

Marketing to China's hinterland

Kevin Lane, Ian St-Maurice, and Claudia Wu

The country has hidden reserves of consumer buying power. But they are hard to reach.

Few executives at multinational consumer goods companies could pinpoint Gaochun on a map. Yet places like Gaochun, a town of 100,000 people in eastern China, are home to hundreds of millions of consumers with money to spend. Companies that dismiss these smaller cities and towns as too poor and hard to reach could be missing a large growth opportunity over the next decade.

It's no surprise that most global consumer goods companies initially focused their efforts on China's three largest cities—Beijing, Shanghai, and Guangzhou. These urban centers, with a combined population of 29 million people,¹ constitute China's most affluent and sophisticated market, commanding no less than 13 percent of the country's disposable income. In recent years multinationals have also expanded their activities beyond these beachheads, into the second- and third-tier cities, to drive revenue growth and consolidate their presence in the country. But relatively few global companies are taking note of the roughly 12,000 smaller cities and towns that dot the Chinese landscape.²

Our research³ found hidden pockets of buying power in these smaller urban areas. Although the potential benefits of reaching them must be weighed against the costs, the total household income in these cities and towns is already about 50 percent higher than that of the first- and second-tier cities combined. The number of households in smaller cities and towns with incomes greater than 3,5000 renminbi a year is expected to grow annually by 7.6 million, or 7 percent, over the next two decades, compared with average annual growth in cities generally of 6.6 million, or 5 percent.

A large, misunderstood opportunity

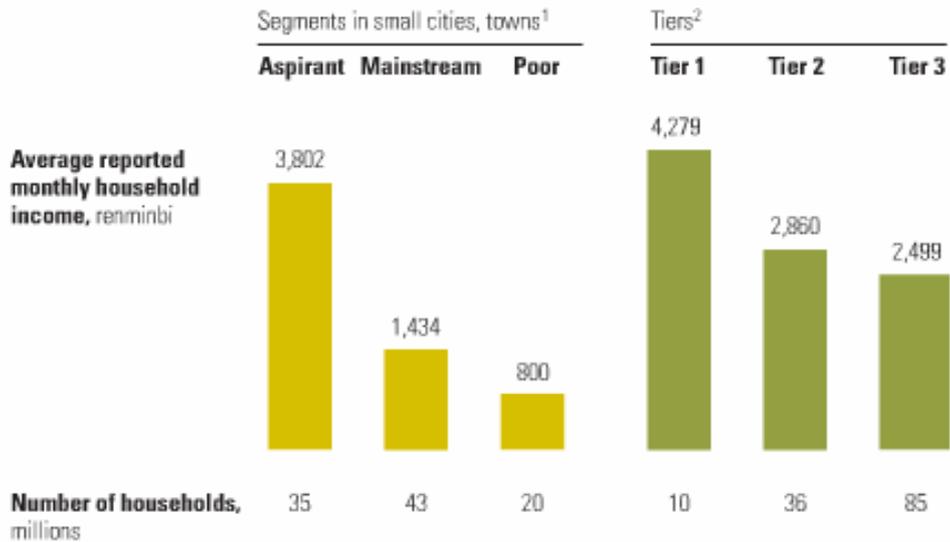
These smaller communities are the gateway between urban and rural China. A lot of them, such as Gaochun, which is 87 kilometers (about 54 miles) south of Nanjing, have only one main street. Government offices, small family businesses, and the surrounding farms dominate their economies. Some have one large retail store similar to a hypermarket and two dozen or so smaller supermarkets. Others have developed more rapidly. In the southwest, for example, Shuangliu has benefited from an international airport serving nearby Chengdu and is replete with modern apartment buildings. Its 210,000 residents enjoy a much wider variety of stores, including a few foreign-branded boutiques. (To read more about two consumers from these small markets, see "When urban meets rural in China".)

Whether towns or small cities, these markets lie just off the radar for most multinational consumer goods companies. Altogether about 400 million people—around a third of China's population—live in these places, and the average household monthly income is 2,200 renminbi (\$260). That isn't far behind the average income of about 2,500 renminbi in third-tier cities, such as Baoding or Mianyang, and the average of about 2,900 renminbi that people make in second-tier cities, like Chengdu or Xiamen.

Marketers often ignore these small cities and towns, perceiving them as too poor to worry about. But though some of their residents (about 20 million households) do indeed have very low incomes, our research unveiled two surprisingly large groups of relatively well-off consumers: a mainstream segment comprising about 43 million households with an average monthly income of 1,400 renminbi and an aspirant segment with an additional 35 million households and an average income of about 3,800 renminbi.⁴ Low, perhaps, by the standards of developed countries, but in China such income levels allow families to make purchases beyond the bare necessities of life and to enjoy a few small luxuries.

Mainstream consumers in these markets can certainly constitute an attractive market, but most companies should focus on aspirants, who expect their next purchases to be bigger and better than their most recent ones. The aspirant segment has earnings approaching the average (about 4,300 renminbi) for people in China's first-tier cities (Exhibit 1).

Aspirants attract



¹ Monthly household income: aspirant, >2,000 renminbi; mainstream, between 1,000 and 2,000 renminbi; poor, <1,000 renminbi; 1 renminbi = \$0.12.

² Cities are sorted into tiers based on factors such as population and GDP per capita; 2nd-tier cities are the 40 cities (primarily provincial capitals) after Beijing, Guangzhou, and Shanghai; 3rd-tier cities include the next 60.

Source: Sept 2005 McKinsey interviews with ~6,000 individuals in Chinese households

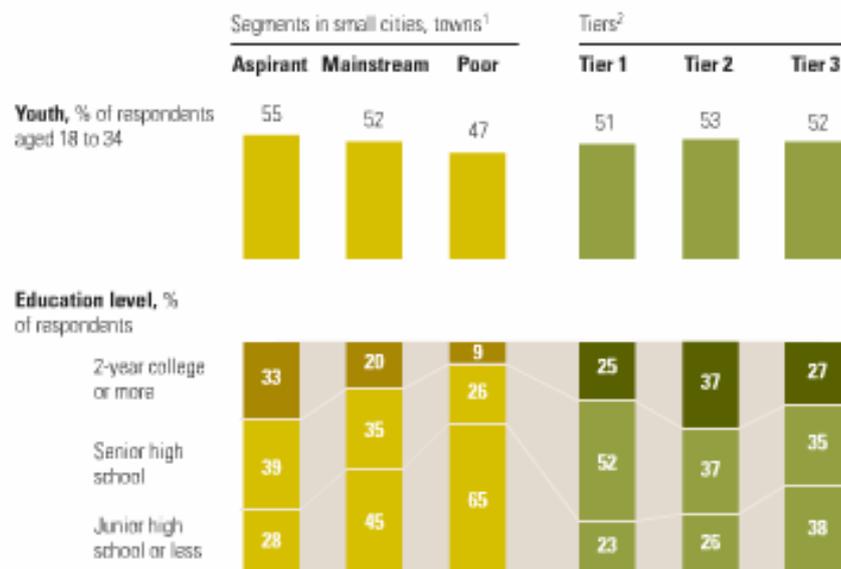
Like big-city consumers in many ways

Along with this hidden buying power, the residents of China's smallest cities and towns have more in common with their big-city compatriots than is evident at first. We asked consumers in cities of all sizes about their TV-viewing habits, for example, and discovered that 58 percent of those in small cities and towns routinely follow international news on television—comparable to the level in first-tier cities and 10 percentage points higher than that in second-tier ones.

People living in China's smallest urban areas are also just as likely as those in the biggest cities to visit supermarkets and single-brand boutiques, possibly because the inhabitants of towns and small cities are attracted to the modern amenities, and hypermarkets aren't as common there as they are in bigger places. More than the residents of bigger cities, people in these markets favor catalog shopping and purchases from shopping programs on TV, perhaps because local stores don't have the variety offered in bigger cities. Direct selling through door-to-door salespeople or local agents is also more effective there than in other urban areas, which may reflect the limited shopping options available in them.

The people who make up the most attractive segment in this market—the aspirants—have traits and desires that set them apart. We found that, compared with the people in other segments in these areas, they tend to be young: 55 percent are 18 to 34 years old, as opposed to 47 percent of the people in the poorest segment. Aspirants are also much better educated; a third of them have completed at least two years of college (Exhibit 2).

Young and educated



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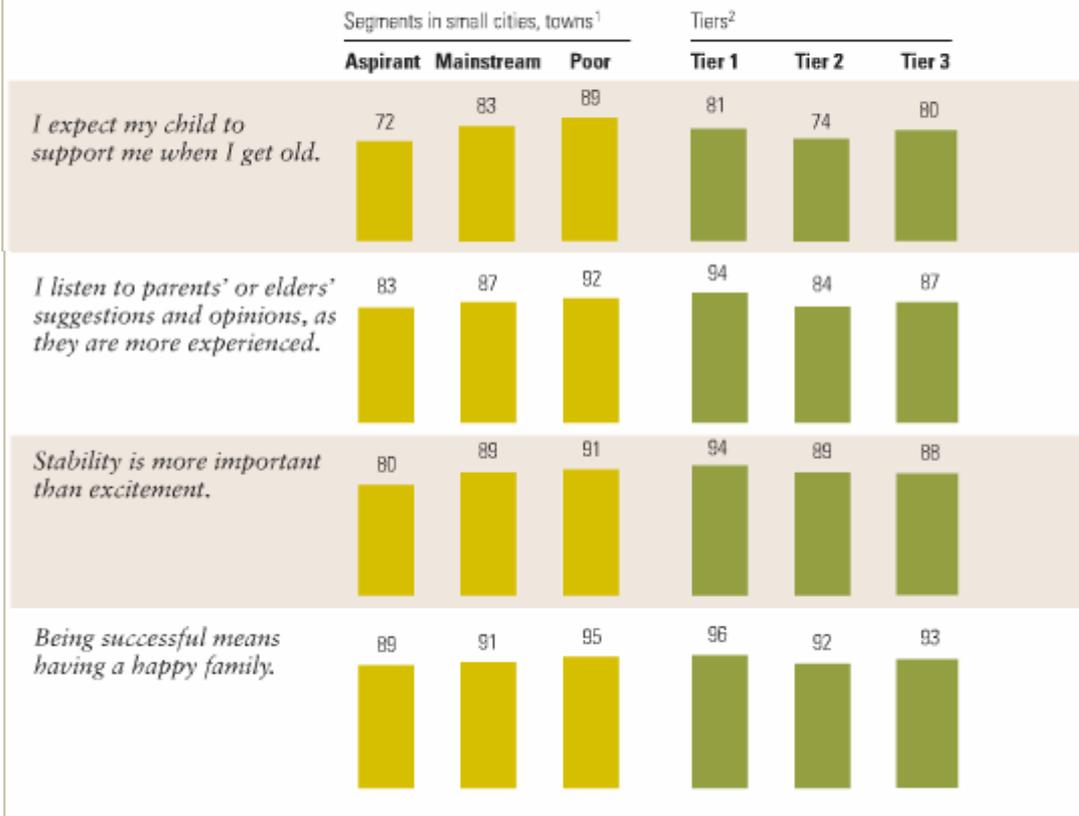
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Source: Sept 2005 McKinsey interviews with ~6,000 individuals in Chinese households

Probing deeper, we found that about 80 percent of the aspirants value stability in their lives more than excitement, as compared with 94 percent of the people in first-tier cities. In addition, the aspirants listen to their elders less and are slightly less likely to equate success with family happiness. They are also much less likely than their in-town neighbors or residents of bigger cities generally to expect their children to support them in old age (Exhibit 3). To highlight some of the relevant characteristics of the aspirant segment, we compared their responses with those from consumers in bigger cities. The similarities between the aspirants and shoppers in first-tier cities could be helpful to multinationals, since they are most familiar with these markets.

Changing attitudes

% of respondents who answered 'strongly agree,' 'agree,' or 'somewhat agree'



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Source: Sept 2005 McKinsey interviews with ~6,000 individuals in Chinese households

Aspirants in China's smallest cities and towns are also slightly more brand conscious than consumers in larger cities: keeping up with fashion trends is very important to 59 percent of the respondents in this segment, compared with 50 percent of consumers in first-tier cities. When asked about the benefits of brands, the responses of aspirants in these small markets resembled those of people in bigger cities: 83 percent of the former said that branded products are higher in quality, and 66 percent said that branded clothes make them feel better, compared with an average of 81 percent and 62 percent, respectively, for people in first-tier cities.⁵

Aspirants in small markets are also making large purchases: for example, 67 percent own air conditioners, and an additional 12 percent hope to buy one in the coming year. Both percentages are well above the average of those in China's other cities. A higher percentage of aspirants own mobile phones and have Internet access than do people elsewhere in the country, except its three biggest cities. Aspirants are also more likely to own cars than are consumers in cities generally—possibly because of the distances aspirants must travel. What's more, 6 percent of aspirants surveyed said they were likely to buy a car within the year, and 10 percent (a percentage higher than the average in cities) said they expect to buy a flat-screen TV.

Connecting with these markets

The potential in China's small cities and towns may well be attractive, but the logistics of serving them are daunting. The number of aspirants who live in them (135 million) roughly equals the total population of China's first- and second-tier cities (137 million) and their average household incomes are comparable to those in the biggest cities. But these people are also scattered throughout some 12,000 small cities and towns and 2,000 counties. As a class

they are difficult and expensive to reach. Few multinationals have cracked the code for serving them effectively; our research suggests approaches that could help unlock this opportunity.

For many product categories, the proportion of consumers in these small cities and towns who think about buying a product but don't is much larger than the proportion in bigger places. Among the aspirant households, for example, 41 percent of those who consider buying a microwave oven don't make a purchase, compared with an average of 24 percent in first-tier cities and 30 percent in second-tier ones. Similarly, 37 percent of aspirants in these small markets think about buying laundry softener and then decide not to do so, as compared with 8 percent in first-tier and 14 percent in second-tier cities.

This falloff effect occurs throughout China, but the decline is sharpest in these small communities. To persuade consumers to do less considering and more buying, most companies should focus on point-of-sale tactics and on affordability. The Taiwanese noodle maker Tingyi, for instance, changed to a lower-cost recipe for noodles sold in small towns. Across China, the company also has 361 sales offices, which work with 4,600 wholesalers and 66,000 retailers. This large network helped generate 12 percent annual sales growth, to 8 billion renminbi in 2005, from 4 billion renminbi in 1999.

Our research also indicates that some products can command a high price if their image complements the modern, sophisticated ambitions of aspirants. The distillery Shui Jing Fang (Swellfun in English) successfully charges 400 to 600 renminbi a bottle for its top-shelf spirits by promoting its elite image and marketing itself as a luxury for successful businesspeople or for special occasions such as weddings. Furthermore, consumers in small cities and towns want their children to study abroad just as much (or more than) people elsewhere in urban China do—which suggests that opportunities may exist for remote-learning products or for linking marketing messages to educational advancement. By understanding these desires, companies are more likely to craft strategies that will help them generate additional consumer purchases, change premium prices, or both.

Breaking habits and moving customers to the right channel can be difficult, but the potential for increased revenue and cost savings make the effort worthwhile. See "Steering customers to the right channels."

Low-cost distribution will also be essential in reaching these far-flung consumers. Few multinationals have found the right distribution model yet, and the best choice will likely vary by industry. Developing low-cost channels, such as catalogs and direct sales, could cut distribution costs as well. (Cash-on-delivery payments are common in China because credit cards and checks are rare, especially in the hinterland.) The US direct-sales company Amway has achieved annual revenues of more than \$2 billion in China by deploying about 130,000 door-to-door salespeople across cities, towns, and even rural villages.

For a market entry strategy, global consumer goods companies rightly focused on China's biggest cities. But as the economy grows and prosperity moves beyond major cities and the coastal region, most companies will have to develop a deeper understanding of the country as a whole. For many companies, wealth hidden in China's smallest cities and towns will be an important factor in the next wave of growth.

When urban meets rural in China

Although hard to reach, China's towns and small cities harbor attractive pockets of prosperity and sophistication that multinational companies should not ignore. Here we profile two consumers from these small markets whom we met during the course of our research.



Luo Yi (Shuangliu)

Luo Yi equates the future with opportunity. Eight years ago, he moved with his wife and son from a small village to Shuangliu, a city of 210,000 people. Shuangliu has prospered as the site of the international airport that serves Chengdu, the capital of Sichuan province, and is much more developed than most small cities and towns: modern apartment buildings, some with elevators, have replaced many of the traditional brick houses.

Mr. Luo, who like his father and grandfather practices traditional Chinese medicine, makes 3,000 to 4,000 renminbi (\$375 to \$500) a month from his clinic and pharmacy. He has dreams of opening a second clinic and of other investments as well. To be successful, he says, someone in business should have savings of 5 million to 10 million renminbi—a figure beyond the imagination of most people in small urban areas.

The family's 130-square-meter home is furnished in a modern style, with a mixture of domestic and foreign brands, but Mr. Luo says that he prefers those from China. "I don't think the quality of foreign brands is better than domestic ones," he says. "I also want to support domestically produced goods." The apartment has an air conditioner in each room, a fully equipped kitchen, and a bath with spalike showerheads. When the family bought a 3,000 renminbi high-definition Skyworth television, the brand was the primary consideration, followed by features and quality. Mr. Luo says that price was the least important criterion.

Outside of work, Mr. Luo's life centers on his nine-year-old son. The Luos bought their apartment so that the boy would have a better place to study and relax. Mr. Luo expects that his family's next major purchase will be a laptop computer—probably from Lenovo—for the boy, but he worries that the Internet could be a bad influence. "The computer is a double-edged sword," he says, "with advantages and disadvantages." He spends 100 to 200 renminbi a month on snacks for his son and about 100 renminbi on books, as well as the occasional toy.

The Luos purchase food, personal-care items, and household goods at the local supermarkets and hypermarket. When Mr. Luo shops at the supermarket, salespeople recognize and greet him immediately. But unlike other people who figure in our research, Mr. Luo says that he is impervious to promotions and in-store recommendations. "In the ordinary course of things, I would not trust [salespeople]. I would buy the goods that the salesmen say are not good," he says.

Gan Shoufu (Gaochun)

Gaochun, a town of about 100,000 people just south of bustling Nanjing, is still connected with its rural surroundings: most of the residents are former farmers who bought property in town, and many still grow some of their own food. A trip to the new hypermarket—much smaller than those in big cities—is a form of family entertainment. For 3 renminbi (about 36 cents) a three-wheeled taxi will take passengers anywhere in town they want to go.

Gan Shoufu, a 47-year-old government worker, lives with his wife and mother in a two-story house that was built more than ten years ago and now begs for renovation. His wife sells small items on the streets, and between the two of them they have a monthly household income of more than 2,000 renminbi.

Like many others in Gaochun, Mr. Gan rests his hopes on the next generation. His daughter studies at a university in Xuzhou, in Jiangsu province, and comes home during the summer and winter holidays. He gives her about 500 renminbi a month and puts additional money aside each month for her marriage. Although he doesn't expect his daughter to support him in old age—he is comfortable with his financial future—he would like to live with her and help care for his grandchildren.

Overall, Mr. Gan is happy with his home life and expects to retire in Gaochun. "Given my age, I'm satisfied where I am now," he says. "The air in Nanjing is not as fresh as it is in rural areas. I would not like living there."

His home furnishings are a mix of traditional and modern styles, his appliances of foreign and local brands: a Japanese Sharp air conditioner, for example, alongside Chinese brands such as a Haier refrigerator and a Panda television. He expects to buy a bigger TV soon from the local appliance shop. Although he has learned about brands through TV, newspaper, and magazine ads, he says he has no particular label in mind. But he, like Mr. Luo, favors local brands for electronics. "When something goes wrong with foreign brands, we would not be able to find people to fix them," he says. For most other items—food, clothes, and furniture, for instance—he doesn't pay much attention to brands.

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About the Authors

Kevin Lane is a principal, Ian St-Maurice is an associate principal, and Claudia Wu is a consultant in McKinsey's Shanghai office.

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Notes

1 The official urban population figures don't include an estimated 10 million temporary residents in these cities.

2 China's cities are generally classified into tiers based on population, per capita income, and other factors. First-tier cities are the largest and most affluent.

3 We interviewed about 6,000 individuals in households throughout China, from the largest cities to semirural communities.

4 For our research, we defined the aspirant segment as households with a monthly income of more than 2,000 renminbi, the mainstream segment as those with a monthly income from 1,000 to 2,000 renminbi, and the rural poor as those with a monthly income of less than 1,000 renminbi.

5 Respondents were allowed to agree with both statements.

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