

360° China

WFFC event highlights business realities, the power of *guanxi*, the evolution of the flavor and fragrance industry, and the new Chinese consumer

In a telling introduction to Women in Flavor and Fragrance Commerce's "360° China" event, Joan Huang (US Smokeless Tobacco) remarked that during her childhood in China the only orange drink she had access to was Tang, which at the time seemed "so sophisticated." Despite this humble past, according to World Luxury Association estimates cited by Mei Xu (Chesapeake Bay Candle), China's luxury goods market is expected to eclipse those of the United States and Japan by 2025. This remarkable evolution was the focus of the day's expert presentations.

Quality and Competitive Challenges

The event coincided with the 30th anniversary of reforms that rapidly brought China from Soviet-style stagnation to world economic power. Matthew Rouse (Tohzen Distribution China) noted, however, that there have been growing pains. There are players coming into the supply chain from myriad directions, he explained, many with no accountability and all with a cost-saving mantra. Facing pressures from the West to freeze or even cut costs, fraud and corner-cutting is common in China. "Anticipating desperation and malicious fraud have to be part of your quality and assurance processes," Rouse said. On the upside, he added, there was growing visible management engagement in QC, QA and supply chain.

China, Rouse noted, is exceedingly energy inefficient; raw material and labor costs are rising. He added that managerial talent is a big problem for Chinese companies crossing into new markets and that international competition would likely come from the purchase of an existing company. At the same time, the country's GDP is slowing along with the rest of the world's, though it is somewhat protected by cash reserves. Finally, Rouse explained that China's reputation as an exporter often obscures the fact that it does a tremendous amount of sourcing. Essentially, he said, the country is "an enormous assembly plant." In this role, Rouse noted, China's relationship and trade with the United States is not quite as important to that equation as typically thought.



Mei Xu, Chesapeake Bay Candle



Bill Jin, Pearlchem

Guanxi: Getting into the Inner Circle

Christopher Langholz (Cargill) underscored the difficulties of doing business as an outsider in China, asking, "Are you in the inner circle or outer circle?" The answer he gave: "You need to be on the inside." This system of *guanxi*, or social capital, is rife with subtle complexities that can provide true business leverage, which is far more valuable than oft-broken contracts. With fraud occurring up and down the supply chain and insufficient protection of intellectual property, relationship- (and circle-) building in China is indispensable. By nurturing interpersonal networks, some semblance of balance can be brought to high-variable cost relationships. In these circles, Langholz said, one is constantly adding to and subtracting from interpersonal "balances," reflecting favors and gifts. These are the real glue of business dealings. Guanxi values relationships over contracts, he added, and by nurturing these networks one can gain true business leverage that contracts do not provide.



The well-attended event underscored China's growing importance in the world of flavors and fragrances. In the luxury goods market alone, the country is expected to eclipse the dominance of both the United States and Japan by 2025.

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The Evolution of F&F in China

In 1978, when Art Maloney (Takasago) first visited China, he, like nearly all Westerners, was a true outsider. At that time, the country's Cultural Revolution had frozen its intellectual and industrial development. Flavored and fragranced products were relatively crude, produced with technology and know-how that was stuck in the 1940s and 1950s. "The only carbonated beverage [at that time] was orange," he said. The beverage's color and stability were less than ideal and essentially tasted of "orange-flavored water." While initial attempts to bring truly orange offerings to the country failed, Chinese consumers have long since developed worldlier consumer expectations for everything from food and cosmetics to clothing and transportation.

Meanwhile, Bill Jin (Pearlchem) noted that the country's development of aroma chemical manufacturing has mirrored that of the larger economy.

Nixon's visit to China in 1972, he said, opened up the country at a time when Western countries, citing environmental concerns, were looking to ship certain manufacturing overseas. The aroma chemical industry has since evolved from producing a handful of synthetics to a much broader range of materials, including naturals. Today, 85% of Chinese aroma chemical producers are privately owned, and only 20% of their output is retained for domestic use.

The New Chinese Consumer

Finally, Xu provided a look at China's fragrance industry, which according to Euromonitor grew some 100% between 2002 and 2007. Between 2007 and 2012, the country is expected to repeat this growth. These figures are remarkable, given that China has little history with fragrance. As mentioned earlier, during the era of Communist rule, loosely 1949–1979, the development of all luxury goods consumption and production was arrested—particularly fragrance and cosmetic culture and technology. Today, however, under a more economically liberal system, fragrances are seen as an affordable luxury and are central to the country's corporate gift-giving culture. And so education via advertising and the media has been a highlight of the contemporary Chinese fragrance market. Despite that many of China's 1.3 billion people have yet to achieve the economic standards that beget luxury consumption, the country still boasts the largest number of fragrance consumers in the

Read about China's citrus revolution on Page 32.

world. And as incomes and education levels rise, so too do appetites for luxury and fashion goods. Already, Xu said, the World Luxury Association estimates the size of the Chinese luxury goods market (2007) at \$8 billion, or 18% of the world's share. The industry's future prospects are clear.

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