

China's wealthy no longer putting on the Ritz

A state crackdown, slowing economy and changing consumer tastes have combined to take shine off luxury goods sales

FT CORRESPONDENTS

On a quiet afternoon this week, a female shopper was browsing through pricey handbags in Beijing's largely empty Shin Kong luxury mall.

"I buy all sorts of brands – Louis Vuitton, Chanel, Prada, Gucci," she said. "Now the price of luxury products in China is much better than before but mostly, I buy them when I go abroad every year."

She may be willing to splash out on big brand names at home and abroad, but Chinese shoppers like her are becoming scarcer. The effects of a government crackdown on expensive gift-giving and the deceleration in the economy are being compounded by changing consumer tastes.

Luxury companies are also suffering from heady expansion based on what a report this week, from US think-tank The Demand Institute and its parent institution, the Conference Board, described as "overly optimistic growth and consumption projections" that have "misled foreign investors".

Luxury spending in mainland China fell last year for the first time, according to Bain & Co, to roughly \$15bn. The consultancy expects it to contract a further 2 per cent at constant currency rates, steeper than last year's 1 per cent fall.

That is a sharp reversal of a decade of remarkable growth, when Chinese luxury spending, at home and abroad, leapt tenfold – from 3 per cent of global luxury spending in 2004 to 30 per cent last year, according to Exane BNP Paribas.

Without its main motor for growth, it is no longer a life of luxury for the world's €250bn industry, which is having to work harder to adjust to the complexities of a more mature and fragmenting market.

Luca Solca, analyst at Exane BNP Paribas, says the Chinese market "hasn't been great for anyone recently, but Prada and Burberry seem to be under greater pressure from China than their peers".

Burberry warned in October that sales had been dented by an "increasingly challenging environment for luxury, particularly Chinese customers".

Many of China's wealthiest spenders have had their fill of the big names and are looking for something different, say analysts. Other, more price-conscious consumers, are buying online. Mean-

while, more Chinese citizens are travelling abroad, where they can see that prices are often 30 per cent cheaper than at home.

The devaluation of the renminbi in August reduced the price gap with Europe, though some luxury brands – notably Chanel – had already tried to address the problem by standardising prices on some of its bags worldwide.

Angelica Cheung, editor-in-chief of Vogue China, says: "The market has changed so much in the past 12 months, not only because of the economy but also because of technology and travel. The companies haven't moved as quickly."

But luxury companies will have to move fast because their expectations of cohorts of new spenders from an emerging middle class are too bullish, as highlighted by The Demand Institute. "Most Chinese citizens have a long way to go before entering the middle class," it said.

Louise Keely, a co-author of the report, described as a "myth" the expectation of reaping benefits by opening luxury emporia in a host of smaller cities. Luxury companies were attracted by the cheap rents on offer from local mayors anxious to boast a shiny new mall and by the big populations of even tertiary cities. But these consumers do not necessarily have the money for a Gucci or Louis Vuitton handbag.

As a result of this rapid expansion, China has more luxury stores than any other country in the world, outpacing the US by a wide margin, according to Bernstein Research, and nearing saturation.

LVMH, the world's biggest luxury goods group by sales, has closed three Louis Vuitton shops in China, including the brand's first outlet in the southern city of Guangzhou, following closures in Harbin and Urumqi.

Jean-Jacques Guiony, the French company's finance director, had said last month that the group might close some shops in second-tier cities. "China, Hong Kong and Macau are suffering," he said. Sales of luxury goods are expected to contract 25 per cent in Hong Kong this year, according to Bain.

The UK's Burberry and Coach of the US have scaled back in Hong Kong, where rents are rising but the number of Chinese visitors is falling.

Some brands are going against the trend with new openings. Hermès, a relatively late entrant to the Chinese market, has expanded slowly, partly due to production constraints. It opened two new shops last year, making a total of 23, which is less than half the size of the network of Kering's Gucci or Louis Vuitton.

As Christopher Bailey, Burberry chief executive, said last month: "The fundamentals of the luxury industry are changing. Growth in Chinese luxury spending is moderating."

Those fundamentals include a newfound confidence among Chinese consumers that makes them less willing to accept what western luxury brands say they should buy.

"There has been a real shift over the past two years in consumer perception about what the right product to buy should be," says Benjamin Cavender of China Market Research in Shanghai. "It used to be about making a safe big brand purchase to show off. That's shifted towards making purchases depending on the individual's interests and lifestyle."

Beneficiaries of this shift include North Face, an outdoor brand, and sports companies such as Nike and Adidas, reflecting a growing emphasis on healthier lifestyles.

Consumers also want to differentiate themselves by spending money on experiences, such as travel, fine dining and the home, instead of buying another designer product, says Emmanuel Hemmerle, managing partner at Emmanuel Hemmerle, a leadership consultancy.

Consumers are also showing more of an interest in homegrown brands, he says, which could favour a nascent domestic luxury industry.

Luxury goods companies are reacting to these changes. Coach, the US leather goods group, is reaping the benefits within China of being more affordable than many of its upscale competitors, but says that spending by Chinese tourists is also growing.

"The Chinese tourist is an increasingly large part of our business globally – notably in Japan and Europe. We are staffing into this trend, increasing the number of Mandarin-speaking store associates in these geographies," it says.

The UK's Burberry is focusing on digital marketing and shifting away from stores, cutting the number of retail staff in Hong Kong by 25 per cent.

The upside of shutting underperforming stores, and focusing on the more dynamic locations, is that China could become a more profitable country for luxury companies. Erwan Rambourg, luxury goods analyst at HSBC in Hong Kong, says: "Staff costs and rents remain reasonable relative to the rest of the world. We think profit margins will

improve because the brands already have enough shops, so can rein in the capex for retail expansion that has weighed on profit margins."

There are already some tantalising signs of improvement. Cartier-owner, Richemont said this month that growth had resumed in mainland China, lifted by retail sales through its own bou-

tiques. Gary Saage, finance director of the Swiss group, last month told analysts that in Hong Kong "it's getting a little less worse . . . but I'm not going to be popping champagne on that".

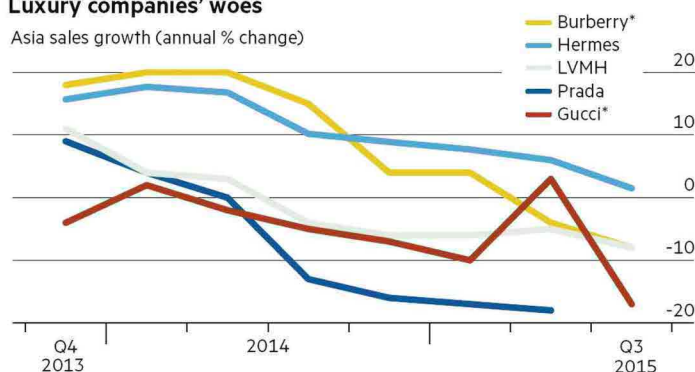
Scheherazade Daneshkhu in London, Ralph Atkins in Zurich, Adam Thomson in Paris, Rachel Sanderson in Milan, Patti Waldmeir in Shanghai, Lindsay Whipp in Chicago, Jamil Anderlini, Wan Li and Christian Shepherd in Beijing

'The market has changed . . . not only because of the economy but also because of technology and travel'

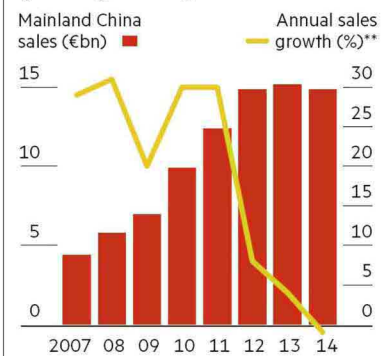
Angelica Cheung, Vogue China

Luxury companies' woes

Asia sales growth (annual % change)



Spending slowing in mainland China



Global picture

Estimated spend by nationality, 2015 (% share)

Rest of world	7
Asia other	10
Japanese	10
European	18
American	24
Chinese	31

Sources: Exane BNP Paribas; Bain * Includes retail and wholesale **At constant currency Photo: Reuters

Excess baggage



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