



# Commercial excellence in China:

## Lessons from the top CPG companies

What does it take for consumer-goods manufacturers to succeed in the fast-growing—and increasingly competitive—Chinese market? Our latest benchmarking yields some answers.

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The dizzying pace of change in China's retail and consumer landscape has kept consumer-packaged-goods (CPG) manufacturers on their toes. In the past few years, demand for their products has grown rapidly in China, but success is far from guaranteed in this evolving and wildly competitive market. The behavior and preferences of Chinese consumers are shifting, aggressive new online and omnichannel players are emerging, and the regulatory environment is becoming trickier to navigate.

Against this backdrop, what constitutes commercial excellence? What are the most successful CPG manufacturers doing that aspiring companies should emulate?

In this article, we present highlights from our latest Commercial Excellence Benchmarking of CPG companies. A collaborative effort between McKinsey and Nielsen, Commercial Excellence Benchmarking is a unique global benchmark that quantifies how a company performs compared with the best industry players. It pinpoints strengths and weaknesses using our proprietary Commercial Excellence Index (see sidebar, "About Commercial Excellence Benchmarking"). It reveals what "winners" do differently from "others"—winners being companies that achieved higher sales growth than the categories they play in, while also outperforming peers on one or more commercial metrics. Winners in pricing, for instance, outgrew others by 3.4 percentage points even while increasing the prices of their products.

Broadly speaking, our benchmarking indicates that top-performing CPG companies develop a more granular view of consumers and local markets; make greater use of data; collaborate more closely, both internally and with customers; and adopt a performance-based mind-set.

## Three market trends

Consumer companies in China are experiencing three fundamental changes, each with a massive impact on commercial practices.

## The spending power of Chinese consumers is increasing

In 2005, only two percent of urban Chinese households were in the "new mainstream" income group—those earning between 103,000 and 222,000 renminbi, or between approximately \$16,000 and \$35,000, annually. By 2016, that proportion had risen to 43 percent, and we estimate that by 2025 the new mainstream will encompass 66 percent of urban households in China (Exhibit 1). The top two income groups—affluent consumers (those earning more than 222,000 renminbi annually) and the new mainstream—have disproportionately contributed to consumption growth.

These consumers are trading up in many CPG categories—that is, they're switching from their preferred brands to higher-priced brands. In McKinsey's latest survey of Chinese consumers, one in five respondents said they traded up, whereas only 2 percent said they traded down to cheaper brands or to private-label products. The highest trade-up rates were in cosmetics, spirits, milk, and personal-care products.

That said, China's population is widely dispersed across the country, and there are vast differences in consumer behavior from one city to the next. To be able to tap into the areas with the highest growth potential, CPG companies need a detailed understanding of local markets.

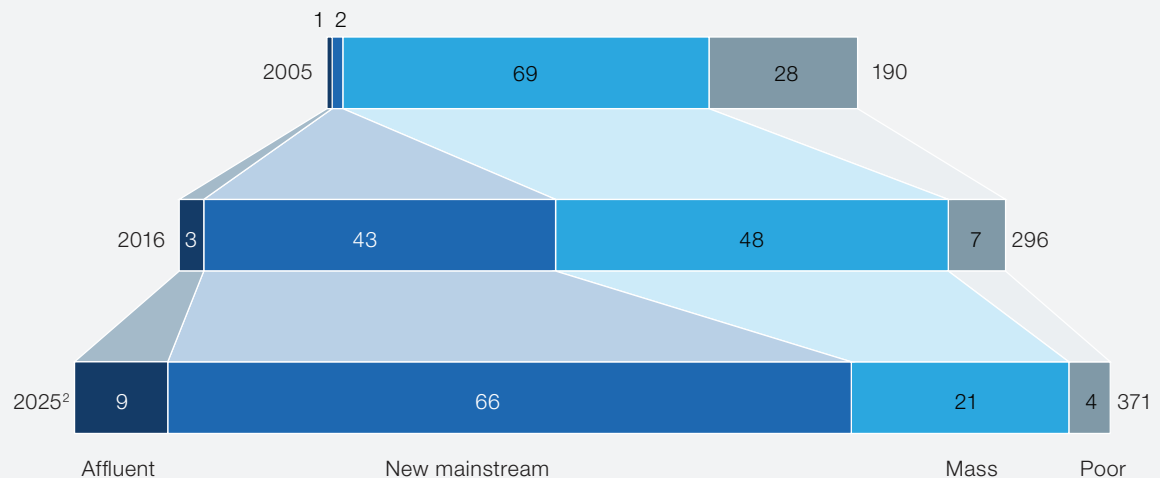
## A new breed of retailer is emerging

China's online retail market has been growing at about 18 percent per year over the past two years, and is now the largest in the world at over \$800 billion. In fact, online retail sales in China are approximately equal to online retail sales in the next six largest markets combined—the United States, the United Kingdom, Japan, Germany, South Korea, and France. And there's much more room to grow: online sales still account for only 17 percent of total retail sales in China.

But the most powerful trend in China's retail landscape today isn't just e-commerce. Rather, it's the emergence

**Exhibit 1 Consumers in the affluent and ‘new mainstream’ income groups have disproportionately contributed to consumption growth.**

Share of urban households by annual household income bracket, % share,<sup>1</sup> and total in millions



<sup>1</sup> Income brackets defined in real terms (affluence represents real economy purchasing power); affluent, >222,000 renminbi (equivalent to >\$35,000); new mainstream, 103,000–222,000 renminbi (equivalent to \$16,000–\$35,000); mass, 37,000–103,000 renminbi (equivalent to \$6,000–\$16,000); poor, <37,000 renminbi (equivalent to <\$6,000).

<sup>2</sup> Data for 2025 are projected.

Note: Figures may not sum to 100%, because of rounding.

Source: McKinsey analysis

of the truly omnichannel Chinese retailer, which offers multiple offline and online touchpoints and allows consumers to move seamlessly from one to the other. Take, for example, the food retailer Hema. Each of its brick-and-mortar locations is a retail store, restaurant, and warehouse all in one. It delivers fresh food and meal kits in 30 minutes or less to consumers located within three to five kilometers of a Hema store. The company proactively migrates offline customers to its digital channels—for instance, by rewarding in-store staff for helping consumers install the Hema app on their smartphones—thereby extending consumption occasions far beyond the store. Hema builds an

integrated view of each of its customers by requiring all transactions to be made electronically, either through its app or Alipay. And it uses data and analytics to constantly generate consumer insights that inform its product mix and sales strategy.

As retailers such as Hema and food-delivery platform Ele.me (both owned by Alibaba) gain ground, CPG companies will need to learn how to partner with them effectively.<sup>1</sup>

### Regulations are constantly changing

CPG companies must keep up with the ever-changing regulatory environment in China. In the last four months

# About Commercial Excellence Benchmarking

This article draws on the results of the 2017 Asia Commercial Excellence Benchmarking, with an exclusive focus on companies operating in China. The survey, developed in collaboration with Nielsen, aims to identify consumer-packaged-goods (CPG) companies' winning practices in commercial functions including marketing, portfolio management, pricing, and trade investment. Survey respondents are typically heads of sales and their colleagues. The survey responses help inform our framework for sustainable and profitable growth, which has eight elements: portfolio mapping and innovation, dynamic customer-portfolio strategy, data-driven marketing, precision revenue-growth management, retail partnerships for growth, digitally enabled in-store excellence, agile growth organization, and predictive growth analytics.

Since 1978, McKinsey has been gathering data and benchmarks on the sales organizations of the leading CPG companies in the United States. Over time, the survey expanded in geographic scope. Our latest global Commercial Excellence Benchmarking, conducted between 2014 and 2017, received responses from more than 280 companies, including eight of the top ten CPG companies worldwide. These companies represent more than \$2.2 trillion in net sales and more than \$55 billion in trade spending. Our respondent base included a cross-section of industry players from all major CPG product categories.

Our 2017 China benchmarking involved 14 CPG manufacturers, a mix of both local and multinational companies. The findings highlighted in this report draw on data from the 2015, 2016, and 2017 surveys.

In the 2017 survey, we used three analytical methodologies. First, we analyzed Nielsen-syndicated retail and consumer data as well as self-reported financial data to distinguish winners from others. We define winners based on sales growth versus the category they play in, as well as commercial metrics such as price increases, reduction in marketing expenses, or per-SKU sales growth. We then compared the self-reported commercial practices of winners to those of others. Next, using the companies' self-reported financial and employment data, we benchmarked participating companies against industry averages. Finally, we created the Commercial Excellence Index, assigning each company a score of 0 to 100. The scores were based on two criteria: (1) sales growth versus the category and (2) return on marketing and sales investments. The industry benchmark and the Commercial Excellence Index give companies a quantitative sense of how they compare with their peers and (assuming they participate in future surveys) how they progress over time.

of 2017 alone, the Chinese government introduced new regulations governing online advertising, food safety, e-commerce, and import tariffs. To stay abreast of—and compliant with—new laws and regulations, CPG manufacturers need agile processes that enable fast communication and coordination among internal departments, rapid decision making, and speedy implementation of market initiatives.

## What sets winners apart?

These trends have compelled the most forward-thinking CPG companies to adjust their commercial practices. We've found that, globally, leaders in commercial excellence are companies that make informed choices about where to play, which investments to make, how to execute in the market, and how to sustain momentum.<sup>2</sup> These choices allow them to consistently outperform the

competition and drive sustainable, profitable growth. In particular, our survey reveals that the winners in China prioritize the following imperatives.

### Take a localized view of the consumer decision journey

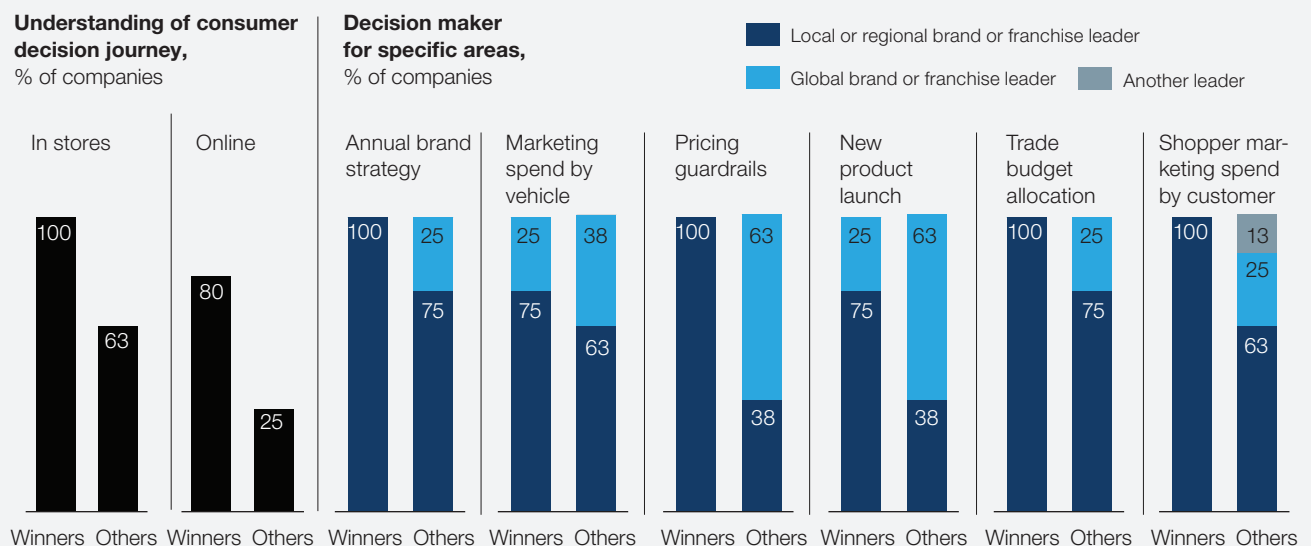
Winners in the Chinese market have invested in generating both offline and online consumer insights, and thus can claim a much deeper understanding of how consumers make buying decisions (Exhibit 2). All winners say they understand the in-store consumer decision journey, and about 80 percent of winners (but only 25 percent of others) say they understand the online consumer decision journey as well—making them much better positioned to partner with China’s emerging omnichannel players. In fact, most

winners build direct-to-consumer capabilities, often through the Tmall platform—not necessarily to generate sales but rather primarily to capture consumer insights—whereas for others, direct-to-consumer initiatives aren’t a priority at all.

Another striking difference between winners and others is in decision rights. Winners place almost all commercial decisions—including setting price guardrails, launching new products, and allocating customer-specific budgets for shopper-marketing initiatives—in the hands of local or regional managers, rather than the global brand leader or global franchise leader. Empowering local managers by giving them decision-making authority is crucial to success in China.

## Exhibit 2

### Winners invest in consumer insights and empower local leaders.



Note: Figures may not sum to 100%, because of rounding.

Source: 2017 Commercial Excellence Benchmarking



### **Foster cross-functional collaboration**

This emphasis on local-market expertise and knowledge is also evident in how winners in China tackle revenue-growth management (RGM) initiatives. At best-practice companies in developed markets, including the United States and Western Europe, a centralized RGM team is accountable for all RGM initiatives. But in China, winners tend to distribute RGM resources and responsibilities across marketing and sales teams, spreading them out across the entire commercial organization. Drawing on local resources for RGM expertise ensures that local-market understanding is embedded into RGM decisions.

Winners in China break traditional silos in other ways as well, to bring the best of their organization to their customers. For instance, winners are more likely to have the head of sales, the head of marketing, and the business-unit leader all participate in joint business planning with key accounts. Winners are also more likely to involve all commercial teams—including sales, category management, and business development—in generating shopper insights. Stronger cross-functional collaboration yields a number of benefits: winners say it has led to supply-chain improvements, trade-spend optimization, and broader reach.

### **Embed data and analytics into decision making**

Winners put big data and advanced analytics to work as they develop commercial strategies. In general, they rely on a larger and more sophisticated set of analytical models, tools, and processes to generate market-specific customer and shopper insights and to unearth the true drivers of performance (Exhibit 3).

For example, to set prices, most winners (but only 50 percent or less of others) take into consideration a number of factors including category promotion intensity and consumer price elasticity. Winners are also more likely to collect insights from the field, conduct empirical or statistical analysis of point-of-sale data, and use conjoint analysis as a consumer-research technique.

Among all companies in China, however, there remains massive opportunity in the use of trade-investment tools: only 63 percent of winners use trade-promotion management tools, and a mere 17 percent use trade-promotion optimization tools. By comparison, in the North American market, 100 percent of winners use these tools.

### **Take customer relationships to a deeper level**

Unsurprisingly, winners devote more time and resources to understanding their customers' businesses. For example, in communicating price changes, all winners strive to understand the impact on the retailer's profits by analyzing both the retailer's sales of the manufacturer's own products as well as the retailer's sales in the entire category. A majority of winners also provide price transition programs to smooth the effects of price changes.

Furthermore, winners collaborate with their customers to drive change and build capabilities. For instance, winners are significantly more likely to allocate additional employee hours to high-growth online retailers and to co-invest with these retailers in online marketing and shopper insights. Every single winner in our survey plans to increase investments in e-commerce platforms Tmall and JD.com.

### **Adopt a pay-for-performance mind-set**

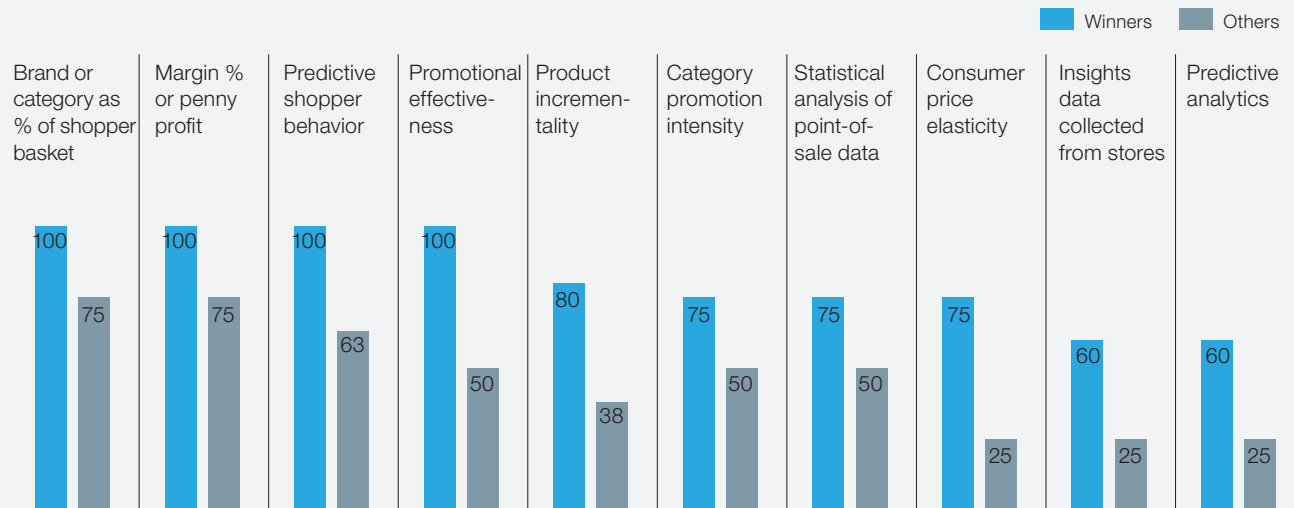
Finally, the most successful CPG companies operating in China keep close tabs on their spending—both in marketing and trade investment. They evaluate their spending regularly and rigorously. It's not that they're constantly looking to cut their marketing or trade budgets; rather, they make sure their spending is geared toward channels and activities that yield high returns on investment.

For instance, when it comes to marketing spending, winners are twice as likely as others to compensate marketing agencies based on performance. They're twice as likely to enter into labor-based agreements or adopt a per diem compensation model, rather than paying fixed fees. Winners tend to consolidate their marketing with two or three agencies (which they rely on primarily for digital and social-media campaigns), whereas others use five or more agencies.

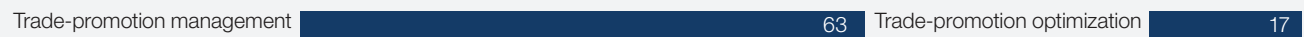
## Exhibit 3

### Winners take a more data-driven approach to strategy development.

Analysis used to develop strategies, % of companies



Use of trade-investment tools, % of companies



Source: 2017 Commercial Excellence Benchmarking

With regard to trade investment, all winners (and most others) have undertaken a shift from nonconditional to conditional trade terms—that is, they're increasingly paying the trade only if agreed-upon key performance indicators are met. By tying trade investments directly to improved performance, CPG companies are making more efficient use of their trade dollars.

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These survey findings show that to achieve commercial excellence in China, CPG companies must become more disciplined and data-driven. The practices highlighted in our survey can serve as valuable lessons for companies seeking to outdo the competition in a fast-growing and fast-changing market.

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<sup>1</sup> For more on manufacturer-retailer collaboration in China, see Brandon Brown, Felix Poh, and Simon Wintels, “Partnering with China’s retailers: A guide for consumer-goods companies,” February 2017, McKinsey.com.

<sup>2</sup> For more on the dimensions that constitute commercial excellence, see the article on the Predictive Consumer Growth framework, by Julie Lowrie, Max Magni, Ryan Murphy, and Sara Prince, forthcoming on McKinsey.com.

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