Deloitte.

China's Consumer Market: Opportunities and Risks

A Deloitte Research Study

Table of Contents

About Deloitte Research

Deloitte Research, a part of Deloitte Services LP, identifies, analyzes, and explains the major issues driving today's business dynamics and shaping tomorrow's global marketplace. From provocative points of view about strategy and organizational change to straight talk about economics, regulation and technology, Deloitte Research delivers innovative, practical insights companies can use to improve their bottom-line performance. Operating through a network of dedicated research professionals, senior consulting practitioners of the various member firms of Deloitte Touche Tohmatsu, academics and technology specialists, Deloitte Research exhibits deep industry knowledge, functional understanding, and commitment to thought leadership. In boardrooms and business journals, Deloitte Research is known for bringing new perspective to real-world concerns.

Introduction

The period 2005-07 could be an important turning point for China's consumer market. Several things will happen or may happen that would hasten the further development of a modern consumer sector. These include the following:

- The end of restrictions on foreign investment in China's distribution sector
- Increased interest on the part of foreign retailers in China's retail sector
- A possible revaluation of the Chinese currency
- Efforts by the Chinese government to shift the sources of economic growth away from investment and exports and toward consumer spending
- Accelerated reform of China's banking system resulting in a bigger and more efficient market for consumer credit
- Tightening of the consumer credit market following a high default rate on automotive loans
- A possible collapse of residential property prices
- Forced consolidation of Chinese retailing companies

Most of these events would have the effect of accelerating the growth of consumer spending, accelerating the modernization of retail distribution, increasing the importance of consumer finance, and increasing the importance of China's consumer market to global retail and consumer product companies. Some, however, would have a deleterious effect on modernization of the sector.

In this report, Deloitte Research considers the changing consumer business environment in China. We offer our predictions about the evolution of the Chinese consumer market as well as the likely strategic implications for global consumer oriented companies.

The consumer economy

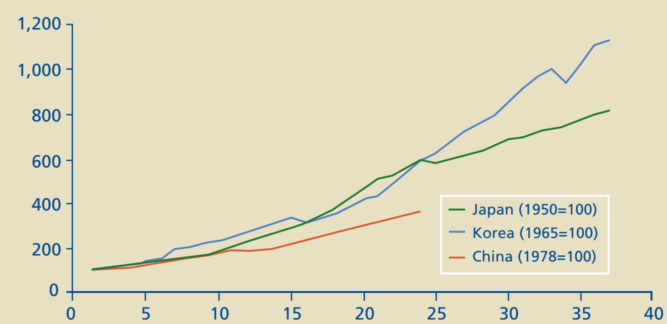
In the past decade, the Chinese economy has grown at an extremely rapid pace resulting in a huge increase in the number of middle class consumers. Hence the current interest in China's burgeoning consumer market. Going forward, the long-term economic future for China appears bright. There are good reasons to believe that China's rapid growth can be sustained for several decades. The result could be a country with a large number of affluent and middle income consumers.

Why is the outlook positive? The answer is that China is in a position similar to that of Japan and Korea in past decades. That is, China is catching up to the world's rich countries by investing in new capacity, adopting modern technologies, and consequently rapidly increasing the productivity of its workers.

In the past, Japan and Korea accomplished this "catch up" process through massive investment in productive capacity. They were able to do this by tapping into a vast reservoir of domestic savings. Moreover, unlike some other high savings countries that failed to catch up, Japan and Korea focused their efforts on developing the capacity to export. In so doing, they forced domestic companies to be sufficiently efficient to compete globally. In the case of China, it too has invested massively in exporting capacity. In the process, it has created huge gains in productivity, thereby enabling incomes to rise rapidly. As in the case of Japan and Korea, this process can be expected to endure for decades.

Yet interestingly, although China's investment spending has actually exceeded Japan and Korea as a share of GDP, its economic growth has been lower than those two countries during their catch-up phases. It thus appears that China's investment money has not been well spent. This is not surprising. A large part of China's massive investment has involved expansion of state-owned enterprises which are notoriously inefficient and unprofitable. China's efficient investment has mostly come from foreign companies which created vast exporting capacity.

Exhibit 1. Economic Growth During Takeoff
GDP Following Takeoff Where 100=Year of Takeoff



Source: World Bank

In the near future, China's government will accelerate the process of privatizing state-owned companies as well as allowing greater foreign involvement in China's domestic sector. In so doing, it should enable investment to become more efficient. Thus, China should be able to grow even more rapidly in the future.

On the other hand, there are two important risks associated with China's long-term growth. First, in order to sustain rapid growth, China must make a further transition to a more market oriented economy. That transition is laden with risks. These include managing the transition away from export oriented growth, difficulties associated with reforming the financial sector, social dislocation from privatization of state-owned enterprises, managing the vast migration of people from rural to urban locations, and avoiding asset price bubbles along the way.

Second, long-term growth will necessarily entail China consuming a much larger share of the world's natural resources. Already this process has had a profound impact on global commodity prices as well as a severely negative impact on China's environmental quality. Although long-term growth will require more efficient usage of resources, it will probably have a permanent effect on global commodity markets. This, in turn, will have geopolitical ramifications. The manner in which China and the rest of the world manage this process will affect growth and stability. Indeed China has already begun to scout the world in search of secure sources of oil and other commodities.

Consumer spending

In 2003, total consumer spending in China was 9.2 trillion renminbi (US$1.1 trillion) of which roughly 41% was spent on food. That was down, however, from 48% in 1997. Such a decline is to be expected when an emerging country economy grows thereby leading to greater discretionary spending power. Thus during that six year period the share of consumer spending going to food and apparel declined, while most other categories increased their share of spending. These included medicine and healthcare, transportation, telecoms, education, housing, and entertainment.

The strong growth in overall consumer spending was due to rapid economic growth of 9% per year resulting in substantially increased household income. From 1997 to 2003, per capita disposable income of urban Chinese increased 64.2% while per capita spending of urban residents rose 55.5%. During that same period, total consumer spending in China rose 64.2%.

Exhibit 2. Consumer spending in China, 2003

Billions RMB, current prices	1997	1998	1999	2000	2001	2002	2003	% Chg 1997-2003
Food	2,683.6	2,755.5	2,845.3	3,029.3	3,325.6	3,487.0	3,789.1	41.2%
Medicine and healthcare	213.0	254.6	300.4	355.9	400.9	455.3	506.4	137.8%
Clothing and footwear	785.0	749.9	727.5	790.6	865.6	884.5	957.5	22.0%
Household durable goods	413.8	484.8	569.3	594.9	656.8	727.3	789.6	90.8%
Transport and communication	289.9	336.9	385.3	436.8	498.0	553.8	614.0	111.8%
Education and entertainment	550.0	643.1	739.2	837.4	945.2	1,056.6	1,170.4	112.8%
Housing	423.6	507.4	598.5	662.9	752.4	842.1	930.5	119.7%
Services	244.3	268.4	296.4	329.6	366.7	400.4	440.5	80.3%
TOTAL	**5,603.2**	**6,000.7**	**6,461.9**	**7,037.3**	**7,811.2**	**8,406.9**	**9,198.0**	**64.2%**
Consumer spending share of total								
Food	47.9%	45.9%	44.0%	43.0%	42.6%	41.5%	41.2%	
Medicine and healthcare	3.8%	4.2%	4.6%	5.1%	5.1%	5.4%	5.5%	
Clothing and footwear	14.0%	12.5%	11.3%	11.2%	11.1%	10.5%	10.4%	
Household durable goods	7.4%	8.1%	8.8%	8.5%	8.4%	8.7%	8.6%	
Transport and communication	5.2%	5.6%	6.0%	6.2%	6.4%	6.6%	6.7%	
Education and entertainment	9.8%	10.7%	11.4%	11.9%	12.1%	12.6%	12.7%	
Housing	7.6%	8.5%	9.3%	9.4%	9.6%	10.0%	10.1%	
Services	4.4%	4.5%	4.6%	4.7%	4.7%	4.8%	4.8%	
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	

Note: exchange rate is 8.28 RMB per US Dollar
Source: Access Asia

Living conditions

The shift in spending toward discretionary items and services was related to a shift in living conditions that resulted from a bigger economy. For example, during the period 1997 to 2003 per capita urban residential space rose 33.1% from 17.8 square meters to 23.7 square meters. This was due to a vast increase in the housing stock, with newer homes tending to be larger than in the past. It also was due to a reduction in average household size. As homes got larger and incomes rose, people could afford to purchase more durable products and had more space in which to store them.

Interestingly, even relatively poor households enjoyed the fruits of economic growth. For example, the share of urban households with access to tap water increased from 61.2% in 1997 to 86.2% in 2003. Rural households also experienced an increase in incomes and living standards. The share of rural households with color televisions rose from 27.3% in 1997 to 67.8% in 2003.

Not only did current living conditions improve, but prospective conditions improved as well. That is, the share of young Chinese obtaining high levels of education rose substantially, thereby increasing expected future earning power. From 1997 to 2003, the share of the population attending universities roughly doubled. Thus the next generation of urban adults will be composed of many more skilled, middle income workers. The expectation of future wealth will raise the confidence of young consumers and, perhaps, make them more willing to spend.

Ownership of durables

China's urban consumers now possess many of the toys common to developed country households. This represents a dramatic change from just a few years ago. For example, in 2003 27.8% of urban households owned a personal computer, up from 2.6% in 1997. In addition, by 2003 there were 269 million mobile telephone subscribers in China, up from 24 million in 1998. Finally, internet usage has grown enormously. In 2003, 79.5 million Chinese households had internet access, up from 2.1 million in 1998. By mid 2004, there were 87 million internet users, a dramatic increase.

More common household electronics and appliances have been ubiquitous for somewhat longer. Since the mid 1990s, most urban households have possessed color televisions, washing machines, and refrigerators. Yet rural household ownership of such products has been growing rapidly.

Thus a large number of Chinese consumers are technologically up-to-date and have access to vast amounts of technological and cultural information. These consumers, mostly young, are growing in number, are experiencing the preponderance of income growth in China, and are the most important target market for global companies interested in China. Notably, many are starting to enjoy the freedom of automobile ownership.

Exhibit 3. Living conditions in China

	1989	1997	2002	2003	% Chg 1997-2003
Per capita urban residential space (sq m)	13.5	17.8	22.8	23.7	33.1%
Annual per capita disposable income of urban residents (RMB)	1,374	5,160	7,703	8,472	64.2%
Annual per capita consumption spending urban residents (RMB)	1,211	4,186	6,030	6,511	55.5%
Per capita balance in saving accounts (RMB)	461	3,744	6,766	8,018	114.2%
Access to tap water (% of urban population)	47.4	61.2	77.9	86.2	
Mobile telephones per 100 residents	1.0	8.1	33.6	42.2	
Color televisions per 100 urban households	51.5	100.5	126.4	130.5	
Color televisions per 100 rural households	3.6	27.3	60.5	67.8	
Computers per 100 urban households	0.0	2.6	20.6	27.8	
Rate entering secondary school from middle school	38.3	51.5	58.3	60.2	

Note: Exchange rat is 8.28 RMB per US Dollar
Source: China Statistical Yearbook 2004

Automobiles

China's automotive market has seen a dramatic change in recent years, owing in part to the large reduction in import tariffs on automobiles following China's entry into the WTO. Consequently, the stock of passenger cars in China increased from 2.3 per 1,000 people in 1998 to 5.4 per 1,000 people in 2003. This number is expected to increase rapidly in the next several years.

Although the market for automobiles in China has grown rapidly, future growth will partly depend on the development of a sophisticated market for automotive loans. As recently as 2003, only about 20% of automotive purchases were financed by loans. The remaining 80% were paid in cash by consumers who painstakingly saved for their purchase or borrowed from friends and family. This was true even after the market for automotive loans doubled from 2000 to 2003.

Further growth in automotive lending will depend, in turn, on a more sophisticated and freer lending market. This will entail freer interest rates (they are now government controlled) so that lenders can price loans according to risk. It will also entail the development of a national credit verification system so consumer creditworthiness can be assessed. Indeed default has recently been so high (running at roughly 30%) that lenders have cut back in order to clean up their balance sheets. The effect has been to depress the overall automotive market.

Exhibit 4. Automotive Statistics

	1998	2003	% Chg 1998-2003
New passenger car registrations ('000)	508	2,083	310.0%
Stock of passenger cars (per 1,000 population)	2.3	5.4	134.8%
Retail sales of petrol ('000 tonnes)	33,278	42,062	26.4%

Source: Economist Intelligence Unit

Under the terms of China's entry into the WTO, the market for automotive financing will be further opened to foreign participation. The effect will be to increase competition for domestic financial institutions, reduce down-payment requirements, and expand the market. In addition, the gradual development of a market for second-hand automobiles will stimulate further development of automotive lending.

Spending on food

Most Chinese prepare their meals when eating at home. Hence the market for packaged, frozen, or prepared foods is relatively limited – although it is growing. While the "yuppie" population of China is rising rapidly, young dual income professionals prefer to eat out rather than bring a prepared meal home. For those not yet married, they rely on a parent or grandparent to cook for them. Consequently, when it comes to meals eaten at home, the market for fresh foods is dominant and freshness is critical. Thus the rise of modern food retailers in China has been predicated, in part, on their ability to offer highly fresh foods with hygienic conditions superior to those of traditional wet markets.

Given that most Chinese have relatively small homes and limited storage space, and given the desire to eat only fresh foods, Chinese tend to shop frequently. Wal-Mart says that a typical customer comes to their stores 3.5 times per week – much more than in the US. Thus the one-stop convenience of a big modern store is somewhat mitigated by the behavior of consumers.

On the other hand, there is a large and growing market for meals eaten out of the home. The success of fast food and quick service restaurants has been notable. For example, Yum Brands, owner of KFC, Pizza Hut, and Taco Bell, operates over 2,000 restaurants in 280 Chinese cities and continues to grow rapidly with strong profitability. Other Western chains have prospered in China as well. Although these chains offer Western style food, they have adapted to suit the tastes and habits of Chinese consumers. For example, although pizza is far removed from Chinese food, it has been popular because, like Chinese food, it can be eaten family style. Yet most restaurants in China are small, independent storefront businesses that were among the first to be privatized as China adopted a market oriented economy. Thus this market remains highly fragmented.

On the other hand, there is a huge opportunity for the consolidation of the restaurant industry. In urban China, millions of consumers love to eat away from home in countless, small restaurants. Many could become franchisees of large global or national chain operations. This has already begun to happen. Many more could be acquired by larger chains. Many small, privately owned restaurants and stores will be eager to join forces with foreign chains. There are several reasons: first, these companies often rely almost entirely on internal financing since, unlike state-owned companies, they lack access to domestic credit. A foreign link will enable outside financing. Second, private property rights are sometimes unclear. That is because, in order to obtain credit, companies will sometimes register as collectives and provide part ownership to government authorities. Yet such a government link can cause problems when selling a business or extracting profits. Thus, a relationship with a foreign company is often preferable.

Interestingly, per capita consumption of milk in China increased 50% from 1998 to 2003. Likewise consumption of meat has increased. At the same people are bicycling less than in the past. The result is that some consumers are starting to get a bit bigger. Consequently, many are becoming more health-conscious and are attracted to food products that emphasize health. This is surely indicative that China is becoming more affluent. It also presages shopping and lifestyle trends that are already prevalent in far richer countries.

Exhibit 5. Food consumption

	1998	2003	% Chg 1998-2003
Consumer expenditure			
Food, beverages & tobacco (US$ m)	176,769	199,057	12.6%
Food			
Meat consumption (kg per head)	47	56	19.1%
Milk consumption (litres per head)	8	12	50.0%
Fruit consumption (kg per head)	39	48	23.1%
Vegetable consumption (kg per head)	178	251	41.0%
Confectionery, sales volume ('000 tonnes)	621	822	32.4%
Beverages			
Coffee consumption (kg per head)	0.02	0.02	0.0%
Tea consumption (kg per head)	0.37	0.41	10.8%
Alcoholic drinks, sales volume (m litres)	19,148	21,354	11.5%
Soft drinks, sales volume (m litres)	10,091	21,956	117.6%
Cigarettes, sales volume (bn units)	1,591	1,737	9.2%

Source: Economist Intelligence Unit

Spending on apparel and fashion

In 2003 Chinese spent roughly US$56 billion on clothing, a figure that is expected to grow rapidly in the coming years. The rise of a middle class, as well as a small affluent class, is creating opportunities to sell more than just basic, low priced clothing. Moreover changes in the rules governing foreign investment in China's retailing sector are creating opportunities for medium sized retail chains to grow quickly in China.

Until recently, foreign retailers had to have a minimum level of capital in order to invest in China. This effectively excluded all but very large retailers such as hypermarkets and home improvement centers. Many medium sized apparel chains were, thus, kept out of China. Instead, foreign fashion brands, mostly luxury purveyors, simply licensed their names to local Chinese companies which opened flagship stores to promote those brands.

Today, however, foreign retailers can open stores without substantial hindrance. Consequently, many apparel retailers based in Hong Kong and other Asian locations have opened stores in China. In addition, many global brands are undertaking a multi-channel approach to the Chinese market. This includes franchising, operating their own stores, and selling their brands to department stores.

Until recently, there were basically two types of apparel sold in China. First, there was low priced, basic apparel sold under local brand names offered in Chinese department stores, foreign hypermarkets, or small family-owned specialty chains. Second, there were luxury brands sold either in franchised boutiques or upscale department stores. There was not much in between.

Today, a middle level of apparel is developing. This involves quality brands, both Chinese and foreign, being sold in department stores and specialty chain stores – the latter mostly foreign operated or franchised. This market includes such companies as Giordano and Esprit. In the case of the latter, the company sees its brand as being upscale but not luxury. It is affordable to the middle class but at a relatively high price point. It is this segment where considerable growth is possible in the coming years. This growth could involve a number of well known global brands that have yet to enter China. Such names as Gap (US), H&M (Sweden), and Zara (Spain) come to mind. Some other foreign brands have recently begun to get their feet wet in China. Among these are Uniqlo (Japan) and Mango (Spain). The rapid development of shopping malls in China will provide fertile territory for these chains.

Exhibit 6. Clothing, Cosmetics, and Perfumes in China

	1998	2003	% Chg 1998-2003
Clothing, sales value (US$ m)	44,388	55,718	25.5%
Cosmetics & toiletries, sales value (US$ m)	4,020	6,062	50.8%
Perfumes & fragrances, sales value (US$ m)	86	130	51.2%

Source: Economist Intelligence Unit

The consumers who are purchasing this new middle level of apparel tend to be China's burgeoning professional class. They are relatively young, well educated, have discretionary purchasing power and aspire to a better life. Their sense of fashion is highly influenced by European luxury brands and by Japanese styles and pop culture to a lesser extent. Hence, chain apparel retailers tend to offer styles commensurate with such tastes. For example, about 70-80% of the merchandise offered by Esprit in China is the same as what is offered globally – with a strong European influence. The remainder is localized to the Chinese market.

Aside from a prospective invasion of foreign specialty apparel chains, the other big potential change in Chinese apparel retailing is the privatization of state-owned department stores. Today, these stores still account for a sizable share of the clothing sold in China – and they are generally poor merchants. That is because they tend to follow the Japanese model of department store management. This involves offering branded suppliers selling space on a concession basis. The inventory risk is borne by the supplier and the department store is essentially a property manager rather than a merchant. The result is a poor mixture of styles and brands.

When privatization has taken place, it has sometimes involved improvements in merchandising. For example, Malaysian department store retailer Parkson has sold management contracts to some privatized department stores. The result is a more modern and focused shopping experience in which brands are better showcased and the brand mix is more rational. In the future, further such endeavors should result in better opportunities for the selling of global brands.

Spending on tourism

A hallmark of a modern, affluent economy is the rise of consumer spending on non-essential services. These include tourism, entertainment, and other forms of leisure. Affluent societies or those that aspire to affluence also experience substantial consumer spending on education. All of this is true in China today.

Consider tourism. In 2003, 20.2 million Chinese left the country to travel abroad. This was up from 8.4 million in 1998. Moreover, most industry experts expect this number to rise substantially in the next few years due to increased spending power, a possible revaluation of the Chinese currency, and relaxed government rules concerning travel abroad. The hospitality industries in many Asian and European countries are actively seeking Chinese tourists. A recent agreement between the UK and Chinese governments sets the stage for an avalanche of Chinese tourists visiting Britain in the next few years. The British tourist industry is busily preparing.

Exhibit 7. Tourism data for China

	1998	2003	% Chg 1998-2003
International tourism, arrivals ('000)	25,073	33,012	31.7%
International tourism, departures ('000)	8,426	20,215	139.9%
International tourism, expenditure (US$ m)	9,205	16,751	82.0%
International tourism, receipts (US$ m)	12,602	17,406	38.1%
Consumer expenditure: hotels & restaurants (US$ m)	19,702	31,196	58.3%

Note: Dollar figures for 2003 are EIU estimates
Source: Economist Intelligence Unit

Within China, travel is expanding and the hotel industry is evolving to accommodate the needs of internal tourists and business travelers. While foreign visitors to China are accustomed to world-class luxury hotels, most domestic travelers stay in very poor facilities that often lack even the most basic amenities. Consequently, some of the world's leading discount hotel chains are planning substantial investments in China. The goal is to offer domestic travelers a higher level of quality at an affordable price (more expensive than typical domestic hotels but far cheaper than luxury accommodations). Thus China's domestic market offers a major opportunity for providers of discount hospitality services. In addition, the expected increase in domestic travel will also drive rapid growth in airlines, restaurants, amusement facilities, and shopping centers.

Savings

Chinese households are famous for saving a large share of their income. As mentioned earlier, per capita urban household income rose more rapidly than consumer spending during the years 1997 to 2003. The result was a 114.2% increase in the size of per capita household savings accounts. The value of total household savings accounts in China rose 123.9% from 4.6 trillion renminbi to 10.4 trillion renminbi. At current exchange rates, that comes to US$1.25 trillion in household savings. Most of that money is now held as deposits in four state-owned banks as well as the Postal Savings system which is expected to be privatized. Under WTO rules, foreign banks will be able to accept deposits in China starting in 2007. Not surprisingly, global financial institutions are eager to take the deposits of China's thrifty consumers. In addition, global retailers and consumer product suppliers are also eager for those consumers to part with some of their savings.

Exhibit 8. Income and Savings in China

Per capita urban household disposable income (RMB)			Outstanding household savings accounts (millions RMB)		
Year	Value	% Chg	Value	% Chg	In billions US Dollars
1989	1,373.9		519,640		
1990	1,510.2	9.9%	711,980	37.0%	
1991	1,700.6	12.6%	924,160	29.8%	
1992	2,026.6	19.2%	1,175,940	27.2%	
1993	2,577.4	27.2%	1,520,350	29.3%	
1994	3,496.2	35.6%	2,151,880	41.5%	259,263
1995	4,283.0	22.5%	2,966,230	37.8%	357,377
1996	4,838.9	13.0%	3,852,080	29.9%	464,106
1997	5,160.3	6.6%	4,627,980	20.1%	557,588
1998	5,425.1	5.1%	5,340,750	15.4%	643,464
1999	5,854.0	7.9%	5,962,180	11.6%	718,335
2000	6,280.0	7.3%	6,433,240	7.9%	775,089
2001	6,859.6	9.2%	7,376,240	14.7%	888,704
2002	7,702.8	12.3%	8,691,060	17.8%	1,047,116
2003	8,472.2	10.0%	10,361,770	19.2%	1,248,406
% Chg 1997-2003: 64.2%			% Chg 1997-2003: 123.9%		

Note: Exchange rate is 8.28 RMB per US Dollar
Source: China Statistical Yearbook 2004

Why do Chinese save so much? Consider why people save at all: economists believe that consumers save in order to smooth their lifetime consumption. If they expect that their earning power will diminish substantially in old age, they will save in order to maintain their living standards during retirement. In addition, consumers save in order to allay the risk of extraordinary expenditures such as healthcare. In urban China, pensions and healthcare have traditionally been the responsibility of state-owned enterprises. As many of these companies have been privatized, this social safety net has been diminished. The result has been increased saving as consumers feel more vulnerable. It should also be pointed out that, at the time the market economy started to be introduced in the 1980s, Chinese consumers had virtually no savings. Thus their behavior is, in part, an effort to catch up.

Today Chinese consumer savings is quite high for a relatively poor country. Therefore the question arises as to whether the rate of saving will decline in coming years now that consumers have achieved a reasonable amount of wealth (there is some short-term evidence that savings has begun to decline. Still, it is too early to detect a trend). Moreover, foreign banks will fully participate in the Chinese financial system starting in December 2006. Thus it is possible that Chinese consumers will be offered a more diverse range of savings instruments including some that offer historically higher returns. This, too, could lead consumers to save less.

Another important factor concerns the mix of urban and rural population. Rural Chinese tend to save a higher share of their incomes than urban Chinese because rural residents have almost no social safety net on which to rely. As rural residents continue to migrate to the cities, the savings rate should decline.

Chinese must save in order to purchase big ticket items as well as to accumulate initial payments for purchases of homes. Yet as consumer credit becomes widely available, consumers will be able to smooth purchases of big ticket items thereby reducing the necessity of saving. In addition, in the early part of this decade the government allowed banks to require smaller initial payments for obtaining a home mortgage. The government also made mortgage interest payments tax deductible. These actions should have the effect of encouraging more home ownership and reducing the amount of saving needed in order to purchase a home.

Finally, just the fact that millions of Chinese own their homes should depress saving. That is because homes are a form of wealth. If consumers expect that the value of their homes will increase in the future, that diminishes the need to save in order to achieve a particular level of wealth.

On the other hand, there is reason to expect that personal savings in China will remain relatively high for a long time. That is because there appears to be a strong cultural bias toward savings. Indeed those Chinese who possess credit cards generally do not maintain a balance and pay off their debts as quickly as they can.

Housing and consumer credit

China's consumer economy is in the process of becoming a credit driven market. Until relatively recently, almost all consumer transactions involved cash and most consumers held no debt of any kind. That has already changed dramatically in the past four years. Starting in 2001, the market for consumer credit evolved rapidly. In 2001, home mortgages and automotive loans were introduced. Mortgages were an important component in the rapid privatization of government owned housing. By 2003 roughly 80% of families in Shanghai, for example, owned their homes. Almost all homes were out of government hands.

The development of a market for mortgages has been due not only to housing privatization, but also the desire of banks to diversify their portfolios of loans. Stuck with a large number of non-performing loans to state-owned companies, they have rapidly expanded mortgage lending in order to improve their asset mix. By 2004, roughly 10% of total bank loans, or about $242 billion at current exchange rates, were consumer loans – 90% of which were in the form of home mortgages. Notably, mortgage lending rose at an annual rate of 115% between 1998 and 2004. Currently, the default rate on mortgages is estimated at between 2% and 3% — hardly onerous. Yet if interest rates rise substantially or if the economy slows, this rate will surely increase. Moreover, rapid increases in property prices have enticed many new consumers into the market. If this "bubble" bursts, however, there could be temporary trouble for mortgage lenders.

Housing privatization should, over time, have two major effects on the consumer market. First, when people own their homes they possess tangible wealth. Economists have long known that the tradeoff between spending and saving is influenced by consumer perception of wealth. The greater the wealth, the less need to save. Moreover, housing prices have been rising. Thus, there are now millions of Chinese with considerable wealth and the expectation of rising wealth. This should stimulate more consumer spending. It should also stimulate Chinese consumers to tap into their considerable financial savings for large purchases. Finally, it should make Chinese consumers more comfortable in taking on non-mortgage debt such as automotive loans and credit card debt.

Second, when people own their homes they tend to spend more on their homes. This means decorating, fixtures, and other forms of home improvement. It also means furniture and furnishings, electronics, and appliances. Thus housing privatization should stimulate spending on home related goods. Indeed, this has happened and is the primary reason for the accelerated investment in China by foreign home related retailers such as Ikea, Kingfisher, and soon Home Depot.

In 2002, credit cards were introduced. By the end of that year there were 1.55 million credit cards in China. By the end of 2004, that number had risen to ten million. Still, the amount of money spent using those cards was rather small and most of it involved corporate rather than personal purchases. It appears that a culture of debt has yet to emerge. Nevertheless, the infrastructure is in place to support transactions should a debt culture develop. After all, over 540 million Chinese possess debit cards linked to bank accounts.

On the other hand, a sizable market for automotive loans is already extant. It is estimated to be roughly $25 billion at current exchange rates. Unfortunately, the rate of default on automotive loans has been estimated at between 30% and 50% indicating that many Chinese consumers are either taking on too much debt or are not concerned about the consequences of bad credit. The latter is more likely. After all, unlike the West, access to credit in China is not yet an important requirement for participation in the market economy. If a consumer loses access to credit because of an automotive loan default, it will not necessarily inhibit future purchasing. More importantly, banks lack adequate information systems and cooperative credit scoring systems to track consumers who default on loans. Thus the cost of default to each individual is not yet sufficiently onerous.

Shopping for the home

As mentioned, home ownership in China has skyrocketed. The result is a strong demand for home related products and home improvement. Keep in mind that, when Chinese purchase a new flat in a high rise building, they are essentially purchasing rooms that are no more than empty concrete boxes. Everything else must be added by the owner including plumbing, electrical wiring, shades and curtains, bathroom and kitchen fixtures and appliances, and flooring. Thus, the market potential is considerable. Although several foreign and domestic home improvement retailers have opened stores in China (Kingfisher, Obi, Home Way), about 80% of home improvement spending still involves less efficient channels. For example, in most big cities in China, there are neighborhoods where the businesses specialize in home improvement. Entire blocks are devoted to small, independent shops that each offer particular products and brands (pipes, kitchen fixtures, baths, etc). Consumers must go to a wide range of stores in order to put together the components for a project. They then hire laborers to perform the work as "do it yourself" is not part of Chinese culture – especially given the low cost of labor.

So what is the competitive advantage of a big home improvement center? These modern stores are targeted at educated professionals who are pressed for time and enjoy the convenience and quality of modern shopping processes. These consumers are also brand conscious and appreciate the selection of premium brands found at modern stores. Moreover, they may also appreciate the authenticity of such brands at modern stores given the high level of counterfeiting that takes place in China. Finally, these consumers appreciate the reliable information that can be obtained from the service staff at such stores. Given the low cost of labor, modern home improvement stores can offer a large number of well trained staff to assist shoppers in planning projects.

Given these competitive advantages, the market share of modern retailers is expected to rise rapidly in the next few years as retailers invest in expanding. Indeed US-based home improvement giant Home Depot is expected to enter the market soon, possibly through an acquisition.

Attitudes toward brands

Chinese consumers appear to have mixed attitudes toward brands. When it comes to luxury products or products for which quality is perceived as highly important, consumers are highly brand-conscious. Thus luxury brands are sought after when purchasing apparel, footwear, jewelry, or cosmetics. When purchasing home-related products, brands are important as well. Chinese consumers prefer to spend more on a known brand name for such products as kitchen and bathroom fixtures, appliances, housewares, and furniture. All of these are products that may be seen by others. Thus the status of the brand is critical.

On the other hand, for many packaged goods that have commodity-like appeal, and which friends and neighbors are not likely to see, brands hardly matter. The ability of some packaged goods suppliers to create strong brand identity and loyalty is, therefore, quite notable.

The fact that premium brands in fashion and home goods are so popular in China is one of the reasons that counterfeit goods have become such an important issue. Counterfeit items enable consumers to obtain the best brands without having to pay premium prices. Moreover counterfeiting, both for the domestic and export markets, has become a huge industry in China. Although senior government officials have expressed concern about the issue, combating piracy is difficult due to the massive infrastructure already in place. In addition, the industry is often protected by local law enforcement. For producers of branded products, this is one of the biggest obstacles to doing business profitably.

Finally, there is the issue of Chinese versus foreign brands. This is a complex issue because attitudes have changed over time and are different depending on the type of product. In the early days of economic reform in China, foreign brands were generally preferred as Chinese consumers recognized the inferior quality of state-produced products. Yet as the economy developed, state-owned companies were privatized and many became much better producers. Pride in the nation's accomplishments compelled some consumers to prefer local brands, all other things being equal.

Today, a more sophisticated consumer appears to be relatively ambivalent about this issue. While nationalism is a strong political attitude, when it comes to business consumers have become comfortable with the nation's achievements. As such they don't feel the need to support local brands in order to promote their country's interests. So while Chinese retailer Lianhua emphasizes its Chinese roots, many analysts attribute the company's success to good management rather than national pride. The implication is that foreign brands should not necessarily be at a disadvantage in China.

Attitudes toward price and quality

Chinese consumers are price sensitive, of course. Yet as the discussion about brands indicated consumers are quite concerned about other attributes of a product or service and will often pay a premium price.

Yet brand name is not the only attribute that concerns Chinese consumers. They also value customer service (despite or because of it's paucity in China), entertainment, and community involvement. For example, Yum Brands, operator of KFC and Pizza Hut restaurants in China, employs four to six people per restaurant for the purpose of developing community relations. These people interact with children and the elderly and organize community events. The goal is to convey the impression that these restaurants are an integral part of the community. Of course given the low wages in China, doing such outreach is more affordable than would be the case in the US or Europe.

Income distribution

As a nominally Communist country, China is expected to have a relatively even distribution of income. Yet China has a de facto capitalist economy which, although it produces rapid growth, possesses many of the vices and inequities typical of a market economy. This includes growing inequality of income and living standards. Specifically, there is a sizable gap between the lifestyles of rich and poor, urban and rural, coastal and interior. Government leaders have expressed growing concern about this gap and have proposed policy measures aimed at reducing the gap and alleviating its social effects. On the other hand, the high standard of living of China's top earners offers a significant and growing opportunity for global consumer business companies.

Consider a few facts. First, the per capita income of the top 10% of urban households in 2003 was 8.5 times that of the bottom 10% and three times that of the middle quintile. The per capita living expenditures of the top 10% of urban households, however, was 5.7 times the bottom 10% and 2.5 times the middle quintile. These lower ratios reflect the fact that higher income households tend to save a much larger share of their incomes.

For the top 10% of urban households, typical disposable income in 2003 was roughly US$7,000 measured at current exchange rates. Yet this number is misleading. That is because the prices of non-traded goods in China are very low by global standards. Thus the market exchange rate does not accurately reflect the true purchasing power of the Chinese currency. Using a more appropriate exchange rate would yield a household income closer to about US$28,000. While not affluent by the standards of developed nations, this level of income is certainly sufficient to support a considerable amount of discretionary purchasing.

The gap in income levels is also reflected in ownership of major durable products. For example, for the top 10% of urban households there are 6.6 automobiles per 100 households. Among the bottom 10%, there are almost no automobiles. Even among the middle quintile, there are 0.6 automobiles per 100 households.

Exhibit 9. Income Distribution in China

Conditions of urban households by income (In 2003, based on survey of 48,000 households)

	Lowest Decile	Middle Quintile	Highest Decile	National Average	Ratio of Highest to Lowest	Ratio of Highest to Middle
Average household size	3.4	3.03	2.68	3.01	0.8	0.9
Per capita annual income (RMB)	2,762	7,754	23,484	9,061	8.5	3.0
Per capita disposable income (RMB)	2,590	7,279	21,837	8,472	8.4	3.0
Per capita living expenditure (RMB)	2,562	5,848	14,516	6,511	5.7	2.5
Per capita spending as share of total (%)						
Food	47.7	39.2	29.9		0.6	0.8
Clothing	7.8	10.6	8.8		1.1	0.8
Household facilities, goods, services	3.6	5.9	8.1		2.3	1.4
Medicine and medical services	6.9	7.1	7.4		1.1	1.0
Transport and communication	6.8	10.2	14.3		2.1	1.4
Education and recreation	12.8	13.9	15.2		1.2	1.1
Housing	12.1	10.1	12.4		1.0	1.2
Other	2.4	3.1	4.0		1.6	1.3
Per capita spending on each category (RMB)						
Food	1,223	2,294	4,333		3.5	1.9
Clothing	199	618	1,276		6.4	2.1
Household facilities, goods, services	92	343	1,173		12.8	3.4
Medicine and medical services	176	415	1,070		6.1	2.6
Transport and communication	174	598	2,082		11.9	3.5
Education and recreation	328	812	2,209		6.7	2.7
Housing	309	589	1,794		5.8	3.0
Other	62	180	579		9.3	3.2
Ownership per 100 households (units)						
Motorcycle	13.4	25.2	31.7	24.0	2.4	1.3
Automobile	0.2	0.6	6.6	1.4	32.9	10.6
Refrigerator	60.6	91.3	103.3	88.7	1.7	1.1
Color television	102.4	128.1	165.2	130.5	1.6	1.3
Computer	3.3	23.4	64.8	27.8	19.4	2.8
Camera	14.1	43.0	84.2	45.4	6.0	2.0
Air conditioner	10.6	54.2	146.8	61.8	13.8	2.7
Dishwasher	0.1	0.5	1.8	0.6	13.5	3.6
Telephone	77.3	97.0	104.0	95.4	1.3	1.1
Mobile telephone	24.6	89.7	158.9	90.1	6.4	1.8

Note: Exchange rate is 8.28 RMB per US Dollar
Source: China Statistical Yearbook 2004

Similar differences exist for many other durable products. For example, 64.8% of the top 10% of urban households owned a personal computer in 2003 while 27.8% of all urban households owned a computer. Similarly large difference existed for air conditioners and mobile telephones. As for the latter, the top 10% of urban households had 159 mobile telephones for each 100 households. This indicated that most affluent households had multiple mobile telephones, similar to households in developed countries.

Regional differences

The inequality in income and living standards in urban China roughly corresponds to geographic differences. The major coastal cities such as Shanghai, Beijing, Guangzhou, and especially Shenzhen were the first to experience market oriented reforms. As such, they grew faster over the past 20 years than most other parts of China and have emerged relatively affluent.

For example, average disposable household income in Shanghai is roughly US$5,000 at current exchange rates, not far below the average for the top 10% of urban households nationwide (US$7,000). The national average for all urban households is roughly US$3,000. Consequently, it is reasonable to infer that the top 10% of households in Shanghai, Beijing, and Guangdong have very high incomes by Chinese standards. If Shanghai's income is distributed similarly to the national pattern, then the top 10% of Shanghai households has an average income of US$15,000 at current exchange rates. Using an exchange rate that measures the true purchasing power of the currency, this would translate into an average purchasing power of approximately $US60,000 per household.

There are also big geographic differences in the way that Chinese spend their money. In Shanghai, people spend far more than the national average on food, housing, recreation, transportation, and communication. Yet interestingly, Shanghai residents are much less likely to own an automobile than residents of Beijing or Guangdong Province. Some geographic differences in spending may be due to differences in regional prices. For example, housing in Shanghai is far more expensive than in many other provinces. Indeed, given such differences in the cost of living, the relative affluence of Shanghai may be overstated.

Not only are there differences in income between the coastal and interior regions, there are also differences within urban centers. In the big coastal cities that have experienced break-neck growth in the past two decades, poorer citizens have been pushed to the periphery as home prices near the center have skyrocketed. The result is not unlike other cities the world over. The affluent live close to the center of things and lower income households populate the edges of the cities. Indeed housing designed for lower to middle income consumers is growing on the outskirts of big cities. Big discount retailers are following consumers to these locales.

Finally, regional differences are not simply about money. China is a highly diverse nation, with many languages, lifestyles, types of food, and business styles. Companies doing business in China must take account of these differences when choosing product and service mixes as well as when managing local enterprises.

Exhibit 10. Regional differences in China of urban households
Data for 2003

	National Average	Beijing	Shanghai	Guangdong	Chongqing	Sichuan	Ratio Shanghai to national avg
Per capita disposable income (RMB)	8,472.20	13,882.62	14,867.49	12,380.43	8,093.67	7,041.87	1.8
Per capita spending by category (RMB)							
Food	2,416.92	3,522.69	4,102.65	3,583.72	2,702.34	2,240.65	1.7
Clothing	637.73	906.21	750.81	559.90	735.01	536.46	1.2
Education, culture, and recreation	934.38	1,964.19	1,833.79	1,437.07	1,025.99	823.72	2.0
Housing	256.45	489.50	641.36	443.72	249.19	224.92	2.5
Transport and communications	721.13	1,688.08	1,258.72	1,272.78	790.26	586.79	1.7
Goods owned per 100 urban households							
Refrigerator	88.73	100.40	102.00	92.56	98.00	91.16	1.1
Color TV	130.50	146.99	167.60	152.52	150.67	131.89	1.3
Computer	27.81	68.31	60.40	56.02	34.67	21.29	2.2
Mobile telephone	90.07	133.68	133.00	150.66	95.67	82.37	1.5
Automobile	1.36	6.60	1.80	4.37	1.33	0.88	1.3

Note: Exchange rate is 8.28 RMB per US Dollar
Source: China Statistical Yearbook 2004

In addition, China is not a single entity when it comes to doing business – especially consumer business. After all, during the period prior to market-oriented reforms (the communist era), each city in China was relatively self-sufficient economically. Local factories produced consumer goods under local brand names and distributed locally. Thus consumers became accustomed to local brands and distribution was highly fragmented. Although this is starting to change, especially with the construction of a national transportation infrastructure, consumer business remains highly localized. To the extent that there are national consumer brands, they are mostly global brands or private labels of global retailers. China remains at the early stages of developing a national consumer goods distribution system.

What does this mean for global retailers and global branded suppliers of consumer goods? It means that business must be organized around local distribution. Hence a retailer operating in several cities must deal with different local distributors for the same product. For example, Coca-Cola has 14 distributors throughout China and retailers must deal with each separately. Retailing remains highly fragmented and primarily local, so branded suppliers must deal with different major retailers in each local market. This localization retards the ability to develop large-scale efficiency. Still, as the transportation infrastructure develops, and as national retail organizations develop, the distribution system will shift toward a national model.

Demographics

China's population growth is relatively slow. Over the next 20 years the population is only expected to increase by 11% to about 1.45 billion. Yet, given China's large population, this represents an increase of 147 million people, or more than the population of Japan. More interesting, however, is the way in which the age distribution is expected to change. Because of declining fertility rates and delayed marriage and childbirth, the number of children and young adults will decline considerably. The under 20 population will drop by 49 million over the next 20 years. In addition, the number of young adults (ages 20 to 34) will decline by 42 million. On the other hand, the number of middle aged adults (ages 50 to 64) will increase by 134 million or 73%. The number of elderly (over 65) will double from 99 million to 199 million.

Exhibit 11. China Population Data and Forecasts
Thousands

Age	2000	2005	2025	% Ch 2000-05	%Chg 2005-25	Chg 2000-05	Chg 2005-25
Total	1,268,853	1,306,314	1,453,124	3.0%	11.2%	37,461	146,810
0 to 4	94,476	82,175	81,227	-13.0%	-1.2%	(12,301)	(948)
5 to 9	103,368	93,897	90,685	-9.2%	-3.4%	(9,471)	(3,212)
10 to 14	125,227	103,107	95,581	-17.7%	-7.3%	(22,120)	(7,526)
15 to 19	102,944	124,612	87,453	21.0%	-29.8%	21,668	(37,159)
20 to 24	95,658	101,863	80,393	6.5%	-21.1%	6,205	(21,470)
25 to 29	118,459	94,482	91,395	-20.2%	-3.3%	(23,977)	(3,087)
30 to 34	124,817	117,304	99,836	-6.0%	-14.9%	(7,513)	(17,468)
35 to 39	102,589	123,619	120,687	20.5%	-2.4%	21,030	(2,932)
40 to 44	82,103	101,383	98,338	23.5%	-3.0%	19,280	(3,045)
45 to 49	83,934	80,749	90,924	-3.8%	12.6%	(3,185)	10,175
50 to 54	61,044	81,948	111,734	34.2%	36.3%	20,904	29,786
55 to 59	45,870	58,791	115,132	28.2%	95.8%	12,921	56,341
60 to 64	40,827	43,091	90,917	5.5%	111.0%	2,264	47,826
65 to 69	34,704	36,772	67,167	6.0%	82.7%	2,068	30,395
70 to 74	24,987	29,140	61,284	16.6%	110.3%	4,153	32,144
75 to 79	15,807	18,540	36,357	17.3%	96.1%	2,733	17,817
80 to 84	7,938	9,742	19,231	22.7%	97.4%	1,804	9,489
85 to 89	3,130	3,833	9,948	22.5%	159.5%	703	6,115
90 to 94	832	1,062	3,823	27.6%	260.0%	230	2,761
95 to 99	132	178	884	34.8%	396.6%	46	706
100 +	9	17	128	88.9%	652.9%	8	111
0 to 19	426,015	403,791	354,946	-5.2%	-12.1%	(22,224)	(48,845)
20 to 34	338,934	313,649	271,624	-7.5%	-13.4%	(25,285)	(42,025)
35 to 49	268,626	305,751	309,949	13.8%	1.4%	37,125	4,198
50 to 64	147,741	183,830	317,783	24.4%	72.9%	36,089	133,953
65 +	87,539	99,284	198,822	13.4%	100.3%	11,745	99,538

Source: US Census Bureau, Int'l Database, Sep 2004

The trends noted above are already well under way. In just the past five years, it is estimated that there has been a dramatic shift in the age composition of the population owing to rapidly changing rates of fertility. For example, the under 20 population declined by 22 million from 2000 to 2005 while the 20 to 34 year old population fell by 25 million. Meanwhile the older cohorts have experienced large increases (see chart).

Finally, among children and young adults there is a large disparity between the numbers of males and females. For example, today there are 50 million males aged 5 to 9 while there are only 44 million females in that age group. Similar differences exist for many other young cohorts. This unusually large gap is due to the one-child policy followed over the past generation. The desire for sons led many Chinese families to undertake measures aimed at assuring male births. This gender disparity could have significant implications for lifestyles of adults in the future. Moreover, it could have an adverse impact on social stability and crime as a large number of men fail to find permanent mates. Finally, a relative dearth of young females will exacerbate the low rate of fertility.

What do these demographic trends augur for consumer business in China? First, the absolute decline in the number of dependent children means that there will be far fewer households in which children are present. This implies less spending on child and teen related products (clothing, toys, and games). It also implies that there will be more money available for adults without children to spend on themselves. Those adults who don't have children or delay having children will likely spend more on eating out, decorating homes, travel, and entertainment.

Second, the increase in the older working age population (50 to 64) has important implications. This age group tends to save more and spend less. It tends to spend more on services and less on goods. It also tends to spend considerably on grandchildren.

The huge increase in the number of elderly Chinese will have vast implications for many industries including healthcare, pharmaceuticals, recreation, fashion, home furnishing, and food service to name a few.

China and the Internet

As in many developed countries, the growth of internet usage in China has been phenomenal. What makes China's experience exceptional, however, is the fact that China has so many people. Consequently, the numbers involved are sufficiently large to attract the attention of many of the world's leading internet sellers. Such venerable US internet companies as Ebay and AOL are highly active in China. These and many other companies have ambitious plans for future growth in China.

By early 2005 there were over 100 million internet users in China, up from 87 million in mid 2004 and 68 million in mid 2003. These users connected to the internet through over 120 million access points of which roughly one third involved high speed access. According to a Chinese government survey, roughly 60% of internet users were male and about 54% of internet users were under the age of 25. In addition, the survey found that about 60% of internet users were unmarried. Thus it appears that the typical Chinese internet user is a young, single, male – not very different from the profile found among early internet users in the West. As in the West, this profile is likely to change in the future as internet usage becomes more ubiquitous.

Exhibit 12. China Internet information
Based on survey conducted by CNNIC, June 2004

Internet users	87,000,000
Websites	626,600
Access method:	
Leased line	28,700,000
Dial up	51,600,000
ISDN	6,000,000
Broadband	31,100,000
Other	2,600,000
Users:	
Female	40.7%
Male	59.3%
Under 25 years old	54.1%
Students	31.9%
Married	39.9%
Single	60.1%

Source: CNNIC

Interestingly, it appears that the growth of internet usage started to slow down in early 2004, in part due to government crackdowns on illegal internet cafes. By 2004, 20% of internet users in China were obtaining internet access via such cafes. In addition, the rise of text messaging by mobile phone users may have diminished the attraction and relative utility of computer based e-mail. By 2004, China's 300 million mobile phone users were sending over one billion text messages every day.

Still, despite the rise of mobile telephony, the internet continues to grow in importance. In 2004, the number of registered websites in China rose 32% to 626,000 sites. Not surprisingly, 84% of these websites are registered in China's coastal cities.

Exhibit 13. Telecommunications and Internet Data for China

	1998	2003	% Chg 1998-2003
Telephone main lines ('000)	82,020	261,963	219.4%
Telephone main lines (per 100 population)	6.6	20.3	207.6%
Phone sets ('000)	131,234	531,998	305.4%
Mobile subscribers ('000)	23,863	268,693	1026.0%
Mobile subscribers (per 100 population)	1.9	20.8	994.7%
Internet users ('000)	2,100	79,500	3685.7%
Internet users (per 100 population)	0.2	6.2	3000.0%
Personal computers (stock per 1,000 population)	4	35	775.0%

Source: Economist Intelligence Unit

The next big step in the development of the internet in China will involve rural usage. The government intends to establish an infrastructure to support the creation of internet access for 900 million rural citizens of China. The implications of such a project are staggering. After all, most of the focus of China's economic development has involved the urban centers. Rural participation in that development has often entailed migration to cities or the absorption of rural areas into the periphery of cities. Now the government wants to bring the benefits of modern society to the entire country. This will mean greater access to economically useful information, more efficient rural-urban supply chains, and the ability to engage in distance learning. These influences could, over time, add substantially to rural productivity and, therefore, rural incomes.

On the other hand, the government seems to have mixed feelings about the internet. It has worked hard to limit the free flow of information and clearly worries about how the internet could subvert its authority. Thousands are employed to monitor internet usage. How the conflicting demands on the internet will be resolved is hard to predict.

Although it is clear that the internet will rise in importance in the years to come, there are several issues that will determine the success of internet commerce. These include the reliability of the postal service, the ubiquity of credit and debit cards, and the degree to which store retailers will play a role in the distribution of goods ordered online.

The distribution sector

Despite much industry buzz concerning foreign investment in China's retail sector, it is worth noting that, as of 2003, foreign funded retailers accounted for only 9.6% of China's retail sales. Moreover, roughly one third of that was due to investors based in Hong Kong, Macau, and Taiwan. Thus retailers based outside of "greater China" only accounted for 6.9% of China's retail sales. The largest foreign retailer in China, France's Carrefour, accounted for less than one third of one percent of China's US$600 billion retail market. In other words, foreigners have a long way to go.

Yet there is plenty of room for growth. Moreover, the rules of the game have recently changed. Indeed China's retailing industry is on the verge of a major acceleration in modernization, foreign investment, consolidation, and privatization. The reason is that the rules governing distribution in China were radically altered in December 2004 in accordance with China's WTO obligations. Before discussing the impact of these reforms, let us first consider what actually happened.

The new rules including the following important changes:

Foreign retailers may own 100% of their Chinese subsidiaries

In the past, foreign retailers were required to have a local partner. Now they can go it alone. However, many retailers may prefer to engage in joint ventures as there are benefits such as obtaining local market knowledge, government connections, and spreading risk.

Foreign retailers may operate in any geographic location within China

In the past, foreign retailers needed local government permission to open stores. For example, Wal-Mart was restricted from entering Shanghai as the local government did not want to create onerous competition for other large retailers such as Carrefour. Under the new rules, Wal-Mart will open stores in Shanghai, Beijing, and elsewhere. Most of the foreign retailers operating in China now have ambitions to create national chains.

Foreign retailers may open an unlimited number of stores per year.

In the past it was difficult to quickly develop critical mass in the absence of a local acquisition. Now, foreign retailers can expand organically at their own preferred speed, opening stores rapidly if they choose. Of course they can also freely acquire local Chinese retailers.

Foreign retailers are no longer required to have a minimum size

Foreign retailers were only permitted to enter China if they had a minimum size in terms of sales, capital, or assets. In the past, such requirements were designed to keep out medium-sized retailers from Hong Kong. They were regarded as, potentially, the most onerous competition to small to medium sized local retailers. Now such retailers are eager and able to participate in the Chinese market.

Foreigners may source global brand merchandise locally

In the past, foreign manufacturers were required to export most of what they produced in China. Now they can sell as much as they want in the Chinese market. This means that foreign suppliers can ultimately integrate their domestic and export operations. In addition, they will be able to import freely.

Foreign companies may integrate all aspects of distribution

This includes transportation, wholesaling, and retailing. As such, they may create vertically integrated organizations rather than rely on local distributors.

The immediate impact of these reforms, however, may not be that great. Consider the following:

Geographic expansion can still be stymied

Although foreign retailers are now allowed to enter any geographic market in China, they will continue to face difficulties as well as informal obstacles. One retailer told us that the new rules actually increase the complexity of doing business in China. Instead of obtaining permission from one central authority, retailers must engage in multiple negotiations with officials in order to obtain all necessary clearances to open stores. In major cities, this can involve 40 to 50 approvals. Officials can sometimes be arbitrary, and sometimes corrupt. Some retailers employ agents to perform the negotiations rather than get their hands dirty.

Export and domestic business will remain mostly separate

The reason is that export oriented manufacturing has evolved to serve the needs of foreign markets, which tend to be very different from domestic requirements. Consequently, major foreign retailers in China, many of which directly procure merchandise in China for their home market stores, keep these organizations entirely separate.

Vertical integration will be limited

Although companies may now do many things, there are reasons to focus on one part of the supply chain. First, many retailers still prefer to focus on their core competencies and outsource other functions such as transportation and logistics. Second, retailers registered on US-based exchanges must comply with the Sarbanes Oxley law that requires companies to certify their internal financial controls. Thus retailers have an incentive to avoid engaging in processes that might make such compliance more difficult and costly. Outsourcing of processes, therefore, is often preferred.

What might be the long-term impact of these reforms?

Acceleration in foreign investment

On the other hand, more investment was likely to take place even in the absence of the reforms. That is because the market is expected to growth rapidly as are the number of consumers with substantial discretionary spending resources. Still, the reforms will entice more foreign retailers to consider China.

Shift of major players toward many markets within China

Until recently, most foreign investment in Chinese retailing involved a focus on a particular region. That is rapidly changing, both due to the reforms as well as the need to seek new markets once old ones become saturated.

Consolidation among Chinese retailers

In response to accelerated foreign investment, as well as a more level playing field for foreigners, domestic retailers in China will seek to achieve greater scale in order to obtain improved efficiency. Already the government has forced some mergers in order to create larger organizations. So far these have not succeeded in creating efficiency. Instead, they have created confusion. Nevertheless, further consolidation is inevitable.

Accelerated privatization of Chinese retailers

As part of the larger process of privatizing state-owned enterprises, the government will continue to privatize retail organizations – especially in second tier and interior markets. The reforms will intensify the necessity of privatization.

Investment into China by smaller foreign players

This is already well under way, especially with respect to Hong Kong based retailers. Indeed it is part of a larger economic integration between Hong Kong and the mainland.

China's retailing industry

China's retailing industry has been going through a rapid change. Until the mid-1990s, the industry mostly consisted of state-run department stores, small independent shops, and many street markets. These all continue to exist. Yet in recent years there has been a proliferation of hypermarkets, supermarkets, and convenience stores in the big coastal cities. Lately there has also been a rapid increase in the number of non-food specialty stores – both small stores that sell apparel as well as large stores selling electronics, furniture, and other home related goods.

Many of the modern retail stores that have been developed in recent years are foreign invested. Such leading retailers as Carrefour, Metro, Wal-Mart, Auchan, Ikea, and B&Q to name a few have been at the forefront of retail investment in China. They are all planning to rapidly expand in China in the next few years.

In addition, there are now several leading local retailers in China that operate modern formats with great success. These include Lianhua, Hualian, and Wumart, each of which operates hypermarkets and supermarkets. In addition, there are some leading local specialty chains such as Gome, a large chain that sells electronics.

The largest domestic retail chain in China is Lianhua. It operates 2,700 hypermarkets, supermarkets, and convenience stores in 16 Chinese provinces. Moreover, Lianhua is now part of a larger retail conglomerate that was created through a government sponsored merger of several Chinese chains. Known as Bailian, this conglomerate was created by the merger of Shanghai Number One Department Store, Shanghai Hualian, Shanghai Friendship, Shanghai Material Trading Centre, and Hualian Supermarket. Shanghai Friendship is the parent of Lianhua, China's largest supermarket chain. Although this and other forced mergers are intended to create organizations with the large-scale efficiency to compete with global giants, there have been problems in integrating different organizations. The planned efficiencies have not yet materialized. Indeed these new giants are, to date, simply holding companies rather than large-scale retail organizations. Whether integration and centralization of processes will proceed smoothly in the future is not clear. Still, more such mergers are likely as the government would like to create organizations that have the potential to compete with global giants.

Exhibit 14. China's Top 20 Retailers
(RMB millions unless otherwise indicated)

Company	Sales turnover Jan-Jun 2004	% change year on year	Sales turnover 2003	Jan-Jun 2004 in US Dollars
Shanghai Bailian	30,393	23	48,517	3,671
Gome Home Appliances	14,832	74	17,792	1,791
Suning	10,553	101	12,098	1,275
Dalian Dashang	9,100	22	18,183	1,099
Carrefour (China)	7,761	19	13,437	937
Beijing Hualian	7,327	39	13,600	885
Suguo Supermarket	6,968	44	9,580	842
Shanghai Agriculture Industry Commerce Supermarket	6,550	9	12,380	791
Shanghai Yongle Household Electrical Appliances	6,500	81	8,760	785
Sanlian Commercial	6,400	31	10,676	773
China Resources Vanguard	5,379	8	10,324	650
Beijing Wumart	4,775	58	8,505	577
Five Star Appliance	4,303	102	5,107	520
Wuhan Wushang Group	4,081	19	7,031	493
Chongqing General Trading	3,956	25	6,569	478
Jiangsu Wenfeng Great World Chain Development Corporation	3,774	45	5,717	456
Wal-Mart (China)	3,723	35	5,853	450
The Homeworld Group	3,457	35	5,272	418
Xinyijia Supermarket	3,322	83	5,900	401
Metro Jinjiang Cash & Carry	3,318	15	5,621	401

Source: Ministry of Commerce

The most important modern format continues to be the hypermarket. These large stores offer food and general merchandise in an environment characterized by self service, centralized checkout, and relatively low prices. In Shanghai alone, there will be 121 hypermarkets by the end of 2005. It could be argued that this represents over-saturation considering the current size of the market. Yet if growth continues at a strong pace the demand for such stores will grow as well. Moreover, they will continue to take market share from department stores and street merchants. Still, the lion's share of hypermarket growth in coming years will come from development of stores in second-tier cities. Each of the major foreign players is now aggressively investing in such locations. The loosening of regulatory restrictions as well as the vast improvement in transportation infrastructure made this feasible.

As for the ubiquitous state-owned department stores, which continue to play a leading role in the retail industries of China's second tier cities, they are good candidates for future privatization. These stores are usually owned by local governments. They tend to be poor merchants, highly inefficient both in terms of supply chain management as well as customer service, and often lose money. Some have been partially privatized. In such cases, these companies have developed a variety of strategies for improvement. Some have invested in alternative formats (supermarkets, specialty stores, hypermarkets), while some have sought to become world-class merchants.

Consider again Parkson, the Malaysia-based department store division of the Lion Group. It has sold management contracts to Chinese department stores. In these cases, the stores are re-branded with the Parkson name and offer modern merchandising with an attractive assortment of major local and global brands.

Changing landscape for distribution

The rise of modern retailing

Modern big box retailers usually offer no price advantage over traditional wet markets and street vendors. Indeed the prices charged in the informal sector are often lower than those at modern retailers. Yet the moderns continue to gain market share – although that gain is mainly at the expense of state-owned department stores rather than the informal sector.

Why are consumers attracted to modern retailers? The answer is that modern retailers have several advantages. When it comes to food, they offer reliable hygiene, air-conditioning, and the convenience of one-stop shopping. In addition, modern stores stay open longer than traditional markets and thus attract shoppers returning home from work late in the day.

Still, when asked about their competitors, leaders of modern retailers in China are apt to list street markets and street vendors rather than other big box operators. They complain that street merchants pay no taxes and needn't pay rent. The result is low prices and a certain kind of convenience. The challenge for big box retailers is to retain the ambience of wet markets while offering the advantages of modern retailing. In the case of Wal-Mart, managers at each store visit nearby wet markets and independent stores as often as three times each day. The goal is to see what items are selling well and at what prices. This enables Wal-Mart to quickly respond to changing demand patterns.

Impact of revaluation

There has been much speculation lately about the future of China's exchange rate. Deloitte Research believes that the Chinese government is likely to revalue its currency within the next two years (for a full discussion of this issue see China at a Crossroads, October 2004). For our purposes, the question arises as to what extent a revaluation will have an impact on the Chinese consumer market.

A revaluation would quickly lead to a reduction in the prices that Chinese consumers and businesses pay for imported goods. The scope of the reduction would depend on the size of the revaluation. Several things would follow from this. First, domestically produced goods would face more severe price competition from abroad. This would create pressures to reduce domestic prices or improve product quality, or both.

Second, in most cases lower prices would lead to increased demand – especially among those consumers for whom price sensitivity is greatest. That would mean relatively lower income consumers would benefit the most. Thus revaluation would stimulate accelerated consumer spending, all other things being equal. Yet not all other things would remain equal. A revaluation would likely have the effect of slowing overall economic growth. That is because it would cause an increase in export prices thereby reducing export growth. Moreover, revaluation would lead to slower money supply growth and, therefore, slower growth of bank credit. Thus growth of exports and investment would decline with commensurate effects on employment growth.

Such a slowdown would not necessarily be a bad thing. Lately the government has been concerned that the economy is overheating. An action that would slow growth would allow the economy to cool off and would lessen inflationary pressures. Moreover, revaluation would clearly shift growth toward domestic demand and away from reliance on exports. The latter is vulnerable to the vicissitudes of the global economy while domestic demand tends to be more stable.

Impact of economic policy

Naturally the path of the economy will play a role in determining the growth of the consumer market in China. There are a number of policy choices that will be made in the coming years that will not only influence the rate of economic growth but the nature of that growth as well.

Consider, for example, that China's leadership wants to shift growth away from export orientation and toward domestic demand. There are two reasons. First, export revenue is vulnerable to economic events outside the country and beyond the control of China's policymakers. Moreover domestic demand tends to be more stable. Second, domestic demand led growth will accelerate the improvement in China's living standards. The question is how to stimulate this shift. Among the options are currency revaluation, eliminating tax incentives for exports, and creating new incentives for consumer spending and consumer debt accumulation. All of these are likely to happen in the near future.

Another policy issue that could influence the consumer market is the issue of rural versus urban development. China's urban economy has been growing far faster than the rural sector. The result is a rising gap in income and a growing migration of rural residents to the cities. The government is keen on alleviating this gap. Hence, while tightening bank credit in urban areas, it has pushed for more credit creation in rural areas. In addition, it has shifted infrastructure spending toward rural areas. The result will likely be an acceleration in rural growth and a more rapid development of discretionary spending power in rural parts of China.

Finally, the government has been concerned about the inflationary effects of excessive money supply creation and excessive economic growth. As such it has undertaken measures aimed at slowing economic growth in order to quell inflation and reduce bottlenecks. The policy appears to be working as inflation has moderated in 2005. Yet this could be misleading as many prices are controlled by the government. Growth remains high and excess money supply growth appears to be stimulating a property price bubble. History shows that asset price bubbles usually end with tears. The challenge for the government will be to reduce money supply growth (probably through currency revaluation) while at the same time offsetting the depressing impact of a collapse in property prices. If property prices in the big coastal cities take a dive, it could have a deleterious impact on consumer spending – especially on the part of relatively affluent consumers.

Shopping centers

The world's largest shopping center is under construction in Dongguan, a town in the heart of the fast growing Pearl River Delta in China. When completed, the South China Mall will encompass 9.6 million square feet. By comparison the largest shopping center in the US, Minneapolis's Mall of America, has 4.2 million square feet. In addition, the South China Mall will have 7.1 million square feet of shopping space versus 2.5 million at the Mall of America. Moreover, there are six other shopping centers in China with more total space than Mall of America, two of which are currently under construction.

Clearly something remarkable is happening. Not only is the scale of these malls unprecedented, but their composition is more akin to Las Vegas than a suburban American mall. For example, South China Mall will include a Tele-Tubbies theme park, hotels, pyramids, a giant windmill, an Imax Theatre, a full size replica of Paris's Arc de Triomphe at the end of a new Champs-Elysee, and Venetian canals with gondola rides. Other malls will have similarly grandiose designs.

China is not alone. Malls on a grand scale are being developed in other Asian countries. Yet due to its size, China's mall construction is especially noteworthy. It signals a new stage in China's economic development. Prior to this period, there was considerable popularity for amusement parks in China. Today, with consumer purchasing power having reached a critical level, amusement is being combined with shopping to create the ultimate recreational experience for Chinese families. In addition, the rise of automobile ownership in China will make transportation to these malls more feasible.

Food and store safety

In a country that has seen several scares involving disease-ridden food, the issue of food safety is critical for food retailers and suppliers. Although the government has strict rules regarding management of the food supply chain, modern retailers have invested heavily in quality control in order to avoid crises. The ability of food retailers to maintain a reputation for food safety and quality is critical to their success. For the large hypermarket chains, food drives the traffic that enables the stores to sell non-food merchandise as well.

In the cases of both food and store safety the danger is that, if something bad happens, the local press will become aggressive in reporting the problem and potentially destroy the reputation of a retailer or supplier. In China, the press has been privatized and, in order to drive circulation, is aggressive in going after private enterprises (especially as they cannot go after the government with impunity).

Market research

One of the great challenges of operating in the Chinese consumer market lies in understanding the consumer. Traditional research techniques can yield inaccurate results. That is because consumers are often apt to provide researchers with misleading information. There is a cultural aversion to telling people things that might be offensive or embarrassing. For example, Chinese consumers might not want to offend a company by saying that they dislike their products. They might not want to admit that they cannot afford to purchase something. Such aversions will lead to inaccurate research results. Therefore, research must be conducted in less transparent ways. That is, consumers must be observed at close range. Experiments must be conducted in order to determine what works and what does not. Clearly, this kind of research is more expensive and time consuming than traditional modes. Yet it is more likely to yield robust information.

Distribution

Distribution in China is getting better. Anyone who has talked to business executives operating in China has probably heard a few horror stories concerning the movement of goods. Those horror stories still take place, but fewer and far between. The reason for the improvement is the massive investment in transportation infrastructure made by the government. The result is much lower lead times. For example, a large home improvement retailer told Deloitte that it now takes one week to move goods from Chengdu to Shenzhen. In the past it took several weeks on poor roads.

On the other hand, there remain serious problems. For example, the movement of perishable goods can be challenging owing to the paucity of refrigerated trucks and distribution facilities. Thus most retailers operate localized distribution of perishables while they are starting to engage in national distribution of non-perishable goods.

Human resources

In discussions that Deloitte Research conducted with global consumer companies operating in China, the issue that kept coming up repeatedly was human capital. The ability to execute a strategy is entirely dependent on the ability to find and retain good quality managers – an increasingly challenging endeavor. Companies often begin their journey in China with a large number of expatriates. Yet this is not sustainable as expats are costly and usually are eager to return home after a few years. Optimally, a foreign company in China should rely on a small number of expats and a large and growing number of local managers. At Metro, the German cash and carry wholesaler, there are 400 employees at the company's Chinese headquarters in Shanghai, of whom 40 are expats. Roughly 90% of the company's store managers are locals. In the case of Wal-Mart, all store managers in China are Chinese. In addition, as in the US, Wal-Mart has a policy of promoting store associates to managerial positions.

Yet retaining local managers is problematic. Due to the enormous economic growth, and especially vast foreign investment, the demand for skilled managers is growing faster than the local supply. Hence, labor costs for managers are rising rapidly. Moreover, managers find that there are often new opportunities at local companies, especially after they have received valuable training from global organizations. Instilling a sense of loyalty to the company and a sense of long-term opportunity has been especially difficult for global companies operating in China. Short term financial opportunities with Chinese companies are often highly tempting.

Another human resource issue is the problem of integrating people into what is essentially an alien culture. Foreign companies investing in China must adjust their corporate cultures to the local environment. One company with a reputation for adjusting well to the local culture is Carrefour, the French hypermarket chain with 57 stores in China as of mid-2005. Carrefour maintains a relatively decentralized organization which may account for its ability to adjust to the culture. The primary issue is one of finding the right balance between the core strengths and strategy of the company and adjusting to the needs of the local market. This is as true of human resource management as it is of merchandising.

Strategic requirements for success

What are the requirements for success in the Chinese consumer market? Based upon examining the experiences, both positive and negative, of numerous consumer oriented companies in China, we offer this brief and incomplete list of success criteria:

Employ good local managers

This is a necessary condition for success. Even if all other aspects of a business are correct, the absence of good managers will condemn the investment to failure. Yet this is highly challenging. The demand for good managers in China is growing faster than the supply. The result is that the cost of managers is rising. Yet more onerous is the fact that the ability to retain good managers is declining. After obtaining training, a good manager will often be vulnerable to the pecuniary offerings of rival companies. The question arises, then, as to how to induce loyalty without paying ransom. There is no easy solution. Still, an effort must be made to instill a sense of long-term involvement and opportunity with a company. Some foreign retailers operating in China take their managers on trips to the home country to obtain both training and a sense of "esprit de corps." Managers must feel that the company has good prospects and that there are long-term career opportunities.

Invest for the long-term

Success in China does not usually happen overnight. It requires painstaking attention to detail and the development of a local organization that is integrated into the local culture and business environment. It often entails much trial and error. Any decision to operate in China's consumer market must entail the expectation that returns will be substantial, but will take time to reap.

Stay true to core competencies (which are not easily defined)

It is a mantra of business schools that companies must focus on their core competencies. Yet when investing in China (or any other emerging market), this is not a trivial issue. After all, it is not always a simple matter to identify the core competency. Take the KFC division of Yum Brands, for example. In China, KFC restaurants offer a considerably different menu than in the US. Clearly it is not fried chicken that is the core competency. Instead, it is the ability to manage a large restaurant chain. Defining the core competency is critical when fashioning a business strategy for the Chinese consumer market. Companies must ask themselves the following questions: What do we offer consumers that will attract them? How are we different from potential competitors? What can we do well in China?

Recognize and adapt to unique cultural differences

While staying true to core competencies, companies investing in China must also adapt to the needs of the local market. Naturally this includes adjusting the mix and attributes of the products and services sold. Yet it also entails adjusting to the business culture of China – or rather the many business cultures of China. After all, China is a fairly diverse country, with many dialects and many different cultural attributes. For example, some companies operating in China have indicated that customers, managers, and salespeople are quite different in Beijing than in Shanghai. These differences can involve work habits, attitudes toward customers, shopping behavior, and receptiveness to marketing messages. Companies must take account of these differences when developing a strategy.

Concluding thoughts

China's consumer market has the potential to account for a disproportionate and significant share of growth for the world's leading consumer oriented companies in the coming years. The challenge will be to navigate the risks and obstacles of operating in the Chinese market while taking full advantage of the opportunity that rapid growth is creating. This will entail exploiting a company's best features while adapting to local needs. It will entail extending a company's culture to a new environment by integrating local managers into that culture. Finally, it will entail creating a truly Chinese organization with mostly Chinese managers who are loyal to the company and intend to make a career to building the business.

Appendix A. Data on Retail Sales by Chinese City, 2003
Ranked by retail sales per capita

	Total Population Millions	Total Retail Sales Rmb bill	% Share of National Total	Retail Sales per capita (RMB)	Avg income per capita RMB	Per cap Retail sales % of avg income
Shenzhen	2.06	50.61	1.10	24,556	21,010	116.88
Beijing	12.37	256.02	5.58	20,697	21,376	96.82
Shanghai	13.78	250.65	5.46	18,189	23,525	77.32
Guangzhou	6.91	125.15	2.73	18,111	21,935	82.57
Xiamen	1.44	20.59	0.45	14,302	16,364	87.40
Haikou	0.63	8.50	0.19	13,578	11,260	120.59
Tianjin	10.16	119.56	2.60	11,768	16,280	72.28
Dalian	5.78	56.04	1.22	9,698	11,770	82.40
Shenyang	6.91	66.11	1.44	9,567	9,543	100.25
Wuhan	7.74	72.64	1.58	9,385	11,391	82.39
Nanjing	5.78	53.76	1.17	9,301	13,568	68.55
Jinan	5.68	40.84	0.89	7,192	7,192	100.00
Hangzhou	6.41	42.61	0.93	6,647	17,322	38.38
Chengdu	10.33	63.77	1.39	6,174	12,478	49.48
Xi'an	7.01	38.78	0.84	5,532	5,515	100.31
Zhengzhou	6.31	33.67	0.73	5,336	11,515	46.34
Harbin	10.12	52.94	1.15	5,231	8,700	60.13
Kunming	4.12	21.26	0.46	5,160	12,799	40.32
Nanning	3.09	15.82	0.34	5,120	11,425	44.81
Changsha	6.08	29.23	0.64	4,808	12,086	39.78
Changchun	7.21	31.57	0.69	4,379	4,362	100.38
Qingdao	7.34	30.33	0.66	4,135	6,955	59.45
Shijiazhuang	9.07	31.33	0.68	3,454	11,528	29.96
Chongqing	31.94	75.70	1.65	2,370	10,124	23.41
Cities	188.26	1,587.49	34.59	8,432	12,919	65.27
National	1,312.75	4,590.09	100.00	3,497	12,225	28.60

Source: Access Asia

Appendix B. Marriages and Divorces in China

	Marriages 1000s	Divorces 1000s	Ratio
1989	9,372	753	12.4
1990	9,511	800	11.9
1991	9,536	829	11.5
1992	9,575	850	11.3
1993	9,154	909	10.1
1994	9,324	981	9.5
1995	9,341	1,055	8.9
1996	9,387	1,132	8.3
1997	9,141	1,198	7.6
1998	8,917	1,190	7.5
1999	8,853	1,202	7.4
2000	8,485	1,213	7.0
2001	8,050	1,250	6.4
2002	7,862	1,177	6.7
2003	8,114	1,331	6.1
% Chg 89-03	-13.4%	76.8%	

Source: China Statistical Yearbook 2004

About the Author

Ira Kalish
Deloitte Services LP
Tel: +1 213 688 4765
Email: ikalish@deloitte.com

Ira Kalish is Global Director, Consumer Business at Deloitte Research. He is an expert on global economic issues as well as the effects of economic, demographic, and social trends on the global retailing and consumer products industries. Mr. Kalish conducts research on global economic issues and has authored in-depth reports on economic and consumer issues in many of the world's major countries. In addition, Mr. Kalish has been widely quoted in the news media. His remarks have been published by The Wall Street Journal, Business Week, The Economist, The Financial Times, and USA Today to name a few. Mr. Kalish holds a bachelor's degree in economics from Vassar College and a Ph.D. in international economics from Johns Hopkins University.

Global Economic Thought Leadership

- **Global Economic Outlook 2005:** Will There Be a Hard Landing?
- **Quotas End, Uncertainty Continues:** Understanding the Impact of the Agreement on Textiles and Clothing
- **China at a Crossroads:** Seven Risks of Doing Business
- **The World's Factory:** China Enters the 21st Century
- **Changing China**
- **Global Recovery at Risk**
- **Globalization at Risk**

Please visit www.deloitte.com/research for the latest Deloitte Research thought leadership or contact Deloitte Services LP at: delresearch@deloitte.com.

For more information about Deloitte Research, please contact Ajit Kambil, Global Director, Deloitte Research, part of Deloitte Services LP, at +1 617 437 3636 or via Email: akambil@deloitte.com.

For Further Information, Please Contact

Consumer Business Leaders

Global
Ed Carey
Deloitte Consulting
Tel: +1 312 374 3048
Email: ecarey@deloitte.com

Americas
Pat Conroy
Deloitte & Touche USA LLP
Tel: +216 830 6602
Email: pconroy@deloitte.com

LACRO
Francisco Perez Cisneros
Deloitte
Tel: +52 55 5080 67 20
Email: fperezcisneros@dttmx.com

Europe, Middle East and Africa
Gilles Goldenberg
Deloitte S.A.
Tel: +33 1 40 88 28 16
Email: ggoldenberg@deloitte.com

Asia Pacific
Yoshiaki Kitamura
Deloitte Touche Tohmatsu
Tel: +81 3 6213 1307
Email: yoshiaki.kitamura@tohmatsu.co.jp

Global Chinese Service Group

John Jeffrey
Deloitte & Touche LLP
United States of America
Tel: +1 212 436 3061
Email: jjeffrey@deloitte.com

Clarence Kwan
Deloitte & Touche LLP
Tel: +1 212 436 4732
Email: clkwan@deloitte.com

Peter Bowie
Deloitte Touche Tohmatsu
Tel: +852 2852 6789
Email: pbowie@deloitte.com.hk

Chris Lu
Deloitte Touche Tohmatsu CPA Ltd.
Tel: +86 21 6335 0202 ext. 1003
Email: chrislu@deloitte.com.cn

Chris Fitzgibbon
Deloitte & Touche
Tel: +44 20 7007 1827
Email: cfitzgibbon@deloitte.co.uk

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in nearly 150 countries. With access to the deep intellectual capital of 120,000 people worldwide, Deloitte delivers services in four professional areas, audit, tax, consulting and financial advisory services, and serves more than one-half of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global growth companies. Services are not provided by the Deloitte Touche Tohmatsu Verein and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas.

As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte", "Deloitte & Touche", "Deloitte Touche Tohmatsu" or other related names.

In the US, Deloitte & Touche USA LLP is the US member firm of Deloitte Touche Tohmatsu and services are provided by the subsidiaries of Deloitte & Touche USA LLP (Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Financial Advisory Services LLP, Deloitte Tax LLP and their subsidiaries), and not by Deloitte & Touche USA LLP. The subsidiaries of the US member firm are among the nation's leading professional services firms, providing audit, tax, consulting and financial advisory services through nearly 30,000 people in more than 80 cities. Known as employers of choice for innovative human resources programs, they are dedicated to helping their clients and their people excel. For more information, please visit the US member firm's web site at www.deloitte.com/us.

Member of
Deloitte Touche Tohmatsu