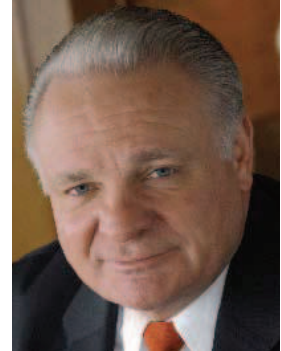


Cracking China's Local Market

In the rough and tumble, purely local, price driven market, few foreign companies dare to tread. As a wise Chinese businessman once told me, uncertainty lies beyond the water's edge. Non-Chinese companies instinctively appreciate the wisdom of this advice and stay away from the purely local market. But should they?

By Jack Perkowski



Dell, the world's second largest personal computer maker, plans to devote more resources to the small- and medium-sized business (SMB) market in China. MAN, the large German truck maker, announced in July that it had reached an agreement to purchase a 25 per cent stake in Sinotruk, China's largest truck assembler, for USD 796 million.

What do these two seemingly different actions on the part of two completely different companies have in common? Both represent steps taken by global

high-end segment of the China market has grown to be as large as the entire markets of most countries in the world. In this part of the China market, companies can bring their products to China as is, with little adaptation necessary to accommodate Chinese pocketbooks. However successful this strategy may be in the short-term though, it ignores a large part of the China market that is served almost entirely by local players.

Before China began its economic reform programme in 1978, the country's domestic market for goods

ment stagnated. For these and other reasons, the China market consisted then of local consumers, local suppliers, and products at the low end of the price and technology scale.

As the Chinese economy developed, the presumption was that the country's local market would begin to shrink or disappear in the face of competition with higher-quality, higher-technology goods from abroad. That has not happened. Instead, the estimated 900 million people living in China's rural economy, whose middling incomes average USD 700 per year, continue to shop for their goods in China's purely local market, in much the same way they did before China's reforms began.

The vast number of people at the bottom of China's income ladder keeps China's local market alive – and growing – in lockstep with the development of China's market for high-end products. Uneven economic development and the vast disparity of income levels in China have perpetuated this market segmentation. Though there may now be a greater variety of goods from which to choose, prices, quality, and technology levels continue to be at the low end of the scale in China's purely local market.

Most foreign companies, if they consider it at all, don't believe the local market is a battleground on which they can be successful – the price levels

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leaders to move out of their respective comfort zones and penetrate the large, purely local market in China. While Dell uses product redesign to lower price points for the extremely price conscious local market, MAN engineers a strategic alliance with an established local player to gain market entry.

When foreign companies come to China, they quite naturally gravitate toward the segment of the Chinese market that demands the best technology from around the world and is willing and able to pay the high prices necessary to buy products that have it. With the country's rapid development, the

and services was a purely local affair. Income levels were uniformly low, so prices had to be kept low. The trucks, industrial equipment, household fixtures, consumer items, and other products used in everyday life were produced by local Chinese companies that did not have access to more advanced technologies from the West. Little, if any, foreign goods were imported into the country, and there were no foreign invested companies in China to produce the higher-priced, higher-technology products and brands commonly found in developed economies. A centrally planned economy stifled innovation, so technology develop-

are too low. In the rough and tumble, purely local, price driven market, few foreign companies dare to tread. But, is this a wise course of action? My long experience in China tells me that understanding China's local market, and making a serious effort to tap into it, is important for several reasons.

First, it's big. China's local market is the part of the market where the vast majority of the country's 1.3 billion population shop and where a great deal of the government's effort is now focused as it seeks to build domestic consumption in the country. As a result, the local market is where the ultimate economies of scale in China will come from. Opting out of this market forsakes those economies.

Second, as income levels continue to rise over time, the local market will bridge the gap technologically. Price levels between the two markets will also merge, but will settle somewhere in between the two – at levels lower than most companies would accept in markets outside of China. This creates an interesting dilemma: Should a company maintain global price levels, give up the China opportunity, and risk losing out to lower-priced Chinese competitors down the road? Or, should it compete in China, recognising that with global pricing mechanisms in place, the "China Price" may soon be the "Global Price?" I would argue that the latter is really the only option if a company has any hope of preserving long-term global competitiveness, not to mention competitiveness within China itself.

Finally, China's immense local market makes it a fertile breeding ground for future competition. Due to its vast

income disparities, the China market tolerates all levels of technology and quality – as long as the price is right. While companies with inferior technology or quality might fail in developed markets, they live to fight another day in China. In a familiar environment where they can compete the Chinese way, local companies have opportunities to gain scale in the local market.

"Companies should recognise that the 'China Price' may soon be the 'Global Price' if they have any hope of preserving long-term competitiveness"

Many of these companies may ultimately fall by the wayside, but some are going to manage to survive, pull themselves up by their bootstraps, improve their quality, and become battle hardened, low priced competitors to the foreign invested companies in China. With the glint of global domination in their eyes, the next step for China's local companies as they successfully compete with the best of the foreign companies in China is the global marketplace.

By their actions, Dell and MAN demonstrate that they understand this dynamic. SMB accounts for more than 25 per cent of Dell's business in China. Dell has decided that this market is so important that it has redesigned its products to lower costs. The company is providing computer models specially designed for rural residents that are priced below RMB 3,500 (RMB 1 = about USD 0.14). In addition, Dell is stepping up its marketing in China's rural communities and ramping up channel expansion to reach

more SMB customers in the third, fourth, and even fifth-tier markets.

MAN is taking another tack. Virtually all of the trucks used in China are made by exclusively local companies. With price points for Chinese trucks as much as 70 per cent lower than trucks made by foreign assemblers – even when those trucks are made in China – it is difficult

for foreign producers to gain market share. MAN decided to penetrate China's local market by buying a strategic stake in China's largest truck producer, a company that already derives 20 per cent of its sales from markets outside China. In doing so, MAN is assured of playing an important role in China's growing truck industry as it expands both domestically and internationally.

One way or another, look for global leading companies to find innovative ways in the years ahead to participate in the growth of the entire China market, not just the part that resembles their markets at home. For those who remain hesitant, just think about what Columbus would have failed to discover if he had simply stuck to sight of the shore. ■

Jack Perkowski is a Wall Street veteran and the founder and Managing Director of JFP Holdings, a China merchant bank. He is also the founder and former CEO of ASIMCO Technologies. Jack is the author of Managing the Dragon and he writes China business commentary on his blog managingthedragon.com.



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