

US BRANDS FACING GREATER VULNERABILITY IN CHINA



Changing Times for US Brands in China

As Bob Dylan famously said, *The Times They Are a-Changin'*, at least for North American brands trying to make a name for themselves in China. With China's ongoing political spats with the US, it doesn't come as a surprise that mainland Chinese consumers are becoming increasingly finicky with American labels.

Many Chinese citizens have been irked by the actions taken by the US on China and Chinese companies, such as the multiple trade tariffs and requesting Canada to detain telecom giant Huawei's Chief Financial Officer Meng Wanzhou late last year on charges of violating American sanctions on Iran.

Signs of Chinese consumers scaling back their purchases of American-made products are becoming more evident of late. With US tech giant Apple recently announcing a downturn in iPhone sales in China, all eyes are now focused on other US brands competing in China's lucrative consumer market.

With the rising vulnerability of US brands in China, where nationalistic sentiment is high, entrenched brands are few and far between, and boycotting by consumers isn't uncommon. While the recent turn of events in US-Sino relations could lead to a loss of dominance by US brands in China, they may benefit home grown Chinese labels that could emerge into local consumer powerhouses in the near future.

Collective Might of Chinese Consumers

Numbering over a billion, mainland Chinese consumers could quickly herd into a patriotic bunch whenever China's interests, or culture, come under a perceived attack by a sovereign state or a foreign corporate entity. For instance, Japanese cars and products were shunned by many Chinese nationals in 2012 and 2013, when China and Japan disputed over the Diaoyu or Senkaku Islands.

With deep pockets and growing influence, the immense collective power of Chinese consumers can make or break any foreign brands selling in their country. That's why many overseas brands in China tend to tread carefully in their marketing and advertising campaigns to avoid gaffes that are deemed culturally provocative in the eyes of the locals.

A case in point was a recent ad blunder by Italian fashion house Dolce & Gabbana, whose three short videos released in China in late 2018 titled "Eating with Chopsticks" were slammed by the Chinese as racially and culturally offensive. Many Chinese consumers stayed away from its boutiques after the incident.

Huawei Incident Sparks Nationalistic Vibes in China

We also see pressure of the collective might of Chinese consumers on US brands. Many Western pundits have attributed the slowing sales of Apple, Starbucks and other US firms in China to an economic slowdown in the world's second largest economy. There could actually be a less-than-noticeable wave of boycotting by the Chinese on particular US brands, according to our on-the-ground insights.

Many Chinese firms in the technology supply chain that are linked to Huawei are urging their employees to buy Huawei handsets and shun those of Apple as a show of solidarity with the Chinese telecom giant. Some are even handing out cash subsidies to their workers for the purchase of Huawei's phones and products.

Besides the charges that Huawei violated American sanctions on Iran, Washington is also accusing the Chinese telecom giant of using its telecom equipment for spying and stealing trade secrets from US tech firms. Huawei has vehemently denied these accusations.

In 2017, another Chinese telecommunication equipment firm ZTE was fined by the US for violating sanctions on Iran and North Korea. The US Department of Commerce also banned US companies from exporting components to ZTE in April 2018. These punitive actions on ZTE by the US, however, didn't trigger the same wave of nationalism in China as they did with Huawei.

The simple reason is that Huawei isn't an ordinary Chinese company. It is one of the most admired and successful home grown firms in China to have made it big on the international stage without any funding and assistance from foreign companies. Huawei's name is also extracted from a patriotic Mandarin axiom implying that the Chinese are making a difference in the world. In addition, the company's founder Ren Zhengfei is a role model for many mainland Chinese, who admire his entrepreneurship, business acumen, diligence and generosity.

That's why the detention of Huawei's CFO—the daughter of Ren—by Canada at the behest of the US has infuriated many mainland Chinese, who feel that their country, as well as Huawei, are victims of harrising by the Trump administration.

Factors Determining Brand Vulnerabilities

Still, not all US brands face the same level of vulnerability in China, where consumers still have reverence for America-made products. The rejection and acceptance of US brands by the Chinese also depends on factors such as brand visibility, the nature of consumption and a debacle, depth of displacement, localisation, consumers' level of education, demographics and brand loyalty.

Visibility and the Nature of Consumption

The visibility, quality and reputation of US labels, plus the type of products sold by them—whether they are consumer staples or consumer discretionary items—will determine their brand vulnerability in China. For instance, the more visible a brand is, the more vulnerable it could become as a victim of Chinese consumers' boycott. In general, consumer discretionary products are more at risk of being shunned by the Chinese as compared to consumer staple items.

Nature of a Debacle

On the whole, US brands in China could be more susceptible to a consumer boycott when nationalistic sentiment is high. But brand loyalty and consumers' level of education are other factors at play when determining the level of vulnerability of US labels. For instance, highly-educated Chinese consumers, especially those who studied overseas, tend to have more brand loyalty to the US, and they may not participate in a boycott, as compared with their less-educated counterparts. Chinese consumers from tier-one and tier-two cities, who are generally more influenced by social media, could also be more eager to participate in the boycott of foreign brands, especially when controversies arise from nationalistic issues.

Depth of Displacement

US labels that can be easily replaced by domestic brands without comprising on the utility factor are more vulnerable in China, as compared with those that can't be easily substituted. We believe that US companies such as Apple, General Motors, Ford, Hilton, Marriott, Tiffany & Co and Walmart—all highly visible, consumer discretionary labels that have no major competitive advantages and operate mainly in tier-one and tier-two Chinese cities—are some of the more vulnerable North American labels in China.

On the other hand, Procter & Gamble, Coca Cola, Estee Lauder, Kimberly-Clark and Carnival (a cruise operator), all of which have lower single-brand visibility in China, due to the variety of products under their labels and limited local competition in their markets, are less at risk of a general boycott.

Localisation

US brands with a solid reputation and high-quality products, particularly those that have strong partnerships with local Chinese firms, as well as those that are helmed by local management teams, are likely to be less susceptible during a consumer backlash.

Increasingly unsettled US-Sino relations could lead to greater vulnerability for US brands in China. This may benefit domestic Chinese labels that could grow into local powerhouses. Still, not all US brands face the same level of susceptibility in China. There will be winners and losers, depending on their quality, visibility, reputation and type of products sold.

As much as times are changing for US brands in China, they are also shifting in favour of home grown Chinese brands, some of which could gain significant market dominance in the world's second-largest economy. That's why it is increasingly important to have on-the-ground research capability and insights in China in order to distinguish the potential winning and losing brands in the country.

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