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China's Beer Industry: Breaking the Growth Bottleneck

By Cherry Lu Cui, Mickey Fang Xu and Jeff Kao

Research report

August 2012

China's beer industry has enjoyed impressive growth over the past three decades—ranking first in the world in terms of output in 2010. But despite its achievements, the industry now faces serious challenges, including slowing growth rates and slim profit margins. To break the bottleneck, the industry must look to new growth sources.

Promising strategies could include introducing high-end products in China's urban markets and launching low-cost but still high-quality products in rural areas. To make these strategies work, Chinese beer companies will need to strengthen their operations on three fronts: brand positioning, distribution and cost control.

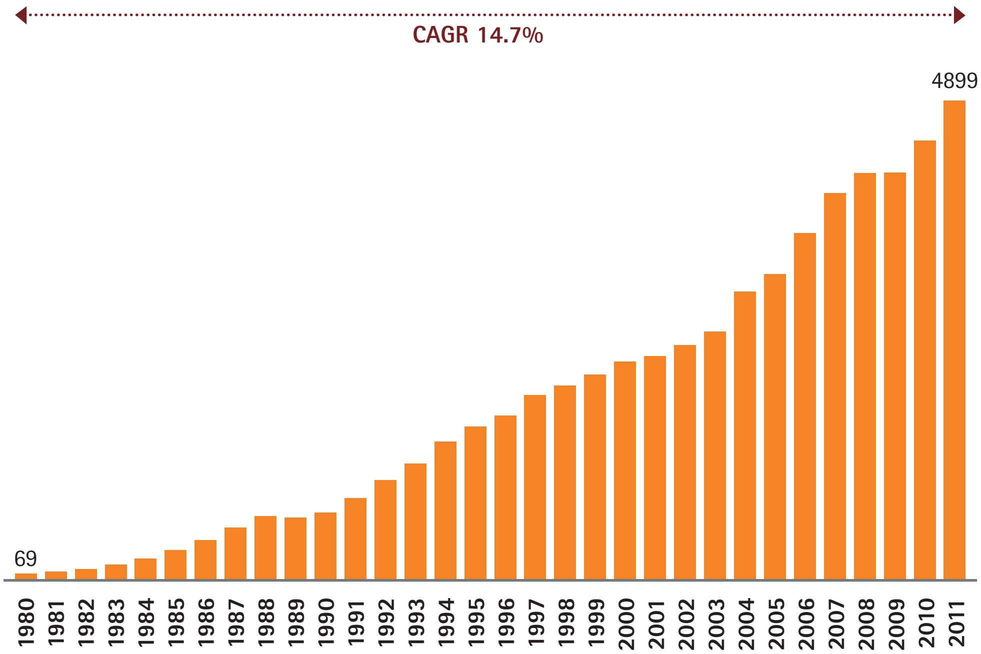
Since 1980, the Chinese beer industry has seen steady escalations in production as well as consumption. (See Figures 1 and 2.) The top four players—Tsingtao Brewery, China Resources Breweries, Yanjing Beer and Anheuser-Busch InBev—accounted for 58 percent of the nation's beer sales in 2011. Still, there is no "national" beer brand; indeed, the industry has decidedly different characteristics across China. The big beer makers are concentrated in China's eastern, central and northeast regions. In these saturated markets, companies compete to serve urban consumers through well-established sales channels including supermarkets, restaurants and clubs. In China's rural regions, characterized by relatively few sales outlets and high transportation costs, beer drinkers can find a slim variety of offerings mostly at small stores.

Despite its achievements, the industry has encountered several obstacles. For one thing, spectacular growth rates from earlier decades have recently lost steam. From 26 percent during 1980-1990, production CAGR shrank to 12 percent in 1990-2000 and 7 percent during 2000-2009. And while per-capita consumption has increased in China, it pales in comparison to numerous other countries—suggesting considerable room for growth.

The industry also has meager profit margins, in part because low-end products account for 85 percent of the domestic market. Fluctuations in prices for critical raw materials such as barley and hops; soaring promotion costs aimed at launching higher-end offerings; and relentless price wars have whittled margins to 6.4 percent—3.9 percentage points lower than the industry average.

Figure 1: Beer production in China, 1980-2011 (million tons)

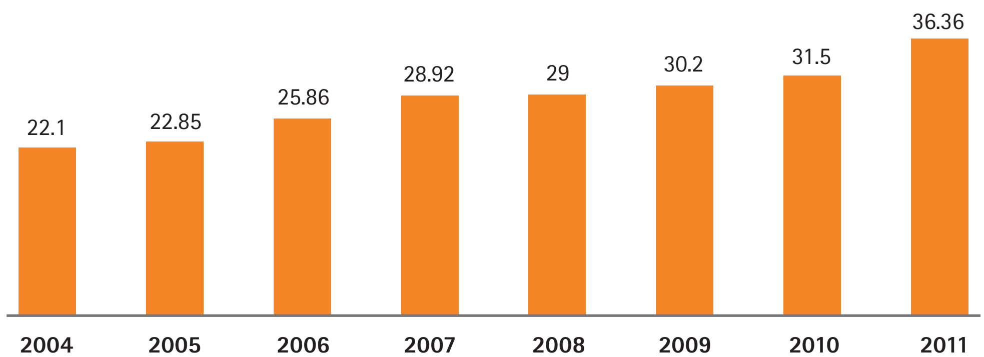
Industry production has enjoyed an average compound annual growth rate (CAGR) of nearly 15%.



Source: China Industrial Economic Statistical Yearbook, data of 2010 from China National Sugar and Alcoholic Commodities Fair, EPS.

Figure 2: Beer consumption in China, 2003-2011 (liters)

Per-capita beer consumption surged from 19.6 liters in 2003 to 36.36 liters in 2011.



Source: Access Asia, Kirin Institute of Food and Lifestyle Report Vol. 22 (2008 Beer Consumption in Major Countries), Accenture analysis, China Economic Information Network.

Wanted: New wellsprings of growth

How might Chinese beer companies surmount the obstacles confronting them? They will not be able to continue relying on low prices to boost per-capita consumption; that would only perpetuate their profit-margin problem. Instead, they must look to other strategies for driving fresh growth—strategies tailored to the unique characteristics of China's diverse markets. We recommend two such strategies: develop high-end products for China's urban markets, and introduce low-cost but still high-quality offerings for China's rural regions.

High-end products for urban Chinese

In China's urban areas, the beer market is mature and saturated, and competition is stiff. Thus beer makers cannot hope to boost sales to dramatic new levels. However, they may be able to enhance profits by developing high-end products for city dwellers. Urban areas offer unique advantages that make them ripe for this strategy. These advantages include rising disposable incomes that have sparked demand (and ability to pay) for taste, quality and freshness as well as for dining out and night-clubbing.

In addition, urban Chinese are showing more interest in healthy living. Beer makers can cater to these preferences by introducing the kinds of high-end, specialty products that people look for in quality restaurants and clubs as well as health-conscious "craft" offerings such as fruit-enhanced, low-calorie or non-alcoholic brews.

How to deliver these premium products to urban Chinese? Simply refreshing product packaging and raising prices will not be enough. Companies will need to research and clarify urban consumers' changing preferences and priorities regarding beer. They will also need to educate consumers about their new products and intrigue them—for example, by using social media sites to describe their offerings and explain how to pair beers with different foods.

Low-cost-but-high-quality products for rural Chinese

In addition to introducing high-end, specialty offerings for urban Chinese, beer companies have a huge opportunity to drive new consumption by developing low-cost products for rural Chinese. China's rural regions offer their own advantages to industry players seeking to catalyze fresh growth. For example, thanks to increasing incomes, more rural residents are buying refrigerators.

Moreover, government policies supporting economic development have helped to strengthen rural transportation and logistics infrastructure, thereby lowering freight, after-sales service and channel-maintenance costs. In addition, urban experiences have elevated rural tastes and expectations: Many young rural Chinese who return to the country after working in the city want the same range of choices and quality in their beer that they discovered during their urban stint.

To capitalize on these changes within China's rural markets, beer companies can offer lower-cost but sufficiently high-quality beers that can be refined and upgraded (including an eventual increase in pricing) as rural tastes evolve. Tactics for achieving this balance include developing marketing campaigns tailored to local characteristics.

For instance, Jinxing Beer Group burnished its corporate image by sponsoring local televised opera programs popular in the countryside. Companies can also provide product information training for distributors as well as invite their input on how to improve offerings to meet rural consumers' preferences. In addition, beer manufacturers can take advantage of the stronger rural distribution network that has resulted from the Ministry of Commerce's "Ten Thousand Villages to One Thousand Townships" market project. This project led to the construction or renovation of more than 400,000 rural stores covering 75 percent of the townships in China's countryside, and almost 1,500 distribution centers. Another 100,000 chain stores are slated for construction in rural areas as well.

Strengthening operations

To successfully execute the two growth strategies described above, Chinese beer companies will need to excel at several operations—particularly brand positioning, distribution and cost control.

Brand positioning

More than 200 domestic brands and nearly 100 foreign brands are all jockeying for market share in China's beer industry. To apply new urban and rural growth strategies under these conditions, we recommend that industry players strive to develop a strong national brand supplemented by regional brands. This approach lays the foundation for more thorough market coverage than a one-size-fits-all brand could. Moreover, the national brand's economies of scale paired with the regional brands' close connection with local markets may create a powerful combination and mitigate the risks inherent in offering a single brand.

Anheuser-Busch InBev has adopted this approach in China. The company has introduced its Budweiser brand nationally while also retaining regional brands it acquired, such as Harbin Beer and Sedrin, both of which are targeted at lower ends of the market.

Tips for achieving this brand positioning include the following:

- Use the national brand's reputation to enhance the regional brands' perceived value.
- Carefully manage regional brands' product quality, to avoid problems that could hurt the national brand's image.
- Use an operating model that centralizes management of business functions such as finance but decentralizes product-related decision making to regional operations. Local managers are best positioned to detect and quickly respond to local consumers' changing needs as well as competitors' moves.

Distribution

Given the diversification and fragmentation characterizing China's beer market, manufacturers rely heavily on regional distributors to gain access to different markets through ready-to-drink channels (such as hotels, restaurants and nightclubs) and non-ready-to-drink channels (supermarkets, malls, convenience stores, retail establishments and online sites). This dependence has made distributors powerful. As a result, some distributors ignore manufacturers' marketing initiatives and put their own interests above those of the beer companies'. For instance, distributors invest more effort in competing with each other to offload products that sell in large quantities quickly than in selling products a company has introduced to build its brand.

To execute their growth strategies, manufacturers must reduce their reliance on distributors and shift the power balance. The following tactics can help:

Build horizontal distribution channels by establishing a manufacturer-specific union of distributors. Provide the union with needed resources such as large inventory throughput, personnel, vehicles and IT systems. This approach creates a strong logistics platform that cuts out secondary and tertiary value-chain players, boosting manufacturers' power and increasing union members' per-unit revenues.

Direct-market beer products online. The Internet provides a conduit to educated consumers interested in high-end products, a wide array of choices and shopping convenience. It also enables companies to gather and analyze huge volumes of data about consumers' purchasing behaviors and preferences—thus deepening manufacturers' understanding of their target markets. Some online retailers have begun driving this trend. Taobao.com, for instance, offers as many as 1,160 varieties of beer, including imported as well as domestic brands.

If cash permits, further exploit the direct-sales model by establishing proprietary "terminals" for ready-to-drink beer. Anheuser-Busch InBev, for instance, has set up Belgian Beer Cafes around the world, including in the Belgian Museum at the Shanghai Expo.

Cost control

To maximize profit from execution of their new growth strategies, Chinese beer companies will need to control costs more carefully than ever. Raw materials—which constitute 20-30 percent of total production costs—are one place to start. The most important ingredient in beer is barley, which influences malt flavor and thus perceived quality of a beer. China traditionally has had barley in short supply, so companies have relied heavily on imports of this key input. They therefore have had little control over the price of this input, which has proved volatile in recent years.

To address this situation, the Chinese government has created a development plan for domestic production of barley. Beer manufacturers will benefit by forging long-term strategic partnerships with local barley producers or setting up their own barley production bases. Tsingtao Brewery took a step in this direction by inviting barley producers to its annual global suppliers conference and naming Mogao Industrial Development Company as its sole strategic malt supplier in Gansu Province. Meanwhile, Yanjing Brewery has been investing extensively in setting up bases for production and processing of barley.

Packaging—another major cost component—can present additional cost-saving opportunities. For example, plastic bottles blending polyethylene naphthalate (PEN) with polyethylene terephthalate (PET), a technology currently being piloted in India, preserve carbonation better than PET-only bottles. They may therefore offer a higher-performing but still inexpensive alternative to PET for companies using plastic bottles.

Finally, beer companies can better control marketing costs by tailoring promotion strategies to product lifecycle stages. For instance, to introduce a product, companies need to quickly establish effective distribution channels; thus, they should invest in promotion campaigns for dealers. As the product gains popularity with consumers and competition heats up, companies should shift to promotional tactics aimed at keeping the brand front and center in consumers' minds, such as conducting beer festivals. For products that have reached the maturity stage, companies need to change focus again—this time, to enhancing perceptions of product quality.

Looking ahead

To catalyze fresh growth, companies in the Chinese beer industry will need to look beyond traditional strategies, such as being the lowest-cost provider. Adapting their approaches to the unique characteristics defining China's diverse markets can open up new and better opportunities for growth. We believe that introducing high-end products to urban consumers and low-cost but still quality beers in rural markets can help beer companies break the growth bottleneck. But delivering on these two strategies will require excellence in brand positioning, distribution and cost control.

About the Authors

Cherry Lu Cui (cherry.lu.cui@accenture.com) and **Mickey Fang Xu** (mickey.fang.xu@accenture.com) are researchers with the Accenture Institute for High Performance in Beijing.

Jeff Kao (jeff.kao@accenture.com) is a senior executive focused on consumer goods and services for Accenture Greater China; he is based in Shanghai.

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