By Dr. Willem Burgers
Author of "The Marketing You Never Knew"
Professor of Marketing and Strategy
Bayer Healthcare Chair Professor of Marketing and Strategy
China Europe International Business School

The China Surprise

Akin to what happened when Japan joined the global free market system, China's joining will introduce new concepts, new methodologies, new frames of reference, new and sometimes very counterintuitive paths to success. Where Japan's contributions concerned mostly products and production technologies, my observations lead me to believe that China's contributions will be more focused on new markets and marketing methodologies. Western companies thought that quality was their strong point against Japanese competition. We now what happened there. Now innovation is the new presumed strong point. Will the same thing happen again?

Rethinking R&D

Any story about China's emergence as a new economic superpower contains somewhere the notion that creativity and innovation serve as the final sources of sustainable competitive advantage for mature economies. Manufacturing and simple servicing tasks can be outsourced and off-shored, but the higher value added, more conceptual, creative and innovative tasks remain at home. Generally there is then the obligatory reference to Western educational systems that encourage creativity.

But how creative and innovative are we really? Let me pierce the veil of self-congratulation. I don't know about engineering and manufacturing, but I do know about marketing. The idea that innovation and creativity in marketing are a source of competitive advantage for industry leaders in the developed economies of the world is preposterous. The brutal fact is that whole industries have no concept even of what marketing creativity or innovation is. As a result they are left unnecessarily vulnerable to new competitors, including new competitors from China. Let me illustrate my point.

In the 1980s the personal computer industry was ruled by giants: IBM, Apple, HP, and Compaq. Minor players included huge companies such as Philips, Siemens, Toshiba, and others. Among them, year after year, they spent billions of dollars on R&D to improve their products and production techniques. But how much R&D money was spent on researching and developing new markets, or on researching and developing new marketing methods?

Not enough to avoid being humiliated by Michael Dell, an eighteen year old student. Dell doesn't invent a better product or production method. He invents a better marketing method. He sells direct and comes to your house or office to fix your computer if it breaks down; and he defeats the whole industry (which makes you wait for weeks to get your computer fixed).

Why didn't the personal computer companies copy Dell? *While the engineers were tearing apart one another's computers to look for better ideas, how many marketing managers were tearing apart Michael Dell's business model?*

There were plenty of nay-sayers when Dell, after his phenomenal success in America, went to Europe. It was said that his method would never work in Europe because of cultural and other differences. Amazingly, though European companies had plenty of time, none possessed the 'intellectual infrastructure' to even try Dell's methods in Europe. All just waited around patiently for Dell to come put them out of their misery. The same thing happened in Asia. The incumbent companies had big marketing departments and experienced marketing managers. But R&D was and is not part of marketing's job description!

This suicidal lack of marketing R&D is not an aberration. An obsession exclusively with the physical product is ingrained in the culture of the personal computer industry. It took nearly two decades, and the return of Steve Jobs – outsider always- before the industry finally thought of trying colors for their computers other than grey, brown, or black.

Apple gained several points of market share by introducing pink and green, etc., computers. Why, over a period of about two decades, did no other company think to <u>try</u> this? When companies only look for innovation in the technical sphere of product and production, they are certain to miss blindingly obvious innovation opportunities in markets and marketing.

The computer industry is not the only industry that thinks only about products and production when thinking about R&D. This narrow approach to R&D is typical of many technical industries.

For example, the pharmaceutical industry, a very much R&D driven industry, has no tradition of attention to non-product features such as brand name, product shape, size, color, etc. This is not because such features are not important. The efficacy of medicine depends substantially on the patient's psychological perception of the medicine. But the industry focuses on R&D of products and production.

Further, the efficacy of medicine depends on the patient taking the product faithfully and appropriately. When patients receive instructions to take a pill once a day, they might ask whether to take it in the morning or evening. The doctor will answer that it doesn't matter.

Doesn't it? Maybe it does! Possibly, patients are more likely to form a habit of taking the product faithfully if they are instructed to take it in the morning after they brush their teeth. This way, the taking of the drug is connected to an established daily habit. But only recently, and only with some companies, have I seen signs that the industry is interested in this sort of research questions.

Research on how to help patients take their drugs appropriately would benefit not merely the patients, it would help the industry. One major reason for lost revenues in the industry is premature discontinuation of a drug by patients.

It is not ill will, or disinterest in patients, or incompetence that causes this industry failure. It is simply that R&D in the industry is focused internally on products and production, not externally on the markets and marketing. It is an example of the same industry-wide blindness we saw in the personal computer industry with respect to colors.

What blindness exists in your industry? In today's hyper competitive environment, and especially in China where today we find the most competitive environment anywhere worldwide, companies cannot afford blindness. To stay competitive and gain advantage it is absolutely necessary that companies today add R&D as a key component to marketing's job description. Here is an assignment for your new R&D department: Identify the most successful companies in China, the world's most competitive environment today. Learn from them.

Goldpartner: Customer-Driven Marketing and Advertising Innovation

Once, when I was teaching a class in Shanghai, one participant raised her hand and asked me to comment on the TV commercials for a popular health food product named Goldpartner. In her opinion the commercials were annoying and disgusting, but the sales for the product kept increasing. Why? Almost everybody nodded. I told myself I had to find out about this company.

Goldpartner Company was established in 2001 for the purpose of selling the Goldpartner health food product. The owner, Mr. Shi Yuzhu, already successfully sold his own brand of Melatonin, a product designed to help people sleep better. Now he wanted to enter the vitamin market. Both local and international companies are fighting fiercely for their share in this emerging market. Mr. Shi definitely had found himself a challenge.

He starts out by applying the same two criteria for product choice he relied on in his Melatonin business: First, there should be scientific support for the product benefits. Second, customers should clearly recognize the benefits.

Research shows that Chinese people typically do not take vitamin and mineral supplements on a regular basis. Nonetheless, there should be opportunity since many people for example are anemic and many people lack calcium. The challenge, Mr. Shi decides, is to develop a product which can supply specifically the vitamins and minerals that the Chinese lack and to convince potential customers of the benefits of such a product.

To create the product, Goldpartner established strategic partnerships with the Chinese Nutrition Society(1) and with Roche (Hoffman-La Roche, the Swiss multinational pharmaceutical company). The Nutrition Society develops the product formula. Roche provides the raw vitamin materials. Goldpartner combines the ingredients and packages the product.

According to the Chinese Nutrition Society, many people do not get sufficient nutrients from their daily food: the intake of calcium, iron, vitamin C, vitamin E, etc is commonly insufficient. On the other hand, based on a typical diet, the Chinese already consume too much phosphorus and copper. Too much phosphorus can cause the loss of calcium and too much copper will hurt the liver. So "Goldpartner" was created to contain the vitamins and minerals likely to be insufficient in the Chinese diet, and without phosphorus and copper. The latter part of the benefit claim is very important because the company had found that the reason that many people in China hesitate to take vitamin and mineral supplements is that they worry about getting too much of a particular vitamin or mineral. Goldpartner offers here a great example of application of an often forgotten rule in marketing planning, namely, that you should not merely find (and build) reasons for customers to buy, but should also find (and take away) reasons for customers not to buy.

In December 2001 the company starts on its second challenge: getting customers to recognize the benefits of its products. The advertising strategy attempted first is to educate people. The advertisement looks like a scientific report to alert people to the conditions of nutrition in China. The product plays a secondary role in the advertisement. Full page newspaper advertisements are run twice per week. But they are run only in three small cities. Goldpartner refuses to spend all its money on untested advertising.(2) After running the advertisements for a while, it is decided that this advertisement strategy does not lead to sufficient sales.

Target customers are surveyed and a new advertising strategy is designed. The new strategy puts the primary emphasis on the product. The message is that this complex vitamin product is designed by the Chinese Nutrition Society, specifically to complement the Chinese diet. In April 2002 the new strategy is tested in several new cities. The new strategy proves more successful than the first. Sales effectiveness is doubled. But the results are still not sufficiently satisfactory relative to the advertising effort.

Goldpartner surveys customers again. The survey results show that people misunderstood the message and felt that Goldpartner was for children. The survey result also show that the claim -Goldpartner does not contain phosphorus and copper- is very convincing when the salesperson asks consumers to switch from competitors. In August 2002, they launch their third round campaign with advertisements emphasizing the different symptoms children/women/the elderly may have when they lack certain elements of nutrition and the excellent results after they take Goldpartner. Commercials are also run with a famous middle-aged actress emphasizing the special characteristic of no phosphorus and copper. The new advertising strategy proves very successful. By the end of November, company sales have doubled compared to August. And now this third advertising campaign is implemented all over China. Several months later, in February 2003, during the Chinese New Year festival (the peak buying period for health food products), Goldpartner reaches its sales peak, outselling all other brands one year after its launch.

What is their secret to success? Their marketing and promotion planning system is truly customer-driven. First they design the product both with reasons to buy and without reasons not to buy. Most companies spend a lot of time thinking about the reasons why customers should buy their product, and very little time thinking about the reasons why customers should not buy their product. In this respect, most companies are not at all taking their customers' perspective. Customers ordinarily and automatically weigh pros and cons of purchasing a particular product, or not. In the case of Goldpartner, taking away the reasons not to buy proved a most powerful motivation for customers to switch to Goldpartner.

Further, the promotion campaign involved a deliberate and continuous process of testing advertisements and talking to (potential) customers. Goldpartner thereby proves itself to be a much more sophisticated company than the majority of the 100 largest advertisers in the United States who do not regularly pre-test their advertisements before running them. Goldpartner is not an exception. Chinese companies typically are very interested in measuring everything. I have been repeatedly surprised at the culture of trust in statistics and numbers.

Next, the marketing planning system in place at most companies allocates marketing resources across some defined time period, or budgeting cycle. Generally such a cycle will be a one year period, or some fraction of a one year period.
Why? Because it takes the earth one year to go around the sun or perhaps because our book keeping system is set up on a one year cycle. This one year cycle may be efficient in a bureaucratic sense, but bureaucratically efficient is not synonymous with customer-driven. So what is a customer-driven planning/budgeting system?

Mr. Shi tells us how he times the allocation of his marketing resources:
"There is no hurry when you test your marketing strategy, but be quick to apply the proven successful strategy to your whole market to pre-empt copying by competitors". In other words, market response dictates marketing spending and the timing of spending.

I have asked a number of marketing and advertising managers why they don't experiment with different advertisements and why so often they neither pre-test nor post-test their advertisements. One explanation I have encountered several times is that the planning cycle is such that testing really does not do much good. Advertising budgets are allocated, space is purchased, advertisements are shown. Once the money has been spent nobody really wants to know if all the money was wasted.

By way of exception, note that Procter & Gamble forces its different brands in a product category to compete with one another for budget allocations. Such a budget allocation process does go a distance toward rewarding brand managers for trying to experiment, research, and measure results of marketing efforts. But most companies of course don't have the option of switching money across different brands. For those companies, it will be a wise move to allocate the money, but not allow for money to be spent unless and until the marketing manager can show with experimental results what the effect will be of his marketing spending.

(1) The Chinese Nutrition Society sets the national nutrition standards for China. The latest standard is "The reference ingestible quantum of nutriment for Chinese" (2000DRIs)

(2) In The Marketing You Never Knew I give a detailed example of a company, Covad, which drove itself into bankruptcy by wasting $40 million on an untested advertisement, proudly insisting in the words of their soon unemployed CEO that they "weren't going to spend $40 million experimenting."

Value Innovation and the Taxi Driver from Xi An

When competition gets really tough, we should look to learn from those who have succeeded in the face of really tough competition. Here is the story of a very successful taxi driver in China. I think the story has an important lesson for anyone in today's ever tougher business climate.

The life of a taxi driver in China is not easy. A typical taxi driver pays a fixed amount of money for his car each day to his taxi company and then races around to hunt down enough customers to finish with a profit at the end of the day. This is possible, provided two drivers join to keep the car on the road for twenty hours or so a day.

A more relaxed option for drivers is to stand in line at the airport for a nice long drive to the city. Such taxi lines can reach lengths of several kilometers and it might take six hours before a taxi is finally at the head of the line to take in a customer.

Yet another option is to park the car at the airport, go into the arrivals hall, and try to cajole a tourist to bypass the taxi stand and follow the driver to the parking lot. This option is favored by generally unlicensed dubious entrepreneurs who then like to negotiate a price from two to three times higher than what one normally would pay. Locals and experienced travelers know to ignore this avenue.

How could an honest man become rich in this industry? The concept of value innovation (see Blue Ocean Strategy by W. Chan Kim and Renee A. Mauborgne) tells us that the challenge is not how to compete, but rather how not to compete. Value innovation tells us when competition gets out of hand to look at all the dimensions of our offerings and consider differentiation not by moving up (a more beautiful car, a uniform) or down (a smaller car, a t-shirt with holes), but by moving into several directions at once, by moving both up and down, with a focus on the total solution sought by the customer.

This value innovation thing might sound a bit theoretical, but not to the taxi driver I met in Xi An. I had gone to Xi An with two professor friends, one American and one from India (and I am from Holland). Upon arrival, the predictable crowd of dubious characters converged on us, shouting "Taxi? You need taxi? Where you from?" I try to ignore these guys, but my friend from India allows she is from India.

"India? I have good customer from India. Look in my book. They write about me!" one guy shouts, pushing a notebook in her face. I tell my friend not to talk to these people and I tell the guy to go away. He doesn't go away. His goal is not to maximize my satisfaction, his goal is to maximize his sales. "Where is your hotel? Where are you from? I'll drive you for free!"

For free? A marketing professor, certainly a Dutch marketing professor, has to investigate how this would work. "I'm from Holland." I admit.

"Holland? I have good customers from Holland. Wait! Here! Read!" He knows I'm the bottleneck in this joint purchasing process by these three foreigners. He leafs through his notebook and thrusts it to me, opened to a page hand-written in Dutch. I can see he didn't write this himself with the help of a dictionary. I have to read. A couple from Holland warmly recommends his services. They used him every day during their stay in Xi An, went to all the sights, with him dropping them off and waiting right at the entrance, negotiating discounts, even organizing a home visit to villagers. He made their visit the most interesting and most hassle free visit to any city in China. He charged them 500 Chinese RMB (50 Euros or 60 US dollars) per day. I go through the notebook. It is full of recommendations …in Dutch, English, German, French, Swedish, Japanese, and so on.

"How many days do you stay? I take care of you, only 500 RMB per day," he says. He is relaxed now. He knows, as do his competitors who are leaving, that once the foreigner reads the book, the sale is made.

"And first to our hotel for free, eh?" I inquire. "For free or you can just pay the meter price," he responds. The shoe is on the other foot now. I talk it over with my friends. "This sounds great," my American friend tells me. "Let's go, we'll pay him the meter price." Generosity is a major flaw in the American character.

But we had a great and very interesting three days with our excellent driver in Xi An. Whenever there were higher prices listed for admission for foreigners than for Chinese, we paid the lower Chinese prices. We had tea with farmers at their home. We never looked at our travel books. He more than lived up to his testimonials.

He had an excellent three days too. No hunting around or waiting endlessly for customers. Two hundred Euros -we tipped- plus some commissions from stores and restaurants I'm sure. We put our notes in his book, he gave us his business card, and several months later friends of ours called him and made reservations with him before leaving for their visit to Xi An. When we met him he already owned his own car, was paying off another car that his wife was driving, and was getting ready to open up a restaurant. That was eight years ago in 1996. I should go back to see how he is doing now. Probably owns a skyscraper.

This man had invented value innovation all on his own. He turned out in fact to have a taxi license. Yet he joined the hustlers in the arrival hall. So he moved his 'distribution strategy' down to a point where regular travelers would not even look at him. But he compensated with a price strategy -for free- that was simply too good to ignore. Hustling and then charging twice or triple the price is one way to make a living. Waiting for a sure ride and charging regular price is another way. Hustling and charging nothing? Now that is innovation.

He made it work by offering a total solution to his customers' needs. We didn't need just a drive to the hotel. No company driver or travel agency was picking us up. Clearly we would need a drive back to the airport and lots of drives in between. And he didn't offer just transportation. More than that, he offered us advice and friendship in a town where none of us had visited before.

Probably we could have saved 50 Euros or so by finding our own taxi each time we needed one. But of course price was no longer the issue since our driver had invented a new market segment for himself. He was not a hustler. He was not a taxi driver. He was not a tour operator. He was all of the above. He was a value innovator. With simplicity and a touch of honesty he had created a valuable niche out of nothing. So when the competition gets too hot and you are not sure how to position yourself, your company, or your brand, consider this alternative: don’t move up, don’t move down, do both.

Price-Endings in China: When Numbers Are Not Just Numbers.

In Western experiments it has been found that people partially ignore the last digit of a price. For many people, intuitively, 69 feels closer to 60 than to 70. It makes sense therefore to have prices end in a 9. In different Western countries from 60% to 80% of prices in supermarkets end with 9.

In the Hualian supermarket in Beijing, however, a survey of prices showed that only 34% of prices end with 9, 20% end with 5, and 15% with 8.

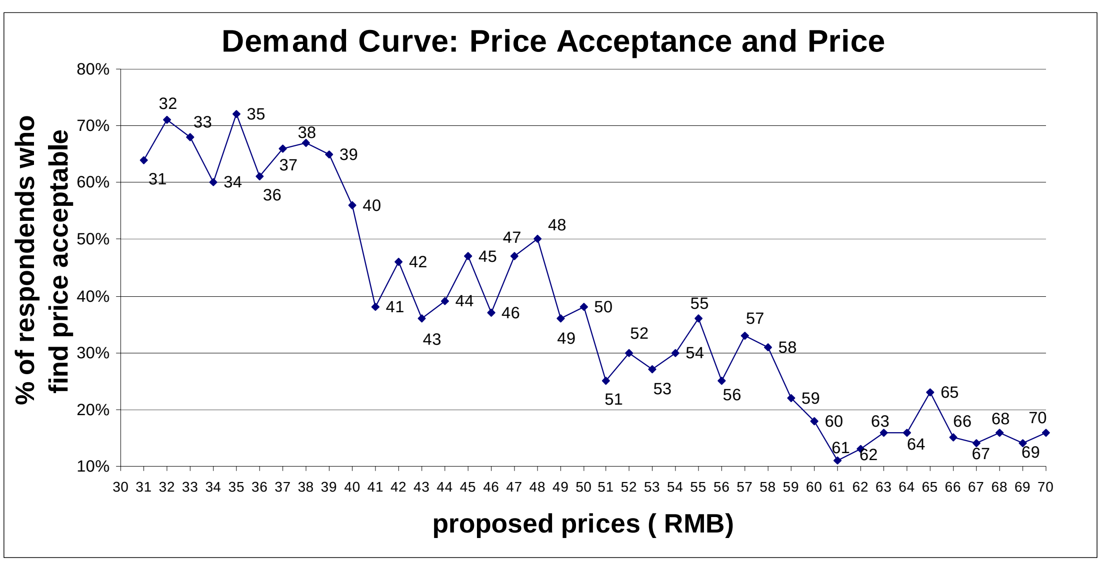
Further, York University Professors Heeler and Nguyen found that 37.4% of retail prices listed on United States websites end in a 9, while on Chinese websites only 9.9% of prices end with 9, just about what would be expected given that there are ten numbers. In contrast, 8 was found to be a very popular price-ending on Chinese websites: 19.3% of prices end in an 8. For US websites, 8.7% of prices end in an 8. Further, in a study of Hong Kong restaurants it was found that an amazing 49.4% of prices end with 8.

We can understand why 8 would be a good number. But why is 5 a good number as price ending? One hypothesis is that if people have some mathematical ability and they have very little money, then they are less likely to ignore the last digit, and more likely to round the last digit up or down in their mind. If consumers decide to round up or down instead of simply ignore the last digit, then 36 becomes 40 in their mind, while 35 becomes 30.

Clearly, numbers are not just numbers, and numbers mean different things in different cultures and maybe in different industries. At least this is so in the eyes of sellers, both in China and elsewhere. The interesting question is: how about customers in China? Are the theories true? Are Chinese customers too really influenced by price-endings? Does the price-ending influence their willingness to pay the price?

In order to find out the influence of the last digit of a price on the acceptability of the price, I had a research company show detailed descriptions of a woman's health product to 1250 women across China (the study was funded by the manufacturer of the product). These women were divided into ten groups of 125 women each. Each respondent in a group was given one range of prices where all prices shown to the women in price group 1 ended in a 1, all prices shown to women in group 2 ended in a 2, etc.

The last digit of the price did make a difference in the price the respondents were willing to pay. The graph below shows the percentage of people willing to purchase the product at prices ranging from 31 RMB to 70 RMB (the range considered feasible by the company that sponsored the research).



The demand patterns across prices in the 30s, 40s, 50s, and 60s are remarkably consistent. The proportion of respondents willing to pay a price of 31, 32, 33, or 34 RMB is lower than the proportion of respondents willing to pay a price of 35 RMB. The same pattern holds for prices from 41 to 44 RMB relative to 45, and again the same pattern holds for prices in the 50s range and the 60s range. Raising the price from a 9-ending to a 0-ending (such as from 39 to 40, etc.) sometimes lowers the percentage of people willing to pay the price, but not always. However, a further raise of the price from a 0-ending to a 1-ending (such as from 40 to 41, etc) consistently produces a significant drop in demand; and consistently it would be better to raise the price further to a 2-ending. Further, once the price is raised from a 5-ending, it is best to move to an 8-ending; doing so would lose you fewer customers than a smaller raise in the price to a 6-ending or 7-ending (58 RMB is an exception on this, retaining fewer customers than a 57 RMB price).

This study shows that in China, as anywhere else, we must not simply follow established practices from elsewhere. We must look at the explanation underlying the practice and consider whether this explanation is also applicable to our special situation. Very often, in marketing, things are the same everywhere. But sometimes they are not