By Martin Roll

Local lessons – the brand experience in China

A number of challenges remain when doing business in China, but steps can be taken to enhance the country brand. Crucially, local engagement lies at the heart of anti-counterfeiting success

Globalisation is one of the truest realities of the current business climate. More and more countries are opening up their markets and inviting foreign companies in. Migration of intellectual capital is more pervasive than ever before. As democratic principles are more widely adopted around the world, cross-national business has increased. These developments have made the world much flatter. On the one hand, globalisation has allowed companies to expand and grow, increase their consumer base and prosper.

On the other, it has brought about increased competition, heightened regulatory monitoring and greater exposure to the fluctuations of the global marketplace.

For brand owners, strategies for both doing business and manufacturing in emerging markets should thus be tailored to local circumstances. Much can be learnt from the experience of local brands – both in their efforts to expand internationally and in their servicing of the local market. China is one instance where these strategies will pay off handsomely.

The usual picture of emerging markets projected by the world media is that of a growing middle class with increased disposal income, converging consumer lifestyles and thriving 'bottom of the pyramid' market segments. While this accurately represents the general conditions in many such economies, it misses another important trend that is gradually emerging: a significant segment of affluent consumers.

A case in point is the rapid rise of the affluent class in some of China's biggest urban centres. Buoyed by the rising fortunes of both indigenous businesses and local professionals returning from foreign shores, many of the world's leading luxury brands have set up shop in China. Further, given their newly attained affluence, Chinese consumers have proven to be freer and more aspirational in their spending than most Western consumers. These spending patterns, and a lack of long-established brand preferences, have prompted luxury brands such as Armani, Gucci, Prada, LVMH and Ralph Lauren to take renewed interest in the Chinese market.

The liberalisation of China has facilitated the gradual integration of this fast-growing economy with the global economy. The easing of trade barriers has enabled a much freer flow of human, financial and intellectual capital across boundaries.

But the biggest change it ushered in was the addition of more than 2 billion consumers to the global demand pool. As developed Western economies reach saturation point, global brands are looking to emerging economies – especially China – as potential markets to expand their growth and profitability. A recent report by the Boston Consulting Group forecast that more than 70% of future business in the global pharmaceutical industry would originate from developing countries.

Jeffrey Immelt, the chief executive of General Electric, admitted that the company expects more than 60% of its growth revenue to emanate from emerging economies in the coming decade. And more than half of all S&P500 firms reported that nearly 47% of their sales and profits, approximating to $2 trillion, came from markets outside of the United States. China is playing a central role in this changing global business paradigm.

Two challenges dominate the effective navigation of the Chinese market for any global brand. Interestingly, they also impact on the ability of domestic brands to expand successfully overseas (and multinationals to market goods made in the country). The first is the extent of government intervention in all aspects of doing business in China; the second is the lack of stringent enforcement of IP law to protect against possible violations.

Government intervention and the country brand

Of the many emerging economies, China is usually presented as a poster child for the negative effects of country branding. The country is an economic powerhouse. Every global company aspires to have a fitting presence in China. The enormous domestic market, the manufacturing boom that has elevated many sections of the society to the middle and even affluent classes, and the many untapped consumer segments have only intensified the Chinese gold rush.

Yet despite this corporate frenzy, consumers have become wary of anything that is labelled "Made in China". The efforts of many local Chinese manufacturers to cut costs and increase exports have led to concerns that producers are cutting corners in the quality of their products, and are thus endangering consumers. Only recently, metal oxides found on toys for toddlers created a huge furore and tarnished the already tainted "Made in China" tag even further. This perception also impacts on international companies that produce goods in China for sale overseas.

However, the growing prominence of many Chinese multinationals on the global scene has mitigated this perception somewhat. Lenovo acquired IBM's PC division and has since become

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one of the top three PC makers in the world. Haier has emerged as a powerful player in the home appliances industry in the tough US market. Many other Chinese companies have made bold acquisitions around the world. These activities have gradually helped to boost positive perceptions about Chinese brands.

But with the Communist party still in direct or indirect control of almost all corporate activities in China, further progress in improving the country's image outside China is still a challenge. One recent high-profile case of government intervention involved Google, which was forced to close down its operations in mainland China and move to Hong Kong because of the censorship of its content. The incident highlighted the role of government intervention and its impact on perceptions of associations with China.

To overcome these challenges to the country brand, three important strategic steps should be taken to help both domestic companies seeking to expand internationally and global corporations entering the Chinese market.

Legitimacy through strategic associations

Chinese companies must establish strong levels of credibility with global consumers as they expand. Apart from tangibles such as quality and cost, the perceptions born of China's political system and its interaction with other countries are perhaps the most significant challenges to this. One important way for companies to counter negative perceptions is through strategic associations.

Chinese companies have traditionally taken the acquisition route to expansion. Joint ventures, strategic alliances and even informal cooperations with other international companies can help to overcome negative perceptions. Similarly, domestic companies can collaborate with international companies entering China, to the mutual benefit of both.

Similarly, global brands entering China should aggressively seek out collaborative associations with multiple stakeholders active at both the national and regional levels. Such associations enable global brands to gain invaluable access to local knowledge and to develop an understanding of the norms of the Chinese market. They also help to circumvent the challenges presented by government intervention and the resulting restrictions on business practices.

Enhancing global presence

Even mighty Japanese brands such as Honda and Toyota and South Korean brands such as Samsung and LG initially had to overcome negative country of origin perceptions before achieving global success. Given the significant resources at their disposal, Chinese brands should aggressively increase their global presence. The thriving domestic market may make such a move appear unnecessary from a profitability perspective, but from a legitimacy perspective, this would help to bring such brands into close contact with global consumers. An awareness of, and familiarity with, Chinese brands should help to allay any unjustified concerns about the "Made in China" tag, to the benefit of all companies that produce goods in the country.

However, the challenge is also to ensure that these benefits can be further enhanced by a gradual easing of government intervention. Google's withdrawal may have had little direct financial impact in China, but the damage to reputation and legitimacy has been significant. As such, the Chinese government should proactively take steps not only to aid outward-bound Chinese companies, but also to attract incoming global brands.

Consistent demonstration of quality

The most fundamental strategy in minimising negative perceptions is to offer consistently top-quality products and services. As important as symbolic actions may be, there is no substitute for substantive worth. Chinese companies should establish an aura of legitimacy by providing quality products and adhering to well-respected business practices, giving these precedence over short-term profitability. These priorities should also be aggressively communicated to a global audience.

Moreover, demonstrations of quality should go far beyond mere product quality. When international organisations such as the World Bank, the United Nations and other watchdogs rank countries in terms of attractiveness, they evaluate criteria such as government transparency, the prevailing business climate and law enforcement, which all influence the overall commercial environment. As such, it would be of great benefit to ensure that the Chinese government plays its part in attracting incoming global brands.

New counterfeiting strategies

Turning more specifically to international companies seeking to do business in China, the next big challenge is the enforcement of IP rights. One industry where this is extremely salient is in the luxury goods sector. As the mature US and European markets reduce their consumption of luxury products, consumers in China are increasing theirs. A recent Boston Consulting Group study concluded that

China's $20 billion luxury market will drive future sales in the sector. China is projected to overtake the United States as the world's largest economy by 2030. Given the increasing levels of affluence, the race to reach Chinese consumers is only going to intensify.

Ralph Lauren is one company which is getting aggressive with its China strategy. Unlike many other luxury brands, such as LVMH and Gucci, Ralph Lauren has traditionally sold its products through department stores. Brand retail stores are especially important for luxury brands to convey premium perceptions of their products. Hitherto, Ralph Lauren (which sells more of its products in Manhattan than in China or Hong Kong) has been complacent in this regard.

But in recognition of the potential which the Chinese market represents, it has now shifted its strategy to open its own brand retail stores in Shanghai. The aim is to open at least 15 stores in mainland China, up from the 35 retail counters it currently has in China and Hong Kong. Since adopting this proactive strategy, Ralph Lauren's stock has appreciated by 46% on the New York Stock Exchange during this fiscal year.

But this expansion has meant that increased attention must also be paid to the counterfeiting problem. For any global brand entering the Chinese market, some key strategic steps can be taken to minimise this threat.

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Connect with consumers on the ground

Unlike many mature Western markets, emerging economies are characterised by many first-time consumers who have only recently acquired sufficient disposable income to purchase products. As such, their needs are evolving. Companies will fare well by establishing a strong on-the-ground network of stakeholders to understand the unique needs of consumers and make persuasive product offerings to them.

By winning over consumers, brands can also be strategically utilised to minimise counterfeiting. Given the fragmented distribution networks in China, global brands can effectively use local consumer groups as secondary monitors of possible counterfeiting. This also creates new opportunities to engage consumers with the underlying value proposition of the brand.

Customise strategically for each consumer segment

As mentioned earlier, a defining characteristic of many smaller Chinese markets – usually referred to as the 'bottom of the pyramid' segments – is the diversity of consumer demographics, purchase preferences and basic needs in evidence. As such, standardised products in any category will preclude companies from successfully reaching all of these consumers. Effective and strategic customisation holds the key to establishing a competitive advantage in emerging economies.

Companies should strive to tailor their products and services for each segment they are targeting. The micro-financing phenomenon is one example of this strategy. Prevalent in many emerging economies, micro-financing schemes lend small amounts to consumers at very low interest rates and with negligible collateral. Although huge multinational banks would like to tap into this market, their inability to operate at such a small scale by customising their products prevents them from doing so.

However, by creating unique offerings for each consumer segment, customisation can minimise rampant blanket counterfeiting of global brands. By constantly tweaking their products to suit the consumer needs, global brand owners can circumvent the challenges of a parallel grey market.

Cooperate with local innovators

Probably the biggest threat to establishing a competitive advantage in emerging economies is the disruptive innovation presented by many local start-ups, which is usually masked as reverse engineering or counterfeiting.

These start-ups benefit from the dual advantage of having insider, first-hand access to the market and consumers on the one hand, and a lack of stringent enforcement of IP rights on the other. This combination of factors is enough for local start-ups to successfully and illegally cut off profits from global brands.

Multinational companies would be well advised to cooperate with these start-ups not only to pre-empt such disruptive innovation, but also to strategically partner with them so that they can jointly reap the potential benefits of such innovation.

Outlook

Emerging economies are challenging, given their unique composition. Increasing competition makes it imperative that companies understand the idiosyncratic nature of these markets, so that they can attain and sustain a competitive advantage. The inherent diversities in markets, segments, consumer tastes and buying patterns should also be carefully considered in order to devise effective strategies that tap into and serve these markets.

Especially in the Chinese market, growth opportunities exist alongside the prevailing challenges of poor legal enforcement of IP rights and rampant government intervention. While companies are attracted by the opportunities to grow and enhance their scope and scale economies, they should also be constantly planning to manage these challenges. The strategies outlined in this article should help companies to in both respects. WTR

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