NO MORE TIERS
NAVIGATING THE FUTURE OF CONSUMER DEMAND ACROSS CHINA’S CITIES

NOVEMBER 2015
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KEY CONCLUSIONS

THE LONG SOFT FALL IN CHINESE GROWTH report produced by The Conference Board China Center in October 2014 predicted a significant slowdown in Chinese GDP growth over the following decade as the economy worked through the results of previous overinvestment, including debt, industrial overcapacity and vacant real estate.

THE PRESENT REPORT ADDRESSES HOW CHINESE CONSUMPTION will evolve against this backdrop. Despite economic and financial gyrations, we project Chinese per capita consumption will grow at an average rate of 4.7% over the next 10 years as incomes rise and the savings rate declines.

THIS MEANS TOTAL CONSUMPTION IN CHINA WILL RISE from $3.7 trillion in 2014 to $6.4 trillion in 2025, with cumulative consumer spending of $56 trillion between 2015 and 2025. China will therefore remain the second-largest consumer market globally after the United States.

NEVERTHELESS, ANNUAL PER CAPITA CONSUMPTION IN CHINA WILL REMAIN RELATIVELY LOW. By 2025 it will be just $4,400, compared with $32,000 in the US today—a level that would seem too low to enable much discretionary spending. At the same time, there remain vast differences in the economic prospects of different Chinese cities. This report therefore describes two new frameworks to help consumer-facing companies identify and capture the best growth opportunities in China.

THE CITY STRATA FRAMEWORK CATEGORIZES 286 PREFECTURE-LEVEL CITIES into 11 segments, or strata. The variables used to create this portrait of urban China indicate an urban economy’s capacity (or lack of capacity) to grow and adapt as the national economy undergoes a profound transition, and hence its capacity to support growth in consumer spending.

WE IDENTIFY THE 40 CITIES THAT PROVIDE THE BEST OPPORTUNITIES over the next decade for consumer sector companies and 39 that offer secondary opportunities. The prevailing narrative that companies should move into Tier 3 and Tier 4 cities in China’s official classification system is misleading, as is the view that companies must be present everywhere to be competitive. A successful growth strategy will need to be much more selective.

THE CONNECTED SPENDERS FRAMEWORK helps companies understand and quantify the demand of those we identify as leading-edge consumers, who will account for 80% of growth in Chinese consumption over the next decade.

CONNECTED SPENDERS ARE DEFINED both by their willingness to spend disposable income they might have and by their ability to spend it—which we gauge by whether or not they are connected to the Internet. There are nearly 370 million people living in Connected Spender households today, a number we project will rise to 590 million people by 2025. They come from a range of income groups and from all regions of China. Their spending patterns will vary systematically across the different city strata.

CONSUMER COMPANIES SHOULD PRIMARILY FOCUS on addressing the demand of Connected Spenders within the most robust strata.
INTRODUCTION

China’s economic prospects are uncertain. The growing debt burden of government and corporate institutions, declining productivity, inefficient investment and a lagging reform process are all cause for concern as growth slows in the world’s second-largest economy. How long the slowdown will continue, and the extent of that slowdown, will depend in large measure on the government’s success in replacing a faltering growth model based on exports and investments with one based on consumption. Many analysts once forecast a soft landing for the economy after more than 35 years of breakneck growth, but that landing point is still not in sight. While we believe the government will pull enough policy levers to prevent a full-blown economic crisis, the danger remains that China is facing a protracted period of declining growth (see sidebar “China’s enduring economic slowdown”).

Amid the uncertainty, one thing remains clear for multinational corporations (MNCs) operating in China. Except under the direst political and economic scenarios, aggregate consumption will continue to grow at a faster rate than in most other economies. The Conference Board predicts that GDP growth will slow from 4.5% a year on average between 2015 and 2020 to 3.6% over the following five years, an estimate that assumes slow progress on reforms. Yet even under these conditions, the Demand Institute and the China Center for Economics and Business project that consumer spending will rise by 5.2% a year in the next decade to reach 40 trillion yuan ($6.4 trillion) in 2025—a substantial jump from the estimated $3.7 trillion in 2014. Even if GDP growth were as much as one percentage point lower, consumption would still grow by more than 4% a year—a faster pace than in most other markets globally. (Appendix A describes in more detail the national outlook for consumption and its underlying components, household income and the savings rate. All forecasts derive from the Conference Board’s projections for GDP growth.)

China therefore continues to present significant opportunities for consumer-facing MNCs. But the
question is where exactly to find those opportunities. Although we see per capita consumption rising by two-thirds in the coming decade, average consumption will still be only 28,000 yuan (roughly $4,400) per year by 2025, emphasizing how little hundreds of millions of Chinese actually consume. In comparison, US per capita consumption is about $32,000 a year.

To focus their resources, companies will need to understand regional variations in consumption: where those with disposable income reside, how many of them there are in any given geography, how much they will be willing to spend and what spending priorities they have. Importantly, companies will also need to confront how China’s policies and future economic development might shape all this.

Take the rich, Tier 1 cities of Beijing and Shanghai. Here, headroom for consumption growth is limited, but these cities’ more-balanced economies mean they are likely to emerge from the economic slowdown relatively unscathed. Consumption growth in many of the 230 cities that fall into what are classified as Tier 3 and 4 cities will be far greater, as a result of aggregate economic growth and gradual convergence in the wealth of China’s richer and poorer regions. These are the cities that conventional wisdom suggests are ripe for investment. But our analysis questions the viability of many as strong consumer markets in the next decade.

Companies will need rich data to enable them to scan China’s landscape properly, understand current and future consumption patterns, and weigh the risks and opportunities for their particular business. To date, such data has been in short supply. To address this, we have developed two new, complementary frameworks that will help companies plan their investment strategies.

The first is a city segmentation. At present, many companies base their investment strategies on the aforementioned city tier system, a classification that divides cities into four groups. These groupings, though, say more about a city’s historical importance as an administrative, logistical, or even military center than its viability as a consumer market. Current or future economic conditions or household consumption are not considered.

We replace the tier system with our City Strata framework. It incorporates analysis of 200 variables—including retail sales, passenger vehicles per capita, and foreign investment—in 286 prefecture-level cities that are home to 1.3 billion of China’s population of almost 1.4 billion. The result is a portrait of urban China that is far richer than a profile based on geographic, demographic, or administrative classifications, or one that uses metrics such as current income levels to give a straight-line projection of the viability of any given market. Instead, the variables indicate an urban economy’s capacity (or lack of capacity) to grow and adapt as the national economy undergoes a profound transition, and hence the prospects for consumption and for consumer-facing businesses. Moreover, the framework gives companies a finer segmentation of the market than they have relied on to date. We have identified and ranked 11 different city strata in terms of their consumption prospects.

The second framework, the Connected Spenders framework, helps companies to home in on the consumers within each city stratum who are most likely to drive spending growth over the next decade. For just as there are large variations in current and future consumption patterns between different cities, there are variations among the inhabitants of each city.

In developing economies, many companies focus their market-building efforts on a growing middle class. But there is no single definition of how much a consumer must earn to qualify as middle class. In addition, the cost of living varies in different countries and different cities, and income levels do not necessarily reflect a consumer’s willingness to spend. Neither do they relate to access to consumer goods. In China and other emerging markets, the challenge of distribution and logistics is significant, which is
why access to the Internet can be so important. The report therefore describes the Connected Spender, defined not by his or her income, but by a willingness to spend spare cash once basic essentials have been bought, and by access to the Internet. The report describes the profiles of China’s Connected Spenders, identifies where they are to be found, and details how they spend their money today and how they are likely to spend it in the future. For consumer-facing businesses seeking to grow in China, these are the customers whose needs will have to be addressed.

In the best of times, companies struggle to make the right investment decisions without sufficiently detailed data. But in times of significant economic uncertainty, the consequences of making the wrong call can be particularly severe. Our City Strata and Connected Spenders frameworks will help companies create value from what will be, under all but the most pessimistic scenarios, a continued rise in consumer spending over the long term, despite the current economic backdrop. They are tools that consumer businesses can use to navigate successfully China’s complex environment.
CHINA’S ENDURING ECONOMIC SLOWDOWN

Many optimists have long forecast a soft landing for China’s economy, but it has yet to materialize. Structural reforms aimed at encouraging more marketization and consumption rather than investment-led growth are still tentative. Instead of heeding the call in the Third Plenum Decision of 2013 for “markets to play a decisive role in resource allocation,” policy makers are yet again choosing to delay action in order to avoid the pain of economic restructuring. China’s productivity crisis—the result of both institutional deficiencies and a maturing economy—remains unaddressed. For these reasons, we believe China is facing a protracted period of declining growth that will be much longer and deeper than many analysts have predicted.

It is not hard to understand why the transition to a more market-led economy might be difficult: abandoning China’s investment-led formula for economic growth challenges the very core of the Communist Party’s governance methodology and patronage system. So although President Xi Jinping and other leaders continue to proclaim ‘reform and opening up’ as the path forward, accumulating evidence points in a different direction, whereby households are exhorted to turn away from the unbridled pursuit of wealth and goods and settle for a ‘moderately prosperous society.’ Marketization is no longer—or at least is not for now—an ideological pillar of reform. Some question whether it ever has been.

Instead, the focus appears to be on fixing the party, fixing politics, fixing society and fixing the economy with a stick rather than a carrot. Hence the reversion to a high level of direct, centralized control and engineered solutions to economic growth and social development. Arguably the means and tools exist to continue running such a model for at least a little while longer. The financing needed for continued, massive investment can be found by leveraging the Central Bank’s balance sheet to provide liquidity for the banking system and to bail out deeply indebted companies and local governments. But the volatilities engendered by such programs are difficult, if not impossible, to control and can cause shocks to the financial system as banks’ asset quality deteriorates when loans go to fund unprofitable government-prioritized projects. More importantly, such policies
cannot address the productivity crisis that China faces.\(^1\) In fact, they exacerbate it, precluding the kind of reforms needed to force uncompetitive companies out of the market, reduce overcapacity and permit more-productive companies to ascend and drive healthy growth.

In place of market-based reforms, we see a range of high-profile policies that are likely to lead to more inefficient investment. There is, for example, the One Belt One Road (OBOR) initiative to connect China with Central Asia, Southeast Asia and Europe via a range of energy and infrastructure investments;\(^2\) the China Manufacturing 2025 program to force the country’s manufacturing up the value chain; the Internet-Plus initiative to build out a digital infrastructure; and the various Megacities projects, designed to create a series of city clusters, each with a population approaching the scale of an above-average-size European country. All are targeted at improving the domestic economy and presented as reforms, but all have the feel of a return to centrally driven growth and development. And while they are on a grander scale than similar plans in the past, there is no reason to believe that OBOR will address China’s overcapacity problems any more than the previous Going Out policy did, for instance, or that China Manufacturing 2025 will be more successful at boosting China’s industrial competitiveness than was the Seven Strategic Emergent Industries policy heralded by the 12th Five-Year Plan just a few years ago. The same is true of the policy response to equity market volatility this year, which demonstrably prevented markets from playing a decisive role in resource allocation or asset pricing. Fortunately, we expect the long-term impact of this episode on consumption to be limited. (The A-Share market crash, we believe, hurt the elite rather than the Connected Spenders on whom this report focuses, most of whom have an annual income of only $10,000 to $20,000.)

Accompanying such policies, and of potentially greater long-term concern for consumption growth, is the slow emergence of a party-driven social campaign against excessive consumption. What began as an anticorruption campaign and a clampdown on unnecessary spending by government officials on banquets, travel and other luxury entertainment and goods is now starting to target excessive household consumption. The government’s proposed Social Credit Scoring System may prove to be a mechanism for controlling it. The scoring system is part of Beijing’s efforts to build a viable and regulated system of credit management and reporting—which in itself should support higher household spending by giving consumers greater access to credit. In its current draft form, however, the proposed system could also help the state shape consumer behavior by monitoring and scoring their spending and borrowing habits. Conceivably, the score could have a bearing on job prospects or the allocation of housing.

It is against this backdrop that The Conference Board projects average annual growth of 4.5% between 2015 and 2020, and 3.6% from 2020 to 2025. Concurrently, we assume the Communist Party and technocratic leadership will be able to pull just enough policy levers to prevent a full-blown economic crisis. It is within this context that we have based our forecasts on consumption growth, the development of City Strata and the growth of the Connected Spenders that this report describes. If, however, China’s economic prospects are at a more dramatic growth inflection point than we anticipate, then our projections related to income growth, savings and the consumption patterns they drive will have to be reevaluated.

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\(^2\) One Belt One Road (OBOR) is the name given to two related regional diplomatic and development initiatives, the Silk Road Economic Belt and the 21st-Century Maritime Silk Road. See Xinhua, “China’s Initiatives on Building,” http://www.xinhuanet.com/english/special/silkroad/.
CITY STRATA:
Understanding the Regional Landscape of China

The current state of regional business decisions

By far the bulk of Chinese consumer purchases are made in cities, which is why understanding consumption in China depends on a deep familiarity with the country’s urban landscape. This entails much more than understanding a given city’s current economic performance. Geographic location, demographics and even the local history are some of the factors that will dictate the future potential of any consumer market—a future that will be vastly different from one city to another.

Influencing many cities’ prospects as the economy slows is the fact that government support of yesterday, which kept most growing rapidly, is becoming less effective as diminishing returns on investment coupled with fiscal restraints make such policy-led growth increasingly unaffordable. This means that stark disparities will remain between China’s cities, despite our expectation that, in the aggregate, the wealth of the richest and poorest cities will to some extent converge over the next decade, as is typical for a developing nation (see sidebar “Partial Convergence”). Some cities will spur the industries and companies that drive the next phase of growth, while others—China’s future Detroits—will get left behind.

These developments, as predicted by The Conference Board in 2014, are already beginning to play out. Mining and other heavy industries have, for many years, been the main source of jobs in provinces in the industrial northeast, such as Liaoning, Jilin and Heilongjiang. But since late 2011, when China’s economic transition began to unfold, jobs have been disappearing, and these provinces are currently China’s worst economic performers. As Premier Li Keqiang noted on a trip to the region in April 2015, “When the Daqing oilfield or [state-owned car manufacturer] FAW sneezes, Heilongjiang and Jilin get a cold.” Similarly, in Taiyuan, a major coal town and the capital of Shanxi province, GDP growth dropped to zero as far back as the first quarter of 2014, according to local news reports.


Which cities have the strongest prospects?

SLOW-GROWING BUT ROBUST STRATA WILL STILL CONTRIBUTE THE LION'S SHARE OF NEW CONSUMPTION.

EXHIBIT 1

<table>
<thead>
<tr>
<th>City Type</th>
<th>Contribution (2014 &gt;&gt; 2025)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Super</td>
<td>$64b per city</td>
</tr>
<tr>
<td>Affluent</td>
<td>$25b per city</td>
</tr>
<tr>
<td>Regional International</td>
<td>$15b per city</td>
</tr>
<tr>
<td>Integrated Industrial</td>
<td>$11b per city</td>
</tr>
<tr>
<td>Satellite</td>
<td>$7b per city</td>
</tr>
<tr>
<td>Tourism</td>
<td>$2b per city</td>
</tr>
<tr>
<td>Inland Core</td>
<td>$7b per city</td>
</tr>
<tr>
<td>Frontier</td>
<td>$6b per city</td>
</tr>
<tr>
<td>Traditional Agricultural</td>
<td>$6b per city</td>
</tr>
<tr>
<td>Modern Agricultural</td>
<td>$8b per city</td>
</tr>
<tr>
<td>Resource Exhausted</td>
<td>$4b per city</td>
</tr>
</tbody>
</table>

GROWTH IN INCOME PER CAPITA (2014 >> 2025)

SIZE REPRESENTS TOTAL STRATUM CONSUMPTION IN 2025
In contrast to the northeast rustbelt, the overall level of wealth is much higher in the urban metropolises of Beijing and Shanghai, and thus the consequences for households and businesses of China’s macroeconomic slowdown have been less severe. Commerce continues largely uninterrupted, and the service industries that will drive China’s future growth are already well developed and continuing to advance.

But there are many cities in between, and the inherent risks of placing big strategic bets on which cities will be part of the discarded rustbelt and which will reinvent themselves into vibrant, services-oriented economies in 10 years’ time can be mitigated with a better understanding of urban China. To date, companies have had to rely primarily on the tier system for segmenting Chinese cities in the process of formulating business strategies. Tier 1 cities are the giant metropolises of Beijing, Shanghai, Guangzhou, Shenzhen and Tianjin. Tier 2 consists mainly of the provincial capitals, though a few additional large cities are included. Tier 3 is a much larger and amorphous group of more than 100 cities, their defining feature being a population of between two million and six million (although a handful of outliers can be found). Tier 4 comprises the 143 prefecture-level cities that are not included elsewhere.5

In recent years, the limitations of the tier system have become increasingly obvious to companies seeking to expand their China footprints. The similarities between the few wealthy megacities in Tier 1 are relatively clear. But the more numerous Tier 2 cities have little discernible connection beyond their status as provincial capitals. Cities in Tier 3, which are three times more numerous than those in Tier 2, suffer from the same lack of coherence. They are not grouped geographically, nor do they have similar levels of wealth, logistical capability, Internet penetration or many other important features of market development. Tier 4 cities seem only to share the fact that they are not included in other tiers.

Thus, especially for consumer goods companies seeking to deepen their presence in China, a strategy anchored on moving from, say, Tier 2 to Tier 3 cities offers little practical guidance. That is because, in essence, the tier system says more about a city’s relationship with the central government in Beijing and its importance as an administrative or logistical hub, or even as a military outpost, than about its current or future strengths as a consumer market.

For companies, this is akin to using a market segmentation tool that lumps Helena, Montana, with Boston, Massachusetts, or Paris with Strasbourg. It can lead to wrong assumptions about the characteristics of different markets within each tier and wrong-footed go-to-market strategies. The alternative—a scatter-shot approach to try to capture consumer growth wherever it might lie—has proved disastrous for many foreign companies. Likewise, those that invested where the government was investing may have enjoyed short-term results, but when investment rates dropped, they discovered a lack of fundamental strength in the local economy.

As city prospects continue to evolve in line with China’s momentous economic transition, a more rigorous segmentation of the market will become all the more important to the formulation of robust market strategies. Our City Strata classification fulfills this need, giving companies a more nuanced understanding of the city landscape and the best consumer opportunities, regardless of their starting position in terms of operating location, market penetration or length of time in China. Wide adoption of the segmentation will enable businesses to make better regional investment decisions and communicate them more efficiently.

The City Strata framework

The City Strata framework analyzes over 200 variables in 286 prefecture-level cities. (See the research methodology available upon request for a fuller description of the analysis.) The variables chosen indicate an urban economy’s capacity to adapt to China’s changing economic conditions, and so serve as a measure of the opportunity for consumer-facing businesses. Moreover, the segmentation is finer than most, as we have identified and ranked 11 different city strata, allowing for a more targeted approach for assessing cities’ prospects.

The framework yields important insights. Conventional wisdom is that the fast-paced growth that many of the cities in Tiers 3 and 4 will see—the result of national economic growth and convergence—makes all 230 cities within them ripe for investment. Our segmentation shows this not to be the case, given their low starting points and what current conditions say about the longer-term health of their economies. The City Strata framework is a road map that shows companies where the best consumer growth opportunities lie in China in the next decade. It can help them decide, for example, which three cities they should consider entering immediately given their strategy and product category; which they should consider for future investments; and which they should avoid altogether for the foreseeable future. As the descriptions of the 11 strata below will reveal, the best opportunities for the majority of MNCs and local giants will be limited to between 40 and 79 of the country’s 286 prefecture-level cities in our database, all within the top three to five strata of our hierarchy. Companies should proceed with considerable caution if considering cities lower down the hierarchy—and most should avoid the last three strata entirely, at least until the opportunities elsewhere have been fully realized. The strata and their relative attractiveness is summarized in Exhibit 1.

6 The strata were developed with cluster analysis, a widely used statistical method for segmentation.
Super Cities

6 cities
116m total population 2014
13% share of 2025 consumption
32% population growth 2014 >> 2025

Dollar amounts expressed in 2013 dollars.
Percentages are growth rates and changes.

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
+38% stratum growth +66% national avg.

INCOME per capita
+24% stratum growth +53% national avg.

HOUSEHOLD SAVINGS RATE
-7% stratum change -5% national avg.

stratum averages across cities
$15,616 per person
58% of GDP
59% of GDP
19m people per city
$102b
76% of population
68% of population
22% of all industrial enterprises

$4,068 $5,618
2014 2025

$6,528 $8,124
2014 2025

31% 38%
2025 2014

National average
Super Cities

BEIJING, CHONGQING, GUANGZHOU, SHANGHAI, SHENZHEN, TIANJIN

- These are the best known Chinese metropolises, and thus the first staging ground for MNCs looking to enter the China market. Many MNCs are already familiar with them, but competition among brands in these cities is intense.

- A high level of wealth, strong support from various levels of government, and well-diversified economies give these markets depth.

- Large populations, elite universities, and some familiarity with international business practices provide the deepest talent pools on which to draw.

Almost everyone is familiar with the names of China’s Super Cities. They are the country’s largest, with a median population of 18 million, and richest. They broadly align with the Tier 1 category most commonly used to segment China’s cities.

For the average consumer, life in a Super City broadly resembles that in any major world city, with access to a wide variety of consumer experiences. From media to clothing to food, the choice of languages, brands and palate are vast. Excellent universities and a significant government presence provide a stable crop of employment opportunities and talented job seekers. These cities are where the best and brightest in China come to make it on the largest, most competitive stage.

Super Cities have well-diversified economies with thriving service sectors (restaurants, finance, hospitality, and health care as well as government functions), all of which sustain economic growth, high wages and a vibrant consumer culture. Shopping malls dot the urban landscape almost as frequently as churches or convenience stores in America.

Households in these urban areas have the means to drive a consumer economy. Nominal median annual GDP per capita was 97,400 RMB ($15,600) in 2013, while average disposable income is higher than for all other strata and on par with that of affluent consumers in other emerging markets. (It is only 15% of the average level in the United States and 20% of the average level in Germany, however.) Such relative affluence combines with diverse employment opportunities to drive high levels of migration into the megalopolises, despite government policy to restrict such movements. Competition for space is therefore high, driving up real estate prices in the commercial and residential sectors for renters and buyers. As a result, real estate demand has remained relatively consistent, even in the recently struggling nationwide market. Today vibrant Super City communities combine ancient Chinese architectural styles with some of the most modern—and many of the tallest—skyscrapers designed by world-famous architects.

The positive dynamics, of course, come with some negative corollaries. Super Cities are the most densely populated of all the 11 City Strata, leading to sidewalks crowded with people and roads thick with traffic. Due to the combination of high population densities and robust levels of wealth, vehicle ownership is relatively high, with median vehicle penetration rates standing at 14 per 100 people in this stratum, causing the authorities to place heavy restrictions on new-vehicle registration. In addition, as with many major urban locales throughout the world, wealth levels are highly uneven. Skyscrapers couple with shantytowns, most often at the physical edges of cities. And despite a relatively strong tax base due to the huge populations in Super Cities, restrictions are placed on migrants’ access to social services.
Opportunities

The opportunities in Super Cities stem from their relative accessibility to foreign companies. Deep markets with large populations and a highly internationalized customer base make them feel similar to more-mature markets elsewhere and are hence easier for foreign companies to serve. As a result, many have established businesses here. There is little doubt that these cities will remain the most lively and internationalized markets in urban China. And while consumer markets in poorer cities may grow faster from smaller bases, they are unlikely ever to reach the level of sophistication found in Super Cities. Brand recognition and development for foreign companies start here.

Challenges

There are two major challenges for MNCs operating in Super Cities: competition and penetration. Foreign brands abound, which means brand loyalty is fleeting in the face of so much choice. Moreover, because consumption is already high, further growth is limited (although even small gains translate into large increases in sales volumes, given the population size). Overall growth rates of consumption in Super Cities have been the lowest of all 11 strata in recent years. Companies new to China may therefore struggle to make their mark here, while established companies have limited headroom for further growth without consolidation tactics.

CHONGQING

The youngest and only inland provincial-level municipality, Chongqing is home to 29.7 million inhabitants and is a major trade, transportation and logistical hub domestically and internationally. Situated on the eastern edge of the Sichuan Basin, it is crisscrossed by rivers and mountains; the Yangtze River, which traverses the whole territory, provides plentiful water resources and convenient water transportation. The nearby Three Gorges Dam, which is the world’s largest, enables 10,000 tons worth of oceangoing ships to reach Chongqing’s Yangtze River port each year, while the municipality’s Cuntan Port is the largest inland river port in China.

The city of Chongqing, known both as the City of Bridges and the Mountain City, is thus shaped by the region’s natural formations. Although the sprawling metropolitan area encompasses rural land that causes the urbanization rate to be just 59%, the center of the city is concentrated in a narrow peninsula where the Yangtze and Yaling Rivers meet. Here the densely crowded skyscrapers of the central business district evoke a mainland version of Hong Kong, rather than an inland version of Beijing. Within them, shopping malls abound, housing many of the same stores that can be found in Milan or on New York’s Fifth Avenue. Chongqing’s metropolitan populace clearly has a taste for high-quality brands, domestic and foreign. And while Internet penetration is the lowest among Super Cities, Chongqing has a robust culture of consumption. The rise of what we call Connected Spenders in this inland megacity will account for a significant portion of consumption growth for this stratum from now until 2025.

But while the wealthier citizens of Chongqing have the access and means to purchase an array of international luxury goods, many of the more-average earners in the city shop from stalls that sell cheap manufactured goods from around China, brought in to the city’s ports via the endless stream of boats that traverse its waterways. This leaves plenty of consumers for MNCs to reach as income and wealth grow in the coming decade.

Despite its range of consumer choices, Chongqing is known primarily as a heavy industrial city, with industrial manufacturing and construction amounting to half of overall GDP. It is China’s third-largest center for motor vehicle production and the largest for motorcycles; the local automaker Chang’an ranked eighth in total vehicle sales in 2014, for example. This makes the city unique among Super Cities, which tend to be more service oriented, and indicates that there will be plenty of room for continued wage growth as the service sector matures.

8 The concept of Connected Spenders is discussed in a later chapter.
**Affluent Cities**

- **21 cities**
- **166m total population 2014**
- **18% share of 2025 consumption**
- **40% population growth 2014 >> 2025**

### GDP per capita 2013

- **$13,386 per person**
- **45% of GDP**

### Service Sector 2013

- **$39b**
- **64% of population**

### Imports 2013

- **8m people per city**
- **24% of GDP**

### City Population 2014

- **8m people per city**

### Retail Sales consumer goods, 2013

- **$4,905**
- **16% of all industrial enterprises**

### Urbanization Rate 2014

- **63% of population**

### Internet Penetration 2014

- **64% of population**

### Foreign-funded Industrial Enterprises 2013

- **16% of all industrial enterprises**

### Consumption per capita 2013

- **$3,723** (2014)
- **$4,905** (2025)

### Income per capita

- **$6,418** (2014)
- **$7,602** (2025)

### Household Savings Rate

- **35%** (2025)
- **42%** (2014)

**Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.**
Affluent Cities

EXAMPLES: QUANZHOU FUJIAN, SUZhou JIANGSU, NINGBO, ZHEJIANG

- High levels of wealth, fast growth, and relatively deep connections to the global marketplace through trade and investment make Affluent Cities some of China’s most vibrant and inviting urban spaces.

- While they are not geographically concentrated, location has given Affluent Cities a leg up. Placement near a coast or large inland river provides logistical benefits, while temperate climates make these cities very livable.

- By international standards, they are undoubtedly large, but compared with Super Cities, they can feel almost quaint because the population density is roughly halved.

The most important coalescing factor for Affluent Cities is their orientation toward external markets via foreign trade—a dynamic largely enabled by their locations. Most are found along the economic corridors of the Pearl and Yangtze River deltas, within the provinces of Fujian, Guangdong, Jiangsu, and Zhejiang in the south of China. This, along with their temperate climates, explains their history as important hubs of grain production and distribution, and as transport and logistical centers. These cities remain export oriented today, having benefited enormously from China’s integration into the world economy, particularly since the country’s entry into the World Trade Organization in 2001.

Also included in this stratum are the cities of Chengdu (in Sichuan), Dalian (in Liaoning), and Qingdao (in Shandong). All have established links with foreign markets through trade and finance. They also have large populations and high GDP per capita. Many of the foreign companies that have operated in China for some time have a growing presence in Affluent Cities.

From 2005 to 2013, Affluent Cities saw the largest absolute increase in disposable income per capita of all 11 strata. This translated into a real, absolute increase of 3.5 trillion RMB ($550 billion) in consumer spending power over the course of the period, compared with an increase of 2.3 trillion RMB ($360 billion) in Super Cities. Already, consumers here have a fairly strong awareness of foreign brands. Chengdu or Dalian may not have the equivalent of the ultra-chic Shanghai Bund development, but the average resident has no trouble finding a Starbucks or similar location for an espresso—and the disposable income to go there regularly.

Transport is good, too, with land and air routes added to the once-paramount river and ocean courseways. Indeed, Affluent Cities are home to five of China’s 14 busiest airports (Super Cities host six). They are also some of China’s greenest cities in terms of the landscape, their open spaces making them feel more tranquil and airy than Super Cities, even with a median population of 7.8 million. These logistical advantages, combined with a relatively relaxed atmosphere, are good for tourism, adding to these cities’ strengths as consumer markets. From West Lake in Hangzhou to the beaches of Qingdao, Sun Yat-sen’s Mausoleum in Nanjing, and the Panda Pavilion just outside Chengdu, Affluent Cities have features that make them attractive destinations for visitors.
Opportunities

Many of the cities in this stratum hit the sweet spot for companies looking to tap into China’s growing consumption. There is a relatively high starting level of wealth, incomes are poised to grow briskly, and markets are less penetrated by MNCs than those in Super Cities. Unlike many of the cities lower down the hierarchy, the potential of Affluent Cities has not been overplayed.

Challenges

Affluent Cities currently feel more livable than Super Cities, but they are already densely packed, and property prices are high. Would-be homeowners have to save hard to get onto the property ladder, dampening consumption due to high savings rates. Moreover, heavy exposure to the global economy means any global economic disruption, such as the crisis of 2008–2009, could hit wage growth because of the impact on trade. In the longer term, rising labor costs within China and slower growth in trade globally may challenge these cities’ competitive power and hence future growth prospects.

QUANZHOU (FUJIAN PROVINCE)

Quanzhou, a coastal city with a long history of foreign trade, is today known as the base camp of domestic brands, serving as a hub for many country-level cities, each of which focuses on manufacturing a specific category of goods—the 138 “famous trademarks” of China. Jinjiang is the city of shoes, for example, while Nan’an is the hometown of building materials.

The unique economy of Quanzhou has shaped household consumption in two ways. First, prosperous manufacturing industries have brought affluence to residents through higher wages, and many residents are wealthy enough to purchase luxury goods during foreign travel (as opposed to purchasing foreign brands at home). Second, the proliferation of locally manufactured goods means that many citizens express a preference for these over foreign equivalents, especially as they tend to be cheaper.

Local and foreign goods are most often sold in the heart of the old city in small, individually owned storefronts built in a traditional Chinese style, called qilou (骑楼). These low-rise buildings hunker on streets lined with trees that provide shelter from rain and the tropical summer heat that envelopes the city. Greenery is a defining feature of Quanzhou, with public parks providing space to spend a leisurely afternoon. Such openness adds to a generally laid-back atmosphere.

Quanzhou places an emphasis on the cultural and creative industries. Two boutique office parks, named Yuanhe 1916 and Ling Show, have been built to provide tranquil and collaborative communities for incubating design companies and for entrepreneurs looking to promote the cultural and historical aspects of the city. They also house museums.

From a high-level policy perspective, Quanzhou is well placed to take advantage of several central-government initiatives. Hailed as the origin of the Maritime Silk Road, it is the only pilot city of the Made in China 2025 policy, a 10-year master plan aiming to upgrade the nation’s manufacturing capacity and build China into a world manufacturing power. The local version, Made in Quanzhou 2025, focuses on transforming and upgrading nine major industries through innovation, quality improvement and the promotion of service industries and green manufacturing, with the aim of placing Quanzhou among the top 10 manufacturing cities in China. In addition, as of 2015, Quanzhou is an Information Consumption Pilot City, which allows its government to focus on building information infrastructure, developing information services and products, and promoting e-commerce platforms for small and medium-size enterprises.
Satellite Cities

13 cities
51m total population 2014
4% share of 2025 consumption
-2% population growth 2014 >> 2025

INCOME per capita 2013

SERVICE SECTOR 2013

IMPORTS 2013

CITY POPULATION 2014

RETAIL SALES consumer goods, 2013

URBANIZATION RATE 2014

INTERNET PENETRATION 2014

FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita

INCOME per capita

HOUSEHOLD SAVINGS RATE

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Satellite Cities

EXEMPLARY: JINHUA ZHEJIANG, ZHUHAI GUANGDONG, YANGZHOU JIANGSU

- As their name suggests, Satellite Cities tend to be within a one- or two-hour drive of an Affluent City or occasionally a Super City.
- They are smaller than Affluent Cities but benefit from being on the periphery of their neighbors’ economic ecosystems and have relatively high levels of wealth.
- Despite the smaller scale these cities are also heavily export-oriented and have benefited from government policy to enable and encourage foreign trade.

There are 13 Satellite Cities, and they are even more heavily concentrated in the rich southeastern provinces, including Guangdong, Zhejiang, and Jiangsu, than Affluent Cities. The exception is Weihai, which stands 65 kilometers east of Yantai in Shandong.

Some Satellite Cities have become well known outside China for the thousands of migrant workers they house in their export-manufacturing campuses. But because of their relatively small size compared with Affluent Cities, they have been off the radar for many MNCs as consumer markets. This may be an oversight. Their proximity to larger, more affluent neighbors has lent them economic benefits and promoted consumerism among their citizens. There are good transportation links, including high-speed rail, with Affluent Cities, for example, and people who live here often travel to Affluent Cities to shop. So while they are not quite suburbs of Affluent Cities, Satellite Cities benefit from being part of their ecosystems.

They also have relatively well-developed service industries, including food and beverages, and hospitality. Several Satellite Cities have lavish golf courses, which make use of the lush greenery found primarily throughout southern China. Zhongshan and even Weihai house some of China’s top-rated courses designed by some of the best-known international professionals including Jack Nicklaus and Greg Norman.

The presence of robust service industries, along with an increasingly well-paid manufacturing force, have allowed both average wages and disposable income per capita in the Satellite Cities to rise to just shy of 90% of the levels seen in Affluent Cities. By 2025, we project average disposable income in Satellite Cities will be slightly higher than in Affluent Cities. So the potential consumer market in these relatively under-the-radar Chinese cities is promising.

For the time being, however, important differences remain between the two strata. Satellite Cities have a total population of 51 million, compared with 166 million in Affluent Cities, housing costs are lower, and the pace of life is slower. Thus, these are less-taxing urban environments in which to live. Yet there are also far fewer goods and consumer experiences on offer. For example, Huizhou, a Satellite City, has a population of 4.8 million people and 18 McDonald’s restaurants. Dongguan, an Affluent City just 100 kilometers away, has a population of 8.5 million people and 59 McDonald’s stores. So although a Satellite City might be just an hour’s drive from a more affluent one, the cultural difference is remarkable, and a foreign visitor coming from Shanghai or Beijing will have the impression of having ventured into a quite different and much more “local” China.

Opportunities

Satellite City markets have not been penetrated to the same extent as cities in the higher strata, and competition is therefore less intense—factors that, when coupled with relatively high levels of wealth, rising wages and higher disposable income, represent significant opportunities for MNCs.
Challenges

How to serve these budding markets profitably, given their small size, is the challenge for foreign companies. One approach would be to couple a Satellite City with an Affluent City to take advantage of economies of scale, although the concept may prove hard to grasp and act upon for business planners accustomed to thinking in more linear terms. In addition, regulations and administrative procedures could undermine the potential operational efficiencies: distribution systems are often fragmented by city-level incentive structures that favor local operators, for example. Moreover, Satellite Cities face similar basic macroeconomic challenges as Affluent Cities, in that they are vulnerable to shifts in global trade and rising labor costs, which could potentially undermine the ability of consumers to increase their wealth and spend accordingly.

JINHUA (ZHEJIANG PROVINCE)

Forty-five minutes by train from Hangzhou, one of China’s most famous Affluent Cities, lies the Satellite City of Jinhua. A relatively small city of 5.4 million people, Jinhua is most famous for producing a type of dry-cured ham. Otherwise, scope for employment as well as consumption is limited, with many residents traveling to Hangzhou to work and shop. Such interaction is the basis for the Satellite City concept.

The pace of life is slower in Jinhua than in its Affluent cousin, and residents often describe the place as a city of leisure. A small shopping district near the city center constitutes the primary commercial area. At the local supermarket, Futailong, which has established stores exclusively in Jinhua, early-morning shoppers look for good deals on the day’s meals. Futailong carries a small selection of foreign brands, including Heinz ketchup and Hershey’s chocolate syrup. Compared with Hangzhou, however, the range of goods available, particularly foreign brands, is restricted.

One hour’s drive from the city is the county-level city of Yiwu, home to one of China’s most famous wholesale markets, the Yiwu Small Commodity Market. This vast compound houses everything from lighters to zippers to Christmas ornaments. Foreign and local businesspeople roam the seemingly infinite rows of stalls to source goods for sale throughout the world. This market is a key location underpinning China’s reputation as the world’s factory, providing low-value commodities found in supermarkets and convenience stores around the globe.

Along the road from Jinhua to Yiwu, signposts declare the creation of the Jinhua Yiwu New City District, a development project designed to build up the entire 37-mile stretch between the two urban areas. Thus Jinhua might develop from being a satellite of Hangzhou to becoming a hub for its own satellite of Yiwu. At present, though, the two cities show marked differences in consumption levels. A well-appointed and busy foreign supermarket in Jinhua, for example, contrasts sharply with its sister location in Yiwu, where on any given day, close to 100 people pack the store’s dank entryway, sleeping, playing cards and loitering but buying little.
Regional International Cities

9 cities
51m total population 2014
16% population growth 2014 >> 2025
4% share of 2025 consumption

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
+63% stratum growth
+66% national avg.

INCOME per capita
+51% stratum growth
+53% national avg.

HOUSEHOLD SAVINGS RATE
-5% stratum change
-5% national avg.

$9,396 per person
55% of GDP
5% of GDP
6m people per city
$25b
59% of population
53% of population
5% of all industrial enterprises

$2,966 $4,824
2014 2025
$4,875 $7,378
2014 2025
35% 39%
2025 2014

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Regional International Cities

EXAMPLES: KUNMING YUNNAN, HARBIN HEILONGJIANG, NANNING GUANGXI

- Regional International Cities have evolved largely as gateways to certain regions within China or to foreign markets such as Russia, Mongolia, Kazakhstan, and Vietnam.

- Proximity to and cultural interaction with non-Chinese markets make most Regional International Cities idiosyncratic and somewhat isolated.

- Perhaps most important, these provincial capitals evolved primarily as administrative outposts. As a result, they are focused not on exports, as Affluent and Satellite Cities are, but on political, economic and cultural interactions. Almost all Regional International Cities are the equivalent of Tier 2 in the conventional classification.

Located across a wide range of geographic areas, Regional International Cities act as gateways from eastern China to farther-flung regions within the domestic economy or, more often, to China’s neighboring countries, and vice versa. Visiting or living in such places often resembles life in Beijing less than life in a neighboring capital such as Moscow, Ulaanbaatar, Astana, or Hanoi. Connecting with consumers and developing a functioning supply chain in Harbin, for example, is likely to require a grasp of Russian language, culture and consumer habits as well as of their Chinese equivalents. Consumer preferences vary widely, as does the availability of foreign brands. Even weather patterns, which can influence consumer spending patterns, are highly variable, with an average low temperature in Harbin of 4 degrees Fahrenheit in December compared with 27 degrees in Xi’an and 37 in Kunming. As a result, residents of Harbin spend significantly more than residents of the other cities on leather products to protect against the bitter cold.

It is their administrative nature that unites these cities in our segmentation. This in part explains their citizens’ lower spending power, in that these cities’ historical rationale was not related directly to commerce but to the bureaucratic functions they housed. The Regional International City stratum consists of nine cities with a total population of 51 million, equal to that of the 13 Satellite Cities. But as of 2014, their real disposable income per capita trailed at 85% that of the Satellite Cities. There are plenty of consumer sales to be made in Regional International Cities, but understanding the limitations to their growth is important.

Opportunities

As administrative rather than commercial centers, Regional International Cities are unlikely to provide consumer pools as deep as those found in Satellite Cities. However, as most are Tier 2 cities, their economies will continue to benefit from local- as well as central-government support. For example, the more western cities in this cohort will undoubtedly see inflows of capital from the One Belt One Road development strategy to connect China with Central Asia, Southeast Asia and Europe via a range of energy and infrastructure investments. This, in turn, may offer opportunities for companies looking to engage in a China Plus strategy.9

9 A China Plus strategy refers to business expansion to other Asian markets, using China as a hub but not an exclusive production location, in order to reduce overdependence and overexposure to the Chinese market.
Challenges

We project that total consumer spending power in Regional International Cities will expand at a pace similar to that of Satellite Cities in the coming decade. But translating that growth into increased consumption is likely to prove more difficult than it will in the latter. Income levels are lower, so consumption as a share of disposable income is higher, and households appear to spend more on basic necessities than in the top three strata. In addition, these cities’ relative geographical isolation means the cost of efforts to win new customers cannot be shared with larger markets, as it can be with Satellite Cities. Regional International Cities are therefore riskier markets. MNCs and large local companies should take care to examine them case by case.

KUNMING (YUNNAN PROVINCE)

Known as the Spring City, Kunming enjoys a very livable atmosphere due to a temperate climate. Its location, nestled in a fertile lake basin on the north shore of Lake Dian and surrounded by mountains to the north, west and east, makes the city and the area around it a favorable place for growing coffee and rice, as well as a popular summer tourist destination. Kunming actively promotes itself as a Regional International City, with land route connections to Vietnam, Burma, and Laos, and it hosts the annual Kunming Import and Export Commodities Fair, which attracts between 4,000 and 6,000 guests from 50 countries. The city is twinned with Denver, Colorado (which has a similar climate during the summer). The arrangement involves mutual investment and cultural interaction.

Kunming has a thriving tourist industry, with more than 1.23 million visitors in 2013. Indeed, more than 50% of the city’s economy is based in the services sector. Yet, like many other cities in China, Kunming has relied on the country’s old development model in recent years by embracing a “build it, and they will come” mentality. As a consequence, the Chenggong New District, located a 30-minute drive south of the city center, has a housing occupancy rate below 30%, with few supporting services such as hospitals and supermarkets.

The city’s main shopping area, Jinbi Square, juxtaposes outdoor stalls selling local goods such as coffee, jade and traditional Yunnan clothing with shopping malls and international supermarkets, including Carrefour and Walmart. During the summer, scores of individuals, many of whom appear to be on holiday, stroll down the main pedestrian street. But while there is a vibrant buzz among the stalls, the more upscale luxury-goods malls only a few hundred yards away are noticeably quieter.

Yet Kunming does seem to have a culture of consumption, with local flower markets operating during the day and multiple food outlets and bars lighting up the streets at night. Residents seem to represent the epitome of the Connected Spender, with low incomes but high consumption.

The serene Green Lake Park, just below the main campus of Yunnan University, provides ample space for visitors and residents alike to while away an afternoon with a refreshing walk or a brisk paddle boat ride. Up the hill from the park, the boutiques and European-style coffee shops that line the streets give the area a tranquil feel.
Integrated Industrial Cities

30 cities
149m total population 2014
12% share of 2025 consumption
11% population growth 2014 >> 2025

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
INCOME per capita
HOUSEHOLD SAVINGS RATE

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Integrated Industrial Cities

EXAMPLES: ZHENGZHOU HENAN, HEFEI ANHUI, DONGYING SHANDONG

- Most Integrated Industrial Cities have made the transition over the past two decades from reliance on mining and minerals to the development of large industrial sectors, producing at least one regional industrial champion.

- Continued reliance on heavy industry makes these cities particularly vulnerable to weak demand and acute industrial overcapacity. But they may provide growth in the future if they can further diversify their economies.

- They are not large or wealthy enough at present to offer much potential for consumer-facing MNCs. Companies should consider these cities’ viability as markets only after they have exhausted opportunities to reach the 384 million consumers in the previous four city strata.

Two decades ago, most Integrated Industrial Cities relied on mining and minerals. Today, most have large, diversified industrial sectors, producing at least one large, regional industrial champion. Indeed, some cities in this stratum can be said to have given rise to China’s modern industry, with some companies becoming domestic leaders in their sectors thanks to local industrial policies. FAW Group in Changchun, for example, produced the first automobile in China, and the city now claims output of automobiles equal to one-fifth of the countrywide total. Similarly, Tangshan is home to the first mechanized coal mine, the first railway with a standardized gauge, and the first steam locomotive. And despite their reliance on one strong industry, often protected by provincial authorities, cities in this stratum have also spawned reasonably strong service economies as the wages of blue-collar workers have risen.

Nevertheless, the differences between Integrated Industrial Cities and the more modern urban centers described so far are palpable. These cities drove China’s old growth model, and about half are located in the rustbelt of the northeast or the resource-rich portion of the country in the far west. For many, location alone provides a harsher and drearier backdrop to urban life. But many are also badly polluted as a result of heavy industrial production and large populations. Three were among the top 10 most air-polluted cities in China in 2014.10

These cities are also much less international. There is less foreign trade, consumers have fewer foreign brands from which to choose, and only a small number of people are employed by overseas companies. An average 5% of industrial enterprises have foreign investors, compared with an average 15% in the preceding four. All this reflects the promotion of domestic industry in many of these cities—a policy known as indigenous innovation. Integrated Industrial Cities are less international in other respects too: against almost every international metric of quality of life—walkability, green spaces, consumer choice—these cities’ performance is inferior to that of the previously discussed strata.

Relatively strong growth in per capita disposable income and consumption will take those metrics from 72% and 69% of Super City levels, respectively, today to 85% and 81% by 2025. At the aggregate level, however, convergence will be negligible. Disposable income will inch up from 92% to 93% of the level in Super Cities in the course of a decade, while consumption will fall from 89% to 87%. This slow convergence is explained by the more rapid population growth expected in Super Cities, of which there are just six, compared with 30 in the Integrated Industrial Cities stratum.

Opportunities

A history of industrial success suggests that the cities in this category could still have a future as powerhouses of industry if companies operating there diversify again as they have in the past. If they develop a genuine culture of innovation, they could...
become not only leaders in a modern Chinese economy, but competitors on the international stage. If they succeed in incubating the General Motors, Hyundais, Boeings, and Siemenses of the future, the purchasing power of their citizenry will explode, feeding the next stage of China’s consumer growth.

Challenges

These are big ifs. The strong policy preference for indigenous innovation, and the myriad institutional factors that constrain China’s innovative capacity, rein in the potential of these cities. It is possible that instead of growing into robust, balanced economies, Integrated Industrial Cities will see the hollowing out of a relatively low-cost industry, a decline in competitiveness, and the stagnation of economic activity.

Consumers here are able to stretch to little more than basic goods. And while income is projected to grow relatively quickly, it will still lag behind that of cities in the higher strata and could come under pressure if industrial productivity growth and logistics to connect with the rest of China remain weak. Nevertheless, companies designing a long-term strategy for China should monitor progress in this stratum carefully.

ZHENGZHOU (HENAN PROVINCE)

Not long after a 60 Minutes report on US television deemed the capital of Henan province China’s largest ghost city, an Economist Intelligence Unit analysis ranked it the country’s ninth-most-promising emerging city. So which depiction is accurate? The truth lies between the two.

An important, centuries-old logistical and trade hub in central China, Zhengzhou resembles any heavily populated but relatively low-income developing urban area. Local taxi drivers claim proudly that it has the third-largest number of cars of any city in China after Beijing and Shanghai, and the snarled traffic provides ample supporting evidence, although official statistics place the city closer to eighth overall.

Like other such developing cities the world over, commerce is abundant but driven largely by small, relatively informal businesses. At the Yinji Commodity Market (the largest and oldest wholesale market in Zhengzhou), for example, shoppers from the area and surrounding prefectural cities peruse seemingly endless stalls of indistinguishable, unbranded clothing and other cheap, fast-moving consumer goods. Some shoppers buy in bulk for resale at retail locations throughout Henan; others buy for themselves. Most residents say Yinji and other similar commodity markets are where they do their shopping, citing cheap prices as the reason.

With an average 3,000 to 4,000 RMB a month in wages ($5,640 to $7,560 a year), individuals do have disposable income, but they can afford only relatively inexpensive local brands. Asked whether he thought most individuals in the city would prefer domestic brands over foreign, one man replied matter-of-factly, “I don’t think people in any city would prefer domestic brands.” Yet most consumer purchasing takes place in physical spaces to which MNCs essentially have no access.

Comparing these commodity markets with the modern consumer spaces in new and old areas alike is striking. On a summer’s day at the Wanda Mall near the center of the old city of Zhengzhou, dozens of people could be found lounging around an international auto company’s display, but only to escape the extreme heat outside. Meanwhile, at the new Dennis Mid-Town Seven Mall in Zheng Dong New District—part of the government’s effort to create a world-class business district—finding even a single shopper proved difficult. At the Millennium Royal Plaza, the New District’s centerpiece, local news reports indicate that only 55% of the office space is inhabited.


13 Data from the National Bureau of Statistics is not complete through 2014 for all prefecture-level cities, so determining the city’s exact current placement in the comparison of total vehicles is not possible.

14 Dahe.cn “Zhengzhou CBD Millennium Royal Plaza has only 45% of occupancy rate: what’s wrong with this landmark building that worth more than fifty thousand per square meter?”, April 18, 2015, http://news.dahe.cn/2015/04-18/104795329.html.
Inland Core Cities

52 cities
202m total population 2014
13% share of 2025 consumption
0% population growth 2014 >> 2025

GDP per capita 2013

SERVICE SECTOR 2013

IMPORTS 2013

CITY POPULATION 2014

RETAIL SALES consumer goods, 2013

URBANIZATION RATE 2014

INTERNET PENETRATION 2014

FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita

INCOME per capita

HOUSEHOLD SAVINGS RATE

+$77% stratum growth
+$64% stratum growth
+$66% national avg.
+$53% national avg.
-5% stratum change
-5% national avg.

$2,433 $4,312

$3,961 $6,515

$6,971 per person

34% of GDP

6% of GDP

4m people per city

$9b

54% of population

47% of population

4% of all industrial enterprises

Percentages are growth rates and changes.
Dollar amounts expressed in 2013 dollars.
Inland Core Cities

EXAMPLES: LANZHOU GANSU, DEYANG SICHUAN, XIANGTAN HUNAN

- These cities are usually important components of inland city clusters, metropolitan circles or economic development zones, and as such are smaller, domestically focused versions of Affluent Cities.

- While geographical locations and industrial structures vary throughout this stratum, disposable income and consumption rates are right on the national average. Citizens here—not those in the richer cities of Shanghai and Beijing with whom many companies are more familiar—represent the typical urban citizen.

The cities at this stratum and below in our hierarchy—which account for the majority of cities in China—are defined less by what it feels like to live in them than by the roles they play within their regional or local economies.

The Inland Core stratum is by far the largest of the top six strata, encompassing 52 cities with a total population of more than 200 million people. In some respects, these cities do not share many economic features. They have different industrial structures, for example, and different levels of performance against macroeconomic indicators. Baoding and Hulunbeier illustrate some of the contrasts: Baoding was recently declared by the China Daily to be China’s most polluted city, while Hulunbeier, which has the second-lowest population density in this stratum, is in the lush green steppes of Inner Mongolia.

What they share, however, is their averageness. It is reflected in their urban landscapes: much as McMansions and strip malls dominate the landscape of Any Town, USA, industrial parks and construction sites create the backdrop for Any Town, PRC. And it is reflected in income levels. With median disposable income of 22,300 RMB ($3,600) per capita—squaring almost perfectly with median rates nationwide—the inhabitants of Inland Core Cities, not the wealthy, Internet-connected consumers of Super or Affluent Cities with whom MNCs are more familiar, represent the typical urban citizen. Indeed, the average resident of Yaan, Sichuan, has only 50% of the spending capacity of his or her Shanghai counterpart.

Cities at this level are also bound by the leading role each plays within a group of less developed cities. In this respect, their function is similar to that of Affluent Cities in relation to Satellite Cities: they act as an anchor that supports regional economic activity, but on a smaller scale. Some, for example, are regional transport hubs. Liupanshui in Guizhou has by far the most passenger railway traffic of any Inland Core City, with the same level as many provincial capitals. Others, such as Xiangtan in Hunan province and Zunyi in Guizhou, are the second cities within somewhat smaller provinces, providing an additional center of economic activity and logistical capacity. And some have abundant resources or a heavy emphasis on certain regional industries. Datong in Shanxi is a regional leader in energy and chemical production, for example.

Opportunities

The near-term opportunity for consumer-facing companies in Inland Core Cities primarily resides in low-cost, mass-market product areas—particularly those that have low barriers to entry. And if MNCs can find a toehold here, understanding the preferences of the average Chinese consumer rather than the affluent consumers they are accustomed to serving in the higher strata, they might find themselves on the road to much greater, nationwide expansion in the low-cost market segment.
Challenges

Stagnant population growth explains in large measure why absolute levels of disposable income and household consumption in these cities will not grow faster than in cities higher up the hierarchy. Hence the relative lack of appeal of these markets, even though per capita consumption looks set to outpace consumption growth in higher-ranked strata. Their isolation from international markets is another challenge. Moreover, with so many cities in this stratum starting at a low level of consumption compared with the 80 cities in the previous five strata, the considerable resources that companies will need to spend in order to identify the right opportunities may not be worth the investment.

LANZHOU (GANSU PROVINCE)

The capital of western Gansu province is unique among China’s large cities. Proximity to Central Asia gives it a relatively large Muslim population. Much of the city’s signage is in Arabic, and many local restaurants are owned and operated by Muslim proprietors, including some of the most popular shops selling La Mian (Ramen), the most famous dish in the area. One of the busiest central bus stations abuts a large white mosque, and many residents dress in traditional Muslim clothing.

In some ways, though, Lanzhou is still a typical large Chinese city. Less than an hour’s drive from downtown, Lanzhou New District, for example, stands only minutes away from the airport yet hosts a plethora of empty residential and commercial buildings, their completion delayed by lack of government funds. Out of 55 enterprises that were meant to relocate to the area, only eight have finished building their facilities and begun operations, according to local government officials.

In the bare brown mountains of western China, Lanzhou has the distinct feel of a city under construction. Signs promoting the One Belt One Road initiative are ubiquitous. The city hopes to become an important export conduit into Central Asia and even Europe, with freight trains running to Alma-Ata, Kazakhstan and Hamburg, Germany. Inbound gas and oil from Central Asia are also set to pass through Lanzhou.

As it is the only city in the province of any size or means, Lanzhou attracts many people from adjoining areas. Malls are notably full of shoppers and provide a range of store types, domestic and foreign.

Still, the city’s logistical challenges and isolated nature mean that many foreign brands are rightly wary of attempting to serve the market. Although the vast majority of vehicles on the road are foreign, it appears that some international vehicle manufacturers might have become overextended in the region. On the unpaved backroad from the airport to the main city (the main highway has recently been under construction) stands a row of foreign auto dealerships, about 30 minutes from the limits of Lanzhou proper. Hardly a person is in sight near the large compounds. Local residents explain that potential customers cannot test-drive vehicles inside the city limits and must go to those more remote locations to do so. However, the dealerships’ evident isolation suggests that companies may have overestimated fundamental consumer demand.
Resource-Exhausted Cities

26 cities
52m total population

3% share of 2025 consumption
-7% population growth 2014 >> 2025

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
INCOME per capita
HOUSEHOLD SAVINGS RATE

$7,712 per person
30% of GDP
7% of GDP
2m people per city

$4b
61% of population
47% of population
3% of all industrial enterprises

$2,444 $4,520
2014 2025

$3,886 $6,741
2014 2025

33% 37%
2025 2014

-% stratum growth +66% national avg.
+73% stratum growth +53% national avg.
-4% stratum change -5% national avg.

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Resource-Exhausted Cities

EXAMPLES: BAIYIN GANSU, LIAOYUAN JILIN, JIAOZUO HENAN

- Heavy dependence on mineral resources jeopardizes the economies of these relatively small cities.
- Location in remote mining regions means they are, almost by definition, cut off from much of the rest of the country.
- Current levels of consumption and residents’ overall purchasing power are weak, due largely to their low-value-added industrial structures.

Mining once sustained Resource-Exhausted Cities. But with reserves diminishing, their outlook is not promising. In 2013, the Chinese government itself labeled them “resource exhausted.” They are smaller than the cities of the Integrated Industrial stratum and, unlike the latter, have not built alternative industries or service sectors capable of driving growth. In addition, their populations are shrinking at a rate of 0.7% per year.

The recent slowdown in the overall economy has hit many Resource-Exhausted Cities particularly hard. China’s coal industry association reported throughout 2014 that up to 50% of coal companies were behind on payments to employees or cutting salaries by more than 10%. And although average incomes will improve over the next 10 years, an annual growth rate of 5.1% will be partially offset by the shrinking population. Thus, a reduction in the savings rate of consumers in these cities will be especially important in undergirding overall consumption growth.

There are 26 Resource-Exhausted Cities with a total population of 52 million—similar to the population of the much richer Satellite Cities (of which there are 13) and Regional International Cities (9 cities).

Currently, real disposable income per capita stands at 68% and 80% of the level of Satellite and Regional International Cities, respectively.

Reliance on mining means that the service sector composes a smaller portion of total economic activity in these cities than in any other city strata. This results not only in limited consumer choice—few financial services and more limited options for everything from restaurants to entertainment, for example—but also in low wage growth. Therefore, it is virtually impossible to begin a virtuous cycle of improved livelihoods, especially in the face of declining mining and industrial activity, since high-wage jobs are what drives higher rates of consumption and thus the creation of even more high-wage jobs.

Remote locations exacerbate the cities’ plight, hindering their participation in the national economy, as do environmental problems such as water shortages, soil salinization, and farmland degradation. All are barriers to urban development. These economies are, at best, stagnant, and their markets currently not viable for MNCs. Without a fundamental transformation, they could disappear altogether once resources run out.

Opportunities

The one piece of encouragement for inhabitants of these cities is that their challenges are recognized by the government, which two years ago announced it was seeking a development strategy for them. The details of the strategy are not clear, but at the very least, Resource-Exhausted Cities will continue to benefit from public largesse. It is conceivable that they will follow the path of cities in the Integrated Industrial Stratum, which could have gone the way of the Resource-Exhausted Cities had they not been able to leverage government support to develop at least one large, domestic industrial player on which to anchor their economies while a broader services sector grew organically as industrial wages rose. This grouping of just-below-average cities in our hierarchy could gain the most if national policy is able to guide the country so that it avoids a middle-income trap, developing significant consumer markets.

Challenges

A minority of people in these cities became very wealthy during the boom years, leading to a level of demand for luxury goods that misled some foreign brands about these markets’ potential. Yet Resource-Exhausted Cities are just that. They are the epitome and the result of the old model of investment-led growth, from which policy makers are in theory trying to wean the economy. Higher unemployment and lower income growth are real risks. Location, disconnected from broader supply chains and distribution channels, also makes them risky investments. These are not likely to be the cities of China’s future.

**BAIYIN (GANSU PROVINCE)**

A 90-minute drive north from Lanzhou, Gansu’s provincial capital, lies the heavily resource-dependent city of Baiyin, where aluminum and copper extraction and processing are the basis of economic activity. Despite the recent downturn in worldwide commodities markets, there still seems to be a modest level of activity at the city’s large aluminum factories a short drive from the city center, although it is clear that business is by no means booming.

Baiyin feels stagnant. The population is a mere 1.7 million, which may seem large by US or European standards but in China barely constitutes a city. That is partly because of the low urbanization rate of 48%; many of the counted “residents” live not in the city itself but in nearby rural areas, in notably decrepit housing. Even so, a drive around the area suggests a mismatch between the size of the population and available employment. Dirt roads and a glaring lack of retail shops also indicate that the area is no hotbed of economic activity. Perhaps the most telling feature, though, is the large earthen monument, in classic communist style, depicting model workers engaging enthusiastically in resource exploration and surveying. The lone structure appears as a monument to past drivers of economic growth.

In the center of Baiyin, one of the main commodity markets, offering a host of knockoff foreign brands so poorly made they are almost comical, is largely empty. About half of the building’s escalators do not work, and shoppers are scarce, especially above the first floor, which mainly houses basic goods and daily necessities.

The consumption outlook for a city such as Baiyin rests on the fact that economic opportunity is declining as demand for China’s resources slackens. The city is too small and shrinking. The economy is too concentrated, with more than two-thirds of economic output coming from heavy industry, manufacturing or agriculture. And employment opportunities are too few. Add to this the prevalence of seemingly abandoned real estate development—common in many other western Chinese cities, too—and Baiyin is a city that epitomizes the areas that MNCs should for the time being avoid.
SHAOGUAN (GUANGDONG PROVINCE)
### Tourism Cities

- **8 cities**
- **17m total population 2014**
- **1% share of 2025 consumption**
- **-6% population growth 2014 >> 2025**

**INCOME per capita**

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2025</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>$4,148</td>
<td>$5,679</td>
</tr>
</tbody>
</table>

**Service Sector 2013**

- **49% of GDP**

**Imports 2013**

- **4% of GDP**

**City Population 2014**

- **2m people per city**

**Retail Sales consumer goods, 2013**

- **$4b**

**Urbanization Rate 2014**

- **51% of population**

**Internet Penetration 2014**

- **48% of population**

**Foreign-funded Industrial Enterprises 2013**

- **5% of all industrial enterprises**

**Consumption per capita**

- **+47% stratum growth**
- **+66% national avg.**

**Income per capita**

- **+37% stratum growth**
- **+53% national avg.**

**Household Savings Rate**

- **-5% stratum change**
- **-5% national avg.**

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Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Tourism Cities

EXAMPLES: HUANGSHAN ANHUI, ZHANGJIAJIE HUNAN, GUILIN GUANGXI

- Tourism cities are largely defined by their connection to a site of natural beauty. In terms of the number of tourists they attract annually, they are second to Super and Affluent Cities.
- These cities enjoy stable economic growth owing to the steady influx of visitors and a well-defined economic rationale. This can both aid and hinder their consumer market outlook.
- Most tourism is domestic; therefore, fluctuations in the national economy will affect Tourism Cities disproportionately.

The group known as Tourism Cities contains the second-smallest number of cities after the Super City stratum, with the smallest aggregate population: 17 million in 2014. The economic well-being of Tourism Cities depends on their popularity, as there is little other economic activity besides tourism. Even so, they do not attract as many visitors or the same high tourism revenue as Super and Affluent Cities, which are famous for their historic and cultural attractions. Rather, the appeal of Tourism Cities lies in their natural beauty. Zhangjiajie, for example, was renamed and developed in 1994 specifically to cater to tourists after the nearby National Forest Park became a UNESCO World Heritage Site in 1992.

Given their reliance on areas of natural beauty, these cities are fairly remote. They are not highly developed, and their populations are relatively small by Chinese standards, with a median of 1.6 million. That may be quite large by US standards; seven of the eight would make the list of the 10 largest cities in the United States. But it is a reminder how MNCs should not be misled by population size, as consumer potential in Tourism Cities is much lower than it is in the likes of Chicago, Philadelphia or Dallas, which have comparable population sizes.

Tourism Cities form by far the most stable stratum—a distinctly positive attribute for a group of cities that otherwise find themselves in the lower levels of our hierarchy. Among the bottom five strata, they will experience the smallest decline in population over the next decade (5.7%), and their principal resource, the landscape, is not set to disappear. This could offer stability even beyond our 2025 projection period.

Consumption, too, is unlikely to change much, with household disposable income and household consumption set to grow at the slowest rate of all strata. (On a per capita basis, both metrics will grow more slowly in Super and Affluent Cities, because their populations will rise substantially.)

Opportunities

Home to just 1.3% of the total population sample covered by our classification, Tourism Cities are likely to see only lackluster organic growth. But at least the market is not shrinking due to migration, as in other lower-ranked strata. The domestic travel and tourism industry will expand as incomes across China increase, and it may even benefit as growth slows if tourists opt for cheaper holidays at home rather than expensive foreign trips. In addition, well-off visitors will be more aware of foreign brands, not only boosting local consumption but potentially enhancing local awareness of such brands. As a result, companies may not have to work so hard to build awareness.
Challenges

Chinese tourists’ preference for vacationing abroad might change as the economy slows, but the super-wealthy will still probably prefer overseas destinations. And however comforting stability might sound, this market has a limited domestic population, and the likelihood of swift economic diversification is low. Hence, many MNCs will not warrant Tourism Cities worth their attention.

HUANGSHAN (ANHUI PROVINCE)

Huangshan is named after the famous mountain at the southern end of Anhui Province, and this attraction makes tourism the pillar industry of the area. With only 1.47 million residents, the city welcomed 1.6 million tourists in 2013. Not only has Huangshan enjoyed great popularity within China (domestic tourism revenue reached 42.4 billion RMB, or $6.7 billion, in 2013), but it has also begun to strengthen its reputation as a tourist destination among foreigners. It was named a World Excellent Destination in 2014 by the Montreal-based World Center of Excellence for Destinations, the first tourist attraction in the world to achieve the title.17

But while tourism drives economic growth in Huangshan, the city does engage in other industries. Owing to the area’s distinctive soil and weather, for instance, the tea industry has become an important part of the local economy, with around 700,000 farmers growing tea for a living. Such niche industries offer a healthy measure of economic stability. Of overall GDP of 47 billion RMB ($7.4 billion) in Huangshan in 2013, 46% was derived from industry and construction and a full 43% from services, largely tourism. It is rare for services to contribute so large a portion of economic activity in a small Chinese city.

One of the city’s main shopping areas is the Tunxi Ancient Shopping Street, where buildings constructed in the styles of the Ming and Qing Dynasties house small stalls of wares for tourists to buy.18 There is local art, including brick, stone and bamboo carvings; cheap mass-produced trinkets; ready-to-eat foods; and agricultural products such as bamboo shoots, mushrooms and chrysanthemums, besides the city’s famous teas.19

Anyone who has visited a Chinese Tourism City will recognize the combination of a site of natural beauty and an ancient shopping street. Both these elements, along with production of tea and bamboo and other agricultural goods, sustain consumption in Huangshan—at least as long as tourism rates remain steady. But the relatively informal and local nature of the shop stalls, combined with the low wage level of the full-time residents, makes the city a less-than-promising platform for sales of foreign goods, as a quick examination of the city’s primary shopping area makes clear.

17 Created in 2006, the Montreal-based World Center of Excellence for Destinations is committed to guiding tourist destinations around the world toward excellence. As an authority on assessment of scenic attractions, it has been partnering with the United Nations World Tourism Organization (UNWTO) and the Pacific Asia Travel Association (PATA).


Modern Agricultural Cities

22 cities
103m total population 2014
6% share of 2025 consumption
-15% population growth 2014 >> 2025

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
+100% stratum growth
+66% national avg.

INCOME per capita
+89% stratum growth
+53% national avg.

HOUSEHOLD SAVINGS RATE
-4% stratum change
-5% national avg.

$4,729 per person
34% of GDP
5m people per city
$8b
51% of population
35% of population
3% of all industrial enterprises

$2,375 $4,757
2014 2025

$3,494 $6,588
2014 2025

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.
Modern Agricultural Cities

EXAMPLES: HEIHE HEILONGJIANG, JINGZHOU HUBEI, YANGJIANG GUANGDONG

- Modern Agricultural Cities are akin to Integrated Industrial Cities in that they have had some success in diversifying away from their primary resource, arable land.

- In willingness and ability to spend, consumers lag behind those of most other strata, although per capita consumption has seen brisk growth in recent years from a small base.

- As with Traditional Agricultural Cities, populations are shrinking faster than anywhere else in China, raising a red flag for companies considering entering these markets.

Two sets of cities are defined by their links to agriculture: Modern Agricultural Cities and Traditional Agricultural Cities. Both sets, along with Frontier Cities, tend to fall within Tier 4 of the conventional city segmentation framework. Conventional wisdom suggests that all Tier 4 cities are key to China’s future consumer growth. Our analysis differs in two ways. First, we remain cautious about this tier’s short- and medium-term prospects. Second, our finer segmentation suggests MNCs should consider Modern Agricultural Cities above other Tier 4 cities.

The 22 Modern Agricultural Cities are richer and more urbanized than most Traditional ones, having been able to develop industrial and service sectors to some extent. Yet they remain less well connected to the outside world than the previous eight strata in terms of trade, interaction with foreign companies, and even Internet penetration.

Of the 11 strata, they have the second-lowest level of disposable income per capita and the third-lowest level of household consumption per capita. That said, they will have the fastest growth in per capita disposable income over the next decade, and share the fastest growth in household consumption per capita with Traditional Agricultural Cities. Income per capita is expected to grow by 6% a year, although it will still stand at only about 80% of the level in the top three strata by 2025. A lower projected savings rate than in other strata means consumption is expected to converge toward that of more-developed cities more quickly.

As incomes rise, the population in Modern Agricultural Cities will fall, and at quite a clip. By 2025, we expect the total population to be 15% smaller than it is today—a red flag for companies considering investing in these cities.

Opportunities

The relatively large size of Modern Agricultural Cities (the median population is 3.7 million) might attract companies seeking deeper market penetration. Land reform, which could see plot owners given equity in new, large-scale farming enterprises, could be another draw. It would boost the agricultural sector’s productivity and with it farmers’ wealth and local consumption in these cities. The proposed reforms are fraught with difficulties, however, with successful land reform being one of the most difficult challenges developing economies can face. The legislative process seems interminable.

Challenges

The rewards for MNCs will not be large, despite comparatively fast growth and the economic convergence of Modern Agricultural Cities with
more-developed ones. The shrinking population is a major concern, given the investments that would be required to serve them. For MNCs, identifying the locations where populations are shrinking—and avoiding them for the time being—is as important as identifying those to which the next generation of spenders will migrate.

HEIHE (HEILONGJIANG PROVINCE)

Heihe, a small city of 1.72 million people, sits on the border of Heilongjiang Province and Russia and, as one of the so-called Open Border Cities,20 serves as a border trade center. Heihe boasts by far the highest level of annual total trade of any of the Modern Agricultural Cities, with international business amounting to more than $4 billion in 2013. From the Russian side of the Amur River, the bright lights of the Yuan Dun shopping center, which juts into the river, can easily be seen. Large Cyrillic letters adorning the center highlight the close relationship between the city and its Russian neighbors.

Indeed, while much changes quickly in urban China, the complex relationship between Russia and China via Heihe may prove to be enduring. Back in 2009, a news report described the dynamics well:

Among Russians in Blagoveshchensk, a two-day train ride east of Irkutsk, the sight of Heihe across the water is a source of both admiration and defensiveness. . . . I was told over and over that although Heihe looks impressive from a distance, up close the city can be dirty and chaotic. Others mentioned that the central government in Beijing lavishes extra attention on Heihe—other cities of its size don’t have those bright lights—because it’s on the border. Russians have seen this sort of thing before: “It’s a Potemkin village,” said Nikolai Kukharenko, the Russian head of the Chinese-government-run Confucius Institute in Blagoveshchensk.

At the same time, Russians love Heihe. Several ferries a day carry over tourists and shoppers looking for cheap Chinese electronics and clothes, and so many people made their livelihood in the “suitcase trade”—buying cheap things in China to sell for a profit in Russia.21

The trade does not simply go one way, though. At a large commodity center and in some commercial streets just within the Chinese border, Heihe residents can purchase all kinds of consumer goods made in Russia.

But despite enjoying a large amount of trade for a Modern Agricultural City, Heihe still relies heavily on agricultural production, with a full 48% of GDP driven by the primary (mostly agricultural) sector. Indeed, with more than 28% arable land and two main rivers (Heilongjiang and Nenjiang), the city has exceptional advantages for development of agriculture and animal husbandry. Based on its regional and geographical advantages, Heihe is promoting advanced agricultural technology and external trade and cooperation with Russia in the agricultural sphere.

Such a strong reliance on agriculture—exceeding that of most other Modern Agricultural Cities—means that Heihe trails much of the cohort in terms of wage levels and per capita consumption expenditure, however. Both metrics lag behind the median levels for this stratum, at 91% and 85% of the median, respectively.

20 This is an official Chinese government designation given to cities that are meant to be base cities for cross-border trade.

Frontier Cities

56 cities
215m total population
13% share of 2025 consumption
-6% population growth

2014 >> 2025

INCOME per capita
Dollar amounts expressed in 2013 dollars.

SERVICE SECTOR 2013

IMPORTS 2013

CITY POPULATION 2014

RETAIL SALES consumer goods 2013

URBANIZATION RATE 2014

INTERNET PENETRATION 2014

FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita

INCOME per capita

HOUSEHOLD SAVINGS RATE

Percentages are growth rates and changes.

$5,590 per person
33% of GDP
4m people per city
$6b
49% of population
3% of all industrial enterprises

+85%
+72%
-4%
stratum growth
stratum growth
stratum change
national avg.
national avg.
national avg.

$2,166 $4,008
2014 2025

$3,792 $6,521
2014 2025

39% 43%
2025 2014

National average

F or tier Cities

Total population 2014
56
cities

215m

-6% population growth

$5,590
per person

33%
of GDP

4m
people per city

$6b

49%
of population

3%
of all industrial enterprises

+85%
stratum growth

+72%
stratum growth

-4%
stratum change

Dollar amounts expressed in 2013 dollars.
Frontier Cities

EXAMPLES: WEINAN SHAANXI, GANZHOU JIANGXI, CHIFENG INNER MONGOLIA

- Just like so-called frontier markets in the world of finance, Frontier Cities look set to achieve high growth rates from a low base. Making investments in them to capture consumer spending, however, will require a high degree of risk tolerance.

- MNCs should exercise caution over the 56 Frontier Cities: their markets are generally too shallow for any but the most basic goods.

- It is more important to look at current levels of income and consumption in these cities than projections. Like other researchers, we expect these cities to grow faster than those in most other strata. But as they currently have just half the income and consumption of the richest cities, their absolute level of purchasing power will be subdued for some time.

Frontier Cities, the penultimate category in our hierarchy, are grouped together in our framework because they share almost no feature distinct enough for us to include them elsewhere. Although they might be more developed than cities in rural regions, the markets of Frontier Cities remain too small to provide sustainable opportunities over the next decade for any but a few MNCs. They are frontier markets, therefore, not in the sense that they represent cutting-edge consumer opportunities, but in the investment sense, where frontier markets are those with lower market capitalization and less liquidity than many other emerging markets.22

There are 56 Frontier Cities, housing 215 million people, or 16.4% of the population of our framework, although the term city is used loosely. The median population is 3.6 million, and the median urbanization rate 50%. Frontier Cities in fact blur the distinction between urban and rural, reflecting the way Chinese cities were conceived of historically, when they were “closely connected to the hinterland through cross-region trade and population movements,” and “there was not a rigid divide between cities and rural areas.”23 In other words, there are plenty of buildings and infrastructure in Frontier Cities, from homes to bridges to office buildings. But the sometimes-sparse placement of these structures, combined with the proximity of farming communities, makes it difficult to distinguish where urban space gives way to agricultural areas. In many other parts of China today, the difference has been made perfectly clear as a result of the urban planning of the socialist era, which sought to direct economic growth by drawing distinctions between urban and rural spaces.

Per capita disposable income in Frontier Cities is 58% of that in Super Cities and 59% of that in Affluent Cities. We expect catch-up growth will raise per capita disposable income by 72% in the next 10 years. But even if this materializes, it will still be just 80% of the level in Super Cities by 2025. That should give MNC strategists impressed by growth projections pause for thought.

Opportunities

Rising disposable income in these cities will likely mean rising purchases of low-end consumer items such as toiletries, day-to-day clothing, and small household appliances. In addition, government policies to boost infrastructure spending in the underdeveloped west of the country, where many Frontier Cities are located, is likely to improve logistical capabilities in the medium term. Therefore, companies that can tap into those distribution channels at relatively low cost, can meet basic consumer needs, and already have a strong presence in China might see some potential in Frontier Cities toward the end of our projection period.


**Challenges**

Despite rising disposable income, most spending will still go toward very basic goods and remain at a level where only a handful of foreign brands will earn significant revenues. This limited consumer power will also be spread over vast distances, in dozens of shallow pools, and will therefore be hard to access. Even a decade hence, Frontier Cities are likely to be among China’s least-connected and poorest areas, and operating a business in them will be more akin to selling goods in rural areas or small towns than the size of their populations suggests. These, however, are the cities that many believe will be China’s primary growth engines as urbanization continues. Yet building more residential and commercial high-rises and connective infrastructure does not an economy make. The majority of companies should avoid these cities until after fully exploring opportunities in the first nine strata and until there has been tangible progress on development policy for these cities.

**WEINAN (SHAANXI PROVINCE)**

Weinan’s claim to fame is that it is the hometown of Xi Zhongxun, father of China’s president and Communist Party leader Xi Jinping. The dense traffic on its eastern approaches has nothing to do with that, however; much of it is heading toward the famous Terracotta Warriors in the provincial capital of Xi’an, one hour’s drive away.

Once in Weinan, it is evident that the city does not represent the bright future of China’s consumption growth. It is characterized by low-rise, run-down homes and office spaces, and few shoppers are to be seen around the main commodity markets in the city center. Temporary workers from rural areas wait around in the morning heat for day labor, usually construction related. Even in the city’s relatively popular Vanguard Supermarket (a Hong Kong–based chain), the main activity witnessed one early morning was a long line of senior citizens waiting to buy discounted eggs.

As in many Frontier Cities, a relatively large portion of economic activity (around 15% of GDP) stems from agriculture. Jobs in the industrial sector, which makes up 55% of GDP, are highly concentrated among a few National Champion companies, including the manufacturing campuses of Lijun Pharmaceuticals and Zoomlion Heavy Industry, a Chinese version of Caterpillar. The city also relies heavily on public investment, with the city government seeking to spend 100 million RMB a year, over an unspecified period, to stimulate tourism. A short drive from the city center, for example, a small cultural center with shops, restaurants and bars is being constructed in traditional Chinese style. This policy is promoted even though, so far, very few tourists seem to make their way to Weinan.

The government is also offering heavy subsidies to Chinese companies investing in the city. A brand-new Wanda Mall opened in August 2015—the fourth such structure Wanda has built in Shaanxi province—owing in large part to preferential tax treatment for the company.

From casual observation, Weinan appears to have a significantly older population than many more-developed cities and to offer relatively few opportunities for younger citizens in terms of employment or consumption.
Traditional Agricultural Cities

43 cities
192m total population 2014

10% share of 2025 consumption
-15% population growth 2014 >> 2025

GDP per capita 2013
SERVICE SECTOR 2013
IMPORTS 2013
CITY POPULATION 2014
RETAIL SALES consumer goods, 2013
URBANIZATION RATE 2014
INTERNET PENETRATION 2014
FOREIGN-FUNDED INDUSTRIAL ENTERPRISES 2013

CONSUMPTION per capita
+93% stratum growth
+66% national avg.

INCOME per capita
+82% stratum growth
+53% national avg.

HOUSEHOLD SAVINGS RATE
-4% stratum change
-5% national avg.

Percentages are growth rates and changes. Dollar amounts expressed in 2013 dollars.

$3,441 per person
34% of GDP

$5b
38% of population

4m people per city

2% of all industrial enterprises

$2,094 $4,051
2014 2025

$3,456 $6,301
2014 2025

36% 39%
2025 2014

National average

stratum averages across cities
Traditional Agricultural Cities

EXAMPLES: CHONGZUO GUANGXI, XINYANG HENAN, LINCANG YUNNAN

- These “cities” are hardly cities at all. They have very low urbanization rates and rely heavily on agriculture to drive economic growth.
- Non-agricultural activity is driven largely by state-led investment, offering the security of basic economic growth but little promise of diversification or vibrancy.
- Population shrinkage is the fastest among the five lowest strata. These cities are the least desirable in the country—for their own inhabitants as much as for MNCs.

The 43 Traditional Agricultural Cities almost defy the city label, with a median urbanization rate of 37%. Yet they are designated prefecture-level cities within China’s nomenclature. They are at the bottom of our hierarchy in part because, like Resource-Exhausted Cities, they have been unable to diversify away from reliance on a single primary resource.

Agriculture accounts for almost a quarter of economic activity. Moreover, the non-agriculture portions of GDP are largely underpinned by public investment, making them highly dependent on the state to drive economic activity and wage growth. Fixed-asset investment, which is largely state-led investment, accounts for a median 86% of GDP, a measure of the lack of dynamism in the industrial, manufacturing and services sectors. All of this is reflected in the underdeveloped way of life in these cities—a way of life that is increasingly anachronistic in the world’s second-largest economy.

Unlike other low-ranked strata, Traditional Agricultural Cities do not appear to have built up significant dependence on real estate, with real estate capital expenditure standing at 11% of GDP at the median—the fourth-lowest ratio of all city strata. This is good in that these cities’ economies are not exposed to the risks of a property bubble. But it also shows their lack of attraction; even in the midst of China’s real estate frenzy, property developers did not invest heavily here.

These moribund urban centers will see their overall population of 192 million fall by 15% over the coming decade as inhabitants seek to build their futures in a more modern, prosperous China. The government encourages such migration, especially toward Inland Core and Integrated Industrial Cities in the western and central regions, indicating that it too doubts these cities’ future prospects.

Traditional Agricultural Cities will experience rapid improvement in per capita consumer spending, which will rise from 51% of the Super City level today to 72% in 2025. But population shrinkage will hit aggregate consumption. At 85% of the level in Super Cities today, it will dip to 77% by the end of the forecast period.

Opportunities

As the most underdeveloped prefecture-level cities in China, Traditional Agricultural Cities will see growth in household consumption per capita outpace that of all other groups apart from Modern Agricultural Cities, as per capita income levels begin to converge across the country.

Challenges

The prospect of fast-growing consumption does not alter the fact that Traditional Agricultural Cities rank the lowest of all strata in terms of inhabitants’ ability
and willingness to spend. Moreover, their markets are small and shrinking. Add to this the challenges of tapping into them, and it is clear why these cities should be last up for consideration by MNCs. Even companies with the most extensive operations in China, selling the most basic fast-moving consumer goods, will struggle. These markets are not only unviable, they are disappearing.

**CHONGZUO (GUANGXI PROVINCE)**

Consumption activity in Chongzuo is noticeably subdued. The area surrounding the main local market, Baijiahui, situated at the city’s center in both the consumer and physical senses, is practically in ruins. To access the main entrance to the mall, it is necessary to climb down and up a ditch that contains a large broken sewer pipe. Inside, shops sell cheap, locally branded or knockoff clothes and small electronics. Another market is closed, undergoing construction, while a visit to a national grocery chain, BHG, revealed only a handful of shoppers. The range of consumer choice, from hotels to restaurants, is decidedly narrower in Chongzuo than most Chinese cities.

Beyond agriculture and a clutch of factories that employ a few thousand workers, employment opportunities in Chongzuo appear limited. Activity at factories producing paper, toys and sugarcane is desultory, while groups of young men stand around, unoccupied.

A 10-minute drive from the city center is ASEAN International City, a 2.3-billion-RMB development project that is set to house a 41-story office building, a five-star hotel, a golf course, and a five-building shopping complex. According to promotional material, the development is meant to promote the economic ties between Guangxi province’s Beibu Bay Economic Zone and its Southeast Asian neighbors. At present, no international clearing bank has a branch in Chongzuo, so trade between the city and its foreign neighbors must be settled through banks in Nanning. Representatives for the development explained that they expect financial-services companies to fill the office space so that trade can be settled directly in the city.

A 15-minute drive past ASEAN International City, sugarcane and banana fields stretch as far as the eye can see. The juxtaposition of a partly built high-rise financial center against a starkly rural landscape is jarring, truly blurring the lines between urban and rural.
PARTIAL CONVERGENCE

The consumption levels of China’s richer and poorer cities are converging. Slower industrial development in richer cities coupled with government investments and faster industrial development in poorer ones is partly responsible. So, too, is increased economic connectivity between Chinese cities, as evidenced by interregional trade and narrowing price differences. But convergence is a multi-decade process. Significant differences in consumption levels will remain for many years.

Our City Strata framework reflects this convergence. Consumption will grow fastest in those cities that start from a low base, and slowest in those with already-high levels of consumption. As a result, national per capita consumption is projected to grow at an annual rate of 4.7% in the next decade, compared with 3% in Super Cities, the city stratum with highest per capita consumption. This will narrow the per capita consumption ratio between the national average and the Super Cities from 66% in 2014 to 79% in 2025.

The three strata in our framework that had the highest levels of per capita consumption in 2014—Super Cities, Affluent Cities and Satellite Cities—will still have the highest levels in 2025, demonstrating how slowly convergence proceeds. Of the three, per capita consumption will grow fastest in Satellite Cities: from 20,900 yuan ($3,300) in 2014 to 32,600 yuan ($5,200) in 2025. These cities will replace Affluent Cities as the stratum with the second-highest level of per capita consumption.

In the lower strata, where per capita consumption growth is generally highest, we expect to see divergence in consumption between cities within the strata. That is because higher projected growth tends to be accompanied by higher risk and variability in outcomes. While some cities will be able to reinvigorate their economies through diversification and smart investments, others will not.
WHO ARE THE SPENDERS?

The middle class: An insufficient concept

Just as there are vast variations in consumption patterns between different cities across China, so there are among consumers in any given city—differences in their means, preferences and behaviors. Simply put, some consumers will drive spending growth more than others. Identifying, understanding and meeting their needs should be fundamental to the growth strategy of consumer-facing businesses.

A common segmentation framework used in China and other emerging markets takes income as its basis. Luxury goods manufacturers home in on high-income consumers. Manufacturers of mass-market goods target middle-income earners. The latter group, often referred to as the middle class, is seen as the big opportunity for consumer goods and services companies. But we believe the notion of a middle class is inadequate as the foundation of a growth strategy. The World Bank defines the middle class as those people who can afford daily expenditures of $10 to $50—an enormous range in purchasing power—but many others define it differently, making it hard for companies to know whom they should target. Moreover, income does not necessarily denote purchasing power. What $50 can buy in a day in Saint Louis, Missouri, is very different from what it can buy in an inland city of China such as Chongqing.

This framework also ignores two other important considerations. The first is mind-set. In the United States and other mature markets, being middle class is not just about the resources an individual has. It is about that person’s engagement with consumer culture. Income is neither necessary nor sufficient for that mind-set to exist. The financial lives and aspirations of consumers can be quite rich, even without abundant economic resources.24

In our view, therefore, consumer culture is different from income, though income is an enabler. A rich consumer culture grows not just from rising incomes but also from willingness to spend that income. In a developed consumer culture, consumers make decisions about how to allocate their spending across categories beyond those required for basic survival. They communicate with one another about new products. They write reviews and share opinions on social media. They experience life in a different way from those who are not part of the culture.

As investment continues to lose steam as a driver of growth, identifying which consumers are already engaged in consumer culture, and which might be

soon, will be key for businesses seeking to capture China's continued consumption growth.

The second consideration ignored by the middle-class framework is access to consumer goods and services. Consumers may have enough income to qualify as middle class, but can they spend it? In China and other emerging markets, the challenge of distribution and logistics is significant. E-commerce, which in China is estimated to account for about 10% of total retail sales, provides some outlet for pent-up demand, especially for consumers outside the top city strata. The Chinese arguably lead the way in online shopping, even if there is contention over e-commerce figures. But it can be easy to overlook the fact that, for the time being, there are hundreds of millions of “middle-class” consumers whom MNCs will struggle to serve because they do not have online access.

Introducing Connected Spenders

To address these shortcomings, we have developed a new framework to identify the consumers able and ready to be higher spenders. We call them Connected Spenders, and they will account for 80% of China’s aggregate growth in consumption in the next decade.

Two features define them. First, once they have covered basic necessities, they have spare cash that they are willing to spend on other things. Second, because they are connected to the Internet, they have access to information and retail channels that enables them to participate fully in a consumer economy.25

In 2014, we estimate, there were about 368 million people, or 27% of the total population, living in Connected Spender households across all city strata. These households accounted for 44% of total consumer spending, or 10 trillion yuan ($1.6 trillion). Their average annual household income was 120,600 yuan ($19,300), compared with just over $72,000 for all households in the United States.

Connected Spenders are a relatively sophisticated group of consumers. They are more educated, urban and younger than consumers overall, and they have higher average incomes (Exhibit 2). They are also extremely confident about their personal economic situation.26

Not all have high or middle incomes, though. Between 2010 and 2014, the period over which we tracked these households, 13% had monthly household income of less than 5,000 yuan ($800), or daily income of just under $30. Only 12% reported monthly household income of more than 20,000 yuan ($3,200), or $85 a day. This compares with median household income in the United States of almost $120 a day between 2006 and 2012, in Germany of $90, and in France of $85. So while Connected Spenders do have spare cash, the vast majority do not have the resources to be heavy purchasers of luxury goods and services. They do, however, buy a wide range of other goods and services. And when they can afford to, they also trade up to better-quality items. Though Connected Spenders are to be found in all city strata, they predominate in the higher echelons and make up a larger share of the population there. More than half are in the top five strata—Super Cities, Affluent Cities, Satellite Cities, Regional International Cities and Integrated Industrial Cities—although this group of 79 cities contains just 38% of the total population in our City Strata framework.

Connected Spenders’ spending habits

Connected Spenders’ consumption habits reflect their ability and willingness to spend on a wide range of categories of goods and services, and their access to consumer markets. Some 43% of their spending is dedicated to non-essential categories, compared with 36% for other consumers. Exhibit 3 shows that Connected Spenders are more likely to spend across a wide range of these categories.

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25 We have used the Nielsen China Consumer Confidence Survey and the related Nielsen Global Online Survey, conducted quarterly between 2010 and 2015, to develop our insights about Connected Spenders.

26 According to Nielsen’s Consumer Confidence Survey in China, their consumer confidence index in 2014 averaged 121, compared with 110 for Chinese consumers in general. A consumer confidence of 100 is considered neutral in the Nielsen metric.
EXHIBIT 2

Who are China’s Connected Spenders?

CONNECTED SPENDERS

YOUNGER
age distribution, % of households, 2014

- 19-34: 43%
- 35-49: 42%
- 50-64: 15%

OTHER HOUSEHOLDS

MORE AFFLUENT
income distribution, % of households, 2014

- 19-34: 29%
- 35-49: 41%
- 50-64: 30%

BETTER EDUCATED
% with college education or above, 2014

- 53%
- 15%

MORE URBANIZED
% living in urban area, 2014

- 91%
- 31%

* low-income households defined as earning a monthly household income of less than $800
middle-income households defined as earning a monthly household income between $800 and $3,200
high-income households defined as earning a monthly household income of greater than $3,200
**EXHIBIT 3**

*Connected Spenders have a higher level of consumption average annual consumption per capita, 2014*

**CONNECTED SPENDERS**

$4400 per year

**OTHER HOUSEHOLDS**

$2000 per year

*across a wide range of consumer products and services use of spare cash, % of households, 2014*
This engagement with consumer culture goes beyond just spending. Connected Spenders are more inclined than other consumers to use financial services; 78% of Connected Spenders report saving some of their income (compared with 53% of non-Connected Spenders) and 43% report buying insurance (compared with 9%).

The spending patterns of Connected Spenders on low incomes (5,000 yuan or less a month, or less than $9,600 a year) indicate the opportunity that even these consumers represent for businesses. A comparison of their spending patterns with those of high-income, non-Connected Spenders (20,000 yuan or more a month, or $38,000 or more a year) makes the point. On average, they buy more categories of non-essential items such as books, magazines and personal-care products, and a solid majority spend on dining out, entertainment outside the home, and education (Exhibit 3).

Compared with high-income Connected Spenders, those on low incomes on average purchase fewer big-ticket items such as jewelry, automobiles and real estate, and do not purchase as many investment and insurance services. But they are just as likely to purchase more-affordable luxuries, such as magazines or cosmetics. For the time being, they are more likely to put savings into current accounts and time deposits rather than the more sophisticated investment vehicles used by higher earners. However, as their incomes grow and they become more aware of and comfortable with other types of savings vehicles, this will change. They will also make more use of consumer credit. The huge growth in peer-to-peer lending platforms to finance weddings, travel and other large purchases is evidence of China’s appetite for credit, though a legitimate concern for any market is that consumers borrow more than they can afford.27

Nielsen retail measurement data for different regions between 2011 and 2014 show, as might be expected, that sales of packaged goods categories overall have grown fastest where the share of Connected Spenders grew fastest. This group of consumers is also the most likely to trade up to higher-quality goods and services across several categories tracked, even when controlling for the higher income of Connected Spenders. Connected Spenders are thus the ones to watch to understand which new consumer categories will grow most rapidly and where there will be trading up within existing categories.28

Dairy products illustrate the point. These are not a staple of the Chinese diet but have shown considerable growth, particularly in locations where the share of Connected Spenders has expanded most. And it is in these areas that sales of liquid milk and yogurt have grown fastest as Connected Spenders have traded up. Where Connected Spenders have proliferated least, sales of powdered dairy products have grown fastest.

The link between the growing number of Connected Spenders and trading up is also apparent in packaged and premade foods and beverages. Confection is an example. Regions with a lower share of Connected Spenders have seen greater sales growth in less expensive, generic, loose-pack candy. Areas with a higher share of Connected Spenders have seen greater sales growth for branded candy products.

The link holds for beauty and hygiene products such as shampoo, conditioner and styling mousse and gel, and for infant-care products such as baby powder and disposable wet tissues. In these categories, which previously were not considered necessities, Connected Spenders have led adoption.

It is critical to note that the effects we observe in this analysis result not from higher income among Connected Spenders—as mentioned, we have controlled for income growth—but from growth in their numbers and from their attitudes and motivations.


28 By trading up, we refer to moving from less expensive, simpler, less prestigious or lower-quality goods and services to ones that are considered more premium along one or more of these dimensions. Trading up often occurs as consumers earn more income and as they become more familiar and engaged with a product or service category.
Connected Spenders are slated to grow significantly, expanding their role as the core of Chinese consumption.
**Growth of Connected Spenders over the next decade**

If GDP grows in line with our projections, the number of Connected Spenders will increase by 60% to about 590 million people by 2025, accounting for 41% of the population (Exhibit 4).29 Their collective spending power will rise from 44% of the total today to 60% in 2025.

As a result, Connected Spenders will drive about 80% of aggregate consumption growth over the period. Just over half of their contribution will be due to their rising numbers, and the rest to their rising per capita consumption. (Non-Connected Spenders will become a smaller group in absolute number, though their per capita spending will rise. The net effect is that their contribution to total spending growth will be just 20%.)

29 Examining Internet penetration growth and other adoption patterns for other technologies suggests that reaching majority penetration may be a tipping point. Once a majority is reached, then penetration growth can actually accelerate for a period before eventually leveling off.

**EXHIBIT 5**

**Connected Spenders are most prevalent in robust City Strata**

Internet penetration will account for 95% of the growth in the number of Connected Spenders over the period. By 2025, another 265 million people will have Internet access. That will mean 75% of the population will be online, enjoying higher bandwidths than today and using devices with many more features (see sidebar “Rising Internet access in China”). Modest growth in population will account for the remainder of the growth in numbers of Connected Spenders. The aging of the Chinese population, combined with relatively slower income growth, will cause a minor drag on growth in their numbers, offsetting some of the gains made by higher Internet penetration.

The top five city strata will retain a disproportionate share of Connected Spenders (Exhibit 5). More than half of the total will reside there in 2025, as their growth in the top strata will outpace that in lower ones. Their contribution to total consumption growth will be in line with their share of total population growth. That said, there will still be strong growth in the numbers of Connected Spenders in the lower City Strata as incomes and consumption...
converge across China. In addition, many of the lower-level cities are the focus of the government’s Internet Plus campaign to expand Internet access.

The presence of Connected Spenders will influence patterns of consumer spending within each stratum (Exhibit 6). For example, in the lower strata—mainly inland cities—where Connected Spenders have lower incomes, basic trade-up categories such as insect repellant, hair-care products, feminine-hygiene products, facial tissues and cleansers, lotions, toothbrushes and chewing gum will see growth as incomes rise above the levels of basic consumption.

In the higher strata, where incomes are higher and Connected Spenders are projected to make up the majority of the population by 2025, the basic trade-up categories are already quite popular, leaving less room for growth. Instead, more-advanced trade-up categories will see the fastest expansion. These include products such as baby formula, liquid milk, soy milk and carbonated soft drinks.

*****

Connected Spenders are concentrated in the top three strata of the City Strata framework, reinforcing our earlier recommendation to consider new investments here first. However, Connected Spenders can be found in every stratum, and their consumption patterns vary systematically across them. Thus, the Connected Spenders framework is an important lens through which to assess growth opportunities. Regardless of whether companies choose to focus their investments in the top strata or build broader market penetration, and regardless of whether they focus on online or offline strategy or both, understanding the different spending habits of Connected Spenders across China will help them ensure they create more value from those investments.

A word on e-commerce. Without doubt, it will support greater consumption. But the economics of distribution dictate that even with e-commerce, companies may struggle to serve Connected Spenders who reside in some lower-strata cities efficiently, due to their low numbers. Companies will need economies of scale, so even in e-commerce, they are likely to concentrate on the cities in the higher strata of our framework.
**EXHIBIT 6**

Where will the growth opportunities be?

ADVANCED trade-up categories in relatively robust city strata

- example products: soy milk, liquid milk, full-brand candy, insect bite treatment

<table>
<thead>
<tr>
<th>BASIC trade-up categories in more challenged areas</th>
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</thead>
<tbody>
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<td>example products: powdered milk, loose-pack candy, insecticide</td>
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</tbody>
</table>

<table>
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<tr>
<th>RELATIVE GROWTH IN ADVANCED AND BASIC RETAIL CATEGORIES, 2013-2025*</th>
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<td>above-average retail growth</td>
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<table>
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<tr>
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<th>Satellite</th>
<th>Integrated Industrial</th>
<th>Regional International</th>
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<td>-0.36</td>
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<td>-0.04</td>
<td>-0.03</td>
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<th>Resource-Exhausted</th>
<th>Tourism</th>
<th>Modern Agricultural</th>
<th>Frontier</th>
<th>Traditional Agricultural</th>
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<tbody>
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<td>0.05</td>
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<td>0.65</td>
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<tr>
<td>-0.43</td>
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<td>-0.05</td>
<td>-0.21</td>
<td>-0.69</td>
<td>-0.31</td>
</tr>
</tbody>
</table>

Note*: Values represent, for a given retail category and region, the difference in growth of the category in the specific region relative to growth of the category in China. Index value of 0 represents the national average growth for a given retail category from 2013 to 2025.
RISING INTERNET ACCESS IN CHINA

We project that China’s Internet penetration will rise to 75% by 2025 from 48% in 2014. The government’s stated targets and supporting initiatives are consistent with this. The projection is a function of our GDP growth forecasts. If actual GDP growth is higher or lower than our forecasts, projected Internet penetration rates will change.

Not all demographic groups are equally represented among current Internet users. Young people aged 15 to 29 are the heaviest users, with 90% online—a penetration rate comparable to that of the United States. They spend 35 to 40 hours a week online, compared with 31 hours among the general population, and are almost twice as likely as the general population to access the Internet using a smartphone, and 50% more likely to use a tablet. Overall, fewer than 15% of Internet users rely on a PC to go online. The well-off and well-educated are also more likely to have Internet access. Those with reported annual incomes of at least 100,000 yuan ($16,000) and those with college educations are 50% to 100% more likely than the general population to be online, for example.

30 Our projection is modeled from data in the World Bank’s World Development Indicators database, which looks at Internet penetration from 1990 for more than 200 countries, and from our own GDP forecasts.

31 Data comes from the Nielsen China Digital Ad Ratings Establishment Survey, Q4 2014–Q1 2015. This survey was fielded via telephone interviews to a representative sample of 46,000 Chinese consumers across 30 provinces and 317 cities. More recent data from the China Internet Network Information Centre confirms that Internet and smartphone penetration continue to rise.
CONCLUSION

Shifts to monitor

The projections in this report are built on current assumptions about how the Chinese economy and government policy will evolve over the decade. Here, we highlight four assumptions and the associated uncertainties that business leaders should monitor.

The most important concerns the level of GDP growth. It is clear that this has slowed, though views vary on how much slower it might become. We see GDP growth declining to an average of 3.6% a year from 2020 to 2025. That is a conservatively low projection, but one that could still prove to be overly optimistic. If it is, the pace of consumption growth forecast in this report will be lower, too.32

A second uncertainty is the growth rate of Internet penetration, which also underpins consumption growth. Our projections and stated government targets suggest rising Internet penetration, while the government’s Internet Plus initiative implies it is committed to building the necessary infrastructure. However, much can change in the coming decade.

The third uncertainty is how quickly the household financial-services sector develops, which in turn depends upon how quickly a regulatory framework develops to support more sophisticated banking products, credit cards and consumer loans. China’s consumer financial-services sector remains underdeveloped, given the size of the economy, but there are signs that it may now evolve quickly, enabled in part by online and mobile technologies. Companies outside the banking sector, most famously Alibaba, which are driving these changes, stand to benefit from increased consumer access to borrowing and electronic methods of payment, as regulators continue to allow more private-sector participation in these activities. But there is a long way to go, and the enduring support of government regulators is far from certain.

Finally, the policy environment in which all businesses operate is uncertain. The government’s “new normal” rhetoric has replaced the goal of attaining a global standard of affluence with the more modest one of a “moderately prosperous society.” And it has become clear that China’s leaders are putting most of their effort into engineering state-led solutions to China’s most pressing economic problems, at least for the time being. It is less clear, however, whether policy makers intend to emphasize consumption-led economic growth and how this would be achieved. The broad policy changes that could occur are

32 A full discussion of the potential negative shocks the Chinese economy may be subject to is beyond the scope of this report. The Conference Board’s China Center for Economics and Business tracks the issue on a weekly basis, and their resources can be explored at the China Center’s website, https://www.conference-board.org/chinacenter/.
manifold, and describing them in full is beyond the scope of this report. They include strengthening social-welfare programs, hukou reforms to enable labor mobility, and subsidies to increase urban-housing affordability.

The environment for businesses is thus far from clear and is likely to remain unclear for the foreseeable future. While many in government might favor a consumption-driven growth model, there is a prevailing ideological pillar that would resist seeing the proceeds of increasing consumption flow disproportionately to foreign brands. This concern, we believe, explains the increase in the number of regulations now being applied to many foreign companies in China.

A road map for selecting investment priorities over the next decade

This report can help guide executives amid this uncertainty. Business leaders as well as policy experts are looking to Chinese consumers to play a bigger role in driving the nation’s economic growth. We believe they will, though only slowly. Consumption will grow by 5.2% a year between now and 2025, which is slower than in the past 15 years but faster than projected GDP growth. As a result, consumption’s share of GDP will rise from 36.6% to 41.5% with annual per capita consumption reaching nearly 28,000 yuan ($4,400) by 2025. This level of consumer spending is still relatively low, but it is a dramatic improvement.

Nonetheless, the economic slowdown, coupled with increasing competition and increasingly sophisticated consumers, means it will be hard for MNCs and large local firms alike to make sound investment decisions. What they need is a road map with the central purpose of guiding geographic decisions: Where to go first, where to go next? Follow-up questions will be, What is the appropriate, risk-adjusted pace of expansion, and who and what will be the growth opportunity in each location?

The most commonly used map of China’s urban landscape to date has been the tier system. But this official classification of cities has been woefully inadequate as a basis for making these critical decisions. Our City Strata framework is a finely segmented and far more relevant replacement that can be updated as economic and business conditions evolve.

Whether companies are long-time players in the market or new entrants, and whatever their goal, they should find the framework to be a helpful guide, though their strategies will vary. Those looking to emulate Nestlé and Yum! Brands, for instance, will seek to travel far and wide. They might start in a few big cities but quickly build from there. Those taking Disney or Apple as their example will make selective investments in retail and service infrastructure in a small number of cities.

Yet overall, we believe the opportunities for geographic expansion are shallower than some business leaders might think. The 40 cities that make up the top three city strata—Super Cities, Affluent Cities and Satellite Cities—offer the best opportunities for most companies. The majority of companies will start and finish their journeys within this group because it will not make sense to go further, at least not for the next 10 years. Some companies will consider the fourth-ranked Regional International Cities. Only a few that are already deeply penetrated in China will pursue the fifth-ranked Integrated Industrial Cities. Companies that are in particular industries, such as tourism, or that have well-established distribution systems might find it beneficial to venture into cities even lower down the hierarchy. But while poorer cities will begin to converge economically with those in the higher echelons, they should be approached with caution. And even within the top strata, there are wide variations in potential. Businesses should therefore proceed carefully, weighing cities one by one and considering their own tolerance for risk.

The framework can help business decisions beyond acting as a basis for targeting consumption growth. It can also guide decisions on where to invest in production, as the industrial structure of a city will shape the skills of the working-age population in the region, while the transportation infrastructure will determine the efficiency of production-related logistics and distribution.
Having used the framework to decide where to direct investment, companies must then decide at whom to focus their reach. We have shown that the notion of a middle class, in the context of China, is inadequate as a way of identifying the group of consumers who will lead consumption growth. Instead, we have delineated a category of consumers who are ready to spend beyond their basic necessities and who can access and engage with modern consumer markets through the Internet. This group of Connected Spenders will constitute almost half the population by 2025, according to our projections.

Connected Spenders are not, by any means, all high earners living in China’s Super cities. They are to be found in all strata, although they will remain concentrated at the upper levels for the time being. Their median monthly income is about 8,500 yuan ($1,360), and 13% of them report monthly household income of less than 5,000 yuan ($800). Yet they are heavily engaged in discretionary spending. They eat out, buy clothes and affordable luxuries, and take vacations. They save and invest their wealth.

These are the consumers companies should prioritize, though they cannot hope to serve them all. Their presence will help companies decide on a geographic strategy and also which subgroups of Connected Spenders to focus upon. Their needs and desires—which will not be the same as those of middle-income consumers in Western economies and, importantly, which will differ between strata—will dictate how best to serve them.

Thus, just as with their approach to different cities, companies will approach and prioritize Connected Spenders, and subgroups within them, in different ways, depending on their industry, strategy, current penetration and brand portfolio, and resources available for investment.

During the years of booming economic growth, it seemed as if consumer businesses in China could not get much wrong. But the situation has changed, permanently. Today, a far higher degree of strategic precision is needed.

The City Strata and Connected Spender frameworks presented in this report will enhance that precision. They will guide geographic-market selection and customer focus, which in turn will enable more focused marketing communications—critical to differentiating a company’s brand in a more competitive environment and arguably neglected during the boom years.

The frameworks are therefore a platform for taking market planning and development to the higher level now needed for success in China’s marketplace, a marketplace that is exciting, puzzling and uncertain but without doubt a significant growth opportunity.
APPENDIX A

NATIONAL PROSPECTS FOR CONSUMPTION GROWTH THROUGH 2025

We project that total consumption in China will grow more slowly in the future than in recent decades, but that it will still expand at a strong clip of 5.2% a year between 2014 and 2025, rising to 40 trillion yuan ($6.4 trillion) in 2025. That translates to a per capita consumption growth rate of 4.7% a year, to reach almost 28,000 yuan (roughly $4,440) in 2025—growth of 66% from 2014 (16,700 yuan, or $2,670). While this growth is undeniably spectacular, it is coming from a relatively small per capita base and will arguably remain modest compared with most mature markets even by 2025. In comparison, annual US per capita consumption is currently about $32,000.

Importantly, our projections imply only very gradual movement toward consumer-led growth in China, with consumption’s share of nominal GDP set to rise from about 36.6% in 2014 to just over 41% in 2025. This is in line with a recent report by the Demand Institute.33

Consumption growth is driven by two components: household income and household willingness to spend or, conversely, the savings rate. Household income is set to see strong growth, bringing about a major change in living standards, while the savings rate will fall. Our projections are described in detail below.

Household income projections

Aggregate household disposable income,24 according to our projections, will grow by 4.4% a year between 2014 and 2025, from 38.4 trillion yuan ($6.1 trillion) to 61.5 trillion yuan ($9.8 trillion).35 This represents


34 Household disposable income is defined by the Organisation for Economic Co-operation and Development as “the sum of household final consumption expenditure and savings (minus the change in net equity of households in pension funds). It also corresponds to the sum of wages and salaries, mixed income, net property income, net current transfers and social benefits other than social transfers in kind, less taxes on income and wealth and social security contributions paid by employees, the self-employed and the unemployed.” https://data.oecd.org/hha/household-disposable-income.htm

35 All projections are cited in 2013 RMB. Dollar equivalents expressed at a current exchange rate of about 0.16 RMB per US dollar.
total growth of 60% over the decade, equivalent to almost $4 trillion more a year in 2025 than in 2014—strong relative to the global economy.

This income growth will yield a significant change in the standard of living. Real per capita income will rise by 4% a year to about 42,000 yuan ($6,800) in 2025 (up 53% from today’s $4,400).

The most important driver of household income will be overall GDP growth. We use the Conference Board Global Economic Outlook projections of GDP growth in our forecasts.\(^\text{36}\) The outlook shows that GDP growth will decline steadily over the decade to average just 3.6% between 2020 and 2025. If the real outcome turns out to be higher or lower, our income projections would be affected. A slightly lower rate than we have projected, but accompanied by a structural shift toward higher value-added manufacturing and services, would result in a proportionally lower growth rate of household income. A substantially lower rate, reflecting a failure to make this structural change, could have severe effects on household income. The entire economy would be likely to continue losing steam, and capital outflows could increase further. If the government chose to respond by fueling capital investment in infrastructure and lower value-added manufacturing, household income might actually grow more slowly than GDP. A “middle-income trap” could occur, with serious consequences for consumer-facing businesses.

On balance, we expect the most likely outcome to be a modest increase in household income as a share of GDP—from 60.8% in 2014 to 63.5% in 2025. The change will be determined by growth in the four main components of household income: wages, household business income (rural and urban), transfer income from the government, and investment income from real estate, equities and other capital.\(^\text{37}\) We project the mix of these components will change over the next decade, with slower growth in wages and rural-household business income, and faster growth in urban-household business income, transfer income and investment income.

Wages, the largest component, will fall slightly as a share of GDP, from 27.3% in 2014 to 26.7% in 2025. Average wages will rise, but total employment will decline. A move away from agriculture and commoditized manufacturing toward the service sector and higher-value-added manufacturing would seem to indicate an increase in formal employment. But we expect the size of the employed labor force to decrease because of aging and the introduction of automation, and there will be some degree of productivity growth. The only way we can see for wages’ share of GDP not to fall would be if the service sector were to grow faster than expected, as services are relatively labor intensive. This would require substantial market liberalization and regulatory reform. At present, this does appear to be the direction the Chinese leadership is taking.

The second-most-important component of income is household business income, which is mostly earned by small businesses, including self-employment and family businesses in rural and urban areas. Overall, we believe that household business income as a share of GDP will increase very slightly, from about 27.7% in 2014 to 27.9% in 2025. The rural portion will fall as urbanization continues and agriculture’s share of the economy dwindles, from 7.5% of GDP in 2014 to 5.6% in 2025. Meanwhile the urban portion will rise, from 20.2% to 22.3%. But although self-employment and family businesses will continue to move to urban areas (the United Nations projects that the share of households living in urban areas will rise from 54% to 65% over the decade), it will not be enough to offset the weakening in small-business income in rural areas.\(^\text{38}\)

Our projections of urban-household business income contain two caveats. If business income is underreported, its share of the economy and its growth could be higher than we project. And if urbanization is slower than anticipated by the United Nations, or if it has less impact on business because a smaller share of people moving to cities will be of working age, growth in urban-household business income could be lower than we project. There is evidence that the movement of labor to urban areas has already largely occurred and that any further urbanization will occur among older and younger populations, who are less likely to be part of the labor force.


37 Population growth plays little role in determining household income’s share of GDP in the next decade, because the total population is barely projected to change.

38 Our projections of urban-household business income contain two caveats. If business income is underreported, its share of the economy and its growth could be higher than we project. And if urbanization is slower than anticipated by the United Nations, or if it has less impact on business because a smaller share of people moving to cities will be of working age, growth in urban-household business income could be lower than we project. There is evidence that the movement of labor to urban areas has already largely occurred and that any further urbanization will occur among older and younger populations, who are less likely to be part of the labor force.
Over and above domestic migration to urban areas, there are policy signals from the central government favoring small-business ownership, such as Premier Li Keqiang’s “mass entrepreneurship” call to action and his encouragement of individual proprietorship enterprises. Anecdotal evidence suggests that young urbanites are responding, particularly in the realm of individually operated e-commerce ventures.

With respect to transfer income, we project rises in both net transfer income and unearned income as a share of GDP. Net transfer income will rise from 2.9% of GDP in 2014 to 3.9% in 2025, driven by the rise in the population aged 65 and older and their attainment of social-security income support. The fiscal viability of social-security funding could affect the path of net transfer income in the next decade and beyond, however. A report from the Chinese Academy of Social Sciences forecasts that outflow from the fund will exceed inflow by 2023; thus, the government may need to increase spending. That would be likely to lead to tax increases and so could have a net downward effect on aggregate disposable income’s share of GDP, even as net transfer income’s contribution to overall income rises.

Household investment income as a share of GDP, while small, is expected to rise from 2.8% in 2014 to 4.9% in 2025. The main assumption underpinning this projection is that real household interest rates will be allowed to increase so that households can earn a small return above inflation, in contrast to some recent years when households’ real interest rates on savings were negative. Real interest rates for consumer savings have already moved into positive territory. Households also find other ways to earn a return on savings, through property investment, trust and wealth management products that fall outside the formal banking sector, and overseas investments, although all these are likely to be limited to a small set of highly affluent households. We should note that the 2015 volatility in the Shanghai A-share market does not materially affect our projections, because the vast majority of consumers have no direct exposure to the stock market.

**Household savings projections**

China’s savings rate is remarkably high: 39.7% of household disposable income in 2014, up from 29.8% in 1999. There are a few main explanations:

**Industrial development.** The government’s investment-led economic strategy required that national savings be channeled into industry. Consumer spending was not encouraged, as household savings were needed to support development. If the economy moves to more consumer-led growth (unlikely in the near term), the savings rate is expected gradually to fall.

**The social safety net.** The government has instituted a more substantial social safety net in recent years, including pension and health care provisions, but the focus has been on urban residents who comply with the hukou system. Households in rural areas or living outside the hukou system do not have the same access to benefits. So far, the aggregate savings rate has not fallen, as households have continued to save for precautionary purposes, including retirement, care of elderly parents, health care, loss of income due to unemployment or disability, and education. A modest improvement in public and private provision of services through remittances and insurance might free some household income for spending. But the overall fiscal burden placed on the central government by its multiple current economic rescue missions makes meaningful increases in social spending unlikely.

**Demographic features.** China’s birth rate has been artificially low for decades, owing to the one-child policy, and its population has aged more quickly compared with other countries at the same point of development. At a macroeconomic level, both features are believed to contribute to a higher savings rate. Policies to encourage childbearing as well as an improved social safety net could alleviate their effect, although initial results show almost no movement on birth rates.

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We project that the national household savings rate will fall from 39.7% to 34.6% over the decade. Our model identifies seven main factors and their percentage contribution to this decline (a research methodology appendix is available on request):

*Access to borrowing capacity and related financial services (27%).* Access to creditcards, consumer loans, and checking and savings accounts that offer overdrafts and other loan products is associated with lower savings rates. Adjustments to policies on home-equity borrowing, which currently require full mortgage repayment before consumer borrowing is permitted, could free some household capital.

*Urbanization (25%).* Urbanization will continue, but its impact on income and savings might decline. This is because the working-age population's share of those migrating to urban areas may be lower in the future. The changes to migrants' income and savings habits would therefore be more muted than in the past.

*Growth in middle income households (17%).* When households reach a certain level of income, they tend to save more, because as income rises, the need to spend does not increase as quickly. The trend does not translate into higher aggregate savings, though, as two forces change over time. One is prices: as household incomes rise, so generally do consumer prices, dampening or even canceling the effect of rising income on purchasing power (and on the capacity to save more). The second is relative income. Income inequality in China is high by global standards. Over the next decade, we expect to see growth in the share of middle-income households, alongside partial convergence among regions (see sidebar “Partial convergence”). Rising levels of education and increasing reliance on services and higher-value-added manufacturing will be the drivers. Middle-income households tend to save less than the most affluent households; thus, the overall result will be downward pressure on aggregate household savings.

*Access to public support and private insurance (13%).* Lack of social support for health care and retirement has contributed to high savings rates. As private and public alternatives to individual savings become more available, the savings rate will decline.

*Education (8%).* More highly educated households save less. Exposure to Western consumer culture moves consumers away from traditional values favoring saving and relative austerity. Educated workers are also likely to have more faith in their future earning capacity.

*Demographic factors (6%).* The effect of demographic change will be relatively small. A higher birth rate, a rise in the share of households with a retired person, and a projected fall in the share of married households will all depress savings.

*Internet penetration (4%).* Internet penetration is forecast to rise from just under 50% today to 75% by 2025 (see sidebar “Rising Internet access in China”). We believe its effect on spending will touch a wide range of consumer categories.

As with our projections of household income, the projected savings rate relies on relatively strong, if gradually declining, growth. If the economy slows abruptly, the fall in the savings rate could be arrested or even erased, as consumers' need for savings would be reinforced. Potential government actions that could create uncertainty around property rights and privacy, such as a proposed Social Credit Scoring System that allows the monitoring of consumers’ spending behavior, could also work against their willingness to spend.
APPENDIX B

CITIES OF EACH CITY STRATUM

(LISTED IN ALPHABETICAL ORDER BY PROVINCE: CITY)

Super Cities: 6

Beijing
Chongqing
Guangdong: Guangzhou
Guangdong: Shenzhen
Shanghai
Tianjin

Affluent Cities: 21

Fujian: Fuzhou
Fujian: Xiamen
Fujian: Quanzhou
Guangdong: Dongguan
Guangdong: Foshan
Hubei: Wuhan
Jiangsu: Changzhou
Jiangsu: Nanjing
Jiangsu: Nantong
Jiangsu: Suzhou
Jiangsu: Wuxi
Liaoning: Dalian
Shandong: Qingdao
Shandong: Weifang
Shandong: Yantai
Sichuan: Chengdu
Zhejiang: Hangzhou
Zhejiang: Jiaxing
Zhejiang: Ningbo
Zhejiang: Shaoxing
Zhejiang: Wenzhou

Satellite Cities: 13

Guangdong: Huizhou
Guangdong: Quanzhou
Guangdong: Shantou
Guangdong: Zhongshan
Guangdong: Zhuhai
Jiangsu: Taizhou
Jiangsu: Yangzhou
Jiangsu: Zhenjiang
Shandong: Weihai
Zhejiang: Jinhua
Zhejiang: Taizhou
Zhejiang: Zhoushan

Regional International Cities: 9

Guangxi: Nanning
Guizhou: Guiyang
Heilongjiang: Harbin
Inner Mongolia: Hohhot
Shaanxi: Xian
Shandong: Jinan
Tibet: Lhasa
Xinjiang: Urumqi
Yunnan: Kunming
Integrated Industrial Cities: 30

- Anhui: Hefei
- Anhui: Maanshan
- Guangxi: Beihai
- Guangxi: Fangchenggang
- Guangxi: Liuzhou
- Gansu: Jiayuguan
- Hebei: Qinhuangdao
- Hebei: Shijiazhuang
- Hebei: Tangshan
- Heilongjiang: Daqing

- Henan: Luoyang
- Henan: Zhengzhou
- Hunan: Changsha
- Hunan: Yueyang
- Hunan: Zhuzhou
- Inner Mongolia: Baotou
- Inner Mongolia: Erdos
- Jilin: Changchun
- Jiangsu: Huai'an
- Jiangxi: Nanchang

- Jiangsu: Xuzhou
- Jiangsu: Yangzhou
- Liaoning: Shenyang
- Liaoning: Anshan
- Liaoning: Yingkou
- Shandong: Dongying
- Shandong: Linyi
- Shandong: Zibo
- Shanxi: Taiyuan
- Xinjiang: Karamay

Inland Core Cities: 52

- Anhui: Huainan
- Anhui: Wuhu
- Anhui: Xuancheng
- Fujian: Longyan
- Fujian: Sanming
- Gansu: Jiuquan
- Gansu: Lanzhou
- Guangdong: Chaohou
- Guangdong: Jieyang
- Guangdong: Shanwei
- Guizhou: Liupanshui
- Guizhou: Zunyi
- Hebei: Baoding
- Hebei: Chengde
- Hebei: Handan
- Hebei: Langfang
- Henan: Xinxiang
- Henan: Xuchang

- Henan: Sanmenxia
- Hubei: Jingmen
- Hubei: Shiyan
- Hubei: Xiangyang
- Hunan: Changde
- Hunan: Hengyang
- Hunan: Xiangtan
- Inner Mongolia: Hulunbeier
- Jiangsu: Lianyungang
- Jiangxi: Yingtan
- Jilin: Songyuan
- Liaoning: Benxi
- Liaoning: Dandong
- Liaoning: Liaoyang
- Liaoning: Tieling
- Ningxia: Yinchuan
- Qinghai: Xining

- Shaanxi: Baoji
- Shaanxi: Xianyang
- Shaanxi: Yanan
- Shandong: Dezhou
- Shandong: Jinan
- Shandong: Liaocheng
- Shandong: Rizhao
- Shandong: Taian
- Shanxi: Datong
- Shanxi: Jincheng
- Sichuan: Deyang
- Sichuan: Mianyang
- Sichuan: Panzhihua
- Sichuan: Ya'an
- Sichuan: Zigong
- Zhejiang: Quzhou

Resource-Exhausted Cities: 26

- Anhui: Huaibei
- Anhui: Tongling
- Gansu: Baiyin
- Gansu: Jinchang
- Guangdong: Shaoguan
- Heilongjiang: Hegang
- Heilongjiang: Qitaihe
- Heilongjiang: Shuangyashan
- Heilongjiang: Yichun

- Henan: Jiaozuo
- Henan: Pingdingshan
- Henan: Puyang
- Hubei: Huangshi
- Inner Mongolia: Wuhai
- Jiangxi: Jingdezhen
- Jiangxi: Pingxiang
- Jiangxi: Xinyu
- Jilin: Baishan

- Jilin: Liaoyuan
- Liaoning: Fushun
- Liaoning: Fuxin
- Liaoning: Panjin
- Ningxia: Shizuishan
- Shaanxi: Tongchuan
- Shandong: Zaozhuang
- Sichuan: Luzhou
### Tourism Cities: 8

- Anhui: Chizhou
- Anhui: Huangshan
- Guangxi: Guilin
- Hainan: Haikou
- Hainan: Sanya
- Hunan: Zhangjiajie
- Yunnan: Lijiang
- Zhejiang: Lishui

### Modern Agricultural Cities: 22

- Anhui: Bengbu
- Fujian: Nanping
- Guangdong: Maoming
- Guangdong: Yangjiang
- Guangdong: Zhanjiang
- Guangxi: Guigang
- Heilongjiang: Jixi
- Heilongjiang: Mudanjiang
- Heilongjiang: Qiqihar
- Henan: Kaifeng
- Henan: Nanyang
- Henan: Zhoukou
- Hubei: Huanggang
- Hubei: Jingzhou
- Hubei: Suizhou
- Hubei: Xianning
- Hubei: Xiangfan
- Jilin: Siping
- Sichuan: Guangan
- Sichuan: Ziyang

### Frontier Cities: 56

- Anhui: Anqing
- Fujian: Putian
- Fujian: Zhangzhou
- Gansu: Qingyang
- Guangdong: Heyuan
- Guangdong: Qingyuan
- Guangdong: Zhaoqing
- Guangxi: Wuzhou
- Guizhou: Anshun
- Hebei: Cangzhou
- Hebei: Hengshui
- Hebei: Xingtai
- Hebei: Zhangjiakou
- Henan: Anyang
- Henan: Hubei
- Henan: Luohe
- Hubei: Ezhou
- Hunan: Chenzhou
- Hunan: Huaihua
- Hunan: Loudi
- Inner Mongolia: Chifeng
- Inner Mongolia: Tongliao
- Inner Mongolia: Wulanchabu
- Jiangsu: Suqian
- Jiangxi: Fuzhou
- Jiangxi: Ganzhou
- Jiangxi: Jian
- Jiangxi: Jiujiang
- Jiangxi: Shangrao
- Jiangxi: Yichun
- Jinlin: Baicheng
- Jinlin: Jilin
- Jinlin: Tonghua
- Liaoning: Huludao
- Liaoning: Jinzhou
- Ningxia: Wuzhong
- Ningxia: Zhongwei
- Shaanxi: Ankang
- Shaanxi: Shangluo
- Shaanxi: Weinan
- Shaanxi: Yulin
- Shanxi: Changzhi
- Shanxi: Jinzhong
- Shanxi: Linfen
- Shanxi: Luliang
- Shanxi: Shuozhou
- Shanxi: Xinzhou
- Shanxi: Yangquan
- Shandong: Binzhou
- Shandong: Heze
- Shandong: Laiwu
- Sichuan: Leshan
- Sichuan: Meishan
- Sichuan: Neijiang
- Sichuan: Yibin
- Yunnan: Yuxi
Traditional Agricultural Cities: 43

Anhui: Bozhou
Anhui: Chuzhou
Anhui: Fuyang
Anhui: Lu’an
Anhui: Suzhou
Fujian: Ningde
Gansu: Dingxi
Gansu: Longnan
Gansu: Pingliang
Gansu: Tianshui
Gansu: Wuwei
Gansu: Zhangye
Guangdong: Meizhou
Guangdong: Yunfu
Guangxi: Baise
Guangxi: Chongzuo
Guangxi: Hechi
Guangxi: Hezhou
Guangxi: Laibin
Guangxi: Qinzhou
Guangxi: Yulin
Heilongjiang: Suihua
Henan: Shangqiu
Henan: Xinyang
Henan: Zhumadian
Hunan: Shaoyang
Hunan: Yiyang
Hunan: Yongzhou
Inner Mongolia: Bayannaoer
Liaoning: Chaoyang
Ningxia: Guyuan
Shaanxi: Hanzhong
Shanxi: Yuncheng
Sichuan: Bazhong
Sichuan: Dazhou
Sichuan: Guanyuan
Sichuan: Nanchong
Sichuan: Suining
Yunnan: Baoshan
Yunnan: Lincang
Yunnan: Qujing
Yunnan: Puer
Yunnan: Zhaotong