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Nongshim: Distributing Korean Spicy Flavor in China*

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Nongshim, the biggest Korean instant noddle producer, entered the biggest Ramen market in the world at 1995. Over the last 18 years, Nongshim introduced more than 10 different Ramen to Chinese consumers, but to fail to gain preference over fierce competitor brands. The Chinese market leader Master Kang won more than 50% market share, Nongshim got less than 1%!

What's the problems? This case investigate the dynamic change of distribution channel on Chinese FMCG markets especially the instant noodle market. Major market research data are provided for marketing executive to make decisions on developing the effective distribution channel strategy in turbulent Chinese FMCG markets.

Key Words: Chinese instant noodle market, Distribution strategy, China FMCG market, Nongshim company

In late 2009, J. Y. Youn, president of Nongshim China in Shanghai, sat in his office room and reached for his second bowl of Shin Ramyun. This spicy, Korean flavor instant noodle had become a regular launch indulgence for Youn ever since he came to China. As he waited for the quarterly business review meeting at 3 p.m., Youn reflected on the company's performance in recent years. From 2006 to 2008, the average market share in most regions in China has turned stagnant, and even worse, it has begun to decline(See Exhibit 1). Now, the average total market share of Nongshim in the China market is only 1%.

The Korean headquarters had come up with a plan to invest an additional $40 million in the China market for the coming year, which would allow Nongshim China to reverse the current situation. In two weeks, Youn was due to make a final recommendation to C. H. Shin, the CEO of Nongshim, about what they should move forward with this money. In preparation for his conference with headquarters' supervisors, Youn had asked his subordinates to help him think through a feasible plan at the quarterly business review meeting. Youn noted, "As the market research manager suggested, the problems were caused by the insufficient development of our marketing channels."(See Exhibit 2).

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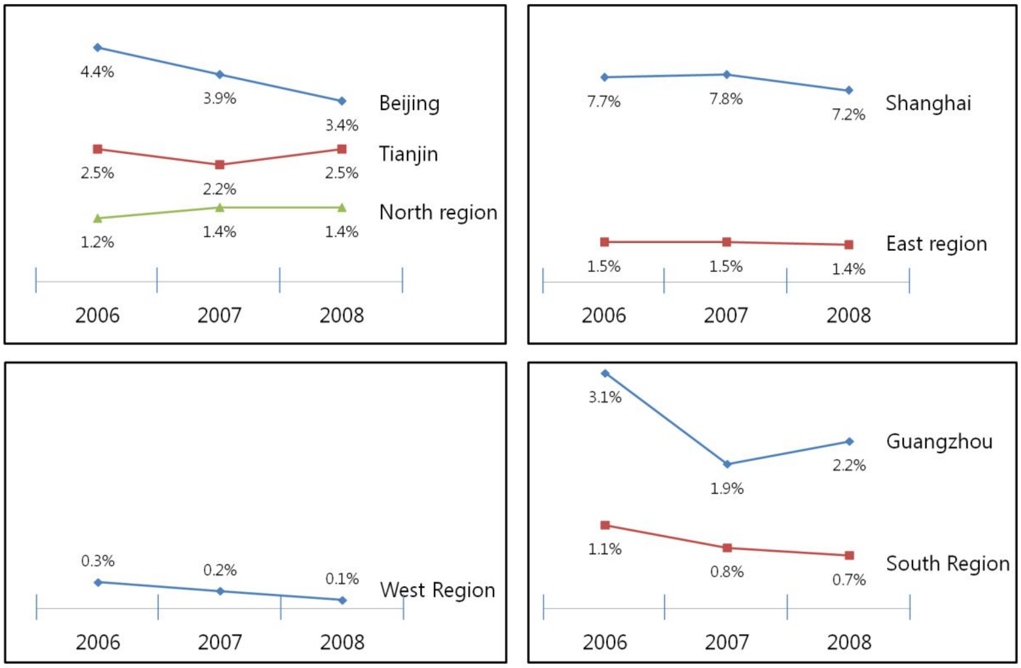
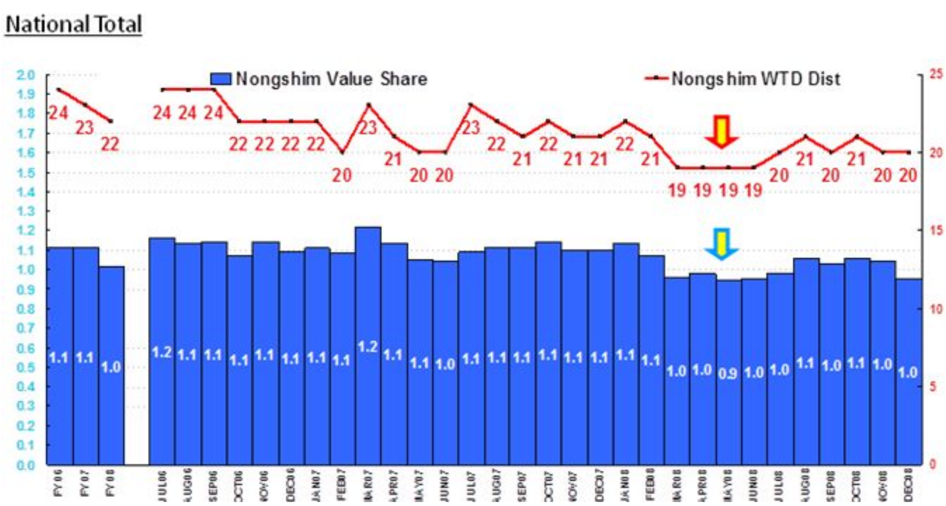
〈Exhibit 1〉 Nongshim's Market Share in Different Regions of China



Source: Internal Document of Nongshim, 2009.

〈Exhibit 2〉 Nongshim's Value Share and WTD Distribution Performance



Source: Internal Document of Nongshim, 2009.

Ⅰ. Company Background

Nongshim is a food manufacturer specializing in instant noodles and snacks, topping the Korean food industry since its establishment in September 18, 1965. Since its inception of year 2000, Nongshim has paid much effort to become a global company and has helped create a better life by providing end-to-end services for promoting health and lifestyle. At the end of 2008, total assets stood at KRW1.73 trillion, 10.7% increase from KRW1.56 trillion posted a year earlier (See **Exhibit 3**).

Ramen (instant noodles) was first introduced to Japan in the late 1950s, after that, many Korean food companies started to manufacture the product; the first was Samyang, in 1963, and then Nongshim began in 1965. Ramen made it possible for consumers to have a quick and inexpensive meal, and its sales continued to grow in both Japan and Korea. The ramen market, however, leveled off in the early 1970s, in Japan, and in Korea, it leveled off in the late 1970s. Since the first instant noodle plant was established in Daebang on Oct. 1966, Nongshim entered the ramen industry as a latecomer in Korea. Although Samyang was the first company to introduce ramen to the Korean market, with continued innovation of their products (especially, 'Shin Ramyun' the most famous product of Nongshim, which was developed on Oct. 1986) and contribution of improving consumers' diets through a variety of noodle products that reflect consumer needs and trends, Nongshim caught up with market leaders in both Japan and Korea markets and eventually gained the largest market share in Korea since the late 1980s(Yoon, 1999).

At present, Nongshim has rolled out all kinds of instant noodles such as Shin Ramyun, Ansung Tang myun, along with various other products like snacks, instant rice, bottled water and fruit juice. Their instant noodles have been popular among Koreans as an alternative to rice—the traditional staple, because

〈Exhibit 3〉 Total Assets of Nongshim (KRW in billions)

	2008	2007	2006
Current assets	623.1	555.7	617.4
Non-current assets	1,102.2	1,003.2	918.4
Total assets	**1,725.3**	**1,558.9**	**1,535.8**
Current liabilities	508.2	464.8	480.5
Long-term liabilities	107.3	69.1	100.4
Total liabilities	**615.5**	**533.9**	**580.9**
Total shareholders' equity	**1,109.8**	**1,025.0**	**954.9**

Source: www.nongshim.co.kr

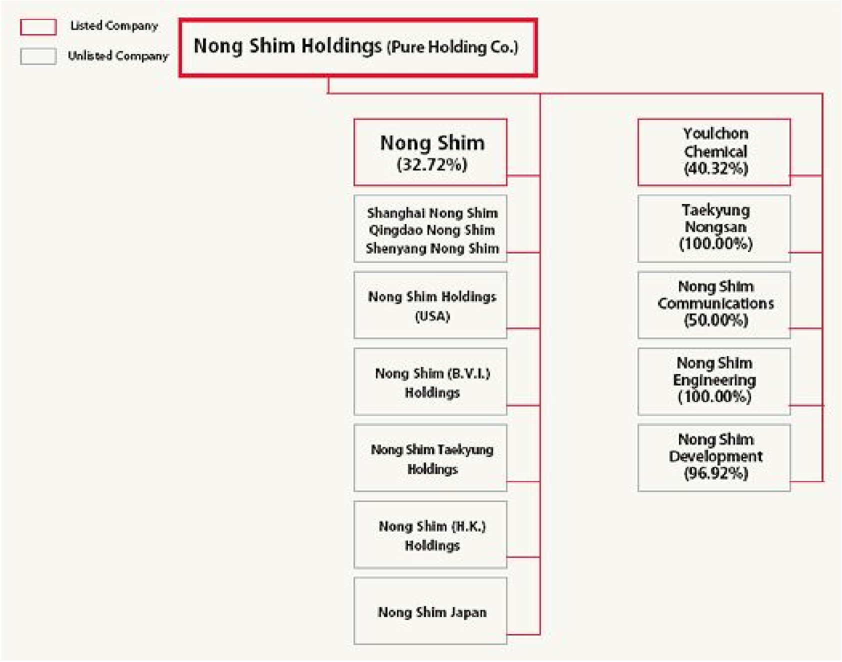
they are tasty, nutritious, hygienic, safe, non-perishable, and convenient. Nongshim has five domestic plants located in Anyang, Ansung, Asan, Kumi and Pusan. At the same time, they also produce bottled water labeled Cheju Samdasu in collaboration with the authorities of Cheju Island. Starting with its most successful product, Shin Ramyun, Nongshim has produced a number of market-leading brands which led them to the top position in the Korean market today.

1.1 Overseas Expansion

After a big success in the Korean domestic market, Nongshim planned to expand to the overseas markets. Their first overseas plant was established in Shanghai, China, on Sep. 1996. After that, Nongshim became a real global company that not only produces instant noodles and snacks, but also contributes to the development of customers' lives and food culture. Nowadays, Nongshim has expanded into about 80 markets overseas by responding to the increasingly changing external environment.

As part of the globalization effort, Nongshim is tapping into overseas markets in a three-tiered way of boosting exports, localizing and enhancing the function of overseas trading firms. As to the effort to boost exports, the company is exporting its products such as instant noodles and snacks to over 80. As part

〈Exhibit 4〉 Demerging of Nongshim (2008)



Source: www.nongshim.co.kr

of the effort, Nongshim is operating three plants in Shanghai, Qingdao and Shenyang and two offices in Beijing and Guangzhou in China. As to the Japanese market, the company has sales footholds in five major cities. Nongshim also expend into North America, such as Los Angeles, New York and Toronto. Through the globalization effort, Nongshim gained knowhow(See **Exhibit 4**) shows the demerging of Nongshim. As of end of 2008, Nongshim Holdings had two listed companies 'Nongshim and Youlchon Chemical' and four non-listed companies such as 'Taekyung Nongsan,' as its affiliates.

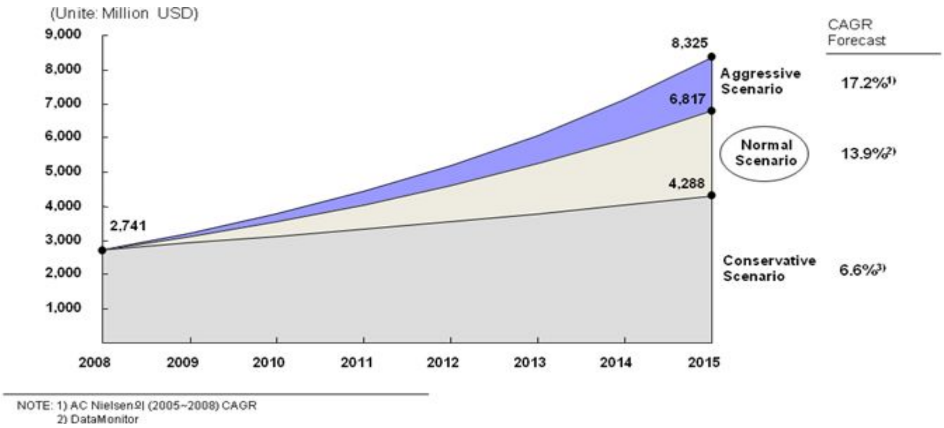
In 2008, Nongshim recorded their overseas markets a 23.6% sales growth from the previous year to US$185.5 million. Viewing sales by region, they posted a 30.3% growth rate in China, 15.0% in the U.S., and 45.5% in Japan. In this case, they achieved an ordinary income surplus of KRW28.1 billion. In addition, Nongshim's exports saw a 16.5% annual growth to US$72.2 million due to balanced growth in the U.S., Canada, Japan, China, South East Asia, Oceania, and Europe, almost everywhere.

II. Chinese Instant Noodle Industry

As one of the key industries listed in the 11th Five-Year Plan in China, the food and beverage industry has met great opportunities to develop rapidly owing to the relevant favorable policies from the Chinese government. Driven by sustained economic development and fueled by enormous inflows of FDI, which will buy consumer confidence, overall food consumption will continue to experience strong growth in China. Total food consumption in China was forecasted to grow by 31.4% to CNY 1.39 trillion in 2013, while per capita food consumption will reach USD $165.5, an increase of 46.3% from 2008 levels. On the other hand, as major cities and market is gradually becoming saturated, investment of food manufacturers has turned to secondary and tertiary cities. This in turn is helping to drive the rise in food consumption, as a wide range of packaged foods become available to more Chinese consumers.

The China instant noodle industry increased year by year since the first package was born in 1970 in Shanghai until today. Recently, with China reportedly accounting for over 50% of the world's instant noodle consumption, the local market is an enormously attractive investment opportunity for local producers and multinationals. As competition intensified ahead of and following the Beijing Olympics, the industry's growth prospects look set to improve as it seeks to make the transition from a cheap, convenient mass-market staple to a premium, healthy product. Instant noodles are now the symbol of convenient, cheap, and unique tasting food that can well satisfy people's hunger. The annual consumption for instant noodles per capita on mainland China, on the average, is 34 packages. In Japan and

〈Exhibit 5〉 Analysis and Forecast of the China Instant Noodle Market (2008-2015)

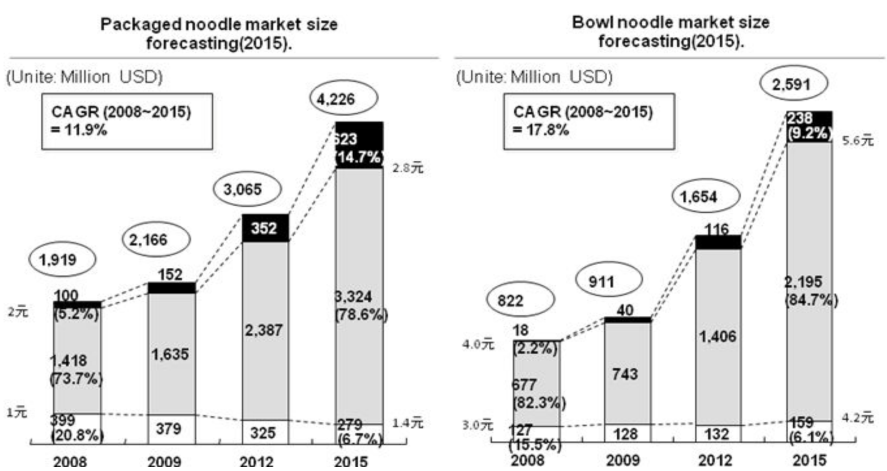


Source: AC Nielsen CAGR Report (2006-2008). Data Monitor Report (~2011).

Korea, where people have similar food habits, the figure is about 50 and 80. In some areas such as second and third tier cities, the instant noodle markets are still under saturated with large potentials. In 2008, the total sales volume of instant noodles was $2,741 million in the China market. It is forecast that China's sales volume of instant noodle will exceed $6,817 million, 2.5 times growth, in 2015; and this market will continue to grow at a normal scenario rate of about 13.9% annually in the following five to ten years (See **Exhibit 5**).

The instant noodle product consists of packaged noodles and bowl noodles. The braised

〈Exhibit 6〉 Packaged and Bowl Market Size Forecasting in the Chinese Instant Noodle Market



Source: Internal Document of Nongshim, 2009.

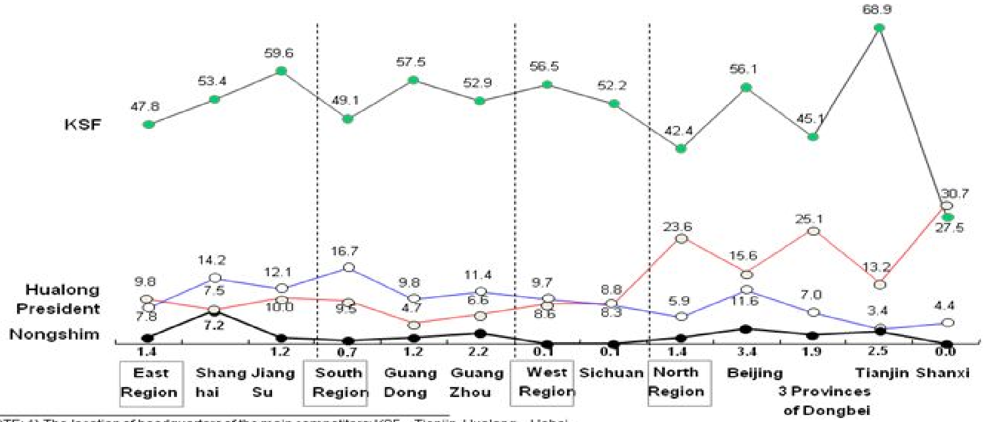
beef taste noodles are still the main product in the China market, and the bowl noodles have grown steadily with the increasing rate from 24% to 29% between 2004 and 2007. In 2008's Chinese ramen market, packaged noodles were proved as the more lucrative product, which is reported as $1,919 million, holding about 70% of the market's overall share. This market is forecast to rise to $4,226 million with the compound annual growth rate of 11.9%. On the other hand, it is predicted that the bowl noodle market share will be increased to 40% in 2015 from 30% in 2008. The average price is forecast to be increasing in the next seven years mainly because of the inflation and rising cost of raw materials (See **Exhibit 6**).

In recent three years, because of the inflation, the instant noodle price has increased greatly from average 1.05yuan to 1.24yuan. The regional noodle product has become boomed and consumers' preferences of the 'Good-Enough' products have increased. Due to the fierce competition, strategy alliance between noodle companies has become a trend. Distribution channels have turned to developing from urban areas to rural areas. Brand value, marketing channels, health and safety, and customers' information are predicted as the core elements of instant noodle manufacturers for success in the near future.

Ⅲ. Competitors

The instant noodle market in China is dominated by three parties. From the competitor's perspective, "KSF" (Tinghsin Group) shares the biggest market by more than 40%. It has a higher market power in almost every region of China. In comparison, other competitors

〈Exhibit 7〉 Market Shares of the Main Competitors Based on Different Regions in China (2008)



NOTE: 1) The location of headquarters of the main competitors: KSF—Tianjin, Hualong—Hebei, President—Shanghai, Baixiang—Henan.

Source: Internal Document, Nongshim (2008).

only have higher market share in their own particular regional segments (See **Exhibit 7**). For example, "Tongyi" (Uni-President Enterprise Group) accounts for a higher market share in the southern part of China. "Hualong" (Nissin Hualong Foods Co., Ltd) has a relatively good market foundation in the second and third tier cities of the northern regions, and recently, they have the tendency to penetrate into the first tier cities.

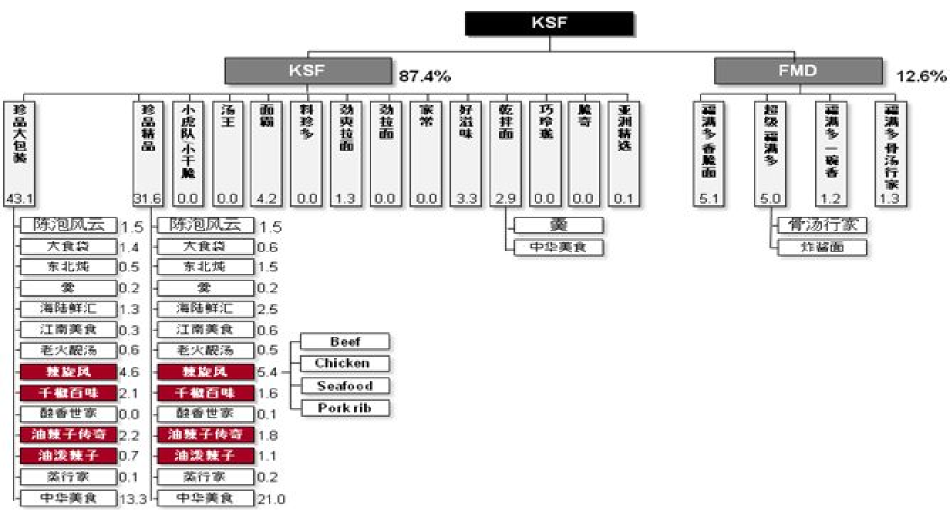
3.1 Master Kang (KSF)

Falling into the temptation of such a large market, the competition is fierce. Among all the players, Taiwanese conglomerates have the best performance and account for the largest market share of instant noodles in the China market. The success of Taiwanese instant noodle enterprises is well illustrated by the rise of KSF, which is owned by Tinghsin Group, the largest packaged-food manufacturer in China. The main strength of KSF is that it has high market share in both the profitable bottled-tea and instant-noodle segments. The headquarters invest 10% of annual turnover into marketing and promotion of new products, ensuring that their products are among the strongest brands in the categories.

According to benchmark analysis, there are four main reasons for KSF's successes in the Chinese instant noodle market:

First, it makes the tastes of its products diversified and localized to cater for different regional consumers. Each taste has been defined after careful investigation. While their Braised Beef Noodle, Laxuanfen Noodle, and Hailuxianhui Noodle are sold nationwide, there are niche variants designed for each specific regions such as Youlazichuanqi (油辣

〈Exhibit 8〉 Total Product Line and Brands for KSF



Source: Nongshim Internal Document, 2009.

子傳奇) flavor, Youpolazi (油潑辣子) flavor selling well in west China, according to consumers' flavor preference.

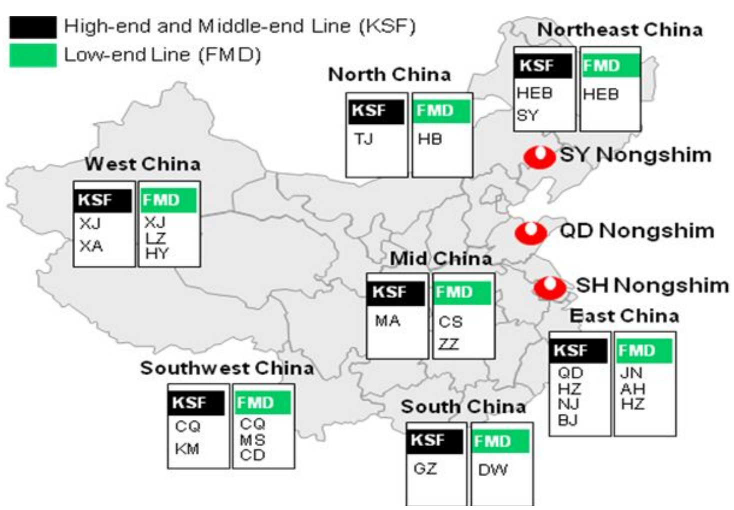
Second, KSF has the capability to maintain constant steady product quality and tries its best to develop various styles. It launched two product lines to conquer the Chinese instant noodle market: Fu Manduo (FMD) and Kangshifu (KSF). The mid tier FMD effectively helped KSF defend against local players while the KSF brand is more likely built for premium (See **Exhibit 8**).

Third, braised beef flavor is the core equity for KSF. It is the top selling product which has contributed 44% of total KSF sales over the years and is still gaining market share at present and it built strong brand awareness of KSF among consumers.

Fourth, KSF established a sales channel from the distributor to the wholesaler and even the retailer for its services in everywhere of China. Its in-depth and national widely distribution networks benefit KSF in expanding their direct distribution channels and logistics inventory capacity, fast product turnover of their wholesalers, increased liquidity, improving the price competitiveness, information collection, as well as efficient regional distributing. It established nationwide factories and use these places as their distribution strongholds (See **Exhibit 9**). In each target market, KSF uses the network distribution way to control their retailers efficiently. The advantages of these territorial expansions and various channels strategy help KSF to keep their leading position in the Chinese instant noodle market for many years.

Thanks to early market entry and substantial

〈Exhibit 9〉 Factories Location and Distribution Footholds of KSF and Nongshim in China



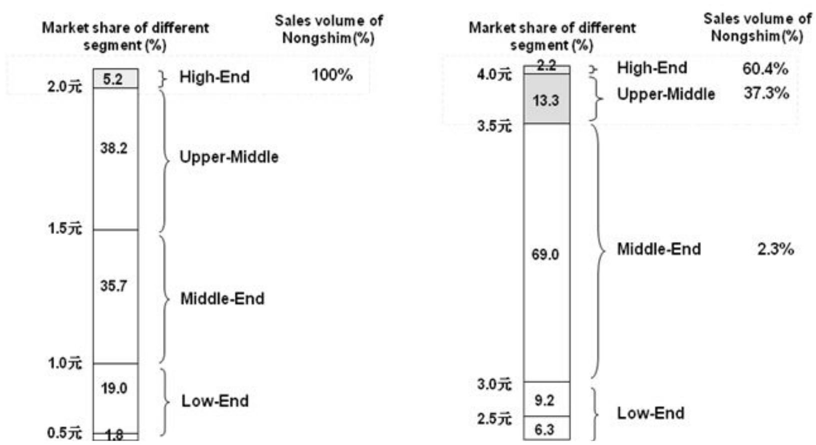
Source: Internal Document of Nongshim, 2009 investment in nationwide distribution, KSF has managed to grab over 40% of Chinese instant noodle sales. However, the company's market share is in decline; having stood at an estimated 49% in 2005, it dropped to 43% in 2007 because of competition from compatriots Uni-President and Nissin Hualong.

3.2 Uni-President

Uni-President Group also plays a noticeable role in the instant noodle market. Like Tinghsin Group, they are also Taiwan-funded enterprises, have similar product lines, similar marketing policies, and even similar enterprise culture. Initiated into the Chinese market with high-end products, Uni-President Group has firmly established its second position in Chinese instant noodle market with competitive advantages similar to those of KSF, including a complete product line, long market developing history, and perfect sales and service system, after several years of steady development.

3.3 Nissin Hualong

As a latecomer to the instant noodle market, Hualong has exceeded many of its forerunners and now is third in the market. It demonstrates the most successful expanding from a local instant brand to a national one. Hualong's performance even shocked KSF and President. As a purely local brand, Hualong has achieved such a performance on the market, where there are two large leading enterprises with longer involving histories, by employing the strategy of "First surround cities from villages, and then occupy the cities," based on sufficient reorganization on the features of Chinese consumer market, to develop its own advantages and avoid its disadvantages and thus to steadily succeed in the mid-end and low-end market,



Source: AC Nielsen Index (2006-2008).

〈Figure A〉 Different Segments of the Chinese Instant Noodle Market which had been blank.

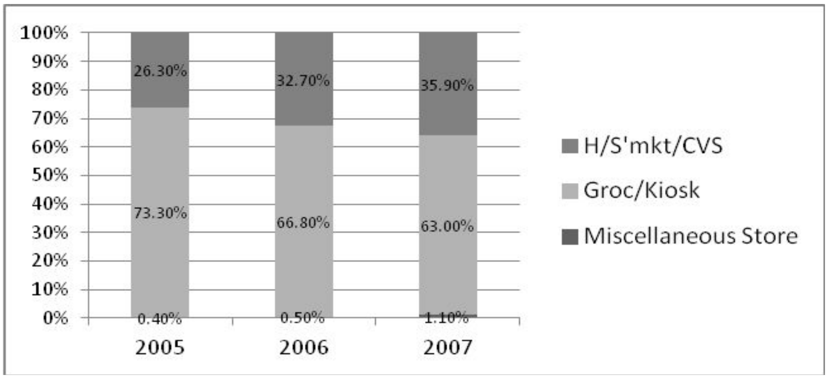
3.4 Segment

Based on price, the Chinese instant noodle market is divided into four segments: high-end, upper-middle, middle-end and low-end (See **Figure A**).

In 2008, the market share of the packaged noodles was about 70%, while the last 30% was the bowl noodles. As **Figure A** shows, the fastest growing segment will be the high-end segment from 5.2% market share in 2008 to 14.7% in 2015 (packaged noodles). The biggest segment will still be the middle-end in the next seven years. In comparison, the low-end market is predicted to be shrinking. In terms of the market value, the bowl noodle market has a similar situation with the packaged noodle market in both high-end and middle-end segments, while, their low-end market is forecast more positively, contrary to the packaged noodle market.

In recent years, intense competition among producers has seen, manufactures focus on marketing and brand-building investments in a bid to make their products standing out among the hundreds of options on offer. This led to rapid proliferation of low-fat and nutritional noodle variants, which typically carry higher price tags and which have proved popular among wealthy, urban consumers. However, they have proved a harder sell at the mass market level, where the price is still prohibitive and where instant noodles are strongly associated with being unhealthy.

The segmentation is obviously based on different brands at present. For example, KSF's "Mian Ba" series focus on the middle-end segment, while another sub-brands, are positioned at the low-end segment. Among all the segments, the high-end segment account for 4.3% market share and, as Nielsen's report in 2008, holding 91% sales volume, Nongshim occupied almost the whole high-end segment both in the packaged noodle market and the



Source: Nielsen Retail Index, Dec. 2008

〈Figure B〉 Channel Situation of Chinese Instant Noodle Market (value %)

bowl noodle market.

3.5 Distribution Channels

Independent retailers and mass grocery stores are the main channels of instant noodle in China (See **Figure B**).

Compared with last three years, hypermarkets and supermarkets have increased their frequency of patronage from consumers. The traditional food retailers appear to be visited somewhat less often than before. The reality is, from the time of early-bird foreign retailers complaining about consumers' resistance to shopping for food and fast-moving consumer goods (FMCG) in a nice, climate-controlled shopping environment in the mid-1990s, organized retail has taken a rapid growth path. This trend could very well have been spurred by the prevalence of counterfeits and low-quality goods being distributed in China. As consumers' incomes reach a certain level, they start to appreciate the better shopping environment and the better assurance of quality and product authenticity that reputable organized retailers provide. This has resulted in the gradual development of hypermarkets/supermarkets in China. Nevertheless, though the Key Account (KA) channel has grown fast in recent years, the main channels for instant noodle distribution are still groceries and kiosks. Since the instant noodle market has almost become saturated in the first tier cities, some manufactures have begun to focus on the second and third tier areas in China.

Ⅳ. New Distribution Situation for Fast Moving Consumer Goods (FMCG) in China

Traditional distribution system was used in the first stage when China operated a planned economy from 1949 to 1978. Then, with the China's economic reforms from 1978, the second stage of distribution system reform has taken place. It not only has changed the forms of logistics and distributions in the country, but also has brought more convenient lives for Chinese consumers. Since China entered the World Trade Organization (WTO) in 2001, China's distribution system development has entered a stage of fast growth(Yau and Steele, 2000). Currently, China's new international links multiplied as its domestic market expanded, and now China is part of more than half of the world's supply chains. At the end of the year 2005, most restrictions to foreign investments and MNE were removed. Many foreign companies have been encouraged by promising market potential to enter the market. Under these circumstances, China's FMCG market distribution channels are changing from only wholesalers and retailers to various types of state-owned, private, and foreign logistics companies in terms of their ownership (Hong and Liu, 2007).

4.1 Distribution Characteristics of FMCG in China

Fast Moving Consumer Goods (FMCG), are the products that are sold quickly at relatively low cost. Though the absolute profit made on FMCG products is relatively small, they generally sell in large quantities, so the cumulative profit on such products can be large(Coulthart, 2006). Examples of FMCG generally include a wide range of frequently purchased consumer products such as toiletries, soap, cosmetics, teeth cleaning products, beverages, and packaged food such as instant noodles, as well as other non-durables such as glassware, light bulbs, batteries, paper products and plastic goods.

Regarding the consumer behavior of FMCG in China, purchase choices are determined by price and value, hence the success of discount stores and multinationals, which are able to buy in bulk and offer low prices. Their choices are entirely unrelated to modern retail; however, they are driven by locality, affordability. In the other hand, for an ever-growing minority, purchasing choices are based on the availability of convenience and the presence of add-value in-store products and services that catenling for their aspiration needs.

In terms of the distribution channel in the FMCG marketing is mainly a supermarket or similar stores(Barschel, 2007). It means the mass grocery retailers which includes hypermarket, supermarket, discount stores and convenience stores are the main distribution channels in Chinese FMCG market. The mass grocery retailers sector experienced explosive growth between 2002 and 2008. It is benefit spectacularly from China's continued economic growth and distribution system reform. From being highly fragmented and typified by small, independent retail outlets, the forms are being transformed by hypermarkets, supermarkets, and discount and convenience stores, as multinationals continue to seek growth opportunities in emerging markets and as local operators expand to protect their market share. The leading multinationals, such as Tesco, Wal-Mart, Carrefour and Auchan are all operating in China.

4.2 Hypermarkets/Supermarkets

The advent of modern trade (MT) distribution market provided Chinese consumers with a wider range of FMCG attractively displayed and priced. The MT has adopted the Western management approach and has been performing particularly well in areas like sourcing, stock ordering, inventory control and handling.

More recently, hypermarkets, which offer lower prices and a broader range of products and services, have increased in popularity, especially in the wealthier coastal cities are more and more popular among the Chinese consumers. Hypermarkets have been able to be cost-competitive because of more efficient and modern distribution systems. These more-efficient distribution systems provide a better opportunity for packaged food, as including instant noodle, bottled water.

In the Chinese consumers' perspectives, awareness is the most important to evaluate store equity. Moreover, most consumers see the store accessibility as the other essential factor of making their shopping decision. Other store equity driving factors, such as efficiency and loyalty program, large store format and wide selection, pricing, and quality products have almost the similar influences to the consumers. In this case, supermarkets have been the preferred format for local operators to upgrade existing premises in line with modern demands. They also provide an ideal balance in terms of real-estate space for expansion and product mix to attract shoppers and maintain profitability. The largest supermarket chain is Lianhua, which operated 3774 stores until 2008 generating almost RMB47 billion in sales. Other major supermarket and hypermarket chains include HuaLian (2108 stores), Nong Gong Shang (3226 stores) and Huarun Wanjia (2539 stores)(Zhongguo lian suo jing ying xie hui, 2008). However, in sales terms, Lianhua has lost its market leading position to Carrefour and Wal-Mart. The foreign retailer giants are gradually seizing the Chinese market day by day. For example, the stores increasing rate of Carrefour is 24% with owning 100 hypermarkets and 212 hard-discount stores. Having acquired Trust-Mat's 100-outlet-strong hypermarket network, Wal-Mart is now the largest retailer in China.

4.3 Convenience Stores/Discount Stores/ Independent Groceries/ Kiosks/ Miscellaneous Stores

Currently there are tens of thousands of small retail shops, kiosks and groceries with different types of ownership selling a great diversity of consumer products, in cities and towns throughout China. Though buyers depend heavily on larger format modern trade, the individual retailer or the traditional trade (TT) is still the leading distribution places for FMCG in China at present(Nielsen, 2008). These types of distribution channels have an incredible geographic reach that can direct contact with the ultimate consumers everywhere. This advantage is obviously for FMCGs distribution; and they are also flexible using in rural places or some third tier cities in China. Even though the independent retailers may have the less competitive price, lower services, worse environment or other disadvantages than MT retailers, their power of penetration cannot be ignored.

In terms of forms, discount stores have proved popular with multinationals, allowing them to appeal to lower-income consumers who would otherwise be beyond the reach of modern retail. Convenience stores are a popular means of expanding in crowed urban centers and of appealing to young and demanding consumers(Zhongguo lian suo jing ying xie hui, 2008). Other places like food retailers, hotels and vending machines —which we call them miscellaneous stores —hold on only a few market shares of total FMCG retailing.

4.4 Open markets/Free markets/Traditional markets

In China, the key-account (KA) distribution channels such as supermarkets or hypermarkets have appeared only during the recent two decades; In the undeveloped places such as some small towns or rural areas the open market still has continued strong growth momentum. Traditionally, farmers and private peddlers are the key players in free markets. However, recently more state- and collectively-owned enterprises, especially some small and medium FMCG companies, are using the free market to sell their products. Since China's vast rural population remains a consumer group that have potentially represent and even bright future of long-term sales growth for retailers and FMCG manufactures, the strategic importance of this channel has long been overlooked by foreign manufacturers and suppliers. Especially in the last two to three years, as major cities have slowly begun to crowd; retailers are expanding into tertiary towns and cities, into rural areas, looking to guarantee future growth prospects.

V. Distributing Korean Spicy Flavor: Nongshim China Development of Nongshim's China Market

The Chinese caring 'taste', 'flavor' and 'color' of their daily food have begun to pursue the 'high scale,' 'diversifies,' 'nutritionally balanced,' 'healthy,' 'convenient' and 'compact' style of their meals(Kim, 2011). Moreover, followed with "Han Liu" (A trend that has made all things Korean popular and Korean cuisine really hot), more and more Chinese young people have become interested in Korean food.

Under this situation, Nongshim entered into the China market in 1995. Owing to distribution network not being formed yet, as well the difficulty in understanding Chinese consumers in a short time, Nongshim used joint venture as the breakthrough procedure. The partner was selected as Want Want, the second largest food company in Taiwan, which owned the most registered trademarks in China at that time. Because the image of the Want Want brand is well known to the public consumers in Mainland China, and within the regions of China, the Group has established 32 sales branches and over 329 sales offices, which has strategic meaning to Nongshim. According to Nongshim's development strategy, Want Want's nationwide distribution networks, local regulatory knowledge and access to what appeared to be a relatively small, high-risk domestic market were exceeding useful to Nongshim. Meanwhile, Want Want had the requirement to diversify their products and planned to aggressively thrust to the China's instant noodle market. Based on this background, the 50/50 joint venture between Nongshim and Want Want started in 1995.

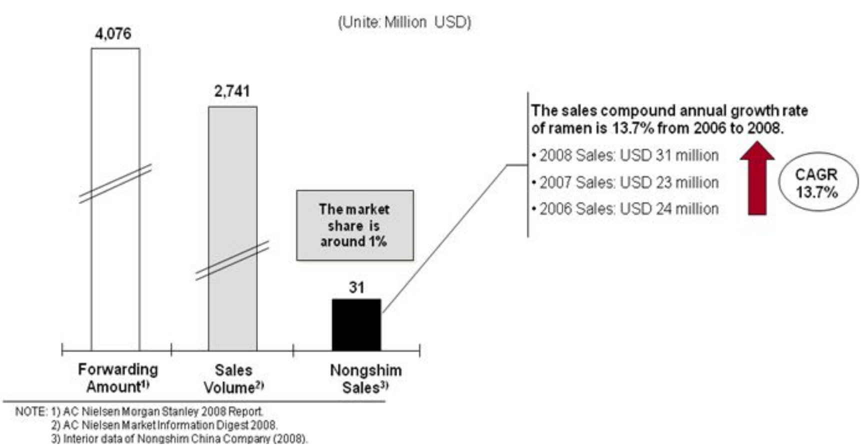
However, in practice like many other joint

〈Exhibit 10〉 Nongshim's Product Line in the China Market

Source: www.nongshim.co.kr

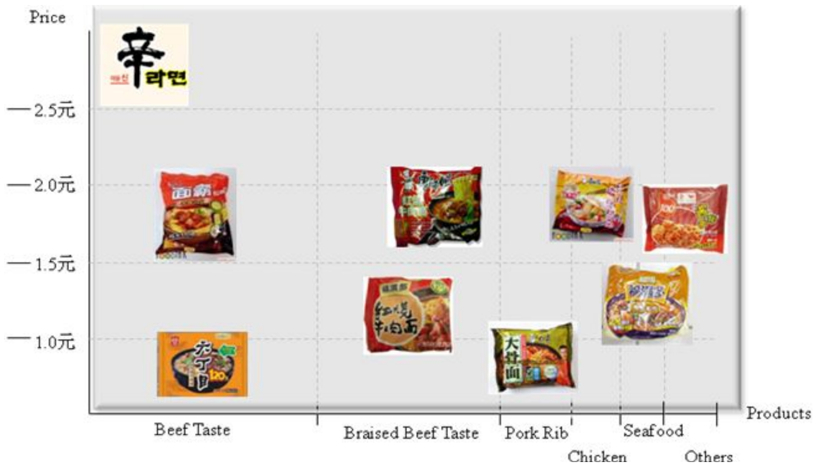
ventures and alliances, Want Want and Nongshim have failed to deliver the original promise. The joint venture ended after Nongshim purchased all the stock, and then decided to do direct investment. So far, with "Shin Ramyun" as the main product, Nongshim has already developed seven kinds of ramen including two local Chinese tastes (See **Exhibit 10**). According to the sales report of Nongshim, the market grew with a compound annual growth rate (CAGR) of 13.7% and the market share is around 1% from 2006 to 2007 (See **Exhibit 11**).

〈Exhibit 11〉 Size of the Chinese Instant Noodle Market and the Market Share of Nongshim (2008)



Source: Internal Report, Nongshim.

〈Exhibit 12〉 Shin Ramyun's Brand Positioning



Source: Internal Document, Nongshim.

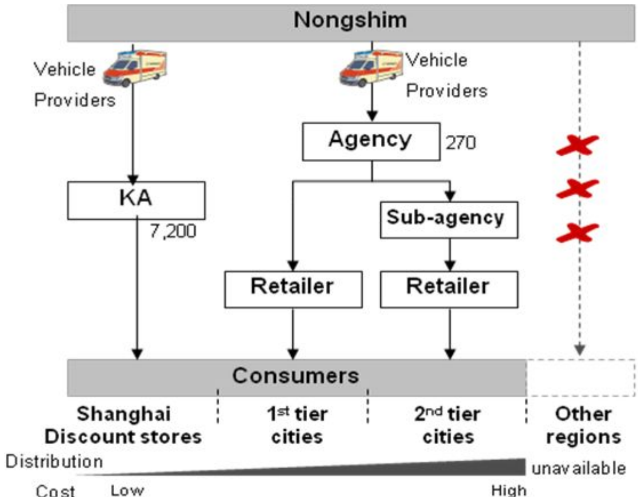
5.1 Shin Ramyun

Shin Ramyun is the most popular spicy and beef tasting product, made of beef flavor and various natural seasoning. Creating a sensation since the first roll out in October 1986, Shin Ramyun has maintained the position as best selling item in Korea. In 2008, Nong Shim's five main noodle products made up an impressive 53.9% share of the Korean noodle market, and among these, Shin Ramyun alone held a 28.2% share of the market (www.nongshim.co.kr). It also is Nongshim's first ramen product with a unique and hot taste introduced in China.

Differentiation strategy was the key factor for Shin Ramyun's success in the China market. When Shin Ramyun was introduced to the China market in 1995, the instant noodle market was divided into the high-end market and low-end market bounded by 1.8yuan(Rhee and Choi, 2006). The low-end market was almost dominated by KSF, President, and Hualong, the G3 of the instant noodle companies. Considering the fierce competition as well as high prices associated with high margins and the fact that sales could be supported by a group of rich consumers, Nongshim decided to position Shin Ramyun in the premium segment (See **Exhibit 12**). The essence of their brand strategy for the high price food brand is the image of high quality new life. The target market is the upper-middle class living in the first tier cities, with incomes of more than 1000 yuan. To fit in with the high price positioning, Nongshim concentrates more on R & D and put a lot of effort into the taste and quality of Shin Ramyun (Kim, 2011).

With differentiation strategy, Shin Ramyun's brand identity has been increased. The unique hot taste and the premium price have

〈Exhibit 13〉 Channel Structure of Nongshim in the China Market



Source: Internal Document of Nongshim, 2009.

attracted a number of consumers who prefer the new life style and high food quality. According to a report of the 2008 China instant noodles competitive landscape, Shin Ramyun was evaluated as one of the fastest growing brands in China's instant noodle market.

5.2 Distribution Strategy

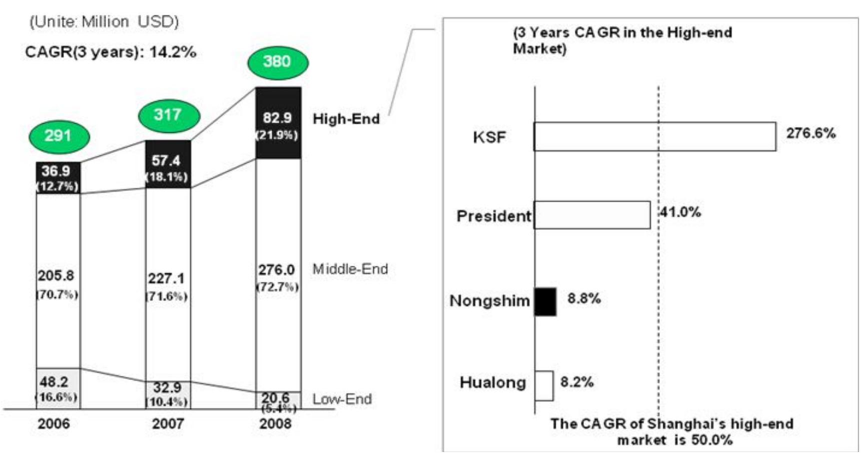
Nongshim adopted different distribution strategies based on different provinces and regions, rather than establish their own distribution systems in the China market (See **Exhibit 13**). Since it is difficult to establish a nationwide distribution network, Nongshim chose a number of metropolises such as Beijing, Shanghai, and Guangzhou as their footholds and spread their distribution channels to other adjacent first tier cities. Considering their penetration capability and their premium product positioning strategy, Nongshim decided to focus on hypermarkets with multi-packs contributing the majority of business in this channel. They wanted to build Shin Ramyun's brand awareness and word-of-mouth effect through hypermarket channels. On the other hand, Nongshim also set up their distribution channels in other cities near those main cities.

According to the distribution structure, Nongshim divided their marketing channels into many categories. Take the Beijing branch for instance; they categorized the distribution channels into seven main channels, about eleven sub-channels and eighteen terminals (See **Exhibit 14**). Meanwhile, they have cooperated with some agencies and brokers. Among these categories, Nongshim picked up two Carrefour hypermarkets as the key stores to exhibit their products. One is located in the Gubei area of Shanghai; the other one is

〈Exhibit 14〉 Channel Categories of Nongshim Beijing Branch

Main Channels		Sub Channels		Terminals		Remarks
A	Mass Grocery Retailers	A1	Hypermarket	A1-1	Hypermarket	MT
		A2	Convenience Stores	A2-1	Chain stores	MT
				A2-2	Independent store	MT
		A3	POST Stores	A3-1	Small size	
				A3-2	Middle size	
		A4	Traditional Groceries	A4-1	Kiosk	
				A4-2	Independent sellers	
B	Restaurant	B1	Restaurant	B1-1	Korean Restaurant	SP
C	Leisure and Entertainment	C1	Sports	C1-1	Golf course	SP
		C2	Entertainment	C2-1	Internet cafe	SP
				C2-2	Night club	SP
				C2-3	Bistros	SP
D	Accommodation & Transportation	D1	Transportation	D1-1	Railway	
		D2	Accommodation	D2-1	Hotel	
				D2-2	Resort	
E	Work places	E1	Work places	E1-1	Troops	SP
				E1-2	Korean companies	SP
F	Special channels	F1	Korean town	F1-1	Korean town	SP
G	Agency/Broker					
*MT: Modern Trade SP: Special Place						

Source: Internal Document of Nongshim Beijing Branch, 2009.



Source: AC Nielsen Retail Index.

〈Figure C〉 Scale of Shanghai Packaged Noodle Market close to the International Trade Exhibition Center in Beijing. In store performances are emphasized and Shin Ramyun is displayed in the most prominent places in these two stores.

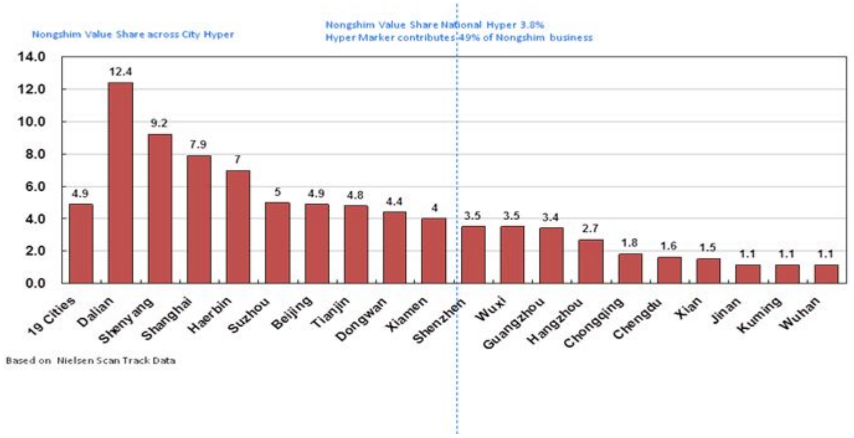
5.3 Current Problems

Though Shin Ramyun had a success after coming into the Chinese market based on their differentiation strategy, the average market share has fallen in recent years. Until 2009, the average total market share of Nongshim in China is only 1% (See **Exhibit 11**).

The decline was driven primary by market share losses in their high-end segment. Shin Ramyun, the most lucrative product of Nongshim, is positioned as a premium brand. A big challenge came from other competitors such as KSF, President, and Hualong to plunder the high-end market, and market growth rate of these companies has significantly increased. The competition is heating up day by day and the battle is not only occurring in the packaged noodle market, but also the bowl market. Take the Shanghai market for instance. (**Figure C** describes the scale of Shanghai packaged noodle market in recent three years.) KSF has the fastest compound annual growth rate (CAGR) of 276.6% in Shanghai's high-end market, and this number is followed by 41.0% of President, which is just a little bit lower than the 50% average growth rate of this market. Compared with KSF and President, Nongshim has a very poor performance with only 8.8% CAGR and Hualong is on the heels of Nongshim with the similar 8.2% CAGR. The premium price positioning may result in the growth limitation of Nongshim in this segment.

5.4 Nongshim's Market Research

Nongshim China had much lower penetration



Source: Internal Document of Nongshim, 2009.

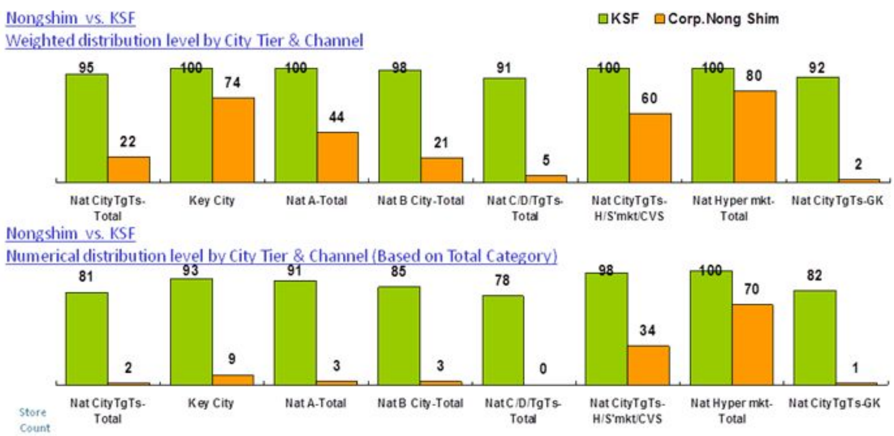
〈Figure D〉 Nongshim's Value Share in Hypermarket, 2008.

of the total population than its major competitors. But its consumers were relative loyal in the category. Periodically, the Nongshim research department fielded a major study to assess the "health" of their marketing channels.

The market research department monitored both the effectiveness of their distribution systems, as well as the cumulative impact of channel coverage on the overall health of their sales. Both quantitative and qualitative research provided data from manual audit stores (such as independent groceries or kiosks) and scanning stores (such as hypermarkets). The result was reported by comparing the benchmark performance with the market leader KSF. "Once we did take notice about our distribution channels, we discovered several things," said Y.S. Kim, the chief of market research team.

First, hypermarket is the core channel (contributing nearly half of Nongshim's business); however, performance is not so good in each city's hypermarket, considering expansion. Nongshim is losing distribution and market share in their current cooperating stores, and facing the strong competition from other competitors (See **Figure D**). In-store performance stagnation might be the main factor in hypermarket share decline. Because in-store share has seen significant drop in last three years, products cannot occupy the best-position selves. It means even with the foo-

〈Exhibit 15〉 Benchmark: Nongshim vs. KSF, Distribution Gap[1)]

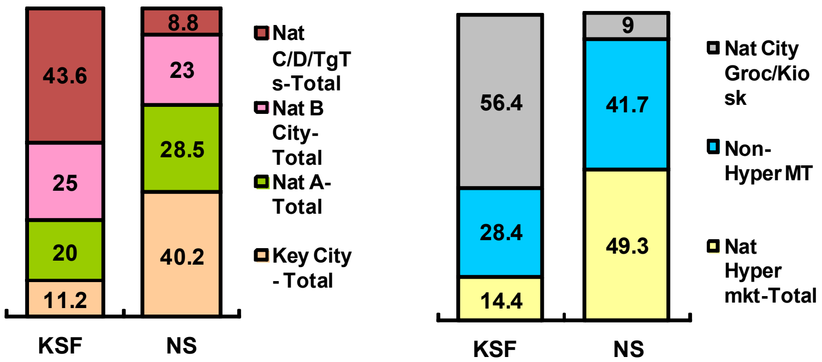


Store Count	Nat CityTgTs-Total	Key City	Nat A-Total	Nat B City-Total	Nat C/D/TgTs-Total	Nat CityTgTs-H/S'mkt/CVS	Nat Hyper mkt-Total	Nat CityTgTs-GK
KSF	1893501	101754	231062	446765		82297	1710	1776420
NS	36413	9599	7833	15406		28552	1197	24006
Gap	1857088	810157	332663	431359		53745	513	1752414

Source: Internal Document of Nongshim, 2009.

1) "A" city (23): Municipalities, Capital city of Province or Autonomous Region and 3 PLC Capitals. (Dalian/Qingdao/Shenzhen is also belonged to A city according to their economy importance)
"B" city (228): Prefecture level city Capitals
"C" city (327): County level city Capitals
"D" city (1301): County Capitals / Urban centres of county towns

〈Exhibit 16〉 Benchmark: Nongshim vs. KSF in Channel/City Tier



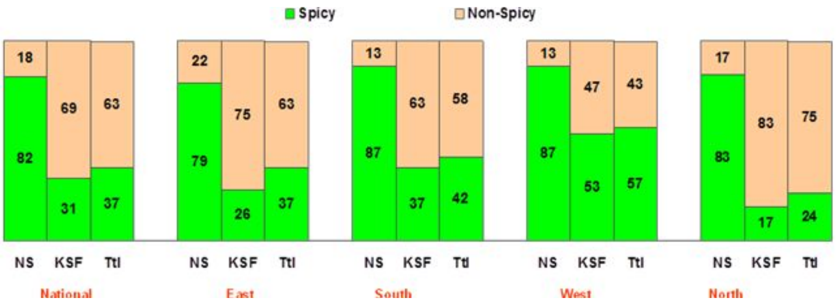
Source: Internal Document of Nongshim, 2009.

tholds of Nongshim, they didn't plant their feet sturdily. In 2008, Nongshim missed over 500 hypermarkets and they still have a big distribution gap with KSF in benchmark (See **Exhibit 15**).

The market research team also discovered that Nongshim's channel expansion to second tier and third tier cities is too limited. Recent years, since major cities have been crowded and markets are gradually becoming saturated, investment of food manufacturers has turned to secondary and tertiary cities in China. Meanwhile, consumers in these regions are evaluated as the highest potential groups in terms of their purchasing power. However, current distribution of Nongshim is very low in these secondary and tertiary cities, even in adjacent markets of their main target cities, such as the developed cities in Zhejiang, Jiangsu, and Guangdong where higher prices are seen. Compared to KSF, Nongshim is more concentrated in key and first city hypermarkets; hence it lacks national presence and scale (See **Exhibit 16**). Moreover, development of Nongshim's marketing channels to non-hypermarket, independent groceries, and kiosks is insufficient. The problem, as **Figure B** indicates that although the KA channel has grown fast in recent years, the main channel for instant noodle distribution is still the groceries and kiosks in traditional formats. So, it is very difficult for Nongshim to build their brand awareness and increase their market share by only counting on hypermarket channels.

With respect to consumer behavior, the market research team discovered that, Nongshim's distribution segments and Shin Ramyun's unique selling points (USP) are incompatible (Kim, 2011). The USP of Shin Ramyun is their spicy taste; nevertheless, Nongshim chose Shanghai, where spiciness is not the traditionally popular flavor in people's daily food, as their first distribution segment and strong-

〈Exhibit 17〉 Benchmark: Nongshim vs. KSF in Flavor

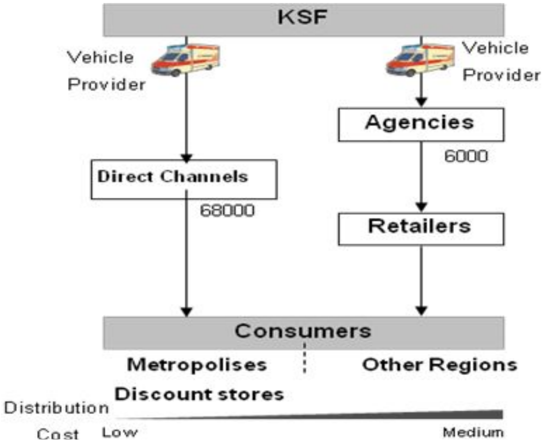


Source: Internal Document of Nongshim, 2009.

hold city. This inappropriate channel segment brings conflict between Nongshim's product line and local citizen's dietary habits. In comparison, KSF provided spicier flavor choices in western China according to regional preference while Nongshim holds spicy taste in all areas (See **Exhibit 17**). Consumers in west provinces such as Sichuan, love spicy food and seem more open to spicy flavor. Once Nongshim can penetrate those areas successfully, it seems easier to build the spicy brand image in the future.

Finally, the team discovered that, unlike KSF's nationwide distribution network, there is no integral and nationwide distribution network for Nongshim in the China market. Based on the location of their factories, Nongshim mainly focuses on distributing products to hypermarkets in first tier cities (See **Exhibit 9**). This fragmented distribution system cannot effectively integrate structural channel elements such as configuration, con-

〈Exhibit 18〉 Channel Structure of Master Kang (KSF) in the China Market



Source: Internal Document of Nongshim, 2009.

nection, inventory, and logistics together. Furthermore, the non-integrated distribution system may curb the information flow between supply chain and operation management. In addition, it will increase distribution cost, as **Exhibit 13** indicates, since with the fragmented system, distribution costs usually account for 8% of Nongshim's total sales volume. **Exhibit 18** shows KSF's distribution structure. It helps KSF to cut down channel links in order to reduce distribution costs—only 4.5% of KSF's total sales volume.

5.5 Critical Decision

Responding to the market research findings posed a difficult sales challenge. "I do believe in our market research to assess the cumulative impact of marketing channels in the long run," said Youn, "however, many other factors may have an immediate short-term impact on our sales, it was often difficult to draw causal relationship between channels and sales."

In two weeks, Youn was scheduled to make a final recommendation to Shin and other supervisors about what plan Nongshim China should roll out within the $40 million investment. Staring at the empty ramen bowl on his desk, Youn mused:

"Was the main problem related to the marketing channels? Should we put all of it in developing our distribution channels? Otherwise, what about we invest 50/50 to both channel development and brand promotion activity?"

Youn knew that this critical decision would be the last chance for him to fix the slow sales momentum in the China market.

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〈Teaching Note〉

Nongshim: Distributing Korean Spicy Flavor in China

Ⅰ. Synopsis

Nongshim, the biggest South Korean ramen (instant noodle), snack, beverage and bottled water manufacturer, has a long tradition for being the marketing leader in the domestic ramen market. With total KRW1.78 trillion sales in 2008, Nongshim has exported their products to over eighty countries. In the China market, despite the company has established three plants in Shanghai, Qingdao and Shenyang and two offices in Beijing and Guangzhou, the performance is not as good as supervisors expected. Problems may result from many aspects. According to their market research report, the main problem might have resulted from their inefficient distribution strategy and incomplete marketing channel development. From joint venture to direct investment, Nongshim developed their unique way to distribute products, however, with only 1% of market share, knowing whether the marketing channel strategy should be changed has become one of the most important issues in their further operation decisions. Meanwhile, as the common consensus among all Chinese instant noodle manufacturers: "Winning the Channels" means "Winning the Market", channel competition will still be the mainstream and will become more fiercely in the future.

On the other hand, major changes in the Chinese macro-environment have made great changes of their distribution channels, which a new dynamically and radically reshaped channel structure has been formed in the domestic FMCG market in China. China's distribution channel members are changing from only wholesalers and retailers to various types. At present, hypermarkets, supermarkets, discount stores, convenience stores and other mass grocery retailers are the main distribution channels in the Chinese FMCG market. Because of the uniqueness, large geographical and cultural diverse challenges of the new Chinese FMCG distribution market, learning how to penetrate market via a sustainable distribution system and how to manage marketing channels more effectively are crucial for FMCG manufacturers, especially the instant noodle companies to conquer the market and keep their profits.

II. Teaching Objectives

This case is designed for a course in marketing and business strategy, specially in FMCG distribution, marketing channels and instant noodle distribution strategy. The teaching objectives are as follows:

1. To understand the importance of distribution strategy in China FMCG, especially the instant noodle market.

2. To learn the distinctive characteristics of China FMCG distribution market.

3. To evaluate the differences of distribution strategies between Nongshim and Master Kang(KSF).

4. To explore ways to improve and develop a new distribution strategy for Nongshim China.

III. Suggested Assignment Questions

1. Discuss the importance of distribution channels for FMCG in the China market. Why are marketing channels so critical for the instant noodle manufacturers?

2. What are the distinctive characteristics of China FMCG distribution market? What are these features could influence or have influenced instant noodle industry in China?

3. What are the differences between Nongshim and Master Kang(KSF) in terms of their distribution strategies?

4. Based on Nongshim's market research, should they change their current distribution strategy? Why and How?

IV. Analysis

1. Discuss the importance of distribution channels for FMCG in the China market. Why are marketing channels so critical for the instant noodle manufacturers?

Based on the features of Fast Moving Consumer Goods (FMCG), highly effective distribution channels can help manufacturers to sell products quickly with relatively low cost. In other words, distribution channels are the lifeline of FMCG manufacturers, because they include logistics, information flow, and finance flow; moreover, they can build a bridge between producers and consumers.

In terms of instant noodle manufacturers, channels competition is still the mainstream in recent years in the China market. In other words: "Winning the channels" means "Winning the market." For instance, on Feb. 8 2006, Uni-President Company held an annual conference with their distribution agents. Two days later, Master Kang(KSF) held a similar symposium with their agents and wholesalers on the same topic, "How to develop dynamic distribution channels." The purposes of the conference are coincidentally identical and obvious: gaining the marketing channels. In fact, whatever "President," "KSF," or other successful instant noodle manufacturers do, they are all the beneficiaries from a well-organized distribution system. This value delivery network is so important that a company's channel decisions directly affect other marketing decisions. For example, pricing strategy depends on whether the company works with national discount chains, uses high-quality specialty stores, or sells directly via the Internet. The firm's sales force and communications decisions depend on how much persuasion, training, motivation, and support its channel partners need. Moreover, whether a firm develops or acquires certain new products may depend on how well those products fit the capabilities of its channel members. At present, many instant noodle enterprises are seeking a way of transformation and innovation in order to develop the best suitable distribution channels to conquer more market share. They realize that the key issue of surviving or winning in the market is distribution channels.

2. What are the distinctive characteristics of China FMCG distribution market? What are these features could influence or have influenced instant noodle industry in China?

Chinese FMCG market is highly fragmented market, FMCG industry in China has to deal with a multitude of retail partners, each of them with very limited regional reach and its own particular sales concept and distribution and supply chain management will be still difficult in this market. In fact, China's distribution system has dramatic changes since the implementation of the economic reform and the open-door policy in late 1978. The transformation has led to a shift of emphasis from unified supply chain system, unified distribution, a complex circulation system that includes multiple forms of ownership, multiple channels, reduction in segments and levels of distribution system, high efficiency and smooth products circulation.

(1) Reform and Development of the Distribution System in China

Before the year 1978, China operated a planned economy and China participated in little trade with the outside world. Because of the slow economy development, consumer incomes increased slowly, and Chinese consumer markets remained poor. Under such circumstance, the Chinese government was concerned with ways to reform its closed and rigidly planned economy, develop China's consumer market and raise the purchasing power of consumers. Since the Third Plenary Session of the 11th Central Committee of the Communist Party of China held in Dec. 1978, the reform of China's economic system was taken place and the commodity market was restored and began to develop. Since then, China's economy and its distribution system have changed and developed rapidly. The reform and development of the distribution system have gone through two stages.

Traditional distribution system was used in the first stage when China operated a planned economy from 1949 to 1978. Under this central economic planning system, China structured its central distribution system and marketing channels into three levels. Within this structure, the flows of commodities from manufacturers to retailers and then to consumers through three-tiers of wholesalers, specifically provincial, municipal and district level wholesalers. This traditional threetier distribution system was operated by a top-down approach in the allocation of production and distribution quotas according to the central government's mandatory plan. The State Planning Commission set overall production goals for factories and collected the output from them. Products from manufacturers were transported to first-level wholesalers in the large cities for intra-provincial sale. They were then distributed to secondlevel wholesalers in municipal districts. Retailers in cities were at the end of the distribution channels. In the context of this unique distribution system, most marketing channels operated within a narrow, specific territory and the business scope was predetermined according to the mandatory economic plan. Limitation is obviously, because of the planned nature of distribution and production was centered upon a specific physical and administrative base, naturally, none of the players under could to compete for survival under this system(Yau and Steele, 2000).

With the China's economic reforms from 1978, the second stage of distribution system reform has continued for more than thirty years until now. It not only has changed the forms of logistics and distributions in the country, but also has brought more convenient lives for Chinese consumers. In this period, the reform went through four sub-stages: "Autonomy to enterprises stage (1978—1985)" were required to establish enterprise autonomy within a non-planned economic system. During that time, a new commodity circulation system was established which the state-owned commercial enterprises played the leading role. Collective-owned distribution networks and individuals, or other private organizations were engaged to engage in this new distribution system. "Development of horizontal links stage (1986-1988)" changed distribution channels from a vertical linkage system to a horizontal one and a dual distribution system was thus formed. Under this system, producers could supply a certain quantity of products to the central government with a specified production contract; meanwhile, they had more discretion to formulate a supplementary plan according to the market needs and sell their products directly to state-owned and private sales wholesalers or retailers in the free markets of different areas. It was good for moving goods from one province to another more efficiently, less time-consuming and lower costly. In this step, bureaucratic and geographical barriers in the distribution channels were removed and eliminated. In the "consolidation and rectification stage (1989-1991)", the Chinese government mainly focuses on attempting to solve some problems such as corruption, inflation and political privileges which created barriers to free trade market. "Proliferation and cooperation stage (1992-2001)" was taken place after Deng Xiaoping's inspection tour of southern China. The structure of distribution system hasa great change which was reorganized into two levels: national level and local level. Several large-scale wholesale centers were established as well as a greater diversity of economic elements was allowed. The retail sector began to open to foreign investors. Joint ventures between Chinese and overseas companies were permitted to sell their products in Chinese domestic market. Private as well as collective wholesalers and retailers became more motivated and began to play a more important role in the distribution system. In addition, several international enterprises entered the Chinese market sonly and began to take an active part in China's distribution channels and logistics.

During a period of over twenty years reform, the old traditional and rigid centralized distribution system has been replaced by a structured, flexible, efficiently and diversified distribution system with multiple types of ownership. Private as well as collective wholesalers and retailers became more motivated and began to play a more important role in the distribution system. In addition, several international enterprises entered the Chinese market sonly and began to take an active part in China's distribution channels and logistics. In this case, China's commercial system and its distribution channels became more flexible (**See Appendix 1**).

(2) New Distribution Situation for FMCG in China

Since China entered the World Trade Organization (WTO) in 2001, China's distribution system development has entered a stage of fast growth. The logistics industry reported an annual growth rate has increased 18.2% in 2007 than last year, and the total logistics and commercial distribution expense has reached to RMB4540.6 billion. Currently, China's new international links multiplied as its domestic market expanded, and now China is part of more than half of the world's supply chains. At the end of the year 2005, most restrictions to foreign investments and MNE were removed. Many foreign companies have been encouraged by promising market potential to enter the market, including some leading logistics service providers, such as UPS, FedEx, and DHL. With these efforts, China's FMCG market distribution channels are changing from only wholesalers and retailers to various types of state-owned, private, and foreign logistics companies in terms of their ownership. Meanwhile, throughout 2007, multinational retail giants continued to commit vast sums towards expansion in China, with Carrefour pledging some 25 new hypermarkets opening annually and Tesco ensuring 10 new stores a year for the foreseeable future. Wal-Mart has also planned more organic expansion, in addition to the pursuit of further mergers and acquisitions opportunities where available.

(3) Main Problems of Current Distribution System

After more than 30 years developments, China's distribution systems have a great change and this benefit for both Chinese domestic corporations and foreign investors. However, some problems, such as the country's underdeveloped transportation infrastructure, high distribution cost, dearth of logistics talent, limited use of technology, fragmented distribution systems, local protectionism combine to hinder the efficient distribution of domestic and imported products, and regulatory restrictions, and so on are still the main problems which most companies are facing nowadays in China.

1) High Distribution Cost

According to Morgan Stanley estimation in 2001, logistics and distribution spending in China amounted to one-fifth of the nation's GDP and twice the proportion spent on logistics and distribution in the United States. According to a December 2001 Economic Intelligence Unit report, on average, 90 percent of a Chinese manufacturer's time is spent on logistics and 10 percent is spent on manufacturing. Derek J. Leathers, President of Werner Global Logistics, which has been in China since 2005, notes that logistics and distribution costs are proportionately three times higher than in developed countries. He said, "In the U.S. or Japan distribution costs are between 6% and 9%, however, in China the low-side estimates are 20%, but many claim it is worth of 30%."

Today, selling costs in China are significantly higher than those in the West. For many FMCG, distribution costs are proportionally 40 to 50 percent higher than they would be in the United States. Though the lack of nationwide connectivity in transportation affects products movement flows, costs, and through put capacity, the existing inefficiencies of the distribution system —especially in terms of material, information, and financial flows—significantly create delays and raise costs.

2) Inefficient Distribution System

As part of the terms of its WTO entry, China agreed to open market sectors and services that, in the past, were protected from global competition. Nevertheless, the distribution and logistics sector remains highly rigid and fragmented, with strongly protected local interests. Yet of the more than 18000 registered companies claiming to offer logistics services in China, not one can offer nationwide distribution services today. No single logistics provider commands more than 2 percent of the market share.

3) Inevitable Current Problems

Other problems such as the regulatory fragmentation environment, the capacity always exceeds true market demand in China, lack of enforcement capability and local protectionism, and some social and political risks such as joint venture or corruption problems are the inevitable problems existing in the current distribution system.

(4) Current Distribution Situation of the Instant Noodle Industry in the China Market

1) Channels become flatter; long channels and short channels exist simultaneously. After the distribution channel reform of China, as the preceding part has discussed, the market transformed from a seller's market to a buyer's market. In the seller's market, whoever occupies the products wins the whole market. However, in the period of buyer's market, the manufacturers must have the predominant and insightful ability of the consumers. In this case, the manufacture's controlling power of the distribution channels must embody their sustainable abilities of developing, managing and maintaining the relationship of consumers. This is what we refer to as flattening channels. With the flat channel strategy, those companies which are not well managed, low market exploited, and slow to respond will be eliminated inevitably. By comparison, those superior distributors could get more margins through using a series of flatten channel strategies which simplify the channel structure and reduce distribution costs. One thing that should be pointed out is that the flatten channel strategy does not ask firms to cut down their marketing process; it requires them to integrate their resources as well as to transform the old channel system into a new one.

2) Some firms neglect the channel's function to push the terminal/consumers directly. This results in the waste of physical and human resources. With the saying supported by "Terminal is the King," a number of firms attempt to distribute products without using market channels. However, this leads them to lose many segments and markets. What is worse, it causes chaotic market quotation. Although consumers are the most important part of the whole distribution, firms cannot keep moving without obtaining the entire market channel system.

3) Requests and motivation of asking for

more profits from distributors are becoming intensive. Due to the low threshold of the packaged food market, several wholesalers and agents who have their own marketing channels have not been satisfied with being distributors only. On the one hand, they have begun to request more price and policy support from the upstream manufacturers; on the other hand, they are trying to form alliances with some small manufacturers to produce their own products with other brands. This results in more and more traditional distributors becoming small firms with both distributors and manufacturers, or dual identities, concurrently. There's no doubt how disastrous it would be if distributors and their upstream manufactures are trying to scramble for the same market.

4) The entire distribution system is more or less being destroyed due to several low competitive firms plundering the channel resource. Since market channel is the lifeline of the instant noodle companies, it is more meaningful and crucial for those low competitive firms, and because the implementation of various channel strategies will lead to the increase of distribution costs, some firms, in order to plunder channels, even use illegal ways such as cheating the distributors to join in them or bribing local government officers. This has not only ruined the entire distribution system, but has also brought an enormous loss to those honest firms.

5) All in all, we can see how significant the market channels are for these instant noodle enterprises. No matter the market leaders such as "KSF" or some promising companies like "Nongshim," the market channels still will be the main focus of their marketing strategy in the future.

3. What are the differences between Nongshim and Master Kang(KSF) in terms of their distribution strategies?

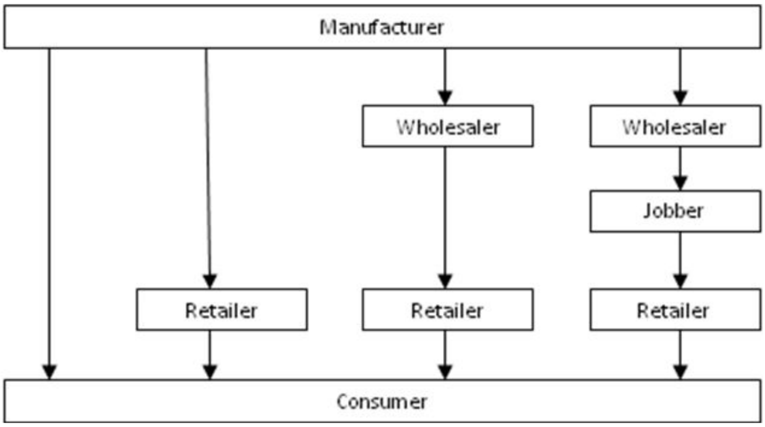
(1) Different Instant Noodle Channel Forms in the China Market

The instant noodle manufacturers use their sales force to sell directly, or sell indirectly through wholesalers or distributors. The basic distribution system is as **Figure A**.

Sometimes, the distribution channel strategies are based on different marketing strategies for each company. There are four kinds of templates as follows:

1) Direct Distribution Template

This template is usually used in urban cities or the areas where the company can be involve in their distribution forces directly. The characteristic of this template is that their distribution channels are dynamic, and they have high control of the price and logistics. At the same time, they can implement specific distribution strategies according to the features of their subordinate members. Direct distribution is one of the fast-growing



Source: Marketing Management 13th Edition, Kotler, 2008.

〈Figure A〉 Distribution Channels for FMCG in China

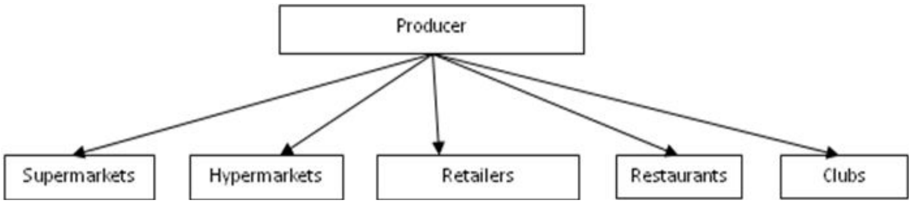
avenues for servicing customers. More and more FMCG companies have turned to this channel in response to the high and increasing costs of reaching target markets through a sales force (**Figure B**).

Considering the penetration capability and their premium product positioning strategy, Nongshim mainly focus on hypermarkets with multi-packs contributing the majority of business in direct channel template.

The biggest advantage of this template is its short channels compared with other templates. Because of its short channels, distribution cost is relatively low, and it is usually swift. It leads to easy promotion, so the price is always stable. In comparison, direct distribution is the most effective controlling system. However, this kind of template is only efficient in metropolis. Therefore, it has sales blind in other regions, and because it requires swift channels, companies require high investment of human and physical resources and high management costs. This template also has limitations relying on the traffic conditions of the territorial segments.

2) Network Distribution Template

Unlike the direct distribution template, the network distribution template requires relatively low human and physical resource invest-



〈Figure B〉 Direct Distribution Template

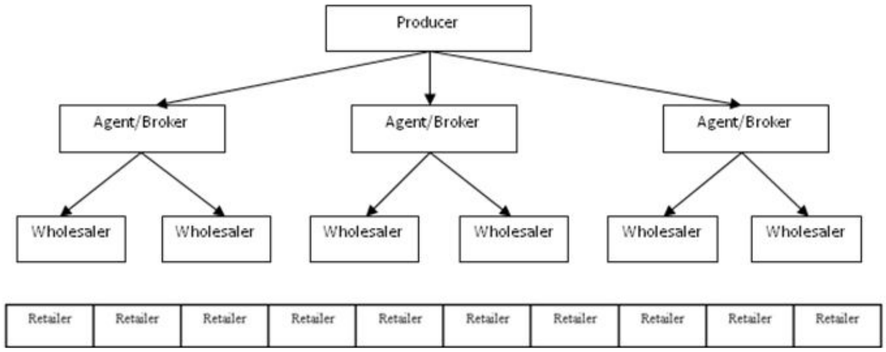
ment. It has vast territorial coverage and high market penetrating capability at the same time. Nonetheless, due to lack of effective restraint on wholesalers, price chaos and scalp products can easily occur. Compared with the direct distribution template, the network template is not swift enough and because channel conflict always exists, it is very hard to control and organize the whole system (**Figure C**).

One good example is KSF. KSF made it mark by effectively operating its wholesalers and agents so that they helped to distribute its products nationally in cities and towns. The reality is, by mainly using this template, KSF owned 552 business offices and 84 warehouses, which are managing 5,872 dealers and 69,096 retailers by the end of 2008. The extensive and highly effective distribution channel network helps KSF keep the leading position of the instant noodle market in China.

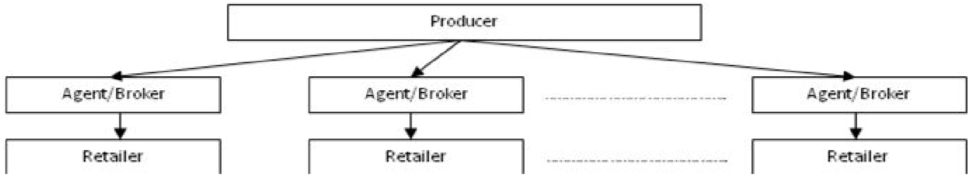
3) Platform Distribution Template

Because of its ability to provide attentive service as well as having the obvious allocation superiority, and its ability to be very swift in the market, this template is mainly used in the first tier cities. (**Figure D**)

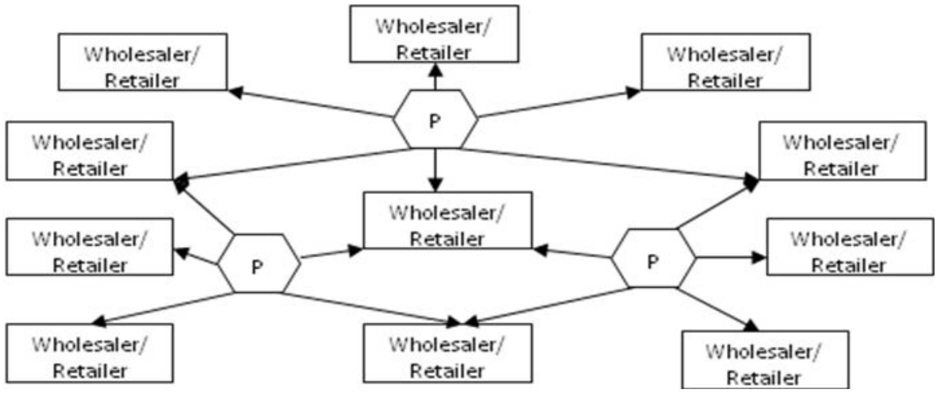
The platform distribution template has a very clear and distinct regional division, so, it has low influences from price chaos and scalp products. Delivery management and after-sales service management are easy to carry out. Meanwhile, distribution network is stable, and the channel-intensive as well as in-depth distribution is easy to implement



〈Figure C〉 Network Distribution Template



〈Figure D〉 Platform Distribution Template



〈Figure E〉 Radial Distribution Template from Open Market

based on this template. To avoid fierce channel competition with KSF, President mainly uses this template. The disadvantage comes from regional restrictions and, due to having to deliver products through agents, it needs a highly organized logistics system and many workers have to be arranged to adapt to this rigorous system. It usually leads to the high management costs.

4) Radial Distribution Template from Open Market

As economic development is reaching rural areas, and with the help of government programs to boost rural development, the vast Chinese rural population remains a consumer group that potentially represent a bright future of long-term sales growth for retailers and FMCG manufactures. For example, by employing the marketing strategy of "First surround cities from villages, and then occupy the cities," Hualong Company uses the radial distribution template to hold the largest market share of the rural areas, particularly in the north part of China (**Figure E**).

According to its specificity, this template presents a dichotomy. Their advantages are that, it is relevantly free, with no regional restriction and low margin but high turnover. The operation is elastic and varied. Moreover, because the allocation is convenient, it has high radial power. On the other hand, its disadvantages are obvious: this template is not systematical and the organization is loose. There are no fixed networks and customers, no in-depth service consciousness, and no maintainable relationship with customers. Meanwhile, due to lack of restraint, price chaos and scalp products can easily occur.

(2) Nongshim's Distribution Strategy

- Nongshim adopted different distribution strategies based on different provinces and regions, rather than establish their own distribution systems in the China market. Nongshim chose a number of metropolises such as Beijing, Shanghai, and Guangzhou as their footholds and spread their distribution channels to other adjacent first tier cities.

- Nongshim mainly focuses on hypermarkets with multi-packs contributing the majority of business in the direct distribution channel.

- Nongshim has cooperated with some agencies and brokers, but their penetration capability is too limited and distribution cost is typical high.

(3) Master Kang's Distribution Strategy

- Master Kang(KSF) has a nationwide sales channel from the distributor to the wholesaler and even the retailer for its services in everywhere of China. Its in-depth and national widely distribution networks benefit KSF in expanding their direct distribution channels and logistics inventory capacity, fast product turnover of their wholesalers, increased liquidity, improving the price competitiveness, information collection, as well as efficient regional distributing.

- Since China is vast in territory, conquering the dispersed rural markets requires many channel links, and the distribution cost is typically high. Take Nongshim for example; if Nongshim wants to distribute their products to Lanzhou or other cities in the west part China, they need to use many wholesalers and agencies. This leads to the rise of the distribution cost, and the channel links will be increased. In this situation, price is usually high and brand will be less competitive. Moreover, because of the long distance transportation, products cannot adapt to the fast change market, and then lose money. In order to solve this problem, KSF established nationwide factories and use these places as their distribution strongholds.

- In each segment market, KSF uses the network distribution way to control their retailers efficiently. By the end of 2008, KSF owned 552 business offices and 84 warehouses, which are managing 5,872 dealers and 69,096 retailers.

4. Based on Nongshim's market research, should they change their current distribution strategy? Why and How?

(1) TWOS Analysis of Nongshim China

- Threat
  - Fierce competition esp. from KSF in core markets.
  - Fragmental Chinese market which is likely in favor of local brands.

- Weakness
  - Low awareness.
  - Limited distribution.
  - Unbalanced product portfolio.
  - Only handling instant noodle category in China.
  - Barely presence in Traditional Trade.

- Opportunity
  - Consumer trading-up trend.
  - Modern trade development to let Nongshim ride on its quick expansion nationwide.

- Strength
  - Strong in a few key & A cities such as SH/BJ/DL/SY/HEB/TJ etc.,
  - Premium image and high product quality
  - Great support from Korea in term of R&D, investment etc.,

(3) Evaluation of the weaknesses of Nongshim's current distribution strategy

1) Considering expansion, performance is not so good in each city's hypermarkets, in which are the core distribution channels with contributing nearly half of Nongshim's total business.

2) The lack of the expansion to second tier and third tier cities.

3) Conflict between Nongshim's distribution segments and Shin Ramyun's unique selling points.

4) The lack of integral and nationwide distribution network. Only focus on Beijing, Shanghai, Guangdong and other metropolises makes Nongshim's distribution network fragmented.

(4) Suggestions and Recommendations

Nongshim shouldn't see the entire China as one market. On the contrary, they should divide China market into several parts and consider the regional effects of their distribution strategy.

In the short term

1) Hypermarket is the core channel (contributes nearly half of Nongshim's business), make sure they are performing well in each city hypermarket along with expansion.

- Strength:
  - In hypermarket, Nongshim's multi packs are selling well due to relative competitive price, they can further support multi-packs in store.

- Challenge:
  - Nongshim is losing distribution and market share in their current cooperating stores, and facing the strong competition from KSF.
  - Promotion is important for hypermarket sales, while promotion types and frequency are extremely important.

- Suggestion:
  - Internally learn from what we have done in Dalian/Shenyang hypermarkets (**See Appendix 2**)

2) To enhance distribution and brand awareness in adjacent markets, such as the developed cities in Zhejiang/Jiangsu/Guangdong where seeing higher price (**See Appendix 3**).

Taking Zhejiang (ZJ) as an example

- Strength
  - Overall average price in ZJ is 1.86/Pack, only next to Shanghai.
  - Near to Shanghai, easy for supply chain management.
  - 5% retail stores in ZJ are modern trade stores, while national level is around 3%.

- Challenge
  - KSF and their braised beef flavor are dominant.
  - Only 21% are spicy, the majority are non-spicy.
  - Nongshim current distribution is very low in ZJ, only 19% in WTD.

- Suggestion
  - Compared to National average, ZJ consumers more prefer seafood flavor, hence Nongshim can leverage their existing seafood flavor of Shin Ramyun.

3) West provinces (esp. Sichuan) are the high consumption area of spicy noodles, once Nongshim can establish the new distribution foothold and can be successful there, they can further built their spicy image (**See Appendix 4**).

Taking Chengdu (CD) as an example

- Strength
  - 60% are spicy flavor; the city is famous for being Hot and Spicy.
  - Nongshim is yet quite good in CD and W1 (Sichuan/Shannxi).

- Challenge
  - Consumers there prefer food not only to be spicy, but also "Ma La" (麻辣) or "Suan La" (酸辣).

- Suggestion
  - Once Nongshim is introducing new Spicy flavors to China, they can first initiate it in west provinces, as consumers there love spicy food and seems more open to new spicy flavor.

In the long term

North and Central provinces should also be Nongshim's focus, as volume contribution due to huge population. Although Nongshim is quite strong in hypermarkets in Shenyang, Dalian, Harbin etc., their total market share is less than 2%, indicating their weak presence outside of hypermarkets and core cities

(**See Appendix 5**).

Taking N1 as an example

- Strength
• Nongshim's factory locates in Shenyang, and share was high in Shenyang and Dalian hypermarkets.

- Challenge
• Limited distribution mainly in hyper-markets, might also think of other modern trade stores;
• Traditional trade is still very dominant while local players are very active and flexible. JinMailang Dongsanfu is the bestselling brand in N1 market, KSF's Dongbeidun also very good in performance; consumers are in favor of local taste.

- Suggestion
• Building distribution network through tradition trade is a long task. In the near future, Nongshim can further ride on current cooperating Modern Trade chains to expand to smaller cities.

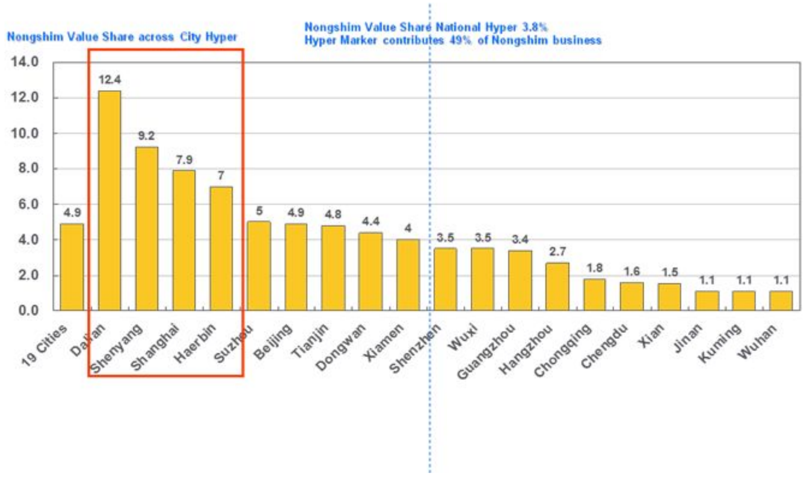
Appendices

〈Appendix 1〉 Brief Reform Process of China's Distribution System

Variables	Stages and Characteristics			
	Before 1978	1979—1991	1992—2001	After 2002
Wholesale	• State-operated wholesale • 1^{st},2^{nd},and 3^{rd} level wholesale	• Trade centre(1984) • Private, collective wholesale	• Agent (1994, 1995) • High speed development of wholesale market • JV wholesale (2001)	• Reform and promotion of wholesalers
Retail	• State-operated Department store • Supply and marketing cooperative	• Individual, privately grocery • Emergence of supermarket and chain store	• Department store began to attenuation • High speed development of chain store • Supermarket, outlet • Foreign retailers entered in China (1994)	• Shopping mall and the expanse of chain store • Convenience store • On-line market
Channel Structure	• Three tiers wholesale and retail distribution system • Commercial ministry, commodity agency and Supply and marketing cooperative	• *"San duo yi shao"* (three mores and one less) • Distribution disordered (1988) • Scalpers	• Agent, large-scale wholesale • Pyramid selling (1991—1998) • Self-established channels (1998) • Channel flattening	• Direct selling • Internet distribution
Channel Controller	• Government • State plan	• State-owned wholesale	• Regional agents (1993—1995) • Supplier (1998)	• Retail giant • Chain store

Source: Taihong, Lu (2005).

〈Appendix 2〉 Nongshim Value Share in Hypermarkets



Source: Internal Document of Nongshim, 2009.

〈Appendix 3〉 The Most Potential Markets for Nongshim

Region	City/ Province	Pop %	Cate.Vol. Contri.%	Per Capita vol. index	Per Capita Income Index	Cate. Average Price	Nongshim Value Share	KSF Value Share
SH	SH	1.5	2.3	1.55	1.81	2.1	7.2	50
E1	JiangSu	6.3	5.7	0.90	1.14	1.6	1.2	52
	ZheJiang	4.0	3.3	0.82	1.58	1.9	0.5	66
E2	Anhui	5.5	15.2	1.10	0.81	1.1	0.0	28
	Henan	8.3			0.83			
GD	Guangdon	7.1	6.1	0.86	1.48	1.9	1.2	51
S1	Hunan	5.7	7.1	1.24	0.93	1.6	0.1	39
	Hubei	5.1			0.87			
S2	Fujian	3.0	4.4	1.47	1.21	1.6	0.8	33
	Jiangxi	3.7			0.82			
W1	Shannxi	3.2	10.5	0.99	0.81	1.5	0.1	46
	Sichuan	7.5			0.84			
W2	Guangxi	4.2	5.0	0.44	0.94	1.7	0.1	55
	Guizhou	3.3			0.79			
	Yunnan	3.8			0.96			
BJ	BJ	1.3	8.1	6.35	1.69	1.8	3.4	50
N2	TJ	0.9	1.1	1.26	1.24	1.5	2.5	56
	Hebei	5.8	8.2	1.41	0.86	1.1	0.1	31
	Shandong	7.8	5.9	0.75	1.02	1.3	1.8	42
	Shanxi	2.8	9.5	3.34	0.86	1.0	0.0	24
N1	Liaoning	3.6	13.1	1.43	0.87	1.2	1.9	38
	Jilin	2.3			0.85			
	Heilongjia	3.3			0.81			

Source: Internal Document of Nongshim, 2009.
- SH/BJ/TJ/GZ/SD (Qingdao)/N1 (Shenyang/Haerbin/Dalian...) are Nongshim's focusing city/province.
- Zhejiang/Guangdong/S2 are more premium markets.
- E2/S1/S2 & North are bigger markets.
- South region are growing rapidly.

〈Appendix 4〉 The Competition Scope in Chengdu/W1

CD	Value %	Value % Chg	WD Selling	Average Price	W1 (Sichuan/Shann	Value %	Value % Chg	WD Selling	Average Price
KSF	55.9	32	100	2.3	KSF	46.1	20	97	2.3
Corp.President	24.8	10	95	2.1	HuaLong	8.8	32	65	1.5
FMD	3.1	6	82	1.1	Corp.President	8.3	-15	49	1.8
HuaLong	2.9	25	53	1.5	Bai Xiang	7.5	87	57	1.0
Bai Xiang	1.5	65	60	1.8	FMD	6.1	10	68	1.0
Corp.Nong Shim	0.6	9	45	3.2	Corp. HuaFeng	6.1	39	50	0.8
					SiMeiTe	4.8	7	40	1.1
					JinFeng	1.3	-4	16	1.0

Source: Internal Document of Nongshim, 2009
- Nongshim's performances were quite good in W1, so they can achieve more as a spicy brand in this spicy land.

〈Appendix 5〉 The Competition Scope in North

BJ	Value %	Value % Chg	WD Selling	Average Price	TJ	Value %	Value % Chg	WD Selling	Average Price	HB	Value %	Value % Chg	WD Selling	Average Price
KSF	50.2	33	99	2.1	KSF	56.2	18	99	1.9	KSF	31.2	27	92	2.1
HuaLong	15.6	24	93	1.5	HuaLong	13.2	9	80	1.2	HuaLong	26.0	-5	96	1.0
Corp.President	11.6	6	96	1.5	FMD	12.7	10	98	1.1	Bai Xiang	15.8	19	86	1.1
FMD	5.9	69	87	1.1	Corp.President	3.4	15	76	1.4	Corp. HuaFeng	6.1	15	72	0.5
Corp.Nong Shim	3.4	6	72	3.2	Bai Xiang	2.8	46	75	1.2	FMD	5.9	42	59	1.0
Bai Xiang	3.0	47	72	1.4	Corp.Nong Shim	2.5	31	66	3.1	Corp.President	3.6	25	44	1.3
ZhongWang	0.7	-84	60	2.2	ZhongWang	1.3	-35	10	0.8	JinFeng	3.0	16	21	1.0
Corp. HuaFeng	0.4	19	9	0.6	Corp. HuaFeng	1.2	4	17	0.6	SiMeiTe	1.0	143	11	0.9
Corp.Nissin	0.2	-73	19	7.3	JinFeng	0.7	182	10	0.9	ZhongWang	0.5	-75	16	1.0
Bai Xiang	0.2	2	13	1.4	Corp.Nissin	0.0	-86	12	2.9	Corp.Nong	0.1	26	8	3.1

SD	Value %	Value % Chg	WD Selling	Average Price	SX	Value %	Value % Chg	WD Selling	Average Price	N1	Value %	Value % Chg	WD Selling	Average Price
KSF	41.6	28	96	2.0	HuaLong	30.7	7	95	1.0	KSF	37.6	43	98	2.1
HuaLong	15.9	9	78	1.3	KSF	23.9	24	92	2.1	HuaLong	25.1	3	93	1.2
Bai Xiang	15.3	2	84	1.1	Bai Xiang	9.3	21	73	0.9	Bai Xiang	7.8	6	74	1.1
FMD	5.7	55	63	1.0	SiMeiTe	9.2	53	70	1.0	FMD	7.5	26	80	0.8
Corp. HuaFeng	5.7	36	48	0.5	Corp.President	4.4	-6	63	0.8	Corp.President	7.0	-9	83	0.7
Corp.President	5.0	-4	49	1.4	FMD	3.6	53	57	0.9	Corp. HuaFeng	5.0	18	73	0.6
Corp.Nong Shim	1.8	13	26	3.2	ZhongWang	2.5	-4	24	0.8	JinFeng	2.8	-11	25	1.0
SiMeiTe	1.6	94	10	1.0	GuoHua	0.1	9	4	0.7	Corp.Nong	1.9	13	36	3.0
JinFeng	1.1	21	13	1.1	Corp.NJC	0.1	159	5	3.3	ZhongWang	0.7	-68	25	1.5
					JinFeng	0.1	-71	3	0.8	SiMeiTe	0.5	27	13	1.0
					Corp.Nong Shim	0.0	45	5	3.6	Corp.NJC	0.2	-39	2	0.8

Source: Internal Document of Nongshim, 2009