

Future of Asia

Five consumer trends shaping the next decade of growth in China

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China is estimated to be the largest consumer economy today as measured in purchasing power parity (PPP) terms. Over the next decade, it may add more consumption than any other country, and is expected to generate more than one-quarter of all global consumption growth, according to our baseline scenario. Among the drivers of this growth are seven key consumer segments identified in previous research by the McKinsey Global Institute (MGI).

But across Asia, consumption is not just rising. It's also growing into a more complex phenomenon as demographic and social changes collide with significant technological advances. A recent report from MGI notes that across the continent, consumption is segmenting and diversifying, while new pockets of growth are emerging.

This article provides a more specific lens on emerging patterns among China's consumers, who are at the forefront of technology adoption, demographic shifts, and new behaviors. Their evolution has the potential to reshape the entire global consumer market.

1. China's rising consuming class is an engine of global growth in many discretionary categories

The growth of China's middle class has been well documented, but its sheer scale continues to be relevant—and remarkable. In 2000, around 1.2 billion Chinese people did not have sufficient income to spend \$11 a day in PPP terms. That is the point at which they are considered to be members of the consuming class, who are able to afford some discretionary goods and services on top of the basic necessities. By 2030, we expect about the same number of people to not only join the consuming class but to climb up the income pyramid within it (Exhibit 1).

Consumers in the upper-middle brackets are likely to drive the lion's share of growth in China over the next decade. By 2030, 60 percent of urban consumption is projected to be driven by upper-middle-income consumers (with annual household incomes ranging from 160,000 renminbi to

345,000 renminbi in real 2020 terms), compared with 35 percent today in our baseline scenario. Another 20 percent of consumption could come from the segment above them, as the "affluent" (with annual household incomes of 345,000 renminbi or more) double their current 10 percent share.

China is steadily becoming a crucial market for categories geared toward consumers with higher incomes. By 2030, it may be home to about 400 million households with upper-middle and higher incomes—roughly as many as in Europe and the United States combined.¹ Over the next five years, it is estimated that the number of millionaires in China may double, from around five million today to ten million in 2025.² Thanks to their rising incomes, Chinese consumers are punching well above their weight. China generates about 17 percent of global GDP today, but accounts for a larger share of consumption in several categories (Exhibit 2). Three patterns are emerging in terms of China's share of global consumption.

First, China is over-represented in discretionary spending categories such as fashion, accessories, consumer electronics, and electric vehicles (EV), relative to its share of global GDP. EVs in particular stand out, due in part to policy support. China not only accounts for 40 percent of global spending on EVs, but its consumption in this category is growing more than seven times faster than the global rate.

Second, China is a similarly outsized market for aspirational goods that are geared to higher-income consumers—think luxury goods, premium beauty and personal care products, and high-end cars. Yet this pattern is not yet observed in some categories of services. In wealth management services and cruises, for instance, China remains under-represented relative to its share of GDP, accounting for less than 10 percent of global revenue pools. This suggests substantial untapped growth potential. Some of that potential is starting to be realized in the case of wealth management. In recent years, this category has been growing at 9 percent per year in China, three times faster than globally.

¹ Upper-middle class is defined as households making over \$22,000 in 2011 PPP terms for international comparability; includes both urban and rural households.

² *Global wealth databook 2020*, Credit Suisse, October 2020.

Exhibit 1

Income growth is lifting urban households into the upper-middle class and above

XX Percentage of urban households

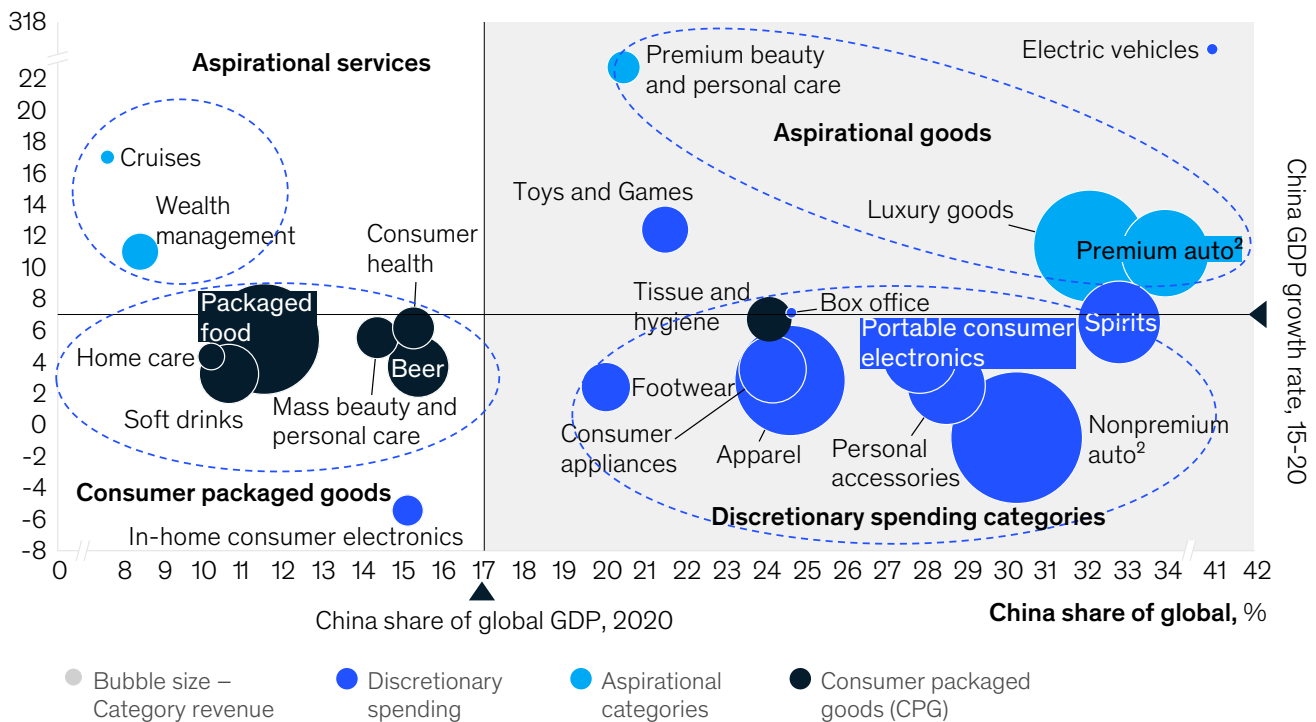
Annual household income RMB, 2020 real		Urban consumption by income group %				Delta 2030 vs. 20			
		2000	2020	2030 E					
High-income	Affluent (>345,000)	1	<1	10	3	20	8	+2x	
	Upper-middle income								
	Mass affluent (230,000-345,000)	1	<1	5	3	31	26	+1.8x	
	Upper aspirant (160,000-230,000)	1	<1	29	23	29	30		
Middle and lower-middle income	Aspirant (85,000-160,000)	3	1	45	48	15	23	-65%	
	Lower aspirant (55,000-85,000)	6	4	7	12	3	6		
Lower-income	Poor (<55,000)		88	94	4	10	1	7	-60%

Note: Numbers may not add due to rounding.

Source: MGI Insights China macro model; McKinsey Global Institute analysis

Chinese consumers “punch above their weight” in many categories

China category growth rate, CAGR 2015-20 %¹



¹2015-19 CAGR for box office and cruises given COVID-19 effects.

²“Premium” or “non-premium” classification based on price of the specific model sold (not the maker).

Note: Share of world consumption and growth rates expressed in value, not volume.

Source: Euromonitor International; McKinsey Luxury Report; IHS Markit; World Bank; McKinsey Global Institute analysis

Third, even as more of China’s population moves rapidly into higher-income brackets, consumption in some categories of “mass” consumer packaged goods (CPG) remains underweighted relative to China’s share of global GDP. For instance, China accounts for 10 to 15 percent of global consumption of home care, packaged foods, beer, mass beauty and personal care, and consumer health products. Nonetheless, many of these categories are growing substantially faster in China than in the rest of the world, so China continues to be an important engine of global growth.

Despite China’s already large contribution to global consumption, there is further room to grow. China’s household consumption is about 38 percent of its GDP, compared with around 50 percent for the whole of Asia–Pacific, 52 percent in the European Union, and 68 percent in the United States.³ Part of this gap is explained by a higher savings rate and associated spending in real estate by many households. But this picture may be changing. As the financial system becomes more sophisticated and new policy directions steer consumers toward alternative investment options and consumption, we may see a shift in the relative weight of flows directed toward financial assets or discretionary spending.

³ World Bank, 2019; final consumption expenditure of households and nonprofit institutions serving households as a percentage of GDP.

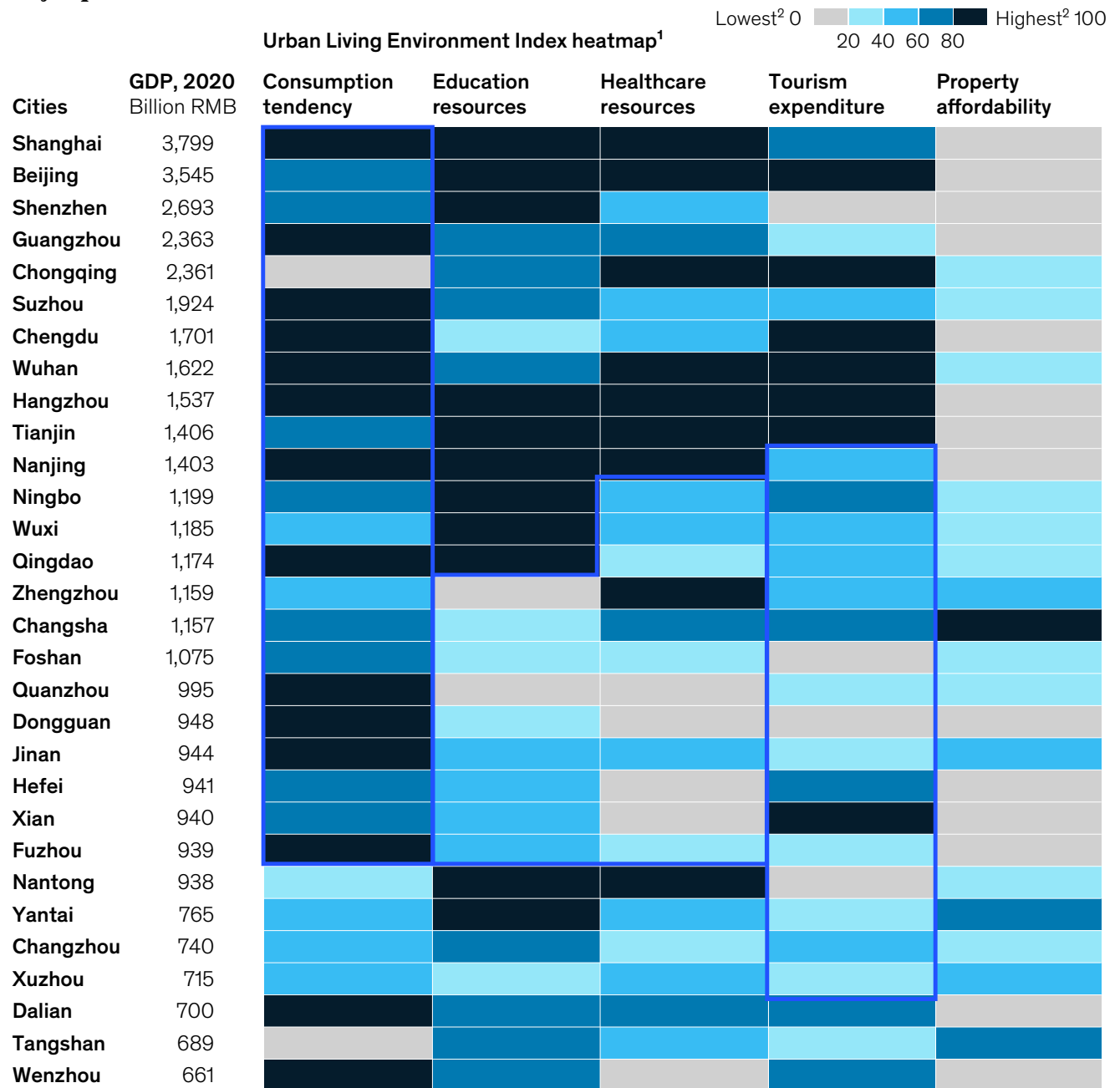
2. Urban consumers are concentrated in China's largest cities, but the next tier of cities could fuel the future

Cities and city clusters remain the engine of China's growth as the nation continues to urbanize. About 90 percent of future consumption growth in China is expected to take place in cities.

But wide variations exist across these markets. As companies develop city and city cluster strategies, they need to understand these differences in order to reach their target segments. We assessed China's largest urban consumption markets on multiple dimensions (Exhibit 3). Four significant patterns stand out:

Exhibit 3

Urban consumers have distinctly different living and consuming environments with four major patterns evident



¹Nine indicators are used to assess five dimensions: consumption tendency = per capita consumption and retail sales as % of GDP; education resources = fiscal education expenditure and teacher per student; healthcare resources = fiscal healthcare expenditure and hospital beds per capita; tourism expenditure = number of tourists and tourism revenue as % of GDP; and property affordability = house price to income ratio.

²Based on relative performance of top 100 cities with highest total consumption.

Source: NBS; McKinsey Global Institute analysis

Consumption is driven by the 30 largest cities, but new hotspots are emerging. China's 30 largest cities are home to 25 percent of the nation's population, who drive 45 percent of total household consumption. Consumers in these cities have considerable purchasing power, spending 80 percent more on a per capita basis than the national average. These cities have historically had the widest array and coverage of retail networks and service offerings. However, there are substantial growth opportunities beyond this list, with some cities outside of the top 30 posting faster growth. Household consumption has been growing by double digits in Guiyang, for instance. Many companies are anticipating these types of opportunities, expanding their reach to include more cities in China where incomes are also rising.⁴

The top ten cities outperform in public services such as healthcare and education. Critical public services such as healthcare and education continue to be strongest in China's largest cities, especially the top ten. These cities have greater fiscal resources to invest in higher-quality infrastructure and facilities. Compared to the national average, their education expenditures per student are 150 percent higher, and they have 20 percent more hospital beds per 1,000 people. The next ten to 15 cities by size appear to have visible gap on these fronts, with only around half of the per capita spending on education and healthcare compared with the top ten. Closing these gaps could further enhance the consumption power of urban residents. Nantong, for instance, has invested in digitizing and standardizing public services. As a result, it ranked 6th out of 110 cities in terms of satisfaction with the quality of public services in China, according to the State Administration for Market Regulation.

As domestic travel booms in China, many cities can contend for tourists' wallets. Even in the wake of the pandemic, the Chinese are eager to travel, and domestic tourists are expected to drive substantial spending. Today, tourism is a large part of the local economy in major cities such as Beijing, Chengdu, and Chongqing. Revenue from tourism-related sectors is equivalent to more than

20 percent of GDP in these cities, compared with a national average of 7 percent. Some tourist hubs have been investing in digital service platforms and transport infrastructure. Examples include Beijing's new airport and a second high-speed railway through Chengdu and Chongqing. But more cities across China can expand their tourism sectors. For example, out of the 30 largest cities in terms of GDP sizes, there is only a small difference in the number of 5A-level⁵ landscapes in the ten largest cities compared to the next twenty cities, at 37 versus 33. Yet the next 20 cities post around 25 percent fewer tourist visits than the top ten cities. Cities have different attractions, of course, but in light of the increasing spending power of Chinese consumers, many have the potential to improve their infrastructure and appeal to tourists.

Housing affordability is a common challenge across most Chinese major cities, limiting consumers' spending power and shifting them to rentals. Housing affordability is one of the biggest issues facing Chinese consumers today. In the top 30 cities, the house-price-to-income ratio (the ratio between the price of a 100-square-meter house and annual household income) is 11.5, higher than the national average of 8.4, based on data from the China National Bureau of Statistics. The ratio is even higher in tier-one cities, at 21. This creates a huge challenge for young Chinese adults, who find housing increasingly out of reach. The share of household budgets devoted to housing in turn limits other types of consumption. Central and local governments have initiated a number of policies to stabilize increases in property prices, such as land reform, limits on ownership, and financing restrictions in major cities. For now, many residents of China's largest cities are shifting to renting rather than owning property. The renting population increased from 11 to 14 percent of the overall population between 2012 and 2019, a trend largely occurring in major cities.⁶ Supply is responding to this rising demand. In six major Chinese cities alone, the stock of rental housing is expected to reach 885,000 units in 2022, up from 135,000 units in 2018.⁷ The Chinese government is making rental housing a priority and offering financial support and tax incentives to encourage its development.

⁴ Sophie Yu and Brenda Goh, "Yum China CEO says to focus store expansion on smaller cities," *Reuters*, September 23, 2021.

⁵ Most important and best-maintained tourist attractions in China, as classified by the Ministry of Culture and Tourism.

⁶ Liu Shuai, Analysis of the development needs and market scale of China's housing leasing industry in 2020. The expansion of rental demand will promote market growth, *Forward – The Economist*, December 2020, qianzhan.com.

⁷ *The rise of China's rental housing market*, JLL, December 11, 2018. Excludes serviced apartments, social housing, dormitories and strata-titled housing.

3. Changing consumer attitudes are driving the growth of Chinese brands

Brand preferences are shifting. In the past, Chinese consumers put a premium on foreign brands, but this tendency has changed in recent years. The notion of guochao—a desire to buy Chinese goods and services in order to connect with local roots and producers—has come to prominence. Support for products “made in China” has led to the emergence of significant local players in some categories. Baidu searches for Chinese brands increased from 38 to 70 percent of all brand searches between 2009 and 2019, with millennials leading the way in domestic purchasing. A survey⁸ of 5,000 consumers in 15 Chinese cities found that the share of respondents who say they would buy a local Chinese brand over a foreign brand has increased from 15 percent in 2011 to 85 percent in 2020. But the strength of this trend varies across categories (Exhibit 4).

In some categories, local Chinese brands (defined as those made by companies with headquarters located in mainland China) have accounted for the majority of the market for most of the past decade. They include most household consumer packaged goods, such as bottled water, tea or packaged foods, and electronics, both portable such as smartphones or in-home such as audio-visual equipment. With a few exceptions, Chinese brands hold market shares of more than 50 percent in these subcategories. In fact, Chinese electronics makers have captured an additional 5 to 10 percentage points of share over the last five years.

In beauty and automotive, global players historically had the largest market share in China, but Chinese players are gaining ground. Chinese automakers have gained share in both the mass and premium segments, now accounting for roughly a third of the market. Chinese premium automotive brands were essentially nonexistent just five years ago, but they now account for 6 percent of the market. When electric vehicles first hit the streets, Chinese players moved quickly to capture almost the entire domestic market in the earlier years of the 2010s. Over the past five years, international players have started to make some inroads, but they still account for less than one-quarter of the Chinese EV market.

The guochao trend has been widely noted in the apparel and footwear categories, but it has played out differently across subcategories. Local apparel brands outside of sportswear gained around 3 points of share between 2015 and 2020. But in sportswear and footwear, local brands dropped by between 5 and 10 percent from 2015 to 2020. Despite that, some large Chinese players exhibited strong growth. Chinese sportswear company Anta Group increased its sales roughly threefold between 2015 and 2020, while Li-Ning grew its sales by 85 percent in the same period.⁹ Furthermore, some global brands saw declines in China in the early part of 2021.

Overall, while an increasing number of Chinese consumers claim to prefer domestic brands, in some cases, it may be that they are simply responding to brands that offer value for money and meet their needs. Previous McKinsey research highlighted that consumers are not always aware of which brands are foreign or domestic¹⁰, and there is increasing ambiguity between the country of origin and the country of manufacture. Many Chinese consumers are so used to seeing global brands such as Olay and Biore that they may actually believe they are local. Some Chinese brands that have packaged themselves as “international” are often mistaken as foreign. Beingmate (a Chinese infant milk powder) was assumed to be a foreign brand by 45 percent of respondents.

The rise of local brands is broader than simply guochao. It is also driven by Chinese products becoming more competitive through attractive design, enhanced features, and improved performance. The Chinese market is vast enough to support both homegrown and foreign brands, as long as producers understand and deliver on what consumers want.

⁸ *Chinese consumers' growing preference for local brands*, Fidelity International, July 10, 2020.

⁹ Euromonitor International.

¹⁰ Daniel Zipser, “The real reason why Chinese consumers prefer local brands,” McKinsey & Company blog, December 14, 2017.

Local brands are gaining share in many categories of consumption in China

XX 3pp increase or more XX Less than +-3pp change XX 3pp decrease or more

Category	Subcategory	Share of local brand sales, 2020, % ¹	Change in share 2015–20, pp
CPG	Bottled water	85	10
	Ready-to-drink tea	98	0
	Home care	67	-2
	Consumer health	64	4
	Packaged food	75	1
Electronics ²	Portable electronics	85	10
	In-home electronics	65	10
	Computers and peripherals	42	5
Beauty	Beauty and personal care	31	3
Automotive ³	Mass (non-EV)	38	2
	Premium (non-EV)	6	6
	EV	77	-18 ⁴
Apparel and footwear	Apparel exc. sports	61	3
	Footwear exc. sports	68	-5
	Sportswear (apparel and footwear)	38	-8

¹Based on headquarters of brand owner in mainland China.

²Market share of electronics expressed in unit sales.

³Change in share from 2015 to first half of 2021 for all automotive categories. Premium and non-premium automotive classification based on maker.

⁴Starting from almost 100% of market in 2016.

Note: Share of local brand sales calculated based on all brands for which data is available. For CPG and beauty, roughly 50 to 90 percent of total market is covered. For apparel and footwear, top 50 to 80 brands are covered, corresponding to roughly 20 to 60 percent of the market depending on the subcategory. For electronics, roughly 70 percent of the market is covered. For automotive, close to 100 percent of the market is covered.

Source: Euromonitor, New car registration database, McKinsey Global Institute analysis

4. China's digital consumers are creating vast pools of data

China's vibrant digital ecosystems are steadily increasing their share of the country's economy, and the boundaries between the physical and digital are continuing to blur. Chinese technology players have created innovative business models, especially in all types of e-commerce, digital payments, food delivery, healthcare, and mobility services. Super apps are now well established and mainstream in China and further advanced than in most other markets.

Chinese consumers have been enthusiastic adopters of digital innovations. Increasing numbers of consumers are going online—at any age. Seniors are becoming netizens. By the end of 2020, consumers aged 60 and over accounted for 11 percent of China's total internet population, a jump from 6 percent in March 2020. We conservatively estimate that at least two-thirds of seniors could be online by 2030, up from around 40 percent today.

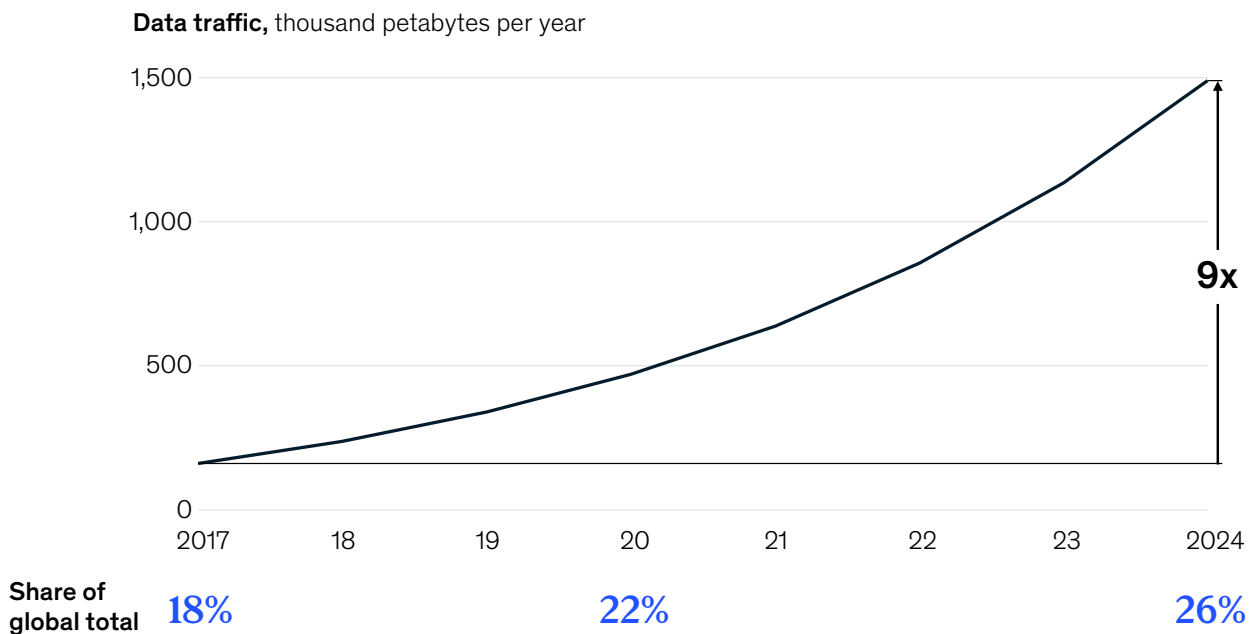
Of course, younger generations are spearheading digital adoption. So-called “digital natives,” the millennials and members of Generation Z born between 1980 and 2012, already account for over one-third of Asia’s consumption, and that share is expected to increase to 40 percent by 2030. Twenty-nine percent of Gen Zers in China spend more than six hours a day on their mobile phones, voraciously consuming video content. This is a generation that is confident in their financial futures, reflected in their willingness to borrow in order to spend. Half of all consumer loans taken out in China have gone to borrowers below age 30.

Moreover, consumers are increasing their spending on digital goods. Purchases of media and video games increased by an average of 20 to 70 percent per year over the past five years in China.¹¹ But even when they are buying physical goods, Chinese consumers are going online. China is the world’s largest e-commerce market—in fact, it is larger than the next nine e-commerce markets

combined. More than 70 percent of China’s consumers¹² are true omnichannel shoppers, combining both online and offline approaches.

The booming digital economy is creating a powerful explosion of consumer data. According to Omnia network estimates, China’s data consumption may grow ninefold between 2017 and 2024. Depending on the scope and definition used, it could become the largest source of consumer data in the world in the next year (Exhibit 5).

Exhibit 5
China is projected to become the largest consumer of data globally



Note: Includes cellular data traffic plus all consumer fixed broadband internet traffic including Wi-Fi. Business internet protocol (IP) traffic over fixed lines and VPNs is not included. Video traffic that is carried over a managed network is also not included.
 Source: Omdia network, McKinsey Global Institute analysis

¹¹ McKinsey Global Media Report, 2020.

¹² Lambert Bu, Violent Chung, Nick Leung, Kevin Wei Wang, Bruc Xia, and Chenan Xia, “The future of digital innovation in China: Megatrends shaping one of the world’s fastest evolving digital ecosystems,” McKinsey & Company, September 30, 2021.

Companies seeking to navigate this phenomenon face three important considerations. First, they need to create and access the right consumer data. Much of the data produced in China comes from digital platforms, and in particular super apps. Companies therefore need to examine whether they have a partnership approach in place to access the right data for their business.

Several brands are leveraging digital platforms to create their own direct-to-consumer (DTC) channels. In other markets, a lack of scale might make a DTC approach challenging, but the enormous size of China's market makes such plays viable. As well as creating a new channel for brands, DTC approaches offer a significant opportunity to access customer data directly. Some global luxury fashion players were first-movers in this space through partnerships with Chinese technology players, but more companies are likely to follow suit in the near future.

Second, companies need to define clear use cases for consumer data in order to deliver tangible benefit to consumers. As these use cases multiply, it is critical to prioritize and understand the value at stake from different approaches. Many digitally savvy companies have explored opportunities to personalize their communications, offers, and some services. Consumers have begun to expect this level of service, which raises the bar for companies to differentiate. At the same time, using consumer data in an integrated way in the physical world is becoming key as customers increasingly demand tailored experiences and even physical products. In China, the first Nike Rise store opened in July 2021, offering individuals a personalized shopping journey.

Finally, companies need to ensure they are managing data in line with consumer needs and regulatory requirements. Data privacy and protection are currently a major concern for consumers and regulators in China (and across the world). There is a large opportunity to create value from consumer data, which survey evidence suggests that many Chinese consumers are willing to share. A 2021 Euromonitor survey found that over 45 percent of respondents in China said that they were willing to share data for personalized offers and deals, a significantly higher share than respondents from North Asia, the United States, and Western Europe at around 25 to 35 percent.

Nevertheless, recent regulatory action in China, including new data protection policies in 2021, has required many companies to rethink and review their handling of consumer data. They may need to renew their focus on delivering the right value for consumers in a way that balances their interests and meets their desire for personalization, while at the same time complying with regulation.

5. Chinese players are at the forefront of the shift toward new market-specific consumption curves

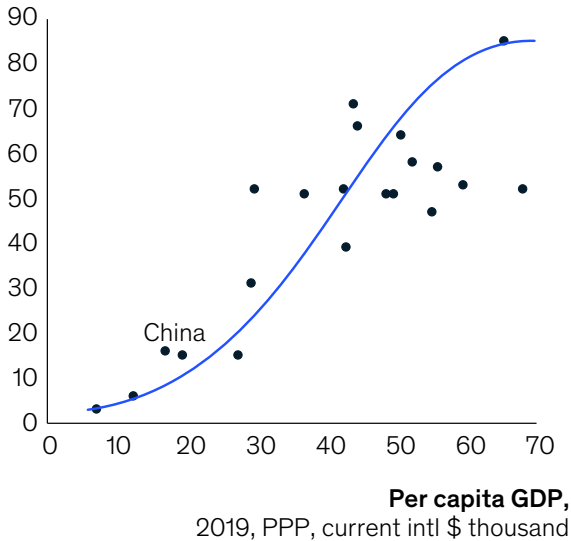
Multinational companies have historically looked at emerging markets through the lens of rising incomes. Income-driven S-curves have occurred across many consumer categories—that is, the penetration of a given product rises slowly until the tipping point when incomes are sufficient to support a steep upward curve in consumption. Once penetration is high, growth tends to plateau. However, a combination of business model innovation, technology-driven unit cost decreases, and new buying behaviors is rewriting consumption patterns in the region. China's technology players are at the global forefront of such shifting curves.

Consider, for example, private-vehicle-based mobility. The penetration of car ownership follows a well-established S-curve, experiencing a sharp increase when countries reach sufficiently high incomes. However, new mobility solutions such as ride hailing have a different profile. Penetration is much less dependent on income; consumers who cannot afford to own a car can access relatively inexpensive rides. While China lags behind many other markets in car ownership relative to population, it has the highest penetration of ride hailing and use of taxis (Exhibit 6).

The income-consumption relationship is being reshaped

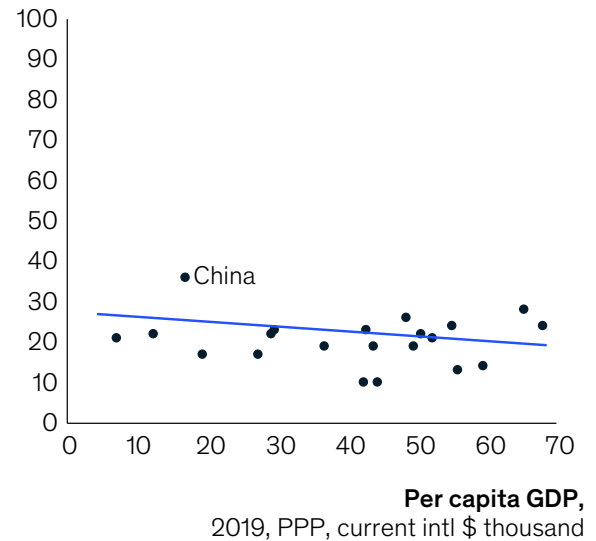
From income-driven S-curves...

Passenger cars in operation,
2020, per 100 people



... to new access curves

Ride hailing and taxi user penetration,
2020, % of population



Source: McKinsey Center for Future Mobility; Newzoo; Sensor Tower; Statista; Strategy Analytics; United Nations, World Bank; McKinsey Global Institute analysis

With 400 million monthly active users, Didi Chuxing has become China’s largest shared mobility platform. Its app supported 30 million rides per day as of December 2020, a figure that is likely to have increased as passengers become more comfortable with sharing transport as the pandemic recedes. Shared mobility value pools could grow in China between 5 to 10 percent a year over the coming decade, according to estimates from McKinsey’s Centre for the Future of Mobility.

A similar phenomenon is playing out in financial services. Conventional products such as mortgages and credit cards still tend to follow an income-driven S-curve, but product innovation is democratizing access and leading to flatter curves that are not as dependent on income. The penetration of mobile wallets is much less correlated with income, and China leads in their adoption, with a penetration rate of about 60 percent. Major players include WeChat and Alipay. In wealth management, new robo advisory services are growing rapidly and reaching previously excluded consumers. For example, Vanguard and Ant Group formed a joint venture in

2020 to launch BangNiTou, a robo-adviser service with a deliberately low minimum investment requirement of 800 renminbi (around \$120 in August 2021); the goal is to expand the availability of financial advice beyond the circle of wealthy investors. Within a year of its launch, the service had acquired one million users, with half of them younger than age 40.

Consumption curves are also changing in gaming. Over the past seven years, Asia’s mobile gaming market has gone from being worth 40 percent less than the computer and console market combined to being worth 50 percent more. The penetration of console-based and computer gaming follows an income-driven S-curve given that consoles and computers involve upfront costs. But mobile gaming, which is often easier for consumers to access, has a lower correlation with income. Its penetration is higher in China than in higher-income countries. The intersection of consumer preferences, innovation, and regulatory changes may shape the development of the mobile gaming industry going forward.

What does all this mean for companies? In a fast-changing market such as China's, finding new ways to serve consumers at all income levels is an imperative—and leading Chinese players are creating the proof of concept for many other global companies.

China's dynamic consumer markets require companies to better understand how to serve markets that are changing radically—socially, demographically, and technologically. They will need to refine their strategy to take account not only of income levels but also new behaviors, even within their established customer bases.

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