



TAKING A SERIOUS LOOK AT FUN

The growth of the
leisure industry
in China

People in China's the growing middle class are working longer and harder, and so they are placing greater emphasis on leisure as well as spending more time on leisure activities (average leisure hours per day increased from 2.16 in 2012 to 2.55 in 2015). They are also willing to spend more money while unwinding from the pressures of work. Alongside this increase in demand, the government has launched various campaigns to promote recreational activities. This has resulted in dynamic growth in the leisure industry. In fact, China's leisure market has recently surpassed that of Japan to become the second largest in the world.



Advertisement of KFC in Beijing Subway

To better understand the growth opportunities in China's leisure market, we conducted a survey in Q2 2017, which spanned 21 cities from different regions and city tiers. The survey covers both general attitudes towards leisure activities, as well as information on five categories of particular interest, namely cruises, theme parks, domestic travel accommodation, restaurants and sports. In this rapidly growing and changing landscape, we seek to bring more clarity and distil how best to capture growth opportunities. So we started by asking the following questions:

- What are the key drivers behind the growth?
- Where are there opportunities?
- How can these opportunities best be captured?

This report focuses mainly on the overarching trends across the leisure industry without always drilling down into specific categories. Information on each category is available separately on request.

PAINTING THE TOWN RED

(MACRO OVERVIEW)

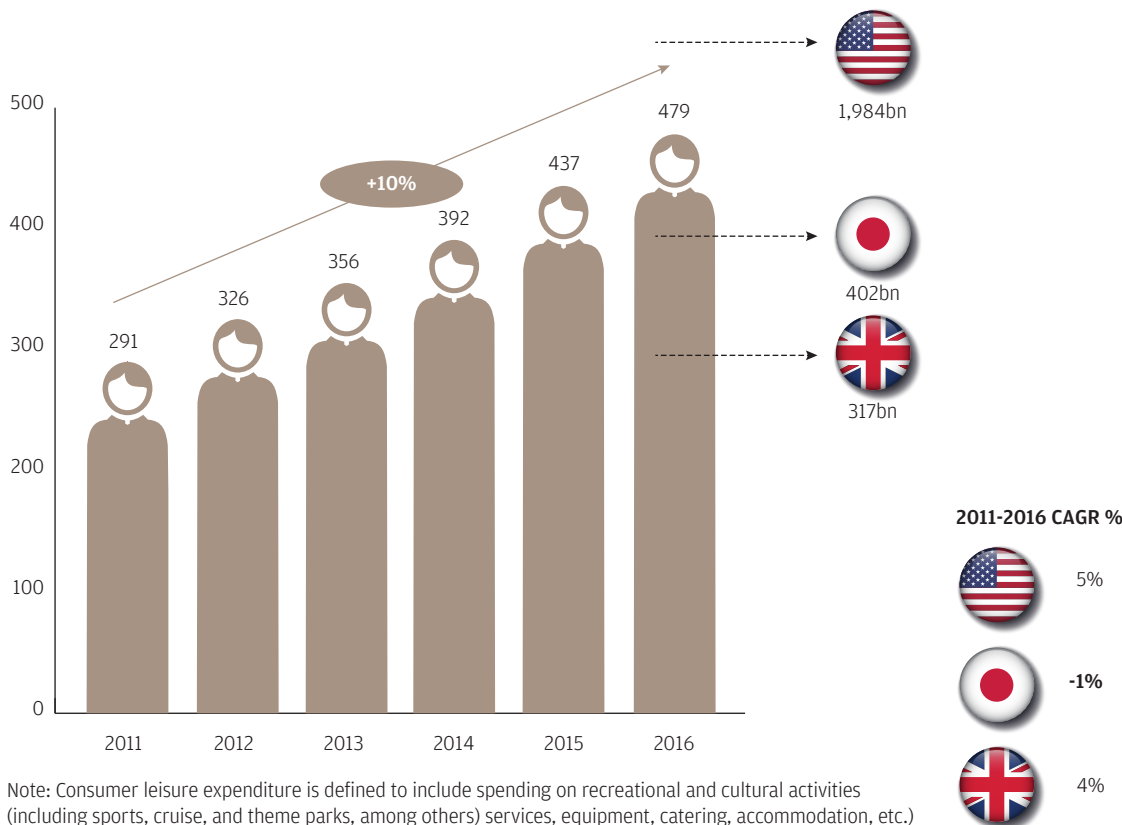
While China's economy entered a period of 'new normal' with mid-to-high single-digit growth, its underlying growth drivers are shifting from investment-driven to consumption-driven. Consumer expenditure in the leisure sector has seen c. 10% Year-On-Year (YOY) growth since 2011, more than double the growth rates of the sector in other major markets. Consumption has been primarily fuelled by rising disposable income and an expanding middle class. China's new middle class consists mainly of the post-80s generation, who were born after the introduction of One Child Policy and raised in an era of rapid economic growth and increasing prosperity.

Compared to their parents, they are more willing to spend time and money to indulge themselves, both in terms of material possessions and of services and experiences. The post-80s generation has now become the major target for the leisure sector in China. Although it is a US\$ 479 billion market today, leisure expenditure as a proportion of total consumer expenditure is still only c. 11% in China, significantly lower than in other major markets such as the US (21%) and UK (17%). So, there is clearly significant scope for further growth.

“CONSUMER EXPENDITURE IN THE LEISURE SECTOR HAS SEEN C. 10% YEAR-ON-YEAR (YOY) GROWTH SINCE 2011”

FIGURE 1:
Consumer leisure expenditure in China

USD bn

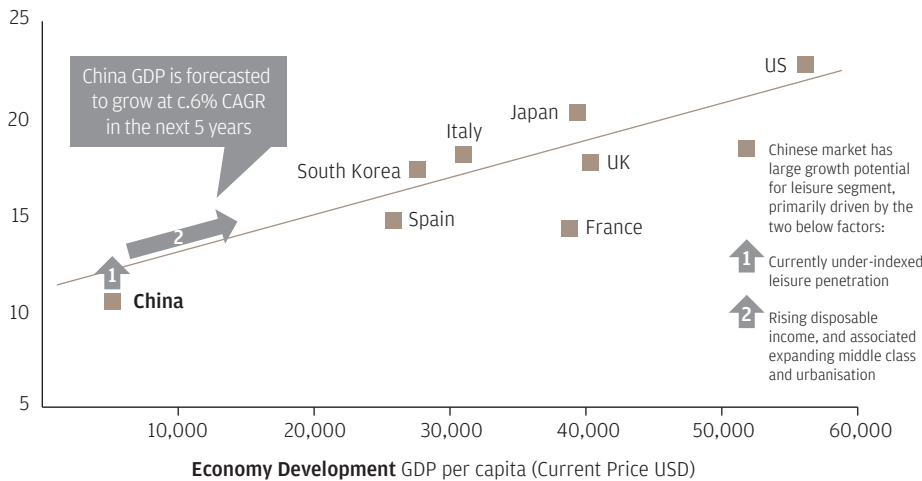


Note: Consumer leisure expenditure is defined to include spending on recreational and cultural activities (including sports, cruise, and theme parks, among others) services, equipment, catering, accommodation, etc.)

Source: Euromonitor

FIGURE 2: China's leisure sector: growth potential

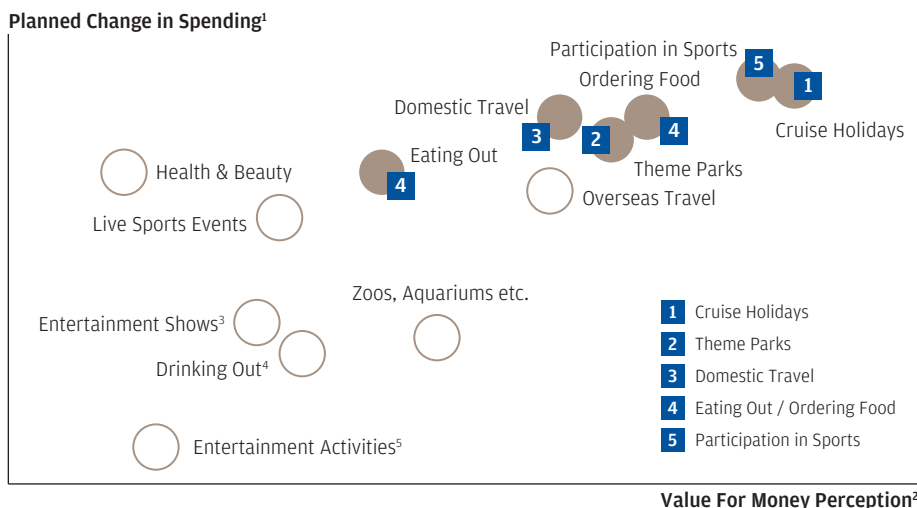
Leisure Spend - Leisure Expenditure as % of Total Consumer Expenditure (%)



Source: Euromonitor, IMF

FIGURE 3: Key growth leisure categories in China, spending trends and perceptions

Planned change in spending¹



¹ Q: How do you anticipate your money spend on the activity to change in the next few years? Select Increase, Same or Decrease (Based on selected activities in G1). Weighted average of all responses; Increase = 2, Same = 1, Decrease = -2

² Q: Do you think the activity has good value for money? Select 1 to 5, with 5=highest value for money, 1=lowest value for money;

³ Incl. concerts, opera, art exhibition etc.

⁴ Incl. on-trade tea, coffee, milk tea etc.

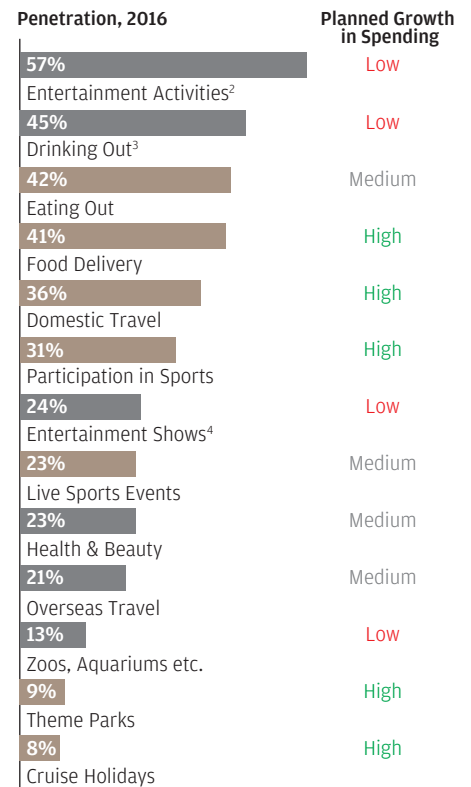
⁵ Incl. going to movies, KTV, bars, clubs etc.

Source: OC&C Leisure Survey 2017

4 An OC&C Insight Taking a Serious Look at Fun

Growth in the leisure sector is driven by a broad range of activities. This is reflected in our survey. Respondents gave a favourable rating for most of the leisure activities we investigated, including both established and newly emerging categories. What becomes apparent is the pivot towards newer experiences such as cruises and theme parks, which people perceive to offer high value for money. Customers say they expect to spend a lot more on these categories in the future, compared to more traditional forms of entertainment such as karaoke. This is particularly interesting, as many of these new experiences are currently in short supply. This issue is examined in more detail on page 8 of this report.

FIGURE 4: Leisure activity penetration % of respondents



¹ G1: Have you conducted the following activities in the past year?

² Incl. going to movies, KTV, bars, clubs etc.

³ Incl. on-trade tea, coffee, milk tea etc.

⁴ Incl. concerts, opera, art exhibition etc.

Source: OC&C Leisure Survey June 2017

THE WORLD IS YOUR OYSTER

(WHERE THE OPPORTUNITY IS)

Chinese customers do indeed have a wide range of options. Growth is driven not just by new choices; in fact, there are three main drivers of growth: (1) new and emerging options, (2) revival of existing options, and (3) upgrade of existing options.

The new and emerging options ...

Chinese customers are becoming more sophisticated. They are continually looking for new experiences by diversifying their leisure options. Compared to conventional activities such as going to the movies, visiting bars and clubs, and karaoke, they are showing greater interest in more novel activities.

For instance, cruises were first introduced in China in the early 2000s, but it's only recently that there's been a surge of brand and service proliferation, especially from international players. Leading international operator Carnival has formed a strategic joint venture with China State Shipbuilding Co. and China Investment Corp. as part of its ambition to develop the Chinese market; Royal Caribbean is increasing the number of ships that use Chinese ports as their home port. The Chinese government is also playing a vital role, by actively developing the cruise industry. For example, there is a plan to build 12 major ports by 2030 and the government provides subsidies for cruise businesses.

According to the Cruise Line International Association, the number of cruise passengers in China grew at c. 76% per annum from 2012 to 2016, reaching 2.1 million in 2016. This, however, still only represents 0.2% of the total population, with a significantly lower proportion of people going on cruises than in developed countries such as Australia (5.4%) and the US (3.5%), indicating huge potential for further growth.



Angry Birds Theme Park in China's Tianjin.

We see a very similar situation in the budding theme parks category, where the entry of international companies and increased investments - by both international and local players - have accelerated overall leisure industry growth in recent years. Internationally, the long-awaited Disneyland opened in Shanghai in 2016 and its first year of operations concluded with total visitor numbers topping 11 million, exceeding Disney's own expectations. However, local operators are not far behind. Fantawild, currently the second largest theme parks group domestically and the fifth largest globally, has aggressive plans for expanding its theme parks business.

Today it operates more than 20 theme parks in China, most of which opened after 2010. It plans to build another 20 in China and abroad over the next five years. The new park openings, combined with Fantawild's highly popular Boonie Bears characters and heavy investment in marketing, drove the total number of visitors across Fantawild parks to 32 million in 2016, a 37% increase from 2015.

According to Euromonitor, theme park attendance in China grew by 9% YOY over the past five years to reach 149 million (more than twice the population of the UK) in 2015, and annual growth is expected to accelerate to 18% till 2020.



The Beijing Winter Olympic Games will bring enormous commercial opportunity.

The revival of existing options ...

Another area of growth comes from categories with strong latent potential which have not yet been fully developed.

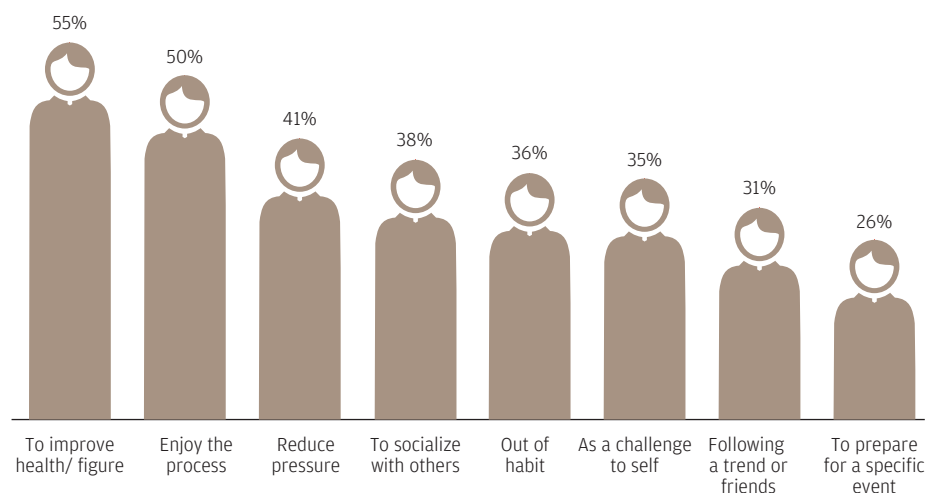
Health and fitness have always been a cornerstone of Chinese culture, with Tai Chi an age-old practice. This had, however, not permeated as deeply into the younger generation until a recent wave of health consciousness started taking this generation by storm. The younger generation now attach greater significance to their health and wellbeing. Even restaurants have been reacting to this trend, with KFC (the largest chain restaurant group in China) recently opening a healthy restaurant concept in Hangzhou, which serves fresh smoked salmon, grilled chicken and salad.

This health consciousness has led to a fitness boom, with a resurgence of sports and fitness. The post-80s generation, especially white collar workers, are becoming active pursuers of fitness. A generation ago, 'working out' was mainly limited to jogging, playing ping-pong / badminton, or stretching out in a public park. Today the post-80s generation are looking for more - they go to the gym, play basketball, hike, ski, dive and much more. They are spending time and money on different kinds of sports, with the aim of improving their health and keeping their figures trim.

As with cruises, government support is playing a key role. A State Council document has set a target of 500 million frequent exercisers by 2025, a c. 39% increase from 2015. Helping to achieve this goal is the construction of new sports venues, growing from 1.57 to 2 square metres per capita. Key areas of development are in football, basketball, volleyball and winter sports - the latter expected to grow considerably with the upcoming Beijing 2022 Winter Olympics.

Sports apparel companies in particular have benefited from this. China is now the largest and one of the highest growth markets for Adidas and Nike, generating c. US\$ 3 billion and c. 4bn revenue for the two companies, respectively in 2016 (and accounting for c. 16% and c. 12% of their global net revenues).

FIGURE 5:
Reasons for participating in sports activities
% of respondents



Source: OC&C Leisure Survey 2017

The upgrades of existing options ...

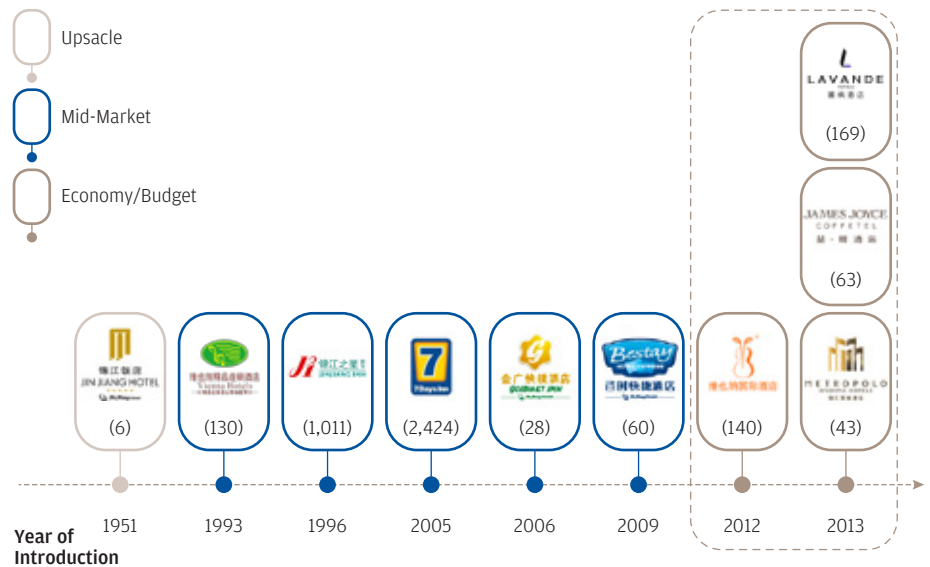
Alongside new and resurgent activities, we see that the more basic forms of leisure are also enjoying rapid growth, in this case coming from both increasing frequency of patronage as well as premiumisation.

We have already seen in our previous study of the restaurant category (2016) that people are eating out more frequently nowadays due to rising disposable income and associated changes in lifestyle. We see a continuation of this trend that is further supported by our study this year. Chinese customers are shifting away from seeing eating out as part of a 'special' occasion such as business settings or celebratory occasions, and are instead incorporating it into their daily lives. In addition, there is a trend towards increased consumption of western food (steak & BBQ, pasta, pizza, etc.) at generally higher prices than Chinese food, indicating that customers are trading up.

In addition, online food ordering has become a big part of the restaurant business. This category has been growing exponentially since around 2010, when third-party platforms such as Eleme and Meituan entered the market with aggressive

FIGURE 7:

Jinjiang Holdings key hotel brand portfolio and number of sites
(# of Hotel Units)



Source: Jinjiang Holdings 2016 annual report

expansion strategies fuelled by heavy discounts for customers. Though menu prices are sometimes marked up when ordering online compared to dining in, platforms and restaurants are offering attractive discounts, which bring the final prices below dine-in prices. Attracted by

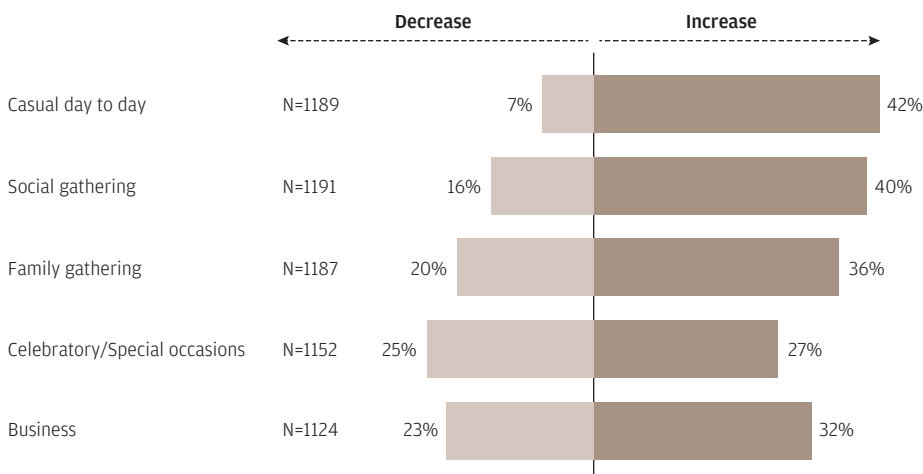
greater convenience, combined with lower prices, an increasing number of customers are ordering food online and thus driving growth in the restaurant market.

In domestic travel accommodation, the number of domestic trips is growing steadily, resulting from both increasing frequency of travel and a growing number of travellers. There is also a move towards more expensive premium offerings in this category. Chinese customers are staying more often in mid-market hotels, with sales in this segment outgrowing others for the past three years. Local players have also started to capitalise on this trend, with major local hotel group Jinjiang diversifying their offering from focusing on the economy segment towards the 'mid-scale and above' segment. In 2013, Jinjiang launched their new mid-scale brand, Metropolo, to serve the increasing demand for higher quality and a better experience.

Beyond the key growth industries showcased above, there is also attractive growth potential in other leisure categories such as health and beauty and overseas travel. In the race to capitalise on leisure trends in China, industry players need to know their position in the field and have a clear strategy on how to capture opportunities.

FIGURE 6:

Change in the past year: consumption frequency - eating out
% of respondents



Source: OC&C Leisure Survey 2017

Some key themes are relevant across China's high-growth leisure markets:

1 Plugging the supply gap

The availability of infrastructure remains a big issue, with a significant supply gap in many of the less established categories. Even with increasing investments over the last few years in categories such as theme parks and gyms, supply still falls short of that in other major countries.

Case study Theme Parks

Accessibility is the key barrier to increased customer engagement in the theme parks category. According to the Themed Entertainment Association, the number of world-class theme parks per 100 million people in China is only 0.2, compared to 2.5 in the US and 3.1 in Japan. In addition, existing theme parks in China are highly concentrated in select cities along the east coast, further limiting accessibility for the overall population. Unsurprisingly, more than 50% of our survey respondents cited a 'lack of opportunity' and 'theme parks being too far away' as the main reasons for not visiting a theme park.

FIGURE 8:
Reasons for not visiting theme parks

% of respondents who did not visit a theme park in the past year

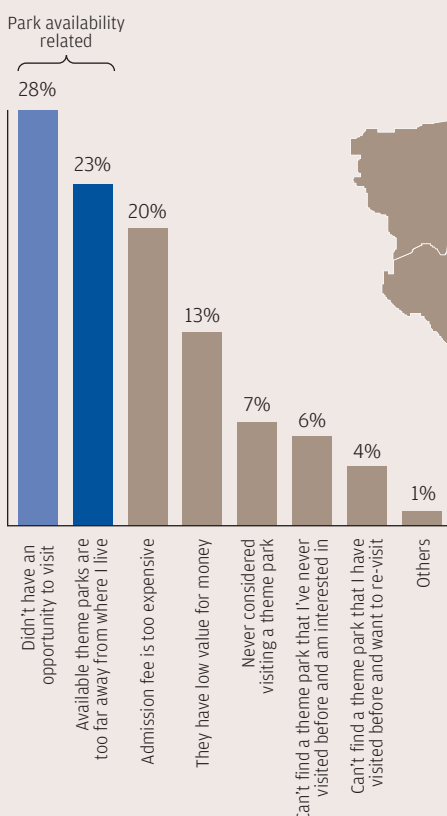
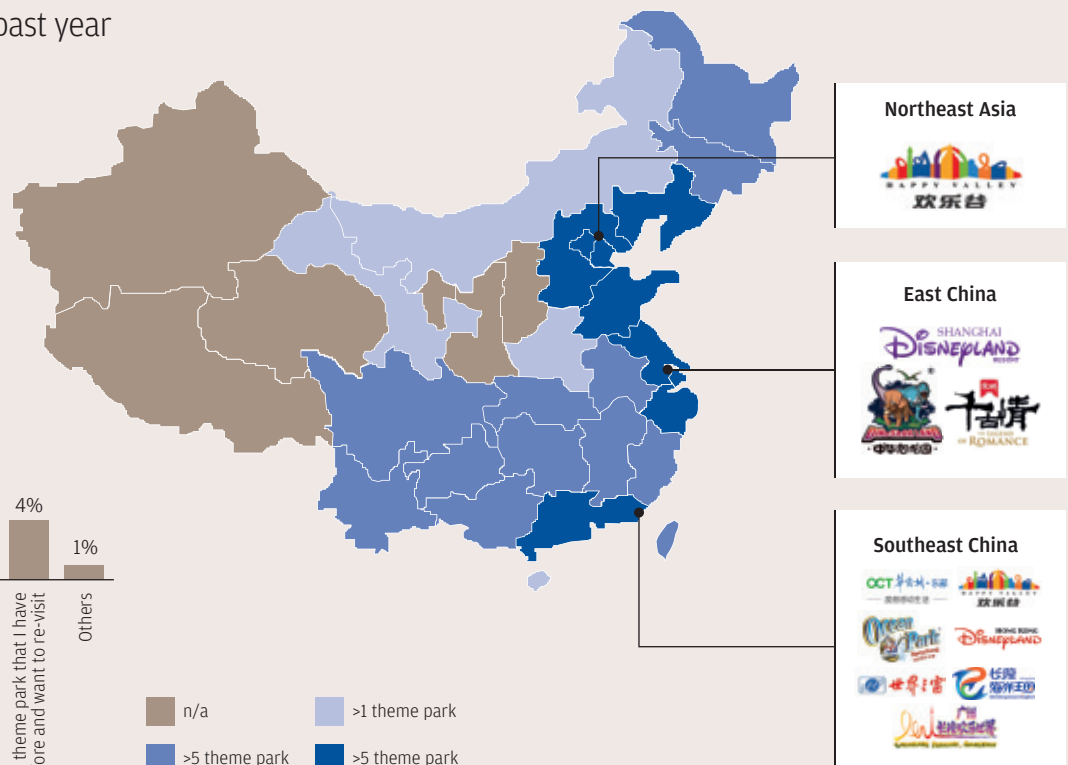


FIGURE 9:
Distribution of the top 100 theme parks in China % of respondents

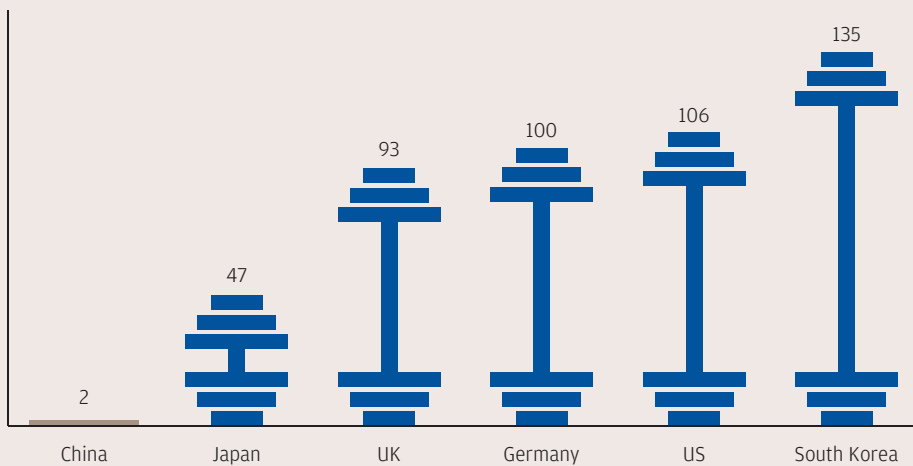


1. The top 100 theme parks in China as defined ranked based on their reputation, scale, revenue, etc.
2. 25 theme parks selected by the Themed Entertainment Association

Case study Sports Facilities (Gyms)

Within sports, infrastructure development is also lagging behind. Taking fitness clubs as an example, the number of gyms per capita is significantly lower than in more established gym markets, with only c. 2 commercial gyms per million inhabitants in China vs 135 in South Korea. This comparison is even starker when we consider that most gyms are currently concentrated in Tier-1 cities (Beijing, Shanghai, Guangzhou and Shenzhen). Not only are fitness networks struggling to meet demand in Tier-1 cities (especially in Shenzhen and Guangzhou); they are also missing out on the large latent potential of Tier 2 cities. Given the larger population (Tier 2 cities have more than three times the total population of Tier 1 cities), and similar income levels, Tier 2 cities offer a huge opportunity for fitness clubs, and even lower tier cities have potential as the overall market matures.

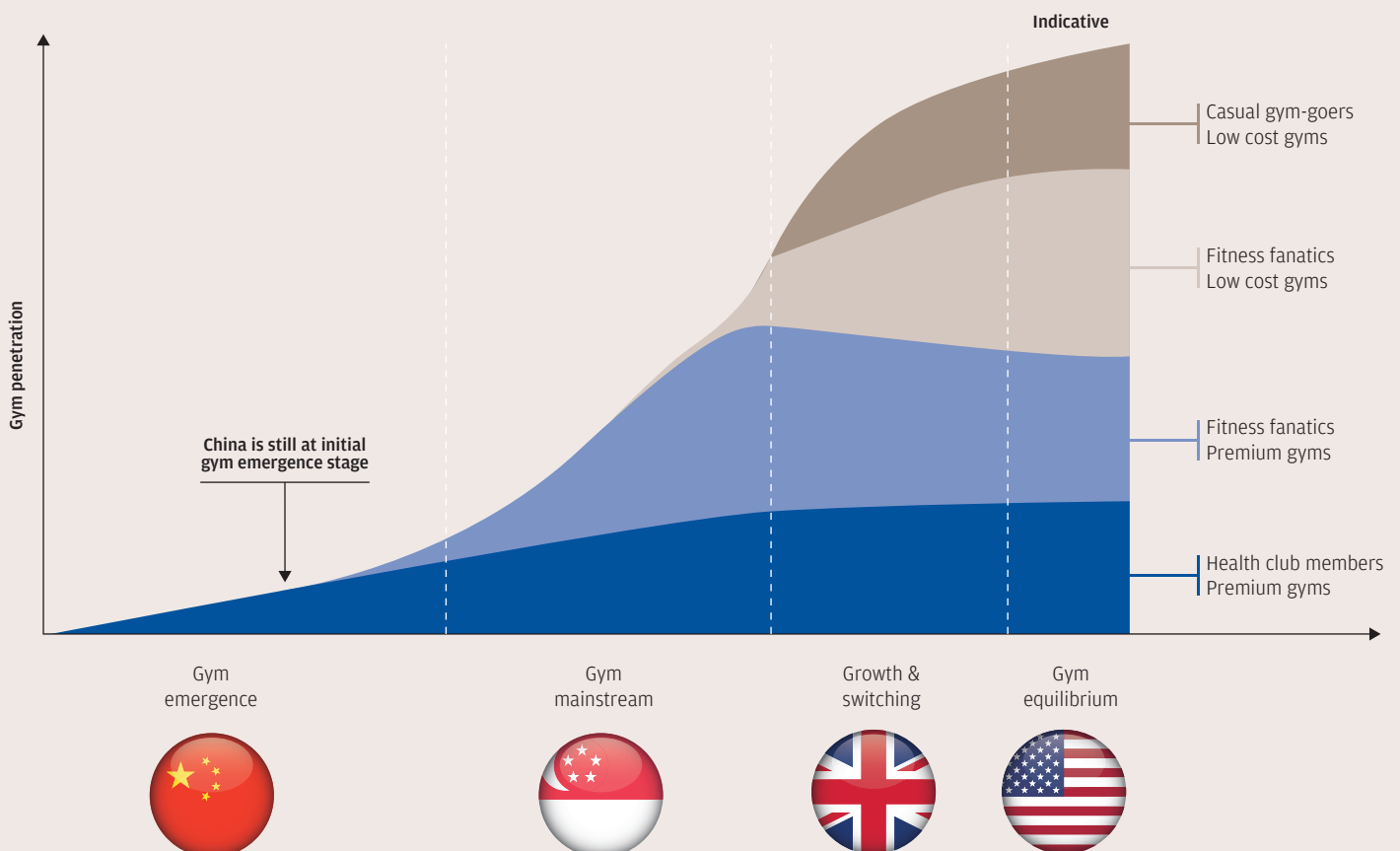
FIGURE 10:
Number of commercial gyms per million inhabitants



“TIER 2 CITIES OFFER A HUGE OPPORTUNITY FOR FITNESS CLUBS, AND EVEN LOWER TIER CITIES HAVE POTENTIAL AS THE OVERALL MARKET MATURES.”

Source: IHRSA 2014

FIGURE 11:
Gym category development maturity curve, conceptual



Source: OC&C Analysis

2 Catering your proposition to target customers

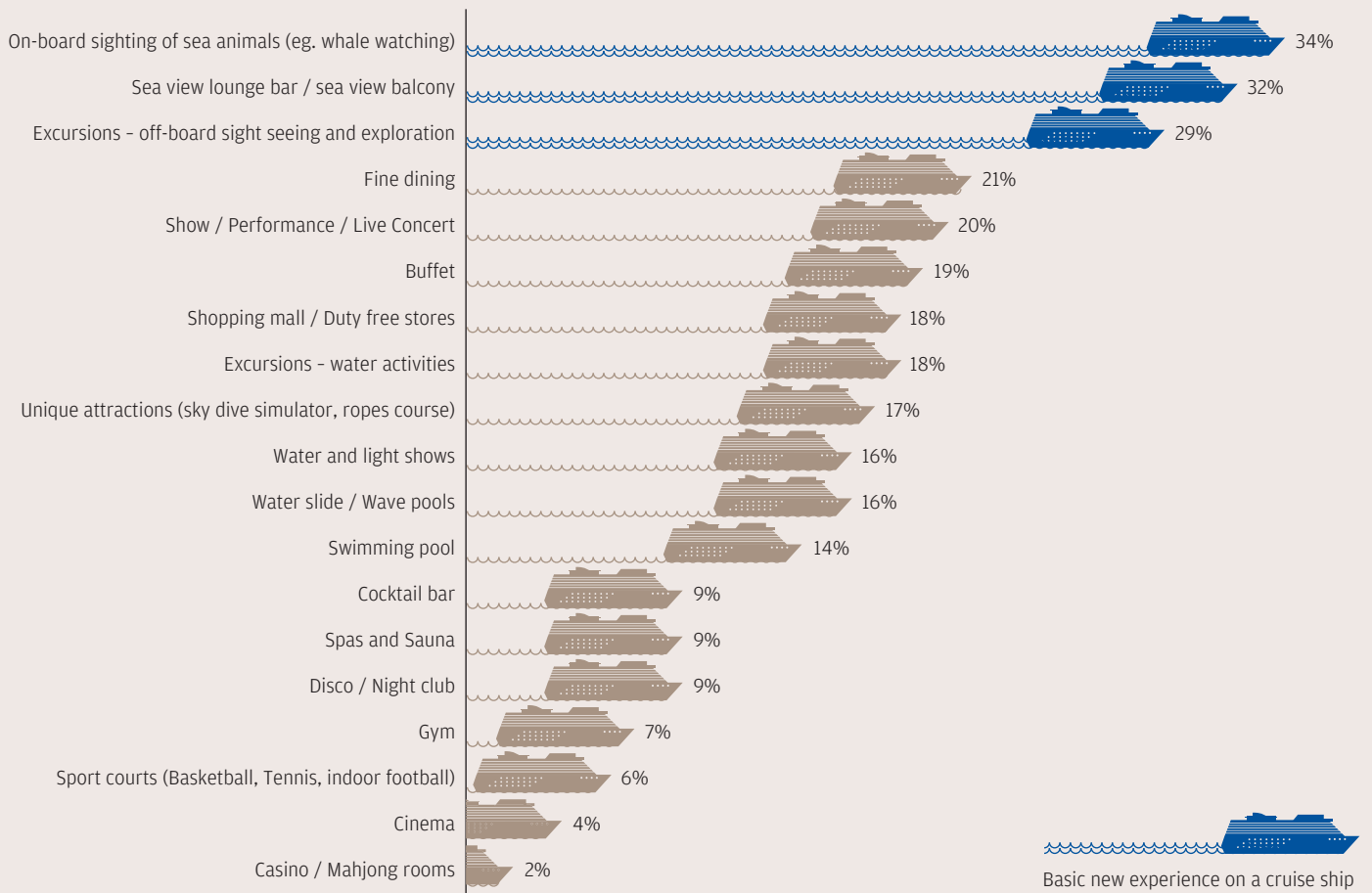
Knowing your customers is almost a no brainer in business, yet it is still worth stressing this point, as we see a failure to meet specific customer needs.

Case study Cruises

Eyeing China's huge market potential, international cruise operators are racing to compete in the market. While they have started catering their offering to local customers, more needs to be done. The foremost difference is in the target demographics. While in the West the retired and elderly are the main customer groups for cruises, in China there is a much larger proportion of customers in their 20s and 30s. To cater to these relatively younger customer groups, international players have started to trial offerings that suit their tastes. For example Princess Cruises, a subsidiary of Carnival, equipped its recently launched built-for-China ship Majestic Princess with karaoke rooms and young Chinese' favourite bubble tea brand Gong Cha.

Customers' familiarity and experience with cruises is also vastly different. As many customers are going on a cruise for the first time, most of them enjoy more of the basic new experience of being on a cruise ship, such as sightseeing on board or having a sea-view lounge/bar. This is set to change as return customers start looking for different activities and it is crucial for cruise operators to be able to cater to these two groups with their differing maturities.

FIGURE 12:
Top 10 things enjoyed most on a recent cruise
 % of respondents who have been on a cruise in the past year



Source: OC&C Leisure Survey 2017

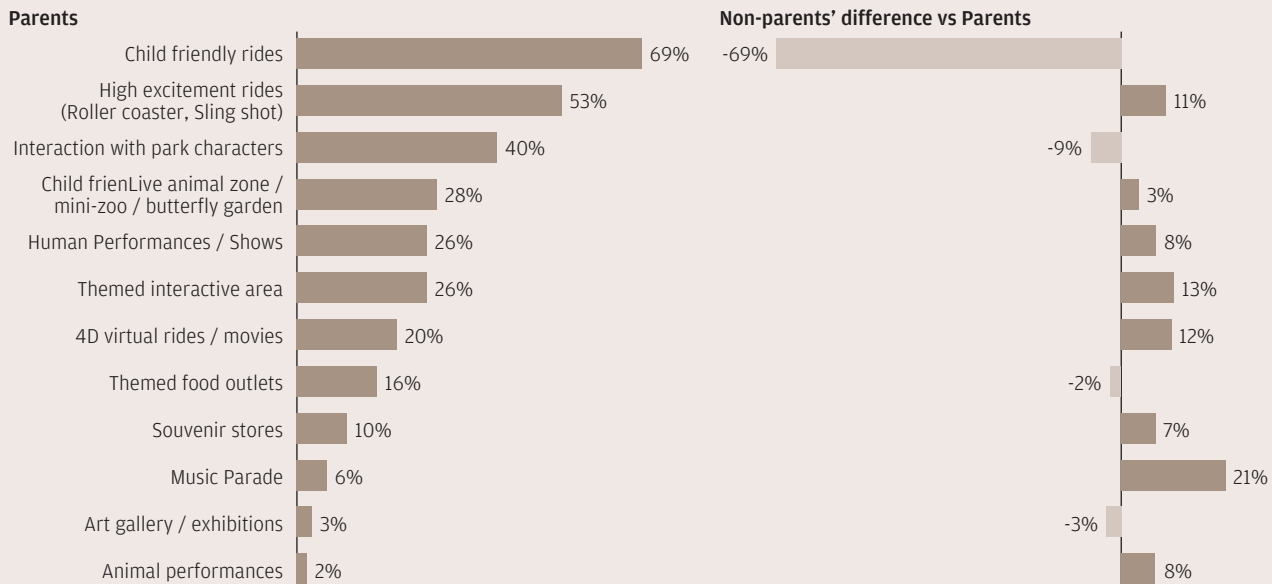
Case study Theme Parks

Within theme parks, it's important to note that there are two quite distinct groups of customers – Young Parents and Youth Excitement Seekers. These groups are looking for vastly different attractions in a theme park. Young Parents care mainly about whether the parks are safe and suitable for family purpose, such as children-friendly rides and interaction with cartoon characters. However, Youth Excitement Seekers (who are mainly teenagers) are looking for high-intensity experiences.

FIGURE 13:

Things enjoyed most in theme parks, parents vs. non-parents

% of respondents



Source: OC&C Leisure Survey 2017

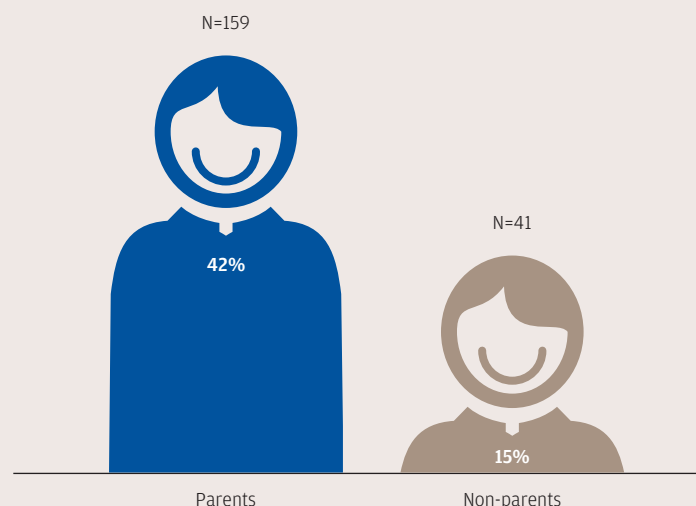
Current theme parks in China seem to fall short in satisfying the needs of Youth Excitement Seekers in particular. Our survey shows that they are less satisfied with their theme park experience than Young Parents. Currently many theme parks target parents (and their families) and have insufficient offerings tailored for teenagers, whereas in other countries such as the US there are plenty of exciting themes and rides available. Nine out of the top 10 theme parks in China ranked by the Themed Entertainment Association have strong family attractions, focusing on history, landscape, architecture or live performances. Some operators are starting to identify this gap and are capitalising on it. For example, Six Flags, famous for its high-intensity rides such as Full Throttle, is building its first park in China and is expecting to draw significant traffic from Youth Excitement Seekers.

FIGURE 14:

Level of satisfaction with last theme park visit, parents vs. non-parents

% of respondents

I enjoyed it very much



“NINE OUT OF THE TOP 10 THEME PARKS IN CHINA RANKED BY THE THEMED ENTERTAINMENT ASSOCIATION HAVE STRONG FAMILY ATTRactions, FOCUSING ON HISTORY, LANDSCAPE, ARCHITECTURE OR LIVE PERFORMANCES”

Source: OC&C Leisure Survey 2017

3 Digitalising your offering

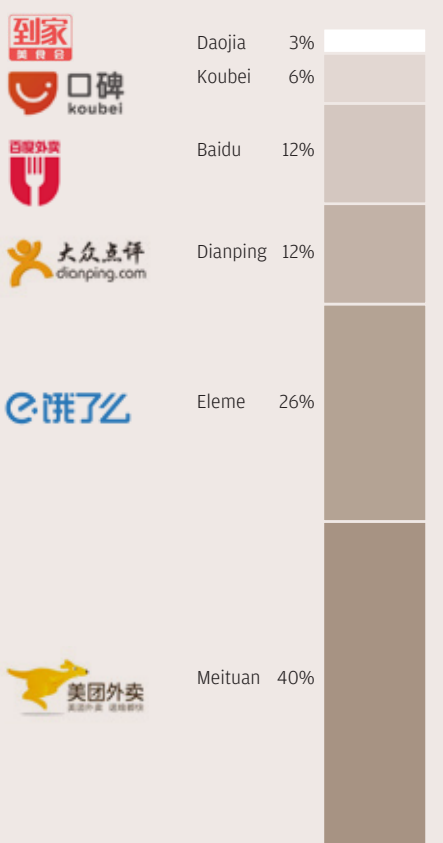
China is at the forefront of digital. China is already the largest online retail market in the world, and the number of mobile internet users has been growing at a double-digit rate. It recently reached 700 million, accounting for 96% of total internet users in China. For Chinese customers, one can live an entire day purely through apps - you can start your day by booking a taxi on DiDi, placing orders on your way to work for your daily groceries on JD (or a lovely dress on Tmall), scheduling manicure service on Helijia during your lunch break, and of course ordering three meals a day on Eleme or Meituan.

Case study Restaurants and delivery

When Chinese customers decide not to cook (which is increasingly common), close to 50% choose ordering online over visiting a restaurant.

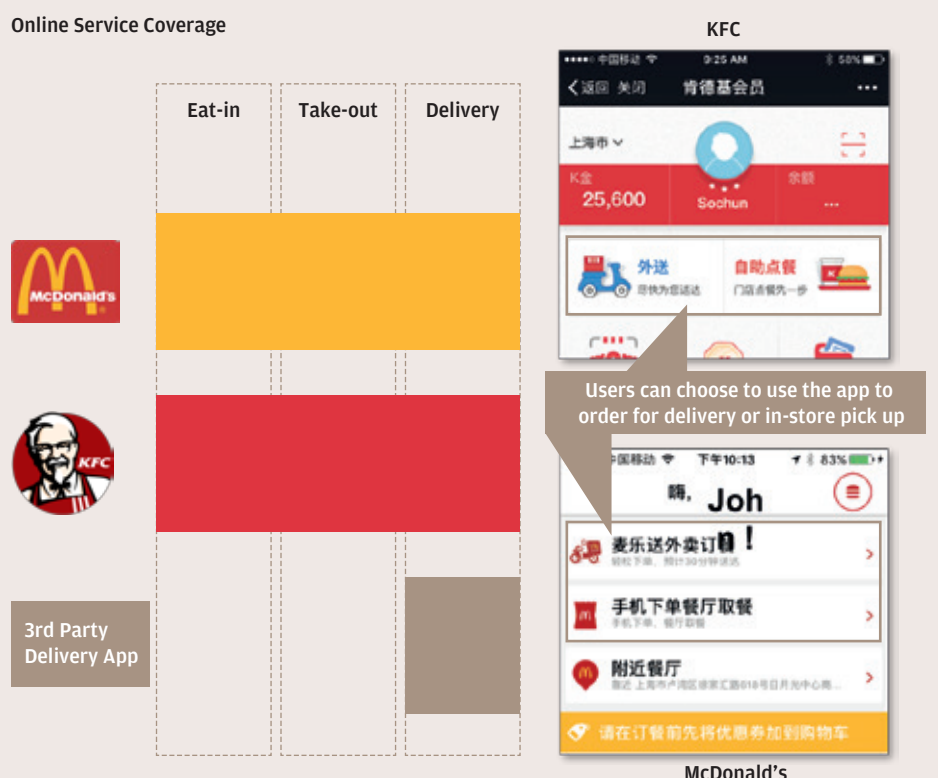
Third-party platforms are key to success as they capture the largest share of customer orders, and are dominated by just a few local players. In food delivery, ordering through third-party platforms has been a critical component for successful restaurants. This surge in online delivery has also encouraged the emergence of a large number of 'dark kitchens' - 'restaurants' without a dining space that focus on serving the delivery market from a centralised kitchen. In terms of online ordering platforms, Meituan and Eleme dominate the market, with over 66% of our survey respondents selecting one of these as their most frequently used ordering app. Further consolidation is expected, with rumoured M&A activities in the market.

FIGURE 15:
Most frequently used 3rd party ordering app
% of respondents



On the other hand, we are starting to see brands (especially larger chains with sufficient scale) developing proprietary mobile apps. Currently, brands' proprietary apps (for example McDonalds, KFC and Starbucks) seek to provide services that improve the in-store experience, such as online ordering for in-store pickup/dining, which is expected to address the pain point of long waiting lines and food preparation time, thus increasing convenience and flexibility.

FIGURE 16:
Proprietary online ordering, McDonald's and KFC



Source: OC&C Leisure Survey 2017

Case study Upmarket domestic hotels

While restaurants seek to improve customer experience using digital tools, hotels aim to retain and extend customer ‘touch points’ and build loyalty.

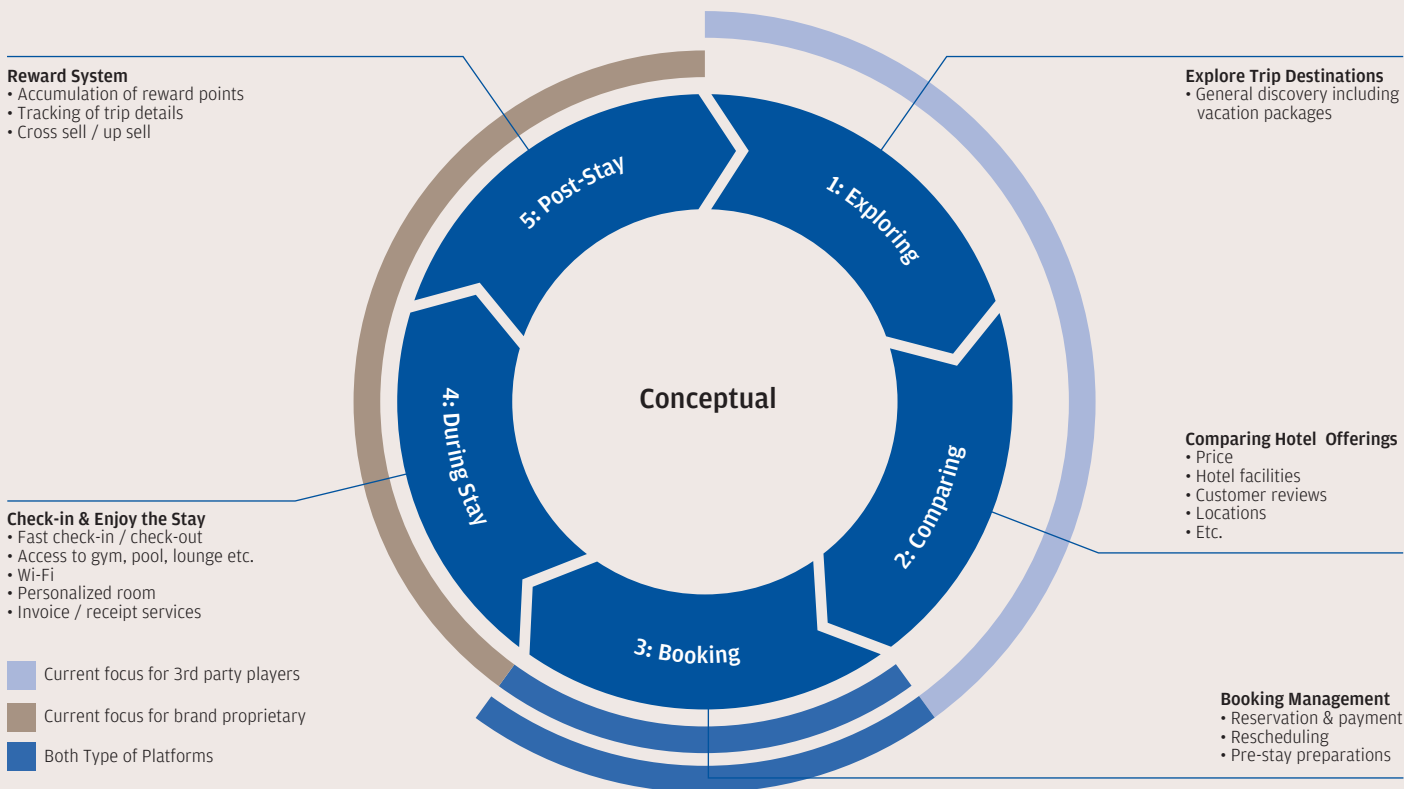
Travel accommodation is a big-ticket and less frequently consumed item, for which customers have a strong need to compare options and prices before making a purchasing decision. Third-party online travel agents (OTAs), therefore, have an inherent advantage, as they can offer convenience and price comparisons. This has resulted in disintermediation between hotels and customers and increased pressure on hotel operators’ bottom lines as they lose some of their margins to OTAs.

Upmarket hotel operators, such as Marriott, Intercontinental Hotel Group (IHG), and Four Seasons operate proprietary online platforms. The strategic focus of their apps is on customer experience. They increase customer touch points, extend interactions with customers from booking, to pre-check-in and reward programmes for post-stay interaction. Marriott, for example, is also offering a price-match guarantee on its proprietary booking platforms in a bid to reduce reliance on OTAs and re-capture customers’ bookings.

FIGURE 17:

Common elements of China’s existing upmarket hotel proprietary online platforms

Hotel Proprietary Platforms (Mid to High Scale Hotel Chains) vs. Third Party Platforms



Source: OC&C Analysis

FIGURE 18:

Interesting functions provided by Marriott apps designed to improve the hotel experience and build loyalty



Selected hotels in China offer a digital keycard service through the app

Chat room service enabling guests to ask questions live to hotel staff

Allows guests to track progress (through loyalty tiers) as well as redeem points

NOT ALWAYS JUST FUN AND GAMES

(OTHER KEY THEMES TO CONSIDER)

It will not always be a smooth ride, and there are many factors that need to be considered by those planning to enter China's leisure market.

4 Pick the right area of focus

It is critical to identify where the opportunities lie in your chosen category and to determine the right positioning for the right customer target groups - e.g. currently underserved teenagers (for theme parks) and mid-to-high priced accommodation for the hotel segment.

5 Address 'hygiene factors' without compromise

Quality and safety are very important purchasing criteria for Chinese customers, especially when it comes to newer categories. It is crucial to deliver without compromise on these factors and to get the message clearly to them.

6 Balance pricing...

A common dilemma for theme parks operators, for example, is the need to offer an affordable price for customers, while being able to recover initial capex investments. Determining the sweet spot in pricing is crucial. There is also great potential in optimizing prices for various menu combinations or travel package

7 ... and find additional revenue streams (revenue management)

Effective revenue and capacity management such as peak vs. off-peak pricing, and capturing ancillary revenue is important (e.g. in China c. 70% of local theme parks' revenue comes from ticket sales, compared to Disney's at c. 40%). This high percentage constrains profitability.

8 Understand structural constraints and leverage government support

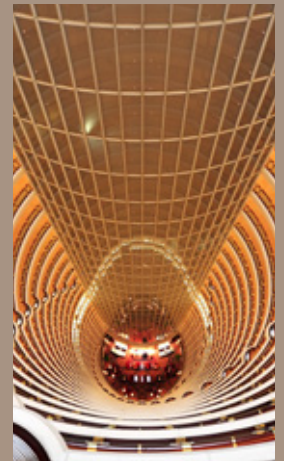
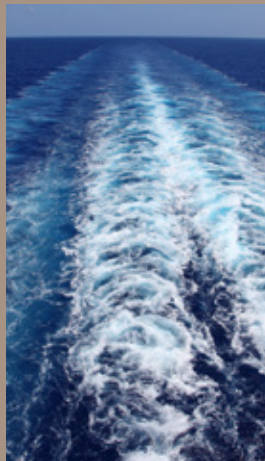
Structural constraints can arise, and range from regulatory issues (such as the requirement that there should be a local partner) to policies (such as government subsidies) and zone planning (such as availability of infrastructure and access). These need to be properly understood and addressed.

A GLIMPSE OF MORE ...

(SNIPPETS OF MORE INFORMATION ON CATEGORIES)

OC&C's 2017 Leisure Survey also delved into more detailed topics for the five selected growth categories in the leisure industry.

Categories covered ...



THEME PARKS

CRUISES

SPORTS

RESTAURANTS

DOMESTIC TRAVEL ACCOMODATION

Selected examples of topics covered ...

- Customer profiles
- Spending patterns
- Key purchasing factors
- Leading brands and perception
- Channel preferences
- Key competitor profiles

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