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# China's Mobile Phone Market

*Market barriers for Japanese vendors*

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## Trouble in the World's Fastest Growing Market

*In 2006, around 132 million mobile phones were sold in China, 14% of the global total of 935 million. By 2010, with still only 50% of Chinese owning a mobile phone, the country's share of the market could rise to 17%, or 195 million mobile phones.*

China's mobile phone market is one of the most promising and fastest growing in the world, but Japanese handset makers have been largely shut-out of it. In 2005 and 2006 alone, four major Japanese mobile phone brands exited the China market.

## Unique Market

The China mobile phone market functions very differently from the Japan market. The top four mobile phone brands in Japan (Panasonic, NEC, Sharp, and Toshiba) mainly work through the major telecom operators -- NTT DOCOMO, KDDI and others. Similar to the US market, telecom operators in Japan purchase mobile phones directly from the vendors. Vendors work with the operators to meet their R&D and design demands in terms of functionality and software and deliver the products according to specifications, while the telecom/wireless operators sell the phones.

In China, telecom and wireless operators predominantly focus on building and operating their networks: carrier-customized models account for only 20% of all China mobile phone sales. For the most part, handset vendors sell their phones directly to consumers (although this is changing).

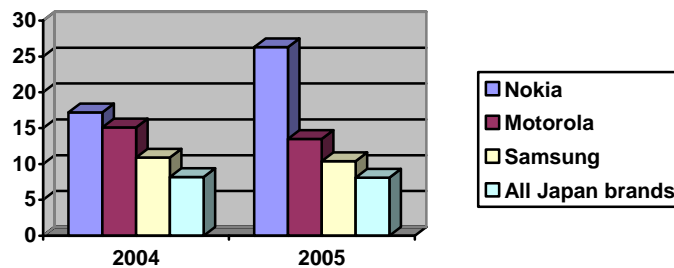
*The China market is extremely competitive, with vendors from the US (Motorola), Europe (Nokia), S. Korea (LG, Samsung, Japan, and local China brands (Bird, TCL, Lenovo, etc.) all competing for the same customers. While China represents the biggest handset market in the world, it is also the most competitive.*

**The market structure and the competitive nature of the China market necessitate a strong local operation and the development of a broad range of products that appeal to domestic consumers.**

- Mobile phone brands that want to succeed outside of China's large cities (the rural and low-income market) need to provide products with a **high price-performance ratio**.
- Chinese consumers are interested in basic functions at a reasonable price, although appearance and entertainment features such as music, games, video, etc. are attractive.

These preferences generally work to the advantage of S. Korean brands, and to the disadvantage of Japanese brands.

**Top 3 Mobile Phone Brands in China vs. Japanese brands (units sold)**



Source: THT Research

## Market Mistakes

There are several miscalculations that are common to Japanese companies in the China mobile phone market:

Japanese companies have focused almost exclusively on the mid-to-high end in the China market, which is an over-crowded and limited market. Most phones have been priced above a comfortable price-point for consumers living outside the big cities.

Japanese companies generally focus on developing superior technology and cutting-edge products. This market strategy involves more



investment of time and money to produce new models, which is less suited for the fast changing, trendy China market. In addition, overinvestment in technology has often been accompanied by underinvestment in sales, marketing, and branding.

Japanese companies entered the China market expecting the rollout of 3G technologies to be imminent, but the Chinese government repeatedly delayed introduction, which resulted in the companies investing to prepare for 3G but unable to recoup their investments.

Overdependence on headquarters. The China subsidiaries of Japanese mobile phone companies are also required to receive approval from headquarters for every decision, which has both limited their ability to adjust to local market needs and slowed the introduction of new models and business strategies.

As a result of these errors, Japanese companies have generally introduced few phone models, at high price points, and that were not up-to-date on the latest in Chinese consumer preferences.

*Japanese companies are also handicapped by anti-Japanese nationalism in China. Japanese companies offering products to which there are no other good alternatives find the China market open to them. But the handset market is crowded by over 60 brands and Chinese consumers are often reluctant to buy Japanese.*

## Misunderstood Failure

Japanese mobile phone brands in China have seen relatively poor sales and high losses, without understanding the reasons for their failure or what they needed to do to reverse their situation. Instead of investigating what needed to be done to succeed in the China market and recoup their initial investments, most of the companies focused energies on trying to learn how to terminate their contracts with the contract manufacturers they were working with for the China market.

Over the course of 2005 and 2006, four Japanese companies withdrew from the China mobile phone market in an effort to cut losses and re-focus on Japan and the global market.

- NEC: November 2006
- Toshiba: April 2005
- Panasonic: December 2005
- Mitsubishi: February 2006



## NEC

NEC withdrew from China's handset market in November 2006 as part of a global restructuring program following several years of heavy losses.

*Between April and September 2006, NEC's PC and handset departments lost 41 billion Japanese Yen, compared to a loss of 16.9 billion during the same period the previous year.*

*The losses at these departments were the major contributors to NEC's total corporate loss of 7.4 billion Yen from April to September 2006, an increase of 400% on the same period in 2005 (1.5 billion yen loss).*

NEC China was a major contributor to the losses of NEC's handset division. Reasons for market failures include:

Management. Reliance on Japanese management team and Japanese management practices. Absolute control from headquarters in Japan meant that the firm could not react quickly enough to market changes.

Overinvestment in R&D and underinvestment in sales and marketing. NEC China invested heavily in 2.5G/3G R&D and quality, but was not able to recoup its investment because of poor 2.5G sales and delayed introduction of 3G in China. At the same time it underinvested in sales and marketing and NEC was thus not able to establish a strong brand image that could compete with top players Nokia and Motorola, or with the competitive Korean brands.

Focus on high-end. NEC China produced mainly mid-to-high end mobile phone models that out-priced many Chinese consumers. Given that the high-end market is relatively small and non-existent outside the major cities, NEC's inferior marketing, lack of strong brand image, and underdeveloped sales channels made it very difficult for the company to reach top tier status.

In early 2006, NEC Corporation's handset division made a strategic decision to reduce investment in 2.5G handset development and replaced twenty high-level handset executives, including the CEO of NEC China, installing a Chinese national as CEO.



**In 2006, NEC China attempted to re-group.** The new CEO began adapting company strategy to local market needs and purchasing handset design solutions from a local China handset design house, which allowed it to introduce new models that would appeal to China consumers faster. NEC mobile phone sales began to improve, with the brand rising from 24<sup>th</sup> to the no. 11 spot in the local market.

**Despite these achievements, NEC headquarters remained dissatisfied from the continuing losses posted by NEC China** as a result of heavy investments in 2.5G, 3G and handset R&D. NEC decided to abandon 2G/2.5G development world-wide to focus on 3G, in an attempt to regain profitability. If NEC's global financial performance had been stronger, it may have been able to continue to absorb the losses from NEC China for another couple of years as the subsidiary increased its market share and sales. However, this was not the case and in November 2006, after ten years in the China market, NEC ceased mobile phone manufacturing at its Wuhan plant and announced that it won't launch any new models in China.

Year	Units
2001	100,000
2002	400,000
2003	1,000,000
2004	1,500,000
2005	2,200,000
2006	900,000

*Table: NEC China Handset Sales (predominantly GSM models)*



## Toshiba

Toshiba entered the China mobile phone market in 2000 when it set up a joint venture, Nanjing Patina Wang Zhi Corporation, with Nanjing Putian and Wang International. The JV, which focused on CDMA handsets, was never profitable and produced more handsets than it sold.

Toshiba's failures were similar to NEC's:

- Phones priced beyond the reach of the masses of Chinese consumers. Toshiba had launched a video e-mail phone for the high-end market that was expensive and never proved popular
- Over reliance on R&D capabilities.
- Neglect of marketing and channel development. Specifically, Toshiba depended too much on its relationship with China Unicom, relying on this single sales channel to the detriment of others.
- Japanese management style not suited to the China market.

In March 2005 Toshiba announced plans to end China handset production and sell its 33% stake in JV Nanjing Postel Wong Zhi Telecommunications Co. (est. 2000) to Nanjing Postel. The sale included all equipment and stakes in the JV.

Year	Units
2001	30,000
2002	120,000
2003	20,000
2004	700
2005	500
2006	0

*Table: Toshiba China Handset Sales (predominantly CDMA models)*

## Mitsubishi

Mitsubishi entered the China mobile phone market in 1999, but made little effort to adjust to local market needs. It failed to exert itself as a market force or to introduce a range of products that would appeal to Chinese consumers. When market competition intensified after 2004/2005, the company was forced to leave the market (February 2006).

Year	Units
2001	50,000
2002	150,000
2003	300,000
2004	400,000
2005	500,000
2006	200,000

*Table: Mitsubishi China Handset Sales (predominantly GSM models)*



## Panasonic

Like NEC, Panasonic expected to replicate its outstanding achievements in the Japan mobile phone market in China.

Panasonic entered the China market in 1996 and failed for similar reasons as did NEC: failure to introduce a variety of lower-end handsets that would appeal to Chinese consumers, Japanese management style and reliance on instructions from Japan headquarters, and under-investment in advertising and marketing.

Unlike NEC, Panasonic failed to take the basic steps that would have allowed it to become profitable in China such as hiring local management or relying on local design houses.

As a result, in December 2005 Panasonic quit the China mobile phone market as part of a restructuring of its global business (that included closing plants in England and the Philippines as well) to focus exclusively on 3G phones.

Year	Units
2001	600,000
2002	1,200,000
2003	2,000,000
2004	2,100,000
2005	1,000,000
2006	300,000

*Table: Panasonic China Handset Sales (Predominantly GSM models)*



## Sony Ericsson

Sony Ericsson is the #6 mobile phone brand in China. Despite being a Japanese company, Sony Ericsson benefits from Ericsson's European association and its long term presence in the China market.

Strong brand. Although SE focuses on mid-to-high end models, its brand awareness is growing in China, mostly due to the popularity of its walkman camera phone. However, with the impending release of Apple's iPod cell phone, SE may find itself more vulnerable in China, particularly because it suffers from the same weaknesses as other Japanese handset vendors: high-end models and weaknesses in its distribution system and after-sales services.



## Conclusions

Lessons to be learned from the failures of NEC, Panasonic, Toshiba, and Mitsubishi in China include:

- **Don't rush to enter a high-cost market such as mainland China's.** China's large territory and market diversity, in addition to its extremely competitive market, make this market an expensive one to succeed in. Companies need to be well-positioned financially to absorb initial years of loss in order to succeed in China.
- **Once you've entered the China market, don't hurry to exit.** Long-term investment and initial losses are common in the China market. Under its new CEO, NEC China had begun to rise in market ranking, introduce new models, and cut production costs, but headquarters closed the operations before the new strategy could prove itself.
- **Don't assume that success in other markets can be easily translated to success in the China market.**

Nevertheless, in spite of recent failures, the potential for success of a Japanese mobile phone brand in China remains. Unlike the Japanese market, which is largely closed to non-Japanese brands, the China market is open to companies willing to adapt to local market demands -- Nokia (Sweden) and Motorola (US) are the two top brands in China, and Samsung and LG have opened China offices with real decision making power and adopted to the demands of Chinese consumers.