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Mapping the Chinese Consumer Market

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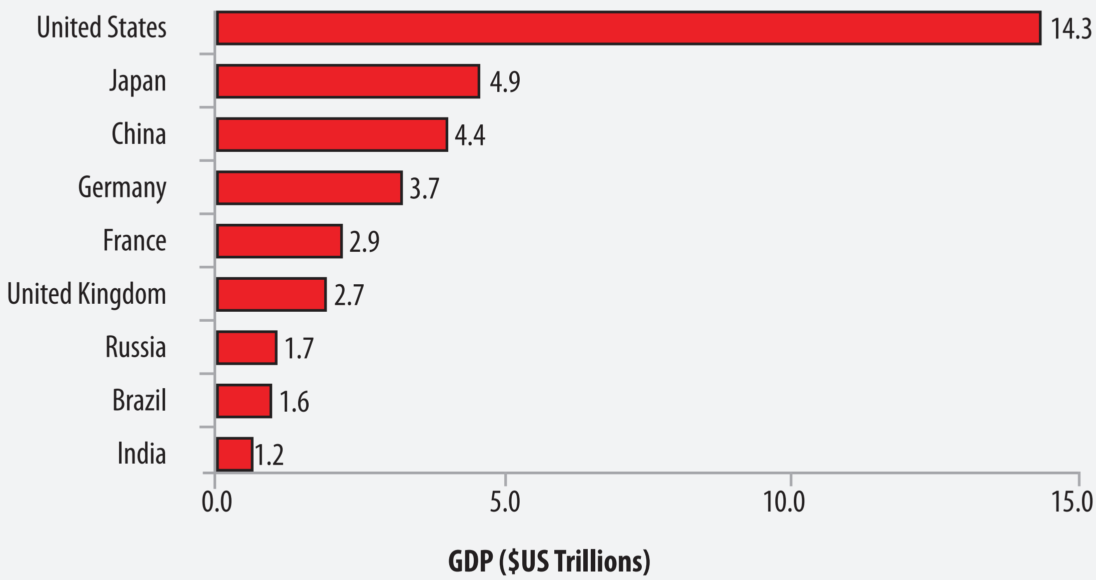
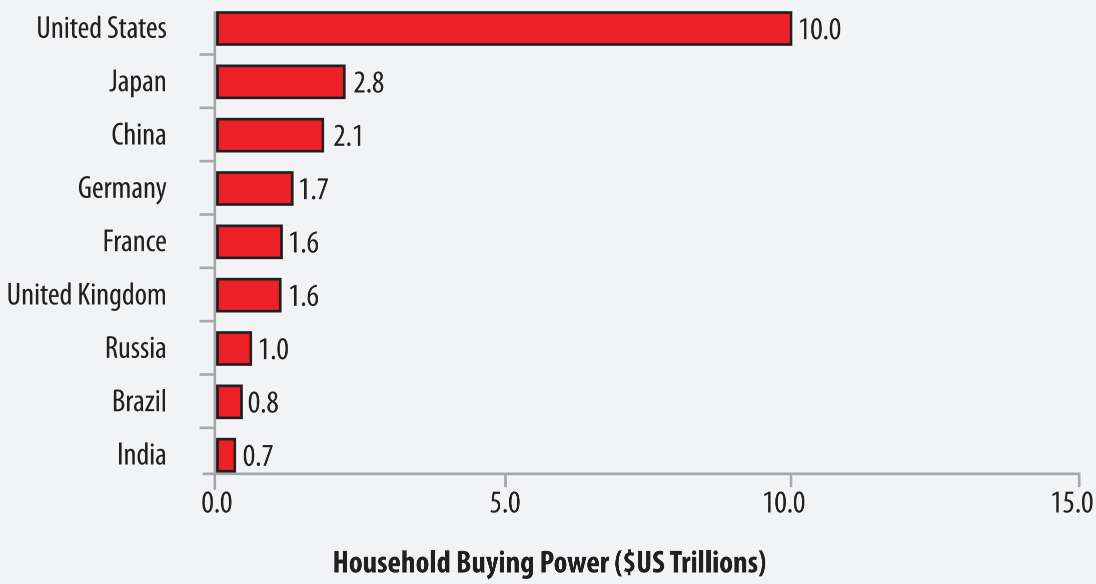
China is the fastest-growing economy in the world. In the last 30 years, China has achieved unprecedented economic growth and a rapid reduction of poverty. Growth of the gross domestic product (GDP) in real terms increased on average more than 10 percent during this period. This transformed China from a low-income country to the third-largest economy, and the second-largest trading nation, in the world in 2008. According to International Monetary Fund estimates, China will be the second-largest economy in the world by 2010.[1]

The economic growth of China has been based on the sustainable growth of its exports, due to international consumer demand, principally in the United States and in the European Union. However, the global financial crisis of 2008, which also affected China's export market, compelled the country to look for other sources of economic growth. One of these sources is domestic consumer demand. Even though China's domestic consumer market is relatively small in comparison to that of the United States, the European Union, and Japan, it has strong potential to become one of the largest consumer markets in the world. The gap between the present consumer market size and its potential growth in the coming years represents a unique window of opportunity for positioning within the Chinese domestic market. (See Graphics 1 and 2, comparing selected countries.)

Graphic 1: Size of Economy in 2008



Graphic 2: Size of Consumer Market in 2008



Starting the long consumer march...

In the 1970s, China's economic model was oriented toward a closed economy, agricultural production, and heavy industry. Its exports were basically raw materials, agricultural products, and a few labor-intensive manufactured products. In late 1978, the country shifted its economic development strategy, and gradually opened its economy to the international market and began an internal reform process. One of the first steps, in mid-1979, was to open four pilot special economic zones – Shenzhen, Zhuhai, Shantou, and Xiamen – in the coastal provinces of Guangdong and Fujian.

Later in 1982, the Chinese government established the Household Contract Responsibility System, which was design to stimulate farmers' initiatives. In 1986, China began a program of reform of the state-owned enterprise system, with an emphasis on economic growth and economic opening. In 1995, China officially transformed the planned economy system into a "socialist market economy" system. In 1997, Hong Kong returned to China under the policy of "one country, two systems." During this period, China also recognized that the private sector economy was an important component of the socialist market economy.

One of the milestones in China's modernization process was the acceptance of China as a formal member of the World Trade Organization in 2001. This achievement gave China the ability to continue with the modernization process, principally, through the revitalization and upgrading of the old industrial base, located mainly in the northeastern region. With this, China also adopted a national strategy oriented toward balanced and sustainable growth, called "scientific strategy of development." Also, the Chinese Constitution was amended to protect citizens' private property rights and promote the rule of law.

All these gradual reforms, oriented to opening the country to the international economy, have been accompanied by a program of attraction of foreign direct investment and aggressive export expansion. These reforms produced highly favorable results in terms of economic growth, international trade, and accumulation of foreign reserves.

Setting-up consumer priorities...

The global financial crisis of 2008 demonstrated that China's economic growth can be sensitive to its reliance upon the international consumer market. When the economies of the United States and the European Union entered into recession, with the consequent constraints on their consumer demand, China's exports and economic growth suffered a significant impact. To respond to the global financial crisis, China put in place a fiscal package of $586 billion to stimulate the economy through investment in infrastructure and upgrading the overall business environment. However, one of the main lessons learned from the economic crisis is the need to rely less on the export market and improve domestic consumption. As a result, China took strong steps to boost domestic consumption.

With the objective of improving domestic demand and pursuing economic growth, China established a series of priorities, including: increase personal income; foster and develop new-growth areas of consumption; improve the consumption environment and consumption-related policies; and improve consumer expectations to increase willingness to spend.

In this respect, the Chinese government has put in place specific economic measures. For example, it is: implementing policies to reduce the tax on the purchase of vehicles; standardizing and developing the market for rental housing; encouraging the purchase of homes for non-investment purposes; increasing consumer credit availability; improving the consumer services system; and improving consumption infrastructure, such as retail outlets.

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The Chinese government is also encouraging consumption in the areas of tourism, sports, and fitness, by, among other means, revising the schedule of national holidays. Special attention is being placed on the development of internet-based commerce, to meet the growing consumer demand through these channels. The Chinese government is also developing an aggressive policy for oversight and review of prices of agriculture, transportation, education, medical care, pharmaceuticals, and real estate commerce, to protect consumer rights and interests. In addition, the Chinese government is committed to eliminating regulation and policies that restrict consumption and is contemplating raising the amount of pensions for retirees; increasing the cost-of-living allowances for urban and rural residents; and increasing subsidies on certain groups and students from low-income families.

To enhance demand in the rural areas, the Chinese government has proposed to increase direct subsidies for agricultural suppliers for superior varieties of crops and for agricultural machinery and tools, and to expand coverage of subsidies. Also, in the rural areas, the government has proposed to implement policies to reduce the vehicle purchase tax and subsidize rural residents' vehicle purchases, as well as promote the purchase of domestic appliances, such as water heaters, computers, air conditioners, microwave ovens, among others. Also, the government has announced measures to encourage retailers to open stores in more townships and towns and expand chain operations in rural areas.

All of these measures are expected to boost the domestic consumer market to achieve economic growth, and also contribute toward the goal of bringing advances gained in the eastern coastal metropolitan areas, discussed below, to the central and western part of the country, as well as to the 54 percent of the Chinese population living in the rural areas.

The new urban landscape...

China overall remains a rural society. Just 46 percent of the population lives in urban areas. This proportion is relatively small in comparison with that of the United States (81 percent) or Western Europe (over 76 percent). Since Chinese society opened to the global economy, China's tendency toward urbanization changed quickly. In 1979, the urban population was around 20 percent. It increased to 46 percent by 2008. It is forecasted that in 2050, approximately 73 percent of China's population will live in urban areas, which will represent around 1 billion people living in urban settlements.[2]

The process of economic opening and rapid economic growth coincided with one of the largest processes of internal migration in the past century. The rapid urbanization of China moved approximately 150 million people from the rural areas to the urban areas during the past three decades. The emergence of the new metropolitan environment in cities like Shanghai, Beijing, Shenzhen, Guangzhou, Chongqing, among others, has resulted in changes in every aspect of Chinese society, and has demonstrated to the rest of the country and to the world a dramatic change in terms of consumption patterns, lifestyle, and consumer expectations.

The urbanization process has been uneven across the different regions (provinces, autonomous regions, and municipalities) of the country. The coastal regions, where the process of modernization started in 1978, are the most urbanized of the country. These regions include Shanghai (89 percent), Beijing (85 percent), Tianjin (76 percent), and Guangdong (63 percent). In contrast, in the

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western regions, where the modernization process has been slow, the population is predominantly rural, and urbanization is low, such as in the case of Tibet (28 percent), Guizhou (28 percent), Gansu (32 percent), and Yunnan (32 percent).

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Overall, China has a relatively young population. The median age in 2008 was 34 years old, below the median age of 40 years old in western European countries, but higher than in other Asian countries, where the average was 28 years old. The structure of the Chinese population shows that more young people are located in the urban areas than in the rural areas, where the populations are older. The economic boom over the past three decades allowed a large portion of the young rural population to migrate to the cities. Cities along the eastern coast were demanding labor with high productivity for the new export manufacturing industries.

In China in 2008, there were 418 million households, out of which 207 million were urban households. The proportion of rural households was roughly the same. Guangdong, Shandong, and Jiangsu, all regions located on the eastern coast, are the regions with the highest numbers of urban households. They constitute in the aggregate 50 million households, representing 24 percent of total urban households. The households in these urbanized areas and in most of the regions of the east coast have adopted western consumption patterns to the largest degree among the urban areas of China and are the primary target market for western companies.

The high degree of penetration of western companies and brands is primarily in cities like Shanghai, Beijing, Guangzhou, Shenzhen, and Chongquing. However, the second- and third-tier cities, such as Foshan, Suzhou, Dongguan, Wuhan, Hangzhou, Chengdu, Qingdao, Ningbo, Wuxi, Shenyang, Dalian, Nanjing, and Haerbin, are becoming large urban consumer markets due to the high numbers of households that have experienced buying power increases over the past several years.

The urbanization dynamic in China has had an impact on household size. Overall, the household size in China has become smaller. The average household size in 2008 was 3.2 persons per household. However, in highly urbanized regions, such as Shanghai (2.7 persons), Beijing (2.7 persons), and Liaoning (2.9 persons), the average household size was lower than the national average. In contrast, the less urbanized regions, such as Tibet (4.7 persons), Hainan (3.9 persons), and Gansu (3.7 persons), were higher than the national average. This situation is shown by the number of small households that are found in the most urbanized areas. For example, in Shanghai and Beijing, 42 percent of the households have only one or two people per household.[3] In contrast, in less urbanized areas such as Gansu, only 22 percent of households fall in this category.

These characteristics reflect different consumption patterns, lifestyles, levels of education, income, among others, that permit the classification of urban households through different socioeconomic strata. There is a small number of urban households at the top of the structure with sophisticated consumer preferences and links to the international consumer market; an emerging middle; and a large proportion of households at the bottom of the structure with traditional consumption patterns.

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Increased urban household buying power...

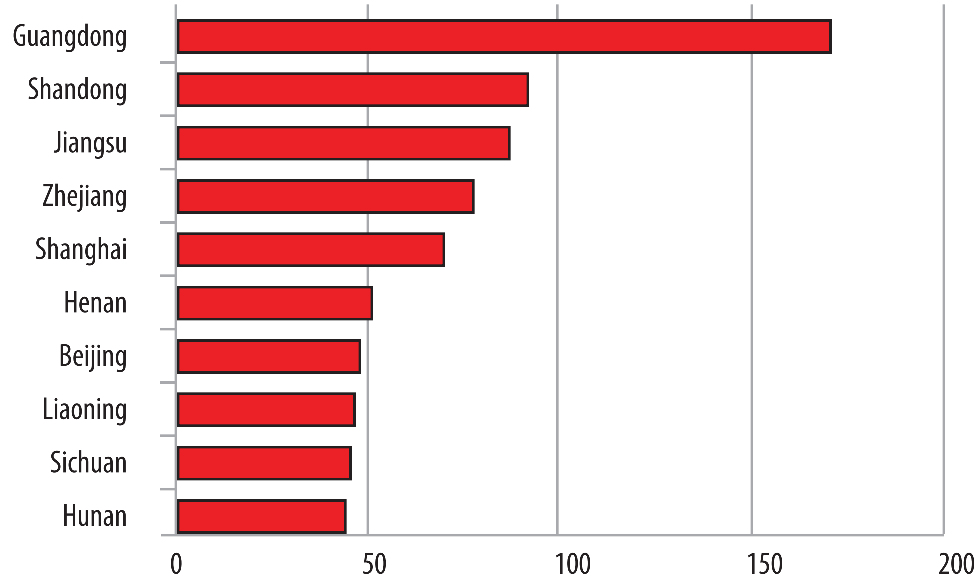
Given that the household is the primary unit of analysis of consumption, China as a consumer market presents among the different regions varying characteristics among its households.

"In 2000, Chinese household buying power was $557 billion, and by 2008, it had reached $1.5 trillion. Out of this amount, 74 percent of household buying power corresponds to urban households."

Household buying power, which represents the amount of money that households spend on goods and services during the year, is largely concentrated among urban households. It has been increasing rapidly as a consequence of economic growth over the past three decades. In 2000, Chinese household buying power was $557 billion, and by 2008, it had reached $1.5 trillion. Out of this amount, 74 percent of household buying power corresponds to urban households, and only 26 percent corresponds to rural households, even though the number of rural households in China is nearly 50 percent of the total number of households in the country. In 2008, average buying power per urban household was $5,376, and average buying power per rural household was $1,813.

In the country overall, the largest buying power corresponds to areas in which economic activity is based on industries oriented toward export manufacturing. There has been rapid economic growth and urbanization, and a greater degree of connection to the international economy. (See Graph 3.)

Graphic 3: Urban Household Buying Power by Region, "Top 10" in 2008 (U.S. dollars, billions)



In 2008, there were vast differences across the different regions of the country in terms of average buying power in urban households. For example, Shanghai has the highest average buying power per urban household, with $11,921. The lowest average buying power per urban household is Tibet, with $2,769. This is primarily a consequence of the distribution of value-added economic activities and the number of households per region. For example, the largest buying power of the country is in Guangdong, an industrial manufacturing region, which had $170 billion in 2008. Shanghai had only $69 billion of buying power in the same year. However, Guangdong had 20.7 million urban households, and Shanghai had 5.8 million urban households. As a result, Shanghai has a larger average household buying power than Guangdong. (See Graph 4.)

Graphic 4:
Average Urban Household Buying Power by Region, "Top 10" in 2008

1. Shanghai
2. Beijing
3. Guangdong
4. Zhejiang
5. Tianjin
6. Jiangsu
7. Fujian
8. Shandong
9. Inner Mongolia
10. Liaoning

The emergence of new urban middle class...

The average buying power per urban household is strongly related to household consumption patterns, and the ownership of goods and use of services. Urban households in places that have high average buying power tend to be more sophisticated consumers, more demanding in terms of quality of products and services, and have awareness of brands and more willingness to try new products, among other characteristics. These aspects coincide with certain characteristics in terms of level of education, occupation, expectations, etc.

Taking into consideration elements such as those mentioned above, it is possible to segment households into socioeconomic strata ("SES"). The most affluent and sophisticated households in terms of consumption are in SES A, and the least affluent and sophisticated are in SES E, with SES B, C, and D in between. In China, the majority of urban households are in SES E. However, the intermediate segments identified as middle class are growing.

Given the distribution of urban households by each SES, in 2008 the overall urban consumer market is structured as follows. SES A has 2.1 million households; SES B, 8.3 million households; SES C, 31.1 million households; SES D, 62.1 million households; and SES E, 103.6 million. As a result, it is estimated that there are 101.5 million households among the urban middle class in China, which represent approximately 301.4 million people.

Data on urban households in China overall show that the average buying power of urban households of SES A in 2008 was $30,107; SES B was $15,054; SES C was $8,244; SES D was $5,269; and SES E was $3,312.[4] However, examining average urban household buying power by SES among different regions of the country, there are large differences. For example, the average urban household buying power for SES A in Shanghai was $66,760 in 2008. In Jiangxi for the same SES A, it was only $8,028. There are similar disparities among all the SES across the different regions. In SES E, in Shanghai, average urban household buying power was $5,861 in 2008, while in Tibet, it was $1,838. The gap in household buying power per SES can mainly be explained by the income distribution of the country, and by other market characteristics, such as access to new products and services, consumer information, consumer expectations, among others.

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Growth in the Chinese consumer market is today based upon growth in the urban areas in the central and western part of the country, and in the future will be based upon continued expansion in these areas as well as in the rural areas. However, the urban consumer market is highly heterogeneous in terms of consumption patterns and lifestyle. For example, in 2008 Chinese urban households spend an average of $1,649 on food. Out of this, $346 was for dining out. The average expenditure on dining out in Shanghai was $1,194, while in Jiangxi it was $150.

This heterogeneity is also shown in the ownership of products among urban households. For example, out of 100 urban households in Guangdong in 2007, there were 18 automobiles; in the same period in Shaanxi, there were 1.4 automobiles per 100 households. The potential for the consumer market in urban households is high, as the penetration of consumer products such as dishwashers, healthcare equipment, automobiles, video cameras, is low (less than 10 per 100 households overall), in comparison with households in other economies such as western economies. However, there are some products that are well positioned in Chinese urban households, such as mobile phones and color televisions, which constitute 165 and 138, respectively, units per every 100 households.

Conclusion...

China is a country that has the largest population of the world. Its rapid economic growth has, over the last 30 years, led the country to move from a low income, semi-closed economy to the third-largest economy in the world. China's gradual openness to the world economy and its modernization has led to a rapid path of urbanization, modernization, and the expansion of household buying power. China's strategy of economic growth has been largely based on exports. Since the financial crisis of 2008, the growth strategy has come to rely more on the expansion of the domestic market and increased reliance on the domestic consumer market. The size of the Chinese consumer market is small in comparison with that of its major trading partners. However, given China's commitment to developing its domestic consumer market, the dynamism of urbanization in the country, the growth of purchasing power of Chinese households, and expansion of the new "middle class," China is expected in the near future to constitute one of the largest consumer markets in the world. The chances for success of international companies operating in China and for companies seeking to position themselves in this market will depend largely on the understanding and monitoring the dynamics surrounding these factors.

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Endnotes:

[1] International Monetary Fund, World Economic Outlook, 2009 (Washington, DC: IMF).
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[4] Adolfo F. Chiri, *The China Consumer Market Report 2009: A Roadmap for Strategic Market Positioning* (Cambridge, MA: Cambridge Insight).