China's Power Brands

Dexter Roberts, with Frederik Balfour, in Shanghai; Bruce Einhorn, in Hong Kong; Michael Arndt, in Chicago; Michael Shari and David Kiley, in New York

Its consumer goods are hot -- and taking on the multinationals

How do you get rich in China these days? Build a brand. That's what 35-year-old Huang Guangyu has done. The Guangdong native started out at 18, renting a market stall in Beijing and hawking cheap plastic appliances. Today, his GOME Electrical Appliances is China's top consumer-electronics chain, with well over 100 stores, $2 billion in sales, and the kind of high-plateau brand recognition that Circuit City and Best Buy enjoy in the U.S.

And thanks to a backdoor stock listing in Hong Kong this summer, Huang's net worth is now at least $830 million. Just one hitch, though. China's domestic retail players, including GOME, are already worried about the impact of foreign competition next year, when Beijing will open the entire country to retailers from abroad.

This little tale neatly sums up the story of China's emerging brands today. Tremendous excitement about the brands, but a good dose of fear about their staying power. Global business executives are certainly agog at the prospect that the next stage of China's superfast development will be the establishment of power brands in everything from retailing to white goods to autos and more -- brands strong enough both to dominate at home and thrive overseas. "They are definitely going global," says Glen Murphy, the Shanghai-based managing director of ACNielsen in China. "With their resources and production base, they are large enough to reach out to the world."

There are plenty of well-known local names besides GOME. Haier Group, of course, is the granddaddy, a $10 billion maker of refrigerators, washing machines, and more, with global ambitions nurtured by its well-known boss, Zhang Ruimin. TCL Corp., with $3.4 billion in revenue, is so powerful in TVs and other electronics that it reached a deal to merge its television business with that of France's Thomson last year and took control of Alcatel's cell-phone business this year. Lenovo Group Ltd., formerly known as Legend, with $3 billion in revenue, is No. 1 in China's PC market. Li-Ning Co. Ltd., founded by a Chinese athlete, is the top seller of athletic footwear and apparel. It went public this year, too. The roster goes on and on.

"LIGHT YEARS AWAY"

But China brand watchers wonder, is this impressive enough? They see the capacity overhang in Chinese industry, the tendency to skimp on innovation, the ever-growing presence of multinationals on the mainland, and the continuing popularity of foreign brands. Share prices for many of China's consumer brand companies are way off this year. Brand awareness of Chinese companies among U.S. and European consumers is, by and large, low. And for every China brands enthusiast, there's a skeptic. "Export their brands successfully?" asks Tom Doctoroff, CEO for Greater China at U.S. ad agency J. Walter Thompson. "Chinese companies are light years away from it."

Then again, so were the Koreans when they set out 20 years ago to join the stable of world-class brand companies -- and no one could have predicted that Samsung, LG, and Hyundai would be the up-and-coming global brands they are now. Like the Koreans, the Chinese are certainly going to stumble. But with all the furious activity going on in the marketplace, some of these brands will emerge as real winners. Unlike the nationalist Japanese, some will hook up with foreign companies to get a boost -- and some will even use the brand name of their foreign partner when they market abroad, as TCL will with RCA, Thomson's big brand in the U.S. China's huge domestic economy gives these contenders the chance to cut their teeth in the most competitive environment on earth. "Market shares will go up and down. Some Chinese companies will lose.

It's a learning process," says Paul Gao, a principal in the Shanghai office of McKinsey & Co. "But there is no doubt that world-class Chinese brands will emerge."

The learning process will involve both making better products and selling them more effectively. Ogilvy & Mather Chairman and CEO Shelly Lazarus recently led a conference of more than a dozen Chinese companies at the former estate of agency founder David Ogilvy. Lazarus was impressed both by their lack of knowledge -- and their hunger. "Most Chinese companies don't yet understand even what we mean by 'positioning' a brand," says Lazarus. "But they are anxious to know. They can't suck it in fast enough. They are going to figure this out. You can see it in their eyes."

Which Chinese companies will be hungry enough to win? China brand watchers pick TCL, Haier, and SVA, a top TV maker. But at this stage in China's tumultuous economy, it's hard to say for sure. Overcapacity has reached 30% in many industries, including televisions, washing machines, and refrigerators, putting tremendous pressure on margins. "Home electronics appliance prices are decreasing 10% to 15% annually," says Chen Kaixun, vice-president of Hisense Electric Co., an appliance maker and rival to Haier. "For the price war, the only thing we can do is decrease our costs." Hisense managed 2% profit growth in the first half. The price war has also hit Haier hard; its Shanghai-listed arm pulled off only 6% profit growth for the first half, despite sharply rising sales. And it's not just white goods. Auto prices have fallen 7% in each of the past two years and are expected to drop at least 10% this year. The television glut is especially severe -- and an aggressive export drive has triggered anti-dumping suits from the U.S. and Europe.

In this punishing environment, China's previous mediocre record in innovation is a liability. It's rare for Chinese companies to meet the international norm of spending 5% or more of revenues on research and development. This spending gap can give multinationals the edge.

TAKING CALLS

That's what happened in cell phones. Between 2000 and 2003, local handset brands such as Bird, Amoi, Panda, and TCL beat Nokia, Motorola, and other global brands on price and flashy features like TCL's gem-studded phone, a big success with the nouveaux-riches. The locals went from a zero share in handsets a few years ago to almost 50%. "We take our Chinese competitors seriously," says Maurice Tan, marketing manager for Nokia China. "They are like a wolf pack."

Yet the wolf pack has been in retreat. In the past year or so, Motorola, Nokia, and Sony Ericsson have rolled out a raft of phones with fancy new functions, pushed aggressively into new markets, and slashed prices. Nokia, for example, has added Chinese handwriting functions, and expanded its relationships with the thousands of small retailers that sell mobile phones across China. Because of the counterattack, TCL has seen its branded handset market share slip from 8% to 6.1% in the last year and a half: Sales of its mobile phones at its Shenzhen-listed arm dropped almost by a third in the first half, while Bird's sales fell almost 20%. Overall, domestic vendors have seen their handset sales slip from 42% of the market last year to 37% in the first half of 2004. Says Patrick Kung, general manager of Motorola's handset business in North Asia: "The locals did very well in the past three years. But starting this year, their growth rate has stalled big time."

Foreign manufacturers such as Hitachi and Samsung have also won back market share in high-end plasma and flat-screen televisions, while Panasonic and LG have recovered some of the sales they lost in microwaves to local brand Galanz. In automobiles, General Motors, Ford, and Volkswagen offer budget models for less than $10,000. That could very well spell trouble for Geely Auto, a six-year-old brand that has quickly captured 4% of the market with cars that sell for as little as $3,500. "The next several years will be difficult for local carmakers," predicts Yale Zhang, director of emerging-markets vehicle forecasts at CSM Asia Corp. in Shanghai.

The increasing competition in retail will also hurt, at least in the short run. Today, Chinese companies have an edge in developing relationships with the thousands of small stores and kiosks where most Chinese shop. But with the World Trade Organization-mandated opening of all China to foreign retailers coming at the end of the year, multinationals such as Wal-Mart Stores Inc. and Carrefour will further expand their franchises, making those ties less important. "As the distribution model changes, it is becoming less and less suited to domestic brands, making it easier for foreign companies to penetrate China," says Qu Honglin, general manager of Local Strategy, a Shanghai brands consultancy.

A final issue that Chinese companies have to struggle with is the depth of management. Many of China's best brands were conceived by heroic entrepreneurs like GOME's Huang or 59-year-old Zong Qinghou. Zong, who spent years laboring in the rice paddies during the Cultural Revolution, is founder of Wahaha, a beverage group that had profits of $196 million last year. (French company Groupe Danone owns 30%.) A hands-on leader, Zong will lead his managers on a tour of street vendors to see how beverages get sold in China's sprawling sidewalk markets. But he scorns market research, and it's not clear how Wahaha would fare without its charismatic founder.

These are all formidable problems. Yet for every setback, the Chinese find a way to move forward. Indeed, losing a few rounds in the most competitive market on earth is excellent training. Look at Lenovo. Several years ago the computer maker hatched big plans to branch out into PDAs, mobile phones, and other areas beyond its expertise in laptops, PCs, and servers. Bad idea: The loss of focus started costing Lenovo -- as Dell Inc. stepped up the pressure in China. Lenovo had to lay off 5% of its workforce last spring. But to its credit, the company has refocused its priorities in the China market, and profits rebounded 24% in the first quarter of its fiscal year.

KEEP EXPERIMENTING

Other companies are realizing they can't skimp on research. Over the next few years, TCL will ramp up R&D from 3% of sales to 5%. Television maker SVA Group spends 6%. "We must invest and develop new products," says Chen Hong, vice-president in charge of overseas markets for SVA. "If we focus on price alone, we don't have a future." If foreign connections will help, so be it. TCL, by acquiring Thomson-RCA's TV line and Alcatel's cell-phone business, has acquired Western brand names, distribution networks in Europe, and a bundle of Western technology. Strong sales in televisions in China and abroad helped push up TCL'S first half earnings by 44%, despite its serious setback in cell phones at home.

Haier has been criticized by overseas rivals for not understanding how to connect with customers better. "One of the steps that many of the Asian companies have missed is the huge investment that's required to build brand equity," says David L. Swift, executive vice-president of Whirlpool Corp.'s North American region, which has had to do battle with Haier. But Haier is learning. It already spends 4% of revenues on research and is creating local product-development teams in Tokyo and the U.S. to differentiate its line and move upmarket.

In Japan, for instance, Haier offers washers that use less water, are quieter, and are narrow enough to fit cramped Japanese homes. "In the past, we tried to design our products in Qingdao and sell them to the U.S. and Japan," says CEO Zhang, 55. "They didn't meet overseas consumers' needs and didn't sell well." Today, Haier has 22 factories overseas, including a refrigerator plant in Camden, S.C. Revenues from Haier's overseas operations are up 53% to $1.3 billion in the first eight months of 2004.

One brand that has seen its global future and acted on it is telecom equipment maker Huawei Technologies Co. It already spends more than 10% of its revenues on research -- and is not only competing successfully against outfits like Cisco in telecommunications gear but could emerge as a consumer brand as well. It now makes handsets and set top boxes for TVs. Its formidable research machine could give it a winning hand.

Back home, many parts of the Chinese market are still up for grabs, thanks to the vastness of the country. Wahaha, for example, has built up its market by avoiding head-on confrontations with PepsiCo Inc. and Coca-Cola Co. and focusing on less-developed markets. It is now a big force in provincial capitals like Kunming, Yunnan. Other companies are customizing products for the hinterland. Guangdong Kelon Electrical Holdings Co. has developed the budget Combine brand of refrigerators and air conditioners for less affluent consumers. Kelon's sales are up 49% this year, and profits are up 11%.

Chinese companies are also learning how to raid the competition. Li-Ning has hired Wu Xianyong, a former manager at Procter & Gamble & Co., to run its marketing and branding. Wu made sure that many of the Chinese athletes at the Athens Olympics wore Li-Ning shoes and other equipment. Such product placement gave Li-Ning an Olympic boost in sales in China, where the company has more than 2,000 outlets and the top spot in athletic shoes, with 12.39% market share. "All of us [Chinese consumer goods] companies must thank P&G for our development," says Li-Ning's general manager Zhang Zhiyong.

Like Westerners, the Chinese are learning how to advertise on a grand scale. Ad spending last year was $24 billion in China, making it the third-biggest ad market in the world. The ad spending will only increase as the 2008 Beijing Olympics approach. Lenovo already became the first-ever Chinese company to be an official "top" sponsor of an Olympics -- up there with Coca Cola and Panasonic -- when it signed on to back the 2008 games. It's part of "a longtime dream to become an international brand," says marketing boss Alice Li.

Meanwhile, the world beckons. Haier has established its foothold in the U.S. TCL, with the Alcatel deal it just signed, has big plans for Europe. Geely Auto has borrowed from the Koreans' early marketing strategy and entered other emerging markets as a first step to overseas expansion, starting with the Middle East.

Some of these efforts will fail. But with every ad campaign, every marketing battle, every product launch, the Chinese learn a little more. Another Chinese juggernaut, like the one that has taken over much of global manufacturing? Not now. But give them time, and the best of these brands will prove themselves.

In every product line, strong brands are emerging to challenge the global market leaders

HAIER
Appliances, TVs

2003 REVENUE: $9.75 BILLION
2003 PROFITS: $193 MILLION
SLOGAN: "Honest and trustworthy forever"

BRAND STRATEGY: Break away from its low-end niche with a push out of small refrigerators and into higher-end products with juicier margins.

KEY CHALLENGE: Convince overseas retailers and consumers that it can make quality appliances.

KEY STRENGTH: Already sells at the likes of Wal-Mart, Sears, and Best Buy.

LENOVO
Computers

2003 REVENUE: $3 BILLION
2003 PROFITS: $128 MILLION
SLOGAN: "Innovation and excellence"

BRAND STRATEGY: After unveiling a new corporate name last year, Lenovo hopes its sponsorship of the 2008 Olympics will boost its profile worldwide.

KEY CHALLENGE: Facing stiff competition at home from Dell, HP, and IBM.

KEY STRENGTH: The market leader in China and strong in most other countries in Asia.

TCL
TVs, Mobile Phones

2003 REVENUE: $3.4 BILLION
2003 PROFITS: $163 MILLION
SLOGAN: "Technology that caters to you"

BRAND STRATEGY: Linked up with France's Thomson, owner of RCA. Will sell as Thomson in Europe, RCA in the U.S., and TCL in developing markets.

KEY CHALLENGE: Protectionism: The U.S. levies 21.25% tariffs on its televisions.

KEY STRENGTH: Strong ties with established brands and network of overseas factories.

WAHAHA
Beverages

2003 REVENUE: $1.23 BILLION
2003 PROFITS: $196 MILLION
SLOGAN: "Youth knows no failure"

BRAND STRATEGY: Plans to use its name to expand beyond beverages and into fast-growing markets such as children's clothing.

KEY CHALLENGE: Rivals Coke and Pepsi fast expanding beyond coastal China and into the interior.

KEY STRENGTH: Has unparalleled penetration into China's smaller cities and rural markets.

GOME
Electronic sales

2003 REVENUE: $2.15 BILLION
2003 PROFITS: $151 MILLION
SLOGAN: "Wherever we're needed--we're there"

BRAND STRATEGY: Plans to add new stores across China and possibly overseas following the opening late last year of its first Hong Kong store.

KEY CHALLENGE: WTO commitments mean China will open fully to foreign retailers by yearend.

KEY STRENGTH: Has nationwide network of stores and enjoys close ties with electronics-makers.

GEELY
Cars

2003 REVENUE: $484 MILLION
2003 PROFITS: $58 MILLION

SLOGAN: "A happy life comes with Geely"

BRAND STRATEGY: Move upmarket while maintaining low sticker prices. Overcome low-quality image first in China, then abroad.

KEY CHALLENGE: Has no joint ventures with foreigners, so it lacks overseas distribution networks.

KEY STRENGTH: Low cost structure compared with major state-owned auto makers.

BIRD
Mobile Phones

2003 REVENUE: $1.3 BILLION
2003 PROFITS: $42.3 MILLION
SLOGAN: "The fighter plane of mobile phones"

BRAND STRATEGY: Facing growing competition at home, Bird plans to expand in markets including France, Italy, and India

KEY CHALLENGE: Focused solely on mobile phones, Bird is vulnerable to a telecom slowdown.

KEY STRENGTH: Leads in smaller Chinese cities, where the market will grow most rapidly.

TSINGTAO
Beer

2003 REVENUE: $907 MILLION
2003 PROFITS: $31 MILLION
SLOGAN: "Enthusiasm everywhere"

BRAND STRATEGY: Leverage its German heritage and reputation as China's oldest beer to build up image overseas.

KEY CHALLENGE: Growing competition at home; sales abroad largely limited to Chinese eateries.

KEY STRENGTH: Close ties with Anheuser-Busch will help it build reputation overseas.

LI-NING
Clothing, Shoes

2003 REVENUE: $121 MILLION
2003 PROFITS: $11 MILLION
SLOGAN: "Anything is possible"

BRAND STRATEGY: Use its sponsorships of up-and-coming young Chinese athletes to grow its brand on the mainland.

KEY CHALLENGE: Faces competition from the likes of Nike, Adidas, and Reebok on its home turf.

KEY STRENGTH: Profile is high due to founder Li Ning, a five time Olympic medalist.

YONGHE KING
Fast Food

2003 REVENUE: $36 MILLION

2003 PROFITS: $386 THOUSAND
SLOGAN: "Delicious food, new concept"

BRAND STRATEGY: Will boost service, restaurant atmosphere, and food quality following a $26.5 million investment by the Philippines' Jollibee.

KEY CHALLENGE: Fast-food in China dominated by McDonald's and KFC.

KEY STRENGTH: Now partnering with Jollibee, which has beaten multinationals at home.

Data: Company reports, BusinessWeek

Business Week – 8/11/2004