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RESEARCH

Chinese consumption will reach $6.5T by 2020: BCG

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Image courtesy of Peninsula Hotels

By SARAH JONES

Even with a faltering economy, Chinese consumption is projected to rise $2.3 trillion by 2020, according to new research by Boston Consulting Group and AliResearch Institute.

Households with disposable incomes of $24,000 or more will drive 81 percent of consumption growth through 2020, creating demand for high-end goods and services. With rising incomes, a younger generation gaining spending power and growing ecommerce expenditures, brands will need to adjust their strategies.

"Because the nature of consumption is changing dramatically, the winning strategies of the past are becoming outdated," said Youchi Kuo, a BCG principal and a coauthor of the report. "It will be more important than ever before for companies to target the right income segments and product categories and to be represented in fast-growing online retail channels."

"The New China Playbook: Young, Affluent, E-savvy Consumers Will Fuel Growth" is based on proprietary data. For this report, BCG's Center for Consumer Insight worked with AliResearch, the research branch of Alibaba.

Optimistic outlook

China's government recently lowered its GDP growth projection for the next five years to 6.5 percent, the lowest outlook since the middle of the financial crisis in 2008-2009. However, even if GDP only rises 5.5 percent, Chinese consumption is on the path to almost double in the same period, growing about 9 percent each year to reach $6.5 trillion by 2020.

Part of the fuel for this growth is the nation's switch toward better paying jobs, in industries such as technology and service. The average wages, and the general consumer sentiment about the likelihood of rising incomes, are both on the up.

The Chinese stock market fluctuations have not had a widespread effect on consumer confidence.

After a government intervention meant to curb falling stock prices, the stock market tumble was thought to be under control, but on July 27 the Shanghai Index dropped by 8.5 percent, its largest single-day fall since February. As for the larger economic picture, the stock market does not directly affect China's economy as whole, meaning that a volatile stock market will most likely not directly impact the daily lives of affluent Chinese consumers (see story).

Image courtesy of Four Seasons

As a comparison, 35 percent of Chinese consumers cite rising incomes as an influence on their expenditures, whereas only 7 percent said the stock market could push them to spend more or less.

The population of upper middle class and affluent consumers is expected to reach 100 million by 2020. These consumers with at least $24,000 in disposable income are going to make up almost a third of urban households, growing their spending by 17 percent each year, and are predicted to generate 55 percent of consumption in cities.

These affluent urban dwellers are widespread. BCG estimates that to reach 80 percent of them, brands will need to be available in 430 different markets. This is particularly important as the fastest growth among affluent households will take place in smaller cities.

Spending on services is projected to rise 11 percent, while physical goods consumption is expected to grow 8 percent in the same period. This is in part because affluent consumers shell out a greater portion of their incomes to services than do their less wealthy counterparts.

Chinese consumers outside Louis Vuitton

Once a consumer enters the upper middle class, their spending on categories such as wine, luxury goods, automobiles and international travel rises, boding well for premium products.

Moving up
The "young generation," in effect the millennials in China, is growing its consumption by 14 percent annually. By 2020, they are expected to make up 53 percent of total spend, up from 45 percent today.

Younger upper middle class consumers will spend 40 percent more than their income equals older than 35. They are less worried about money than the "last generation," having been through less economic unrest.

Image courtesy of Value Retail

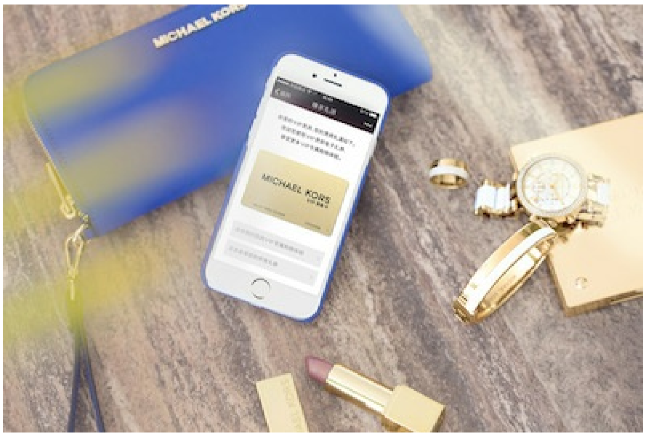
This new generation is more educated, well traveled and sophisticated than older Chinese consumers, making them more discerning and brand aware. Compared to their peers in the United States, Chinese consumers are able to name more brands, feel more of a personal connection to brands and are more likely to act as an advocate for their favorite labels.

Chinese consumers' adoption of ecommerce is also set to create changes. Whereas only 3 percent of consumption was through ecommerce in 2010, online purchases now account for 15 percent of spend.

Online is expected to outpace offline in sales growth up to 2020, growing at rates of 20 and 6 percent respectively. Ecommerce will then represent 24 percent of all private consumption, or $1.6 trillion.

Consumers often turn to ecommerce to get access to products not sold in stores. This is also a place to find premium priced merchandise, leading to greater online purchases among affluent families.

The 410 million online shoppers in China make about half their online purchases on mobile devices today, but by 2020 it is anticipated that three quarters of all ecommerce sales will go through mobile.



Michael Kors WeChat platform

Even with a growing move toward ecommerce, the store environment still holds a place in the purchase process, as Chinese consumers often make contact with products via displays before making an online purchase.

"Ecommerce is transforming China's marketplace," said Hongbing Gao, director of AliResearch. "Our research found that ecommerce actually stimulates new demand in China by filling many needs that aren't being met by brick-and-mortar stores."

Brands need to take into account that what may have worked years ago may not be as effective today.

Luxury brands managed to reap huge profits with crude strategies in China a few years ago, but now only smart marketers versed in cultural norms will survive, according to a China Luxury Advisor partner at Luxury Interactive 2014.

As brands initially set up operations in China, they struggled with awkward localization efforts, overexpansion, sluggish online activities, poor choice of local partners, miscommunications and more. Such mishaps today are becoming unacceptable and brands that want to succeed in China must adhere to several guiding principles (see story).

"Consumer product companies must remain focused on China," said Jeff Walters, a BCG partner and a coauthor of the report. "Not only will China remain one of the world's greatest growth opportunities, but that growth will come from different products and through different retail channels."

Final Take

Sarah Jones, staff reporter on Luxury Daily, New York