Planning for the Consumer Shift in China: 5 Key Supply Chain Focus Areas

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With a population of 1.3 billion people, China accounts for almost 20 percent of the world’s population. It covers 3.7 million square miles and has a GDP Purchasing Power Parity (PPP) of $13.39 trillion (U.S.) and $9,844 per capita. The country’s middle class, now estimated at more than 300 million people, is growing at a tremendous rate, with incomes tripling in the past 10-15 years. It’s estimated to reach 600 million people by 2020, when 400 of its cities will boast 250,000 middle class residents. By comparison, the entire U.S. population is 313 million.¹

These numbers indicate vast market opportunity. At the same time, major supply chain challenges exist in China, which, if not proactively considered and addressed by companies looking to increase their business in the region, could prove a barrier to growth.

From a highly fragmented supply chain, to under-developed infrastructure, to intellectual property protection concerns, to a lack of a pan-China distribution system that would help move goods to consumers, the China logistics landscape is complicated. So how can manufacturers take advantage of opportunity in China in this environment? There are five key supply chain areas that companies should focus on to get ahead in this market.

Area #1: Supply Chain Structure Shifts: From Export to Domestic

The first supply chain focus area involves the shift from an export supply chain structure to an emerging domestic one. This shift is being driven by an increasing demand for higher-quality products that can be...
manufactured in China to serve the China market.

There are several product categories that are moving to a more domestic structure, such as high-tech equipment, and in particular mobile devices that allow access to lower-cost smart phones for the Chinese market. Apparel and accessories is another industry making the shift. A third industry is healthcare, where concerns about quality in China have driven a growing demand for Western-quality healthcare. Today, many branded pharmaceutical companies are now setting up manufacturing in China to serve China.

These market shifts have huge supply chain implications, and there are a lot of considerations. First, companies have to have someone with on-the-ground expertise to make sure that products can get from manufacturers to distribution centers. Next, there is the factor of how to speed up the supply chain once on the ground when companies are distributing pan-China to meet growing consumer demand for faster product deliveries. They also have to have the technology that allows them to track and manage the supply chain to ensure they are meeting consumer demand. Then there is the returns side of the equation to make sure that companies are set up to handle refurbishment and repairs.

Overall, says Craig Foster, UPS Senior VP APAC Region, Healthcare and Supply Chain Logistics “You have to understand the requirements of your customer before you can operate in China. If we can coin a term, the ‘Logistics economy’ is still export-focused, but going through changes now to a domestic consumer, and Asian two-way trade-focused economy, so you have to understand how to use enterprise zones, whether bonded or non-bonded, based on customer requirements.”

To succeed in domestic distribution, companies should start with a supply chain analysis that will tell them whether they are set up for success. A good supply chain analysis takes into account factors such as distribution patterns, and where a company’s projected customers are, and provides valuable insights around topics such as whether they should remain in bonded facilities (what most companies in the region use today) or move to non-bonded, and what strategic locations they should target for distribution in order to reduce transportation costs, gain more visibility over products in the supply chain and get products to market more efficiently. UPS can perform these supply chain analyses on behalf of customers.

Area #2: Complex Regulatory Environment

The second supply chain focus area is regulatory compliance. Regulations in China are highly complex. To paint a picture, China has more ports of entry and more borders than any other country. Its 3.7 million square miles share borders with 14 different countries, among them Russia, India, Mongolia, Pakistan, Afghanistan, Vietnam, North Korea and Bhutan.

In China today, there are about 62 EPZs (Exporting Processing Zones), 14 FTZs (Free Trade Zones), 10 BLPs (Bonded Logistics Parks), 28 BLCs (Bonded Logistics Centers), 14 BPAs (Bonded Port Areas) and 16 Integrated FTZs (Integrated Free Trade Zones). Knowing how each of these zones work is important.

Adding to the complexity factor are the often vast regulatory differences between municipal governments and ports of entry across the country. “China doesn’t have a unified case law system, so there are different procedures and classifications at different points of entry,” explains Craig Allen, Deputy Assistant Secretary for China, U.S. Department of Commerce International Trade Administration. “Importers must be well-documented. Be careful about classification and keep good records to be sure one is compliant if audited.”

Even transporting goods within the country sees differing regulations, Allen says. “Remember how large China is. Northern China and Southern China are as different as Maine and New Mexico. For the
same reason we have authority at local levels, so do they. The orientation of the current leadership is to allow greater municipal authority, not less, but also, some conformity with national.”

UPS can help companies navigate complex regulations in China. “Companies can tap into our customs brokerage group, which has deep expertise in China,” says Bill Ansley, UPS Vice President of Trade Management Services. “By working with one provider in all markets who understands the complexities and has a record of cooperating with the government, companies can simplify their processes and tap into existing expertise.”

Area #3: Inland Market Growth

The third focus area is inland market growth, which represents a changing dynamic of the China logistics landscape. Not long ago, when referring to growth in China, everyone was talking about the East Coast. Today, that growth has spread to Central China, where a growth of manufacturing jobs has led to a growing middle class that is increasingly interested in Western goods.

“American products are extremely well-received [in China] because they’re well-made and durable,” says the Department of Commerce’s Allen. “If they’re right for the America middle class, they’re right for the Chinese middle class. The Chinese are worried about Chinese-made products. We especially see this in pharmaceuticals, medical devices and healthcare. Chinese will purchase foreign products because they’re safe and well-made with integrity.”

Getting those Western goods to the region has not been easy for manufacturers, however. Harvey Rickles, Contract Logistics International Marketing Director, UPS explains that “A lot of goods we would see in Western countries, they couldn’t get in China. High-tech and consumer goods, for example, were made for export only.”

Rickles points out several specific challenges for companies looking to export goods to inland China markets. First, China is comprised of local and regionalized suppliers, meaning that they cannot cover the whole country. Companies have to work with multiple providers to get products to market. It’s also more complex logistically to move products inland due to infrastructure challenges, such as road networks that become increasingly sparse the farther west you go.

There is good news, however. Initiatives are underway to develop some major cities in China as logistics hubs across the country. This move will help manufacturers get goods to inland China faster and more efficiently. Companies also now have the option to use a single provider as some third-party logistics providers like UPS have built out their warehousing, distribution and transportation infrastructure in the region. By using a single provider that has regional facilities, companies can distribute products to the whole market and position themselves closer to end customers.

Area #4: Fragmented Logistics Provider Networks

The fourth area of supply chain focus: navigating fragmented logistics provider networks. There are approximately 100,000 logistics providers throughout China today, making it extremely difficult to find a pan-China fulfillment and transportation solution to reach the fast-growing consumer market. Adding to the challenge, the overall logistics costs in China are between 17-18 percent of its GDP. When compared to Europe and the United States, which are in the 9-10 percent range, one can see that doing business in China is more expensive.

Explains Foster: “You get a lot of companies that are competing for the business but no way to tie them together to make a pan-China distribution system. UPS now provides a domestic pan-China warehousing fulfillment solution that ties together with our freight forwarding, brokering, domestic China warehouses and transportation. The key is linking with IT platforms for warehouse distribution in China. Companies want high-quality logistics in China at a price point that’s acceptable.”

FTZs are special economic areas approved by Customs and physically separated. They include three major functions: bonded warehousing, processing trade and entrepot trade.

Integrated FTZs are special areas approved by State Council to adapt to the development of modern logistics. They are physically separated and enjoy the same preferential policies as those applied to BLP, FTZ and EPZ.

BPAs (Bonded Port Areas) are areas approved by State Council to adapt to the development of modern logistics. They enjoy the same preferential policies as those applied to FTZ and EPZ.
As referenced above, the Chinese infrastructure was built for import/export to get finished goods to and from the coast. However, infrastructure to Central China from the coast is lacking. The eastern portion is well-developed with a pretty good road network. There are extensive internal waterways, but that area has to be greatly expanded to meet the growing demand.

**Area #5: Booming E-Commerce Demand**

The fifth supply chain focus area that is bringing change to China is the massive growth of e-commerce in China’s heavily populated urban areas. A study by the Boston Consulting Group indicates that China is going digital very quickly. By 2016, the study says, the country will have more than 730 million internet users and more than 380 million online shippers, up from 145 million in 2010. Even China’s smaller cities are migrating to digital technologies rapidly. More than 16 million from the country’s Tier 3 and Tier 4 cities are using mobile internet.

Put another way, China has a population using e-commerce that rivals the United States and the European Union combined. Which leads to another challenge: how do you fulfill and deliver the goods?

The Chinese government is working on it. In its most recent five-year plan (2011-2015), the Ministry of Industry and Information Technology unveiled a number of policies to “drive e-commerce in China...” says a new study from KPMG, Glamour Sales and Moguji. “...in line with its overall transition from an investment heavy growth model to more emphasis on domestic consumption.”

Among the developments are a drive to greater broadband and 3G coverage across the country. (The government is targeting 1.2 billion 3G/4G users by 2020, up from 233 million at the end of 2012 and 325 million in June 2013.)

In the study, KPMG cites CLMA, an Asian brokerage and investment group, which estimates that by 2015 e-commerce transactions in China will reach $540 billion (U.S.) or 75 percent of retail transactions. By 2020, the e-commerce market is forecasted to be larger than those of the U.S., UK, Japan, Germany and France combined.

Companies must prepare to deliver on this demand, and getting logistics right in the dense urban cities where China’s e-commerce growth opportunities lie is not an easy proposition. Companies need logistics providers with a range of service options and a broad reach. They need to ensure the right resources and tools to provide visibility across the supply chain and deliver on growing consumer expectations.

**Conclusion**

With great challenges also comes great opportunity. The key to getting ahead in the five supply chain focus areas – and getting ahead in the China market – is to have an understanding of the challenges and their impacts on the supply chain and the right team to help you navigate them.

Commerce’s Craig Allen sums it up by saying; “Find a good agent and distributor, that’s the key. You need someone to physically manage the goods and after care. Chinese employees are the answer. Ask 100 American companies what their problems are and they’ll say [finding] good agents and distributors is No. 1. That’s what my organization does. There are 120 medical equipment distributors in Shanghai. Ten or 12 are looking for good American companies with a track record, finances, relationships and who can start to immediately sell their product.”

“When you get up to $10 million, $15 million, $20 million, you can go on your own. Then you need a whole new stream. Ultimately, every American company needs to take over, but not during the agent/distributor phase. Over time you’ll have to have an American or groom a Chinese employee or a young Chinese MBA that can help you grow.”

Craig Foster of UPS agrees and also advises that “when you start exceeding that $15-$20 million level you may want to also consider an international 3PL that can run your warehouse/fulfillment and transportation operations in China, allowing you to lease your operation with a trusted provider while at the same time, having greater control than you would through a distributor. This way you can focus on your product and let logistics professionals focus on your logistics.”

The takeaway: Find the right partner and go west...and inland. Set your company’s supply chain operation up to deliver on the largest consumer shift in history.