

The seven faces of China's consumer



Highlights

Boosting domestic demand and delivering higher standards of living have been raised as top priorities in the 14th Five-Year Plan, which will be the guiding document for China's policy agenda in 2021-2025. Unlocking the full potential of the consumer market will be a critical component in China's long-term outlook.

In general, China's consumption sector looks set to surpass that of the US soon, given the rise of the massive middle-income class. The next step may be to convince private households that now is the time to enjoy life by spending more on material comforts.

In this report, we identified seven connected yet distinct consumer profiles that will shape the future of China's consumer society:



The new urbanites: Urbanization will unlock the spending power of the new urbanites, with their improved living standards and disposable income, aspiration for upward social mobility, and the cities' advanced digital infrastructure.



The silver generation: The sizeable first generation that rode the tide of China's economic boom is retiring. At the peak of their saving cycles, many are just as willing and ready to spend on leisure and recreation as health care and exercises.



Small city big spenders: Skyrocketing home price and strong demand for purchase have squeezed the disposable income of those in the large coastal cities. With home purchase being a more attainable goal and lower cost of living, consumers in the smaller inland cities are becoming bigger spenders.



The health conscious: Even though China consumers are able to return to "normal life" quickly after the initial COVID outbreak, the psychological impact may last much longer. Many are willing to pay a premium for quality and healthy products while avoiding human contact.



Planet first: The Government's ambitious commitment to carbon reduction is well-aligned with the consumers' growing preference to spend with a higher purpose in mind. Their preferred brands are the ones that stay ahead of the Government's mandate to do good for the planet.



Experience everything: China's tech-savvy consumers expect more compelling and personalized experiences from their preferred brands. To them, shopping becomes a social entertainment activity and with many experiences available virtually, rural consumers can also be trendsetters.



The ascendant consumers: Consumers who were previously marginalized are shaping new relationship with brands with their growing economic power. They expect their evolving needs on service, convenience, and quality to be recognized, understood and satisfied at all times.

On each of these profiles, actionable triggers have been identified in order to tap into their business potential. With our experienced teams, successful consumer businesses can get ahead of consumers' evolving expectations, and ready themselves for a new stage in China's consumer society.

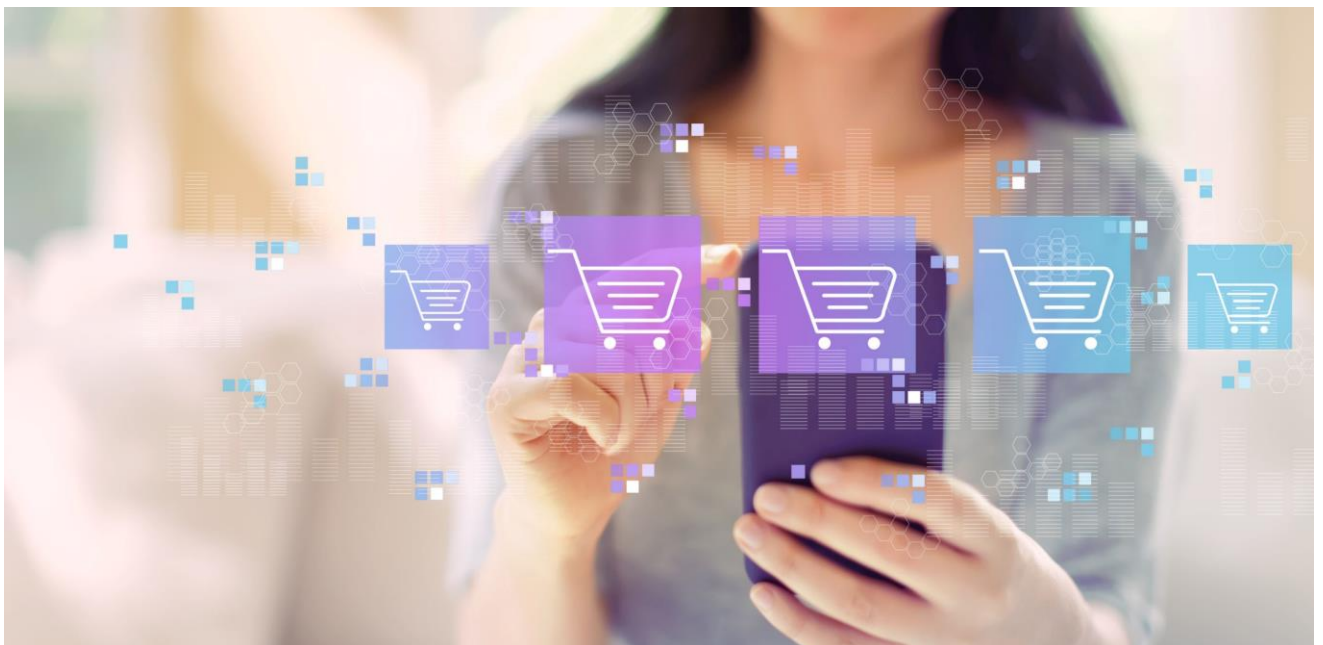


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1

Domestic demand in 14th Five-Year Plan

Emphasis on “dual circulation”

The Outline of the 14th Five-Year Plan for National Economic and Social Development¹ (14FYP) and Vision 2035 have been ratified on the last day of the 4th session of the 13th National People’s Congress (NPC) in March 2021. It will shape China’s development in 2021-2025 and beyond, which will in turn lay a solid foundation toward achieving the second of the two centennial goals - to become a “strong, democratic, civilized, harmonious, and modern” socialist country by 2049².

The 14FYP clearly states that China will accelerate the establishment of “dual circulation”. The term was first coined by China’s President Xi Jinping at the 2H2020 Politburo meeting on economic policy in May 2020. Under the “dual circulation” initiative, domestic and foreign markets can boost each other, with the domestic market as the mainstay, to start a new journey of building a modern socialist country. The initiative is China’s response to the turbulent adjustments in international economic, technological, cultural, security, and political structures, while the potential in domestic demand remains robust.³

Significance of consumption in China’s new development stage

Beyond the rebalancing needs

The emphasis on domestic demand is not new in China’s economic growth agenda. While improving household livelihood has been a longstanding aspect of the previous FYPs, the role of domestic household consumption in economic growth, as opposed to reliance on investment and exports, became a priority since the 11th Five-Year Plan (2006-2010)⁴. The priority to rebalance has reversed the falling share of domestic consumption in the economy, to 54.3% of GDP in 2020 from the low point of 49.3% in 2010.

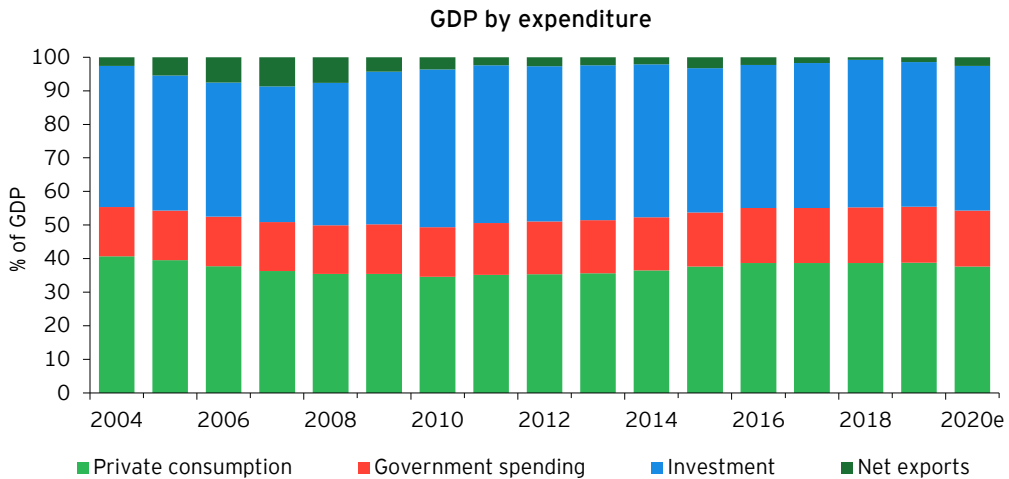
1. www.gov.cn/xinwen/2021-03/13/content_5592681.htm

2. cpc.people.com.cn/n1/2020/1104/c419242-31917784.html

3. paper.people.com.cn/rmrb/html/2020-08/25/nw.D110000renmrb_20200825_1-02.htm

4. www.gf.gov.cn/gongbao/content/2006/content_268766.htm

Fig 1 Consumption demand accounted for 54.3% of GDP in 2020



Source: Wind

Emphasis on higher standard of living

However, it is noted that the coverage on domestic consumption in the 14FYP has taken on new significance. It has become much more specific in terms of not only reinforcing the role of domestic demand as a primary driver for China's economic growth, but also the comprehensive upgrade of its quality in combination of progress in the digital economy and improvements in social welfare.

Vision of a digital China

Specifically, the 14FYP noted that digital technology will reach every corner of social interactions and daily lives in China. From shopping, health care, education, entertainment, to daily travels, digital footprints will be considered an important asset in the development of third-party big data service industry, and that will lead to a comprehensive transformation in China's industries.

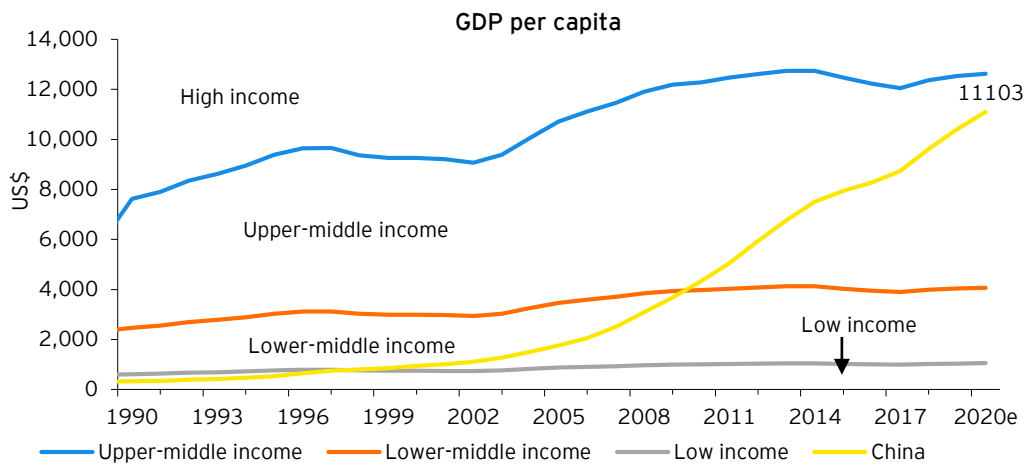
Sustainability precedes the pace of economic growth

Second, the 14FYP emphasized that in addition to generating further increase in the household income level, it will strive to deliver higher standard of living and greater sense of satisfaction to the populace. Meanwhile, it downplayed the significance of the annual GDP growth target in 2021-2025. Compared to the 13th Five-Year Plan that proposed an actual numerical target for economic growth, "high-quality, healthy, and reasonable economic growth" became the objective in the 14FYP.

Consumption as the champion in sustainable long-term growth

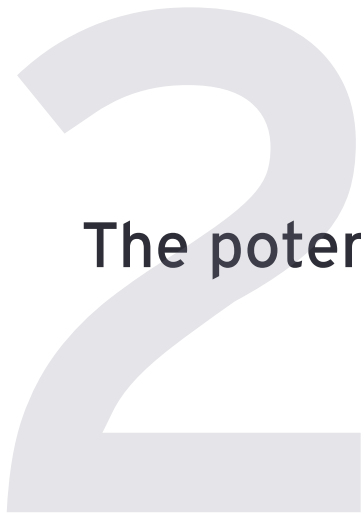
As the economy successfully doubled in size in 2020 from 10 years ago, China's GDP has exceeded US\$10,000 on a per capita basis. This is beyond the central value of the income range of upper-middle-income countries by the World Bank's definition⁵. Even with the Government's conservative real economic growth projection at 6% in 2021, China is set to be among the high-income countries during the next five-year period. It is now the time for domestic demand to lead China's transformation from high-speed growth to high-quality development.

Fig 2 China set to become a high-income country with the 14FYP



Source: World Bank

5. blogs.worldbank.org/opendata/new-world-bank-country-classifications-income-level-2020-2021



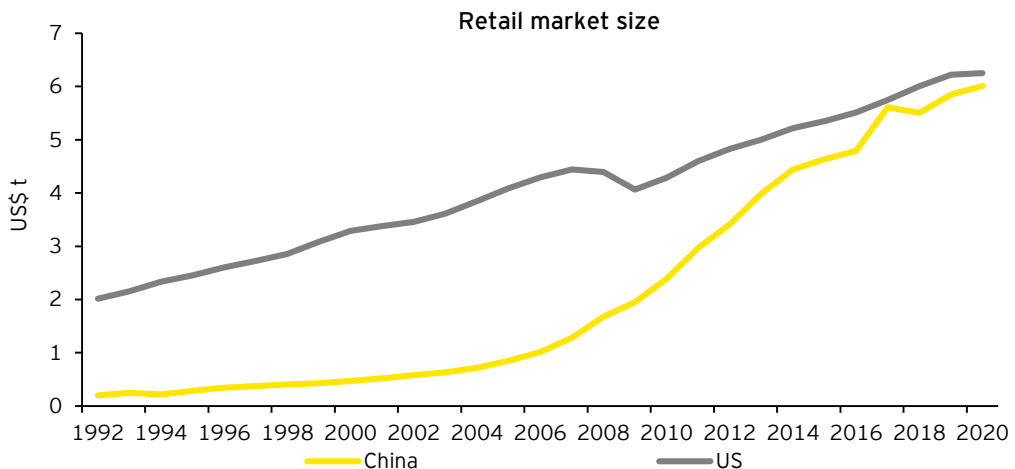
The potential of China's consumers

Now is the time to enjoy life

A massive and growing middle class

In general, China's retail sector is already the world's second largest and looks set to surpass that of the US soon. In 2010, most urban Chinese households had enough money to cover basic needs like food, clothes, and housing, with median disposable income per capita at around RMB21,000 per year. In 2020, the median urban disposable income has more than doubled to around RMB44,000 per year, and a lot of well-to-do households are now having ample funds for leisure like regularly eating out, beauty products, flat-screen TVs, and holiday travel. By 2024, the Development Research Center (DRC) of the State Council expects that the nation will have at least 560 million middle-income consumers⁶.

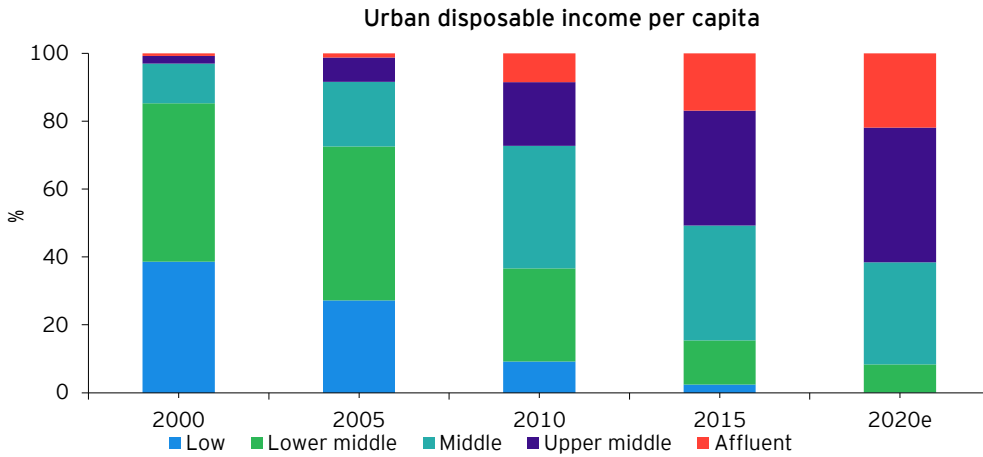
Fig 3 China's retail market set to become the world's largest soon



Source: Wind

6. h5.drcnet.com.cn/docview.aspx?chnid=1002&leafid=26601&docid=5952322&uid=02&version=integrated

Fig 4 China's rapid transformation to a middle-class society

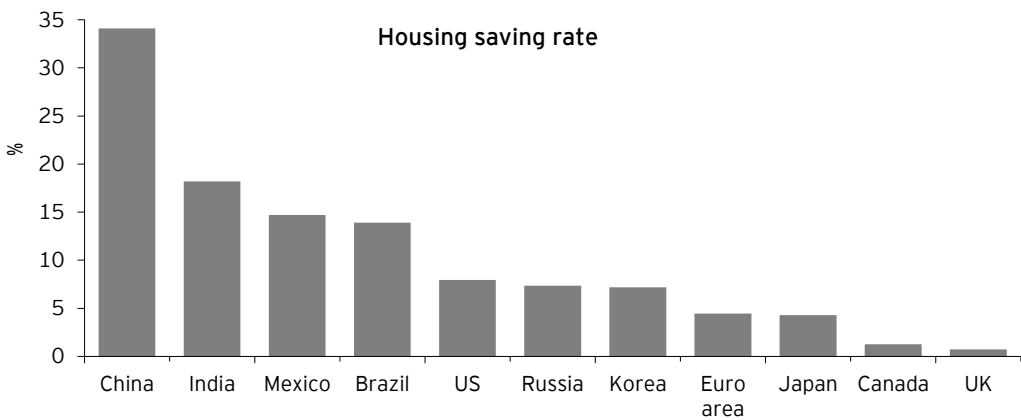


Source: Wind, EY

Unleashing the spending power

However, there is still significant potential in China's consumers that has yet to be unlocked. As a share of GDP, China's private consumption expenditure is uniquely low by international standards. It reflects a persistent trend in China's household savings rate that has been well-studied by academic researches^{7,8}, with social precaution (insufficient social security protection) and birth control policy often attributed as some of its main drivers.

Fig 5 Household savings rate is uniquely high in China

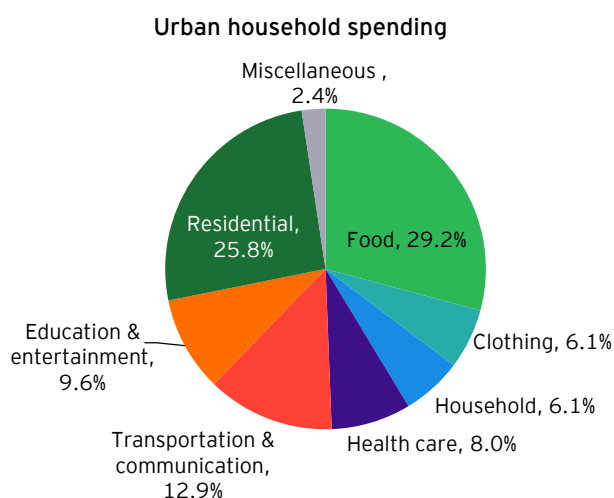


Note: Saving rates based on latest available figure for China (2020), Mexico, Korea, Euro Area, Canada and UK (2019), and India, Brazil, US, Russia, and Japan (2018)
 Source: National Bureau of Statistics of China, OECD, Reserve Bank of India (RBI), Central Bank of Russia (CBR)

7. Zhang, L., R. Brooks, D. Ding, H. Ding, H. He, J. Lu, R. C. Mano, *China's High Savings: Drivers, Prospects, and Policies, Selected Issues Paper*, 2017 AIV consultation with the People's Republic of China, 2017.
8. Choukhmane, T., N. Coeurdacier, K. Jin, *The One-Child Policy and Household Savings*, CEPR Discussion Paper No. DP9688, 2013.

To fully unleash the potential of China's consumer economy in the 14FYP, the focus should be to convince private households that now is the time to pursue better quality of life by upgrading their material comforts. The reform on the social safety net, after all, is accelerating⁹, and birth control policy has been all but relaxed, while the improvement of people's livelihood has been a top policy priority. Specifically, we note that favorable policy, demographic and geographic factors will favor the rise of the new urbanites, the silver generation, and the small city big spenders who will shape and lead China's consumer market.

Fig 6 The shares of entertainment and services have yet to fully take off in urban household spending



Source: Wind

FutureConsumer.Now and Future Consumer Index

In the face of their rising spending power, China's consumers will reasonably expect better selection of products and services to cater to their evolving demands. It is up to the leaders in the business sector to anticipate the emerging expectations, reinvent themselves, and build the capabilities that future relevance will require.

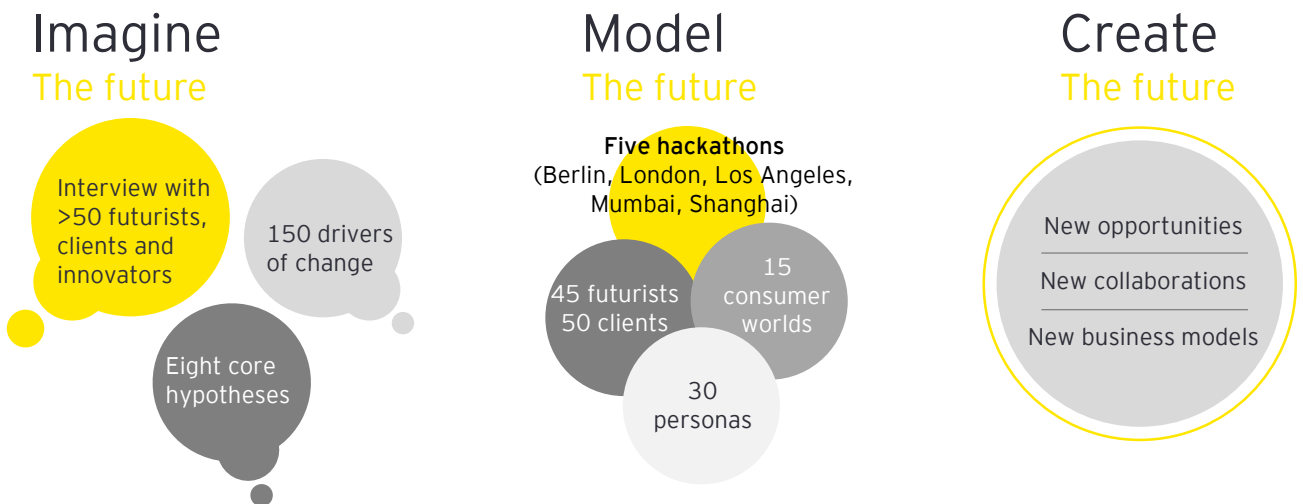
9. www.imf.org/external/pubs/ft/fandd/2018/12/social-protection-in-china-wills.htm

Modeling future consumers around the world

The main tenet of the EY FutureConsumer.Now program is to understand how companies must adapt and transform their business¹². Over the last three years, EY worked with over 200 futurists, client leaders and industry experts to create 150 drivers of change and eight core hypotheses that can help companies stress test themselves for the future. This was followed by a series of multi-day “hackathon” workshops in five cities (Berlin, London, Los Angeles, Mumbai and Shanghai), when local participants modeled the kind of world they think could emerge, how consumers would live in that world, and the business implications and opportunities presented by that world¹¹.

Building upon the insights from FutureConsumer.Now, EY also created the Future Consumer Index (FCI)¹² to understand and track emerging consumer behaviors and sentiments around the world. As a regular survey administered to over 10,000 respondents, it covers consumer behaviors, sentiments and intent since COVID. With more than 1,000 respondents from China that are predominantly educated, upper-middle to high-income and located top-tier cities in coastal areas, it can provide a unique perspective of the leaders in China’s consumerism.

Fig 7 FutureConsumer.Now



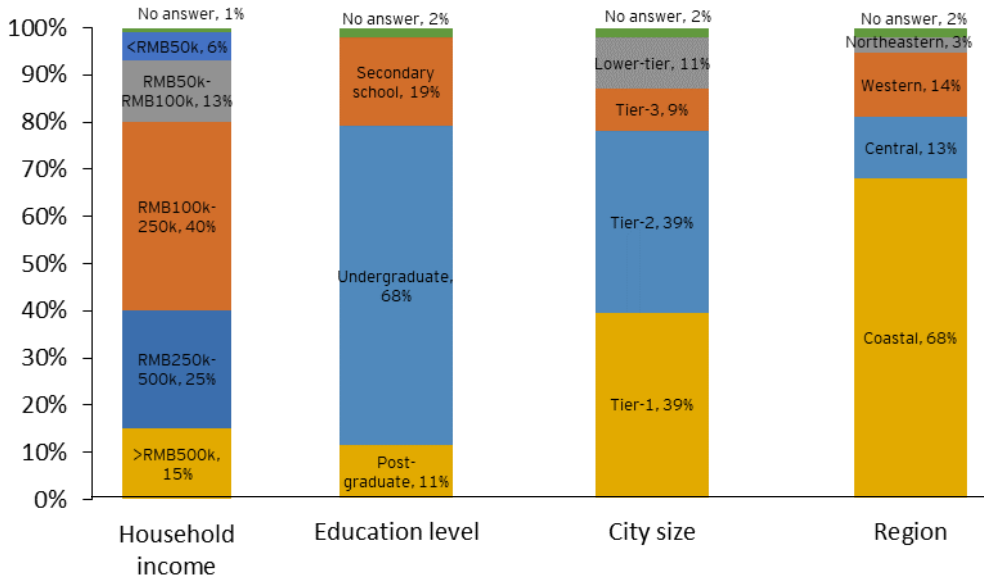
Source: EY

10. www.ey.com/en_gl/future-consumer-now

11. Even though the worlds mentioned here are uniquely linked to each of their location, each is a vision of a future world that represents a common, global theme rather than a geographic location.

12. www.ey.com/en_gl/future-consumer-index, EY, October 2020.

Fig 8 Profile of Chinese respondents in the FCI survey

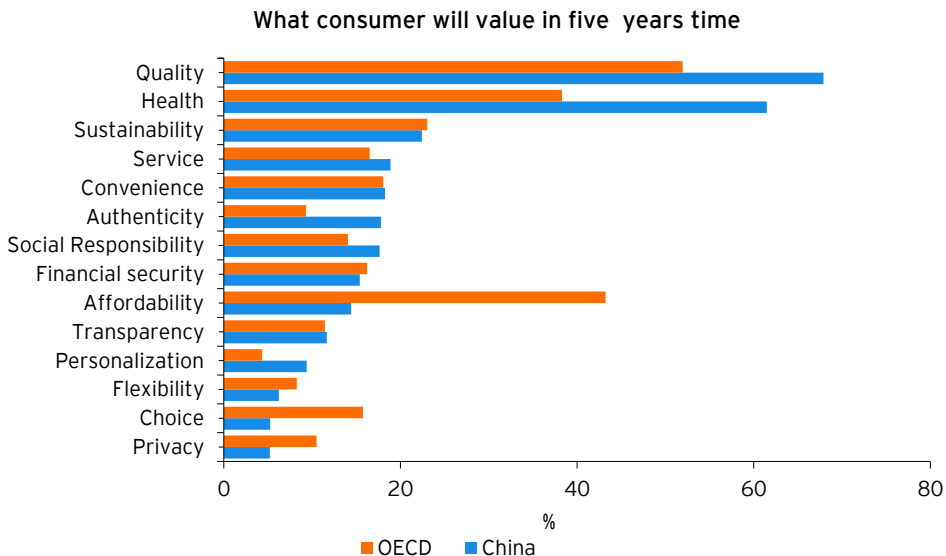


Source: EY

Salient features of Chinese consumers

While our FCI respondents from across the world feel that the quality and healthfulness of their products will be highly valued in the long term, Chinese consumers stand out with higher expectation in service, product authenticity, and customization. They are also more enthusiastic on the deepening of digitalization within the consumer space, but have relatively lower demand in affordability, privacy, and choice. Given these patterns, we expect four personas will stand out in the future - the health conscious, the planet first, the experience everything, and the ascendant consumers.

Fig 9 China's consumers have unique expectations



Source: EY Future Consumer Index

3

The new urbanites

New opportunities in the smart cities

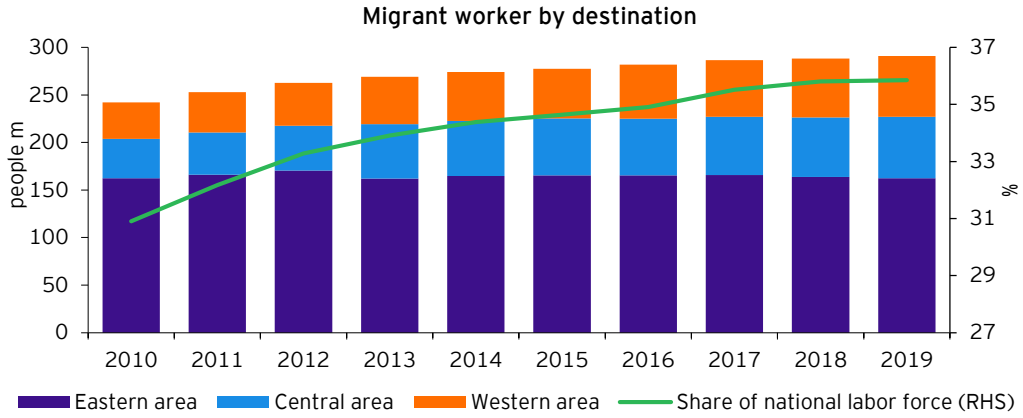
Living standard improvement with new urbanization

Defined as rural workers who move to urban areas in pursuit of non-farm job opportunities for more than six months a year, there are 285.6m migrant workers accounting for over 35% of China's labor force in 2020. In the past, the ample supply of surplus rural worker finding casual employment in factories and construction sites kept China's labor cost low. Due to the transient nature of migrant workers and their lack of residential registration (hukou), their access to public service such as low-rent housing and public education for their children was limited for a long time. Together with the uncertain prospect of work, this has led to strong propensity for them to save compared to local workers at similar income level¹³.

In recent years, however, China has arguably reached the "Lewis' Turning Point" – the supply of surplus rural labor has run out with widespread implication on labor costs. To attract more workers, city governments and businesses had to offer more attractive terms. In the past decade, the improvements in social insurance coverage have made migrant workers eligible for some protection. As emphasized in the 14FYP, new urbanization will further allow them to settle down permanently with better access to opportunity for upward economic mobility.

13. Dreger, C., Wang, T. and Zhang, Y. (2015), *Understanding Chinese Consumption: The Impact of Hukou*. *Development and Change*, 46: 1331-1344. doi:10.1111/dech.12198

Fig 10 Migrant workers account for around 35% of China's labor force

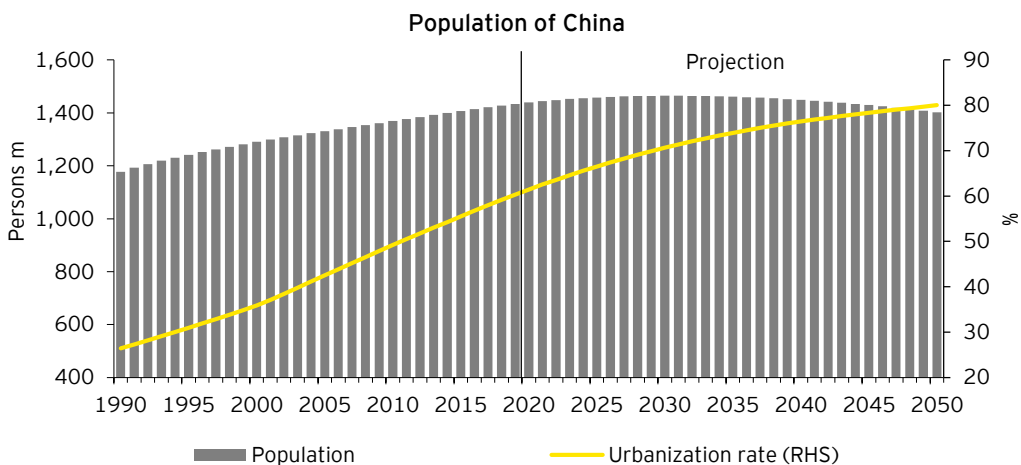


Note: As of 2019
Source: Wind

A leap in purchasing power

The Central Committee for Economic Affairs announced in August 2019 that major city clusters will be the focus of urbanization strategy¹⁴, and rural residents may settle to benefit from the better social welfare and modern infrastructure¹⁵. Their children, for example, can be part of the urban education system with access to modern vocational training, as they reunite with their families. That can structurally reduce their need for extra savings. Cai Fang, Vice-President of the Chinese Academy of Social Sciences, noted that if migrant workers were transformed into urban residents, their consumption could increase by as much as 27%¹⁶.

Fig 11 Urbanization helps generate new inflow of labor in urban production centers



Source: UN World Urbanization Prospect 2018, National Bureau of Statistics, State Council of China

14. cpc.people.com.cn/n1/2019/0826/c64094-31318325.html

15. www.gov.cn/zhengce/2020-04/10/content_5500749.htm

16. epaper.chinadaily.com.cn/a/202101/25/WS600dffba31099a2343537e0.html

In addition, with the 14FYP pledging to allow further marketization of rural land, migrants may also be able to cash in their land wealth as they relocate. It could be a substantial boost of their wealth that will further increase their propensity to consume as they resettle. All in, the new lifestyle in the city clusters will attract not only new supply of workers but also a leap in consuming power on a national level.

Smart cities enabled by new infrastructure

To accommodate the new residents, city clusters need to undergo makeovers to expand their capacities and boost livability through the alleviation of pollution and congestion. It can be made possible by becoming smart cities with wide-ranging adoption of advanced technology in logistics and city management. Investment has already started particularly on new infrastructure such as the 5G network, artificial intelligence (AI), the Internet of Things (IoT), ultra-high voltage power grid, intercity high-speed rails, and major data centers¹⁷.

The infrastructure upgrade has accelerated in 2020 with government stimulus. By end-2020, China has built 580,000 5G base stations, up from 126,000 in end-2019¹⁸. 5G signals already cover more than 300 cities at prefecture level and above, strengthening China's world leadership position in the technology. This will transform the way of urban lives in China, fuel industrial upgrade, and bring a new level of digitization to society.

How EY can help

Digital fulfillment and long-term value

Becoming a gold standard brand

In the past decade, China has already experienced the benefit of urbanization as migrant workers settled in cities. Integrating that with ubiquitous digital infrastructure, it is going to open a whole new level of possibilities. For example, in a world where decisions are optimized by big data, a family's grocery shopping can be planned based on traffic condition, shelving time of fresh produce, and live updates of discounts.

New urbanites can also become "better versions" of themselves in the city with AI being an integral part of life. Behind the scene, each person's AI gathers and analyzes data on their behalf and connects them to the AI of their peers in real time to share and exchange information. Desirable behavior - online and offline - could result in prioritized access to products and services. This flow of insights helps society to efficiently allocate resources and people to optimize their lifestyles while enjoying themselves.

17. *Insights on China's post-outbreak economic relief package*, EY, 2020

18. www.gov.cn/xinwen/2020-12/24/content_5573126.htm

In the world of the new urbanites, successful businesses will be those that can fully integrate with the digital infrastructure. They should establish themselves as “gold standard brands” that partake in desirable behavior, proactively reward customers and take full advantage of the big data in business planning. In return for active participation in the system, they receive positive ratings from consumers, suppliers, and the state.

Advanced digital fulfillment strategy

The digital infrastructure is going to blur the lines between the physical, digital, and biological spheres. Customer demand and feedback are more readily relayed back to manufacturers and developers to inform business decisions as customers gamify their decisions. For the consumer sector, business optimization is done through increasing end-to-end visibility and connectivity with logistics stakeholders, the automation of processes and the reduction of inventories and workforce.

Fig 12 Retail enabled by advanced digital fulfillment



Source: EY

Long-Term Value Proposition

To enhance customer affinity, businesses will need to have a clear purpose-driven strategy and demonstrate their standing in terms of positive societal impact. Through our Long-Term Value (LTV) Proposition, EY supports clients in obtaining a societal perspective on their business models and value drivers. We also help embed a compliance system on related parties such as key management, investors, partners and suppliers to create an ecosystem of common purpose.

Fig 13 EY Long-Term Value (LTV) proposition



Source: EY

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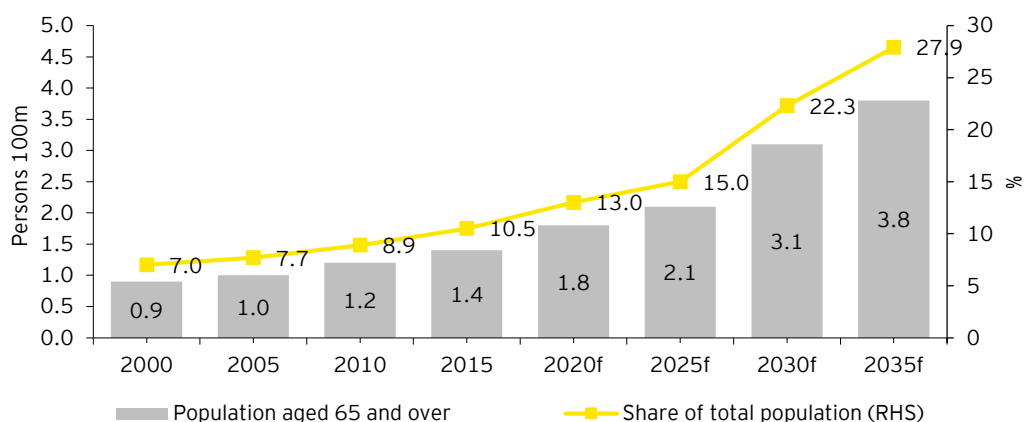
The silver generation

Explore the potential of China's senior market

A rapidly aging population

China is not only the country with the largest population on earth, it is also one of the countries with the fastest aging population. This is mainly due to decades of falling birth rates on the one hand and steeply rising life expectancy on the other hand. The number of citizens aged 60-65 and above 65 stood at 78m and 176m respectively at end-2019, accounting for 5.6% and 12.6% of the population respectively. The size of population aged above 65 is expected to rise to 210m by 2025 and 380m by 2035, according to the China Development Research Foundation (CDRF)¹⁹. Tackling the problem of aging population has become one of the key focuses in the 14FYP. Meanwhile, this demographic also presents a consumer market that has yet to be fully captured.

Fig 14 China's senior population is expected to rise rapidly



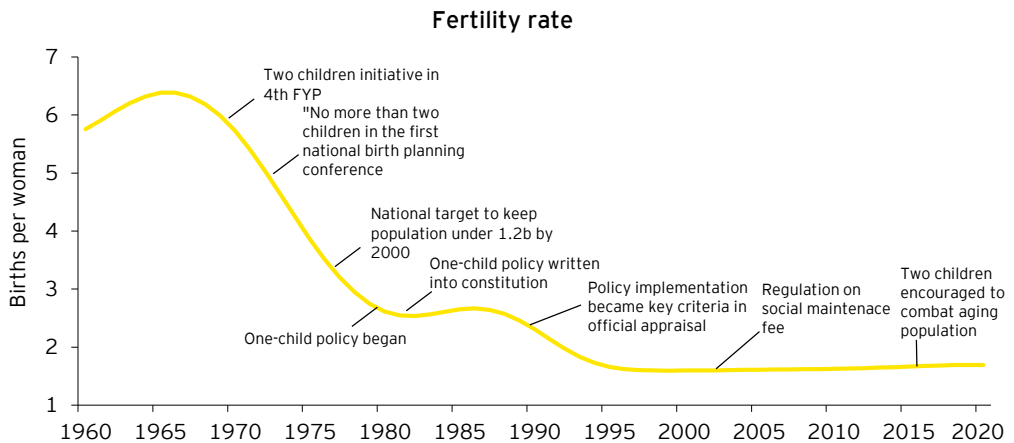
Source: Wind, CDRF

19. www.chinanews.com/gn/2020/06-19/9216394.shtml

Legacy of the one-child policy

Facing demographic pressure, the Government officially began its “one-child policy” in 1980. China’s fertility rate has since declined steeply from its peak at 6.384 in 1966 to below its natural replacement level at 2.1 in 1992²⁰. The decline in childbirth gave China one of the lowest child dependence ratio in the world, such that it was able to enjoy demographic dividend with a large working-age population relative to its total population to fuel its rapid economic rise in the previous decades.

Fig 15 Timeline of one-child policy



Source: Wind

Having fewer children means family saving will increase. On the expenditure side, less spending on children, especially as regards education, allows the families to save more. On the income side, having less children also implies having no intergenerational support as there will be less old age support, such that it makes the decision to save for retirement a necessity.

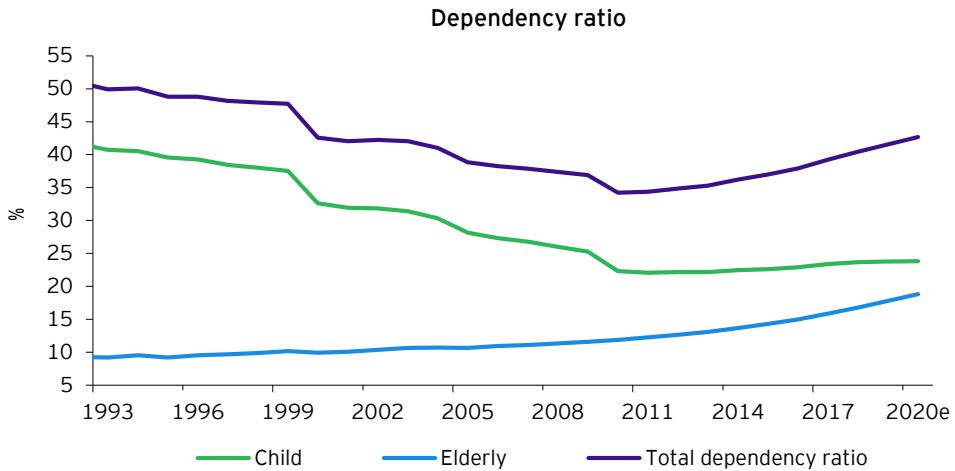
Thirty-five years after its announcement, the one-child policy was officially ended in 2015. It has since been followed by various adjustments, including a full relaxation of birth control policy proposed in the northeastern provinces²¹. China’s birthrate, however, has yet to rebound strongly as anticipated. It is arguably attributable to delayed average age at first marriage, preference for single and individualistic lifestyle, and rising cost of child-rearing²². As such, in addition to initiatives such as education and health care support, more measures at both national and local government levels such as monetary incentives and tax deductions are likely necessary to encourage women of child-bearing age to have more children.

20. J. Kallgren, “Birth Control in China 1949-2000: Population Policy and Demographic Development,” *The China Quarterly*, 2004, ©RoutledgeCurzon

21. www.chinanews.com/gn/2021/02-20/9414819.shtml

22. pdf.dfcfw.com/pdf/H3_AP201901041282086287_1.pdf

Fig 16 Childbirth has yet to pick up strongly after the one-child policy ended



Source: Wind

First generation beneficiaries from China's economic boom

Meanwhile, the first generation of workers that rode the tide of China's economic boom is retiring, taking advantage of one of the world's lowest retirement ages²³. At the peak of their saving cycle, the silver generation is able to accumulate more assets than their previous generations. In addition, their livelihood after retirement is supplemented with rising pensions that are subsidized by the Government. Given China's long life expectancy, the retired generation will likely be healthy, energetic, and with both time and money at their disposal.

How EY can help

Marketing effectiveness

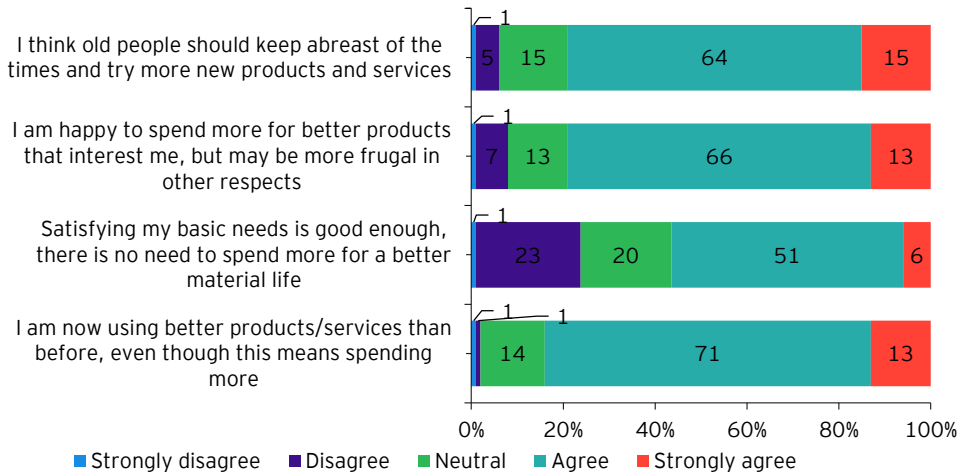
A strategy to position at the senior market

The senior market in China's consumer sector remains underexploited. To some extent the silver generation continues to be viewed as being more inclined to save than to spend on discretionary items, and more reliant on traditional word-of-mouth than modern technology. The fact, however, is quite the opposite. A comprehensive survey found that senior consumers are not only willing and ready to spend, but they also have vast profiles of interest in service and product spending. In addition to spending on health care, they like eating out, going to karaoke, cinema, and spending on gyms and exercise. Many of them also feel that are marginalized by the market which primarily focuses on the younger generation²⁴.

23. The retirement age in China currently is 60 for men and 55 for female civil servants and 50 for female workers, with plan for postponement in the 14th Five-Year Plan

24. research.hktdc.com/tc/featured/china-focus1

Fig 17 The silver generation is willing to spend on better products and services



Source: HKTDC research

In November 2020, the State Council released a plan to lower the technology barrier facing the senior population²⁵. The plan made clear that the digital society should make sure that the elderly population is included, and the bottlenecks in digital travel, health care and consumption should be eliminated. For successful consumer businesses, the next step should be to invest on channels that can understand and exploit the consumption habits of the senior market. It should involve a dedicated strategy with products and services designed for the silver generation.

Marketing Transformation

The EY Marketing Transformation provides actionable strategy for business growth, based on a holistic view of opportunities and challenges and a better definition of the go-to-market requirements. Specifically, we can help to: 1) establish a framework to define and understand priority customer segments; 2) consolidate customer data across organizational, technological and political silos; and 3) deploy different strategies against different segments and maintain segments dynamically over time.

Fig 18 Building a customer segmentation strategy in marketing transformation



Source: EY

25. www.gov.cn/zhengce/content/2020-11/24/content_5563804.htm

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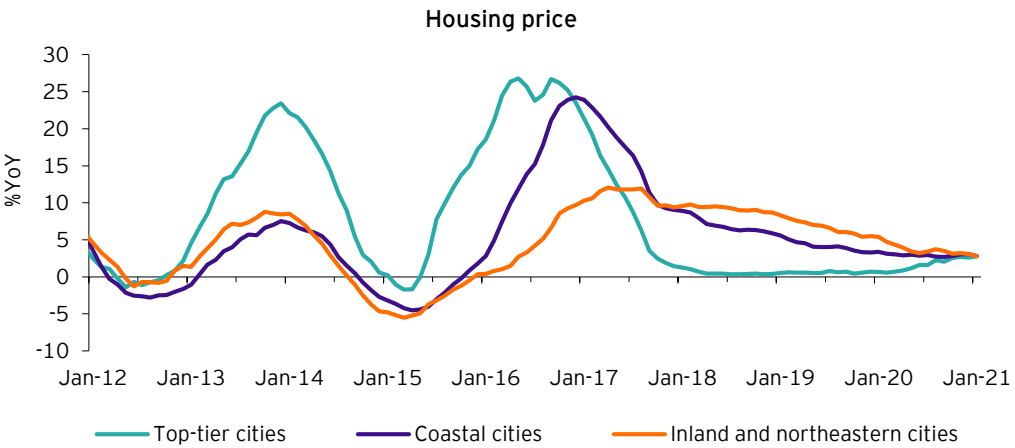
Small city big spenders

Provincial drivers in China's consumer society

Persistent demand in large coastal cities led to higher home prices

In addition to the demographic factors, the household's decision to save is also affected by geographical considerations. Specifically, despite China's urban home ownership ratio is reportedly as high as 96% in 2019²⁶, thanks mainly to the housing reform in the 1990s, commodity housing remains in strong demand. This is especially the case for larger coastal cities, where population inflow, the need for upgrades in living standard, cultural expectations, and expectation for asset appreciation led to persistent hike in housing prices.

Fig 19 Housing prices have been rising more sharply in top-tier and coastal cities

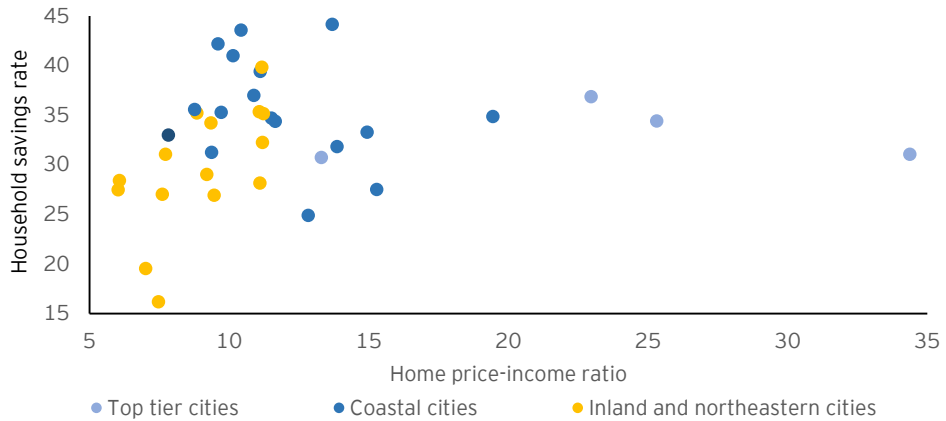


Source: Wind

26. www.xinhuanet.com/fortune/2020-04/27/c_1125910537.htm

Evidence in China suggests that strong demand for home purchase could positively affect household savings through down-payment effect and mortgage effect, as potential home buyers have to put up additional savings²⁷. Rising housing prices would make that incentive even stronger as buyers expect property to be even less affordable in the future.

Fig 20 Correlation between household savings rate and home prices

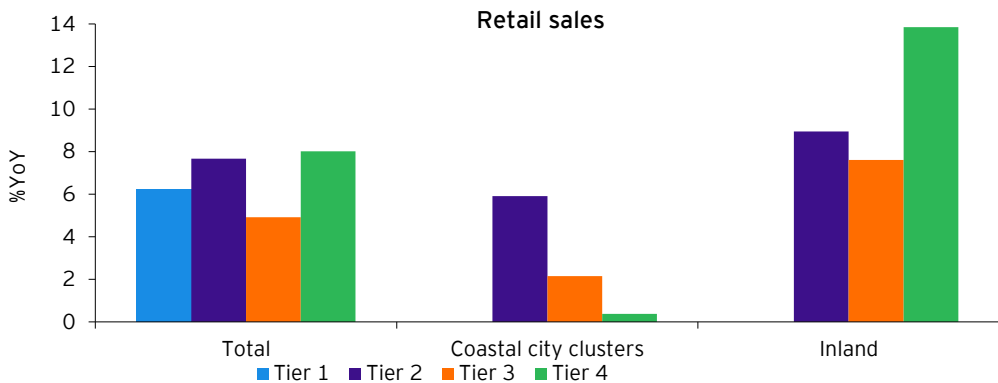


Source: Wind

Affordable smaller inland cities make for stronger spending power

In small, inland cities where housing is more affordable, people have a stronger propensity to consume, and their rapidly rising disposable income in recent years also affords them considerable spending power. Meanwhile, the spending power of dwellers in major coastal cities is squeezed by the combination of higher cost of living and heavy housing burdens.

Fig 21 Lower tier inland cities have the strongest growth in retail sales



Note: As of 2019. Coastal city clusters include cities in Jingjinji (Hebei and Tianjin), Yangtze River Delta (Anhui, Jiangsu and Zhejiang), and Guangdong
Source: Wind

27. Waxman, A., Y. Liang, S. Li, B. Panle Jia (2018), Tightening Belts to Buy a Home: Consumption Responses to Rising Housing Prices in Urban China. dx.doi.org/10.2139/ssrn.3244054

Integrated commercial analytics

Understand the more nuanced consumer preference

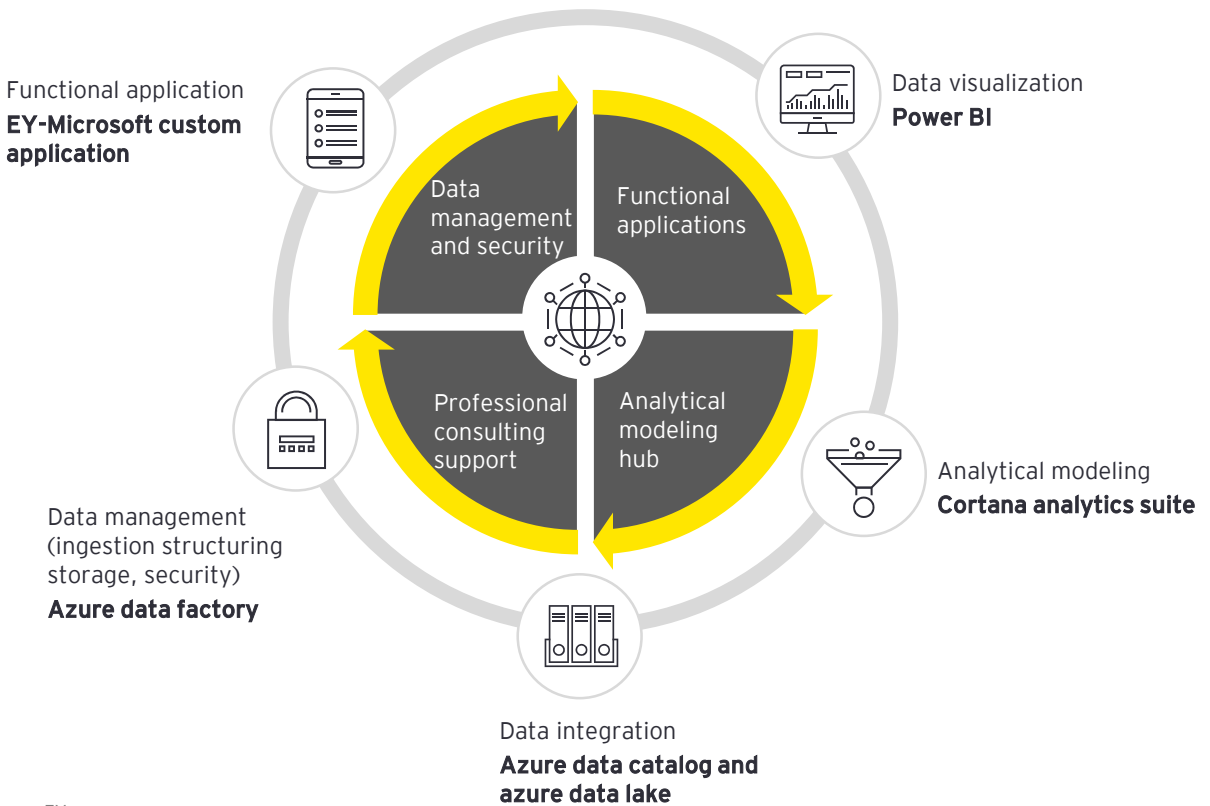
As growth driver in the consumer sector moves away from the traditional supercities, successful businesses should expect customer expectations to become more heterogeneous. The marketplace will reflect the vast topographical and cultural differences that go beyond the traditional categorization of cities by size and population. As such, the strategies that brands have built up in first-tier cities over the past decades may be inadequate for driving performances. Businesses have to reinvent themselves and adopt a new marketing strategy in the face of unique consumer demands.

Businesses wishing to embed themselves in the growth engine should capitalize on advances in data and technology to power the next generation of commercial analytics. While in the past analytics have been heavy on rearview insights based on single-sourced data snapshots, it is now capable to integrate multiple data sources and produce continuous, forward looking insights. However, to fully leverage on the insights, businesses must advance in tandem with their ability to produce analytics at scale and their analytics consumption skills to drive new decisions.

Commercial Analytics Services Hub

EY joined forces with Microsoft to deliver the Commercial Analytics Services Hub (CASH) by combining leading-edge analytics solution with a deep consumer sector domain knowledge. It helps to boost marketing productivity through trade promotion optimization: predictive modeling and optimization analytics to provide differentiated insights and improved confidence for determining optimal promotion strategies. The model also provides post-event analysis that offers the ability to evaluate promotions and determine the driving factors behind performance.

Fig 22 The EY-Microsoft Commercial Analytics Services Hub



Source: EY

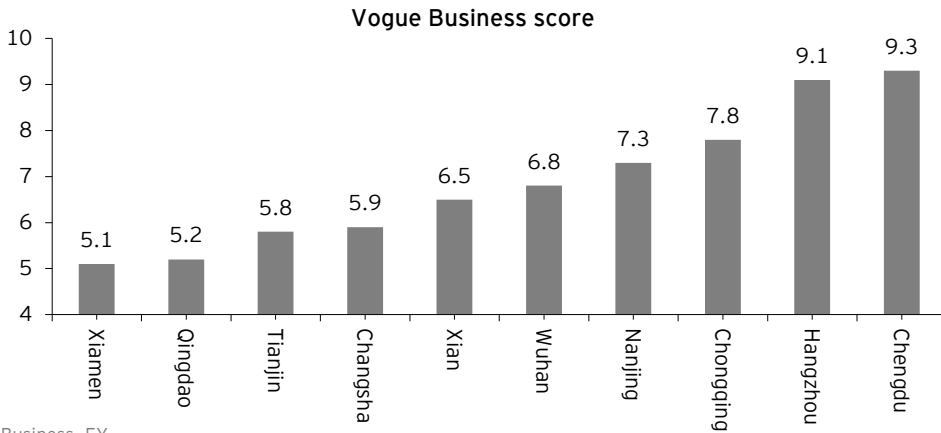
Example *2020 New Fashion Capital Index Report*

To understand the differentiation of China's cities in terms of fashion and luxury spending, Vogue Business in China collaborated with EY Parthenon in 2020 to understand the characteristics of 12 cities in terms of their consumption power, commercial potential, cultural charm, trend-setting talent, and innovation potential. The result is expected to contribute to the upgrading and development of the Chinese fashion market.

The collaboration resulted in a report titled 2020 New Fashion Capital Index Report. Through quantitative analysis, survey and interviews with industry insiders, the report found that beyond the traditional hubs such as Beijing, Shanghai, and Shenzhen, these cities in general are shaping the future of China's fashion industry: 1) Chengdu stands out at nurturing local youth culture; 2) Hangzhou is home to promising creative capital and business potential with solid technology financial and policy support; and 3) Chongqing and Nanjing are closely following with strong regional leadership.

In addition to city rankings that focus on the strengths and weaknesses of each city, the report also reviewed the position of regional governments at aligning with the country's development by committing to cultivate the local fashion industry. For example, the Central Government stimulus since the COVID-19 outbreak is going to lend particular support to the development of Wuhan, which could become a new leader in China's culture and fashion market.

Fig 23 Vogue Business score is a measure of trend-setting power of 12 leading cities



Source: Vogue Business, EY

6

The health conscious

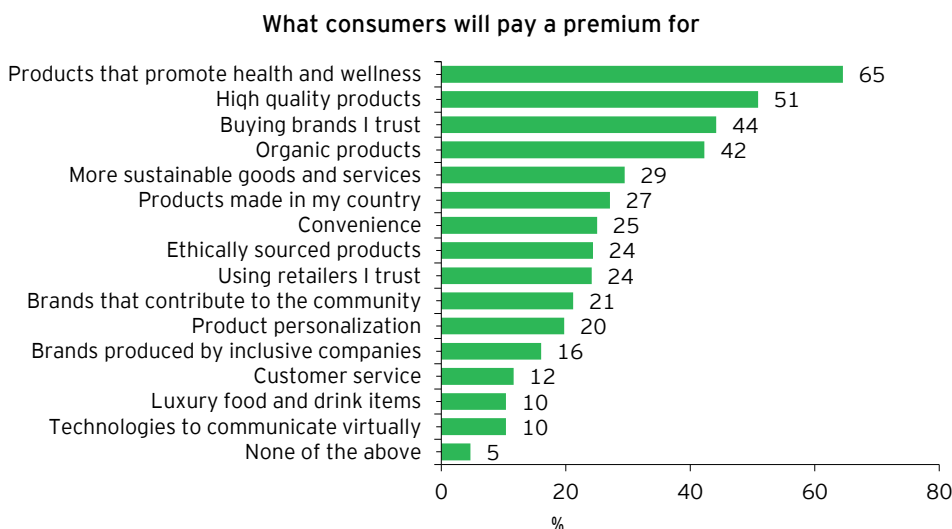
The digital new normal in the post-pandemic world

Health and wellness over luxury and convenience

Even though Chinese consumers have been able to return to “normal life” quickly after the COVID-driven lockdown, the pandemic has already changed the way consumers think about what they buy and how they spend their time. The EY FCI found that health benefit and product quality, respectively, are expected to be top priority long after the outbreak has ended. In particular, 85% of respondents considered that in the longer term, they will be more aware and cautious about physical health, and 82% said they are willing to make healthier product choice.

The respondents are willing to take awareness into action, as 65% of responding consumers are willing to pay a premium for high-quality products that promote health and wellness compared to products that emphasize luxury (10%) or technology (10%) alone. As intangible factors, the authenticity of health and wellness will rely on established brands and products that are made domestically, by large corporations, and recognized through previous purchases.

Fig 24 Consumers are willing to pay a premium for high-quality products that promote health and wellness



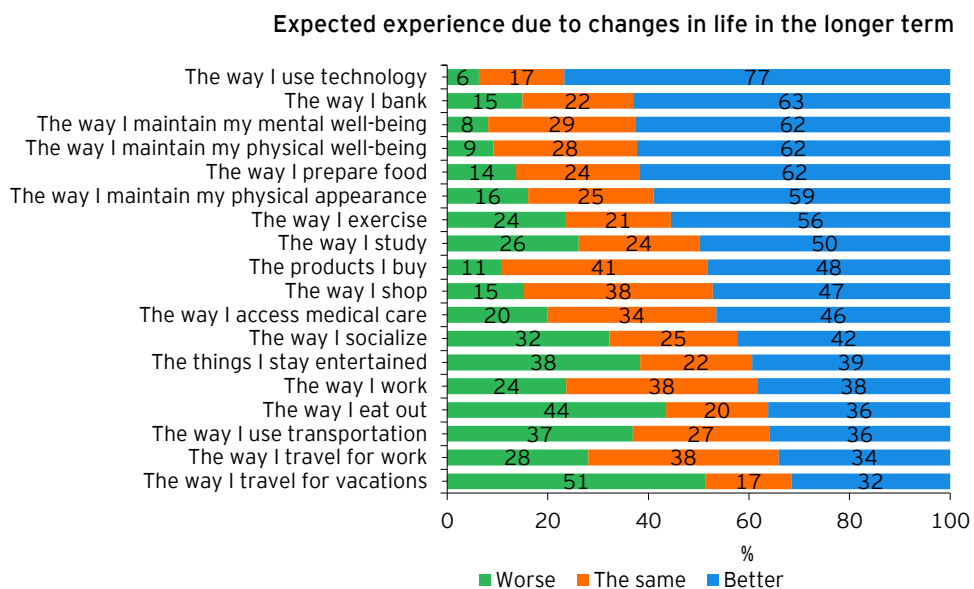
Source: EY

Expectation on hygiene and contact avoidance will continue

In terms of shopping experience, hygiene and sanitization remains priority for the respondents, with many becoming more favorable to contact-less delivery or cashless payments to avoid touching things when shopping, even as many respondents are optimistic that much of social life will soon return to normal. The survey also showed that consumers appreciate establishments that take visible steps to keep customers safe and are willing to be transparent in all that they do, even if that means compromising their privacy sometimes.

However, even if sanitization procedures are fully in place, respondents are realistic that not everything will return to normal. For example, despite the near-complete recovery in most aspects of China's economy since the COVID-19 outbreak, restaurant receipts continued to decline by 2.3% in January and February 2021 from the same period in 2019. This is particularly the case on expectations of travel in the near future, with around two thirds of respondents expecting at least months before they will feel comfortable travelling on plane or cruise ship again.

Fig 25 Expected experience to changes in life due to COVID-19 in the longer term



Source: EY

The silver generation favors digital transformation

Perhaps understandably, the silver generation is more health conscious and concerned about maintaining physical wellbeing after COVID than the general population. They also tend to be more pessimistic in terms of the time it takes for travel to return to normal. Perhaps as a consequence, the silver generation is more adaptive to digital, with a higher share of them foreseeing a more complete shift toward cashless payments, contact-less delivery, online shopping and banking, and digital entertainment in the long term.

Fig 26 The silver generation agrees to more digital transformation in consumer experience

Rank by degree of agreement	The silver generation	The younger generations
1	Make healthier choices in the products I purchase	Be more aware and cautious about my physical health
2	Be more aware and cautious about my physical health	Make healthier choices when buying products
3	Be more aware and attentive to my family needs	Be more cognizant of hygiene and sanitation when shopping
4	Use less cash	Be more aware and attentive to my family needs
5	Be more aware and cautious about my mental health	Be more aware and cautious about my mental health
6	Use contact-less delivery or cashless payments to avoid touching things while shopping	Gravitate more toward brands I know and trust
7	Be more cognizant of hygiene and sanitation when shopping	Reappraise how I spend my time on the things I value most
8	Will switch brands if service falls below their promise	Be more aware and cautious about my spending
9	Do more of my shopping online and only visit stores that provide great experiences	Use less cash
10	Gravitate more toward brands I know and trust	Use contact-less delivery or cashless payments to avoid touching things while shopping
11	Be more aware and cautious about my spending	Will switch brands if service falls below their promise
12	Bank online more	Expect to be able to work more flexibly
13	Do more of my durables shopping (e.g., clothing) online	Pay more attention to the social impact of what I consume
14	Pay more attention to the social impact of what I consume	Do more of my shopping online and only visit stores that provide great experiences
15	Shop online more for products I previously bought in stores	Pay more attention to environmental issues
16	Reappraise how I spend my time on the things I value most	Bank online more
17	Shop online more for groceries	Shop online more for products I previously bought in stores
18	Use digital media more for entertainment	Do more of my durables shopping (e.g., clothing) online
19	Willing to pay more for better internet connection at home	Use digital media more for entertainment
20	Pay more attention to environmental issues	Shop online more for groceries
21	Be more aware and attentive to my community needs	Save more
22	Use public transportation less	Be more aware and attentive to my community needs
23	Expect to be able to work more flexibly	Use public transportation less
24	Spend more on experiences	Willing to pay more for better internet connection at home
25	Consolidate my shopping into less frequent, but larger trips	Will postpone purchase of big-ticket items till the pandemic is over

Note: Only the top 25 responses are included
Source: EY

D2C transformation and blockchain transparency

Connect directly with customers online

The increased reliance on digital after the pandemic has accelerated the need for businesses to implement direct-to-consumer (D2C) capabilities. As digital disruption lowers the barrier for transactions, it enables brands to reach out to its target customers directly and scalably, and bypass wholesalers and retailers in the process. It fundamentally changed the way consumers interact with brands, such that only businesses that can connect with customers and show deep understanding of their needs can stay relevant with the growing competition.

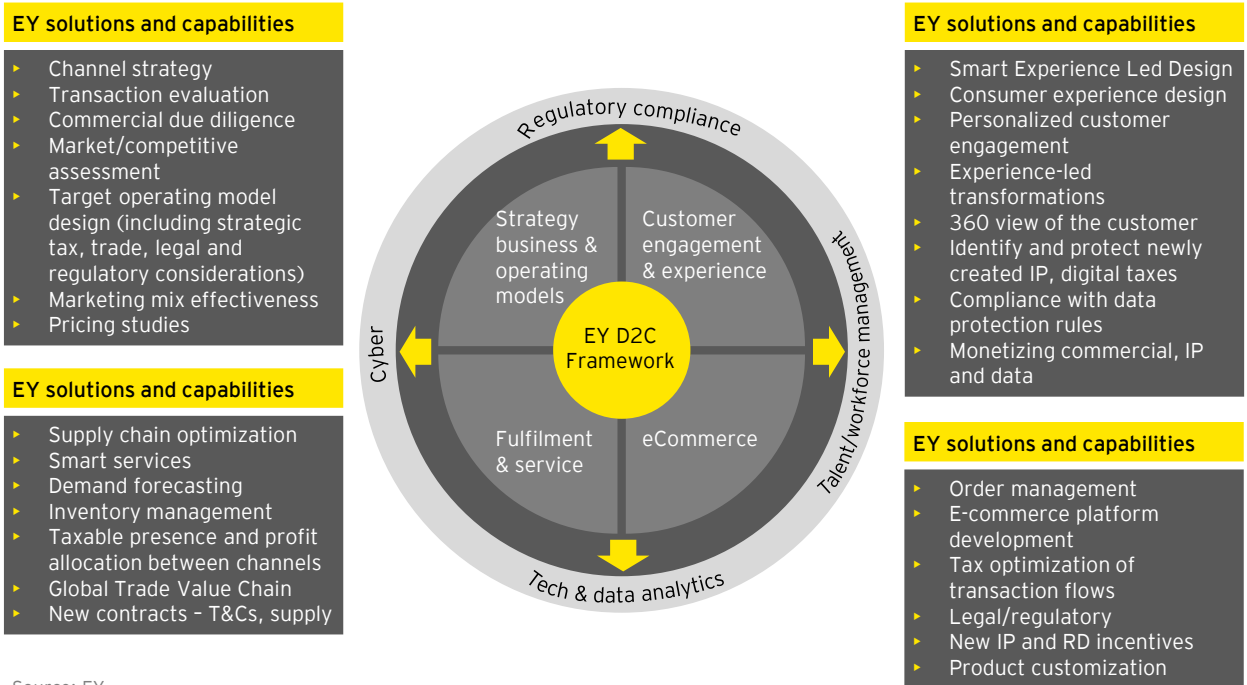
In China, live streaming sales have grown significantly since the COVID-19 lockdown in early 2020. High profile CEOs and famous key digital influencers appeared in online channels to connect with customers, who can then explore products through add-on miniprograms in leading online platforms. For example, CEO of Lin Qingxuan, a cosmetic brand, joined livestream to promote his own products when the company suffered 90% sales decline at the beginning of the COVID-19 lockdown. The revenue increased 45% versus the same time last year.

Direct to Consumer (D2C) framework

The EY Direct to Consumer (D2C) framework can help consumer products and retail companies establish a direct, data- and tech-driven two-way relationship between their brands and consumers, stakeholders and influencers. And it can support experiences, transactions, communication and collaboration across multiple channels.

Our solution can provide: 1) a holistic D2C strategy including channel strategy, operating model design, pricing, and product mix; 2) capabilities around inventory management, distribution and logistics and after-sale service support; 3) a seamless customer journey across channels, including personalized marketing, loyalty programs and communication strategy; and 4) a technology platform to enable the entire e-commerce ecosystem, including order management, payment processing and sales support.

Fig 27 EY D2C Framework



Source: EY

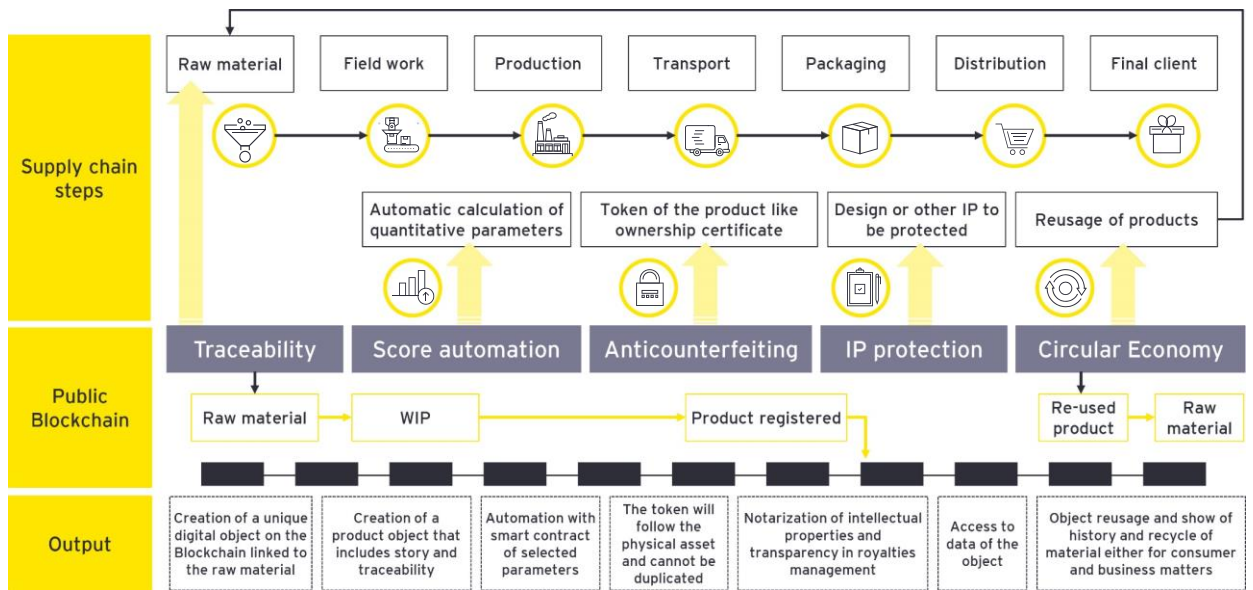
Blockchain for supply chain transparency

China’s concern for frozen food packages tainted with the COVID-19 virus added to the consumers’ desire for end-to-end supply chain transparency. Until now, Chinese consumers often depend on brand recognition as an indicator of product quality and safety, but blockchain technology can provide more reliable information on product sources. Blockchain is a decentralized ledger that keeps a record of each transaction that occurs across a network, which enables a decentralized exchange of trusted data - a “shared record book.” By integrating siloed systems and processes along the supply chain into a single environment, transparency in blockchain technology narrows the knowledge gap between the seller, the regulator and the customer, and differentiate premium products in the market for their verifiable quality and safety.

OpsChain traceability for consumers

EY is one of the market leaders for a public blockchain solution, with capabilities to support clients' transformation needs. Specifically, EY OpsChain traceability for consumers can help companies deliver end-to-end transparency across the supply chain. Our technology and human-centric solutions help 1) provides the capabilities to integrate supply chain processes across ecosystem partners; 2) identify key differentiators; and 3) tokenize assets to establish traceability and automate change of ownership.

Fig 28 Blockchain provides transparency together with automation and data protection



Source: EY

The planet first

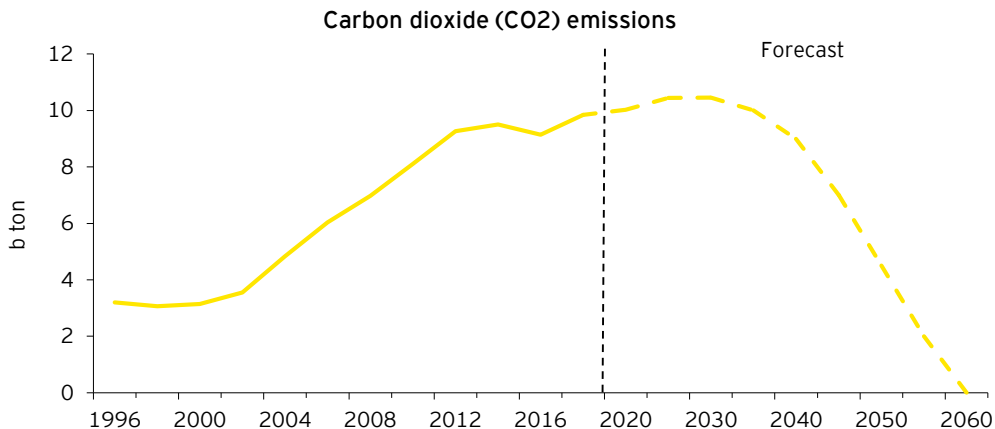
Partnership for a better environment

Carbon neutrality by 2060

Rectified together with the 14FYP in the 2021 NPC, “Vision 2035” is a midterm economic strategy that paves the way for China to fully become a modernized socialist nation and a greater power in the world by 2050. Highlights of the strategy include China’s commitment on “fundamental improvement in ecological environment” and “reduction in carbon footprint”, following President Xi’s pledge for China to reach peak carbon emissions by 2030 before reaching carbon neutrality by 2060.

Achieving these goals will be a boost to the commitment that China made under the Paris Agreement. It will however require drastic actions at the national level, from transitioning away from fossil fuels, upgrading the transportation and industrial sector and a successful implementation of a national carbon trading scheme, to a change in the consumers’ mindset to favor environmentally friendly products.

Fig 29 Carbon neutrality in 2060 requires a drastic reduction in emissions in the coming years



Source: Institute of Climate Change and Sustainable Development at Tsinghua University, EY

Making a difference as a collective consumption habit

The ambition of the Administration reverberates with shifting sentiments in the Chinese households. Our FCI shows that post-COVID, sustainability is ranked just behind quality and health as the third most desired value that consumers expect in five years' time. Expectation for improvements in social responsibility, likewise, was higher among China's consumers.

The planet first consumers prioritize their desire to make a difference by actively working for a higher purpose: greater individual, environmental and global well-being. Environmental impact will become an important parameter in the consumers' decision to spend. With the objective of the policymakers and the market in alignment, government regulations will be welcomed as ways to incentivize further actions. We expect consumers, investors, and corporate interest in environment preservation will shape China's consumption habits together.

However, consumption habits will be fragmented. A focus on food security and sustainable nutrition does not reduce the desire of consumers to explore new tastes and food sources. Consumers distinguish between 'rushing' and 'caring'. With the former, they eat meals that fulfil a nutritional need in a busy lifestyle. With the latter, preparing and eating food is a social experience. Companies evolve brands to meet both needs: mass market staples and premium products that deliver new culinary experiences.

How EY can help

Climate Change and Sustainability Services and Purpose-Led Transformation

For consumer businesses' intent on playing a leading role on environmental awareness in China, the ability to move quickly and decisively will become more critical but also more difficult. First, businesses will need to set up a decision-making mechanism and increase operational and performance effectiveness to deliver long-term value in compliance with government and industry requirements. Second, they also have to internalize the purpose of environmental awareness, institute organizational behavior and culture change, build reputation, and proactively align to shifting consumer expectations.

Corporate actions on China's carbon neutral journey

The EY Climate Change and Sustainability Services (CCaSS) team understand the risks and opportunities arising from climate change and sustainability issues and utilize top-notch resources and global influence to help consumer products and retail companies establish a management mechanism from decision-making to operational effectiveness. Our teams bring together professionals with experience in engineering, science, business, finance and operations coupled with a deep understanding of specific policy and regulatory instruments.

Since China announced its target of carbon neutrality by 2060, Chinese companies have taken actions on the carbon neutral journey. EY CCaSS team has extensive experiences on supporting clients to setup carbon target and undertake strategies. We could assist clients better understand emission reduction opportunities based on the emissions profile and the abatement potential of different technologies and the potential emissions impact of different policy options.

Our work process includes (1) measuring current emissions; (2) identifying opportunities to reduce emissions; (3) developing an offset strategy to credibly offset any residual emissions; and (4) disclosure. In addition to helping clients respond to regulatory and market drivers, as well as to the impact of climate change on supply chains, our teams also can help clients benefit from opportunities related to new carbon markets and renewable energy market drivers. The services we offer also include:

- ▶ Assessing the greenhouse gas emissions of products or services
- ▶ Establishing the carbon footprint of your products
- ▶ Providing strategy advice related to carbon markets and renewable energy
- ▶ Helping clients calculate the potential impacts of carbon markets on asset valuations, including carbon credits
- ▶ Developing or assessing energy optimization strategies and programs
- ▶ Undertaking feasibility analysis of renewable energy or carbon abatement strategies
- ▶ Building or assessing marginal abatement cost curves
- ▶ Conducting energy monitoring and assessments
- ▶ Undertaking climate risk and vulnerability assessments

Purpose-Led Transformation™

From the market point of view, successful businesses also have to leverage the power of purpose. We define purpose as an organization's reason for being that serves to set strategic vision and decision-making. A strong purpose is key to delivering value and meaning for customers, employees and other stakeholders, which boosts the prosperity of the organization.

EY Purpose-Led Transformation™ (PLT) helps clients sharpen and activate their purpose to set a strategic vision and achieve innovation and growth. It is a repeatable three-phase process:

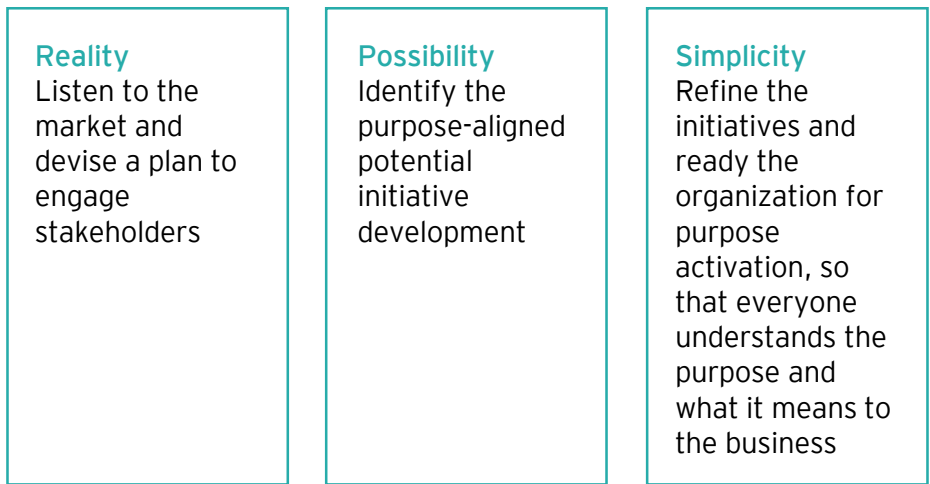
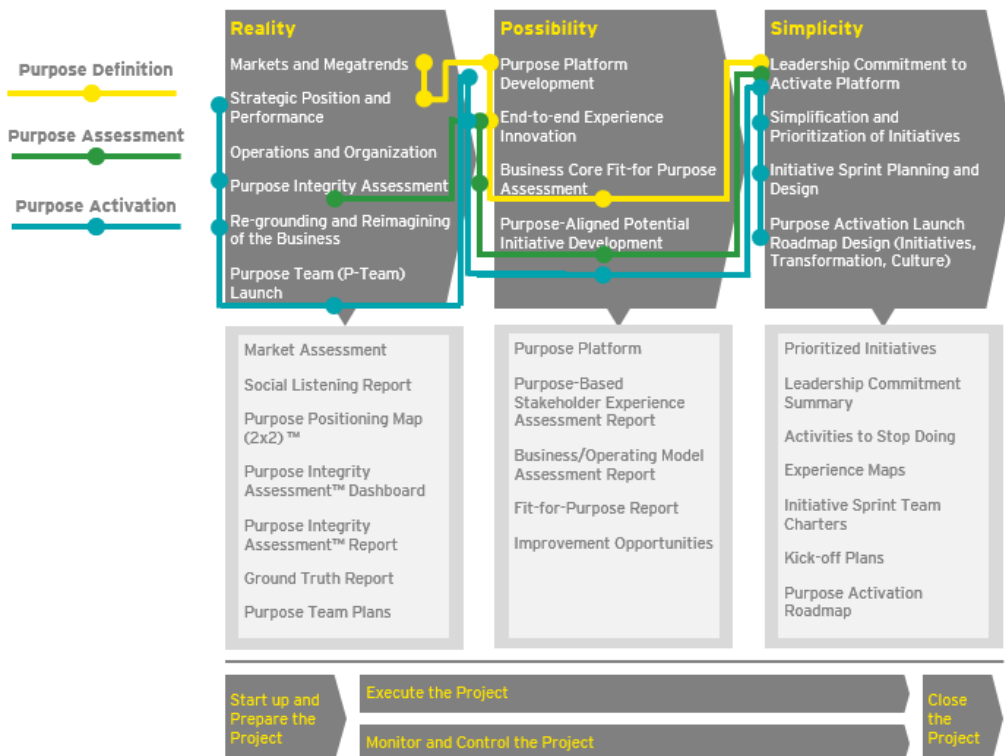


Fig 30 EY Purpose-Led Transformation (PLT) helps clients sharpen and activate their purpose



Source: EY



Experience everything

Shopping as the ultimate social entertainment activity

Experience-based shopping versus task-based buying

With more incentive to spend, China's tech-savvy consumers will be hungry for more enjoyable and personalized experiences from their preferred brands. In this world, consumers expect immersive shopping to become one of the most exciting and rewarding experiences in everyday life, while mundane buying transactions are taken care of by AI - swiftly, silently and conveniently.

Insatiable demand for novelty and value drives companies to innovate relentlessly. Words such as "convenience," "experience" and "retail" are redefined. "Good enough" products are no longer good enough to maintain consumer loyalty. They don't just ditch brands that fail to give them what they want; they exercise their responsibility to give negative feedback.

Also, among this segment of consumers, they enjoy co-creating products with people in their network. Product design and innovation become social, circular and iterative. Brands involve themselves in the process, but as facilitators and equal partners. At the physical stores, consumers experience their brands of choice at immersive destinations that feel like a mix of art gallery, theme park and religious temple. It gives a space for consumers engage with the brand in novel and unexpected ways. Their purpose is to impress new customers and deepen the connection with the loyal customers.

Identifying consumer trends through big data

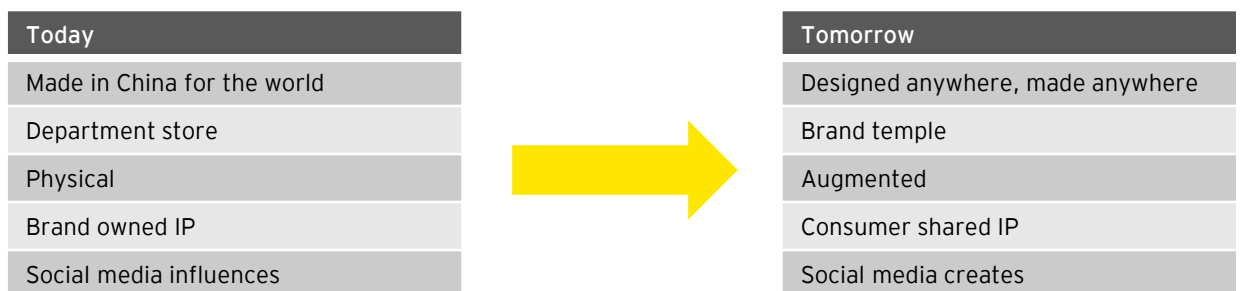
Compared to the FCI respondents from the OECD countries, China's consumers are relatively less concerned about privacy while they tend to prefer a more customized retail experience. China is already a fertile ground for big data modeling by businesses seeking to stay ahead of shifting consumer trends.

By entrusting their personal information to businesses, consumers expect the simplicity of a well-curated life, with goods and services tailored to their needs. In return, anticipating the consumers' constantly evolving demands will set the brands up for prosperity. It is important to note, however, that consumers will expect companies to use personal data responsibly. The consequences for any company that breaches this trust can be devastating.

Rural consumers on the same page as urban trendsetters

With brand presence changing from physical to virtual/augmented, rural and small-town consumers no longer have to move to major cities for the experience. Through not only the new digital infrastructure laid down by the Government, but also supply chain innovation, rural consumers are put on the same page as urban trend setters in top-tier cities to co-create experience and define brands.

Fig 31 Paradigm shifts with the experience everything consumers



Source: EY

How EY can help

Customer-centricity

For the experience everything consumers, successful consumer companies will need to develop greater customer-centricity through ever-improving digital adoption and experience. Consumers expect their favorite retail brands to curate the products they want. They prize interactions with brands, for example, through events, online and offline communities, and social media conversations, where they are enabled to participate in design and creation.

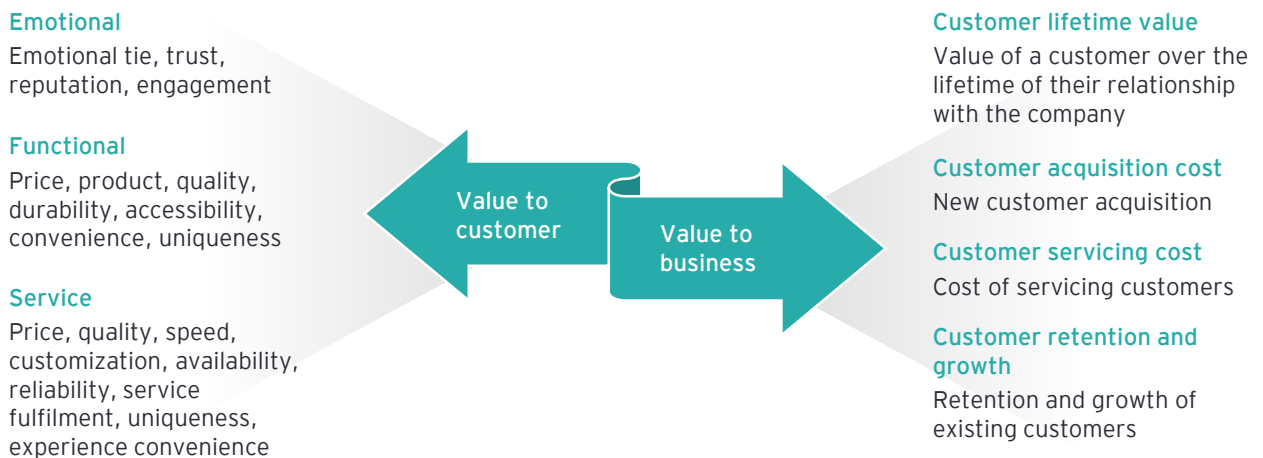
Adopt the right platform

Businesses also need to fundamentally rethink the way they enable and measure experiences. Specifically, how do customer motivations and behaviors reflect their value and financial outcomes, and how interactions that optimize customer experiences deliver value at scale and accelerate the value chain of technology, processes, people and ecosystems.

SMX Economic Value Model

The EY Smart Experience (SMX) Economic Value Model quantifies the impact of experience strategies at every possible interaction point based on the value to the customer and the business. The SMX score is a set of real-time metrics of consumer experience on the interface. It is then subjected to an AI native approach that integrates to the existing customer journey orchestration stack to activate engagements.

Fig 32 The SMX Economic Value Model



Source: EY

Be an experience creator

An important challenge for businesses is to reconsider the future of physical shops as consumers shift toward online channels. We believe store space is an asset that retailers can leverage to become an experience creator - interactive space that justifies the premium they command. To build the gravitational pull for customers, however, the stores must stay cutting-edge and relevant. Meanwhile, digital solutions such augmented (AR) and virtual reality (VR) technology applications can blend in seamlessly to support offering.

Accelerated Experience Delivery

The EY Accelerated Experience Delivery approach is a continuous cycle of experience design and deployment:

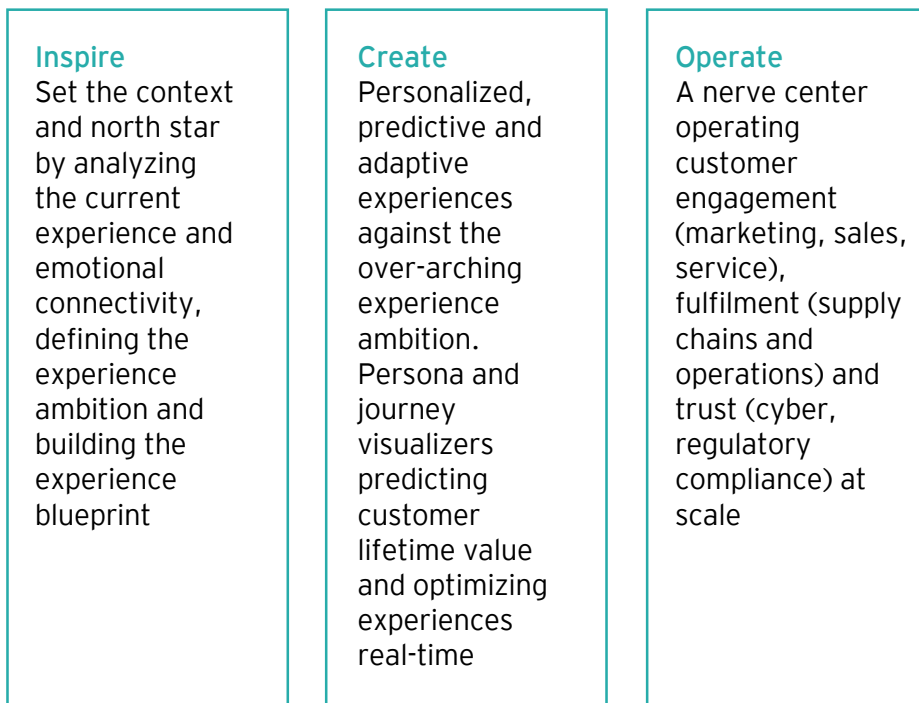
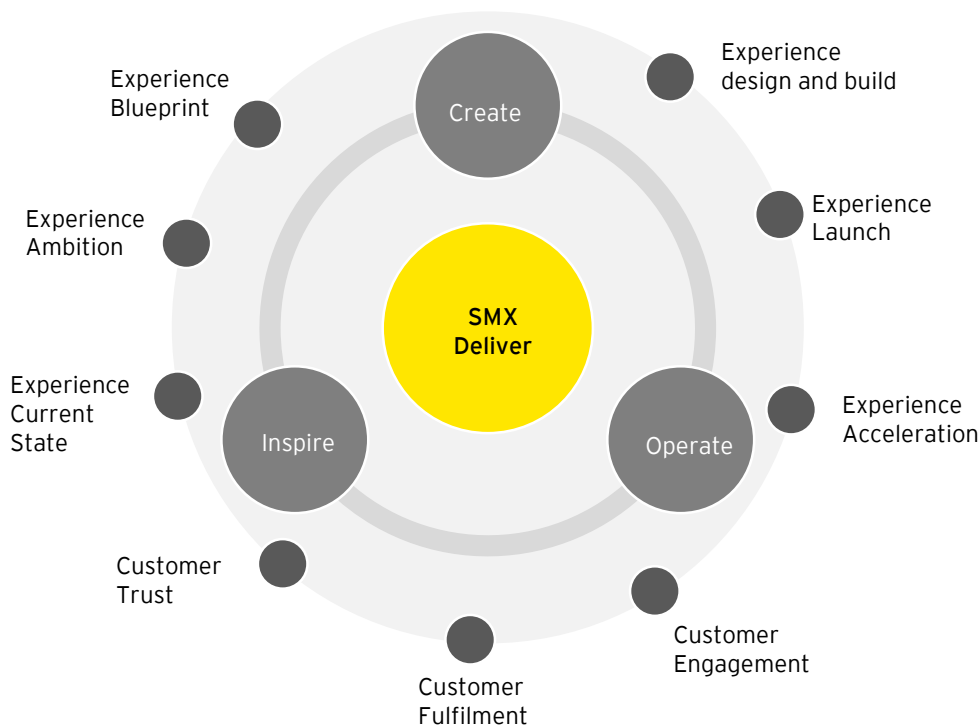


Fig 33 The Accelerated Experience Delivery approach



Source: EY

Example Sephora

Sephora believed that the physical store is still the nerve center of the company. Digitizing the store became a priority and Sephora has unveiled its new range of stores that ingeniously combine offline and online components.

With the physical store positioning as an experience creator that is the main channel to attract traffic, Sephora developed four key enablers to drive growth: 1) Sephora's own private brands target young and fresh customers with limited purchasing power while other brands target mid-to-high end customers; 2) Through its accelerator program, it brings in exclusive brands increasingly. In the process, it brands itself as not only a retailer but also a beauty influencer; 3) Its digital facilities are designed to enhance customer in-store experience; and 4) Its new range of stores - Studios - is designed to ingeniously combine offline and online components.

Making its debut in 2017, the Sephora "Studios" brings the experience of an exclusive makeup room to its customers. With limited physical products on shelves, the focus of the studio is on service and experience with interactive mirrors for customers to try on products using AR technology. The experience is seamlessly integrated with Sephora's digital platform such that customers may explore products on "Cloud Shelves". It also allows customers to scan images on store windows and products using its app to receive additional customized beauty content.

9 The ascendant consumers

Consumer satisfaction at every micromoment

Respect the sense of confident purpose

With the growth of the middle class and expansion of the consumer market, Chinese consumers have the kind of buying power they have never experienced before. Consumers will be kings – or queens – and newly crowned at that. In the world of the ascendant consumers, they are proud in expressing who they are, and happy to use their growing economic and social power to dictate terms to the brands.

Consumers in this world are self-confident in their identity and assertive about their place in the global economy. The needs and preferences of themselves and their peers must be recognized, understood and satisfied. They reward brands that do not just listen to their demands, but put them at the center of every product, service and experience they offer.

To prosper with these consumers, businesses have to adapt to the rapidly evolving needs of their consumers, respect their sense of confident purpose and invest to understand their changing context and their complex and multi-faceted sense of identity. The evolution of technologies such as AI, mobile payments, voice recognition and VR creates new possibilities for them to achieve this which also accelerates the pace of development.

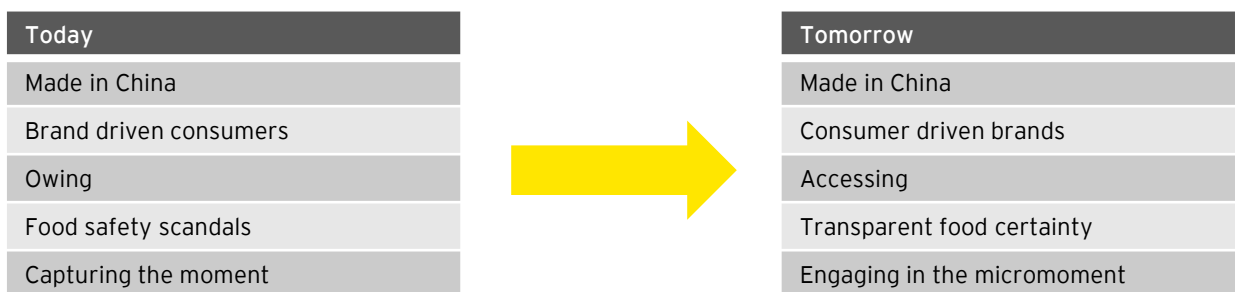
Brands need to be agile. However, they need to take agility to a new level, adapting not just to the consumers' needs in the moment, but in the micromoment. There will still be opportunities to engage consumers - but they will be fleeting. The window will close as quickly as it opens. Acting "now" will be too late, in the sense that brands will only thrive when they can anticipate what consumers are about to want, and they can then be ready to meet that particular need once it arises. Brands that cannot act at that pace will be left behind.

Agility of domestic brands

International brands will no longer confer status in themselves. Not only is the market developing a preference for domestic brands where there is little perceived difference in product quality, domestic brands are also in better positions to provide the innovative services, advice and curation expected by the ascendant consumers.

Their perceived “localness” also resonates with the sentiments of the ascendant consumers. That will further reinforce the prominence of brand identity, which will become more valuable than physical goods in the long-term. To compete with local brands, multinationals will need to sacrifice global synergies to deliver local authentic product stories.

Fig 34 Paradigm shifts with the ascendant consumers



Source: EY

How EY can help

Supply chain reinvention

The necessity of dark stores

For the ascendant consumers, successful consumer companies will need to deliver faster and more customized service based on new technologies and supply chain models. A solution to shorten delivery time is “Dark Stores”. As the demand for e-commerce has surged in the past year, companies will need to re-optimize their supply chains to meet this expectation. As the name implies, dark stores are not meant to attract customers. Instead, they are fulfillment centers that are meant primarily for storing, sorting, and handling orders for online businesses.

The concept of dark stores came from transformed physical stores. Traditionally, retail chains operating with an omnichannel approach are known to use a centralized distribution center or regional distribution center covering a large geographic area to fulfill their orders, but the fulfillment speed might be lacking due to the increasing demand of sales during unexpected times. Increasingly, dark stores become specialized operations that offer more picking accuracy at strategic locations that both offer lower rental costs and enhance deliveries.

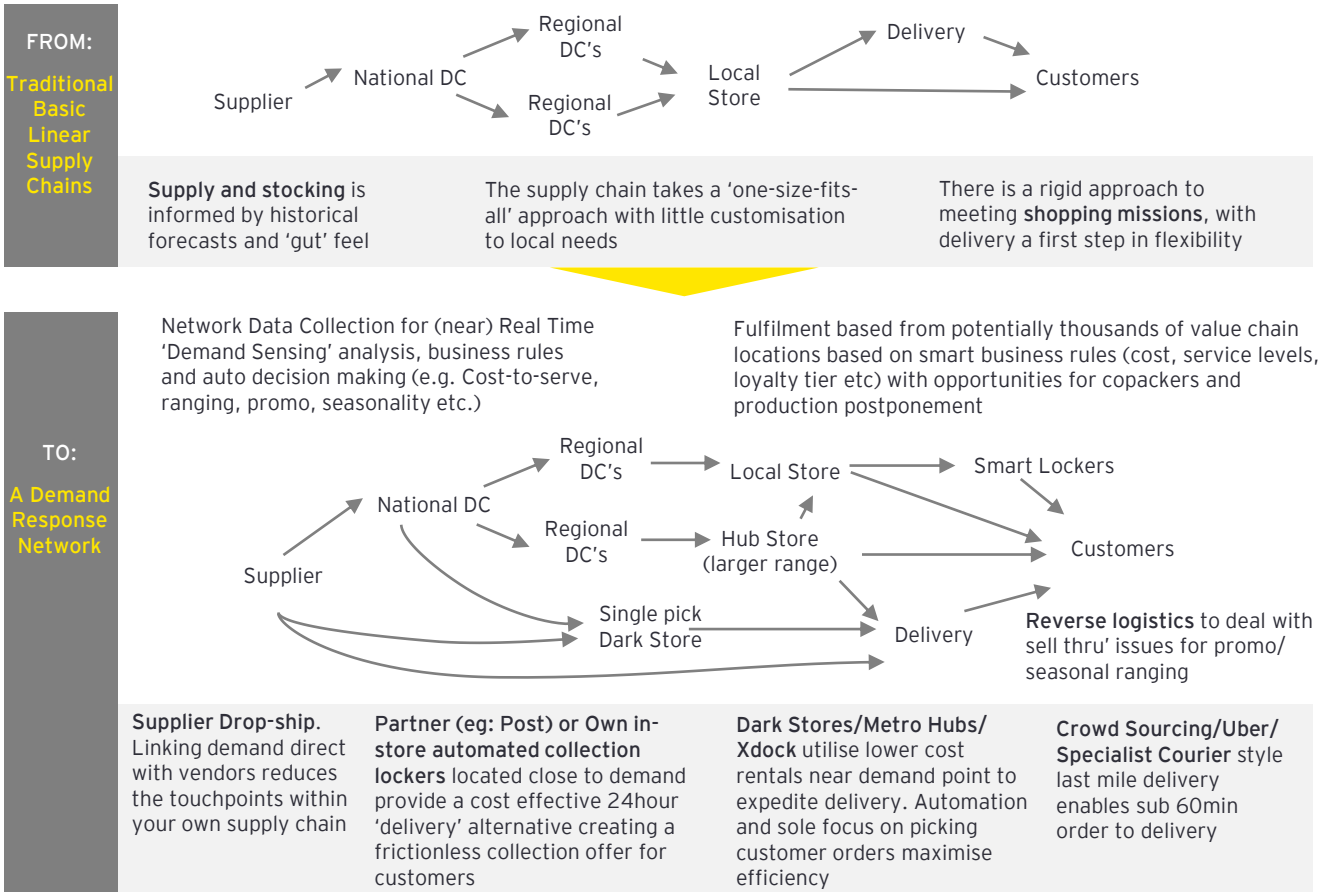
Network Design, Omnichannel and Logistics Strategy

The EY Network Design, Omnichannel and Logistics Strategy reviews the physical supply chain and designs a new network to reduce complexity and cost whilst improving service levels. It helps to identify investments that must be made in manufacturing and warehousing capacity to support new markets, channels or products.

For example, EY is able to help companies build an agile supply chain to compress the new project development lead time especially in the fast fashion and consumer electronics space. From this solution, we understand that successful businesses cannot focus on just the consumer trends now, which can quickly become a standard expectation as adoption grows. Instead, a “next-generation” network design focuses on offering the flexibility to respond to the highly individualized and volatile customer demands tomorrow.

To enhance success, we also understand that network design is much more than modeling. Instead, our solutions follow an integrated approach with an implementation roadmap. It requires heavy stakeholder engagement to achieve favorable configurations with minimal disruption to customers and vendors.

Fig 35 From linear supply chains to smart demand response networks



Source: EY

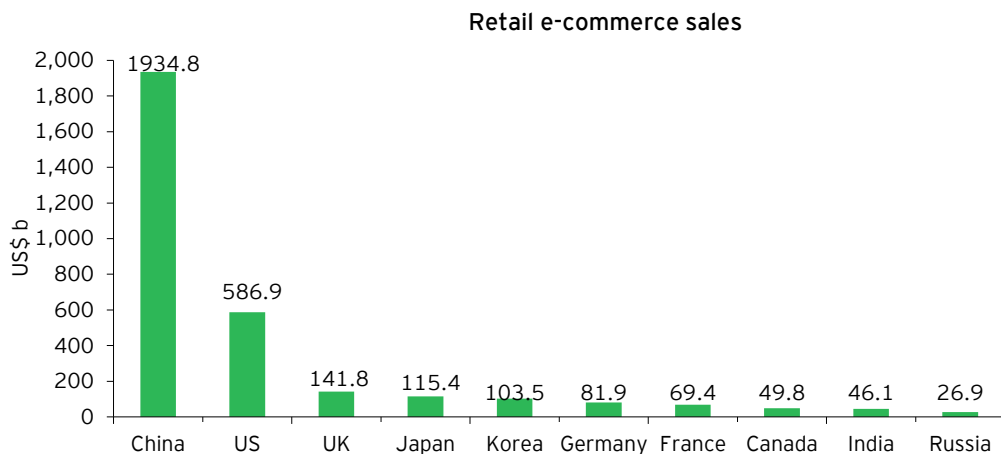
10

China's (and the world's) new retail age

The future starts here

China is an enormous, high-growth consumer market that is already at the world's forefront in terms of digital adoption. Across China today, consumers are increasingly empowered by the country's economic rise and the implementation of technologies that make life seamless. In 2020, 24.9% of retail transaction in China was done online²⁸, making it the world's largest online merchandise sales market²⁹. With 855m avid digital consumers³⁰ and the right policy mix behind it, the new retail age is only just beginning in China.

Fig 35 From linear supply chains to smart demand response networks



Source: eMarketer

28. www.gov.cn/xinwen/2021-01/19/content_5581163.htm

29. www.gov.cn/xinwen/2020-07/02/5523479/files/0a2c57d8ba6d4e26b83d96cdd764d6f0.pdf

30. www.cac.gov.cn/pdf/20190829/44.pdf

The world's laboratory on consumer trends

But the vast market is not the only reason why every consumer-facing company needs to be doing business in the country. China's consumers are spoilt for choices and their expectations, from technological innovation to customization and ultra-convenience, are very high. They will jump from one experience to the next as attention spans dwindle. Businesses will need to think carefully about how to set themselves apart from the crowd. Getting it wrong, and they could ruin their own brands or make themselves irrelevant.

The uncompromising attitudes of these new confident consumers will become an important driver of change, and that makes China a huge laboratory. From its e-commerce platforms, digital payment methods, online streaming personalities to its supply chain reinventions, many of the new behaviors, trends and business models that will redefine retail are emerging here today.

No brand can afford to ignore China

The shockwaves from this explosion of consumer innovation will be felt far beyond China's borders. Just as China's experience may provide insight of the post-pandemic new normal for the health-conscious consumers worldwide, its investment on smart city infrastructure, drive for a better environment and concern for population aging are hardly unique. The need for businesses to analyze and understand the market, position its strategy, and identify growth enablers are one and the same. Whether or not companies in other countries want to copy what they see in China, or adapt it, or create something different in response to it, no brand can afford to ignore China.

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