Chinese Consumers Series - Issue 2

A bird's eye view on China's consumer market
– from past to present and into the future

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Service consumption is set to further increase and serve as the main growth driver of consumption

Consumption upgrade is and will continue to be a prominent force driving the transformation of China's consumer market

The millennials allocate more of their income to lifestyle services and experiences

Technologies will continue to affect every stage and aspect of the shopping journey, both online and offline, from browsing, delivery, supply chain, payments and more

FUNG BUSINESS INTELLIGENCE

China's consumer market is entering a new chapter of development. In our Chinese Consumers Series Issue 1 "*Understanding China's new consuming class – the millennials*", we identified the characteristics of China's new consumer group and explored how they lead the change in the consumer market. In this article, we look at the evolution of China's consumer market in the last two decades and discuss the trends that will influence the consumption landscape in the coming five years.

From past to present

Consumer market at a glance

Consumer market has increased tenfold over the past 20 years; growth started to slow in 2008

China's consumer market is undergoing a transformation from a high-growth market to a moderate-growth one. Total retail sales of consumer goods increased tenfold to 33.23 trillion yuan in 2016 from 3.1 trillion yuan in 1997 (Exhibit 1). Looking at the growth rate, it reached the peak at 22.7% yoy in 2008, and has started to slow down thereafter. In 2016, the growth rate stayed at 10.4% yoy. Apart from the uncertainty of the macroeconomic environment, the evolving "new normal" economy and changes in consumer behavior also contributed to the slower growth of the total retail sales of consumer goods. Although retail sales growth is slowing, it marks a healthier and more mature consumer market. Quality of goods is getting better while combating counterfeit products is high on the government's agenda. The regulating environment has also improved gradually.

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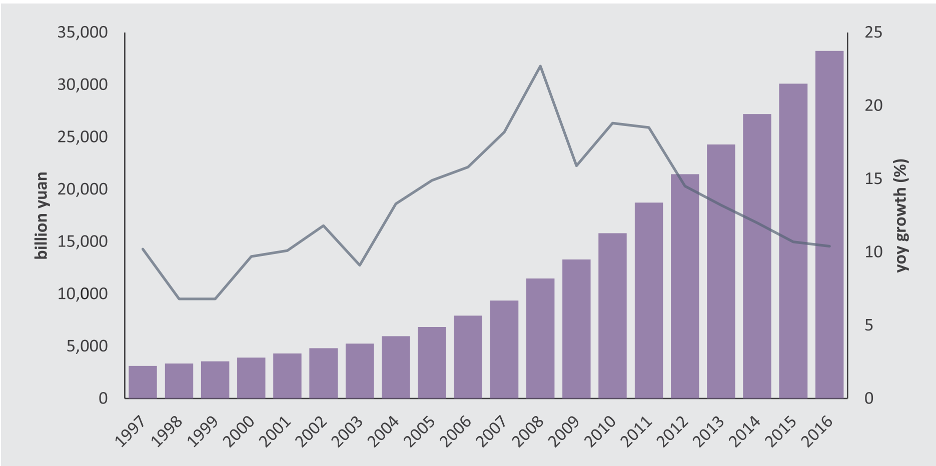
Exhibit 1. Total retail sales of consumer goods, 1997 – 2016



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Household consumption level has increased steadily

Household consumption level in China measures the household consumption expenditure over population. Over the past 20 years, household consumption level of urban residents has increased at a more rapid rate than their rural counterparts (Exhibit 2). With increasing household consumption expenditure, residents have higher spending power and they can upgrade their consumption.

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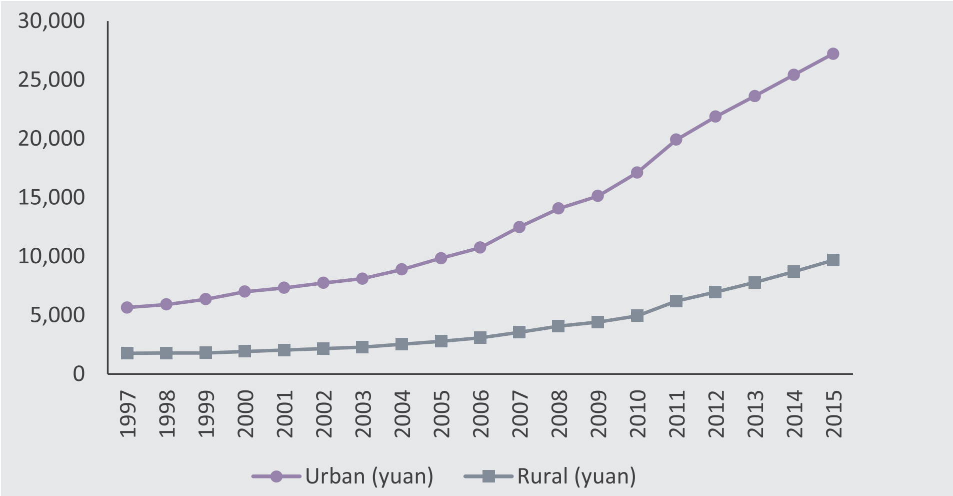
Exhibit 2. Household consumption level, 1997 – 2015



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Increasing urbanization

Urbanization has been a key trend over the course of China's development in the last two decades. Now, over half of China's population lives in urban areas – the share of urban population increased from 31.91% in 1997 to 57.35% in 2016 (Exhibit 3). The retail infrastructure of urban areas is better than rural areas, and the spending power of urban residents is higher than rural residents. Higher urbanization rate is certainly a major growth driver for the consumer market.

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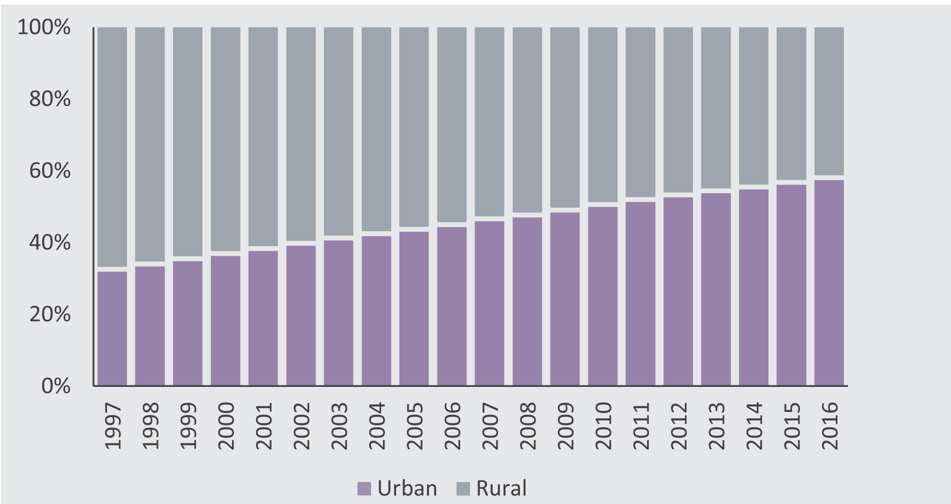
Exhibit 3. Population by urban/rural, 1997 – 2016



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Channel shift: Emergence of new retail formats

Over the past years, consumers have been shifting from big-box retailers to small-format retailers. Small-format shops have gained increasing popularity as they can better address consumers' increasing demand for convenience, personalization, and fast services. Exhibit 4 compares the number of retail outlets of department store, supermarket and convenience store. There is a clear trend that the number of convenience store outlets has been on the rise, while the growth pace of department store and hypermarket outlets has slowed as a result of higher operating costs and the shift away of consumers from large-scale retailers towards smaller retail formats which suit their personal unique needs better.

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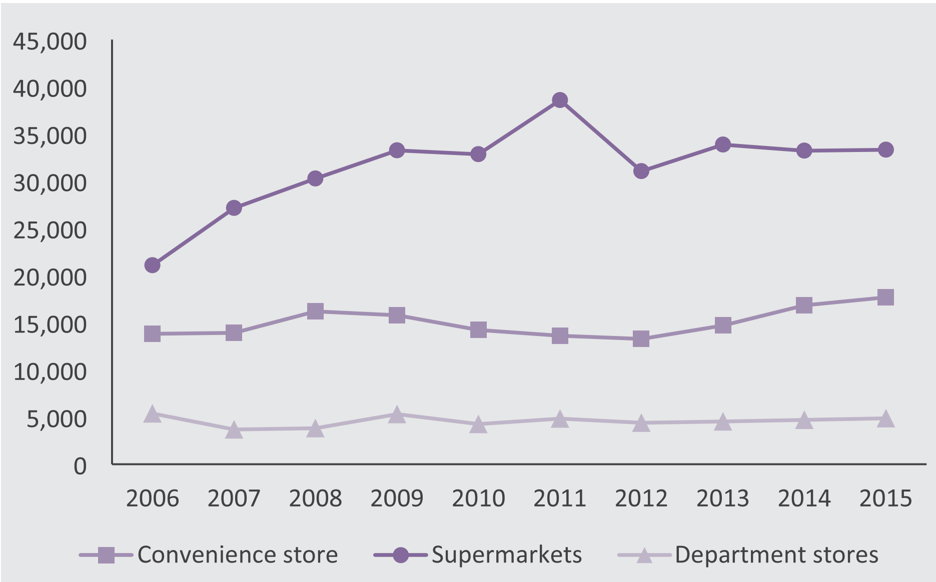
To gain back their market share, some large-scale retailers, especially supermarket and hypermarket players, have opened convenience stores or community stores to serve residents in the neighborhoods. For example, Carrefour has been very active in pursing small-format strategy. It has opened 17 smaller-scale retail stores – Easy Carrefour in Shanghai. With an average area of around 300 sqm, each Easy Carrefour store sells about 4,000 SKUs and serves around 300,000 customers per month.

Exhibit 4. Number of stores of different retail formats, 2006 - 2015



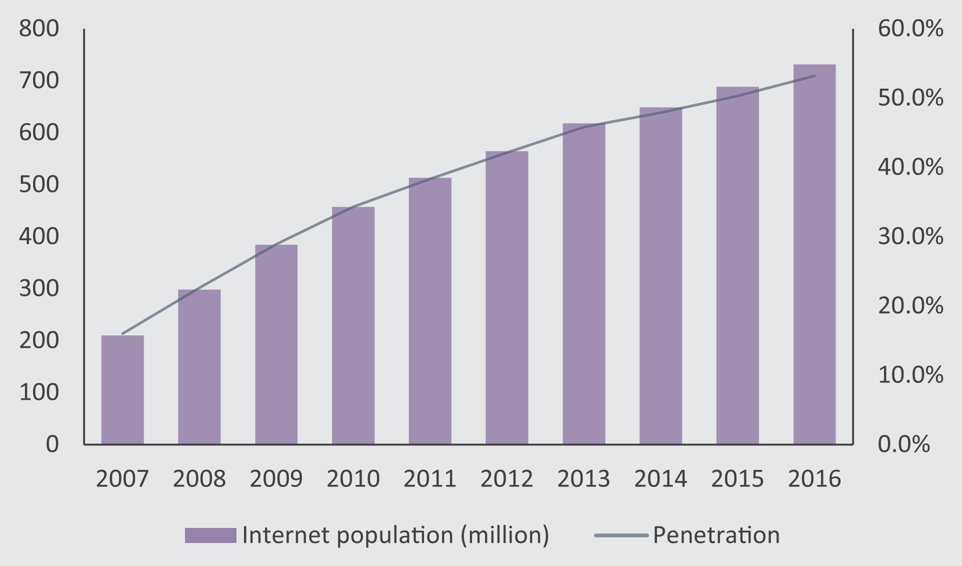
Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Changing consumer needs, new consumption trends

Internet and mobile penetration increases, altering the consumption landscape

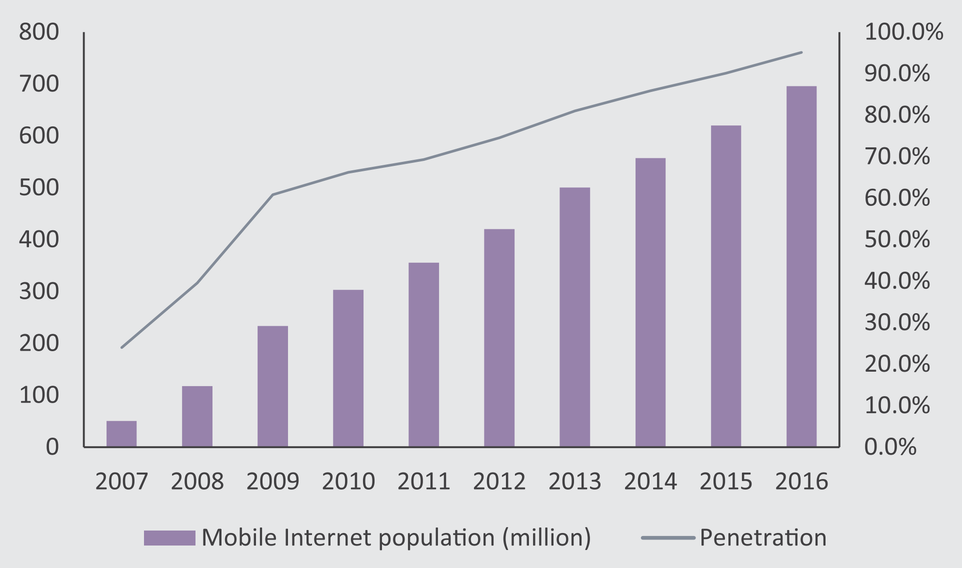
The evolvement of e-commerce is probably the most significant change in China's retail sector in the last decade. Internet population increased from just 137 million in 2007 to 731 million in 2016, with the penetration rate reaching 53.2% (Exhibit 5). In particular, the usage of mobile Internet has increased dramatically over the past years. In 2007, there were only 50.4 million people using mobile devices to access the Internet; the number went up to 695.31 million in 2016, with over 95% Internet users were on mobile (Exhibit 6).

Exhibit 5. Internet penetration, 2007 - 2016



Source: China Internet Network Information Center; compiled by Fung Business Intelligence

Exhibit 6. Mobile Internet penetration, 2007 - 2016



Source: China Internet Network Information Center; compiled by Fung Business Intelligence

The continuing mobile revolution has changed the retail landscape. Chinese online shoppers are increasingly using mobile devices to make purchases. The increasing penetration of smartphones and growing prevalence of mobile payments have made mobile shopping more popular. According to the National Bureau of Statistics of the PRC, the transaction value of China's online retail market increased 26.2% yoy to reach 5.16 trillion yuan in 2016 (Exhibit 7), up from 0.8 trillion yuan in 2011. Within the online sector, the growth of the transaction value via mobile devices is even more significant, up from nothing in 2011 to 3.3 trillion yuan in 2016 (Exhibit 8).

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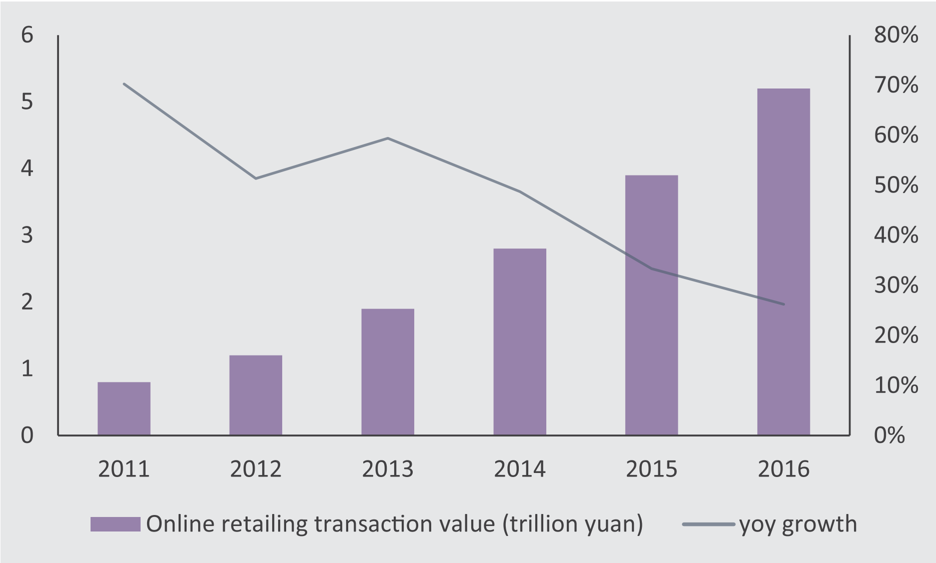
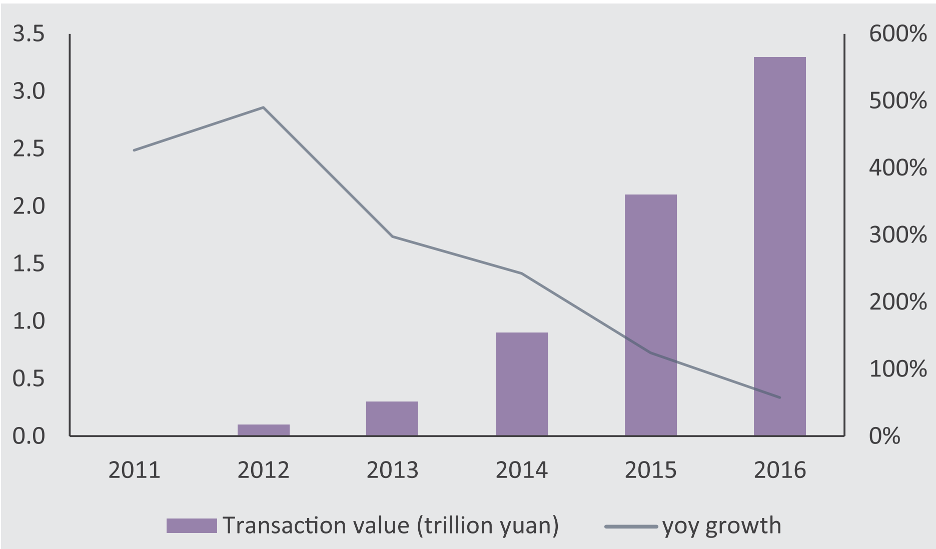
Exhibit 7. Online retailing transaction value, 2011 – 2016



Source: iResearch and National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

Exhibit 8. Transaction value of mobile shopping, 2011 – 2016



Source: iResearch; compiled by Fung Business Intelligence

A desire for omni-channel shopping experience

Under the "New Retail" regime, retailing is no longer online nor offline only; it involves the integration of the both. In recent years, retail operators are taking online-and-offline (O2O) integration more seriously. They leverage mobile, social media and technologies to bridge the gap between offline, online and mobile channels. Some common O2O initiatives adopted by companies include: leveraging mobile technologies to provide personalized services, offering "click & collect" pick up options and smart lockers, enhancing in-store payment services, to name but a few.

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Driven by the needs of consumers, O2O has gone way beyond pure retailing. The manifestation of different forms of O2O business practices has been spread across various industries, particularly services subsectors such as catering, travel, education, automotive and real estate. Sharing economy, social selling, and live broadcasting are also some of the new phenomena.

Increasing demand for high-quality products

Ongoing concerns in China over unsafe and counterfeit products have undermined trust in many locally produced goods, pushing consumers toward foreign brands that are generally perceived to be of higher quality. At the same time, the increasingly health-conscious Chinese consumers also demand safer food and genuine products, providing tremendous opportunities for foreign brands and retailers. An increasing number of international brands have expanded aggressively into the China market over recent years. Cross-border e-commerce (CBEC) has become a popular channel for foreign brands and retailers to sell their products in China. They do not need to obtain Chinese business license or register a company, nor do they need a physical presence in the country if they sell on authorized CBEC platforms such as Tmall Global, JD Worldwide, Suning Overseas, Jumei Overseas.

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For further information on CBEC, please read our publication "*Spotlight on China Retail – Cross-border e-commerce*".

Demographics change bolsters demand for certain categories of products: demand for children-related and elderly products and services increase

The nation-wide implementation of the "Two-Child policy" and the rapidly aging population have changed the population structure of China. Couples in China are now allowed to have two children. According to Credit Suisse, the new policy will bring about 3 to 6 million additional babies per year in China, a population boost of 17% to 33% from the current 16.5 million newborn babies per year. The new baby boom is estimated to bring an additional consumption of 120 million to 240 million yuan per year, representing around 4% to 9% of total retail sales in China, fuelling the demand for children-related products and services.

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On the other hand, the growing size of the elderly population has driven the demand for elderly products and services. The number of citizens aged 65 or above has increased gradually over the years and accounted for 10.5% of the total population in 2015, compared to just 6.5% back in 1997 (Exhibit 9). The booming silver hair market provides a huge and relatively untapped market opportunity for companies.

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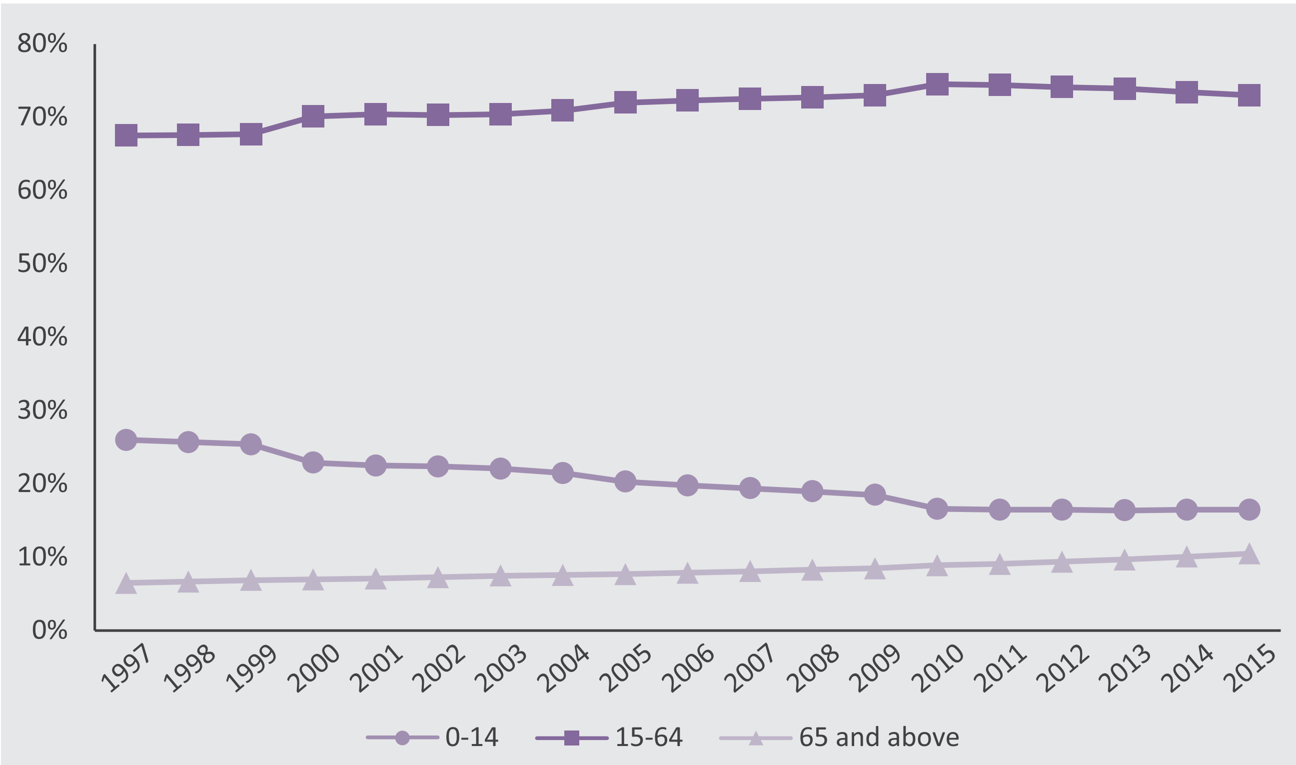
It is noteworthy that the spending patterns of the elderly people may alter in the future as their needs and preferences change overtime. According to McKinsey's survey in 2011, the elderly were more inclined to save and less willing to spend on discretionary items such as travel, leisure, and nice clothes. These tendencies will probably be much less apparent in 2020, as the coming group of elderly is more willing to spend, especially on healthcare products and services. Additionally, they are also more tech-savvy and are more open to new retail channels and retail concepts.

Exhibit 9. Population by age, 1997 – 2015



Source: National Bureau of Statistics of the PRC; compiled by Fung Business Intelligence

…And into the future

China's consumer market in the next five years

Consumption will continue to be a major growth driver; consumer market is expected to grow 10%-12% annually during 2016-2020

Consumption will continue to play an important role in driving the growth of China's economy. Total retail sales of consumer goods are expected to grow 10% to 12% annually during the 13th Five-Year Plan period (2016-2020). Service consumption is set to further increase and serve as the main growth driver of consumption, while the millennials ("post 80s" and "post 90s" generation) as well as the growing middle class will be the dominant consumer groups in the coming years.

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Consumption upgrade will remain an inevitable trend

Consumption upgrade is and will continue to be a prominent force driving the transformation of China's consumer market. The increasingly sophisticated Chinese consumers will continue to look for better lifestyle experience and higher quality products. Apart from the consumption upgrade for basic necessities such as food, apparel, household products, etc., we expect some new consumption segments, particularly health-related consumption, children- and elderly-related consumption, and green consumption to grow fast as new needs and preferences emerge.

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Spending will shift from products to services, and from mass to personalized products and services

As illustrated in our Chinese Consumers Series Issue 1 "*Understanding China's new consuming class – the millennials*", the new Chinese consumers, particularly the millennials, are bored with the homogenization of products, and they increasingly look for more special and exciting elements. Meanwhile, they allocate more of their income to lifestyle services and experiences such as spas, travel, and entertainment. To better cater to the changing consumer needs, many retailers have started to revamp their stores by introducing special themes and exciting elements, and expanding services offerings. Providing more experiential elements and enhancing customer service will remain crucial to attract more customers to the stores and prolong the duration of their stay.

The millennials allocate more of their income to lifestyle services and experiences such as spas, travel, and entertainment.

In addition, standardized products and services will no longer satisfy consumers' demand as they increasingly demand personalized and unique offerings. In the coming years, we expect the consumer-to-business (C2B) model, where consumers come up with personalized needs or requirements, and businesses produce the products or services according to the requirements of the consumers, will become the new focus.

Technologies will drive new forms of retailing and affect every stage of the shopping journey

New technologies and new business models are reshaping and transforming the retailing landscape. We expect this trend to continue and accelerate in the coming years as more companies now utilize various new technologies such as Internet of Things (IoT), artificial intelligence (AI), virtual reality (VR) and augmented reality (AR), as well as data analytics to provide more personalized services to customers and enrich the shopping experience. Meanwhile, technologies will continue to affect every stage and aspect of the shopping journey, both online and offline, from browsing, delivery, supply chain, payments and more.

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