative of the issues companies that expand internationally using franchising often encounter. The case focuses on internationalization drivers, a discussion of franchising as an option for market entry, and related questions of localization.

The Mattel case looks at the company's second market entry to China. In their first attempt, they encountered major difficulties due to a lack of localization, overestimation of its brand popularity, wrong pricing strategy, and failure to understand the different perception of toys and the Chinese culture in general. They failed to capture the Chinese market with the over-the-top and poorly executed House of Barbie store in Shanghai. After several years of experience, the company tried to re-introduce the Barbie brand to the Chinese consumers.

Part IV highlights companies and individual brands in the food and beverages sector (TPressso, Coca Cola, and Danone).

Both China's hot and soft drink market segments have been changing rapidly. In 2014, the Chinese consumed 1.28 billion kilograms of hot drinks, with hot tea accounting for 82 % of the total volume. While hot coffee holds a comparatively small share of the Chinese hot drinks market (5.7 %), it will register the highest growth in volume terms between 2014 and 2019 with a cumulated average growth (CAGR) of 15.4 %. Hot tea, on the other hand, will only grow at a CAGR of 5.6 % over the same period. Overall, the share of hot tea will decline (Canadean, 2015). Preference for soft drinks categories have been shifting from carbonated soft drinks towards non-carbonated soft drinks. Chinese consumers also favor international brands, and are becoming more health conscious. Between 1979 and 1995, international brands, such as Coca-Cola and Pepsi, dominated the market. From 1996 to 2000, bottled waters like Wahaha, Robust and Nongfushangquan became also very important, to be complemented by Master Kong's tea, which became very popular. Sales for 2015 for food & non-alcoholic drinks spending was forecast with $US 1294bn with future estimated growth (Business Monitor, 2015). In the category of milk beverage, the market has been significantly growing in the last few years. The main brands in 2010 were Wahaha and Robust, selling especially children's products.

The Tpresso case follows the famous Nespresso capsule idea and discusses market entry into China with a luxury tea machine. Selling a tea machine to a nation of tea drinkers is a huge challenge and the Swiss company faced problems with its positioning in different market segments and had to decide whether to

Table 1 Case overview and topics

		AUTOMOTIVE		RETAIL			FASHION, LUXURY, AND PLAY				BEVERAGES AND FOOD		
TOPICS		Audi	Peugeot	Marks & Spencer	IKEA	Tesco	Gieves & Hawkes	HTH	Athlete's Foot	Mattel	TPresso	Coca Cola	Danone
Market Entry	Intern'l Drivers			●					●			○	
	Entry Decision	●		○			●	●	●	○	○		
	Entry Speed	○	●			○							
	Joint Ventures	○	○			○							
	Franchising								●				
	Market Research							●	○	○		●	
Positioning Factors	Luxury						●	●			●		
	Premium	●						○			●		
	Good-enough										●		
	Low Cost				○								
	Strategy	●			●				○			●	
	COO	●					●				○		
Branding Factors	Brand Change					●	○						●
	Brand Loyalty					●							●
	Awareness					●							○
	Channel-Branding				○								
	Preferences		○		○			○		●			○
	Repositioning		●										○
Marketing Mix Factors	Product						○			●	●		○
	Pricing				○		○			○			
	Place			○	○		○						
	Promotion						○				●		
	Localization			●	●				○	●			
	Strategy		●	●	●							●	○

●	Main focus
○	Additional focus

up-trade to the highest luxury segment or to down-trade to the good-enough market to increase volume sales.

Coca Cola, the well-known global brand needed to reconsider its marketing strategy in China. This case gives an overview on the Chinese soft drink market and the challenges Coca-Cola needed to face and overcome in order to stay ahead in the Asian market. As Chinese consumers shifted towards a healthier life style, including non-carbonated soft drinks, such as ready-to-drink teas, juices and milky flavored beverages, the question was how Coca-Cola Company's number one brand could succeed and remain successful in the country.

The French food giant Danone has a longstanding presence in China. It entered the Chinese market as early as 1987. However, its interest into China's infant formula market was quite recent. With the Dumex brand, China has become the largest market for Danone in baby nutrition, accounting for 4–5 % of its total company sales. But the worsening regulatory environment and intensifying competition made Danone increasingly posed problems for the company. The case looks at how a company could face such a scenario by reinforcing its brand and by revamping its strategy.

Finally, *Part V* provides some insights on preparing business activities in China and closes with an outlook for the future.

Table 1 provides an overview on cases and topics discussed in this book.

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Part II

Automotive Industry

Audi and the Chinese Market: A Success Story

Sylvie Hertrich and Ulrike Mayrhofer

Case Synopsis

Research Problem

The German company Audi (Volkswagen group) has become the leading 'premium' car brand in the Chinese market. China remains a complex market, which is difficult to enter, and it therefore seems interesting to analyze key success factors that have allowed Audi to develop in the world's largest automobile market. Audi has chosen to concentrate production facilities in Germany and it is thus necessary to examine major benefits and risks associated with the recent decision to significantly increase production capacities in China.

Case Summary

Audi, a major actor in the 'premium' car market, appears to be highly successful in China, which has become the company's first market worldwide. The company has acquired an important experience on international markets and entered the Chinese market in 1988. Since then, Audi has continuously developed its sales in China and has also established several production facilities. Today, competition in the 'premium' segment is strong, and German competitors BMW and Mercedes also follow ambitious development plans in China. The Audi brand thus has to multiply its efforts to remain the market leader in this segment.

S. Hertrich (✉)
EM Strasbourg Business School, University of Strasbourg, Strasbourg, France
e-mail: sylvie.hertrich@em-strasbourg.eu

U. Mayrhofer
IAE Lyon, Jean Moulin Lyon 3 University, Lyon, France
e-mail: ulrike.mayrhofer@univ-lyon3.fr

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Learning Objectives

- Familiarize students with the characteristics of the premium market segment in China,
- Analyze the approach used by a foreign car company to develop in the Chinese market,
- Identify key success factors that can help foreign companies to establish themselves in China.

Themes and Tools Used

- Strategic positioning
- Competitive advantage
- Foreign market entry
- Strategy
- Country-of-origin

Target Audience

Business schools and universities (initial and executive education).

1 Introduction

During one of his business trips to China, Audi's CEO (Chief Executive Officer), Rupert Stadler, proudly announces several key figures concerning the company's sales in the Chinese market for 2012: the brand delivered 405.838 vehicles to Chinese customers, which corresponds to an increase of 29.6 % in regard to the previous year. He emphasizes that China has become Audi's first market worldwide, representing 27.9 % of the company's vehicles sales, well ahead before Germany and the United States. The local management team of Audi is pleasantly surprised about these figures, but also aware that competition in the 'premium' car segment remains strong. BMW and Mercedes have considerably increased their efforts to catch up with their German competitor. Several new managers have recently joined the team of Audi China and they ask themselves how Audi has succeeded in establishing itself as the leading brand in the 'premium' segment of the world's first automobile market. Will the identified key success factors allow the company to continue its ongoing growth in China? Which actions should be conducted to prepare the company for the coming years on a very complex and fast-evolving market?

2 Audi: A Premium Brand

Audi is part of the German Volkswagen Group, one of the world's biggest automobile manufacturers, who owns a large portfolio of brands, ranging from smaller cars to luxury class vehicles: Audi, Bentley, Bugatti, Ducati, Lamborghini, MAN, Porsche, Scania, Seat, Skoda, Volkswagen Commercial Vehicles and Volkswagen Passenger Cars. The different brands can benefit from the financial expertise and resources of the Volkswagen Group, particularly when they need to make important investments. The Audi company can thus develop synergies with the Volkswagen Group, e.g., for R&D projects and foreign market entries where costs can be shared, and make significant savings, especially with regard to supplies. According to specialists, Audi can save almost 10 % on supplies compared with independent car manufacturers, since many parts and components can be bought via Volkswagen's central purchasing office. Unlike its German competitors BMW and Mercedes (Daimler Group), the company can also make relatively high margins on smaller sized models, e.g., the Audi A1 model (Hertrich & Mayrhofer, 2011), as numerous parts and components can be bought via Volkswagen's central purchasing unit. At the same time, Audi enjoys real autonomy concerning the purchase of certain higher quality materials for its 'premium' vehicles.

Today, Audi has become one of the leading 'premium' brands on the global car market (Hertrich & Mayrhofer, 2015). In the automobile industry, the 'premium' segment ranges between the general public segment (for example, Ford, Peugeot) and the luxury car segment (for example, Bentley, Bugatti) and has the following characteristics: high technology, high price, personalised customer service, exclusive distribution, customer experience and products with a strong image. Audi develops a differentiation strategy, which is mainly based on technological superiority and the quality of services. This strategic positioning, which concerns the whole range of products, is illustrated by the slogan *'Vorsprung durch Technik'* (progress through technology), which is used by the brand throughout the world, sometimes even in German to emphasize the country of origin of the company—"Made in Germany" (Barmeyer & Hertrich, 2003; Ghauri & Cateora, 2014; Mayrhofer, 2012).

3 Audi: An International Company

In 2012, Audi's sales turnover stood at 48.8 billion Euros, with a net profit of 4.4 billion Euros. The company sold 1.45 million vehicles, of which 1.19 million vehicles were sold in international markets (81.9 % of the brand's sales). Table 1 indicates the breakdown of vehicles sold by Audi in major markets. China (27.9 % of total sales) appears to be the most important market of the brand, followed by Germany (18.1 %) and the United States (9.6 %). One can also observe that Audi is experiencing a strong growth in several emerging markets (China: +29.6 %, Russia: +44.1 %) where the 'premium' segment is enjoying strong growth rates, but also in the United States (+18.5 %) where the company has significantly invested in communication campaigns.

The head office of Audi is located in Ingolstadt, near Munich. The company has chosen to manufacture a major part of its vehicles in Germany, despite high labor costs: Audi has two production facilities in the country, one in Ingolstadt, in Bavaria, the other in Neckarsulm in Baden-Württemberg. Several reasons explain

Table 1 Breakdown of Audi vehicle sales by main market (2012)

Country	Number of vehicles sold in 2012	Variation compared with 2011 (in %)
China	405,838	+29.6
Germany	263,163	+3.6
United States	139,310	+18.5
United Kingdom	123,640	+7.2
France	62,202	+0.3
Italy	50,085	−17.0
Spain	36,139	−11.7
Russia	33,512	+44.1
TOTAL	1,455,100	+11.7

Source: Adapted from http://www.audi.com

Table 2 Geographic location of Audi's production facilities (2012)

Production site	Number of employees	Number of vehicles produced
Ingolstadt (Germany)	33,729	583,824
Neckarsulm (Germany)	14,247	265,622
Brussels (Belgium)	2372	118,200
Martorell (Spain)	1500	19,654
Györ (Hungary)	7322	39,518
Bratislava (Slovakia)	2200	53,707
Changchun (China, joint venture)	9700	310,036
Aurangabad (India)	140	4674

Source: Adapted from http://www.audi.com

this location choice. First, the German and other European markets remain important for the company, thus reducing transportation costs and facilitating logistics processes. Second, the company can benefit from the positive "Made in Germany" image, which is highly valued by potential customers in the 'premium' segment. Thirdly, the concentration of activities allows the control and supervision of R&D, production and sales activities, thus limiting the risk of loosing core competences and being confronted with quality problems. Nonetheless, several models and components are also produced outside Germany. Audi thus has a production subsidiary in Brussels (100 %-owned) where it produces the Audi A1 model. The production of the Audi Q3 takes place at the Seat plant in Martorell, in Spain. The company is also manufacturing engines and some models in its factory in Györ, in Hungary (100 %-owned). This subsidiary produces 1.9 million engines per year, part of which are delivered to other brands of the Volkswagen Group. It is important to mention that the labor cost in Hungary is 80 % lower than in Germany. The Audi Q7 model is manufactured at the Volkswagen plant in Bratislava, in Slovakia. Audi has also set up a production facility in Changchun, in China (a joint-venture signed between the Volkswagen Group and the Chinese manufacturer FAW, First Auto Works) where it produces vehicles for the local market. Recently, an assembly unit was set up at the Skoda plant in Aurangabad, in India where Audi plans to produce vehicles for the local market (see Table 2).

4 Audi in China

Audi entered the Chinese market in 1988, providing the brand a "first-mover advantage" compared to its competitors (e.g., BMW established its first joint venture with a Chinese partner in 2003). It was the first 'premium' car brand to produce vehicles in China, signing a license agreement with the Chinese car manufacturer FAW (First Auto Works) for the production of the Audi 100 model. In 1991, the Volkswagen Group and FAW set up a joint venture named 'FAW-Volkswagen Automotive Company (FAW-VW)', mainly because of legal requirements. At that time, entering the Chinese market was only possible through exports or equity investments shared with Chinese companies. For establishing the joint venture, Volkswagen had to conduct long negotiations with the Chinese government, which became one of its clients. Today, the joint venture is owned by Audi AG (10 % of the capital), Volkswagen (20 %), Volkswagen China Invest (10 %) and FAW (60 %). The factory, which is Audi's main production facility outside Germany, manufactures vehicles for the Audi and Volkswagen brands since its creation. The history of Audi in China is presented in box 1.

Box 1 The History of Audi in China

1988	Audi and First Auto Works (FAW) signed a technology transfer and license contract for the manufacture of Audi cars at FAW (Audi 100 model).
1990	Volkswagen and FAW signed an agreement on establishing a joint venture with an annual production capacity of 150,000 cars.
1990	Opening of the FAW-Audi car assembly line.
1991	Creation of the joint venture FAW-Volkswagen Automotive Company.
1995	FAW, Volkswagen and Audi entered into a tripartite joint venture agreement, marking the formal inclusion of Audi cars in the scope of the company's production.
1996	The first Audi 200 rolled off the assembly line.
1999	The Audi A6 rolled off the FAW-Volkswagen assembly line.
2001	The Audi A8, Audi's flagship model, was released in the Chinese market.
2003	The Audi A4 was put into production in China.
2005	The all-new CKD (Completely Knocked Down) A6 was officially released in Shanghai.
2005	The all-new CKD A4 was announced to hit the market in China.

(continued)

2006	FAW-VW Audi Sales Division was established in Changchun. The premium SUV Audi Q7 made its official debut. The all-new Audi TT was officially released in the Chinese market.
2007	The 100,000th Audi A6 rolled off the assembly line at FAW-Volkswagen.
2007	Audi became the first premium car brand to reach annual sales of 100,000 units.
2008	The Audi R8 Spyder hit the Chinese market. FAW-VW Audi officially released the all-new CKD Audi A4.
2009	The Audi Q5, which combined innovative Audi design and world-leading technology, made its official debut.
2010	FAW-VW Audi Sales Division announced the official release of the CKD Audi Q5. FAW-VW Audi celebrated its 1,000,000th sale in Changchun: after 22 years of constant expansion, Audi became the first premium automobile brand with a cumulative sales volume of one million units in the Chinese market. FAW-VW, Audi and Tongji University jointly launched the Audi-Tongji Joint Lab.
2011	The all-new state-of-the-art flagship Audi A8 hit the Chinese market. The keenly expected star model Audi Q3 makes its global debut at the Shanghai Auto Show. The Audi R8 Spyder Matrix was unveiled at Beijing's The Place. The Audi flagship model A8 was released in Guangzhou. A grand launch celebration was held for the Audi A1 series at the Beijing National Stadium. The Audi A7 Sportback, a premium 4-door sport sedan, hit the Chinese market. Audi ranked first in the J.D. Power Sales Satisfaction Index and China. Customer Service Index for the tenth consecutive year, becoming the most customer-preferred brand in China's automobile market.
2012	The new Audi A5 and S5 series were officially released at Beijing's 798 Art Zone. The all-new Audi A6 made its official debut in Guangzhou. April 23, 2012: FAW-Volkswagen and Audi brought the Audi A6L e-tron, Audi Q3 Jinlong Yufeng Concept and Audi RS Q3 Concept to the Beijing Auto Show for their international debut. The premium Audi Q3 SUV was launched at the Guangzhou Stadium. The new Audi A4 was officially released in Qingdao. FAW-VW Audi once again topped the J.D. Power SSI and China CSI, beating all other premium car brands. The all-new Audi A8 30 FSI, 55 TFSI Quattro and S8 were officially launched.

(continued)

> The Audi R8 China Edition, the first mass-produced Audi model featuring Chinese characters in its interior decoration, was released at the Shanghai Audi International Circuit.

Source: adapted from: http://www.audi.com

Audi has three main locations in the Chinese market. The headquarters of Audi China are established in Beijing and coordinate the activities of the company in China (strategy, procurement, logistics, marketing, controlling etc.). The joint venture 'FAW-Volkswagen Automotive Company' is located in Changchun, in the North East of China, and produces the Audi A4, A6 and Q5 car models for the Chinese market. In 2012, the annual production capacity of Audi in China reached 350,000 vehicles. Sales activities are also managed by the joint venture. In 2014, Audi will open a new production site in Foshan, in South-East China, to assemble the Audi A3 model. The opening of the new plant and the expansion of the Changchun plant will allow Audi China to increase its production capacity to 700,000 vehicles.

Today, almost the whole range of Audi car models is available for Chinese customers. 90 % of deliveries concern private customers (B to C) and 10 % business clients (B to B). Audi cars are sold via an exclusive dealership network, comprising more than 350 dealerships in more than 100 cities. The objective is to reach 500 car dealerships by 2017. The company has always introduced its newest technologies to China. Audi was elected the most successful brand in "Best Cars 2013", an annual award provided by a major Chinese automobile magazine.

In terms of sales, Audi (405,838 vehicles in 2012) seems well ahead of its German competitors BMW (326,000 vehicles) and Mercedes (196,000 vehicles) in the Chinese market. All three carmakers run production facilities in China where they have quadrupled their production in the last 5 years. Today, they account for 75 % of premium cars sold in China. The three competitors have considerably increased their efforts to improve their market position: in 2011 and 2012, BMW has enjoyed faster growth than Audi and Mercedes has set the objective for China to become its largest market. Mercedes opened 75 new dealerships in 2013. Competition remains strong and Audi has to pursue its actions to remain the leading premium brand in the world's biggest automobile market. The company intends to increase its market-share in China, which is currently limited to 3 % (compared to 8 % in Germany and 5 % in Europe). It plans to develop local production capacities to reach 700,000 units annually, to launch three new models every year and to extend its distribution network from 300 (in 2012) to 500 by 2017 and 700 dealerships by 2020.

You have recently joined the management team of Audi China and you are asked to participate in the meetings concerning the ambitious development plans of Audi in the Chinese market. Two questions seem of particular importance:

1. Audi has become the leading 'premium' car brand in the Chinese market. Which are the main key success factors of Audi in China?
2. Audi has decided to significantly increase its production capacities in China. The objective is to produce a major part of cars sold in the Chinese market in the two local production plants. Which are the main benefits and risks associated with this strategic choice, notably in regard to the image associated with Audi as a brand "Made in Germany"?

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Can PSA Peugeot Citroën Succeed in China?

Zhuomin Qin

Case Synopsis

Research Problem

What are the reasons for PSA Peugeot Citroën's poor performance in the Chinese market?

Case Abstract

The aim of this case study is to present and evaluate the strategy of the French automobile maker PSA Peugeot Citroën in the Chinese market. As compared to competitors such as GM, the company's performance decreased under the rapid development of the Chinese automobile market. The case study is mainly based on secondary data acquired from the company's annual report, industry reviews, and analysis, and online articles.

Learning Objectives

The case was prepared for students to learn about market entry and development in the Chinese market, facing increasing turbulences in the automotive industry. The objectives could be reached step-by-step with the following details:

- Discuss advantages and drawbacks of first-mover advantages;
- Identify the challenges of the global automotive industry in particular and the problems international players have in China;

Z. Qin (✉)
Tias School for Business and Society, Utrecht, The Netherlands
e-mail: jshan.zh@gmail.com

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- Understand the role of joint ventures for Chinese market entry and operations;
- Investigate changing consumer preferences and income levels;
- Identify ways and means to improve poor performance in the Chinese market.

Themes and Tools Used

- Competitive analysis
- Concept of first-mover advantage
- Two-dimensional positioning chart
- Entry speed
- Brand repositioning
- Strategic marketing

Target Audience

Students interested in strategy development, first-mover advantages, market entry and market building, and positioning, China.

Questions

1. Is the Chinese automobile market really attractive and favorable? Why?
2. How is PSA doing in China? What are the key success factors (KSFs) of PSA in the Chinese Market?
3. Why did GPAC (Guangzhou Automobile Group Co. Ltd.) fail? If you were a board member of GPAC, what could you have done to prevent the failure?
4. Regarding the KSFs, what are the difficulties for PSA in developing and sustaining unique sources of competitive advantage?
5. What is the most valuable marketing strategy for DS in the current situation?
6. If the managerial team decides to operate DS no longer under Citroen's name, can this strategy solve the identity crisis of DS? Why?

1 Introduction

2013 is not an easy year for Philippe Varin, the chief executive officer of PSA Peugeot Citroën.

In the past year, the sales of PSA fell to 55.45 billion euros with an annual loss of 5.01 billion euros in its revenue, which decreased 5.2 % in growth rate as compared to 2011, due to the downsizing European market. In addition, for the adaptation of the new accountancy policy, PSA had to write down part of their assets, which valued 4.13 billion euros from their balance sheet.

Varin found that PSA had been over-reliant on the European market since he became the CEO, but he also noticed that this chronic problem could not be completely solved in a short time. The automobile giant was severely hurt by the European debt crisis; the only solution Varin saw was the Chinese market, which was the only market with noticeable positive growth for PSA in 2012, and which became the new hope for PSA.

However, though PSA was one of the pioneers entering the Chinese market, it seemed to barely enjoy a first-mover advantage. Volkswagen, which has a similar company size as PSA, sells nearly 10 times more than PSA sells in the Chinese market in 2012, even though the 2012 sales in China can be seen as a record for PSA (Exhibit 1, Appendix). In fact, considering the big investment PSA had made in China, it was supposed to achieve a better standing in this huge market. This case, therefore, describes the dilemma PSA faced in the Chinese market, trying to find the reasons that led to the poor performance.

2 PSA Peugeot Citroën

PSA Peugeot Citroën (PSA), a French multinational automobile manufacturer with two globally renowned brands—Peugeot and Citroën, is the second-largest automaker in Europe and the seventh-largest in the world measured by 2011 unit production (see Exhibit 2, Appendix; European Equities, 2013).

Beside automobiles, the company also established several subsidiaries that provide financial service (Banque PSA Finance, GIE PSA Tresorerie), logistics service (Gafco, but PSA sold 75 % of shares to Russian Railways for €800 m in November, 2012), petrol and diesel engines (Peugeot Citroën Moteurs), automobile equipment (Faurecia), and machine tools for the automotive and aircraft industry (Process Conception Ingénierie).

PSA managed its international business mainly through direct investments and partnerships, including new investments of manufacturing plants in India and Kazakhstan (Pearson, 2011), and joint ventures in China (Dongfeng Peugeot Citroën Automobile and Changan PSA Automobile), the Czech Republic (Toyota Peugeot Citroën Automobile Czech) and several other fast-growing countries (see Exhibit 3, Appendix).

Till the end of 2012, PSA had sales operations in 160 countries, 16 production facilities and joint ventures, with 202,108 employees worldwide (PSA Annual Report, 2012). In 2012, PSA sold more than 2.9 million specialty and light utility vehicles, which accounted for 69 % of the profit stream of the company; besides, the sales of automotive equipment from Faurecia occupied 23.5 % of the total sales, while the income from providing financial service and other businesses contributed to the rest of sales (PSA, Annual Report, 2012)

3 PSA Peugeot Citroën in China

3.1 The Chinese Automobile Market

The Chinese automobile market, which attracts many multinational automobile manufacturers by its large potential customer base and its rapid growth rate, is predicted to reach 22 million sales in 2020, bigger than either the European or North

American markets (Wang et al., 2013). According to the forecast of PSA, China will “overtake France as its biggest market from as early as 2015, as Europe’s second-largest automaker increases the number of dealerships and expands into smaller Chinese cities” (Bloomberg, 2013).

According to research by McKinsey, Chinese citizens today have a higher possibility to buy more expensive vehicles (prices ranging from 250 to 800 thousand RMB) than in the last decade (Wang et al., 2013) because of increasing income. Meanwhile, as consumers in Tier-1 and Tier-2 cities are seeking greater value, quality and integrity in the products they purchase (Booz & Company, 2012), and tend to buy more expensive cars, multinational players are putting more efforts on the marketing of middle-end and high-end products (Wang et al., 2013).

The alluring market has become a strategic area essential for most automotive companies today. In order to have easier access to this huge market without spending a large amount of money and to have a better understanding of the local customer needs, joint-ventures with large Chinese automobile manufacturers, such as First Mobile Works (FAW) and Guangzhou Automobile Group Co. Ltd. (GAC Group), are preferred by multinational automobile companies.

3.2 PSA’s Operations

PSA entered the Chinese market in 1985 by forming The Guangzhou Peugeot Automobile Company (GPAC), a joint venture between PSA and the Guangzhou Municipal Government. This joint venture was one of the first foreign-Chinese joint auto-making ventures, and had a model line that produced the Peugeot 505 and 504.

In GPAC, the French automobile manufacturer only accounts for 22 % of the shares, nevertheless, they are the real boss: PSA had the veto power on the decisions, so they have the full control of the joint venture. However, PSA did not enjoy its first mover advantage in the Chinese market; till 1997, the company reported a total loss of 10.5 billion RMB with an extremely low annual capacity (maximum production 21 thousand in a year, while the lowest standard of the Chinese government requirement is 150 thousand per year), hence, the joint venture had to announced a dissolution in March 1997, and PSA sold out its stake in GPAC (PSA Peugeot-Citroën, 2004).

Prior to the failure of GPAC, the Dongfeng Peugeot Citroën (DPCA) was officially set up as the joint venture of PSA and the Dongfeng Motor Corporation in 1992 and introduced its first PSA-branded model in 2002. This joint venture has two production bases in Wuhan, Hubei province, and the R&D center is located in Shanghai.

In 2010, PSA announced a new 50–50 joint venture plan with another Chinese automobile maker, Chang’an Automobile Group. The new plant was brought into operation in 2012 and manufactured 6 new engines and 12 new models between 2011 and 2015, including Peugeot 308, 508 and Citroën DS4 and DS5 (PSA Peugeot Citroen, 2012).

3.3 Marketing Strategy of PSA in China

In the European market, both the Peugeot and the Citroën brand are targeting the middle class, and are positioned as "car for experience", with the Citroen brand being positioned closer to the low-end than Peugeot (Fig. 1).

However, the positioning of Peugeot and Citroën is slightly different in the Chinese market: Based on the price and target customers, Peugeot is targeting the middle class, while Citroën tends to target the upper-middle class.

In China, a three-box design is considered to be more elegant than hatchbacks; therefore, the Chinese customers prefer three-box designs rather than hatchbacks, PSA re-designed some of its models to better suit the local demand: For example, the Dongfeng Citroën C2 sold in the Chinese market was designed based on the Peugeot 206 model and differs from Citroën C2 model sold in more developed market. Besides, the Peugeot 207 model is re-designed as three-box design.

In recent years, except from developing the markets in first and second tier cities, PSA also focused on exploiting the market in third and fourth tier cities by introducing new models and re-designing the old ones (Xinhua News, 2013). According to Gregoire Olivier, the chief executive officer of PSA Asian operations, PSA expected to boost its sales to 540,000 vehicles in the Chinese market in 2013. Also, in order to expand its market share, PSA planned to increase the number of dealerships to 944 by the end of 2013. The CEO of PSA Asian seemed really

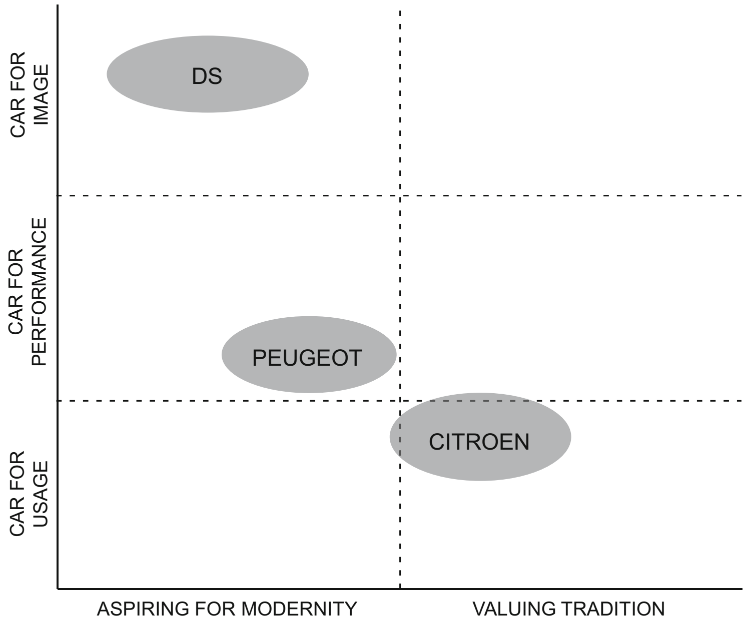

Fig. 1 Current brand positioning of Peugeot and Citroën. *Source*: Adapted from PSA Peugeot Citroën (2013a, 2013b, 2013c)

confident about the future. “This year we expect is going to be another good year. We’re on a very active development plan and very nice growth”, (Bloomberg, 2013).

On the other hand, to increase the brand awareness among Chinese customers, PSA spent a large amount of advertising budget to support its introduction of models. In the beginning of 2013, PSA became the top foreign spender for prime-time advertising slots on state-owned China Central Television, which is the most widely watched television program in the country (Bloomberg, 2013). Besides, PSA also launched its advertising on automobile and lifestyle magazines such as “Automobile Magazine” and “MING Lifestyle”, and created online forums and Weibo (Chinese Twitter) feeds to interact with its fans and customers. Furthermore, PSA is actively attending the national car exhibitions of China to show its innovative technologies.

4 Performance of PSA in the Chinese Market

Till the end of 2012, the dividend income of PSA in the Chinese market amounted to 776 million RMB. The Peugeot 308 sedan became the bestselling Peugeot model in the Chinese market; and the Citroën C4 model sales ranked among the top 5 in its segment. Meanwhile, the number of DPCA dealerships increased by 13 % to 728, and 25 dealerships of the new-formed joint venture, Chang’an PSA Automobile (CAPSA), were already opened in China. Figures 2 and 3 show the contribution percentage of each PSA model:

It seems that PSA was doing well in the Chinese market. In 2012, PSA reported losses in European, Latin American and Russian market, while China was the only market where it can make profit (CAIA, 2013). As shown in Fig. 4, PSA’s market share only grew in the Chinese market while it was declining in other markets.

However, the actual situation of PSA in China was not that positive. Although PSA claimed that the introduction of the Peugeot 308 achieved a great success in

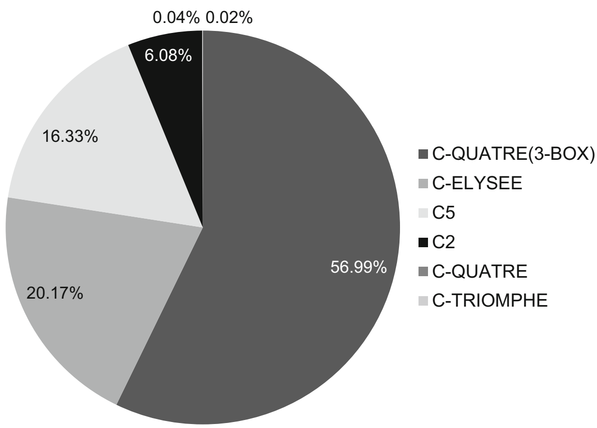

Fig. 2 The contribution percentage of Citroën models. *Source*: Adapted from auto.sina.com.cn, 2013

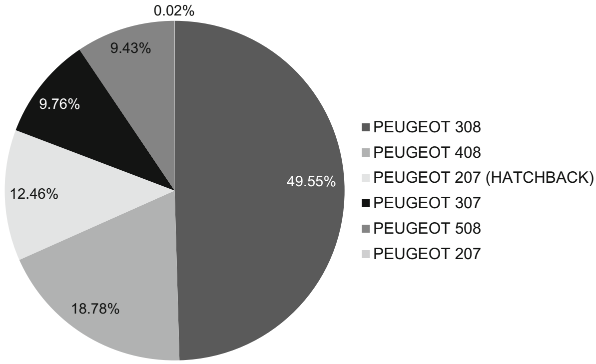

Fig. 3 The contribution percentage of Peugeot Models. *Source*: Adapted from auto.sina.com.cn, 2013

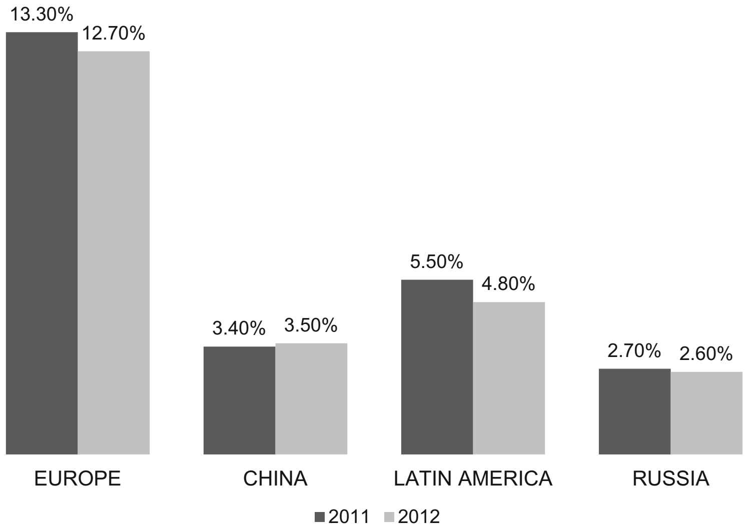

Fig. 4 Cars and light commercial vehicles—Market share. *Source*: Adapted from PSA Peugeot Citroën (2013a, 2013b, 2013c)

the Chinese market, according to the statistical data of the Chinese Automobile Industry Association, the sales of Peugeot 308 only ranked 79th in its segment in 2011, and 56th in 2012. Besides, the market share of PSA in China once 5 % in 2004, decreased to 3.5 % (Chang, 2013). In addition, compared to other multinational automobile manufacturers, the performance of PSA was poor. For instance, in the fiscal year 2011, the profit of PSA in the Chinese market was 145 million euros whereas the profit of General Motors, which entered China much later than PSA, was more than 3 billion dollars—which was more than 2.17 billion euros—in the same period (General Motors, 2012).

5 Problems that Led to Poor Performance

Automobile market commentators and industry insiders believe that the unsatisfactory performance of PSA in the Chinese market can be assigned to the following reasons:

5.1 Positioning

Positioning seems to have become one of the major problems of PSA. After looking at the current positioning map of PSA brands (as shown in Fig. 1), Varin and his managers found that the positioning of Peugeot and Citroën were almost the same, and the model equipment and prices between these two brands were also similar. This resulted in a fierce competition between Peugeot and Citroën (21 CBH, 2013a, 2013b).

The CEO starts to think about differentiating the positioning of Peugeot and Citroën. According to his plan, the two brands should be gradually moving to "clearly differentiated customer territories" (as shown in Fig. 5), and the outcome of re-positioning should be the position shown in Fig. 6.

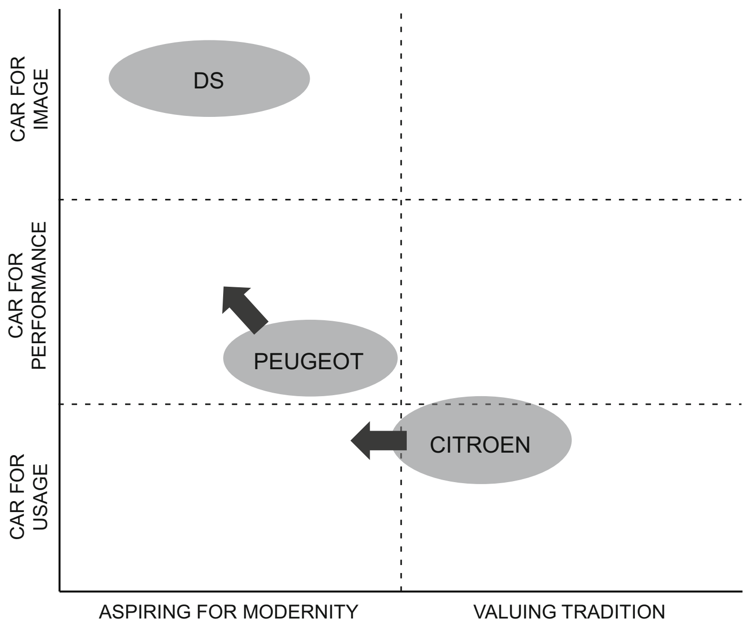

Fig. 5 The re-positioning process of Peugeot and Citroën. *Source*: Adapted from PSA Peugeot Citroën (2013a, 2013b, 2013c)

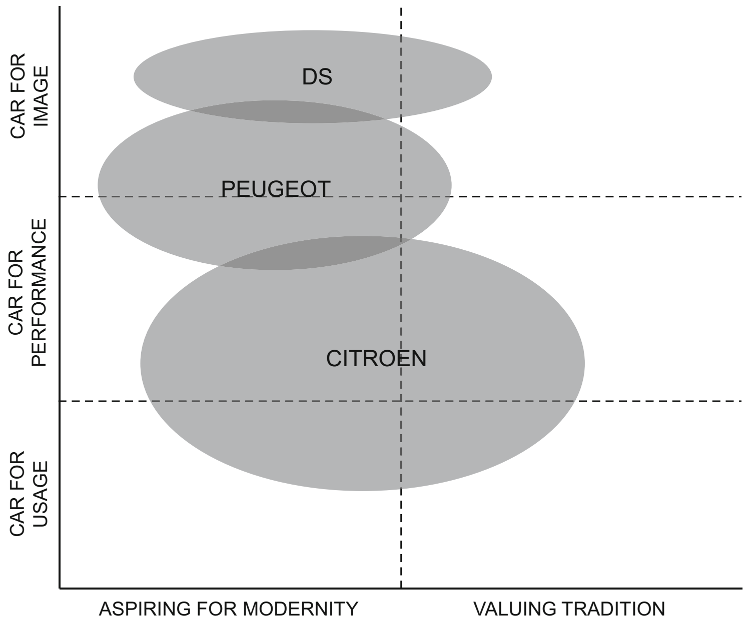

Fig. 6 The brand positioning of Peugeot and Citroën after re-positioning. *Source*: Adapted from PSA Peugeot Citroën (2013a, 2013b, 2013c)

However, Varin and his team found a more serious problem: in Chinese market, customers perceive Citroën as a premium brand while Peugeot is perceived as a middle and low-end brand.

The trouble was that the official brand positioning of Peugeot and Citroën was opposite to the customer perception: no matter whether seen before or after the re-positioning, the market positioning of Peugeot was higher than that of Citroën. Moreover, the new C5 and C4L model, as well as the new Citroën DS models—which were seen as PSA's flagship product oriented towards the high-end market of China—were aiming to seize the market share in high-end markets, which would reinforce the positioning misunderstanding of customers and cause confusion to PSA's strategic partners; but if PSA finally corrected the customer perception of the two brands in China, the high-end products under Citroën brand would fall into an identity crisis again: customers would be doubtful, why a low-end brand would launch such an expensive model.

If PSA could not find a good solution for this problem, the situation would finally turn out to be a no bid for the new C5, C4L and DS model, since the target customers of Citroën brand could not afford the price, while the target customers of the new C5, C4L and DS were reluctant to choose these product since they were positioned as a low-end brand.

Several industry insiders suggested that it would be better to launch the DS without linking it to the Citroën brand, because the brand equity of both Peugeot and Citroën was low in China. They believed this could decrease or even remove the negative impact of low quality and low-end image of Citroën from the DS brand, since the Lexus case of Toyota already proved that this strategy can be a successful solution. Yet the managerial team of PSA was still wondering the feasibility of this move.

5.2 Product

According to the commentators and industry insiders, another serious problem that blocked the profitability of PSA in Chinese market was related to the product. Although PSA had taken several Chinese consumer preferences into consideration when introducing the models, their product still did not fit Chinese customer needs: the PSA's models were too focused on a design that ignored the core preferences of normal Chinese customers for automobile purchasing. For example, Chinese people prefer large space and travel comfort, however, the back window of Citroën DS4 cannot be opened and the wheelbase of Citroën DS5 only has 2727 mm, which is too cramped (Auto China, 2012a, 2012b).

Besides, before 2009, PSA seldom introduced innovative models into the Chinese market as they did in the European market but only re-designed old models; all their models sold in the Chinese market were out-of-date and already eliminated from the European market (21 CBH, 2013a, 2013b). However, PSA's competitors, such as, Toyota, Volkswagen, and General Motors launched numerous innovative models with designs based on customer preferences; hence, these brands attracted the middle and high-end market with rapid speed. When PSA finally introduced its new middle and high-end model CS5 in China in 2009, the market was already saturated and it was difficult for PSA to grab a share of the profit from this market.

Moreover, the after-sales service of PSA was poor in China, which created a negative word-of-mouth effect for the company (Auto China, 2012a, 2012b). With the low quality image that was caused by the introduction of outdated models several years ago, fewer Chinese customer would take PSA's models into consideration when they wanted to buy a vehicle, even though PSA introduced its high-class model Citroën DS recently.

Moreover, when introducing new models into the Chinese market, PSA did not even notice the new government regulations: according to the Automobile Register Regulation issued by the Beijing Government, automobiles that were registered in the Beijing region had to comply with the emission standards in the new regulation set up by the Chinese Government. However, the emission of the new Citroën DS3 was not in accordance with the new regulations, which seriously affected the brand image and the sales of the new model. Strikingly, PSA's competitors were already aware of the announcement of new regulations several months ago and released new models that conformed to the government regulations.

Public opinion, as expressed by a former fan of Peugeot cars, who changed his Peugeot 308 to Audi 2 years ago due to the poor after-sale service of PSA, was that the *"company should eliminate the out-of-date models from the Chinese market and* *undertake a detailed research of customer preferences and government regulations, analyze the market situation and the competitors, then design new models based on those information... Besides, they really should teach their staff what is the right time to show their pride, especially the after-sales department!"*

6 Can PSA Break the Dilemma?

"Too small, too mainstream, too Europe-dependent." These are the phrases Varin used to summarize the problem of PSA, when he became the CEO of the company. Until now, the CEO and his team had still been striving to pull the European automobile giant out of the slough.

PSA needed immediate progress to find itself back on the right track in the Chinese market, and to recover from the big losses in the European market. A recent announcement showed that PSA achieved another milestone in the Chinese market: on 8th of July, PSA announced that during the first half of this year, its global sales was 1.46 million vehicles, which decreased 9.8 % compared to the first half of last year; however, in the Chinese market, PSA's growth rate amounted to more than 30 % (CAAM, 2013).

However, PSA still had a long way to go on its expansion path in the huge Chinese market. According to an industry review, the DS models manufactured by Chang'an PSA—on which a great expectation was placed—only sold 257 DS5s, 36 DS3s and 49 DS4s in the first 4 months of 2013. *"It looks like a joke that Chang'an PSA wants its DS models achieve 3 % market share in 2015,"* said one of the commentators (Auto China, 2013).

The second half-year of 2013 already came and the managerial team of PSA is now facing more severe situations—on the one hand, they have to solve internal troubles, while on the other hand the competition in the Chinese market is becoming fiercer. Varin and his team need to make some tough decisions to break the dilemma—this will undoubtedly be mentioned in the Chronicle of PSA history.

Appendix

Exhibit 1 Top 15 foreign brands in the Chinese market (2012)

Ranking	Brand	2012 Sales (no. of cars)
1	Volkswagen	2,050,193
2	Hyundai	855,996
3	Nissan	751,509
4	Toyota	745,565
5	Chevrolet	704,857
6	Buick	700,007
7	Honda	587,415
8	KIA	480,556
9	Ford	418,501
10	Audi	328,700
11	Suzuki	253,471
12	Skoda	230,003
13	Citroën	223,801
14	Peugeot	216,227
15	Mazda	171,771

Source: Adapted from www.cncap.org & China Association of Automobile Manufacturer [accessed 20 September, 2013]

Exhibit 2 World ranking of automobile manufacturers (2013)

Group	Total production
Toyota	10,104,424
G.M.	9,285,425
Volkswagen	9,254,742
Hyundai	7,126,413
Ford	4,873,450
Nissan	4,631,673
Honda	3,582,410
PSA Peugeot Citroën	2,909,016
Suzuki	2,825,089
Renault	2,725,899

Source: Adapted from Organisation Internationale des Constructeurs d'Automobiles. http://www.oica.net [accessed 13 March, 2014]

Exhibit 3 Timeline of PSA's international expansion

Time	Step
1978	PSA Peugeot Citroën acquires Chrysler Europe
1979	The Talbot brand is introduced to replace the Chrysler brand in Europe
1985	PSA and the Guangzhou Municipal Government formed the Guangzhou Peugeot Automobile Company (GPAC)
1992	DCAC joint-venture set up with Dongfeng Motors to assemble Citroën ZX models in China
1997	PSA sold out its stake in GPAC due to the loss
1998	Acquisition of Sevel Argentina
2001	Porto Real production plant inaugurated in Brazil
2002	Joint-venture DPCA created with Dongfeng Motors to expand cooperative production of Peugeot and Citroën models in China
2005	Joint PSA Peugeot Citroën—Toyota production plant inaugurated in Kolín, Czech Republic
2006	New production plant inaugurated in Travna, Slovakia
2011	Signature of a joint-venture with China Changan Automobile Group in China (approved by the Chinese authorities in July 2011)
2011	The Russian based joint venture between PSA Peugeot Citroën (70 %) and Mitsubishi Motors (30 %) established a factory in Kaluga

Source: Adapted from PSA Peugeot Citroën. http://www.psa-peugeot-citroen.com [accessed 12 October, 2013]

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Part III

Retail Industry

Marks & Spencer: A Global Expansion to Acquire Lost Momentum?

Umair Ahmed

Case Synopsis

Research Problem

Marks & Spencer is one of the most admired food & fashion retailer worldwide. The company is almost 120 years old and is regarded by several business scholars as the leader of contemporary management practices in the twentieth century. It was experiencing, perhaps, one of its most glorious periods during late 1990s when it was struck with the obstacle of globalization. The company seemed to be ill-prepared to tackle the challenges of international marketing but was still determined to correct the situation. The company is now on track to launch its biggest international drive ever but Marc Bolland, the new CEO, has his work cut out to ensure that he does not repeat the mistakes of the past, adapts the organization to the requirements of twenty-first century and makes M&S an exemplary international retailer.

Case Summary

By 1996 Marks & Spencer had 645 stores worldwide most of which (58 %) were in UK, Europe and Canada. The trend of globalization saw a blossoming of fashion retailers, which offered a better customer value proposition and proved stiff competition for M&S. M&S had to immediately contract its international expansion and it virtually became a local retailer. More than a decade has passed but the tremendous fall experienced by M&S in early 2000s has made it a shadow of its glorious

U. Ahmed (✉)
Tias School for Business and Society, Utrecht, The Netherlands
e-mail: umair_iobm@yahoo.com

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past. It has had limited success till mid 2000s but deep down M&S executives know they are only treating the symptoms and not the disease.

Learning Objectives

Success of an organization in the global market place is increasingly getting dependent on its capability to sense underlying growth drivers, consider sensitivities of the local markets and remain flexible enough to adapt to latest trends. M&S learnt its lesson the hard way. It replicated its successful business model in the international markets and found out that the globalized world required a completely different marketing landscape.

Themes and Tools Used

- First and second internationalization drivers
- Marketing orientation
- Elements of local culture
- Localization
- Marketing strategy

Target Audience

Master students and interested practitioners

Questions

Does M&S need a "revolution" or Marc Bolland's gradual "evolution"? How can M&S align itself with contemporary realities of the fashion market? How can it check the advance of the "fast-fashion" trend? What should be M&S competitive advantage? The international experiment for M&S did not prove fruitful in the past; will it prove fruitful again?

1 Introduction

When Marc Bolland assumed office mid-2010 as the new CEO of M&S he knew that he had a gigantic task on his hand to turn around one of the biggest, but struggling, global food and fashion retailers. Whatever the reasons were, it is still known that two major contenders declined the top job of M&S at that time namely Andy Bond (ASDA CEO) and Justin King (Sainsbury CEO) (Sky News, 2014). Bolland could at best guess why his major competitors for the top job did not wish to compete because at present M&S was definitely giving him a headache.

"The business is in good shape and we have strong foundations on which to build through evolution not revolution" (International Business Times, 2014), said Bolland soon after joining M&S. Of course Bolland was trying to be optimistic

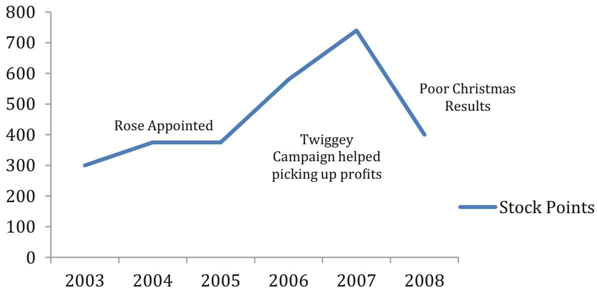


Fig. 1 Dwindling M&S profits. *Source*: Adapted from Thompson Stream. http://thomsonreuters.com/en/products-services/financial/investment-management/datastream-professional.html [accessed 10 July, 2014]

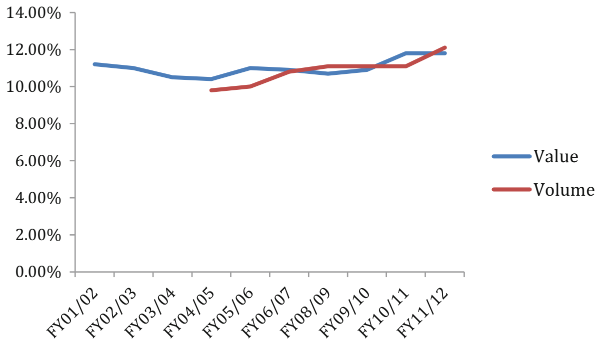


Fig. 2 Stagnant M&S market share (UK clothing market share). *Source*: Company Data, Kantar Fashiontrek, Morgan Stanley Research

when he said that because most indicators showed a struggling picture for M&S (see Fig. 1).

The British retailer since 2010 had still not shown signs of sustainable recovery and had been rapidly losing market share in the UK to its competitors, especially from Next, Debenhams and Primark. For M&S the period between 2010 and 2014, in the UK, has been that of a steady decline. A paltry increase 0.2 % in market share from 2010 to 2014 seems not doing justice to the 500 million pound investment in store uplift (Chapman, 2012) (see Fig. 2). In the last 3 quarters of 2012, M&S was said to lose around 92 basis points in market share (Neilan, 2013). In fact Bolland, appointed in May 2010, has presided over 3 straight years of declining quarterly like-for-like sales in M&S's general merchandise arm—which includes fashion clothing (Loom, 2014).

2 M&S: A Look Back

The story of M&S has been a very interesting one. Peter Drucker, one of the leading business gurus in the world, once said, "M&S is a management giant in the western world" (Mellahi, Jackson, & Sparks, 2002). Another contemporary business writer Peter Doyle said that if he had to pick one company that "exemplified consistent long-term growth, profitability and customer satisfaction, it would be Marks and Spencer. . ." (Mellahi et al., 2002).

Table 1 M&S rise and fall

Financial year	Sales (£m)	Pre-tax profits (£m)
1978	1400	160
1980	1800	180
1982	2200	220
1984	2700	280
1986	3600	375
1988	4500	500
1990	5500	600
1992	5450	610
1994	6500	850
1996	7300	980
1998	8200	1150
2000	8000	400
2002	7500	170

Source: Marks & Spencer, Corporate Website

It is no wonder that such positive remarks about M&S, from prestigious business academicians, came during 1990s, a period when M&S was at its peak (see Table 1). In fact it would be fair to say that before the beginning of twenty-first century M&S had only known one taste and that was success. M&S was started by Michael Marks as a stall in the Leeds market in 1884.

Initially M&S had outlets in form of the 'penny bazaars'. After the death of Micheal Marks, in 1907, his son (Simon Marks) and son's friend (Israel Sieff), an English businessman, transformed M&S from 'penny bazaars' to an iconic and contemporary British retailer (see Appendix, Exhibit 1) (Comay, 2002). 1984 saw Lord Rayner becoming the Chairman of M&S. He was the first non-family Chairman since 1914. Rayner took M&S to an expansionist track both at home and abroad. M&S saw itself expanding in USA, Hong Kong and the Asia Pacific region. In 1991 Sir Richard Greenbury whose main focus was cost control succeeded Rayner. Greenbury was an outspoken personality and he once described his critics as 'teenage scribblers' (Mellahi et al., 2002). But then in the late 90s M&S faced a huge crisis due to unexpected competition from value competitors like Next, Debenhams, Gap, Primark, Zara and Mango (Mellahi et al., 2002). There were several reasons for this cutthroat competition but the most compelling reason was the opening up of China as a major production facility for most retailers that enabled the clothing retailers to employ cheap sourcing and thus offer value-based designer products.

Such was the blossoming of competitors in clothing retail sector that M&S was forced to close all of its overseas operations (BBC, 2001). In context of the competitive pressures M&S was facing at that time, Paul Cheeseright, a renowned industrial writer, said: "It's globalization working at a High Street level. A retailer isn't just competing with its next door neighbor, it's competing worldwide, and if it gets it wrong, there are not only domestic firms which will try to supplant it, there are international ones" (BBC, 2000). In fact it was only in 2004 that M&S started experiencing an improvement when Stuart Rose was appointed CEO otherwise the company looked all set for a takeover (BBC, 2014). Stuart Rose's turnaround strategy involved focusing on Per Una clothing range and glamorizing the M&S brand through advertising. Per Una was a funky clothing range launched in 2001 and was targeted towards women aged 25–35 but it was never able to woo its intended audience (Ryle, 2004). Stuart Rose was able to check that trend and ensure Per Una revival; "Rose turnaround strategy involved taking control of women's fashion brand Per Una, selling non-core businesses and injecting glamour into its brand by using celebrities such as Twiggy and Antonio Banderas in its advertising"(BBC, 2014). Rose was able to lift the M&S bottom-line for a bit but the recession in 2008, which badly hit the UK, had far-reaching affects on M&S profitability (see Fig. 1). They say "don't put your eggs in one basket" and certainly this proved to be increasingly true for M&S that had to rely on the UK for 90 % of its revenue (Issuu, 2014). The recession meant considerable decrease in consumers' disposable income and thus value retailers like Primark were capitalizing on the economic situation.

3 Internationalization, Contraction and Internationalization Again

Marks & Spencer began its international adventure in the 1940s when it started exporting its St. Michael's brand to various countries but the real international drive came in late 1980s when Marks & Spencer explored the Far East and Canadian market. By 1996 Marks & Spencer had 645 stores worldwide most of which (58 %) were in UK, Europe and Canada (Alon, 2014). The struggles of late 1990s and early 2000s saw M&S closing most of its overseas operations. Some presence was still there internationally in form of franchises but as such M&S was no more a brand with international retail presence. Stuart Rose, CEO of M&S (2004–2008), described his predecessor's move of closing international stores as "retail vandalism" (Wood & Finch, 2009). Rose decided to re-open closed international stores but his focus was more to open them in form of joint ventures or franchises as opposed fully owned properties of M&S. By 2009 M&S had 315 stores operating worldwide (excluding UK) (Wood & Finch, 2009).

Mr. Bolland intended to continue global expansion of M&S in the same vein. His strategy was similar to that of his predecessor i.e., to enter international markets through franchises and partnerships. The most recent examples of that was M&S's entry into India and Saudi Arabia. In India, M&S has partnered with Reliance Retail (James Hall, 2008) while in Saudi Arabia with Al Futtaim (Gulf Business, 2012). In fact the first standalone M&S lingerie and beauty store opened recently in Saudi Arabia; perhaps one of the most unexpected market for such a venture considering the cultural and religious norms in Saudi Arabia (Docstoc, 2014).

The key feature in the second internationalization wave was M&S's attempt to adapt itself to local markets. For instance in India M&S offered better prices and adapted itself to local tastes and preferences. "What's become clear to us is that many things that M&S does around the world are applicable to India, but there are also other things that the Indian market requires international retailers to do differently," said Mark Ashman, the chief executive of the M&S-Reliance joint venture (Thenational, 2014). The 'differently' that Mr. Ashman referred to were increasing the percentage of goods sourced in India, brightening up color schemes of the store & merchandise (for instance men's polo shirts in India come in 16 colors when compared to only 5 in UK) and putting breast pockets on men's shirts (because Indian men prefer carrying a pen) (Thenational, 2014; Shah, 2014). The changes in the merchandise were not restricted to the men's merchandise only; the women merchandise saw introduction of higher necklines and lower hems for blouses & T-Shirts. Furthermore, an extended curve was given to women slim-fit trousers because Indian women had heavy bottoms (Shah, 2014).

4 China: The M&S Misadventure

The latest example of a sour investment by M&S was its attempt to enter China in 2008. Their flagship store in Shanghai had poor reviews (Mail Online, 2014) and M&S quickly had to arrange for relocating some of their stores in Shanghai to other parts of the country (USA China Daily, 2014). Reasons for such an inglorious failure in China were the clothes being too expensive, too British, unavailability of merchandise on the shelf and no consideration for the local preferences on sizes & colors (Mail Online, 2014). In fact several analysts attributed M&S failure in China to their inability to understand the Chinese culture. It is said store location and format were not in accordance to Chinese superstitious belief (Law Teacher, 2014). An elaboration of Chinese superstitions regarding store layout would always touch upon Feng Shui, a Chinese art for orienting buildings and dwellings. Buildings that do not follow the Feng Shui way of construction are usually considered to house negative energies. In simple words the M&S store in Shanghai was in contradiction with Feng Shui way of construction and thus was considered a place of bad luck and negative energies. According to prevailing superstition this bad omen was what caught hold of an Indian customer named Harshit Shah who fell from the escalator and died (Law Teacher, 2014).

It seemed M&S was stuck in between; whether to target the Chinese market or the sizeable expat market in China. The failure in China would have given valuable lessons to the management. One of the most important ones would have been how to segment the market in an international context; thus considering attributes such as local preferences, culture, beliefs and values.

There were numerous problems cited in the marketing mix implemented by M&S in China. Besides the obvious shortcomings in the size, color and design of clothing products, consumers also cited problems in packaging and language for the general merchandise section. The place selected by M&S for opening the flagship store was said to be an old town and not a retail destination area.

M&S has been in search for a partner to continue its existing business ventures in China but Shaun Rein, an analyst at China Market Research said, "They are basically conceding defeat but they can't say that, instead they are saying they will have to grow through partners, who will put up the capital".

He further added on, "M&S are an example of what not to do in China: they came in with extremely large flagship stores in areas where the rents are too high, their pricing was in the middle range, their sizing is all wrong, and they typically attract 60-year-old Chinese women and expatriates. Few of the younger women who were their target actually shop there" (Financial Times, 2014).

5 What Went Wrong?

M&S has been in a continuous phase of reform since its decline in the late 1990s but it was clear from the issues, which keep on occurring now and then that the fundamental problems still need to be addressed before M&S can think of becoming a truly global brand.

5.1 Home Market

There was a time when M&S used to be the most profitable UK retailer at home but that title now belongs to Next (Ruddick, 2014). In 1997 M&S had 16 % of the women wear market that has plummeted to 11.2 % in 2013 (The Independent, 2013). In late 1980s & 1990s M&S expanded globally from a position of strength but still failed. Can they, in present circumstances, expand globally from a position of weakness?

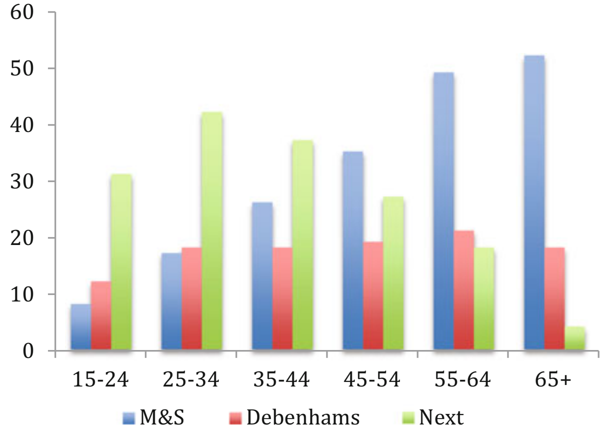
5.2 Ageing Consumer Base

The average age of an M&S customer is 49 yeas old (Fig. 3) (White, 2013). According to Tony Shiret, one of the leading retail analysts at Credit Suisse, M&S cannot expect to have a long-term future "with this type of demographic profile" (James Hall, 2008). The perception of M&S catering to the older aged customer is not only prevalent in its home market but was also seen when it launched its flagship store in China.

The latest attempt to curb their image, of catering to the ageing customer, was to launch the 'leading ladies' campaign. The leading ladies campaign starred famous women celebrities of different ages; perhaps shows M&S is conscious to ensure it appeals to younger segments. M&S executive director for Marketing & Business commented, "M&S is a democratic brand which is relevant to women of all ages and strands of life; it is therefore natural for M&S to celebrate women in this way" (Vogue UK, 2014). The challenge though, for M&S, is to make the customers of 'all' those ages believe that it really is 'relevant' to them.

Besides the ageing consumer base M&S also faces the dilemma of knowing who their customers actually are. According to a report by Mintel the M&S shopper can

Fig. 3 M&S—ageing customer base (age-wise % people visiting competitive stores). *Source*: Verdict Research



be defined as ‘affluent’ class but the question was which socio-economic class was the M&S targeting? Furthermore a collage of M&S brands for the female consumer can be a devastating experience for her because she has to toil so hard to discover what she wants.

5.2.1 Suppliers and Quality

Before the opening up of China, to the world, in the 2000s M&S always proudly stated that all its products are sourced from UK suppliers but after facing the cutthroat competition from value competitors M&S decided to start sourcing for its products from cheaper markets. This had its consequences on the quality and thus that was one of the main USPs, which differentiated M&S from its competitors. The dilemma though is that it is a two-sided sword. If M&S sources from UK it makes the price of its products in the international market very uncompetitive and if it decides to source products from elsewhere it results in a depreciation of its quality image?

5.2.2 Supply Chain and the Internet

Whenever press or media refer to M&S competitors they often use the word “nimble competitors”. For instance the case of Zara is often quoted when talking about Supply Chain excellence is clothing retail industry. Zara is a vertically integrated company with almost all operations in-house and fully owned unlike M&S that has several sourcing agents and has several operations of the supply chain outsourced. Zara also has only one distribution center in Spain that serves all the worldwide Zara stores (Berfield & Baigorri, 2013). In contrast M&S has 110 different warehouses only in UK though they are already working on following the Zara model by building a huge distribution center in Castle Donington (All Port, 2014).

Thus the “nimble” competitors are not only nimble because they can get the stuff to the store faster than M&S but also because they can delay their decision to produce and sense what the market wants. On the other hand M&S has to make the decision about next season's clothes almost 6–12 months in advance.

Marc Bolland has taken it a point to ensure that M&S remains "dot com ready" and for this reason a new and furbished website has also been launched to engage customers. In fact according to his latest vision he intends to serve several markets only through the website (marksandspencer.com, 2014). The challenge though would be how M&S manages to run the online space with a faulty supply chain.

5.2.3 Insensitivity to Needs of the Foreign Market

Uncompetitive pricing and culturally insensitive merchandise can be a recipe for disaster in any market. A classic example of this mistake was seen when M&S went to China in 2008. The clothing merchandise was not up to the mark; the sizes, colors, and designs were not in accordance with local preferences.

Another case of similar mistake by M&S was their entry in India. Initially when M&S entered the Indian market the shirts for men did not have pockets. Indian men like to keep their pens in their shirt pockets. In addition the slim fit trousers for women had less space on the hip region considering women in India have heavier bottoms (Shah, 2014).

6 Future Outlook

On April 1, 2014 M&S revealed its massive expansion plan of opening 250 new overseas stores. At present a total of 455 overseas store exist; the proposed expansion can more than double the footprint M&S had in 2010 (337) (Ruddick, 2014) and this could take the total tally of overseas stores to 700. Interestingly the focus of the new expansion seems to concentrate on "food, beauty & lingerie". Does this mean M&S has unofficially accepted defeat in the clothing sector?

According to M&S the proposed expansion plan is going to bring about 40 % growth in profit and 25 % growth in revenue. The focus of the expansion will be five key markets namely India, Russia, China, Middle East and Western Europe.

The present financial report card does not paint a rosy picture for a global expansion. The net debt, according to latest reports, stands at 2.3 billion pounds (Okolie, 2014) that works out to be 1.9 times trailing to EBITBA. This is incredibly high by previous standards. Having said that their recent M&S lingerie and beauty expansion plans in Saudi Arabia have been highly successful though M&S is still struggling in China except that their 'red wine' is still popular in world's second largest economy (Interactive, 2014).

The present strategy seems to be geo-sensitive i.e., they are marketing different products for different markets. Flagship or full service stores in China, food for Western Europe, clothing for India and beauty & lingerie for both India and Middle East. The present expansion strategy suggests that they are pursuing overseas markets to achieve a bailout for their wilting clothing sector.

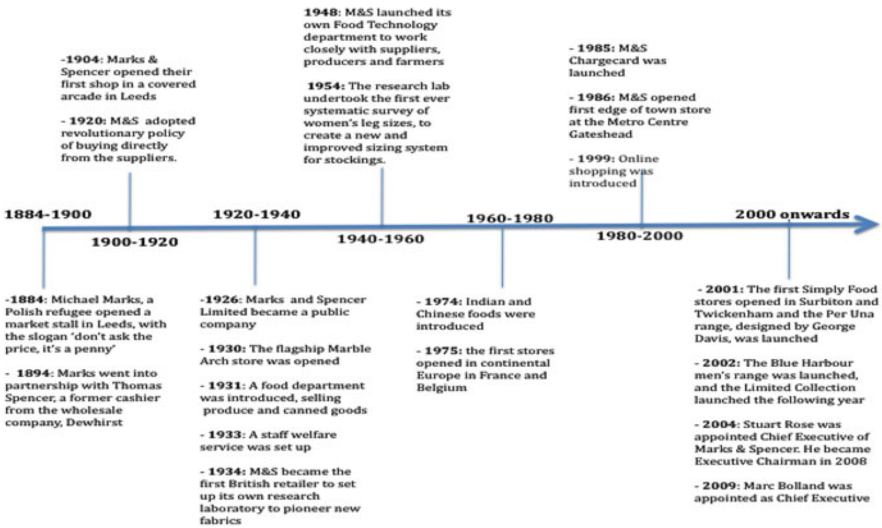
Before Marc Bolland adds on 250 stores to its existing tally of 455 worldwide stores he has some tough questions up his sleeves. What are long-term repercussions of such a strategy in an international context? What signal does this send to M&S regional and international competitors? Is the expansion in the retail outlets worthwhile considering different markets only have preference for certain M&S products? What does M&S really stand for; food, general merchandise or clothing? How can he best migrate younger customers to the M&S brand?

The list of questions for Mr. Bolland is endless but perhaps time will prove to be the best answer. Till that time the fundamental question still stands unanswered:

The international experiment for M&S did not prove fruitful in the past; will it prove fruitful again?

Appendix

Exhibit 1 M&S Timeline



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IKEA in China: A "Glocal" Marketing Strategy

Veronica Giunta

Case Synopsis

Research Problem

Over the past few decades, with the increasing globalization of markets, companies have found themselves struggling to design effective marketing strategies that allow them to "go global" while catering for the peculiar needs of local markets. However, striking a balance between global and local strategies often proves challenging and requires adopting a trial-and-error approach.
Such an issue becomes even more complex when it comes to entering new developing markets, presenting peculiar social and economic dynamics. A lack of understanding of cultural differences and customers' preferences of such markets, together with the limited resources of companies, add in fact complexity to the process of designing effective business strategies.

Case Summary

The present case study examines a strategic issue encountered by IKEA, the giant Swedish furnish company, while expanding into the Chinese market. After years from its entrance in the Asian country, IKEA was still struggling to achieve positive financial results. A lack of understanding of the local peculiarities of the market prevented the company from implementing an adequate targeting strategy and occupying a strong competitive position in the market. As a consequence, the global marketing strategy adopted proved to be a failure in the Chinese market. IKEA was thus forced to reconsider not only its marketing strategy but also the

V. Giunta (✉)
TIAS School for Business and Society, Utrecht, The Netherlands
e-mail: veronica.giunta90@gmail.com

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universality of its business proposition. Once again, the main issue was striking a balance between local and global in order to implement an effective business strategy.

Learning Objectives

The case study aims at exploring the impact of cultural, economic and socio-demographic characteristics of local markets on the implementation of global marketing plans. More precisely, the effect of such peculiarities on segmenting, targeting and positioning strategies will be examined. The main goal is that of providing the readers with valuable insights into the interaction of global and local forces in shaping market dynamics and consumers' preferences.

Themes and Tools Used

- Marketing strategy
- Targeting
- Localization
- Marketing mix
- Balance between globalization and localization

Target Audience

Master students and executives interested in learning about key success factors in China.

Questions

1. What is the impact of local factors on the implementation of global marketing strategies in new markets?
2. To which extent should companies consider local peculiarities in designing global marketing strategies?
3. Is it possible to create a universal business proposition and marketing strategy applicable to every market?
4. To which extent can a lack of understanding of socio- demographic peculiarities of the local market prevent companies from implementing adequate targeting and positioning strategies?
5. How can companies strike a balance between "global" and "local" in designing an effective marketing strategy?

1 Introduction

After five years from the opening of its first store in China, IKEA, the giant Swedish furnishing company, was still struggling to expand its market share and achieve a sales volume large enough to ensure business profitability in the Chinese market.

Over the years, IKEA has undergone a significant international expansion, becoming one of the biggest players in the global market and achieving staggering financial results. After having successfully established its presence in several markets in Europe and in the US, IKEA turned its attention to China in the late 90s. The Chinese market with its booming economy and growing middle-class represented a huge opportunity to enhance its financial performance.

However, accomplishing IKEA's mission of "delivering low prices and high - quality furnishing solutions to the many" proved to be extremely difficult in China. The Chinese market shows significant cultural and demographic differences embedded in its strong millennial cultural heritage. The old Chinese values and traditions coexisting now with emerging social trends, based on the "westernization" of society, made it China an extremely complex market to enter. It comes thus as no surprise that IKEA had to struggle to find an adequate position in the market and develop a pricing strategy adequate to deliver value to customers. In mid-2003, the president of IKEA China, Ian Duffy, and some executives gathered in their Beijing office, decided to find a solution and develop a new market strategy for IKEA China.

Understanding the reasons behind IKEA's weak position in the Chinese market was the first crucial step in order to solve the problem. After the managers of IKEA China had arrived and taken a sit in the office, Duffy started the meeting saying:

"IKEA's concept has proved successful in every market we have entered. Delivering low prices and high quality products to the many seemed to be a universal formula to achieve success globally. However, our poor performance in China has proved that this formula is not always right. It is therefore time to rethink about our strategy and find a new path to follow if we are to become successful in the booming Chinese market and realize our mission to become a market- leader worldwide."

The Chinese furnishing industry was growing incredibly fast and the opportunity for profit was enormous. However, IKEA's value proposition seemed to be not in line with Chinese consumers' buying behaviour and it was unable to deliver added value. The main problem seemed to be caused by an inadequate targeting and pricing strategy that caused IKEA to occupy a weak position in the market with respect to competitors. At the root of this strategic issue there was a lack of understanding of the peculiar buying preferences and consumption patterns of the different consumers' segment. Such a poor market understanding resulted in IKEA's unsuccessful positioning in the market. Several questions needed to be answered to get at the core of the problem. What was the right market target for IKEA in China? Who are the "many" in China? Which position allowed the achievement of a competitive advantage? How would have socio-economic trends affected Chinese customers' buying behaviour in the following years?

It was crucial to find a solution as soon as possible in order for IKEA to establish a competitive position in the market in the early stage of the furniture industry's growth, ensuring also financial success over the following years. The way to go was long and difficult but IKEA's CEO was determined to build strong position in the Chinese market and was convinced of the huge market potential and of the eventual success of IKEA.

2 Background Notes

2.1 IKEA in a Nutshell

IKEA is the world's largest furniture retailer. IKEA produces a wide variety of well-designed, functional products ranging from tables and chairs to kitchen furniture. With 345 stores in 42 countries, IKEA is committed to "improving the everyday life of the many" by providing quality products at low prices worldwide (IKEA, 2014).

To achieve its corporate mission IKEA has been constantly committed to reduce costs and innovate continuously. Crucial to its success has been building long-term supplier relationships, investing in highly automated production and producing large volumes to achieve operations' effectiveness. Sweedwood is the only production company owned by IKEA and it accounts only for 10 % of IKEA's purchases. IKEA's long-term relationships with suppliers are the basis for creating the lowest price through an efficient and reliable production, with high quality results and minimum waste. Purchasing agreements with suppliers allow to have flexibility and to adjust the production volume to market conditions. In most of the cases IKEA buys 90–100 % of its suppliers' capacity; as a result the company can influence the way they produce and reduce their bargain power. To ensure that quality standards are met by every supplier, IKEA strictly set and control the quality standards and often train directly its suppliers.

Purchasing teams are located around the world and work with suppliers in more than 50 countries. As for 2013, the top five selling countries are China, Poland, Italy, Sweden and Germany (see Fig. 1).

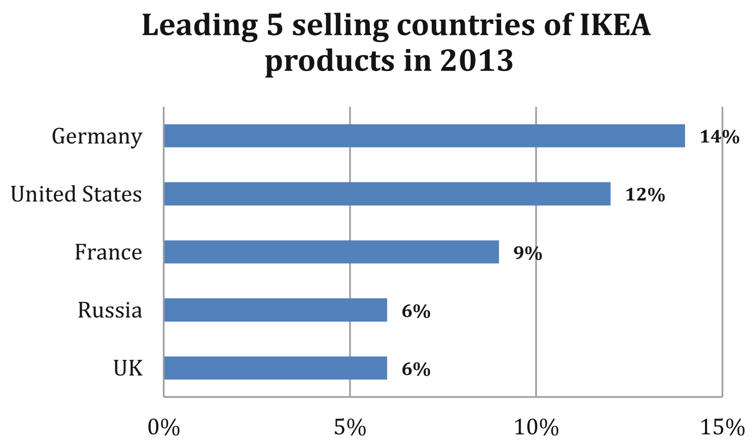

Fig. 1 Leading 5 selling countries of IKEA products in 2013. *Source*: Adapted from http://www.statista.com/stats/IKEA/

In order to provide customers with the greatest value for money, IKEA's furniture is designed to be self-assembled by end—users. This solution allows IKEA to reduce both manufacturing and transportation costs and give customers the lowest possible price.

Store experience is another peculiar element of the IKEA concept. The IKEA stores, mainly located outside the city Centre, are in fact powerful tools to show customers products functionality and benefits and convey IKEA's main values. In IKEA's stores customers can in fact try products, get ideas about possible furnishing solutions and enjoying a "feeling at home atmosphere" not only in the showrooms but also in the stores' restaurants and cafes. IKEA stores are mainly located outside the city centre and are easily accessible by car. Customers can therefore go there buy the ready to assemble piece of furniture and bring their purchase home by car. The main advertising tool used by IKEA is its famous catalogue showing the annual product offering with its relative prices. TV and newspaper have also been used to build –and strengthen its brand image and over the last few years year IKEA has been increasingly using social media (Facebook, Twitter) to engage its customers.

IKEA's "many people" are in general represented by customers belonging to the middle class. In particular, IKEA's main target group is made up by younger customers, like students or young professional with a limited income, searching for "startup solutions" for their houses, or families searching for furnishing solutions with a decent quality and innovative design enabling to save money.

2.2 IKEA's History

IKEA was founded in 1943, by the 17-year-old Ingvar Kamprad in Sweden. Originally IKEA products included pens, picture frames, wallets, watches, jewellery, and nylon stockings, sold directly door- to-door to customers by Kamprad. Furniture produced by local manufacturers was introduced into the IKEA products' range in 1948 and it received such a positive customers' response that in the following years all other products were discontinued. Due to IKEA enormous success, in 1951 its founder decided to advertise and sell furniture on a larger scale using a catalogue. The IKEA catalogue remains still today one of the main marketing tools used by IKEA. The first IKEA showroom was opened in Älmhult, Sweden in 1951 and it became the first IKEA store in 1958. From that moment on, IKEA stores became crucial in delivering the IKEA experience and helping the company differentiate from competitors delivering added value to customers. Due to competitors' pressure on suppliers to boycott IKEA, in 1955 Kamprad decided to start designing IKEA own furniture. This decision turned out to be crucial to IKEA success in the following years since it allows the company to focus on low prices, improve functionality and create exclusive and cutting- edge design products. Problems with suppliers led the company to start purchasing from foreign producers in Eastern Europe. During the 1960s the concept was taken even further by introducing the warehouse principle. A huge store in Stockholm was opened where customers picked the products from the shelves themselves. IKEA turned a capacity problem into a new way of delivering products to customers, which is now a cornerstone in the IKEA way of doing business.

A production process design, aimed at keeping waste to an absolute minimum, became key to provide customers with the lowest possible price. Using raw materials efficiently, applying technical innovations and encouraging a strong collaboration between suppliers and designers were crucial steps to produce low price well designed and functional products (IKEA, 2014). At the same time, IKEA began testing the concept of flat packaging to reduce costs. Such a solution allows in fact not only to reduce transportation and labour expenses but also to lower storage space and decrease transportation damage. The IKEA concept based on low prices and innovative design became increasingly successful and allowed the Swedish retailing company to achieve excellent financial results and constantly increase its market share worldwide (see Figs. 2, 3 and 4).

Fig. 2 IKEA's revenues (in €billion). *Source*: Adapted from www.ikea.com (2014)

2010	2011	2012	2013	2014
316	325	338	345	361

Fig. 3 IKEA's stores. *Source*: Adapted from www.ikea.com (2014)

2010	2011	2012	2013	2014
699	734	775	776	821

Fig. 4 IKEA stores visits. *Source*: Adapted from www.ikea.com (2014)

2.3 International Expansion and Strategy

The international expansion of IKEA started in 1963 with the opening of its first store in Norway. From that moment on IKEA showed a massive expansion. The first IKEA store outside Scandinavia was opened in Zurich in 1973. The success in Switzerland paves the way for a rapid expansion into Germany, today IKEA’s largest market. IKEA arrived then in Australia and Canada, in 1976 and 1977 respectively. The expansion in Europe continued in Austria (1977), the Netherlands (1979), France (1981), Belgium (1984), UK (1985), Italy (1989), Hungary (1990), Poland (1991), Spain (1996), Russia (2000), Portugal (2004). IKEA opened its first store in USA in 1987 and in Japan in 2006. Today IKEA is present in 44 countries with 355 stores (see Table 1).

As Anders Dahlvig, former CEO of the IKEA Group, explains the main reason behind the decision of expanding globally was the limited opportunity for growth in the Swedish market. Being a domestic Swedish company for over 20 years, however, allowed IKEA to develop a strong corporate culture and establish a unique concept, differentiating from its main competitors. Kamprad strongly believed that the uniqueness of IKEA concept and its culture would have been the key to achieve competitive advantage and become successful worldwide. The first phase of IKEA’s global expansion was therefore focused on consolidating and spreading the IKEA’s concept through a replication strategy. In order to conceptualize IKEA business idea, in 1976 Kamprad wrote the “Testament of a Furniture Dealer”, a written document codifying IKEA values and beliefs that should have served as a guideline during the internationalization process. Following a replication strategy, with a relatively fixed format, was also justified by the attempt to realize cost efficiencies from exploiting massive economies of scale. Stores were built following a standardized format and using the characteristic blue-and-yellow color. A fixed product range with only minor adjustments was offered in all the markets and the IKEA’s catalogue was the main marketing tool worldwide. HR was focused on finding people matching IKEA’s culture in order to create consistency in its image globally and IKEA’s values and mission were the main guiding lines in every market entered.

The fast international growth of IKEA raised the issue of implementing local according to different market units. Kamprad himself, however, rejected this option since it could have resulted in a highly dispersed product range, in conflict with the IKEA concept. His view was clear: *“We shall always be one IKEA, one business idea and one culture”*.

The notorious problems encountered entering the US market during the 1980s demonstrated how a marketing strategy based on indiscriminate replication is not always the most appropriate one. IKEA needed to implement minor adjustments to the product range and communication strategies proved, to become successful in the US market. As a result of the US experience, a global market approach with minor local adaptations appeared to be the best solution to build a strong and unique brand image and achieve IKEA’s mission all over the world (Wei & Zou, 2007).

With regard to IKEA’s global success Dahlvig said:

Table 1 IKEA's international expansion

Country	Number of IKEA stores	First IKEA store
Australia	7	1975
Austria	7	1977
Belgium	6	1984
Bulgaria	1	2011
Canada	12	1976
China	16	1977
Cyprus	1	2007
Czech Republic	4	1991
Denmark	5	1969
Dominican Republic	1	2010
Finland	5	1996
France	29	1981
Germany	46	1974
Greece	5	2001
Hungary	2	1990
Iceland	1	1981
Ireland	1	2009
Israel	2	2001
Italy	20	1989
Japan	6	1977
Kuwait	1	1984
Lithuania	1	2013
Malaysia	1	1996
The Netherlands	12	1978
Norway	6	1963
Poland	8	1991
Portugal	3	2004
Qatar	1	2013
Romania	1	2007
Russia	14	2000
Saudi Arabia	3	1983
Singapore	2	1978
Slovakia	1	1992
Spain	19	1980
Sweden	18	1958
Switzerland	9	1973
Taiwan	4	1994
Thailand	1	2011
Turkey	5	2005
United Arab Emirates	2	1991
UK	18	1987
USA	38	1985

Source: www.IKEA.com (2014)

"We have taken the concept and planted it in many different countries. Since the concept has been unique and together with the Swedish touch, in terms of Scandinavian style, we have stood for something different from the local, domestic competition. That uniqueness has given us the same advantages in each country that we had in Sweden in the early days" (Kling & Goteman, 2003).

3 IKEA in China

IKEA entered China in 1998 opening its first retail store in Shanghai followed by another store in Beijing in 1999. IKEA was one of the first furniture-company to establish its presence in China. The company's trading partnership with China dates back to the early 1960s. IKEA had therefore a solid network of Chinese suppliers and a good understanding of the Chinese furniture industry when it entered the Chinese market.

Over the years, IKEA expanded its presence in China opening new retail stores (Beijing, Guangzhou, Nanjing) and establishing several trading offices and a purchase center. IKEA's name was translated into *yijia* (comfortable home), a translation in line with the core values of the company.

The decision of entering the Chinese market was prompted by the economic growth recorded since the beginning of the 1980s. Industrialization, rising incomes, better education, postponed life stages, urbanization and the widespread of Western values give birth to a growing middle classes with new needs and consumption patterns. The Chinese middle class has been growing incredibly fast: the per-household disposable income of urban consumers is expected to double from about $4000 to about $8000 between 2010 and 2020 (Atsmon & Magni, 2012).

However, the huge potential in terms of profit came together with a high degree of risk due to the lack of experience in the market. The rapidly changing dynamics in consumers' behavior, coupled with a strong heterogeneity in terms of customers' preferences, made it difficult for IKEA's managers to predict future market trends and develop a well-defined marketing strategy. The probability of being successful in China appeared to be lower than in the markets entered before. However, the CEO strongly believed in the project of expanding IKEA's business in China. After having researched the market, Ian called a first meeting to illustrate the results and discuss a possible expansion strategy.

3.1 The Chinese Market: Huge Potential and High Risk

China has enjoyed more than 20 years of rapid economic development since it opened its doors to the international market with open door policy started by Deng Xiao Ping in 1978. The GDP has been increasing steadily by an average annual increase of 7–8 %. Due to the increased purchase power of Chinese consumers and the growing popularity of Western values, demand for high-end Western products soared. It is estimated that China currently has approximately 30 million middle-class consumers with annual incomes ranging from $10,000 to $50,000.

The healthy economy coupled with rising income and a booming estate market provided impetus to the growth in Chinese furniture market. After the housing reform in the Chinese mainland, demand for privately owned homes has been constantly increasing in both urban and rural areas, leading to a consequent surge in furniture sales.

China's low labor cost, growing consumer market and sharply declining import tariff rates attracted a number of foreign furniture companies. China became not only a world-class location for setting up furniture factories and an important export base but also a promising market for global furnishing companies.

However, the high import taxation the complex government regulation, strong competition of local players and the complexity of the consumer buying behavior, entering the Chinese market can prove extremely difficult.

3.2 Competition and Industry structure

The Chinese furniture industry consists of around 50,000 companies and 5 million employees (Cao et al., 2004). Most of these companies are small- to medium-sized operations with annual sales less than $36 million or CNY ¥ 300 million (Hu, 2003). Large-size companies only account for 3 % of the total industry (Cao et al., 2004). Concentration of the industry is lower than in other industries, consequently there are few big most influential brands in the market. Nonetheless, competition has been increasing over the years, and a number of branded local enterprises of a certain scale have emerged together with international companies.

In terms of ownership, at least 90 % of Chinese furniture companies are not state owned; there is a diversified range of ownership types, including foreign owned, domestic Chinese privately owned, stock-holding companies, as well as various joint ventures (Cao et al., 2004).

The Chinese furniture industry is mainly distributed in four regions from south to north along the east coastline, with the south by far the busiest region. Together, the four regions contributed 90 % of the industry's total shipments and more than 80 % of export shipments in 2003 (Cao et al., 2004).

Guangzhou, Shanghai, and Beijing are traditionally considered to be the top target markets in China for high-end products because of their heavy concentration of middle-class consumers. Other markets are also rapidly emerging. The growth of the furniture market in China is expected to continue over the next years . In particular, in the 5 years through the end of 2014, the Chinese furniture industry was expected to grow at an annualized rate of 22.2 % to $20.2 billion (Ibis World, 2014).

3.3 Competitors

In the Chinese market IKEA has to compete with a number of rivals both local and international. According to Wen, BQ, OBI and HOLA appear to be the strongest international rivals but the competition from local players is increasingly growing (Wei & Zou, 2007).

3.3.1 Hola

Hola, a brand from Taiwan, entered the market in 2004 and presents a lower expansion, in terms of density of stores in each city. However, its growth has been incredibly rapid and it has already 11 stores in mainland China in 2005. Hola chose to enter big shopping malls in the city centre, starting from Shanghai Bailian Xijiao Shopping Mall, instead of purchasing a place to build its own stores in order to benefit from high flows of visitors. In order to achieve competitive advantage, Hola focused on a strategy based on continuous product innovation, shortening the period of new product updates, accelerating the speed of design creation and expanding products' range on a regular basis.

3.3.2 B&Q

B&Q is a British furniture-company that has become one of the market-leader in China. From the opening of its first store in China in 1999 B&Q has developed a strong brand awareness and try to differentiate from competitors providing innovative services for customers. These include design and decoration services, installation services for kitchen and bathrooms and wall painting services for the Chinese apartments. The main objective is helping customers transform their houses through stylish and innovative solutions. The key to B&Q success depends also on wide range of stylish products in line with Chinese preferences for furnishing solutions with low price, good quality and innovative style.

3.3.3 OBI

OBI is a German furnishing company. It entered China in 2000 investing more than RMB 1.22 billion. AS B&Q, OBI sells furniture as well as decorating materials with high quality and reasonable prices. OBI possesses a sophisticated logistic system and advanced purchasing and distribution networks in China. However, as BQ, OBI can be considered more as a furniture "supermarket" store. It in fact purchased ready-made products only and is not involved in products' design or manufacturing.

3.3.4 Qumei Group

Qumei Group is the largest wooden furniture producer in China. Founded in 1987, Qumei Group had a wholly owned subsidiary dealing with sales and distribution, and two joint ventures with European firms for designing and manufacturing furniture. In China, Qumei is popular, especially among upper- and middle-income consumers thanks to its high quality products.

3.3.5 Markor Furniture International

Markor Furniture International Co., one of the largest furniture exporters in China, created its own brand in the country in 2002. The company established a partnership with Ethan Allen, to introduce the advanced international chain store management model of the biggest furniture retailer in the United States, and start its expansion in the country. As for 2004, Markor opened 30 stores in large and medium-sized cities including Beijing, Shanghai, Tianjin, Hangzhou, Suzhou, Ningbo, Dalian, Chengdu, Chongqing, Wuhan, Shenzhen, Guangzhou, Xiamen, Shenyang and Urumqi etc. Thanks to its products' exclusive design, stylish shopping area and high-quality services, Markor is becoming extremely popular among the middle class in large and medium-sized cities.

3.3.6 Royal Furniture

Royal Furniture mainly produces high-end civil furniture products. The company has one the highest output and sales volume among furniture companies in China and it has built a strong distribution network. In addition to 100-plus regular chain stores in major medium and large cities of China, Royal brand has more than 3000 licensed stores.

3.3.7 Chengdu QuanU furniture Co

Chengdu QuanU furniture Co., Ltd is one of the largest large-scale board furniture enterprises in China, integrating research, development, production and marketing. Established in 1986, QuanU furniture set up 20 workshops, one R&D center and marketing center, 20 offices in other provinces or cities, hundreds of distributors, over 1000 exclusive stores. QuanU products range includes more than 30 categories and 200 different styles (see Figs. 5 and 6).

Product Category - Retail Channels	Home Improvement Products	Home furniture
Specialty Stores	Beyond, Fuannai, Mercury, Violet, Veken	Quanyou, Huafeng, Red Apple, Qumei, Huari, Royale, M&Z, LandBOND, Marlor
Furniture marts	IKEA, Hola, Home Depot, B&Q, Illinoi	
Mono-brand furniture malls	EasyHome, HOBA, Yuexing Furniture, JSWB, Red Star Macaline	

Fig. 5 Major retail channels for home products in China. *Source*: Adapted from Li & Fung Research Centre (http://www.funggroup.com)

Brand	HQ	Retail stores	Business Scope	Future strategy
Quanyou	Sichuan, China	3000 POS	Design, production, retail distribution	Teaming with worldwide designers; 3 innovation centres in Chengdu, Shenzhen, Italy
Qumei	Beijing, China	600 POS	Design, production, retail distribution	Alliances with local and international designers; positioning as Original design of Europe
Red Apple	Hong Kong	n.a.	Design, production, retail distribution	Investments on new technologies and equipments
Huafeng	Dalian, China	200 POS	Production, retail distribution	
LANDBOND	Guangdong, China	1000 POS	Production, retail distribution	Pruduct differentiation (original design)
M&Z	Chengdu, China	700 POS	Design, production, retail distribution	Focus on quality (adoption of german production techniques and design)
Royale Furniture	Hong Kong	1723 POS	Production, retail distribution	Stores expansion
Markor	Shanghai, China	n.a.	Design, production, retail distribution	Stores expansion

Fig. 6 Major players in the Chinese retail market. *Source*: Adapted from Li & Fung Research Centre (http://www.funggroup.com)

4 IKEA Enters the Chinese Market

4.1 A Difficult Choice

In spite of the difficulties of entering the Chinese market, Ian Duffy was sure that establishing its presence in China was a necessary step in IKEA's global expansion. During one of the meeting with his staff he said:

"The opportunity for profit in China is huge. The Chinese market has been growing steadily in the last three decades. The GDP is expected to grow constantly in the next decades and Chinese consumers' buying power will increase significantly leading to an expansion of the middle class. More and more customers are searching for innovative solutions to furnish and decorate their houses and Western products have become more and more popular. I have therefore all the reasons to believe that IKEA can be successful in delivering its mission in the Chinese market. IKEA with its low- cost and well- designed solutions can offer the "many" in the Chinese market with the opportunity to realize their desire of having a Western lifestyle. However, in order to take advantage of such a positive economic environment we should move fast. We need to establish our presence in the market before our competitors."

Some of the other managers were, however, more sceptical about entering the Chinese market. One of them showed his concerns saying:

"China is not just another country in Europe. The Chinese market presents peculiarities and dynamics totally different from all the other markets we entered so far. Customers are very price sensitive and, as far as I know, they are not used to furniture solutions like the one provided by IKEA. Furnishing a house is more like a ritual for Chinese people. Long-lasting and high - quality solutions are therefore preferred. In addition, entering the Chinese market IKEA will be faced by the competition of local enterprises"

Ian replied saying:

"You are looking at the past, I am looking at the future. Things are changing in China. Customers' preferences are getting more and more similar to their Western counterparts. There is already a significant demand for Western products and this trend will continue in the following years. As far as competition is concerned, local competitors are very small and there is not currently a well-establish strong brand in the furniture market. At the same time, IKEA has already a strong network of suppliers in the country. I am aware of the risks involved but I am also aware that the financial reward at stake is far bigger. I know that we will have to go through a long and difficult path before establishing our presence in the market. Nevertheless, I am sure IKEA will become as successful in China as it is in the other markets."

The meeting lasted for hours, but at the end everyone was convinced that entering the Chinese market was worth taking a certain amount of risk.

4.2 Initial Position and Challenges

Once the decision of entering the market had been made, a number of points with regard to the business strategy to follow needed to be addressed.

Until that moment, IKEA's geographic expansion had followed a standard marketing strategy. IKEA's concept and marketing preposition remained the same in all the markets and only minor adjustments to products and advertising had been made. Such a strategy was in line with the mission of establishing a unique brand image and achieving alow-price, high quality position in the furniture market worldwide. Duffy was sure that following the replication strategy adopted so far IKEA would have been successful also in the Chinese market:

"The IKEA concept has evolved over more than 40 years as a result of a growth process based on continuous innovation and a strong and well defined corporate culture. Remaining faithful to our mission of improving the life of the many through low price and high quality solutions has been the key to expand globally and become the successful company we are today. The result today is a strong and tested concept that with some minor local adjustment has become famous worldwide. I therefore believe that the path followed till now will bring us to a strong success in the Chinese market. After a careful research of the market, it appears clear that Chinese customers are embracing consumption patterns very close to Western consumers."

One of the European country managers replied:

"I am aware of the undergoing changes in the Chinese market but I am still doubting about adopting a standardized strategy in China. Without any shade of doubt, Western values and lifestyles are becoming more and more popular, but China is a country with a totally different cultural heritage compared to the markets we entered so far. I therefore believe that we should adopt marketing strategies directly tailored to the Chinese customers' values and perceptions. I am afraid that only minor adjustments won't be enough. Don't get me wrong. I believe that IKEA concept is our strength and shouldn't be change but I am wondering if our concept will be able to deliver value also to the "many" in China. And anyway, who are "the many" in China? To which segment group IKEA's solutions will deliver the most value? And is our current position appropriate to the Chinese market? These are questions we should think of before implementing our marketing strategy."

But Duffy continued saying:

"I see your point and we have already thought about some adjustments to consider. However, the thing we should not forget is that our success depends on a unique business idea, a unique culture and our unique heritage. There should be only one IKEA and one culture all over the world. There are certain eternal truths that will never change. This is the starting point for all we do. The IKEA Concept is something that we will never adjust. We shall always offer the lowest price, we shall serve the manypeople. The many will be our target group also in China. We will start testing our concept in the main cities where western lifestyle are well established and gradually try to penetrate the market. A global approach is necessary; it is the key to maintain low prices through economies of scale and acquiring a big market share through brand awareness. The uniqueness of the IKEA concept and its homogenous application worldwide allowed us to build a strong brand recognized globally achieving competitive advantage. I am confident this will be the case also in China"

After several meetings, the managers finally decided that IKEA would have adopted a replication strategy also in China. The IKEA concept and the marketing mix adopted in the already established markets remained therefore the same. The only significant differences were minor products' adjustments and a different location of the stores. In fact, as most of Chinese consumers do not have access to cars, IKEA stores in China are located closer to city centers.

The adoption of a standard marketing strategy globally was justified in particular by the necessity to achieve economies of scales and accomplish IKEA mission of delivering low prices, high-quality products for the many by reducing costs. Such a strategy proved to be inadequate in China and demonstrated that, as Linda Xu, Public Relation Manager of IKEA China, remarked, "many take-for-granted practices elsewhere may be impossible in China".

4.2.1 Pricing

The main challenge IKEA faced in the Chinese market was implementing an effective pricing strategy. Low prices are the cornerstone of IKEA's vision and its business concept. However, IKEA's prices were not considered low by the middle-class Chinese customers, IKEA's main target segment. Chinese customers' purchase power was in fact significant lower than that of their counterparts in developed countries. IKEA products were, consequently, not affordable to the vast majority of Chinese customers. Even if a significant portion of Chinese customers, particularly the younger generations, were attracted by IKEA's innovative solutions, symbols of Western lifestyles, they were simply not able to buy them.

IKEA "low" price and essential products were also not in line with the consumption patterns of the Chinese upper classes that were more inclined to buy foreign products as a symbol of status and not for their functionality. In such a market where foreign brands were seen as aspirational brands and low prices were the rule for everyday-life products, IKEA positioning and pricing strategy seemed unable to create value to its target group. Furthermore, the IKEA concept based on the value for money proposition was completely alien to the Chinese traditional culture. As the Chinese proverb *haohuobupianyipianyimeihaohuo* (high quality goods are not cheap, and the cheap goods are not high quality) suggests, in the Chinese consumers' view, low prices are often associated to low quality. This cultural aspect caused resistance to IKEA products mainly among older generations. In addition, IKEA was subject to a strong pressure by local producers of furniture. Local competitors were in fact offering furniture solutions of similar quality at significant lower prices. A sofa sold at RMB 3299 in IKEA was priced around RMB 1800–2500 in a regular local store, such as the Orient Home or the Third Ring furniture in Beijng, or the Jinhaima furniture chain stores in Shanghai and Guangzhou.

High pressure from competitors' lower prices coupled with high import tariffs made it even more difficult for IKEA to decrease significantly its costs. As a consequence, finding an adequate price to reach a substantial target group and become profitable appeared to be a difficult goal to achieve.

4.2.2 Targeting–Positioning

The poor result achieved in the Chinese market in the first year forced IKEA's manager to reconsider the marketing strategy adopted so far. According to Duffy, the main problem in the Chinese market was the inadequate pricing strategy adopted. Reducing prices was therefore seen by Duffy as the only measure necessary to solve the problem. However, Linda Xu, Public Relation Manager of IKEA China, was convinced that the problem was far more complex. In her view, IKEA's poor performance was due to its lack of understanding of Chinese customers buying patterns and preferences.

"Before deciding if our pricing strategy is wrong or not I think we should understand what IKEA represents to Chinese customers and who is our target group." Linda said during one meeting. *"I believe that our main problem is a lack of understanding of the Chinese market and of its different segments. Customers are the starting point of all successful marketing strategies. If we want to change our current strategy successfully, we should first identify who are our customers and then find a profitable way to deliver them value. What we did was exactly the other*

way around. We just took for granted that there is only one formula right under every circumstance. We just assumed that the middle income segment in China and the middle class in developed countries are similar in terms of needs and consumption patterns while this is not the case."

Duffy seemed, however, reluctant to change drastically IKEA's strategy:

"I agree to a large extent but, again, there should be a balance between serving customers needs and building on our internal capabilities and culture and values. It is more a matter of knowing our strengths and foreseeing new opportunities that allow us to expand our market share and increase profitability. Our main goal is that of preserving our company identity and spread our concept worldwide while improving our financial performance. The starting point should always be the IKEA' s concept. Customers will buy IKEA' s offering as a result of having correctly implemented the concept in the market. Hence, I do feel that pricing is our main issue right now."

Linda tried to get her point across explaining further her reasoning:

"*Considering the overall middle class an homogenous segment, without paying attention to different sub- groups, in particular in terms of age, prevented IKEA from identifying customers specific needs and implementing effective marketing strategies accordingly. As a result, IKEA had an unfocused position in the market. This creates confusion among the customers about what IKEA stands for. Our inadequate value proposition prevents us from achieving competitive advantage and beat our competitors. Pricing is certainly a problem but we can decide about our pricing strategy only after determining our target group and overall position in the market. IKEA' s products are not low-price in China. Our current position is not that of best- cost provider like in other markets. IKEA is perceived more as an aspirational brand, symbol of innovation and western lifestyles. Younger customers seem the more appealed by our concept and innovative design but they simply can' t buy our products."*

One of the other managers supported Linda's view:

"I *agree with Linda. We should first define a target and find a new positioning strategy. To be an aspirational brand for the already establish high quality luxury products target upper-middle classes. And what it is crucial to take into account are the differences between young and older generations. Young customers have shown to be more inclined to embrace western lifestyles. Their consumption of western product goes well beyond a symbol of status and is more about adopting a new way of life differentiating from the old generations and breaking with past tradition and culture. They are just in search for new way of self-expression and innovative and personal solutions to furnish their houses."*

4.3 Reviewing Marketing Strategies

At this stage, it was clear that IKEA needed urgently to change its positioning strategy and revise its pricing accordingly if it were to become profitable in China. The options available were different. Firstly, IKEA could maintain the position of best quality provider, trying to reduce its prices and become affordable to a wider section of the market. IKEA could also change completely its strategic position. In this case, IKEA could start offering higher quality, higher prices products targeting the high class. In this case IKEA should position itself more as luxury and aspirational brand. In making this decision, emerging trends should be taken into account as well as demographic difference in particular with respect to age. The main objective should however be that of identifying a defined target and formulate a new value proposition accordingly.

5 Real Solution Adopted

To become attractive to Chinese customers and boost sales, IKEA decided not to give up on its traditional concept of simplicity, functionality and low prices. IKEA continued to advocate its furniture philosophy to Chinese consumers, targeting the youngest members of the middle-class. This generation born during China's "One Child Policy" is in fact considered impulsive, easy to influence, very social, and committed to leading foreign consumer brands" (Wei & Zou, 2007).

Aware of emerging social trends among the youngest generation and of their willingness to embrace western values, IKEA focuses on innovation, encouraging customers to break with traditional values. As Ulf Smedberg, IKEA China marketing Manager, pointed out, the company kept promoting its home decoration values, including 'make good use of your space', 'simple is beautiful', and 'save money by doing it yourself' in an attempt to re-educate the youngest consumers to IKEA concept. IKEA tried to position itself as a company with an unique competence with regard to interior design, helping customers improving their own living space and encouraging self-expression and personal choices in decorating their houses.

The first step taken by IKEA in implementing its reviewed strategy was reducing prices to be included in the set of choice of its target group. Since 2000, IKEA has cut its prices by more than 60 %. One example is the price of its "Lack" table that has dropped to 39 Yuan from 120 Yuan when IKEA first came to the Chinese market (Hansegard, 2012).

According to Chinese business review, IKEA's China sales rose 35 % in 2003 after lowering prices nearly 10 %. Sales were up 50 % in the first three months of 2004 (Miller, 2004). To achieve such a massive price decrease, IKEA built a number of factories in China and increased local sourcing of materials. While globally 30 % of IKEA's range comes from China, about 65 % of the volume sales in the country come from local sourcing (Wei & Zou, 2007). This strategy reduced enormously production costs and resolved the problem of high import taxes. To save on repair costs and ensure high quality standards the company also started performing local quality inspections. IKEA plans to reduce prices further, helped by mass production and trimming supply chain costs. However, recent tensions with suppliers might represent an obstacle in achieving this goal.

5.1 Current Target Group

The second step was identifying a well-defined segment group in line with the company's capabilities and values. As IKEA focus in China are "the many people" of the growing urban population, open to western lifestyle and competing for living space in the mega-cities. People in needs of new and functional home furnishing solutions that IKEA is well-suited to serve.

Currently, IKEA main target group are middle- class people aged 25–35. IKEA's customers are generally better educated, earn higher incomes, travel more than the average Chinese and they often have families with children (Burt et al. 2011). Women represent 65 % of all customers. They are in fact the ones in the family making the actual purchase decisions about home furnishing. A typical IKEA customer earns about 3300 RMB per month–the national average is 1000 RMB and buys 300 RMB of merchandise per visit (China Business Review, 2004).

5.2 Advertising and Channel Branding

To reach Chinese customers and spread the company's values, IKEA had to use different communication vehicles and innovative ways. Apart from TV, newspaper, IKEA website and its famous catalogue, social media represent the privileged channel to reach IKEA target group. The youngest generations are in fact keen on interacting and sharing opinions on virtual platforms and searching and sharing information on the web. IKEA communicates in particular through micro blogs such as Weibo (Hansegard, 2012).

PR activities also play an important role in engaging customers and spreading IKEA's "non-traditional" values. A recent event hosted by IKEA was a traditional Swedish wedding for three couples in its Nanjing store. Another example of IKEA's creative marketing efforts is the decoration of the inside of elevators in 20 lower-income apartment buildings in Beijing to show residents how IKEA can make their small apartments modern and pleasant without spending much money.

IKEA's stores represent an additional effective marketing tool in the Chinese market. Chinese consumers consider IKEA's store not only a place to go shopping but also as a social area to share free moments. It is not uncommon to find sleeping in the beds and sofas or reading a book in the room settings. Even though the majority of visitors do not buy any product, the company encourages people to go in its store and enjoy the IKEA experience confident that they will soon turn into loyal customers. IKEA's store became so popular among Chinese people that Celia Hatton, a BBC journalist, defined them as "museums of modern inspiration of consumption for Chinese consumers eager to experience the Western lifestyle" (Hatton, 2013).

6 Results and Future Trends

After years of struggling in China, IKEA was finally able to generate a profit for the first time in 2012. IKEA sales increased by 21 % to 540 billion RMB, generating a profit of 6 billion RMB. The company became also the largest foreign commercial landowner in China with 15 million of visitors in their brick-and-mortar stores and 24 million online visitors (Marketing to China, 2012).

According to Patti Waldmeir, this financial result was due to the implementation of a 'glocal' strategy that enables the company to create value for customers and differentiating from the competition (Waldmeir, 2014). After the release of IKEA 2012 financial results, Mikeal Ohlsson, the CEO of IKEA Group, announced IKEA plans to further its expansion in China reaching a total of 40 stores in China by 2020. However, although IKEA has gained a strong position in the Chinese market the threats to overcome are several. Increasing pressure from local competitors, tension with local suppliers, ever-changing customers needs, the growth of e-commerce (e.g. TaoBao Mall, QuMai platform etc.) are only some of the potential threats that IKEA will have to face to stay successful. In such a competitive and complex market will IKEA succeed in maintaining the current position over time? And will IKEA's current "glocal" marketing strategy be sustainable in the future?

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China's Retailing Graveyard: A Case Study of TESCO

Pauline Cosijn

Case Synopsis

Research Problem

In the case of Tesco, had the retail company focused enough efforts in terms of building brand loyalty? Does it make sense to use a Chinese partner's brand? When it the right time to change to one's own brand, and how?

Case Summary

Many foreign firms have entered the Chinese retail market, lured by the prospect of a rapidly growing middle class. However, difficulties arise due to the inability of retailers to truly understand the country. In 2013, Tesco announced it would partner up with China Resource Enterprise (CRE), after the retailer had tried to crack the Chinese retail market for 9 consecutive years. The case follows a series of events that led to Tesco's eventual withdrawal from the Chinese retail market.

Learning Objectives

Understanding and finding the underlying risk factors that are associated with expanding business operations to foreign countries.

P. Cosijn (✉)
TIAS School for Business and Society, Utrecht, The Netherlands
e-mail: paulinecosijn@gmail.com

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Target Audience

Master students studying international business, marketing, and strategy with a special focus on China. Practitioners interested in key success factors in China.

Themes and Tools Used

- Brand loyalty/awareness
- Brand change
- International market expansion risks
- Joint ventures
- First mover advantage
- Entry speed
- Exit strategy

Questions

1. Had Tesco done enough in terms of building brand loyalty? What is the benefit for a company to create brand loyalty in the long-term?
2. Compared to its competitors Wal-Mart and Carrefour, Tesco entered China rather late? What do you think are the advantages and disadvantages of this decision?
3. What is the real reason for Tesco's failure in the Chinese market?
4. Why would Tesco decide to form a joint venture for entering the Chinese retail market? What are the advantages and disadvantages of this strategy?
5. What role do logistics play in establishing a retail chain in the Chinese market?

1 Introduction

To open a shop is easy; to keep it open is an art—Chinese proverb

20 July 2014—Philip Clarke was staring out of the window of his office. The moment he had heard the news that morning an enormous weight had been lifted off his shoulders. The day had started like any other until that board meeting at 11 o' clock. It was then that he was formally asked to resign from his position as Chief Executive. After 40 years his career at Tesco would abruptly come to an end. But back in his office, Clarke just could not understand why he was feeling so relieved.

One month earlier Tesco announced to turn its unprofitable operations in China into a state-run company. By doing so, the supermarket chain became the latest retailer to give up on cracking China on its own.

Besides relief Clarke felt somewhat powerless. He had just been given his second profit warning, and already was asked to leave the company—the company he had dedicated his life to for so many years. In trying to unravel the reason for Tesco's failure in China, Clarke started to think back to where the story of Tesco started and what the reasons for entering the Chinese retail market had been in the first place.

2 Tesco's History

When Jack Cohen started to sell groceries in London in 1919, Tesco started life. Five years later in 1924, the Tesco brand first appeared when he bought a shipment of tea from Mr T.E. Stockwell. The initials were combined to form the name Tesco. In 1929, Mr Cohen opened its first flagship store in Burnt Oak in the Northern part of London. The brand continued to grow in 1930 when Mr Cohen built a headquarters and warehouse. In 1932, Tesco became a private limited company.

Tesco quickly expanded as it started buying up rival shops. During the 1960s, the supermarket chain started to expand rapidly as it began to widen its product offering. Tesco revolutionized the way people managed their groceries in the UK. By the 1970s, it started with the building of a national store network to cover the whole of the UK. By 1979, total sales of the brand were £1bn, and by 1982 these numbers had doubled to more than £2bn.

In the 1990s, Tesco started an aggressive marketing campaign in an attempt to overtake Sainsbury's as the UK's leading grocery. In 1992, the company launched its slogan '*every little helps*', which was followed by the launch of the Tesco Club card scheme, which helped Tesco to overtake its biggest competitor in the retail market. In 1996, Tesco expanded overseas opening shops in Poland, the Czech Republic, and Slovakia and appointed Sir Terry Leahy as chief executive in 1997 (Clark, 2014).

In 2004, Tesco expanded operations to the world's fastest growing retail market—China -, by acquiring a £140 m stake in a Chinese hypermarket chain named Hymall. The joint venture agreement with Ting Hsin was part of Tesco's strategy to overtake Wal-Mart as the world's largest supermarket operator.

"China is one of the largest economies in the world with tremendous forecast growth and a market we have researched extensively over the last three years," said former chief executive Terry Leahy (Neville, 2013).

Tesco's move to China was expected as the company was already present in South Korea, Japan, Taiwan and Thailand. At that time, Tesco was operating in 13 countries worldwide.

3 The Retail Environment in China

China's 1.2 billion population has been of interest to many retailers and manufacturers of consumer products. Over the years, Chinese consumers started to afford better quality of life, which led to an increase in consumption of both necessary and luxury products (see Fig. 1). Average incomes rose, and Chinese citizens in urban areas started to earn an average annual income around £1.900.

Since 1978, the country achieved an average 9.9 % annual GDP growth, and the International Monetary Fund (IMF) forecasts the Chinese economy to surpass the US by 2016. Although growth projections are lower for the upcoming 5 years, the annual growth rate still outpaces other BRIC countries (see Fig. 2).

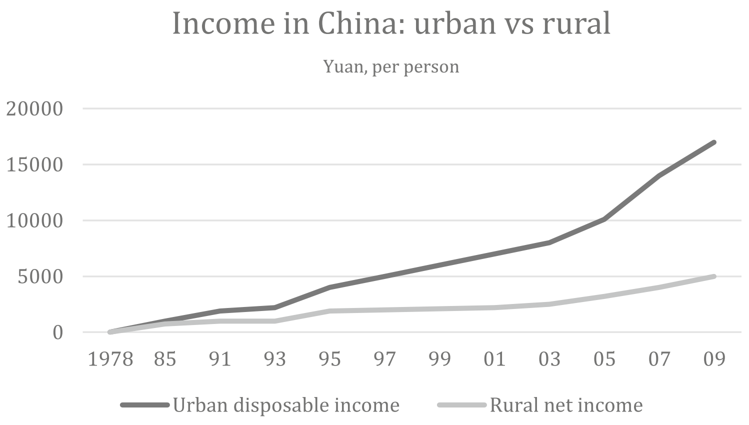

Fig. 1 Urban vs. rural disposable income. *Source*: Adapted from The Economist (2014) Currency: £1 = ¥9.55

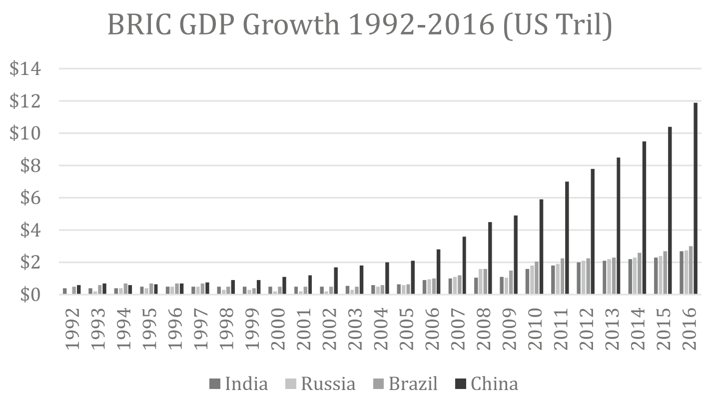

Fig. 2 GDP growth. *Source*: Adapted from Prudential Real Estate Investors (2012)

China lagged behind other BRIC countries with similar cultures in terms of household spending rates. Therefore, China still had significant unrealized upside potential. To get in line with Asian neighbors, household spending as a percentage of GDP could rise to around 50 % (see Fig. 3).

In the beginning of 1990, consumption patterns in China increased to a level where distribution could no longer meet local demand. This increase incentivized the development of new supermarkets. In the search for globalization, many Western and Asian retailers explored opportunities in China in the hope of capturing market share. The predominant retailers were often owned and operated by state-owned enterprises. Chinese shoppers however, had recently gained interest in foreign and smaller-format retailers (see Fig. 4).

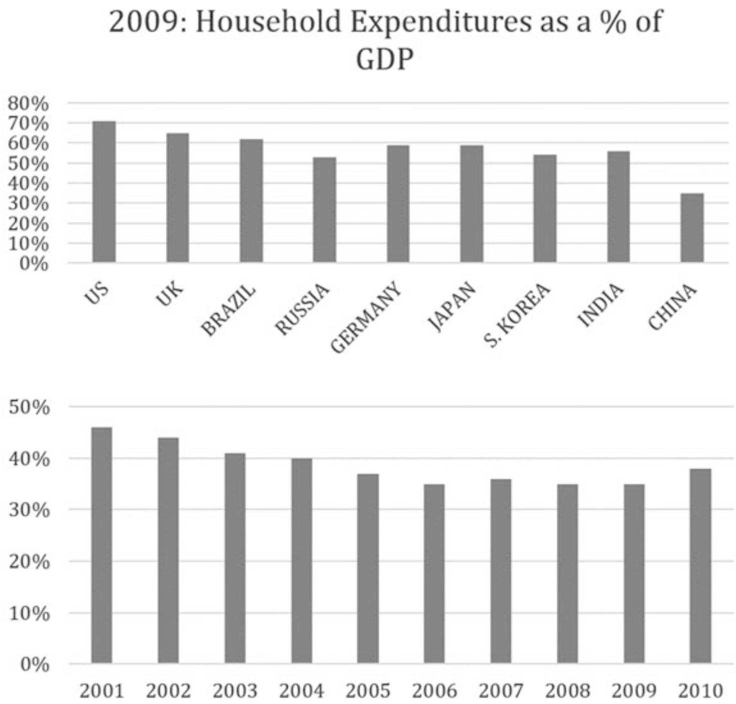

Fig. 3 Household expenditures. *Source*: Adapted from Prudential Real Estate Investors (2012)

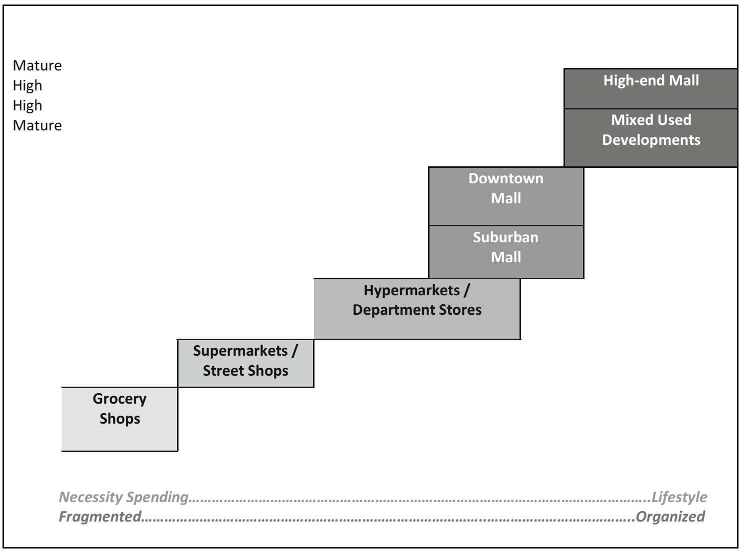

Fig. 4 Timeline of changes in Chinese retail formats. *Source*: Adapted from Prudential Real Estate Investors (2012)

As China was the second largest retail market, it was no wonder that some of the world's leading retail chains including Wal-Mart, Carrefour and Tesco were exploring the market. Wal-Mart and Carrefour entered China in the mid-1990s. Tesco, however, waited until the regulatory environment became more favorable in 2004.

4 Tesco's Expansion

Tesco made its move to enter China in 2004, buying a stake in local hypermarket operator Hymall, which operates under the company Ting Hsin. The following 2 years Tesco opened 5 new outlets under the Hymall name and launched its own-label products in China. In 2006, Tesco paid its partner, the Taiwanese retailer Ting Hsin, £180 m to boost its share in Chinese venture Hymall from 50 to 90 %. Since September 2004 Tesco held a 50 % stake in the venture. The newly adopted strategy is to conquer China on its own.

"*The deal, which is valued at around 180 million pounds, will allow the partnership to accelerate its growth in China whilst continuing to benefit from Ting Hsin's invaluable local knowledge*", Terry Leahy announced. "*We have seen exciting growth in China since announcing the joint venture two years ago and are looking forward to the partnership entering a new phase*" (Walsh, 2006).

"*Had we decided to enter the Chinese market on our own to soon*?" Philip Clarke thought to himself. In trying to pinpoint the moment where a wrong decision had been made, his thoughts paused for a moment. Clarke, who had not yet been appointed as chief executive, had watched from the sideline how Terry Leahy had made the decision to speed up the retail expansion. The reason for choosing a partner in the first place was to gain more knowledge of the retail market and consumer preferences. *"Perhaps we believed we had figured out the Chinese retail market too soon."*

When entering China, Tesco had taken a more conservative approach, compared to other retail competitors. The retail company only focused on the four main urban centers—Shanghai, Tianjin, Guangzhou and Beijing. By doing so it had a long way to catch up in terms of establishing brand awareness and loyalty, as the retail company had been hiding behind Hymall and its Happy Shopper logo.

This policy changed in September 2006, when the retail company announced it would introduce 500 products, including noodles, soap and napkins, under its own brand. Few British visitors would be able to recognize Tesco in China, as the merchandise could not have been more different from back home. In tradition of Asian wet market, the frogs, turtles, fish and silkworm grubs were freshly displayed (The Guardian, 2013).

In January 2007, the first store operating under the Tesco name opened, in order to start developing brand awareness. The store, in Beijing, added to the total of 46 stores in the North, South and East region of the country (see Fig. 5 for a map of China). The company set out plans to open ten stores a year under the Tesco name. In February 2011, the retailer signed a joint venture to build three more shopping

Fig. 5 Map of China. *Source*: CIA The World Factbook https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html [accessed 18 December, 2014]

malls. Later that year Tesco's full-year results showed an increase in sales with 5 %, but local operations failed to break-even in the second half of the year. Newly appointed Chief Executive Philip Clarke announced that Tesco would reduce its numbers of store openings in the country. He further mentioned that it had been more difficult than expected to get prime locations.

In April 2012, the retailer announced its full-year results for 2012. Tesco reported a 4.1 % increase in sales in China. The retailer mentioned it has taken *"a more cautious stance"* on China, because of *"persistently high inflation"* and pressure on wag costs. By 2012, the retailer announced closure of four of its hypermarkets in China as it struggled with that it called the "challenging" environment in the country. Analysts argue whether the company had done enough in terms of building brand loyalty (Tesco Annual Report, 2012). In April 2013, the retailer's annual numbers showed it sales had fallen 1.1 %.

"We still see an excess amount of new space being opened in the market—ahead of customer demand—and we have moderated our pace of development accordingly. We opened just 12 new stores this year and closed five underperforming stores as part of our increased focus on our three strongest regions. China remains a strategically important market for Tesco," Philip Clark says. *"We will focus our efforts on establishing and then pursuing a profitable approach to growth"* (Thomas, 2013).

In May 2013, reports emerged that Tesco had been looking for a partner in China. Tesco at that time declined to comment. By June 2013 sales in China fell 4.9 % in the first quarter of Tesco's new financial year. Tesco said the whole sector had been affected by the bird flu outbreak and a food safety scare involving pork.

"China is a business we said we are going to focus much more on profitable sustainable growth," Clarke says.

In August 2013, Tesco confirmed it was in negotiations to merge its Chinese operations with local retailer China Resource Enterprise (CRE) (CBR, 2013), which is the subsidiary and listed company of China Resource Holdings. CRE focuses on retailing, beverage, food processing and distribution.

5 Consecutive Setbacks

In 2013, Tesco announced it was in talks to team up with China Resources Enterprise Ltd (CRE), a move that followed decisions to abandon the United States and Japan and focus on investing in its British home market.

Later that year, Tesco finalized the deal with CRE in order to create the largest food retailer in China. The joint venture would combine Tesco's 131 outlets in the country with CRE's almost 3000 stores. CRE would own 80 % of the new chain and Tesco would be left with 20 %. Tesco believed the merger would create combined sales of around 10bn. But the deal left a question mark over the future of the Tesco brand in China and would bring an end to the group's independent business in one of the world's fastest growing retail markets.

"The partnership creates a strong platform in one of the world's largest markets", Tesco chief executive Philip Clarke announced in a statement."We can now combine our strengths to build a profitable multichannel business, offering our customers in China the best of modern retail."

Although Tesco claimed the merger followed a series of joint ventures struck between CRE and other multinational companies, it was seen as retrenchment strategy after declining sales. Retail analysts noted that the decision actually meant that Tesco had surrendered itself and was giving up, portraying the difficulty of foreign companies' experience in negotiating with suppliers and regulators in fast-growing risky markets.

The partnership would mean that the brand was left with a minority share in the partnership, and some analysts believe this option was the most favorable for the company. *"Tesco finally finds a big giant to salvage them"*, said Kenny Wu, an analyst at Society General Ji-Asian Hong Kong. One Hong-Kong based M&A banker told Reuters that Tesco, like France's Carrefour, was eager to address the problems in its own home market.

"*Tesco has been struggling in China and has been losing money. This may look win-win, but in reality, Tesco is saying: "I can't figure out China,"* he said (Parry, 2013).

Tesco is not alone in its inability to become successful in China. Earlier in 2013, media reported that global retail giants Wal-Mart and Carrefour were closing several of their underperforming stores in China. The question arises just why so many Western retail giants have struggled to succeed in China? If global retailers like Wal-Mart, Carrefour and Tesco are struggling, what hope is there for the rest? What were the mistakes made by Tesco in China? And what strategies are there for retailers to become successful in China?

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Part IV

Fashion, Luxury, and Play

Take the Opportunity to Pilfer a Goat: Lessons from Gieves & Hawkes

Klaus Heine, Katharina Kübrich, and Jaihak Chung

Case Synopsis

Research Problem

How can Western small and medium-sized luxury brands expand in China?

Case Summary

At the beginning of the 1990s the first wave of big Western luxury houses entered the Chinese market. This marks the absolute ground zero of Western luxury brands in China when even big names such as Chanel or Rolex were virtually unknown. After not much more than two decades, China is now considered as the world's most important luxury market, which naturally attracts attention from almost any luxury player worldwide. Currently there is a new wave of expansion into the Chinese luxury market led by Western small and medium-sized enterprises (SME), who expect the market to be increasingly open for their connoisseur products. A prime example of such a luxury SME expanding to China is Gieves & Hawkes (G&H), a time-honored British bespoke gentleman's tailor. G&H 's China expansion marked a turning point in their history—not because it did not work out, but because they were by far more successful than expected. As a market entrance strategy they decided to work with a Chinese distributor. They selected the Hong

K. Heine (✉)
EMLYON Business School, Shanghai, China
e-mail: heine@em-lyon.com

K. Kübrich
Berlin Institute of Technology, Berlin, Germany

J. Chung
Sogang University, Seoul, South Korea

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Kong-based company Trinity Limited, who introduced the brand to the Mainland in 2006. In 2012 Trinity already operated about 100 G&H boutiques in China—while there were only about a dozen loss-making stores in the UK. G&H's China adventures took a surprising turn: As the distributor became so successful, it could even afford to take over the British parent company. Keen to grow further, they then started to open new stores in more remote Chinese cities and to extend their product range in other categories and with more affordable products for the aspiring Chinese middle-class. They also took into account the changing consumer preferences towards sophistication and connoisseurship, for instance, by emphasizing the British heritage and by developing a prestigious new store concept. However, it remains open in how far their growth objectives are compatible with the changing consumer preferences. A central question for G&H is: How can they manage the trade-off between growth and exclusivity to ensure a successful development of their brand in China and beyond?

Learning Objectives

Working on this case study will show students how to

- Plan a market entrance strategy into the Chinese luxury market
- Analyze the (changing) preferences of Chinese luxury consumers
- Adopt branding and marketing-mix to the luxury segment
- Analyze the key success factors for luxury brand management in China

Themes and Tools Used

- Strategy formulation and implementation
- International market entrance strategies
- SWOT
- Luxury brand management
- Marketing-mix

Target Audience

Students with basic knowledge of strategic analysis and consumer behavior. Case can be used for classes about international marketing, strategy, luxury marketing or China-related issues.

1 Introduction: The Chinese Luxury Market

At the beginning of the 1990s the first wave of big Western luxury houses entered the Chinese market. This marks the absolute ground zero of Western luxury brands in China when even big names such as Chanel or Rolex were virtually unknown. After not much more than two decades, China is now considered as the *world's most important and influential luxury market* by many luxury companies and experts (KPMG, 2013), which naturally attracts attention from almost any luxury player worldwide.

Today the Chinese luxury market stands at the beginning of a new era, which relies on some interrelated trends: As the Chinese government aims at increasing the country's share of value-added in the global production chain, the cultural and creative sector was elevated to superior status in the national economy in their recent 5-year Plan. This plan is thoroughly implemented, for instance, by the Shanghai Creative Industries Association, which actively sets-up and supports creative industry spaces. As a result, China is shifting its economic orientation from low-end production to *higher-end and creative industries* (Wuwei, 2011).

Another recent development is China's New Cultural Revolution: Luxury was and still is highly associated with Western culture, and therefore Western luxury brands were generally perceived as being more luxurious and prestigious. The "young emperors", the generation born after 1978, is driving the "sinofication" trend and will change the Chinese luxury market. They represent the best educated, most confident, but also the most self-centered and ambitious among all living generations in China (Hedrick-Wong, 2007). They are increasingly comfortable with Chinese culture and tradition and much more receptive to Chinese luxury brands. As this is a typical evolution of luxury consumers, the "nouveau riche" attitude of new and inexperienced consumers will be progressively replaced by a more sophisticated and discrete style (Han, Nunes, & Drèze, 2010).

The development of a new creative class is reflected by the wave of Western small and medium-sized enterprises (SME) currently expanding into the Chinese luxury market as they expect the market to be ready for their connoisseur products in the next three to five years. A prime example of a luxury SME expanding to China is Gieves & Hawkes (G&H), a time-honored British bespoke gentleman's tailor.

2 Market Entrance of Gieves & Hawkes in China

G&H's expansion to China marked a turning point in their history—not because it did not work out, but because they were by far more successful than expected. As a market entrance strategy they decided to cooperate with a Chinese distributor. They selected the Hong Kong-based company Trinity, who introduced the brand to the Mainland in 2006. In 2012, Trinity already operated about 100 G&H boutiques in China, while at the same time, G&H operated only around a dozen stores in its home market. This led to a surprising turn in G&H's China adventures: As the distributor developed so successfully, it could even afford to take over the British parent company.

In May 2012, Trinity paid £ 32.5 million (about € 27 million) initially and additionally agreed to pay up to £ 60 million (about € 50 million) over 18 years depending on the achievement of growth targets for the brand (Jones, 2013). So they had a reverse journey compared to most luxury businesses: they did not rely on a strong business in the home market, but had built up their success at first in China (KPMG, 2013). Trinity's business tactics remind one of one of the 36 Chinese stratagems: "Take the Opportunity to Pilfer a Goat" (Shùn shǒu qiān yáng), which

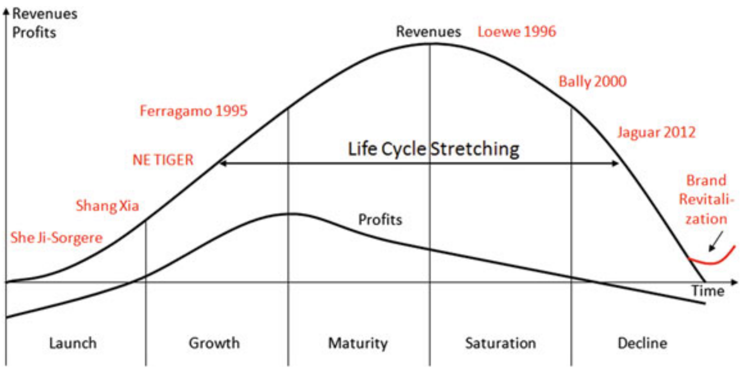

Fig. 1 The (Luxury) brand lifecycle. *Source*: Adapted from Chevalier and Mazzalovo (2008)

suggests remaining flexible while carrying out a plan and taking advantage of any opportunity that comes up (Köster, 2009). In addition, Trinity's strategy reflects a new type of brand revitalization, which starts in China and then moves on with the brand's core market (see Fig. 1).

3 Trinity & Mr. Fung

At the beginning of the 1990s high-end department stores, luxury malls or other luxury business infrastructure did not exist in China. As a consequence, a peculiarity of the Chinese luxury market is, in contrast to Europe, that *luxury distributors developed to become powerful players*. Many of them have the potential and the desire to create their own luxury brands in China. As shown in Fig. 2, distributors reflect one of the key players attempting to create Chinese luxury brands (which we focus on with this chapter). Currently they are competing in finding hidden connoisseur brands in Europe, which they can bring to the Chinese market. Distributors often specialize in a specific category, for instance, Bluebell Group (in lifestyle products), ImagineX (fashion), Sparkle Roll Group (automobiles and jewelry) and Trinity (high-end to luxury menswear).

Trinity is part of *Fung Holdings* Limited, a privately held multi-billion Euro business headquartered in Hong Kong, which has shares in various companies engaged in trading, logistics, distribution and retailing. Most notably, it is a major shareholder of publicly listed Li & Fung Group, one of the biggest global sourcing companies specializing in garments. Victor and William Fung, the founder's grandsons—also known as "the Fung brothers"—control big parts of the Fung businesses. Victor Fung is also chairman of the Trinity group and already accustomed to exceptional growth rates of its businesses. Trinity *manages international menswear brands in Greater China* that they either own or operate under long-term licenses. In 2013, the group operated 450 retail stores in Greater China, of which 369 stores were in the Mainland (Trinity, 2012). Before the takeover of the British parent company, *Victor Fung visited the brand's flagship store* in London for some

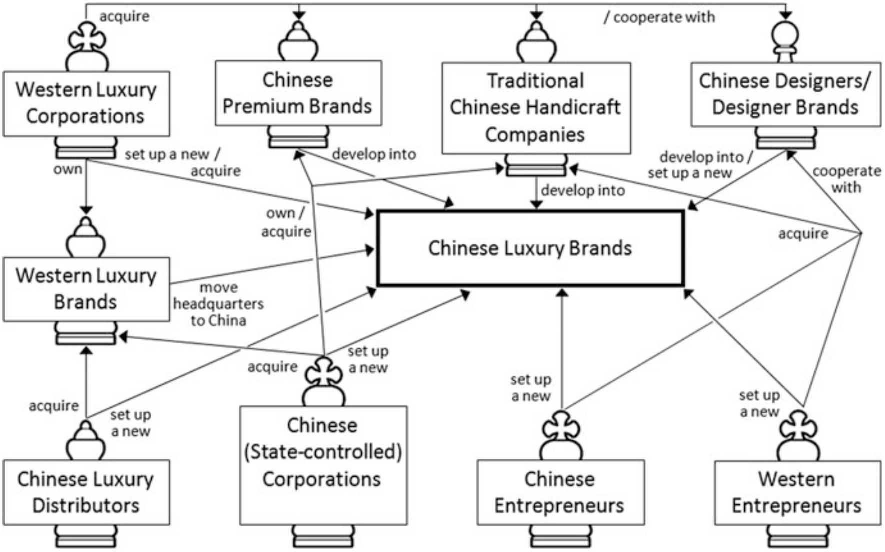

Fig. 2 Creating Chinese luxury brands: major players and strategies. *Source*: Authors

(test) shopping. Staff realized who their visitor was and invited him for a tour of the premises, which are packed with history, culture and myth. Fung was convinced he had discovered a hidden gem (The Sunday Times, 2013). His managing director, Sunny Wong, thinks so, too: "Premium heritage brands such as Gieves & Hawkes are rare jewels and change hands infrequently" (Steiner, 2012).

Besides G&H, Trinity has also *acquired another British menswear brand*, Kent & Curwen, and the Paris-based brand Cerruti 1881. Wong further explains the business model: "We spent several years transforming our original export business into a high-end retailer operation. To do this, we exited our profitable export business which included disposing of factories in China, in order to focus on our key brands" (KPMG, 2013).

4 History of G&H: From Thomas Hawkes to Ray Clacher

The roots of G&H can be traced back to 1771 when Thomas Hawkes established his cap brand and later became the outfitter of the British Army. Gieves, nicknamed Thieves because of its high prices, was founded in 1785 to provide the Royal Navy with uniforms. In 1974, Gieves and Hawkes merged to make both military and business suits. The new company moved to No.1 Savile Row in London, a famous street for bespoke tailoring of menswear, where it remains operating its flagship store. The basement still hosts a team of coat-makers, trouser-stitchers and tailors and upstairs is a treasure trove of old uniforms, ceremonial outfits and memorabilia: handwritten orders from royalties such as the Duke of Wellington and clothes worn by iconic people such as Admiral Nelson and Princess Diana. G&H holds three royal warrants appointed by the Queen, the Duke of Edinburgh and the Prince of Wales (Trinity, 2012).

Despite its proud history, the British business *had not made profits since 2005*, due to the slowdown of the economy and changing consumer preferences in the UK. The long-term decline of the traditional tailoring market went along with an increasingly casual lifestyle and the emergence of more fashionable competitors such as Armani and Hugo Boss. In the most recently published financial report for the fiscal year ending December 2010, the company reports revenues of £ 15.6 million (about € 19 million) and a loss of £ 2.5 million (about € 3 million). Since then, Trinity does not break down the sales and profit figures for their individual brands. However, according to industry sources, the brand's performance has improved markedly since then (Jones, 2013). In its brand lifecycle, G&H had clearly reached the stage of decline in its home market (see Fig. 1).

Keen to revitalize the brand, Fung was looking out for a new managing director and finally *promoted Ray Clacher,* who had driven the tailor's rapid growth in China and originally signed the licensing deal with Trinity. As The Sunday Times (2013) puts it charmingly: "Thick-set, garrulous and open, he is not the patrician gentleman who would have been running the company a generation ago." After rising through the trainee scheme of Marks & Spencer, Clacher had earned his spurs at Littlewoods, House of Fraser and Benetton before he had joined G&H in 2002.

5 Brand Revitalization

With Mr. Fung at the helm, Clacher aims pushing profitability and further growth: "We're on the ground floor of every major shopping centre in China. It should be like that in the rest of the world" (Robinson, 2013). At the same time, he has to make sure that G&H meets the general luxury criteria: Luxury brands are regarded as images in the minds of consumers that comprise associations about a high level of price, quality, aesthetics, rarity, extraordinariness and a high degree of non-functional associations (Heine, 2013). Clacher tries to manage the trade-off between high growth rates and exclusivity with his brand revitalization strategies (see Fig. 1):

- **Democratization of G&H**: By increasing the accessibility of the brand's offerings in China and worldwide, Clacher wants to exploit the purchasing power of the middle-class: "I want to win the hearts and minds of the middle class. Clothing is all fast-fashion throwaway now, but I still think there are those people—doctors, bankers, lawyers, city boys—who want to invest in a label and feel like it's going to last. We can't just remain this lovely unpolished diamond that nobody knows about in Savile Row. We want to open it up to the world" (The Sunday Times, 2013). McKinsey expects the Chinese upper middle class segment with household incomes of RMB 106,000 to 229,000 (about € 88,000 to 190,000) to become the principal engine of (luxury) consumer spending over the next decade: Between 2012 and 2022 they expect the share of upper middle class on urban households to grow from just 14 % to 54 %. Compared with the four tier-one cities, Beijing, Shanghai, Guangzhou, and Shenzhen, middle-class growth rates will be far greater in smaller cities of the north and west (McKinsey/Barton, Chen & Jin, 2013).

- **Strengthening the British country-of-origin image**: Clacher intends to further strengthening the British brand image. Therefore, the headquarter remains in London and substantial resources were invested in the renovation of the original company building at Savile Row. Clacher also decided to increase the share of British-made products: "23% is already made in the UK, but we need more good British factories. They are there, we just need to find them and work with them. We want to be a sustainable company that's 100% made in the UK." On the other hand, the company owners are now Chinese and the center of major strategic decisions and operations shifted to China, which remains also by far the company's biggest market with a great majority of the stores.
- **Becoming an international lifestyle brand**: Clacher aims to shift the brand from a venerable and traditional menswear label to an international luxury lifestyle brand. However, the new creative director Jason Basmajian, an American who had worked before joining G&H for Donna Karen, Calvin Klein and Brioni, needs to balance between the traditional origins in terms of very high-quality tailoring, and modern customer needs for stylish fashion—to create an "international brand with a British accent" (Neel, 2013). Basmajian's target is to develop a cross-generational brand that appeals to father, grandfather and son: "I want it to attract the 25-year-old without alienating the 65-year-old" (Zhang, 2013).

The revitalization strategies are reflected in the marketing mix described below.

6 Development of G&H's Price and Product Strategy

6.1 Trading Up and Down

G&H offers bespoke tailoring in China with suits starting at RMB 20,000 RMB (about € 2400); a bespoke suit takes nearly 2 months to complete. Ready-to-wear suits start at RMB 4300 (about € 520). G&H decided to stretch its price range by offering more expensive and also more accessible products. For instance, the average price for a wool jacket is about RMB 3000 (about €360) and goes up to RMB 12,000 (about € 1500) for a cashmere jacket (Au, 2013). The zenith of luxury is a suit made of Vicuna cloths for about RMB 250,000 (about € 30,000). However, Clacher resumes "China is not the straightforward cash cow that it was" (Marian, 2013). With rising experience and sophistication, consumers are increasingly critical, request more information about the products and question the reasonability prices (McKinsey/Barton, Chen & Jin, 2013). Especially in China, based on Confucian values, consumers are generally considered as price-conscious and bargain hunters. Thus, Clacher believes that prices, even for luxury products, have to be justified by special features or benefits. In addition, he decided to offer discounts to loyal customers. As a subsidiary of the sourcing giant Fung, obtaining the best raw materials for a good price is not an issue. Clacher explains: “Trinity has clear advantages in terms of supply chain expertise. We can now find the best vendor, leverage on the scale of the business and get the best prices. We couldn’t do that before with just 14 stores in the UK” (Au, 2013). Besides the vertical differentiation, Clacher plans to stimulate further growth also with brand extensions into various other fashion categories including leather goods, shoes, sportswear, outwear, knitwear, watches, fragrances and eyewear (Zhang, 2013). For this purpose, he believes that licensing is not an adequate approach, potentially only for non-core categories such as fragrances and eyewear (Neel, 2013).

6.2 Adapting Products to Chinese Taste

Based on the company’s origin, the style of suits is inspired from equestrian dresses and military uniforms. Hence, they have a straight and robust design with firm shoulders and buttons not far above the stomach. However, according to Clacher, “Asians tend not to like their suits too pinched, so we let out the arm holes, take out the waist and increase the shoulder line”. To fulfill the specific requirements of the Asian local markets a specialized design team was built up in Hong Kong (Au, 2013). Thus, the product portfolio for suits now ranges from regimental uniforms for members of the British royal family to three-piece suits for trendy businessmen. Chinese taste further impacts the product portfolio: Some products such as cufflinks and double-cuff shirts are popular in Britain, but in China and other emerging markets consumers favor more fashionable and casual lifestyle products. Therefore, G&H started selling fashionable chinos, cashmere jackets and lumberjack shirts in China (Conti, 2013).

6.3 From “Show-off” to “Way of Life”

The emergence of the creative class along with the constant (over) exposure of Chinese consumers to luxury brands led to some “logo fatigue”. In contrast to “mass luxury”, there is a trend towards more sophisticated connoisseur brands that offer unique and high quality luxury—(Bain, 2013). This development reflects also the typical evolution of luxury markets from “show-off” to the “way of life” (or “in the know”) phase that was observed in more mature Asian economies such as Singapore (Chadha & Husband, 2006). This trend is additionally driven by the new anti-corruption legislation (Bain, 2012). China has a gift-giving culture: especially between businessmen and government officials it was prevalent practice to exchange luxurious gifts (Hurun, 2014). This is seen as a wise investment—and from many also as bribery. Therefore, the Chinese government attempted to limit this practice by enacting several anti-corruption campaigns since 2011. On the one hand, this had a negative impact on luxury sales, in particular on traditional gift categories such as watches and menswear (Bain, 2013; Forbes, 2014). On the other hand, this fuels the trend towards more understated and subtle luxury. In addition, it drove the popularity of Chinese luxury brands, which are also pushed by the current first lady, Peng Liyuan, who is often seen in public wearing fashionable Chinese luxury items (Jing Daily, 2013).

7 Development of G&H's Distribution Strategy

7.1 Further Expansion Worldwide and in China

Besides the over 100 G&H boutiques in China, Trinity plans to introduce its British subsidiary company to the markets in America, Russia, and the Middle East and also to expand further in Asia, for instance to Singapore (Neel, 2013). In addition, G&H sees also much potential for further store development in Mainland China, especially in third and fourth tier cities (Uttam, 2013). Clacher observes that these regions develop quickly: "What we are finding more and more is that there is local expertise—great shopping mall owners, great distributors that we need to tap into". Currently already one-third of the G&H shops in China are located in three and four tier cities. Although it still takes in average five G&H stores in tier four cities to generate the same revenues as in a single store in a tier one city, the company believes that their investment will pay off in the future. Some initial evidence for the success of this strategy provides the store in Taiyuan, a fourth tier coal mining city in the south of Beijing, which is already one of the top five G&H stores worldwide by revenues (Marian, 2013).

7.2 Trend towards Non-domestic Luxury Spending

Due to the higher disposable income, travelling outside the Mainland is getting more and more popular for Chinese, which may influence luxury distribution strategies in China and abroad (Fung Business Intelligence Centre, 2013). KPMG (2013) reports that in 2012, 71 % of wealthy consumers were traveling overseas compared to just 53 % in 2008. Almost two-thirds of the respondents claimed to purchase luxury items during their trips (McKinsey/Barton, Chen & Jin, 2013). In total, about 60 % of luxury purchases by Chinese consumers are already made outside Mainland China (Forbes, 2014). This has a simple reason: in a study by the Chinese Ministry of Commerce prices of 20 luxury brands over various categories including apparel, leather goods, and watches, were in average between about 45% and up to even 72% higher in the Mainland compared with Hong Kong, the US and France, which is mainly due to higher taxes (Gutsatz, 2012). These price gaps helped a new e-commerce business model termed "daigou" to emerge, which refers to people who are "buying on behalf of others" (CIC, 2011). The service is provided on Internet platforms such as Taobao: people offer to buy luxury products abroad for the users and ship them then to them. Sunny Wong observed that "Mainland Chinese consumers see us on number 1 Savile Row" and that they orientate on what they see in foreign fashion capitals and the preferences of Western consumers.

Therefore, he believes that the brand requires a strategic presence in Europe and the US (Conti, 2013).

7.3 New Store Concept

The store at Savile Row is the model for the brand's stores throughout China. For instance, they house displays of vintage garments and photographs of the royal princes (Au, 2013). In July 2013 G&H opened its first street-level store in Hong Kong on Ice House Street, a 1351 square-foot space, after already having four other points of sale in Hong Kong (Zhang, 2013). Besides references to Savile Row, this new store also adapts to China-specific consumer preferences: it is designed like a men's club with grey flannel-covered walls and handcrafted bronze installations (Uttam, 2013), it provides clients a space for meetings or other events and offers concierge service, a whiskey and cocktail bar and a working fireplace for creating a "domestic" feeling (Conti, 2013). The new store concept also reflects the relevance of in-store experience for Chinese luxury consumers, who expect maximum respect, attention and personalized services. Wong further explains the concept: "Menswear relies mainly on repeat business; therefore we offer our loyal customers VIP service. We notice that our male customers in China tend to shop in groups—this is for a number of reasons, including gifting, use of their VIP cards and perhaps also an element of showing off. Many of our shops in Mainland China therefore have comfortable sitting areas where our customers can relax and take their time trying on and purchasing" (KPMG, 2013).

7.4 Contraction in the UK

Because of ongoing losses, the management considered closing down the outlets in the UK except the flagship store at Savile Row and to focus on the cash cows: Asia, America and the Middle East. They already shut down the store in Leeds and ended the concessions at House of Fraser, a British premium department store group. However, they decided to keep the remaining eleven British stores. Clacher explains: "The fact is that we have this business, it exists and it's so hard to build up a business like that. If you've got a store that's been in Chester for 50 years you've got to be barking mad to walk away from it" (The Sunday Times, 2013). Even when G&H extends its offerings with more accessible and fashionable products, not everyone is convinced that the British stores will return to profitability. Neil Saunders, a retail consultant, believes: "That will probably work well in London, but when you get to Bath the number of people wanting to buy these kinds of suits at these levels is relatively small." And Eric Musgrave, a fashion journalist, adds the fact that most of the people able to buy G&H suits would regularly pass through London anyway (The Sunday Times, 2013).

8 Development of G&H's Communication Strategy

8.1 Celebrity Marketing

Besides adverts in men's magazines, G&H agreed to a deal to dress Kevin Spacey for the American drama series "House of Cards" and aims at concluding similar agreements with English actors such as Eddie Redmayne. With celebrity endorsement G&H makes use of a widespread luxury-marketing tool in China. Basmajian observes that royalties exert a special fascination on Chinese consumers: "The idea of heritage and dynasty speaks culturally to the Chinese audience. They can understand that it's about quality and longevity" (Uttam, 2013). G&H is known for its illustrious clientele: Prince William wore a G&H suit for his engagement portrait, and the house has also dressed Sean Connery, David Beckham and former British Prime Minister Gordon Brown (Jones, 2013).

8.2 Improving Quality Perception by Ingredient Branding

Due to the danger of receiving fakes, missing quality control and uncertainty in the legal frameworks, Chinese consumers tend to lack trust in product quality (CIC, 2011). In a country that only recently started shifting its focus away from cheap mass-market production, consumers tend to be more suspicious and question the value-for-money of products and therefore refer especially to the value of their materials and components (Marian, 2013). To improve their consumers' quality perception, G&H makes use of ingredient branding by cooperating with Woolmark Gold. Woolmark is a not-for-profit organization owned by more than 27,000 Australian woolgrowers. They undertake marketing campaigns within the global textile and fashion industries to drive demand of Australian (Merino) wool and to improve brand awareness and image. This made Woolmark the world's best-known textile fibre brand providing consumers with an assurance of fibre content and quality. In 2012, they launched the luxury ingredient brand Woolmark Gold, which positions Merino wool as the prestigious fiber of choice in the rapidly growing Chinese luxury market. The Woolmark Gold label on a garment guarantees that it was made of Australian Merino wool and woven or spun by one of an elite group of accredited spinners and weavers. While Woolmark Gold aims to increase the preference for wool as a luxury product across Chinese consumers, G&H attempts to increase the quality perception of their products by ingredient branding. Clacher believes in this win-win cooperation: "Our company has a longstanding tradition of craftsmanship, selecting only the finest fabrics available in the world. The Chinese consumer demands the real thing and Woolmark Gold gives us a genuine seal of approval" (Woolmark, 2013). The cooperation is communicated by G&H window displays and the co-branded film "A Link through Time", shot by Oscar-nominated British director Mike Figgis, which showcases G&H's new Royal Line.

8.3 Cultural Events and Sponsoring

As a traditional British brand, G&H emphasizes its strong cultural capital in brand communication. For instance, they sponsored and dressed the Jerusalem Quartet during the International Chamber Music Festival in Hong Kong, "bringing together the worlds of style and performance" (Trinity, 2012). In addition, they launched the 2012 fall/winter collection in Beijing's popular gallery district "798ArtZone" and in March 2013, G&H opened a new store in Shanxi providing a "military uniform showcase and tuxedo presentation" (Trinity, 2012).

8.4 Social Media Engagement

The Fung Business Intelligence Centre (2013) found that 57 % of Chinese consumers regularly follow brands on social media sites, compared to only 38 % of consumers worldwide. Chinese consumers tend to pay great attention to online word-of-mouth before making final purchase decisions. Besides the information exchange, one of the most favorite actions in online discussion forums is showing off and commenting on already purchased luxury products. In general, topics that Chinese users are mostly interested in include the price of products, issues of style, celebrities, oversea purchases, advertisements, quality, service, counterfeits, designers, and brand history (CIC, 2011). Considering the relevance of digital marketing in China, G&H redesigned its website and launched various social media campaigns. For instance, they created a movie about: "How to get dressed in 90s", starring Jake Parkinson-Smith, a nightclub owner and friend of Prince William and Prince Harry (Conti, 2013). As Clacher plans to "get people talking", these movies and advertising campaigns are communicated on G&H's digital channels on Facebook (about 8600 followers in early 2014), Youtube and Twitter and on equivalent Chinese platforms including Kaixin, Youku, and Weibo (Neel, 2013). G&H also makes use of social channels to trumpet its royal connections and celebrity customers, for instance, with its recent Facebook posting: "Mr. Dermot O'Leary wearing a custom Gieves & Hawkes three piece suit at the National Television Awards" (Au, 2013).

9 Additional Questions

1. How do you evaluate the success of G&H's market entrance strategy in China, the cooperation with the distributor Trinity?
2. What are the opportunities and threats for the future development of G&H in the Chinese luxury market?
3. Discuss the strength and weaknesses of G&H's revitalization and marketing-mix strategies to manage the trade-off between growth and exclusivity. What recommendations can you put to G&H for its future progress in China?

4. Discuss the relevance of the British outlets for G&H's success in China. Should they keep the nation-wide retail network or concentrate on London?
5. In how far do the social media strategies "to get people talking" go with an exclusive British luxury brand?

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HTH's Exploration in China

Dong Bian

Case Synopsis

Research Problem

How does HTH conduct market research and how should it enter the market in China?

Case Summary

HTH is a high-end home furnishing fabrics "editor". Since it was a subsidiary of a global famous luxury group M, it benefited from M's production facilities: two printing mills and two weaving mills with the most advanced production lines, as well as the most traditional looms and frame printing lines. After producing its collections, HTH distributed these collections worldwide through building up a well-organized distribution structure composed of showrooms, sales teams, and franchised distributors. HTH's creations were very popular among many developed countries, such as France, UK, Germany, Italy, Spain, Switzerland, Belgium, Greece, USA, Canada, Australia and Japan, etc. HTH was esteemed as a luxury brand in the furnishing fabrics sector.

The financial crisis exploded in 2007 badly influenced the global luxury market, including the sector of the high-end furnishing fabrics. Yet, luxury consumption in the emerging economies, especially in China, kept growing in a relatively high speed. The management team of HTH realized that the demand was getting saturated in developed countries. They thought that it was time to explore the business in emerging economies, where the market demand grew rapidly. HTH

D. Bian (✉)
CAPA Shanghai, Shanghai, China
e-mail: dbian@capa.org

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made China their first trial. They planned to conduct a complete market research and then enter the market with effective and sustainable strategies.

Learning Objectives

The case was prepared for students to learn about market research, and how to formulate and implement a market entry strategy fitting the local environments. The objectives could be reached with the following details step by step:

- Understand the furnishing fabrics industry and the organization of HTH (business model, product portfolio and distribution structure in Western countries, etc.).
- Identify HTH's competitors and competitiveness, and get to know the market competition situation.
- Learn about Chinese consumers' preference on furnishing fabrics compared with Western consumers.
- Discuss the practical approaches to formulate and implement the market entry strategies.

Themes and Tools Used

- Market environment analysis
- Basic methodology in conducting qualitative market research
- Competitive strategy formulation

Target Audience

This case is prepared for MSc students in studying marketing or strategic management.

1 Introduction

It was a sunny afternoon in Paris. Miss Tang was walking on the "CAMBON" street, which was full of art, luxury, and fashion. Having passed Chanel's first shop, Miss Tang entered the office of HTH, a Rococo architecture building. Inside the office, the sofas, chairs, curtains and walls were upholstered with various fabulous furnishing fabrics in a harmonious way. HTH, the expert of furnishing fabrics, was called the creative genius in this sector. Its creations were widely accepted by individual consumers, interior designers and various organizations.

HTH was a manufacturer and also a distributor of furnishing fabrics. This kind of enterprise was called "editor" in Western countries, because they worked like editors: they collected the well-designed furnishing fabrics all around the world; sometimes, they designed and produced some fabrics by themselves; then they compiled these fabrics into their collections; at last, they distributed those collections to global markets. There were plenty of "editors" in the world. HTH was considered as one of the luxury brands in the furnishing fabrics industry, due to its remarkable designs, high quality and excellent service. HTH's business covered many developed countries, such as France, UK, Germany, Italy, Spain, Switzerland, Belgium, Greece, US, Canada, Australia, South Korea, Japan, etc.. Its business had run very well until 2007, when the global crisis exploded. The furnishing fabrics consumption in developed countries was badly influenced. HTH's sales revenue decreased. The executives of HTH realized a serious fact: the demand in developed countries was getting saturated, thus a slowdown in the growth of demand, or even a decrease in the demand would be inevitable. The executives of HTH thought that it might be the right time to explore some new markets. Emerging economies came to their mind. Emerging economies kept growing rapidly, and the market demands in these countries were very dynamic. Among the emerging economies, HTH valued China with a huge potential. China's GDP kept growing during these years with an annual rate around 9 %, which could be hardly seen in other countries. During the global crisis, the luxury industry had been negatively affected in most of Western countries, especially in US and Western Europe, but, in China, the luxury brands' revenues kept growing with satisfying rates. Thus, HTH believed that China was a huge market for many of the luxury brands. Would it be good for a luxury furnishing fabrics brand? This is actually the mission that Miss Tang got from HTH. They invited Miss Tang to do a market research project to further understand the Chinese furnishing fabrics market. Based on the research, HTH's executives would make a final decision on whether they would start business in China.

2 Chinese Preference on Furnishing Fabrics

Having done the marketing research, Miss Tang found that there were many differences between the preferences of Chinese consumers and Western consumers on furnishing fabrics. Chinese consumers preferred fabrics with bright and rich colors, while Western consumers preferred fabrics with harmonious and quiet colors. Besides, in terms of choosing the fabrics to make the curtains, Chinese consumers preferred the soft fabrics. While Western consumers preferred fabrics that gave a hard touch. Miss Tang thought about developing a new product line for Chinese consumers. But the cost exceeded her expectation.

According to an official report from World Luxury Association: Although Chinese luxury consumption kept growing fast, Chinese consumers actually only bought products from the luxury brands which are worldwide well known, such as Gucci, Chanel, Louis Vuitton, etc. They seldom paid for unknown luxury brands, although the product quality could be quite high. It exactly explained the dilemma of luxury furnishing fabrics brands encountered in China. Their products were well designed and manufactured. They were well accepted in the Western countries, but not in China.

3 HTH Background

HTH was a subsidiary of the brand M, which was esteemed as one of the top luxury brands in the world. Brand M sold fashion products, accessories, tableware and furniture. Different from company M, HTH sold high-end furnishing fabrics. As a subsidiary, HTH benefits from the manufacturing facilities of its mother company: two weaving mills and two printing mills, with superior equipment and highly skilled craftsmen. It was hard to find another "editor" in Europe, who had the similar manufacturing facilities as HTH. Thus, it was very hard for the other "editors" to make the same promise as HTH did: "we manufacture all our fabrics only in France." Except for these four well-equipped mills, HTH had its own logistics company with a warehouse of more than 2000 square meters. There were storage, cutting, shipping, sampling, production, and accounting departments based in this logistics company. HTH's head office was located in Paris. It set up a branch office in New York. HTH had a very talented designer team. Each member of the team had strong background in furnishing fabrics design and interior decoration design. HTH's creations were remarkable for the creativity, uniqueness, identifiableness, and fineness. HTH's collections were favored by plenty of outstanding designers all over the world.

4 Product Portfolio

HTH had 3 sub-brands: Parallelism, Badge, and Chivalry. Each of them had distinctive characteristics.

4.1 Parallelism

This sub-brand was created in 1981. The characteristics of its creations were innovative, surprising in touch and shimmering in color. Parallelism's collections were quite popular among the modern designers for its contemporary style, uniqueness, and identifiableness. Parallelism adopted a variety of materials in its collections: cotton, linen, silk, wool, mohair, polyester, polyester trevira CS, Rayon, etc. Besides, Parallelism used various weaving technologies to realize some distinctive effects, such as jacquard, satin, velour, flock, and brocatelle, etc. (The fabric glossaries that had been mentioned above could be found in the Appendix with the explanations).

Due to these distinctive features, Parallelism was selected as the long-term suppliers for many global leading luxury hotels, such as Plaza Athénée Hotel Paris, Four Seasons Hotel, The Venician Las Vegas, Ritz Carlton, Villa des Orangers Marrakech and Savoy Hotel London.

4.2 Badge

Badge was a luxury furnishing silk maker. The history of Badge could be traced back to four centuries ago. It was composed of several distinguished family enterprises of furnishing silk in Lyon, which was the ancient silk manufacturing center in Europe. With its rich archives and know-how, Badge had succeeded throughout the years by integrating the fresh elements into antique designs with the contemporary colorings and faithful reproductions. It was exactly what people called "neoclassic" creation. Covering several important periods of French civilization, from seventeenth century to today, Badge collections could be classified into four series: damasks, striped or embossed silk velvets, taffetas, and lampas (These fabric glossaries' explanations could be found in the Appendix).

Badge collections were widely used in many historical places: some palaces, such as Versailles Palace in France and Royal Palace in Thailand; art centers, like Louvre Museum; political centers, as French Senate; also some leading luxury hotels, such as Bristol Hotel, Plaza Athénée Hotel in Paris, Meurice Hotel, and Metropole Hotel.

4.3 Chivalry

Chivalry was a French cultural heritage brand dated from 1814. The distinguished characteristic of this brand was that it mainly chose horsetail as the raw material to make furnishing fabrics. Horse was connected to the noble spirit, and was esteemed as the synonym of strength and vigor. The horsetail shimmers, like silk, gave very slippery touch. The textile made of horsetail could be used over centuries without wearing out. Chivalry mainly purchased the horsetail from Argentina, where the horsetail's quality was the best. Except for horsetail, the supplementary raw materials that Chivalry sometimes adopted were sisal, linen and cotton. Chivalry bought the sisal only from Madagascar.

The mill of Chivalry was located in a village 200 km away from Paris. Because of the special texture of horsetail and sisal, Chivalry chose a traditional manual weaving method to achieve the best effect of the textiles by adopting the traditional looms, which could be traced back to a century ago. This kind of manual weaving process required highly skilled craftsmen, which made this mill's average daily output to be around 4 yards, because of handwork in each of the production processes, including raw material filter, dyeing, weaving, and quality control. Chivalry was awarded the "French National Cultural Heritage" by French government.

Due to the historical value of this brand, the nobleness of its collections' raw material, and the sophisticated craftsmanship, Chivalry collections were used in many noble places: art centers, such as Louvre Museum, ComédieFrançaise, and Metropolitan Museum; famous castles, such as La Malmaison, Le Trianon, and Fontainebleau; political centers, like French Senate, French National Assembly, Buckingham Palace, and White House.

5 Distribution Structure in Western Countries

As the furnishing fabrics industry evolved throughout years in Western countries, market structures were well established. Each "editor" had set up its own distribution network. It was clear for the interior decoration designers which furnishing fabric brands should be chosen in certain projects. Thus, the market structures in Western countries were in good order.

HTH had already well built its distribution structure in Western countries. It set up two showrooms in Paris and one in New York. These showrooms were not for selling products but for displaying HTH's furnishing fabrics. There were, generally speaking, three kinds of clients who came to visit the showrooms: the first was individual consumers/proprietors, who needed to decorate their house(s); the second was interior decoration designers, who came to the showroom to select some furnishing fabrics for certain interior decoration projects; the last was organizational clients who needed furnishing fabrics for their projects, for example: the furniture manufacturers needed furnishing fabrics to upholster sofas, beds and chairs; the private aircraft companies needed furnishing fabrics to upholster the chairs and walls in the aircrafts, etc. In the showrooms, clients could choose any furnishing fabrics as they prefer, and ask for small samples for free. No matter whether the client was an individual buyer, a professional designer or an organization, the price was the same in the showrooms. However, professional or organizational clients could receive further discounts by contacting the customer service representative appointed by the company in private. Doing all of these was to protect the pricing system of HTH. If individual consumers got the same price as did professional designers or organizations, the HTH's pricing system would be negative impacted. What was worse, HTH might lose the trust of customers. This kind of pricing mechanism could also help to keep a stable profit margin for franchised distributors and retailers.

In addition, HTH had a sales team, which did not only support the sales in showrooms, but also worked on promoting sales in other fields. The function of HTH sales team included implementing the training program for retailers and distributors, presenting and selling the collections to organization users and interior design companies, while, HTH's sales team never competed with its franchised dealers and distributors. If they were bidding for the same project, the sales team would help the dealers or distributors to win the bid, rather than competing against. HTH's business model and distribution structure kept the company running well in the Western countries.

6 Main Competitors

There were not so many competitors in the high-end furnishing fabrics market, and their distribution structures in the Western markets were quite similar to HTH's. The competitive advantages of some competitors are shown below.

6.1 Lelièvre

Focusing on manufacturing the furnish fabrics, Lelièvre was good at producing variety of velvets (the products of the main competitors). Its average price was 10 % lower than HTH's.

In order to expand its product portfolios, Lelièvre bought Tassinari & Chatel, a traditional furnishing silk manufacturer in France. In addition, Lelièvre gained the distribution license of Kenzo Missioni Home.

6.2 Pierre Frey

It was famous for the remarkable pattern design. Pierre Frey had no sub-brand. Its average price was close to HTH's.

6.3 Rubelli

Established in 1858 by Lorenzo Rubelli, it was famous for its know how in manufacturing high-end furnishing silk. Rubelli mainly chose natural materials in making fabrics, such as silk, linen, cotton, and wool.... Rubelli had no sub-brand. Its average price was slightly lower than HTH's. Rubelli gained a distribution license of Armani Casa.

6.4 Manuel Canovas

The brand was created in 1963 by Manuel Canovas in Paris. Its creations were recognized by the shimmering colors. Manuel Canovas had no sub-brand. Its average price was slightly lower than HTH's.

In terms of the pricing strategy, only slight differences could be found between these competitors and HTH. What making HTH differentiated from the others were its product characteristics. HTH used to have a brand positioning research by a consulting firm: in terms of the value of art, Chivalry ranked No. 1 among all the high-end furnishing fabrics brands; in terms of the value of heritage, Badge ranked No. 1; but in terms of industrialization, both Chivalry and Badge were weaker than Lelièvre, Pierre Frey, and Manuel Canovas; in terms of Stylishness, Parallelism ranked as No. 2, but in terms of industrialization, Parallelism was weaker than both Armani Casa and Kenzo Missioni Home.

Having followed a 2 months' training program in HTH, Miss Tang learned a lot about HTH's products, operation and business model, as well as its main competitors. However, all the information she received was based on Western market situations and was probably not transferable to China. She was wondering what the situation in China would actually be like.

7 The Decision to Enter China

According to the official report from the World Luxury Association, Chinese luxury consumption had reached 10.7 billion US dollars by the end of March 2011 (excluding the consumptions of luxury cars, yachts and aircrafts). China, whose luxury consumption accounted for one fourth of global luxury consumption, became the world second largest luxury market followed Japan. Besides, because of the high tariffs imposed on luxury goods, the prices of foreign luxury goods were higher in China mainland compared to Western countries. Thus, many Chinese consumers went abroad for luxury shopping. In 2010, Chinese consumers spent 50 billion US dollars in buying luxury products overseas.

The executives of HTH were confident with the potential of the luxury market in China, although Chinese luxury consumptions concentrated on jewelry, bags, watches and garments. But Chinese luxury consumption habits and propensities changed gradually. More and more luxury consumers became interested in luxury cars, yachts, aircrafts, and real estates. Furthermore, plenty of high-end real estate properties were under construction in China. The executives of HTH believed that there would be a huge potential for the high-end interior decoration materials. In addition, many of the competitors already entered China or had the plan.

8 Competitors' Distribution in China

The main competitors of HTH: Lelièvre (who had the distribution license of Kenzo Missioni Home), Pierre Frey, and Rubelli (who had the distribution license of Armani Casa) had already entered China. Only Manuel Canovas was absent. Those competitors who had already entered the Chinese market all set up their own distribution network.

8.1 Lelièvre

Without building its own sales team, Lelièvre chose to work with two high-end agencies: one was located in Beijing, and another in Shanghai. Each of them distributed the furnishing fabrics of Lelièvre exclusively in their own areas. These two distributors that Lelièvre had chosen were actually the wholesalers, who had built good partnership with the retailers all around China. Instead of selling or buying the fabrics in large quantity from Lelièvre, these wholesalers only bought the samples, and then they sold these samples to retailers. These retailers would sell the fabrics to the clients, such as individuals, interior decoration designers, and organizations. Once a retailer received an order from a buyer, the order form would be delivered to Lelièvre through the wholesaler. Thus, it was the retailer sold the fabrics for Lelièvre. Unfortunately, Lelièvre had no contact with the retailers and its sales performance was not much satisfying.

8.2 Pierre Frey

Pierre Frey authorized the distribution rights to many distributors around China. Some of them were wholesalers, and some were retailers. Indeed, Pierre Frey tried to build a firm presence in the market. However, as so many distributors were franchised, they competed with each other. Especially when the distributors of Pierre Frey encountered in the same project, a fight for bidding cannot be avoided. As a result, the profit margin was eroded for most distributors of Pierre Frey. Gradually, they gave up to sell Pierre Frey products.

8.3 Rubelli

It chose to work with only one luxury furniture retailer in China. This retailer worked with many luxury-furniture brands, such as Fendi, Bottega Veneta, Versace, etc. However, since this retailer mainly distributed the final products, it lacked know how in selling raw materials of interior decoration, such as furnishing fabrics. Besides, it did not have manufacturing facilities to help clients assemble the furnishing fabrics into furniture. Thus, Rubelli's sales revenue in China was not satisfying. Even worse, the retailer was involved in a lawsuit. Its reputation was damaged seriously and all of its stores had to be closed. Rubelli's business in China was negatively impacted either.

9 Distribution Structure in China

Since HTH's distribution network in Western countries was successful, Miss Tang considered building a similar one in China. After estimating all the costs, Miss Tang gave it up, since it was too expensive to open a showroom in the central business area in Shanghai or Beijing. Just for the commercial rent, the cost could reach 150,000 to 200,000 US dollars per year. Besides, Miss Tang thought that it was not the right time to build a sales team, for the market of high-end furnishing fabrics was not mature in China. If they opened the showrooms and built the sales team, the sales revenue might not fully cover their total cost. After analyzing, Miss Tang thought to explore the market in China by franchising local distributors, since they already had well established sales team, showrooms and customer relationship. By the cooperation, HTH could build up its brand image and gain a market share in China within a short term and an acceptable cost. But how to choose good partners became critical. Chinese furnishing fabrics market was still underdeveloped, and the marketing structure of this sector was disordered to some extent. Wholesalers might also do retailing. Some distributors selling luxury products might sell low-end products as well. Thus, a thorough investigation was needed for choosing the most suitable franchisee(s).

Questions

1. For market research, which aspects of information need to be collected about the competitors in China? How to get the information and how to verify?
2. What kind of research needs to be done to facilitate the location selection process, if HTH was entering China?
3. For HTH's competitors, what are the disadvantages of their distribution network in China? And, what can be learnt by HTH?
4. Compared with competitors, what are the advantages and disadvantages of HTH products?
5. The preferences of Chinese and Western consumers in furnishing fabrics are quite different. Should HTH launch a new product line in China? Otherwise, what need to be done in solving the problem?
6. In order to increase the competitiveness of HTH, what kind of strategies can be adopted in China?

Appendix: Fabrics Glossaries

Brocatelle	a specific type of medium weight brocade utilizing four or more sets of threads, equally for warp and weft. It has large patterns in high relief to appear embroidered or puffy. It is woven finely for formal, refined and sophisticated wear.
Damask	a formal satin base Jacquard fabric of linen, cotton, silk, or wool with reversible patterns. It is medium weight with variety in colors and patterns. Used in decorative fabric situation.
Flock	a material made by cutting or grinding textile fibers to fragments. There are two types of flock: precision cut flock, all fiber lengths are approximately equal, and random cut flock, the fibers are ground or chopped to produce a broad range of lengths.
Jacquard	a weaving system, which utilizes a versatile pattern mechanism to permit the production of large and intricate patterns.
Lampas	a type of luxury fabric with a background weft (a "ground weave") typically in taffeta with supplementary wefts (the "pattern wefts") put on top. To form a design, sometimes it is also woven with a "brocading weft". Lampas is typically woven in silk, and often has gold and silver thread enrichment.
Mohair	a fabric obtained from yarn made from the silky hair of the Angora goat.
Polyester	a man-made fiber where the forming substance is any synthetic polymer. It has high strength and is resistant to shrinking and stretching. It is also wrinkle resistant.
Polyester trevira CS	a kind of polyester, which is anti-fire.

Rayon	a man-made fiber basically composed of regenerated cellulose.
Satin	a basic type of weave with up to eight weft threads are tied down with one floating weft thread. It is light to medium-weight with glossy face and a dull back.
Taffeta	a crisp, smooth plain-woven fabric made from silk or synthetic fibers.
Velour	a closely napped fabric with a soft, velvet-like texture, used for clothing and upholstery. It includes some velvet, and all plush-pile surface cloths.
Velvet	a pile woven cotton, silk, or rayon fabric with a soft yet sturdy face, like plush but with a shorter pile; the underside is plain.

Master International Franchising in China: The Case of the Athlete's Foot

Ilan Alon

Case Synopsis

Research Problem

The case describes franchising in China, the Athlete's Foot Company, and the experiences of the Chinese master franchisee—Mr. Rick Wang. Despite the initial success of this franchise system in China, Rick quickly ran into financial and operational problems.

Case Summary

Franchising in China is a relatively new and growing phenomenon, which has gained momentum since the 1990s. Among the franchising pioneers in China are large and well-known food and beverage brands, such as KFC and McDonald's. Less well known, but equally important, are the non-food retailing and service industries, which also made inroads in China using franchising. One such example is the case of the Athlete's Foot Company. This American company has been a major competitor in the athletic shoes and sportswear sectors globally, made early entry into China using master international franchising, and, consequently, ran into problems indicative of the issues companies that expand internationally using franchising often encounter.

Learning Objectives

The case can help achieve the following objectives as it:

I. Alon (✉)
University of Agder, Kristiansand, Norway
e-mail: ilan.alon@uia.no

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1. Illustrates the benefits of adopting a franchising operation mode in the Chinese market for the purpose of globally expanding business activities;
2. Allows students to familiarize themselves with relevant procedures for building a franchising business;
3. Encourages students to discuss the primary problems confronting the franchisor & franchisee;
4. Provides an illustrative example of a start-up enterprise in a quickly changing business environment;
5. Requires students to propose possible strategies in response to operational crises, including taking steps toward the achievement of tactical and strategic goals.

Themes and Tools Used

Opportunity research and predictions of:

- Market demand;
- Market size;
- Market structure and competition;
- Margin analysis.

Find an appropriate partner to build franchise relationship, ideally one who has:

- Experience and a reputation in franchising (market presence, market share, number of company owned outlets);
- Outlet performance experience;
- Knowledge of the business format (training, operations systems, field support);
- Understands the terms of the licensing agreement;
- Has a market-development plan;
- Understands the intricacies of franchise fees and royalties;
- Has knowledge of available resources, avenues of supply, etc., specific to the target environment.

Create a detailed plan for business operations, including:

- Site selection;
- Outlet construction;
- Employee training;
- Inventory and operations management;
- Advertising and market promotion;
- Supply chain.

Target Audience

This case is appropriate for use in an entrepreneurship course to introduce building a new business through franchisee mode. It provides a practical example for students who wish to start a franchising business. It can also be used in sessions on international business, international marketing, global franchising, business strategy, operations, and response to crisis in general management courses.

Questions

1. What did Rick do as he prepared to become a master franchisee? What factors in Rick's preparation led to the initial success of the franchise, and what factors resulted in the subsequent crisis?
2. What factors led to the problems Rick's company experienced? Please give your suggestions for solving the company's problems.

1 Introduction

One day in late 2001, Rick Wang, the managing director of RetailCo Inc., the master franchisee for The Athlete's Foot in China, was reviewing the most recent sales report of his company. He found that the sales volume for the past 6 months had declined precipitously, down almost one- third from what it had been only 1 year ago. Inevitably, Rick was concerned.

RetailCo Inc. had had a banner year in 2000; however, the company had experienced a cascade of problems beginning in 2001. At the start of that year, the company was forced to deal with pressure due to a supply shortage of major products, which could deal a deathblow to any small retailer. In quick succession, financial crises and sales problems related to the lack of product created a systemic disaster. Unless he acted quickly and decisively, RetailCo. might not survive this confluence of major problems.

2 Rick Wang and RetailCo. Inc.

Rick Wang was a typical American-born Chinese, able to speak native American English and Chinese. His parents had immigrated to Taiwan and then America when they were fairly young; regardless of their geographic location, however, the family maintained strong cultural ties to its homeland. Rick was raised in a traditional Chinese family in the US. After graduating from the University of Southern California with a degree in Communications, he began his career as an Account Director at Lintas, a well-regarded international advertising agency. After that, he transferred to work for Foremost Dairies Ltd., a leading manufacturer of milk and ice cream in Taiwan, as a Marketing Director, and thus gained experience in short-shelf-life consumer goods.

In 1992, he moved to his parents' hometown, Shanghai, and worked for Shanghai Fuller Foods Ltd. as vice president of marketing. He assisted in the building of the company's factory in Jinqiao district and developed new brands of Fuller milk and ice cream. Under Rick's leadership, the brands "Qian Shi Nai" (milk) and "San

Marlo" (ice cream) quickly achieved market leadership in the area, known by almost all the residents in Shanghai. In late 1997, Shanghai Fuller Foods Ltd. was sold to Nestle; Rick decided to strike out on his own.

As a result of a chance encounter, Rick Wang became acquainted with the athletic footwear industry and became a retailer. Rick retains a vivid memory of the day he was introduced to the possibilities of this retailing niche:

One day, when I was playing softball with a bunch of my American friends who then worked at Nike, one of them said to me, "Rick, since your ice-cream business has been sold, what do you want to do now?" I said, "I don't know yet. Maybe I'll go back to San Francisco, or back to Taiwan." He said, "Why don't you consider overseeing our Nike stores in Shanghai?" I asked, "Nike stores? Can I make money?" And he replied immediately, "Sure, they can make a lot of money!" I asked for the financial statement, which he showed me the next day. After looking carefully I said, "Ok. Let's do it."

Rick Wang, at that time, had no experience in either the sports footwear industry or any direct knowledge of in-store retailing, but he was very excited about his new business venture. RetailCo Inc. was established with the intention of managing the retail realities of athletic footwear sales.

His optimism notwithstanding, Rick's hasty involvement and lack of experience in the footwear retailing industry led to the poor performance of his stores. In the 6 months after the company was established, no profit would be made. As the situation worsened, Rick anxiously sought expert advice. He began by educating himself on the Internet, searching terms such as "athletic footwear retail", "sport retail", and "sports shoes retail"; surprisingly, he found that almost every page of his searches revealed one American company, The Athlete's Foot, Inc. Like many entrepreneurs, Rick recognized the value inherent in modeling his own activities on those of an industry leader.

2.1 The Athlete's Foot, Inc.

The Athlete's Foot, Inc, based on Kennesaw, Georgia in the United States, is the world's foremost franchisor of athletic-footwear operations. It grew from a small, family-run store to an international retailer in three decades. Today, The Athlete's Foot owns about 800 corporate and franchise stores in over 40 countries (see Table 1).

The history of the growth of the Athlete's Foot is a model of aggressive business behavior. In 1971, Robert and David Lando opened the world's first athletic-footwear specialty store—named The Athlete's Foot—on Wood Street in Pittsburgh, Pennsylvania. The very next year, The Athlete's Foot, Inc., began franchising its business model domestically. The first franchise agreement was signed by Killian Spanbauer, who opened a store at the Sawyer Street Shopping Center in Oshkosh, Wisconsin. After that, The Athlete's Foot began a period of focused expansion: by 1976 there were more than 100 stores; only 2 years later (1978), there were more than 200 Athlete's Foot outlets in America.

Table 1 Countries where the Athlete's Foot stores are located. *Source*: Adapted from www.theathletesfoot.com

Antigua	Venezuela	Greece	Nicaragua	St. Kitts
Argentina	Cyprus	Honduras	Martinique	St. Lucia
Aruba	Denmark	Indonesia	Panama	St. Maarten
Australia	Dominican Republic	Italy	C.I. Jersey	Taiwan
Bahamas	Ecuador	Japan	Poland	Thailand
Barbados	EI Salvador	Jamaica	Philippines	Turkey
Canada	France	Kuwait	Portugal	Uruguay
Chile	Guadeloupe	Malaysia	Republic of Palau	United States
China	Guatemala	New Zealand	Reunion Island	Trinidad
Costa Rica	Guam	Malta	Spain	South Korea

That same year, the company began to internationalize its franchising efforts; in 1978, the first of what was to become many international franchises opened, at 16 Stevens Place, in Adelaide, Australia. This milestone event encouraged The Athlete's Foot to franchise an additional 150 stores in international markets by 1979.

After a decade of successful market penetration, the Athlete's Foot, in its second decade, began a period of adjustment. In the early 1980s, Group Rallye purchased the Athlete's Foot from the Lando family and became the owner of the Athlete's Foot. This buyout provided crucial financial support to the company at a time when it needed to pay more attention to product design and customer service—rather than focusing exclusively on expansion. For example, the company inaugurated a system-wide commitment to customer service. In order to help customers to find the "right" footwear, or at least to help to determine the proper fit, sales associates underwent training at "Fit University," introduced by the Athlete's Foot Wear Test Center to provide education on the physiology and anatomy of the feet and to enable sales associates to properly fit athletic footwear. This focus on educating its sales force—who, in turn, educated customers about the value of relying on The Athlete's Foot as a consumer-oriented facility—paid almost immediate dividends.

In the 1990's, the Athlete's Foot consolidated its market standing even as it continued its enviable international growth. The Athlete's Foot changed its name to the Athlete's Foot, Inc. and moved its headquarters to Kennesaw, Georgia, after Euris purchased Group Rallye in 1991. The company's structure was reorganized into two divisions as a result of this change in ownership: a marketing team serviced franchises and a "store team" operated company-owned stores. The marketing team did an impressive job in the years following the reorganization. The Athlete's Foot, Inc. grew to more than 650 stores worldwide in 1997 and was named the No. 1 franchise opportunity by *Success* magazine that same year. After a dynamic new CEO, Robert J. Corliss, joined the company in 1999, the company experienced a record growth year—opening 37 corporate stores in six countries and 87 franchise stores, the most franchises in company history. The other division, the operations' team that managed company stores, also achieved significant success during this period. The company launched a new-store design featuring an innovative, customer-oriented technology called the FitPrint System[1]. This innovation was to lead to a competitive advantage for the Athlete's Foot, Inc. As a result of franchise oversight and marketing innovations, the company was awarded the "Trendsetter of the Year" award by the sporting goods community for 1999 and 2000.

The growth story of the Athlete's Foot became a model for franchising even as it successfully continued its almost-three-decades-long tradition of domestic and international expansion. Many would-be entrepreneurs were drawn to the company, for reasons linked to the company's focus-points: customer service, aggressive marketing, and control of the pipeline from production to point-of-sale. Comments from franchisees illustrate the company's magnetic effect on franchisee development. Jaclyn Hill from Auburn said that her "decision to join The Athlete's Foot was based primarily upon them having an established, customer-service focused program to sell athletic shoes." Powell's Kyle H. Johnson commented, "The Athlete's Foot was my choice when I decided to enter the retail industry for several reasons. Some are obvious such as access to vendors, reasonable franchise fees, and fair royalty rates. Beyond that, they offer a tremendous amount of support." (www.theathletefoot.com).

2.2 An Athlete's Foot Master Franchisee in China

Rick Wang was one of many entrepreneurs interested in pursuing business opportunities in the footwear retailing sector; Rick, however, had not followed the less-risky entrepreneurial path of franchising, but had struck out on his own, with problematic results. His research on the successes of the Athlete's Foot's management model led him to contact that company. At that time, Rick had little knowledge of how franchising worked, or what potential benefits he might realize. In fact, his ostensible reason for contacting the company was his belief that he might pick up some pointers from this more-experienced retailer:

I was not a believer in franchising, recalls Mr. Wang. I did not believe in franchising because I did not believe in paying so much money to buy somebody's brand and then putting more money in to build it. I can do by myself. But I decided to contact the Athlete's Foot because I really knew that I needed help.

Rick Wang decided to fly to Atlanta, to view the company's headquarters and evaluate the company and its team. This trip was fruitful. As a potential Chinese partner, Rick received a warm welcome from the CEO and the entire management team during his visit. Among his stops, he was especially impressed by the inventory control system in the merchandize department. Rick recalled,

I wasn't very excited until I walked into the merchandize department and I saw their buying team, how they bought products. I saw how intensively they controlled the inventory system, using a very high-tech system. And then I started to learn the

[1] According to Athlete's Foot, Inc., the FitPrint System is a proprietary state-of-the-art computerized technology that measures pressure points at different phases of a customer's gait.

science behind the retailing. And I started to realize perhaps I need to pay the tuition to learn this. It's always the case: if you want to dance, you have to pay the band.

After Rick returned to China, he immediately started his franchise and retail plan. He first persuaded the board of RetailCo. to agree to his idea of becoming the master franchisee of an Athlete's Foot structure in China. Second, he efficiently worked out a negotiations' plan with the US franchisor on the subjects of sales territory and royalty fees. He suggested separating the huge Chinese market into three regions: East China Area, North China Area and South China Area. The region of East China, stretching to the cities of Chengdu and Chongqin, was the biggest and potentially the most important market in China; it was in this area that Rick planned to focus his efforts. The region of North China, including Beijing, although a potentially lucrative market, was to be a secondary consideration. Last, development of the South China Area was to be delayed until after the first two regions were penetrated: the proximity to Hong Kong, with its history of appropriating brand names and flooding the market with cheaper copies, made immediate consideration of this region a risky and ambiguous proposition.

In terms of royalty fees, Rick fortunately negotiated a fairly good deal with The Athlete's Foot, Inc. The monthly royalty was to be 2.5 % of net sales. Other initial-area development fees—including franchising fees, fees for additional stores, purchasing an MIS system, an employment-control system, etc.— totaled a few thousand dollars per store. In addition, Rick requested discounts related to any future fees for local marketing. All the funds for initiating business were to be self-financed.

When the deal was made, Rick, together with his six colleagues, went to Atlanta for the "New Owner Training" at Athlete's Foot's, Inc. Within 6 weeks, they had completed their "On Site Training" and had practiced operating the business: they worked in a store, sold shoes, helped people with their fittings, and even worked in the warehouse, experiencing first-hand the realities of inventory control. They also learned how to work internal-control systems and marketing procedures. Overall, their training covered issues related to marketing, merchandizing, operations' management and employee sales training. Rick commented: *It was just fascinating, like going back to school. It was very enjoyable.*

Their efforts paid off. In September 1998, the first store of the nascent master franchisee's China operation was opened in the Parkson Department Store on the Huaihai Road in Shanghai—in the East China Area. The Parkson was the most popular department store with an ideal demographic: the youngest customers between the age of 20 to 35—those considered most devoted to brand-names and most style conscious—shopped on fashion-oriented Huaihai Road. Therefore, the first store was actually in the fashion center amid a favorite venue of young consumers. The store was opened on the ground floor of Parkson's with the same store design and equipment as those in the US. Beautiful store design and abundant/diverse name-brand products made the store attractive to customers.

Rick achieved success in starting his retail franchising at a time when the franchise concept in the Chinese market was new and innovative, and the sports footwear market was underdeveloped. His business instincts, his knowledge of the Shanghai market and his training at Athlete's Foot, Inc.'s headquarters combined to initiate a signal success in what was then a relatively new entrepreneurial concept.

3 Business Context

3.1 Franchising in the Chinese Market

The franchise concept first entered the Chinese market in the early years of the 1990s with the emergence of reputable international franchising companies such as KFC and McDonald's. They originally entered China in the early 1990s, building corporate stores first. After having achieved steady sales volumes and sufficient economies of scale, they cautiously but aggressively expanded. These pioneer global franchisors included dominant players in the fast-food industry and various master franchisors in other industries such as 7-Eleven convenience stores, twenty-first century Real Estate, EF education, Avis auto rental, Kodak film developing, Fornet laundry service, etc. These firms contributed to China's franchising market development—and created an awareness among an increasingly entrepreneurial class that franchising held substantial positive outcomes for those able to enter into such relationships.

Overseas franchisors tended to adopt one of two approaches when operating in the Chinese market: the franchise of a product or trade name (product name franchising), or the franchise of a particular business model in exchange for fees or royalties (business format franchising). Corporations, which had a strong capital background, like McDonald's and KFC, would choose an offshore franchise retail model (see Fig. 1) to ensure effective control over product quality and company

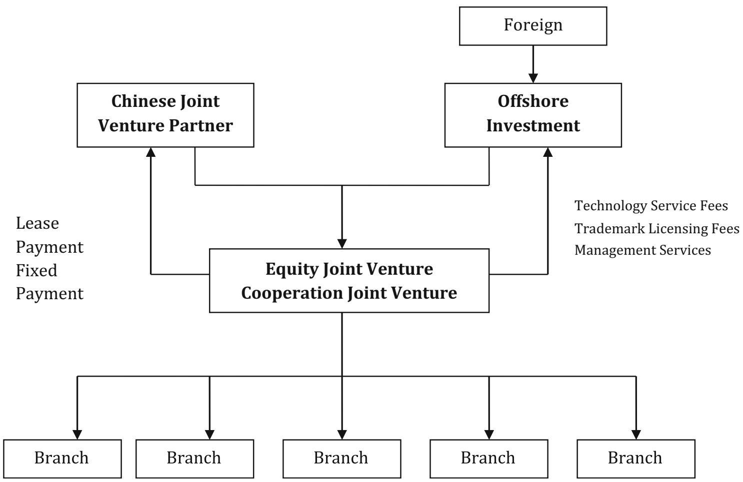

Fig. 1 Offshore franchise retail model. *Source*: Adapted from Mendel, Fraser "Legal Issues Related to Franchising in China". www.sinofranchise.com

operations. Small- and medium-sized franchisors would often choose direct franchising by seeking a local franchisee. Franchisors, licensing to local partners, can take advantage of local knowledge, saving the costs resulting from distance—both in terms of logistics and culture.

Since the end of the 1990s, franchising has become a mature, steady growth opportunity in China. By the end of 1997, there were just over 90 franchisors in China and about 30 franchise stores. One year later, however, the number had grown to over 120 franchisors with sales volume of over 50 million RMB (US$ 6.05 million), among which 40 % were franchise stores (ChinaOnline, 1999). By 2000, the number of franchisors approached 600. The sales volume also increased dramatically, jumping about 80 % from 1999 to 2000. This remarkable growth (at the time of this article, franchising is growing at a high double-digit growth rate) continued in the years that followed.

Franchised businesses in China vary along a wide spectrum of business sectors. Companies in over 30 industries have chosen franchising as a business model to sell their products and expand in this market. Retail and food/restaurant operations have always been the dominant franchising industries, accounting for 35 % and 30 % of total franchisors respectively. Other segments experiencing significant growth include education, business services, auto services, interior decoration, beauty & health, laundry, etc. The service sector has also grown in importance in recent years.

3.2 Market Environment

In the late 1990s, as many in the global market were aware, China was becoming the land of opportunity. China's strong and steady growth, proven by 10 years of continual GDP increases, seemed unstoppable. Economic growth led to an increase in personal incomes, especially in larger cities. The emergence of a large middle class, often consisting of well-educated professionals, added to the consumer demand for globally recognized, quality products.

Domestically, the Chinese government made great efforts to regulate the market and standardize the business environment. To facilitate access to the World Trade Organization, China committed itself to removing more market-entry barriers, creating a more open market for international investors. The laws and regulations governing franchise businesses were, thus, improved. On November 14, 1997, the Ministry of Internal Trade published and released the very first Chinese franchise law, *The Regulation on Commercial Franchise Business (for Trial Implementation)*. Afterwards, the Regulation was revised and improved several times: in 2005, *The Law on Commercial Franchise Business Administration* was eventually released as a basic rule for franchise operations in China.

Market competition in China was less rigorous than that in the United States. In the athletic footwear retailing industry in China, for example, there were few capable players in the early- to mid-1990s. Meanwhile, the demand for high-quality athletic footwear increased as consumers' incomes increased (see Table 2). Market research for 1998 indicated that people in Shanghai owned only one pair of

Table 2 Consumption of recreation goods in entertainment and sports sector, 1997–2003. *Source*: Adapted from China Statistics Yearbooks

	1997	1998	1999	2000	2001	2002	2003
National	112.5	125.99	125.33	146.92	139.35	245.16	264.47
Shanghai	301.11	301.95	372.05	407.99	387.67	540.96	587.06

athletic footwear. By 2005, they had, on average, three pairs. In terms of style, people's preferences changed from choosing footwear for functional purposes to opting for fashion. Athletic footwear retailers selling name-brand shoes had what seemed to be a promising future.

3.3 The Glorious Age

The success of his first store encouraged Rick to open more stores, more quickly than he had initially planned. In the months following his franchise-premiere in Shanghai in 1998, Rick adopted an aggressive expansion strategy, opening a new store every 22 days. After spreading the business to the North China region, the company opened 40 corporate stores in 7 other Chinese cities. The company realized a profit in its second year of operations, reaching a sales volume of US$ 14 million in 2000.

Every one of RetailCo.'s stores acted in accord with the standard of global Athlete's Foot, Inc. The stores, equipped with indoor music, sports videos and fashionable designs, established a pleasant atmosphere for shopping. All stores provided the best possible service for their customers. The service staff in every store was trained before they began their work—also in accordance with the model that Rick and his team had seen in Atlanta. In addition, every store was equipped with computers for billing and inventory control. In fact, the inventory-control system was an advantage that distinguished Rick's stores from other retailers. By adhering to strict, computerized tracking of product, store managers were able to react promptly to shortages or excesses of inventory. The company used the franchisor's proprietary pricing model by utilizing aggressive price reductions to manage inventory excesses. More important than the store brands the store marketed were famous internationally branded sports goods, such as Nike, Adidas and Reebok, which were available at the stores. A pioneering store atmosphere, an excellent inventory-management model, and an availability of famous brands quickly made the Athlete's Foot a premier competitor in the Chinese sports retailing industry.

Domestic promotion of the Athlete's Foot brand name was also done aggressively. Besides media advertising, the company put more emphasis on direct and in-store marketing. It organized three-on-three street basketball games and tournaments to grab the attention of young sports' lovers. The company also sponsored high-school basketball teams to further inculcate brand-name recognition of both the stores and its products among teenagers. In-store marketing activities included cooperation with the fast food giant, McDonald's; monthly newsletters advertising the Athlete's Foot were distributed in McDonald's stores. Nevertheless, the brand-building process was not as successful as it had been in the US. People responded to the brands of products more than to the retail brand itself: consumers visited stores because they could find internationally known products, not necessarily because they were drawn to The Athlete's Foot as a brand. This customer motivation would lead to substantial problems for Rick in future years.

In 2000, Rick started, cautiously, to seek appropriate franchisees in an attempt to expand the business. Rick selected one sports' goods franchising exhibition in Beijing as the venue for promotion of his franchise opportunities. Almost 500 applicants applied for franchises in one day, far exceeding Rick's expectations. Some applicants even came with large amounts of cash as testament to their financial abilities (and solvency). Rick was concerned, however, about the values of the applicants; he wanted to ensure that the selected candidates were service-oriented and fully understood the partnership requirements related to franchising. Carefully vetting all of the applicants, Rick short-listed 20 candidates. These finalists had strong financial capabilities as well as fine educational backgrounds; they could understand the vital realities involved in franchising's partnerships. RetailCo. invited these 20 candidates to come to the Shanghai Office and have face-to-face meetings with the board. Finally, one—out of five hundred—was signed with RetailCo to be the first sub-franchisee of The Athlete's Foot, Inc. Later, using the same careful scrutiny, 12 additional sub-franchisee stores were developed in second- and third-tier cities such as Nanjing, Wuxi and Ningbo.

4 Signs of Problems

In 2001, in spite of—or possibly due to—its rapid growth, the company gradually felt pressures related to cash flow, marketing and supply. The first "pressure" came from the need to commit large amounts of capital to obtaining retail venues. Since the location of retail stores is related to sales' performance, gaining a quality location is crucial. Rick's good fortune in being able to open his first store at a high-traffic, upscale shopping area in Shanghai was often difficult to replicate at equally moderate rental rates. Obtaining a quality retail space in China usually requires at least a 24-month leasing commitment; in some department stores, a 36-month rental agreement was often the norm. To lock in quality locations in this competitive a retail real-estate market, the company signed long term contracts, looking to best competitors by securing desirable locations. This laudable approach to ensuring franchisee success, however, required an immense commitment of up-front capital. RetailCo. took over prime spaces in department stores, but the cost of doing so was great. Unfortunately, when market conditions changed and sales decreased, the pressure caused by an insufficiency of ready-reserves of cash inevitably increased.

A second pressure was related to a problem many "breakthrough" franchisors experience in new markets: since 2001 the Athlete's Foot had started to lose its "first-mover" advantage. China began in 2000 to finalize preparations for entry into the WTO. The global financial community was increasingly convinced by then that the immense potential of the Chinese market was soon to become a reality. As a result, the athletic footwear market—along with every other foreign franchise business—underwent major changes, foreign direct investment (FDI) increased. In department stores, the space for sporting goods enlarged dramatically from 300 square meters to 700 square meters, then 1000, 1500, and finally to an average of 3000 square meters. This meant that franchising space allotted to The Athlete's Foot was, as a percentage of total space, gradually diminished. More footwear retailing players joined the industry; for example, Quest Sports started to open its stores in China in 2001. Competition also came from local players, who were able to insinuate themselves in this market due to competitive pricing, enhanced customer service and increased products' quality. In other words, these local competitors learned from Rick's Athlete's Foot franchises what Rick had learned from the franchisor. A final concern occurred when individual brands opened more of their own stores.

As a result of its success in the market—partly related to the improved business climate in China as a whole—RetailCo./The Athlete's Foot was, paradoxically, losing its competitive advantage. In 1998, the size of an Athlete's Foot store was almost 100 square meters, often occupying one-third of the total size of the sporting goods section of a large department store. The typical store was supplied by several world-famous brands, like Nike, Adidas, Reebok, etc. The rest of the sporting goods' space was devoted to selling locally branded products and sports equipments: footballs, basketballs, tennis rackets, etc. Although the goods sold in an Athlete's Foot store were exclusive and superior to others, the above-mentioned changes led to a 10-fold increase in the amount of store-space devoted to sporting goods. Athlete's Foot did not/could not grow as fast, now (post-2001) occupying merely one-fifteenth of the total space devoted to sporting goods in a large department store. Size and visibility matter: the "idea" of Athlete's Foot became increasingly insignificant in customers' minds.

Worse, for Rick, was the fact that his suppliers—the producers of the often-popular styles and models his growing customer base demanded—began to increase their own penetration of what had previously been a fairly wide-open market. The Athlete's Foot multi-brand approach was forced to compete directly with brand-name suppliers who opened their own outlets in direct competition with him. Inevitably, Rick found it difficult to get the most desirable brand-name products for his stores; the home office—although committed to Rick's status as the master franchisor—was unable to put enough pressure on producers to stem the tide. Rick's stores were unable to keep current inventory of the most recent styles and most in-demand products.

With declines of comparative store size and product varieties, and increases in competition from local and brand-specific market entrants, the Athlete's Foot found itself squeezed out of high-value department store venues. Department stores welcomed the single brand retailers because they were content with the smaller ratios of retail space; besides, grouping single-brand retailers together made department store one, huge multi-brand store. The Athlete's Foot had to move to street-front locations, which commanded higher rents and were less popular with the purchasing public. Thus, costs increased but revenue decreased.

What should Rick do?

Rick Wang realized the company was in risk of bankruptcy if he did not immediately address the radically changed demands of the marketplace.

Appendix

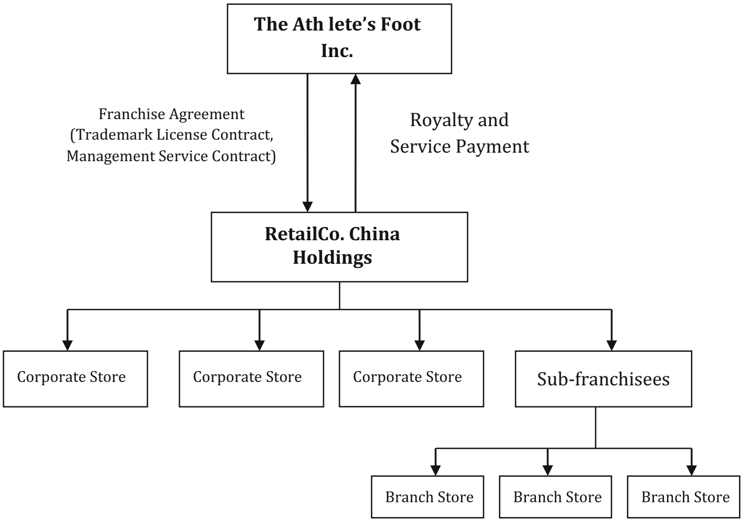

Exhibit 1 Franchise structures of the Athlete's Foot in China. *Source*: Author

Mattel's Second Attempt to Crack the Chinese Market: Will China Embrace the American Barbie Doll This Time?

Britt Kühne

Case Synopsis

Research Problem

When Mattel entered the Chinese market for the first time, it encountered major difficulties due to lack of localization, overestimation of its brand popularity, wrong pricing strategy, and failure to understand the different perception of toys and Chinese culture in general. Mattel failed to capture the Chinese market with the over-the-top and poorly executed House of Barbie store in Shanghai. Mattel still believes in the potential of the Chinese toy market and is therefore currently looking for a new strategy to re-introduce Barbie to the Chinese consumers.

Case Summary

Mattel, the American toy manufacturing company, is a truly global brand; they sell their products in over 150 countries. After having expanded to Canada and Europe, most of their growth has been taking place in emerging markets. Though one of the biggest emerging markets, China, seemed a logical choice for the company, they have failed to capture this market with their 'House of Barbie' store in Shanghai. Mattel is currently looking for a new strategy to re-introduce Barbie to the Chinese consumers. The newly appointed International Marketing Manager, Raymond Starck, will be leading this challenging project. In order to come up with a new plan, Raymond decided to look into the mistakes Mattel made at the time.

During this, he discovered that Barbie was not perceived as a lifestyle brand, like it is in Western countries where many generations grew up with the brand. Mattel

B. Kühne (✉)
Tias School for Business and Society, Utrecht, The Netherlands
e-mail: brittkuhne@gmail.com

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did not take into account that the local consumer taste in China was completely different from that in other countries. The pricing strategy was confusing for the Chinese consumers, who appreciate luxury products of a high quality. In addition to this, Raymond also discovered that Mattel initially misinterpreted China's consumer behavior. He found two critical factors Mattel had not paid attention to: China's tiger parents and the shopping behavior in China.

While researching the company's previous mistakes, Raymond realized that Mattel's main issue was figuring out the right blend between localization and globalization of the brand. Mattel would have to localize Barbie just enough to suit the local culture, while still being perceived as a foreign brand, since most Chinese would then associate it with luxury and uniqueness.

Learning Objectives

- Understand the dynamics in Emerging Markets
- Be able to write an International Marketing Plan
- Be able to come up with a new Market Entry Strategy
- Understand Chinese tastes, symbols, and preferences

Themes and Tools Used

- Price elasticity for luxury goods
- Product variations for Chinese customers
- Localization
- Global market research

Target Audience

Master students in International Marketing and International Business; students of Luxury Marketing and Management; executive managers with a focus on China.

1 Introduction

Many foreign companies entering this challenging and rapidly growing market often refer to China as '*the graveyard of ambition*'. Mattel, the American toy manufacturing company, agrees with this. After the unsuccessful launch of its Barbie doll in the Chinese market in 2009, Mattel's new CEO, Christopher A. Sinclair, is now looking for a new strategy to re-introduce Barbie to the Chinese consumers. The newly appointed International Marketing Manager, Raymond Starck[1], will be leading this project. He will start by investigating the reasons why Mattel failed to capture the Chinese market with its 'House of Barbie' store

[1] Both the name and story created around him are fictitious.

in Shanghai and will try to come up with a new plan that focuses on the right mix of localization and globalization, which he perceives to be a major issue. Raymond is under a lot of pressure because he needs to prepare a meeting to present his analysis.

2 Mattel Inc. and Barbie®

Being the youngest of ten children of Polish immigrants, Ruth was a secretary for Paramount Pictures in Los Angeles when she married Elliot Handler, who was an industrial engineer at that time. In 1938, they had already started a company together, called Elliot Handler Plastics. They initially started out by designing and manufacturing light fixtures and furniture, later followed by costume jewelry. The jewelry Elliot designed was experiencing a surge in demand. When they attracted four business partners, the company quickly grew to become a $2 million enterprise. In order to keep up with the demand, they set up four floors of production operations in Los Angeles, employing over 300 workers during their peak. However, after the Second World War in 1945, Elliot grew restless and decided that the company needed a new business approach in order to be able to compete in the faster-changing post-war world. Unfortunately, his plans led to a dispute with the partners, causing him to sell his interest in the company at a loss (Mattel Inc., 2015). Shortly afterwards, he was looking for a new business model.

In 1945, Ruth reconnected with a mutual old friend, Harold "Matt" Matson. Together they started Mattel Creations, with Elliot as their product designer and Matt overseeing manufacturing operations (Mattel Inc., 2015). Mattel Inc. was formally founded in 1945, in Southern California. While watching her daughter Barbara and friends play with paper dolls of adult women imagining themselves as grown-ups, Ruth got hit with an idea. She thought by herself, "Why not make a teenage doll that little girls could play with?". Her market research showed that there were no other three-dimensional teenage dolls on the market yet. Though Elliot was feeling unsure, Ruth still decided to pursue her vision and created the Barbie® doll.

Three years after Ruth had the idea and 14 years after the start of the company, Mattel first introduced Barbie® at the annual Toy Fair in New York on March 9, 1959. The top buyers were sceptical at first; the doll, named after Ruth and Elliot's daughter, was completely unlike the baby and toddler dolls popular at the time. The launch of the doll shocked the industry pundits and toy critics. They simply did not realize that the world had been waiting for a new toy like this. Thanks to an innovative television ad campaign, the doll quickly caught the attention of young girls across the country, proving all skeptics wrong (Barbie Collector).

Today, Mattel is a publicly traded company, with corporate headquarters in El Segundo, California. In addition to their best selling Barbie® brand, Mattel's portfolio also includes Hot Wheels®, Monster High®, American Girl®, Thomas & Friends® and Fisher-Price® brands, as well as a wide array of entertainment-inspired toy lines. Mattel's vision is 'creating the future of play'.

According to Mattel's latest Annual Report, the company was leading the toy industry with $7.1 billion in gross sales in 2013 and more than $900 million in net income. They employ nearly 30.000 people in offices across 40 countries and sell products in over 150 countries worldwide (Mattel Inc., 2013). More financial highlights from the 2013 Annual Report can be found in the appendix. Despite being an industry leader, Barbie's sales fell for the third straight year in 2014. Therefore, Mattel made some changes in their management team. The newly appointed CEO, Christopher A. Sinclair, has served on the board of Directors since 1996 and on the Executive Committee since 2011. Sinclair was now about to developing a comprehensive plan to improve the company's performance. The board members were pleased with his appointment. Michael Dolan, Independent Lead Director at Mattel, said, "[Christopher] is moving with urgency and we are delighted that, with his agreement to sign on as CEO and continue to lead the effort personally, there will not be any delay in implementing the changes necessary to get Mattel back on track" (Nasdaq, 2015).

Raymond had carefully analyzed these facts. He was now feeling the need to go back into the past in order to understand Mattel's objective in entering emerging markets, particularly China.

3 Expansion Into Emerging Markets and Economic Downturn

After their successful expansion into Canada and the European market, Mattel's new strategy, 'Mattel 2000', focused on the company's new direction during the 1990s. Mattel's former CEO, John Amerman, noted, "There are twice as many children in Europe as in the U.S., three times as many in South-America and fifteen times as many in Asia. The potential market for products like Barbie is mind boggling". He also understood that these opportunities for international growth come with formidable challenges and was hesitant at first (Keegan & Green, 2008). However, Mattel's executives were convinced that the company's best growth opportunities for the mid 1990s were in other overseas markets. They decided to first focus on the (then) emerging markets in Central and Eastern Europe that were recovering from communism. 'Friendship Barbie', a doll especially designed for these new markets, was developed. The doll was less elaborate in order to reflect the basic lifestyle children were experiencing while living in a former-communist country. Soon, Mattel's international sales grew from $135 million in 1982 to $1.7 billion in 1992 (Funding Universe, 2015).

The first big emerging market Mattel entered was India, where Barbie was introduced in 1991. Having faced several image problems, Mattel decided to localize the doll in 1998. The Indian Barbie doll, modeled after Katrina Kaif, a popular Bollywood actress, has been a success ever since. According to New Delhi retailers, Barbie's success can be explained by the fact Barbie has good brand presence and has been facing "no competition" in India. Mattel decided to exclusively target children and to invest heavily in advertisements on various popular kids TV-channels. They opened a large number of shop-in-shops in successful toy stores spread across the country, which increased the overall exposure of the brand (Gupta & Wang, 2011). Another reason for their success can be explained by the fact that the Indian toys market had been growing rapidly with an annual rate of 15.2 % over a 5-year period from 2004 to 2009 (Awal, 2011).

Around that time, Mattel also introduced Barbie in a number of South-American countries. Especially Argentina turned out to be a successful country for Barbie. In 2008, after having built the brand for over 20 years, the company opened a 7000 square-foot flagship store in Buenos Aires. The store did not solely sell Barbie branded clothes; it also sold Barbie jewelry and Barbie accessories. Besides, there also was a beauty salon and a Barbie café for the parents, and a separate room called 'Casa Barbie' where Barbie-themed birthday parties for children could take place. The store was extremely successful, mainly because of the popularity of the Barbie doll, which was featuring in the Broadway-style musical 'Barbie Live' in the capital city. The store was a pilot that, when successful, would be introduced to other cities as well, to celebrate Barbie's 50th anniversary (The Telegraph, 2008).

In the same period Mattel opened their Argentinian store, the company was experiencing a very challenging year. It seemed that the toy industry was not immune to the downturn in the global economy. Mattel recognized that consumer confidence had reached an all-time low in December 2008, as they were fearful of the economy's direction. Normally, December should have been their 'peak' month in terms of sales. The start of the economic crisis caused consumers, specifically in Western countries, to drastically cut back their discretionary spending (Mattel Inc., 2008).

As a result, Mattel's net sales in that year decreased by 1 % as compared to 2007 (Mattel Inc., 2008). Their gross profit, as a percentage of net sales, decreased with 1.1 % as well. Their income before income taxes as a percentage of net sales declined even more: from 11.8 % in 2007 to 8.2 % in 2008. Contributing to this decline in income were lower gross margins, higher advertising and promotional expenses, and higher other selling and administrative expenses, which were all negatively impacted by the lower sales in the fourth quarter of the year (Mattel Inc., 2008).

The poor financial situation in America and Europe caused Mattel's opportunities in their traditional markets to dry up. The following tables provide a summary of the gross sale changes in their International segment in both 2007 and 2008. The first table provides numbers of 2007 versus 2006, when the economy was still in their favor. The second table provides the same information, but then from 2008 versus 2007 (Tables 1 and 2).

As a consequence, in 2009, Mattel started to focus more on emerging markets as their next frontier. As for many Western brands, expanding into China was high on their agenda. The company mainly decided to focus on China because of its future demographics; China's population would be reaching 1.4 billion in 2030: an increase of 4.7 % from 2012 (Euromonitor, 2014). The burgeoning middle class in Emerging Markets such as China would be creating a whole new generation of toy-buyers. In addition to this, Mattel's retail sales in China had been growing by 15 % in 2009 (Mattel Inc., 2009), so it seemed a logical choice for them to further expand their Barbie brand in this market.

Raymond recognized that the choice of expanding in the Chinese market made sense for Mattel. However, before being able to research the House of Barbie in Shanghai, he needed to collect more information on Barbie, the brand, first.

Table 1 Percentage changes in gross sales within their international segment in 2007 versus 2006 (adapted from Mattel Inc., 2008)

Non-US regions	% change in gross sales	Impact of change in currency rates (in % points)
Europe	16	9
Latin America	23	5
Asia Pacific	15	7
Other	3	6
Total international	17	7

Table 2 Percentage changes in gross sales within their international segment in 2008 versus 2007 (adapted from Mattel Inc., 2008)

Non-US regions	% change in gross sales	Impact of change in currency rates (in % points)
Europe	−6	2
Latin America	7	2
Asia Pacific	4	0
Other	−4	−3
Total international	−1	1

4 The Barbie® Brand

Barbie's first job was that of a teenage fashion model. She was sold as both a brunette and a blonde, though her blonde look was most successful. Her looks mirrored the glamour of the 1950s, with celebrities like Marilyn Monroe and Elizabeth Taylor. Barbie had high-arched brows, pursed red lips and a ponytail with curly bangs. With a pale skin, slim and long legs, and a very narrow waist, she represented the all-American ideal women (Barbie Media, 2015). After having been a fashion model, 125 other careers followed. Barbie was able to pursue every career dream she had, making her an inspiration to many young Western girls.

Not only had Barbie's career changed, her looks also changed in order to reflect the changing fashion and cultural trends. During her first few years of existence, an average of 6 new Barbie's were designed each year. Mattel also introduced a colored Barbie in 1968 to appeal to the growing African-American market. With other ethnic markets growing as well, Mattel later also introduced a Hispanic and Asian-American Barbie.

Over the years, there had been some controversy about Barbie's figure. Parents started noticing that her body had impossible measurements and was thereby teaching their young daughters that they had to look the same. Media were talking about the so-called 'Barbie Syndrome'—a term used to describe the desire of females to create a similar physical appearance and lifestyle representative of the Barbie doll (Lind, 2008). Mattel finally responded to this by redesigning Barbie's body in 1997, giving her a wider waist, smaller hips and a smaller bust (BBC News, 1997).

Despite a large number of accusations, Barbie had become a real lifestyle brand in the US and other Western countries. Ben Cavender, explains, "Barbie in the US has a very long history, people grow up with the brand, their parents grow up with the brand, so brand recognition is very high" (BBC Business News, 2011).

5 House of Barbie in Shanghai

After the successful launch of the Barbie flagship store in Buenos Aires, Mattel opened the world's largest doll store called 'House of Barbie' in China in March 2009. The 36.000 square-foot store was located in a six-story high building on the expensive shopping street HuaiHai Road and had cost Mattel around $30 million. Similar to the Buenos Aires store, it included a spa, restaurant, beauty salon and a cocktail bar. Exclusively for this launch, Mattel also created a localized doll named Ling (Carlson, 2013; Gupta & Wang, 2011). They designed the store to target both young girls and women in their twenties, as it offered a clothing-line designed by Patricia Fields[2] and Barbie cosmetics. The store also served alcoholic beverages in the Barbie Bar. The House of Barbie intended to launch Barbie as a lifestyle brand for both Chinese girls and women. It was a bold move from Mattel as it was China's first—and only, all-doll store.

Despite all efforts Mattel had put in this store to create the 'ultimate Barbie experience', sales dramatically failed to meet expectations and the House of Barbie had to close its doors in March 2011 (BBC Business News, 2011).

The failure of the expensive store resulted in a lot of negative media attention, with a large number of business magazines and international newspapers publishing their harsh critiques. The event even became an example of 'bad internationalization' in certain management books. Raymond understood that if Mattel was going to enter China again, he would really have to convince the board with his ideas as executives did not want to risk damaging the image again.

6 Why Did Mattel Fail?

Raymond decided to look into why the House of Barbie store failed, before trying to formulate a new strategy for Mattel. He discovered the following three main mistakes Mattel made while entering the Chinese market: Barbie was not a lifestyle brand in China (yet), there was a huge difference in local consumer tastes, and they had the wrong pricing strategy.

[2] Well-known 'Sex and the City' designer

6.1 Lifestyle Brand

Though the Barbie doll had been relatively popular with girls in China ever since it was launched in the market, the Barbie brand was not. Barbie had been on sale in the Chinese market for 9 years, but since Chinese mothers did not grow up with Barbie, they never fully understood the Barbie culture. Chinese children simply liked the doll and her looks but did not understand the all-American lifestyle linked to the doll.

Gar Crispell, former General Manager of the House of Barbie in Shanghai, said, "The concept of the store [was] wrong". Ben Cavender, analyst at China Market Research, explains, "in China, [. . .] nobody really knew what Barbie stood for" (BBC Business News, 2011). Mattel assumed that China would be ready for a store packed with lifestyle Barbie items and services, but they were wrong. Helen Wang, author of 'The Chinese Dream' and business consultant, concluded that because "Barbie is not a cultural icon in China as she is in America, Chinese consumers couldn't care less about Barbie-branded products. [Therefore], the Barbie fashion clothes for young women would only make sense if Barbie is a cultural icon and established lifestyle brand", she explains (Wang, 2012).

Raymond thought about the role of cultural icons. It seemed to him that they could be lucrative for Mattel as they often bring in a higher level of brand loyalty and brand recognition, which the Chinese market was currently still lacking. Most multinational trading companies therefore wanted to establish their commodities as cultural icons in other countries as well (St. Clair, 2008). Raymond understood that the creation of cultural icons takes time and he was going to investigate this challenge after the completion of his research.

6.2 Local Consumer Tastes

Raymond was also wondering whether Mattel paid sufficient attention to local consumer tastes. Although Barbie is often seen as the 'ideal women' in America and other Western countries, the image of the ideal woman in China is very different. Raymond knew that most women were still embracing traditional Chinese values and tended to prefer cute and girlish clothes over sexy clothing (Chairman Media, 2013). To make sure, he consulted various sources he had been collecting on his desk.

Shaun Rein, founder and managing director of China Market Research Group, said that, "Odd as it sounds, Snoopy-branded clothes, cartoon logos and all, are hot sellers for women entering the white-collar workforce" (Rein, 2010). The preference for cute or childlike products is also being referred to as part of the 'Kawaii' culture. This term was initially used to describe the Japanese obsession with cute characters, toys, food, games, house ware and fashion (Read, 2005). Over the years, Kawaii had developed itself from being a small subculture in Japan, to an important part of Asian modern culture as a whole. The affinity for cute products has grown tremendously.

An example of a brand that completely aligns with the Kawaii culture is Hello Kitty. That might also be the main reason behind the great success of the brand in Asian countries, including China. Hello Kitty could be a benchmark for Barbie in China. Since Raymond was not very familiar with the brand yet, he decided to look up some more information.

Successful Kawaii Brand in China: Hello Kitty

Hello Kitty is a brand phenomenon in many countries around the world, especially in Asian countries. The main reason for its success in these countries is because the brand aligns with the local consumer tastes and has created its own brand image. According to Helen McCarthy, author and expert on Japanese animation and comics, Hello Kitty stands for "the innocence and sincerity of childhood and the simplicity of the world". Originally, the 'cute' cat was conceived as a character that would appeal to girls in their pre-puberty years, but about 10 years after her entry into the market, she was no longer regarded as being for young girls only. Esther Walker explains, Hello Kitty was being "marketed [. . .] to teens and adults, appealing to their sense of nostalgia. As 8 year-olds they would have used Hello Kitty pencils and pencil cases in the classroom; in their late teens and early twenties, they reached for Hello Kitty satchels and make-up mirrors" (Walker, 2008).

Raymond realized that unlike Hello Kitty, Barbie is not considered as a 'cute' doll, but as a 'sexy' doll. Customers found the dolls and clothing sold in the store simply "too sexy and revealing" (Rein, 2012). Helen Wang explained, "The Chinese concept of 'femininity' is very different from that of Americans. In China, 'feminine' is more about sweet and soft rather than smart and strong, more about gentle and loving rather than dazzling and fashion-forward. Although [Mattel had] created a Chinese Barbie Ling with black hair who wears Chinese attire, [it] failed to understand what Ling would represent in order to appeal to Chinese girls" (Wang, 2012).

Raymond was facing a tough decision: Would Mattel need to localize Barbie into a cute doll in order to suit the local consumer tastes, or should they differentiate themselves by staying all-American and sexy? Or was there a potential 'grey area' for them to discover as well?

6.3 Pricing Strategy

Luxury sales in China increased by a real $9.6 billion in 5 years to 2014, with 2015 expected to grow by 6 %. Figures on the growth of estimated luxury spending are impressive, ranging from a double-digit growth rate annually over the next few years (Albatross, 2015) to an estimated increase by 52 % in real terms in the 5 years

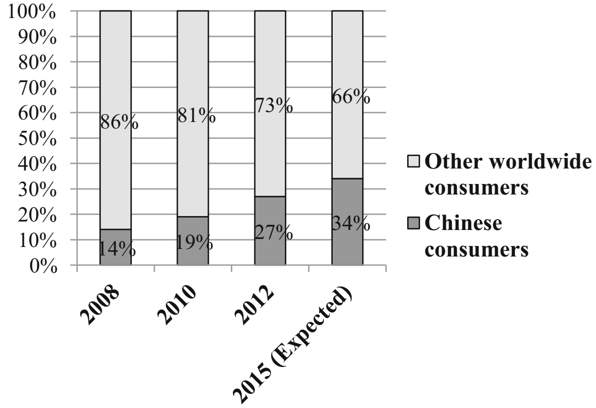

Fig. 1 Luxury goods consumption worldwide 2008–2015. Adapted from McKinsey (2012)

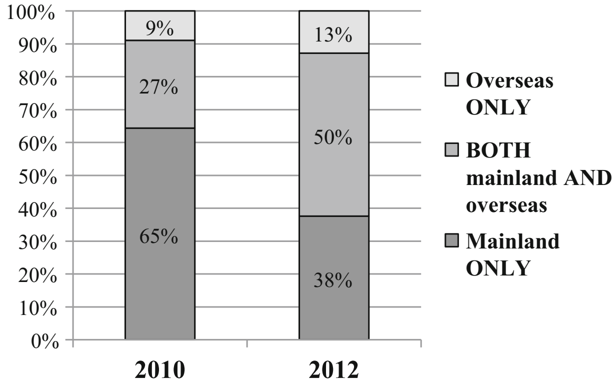

Fig. 2 Share of luxury shoppers purchasing in mainland China and/or abroad. Adapted from McKinsey (2012)

to 2019 ($405 billion) (Luxury Society, 2014). Since 2012, Chinese shoppers have been the largest group of luxury shoppers in the world (Albatross, 2015) (Fig. 1).

Interesting is that more than half of these luxury products are being bought outside the mainland (Fig. 2) (Albatross, 2015). There are a number of reasons behind this phenomenon.

First, there is a price discrepancy between the luxury products sold in China and overseas. The high 'luxury tax' makes the average price of luxury goods sold in domestic stores much higher than those sold abroad (McKinsey, 2012). Luxury goods sold in China are on average 45 % more expensive than in Hong Kong, 51 % more expensive than in the United States, and 72 % more expensive than in France (Albatross, 2015).

Second, the income levels in China are increasing rapidly. The rising numbers of new entrants to the luxury market tend to crave products that clearly display their newfound status, often from brands that are widely recognizable (Albatross, 2015). This, together with the fact that Chinese citizens can obtain visas for Europe or the

US easier, results in traveling abroad—and buying abroad—to becoming more accessible.

Third, because of the Internet, Chinese consumers are more aware of the trends and what is available worldwide. The limited number of products offered and the delayed access to the newest collections in their home country can frustrate them. Therefore, they will travel abroad in order to acquire the product they want.

Finally, there is a general perception under Chinese consumers that foreign made goods are better than those manufactured in China. The 'country-of-origin effect' causes them to buy their products abroad. There is also an issue with the 'authenticity' of the product. Since China is known for its counterfeits of luxury products, many Chinese consumers prefer to buy their goods in other countries (Albatross, 2015).

Knowing that Chinese consumers are the number one luxury spenders worldwide (China Luxury Market Study - Bain & Company, 2013), Mattel's pricing strategy has been similar to other foreign brands entering the Chinese market; they were rather expensive. A pair of Barbie branded jeans cost as much as 1.000 Yuan (€147) (Wang, 2012).

Mattel however did make the mistake to sell the exact same Barbie doll that was being sold at the House of Barbie at a much lower price in other department stores. This made Chinese consumers question the quality of the product and damaged the brand image. Adding this together with the fact that Barbie was not perceived as a popular brand, and the availability of countless knock-off Barbie's, made that Chinese consumers did not want to buy their Barbie products in the House of Barbie store.

Knowing this, Raymond found himself in a dilemma. He knew that Barbie had to be sold in department stores in order to reach a large amount of customers. However, Barbie also had to be positioned as a luxury and high quality product, as this is something Chinese customers highly value. Can these two be combined?

6.4 Consumer Behavior

In addition to the three main mistakes, Raymond also discovered that Mattel had initially underestimated China's consumer behavior, which was completely different from that in other emerging markets. He found that there were two critical factors Mattel had to keep in mind next time: China's tiger parents and the shopping behavior in China.

China's 'Tiger Parents'

Peter Broegger, Senior Vice-President and General Manager Asia-Pacific at Mattel, told Wall Street Journal that he now understood, "joy and learning are like oil and water in China" (Wall Street Journal, 2013). The 'One Child Policy' that was introduced in 1979 created a new mind-set for the babies born after that year. Since families only had one child, all available resources were funneled into the child's future (Chairman Media, 2013). Moreover, China has a so-called 'face' culture; meaning that people's sense of worth is highly affected by how much respect they get from others. It is a parents' job to make sure that their only child is well-developed (Live Science, 2013). Since China praises educational success, many parents consider toys as a waste of time and money.

China's 'Tiger Parents' are parents that focus on education and extracurricular activities (The New Economy, 2015). They would rather have their children reading books than playing with toys. Barbie dolls, or dolls in general, were often seen as a distraction. Luo Chongzong, a 33-year-old education-minded parent, explained that her 9-year-old daughter "Loves those dolls", but she had to stop buying them for her because "They distract her from her studies. She'll spend hours braiding her hair, dressing and undressing her" (Wall Street Journal, 2013).

An example of an all-American company that is currently performing very well with Chinese tiger parents is Disney. Disney understood the demand for education-related toys and decided to tie their entertainment brand to a chain of English Learning Centers. While playing with a Mickey Mouse toy, Chinese children are now learning new skills as well.

Though the controversial One Child Policy changed and became more relaxed 2 years ago, it did not have a significant impact on the family composition yet. The new policy allows up to 11 million Chinese couples to have a second child. However, until now, only 470,000 babies were born as a result (Christianity Today, 2015). But just as China was developing itself more and more at a faster pace, their opinion about having a second child might change as well. Raymond knew that he and his team should therefore keep an eye on these statistics as they could possibly have a significant effect on Mattel's future sales.

Shopping Behavior

Although Mattel had less experience with Barbie in China than it had in Argentina, they started with a store more than five times the size of the one in Buenos Aires (Gupta & Wang, 2011). Shaun Rein believed that their decision to open a big store in China made sense, "A tiny store makes consumers feel put off and disrespected. In most cases it is important to invest in a top-of-the-line store with the newest season's products. An increasing number of Chinese know what's offered in other markets from traveling abroad and surfing the Web" (Rein, 2010). In this case, however, the store was simply too big and too expensive. Since the Chinese are still getting to know Barbie, they should have been treated as new consumers. Helen Wang states, "They are not yet as sophisticated as their counterparts in the West. Although China has changed significantly, it hasn't changed to the point that 6-year-old girls would want to have their own fashion runway. [. . .] The market was simply not ready for that" (Wang, 2012).

Shaun argues that their decision to open a stand-alone flagship store was not the correct thing to do, since "It is usually better to build a large store within a mall or department store, where the foot traffic is. Because of snarling traffic and dizzying pollution, most Chinese prefer to go to one indoor destination rather than walk down the streets. They expect to shop, eat and hit beauty salons in a single place with nice air conditioning and a clean environment. They don't like to go out of their way to a single store unless that store is really special. And most foreign brands, having entered China only in the last decade or so, need to go where the customers are to catch people who have no experience with them" (Rein, 2010).

In addition to this, Raymond considered whether Mattel made some simple, but crucial mistakes in the execution of the store. There was no sign that said 'Barbie' in front of the store; the only thing consumers could see was the bright pink light that shone outside. A pink light might sound innocent in Western countries, in China, however, a pink light district is associated with a much more adult style of trade (BBC Business News, 2014). Another mistake Mattel may have made is that it based all activities in the store in English, not in Mandarin; the language spoken by young Chinese girls (Thomas, 2013).

The fact that the store was targeted at both young girls and adult women did not help either; it resulted in a misconnection with both segments (Gupta & Wang, 2011). Young girls were not interested in fancy cocktails and spa treatments, whereas adult women did not want to be associated with children's birthday parties.

7 A Second Attempt of Going to China?

Considering all the information he collected and the experience of going to other emerging markets, Raymond knew that it would not be easy to be successful in China. In order to succeed in a dynamic foreign market, Mattel needed to be able to change and/or adjust their plans quickly. Their decision to expand into new countries could lead to enormous profits, but also comes at a higher risk. He knew that Mattel's main problem in China was figuring out the right blend between localization and globalization of the brand. Mattel had to localize Barbie just enough to suit the local culture, while still being viewed a foreign brand, since most Chinese would then perceive it as luxurious and unique. If consumers do not view it as being unique, it simply becomes a more expensive version of a product that was probably already available in China.

Raymond was convinced that Mattel could succeed in China. He now had to take the lead during Barbie's second big entrance into the country. His job was to create and present a whole new market entry strategy that fits the dynamics and cultural factors of the Chinese market, along with a marketing plan for the first year. While writing this strategy, he had to keep in mind the heritage of the past and the fact that Mattel, at that time, did not localize enough. Thus, he had to think about how this could be done more successfully in the future. With the information he collected, he thought he would be able to develop arguments to convince the board of the company to try again. In addition, he also involved external research agencies to collect more data on local competitors and changing consumer preferences. Will he succeed in convincing the management board? And will Mattel succeed in China this time?

Additional Questions

1. The case mentioned that Mattel had already launched a localized Barbie called Ling on the Chinese market. Explain why you think this did not work out for them.
2. Would you recommend Mattel to open a new 'House of Barbie' store if they return to China? Explain your answer.
3. How would Mattel be able to create a new strategy that allows them adjust it more quicker and more easily? Explain your answer.
4. Create a new market entry strategy that fits the dynamics and cultural factors of the Chinese market.
5. Create a marketing plan that aligns with the market entry strategy.

Appendix

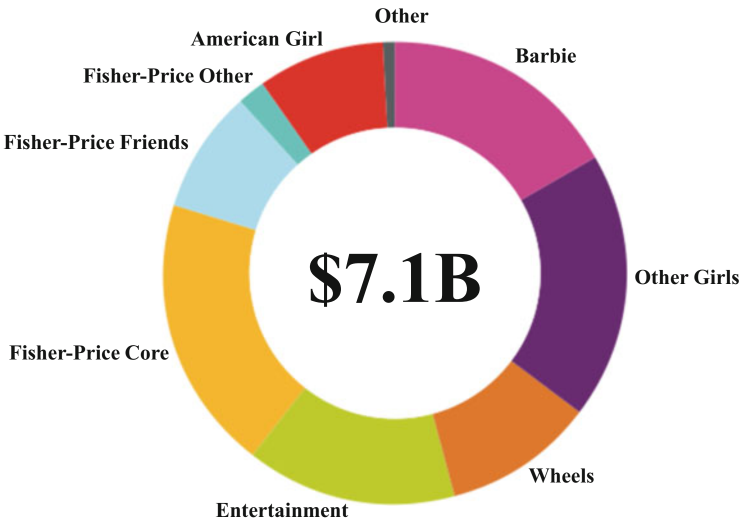

Exhibit 1 2013 gross sales by brand. *Source*: Mattel Annual Report http://corporate.mattel.com

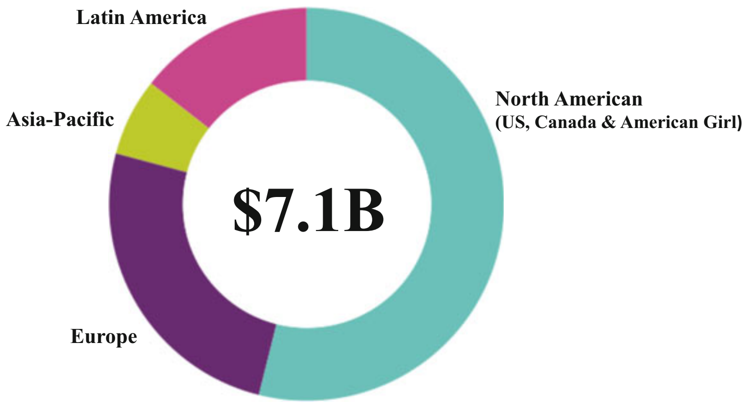

Exhibit 2 2013 gross sales by region. *Source*: Mattel Annual Report http://corporate.mattel.com

Exhibit 3 2013 financials at-a-glance

Year	Gross sales (in millions)	Earnings per share
2011	$6841.1	$2.18
2012	$7052.6	$2.22
2013	$7117.8	$2.58

Source: Mattel Annual Report http://corporate.mattel.com

Exhibit 4 Total shareholder return (For the year ending December 31, 2013)

	1 Year (%)	3 Year (%)	5 Year (%)	10 Year (%)
Mattel Inc.	34	28	29	13
S&P	32	16	18	7

Source: Mattel Annual Report http://corporate.mattel.com

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Part V

Beverages and Food

TPresso: Is the Tea Machine Too Cheap for the Chinese Market?

Christiane Prange

Case Synopsis

Research Problem

How can a product be introduced in a foreign market, where the underlying values seem to run counter to the product's use and functionality? Is Monodor able to repeat the success of the Nespresso capsule system and is it likely to succeed in the Chinese market?

Case Summary

The case begins before the launch of TPresso in China in 2011. TPresso is an automated tea system produced by the Swiss company Monodor. It builds on the success story of Nespresso in the coffee capsule market and now introduces a high-end tea machine that uses capsules in order to make tea. Monodor was founded in 1991 by Eric Favre. Eric originally invented Nespresso coffee capsules for Nestlé in 1976, but then left the company to start his own business. Having successfully developed the idea of the tea capsule, Eric and his wife Anna-Maria decided to launch the Tpresso capsule first in China, i.e., before entering their Swiss home market. China is a country where drinking tea has been part of an old tradition, following specific rules, ingredients, and procedures. Apart from cultural challenges that affect consumer behavior, Monodor needs to develop its segmentation approach and marketing strategy to succeed in China. This implies enhancing the tea drinking experience for those who do not have the time to engage in traditional and lengthy procedures of preparing the beverage. It relates to setting

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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the right price for a luxury product in a brand conscious community. Moreover, it is important to realize that China is a very heterogeneous market with different regions. Their future development may impact the way Monodor is able to attract an increasing middle class in China.

Learning Objectives

Illustrate the importance of China's traditional values for successfully marketing new products, which may run counter to an increasing desire to be part of a segment of international luxury consumers. Introduce students to a discussion on cultural values and their changeability. Consider the heterogeneity and future development of the Chinese hot drink market with a special perspective on luxury goods and the Chinese economy in general. Show the need to reflect upon trading-down or trading-up strategies to attract sufficient market segments.

Themes and Tools Used

- Luxury marketing
- Country-of-origin effect
- Trading-up versus trading-down
- Consumer behavior in China
- Different market segments: premium, luxury, good-enough market
- Product policy

Target Audience

The case can be used for graduate students, who have already been exposed to the essentials of marketing. The case is equally suitable for courses in international marketing, luxury marketing, and consumer behavior, especially with an Asian focus. It is recommended that students have already been exposed to issues of intercultural differences in marketing, the management of the "4P's" and some basic insights into international marketing.

Questions

1. What is your assessment of how well Monodor is handling the conflict between traditional tea drinking customers and modern technology?
2. What is the key positioning advantage of Monodor in China?
3. Can China be treated as a single market in terms of a variety of indicators, such as, culture, values, purchasing power, etc.?
4. How can the market for luxury products in China be segmented?
5. Are the Chinese economy and the hot drink market likely to change (some additional research required)?
6. Should Monodor engage in trading-down strategies to attract larger customer segments or should it rather increase the price positioning (trading up)?

1 Introduction

The Swiss company Monodor and its CEO Eric Favre, who invented the famous Nespresso coffee capsules for Nestlé, was facing a real challenge. In addition to marketing coffee capsules, Monodor had started to produce a high-end tea machine that uses capsules to make tea. The Swiss company had chosen to first launch its trademark "Tpresso" in Asia to "revolutionize tea consumption in China".

Having been infatuated with the idea of tea drinking and tea capsules for almost 30 years, Eric and his wife Anna-Maria were about to present the tea capsule machine Tpresso in Bejing. But China is a country where drinking tea has been part of an old tradition, following specific rules, ingredients, and procedures. Eric knew that it would be difficult to introduce his second innovation to this challenging market and he wondered whether he could use the same marketing strategy he had already used to introduce Nespresso capsules elsewhere. Going to China, his objective was not to replace the hundreds of years old tea-drinking ceremony but to enhance the tea drinking experience for those who do not have the time to engage in traditional and lengthy procedures of preparing the beverage. He also knew that he would only succeed if he were able to better understand the desire for luxury products and the related positioning strategies at the top-end of the market. The road ahead would not be an easy one but Eric was convinced that the tea party in China could be a success.

2 The History of Chinese Tea Drinking

Chinese people have been drinking tea for thousands of years (see Appendix, Exhibit 1). According to a legend, tea was first discovered by the Chinese Emperor Shennong in 2737 before Christ when a leaf from the tea plant (*Camellia Sinensis*) fell into a pot of boiling water. Deeply ingrained in Chinese culture, tea is considered as essential to life as six others elements: rice, oil, soy sauce, firewood, salt and vinegar. Drinking tea in China is part of the traditional way of life and the tea production affects the economic growth of the country.

Especially, the tea ceremony (see Appendix, Exhibit 2) is one of the country's most sacrosanct traditions. The idea is to produce the finest and most aromatic brew from high quality tea (usually *Oolong* or *Pu Erh*), to taste the variations in flavor and to finish as the tea changes over many infusions. All of this is done with the skill, knowledge, and movement by the tea master that takes years of training and knowledge about tea. The art of preparing and making tea is called *Cha Dao*. The smells and taste are the most important parts of the ceremony, so the rules for making and pouring tea vary depending on the type of leaf used. Usually an unglazed purple or red clay pot and cups are used, with *Yixing* (a small area near Shanghai) clay being the most sought after due to the belief that it absorbs any toxins from the tea and water. The pot and cups are unglazed so as to allow the tea oils and resins to be absorbed into the material during the curing process which involves soaking the utensils in tea for a few hours a day for up to a week. After the pot and cups are cured they are ready to be used for the ceremony, however the more they are used the better. Because the clay is cured with one type of tea, it should not really be used to brew other types of tea as this would alter the purity of the flavor. Ever since, tea production has been a major business segment in China. In 2009, the total tea production in China amounted to 1340 thousand tons with domestic consumption rising to 77.3 %. International companies have discovered the challenges of the market and have become aware of this huge potential market. Currently, many competitors are working on products that comply to both the tradition of drinking tea in China and new technological advancements.

3 From Nespresso to Tpresso: A Brilliant Extension of a Successful Concept?

One of the leading players in the international capsule market is the Swiss-based company Monodor, founded in 1991 by Eric Favre. Eric originally invented Nespresso coffee capsules for Nestlé in 1976, but then left the company to start its own business. Nestlé Nespresso SA is nowadays an international well-know company. Nespresso was launched in 1986 in Switzerland and Italy with the C100 and C1100 machine models manufactured by Turmix. Capsule production began in Switzerland, and coffee varieties include Bolero, Capriccio, Cosi and Decaffeinato. In the 1990', the company entered the USA, Germany, the Netherlands, the UK, Middle Eastern, and Asian countries like Singapore, Malaysia, and Taiwan. Present in more than 30 countries with 12 subsidiaries and 300 employees, Nestlé Nespresso has around 6500 points of sale. Nestlé-released 2009 sales figures for Nespresso were 2.77 billion Swiss Francs (nearly US $3 billion) with an average of 30 % annual growth since 2000.

With Monodor, Eric wanted to repeat the Nespresso capsule success story, now with tea. In fact, people are used to capsules with coffee and Nespresso achieved record sales of 3.2 billion Swiss Francs in 2010. Having successfully developed the idea of the tea capsule, Eric and his wife Anna-Maria decided to launch the Tpresso capsule system at a press conference in Beijing, and shortly afterwards introduce it to the Swiss market. Favre told the group that, if in the 1970s he'd aimed to make goof-proof, easy-to-make yet qualitatively top-flight Italian-style espresso available in the home and the office, the aim of his current Tpresso project was to fuse high tech-capsule technology, a futuristic-looking tea set and sophisticated tea maker that sets proper water temperature for each tea, with ancient Chinese tea traditions.

Favre had spent 18 years and 25 million Swiss Francs developing his latest product. He realized that it was impossible to keep other players out of the market. For instance, last September, Nestle had launched a tea-making system, called Special T in France and Switzerland, and the company had revealed in a news release that the first signs from the launch were promising, although no specific figures had been released yet. "*We are now focused on building up the future of this product in these markets,*" said Nestlé spokeswoman Nina Caren Backes at the time (Dow Jones News, 2011). However, Eric was not concerned about competition from other brands such as Special T as he believed in the better quality of his own product and he knew that bringing know-how to the product was more important. It was this knowledge the company had built over several years that now presented a real competitive advantage.

In fact, the birth of the Tpresso machine can be located somewhere else. Eric Favre and his wife Anna-Maria had been tied to one another by a non-corroding love. Their mutual support was witness of their merging affection like the mixture of water and tea. Mr. Favre knew that Mrs. Favre liked to taste a good cup of tea. Indeed, a trip to Japan made the Italian woman discover the joyfulness of drinking tea. After two weeks spent in Japan she was becoming so used to drinking tea that she bought several tea portions at the airport in order to bring them home. Eric decided to offer her a magical gift: a tea machine. Thus, the original Tpresso system was inspired by their seraphic love. The inspiration was further fuelled by previous research results of the coffee capsule system and 10 years later, the baby of their love was born: a tea capsule. Tpresso was closely tied to the life concept of the Favre couple: to be in perfect harmony with nature. This corresponds to Chinese Taoism—the metaphysical concept signifies that the primordial essence of life is part of the nature and universe. Especially older Chinese people believe that it is possible to enjoy natural and pure tea at home without any special effort, thus reaching a point where there is full harmony with nature.

4 The Tpresso Machine and Tea Capsules

Tpresso is a machine that uses capsules to make tea: it works in the same way as a Nespresso machine for coffee. Consumers have to buy the machine first: the machine is sold with two cups and a glass teapot, which are specifically designed to preserve and enhance the taste of tea. Capsules are not reusable but consumers need to buy new ones regularly. To obtain a cup of hot tea, the capsule has to be put into the machine. Then, the machine processes it using pressure and steam and the tea is ready after 50 s. Monodor manufactures the capsules using high-end teas coming from China. Eight tea sorts are available, and the machine can only be used with Monodor's capsules. To preserve the taste of tea, the water used by the machine is filtered and all the components of the machine are made of materials that do not alter the taste of the beverage. In a traditional Chinese teashop, hundreds of different types of tea are available, with various grade of quality. Monodor decided to offer a range of different types of capsules, all made with traditional tea varieties.

5 Tpresso and the Chinese Market

Tea drinking in China is like wine tasting in France. Whereas Europeans think of tea as a hot beverage, in China it can come with different degrees of tepid, depending on the tea. As with wine in the West, there are different aromas and tastes. Favre knew quite a bit about the hot drink market having also worked as the

Table 1 Hot drinks market value growth, 2005–2009

Year	$ million	CNY million	€ million	% Growth
2005	7686.2	52,580.6	5527.6	–
2006	8256.0	56,478.3	5937.4	7.4
2007	8906.5	60,928.6	6405.2	7.9
2008	9592.8	65,622.9	6898.7	7.7
2009	10,281.3	70,333.1	7393.9	7.2

Source: Adapted from Datamonitor, 2010, Industry Profile Hit Drinks in China (Reference code 0099–0803)

Chief Executive of Nespresso between 1985 and 1990. Eric had explained his plans several times. He remembered the launch of Nespreso in 1989, when nobody believed in coffee capsules. Nowadays, millions of them were sold. Probably, it would be easier to sell a new system for tea just because people already knew about the coffee capsule. So he just wanted to reproduce the Nespresso story but with tea. And Favre was quite sure that TPresso could become the Nespresso of tea, probably in less time. He also knew that an estimated 1200 billion cups of tea were consumed every year, compared with 800 billion cups of coffee.

In 2009, the Chinese hot drinks market generated a total value of sales of $10.3 billion. Tea makes up for 96.7 % of the hot drinks value sales, which are $9.9 bilion.[1] Coffee, in comparison, only made up for 1.9 % of market value (Table 1).

In comparison, the Japanese tea market had only been growing by a CAGR of 1.1 % in value. In terms of volume, the Chinese hot drinks market had been growing at a CAGR of 1.8 % between 2005 and 2009. The overall market volume was expected to rise to 650,900 t by the end of 2014, which represented a CAGR of 1.6 % for the 2009–2014 period. In terms of value, the market was also forecast to grow further, but slowing down, with an anticipated CAGR of 6.7 % for the 5-year period from 2009 to 2014. This led the market to a value of $14.2 billion by the end of 2014. However, figures need to be interpreted carefully as there are several conflicting sources of data (Wooeb News, 2011) (Table 2).

In spite of the promising market potential, entering the Chinese market for a product like tea is a real challenge. Drinking tea in China is part of the traditional way of life of the population. It is part of the Chinese culture and it affects the whole population, whatever the social classes. And there was also critical sentiment, as expressed by the following statement:

> *"One would have thought that tea has the convenience thing all figured out, with that teabag thing, but no, that isn't convenient enough. Instead, the Tpresso, priced at a modest 5000 yuan (US$ 768!) is being marketed to 'younger consumers who don't have time to brew tea in the traditional way.' So now they can buy overpriced tea in little plastic turds" (Alter, 2011).*

[1] Due to the very high proportion of tea in the hot drinks market, and due to the lack of reports only related to tea, the figures given on hot drinks in general are assumed to be valuable for the tea market.

Table 2 Hot drinks market volume growth, 2005–2009

Year	Million kilograms	% Growth
2005	558.9	–
2006	568.4	1.7
2007	578.8	1.8
2008	589.8	1.9
2009	600.5	1.8

Source: Adapted from Datamonitor, 2010, Industry Profile Hit Drinks in China (Reference code 0099–0803)

But Eric hoped that his experiences with Nespresso may help him and he was quite confident about the success of his company's product in China. André Übersax, president of the Swiss-Chinese chamber of commerce further said that far away from being self-sufficient like India, the Chinese society was opening itself to the world and that it was aspiring to possess Western brands.

6 Tpresso's Positioning and Chinese Luxury Consumers

Tpresso's positioning was focused on several elements: Tpresso was a high-end machine that perfectly allied Swiss technology and Chinese tradition by making tea while preserving its flavor and its healthy properties.

A long-term investment gave birth to a real sophisticated machine. The company emphasized the elements that would be purchase incentives for its target customers: modernity, ability of the machine to preserve the flavor and healthy properties. Tpresso's positioning particularly emphasized the fact that modernity can sublimate tradition. It also stressed the national origin of Monodor to make use of positive perceptions of the country. Indeed, Switzerland had, among others, been well known for its high-end and reliable watches, chocolates, and prospering banking sector. For instance, half of Switzerland's US$ 8 billion annual watch export goes to China (KPMG, 2007). With the positive country of origin effects, Monodor hoped that the perception of its tea machine would be influenced by the good reputation of high-end and reliable Swiss products. However, Monodor, as a Swiss company, could also be seen as lacking credibility as far tea is concerned. Switzerland is not known to be a country of tea specialists, or a country where drinking tea is a tradition. There is a risk that a Swiss company might be perceived as not having enough knowledge of tea to have pretensions to revolutionize the way of making it. Thus, being Swiss-based can be a disadvantage or an advantage.

Eric Favre defined TPresso's target customers as rich Chinese people, who like cool stuff. With a price-tag of 5000 ¥ (EUR 635) for the tea making machine, special teapot and tea cups, and 1.5–3 Swiss Francs for a capsule, Favre stressed that it was a luxury product and he was hoping to sell up to six million capsules in the first year of entering China. On the one hand, the consumers targeted by Monodor cared more about the healthy properties of tea than about its traditional and symbolic value (Askensai, 2011). They considered tea as a healthy drink, and drink it for its properties rather than because it is a symbol of Chinese millenary culture. Thus, it is usually said in China that tea produces anti-oxidants and allows the body to resist against weaknesses. It also lessen cholesterol; it strengthens body natural immune system; it has of course a pleasant and fragrant smell and taste; it reduces stomach bloodedness due to over eating; it freshens breath especially if you smoke or drink coffee regularly and finally tea is the perfect drink for anyone during illness recovery, dieting or stress. Women were Favre's main target. This aspect was highlighted by the fact that women were starting to gain economic independence and could now spend their own money in order to buy luxury products. The modern female luxury shopper included the business woman, the celebrity and the newly independent rich wife.

On the other hand, some figures could enable a better understanding of the scale of the potential market for this product. The following differences between income levels can be identified for 2000, 2010, and 2020 (forecast) (McKinsey, 2011):

- *Affluent:* consumers with household income that exceeds $ 34,000. This accounts for only 2% of the urban population in 2010, or 4.26 million households.
- *Mainstream:* consumers with relatively well-to-do households with an annual disposable income of between $16,000 and 34,000. This group is still comparatively small with fewer than 14 million households in 2010.
- *Value:* this segment represents the large majority of consumers living in households with annual disposable incomes between $ 6000 and $16,000, just enough to cover basic needs.
- *Poor:* this segment represents consumers with less than $ 6000 and has been mainly ignored by Western firms.

According to the census conducted in 2010 Nov. 11th (which is the latest source of data available), the total Chinese population was 1.34 billion people. Urban people represent 46.68 % of this population, that is to say 665.57 million people. The average annual revenue of the urban population is 19,109 ¥ ($2866): the annual revenue of the rural population is about three times as low as the urban population's revenue (5919¥, $887). Table 3 depicts the per capita GDP per region in 2010 (or later).

Eric felt that figures reinforced his desire to enter the Chinese market as they clearly illustrated its huge potential. But he also realized that only looking at average revenues blurred the fact that significant revenue inequalities existed among the Chinese population. For example, considering only the urban people with high revenues, their average annual revenue per capita was 139,000 ¥ ($20,850). Only 5 % of the Chinese population earned more than 300,000 ¥ ($45,000) per month but this small share of very rich people within the population still represented 50 million people! Another figure showed that even a minority of well-off people could represent a significant number of people. And more than 960,000 people on the Chinese mainland had a personal wealth exceeding 10 million ¥.

Table 3 GDP per region

Rank	Region	GDPPC (USD)	GDPPC (PPP)	GDP (in 100 million of CNY)
	Mainland China	4394	7539	397,983
1	Shanghai	10,828	18,575	16,872.42
2	Tianjin	10,400	17,841	9108.83
3	Beijing	10,378	17,803	13,777.94
4	Jiangsu	7682	13,178	40,903.34
5	Zhejiang	7390	12,677	27,226.75
6	Inner Mongolia	6969	11,955	11,655.00
7	Guangdong	6440	11,048	45,472.83
8	Liaoning	6172	10,589	18,278.29
9	Shangdong	6078	10,428	39,416.20
10	Fujian	5748	9862	14,357.12
11	Jilin	4614	7915	8577.06
12	Hebei	4152	7123	20,197.09
13	Hubei	4079	6998	15,806.09
14	Chongqing	4043	6935	7894.24
15	Shaanxi	3966	6804	10,021.53
16	Heilongjiang	3946	6770	10,235.00
17	Ningxia	3853	6609	1643.41
18	Shanxi	3759	6449	9088.06
19	Xinjiang	3670	6295	5418.81
20	Henan	3605	6184	22,942.68
21	Hunan	3576	6135	15,902.12
22	Qinghai	3545	6082	1350.43
23	Hainan	3496	5997	2052.12
24	Jiangxi	3127	5365	9435.01
25	Sichuan	3104	5325	16,898.59
26	Guangxi	3050	5232	9502.39
27	Anhui	3045	5223	12,263.36
28	Tibet	2497	4284	507.46
29	Gansu	2379	4082	4119.46
30	Yunnan	2320	3981	7220.14
31	Guizhou	1953	3351	4593.97

(Based on figures of China's Census 2010, adapted from Wikipedia http://upload.wikimedia.org/wikipedia/commons/2/24/GDP_per_capita_of_Chinese_provinces.PNG; accessed 10 December, 2010)

The target consumers were high revenues people, who were ready to spend money on sophisticated products: the high price of the product would not be a disincentive to purchase for them. This reflects a general trend in Chinese consumer behavior as Eric know from talking to his market analyst in China, Tom LiPing.[2]

[2] Both name and position are fictitious.

Tom regularly monitors the luxury market segment in China and he knows a lot about the development of the sector and the behavior of high revenue people. Asia is the largest target market for luxury brands, accounting for more sales than any others regions. Consumption of luxury goods in China reached USD six billion in 2006, making up 12% of the global consumption of goods, and predictions that this will increase to 29% in 2015 (Goldman Sachs, 2007). However, just a tiny fraction of China's huge population can afford buying luxury goods. Demand for luxury and fashion products has traditionally been regarded as highly susceptible to swing in line with the economic sentiment. Luxury brand have however now enjoyed many successive years of growth. The worldwide sales of luxury goods are expected to grow at an average of about 6% up to the end of the decade, with the sector growing by as much as 9% in Asia.

With the elevation of living standard in China, the public awareness and the demand for a safer tea has risen significantly. The consumption concept seems to shift from a price-based to a safety-based strategy, and consumption of organic tea is increasing. Drinking tea for its functional and healthy values becomes a new trend. Those modernized consumers will not mind seeing a Swiss firm launching a machine that supposedly makes a tea that is better than "traditional" tea, since it preserves and enhances the taste and the natural properties of tea.

7 Tea Consumption Habits of Chinese People

Chinese people have drunk tea for thousands of years and this tradition is maintained in a lot of events of Chinese daily life. In fact, this national drink has been designated as the currency of the country during some periods through history. At the beginning, tea was valued more for its medicinal characteristics, but today it is an art to make it and drink it. Tea is still used in Chinese medicine and cuisine. Drinking tea is regarded as a culture involving the methods of preparation, the equipment used and the occasions in which it is consumed. Chinese people use to drink tea very often; for example, when showing respect to older generations, in family gatherings, when children apologize to their parents, in large family meetings, ceremonies and common meals. Chinese people choose the ingredients and the people preparing it, regarding to the occasions mentioned before. Even though this culture is deeply rooted in rural areas, nowadays instant tea is the largest brand. This means consumer behavior is changing, because people in urban areas have less and less time to prepare tea and because of companies' efforts to sell more diverse products at higher prices.

Consumption habits also differ across regions: Western provinces prefer teas with stronger aroma and taste, in Sichuan province people prefer green flavored teas and in some others regions such as the South and East the local production is the most consumed. People in Tibet and the North West of China usually consume larger quantity of tea, followed by those in big or middle cities. People in the North of China prefer scented tea, while Southern consumers prefer green tea. People in big cities such as Beijing, Tianjin, Shanghai, Hangzhou etc. like to drink high grade green tea like Longjing tea and Biluochun tea. People in Guangdong, Fujian and Taiwan provinces like Oolong tea best.

Each Chinese consumes approximately 20–25 g of dry tealeaf each day. Tea is also an important element in social life: it is for example drunk during business meetings or with friends. The development of the new wealthy Chinese middle-class enhances the development of conspicuous tea consumption: those consumers drink expensive and refined teas as a symbol of their status and wealth.

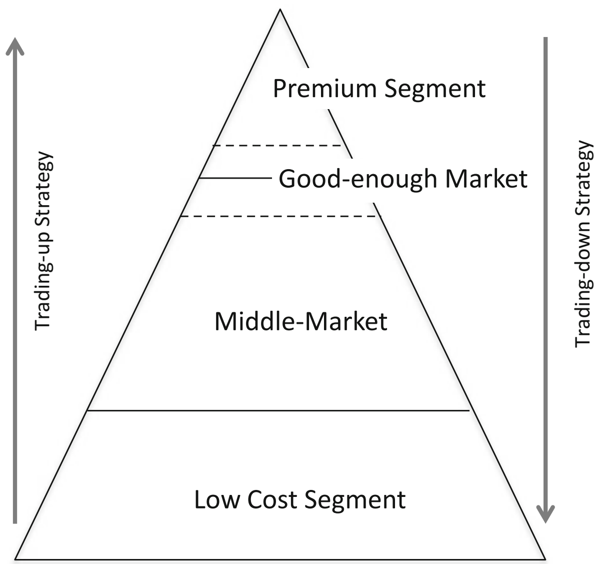
8 Product and Pricing Strategies in China

When Eric wanted to launch the TPresso machine in China, he was well aware that the market was specific, especially with the drive towards upper segments of the market. He remembered an old chart, he was looking at a while ago and contemplated: Would the luxury segment at the top of the pyramid be large enough in terms of volume? Or maybe, he could lower the positioning to target the "good-enough market", a segment that requires high quality but can be targeted at lower prices (Gadiesh, Leung, & Vestring, 2007) (Fig. 1).

8.1 Product Launch and Positioning

The first tea machines, which have been assembled in China, with technological parts made in Switzerland, Germany, France and Italy, will go on sale in China in

Fig. 1 Market segments. *Source*: Author



April. Later this year Tpresso will be launched in Korea, Japan and Hong Kong, before coming to Europe (Mawani, 2011).

Because of similarities tea tasting has with wine tasting, the Favres asked wine glass designer Jacques Pascot to design the Tpresso Tpot and Tcups (in Bayel crystal) so that the refined, subtle tastes and fragrances of each brew are optimally channeled. To encapsulate the essences of teas, Favre developed a machine called a "tea crumbler" that crumbles leaves as gently as human fingers do, thus making the leaves "bleed". Because the machine is hermetically sealed in an inert atmosphere, no freshness is lost as crumbled leaves are quickly transferred to the capsules that protect them from light, oxygen and humidity.

While the product targets the high-price market segment and thus wealthy consumers with Western brand preferences, the product's launch may still be hampered by several potential disincentives to purchase. In fact, a Western manager needs to learn a lot before settling a business in China which also includes the specificities of the luxury industry in China that follows different rules. The pricing strategy for the new product launch also has to be very well defined as consumers may be more sensitive to price changes with products challenging their traditional way of living. Thus, a whole array of negative feelings may occur with the product, some of which may be related to Western country perceptions, thus as country-of-origin effects or personal animosity that Chinese consumers may develop about foreign brands. Moreover, the reputation of the company has an important role to play here. How will Chinese consumers perceive this Swiss company willing to change their traditional tea consumptions habits? May Chinese inherent pride in their own culture lead to a potential boycott of the product? Are Chinese so open minded that they will allow a European company to revolutionize what is and has always been a tradition? Indeed, from a European point of view, the market in China is not easy to pierce.

8.2 Pricing Strategy

A first potential disincentive to purchase might be the price of the product. The capsules will be sold at a relatively low price, but the consumer will have to spend around 5000 ¥ to buy the machine. This represents a very high price and a significant initial investment, especially for a country like China. China is a two-tier society where habits are different from the rural to the urban areas but the consumption of tea is quite homogeneous and is following the same traditional basic rules in the whole country. Thus, even if a part of the society is adopting a modern way of life, somehow living like European do, a large majority of consumers might consider that this is too expensive for a machine that only makes tea, given that you can make tea with water and a less expensive teapot.

Chinese are quite sensitive as far as the prices of products are concerned (Berger, 2010). Companies in China mainly realize a low margin and a high volume sales strategy. Nevertheless, international brands are often seen like quality brands, that justify higher prices. Thus, even if the "low cost" strategy is preferred by a large majority, a Chinese famous sentence says: "*pian wu yi hao huo*", meaning that the cheapest is never the good one. Further empirical data are favorable of the Tpresso concept. There is also an increasing tendency of trading up, especially when it comes to housing, utilities, and food, but this goes along with searching for the 'best price' (McKinsey, 2011). Another point to be highlighted here is that the pricing of a Tpresso machine and capsules will remain the same, wherever it is sold in China. However, when buying tea from producers, the tea price may change from one producer to another, depending on the quality of the tea, whether it is made from leaves that are whole, cut or broken—knowing that the higher grade of tea is the one made from whole leaves and that the dust that is left over as a result of the grading process at the factory, is then used for low quality teas in teabags.

9 The Future

Even though he realizes that it will not be easy, Eric feels very positive about the Chinese market. But he knows that launching the tea machine directly in China is a bold bet for Monodor, and this strategy seemed riskier than simply launching its product in France or Switzerland. But Monodor is well aware of the challenges it is facing in China. The company has clearly identified all the disincentives to purchase that could negatively impact its sales development, and has tried to overcome them. Its targeting and positioning is clearly matching Chinese consumer segments. The main goal of Monodor now is to appear as an innovative firm while avoiding to deter Chinese customers by entering the field of traditional tea ceremony. At present, it seems that Monodor has found the perfect balance between innovation and tradition, partly thanks to its strategic partnerships with key Chinese players in the tea sector. Monodor is also looking for new partnerships in order to expand its supply and distribution network in China. The company's long-term goal in the country is to reach a 20–30 % market share of all tea sold in China within 20 or 30 years, and to further develop the product in Western European countries. Can Monodor successfully manage this challenge?

Appendix

Exhibit 1

Important Dates in the History of Tea (*Source*: http://www.inpursuitoftea.com)

2737 B.C.E. Tea is reportedly first discovered in China by the mythical second emperor, Shen Nung, known as the Divine Healer, when leaves of the *Camellia sinensis* plant drift into a heated open pot of water.

350 A.C.E. The first description of drinking tea is written in a Chinese dictionary.

400–600. The demand for tea rose steadily. Rather than harvest leaves from wild trees, farmers began to develop ways to cultivate tea. Tea was commonly made into roasted cakes, which were then pounded into small pieces and placed in a china pot. After adding boiling water, onion, spices, ginger or orange were introduced to produce many regional variations.

618–906. T'ang Dynasty. Powdered tea became the fashion of the time. It was often mixed with other ingredients and brewed, reducing the real tea taste. Nobility made tea a popular pastime. Caravans carried tea on the Silk Road, trading with India, Turkey, and Russia.

780. Poet Lu Yu, wrote the first book of tea, making him a living saint, patronized by the Emperor himself. The book described methods of cultivation and preparation.

805. The Buddhist monk Saicho brought tea seeds to Japan from China.

960–1280. Song (Sung) Dynasty. Tea was used widely. Powdered tea had become common. Beautiful ceramic tea accessories were made during this time. Dark-blue, black and brown glazes, which contrasted with the vivid green of the whisked tea, were favored.

1206–1368. Yuan Dynasty. Genghis Khan and Kublai Khan conquered Chinese territories and established a Mongolian dynasty in power for more than a century. Tea became an ordinary drink, never regaining the high status it once enjoyed.

1368–1644. Ming Dynasty. People again began to enjoy tea. The new method of preparation was steeping whole leaves in water. The resulting pale liquid necessitated a lighter color ceramic than was popular in the past. The white and off white tea-ware produced became the style of the time. The first Yixing pots were made at this time.

1618. Chinese ambassadors presented Czar Alexis with a gift of several chests of tea.

1669. Close to 150 pounds of tea were shipped to England.

1776. England sent the first opium to China. Opium addiction in China funded the escalating demand for tea in England. Cash trade for the drug increased until the opium wars began in 1839.

1857. Tea plantations were started in Ceylon, though their tea would not be exported until the 1870s.

1869. A deadly fungus wiped out the coffee crop in Ceylon, shifting preference from coffee to tea.

1869. The Suez Canal opened, making the trip to China shorter and more economical by steamship.

1908. Thomas Sullivan invented tea bags in New York, sending tea to clients in silk bags, which they began to mistakenly steep without opening.

Exhibit 2

Process of the Tea Ceremony (http://www.chinalifeweb.com)
The pot is rinsed with boiling water.
The tea leaves are added using a bamboo scoop until about 1/3 of the pot is filled.

Perfect temperature water (depending on the tea) is poured into the pot until overflowing (this is to wash the tea and remove any fermented flavor).

The lid is place on the pot and the tea is poured into the decanter. The tea is poured from the decanter into the clay cups to warm and cure them.

First infusion—Perfect temperature water is poured into the pot until water emerges from the spout. No bubbles should form in the liquid. The lid is returned and the liquid from the cups are poured over the pot to keep an even temperature. The pot is left for about 15 s or until the drop at the end of the spout has disappeared. The tea is poured into the decanter to mix the brew. Each smelling cup is filled with tea and then topped with the drinking cup and served.

The guest lifts the smelling cup to breath in the aroma then drinks. The tea should be drunk in 2 or 3 small sips with the tea passing through the teeth making a slight hissing sound. This is to bring air into the brew for maximum flavor.

Further infusions—The process for the first infusion is repeated but the brewing time is left longer (usually about 10–20 s extra for every infusion). A good tea can be infused up to 8 times (Pu Erh up to 20 times) with the 2nd infusion usually considered the best but connoisseurs take delight in tasting how the tea liquor looks and tastes different with every infusion.

At the end of the ceremony the tea is removed from the pot and placed in a clean bowl for the guests to observe whilst the tea master carefully cleans all the utensils.

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Coca-Cola in China: Will Their Brands Survive in This Challenging Market?

Patricia Schnitger

Case Synopsis

Research Problem

How can Coca-Cola's number one brand succeed in China?

Case Summary

The China Industrial Information Issuing Center recently reported the carbonated soft drink market share: its share dropped to 22 % compared to 36 % in 2000. China's soft drink market has been changing rapidly. In the past decade the soft drinks categories have been shifting from carbonated soft drinks towards non-carbonated soft drinks. Although Chinese consumers favor international brands, they are becoming more health conscious and due to the current economic situation more careful with spending their money. The world's leading beverage company in carbonated soft drinks (CSD), Coca-Cola, will have to adjust their market strategies for the Chinese market, as this growth potential market will need a different approach compared to the Western countries. This case study will give a view of the Chinese soft drink market and the challenges Coca-Cola needs to face and overcome in order to continue to stay ahead in the Asian market. As Chinese consumers shift towards a healthier life style including non carbonated soft drinks such as ready-to-drink teas, juices and milky flavored beverages, the question is how the Coca-Cola Company's number one brand can succeed and remain successful in the largest country of the world with a population of 1.3 billion?

P. Schnitger (✉)
Tias School for Business and Society, Utrecht, The Netherlands
e-mail: patricia_ann6@hotmail.com

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Learning Objectives

Working on this case study will show the student how to

- Identify key success factors in the Chinese beverage market
- Understand the different segment of the soft drink market
- Analyze the key success factors of the competitors in the market
- Consider the importance of consumer preferences

Themes and Tools Used

- External environmental analysis (e.g., influence of the government)
- Industry analysis, using Porter's Five Forces model
- Strategy formulation and implementation
- Consumer segmentation

Target Audience

Students with basic knowledge of strategic analysis and consumer segmentation. Case can be used for classes in international marketing, strategy, environmental analysis or China-related issues.

1 Introduction: The Coca-Cola Company

Coca-Cola was founded by Dr. John Pemberton in Atlanta, Georgia in 1886. Pemberton, a local pharmacist developed a syrup, added carbonated water and took a sample to the local Pharmacy where the beverage was sold for $0.05. He then teamed up with bookkeeper Frank M. Robinson and together they created the trademark name and script logo Coca-Cola. During the first year they sold nine drinks per day. Today, 127 years later, more than 1.7 billion Cokes are sold per day: it is available in more than 200 countries and is in the top three of the most powerful brands in the world with a brand value of $50.2 billion (Forbes, 2013).

1.1 Coca-Cola in China

The first Coca-Cola cans were shipped to China in 1978 and the company opened its first plant shortly afterwards, making it the first US company to distribute its products in China. Today, 35 years later, the company has an ownership stake in 24 bottling joint ventures owned partly by Swire Beverages and Kerry Group (Russel, 2011). In addition, Coca-Cola operates and owns an enterprise in Shanghai and Tijanjin, which produces beverage concentrates. Due to strong relations with the Chinese government and local companies it has established nationwide operations and generated a strong market presence. Coca-Cola's Asian headquarters are located in Hong Kong, serving 43 countries in the Pacific area and employ 50,000 local Chinese employees.

Coca-Cola's product portfolio consists of 20 varieties of beverages, with more than 50 flavors of full, low and no-calorie sparkling beverages, juice drinks, water, sports and energy drinks, teas, coffees, and dairy based beverages. In 2012 China counts for 8 % of The Coca-Cola Company's global sales by volume, growing at double digits. However the strong decline of share in the carbonated soft drink segment could be worrying as Coca-Cola's world-wide leading brands, Coca-Cola, Diet Coke, Fanta, Sprite and Coke Zero are all carbonated soft drinks. Sprite however has shown a steady growth of 18 %. It is perceived as a healthier beverage than Coca-Cola because of its clear color and lemon flavor, and is Coca-Cola's number one brand in the CSD category in China. In order to remain competitive in the fast growing tea and juice market, Coca-Cola has differentiated its original Sprite and has introduced Sprite-tea to its carbonated soft drinks portfolio, which is a carbonated blend of local green tea flavors only available in China.

China and the Pacific area account for 18 % of the worldwide unit case volume and 8 % of its revenue. In the past decade, the Coca-Cola beverages consumption per capita in China has grown from 10 consumptions to 39 consumptions per person per year, which leaves a huge growth potential when comparing these figures to the rest of the world. Coca-Cola's worldwide objective for 2020 is to double its servings and annual sales to $200bn, where it is expected that the bulk of this growth will come from China and other emerging markets.

1.2 Coke's Successes and Difficulties in China

Coca-Cola has had many successes but also challenges to overcome in the past decades in China. The initial rebranding of the Coca-Cola name in China led to the name Ke-kou-ke-la. Coke only discovered that after investing thousands of advertising materials, that the phrase meant "bite the wax tadpole" or "female horse stuffed with wax". After researching 40,000 Chinese characters it came up with "ko-kou-ko-le" meaning "happiness in the mouth", which fits its global happiness branding strategy (Anvari, 2013).

In the past decade, Coca-Cola adapted the 'Think global, act local approach', encouraging local organizations to develop new drinks and adapt local initiatives. Since the opening of its first bottling plant, it has built a fully domestic network of suppliers. The majority of the Coca-Cola beverages are sold through the wholesale distribution networks, ranging from major state-owned companies to local independent wholesalers, giving Coca-Cola the opportunity to reach a large share of the country. The initial challenges were to supply the high quality packaging materials, although Coca-Cola seemed to have overcome this challenge by investing in financial and technical advice. Today, the main challenge is to find qualified local personnel and to adapt to the changing trends in retail and consumption models.

In 2001 Coca-Cola and Nestle each invested 50 % stake in a joint venture: Beverage Partners World Wide, mainly selling their Lemon Tea and Original Leaf Tea brands (Want China Times, 2011). However, in the first quarter of 2012, Nestle announced the ending of its 10 year cooperation with Coca-Cola in the beverage market: Nestle taking back its Lemon Tea brand and the Original Leaf Tea brand remained with Coca-Cola. This posed a challenge for Coca-Cola as Nestle owns the worldwide known leading tea brand, Nestea. Nestlé's operations now focus on collaborating with Chinese companies and investing in production lines in China. Today, Nestle owns 31 factories and four Research and Development sites in China, employing over 47,000 people. It has the majority of stakes in partnerships with Hsu Fu Chi (Chinese snacks), Yinlu (ready to eat rice and ready to drink milk), Totole, Haoji, (bouillons) and Dashan (bottled water). Its core products are; dairy, snacks, bouillon, cereals, ice cream and beverages (Nestle, 2013).

The Coca-Cola Company has focused on a number of strategies in the past decade: (1) growing rapidly in the juice market through collaborations; (2) investing in the core brands (Coca-Cola, Coca-Cola zero, Diet Coke and Fanta), (3) introducing a variety of packaging and expansion of cooler facings: Coca-Cola invests in cooler and vending equipment in order to expand in chilled availability. Cooler facings refer to the number of facings of different beverage categories available in the coolers.

In order to expand its Chinese market presence and distribution channels, Coca-Cola attempted to acquire Huiyuan in 2009, which controlled 8.5 % of the Chinese fruit and vegetable juice market and 40 % of its pure juice market; however, the bid failed, which was a set back for Coca-Cola's strategy to grow rapidly in the juice sector. The Chinese government feared a monopoly position, which could have lead to increasing entry barriers and squeezing out smaller producers. The Chinese government was afraid to give foreign firms major stakes in large national players, associated with a potential loss of governmental control (Rein, 2009). According to China law blog, the Chinese government approves foreign companies to purchase non-majority interest in strong successful Chinese companies, only if there is some benefit for China, such as technology transfer or access to foreign markets.

In 2012, Coca-Cola's brands accounted for a 55 % share of China's total Carbonated Soft Drink (CSD) market, in comparison to Pepsico at 32 % share (Yagalla, 2013). In 2011 Coca-Cola showed a 13 % growth in volume in China. This had been the ninth consecutive double digit growth year; however in the first quarter of 2013 the growth figures for its carbonated category was 1 %. According to Coca-Cola this was due to bad weather and the economic slowdown. Coke's non-carbonated drinks (NCD) showed an increase of 16 % volume share, mainly due to the Minute Maid portfolio. Despite the Company's success in the juice market, Coca-Cola's share in China's NCD sector is only 6.6 % by volume, compared to the leading companies Tingyi (14 %) and Hangzhou Wahaha group (10 %) (Euromonitor).

Coca-Cola suffered brand damage due to water quality problems. In April 2012 several batches of one of the bottlers' products were found contaminated with chlorine. According to The Company it posed no threat to human health. A mainstream beverage brand satisfaction survey among the Chinese consumers followed this event, and it dropped six spots from a prior edition in 2010 (Chinabevnews, 2012a, b, c, d). In early 2013 a Chinese popular TV show started a rumor around an illegal fungicide in Coca-Cola's orange juices, warning people not to drink their orange juice brands. According to Coca-Cola the rumors were untrue and filed a police report, holding the perpetrators legally responsible (English news cn, 2013). Such events can harm a brand or even an entire category, such has happened with contaminated baby milk in 2012.

Coca-Cola's strong collaboration with McDonald's has had a positive impact on sales and awareness of the Coke brand, as it is the sole soft drink supplier for the chain. McDonald's will be opening 300 stores in 2013 and has 15.6 % share in the fast-food market. Furthermore in 2011, Coca-Cola's CEO, Muhtar Kent, announced to invest $4 billion by 2014 in China, focusing on expansion of current factories, marketing and distribution channels toward the second, third and fourth tier markets.

These strategies are expected to have a great growth potential, rather than trying to invest in the acquisition of Chinese beverage firms, as it had already failed the bid of the acquisition of Huiyuan in 2009 (Arredy & Esterl, 2011).

1.3 Bottling Partners

Coca-Cola works with 275 bottling companies worldwide, who are responsible for manufacturing and the distribution of their products. In 2011 and 2012 Coca-Cola opened its 41st and 42nd bottling plant respectively in China and is planning to open its 43rd plant in 2013 giving the company a major stake in the Chinese market. The three major bottling partners are COFCO Coca-Cola beverages, Swire Beverages and Coca-Cola Bottling Investment Group China.

COFCO Coca-Cola Beverages Limited (CBL) was established in 2000, which was a joint venture funded by COFCO Corporation as the majority at 65 % and The Coca-Cola Company at 35 %. CBL engages in the bottling production and sales and distribution of Coca-Cola products in 16 provinces, cities and autonomous regions in China under the franchise agreements with The Coca-Cola Company. At the end of 2010, CBL delivered 486 million unit cases, which made CBL become one of the top ten Coca-Cola bottlers in the world.

Swire Beverages has the franchise to manufacture, market and distribute products of The Coca-Cola Company in Hong Kong, Taiwan, and seven provinces in Mainland China. Swire Beverages is one of the largest Coca-Cola bottlers in the world and works closely with The Coca-Cola Company on brand development and marketing. The relationship with Coca-Cola began in 1965 with the acquisition by Swire of the majority shareholding in a Coca-Cola franchise in Hong Kong, a business known today as Swire Coca-Cola HK Ltd. Swire Pacific acquired the Coca-Cola Bottling Company of Salt Lake City in 1978.

In January 2006, Coca-Cola formed its Bottling Investments Group to bring all of its company-owned bottling operations under one roof and serve as a clearing-house of sorts to acquire bottlers' broken operations and fix them up for future sale (Woke, 2012).

2 The Soft Drink Industry in China

Soft drinks in China refer to those artificial or natural beverages with the alcohol content of less than 0.5 %. The four major Chinese soft drink categories are carbonated beverages, bottled drinking water, fruit and vegetable drinks and ready to drink tea. This industry is rapidly growing with a volume output of more than 130.0000 million tons in 2012, a growth of 10.7 % from the previous year (Chinabevnews, 2013). However carbonated soft drink category still has a large share of 22 %, but is decreasing in volume compared to the other categories, and compared to 2000 when it had a share of 36 %. Over the past 5 years herbal drinks, such as ready to drink teas, have been the fastest growing beverage category, with a compound annual growth rate of over 35 %. The carbonated beverage market is led by Coca-Cola (Coca-Cola, Diet, Zero, Fanta, Sprite) at 15.8 % share, Tingyi at 13.1 % share and PepsiCo at 4.9 % share. Since 2011 Tingyi and PepsiCo have a partnership in the production of food and soft drinks. The four largest soft drink brands by sales in 2012 are Jiaduobao (herbal tea): 11 %, Coca-Cola regular: 10 %, Lulu (an almond drink):10 % and YS Coconut Milk Drink:8 %. It is the first time that the Jiaduobao brand has outperformed Coca-Cola regular (Chinabevnews, 2012a, b, c, d).

2.1 Carbonated Soft Drinks (CSD)

In 2011 the consumption of carbonated soft drinks was approximately 10.34 l per person, compared to the US at 167.5 l per person, indicating a major difference in consumer habits. In the same year the Chinese carbonated soft drinks market had total revenues of $10.9 billion (Market research, 2012). The declining share of carbonated soft drink consumption posed the most important challenge to soft drink multinationals. According to Euromonitor the share of CSD in the total soft drink industry declined from 36 % in 2000 to 17 % in 2010, and will show a limited growth of 2 % between 2010 and 2015. The main reason for this change is raising health and nutrition awareness. Chinese consumers have been more and more concerned about their health, nutrition and sustainability in their lifestyle (Booz & Co, 2011). According to a Mintel research (2012), 50 % of Chinese consumers consider carbonated drinks as a treat, 67 % of the CSD users desire to purchase a diet or low calorie drink and 75 % of consumers are looking to buy drinks with natural flavors.

2.2 Non-Carbonated Soft Drinks (NCSD)

The NCSD is the largest category of soft drinks in China, divided into ready to drink teas and coffees, bottled water, juices and flavored milky drinks.

Bottled and Mineral Water Segment Bottled water is the largest category. Natural water is scarce, as rivers are polluted and the quality of living standards are improving, therefore consumers' demand for better quality drinking water is increasing. Moreover the demand for premium water brands is increasing. According to a Sinomonitor International report in 2012 this premium market will expand by 80 % over the next 5 years, the majority being in hands of western brands, such as Perrier and Evian. In the bottled water segment Nufu Spring has 80 % market share, followed by Master Kong, Wahaha, Uni-president, Robust and Nestle. These six brands dominate the market, which will be discussed in Sect. 4.

Juice Segment The juice segment is the most fragmented due to low entry barriers in product know how and increasing variety of flavors (UBS, 2012). Coca-Cola's Minute Maid has been the leading brand in this segment, followed by Pepsi's juice Tropicana.

Tea and Coffee Segment China is the world's largest tea drinking country, with an output of 1.4 million tons of tea in 2010. The domestic market consumed 1.1 million tons of tea, which is served as an alternative to water. The development of ready to drink tea drinks has become more successful due to strong marketing campaigns linking the brands to healthy lifestyle and sporting interests. Especially herbal tea has made a huge progress in sales volume.

Flavored Milky Drink Segment The flavored milk segment has become a major component in the soft drink consumption, accounting for 17 % share (Chinabevnews, 2011). In 2009 Coca-Cola introduced a new Minute Maid flavor, Minute Maid Pulpy Super Milky; a fruit flavored dairy drink, tapping into to the Chinese dairy market. Although the launch was successful, in 2011 Coca-Cola was accused of producing tainted products in China, where its Minute Maid Pulpy Super Milky drink was linked to a death of a child and poisoning of three other people.

3 Competition

Next to the decline of the carbonated soft drink sector a second challenge Coca-Cola faces, is the strong competition in the non-carbonated soft drink segment and the increase of competitive domestic beverage industry.

In 2010 Coca-Cola was the dominant soft drink maker in the cola category with a 16.8 % share, followed by Tingyi with 14.4 %, the Hangzhou Wahaha Group Co. Ltd with 7.2 % and PepsiCo at 5.5 % (Euromonitor, 2011). In the non-carbonated drink sector, Tingyi had the dominant share of 14 %, followed by 10 % for Hangzhou Wahaha and 6.6 % by volume share for Coca-Cola, although for the juice category separately Coca-Cola is the leader with 30 % share by volume followed by Tingy's 26 % (UBS, 2012).

3.1 The Hangzhou Wahaha Group Co. Ltd

The Hangzhou Wahaha Group Co. Ltd is China's leading domestic beverage producer, owning brands such as Wahaha brand water, iced tea, fruit drinks, vitamin-enhanced milk drinks and Future Cola. The latter was introduced in 1998 in order to gain share in the carbonated soft drink market in China, and strongly resembles Coca-Cola's label. In 2003 Future Cola held a 7 % market share versus Coca-Cola's 24 % share. Wahaha employed several marketing techniques for its Future Cola brand in order to gain market share, e.g., a strong advertising campaign promoting its products as patriotic brands and using domestic celebrities to promote the brand. In addition, it carefully selected its regions, targeting consumers in third and fourth tier areas pursuing a low cost strategy. The latter has been successful as the rural consumers are very price conscious. Furthermore it diversified into the personal care products in 2002. In 1996 a joint venture between Danone and Wahaha was established, but after long-term disagreements it ended the joint venture in 2007. A majority of the company is in Chinese state hands, which has 70 subsidiary companies and 40 manufacturing bases throughout China. In recent years Wahaha has expanded to Europe and The United States (Miller, 2011). In January 2013, The Group has signed a sponsor deal with British football club Manchester United for its new energy drink: Qili. Qili was introduced in April 2012 and sold 20 million cans during the first 2 months.

The Wahaha Group is changing its strategy by a recent venture into the retail market and opening its first shopping mall (Chinabevnews, 2012a, b, c, d).

3.2 Tingyi and PepsiCo

Tingyi-Ashahi a venture between a Japanese and Cayman Island firm, sells ready-to drink tea, bottled water and juices. As PepsiCo ranked fourth in China's soft drink market it swapped its bottling operations in China for a 5 % stake in Tingyi beverage bottling business in order to narrow the gap with Coca-Cola. Tingyi will now also distribute PepsiCo's carbonated soft drinks and PepsiCo will continue to own the branding of the products, including Tropicana and Gatorade (Bloomberg news, 2011). In the second quarter of 2012, PepsiCo had a 29.6 % market share in the carbonated soft drinks segment. In November 2012 PepsiCo opened its largest $40 million Research and Development facility in Shanghai, in order to boost sales in the Asian region. It will be focusing on new products and innovations in the food and soft drinks market. In 2012 Tingyi faced a slowdown of the overall growth in their beverages. This was mainly due to the economic slowdown and low growth of the beverage industry. According to AC Nielsen's survey in 2012, Tingyi's market share (sales volume) was 48.2 % for ready to drink tea and 23.7 % for bottled water, which made it the market leader. Due to the partnership with PepsiCo its market share in diluted juices was 29.6 %, also making it the market leader. Master Kong water, a Tingyi brand, holds the No1 position in the market (in sales volume) in the bottled water segment (Chinabevnews, 2012a, b, c, d). In the ready to drink tea market Master Kong holds over 50 % share (COM, 2011).

At the end of 2012, PepsiCo made a deal with Burger King in China, which is surprising as Coca-Cola and Burger King have a long term partnership in the US and Europe. Burger King is the second world's largest hamburger chain, with 100 restaurants in China. It is planning to expand significantly in China.

3.3 Want Want China Holdings Limited

Want Want (2013) and its subsidiaries (Long Wave Foods Limited, Want-Want Foods Limited and others) are responsible for the manufacturing and distribution of dairy products and beverages, including flavored milk, yogurt drinks, ready to drink coffee, tea, juice and carbonated drinks. This by origin Taiwanese company produces different foods such as rice crackers and snack foods and owns the most registered trademarks in China. Its products are exported to over 50 countries worldwide. In November 2011, Want Want partnered with Morinaga, a Japanese food and beverage company with its main business in milk powder formula, dairy related products and raw materials. As it is well known for its technology know-how and its high quality products, Want Want sees this collaboration as an opportunity to expand into China's chilled product market, using Morinaga's expertise. Want Want's dairy products and beverages revenues grew 30.6 % from $1.067 million in 2010 to $1.394 million in 2011 (Chinabevnews, 2011). In July 2013 the scare of baby milk contamination of manufacturer Fonterra in New Zealand could hurt Want Wants earnings as it sources raw milk from Fonterra, however has brightened the outlook for China's domestic dairy industry.

3.4 China Mengniu Dairy Company Limited

Mengniu and its subsidiaries manufacture and distribute dairy products in China and is one of the leading companies in its category. Mengniu provides a diverse product range in three categories being liquid milk, ice cream and other dairy products, with its core brand being Mengniu. 89.6 % of the revenue comes from the liquid milk category, 8.8 % accounts for ice cream and 1.6 % for other dairy products (Mengniu, 2012). UHT milk is the core product in the liquid milk category, followed by milk beverages and yogurt. COFCO is the single largest shareholder of Mengniu and Danone a strategic shareholder. In June 2012 a strategic cooperation was signed with Arla foods, a dairy industry leader in Europe. In 2012 Mengniu's revenue accounted for RMB 36 billion up from RMB 23.7 billion in 2008. In May 2013, Danone and Mengniu signed a framework agreement for a joint venture for the production and sales of chilled yogurt products in China, with an estimate market share of 21 % and 13 factories across China.

Due to the dairy contamination scare in New Zealand in June 2013, Mengniu's stock went up 5.2 %. Mengniu's changed its slogan in 2012 to "A little Happiness Matters", which resembles the Coca-Cola slogan: "Open Happiness".

4 Coca-Cola's Challenges

The challenges Coca-Cola will have to deal with in order to remain a leading soft drink multinational in China are related to fierce domestic competition and market trends. PWC (2012) has identified five major challenges in China: Different and diversifying culture, complicated geography, strict governmental rules and regulations, less distribution channels compared with domestic companies and pressure of cost management. As the Chinese culture differs substantially from the Western market, multinationals cannot just copy and paste their current business models into the Chinese market and will need to be adjusted accordingly. As said by PWC (2012), the Chinese Food and Beverage market is among the most attractive markets in Asia Pacific. Its food and beverage risk/reward Business Monitor International (BMI) rating was 61.31, which has emerged to the top among the major Asian and Pacific economies. China's expected growth rate in the next 3 years is 2.7–3.6 %.

4.1 Governmental Issues

In addition to the challenges of the competitors in the soft drink market, China's government set up the Eleventh Five Year Plan Period in 2006, in order to clarify national strategic intention, identify government work emphasis and guide market behavior. During this period China has focused and will continue to adjust the beverage product structure to a healthier portfolio and to reduce the proportion of the carbonated beverages (11th five year plan, 2006). Strict supervision on food safety and anti monopoly policies are under continuous investigation. Although the Chinese economy has grown 30 % over the past 4 years, its domestic consumption rate remains low. Chinese leaders realize they must switch from China's economic focus from export-led to domestic consumption driven in order to maintain growth, also tapping into the consumers in the lower tier cities, explained in the following paragraph.

4.2 China's Tiers

Most international companies looking for opportunities in China have merged into Shanghai and Beijing, otherwise known as the first tier cities, and ignore less developed area, thinking these areas are too poor. However these regions, called the second, third and fourth tier cities, housing more than 800 million Chinese are where the economic growth will appear in the next decades. The Chinese government has been focusing more on these regions trying to improve their health care situation and boost their consumption. Although the average disposable income in the higher tier cities is three times that of the lower tier cities, the consumer market in the higher tier cities is reaching saturation. As the incomes are rising in the second, third and fourth tier regions, consumption growth in all product categories will be the main driver for China's domestic economy. It is therefore an opportunity for businesses to focus on the consumers and their behavior in these regions in order to capture economic growth.

4.3 Water Scarcity

China is one of the world's most water rich countries, however it faces a major threat as the water resources are unevenly distributed: the majority of the resources are concentrated in the South and far West, leaving the North with a huge problem of water scarcity, also due to the result of rapid economic growth. The government has tried to promote water conservation and limit water use, but this has had little impact due to growing demands of drinking water, irrigation, energy production and other uses (Moore, 2013).

As water is the major ingredient of Coca-Cola's products, it is a global challenge for the company as each region differs in water resources. It has implemented a water efficiency and wastewater treatment strategy to encourage long term sustainability.

4.4 Consumers and Prices

Brand awareness among Chinese consumers is rising, while brand loyalty is remaining stable. More and more consumers have been choosing among growing number of favorite brands (McKinsey, 2011). They want to be associated with companies and brands that share their values and dreams. The Chinese have a strong sense of community, heritage and pride. Chinese consumers shop online almost four times as often as European consumers and for multiple product categories, including food and beverages. Moreover the spending pattern of young Chinese has changed compared to the older generations. They have more to spend and look out for western brands. In terms of pricing, in recent years the Chinese economy has shown an increase of labor costs and ongoing high raw material prices. Moreover consumers have been looking for smaller consumer goods packaging. In the soft drink market a shift from 600 mL towards 500 mL has taken place and in combination with rising prices this could have an effect on the beverage companies.

5 Will Coca-Cola Remain Market Leader in the Carbonated Soft Drink Category?

Although Coca-Cola has a relative strong market share in China with its Minute Maid and Sprite brands, the world leading brands regular Coca-Cola, Diet Coke and Fanta remain weaker compared to the rest of the world. With China's increasing health conscious consumer and fierce domestic competition, it remains questionable if Coca-Cola will be able to succeed with its carbonated soft drink category. Even with its large distribution channel and product differentiation strategies, the question remains which strategies Coca-Cola could develop in order to change the Chinese soft drink culture and succeed with its world wide number one brand: Coca-Cola?

Additional Questions
1. Which of the challenges Coca-Cola faces are controllable and which are non-controllable?
2. Which of the competitors is likely to challenge Coca-Cola the most? What type of information would you need to search for in order to give a better answer?
3. Should Coca-Cola expand into second and third-tier cities? Identify the target potential and discuss the challenges?
4. How would you describe the different consumer segments in the soft drink market?
5. Discuss which factors are likely to change consumer preferences.

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Danone–Dumex in China: The First Drink of Milk

Hua Li and Yao Chen Grenot

Case Synopsis

Research Problem

September the 16th, 2013, a 20-min broadcast under the headline "The First Drink of Milk" was aired by China Central TV news channel (CCTV), alleging that Danone Dumex bribed hospital staff to boost sales of its infant formula products. After suffering from a series of setbacks since the beginning of the year 2013, Danone was once again under the spotlight of public scrutiny.

The French food giant has a longstanding presence in China. It entered the Chinese market as a precursor as early as 1987. However, its interest into China's infant formula market was quite recent. In 2007, Danone acquired International Nutrition Co., Ltd., which possessed the brand Dumex, one of the leading infant formula brands in Asia. Thanks to Dumex, China has become the largest market for Danone in baby nutrition, accounting for 4–5 % of its total company sales.

China has been a promising land for foreign formula makers. Big market size, huge growth potential, high margin and popularity of foreign brands, all of these

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This case has been written on the basis of published sources only. Consequently, the interpretations and perspectives presented are not necessarily those of Danone Group or any of its employees. The case is developed solely as the basis for class discussion. The authors do not intend to illustrate either effective or ineffective management. Certain names and other identifying information may have been disguised to protect confidentiality

H. Li (✉)
EMLYON Business School, 23, avenue Guy de Collongue, CS40203 69134 Ecully Cedex, France
e-mail: li@em-lyon.com

Y.C. Grenot
COM CHINE Consulting, Lyon, France

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apparently make China an Eldorado for foreign formula makers. But the political climate has been changing rapidly. A series of new regulations issued by the government sent a clear signal that Chinese authority was set to consolidate the infant formula industry and provide support for big domestic firms. The worsening regulatory environment and intensifying competition made Danone realize that it could no longer rely merely on Dumex. The company saw Dumex's sales tumble as a result of the scandal. To avoid such things happening in the future, the company needs to revamp its strategy in China.

Research Problem

This case aims at helping students understand how such a scandal could happen, what could have been done to prevent it in the first place and what should be done in the future. The case offers information for students to perform analyses to answer these questions. Insights can be drawn from firm strategy, industry structure, government regulation and cultural environment.

Learning Objectives

1. Identify the causes of the bribery scandal
2. Discuss the role of ethics in marketing management
3. Explore different strategies for restoring consumers' trust in brand
4. Understand the importance of crisis management
5. Explore issues of concern for foreigner companies doing business in China

Themes and Tools Used

Depending on the perspective of analysis and the course objective, this case can be used for the following three themes:

1. Crisis management, to realize the fragility of corporate image and the need to actively maintain them.
2. Strategic management, to cover practical issues that firms face in emerging markets, including lack of regulation, government interference in business, business practices and cultural relativity, and political uncertainty.
3. Business ethics, to explore the ethical implications of decision making in the marketing arena.

Target Audience

The case is suitable for a wide range of audiences, including undergraduates, MBAs and senior executives. It is especially useful for executives and managers establishing and developing businesses in China. The case discussion will be largely enhanced if some of the participants already have some professional experiences in China.

Questions

1. How did the bribery scandal arise?
2. What could have been done to prevent the scandal in the first place?
3. What is crisis management? Comment on Danone's crisis management during the bribery scandal.
4. What are some of the major issues that foreign investors need to understand when doing business in China?
5. Facing the worsening political environment and intensifying competition, what should Danone do? What specific suggestions would you like to make to Danone?

"The First Drink of Milk"

In the maternity ward of a big hospital in Tianjin, a young couple, Liu and Chen, was feeding their newborn with a bottle of milk.

> *"The bottle was given by the nurses," said the father, "we don't know which brand of baby milk is inside." "They never told us about breastfeeding," the young mother added.*
> *"The distribution of milk is unified in our hospital," confirmed one staff to journalists of China Central TV. "This floor is Dumex. Upstairs is another brand."*
> *"These infant formulas can be found at the hospital shop. The nurses told us that it is prohibited to do promotions of 1st age milk powder through normal sales channels, except at the hospital shop. We can get a discount if we buy a carton of 6 cans," said another young mother.*

1 Introduction

September the 16th, 2013, a 20-min broadcast under the headline "The First Drink of Milk" was aired by China Central TV news channel (CCTV), saying that millions of young parents in China have had similar experiences like the young couple depicted in the opening story. The report alleged that formula makers bribe hospital staff to feed newborns their products before mothers even had an opportunity to breast-feed.

Although the report spoke broadly about all formula makers in China, Danone's Dumex was the only company name overtly mentioned. "*We paid huge amount of money to doctors and nurses in hospital maternity wards to use our products on the newborns*.", a former sales manager of Dumex Baby Food Co., a subsidiary of France's Danone SA, admitted to the journalist of CCTV in the report.

Earlier this year, Danone, along with some other foreign infant-formula makers such as Nestle, Mead Johnson and Abbott, has just been sanctioned by China's regulators for anticompetitive practices (Ide, 2013). In August, Danone had to recall its formula products in Asia due to an unfounded contamination scare stemming from New Zealand-based supplier Fonterra (Tajitsu & De Clercq, 2014). Just days after issuing these massive recalls, Danone was once again under the spotlight. But this time, the bribery scandal posed a much bigger threat to the seemingly ever-growing business of the French group in China.

2 Regulation of Breast Milk Substitutes Marketing in China: The 1995 Code

In China as in other countries, the marketing of infant formula has long been a controversial topic. The World Health Organization (WHO) advocates exclusive breastfeeding up to 6 months of age, stating that breastfeeding not only contributes to the health and well-being of infants but also to those of mothers. Research shows that breastfeeding can lead to better protection for infants against infectious and chronic diseases and helps to reduce the risk of ovarian cancer and breast cancer for women. WHO emphasizes that breastfeeding should be initiated within the first hour after birth to make sure that the newborn can benefit from colostrum, which produces only in the first few days of lactation but is rich in antibodies and protein (WHO, 2014a). In 1981, the WHO's decision-making body—World Health Assembly passed a code to regulate inappropriate sales promotion of infant formula. Since then, 103 countries, including China, have launched legislation to implement parts of this code (WHO, 2014b).

In 1995, China launched a similar regulation to ensure the impartiality of health workers in the marketing and distribution of breast milk substitutes. Under the 1995 code, companies of infant formula are prohibited from using hospital personnel to promote their products to the families of babies younger than 6 months (Government, PRC, 2014). Companies can't distribute free samples or sell the products at a discount to pregnant women, their families and hospitals. Nor may they influence the sales of their products by offering hospitals funding, equipment or information.

However, until the CCTV's report on bribery scandal, enforcement of this regulation had been weak and nearly nonexistent. Many foreign infant formula makers had managed to find ways to get around the 1995 code, according to a special report of Reuters (Harney, 2013).

It seems that the attitude of China's related enforcement bodies has changed drastically. Chinese government is determined to curb the illegal practices of formula companies and consolidate domestic firms in this highly profitable market, which has been gradually encroached by foreign brands.

3 Danone Entering the Chinese Infant Formula Market

Danone has a longstanding presence in China. It entered the Chinese market as a precursor as early as 1987. Through numerous joint ventures, acquisitions, and sell-out and investment, the French group has established its foothold in various sectors in China, ranging from dairy, beverage, biscuits, to medical nutrition. However, its interest into China's infant formula market was quite recent. It was not until 2007 the French food giant started to lay eyes on the baby food market.

Started from the beginning of the year 2007, unhappy with the mediocre performance, Danone decided to turn away from Bright Dairy, ending a 15-year joint venture contract in the dairy sector in order to secure a more powerful local partner MengNiu. This attempt finally ended in failure in December 2007, as Mengniu vividly rejected the capital control approach of the French group.

At the same time, another battle broke out between Danone and its local joint venture partner Wahaha in the beverage sector, which had been thus far the most profitable business sector of the company in China. Having discovered that Wahaha ran parallel businesses outside their joint venture, Danone filed a lawsuit against its main partner in China. Unexpected to the French group, this otherwise seemingly simple lawsuit evolved into a series of long, painful and highly publicized legal disputes. Undoubtedly, this is a big blow to the brand image of Danone, and particularly so in a market like China, where consumers, easily stirred by the feelings of nationalism, tend to cast wary eye toward foreign companies. The battle ended 2 years later by the breakup of joint venture, leaving Danone with no other choice but to give up what it had successfully established with Wahaha on the soft drink market.

Worldwide, Danone had refocused its activities and sold out its cookie business LU. In July 2007, the Group unveiled its most ambitious acquisition ever: a 12.3 billion-euro offer for Dutch baby-food maker Royal Numico N.V. "*Numico has all the characteristics we like: health orientation, extremely good R&D, market leadership and exposure to high-growth markets,*" said Antoine Giscard d'Estaing, Danone Chief Financial Officer when commenting on the "surprisingly high" transaction price. The "*market leadership and exposure*" refers specifically to the brand Dumex, the market leader of infant formula milk powders in China, Malaysia, Thailand and Vietnam, which Numico just bought in 2006.

Given the difficult circumstances encountered in China, Danone had indeed seen great hopes for Dumex.

4 About the Dumex Brand

Unlike other big international players on infant formula market in China, Dumex has an unusual and somehow mysterious background.

The brand was created in 1946, referring initially to Danish United Medical Exports, a trademark under which the East Asiatic Company (EAC) sold antibiotics to Indian and Thai hospitals. EAC itself was founded firstly in Thailand in 1884, and later listed at the Danish stock exchange.

After several decades of development and growth in its core business, Dumex expanded into the canned milk powder sector, continuing enlarging its presence on Southeast Asian market.

In 1992, EAC entered China by establishing a joint venture under the name of International Nutrition Co., Ltd. with Shanghai Xin'an Dairy, a small local manufacturer of low-priced liquid milk in sachets. Three years later, the joint venture, International Nutrition Co., Ltd., started producing Dumex infant formula milk powder in China. For Chinese consumers, Dumex was labeled as a Danish brand.

In 2002, in a press release issued by the brand regarding some media allegations of possible contamination incident of milk powder produced in Denmark, Dumex claimed that they sourced their milk from Shanghai and nearby regions. Contrary to what had been advertised over the years, the company's spokesperson explained to the media: "*Dumex was a Danish brand, but not a Danish product*".

In the early 2000s, while most international brands, such as Mead Johnson, Wyeth and Abbott were on the sideline of China's market, Dumex had focused its resources on China and achieved significant market share. In 2003, Dumex launched its new range of golden pack, successfully upgraded its brand image and became the market leader in most coastal and provincial capital cities. By 2007, the China infant formula market grew to 14 billion RMB, more than triple its size compared to 2003. Dumex was the biggest winner with 44 % of market share, ranked as No. 1 brand both in terms of sales volume and turnover nationwide.

5 Ambitions of Danone

The success of Dumex suits perfectly the ambitions of Danone in China. In 2007, while stagnating somehow in dairy and beverage sectors, the French food giant became increasingly attracted by the huge potential of the infant food sector.

Skillful in mergers and acquisitions, Danone took over International Nutrition Co., Ltd., the newly acquired entity, focusing mainly on financial control, while leaving the day-to-day business operations to ex-Numico managers.

Amongst them, Lu MinFang was without doubt the rising star. Lu joined Dumex as the marketing director in 2005, after having worked for 10 years for Shanghai Johnson Pharmaceuticals, a Johnson & Johnson subsidiary. Years of experience in Pharmaceutical industry made him extremely acquainted with distribution channels of medical care and helped him built up excellent relationships with many hospitals. Under his direction, Dumex redefined its marketing strategy, giving more focus on close collaboration with health care professionals for the development of customer base. This became a key driver to the brand's growth in the following years.

In 2008, the scandal of melamine-tainted milk was all over the news across the nation. Sanlu, the Chinese leading brand in the low-end market, and many other local producers were reported of using toxic chemicals to make their milk protein rich. Massive product recalls had been organized and domestic brands' credibility fell to the lowest point.

Some media pointed the finger at Dumex as well, saying that more than 40 babies having developed kidney stones after drinking Dumex milk. Danone group reacted strongly against these accusations. It opened its factory's door to government inspections for several months, and submitted samples of more than 2000 batches of products to Shanghai Quality Bureau. Dumex was finally cleared of the accusation. The company proclaimed that all its milk was imported from Australia and New Zealand, and renamed in December 2008 International Nutrition Co., Ltd. as Dumex Baby Food Co., Ltd.

After the incident, how to restore consumers' trust was the priority of Dumex top management. To Lu and his team, it became even more obvious that collaboration with health care professionals is a quick way to build up brand credibility. In China, professional opinion leaders play a significant role in the promotion of products and services. In an immature market of infant formula, recommendations of pediatricians would be the most efficient way to gain the trust of young parents looking for the best products for their babies.

In 2009, Dumex established more than 100 DOHaD pregnancy nutrition guidance centers with partnership of leading hospitals in more than 70 cities. DOHaD stands for Developmental Origins of Health and Disease, a pathogenesis concept of disease, proclaiming that many disorders such as coronary heart disease, stroke, hypertension, type-2 diabetes and osteoporosis, originate from unbalanced nutrition before birth and during early infancy.

"We believe that educating young Chinese men and women about the DOHaD concept is absolutely important to China, the most populous country in the world," Mark Hansen, chairman of the International Society for DOHaD, at a press conference in Beijing.

"Before answering to those many questions about pregnancy and spending a lot of money on baby related products," added by Lu Mingfang, "young mothers-to-be should first go to a pregnancy nutrition guidance center to design a balanced diet for herself."

Dumex managed to maintain a double-digit sales growth in 2009. Lu was promoted to General Manager of Dumex Baby Food Co., Ltd. Meanwhile, the infant formula market landscape became more and more competitive and consolidated. According to Euromonitor International, since 2005, the retail sales value growth of infant formula in China has been as high as 20 % per year. International big players such as Mead Johnson, Nestle and Abbott, all started to consider China as their development priority (Fig. 1).

In 2010, Dumex launched the « 1000 Days Program », an educational program aiming to provide pregnant women and young mothers with nutritional information

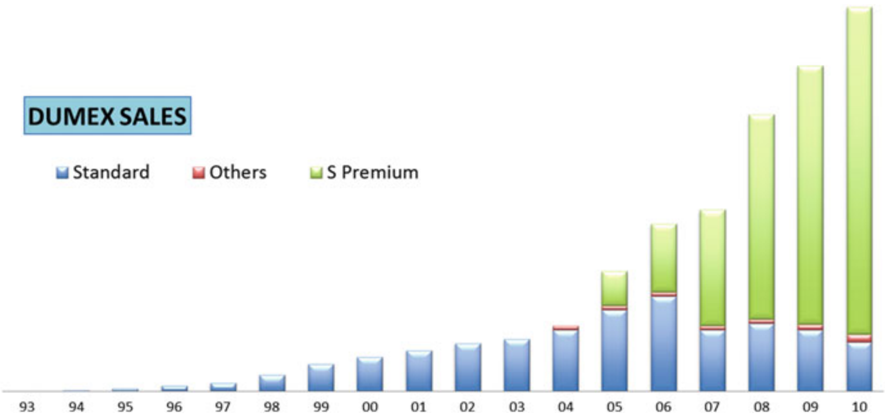

Fig. 1 Dumex sales. *Source*: Adapted from 2011 Investors Seminar—Dumex China presentation by Jeffrey LU (Lu Mingfang), http://media.corporate-ir.net/media_files/IROL/95/95168/250511_J._LU_-_Dumex_China.pdf, 25 May 2011

about the first “1000 days” of a child’s life, from birth to age 3. According to Danone’s official Twitter account, till 2012, over 2.5 million Chinese mothers have joined the « 1000 Days » virtual community, making it one of the best social media launch in the baby food sector in China.

In 2012, facing the voracious demand of Chinese consumers for premium quality products, Danone group renovated the Dumex brand by upgrading the formula and the packaging. “*The renovation was extremely well received*,” announced Danone group in a conference call of quarter three sales worldwide (Thompson Reuters, 2012), “*the execution at the point of sales has been another factor fueling the growth of our brand with a 15 % market share value-wise in the Modern Trade obtained at the end of August 2012*.”

Thanks to Dumex, China has become the largest market for Danone in baby nutrition, accounting for 4–5 % of its total company sales.

6 Infant Formula Market in China: An El Dorado for Foreign Firms

China has been a promising land for foreign formula makers. Unlike most of the developed countries where breastfeeding is largely favored, China has seen rapid decline in breastfeeding rates over the last two decades. Official report from the government shows that only 28 % of Chinese women were exclusively breastfeeding at 6 months as of 2008, down from 51 % in 2003 (China News, 2014). Research from independent organizations suggests the real figure is much lower. A study published in the Journal of Health, Population and Nutrition in 2010 reports that exclusive breastfeeding rates at 6 months in some parts of China reached as low as 0.2 % (Qiu, 2010).

The laissez-faire attitude of Chinese enforcement authorities toward the 1995 code had undoubtedly contributed to the huge drop of breastfeeding rates. The aggressive marketing of infant formula makers has misled a lot of parents to believe breast milk is not nutritious enough for their babies. Given the rising concerns over food and environment problems in China, many parents consider infant formula to be safer as they worries antibiotic and preservatives contained in mothers’ diet could transfer to breast milk.

China’s high rate of cesarean sections—the world’s second highest at 46 % of all deliveries—is another important factor leading to the use of infant formula. Many mothers start babies on formula for the fear that drugs used in the operation would affect their breast milk. Moreover, China’s so-called “4-2-1” family structure, four grandparents and two parents doting on a single child, favors the active participation of grandparents in looking after the babies. Infant formula is thus preferred, as it is more convenient for the elders to feed the newborns.

All these factors are conducive to the development of infant formula industry. According to a recent report from Euromonitor, infant formula sales in China reached RMB 77 billion (USD 12.55 billion) in 2012, making China the second

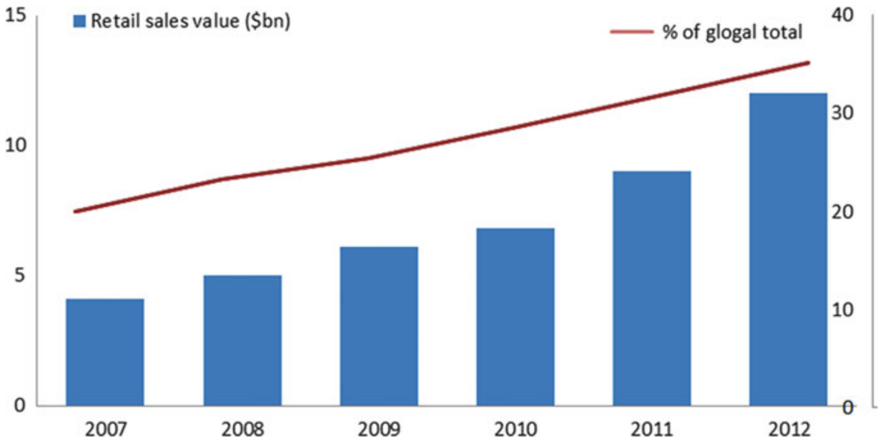

Fig. 2 Sales of milk formula in China. *Source*: Graph adapted from Financial Times[13]

largest formula market in the world, just behind the United States (Euromonitor International, 2013).

With an expanding population and growing middle class, China's formula market has been growing rapidly. In 2013 alone, sales of baby formula grew over 21 % (Shanghai Daily, 2013). Chinese government recently announced to relax its one-child policy, allowing couples to have two children if either parent is an only child. Experts predict that this policy will be a further boost to the infant formula industry. The demand is expected to keep growing at a rate of 10–20 % per year within 5 years from 2015 onwards (Tsang & Lucas, 2013). Euromonitor projects that, by 2017, China will account for about half of all global sales. This projection is conservative as it was drawn without taking into account of the potential impact of the second-child policy, which went into effort in December 2013 (Fig. 2).

Domestic formula companies have failed to grab as much of this growth as their international peers. In 2012, five of top 10 best-selling brands were international, according to Euromonitor International (see Appendix for more information about the top 10 companies). Four foreign companies alone—Mead Johnson, Danone, Nestle and Abbott control about a third of the Chinese market (Redruello, 2013).

Most of domestic formula companies, however, have seen their sales sliding to the lowest point in the aftermath of the massive scandal over melamine-tainted milk in 2008, when six infants died of severe kidney damage and an estimated 300,000 babies suffered painful kidney stones after drinking tainted baby formula of a local brand "Sanlu" (Ramzy & Yang, 2008). Since then, a series of food safety scandals sparked fears of Chinese parents for domestic formula producers. Worried parents turn to foreign brands and are ready to pay premium price to secure safe products for their babies. Those who can afford it even choose to buy imported formula, usually hand-carried from overseas to ensure it's the real thing.

Gross profit margins for foreign-brand formula sold in China are 60–70 %, according to separate research by CMRG and consumer-market analyst Mintel.

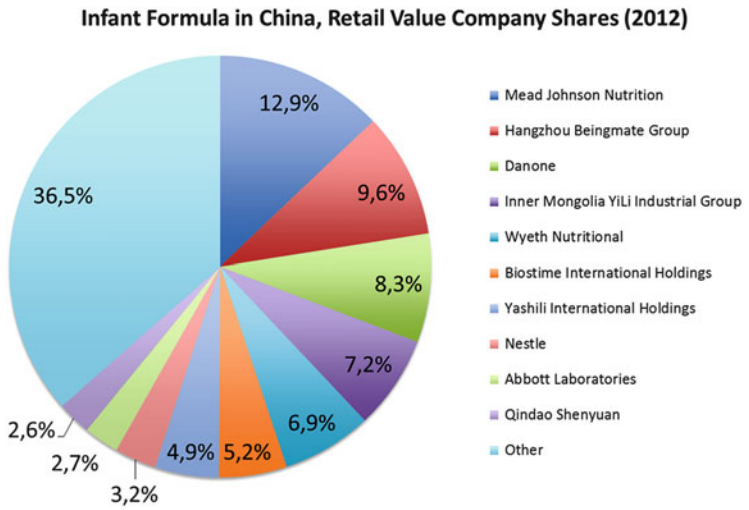

Fig. 3 Infant formula in China, retail value company shares (2012). *Source*: Adapted from Euromonitor International, 2012

An article appeared in the South China Morning Post provides a comparative study of formula prices in China and other countries, showing that Chinese parents are paying a hefty premium—nearly double the price for the same brand compared with parents overseas (Robertson, 2013) (Fig. 3).

The health scare of Chinese parents and high margins of foreign brands gave rise to the formula smuggling business. Cans of formula were mass purchased straight from the shelves of supermarkets abroad and shipped to China, leading to fears of shortage in regions/countries such as Hong Kong, Australia, New Zealand, Germany and Britain. Supermarkets in some countries started to ration the amount of formula customers could buy. For example, retailers in Germany limited the number of cans of formula that can be purchased by a customer to two within a single day (Hatton, 2013). Hong Kong went even further to make it a crime—milk smugglers would face fines of up to HK$500,000 ($64,000) and risk up to 2 years in prison.

Foreign companies have likened the explosion of infant formula market in China to a “white gold rush”. Big market size, huge growth potential, high margin and popularity of foreign brands, all of these apparently make China an Eldorado for foreign formula makers. But there are clouds on the horizon. The political climate has been changing. To multinational companies as Danone, big challenges had yet awaited ahead (Fig. 4).

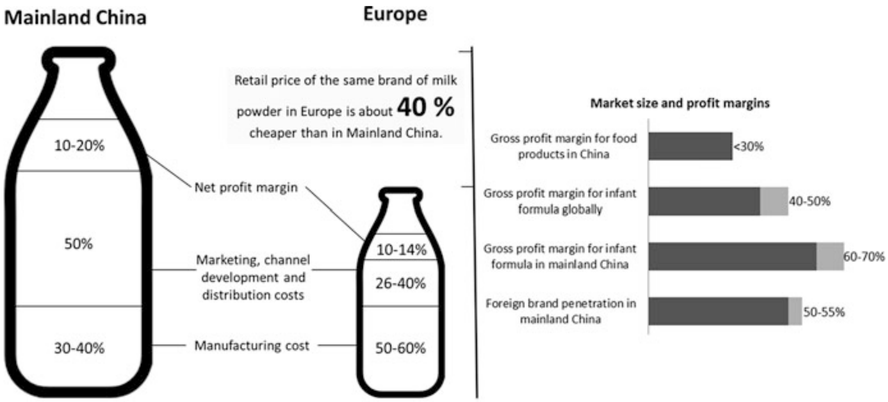

Fig. 4 Estimates of breakdown of cost/profit for milk powder. *Source*: Graph adapted from South China Morning Post[16]

7 2013, The Year of Troubles for Danone

The big, highly profitable market started to cause headaches for the managers of Danone in 2013. In the second quarter of 2013, the National Development and Reform Commission started an investigation on high prices charged by some leading infant formula milk powder producers, including Dumex, Mead Johnson, Wyeth and Abbott. People's Daily, the official newspaper of Chinese communist party, lashed out at the unreasonable high prices charged by some international formula companies in China, claiming that prices of those foreign brands had been increased about 30 % since 2008. Danone then paid a fine of 117 million RMB and accepted to cut Dumex products' prices by up to 20 %.

In June, the government released a policy aiming to further strengthen the regulations in baby milk industry. The new policy prohibits the bulk importation and repackaging of milk powders, and requires all infant formula to be labeled in Chinese before being imported to the country.

This new policy is intended to suppress opportunistic small domestic firms, which either have severe quality issues or claim to sell imported baby formula but in reality only repackage bulk powders into small size for retail. Yet it affects big companies such as Danone, Mead Johnson and Abbott as well. Except for Nestle group, none of these big international brands has real production units established in China. Their factories, like the one of Dumex, are only repackaging units.

Thus by May 2014, the end of the transition period prescribe by law, Danone has to transform production lines of its plants in China. The new regulations, together with previous antitrust charges, sent a clear signal that Chinese authority wants to support large domestic producers and help them to restore consumers' confidence in local brands. It has been reported that Chinese government also considers providing

30 billion RMB ($4.92 billion) in industry support and setting a goal of cutting the market share of foreign brands in high-end powder sales by more than half (Fangqing, 2013).

But the worse was yet to come…

In August, Danone's biggest supplier, the New Zealand wholesale dairy exporter Fonterra, said it had found a potentially fatal bacterium in a range of raw milk powder sold to multinational companies. As a consequence, eight companies including Dumex, Abbott and Nestle urgently issued massive product recalls across China and other South-East Asian countries.

The scare finally turned out to be a false alarm. Danone later claimed the recall of Dumex and Karicare infant formula products in Asia had cost the group 350 million euros in lost sales. As a result, its baby food sales fell 8.6 % in the third quarter, reversing a 15.2 % rise in the first half-year.

In September, the CCTV report on bribery scandal made Danone once again the target of public scrutiny. Many national and international media followed suit, running stories about Danone Dumex paying hospitals "sponsorship fees" of up to 10,000 RMB for promoting its products. Some cynically speculated that the report was just another political spin manufactured by Chinese government to gain public support for its plan to rebuild the domestic infant formula industry.

Whichever it is, for Danone, the damage had been done. Dumex brand image of "best nutrition for baby" was dragged through the mud on millions of television screens across all China. Dumex saw its sales tumble. Sales were virtually "zero" in December, the firm's top management said in an investor call. Danone's growth in China fell off the cliff. According to a report compiled by Sanford C. Bernstein (Whitehead, 2014), Danone's growth averaged −58 % in the last 5 months of the year 2013 with a deteriorating trend in each month from August (−39 %) to December (−65 %).

While Danone suffered massive losses, some companies managed to seize the opportunities to increase market shares. Nestle has made some major gains. Biostime, Yili, Beingmate and Mead Johnson have each seen growth as well. Some even chose this moment to make its debut in China. For example, Japan's Asahi Group's Wakodo unit and Taiwan-owned noodle maker Tingyi Holding announced a joint venture to market imported formula.

8 Action Against the Scandals

Facing the bribery accusation, Danone responded immediately with a knee-jerk reaction of denial. "*Dumex Baby Food Co strictly adheres to Chinese laws and regulations,*" a company spokeswoman said in a statement the day after the CCTV report (BBC, 2013).

Under the pressure of media bombard, the company expressed "*deep regret*", stating that it accepted "*full accountability*" for management lapses. In an emailed statement released on October 12, nearly one month after the outbreak of the scandal, the company concluded that the allegations were linked to a Dumex-sponsored program for mother-and-care education in China, which "*was not properly managed in some cases*" (Thomson, 2013).

"Dumex policies include support for maternal breastfeeding, as well as compliance with all local and nation regulations in China. However, even though the program is in good condition it has been found that the educational program was not appropriately managed in some cases. This resulted in some practices that contradicted the purpose of the program, which violated company-wide policies. The company has expressed it deep regret for these shortcomings."

It said it had suspended the program in all regions and claimed to take disciplinary action according to company policy and introduce mandatory training in marketing responsibility for all employees (Astley, 2013).

"This specific training will be completed in a 3 month period. At the same time, Dumex China will further strengthen its internal management and governance systems."

"Dumex will continue to strictly follow all regulations set by the Chinese government and local authorities, as well as the guidance of the World Health Organization. We welcome the supervision from the government, media and public," the statement added.

On December 3, Danone appointed new management team for Dumex China, naming Boris Bourdin as new general manager to replace Lu Minfang.

The worsening regulatory environment and intensifying competition made Danone realized that it could no longer rely merely on Dumex. The company planned to overhaul its offering for China in 2014, including launching a revamped Dumex product and introducing other brands like Aptamil, Cow & Gate and Nutricia to the Chinese consumers.

"*Don't think we are going to rebuild the same animal, we are going to build a new one, a better one, especially in terms of margins,*" said Danone CEO Franck Riboud on an investor call.

Danone is set to regain Chinese consumers' trust. However, with increasing government interference, this will be a hefty challenge...

Appendix

Name of company	Market share	Description
Mead Johnson 美贊臣	12.9 %	– Founded 1895, headquartered in Illinois, USA – Flagship products is Enfamil infant formula – 2/3of average annual revenue comes from outside of the USA – Wide distribution coverage and marketing activities – Gaining a strong presence in emerging markets – Reports published in 2012 claimed that Mead Johnson's milk formula contained vanillin. These proved to be erroneous, and Chinese government apologized – Asked by Chinese government to cut prices in 2013 amidst investigation into antitrust violations/price-fixing by 5 foreign infant milk companies
Beingmate 貝因美	9.6 %	– Founded in 1992, headquartered in Hangzhou, PRC – Specializes in R&D and independent production lines of infant food including baby formula – Strong brand image as "baby nursing experts" – Not implicated in 2008 melamine scandal (or other similar scandals); enjoyed strong profits & growth following the incident – Poses a strong challenge to dominance of international brands – Benefits from a partnership with Swiss food group Hochdorf Holding AG
Danone 达能	8.4 %	– Founded 1966 in France – Acquired in 2007 International Nutrition, which owns Dumex brand in 2007 – Dumex produces milk powder, liquid milk, cereals, supplements, etc. – Dumex markets products in emerging markets (China, Thailand, Malaysia, Brunei, the Philippines, Russia, India, Middle East % E. Africa)
Inner Mongolia Yili 伊利	7.2 %	– Founded 1993 in Hohhot, Inner Mongolia, PRC – Processes & manufactures milk products; was once known as a "Chinese national brand" – Implicated in the 2008 melamine-tainted milk scandal; lost its status as a "Chinese national brand" – Suffered further losses in 2012 when GAQSIQ found unusual levels of mercury in its baby formula
Wyeth Nutritional 惠氏	6.9 %	– Founded 1860 in Pennsylvania; headquartered in New jersey, USA – Large, research-driven pharmaceutical and healthcare company – 85 % of business is done in emerging markets – Infant formula company bought by Nestle in 2012 – Asked by Chinese government to cut prices in 2013 amidst investigation into antitrust vilolations/price-fixing by five foreign infant milk companies

(continued)

Name of company	Market share	Description
Biostime International 合生元	5.2 %	– Founded 1999 in Gruangzhou, PRC – Products included infant formula, probiotic supplements, nutrition supplements, dried baby food, etc. – Growing very quickly: revenue grew sixfold between 2009 and 2012, to RMB 3.4 billion; wide distribution network and high penetration
Yashili International 雅士利	4.3 %	– Founded 1989 in Chaoan, Guangdong, PRC – Leading privately-owned infant formula/soymilk company is China – Infant formula accounts for 80 % of sales. Target consumers are in middle- to high-end market. Distributes to over 105,000 retail outlets – 3 different Yashili brands were implicated in 2008 melamine scandal, suffered RMB 787 million in losses due to recalls and decreased sales – Since 2010, the group has sourced all of its infant formula products from New Zealand
Nestle 雀巢	3.2 %	– Founded 1905 in Switzerland – Produces huge range of goods: baby food, bottled water, cereals, coffee, candy, dairy products, snacks – Annual sales of USD one billion – In 2011 was listed as no.1 in Fortune 500 as the world's most profitable corporation – Has been widely criticized for methods used to market baby formula in developing markets – In 2008 melamine milk scandal, Taiwan health ministry reported that six types of Nestle's milk powder produced in China contained traces of melamine, which were recalled – Asked by Chinese government to cut prices in 2013 amidst investigation into antitrust violation/price-fixing. Nestle agreed to cut formula prices by 11 %
Abbott Nutritional 雅培中国	2.7 %	– Founded 1888 as part of Abbott laboratories, headquartered in Illinois – Specializes in baby food (flagship formula Similac, Isomil, and Gain) and other health products – In the past 5 years has spent hundreds of millions of dollars on new manufacturing/research plants, to capitalize on China's growth – Total pediatric sales in 2013 increased 2.5 % to USD 987 million – Asked by Chinese government to cut prices in 2013 amidst investigation into antitrust violation/price-fixing. Abbott is cooperating with government requests
Qingdao Shengyuan 圣元	2.6 %	– Founded 1998 in Qingdao, China – Produces milk formula and other dairy products – Abbott Nutritional is considering acquiring Qingdao Shengyuan – Sheng Yuan brand infant milk formula was implicated in 2008 melamine scandal

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Part VI

Summary and Outlook

Preparing Business Activities in China

Christiane Prange

The cases in this book have provided a broad overview on potential problems companies may encounter when entering China. Problems cut across all stages of environmental and marketing research (environmental, company, product, consumer, etc.) and need to be solved in order to pave the ground for successful operations in the country.

On the *macro-environmental level*, the following issues deserve major attention. From the legal side, companies need to comply with both formal and informal rules, and have to keep abreast with changes impacting their business, e.g., changing frameworks for e-commerce, advertising, etc. Laws and regulations are likely to change to match the rapid economic development. Economic analysis should include trends, such as, increasing purchasing power, skilled work force at low labor cost, increasing property prices, high inflation rates, slow-down of growth rates, etc. Looking at social factors, population growth and aging population rates play a major role, especially for companies targeting the middle-market segment. Also, a partial adherence to Western behavior may be a characteristic sign of consumer behavior, while intrinsic cultural values still dominate the way transactions are launched and implemented. With regard to technological developments, the emergence of e-commerce and mobile business has had a major impact on shopping behavior. Factors to be analyzed are the safety of online payment solutions, and new ways of mobile distribution, including multi-channel sales. One major change pertains to the use of credit cards, which previously had a low acceptance as a payment method. Today, the majority of Chinese uses a card from Union Pay International (UPI). UPI is a bankcard association established under the approval of the State Council and the People's Bank of China, and has become a central and pivotal part of China's bankcard industry. At present, the Shanghai-headquartered UPI has about 400 domestic and overseas associate

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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members, covering 140 countries/regions. The situation changed in 2015, when global bank card operators including Visa and MasterCard were allowed to seek licenses to clear domestic Chinese payment. Other ongoing concerns for China are ecological issues, predominantly pollution, that can imperil the country's economic development. In January 2015, China significantly upgraded its Environmental Protection Law, enabling local governments to fine polluters on an ongoing, daily basis until the problems are fixed.

On the *industry level* of analysis, competitive forces have also changed in the last few years. Driven by the Chinese government's desire to break China's dependence on foreign technology and to move away from the 'made in China' to an 'innovated in China' model, many Chinese companies attempt to become key players in the international market. Indeed, the Chinese *zizhu chuangxin* ('homegrown innovation') initiative has become the watchword for the future to transform China into an innovation-driven economy. This development has consequences for the supplier market, which is subject to increasing prices. China as 'the factory of the world' is a model past its due date, at least in the prospering regions. Supplier power is gradually increasing with companies' having to negotiate harder to obtain good prices. Also, changing buyer power is affecting the success of foreign countries. Accelerated change of commoditization transforms into growth but also leads to consumers dictating demand and buying preferences. While foreignness of brands provided a safeguard in the past, today local competitors in many industry sectors gain in attractiveness.

For example, the Internet company Tencent, founded in 1998, and based in Shenzhen, offers mobile instant-messaging services. Outside China, Tencent's best-known product is WeChat, which is eroding the popularity of Sina Weibo within China and appears to be well on its way to establishing itself as China's first global Internet brand. WeChat already dwarfs its competitors in terms of audience, with more than 500 million users, 100 million of them outside of China. It is available in eight languages, Argentine soccer star Lionel Messi has signed on as the company's global spokesman, and it is now the fifth most downloaded smartphone app in the world (after Google Maps, Facebook, YouTube, and Google Plus) (Keating, 2013). Increasing preference for local brands is also visible in the automotive industry. In the first half of 2015, sales of Chinese-branded sport utility vehicles (SUVs) rose roughly 30 % versus 12 % for foreign names. From January to June, six of China's 10 best-selling SUVs were domestic (Pesek, 2015). If this trend spreads to other sectors, international companies will have to face fiercer competition than ever.

On the level of *consumer analysis and marketing research,* much has been said in previous chapters. While most companies have focused on top tier cities, a myriad of factors (infrastructure changes, increasing mobility, higher income) have started to redirect the attention of consumer marketers towards China's lower tiered cities as the future growth segments of the country. This has increased challenges in terms of gathering information from a more diverse set of consumers spread over a much broader geographical area, requiring researchers to come up with innovative approaches to collecting and analyzing data. Growing demand exists to gain insight on market segmentation, product pricing, and branding studies. Many segments are influenced by traditions, tastes, geographic specificities, and others, which results in a heterogeneity of different areas much like they exist in Europe. Good research needs to take this into account both in the design of studies and in the approach to consumers. It also requires the availability of information on purchasing behavior and product preferences, which is more difficult to obtain from rural areas. Due to the rapidly changing nature of consumers and their environments, market research needs to be conducted on a permanent basis.

Marketing and market research in China is markedly different from the situation in the West. Rather than investigating mature markets, it reflects the objectives of companies operating in emerging market environments, even though the scenario in large top-tier cities seems to convey a different picture. In the West, typical companies monitor the satisfaction of consumers, agencies develop new concepts, or segment target audiences. Typical research projects are therefore customer and employee satisfaction studies, branding studies, concept tests and segmentations. In China on the other hand, a high proportion of research projects (over 60 %) are focused on market assessment studies, in which clients (often foreign companies) are asking for a comprehensive explanation of how markets are structured, who the key players are, and what the market size is (Harrison, 2015). While quantitative market studies are important, qualitative ones are even more so because they help to detect the nuanced differences between Chinese and Western consumer behavior.

Apart from product- and marketing-related problems, major challenges pertain to differences in culture, mindset, and business customs. In the past, hundreds of consultants, trainers, professors, and other experts have formulated principles of 'Doing Business in China', reminding us of what to do and what to avoid. For instance, Bain & Company (2008) formulated some 'Principles of Winning in Emerging Markets', reiterating the necessity of local hires to account for cultural specificities. Too often, multinationals count on expatriates to succeed in China. However, firms that cultivate a strong management team with market insight gain a competitive edge not only in product design, communication, and distribution, but also in avoiding critical issues on the inter-personal level. Several multinational companies have understood this and organize their business with up to 95 % local employees. Most reports and consultants further agree on the importance of the following barriers to success: the time to build relationships in China, the importance of family and relations, brand loyalty, institutional voids, and many others. Probably, they are right and some of the underlying stereotypes also apply. However, two considerations seem to be more important.

First, and deeply anchored in Western thought, is the perceived dominance of developed countries vis-à-vis emerging markets. Western cultures tend to be missionary nations, believing that the non-Western peoples should commit themselves to the Western values of democracy, free markets, limited government, human rights, individualism, the rule of law, and should embody these values in their institutions. Too often, great cultural traditions with significant and superior achievements are ignored. As a result, there is a fading appeal of Western customs in some aspects with non-Western nations showing increasing confidence in and commitment to their indigenous cultures. Actually, what universalism is to the West, imperialism is to the rest of the world (Huntington, 1993)—and there is no justification for it.

Multinational companies that want to succeed in China need to adopt a far more humble approach with respect to China's heritage and current management practices. This includes a willingness to learn and to change 'Western Principles of Doing Business'. Indeed, China today offers more management lessons than any other country in the world. Boston Consulting Group partners have recently studied more than 30 large private Chinese companies and found that most of them display a mentality that values high asset turnover and good timing over perfection; a Confucian preference for simple organizational structures, with everyone reporting to the top; a deep fear, stemming from China's past instability, of too much debt; and skills in dealing with different levels of the powerful state. The good companies, however, are defined by something more: high aspirations and openness to experimenting with radically different management techniques and practices (Hout & Michael, 2014).

A second major success factor is the fact that clear-cut guidelines that work in the West do not work in China and firms need to embrace tensions between alternative roadmaps. These tensions are swirled around seemingly contradictory but interwoven forces. For Westerners it is difficult to understand that there is more than black-and-white-thinking, such as, shades of gray, or completely different alternatives. Figure 1 illustrates some challenges in terms of market entry preparation, segmenting, targeting, branding, and overall mindset.

For instance, firms may need to modify existing internal resources to remain competitive while, at the same time, explore new business models and tap into unknown sources of value generation. Managers and firms need to continuously update their knowledge while being open to unlearn and challenge previously

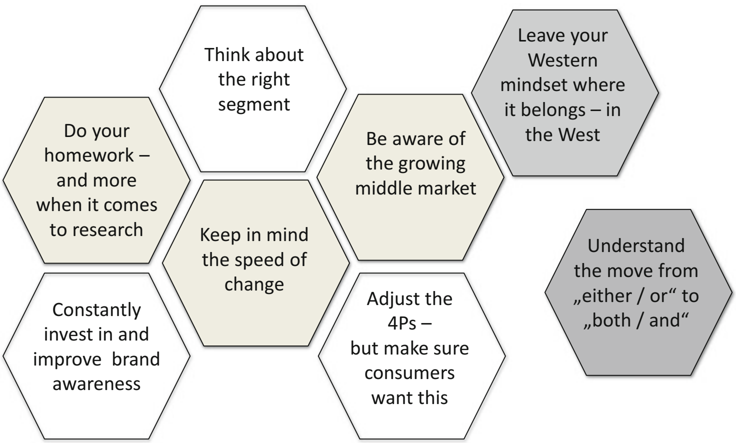

Fig. 1 Some challenges of doing business in China. *Source*: Author

acquired recipes and managerial tools. This requires that they engage in reconfirming existing mindsets but also in questioning them. Many activities require a lot of time to be implemented, while others occur at path-breaking speed. In marketing terms, consumers may demand Western-style premium products but at the same time favor local manufacturers, thus segmenting becomes important. Many Chinese consumers have become very rich, but many are still very poor, thus targeting the increasing middle market is vital. Localization is relevant when it comes to the 4P's of the marketing mix, but some globalization could also be attractive. All these challenges elaborate calls for paradoxical 'both/and' instead of 'either/or approaches' to management (Collins & Porras, 1994).

While the mindset of Chinese business partners and consumers may be quite different, having both the patience and the ambition to discover them is an important step to success.

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The Future

Christiane Prange

What is the future of China? For many people, this question already seems to indicate that China's future is at risk. Concerns, among others, deal with the factual slowdown, this year's stock-market plunge, and an increasing purchasing divergence between rich and poor people. In 1978, China was one of the poorest countries in the world. The real per capita GDP in China was only one-fortieth of the U.S. level and one-tenth the Brazilian level. Since then, China's real per capita GDP has grown at an average rate exceeding 8 % per year. In 2015, China's GDP grew 7 % in the first quarter, and this is far away from forecasting a downward spiral. The current development indicates that China's economy is in a steady slow growth but is heading for better with an economy moving away from pure exporting and instead focusing on services and innovation. As fast-paced growth is more difficult to obtain from services than from manufacturing, the Chinese Government has adopted a series of policies and measures to stabilize the growth, promote reform, adjust the economic structure and benefit the public. China's economy now enters the state of 'new normal', which will pose challenges in its own right (Xu, 2015). Of course, stock market hassles and inequality remain to be pressing topics, but these problems are not unique to China.

Overall developments of China's economy anticipate answers to the main questions of this book: What is the future of marketing in China? What is the role of premium-branded Western products? What is the future of foreign multinational firms in China?

The future of marketing in China will depend on whether globalization continues to allure consumers. In the current stage of development, China's consumers are at crossroads: adopt Westernized products and brands, or support national products to elevate local manufacturers' quality and global reach? While the two options are

C. Prange (✉)
School of Economics and Management, Tongji University, Shanghai, China
e-mail: christiane.prange@icloud.com

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not mutually exclusive, examples show that national brands gain in attraction and reach. For instance, digital leaders like Alibaba (e-commerce) and Xiaomi (smartphones) are already emerging as top global contenders. With local competitors entering the landscape, it will become more difficult for foreign multinationals to compete in China. A key factor in purchasing behavior across industries will be to grasp the core demands of consumer groups across age categories to win emotional support, make the products that fulfill a need and promote life-long brand loyalty and trust. These objectives cannot be met in the short run, which re-iterates the need for long-term investment and commitment in China.

Two mutually related trends seem to emerge. One is event-based sales and promotion, and the other pertains to online- and social media transactions. An indicative example of the first trend is Single's Day in China. In 2015, shoppers spent more than US$9bn in the first 12 h of China's Singles' Day sales on 11th November, topping last year's total for the world's biggest online shopping day. 11 November is not a traditional Chinese festival but online shopping platform Alibaba has been pushing it since 2009, first marketing it as an "anti-Valentine's Day"—11/11 being a date heavy on ones—with hefty discounts to lure the country's singletons and price-sensitive buyers. With sales hitting new highs year after year, Singles' Day has become a lucrative business opportunity embraced by all online retailers in China, with competition between them turning increasingly fierce (The Guardian, 2015). Single's Day is but one example for event-based communication and sales – others are widespread and multiplying.

In a related vein, the digital explosion in China is undeniable and growing in complexity. Mobile phones are used for all sorts of services, from opening a bank account, contracting a property agent, payment services, dating portals, child-care, and language learning. There is virtually no remaining sphere of human life that has not been captured by mobile apps. With more than 649 million mobile Internet customers in China, the tendency is increasing. Among those users, 432 million watch online videos. In fact, Chinese consumers spend 170 min a day on mobile devices, which is longer than TV, radio and print combined. Especially, mobile video will become the major trend in delivering information and entertainment in the future, and that is particularly true for advertising (Rust, 2015). These trends are likely to change the way companies formulate and locally implement their communication strategies.

When it comes to brand preferences and brand management, there is huge opportunity. In most product categories, hundreds or thousands of local firms compete for domestic market share, leaving profit margins razor thin. And because foreign brands have taken much of the market's high end, most Chinese companies are forced to compete on cost, leaving little room for investment in R&D or marketing and branding. For foreign firms branding is a huge differentiator, mainly because of their country-of-origin advantage. However, according to the 'Top 100 Most Valuable Global Brands 2010' ranking, China already has some of the world's most valuable brands. China Mobile, valued at $56 billion, ranks first among global mobile operators. ICBC, valued at $38 billion, is the most valuable bank brand. Haier manufactures more appliances than any other white goods maker. Collectively, China's top 50 indigenous brands are worth a whopping $280 billion (Millward Brown, 2011). In the future, country-of-origin advantages coupled with high-end products are unlikely to be the sole source of differentiation for foreign firms. Instead, they will have to engage in innovative brand building to match Chinese firms' evolving brands that increasingly gain consumer esteem and preference. Also, new ways of utilizing the ideographic nature of each character in Mandarin may provide ample room for experimentation, playfulness, and innovation. Indeed, visual branding can play a huge role in corporate identity, not only for Chinese but also for foreign multinationals.

Overall, the future of multinational firms in China is positive but getting tougher. Twenty years ago, chances were high that foreign market entrants were to succeed. Today, being foreign per se is not an advantage. While China is one of the top emerging markets, it is a hugely heterogeneous and diversified country. There is no single strategy to succeed in China: Both low-end and high-end challenges exist, with each segment requiring different marketing tools and techniques. Companies in each segment follow their own rules and former competitive advantages of Western firms can easily erode.

Thus, changing propositions relate to investments in services, as opposed to manufacturing, the exploration of inland provinces, the adaptation and potential re-invention of profitable business models, and the attraction of local talent to understand what and where China is today and where it wants to be in the future – all from an insider's perspective.

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Author Biographies

Umair Ahmed is a business professional, who lives in The Hague, Netherlands and is passionate about the retail industry. He grew up in Karachi (Pakistan) and has worked in various industries involving retail banking, business information, energy, and logistics. After moving to The Netherlands, he pursued a M.Sc. in Business Administration from Tias Business School, and in line with his interest wrote a research paper on Store Brands. At present, he is working in one of the global leading business information companies in Amsterdam and is mostly involved in working with FMCG executives in identifying new opportunities in the packaging industry. Umair likes to stay abreast with latest developments in business, the political and the social arena.

Ilan Alon is a professor of Strategy and International Marketing at the University of Agder, Norway, as well as a visiting scholar at Georgetown University, USA. The author of several books, Alon has taught at top business schools globally, and consulted in marketing and international business for multinational corporations and government organizations. He is the editor of the International Journal of Emerging Markets, which publishes cutting-edge research on developing and transitioning economies. Researching China, in particular, Ilan examines the impact that international business institutions and differences have on inward and outward internationalization.

Dong Bian is the director of Academic Affairs at CAPA Shanghai. He has over 10 years of international teaching and research experience in Europe, including International Executive Training and Consulting. He has taught business related courses in East China Normal University's Global Curriculum, as well as the EM Lyon Business School Asia Campus. Previously he has held such positions as Sales Marketing Manager and Business Development Manager in large multinationals such as Huawei Technologies and Greek Intracom. His research has mainly focused on competitive advantage sustainability, time-related strategy formulation and implementation, international entrepreneurship, and international business between China and Europe.

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Yao Grenot Chen is a marketing communication consultant specialized in China. Coming from Beijing, Chinese/French bicultural, she graduated in political science (Beijing Foreign Affairs College in 1995) and in international business management (HEC Paris 1999). Yao has worked 2 years for the Trade Commission of the French Embassy in China and more than 10 years in L'Oréal group in Shanghai and Beijing. In addition to her consulting business, she is also a cross-cultural communication trainer. She gives lectures of international marketing at EMLYON Business School and other business schools since 2013.

Jaihak Chung is a professor of Marketing at the Sogang University, Republic of Korea, as well as a visiting scholar teaching High-tech Marketing in Asia at EMLYON Business School, China, and IESEG, France. He earnt his Ph.D. degree in management from Cornell University, USA. He specialized in analyzing big data for consumption cultures in Asia and consulting in innovative product development. He is currently the chief-in-editor of the Asia Marketing Journal.

Pauline Cosijn is a business professional, who lives in Amsterdam, The Netherlands. She received a Bachelor degree in Business Administration, which allowed her to live abroad in Madrid (Spain) as part of an exchange. After this international experience, she decided to pursue a Master's Degree in International Business Administration (TIAS Business School, 2015). During both her Bachelor and Master she specialized in international marketing, and in line with her interest wrote a research paper on the effects of brand-level differentiation on consumer perceptions and loyalty in the FMCG industry. Currently she is actively pursuing a career in the retail/FMCG industry. Pauline likes to stay abreast with the latest developments in business, retail and the FMCG industry.

Veronica Giunta is a marketing professional with a strong passion for international marketing and advertising. During her academic studies, she focused intensively on international trade and marketing and obtained a M.Sc. in International Business Administration with a Marketing Management specialization from Tias Business School. Thanks to a period of study in Beijing, she also developed a deep interest for China, and business and marketing strategies in this emerging country. At present, Veronica is working as channel marketer for the global company CSM. In her current position, she is in charge of analyzing the food service, anticipating new trends and identifying new business opportunities.

Klaus Heine was teaching the first luxury marketing course at a German university at TU Berlin and specialized with his doctoral dissertation in "The Identity of Luxury Brands". He conducted the first millionaire survey in Germany about their luxury preferences and various other qualitative and quantitative luxury consumer surveys in Europe and on-site in China. Klaus Heine works as assistant professor of luxury marketing at EMLYON business school in Lyon and Shanghai, where he combines teaching about luxury brand management with applied-oriented research and practical projects.

Sylvie Hertrich is a professor of Marketing at EM Strasbourg Business School (University of Strasbourg). She earnt her Masters degree of International Management and a Ph.D. in Management from the University of Paris Pantheon-Assas, and has been a visiting professor on the five continents. Her client list includes the likes of Accor Group, Air France, Alfa Romeo, Audi, BMW, Bouygues, CFCE, Citroen, French Tourism, Hermes, Nina Ricci, Bugatti Peugeot, SNCF, Saab, Volvo. She is a co-author of books, book chapters and over 50 business cases like Adidas, Audi, Club Med, Danone, Disneyland Paris, Hilton, Lustucru, McDonald's, Peugeot, W hotels. Sylvie is also a member of HuManiS Research Center (University of Strasbourg), and her research activities mainly focus on three topics: Tourism Marketing, Luxury Marketing, and International Marketing. She is the recipient of a number of distinctions.

Katharina Kübrich is consultant for digitalization, marketing and innovation management based in Germany. She completed her Ph.D. studies in business administration at the Berlin Institute of Technology and Tongji University Shanghai. She delivers strategic consultancy for digital marketing, Internet of Things (IoT), know how protection, and e-/m-marketing for Chinese and German multinationals and startups. As a visiting scholar Katharina gives lectures on innovation and strategy at prestigious universities in China, France and Germany.

Britt Kühne is a fashion and marketing professional living in The Netherlands. During her Bachelor of Business Administration in Fashion at TMO Fashion Business School, she did an internship at the buying department of the largest high-street lingerie brand of the Benelux. During this time, she learnt a lot about retail, branding and marketing. After her graduation from TMO, she won a scholarship for 'Women in Business' from TIAS School for Business and Society, where she pursued an M.Sc. in Business Administration with a specialization in Marketing. In line with her interests in marketing, international business, and Asian cultures, she wrote this case study on the internationalization of Mattel. Britt likes to stay informed about the latest developments in business, marketing, and fashion.

Hua Li is an Assistant Professor of Marketing at EMLYON Business School. She received her Bachelor degree from Xian Jiaotong University, China, and her Master degree and Ph.D. from IAE Aix Management School at University of Aix-Marseille, France. Hua's research interests are primarily in the areas of consumer motivation and cross-cultural consumer research. Her work has been presented in international conferences including European Association for Consumer Research (EACR), European Marketing Academy Conference (EMAC), Transformative Consumer Research (TCR) and American Marketing Association (AMA).

Ulrike Mayrhofer is a Professor of Management at IAE Lyon, Jean Moulin Lyon 3 University. She is the Academic Director of the International MBA and President of Atlas/AFMI (Association Francophone de Management International—Francophone association for international management). Her teaching activities concern international management, strategic management and international marketing. She is a recognized specialist of internationalization strategies and has published several books and case studies as well as many articles in scientific and professional journals. She is a member of the editorial board of several journals including International Business Review, Journal of World Business and Management International.

Christiane Prange is a Professor of Global Strategy and Marketing at Tongji University, China and the Director of the AgileVentureLab, a think tank specialized in researching corporate agility management. She obtained her Ph.D. from Geneva University, Switzerland, and has lectured as a visiting professor in more than 10 countries, including Austria, China, Malaysia, Russia, Romania and U.K. She has also consulted multinational companies on marketing and internationalization strategies, global innovation management, and agility. She has published five books and several journal articles, and has presented her work at major international conferences, including Strategic Management Society (SMS), Academy of Management (AOM), and Academy of International Business (AIB).

Patricia Schnitger is a business professional living in Amsterdam, The Netherlands. In 2003, she graduated from the International Institute for Hospitality Management in The Hague, receiving a Bachelors degree in Business Administration. After 5 years in different roles at Starwood Hotels and Resorts in New York and Amsterdam, she continued her career in sales at Coca-Cola Enterprises Netherlands. Due to her drive and interest in international marketing and sales in multinationals, she decided to follow the Masters in International Business and Administration, specializing in Marketing at TiasNimbas in Utrecht, The Netherlands in 2011. Patricia graduated with distinction in 2012, writing her thesis about the relationship between co-creation and the business results of the top 10 largest multinationals in the FMCG industry. After 8 years of different roles at Coca-Cola Enterprises NL, she decided to pursue her career at Diageo, where she has been working as a Channel Manager, responsible for the independents channel in The Netherlands, since May 2015.

Zhuomin (Shan) Qin M.Sc., Shanghai, P.R. China, grew up as a Y-Generation digital native in the economic booming age of China. Zhuomin has a natural understanding of this fast-growing and dynamic market. Benefiting from a M.Sc and a B.A degree from TIAS School of Business and Society in the Netherlands, Zhuomin has acquired an international vision and has used it to thinking critically by applying a strategic framework. Currently, Zhuomin is working as Digital Brand Strategist in Fred and Farid Shanghai, serving both local and international clients such as Tencent, Diesel and HP by providing creative branding strategy solutions in accordance with Chinese market insights.