ISSN: 1934-4244

The Future of the Luxury Market in China

Rebeca Santos

rsant034@fiu.edu

Florida International University

The Future of the Luxury Market in China

As Europe and the United States struggle with the debt crisis, multinational companies are beginning to focus their investment in the Asian market, specifically China. While there are recent reports of some economic problems in China with the slowest expansion in three years and decreased spending, luxury brands continue to expand because of the large demand between the growing middle class and wealthy consumers. Bain & Co. stated that China's $35 billion luxury market is the second largest in the world and that one in four luxury global shoppers is Chinese (Chan, 1). Companies such as Hublot and Montblanc that sell luxury Swiss watches continue to open new stores in China (DeMarco, 1). According to CLSA, an Asian investment bank, China currently represents 10% and will represent 44% of global demand for luxury goods (Chan, 1). This increase in demand, as stated in The Economist, is because of the increase in disposable income, sophistication and wealth of Chinese consumers, and growing urbanization in most Chinese cities (Fung, MacAusland, & Mazz, 1). Another reason for this increased demand for luxurious goods is attributed to Chinese culture. These items are purchased to demonstrate status to others participating in this Chinese gift giving society. In fact, the CLSA estimated that 30% of the luxury items were bought as gifts (Chan, 1). When giving a gift in China, the item must be the newest, highest quality, priciest item in the market. Gifts are used both for their professional and personal lives because they believe in eventual return or exchange from their gift giving actions (Chan, 1).

According to Bloomberg, the most recent major increase in demand for luxurious goods projected for the future is because of the leadership change in China (Chan, 1). Vice President Xi Jinping is set to become the head of the Communist Party and Vice Premier Li Keqiang is set to become Premier. It is believed that the Chongqing party's chief Bo Xilai's scandal revealed corruption and the government limited spending on luxury items using government money because of this (Chan, 1). This caused the decreased spending in gifts in China and companies like Burberry Group Plc. decreased in sales. Although consumers have spent less this past year, the change of leadership will replace any uncertainty about the future of business in China and companies such as Louis Vuitton believe that they will see an increase in sales of 10% in the next six months due to the new government officials. They believe the new officials will create regulations to clear up unknown details of investments (Chan, 1). Once the governmental transition is made, according to Nancy Wong, customers will know who to send gifts to (Chan 1). Government related gifting is expected to pick up again by the second half of next year. Because of these projected results, companies such as Chow Tai Fook will expand to 200 stores in China by next year, even expanding to second and third tier cities such as Chengdu and Wuhan (Chan, 1).

China's economy is improving with increased industrial production, sales, investment, and demand in September 2012. The International Monetary Fund projected that economic growth in Asia will rise from 7.8 percent to 8.2 percent in 2013 (Chan, 1). Wealth-X is also reporting that luxury retail sales will grow to double digits compared to the single digit growth expected for Europe and North America (Kauffman, 1). China is also encouraging foreign investments and has raised Qualified Foreign Institutional Investor quota from its current $80 billion. It is the second time it has been increased this year and Guo Shuqiing, the head of the Chinese Securities Regulatory Commission, plans to expand this limit once it gets used. Not only will Shuqing raise the limit on institutional investment but is also looking to increase the investment limit for individual Qualified Foreign Institutional Investor quotas and possibly give them tax breaks (Bloomberg News, 1).

The American company, Estée Lauder, is expanding its foreign investment in China by adding a completely new brand created for the luxury market called Osiao. With China representing $500 million in 2012 sales of the $2 billion earned in Asia and 12 of 28 of Estée Lauder cosmetic brands are sold in China, this new venture demonstrates Estée Lauder's confidence and potential it sees in China because it is not only one product, but also an entire brand of expensive products (Kahn, 1). Created at the research institute in Shanghai and manufactured in Japan, the brand is designed around Chinese medicine and ingredients like ginseng with English labels in order to market a skin care line dedicated to the Asian consumer (Singer, 1). It is a remarkable experiment created under the leadership of Mr. Freda, president of Estée Lauder since 2008, which could test the brand's credibility. Through market research, Estée Lauder found that Asian women looked for skin care products that added "clarity and luminosity" and the brand will offer products that do this along with an in-store counter service of advisers created to imitate traditional apothecaries. Starting with a launch in two department stores in Hong Kong and on Cathay Pacific Airways, Estée Lauder will have to compete with European brands such as Lancôme as well as local brands like Aupres (Singer, 1). If this brand's market testing proves to be successful, Osiao will expand to Mainland China, Japan, and then throughout Asia in the next couple of years.

Estée Lauder is targeting Asian women willing to pay higher prices such as $211 for a facial serum for this luxury functional brand with a valued reputation before buying cheaper skin care products already in the market. Osiao will be made to appeal to Asian consumers who travel internationally and shop in duty free stores (Singer, 1). It is, therefore targeting the average consumers of Estée Lauder and Clinique and the growing wealthy class of China. In order to target this market, the company made strategic decisions to appeal to the Chinese people. For instance, before creating the product, Estée Lauder found that Chinese women care more about skin care products than other cosmetics and perfumes so it created a product line of skin care. It was named Osiao because the first letter "O" conveys symmetry and "a sense of harmony and balanced skin" and it is also five letters, which is considered a lucky number in China (Singer, 1). Estée Lauder also conducted various studies of thousands of Chinese women to find that they value skin care that provides youthful radiance, luminosity, and clarity and created a brand to serve these functions. Because they found that Chinese consumers believe in the positive results achieved with medicinal plants, Estée Lauder used herbs and ganoderma mushrooms as the main ingredients for their Osiao skin care products (Singer, 1).

According to an analyst Connie Maneaty, Estée Lauder's risky investment shows how important China will be for the company for twenty to thirty years (Singer, 1). Because Estée Lauder is already a reputable company, the most significant marketing challenge is getting the Asian consumer to become loyal to the new brand. The brand is not a new concept and there is a great amount of targeted consumers, but the quality of the product will determine a repeated purchase. Not only will the company have to compete with premium European products like La Mer, but also and most importantly differentiate themselves and look more appealing than local company products that contain the same Chinese ingredients and market a similar concept. Marshall Fisher, a professor of Wharton School at the University of Pennsylvania, believes that this investment like others luxury companies have taken in China will be successful. Fisher has stated that although "average disposable income in China is below that in the West, it is such a big country that the top of the income pyramid is huge" and "this has made China a prime target for luxury brands." Fisher also explains that luxury brands have succeeded because of their willingness to make changes for Chinese local culture and that is exactly what Estée Lauder has done (Kahn, 1).

Some are not as optimistic about the luxury market in China and are not as positive that the country will continue on this path of growth. Earnings for high-end companies such as Tiffany's and Burberry have decreased in the past few months (Berman, 1). Companies like Coach, for instance, have increased in sales because of the luxury value offered at affordable prices along with their coupons and outlet stores (Little, 1). Bain also found in a study that in 2011, 50% of luxury goods were bought in other countries. As more Chinese people travel each year, they are planning trips abroad for shopping (Fung, MacAusland, & Mazza, 1). Due to the high luxury taxes, import taxes, and 17% value added tax; it has become significantly cheaper to buy these items abroad. For instance, Louis Vuitton products are about 35% more expensive than the Louis Vuitton prices in Paris (Fung, MacAusland, & Mazza, 1). There are also new country political risks involved that must be taken into consideration for foreign investment. Bloomberg reports that economic growths in China will slowdown in the next few years because the transition of farmers moving to work in factories for production has decreased as most workers have already transitioned (Orszag, 1). This decrease will lower the shift in productivity and there will be more shortages in workers due to the policy barriers that prevent workers from migrating to cities. China's new leadership will most likely uphold these restrictions and possibly worsen China's economy. The International Monetary Fund has stated that China will reach a turning point around 2020 or 2025 (Orszag, 1). Recent data has supported this prediction with China's economy expanding by 7.6 percent, its slowest performance in three years. Third quarter data support a weaker performance (Chang 1). Although the leader Hu has stated that China plans to lessen its state control of the economy, there is a great deal of risk involved when conducting business in a country governed by the Communist Party (Kauffman, 1). The executive chairman of the luxury retailer Shanghai Tang states that his largest worry in China is the political instability in China and is aware that this could create obstacles in the future. However, he still foresees success in China and Asia and does not see Europe as a future place for business and is attempting to build the first Chinese luxury brand despite these known risks (Kan, 1).

Although some companies are reporting slowdowns, companies continue to dive into the luxury market in China. The most recent major company to do this was EBay, the company creator of an online market place, even though it failed in China five years ago. EBay made a deal with Xiu.com, a luxury online seller, in which the Chinese will be able to buy products from U.S. sellers, but Xiu.com will manage all sales, shipments, and customer service (Chaudhuri ,1). According to a spokesman from EBay, like other companies their reasoning for entering China was that it seemed like the right time because of the growing middle class demand in China. Chinese consumers increased sales by 40% in 2011 (Kucera, 1). The western brands offered attracted locals and this new agreement will allow Xiu to translate the website so that it appeals more to Chinese consumers who have culturally different tastes. Analysts like Victor Anthony believe that luxury goods are an excellent market to begin business in China (Kucera, 1). Even though companies like Amazon.com have struggled when entering China, EBay's approach may work because of the high demand for brand name Western design products. It will be able to compete with website sellers such as Alibaba because of the PayPal system that allows

Americans to sell to Chinese consumers (Kucera, 1). Other companies such as Longchamp continue with their expansion plans in China. The chief executive Jean Cassegrain stated that even though Asia's economy has slowed "the purchasing power of Chinese consumers continue to increase and is not going to change" (Siddiqui ,1).

The confidence reiterated by the Longchamp chief executive can also be demonstrated with the investments of major multinational corporations in China in the past few years (Siddiqui, 1). Even with reports of economic slowdown and decrease of spending, the luxury market still prospers and it is predicted that it will continue on this path of success. Even with the reports of decreased sales, the luxury good sales has increased by four percent in 2011 and is expected to become the second largest luxury goods market after the United States (HeraldNet, 1). Although China creates a great deal of political uncertainty, the fact still remains that Europe and the United States, areas where most luxury goods companies started and have grown from, are currently in crisis. Continuing expansion in these countries could pose even greater risks. Currently, if asked, the answer to most luxury companies' plans of expansion all leads to one country. It is where demand for luxury brands is high and expected to grow. It is where global companies feel they need to go to find their next step towards success in the middle of crisis. Most luxury companies would answer China.

References

Berman, D. (2012, October 25). The rise and fall of china's luxury boom. *The Globe and Mail*. Retrieved from http://www.theglobeandmail.com/report-on-business/rob-magazine/the-rise-and-fall-of chinas-luxury-boom/article4634488/

Chan, V. (2012, October 31). China Luxury Sales to Get Boost after Leadership Change. *Bloomberg*. Retrieved from http://www.bloomberg.com/news/2012-10-30/china-luxury-sales-to-get-boost after-leadership-change.html

Chang, G. G. (2012, July 15). China's "heart attack" in june: Beijing overstated q2 growth. *Forbes*, Retrieved from http://www.forbes.com/sites/gordonchang/2012/07/15/chinas-heart-attack-in june-beijing-overstated-q2-growth/

Chaudhuri, S. (2012, November 12). ebay in deal with chinese online retailer xiu.com. *Market Watch: The Wall Street Journal*. Retrieved from http://www.marketwatch.com/story/ebay-in-deal-with chinese-online-retailer-xiucom-2012-11-12?reflink=MW_news_stmp

"China to Raise RQFII Quota, Boost Foreign Investor Access." 11 Nov 2012: n. page. Web. 4 Feb. 2013. <http://www.bloomberg.com/news/print/2012-11-11/csrc-says-china-ready-to-increase-foreign investor-access.html>.

Chinese shoppers power global luxury sales. (2012, October 15). *Herald Net*. Retrieved from http://www.heraldnet.com/article/20121015/BIZ/710159883

DeMarco, A. (2012, July 24). Luxury brands still flock to china. *Forbes*, Retrieved from http://www.forbes.com/sites/anthonydemarco/2012/07/24/luxury-brands-still-flock-to-china/

Flanders, S. (2012, November 08). China congress: Hu jintao says reforms to deepen. *BBC News*. Retrieved from http://www.bbc.co.uk/news/business-20248116

Fung, J., MacAusland, C., & Mazza, G. C. (2012, January 03). Louis vuitton and the traveling Chinese consumer. *Knowledge @ Wharton*. Retrieved from http://knowledge.wharton.upenn.edu/article.cfm?articleid=2901

Kan, D. (2012, November 11). Promoting a chinese brand…to the chinese. *The Wall Street Journal*. Retrieved from http://online.wsj.com/article/SB10001424127887323894704578112343195484994.html

Kahn, B. (2012, October 15). Estee lauder's new skin care brand in china: The potential for high-risk, high-reward. *Knowledge @ Wharton*. Retrieved from http://knowledgetoday.wharton.upenn.edu/2012/10/estee-lauders-new-skin-care-brand-in-china the-potential-for-high-risk-high-reward/

Kauffman, S. (2012, November 13). China's growing affluence accept new leader. *World Property Channel*. Retrieved from http://www.worldpropertychannel.com/featured-columnists/chinese millionaires-ultra-high-net-worth-individual-in-china-uhnw-in-china-uhnw-china-cites-hu-jintao xi-jinping-6272.php

Kucera, D. (2012, November 12). Ebay returns to china in xiu.com deal to sell fashion. *Bloomberg Businessweek*, Retrieved from http://www.businessweek.com/news/2012-11-12/ebay-returns-to china-in-xiu-dot-com-deal-to-sell-fashion

Little, K. (2012, October 23). Luxury retailer finding upside in china. *CNBC* . Retrieved from http://www.cnbc.com/id/49521019

Lowery, A. (2012, October 23). http://www.dailymail.co.uk/news/article-2221798/mulberry-shares plunge-posh-bags-firm-warns-chinese-spending.html. *Daily Mail*. Retrieved from http://www.dailymail.co.uk/news/article-2221798/Mulberry-shares-plunge-posh-bags-firm warns-Chinese-spending.html

Orszag, P. (2012, November 13). China's new leaders face an economic turning point. *Bloomberg*. Retrieved from http://www.bloomberg.com/news/2012-11-13/china-s-new-leaders-face-an economic-turning-point.html

Rapoza, K. (2012, October 16). China's middle class muscles in on luxury class. *Forbes* , Retrieved from http://www.forbes.com/sites/kenrapoza/2012/10/16/chinas-middle-class-muscles-in-on-luxury class/

Siddiqui, S. R. (2012, October 17). French luxury firm longchamp eyes china expansion. *Business Recorder*. Retrieved from http://www.brecorder.com/arts-a-leisure/261-life-a-style/86459-french luxury-firm-longchamp-eyes-china-expansion-.html

Singer, N. (2012, September 24). At Estée Lauder, A Brand is Developed Just for China. *The New York Times*. Retrieved from http://www.nytimes.com/2012/09/25/business/estee-lauder-develops-a brand-just-for-china.html?pagewanted=all&_r=0

Stevenson, A. (2012, October 12). China fears take toll on luxury groups. *Financial Times*. Retrieved from http://www.ft.com/intl/cms/s/0/c651dac2-1902-11e2-af4e-00144feabdc0.html