

China Sourcing and Marketing Strategies: The New Economic Dynamics

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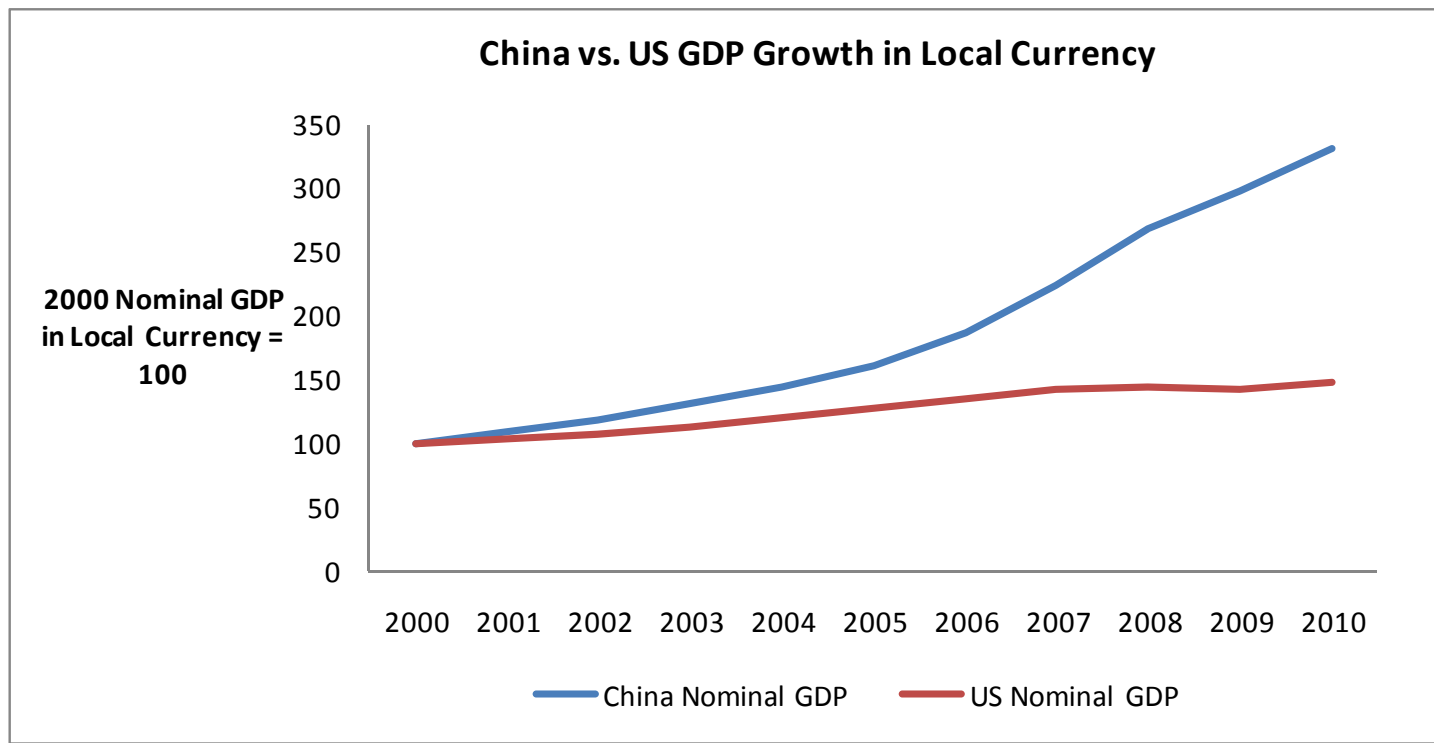


Chinese Economic Trends



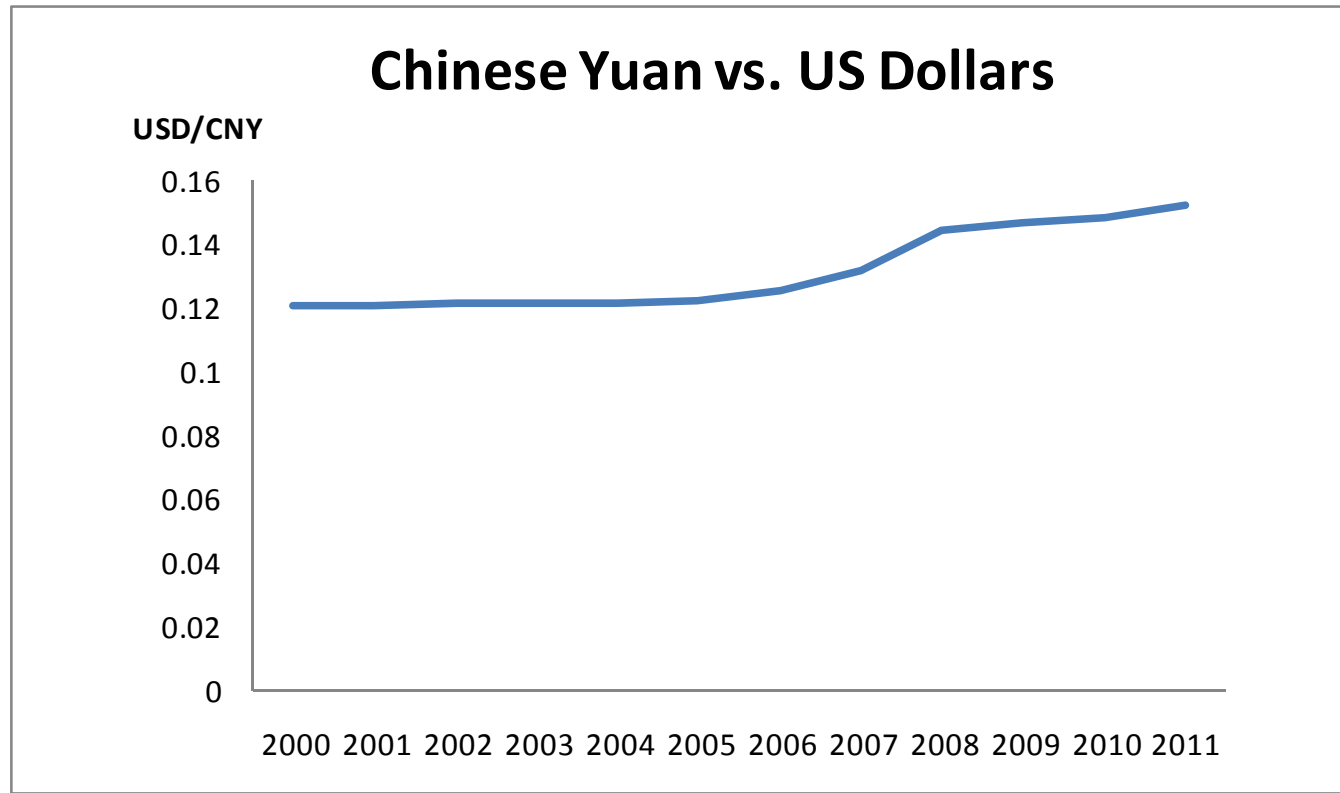
China's economy has grown 15% per year since 2000, narrowing the GDP gap with the US by 15%

- 14.5% average annual growth in China for the past 10 years vs. 3.9% annual growth in the US
- China's nominal GDP was 88% lower than the US in 2001, but only 74% lower in 2010.



The RMB has appreciated 25.6% since 2000

- The value of the Chinese Yuan started to increase against the US dollar in 2007, and its value has risen 15% since then.

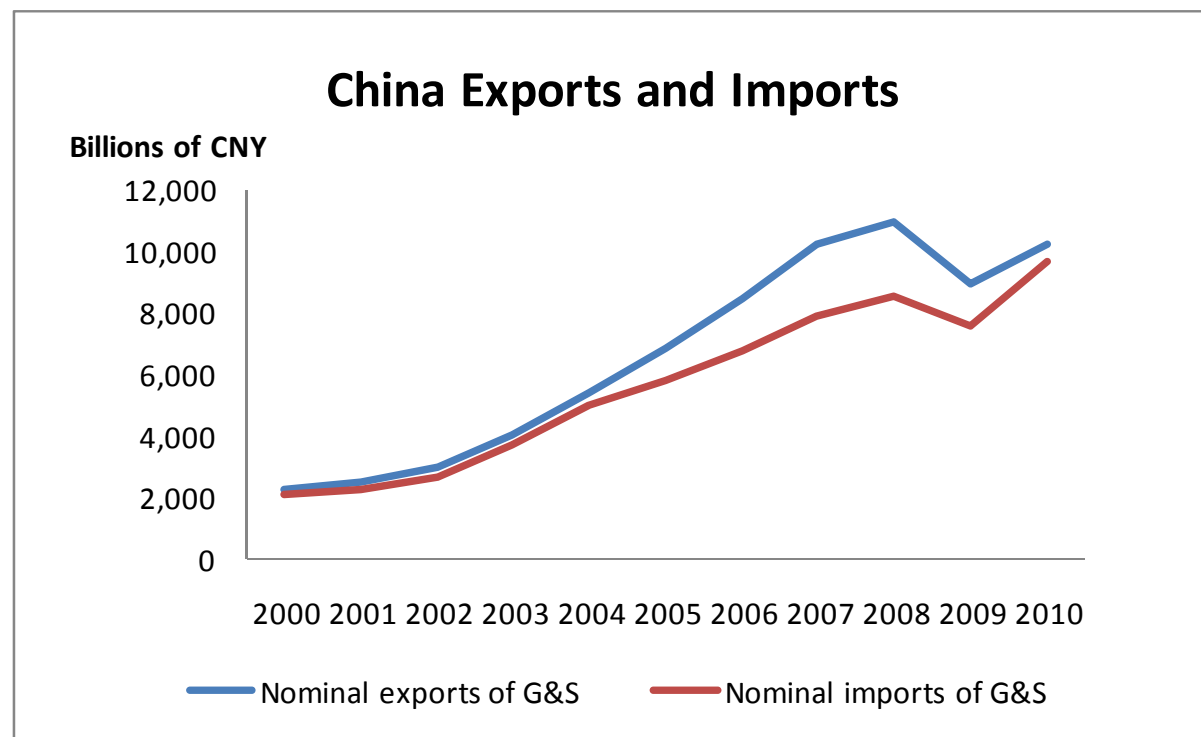


China and US Trade



Chinese exports have tripled in value since 2000, increasing to 27% of China's GDP in 2010

- Chinese exports reached \$1.5t in 2010, with an average annual increase of 13% in the past 10 years.
- Exports as a percentage of GDP increased from 23% in 2000 to 27% in 2010



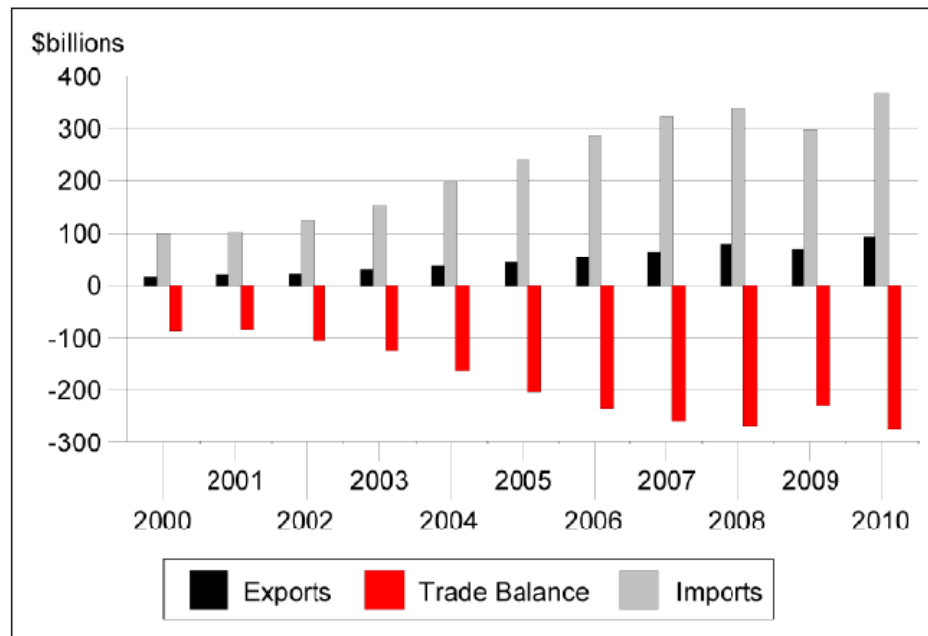
Source: Boston Strategies International analysis of data from EIU



US-China trade

- Total US-China trade rose from \$2 billion in 1979 to \$459 billion in 2010.
- China is currently the US's second-largest trading partner, the third-largest export market, and the biggest source of imports for the US.

Figure 1. U.S. Trade With China: 2000-2010



Source: U. S. International Trade Commission DataWeb.

Note: Data for 2010 estimated, based on January-October 2010.



Trend: from low value products to technologically advanced products

- Between the 1980s and 1990s, almost all Chinese exports were low value, labor intensive products, such as toys, footwear, and textiles.
- Advanced technology products (ATP) accounted for 30% (\$90b) of total Chinese exports to the US in 2010, up from 19% (\$29b) in 2003. Chinese exports represented 30% of total US ATP imports, up from 14% in 2003.



Major US-China Trade Issues

- A manipulated currency policy distorts the Chinese Yuan's value.
- Health and safety concerns for certain Chinese products
- China has failed to fully meet its obligations to the WTO
- Chinese government required producers to source from local suppliers to promote development of certain industries



A brief history of China's currency policy

Year	Policy	Appreciation
1994-2005.7	Pegged its currency to the US dollar at about 8.28 RMB/USD	0%
2005.7 - 2009.7	Moved to a “managed float” based on a basket of major foreign currencies	21.1%
2009.7 - 2010.6	Halted appreciation and kept exchange rate relatively constant at 6.83 RMB/USD to limit the impact of global recession	0%
2010.6 - present	Began to let the RMB appreciate again but committed to keeping fluctuations incremental	3.5%



Will a fast increase in the RMB bring jobs back to the US?

- Chinese imports will become more expensive, increasing component costs for US manufacturers
- It takes time and money to re-establish another low cost supply chain to maintain current margins.
- US-based manufacturers won't return to the US market for procurement, and they will search for options in South Asia or other low-cost developing regions.
- A sharp increase in the RMB won't benefit either the US or China



Health and safety concerns about Chinese products

- China's record of enforcing health and safety regulations and standards for food consumer products, and medicines is poor
 - Some imported toys from China contained dangerously high levels of lead and cadmium (toxic chemicals used in paint)
 - In 2007, certain toothpaste products from China was found to contain poisonous chemicals.
 - In 2007, the FDA recalled over 150 brands of pet food from China, believing that it caused the sickness and deaths of numerous pets in the US.



China's issues with WTO compliance

- Failure to enforce intellectual property rights effectively, especially for products such as movies, books, and music
- Industrial policies and national standards that promote Chinese firms
- Discriminatory and unpredictable health and safety rules on imports (especially agricultural products)



Protectionism & Industrial policies

- 70% of China's R&D is government-funded
- As government procurement favors domestic firms, it's almost impossible for any non-Chinese companies to participate in the government procurement market
 - Eg. Turbine production



Is China Still an Attractive Market for You?



Understanding Chinese consumer behaviors and wealth distributions

- Chinese love savings
- Chinese consumer view US-made products
 - High quality, high price
 - A symbol of wealth
- Wealthy population is concentrated in the East coast, Yangtze Delta and Pearl Delta



Urban income does not support increased spending

- Disposable income : RMB 17 trillion, 44.5% of GDP
- 76% of total income goes to mortgage, retirement and education.
- 39% of businesses are in major high growth areas
- Total disposable income in developed areas: RMB 1.6 trillion



Extremely high housing prices incent savings

- Housing payback period (Housing price / Annual Wage) is 29 years in China – the same ratio is 10 in the US
- Chinese consumers need to save more to afford a home

City	Average Housing prices	Average Personal Income	Payback period
Beijing	1,978,101	56,075	35
Shanghai	1,849,441	64,200	29
Shenzhen	2,125,794	63,360	34
Hangzhou	1,537,186	59,760	26
Nanjing	927,568	45,360	20
Average	1,683,618	57,751	29



The student loan market is immature

- Most families pay for their children's tuitions and living expenses in college from personal savings
- Government-subsidized student loans are almost the only ones available
- Only 12% of students in Guizhou Province secure student loans, the highest student loan ratio in China



Weak social security and health care systems

- China started building its social security system no more than 20 years ago and the pool is not large enough to handle the large amount of aging population
- Due to the privatization of a large number of the state-owned enterprises, many Chinese citizens lost their previous “free coverage” for health care insurance.
- Most private employers do not provide health insurance for their employees.



Chinese consumers and corporations save more than 50% of their total income

- Low consumption and high savings
 - Private consumption spending accounts for only 37% of GDP in China vs. 71% in US
 - Gross national saving rates: 54% in China vs. 9% in US
- Chinese consumer behavior rationale
 - High housing prices
 - Weak social security and health care system
 - Immature student loan market



The Chinese upper middle class is small

- Only 1.5% of the Chinese households (20m) can afford US living standards
- A typical upper middle class Chinese family has \$15.5k for expenditure
 - Expenditure is defined as income left after tax payment, mortgage payment, retirement and education savings.



Exchange rates will determine Chinese disposable income

- Based on 9% annual GDP growth and no change in exchange rates, China will have 27m middle class households with \$20k in disposable income in 2015
- If the exchange rate increases a cumulative 25%, there will be 36m middle class households in China in five years, each with \$20k of disposable income



Marketing strategies for China

- Focus on establishing brand recognition and creating luxury feelings for consumers
 - Market for American-branded products is large, but it takes time to build brand recognition
 - Competition with other foreign companies is intense in consumer goods and household durable goods
 - Market for American-made products is small and concentrated in urban areas because the goods are more expensive (due to higher labor costs)
- Emphasizing “healthy”, “natural” and “premium quality” concepts
 - Lower middle class Chinese consumers are willing to pay high premium for imported health products and children’s food.



How to Sell to China

- Fully understand the Chinese market
 - Competition is stronger for low-cost goods, requiring a higher degree of product differentiation
 - High-tech goods face more government regulations
- Find the right partner
- Take advantage of government incentives to encourage joint ventures and direct investment from foreign companies , which differ by region



Should You Continue to Buy from China?



Source high tech products from the East coast and labor intensive products from the West

- Source technologically advanced products from the East coast of China to leverage its growing highly educated labor force
- Source labor-intensive products from inland China – The wage difference between inland cities and those on the east coast is 3-5X



Conclusion

- No rapid changes in trade conditions due to a smooth RMB appreciation policy
- A big market for American-branded but locally made products
- A small market for American-made luxury products.
- Establishing strong brand recognition is essential to enter the Chinese market .
- Source technologically advanced products from the East coast.
- Source labor-intensive products from the West.
- An efficient supply chain is the key to a successful low-cost strategy



Thank You!

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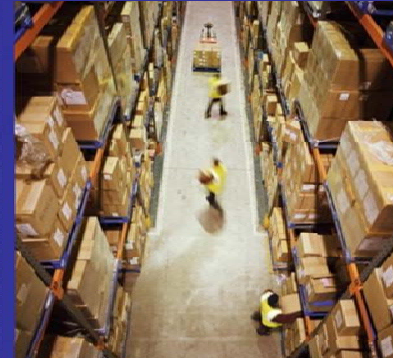
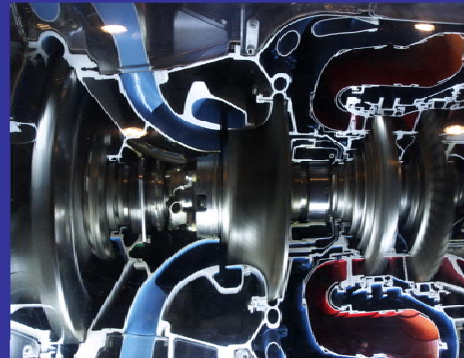


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