



# The Path to Profitability

Insights from China

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A global manufacturer of fast-moving consumer goods, with sales over \$10 billion, struggled to make a profit in China. The company had trouble understanding the peculiarities of the China market —its price sensitivities, challenging advertising and distribution systems, limited skilled labor pool, and high staff turnover. Based on an in-depth understanding of these market insights, Axia, a strategy and implementation consulting firm, helped determine the path to profitability.

To address China's significant regional differences, Axia and the client developed four different Go-To-Market (GTM) models, which varied by the cost of media and effectiveness of intermediaries. The goal was to keep the plan both simple and flexible, while paying close attention to the sales and marketing capabilities that needed to be developed. The results included 32% year-over-year sales growth, financial break-even, and a significant improvement in short-term performance.

## Background

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Axia's client invested in China for ten years without generating a profit. The manufacturer tried cutting prices, building their own plant, growing the sales force to over 150 colleagues, advertising on television in multiple cities, and employing several distribution models. Nothing worked. Because the peculiarities of the China market were particularly difficult for senior management at headquarters to understand, they engaged Axia to determine the path to profitability and develop a realistic plan to achieve it.

## Key Insights & Implications

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The key findings from data analysis, management interviews, customer interviews, and field visits were:

- **Consumers are both price sensitive and brand conscious**

Because they have little disposable income, Chinese consumers are among the most price sensitive in the world. The typical purchase mode is haggling for cheap, copycat goods that are treated as commodities. Consumers resist paying a premium unless they can link it to a display of status and success. Multinationals often struggle to price effectively and hook consumers on repeat purchases of their brands.

- **Television advertising is costly and corrupt**

Despite limited disposable income, 98% of Chinese families own televisions. Competition for television advertising time is high, due to heavy investment in brand building across many inherently more profitable industries and categories, such as electronics and financial services. Television advertising is also expensive because of rampant corruption. When programming from larger cities is

*Think of China as  
many distinct regions  
rather than a country.*

shown in smaller satellite cities, the commercials are “intercepted” and replaced with locally sold ads. Multinationals are often forced to pay for commercials in every individual city in which they are shown, even when advertising nationally—thus paying twice for the same air time. As a result, advertising funds are typically a constraint to growth, unless companies find less-expensive ways to build their brands.

- **Plants can be over-engineered**

Multinationals often bring a “developed country mindset” to China, and then suffer the consequences. Companies spend a lot of time and energy developing manufacturing systems and standards to ensure automation, efficiency, quality, and timeliness across all their plants.

In China, this can lead to over-engineered plants. Straddled with the resulting high fixed costs, these companies have a hard time competing in China’s price-sensitive market. They must then scale back investments in the country or make a drastic change to their supply model.

- **Distribution is complex and difficult**

It is best to think of China as a group of distinct regions, not as a single entity. Each region has significant differences in consumers, retailers, infrastructure, and intermediaries. One of our client’s managers commented, “Our products are sold in 30 cities, but we really don’t know much about the trade in most of them.”

For example, confectionery is seasonal in Shanghai, less so in Guangzhou, and not at all in Beijing and Chengdu. Most retailers are decentralized, and their adherence to corporate direction on plan-o-grams, promotion schedules, and pricing varies widely. Poor road conditions require local intermediary expertise to service retail outlets.

Although there is a wide variance in their capabilities and effectiveness, most intermediaries are passive. They don’t have much cash, they compete mostly on price, and they usually wait for the manufacturer to give direction. All of these factors create complexity in getting products to market, gathering intelligence on the changing market, and developing strong relationships with trade partners.

- **Limited skills and high turnover are problems**

There is a lack of sophistication in strategy, category, and execution skills at most levels. For example, sales forces are not typically trained or managed well, lacking key account selling, route planning, data analysis, and other core capabilities. Compounding this issue is significant staff turnover. The booming economy results in high turnover rates as employees move on to better opportunities once they have gained experience. Many companies

*Build expertise and achieve success in one region before moving on to the next.*

have found that focusing on human resources, training, and retention has become a critical success factor.

## Recommendations

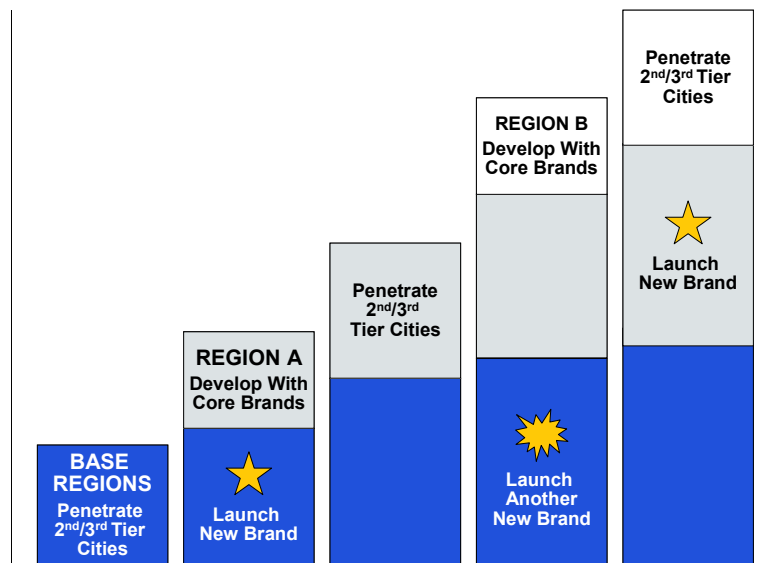
Building on these insights, Axia worked with management to develop strategies and tactics that achieved senior management goals with local management buy-in. Key recommendations included:

- **Focus on one region before spreading out**

Our client had an over-engineered plant with high fixed costs, and needed to increase their distribution to become profitable. They were also having trouble building brand equity and attracting consumers. Fast geographic expansion had been expensive and dangerous. Each new major city required a significant media investment (due to commercial intercept), and each new region had its own peculiar consumer, retailer, distribution, and other market complexities. With marketing and sales capabilities being extremely limited, expanding too quickly was a recipe for disaster.

The solution was to develop regions using a staged approach, achieving success in one before moving on to the next. As one industry executive put it, “China is full of nearby second- and third-tier cities to pursue. Why move on so quickly?” As each region was developed, expertise was built in targeting consumers, retailers, marketing, and promotions. This expertise was leveraged in launching new products in that region. The following diagram illustrates the staged approach to developing regions and launching products.

Figure 1. Staged approach to regional development and product launches



*There is no **one** answer to the China question.*

▪ **Keep solutions simple**

Due to significant regional differences, there was no one answer to the China question. There was a risk, however, that treating each region individually would be too complex for the capabilities of the organization. Axia’s solution was described as “brilliantly simple” by one senior manager. Four GTM models were developed, based on the two variables that represented the biggest differences between cities: television media cost and level of intermediary (wholesalers and distributors) effectiveness.

For example, if television media cost in a city was high, alternative marketing vehicles (*e.g.*, billboards, buses, radio, in-store promotions, and presence) were deployed to build brands and attract consumers. If media cost was low, the focus was on creating pull through television advertising. If intermediaries were effective at gaining distribution, establishing store partnerships, and executing promotions in a city, the focus was on supporting their efforts. If they were not effective, the client deployed a larger direct sales force to influence store conditions.

Axia helped the client plot cities on the GTM matrix and prioritize them for development (see graphic below). Cities with low media cost and high intermediary effectiveness were most attractive. The GTM model was then combined with the staging of cities and products to produce a comprehensive strategy of investment levels and types.

Figure 2. Cities were plotted on a matrix composed of four GTM models.

		Intermediary Effectiveness	
		Low	High
TV Media Cost	High	<p><b>GTM Model 1</b></p> <ul style="list-style-type: none"> <li>• Limit TV spend, utilize alternative marketing vehicles</li> <li>• Heavy direct sales force coverage</li> <li>• <i>E.g.</i>, Chengdu</li> </ul> <p><b>LEAST ATTRACTIVE</b></p>	<p><b>GTM Model 2</b></p> <ul style="list-style-type: none"> <li>• Limit TV spend, use alternative marketing vehicles</li> <li>• Leverage distributors &amp; wholesalers</li> <li>• <i>E.g.</i>, Wuxi</li> </ul>
	Low	<p><b>GTM Model 3</b></p> <ul style="list-style-type: none"> <li>• Focus on creating consumer pull through TV</li> <li>• Heavy direct sales force coverage</li> <li>• <i>E.g.</i>, Guangzhou</li> </ul>	<p><b>GTM Model 4</b></p> <ul style="list-style-type: none"> <li>• Focus on creating consumer pull through TV</li> <li>• Leverage distributors &amp; wholesalers</li> <li>• <i>E.g.</i>, Tianjin</li> </ul> <p><b>MOST ATTRACTIVE</b></p>

▪ **Build strong marketing and sales capabilities**

High media costs and price sensitivities require creativity in designing alternative marketing models that build strong brands and create consumer pull. Regional differences and complex distribution require local knowledge, close management of intermediaries, and strong relationships with retailers. Axia helped

*Learning when and how to **change** strategies is much more critical than following one specific strategic direction.*

assess the organization's marketing and sales capabilities, and then designed a program to dramatically increase training, recruiting, and retention. Key areas of improvement were promotion design, intermediary incentives, key account selling, route planning, developing new cities, and data analytics.

- **Maintain flexibility**

The consumer, retail, and intermediary markets are changing rapidly across China. Long-term strategic planning is helpful for setting goals and the vision for growth, but not execution. Learning when and how to change strategies is much more critical than following one specific strategic direction. Axia helped the organization identify ways to better gather market and competitor intelligence from the field, analyze and predict changes, and then communicate new decisions and direction more effectively.

## Results

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- **32% year-over-year sales growth**

- **Break-even in 3.5 years**

- **Improved near-term profitability**

Axia helped the client develop a detailed plan for achieving deeper penetration into regions, developing cities, increasing prices, and launching new products. The plan achieved senior management's objectives of long-term growth and near-term profitability. The plan also met local management's requirements of addressing the many differences within regions and cities, such as media costs, intermediary effectiveness, consumer spending patterns, and retailer penetration. The plan identified the cities to develop, the GTM model and tactics, and full financial and operating details.

After ten years of unprofitable growth, the impact of Axia's recommendations was 32% year-over-year sales growth and achieving financial break-even in 3.5 years.

In the near term, Axia helped the client develop a ten-point plan to significantly improve performance. Twelve-month inventories in the trade were eliminated and significant growth was driven by increased distribution, improved merchandising, higher-ROI promotions, and key account plan-o-gram changes.

Axia's combined recommendations established the path to profitability and renewed senior management's confidence in their ability to create a successful business in China.

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