Winning the Wallet of Today's Chinese Consumers -
A look at consumer buying preferences
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Introduction

Among the factors viewed as having complicated the market entry of foreign brands into China have been the perceptions, largely correct, of its vastness and complexity, together with the diversity of its cities and provincial economies. China, as a market, is more analogous to the Eurozone than it is to a single nation. As China’s economic growth and the benefits of globalisation have been unevenly distributed among Chinese cities, it should be no surprise that retail markets present many nuances and much to contemplate when crafting an entry strategy.

There are different ways of segmenting the China market: by region and province; by income and wealth strata; and by administrative divisions. In this study, Deloitte starts by looking at the differences among first-, second-, third-, and fourth-tier cities, and our research shows shades of similarity in consumer demand across these cities. By computer-assisted telephone interviewing (CATI) supplemented by other concurrent research, Deloitte has investigated the retail market in China. We set out in search of answers to the following questions:

1. Where are the consumers for international brands in China?
2. Is there any difference in brand-buying behaviour between men and women?
3. What are the top criteria for consumer retail purchases in China?
4. How loyal are Chinese consumers to the brands they buy?
5. How ready is the Chinese consumer to accept new brands and concepts?
6. What premium are the Chinese willing to pay for abstract concepts such as low-carbon or organic as product attributes?
7. Geographically, where should international brands start on entering the China market?

In this survey, we (a) introduce the market and the research methodology; (b) summarise the findings; (c) discuss the results in greater detail; and (d) draw out some of the implications of this research for China retail market players and prospective entrants.
Key findings

In respect of the key questions Deloitte sought to answer, our findings were as follows.

1. International brands are marketable to a consistent share of the population across city tiers.
2. Brand image influences men’s choices more than it does those of women.
3. Value for money is eclipsing brand as the top criterion for purchases.
4. The Chinese consumer is willing to experiment and try new brands, products and services.
5. Consumers in China have unclear perceptions about many brands and products, which presents opportunities as well as challenges.
6. Consumers are unwilling to pay a premium for abstract concepts.
7. Deciding which cities to enter with a retail concept is not as clear-cut as before.
Methodology - four tiers, eight cities

China is not a single market. It is enormous and diverse, and may be segmented geographically, culturally, and socio-economically. For the purposes of this research, we have chosen to segment China according to administrative units: tiers of cities, with the first tier comprising China's largest cities such as Beijing and Shanghai, together with the second, third and fourth tiers (Figure 1). We expected to find differences among these tiers with respect to stages of consumer development and the maturity of the retail landscape.

To compare retail consumer markets among the four tiers, we selected cities in each tier as targets for our survey and analysis. Among the first-tier cities, we selected Shanghai; in the second tier, Chengdu, Jinan and Hefei were selected; in the third tier, Zhongshan and Xiangfan, Changshu and Xinnin were our fourth-tier target cities (Figure 2). Geographically, the eight cities selected have a wide span, with locations in northeast, east, southeast and southwest China. Economically, the affluence level in each city is on or above its tier average. Our aim was to select cities across tiers that are representative of greater retail market potential, and there was no assumption that the cities chosen were statistically representative of any tier.

The survey respondents included a combination of mobile phone and fixed line users. The sample sizes for the first- and second-tier cities were between 270 and 307. For the third- and fourth-tier cities, sample sizes were approximately 200 each.

We required the survey population to be balanced in terms of gender and age. Only respondents between 18 and 45 years of age were included in the survey. Respondents were selected for even distribution age among six ranges (18 to 25, 25 to 30, 30 to 35, 35 to 40, and 40 to 45 years of age), with the middle-age group (25 to 40) no less than 60 percent.

"We see many lower-tier cities with potential, as there are always rich people, even in the poorer regions"

- Cosmetics brand executive

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**Figure 1. City tiers by administration level in the Chinese Mainland**

- **Municipality**
  - Tier 1: 4 cities
    - Beijing, Shanghai (two municipalities), Guangzhou & Shenzhen
    - Two municipalities plus two traditionally recognised tier one cities in terms of level of economy development, population, and overall infrastructure, etc.

- **Provincial capitals/sub-provincial cities**
  - Tier 2: 34 cities
    - Two municipalities: Tianjin & Chongqing
    - 26 provincial capitals, where provincial governments are located and usually facilitated with best logistics, and education infrastructure
    - 6 from the 15 sub-provincial cities, which are the largest prefecture-level cities and are given more autonomy economically.

- **Prefecture cities**
  - Tier 3: 249 cities
    - Prefecture cities administered under provincial government

- **County cities**
  - Tier 4: 368 cities
    - Tier 4 cities are the county level cities

- **Counties**
  - Tier 5 and below
    - All administrative entities below county cities

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Source: China Statistics Bureau, Deloitte Analysis
Consumer retail preferences were gauged with regard to purchases of shoes and other apparel, and patronage of restaurants and gyms. Respondents were queried as to preferences for, and recognition of branded products. Various other questions were asked to measure consumer acceptance of new trends and technologies, and absorption of new brands.

In addition to the consumer telephone interviews, a number of interviews were conducted with retail executives in China. These highly-informed people were asked about their companies’ current presence in China, target cities and regions, and plans to expand (or downscale) operations. Their opinions were solicited on which cities presented profitable opportunities; what are the prospects and challenges for consumer retail business in the lower-tier cities and in China generally; and how well Chinese consumers can be expected to embrace new products and concepts.

Figure 2. Cities of the Chinese Mainland included in the survey

<table>
<thead>
<tr>
<th>City</th>
<th>Official disposable income* (RMB/year)</th>
<th>Ranking**</th>
<th>Wealth level within the tier</th>
</tr>
</thead>
<tbody>
<tr>
<td>T1</td>
<td>Shanghai</td>
<td>23,623</td>
<td>4</td>
</tr>
<tr>
<td>T2</td>
<td>Jinan</td>
<td>18,004</td>
<td>23</td>
</tr>
<tr>
<td></td>
<td>Chengdu</td>
<td>14,849</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>Hefei</td>
<td>13,426</td>
<td>73</td>
</tr>
<tr>
<td>T3</td>
<td>Zhongshan</td>
<td>20,317</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Xiangfan</td>
<td>10,912</td>
<td>186</td>
</tr>
<tr>
<td>T4</td>
<td>Changshu</td>
<td>N.A. (average income - 28,732)</td>
<td>N.A.</td>
</tr>
<tr>
<td></td>
<td>Xinmin</td>
<td>N.A. (average income - 13,691)</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

* Actual disposable income is believed to be higher, but government statistics are consistent across cities
** 2007 ranking of disposable income by 336 cities above T3

Source: China Statistics Bureau, “China Top 100 Cities in 2007”, Deloitte Analysis
The results of Deloitte’s CATI exercise, together with insight gained from interviews with key executives, provided the following detailed answers to the questions guiding our research.

**Finding: International brands are marketable to a consistent share of the population across city tiers**
Taking purchases of shoes as indicative of apparel purchases, Deloitte asked how many pairs of shoes respondents had purchased in the past year (2009), and at what prices. Support for premium products was found to be proportional to population across cities. This was indicated by the general consistent proportion of consumers in these cities who were willing to pay RMB 600 or more for a pair of shoes [Exhibit 1]. The lower price segment of the market is not as consistent from city to city with pricing generally considerably lower as we move down the city tiers.

"We are looking for our 'big growth' in third- and fourth-tier cities, while we maintain our presence in big cities to build our brand image. We also test our new products in big cities."

- An executive from a leading Chinese home appliance brand

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**Exhibit 1. Pricing of most expensive pair of shoes purchased in 2009 across cities**

<table>
<thead>
<tr>
<th>City</th>
<th>&lt;300 RMB</th>
<th>300-600 RMB</th>
<th>601-1,000 RMB</th>
<th>&gt;1,000 RMB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>37%</td>
<td>43%</td>
<td>53%</td>
<td>31%</td>
</tr>
<tr>
<td>Chengdu</td>
<td>35%</td>
<td>32%</td>
<td>58%</td>
<td>31%</td>
</tr>
<tr>
<td>Hefei</td>
<td>21%</td>
<td>35%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Jinan</td>
<td>6%</td>
<td>16%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Xiangfan</td>
<td>1%</td>
<td>37%</td>
<td>31%</td>
<td>31%</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>8%</td>
<td>37%</td>
<td>55%</td>
<td>46%</td>
</tr>
<tr>
<td>Changshu</td>
<td>8%</td>
<td>40%</td>
<td>58%</td>
<td>44%</td>
</tr>
<tr>
<td>Xinmin</td>
<td>9%</td>
<td>17%</td>
<td>32%</td>
<td>26%</td>
</tr>
</tbody>
</table>

\( n = 1,966 \)

Source: CATI, Deloitte Analysis
Finding: Brand image influences men’s choices more than it does those of women. Deloitte wanted to examine whether the shopper’s gender was a factor in these purchasing decisions. We asked male and female respondents questions about their purchases of shoes in terms of both price and volume. Men were found to be using brand as a short-cut for evaluating quality. Women are moving past brand in their buying habits. This is also consistent with previous research we have conducted.

In all cities, more men than women were found to prefer international-brand shoes [Exhibit 2]. We found that women purchased shoes in greater numbers and more consistently across cities than did men. Female frequent buyers of shoes (indicated by number of female interviewees who bought seven or more pairs of shoes in 2009) generally surpass male frequent buyers [Exhibit 3].

In first- and fourth-tier cities, women’s apparel spending appears to surpass that of men; while in second- and third-tier cities, men’s apparel spending was equal to or greater than women’s [Exhibit 4].

Exhibit 2. Percentage of respondents whose most expensive shoes are of international brands

Exhibit 3. Percentage of respondents who purchased 7+ pairs of shoes in 2009 by (by gender across selected cities)

Exhibit 4. Percentage of respondents who purchased a pair of shoes for 600+ RMB in 2009 (by gender across selected cities)

Source: CATI, Deloitte Analysis

n = 1,966

Source: CATI, Deloitte Analysis

Finding: Value for money is eclipsing brand as the top criterion for purchases

Quality, often intuitively judged as reflected in a product’s price or brand, is the top criterion when consumers in the third- and fourth-tier cities make purchases. However, value-for-money is consistently the top decision factor in consumer retail purchases in the first- and second-tier cities; and it increasingly drives many purchases in third-tier cities [Exhibit 5].

Over time, the importance of value for money may be expected to rise in all tiers. Consumers are getting more sophisticated in thinking about whether what they buy is really worth the money they pay.

Exhibit 5. What are the top factors that drive a purchase? (across all eight cities)

Source: CATI, Deloitte Analysis
Finding: The Chinese consumer is willing to experiment and try new brands, products and services

In the second- and third-tier cities, retail consumers are more willing to try new premium brands with a value proposition, which is good news for brands not yet in the market.

Over half of respondents across all cities were interested in trying new premium brands. Also in the second- to fourth-tier cities, the brand’s impression of added value in the form of a “new function or service” stimulated an impulse to buy. Consumer respondents in Xiangfan were least likely to try a new brand [Exhibit 6].

Comparatively greater challenges to introduce new brands in the first-tier cities exist. But with 70 percent of Shanghainese willing to try new brands, it is hardly a rigid consumer. For Shanghai residents purchasing shoes, international brands are a greater factor in purchasing decisions than they are for shoppers among the second-, third- and fourth-tier cities. As to retail promotion, word-of-mouth and well-positioned media and advertising campaigns seem critical for new brands in first-tier cities; word of mouth was especially important to Shanghai and Chengdu respondents [Exhibit 7].
Finding: Consumers in China have unclear perceptions about many brands and products, which presents opportunities as well as challenges

When probing on the most expensive pair of shoes, we also asked which brand was purchased. Over 50 brands were cited, but two sportwear brands came up most frequently: Nike and adidas.

Across all tiers of cities, respondents’ perceptions of two popular international sport shoe brands were generally consistent with or higher than their actual market positioning, especially in the first- and second-tier cities. However, there was some confusion about the origins of these brands. There was less clarity or certainty about international brands in the second- to fourth-tier cities, where from 24 percent to over 45 percent of respondents misperceived brands. In these cities, respondents who purchased Nike and adidas took them to be domestic brands, or simply failed to recognise whether these brands were international or domestic (Xiangfan, where 96 percent of consumer respondents correctly identified these brands, was an outlier in this regard) [Exhibit 8].

Although no single brand was found to be dominant in the selected cities, in each city respondents were aware of at least one or two popular domestic brands indicating local brand strength. Perception of local brands aligned remarkably well with the brand’s actual positioning, indicating respondents’ greater awareness of domestic brands than of international ones [Exhibit 9].
Finding: Consumers are unwilling to pay a premium for abstract concepts

The impacts of “low carbon” or “environment friendly” marketing strategies for products were not perceived as effective in generating sales. Consumers will only pay a premium for goods with direct and clearly perceived benefits, albeit, even if not proven.

A certain degree of wealth is needed to support abstract benefits; for example, “low-carbon footprint” or other environmental credentials- with energy efficiency being the exception (but the benefits accrue directly to the consumer). Low carbon goods earned a very low premium over conventional substitutes because the benefits were not readily perceived.

A majority of consumers recognised the concept of “low carbon”, but did not consider this a motivation to buy goods marketed in this way. Consumers tended to regard low carbon claims as the manufacturer’s declarations of social responsibility rather than as selling points expressing a key value proposition. Those consumers who accepted low carbon as a value proposition were willing to pay a 10-20 percent premium over goods not making this claim; but these represented only 10 percent of consumers [Exhibit 10].

"I do not think Chinese consumers focus on environmental factors. If they like a product and it is priced right, they will buy it. Customers are brand driven (more than product attribute driven). Environmentally friendly is not a selling point to them. A prestigious brand is more important."

- Executive from a clothing brand
Goods such as organic foods and 3G technologies were frequently misperceived by consumers. Fifty percent of respondents in Deloitte’s survey report having tried organic food [Exhibit 11].

We remain guarded in our interpretation of this finding because there is unlikely enough genuine organic food in the China marketplace for 50 percent of the population to have tried it.

"Most home appliance brands are using 'low carbon' as a slogan to market themselves. However, only a small portion of consumers will value this concept. Most consumers do not really understand how a plasma TV can reduce carbon emissions compared with a conventional."

- An executive from a leading Chinese home appliance brand

Exhibit 11. Are you eating or have you ever eaten organic food?  

<table>
<thead>
<tr>
<th>City</th>
<th>Have eaten</th>
<th>Know but have not eaten</th>
<th>Do not know</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chengdu</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hefei</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jinan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Xiangfan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zhongshan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Changshu</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Xinmin</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CATI, Deloitte Analysis
The proportion of reported consumers of organic food rises with income up to the high-income range of over RMB 15,000, where the share of these consumers drops sharply. At least 80 percent of respondents claimed to know something about organic foods, although this rate was lower outside the first-tier city of Shanghai [Exhibit 12].

For those who know about organic food but have not had it, the willingness to buy it is low, especially in Shanghai [Exhibit 13]. The underlying reason is that food safety has become a major concern for Chinese consumers in recent years, following a high-profile scandal involving tainted milk. This initially led consumers to consider purchasing organic foods for their families. However, a lack of industry standards and abuse of the “organic” and “green” concepts reduced consumers’ trust in products bearing these labels; that is, many consumers now doubt whether what they paid for is really organic food (and for good reason, as explained above). The distrust is especially high in big cities like Shanghai probably because consumers are more educated and sophisticated about organic products and question the origin of those products.
"Low carbon is part of doing business. Consumers just expect companies to be low carbon. From a PR perspective, low carbon will create a positive view of the brand and is good for the company's public image. It is not the way to advertise a product."

- Executive from a quick service restaurant chain
Finding: Deciding which cities to enter with a retail concept is not as clear-cut as before. For premium brands, a definite “halo effect” results from market penetration in the first-tier cities. For cities among the lower three tiers, the high preference for brands “seen in big cities” indicates the desire of those shoppers to emulate the first-tier city lifestyle [Exhibit 7].

A recognised brand is critical to gaining access to department stores, a conventional channel for apparel. Department stores and stand-alone shops still prevail as the top channels for shoe purchases across second-, third-, and fourth-tier cities [Exhibit 14]. More than 20 percent of respondents said they had increased their shoe purchases through these two channels [Exhibit 15].

"Absolutely enter via tier one cities. We need to prove our model there. Could we successfully put a site in a tier two city? Yes, but it would do nothing to move the needle."

- Executive from an international fitness company

"We prefer brands that already have high brand recognition before bringing them into our lower-tier city stores"

- Executive from a department store operator

Exhibit 14. Top two channels to purchase shoes (across five cities)

Exhibit 15. Purchasing increase through different channels (across five cities)
For mid-market and other brands, the first tier may be bypassed as such brands can now be successfully established in the second-tier cities. Respondents across all tiers of cities share common perceptions of big brands: not all big brands are international; big brands typically offer pleasant shopping environments, high-quality products, and reliable after sale service [Exhibit 16, 17].

Exhibit 16.
Do you agree with the statement of “Big Brands are All International Brands”? (Percentage answering “Yes” across 8 cities)  

<table>
<thead>
<tr>
<th>City</th>
<th>Percentage “Yes”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>30%</td>
</tr>
<tr>
<td>Chengdu</td>
<td>40%</td>
</tr>
<tr>
<td>Hefei</td>
<td>20%</td>
</tr>
<tr>
<td>Jinan</td>
<td>10%</td>
</tr>
<tr>
<td>Xiangfan</td>
<td>30%</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>40%</td>
</tr>
<tr>
<td>Changshu</td>
<td>20%</td>
</tr>
<tr>
<td>Xinmin</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: CATI, Deloitte Analysis

Exhibit 17. Do you think big brands products are of good quality, have good after-sales service level and/or good shopping environment? (Percentage answering “Yes” across 8 cities)  

<table>
<thead>
<tr>
<th>City</th>
<th>Percentage “Yes” for Good Environment</th>
<th>Percentage “Yes” for Good Quality</th>
<th>Percentage “Yes” for Good After-sales Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>80%</td>
<td>60%</td>
<td>50%</td>
</tr>
<tr>
<td>Chengdu</td>
<td>70%</td>
<td>50%</td>
<td>40%</td>
</tr>
<tr>
<td>Hefei</td>
<td>60%</td>
<td>40%</td>
<td>30%</td>
</tr>
<tr>
<td>Jinan</td>
<td>50%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Xiangfan</td>
<td>40%</td>
<td>20%</td>
<td>10%</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>30%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Changshu</td>
<td>20%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Xinmin</td>
<td>10%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: CATI, Deloitte Analysis
"It has been a typical entry model for high-end fashion brands, i.e. enter Hong Kong, Shanghai, Beijing first to get 'eyeballs', then selectively approach second and even lower tier cities. It's relatively easy to make marketing events at first tier cities with nationwide impact."

- Executive from an international fashion brand

Exhibit 18. Do you think big brands products are of a reasonable price or are good value-for-money? (Percentage answering "Yes" across 8 cities)

Source: CATI, Deloitte Analysis
Summary: How to enter the China retail market

Taken together, the findings are instructive for current and potential China market entrants. High-income earning retail consumers are more likely to view price as a symbol of quality, and first-tier city consumers tend to view international brands positively and in many cases, as offering value for money. Consumers more readily recognised the positioning of domestic brands than foreign brands. In respect of shoe purchases, no correlation was found between the retail consumer’s income and the number of pairs they purchased, implying that apparel buyers simply move downmarket if their income does not support their buying preferences.

For retail consumers in the top three city tiers, value for money is of greatest importance. However, retail consumers in the lower tiers take signals from what first-tier city consumers are buying. This behaviour would seem to support the entrance strategy described as “Be seen in first-tier cities, make money in second-, third-, and fourth-tier cities,” which is being followed by more and more retailers and brand owners in China. With the market dominance of domestic and international brands in first-tier cities, consumers elsewhere may be more “hungry” for new brands, especially international brands.

"We typically know within three months if a brand is inappropriate for the market. We might give it a year if we think it is an awareness issue."
- Executive from a department store operator

"We're pulling out of the market temporarily until market conditions and supportive infrastructure improves. The level of industry honesty about difficult China can be for our business is disappointing."
- Executive of an MNC

"In China's lower tier cities, you often find there are domestic brands with very strong market position and large groups of loyal customers for years. Many of those domestic brands are actually quite expensive."
- Executive from a ladies apparel brand
Deloitte’s survey of Chinese retail consumers in all four tiers of cities in China produced findings that will be instructive to companies planning to enter these retail markets. The results confirmed that international brands should achieve a scale presence in the top cities in order to make an impact. Other salient results are as follows.

Brands are an important signal to buy. For premium products, there is demand and interest in new brands in the lower-tiered cities. Penetrating the department stores, which are top of the market in those cities, requires that brand awareness already be established.

Brand development does not necessarily need to be done in the first-tier cities, but the resulting “halo effect” makes success there relevant. Establishing a brand in Shanghai, Beijing or Hong Kong gives that brand visibility that will likely boost sales in the rest of the country. Brand visibility in the first-tier cities is important to retail promotion in other cities, while word-of-mouth is of critical importance to establishing new brands in the first-tier cities.

The Chinese consumer’s sophistication is rising, but generally lags his or her Western equivalent. Shoppers increasingly want value for money, which is replacing brand and cost as the key decision factor in purchases. This bodes well for many western mid-range brands (which are likely to be perceived as premium in China).

In the second- to fourth-tiers cities, new functions or features may drive purchases. However, some new concepts or products, such as “organic” products, may be misunderstood, or their value may not motivate Chinese consumers to buy. While developing softer attributes such as environmental credentials may promote a brand’s reputation for social responsibility, it does not lead directly to a pricing premium in this cost-conscious and confused marketplace. Features with clear and direct benefits to the consumer are better able to secure premium prices.

International brands need to carefully analyse their target markets before entering China, and they should continuously monitor their brand positioning after market entry in order to reach their targets and capture market share.

"Finding the right location and suitable lease terms are key challenges for us when entering new markets"
- Retail executive
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