

**China's** economy, the world's second-largest (measured at purchasing-power parity), has been gradually liberalizing and expanding since Deng Xiaoping introduced market reforms 20 years ago. In 2001 the country joined the World Trade Organization. China now runs a trade surplus with the United States; it has also begun developing a high-tech industry and cleaning up state banks (many of which are drowning in non-performing loans). Ambitious overseas Chinese are returning to become entrepreneurs, and foreign firms, dreaming of China's 1.3 billion potential consumers, invested \$57 billion in China in 2003; the economy's recent growth—9.1% in 2003 and an annualized 9.8% in the first quarter of 2004—has been such that fears of overheating have led the government to discourage banks from lending and try to tighten the housing market. The government is also under foreign pressure to let the undervalued Yuan appreciate, which would hurt exports.

**India**, under the Congress Party, ran a socialist economy. Only in the early 1990s did it begin to open up. The process accelerated once the Bharatiya Janata Party took power in 1999: Atal Behari Vajpayee, India's prime minister, opened India to more foreign direct investment and allowed several major privatizations. India's economy is still heavily agricultural; in 2003 a good monsoon contributed to a jump in GDP. India also benefits from having an English-speaking work force that can take on remote-services jobs (to the dismay of American politicians). Local manufacturers are learning to innovate and compete globally, and the middle class is expanding. India now has more than \$100 billion in foreign-exchange reserves after running out altogether in 1991. But India's

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percentage of world GDP is still tiny compared with China's, and the poorest states have

yet to benefit. Mr. Vajpayee and the BJP were punished for the disparities by losing power after general elections in April and May 2004; news of the loss sent Mumbai's stock markets tumbling. Manmohan Singh, the new prime minister, and Palaniappan Chidambaram, his finance minister, have promised to work on reducing the deficit and increasing access to jobs and education.

World over, the intelligentsia discussing the emerging markets have spent significant energies on India and China. So does this first issue of Neo from the Class of 2005. ISB is also hosting the China-India conference called '*Will the 21<sup>st</sup> century belong to India and China?*'. These two countries, apart from being neighbors, are emerging as two of most important trading partners on the world economic scene.

As you already know, we have established the Emerging Markets Knowledge Centre EMKC@ISB (<http://www.isb.edu/isbwebconf/index.html>). The site contains repository of knowledge on the emerging markets and is an important step towards our endeavor to develop a sound understanding of these markets and then leverage from the understanding. We would also like to invite the students to contribute their learning's/experiences in emerging markets in form of articles which can be posted on the site.

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**India Vs China - Some interesting comparisons**

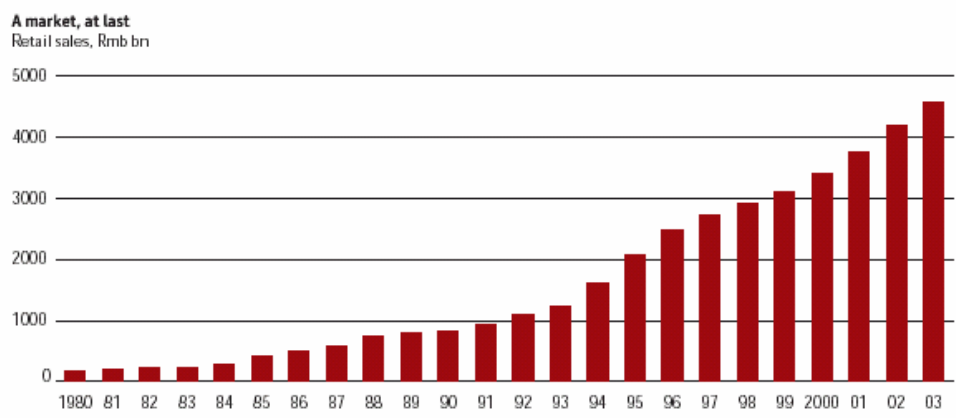
<b>Economic Indicators (2008 forecast)</b>	<b>China</b>	<b>India</b>	<b>China / India</b>
Nominal GDP (at PPP) (US \$ billion)	10,994	4,746	2.3
GDP per head (at PPP) (US \$)	8,190	4160	1.9
Share of World's goods exports (%)	8.83%	0.9%	9.8
Passenger Cars (stock per 1000 pop)	16.23	8.62	1.9
Petrol Consumption ('000 tons)	142,904	7088	20.1
Retail Sales (US \$ million)	736,434	555,698	1.3
Cosmetics & Toiletries (US \$ million)	9,350	5209	1.8
Television Sets (stock per 1000 pop)	478	102	4.7
Energy Consumption (kg oil equivalent per head)	1110	397	2.8
Alcoholic Drinks (sales volume million liters)	25435	1892	13.4

(Source: *www Economist.com*)

**Chinese Retail and Consumer Goods Industry**

The retailing and consumer goods industry was one of the first areas in the Chinese economy to witness multinational presence with companies starting operations in the early nineties. This was partly aided by the government not considering retail to be a strategic segment and accordingly allowing multinationals to establish their presence. Owing to the large potential in terms of the market

for consumer goods and with per capita incomes on the rise owing to rapid growth in the Chinese economy there a tremendous upside in the retail industry. China's annual retail sales are expected to exceed 5,000 billion Yuan (about 605 billion US dollars) this year, up over 10.5 percent year-on-year, according to a report issued by the Ministry of Commerce.



Source: Economist Intelligence Unit

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Consumption is rising in all sectors of the economy, indicating how strong the domestic market in China is at present. This is despite the social problems, such as growing unemployment and the increasing divide between rich and poor that have been created by such meteoric growth rates. However, rise of local competition, relatively short life cycles of products due to rapidly changing consumer preferences, over supply in the urban markets, human resource crunch in terms of trained manpower, weak distribution infrastructure are the potential threats to the growth of multinational companies investing in China.

The Chinese government continues to put a lot of pressure on the domestic retail sector to continue its rapid development. Yet, at the same time as

making entering the market harder for foreign retailers, the government is still telling local chain store companies that they are crucial to boosting consumer spending and hence helping China grow. Local companies have claimed a sizeable market share back from foreign products for many types of consumer good consumer and many other types of goods, perhaps the most important challenge of the next few years will be how to handle a series of markedly different tiers in a market.

However, China's internal market cannot just continue to grow in size, but must continue to grow in sophistication and competitiveness. It is here that foreign retailers have the expertise to meet the growing sophistication and value-for-money demands of China's consumers.

**Historical Growth Trends in China's Retail Industry**

<b>Per capita consumer expenditure* by broad sector at current prices, 1995–2001</b>							
<i>RMB per capita</i>	1995	1996	1997	1998	1999	2000	2001
Food	1,430.94	1,731.69	1,792.91	1,836.52	1,869.49	1,934.16	2,118.57
Medicines & healthcare	89.22	112.92	141.17	169.87	199.04	220.31	247.71
Clothing and footwear	388.28	527.23	513.59	492.46	466.53	488.75	529.75
Household durable goods	240.61	207.91	253.56	299.59	346.20	344.96	383.81
Transport & communication	138.57	161.76	191.04	220.18	249.49	267.84	299.10
Education & entertainment	253.37	303.84	363.81	423.89	484.51	525.40	587.88
Housing	202.72	227.33	282.81	339.05	396.22	427.14	479.11
Services	122.67	143.04	159.63	175.51	191.09	201.47	223.38
<b>TOTAL</b>	<b>2,866.38</b>	<b>3,415.71</b>	<b>3,698.51</b>	<b>3,957.07</b>	<b>4,202.58</b>	<b>4,410.04</b>	<b>4,869.31</b>

Source: Access Asia & China Economic Quarterly based on national and international statistical estimates.

Note\*: Includes institutional spending and expenditure by distributive trades

**Retail sales as a proportion of consumer expenditure, 1995–2001**

<i>RMB billion</i>	1995	1996	1997	1998	1999	2000	2001
Consumer expenditure*	3,454.93	4,163.31	4,559.23	4,930.03	5,293.90	5,615.26	6,266.27
% change	65.50	20.50	9.51	8.13	7.38	6.07	11.59
Retail sales	1,986.64	2,395.52	2,644.76	2,827.55	3,023.10	3,318.86	3,586.79
% change	27.01	20.58	10.40	6.91	6.92	9.78	8.07
Retail sales % of expenditure	57.50	57.54	58.01	57.35	57.11	59.10	57.24

Source: Access Asia & China Economic Quarterly based on national and international statistical estimates.

Note\*: Includes institutional spending and expenditure by distributive trades

**Case Illustration A - Carrefour (a success story)**

Carrefour, the world’s second-largest retailer, made rapid strides after setting up shop in China in 1995. The Chinese retail market lacked exposure to a modern shopping environment and Carrefour seized this opportunity to emerge as the second biggest supermarket chain by turnover within five years of starting operations. However, regulatory violations in terms of its ownership share (capped at 65% by the government) resulted in Carrefour being restricted from opening new stores for more than two years. However, despite this temporary setback the Company’s expansion plans are back on track and the Company plans to open at least a dozen stores in the current year.

Carrefour has seen revenues from existing stores growing (Sales rising from Rmb8.1bn in 2000 to Rmb13.4bn 2003, according to reports from China’s Ministry of Commerce). The Group serviced 175 million customers in 2003 and store traffic was up 35.5% over 2002. Further, even in the period of limbo in terms of opening new stores, Carrefour has been in constant contact with potential and existing local partners to start new ventures in the country.

**The Strategy:** Carrefour was determined to develop a nationwide network ever since it arrived

in China. It adopted a strategy of having a different partner in each location as against a single partner for entry into the entire Chinese market (readers can contrast this with the Otis elevator case we studied in class). This strategy (which did not work too well in Unilever’s case - Also covered in this issue) could have backfired by giving the company too many different partners to handle. Instead, it has turned its local support in each location to its advantage.

- Local partners have preferred supporting Carrefour for economic purposes in its negotiation with local authorities
- Locally based partners have also helped the Company obtain access to good sites and aid stores in developing a local flavour.
- Carrefour does not have its own distribution network and relies on suppliers to deliver their goods to its stores, which further enhances the level of local support.

**Other Elements of Strategy**

**A Territorial Network with Multiple Formats**

Organized around the hypermarket within a region, its logistics chain and shared negotiation and purchasing resources, the Group can establish smaller format stores, supermarkets,

convenience stores, and hard-discount stores, all operated on a regional scale. This is how Dia opened its first 40 stores in Shanghai, then 15 in Beijing, and how Champion will establish its first supermarket in the city in 2004.

### **Competitiveness Through Synergies Between Countries**

The Group leverages its global expertise in establishing stores with the Italian team participated in the preparations for the new supermarkets in China.

### **The Margin Aggregation Approach**

The concept, developed at the initiative of Champion France, consists of giving priority to the margin volume, and evaluating it as an aggregate rather than as a percentage of sales, which means, in physical terms, a calculation of margin per linear meter in each store. This project, which involves the entire value chain, upstream to downstream, from supplier to end customer, is being deployed across the whole Group and has become a major international project, managed firmly and tracked monthly in every country.

### **Optimization Of The Logistics Chains**

Logistics are optimized by using common management methods and tools. The Company has benchmarks between countries that form the basis of exchanges of good practices. Further, the Company deploys an international warehouse system, along with restocking tools and a performance measurement program SPM (Supplier Performance Management).

### **Social Responsibility**

The Group has helped implement programs to obtain products grown using integrated farming

methods. It was heavily involved in the fight against the SARS epidemic, in particular, by ensuring the medical monitoring of employees. The Carrefour International Foundation also donated 100,000 N95 masks to the city of Beijing to fight SARS.

### **Competition**

When pitted against major global competitors Carrefour has benefited from its early mover advantage and from an aggressive strategy. No other company has been able to take advantage of the lull in Carrefour's growth. Wal-Mart has expanded but not at such a rate that it is likely to squeeze Carrefour, at least for a few years. New entrants have either only just entered the market (as is the case with Germany's Metro) or have yet to arrive (as with the UK's Tesco).

Wal-Mart however remains the biggest potential threat - it buys from the Chinese market goods worth US\$12bn-15bn annually (Carrefour sources around US\$1.5bn- 2bn worth from China each year) making it China's single biggest customer. Clearly, this has given it a lot of know-how in buying goods cheaply in the world's major cheap manufacturing centre.

### **The Future**

In a rapidly changing environment as China nears its entrance into the WTO, the Group is growing its market share, training local employees for its expansion, developing organic products and Chinese "Carrefour Quality Line" products, and has established four merchandise hubs. Assuming that it has learned from the operational experience accumulated in the last few years, Carrefour would seem to be well positioned to continue expanding and remain profitable.

**Carrefour – Growth In number of retail outlets**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>ASIA</b>										
Hypermarkets	9	13	24	39	59	80	94	105	123	144
Hard discount										55
<b>Total</b>	<b>9</b>	<b>13</b>	<b>24</b>	<b>39</b>	<b>59</b>	<b>80</b>	<b>94</b>	<b>105</b>	<b>123</b>	<b>199</b>
<b>CHINA</b>										
Hypermarkets		2	3	7	14	20	24	24	32	40
Hard discount										55
<b>Total</b>		<b>2</b>	<b>3</b>	<b>7</b>	<b>14</b>	<b>20</b>	<b>24</b>	<b>24</b>	<b>32</b>	<b>95</b>

Source: Carrefour consolidated financial statements

**Case Illustration B - Unilever and Procter & Gamble**

**Unilever Reassesses**

Unilever, the Anglo-Dutch consumer-goods and food maker, established operations in China in late 1980s, at around the same time as the US Company, Procter & Gamble. But Unilever has found the going much harder than its rival.

In this issue we intend to identify the reasons and the main tenets of Unilever’s China strategy which resulted in a not so impressive performance of the FMCG major in one of the Emerging Markets in Asia. Unilever’s initial attempts to offer a **broad portfolio of products** and a **decentralized approach to selling** its family of goods were the two main bottlenecks in its strategy. Unilever’s plans were ambitious. Within 10 years, it formed 12 joint ventures in operation. However, its strategy of attempting a broad attack on China’s markets explains why it struggled—and offers lessons for other, ambitious foreign companies.

**Possible drawbacks in strategy:**

**Too many partners.** For each of its diverse range of products—toothpaste, detergent, ice cream,

sanitary napkins etc.—Unilever teamed up with a local company. From the start, therefore, Unilever found itself negotiating with a stream of partners. Many partners were not able to deliver as per the agreement. At the outset, it seems sensible to ally with a Chinese company to gain access to its distribution network, but in practice, many of these networks barely existed. Additionally, majority of the intermediaries in the supply chain had no information about customer preferences and interest in customer satisfaction.

**Lack of focus.** Because of its broad range of products, Unilever was compelled to let each venture get on with its own promotion and marketing, unable to draw on synergies or even transfer experiences from one product to another. This, in turn, made teamwork a problem; selling ice cream obviously calls for different marketing and strategy than selling soaps and toothpastes, lessening the need or motive for working together

**Staff turnover.** Staff retention proved a problem for Unilever. Managing human resources is a persistent problem for many companies in China, and Unilever's record was no exception to the same. Its main competitor, Procter & Gamble, stood in contrast to that and built up a reputation for being tough but loyal to its staff.

### **Procter & Gamble Approach**

Procter & Gamble, by contrast, began with a more focused approach, launching and developing only its shampoos. It spent heavily on advertising and focused the spending on a small range of products. This enabled it to establish separate identities for its various shampoo brands. Only after it had successfully established its shampoos in the market did it move on to other product lines. This allowed it to claim market share by a clearly differentiated range of shampoos- Vidal Sassoon for fashion, Head & Shoulders to cure dandruff, and so on. Procter & Gamble worked hard to get its goods into every available retail outlet: taking maps of cities, marking the location of stores. P&G set specific and measurable goals and the fact that it did not have a host of joint-venture partners to manage and integrate facilitated the achievement of these goals.

However, things didn't always go Procter & Gamble's way. Having reached out to stores

across cities to get its goods on shelves, it had problems with accounts receivable in its initial years. It also took a financial hit as a result of having granted easy credit terms to a lot of customers. In the last three to four years, it has faced stiff competition from low-priced local alternatives.

### **Unilever update**

Unilever has been quick to react to the P&G challenge and has made several, big changes that have improved its performance. Its cost-cutting measures have allowed it to become more competitive and unified. Moving its household and personal-care production lines to Hefei in Anhui (one of China's poorer provinces), not only saves money due to its cheaper location but also can use fewer people. This change, in turn, has helped the company address some of its weaknesses listed above: fewer people means a stronger, more focused team, which in turn allows a stronger concentration on issues such as brand architecture.

On the back of all these changes (lower costs and a more coherent strategic outlook), Unilever has been able to take the struggle P&G and with local Chinese companies to their ground. Recently a 30% cut in the price of its Omo detergent helped double sales volume.