



THE COMING OF AGE

China's new class of wealthy consumers

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The authors wish to thank Glenn Leibowitz, Eugene Lin, Vivian Shen, Hai Ye, Jingyi Zhang and Rachel Zheng, for their contributions to this report.

CONTENTS

Executive summary	6
The coming of age: China's new class of wealthy consumers	8
Fast-growing, fast-changing	10
The unique profile of China's wealthy consumers	14
A needs-based segmentation	20
Conclusion	27
Insights China by McKinsey	31

Sidebars:

About the research	9
Retail appeal	13
The power of brand awareness	18
Pricing	26

EXECUTIVE summary

Marketers are well aware of the sudden and fast-growing prosperity enjoyed by Chinese consumers, and many are already seeking to serve the wealthiest. There is much to play for. In 2008, the number of wealthy households in China reached 1.6 million. By 2015, it will have more than 4 million households, making it the world's fourth largest country in terms of its number of wealthy households after the US, Japan and the UK. Moreover, in such a fast-growing and young market, companies can do much to shape the taste, spending habits and loyalty of consumers in a wide range of industries such as automotive, real estate, banking services, consumer electronics and consumer luxury goods.

The scale of the opportunity is such that companies need to tailor their strategies to meet the specific needs of China's wealthy consumers. To help them in their task, McKinsey recently conducted what we believe is the most extensive research to date of these particular consumers to better understand what drives their spending behavior. Some of the research results are shared in this report, which shows three main findings:

1. The fast-growing and fast-changing nature of the segment

The wealthy currently account for less than 1% of urban Chinese households, but their numbers are growing at around 16% per annum. About one half of today's wealthy consumers were not wealthy four years ago, and more than half of those who will be classified as wealthy in five to six years are not wealthy today. At present, the wealthy are concentrated in the East and Central South regions of the country, and around 30% live in China's four largest cities. But a large proportion of the next generation of wealthy consumers will come from smaller ones. We estimate that three-quarters of the growth in the wealthy consumer segment will come from consumers who do not currently live in the four biggest cities.

2. Wealthy Chinese consumers are unique: they differ from both their global peers as well as less wealthy Chinese consumers

The differences are many. Most striking is how much younger they are than their global peers. On average, wealthy consumers in China are 20 years younger than those in the US and Japan. They



are also much better educated than other Chinese consumers and are more often self-employed. There are also marked differences between the wealthiest consumers and most other consumers in China. For example, the wealthy trust foreign brands more, find it difficult to keep a work-life balance, and are more comfortable about borrowing money.

3. The importance of a needs-based segmentation

China's wealthy consumers are not only different from their foreign peers and less wealthy Chinese consumers, they are also different from each other in terms of their attitudes and behavior. We therefore offer a clear and actionable segmentation of China's wealthy consumers that has important strategic implications, some of which we explore in this report.

Current global economic conditions will slow the spending of even the wealthy. But that does not detract from the importance of China's

wealthy consumers to manufacturers, retailers, and service companies across many sectors. Winning these consumers will require companies to innovate and adapt their products, services and marketing strategy, be they companies that traditionally focus on serving the wealthy, or those that have hitherto served mainstream consumers in China but are now considering selling premium products to the wealthy. In the course of the next few years, they can build lasting brands. Our findings will help them in their task, enabling them to better meet the needs of different types of wealthy consumers in China, and to market to them in more compelling and cost effective ways.

In such a fast-growing and young market, companies can do much to shape the taste, spending habits and loyalty of consumers in a wide range of industries.

THE COMING OF AGE

China's new class of wealthy consumers

Marketers are aware of the sudden and fast-growing prosperity enjoyed by Chinese consumers, and many are already seeking to serve the wealthiest. In the course of five years, for example, increased wealth coupled with changing attitudes to the display of wealth have seen sales of luxury fashion goods triple, luxury cars rise fivefold, deluxe villas and apartments rise sevenfold and premium whiskies tenfold.

There is much to play for. Last year, the number of wealthy households¹ in China reached 1.6 million. By 2015, it will have more than 4 million households, making it the world's fourth largest country in terms of its number of wealthy households after the US, Japan and the UK.² Moreover, in such a fast-growing market, companies can do much to shape the taste, spending habits and loyalty of consumers in a wide range of industries such as automotive, real estate, banking services, consumer electronics and other luxury consumer goods. Over half of wealthy Chinese consumers who now buy luxury fashion goods only started doing so in the last four years, and only

a minority can name as many as three luxury brands in any given category.

The scale of the opportunity is such that companies should be tailoring their strategies in China to meet the specific needs of wealthy consumers. To help them in their task, McKinsey recently conducted what we believe to be the most extensive research to date of these consumers to better understand what drives their spending behavior (see sidebar, "About the Research").³ The research reveals fascinating details about the number of wealthy households, their location and their make-up. Wealthy consumers' attitudes and behavior differ from those of their foreign peers. They also differ from those of most other Chinese consumers, be they mainstream consumers or those in the higher earnings bracket—the 'mass affluent'.⁴ But there are also important differences between wealthy consumers themselves. Such insights will help shape the strategies of companies wishing to serve this increasingly important consumer segment.

1 Defined in our research as urban households with annual income in excess of 250,000 renminbi (or 200,000 renminbi in real 2000 terms).

2 Forecasts in this report take into account current economic conditions and assume growth of the number of wealthy households will slow in 2009 and 2010, and re-accelerate from 2011 to 2015 and beyond. Although the long-term economic outlook for China remains strong, our figures may need to be revised should economic conditions further deteriorate.

3 This research complements the "Annual Chinese Consumer Survey" series by McKinsey's Insights China. The survey, first published in 2005, is based on interviews with 6,000 consumers across different income groups, ages, cities and regions, providing a deep understanding of the attitudes and behavior of Chinese consumers. The 2009 survey, currently in progress, will cover 15,000 consumers in 58 Chinese cities.

4 For the purposes of this research, a mainstream consumer is defined as one living in an urban household with a minimum annual income of 7,200 renminbi. A mass affluent consumer is one living in an urban household with annual income in excess of 96,000 renminbi but less than 250,000 renminbi.



About the research

Research was conducted in the last quarter of 2008. It consisted of:

- Ethnographic research involving two-hour home visits and two-hour accompanied shopping trips with wealthy consumers in four cities (Beijing, Shanghai, Shenyang and Shishi) to understand wealthy consumers' lifestyle, attitudes and needs, and to generate hypotheses to explore in interviews.
- Face-to-face interviews of between 35 and 45 minutes with 1,750 wealthy Chinese consumers. Respondents were selected from different geographic regions and 16 different cities. Three of these were tier-1 cities, nine were tier-2 cities, and four were tier-3 cities. The selection process ensured diversity of age, gender, occupation and other key demographics.
- Extensive interviews with brand managers and marketing specialists serving wealthy consumers across different sectors.
- Visits to over 80 luxury brand stores in tier-1 and tier-2 cities and 120 consumer exit-surveys to study and compare store performance.
- Factor analysis to identify key themes around consumers' attitudes about their lifestyle, financial management and luxury consumption; cluster analysis to arrive at a needs-based segmentation of wealthy consumers.

EMPORIO ARMANI

CHANEL

GUCCI

LOUIS VUITTON

GIORGIO ARMANI

BALLY

OMEGA

Cartier

HERMÈS
PARIS

BURBERRY

TIFFANY & Co.

ROLEX

P R A D A

BOSS
HUGO BOSS

Salvatore Ferragamo

FAST-GROWING and fast-changing

Size

Less than 1% of urban Chinese households are currently defined as wealthy, compared with around 10% in the United States, Germany and Japan. However, China's wealthy consumers account for roughly the same high proportion of national private savings, and their numbers are fast growing. Even allowing for the current economic slowdown, the number of wealthy households in China is likely to grow at an annual rate of around 16% for the next five to seven years.⁵ In developed markets, the figure is expected to be largely in line with their GDP growth. As a result, China will have more than 4 million households by 2015, making it the world's fourth largest country in terms of its number of wealthy households after the US, Japan and the UK.

Just how quickly marketers will have to move to keep pace with wealthy consumers is illustrated by the fact that about one half of today's wealthy consumers were not wealthy four years ago, and over half

of those who will be wealthy in five to six years are not wealthy today. Spending habits can change quickly when market growth is so explosive. For example, only a few years ago, Chinese consumers made most of their luxury goods purchases abroad. Today, 60% are made in mainland China. Companies will need deep and constantly-updated knowledge about their customers' behavior and needs to keep ahead of such rapid developments.

Location

As expected, China's biggest and most economically developed cities are where a disproportionate number of the wealthy are to be found. But this too is changing and companies will have to adapt their strategies accordingly.

The wealthy are concentrated in certain geographies – namely the East and Central South regions. China's four richest 'tier-1' cities⁶ (Shanghai, Beijing, Guangzhou and Shenzhen) account for around

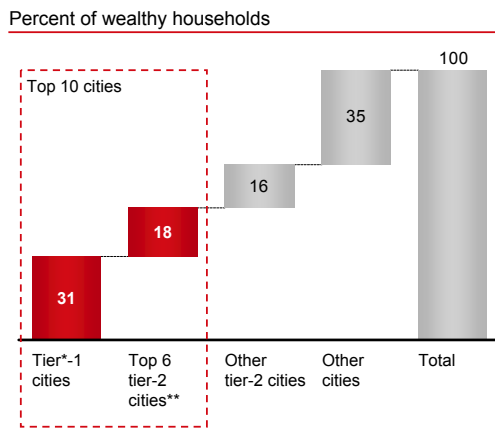
⁵ Macroeconomic analysis and forecasts in this report are based on findings from McKinsey Global Institute's urbanization study: "Preparing for China's Urban Billion." This study generated detailed historic and forecast data on population, income, and consumption in more than 800 Chinese cities, and explored the global economic and social implications of the unprecedented expansion of China's cities.

⁶ Around 800 Chinese cities are grouped into four different tiers according to their level of total consumption and future growth of total consumption.



exhibit one

Where the wealthy live



* About 800 Chinese cities are grouped into four different tiers according to their level of total consumption and future growth of total consumption
 ** Tier-2 cities among top 10 cities in terms of aggregated income of wealthy households, whose annual household income in excess of RMB 250,000
 Source: McKinsey Global Institute, Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

China will have more than 4 million households by 2015, making it the world's fourth largest country in terms of its number of wealthy households after the US, Japan and the UK.

30% of wealthy consumers; the top 10 are home to some 50% compared with around 25% in the top 10 US cities (Exhibit 1).

Marketers wanting to target China's wealthy naturally tend to focus on its two richest cities—Shanghai and Beijing, where competition is already

fierce. There is a danger, however, that companies underestimate the importance of China's smaller cities. In Beijing, the biggest brand names often have several retail outlets, but many go unrepresented in Chengdu or Wenzhou, even though Chengdu has more wealthy households than

Three-quarters of the growth in the wealthy consumer segment will come from consumers who do not currently live in tier-1 cities.

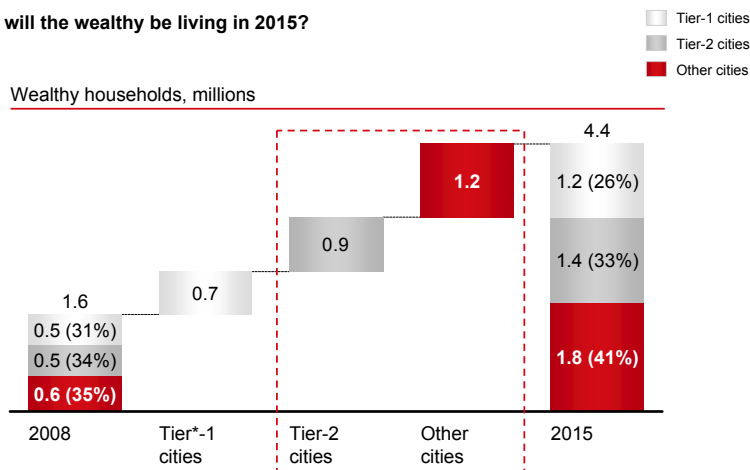
Detroit, and Wenzhou as many as Atlanta⁷ (see sidebar, “Retail Appeal”). Our research indicates that within five to seven years, many of China’s smaller tier-2 cities will be comparable to today’s biggest tier-2 cities in terms of the

number of wealthy households living there. Furthermore, three-quarters of the growth in the wealthy consumer segment will come from consumers who do not currently live in tier-1 cities (Exhibit 2).

exhibit two

Geographic evolution

Where will the wealthy be living in 2015?



* About 800 Chinese cities are grouped into four different tiers according to their level of total consumption and future growth of total consumption
Source: McKinsey Global Institute, Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

⁷ Households in Detroit and Atlanta with annual income equivalent to 250,000 renminbi (purchasing power parity adjusted).



Retail appeal

Retail stores that attract wealthy Chinese consumers pay attention to four key factors:

- Convenient and well-situated location. Some 80% of wealthy Chinese consumers say they do not plan to visit any particular store. Stores therefore need to be conveniently located within a cluster of stores, and preferably luxury-oriented ones. Our research shows that shopping malls can attract almost three times as many consumers as stand-alone stores. However, high competition means the best retail spaces are increasingly difficult to secure, so retailers should consider entering early relationships with developers, particularly in tier-2 cities that may only support a single luxury shopping mall in the near future.
- Smart visual merchandising. Our store visits and interviews indicate that while the quality and selection of products are important to consumers—many complain that items are too often out of stock or not offered in the right size—the visual presentation of merchandise is more important still. In fact, visual presentation

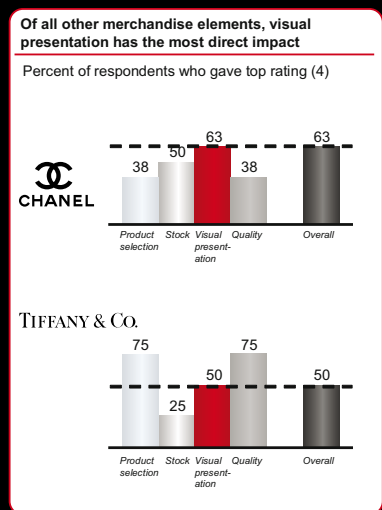
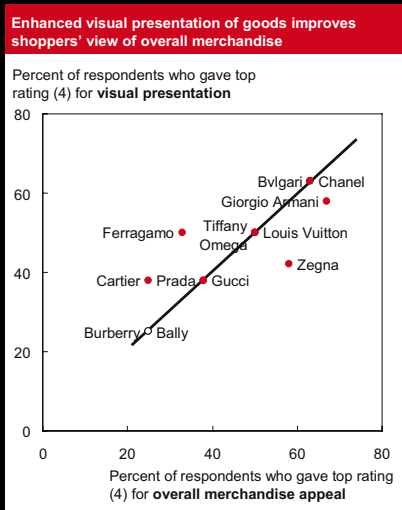
can influence the perception of product selection and quality more than the products themselves (Exhibit A). We also found that a more spacious store almost always improves customers' perception of the visual presentation.

- Superior store service. Many customers are dissatisfied with the level of in-store service, complaining that staffs are inattentive except when trying to push customers into making a purchase. Very few customers in China regard store staff as good 'brand ambassadors,' suggesting significant room for improvement for many luxury goods brands.

- Long-term consumer relationships. The loyalty programs offered by most brands in China are discount-based and hence unsophisticated. However, as the Chinese market matures and consumers become more demanding, luxury brands will have to offer much more generous and comprehensive VIP programs to stay competitive. Importantly, building CRM capabilities will help luxury goods players better understand their biggest spenders' domestic and overseas shopping behavior and preferences.

Exhibit A

The power of presentation



Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey (Store Exit Survey, Retail Store Diagnostic Visits)

THE UNIQUE PROFILE of China's wealthy consumers

How best to target China's wealthy consumers? When they decide to buy a new watch or leather bag, do they want a genuine brand or will they be content with a look-alike? When the time comes to buy a new car, are they more impressed by the endorsement of a young, glitzy celebrity or an older, more sophisticated one? And if a new mobile phone is on the shopping list, are they more likely to buy one that is deliberately positioned as a luxury brand?

The McKinsey research sheds light on these differences, revealing how the wealthy differ from their foreign peers and, their wealth apart, other Chinese consumers. These insights are important for companies that have traditionally focused on serving the wealthy overseas and that are now seeking to shape their services and products for the Chinese market. They are also important for companies that have hitherto focused on mainstream consumers in China, and that now have the opportunity to stretch their existing Chinese business and brands and sell premium products to the wealthy.

Different to wealthy foreign consumers

One of the most significant factors that distinguishes China's wealthy

consumers from their foreign counterparts is their youth. Some 80% are under 45, compared with 30% in the United States and 19% in Japan (Exhibit 3). Because they are newer to the consumer market and to wealth, they are also less knowledgeable about luxury brands (see sidebar, "The Power of Brand Awareness"). In addition, China's wealthy appreciate the functional benefits of any particular purchase—the quality, material, design, craftsmanship—more than wealthy consumers elsewhere. The emotional benefits of a purchase—what it says about its owner's taste, for example—still count, as they do for the mainstream Chinese consumer. But they matter less than they do for consumers in more mature markets.

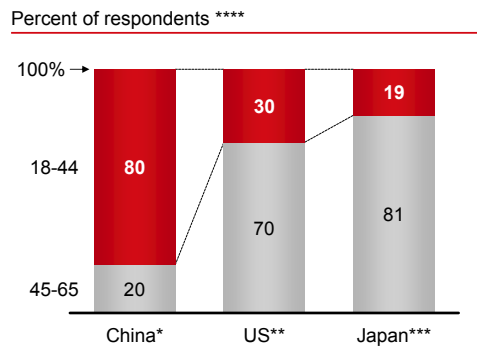
Such differences have clear strategic implications. For example, to capture a younger consumer, Lancôme has emphasized the importance of taking early action to prevent the signs of aging when promoting its anti-aging range in China. As a result, it has boosted sales among younger consumers significantly and is now the largest luxury cosmetics and skin care brand in China. Addressing lower brand awareness in China, the manufacturer of Louis XIII, a luxury cognac, replaced its traditional advertisements showing various



exhibit three

Young and wealthy

80% of wealthy consumers in China are below 45 years old



* Annual household income is above RMB 250,000
 ** Annual household income is above USD 70,000 (PPP adjusted)
 *** Annual household income is above Yen 8 million (PPP adjusted)
 **** For the purposes of this research, only consumers 18 – 65 years old are included in the analysis
 Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

luxury images such as pianos, horses and yachts with simpler ads, often focusing on the bottle and packaging alone. Other brands have taken into account the Chinese consumers' appreciation of functional benefits by emphasizing product quality. For example, when Italian fashion brand Ermenegildo Zegna opens

new stores, it gives demonstrations of how its ties are made to emphasize the craftsmanship.

Companies should nevertheless be wary of radically changing their global brand positioning. When it first came to China in the 1980s, Swiss watchmaker Longines launched a special, altogether

The wealthy have a greater preference for foreign brands and are more likely to try new technology.

brasher Chinese product line that was meant to appeal to China’s wealthy consumers. It failed to do so. In the words of Longines’ Vice President of Marketing, Li Li, Chinese consumers “felt suspicious when they discovered products on offer in other countries were drastically different.” In 1994, the company opened a domestic head office in China and repositioned itself as a classic, elegant brand in line with its global positioning. China is today Longines’ largest market.

Different to the mainstream consumer

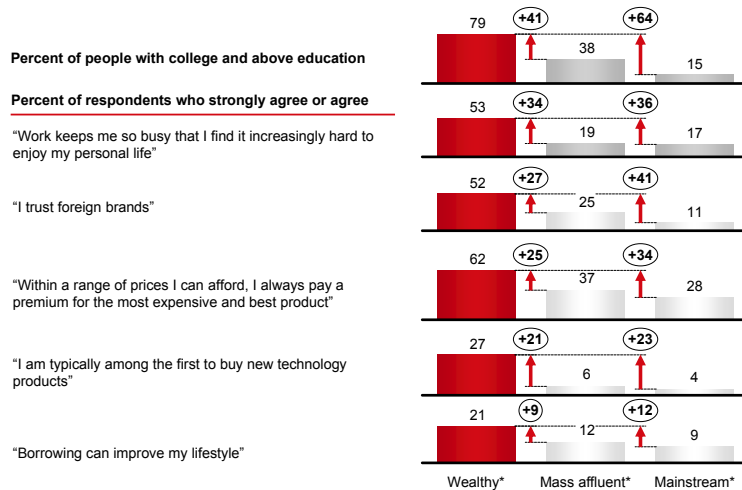
As expected, the research also shows sharp differences in attitudes and behavior between wealthy and mainstream Chinese consumers. For example, 21% of wealthy consumers said they agreed that “borrowing can

improve my lifestyle,” compared with 9% of mainstream consumers. There is also an important difference in their openness to trying new things—the wealthy have a greater preference for foreign brands and are more likely to try new technology. In addition, the wealthy find it more difficult to maintain a satisfactory work-life balance. More surprising perhaps, is the gap in attitudes and behavior between the wealthy and the mass affluent. Exhibit 4 gives more details.

The research also looked at the different ways the wealthy spend their leisure time, and how it impacts marketing. The wealthy, like other Chinese consumers, not only spend huge amounts of time in front of the T.V., but a good deal of time surfing the internet too. They also spend more time outside of the home than other consumers: they like participating

exhibit four

How the wealthy differ



* Mainstream: Consumers with minimum annual household income of RMB 7,200 for tier-4 cities, RMB 9,600 for tier-3 cities, RMB 14,400 for tier-2 cities, RMB 19,200 for tier-1 cities; Mass Affluent: Consumers with annual household income between RMB 96,000-250,000; Wealthy: Consumers with annual household income in excess of RMB 250,000

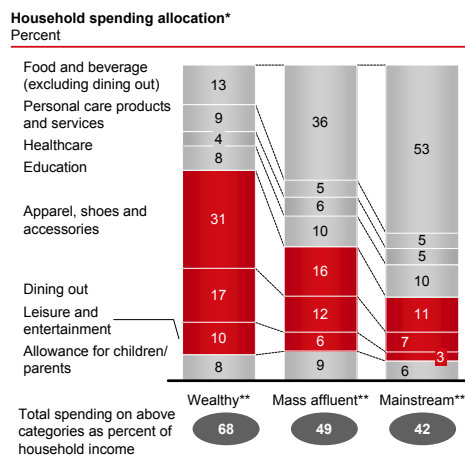
Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey, 2008 Chinese Consumer Survey

in sporting activities, visiting health spas and drinking and eating out. This is reflected in their spending. The wealthy spend 17 % of their household income on dining out, for example, whilst mainstream consumers spend 7%. They spend 10% on leisure and entertainment compared with 3% for mainstream consumers. (Exhibit 5). Because of the amount of time they watch T.V., the medium remains an effective way to reach wealthy consumers. However, the research shows that internet advertisements as well as blogs are also effective and have far greater impact on the wealthy than on any other consumer. Companies should also bear in mind the amount of time the wealthy spend outside of the home. Premium whisky companies might consider, for

example, holding marketing events in bars and clubs frequented by the wealthy. Watch company Omega, recognizing that the wealthy like to be outside and active, has been the leading sponsor of the China Golf Tour since 2005.

exhibit five

Spending patterns



* Does not include spending on housing, private health insurance, house mortgage, etc.

** Mainstream: Consumers with minimum annual household income of RMB 7,200 for tier-4 cities, RMB 9,600 for tier-3 cities, RMB 14,400 for tier-2 cities, RMB 19,200 for tier-1 cities; Mass Affluent: Consumers with annual household income between RMB 96,000-250,000; Wealthy: Consumers with annual household income in excess of RMB 250,000

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey, 2008 Chinese Consumer Survey

The wealthy spend 17 % of their household income on dining out, whilst mainstream consumers spend 7%.



The power of brand awareness

Except for a few leading brands, unaided brand awareness remains quite low in China. Moreover, when Chinese consumers do recall names, they often confuse luxury brands with premium ones such as sporting label Nike, watch brand Casio, and jewelry retailer Chow Sang Sang. Improving brand awareness is critical to improving the entire performance of a brand in China (Exhibit B). But there are no easy means of doing so.

Building brand awareness requires commitment and scale. The most successful and familiar brands tend

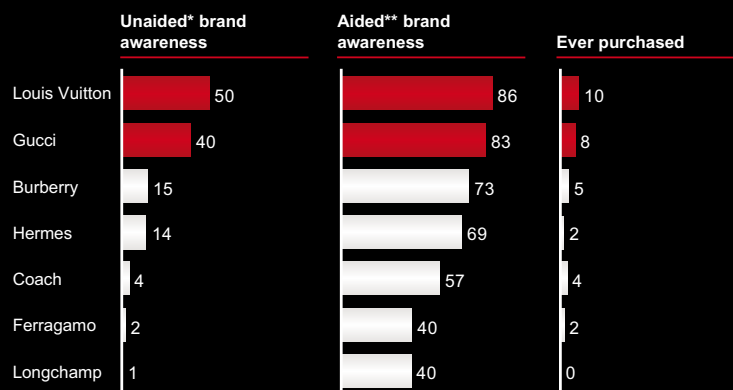
to be those that have been in China longest and that have been backed by years of marketing investment. Companies often have to build scale rapidly in order to support such high marketing spend and the broad distribution network that delivers brand awareness. Brands that cannot afford such investments will have to narrow their consumer and marketing focus in order to generate the high level of unaided brand awareness that leads to higher purchase rates.

Exhibit B

The power of brand awareness

Percent of respondents

LEATHER GOODS EXAMPLE



* The original survey question is: "When you think of luxury brands (by category), which brands (maximum 3) come to your mind?"

** Brand name listed in the survey questionnaire and shown to respondents

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey



A NEEDS-BASED segmentation

As mentioned, the research reveals certain characteristics that mark China's wealthy consumers apart from their global peers and from other consumers in the Chinese market. But given the size of the wealthy consumer segment and its growth potential, the most successful marketers will also need to understand the differences between wealthy consumers.

We first looked at demographic factors such as age, gender, region, city tier and income to see if they had any impact on respondents' attitudes towards, say, borrowing, fashion trends, or the display of wealth. The only demographic factor that seemed to matter was region or city tier. So for example, wealthy consumers living in tier-1 cities are more conservative in their attitude towards saving and are more family-focused, while those in tier-2 and tier-3 cities tend to be less trusting of foreign brands.

More meaningful differences were revealed when we considered what respondents' answers revealed about their needs – the need to feel

unique, for example, or the need to feel financially secure. This analysis uncovered seven distinct segments among our wealthy consumer group.⁸ Exhibit 6 demonstrates the extent to which this needs-based segmentation reveals differences between wealthy consumers. Exhibit 7 describes the key characteristics of each of the segments.

Consumers in what we describe as the Luxuriant segment, for example, tend to be grouped in China's wealthiest cities. Besides being amongst the wealthiest consumers, they are also those who are most familiar with, and concerned about, luxury. They never settle for less than the best, and are attracted by high-end, high-fashion brands such as Hermes and Chanel. Consumers in this segment are a brand's best friend, buying frequently and telling their friends about their purchases. They avoid the brash, opting instead for under-stated, sophisticated chic, and are seen in their social circles as trend setters. Although they work hard, they also find time to socialize,

⁸ The seven segments were derived from a robust, quantitative methodology based on the different needs and attitudes of 1,750 respondents. First, we performed a factor analysis to identify a set of needs and attitudes that clearly differentiated consumers. This was followed by a two-step segmentation utilizing both hierarchical clustering and K-means clustering to arrive at seven segments that would be actionable and meaningful to a broad set of companies.



exhibit six

A needs-based segmentation

Weighted average deviation from mean (percent points)*

	Mean Percent**	Needs-based segmentation	Age	Income	City tier	Region	Gender	Occupation***	Education
I need to earn more to provide a better life for my family	31	13.9	1.5	1.0	3.4	2.0	2.8	0.2	5.0
I buy luxury goods because I want to have a unique style that stands out	34	13.8	2.2	3.3	3.5	4.3	0.2	1.7	3.1
I don't feel the need to purchase genuine luxury fashion goods	31	19.4	4.2	0.7	3.6	3.4	1.0	1.6	1.2
I always pay a premium for the most expensive and best product	62	14.8	5.1	0.3	5.6	4.1	2.0	2.7	1.7
I trust foreign brands	52	18.9	4.4	2.0	5.5	4.8	0.5	1.9	4.4
I find it increasingly hard to enjoy my personal life due to work	54	21.0	3.1	1.6	2.5	3.8	0.5	2.2	1.8
My household income will significantly increase in the next 5 years	56	8.6	3.1	2.7	2.3	3.3	3.3	2.1	4.3

* Weighted average of absolute deviation of each group from mean, sample size as weighted factor

** Percent of respondents who strongly agree or agree with the statement

*** Includes employed, self-employed and unemployed; excludes "others"

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

travel and spend time with their families. Health-conscious, they like visiting the gym or a health spa.

Compare this with the Demanding segment. Self-made men and women, they have more money than they need and are satisfied with their success, although they still work hard. Unlike those in the Luxuriant segment,

these consumers do not have a taste for luxury goods, especially luxury fashion. They rarely buy the very best and are often content with look-alikes. They also make an effort to compare prices before buying, even for products they can easily afford. Occasionally, they splurge on something that will make them stand

Seven segments

	Avg.HHI RMB Thousands	% of wealth	Key characteristics
1 Luxuriant	590	22	<ul style="list-style-type: none"> Highest income and located mainly in tier-1 cities; higher proportion of females Care about health, the environment and the quality of family life Passionate about luxury goods Sophisticated, low-key style; fashion leaders Quality matters more than brand; against look-alike products
2 Demanding	585	13	<ul style="list-style-type: none"> Higher income than most yet amongst the hardest working Prefer flashier products that help them stand out from the crowd Less willing to pay for the best; hard to please Not confident future earnings will grow significantly; dislike borrowing
3 Flashy	542	22	<ul style="list-style-type: none"> Slightly above average income, with greater numbers in tier-1 cities Big luxury goods spenders and showy; the brand is important Prepared to buy look-alike products Go out of their way to find the cheapest price Confident financially but continue to work hard; care less about health and the environment
4 Urbane	511	14	<ul style="list-style-type: none"> Lower than average income, with greater numbers in tier-1 cities; higher proportion of males Care significantly about health, the environment and the quality of family life Sophisticated, but low-key and spend less on luxury goods than those in the Luxuriant segment Care more about product quality than the brand; against look-alike products
5 Climber	493	8	<ul style="list-style-type: none"> Lower than average income, with greater numbers in tier-2/3 cities Status conscious and keen to socialize with the up-and-coming and influential Appreciate luxury goods but do not regard them as a necessity Not willing to pay more for better products; go out of their way to find the cheapest price Less confident financially
6 Down-to-earth	492	10	<ul style="list-style-type: none"> Younger and newer to luxury and wealth; greater numbers in tier-2 cities Value family life over social life Care little about higher-end products; little interest in foreign brands When they do spend on luxury, they stick to quality and low-key products Confident financially, but feel peer pressure to earn more
7 Enthusiast	479	11	<ul style="list-style-type: none"> Among the lowest income, with greater numbers in tier-2 cities Enthusiastic about luxury goods; would like to buy more than they can afford Very showy; like brands that help them stand out from the crowd Prepared to buy look-alike products; favor Chinese brands

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

apart from the crowd, but on the whole there are few luxury products and services that tempt them: they prefer to buy more functional items such as T.V.s, sound systems and cars.

Those in the Down-To-Earth segment are the least wealthy in terms of their financial assets, though they earn only slightly less than consumers in other segments. They are the youngest and the most recent newcomers to wealth and luxury. As a



result, they are relatively unchanged by their wealth and their tastes and attitudes are closer to those of the mainstream consumer. Many live in tier-2 cities, are family-oriented and hard-working, but are concerned that others make more money than they do. They would certainly spend more on luxury goods if they could afford to do so, but for the time being are looking for good quality at a reasonable price.

The seven segments give guidance on which consumers to target as well as how to target them in terms of product, price, marketing and media strategy. However, to establish how a single strategy might capture several segments and therefore help companies maximize consumer reach and impact, we went on to

examine how the different segments related to each other. We found that for most industries it could be helpful to look at each segment according to its members' willingness to pay a premium for what they regard as the best, and the degree to which they are keen to show off their purchases —what we dub 'showiness'.

Exhibit 8 shows the resulting 4 clusters. It shows that the two largest clusters in terms of aggregate wealth are both willing to pay a premium for what they regard as the best, but one is showier than the other.

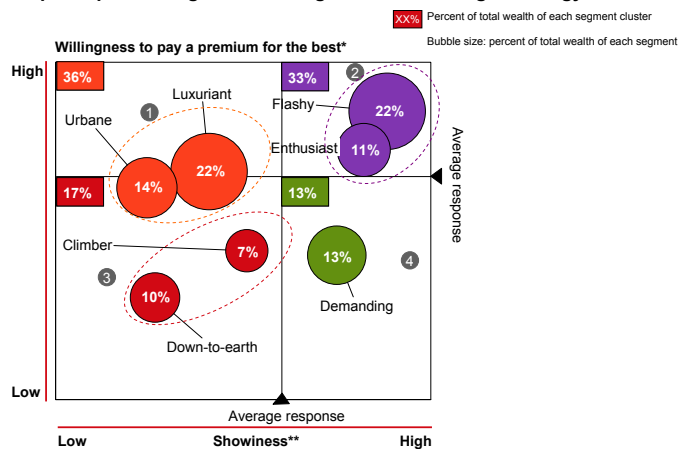
The economic importance of the two largest clusters—together they account for some 70% of the total wealth of this consumer segment —means they are likely to be primary targets. Yet companies should also

Given the size of the wealthy consumer segment and its growth potential, the most successful marketers will also need to understand the differences between wealthy consumers.

exhibit eight

Optimal impact

Grouping consumers by their willingness to pay a premium for the best and their showiness can help companies target several segments with a single strategy



* The original statement is: "Within a range of prices I can afford, I always pay a premium to get the most expensive and best product"

** The original statement is: "I prefer luxury goods that are low-key and understated"

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey

Their knowledge of the brand makes them demanding customers, so companies wishing to serve them will have to make sure they offer the very latest products and styles.

be aware how the relative weight of each cluster might differ between regions, city tiers and even individual cities. In tier-1 cities, for example, the biggest cluster consists of consumers who are willing to pay for what they regard as the best, but are not showy. In tier-2 and tier-3 cities, the importance of more price-sensitive, showy consumers rises significantly (Exhibit 9). The weight of the different clusters will also change over time. Companies wanting to build early brand advantage therefore need to consider investing in those segments that are of less significance today, but that will grow in importance. Our research suggests the bottom left-hand cluster will grow the quickest over the next five to seven years, consisting as it does of consumers

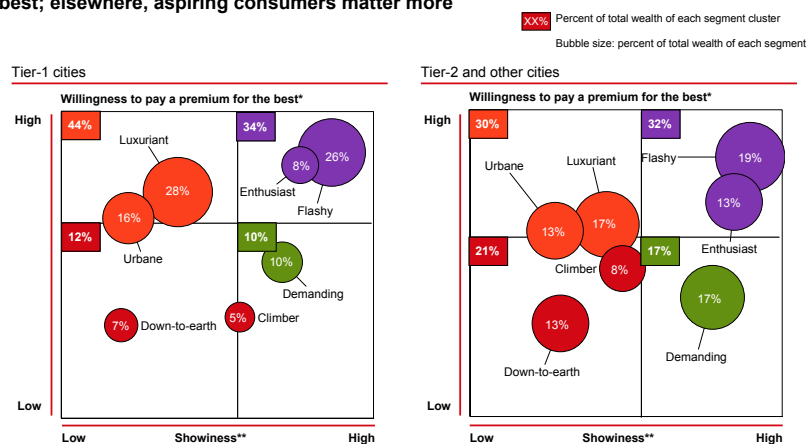
who live largely in tier-2 and tier-3 cities that will see fast economic growth (see sidebar, "Pricing").

How might these four clusters impact a company's strategy? Consumers in the top right-hand cluster, for example, are united in their 'willingness to pay for the best' and their 'showiness'. For them, the brand is what matters most, and they are keen for others to notice the brands they buy. Logos and marketing should therefore be bold. Brand extensions should also be considered, as these consumers are very attached to their favorite brands and will buy across categories. Their knowledge of the brand makes them demanding customers, so companies wishing to serve them will have to make sure they offer the very latest products and styles. They should also

exhibit nine

Different cities, different strategies

In tier-1 cities, it is important to capture consumers willing to pay a premium for the best; elsewhere, aspiring consumers matter more



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make sure sales representatives look and behave in a way that accurately reflects the brand image: consumers in this cluster will notice any mismatch and not be impressed.

Car manufacturer BMW has positioned itself to appeal to consumers in this cluster. Its product line in China is as wide as elsewhere, and it advertises across a range of channels such as glossy magazines, T.V. and the internet to raise wide brand awareness. Its annual 'BMW Experience Day' showcases its latest models and gives consumers a chance to test-drive the cars. BMW has also developed a long wheelbase version of its 5 Series with more space and amenities in the rear seats to cater for growing demand for chauffeur-driven cars. In other markets, BMW has promoted "driver-focused" cars.

Compare all this with consumers in the top left-hand quadrant. They too are united by their willingness to pay, but they are far less showy. They want the latest and the best, but they are more familiar with and loyal to certain brands, having built a longer, more personal history with their favorite ones. These consumers also place greater importance on the attributes of a product or service than the brand, and will only buy what they regard as the best within any category.

Companies serving this cluster should again offer a strong product line and excellent service. However, the product must be less conspicuous, and the marketing more subtle. Celebrities that market the brand

should reflect the sophistication and maturity of consumers in this cluster, and care should be taken not to dilute the brand through over-exposure. VIP programs and selective marketing channels work best.

Watchmaker Patek Philippe addresses this cluster. It chose prime sites for its two flagship Chinese stores, one of which is situated in a historic building in Beijing that once housed the US embassy. The setting resonates well with a brand that promotes a sense of heritage and tradition. In its stores, Patek Philippe offers such a wide range of models that it attracts international as well as Chinese customers.

They [top left-hand quadrant consumers] want the latest and the best, but they are more familiar with and loyal to certain brands, having built a longer, more personal history with their favorite ones.



Pricing

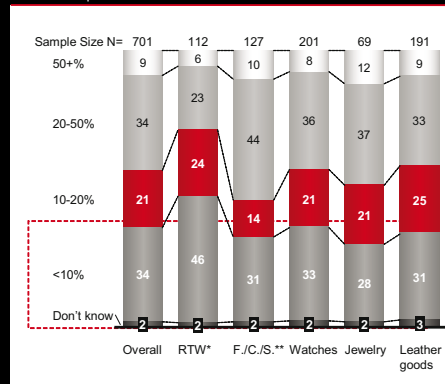
The prices of luxury goods in China are typically higher than overseas, largely due to Chinese taxes. Furthermore, price sensitivity among wealthy consumers varies significantly depending on segment. For instance, when asked whether they would go out of their way to shop for the best-priced luxury goods, almost 40% of those in the Flashy segment agreed, but less than 15% of those in the Enthusiast segment agreed. Not surprisingly, cross-border pricing is a contentious issue for luxury goods brands.

Chinese consumers typically underestimate the price gap: over 30% believe it to be less than 10% (Exhibit C). Moreover, when they shop overseas, they cite better quality and selection as the main reasons, not lower prices. 40% of respondents agreed that price was one of the three main reasons for buying overseas, while over 60% cited better product.

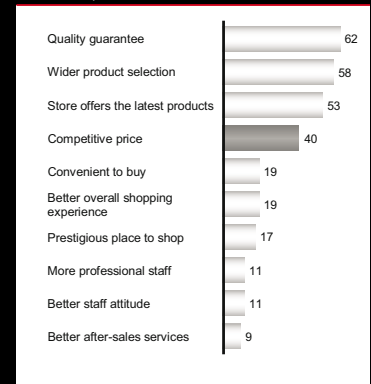
Exhibit C

The price gap

“What is the price difference between luxury goods sold in Mainland China and overseas (including Hong Kong/Macau)?”
Percent of respondents



Reasons for purchasing luxury goods overseas
Percent of respondents



* Ready-to-wear

** Fragrance/cosmetics/skin care

Source: Insights China by McKinsey – 2008 Wealthy Chinese Consumer Survey



Conclusion

The rapid growth in number of China's wealthy consumers makes them a key target for any company that can offer the products and services that will meet their needs. Current global economic conditions will slow the spending of even the wealthy. But that does not detract from their importance. Building early relationships with these consumers in China is critical given that brand loyalty is so low, and that so many of tomorrow's wealthy consumers will be influenced by today's. Which companies ultimately win their trust and loyalty will be determined in the next few years. The victors are likely to be those companies that best understand the fast-changing make-up of this consumer group and that can start shaping its tastes and buying behavior now, despite the slowdown. Those same companies will be shaping their own long-term success.



Insights China provides businesses with the data, analytics and support of McKinsey experts that will help them craft robust strategies for China's rapidly changing marketplace. The service puts a wealth of information and analysis at business leaders' fingertips, backed up by rapid, customized problem-solving and decision-making support.

The data and analysis combines results from McKinsey's annual Chinese consumer surveys with proprietary macroeconomic and demographic data and analysis from the McKinsey Global Institute (MGI). Since 2005, we have interviewed more than 30,000 Chinese consumers, giving us a deep understanding of Chinese consumers' attitudes and spending behavior in more than 100 product categories. The respondents come from a wide range of income and age groups, regions and cities, and are representative of 80% of China's GDP, 90% of its disposable income and 50% of its population. In 2008, we conducted an additional study of 1,750 wealthy Chinese consumers with annual household income in excess of 250,000 renminbi, giving us unprecedented insight into the behavior of this fast-expanding and economically important consumer segment. MGI data includes detailed historic and forecast data on population, income, and consumption for more than 800 cities. The data are updated twice yearly to account for changing macroeconomic conditions.

McKinsey experts are at hand to offer guidance, including the facilitation of workshops to address specific business issues. In addition, we have a registered panel of more than 5,000 mainstream Chinese consumers and 500 wealthy Chinese consumers to help further explore such issues in a timely fashion.

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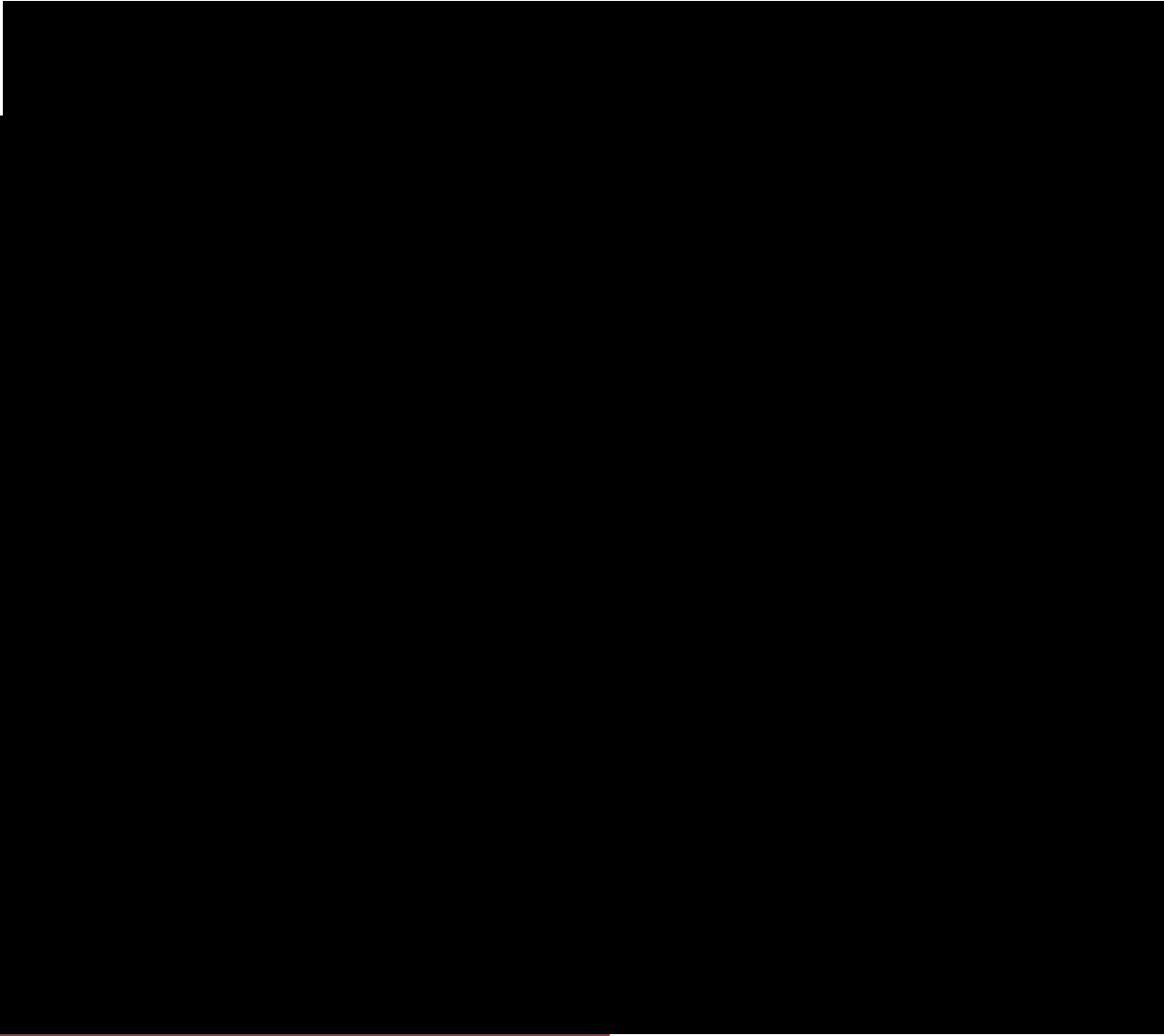
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