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Opportunity for luxury brands in China

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International School of Management Paris

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Opportunity for luxury brands in China

ABSTRACT

Given the scale of the Chinese market, international luxury brand to continue or become successful must win in China to continue winning in the rest of the world. Chinese yuppies are driving the demand, buying everything from expensive watches to imported cars. Those that are able to gain and maintain a preferential share of these Chinese affluent consumers will be able to sustain their global image and compete in equal terms with the future emerging Chinese luxury brands. The reason Chinese affluent men and women buy Rolex watches and Louis Vuitton bags are not simply because of the Swiss craftsmanship or French design. Their motivation to buy these luxury brands has its roots in the more complex Confucian values and demand for social recognition, and the growing influence of Western values. For this reason it is important to understand the roots and changes of the culture and values that determine the buying behavior of the modern Chinese affluent consumer.

Key-words: Luxury brands in China; China affluent consumer; Chinese yuppies; The Me generation; The young emperor generation

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Luxury market in China

China has become the world's second largest consumer of luxury goods surpassing in 2008 the U.S. to become, along with Japan, the world's largest purchaser of luxury items with annual growth in demand of 20%. Today's China has an estimated 18 thousand billionaires, 440 thousand multimillionaires, and a fast rising middle class of around 250 million who have high purchasing power and are eager to spend in luxury goods. These wealthy Chinese spend USD 8 billion on luxury goods in 2007 (Morisset and Lee 2008).

Chinese yuppies are driving the demand, buying everything from expensive watches to imported cars. Enjoying the sudden economic freedom, the newly rich capitalists are eager to demonstrate their social standing buying the obvious luxury must-haves: traditional French labels and expensive watches. According to the Time global luxury survey (2007), 22% of affluent consumers in China own a Rolex, 66% of affluent Chinese men have bought at least one watch in the past six months, and have paid an average of \$2,253 per watch. The most owned luxury fashion brands in China are Lacoste, Valentino, Chanel, and Bally. The top luxury beauty brands are Estée Lauder, Lancôme, and Guerlain. More than 50% of the affluent Chinese consumers own either a Lancôme or an Estée Lauder product. On average, affluent Chinese consumers spend up to USD 280 for a single skin-care product. Skin care is almost three times as popular in China as makeup and account for 26% to 35% of total cosmetic sales.

Despite the present gloomy international economy in the Western countries or emerging economies, the still-robust Chinese market offers the brightest prospect for luxury goods in the near future. A good example of optimism in the Chinese luxury market was the Auto Shanghai 2009 where luxury car maker Mercedes Benz presented a record high number of premieres along with an impressive lineup of 35 models. Its rival BMW presented two world debuts, three Asian premieres and a sport model

especially for China. The general believe is that China's auto sales in 2009 will continue growing from the 9.38 million units sold in 2008, break the 10 million barrier, and overtake the US as the world largest market (LI, Fangfang, GONG, Zhengzheng, and XIAO, Ma, 2009).

The world has become harder to forecast and seize future opportunities. The high-end consumption and specially the luxury market is definitively the area with the highest uncertain factors. The facts are that China has been the first economy to show improvements from the devastating industry downturn that began in the second half of 2008. The Chinese government stimulus policies are starting to take effect. In the case of the automobile industry, the stimulus package was felt in the first quarter of 2009, when domestic sales surpassed the US market for three months in a row making China the top automaker of the world. The monthly sales in March reached a record of 1.11 million vehicles, an increase of 34.1% from February, and a 5% increase from last year (LI, Fangfang, GONG, Zhengzheng, and XIAO, Ma, 2009). This means that China will continue to grow and with it the luxury goods market.

China being the second largest market in the world for luxury goods means that no established or aspiring international luxury brand can ignore the Chinese market. Luxury brands to continue or become successful must win in China to continue wining in the rest of the world. Given the scale of the Chinese market, luxury brand that are able to gain and maintain a preferential share of the Chinese affluent consumers will be able to sustain their global image and compete in equal terms with the future emerging Chinese luxury brands.

The Chinese will certainly not continue simply as buyers of western luxury goods. It is to be expected that in the near future they will use their rich cultural heritage to develop their own luxury brand to compete worldwide. They may start with forming joint ventures in other markets or simply acquiring overseas luxury brands to learn to develop their own. For this reason it is important for established or aspiring Western international luxury brands managers to understand the Chinese affluent consumer and

how to win in the luxury market in China to be sustainably successful in the global market.

Luxury consumption in China

China has a much longer history of luxury consumption by its upper class than the Western world, as can be readily seen in the many Chinese and Western museums displaying Chinese bronzes, ceramics, paintings and other historical artifacts. The traditional Chinese society was organized according to the doctrine of Confucianism and an elite class of scholar-bureaucrats that helped the emperor to manage the country. These scholar-bureaucrats, selected from the young talented people by a national examination system, were able to obtain tremendous fortune and power through their educational and cultural accomplishments. They formed the early Chinese leisure class as characterized by Thorstein Veblen (1899) in his book *The theory of the leisure class*, by incorporating conspicuous leisure and consumption in their daily lives.

The scholar bureaucrats were at the top of Confucian social ranking, followed by the farmers, the artisan, and, last of all, the despised merchants. Remains of this hierarchy is still present in many cultures where a person with an University degree is considered having a superior status to a person doing manual labor, the traditional western white collar and blue collar social difference, and the lingering suspicion of merchants that don't produce anything but make a profits on other people's work. Veblen (1899, p. 37) describes this low esteem of labour by the western social elite: ... *there are few in the better class who are not possessed of an instinctive repugnance for the vulgar forms of labour.*

The scholar-bureaucrats of ancient China according to Xiao Lu (2008) understood the beauty of life and in their leisure time enjoyed classical gardens, lacquered ware, faience and porcelain, gold and jewelry, decoration and stationary, furniture, white spirits, and gastronomy. Many scholar-bureaucrats were also famous poets, painters, and calligraphers as can be seen in the in the impressive collection of the Shanghai Museum. They were both artists and the patrons-client of artists.

The quest for luxury brands in China explains Xiao Lu (2008) is the combine of traditional pursuit of fine art and craftsmanship, and modernity represented by the western luxury industry. He points out that the life style of the ancient elite still remains in the mind of the Chinese people. This explains why the rapidly increasing numbers of Chinese affluent consumers have such a demand for imported western luxury brands, but also represents an opportunity for aspiring Chinese luxury brands to recall the lifestyle of their ancestors from China's long and splendid past.

Chinese Affluent Consumer

The generations of Chinese that came to age over the last half century have been deeply affected by massive and social upheavals starting from the formation of the Republic of China and the end of the Qing Dynasty in 1912 that put an end to over two thousand years of imperial rule, the war of resistance against Japan from 1937 to 1945, the civil war and the victory of the Chinese Communist Party in 1949, the rule of Mao Zedong and the elimination of private businesses, the Cultural Revolution between from 1966 to 1976 with the pursuit of the intellectual class, the start of the transition period under Deng Xiaoping in 1978 with the gradual opening of the market, the emergence of the urban private sector in the late 1990's, and the accession to the World Trade Organization (WTO) in 2001.

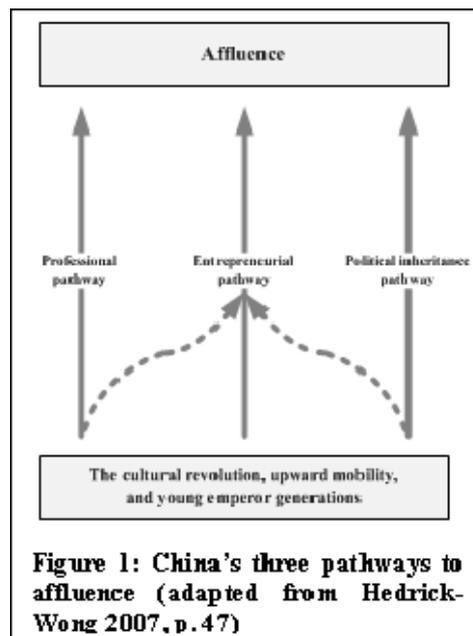
From this historical perspective, it is easy to understand that the personal experiences differed greatly from one generation to the next. Hedrick-Wong (2007, p. 37-40) uses this historic perspective to describe broadly four generation:

1. **Founding generation** represented by those that are 70 years and older. This generation was at least 40 years old in 1978 when the reform and marketing started and most have missed the opportunities it offered. Many did not have the skills or motivation to take advantage of the new market economy.
2. **Cultural Revolution generation** who are between 50 and 65 years old. The lucky ones of this generation, who could continue their interrupted education, or who had the contacts and resources to go into business, the 1980s and 1990 represented many great

opportunities. Many took these opportunities and most of China's entrepreneurial pioneers came from this generation. An example is the billionaire founder of Gome in 1987, today the largest appliance retailer in China (Jin, Li; Liao, Li; Guo, Ruoran & Zhu, Jielun, 2007).

3. **Upwardly mobile generation** who are 30 to 49 years old. The members of this generation were in the early 20s when the 1978 reforms started and so were the first to benefit from them. Most of them became better educated than the previous generation and were able to learn skills relevant to the emerging market economy. In today's China education and the prestige of the university attended is a key factor toward social prestige and better paid employment in the tradition of the scholar-bureaucrats of ancient China.
4. **Young emperor generation** refers to those born after the marked reform started in 1978, and after the 'one child' policy was introduced in 1979 by the Chinese government. This generation was born into a new era in China represented by the marked economy and in a family context where a single child is the norm. They were dubbed the 'young emperors' because they grew up spoiled as no children in China had for generations. This because their parents doted on their single child, assisted enthusiastically by the grandparents. This generation is the best educated, most confident, and ambitious among all the living generations in China. They are self-centered, frequently self-indulgent, and the most avid and savvy consumers. This generation is also called the 'one child' or 'me' generation.

The last three generations – Cultural Revolution, upward mobility, and young emperor generations - have clearly abandoned the revolutionary ideals for collective prosperity and socialist equality for personal affluence by one of the three possible pathways illustrated in Figure 1: the professional pathway, the entrepreneurial pathway, and the political inheritance pathway (Hedrick-Wong, 2007, p. 40-47).



The professional pathway started in China only with the arrival of the foreign multinational companies in the 1980s. China's educational institutions responded quickly to the new demand and already in 2004 there were 89 universities approved to offer MBA degrees and over 10 thousand students graduating with MBAs that year (Hedrick-Wong, 2007). Today we have Chinese executives in all levels of foreign multinational operating in China with salaries and bonus equivalent to the US and other western countries.

The 'young emperor generation' and in a lesser extend the 'upward mobile generation' took full advantage of the professional pathway to affluence. From these executives, an increasing number are abandoning promising careers in multinational companies to launch their own start-ups crossing over to the entrepreneurial pathway.

A survey about their future plans among the students of the 2008 MBA class at Fudan University in Shanghai showed that less than 10% wanted to work for the government, 20% indicated that they wanted to work for multinational companies, and the rest wanted to start their own businesses. Even among the 20% who planned to join multinational companies about half wanted to learn from them before starting their own business later in their careers (Hedrick-Wong 2008, p. 27). The MBA students at Fudan University are among the elite of China, but such entrepreneurial ambition

with a single-minded determination to succeed is common among the urban 'young emperor' generation.

The amazing phenomena of contemporary China is how the spirit of entrepreneurship survived the elimination of private business promoted by Mao Zedong after 1949 and the Cultural Revolution to start flourishing after Deng Xiaoping of his modernization program in 1978. Many of the three last generations - Cultural Revolution, upward mobility, and young emperor – negotiated their ways successfully through the entrepreneurial pathway to affluence. The type of businesses they started was a direct consequence of their generational background. This because for these generations growing up in different decades meant huge gaps in education, management skills and business experience.

Private wealth was eliminated under Mao Zedong and so the inheritance pathway to affluence had to do with what was called the 'princeling' phenomena. This is the designation given to the children of leaders and high officials that before the 1980s were given priority in terms of schooling and access to high positions within the government. After 1978 many 'princelings' instead of a government career to affluence opted to go into business or to pursuing high profile corporate careers with multinational companies using to full advantage their better schooling, political connections, and family pedigree.

Independent of the pathway to affluence, their diverse backgrounds, and generational differences, the affluent Chinese consumers' share one thing in common, according to Hedrick-Wong (2007), they are all 'nouveau riche'. Because of the suppression of private enterprise and wealth after the victory of the Chinese Communist Party in 1949, they are all being rich for the first time, and can't wait to show it to everybody. Chinese consumers have a marked fascination for branded luxury products because these are seen as providing the instant proof to everyone of their status of new wealth and success. This is more the case of the mass affluent than among the really rich. The mass affluent or those aspiring to be rich prefer products that are recognized to being expensive to dazzle and shine others.

It is reasonable to expect that China's affluent consumer will evolve quickly and that the crass 'nouveau riche' attitude of today will be replaced by sophistication and a more discrete taste and style. The successful luxury brands in China in order to continue successful must stay abreast of these changes. The new entrants into the luxury market may profit from these changes as they occur by catering to the new taste for sophistication and style and substituting brands that will inevitably burn out due to the excessive 'nouveau riche' appeal.

Conspicuous consumption in China

The willingness of affluent consumers to pay more when comparable consumer goods is available for much less and so advertises the fact that they can effort such luxury is what the economist labeled 'the Veblen effect' based on Veblen's (1899) book *The theory of the leisure class*. This conspicuous consumption is, however, not the only form of display wealth of the affluent Chinese because of their social value system based on Confucianism.

The traditional Confucian value system is based on eight virtues – faithfulness, filial piety, benevolence, love, courtesy, loyalty, frugality and a sense of shame – that are the moral pillars that dictate the Chinese social behavior and so also its consumer behavior. The affluent Chinese consumer behavior influenced by Confucian values: collectiveness and family, respect and superiority, and glory and awareness of shame (Xiao Lu, 2008, p. 6-7):

- **Collectiveness and family** is a key influence on individual behavior in China. This influence is the main reason that affluent Chinese consumers give more value to the brands than on the products themselves. The more famous and expensive the brand, the more recognition they get. This is the reason of the success of ostentatious luxury brands such as Rolex, Luis Vuitton, Armani, Gucci and Christian Dior in China.
- **Respect and superiority** generates the fundamental need to be respected by others and having their respect as a key indicator of social superiority in China. Conspicuous consumption is today the easiest and fastest way to attract attention. The value, image and

awareness of luxury brands among the public can fulfill the need of their consumers to impress others and so establish their superiority.

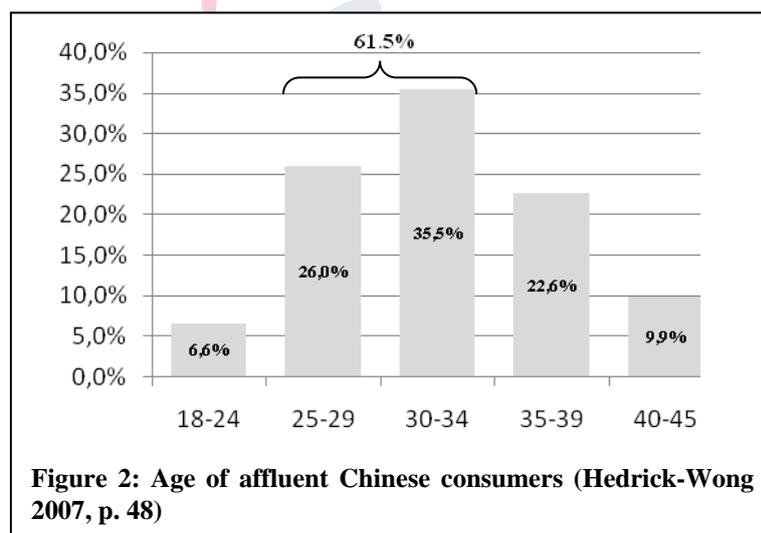
- **Glory and awareness of shame** pressures people to succeed in the Chinese society. Wearing or using luxury brands an individual can bring glory and respect to the family and to the wider community as clear sign of his or her success. It may even lead to being admired and accepted as being part of the Chinese elite without any personal achievements or political family heritage. This kind of pressure often pushes people toward vanity and the need to disown their true origin. Verblen (1899, p. 74) characterizes this behavior as follows: ... *the consumption of these more excellent goods is an evidence of wealth, it becomes honorific; and conversely, the failure to consume in due quantity and quality becomes a mark of inferiority and demerit.*

The reason Chinese affluent men and women buy Rolex watches and Louis Vuitton bags are not simply because of the Swiss craftsmanship or French design. Their motivation to buy these luxury brands has its roots in the more complex Confucian values and demand for social recognition, and the growing influence of Western values. For this reason it is important to understand the roots and changes of the culture and values that determine the buying behavior of the modern Chinese affluent consumer.

For example, in traditional Chinese culture individualism is only tolerated on condition that it remains personal and has no influence on collective interest and does not conflict with social or moral standard. In communism, individualism is totally rejected because it does not conform to ideal of the common interest of the collective. On the other hand the Western value of individualism is being used to attract the attention of the 'young emperor' generation consumers and to encourage them to express freely their own taste. The recent commercial for the M-Zone service of China Mobile has the slogan 'My zone, I decide'. Up to today though, the promotion of individualism like it is common in the Western society has been limited and is tolerated only unofficially.

In promoting and advertising a luxury brand in China special attention must be given to the culture and values of its 'leisure class' as defined by Veblen (1899), and represented by the emerging upper-middle class and super-rich. These people are the opinion leaders in the Chinese society. The opinion, conspicuous leisure, and consumption of this well-educated elite influence lifestyle trends and attitudes lead the evolution of the Chinese consumer society. They are the role model of success to be imitated by the people who aspire to join them.

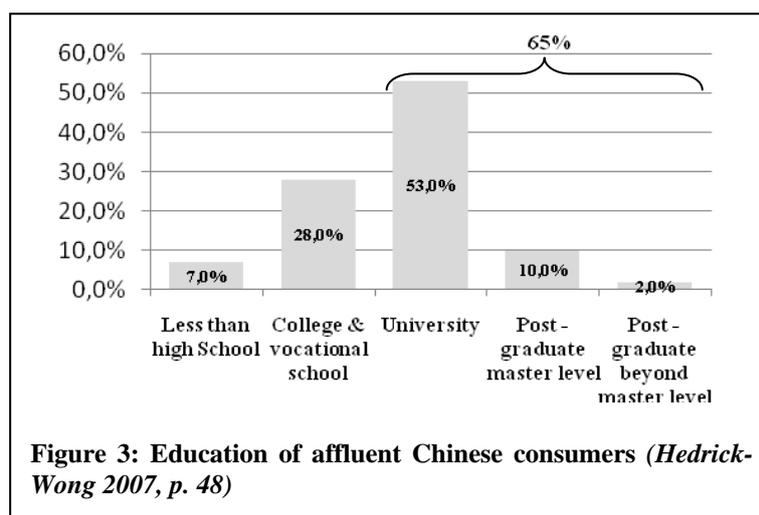
The social class distribution in today's China is changing with the economic evolution and consequently is not completely developed. The majority of the Chinese population still lives in rural areas. The new emerging social class that benefited from the opening policy since 1978 is concentrated in the economic developed urban areas like Beijing, Shanghai, Guangzhou, Shenzhen, Chengdu and Chongqing.



China's elite cannot simply be defined by demographic and economic terms. They must also be classified by the generation they belong to and their path to wealth. From the demographic to point of view, as illustrated in Figure 2, the overwhelming majority or over 90% of the affluent urban Chinese are below the age of 40. Some 62% of them are between 25 and 34 years old, and another 23% are between 35 and 34 years old.

An impressive number or 65% of the affluent Chinese have university and post-graduate education as shown in Figure 3, some 28% have

attended college and vocational schools, and only 7% are not high school graduates (Hedrick-Wong 2007, p. 47-48). This is consistent with the generation perspective explained before, particularly with the better education, greater confidence, more ambition of the younger generation, and better at taking advantage of the opportunities offered since the introduction of the marked economy in 1978.



The Chinese affluent consumers are avid users of media, as shown in Table 1 (Hedrick-Wong 2008, p. 48-49). Internet usage is above 90% for all the ages, except for those between 30 and 34 where usage is 79%. Virtually all of them watch TV regularly, and their readership of magazines is quite high, especially among those who are 18 to 24 and 30 to 45 years old. Their readership for newspapers, however, is lower. From the media usage it is evident that for luxury brands the best opportunity to create brand awareness is the high magazine readership of the affluent Chinese consumer.

Age Group	Newspaper	Magazine	TV	Internet
18 - 24	84%	97%	98%	100%
25 - 29	44%	78%	97%	91%
30 - 39	64%	88%	98%	79%
35 - 39	94%	98%	99%	100%
40 - 45	77%	96%	100%	93%

Table 1: Media exposure of the affluent Chinese Consumers (Hedrick-Wong 2007, p. 49)

How to win in the luxury market in China

The meaning of luxury products in the Chinese culture is an important aspect of the consumption of luxury brands by the affluent Chinese consumer. For some, conspicuous consumption and the necessary high brand awareness are the important decision factor for a purchase; for others, functionality and quality are the key decision factor for a purchase of a luxury brand. These are opposing values in the mind of the affluent Chinese consumer: the first is the new ideology of modernity, wealth, success, and achievement, and the second are the traditional Confucian values of frugality, economy, modesty and humility. According to Xiao Lu (2008, p. 196-201) the majority of the Chinese consumers of luxury brands decide their purchase based on conspicuousness because of their social awareness and that here are relatively few that decide based on their needs, such as the satisfaction of possession. For this reason the vast majority of the Chinese affluent consumers prefer owning a Rolex watch due to its flashy luxury brand and high price image to the sophisticated pleasure of owning a little know Breguet watch.

In the Western culture, luxury consumption has become more discrete and affluent consumers pay more attention to personal involvement with the product than to the more conspicuous social aspect of the luxury brands. In China, on the other hand, the affluent Chinese consumer in his mind links brand awareness to luxury products. For them a product may have all the necessary luxury attributes but, without brand awareness, it will be considered as a high-quality product or a work of art, rather than a luxury brand (Xiao Lu 2008, p. 75).

Luxury brands that want to succeed in China must obtain high brand awareness. This because the Chinese affluent consumers choose only from among famous luxury brands that satisfy his need for conspicuous consumption, and are unwilling to risk paying a high price on an unknown brand in China, even if the brand is internationally recognized as a luxury brand.

The best strategy for luxury brands to penetrate the Chinese market is first get a reasonable understanding of the Chinese affluent consumer, then create 100%-owned stores in luxury shopping areas of every targeted city, and at the same time aggressively build local brand awareness. This strategy to be successful requires a substantial investment between three and five years to build the necessary brand awareness. This strategy was adopted by Patek Philippe that opened its first store on the Bund a luxury shopping area in Shanghai with great success. For the two consecutive years its classic watches displayed in the store windows were sold out several times (Xiao Lu 2008, p. 188). At the end of 2007, Patek Philippe opened its second store in Beijing in the new luxury shopping area constructed for the Olympic Games of 2008.

Another possibility is to create a joint venture with a local distributor of luxury goods. The advantage of this approach is that the local distributor will bring to the joint venture the indispensable understanding of the affluent Chinese consumer, the knowledge to set up the right distribution network, and the experience in the effective use of the local media to create the necessary brand awareness. Many of the successful luxury brands in China like Lacoste, Louis Vuitton, Zegna, and Cartier started this way (Xiao Lu 2008, p. 189).

The easiest way to enter the Chinese market is to find a local distributor to handle the distribution. This approach brings the benefit of low investment and local knowledge, but it also means less control over brand image and communication in the market. Many brands like Givenchy, Cerruti 1881, Valentino, Pierre Cardin, Lancel, and Longchamps entered the Chinese market this way (Xiao Lu 2008, p. 188).

The use of a local distributor is also the best way to enter the Chinese market for aspiring luxury brands that don't have a high awareness in Europe and the U.S. and limited capacity to invest. What these emerging brands lose in control over their brand they gain in having a presence in China. In many cases the Chinese market has much more potential for growth and profits than the original market for these aspiring brands. An interesting example is the case Foli Folie, the Greek lifestyle accessory

brand. When it entered the Chinese market in 2002, very few people knew the brand. In 2007 its Chinese distributor had set up more than 40 stores in 23 cities, and the brand has become very popular and widely accepted by the Chinese affluent consumers (Xiao Lu 2008, p. 189).

The future of Chinese luxury brands

As mentioned before in the not so far future we will see Chinese luxury brands entering the world market building on their rich cultural heritage. For a Chinese luxury brand to be successful it requires three basic conditions: craftsmanship, products that are aesthetical appealing, and international acceptance as producer of luxury goods. The first two conditions that are fundamental for a luxury brand are part of the Chinese heritage and can be easily adapted to appeal to the world's 'leisure class'. The third condition, the acceptance as a producer of luxury goods will take a bit longer because it will be necessary to erase, like the Japanese did, the image of a producer of low quality cheap products.

In the Chinese luxury market, there are several Chinese brands with a traditional good local image in the Chinese low-end market. Their design and management cannot yet compete with the international luxury brands. For them to compete in the international market they will have to reposition themselves. They will have to build international management teams and work with experts in Western luxury branding. One possible way for these brands is forming joint ventures in other markets or simply acquiring overseas luxury brands to learn to develop their own.

Xiao Lu (2008, p.191) points out that it is important for a Chinese luxury brand to succeed in the world markets, to be successful in the domestic market. Having international recognition breeds confidence in the brand among the Chinese affluent consumers. Because all Chinese luxury brands face the same problem, the only way for them to succeed in the domestic market is to acquire the needed international recognition. For this reason it is expected that they will make a great effort to break into the global luxury market, and that in the future established Western luxury brands will have to compete with these emerging Chinese luxury brands.

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