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# Meet the Chinese consumer of 2020

**Evolving economic profiles will continue to be the most important trend shaping the market.**

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**Most large consumer-facing** companies realize that they will need China to power their growth in the next decade. But to keep pace, these companies will also need to understand the economic, societal, and demographic changes shaping the profiles of consumers and the way they spend. This is no easy task not only because of the fast pace of growth and subsequent changes in the Chinese way of life but also because of the vast economic and demographic differences across the country.

These differences are set to become more marked, with significant implications for companies that fail to grasp them. Since 2005, McKinsey has conducted annual consumer surveys in China, interviewing a total of more than 60,000 people in upward of 60 cities.[1] Our surveys have tracked the growth of incomes, shifting patterns of expenditure, rising expectations—sometimes in line with those of the respondents' Western counterparts and sometimes not—and the development of many different consumer segments. Those surveys now provide insights to help us focus on the future. We cannot, of course, predict it with certainty, and external shocks might confound any forecast. But our understanding of consumer trends to date, coupled with an analysis of the economic and demographic factors that will further shape them in the next decade, serve as a useful lens for contemplating the profile of the Chinese consumer in 2020.

## Changing demographics

Many of the changes taking place in China are common features of rapid industrialization: rising incomes, urban living, better education, postponed life stages, and greater mobility. Japan saw similar changes in the 1950s and 1960s, as did South Korea and Taiwan in the 1980s.

But some unique factors are also at work, such as the government's one-child policy and the marked economic imbalances among regions. Our analysis reveals important insights into the likely demographic and socio-demographic profiles of Chinese consumers at the end of this decade.[2]

Changes in economic profiles have been and will continue to be the most important trend shaping the consumer landscape. The Chinese are certainly getting richer fast: the per-household disposable income[3] of urban consumers will double between 2010 and 2020, from about \$4,000 to about \$8,000.[4] That will be close to South Korea's current standard of living but still a long way from its level in some developed countries, such as the United States (about \$35,000) and Japan (about \$26,000).

[1] The latest survey, carried out in 2011, gauged Chinese consumers' attitudes and spending behavior for about 60 product types and 300 brands. The respondents—representing a wide range of incomes, ages, regions, and cities—accounted for 74 percent of China's total GDP and 47 percent of the total population.

[2] We focus on urban consumers in this report.

[3] Urban-household disposable income—the combined disposable income of all members of a household—is defined as total household income minus income taxes and contributions to social security.

[4] In 2010 real terms for all dollar and renminbi figures in this article, unless stated otherwise.

The current vast differences in income levels will persist, however, although the numbers at each level will shift dramatically (Exhibit 1). At present, the great majority of the population consists of “value” consumers—those living in households with annual disposable incomes between $6,000 and $16,000 (equivalent to 37,000 to 106,000 renminbi), just enough to cover basic needs. “Mainstream” consumers, relatively well-to-do households with annual disposable income of between $16,000 and $34,000 (equivalent to 106,000 to 229,000 renminbi), form a very small group by comparison. China has fewer than 14 million such households, representing only 6 percent of the urban population. A tiny group of “affluent” consumers, whose household income exceeds $34,000, accounts for only 2 percent of the urban population, or 4.26 million households.

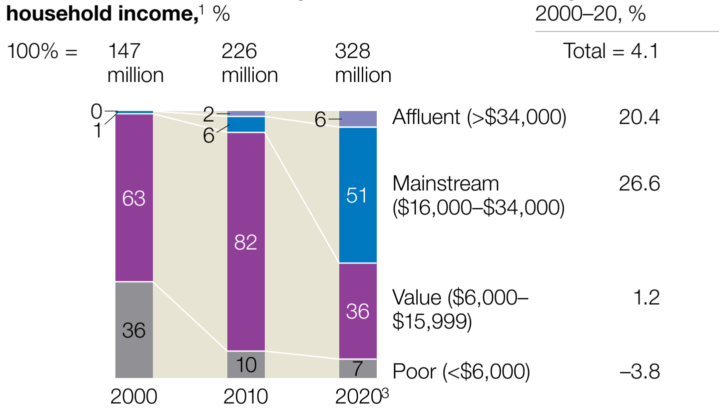
Until now, these divergences have presented multinational companies operating in China with a choice: to target only mainstream and affluent consumers or to stretch the brand to serve the value segment. Those that took the first course could more or less maintain the same business model they applied in other parts of the world, without needing to de-engineer their products. But in taking that approach, they limited themselves to a target market of 18 million households. Companies that chose to serve the value category benefitted from a much bigger market to play in—184 million households—but their products had to be cheaper, they were forced to adapt their business models, and profitability was lower.

Exhibit 1

## The share of Chinese households in each income level will shift dramatically by 2020.

**Share of urban households by annual household income,**[1] %

**Projected CAGR,**[2] 2000–20, %




[1]In real 2010 dollars; in 2010, $1 = 6.73 renminbi.
[2]CAGR = compound annual growth rate.
[3]Forecast.

This situation is changing. Because the wealth of so many consumers is rising so rapidly, many people in the value category will have joined the mainstream one by 2020. Indeed, mainstream consumers will then account for 51 percent of the urban population. Their absolute level of wealth will remain quite low compared with that of consumers in developed countries. Yet this group, comprising 167 million households (close to 400 million people), will become the standard setters for consumption, capable of affording family cars and small luxury items. Companies will be able to respond by introducing better products to a vast group of new consumers, thus differentiating themselves from competitors and earning higher profits. Nevertheless, value consumers, whose ranks will fall to 36 percent of urban households in 2020, from 82 percent in 2010, will still represent an enormous market for cheaper products: 116 million households, or 307 million consumers.

Affluent consumers will remain an elite minority, making up only 6 percent of the population in 2020. (In the United States in 2010, more than half of the population earned at least $34,000.) But that 6 percent will translate into about 21 million affluent households, with 60 million consumers.

While income is expected to rise across China, some cities and regions are already significantly wealthier than others. Understanding these variations in the rate of development is important because they will affect which categories of goods and services grow most rapidly, and where.

Today, about 85 percent of mainstream consumers live in the 100 wealthiest cities; in the next 300 wealthiest, only 10 percent of consumers are mainstream, but that percentage will rise to nearly 30 percent by 2020. At that point, many families in these cities will be able to afford a range of goods and services (such as flat-screen televisions and overseas travel) that are now largely confined to the wealthiest urban areas. Exhibit 2 explains the distribution of income in four different groups of cities. Some of them (Foshan in Guangdong, for example) are small in terms of absolute GDP or population size. But it's worth noting that the affluence of their populations could make them as attractive to companies as leading tier-one cities, such as Shanghai and Shenzhen.

## New spending patterns

An understanding of China's changing economics and its impact on the profiles of consumers helps to identify some key trends in spending patterns in the next decade. We discuss three: high growth in discretionary categories, the tendency to trade up as consumers spend some of their discretionary income on better goods and services, and the emergence of a senior market.

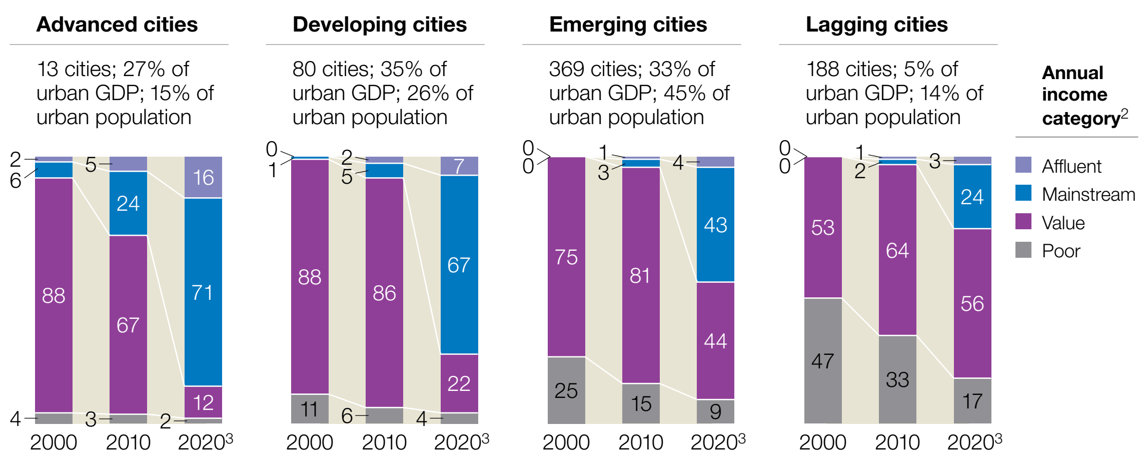
### Higher discretionary spending

Bigger incomes and government efforts to increase consumption will benefit all consumer-facing companies, though to varying degrees, depending on their product portfolios.

Exhibit 2

**The change in income distribution will vary across cities and may suggest new markets.**

Income distribution by category,[1] %




[1]Figures may not sum to 100%, because of rounding.
[2]Affluent = >$34,000; mainstream = $16,000–$34,000; value = $6,000–$15,999; poor = <$6,000.
[3]Forecast.

Discretionary categories will show the strongest overall growth—13.4 percent—between 2010 and 2020, as these goods become affordable to growing numbers of consumers. Next come semi-necessities (10.9 percent growth) followed by necessities (7.2 percent). These average figures will of course vary significantly by region and city.

Exhibit 3 shows forecast annual consumption by category for 2020 and the rising importance of discretionary spending. Each broad category includes subcategories, some of which are more discretionary than others and expected to grow faster. For example, a discretionary category within food—dining out—is expected to grow by 10.2 percent a year in the coming decade, against 7.2 percent growth for basic food ingredients.

Of course, the wealthiest people—those in our affluent segment—will be the main consumers of discretionary items. Less obvious is the *extent* to which they will be able to afford more such items in 2020, compared with people in other income groups, as their numbers and wealth grow. Our consumption model suggests that in 2010, average household spending for value, mainstream, and affluent consumers was about $2,000, $4,000, and $12,000, respectively. These figures will jump to $3,000, $6,000, and $21,000, respectively, by 2020. So although all consumers will increase their spending, the gaps between different income groups will widen significantly. Stark disparities in standards of living are emerging in China.

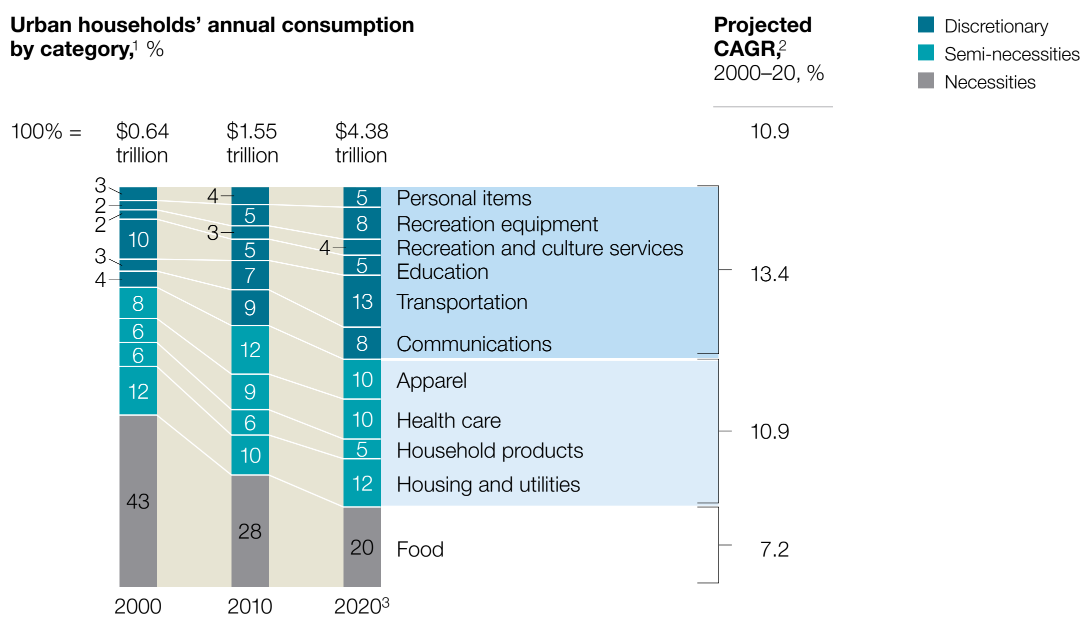
## Aspirational trading up

The second noticeable trend in spending is a propensity to trade up, driven increasingly by consumers aspiring to improve themselves, the way they live, and their perceived social standing. Many Chinese, like their Western counterparts, judge themselves and others by what they buy.

Strong early growth in developing markets comes when large numbers of consumers try products for the first time. As markets mature, growth relies on consumers who buy more goods and services more frequently and trade up to buy pricier versions of items they already have. This pattern explains why some basic-necessity categories have little room for growth: many consumers can already afford such items and probably won't buy a great deal more of them. But that does not mean no growth at all. Take the market for sauces and condiments. Most people can already afford to buy as much as they need of these items. But the increased attention now paid to health and well-being shows that even here, companies have trading-up opportunities.

Exhibit 3

**Discretionary spending is expected to grow considerably by 2020.**




[1]In real 2010 dollars; in 2010, $1 = 6.73 renminbi. Figures may not sum to 100%, because of rounding.
[2]Compound annual growth rate.
[3]Forecast.

Such opportunities also exist within semi-necessity categories, such as apparel, health care, and household products: more consumers will be able to afford different outfits for different occasions, for instance, or to buy additional branded products. As a consequence, brands focused on mass-market consumers might need to be repositioned to suit their rising aspirations, while newer, younger brands may be able to leapfrog more established competitors by offering premium products and crafting a premium brand image.

But it is the top end of the market that will benefit most from trading up: growth at the high end of some consumer goods categories already outpaces average growth for those categories as a whole. Sales of premium skin care products, for instance, rose by more than 20 percent a year in the past decade while the industry average was 10 percent.

Annual volume growth rates of more than 20 percent are foreseeable for luxury SUV cars, compared with around 10 percent for basic family models. China had already become a leading luxury market by 2010 and could overtake Japan to become the biggest such market by 2015.

### Emerging senior market

The aging of China means that as a share of the total population, it will have five percentage points more people above the age of 65 in 2020 than it has today. That is an extra 126.5 million citizens, clearly an important consumer segment. What is equally important is the way the spending patterns of older people in 2020 will differ from those of older people now. In our 2011 survey, the elderly were more inclined to save and less willing to spend on discretionary items such as travel, leisure, and nice clothes. These tendencies will probably be much less apparent in 2020.

Most people in China over the age of 55 experienced the harsh conditions of the Cultural Revolution, in the late 1960s and early 1970s. Not surprisingly, they think it important not to spend frivolously. Among residents of tier-one cities, 55- to 65-year-olds allocate half of their spending to food and little to discretionary categories: only 7 percent goes toward apparel, for example. People who are ten years younger devote only 38 percent of their spending to food but 13 percent to apparel. Indeed, our consumer surveys have revealed that although today's older consumers behave very differently from younger ones, today's 45- to 54-year-olds—the older generation come 2020—have spending patterns similar to those of 34- to 45-year-olds (who allocate 34 percent of their spending to food and 14 percent to apparel). This finding implies that companies will have to rethink their ideas about what older Chinese consumers want.

## Implications for companies

The biggest challenge is building and sustaining a leading position in China and, for multinationals, using it to drive global growth. In fact, as the country with the world's largest group of mainstream consumers, it could be an excellent test bed for companies that serve this consumer segment. Our analysis indicates that huge variations in the growth rates of companies operating in China come 2020 are likely, depending on the product category, consumer segment, and geography.

A second challenge is that China is so vast and its regions so diverse it should be treated almost as a collection of separate countries. Companies should redefine the roles of their regional divisions and headquarters, delegating more decision-making power to the former. Many companies already operate with three, five, or even more regional bases, but these tend to function only as sales offices, executing instructions from the top. Consumer needs could become so varied across China's regions that local insight and strategic decision-making power will be vital. Regional offices should therefore receive full responsibility for their own profit-and-loss accounts, strategic planning, consumer research, innovations, portfolios, route-to-market models, and marketing. The corporate center should have a redefined role—serving the individual units and safeguarding the company's brands—with less power and at a lower overhead cost.

A third challenge stems from the fact that undifferentiated mass consumption and the rising cost of ads made the scale of a brand or product crucial to its success in the past decade. Companies provided the same value proposition—usually framed around a product's functional benefits—to all types of consumers, while stretching brands across product categories and price tiers to leverage scale and garner market share. Over the next decade, the game will change to take account of the emergence of different categories of consumers and their own sense of their differences and individuality. Companies will need the crispest value propositions to connect with each group and to stand out from competitors. By 2020, they will have to position brands (or sub-brands) to target narrower consumer segments and offer more tailored value propositions. Brands extended across too many consumer segments and price points may struggle to defend their market position. Hard though the transition could be, at some point companies that have focused on maximizing their brands' scale will have to adopt a model based on a portfolio of more targeted brands or sub-brands to connect with different consumer segments.

No doubt China and its consumers' behavior will take some unexpected turns over the next decade. Nonetheless, our research reveals the clear direction of travel. To be sure of taking part in that journey, companies in the market should start making the acquaintance of China's 2020 consumers today.

Read *Meet the 2020 Chinese consumer*, the full report on which this article is based, on mckinseychina.com.

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