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**Retail** July 10, 2007, 7:30AM EST

# China: Luxury Retailers' Travails

High-end goods are suffering on the mainland due to a pinched middle class and brands' failure to create a loyal following

by [Tom Doctoroff](#)

The largest luxury manufacturers are salivating at the prospect of striking it rich in the world's fastest-growing market. Trend lines dazzle. China is now the third-largest consumer of luxury items; the PRC boasts more millionaires than Japan; diamond engagement ring penetration now exceeds 70% in Beijing, Shanghai and Guangzhou; automobile purchases skyrocketed by 50% in 2006 and that was a slow year.

The entire "new generation" is seduced by flash. The CEO and founder of

Metersbonwe, China's largest youth fashion brand, has a collection of more than 40 Mont Blanc pens.

However, China's luxury landscape is loaded with booby traps. Any visitor to Plaza 66, Shanghai's most exclusive shopping mall, will wonder, "Where are all the people?"

For most brands, profit is elusive and volumes are weak. Cadillac drove ashore confidently but recently stalled. The Passat is struggling to escape from Volkswagen's heritage as "the taxi company." Hugo Boss is another label lost in the "sub-premium" jungle, not a head turner.

Contrary to conventional wisdom, knock offs are not a big threat. Any image-conscious mainlander who can afford the real deal would not be caught dead with a fake.

## **PENNY PINCHED**

So, what's not going right?

First, the country's ambitious new middle class is penny pinched. Spending is constrained. Even in coastal cities per capita income is an eighth of America's. In China, a yearly income of US\$25,000 is almost a king's ransom. Status-mad 30-somethings buy Gucci key chains, not Prada handbags. Import tariffs make luxury items even dearer.

Second, premium products are largely undifferentiated, a tangled glob of glitter. Chinese still don't know a Mercedes from a BMW.

In less than 10 years, China's brand universe has gone from darkness to big bang and its luxury landscape is an untamed wilderness. Luxury junkies are loyal to no one - they reach for the latest fix, and then switch promiscuously.

Making matters worse, marketing efforts are too centralized, not rooted in Chinese insight. Shanghai's chic Huaihai Boulevard is plastered with blond ice goddesses that neither provoke nor intrigue.

Third, luxury brands are easily tarnished by association with the "wrong type" of customer. There are two China's. The first is rising. It is dynamic, upwardly mobile, young and optimistic. The second is falling, a land of hulking state-owned enterprises, profit-free zones in which Rolexes are doled out as bonuses. It's a land of plump apparatchiks, rigid hierarchy, epic corruption and shiny US\$2,000 suits that make gangsters blush.

Any brand tainted by association with "old China" has been kissed by death. If a brand signals sleaze, not achievement, the gig is up. Alfred Dunhill has already been lost to the dark side.

## **TIPS FOR SUCCESS**

Is every luxury product doomed? Not necessarily. A few brands - for example, Mont Blanc, Cartier, Louis Vuitton and Zegna - are doing well in terms of both volume and margin. They have tailored efforts to address the realities of the marketplace via:

- \* A constant innovation stream to satisfy a trenchant "need for new." Chinese buy a new mobile phone once every six months. In the US, it's once every two years;
- \* Skillful portfolio management that balances high-end image and affordable scale (e.g. Zegna vs. Zegna Sport);
- \* Designs that address the need to show off, albeit in an understated way (e.g. Mont Blanc's subtly obvious white star, Cartier's classic watch face, gently framed in gold);
- \* Consistent communications that position luxury as "substance," a publicly-displayed "tool of advancement" rather than a private "indulgence" (e.g. Martell's no-nonsense "connoisseurship" vs. Hennessy's "heart of cognac");
- \* Education programs that teach how to wield a brand for maximum impact (e.g. Johnny Walker Blue taste tests);

Coco, we're not in Paris anymore. Middle Kingdom consumers have limited purchase power, lack experience navigating the brand terrain and are divided between 21st century strivers and Paleolithic central planners. However, given the country's incontestable dynamism, the best and brightest brands can, in fact, glitter like gold.

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