

From the Desk of...

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Understanding the affluent consumers of China; the pent-up energy of China's entrepreneurs has been unleashed and makes for an alluring prize for consumer marketers and financial advisors, Dr Yuwa Hedrick-Wong reports.

July 2007: Private wealth creation in China has been accelerating rapidly in recent decades. Economic reform has unleashed the pent-up energy of China's entrepreneurs and the result has been an explosion of business start-ups, expansion and investment. Rapid growth of the middle class (defined as those earning US\$6,000 to US\$25,000 p.a.) was the first to catch attention, whose numbers grew from practically zero over a decade ago to an estimated 87 million in 2005, expected to rise to 317 million strong by 2015.

The current size of the affluent in China is about 2.9m and is projected to rise to 8.5m by 2015

A more recent phenomenon, and a more alluring consumer market prize, is the emergence of the *affluent*, defined as those belonging to households earning more than US\$25,000 per year. Adjusting their income for purchasing power parity, the average income of the affluent in the three cities of Shanghai, Beijing, and Guangdong, estimated at US\$60,000 a year, would be equivalent to households in the US earning between US\$100,000 to US\$150,000 per year! The current size of the affluent sector in China is about 2.9 million and is projected to swell to 8.5 million by 2015.

Purchasing power of the affluent is due to both their average higher income and their discretionary spending power – i.e. the portion of households' expenditure that is not allocated to providing daily necessities such as food, transport, rent, etc. For Chinese households earning less than US\$6,000 per year, for example, almost 100% of their disposable income is spent on basic necessities. It is only after household income crosses the US\$6,000 threshold that their marginal

expenditures quickly shift from basic necessities to discretionary items.

Discretionary spending is therefore a very important driver of new demand; colour TVs, air conditioners, washing and drying machines are top-of-mind items that a middle class Chinese household would purchase as soon as they can afford them. For the affluent, their demand growth is even more dynamic. While the affluent households have higher income per se; the portion of their income that is spent on discretionary consumption items also rises as their income increases. For Chinese households earning US\$6,000 to US\$25,000 per year it has been estimated that only some 35% of their income is spent on discretionary items. On the other hand, for those earning over US\$25,000, some 75% of their income is spent in discretionary consumption on average. Given the projected rapid increase of the size of the affluent, their collective discretionary spending is also projected to grow from a relatively modest US\$17.7 billion to an impressive US\$117.4 billion in 2015.

The affluent are highly concentrated in China's three major cities; Shanghai, Beijing and Guangdong ... whose total discretionary spending will rise to US\$54.9 billion

Not surprisingly the affluent are highly concentrated in the three major cities of Shanghai, Beijing and Guangdong, where economic growth has been the fastest. Not only do these three cities currently account for over one-third of all China's affluent households, it is expected that they will account for close to half of China's affluent by 2015. The affluent populations of the three big cities will have close to four million in 2015, whose total discretionary spending of the affluent in these three cities will rise from US\$6.9 billion in 2005 to US\$54.9 billion (an

implied annual compound growth rate of 23%) by 2015.

A Summary Profile of China's Affluent 146

Among the affluent, most (75%) are male, astonishingly young (86% under 46, 22% under 30), 67% of them are married, 77% of them are also with children. They are also extremely busy; 23% of them have less than 10 hours a week of leisure time and another 30% have between 10-20 hours of leisure time a week. The affluent are also impressively well educated; 83% have university degrees and above and 33% have post-graduate degrees. Only 6% have just high school education or less.

**astonishingly young, very well educated,
mostly married with families ... and very busy**

Close to half of the affluent have had significant overseas living and working experiences. The USA tops the list, followed by the UK and Canada. This all suggests that they are very likely to be well informed of overseas trends and styles and can readily access information on what they need to know outside of China.

Property Ownership

Compared with a complete absence of private property ownership less than a decade ago, a common aspiration today in China is to own a private condo. Home ownership embodies both a significant household asset as well as status. 59% of them bought their first property before 2000 which were relatively modest (mostly under US\$65,000 and less than 150 sq.m) but the situation was very different as the affluent started to buy their second, third and fourth properties. By 2000 all affluent of Chinese owned their first property but by 2002, 65% had a second and by 2004 26% had a third and 8% of them a fourth -- each property getting bigger and more expensive than the last. Remarkably, 76% of those buying a fourth property had no mortgage on it! Property is currently the single most important asset category, the next being domestic stocks, but by only 35%. Some 34% have fixed savings deposits in RMB, which ranks third.

The Affluent Lifestyle

In China, affluence is a relatively new phenomenon but businesses looking to tap into them have reassuringly found the Chinese to be avid

consumers; they love to spend! Based on a tracking study of about 15,000 households in urban China, the range of income levels where the so-called luxury lifestyles are adopted is between US\$21,000 and US\$30,000; the income threshold of the affluent is US\$25,000, so this is literally at the mid-point of the range. In other words, virtually all affluent in China have either crossed this range of income thresholds, or well on their way to do so.

Golf: played by 40% of the affluent about every week, 62% having taken up the game only in the past four years;

Buying luxury goods: 48% believe them to be of better quality and therefore worth buying and many seeing them as a means of pampering oneself, slight more so than 'enhancing social status' or 'being trendy'. The channels of information of choice are fashion magazines first (63%) followed by business magazines then simply visiting the retail stores. Word of mouth, TV and newspapers trailed.

Overseas travel: before 1998, personal travel overseas was literally unheard of, but by 2006, over 30 million Chinese visitors went overseas for personal reasons. 76% of the affluent have traveled overseas in the last two years and 50% of them have done so more than once with 22% actually going overseas for more than three times. While Asia continues to be their most favored destinations, 25% of the affluent now prefer visiting Europe, 13% North America. The affluent do not seem to go overseas for entertainment or for rest and relaxation; these they prefer to do in domestic travel -- shopping, on the other hand, is clearly an activity preferred when overseas

Dining out; the affluent dine out a lot for both personal and business reasons and it appears that they hardly eat dinner at home.

**When it comes to choosing what to buy and how,
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'convenience' and 'luxury'.**

When it comes to choosing what to buy and how, the four key factors are 'brand', being 'green' (environmentally friendly), 'time constraints' (convenience) and 'luxury' (pampering oneself), the most important factor being convenience, consistent with the fact that, by and large, they have little leisure time and wish to spend whatever small amount of leisure time they have with their families. Making goods and services available to the affluent in the

most “hassle free” and convenient way is clearly a winning proposition.

Conclusion and Business Implications

China’s affluent residents of Shanghai, Beijing and Guangdong are strikingly young and impressively well educated. The family structure of the vast majority of them is that of the nucleus family (with a single child) and their numbers and their discretionary spending power, are growing fast. They are sophisticated consumers in terms of being well educated and very well informed about global trends, enhanced by extensive overseas travel and from having close relatives living abroad. They are a generation of car owners, golf players and, above all, property owners. Their investment portfolio, however, is relatively unsophisticated with few engaging professional investment or financial advisors.

They are clearly ambitious, confident and independent-minded people, but remain very family oriented. Their dilemma seems to be that they are very pressed for time yet yearn for leisure moments, especially time with their families. Their consumption decisions are therefore highly sensitive to the convenience factor, along with concerns for quality and lifestyle needs.

Given their high income and property-derived wealth, professional investment and wealth management expertise is clearly an area of great growth potential.

The affluent of China have come of age as a significant consumer segment. Their spending power, sophisticated tastes and knowledge as well as their complicated and busy lifestyles make them alluring, yet challenging. A better understanding of them is the first step in winning their trust as business partners and loyal customers.

Acknowledgement

This article was edited from a report authored by Dr Yuwa Hedrick-Wong, Economic Advisor to MasterCard International. MasterCard and HSBC formed a knowledge partnership in 2006 and jointly commissioned Fudan University in Shanghai to conduct the research that produced the report and these conclusions.

To read the full report complete with graphs and additional statistics please download this from a link on the author’s web page

www.insightbureau.com/HedrickWong.html

About Dr. Yuwa Hedrick-Wong

Dr. Yuwa Hedrick-Wong is Economic Advisor to MasterCard International and Chief Economist and Director of Asian Demographics. He is a highly respected commentator, writer and economist based in Singapore. He heads the MasterIntelligence Knowledge Panel and writes for the MasterCard quarterly *Insights*.

He is the author of a series of books on Asian consumer markets; *Holding up Half of the Sky* on women consumers in Asia, *The Glittering Silver Market* on the rise of elderly consumers in Asia, *Succeeding Like Success* on the affluent consumers of Asia.

Dr Yuwa Hedrick-Wong is a regular speaker at conferences and client events and regularly provides briefings to regional and corporate head office management teams.

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