

McKinsey
& Company

Future of Asia

Consumer

Seven segments
shaping China's
consumption landscape

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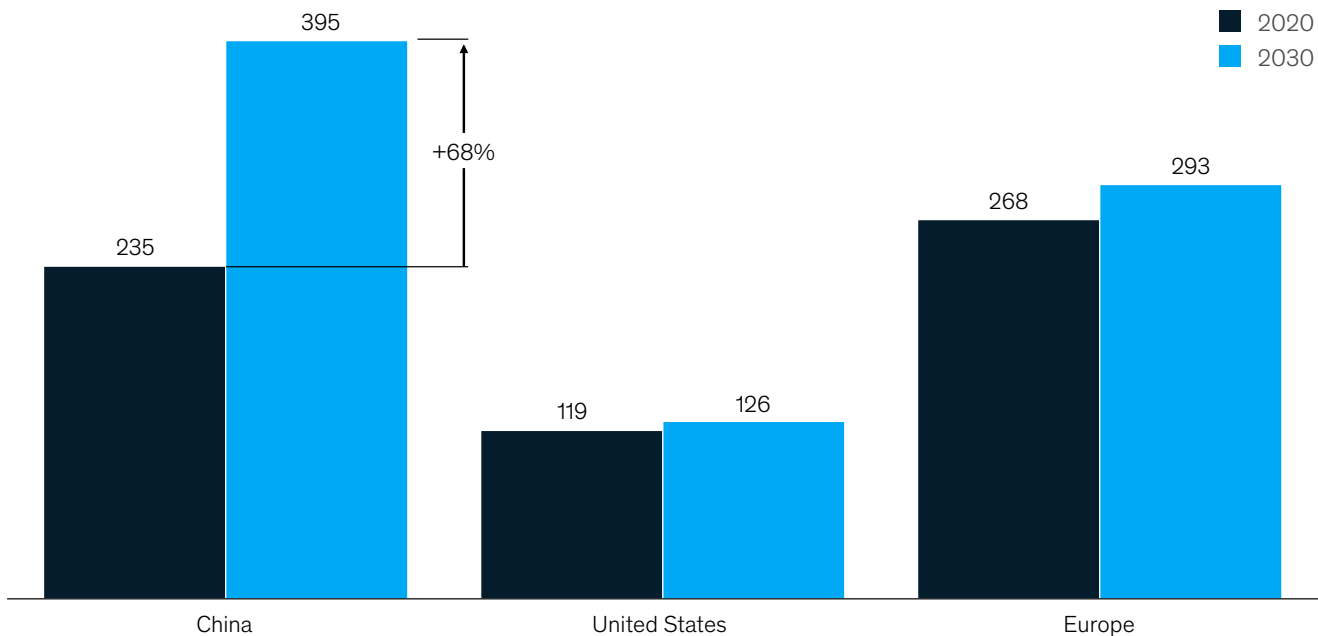
The sheer scale of China's consumer markets continues to matter. China offers a \$5 trillion consumption growth opportunity over the next decade, according to new research from the McKinsey Global Institute. Incomes are rising at pace. Consider households in the upper-middle income and above (with annual incomes

of \$22,000 or more in 2011 international dollars, purchasing power parity basis). Today, China is home to fewer of these households than Europe. In just ten years, China could almost account for as many as Europe and the United States combined at about 400 million (Exhibit 1).

Exhibit 1

Over the next decade the number of upper-middle income and above households in China is expected to grow by almost 70%

of households in upper-middle income and above, million
(with annual incomes of \$22,000 or more in 2011 international \$ purchasing power parity)



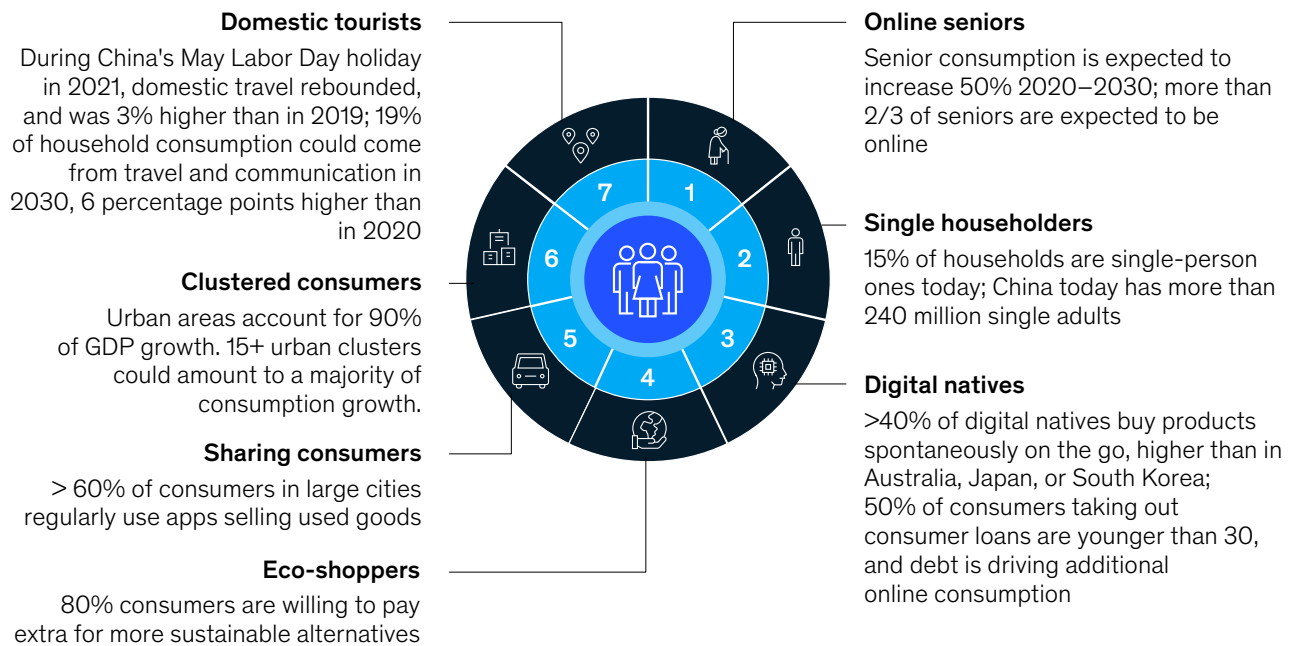
Note: Projections based on McKinsey's baseline scenario, which assumes that China, the US and Europe's long-term growth trajectory is not materially affected by the pandemic. Growth outcomes will depend on the shape of the recovery from the pandemic and other macroeconomic factors in different geographies.
Source: McKinsey Global Institute analysis

But a new chapter is being written that goes beyond scale and rising incomes. A combination of demographic and social change, and the inexorable penetration of digital technologies

is reinforcing the diversity of these markets, prompting changing consumer preferences and behavior in sometimes surprising ways. How well do we know China's consumers? Let's look at some of them (Exhibit 2).

Exhibit 2

Seven consumers driving growth in China



Source: McKinsey Global Institute analysis

The online senior

The over-60s are expected to account for around one-quarter of China's population by 2030, an increase in the number of seniors of as much as 45 percent. Their consumption is expected to grow by about 150 percent during this period, twice as fast as overall consumption growth in China. The aging of China's population, and consumption opportunities, are well appreciated by many companies and investors.

However, the seniors market is changing, notably because so many of the older age group are now active online. In China, a minimum of two-thirds of seniors are expected to be online by 2030. Because so many elderly were housebound during the pandemic, this trend has accelerated.

By the end of 2020, China's over 60s accounted for more than 11 percent of the country's internet users, almost doubling their share in only nine months. Ali Research reported that the number of seniors' monthly average users of one of the largest e-commerce platforms in China grew year-on-year about 30 percentage points faster than other age groups in 2020.

Chinese technology companies are increasingly adjusting their offerings to seniors to tap into their embrace of digital. The largest ridesharing and e-commerce platforms have all created tailored versions of their apps with increased support functions and better accessibility. However, companies and investors seeking to tap into this

vibrant seniors market will need to assess the large inequality that still abounds in the senior segment.

Around 25 million seniors in China have relatively higher incomes, living on more than \$50 a day (2011 international dollars, purchasing power parity basis) and will drive consumption growth in categories such as health, housing (including specialized assisted-living facilities), and leisure. However, almost double that figure—over 48 million seniors—may live on less than \$11 a day (2011 international dollars, purchasing power parity basis) in 2030, and have difficulty making ends meet.

The single householder

Demographic trends have a significant influence on China's consumption landscape. China's total fertility rate continues to fall, from 1.6 in 2000 to 1.3 in 2020. In 2020, there were 12 million births, compared with 18 million births in 2000—a drop of 32 percent that left China's birth rate at its lowest level in 60 years. This is one factor behind a shrinkage in the size of its average household by almost 30 percent from 3.6 people in 1999 to 2.6 people in the latest census.

But there are social changes, too. Over the past 30 years, the age at which people get married and also the age at which they have children has increased by three years. Even before the new census results, the United Nations projected that the number of under 15s could shrink from 18 percent of the total population to 16 percent in the next decade.

Not only is the size of the average household shrinking, but the single-person household is becoming ever more prominent. Today, more than 15 percent of Chinese households are single-person ones, more than double the share in 1999. The number of single adults has now topped 240 million, and they are driving a robust singles economy.

Reflecting the rising prevalence of single people, for instance, pet ownership in China has more than doubled in just five years. Catering for people exercising and even entertaining themselves alone, in China there are now one-person gym modules and mini karaoke booths.

A growing number of companies are now even exploring the potential for products and services that offer companionship, human or otherwise. For example, an “AI companion” chatbot has already reached hundreds of millions of users, many of them single people.

The digital native

So-called “digital natives” born between 1980 and 2012 and including members of Generation Z and millennials already account for over one-third of Asia's consumption. Twenty-nine percent of Gen Zers in China spend more than six hours a day on their mobile phones, voraciously consuming video content.

They are also spontaneous buyers—more than 40 percent of China's digital natives buy products on the go, compared with 20 to 30 percent in Australia, Japan, and South Korea. Members of this generation are generally optimistic about their financial future.

In a McKinsey survey of Gen-Z consumers conducted before the pandemic in October 2019, 87 percent of respondents from China said that they “felt very confident that I will be able to meet my financial goals for the life I want.” This was one of the highest readings within Asia.

That confidence appears to be reflected in a willingness to borrow to finance consumption. In the same McKinsey survey, 53 percent of Chinese respondents agreed with the statement, “I buy what I want and need, even if it means I have to do it on credit.” In China, half of all consumers taking out consumer loans are younger than 30 and are driving additional online consumption in categories such as apparel and consumer goods.

The eco-shopper

Asia is on the front line of climate risk, accounting for two-thirds of the global risk of economic disruption emanating from changes in the natural world. Concern is rising in Asia.

In an Ipsos poll conducted in late 2019, 85 percent of Chinese respondents said that they had made changes to the products and services they buy because they were concerned about climate change, the fourth highest reading out of 28 countries surveyed. Rising concern about the

environment is translating into a rising willingness to pay for more sustainable products and packaging.

In a recent McKinsey survey, more than 80 percent of Chinese respondents, the most of any country polled, expressed willingness to pay for sustainable packaging. Concern about the environment is fueling “green” shopping preferences. A leading e-commerce player reported that the volume of green purchases on its platform has risen as much as 70 percent in 2017, with local Chinese local brands accounting for more than 85 percent of such sales.

Although sustainable alternatives are more expensive—exceeding 30 percent more in some categories, two factors are propelling the rise in green consumption. First, rising incomes are closing the gap between willingness to pay and price premiums.

Second, companies are finding innovative ways of reducing the price of green goods. For instance, a Chinese made electric vehicle (EV) costs only around \$5,000, making it one of the best-selling electric vehicles in the world (although most revenue comes from domestic sales).

The sharing consumer

Economic pressures, changing consumer attitudes, and technology have combined to prompt many Asian consumers to consider alternatives to traditional ownership of goods in order to fulfill their needs. The rental and subscription economies are gaining traction in, for instance, mobility, where ridesharing is growing quickly across Asia; housing, reflecting the fact that some of the most expensive property cities on a price-to-income basis are in China; and electronics.

Consumers are also embracing secondhand ownership. China's used or preowned goods market from cars to items of clothing has doubled since 2016 to \$145 billion. According to QuestMobile, it is estimated that more than 60 percent of consumers in China's largest cities regularly using apps selling used goods. The largest secondhand goods e-commerce platforms had more than 30 million sellers and doubled its gross merchandise value in 2020.

Another increasingly pervasive shift is toward ownership of digital, rather than physical, goods and services. For all these shifts, consumers in China still remain likely to own more, rather than less, in the future, as incomes continue to expand.

The clustered consumer

About 90 percent of consumption growth in China is expected to take place in cities given continuing urbanization. China's megacities are set to experience growth in their high-income households. Shanghai alone is expected to add about 3 million high-income households, not far short of the 3.2 million increase expected in the whole of Japan.

But the story about urban consumption is not restricted to megacities. So-called middleweight cities are growing 2 percentage points faster than the 50 largest cities in Asia. Increasingly, companies will also need to understand how cities interact with each other.

Chinese cities can be grouped into different clusters based on their similarities in terms of consumer behavior, geographic proximity, and infrastructure network. The government of China's plan to connect urban clusters with railway and road networks could facilitate consumption growth within and across different clusters. Companies can develop tailored strategies for 15+ clusters and adjust their go-to-market approach.

The domestic tourist

As incomes rise, spending on discretionary categories will increase. Travel and communication now accounts for 16 percent of household consumption, up from 13 percent in 2010. It is expected to rise to 19 percent by 2030. China's tourism industry was thriving before the pandemic.

The number of domestic trips grew from 2.1 billion in 2010 to over 6 billion in 2019 while international travel expanded from 52 million to about 160 million. The pandemic inevitably reduced international travel to almost zero and even domestic tourism by almost half during 2020. However, while the effects on international travel still linger, domestic travel has fully recovered and even outperformed 2019. There are multiple signs of a bounce back in tourism.

During 2021's May labor day, domestic trips were up 3 percent from the same day in 2019. Reservations via China's largest online travel agency Ctrip were up 30 percent year-on-year, and hotel average occupancy bounced back to 2019 levels. These gains partly reflect the waning of the impact on people's lives of the pandemic in China, but also the fact that many companies engaged in tourism and travel have made strenuous efforts to overcome caution due to the pandemic and tap into latent demand.

For instance, 7 Days Inn launched "Safe stay" activity, offering discounts and implementing strict standards for disinfection during the 2021 Chinese New Year, while Air China provided eligible passengers with free refunds and rescheduling services.

Some regional companies were able to recover sales in advance of recovery across the rest of the economy. For example, Hainan's duty free

sales in particular more than doubled in 2020. A new McKinsey survey of attitudes among Chinese tourists reveals short-term concerns, but continued positivity about long-term domestic travel (outdoor scenic trips are the most popular, followed by beach or resort holidays).

The sheer scale of China's consumer markets and rising incomes remain key considerations for consumer-facing companies, but they need to move beyond these lenses and track, understand, and learn how to serve markets that are changing radically—socially, demographically, and technologically. They will need to refine strategy to take account not only of income levels, but also new channels and new behavior even within their established customer bases.

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