Selling into China: Practical Insights for a Faraway Place

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Introduction
Start with Existing Customers
A Two-Tiered Market
One Market of Many Regional Markets
The Wild, Wild East of Channels
When and Where is the Demand
Final Thoughts

China is the hottest topic (maybe too hot) in the business press today. There are countless articles about the Chinese political climate, economy and business practices, growth of the Chinese consumer, outsourcing to China, and the impact of imports from China. All of these articles are certainly interesting and provide some useful information, but they leave a lot of unanswered questions for business-to-business (B2B) marketers.

Over the past 1 - 2 years RS USA has worked with several B2B clients to understand the Chinese market and identify growth opportunities. These clients include manufacturers of factory automation components, supply chain technology, and computer products.

This article consists of practical insights on selling into China based upon RS USA's work with these clients and conversations with many other clients. With these insights you and your company can think coolly (but quickly) about China-related risks and opportunities rather than worrying and wondering anxiously about all of the hype. In a future article we will offer practical insights on how to compete against (or co-opt) cheap imports from China and other parts of the world.

The Chinese Dilemma: Should I Go Now? Wait? Or Am I Too Late?

The dramatic growth and size of the Chinese economy implies significant potential for sales for companies in the B2B space, if not now, then in the long-term. Yet everything one reads says that China is neither a simple or risk-free place to do business, and that is no doubt true. Should a company wait until China becomes more settled, and then enter the market - but take the risk of entering too late? Should a company enter now, make the necessary (and probably significant) investment, but take the risk of being on the "bleeding" edge. Read on »

Introduction
Start with Existing Customers
A Two-Tiered Market
One Market of Many Regional Markets
The Wild, Wild East of Channels
When and Where is the Demand
Final Thoughts

Start with Existing (and Maybe Your Competitors') Customers

First follow your existing customers, especially your major customers. As we all know many manufacturers have already moved production to China (and more are considering doing so), and thus for companies that sell into manufacturing a starting point is their customers. Have your major customers moved production to China, or are they planning to do so in the near future? How well does your company know and understand your major customers' initiatives and plans for China?

What about your competitors and their customers? If your customers have moved it is a good chance that your competitors' customers have done so too. Have your competitors moved operations to China? If your competitors are asleep at the wheel (see the next paragraph), moving to China could be an excellent opportunity to win new customers and take share.

A cautionary tale. One of RS USA's clients had just received an unusually large order from one of its major OEM customers, and while everybody was celebrating they found out that this customer had plans to move all of its North American production to China and seek local suppliers for the client's product. The large order was the customer's last order for its North American factories and was intended to help the customer make the transition. No one in the client's organization either knew about or fully understood the customer's plans, which were obviously a complete shock. Since then the client has moved quickly to develop Chinese production and compete for the business.

To avoid this fate a company should strengthen its account management and develop more effective marketing programs for its major customers. With stronger account management a company can get a broader perspective of its customers and thereby better understand its customer's needs, expectations, and initiatives on a global scale. This enables a company to develop more effective programs and maintain better account control. It does not mean, though, that a company can always prevent its customers from making unfavorable decisions such as moving production to China and considering local suppliers, but it does mean that if it happens the company will know about (and can possibly influence) such initiatives and can take action accordingly. For more about key account marketing please check out our article on the RS USA website.

In some cases a company can serve and support existing customers that have moved their production to China from the U.S., although there would be an increase in travel and logistical issues. The key issue is whether or not the company's offering is unique enough and provides such benefits that its existing customers will still specify its brand and products for their Chinese operations. If YES then it is possible to serve and support this demand from the U.S., but the company will need to monitor the risk of not being local. Read on »

Selling into China: A Two-Tiered Market

RS CONSULTING

Introduction

Start with Existing Customers

A Two-Tiered Market

One Market of Many Regional Markets

The Wild, Wild East of Channels

When and Where is the Demand

Final Thoughts

The influx of U.S., European, and Japanese companies (or investment by those companies) into China has created, in many cases, a two-tiered market of "foreign companies", which includes multi nationals, joint ventures and wholly financially owned enterprises, and Chinese companies. Typically there are very different marketing requirements for foreign versus Chinese companies.

The marketing requirements for foreign companies (i.e., the existing customers) are more straightforward for several reasons:

- Foreign companies are relatively fewer in number and identified more easily
- They are more likely to have experience with U.S. (or foreign) brands and products and, as mentioned previously, may even be an existing customer. Therefore they are more willing to consider such brands and pay a premium.
    - In some cases headquarters or the parent corporation may actually specify a U.S. (or foreign) brand, but some foreign companies are aggressively seeking out local supply in order to lower costs.
- Typically foreign companies purchase larger volumes since larger companies are the ones who have moved first into China, although many smaller companies have moved (or are moving) to China

For Chinese companies (i.e., potential customers) the marketing requirements are more complex, and the opportunities less certain. There are differences by each product market, but here are some general insights:

Price is certainly important, and one definitely hears this: "All the Chinese care about is price, price, price". A company will need to offer a low-priced product of acceptable quality to successfully sell to many Chinese customers, but from RS US's experience price is not the always the most important factor and other factors certainly play a role and can help a company "win" with certain customer segments.

- First not all Chinese customers - like U.S. customers - are the same. Some Chinese customers have grown and now compete both domestically and internationally, and often these larger companies seek better products and well-established brands and are willing to pay a higher price for these products. They need these higher-quality products and brands to compete in the international markets.
- Secondly the Chinese economy is still underdeveloped in terms of logistics and information. In recent studies conducted by RS US we found some Chinese customers, both large and small, willing to pay for faster or more reliable delivery and tech support. Chinese customers are eager to hear and learn about the latest technical developments in other parts of the world.

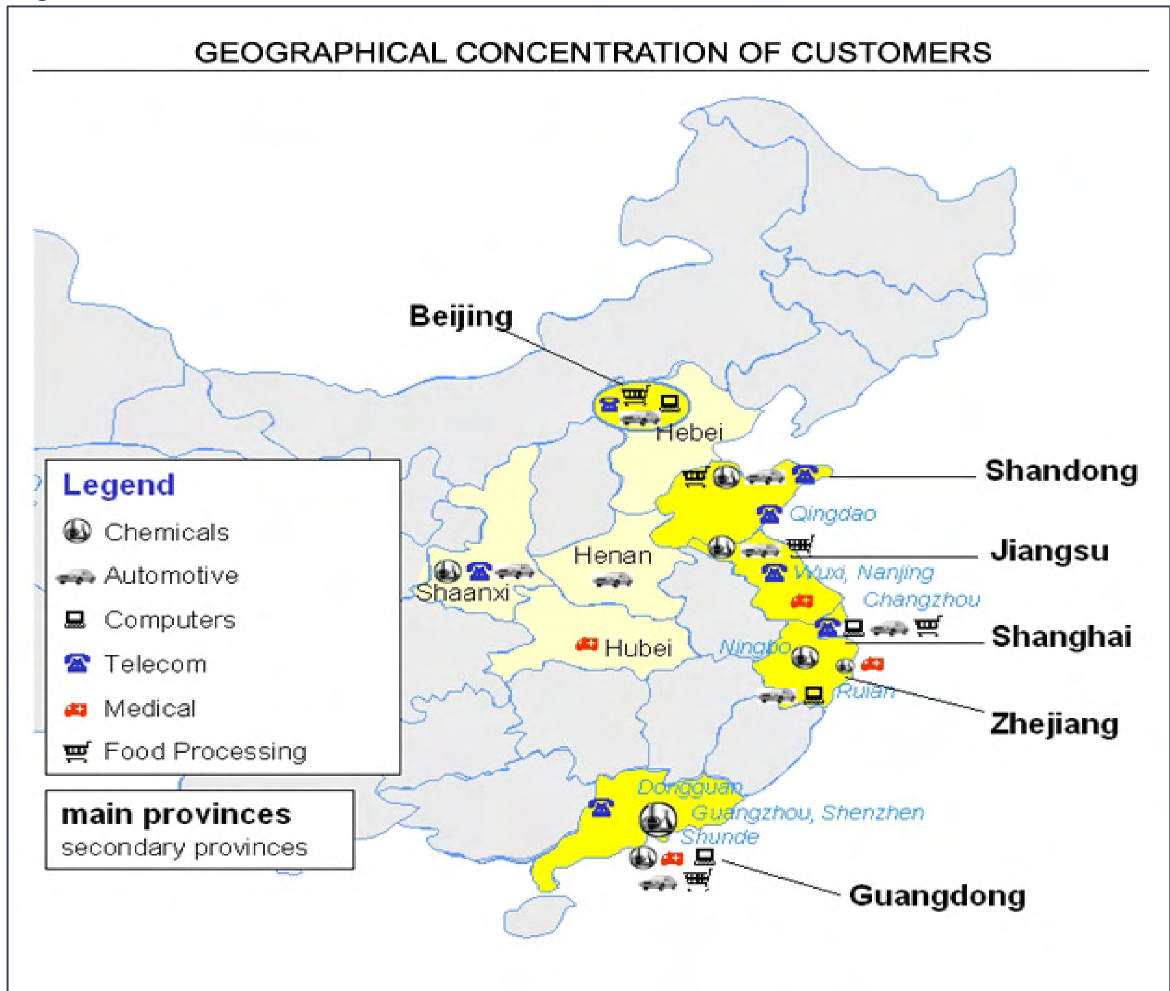
Read on »

Selling into China: One Market of Many Regional Markets

RS CONSULTING

Introduction
Start with Existing Customers
A Two-Tiered Market
One Market of Many Regional Markets
The Wild, Wild East of Channels
When and Where is the Demand
Final Thoughts

China consists of distinct regions and is probably more akin to Europe than the U.S. RS USA attributes this to several factors: large geographic size and cultural differences, particularly between the North and South; underdeveloped logistics which hinders or prevents an effective system for "national" distribution; and regional concentration of certain industries.



This regionalization is a two-edge sword for companies pursuing B2B opportunities with Chinese customers. A company could focus its marketing and sales efforts by targeting certain regions and thereby limit its investment and realize higher returns. Given a company's market focus it may actually make sense to do so since most or nearly all of the potential customers could be in certain regions. On the other hand a company would need a regionally based organization and marketing strategy to compete effectively nationwide for a greater number of Chinese customers. A much larger investment and greater risk would be required to compete nationally. Read on »

Introduction

Start with Existing Customers

A Two-Tiered Market

One Market of Many Regional Markets

The Wild, Wild East of Channels

When and Where is the Demand

Final Thoughts

Like many developing countries the channels of distribution are dramatically different from what most U.S. companies have seen/experienced, and are what RS US would call "immature". Nearly all B2B markets in China are in their infancy with high growth expectations, and as one would expect, there are a myriad of vendors and brands pursuing those potential opportunities. Furthermore there are typically no previously established channels of distribution given China's history, and as a result many different types of channels and variations within each channel type have sprouted and grown to meet demand. This chaotic development has been fostered or exacerbated by low labor costs, general lack of sophisticated information systems and again the large geographic size and underdeveloped logistics. In other words a lot of channel confusion.

There is clearly a higher level of direct selling in China than in the U.S., and RS USA has seen clients justify direct sales at a much lower sales threshold than typical for the U.S. Direct sales is an option for companies pursuing Chinese companies as way to develop the market, establish the company's presence and brand, and if necessary, circumvent the position of competitors in indirect channels. It is more feasible to hire and manage a direct sales force on a regional basis and obviously a much greater challenge to do so for China as a whole.

We have also seen a considerable degree of two-step distribution in which a regional (possibly national) importer/distributor sells to local brokers or resellers and, in some cases, directly to end users or OEMs in their home territory. This type of channel may sell a single or multiple brands within a product category, and they typically fulfill demand and have limited/no ability to develop a market. Such channels seduce many companies because they seem to offer a relatively easy route to market ("one channel partner = high coverage"). However these channels are generally not a good fit for new technologies or products or new entrants, and even established companies selling more mature products run the risk of overdistribution and price erosion with such channels.

Lastly there are value-added resellers in China that primarily sell directly to end users within a region, although they may sell, to some degree, to other resellers. This type of channel is a fit for companies selling new technologies and products for the Chinese market because of their value-add and ability to develop a market, but they have limited market coverage either in terms of geographic coverage or the solution that they offer. Many companies entering China fail to sign up enough of these channel partners and thereby limit their opportunities.

The B2B markets in China will eventually sort themselves out as the markets evolve and the channels become more rational and efficient, but this will likely take longer in China given the lack of business infrastructure. And a company entering this market in pursuit of Chinese customers cannot wait. Those companies that take the time (rather than the easy way) to understand the marketplace and develop an appropriate (not necessarily convenient) channel strategy
- in both the short and long-term - will be positioned to "win".

Read on »

RS CONSULTING

Introduction
Start with Existing Customers
A Two-Tiered Market
One Market of Many Regional Markets
The Wild, Wild East of Channels
When and Where is the Demand
Final Thoughts

Despite all that is written about the Chinese economy and China being the factory floor of the world, RS USA has found short-term demand of Chinese companies for B2B products sold by U.S. companies to be "less than expected", albeit growing. This is in contrast to consumer products that have become major markets for many U.S. companies such as Motorola. And to be sure there are some B2B success stories like the sale of equipment and construction/installation services for infrastructure projects in power generation and telecommunications. But all in all, B2B markets in China have been an intriguing, long-term play for many U.S. companies.

RS US attributes this perspective to two factors: generally unsophisticated operations and information systems; and price, price, and price.

It is no secret that a policy goal of the Chinese government is employing its people. With the relatively low wages, Chinese companies typically use labor to do what would be automated in developed countries, and therefore labor represents a much higher percentage of total cost. This is particularly true for the state-owned companies, which still represent a significant but declining part of the economy, and less so for privately owned companies.

Aside from raw materials and supply items, nearly all B2B products from the U.S. seek to deliver value by increasing performance, efficiency, and productivity, but this is less benefit in a country where the incentives run counter to reducing labor costs. Furthermore the value delivered by many U.S. products depends upon sophisticated information systems, which again are generally lacking in China.

Like many things in China this is changing. Privately owned companies are growing versus state-owned companies. Wage and labor costs will increase as the economy continues to grow and develop, making investing in equipment for higher productivity more attractive. And some technology vendors with whom RS USA has spoken predict strong growth for their products in the near term.

Low prices are a double whammy. RS USA has seen markets where there is reasonable unit demand, but price levels are 30% - 50% less than in developed countries. Thus the total market size is reduced significantly. Furthermore the low price levels and distance really prohibit U.S. companies from exporting to China and competing in parts (sometimes all) of the market. In other words the U.S. company is priced-out of certain segments due to its U.S.-based cost structure, and it would need to establish local production to compete more widely.

Read on »

RS CONSULTING

Introduction
Start with Existing Customers
A Two-Tiered Market
One Market of Many Regional Markets
The Wild, Wild East of Channels
When and Where is the Demand
Final Thoughts

Does this sobering view of sales potential mean that your company should wait it until the China economy evolves to a more stable state?

RS USA believes that China is particularly attractive for companies whose products enhance performance and productivity for their customers. There is often a niche opportunity for these types of products, and customer acceptance and demand will increase as the economy evolves. In the short-term the sales might be relatively small, but they are often growing double digits (and who could not use that?!), and being there now positions your company for the long-term. As for suppliers of raw materials or supply items the answer is more "wait and see" given the challenges of creating a unique position and low price levels.

And stay tuned for our next article on how to compete against (or co-opt) cheap imports from China and other parts of the globe.