China: to market, to market

The key to cracking China lies in understanding the demographic, geographic and economic peculiarities across its provinces and prefectures. High distribution costs relative to margins and a large, well-spaced population have seen each area develop its own culture. Failure to grasp this has ruined the ambitions of many a good enterprise that incorrectly targeted consumers who either couldn't afford its products or were simply not sufficiently numerous to justify significant distribution and marketing costs. By Dr Clint Laurent.

Map Key

Province
Total GDP (US$ Bn)
Population (000's)
GDP per cap (US$)

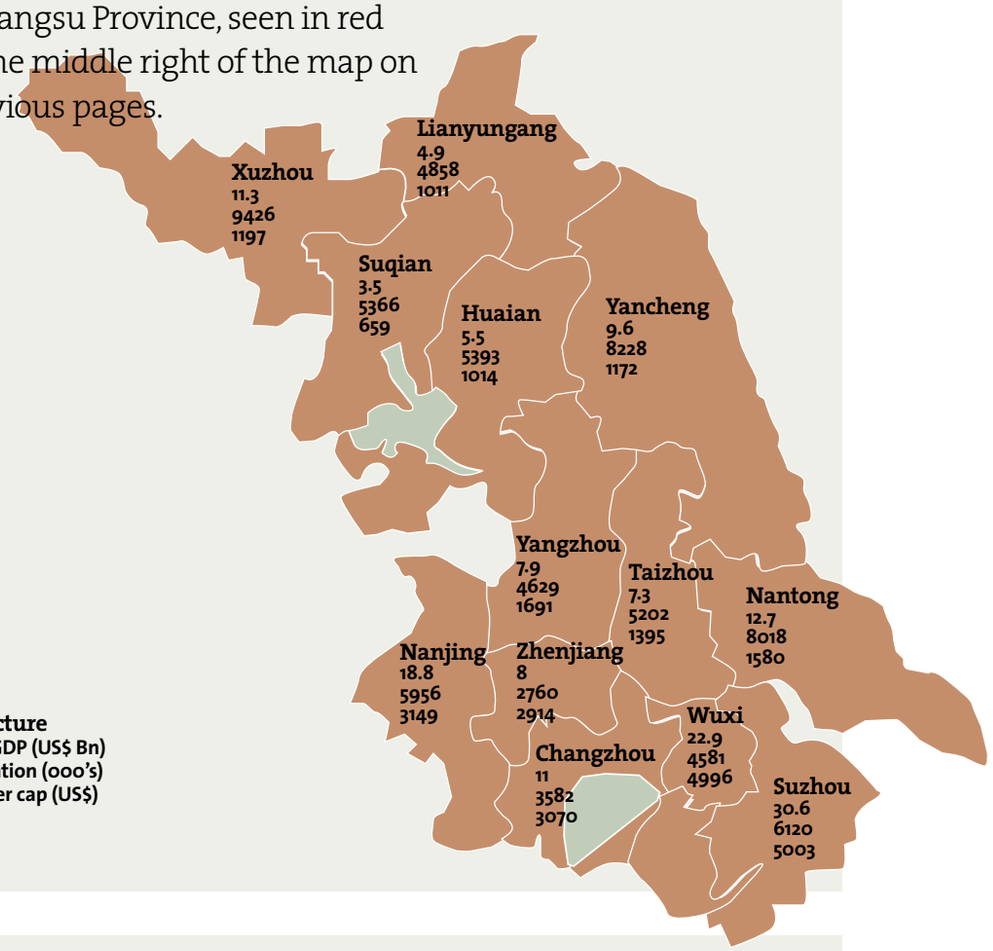
- Provinces in the Pearl River Delta
- Provinces in the Yantze River Delta
- Provinces in Greater Beijing
- Provinces with GPD under US $20 Bn
- Provinces with GPD under US $60 Bn
- Provinces with GPD under US $100 Bn
- Provinces with GPD over US $100 Bn

Other countries in Asia

Japan 4872 127610 38178	Taiwan 296 22658 13066	Malaysia 100 25048 3996
India 522 1048923 498	Indonesia 179 207532 863	Singapore 91 3390 26944
South Korea 496 47925 10340	Hong Kong 165 6852 24046	Philippines 81 80834 1007
Australia 385 19081 20157	Thailand 143 62037 2308	Vietnam 38 79202 480

Jiangsu Province: Prefectures

This shows individual prefectures in Jiangsu Province, seen in red in the middle right of the map on previous pages.



Key

Prefecture
Total GDP (US$ Bn)
Population (000's)
GDP per cap (US$)

Statistics: Higher income earning regions

	Pearl River Delta	Yantze River Delta	Greater Beijing	Total of regions
Total prefectures in region	54	25	54	**133**
Share of all Prefectures (%)	15	7	15	**37**
Share of top 98 (%)	23	20	19	**63**
Number in top 98	23	20	19	**62**
Prefectures needed to reach 50% of 40K + households in region	9	4	5	**18**
To reach 75% of 40K + households in region	21	10	16	**47**

Growth of household incomes in China, while important in a macro sense, is misleading in an operational sense. While there has been a very real increase in the incomes of households – particularly in urban areas – it is important to appreciate that this is biased to the areas in which it has taken place and that the geographical size of China makes the operational implications of these biases considerable. To understand the variation of each region's marketing consider the following three divides.

1.
China is one nation but it is multiple markets so for analysis and planning purposes consider China at a Province level. There are 31 Provinces – four of which are municipalities (eg Beijing and Shanghai). These provinces are large with an average population of 41 million and, as shown in Figure 1, some, such as Guangdong, Jiangsu, Shandong and Zhejiang, have a larger GDP, population and GDP per capita than some Asian countries. This justifies the need for separate marketing plans for separate provinces.

2.
Provinces themselves have concentration of wealth – just like a country. The second key divide of the population is Prefectures, which are administrative districts within a Province. The number of such districts in a province varies substantially, from 21 in Guangdong to four in Ningxia. Prefectures within a province also vary significantly in wealth and income and those associated with the capital city of the province tend to be the most affluent. Chart 2 shows the variance in the prefectures for Jiangsu Province. Just three prefectures, including the Provincial Capital, account for half the total GDP of the province with the same three accounting for only 22 per cent of the provinces' population.

3.
The urban/rural divide. Rural workers are less productive than urban workers, a trend exacerbated by the changing demographics as better educated young persons move to urban areas seeking higher paying jobs. Consequently the rural population is becoming an older, less educated demographic, increasingly of retirement age and with limited earning potential. To give some measure to this divide, the average urban Chinese household earned US$3,649 per annum, compared with US$1,380 for the average rural household. Thus the difference in consumption power across provinces and prefectures is considerable and savvy marketers need to understand this and focus their efforts on those areas where the consumer class exists.

To segment China in a logical manner, we need to identify prefectures that:

a. Have a sufficiently large number of households.
b. Have a meaningful proportion of population with the income for discretionary spending.
c. Are relatively close to each other.

A good way to identify the priorities of prefectures is to examine the share distribution as shown in the graph on the right of page 27. This shows the proportion of all urban households earning over Rmb 40,000 in each prefecture in 2005, with the largest on the left and the smallest on the right. Assuming that Rmb 40,000 is the 'trigger point' for affordability for the product or service in question, then the greatest efficiency will be in focusing efforts on prefectures on the left. The single most important revelation of the chart is that 50 per cent of all urban households earning over Rmb 40,000 in 2005 live in just 36 prefectures or to put it another way approximately 10 per cent of the geographical coverage of China reaches 50 per cent of the consumers earning over Rmb 40,000. To reach 75 per cent of the Rmb 40,000+ households add an additional 62 prefectures which is still only 27 per cent of the geography of China.

If the individual provinces grow at the same relative rates as they have for the last five years, the degree of change in terms of geographical focus by 2015 would be quite small. A brand needs only add a further 16 prefectures over the next decade to still be reaching half of all urban households earning over Rmb 40,000.

If the barrier is raised to say Rmb 60,000 (US$7,000), the point at which car purchases start to occur, then just 27 prefectures account for 50 per

cent of such households with 78 accounting for 75 per cent. If, in the case of cars, there is a need for a critical mass to justify the investment in a dealership, and that critical mass is 250,000 households in a single prefecture then only 11 prefectures justify the effort. This, of course, has considerable implications for the marketing strategy of many foreign companies selling brands and services seeking consumers with that income. Such companies firstly need to ask themselves - are they sufficiently concentrating on the 'relevant' prefectures and have they achieved adequate levels of penetration and market share to consider expanding to the next prefecture 'opportunity'? If the answers to these questions are at all ambivalent then companies need to restructure their distribution and marketing budget. These companies also need to ask how realistic are their sales forecasts? That is, how does their planned sales volume compare to the reachable consumer base and what percentage market share does it imply. For example, if a prefecture has 122,000 households with an income over Rmb 60,000 and the sales plan assumes that one unit will be sold to 60,000 households in that prefecture then that implies a 50 per cent market share. Okay if there is only one competitor – but not so good if there are four or five.

A QUESTION OF GEOGRAPHY

Compare the geographical size of China with that of Europe and the United States. In both cases the physical distances are large. Furthermore, while labour costs are cheaper in China than in Europe and North America, the physical costs (fuel, equipment etc) of logistics aren't and this will impact on the profits derived from a product selling to a US$5,000 household in China versus a US$67,000 one in the US. Therefore geographical focus is very important at least initially while a company is establishing its brand or service and needs maximum ROI.

The table on page 24 summarises the three main regions historically used for more expensive brands. These three contain 62 of the 98 prefectures accounting for 75 per cent of the households Rmb 40,000+ per annum and make a valid strategic focus.

Also, interestingly, based on our definitions of the regions, each accounts for around 20 of these key prefectures. However, clearly the Yangtse River Delta is the most efficient with just 25 prefectures, of which 20 are in the top 98 nationally, meaning only four need to be covered off to reach half the region's wealth. This table also demonstrates there is benefit in being selective. For the Pearl River Delta a brand needs only be in 21 of the 54 prefectures in that region to reach 75 per cent of the Rmb 40,000+ households there.

Finally it is useful to look at how the profit potential of prefecture/market segments varies. The average urban household in China spends 69 per cent of its income. If it is assumed that a particular product or service in total accounts for 0.5 per cent of the average household's expenditure and has a gross margin of 40 per cent to the manufacturer/provider then in the top ten prefectures the average gross revenue per prefecture of the sector is US$12.0 million; that in one of the middle 10 of the core 98 prefectures the average gross revenue per prefecture would be US$2 million and in the last 10 of the core 98 prefectures the average gross revenue per prefecture would be US$1.3 million.

If it is further assumed that an individual brand has 20 per cent market share then the net funds available to the brand for marketing, advertising, distribution, overheads and profit contribution would be an average per prefecture of US$2.4 million in one of the top 10, but 0.4 million in the middle key prefectures and 0.3 million in the last 10. Is it any wonder that the top two prefectures Beijing and Shanghai are the recipients of so much marketing effort?

International companies need to ask, how realistic are their sales forecasts?

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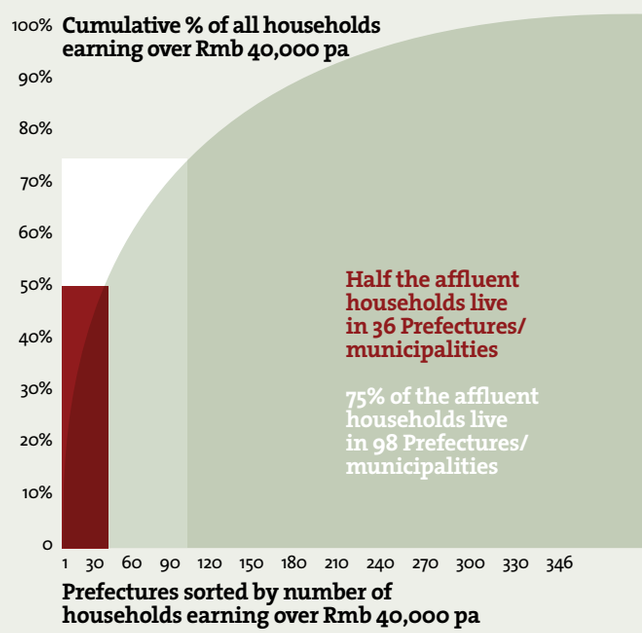
Core Prefectures

An analysis of the profit potential of a particular prefecture/market segment and how this varies by different sized prefectures.

Typical household income and expenditure pattern

	Rmb pa	US$ pa
Average for segment in year		
Income per household pa Rmb	62,491	7,547
Expenditure per household pa Rmb	42,942	5,186
Expenditure as % income	68.7%	
Total expenditure per household pa	**42,942**	**5,186**
Food	9,105	1,100
Clothing	2,193	265
Household facilities, articles, services	2,047	247
Medicine and medical services	5,220	630
Transportation and communications	8,184	988
Recreation, education, cultural services	8,855	1,069
Residence	6,235	753
Misc. commodities and services	1,104	133

Average of the 98 core prefectures

	Top 10	Mid 10	Last 10
	(US$ millions pa per prefecture)		
Total revenue (US$ millions) (households 1% of expenditure)	29.9	5	3.1
Gross revenue at 40% margin	**12**	**2**	**1.3**
Single brand gross revenue at 20% market share	2.4	0.4	0.3