
Distribution Issues Analysis Team Research Report

Consumption and Distribution in China and Southeast Asia
-Responding to Changes in Markets and the Population Structure-

Tatsuro Watanabe, Team Leader

Researcher, Research Center for Asia Industries
Dean of Graduate School of Commerce
Professor, School of Commerce

Our Team members published the following treatises in 2014, concerning to consumption and distribution in China and Southeast Asia. These focus on the strategies to respond to changes in consumer behaviors and population structure by manufacturers and Retailers.

1. Site Restrictions on Large-Scale Retail Stores and City Planning in China

Since China embarked on a unique socialist market economy after the economic system reform of 1978 and the constitutional amendments of 1993, its transition to a market economy has advanced rapidly, and corporate competition has expanded at a feverish pace. Such competitive behavior among companies has often bordered on what would be considered illegal in Japan, the U.S., and the EU. This is largely due to both the inadequacy of China's policies and legal structures, which are the minimum necessary to the functioning of a market economy, and the perpetuation of vested interests and institutions from the former regime. This situation of inadequate laws and regulations supporting a market economy was put forth as a point of contention at the World Trade Organization (WTO) membership negotiations that China was supposed to address, but the issue has remained largely unresolved since China gained WTO membership in the December 2001 WTO session. This situation has an adverse effect on both Chinese domestic enterprises and foreign enterprises that are already operating in China or that are considering entry into China. The fact that the relevant legal framework is inadequate means that the rules of economic engagement have yet to be determined, resulting in a high degree of uncertainty. This situation therefore induces illegal behavior and opportunistic behavior on the part of corporations, which results in hindering an awareness of compliance and impedes the fostering of ethical business transactions.

Concerned about this situation, in the early part of the 2000s decade, Chinese government agencies began working on establishing a structure for economic regulation

that would be appropriate for the country's socialist market economy. In response, government institutions in Japan, the U.S., and the EU sent delegations of specialists on legal system development to aid this endeavor, so that companies from their countries would not be put at a disadvantage. As a form of technical assistance (a legislative assistance project), the Japanese government, through JICA, implemented the Economic Legal Infrastructure Development Project from 2004 to 2008, which consisted of three subprojects on corporate law, antitrust law, and laws concerning market distribution.

Among these, the one most closely related to the distribution system and distribution policy was the subproject on laws related to market distribution. In this regard, the main topics and what later became the major points of contention as actual policy issues were issues related to how retailers exercise their buying power vis-à-vis suppliers, measures to promote consumer marketing, and the formulation of city planning mechanisms and site restrictions on large-scale retail stores over a certain size (large-scale stores). The former topic has already been discussed many times, so this study will focus on the latter.

Specifically, this study defines what is meant by the term “market distribution-related laws” and verifies that high priority has been placed on site restrictions for large-scale stores in many areas covered by these laws. It also considers the appropriate legal framework for China, taking Japan as a case study and organizing, from the standpoint of the system's subsidiarity and evolution, a theoretical framework that considers the legal system as it relates to restrictions on land use and large-scale store locations and other aspects of city planning. And finally, it examines the background, objectives, and limits of legal system development in China and opines on future trends.

(From Tatsuro Watanabe, Site Restrictions on Large-Scale Retail Stores and City Planning in China: From the Standpoint of Organizational Enhancement and Development, Japan Society of Marketing and Distribution, *Journal of Marketing & Distribution*, Vol. 17, No. 2, December 2014, pp. 47-63.)

2. O2O Between On-line Retailing and Traditional Retailing in China: The Development of the Omni-channel Strategy

The Chinese market for online retail sales has boomed in recent years. Growth of the Internet retail market in China has been much faster than that of the U.S., Western Europe, and Japan, and it has had a major impact on traditional retailing that focuses on opening physical stores. In the West and Japan, online retailing took off after the traditional retailing business had already reached maturity and had undergone a considerable degree of reorganization and integration. As a result, leadership of retailing overall remains more or less in the hands of traditional retailers, and the pace of online retailing growth is only slightly slower than that in China.

On the other hand, traditional retailing remains a developing industry in China, as online retailing has exhibited dramatic growth thanks to the explosion in online retail sales as a result of the rush into online communities and the rapid growth in the number of people using the Internet. In response, many traditional retailers have also jumped onto the online bandwagon. This has led to direct competition between online and traditional retailers. However, some companies are developing a blended business model that follows the omni-channel, or so-called O2O (online to offline, offline to online) strategy. Although suitable definitions of omni-channel or O2O do not yet exist in the academic sense, this paper will use these terms as they are understood in the practical sense. O2O will refer to the set-up that seeks to promote sales and attract more customers by operating online and offline sales activities in tandem. Omni-channel will refer to the set-up that induces customers to make purchases by seamlessly linking the online and traditional retail channels.

Behind this, there are the recently rapid aging of Chinese society and the debut of the 1980s and 1990s generations, who were born and grew up after the government reforms and who are fully versed in the Internet. These groups are increasingly becoming China's mainstream consumers. This group is the driving force behind online sales. This study seeks to confirm the status of growth in online retailing and to examine what impact online retailing is having on traditional retailing and on retailing in general from the viewpoint of competition and integration between these two business models.

Omni-channeling leads to expansion of retail product arrays. This means that for online sales, there is theoretically no limit to expanding the breadth and depth of merchandising. This characteristic of online sales prompts the following questions. Will today's classification for types of retail business, such as convenience stores,

supermarkets, hypermarkets, department stores, and shopping centers, remain in the future? If online sales spread, will the manufacturer-driven multiregional multichannel system be necessary? Will it be possible to control interregional price wars? Will the spread of online sales turn physical stores into mere showrooms?

These questions can be rephrased into theoretical issues concerning the limits of types of retail business. Recent research on them has been characterized by the following trends. The first focuses on industrial transformation through technological innovation and the birth and establishment of new retail businesses. This includes, for example, research on retail industries as the critical point for revolutionary management techniques, research advocating retail innovation models, and research proposing the concepts of format and formula as mezo-concepts for retail businesses. It also includes the trend of focusing on consumer preferences with regard to stores and types of retail businesses.

According to the framework proposed by Mukoyama (2009), there are differences among intra-industry and cross-industry strategic groups, whether these groups are general or specialized, in regard to formats that are widely recognized, such as convenience stores, and how the development and evolution of their format should be considered. In particular, studies conducted on China and Southeast Asia point out that retailers from the West and from the Asian region have developed their store networks by adapting to the unique markets of each country, region, and city and by using various formulas and formats for each segment in markets that are fragmented by differences in income levels, ethnicity, religion, and specialization. This illustrates that further segmentation of the retail industry is a tacit assumption.

However, growth of the omni-channel strategies, which incorporate competition and integration between online and offline retailing, is promoting a horizontal reorganization by breaking down the barriers of traditional retailing through lower prices and expanding the breadth and depth of product offerings, or what is referred to as the retail mix, which is a measure of industrial classification. At the same time, this is spurring the vertical integration and reorganization of the wholesale and retail stages, as well as the distribution and financial functions of the retail industry.

The situation described above not only can be viewed as a movement toward reassessing conventional views of retail sector theory, but can also be considered a leading indicator for the U.S., Europe, and Japan. However, this paper is not an argument in favor of reassessing theories about retailing. Instead, it is premised on the following three points.

1. What kind of business model is being adopted by China's online retail sector to achieve rapid growth?
2. How is offline retailing engaging with online retailing in response to this trend?
3. How is competition between and integration of online and offline retailing proceeding, and what are the major issues involved?

(From Tatsuro Watanabe, *The Development of O2O and Omni-channel Strategies at Online and Offline Retailers in China: Business Model Competition and Integration*, Tatsuro Watanabe (ed.), *The Distribution and Marketing Revolution in China and Southeast Asia: Markets and Competition Under Internal Globalization*, March 2015, Chapter 3.

3. Procter & Gamble’s Channel Strategy in China

Procter & Gamble (P&G) started out as a small soap and candle maker in Cincinnati, Ohio, in the U.S. Today it is one of the world’s largest consumer packaged goods company, with annual sales of \$83,062 million in the fiscal year ending June 30, 2014, and a product reach that extends to 180 countries (Table1). Breaking down the company’s sales by geographical area, North America is the largest, at 39%, followed by Europe at 28%, Asia at 16%, Latin America at 10%, and India, the Middle East, and Africa (IMEA) at 7%. Although developed countries account for 61% of P&G’s sales, developing countries with rapidly expanding economies make up a high 39%. In particular, sales volumes and revenues in the Greater China region (which includes mainland China, Hong Kong, Macao, and Taiwan) are second behind the United States.

Table 1. Trend in P&G Business Results (2009-2014)

Units: \$ million, persons

	Sales	Gross profit	Operating profit	Net profit	Number of employees
2009	73,565	36,882	14,189	13,436	132,000
2010	75,785	39,663	15,306	12,736	127,000
2011	79,385	40,551	15,233	11,797	129,000
2012	82,006	40,595	13,035	10,756	126,000
2013	82,581	41,190	14,330	11,312	121,000
2014	83,062	40,602	15,288	11,643	118,000

Source: Compiled from annual reports.

P&G sells 23 brands in the Chinese market, with sales of approximately 36 billion RMB in the fiscal year ending June 30, 2014 (Table 2). Sales of the four hair care brands—Pantene, Head & Shoulders, Rejoice, and Vidal Sassoon—total about 20 billion RMB, which amounts to a 40% market share. Pampers disposable diapers in baby care and Whisper feminine care products have combined sales of about 8 billion RMB. In addition, Crest has achieved a 20% share of the oral care market, and Olay has a 9% share of the skin care market. These major brands make up about 70%-80% of P&G’s sales in China.

P&G entered China in 1988 and has expanded there along with the changes in China’s market environment. By being an early market entrant that enabled it to obtain an oligopolistic market share, the company has had a significant influence on the

development of China's distribution system and market for daily necessities, and particularly on the growth of domestic manufacturers. In response to the constantly changing Chinese markets, P&G has made many adjustments in such areas as its product development, pricing, and channel strategy. In terms of its channel strategy, the company has been forced to deal with a complex distribution structure that consists of dual structures for urban and rural areas, economic disparities among regions, and the coexistence of small wholesalers and retailers with large chain stores, as well as the more recent boom in online sales. Also, P&G and domestic manufacturers have followed different growth patterns in their channel strategies.

Table 2. Introduction of P&G's Major Products in the Chinese Market

Category	Brand	Chinese name	Release date
Hair care	Head & Shoulders	海飛絲	October 1988
	Rejoice	飄柔	October 1989
	Pantene	潘婷	March 1992
	Vidal Sassoon	沙宣	September 1997
	Clairol	伊卡璐	November 2003
Skin care	Olay	玉蘭油	May 1989
	SK- II	SK- II	September 1998
Toothpaste	Crest	佳潔士	September 1995
Baby care	Pampers	幫寶適	May 1997
Detergent	Tide	汰漬	August 1994
	Ariel	碧浪	February 1993
Toilet soap	Safeguard	舒服佳	November 1992
Feminine hygiene	Whisper	護舒寶	October 1991

This paper describes the process of P&G's development in the Chinese market and analyzes its channel strategy, which has become the key to its growth. It divides this development into three stages: the wholesale channel development stage (1988-1997), the building of channel systems for each client (1998-2012), and the pioneering of new channels (from 2013 on). The changes in channels during each of these periods are analyzed to shed light on the following three issues. (1) How did P&G build an oligopolistic position in the Chinese market? (2) What issues did P&G face in dealing with the changes in the distribution structure and market environment? (3) How does P&G's channel strategy differ from those of domestic manufacturers?

From Li Xue, "P&G's Channel Strategy in China", Tatsuro Watanabe (ed.), *The Distribution and Marketing Revolution in China and Southeast Asia: Markets and Competition Under Internal Globalization*, March 2015, Chapter 4.

4. The Development of the Southeast Asian Regional Retail Industry in the Vietnamese Retail Market for Food and Daily Necessities

Japanese companies have been turning their sights to the ASEAN region for investment as part of the so-called "China Plus One" movement that has sprung up from concerns about an economic slowdown and increasing political friction in China. According to international balance of payments statistics on foreign direct investment (by region) from the Japanese Finance Ministry, Japanese direct investment in the ASEAN region totaled ¥2,333.1 billion in 2013, up about 2.7x from the previous year, exceeding direct investment in China which totaled ¥887 billion.

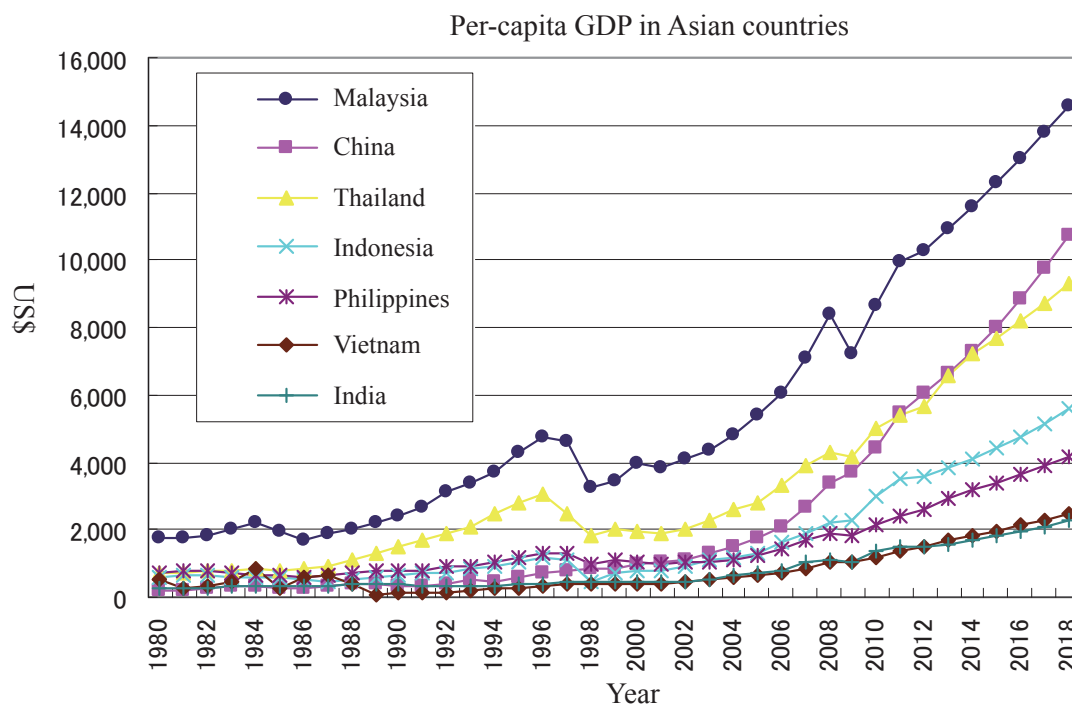
On May 3, 2013, the first Japan-ASEAN conference of finance ministers and central bank governors was held in New Delhi, India. The objective was for Japan to spur its own growth by strengthening its financial cooperation with Southeast Asia.

Per-capita GDP has been on an upward trend in ASEAN and other Southeast Asian countries since 2000 (Figure 1). Singapore's per-capita GDP exceeded \$50,000 in 2011, and Malaysia's exceeded \$10,000 in 2012. According to the economic classifications of the World Bank, Singapore is now classified as a high-income economy, and Malaysia is an upper middle-income economy.

The growing per-capita GDP of Southeast Asian countries is turning Southeast Asia not only into a production base, but also into a consumer market. Retailers, who see

Southeast Asia as a consumer market, have been going into Southeast Asia one after another, and even Japanese retailers consider Southeast Asia to be an increasingly important market.

Figure 1. Trend in Per-Capita GDP in Asia



Source: IMF World Economic Outlook Database, October 2014

The consumer markets in Southeast Asia are home to many kinds of consumers who differ in such characteristics as their ethnicity, language, religion, life style, and diet, as well as in their level and distribution of income. Although the formation of the ASEAN Free Trade Area in 2015 aims to liberalize tariffs, investment, and the movement of people, and to encourage economic integration, the markets in these countries will remain fragmented because of each country's uniqueness and diversity.

As stated above, economic development in Southeast Asia started in Singapore, Malaysia, and Thailand, and foreign-affiliated (European, U.S., Japanese, Korean, etc.) enterprises are well established there. In addition, a significant volume of research has already been done on the situation in these countries. However, Vietnam, Indonesia, and the like are expected to embark on real economic development going forward, and this will spur entry by foreign-affiliated firms. Therefore, there is much room for research into the characteristics of the retail markets in those countries. The present study thus takes as its topic the retail market for food and daily necessities in Vietnam.

Since the 1980s, the Vietnamese government has been implementing the Doi Moi policy, a unique liberalization and reform policy based on economic development and international harmony. The country's transition to a market economy and integration into the global economy has progressed in recent years, with Vietnam joining ASEAN in 1995 and the WTO in 2007.

Vietnam's GDP has grown continuously since Doi Moi's implementation (Table 3). The International Monetary Fund (IMF) predicts that per-capita GDP will surpass \$2,000 in 2016. The middle class is expanding, which is expected to stimulate consumption and bring about life style changes. For example, when China's per-capita GDP crossed the \$2,000 threshold around 2007, more than 90% of urban households owned such consumer durables as washing machines, refrigerators, and air conditioners; automobile ownership in 2006 was up more than 10% over the previous year, to 35 million vehicles; and personal computer ownership more than tripled in five years to exceed 74.1 million units. According to the United Nations' *World Population Prospects*, Vietnam's population as of 2010 was about 87.85 million people, of which those in the 65 and over age bracket constituted a mere 6%, and the average age was 28.2, meaning that Vietnam is a young country with a promising future.

Table 3. Trends in Vietnam's GDP and Per-Capital GDP

Category	Unit	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP (nominal)	\$billion	35.10	39.56	45.45	52.93	60.93	71.11	90.30	93.17	103.58
Per-capita GDP(nominal)	\$	440.21	489.03	554.07	636.91	724.05	835.10	1,047.88	1,068.33	1,173.56

Source: IMF World Economic Outlook Database, October 2014

This study focuses on the retail market for food and daily necessities in Vietnam, which is expected to grow as a consumer market. This market was chosen for the study because it is thought to strongly reflect local characteristics in that, unlike such product categories as electric appliances or clothing, food and daily necessities are closely related to the traditional Vietnamese diet and life style. Not only local companies, but foreign companies as well are setting up in Vietnam to operate in this kind of retail market for food and daily necessities. In the light of discussions on the globalization of retailing, this study will thus take a critical approach to examining how foreign companies are faring in a retail market for food and daily necessities that is strongly influenced by local characteristics.

The study consists of the following: The study first takes up the hypothesis of regional strategy from a discussion of regionalization in the context of the globalization of retailing and the headquarters functions in internationally developing areas. This is followed by a discussion of problems involved in regulating foreign capital and modernization of the distribution structure as factors in the current state of Vietnam's retail market for food and daily necessities, as well as a description of the structure of Vietnam's retail sector for these products. What comes to the fore here are the foreign retailing groups that have developed not only in Vietnam, but in Southeast Asia in general, in addition to both the domestic Vietnamese retailers and the global retailers that have developed standard store brands on a global scale. This study categorizes these foreign retailing groups as "Southeast Asian regional retailers" and examines their international development in Vietnam's retail market for food and daily necessities from the point of view of their regional strategies.

From Taichiro Sahara and Tatsuro Watanabe, *The Development of Southeast Asian Regional Retailers in Vietnam's Retail Market for Food and Daily Necessities*, Tatsuro Watanabe (ed.), *The Distribution and Marketing Revolution in China and Southeast Asia: Markets and Competition Under Internal Globalization*, March 2015, Chapter 5.