An analysis of the chinese spirit industry

China has a long tradition of alcohol consumption, dating back many millennia; in fact, in China, wine is sometimes called the “ water of history” because of its intertwined history with Chinese society (Confucius Institute), whether it has been spiritual, physical, or economic. From the very beginning, alcohol played a large role in the country’s culture – as a dowry gift, a poetry muse, or a fallen warrior’s funereal rites (Cultural China). Today, it is used as a way to celebrate life, and one can see this line of thought even in the Chinese language: for example, the phrase jiuxi, or “ alcohol banquet,” is taken to mean that every person’s life should involve some sort of drinking. It is considered proper to celebrate major rites of passages, such as weddings, making a fortune, or even buying a house, with alcohol (Cultural China). One characteristic of Chinese society is that every person has a type of alcoholic drink to suit their lifestyle or circumstances: the elderly, for example, consume herbal spirits to stay healthy, while local spirits are generally used in business or government settings (Euromonitor). In this paper, we will: (1) perform a cursory examination of the Chinese spirit industry via Porter’s five forces framework; (2) narrow the focus down to a brief analysis of one specific company; (3) compare how different country’s environments can affect business operations through via comparison with another country – Hungary.

Chinese Spirit Industry Analysis

Buyer Power

The spirits industry in China as a whole is extremely fragmented, with both large national and smaller local producers acting as players in the market (Euromonitor). This means that buyers have a variety of choices when it comes to what they ultimately choose to consume or purchase; however, consumers also possess limited power because they are often bound to their favorite brands of alcohol by virtue of brand loyalty (Tea World). Manufacturers of popular drinks such as Wuliangye and Maotai have the power to – and often do – raise prices as they see fit because they know that consumers will purchase them despite the price increases (Euromonitor).

Supplier Power

Outside of equipment and machinery, the main type of input that goes into spirit production is the raw material – such as corn, barley, or rice and other grains – that is then distilled into the final product. Because of the highly commoditized nature of these inputs, supplier power does not seem to be a large threat in this industry. Additionally, many firms have vertically integrated their distilling and bottling operations up to the point that their businesses form towns – take Wuliangye's Liquor City and Maotai Town, for two examples (Wuliangye, Liu).

Threat of New Entrants

Although it may not cost much to start up a small-scale alcohol production facility, the critical mass that is needed for a company to establish key distribution channels, attain economies of scale, and have the marketing resources necessary to be successful on a wide scale requires a large initial capital expenditure. Additionally, foreign firms generally are discouraged from entering the Chinese market because of (1) the disinterest of the Chinese public to brands they do not know about and (2) a lack of cultural knowledge that inevitably leads to, if not outright failure, limited success (Moller).

Threat of Substitutes

The main substitutes for products in this industry sector are other forms of alcohol: namely, beer and wine. Although local spirits remain popular, beer is by far the most purchased and consumed drink in the Chinese alcohol industry as a whole, a status quo that shows no sign of changing in the near future (Euromonitor). Grape wine – not to be confused with Chinese white or yellow wine – which been praised for its cardiovascular health benefits, is another player that will become increasingly more powerful as the Chinese become more health-conscious (Euromonitor).

Competitive Landscape

Because of the economic recovery and an increase in disposable income, spirit volume sales in China increased 5% in 2010 over 2009 (Euromonitor). As mentioned before, the market contains many players and is generally fairly fragmented and competitive; when it comes to foreign competition, though, there seems to be two sides to the story. On the one hand, import sales across virtually all spirit categories – excluding gin – decreased, while spirit exports from China increased; by far, locally produced products comprise the vast majority – over 90% – of Chinese spirit consumption (Euromonitor). On the other hand, the growing Chinese economy, attractive business environment, and increasing openness of the country are sure to attract viable foreign competitors in the near future.

Wuliangye Background and Analysis

Wuliangye Yibin Company Limited is a Chinese beverage company that specializes in the manufacturing of alcoholic products. As of 2010, it is forty-eighth in terms of global market share in the spirits industry (Euromonitor). Wuliangye's product portfolio comprises of many different types of liquors across multiple price points, from economy to premium to mid-market (Wuliangye). Its main product is Wuliangye, the leading Chinese white wine, or baijiu, brand in the country, with over 40% of the market share (China Economic Review); this product is made from a centuries-old recipe that comprises of a blend of five different raw materials (Wuliangye).

Because Chinese consumers are traditionally extremely loyal to their favorite brands (Tea World), Wuliangye, with its baijiu market leadership position and powerful brand name, has a strong advantage over incumbents: despite the economic downturn, its profits have increased steadily from 2007-2009 (Euromonitor). As a result of its brand development and marketing strategy, the company was awarded 39 gold medals for its products in 2005, sharply increasing brand awareness and further strengthening its hold on the market (Euromonitor).

The company's core strength arises mainly from two factors: (1) its aforementioned brand equity and (2) the intrinsic popularity of its main product category, baijiu: according to the magazine China Economic Review, baijiu is the most popular drink in the world in terms of sheer volume sold. For Wuliangye, this means that the company has the opportunity to not only capture value at home, but also abroad -its products are already exported to 26 countries (Euromonitor) – particularly as the global economy continues to recover. It does however, face threats from potential foreign incumbents, changing consumer sentiments in China that result from growing health awareness and increasing government restrictions on alcohol purchase and consumption, and a potential decrease in consumer demand for baijiu as the Chinese alcohol industry expands (NielsenWire).

Wuliangye Distillery vs. Zwack Unicum: How the Country Can Affect Operations

Market Impact

As companies, both Wuliangye and Zwack Unicum hold large brand portfolios that span multiple drink categories and price points; as drinks, Wuliangye and Zwack are seen as the “ national shots” of their respective countries – additionally, both drinks dominate their respective market categories of baijiu and unicum. Moreover, their potential domestic markets are superficially similar – both cultures have long histories of alcohol consumption. However – as mentioned before – because Chinese consumers are generally fiercely brand loyal, Wuliangye may find it more easy to keep its market leader position, particularly as foreign firms struggle to successfully enter the Chinese spirit industry (Euromonitor).

Zwack, on the other hand, operates in an environment where its local consumers are shopping based more on price point than on brand name (Leone); additionally, the Hungarian market is already rife with significant foreign competitors that operate through local subsidiaries that encroach upon the wholly local producers’ territory (Euromonitor). To underline this contrast with an example, Wuliangye was able to increase its prices by 14%

in 2010 (Euromonitor) while Zwack's decrease in profit margins as a result of high Hungarian taxes shows that it cannot raise its prices for fear of losing customers. This is partially because of the differing economic environments of the two countries: China's GDP in 2010 grew an incredible 11% , while Hungary's grew a mere 0. 6% (Euromonitor). As a result, Chinese firms feel more comfortable not only raising product prices, but putting more focus on premium products as their consumers become wealthier (Euromonitor). Not only that, but the business conditions in China are intrinsically just more favorable than those in Hungary, with about 80% of firms reporting to either have turned a profit in the past year or expect to turn a profit soon (Jingli).

Government Impact

Government regulation of alcohol purchase and consumption in China has historically been relatively lax, with a minimum purchasing age only having been established and enforced in the mid-2000's and no legal drinking age on the books (Euromonitor). However, there has been an increase in effort on the government's part to stop drunk driving and to raise awareness of the dangers of alcohol in general, mainly as a result of the large number of vehicular accidents in first-tier cities that occur because of alcohol; this has resulted in more stringent advertising regulations and decreased alcohol consumption (Euromonitor).

Another way that government may significantly affect Wuliangye's success is that it is a state-owned company, which means that it historically has been treated more favorably by the administration than its private counterparts, though this may be changing (Woetzel). On the down side, the Chinese government also provides extremely enticing economic benefits for foreign firms operating on Chinese soil (Euromonitor); this, combined with the aforementioned profitable business environment, may invite foreign firms to increase their efforts to move in on what has long been a domestic-dominated market.

Zwack, on the other hand, must contend with Hungary’s high value-added and excise taxes – both of which not only eat into profit margins, but also encourage underground competition in the form of black market alcohol production. Although Hungary’s corporate tax rate – 16% – is about half of China’s 33%, the additional 25% VAT puts a large financial burden on Hungarian companies.; thus, a typical Hungarian spirit manufacturer can only capture 17. 6% while a Chinese spirit manufacturer can capture close to 50% of the value chain (Euromonitor).

Cultural Impact

Though consumers in both countries partake in spirit consumption on a fairly regular basis, Hungary has a significant advantage in the fact that its alcohol consumption per drinking age person is nearly three times as high as China’s (Keller). However, it should also be noted that China’s population and, thus, potential market, is significantly larger than that of Hungary’s, meaning that Wuliangye has much more room to expand – particularly in developing urban areas – than Zwack does in Hungary’s saturated market (Zoltan). This means that while Wuliangye can focus mainly on geographic and market penetration, Zwack must constantly roll out new products, such as flavored variations on its existing drinks.

Moreover, although both countries rank fairly high in terms of alcohol consumption, Chinese consumers, particularly the affluent, are becoming more health conscious; as a result, this has put pressure on Chinese spirit manufacturers to develop a “ health spin” for their products; Wuliangye, for example, has a subsidiary called “ Wuliangye Health Spirits” which specializes in manufacturing and distributing herbal spirits; in contrast to their normal product lines, these are marketed as carrying health benefits (Interfax). Hungarian consumers, on the other hand, are less health conscious in this regard (Euromonitor), meaning that local producers do not have to make an attempt to change their product portfolio to appear “ healthier” to their consumers.

Conclusion

As we can see, the country that a firm operates in turn affects the way that the business operates, and not only a political level. China, with its booming economy, has consumers that may be less price sensitive than a country like Hungary, who has struggled economically in recent years. However, changing social pressures such as increasing awareness of the implications of excessive alcohol consumption on health have forced Chinese spirit manufacturers to rethink their product line, while their Hungarian counterparts must deal mainly with the challenge of how to continuously innovate their product portfolios. Whatever the country, each location carries with it different advantages and disadvantages, all of which a firm must consider in its daily operations and decision making processes.