

Mapping China's middle class

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Generational change and the rising prosperity of inland cities will power consumption for years to come.

The explosive growth of China's emerging middle class has brought sweeping economic change and social transformation—and it's not over yet. By 2022, our research suggests, more than 75 percent of China's urban consumers will earn 60,000 to 229,000 renminbi (\$9,000 to \$34,000) a year.¹

In purchasing-power-parity terms, that range is between the average income of Brazil and Italy. Just 4 percent of urban Chinese households were within it in 2000—but 68 percent were in 2012.² In the decade ahead, the middle class's continued expansion will be powered by labor-market and policy initiatives that push wages up, financial reforms that stimulate employment and income growth, and the rising role of private enterprise, which should encourage productivity and help more income accrue to households.³ Should all this play out as expected, urban-household income will at least double by 2022.

Beneath the topline figures are significant shifts in consumption dynamics, which we have been tracking since 2005 using a combination of questionnaires and in-depth interviews to create a detailed portrait by income level, age profile, geographic location,

¹All income figures refer to annual household disposable income, in real (2010) terms.

²Households in this income range, which we define as middle class, spend less than 50 percent of their income on necessities and display distinctive consumer behavior.

³For more, see "What's next for China?," January 2013, mckinsey.com.

and shopping behavior.⁴ Our latest research suggests that within the burgeoning middle class, the *upper* middle class is poised to become the principal engine of consumer spending over the next decade.

As that happens, a new, more globally minded generation of Chinese will exercise disproportionate influence in the market. Middle-class growth will be stronger in smaller, inland cities than in the urban strongholds of the eastern seaboard. And the Internet’s consumer impact will continue to expand. Already, 68 percent of the middle class has access to it, compared with 57 percent of the total urban population (see “China’s e-tail revolution,” on mckinsey.com).

Importance of the ‘upper’ cut

The evolution of the middle class means that sophisticated and seasoned shoppers—those able and willing to pay a premium for quality and to consider discretionary goods and not just basic necessities—will soon emerge as the dominant force. To underscore this group’s growing importance, we have described it in past research as the “new mainstream.”⁵ For the sake of simplicity, we now call consumers with household incomes in the 106,000 to 229,000 renminbi range upper middle class. In 2012, this segment, accounting for just 14 percent of urban households, was dwarfed by the mass middle class, with household incomes from 60,000 to 106,000 renminbi. By 2022, we estimate, the upper middle class will account for 54 percent of urban households and 56 percent of urban private consumption. The mass middle will dwindle to 22 percent of urban households (Exhibit 1).

The behavior of today’s upper middle class provides some clues to China’s future. Our research indicates that these consumers are more likely to buy laptops, digital cameras, and specialized household items, such as laundry softeners (purchased by 56 percent of the upper-middle-class consumers we surveyed last year, compared with just 36 percent of the mass middle). Along with

⁴Since 2005, we have interviewed more than 70,000 Chinese consumers in upward of 60 cities to gain a deep understanding of attitudes and spending behavior in 100-plus product categories. The incomes, ages, regions, city clusters, and city tiers of the respondents—representing 74 percent of China’s GDP and 47 percent of its total population—vary widely.

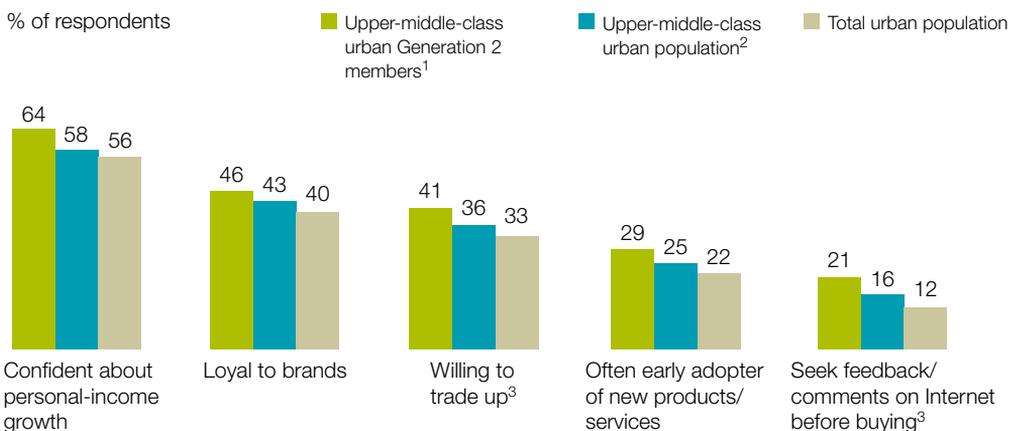
⁵See Yuval Atsmon and Max Magni, “Meet the Chinese consumer of 2020,” March 2012, mckinsey.com.

These G2 consumers today are typically teenagers and people in their early 20s, born after the mid-1980s and raised in a period of relative abundance. Their parents, who lived through years of shortage, focused primarily on building economic security. But many G2 consumers were born after Deng Xiaoping’s visit to the southern region—the beginning of a new era of economic reform and of China’s opening up to the world. They are confident, independent minded, and determined to display that independence through their consumption. Most of them are the only children in their families because when they were born, the government was starting to enforce its one-child policy quite strictly.

McKinsey research has shown that this generation of Chinese consumers is the most Westernized to date. Prone to regard expensive products as intrinsically better than less expensive ones, they are happy to try new things, such as personal digital gadgetry. They are also more likely than previous generations to check the Internet for other people’s usage experiences or comments. These consumers seek emotional satisfaction through better taste or higher status, are loyal to the brands they trust, and prefer niche over mass brands (Exhibit 2). Teenage members of this cohort already have a big influence on decisions about family purchases, according to our research.

Exhibit 2

Generation 2—Chinese consumers in their teens and early 20s—takes a more Western approach to shopping.



¹People born after the mid-1980s and raised in a period of relative abundance.

²Annual household income of 106,000–229,000 renminbi (equivalent to \$16,000 to \$34,000 in 2010 real terms).

³Personal-care-product example.

Even as the G2 cohort reshapes Chinese consumption patterns, it appears to be maintaining continuity with some of the previous generations' values. Many G2 consumers share with their parents and grandparents a bias for saving, an aversion to borrowing, a determination to work hard, and a definition of success in terms of money, power, and social status. For the G2 cohort, however, continuity in values doesn't translate into similar consumer behavior. Likewise, 25- to 44-year-old G1 consumers, despite their loyalty to established brands, are more open than their parents to a variety of schools of thought, and as retirees in the years ahead they will certainly demonstrate a "younger" consumption mind-set than today's elderly do.

The rise of the west (and the north)

In 2002, 40 percent of China's relatively small urban middle class lived in the four Tier-one cities: Beijing, Shanghai, Guangzhou, and Shenzhen. By 2022, the share of those megacities will probably fall to about 16 percent (Exhibit 3). They won't be shrinking, of course; rather, middle-class growth rates will be far greater in the smaller cities of the north and west. Many are classified as Tier-three cities, whose share of China's upper-middle-class households should reach more than 30 percent by 2022, up from 15 percent in 2002.

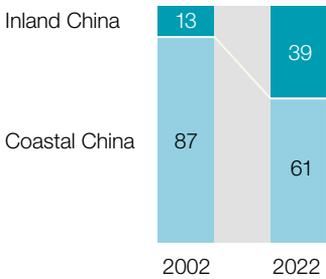
Tier-four cities, smaller still, will also be part of that geographic transition. Consider Jiaohe, in Jilin Province. This northern inland Tier-four city is growing quickly because of its position as a transportation center at the heart of the northeast Asian economic zone, an abundance of natural resources (such as Chinese forest herbs and edible fungi), and the fact that it is one of China's most important production bases for grape and rice wine. In 2000, less than 1,000 households out of 70,000 were middle class, but by 2022, those figures are set to rise to 90,000 and 160,000, respectively.

Another Tier-four city, Wuwei, in Gansu Province, is growing rapidly because it's within the Jinchang–Wuwei regional-development zone and at the junction of two railways and several highways.

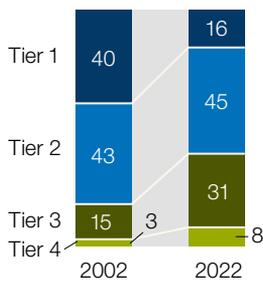
Exhibit 3

The geographic center of middle-class growth is shifting.

Share of middle class,¹ by geography, %



Share of middle class,¹ by type of city,² %



¹Based on information for 266 cities; data for 2022 are projected. Cities in China are grouped into 4 tiers based on their economic development and political importance. For Tier-1 cities, 2010 nominal urban GDP is >932 billion renminbi; for Tier-2 cities, 120 billion–932 billion renminbi; for Tier-3 cities, 22 billion–120 billion renminbi; for Tier-4 cities, <22 billion renminbi.

²Figures may not sum to 100%, because of rounding.

Wuwei too had less than 1,000 middle-class households (out of 87,000 total) in 2000. By 2022, though, 390,000 of the city's 650,000 households should be middle class.



Continued strong growth in the size and diversity of China's middle class will create new market opportunities for both domestic and international companies. Yet strategies that succeeded in the past, given the wide distribution of standardized products for mass consumers, must be adjusted in a new environment with millions of Chinese trading up and becoming more picky in their tastes. A detailed understanding of what consumers are doing, how their preferences are evolving, and the underlying reasons for their behavior will be needed.

Armed with better information, companies can begin tailoring their product portfolios to the needs of increasingly sophisticated consumers and revising brand architectures to differentiate offerings and attract younger consumers eager for fresh buying experiences. There will be not only challenges but also plenty of opportunities for companies whose strategies reflect China's new constellation of rising incomes, shifting urban landscapes, and generational change. ◉

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For more data on the middle class in China's cities—or urban growth across the world—see the McKinsey Global Institute's new app, *Urban World*, available for iPad and Android tablets. An interactive map offers customizable visual displays of current and projected populations, household incomes, and GDP for more than 2,600 cities globally.

Download the complimentary *Urban World* app in the iTunes Store (appstore.com) and Google Play Store (play.google.com).