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Here comes the modern Chinese consumer

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Despite concerns about economic growth, the country's consumers keep spending. Yet our latest survey reveals changes in what they're buying and how they're buying it.

Cooling economic growth, a depreciating currency, and a gyrating stock market are making political and business leaders concerned that China's economic dream may be ending. Yet Chinese consumers remain upbeat. In fact, consumer confidence has been surprisingly resilient over the past few years as salaries have continued to rise and unemployment has stayed low.

However, our latest survey of Chinese consumers reveals significant change lurks beneath the surface. Reflecting 10,000 in-person interviews with people aged 18 to 56 across 44 cities, our *2016 China consumer report* found that the days of broad-based market growth are coming to an end. Consumers are becoming more selective about where they spend their money, shifting from products to services and from mass to premium segments. They are seeking a more balanced life where health, family, and experiences take priority (Exhibit 1). The popularity of international travel is astounding among Chinese consumers, as is their adoption of trends such as mobile payments. And despite many similarities, consumer behavior can vary significantly among the country's 22 city clusters.

In short, our latest research suggests we are witnessing the modernization of the Chinese consumer, and that will only make the market more challenging for consumer-goods companies. But for those able to get it right, the rewards may be substantial. In this article, we'll examine the evolving behavior of Chinese consumers through three lenses: how willing they are to spend, what they are buying, and where they are buying.

How willing they are to spend

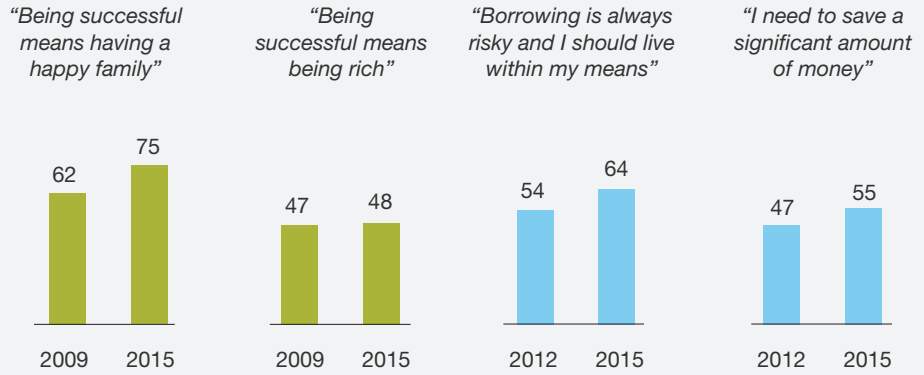
When asked about their expectations regarding future income, 55 percent of consumers we interviewed were confident their income would increase significantly over the next five years—just two percentage points lower than in 2012. (By comparison, just 32 percent of consumers in the United States and 30 percent in the United Kingdom agreed with the same statement in 2011.)

That's not to say that Chinese consumers are unaware of the deteriorating condition of the economy. A growing number are seeking to save and invest, and we found differences in consumer confidence widening at a regional level (Exhibit 2). While confidence about income growth during the next five years rose to 70 percent in the Xiamen–Fuzhou city cluster, for example, it decreased to as little as 35 percent in Liao Central.

Exhibit 1

Most Chinese prioritize happiness over wealth and feel an increasing need to save money.

% agreeing with statement

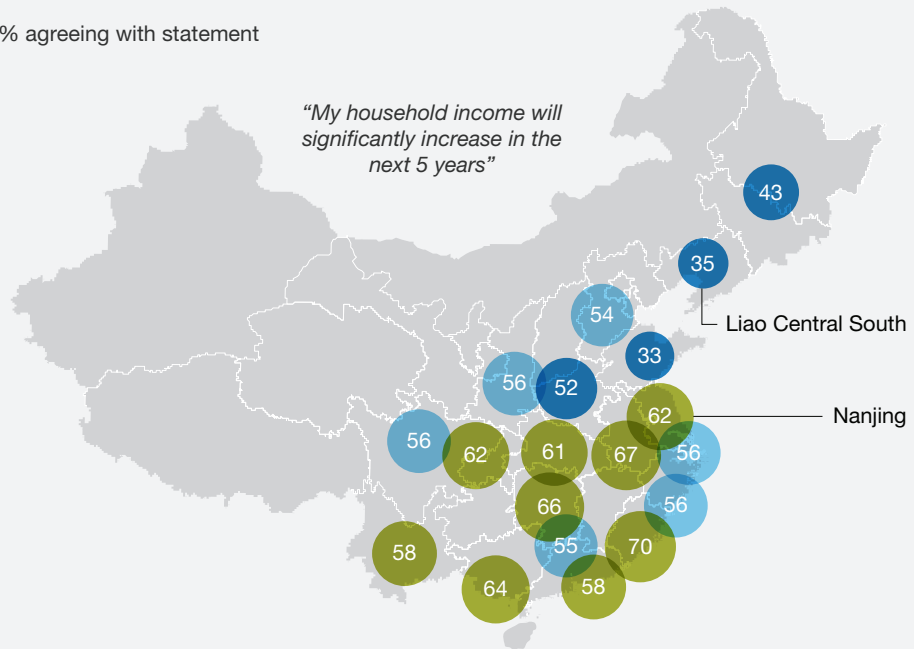


McKinsey&Company | Source: McKinsey 2016 China consumer report

Exhibit 2

Chinese consumers remain upbeat about their future.

% agreeing with statement



Note: Since 2009, McKinsey's ClusterMap has organized 729 of China's 939 cities into 22 city clusters ranging from 2 to 84 neighboring cities and resulting from 3 forces that shape China's urban configuration: government policy, economic linkages, and consumer preferences. Survey data not available for 3 of the 22 city clusters.

McKinsey&Company | Source: McKinsey 2016 China consumer report

What they are buying

We found that consumers are generally becoming more selective about their spending. They are allocating more of their income to lifestyle services and experiences—over half plan to spend more on leisure and entertainment (the 50 percent surge in box-office receipts in the past year is just one indicator of that trend). At the same time, spending on food and beverages for home consumption is stagnating or even declining.

Chinese consumers are also increasingly trading up from mass products to premium products: we found that 50 percent now seek the best and most expensive offering, a significant increase over previous years (Exhibit 3). It's no surprise that the growth of premium segments is outpacing that of the mass and value segments, and foreign brands still hold a leadership position in that premium market. What's more, a rising proportion of Chinese consumers focus on a few brands, and some are becoming loyal to single brands. The number of consumers willing to switch to a brand outside their "short list" dropped sharply. In apparel, for instance, the number of consumers willing to consider a brand they hadn't before dropped from about 40 percent in 2012 to just below 30 percent in 2015.

Becoming part of the closed set of the 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 them.

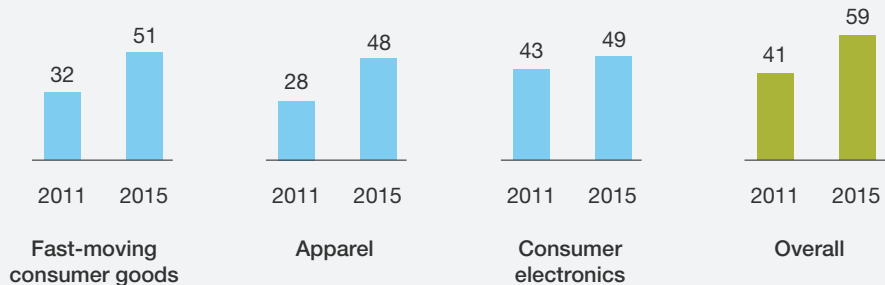
Exhibit 3

Chinese consumers increasingly desire premium products.

% agreeing with statement

"Within a range of prices I can afford, I always pay for the most expensive and best product"

"I would buy famous-branded products if I had more money"



McKinsey&Company | Source: McKinsey 2016 China consumer report

With a few notable exceptions, such as Huawei’s growing share of the premium-smartphone market, Chinese brands have not gained much traction in many premium segments, such as skincare, cars, sports, and fashion. That contrasts starkly with the mass segment of the market, where local brands are winning market share from foreign incumbents by offering a much stronger product proposition.

Where they are buying

Although China is the world’s largest e-commerce market—generating revenue of about 4 trillion renminbi (\$615 billion) last year, around the same as Europe and the United States combined—and consumers increasingly purchase online, physical stores remain important. Consumers engage with brands both online and offline (Exhibit 4), and satisfaction with physical stores remains higher than with online ones. But the gap is narrowing, especially as satisfaction with hypermarkets declines.

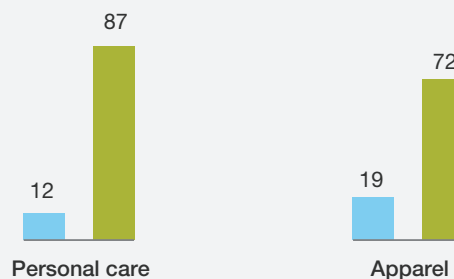
One trend that is helping maintain interest in physical stores is “retailtainment.” Two-thirds of Chinese consumers say that shopping is the best way to spend time with family, an increase of 21 percent compared with three years ago. Malls—which combine shopping, dining, and entertainment experiences the entire family can enjoy—have benefited most from this trend, at the expense of big-box retail outlets such as department stores and hypermarkets.

Consumers also reinforce family ties through travel: 74 percent of consumers say it helps them to better connect with family, and 45 percent of international trips were taken with

Exhibit 4

Online shoppers are much more likely to visit a physical store before making a purchase than shoppers in physical stores to visit an online store.

■ % of **physical** store shoppers visiting **online** stores before purchase
■ % of **online** shoppers visiting **physical** stores before purchase




McKinsey&Company | Source: McKinsey 2016 China consumer report

family in 2015, compared with 39 percent in 2012. More than 70 million Chinese consumers traveled overseas in 2015, making 1.5 trips on average, and shopping is integral to this experience. Some 80 percent of consumers have made overseas purchases, and nearly 30 percent actually base their choice of a travel destination on shopping opportunities. Among international travelers, around half of their watch and handbag purchases are made overseas, while apparel and cosmetics are the most frequently purchased categories.

Overall, Chinese consumers are adopting new products, services, and retail experiences at rates unseen in developed markets. To take one example, mobile-payment penetration in China went from zero in 2011 to 25 percent of the population in 2015. At the same time, there are still differences in how Chinese consumers in various regions spend. While new highways, high-speed-rail links, and mobile Internet access have strengthened connectivity between neighboring clusters over the past few years, we found that differences across the country's 22 geographic clusters¹ have grown even more pronounced. For instance, 35 percent of consumers in the Shanghai city cluster have purchased apparel online in the past six months, compared with just 4 percent of consumers in the Chengdu city cluster.

¹ Since 2009, McKinsey's ClusterMap has organized 729 of China's 939 cities into 22 city clusters consisting of as few as 2, and as many as 84, neighboring cities. These 22 city clusters are a result of three forces that shape China's urban configuration: government policy, economic linkages, and consumer preferences.



The Chinese consumer is evolving. Gone are the days of indiscriminate spending on products. The focus is shifting to prioritizing premium products and living a more balanced, healthy, and family-centric life. Understanding and responding to these changes in spending habits will be decisive in determining the companies that win or lose, whether international or domestic competitors. And while scale, speed, and simplicity proved advantageous in the past 15 to 20 years, the changing shape of Chinese consumption seems sure to topple some giants of the past and elevate new champions. Which will your company be? 

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