

# What's driving the Chinese consumer

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Confidence keeps rising among the country's consumers, despite economic headwinds—but just what they are buying (and where and how) is evolving rapidly. Companies should pay attention.

**The Chinese consumer** has become much more health conscious and more focused on value—although that doesn't mean they want cheap products. On the contrary, a new survey by McKinsey principals Fang Gong and Daniel Zipser finds that Chinese consumers are spending on luxury items as well as services, and often do so when traveling abroad—where they sometimes find better prices. In this episode of the *McKinsey Podcast*, Gong and Zipser talk with McKinsey's Glenn Leibowitz about the important trends emerging among Chinese consumers, and the opportunities—and challenges—they present companies and retailers.

## Podcast transcript

**Glenn Leibowitz:** Hello, and welcome to the *McKinsey Podcast*. My name is Glenn Leibowitz, and I'm the head of external relations and publishing with McKinsey's Greater China Practice. I'm based in Taipei, Taiwan. Today I'm speaking with Daniel Zipser and Fang Gong. Daniel leads McKinsey's Consumer Practice in Greater China and is the author of a new report on the Chinese consumer,<sup>1</sup> which we're going to talk about today. Fang Gong is a partner who covers the consumer sector in China as well, and he'll be joining Daniel to share his perspectives on some of the key findings from the new report.

Daniel, before we dive into what you learned from the survey, tell us about why you decided to conduct the survey in the first place. How did you go about doing it?

**Daniel Zipser:** We have been conducting research annually on the Chinese consumer since 2005. The 2016 report is based on a survey of 10,000 consumers, with face-to-face interviews in 44 cities. The tension this year is particularly high, given the whole world is looking at China's economy. Observers are eager to better understand what is driving the Chinese consumer today. How is Chinese consumer confidence? Is the Chinese consumer still spending? We

<sup>1</sup> See Yougang Chen, Fang Gong, and Daniel Zipser, "Here comes the modern Chinese consumer," March 2016, McKinsey.com.

were surprised to see that consumer confidence in China over the past three years has basically not changed.

The Chinese consumer is still confident and still spends both in China as well as outside China when traveling. The one thing that is different today, though, is we no longer see broad growth across all of the categories or across all of the cities. Parts of China have seen a decline in growth, sometimes even negative growth in some of the categories. But other parts have increases in spending and confidence. Particularly interesting are the coastal areas: if you take the area around Shanghai, you see that consumer confidence has further increased over the past three years.

At the same time, in northeastern China, take Harbin as an example, you see a steep decline in consumer confidence, given the overall macroeconomic situation. If you just look at averages, there's no change. If you go one level deeper, you see fundamental changes.

**Glenn Leibowitz:** What are some of the trends you're seeing in this year's survey?

**Daniel Zipser:** We see a Chinese consumer who's still spending, and the consumption of the Chinese consumer increased by double digits last year. You see a shift from products to services, where a consumer's no longer increasing how much he eats and how much he drinks, but instead he's spending more on entertainment—be it to movie theaters or for weekend trips. This is where the consumption is moving to. This is very different compared with when we've researched the Chinese consumer in past years. Today, we clearly see that trend.

At the same time, you also see a trend toward “premier-ization.” In many food and beverage categories, the actual volume growth, or how much people eat and drink, is flat. What is driving the overall growth for our food and beverage clients is a large increase in the price the consumer's willing to pay. Today, the Chinese consumer is looking for the best and the most expensive products, so you see premium companies and premium brands—be it in the auto space, in the cosmetic space, or in the alcohol space.

**Glenn Leibowitz:** One of the trends that you highlight in your report is a growing loyalty to brands. You say consumers are considering fewer brands these days and are sticking to the ones that they trust. Tell us a more about that.

**Fang Gong:** A couple years ago, when we talked to our clients in the consumer and retail industries, we heard a lot of complaints about the low loyalty level of Chinese consumers. Today, based on the reports, we cannot say that it's completely changed, but we can say that the loyalty level of Chinese consumers has been improving. Probably not to a single brand, but to a short list of brands that are in the consumer's consideration set—and not only in their daily consumption category, such as food or apparel, but also in big items, such as automotive.

There are two reasons behind that. One reason is, of course, because the Chinese consumers are more sophisticated now compared with before. They have experienced a lot of different brands, and they can tell which one is better than the other one. On the other hand, Chinese consumers, thanks to social media, have been influenced by what other people have experienced with certain brands. It's no longer necessary that they have tried these brands before.

**Daniel Zipser:** It's very interesting what you're saying, because I see many people, particularly foreigners, accusing the Chinese consumers and saying, "You know what? If there's a cheaper deal, they just jump, and they just buy something else." That may have been true in the past, but if you enter the market and are just a cheap new brand, there's no way you will be successful. Chinese consumers stay with brands on their short list. It's extremely difficult for a new brand to enter the China market.

**Fang Gong:** When we talk to clients, we always emphasize that Chinese consumers are not looking for low prices. They're looking for value. The value could be low price but it could also be high-quality goods with a reasonable price. That being said, we do expect Chinese consumers will continue to improve their loyalty level. At some point, they will be very loyal to certain brands.

**Glenn Leibowitz:** So healthy living is another interesting trend that you mention in your report that is on the rise. People are not just working all the time—they're actually starting to enjoy themselves and also care more about what they eat and how they take care of themselves. They're starting to exercise more. What did you find in your survey around this trend?

**Daniel Zipser:** As long as I can remember, people have talked about it. You see this emphasis on seeing Chinese consumers becoming more health oriented. To be honest, that conversation has been going on for ten years. But only a year ago did it really break through. If you look today, the number of Chinese running and doing exercise is higher than in the US. Sports-performance products have really increased. I have not seen any Chinese without wrist bands while jogging and exercising. It is a different world compared with what it was two or three years ago.

**Fang Gong:** If you look at the people around you, many have some kind of band on their wrist. The band I wear is from a local Chinese company with only a two-year history. But last year, they sold 12 million units, which makes them the second-largest wearable-device company in the world.

On the other hand, if you look at what people post on WeChat, people used to post about the restaurants where they dined, or pictures of their friends and family. But now you see that people post pictures after they go running, people post pictures after they exercise in the gym, or they post statuses from their sports bands. That's clearly a trend that we see in the market.

**Daniel Zipser:** What I like about that example is that we are so often asked the question, “Is China different?” And, “Aren't those all global trends?” This is a perfect example that this is not a China trend. The whole world is looking for health and well-being.

**Fang Gong:** Chinese people like food, but if you go to the shopping malls, if you go to the prime locations, you can see that clearly the fast-food chains are starting to disappear from those very prime locations. Replacing them are the restaurants that emphasize organic food and healthy dining.

**Glenn Leibowitz:** That's fascinating. Thanks for sharing that. What about family focus? I've been here for a while and, to me, the Chinese have always been family focused. That's just the way I see them. What have you seen that has changed, say, in the past few years, that was reflected in the survey that you conducted?

**Fang Gong:** We see that recently people have been emphasizing, in terms of their consumption behavior, that they try to find time with the family. One example I can give is shopping behavior. When we did the report in 2012, we saw that when Chinese consumers go shopping, they went with the family. That's one of the major activities during their weekends.

This year, when we redid this research, we found that people continue to spend a lot of time with their families during the weekends in shopping malls. But their demand or their requirements have changed. In the shopping malls, they're not only looking to purchase stuff—they're looking for experiences, spending time with their families. The stores in the shopping mall, roughly 20 or 30 percent of them, are stores selling products. A major part of these stores in the shopping malls are cinemas, restaurants, playgrounds for the kids, as well as gyms and also beauty spas.

I take my daughter to shopping malls very often with my family during the weekends. Because of the sometimes foggy weather in Shanghai, my daughter has to go to those shopping malls to have fun. Our family has five different memberships from different indoor playgrounds in five different shopping malls. Before we go, we normally ask our daughter, “Which one do you want to go to?” The five options are totally different. Then she will pick one, and that will decide where the whole family will go. We have lunch there with my wife, with my daughter, and with my parents or my wife's parents. My daughter has a lot of fun. Then my wife and I may go to watch a movie after lunch, while my parents take my daughter home. I'm sure that's a very typical day for many of the families in China.

Another example is the travel industry. We can see a clear trend that Chinese consumers, when they decide where to go in terms of domestic travel, they're looking for good resorts, close to the city—also places with good activities, with good restaurants, because they are spending the weekends with their families.

**Daniel Zipser:** I often get the question, “Is retail dead?” Physical retail. The question makes sense, given China is by far the largest e-commerce market in the world and has the highest online penetration. At the same time, it’s also clear from looking at the Chinese consumer that physical retail is still an absolutely critical and important part of the shopping experience.

There is so much talk about online-only brands, and there may be exceptions where that is true. But in general, the physical interaction with the brand and the physical retail location remains important. It may not always be the sole purpose where the transaction happened. If you take a comprehensive view from a brand perspective, you do need to be able, as a brand owner, to cover the physical retail in order to create the experience and to cover the online site to fulfill the transaction.

**Fang Gong:** A couple of years ago when Alibaba rolled out or sponsored a couple of online-only brands, a lot of consumer brands were scared, because they were afraid that with this pure online model the physical-model players would be driven out of the market. Now we do see a trend of merging between online and offline. Those traditional offline players have been spending aggressively on the online space, rolling out what we call an omnichannel strategy. But for the pure online players, they are also spending on offline. They are opening stores so that consumers have a good experience with the product, which will in turn drive traffic or the purchase back to the online store. We do expect that e-commerce in China will continue to grow rapidly. On the other hand, the physical store will remain critical in terms of the consumer experience.

**Daniel Zipser:** It makes complete sense. Take your example with your daughter going to the shopping mall and being able to go to a playground on the weekend. That’s where she experiences the toys. That’s where she experiences all those great kids’ brands that we have in China. You may later decide to buy them online, but your daughter’s having the experience in the playground, in the malls where you take her on the weekends.

**Fang Gong:** Yep, exactly.

**Glenn Leibowitz:** Daniel, Chinese consumers seem to love to travel overseas. When they travel, they like to shop. What stands out in your survey about this trend? What did you see?

**Daniel Zipser:** Chinese people have always liked to travel and see new things, so I don’t think that’s new. I think what is new is that the scale is at reach. You have more than 100 million trips of Chinese outside of China, overseas. What has also changed is the magnitude of spending, shopping outside of China. If you take categories such as handbags and the skin-care category, you have a substantial part of the total consumption of China actually not happening within China. But people do travel, and a third of them choose the location where they travel to based on where it’s best to shop.

Half of the handbag spending of the Chinese has actually not been in China but has been outside China. That has big implications for our clients. First of all, many of the luxury-goods companies do not see big revenue increases in China today, because Chinese consumers use the opportunity to travel overseas to buy, particularly luxury goods. They experience a lower price. They may buy for their friends. So it is a new challenge for companies.

If you take the Chinese who last year traveled outside of China, of their total spending—including all the rent, what they paid for their kids' education, and insurances—30 percent of the total spending actually has not been inside China but outside of China. It has reached a magnitude that is no longer possible for any brand owner to ignore.

**Fang Gong:** The implication to the business world, on the one hand, is how to capture the Chinese overseas consumer spending. But on the other hand, what we saw from many of our clients, especially from the international clients, is how can they do the pricing right in China versus overseas?

Because not only in the luxury segment but also in the mass market, we do see that there's a pretty big price difference between the same products sold in China versus those sold in the US or in Europe or even in Hong Kong and Taiwan. So that creates a big price-arbitrage opportunity for Chinese consumers, who may purchase the product when they travel abroad or may use cross-border e-commerce to get products. So pricing will be a big challenge for a lot of these international brands.

**Daniel Zipser:** There's another thing that is a clear opportunity. If you think about how long the Chinese travel outside of China, it's a week or two at most. The rest of the year, there needs to be a way to create an opportunity for the Chinese consumer who experienced new brands, new products outside of China, to buy those products. You mentioned cross-border e-commerce, which is a critical element of that. It does allow people to buy products in China that may not be available in the Chinese market in stores yet. That is a great opportunity.

It does come with a challenge, though, because you have the problem of how to position a brand. Do you just take the Italian positioning and apply it to China? How do you deal with a situation where the Chinese consumer experiences the brand even before it is launched in the Chinese market? It changes the world, and it changes how Chinese consumers experience brands during a launch.

**Glenn Leibowitz:** Do you have final observations about your report that you want to share?

**Daniel Zipser:** The main finding from the report is that, despite the economic situation China is in today, Chinese consumers remain confident—and in 2015 they continued to substantially increase spending, be it within China, be it outside China. We do see shifts—from buying products to buying services, and from buying mass products to buying premium products.

**Glenn Leibowitz:** Fang, are you still pretty optimistic about the Chinese consumer?

**Fang Gong:** Yes. Chinese consumers will continue to spend despite the slowing down of the macroeconomy. They're also asking for more. The bar has been rising, and their needs have diversified, so consumer-goods companies or retailers need to follow the consumer trends.

**Glenn Leibowitz:** Daniel, Fang, thanks so much for joining us today. Thanks for listening to our conversation. If you'd like to download this report, head over to [McKinsey.com](http://McKinsey.com).

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