Capture the New Market Frontiers

Unlocking the untapped mass markets within China
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Cover picture: Sichuan Mianyang. Mianyang is one of the Tier 3-5 cities discussed in this report.
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By Yang Chengbin

When people talk about the emerging Chinese markets, they typically associate them with the gleaming skyscrapers springing up in Shenzhen, the new bustling Pudong area of Shanghai, and the ever expanding concentric rings of modern highways in Beijing. These are things Chinese that people nowadays are very familiar with. You may not realize that there is indeed much more beyond this preconceived notion of the Chinese emerging markets.

• On top of the 25 leading major cities in China such as Beijing and Shanghai, there are 305 cities with vast untapped market potential that collectively account for 43% of the country’s GDP and 39% of its urban population.

• Scattered across central and eastern China, the majority of these cities are located on the periphery of the more well-known major cities, with which some of them are so tightly connected that they altogether constitute separate spheres of economic influence and activity.

• “Hidden” within the 305 emerging cities are candidates for those with the highest GDP growth and the highest per capita GDP in China. They are not from the incumbent league of 25.

China is indisputably one of the world’s most exciting emerging markets. With its remarkable economic development and social reform during the past two-odd decades, the markets of large coastal cities that were the earliest to boom are becoming increasingly saturated with overwhelming competition. Many companies have come to realize the strategic importance of expanding and diversifying their presence into those untapped sectors of the Chinese market. This entails not only market expansion but transformation of the corporates themselves. Despite their awareness of this, the majority of them, particularly the MNCs that have been well entrenched in the coastal cities, seem to have limited knowledge and experience of those emerging and untapped markets.

By way of quantitative and qualitative analysis, IBV China has conducted an exploratory study of 654 cities in China based on published statistics from relevant government departments and research institutes. By classifying Chinese cities into six tiers and analyzing them statistically, IBV China has found that unlike the increasingly saturated and competitive Tier 1&2 cities, those in the third to fifth tiers have the potential to create more consumer demands and to have faster market growth. To expand into those Tier 3-5 consumer markets, companies would have to make their assessment according to their own and industry-specific requirements, and to pursue a localized, proven approach to strategic planning that covers products, channels and business models.
Our Methodology

All statistics in this study are sourced from relevant government departments and research institutes. The urban population and economic data was gathered from the China City Statistical Yearbook published by the National Bureau of Statistics of China (NBS). This study adopts the NBS statistical definition of “urban” or “city”, which excludes places that fall outside of narrowly defined city boundaries. According to the China City Statistical Yearbook 2005, there are a total of 661 cities at or above the county level in China (excluding Hong Kong, Macau and Taiwan), of which 374 are county-level cities. Worthy of mention is the fact that Lhasa and six county-level cities are excluded from the urban statistics. Accordingly the city-tiering strategy of this study was based on sample sizes limited to the 654 Chinese cities at or above the county level. But during the segmentation of cities, county-level cities were in fact excluded from some types of analyses due to the limited availability of relevant data. Considering the current scale of economy and population of county-level cities in China, their exclusion from statistical analyses had no significant impact on the findings.

A quantitative and close qualitative analysis of the urban population and economic statistics of these 654 cities is the starting point of our investigation into how these cities were grouped into different tiers according to similarity in population levels and economic growth. Since there are no universally accepted criteria for the tiering of Chinese cities, our tiering methodology and findings merely serve as a framework and basis for the purpose of analyzing China’s largely untapped cities.

This study aims to provide a high level overview of the consumer markets of Tier 3-5 cities in China, through which companies both at home and abroad may enrich their understanding of these emergent markets. The IBV methodology employed was designed to guide the effective running of this study, and should in no way be considered the benchmarks for this topic. Our findings should be taken as IBV’s observation of specific issues, and do not represent any assessment by IBM of the cities involved or any criteria for the purpose of ranking these cities.
Capture the New Market Frontiers
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With its strong and continued economic growth, China has become one of the world’s most dynamic emerging markets. While there is a huge influx of capital and business activity taking place in this new continent of investment opportunities, attention remains focused on the coastal regions rather than the country’s vast swathes of relatively untapped territories. It is unquestionably true that China’s economic hotspots scattered along her coastal provinces have been on the front line of reforms for the past two decades. But against this traditional backdrop, a new trend has emerged: some of the once-neglected cities have been developing at the same, and possibly even higher, growth rate in recent periods (Figure 1).

Along with its rapid economic growth, China is undergoing massive urbanization, so much so that the country’s predominantly rural demographics are being fundamentally transformed. Projections have it that between 2005 and 2010 the yearly average net increase of the urban population will be 15 million, and by 2010 the urban population will exceed 600 million, accounting for almost 45% of the country’s total population (Figure 2).

China’s sustained economic development and mass urbanization will trigger the further expansion of its consumer market.

Figure 1: GDP growth rate by province, 03-04 YOY

Figure 2: China Population Forecast

Source: UN, IBV analysis

Note: Not incl. Taiwan data
Source: NBS, IBV analysis
As these trends continue, it is foreseeable that the Chinese urban consumer market is going to rapidly evolve by leaps and bounds.

Out of economic consideration and because of major trends in policy orientation, geographical proximity and demographic characteristics, a major part of domestic and foreign investments and business activity are specifically targeted at coastal port cities, and even more so at the large and mid-sized metropolises of these areas. Added to this is the world spotlight that these cities have been thrust into by the impending 2008 Olympics in Beijing and the 2010 World Expo in Shanghai. But one noteworthy fact that emerges from the many years of development that these cities have undergone, is the incredibly intense competition in these consumer markets and the increasingly saturated conditions in certain product and service sectors. In Beijing for example, the number of private autos reached 1.81 million according to year-end statistics for 2006. With over 15 million permanent residents in Beijing, this means that private auto ownership has risen to a level of 120 per thousand people, which is tremendously higher than the national average rate of 23. This degree of market saturation is also observable in the telecommunications market. By the end of 2004, land phones and cell phones had a 78% and 122% penetration rate respectively at the city's district level, in marked contrast to the corresponding average figures for those cities at or above the county level nationwide (38% and 45%). Similar observations could also be made of other consumer markets close to the coastline, such as Shanghai and Guangzhou. Given the increasingly limited growth potential and its impact on profitability and competitiveness, it is therefore imperative that both domestic and foreign companies must make inroads into those emerging markets for a truly sustained presence.

In terms of total GDP and per capita income, those “untapped” parts of China will be markets that offer great potential worldwide over the next five years. While there were only 6 provinces with an annual GDP of over RMB1,000 billion in 2005, there will be 14 by 2010. That year will also see a total of 10 provinces - in stark contrast to a putative zero in 2005 - with an annual per capita income of over RMB35,000. So researching, understanding and targeting those emerging markets, coupled with all the necessary steps for market sizing and segmentation, channels building and strategic planning, would make any company, be it domestic or foreign, better able to expand its footprint into those unexploited enclaves.

**City Tiering: ways to identify and understand the emerging markets**

To help companies understand the emerging consumer markets in China's lower tier cities, IBV China has conducted a study of 654 Chinese cities that collectively account for 92% of the country's total GDP and 46% of its total population. This study will offer a new perspective into those emerging markets and deliver strategic advice on issues like business expansion and market entry.

**City Size**

IBV China made use of its own tiering methodology to classify 654 Chinese cities into six tiers (Figure 3). Our study reveals that Tier 1 & 2 cities are predominantly large and mid-sized cities located in coastal provinces, such as Beijing, Tianjin, Shanghai, Guangzhou, and Shenzhen, which have always been China's economic hot spots, garnering the national limelight in terms of capital flows and business activity. Their significance to the country's economy and consumer market is also evident in their share of the country's population and GDP: Tier 1 and 2 cities account for 3% and 6% of the national population, 6% and 14% of the total urban population, and 13% and 21% of the country's GDP, respectively.

Tier 3-5 cities include, most notably, Shijiazhuang, Changzhou, Wenzhou, Xiamen, Zhongshan (Tier 3); Qinhuangdao, Zhenjiang,
Huizhou, Changde, Liuzhou (Tier 4); Fushun, Weifang, Anqing, Xiangtan, Beihai (Tier 5). They collectively account for 18% of the country’s population, 40% of its urban population, and 43% of its GDP. Their significance to the country’s economic well being and its consumer market should not be overlooked.

Two thirds of the Tier 6 cities (such as Chifeng, Zaozhuang, Tongcheng, Ruijin, and Lufeng) are at the county level. Considering their current scale of economy and population, the influence and attractiveness of these cities remain limited for the time being. The chances for some of them to become investible emerging markets should not be ruled out if China is to keep going with its economic development and urbanization.

**Growth Potential**

The city segmentation analysis has shown that in terms of size, Tier 3-5 cities are important emerging markets within China. In terms of growth, they are also sources of massive untapped market potential. According to NBS data, the average GDP growth of all Chinese cities was 15.1% between 2003-2004, during which period Tier 3-5 cities achieved an average growth of 15.9%, putting them comfortably on a par with the 15.8% of Tier 1&2 cities. The five fastest-growing Tier 3-5 cities also achieved a 32% growth, well outperforming their Tier 1&2 counterparts (18%)\(^{12}\). So it is not inconceivable to suppose that the stronger inroads into Tier 3-5 cities not only will create a larger and wider market for corporates but also will leave them embedded in a more potential market.

**Geographic Distribution**

Contrary to the common belief that the lower tier cities are concentrated in the less developed inland or in the remote west of China far away from the eastern coastline, our study shows that the majority of Tier 3-5 cities are located in eastern and central China. Among the 305 Tier 3-5 cities, 169 are situated in coastal provinces, and 82 are in the central regions lying in close proximity to the coastal provinces. Only less than 1/5 are located in western China\(^{13}\). To put it in another way, about 2/3 of these Tier 3-5 cities are concentrated in 9 provinces, which are Shandong, Zhejiang, Jiangsu, Henan, Guangdong, Fujian, Liaoning and Hunan. With the exception of Henan and Hunan, these are all coastal provinces\(^{14}\). On top of this, the 11 provinces along the eastern coastline of China collectively account for 62% of the total population of these 305 Tier 3-5 cities and 66% of their total GDP\(^{15}\). The high degree of geographic concentration of Tier 3-5 cities

### Figure 3: Characteristics of Tier 1-6 Cities

<table>
<thead>
<tr>
<th>Tier</th>
<th>Number of Cities</th>
<th>% of National Total Population</th>
<th>% of National Urban Population</th>
<th>% of National Total GDP</th>
<th>Average Population (10K)</th>
<th>Average GDP (RMB 100M)</th>
<th>Average GDP per Capita (RMB)</th>
<th>Average Annual Salary (RMB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>3</td>
<td>6</td>
<td>13</td>
<td>937</td>
<td>4,481</td>
<td>48,125</td>
<td>28,740</td>
</tr>
<tr>
<td>2</td>
<td>21</td>
<td>6</td>
<td>14</td>
<td>21</td>
<td>390</td>
<td>1,373</td>
<td>37,194</td>
<td>20,367</td>
</tr>
<tr>
<td>3</td>
<td>19</td>
<td>2</td>
<td>4</td>
<td>9</td>
<td>127</td>
<td>659</td>
<td>59,001</td>
<td>20,630</td>
</tr>
<tr>
<td>4</td>
<td>77</td>
<td>5</td>
<td>12</td>
<td>16</td>
<td>92</td>
<td>279</td>
<td>31,635</td>
<td>17,517</td>
</tr>
<tr>
<td>5</td>
<td>209</td>
<td>11</td>
<td>23</td>
<td>18</td>
<td>66</td>
<td>120</td>
<td>18,012</td>
<td>13,943</td>
</tr>
<tr>
<td>6</td>
<td>324</td>
<td>18</td>
<td>40</td>
<td>14</td>
<td>74</td>
<td>61</td>
<td>8,394</td>
<td>11,438</td>
</tr>
<tr>
<td>Rural</td>
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<td>54</td>
<td>N/A</td>
<td>8</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

The tiering analysis of Chinese cities can help companies identify and understand key potential markets in China, laying the groundwork for further analysis.
suggests that companies seeking inroads into these emerging markets from Tier 1&2 cities are not taking a path as tortuous as one would have expected (See Figure 4).

**Population**

Although the majority of Tier 3-5 cities have a population of less than 1.5 million (particularly in the range of 0.5 to 1 million), there are 20 cities (such as Shijiazhuang and Changzhou) that have a population of over 1.5 million. Cities having a population size of 1.5 million are obviously small compared with Tier 1&2 cities, but they do dwarf Birmingham, the second largest city in the UK, stand on a level with Hamburg, and are twice the size of San Francisco. 20 such cities would then make up a huge consumer market of over 30 million strong.

**GDP**

A large number of Tier 3-5 cities have a GDP output of less than RMB30 billion (particularly in the range of RMB10 to 20 billion). Faring better are Dongguan, Tangshan and 13 other cities with a GDP output of over RMB60 billion. Obviously their GDP performance is still relatively low compared to Tier 1&2 cities.

Looking at the various tiers of cities in China, it is noteworthy that Tier 4 are closing in on Tier 2, and Tier 3 are considerably outperforming Tier 1&2 (Figure 3) as far as average GDP per capita is concerned. The stellar performance of Tier 3 group is attributable to the relatively high level of GDP per capita common to those constituents which are major bases of energy industry.

**Income**

Although the average per capita annual income for most Tier 3-5 cities is below RMB20,000, (particularly in the range of RMB10,000-15,000), 12 of these cities carry a corresponding figure of over RMB25,000 or one that is close to or even beyond the respective levels of Tier 1 and 2 cities (i.e. RMB29,000 and RMB20,000). One noteworthy point is that 9 of them, such as Yiwu and Wenling, are located in the eastern coastal province of Zhejiang.

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The segmentation analysis of newly emerging cities can serve as the basis for companies to identify the most alluring and befitting markets for potential expansion.

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**Figure 4: Geographic Distribution of Tier 1-6 Cities**

Note: Not incl. Taiwan data. Tier 3 cities include 16 from eastern, 1 from central, and 2 from western regions; Tier 4 cities include 48 from eastern, 17 from central, and 2 from western regions; Tier 5 cities include 105 from eastern, 64 from central, and 40 from western regions

Source: IBV analysis
City Segmentation: identifying the ‘launch pad’ for ventures into untapped markets

Companies have to identify the most befitting Tier 3-5 cities based on their own features and industry-specific attributes as a launch pad for their ventures into these largely untapped markets. Critical analysis of their segmentation was made from multiple perspectives by IBV China based on statistics concerning their population, GDP per capita, fixed asset investments and other variables.

Of the 305 Tier 3-5 cities 53 are outperforming nearly all of their urban peers in terms of population and GDP per capita (Figure 5). They should be considered the more attractive and alluring markets. Accounting for only 17% of the Tier 3-5 segment in terms of total number of cities, the 53 strong cohort comprises 29% of the population and 42% of the GDP of all Tier 3-5 cities, representing the hard core of the emerging Tier 3-5 markets. As a matter of fact, many of these cities are by no means inaccessible or remote; 39 of them are located in the eastern coastal areas, and 9 in central China. Only 5 are found in the western parts of the country.

Mention should also be made of those Tier 3-5 cities above the county level, where 41 out of 153 are shown to have a larger population and a higher level of fixed asset investment (Figure 6). Considering the trend of investment-driven economic growth in China, the market potential of these 41 cities is hardly negligible. The geographic distribution of these cities across the country - 27 in eastern coastal areas, 7 in the central plains and 7 in the western parts of China - speaks much again of their concentration and accessibility.

Figure 5: Population vs. GDP per Capita

![Graph showing population vs. GDP per capita](image)

Note: N=305 Tier 3-5 cities
Source: NBS, IBV analysis

Figure 6: Population vs. Fixed Assets Investment

![Graph showing population vs. fixed assets investment](image)

Note: Due to the limited availability of data, N=153 Tier 3-5 cities, where cities below the county level are excluded.
Source: NBS, IBV analysis

Given the multiple features of industries and products, companies have to identify their markets according to their own needs and priorities, or determine their portfolio of expansion targets. Based on a cross-perspective analysis. The following is an exploratory investigation by IBV China in respect of the retail industry, dealing specifically with the markets of 152 Tier 3-5 cities above the county level.
Among these 152 cities, there are 111 where annual retail sales of social consumables are still below RMB10 billion.\textsuperscript{27} The retail market potential of Tier 3-5 cities in relation to social consumables were therefore analyzed by comparing the current figures of individual cities - specifically, the per capita retail sales for consumption and the per capita annual income level - against the corresponding averages of all 152 cities (Figure 7). Our findings show that 22 cities have an above-average annual income level and a below-average volume of per capita retail sales. Obviously there is much untapped purchasing power here that makes it worthwhile for exploration. Again, of these 22 cities 10 are located in the eastern coastal provinces, 5 in the central hinterland, and 7 in western China.\textsuperscript{28}

Further data and analysis of other dimensions (consumption behaviour, retail format, channel structure, etc.) is definitely needed before a more comprehensive understanding of these retail markets can emerge. On site inspection may also be needed to support any findings. This approach equally applies to any other industries. It is imperative for companies to evaluate and figure out these untapped markets using their own choice of criteria and perspectives that are fully justifiable against their own requirements.

**Conclusion**

China’s phenomenal economic growth makes it one of today’s most notable emerging markets. Within this national market is the emergence of largely untapped local markets resulting from the gap in economic development among different parts of the country. Increasing saturation and competition at the markets of Tier 1&2 cities have been a cause of concern for current players and likely future market entrants. To many of them expansion of their presence into those uncharted yet flourishing locales throughout the Chinese soil is a compelling imperative that warrants the continued expansion of their market shares, improvement of their profitability, and augmentation of their competitiveness.

This should be accounted a revelatory and exploratory study merely into the untapped markets of Tier 3-5 cities. The wide choice of these cities necessitates 1) considerable tact and discretion by companies to identify worthwhile exploration targets according to their own specific conditions and industry-specific features, 2) the development of effective product and channel strategies, and 3) the selection of proven modes of operation. Among those that can be taken as launch pads for expansion are those lying in close proximity to Tier 1&2 cities. Alternatively, the frontiers of market can be extended through the help of local partners or expansion channels such as online, direct and catalog sales.

**About the author**

Yang Chengbin is a Senior Consultant with the IBM Institute for Business Value in China. He can be reached at yangcb@cn.ibm.com.

**Key Contributor:**

Feng Yueqi is a Senior Consultant with the IBM Global Business Services, Strategy and Change.

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## Overview
- **Tier 1**: Shanghai
  - 6,341 square kilometers
  - One of China's four municipalities
  - Center of the Yangtze River Delta
  - Will hold the 2010 World Expo

- **Tier 2**: Nanjing
  - 6,597 square kilometers
  - Capital of Jiangsu Province, Eastern China
  - 300km from Shanghai
  - 380km down the Yangtze River into the East China Sea

- **Tier 3**: Shijiazhuang
  - 3,255 square kilometers
  - Capital of Hebei Province, Eastern China
  - 300km from Beijing and Tianjin
  - Beijing-Shijiazhuang expressway will reduce the travel time between the two cities to an hour

- **Tier 4**: Huizhou
  - 11,200 sq. km (land), ¼ of Pearl River Delta Economic Zone
  - Has 2 state-level development zones and 1 state-level first-class harbor
  - 47 sea miles from Shenzhen and Guangzhou Airport by car

- **Tier 5**: Fushun
  - 2,356 square kilometers
  - Situated in Liaoning Province, Eastern China
  - 45 km from Shenyang, 40 km from Shenyang Airport, 200 and 400 km from Yingkou and Dalian Harbor
  - Used to be China's important coal production base

- **Tier 6**: Hechuan
  - 12.4
  - Petrochemical: China's 2nd largest petrochemical industry base
  - Electronics: World's biggest production base of batteries and laser heads, Asia's biggest production base of telephones and computer motherboards, one of China's biggest production base of TV sets, car radios, cameras and so on
  - Others: Tourism, mining, machinery, electronics, textile, etc.

## Urban Population (2004, Million)
- **Tier 1**: Shanghai
  - 12.9

- **Tier 2**: Nanjing
  - 5

- **Tier 3**: Shijiazhuang
  - 2.2

- **Tier 4**: Huizhou
  - 1.1

- **Tier 5**: Fushun
  - 1.4

- **Tier 6**: Hechuan
  - 1.5

## GDP (2004, RMB Billion)
- **Tier 1**: Shanghai
  - 737
  - Annual growth rate 13.6%

- **Tier 2**: Nanjing
  - 176
  - Annual growth rate 17.2%

- **Tier 3**: Shijiazhuang
  - 69
  - Annual growth rate 16.2%

- **Tier 4**: Huizhou
  - 41
  - Annual growth rate 15.5%

- **Tier 5**: Fushun
  - 28
  - Annual growth rate 15.5%

- **Tier 6**: Hechuan
  - 12.4

## GDP per capita (2004, RMB)
- **Tier 1**: Shanghai
  - 57,423

- **Tier 2**: Nanjing
  - 35,464

- **Tier 3**: Shijiazhuang
  - 31,850

- **Tier 4**: Huizhou
  - 37,681

- **Tier 5**: Fushun
  - 19,635

- **Tier 6**: Hechuan
  - 8,241

## Average Salary (2004, RMB)
- **Tier 1**: Shanghai
  - 30,002

- **Tier 2**: Nanjing
  - 26,585

- **Tier 3**: Shijiazhuang
  - 15,893

- **Tier 4**: Huizhou
  - 13,570

- **Tier 5**: Fushun
  - 14,386

- **Tier 6**: Hechuan
  - 11,166

## Major Industries
- **Tier 1**: Shanghai
  - Auto: E.g. VW, GM joint-ventures
  - Steel & Iron: E.g. Bao Steel, China's leading steel & iron group
  - Financial: China's financial centre, aim to become international financial centre
  - Others: Shipping, electronics, petroleum & chemistry, machinery, pharmacy, etc.
  - Petrochemical: China's 2nd largest petrochemical industry base
  - Electronics: Strong capability in both R&D and production, with over 400 enterprises and about 30 research institutes in the industry
  - Automobile: E.g. IVECO, JV by FIAT and SUZUKI
  - Others: Steel and iron, machinery, biological and pharmacy, etc.

- **Tier 2**: Nanjing
  - Petrochemical: China's important pharmacy base for antibiotics and chemistry staples
  - Electronics: R&D and manufacturing of TV, telecommunication device, and other instruments
  - Textile: China's important textile base
  - Others: Machinery, chemistry and construction materials, etc.

- **Tier 3**: Shijiazhuang
  - Pharmacy: China's important pharmacy base for antibiotics and chemistry staples
  - Electronics: R&D and manufacturing of TV, telecommunication device, and other instruments
  - Others: Machinery, chemistry and construction materials, etc.

- **Tier 4**: Huizhou
  - Petrochemical: China's important coal and petroleum processing base
  - Others: Tourism, mining, machinery, electronics, textile, etc.

- **Tier 5**: Fushun
  - Coal and power generation
  - Mining
  - Others: Textile, biopharmacy, machine processing, food processing, tourism, etc.

- **Tier 6**: Hechuan
  - Petrochemical: China's important coal and petroleum processing base
  - Others: Tourism, mining, machinery, electronics, textile, etc.

Source: local government website, IBV China Analysis.
References

1. These 6 county-level cities include Huolingele, Xingcheng, Jiutai, Hailun, Jingshan, and Rikaze.

2. NBS divides China into three regions, i.e. Eastern China, Central China, and Western China. The eastern region includes coastal provinces like Liaoning, Hebei, Beijing, Tianjin, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, and Hainan. The central part includes Helongjiang, Jilin, Shanxi, Henan, Anhui, Jiangxi, Hubei, and Hunan. Other provinces belong to Western China. Our study focus more on cities in China's central and western parts, and smaller cities located in the eastern region.


9. Ibid.

10. Ibid.

11. Ibid.

12. Ibid.

13. IBV analysis.

14. Ibid.


16. Ibid.


21. Ibid.

22. Ibid.

23. IBV analysis.

24. Due to data limitation, the segmentation analysis here only covers 153 county-above cities, not including other 152 county-level cities.

25. IBV analysis.

26. Due to data limitation, the segmentation analysis here only covers 152 county-above cities, not including Beihai and other 152 county-level cities.


28. IBV analysis.