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Winning the Hearts and Minds of China's Consumers



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Winning the Hearts and Minds of China's Consumers

Thanks to a rapidly rising middle class, China is one of the largest and fastest-growing domestic markets for multinational consumer companies. As a result, global businesses such as Adidas, Carrefour, Procter & Gamble, and Yum! Brands have seen growth in China soar over the past five years. But great success can bring even greater expectations. For the good times to continue, companies must look beyond China's compelling demographics and into the hearts and minds of its consumers. There they will find the hopes, dreams, and fears that drive consumption trends in this strategic market.

Until recently, success for many multinationals in China was driven by geographic expansion in pursuit of new consumers. Going forward, we believe that the game will slowly shift to one in which marketing becomes a source of great advantage. For at least the next decade, the top 50 cities will continue to represent a large share of urban purchasing power in China. Most major consumer-goods companies are already present in these markets and are bombarding consumers with so many promises and products that shoppers readily abandon one brand to try another. In order to win in the next phase of China's rapidly developing economy, companies must secure a marketing advantage through consumer insight and segmentation, and they must ensure lasting brand loyalty by developing superior product functionalities and emotional brand affiliations.

In February and March 2007, The Boston Consulting Group's Center for Consumer Insight in Asia conducted a large-scale survey in 13 cities. The survey included more than 4,000 Chinese consumers representing a range of household incomes and regional characteristics. That effort was supplemented by in-depth qualitative research consisting of focus groups, home visits, and "shop-alongs." Our results indicate that the trends in consumer behavior that are playing out in other parts of the world are also emerging in China—often in ways that differ from other markets and across the country's top-, middle-, and lower-tier cities.

China is changing and changing fast. The past decade brought prosperity but also uncertainty. A young mother in one of our focus groups expressed mixed feelings about the economy's rapid advance: "China has changed so much; my parents would never have imagined the life that I'm leading now. I fear that my child's life will also change dramatically—so much so that she will be unable to relate to me. But I believe the changes are for the better."

Such thoughts make their way into attitudes toward spending and consuming, resulting in a highly complex market in which market share can shift quickly. Armed with superior insight into consumer behavior, a relatively small player could leapfrog the competition and usurp a market leader's position with remarkable speed. Today's leaders must anticipate consumers' attitudes or risk losing ground to competitors.

A Market in Transition

Having weathered extraordinary economic and social change, Chinese consumers are ready to enjoy the fruits of their labors. They are, for the most part, proud of their accomplishments and confident about their financial future. As a result, most families plan to continue pursuing their dreams as they see them become increasingly achievable.

Over the past 15 years, disposable income in China has risen three to five times faster than income in the developed world, bringing better living conditions and more sophisticated tastes. Our survey indicates that most Chinese families plan to increase their spending in the near future. Much of this wealth will go toward furnishings for bigger and newer homes, upgraded consumer electronics, better personal-care products, and goods and services to educate children and improve their prospects.

Yet marketers should beware of taking too simplistic a view of consumers' attitudes toward spending, which are, in fact, quite complex. Decades of rapid change have brought stress and insecurity, and a greater percentage of Chinese report such feelings than do consumers in other countries. One manifestation of Chinese consumers' concerns is that savings rates continue to be high to make up for the lack of a social safety net. Another is that young consumers (most of whom are only children) feel a strong obligation to care for their parents and grandparents in the years ahead.

Consumers' optimism about the future is also tempered by questions about how a more affluent society will affect their children's future. Although many Chinese will increase their spending as their income grows, how they spend could change dramatically. Understanding the complex attitudes of China's consumers will be crucial in marketing to them.

Differences Among Generations

Because China is changing so fast, generations only a decade apart have grown up in quite different

circumstances, and that has created some striking cross-generational disparities. Consumers in our survey aged 40 to 50, many of whom had their education interrupted by the Cultural Revolution, are less equipped—psychologically and financially—to deal with the westernizing environment. They have benefited from the improved economy but not as much as the younger generation has. These middle-aged consumers tend to be frugal and to spend more conservatively.

Consumers aged 30 to 39 experienced some hardship in childhood, but they received the bulk of their education after the Cultural Revolution and have benefited from the country's economic reforms. They are now at an age when careers loom large. More than other groups, they feel that they are working harder than before and want to be recognized for their effort. But they also report feeling more stress related to growing older. And despite the fact that they are satisfied with the time they give to their families, they feel that they are more isolated and don't spend enough time with friends. On the positive side, this generation is relatively well-off and more willing to spend than their older brothers and sisters; they are particularly likely to trade up on home decor products and appliances, financial services, and, of course, products that enhance their children's lives.

China's twentysomethings, known as its "little emperors," are the first generation to have grown up under the one-child policy. As a result, they have been pampered and are relatively guilt free about sampling the many Western goods that are flowing into the market. In addition to spending on themselves, they have also been on the receiving end, enjoying the generosity of doting relatives. It's not all gravy for this generation, however. They feel pressured to find the right mate, establish themselves in a career, and furnish their first homes in good taste.

China's teenagers are optimistic and confident. Also the beneficiaries of generous relatives and parents, they enjoy significant spending power and, especially in the top-tier cities, are eager to try new brands. Most of their money goes for clothing, snacks and beverages, and technology,

and the teens have a strong influence on their families' purchases in these categories. The teenagers in the larger cities are increasingly savvy about technology. They spend 10 to 20 percent of their pocket money on mobile phones and Internet fees, 15 to 30 percent of their leisure time on the Internet, and 20 percent of their time watching television. They are especially interested in international programs, whereas teens in lower-tier cities spend about one-quarter of their leisure time watching domestic television shows.

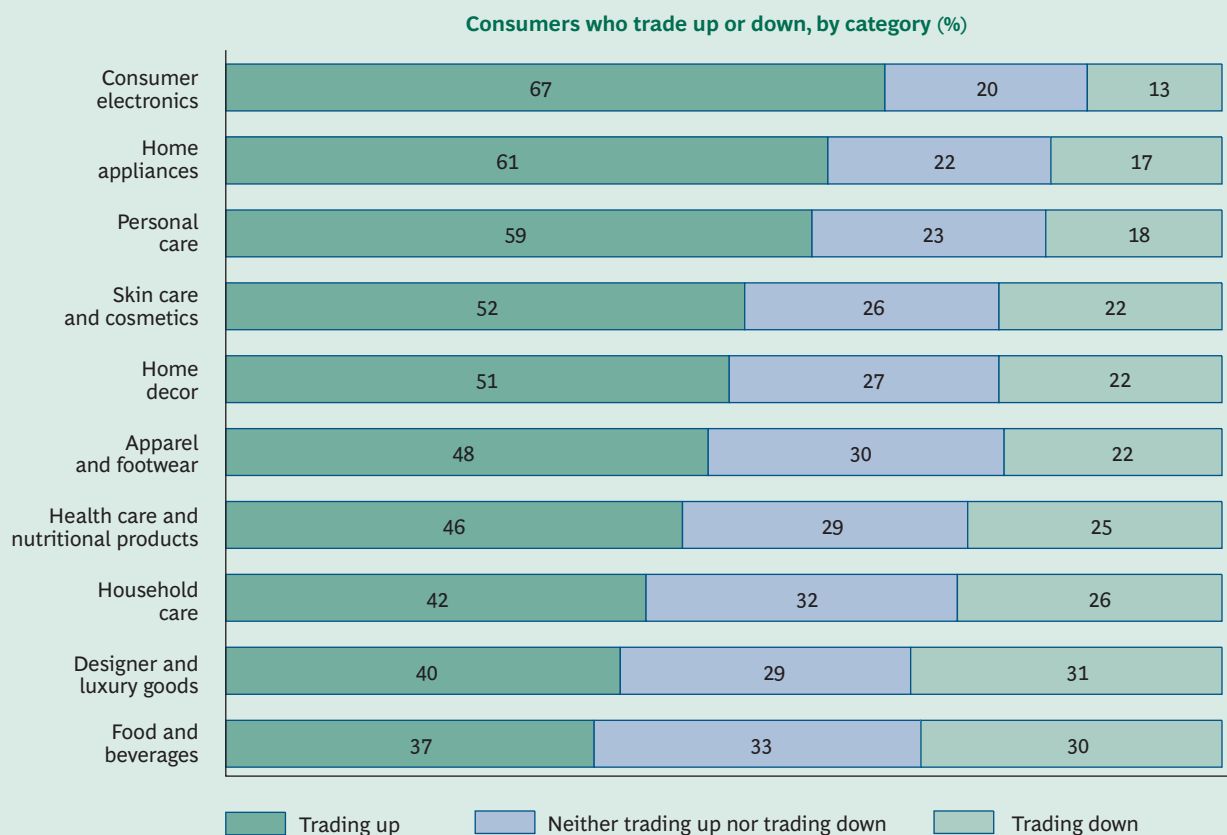
The fact that Chinese consumers from one generation to another and one region to another have had widely divergent cultural and political experiences presents a huge challenge to marketers. How, for instance, should a marketer position a brand targeted to a particular demographic when consum-

ers' attitudes and behaviors differ so significantly across the country? What's more, consumers at all levels and regions are moving up the socioeconomic ladder and are eager to trade up to new—and better—products. As a result, China is expected to become the world's third-largest consumer market by 2010 and the second largest by 2015. Such an important, yet challenging, market calls for the world's best marketing practitioners to make China their home.

Trading Up Beats Trading Down

The economic boom in China has aligned consumers' needs with business capabilities to fuel a trend toward trading up to better products in almost all consumer categories. (See Exhibit 1.) Indeed, one

Exhibit 1. Trading Up Beats Trading Down Across Product Categories in China



Source: BCG China Consumer Behavior Quantitative Research (a survey of 4,258 consumers in 13 cities in 2007).

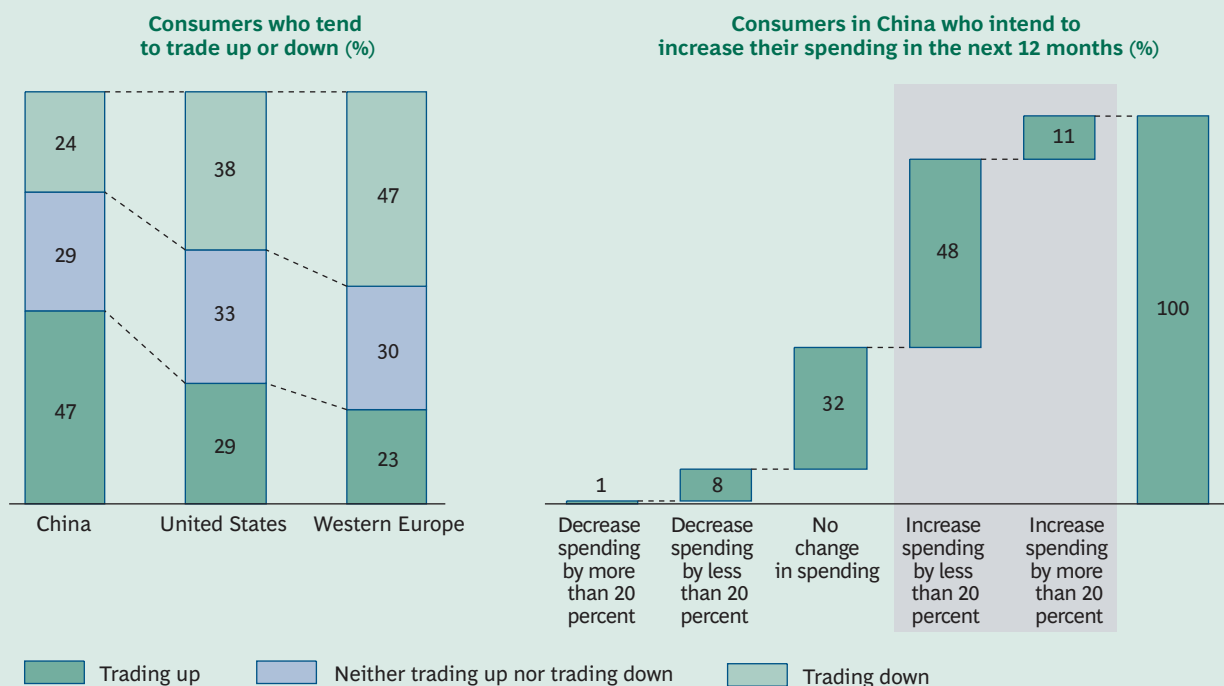
of the most significant findings from our research is that the percentage of Chinese consumers who are planning to increase their spending in the near future is more than six times that of those who will spend less. (See Exhibit 2.) That is a much wider spread than in either the United States or Western Europe. Trading down is more prevalent in the West, partly because of the popularity of large retailers, such as Aldi, Carrefour, and Wal-Mart, that offer good value at lower prices. In China, however, shopping at some of these retailers is perceived to be trading up, especially when the products they offer are compared with products offered in China's traditional trade channel and unbranded products in general.

Three major forces are driving Chinese consumers' strong interest in trading up. First, and most obvious, is the natural desire to try new and better products as incomes rise and the economy improves. Second, the absolute price point of products in the

value segment is much lower in China than it is in the West, and the value segment itself occupies a larger percentage of the overall market; as a result, there is more room to trade up than to trade down. Mass-market skin-care products, for example, cost only RMB 10 to RMB 30, whereas premium brands go as high as RMB 400 to RMB 600. Finally, many consumers who purchase mass-market and value brands look forward to being able to afford higher-price products because of concerns about the quality and integrity of the ingredients in cheaper products. Western companies have been more successful in capitalizing on this trend with sophisticated marketing efforts and global brands that offer superior benefits.

All age groups exhibit a tendency to trade up, but the trend is strongest among younger people aged 18 to 29—less because of their higher incomes than because of their greater willingness to indulge themselves. The trend is also present across all in-

Exhibit 2. Trading Up Is Much Stronger in China Than in the United States or Western Europe



Sources: BCG China Consumer Behavior Quantitative Research (a survey of 4,258 consumers in 13 cities in 2007); an online survey of 9,093 European adults (from Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, and the United Kingdom) in September 2006; an online survey of 2,059 U.S. adults in October 2006.

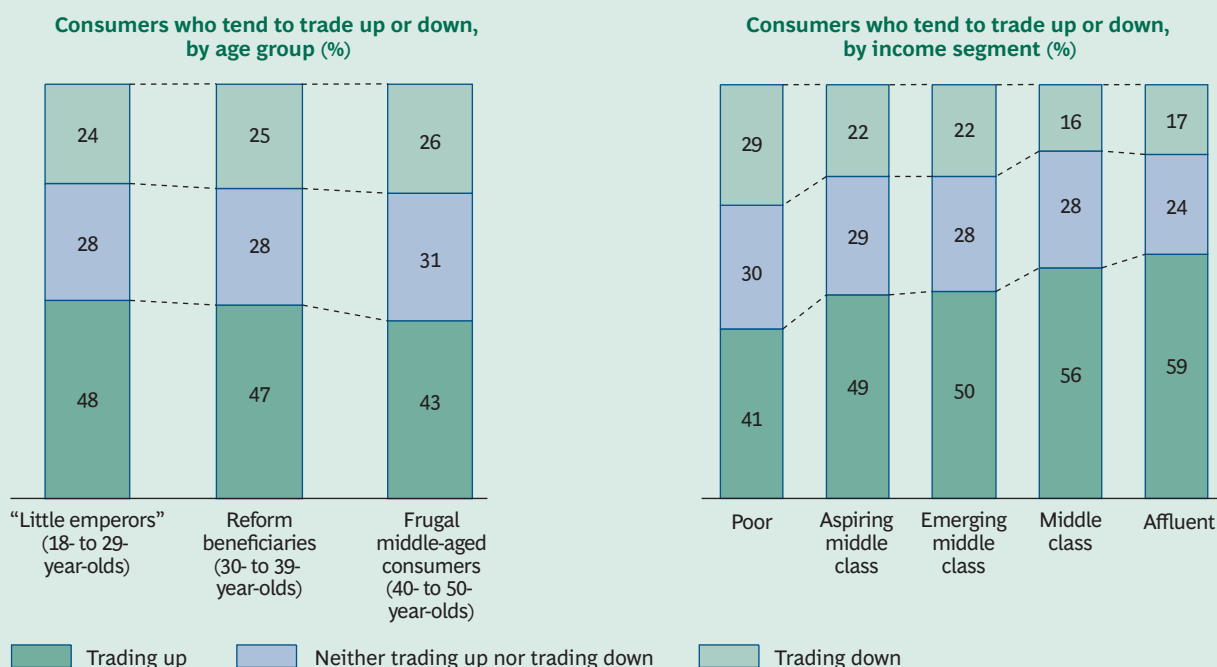
come levels—from about 40 percent of the poorest group, to 50 percent of the emerging middle class, to nearly 60 percent of the most affluent—and across city tiers. (See Exhibit 3.)

Although trading up is strong across all city tiers, affordability and brand exposure significantly influence the degree to which consumers trade up. In skin care, for example, consumers in the lowest-tier cities trade up from Dabao to Olay and Pond's, whereas consumers in the top-tier cities are more likely to trade up from L'Oréal to Estée Lauder and Lancôme. The challenge for suppliers will be to anticipate differences among consumers in various city tiers, age groups, and income segments and tailor their marketing messages and value propositions accordingly—whether by encouraging consumers to trade up to midprice products or inviting them into the luxury brands by highlighting their greater benefits and brand appeal.

Trading Up Across Categories. Chinese consumers differ considerably from Western consumers in the categories they identify for trading up. When we asked consumers to choose from a list of ten categories those in which they were most likely to trade up, our respondents ranked consumer electronics highest, whereas this category comes in fourth for U.S. consumers and sixth for Europeans. Personal care, which is ranked seventh by Europeans and eighth by U.S. consumers, ranked third in China. Apparel and footwear, a category that ranks number one in Western Europe, is sixth in China. (See Exhibit 4, page 6.)

We also found interesting similarities and differences between the affluent and low-income segments in the categories selected for trading up. For instance, in basic necessities such as apparel and food, the affluent segment spends only about 3 times the amount the low-income segment does. But in luxury categories such as home decor and

Exhibit 3: Trading Up Is a Powerful Trend Across All Generations and Income Levels in China



Source: BCG China Consumer Behavior Quantitative Research (a survey of 4,258 consumers in 13 cities in 2007).

Note: Income segments are defined as follows: poor = less than RMB 2,000 per month; aspiring middle class = RMB 2,000 to RMB 3,000 per month; emerging middle class = RMB 3,000 to RMB 5,000 per month; middle class = RMB 5,000 to RMB 8,000 per month; affluent = more than RMB 8,000 per month.

appliances, the affluent spend as much as 10 to 20 times what low-income consumers spend. Such differences can sometimes be attributed to the “wealth effect”: to impress their friends, people who are newly wealthy tend to spend the bulk of their money on “prestige” products with highly visible logos.

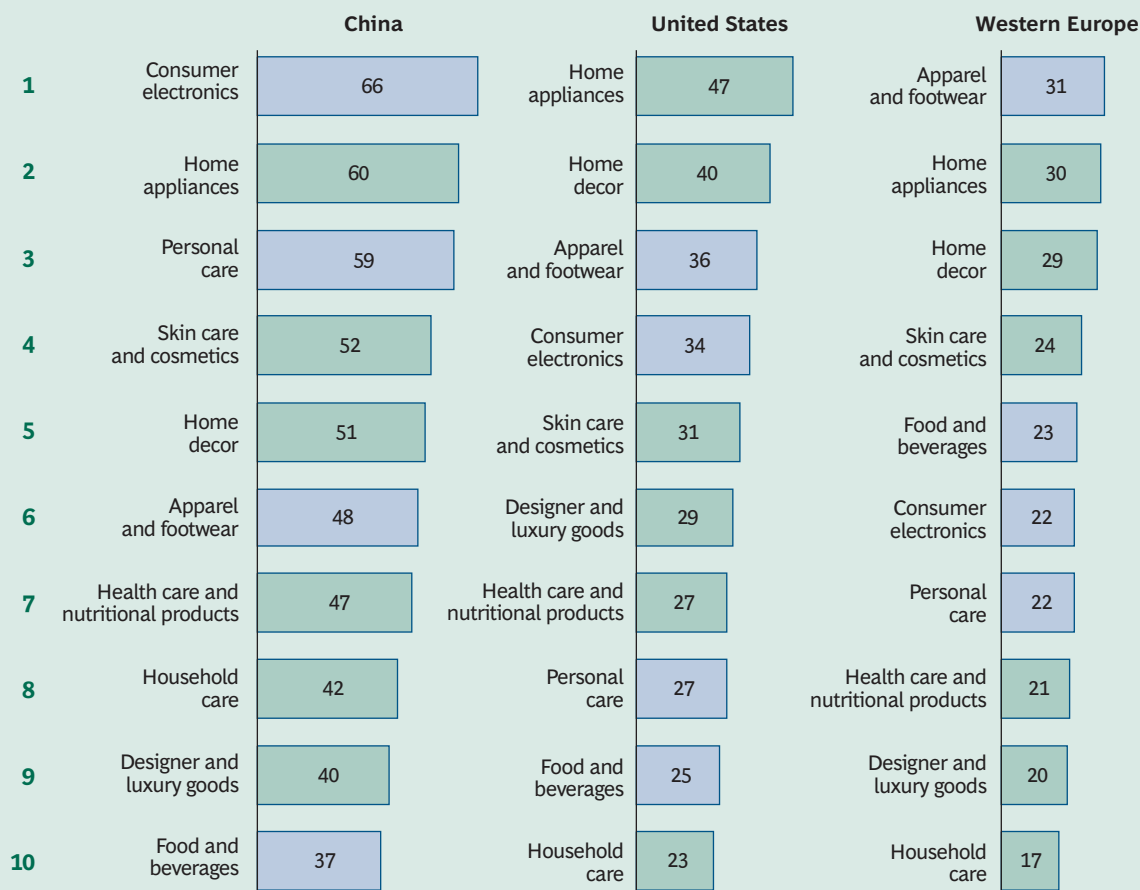
Finally, products designated for trading up can vary significantly within a category. In food and beverages, a category that in general ranks low for trading up, we found that more than half of Chi-

nese consumers would trade up for baby food and dairy products—partly because of recent concerns about the danger of inferior products—whereas less than one-third would trade up for fast food, soft drinks, snacks, and liquor. That demonstrates the importance of “de-averaging” general category trends. Categories that, on average, have the lowest numbers for trading up often contain subcategories in which consumers are willing to spend more.

The Power of Brands. The Chinese put more faith in brand names than do consumers in the United

Exhibit 4: Chinese Consumers Differ Significantly from Westerners in the Categories They Choose for Trading Up

Categories consumers choose for trading up (%)



Sources: BCG China Consumer Behavior Quantitative Research (a survey of 4,258 consumers in 13 cities in 2007); an online survey of 9,093 European adults (from Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, and the United Kingdom) in September 2006; an online survey of 2,059 U.S. adults in October 2006.

States and Western Europe. Half of the Chinese consumers in our survey who trade up would purchase a product because of its brand name, whereas only 33 percent in the United States and 20 percent in Western Europe would do so. (See Exhibit 5.) But the attraction of brands in China is often more a matter of practicality than emotional appeal. A well-known brand in food, for instance, ensures safety and nutritional value; in apparel, it means good material; in skin care, it promises effectiveness and health; in home furnishings, it suggests durability and safety. In emerging markets, product safety and quality can't always be taken for granted; a noted brand assures consumers that the product will live up to its claims.

The Chinese also deliberate long and hard over their brand options. For high-end products, they typically spend a few months browsing in stores and online to gather as much information as possible about product features and brand differences,

especially in categories involving technology, such as consumer electronics.

Chinese consumers are eager to experiment with other brands, and they even switch in and out of price segments in search of more value. Given this propensity to shop around, the challenge for suppliers will be to differentiate their products sufficiently to encourage loyalty and trading up within the brand. For retailers whose stores are well respected, consumers' willingness to try a new brand—especially if it promises good value—could be an opportunity to create a profitable private-label line, which may even command a premium.

Word-of-mouth recommendations from friends often carry more weight in China than television advertising or a sales pitch—although this can vary by region. Medical doctors' recommendations, for instance, enjoy considerable credibility in midtier cities, but consumers in the larger cities tend to be

Exhibit 5: Chinese Consumers Care More About Brands Than Westerners Do



Sources: BCG China Consumer Behavior Quantitative Research (a survey of 4,258 consumers in 13 cities in 2007); an online survey of 9,093 European adults (from Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, and the United Kingdom) in September 2006; an online survey of 2,059 U.S. adults in October 2006.

Note: A reason was considered to be chosen by a respondent if he or she gave it a 4 or 5 on a scale of 1 to 5, with 1 meaning that it “does not describe my situation at all” and 5 meaning that it “describes my situation very well.”

more skeptical of such advice. To get the word out about their products, suppliers and retailers should work hard to convert past users into brand disciples. Given the wide availability of substitutes, flawless end-to-end execution is key to keeping consumers from trying other brand offerings.

Treasure Hunting the Chinese Way

Although better salaries and living conditions have allowed many in China to trade up to more expensive products, the Chinese continue to spend as carefully and conscientiously as they did when they had less. In the home appliances and consumer electronics categories, for instance, consumers are most attracted to technical or functional features that offer convenience, easy storage, durability, and

reliable service. In the personal-care category, they care most about health benefits and the quality of the ingredients.

Rather than describe Chinese consumers as either trading up or trading down, we might more accurately characterize their spending behavior as a *treasure hunt* for value—even when they are paying a premium price. Yet as carefully planned as their purchases may be, there’s no question of scrimping or going without. Instead, they are getting a good deal and exercising their talent as smart shoppers. (See the sidebar “Wang Le Explores Her Thoughts on Shopping.”)

Chinese consumers use a number of strategies when hunting for treasures. Like consumers in other countries, they try to know market prices and compare them across stores. They buy products on

Wang Le Explores Her Thoughts on Shopping

In the course of our survey, we encountered many instances of a discriminating attitude toward spending, but Wang Le’s story tells it best. A typical 31-year-old mother, she works as a nurse and lives with her husband and their infant son in Shanghai. She also manages a household income of RMB 8,000 per month and has given considerable thought to how she budgets it:

“I shop a lot in my spare time. It’s my hobby, and I enjoy getting a good deal. But shopping is my responsibility as well. I have to consider my family’s financial status, determine our budget, decide which products to buy, and choose between something expensive or cheap. It’s rarely an easy tradeoff. In fact, I consider shopping to be one of my two jobs. My first job at the hospital is to make money, and my second job at home is to shop in ways that will save money and provide good value.

“Well-known brands are important to me because I can trust their quality. I have a Whirlpool washing machine, a Sanyo TV, a Panasonic refrigerator, and my digital camera is a Nikon. I favor Nivea and Avon in cosmetics. But I’m not particularly loyal to any brand. If there is another brand that offers better quality or a lower price, I’ll try it. I believe for-

eign brands tend to have better reputations for quality, but there are a lot of local brands that are more appealing to Chinese tastes and needs. And local brands often provide better value for the money.

“I have more choices nowadays in products and brands. But I can always find the best value for my money by searching out promotions, seasonal discounts, bulk purchases, and the like. One time I bought an expensive dress in a store, and afterward I found the exact same dress in another store on sale at a 40 percent discount. This was a big lesson for me. Since then, I always look through ads and brochures to get an idea of the prices before I go shopping for a particular item. I also compare prices at different stores to get the best deal. It makes me really happy when I find something nice at a price lower than I had expected to pay. It feels like winning the lottery, and I love to tell my friends.

“I’m happy with my life, and our living standard is steadily improving. But still, I need to plan for my child’s future. We want to give him the best education, and it’s our dream to send him to study abroad. To do that, I carefully follow our budget, look for the best bargains, and save for his future. As a good wife and mother, it’s what I should do.”

sale and shop at wholesale markets. They buy off-season or defer a purchase until the price comes down. They purchase online and from catalogs, and they even buy knockoffs when the resemblance to the real thing is good.

One strategy that isn't common elsewhere is to go shopping with a group of friends and try to negotiate a group discount. Another is to shop at parallel-sourcing stores. Such retailers purchase brand-name products from alternative distributors at lower prices—lower because the distributor has eliminated some costs or because the product is near the end of its shelf life. The savings are passed on to the customer in prices that are as much as 40 percent lower than the prices for the same brands in other stores.

When we asked Chinese consumers who bargain hunt about their reasons for doing so, more than half of them cited the ability to spend more on something else as their top reason. They also reported enjoying the “thrill of the hunt” for a product that is worth more than they end up paying. Not being able to afford anything but the cheapest products was at the bottom of the list, as it is for Western consumers.

Implications for Suppliers

It would be hard to overestimate the complexity of China's market. Not only does it represent a variety of demographic segments with divergent cultural experiences, but also the segments are constantly shifting. The only way to anticipate the shifts is to develop an intuitive understanding of how customers think and feel about their lives, keep a close watch on consumption trends, and focus on building sustainable brand loyalty.

To attract China's treasure-hunting consumers, suppliers must establish strong, branded relationships with them, provide the kinds of products that appeal to practical concerns and emotional needs, and be willing to customize their offerings to meet the needs of a geographically diverse population. Because China's far-flung markets are highly localized—each with its own retailers, middlemen,

and competitors—brands must be built region by region.

Global companies in China will be wise to focus on product innovation and improvements rather than on price alone. Whether the price is high or low, Chinese consumers are becoming more discerning and demanding. They want reassurance about quality and practical benefits at all price points.

Yet even a well-established and trusted brand can't maintain its position for long if its technical and functional benefits become undifferentiated from the competition's. So suppliers must constantly up the ante on innovation and quality—which can mean rendering one's own products obsolete before the competition does. Still, any new benefits claimed for a product must be credible to Chinese consumers, who have become highly skilled at distinguishing marketing hype from reality.

Many consumers in our survey expressed a strong desire for more living space. Therefore, products that help make a home seem cleaner or less crowded—such as personal stereo systems, air purifiers, and noiseless and self-cleaning appliances—will be highly appreciated. Appliances and furniture, as well as home-decorating advice and cleaning services, will be important for families that are able to move into larger apartments.

It shouldn't be surprising that the most popular trading-up categories—consumer electronics, home appliances, personal care, skin care and cosmetics, and home decor—are also the categories favored by young singles and newlyweds. Global suppliers, especially, should pay close attention to the unique characteristics of China's market—its wide-ranging income levels and geographic variety. They will need to target premium-price products, such as those in the trading-up categories mentioned above, to younger consumers, wealthy households, and consumers in large cities.

Products offered in China's lower-tier cities, where incomes are smaller, should emphasize quality and durability. But whatever the market segment, all Chinese consumers put great stock in tangible benefits. So suppliers should demonstrate their

claims in their marketing efforts. A well-established umbrella brand, for instance, is often effective in launching new products in China. It gives credibility to promises of safety and quality, and provides scale economies in a diverse marketplace with surging media costs. But such a brand must be coupled with good in-store execution to ensure its power at the local level.

The following questions will help suppliers think about their readiness for China's increasingly dynamic and complex market:

- Do we have processes to help us monitor, understand, and anticipate consumers' concerns about the future?
- Are we ahead of our competitors in identifying and capturing trading-up and treasure-hunting opportunities?
- Does our brand strategy take into consideration geographical differences and potential behavioral shifts? Does our marketing strategy account for differences among age and income groups and across price segments and regions?
- Are we as focused on building lasting consumer loyalty as we are on expanding our geographic footprint?
- Are we too focused on price and not focused enough on innovation and value? Do we align innovation with rapidly evolving consumer needs?

Implications for Retailers

Attracting consumers who are eager to trade up is critical to driving productivity and profitability in China—for retailers as well as suppliers. Like suppliers, retailers can't rely indefinitely on footprint expansion and must become more sophisticated at capturing a larger share of wallet from consumers. And because consumers selectively trade up in some categories and not in others, retailers must make sure that the categories they carry are the ones that treasure-hunting consumers will seek. Indeed, excellence at providing con-

sumers with opportunities to trade up will prove to be a key point of differentiation against the competition.

Like their suppliers, retailers must look beyond pricing as a long-term source of differentiation and must focus instead on a product's technical and emotional benefits. Some retailers may choose to limit their role to that of a discounter, others to that of a provider of premium goods. In either case, by understanding the drivers of trading up in their categories—and through careful visual merchandising, pricing architecture, and quality assortment—retailers can capture both current and future treasure-hunting consumers.

Store format—location, size, and layout—is also critical in attracting consumers who are eager to trade up. And, of course, service is extremely important. Because consumers often trade up across brands, retailers in certain categories should consider providing their own sales services rather than using their suppliers' promoters and salespeople, which represents today's de facto model.

Private-label products offer another good opportunity to encourage trading up, but retailers must resist the Western practice of merely offering a low-price alternative. It's not as simple as stripping out costs or features to make a cheaper product. Instead retailers should focus on their customers' uncompromising desire for value and quality and their willingness to trade up. In categories such as home appliances and electronics, where consumers typically trade up for technical benefits, retailers should source the latest models and maintain shorter SKU life cycles.

To monetize the trading-up phenomenon, retailers must launch an all-out effort and in some cases be prepared to completely reposition their strategy. In such a rapidly changing consumer landscape, there is no time for complacency: successful retailers must continue to evolve; those that don't risk obsolescence.

The following questions will direct retailers to opportunities they might have overlooked in this rapidly emerging market:

- Do we understand the thoughts and feelings that shape our customers' shopping behavior?
- Are we too focused on price?
- Are we capitalizing on the trading-up and treasure-hunting trends in products, services, and merchandising?
- Are we segmenting our customer base and using our insights to help our customers trade up to better value?
- Do we have a plan for encouraging our customers to stay loyal to our brand?

Most global consumer and retail companies understand that succeeding in China's huge market is an imperative. Yet too many have concentrated on footprint expansion and near-term opportunities at the expense of understanding the massive changes Chinese consumers are undergoing. To be a winner in this most strategic market over the long term, companies must focus on Chinese consumers and how their experiences are driving the trading-up and treasure-hunting shopping trends that will play out in many profitable ways for years to come.



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Acknowledgments

The authors would like to thank their colleagues William Jiang, Gillian Moore, Jennifer Tam, and Jeff Walters for their contributions to this report. They would also like to thank Sally Seymour for her contributions to the writing of the report and Barry Adler, Gary Callahan, Elyse Friedman, Kim Friedman, and Gina Goldstein for their contributions to its editing, design, and production.

Original primary research contained in this report was developed by BCG's Center for Consumer Insight (CCI), which leads BCG's consumer research. As a global center of expertise, the CCI provides resources that are mobilized through our engagements around the world and deeply integrated into our efforts to bring clients the full value of superior knowledge through innovative approaches to consumer research. The CCI also leads the firm's proprietary research for publications on consumer trends and purchasing patterns. As an advisor to companies in many industries, BCG has long recognized the fundamental value of identifying and leveraging consumer insights for strategy development and as a key source of sustainable competitive advantage.

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