

## The Economic Downturn and the Chinese Consumer: *Opportunities for Companies That Leverage Consumer Understanding*

### China is not immune.

China has experienced nearly two decades of torrid economic growth, with annual GDP increases around ten percent from 1990 to 2008. It emerged quickly and relatively unscathed from the Asian financial crisis as well as from SARS. It is clear now, however, that China is not immune from the current global downturn. Forecasts for GDP growth have been continually revised downwards since late last year, and the latest consensus appears to have settled in the five to eight percent range for 2009.

The engine of economic growth in China had been heavily dependent on investment and export-driven industries, with domestic consumption contributing only about 35%-40% to GDP in recent years, compared to about two-thirds in the United States. The Chinese consumer has gotten a lot more attention recently, however. Speculation abounds on

whether domestic consumption will be able to back-fill for the slowdown in exports, and whether the rural stimulus package will have any real effect.

L.E.K. has recently conducted a proprietary study along with CTR<sup>1</sup> on a demographically and geographically balanced set of consumers to reveal deeper insights on how Chinese consumers have fared during the last year, their hopes and aspirations about the future, how shopping patterns have changed, and how individual product categories are impacted. By implication, this provides consumer product companies, retailers, as well as financial investors with information that allows them to more confidently formulate strategies in this unprecedented environment.

As expected, consumer confidence is low and as of January 2009 has matched historical lows (see *Figure 1*). Furthermore,

based on our research, this downturn has materially impacted consumers' incomes. More than one-third of consumers surveyed reported decreases in family income. Not surprisingly, the impact was most strongly felt in our survey city of Zhongshan, in the heart of China's export base.

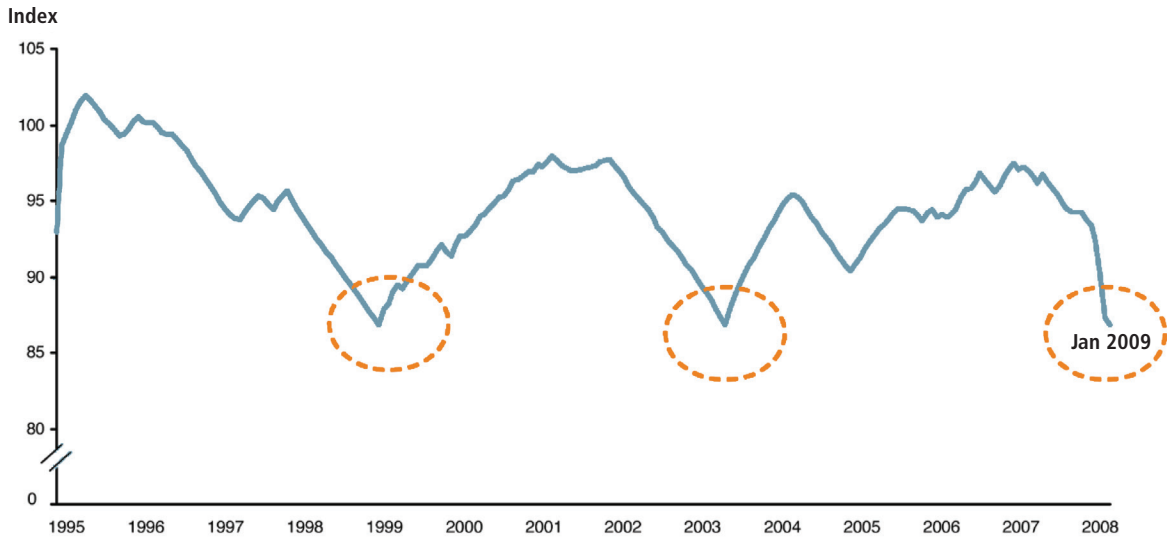
Despite this, however, Chinese consumers remain as a whole relatively optimistic. Fewer than 20% of those surveyed indicate that they are pessimistic about their family prospects, whereas 36% are either optimistic or very optimistic – a statistic that would make many leaders of developed nations envious. Furthermore, the amount of spending has not changed much – nearly 80% of consumers have either maintained or increased their consumption. On the downside, Chinese consumers on average expect that this downturn will last 2.2 years – well into 2011.

1. CTR is a leading domestic consumer research firm

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**Figure 1**

Consumer Confidence Index Evolution in China (1995-2008)



Source: National Bureau of Statistics of China, AC Nielsen, L.E.K. analysis

### Opportunities in Product Categories

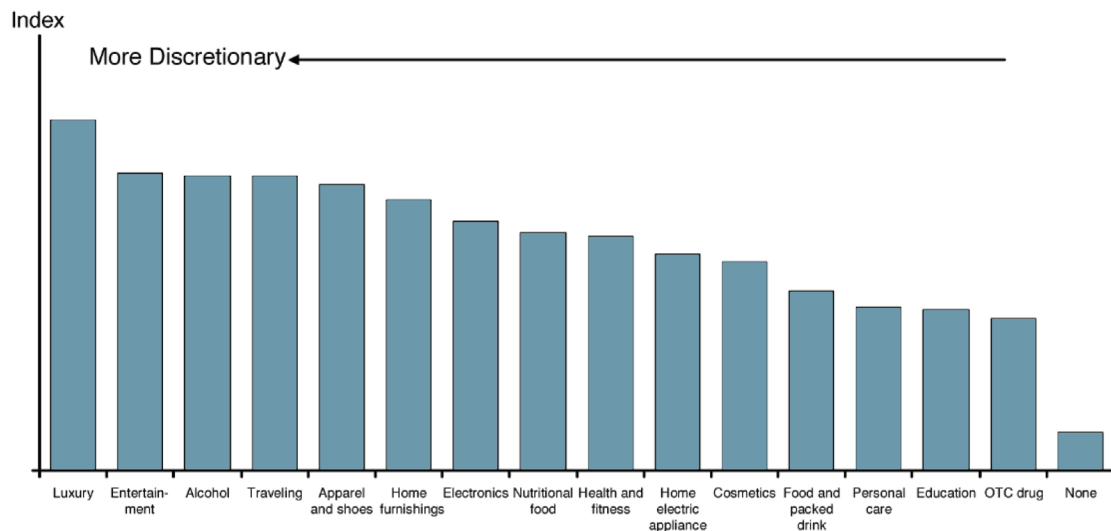
Translating the general into the specific, what products are likely to do well in a downturn? Unsurprisingly, luxury products

and entertainment would fare badly, as these would be the first items consumers decrease spend on if their incomes decreased. However, our research shows that OTC drugs, education-related expenses, and personal-care items would all fare very well (see *Figure 2*).

In fact, our research shows that consumers whose incomes have decreased have actually spent more on cosmetics (such as using lipstick as an affordable treat) and education (hoping for a better life for their children).

**Figure 2**

Items to Be Purchased Less if Income Decreased



Source: CTR research, L.E.K. analysis

For other products, the opportunities may be more subtle but just as powerful if brand owners can understand their consumer and identify and leverage competitive differentiators. Some examples that emerged from our research include:

- Core consumers of **alcoholic beverages** are generally younger and have higher incomes, but among older consumers alcohol is seen as less discretionary. Core consumers have come to value quality and brand, more so than price. This allows brand owners to fine-tune their marketing and pricing strategies towards different consumer groups.
- Older consumers view **nutritional supplements** as most non-discretionary (intuitive) but so do consumers in third-tier cities (perhaps not so intuitive); brand owners may consider adjusting their investment mix or focus to capitalize on this.
- A higher proportion of males are purchasers of **home furnishings** than females. After-sales service has been the most important purchase criteria and has become even more important since the downturn. What this means in terms of advertising message and levels of after-sales service required is something for retailers to consider.

In terms of channel, **overseas** and **internet purchases** have increased greatly, at the expense of brand stores. **Hypermarkets** and **supermarkets** have also gained shopping frequency. The increasing availability of modern trade and changing consumer tastes are already shifting purchasing channels for many products.

For example, OTC purchases are shifting away from hospital dispensaries to chained pharmacies, and on-trade consumption of alcoholic beverages is increasing faster than off-trade in certain regions.

This may be a good time to assess the distribution system for consumer products companies to make sure channel coverage is in line with market trends.

**Chinese consumers do feel the impact** of the economic downturn, and despite the relatively low levels of consumer confidence, spending appears to be holding up. Spending pattern and channel changes impact product categories differently, and armed with the right data and consumer insight, companies can gain a competitive edge in this market.

### These are turbulent times for retailers, consumer products companies, and financial investors, and L.E.K. can help you navigate through them.

L.E.K. works with a broad spectrum of retailers, consumer products companies, and financial investors on their most important challenges, including:

- Growth/expansion strategy
- Market entry strategy
- Channel strategy
- Pricing strategy
- Operational issues

For more information, including an in-depth look at our research findings, please contact Lana Guo at +86-21-6122-3900 or l.guo@lek.com.

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