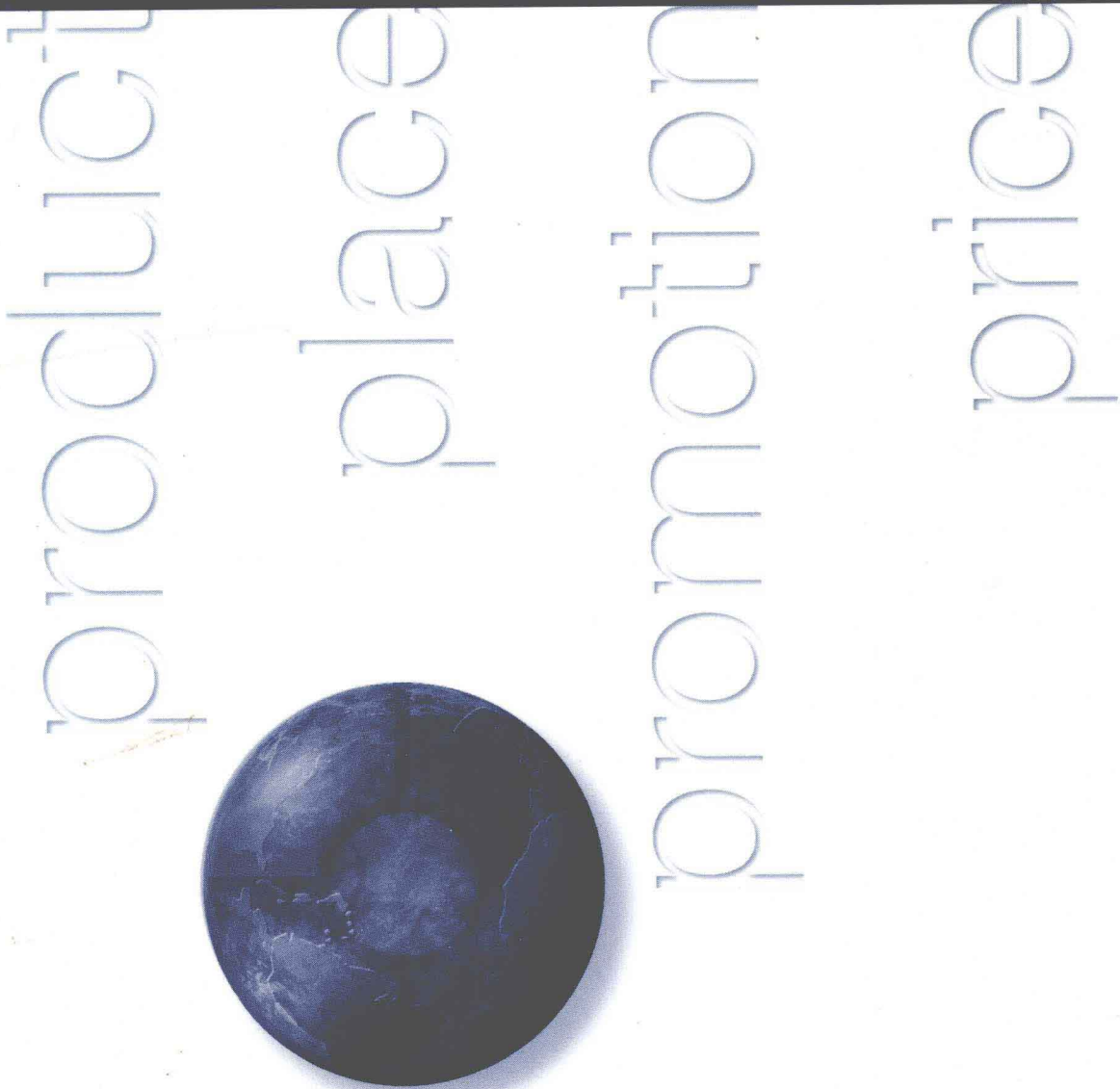


# Applications in Basic Marketing

Clippings from the Popular Business Press

2000-2001 Edition



William D. Perreault, Jr. E. Jerome McCarthy

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## Clippings from the Popular Business Press

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2000-2001 Edition

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and

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2000-2001 Edition

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# Preface

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This is the eleventh annual edition of *Applications in Basic Marketing*. We developed this set of marketing “clippings” from popular business publications to accompany our texts—*Basic Marketing* and *Essentials of Marketing*. All of these clippings report interesting case studies and current issues that relate to topics covered in our texts and in the first marketing course. We will continue to publish a new edition of this book *every year*. That means that we can include the most current and interesting clippings. Each new copy of our texts will come shrink-wrapped with a free copy of the newest (annual) edition of this book. However, it can also be ordered from the publisher separately for use in other courses or with other texts.

Our objective is for this book to provide a flexible and helpful set of teaching and learning materials. We have included clippings (articles) on a wide variety of topics. The clippings deal with consumer products and business products, goods and services, new developments in marketing as well as traditional issues, and large well-known companies as well as new, small ones. They cover important issues related to marketing strategy planning for both domestic and global markets. The readings can be used for independent study, as a basis for class assignments, or as a focus of in-class discussions. Some instructors might want to assign all of the clippings, but we have provided an ample selection so that it is easy to focus on a subset which is especially relevant to specific learning/teaching objectives. A separate set of teaching notes discusses points related to each article. We have put special emphasis on selecting short, highly readable articles—ones which can be read and understood in 10 or 15 minutes—so that they can be used in combination with other readings and assignments for the course. For example, they might be used in combination with assignments from *Essentials of Marketing*, exercises from the *Learning Aid for Use with Essentials of Marketing*, or *The Marketing Game!* micro-computer strategy simulation.

All of the articles are reproduced here in basically the same style and format as they originally appeared. This gives the reader a better sense of the popular business publications from which they are drawn, and stimulates an interest in ongoing learning beyond the time frame for a specific course.

We have added this component to our complete set of **Professional Learning Units Systems** (our **P.L.U.S.**) to provide even more alternatives for effective teaching and learning in the first marketing course. It has been an interesting job to research and select the readings for this new book, and we hope that our readers find it of value in developing a better understanding of the opportunities and challenges of marketing in our contemporary society.

**William D. Perreault, Jr. and E. Jerome McCarthy**

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# Marketing's Role in the Global Economy and in the Firm

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## 'Keep On Truckin':

# Muslim Town in Serbia Finds Riches and Risks On the Road to Kosovo

'Bosniaks' Dare to Deliver Where Many Fear to Go; Of Banditry and Bigotry

'We Have a Nose for Money'

BY ROBERT BLOCK

*Staff Reporter of THE WALL STREET JOURNAL*

NOVI PAZAR, Yugoslavia — Once upon a time, this Serbian city was a crossroads on the Turkish caravan routes, a prosperous market town trading and trafficking in goods through the badlands of the Balkans.

Five centuries later, things haven't changed much.

Almir Bruncevic, a 25-year-old purveyor and transporter of counterfeit designer jeans, is proof that commercial traditions die hard in this part of the world. Several times a month, Mr. Bruncevic drives not a mule, but a silver Mercedes that is loaded with stacks of illicit denim bound for Kosovo.

Kosovo isn't as far away or as exotic as the casbahs of Turkey or the medieval cities of the Adriatic, but it's a lucrative market. And the trade, both legal and illegal, has given a new sense of purpose to this city.

"The goods are here in Serbia. The demand and cash are in Kosovo. We just connect the two," boasts Mr. Bruncevic, nursing a Coke made in Hungary and smuggled into town by local traders. The "we" are the Muslim Slavs of the Sandzak (pronounced SAND-jack) region of Yugoslavia, who over the past eight months have become the brokers and transporters of Serbian building materials, food and countless other products to Kosovo.

### Supply and Demand

In the aftermath of the North Atlantic Treaty Organization's victory in Kosovo, ending years of Serbian repression, Kosovar Albanians want nothing to do with Serbs. With ethnic hatred and lust for revenge running rampant in Kosovo, Serbian businessmen and companies lost their Albanian partners, their

shops and sometimes their lives. Nonetheless, after months of war, the demand for low-cost goods from Serbia is higher than ever.

Into this vacuum have stepped the Muslim Slavs from Novi Pazar, venturing where Serbs fear to tread, let alone trade. The business is risky: Many Serbs and Albanians in Kosovo resent what they see as the opportunism of the Sandzak Muslims. Drivers and businessmen from Novi Pazar have been threatened, beaten and, in at least one case, killed. But the lure of quick money keeps them on the road.

The Sandzakis, or Bosniaks as they prefer to be called, have been using their religion and their own history of problems with the Serbs as a passport to make deals with the mainly Muslim Kosovars, as well as with the NATO-led peacekeeping forces occupying the province.

Like the ethnic Albanians of Kosovo, the Muslim Slavs of Sandzak have been the victims of state repression under President Slobodan Milosevic, and the targets of sporadic bombings, kidnappings, torture and murders, especially in the early '90s. Many U.S. Balkan experts consider the region the target of a possible Milosevic offensive if the president feels his leadership is threatened.

The way the Muslim Slavs have managed to survive all this is through economic opportunism, and not resorting to the ethnic violence common in this part of the world. In the face of political harassment and the hardship of international trade sanctions imposed on Belgrade for its role in the breakup of Yugoslavia, the Muslims took refuge in pirate manufacturing industries, turning the country's pariah status to their advantage.

Novi Pazar, whose very name means money (either New Market or New Turnover, depending on the translation), is now home to about 600 factories that churn out counterfeit Levi's, Calvin Klein and other labels worth an estimated \$100 million annually. The jeans, tops, shoes and accessories are shipped to markets as far away as Russia, making the city the unofficial denim capital of the Balkans.

The owners of the workshops know that Mr. Milosevic, desperate for infusions of tax and bribe money, is unlikely to crack down on them at the behest of Western officials griping about infringements of trademarks and licensing agreements.

Signs of Sandzak's latest business ventures are as conspicuous as a fleet of 18-wheelers in a front yard. The growth of opportunity in Kosovo just 50 miles away has sparked an explosion in the transport industry in Sandzak. Novi Pazar today looks more like a residential trucking depot than a city of 100,000 people. Cabs and trailers are everywhere — they jam the narrow streets and are parked outside houses like family cars.

"A year ago, there were about 10 people seriously involved in transport. Now there are hundreds," says Rasim Ljajic, a regional political leader. "All it takes here is one person

to get an idea, and then everyone follows."

In the early morning hours, dozens of trucks roll toward the Kosovo border. Some truckers stop at roadside motels or cafes on the Serbian side of the frontier, waiting until a policeman they know, and can bribe, starts his shift. Serbia hasn't banned all trade with Kosovo, but it prohibits the export of food and livestock, which have become the favorite cargo of some drivers.

Dzemal Zutic, a k a "Zuti" or "Yellow" because of his blond hair, owns a fleet of 10 trucks delivering construction materials across Kosovo. In the building-supply business for a decade, Mr. Zutic decided to get into trucking when the conflict with NATO ended in June. "It was clear during the war that when it was over, there would be opportunity for us," Mr. Zutic says. "We have a nose for money and we are the only ones with clean hands in Kosovo."

Indeed, Sandzakis were happily left on the sidelines during the war. Unlike in the rest of Serbia, there was no mobilization here, since the Serbs didn't trust the Muslims. In 1998, at the height of the fighting between Albanian separatist guerrillas and Serbian security forces, at least 15 Muslim Slav police officers were fired for refusing to go to Kosovo to fight against their Muslim brothers.

But clean hands aren't a guarantee of trouble-free business. After dark, when the lights decorating the minarets of Novi Pazar's 19 mosques illuminate the city's skyline, a greasy spoon on the outskirts of town comes to life. Mr. Zutic and dozens of other truckers gather here at the Bife Bosna for coffee, juice and gossip. All of them trade in Kosovo, though few want to talk openly about it. Some fear the Serbian taxman, since their business is in German marks traded at black-market rates. Most, however, are anxious not to tempt ethnic extremists in Kosovo. Almost everyone has a story of someone they know getting robbed, hijacked, threatened or beaten up.

### Sticks and Stones

"Every time you drive down there you never know what will happen," says Mr. Zutic over the din of Serbian folk music. "This is a high-risk business."

Kosovo Serbs accuse the Sandzakis of having sat out the war with NATO, waiting to make money. When traveling through Serbian enclaves in Kosovo, drivers say their trucks are stoned, and they are sometimes stopped at makeshift barricades and threatened for doing business with Albanians.

Some Albanians, on the other hand, see the Muslim drivers as wallets-on-wheels, ripe for the picking. Almost every day there are reports of trucks being stopped by armed gangs, the drivers forced to part with large sums of cash. "Most of the trouble is banditry. The Albanians know that on the way down, we're full of goods and on the way back loaded with money," says a driver who transports food to Kosovo and identifies himself only as K.G.

(Cont.)

Highway robbery is among the least of the drivers' worries. Since the end of the war, many Albanians have been gripped by fierce nationalism. Tens of thousands of non-Albanians, including Muslim Slavs, have been driven from their homes in Kosovo. Hundreds have been killed by Albanian extremists bent on creating an ethnically pure ministate. What makes life particularly dangerous for Muslim Slavs is that they speak Serbian, widely considered the language of Kosovo's oppressors.

### Murder of a Cleric

According to Sefko Alomerovic, the president of the Helsinki Committee for the Protection of Human Rights in Sandzak, there have been at least seven reported cases of serious attacks by Albanians on Muslim Slav truck drivers, including the murder of Sefket Dragolovcanin, a Muslim cleric delivering milk to Kosovo. He disappeared last August. Three weeks later, his body was found in an Albanian village near Jablanica. The only crime he and the others committed, Mr. Alomerovic says, was speaking Serbian.

Drivers have since worked out ways to limit their risks. "Most of us have our Albanian business partners with us to help if the situation gets difficult," says Mr. Bruncevic, the jean dealer. "But it's 50-50. You never know who will give you trouble, the Serbs or the Albanians. The money makes it worthwhile, but your life is constantly on the line."

Mr. Bruncevic knows this better than most. In December, he was returning from Kosovo when he got a flat tire in the divided town of Mitrovica. The north of the town is a Serbian enclave. Mr. Bruncevic was stranded in the Albanian south side. A group of youths approached him, asking something in Albanian. Mr. Bruncevic explained in Serbian that



he was a Muslim from Sandzak. "That's when they started to hit me and smash my car," he recalls.

### A NATO Rescue

Luckily, French peacekeepers were nearby. They fired into the air, scattering the attackers. "I have no doubts NATO saved my life, but my car was trashed. It cost me \$3,000 to get it fixed," Mr. Bruncevic says.

The danger and unforeseen costs of doing business in Kosovo, however, haven't been much of a deterrent. If anything, they have added to the attraction, justifying a markup in shipping costs of as much as 300%.

For the Albanians, even with the additional costs, goods from Serbia are still cheaper than those from other countries. Kosovo, although run as a United Nations protectorate, is still technically part of Serbia, and there aren't any tariffs or duties. In addition, the Yugoslav dinar is constantly falling against the

German mark, which has become the official tender in the province.

The result is that Kosovo groans with goods coming from Novi Pazar. "They are good quality. And people here are used to the things Bosniaks bring," says Shefki, an Albanian trader at Pristina's central market who didn't want to give his full name. "People also know Bosniaks are Muslim and have problems [with Serbs] maybe as much as we did."

### Risks of the Middleman

Serbian companies, as well, appear happy with the arrangement. "Of course, since the war we can't deliver our products there," says Nikola Svilengacin, a spokesman for Polet Novi Becej, a building-supplies manufacturer in northern Serbia whose roofing tiles are hot sellers in Kosovo. "We sell directly to buyers in Novi Pazar. What they do afterwards with those

products is none of our business."

Bearing the risk in all of this are the drivers and businessmen from Novi Pazar. They buy the goods from the Serbian producers and companies up front. They run the gantlet of bandits and threats. All business with Albanian buyers is done orally, on the honor system. There are no contracts, no deposits and no guarantees that they will get paid upon delivery. And yet, "we always deliver, and the Albanians always pay," Mr. Bruncevic says.

But how long before the business gets too dangerous or Mr. Milosevic decides to crack down? Mr. Bruncevic shrugs. "It could all end tomorrow. But right now there is money to be made and it's what we Bosniaks do best."

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## Reading the Tea Leaves, China Sees a Future for Coffee

BY IAN JOHNSON

Staff Reporter of THE WALL STREET JOURNAL

BAOSHAN, China — All the coffee in China is a trifling amount. But now, after long being kept at bay by Chinese politics and poverty, the drink is making two inroads into this nation of tea drinkers.

One is here, by China's lush southern border with Burma, where officials are telling farmers to stop growing tea and sugarcane and start planting coffee, which has greater potential for revenue — and tax dollars.

Meanwhile, in China's crowded cities, foreign coffeehouse chains are gambling they can buck tradition and create a coffee culture in the land of the teahouse.

The change won't come easily. While Beijing wants the coffee from Baoshan and the rest of Yunnan province to sell like Jamaica's high-priced Blue Mountain beans, production has been plagued by corruption, politics and chronic low quality. And while chains such as the U.S.'s Starbucks Corp. and Tully's Coffee and Japan's Manabe Kohikan open new coffee bars by the month, coffee sales have declined slightly over the past four years, according to market researchers. Future growth, they say, is likely to be in low-end instant coffees and presweetened coffee mixes.

But that's not the vision driving coffee's missionaries. Here in Baoshan, a major outpost on the old Burma Road, Mayor Yang Jingjian uses a barrage of statistics and rhetoric to persuade the local populace to switch to coffee, arguing that the hard-to-grow and harder-to-roast beans will make them — and his government — rich.

The region around Baoshan now has 5,000 acres of coffee, Mr. Yang says. He wants to double that within five years and make coffee the region's major cash crop. By then, he promises farmers, coffee will have nearly doubled their annual income.

From missionaries 100 years ago to reform-minded communists in the 1980s, many have been attracted by the bean's potential to earn money. But coffee, first condemned by nationalists as a foreign intrusion and later by communists as the "tail of capitalism," was politically incorrect — until recently.

"Politics and coffee have a long relationship," the mayor concedes. "Now the government is all for it."

Farmers may be another matter. At the bottom of a verdant valley planted with coffee, bananas and papayas, one of Mr. Yang's star coffee growers casually announces that he and many of his neighbors want to abandon coffee in favor of longans, a fruit resembling litchis. Mr. Yang shakes his head in

frustration and, as though talking to a simpleton, bellows: "Don't talk to me about longan. You have to stick to coffee, understand?"

The man nods skeptically. He knows it's easier to yield to the pressure of local authorities. But he also knows that coffee plants take three years to mature and must be cut back after seven, while longans bring rich harvests almost immediately.

In fact, this desire for fast profits, widespread among Chinese farmers, has crippled China's coffee-growing aspirations, says Robert Tibbo, with Eastern Strategic Consulting Ltd. in Hong Kong. With most coffee plucked early and processed as cheaply as possible, Yunnan coffee remains inferior. At the end of a busy day touring the countryside, Mayor Yang proudly presents a visitor with what is purported to be a bag of choice green coffee beans. A quarter of these beans later turn out to be too low quality for roasting when inspected by a roaster in Beijing.

While the central government has budgeted funds for advanced processing and roasting equipment, local press reports say much of the money was siphoned off by

corrupt officials. Last year, China produced 3,400 metric tons of coffee. Virtually none was fit for export, with almost all being ground into instant coffee. "It's a mess down there," Mr. Tibbo says.

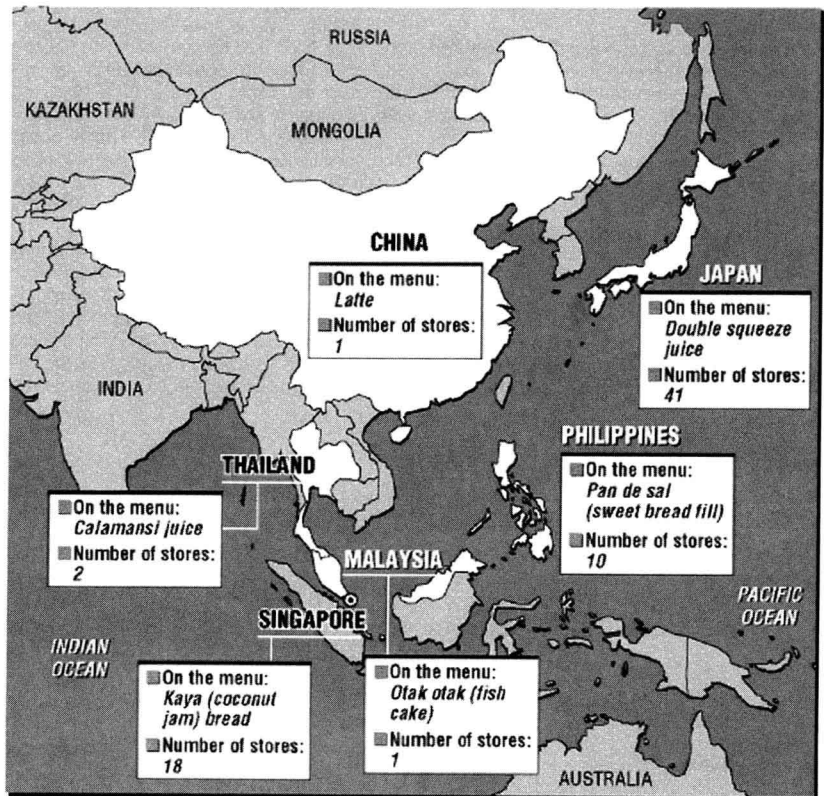
Up north, in China's big cities, coffee has a slightly more promising hold, although the vast majority of people still measure their lives in sips of tea rather than coffee spoons. Most coffee is sold to hotels, and almost all the coffee sold at retail is instant.

Undeterred, gourmet-coffee retailers have moved aggressively into China. Starbucks opened its first coffeehouse last month in Beijing, promising to open up to another dozen by mid-2000. "We're going to create a market that may not exist currently," says Lawrence Maltz, chairman of Beijing Mei Da Coffee Co., which has been licensed to open Starbucks in China.

Starbucks's belief in China is based on a simple certainty: Coffee consumption is directly related to income. Following the pattern of other countries, China's rising income is supposed to mean growing coffee sales — as has been the case in Japan, where the tea

## Planet Starbucks

The ubiquitous coffee chain gives a dash of international flair to its cafes in Asia



Source: Starbucks Coffee International

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(Cont.)

ceremony has taken a back seat to street-corner coffee vending machines.

To a degree, this is also true in China. Coffee shops have become popular meeting places and a \$2 latte is a status symbol in China, which has a per-capita income of \$750. Says Mr. Maltz: "We can't build our business on expatriates and tourists."

For the next few years, however, there may be no other choice. With income levels in China low, coffee consumption has stagnated over the past four years — reflecting a leveling-off in the number of expatriates working in China.

Besides income, a major hurdle is deeply ingrained views toward food and health in

China. Traditional medicine views coffee as a "warming" beverage — something that holds true whether the drink is sold scalding hot or as one of Starbucks' iced frappuccinos. Thus, says Mr. Tibbo of Eastern Strategic Consulting, coffee has been slow to catch on in southern China's Guangdong province, the richest — and warmest — part of China. "It's a northern drink and pretty much only in the winter months," Mr. Tibbo says.

The dangers of overestimating China's eagerness to embrace coffee can be seen in its import statistics. When China's economic boom began to gather pace in the early 1990s, foreigners flocked to China and coffee sales began a modest expansion, growing between

5% and 8% a year. In 1996, as experts began predicting that China was the next big coffee market, government coffee traders imported 12,000 metric tons of coffee, almost six times the previous year's imports. That year, however, turned out to be the end of China's coffee-drinking growth period. "I think most of those beans are still sitting in Chinese warehouses, waiting to be roasted and ground," says a Beijing coffee roaster.

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# Dell Cracks China

No way, the skeptics scoffed, could Dell take its all-American model to China. So why is it being imitated? ■ *by Neel Chowdhury*

It's a wet morning in old Shanghai, and Dell salesman Peter Chan is selling hard. As the Yangtze River flows by the Bund district a few floors below, Chan is getting into a flow of his own. His subject: computers and the unique benefits of Dell's direct-selling model. His customer: Xiao Jian Yi, deputy general manager of China Pacific Insurance, a fast-growing state-owned insurance company. The audience: three of Xiao's subordinates.

China Pacific, a potentially big account, is in the process of computerizing its entire billing system. It already has about 400 desktops and about 70 servers, mainly from IBM and Hewlett-Packard. But Xiao needs more hardware. Much more.

Though Xiao's sleep-heavy eyes suggest he's heard it all before, Chan excitedly says that "direct selling" means China Pacific can order PCs directly through the Internet, the telephone, or salesmen like himself. At the mention of the Internet, still a rare marketing tool in China, the fustily dressed bureaucrat visibly perks up.

Chan goes on to explain that direct selling not only eliminates middlemen—saving Xiao and China Pacific a chunk of change—but also means that Dell can build China Pacific's computers to the firm's exact requirements, from the hardware on the outside to the software on the inside. A murmur of approval ripples through Xiao's subordinates. By the time Chan finishes with a description of Dell's convenient after-sales service, the rain has stopped and Xiao is smiling. "All salesmen from computer companies are aggressive," he says. Then Xiao whispers to FORTUNE: "But the Dell guys are even more aggressive."

That aggressiveness is beginning to pay off. Not only did Dell reel in the China Pacific account, but it is well on its way to becoming a major player in China. Last August, 34-year-old billionaire Michael Dell opened the fourth Dell PC factory in the world in Xiamen, a windswept city halfway between Hong Kong and Shanghai on China's southeastern coast. The point of Dell's push into China seems so obvious as to be a cliché: China is becoming too big a PC market for Dell, or anyone, to ignore. "If we're not in

what will soon be the second-biggest PC market in the world," asks John Legere, president of Dell Asia-Pacific, "then how can Dell possibly be a global player?"

China is already the fifth-largest PC market, behind the U.S., Japan, Germany, and Britain. But if PC shipments in China continue to grow at an average annual rate of 30%—as they have over the past three years—China's PC market will surpass Japan's in only five years. Not even the Asian crisis has slowed down this growth. While crisis-wracked Asian markets like South Korea saw a 46% decline in PC shipments in 1997-98, for example, PC shipments to China surged 48%.

Though the competition is intense, Dell is confident it has a strategy that will pay off. First, it has decided not to target retail buyers, who account for only about 10% of Dell's China sales. That way Dell avoids going head to head against entrenched local market leaders like Legend. "It takes nearly two years of a person's savings to buy a PC in China," notes Mary Ma, the chief financial officer of Legend. "And when two years of savings is at stake, the whole family wants to come out to a store to touch and try the machine." Dell just isn't set up to make that kind of sale yet.

Instead, the company thinks it can make big inroads by selling directly to corporations. Established American PC makers in China—Hewlett-Packard, IBM, and Compaq—depend largely on resellers. Because of the cost savings derived from cutting out the middleman, Dell believes it can sell computers at lower prices than its competitors can—and thus steal market share. Already the gambit seems to be working: At the end of last year Dell's market share tripled to 1.2%, while Compaq's fell from 3.5% to 2.7%.

The outlook wasn't always so rosy. When Dell set up its first Asian factory in Malaysia in 1996, there were serious doubts as to whether its direct-selling model would work. Skeptics fretted that Asia's low Internet penetration and the value Asians put on personal relationships with distributors would punish the Dell model. But in practice Dell has managed to pump up sales during one of Asia's worst economic crises. That has silenced

most of the critics.

In fact, the direct-selling model has almost certainly been a boon, not a barrier, to Dell's plans. "With low-priced, entry-level PCs shaving traditional profit margins, the direct-order model is gaining popularity across Asia," says Archana Gidwani, an analyst with the Gartner Group in Singapore. She figures that starting in 1998, direct sellers like Dell saw shipments in Asia jump 15%, while Hewlett-Packard, IBM, Compaq, and other PC makers that go through resellers saw shipments decline 3%. And she expects 40% of Asia's PC shipments to be ordered directly this year, up from roughly 30% last year. "Dell," she concludes, "is changing the way computers are being sold in Asia."

Though Dell started shipping computers in China only last August, it has already risen to become the country's eighth-largest PC maker; quarter-on-quarter sales are growing 50% on average, admittedly from a very low base. Dell will not say if its operations there are profitable yet.

More impressive is the fact that Dell is starting to rattle Chinese PC makers like Legend and Founder by nibbling into their most valuable client base: state-owned enterprises. These bureaucratic behemoths may seem an odd fit with Dell's fast-as-lightning direct model, but somehow it works. Two-thirds of Dell's corporate customers in China are state-owned enterprises, up from next to none ten months ago. The rest of Dell's customers are multinationals like Ericsson, Nortel, Motorola, and Ford. Dell hopes to keep signing up more Chinese companies—not easy, given the price-slashing tactics of the small shops that sell cheap PCs with bootlegged software. But if it does, then Dell will do something few U.S. companies in China ever manage to do: turn a profit without investing a fortune in manufacturing and without sharing the booty with a Chinese partner or middleman.

Why is Dell's direct model winning in China? First, look at the way Dell is selling to the Chinese. Shredding the myth that to sell in China requires padding the egos (and wallets)

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of capricious bureaucrats—usually during long and boring banquets—Dell is winning over the chief information officers of state-owned companies the American way: with speed, convenience, and service. “We don’t have to change the formula,” insists Dell salesman Peter Chan. “It will work in the U.S., China, India, or even in space.”

At the heart of that “formula” is the simple tenet that the customer knows best. When Dell’s Chan pauses for breath after his sales pitch at China Pacific, for example, the newly awakened Xiao peppers him with questions. How quickly will the computers arrive? Can Excel be loaded onto the hard drive? What kind of service does Dell offer? And, ahem, how much?

What is powerfully clear is that Xiao knows computers. He knows what he needs from Dell. He knows how much he wants to pay. Critically, Xiao knows enough that he does not need to see or touch the machine, or even raise a few glasses of Tsingtao beer with a honey-tongued distributor, before he orders it. All Xiao needs is a phone or, better yet, an Internet connection, to buy what he needs.

Such tech savviness and straightforwardness is increasingly common in China, and that is a terrific advantage for Dell, whose biggest perceived shortcoming was that it lacked the kind of service network that Hewlett-Packard or IBM has. These service networks can provide companies like China Pacific with technical advice and long-term system consultancy. But as Xiao makes clear, Chinese managers are growing more and more tech savvy on their own. They simply don’t need that kind of babysitting—and they don’t want to pay for it. “We may still need some consulting services, but in our front offices we know how to choose our equipment,” says Xiao. “Dell provides exactly what we need, and with Dell we can choose exactly what we want.”

In response, IBM, Hewlett-Packard, and other PC makers are changing tactics. Says Dennis Mark, Hewlett-Packard’s computer-marketing director in Asia: “We’re doing less with smaller local companies and focusing our resources more on big nationwide technology projects.” For now, that gives Dell a clean shot at the low end of the PC market. But down the line Dell too may want to go after bigger, more complex sales. At that point competitors like Hewlett-Packard and IBM will have a considerable head start.

In the meantime, Dell will have its hands full in the direct-sales market. Chinese Internet use is spreading like a brushfire. Between 1997 and 1998, according to technical consultants at International Data Corp., the number of Internet users in China jumped 71%, to more than two million. But so far Dell sells

## We’re No. 8!

After only ten months in China, Dell has reached No. 8 in PC shipments.

1. Legend
2. IBM
3. Hewlett-Packard
4. Founder
5. Compaq
6. Great Wall
7. Toshiba
8. Dell
9. NEC Japan
10. Acer

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only 5% of its PCs in China through the Net, compared with 25% worldwide. Dell’s telephone sales also represent just a small percentage of its total, even though the company advertises aggressively on billboards. Part of the problem is that the Chinese are uncomfortable with credit card sales.

For now, however, Dell’s going to have to invest more time and money in door-to-door sales calls to Chinese companies than it might like. For example, Dell’s two dozen or so young, gung ho salesmen in Shanghai usually make three to four sales calls a day and spend roughly one-third of their time on the road. Not an easy life, but they are well rewarded for it. Dell will not tell how much they make, but says its sales staff in China is paid salaries and commissions commensurate with those paid in Hong Kong and the U.S. That’s expensive, and until China catches up to the West in terms of Internet penetration and credit card use, those costs will take a tidy chunk out of Dell’s earnings.

To offset its higher-than-expected marketing costs, Dell is cutting out fat and boosting operational efficiency at its Xiamen plant. In fact, Dell’s modest manufacturing operations are a paragon of financial restraint in a country like China, where land and equipment costs can spiral out of control.

In Xiamen the operation is lean and smart. The entire assembly process employs only about 200 workers and is housed in a modest, airy room about the size of a high school gym. Workers scrutinize sales sheets detail-

ing the hardware and software specs of each computer, which is then built according to the buyer’s taste (luckily for Microsoft, the Chinese version of Word for Windows is the leading software request).

After the “fully loaded” computer rolls off the line, it goes to Xiamen’s sleek and spacious airport to be flown to wherever the customer is located. In China the time it takes for a Dell PC to reach a customer, from order to delivery, is nine days, about the same as in the U.S. “We’re leading the entire Dell world in terms of keeping to our promised delivery date,” boasts David Chan, president of Dell China.

Behind that boast, of course, is China’s increasingly impressive infrastructure of roads, airports, and ports. Belying those horror stories of endless paperwork slowing the traffic of goods or bad phones or potholed roads, most of urban China is relatively well linked. Bureaucratic bottlenecks do arise from time to time, but Dell’s just-in-time model is probably easier to execute in China than it would be in, say, the Philippines or India.

Getting the PC to the customer quickly also saves Dell a ton of cash. Because its just-in-time model forces Dell to keep its inventory levels low—about six days’ worth of supply, compared with 40 for Chinese PC leader Legend—Dell saves time and money that would otherwise be wasted on warehousing. Shorter inventory cycles also give Dell a greater degree of control over price and profitability than its Chinese competitors have. “The sub-\$1,000 PC has been driven by Chinese distributors who have to move obsolete products that have been lying around their warehouses,” argues Dell’s Legere. “We’ll never be driven by those factors, because our inventory cycles in China are so short.”

Also greasing the efficiency of Dell in China is money, or to be more precise, stock options. David Chan says the options scheme is meant to “instill a sense of ownership,” but most Chinese workers are likelier to see a direct link between their output and the stock price—which is, after all, not a bad way to look at it. Around August every employee in Xiamen got roughly 200 shares of Dell, back when its stock was trading near \$60. Three months later Dell’s shares had shot up to \$110, giving each employee a paper gain of about \$10,000. That equals roughly one year’s salary for the average Xiamen worker. “Then it dawned on me that they had no idea of the value of the paper in their hands,” says Chan. After the worth of the options was explained at a workers’ meeting, Chan noticed an uptick in productivity: “They were good before. Now they’re better.”

So what can go wrong? To some extent, Dell has had to deal with the traditional bugbears of factory life in China: idleness and

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corruption. The concept of a job for life, though no longer a guarantee in today's China, still attracts workers who expect to spend hours drinking tea or reading the papers on the factory floor—and keep their jobs. Dell China executives acknowledge that at first a little “reeducation” was necessary in Xiamen so that workers understood that their jobs depended on their performance.

Corruption has been a trickier issue. Though Dell vehemently denies that it has ever paid a bribe to get a license or a sales order, David Chan admits he had to “terminate” two Chinese employees suspected of corruption. It's no coincidence, either, that Dell's top salesmen in China are not mainland Chinese but predominantly Overseas Chinese from Hong Kong or Singapore, where the sales culture is defined more by doggedness than by personal favors. Peter Chan, for example, is from Hong Kong.

The company must also grapple with the problem of software piracy. Microsoft estimates that over 95% of the software in use in Chinese corporations is stolen. In fact, setting up a factory in China was Dell's defense against pirates. Concerned that pirates would load bad software onto its machines, ruining its reputation, Dell now controls the process from beginning to end. That quality control is a relief to Dell, its customers, and Microsoft, which collects its Dell-related revenue reliably. But quality costs: No matter how frugal Dell's operations, it cannot compete on price with the small job shops that sell knockoff

PCs equipped with bootleg software. Dell computers sell for about the same as in the U.S.—\$1,200 to \$1,500 each, depending on what is loaded.

**D**ell's biggest problem, though, is a product of its success: Because the Dell direct model is so simple, it can be copied. And that's just what Legend is doing. “Yes, we're using Dell's direct-selling model when we target Chinese government companies or multinationals in China,” admits Mary Ma. For a start, Legend is aping Dell's cash-management model, reducing the time it takes to get payment from its distributors by half, to 30 days. It is also rapidly moving toward Dell's just-in-time delivery model, trying to sell directly to its corporate customers and shaving excess inventory. It is even offering stock options to employees. All these copycat moves will make Legend a more formidable company and should therefore have Dell worrying.

Another cause for concern is China's often nationalistic politics, which can quickly turn against U.S. corporations. Consider, for example, the rash of anti-American demonstrations that swept across China after NATO's accidental bombing of the Chinese embassy in Belgrade in mid-May. Not only were U.S. embassies pelted with eggs and stones, but so were Nike and McDonald's outlets. Given the billions at stake in the telecom and PC markets in China, high-profile U.S. companies like Motorola or Dell could be vulnerable to

the ups and downs in Sino-American relations, though retail outlets, not tech factories, seem to be bearing the brunt of patriotic dudgeon so far. “It's not a given for U.S. companies, especially information technology companies, to come into China and grab the entire market,” warns Dong Tao of Credit Suisse First Boston Securities in Hong Kong. “The Chinese government has made no secret of the fact that it wants to promote national industries like IT.”

Where will Dell be in China five years from now? It will probably never be the No. 1 PC maker in China, or even No. 2, slots that are likely to be occupied by local manufacturers, which will always be able to sell more cheaply to China's masses. Ironically, that seems to suit Dell just fine. Grabbing market share, in the U.S., China, or anywhere else, has never been its highest priority. Profits are. Says John Legere of the estimated \$25 billion in revenue that computer sales will generate in China by 2002: “Even if we get 1% of \$25 billion, that's a lot. You don't need to be the market leader in China to be profitable.”

One thing's for sure: The Dell model is working in China. And as long as China's PC market continues to grow, Dell is ready to grow with it—provided it sticks to that model and continues to execute it better than anyone else.

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# HOW LEGEND LIVES UP TO ITS NAME

## The state-owned PC maker aims to become a Chinese IBM

**T**he shiny new research center for Legend Holdings, China's leading PC maker, is teeming with activity. Young hipsters and nerds alike bustle down corridors or clack on keyboards. While two-thirds of the 120 researchers are designing new computers, the rest are testing everything from how smoothly they run software to what happens when they fall off a desk to how well they hold up in the 100F-plus sizzle of China's summer.

So far, Legend—and its PCs—are holding up just fine. Even though its research center can't match the resources of Compaq or IBM, it is Legend that's turning up the heat on those rivals and others. The \$758 million Beijing-based computer company saw its sales grow by 106% last year, making it the biggest seller of PCs in the fastest-growing computer market on earth—a title that foreign rivals had hoped to capture. But with 15% of China's sales, Legend has twice the market share of its closest competitor, IBM. "We plan to be among the top 10 PC manufacturers in the world by 2000," vows Yang Yuan-qing, general manager of Legend Computer Systems Ltd. Legend's goal: to sell 1.5 million computers in 2001, up from 800,000 units today.

How did Legend dash the dreams U.S. PC makers had of dominating the Chinese market? Credit the company's low prices, broad product range, helpful software, and vast distribution network. Just as important have been Legend's strong links to the Chinese government, which accounts for 25% of Legend's sales, and the decision to push state-of-the-art PCs, not yesterday's models. That helped remove the stigma associated with buying a local computer. Consumers "stopped being ashamed of buying a Chinese brand," says Sean Maloney, senior vice-president for sales and marketing at Intel Corp., which urged Legend to sell the more powerful PCs. "Legend has become synonymous with high tech."

**LOCAL HERO.** The computer maker is also benefiting from China's love affair with the PC. Desktop-computer sales there are expected to swell 30% this year—double the growth that's forecast for the U.S. market. If this torrid pace keeps up through 2002, some 10.3 million PCs will be sold in China that year, making it the No. 3 market in the world following the U.S. and Japan. (Sales are higher in the U.S. and Japan.)

But Legend's ambitions go well beyond the PC. The company is aiming for nothing

short of becoming China's version of IBM—a full-service provider of computers, software, and high-tech knowhow. In the past 12 months, Legend has parlayed its local savvy into development and marketing alliances with Microsoft Corp. and IBM, among others, to take the company into new markets, including software and systems-integration services for China's businesses. This month, Legend plans to sell in China a handheld computer that will challenge 3Com Corp.'s popular Palm computer. "As a local company, we have much more insight into the needs of Chinese customers," says Legend's Yang.

In China, hand-holding is need No. 1. After all, it is a population of PC newbies with only 1 out of every 175 Chinese currently owning a computer. Legend understands this better than foreign PC makers do. The company has developed a variety of software products for first-time customers that are bundled with its PCs, including tutorial programs on everything from using the World Wide Web to mastering home finances.

Legend will test just how well that formula works in a new market: palm-size computers. After one year of development work with Microsoft, Legend's palm-size computer, called Tianji, will appear this month running Microsoft's Windows CE software. As with PCs, Legend has tailored the product to the local market by including a stylus for entering Chinese characters and

English letters and by installing a powerful English-Chinese dictionary. Legend and Microsoft also are working with 10 local software companies to develop applications for the product. And with a price of around \$540 in China, the Tianji is \$60 less than the price of 3Com's Palm computer.

**HEMORRHAGE.** Just two years ago, Legend might have been viewed as the least likely to survive. The company, founded in 1984, was hemorrhaging \$25 million a year and lagging behind multinational rivals IBM, Hewlett-Packard, and Compaq. Then Legend launched a vicious price war, cutting prices three times in one year. With lower production and distribution costs than its foreign rivals, Legend now sells its desktop PC with a Pentium II chip for about \$1,200, or 30% less than IBM or Compaq.

State-owned Legend, which is listed on the Hong Kong stock exchange, has something else going for it: a strong distribution network. That's what has stymied foreign competitors. In the past 10 months, Legend has added 800 distributors and now has close to 1,800 across China. It also has its own retail stores that sell Legend products, make repairs, and offer free training for China's often first-time users—including home visits. With 11 shops now open, Legend plans to have more than 50 by yearend. "They have an extremely well-developed distribution network," says Tony C. Leung, director of

