

Understanding China's tiered city system

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It is simply not feasible to approach China as one market. One of the first decisions to make when devising a market strategy is to determine which regions and cities to target. One of the most effective ways is to segment China into local categories to understand consumer behaviour, income level and local trends. Many economists, consultants and businesses classify China based on a 'tier' system to rank cities¹.

The tier classifications

The Chinese government doesn't have an official definition for the tiers and many businesses use slightly different methods for classification such as Gross Domestic Product (GDP), political administration, population size, development of services, infrastructure, cosmopolitan nature, retail sales etc. However, it is generally considered that there are four tiers with different consumer behaviours, income levels and business opportunities.

GDP

Generally, each city is first classified by GDP. China's cities range from US\$350 trillion to minor cities with GDP under US\$20 billion:

- Tier 1 – all first-tier cities have a GDP over US\$300 billion
- Tier 2 – cities with GDP of US\$68–299 billion
- Tier 3 – cities with a GDP of US\$18–67 billion
- Tier 4 – a GDP below US\$17 billion

Politics

China has four levels of political administration and the two special administrative regions of Hong Kong and Macau:

- Tier 1 – cities directly controlled by central government
- Tier 2 – provincial capital cities and sub-provincial capital cities
- Tier 3 – prefecture capital cities
- Tier 4 – county-level cities

¹ The special administrative regions of Hong Kong and Macau are not classified within the tier system.

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Population

The core city and urban areas surrounding the main city are taken into account to define metropolitan areas:

- Tier 1 – cities with more than 15 million people
- Tier 2 – cities with 3–15 million people
- Tier 3 – cities with 150,000–3 million people
- Tier 4 – cities with fewer than 150,000 people.

Rural areas are villages close to Tiers 2, 3 and 4 cities.

The four tiers and their characteristics

Tier 1

Beijing, Tianjin, Shanghai and Chongqing are directly controlled by China's Administration Centre. Along with Guangzhou they make up the five cities that qualify across all three major categories as tier one. Many classifications also place Shenzhen in this tier while some place Chongqing in tier 2.

First-tier cities represent the most developed areas of the country with the most affluent and sophisticated consumers. They are large, densely populated urban metropolises that have huge economic, cultural and political influence in China. Tier 1 cities attract great attention from foreign enterprises due to income levels that are much higher than the national average and a large number of middle class residents who have higher levels of imported wine consumption.

They offer the largest consumer base for imported wine, boasting the most mature on-trade and off-trade environment in China. Compared to lower-tier cities, distribution players in higher-tier cities are more professional. Imported wine is priced more reasonably than in lower-tier cities. However, there is more competition and they are more saturated.

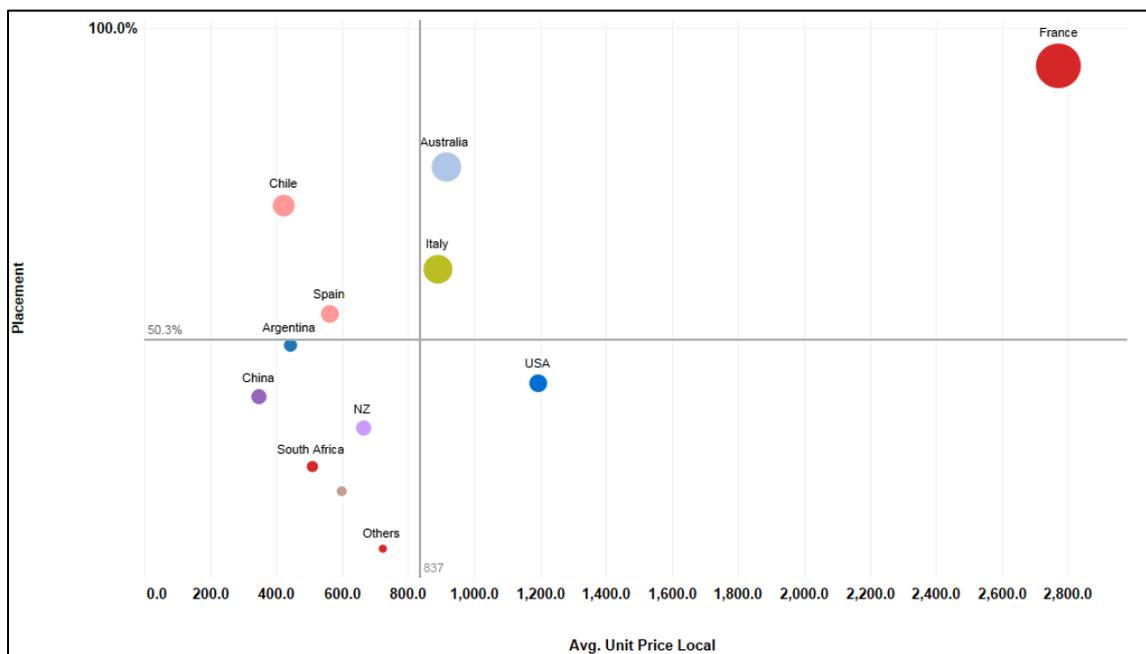
Consumers are more aware and consume more Australian wine.

Australian wine is well-positioned in first tier cities. For example, in the Guangzhou on-trade market, Australia is positioned second only to France in terms of placement² and average number of still wines per outlet, well ahead of Chile and Italy, and its average unit price is third after France and the US (see figure 1). The average unit price of French wines in the on-trade is inflated by Bordeaux while the US position is dominated by Cabernet Sauvignon from the Napa Valley.

² Percentage of outlets with at least one wine from this country

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Figure 1: Positioning of wine by country of origin in Guangzhou on-trade market 2016
Average unit price in CNY



Source: MIBD Market

Tier 2

The list of cities includes Chengdu, Wuhan, Hangzhou, Harbin, Shenyang, Nanjing, Jinan, Changsha, Zhengzhou and another 20 cities.

Second-tier cities have become increasingly attractive for investment. They are some of the fastest growing areas. Consumer behaviour is evolving quickly and, in general, trends are similar to first tier trends.

The second tier is generally made up of provincial capitals, sub-provincial cities, Special Economic Zones such as Guangdong Province, and other more developed cities with cultural and economic influence.

Over the past decade, Tier 2 cities have received increased attention and investment from foreign companies due to lower labour costs, less competition, lower operating costs for retailers, and rapidly increasing consumer spending habits. Even within this tier there are substantial differences in the economic, population and consumer habits in each city.

Because they are attracting increased domestic and international investment, the economic growth of some of these cities is even higher than that in Tier 1 cities.

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With a continued growth in income, consumers here start to have the ability to try imported wine. However, the market development is still at an earlier stage and pricing is less transparent than in higher tier cities.

Consumers are less aware of and consume less Australian wine.

Tier 3

There are over 130 third-tier cities, including Daqing, Weifang, Changzhou, Zibo, Zhuzhou, Hengyang, Wuhu and Qijing.

They generally lag behind first and second tier cities in terms of economic growth and development, although many are still considered to be very significant economically and historically.

Many of third-tier cities are considered to be convenient and relatively inexpensive locations for a number of large industries and big companies.

They are generally open coastal cities, high-income cities and cities with significant economic development.

Tier 4

There are over 400 cities in this tier. Some of the more well-known ones included Quanzhou, Datong, Shiyuan, Rizhao, Fushun, Huaihua and Huzhou.

Often lumped together, cities in this category represent the majority of China's urban population and combined income. The rapidly changing rates of development across China have great potential to change many of these lower classifications.

Wine consumption differences by city tier

Urbanisation has been a driver of growth in China. In 1990, 26 per cent of China's population lived in cities. By 2015, 56 per cent of the population lived in cities. In 2016, the adult urban population of China was 430 million, up from 378 million in 2014.

Disposable incomes are also on the rise. In 2015, the average disposable income of Chinese residents increased 8.9 per cent. This has contributed to the urban upper-middle class adult population reaching 112 million, up from 95 million in 2014. It is this section of the Chinese population that can afford to regularly purchase imported wine. Wine Intelligence estimated that in 2016, there were 48 million urban upper-middle class imported wine drinkers, up from 38 million in 2014. Wine Intelligence has projected the number of imported wine drinkers will climb to 88 million by 2020 and 160 million by 2025.

Wine Australia providing insights on Australian Wine

Wine Intelligence examined the differences between higher-tier and lower-tier city imported wine drinkers in terms of their wine consumption and purchase patterns (see figure 1). Their research suggests there is significant variation in consumer behaviour between city tiers. Consumers in lower-tier cities are often just starting out on the income ladder and they are at an earlier stage in wine consumption. Consumers in higher-tier cities are more likely to enjoy trying new and different wine styles on a regular basis. Consumers in lower-tier cities are more risk-averse than those in higher-tier cities and thus offering them the opportunity to try before buying may assist in helping their decision-making process.

Figure 2: Differences in city tiers



Source: Wine Intelligence

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