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McKinsey Consumer & Shopper Insights

2010 Annual Chinese Consumer Study

Trading up or trading off? Chinese consumers become increasingly pragmatic

McKinsey Insights China

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Trading up or trading off?
Chinese consumers become increasingly pragmatic

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Contents

Executive summary

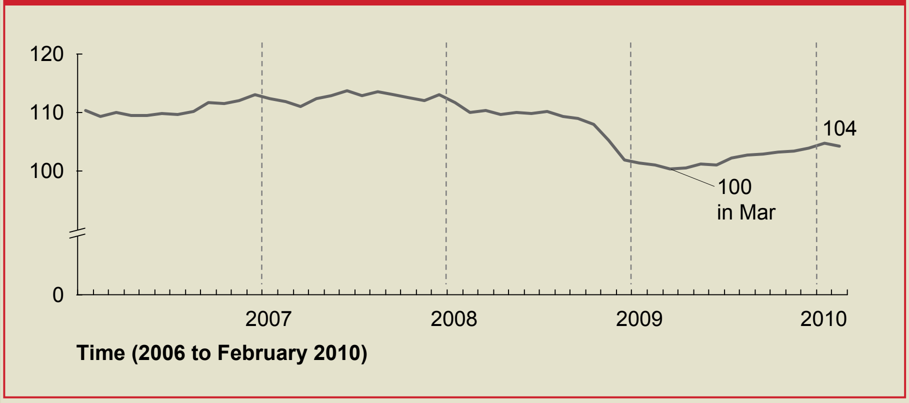
One of the main ways the global credit crisis has played out among the world's developed markets has been through the wallet of the formerly free-spending consumer. Hard-up shoppers are deciding to save rather than spend. In China, however, consumers have reacted in quite different ways. After a modest dip in 2008, Chinese GDP and consumption rebounded strongly in the wake of a flood of new liquidity unleashed by the state banking sector into the economy. Led by auto and property-related goods, and helped along by a slew of government and private-sector incentives, the retail sales growth rate soared to 40% by the end of 2009 [Exhibit 1]. As a result, the Chinese consumer sector is now arguably the healthiest of any major economy in the world.

In some ways, overall spending patterns in China remain quite conservative. Consumption is rising strongly in line with rapid income growth, but households still retain more than a third of their income as savings, and buying on credit remains the exception, not the rule. More interesting, however, is that while Chinese consumers are evolving at times along lines already seen in developed markets, they are also blazing a more pragmatic – but uniquely Chinese – trail.

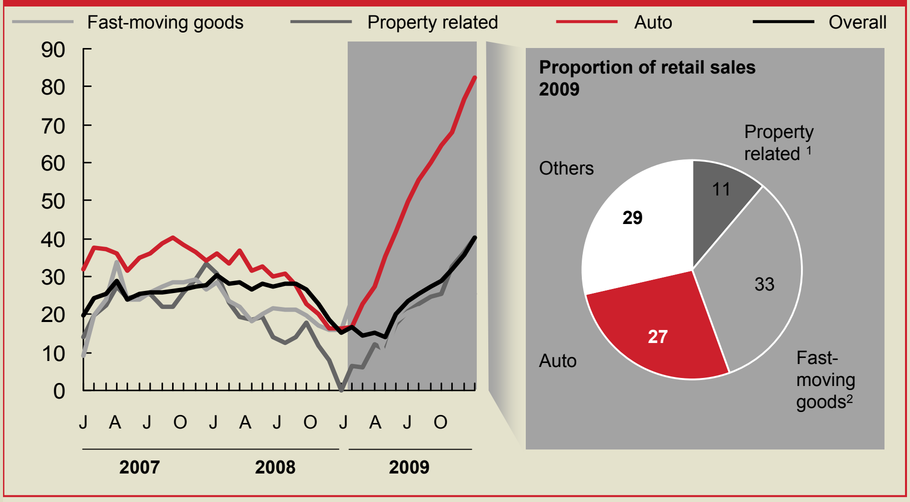
As in the west, consumer behavior is becoming increasingly complex and demanding, as shoppers' horizons expand beyond basic concerns over product functionality. Today, Chinese buyers are willing to research and seek out product nuances. They are willing to pay more for better value and quality. And new segments of consumers are emerging, such as the youth-driven 'what fits me' group, whose purchases are driven more by a spirit of individualism than by the desire to make a social statement.

At the same time, however, local behavior patterns are diverging from norms in the West and Japan in a number of ways. Chinese consumers remain very brand conscious, for example, but their intense focus on value means that brand loyalty is often a secondary consideration. They regard the needs or interests of their families as more important than their Western counterparts, and they have adopted word-of-mouth as an extremely important way to research and source products.

Consumer Confidence Index
Index, 1996 = 100



Retail sales of sizable enterprises growth rate (YOY)
Percent, monthly



1 Includes white goods, household electronics, furniture and construction & decoration material
2 Includes apparel, food and beverages, books and magazines, etc.

SOURCE: NBS; McKinsey

Exhibit 1: Quick government action resulted in a modest decline in the Consumer Confidence Index, sustaining overall consumption levels

Starting from the end of 2008, the government announced specific policies to stimulate consumption

- Started rural subsidy program for white goods
- Offered tax relief on cars with engine displacement below 1.6L; extended auto rural subsidy policy on motorcycles to 2013
- Significantly increased affordable housing supply
- Increased pensions and income subsidies to the poor
- Raised basic minimum salary level in certain areas

Autos as share of total retail sales rose from 21% in 2008 to 27% in 2009

Most intriguingly, though, China's consumers have evolved significantly in the way they prioritize their purchasing across different categories of goods by 'trading-off' – maximizing their buying power by spending more in the categories they care most about and less in others. Increasing numbers of shoppers, for example, are now buying for health reasons, with half this group comprised of middle-aged parents or retirees. Overall, some 58% of people in this group were buyers of health food supplements, compared to 25% of consumers generally. Other shoppers (in particular higher-income women) are now increasingly fashion conscious. Almost 100% of this group are spending more on clothes, while 81% have upped spending on shoes, compared to respective rates of 53% and 46% for Chinese consumers overall. Both groups, however, are simultaneously abstaining from purchases of other types of goods to help pay for their increased spending in these types of goods.

These emerging trends bear witness to an ongoing transformation in Chinese consumer behavior patterns as they evolve into some of the most complex in the world. As new products continue to emerge and more people in China find themselves with significant discretionary income and choices, companies need to adapt their strategies to capture the trade-off opportunity. Educating consumers about spending options is one possibility. Exploiting word-of-mouth (especially via online media) as a conduit for product information and adjusting product development cycles to continuously innovate and excite consumers are others.

Finally, the size and reach of China's far-flung markets mean that the impact of any given trend may vary from place to place depending on local circumstances. Companies need regionally-focused strategies based upon conditions on the ground. For this reason, we anticipate that the cluster-based strategies first introduced in our 2009 Chinese Consumer Study (and the McKinsey *ClusterMap*) will become increasingly important to managers as they look to shape regional strategies or empower local teams to do so.

1 McKinsey Insights China conducted its first Annual Chinese Consumer Study in 2005 and has since studied over 46,000 consumers. The 2010 survey, conducted between December 2009 and March 2010, covered 15,000 consumers in 49 Chinese cities. For more details, please visit http://solutions.mckinsey.com/insightschina

More demanding and pragmatic behaviors – China's consumers do it their way

The core group of consumer trends we have identified in previous studies still seems firmly in place. Retail spending continues to grow, and as consumers become increasingly sophisticated, they demand more, and are willing to pay more, for better products. In addition, the dramatic increase in pre-purchase research (driven by growing internet use and numerous product safety scandals) that we highlighted last year continues to hold true.

However, one of the clearest messages to have emerged from our 2010 survey is that Chinese consumers are today developing a very distinctive identity. Not only do they have very individual tastes and priorities, they also have their own unique ways of choosing and buying products. As these patterns evolve, companies will need to come to terms with the dynamics of Chinese consumer behavior if they are to best position themselves in the market.

Fewer trips, bigger baskets

Historically, Chinese consumers have shopped about five times more often than their counterparts in the US, but their basket sizes have been only about a quarter the American equivalent. Today, however, a decline in shopping frequency goes hand in hand with growing basket size. Overall, we saw shopping frequency across China's home and personal care category decline from 0.6 purchasing trips per week in 2008 to 0.5 trips in 2010, while average basket size increased from Renminbi 18.42 in 2008 to Renminbi 24.10 in 2010 [Exhibit 2]

This trend towards fewer but higher ticket shopping trips is in line with the Chinese consumer's general convergence with consumers in the west. But it does not apply across the board. One unusual aspect of evolving consumption patterns in China is the enduring enthusiasm

HOME/PERSONAL CARE EXAMPLE

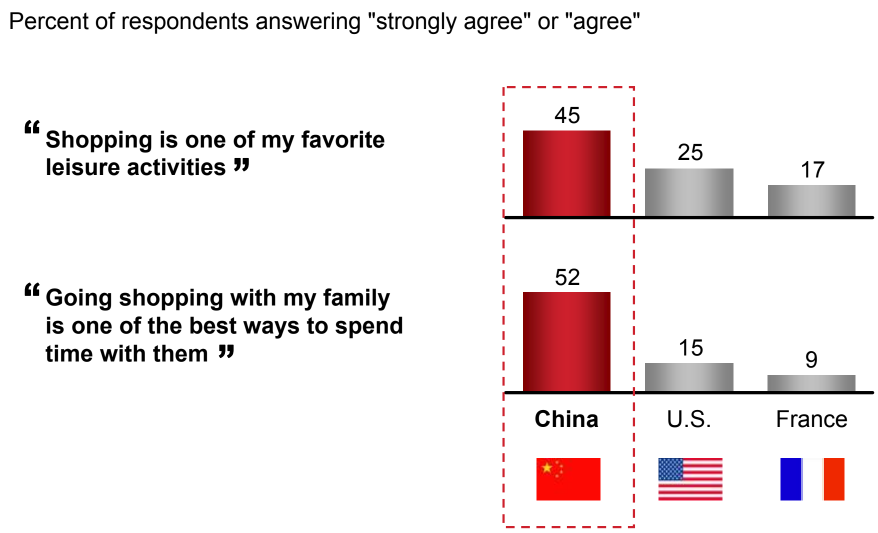
	Average shopping frequency Times per month			Average basket size RMB		
	2008	2010	Change	2008	2010	Change
Shampoo	0.33	0.48	↑	29.88	31.86	↑
Hair conditioner	0.88	0.45	↓	19.32	22.48	↑
Lipstick	0.39	0.30	↓	33.80	40.13	↑
Toothbrush	0.51	0.67	↑	6.36	10.39	↑
Bath liquid	0.53	0.42	↓	24.22	28.54	↑
Face cleanser	0.60	0.37	↓	32.63	35.23	↑
Laundry detergent	0.67	0.60	↓	10.11	14.20	↑
Softener	0.38	0.46	↓	16.16	20.63	↑
Dish washing detergent	0.95	0.60	↓	6.61	9.57	↑
Average[1]	0.61	0.49		18.42	24.10	

1 Weighted average of 11 comparable home/ personal care products

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2008, 2010)

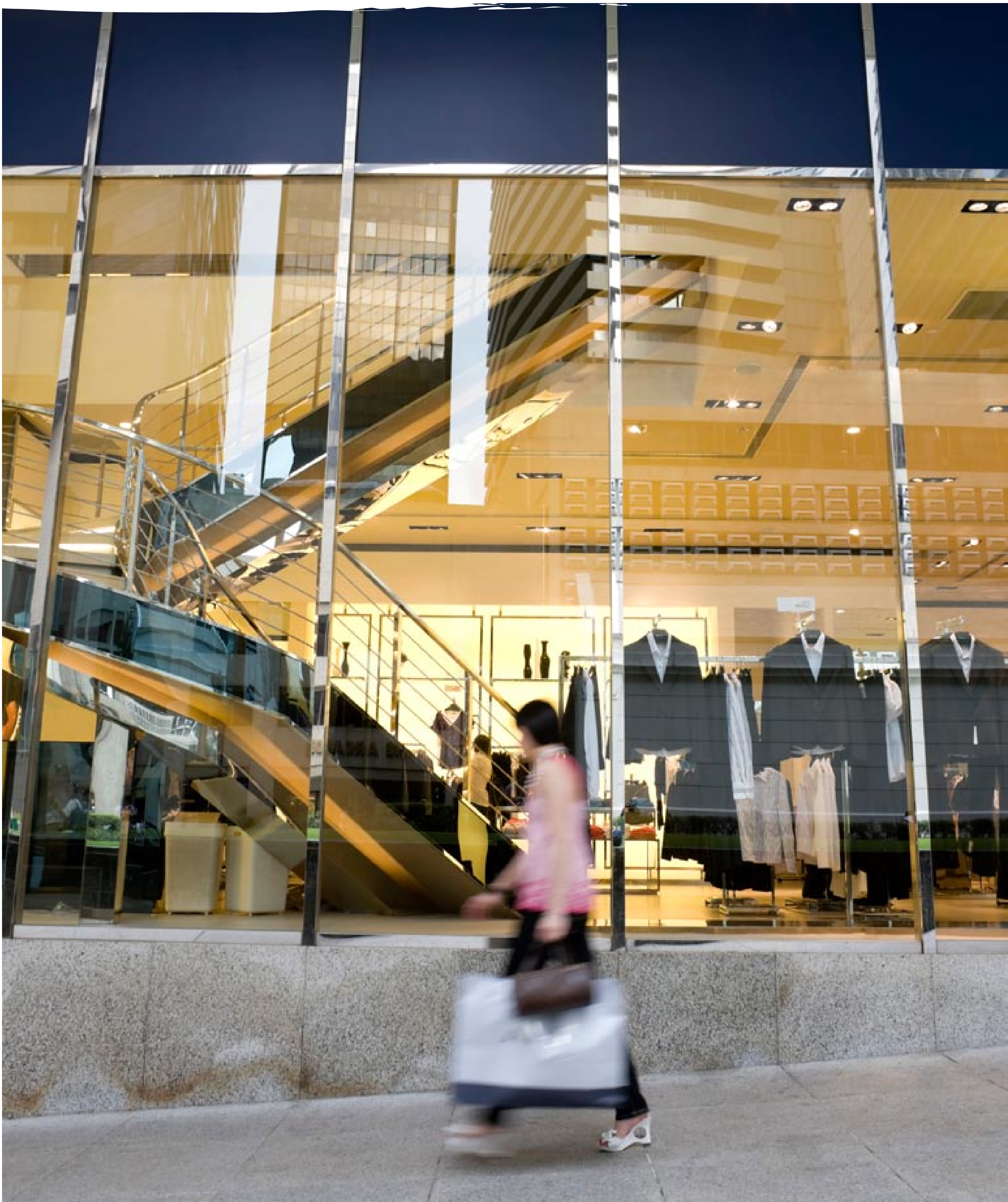
Exhibit 2: For most products, Chinese consumers are shopping less frequently;however, average basket size is increasing

Exhibit 3: Chinese consumers see shopping as one of their favorite leisure activities and one of the best ways to spend time with family



SOURCE: How the World Shops (2008)

local consumers have shown for the concept of 'retailtainment', whereby families transform their shopping trip into a fun day out at the mall or hypermarket with their kids (perhaps unsurprising given the shortage of alternative public entertainment and green spaces in most Chinese cities). In our survey, some 73% said they regarded shopping as a leisure activity, 45% identified it as one of their favorite pursuits (vs. 25% in US and 17% in France), and just over half said it was one of the best ways of spending time with their families – significantly higher than for consumers in the West [Exhibit 3]. As such, Chinese consumers are often 'shopping' without any specific intention to buy. Sometimes they are simply window shopping or comparing prices. Other times, they may be indulging in shopping as a sport, competing with friends to measure their ability to find the best deals.



More than just the basics

Chinese buyers have always regarded a product's basic functional attributes (i.e., does it work well/taste good?) as the most important key buying factor. While this remains the case today, our survey also records a gradual shift in attitudes towards more sophisticated decision criteria. Flat panel TV buyers, for example, are no longer concerned with just picture quality (partly because picture quality is now far better than that of the transmitted signal), but are now also focused on issues such as aesthetic appeal or innovative features. Purchasers of laundry detergent, meanwhile, are now increasingly demanding "good scent" (up from 40% in 2008 to 61% this year) as well as "appealing package design" (28% today compared to 16% in 2008). As in other parts of the world, this reflects a transition to an environment where consumers are able to demand more than just basic product functionality and where individual tastes are becoming increasingly differentiated.

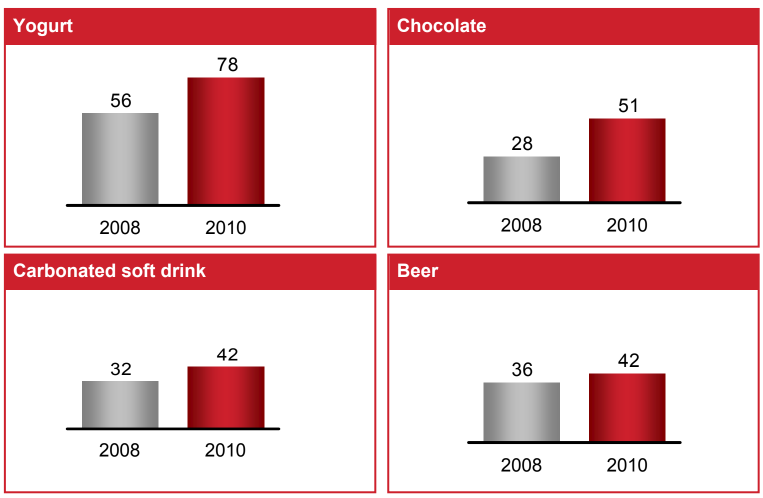
Again, however, purchase decisions among mainland shoppers are often framed by a uniquely Chinese perspective. Local consumers have become increasingly health conscious, for example, in the last few years. This issue, of course, is increasingly important globally, but the experience in China has also been shaped by a spate of product safety scandals, including incidents involving powdered milk, cooking oil, eggs, laptops and skin cream. Resultant concern over possible contamination has in turn driven a broader awareness of the relative nutritional merits of different food products. Chinese mothers, for example, may be among the most sophisticated in the world in their ability to identify very specific ingredients as they compare various brands of foods. This has probably contributed to the growing number of local consumers who cite 'health' as a key buying factor [Exhibit 4].

Another area where Chinese shoppers are picking up on global trends is the way in which their purchase decisions are now increasingly influenced by 'emotional' considerations. The speed and enthusiasm with which Chinese shoppers have adopted emotional elements as key buying factors has been remarkable.

In particular, the importance of the 'status' value of any given purchase has grown strongly since 2008 [Exhibit 5], especially for aspiring or lower-middle class consumers, for whom the appearance of success is most significant. Another fast-growing, although still emerging, key buying factor is the "what fits me" (or "what's good for me") category that is just beginning to emerge in China's younger and more affluent demographic. These shoppers are concerned less about following the crowd or how what they buy defines them in the eyes of others and more about how specific products fit their real life needs. It tends to be the main reason why consumers trade up when their circumstances change and also why they tend to be more satisfied with better products. Currently prominent mainly in major cities such as Shanghai, the 'what-fits-me' mentality will probably grow in significance nationwide as incomes continue to grow throughout the country.

Percent of respondents who quoted "health" as one of the top 5 KBFs when buying the following products

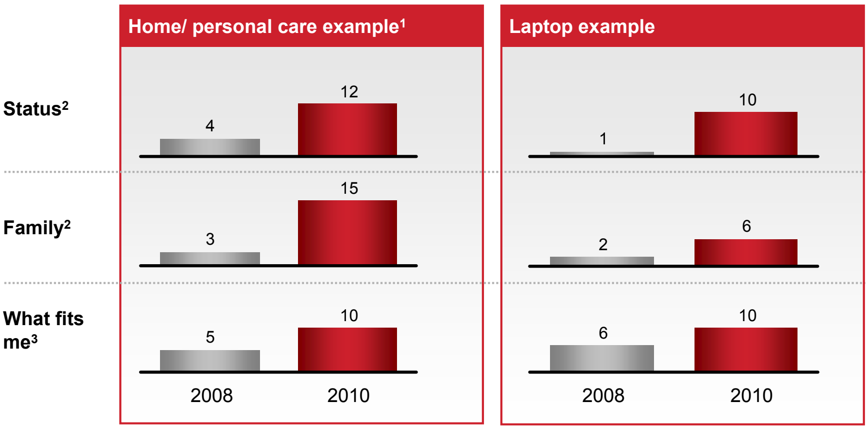
FOOD & BEVERAGES EXAMPLES



SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2008, 2010)

Exhibit 4: Chinese consumers are shifting to "more sophisticated" product attributes key buying factors – Health

Exhibit 5 : Purchase decisions by Chinese shoppers are now increasingly influenced by "emotional" considerations



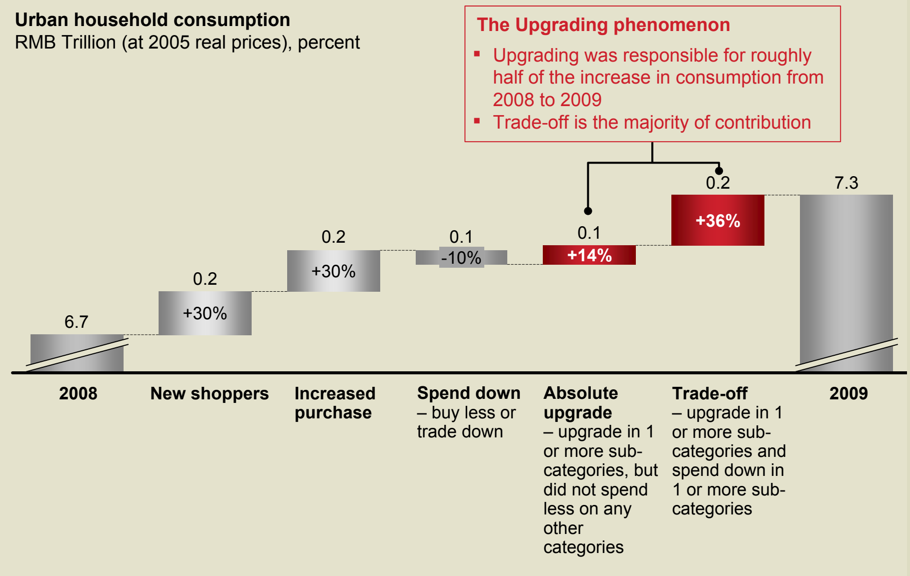
1 Facial moisturizer data for "status" and "what fits me"; laundry detergent data for "family"
2 Purchasing this brand can showcase my status
3 Using this brand makes me feel like my family is better off
4 It is a brand for people like me

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2008, 2010)

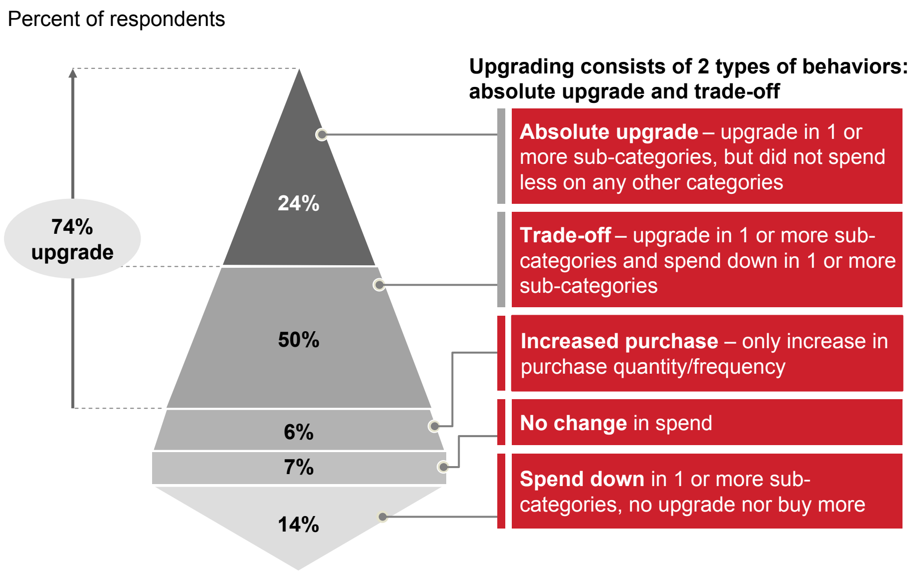
The pragmatic trade-off

As consumer incomes in China continue to rise, so also does the desire to buy more and better products. In our survey, we found that roughly ¾ of all urban households said they had upgraded in at least one product category. This trend accounted for half of all consumption growth nationwide in 2009 [Exhibit 6]. However, for mainland consumers, upgrading is only part of the story. The other part is the way that local consumers have adapted this practice by making an explicit choice to finance their increased spending in categories that mean most to them by "trading-off" in other, less important, categories. For this reason, the apparent 74% upgrade rate in 2010 is illusory. In reality, our survey shows that only 24% of consumers upgraded without simultaneously trading-off. Fully 50% of Chinese urban residents actively traded-off their improvements in one product category with spending reductions in others [Exhibit 7]. Purchase upgrades in between one and three categories were supported by corresponding reductions in as many as

Exhibit 6 : Upgrading accounts for half of all consumption growth nationwide



SOURCE: McKinsey Insights China - Macroeconomic update (March 2010) , Annual Chinese Consumer Study (2010)



SOURCE: McKinsey Insights China – Annual Chinese Consumer Study (2010)

Exhibit 7 : Almost three-quarters of consumers reported upgrading in the past year

seven categories. Although our survey data suggests a marginally greater inclination for consumers to trade-off in categories such as packaged food compared to categories such as alcohol or consumer electronics, we found in practice that the incidence of the trade-off behavior was relatively evenly spread across categories.

These emerging trade-off behavior patterns underline our assertion that Chinese consumers have today become some of the most pragmatic in the world, willing to make very explicit choices about spending their growing income. This is a key insight for marketers seeking to capture growth. In particular, we found significant trade-off activity in seven different areas. Our survey showed, for example, that more than 70% of trade-up demand for dining out and 50% for alcohol is driven by white-collar males who are willing to sacrifice spending on personal care and packaged-food products in order to improve their standing with clients or colleagues. In addition, we found that some 80% of trading up to higher-quality clothing, shoes and accessories was due to wardrobe upgrades. Surprisingly, this trend applies not so much to high-income 'fashionistas' as it does to lower-middle income consumers looking either to impress in job interviews or otherwise advertise their graduation from the 'working' to the 'consumer' class. In each case, the increased spending was balanced by trade down decisions in three or four other product categories.

This very distinctive consumption trend has implications for the way companies develop their local marketing strategies. For one, they can invest more in consumer education so as to encourage upgrading. Manufacturers who focus on convincing consumers of the importance of a particular product category and, within that, of a better, more expensive product have a better chance of persuading potential buyers to upgrade within that category rather than another one. For example, apparel manufacturers often emphasize the importance of owning better, trendier clothes in order to showcase one's status. We have found that consumers who buy into this concept are much more likely to upgrade their purchases of clothes and accessories, while trading off in other categories.

Another way to influence trade-off decisions involves using cross-category promotions to influence purchase decisions within a category that consumers have targeted for upgrading. For example, consumers who upgrade their choice of entertainment venue are also likely to upgrade their choice of alcohol, creating potential for wines and spirits vendors to partner with trendy venues to market their products. Similarly, consumers who upgrade their dairy products are also likely to look for upgrades in snacks, chocolates, and health supplements, creating further co-promotion possibilities.

In addition, adjusting product development cycles can also be a productive strategy. Companies that introduce more frequent product variations (e.g., new flavors, changed packaging, etc) can often transform a less fashionable category into a more exciting one by convincing consumers to participate in the latest, "coolest", trend.

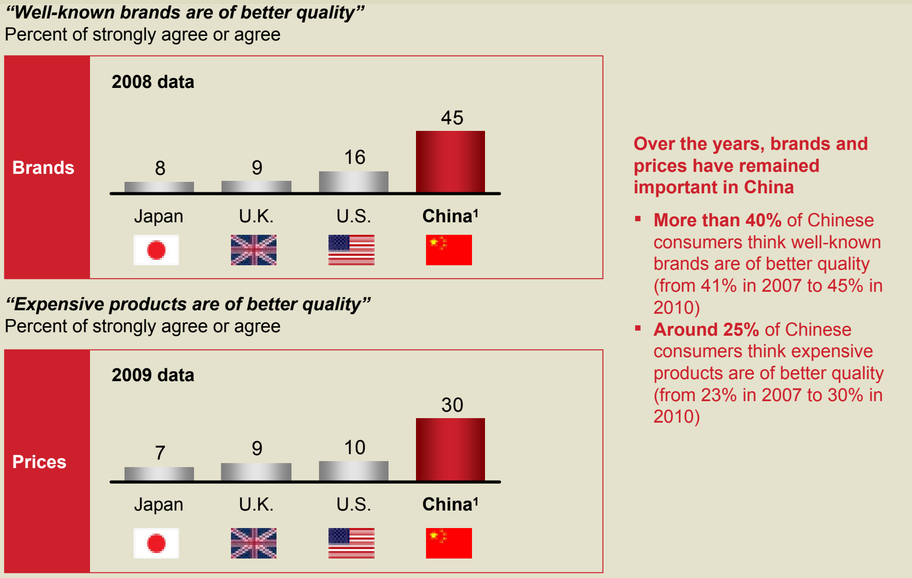
Brands appeal, but only at the right price

Another way in which standard consumer behavior patterns are subject to variation in the Chinese market is reflected in the very methodical way local shoppers decide what they are going to buy. One longstanding tenet of Chinese retailing is that consumers are extremely brand conscious, with some 45% believing that higher pricing corresponds directly to better quality, compared to just 16% in the US and 8% in Japan.

In the same way, far more Chinese consumers are willing to buy more expensive branded products than their counterparts in the rest of the world [Exhibit 8]. While this impression is gradually becoming less pervasive, it remains a core belief and explains why less known brands continue to be less successful in China. It also explains why manufacturers can sometimes boost market share by raising their prices.

However, consumers' final purchasing decisions are based

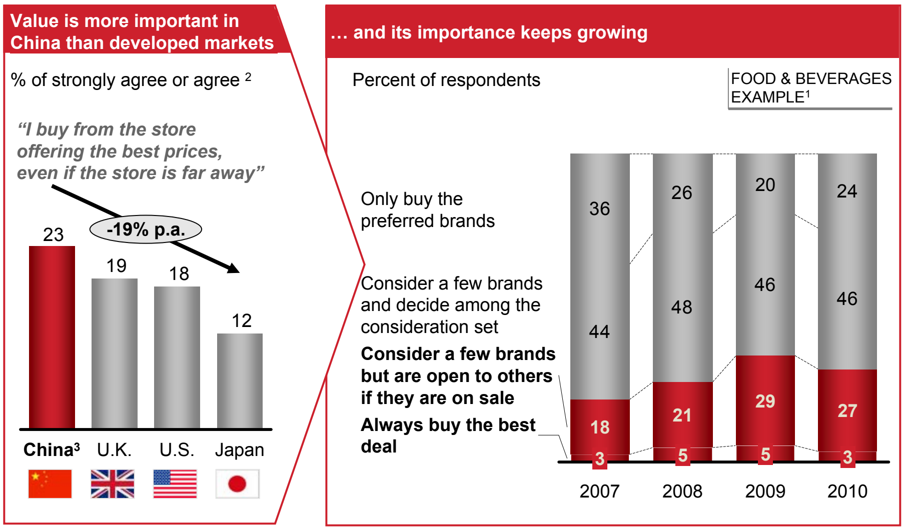
Exhibit 8 : Consumers believe that products from well-known brands and/or more expensive products are of better quality



1 2010 data

SOURCE: McKinsey Insights China – Annual Chinese Consumer Study (2010); Online Benchmark Surveys (2008, 2009) on more than just branding alone. Indeed, the fact that Chinese consumers are very brand conscious does not necessarily mean they are brand loyal. While consumers tend generally to gravitate towards the biggest brands, the final purchasing choice is very often made on the basis of their assessment of the relative value offered by a handful of competing products. Our survey showed that 23% of shoppers in China would go out of their way to buy from stores that offered the best prices, compared to 19% in the UK and just 12% in Japan [Exhibit 9]. Chinese shoppers will first budget for their purchase, then compile a short-list featuring a handful of specific brands, and finally hold a beauty contest to decide which is the most appealing option. This will often involve significant research, perhaps conducted as part of their leisure-time

Exhibit 9 : Value is more important to Chinese consumers and its importance is increasing over time

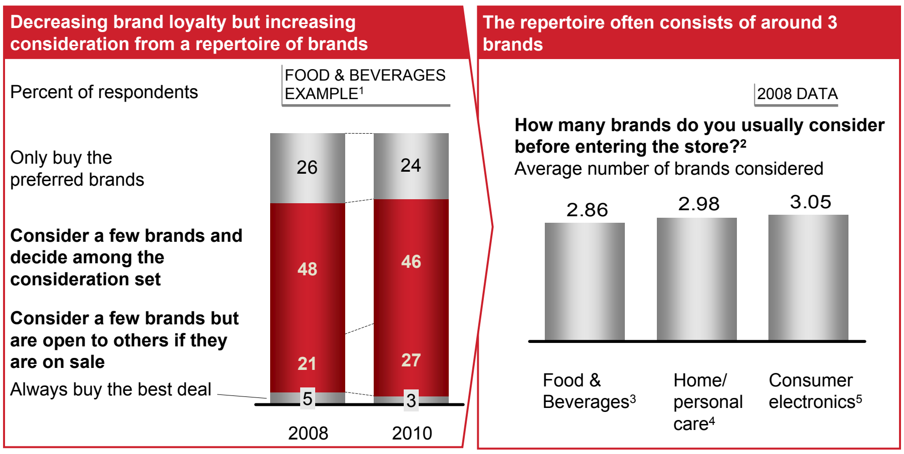


1 Weighted average of 5 food & beverage products (UHT/fresh milk, yogurt, chocolate, beer, and carbonated soft drink)
2 U.K., U.S., and Japan data were from 2009 online consumer survey
3 Weighted average of food & beverages, consumer electronics, apparel and home/ personal care

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2007-2010); Online Benchmark Survey (2009) window shopping. These very characteristic behavior patterns typify the growing complexity of the modern-day Chinese consumer.

Fundamentally, this complexity relates to the lengths to which shoppers will go to identify which product to buy and where they will buy it. While quality remains a critical consideration, at the end of the day value remains the most important criteria, with many consumers willing to go well out of their way to look for the best deals. That said, shoppers generally only finalize purchase decisions in-store [Exhibit 10]. This means that in-store promotions and ads continue to be effective techniques to tip the balance towards a particular brand. In addition, promotions often lead shoppers to make impulse purchases as they seek to maximize value by stocking up on perishables for future use.

Exhibit 10 : Majority of consumers choose from a small repertoire of brands once they enter a store



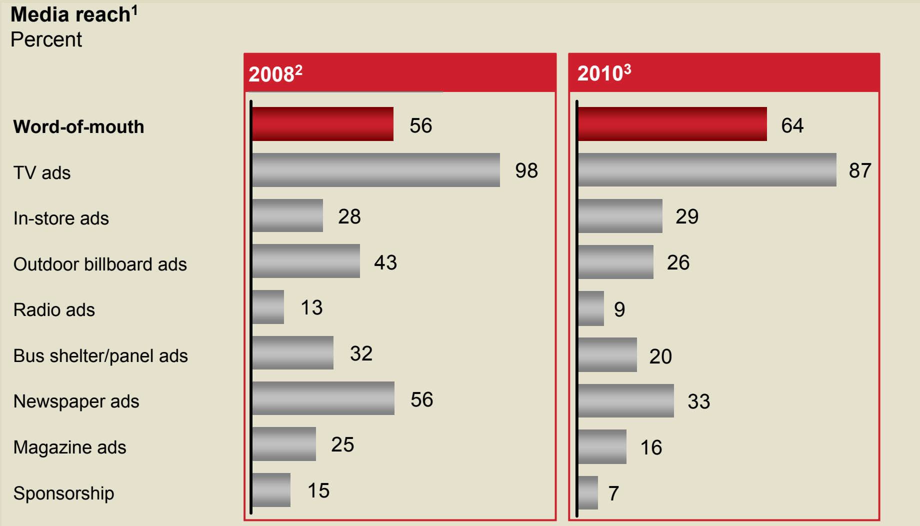
1 Weighted average of 5 food & beverage products (UHT/fresh milk, yogurt, chocolate, beer, and carbonated soft drink)
2 Among respondents who claim to consider a few brands and decide which one to buy in the store or consider a few brands but are open to others if it is on promotions in the store
3 Weighted average of 17 food & beverage products
4 Weighted average of 13 home/ personal care products
5 Weighted average of 7 consumer electronics

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2008, 2010)

Smarter shopping and word-of-mouth

As they assess the relative merits of different products before making a purchase, Chinese consumers adopt a number of techniques to help with their decision. Unsurprisingly, given rocketing internet usage in China, online product reviews are becoming increasingly important research tools, especially in higher-value categories, and for younger audiences. This is broadly in line with current consumer practice throughout the world. The impact of this trend in China, however, has increased significantly recently as more and more consumers come to see the internet as a credible source of information. In our 2010 survey, some 56% of consumers said they regarded online advertising as credible, up from just 29% in 2009. Similarly, 70% of Chinese shoppers said they found retailer websites credible, with 67% saying the same about manufacturers' sites. This contrasts strongly with Western practice, where consumers generally prefer to source product information from 3rd party sites. The fact that online information is held in such high regard in China makes the internet an extremely important medium for shaping consumer opinion. On average, some 25% of mainland shoppers said they used the internet for product research vs. 12-16% in the US; for big-ticket items such as autos (45%), numbers can be significantly higher.

Chinese consumers are willing to go much further in researching purchases than the average consumer in the West. Word-of-mouth has therefore grown strongly in recent years as a source of consumer information, helping buyers decide either what to buy or where to buy it. This can involve sounding out family and friends for their views, but it can also include sourcing person-to-person information online (i.e., through chat forums). Compared to other parts of the world, instant messaging is wildly popular in China, with "chat frequency being about thirteen times greater than email in China, compared to roughly equal use of each medium in the US". And with some 384 million mainland users by the end of 2009 – more than the entire population of the United States and Canada combined – the Chinese internet provides fertile ground for opinions of all shades.In fact, although television advertising continues to dominate in China, word-of-mouth is now by far



1 Percentage of respondents who have received product information via certain source of information in the past 2 months
2 Not specific to any category
3 Weighted average of food & beverages, home/personal care, apparel, and consumer electronics

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2008, 2010)

Exhibit 11 : Media reach of word-of-mouth has been increasing steadily over the past few years

the next most popular source of information about brands and products, with 64% of respondents in 2010 saying it influenced their purchasing decisions, compared to 56% in 2008 [Exhibit 11]. In addition, secondary sources of product information such as word-of-mouth or online research are today serving an important complementary function to TV advertising by helping consumers to analyze the relative merits of different products and arrive at their final decisions. Word-of-mouth has become such an important channel for consumer information in part because so few brands in China have been around long enough to inspire loyalty among consumers, and in part because many products themselves are also relatively new to the market. In addition, consumers are often seeking more expensive brands for the first time, and so have little experience of what to expect. Finally, it may also reflect the fact that the very best deals are often hard to find given the growing numbers of products and supply sources in China in recent years.

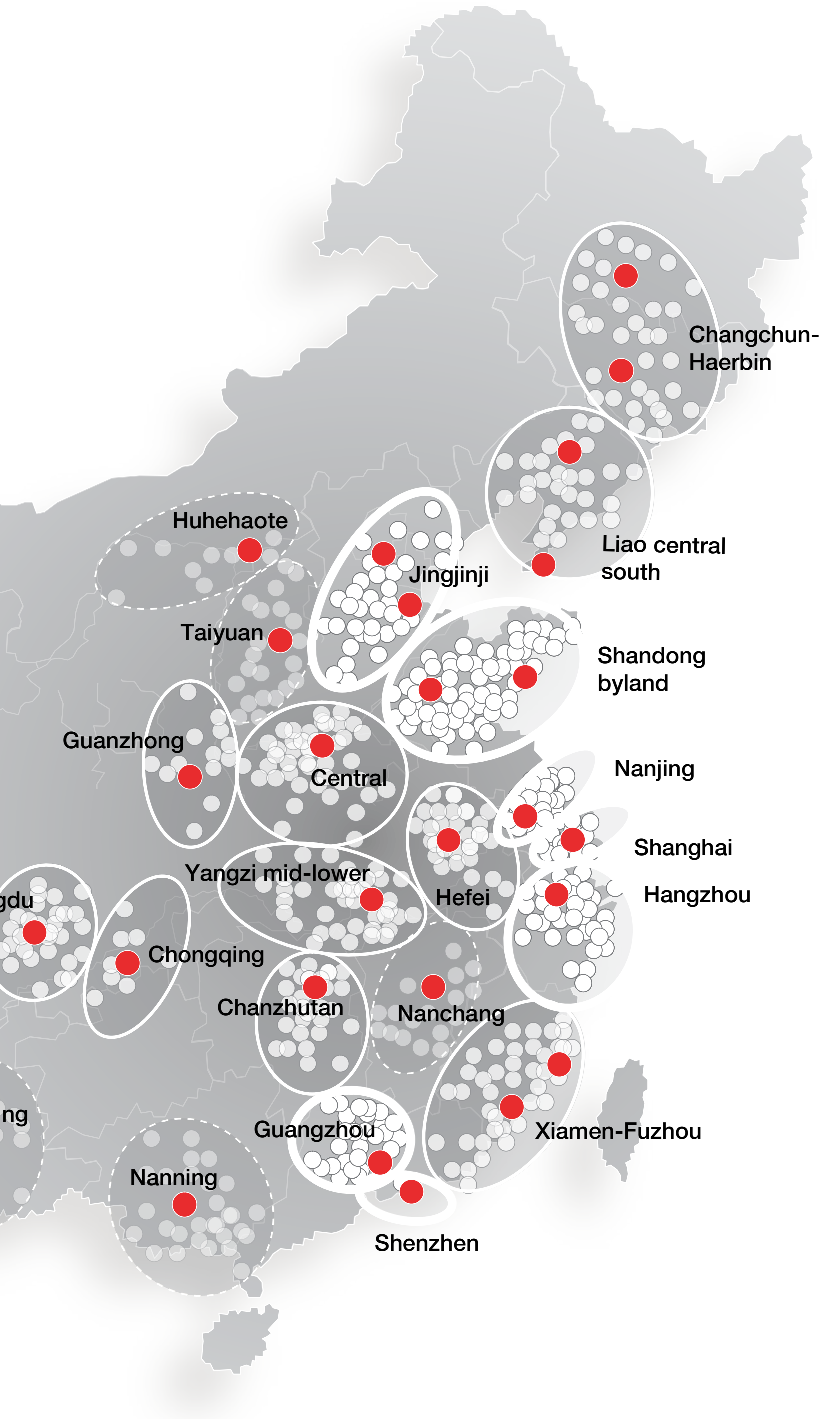
Exhibit 12 :
We divided China into 22 clusters, representing-
92% of urban GDP in 2015

McKinsey *ClusterMap*

Source: McKinsey Insights China; McKinsey analysis

A geographically diverse consumer base

As of January 2010



Cluster name (# of cities)	Cluster GDP | Hub city GDP
Mega clusters	
Jingjinji (37)	10.8% | 7.9%
Shanghai (19)	10.8% | 6.2%
Shandong byland (67)	9.0% | 2.1%
Hangzhou (38)	6.7% | 1.6%
Guangzhou (24)	6.6% | 2.6%
Nanjing (27)	4.8% | 1.8%
Shenzhen (2)	4.3% | 2.9%
Large clusters	
Liao central south (30)	4.3% | 2.4%
Xiamen-Fuzhou (42)	4.2% | 1.4%
Yangzi mid-lower (42)	4.0% | 1.8%
Central (40)	3.8% | 0.7%
Changchun-Haerbin (36)	3.6% | 1.6%
Chengdu (29)	3.2% | 1.6%
Hefei (29)	2.8% | 0.8%
Changzhutan (28)	2.2% | 0.8%
Guanzhong (15)	1.9% | 1.2%
Chongqing (6)	1.8% | 1.5%
Small clusters	
Nanning (28)	1.8% | 0.3%
Nanchang (22)	1.7% | 0.6%
Taiyuan (19)	1.4% | 0.5%
Huhehaote (10)	1.3% | 0.4%
Kunming (16)	1.1% | 0.5%

In last year's China Consumer Study, we introduced the McKinsey *ClusterMap* – a practical method of segmenting China's many discrete markets by reference not simply to geography or city tier, but also to less tangible concepts such as income, dialect, economic and trade linkages, and common consumer attitudes and preferences. By identifying city 'clusters' comprised of groups of cities throughout China that are evolving within 300km of one or two large city hubs, the McKinsey *ClusterMap* enables companies to implement new synergies among sales forces, distribution channels, and supply chains and to reach out to a more coherent demographic than would be possible by managing on a single-city basis or by simply carving China up into arbitrary geographic regions [Exhibit 12].

This year, the relevance of the *ClusterMap* concept has increased. Regional economies continue to develop according to their individual dynamics, while consumer trends in specific clusters have intensified as companies begin to focus on building regional strongholds and creating profitable businesses in their targeted areas [Exhibit 13].

As a result, regional variations of one type or another can have a major impact on the way the trends outlined earlier in this report play out from cluster to cluster. For example:

- Bigger baskets, fewer trips – the trend towards larger basket sizes but fewer shopping trips holds good for most city clusters, but not all. Some clusters registered no change in this area, while two – the 'Central' and Chengdu clusters – reported an increase in shopping frequency and one – Chengdu – a decrease in basket size.

- More than just the basics – again, the overall trend holds true in most clusters, but can reveal radical divergences in others. The importance of status, for example, as a key buying factor for purchasers is far more prevalent in Shanghai than in the Yangzi river mid-lower reaches cluster (i.e. around Wuhan) which recorded a sharp decline for this category from the 2008 to 2010 surveys.

- Smarter shopping and word-of-mouth – significant divergences from norms for this area also occur, most prominently in Shenzhen, which is the only major cluster to report a preference for TV ads over word-of-mouth as a source of credible product information, possibly a result of the high proportion of its population that hail from other parts of the country. In addition, consumers in Shenzhen appear to have a disproportionate preference for what are considered in other clusters to be niche channels such as bus ads, outdoor billboards and road shows.

As the data in our survey demonstrate, therefore, specific consumer behavior patterns can vary significantly across different clusters, a pattern we believe will continue as consumers' incomes increase and the dynamics of China's industrial base evolve. For this reason, cluster-based strategies are likely to be key to success for companies intending to sell into Chinese markets in future.

Exhibit 13 : Relevance of geographic clusters is steadily increasing as income differences across city tiers become less striking

Tier-driven
Geography-driven[1]

		2005	2008	2009	2010
General attitudes	Outlook towards financial future	Tier-driven	Tier-driven	Geography-driven	Geography-driven
	Importance of saving	Tier-driven	Geography-driven	Geography-driven	Geography-driven
	Concern about product safety	Geography-driven	Geography-driven	Geography-driven	Geography-driven
	Willing to try new things	Geography-driven	Geography-driven	Geography-driven	Geography-driven
	Individualism	Geography-driven	Geography-driven	Geography-driven	Geography-driven
Attitudes towards consum-ption	Preference for well-known brands	Tier-driven	Geography-driven	Geography-driven	Geography-driven
	Preference for Chinese brands	Tier-driven	Tier-driven	Geography-driven	Geography-driven
	Price sensitiveness	Tier-driven	Geography-driven	Geography-driven	Geography-driven
	Loyalty to preferred brand	Tier-driven	Geography-driven	Geography-driven	Geography-driven
	Willingness to pay premium	Tier-driven	Tier-driven	Tier-driven	Geography-driven
	Preference for modern channel	Tier-driven	Tier-driven	Tier-driven	Geography-driven
	Internet activity	Tier-driven	Tier-driven	Tier-driven	Geography-driven
Geography driven differences		3/12	7/12	9/12	12/12

1 Geography-driven in 2005-2009 represents region driven, while in 2010 means cluster driven

SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2005-2010)

Conclusions

Chinese consumer behavior is continuing to develop quickly. Having escaped the retrenchment experienced by developed economies since late 2008, Chinese consumers are evolving in ways quite different from what past experience would suggest, either in China or elsewhere. This presents opportunities for newcomers just as it requires incumbents to adapt their existing strategies. In the past, companies would enter China with their existing products, strip them down to basics in order to cut prices, and then sell them indiscriminately nationwide, effectively hitching their wagons to China's double digit rate of consumption growth.

Today, however, the fact that local consumers both appreciate and demand higher-quality products means that many companies who until recently struggled to find a niche in China are now able to sell their products and also to locate potential partners with whom to work. Conversely, those who have previously relied on a low-cost, low-quality business model may discover they are on the losing end of the trade-off decision, requiring a shift to reemphasize value.

In addition, the rapid emergence in China of emotionally-driven buying factors means that companies that in the past have had problems effectively marketing their products are now better positioned to win over consumers by appealing to them on an emotional level, using strategies similar to those used in other markets for years. These emotionally-driven purchases include those motivated by considerations such as status, family, and the individualistically-driven concept of 'what fits me'.

Companies must recognize the Chinese consumer's unique experience, especially when it comes to the information it needs. Meeting China's often-stringent health and safety standards, therefore, is not simply a question of jumping through the regulatory hoops, but also an opportunity to appeal to an increasingly health-conscious consumer. The local preference for word-of-mouth as an avenue for product research means companies must focus increasingly on exploiting this medium, especially via online resources.

Finally, because consumer behavior patterns differ widely across regions and income groups, there is no one-size-fits-all approach. Managers should develop regionalized strategies, tailoring product portfolios to meet local tastes and managing by geographic clusters that cater better to the varying environments now evolving across the country.

About the authors

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Yuval is a core leadership group member of McKinsey's Greater China Consumer Practice and Asia Pacific Strategy Practice. His work is focused on serving leading multinational and Chinese consumer companies on topics such as growth strategy, go-to-market strategy, and capability building, drawing from McKinsey's deep understanding of market dynamics and consumer behavior.

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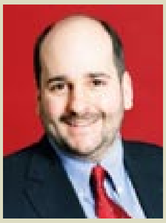

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McKinsey Insights China

Insights China provides businesses with the data, analytics and rapid, customized problem-solving and decision-making support to help build robust strategies for China's rapidly changing marketplace. The data and analysis combine results from McKinsey's annual Chinese consumer studies with proprietary macroeconomic and demographic data and analysis from the McKinsey Global Institute (MGI).

McKinsey Insights China updates the macroeconomic models regularly - the national model every six months and city level model annually to retain the most recent view of the Chinese market at a highly granular level. These frequent updates ensure that the latest economic activities and policy changes are reflected in our forecasts of demographic, economic and consumption variables at the individual city level.

Since 2005, we have conducted the largest study of Chinese consumers on an annual basis. We have interviewed more than 46,000 Chinese consumers across over 60 cities, giving us a deep understanding of Chinese consumers' attitudes and spending behavior in more than 100 product categories. The respondents come from a wide range of incomes, ages, regions, city-clusters and city-tiers, and represent 80 percent of China's GDP, 90 percent of its disposable income and 50 percent of the population.

In 2008, we conducted an additional study of 1,750 wealthy consumers with annual household incomes in excess of RMB 250,000, giving us unprecedented insight into the behavior of this fast expanding and economically important segment.

McKinsey experts are at hand to offer guidance, including the facilitation of workshops to address specific business issues. In addition, we have a proprietary, pre-profiled panel of more than 12,000 mainstream Chinese consumers and 1,000 wealthy Chinese consumers to help further explore such issues in a timely fashion.

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