

2016 China Consumer Report

The Modernization of the Chinese Consumer

Consumer & Retail Practice March 2016



Daniel Zipser
Yougang Chen
Fang Gong

March 2016

Consumer & Retail Practice

The Modernization of the Chinese Consumer

Daniel Zipser
Yougang Chen
Fang Gong

Since 2005, McKinsey has conducted comprehensive surveys of Chinese consumers. In this edition, we surveyed

10,000 consumers
across **44** cities

representing

75% of China's GDP

and

one-half of the population

Contents

Introduction	1
I. Willingness to spend – Chinese consumers remain confident	3
II. What to spend on – Changing shape of consumption	6
1. Loyalty to brands	8
2. Healthy living	8
3. Family focus	10
4. Experiences / international travel	11
III. How to spend	13
IV. Where to spend – Prioritizing city clusters	15



Introduction

The eyes of the world are on the Chinese consumer. Cooling economic growth, a depreciating currency, and a gyrating stock market are making political and business leaders concerned that China's economic dream may have finally ended, and tough times lie ahead.

Despite the gloomy news about the state of the economy, consumer confidence has remained surprisingly resilient over the past few years, as salaries have continued to rise and unemployment has stayed low. Chinese consumers remain upbeat about their futures.

However, beneath this statement lurks significant change. The days of broad based market growth are coming to an end as consumers become more selective about where they spend their money. Spend is shifting from products to services, and from mass to premium segments. Consumers are seeking a more balanced life, where health, family, and experiences take priority. In short, our research suggests that winning in the China market will become more challenging for consumer goods companies. For those that get it right, however, the reward will be substantial.

These are among the main findings of McKinsey's survey of Chinese consumers, the latest in a series that began in 2005. For our 2016 Consumer Report, we conducted 10,000 in-person interviews with people, aged 18 to 65, in 44 cities representing China's major regions and tiers.

The survey results also highlighted the astounding popularity of international travel among Chinese consumers and their exceptionally rapid adoption of trends such as mobile payments. In addition, the study confirmed the great variation in consumer behavior among China's 22 city-clusters. Cluster differences have even increased in recent years, despite the increased flow of information between clusters online and growth in domestic travel.

Overall, what we are seeing is the modernization of the Chinese consumer. In this report, we will look more closely at that phenomenon through four lenses: consumers' willingness to spend; what they are spending on; how they are spending; and where they are spending.



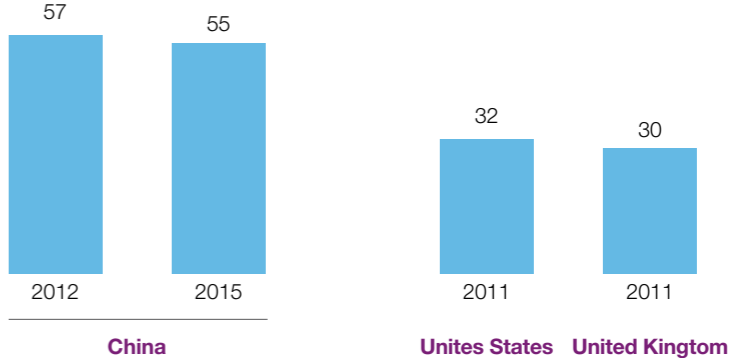
I. Willingness to spend – Chinese consumers remain confident

When asked about their expectations regarding future income, 55% of consumers were confident their incomes would increase significantly over the next 5 years, a mere 2 percentage-point drop from 2012. By comparison, only 32% of Americans and 30% of UK consumers agreed with the same statement in 2011 (Exhibit 1).

Exhibit 1

Consumer confidence largely unchanged

“My household income will significantly increase in the next 5 years”
Percent of respondents who strongly agree or agree



Source: McKinsey 2016 China Consumer Report

Regional differences in consumer confidence have widened. While confidence has decreased in the Liao Central South city-cluster, and is now as low as 35%, confidence rose to 62% in the Nanjing city-cluster (Exhibit 2).

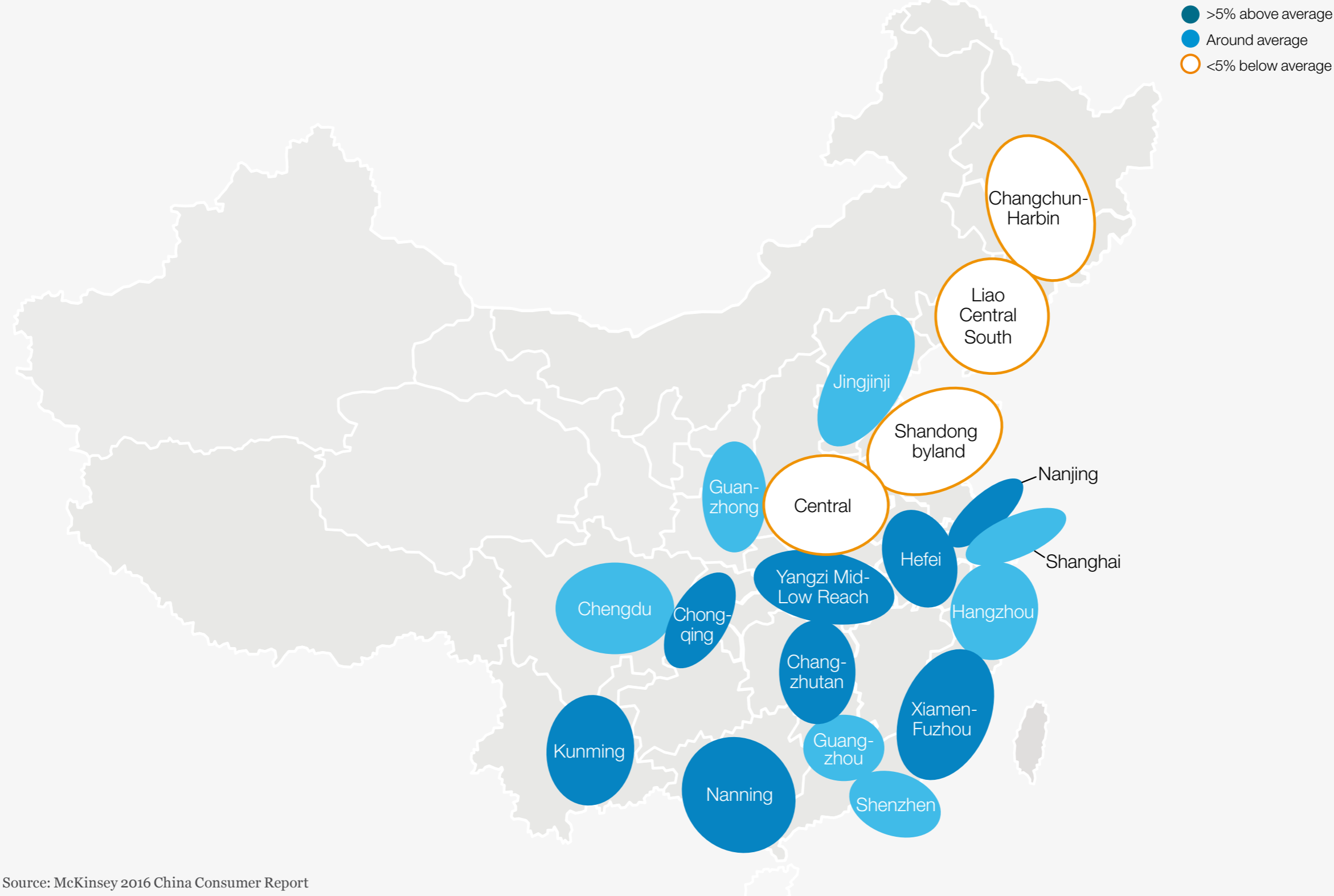
Despite these pockets of optimism, Chinese consumers are not unaware of the deteriorating condition of the economy, and a growing number of consumers are seeking to save and invest.

Nonetheless, continued confidence is encouraging consumers to continue their spending habits.

Exhibit 2

“My household income will significantly increase in the next 5 years”

Percent of respondents who strongly agree or agree



Source: McKinsey 2016 China Consumer Report

II. What to spend on – Changing shape of consumption

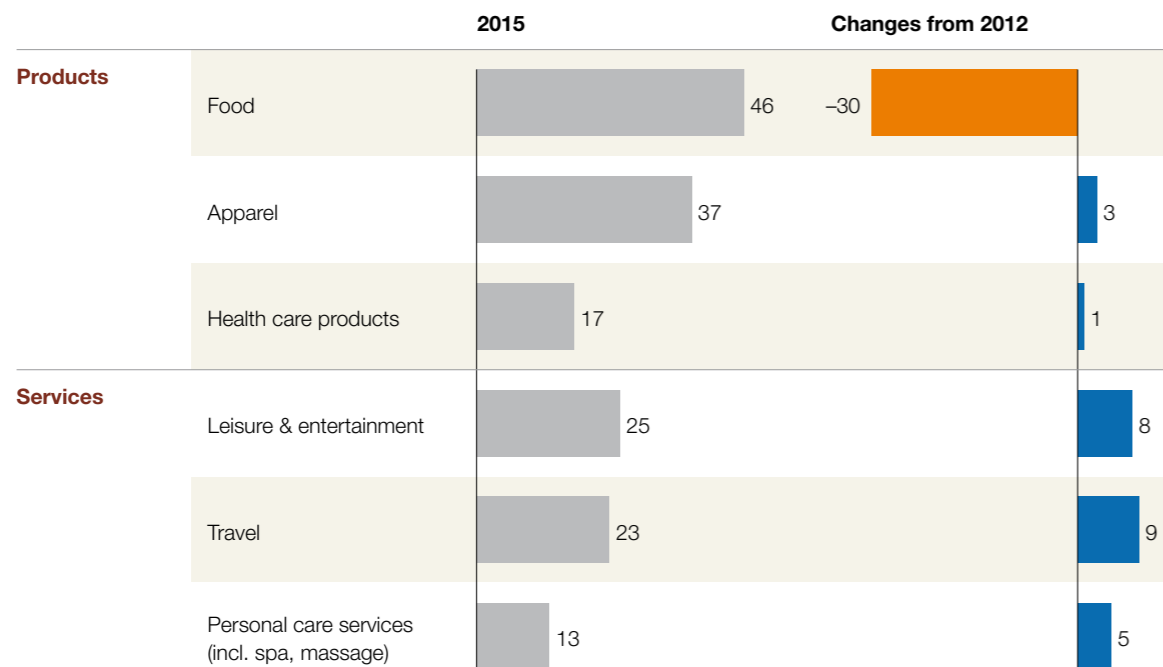
While Chinese consumers continue to increase their spending, the shape of that spending is changing rapidly. The days of fast, broad-based growth are ending, as consumers become more selective about what they spend their money on.

Consumers are allocating more of their income to lifestyle services and experiences such as spas, travel, and entertainment. More than a quarter of the consumers we surveyed are planning to spend more on leisure and entertainment (Exhibit 3).

Exhibit 3

Shift from products to services

Top 3 categories to spend more if income increases
Percent



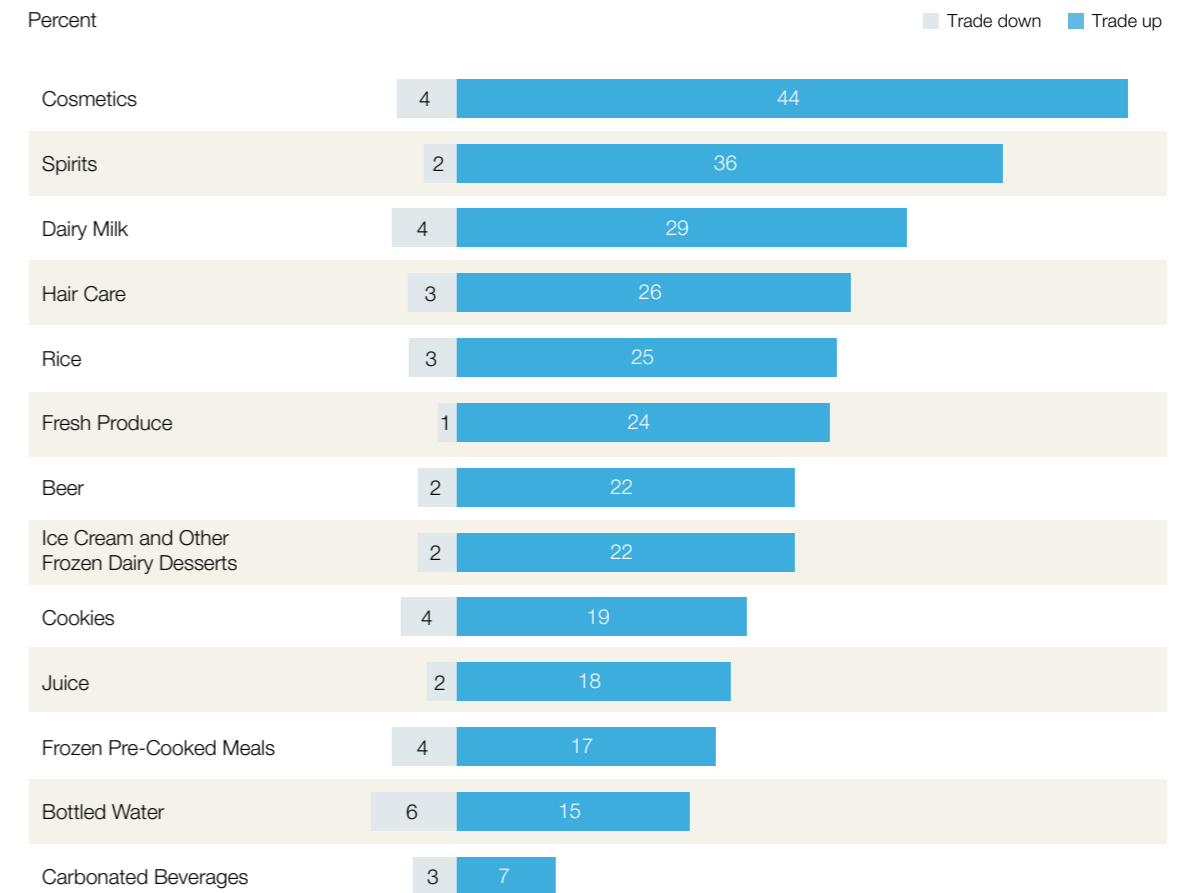
Source: McKinsey 2016 China Consumer Report

The 50% surge in box office revenues over the past year is just one indicator of how willing Chinese consumers are to shift their spending toward activities like watching the latest movie. At the same time, spending on food and beverage consumption at home is stagnating.

Chinese consumers are increasingly focusing their spending on trading up for premium products over mass products (Exhibit 4). 50% seek the best and most expensive product, a significant increase over previous years.

Exhibit 4

Shift from mass to premium



Source: McKinsey 2016 China Consumer Report

This trend towards premium products is already well underway, and growth of the premium segments is outpacing that of the mass and value segments. Volume growth – particularly in food and beverage – is mostly flat.

Foreign brands still hold a leadership position in the premium segment. With a few notable exceptions, such as Huawei's growing share of the premium smartphone market, penetration by local companies in premium segments remains limited. Chinese brands have not gained much traction in many premium segments such as skincare, premium cars, sports apparel, and fashion.

This is in stark contrast to the mass segment of the market, where local brands are winning market share from foreign incumbents through a much stronger product proposition. Given this strong increase in the mass segment, local brands have been gaining share – a trend we anticipate will continue.

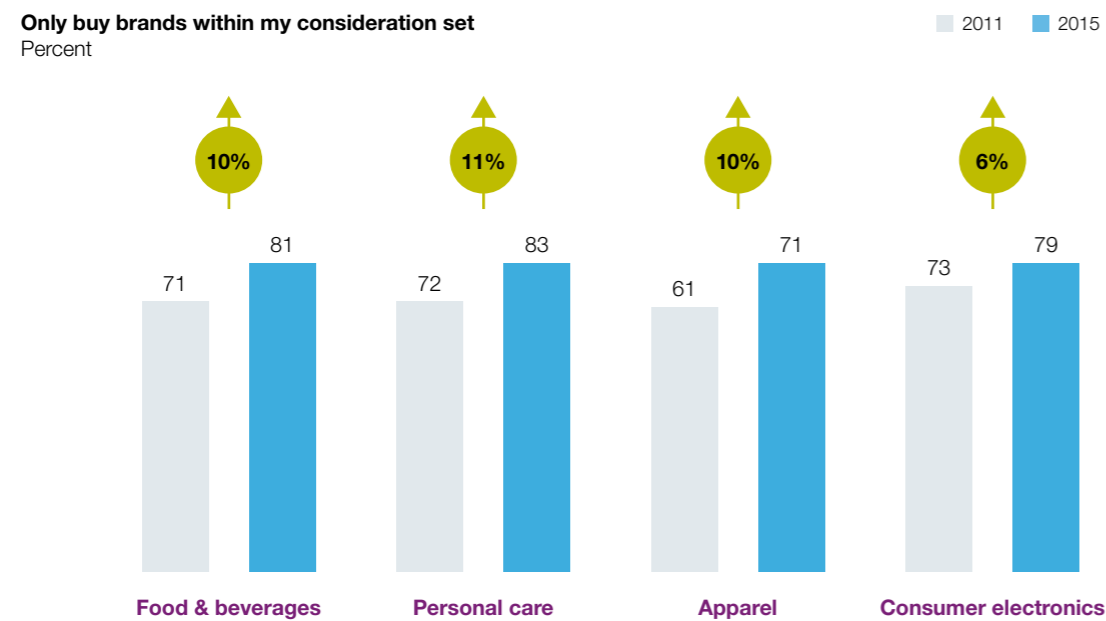
Winning brands will be those that understand and leverage four key consumer trends.

1. Loyalty to brands

A rising proportion of Chinese consumers focus on a few brands, with some becoming loyal to single brands. The number of consumers willing to switch to a brand outside their “short list” sharply dropped. In apparel, for example, the number of consumers willing to consider a brand outside of their consideration list dropped from ~ 40% in 2011 to just below 30% in 2015 (Exhibit 5).

Exhibit 5

Trend 1 – Increasingly brand loyal



Source: McKinsey 2016 China Consumer Report

Becoming part of the closed-set of few brands that consumers consider, or even the one brand that consumers prefer, is increasingly challenging. Fewer consumers are open to new brands, and promotions are becoming less effective at encouraging consumers to consider new brands.

2. Healthy living

Chinese consumers are finding that growing incomes and rising standards of living can take a toll on their personal lives. In our survey, 42% of consumers said they find it increasingly difficult to enjoy their lives, and 45% expect to face more pressure in the future.

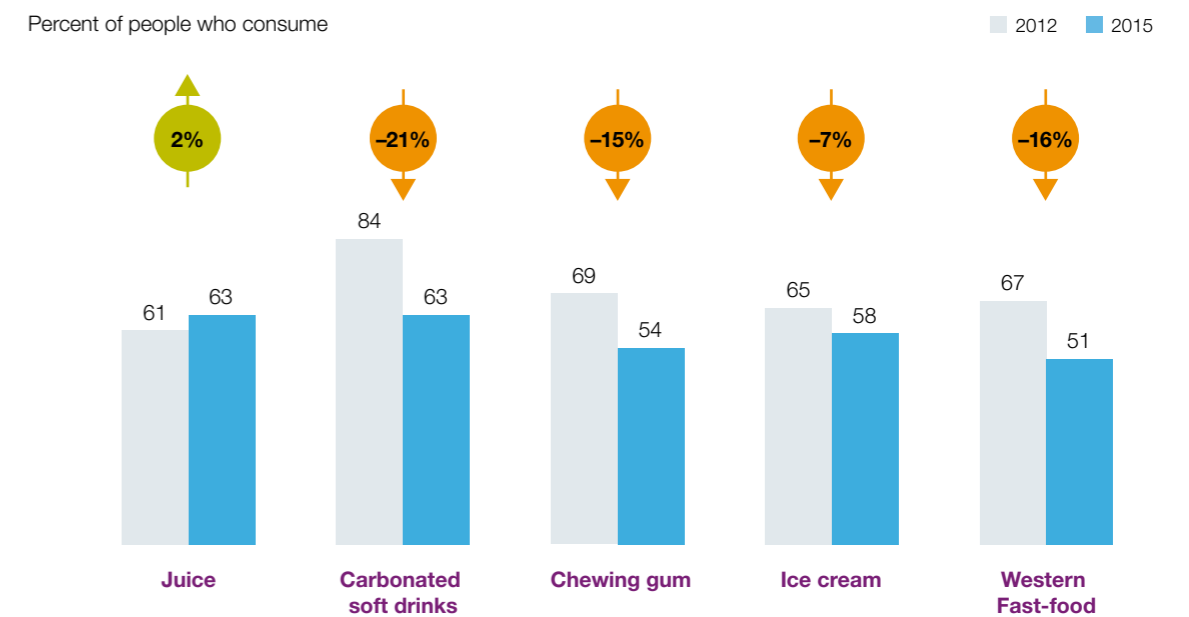
Consequently, an increasing number of Chinese consumers are striving to achieve more balanced lives by eating healthier and safer food, practicing preventive healthcare, and pursuing sports activities.

After witnessing a series of food scandals over the past 5-10 years, food safety is of rising concern to Chinese consumers: 72% of consumers now worry that the food they eat is harmful to their health, up from 60% in 2012.

What is new is that today more than 50% of consumers are now focused on eating healthy and nutritious foods. Fruit juice penetration is up 2%, while categories perceived as being less healthy have seen penetration drop: 21% for carbonated soft drinks, 15% for chewing gum, and 16% for Western fast food (Exhibit 6).

Exhibit 6

Trend 2 – Healthy living



Source: McKinsey 2016 China Consumer Report

Even within these losing categories, however, you will find winners. Schweppes has fueled growth by successfully creating a brand around health with its +C drink, which contains vitamin C. Bright has built a billion-dollar brand, Momchilovtsi, with an ambient yogurt product that does not need to be refrigerated.

“Organic/green food” has become one of the top criteria Chinese consumers use to identify the safety of food, with 38% of consumers mentioning this attribute among their top three criteria, despite the absence of a credible organic certification in China.

Some companies developing credible food certification standards have shown promise. For example, in 2009, Olé became one of the first supermarkets to focus on selling organic and imported foods.

Chinese consumers' healthy lifestyle aspirations also influence how they view healthcare. Concerns about illness remain the number one reason Chinese consumers save, with 58% citing worries that a family member could fall ill as one of the top three reasons for saving.

Attitudes such as these have driven growth in demand for preventative healthcare products such as private medical insurance, regular health checkups, lifestyle apps, and wearables, all of which are approaching levels of demand seen in Japan.

Finally, to keep healthy, Chinese consumers are increasingly participating in sports and are purchasing sporting goods. 73% of urban consumers are now participating in sports activities, a rate that is comparable to the US, where 70% of American consumers participate in sports. And the rate of participation in sports activities among Chinese consumers has been increasing three to four percentage points each year.

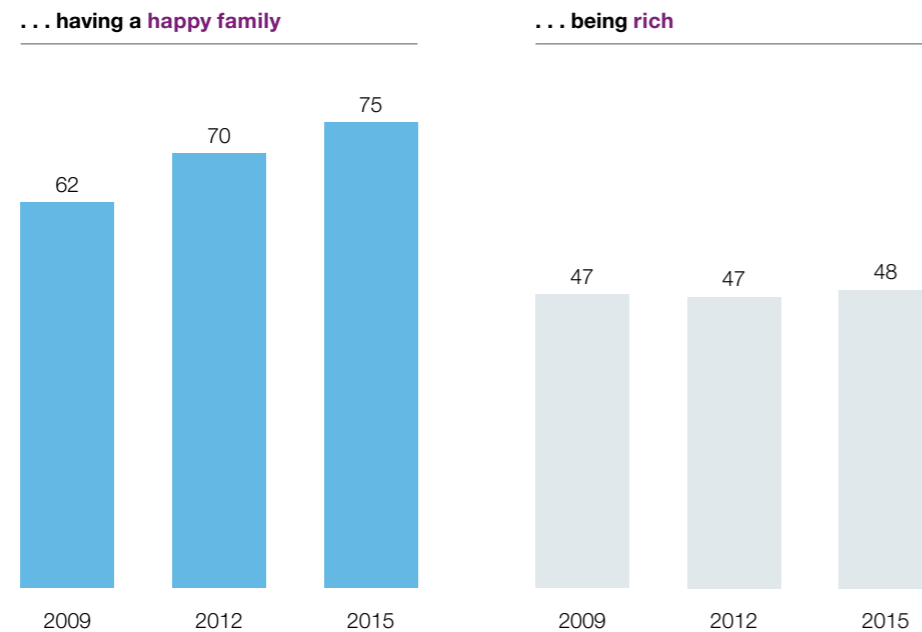
3. Family focus

Having a happy family defines success for Chinese consumers. While consumers continue to pursue social status and wealth, the importance of the family has grown steadily over the last few years (Exhibit 7).

Exhibit 7

Trend 3 – Family focus

Being successful means . . .
Percent of respondents who strongly agree or agree

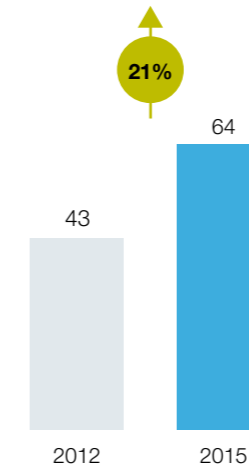


Source: McKinsey 2016 China Consumer Report

Exhibit 8

Trend 3 – Family focus

Going shopping with my family is one of the best ways to spend time with them
Percent of respondents who strongly agree or agree



Source: McKinsey 2016 China Consumer Report

These trends are having a profound impact on the consumer sector. Despite the rise of e-commerce, the appeal of “retailtainment” has only increased in recent years. Two-thirds of consumers say that shopping with the family is the best way to spend time with them, an increase of 21% compared to three years ago (Exhibit 8).

Shopping malls have benefited most from this trend. Consumers are moving away from big-box retail outlets such as department stores and hypermarkets, and are spending more time in shopping malls, which combine shopping, dining, and entertainment experiences that the entire family can enjoy.

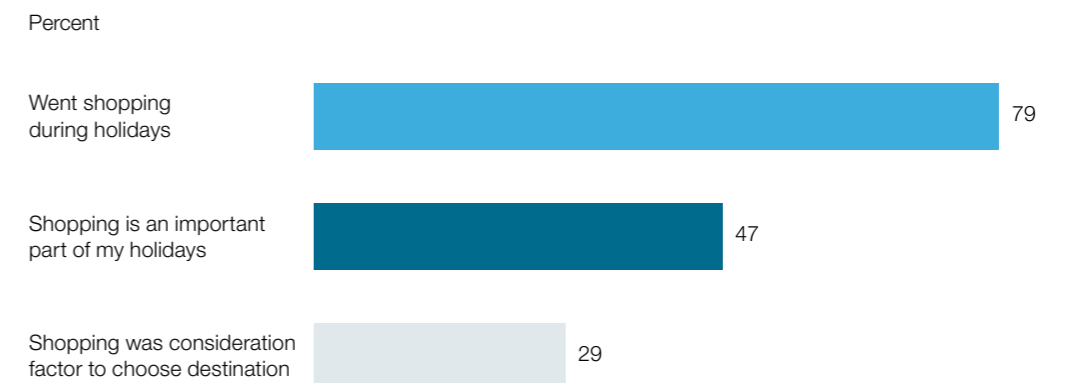
Travel is another way for consumers to reinforce family ties, with 74% of consumers saying travel helps them to better connect with their family. 45% of international trips were taken with family in 2015, up from 39% in 2012.

4. Experiences/international travel

More than 70 million Chinese consumers travelled overseas in 2015, making 1.5 trips on average. Shopping is integral to the Chinese consumer's travel experience: 80% have made overseas purchases, and nearly 30% even decide their travel destination based on shopping opportunities (Exhibit 9).

Exhibit 9

Trend 4 – Experiences/international travel



Source: McKinsey 2016 China Consumer Report

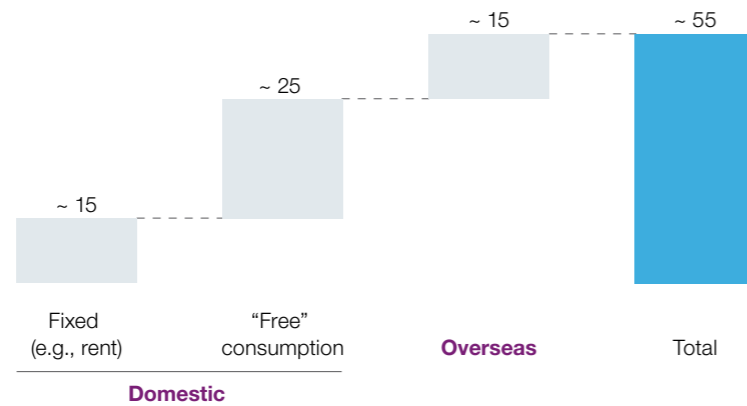
III. How to spend

For the 70 million Chinese who travel overseas, approximately 25% of their total consumption is related to their overseas trips, of which around half is spent on travel-related expenses, with the other half being spent while shopping (Exhibit 10).

Exhibit 10

Trend 4 – Experiences/international travel

Annual consumption for an individual urban international traveler
Thousand RMB



Source: McKinsey 2016 China Consumer Report; UNWTO (2015)

Among international travelers, around half of their watch and handbag purchases are made overseas. Apparel and cosmetics are the most frequently purchased categories.

Rapid adoption of new trends

Amplifying the importance of these trends is the willingness and rapidity with which Chinese consumers adopt new trends. Chinese consumers are adopting new products, services, and retail experiences at rates unseen in developed markets. For example, mobile payment penetration in China went from zero in 2011 to 25% of the population in 2015.

China is the world's largest e-commerce market, generating revenues of nearly RMB 4 trillion last year – around the same as the US and Europe. Yet, physical stores remain important as consumers engage with brands both online and offline.

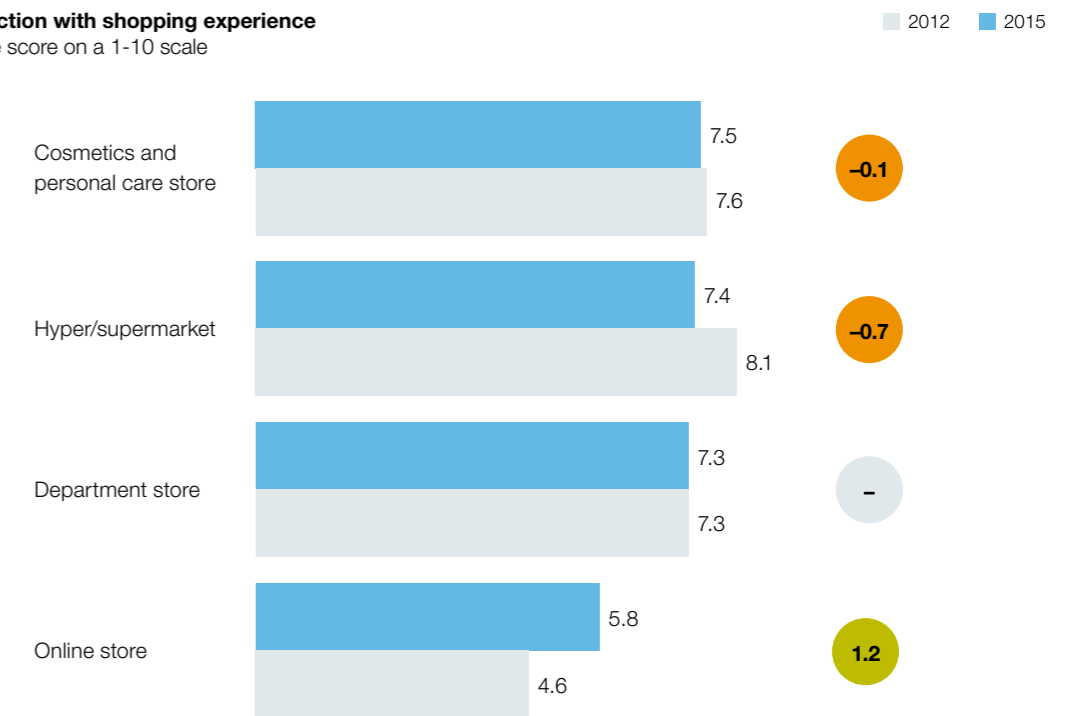
While consumers continue to express higher satisfaction with physical stores than online channels, the gap is narrowing as online stores grow in popularity (Exhibit 11).

Exhibit 11

Channel trends – Online experience catching up

FACIAL MOISTURIZER EXAMPLE

Satisfaction with shopping experience
Average score on a 1-10 scale



Source: McKinsey 2016 China Consumer Report





IV. Where to spend – Prioritizing city clusters

Since 2009, the McKinsey ClusterMap has helped companies organize 729 of China's 939 cities into 22 city-clusters consisting of as few as two, and as many as 84, neighboring cities. These 22 city-clusters are a result of three forces which shape China's urban configuration: government policy, economic linkages, and consumer preferences.

While the roll-out of new highways, high-speed rail links, and mobile internet access have strengthened connectivity between neighboring clusters over the past few years, differences across the 22 geographic clusters have become even more pronounced during this time.

Take consumer confidence as an example – 70% of consumers in the Xiamen-Fuzhou city-cluster, which lies on the coast across from Taiwan, say they are confident their income will significantly increase over the next five years. The Shandong-Byland city-cluster, which lies on the coast between Beijing and Shanghai, is comparatively pessimistic, with only 33% of its consumers expressing the same level of confidence.

As Chinese consumers in different clusters evolve at a different pace, it's imperative that marketers take a granular view of China to ensure their product and go-to-market strategies are fit for purpose.



Our survey clearly shows that the Chinese consumer is modernizing. Gone are the days of indiscriminate spending on products. The focus is shifting to purchasing more premium products, and living a more balanced, healthy, and family-centric life.

Understanding and responding to the evolution of China's consumers will be decisive in sorting out what companies win and lose, both international and domestic competitors. While scale, speed, and simplicity proved advantageous during the past 15 to 20 years, the changing shape of Chinese consumption is set to topple some giants of the past, and elevate new champions.

Which will you be?

The authors wish to acknowledge the support of Caleb Balloch, Hong Chen, Mason Ji, Glenn Leibowitz, Naomi Yamakawa and Cherie Zhang.

Daniel Zipser is a Partner in McKinsey's Shanghai office and leader of its Consumer & Retail Practice in Greater China. **Yougang Chen** is a Partner in McKinsey's Hong Kong office. **Fang Gong** is a Partner in McKinsey's Shanghai office.

About the 2016 China Consumer Report

The study included a comprehensive survey of Chinese consumers:

- The survey was conducted from September to November 2015. This is part of a series of comprehensive surveys of Chinese consumer behavior conducted by McKinsey since 2005.
- The survey sample included 10,000 respondents from 44 cities, representing approximately 75% of China's GDP and one-half of the Chinese population.
- The survey covered more than 300 brands and more than 100 products, including chocolate, carbonated soft drinks, sports shoes, facial moisturizer, laptops, smart phones, etc.
- 60-minute door-to-door interviews were conducted with respondents, covering general attitudes and shopping behavior, trade-off behavior, channel usage, and omni-channel behavior.
- The survey included a deep dive into four product categories: fast moving consumer goods (which includes food, beverages and personal care products), apparel, consumer electronics, and healthcare.

About the Greater China Consumer & Retail Practice

McKinsey is by far the largest global management consulting firm in Greater China. Today we have more than 700 Partners, consultants, and professional support staff located across five locations in Greater China: Beijing, Shanghai, Shenzhen, Hong Kong, and Taipei.

We are the trusted advisor to the region's leading businesses, governments, and institutions. Our primary mission is to help our clients achieve substantial and enduring impact by tackling their biggest issues concerning strategy, sales & marketing, operations, organization, technology and corporate finance.

We partner with consumer goods and retail companies to define their strategies and strengthen their organizations and operations. To help clients stay at the leading edge, we have built advanced expertise and capabilities in the biggest opportunity areas today, such as digital, customer & revenue management, and advanced analytics.

Since 2005, we've conducted comprehensive surveys of consumer attitudes and behavior in China. This report is based on the latest edition of the survey.

For more information, please contact one of the authors of this report:

Daniel Zipser

Partner & Head of the Greater China Consumer & Retail Practice
Shanghai
daniel_zipser@mckinsey.com

Yougang Chen

Partner
Hong Kong
yougang_chen@mckinsey.com

Fang Gong

Partner
Shanghai
fang_gong@mckinsey.com

