



# **The New Asian Middle Class**

**Asia House**

**Dominic Barton, Global Managing Director  
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**4 April 2013**

## Topics for discussion



1 Asia's New Middle Class

2 The new Chinese consumer

3 Seizing the opportunity



## Asia's New Middle Class

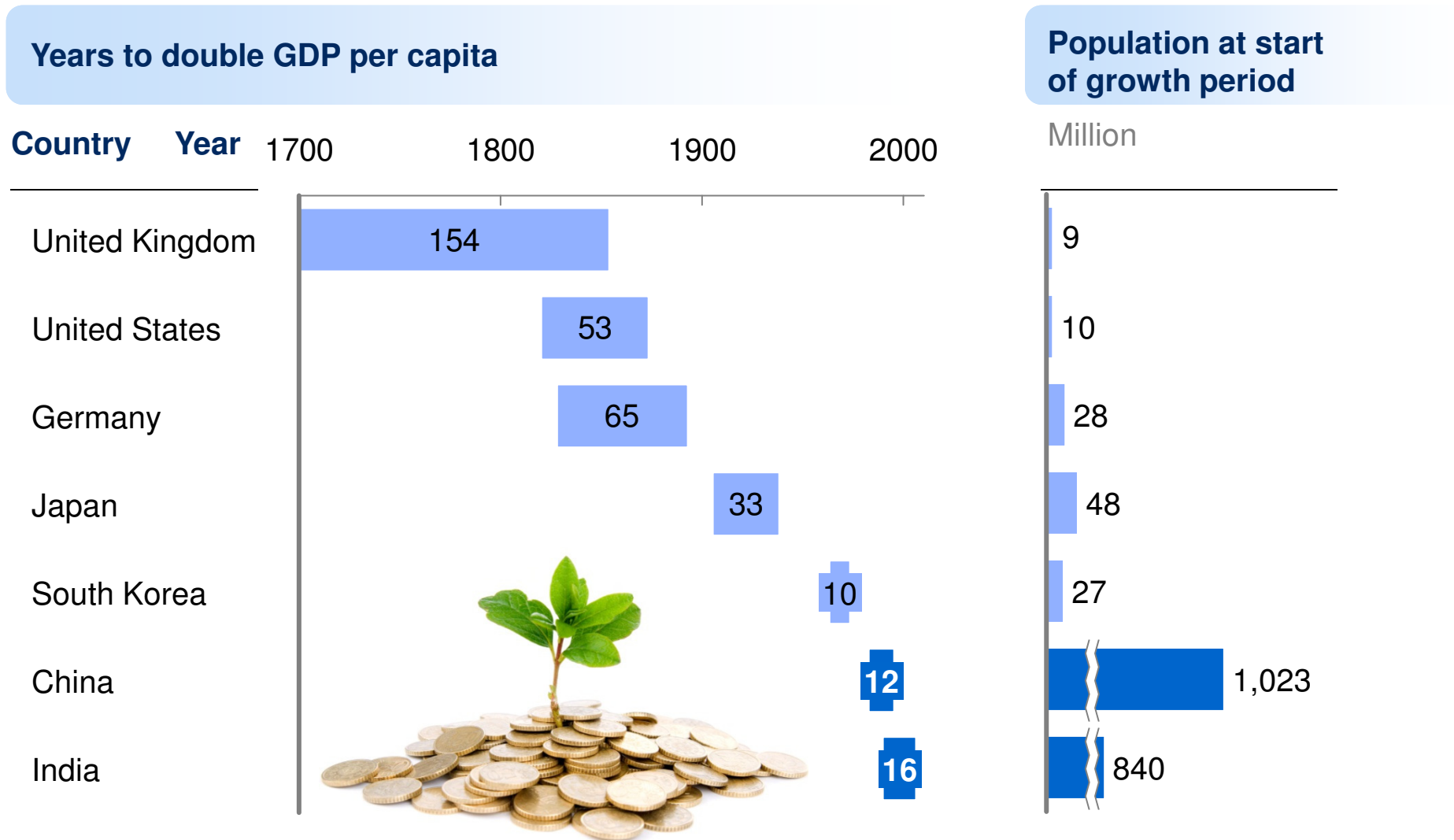
- From 2009 to 2030, **2.7 billion new middle class consumers** will rise from Asia – out of a total 3.0 billion new middle class consumers globally
- Consumption in emerging markets in 2030 will be \$30 trillion – **\$12 trillion will come from China, India, and Indonesia**
- **440 emerging market cities – 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

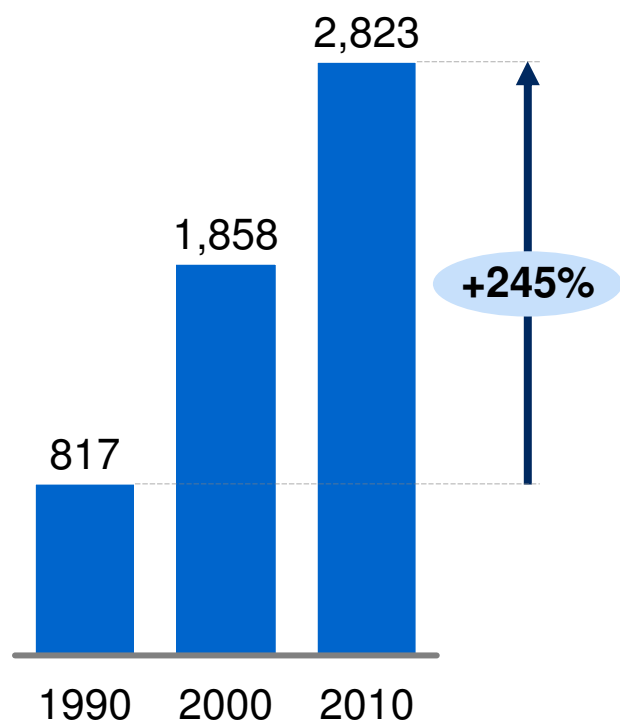


SOURCE: Angus Maddison; University of Groningen; Resource Revolution: Meeting the world's energy, materials, food, and water needs, McKinsey Global Institute, 2011

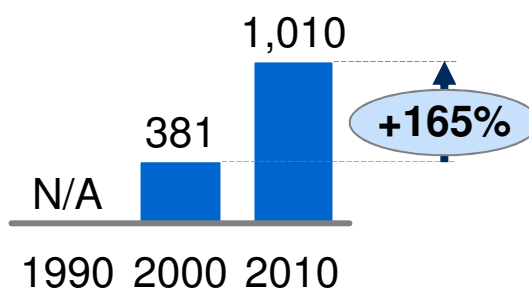
# Asian consumers' disposable incomes have been rapidly increasing over the last 2 decades

Per capita disposable income  
USD (2010 real terms)

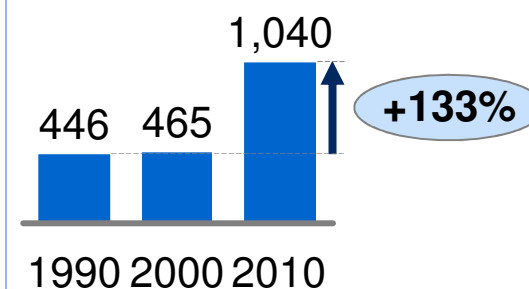
## Urban China



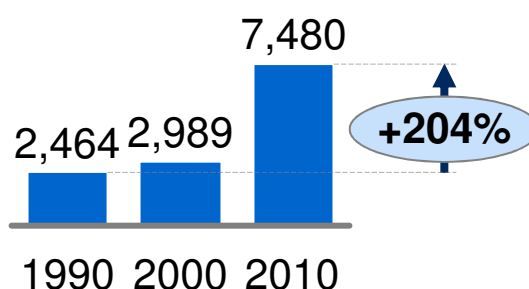
## India



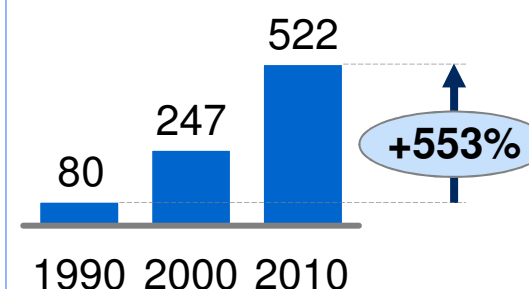
## Indonesia



## Turkey



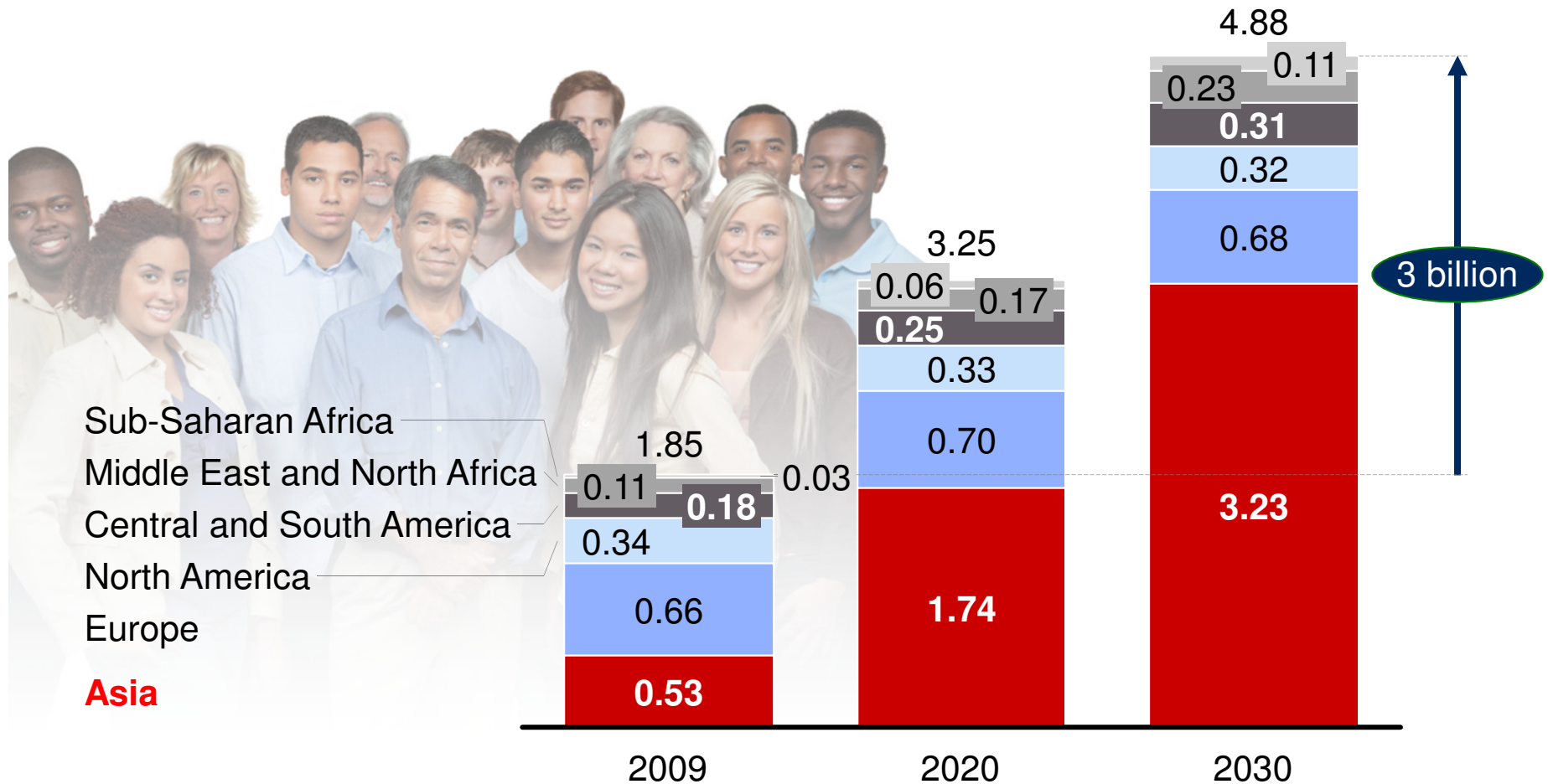
## Vietnam



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

## Global consuming class<sup>1</sup>

Billions of people



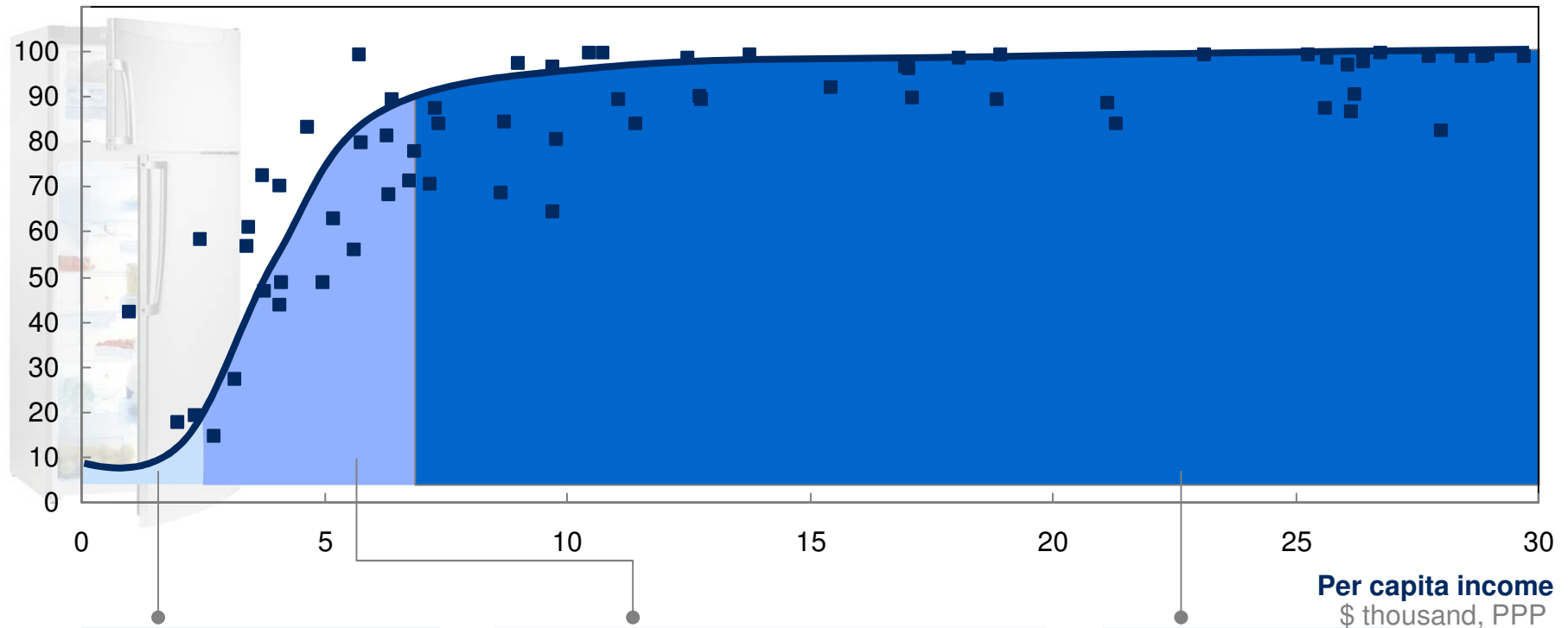
<sup>1</sup> Consuming class = \$10 or more daily disposable income or \$3,600 annual income (constant 2005 USD at purchasing power parity)

## 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

■ Country X



#### 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

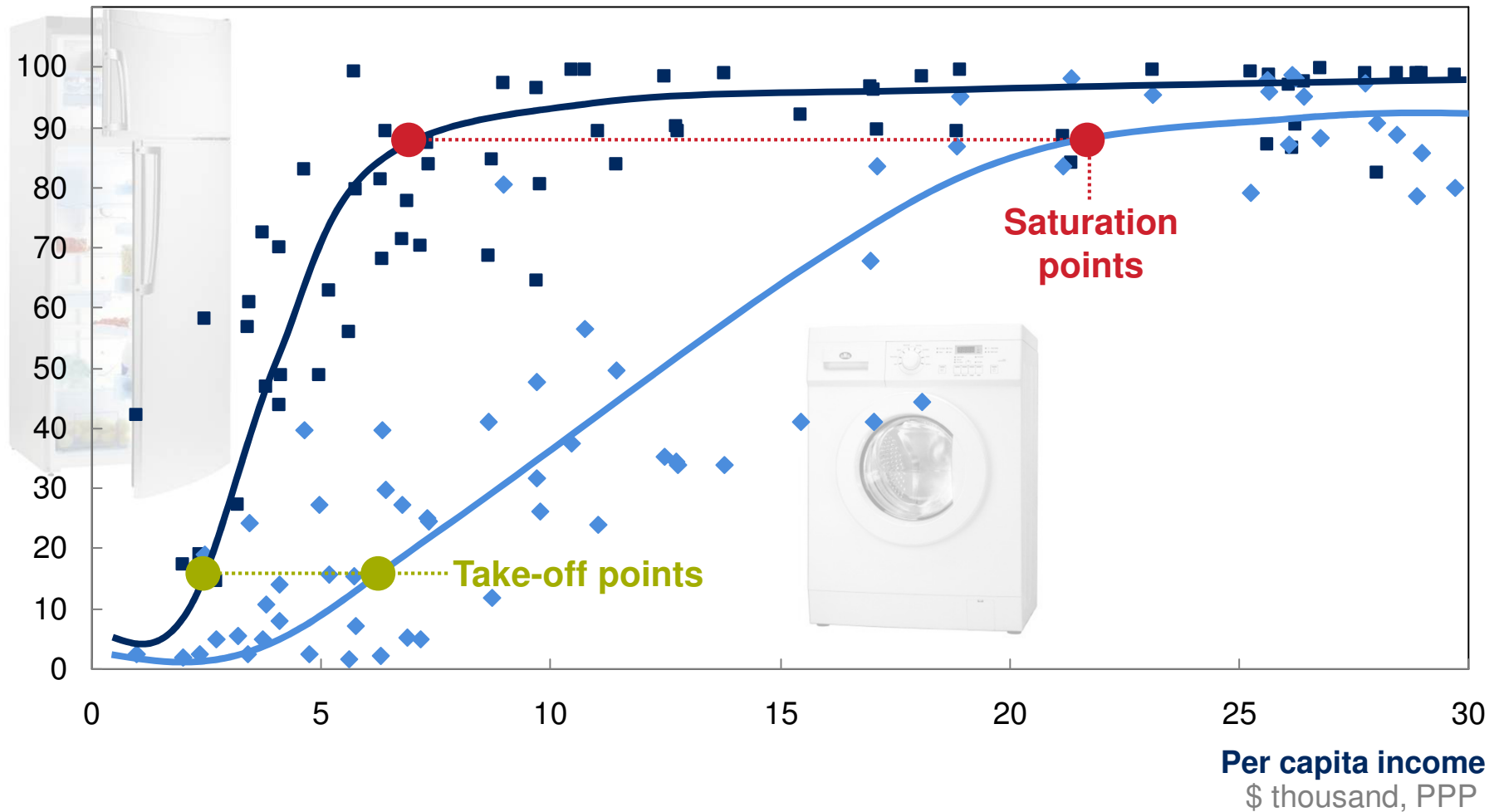


# The specific point and speed where consumption takes off varies across products

■ Refrigerator    ♦ Washing machine

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

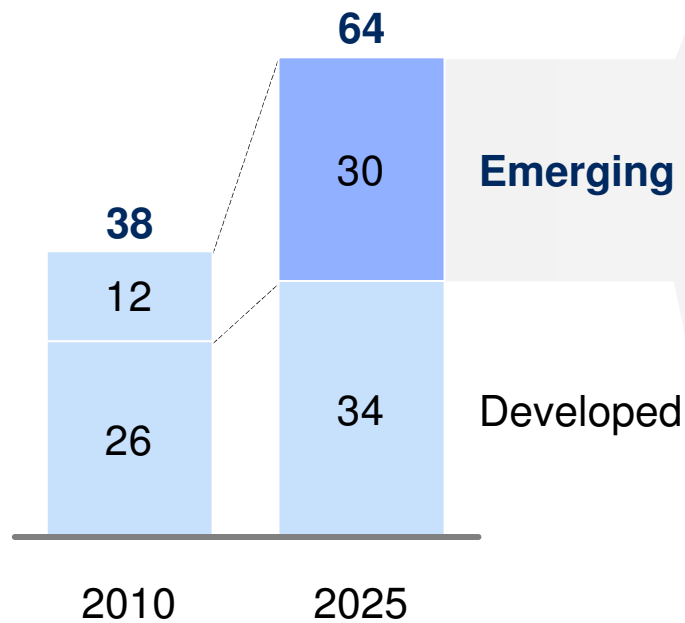
Percent penetration



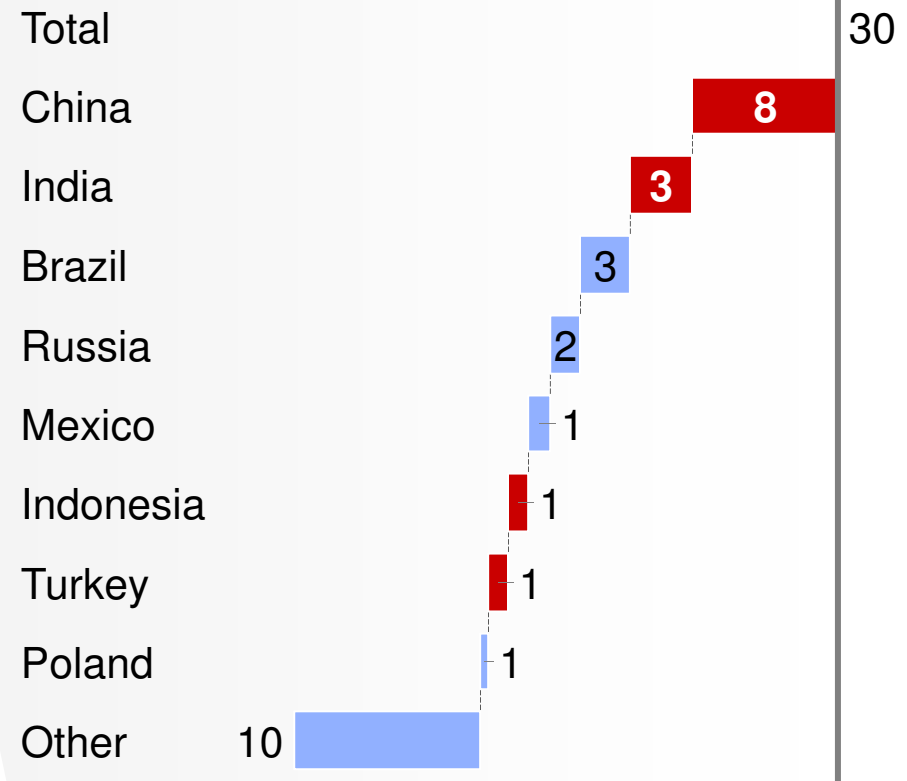
## Emerging market consumption will be \$30 trillion by 2025, nearly half of global total

### World consumption

\$ Trillions



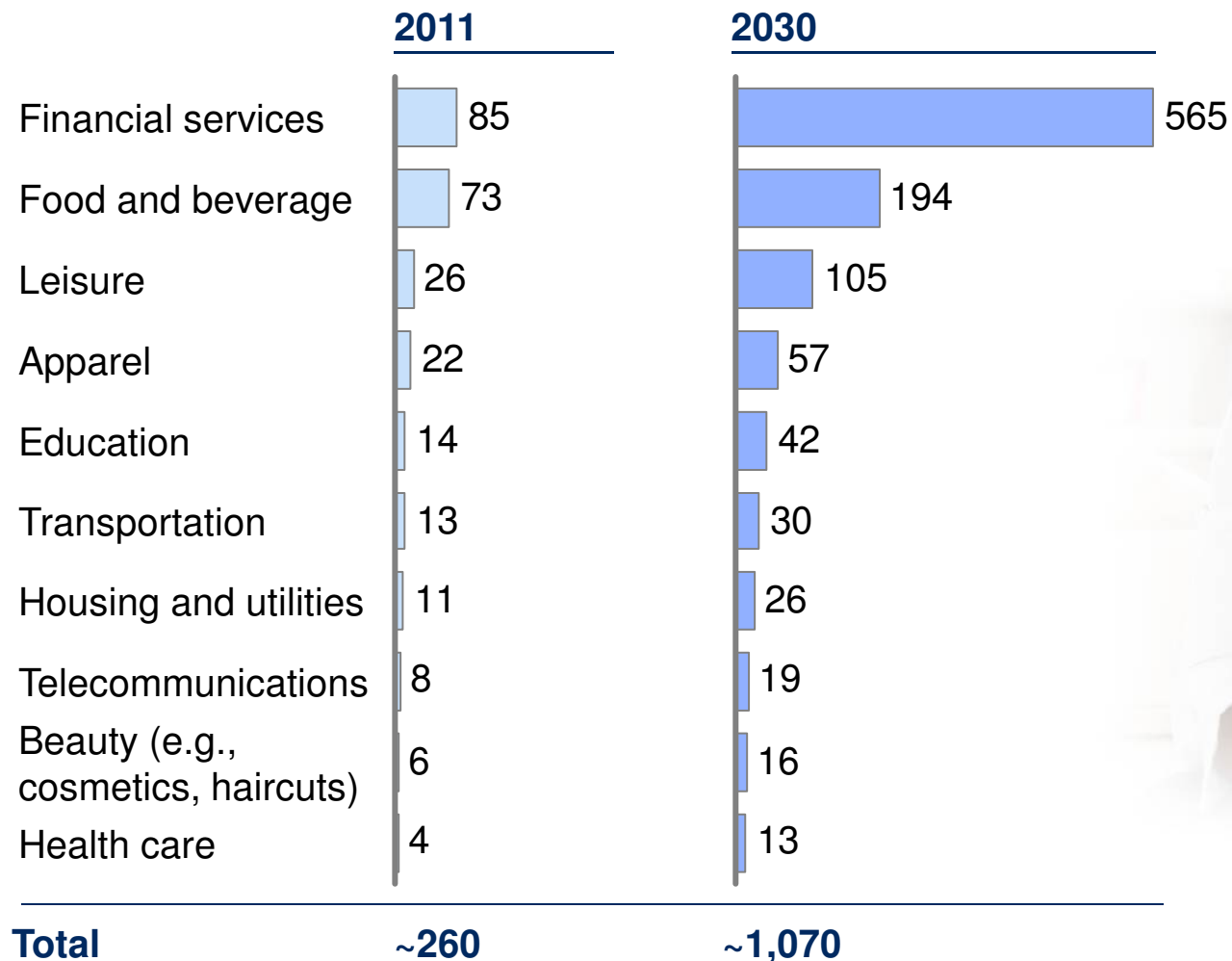
### Emerging market consumption in 2025



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

### Indonesian middle class spending

\$ billion, 2010 prices



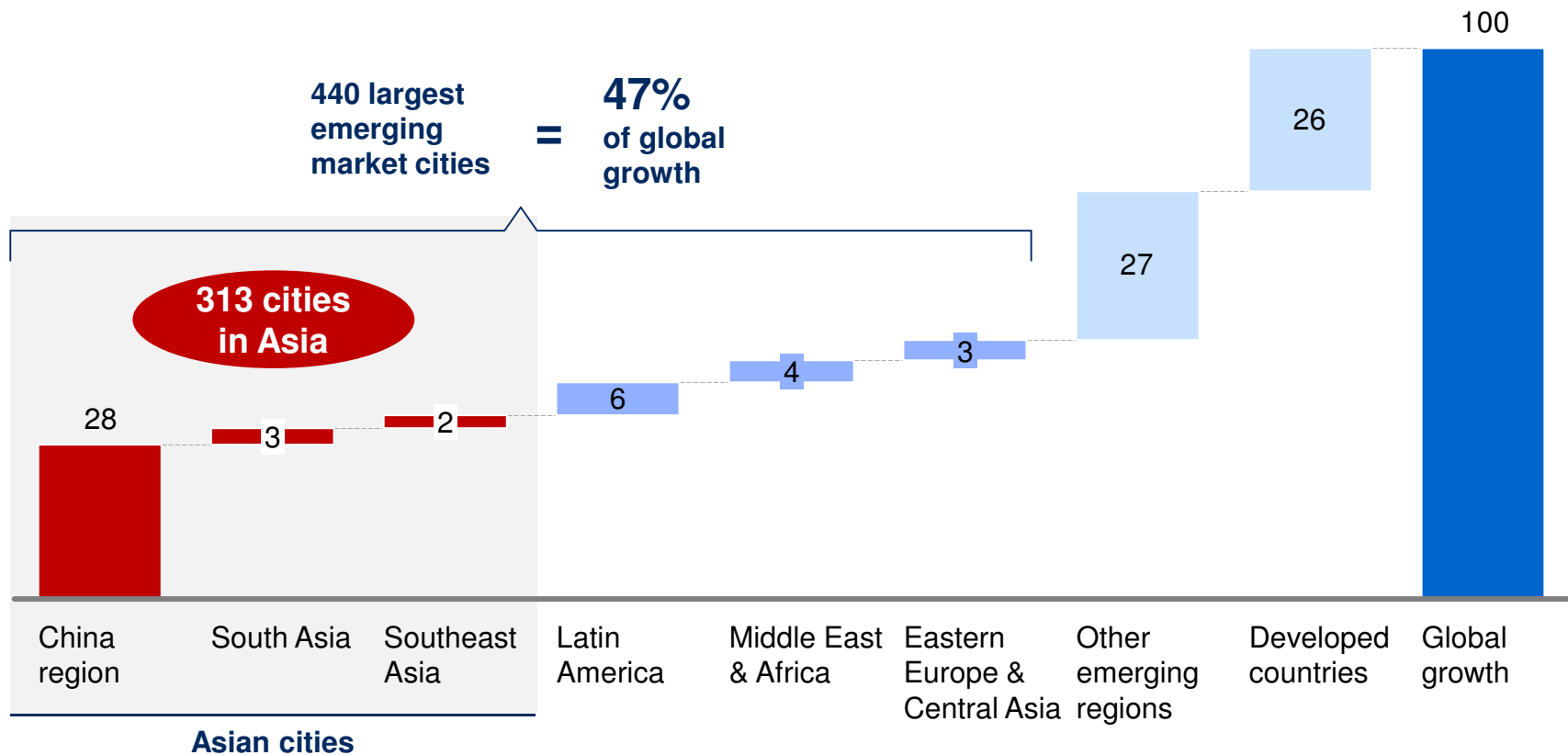
SOURCE: Canback Global Income Distribution Database; Indonesia's central bureau of statistics; McKinsey Consumer and Shopper Insights Indonesia study, 2011; McKinsey Global Growth Model; McKinsey Global Institute analysis

# 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

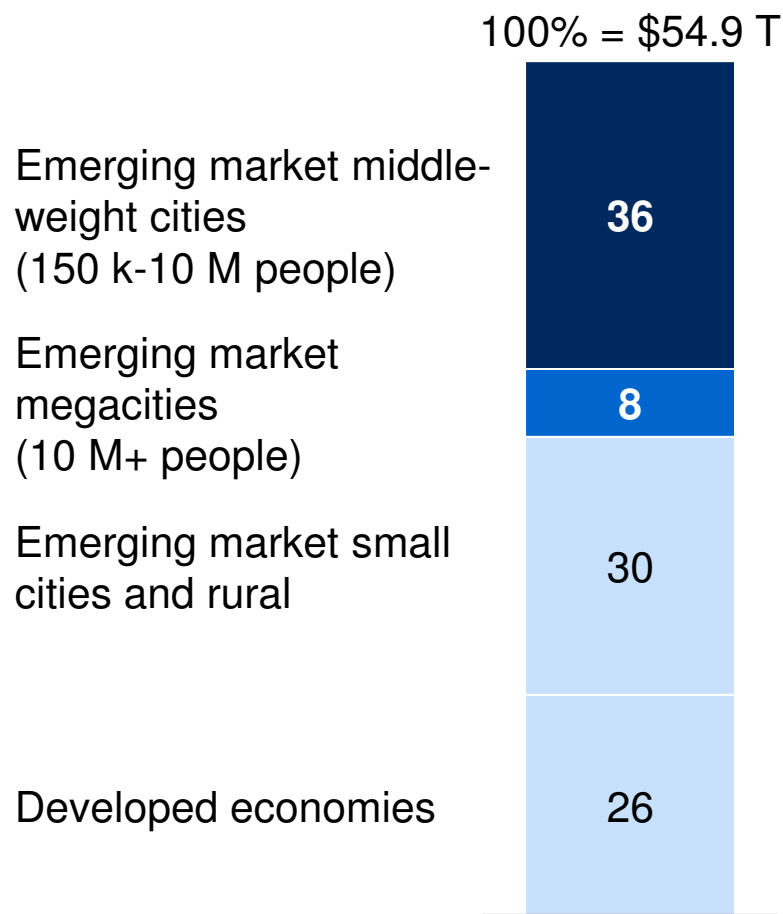


**In China, 15-20 MM people move to a city each year – equal to adding New York City twice**



## 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

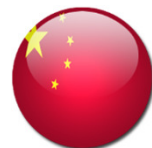


#### Pekanbaru, Riau

Island of Sumatra, western Indonesia

1 million inhabitants

7.3% GDP CAGR expected through 2030



#### Foshan, Guangdong

Southeast China

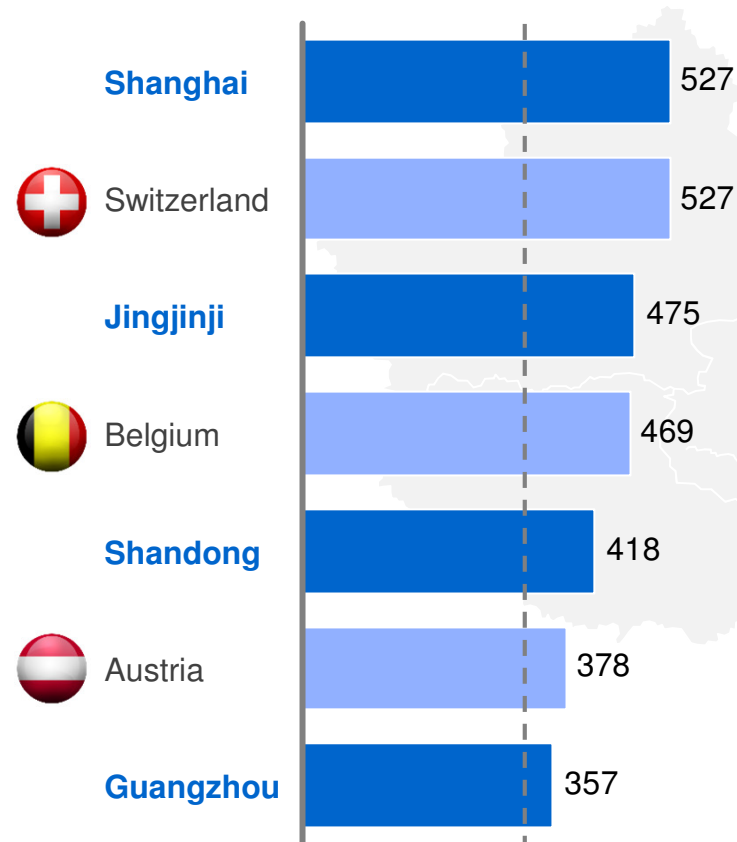
4 million inhabitants

China's 7<sup>th</sup> largest city by GDP

## 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

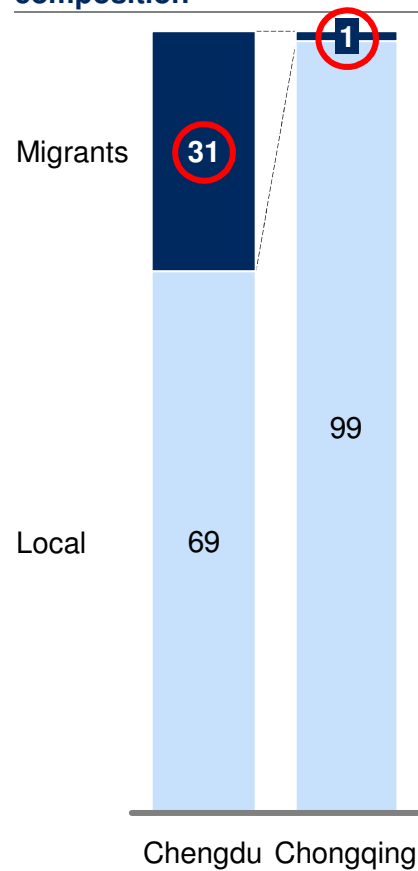


# Different city clusters have distinct characteristics, even in the same province

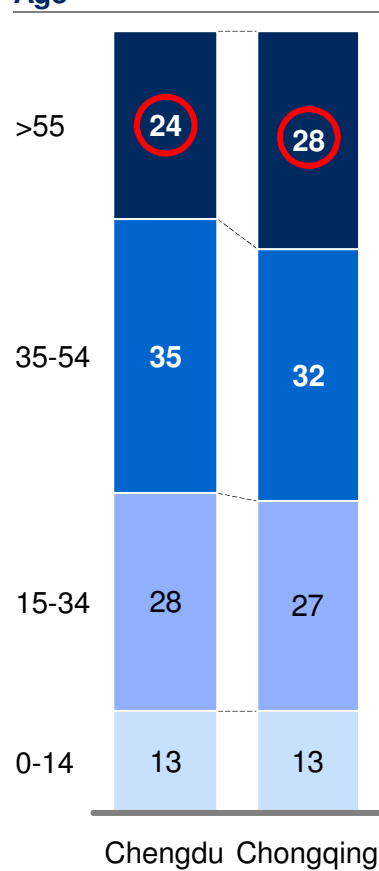
## Chengdu and Chongqing city clusters, Sichuan province

Percent

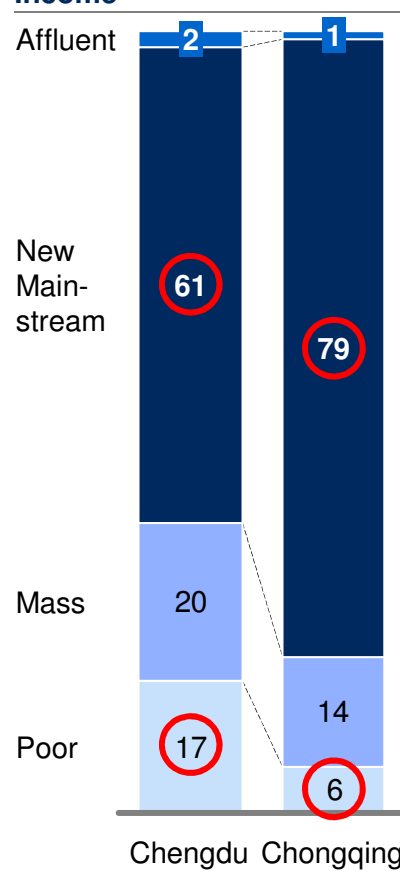
### Population composition



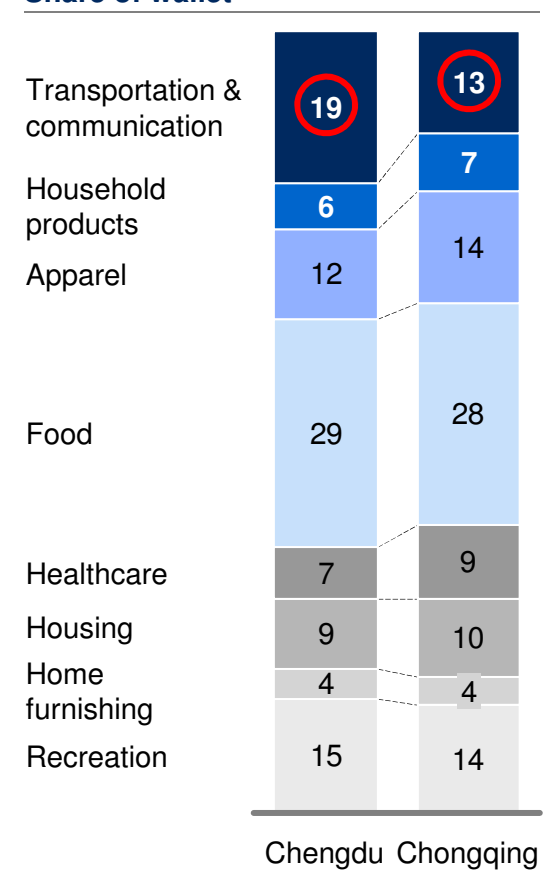
### Age



### Income



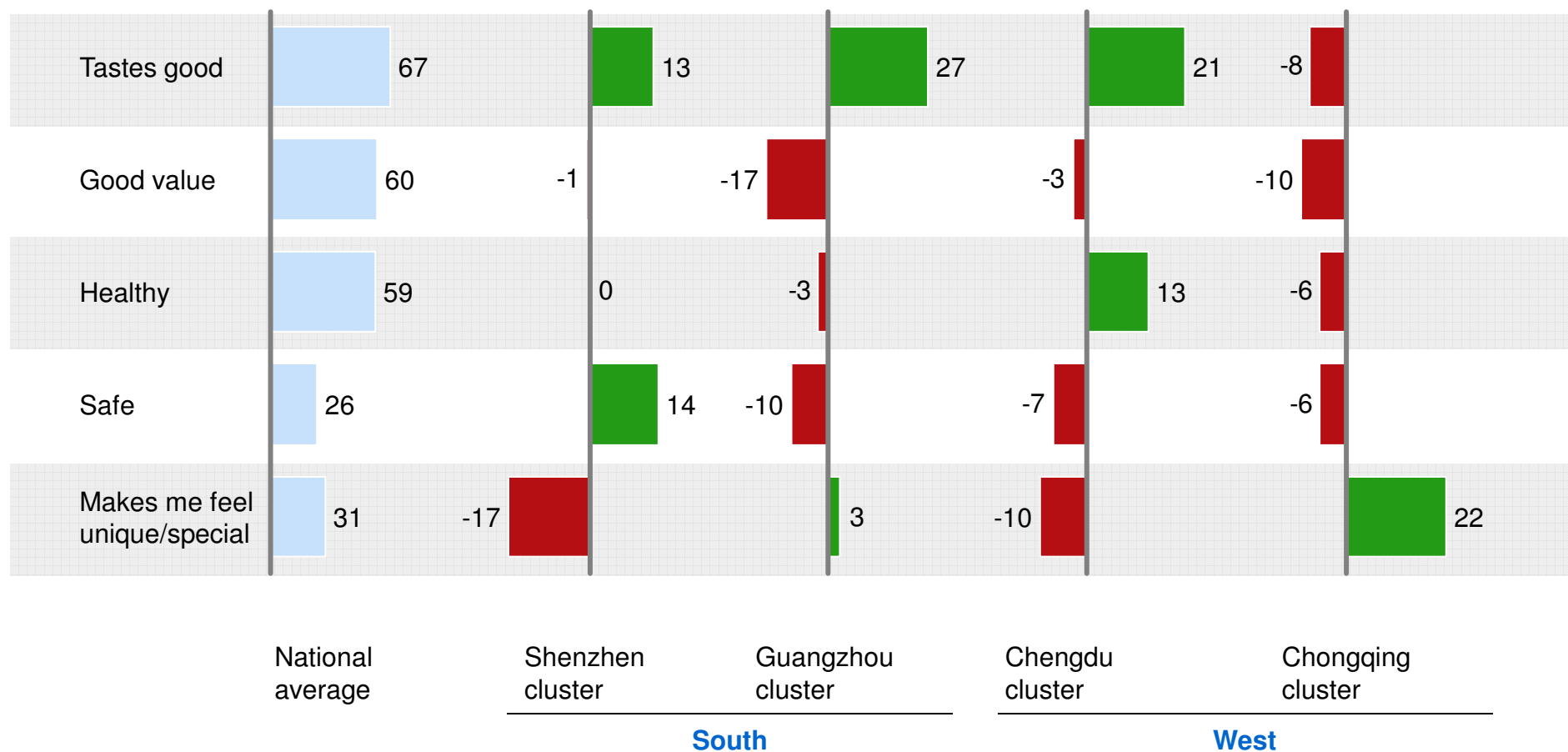
### Share of wallet



## 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)



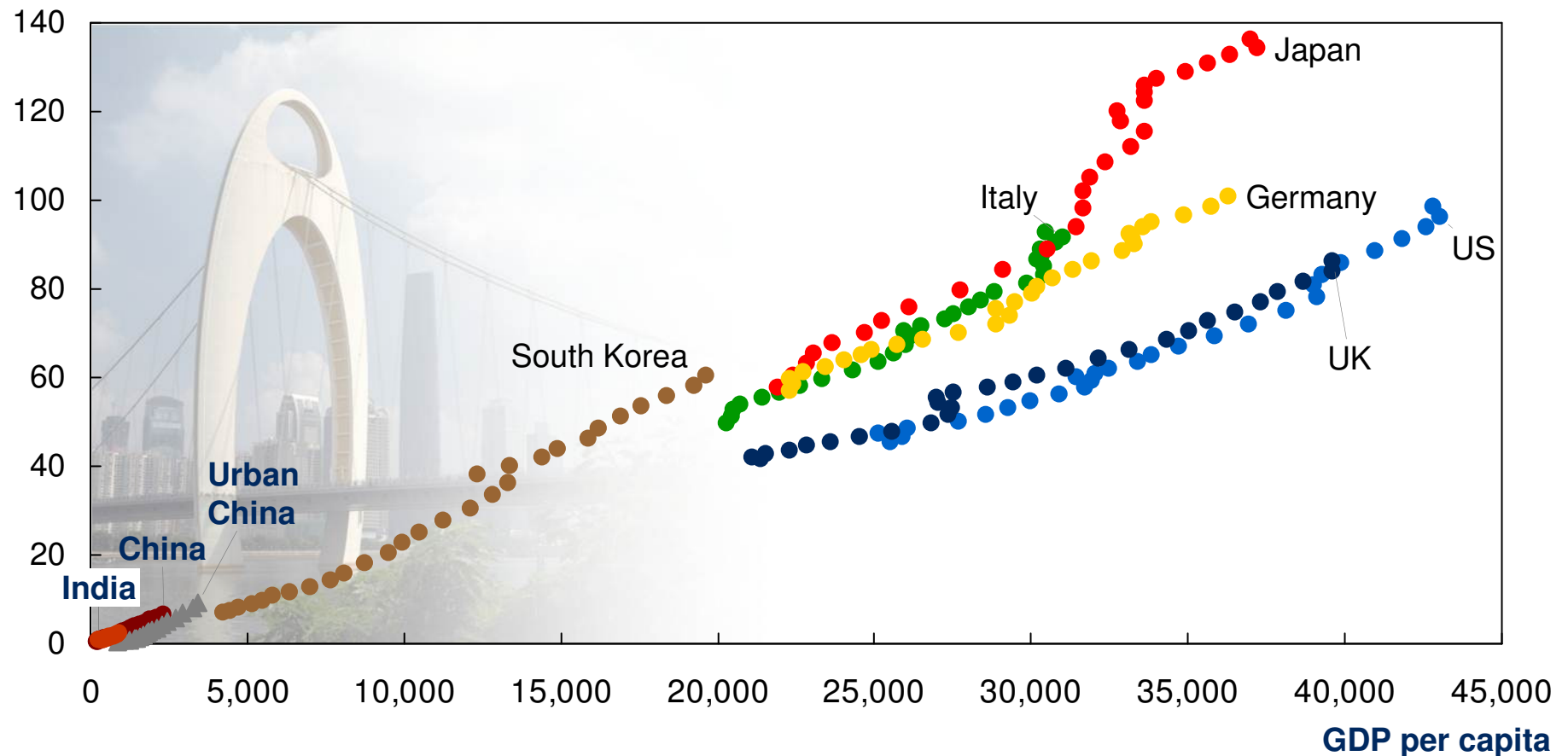


# As people move to cities and incomes rise, so will demand for new homes, transportation networks, and other infrastructure

## Capital stock vs. GDP per capita by country and year, 1980–2008

\$ Thousands, sample of selected countries, constant 2005 prices and exchange rates

### Capital stock per capita<sup>1</sup>



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

# 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

## Topics for discussion



1 Asia's New Middle Class

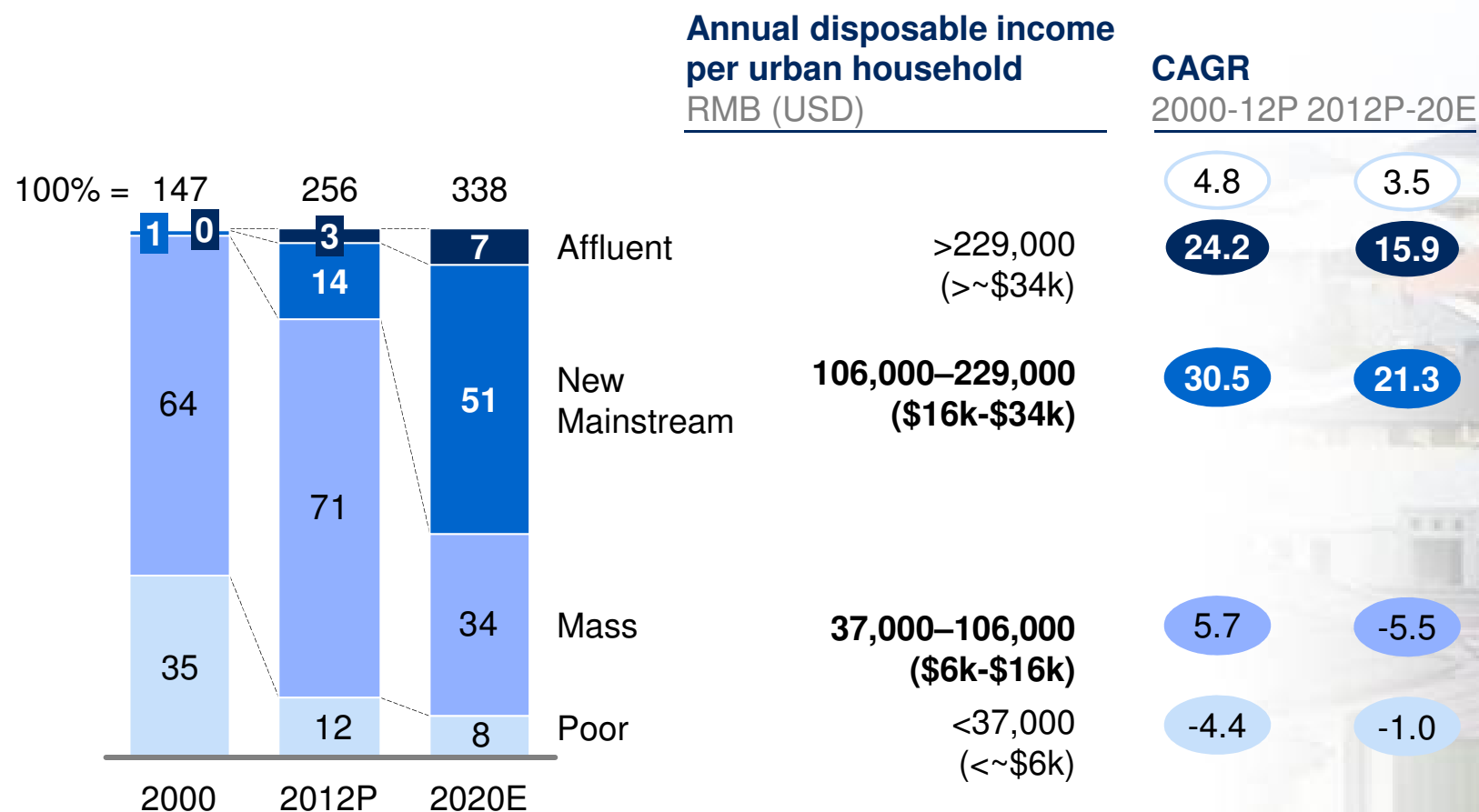
2 The new Chinese consumer

3 Seizing the opportunity

# 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








## 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%

# 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**

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

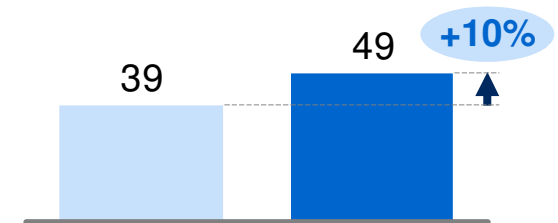
Percent of respondents who agree

“Expensive products are of better quality”

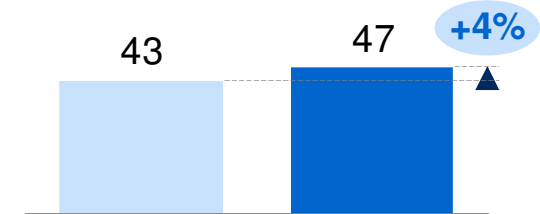


“Within a range of prices I can afford, I always pay a premium price for the most expensive and best products”

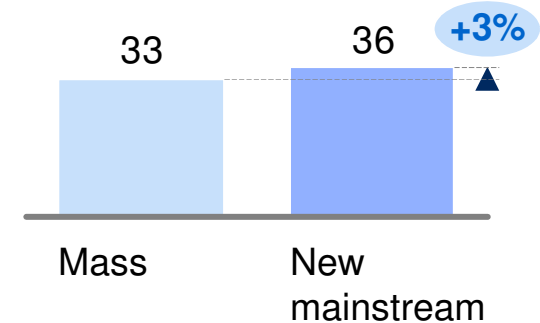
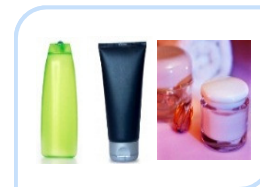
Consumer electronics



Food and beverages



Personal care

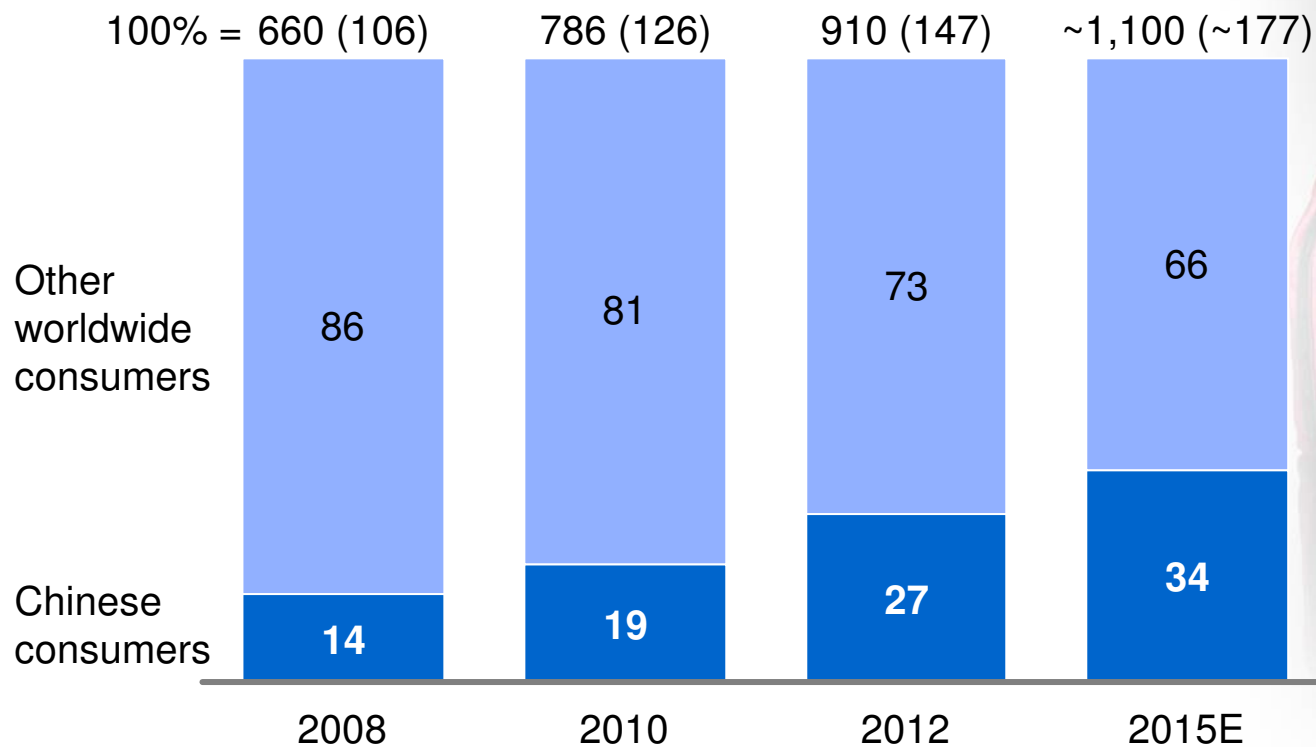




## 2 Trading up is expanding the Chinese luxury market – Chinese consumers will overtake Japan as the world's largest luxury market by 2015

### Luxury goods consumption worldwide 2008-2015

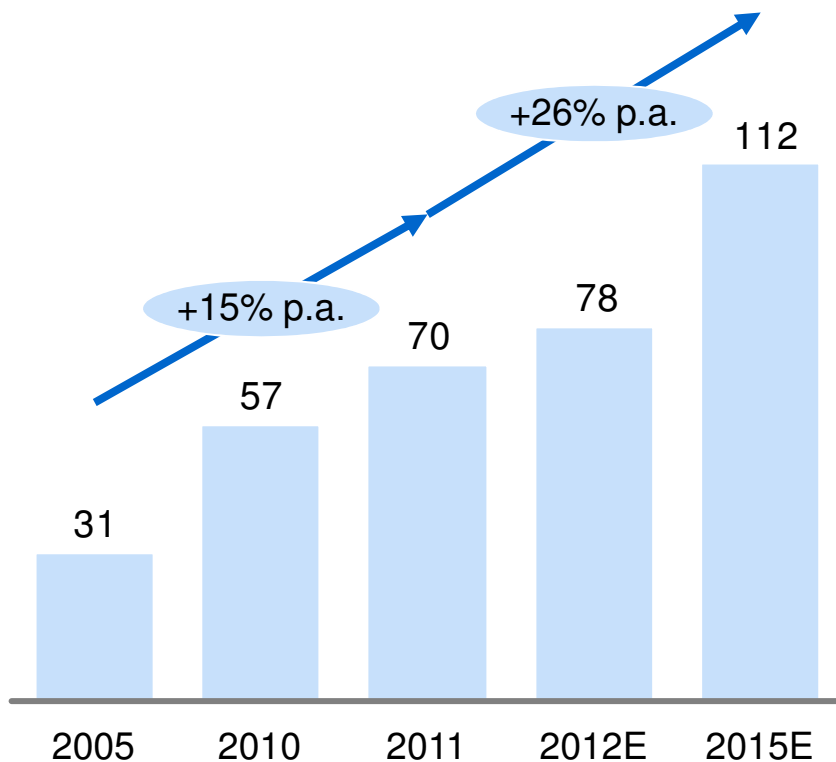
2012 RMB billions, percent (USD billions)



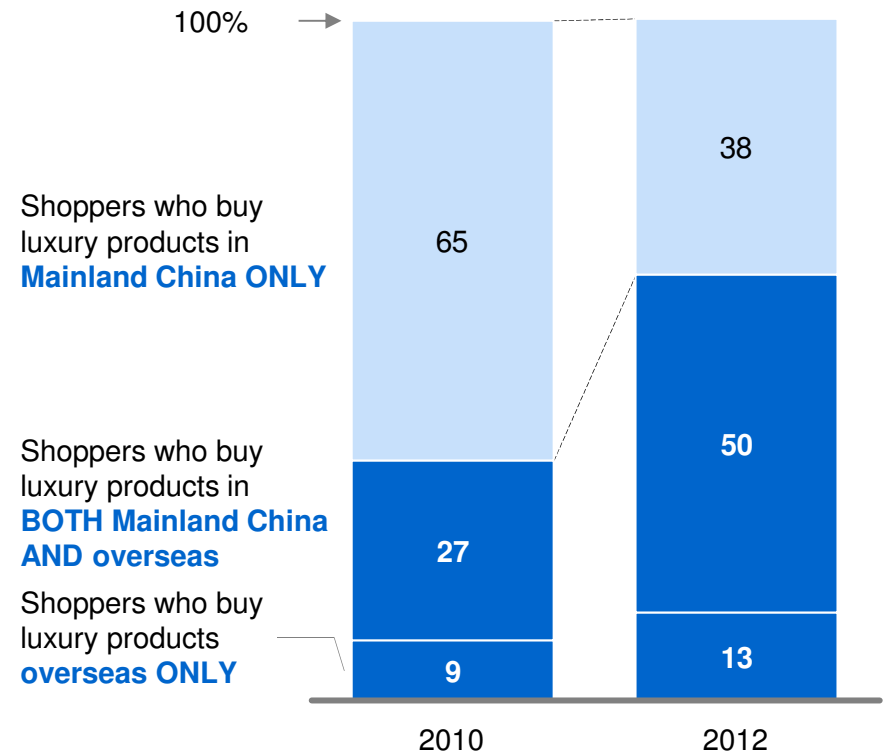
SOURCE: McKinsey Insights China - Luxury Consumer Studies (2008, 2010, 2012); literature search; experts interviews; HSBC report; Company financial report

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

China outbound travelers  
Millions



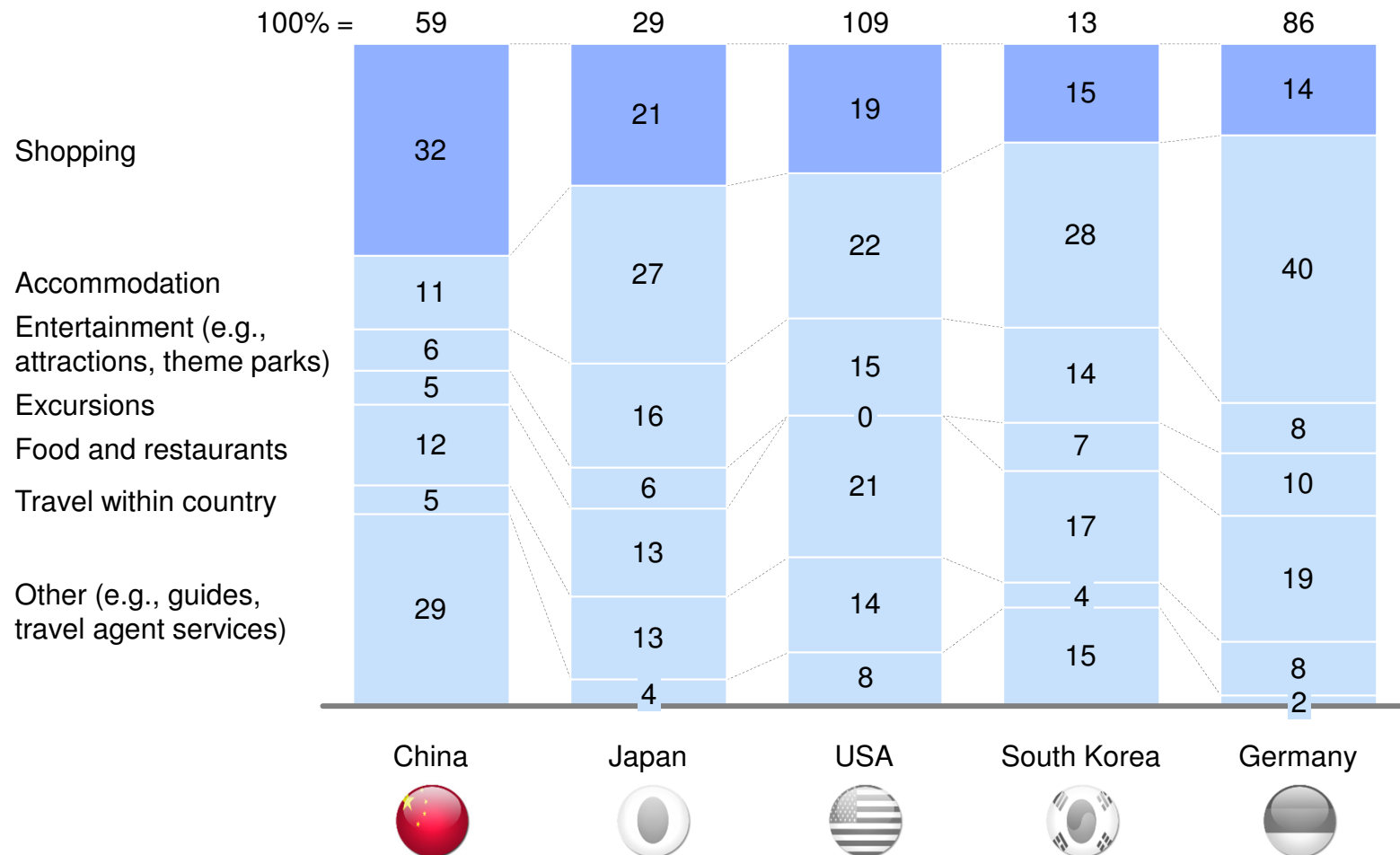
Share of luxury shoppers by shopping destination  
Percent



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

### Tourist expenditure by home country

Percent, USD billion

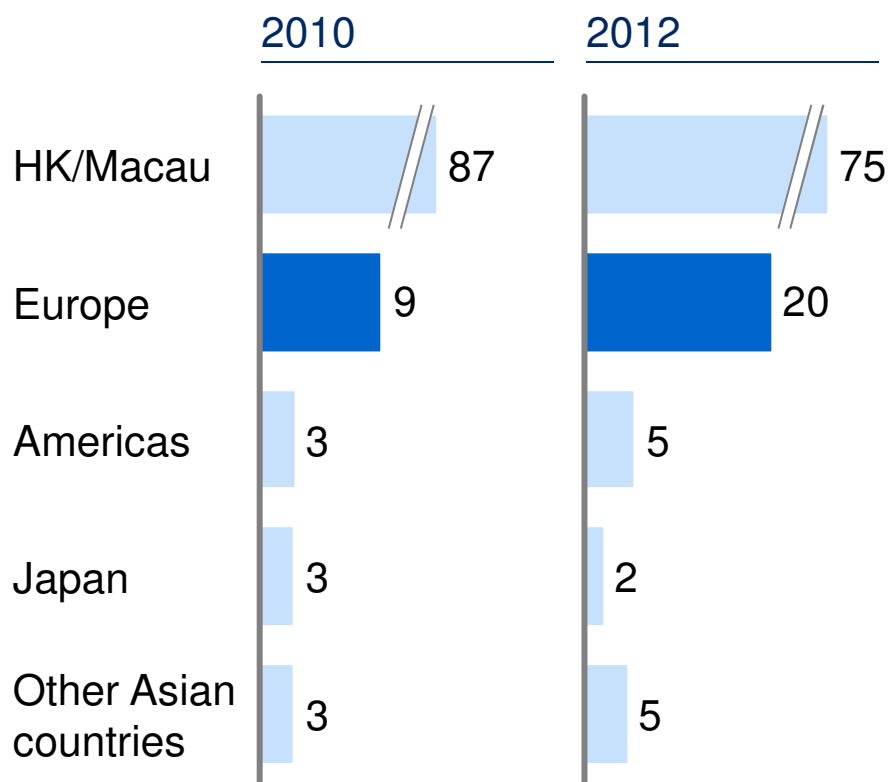


SOURCE: Euromonitor International from official statistics, trade associations, trade press, company research, trade interviews, trade sources

## 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.

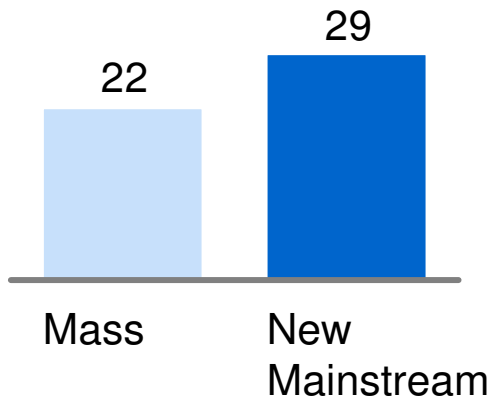
– A Shanghainese woman

### 3 New Mainstream consumers are more brand loyal ...

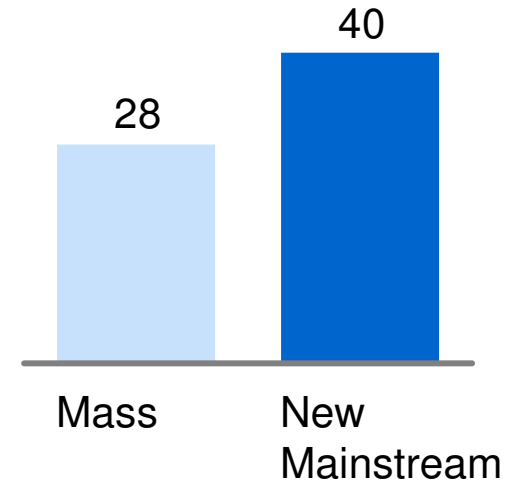
**I only buy the brand I prefer**

Percent of respondents agreeing

#### Washing machine



#### Mobile phone

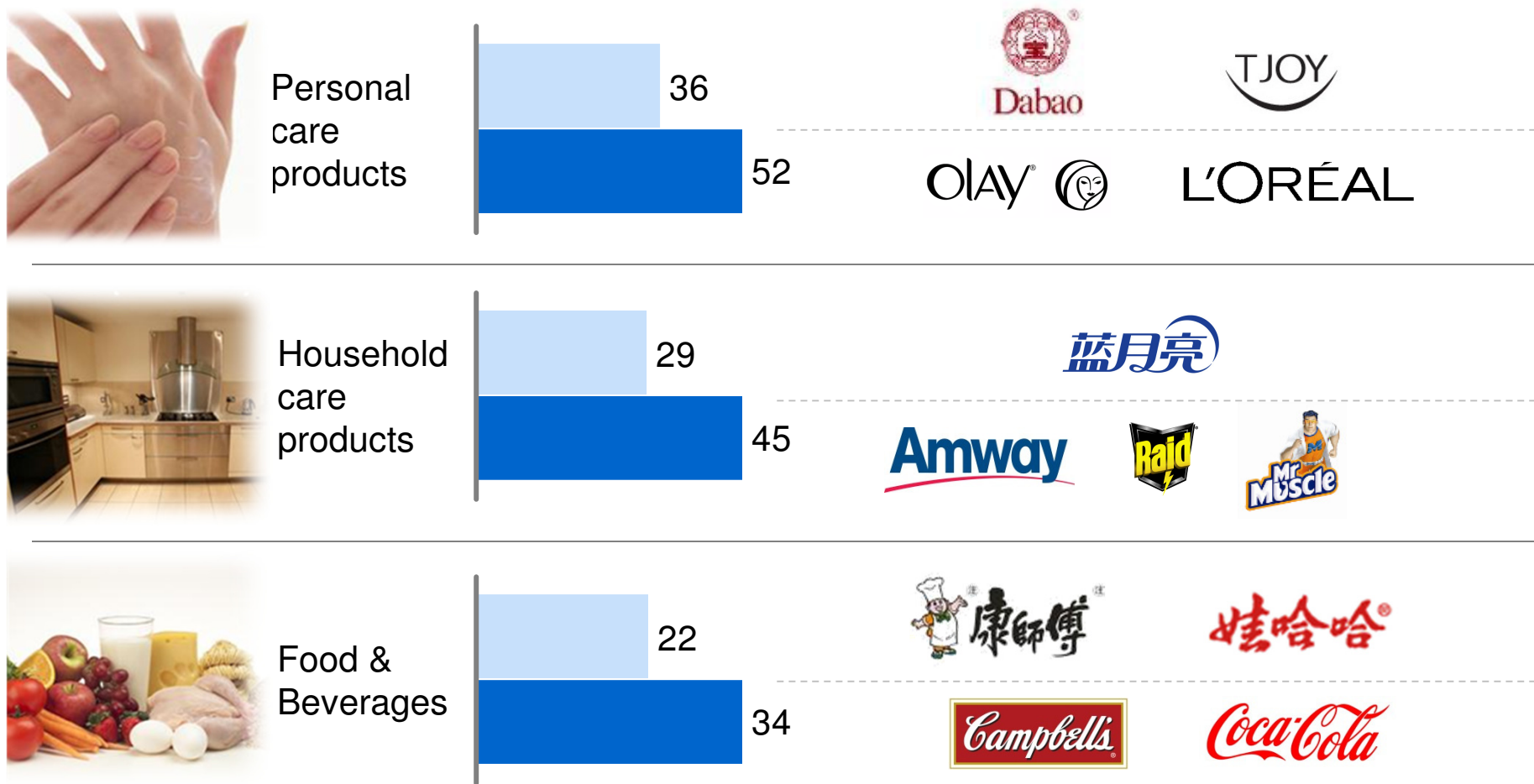


### 3 ... and have a stronger preference for foreign brands than Mass consumers

Mass New Mainstream

#### Brand preference by category

Percent of respondents preferring foreign brands over Chinese brands

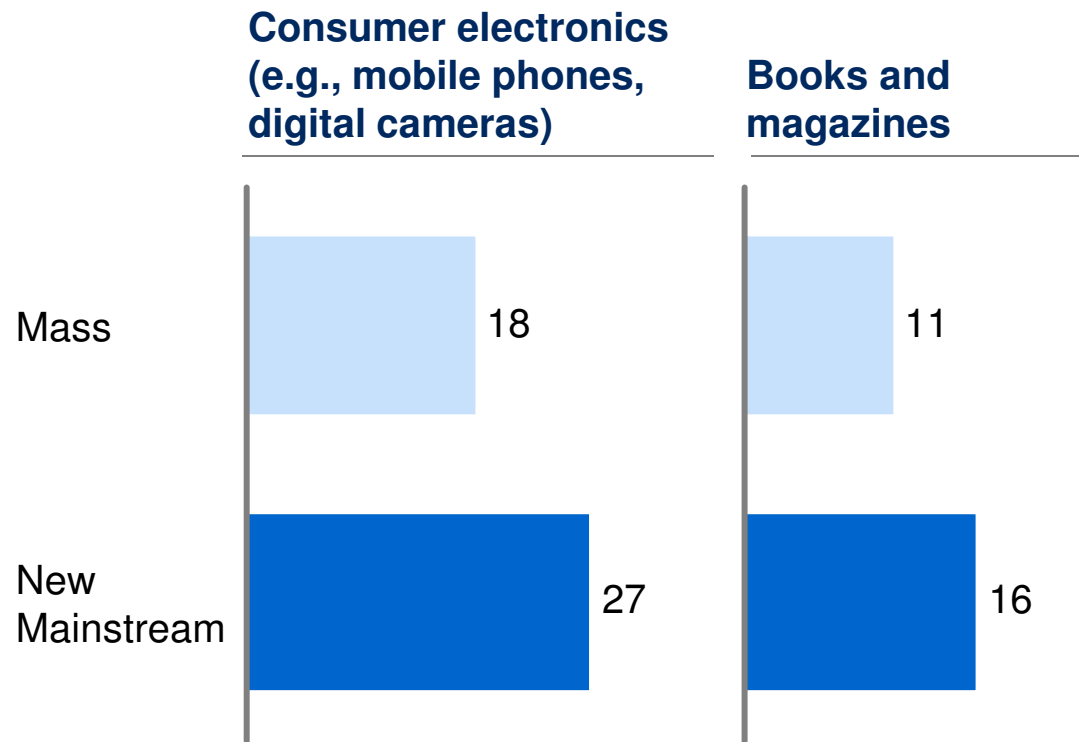




## 4 New Mainstream consumers shop online more than Mass consumers

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

Percent of respondents



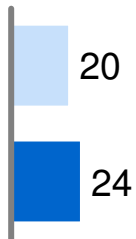
## 4 They also use the Internet more for researching online and offline purchases

Mass New Mainstream

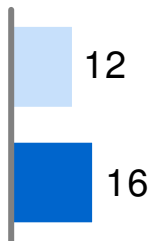
I will not make a purchase before researching it first on the Internet

Percent

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

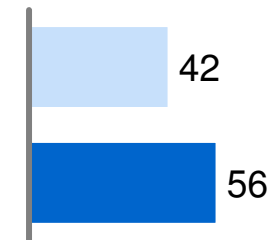


When purchasing personal care products

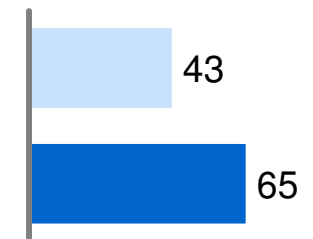


Percent of users who trust each information source

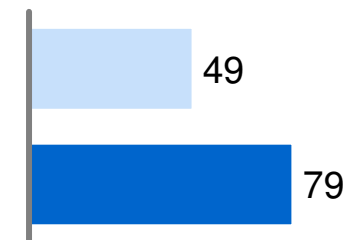
Internet



Online forum (e.g., Dianping)



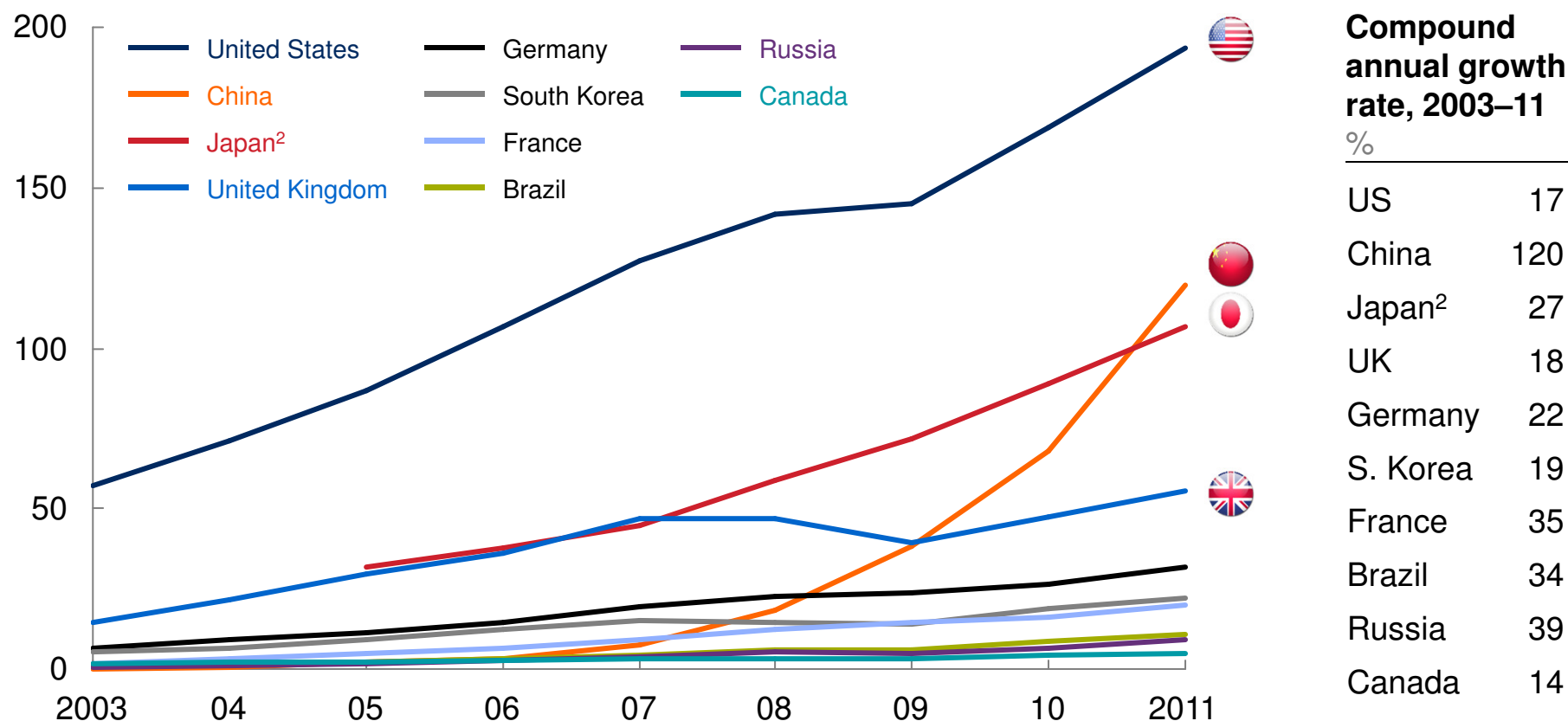
Social media site (e.g., Renren, Kaixin)



## 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<sup>1</sup>

\$ Billion



<sup>1</sup> Excluding online travel

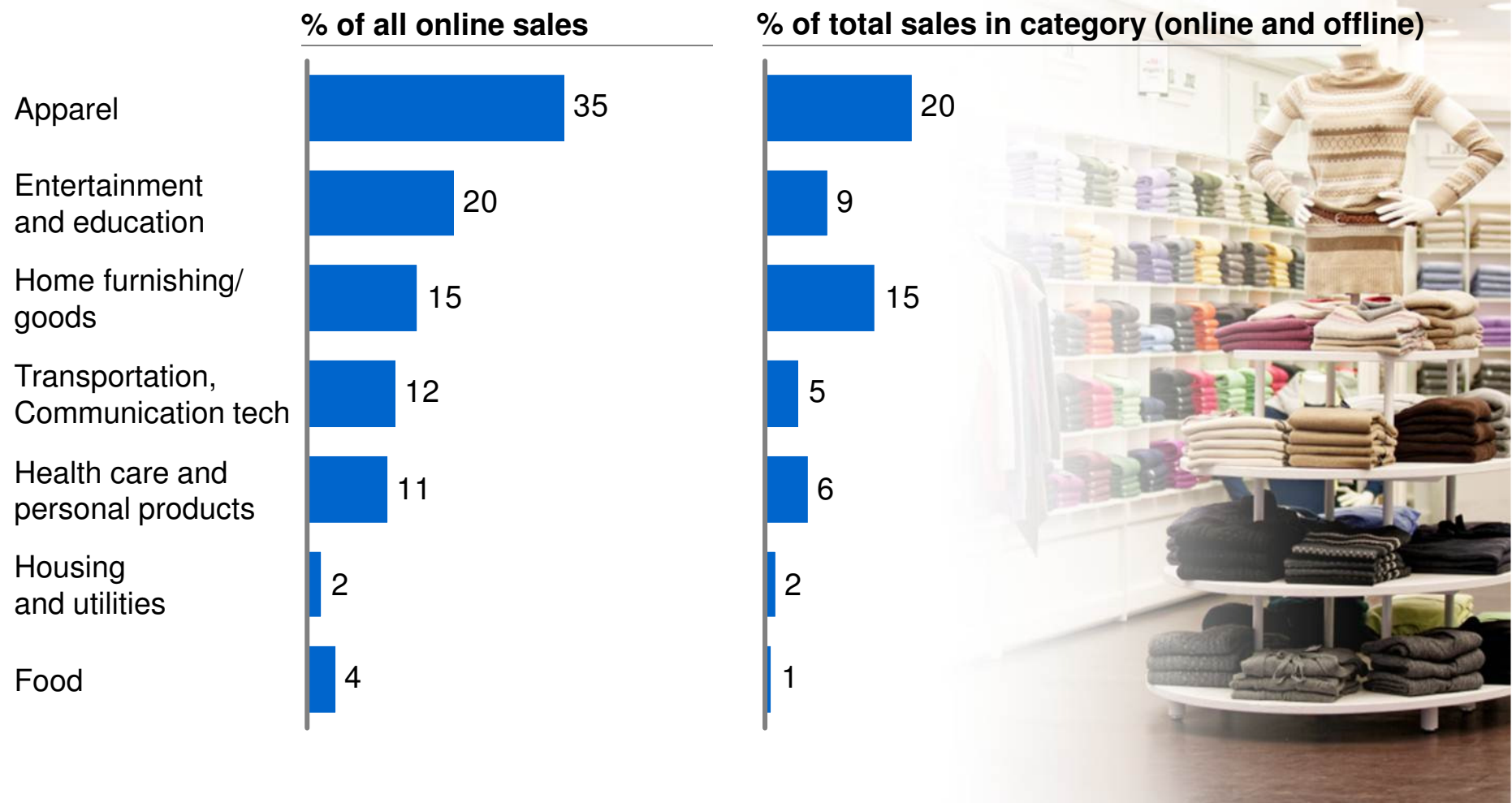
<sup>2</sup> Japan's CAGR covers 2005–11

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

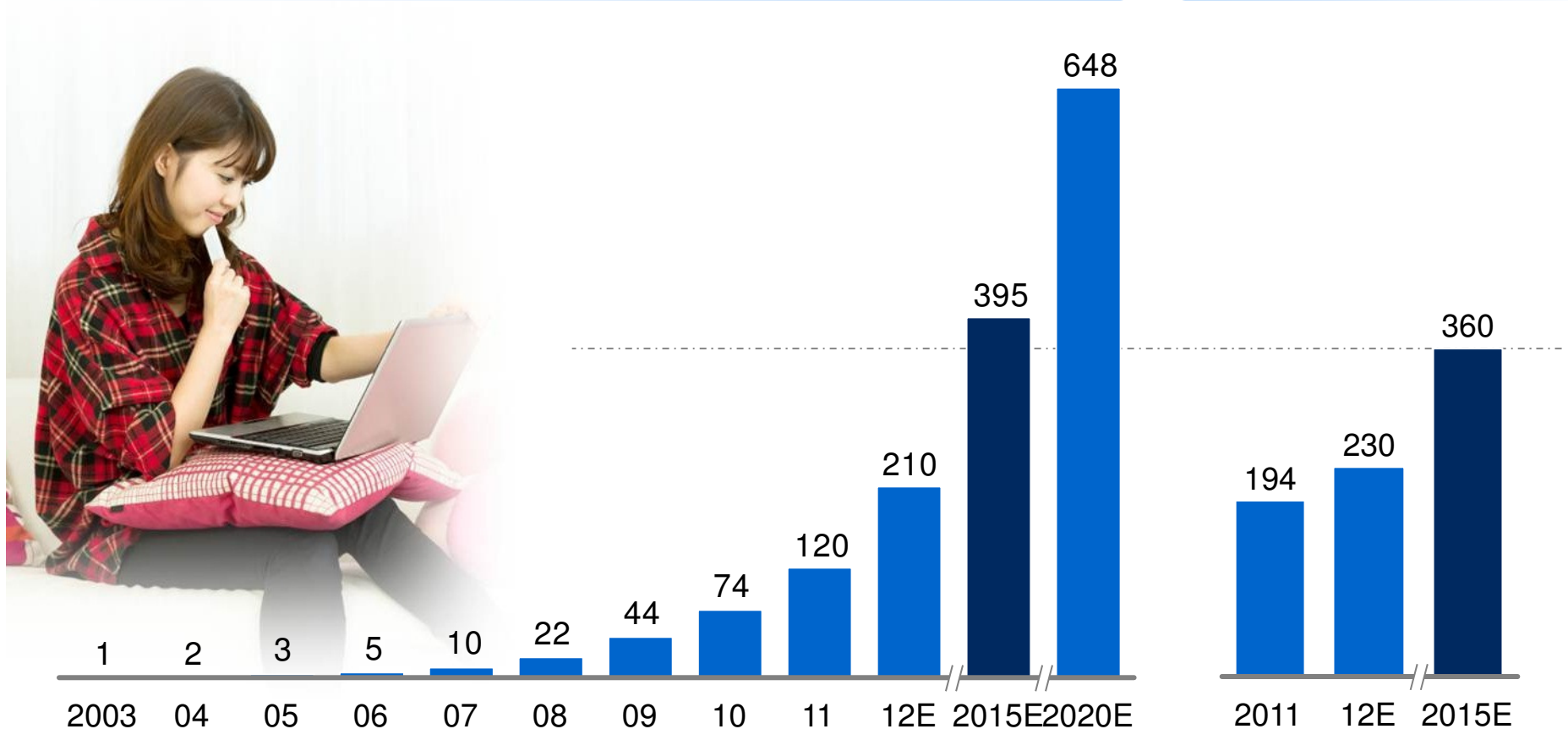
%



#### 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



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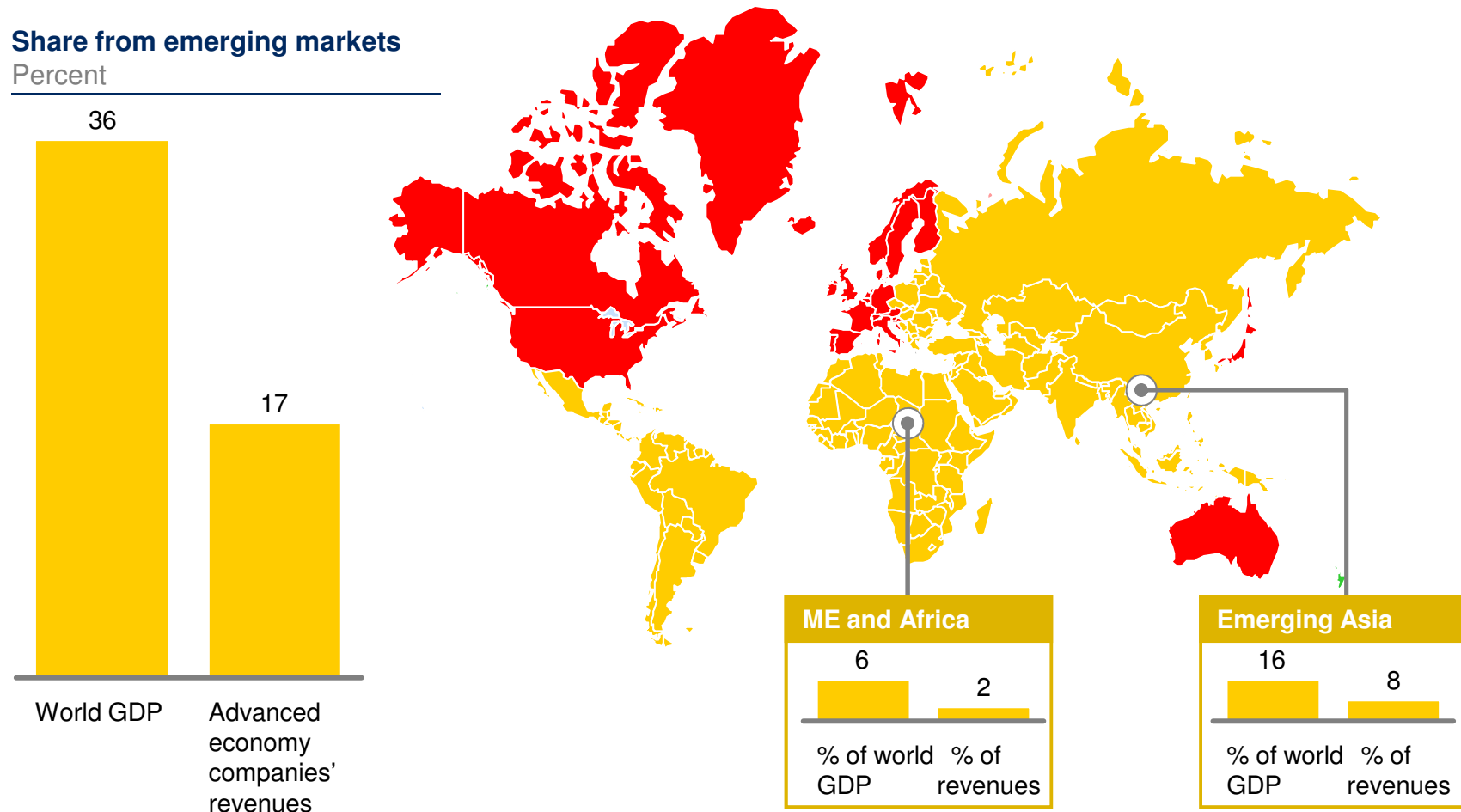


# Western MNCs have an enormous opportunity to shift their business to Asia

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

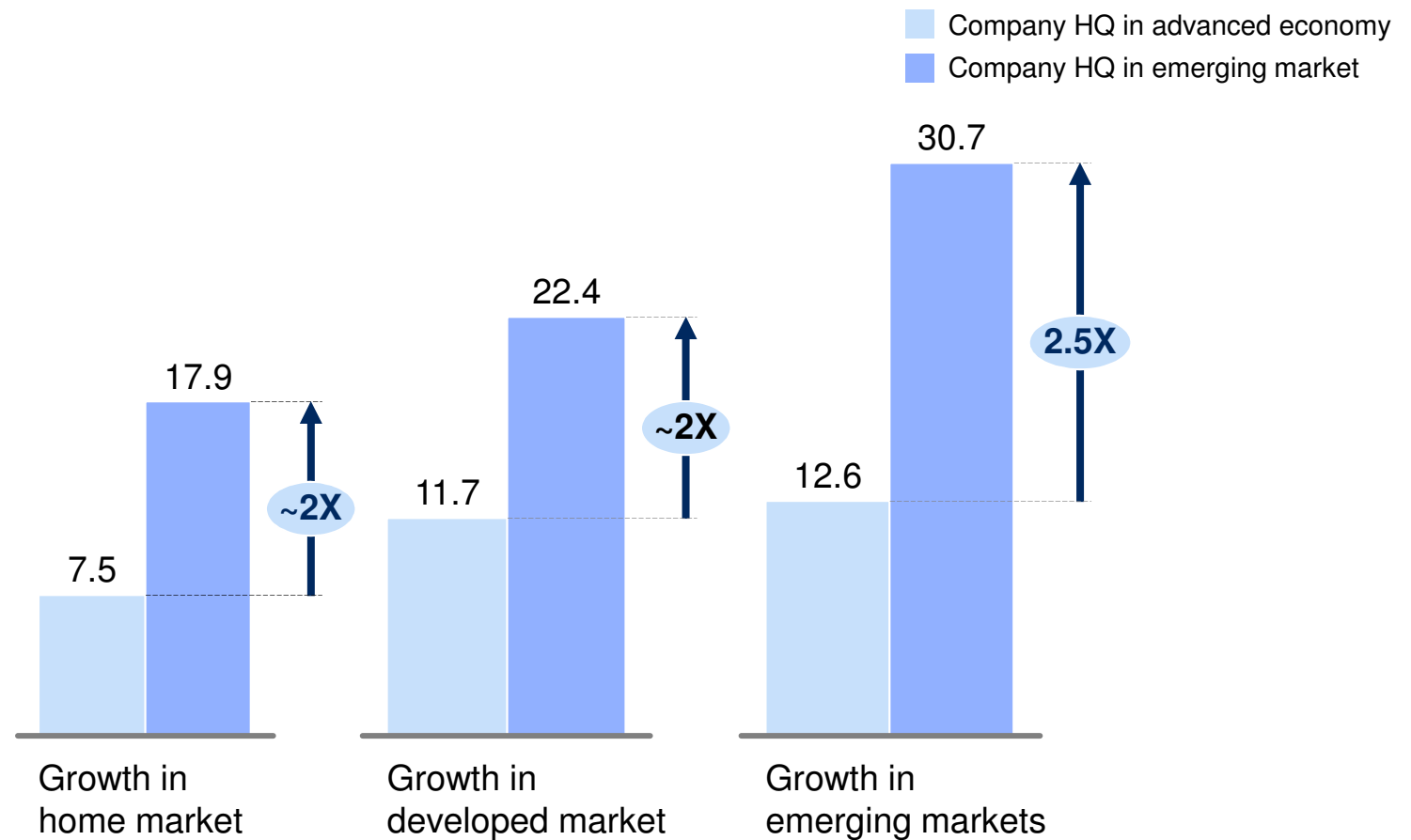
## Share from emerging markets

Percent



## Emerging market companies are already growing faster than advanced economy rivals

### Revenue CAGR



# 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)

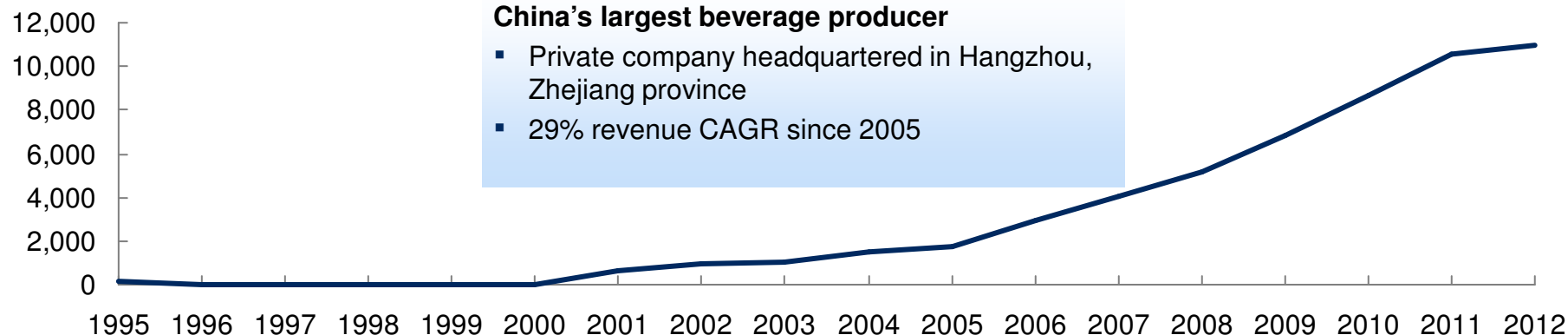
- Developed flexible R&D to quickly copy successful products and take them to market through a trial and error strategy; e.g., bottled water (1996) and Future Cola (1998)
- 2009: Branched out to children's apparel
- Refined distribution model to be able to provide higher trade margins, rebates, and bonuses

## 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



# 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)

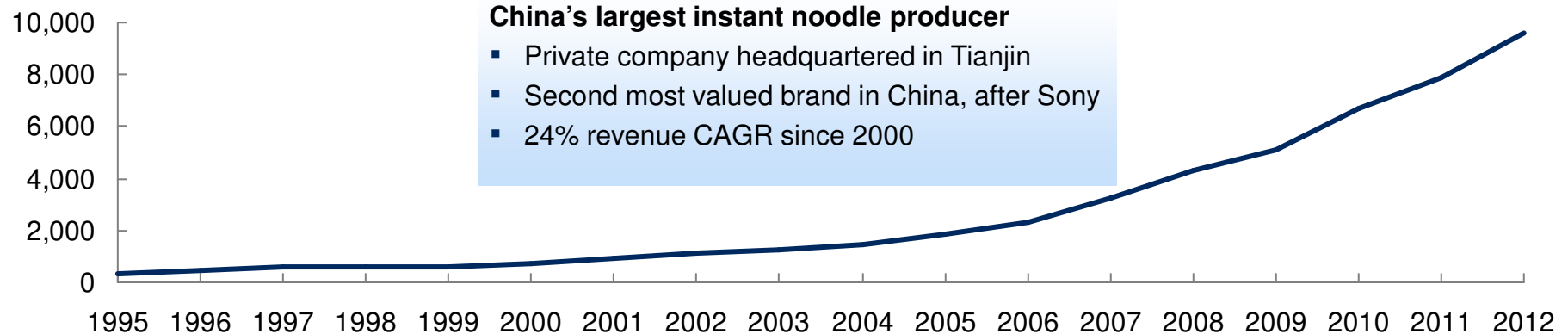
- Entered the bakery and beverage business
- Started to build a systematic distribution system
  - Turned original wholesalers to distributors
  - Built sales offices in major cities;
  - Created on-the-ground sales teams in charge of outlets

## 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





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