The New Asian Middle Class

Asia House

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Topics for discussion

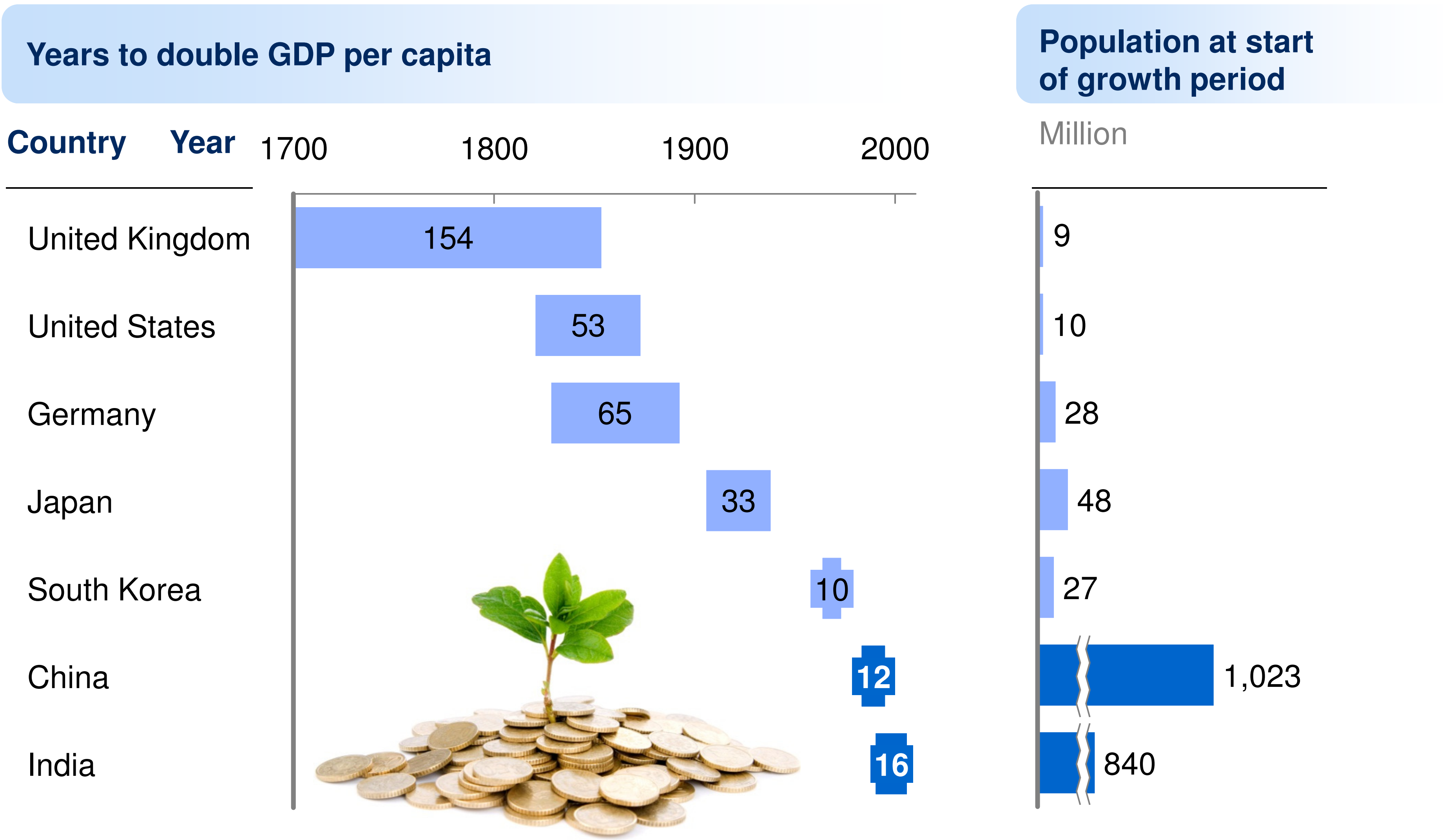
1. **Asia's New Middle Class**
2. The new Chinese consumer
3. Seizing the opportunity

Asia’s New Middle Class

- From 2009 to 2030, **2.7 billion new middle class consumers** will rise from Asia – out of a total 3.0 billion new middle class consumers globally
- Consumption in emerging markets in 2030 will be $30 trillion – **$12 trillion will come from China, India, and Indonesia**
- **440 emerging market cities – 313 from Asia – will fuel nearly half of all global growth** in GDP through 2025
- **Middleweight cities (150,000 to 10 M people) will contribute 4.5x more** to global growth than megacities (10 M+ people)
- Emerging market cities will become the leading consumer markets – **each city cluster has distinct preferences**

Five mega-trends reshaping the global economy

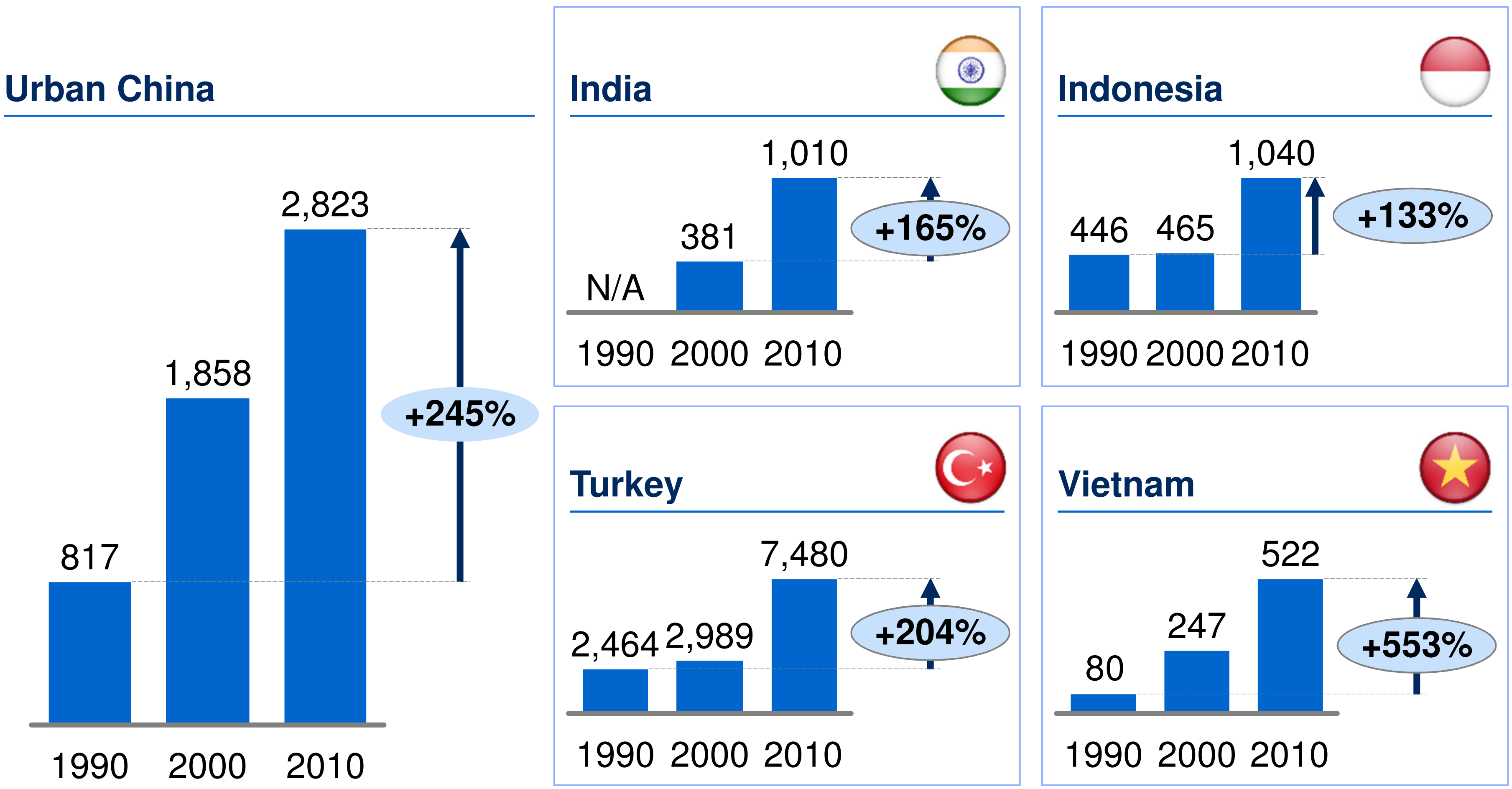
Incomes are rising in developing economies faster, and at a greater scale, than at any previous point in history



SOURCE: Angus Maddison; University of Groningen; Resource Revolution: Meeting the world's energy, materials, food, and water needs, McKinsey Global Institute, 2011

Asian consumers' disposable incomes have been rapidly increasing over the last 2 decades

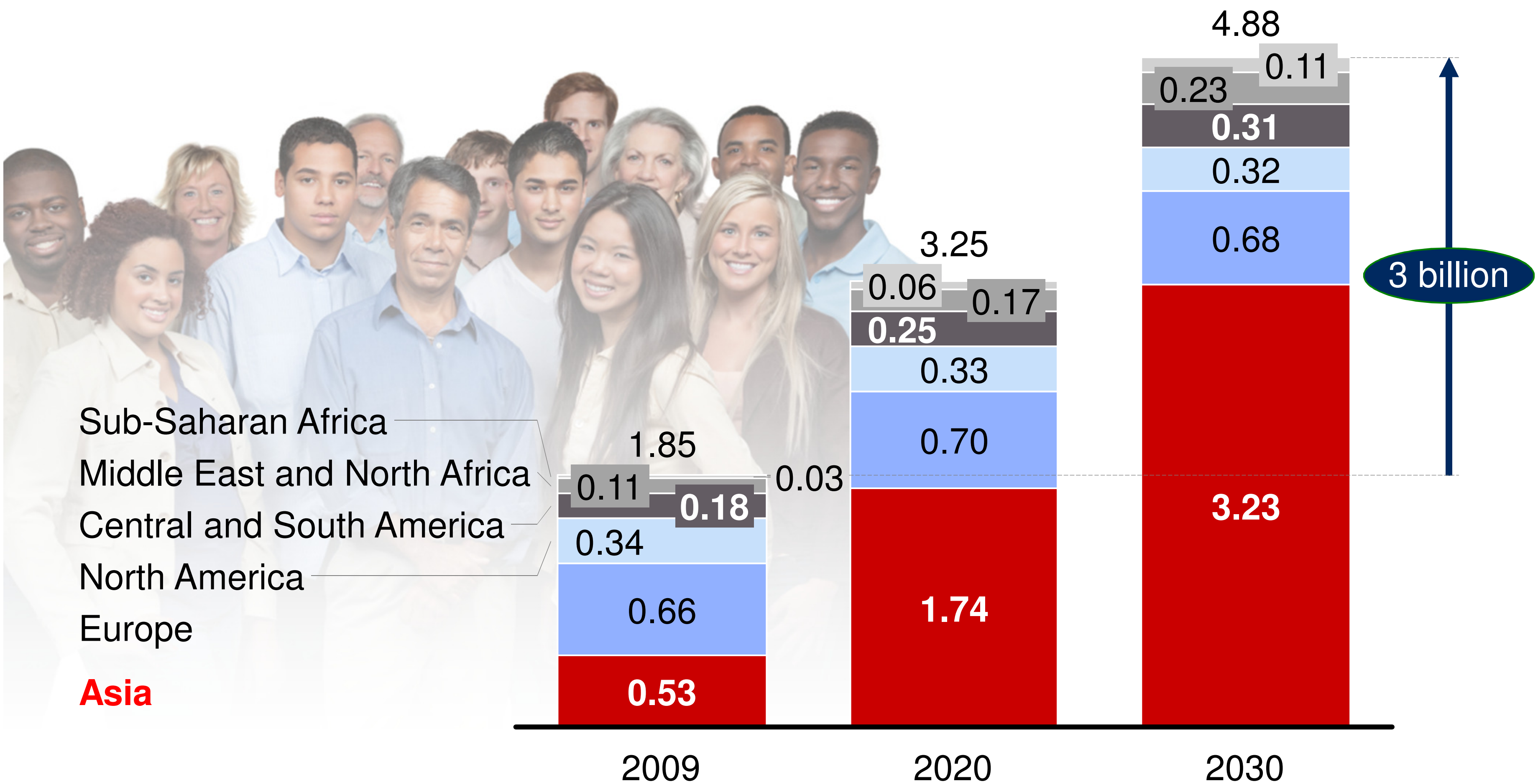
Per capita disposable income
USD (2010 real terms)



SOURCE: McKinsey analysis; Global Insight; Economist Intelligence Unit

This ongoing transformation will create 3 billion new middle class consumers with $3,600/year disposable income, fuelling demand for goods

Global consuming class[1]
Billions of people

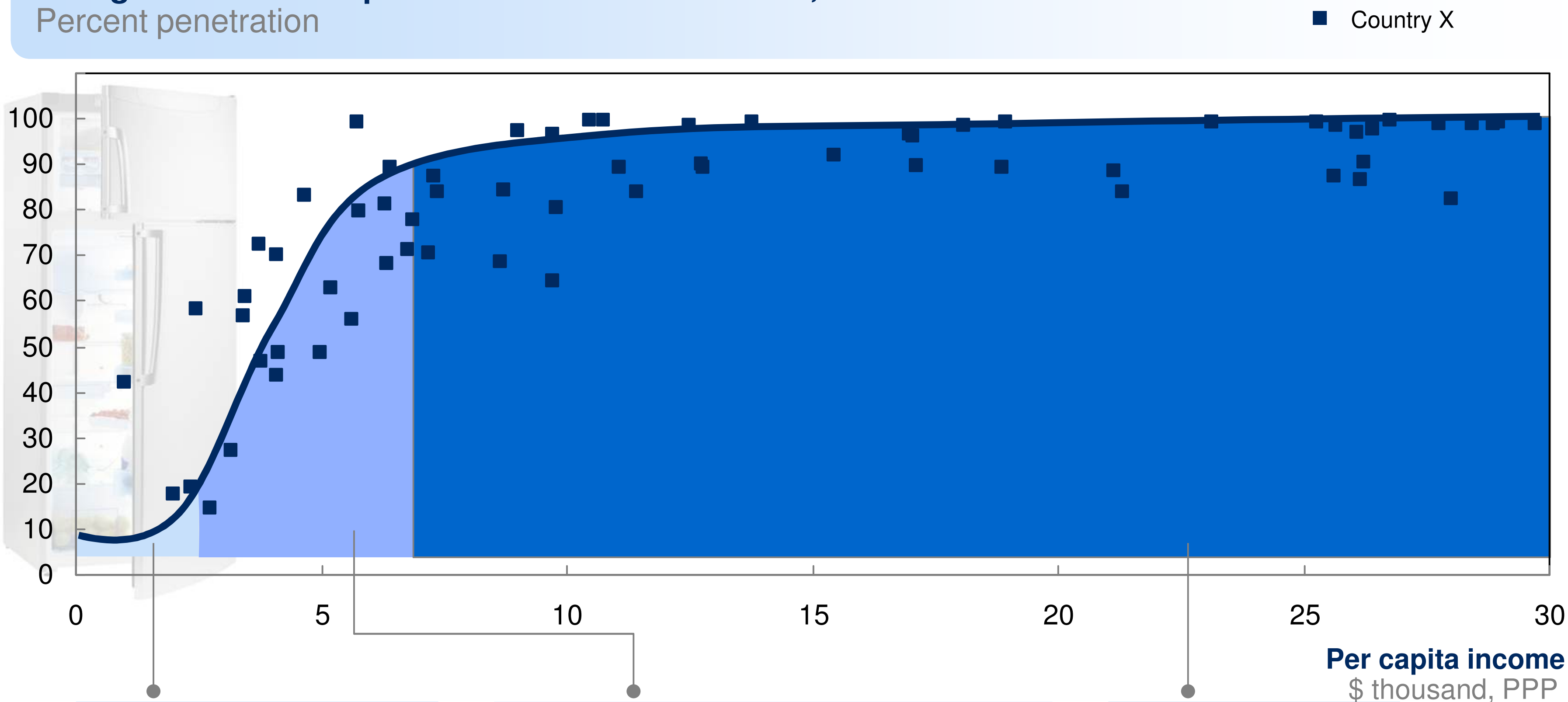


1 Consuming class = $10 or more daily disposable income or $3,600 annual income (constant 2005 USD at purchasing power parity)

SOURCE: McKinsey Global Institute

At $3,600/year per capita income or ~$7,000/year per household, consumption of most goods rises steeply – refrigerator example

Refrigeration market penetration across countries, 2007
Percent penetration



Low affordability income
- Product still too expensive for most consumers
- Market growth rate below income growth

Take-off income
- Incomes reach a threshold where product becomes affordable for consumers
- Market growth takes off at a rate that can substantially exceed income growth

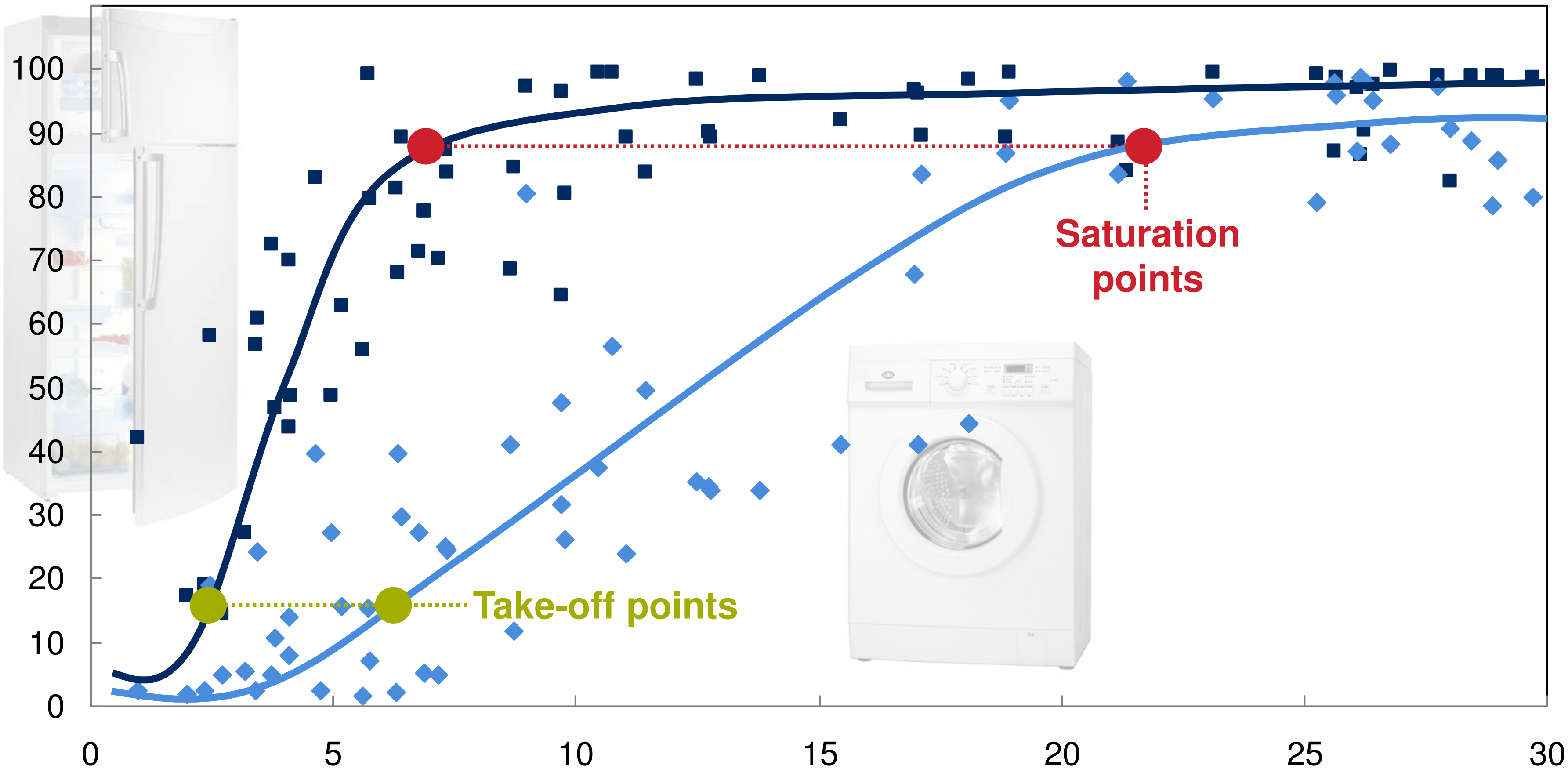
Saturation income
- Market reaches high penetration
- Market growth slows down

SOURCE: Euromonitor; McKinsey Global Institute analysis

The specific point and speed where consumption takes off varies across products

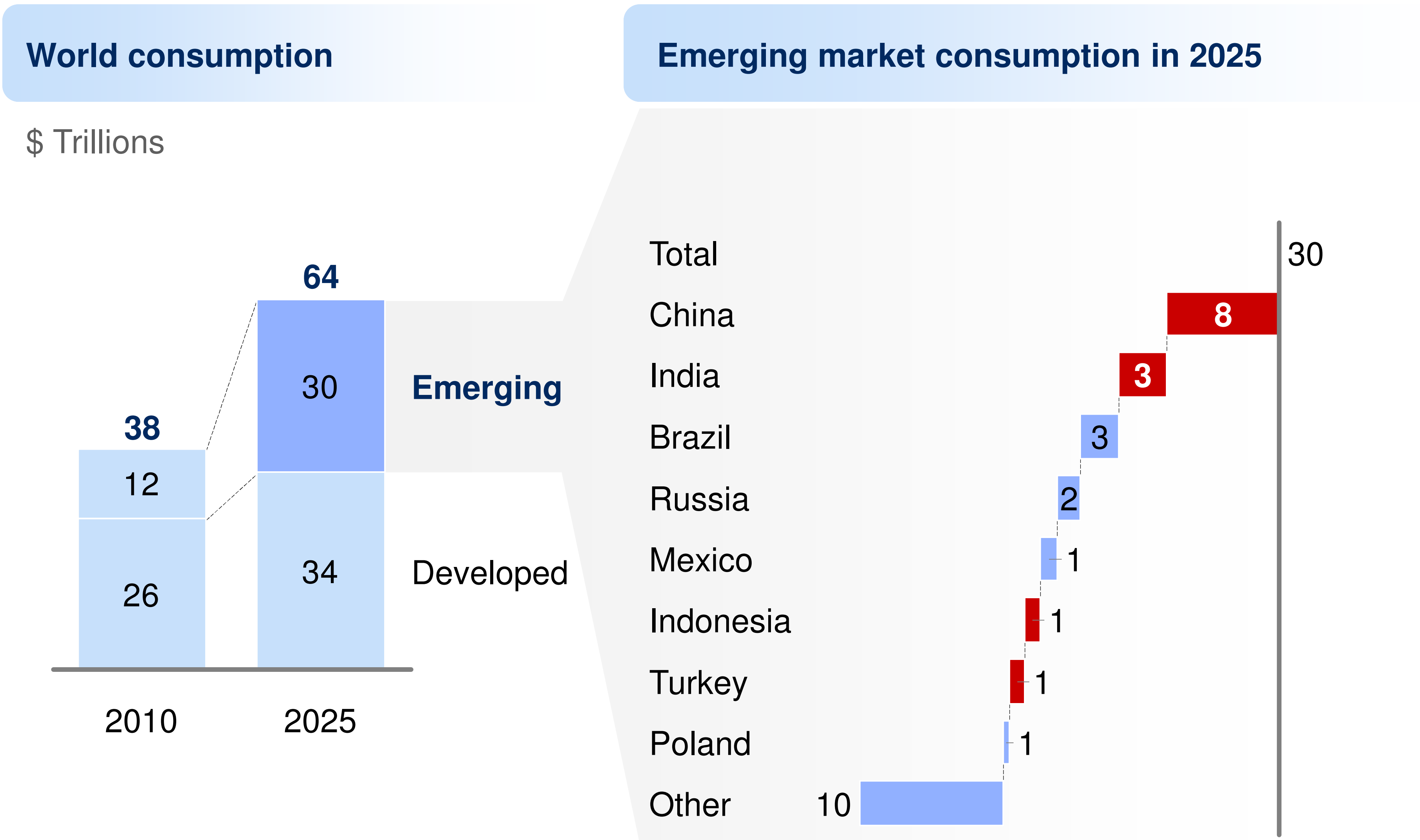
■ Refrigerator ◆ Washing machine

Refrigeration and washing machine market penetration across countries, 2007
Percent penetration



SOURCE: Euromonitor; McKinsey Global Institute analysis

Emerging market consumption will be $30 trillion by 2025, nearly half of global total



SOURCE: McKinsey Global Institute

For example, the rise of Indonesia's consuming class presents a $1 trillion opportunity

Indonesian middle class spending
$ billion, 2010 prices

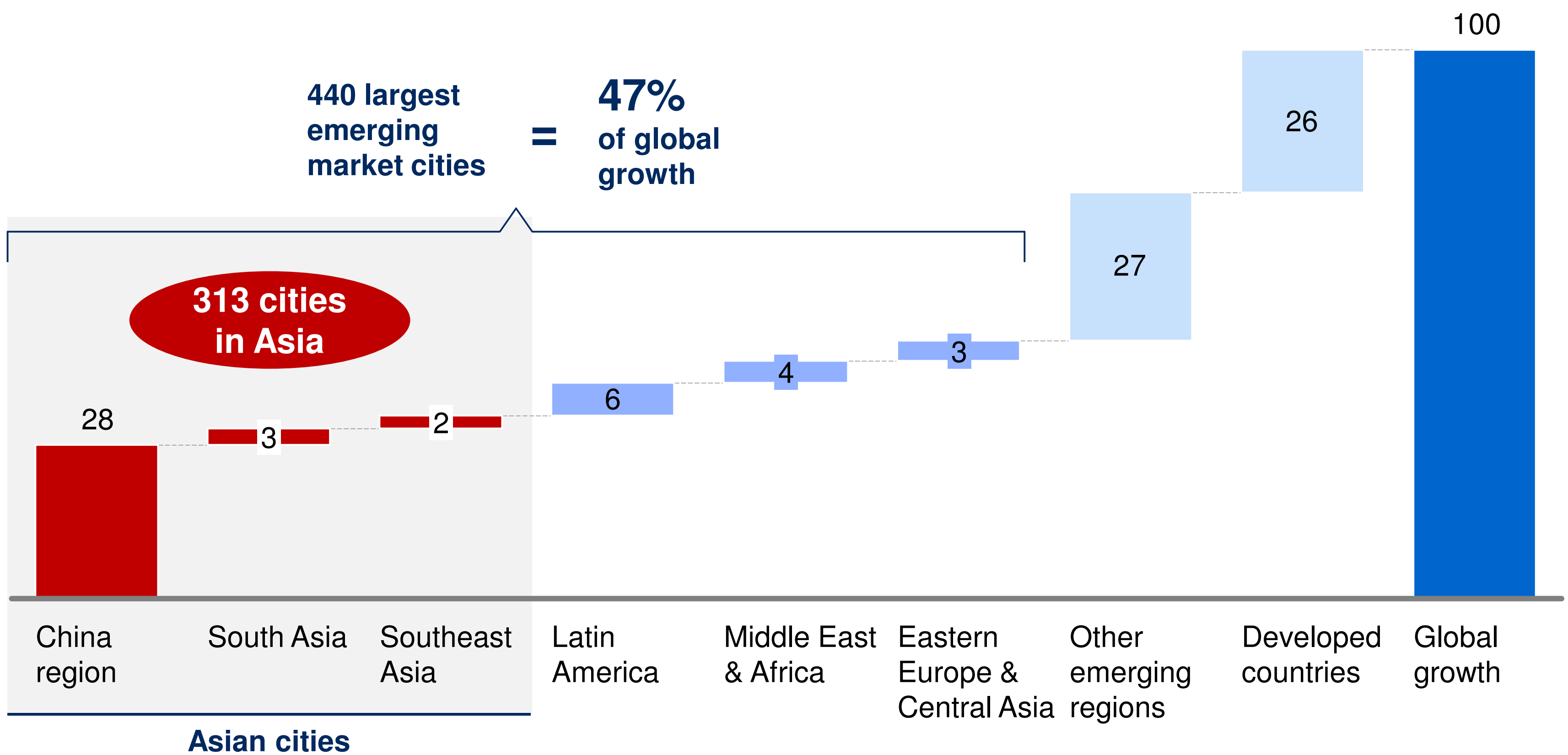
	2011	2030
Financial services	85	565
Food and beverage	73	194
Leisure	26	105
Apparel	22	57
Education	14	42
Transportation	13	30
Housing and utilities	11	26
Telecommunications	8	19
Beauty (e.g., cosmetics, haircuts)	6	16
Health care	4	13
Total	**~260**	**~1,070**

SOURCE: Canback Global Income Distribution Database; Indonesia's central bureau of statistics; McKinsey Consumer and Shopper Insights Indonesia study, 2011; McKinsey Global Growth Model; McKinsey Global Institute analysis

440 cities in emerging markets will fuel nearly half of the growth in global GDP through 2025

Emerging 440 (440 largest cities in emerging markets)

Percent contribution to global GDP growth, 2010–2025
100% = $50.2 trillion

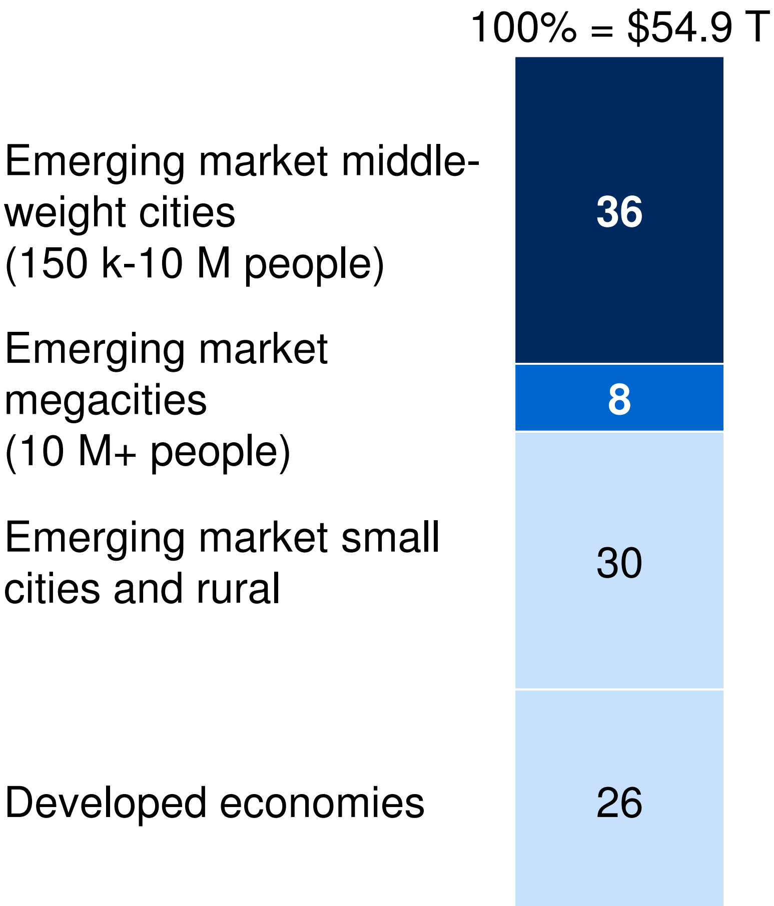


In China, 15-20 MM people move to a city each year – equal to adding New York City twice

SOURCE: McKinsey Global Institute Cityscope 2.0

Middleweight cities in emerging markets will contribute 4.5x more to global GDP growth than emerging market megacities

Share of global GDP growth, 2007-25
Percent



Examples

Surat, Gujarat
West coast of India
4 million inhabitants
40% of India’s textile production

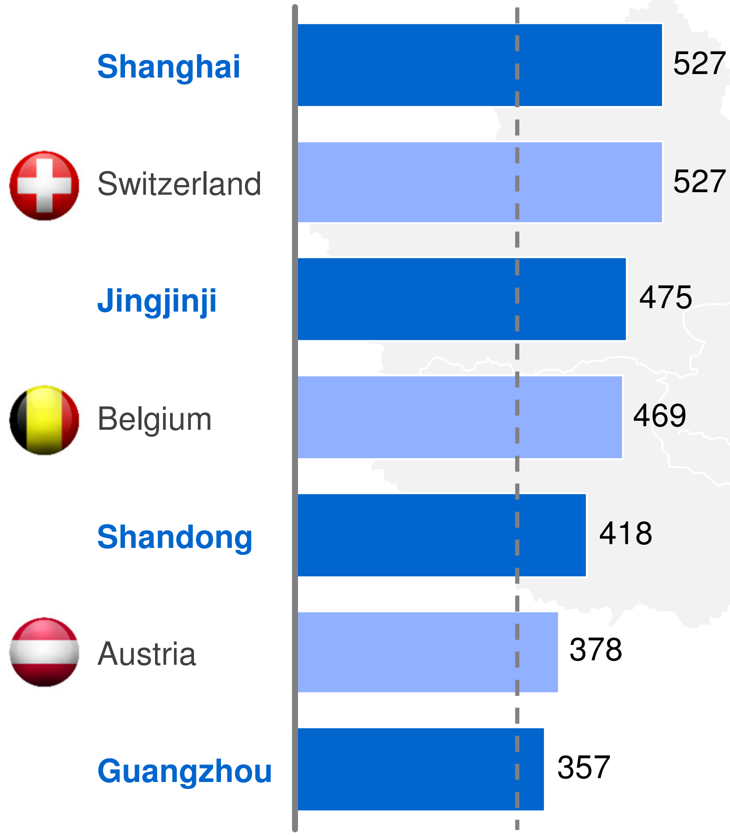
Pekanbaru, Riau
Island of Sumatra, western Indonesia
1 million inhabitants
7.3% GDP CAGR expected through 2030

Foshan, Guangdong
Southeast China
4 million inhabitants
China’s 7th largest city by GDP

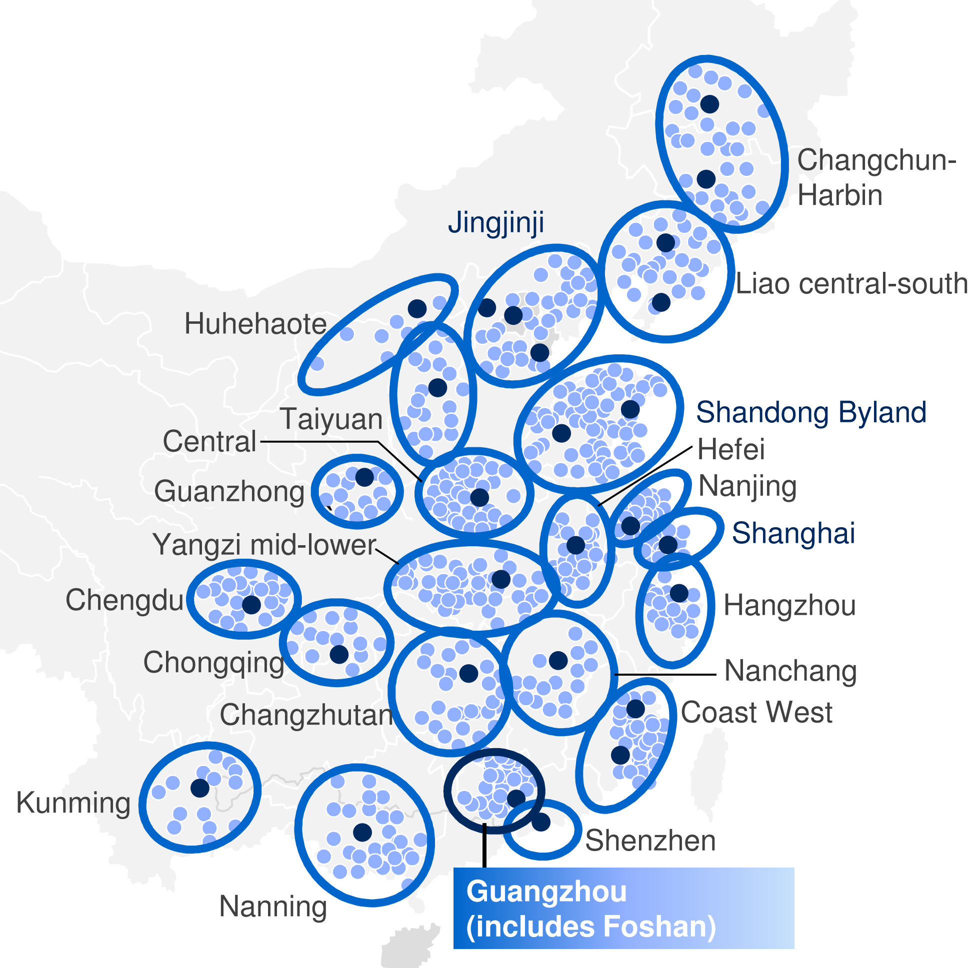
SOURCE: McKinsey Global Institute CityScope 1.1

Cities can be grouped into clusters around a hub city – some clusters are already economically larger than entire countries

2010 GDP for urban clusters
$ Billions



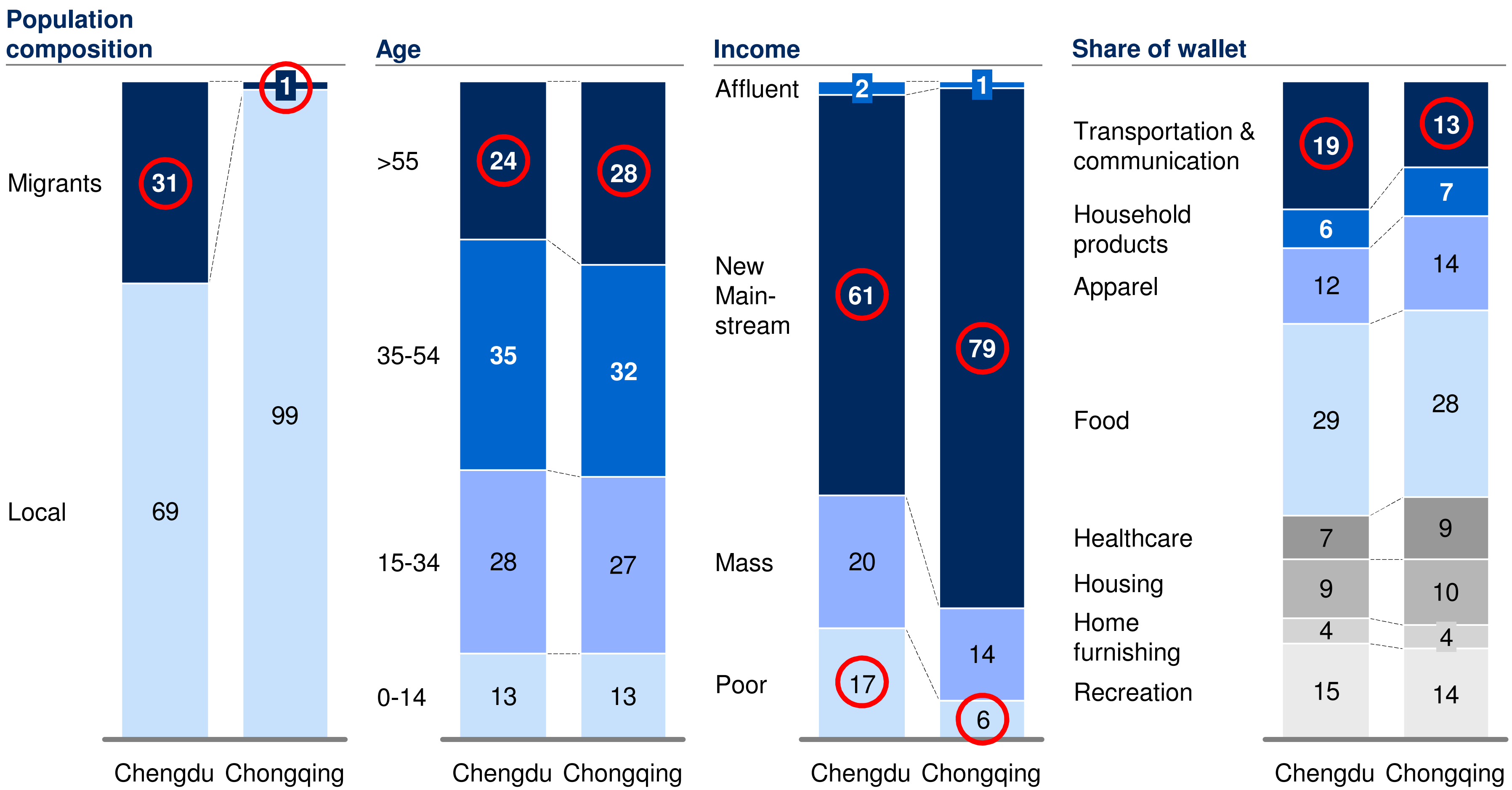
Urban clusters in China and their hub cities



SOURCE: McKinsey Global Institute

Different city clusters have distinct characteristics, even in the same province

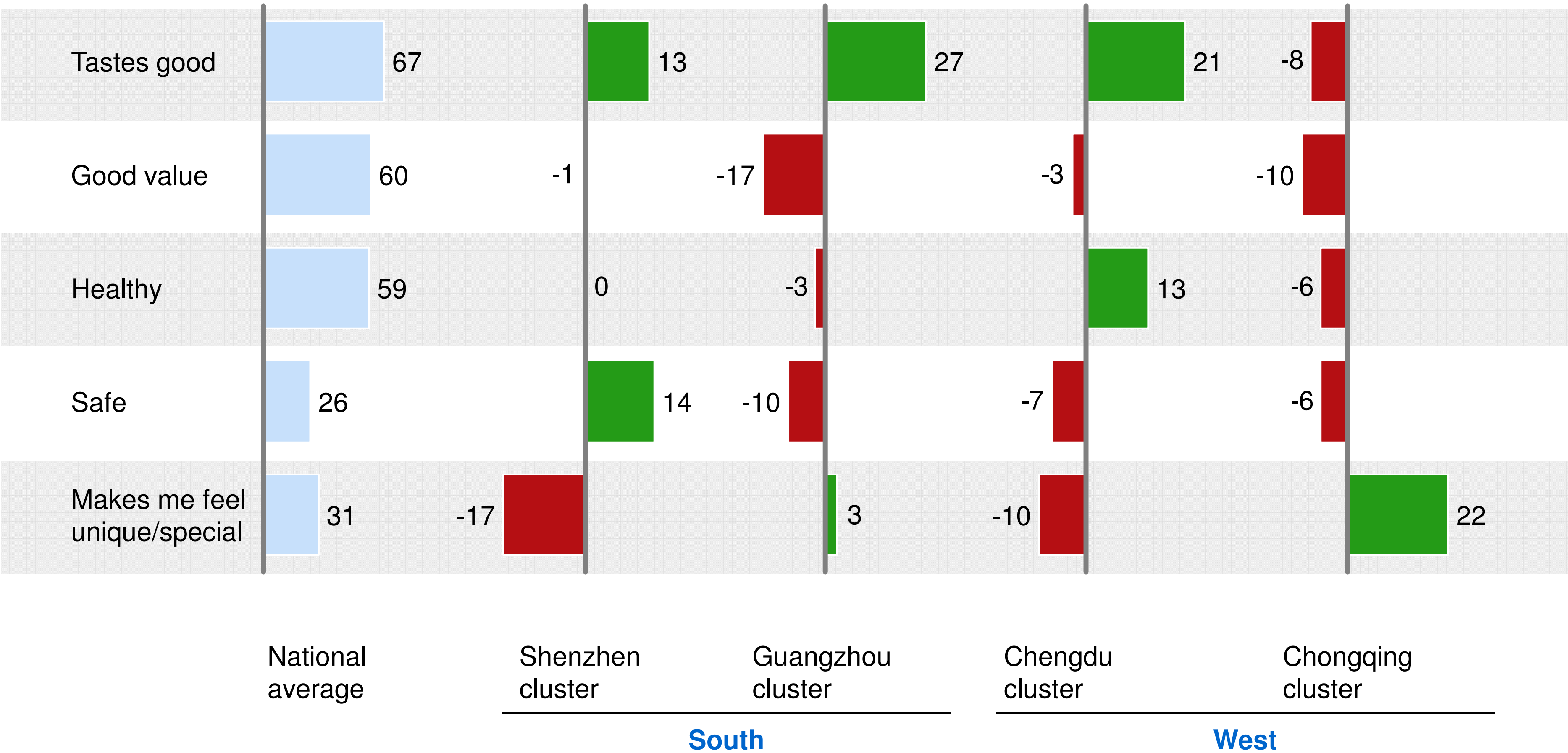
Chengdu and Chongqing city clusters, Sichuan province
Percent



SOURCE: Mckinsey Insights China – Annual Consumer survey (2012), McKinsey Insights China – Macroeconomic model update (Apr. 2012)

Consumer preferences also differ across clusters, even between tier 1 cities in the same region – beverage example

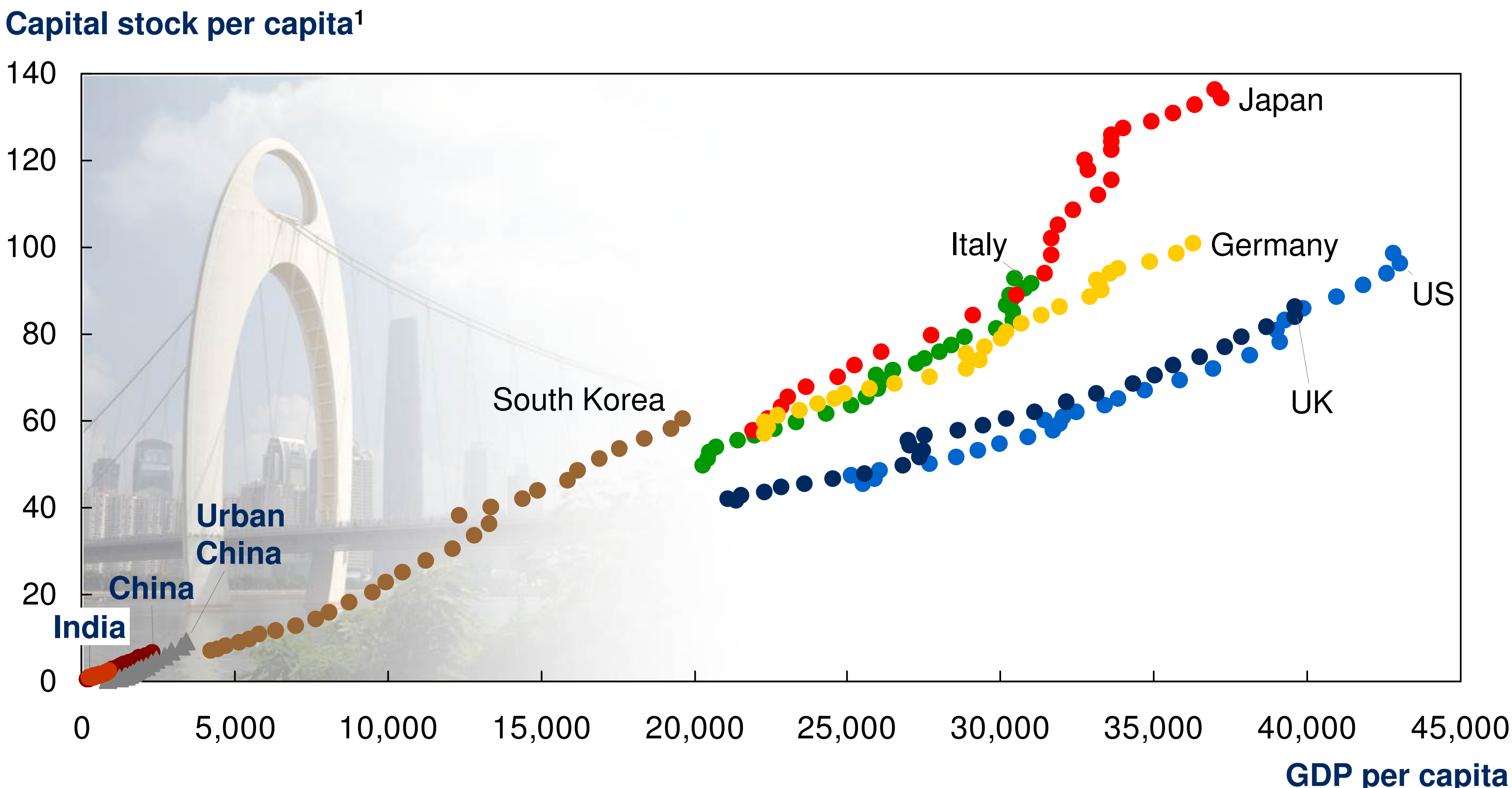
Top 5 beverage selection criteria
Percent of respondents (“Mass” consumers - $6k-$16k/37k-106k RMB/year income)



SOURCE: Mckinsey Insights China – Annual Consumer survey (2012)

As people move to cities and incomes rise, so will demand for new homes, transportation networks, and other infrastructure

Capital stock vs. GDP per capita by country and year, 1980–2008
$ Thousands, sample of selected countries, constant 2005 prices and exchange rates



1 Stock of net fixed assets at the end of the year, assuming 5% depreciation rate for all the assets

SOURCE: McKinsey Insights China; McKinsey Global Economic Growth Database; McKinsey Global Institute

Emerging market cities will become the leading consumer markets globally – even for products catering to the elderly

xx Emerging
xx Advanced




2025 Rank	Elderly, higher-income consumers	Young entry-level consumers	Laundry care products	Municipal water demand
1	Shanghai	Lagos	São Paulo	Mumbai
2	Beijing	Dar es Salaam	Beijing	Delhi
3	Tokyo	Dhaka	Rio de Janeiro	Shanghai
4	Tianjin	Ouagadougou	Shanghai	Guangzhou
5	Mumbai	Khartoum	Mexico City	Beijing
6	São Paulo	Ghaziabad	Moscow	Buenos Aires
7	Osaka	Sanaa	Bangkok	Kolkata
8	Chongqing	Nairobi	Istanbul	Khartoum
9	Delhi	Luanda	Manila	Dhaka
10	Nanjing	Baghdad	Johannesburg	Istanbul
11	Guangzhou	Kampala	Belo Horizonte	Dallas
12	New York	Ibadan	Porto Alegre	Pune
13	Seoul	Lusaka	Buenos Aires	Las Vegas
14	Hong Kong	Kinshasa	Tianjin	Karachi
15	Wuhan	Kano	Tehran	São Paulo

SOURCE: McKinsey Global Institute

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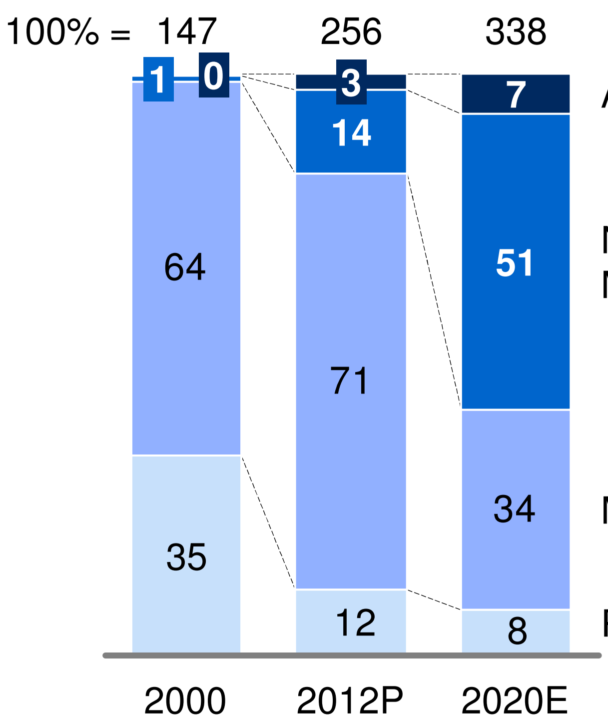
Wealthier “New Mainstream” consumers are quickly replacing “Mass” consumers as China’s largest group of urban consumers

Number of urban households by annual household income
Million households, percent



Segment	Annual disposable income per urban household RMB (USD)	CAGR 2000-12P	CAGR 2012P-20E
Total		4.8	3.5
Affluent	>229,000 (>~$34k)	24.2	15.9
New Mainstream	**106,000–229,000 ($16k-$34k)**	30.5	21.3
Mass	**37,000–106,000 ($6k-$16k)**	5.7	-5.5
Poor	<37,000 (<~$6k)	-4.4	-1.0

SOURCE: McKinsey Macroeconomic model update (Apr. 2012)

How does the New Mainstream consumer differ from the Mass consumer?

1. Younger and has different attitudes toward consumption
2. Prefers expensive and luxury goods
3. More brand loyal and prefers foreign brands
4. Uses the Internet more for researching and making purchases

1 New Mainstream consumers are younger, live primarily in tier 1 & 2 cities, and seek more intangible benefits from purchases

			New mainstream consumers	Vs.	Mass consumers
Who they are		Household income	RMB 106-229 K ($16k-$34k USD)		RMB 37-106 K ($6k-$16k USD)
		% under 35	45%		37%
Where they live		% in tier 1 & 2 cities	74%		43%
		% inland	17%		36%
What they are looking for		Durability	36%		61%
		Emotional benefits	23%		15%

SOURCE: McKinsey Annual Chinese Consumer Survey (2012)

1 This younger group includes many 2nd generation, or "G2", middle-class consumers, who have different attitudes toward consumption

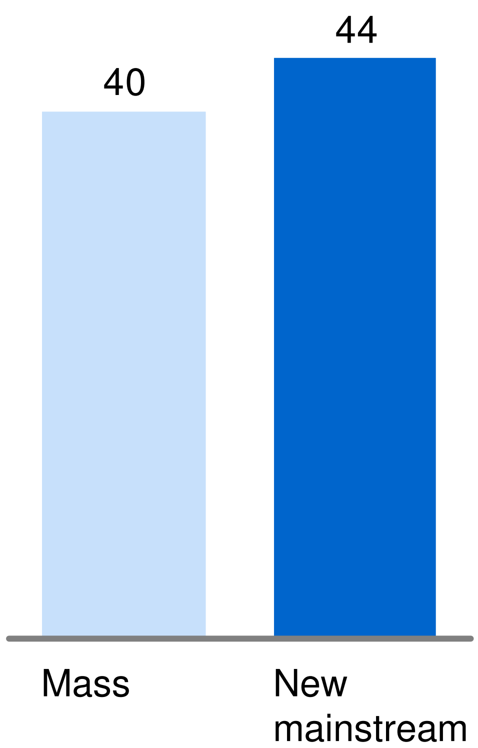
- The **first generation** middle class lived through many years of shortage and are **primarily concerned about economic security**
- **G2 consumers were born and raised in abundance** and are mostly the only children in their families
- G2 consumers are **more confident about their financial future**, are interesting in trying new products, and are more brand loyal than other middle class consumers
- **In 2020, 35% of total consumption** in China is expected to come from G2 consumers
- G2 consumers will be major purchasers of **leisure, personal services, travel, and high-end hospitality**

SOURCE: McKinsey Insights China

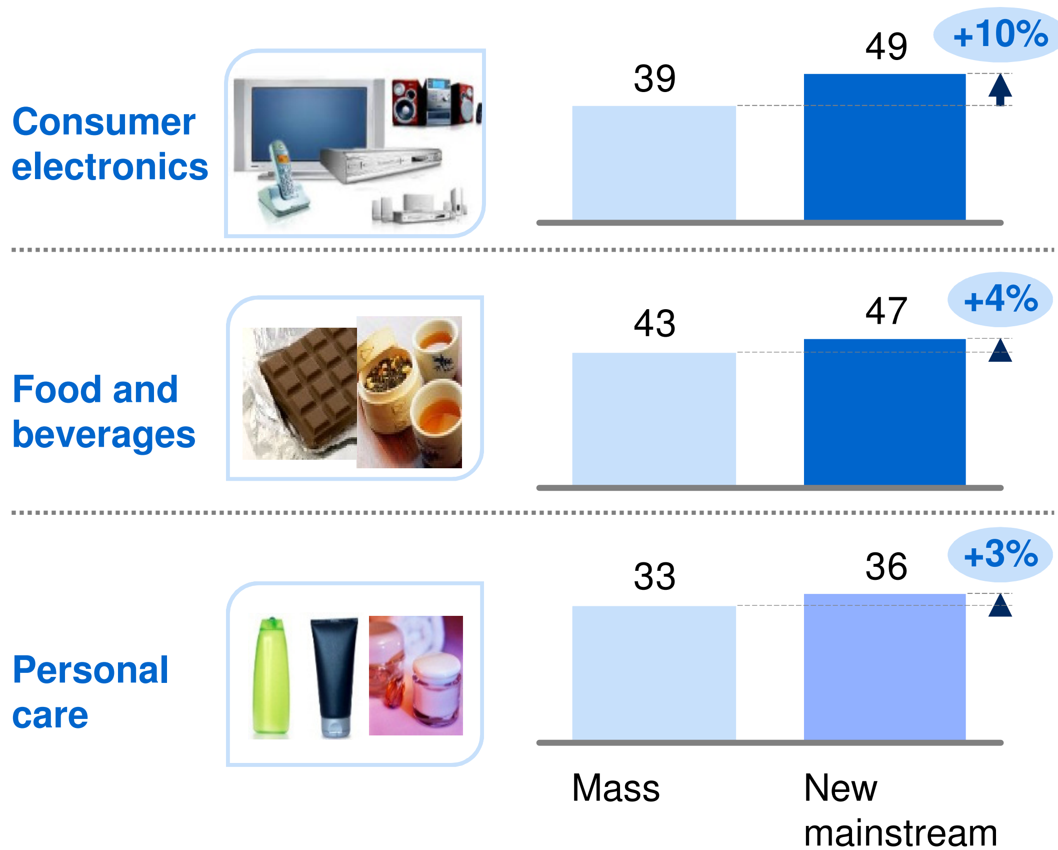
2 New Mainstream consumers believe expensive products are of better quality and are more likely to trade up

Percent of respondents who agree

"Expensive products are of better quality"



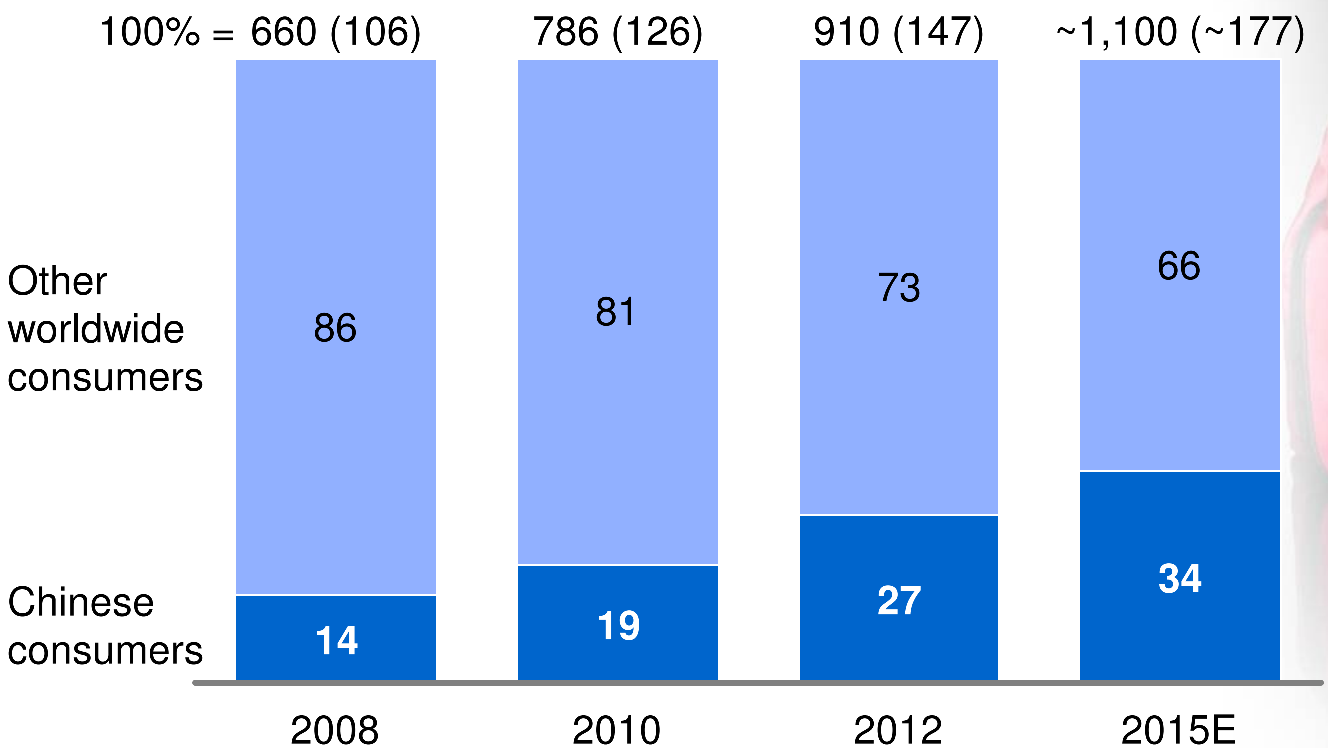
"Within a range of prices I can afford, I always pay a premium price for the most expensive and best products"



2 Trading up is expanding the Chinese luxury market – Chinese consumers will overtake Japan as the world's largest luxury market by 2015

Luxury goods consumption worldwide 2008-2015

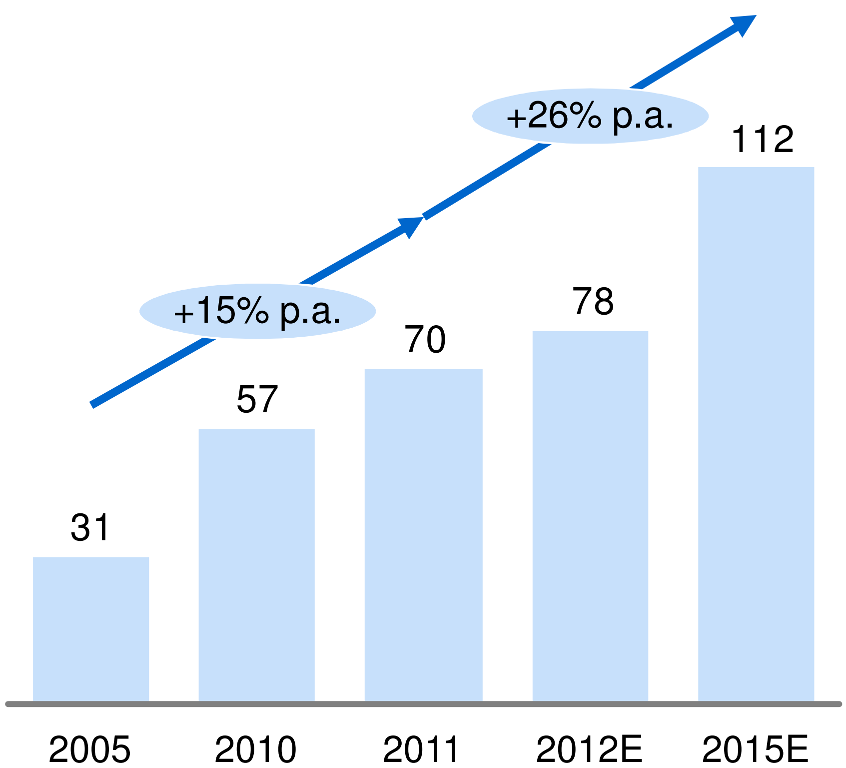
2012 RMB billions, percent (USD billions)



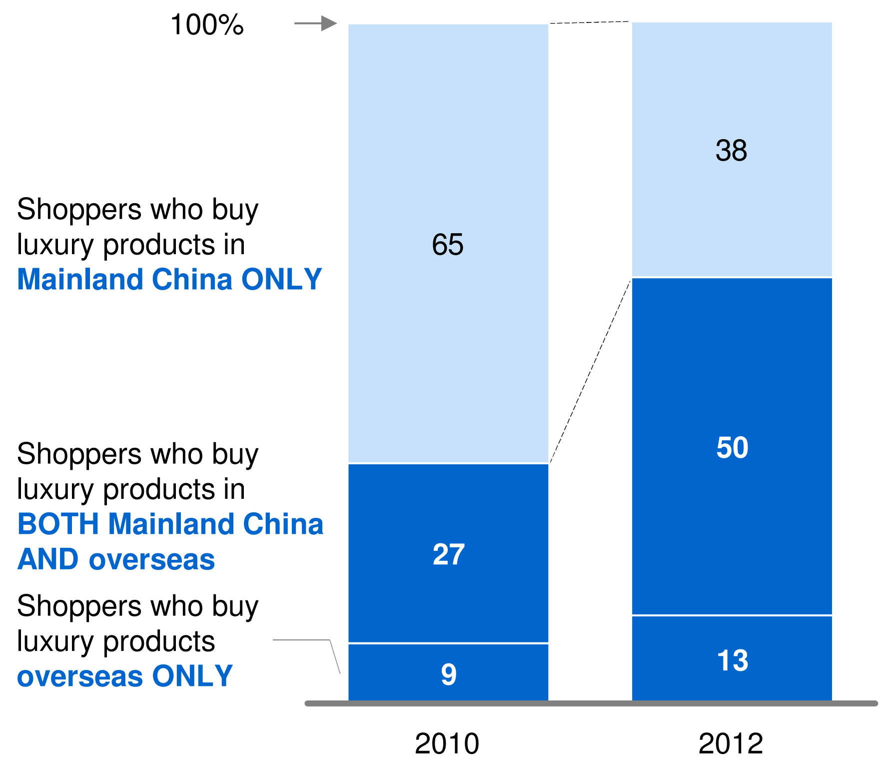
SOURCE: McKinsey Insights China - Luxury Consumer Studies (2008, 2010, 2012); literature search; experts interviews; HSBC report; Company financial report

2 Rising tourism is broadening the footprint of Chinese luxury consumers to other countries

China outbound travelers
Millions

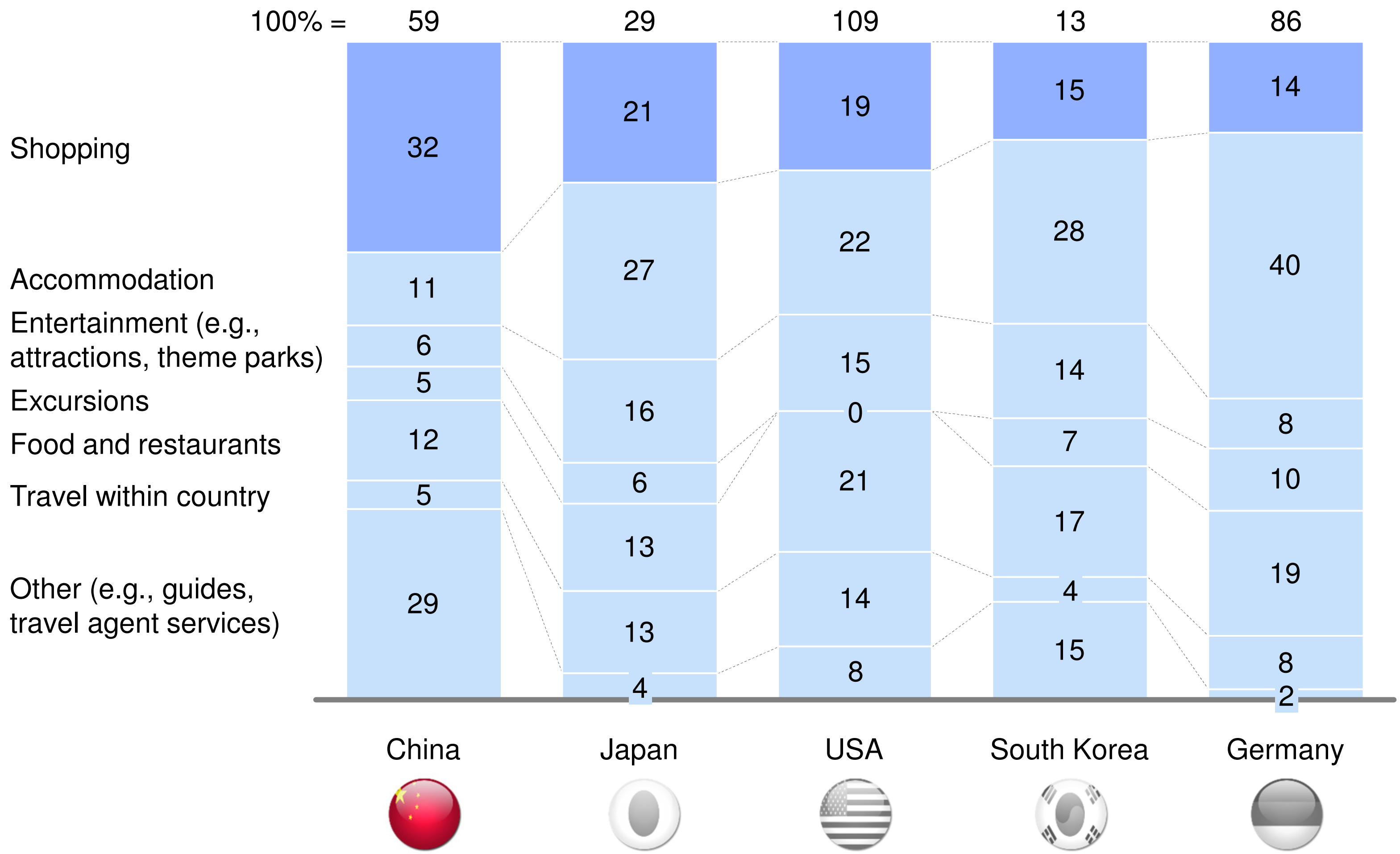


Share of luxury shoppers by shopping destination
Percent



2 Tourists from China spend much more on shopping than those from other countries

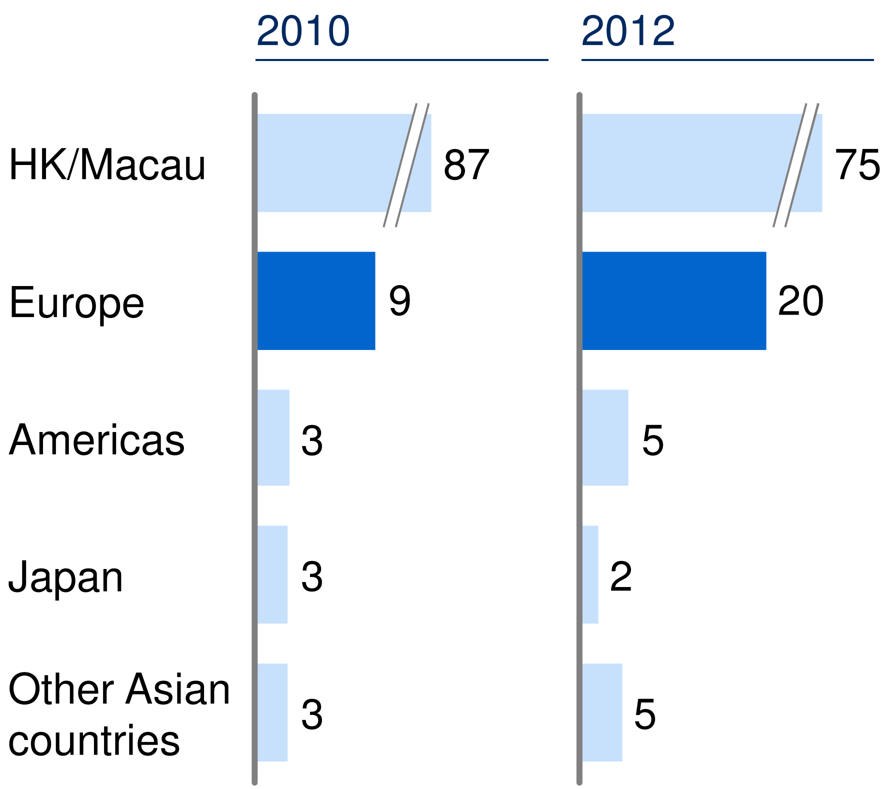
Tourist expenditure by home country
Percent, USD billion



SOURCE: Euromonitor International from official statistics, trade associations, trade press, company research, trade interviews, trade sources

2 Europe is growing in appeal among Chinese luxury shoppers

"Where have you made your most recent overseas purchase?"
Percent of respondents



"We went to Europe because the Euro dropped and we felt like going there too.
– A Beijing business man

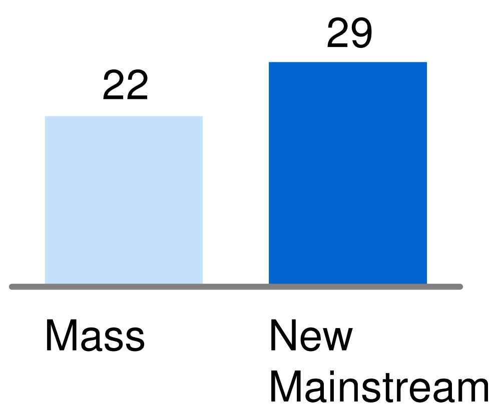
"My 16-year old daughter bought me shoes in Europe. The mid-aged European knelt down to help her and talked with her very nicely. In China, they wouldn't refuse to sell to her but they wouldn't serve her amiably.
– A Shanghainese woman

SOURCE: McKinsey Insights China – Luxury Consumer Studies (2010, 2012)

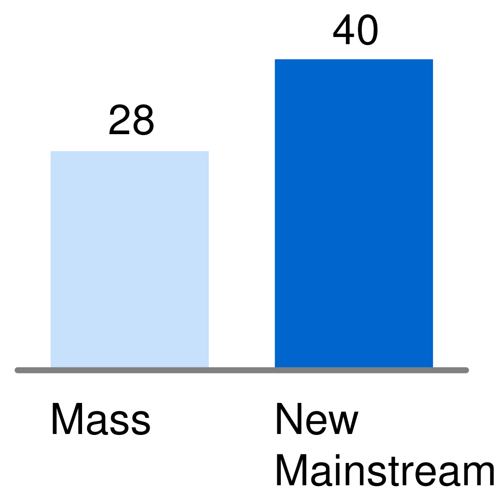
3 New Mainstream consumers are more brand loyal …

I only buy the brand I prefer
Percent of respondents agreeing

Washing machine



Mobile phone



SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2012)

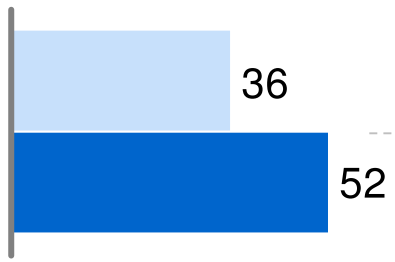
3 … and have a stronger preference for foreign brands than Mass consumers

Mass | New Mainstream

Brand preference by category

Percent of respondents preferring foreign brands over Chinese brands

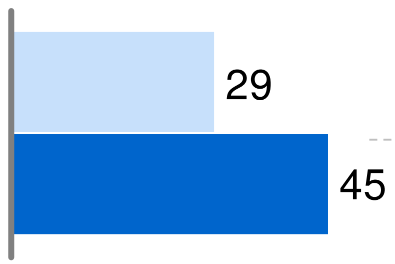
Personal care products



Dabao TJOY

OLAY L'ORÉAL

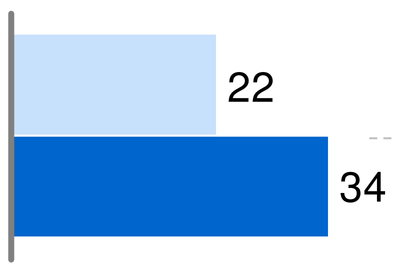
Household care products



蓝月亮

Amway Raid Mr Muscle

Food & Beverages

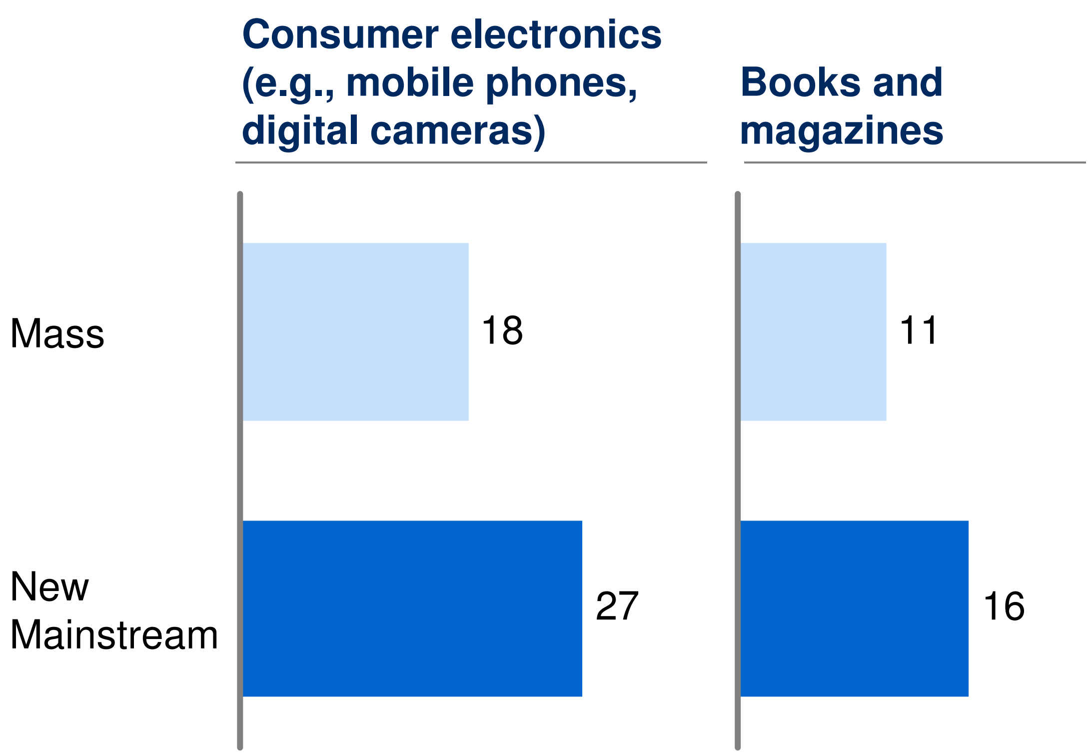


康師傅 娃哈哈

Campbell's Coca-Cola

4 New Mainstream consumers shop online more than Mass consumers

Did you purchase a product online in the past 12 months?
Percent of respondents



SOURCE: McKinsey Insights China Chinese consumer survey (2012)

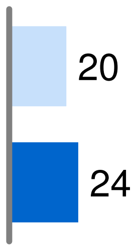
4 They also use the Internet more for researching online and offline purchases

Mass | New Mainstream

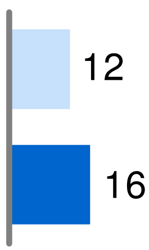
I will not make a purchase before researching it first on the Internet

Percent

When purchasing consumer electronics (e.g., mobile phone)

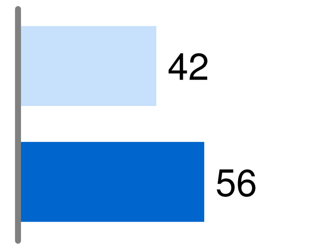


When purchasing personal care products

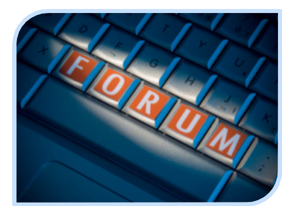


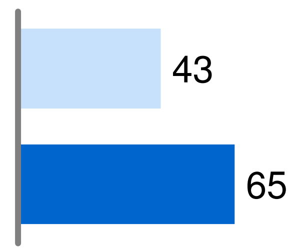
Percent of users who trust each information source

Internet

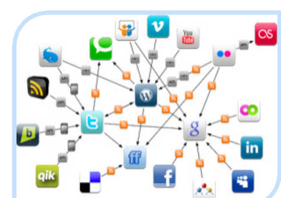


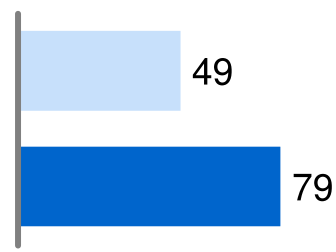
Online forum (e.g., Dianping)





Social media site (e.g., Renren, Kaixin)

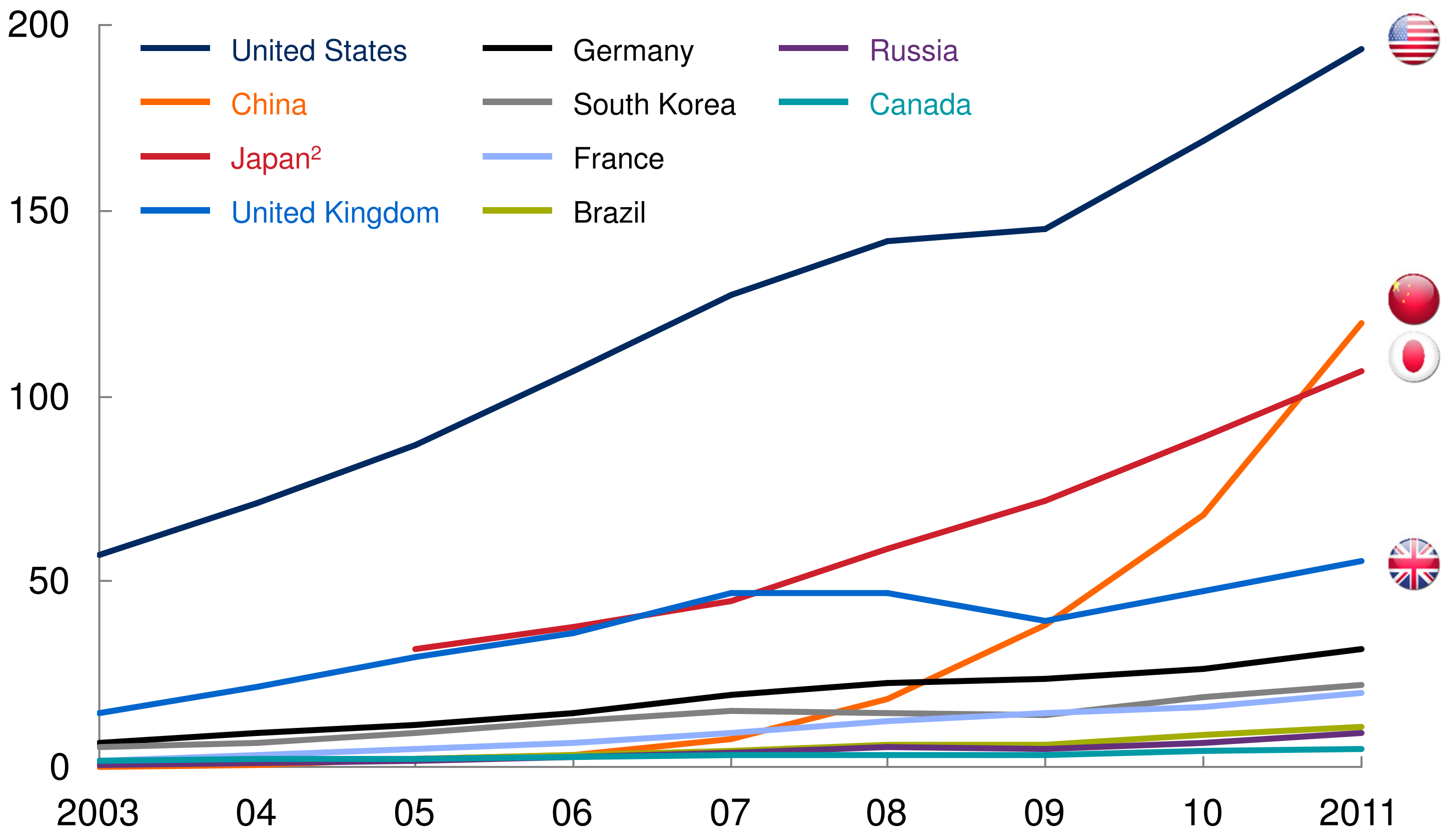




SOURCE: McKinsey Insights China – Annual Chinese Consumer Studies (2012)

4 China's changing consumer market and growing Internet penetration have fuelled its rapid ascent into the second-largest "e-tailing" market

2003–2012 e-tailing (online retail) market[1]
$ Billion



Compound annual growth rate, 2003–11
%

US	17
China	120
Japan[2]	27
UK	18
Germany	22
S. Korea	19
France	35
Brazil	34
Russia	39
Canada	14

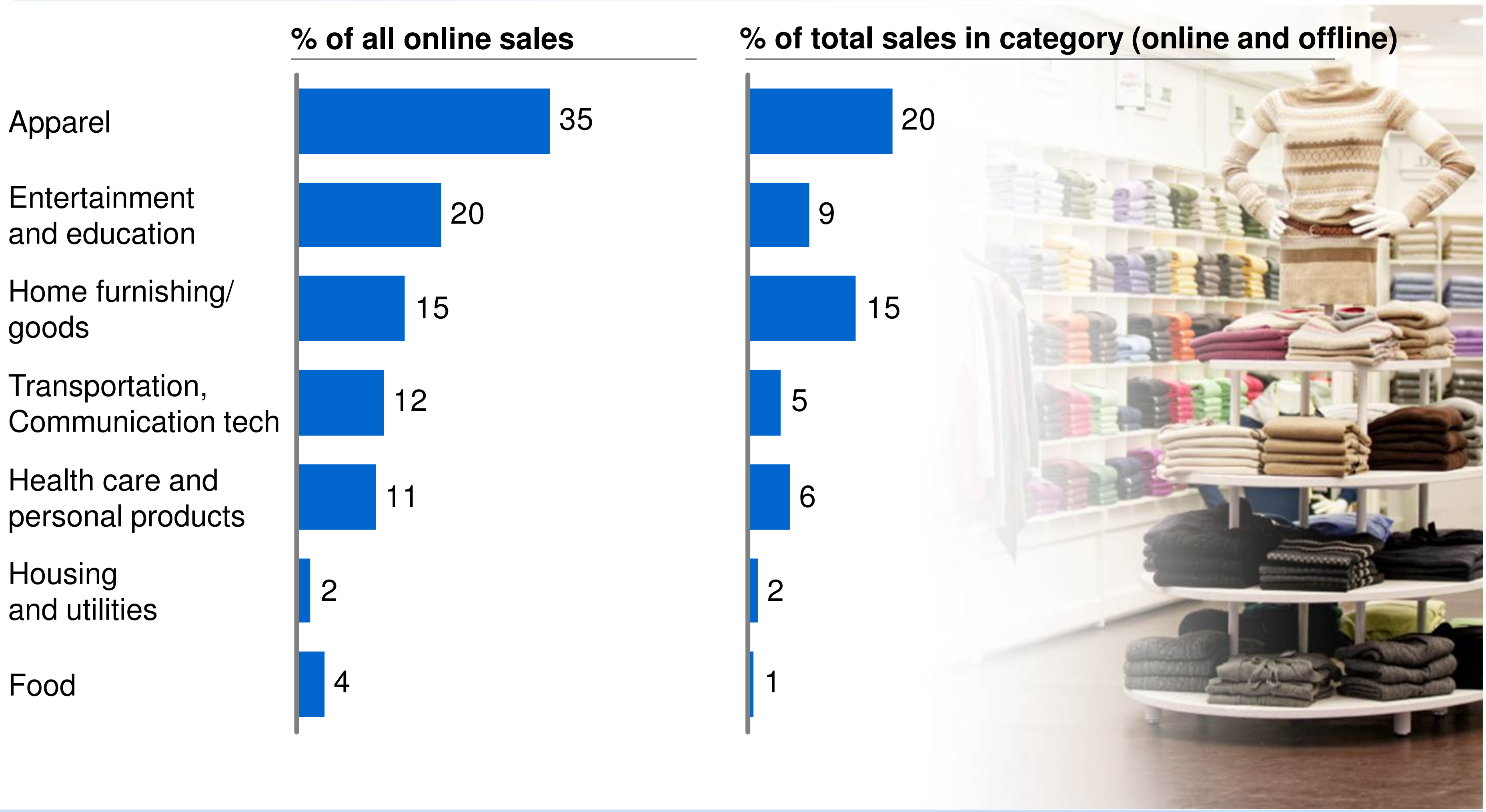
1 Excluding online travel
2 Japan's CAGR covers 2005–11

SOURCE: Euromonitor; Forrester; US Census Bureau; Japanese Ministry of Economy, Trade, and Industry; iResearch; McKinsey Global Institute analysis

4 70% of online purchases in China are for apparel, entertainment and education, and home furnishing/goods

China's e-tailing product category share, 2011

%

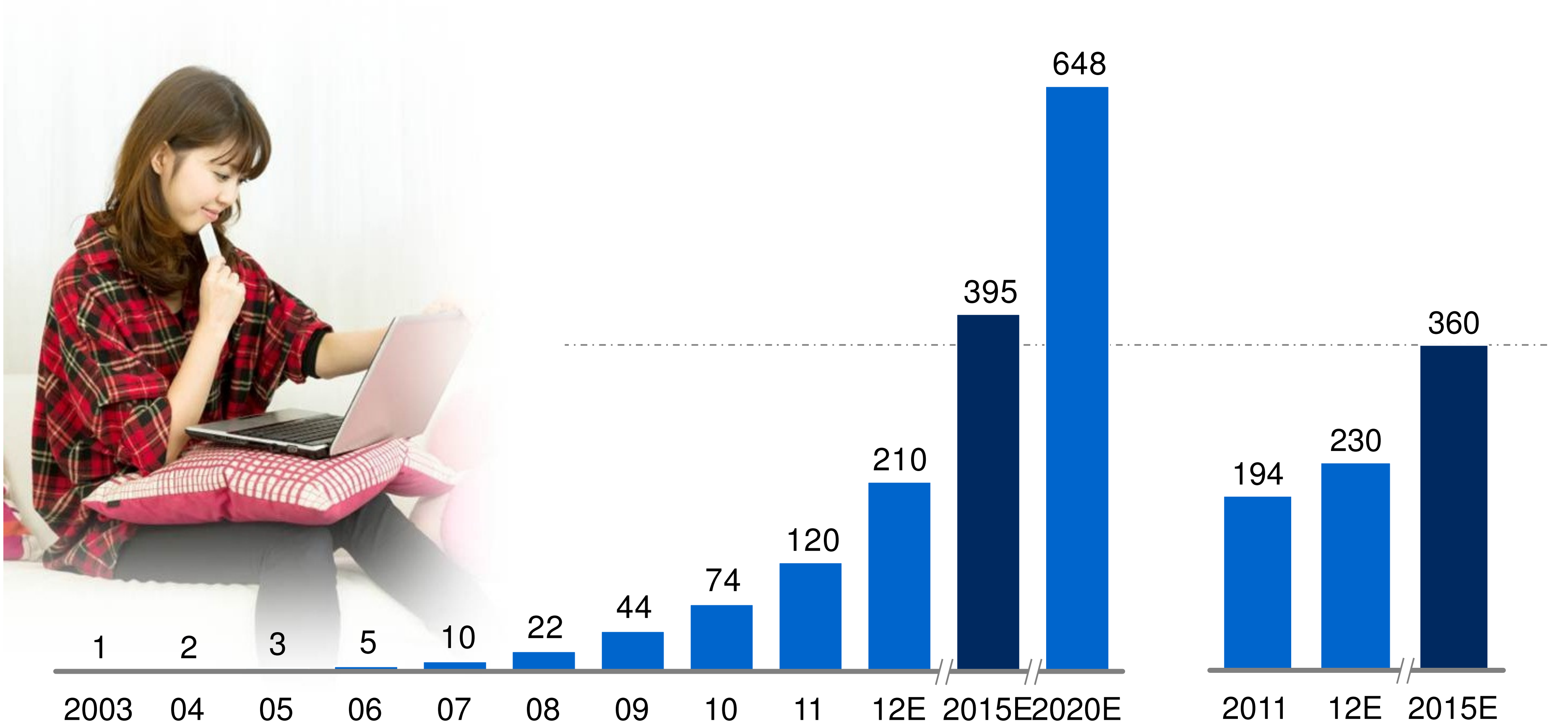


SOURCE: McKinsey Global Institute analysis

4 If broadband and mobile Internet continue to grow, China's e-tailing market could surpass the US by 2015 and grow to $650 billion by 2020

China's e-tailing market
USD billion

US e-tailing market
USD billion



SOURCE: iResearch; McKinsey Insights China database; McKinsey Global Institute analysis

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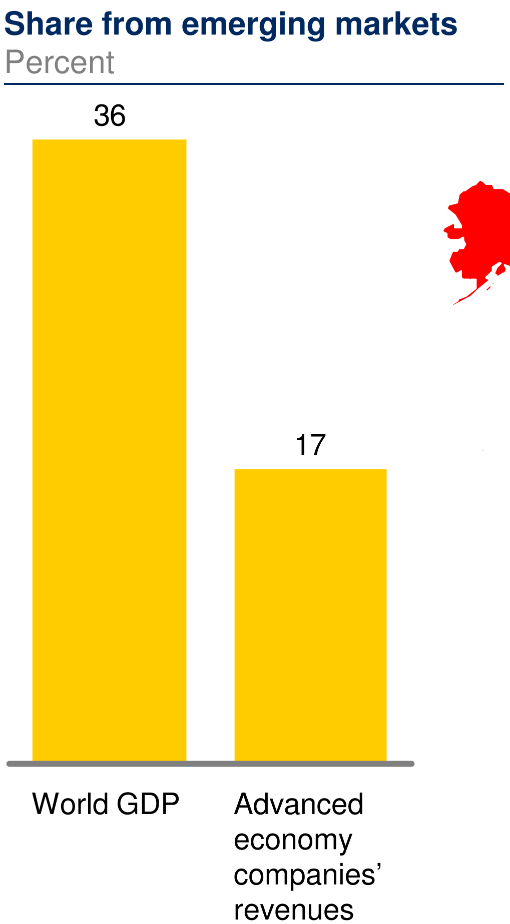
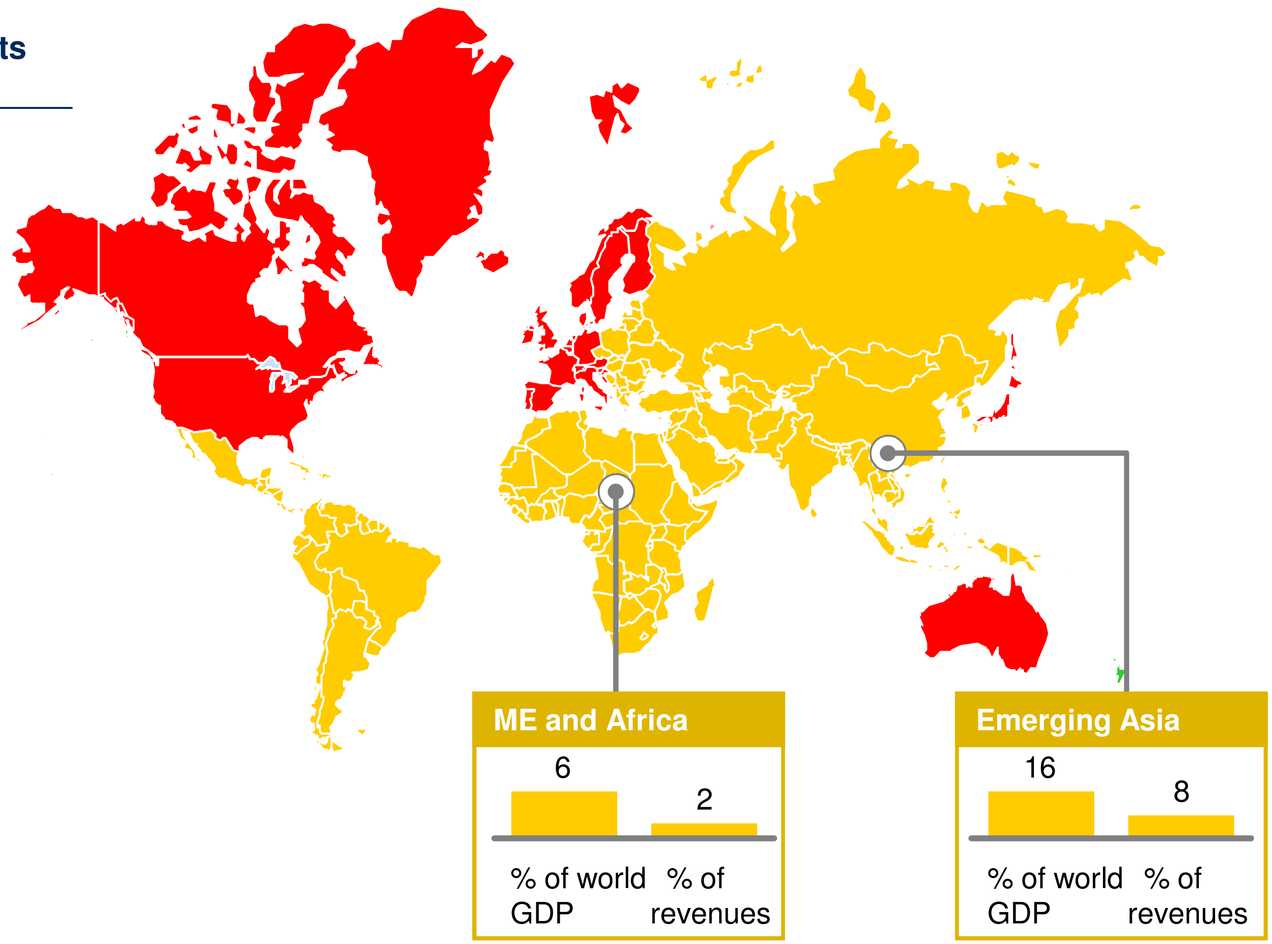
2 The new Chinese consumer

3 **Seizing the opportunity**

Western MNCs have an enormous opportunity to shift their business to Asia

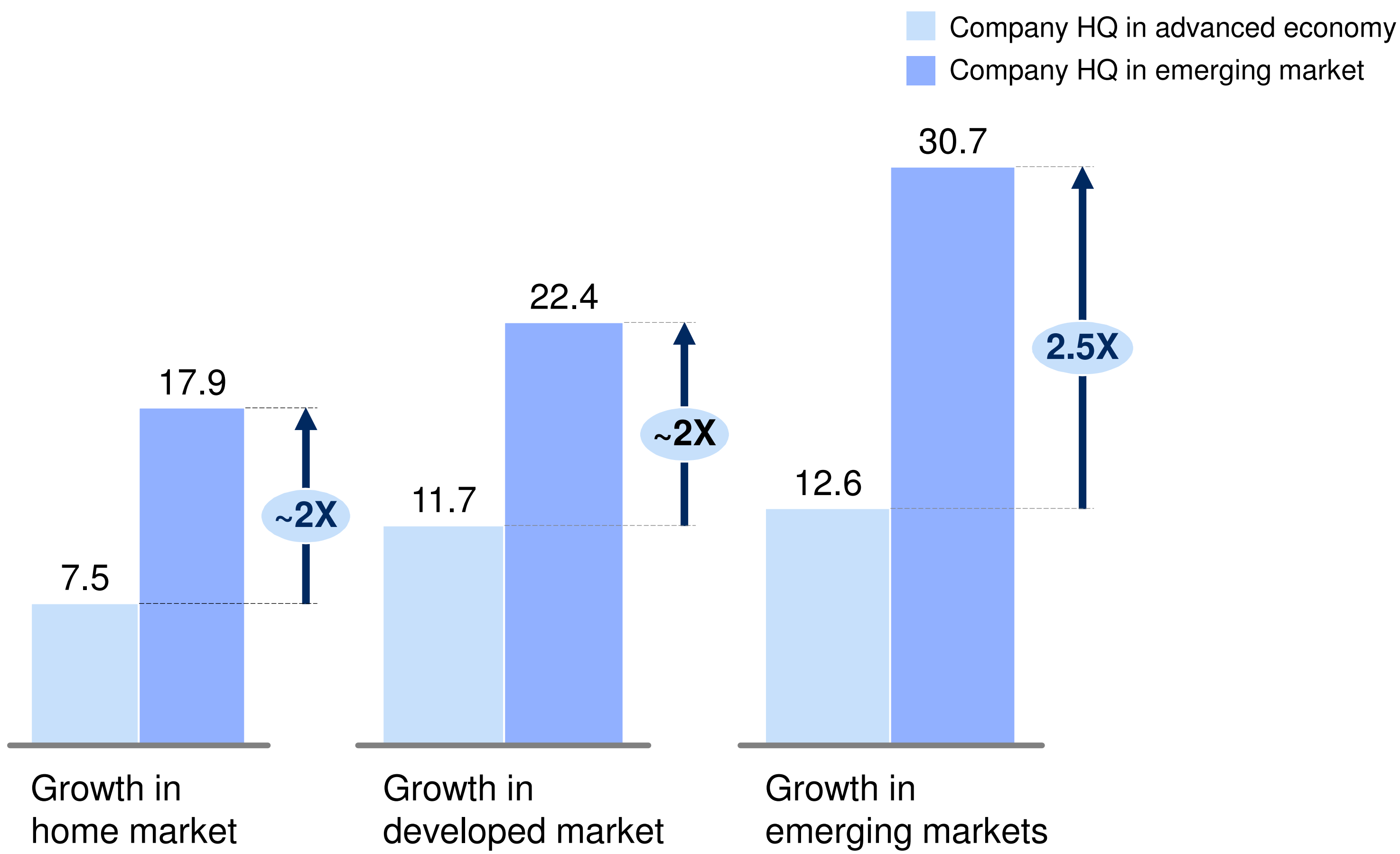
By geography, revenues of advanced economy companies vs. World GDP





Emerging market companies are already growing faster than advanced economy rivals

Revenue CAGR



SOURCE: Growth decomposition database; McKinsey analysis

Wahaha – innovation-driven growth

Entry and countryside focus (1990-1995)

- Used cheap products and strong third-party distribution model to successfully penetrate the vast rural areas surrounding big cities in China

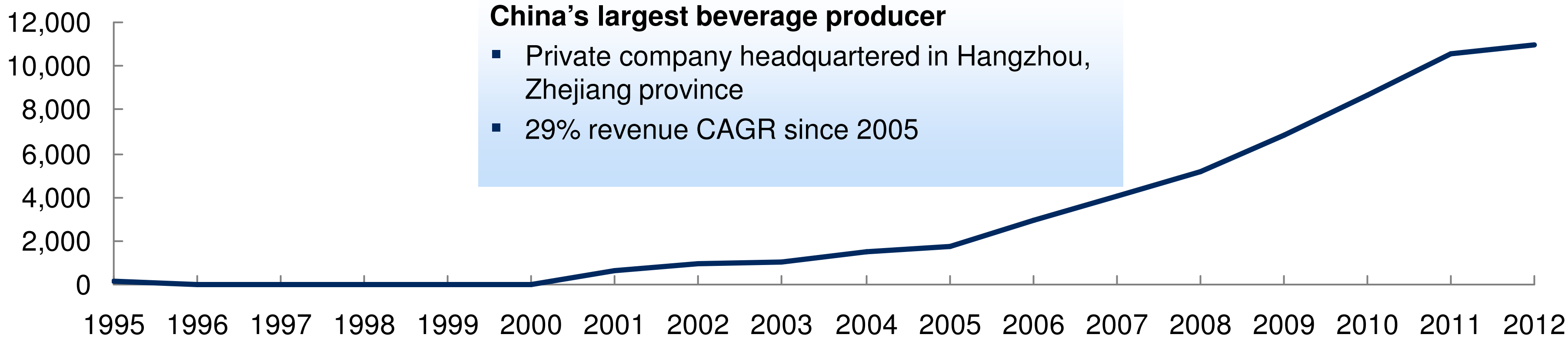
Strong innovation and distribution (1995-2005)

- Developed flexible R&D to quickly copy successful products and take them to market through a trial and error strategy; e.g., bottled water (1996) and Future Cola (1998)
- 2009: Branched out to children's apparel
- Refined distribution model to be able to provide higher trade margins, rebates, and bonuses

Continued expansion and diversification (2005-present)

- Has started to pay more attention to tier 1 cities in recent years
- Entered infant milk market in 2010
- Invested in commercial property in 2011 and plans to build 100 shopping malls in 3-5 years

Sales revenue
USD mn



China's largest beverage producer

- Private company headquartered in Hangzhou, Zhejiang province
- 29% revenue CAGR since 2005

SOURCE: Annual reports; Euromonitor; literature search

Kang-Shi Fu – strong branding and active partnership strategy

Entry and healthy growth (1988-1996)

- Started instant noodle business and quickly built a leading position (50% market share by 1996)
- Built 7 new factories in major cities in China to accelerate national coverage

Diversification and improved distribution (1996-2000)

- Entered the bakery and beverage business
- Started to build a systematic distribution system
  - Turned original wholesalers to distributors
  - Built sales offices in major cities;
  - Created on-the-ground sales teams in charge of outlets

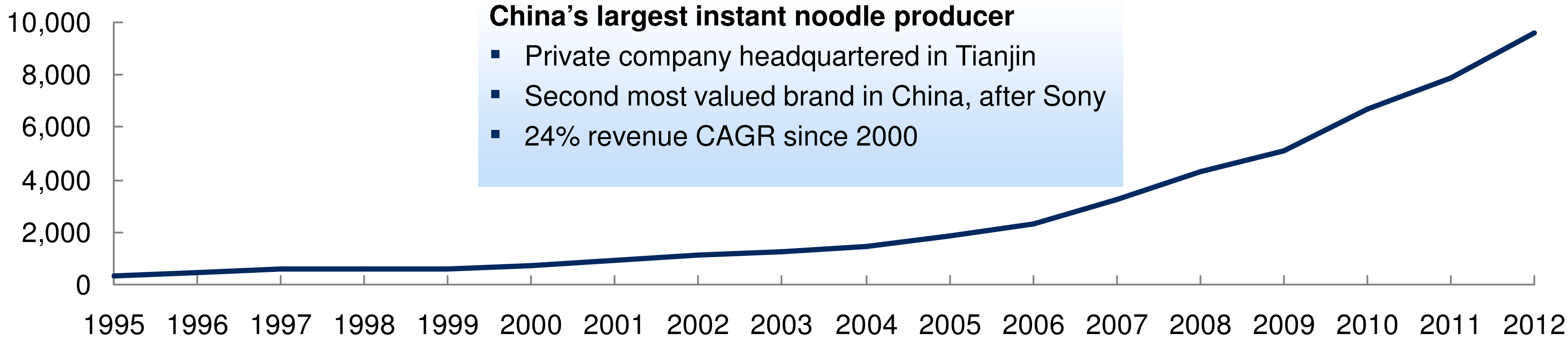
Expansion, POS execution focus and partnerships (2000-present)

- Invested heavily in advertising and capacity in early 2000 (achieved leadership in RTD tea market with ~40% market share)
- Focused on top modern retailers with direct distribution to ensure improved service levels and product availability
- Deployed more resources to develop presence in rural areas
- Formed alliance with Pepsi China (2011) to distribute all Pepsi beverages for the China market

Sales revenue
USD mn

China's largest instant noodle producer

- Private company headquartered in Tianjin
- Second most valued brand in China, after Sony
- 24% revenue CAGR since 2000



Seizing the opportunity – three lessons from emerging market companies

Emerging market companies …

Risk appetite

Have higher **appetite for risk and invest more aggressively**

- Lower dividend payout rate: 39% vs. 80% earnings returned to shareholders
- Faster fixed assets growth: 12% per year vs. 7.4%

Agility

Make decisions and allocate reallocations with more agility

- Concentrated ownership – 40% majority shareholder vs. 10%
- Higher asset turnover and capex reallocation to new business opportunities (~1.2X)

Innovation

Are **innovating at breakneck speed**

- ~3X growth rate in # of patents filed over last 10 years

SOURCE: McKinsey analysis; *Granularity of Growth*

The New Asian Middle Class

Asia House

Dominic Barton, Global Managing Director
McKinsey & Company

4 April 2013

McKinsey&Company