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Going to Market  
in China

*How Consumer Goods  
Companies Can Find  
Optimum Profits in the  
New Consumer  
Marketplace*



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## EXECUTIVE SUMMARY

*Going to market in China is a complex undertaking, particularly given the vast size and population of the nation itself. Most fast-moving consumer goods (FMCG) companies, in an effort to enter China and expand rapidly with minimal up-front financial investment, defaulted to a wholesaler distribution strategy. Though this model served companies well initially, it has outlived its usefulness—at least in many markets across China. To capture the economic potential of China, leading FMCG companies will have to consider both more direct distribution and more exclusive third-party distribution approaches.*

*There are any number of considerations that companies must take into account when creating a go-to-market (GTM) strategy for China—and each company’s analysis of the distribution formats that are in its best interest will be different. But more than anything, a GTM model, based on segmented point-of-sale approaches, is imperative. The precise segmentation will depend on a careful analysis of such critical elements as the types of products being offered, brand strength, consumer preferences, competitive environments, complexity of SKUs, retail channels, location of consumer markets (rural, urban, or anything in between), and profitability expectations. If such an assessment is done well, an FMCG company can anticipate significant growth and profit upside in the Chinese market.*

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## HIGHLIGHTS

- Go-to-market strategies in China can no longer rely solely on “arms-length” wholesalers.
- To take advantage of the potentially vast Chinese market, fast-moving consumer goods (FMCG) companies must increasingly consider direct distribution and more exclusive third-party distributor partnerships, depending on the characteristics of the retailer, the consumer market, and the products being sold.
- By creating a sales mosaic that takes into account types of products, brand strength, consumer preferences, competitive environments, complexity of SKUs, retail channels, location of consumer markets (rural, urban, or anything in between), and profitability expectations, FMCG companies can craft a strategy that evolves with the Chinese market.

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## THE CHALLENGE IN CHINA

With a population of more than 1.3 billion spread out over 3.7 million square miles, China is home to more than 650 cities—just fewer than half of them with more than 1 million people—and immense stretches of countryside. To go to market in such a limitless and diverse territory, many consumer goods companies have historically adopted third-party sales and distribution models to reach retail customers. Although there are many variants of these models, they generally share a set of characteristics:

- *They use wholesalers and intermediaries to reach target customer segments throughout the country.* By leveraging strong wholesaler networks in China, companies seek to avoid the costs and complexities of selling and distributing products directly to many small and medium-sized outlets.

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- *They focus on pushing products through the channels.* In the context of this third-party go-to-market (GTM) model, “volume” is king. The key is to sell as much as possible to intermediaries. SKU penetration, merchandising, price control, and service levels are secondary. Volume discounts, in one way or another, are critical to selling the quota.
  - *They employ aggressive order-taking capabilities.* Front-line salespeople are evaluated by their skill in “pushing” products or taking orders, rather than their knowledge of the needs and preferences of retail customers or consumers. Given the emphasis on taking orders, the use of sales capabilities and account management tools is limited.

Although this third-party model initially proved valuable in achieving rapid and relatively extensive coverage in many cities and in navigating the political, social, and infrastructure eccentricities of China, it is no longer optimal for most companies. Indeed, it is extremely constraining. For one thing, although wholesalers and other third parties served as the perfect ticket for FMCG companies to cover a broad geography quickly and (presumably) cheaply, their distribution networks are rarely exclusive, typically distributing multiple competitive products.

That was OK when China’s markets themselves were relatively limited, with money and buying power concentrated in a few big cities and less to be gained from the smaller cities and rural markets. But now in China, a much greater number of items are vying for limited retail shelf

space in both urban and rural areas. And consumers are being bombarded with products and promotions by any number of domestic and multinational companies. Statistics highlight the product and purchasing frenzy best: In 1998, only 9 percent of rural households and 72 percent of urban homes had refrigerators; by 2008, these numbers had ballooned to 26 and 91 percent, respectively. What’s more, appliance penetration outside the cities recently got a boost when the Chinese government launched an initiative that gives rural consumers a subsidy of as much as 13 percent for purchasing a major appliance. In such a pressurized and crowded sales environment, distributing through a non-exclusive intermediary is tantamount to a company simply throwing its products into the market with no control over how they are displayed and sold.

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Further, the evolution of retail channels and the emergence of new retail formats are creating a greater need for segmented service levels and models that cater to multiple customer segments. For example, convenience stores and eateries are increasingly popular venues for sales of consumer goods—and they couldn't be more different from traditional mom-and-pop grocery stores. Convenience outlets require more frequent service, a greater number of promotions, and a much wider range of SKUs than the old-fashioned grocery stores. Similarly, point-of-sale materials in eateries are very different from those used in a retail site.

Finally, with more money to spend, Chinese consumers are becoming more sophisticated, demanding a greater variety of products and better quality at affordable prices. To respond quickly to changing customer preferences and stay a step ahead of competitors, FMCG companies must have access to valuable and targeted point-of-sale information that will enable them to make intelligent decisions about pricing, assortment, promotions, and shelf space—in virtually real time.

But wholesale arrangements work against this. Chinese wholesalers tend to be somewhat abstruse

operations; after they take ownership of the inventory, wholesalers give manufacturers only minimal information about product sales, pricing, and distribution. It's difficult to even track which wholesaler, among the many that may handle the product in a multi-tiered system, actually sold the item to the retailer. Because of this dearth of explicit data, companies typically lack the very information they need to best compete, such as consumer purchasing behavior broken down by SKU, point-of-sale location, and demographics.

Finally, and perhaps most troubling of all, the multi-tiered wholesaler

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model actually is not as low cost as it appears at first blush. The typical Chinese wholesaler network generally comprises multiple tiers of third parties, and each player in the pyramid wants a piece of the profits. Also, a commonly ignored hidden cost is pricing and promotion fund leakage. Under the traditional wholesaler model, consumer goods companies frequently offer discounts and promotions that are passed on to retailers and consumers. However, in China, it isn't possible to track whether promotional discounts actually make it all the way to the consumer or remain in the hands of the wholesaler; one can safely assume that the answer probably is a bit of both. In addition, the wholesaler

model is plagued by frequent stockouts and difficulties in maximizing product assortment. This is primarily because wholesalers tend to focus on high-volume products and traditionally neglect new, small-volume SKUs. Yet these new SKUs are precisely the items that FMCG companies are hoping will provide a measure of differentiation and improved profitability for their product lines. As a result, when all costs and missed profit opportunities are taken into account, companies are forgoing 15 to 20 percent of net profits by their embrace of the third-party GTM model.

Although many FMCG companies have been less than satisfied with the wholesaler/third-party arrangement

in China for some time, only now are these companies expressing an urgency to design a fresh model. The main reason: As purchasing power in China for everyday goods from toothpaste to soap to snacks to beverages grows rapidly—not just in the mature, large Tier One and Two cities but also in the fast-growing Tier Three and Four cities and rural areas—FMCG companies are faced with a greater GTM opportunity than ever before. But to take advantage of this opportunity in China's rapidly evolving and potentially lucrative consumer environment, FMCG companies must be nimbler, gain better control of their distribution channels, and emphasize product and sales innovation.

## FIVE STEPS TO GO TO MARKET

In our experience, there are five strategic go-to-market concepts that a successful consumer goods company must embrace in China. Very few companies have succeeded in realizing all five, but there is huge upside for those organizations that do so.

### 1. Craft an optimal value proposition for each customer segment, recognizing the fluidity of the segments

The best way to look at China now is as a series of local consumer markets, each with thousands of different outlets for goods and a broad mix of channels, including modern trade, such as large chain stores (e.g., Walmart); traditional trade (local mom-and-pop stores); and on premises (restaurants, schools, and Internet cafes). Further, there are huge geographic differences as companies move across China:

- *North China:* Several relatively wealthy Tier One cities, such as Beijing, Tianjin, and Xi'an, and a large number of less developed cities and counties.
- *East China:* Many sophisticated consumers and a partiality to Westernized lifestyles and tastes in cities like Shanghai and Nanjing.

- *South China:* Economically developed and very urbanized. In addition to such megacities as Guangzhou and Shenzhen, there are many small but well-developed Tier Two cities like Dongguan and Shantou.
- *West China:* The least developed area with the largest rural population, lowest income levels, and most underdeveloped transportation infrastructure.

Though this analysis is valuable as a starting point for an intelligent GTM strategy—for example, customers in different regions have contrasting tastes and budgets—it is important not to be too rigid about its conclusions. Each of these regions is significantly fragmented—they are not monoliths. Further, their configuration is not static. To illustrate, as the government accelerates its investment in the rail system, the distinctions between megacities and/or tiers will shift even more rapidly.

But however the Chinese market is mapped out, FMCG companies must first create an overall strategy for marketing their products in suitable channels and geographic segments. This strategy should include a plan for offering the right product assortment,

providing differentiated in-store execution, negotiating lucrative profit margins and commercial terms, and designing appropriate service levels and logistics models.

In developing optimal value propositions, FMCG companies must, for example, contrast the needs of traditional trade (mom and pop) stores in a Tier Three city and a Tier One city. In Tier Three, where consumers are less flush than in the bigger urban areas, the store may prefer a narrower product line with smaller (and cheaper) packages that are presorted and can be “dropped” onto shelves easily. The same store located next to an Internet bar in a Tier One city would more likely support a wider range of product SKUs with much larger package sizes.

Moreover, order sizes in Tier One may be sufficiently large and deliveries sufficiently frequent that serving these outlets directly (rather than through a wholesaler) is a much more profitable approach—and provides for much more control.

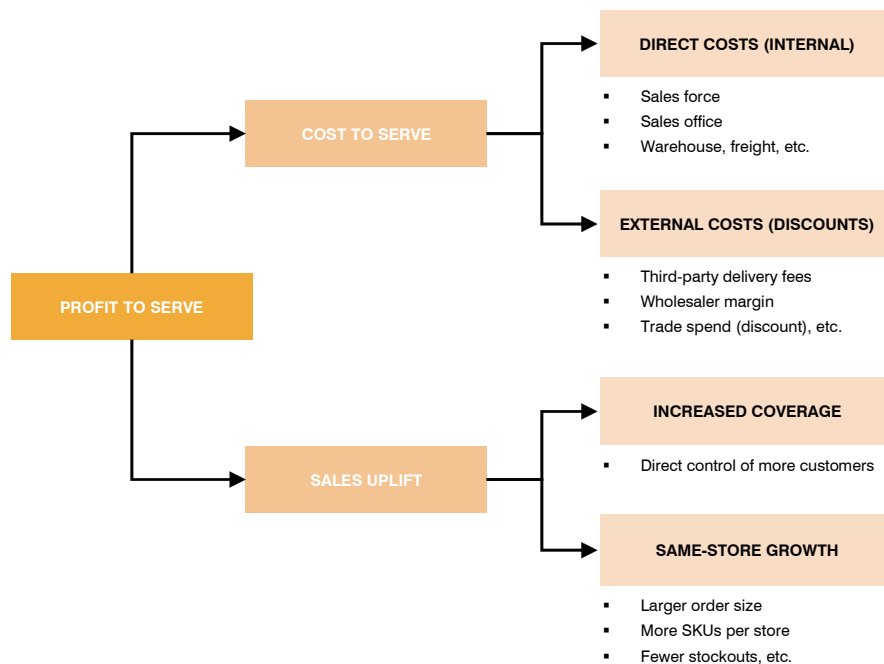
Emerging mini-markets in lower-tier cities illustrate another fresh set of assessments that FMCG companies must make. These outlets typically follow open-shelf supermarket-style formats but are stand-alone stores like mom-and-pop operations, not the organized chains usually found in more developed regions. Because they are something of a hybrid (part modern trade and part traditional trade), mini-markets require unique GTM approaches, such as sophisticated product assortment,

promotion, and point-of-sale support with little standardization in order volumes and logistics.

## 2. Understand the profit-to-serve implications

Most companies’ economic analyses of go-to-market strategies fail because they focus solely on the cost to serve of a particular store (or a series of stores) in a particular region. While this may identify the cheapest approach to providing products for various channels, it ignores the potential revenue impact—up or down—of changing any aspect of the GTM mix. For that reason, in our experience, the profit-to-serve model is a far better evaluation tool. It involves two sets of calculations (*see Exhibit 1*):

*Exhibit 1*  
*Optimal Channel Mix*



Source: Booz & Company analysis

*First, the cost to serve:* This includes, for each channel, such variables as direct costs (the costs of distribution from plant to wholesaler or plant to retailer and sales force budgets) and external costs (promotions and discounts).

*Second, the sales uplift:* This involves estimating potential revenue and sales gains or losses of different distribution model scenarios, focusing specifically on the impact of varied point-of-sale approaches, increased number of SKUs, and out-of-stock reductions.

In this profit-to-serve model, it is the sales uplift less the cost to serve that is a truer indicator of a GTM model's attractiveness.

### 3. Create a mosaic of models and channels

Once these analyses are complete, what does an FMCG company do with the results? In short, the challenge is to create a mosaic of models and channels appropriate for the company's product line and profit needs across China. The mosaic must address such dimensions as type of sales and distribution model (e.g., pre-sales, route sales, telephone-based sales); sales call content and its implications for the role and profile of the sales force (e.g., account openers, business advisors, in-store merchandisers); and whether the FMCG company will own the channel or partner with a third party to serve

it. Clearly a one-size-fits-all model is no longer optimal (*see Exhibit 2*). In some cases, the most attractive alternative is to control the outlets directly through some sort of direct selling and distribution (DSD) model. This approach generally makes sense when there is significant revenue upside to working directly with the retailer and when the potential revenue lift outweighs the additional costs of logistics and managing the supply chain.

In other cases—for example, where the sales volume and potential sales lift do not justify additional costs of distribution—it might make more sense to continue to distribute through a wholesaler. However, if that option

**Exhibit 2**  
*Possible Go-to-Market Strategies*

		CUSTOMER SIZE		
		Large	Medium	Small
Tier One/Two City	Direct Selling and Distribution			Wholesale
Tier Three/Four City		Exclusive Distributor		
Rural	Generic Distributor			

Source: Booz & Company analysis

is chosen, an arm's-length arrangement with the wholesaler need not be the only outcome. True partnerships can be formed with third-party distributors by designing a contract based on incentives for performance and sales growth, which in turn requires the transparency of data that is critical to the operations of the consumer goods company.

The economics are only a starting point for an optimal mosaic. Many other dimensions must be considered as well:

- What level of support and complexity is required at the point of sale for individual products? The greater the service support needed, the more control an FMCG

company must have over the distribution channel.

- How strong is the brand? A strong brand enjoys a great deal of consumer and retailer loyalty and demand and could be distributed by either wholesalers or DSD—in other words, the cheapest route. However, a weaker brand, with a lot of SKUs, would need to rely more on direct-sales models.
- Can the FMCG company execute against its service goals under the intended value proposition? For example, can the company adopt a DSD approach and match customer expectations about frequency and size of the drop?

- Which GTM models are used by competitors—both the nimble local Nationals as well as MNCs? Given the competitive dynamics, what market expectations must be met by the company?

- Can the company overcome transition challenges and effectively get from the current model to the ideal state with minimal disruption?

#### 4. Upgrade vertical growth capabilities

Merely changing the model will not deliver the desired results. With the mosaic defined, it's essential to manage the new model with the right tools and capabilities. These will ensure that the company drives vertical coverage (the ability to sell additional SKUs into the

*The economics are only a starting point for an optimal mosaic. Many other dimensions must be considered as well.*

points of sale) as well as horizontal coverage (the number and mix of points of sale).

At a minimum, a company should have four types of skill sets and tools:

- *Account planning:* Routinized tools must be in place to identify, plan, and execute new growth opportunities against each segment. These tools are critical to capture and expand the company's relationships with customers and retailers.
- *Customer insight and business intelligence:* Nowhere are these data sets and capabilities more essential than in China, where an FMCG company's customers, markets, and competitors are likely to change at a

moment's notice. An ongoing effort to capture consumer information and identify marketplace changes is a must.

- *Distributor and third-party management:* The new relationships in the new GTM model—a shift from arm's-length third-party arrangements to truer partnerships—will require expanded management capabilities to ensure operational transparency and aligned performance goals.
- *Supply chain design and execution:* With the shift toward more direct selling and distribution, optimizing the distribution and warehousing of products in the supply chain is important.

## 5. Build the talent

Last, but by no means least, is the urgency of building internal talent—from front-line salespeople to local leadership. Indeed, the first four steps for succeeding in China can be realized only if the FMCG company has the talent and capabilities to implement and sustain these new strategic approaches. This is no small issue. While the talent pool in China is improving, with more and more individuals studying and developing the skill sets demanded by Western companies, the number of people needed to fill the most critical jobs at FMCG companies is simply not yet within reach.

This talent gap is perhaps most pronounced in sales forces. Currently,

*Facing a skills shortage, companies must look to near-term and long-term solutions.*

most FMCG sales operations in China emphasize selling in (that is, selling to third parties, such as wholesalers) rather than selling out (selling to point-of-sale customers). But in order to thrive, FMCG companies must do a better job of controlling the last leg of distribution and they must develop a new breed of salesperson adept at point-of-sale execution and utilizing point-of-sale data for planning. These salespeople must be deeply knowledgeable about consumer market conditions in China, even as these conditions change rapidly, and their compensation and training should be aligned with the nature of their jobs.

Facing a skills shortage, companies must look to near-term and long-term

solutions. At a minimum, companies should ask themselves these questions:

- Do we have a holistic people strategy for talent development that aligns with our three- to five-year distribution strategy and anticipates the go-to-market skill sets that will be needed in the coming years?
- Are the current incentives and compensation levels sufficiently attractive to recruit and retain top sales talent? Job shifting in China is pervasive; in 2008, personnel turnover in Chinese companies was an average of five times that in its U.S. counterparts.
- Do we have clear and measurable go-to-market key performance

indicators in place, and are we appropriately incentivizing our talent based on desired performance?

- Do we have managers who are capable of motivating the sales force in the new distribution models?
- How can development be accelerated through enhanced training? Can we strengthen training by rotating our future leaders to geographies outside China for a period of time? What other avenues can we consider?

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## CONCLUSION

Establishing a successful go-to-market strategy in China is fraught with complexity and difficult decisions, which is probably why many FMCG companies have ignored the problem rather than address it head-on. However, the results of addressing the issue can be well worth the effort. To get started, we offer a series of questions that companies should consider. It's just the beginning of an in-depth analysis that must be conducted, but the answers will provide a road map for what ultimately will be a potentially lucrative GTM model.

- Are you profitably selling in all the points of sale and channel outlets that you should be, given the characteristics of each of your brands? If not, do you understand why not?
- Are you effectively providing the right value proposition, service levels, and in-store execution for each customer segment?
- How well do you understand the economics of profit to serve as it relates to your products, channels, and organization today?
- How coherent is your channel strategy?
- How ready are you for a segmented distribution strategy with differentiated value propositions by segment?
- How well do you understand the distribution and sales strategies chosen by your competitors—both multinational and Chinese rivals—and are you positioned to compete?
- Do you clearly grasp the effect that the growth of Tier Three and Four cities in China could have on your sales efforts and on your brand strength, and do you have a distribution strategy to take advantage of these new markets as they develop?

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