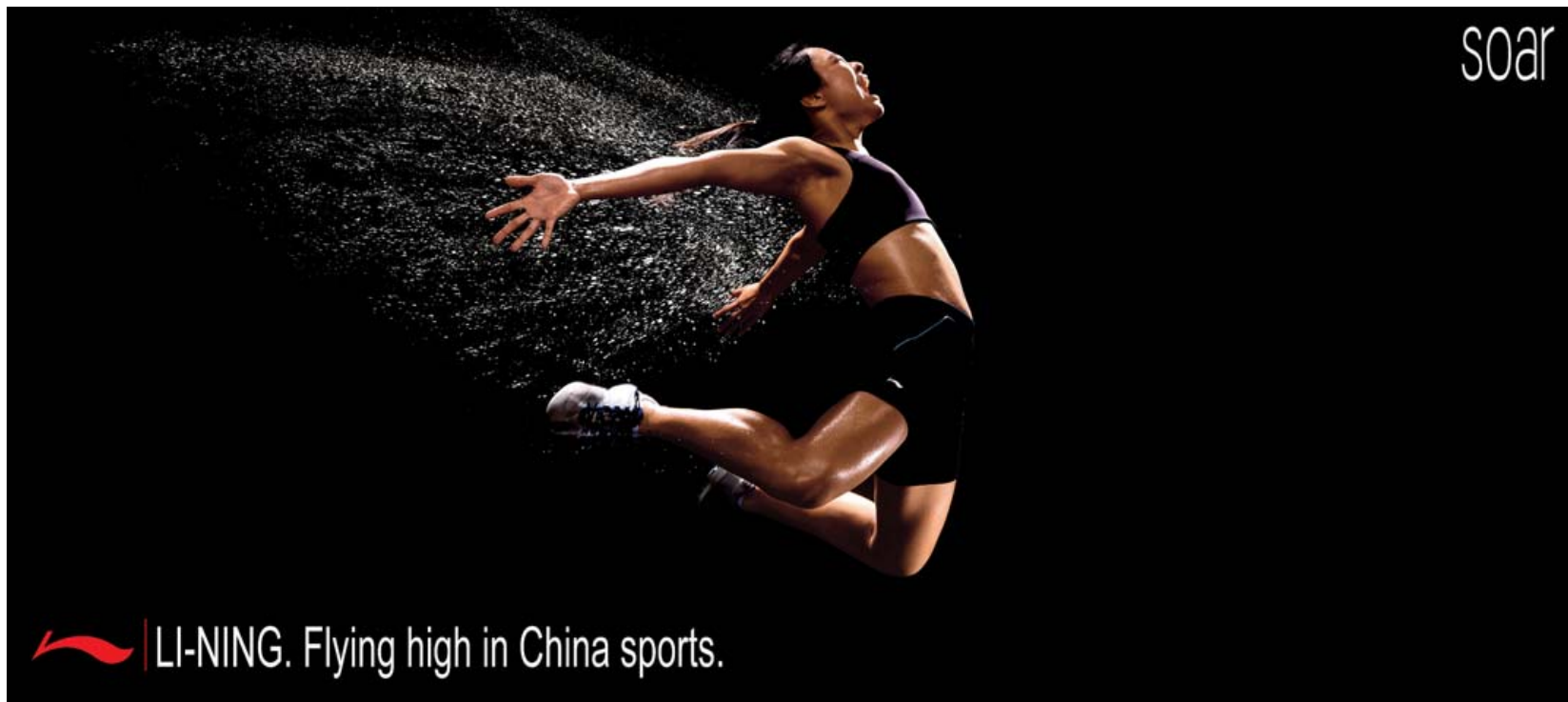


## Special report

### Premiums, loyalty, promotions

#### Verbatim:

'While global brands are seen as having higher quality ... local brands retain a larger portion of market share.'



A handful of Chinese upstart brands occupy a niche outside major metro cities—giving global brands a reason for concern.

# A premium niche

## Buyers in China's lesser cities like giveaways, promotions

By MICHAEL FIELDING  
Staff Writer

In the battle for the Chinese consumer's expanding pocketbook, domestic brands have become entrenched in the nation's third-tier cities, where old-fashioned promotions and brand-building efforts have captured a massive—and fiercely loyal—consumer base.

Residents of those third-tier cities, defined largely by the level of bureaucracy operating there and average income, number more than 130 million, compared with just 110 million in the first- and second-tier cities combined. Home to 17% of China's population, the 200 or so third-tier cities form the Chinese market of the future, market analysts predict. While consumers in the third-tier cities earn an average monthly income of US\$120—one-tenth of what their big-city counterparts take home—their aggregate spending power is something that marketers shouldn't ignore.

Mobile phone maker TCL Corp. and Beijing Li-Ning Sports Goods Co. Ltd. certainly haven't. While their names remain largely unfamiliar in the global brand big leagues, they're some of China's most successful national brands. That's no small feat, considering that many Chinese consumers perceive multinational brands as having better marketing, enhanced R&D and more financial resources than domestic brands.

"While global brands are seen as having higher quality ... local brands retain a larger portion of market share," says Gilbert Lee, Chicago-based Research International's national research director for China.

The urban middle-class lifestyle depicted in the international brands' advertising falls short in third-tier cities, where the practical advantages of the product are rarely touted by global brands. Meanwhile in those areas, where years of little to no competition means consumers have gotten paltry information about products, especially the global brands that are relatively new to the market,

the promotions and premiums offered at the point-of-sale are highly important.

"Most of our customers are repeat customers," says Abel Wu, Li-Ning's vice president of marketing who oversees international business relations for the sporting goods and clothing company. "They are loyal because of the good value in terms of product vs. pricing."

Of the more than 600 Chinese cities, first-tier cities consist of provincial capitals, cities under the direct administration of the central government and economically healthy prefecture-level cities. Second- and third-tier cities are the smaller markets of prefecture-level cities, county-level cities and key towns in both devel-

oped and rural areas.

Consumers in the third-tier cities have been wooed successfully by local brands that have appealed to their sense of patriotism and frugality. In fact, third-tier cities are expected to become the next arena of price wars as multinational brands try to stake a claim in a market dominated by domestic brands.

For example, Coca-Cola Co., which is well-established in larger cities and controls 35% of the carbonated soft drinks market, has minimal market share in third-tier cities. The Atlanta-based company has been selling Coke at a reduced promotional price (the equivalent of 12 cents U.S.) in those markets to encourage retailers to

#### Special report



A perceived global presence and affordable products are highly appealing to younger Chinese consumers.

# Chinese niche market focuses on practical

stock the American drink on shelves that are now full of local soda brands, such as the wildly popular Future Cola, a product of the Hangzhou Wahaha Group Company Ltd. Wahaha, which has concentrated its marketing in the third-tier cities, is absent from the shelves of top supermarkets in the major markets, where Coke, PepsiCo. Inc. and Japanese soft drink makers dominate.

Despite rising incomes, however, disposable incomes remain fairly flat in the nation's third-tier cities. Buying Colgate toothpaste, for example, may mean forgoing Duracell batteries for a cheap, local brand. It's that difference between first-tier and third-tier Chinese market consumers that many global brands have long failed to understand.

And so Coca-Cola (along with only a handful of others, such as Colgate, Motorola and Wrigley) remains one of the few global brands to even try to reach the third-tier city segment.

Meanwhile, the local shelves are well-stocked with Li-Ning shoes, designed for six sports (basketball, soccer, tennis, gymnastics, running and table tennis). Its premium shoes are sold at about one-fourth the price of Nike (US\$70 v. US\$159 for top-end basketball shoes), its nearest competitor as measured by total sales.

Formed in 1990 by its Olympic gold-winning gymnast namesake, the athletic footwear and apparel company also has been consistently and aggressively building an international profile. In 2000, it sponsored the French gymnastics team at the Sydney Olympics; one year later it opened its first overseas store in Spain; in 2004, Li-Ning began a four-year agreement to sponsor the Spanish men's and women's national basketball teams (although Adidas won the bid to sponsor the Chinese team at the 2008 Beijing Olympics); and in January the National Basketball Association signed a three-year agreement to allow its players to promote the brand in China.

As its two top competitors, Nike and Adidas, carved up Shanghai, Beijing and Guangzhou between them, Li-Ning was busy in smaller cities promoting its brand as both international and affordable, an otherwise impossible combination that consumers in third-tier cities could only dream of.

Although the brand counts young executives in its ranks, Li-Ning's target customers are male high school and university students ages 14 to 30 living in second- and third-tier cities.

Li-Ning's annual sales have increased by more than 30% year over year since 2001,

following the company's new campaign to become an international brand. In 2004, it registered \$230 million in total sales worldwide, with the bulk (97%) in China.

Much of the company's success in these markets can be attributed to heavy promotions and brand-building efforts, Wu says.

Promotions are highly effective with many Chinese consumers: Those 25 and younger—who have little or no recollection of China before Deng Xiaoping's now-famous “to get rich is glorious” proclamation—and those ages 45 and above, who are price-conscious and have less brand sophistication, are likely to respond more favorably than those in the middle range.

(The middle generation, ages 25 to 45, is in its prime income-earning period and are the first of the so-called little emperors

generation of single-child families, notes George Haley, professor of marketing at University of New Haven in Connecticut and author of *The Chinese Tao of Business*. “Wealthy Chinese are very brand-conscious, and the idea of buying when they wish at whatever the going price is when they purchase is a matter of pride.”

Promotions, then, tend not to work on this group but rather to mimic that middle generation's product and brand choice as best they can; as a result, the younger generation and older generation

both pay more attention to promotions, Haley explains.

Li-Ning has tailored its promotions for various segments of the population within the small cities, for example. The company's global muscle appeals to youngsters: For example, to cater to its core customer base—high school and university students—the company hosts a “College 3-on-3 plus 1-on-1 challenge basketball game,” in which, following a normal 8-minute 3-on-3 match, each captain plays a 2-minute 1-on-1 game with double scoring. The winning team and the best captain get a chance to go to Spain to meet the Spanish national basketball team.

Meanwhile, for its older customer demographic, the company plays up the value of its products in more traditional price-focused promotions at the local level. For older Chinese, the price speaks for itself.

At the same time, in third-tier markets, consumers traditionally respond favorably to premiums. “Local brands do more premiums,” explains Luis da Rosa, business director for Leo Burnett China. “The reason is that it tends to have a more immediate result.”

In Li-Ning's case, Wu says that its two regular promotional periods are during the Spring Festival in late January and early

February, and the national holiday Oct. 1.

They typically jump-start total sales by 25%. Most recently, customers at the 3,000 retail outlets who spent more than \$40 received Li-Ning anniversary T-shirt.

Li-Ning's other marketing tactics help support promotional efforts in second- and third-tier cities. One of the most popular professional sports in China, the NBA is estimated to have about 600 million fans, and so “local consumers ... automatically think the (Li-Ning) brand is on par with international brands' in the wake of its partnership with the NBA, says Burnett's da Rosa.

Haley agrees: “The Chinese associate the ability to compete globally with high quality.”

The company also has released a television commercial filmed in Africa in which a Chinese tourist donned in safari gear encounters an African tribe, competes with the local athletes and is transformed into a Li-Ning-wearing victor-crowned tribal leader.

“Young Chinese consumers do favor humor,” da Rosa explains.

Altogether, the world's global powerhouse brands are likely to run into some unexpectedly tough consumer markets in China's heartland.

“The competition in China is hypercompetitive,” Haley adds. “(Chinese consumers) respond to appeals of nationalism. So they're more brand-conscious than most Western consumers, believe it or not.” ■

**‘Local brands do more premiums. The reason is that it tends to have a more immediate result.’**



Once courted, Chinese consumers are fiercely loyal.

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