

# ***China Briefing: The Growing Opportunity***

## **A look at China's economy, consumer market, floor covering demand and logistics channels for the floor covering industry**

### ***Fast Facts:***

- ❖ *Retail sales in China amounted to nearly \$2.1 trillion in 2010, nearly one half of the US retail market.*
- ❖ *China is the second largest luxury market in the world.*
- ❖ *Chinese consumption will reach \$16 trillion by the end of this decade making China the largest consumer market in the world.*
- ❖ *Between 1.6 billion and 1.9 billion square meters of new floor space will be needed each year between now and 2025 to accommodate China's urban migration. This yearly increase is the size of the entire US market.*
- ❖ *US exports of floor covering to China increased by 36.8% in the first eight months of 2011.*
- ❖ *Floor covering is viewed as a building material, not as a decoration in China.*
- ❖ *Most floor covering is retailed and installed by manufacturers.*
- ❖ *China's floor covering market in 2011 was estimated at 42 billion square feet.*

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# The growing opportunity in China

## A Brief for the Floor Covering Industry

**Introduction** The rate and duration of China's economic rise is unprecedented in human history. New cities housing millions of people now stand over what was farm land only a few years ago. While much of the world suffers economic paralysis, China continues its economic climb and will soon become the world's largest economy. The only question is when it will happen, not if.

The USA has been slow to recover from the housing downturn. The American floor covering industry has contracted 30% over the last three years while China's flooring industry is growing at the rate of 15% per year. Catalina Reports estimates that China's floor covering market was 42 billion square feet in 2011, more than twice the size of the US market which is estimated at 17.6 billion square feet. The opportunity and future need for floor covering is so large it's staggering, even difficult to calculate.

While millions of Chinese remain poor, hundreds of millions will see their disposable incomes grow dramatically in the next few years. The government has targeted increased consumerism and development of Tier 2 and Tier 3 cities in the Western and Central regions as two major goals to be accomplished in the 12<sup>th</sup> Five Year Plan (2011-2015). Economic growth and increased consumption will require improved logistics to get products to the new consumers. China is focused on addressing the weaknesses in the existing logistics and distribution system to enable the country to meet the challenges it has set out for itself in the current Five Year Plan.

The new market and spending power due to China's rising consumerism holds enormous potential for manufacturers around the world but many do not know how to enter the market or even where to begin an investigation. There are many international companies already operating inside China. China has grown to be General Motors' largest market and yet other foreign companies have failed. Hard lessons were learned by Best Buy and B&Q which have closed all of their stores in China. It gives pause to those considering this foreign market. Why do some fail and others prosper?

Some fail because they simply don't understand the Chinese market, others because they have an inappropriate business model, still others fail to navigate the many unique hurdles the Chinese market offers, everything from government regulation to poor logistics. Entering the Chinese market will be challenging and will require overcoming unanticipated difficulties. The best way to mitigate these difficulties is to study and understand the market dynamics that are currently in place and a through a willingness to listen, learn and change along the journey toward success

This report is the most definitive overview of the Chinese floor covering industry to date. The questions we set out to answer in this year's research project are: Is there enough consumerism growth in China's residential market to create a viable opportunity for new flooring companies? How do Chinese consumers buy flooring? What is the status of the country's logistics channel and how does product get to market? What is the best way to learn about the Chinese culture, market and industry players? While this paper does not seek to provide definitive answers for any individual's approach to the Chinese market, it does provide an authoritative view of critical factors companies must consider when assessing whether and how to participate in the world's fastest growing economy.

## Table of Contents

Introduction	2
<b>1. China's rapid economic advancement</b>	4-6
<i>GRAPH</i> : Historical Ranking by Nominal GDP	4
<i>GRAPH</i> : World GDP Growth Rates by Country	5
China's consumer market	5
China's luxury market	6
Portrait of a Chinese consumer	6
<b>2. China's floor covering market</b>	7-11
The great urbanization	7
China's increasing demand for floor covering	8
<i>Figure 1</i> : China's Population Density	8
<i>Figure 2</i> : Overview of China's Five Year Plans	9
<i>Figure 3</i> : The Hykou System	9
<i>Figure 4</i> : China's Geographic Regions	10
Focus on sustainable building and products	11
<b>3. China's retail channel and performance</b>	12-15
More emphasis on what goes in the home	13
Importance of brands	13
Retail lessons learned	13
<b>4. China's retail flooring channel.</b>	15-20
Manufacturer owned retail flooring stores	16
Home design and flooring malls	17
Stand-alone flooring retail stores	18
Decorating centers	18
Department stores	19
E commerce	19
<b>5. The state of China's logistics channel</b>	20-24
How product gets to market now	22
Roads	22
<i>Figure 5</i> : china's highway system	23
Rail	23
Air and sea	24
<b>6. Channel options</b>	25-29
<i>Figure 6</i> : Channel Functions	25
OEM	25
Partnerships – Foreign Investment Partnerships	26
Independent distributors	27
The Challenges of doing business in China	27
Agents	27
Owning retail stores	27
Finding Guides	28
Getting Started	29

# 1. China's rapid economic advancement

**The speed of China's economic advancement is unparalleled in recent history. The statistics are mesmerizing, which may explain why some are slow to believe that it is real or sustainable. The memory of Mao's uniformed masses and starving peasants seem to persist in some people's image of China. The fact is that "old China" is gone. The real question is if the "new, advanced China" can be sustained, and, for the rest of the world, the question is how it will be affected.**

The Chinese government has shifted its focus from an export led economy to increasing its domestic consumption and becoming the world's market place. Guided by a series of five year plans, China has made remarkable progress. In 2011, China began its 12<sup>th</sup> Five Year Plan with a major shift in emphasis towards domestic matters. Some of its goals include increasing domestic consumption, improving the lives of its citizens and preserving resources. China's intent is to assure a happier society and support for the government. The focus to improve people's lives creates a massive, new consumer market with both opportunities and challenges for the rest of the world.

China's blend of communism, free market and centralized decision making has allowed it to move significantly faster than the Western world. Over three decades China has shifted from a centrally-planned to a market-based economy growing at an average rate of 9.7% per year. Between 2003-2007, China's growth averaged about 11% per year. With most of the world's economies suffering from recession, in 2010 China's GDP grew 8.7% (10.3% when adjusted for inflation as shown in the chart on page 5). This was its lowest annual increase in GDP in five years. Accounting for 17% of the world's total GDP, China is second only to the US (18.3%) and ahead of the Euro zone (13%) and Japan (5.3%).

When China became a member of the World Trade Organization in 2001, its exports were valued at \$509 billion USD; it was dubbed "the World's Factory." By 2006, its exports grew to \$2,173 billion USD. Today, China exports nearly \$3 trillion USD in goods. It is now the world's largest exporting country and that probably won't change, even as it shifts its attention to domestic consumption.

In 2010 China became the world's second largest economy, surpassing Japan, and in 2011 it surpassed Japan again as the second largest luxury market. It is projected that China could overtake the US as the world's largest economy as early as 2012

## Historical Ranking by Nominal GDP

1990	China was not among the top 10
1995	China was the 8th largest world economy
2000	China was the 6th largest world economy
2005	China was the 5th largest world economy
2010	China was the 2nd largest world economy

Source: World Bank

In terms of GDP growth rates, today emerging markets are out pacing the largest economies. The US, the world's largest economy, is ranked 127<sup>th</sup> in GDP growth on an annual basis when adjusted for inflation. Germany is ranked 110<sup>th</sup> while China is 6<sup>th</sup>.

**Imports.** China ranks third in the world in imports with 1.37 trillion USD in goods imported in 2010 - ahead of Germany, Japan, France and the UK. China's import market is exceeded only by the US with 1.935 trillion and the European Union at 1.690 trillion, according to the CIA's world fact book.

**Exports.** China's exports exceeded 1.5 trillion USD in 2010 ahead of Germany with 1.303 trillion and the US with 1.289 in exports.

In spite of these economic facts, many still perceive China as a "poor country." Indeed, there is much poverty in China, especially when compared to its most direct economic competitors. Its average per capita income in 2010 was merely \$4,000- \$6,000 USD. (This figure varies widely by source and methodology). But the low income bracket is obviously not the target for Western companies. The middle class in China has a much larger disposable income.

## China's consumer market

*Forbes* reports that in 2010 China's consumer market was estimated to be worth \$1.7 trillion USD and Credit Suisse projects that will swell to \$16 trillion by the end of this decade.

The National Academy of Social Science in China estimates that 23% of China's 1.3 billion citizens, or roughly 300 million, are now among the middle or higher income classes with enough money to purchase

### GDP GROWTH RATES

World GDP Comparisons by Country by %					
1	Qatar	16.3	64	Chile	5.3
2	Paraguay	15.3	65	Burma	5.3
3	Singapore	14.5	66	Uganda	5.2
4	Taiwan	10.8	67	Isle of Man	5.2
5	India	10.4	68	Chad	5.1
6	China	10.3	69	Liberia	5.1
7	Turkmenistan	9.2	70	Egypt	5.1
8	Congo, Republic of the	9.1	71	Sudan	5.1
9	Sri Lanka	9.1	72	Azerbaijan	5
10	Zimbabwe	9	73	Kenya	5
11	Peru	8.8	74	Sierra Leone	5
12	Botswana	8.6	75	Turks and Caicos Islands	4.9
13	Uzbekistan	8.5	76	Pakistan	4.8
14	Uruguay	8.5	77	Mauritania	4.7
15	Nigeria	8.4	78	Bermuda	4.6
16	Turkey	8.2	79	Nepal	4.6
17	Afghanistan	8.2	80	Israel	4.6
18	Maldives	8	81	Djibouti	4.5
19	Ethiopia	8	82	Sao Tome and Principe	4.5
20	Yemen	8	83	Nicaragua	4.5
21	Thailand	7.8	84	Mali	4.5
22	Dominican Republic	7.8	85	Suriname	4.4
23	Laos	7.7	86	Namibia	4.4
24	Zambia	7.6	87	Colombia	4.3
25	Belarus	7.6	88	Costa Rica	4.2
26	Argentina	7.5	89	Bolivia	4.2
27	Niger	7.5	90	Oman	4.2
28	Panama	7.5	91	Libya	4.2
29	Lebanon	7.5	92	Senegal	4.2
30	Brazil	7.5	93	Ukraine	4.2
31	Philippines	7.3	94	Brunei	4.1
32	Congo, Democratic Republic of the	7.2	95	Bahrain	4.1
33	Malaysia	7.2	96	Slovakia	4
34	Mozambique	7	97	Kosovo	4
35	Kazakhstan	7	98	Mauritius	4
36	West Bank	7	99	Russia	4
37	Papua New Guinea	7	100	Burundi	3.9
38	Moldova	6.9	101	Japan	3.9
39	Vietnam	6.8	102	Poland	3.8
40	Hong Kong	6.8	103	Andorra	3.8
41	Bhutan	6.7	104	Tunisia	3.7
42	Malawi	6.6	105	Saudi Arabia	3.7
43	Tanzania	6.5	106	Malta	3.7
44	Tajikistan	6.5	107	Guyana	3.6
45	Rwanda	6.5	108	Albania	3.5
46	Georgia	6.4	109	Curacao	3.5
47	Niue	6.2	110	Germany	3.5
48	Seychelles	6.2	111	Guinea-Bissau	3.5
49	Timor-Leste	6.1	112	Luxembourg	3.4
50	Korea, South	6.1	113	Togo	3.4
51	Indonesia	6.1	114	Central African Republic	3.3
52	Mongolia	6.1	115	Algeria	3.3
53	Gibraltar	6	116	Syria	3.2
54	Cambodia	6	117	United Arab Emirates	3.2
55	Bangladesh	6	118	Ecuador	3.2
56	Burkina Faso	5.8	119	Morocco	3.2
57	Ghana	5.7	120	Estonia	3.1
58	Gambia, The	5.7	121	Finland	3.1
59	Gabon	5.7	122	Jordan	3.1
60	Solomon Islands	5.6	123	Canada	3.1
61	Mexico	5.5	124	American Samoa	3
62	Sweden	5.5	125	Guernsey	3
63	Cape Verde	5.4	126	Cameroon	3
			127	United States	2.8

Source: CIA World Fact Book

middle class goods such as cars, computers, flooring and furniture. While forecasts for the future size of the middle and higher income classes swing widely, many estimates say the middle class will hold roughly 350 million consumers by 2015 and as many as 700 million to one billion by the end of this decade. Whatever the figure, everyone agrees the consuming class of China will be massive. The Chinese already buy more cars, diamonds, cell phones and computers than the rest of the world; in fact, more middle and upper-end French wine is sold in China than in France.

It's easy to understand why some people have a hard time accepting such astounding consumer numbers from a country that has, in many respects, just barely entered the modern age. The question is not whether the country is poor or rich but rather how many people have money to spend. Due to the sheer magnitude of people even a small percentage with moderate purchasing ability creates a huge market opportunity.

## China's luxury market and consumers

China is already the second largest luxury market in the world and Chinese shoppers are expected to spend \$15.6 billion USD in 2011, according to the China Market Research Group in Shanghai. The number of China's wealthy is difficult to pin down, but according to The Julius Baer Group, a Swiss private banking concern, there are now at least 960,000 people in China worth more than \$1.5 million USD; that is up 9.7% from 2010. There are 271 billionaires, up from 189 last year. This puts China behind only the US in the billionaire count (413 in the US). McKinsey estimates there will be about four million wealthy households in China by 2015 while Asia's leading independent brokerage and investment group estimates that by the end of this decade, China's share of the global luxury market will exceed the US share by 45%.



*Louis Vuitton flagship store in Shanghai*

## Portrait of the Chinese consumer

After surveying 132 multinational companies doing business in China, the American Chamber of Commerce in China painted a broad brush picture of the Chinese consumer. It describes the core consumer this way:

*He or she will be between 21 and 40 years old, live in Tier 1 or 2 cities and earn a middle class income between \$1,583 and \$7,915 per month. In addition, the new Chinese consumer is Internet-savvy and will have grown up in the era of market liberalization and globalization, while having avoided the hardships of previous generations. As a result, he or she is more confident and bold, more self indulgent and indulged (if they are under 30, they probably have no siblings and were the focus of family life in their homes) and more likely to spend money on travel and leisure pursuits than their parents, who probably viewed such activities as unaffordable luxuries.*

The wealthy consumers in China are about 20 years younger than in the US and Japan giving retailers a longer window to tap into the purchasing power of this group.

China has an ingrained “two-class” culture that is perpetuated by the Hukou System, a residency permit system that controls population growth and location. It is important to understand the Hukou system since it impacts everything from the variability of reported statistics to the availability of inexpensive labor. (See Figure 3 The Hukou System). In some data, such as purchasing power, the lower class may not be included since they have little money to spend. Likewise, “grey money” (unreported income) is common but not taken into consideration when estimating purchasing power. Regardless of who or how the counting is performed, no one denies that the middle class is large and will get much larger.

## 2. China’s floor covering market

According to Stuart Hirschhorn, president of the Catalina Reports, **the Chinese** domestic floor covering market dwarfed the US market in 2011 with an estimated 42 billion square feet of flooring sold vs. the US which is estimated to have been 17.6 billion square feet. Consumption in the US is 56 square feet compared to 32 square feet in China.

Another major difference in the markets is the average price per square foot of flooring sold. The high percentage of low-cost ceramic tile that makes up the preponderance of the Chinese market drives the overall average cost of flooring in China down to \$0.60 a square foot compared to \$1.00 in the US.

**China’s flooring market by product type in billions of square feet**

Ceramic tile	75%	31.5 billion sf
Carpet and rugs	9%	3.78 billion sf
Resilient	5%	2.10 billion sf
Wood and bamboo	4%	1.68 billion sf
Laminate	4%	1.68 billion sf
Stone	3%	1.26 billion sf

Source: Catalina Reports

Wood flooring’s market share has been increasing by about 7% yearly since 2008 and is desired by new home owners. Carpet is largely used in the commercial hospitality market. Resilient flooring, while making up only 5% of the market still represents over 2 billion square feet. One major Chinese resilient manufacturer stated that China cannot keep up with the growing demand for resilient flooring. A major driver in the growth of the Chinese flooring market is its continued urbanization and resulting construction boom.

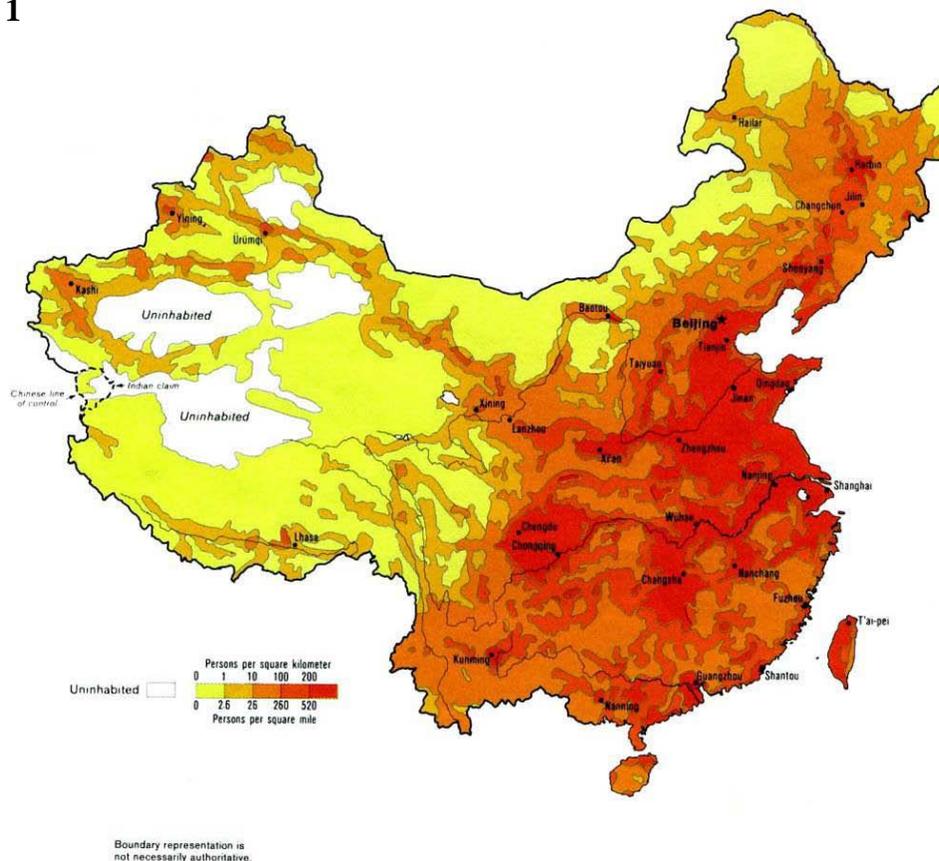
**The Great Urbanization** - a systematic relocation of people from rural to urban centers is fueling the rise in consumerism, a construction boom and increasing demand for floor covering.

In 1980, about 20% of China's population lived in cities. Today, 47% or roughly 660 million people live in cities. This migration is redistributing some of China's population into the Central and Western regions and into new satellite cities outside urban centers. This is one way in which China is increasing its domestic consumption – by moving rural dwellers to cities for better jobs and living conditions. This massive urbanization requires equally massive new infrastructures of every kind.

Most people have heard of Shanghai, Guangzhou and Beijing but there are hundreds of very large cities that are not as familiar. Many of these are brand new, built within the last five years, or are urban centers not classified by the government as cities. In its 2008 study, McKinsey Global Institute found 195 such urban centers that were not on anyone's radar screen. McKinsey estimates that by 2025, 221 cities will have populations of 1 million or more; 23 with over 5 million and 8 mega cities with over 10 million. Compare that to Europe today which has only 35 cities of a million or more.

China: Population Density

Figure 1



## Figure 2: Overview of China's Five Year Plans

Since 1953 China has set forth its development strategy in a series of Five Year Plans, each focused on detailed economic development guidelines for all of its regions. In its 11th Five Year Plan (2006 - 2010), China set forth a "people centered" strategy aiming to achieve a "harmonious society" that balanced economic growth with distributional and ecological concerns. Under this plan, considerable progress was made to improve basic public services, social protection, education and health, but structural issues remained.

Partly due to global economic weakness, the 12th Five Year Plan (2011 - 2015) turns its focus inwardly to a more domestic pattern of growth. The Plan has five main objectives:

- Maintain stable and fast economic growth and create more jobs;
- Increase domestic consumption and urbanization, reduce energy use and carbon emissions;
- Increasing incomes, reduce poverty and improving the living standards and quality of life;
- Improve access to basic public services, increase education levels, develop a sound legal system, and ensure a stable and harmonious society; and
- Improve efficiency of government and further integrate into the world economy.

[Source: The World Bank](#)

## Figure 3: The Hukou System

Unlike the Western world where people migrate at will to find jobs, China uses an ancient residency permit process called the Hukou System to control and direct population migration. The government can advise companies to open in a new or underdeveloped region and then guarantee workers by only authorizing living permits in that area. Anyone seeking a higher paying manufacturing job must have that authorization to relocate. iPhone manufacturer Foxconn is an example of how the government can direct growth inside China. Foxconn is building new manufacturing facilities inland where labor will be less expensive and thus bring 200,000 new jobs to less developed areas. The government will facilitate Foxconn's efforts by authorizing permits to workers interested in moving for better paying jobs.

Another impact of Hukou is that it perpetuates a two class system in China. One is a growing urban class whose members have basic social welfare and full citizenship; the other, an underclass of migrant workers with neither of those privileges. They may inhabit a city but are not counted among the urban population. This is why population statistics can often be skewed. A city of 10 million may actually have 15 million with 5 million uncounted migrant workers living in slum-like conditions.

Research indicates this group of migrant workers could total 160 million people who earn meager wages and have little chance of legally settling in that urban area. These people are not counted in consumer market statistics. They are counted in national population statistics which lowers the average annual income figure.

The Hukou system creates a pool of cheap labor which provides the Chinese with people who will perform menial tasks inexpensively. This impacts retailers by virtually eliminating **Do It Yourself**, a lesson that was recently learned by Home Depot and B&Q. If someone can afford the product, they can afford the labor to have it installed.

## China's increasing demand for floor covering

Between 1,600 million and 1,900 million square meters of new floor space will be needed each year between now and 2025 to meet the needs caused by the urban migration. This yearly increase is the size of the entire US floor covering market. *Floor Covering Weekly* reported the US floor covering market was 1,653 million square meters in 2010. Here's how McKinsey, who studies China's growth and business development, describes it:

**“By 2025 cities will construct 40 billion square meters of floor space in 5 million buildings, of which up to 50,000 will be skyscrapers – the equivalent of building up to two Chicago's every year. The incremental growth alone in urban China's consumption between 2008 and 2025 will be the equivalent to the creation of a new market the size of Germany's in 2007.”**

That's a staggering demand. Every square meter of floor space will need floor covering.

**Figure 4: China's Geographic Regions**



*China already has more than 150 cities with populations of more than one million and could have as many as 221 cities with one million or more people by 2025, according to the McKinsey Global Institute.*

## Focus on sustainable buildings and products is increasing

Anyone considering entering the market in China with a building product such as flooring must consider the importance of sustainable products to the massive commercial building market.

China was recently referred to in the *New York Times* as the world's "green incubator of architectural ideas." A recent example of green building design is the Vanke center (bottom left), a combined office, hotel, and exhibition complex in Shenzhen. It received a "platinum" rating (the highest) by LEED, the internationally recognized building certification system.

The Wuhan New Energy Institute and Exhibition Center (bottom right) is a new project of 70,000 square meters in the Wuhan Future City development zone in Wuhan, China. The tower will be surrounded by five laboratory buildings and an exhibition center. The combination of [BREEAM](#)-international New Built label and a 3-STAR award of the Chinese Green Building Evaluation Label implies this building will be one of the world's most sustainable office-towers in the world. The building will be both zero carbon and zero energy and includes many other green building strategies.

China has a long way to go to combat pollution, a point recognized by China. The government, businesses and the people are all very focused on actions to improve the environment.

*Sustainable development – economic growth that improves lives without polluting the environment or exhausting natural resources – is an especially serious matter in developing countries. China knows it has no choice but to embrace environmentalism.*

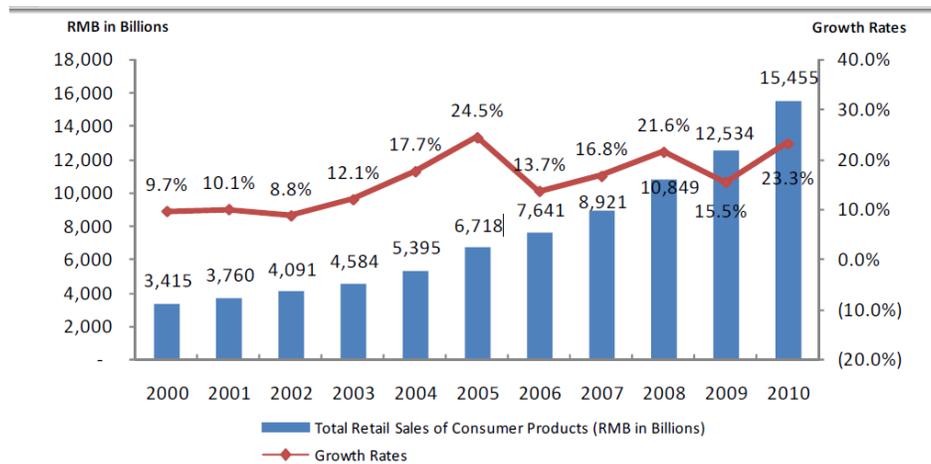


### 3. China's retail channel

Although experts thought inflation would throw a cloud over China's retail sector in 2011, latest figures published in December 2011 indicate China's retail sales increased 16.3% in the first quarter of 2011 while GDP expanded 9.7%. Investment firm Thomas White expects retail sales to double in the next three years.

#### China's retail performance

Retail sales in China amounted to nearly \$2.1 trillion (15.45 trillion RMB) in 2010, nearly one half of the US retail market. According to the Ministry of Commerce, this represented year on year growth of 18.4%



Source: National Bureau of Statistics of China

Despite the challenges of doing business in China, more than half the world's global retailers are now conducting business there. Many American companies have been very successful; GM reports China is its biggest market; Starbucks operates 500 stores in 42 cities across mainland China and plans to expand that to 1,500 in three years.

The most recent published survey of the American Chamber of Commerce in Shanghai reports US companies had their best performance ever in 2010 with revenue, profitability and market share up sharply from 2009. In fact, nine of out 10 US companies in China forecast a revenue increase for 2011.

#### **Among the report's highlights:**

87% of US companies in China reported revenue growth in 2010, surging from 47% in 2009;

79% of US companies say they are operating profitably in China, up from 65% in 2009;

61% of US companies in China state they have increased their market share for China products and services, up from 40% in 2009.

## China's change places more emphasis on what goes in the home

Not long ago most homes in China were small and rudimentary; densely populated apartments providing families with space to sleep. Gatherings and parties generally took place in private rooms at local restaurants, almost never at home. As the middle and upper classes grow, their new living space creates a major change in lifestyle. They now have room to entertain and that means they not only need more products for their home but the quality and type they buy has taken on new importance. Their home now reflects their new lifestyle and affluence. Felix Tang, head of Brands Development for Tahohya explained that "HomePar", the new slang term for home party, is becoming a retail driver. As home sizes increase, entertainment increases. Living spaces need to be designed for parties as well as reflect the personality of the host. Successful young business people see this as an opportunity to express themselves and floor covering is an important element in that interior space.

## The Importance of brands

Thomas Baert, president of China Floor, says that Chinese consumers trust American and European brands. Our research indicates that the Chinese would actually prefer to buy American and European brands. Many Chinese buyers prefer to buy from large companies with established brands. This is not just a cultural bias but is also due to the fact that many Chinese buyers are new to the buying process. It was only 20 years ago that market controls were loosened. Discounted and counterfeit brands are available in everything from cigarettes to automobiles. The current growth of consumerism and wealth has created many first-time buyers who are unfamiliar with having choices and purchasing relatively expensive items. While consumers want low prices, they also want to know they are purchasing the real thing and, therefore, feel more confident to shop in manufacturer branded stores. Baert underscores the importance of brands saying, "In China first you build a brand, then sales follow."

## Retail lessons learned

**Best Buy and Kingfisher (owner of B&Q) and Home Depot have learned that one cannot simply take a successful western retail model to China and expect it to succeed in that culture.** The words of Peter Drucker are sage marketing advice for anyone entering the Chinese market:

**"True marketing starts out with the customer, his demographics, his realities, his needs, his values. It does not ask, 'What do we want to sell?' It asks, 'What does the customer want to buy?' It does not say, 'This is what our product or service does.' It says, 'These are the satisfactions the customer looks for, values, and needs'."** - Peter Drucker

To illustrate some differences, here are some lessons learned by a few of the West's best retailers in China.

**Best Buy**, the world's largest retailer of electronics, withdrew its Western brand and western-styled stores from the Chinese market in February 2011. Best Buy loaded its stores with high quality, branded electronics and counted on its high quality service to justify higher prices and drive sales. It didn't work.



In America, service matters. Best Buy assumed that the same model would work in China. The Chinese found Best Buy's prices to be higher than other local vendors and had no appreciation for future service excellence. Service became secondary and purchasing decisions were made on price.

Selling expensive products is not the problem as proven by the fact that Chinese consumers pay 30% more for an iPod than in the US but that same price is charged at all stores. Five Star Electronics, a Best Buy subsidiary retailer in China, sold nearly \$4 billion USD in 2009, but it did not include a premium for Best Buy's service. The Chinese are very price sensitive when products are not differentiated, as in the case of branded electronics at Best Buy, a premium for service was not acceptable. The Chinese consumer wanted low price, not a "buying experience."

Closer to the flooring industry, the large European DIY retailer **B&Q**, owned by UK giant Kingfisher, learned a different lesson: After closing 22 stores in China, Ian Cheshire, CEO of [Kingfisher plc](#), explained that big-box DIY "is not the model for China." Rather it is a market where tradition dictates that consumers do not install product themselves. In urban areas (where the target consumer lives) it is culturally customary for labor to be performed by migrant workers. As one seasoned tile sales person explained:

*Despite the fact that we perceive China as a relatively "poor" country and associate it with "cheap" products, the Chinese are not DIY consumers.*

**"Poor people are the only people in China who would bother taking on a do-it-yourself home improvement project; who can't afford to hire China's abundance of cheap labor to do it for them? China's culture is Do It For Me, (DIFM) not DIY."**

## **Key Point: When it comes to home goods such as flooring, Chinese consumers are Do-It-For-Me customers.**

Another lesson learned from many sources is that Chinese consumers love American brands. Part of their interest is based on adopting the Western lifestyle; the other is a perception of quality. A designer who had just purchased flooring at a building materials mall explained why he didn't shop at Home Depot:

**"I went there expecting new and unique American products ... but most of what Home Depot sells is stuff made in China. Who cares about that."**

Despite their losses, none of the large retailers mentioned here plan to tuck their tails and run from China - the market opportunity is just too large. Best Buy bought the Chinese chain, Five Star Appliance, which it plans to expand to 800 - 1,000 stores in 45 Chinese cities within three to five years. Likewise, Kingfisher, owner of B&Q, announced a new approach targeting *Do It For You* which it will use to re-enter the market and focus on installed products.

### Examples of American brands doing well

Yum Brands has grown its KFC division into the largest restaurant chain in China because it adjusted its product to fit the market. There, KFC offers white rice and congee, two staples of the Chinese diet, alongside its famous fried chicken. Yum is opening new KFC restaurants at the rate of one per day.



Coffee giant Starbucks has been wildly successful in China in spite of the country's history and tradition with tea. The company has over 500 operating stores and says it is expanding to 1,500 in the near future. Starbucks' success, while counterintuitive, has been partly due to the appeal of foreign brands and a Western lifestyle.

These are examples of companies that have adjusted their brand to include attributes familiar and important to the Chinese consumer.

## 4. China's retail flooring channel

**In China, flooring can be purchased from retail stores and even the Internet, but similarities to Western markets stop there. There are no buying groups or home centers promoting flooring. The majority of retail stores are owned by flooring manufacturers who also install and service the floor.**

The retail channel in China is very fragmented with the 50 largest retailers accounting for less than 5% of the total market. When it comes to purchasing flooring there are a number of retail options but just like China itself, many of them are evolving as the market grows. **A major factor affecting where flooring is purchased is the fact that flooring is considered a building material, not a home decoration,** and as such is often grouped with plumbing fixtures and lighting.

Flooring manufacturer owned stores and home products/design malls are by far the largest retail outlets for flooring in China. It is also sold through stand alone retailers, department stores, decorator shops and the Internet. Manufacturer stores (Nature, Elegant Living, Power Dekor for example) can be stand-alone units or showrooms located within large, multi-story structures where other home products such as plumbing and lighting fixtures are sold. Some industry executives are questioning whether the number of manufacturer owned stores located in shopping malls has already exceeded demand.

## Manufacturer owned retail flooring stores

### The Evolution of China's retail flooring channel

In the 1990's, PowerDekor, the largest manufacturer of wood flooring in China, was receiving a high percentage of product claims due to poor installation or exaggerated performance promises made by its retailers. PowerDekor solved the problem by taking control of its product from raw material (it owns 250,000 acres of forest land) to end user by opening its own retail stores and selling its products installed. Today, PowerDekor is one of the largest wood flooring retailers in China with a nationwide distribution network servicing its own 2,700 retail outlets. Following PowerDekor's lead, other manufacturers either opened their own stores or began to franchise branded retail stores. Nature China Flooring claims to have over 3,000 retail stores in 1,600 cities across China. Companies like Elegant Living's Baroque brand, China Floors' Lamett brand and others have hundreds of branded retail stores that carry only that manufacturer's products.

The following is a sampling of the largest wood and laminate flooring manufacturers in China with their own retail stores. These stores may be stand alone or contained within large building products and design malls. In all, we estimate there are over 10,000 manufacturer owned retailers focused on wood and laminate flooring in China today.

**Nature** (China Flooring Holding Company Limited) bills itself as holding the largest share of the wood flooring market in China by retail sales value accounting for 6.5% of branded wood flooring products sold in 2009. Nature operates more than 3,000 retail stores.

**Power Dekor Group**, which manufactures laminate and wood flooring, has more than 2,700 retail stores. Power Dekor has a joint venture partnership with Anderson (US) and Kahrs (Sweden). They have OEM arrangements with Formica, Pergo and Armstrong, among others. It owns 100,000 hectares of forest plantation and seven HDF/MDF factories

**Elegant Living** (Samling), whose largest shareholder is Samling Global Limited, manufactures engineered wood flooring and in 2010 increased its outlets in China from 825 to over 1,000. Elegant Living enjoys a joint marketing effort with Mannington Mills (US).

**Lamett** (China Floors), which manufactures solid and engineered wood flooring, laminate flooring and luxury vinyl tile has approximately 200 retail stores in China.

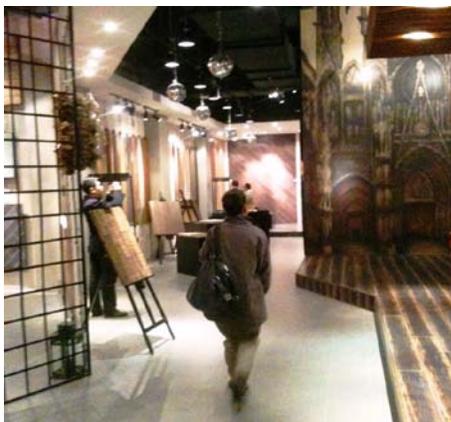
The wood floor covering industry in China is guided by the China National Forestry Products Industry Association which receives its guidance from the State Forestry Association. CNFPIA has over 1,000 institutional members within the forestry sector across China.

## Home design and flooring malls

As described above, single product stores are often located in department stores or mall settings, even large multi-storied buildings, in leased space. They are open to the public, targeting new homebuyers and designers. Some malls are extremely high end with atriums and glassed in elevators like the Global Furnishing Design and Exhibition Center in Pudong owned by developer Red Star Macalline. Entire floors are dedicated to a single product category and showrooms are upscale. Some Chinese flooring manufacturers question whether there are already too many flooring stores in these malls. After several visits to different locations, we concur that consumer traffic may not be sufficient, at least in the locations we visited, to sustain continued growth. This does not mean there isn't potential in other areas or tier two cities.



*The Global Furnishings Design and Exhibition Center in Shanghai is 10 stories tall with one entire floor devoted to flooring showrooms owned by manufacturers.*





## Stand-alone flooring retail stores

There are independent, stand-alone, floor covering stores in China mostly located in retail areas that specialize in building products. For example, in Shanghai there is a street called Yi Shan Lu (Lu means road) where several carpet and resilient stand alone stores are located with manufacturer's showrooms like the American company Kohler or the Spanish ceramic maker Roca.

In the middle of Yi Shan Lu is the Shiningmen Shopping Mall of Flooring and Timber where independent carpet companies F&X Carpet and Feng Ya Carpet exhibit next to showrooms of PowerDekor, Nature, Vohringer and Pergo to name a few. Some showrooms are run by manufacturers' agents like HiStep Healthy Living Ltd, which is the exclusive agent representing Quick Step, Karelia, ParKy, Egger, Lauson and Wicanders.



## Decorating centers

One of the fastest growing outlets for flooring is the decorating center. SiTrust Decorating Centers are located in 10 cities across China with 25 SiTrust locations in Beijing alone. Each center employs a staff of decorators who help buyers design the interior space of their homes for a fixed price per square meter of space. The design fee includes products and installation. One of their stores in Beijing is in a large three-story building where products are exhibited by product category. Products range from doors to toilets, furniture, flooring, wallpaper and drapes. Seven different laminate flooring manufacturers were represented in addition to wood flooring, an important segment of their total business.

In this case, manufacturers supply the installed material to the consumer and invoice the decorating center which collects from their customer. This type of floor covering retailer represents a very small percentage of the market today but appears to be quickly growing in popularity.

## Department stores

In China, most department stores are an accumulation of rented spaces under one roof, more like a Western shopping mall than a Western department store. The building owner leases spaces to retailers and either collects rent from tenants or collects a commission from tenant sales under concessionaire agreements. Under these two schemes, the department store does not take title to the goods or provide services such as marketing or centralized payment.

In these locations it is not uncommon to have multiple vendors with identical products competing next door to one another. HomeValue, for example, is a five-story building housing independent floor covering shops like Feng Ya Carpet that imports Horizon carpet made in the USA purchased through an agent in Hong Kong. In the same building, other flooring manufacturers sell their products directly to the customer.

Chinese high-end department store giant, Parkson, caters to the middle and upper class buyers relying heavily on recognized luxury brands in western-style high-end format. When asked if it had considered carrying floor covering, including high-end hand knotted rugs, its response was a resounding “No! Flooring is a building material, not a decoration.” Not all department stores would have the same response but then not all are like Parkson.

Likewise, Tayohya, a home products store modeled after Crate and Barrel, with 30 shops in Shanghai and 500 throughout China, has no plans to carry floor covering. Although neither chain carries flooring, visiting with the buyers revealed interesting changes in consumer life styles. An example: at Tayohya just a few years ago one of their best selling items was the shower curtain. Now Chinese bathrooms are glassed in and do not use shower curtains. They refer to this style transition as “Chinese co-fusion” rather than Western. It is an indicator of how quickly consumer preferences are changing and why manufacturers have to stay in tune with the consumer.



## E-commerce

The easiest way to access global product knowledge is the Internet. While the Chinese government exerts some control over the news, electronic commerce is alive and well with 420 million Internet users and growing by the minute.

It is impossible to know how much flooring is sold over the Internet in China but we know that the Internet is becoming an increasingly important channel in China's retail picture.

According to iResearch, online retail sales in China reached 498 billion RMB in 2010 and accounted for 3.2% of total retail sales of consumer goods. It is expected to climb to 5.3% by 2012. China's Chain Store & Franchise Association reports that 34 of the top 100 retail chain owners started offering online shopping services in 2010 helping e-commerce rise 22% that year.

As consumption grows in cities away from the developed Tier 1 cities, Internet sales will be one solution to address the stark regional differences in tastes and buying habits that makes maintaining inventory for a national chain in China difficult. Centralized inventory feeding e-commerce sales can meet all of the regional preferences. Parkson Department Stores predicts Internet sales could become 50% of its total business while Tayohya expects its current internet sales of 15% to grow to 25% in a couple of years.

## 5. The state of China's logistics channel

### How will the country meet the demand for logistics over the next five to 10 years?

Even though China is about the same geographic size as the US, the country's major manufacturing centers, wealthiest consumers, and five of the world's largest seaports, are all located along China's Eastern and Northern coasts. For that reason, complex logistics systems were not a necessity in the past. Now, the government's focus to increase consumerism and develop the Central and Western regions, creates the need to move large quantities of raw materials and finished products to and from the country's interior. Consequently, they are moving quickly to build and expand logistics systems and the pace is frantic to catch up with demand. As Andrew Hatherley, Executive Director of CB Richard Ellis Asia said, "At least short term there is an imbalance in supply (of logistics services) based on demand which could inhibit the growth desired by the government." The Chairman of China Federation of Logistics and Purchasing, the State's only approved large scale logistics organization, has commented that his government is "determined to cure its 'chronic disease' in logistics."

The push to improve logistics services has been underway for only a half dozen years. In 2005, the government opened the country to foreign logistics companies to establish wholly owned foreign enterprises. In 2009, the State Council issued the Plan on Restructuring and Developing the Logistics Industry. In 2011, with implementation of the 12<sup>th</sup> Five Year Plan, new guidelines were issued offering fiscal and administrative incentives to logistics companies.

In order to achieve the goals of the 12th Five Year plan, improving logistics became a national priority. Billions of dollars have been allocated from public and private sectors to rapidly improve the country's logistics infrastructure.

China's national transportation investment policy is closely linked to its trade and economic policy. China recognizes the vital role that transportation plays in meeting the needs of its urban growth and is investing approximately 9% of its GDP annually to expand its logistics and transportation systems.

***Identified logistics projects underway in China include:***

- ❖ Reducing logistics costs;
- ❖ Building six new rail lines totaling 17,000 km (10,563 miles); including
  - 6 railway transportation hubs;
  - 18 intermodal yards;
  - 40 container handling stations;
  - 150 intermodal substations;
- ❖ 1 million km (621,371 mi) of rural roads;
- ❖ Connecting all cities with more than 1 million people and 90% of cities with 200,000 to 1 million people to the national road network; and
- ❖ Improving and expanding 7 seaports.

Building infrastructure does not address all of the problems however. Weaknesses in the current logistics system center on transport and taxation; problems that are deeply rooted in the country's culture, geography, distribution of wealth and stage of development. Dr. Liang Huanlei, a business analyst at the Distribution Productivity Promotion Center of Chinese Commerce, has candidly said that the government's new guidelines are indeed comprehensive but when it comes to practice they may not be fully carried out.

Logistics costs currently represent between 18% and 20% of the total cost of product manufacturing and delivery, double that of the US and EU which run less than 10% of GDP. Of this amount spent on logistics, only 2.7% is spent on third party logistics (3PL) services compared to 30% in Western Europe and over 20% in the US.

One cause for high logistics costs is the 25% tax levied on logistics companies. This not only increases the cost of total logistics but discourages development of large national logistics companies. Businesses find ways to work around the system. Some establish in-house logistics departments to provide their own service without registering as a logistics company. Some small, local businesses work with their local government to operate "out of compliance," or receive refunds from the local government to reduce the amount of tax they pay while maintaining jobs for local citizens.

3PL contract logistics has been growing at the rate of 111% per year since 2009, according to Transport Intelligence, and it is forecasted that logistics revenue will continue to rise 110% per year through 2013.

The shortage of logistics professionals is being addressed by the Department of Supply Chain Management at Tsinghua University, considered the second best university in China. Fourteen professors in the department hold degrees from universities outside of China including MIT, Purdue, NC State, NY State and the University of Arizona. All classes are taught in English with 60 to 70 BS, MBA and PhD degrees issued each year. Graduates often find high level positions within the government's ministries focused on transportation and logistics.

Obviously there are ways to operate within the system while remaining competitive or companies like Wal-Mart, Ikea, Coca Cola and others could not operate so successfully in China. State owned

Sinotrans, the largest logistics company in China, often works with other large 3PL companies to develop programs to supply services to large multi-national manufacturers and retailers such as those listed above. They have established relationships with DHL and other international 3PL companies. Sinotrans' strength is handling commodities for the State such as oil and steel.

## How product gets to market now

To understand how product moves from importer or manufacturer to the consumer, we look at the various distribution channels as they exist now and are expected to evolve. In China the majority of logistics cost is spent on transportation rather than inventory, handling and warehousing.

China uses its vast waterways, seaports, roads and rail systems to move product but 75 % of freight in China is moved on its roads. There are approximately 700,000 logistics companies in China (compared to 7,000 in the US). The logistics and transport industry is so fragmented that the top 20 companies account for only 6% of the country's total logistics revenue. Most of the 700,000 companies are family owned businesses employing only their family members and transporting goods. They offer no other services.

Consumers focus on price rather than service to determine which company they use. In the Chinese culture, it is accepted that if the product does not arrive today it will be delivered tomorrow or the next day. There has been no need to spend money on a computer system that tells the customer where their package is at any given time. Low price rules.

Jeffrey Wong, KPMG Partner and specialist in logistics, explains that customers have not experienced highly sophisticated logistics services and therefore have low expectations. While computers supply efficient distribution systems, lower investment, bare bones organizations have lower operating cost resulting in lower prices in the short term. Until excellent service becomes an expectation, customers will continue to support low cost mom & pop delivery companies. Recently, Sinotrans discontinued its "express service" or small package delivery service they performed in partnership with DHL because it was unable to compete with smaller, low cost providers.

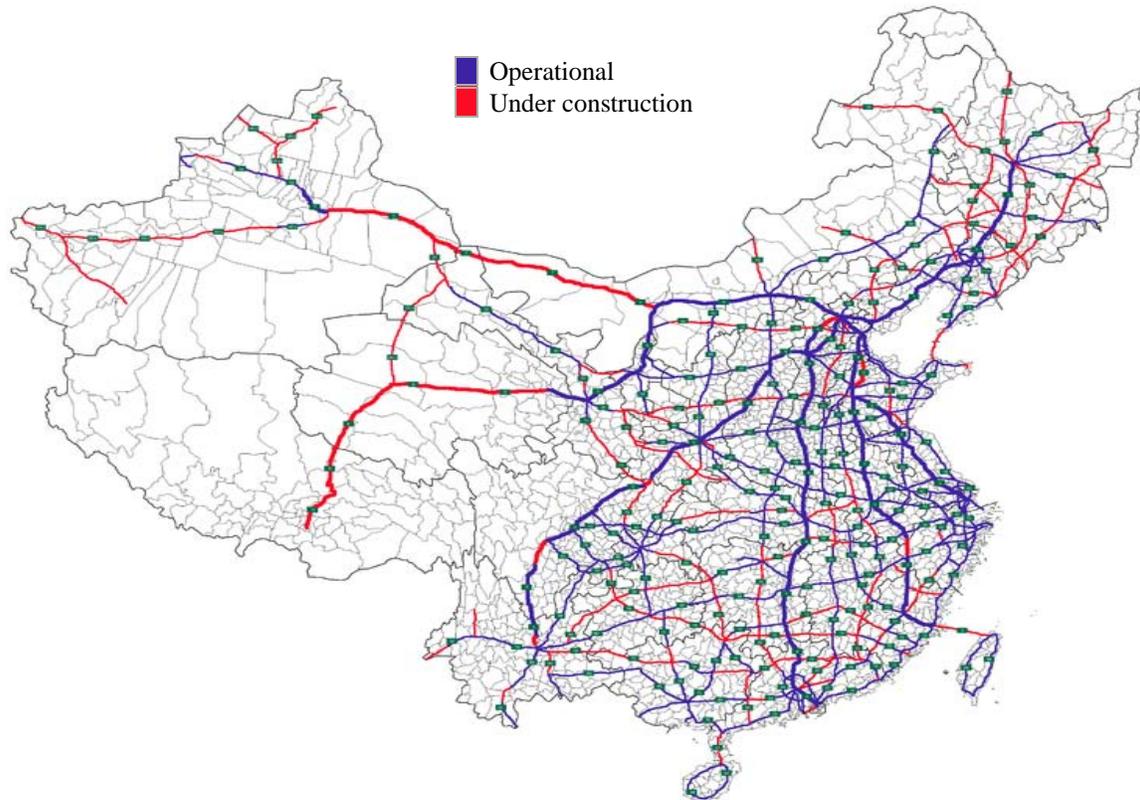
## China's Roads

In terms of length of expressways in operation, China ranks second in the world with 45,000 miles in its National Trunk Highway System (NTHS), second only in length behind the US's 60,000 miles. American roads are better quality with less congestion and higher speeds. To reduce the congestion in China, the country plans to increase its highway network under a plan titled "7918 Network," modeled after the US interstate network. The new system will link all provincial capitals as well as cities with a population of more than 200,000.

The system will incorporate:

- 7 Highways from Beijing
- 9 North -South vertical expressways
- 18 East - West horizontal expressways

In addition, major roads are planned to connect China with its Southeast Asian neighbors and Russia to support increased trade.

**Figure 5: China's highway system**

The existence of toll roads contributes to the high cost of transportation and slower speeds. Tolls account for one third of the operating cost of logistics companies. Early on, in an attempt to build many roads quickly, the State loaned money to private companies or local governments to build roads and authorized them to collect tolls to recover their investment. The end result is an inefficient collection of roadways connected by toll booths. In the worst example, one section of 10 km (6 miles), a truck must stop four times to pay tolls to four separate companies.

The National Development and Reform Committee has been charged by the government to reform the toll road system. Their first move will be to take control of all major roads by working with local governments and private companies that currently operate them. Second, it will eliminate tolls on all secondary roads. The elimination of toll stops will reduce cost for transportation companies and improve efficiencies by increasing speeds and reducing travel time for freight carriers.

### China's Rail System

The advantages of rail freight match the goals of Chinese government: efficient, low cost and green freight movement. Growth of the rail system is strongly supported with another \$100 billion USD planned to increase the 28,000 miles of high-speed tracks and to create separate systems for freight and passenger traffic. The tonnage hauled by China's rail system increased in 2010 by 9.3% to 3.6 billion tons, an amount equal to the entire freight carried last year by the combined rail systems of Britain, France, Germany and Poland, according to the World Bank.

### Planned Railway Container Era.

Dr. Simin Huang of Tsinghua University explained the government's plan is to build a rail system infrastructure that contains 18 State-owned railway container hubs. These regional centers would accept large rail shipments and then disperse the freight to 400 to 500 container stations via trucks. The centralized government is the moving force behind this organized expansion of capabilities since it will require the coordination of multiple branches of the federal government as well as local and regional governments. In 2009, a Minister of Transportation was appointed to coordinate this effort. A plan for accelerating development of Sea-Rail Intermodal Transportation was submitted in October 2011 which proposes to increase sea-rail freight by 20% or more by 2015.

### Air Cargo

Air cargo is the fastest growing segment of the freight movement in China although it represents only a small percentage of the total tonnage and is not a major factor in the movement of floor covering. However, it is interesting to note the growth in this sector. China has 175 international airports. Hong Kong is the largest air freight handler in the world followed by Memphis, TN due to FedEx's Memphis hub.

### Sea Ports

Most floor covering imports and exports are shipped in containers by sea, making seaport location, efficiency and connectivity to ground and rail logistics an important factor. China has 36 ports and 7 of the top 11 seaports in the world. In comparison, the busiest port in the US is Los Angeles, ranked 17<sup>th</sup>. New ports are being developed and current capacities expanded.

The expansion of Shanghai's Port of Yangshan is an example of the investment being made in port infrastructure as part of the 12<sup>th</sup> Five Year Plan. The first two phases of the \$12 billion USD project are complete and open, with a 2015 target year for achieving full capacity. It has already made Shanghai the world's busiest and largest container port handling 30 million, 20 foot units this year. Located about 20 miles off shore, the port is connected to the mainland by a highway bridge. Its 33 to 50 foot deep sea berths will have the highest productivity in the world. It operates 365 days a year with as many as nine cranes unloading each container ship.



## 6. Channel Options

Each channel option requires manufacturers to perform certain, specific duties and their profit opportunity will be determined by the number of functions and risk they are willing to assume.

Most foreign manufacturers approach a new market with the desire to sell full containers from their factory dock and depend on the buyer to do everything needed to get the product to the consumer. The other extreme, in China especially, is the manufacturer that is willing to accept responsibility until its product is installed in a satisfied customer's home.

In an effort to inform companies considering expansion into the Asian market, we have reviewed the shifting landscape of the Chinese market, studied the ways product is physically moved from manufacturers or warehouses to consumer and where and how the consumer can purchase those products. Companies must consider all of these when considering China as market opportunity.

Below is a chart that summarizes the functions of each of the various channel options.

**Figure 6: Channel Functions**

	Sea/Land Transp.	Maintain Inventory	Whse	Order Taking	Break Bulk	Invoice	Transport	Collection	Sales /Training to Retailer
OEM	X								
Mfg Partner	X	X							
Ind. Wholesaler	X								X
Agent	X	X	X	X	X	X	X	X	X
Direct to Retailer	X	X	X	X	X	X	X	X	X
Own Retailer	X	X	X	X		X	X	X	X

Here are the various avenues a manufacturer can take. None of these are strict definitions which must be followed and instead are business relationships that are modified to meet the needs of the parties.

### Original Equipment Manufacturer (OEM)

OEM simply means that one company manufactures a product for another company which then sells that product under the buyer's brand. It requires a low investment and comparatively low initial risk because the original manufacturer of the goods is not required to spend time or money to merchandise, sell or deliver the goods past the original sale. Those functions are left up to the channel partner which means the original manufacturer does not need deep market knowledge or know-how to navigate other challenges of doing business. Since so little is required from the OEM manufacturer, profitability is usually very low and the product may be easy to replace unless it is differentiated through technology or some other unique feature.

Simply having "Made in America" on the package adds perceived value for some Chinese consumers. One Chinese wood flooring manufacturer takes pride in the high end wood flooring

products he buys from America and sells at a nice profit because he stresses the quality of products made in the US. OEM agreements must be carefully constructed to protect intellectual property rights and bridge the communication gap that exists between cultures.

### Partnerships.

“Partnerships” are another way for manufacturers to create symbiotic relationships however finding the right strategic partner is key. Partnerships capitalize on the local market knowledge of one partner and the products of the other. An example is PowerDekor representing Anderson Hardwood Floors, a division of Shaw Industries. PowerDekor gives Anderson a window into the Asian market while their roles are reversed in America.

Partnership law in China is highly regulated by the PRC Partnership Law and no partnership should be undertaken without the benefit of professionals such as those listed at the end of this paper. There are several kinds of foreign partnerships allowed in China but perhaps the one most likely to be used by someone investing in or creating a partnership with an existing Chinese flooring concern is the **Foreign Investment Partnership (FIP)**. This is a relatively new vehicle which became effective in March 2010, and was designed to open the door to foreign investment and increase employment in China

Unlike more traditional joint ventures in China, FIPs are not limited to high or new technology industries. FIPs can be formed by two or more foreign investors (individuals or companies) or by foreign investors together with one or more Chinese institutional or individual investors. Foreign investors can also join an existing domestic partnership by making new contributions or acquiring partnership interests. There is no minimum registered capital requirement for FIPs and capital contributions can be made in cash or kind, including intellectual property rights and services

The caution with FIPs is that they are new in China and the measure that the FIP contains few practice guidelines leaving the door open for changes in the future.

## The Challenges of doing business in China

- ❖ China’s current legal and regulatory system can be opaque, inconsistent and sometimes arbitrary. Two thirds of American companies doing business there in 2010 characterized the regulatory environment as their top hurdle.

- ❖ Protection of intellectual property rights is a concern for American companies. China has made significant progress toward a market oriented economy but protection of local firms, especially state owned firms, can still exist.

- ❖ Foreign businesses tend to under-estimate the challenges of market entry and fail to sufficiently investigate the market situation. Visiting the country and engaging help from experts who can open doors and support networks is essential.

- ❖ Differences in culture make communications challenging. It’s not just the language barrier. The Chinese are eager to please and it is not uncommon to hear “yes” as a polite response and mistake it for an affirmation. These small differences can lead to miscommunication.

- ❖ Lack of credible market research is a challenge.

- ❖ Difficulty finding and retaining critical talent has become harder in a booming economy.

### Skilled Workers

Last year salaries rose in China by 7 percent. Ten years ago flooring manufactures located in rural manufacturing hubs could count on a long line of people waiting outside their door to take the next opening. Those same manufacturers now complain that it is difficult to find and retain good workers because skilled workers, particularly younger ones, frequently change jobs for better opportunities. More and more, the Chinese worker wants to feel valued, receive training and hope for advancement just like their Western counterparts. In the current environment, changing jobs often for new opportunities has no negative stigma.

## Independent distributors

Westerners would normally think of independent distributors next when considering channels to market, however as explained earlier in this paper, a big percentage of building products are sold to the consumer through manufacturer owned, franchised or licensed retail stores. Independent distributors do exist but they are few and difficult to find. For example, Sanyuan Jiancai began as an agent distributing vinyl for Tarkett. Five years ago, however, Tarkett began selling through additional agents and kept shrinking this distributor's territory. Sanyuan Jiancai negotiated an exclusive distribution agreement on some products produced by Hanwha in Korea and discontinued their relationship with Tarkett. With warehouses in Shanghai and Beijing, they sell independent floor covering companies like those found on Yi Shan Lu, employing six salesmen in Shanghai and seven in Beijing.

The company uses independent transportation companies to deliver their products but provides installation of their products to consumers as do most Chinese manufacturers. Unlike wholesalers in the West, they carry only the product line made by Hanwha and currently are not considering expanding into other product categories.

## Agents

Agents are another avenue manufacturers might consider. This assures the manufacturer of a knowledgeable sales force with relationships in the market.

There are a variety of types of agents which range from very large companies that are similar to distributors, to the individual salesman representing one or multiple companies. If the agent does not have a warehouse, order desk, credit department and invoicing capability, these functions must be performed by the foreign manufacturer since there are few large 3PL companies to provide this service.

Many of the agents are based out of Hong Kong, a remnant of the time when China was closed to foreigners and the British controlled Hong Kong acting as a link between East and West.

## Owning retail stores

For the bold and aggressive manufacturer, there remains the choice of slugging it out toe-to-toe with others by opening their own retail stores. Be ready to build warehouses, invest in inventory, field a sales force and man the stores. Business in China is not only performed on the national scale but each local government needs to be involved in the planning of every location. There are numerous stories of successes and disasters but one thing is certain, China is a unique market and must be analyzed through the eyes of the Chinese businessman, government and most importantly the consumer. Learn from the success of KFC serving rice and congee along with their famous fried chicken as opposed to Kingfisher who expected low service and low price to draw customers in like it does in the rest of the world.

Hundreds of millions of customers with newly created wealth, anxious to consume, anxious to emulate a new, modern lifestyle in larger, better designed living spaces are waiting. There is no question about the existence of a tremendous new opportunity but there is a big question about how the market should be approached.

## Finding guides

Because of the complexity of the Chinese market we caution against trying to enter the market without professional guidance. OEM and partnership options offer built in information resources from the partner company that would not otherwise have available. There are other sources of information but not as easy to find as in the West. For example, Europe has a group of top independent distributors called HomeDecor International that often serve as eyes and ears for non-European manufacturers. In the US, the National Association of Floor Covering Distributors offers manufacturer members a way to show their products to independent wholesalers. Establishing a national network of independent distributors in China would be nearly an impossible task.

Buying groups composed of independent floor covering retailers such as CCA Global Partners, Abbey, StarNet or NFA in the US do not exist in Asia. Since most large retail floor covering chains are manufacturer owned or licensed, the only way to easily access these chains is through a partnership with one of those manufacturers. Selling direct to large retailers such as big box or department stores would be possible; however, China's view of floor covering as a building product rather than a decoration again limits the possible outlets that are available. Department stores that lease space to independent retailers are not a place to start since their main interest is rent; not in promoting products for renters. Decorating centers offer a good opportunity for the future and anyone getting in on the ground floor may be positioning themselves for tremendous growth in the future.

There are third parties that can help any size project. Dr. Simin Huang of Tsinghua University worked for five years on a project with General Motors to develop its Chinese strategy. Today, General Motors sells more cars in China than any other country in the world. The US Department of Commerce, Commercial Services Division is also anxious to help any American company interested in exporting to China. Both of these opportunities come with a cost but that cost may be money well spent.

Many large American companies have complete divisions established in China specifically to help foreign companies navigate the unique legal and accounting regulations in China. Here are a few such experts that helped contribute to this research paper. These executives are fluent in both Chinese and English languages, cultures and business.

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## So where does a company start?

**Remember that market knowledge and patience are two major keys to success in taming the dragon.**

- ❖ Identify why an expansion into China's market could be important to your company: increase sales, expand customer base, capitalize on a growing opportunity, establishing new manufacturing location?
- ❖ Become acquainted with the market, culture and business environment. Start by attending [Domotex asia /CHINAFLOOR](#), the largest floor covering trade show in Asia. This is an easy way to see product, meet people, get exposure to the culture and establish contacts. The show is held in Shanghai in March each year with over 1,200 exhibitors and 40,000 attendees. While there, identify differences in products and styling as well as displays and sampling. Spend a few extra days in Shanghai to visit the retailers identified here such as Yi Shan Lu and Macalline's Global Furnishing Design and Exhibition Center. Then contact people that are intimately familiar with the industry and market in China to develop a realistic strategic plan, timeline, action list and budget.
- ❖ Seek out experts in the floor covering industry who have knowledge, expertise and connections in the China's flooring market. For more information contact the Floor Covering Institute, to identify the best partners and opportunities in the floor covering industry.

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