Winning in China’s mass markets
New business models, new operations for profitable growth

In recent years, most established foreign multinational companies (MNCs) have enjoyed strong revenue growth and profitability by riding on the back of China’s spectacular economic growth. China already contributes on average nearly 10 percent of the global revenues of the 180 MNCs in our 2006 survey. But in China’s rapidly changing environment, recent success is no guarantee for the future. Industrial and consumer products companies alike will have to reevaluate their business models and operations to sustain rapid revenue growth and profits.

In industries ranging from automobiles to electronics, lower-end product segments often account for the largest portion of the total market and these segments are also growing the fastest. China’s lower-middle class – which we define as having a household income of US$3000 to US$6000 – is expected to grow to 41 percent of all households by 2008. MNCs counting on China for strong revenue and profit growth – or simply hoping to maintain market share – will need new approaches to win in price-sensitive mass markets while preserving their market leadership in higher-margin, premium market segments.

Most MNCs seeking to penetrate mass markets will also need to venture out of familiar major cities, like Beijing and Shanghai, and into what we define as “emerging” cities in China. In 2005, this group included 305 tier 3 to 5 cities, which collectively accounted for 43 percent of China’s GDP and 39 percent of the total urban population. The majority of these emerging cities are not in fact “remote” or “inland” – 58 percent are located in coastal provinces and are accessible by road or rail from major tier 1 cities. Our analysis shows that 81 percent of tier 3 to 5 cities have average salaries that fall into our definition of the mass market, compared to 52 percent of tier 1 and 2 cities.

Business model and operational innovation to win in the mass market
Lower cost structures will typically be needed to support profitability in price-sensitive segments. Companies who get this formula right can enjoy a sustainable competitive advantage extending well beyond low prices. Serving mass markets potentially impacts how companies do business across the value chain, from R&D to after-sales service and support (see Figure 1).

Will products developed for the mass market be based on global designs or developed from scratch in China? Will global or local suppliers be used? How will companies expand their sales and distribution capabilities to reach tier 3 to 5 cities? Is there enough of the right talent at salary levels and locations outside of tier 1 to 2 cities? These and other questions must be considered as part of companies’ mass market strategies.
Key operational levers
Our experience and interviews suggest that companies must focus on at least three critical areas to build flexible and cost-effective operations to serve the mass market profitably:

- Sales and distribution channels – Transform inefficient, multi-layered sales and distribution channels suffering from limited collaboration and visibility into far reaching, cost-effective channels that provide valuable information about end customers
- R&D and procurement – Develop products tailored to the needs and price points of the China market; develop deeper collaboration with cost-effective local suppliers
- Human resources – Alleviate talent shortages and develop a large pool of cost-effective, scalable talent with the right skills for mass markets

Is your company prepared?
- Have you carefully evaluated the mass market opportunity for your company’s products and services in China? Do you have a strategy in place?
- Have you developed the right business models to pursue the mass market opportunity? What adjustments need to be made both in China and globally?
- Are your operations prepared for the mass market opportunity in key areas, such as sales and distribution channel management, R&D, procurement and human resources?

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FIGURE 1.
Are your business models and operations aligned with your China strategy?

Source: IBM Institute for Business Value analysis.