Cracking China's Market

Adapting to Chinese Customs, Cultural Changes, Companies From U.S., Europe Find Profit

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Beijing

LONG-HELD perception: China is a perpetual market of tomorrow, sucking money from foreign companies tantalized by visions of a billion new consumers, even as hope of profit recedes year by year.

Dawning reality; China has turned into a profitable market for foreigners in relatively short order.

Capitalizing on dramatic changes that include the emergence of urban consumers, more open local governments, the spread of modern retail outlets and the entrepreneurialism of the Chinese, a critical mass of foreign companies are now making money in China. According to an August report by the American Chamber of Commerce, 64% of about 200 companies surveyed in China say they are profitable.

As multinational *consumer-products companies such as Coca-Cola, Eastman Kodak and Motorola make further inroads—and more money—in a rapidly changing China, their logos are becoming an integral part of the nation's landscape*

China is now **Eastman Kodak** Co.'s second-biggest film market after the U.S., and sales here are growing faster than in any other major market, the film firm says. Food conglomerate **Groupe Danone** SA of France has in the past six years built a $1.2 billion business in China that is profitable in all its divisions. Germany's **Siemens** AG, selling everything from washing machines to high-speed railways, saw double-digit profit growth last year in China, now its No. 3 market after the U.S. and Germany. **Procter & Gamble** Co. has invested $1 billion in China and says its operation here is profitable. The KFC restaurant chain, owned by **Yum Brands** Inc., opens a new store every other day in China, all funded by its Chinese profits, "China is an absolute gold mine for us," Yum's chief executive David Novak told analysts recently.

China continues to be one of the most challenging markets around owing to brutal price wars, backstabbing business partners, widespread counterfeiting and a slow-moving judicial system. But here is how some of the most successful players in China are turning a profit:

Kodak: Just $12,000 to Run an Outlet

Under a tropical evening sky in Xiamen, executives from Eastman Kodak pile out of a minibus to be greeted by hundreds of cheering workers. They climb to a stage festooned to red-and-gold Kodak colors, and a worker reads a poem commemorating production of the 20-millionth Kodak disposable camera in this seaside city. "Kodak, I love you," he gushes.

Kodak is loving China back. "There were a lot of people that were burned and hurt and called China a shattered dream," says one of the executives, Ying Yeh, a vice president for Kodak. "But I never had any doubt."

Kodak, which is based in Rochester, N.Y., has nearly 8,000 photo stores across China, one of the country's largest retail networks in any sector. The company taps the desire of many Chinese to run their own businesses while helping them negotiate the ins and outs of setting up shop on their own. Because of China's vast size, foreign companies seeking national reach must rely to an unusual extent on such a far-flung network of people, then find ways to tie their interests to the company's own.

One Kodak campaign, "99,000 Will Make You a Boss," offered all the necessary photo-development equipment, training, and a store license for the equivalent of a one-time fee of 99,000 yuan, less than $12,000. Kodak negotiated a deal with the Bank of China and other big banks to arrange financing for individual operators lacking capital. As its numbers of distributors and outlets boomed, Kodak factories have fed these "mini-bosses" with competitively priced cameras and film. That's thanks to a big

Opening Doors for Big Business

Multinational companies are expanding their operations in China and turning profits. Some examples:

COMPANY	SCALE OF OPERATIONS	EMPLOYEES	TOTAL INVESTMENT	PROFIT DETAILS
Coca-Cola	31 bottling plants with three joint-venture partners and two concentrate plants	20,000	$1.1 billion	Profitable for eight years
Danone	More than 50 manufacturing plants for biscuits, beverages and dairy products	25,000	NA	Operating profit margins higher than the company's global average, amounting to at least $140 million in 2001
Kodak	Five manufacturing plants for cameras, chemicals and film and more than 8,000 outlets	5,000	$1.2 billion	Company says it's profitable
Motorola	Two manufacturing plants for mobile-phone handsets, cellular networks and semiconductors	12,000	$3.4 billion at end of 2001	Company says it's profitable
Procter & Gamble	Five plants for food, personal care and household consumer goods	4,000	$1 billion	Company says it's profitable
Siemens	40 companies with businesses including telecommunications, machine automation, power, transport and home appliances	21,000	More than $610 million	Profit grew at double-digit rates in 2002
Yum Brands	Close to 800 KFC restaurants and 100 Pizza Hut restaurants	40,000 to 50,000	More than $400 million	China is expected to account for 29% of international profits for 2002

Source: The companies

bet Kodak made on manufacturing in China in 1998, when it picked up three debt-laden state firms and many of their workers for over $1 billion. In return, Beijing barred new foreign-invested film factories for four years.

The gamble helped Kodak, a distant fourth when it arrived in China in 1994, leapfrog rivals including Japan's **Fuji Photo Film** Co., which relies on imports to stock its stores. Today, Fuji's market share has shrunk to 25% compared with Kodak's 63%.

Kodak is now expanding in China's poorer west. In a country where fashion and new lifestyles spread at warp speed, many are buying cameras for a first time to record the change. Says Paul Walrath, a plant manager in Xiamen and a 26-year Kodak veteran, "We're counting on great performance in China to drive the company where we want to go."

Danone: Master of Piggybacking

Like Kodak, France's Danone was a relative latecomer when it started building its China business around 1996. It decided to piggyback off the successes of domestic brands rather than to build all its businesses from scratch, in 1996 buying a controlling stake in Hangzhou Wahaha Group Co., an enterprising maker of vitamin-enriched milk drinks targeted at children.

Danone embarked on a massive expansion for Wahaha—building multiple plants across the country, backed by a huge advertising campaign—that pushed annual sales from 800 million bottles when it bought the company to four billion bottles within two years. It then quickly leveraged that scale, distribution network and brand-name recognition into a new business: bottled water, for China's increasingly health-conscious population. Through the same obsessive focus on scale and speed, Danone has built Wahaha into China's biggest water company—and made China into Danone's biggest water market, with $908 million in revenue in 2001.

In launching a new drink, Danone expects that prices will collapse by 50% within three years, thanks to local competition. Only through investing heavily up-front is it possible to achieve economies of scale and, hence, profitability. "You need to recover your investment before the price wars start," says Simon Israel, Danone's Asia-Pacific chairman. "I've never seen anything move so fast as it does in China."

Rare for multinationals, Danone acquires Chinese companies but continues to sell their products under their own brands. The strategy has smoothed the way for a steady diet of acquisitions and curried favor with Chinese executives and officials, who are loath to see national brands go under.

Today, 80% of Danone's sales here are under Chinese brands. The company has so played down its multinational origins that it was asked by the government to help Wahaha manufacture a "domestic" cola to take on Coke and Pepsi. Thus did Danone, which does not sell soft drinks anywhere else in the world, become the parent of Future Cola, which holds the No. 3 spot in China and is known as "the Chinese people's own cola."

The moves have handed Danone dominance despite its late start. The company had $1.2 billion in sales here in

2001 and is one of China's largest food and beverage concerns. Danone has more than 50 plants and 25,000 employees around the country, all built up in the past six years.

Coca-Cola Co. which has seen eight straight years of profit in China, says sales are growing faster here than anywhere in the world. The Atlanta-based company already reaches 600 million consumers in China's large and medium-size cities, but its latest drive focuses on reaching the other half.

A survey the company conducted in Yunnan, a largely rural province in the southwest, revealed that most consumer offerings, from ice cream to drinks, cost between six cents and 36 cents, which means a 30-cent can of Coke was too expensive for many. Coke's solution: ramp up its business in returnable bottles, in which a customer drinks a Coke on the premises of a shop or restaurant. The business, which drives down costs because bottles and crates can be reused many times, brings the price of a Coke servicing down to a single yuan—about 12 cents.

"We're looking for this to be a solution for our rural markets," says Nick Moore, region manager for the North and Southwest China Region.

Such minute price distinctions are crucial in China. At an Internet cafe in Tangshan, where customers can surf the Web for an hour for a mere 24 cents, 2,000 cases of Coke sold last year, compared with 300 cases in 2001, before Coke launched its cheaper drinks in returnable bottles. "Customers always want the cheapest thing to drink," says the cafe's owner. "Now, the Coke is the same price as the water."

Yum Brands: Localize, Localize

When KFC set up its first China store in 1987, the venture was seen as so politically sensitive that the site required the approval of the Beijing mayor, and foreign novelty was a big part of its appeal. Recently, it took Yum Brands only a day to get most of the approvals it needed to set up a new Pizza Hut restaurant in the central city of Zhengzhou.

Globalization is taking hold in China faster than anyone expected, and fast food has become part of the Chinese landscape. Catering to national tastes, KFC offers soup, rice and Chinese breakfast porridge. It does its own tests and product launches with minimal input from the home office in Louisville, Ky. "We're free to create our own products. Our company is not a company that micromanages from a distance," says Sam Su, president of Greater China for Yum Restaurants China.

KFC now has about 800 restaurants here and plans to open 200 a year for some time to come, and China is the company's biggest source of profit after the U.S.