

Case Study: Roadmap for a Chinese F&F Multinational

Understanding the needs of customers in North America and Europe and being able to deliver innovative solutions to them will be critical for Chinese companies looking to become global

It's official: Last year China became the world's second-largest economy after the United States, surpassing Japan. In 2010 China boasted a GDP of \$9.872 trillion and a GDP growth rate of 10.3%.^a This remarkable growth has effected significant changes to traditional dynamics between China and the rest of the world economy.

"For a long time, the market structure in China was quite simple," notes a 2010 Credit Suisse report on Chinese companies.^b "Domestic companies mainly focused on cheap low-quality products, while Western companies targeted the premium segment. The competitive landscape is, however, evolving very rapidly. Chinese capital goods companies are steadily climbing the quality ladder."

"In just one generation the Chinese market has caught up to all of the Western markets in terms of technologies and products available to consumers, as well as consumer expectations," says Art Maloney, vice president of sales and marketing, fragrance, for Apple Flavor & Fragrance USA Corp. (Apple F&F USA). Maloney, who speaks Mandarin, has more than 30 years of industry experience with IFF and Takasago, and has witnessed China's evolution since his first visit in 1978, adds, "The Chinese consumer is as sophisticated as any consumer in the world."

As a result of market growth and increased sophistication, Anthony Leardi, Apple F&F USA's vice president of technology and innovation, says, "Over the years the Chinese companies have been very domestic, looking internally. Now they're starting to look externally."

Growing Market With Price and Quality Demands

Maloney and Leardi—who has more than 25 years of industry experience with Givaudan and Takasago—are working in conjunction with consultant Trevor Rahill, president of Focus International LLC, and his senior China advisor, Gerard Poon, with more than 50 years of industry experience. Together, they are spearheading the US phase of the Shanghai-based company's globalization strategy, overseeing expansion of its Edison, New Jersey facility, and shepherding Western companies into China with unique fragrance and flavor ingredients and market



Anthony Leardi



Trevor Rahill



Art Maloney

"Customers like to see companies come in knowing their market, knowing their technology, and bringing something new and unique." –Anthony Leardi

experience. Meanwhile, as the company is growing on its home turf to provide a domestic alternative for budding Chinese multinationals.

"Multinationals are investing a huge amount of money in China," says Rahill. However, he adds, "They are only working with Western-owned F&F companies and I think they are missing out on accessing the unique abilities and knowledge that a local company ... can bring them while also meeting their quality requirements."

"It's very important, when you enter the market, to do your homework and see what your competition is doing," says Maloney. "Most importantly you have to talk to the consumer to get a handle on what their requirements and aspirations are, because China is a vast country with many different ethnic groups." Maloney says that while luxury product sales are strong, the Chinese mass market is growing fastest, affecting pricing constraints, but not demands for quality. "Like in any market," he says, "the product has to perform and support its claims. Chinese

^a New York Times, 8/15/2010

^b R Hess, *The Emergence of Competitive Chinese Companies*. <https://emagazine.credit-suisse.com> (2010)

consumers are going to expect a high-quality product: it has to perform the way [the] advertising says it's going to perform.”

The Apple F&F USA team notes that the Chinese market is fast-growing and competitive and that relationships are key to maintaining market share. The market can be broken into three distinct segments, they say:

- International;
- Growing local giants; and
- Local.

The defining factor for each level is access to technology—the higher up on the ladder, the more technology required. The Apple F&F USA team notes that the “growing local giants” sector is where most Chinese and international companies directly compete against each other. However, the advantage is clearly on the side of foreign companies that have not only been established longer than domestic competitors but in fact have been servicing the Chinese market longer than local players.^c In addition,

^c For perspective, Apple F&F was established just 15 years ago.

At a Glance: Apple Flavour & Fragrance Co., Ltd.

Founded: 1996

Headquarters: Shanghai

Chairman and general manager: Wei Zhonghao

Employees: 800+, including 200 technical and creative staff

2010 sales: More than 1 billion RMB (\$180 million); 90% domestic, 10% international

The founding of Apple Flavour & Fragrance Group (formerly Shanghai Apple) in 1996 followed the opening up of the market and the privatization of state-owned enterprises (SOE). Chairman and general manager Wei Zhonghao previously worked for Peacock, a privatized SOE based on Hainan Island, and then for Boton, based in Guangzhou. While the company initially focused on building its market share in China, the company has gradually expanded its distribution and international customer service networks and, in 2004, opened its Edison, New Jersey, office and lab. The company's US activities focused primarily on aroma chemicals and ingredients, while also providing product development input for the China-based R&D team using North American product introductions. Today, the Apple Flavour & Fragrance Group produces fragrances, food and beverage flavors, tobacco flavors, aroma chemicals, and ingredients. The group's sales of compounded flavors and fragrances are focused primarily in China and, to a lesser extent, Southeast Asia, while its aroma chemicals and ingredient businesses are now established in the United States, Europe and other global markets.

the team says, “The local market is very fragmented and so economies of scale have not yet been realized, which needs to be addressed in the future.”

Meanwhile, they point out that the perception of a lack of quality and innovation among Chinese players has made growth and expansion difficult thus far—a serious roadblock to obtaining multinational customers.

Rahill notes, “At this time, many Chinese companies are still going to the foreign firms because they have global reach, innovation and perceived better quality.”

As a result, many Chinese F&F companies have opted to be ingredient suppliers, ceding value-added activities to global organizations. However, the domestic industry does dominate the competitive low-technology, low-cost, “purely local” customer base. While Maloney, Leardi and Rahill understand the value of this base for the Chinese F&F industry, they're focused on gaining the types of technologies and specialties that can lift a Chinese company into the international tier, servicing large domestic and multinational customers. Maloney concludes that it is just as important for aspiring Chinese multinationals to be perceived as being of global quality at home as it is abroad.

“Local companies that are growing will eventually be global,” says Rahill. If a Chinese F&F company can establish its perception in the market place as being an international company, a successful transition will be possible.

“Opening an office in the United States is a step along the way of becoming global,” says Leardi of Apple F&F USA's strategy. “In order to be treated as a global company [Apple F&F] has to satisfy its local market as well as an international one. And it's an opportunity for foreign companies to get a look into China ... when they want to expand into, or even just understand, the market.”

Seeking Unique Ingredients, Research and Market Understanding

“In terms of fragrances, there are some Chinese products that are Chinese-oriented, but I'd say by and large the fragrances that work in China are fragrance types that we see in products in the Western world,” says Maloney. For example, he says, “For functional cleaning products we'll see traditional lemon fragrances.” At the same time, Maloney explains, “We're seeing many new fragrance introductions [in the Chinese market], just as we're seeing in the Western world. The products and fragrances have to be rejuvenated—it's a very competitive market. Marketing and market research is so important to identify what types of relatively new fragrances are going to be appreciated by the Chinese consumer.”

Meanwhile, he says, “The Western world is looking to the Eastern world for various types of wellness [solutions]. Maloney cites the rising popularity of alternative medicines in the west as just one example. At the same time, he explains, “Wellness is becoming an increasingly important factor for the Chinese consumer because there is a pollution problem. We have seen cosmetic products [launched] that protect the skin from pollution and the

environment over the last three or four years. So here is another path to the consumers' needs."

As a result, through its naturals program and botanical garden, the company is focused on researching and commercializing various herbs and flowers from China which have folkloric—and perhaps actual—benefits for use in perfumery. "It's an example of knowing what the Chinese consumer needs and then technically designing products that respond to them, but also ensuring that when the consumer uses the product it performs the way the advertising says it's going to," Maloney says, adding that the company invests ~6% of revenues into R&D.

"Customers like to see companies come in knowing their market, knowing their technology, and bringing something new and unique," says Leardi, adding that companies should "look to technical staff to bring new materials and compounds to the creative groups to introduce truly unique fragrances. And they should find a way to take the consumers' expectations and bring them into the R&D and creative processes. It will benefit all concerned if this dialogue is encouraged by the management."

As a tool for research, Leardi believes Apple F&F's botanical garden—based just outside of Shanghai—will allow the company to take traditional Chinese ingredients into the 21st century by better understanding and validating the effects of various extracts for commercialization: "It's about taking something that's been at the laboratory and development stage and bringing it to the marketplace in a form that we can use." In cooperation with university researchers and using headspace analysis, the company is working to launch materials with unique psychological and odorant benefits. (Leardi declined to specify ingredients at this time, as the program is in its nascent stages.) "They [Apple F&F] have a plantation where they're growing plants to do further studies and extractions," says Leardi. "They're doing cross-breeding of plants to look for new types of aroma materials that are different from what's out there now." At the same time, the company has constructed a facility outside of Shanghai dedicated to natural flavors and extracts to meet the growing demand. This, Rahill notes, is unique in the Chinese industry, which has tended to focus on synthetics. Meanwhile, Apple F&F USA is expanding its Edison, New Jersey site, with support coming from an international team based at the Shanghai fragrance center.

Grow With the Growers: US Expansion and Beyond

Through this strategy, Apple F&F hopes to position itself with a global customer base that will increasingly seek advice and expertise in penetrating the growing middle class Chinese consumer market, which is expected to one day top that of the United States. The company, says Maloney, "has some very definite growth aspirations for the rest of the world; North America is going to be a stepping stone," adding that its North American initiative will ultimately target all markets. "The US market is the largest F&F market in the world and in many ways is the center of the F&F industry from a Chinese perspective," the Apple F&F USA team says.

"To be considered a global company the first issue is to establish one's credibility in the US market." At the same time, the company seeks to have a proven international presence in place as Chinese customer companies grow to a larger, more sophisticated scale that requires expansion overseas. This is what the Apple F&F USA team describes as "grow with the growers."

Rahill adds, "I think one of the strengths of a Chinese company is an emerging market strategy. They're particularly attuned to be more competitive in those marketplaces. The markets in South America, India, Eastern Europe and the Middle East are all markets where a good, agile Chinese company could be quite effective. That will come in the future."

In addition to market access, the company is looking to draw inspiration from the North American market dynamism, characterized by fragrance creativity and countless new product launches. Bringing this level of product development to Chinese customers is expected to make them more competitive with established multinationals at home and abroad. As the team points out, "Chinese customers and consumers are yearning for the next new idea."

The US expansion will initially focus on compounded fragrances, followed by compounded flavors. "Customers who manufacture finished products in China or Asia can now have their fragrances developed in the United States," the team explains, adding that the ingredients used in the development process in the United States will be the same ones used in the manufacturing in China.

"Customers will not only have the opportunity to provide unique odor experiences but can stimulate consumers' senses and imaginations as well," says Maloney. "The Chinese have always been able to appreciate the yin and yang, the coupling of diverse attributes into a harmonious whole. We now have the opportunity and the means to create new fragrances expressing this concept."

This global market, production and technology expansion effort, which could include "strategic acquisitions in targeted markets," is aimed at positioning Apple F&F as a global player. The goal, says the team, is to address the mature markets of North America and Europe before spring boarding the company and its customers into booming emerging markets.

Major F&F Industry Player From China?

"It is certainly inevitable that a major industry player will emerge from within China, but it will not be easy," says the Apple F&F USA team. Growth, they add, can come from organic growth, but acquisitions will be required for fast expansion. "The biggest hurdle will come from coordinating management styles and cultures to build a cohesive global structure," they say. "Understanding the needs of customers in North America and Europe and being able to deliver to them innovative solutions will be critical for Chinese companies to become global."