A Cross-Cultural Initiative: Engaging China’s Middle Class

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Abstract

This project seeks to analyze and evaluate China’s growing middle class and fill a gap in the literature of economic growth inequalities between urban and rural households as well as to answer growing demands from Generation Y.

An evaluation will show the current relationship between foreign direct investments and domestic consumption increases, urban and rural income levels and changing trends within the middle class. We will conduct data collection, interviews, library research and econometric analyses to show where reform policies have worked and new markets will be most profitable.

In particular, we will examine new markets for potential growth, the emergence of Generation Y, changes in consumption behaviors, and savings rates for urban and rural households. Specifically, an analysis will be conducted of the Lorenz curve, income disparities, per capita urban and rural income levels, and foreign direct investment (FDI) and domestic consumption levels, along with other qualitative analysis from observations, interviews and literature.

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1. INTRODUCTION

China’s current economic growth pattern is shifting it from an industrializing, production-centered economy to a consumer culture that continues to expand at an unprecedented rate. The growing middle class, particularly Generation Y, has been developing needs that will decrease income inequalities and narrow the volatile gap between the rich and poor. Increased incomes from the growing middle class will increase demand for the creation of new markets. This shift from a traditional labor-intensive workforce to a consumer culture will merge appropriately with Chinese and foreign companies’ strategies, focused on increasing trade and investments to meet the needs of Chinese consumers’ demands for energy, household and recreational products, and science and technology goods and services. What global repercussions will an increase in consumption have on a China that is shifting from being “Made in China” to “Sold in China?”

The hypothesis is that the demand for new markets, such as the golf and science and technology industries, will increase as middle-class consumption and buying behaviors increase, powered by Generation Y. Income inequalities between rural and urban households will narrow, as infrastructure and development expands outward in China, causing the Lorenz curve to decrease in its degree of inequality. Domestic consumption will continue to outperform foreign investments in the future as domestic China begins to consume the products it produces. In 2007 China’s Bureau of National Statistics reported that although China’s economy remains dominated by foreign direct investments, domestic consumption outperformed foreign investments in becoming the biggest driver of economic growth for the first time in seven years. In 2007, reported consumption continued to grow at around 10%, but these statistics represent an underestimation due to poor calculations related to service sector consumption. Domestic consumption will act as a sustainable driver for economic growth. The low-middle classes, with yearly incomes between USD 4,000-USD 12,000, are the backbone of future economic growth within China during the next several decades, predominately Generation Y.

2. GENERATION Y

China’s Generation Y represents approximately “250 million people born between 1980 and 1990, which is roughly 83% of the United States population. Optimism for the future, enthusiasm for consumerism, entrepreneurship and acceptance of transforming modern China into an economic superpower through advances in technology are attitudes highly regarded by Generation Y.”

One study found that Generation Y single children often consume an astonishing 50% or more of family expenditure in some major cities. As Generation Y grows, foreign direct investments will increase, restrictions on international trade and finances will decrease, and the knowledge of technological advances will be shared, ultimately improving multi-lateral relations. The “vast majority of Chinese middle-class youth expect to spend more money in 2008 than 2007.”

Generation Y is changing the traditional spending habits through adopting Western buying habits and becoming less frugal with their money.

Generation Y will have to deal with growing socioeconomic problems between urban and

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3 Rein, Shaun. *China’s Private Equity Boom*. report from BusinessWeek. 2007
rural residents resulting from modernization. One demographic consequence of the "one child" policy is that China is now one of the most rapidly aging countries in the world. However, this challenge will be met by new entrants in the work force and over 300 million migrant workers from rural areas moving into cities. Local socioeconomic instability could cause a decrease in trade with foreign companies as government tries to focus on programs and industries that will promote economic growth to increase GDP. Foreign entrepreneurs and companies have to be aware of the cultural differences created when there is an increase in foreign investments. New industries being introduced to China’s local economy have to address issues in a manner that is effective and affordable, and aligned with political agendas in regard to economic development. An industry that promotes local growth by creating jobs and increasing management skills through education programs, addresses urban and rural residential socioeconomic issues by increasing the number of jobs for low-middle class workers. An increase in jobs will push income rates upward, generating higher consumption rates from middle class consumers. These companies will yield higher returns from the local economy and stability of that industry, I am suggesting that the golf and science and technology industry are the most effective for addressing the above dimensions.

Since Generation Y is embracing Western spending habits, the golf and science and technology industries provide profitable opportunities to capture the needs of consumers. Youth consumers will be driven to own the newest electronic devices and will actively partake in new forms of entertainment activities. Since middle-aged consumers in the low-middle class have felt the impact of the global financial crisis, a decrease in consumption will result as these consumers will become more mindful of their spending behavior. However, a large gap between the rich and poor still exists, due to income inequalities, which is explained by using the Gini Index.

3. INCOME INEQUALITIES

Income inequality closely parallels consumption inequality, although consumption inequalities have a lower growth rate than that of income inequalities. The Gini Index measures the degree of inequality in the distribution of family income in a country. The index is calculated from the Lorenz curve, in which cumulative family income is plotted against the number of families arranged from the poorest to the richest. The index is the ratio of (a) the area between a country's Lorenz curve and the 45 degree helping line to (b) the entire triangular area under the 45 degree line. The more equal a country’s income distributions, the closer its Lorenz curve will be to the 45 degree line and the lower its Gini index. Ideally, in a perfectly egalitarian society everybody would have exactly the same income. In Figure 2, when $g$ equals 0, the slope of the line equals 45 degrees. Figure 2 and 3 show that when the curve moves farther away from 0, the greater the difference in income distributions becomes; causing an increase in income and consumption inequalities. In 2007, China’s Gini Index for the distribution of family income was 47, representing a 47 degree curve away from the equilibrium point where $g$ equals 0. This confirms the wide gap between the rich and poor.

Commonly, households with low incomes tend to exceed their income as a result “of dissavings or government subsidies for urban residents” (Wu & Perloff). Government subsidies are causing increases in inflation, which could lead to shortages of goods if consumers begin hoarding out of concern that prices will increase in the future. However, government subsidiaries are needed to increase growth and encourage an increase in spending from the middle class. If there is a disparity of goods to consumers, the supply and demand curves cannot reach a point of
equilibrium. The golf and science and technology industry will serve as stimulation for economic growth in low-middle income households, especially in light of the recent economic slowdown. This is will generate more jobs available to income households in need of employment. This strategy only solves part of income inequality concerns.

The following sections will discuss how the golf and science and technology industries will increase foreign trade and investments, while narrowing the gap between the rich and poor and increasing middle class family household incomes.

In 2008, McKinsey Quarterly Report stated that “about 600 million Chinese now live in cities, yet that represents only 46% of the population, compared with more than 80 percent in the United States,” suggesting China’s cities are likely to grow considerably. New research by the McKinsey Global Institute projects that by 2025 China’s cities will “add 325 million more people, including about 230 million migrants. Following the current trend, the country’s urban population will reach 926 million by 2025 and top 1 billion by 2030.” Due to an extraordinarily high savings rate, Chinese individuals with an appetite to consume are looking for new activities to enjoy with family and friends.

4. GOLF INDUSTRY

The golf and science and technology industries provide goods and services that hold important dimensions to brand and price conscious consumers. The golf industry, including miniature golf, will improve the unemployment rate due to increases in urban population growth and provide an affordable activity to the middle class. As of 2008, China's golf industry had already experienced 24 years of development. “It grew from the initial golf equipment-oriented market, to the later golf membership-oriented market, then to the present golf tournament-oriented market.” China's golf industry has developed both firmly and constantly, but still remains to be socially acceptable to only the wealthy. The entire golf industry continues to be strong despite other dips in the economy. The future looks even stronger for the industry. As Rick Jacobson notes, the “heyday of golf course construction is over in the US,” suggesting that China stands at the pinnacle for golf course development. Analysis of the US golf industry by SRI International suggests that China’s golf industry can expect similar, if not higher returns in years to come due to the decline in the US.

Approximately $62 billion worth of goods were sold in the US, and 56 million people around the globe play golf. During the past two decades in the US, the golf industry has outpaced inflation and does much better than other industries including gambling and amusements, around $55 billion, and even the movie industry at $58 billion. On average, commercial golf courses have annual revenue of $1 million. Comparing the historical growth pattern of golf in the US to China’s current golf industry environment, the pattern shows that the industry has not yet reached its peak and will grow considerably in the next two decades, a result of infrastructure improvements and city development.


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Hosted by The Berkeley Electronic Press
Miniature golf promotes pro-green direction for course development in city parks, which the government currently lacks in its development policies. The usage rate of city parks in megacities such as Beijing and Shanghai are extremely high with peak usage in the mornings and evenings, and offer over ten usable city parks for miniature golf courses in each target city. City dwellers in high-rises with little access to a green environment will be attracted to the pro-green environmental direction miniature golf courses in city parks will provide. The difficulty in attaining government approval for construction will act as a barrier to entry into the miniature golf market. However, the profitability and long term sustainability of this industry presents advantages for reducing employment and increasing consumption rates for all income classes.

On average, a miniature golf course opened during the daytime from 10 am to 6 pm with 100 games played per day at $6 USD ($40 RMB) per person will amount to daily profits of $600 USD ($4,080 RMB). From 6 pm to 10 pm with 120 games played per day at the same rate will amount to daily profits of $720 USD ($4,896 RMB), totaling for a per day amount of $1,320 ($8,976 RMB). Per month profits would equal a total of $39,600 USD ($269,280 RMB), and a 4-month period would equal a total of $158,400 USD ($1,077,120 RMB). A 4-month period was used to describe the seasonal changes of golf in certain locations of China where the environment affects a person’s ability to enjoy the game outside. City malls have been designated as possible development locations, allowing for yearlong availability to consumers for play.

Miniature golf targets middle class consumers, especially Generation Y, with discretionary incomes and outlets for entertainment, but is not limited for high and low income levels. The demographic dimensions of marketing miniature golf are relatively straightforward, as miniature golf targets all income brackets, education levels, occupations, and ethnicities. Miniature golf is a non-inventory, non-commodity business; the cash revenues stay with the owner. Operators of courses are renting space, and don't have inventory to replace. In most cities, the cost of one movie ticket would allow a family of four to play miniature golf. There are many ways to market the miniature golf business to the entire community. It appeals to everyone. You can market miniature golf to a wide variety of groups, ranging from kids to senior citizens. The challenge in designing a miniature golf course is to make it interesting to play. How a course plays is the key to bringing people back to play it again and again.

Unlike miniature golf of old, windmills and standing bears are not found on today's courses. Miniature golf courses do need unique elements to hold the players interest. Greens that bring water, sand traps and rough turf into play add this uniqueness to miniature golf, while still maintaining an interesting and challenging game. Designs today must encompass elements of beauty and nature, in order to capture the interest and excitement required for a profitable business. Interesting shots bring repeat business. Undulations, banking, the size of the greens, the position of the cups, the mix of easier holes with more difficult holes to prevent back-up on the course, are the difference between success and failure. “On a well designed course a player is rewarded for a good putt without being overly penalized for a poor putt. If you hit the putt correctly it will go in the cup. If you hit poorly it may take two or three putts to get it in the cup, but you are not "out of play" or holding up the group behind you.”

8 Harris Miniature Golf Course. 2009
The development of miniature golf in China lies in the ability to secure city parks as areas of operation, since the population is greater in urban areas compared to rural areas. The continued success of the golf industry will be determined by the growth of Generation Y and the emergence of the middle class with high saving rates and discretionary income.

5. SCIENCE AND TECHNOLOGY INDUSTRY

China is now the world's largest exporter of technology goods (although much of the work is on behalf of foreign firms). It is already the world's largest mobile-phone market and the second-largest market for PCs. Moreover, at the end of 2005, China had around 110m internet users, and today China has 430m mobile-phone users.9 Domestically, China is now the sixth-biggest buyer of high-tech goods and services in the world; by 2010 it will be in third place, behind America and Japan. Meanwhile, revenue from software and services has increased by around 50% between 2000 and 2005.10 China's lead is partly the result of coordinated government action. Centralized economies can pour resources into projects and direct the development of entire industries. For mobile phones, China established a second state-owned operator to challenge the incumbent. Also, leapfrogging has allowed government-initiated policies to surpass one form of technology to another, moving directly to advanced technological instruments.

The science and technology industry are very attractive to any firm, since Generation Y is adopting Western consumption trends and the sheer number of consumers they represent. China’s Generation Y is by far more connected to the Internet and by mobile phones than any generation in China. Each year four times as many students in China become engineers than do U.S. students, placing the U.S.’s technological and scientific superiority in jeopardy. Cutting-edge improvements with the internet, and business and personal electronic devices have skyrocketed investments for companies. Economists use this statistic as an indicator for possible future breakthroughs in this industry

Another striking finding is that although revenues and R&D spending are around 20% higher than in 2000 among the top 250 global technology firms, the level of employment is lower. Does that mean automation is putting people, even in the most advanced industries, out of a job? Instead of implying that the human-capital intensity of the technology industry has declined, the opposite is more likely: companies are increasingly outsourcing their operations to smaller, specialist firms—many of them in China, India and Taiwan, as well as in the West—that do not appear in the top 250. As a result, the rise of Asia is best characterized as the welding of the region into the global technology supply chain, in a way that benefits firms in other parts of the world as well.11

The science and technology industry will continue to grow as innovation and knowledge is transferred from one country to another. New firms have the opportunity to offer better products than existing firms in the market and have the ability to attract price conscious consumers.

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9 Reference from Different Strokes: China and India are emerging as technology titans, but in different ways. The Economist 2006
10 Ibid.
11 Reference from Different Strokes: China and India are emerging as technology titans, but in different ways. The Economist 2006
Existing firms have the advantage of maintaining a strong customer base as new consumers enter the market and recognize leading brand names, increasing the number of brand conscious consumers in China.

6. CONCLUSION

The demand for new outlets such as the golf and science and technology industries will continue to grow, while middle-class consumption and buying behaviors increase, powered by Generation Y. Income inequalities between rural and urban households will narrow, as infrastructure and development expand outward in China, causing the Lorenz curve to decrease in its degree of inequality. Domestic consumption will continue to outperform foreign investments in the future as domestic China begins to consume the products it produces. Domestic consumption will act as a sustainable driver for economic growth. The middle class will emerge as the backbone for future economic growth and stability.

The shift from an industrializing economy to a consumer culture has allowed China to continue to expand at an extraordinary growth rate. If domestic Chinese and foreign companies’ strategies are focused on increasing trade and investments to meet the needs of Chinese consumers’ demands, firms’ capital investments will increase, along with consumer demands. The global implications of China shifting from being “Made in China” to “Sold in China” are still to be seen, but one can safely assume that if domestic China continues to grow, countries dependent on the production of goods from China will have to shift operations elsewhere.

This is an ongoing study and will be continued next year, inspired by the life changing experience of studying and living in China between 2007 and 2008. If but one lesson was learned, it lies in the ability to get the other person’s point of view and see things from his angle as well as from your own.
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Table 1: statistics from International Monetary Fund (IMF) and Chinese State Administration of Foreign Exchange. 2008

Figure 1: statistics computed from National Bureau of Statistics of China. (Total retail sales of consumer goods)

Figure 2: Chester, Marvin. The Visualization of Wealth Distribution and the Gini Index. June 2007

Figure 3: Colin A. Hughes, A Handbook of Australian Politics and Government, (Canberra: ANU Press) 1977, p. 129

Figure 4: statistics computed from National Bureau of Statistics of China. (Annual per capita income levels)

Figure 5: statistics computed from National Bureau of Statistics of China. (Totals of urban and rural households saving deposits)
Table and Figures:

### Table 1. China’s Foreign Exchange Reserves: 2001-September 2008

<table>
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<tr>
<th>Year</th>
<th>Billions of U.S. Dollars</th>
<th>As a % of Chinese GDP</th>
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<td>2001</td>
<td>215.6</td>
<td>18.1</td>
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<tr>
<td>2002</td>
<td>291.1</td>
<td>22.1</td>
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<tr>
<td>2003</td>
<td>403.3</td>
<td>28.1</td>
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<td>2004</td>
<td>609.9</td>
<td>31.5</td>
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<tr>
<td>2005</td>
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<td>2007</td>
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<tr>
<td>September 2008</td>
<td>1,905.6</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

Source for actual data: International Monetary Fund (IMF) and Chinese State Administration of Foreign Exchange.
Note: Year-end values (except for 2008).

### Figure 1


**Total Retail Sales of Consumer Goods % Share by Sector in Dec. 2008**

Figure 2

Chester, Marvin. The Visualization of Wealth Distribution and the Gini Index. June 2007

Figure 3

Figure 4

Statistics computed from National Bureau of Statistics of China. Annual per capita income levels

Figure 5

Statistics computed from National Bureau of Statistics of China. Totals of urban and rural households saving deposits