



Think regionally, act locally: Four steps to reaching the Asian consumer

The most successful global consumer enterprises are radically reshaping their organizations and business models to suit the region's rapidly evolving high-growth markets.

Todd Guild

Asia's emerging economies are leading the world out of recession, and the region's consumers are taking the baton from their overextended counterparts in developed countries. Are the largest global consumer enterprises ready for this momentous shift?

McKinsey's experience suggests that even the most sophisticated multinationals must change significantly to realize Asia's growth potential. The region is as diverse as it is vast. Its markets come in a bewildering assortment of sizes and development stages, and its customers hail from a multitude of ethnic and cultural backgrounds. Their tastes and preferences evolve constantly. The speed and scale of change in Asian consumer markets can surprise even experienced executives. To meet the challenge, global companies will have to organize themselves regionally to coordinate strategy and use resources in the most efficient way while at the same time targeting the tastes of consumers on a very local level.

In Asia's high-growth markets, these companies face intense competition from low-cost local players; customers with modest incomes, disparate preferences, and minimal brand loyalties; and fragmented distribution channels. Some of the problems will recede as the region's economies mature. For now, though, the savviest players are trading their old management practices—including largely

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independent country operations and centralized administrative structures—for leaner, faster, more flexible, and regionally collaborative ones. They are strengthening their in-country operations while creating small, fast, and entrepreneurial regional leadership teams, which at their most successful adeptly allocate resources across markets, leverage scarce executive talent, drive innovations from one market to another, and relentlessly cut costs.

Four general principles sum up the changes needed to reach Asia's new consumers through a strategy that's both regional and local. Global companies must revamp their corporate structures so that operations in Asia enjoy a high status commensurate with its long-term profit potential and have the autonomy needed for significant results. They have to focus on growth opportunities in urban clusters. Their products and prices must be tailored to local preferences. Finally, they must learn how to market, sell, and distribute products through a variety of channels and retail formats.

For global consumer companies, building this kind of regional–local structure can be an enormous challenge—but it can't be ignored. Instead of treating Asia as a sideshow, they must act on the assumption that success in Asian markets is necessary for survival.

Go where the growth is

Asia won't replace the United States as the lead engine of global growth—at least not for five to ten years. At the end of 2008, the GDP of the whole of Asia was just under \$14 trillion, roughly the same as the GDP of the United States alone. Private consumption accounted for only about half of Asia's GDP, compared with 72 percent in the United States. Asia's three billion people spent less than \$7 trillion; America's 300 million, upward of \$10 trillion.¹ If Asia fails to stoke internal consumption, the region may grow more slowly over the next decade than it did in the last (see "A consumer paradigm for China"). Yet some observers think private consumption in the region's emerging economies could grow enough, as early as this year, to offset falling consumption in the United States and the European Union. Even under dour assumptions about the prospects for Asian economies, the region is likely to contribute more than half of all growth in global consumption by 2020.

Such macroeconomic perspectives understate Asia's significance for individual companies. In dozens of product categories, the Asian consumer is already global king. China is the world's biggest market

¹Global Insight. Unless otherwise noted, Asia as used in this article comprises the following economies: Australia, Bangladesh, Bhutan, Brunei, Cambodia, China, Hong Kong, India, Indonesia, Japan, Laos, Malaysia, Maldives, Mongolia, Nepal, New Zealand, the Pacific Islands, Pakistan, the Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand, and Vietnam.

for many household products, including TVs, refrigerators, and air conditioners. This year, for the first time ever, China will probably top the United States and Japan as the world's largest automobile market by number of vehicles sold. China's rank may slip back again as sales in those two advanced economies recover. Even so, with China's car ownership at fewer than 14 vehicles per thousand citizens, compared with more than 400 per thousand in the United States, the long-term trend is clear. For manufacturers such as GM and Volkswagen, which

Japan's frustrations in China

Brian Salsberg

Japanese companies were among the earliest to enter China when it opened its doors to foreigners, three decades ago. The leading Japanese brewer Suntory, for example, was the first foreign company to form a joint venture in China's beer market. Lawson, Japan's second-largest convenience store chain, was the first overseas retailer to get a franchise in Shanghai. But discouraging experiences in the early years created a sense of skepticism about the prospects for long-term success.

Today, Japan's consumer companies lag far behind their global rivals in China, despite that early market entry, geographic proximity, and the Chinese consumer's high regard for the quality of Japanese brands. A McKinsey analysis of 12 consumer-facing industries found that, except for a few standouts in areas such as automotive and skincare, Japan's leading consumer companies struggle in China. Some have abandoned hope of building successful businesses there and are focusing on other areas, such as Southeast Asia. Sectors where Japanese companies have had particular difficulty include packaged foods, personal care, household care, PCs, and mobile handsets.

A McKinsey survey of senior executives at more than 30 leading Japanese companies (primarily in the consumer sector) found that the respondents generally saw China as an essential market. Yet many acknowledged that their companies had experienced only limited success there and expressed feelings of frustration, even futility, about the possibilities for improvement. A surprising number thought it was too late to establish a significant presence.

Almost all the respondents expected less than 10 percent of their companies' revenues to come from China over the next three to five years; more than half said less than 5 percent. More than 70 percent of the respondents thought that now is the right time for further investments in China; 21 percent said that it's already too late or that they felt unsure whether investments make sense now. Sixty percent reported that Chinese nationals accounted for less than a tenth of the executives their companies employ in China. Only 25 percent said that they have programs to let Chinese executives spend time in Japan. Respondents at just two companies characterized their Chinese operations as "highly independent" from headquarters.

Many respondents expressed frustration with China's weak legal and regulatory systems, but they acknowledged the problems their companies have in managing government relations, attracting capable Chinese employees, and tailoring products to the needs and budgets of local consumers. Those difficulties are all the more striking given China's strategic importance to companies based in Japan, whose home market is mature and shrinking. For many Japanese consumer companies, success in China could prove the key to global competitiveness—or even survival.

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made big bets in China early, booming sales there help offset home market losses. Later arrivals like Ford and the big Japanese carmakers (see sidebar “Japan’s frustrations in China”) are scrambling to catch up.

No company illustrates Asia’s potential better than Yum! Brands, the proprietor of KFC and Pizza Hut. KFC opened its first restaurant on China’s mainland in 1987, now operates 2,497 in the country (compared with 5,253 in the United States), and counts on it for nearly 30 percent of global revenue. Yum!’s total sales there, which soared 31 percent last year, helped the company shrug off the US recession. CEO David Novak, who tells investors that Yum!’s business in China is merely “in the first inning of a nine-inning ball game,” vows the company will eventually have more than 20,000 restaurants in the country. He says KFC in China “can be every bit as big as McDonald’s in the US.”

But for many global companies with operations in China, a new phase is about to begin. The past decade was a time of market entry and gradual increase in scale. In the coming decade, overseas players will push for market leadership. India’s consumer market lags behind China’s by five to ten years, but similar stories of booming growth are unfolding there. Already, India is the world’s fastest-growing mobile-phone market, adding more than ten million new subscribers a month. Its top consumer companies, including Hindustan Unilever, Nestlé India, Godrej Consumer Products, and Colgate Palmolive, have posted cumulative annual growth rates of 14 to 19 percent over the past five years while sales at the country’s leading retailer, Pantaloon Retail, soared by 68 percent. Throughout Asia, products and market segments are growing explosively, in sudden waves of 70 to 100 percent expansion that could run for years. Global businesses that can’t ride those waves may drown in them.

Change the game

Asia’s emerging markets are a hypercompetitive free-for-all. Local rivals offer products with incremental innovations in ever-shorter product cycles—typically, at prices global companies find hard to match. Consumers don’t know established global brands and show little loyalty to the brands they do know. Marketing strategies are complicated by the uneven development of Asia’s telecom networks. The predominance of small, family-owned retail outlets thwarts efforts to control the distribution and display of products. For global consumer giants, fidelity to methods that work back home can be futile.

Leverage innovation and talent through regional teams

One key to success is rethinking organizational models. Many global companies try to use an international division run from the global

home office to supervise their operations in Asia. Companies with large operations there may well have a regional headquarters, but often it oversees an assortment of country-specific fiefdoms that don't collaborate and sometimes operate in their own languages, frustrating communication. For Asia, that's often the worst model, leaving C-level executives at headquarters two layers from the most important growth markets, oblivious to the speed of change and the scale of the opportunity.

So global consumer companies are experimenting with alternative management practices and organizational models to ensure that Asian operations get the capital, talent, and C-level attention they need to compete. Some companies organize Asian operations as independent business units, with their own capital budgets, partnerships, and P&Ls. Yum! Brands, for instance, has three divisions: the United States, China, and elsewhere. In 2008, after years of running retail operations in China and Japan separately, Wal-Mart Stores established an Asia office in Hong Kong to spread best practices across the region.

Often, successful Asian organizational models involve teams of senior executives with diverse cultural and market experiences, who work together to improve performance throughout the region. These regional teams set priorities, as well as mobilize expertise and resources to achieve scale advantages that can't be realized at the level of any single Asian market. They plan strategically; drive supply chain and cost-cutting initiatives; oversee recruitment, product development, and strategic alliances; and make crucial decisions about distribution channels, formats, and categories. Collaboration and a sense of entrepreneurial pace characterize these regional teams. Top executives and specialists hop around markets, encouraging product designers in China, for example, to learn from innovations in Japan or a supply chain leader in India or to investigate techniques that simplified operations and lowered costs in Malaysia. According to many executives, getting managers throughout the region to speak a common language is essential for spreading such best practices.

Think cities, not regions or countries

To be effective in Asia, consumer companies must think regionally but sell locally: they do better by focusing on urban clusters than by conceiving of an entire country as one market. In recent years, many multinationals have tried to understand Asian markets more precisely by dividing them into subnational megaregions or attempting to craft multitier urban strategies based on population size or household income. Because these approaches miss crucial variations in consumer preferences and behavior, resources are invested less than optimally. McKinsey's experience suggests that in Asia, urban clusters are

the most appropriate strategic and marketing unit for consumer businesses. Often, we advise clients to forget the forest and see the trees.

In developed and emerging Asia alike, cities are by far the dominant nodes of mass consumption, and their importance will surely grow. In Japan, more than half of all consumers live in Tokyo or Osaka. A fifth of South Korea's live in Seoul. In China, the McKinsey Global Institute estimates, more than 350 million people will leave the countryside by 2025, creating more than 23 megacities with populations upward of 5 million.² In India, more than 700 million people will make the same journey by 2050, creating as many as 36 megacities.

The scale of these migrations has no precedent. They will create huge opportunities for global consumer companies—but also huge headaches. After pouring into the cities of China and India, the migrants will assume new social identities. They will be open to new foods, fashions, forms of entertainment, and ways of living, but they will be fickle customers unfamiliar with established brands. Asked to identify the top contenders in apparel, Asia's new urbanites are as apt to name local upstarts as, say, Louis Vuitton or Gucci.

As they prosper, their preferences will probably grow more diverse. In 2005, when McKinsey initiated extensive surveys of Chinese consumers, we found that the size and GDP of the cities where they lived predicted their spending habits reliably. People who lived in Beijing, Shanghai, and other first-tier cities, for example, tended to buy similar products. Over the next three years, as the number of China's middle- and high-income households tripled, geography became more important. By 2008, city of residence predicted 9 out of 12 of these attitudes (For more, see "Understanding China's wealthy").

Thus, in recent years, the market for premium refrigerators has grown by 20 percent in Shanghai but by only 8 percent in neighboring Nanjing. Consumers in Guangzhou are much more likely to buy cameras with sophisticated LCD screens than those in Shenzhen, another first-tier city only 100 kilometers away, who demand portable, thin models. Global companies must think carefully about where and how to play in Asia's urban markets.

Customize locally, don't tweak

Long gone are the days when global companies could charge Asians a premium to buy products designed for consumers in developed markets. It's not enough even to tweak existing product lines for Asian sensibilities. Success now requires the ability not only to understand

² For the full McKinsey Global Institute report, see *Preparing for China's Urban Billion*, available free of charge online at mckinsey.com/mgi.

regional and local tastes and preferences but also to design products and services in Asia.

South Korea's LG Electronics struggled when it came to India in the 1990s until a change in foreign-investment rules enabled the company to invest in local design and manufacturing facilities.³ Noting, for example, that many Indians use their TVs to listen to music, LG introduced new models with better speakers and, to keep prices competitive, less costly displays. The company marketed many other original products, including appliances with programming menus in local languages, refrigerators with brighter colors and smaller freezers, large washing machines for India's big families, and microwaves with one-touch "Indian menu" functions. Those innovations were possible because LG invested heavily in local R&D and staffed its operations with thousands of top-notch Indian designers and engineers. LG's product innovation center in Bangalore is the company's largest outside South Korea. The company is India's market leader in TVs, refrigerators, air conditioners, and washing machines.

Local design is all the more important in Asia because customers in many of its markets expect a very wide variety of offerings and short innovation cycles. Yum! Brands' Pizza Hut restaurants in China sell as much Chinese food as pizza, and in 2004 the company launched a new chain, East Dawning, that serves only Chinese food. KFC tailors menus to local palates and launches new items every month. Tingyi, the Taiwanese company that is the mainland's leading instant-noodle vendor, used local designers to reshape a whole product category, creating separate premium and low-cost brands.

In Asia, price is a crucial part of customization. For all but a few categories, volume—not a high profit margin—is the key to sustainable success. Products in categories such as apparel, automotive, and consumer electronics are sinking to price points that were unthinkable only a few years ago. What's more, sophisticated consumer companies like P&G and Hindustan Lever have repeatedly found that compelling entry-level products and brands are essential for attracting consumers to higher-priced ones, often by "de-engineering" premium products to focus on the features and attributes that Asian customers value most. P&G, for example, cut the price of Crest toothpaste more than 50 percent in China by reducing the cost of packaging, which is less important to consumers than being able to choose from a variety of flavors.

Financing can play a role too. Levi Strauss recently announced that it would let customers in India pay in three monthly installments

³See Pramath Raj Sinha, "Premium marketing to the masses: An interview with LG Electronics India's managing director," *mckinseyquarterly.com*, September 2005.

for jeans costing more than \$33. A pilot version of the program, in Bangalore, showed the company that consumers who took advantage of this option spent an average of 50 percent more. Introducing it enabled Levi Strauss to preserve the status of its jeans as an upmarket, aspirational product, while bringing them within reach of millions of less affluent young consumers.

In pushing prices lower, supply chain management matters no less than financing and design. Asia's savviest consumer businesses have embraced the techniques pioneered by fast-fashion retailers and Japanese automakers in picking up the pace and lowering the costs of the entire supply chain. LG, for instance, has shortened

order-fulfillment cycles in Asia from months to just weeks. Retailers and consumer product companies are learning that fast supply chains for some categories assure fresher products and a quicker response to trends in everything from fashion to consumer electronics.

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Penetration rates for traditional and online media are lower in developing Asia than in developed markets, so efforts to influence purchase decisions are more complex. Consumer companies must be adept at shaping the consumers' view of brands across a number of channels and through a variety of media—not only TV, radio, print, and the Internet, but also events, outdoor ads, mobile messaging, in-store promotions, and educational campaigns. Managing this shift to multichannel retailing and sales calls for new approaches to marketing and brand building.

Modern retail chains account for only about a third of all consumer goods sales in China and for less than a fifth in India; small, family-run shops are much more important. In all formats, consumer product companies must somehow influence access to shelf space and display, since point-of-sale factors have an ever greater impact on purchase decisions. For now, key-account management is less important in Asia than it is in developed markets. Many global companies get things wrong because they attempt to rely on the sales teams of third-party distributors and the key-account-management routines that worked at home or in the past.

Adapting quickly to capture growth from direct-to-consumer channels will also probably become more important in Asia, as it already is

elsewhere. In some urban clusters, for categories such as consumer electronics and apparel, online sales growth is beginning to overtake traditional channels. In Japan, sales in direct channels have exceeded those in department stores so far this year. Sales at TaoBao, China's largest online retailer, have soared to more than \$14 billion annually since it was launched, in 2003. Lancôme reports that its partnership with Baidu, China's largest search engine, helped lift online sales in China by 30 percent. And AmWay has become one of China's largest consumer packaged-goods companies by selling its products door-to-door through a network of 300,000 sales representatives.



As Asia's economies evolve and mature, today's frenetic, hypercompetitive, fragmented marketplace will inevitably give way to a more settled one, with fewer players enjoying larger market shares and better margins. The penetration of modern retail formats will increase. But the journey will be long and filled with twists and turns.

The author wishes to acknowledge the contributions of Yuval Atsmon, Tiffany Lee, Jennifer Li, Evelyn Lu, Max Magni, Ireena Vittal, and Ming Zhang to this article.

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As the winners learn to make decisions quickly to meet the demand for speed, scale, localization, and low costs, they will test and adopt new and more entrepreneurial management practices. These companies will probably share four characteristics. Their fast, adaptive business models will leverage scale and innovation throughout Asia, and regional organizational structures and operating practices will reflect this shift. But resources will be focused locally, on the development of category, format, and brand strategies targeting the explosive growth opportunities of sharply defined urban clusters, not countries. Products tailored and priced to meet cluster-level tastes and needs will be supported by faster, lower-cost supply chains. Finally, brand marketing skills will be used to market and sell across a variety of channels. For global consumer businesses, the struggle for Asia has now been joined—cluster by cluster, city by city. ○