Macroeconomic Evaluation of China's Consumers

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With China's economic rise, a new type of consumer is being born. Incomes are rising, consumers are feeling increasingly optimistic about their financial futures and new consumer demographics are emerging.

The Global Financial Crisis in 2008 had caused economic downturn in most of the world, yet it did virtually nothing to curb China's growing retail sales, which were estimated to have steadily increased by at least 11 percent year-on-year since 2007.

This more curious and affluent market has driven up demand for foreign goods. As such, with sales sagging abroad, a variety of foreign firms are looking to sell to the Chinese consumer market.

Multinational department store chains such as Walmart and Carrefour; global automakers from BMW and General Motors; and international fashion retailers such as Gap and H&M have all contributed to this growth within the last few years, and have already established a strong foothold in many major cities. Business failures (such as Best Buy's pull out of the country) have been hotly discussed, but the massive market potential has left many foreign companies undeterred.

In the 2011 PwC Global CEO Survey, 33 percent of retail CEOs dubbed China the most important company for growth over the next three years – quite a powerful statement of confidence in the rise of the Chinese consumer.

This all begs the question of what ever happened to the thrifty (or yet unempowered) Chinese consumers, with one of the highest savings rates in the world. Alive and well...yet a demographic in transition. The real excitement about the Chinese consumer is largely based on potential.

China's consumer spending composes a surprisingly small portion of its economy. Private consumption accounts for only 36 percent of China's GDP, a low figure compared to other major economies. For the United States, United Kingdom and Japan, consumption adds up to approximately 71 percent, 67 percent and 55 percent respectively.[1]

Low private consumption is largely due to the country's traditional strategy for economic growth. China has long inhibited local consumption in favor of the accumulation of capital, followed by heavy investments into local production and export goods.

This can be seen in some of the older financial structures of state-owned enterprises (SOEs), which typically did not have a standard system of issuing dividends. Instead, earnings were often retained by companies, and invested into projects that can generate even more capital. Since SOEs represent a large portion of China's growth, their inability to pay out their profits to the investing public are seen as a major cause for China's low consumption. Further, the salary structure of such firms tends to put a great deal of money in the hands of a just a few...hardly empowering the consumer masses.

On a microeconomic level, combined with a widely-held tradition of frugality (to which different analysts attribute different levels of influence on savings rates), many potential consumers save large amounts of money for necessities such as healthcare and especially education. Even as China's consumer credit system is expanding rapidly and credit becomes more available, not many consumers are actively using it.

Some academics hold that the Global Financial Crisis of 2008 was a wake-up call for many of the country's officials and business leaders. Academics from this camp hold that the financial crisis demonstrated just how vulnerable the industry and export-centered economy is to foreign shocks. Others hold that – while pre-2011 indicators may have suggested such a transition – the Chinese government has yet to take any real action to empower its consumer masses.

Key to the potential of the Chinese consumer is age. The growing demand for more expensive foreign name brands and imported goods (especially the case for the industries in food, clothing and luxury items), is largely from China's younger generation. Surveys have shown that the majority of Chinese consumers for luxury products are aged between 20 and 40 - considerably younger than those in the United States and Europe, who are typically in the 40 to 70 age range.

This spending is believed largely to be based on a sense of financial security and future optimism, as the prices for these goods are relatively constant between these countries, yet the younger Chinese shoppers are not earning more than their Western counterparts.[2]

High Potential Sectors to Sell to China

Among the growing sectors with the highest potential in retail sales are healthcare and food and beverages. Increasing penetration to lower-tiered cities will only continue to foster this opportunity.

[1] McKinsey & Company. Unleashing the Chinese Consumer. 2010

[2] KPMG. http://www.kpmg.com/CN/en/IssuesandInsights/ArticlesPublications/Documents/Luxury-brands-China-200703.pdf

Healthcare and Pharmaceuticals

China has long been ramping up its local healthcare standards, and it is small wonder that sales in healthcare and pharmaceutical products have had annual growth rates of 15 to 20 percent within the last few years. The central government has created state-wide programs such as the National Essential Drug System in 2009, which seeks to increase healthcare provisions to all government-operated clinics across China. As a part of this plan, a list of essential drugs is to be maintained and made available at each of these institutions for an extended period of time.

A relatively lenient healthcare regulation in China also means that there is a lot of leeway for product and technology innovation within this sector. As healthcare is often regarded as essential, products have an almost universal appeal and their overall demand is unlikely to slow down. Together with rising personal incomes, stronger demand for better quality products and the fact that new markets are continuing to be penetrated at lower-tiered cities in the west, healthcare companies will have a huge room for growth in the coming years.

Food and Beverages

While food and beverage chains are already widespread in most Chinese cities, their annual growth in sales have consistently been 10 to 15 percent in the last three years. Similar to healthcare, they are essential products, but they can be heavily diversified to suit varying tastes and demographics.

Foreign companies have already established large fast-food chains such as McDonalds, Kentucky Fried Chicken and Pizza Hut, as well as coffee shops like Starbuck's. Soft drink manufacturers such Pepsi and Coca-Cola continue to expand their sales.

However, recent trends suggest that consumers have become more aware of the relatively unhealthy qualities of fast food and other products. While this may not have a large impact on general sales, it is of note that more and more consumers are now actively pursuing healthier alternatives. Increasing penetration by companies to lower-tiered cities will only continue to foster this opportunity.

A Look at Luxury Goods in China

The Chinese Ministry of Commerce says a reduction in import duties on luxury goods in China is an inevitable trend, owing largely to the significant number of Chinese who currently travel overseas to purchase luxury goods. While such a move would likely have a dramatic effect on China's market for luxury goods, it would likely only fuel the fire of the substantial and rising demand for such goods.

Luxury items have long had a strong appeal to China's increasingly wealthy consumers. Foreign name brands such as Louis Vuitton, Gucci and Cartier have long established a strong presence in China. And with a 16 percent to 20 percent growth within the last three years, according to reports from McKinsey & Company, these products are likely to retain their high demand. Other analysts have predicted that China's annual consumption of luxury goods will reach US$14.6 billion by 2012.

The Chinese market for foreign luxury brands is hot from the point of the Chinese business individual as well - Chinese acquisitions of stakes in luxury-brand companies have totaled US$125 million so far this year, compared with US$69 million for all of last year, according to data provider Dealogic in a June 13 report by the Wall Street Journal.

Chinese consumer demand for foreign luxury goods differs from its Western equivalent and is rapidly evolving.

"In developed markets where the average household income is higher, such as the U.S. or Europe, consumers purchase luxury goods for durability and superior quality. In comparison, in China, luxury goods and services tend to sell because of their high social status and prestige," according to Shian Chuan, regional marketing manager for luxury office-space provider, Servcorp.

In line with traditional principles of modesty and self-restraint, most luxury goods were not marketed as exclusive or glamorous accessories, but as a practical "means to an end" in achieving one's career goals. Luxury goods, and especially those from foreign brands, are seen as finely-crafted items and personal rewards. This way, they reflect a person's ability and success, which would help attract opportunities in a competitive work environment based on achievement and merit.

"Luxury goods and services allow consumers to flex their wealth and high social-status to their peers…to convey their business strength and backing," added Ms. Chuan.

This is particularly true for foreign luxury goods, the quality (and price) of which are largely seen to fully embody the meaning of "luxury."