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## China's new pragmatic consumers

**They spend more in categories they highly value, and they generally trade down in less compelling ones.**

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**Increasingly, Chinese consumers** are behaving like their counterparts in the developed world. They are more demanding and pragmatic than ever as their horizons expand beyond basic concerns about product features. Also, they are willing to pay for better value and quality and are spending more time researching and exploring product nuances. Yet McKinsey's 2010 survey of China's consumers also found that they are blazing a uniquely Chinese trail (see sidebar "About the research"). The country obviously offers some of the world's biggest growth opportunities—but only for consumer product companies that understand and respond to this rapidly evolving marketplace.

Chinese consumers remain brand conscious but, unlike shoppers elsewhere, they focus on value so intensely that brand loyalty is often secondary. The needs or interests of their families have greater importance for them than for their counterparts in the developed world. Word of mouth has become a more significant source of product information than it is elsewhere, thanks largely to fast-growing use of the Internet, which Chinese consumers see as a credible information source (see sidebar "Chinese consumers and the Internet").

Most intriguingly, though, China's consumers prioritize purchases across different product categories by trading off among them: the Chinese maximize their buying power by spending more in the categories they care about most and less in others. Also, the size and reach of China's far-flung markets mean that any trend's impact may vary from place to place, depending on local circumstances (see sidebar "A geographically diverse consumer base").

These trends bear witness to a transformation in the behavior of the Chinese as they develop into some of the world's most complex consumers. China is now the planet's second-biggest economy, after the United States, and its consumer sector may be the healthiest of any major country. In the past, consumer companies could enter China with their existing products, strip them down to basics, and then sell them at low prices throughout the country, thus hitching their wagons to China's double-digit consumption growth. Today, local consumers, like those in developed markets, appreciate and demand better products. Many companies that have struggled to find a niche in China may therefore now find a market for their products and attract partners. Conversely, companies that have relied on low-cost, low-quality business models may end up on the losing end of trade-off decisions and could require a shift to value. In this article, we highlight the major changes in Chinese consumer behavior and offer some ideas about how to address them.

### **Fewer trips, bigger baskets**

Historically, Chinese consumers have shopped about five times a week more often than their US counterparts, but their average basket size has been only a quarter of the US equivalent. Our research this year, however, found that shopping frequencies were declining and basket sizes growing. Overall, in China's home and personal-care category,

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## About the research

McKinsey Insights China conducted its first study of Chinese consumers in 2005 and has since surveyed over 46,000 of them. The 2010 survey,<sup>1</sup> conducted from December 2009 to March 2010, covered 15,000 consumers in 49 Chinese cities across all major geographic regions, city clusters, city tiers, and income segments. The research addresses the evolution of the Chinese consumer's overall attitudes, behavior, and preferences and identifies purchase patterns and

motivations relevant to key consumer goods categories, including apparel, automotive, consumer electronics, food and beverages, and home and personal care.

<sup>1</sup>Yuval Atsmon et al., "2010 Annual Chinese Consumer Study: Trading up or trading off? Chinese consumers become increasingly pragmatic," McKinsey Insights China, August 2010.

the number of weekly purchasing trips fell from 0.6 in 2008 to 0.5 in 2010; the average basket size rose from 18.42 renminbi in 2008 to 24.10 renminbi in 2010.

The trend toward fewer but more costly shopping trips reflects the Chinese consumer's convergence with developed-world norms. One reason for this change is that Chinese shoppers are increasingly attracted to modern retail formats such as hypermarkets, which offer a broad selection of attractively priced goods of consistent quality. Also, the Chinese have more money than they did and can spend more on each shopping excursion, so they don't have to waste time making multiple trips to stores. This finding suggests that as the Chinese consumer's quality of life improves, time becomes more valuable.

One unusual aspect of the evolving behavior of Chinese consumers is their enthusiasm for shopping as entertainment: families transform shopping trips into fun days at the mall or hypermarket. In our survey, some 73 percent said they regarded shopping as a leisure activity, 45 percent identified it as one of their favorite pursuits, and just over half said it was among the best ways of spending time with the family. Those numbers are greater—by an order of magnitude—than those for consumers in the West. Chinese consumers often shop without any intention of buying. Sometimes they are window-shopping or comparing prices. At other times, they may be shopping as a sport, competing with friends to find the best deals.

Chinese consumers still shop much more frequently than their counterparts in developed markets do, but we expect the trend to fewer visits and bigger basket sizes will continue, at least among segments such as young professionals with families. As a result, we think many current global retailing practices will become more relevant in China—from bigger package sizes to home delivery services to loyalty programs. Also, fewer shopping

## Chinese consumers and the Internet

The Internet in China, new McKinsey research shows, is poised for rapid growth and change. It is already an important, even routine, part of making a purchase; Chinese consumers use it to learn about products they have considered buying and to hunt for bargains. Even among the majority who have so far spurned e-commerce, use of the Internet to research purchasing decisions is extensive. And it's striking how quickly connectivity has woven itself into the texture of daily life. More than 75 percent of users agreed or somewhat agreed that "I cannot live without the Internet."

Like most things in China, the numbers are staggering. As of June 2010, China had 420 million Internet users—more than five times as many as India and nearly twice as many as the United States—and was adding new users at a rate of 6 million a month. About half of China's urban population uses the Internet, and one in every seven rural residents. By 2015, we expect, urban Internet PC penetration will reach 66 percent, a level similar to that of Western Europe today, and rural penetration will double, to almost 30 percent. All told, China will have more than 750 million Internet users, including those with mobile devices.

Here we present a summary of the most important findings from our 2010 survey.<sup>1</sup>

### Internet usage in China: Who and how

Compared with the average Chinese citizen, Internet users are younger, more educated, and more prosperous. Of China's Internet users aged 15 to 65, 70 percent are under 34. Forty-one percent have college degrees (but only 25 percent of the population), and 71 percent make at least 55,000 renminbi, the threshold we define as middle class (compared with 33 percent of the population).

For companies marketing to China's consumers, most of the key target audience is already online. Among middle-class Chinese, for example, 88 percent use the Internet. While 47 percent of Chinese aged 35 to 44 are online, Internet penetration rises to 84 percent (in the same age group) among people with a middle-class income and a college degree.

Once the Chinese start using the Internet, there is little difference in the amount of time they spend online (19 hours a week). Even the applications used are similar. Among the five most popular—music and video streaming, instant messaging, social networking, gaming, and reading—there are only minor differences across groups, regardless of age, income, or location.

We do see variations in the way people in different regions use the Internet. In

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the Shenzhen area, just across the border from Hong Kong, 60 percent use e-mail, compared with just 26 percent in next-door Guangzhou. Why such a big difference? More than 85 percent of Shenzhen's residents are migrants, compared with 27 percent of Guangzhou's; they use e-mail to stay in touch with family.

### **Reaching Chinese consumers on the Internet**

For marketers, an important question is how much to spend on the Internet and how to spend it. TV remains the biggest expense for large advertisers; spending more online, then, implies spending less on television. In fact, recent inflation in the cost of TV advertising, combined with a decline in viewership, means that advertisers must spend more today than they did a few years ago to reach the same number of viewers.

Many advertisers are therefore awaiting the tipping point when Internet advertising becomes a real alternative to TV. In McKinsey's view, they will have to wait at least a few more years. The Internet is far from replacing TV as a way to communicate with consumers. In 2010, an average of 85 percent of them, across a number of categories, said they had received information from TV in the previous two months. That's a big number but a noticeably lower one than gave the same response in 2008—98 percent. Online sources, by comparison, reached, on average, 24 percent of consumers. The mass reach of television means that it remains

essential. Many Chinese consumers won't even consider brands they haven't first seen on TV, believing that those capable of affording expensive advertising spots must be backed by successful companies.

But the Internet has its own advantages. In our 2010 survey, more consumers rated online advertising (56 percent) than TV (46 percent) as credible—a stunning change in perception. In 2009, TV ads were credible to 55 percent of consumers and online ads to only 26 percent. The Internet is gaining clout in other ways too. One in four Chinese Internet users will not purchase a product before researching it online, a sharp increase from 2008. Then there is the growing credibility and popularity of social media, an increasingly important factor in motivating product and brand choice.

Another important consideration is that the Chinese trust the Web sites of retailers and manufacturers and are more likely than consumers in other countries to go there for information. In the United States, consumers prefer to consult consumer and third-party reviews. Of Chinese consumers doing research before purchases, 66 percent browsed company Web sites.

### **Online shopping**

Online sales are growing fast in China but are still limited—no more than 2 percent of the total, McKinsey estimates, although the numbers are difficult to track. So it isn't surprising

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that for many companies, e-commerce, by and large, has not been a high priority.

But that may be the wrong way to look at the market; if you consider instead growth and potential, e-commerce matters. The market research firm iResearch estimates that China's online retail market nearly doubled in 2009, to \$39 billion, from \$19 billion in 2008. That makes it the world's second-biggest e-commerce market, after the United States (\$156 billion). And the Chinese e-commerce market could get much bigger: only a third of the country's Internet users shop online, compared with two-thirds in the United States.

Once people start buying things online, the Internet can quickly command a sizable share of their shopping. Apparel is the most popular category, accounting for 36 percent of online Chinese consumer goods spending;

personal digital products come next, with 29 percent. In food and beverages (the biggest retail category), e-commerce is still nascent—only 8 percent of online consumers buy them online. That accounts for just 2 percent of online sales and 0.2 percent of all such spending.

Online shoppers are even younger, more educated, and wealthier than online users: 75 percent of online shoppers are 34 or younger, 53 percent have a college degree, and more than half are middle class or above. It's worth noting that the top 20 percent of online shoppers account for 70 percent of all sales—and this group is still younger, richer, and better educated than the rest.

<sup>1</sup>Yuval Atsmon et al., "2010 Annual Chinese Consumer Study: Digital nation on the rise: Profiting from China's Internet revolution," McKinsey Insights China, September 2010.

trips mean fewer chances to hook consumers, so companies will have to maximize each opportunity, perhaps using promotions such as instant coupons and bundled-product discounts. Compelling in-store displays will rise in importance.

Attracting consumers to the stores will increasingly be front of mind. In several cities, the French hypermarket chain Carrefour runs a fleet of regularly scheduled buses for shoppers and offers free parking. In the future, making the shopping experience even more a form of family entertainment could prove fruitful—for example, putting restaurants on the premises of stores, adding children's play areas, or opening adjacent movie complexes.

### **More than the basics**

For years, Chinese buyers have regarded a product's functional attributes—does it work reliably or taste good?—as the most important buying factor. That's still true, but our



survey also found a shift toward more sophisticated criteria. Flat panel-TV buyers, for example, are now concerned not only with picture quality but also with aesthetic appeal or innovative features. Purchasers of laundry detergent increasingly demand a “good scent” (up to 61 percent this year, from 40 percent in 2008) and “appealing package design” (28 percent today, compared with 16 percent in 2008). As in other parts of the world, this development reflects a transition to an environment where consumers have the means to demand more than basic product features, and catering to refined tastes is increasingly the norm.

Nonetheless, a local perspective informs purchase decisions. After a spate of food safety scandals, Chinese consumers, like their counterparts in the developed world, have become more health conscious. Much more than elsewhere, fear of possible contamination has driven a broader concern about unsafe products, especially everything used by children (food, beverages, toys, and apparel). As a result, Chinese mothers have become among the most sophisticated in the world at looking for materials or ingredients they deem potentially harmful for their children.

Chinese shoppers are also moving in the direction of consumers elsewhere in that emotional considerations increasingly influence purchase decisions. In particular, the importance of any given purchase’s status value has grown strongly since 2008, especially for aspiring or lower-middle-class consumers, for whom the appearance of success is most significant. Another fast-growing key buying factor is the “what fits me” (or “what’s good for me”) category emerging in China’s younger (and more affluent) mass-market demographic. These shoppers are less concerned about following the crowd or the way what they buy defines them in the eyes of others than about how specific products fit their real-life needs. This factor is the main reason consumers trade up when their circumstances change and also explains why they tend to be more satisfied with better products. The “what fits me” mentality, prominent mainly in major cities such as Shanghai, will probably grow in significance nationwide as incomes rise throughout the country.

In addition, intangible, emotional factors are beginning to drive the purchase decisions of younger, often better-off consumer segments. This trend favors companies that had problems marketing products in China but can now create effective strategies resembling those long used in Western markets. These companies could create emotionally driven consumption occasions (in social settings, for example) or introduce brands aimed at satisfying emotional needs (for example, self-indulgence or rewards).

### **Brand appeal, but only at the right price**

One tenet of Chinese retailing is that consumers are extremely brand conscious: 45 percent believe that higher prices correspond to better quality, compared with just 16 percent in the United States and 8 percent in Japan. Likewise, far more Chinese consumers than shoppers elsewhere are willing to buy more expensive branded products.

## A geographically diverse consumer base

In our 2009 China consumer study,<sup>1</sup> we introduced the McKinsey ClusterMap, a way of segmenting the country's many discrete markets not only by geography and city tier but also by income, dialect, economic and trade linkages, and common consumer attitudes and preferences. This approach helps companies to identify synergies among sales forces, distribution channels, and supply chains and to access more coherently defined demographic groups than would be possible on a single-city basis or simply by carving up China into arbitrary geographies. Regional variations can have a major impact on the way the trends outlined in this article play out. Consider a few examples.

1. **More than just the basics.** The overall trend holds true in most clusters. Nonetheless, the importance of status as a key buying factor for purchasers is far greater in Shanghai than in the cluster around Wuhan, where sales for the high-status category declined sharply from the 2008 to the 2010 surveys.
2. **Bigger baskets, fewer trips.** The trend toward larger basket sizes but fewer shopping trips holds for most city clusters, but not all. Some registered no change, while the central cluster (cities surrounding Zhengzhou) and the Chengdu cluster reported increased shopping frequencies and,

in the case of Chengdu, decreased basket sizes.

3. **Smarter shopping and word of mouth.** Significant deviations from the norm also occur, most prominently in Shenzhen, the only major cluster to report a preference for TV ads over word of mouth as a source of credible product information. This peculiarity may result from the high proportion of Shenzhen's population who come from other parts of the country and thus live away from their extended families. In addition, Shenzhen's consumers appear to have a disproportionate preference for what, in other clusters, would be considered niche channels, such as bus ads and billboards.

No one-size-fits-all approach will work in China, because consumer behavior patterns differ widely across regions and income groups. Managers should tailor their product portfolios to meet local tastes and manage by geographic clusters that cater more effectively to the country's evolving consumer environments.

<sup>1</sup>Yuval Atsmon et al., "2009 Annual Chinese Consumer Study, Part II: One Country, Many Markets—Targeting the Chinese Consumer with McKinsey ClusterMap," McKinsey Insights China, September 2009.



Chinese consumers are extremely pragmatic, however, so they base purchase decisions on more than just branding. Indeed, the fact that Chinese consumers are conscious of brands does not necessarily mean they are loyal to them. While consumers tend to gravitate toward the biggest brands, the assessment of relative value offered by a handful of competing products is often the basis of choice. Our survey showed that 23 percent of shoppers in China would go out of their way to buy from stores that offered the best prices, compared with 18 percent in the United States and 12 percent in Japan. While quality remains a critical consideration, value is the most important one.

Chinese shoppers first budget for purchases, then compile a shortlist with a handful of specific brands, and finally hold a “beauty contest” to determine the most appealing one. The decision often involves significant research, perhaps conducted in leisure time window-shopping. Since consumers generally make the final purchase decision in stores, promotions and ads in their premises are still effective to tip the balance toward particular brands. In addition, promotions often lead shoppers to make impulse purchases as they seek to maximize value by stocking up on perishables.

### **The pragmatic trade-off**

As income rises in China, so does the desire to buy more and better products. In our survey, we found that three-quarters of urban households said they had traded up in at least one product category. This trend accounted for half of all consumption growth nationwide in 2009. But trading up is only half the story. Chinese consumers are doing so by explicitly choosing to finance increased spending in categories that mean the most to them by “trading off”—cutting expenditures—in less important categories. That’s why 2010’s 74 percent upgrade rate is misleading (Exhibit 1); in reality, only 24 percent of consumers upgraded without trading off. Fully 50 percent of Chinese urban residents actively traded off spending increases in one product category with reductions in others. Trading up in one to three categories involved corresponding reductions in as many as seven (Exhibit 2).

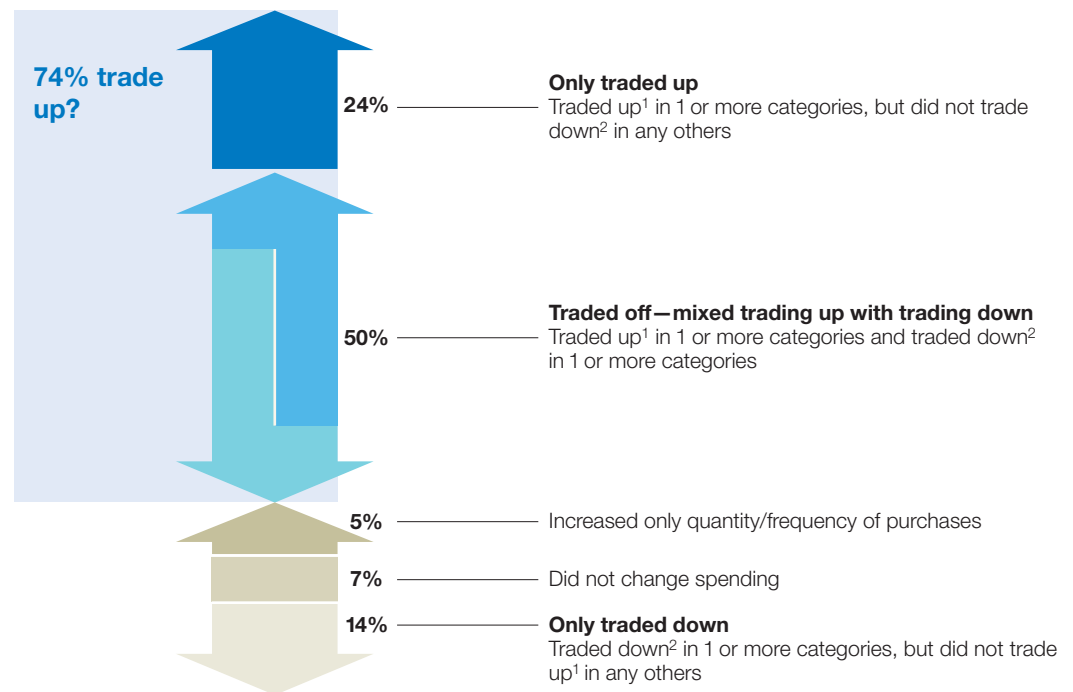
Obviously, trading off isn’t a specifically Chinese phenomenon. When we compare China with developed countries, differences are clear, however. Consumers elsewhere tend to trade up as they get wealthier. Some start relying on credit, often spending more than they can afford. Not in China. Consumers there remain very concerned about financial stability and spend within their means. When Chinese consumers decide to spend more in a category they particularly value, they generally trade down in one or more less compelling categories. These behavior patterns underline our assertion that the Chinese have become among the world’s most pragmatic consumers, willing to make explicit choices about spending their growing income. This is an important insight for marketers seeking growth opportunities.

Our survey found significant trade-off activity in seven product categories. More than 70 percent of trade-up demand for dining out and 50 percent for alcohol come from

## Exhibit 1

## The survey's initial conclusion—that three-quarters of Chinese urban consumers traded up on quality and price—is misleading.

% of respondents



<sup>1</sup>Traded up: bought the same amount of a particular product but at a higher quality and price.

<sup>2</sup>Traded down: either bought the same amount of a particular product, but at a lower quality and price, or purchased less of the product at the same quality and price.

Source: 2010 McKinsey survey on Chinese consumers

white-collar men who want to improve their standing with clients or colleagues and trade down on personal-care and packaged-food and snacking products to balance their overall spending. Some 80 percent of trade-up demand for higher-quality clothing, shoes, and accessories came not from high-income “fashionistas” but from lower-middle-income consumers looking to impress job interviewers or advertise their ascent from the working to the consumer class. In each case, trade-down decisions in three to four product categories balanced increased spending.

This distinctive consumption trend has implications for the way companies develop local marketing strategies. For one, they can invest more in consumer education (for example, through corporate Web sites or in-store promoters) to encourage trading up. Manufacturers that focus on convincing consumers of the importance of a particular category—and, within it, of a better, more expensive product—have a stronger chance of persuading potential buyers to upgrade in that category rather than another one. Apparel

manufacturers, for instance, often emphasize the importance of owning better, trendier clothes to showcase one's status. We find that consumers who buy into this idea are much more likely to upgrade their purchases of clothes and accessories, trading off in other categories.

Companies can also use cross-category promotions to influence purchase decisions in a category consumers have targeted for upgrading. Since consumers who upgrade their entertainment venues may well upgrade their alcohol consumption, wine and spirit vendors might partner with trendy bars and restaurants. Consumers who upgrade dairy products are likely to upgrade their snacks, chocolates, and health supplements, creating further copromotion possibilities.

### Smarter shopping and word of mouth

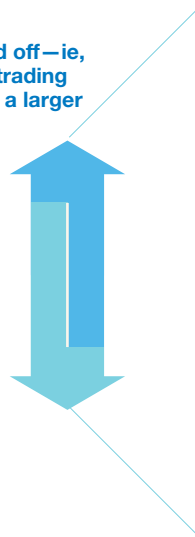
Chinese consumers have adopted various techniques to help them decide which products to buy. Online comparisons or reviews are increasingly important research tools for younger audiences and for the middle class and above—the Internet had about 420 million users in mainland China by June 2010.<sup>1</sup> These trends are broadly in line with consumer behavior throughout the world.

<sup>1</sup>July 2010 report from the China Internet Network Information Center (CNNIC).

Exhibit 2

## Half of Chinese urban residents traded off higher spending in one product category against spending reductions in others.

Consumers who traded off—ie, mixed trading up with trading down—traded down in a larger number of categories.



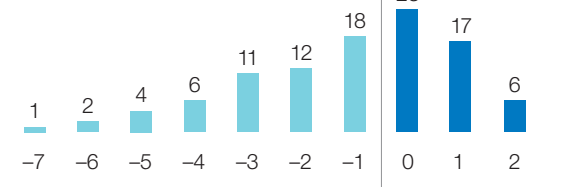
% of respondents who traded up or down

Traded down<sup>1</sup>

54%

Traded up<sup>2</sup> or stayed the same

46%



**Net number of categories traded** (for example, a consumer who traded up in 5 categories and traded down in 7 is counted in the -2 column)

<sup>1</sup>Traded down: either bought the same amount of a particular product, but at a lower quality and price, or purchased less of the product at the same quality and price.

<sup>2</sup>Traded up: bought the same amount of a particular product but at a higher quality and price.

Source: 2010 McKinsey survey on Chinese consumers

In our 2010 survey, 56 percent of Chinese consumers said they regarded online advertising as credible, up from 29 percent in 2009. Similarly, 70 and 67 percent of Chinese shoppers said they found retailers' and manufacturers' Web sites, respectively, credible. (In the developed world, by contrast, consumers prefer to get product information from third-party sites.) The fact that online information is so highly regarded in China makes the Internet extremely important for shaping consumer opinion. On average, 25 percent of mainland shoppers said they never buy a product without first checking the Internet, compared with half that percentage in the United States. For big-ticket items, the proportions can be significantly higher in China, approaching 45 percent for autos.

Chinese consumers do much more research before purchasing a product than average consumers in the developed world do, so middle-class consumers often take a long time to make decisions, if only because some things can cost more than their monthly income. In a survey on PC purchases, for example, Chinese consumers said they might take three to six months to buy a computer and visit a store three to five times. Decision making is especially protracted for big-ticket items but can take quite a while for foods, beverages, and personal-care offerings, as well, given the increasing number of brands and new products available.

Word of mouth has grown strongly in recent years as a source of consumer information: shoppers are sounding out family and friends and getting advice online through chat forums. True, television advertising continues to dominate in China as an information channel for products and brand awareness. But word of mouth is by far the next most popular source of leads: in 2010, 64 percent of respondents said that it influenced their purchasing decisions, compared with 56 percent in 2008. Word of mouth and online research also play an important role in complementing TV ads by helping consumers to analyze the merits of different products and to arrive at their final decisions.

Word of mouth may be more powerful in China than in developed countries. An independent survey of moisturizer purchases, for example, observed that 66 percent of Chinese consumers rely on recommendations from friends and family, compared with 38 percent of their US counterparts. Word of mouth seems to have become such an important channel because a huge number of brands and offerings now tempt Chinese consumers—who are not accustomed to such product diversity—as well as the fast pace of product innovation. While TV demonstrates which brands are big (and therefore a “safer” choice), it is not a trusted medium; in-store information is critical but mostly influences the final decision. Chinese consumers therefore want to shape their short list with help from family and friends. Often, they also aim to make sure that their choices make them look smart.

For companies, these findings suggest that it has become essential to invest in and develop a world-class Web site that provides extensive information to consumers. Viral

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marketing is crucial too. In one product category we recently researched, we found that recommendations from SMS (short message service) text messaging accounted for nearly a quarter of the influence on the final brand selected. Some manufacturers have set up sites on the Web to promote discussion of their products in forums they control.



One of the clearest messages from our 2010 survey is that as Chinese consumers become more like their developed-market counterparts, they are also creating a distinct identity. They have not only distinctive tastes and priorities but also unique ways of choosing and buying products. As new offerings emerge and more people in China find themselves with significant discretionary income and choices, consumer product companies must adapt their strategies to capture the opportunity. ○

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