

# **The Rise of Middle Class Luxury Consumption in China**

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December 2012

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## **Abstract**

This thesis explores what motivates middle class Chinese to consume expensive, imported luxury products. China's middle class is larger than the population of the United States and is expected to more than double within the next decade. Despite China's unprecedented economic growth over the past generation, per capita income is still relatively low. In addition, growing income inequality has widened the gap between China's wealthy and the rest of the population. Nonetheless, middle class Chinese are demanding luxury goods with premium price tags and steep import taxes. Based on questionnaire responses of nearly 200 Chinese shoppers, this paper seeks to understand the relationship between luxury consumption and social status.

## Table of Contents

Abstract .....	2
Acknowledgements .....	4
Introduction .....	5
Definition of terms .....	6
Explanation of concepts .....	7
Literature Review .....	9
Hypothesis .....	11
Methodology .....	12
Survey Results .....	14
Main Motivations .....	16
Social Status .....	17
Conclusion .....	19
References .....	22
Appendix .....	24

### **Acknowledgements**

I would like to thank my interviewees who spent time answering my questions and talking with me. I would also like to thank Professor Rogerson and the Public Policy department for the grant that made this project possible. Finally, my sincere gratitude to Professors Kelley and Zanalda and my classmates for their support, guidance and feedback during the past year.

## **Introduction**

In the United States, the middle class is the largest social class characterized by a decent income and a comfortable standard of living. However, in China, the middle class is dwarfed in size by the poorer working class and in wealth by the upper class. Despite China's status as the world's second largest economy, its middle class earns far less than those of other top global economies (World Bank 2012). Nonetheless, middle class Chinese are consuming pricey, imported luxury goods in growing numbers (KPMG 2011). This paper investigates what motivates this group of consumers to buy luxury goods they often cannot readily afford. Understanding what drives this growing trend of disproportionate middle class spending on luxury goods will illuminate underlying shifting social attitudes and the importance of social status.

Specifically, this paper will explore whether middle class Chinese view luxury consumption as a means of upward social mobility and whether this is a main motivation behind luxury purchases. Social mobility via consumption is relevant in the context of China's growing income gap and the government's attempt to combat social inequality. Chinese luxury consumption is also significant because it is historically unprecedented. Early last year, China overtook the United States to become the world's largest consumer of luxury goods, accounting for about 20-25 percent of global purchases (Hurun 2012). In comparison, one-third of global luxury sales are attributable to emerging markets, including Brazil, Russia, India, and China (KPMG 2011). China, Japan, and Korea make up more than half of worldwide sales (Bain 2011). Thus, China's portion of luxury consumption is huge compared to both developing and developed nations.

China's level of luxury consumption is also unprecedented because the middle class accounts for nearly half of all purchases (Tan 2012). When Japan and Korea were developing countries, their middle classes only accounted for 10-15 percent of luxury sales (Chadha 2006). These statistics are even more striking given China's middle class is relatively new, arising a mere generation ago in the late 1970s at the beginning of Deng Xiaoping's economic reforms (Garner 2005). In the two decades following the implementation of these market-oriented policies, China's gross domestic product (GDP) grew by an average of ten percent annually (World Bank 2012). This extraordinary growth lifted millions out of poverty, creating a middle class that numbers approximately 335 million today (Ray 2012). Despite this newfound wealth, middle class Chinese remain far poorer than their Western peers, yet many are contributing to China's surging demand for imported luxury products.

### **Definitions and Terms**

For this project, luxury consumption is defined as purchases of high-end or brand name fashion goods, including accessories – handbags and jewelry – and clothing. Most popular luxury brands in China are American or European, including affordable luxury retailers like Coach, Longchamp, and Tiffany & Co. as well as high-end retailers like Burberry, Cartier, and Gucci. Foreign goods sold in China are subject to government-levied import taxes ranging from ten to 20 percent of the retail price (Tan 2012). Additionally, most companies sell merchandise in China at higher price points, so luxury goods on average cost 1.5 times more than the same products in the US (Ray 2012).

Most of China's middle class live in urban areas where incomes have risen 150 percent over the past decade (Hurun 2012). People earning between one and two thousand *renminbi*

(RMB) per month are defined as lower middle class or borderline working class. Those earning between 2,000-7,500 RMB per month fall into the average middle class category, while those earning beyond this range are members of the upper middle class (Tan 2012). For reference, 1,000 US dollars is approximately 6,200 RMB (World Bank 2012).

### **Confucian Cultural Concepts**

I would like to introduce a few interrelated cultural concepts derived from Confucianism that are important for understanding the later discussion on consumer motivations: Face, *guanxi* and gift-giving, and collectivism.

#### Face

Face is a concept rooted in traditional Confucian values that is analogous to one's reputation; 'losing face' is akin to damaging one's reputation (Lu 2008). Face "stands for [a] kind of prestige achieved through getting on in life, through success and ostentation [and] is a function of [one's] social status" (Yau 1994, 74). It can be "obtained through personal qualities or derived from non-personal characteristics such as wealth, social connections, and authority through personal efforts," and lost "when conduct or performance falls below the minimum acceptable standard, or when some essential requirements corresponding to one's social position are not satisfactorily met" (Yau 1994, 74). Thus, face is imparted by others, but can also be lost when one does not meet others' expectations of behavior or treatment.

#### *Guanxi* and Gift-giving

The concept of face is embedded in interpersonal relations or *guanxi*, a term associated with one's network of relationships. Maintaining *guanxi* through building personal and professional connections is an important social value (Lu 2008). A major aspect of managing

interpersonal relations is doing favors or giving gifts, a “‘social investment’ for which handsome returns are expected” (Yau 1994, 73). Gift-giving can be a means of obtaining or continuing a friendship or business partnership. The exchange of gifts creates an ongoing obligation to reciprocate. If once receives a gift, one is expected to accept and thereby agrees to the obligation to reciprocate. Gifts also convey the giver’s respect for the recipient and their mutual relationship.

Gift-giving is a common practice in the professional sphere where “*guanxi* oils the wheels of government bureaucracy and business alike” (Chadha 2006, 174). In a business relationship, gift-giving reciprocation will normally result in a more expensive or exclusive gift in order to maintain the moral superiority and indebtedness of the other person (Chadha 2006 and Lu 2008). By maintaining the social ties and saving face for the parties involved, gift-giving helps preserve the harmony within the group, which is important in Confucian thinking.

### Collectivism

Social harmony ties into collectivism, another Confucian value that plays into face, *guanxi*, and gift-giving. Face can be collectivist in nature because one can gain or lose face on behalf of others. For example, “adorning yourself with visible symbols of success is not just for your own glory, [but also] for the greater glory of your family” (Chadha 2006, 145). People influenced by collectivistic values believe that conforming to the norms set by society, their peers or class, is the proper way to behave. Therefore, if luxury brands become the norm in a collectivistic culture via gift-giving, then it makes perfect sense to buy them (Chadha 2006). In the context of luxury consumption, gifting high-end goods can help maintain *guanxi* and preserve face.

## **Cultural, Social and Political Motivations**

Many researchers have studied this rise in Chinese luxury consumption, citing the economic transformations that have made this phenomenon possible (Atsmon 2010, Chadha 2006, Lu 2008, 2009). However, some authors come short of investigating why people are purchasing luxury goods while other studies examine the buying motivations among the super-rich (Bain, KPMG) or Hong Kong and Taiwan consumers (Lee, Lin). The various proposed arguments fall into three main categories: cultural, social, and political.

### Cultural Motivations

Two main cultural explanations for Chinese luxury consumption are: Confucian values and an obsession with Western brands. A number of authors discuss the importance of saving face for the wealthy as non-luxury gifts would be socially inappropriate. A rich person may lose face if he gives inexpensive gifts, given the recipients know of his wealthy background (Lee 2008). However, these studies do not cover whether gifting luxury goods is also a form of face-saving behavior for the middle class. Other research analyzes how collectivist attitudes influence luxury purchases among upper class consumers in coastal and inland cities (KPMG 2007). Again, this geographic analysis is not applied to a middle class sample.

Regarding an obsession with Western brands, several authors put forth this fixation as a possible motivating factor behind luxury purchases. In surveys of Asian consumers, Chadha found many respondents favored products from European brands (2006). The Hurun Report's annual publications corroborate this finding as most of the top ten luxury brands in the mainland are consistently foreign (Hurun 2012). Moreover, the report suggests many luxury consumers aspire to lead a Western lifestyle. However, possible causal relationships between these this variable and consumption are not studied and the aspirations of the middle class are not

extrapolated from the total data set. Another author claims the “desire to imitate Western lifestyles is attributed to the influence of promotional media from Western brand producers,” but this only explains the availability of media portrayals of Western lifestyles, not why Chinese want to emulate them (Tian 2011, 24). It will be interesting to discern whether middle class Chinese seek to join the upper ranks of society by chasing after a Western lifestyle.

### Social Motivations

Social factors explaining luxury consumption also fall into two main sub-categories: Conspicuous consumption and upward mobility. A couple studies present an extensive breakdown of the main kinds of luxury consumers and how consumer type influences one’s luxury purchases (Atsmon 2010, KPMG 2011). For many consumers, luxury purchases are conspicuous, or made solely based on brand recognition or price. Conspicuous consumption merely explains why some people buy certain brands instead of why they are drawn to a specific product. Another consumer type is motivated by social ascendance, but both authors do not surmise why consumers want to show off their socioeconomic status in the first place.

Two other papers also explore possessing luxury goods as a means of climbing the social ladder (Lee 2008, Lin 2009). They surmise the wealthier one becomes, the more luxury goods one naturally accumulates. This proposition assumes increasing wealth and does not account for desired or faux social mobility. Lee’s study presents similar results, however her findings are rather limited as her survey only asks if people agreed or disagreed at varying levels with the statement: “Owning luxury products can help me improve my social standing” (2008, 24). Because of the sentence’s wording, agreeing with it does not necessarily imply the respondent consumes luxury goods in order to climb the social ladder. Even if this is the case, this paper will investigate where this factor ranks relative to other luxury consumption motivations.

## Political Motivations

The major political factors that may influence luxury consumption are the effect of government policies like taxation, advertising restrictions, and economic reforms on spending. Some of the literature addresses how companies have responded to import taxes or advertising restrictions on commercial content, length or billboard size, but do not examine the consumers' responses or the impact on purchasing motivations. Many researchers cite the importance of government-spearheaded economic policies that have fueled China's luxury boom; mainly, increased disposable income has enabled Chinese to buy luxury products. However, some come short of investigating why, given improving economic conditions, people are turning towards luxury consumption. Regardless, this paper focuses mainly on socio-cultural motivations.

In summary, many sources focus on luxury consumption among China's super rich, while others analyze consumption factors in the context of geographic or age variables. None of the English-language literature surveyed explicitly investigates the motivations behind middle class luxury consumption in China as this paper aims to do.

## **Hypothesis**

I predict cultural and social factors mainly influence Chinese middle class luxury consumption with political factors playing an indirect role in shaping socio-cultural forces. China's rapid economic growth, attributable to government policies and political mandates, drastically altered the composition of China's social classes in the last generation. Growing wealth across all classes has improved living standards while opening-up reforms have introduced Chinese to Western culture, media, and lifestyles. I believe this access to the West, coupled with changing social values and newfound wealth, have increased the importance of

social status. In turn, I think this importance is reflected in consumption motivations, including how purchases are made and the influence of friends on purchases. The birth of China's nouveau riche has likely caused some members of the middle class to seek a richer lifestyle and/or higher social standing, often through disproportionate spending on luxury goods.

## **Methodology**

This project relies on a five-question survey given to 197 middle class Chinese consumers about their luxury spending habits and motivations (see appendix for a list of questions). Questions were worded to be as open-ended and unframed as possible to be open to discovering factors not considered in the hypothesis or the literature. I gave out these surveys over a nine-day period in May 2012 in Shanghai, China.

### Survey Design

In order to get a sample of middle class consumers, I asked respondents to choose their monthly income from five option ranges. I used ranges because I felt people would be more willing to answer this instead of stating their income. For those uncomfortable giving an income range, they were asked their occupation or to self-identify into four social class options. The next question asks about saving up for purchases to gauge the affordability of luxury products because saving may be an indicator of disproportionate spending. The final three questions are open-ended and aim to understand consumers' main purchasing motivations with a focus on social status. I noted respondents' genders as an additional piece of information.

Most of these surveys were conducted at the International Finance Center (IFC), a luxury business and shopping complex, Plaza 66, a high-end mall, and at Xujiahui subway station which serves a shopping district of six interconnecting malls. The first two locations are Shanghai's

largest luxury malls. To diversify the sample, interviewees were also surveyed at non-luxury malls and popular shopping streets, including West Nanjing Road and Sichuan Road, where many middle-class shoppers frequent.

### Interviews

In addition to consumers, this project relies on information collected from interviews with non-consumers including: A luxury industry blogger, a consultant who has worked with LVMH, a Shanghai-based American designer, an editor of a luxury news publication, a New York Times journalist, and a Fudan University professor. Data collected from these interviews were analyzed with the survey results to code the open-ended answers into a few categories.

### Limitations

One limitation in this project is the rather limited interviewee pool which only consists of urban Chinese living in Shanghai. Thus, the data may be skewed towards urban middle class residents and therefore may not be representative of the average middle class population.

However, it is important to note the majority of China's middle class lives in cities. Results for some questions, such as income levels may not be accurate as people may be prone to overstating their income. Some of the respondents were in pairs or groups, so the presence of peers may have influenced their individual responses, particularly in regards to the question on view of friends who own luxury goods.

## **Survey Results**

### Income Distribution

Of the 197 respondents, all but nine shared their monthly income from the five option ranges: less than 1,000 *renminbi* (RMB), 1,000-5,000 RMB, 5,000-10,000 RMB, 10,000-20,000 RMB, and greater than 20,000 RMB. About 15 percent of the participants fall into the bottom two income categories of under 1,000 RMB and between 1,000-5,000 RMB per month. Nearly one-third belong to the next category of 5,000-10,000 RMB per month while another third makes 10,000-20,000 RMB per month. The remaining 17 percent of the people surveyed fall into the highest income bracket. This distribution is not representative of the actual makeup of China's middle class because the bottom two categories are underrepresented. The nine people who chose not to reveal their income instead shared their occupations which all can be defined as white-collar professions, so they would most likely fall in the 5000 RMB and up categories.

About 40 percent, or 81, of the respondents were male and all but 12 of these individuals fell in the top three income brackets. Through answers to subsequent questions, I ascertain that the majority of men worked in business. It is important to note a variety of professions in China ranging from marketing, sales, and entrepreneurship may be classified as 'business' roles. Although women account for about two-thirds of the individuals in the lower two income ranges, they also account for 20 of the 33 people in the highest-earning category. Given the relatively small sample sizes of individual income brackets, these figures may be insignificant, but any income shortcomings by women in the lower ranges is countered by the highest category.

Figure 1: Income Distribution

<b><u>Income range (RMB/month)</u></b>	<b><u>Number of responses</u></b>	<b><u>Percentage</u></b>
<1,000	9	4.57%
1,000-5,000	22	11.17%
5,000-10,000	58	29.44%
10,000-20,000	66	33.50%
>20,000	33	16.75%
Total	188	
Non-responses	9	

### Saving Up for Luxury Purchases

Two-thirds of respondents stated they have saved up for a luxury purchase. The majority, or nearly two-thirds, of these savers spend one to six months saving. Sixteen percent save for less than one month whereas another 27 percent save for half a year or more. Every income range has respondents who declared they save up for luxury products, but only five of the twenty individuals who save for less than a month made less than 10,000 RMB per month (see appendix for figure).

There is a correlation between income and amount of time saved with the upper middle class consumers spending less time saving, on average. Based on the surveyed sample, these savings rates indicate the lower and average middle classes generally spend a more disproportionate amount of income on luxury purchases. Men and women both save, but men, on average, spend less time saving which may be a function of gender-based income disparity. Of the non-savers, many stated they simply save as a habit and therefore do not have to save up specifically for a particular item. In contrast, this indicates the people devoting half a year or more saving for a single purchase are spending extravagantly on that one good.

### Main Motivations

For the third question, the top four major motivations for luxury purchases were: Display one's status, follow Western trends or fashions, gift-giving, and self-reward. Based on the literature and the interviews with industry professionals, these stated motivations categorize into three main underlying motivations: gift-giving, saving face, and social status or social mobility. More men than women gifted luxury goods and women outnumbered men in self-reward luxury purchases. In fact, one-third of the men stated they almost always buy luxury products as gifts, mainly for clients or family. Interestingly, men and women stated Western fashion as a motivation in approximately equal percentages, although more people from the higher income levels mentioned this factor, so these responses support the idea that "taste among the upper-middle class is increasingly converging towards that of the Western consumer" (Garner 2005, 84).

### Influence of Friends

Nearly three-quarters of respondents had positive impressions of friends who own luxury items, with no significant variations between genders. Many positive comments described luxury-owning friends as stylish, sophisticated, or having good taste. On the other hand, fifteen percent of respondents had negative opinions; all but two of these responses came from the top three income ranges. This concentration suggests the richer one is, the more likely he is to view some luxury-owning people as flashy. Moreover, all respondents who were in pairs or groups had positive impressions of friends with luxury items.

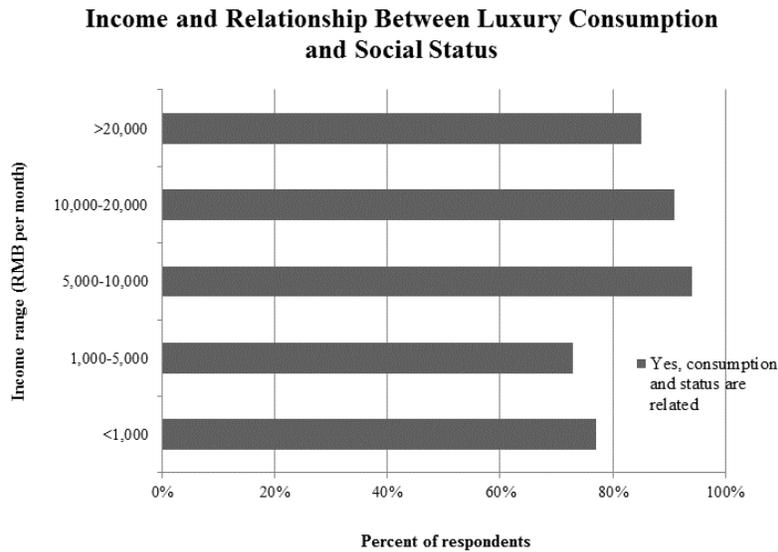
The influence of the opinion of one's reference group reveals why some Chinese buy brand-name products to identify with peers. One woman stated when her friends started buying designer clothes, she followed suit. By engaging in this imitation consumption, a person

identifies with friends and subsequently expects to be evaluated positively in order to preserve face. The importance of saving face for middle class Chinese means how their friends perceive them dictates their consumption behavior, creating a concern for the public meaning of their possessions. Many Asian consumers are not interested in the inherent image of a brand, they only care about how the brand is perceived among their peers (Chadha 2006). This is supported in the survey results as more than half of respondents believe certain brands connote prestige. Additionally, many respondents who stated they saved up for a luxury purchase cited brand prestige as a reason for saving up to buy high-end. Owning luxury goods is an outward display of one's status and connectedness to one's reference group.

### Social Status

Finally, an overwhelming majority, 80 percent, of respondents across all income categories believe there is a relationship between luxury consumption and social status. Surprisingly, the two lowest ranges had slightly lower percentages of yes responses to question five. However, the sample sizes in each of these ranges were the smallest, so one no response had a greater impact on the overall percentage. Additionally, nearly all respondents mentioned gift-giving at least once during the survey while 83 percent mentioned saving face. In other words, about three-quarters of all respondents cite both factors, illustrating the relationship between these two concepts.

Figure 2: Relationship Between Luxury Consumption and Social Status



Gift-giving a luxury item expresses a giver's sincerity and respect for a *guanxi* relationship. One respondent shared how the giver preserves face for himself as a luxury gift is expensive enough to match his income and may also confer face on the recipient if they like and get use out of the gift. Hence, gifts are offered to create face for both the giver and the receiver. Businessmen in particular stated buying limited edition products for clients made the recipients look more prestigious, reflected well on their company as well as themselves. Dozens of comments indicate respondents engage in gift-giving to create social capital as a means of strengthening a *guanxi* network. So these middle class gifters use economic capital to create or enhance social capital.

There is a cyclical relationship between using money to buy luxury products to increase one's social capital or perceived social standing, which in turn can have a positive effect on one's economic situation, through a promotion or securing a deal with an important client. Nearly all respondents who said they were in a client-oriented role believe making a client happy makes the company look good which improves their own chances of getting a promotion. The

former is a collective goal for the company while the latter is a personal goal as climbing the corporate ladder can increase one's standing on the socioeconomic scale. One third of business professionals stated that getting a promotion or raise would make enable them more readily to buy luxury goods for themselves or as gifts for people other than clients.

The survey results confirm the importance of social status as predicted in the hypothesis. In dynastic China, and recently during Mao's rule, one's socioeconomic status was set for life; there was little social mobility. Today, increasing wealth has allowed many to join the upper middle and upper classes. "Wealth is the most significant determinant to status in Chinese society, followed by power and knowledge" (Li 1998, 154). The possibility of social advancement through the accumulation of wealth has increased the importance of luxury belongings for the middle class: "The more you spend and the more you flash the cash, the higher your status in society" (Chadha 2006, 144). By buying luxury goods, middle class Chinese can signal their ability to afford branded products, command respect from friends, and project an image of being wealthy. Therefore, social status and desired upward social mobility are major motivating factors behind middle class luxury consumption.

## **Conclusion**

The rise in middle class luxury consumption illustrates the link between changing social attitudes and consumption. A little over a generation ago, Chinese people generally avoided showing off one's wealth and favored frugality. Today, displaying one's success through wearing designer clothing or carrying a luxury handbag is not only not looked down upon, but becoming more acceptable. In fact, gifting of luxury goods may even be expected to maintain *guanxi* and save face. Socio-cultural values against which behavior is evaluated have changed

significantly from the past. Thus, traditional Confucian values have evolved to justify luxury purchases in an increasingly materialistic China.

This uptick in materialism via luxury consumption is also a reflection of China's process of modernization. As a developing nation with recently formed social classes, China is in a phase where social status, a once almost irrelevant concept, is becoming more important and divisive. Many Chinese are naturally eager to show off their newly acquired wealth, sometimes through luxury purchases based on logo size. As China matures, conspicuous luxury consumption should fall as consumers buy high-end items primarily for their quality.

This form of conspicuous consumption vis-à-vis stage of economic development is also a function of broader government goals. Following the implementation of China's opening-up policies in the early 1980s, China has been obsessed with economic growth on a national and individual level. The government's main priority has centered on improving the people's welfare and standard of living (Ray 2012). Consequently, government policies focused on increasing prosperity fosters an economic achievement mentality. The main way to display one's financial success is through luxury consumption. One respondent quoted Deng Xiaoping's famous statement "to be rich is glorious" as a motivation and justification for buying expensive luxury items.

By 2025, China's middle class is expected to more than double to 800 million, making it China's largest social class (World Bank 2012). This group will be a huge consumer force whose spending habits will impact the Chinese and global economy. As the Chinese Communist Party (CCP) tries to transition from an export-based to a domestic consumption-driven economy, it will be important to examine the types of consumption CCP policies encourage. As the survey responses reveal, some consumers are spending beyond their means on luxuries. Should this

trend continue, rising household debt may become a serious problem, especially with the introduction of credit cards. Five years ago, 95 percent of the banking cards used by Chinese people were debit cards (Hao 2006). Today, many Chinese borrow from family and friends, a practice which will likely surge with the increasing availability of credit cards (Hurun 2012). So, the CCP may want to consider regulating luxury consumption should overspending become widespread. Middle class borrowing habits in relation to consumption is an interesting topic that warrants further research.

Finally, the major implication of social status-motivated middle class luxury consumption in China is the impact of faux social status projections on society as a whole. Maintaining a ‘harmonious society’ is one of the Chinese government’s main agendas, but middle class displays of misleading or inaccurate social status signals can destroy the social peace. China’s middle class is the fastest-growing demographic in the world’s largest and fastest-growing luxury-consuming nation. This group’s consumption patterns will have worldwide impacts. As China emerges as a global leader, the government faces the extraordinary challenge of ensuring this rising trend of middle class luxury consumption does not result in negative consequences.

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## Appendix

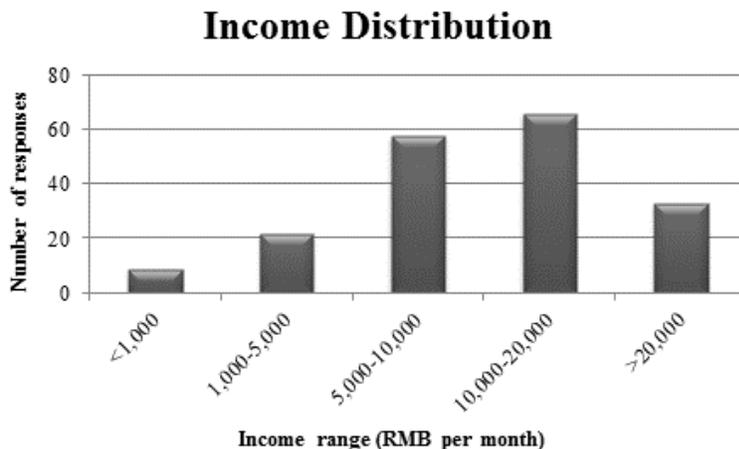
### A) Survey given to consumers

1. What is your occupation or monthly income from the following ranges:
  - a. <1000 RMB
  - b. 1000-5000 RMB
  - c. 5000-10000 RMB
  - d. 10000-20000 RMB
  - e. >20000 RMB
  - If a respondent did not want to reveal his/her income, he/she was instead asked:  
How would you describe yourself from the following: working class, middle class, upper middle class, upper class?
2. Do you typically have to save up to buy a luxury product? If so, for how long?
3. What is your main motivation for buying luxury goods? \*
4. What do you think (how do you view) friends who own luxury goods? \*
5. Do you believe consuming luxury goods is related to one's social status? If so, how/why?  
\*

\*indicates open-ended question

### B) Question 1

Figure 3: Income Distribution



C) Question 2

Figure 4: Time Spent Saving



D) Question 4

Figure 5: Impressions of Luxury-Owning Friends

