

Greater China Consumer & Retail Practice

China consumer report 2020

The many faces of the Chinese consumer

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This year's Double 11 GMV on all platforms was up

31%

China's slowing GDP and the trade dispute with the U.S. have injected a cloud of uncertainty into the Chinese economy. Some observers have predicted that these developments will spell bad news for Chinese consumption, which has thus far been a powerhouse for economic growth.

Our research shows that they may not need to worry so much.

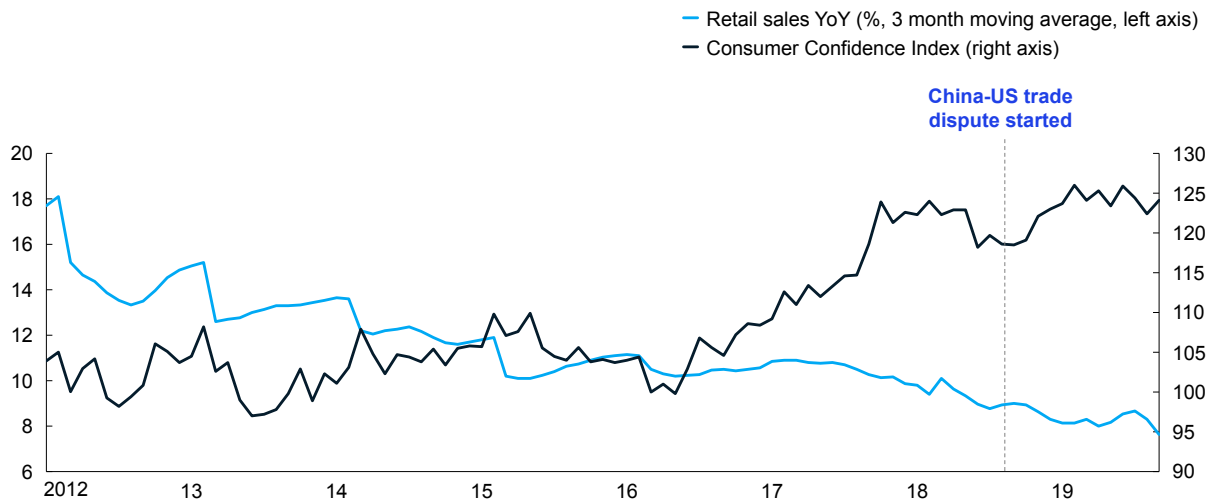
Although traditional drivers of China's economy – investment, exports, and manufacturing – are struggling, the country's consumers remain confident. After dipping in the second half of 2018, the Consumer Confidence Index hit a ten-year high earlier this year. (Exhibit 1) Consumers in China are proving to be

remarkably resilient and remain a powerful, transformative force not just in China but also across the globe. Although it's likely the growth rate for consumer spending will be slightly lower in 2019 than in 2018, consumers continue to increase their spending by a considerable margin and are eager to pay for items with a strong value proposition. This year's Double 11, for instance, was record shattering. Total sales on all platforms were up 31 percent over last year and reached RMB410 billion (US\$58 billion), far more than Cyber Monday and Black Friday's online sales combined.

Exhibit 1

Although retail sales growth has slowed, the Consumer Confidence Index has bounced back since the start of the China-US trade dispute

Retail sales growth vs. Consumer Confidence Index (Jan. 2012 through Sep. 2019)



Source: National Bureau of Statistics

Chinese consumer spending represented

31%

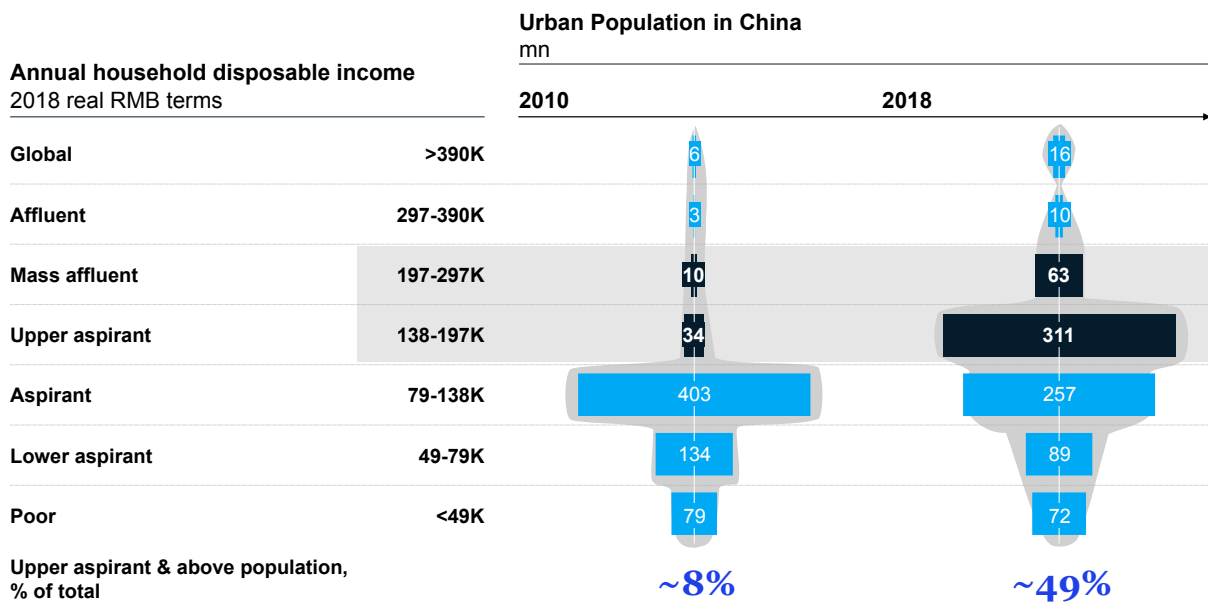
of global household consumption growth from 2010 to 2017

The overall pace at which Chinese consumption has grown is almost hard to imagine: Just a decade ago, most urban Chinese had enough money to cover basic needs like food, clothes, and housing (92 percent had annual household disposable incomes of 140,000 renminbi or less). Today, half are living in relatively well-to-do households (annual disposable incomes of 140,000- 300,000 renminbi) where they have ample funds for perks like regular meals out, beauty products, flat

screen TVs, and holiday travel. (Exhibit 2) Most rural Chinese, on the other hand, remain relatively poorer; nearly all the growth has come from cities. These urban consumers are now the main driver of the Chinese economy, with their spending accounting for more than 60 percent of GDP growth¹. And across the globe, Chinese consumer spending represented 31 percent of household consumption growth from 2010 to 2017².

Exhibit 2

The middle class population is rising in China



Source: McKinsey Global Institute

¹ In 11 of the 16 quarters since 2015

² Source: World Bank data

Now, ten years into this expansion, consumer behavior is shifting and we see a bifurcation among Chinese consumers. On one hand, a segment of consumers in lower tier cities continues spending money freely without any worry about cost or saving for the future. Other consumers, though, mostly in large, expensive cities like Beijing, Shanghai, and Guangzhou, are responding to the dip in China's economic growth and the increased cost of urban living by adjusting their attitudes and, in some cases, their spending.

This is the subject of McKinsey's most recent China Consumer Report, which is part of a series of comprehensive reports the firm has done on urban

Chinese consumer behavior since 2005. Between May and July 2019, we surveyed 5,400 respondents from 44 cities, representing approximately 90 percent of China's GDP and half of its population. We asked them about their spending patterns in 2018 versus the previous year and tracked their attitudes and expectations about products across a variety of categories. We also did deep dives into several different consumer segments to reveal deeper layers of insight. This year, we present five key consumer trends that companies need to know to help them formulate their operational strategies and stay competitive in one of the world's most important markets.



Young, free-spending consumers in lower tier cities are today's growth engine.

This important set of consumers is unaffected by slowing growth and rising living costs and has an outsized impact on spending growth.



Most Chinese consumers are increasingly discerning, savvy, and frugal about their spending.

Meaningful distinctions exist across how consumers are behaving and we highlight three additional consumer segments to take note of.



The health conscious movement is here to stay.

A large majority of consumers say they are seeking a healthier lifestyle, which presents opportunities for companies to define what health really means.



Chinese consumers continue to be more sophisticated travelers.

Consumers are moving away from the predictability and low prices of large group tours in favor of smaller, higher-end tours and self-guided adventures.



High-end Chinese brands are increasingly appealing.

Consumers want to connect with their cultural heritage and are willing to see Chinese brands as both desirable and high quality. This represents opportunities for both domestic brands and multinational players.

Trend 1:

Young Free Spenders in lower tier cities are today's growth engine

Young Free Spenders constitute 25% of the population but

60%

of total spending growth (2018 over 2017)

This year, we identified an important category of consumers who play an outsized role in keeping Chinese consumer spending surging ahead: **Young Free Spenders**. These consumers are young digital natives who reside predominantly in tier 2, 3 or 4 cities, where living costs are lower. Flush with disposable cash, they are optimistic about their futures and have little hesitation about spending their money, whether on a new tech device, an overseas trip, or high-end skincare. They have a lot more time on their hands than their counterparts in larger metropolises. Consumers in smaller cities tend to leave work and arrive home at 5 or 6 pm and spend a

lot less time commuting. This allows them free time to eat out, follow the latest trends, and buy products that will enhance their lifestyle and social status. Young Free Spenders also believe that expensive products are generally better than cheaper ones and they aren't particularly concerned with saving for the future. Such habits afford them considerable spending power. The segment accounts for only one quarter of our survey population but is responsible for almost 60 percent of 2018's total spending growth over 2017. In nearly every category we track, Young Free Spenders have significantly boosted their purchases. (Exhibit 3)

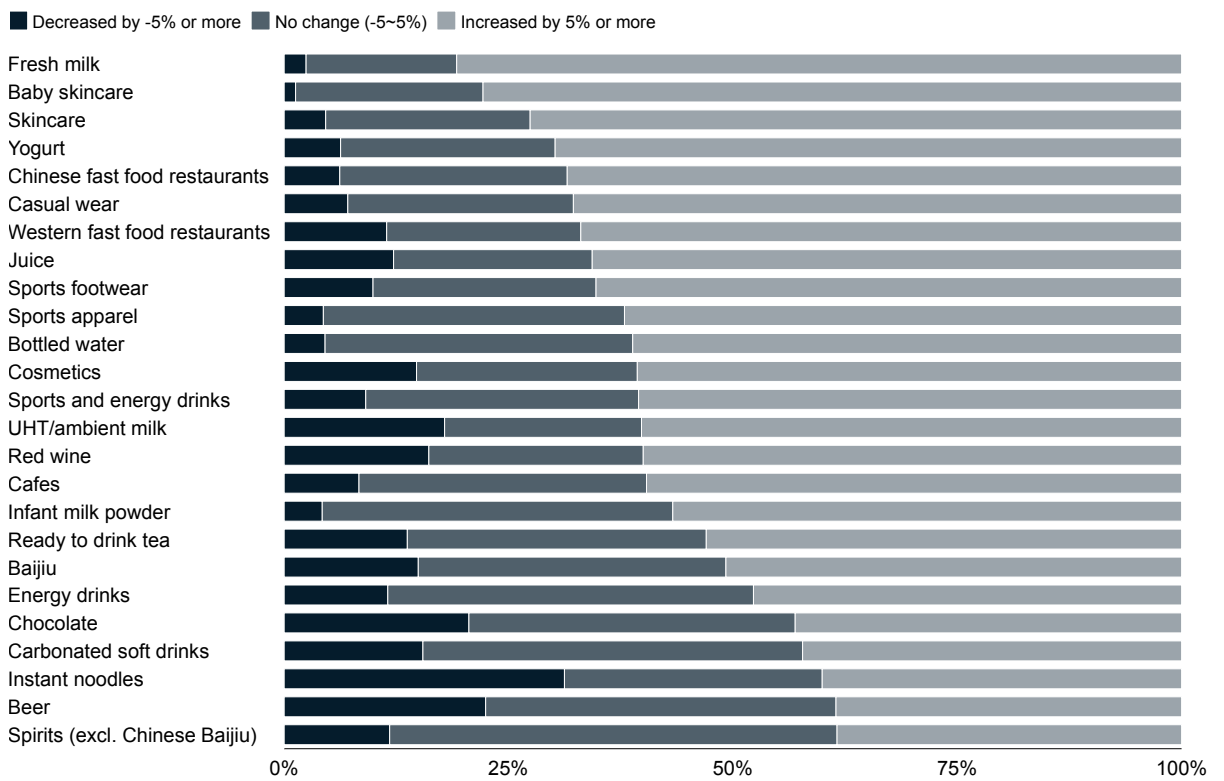


Exhibit 3

Young Free Spenders show significant net spending increase in all categories

Change in actual spending by category (2018 vs. 2017)¹

% of respondents, Young Free Spenders (N = 313), ranked by % of consumers increasing spending



¹ Question: Thinking of your/your family's consumption behavior in 2018, do you notice any change in spending in categories listed below when compared with 2017? What is the level of change per below?

Source: McKinsey China Consumer Survey

Relatively affluent households now account for more than

34%

of the population in tier 3 and 4 cities

Although much of the attention on China's new generation of affluent consumers has focused on urban areas like Beijing and Shanghai, the emergence of this group shines a spotlight on the importance of consumers in lower tier cities, such as Mianyang, Yancheng, and Zigong. In recent years, the numbers of middle and upper middle-class consumers in smaller, lower-profile tier 3 and 4 cities have risen at a rapid clip. The number of households with annual disposable income of 140,000-300,000 renminbi

in tier 3 and 4 cities increased by 38 percent CAGR from 2010 to 2018, greater than the 23 percent growth seen in tier 1 and 2 cities. These relatively affluent households (what we call 'upper aspirant' and 'mass affluent' classes) now account for more than 34 percent of the population in tier 3 and 4 cities, nearly the proportion found in high-tier cities five years ago. (Exhibit 4)

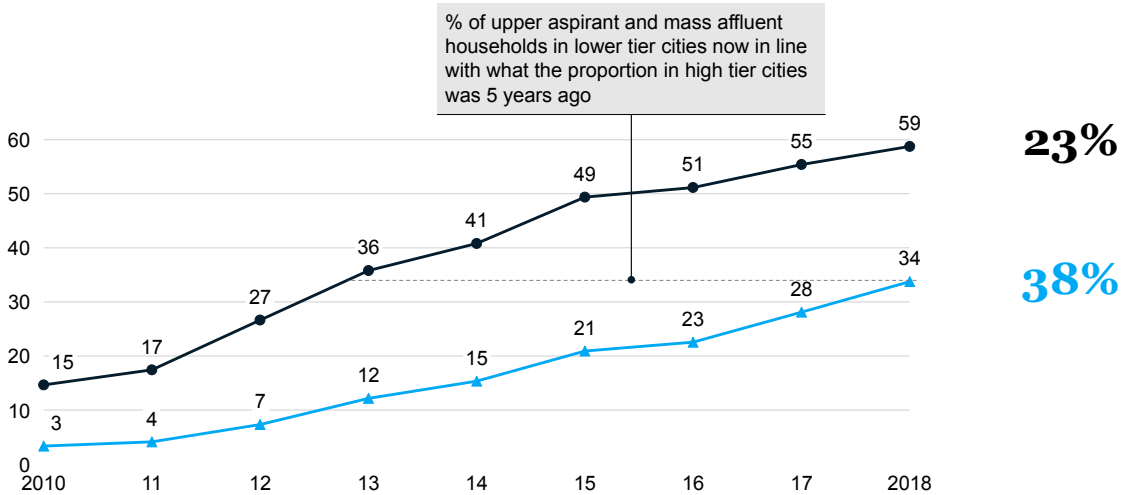
Exhibit 4

Well-to-do consumers have increased significantly in lower tier cities

● Tier 1 and 2 ▲ Tier 3 and 4

% of upper aspirant and mass affluent households

CAGR of number of upper aspirant and mass affluent households 2010-2018



Source: McKinsey Global Institute

The increased spending of Young Free Spenders in lower tier cities has been fueled, in part, by ecommerce platforms such as Pinduoduo, which have helped expand the availability of branded products in these cities. Consumers can

now purchase more than a thousand brands on these platforms, and they account for anywhere between 10 and 30 percent of a category's sales on these sites.

Trend 2:

Most Chinese consumers are increasingly discerning, savvy, and frugal about their spending

Although Young Free Spenders are seemingly immune to the realities of slower economic growth, this isn't the case for most Chinese consumers. A majority of our respondents showed signs of greater caution in their spending. Sixty percent told us they weren't interested in spending rashly, even if they felt "rich," a jump from the 52 percent of respondents who said this in 2017. (Exhibit 5)

It's not hard to see why. Between 2012 and 2018, consumption expenditure in China's cities rose 65 percent, outpacing inflation and GDP growth, while at the same time income growth slowed. Disposable income per capita rose 9 percent in 2018, down from 13 percent in 2012. Consumers, however, are reacting to economic tightening in different ways. We have identified several groups of these more cautious

consumers. Some continue to increase their spending and don't mind paying higher prices while others have moved in the other direction and are trying to save money.

Discerning Consumers are busy, affluent, middle aged Chinese who, like Young Free Spenders, have plenty of money to spend. But unlike their free spending counterparts, these consumers don't have much free time for entertainment and are interested in trading up to more expensive products mainly to get better quality, not attain social status. Discerning Consumers increased their spending in 23 out of 25 categories and accounted for 23 percent of 2018's spending growth.

Savvy Shoppers also care about better quality products but, with slightly lower incomes than Discerning Consumers and Young Free Spenders, they aren't

60%

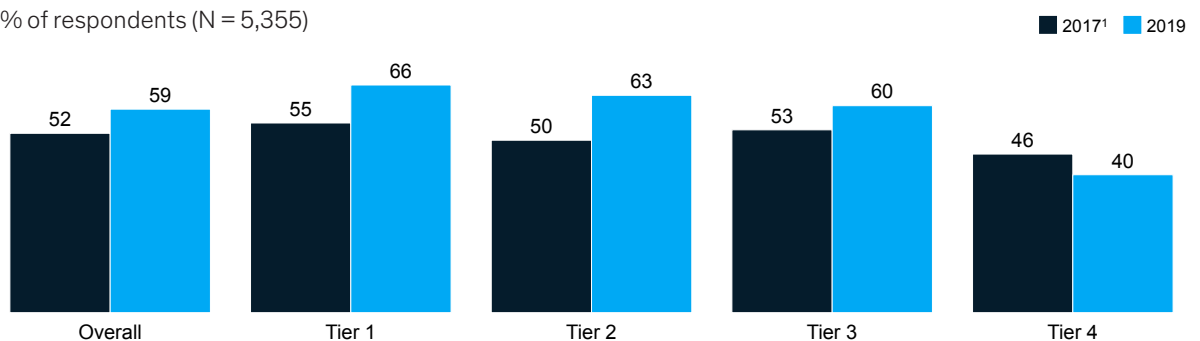
told us they weren't interested in spending rashly, even if they felt "rich"

Exhibit 5

Consumers want to save more and prepare for the future, especially those in higher tier cities

"Even when I am rich, I won't consume rashly. I should always prepare for future uncertainty"

% of respondents (N = 5,355)



¹ 2017 numbers are based on online/mobile respondents only (a subset of total respondents) to ensure compatibility with 2019 numbers

Source: McKinsey China Consumer Survey

always willing to pay more for them. In fact, they traded down to less expensive products in more categories than they traded up. (Exhibit 6) At a stable place in their lives, financially and personally, Savvy Shoppers have both the time and inclination to do the careful product evaluations needed to find better, longer lasting products without paying more. These consumers are more likely to be married, middle aged, female, and living in expensive tier 1 cities. They account for just 6 percent of the year's spending growth.

Frugal Consumers represent a new category of consumer behavior. Accounting for 10 percent of our survey population, these individuals decreased their spending on categories across

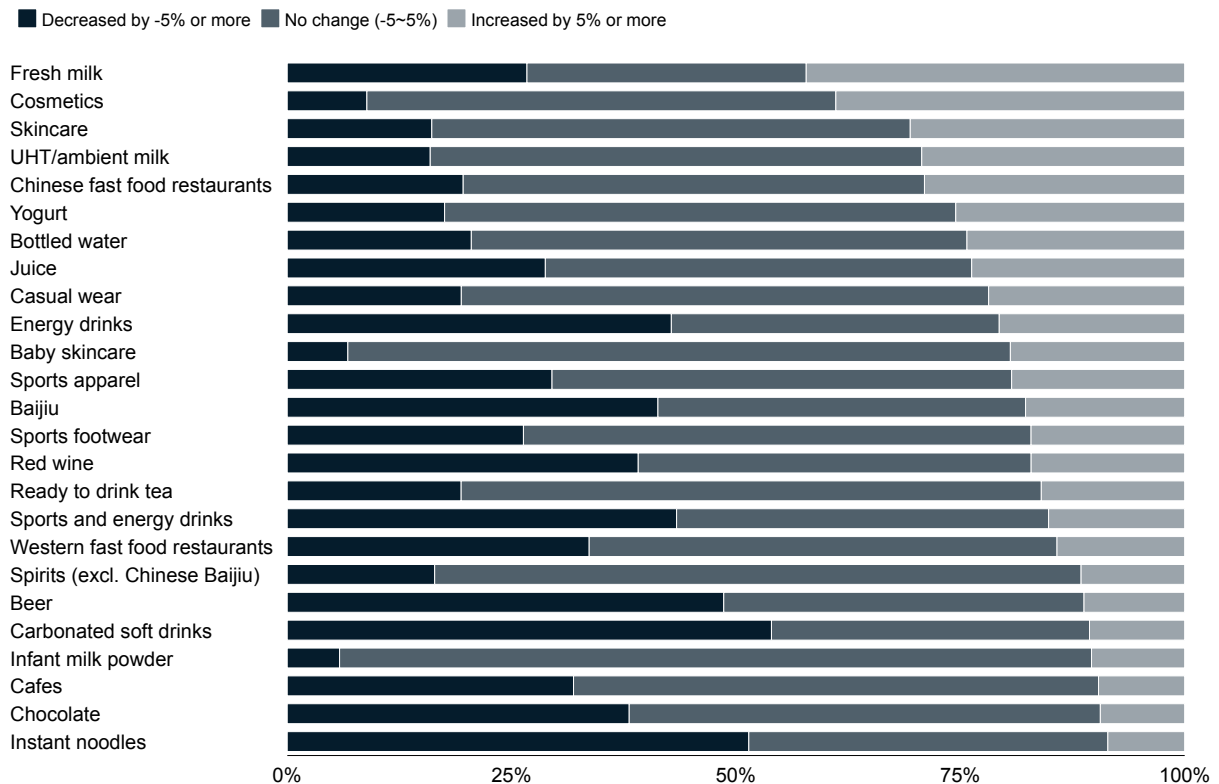
the board, with the biggest declines in nice-to-have categories that are often the first to go when spending gets tight, such as energy drinks, sodas, bottled water, and Chinese Baijiu. (Exhibit 7) These consumers have lower incomes than other segments and are more likely to live in tier 1 and 2 cities, so it's not surprising that low prices and saving money are more important to them than quality and brand appeal. Frugal Consumers are most likely to be young and single. They are also busy, hard working, and feel reasonably confident about their future. While this optimism does not always translate into spending more money on a daily basis, they do tend to spend on important moments in life.

Exhibit 6

Savvy Shoppers have become more selective and are trading off across categories

Change in actual spending by category (2018 vs. 2017)¹

% of respondents, Savvy Shoppers (N = 288), ranked by % of consumers increasing spending



¹ Question: Thinking of your/your family's consumption behavior in 2018, do you notice any change in spending in categories listed below when compared with 2017? What is the level of change per below?

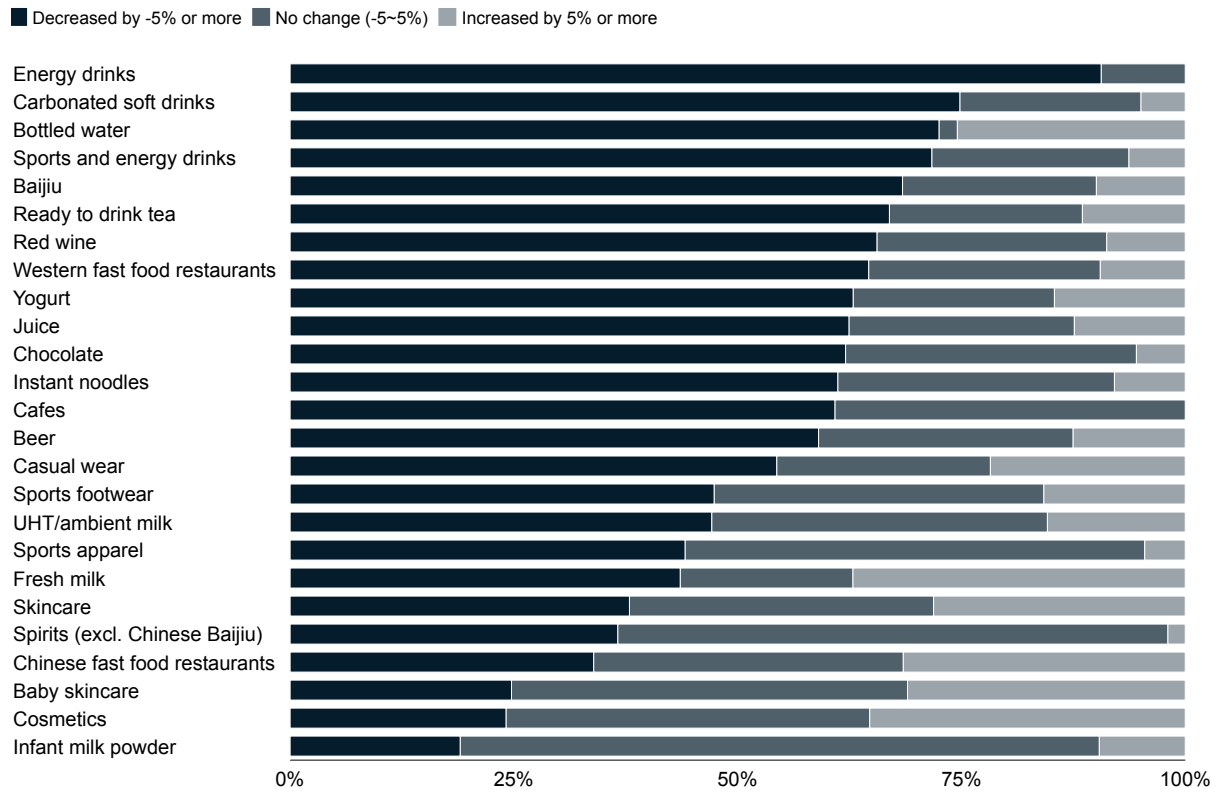
Source: McKinsey China Consumer Survey

Exhibit 7

Frugal Consumers are decreasing their spending across the board

Change in actual spending by category (2018 vs. 2017)¹

% of respondents, Frugal Consumers (N=131), ranked by % of consumers decreasing spending



¹ Question: Thinking of your/your family's consumption behavior in 2018, do you notice any change in spending in categories listed below when compared with 2017? What is the level of change per below?

Source: McKinsey China Consumer Survey



Trend 3:

The health conscious movement is here to stay

As consumers strive to take care of themselves amid the stress, congestion, and pollution of urban living, they are expecting to increase their spending mainly on categories related to health and lifestyle. (Exhibit 8)

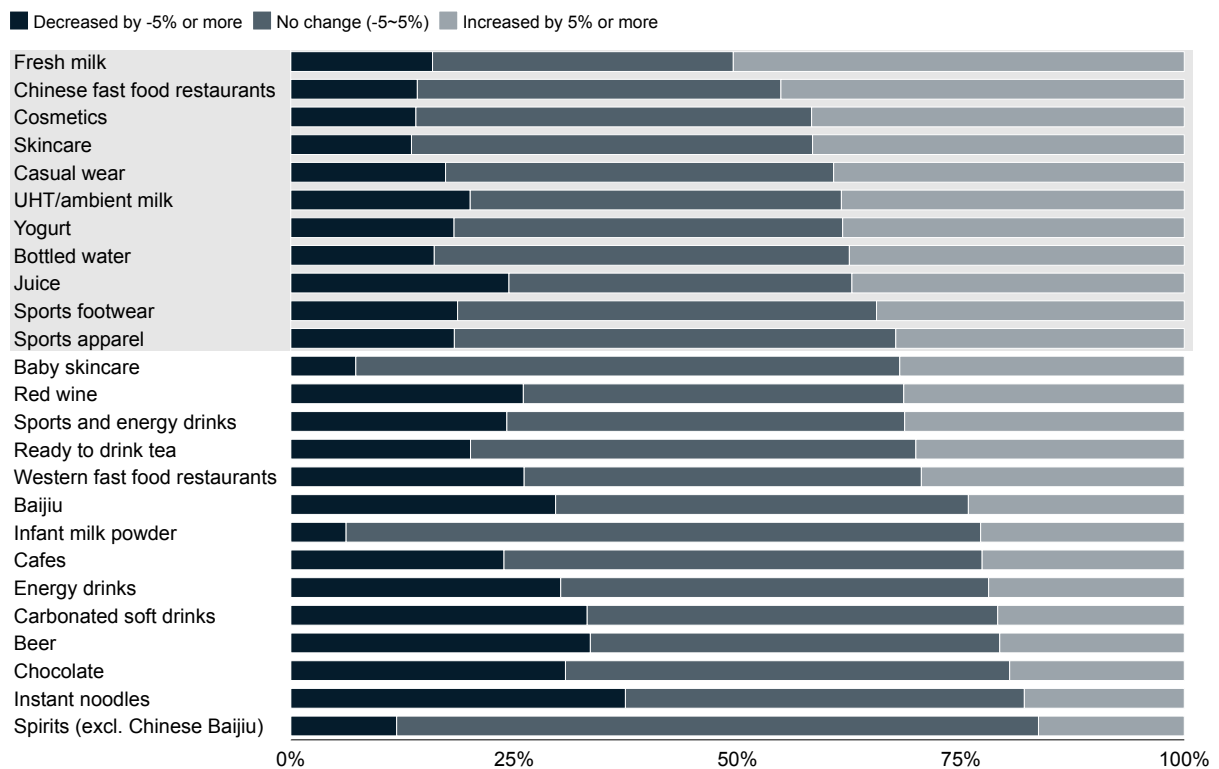
Health conscious consumers are paying more attention to their food choices, in a way that goes beyond simply ensuring food safety. This year, more consumers said they were intentionally choosing healthier food. This was true across city tiers but most pronounced in tier 1 cities.

Exhibit 8

Consumers are increasing their spending mainly on categories related to health and lifestyle

Change in actual spending by category (2018 vs. 2017)¹

% of respondents (N = 1,325), ranked by % of consumers increasing spending



¹ Question: Thinking of your/your family's consumption behavior in 2018, do you notice any change in spending in categories listed below when compared with 2017? What is the level of change per below?

Source: McKinsey China Consumer Survey

60%

of consumers in large cities said they always check the ingredient labels for packaged food

Sixty percent of consumers in large cities said they always check the ingredient labels for packaged food and will not buy a product if it doesn't seem healthy. Two product categories that have benefited from this are fresh milk and yogurt, both of which have health halos. Among the 25 product categories we tracked, fresh milk was the top product Chinese consumers said they spent more on in 2018, compared to 2017. Half of all respondents told us they were buying more of this product and 38 percent said they were buying more yogurt. Young Free Spenders, in particular, are interested in buying

yogurt that features natural ingredients. Fifty-five percent said "healthy and natural ingredients" is their top buying factor.

Subtle distinctions exist in how consumers approach health in high versus low tier cities. Consumers in lower tier cities haven't reached the same level of understanding about what constitutes a healthier lifestyle as consumers in high tier cities. For instance, top categories lower tier consumers are spending more on include carbonated soft drinks and juice.

Trend 4:

Chinese consumers continue to be more sophisticated travelers

Seeking more enjoyable experiences in their lives, consumers are booking lots of trips. Spending by urban Chinese on travel between 2014 and 2018 outpaced GDP growth, increasing by 14 percent CAGR versus 7 percent. (Exhibit 9) Yet as they travel more, consumers are becoming more sophisticated and discerning about how they plan their trips. For domestic travel, over 60 percent of Chinese say they now prefer self-guided excursions instead of the large package tours that were popular a decade ago. (Exhibit 10) This is especially true for tier 1 travelers (80 percent said they prefer self-guided tours). When Chinese travelers do book packaged tours, they are increasingly choosing smaller, higher-

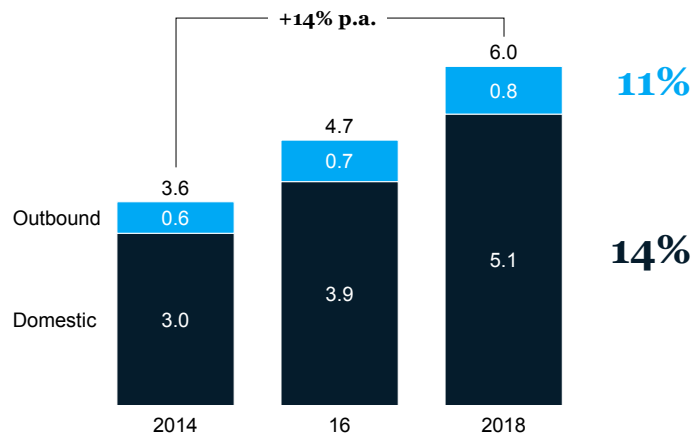
end options. Consumers 45 years and older are particularly interested in smaller tours (32 percent said this was their preference).

The majority of trips taken by Chinese consumers continue to be to destinations within China. Yunnan and Sichuan are two of the most popular. Tier 1 city travelers are more likely than lower tier travelers to venture outside of China and take longer trips (greater than eight days). When it comes to outbound travel, Chinese travelers still favor Greater China (Hong Kong, Taiwan, Macau) and Asian destinations (Japan, Korea and Southeast Asian countries), but long-haul (e.g., Europe, North America) and niche destinations (e.g., Iceland) are also on the rise.

Exhibit 9

High growth for domestic and outbound travel from 2014 to 2018

Spending on China domestic and outbound trips
Trillion RMB

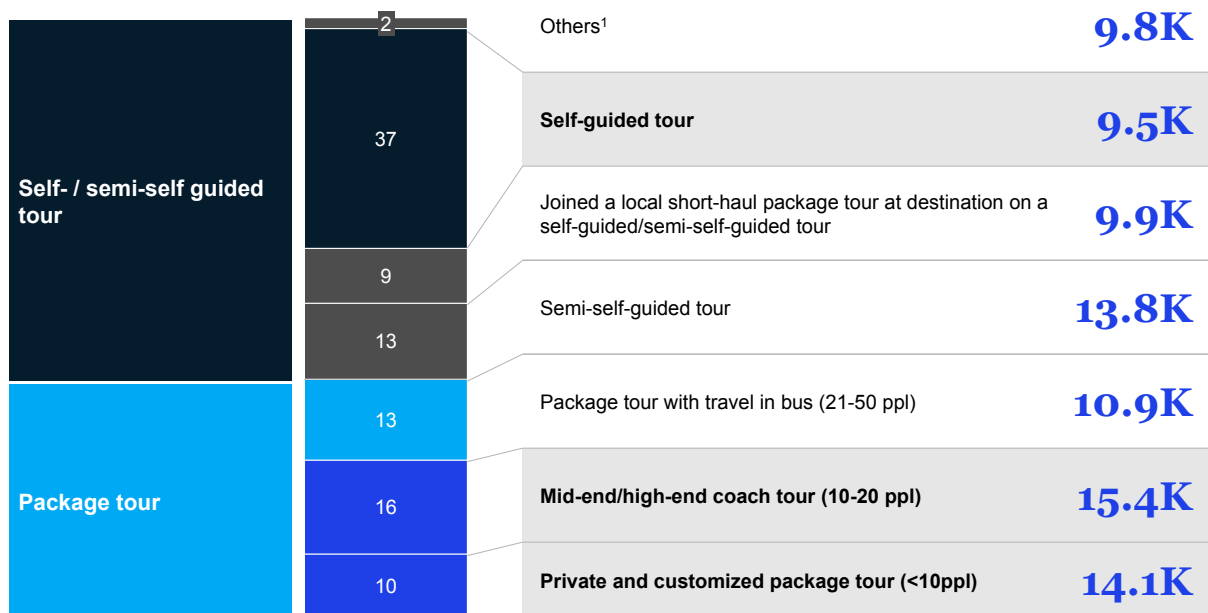


Source: Local tourism statistics; Press search

Exhibit 10

Chinese travelers prefer self-guided excursions and small-sized premium tours

Type of trip for the most recent domestic trip and average spending per trip
% of survey respondents (N = 1,058)



¹ including river cruise and other types

Source: McKinsey China Consumer Survey

Trend 5:

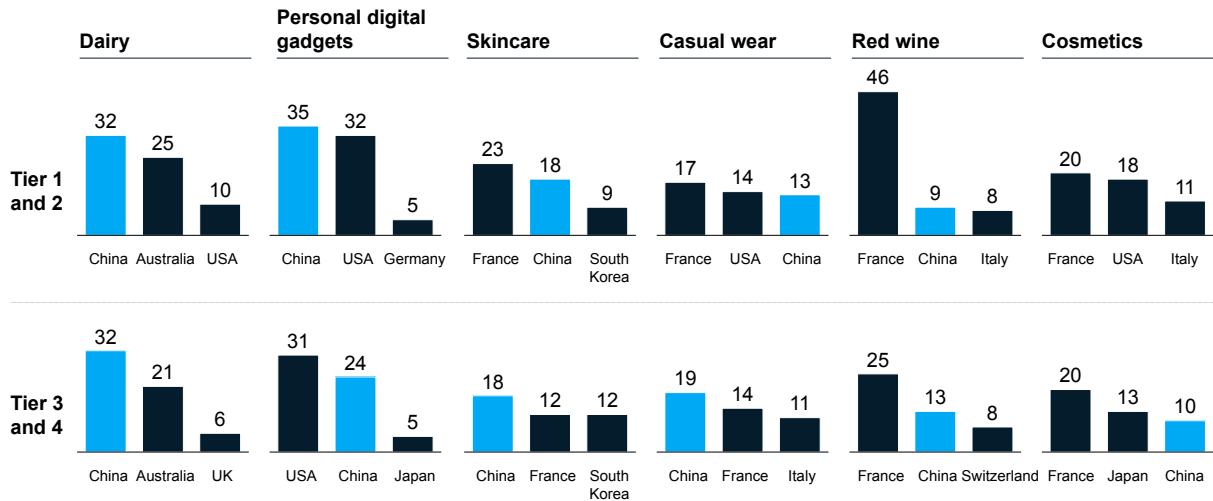
High-end Chinese brands are increasingly appealing

Gucci sunglasses, Mercedes SUVs, Godiva chocolate, Gillette razors. Western brands used to be the mark of a comfortable, modern, middle class lifestyle in China. In contrast, shoppers perceived Chinese brands to be of inferior quality and lacking in cachet. In recent years, this has changed dramatically. Instead of focusing on lower priced products, many Chinese players have upgraded the quality, performance, and value of their offerings. In our survey, respondents told us they had a clear preference for Chinese brands over foreign ones in 13 out of 19 categories. These include basic items like tissue paper, home cleaning products, milk, and fresh food, as well as products more connected to identity and lifestyle, such as phones, computer tablets, beer, and household appliances like refrigerators. Between 33 and 57 percent of Chinese consumers say they prefer local brands in these categories. (Exhibit 11)

New this year is the fact that many consumers are also likely to pick local brands for more expensive premium products. China is one of the top countries of origin for higher end digital devices, skincare, cosmetics, and red wine. Consumers are even developing a taste for Chinese fashion – not generic knock offs but carefully crafted and branded clothes by Chinese designers like Ms Min, Ming Ma and Angel Chen. These fashion lines now appear alongside top Western brands in China's luxury department stores. Outside the luxury market, brands like Icicle have successfully catered to consumers seeking affordable homegrown fashion.

Top 3 countries of origin that consumers most likely buy when purchasing premium¹ products

% of respondents in tier 1 and 2; tier 3 and 4 cities, N = 745/580



¹ Premium definition varies by price tier across categories. For a 1 liter bottle of dairy beverage, RMB 60-100; for personal digital gadgets, RMB 5,000-12,000 for a smartphone; for skincare, RMB 1,500-5,000 for 50ml; for casual wear, RMB 8,000-20,000 for a jacket; for a bottle of red wine, RMB 2,000-5,000; for cosmetics, RMB 300-500 for lipstick.

Source: McKinsey China Consumer Survey

At the same time, Chinese consumers remain confused about where brands originate. Many believe that global brands with a longstanding presence in China are local brands. Half of all consumers say 7-Up is a Chinese brand and 49 percent think the same of Yakult drinks, which hail from Japan. On the other hand, Chinese brands that have

packaged themselves as international are often mistaken as foreign. Le Conte chocolate and BeingMate infant milk powder are thought to be foreign brands by 42 percent of respondents.



Implications for brands

Double down on the Young Free Spenders

Until recently, most global brands devoted the bulk of their marketing resources to China's largest cities like Shanghai or Beijing. We expect the buying power of Young Free Spenders in lower tier cities to only increase and thus represent a growth engine for a wide range of categories. Companies should spend time understanding who these consumers are and what their key buying factors are, then have a clear plan to reach them. Developing premium and aspirational products that are going to appeal to these consumers and focusing on the route to market and distribution in lower tier cities will be key. Companies will need to carefully consider their omnichannel strategies¹, since many Young Free Spenders enjoy shopping in trendy malls, as well as spending time online.

In our survey, we found that consumers in tier 3 and 4 cities are more motivated by social engagement and product exclusivity than shoppers in tier 1 and 2 cities. As a result, parties and exhibitions may be more valuable in reaching Young Free Spenders than traditional marketing campaigns. Product offers that feel unique to them are also likely to have appeal, as are creative uses of social media. Platforms like WeChat and Douyin (Tik Tok in English) now offer new direct-to-consumer channels or mini-programs that brands can use to influence and engage with consumers and drive sales. We've seen brands create a variety of programs, including attention-grabbing games and quizzes, one-off opportunities to purchase unique products from online and physical stores, and options for self-designed products or reservations for personalized services. Brands that want to capture the hearts and

minds of Young Free Spenders should embed such social media engagement capabilities into their organizations.

Monitor consumers who are “trading off”, especially in higher tier cities

Companies will need to decide if their strategy should include Savvy and Frugal consumers as target segments. Together, these two groups comprise 31 percent of the urban population and reside primarily in higher tier cities. Brands that decide to target these consumers could pursue strategic partnerships with ecommerce players such as Pinduoduo, which do an effective job of reaching these segments. These platforms can provide insights about and access to Savvy and Frugal consumers without encroaching on a brand's more premium positioning and pricing in other channels.

Capitalize on the health trend

With 72 percent of urban consumers saying they are actively seeking a healthier lifestyle, many brands have an enormous opportunity to proactively shape perceptions about what it means to be healthy. In the vitamins and supplements category, for example, companies could emphasize their products as 'herbal' and 'natural' and highlight their value in preventative care.

In addition to selling products, companies will also want to emphasize how experiential offerings can contribute to a healthy lifestyle. Gym and fitness players, for instance, could upgrade their offerings beyond lessons and classes to include lifestyle elements like juice bars and relaxation lounges. Focusing on the quality of personal trainers and offering hassle-free experiences (such as online booking for training and classes) are also key factors in boosting enrollment.

72%

of survey respondents told us they were actively seeking a healthier lifestyle

¹Source: McKinsey Digital, "China digital consumer trends 2019"

Create distinct, memorable experiences that will surprise and delight China's more sophisticated consumers

The fact that many Chinese travelers have grown tired of the standardized approach of large tour groups is further evidence that consumers are seeking not just high value products or services but novel experiences. Some retail brands have responded by creating immersive experiences for consumers. For example, Lululemon built a fitness and yoga community for consumers that centers on regular classes and large yoga events. Nike personalizes a customer's interaction with the brand and offers tailored shoes through its Nike by You program. Eyewear company Gentle Monster creates a sense of modern design and contemporary art in its brick-and-mortar stores and holds seasonal themed in-store exhibitions to maintain a sense of freshness.

Be smart about how you incorporate Chinese elements into your products

Thanks to the government's campaign to boost national pride and the ongoing trade dispute with the U.S., Chinese consumers have plenty of reasons to be patriotic with their spending.

Multinational companies should respond to the desire for Chinese products with innovation, introducing Chinese elements to their products and their branding in ways that feel sophisticated and authentic. For example, L'Oreal collaborated with the National Museum to offer five limited edition lipsticks that reflect China's artistic heritage. Each container features an image inspired by the classical elegance of five historic Chinese beauties. To allow for this kind of innovation, multinational companies should give greater freedom and flexibility to local teams.

Chinese companies should take advantage of this trend by celebrating their Chinese heritage and origin, as this is something Chinese consumers are increasingly craving. Companies should pair this with continuous improvements in quality and desirability to create a value proposition that will be hard to beat. For example, Erdos, the world's largest maker of cashmere products, is moving into a more premium segment and emphasizing the higher end craftsmanship and design of these products.

Conclusion

Chinese consumers are responding in distinct ways to the country's current economic uncertainty and slowing growth. Some continue spending freely and seeking out more expensive options, while others have grown more discerning and are tightening their belts. But for the large majority of consumers in our survey, there is a consistent story. These consumers remain confident and will collectively represent an economic powerhouse for the foreseeable future.

About the McKinsey China Consumer Survey

Our study combined a comprehensive survey of Chinese consumers, in-depth research, and observations from our work advising companies in China. The survey was conducted from May to July 2019, and is part of a series of comprehensive surveys of Chinese consumer behavior conducted by McKinsey since 2005. The survey sample included approximately 5,400 respondents from 44 cities, representing approximately 90 percent of China's GDP and more than half of its population.

We conducted online research with respondents, covering consumers' general attitudes and purchasing behavior, key trends regarding their consumption patterns and leisure habits, and attitudes toward life, success, money, and health. The survey included a deep dive into apparel, cosmetics, and fast moving consumer goods categories, including food, personal care, and household products. Our research was supplemented by additional research that McKinsey is conducting on consumer sentiment in 26 countries. Results from our 2019 Global Sentiment Survey are available on [mckinsey.com](https://www.mckinsey.com).

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