

Lightning strikes, lustre off lux

The luxury goods market may be slowing, but China is still the best bet for high-end brands, writes *Liana Cafolla*

Illustrations by Martin Megino

Just a year ago, the goose that lay golden eggs seemed unstoppable. Luxury brands around the world were announcing record sales and the most exciting market was, of course, China. With eyes blinded by the glitter of the country's seemingly unquenchable consumerism and its double-digit GDP growth, luxury brands flocked to the mainland market.

These days, the spiraling growth forecasts for the global luxury market are almost all gone.

From the U.S. to Japan, the top two markets for most luxury brands, sales are down, often by double digits, and luxury groups are pulling no punches in their reports.

In January, Swiss-based Compagnie Financière Richemont SA, the world's second-largest luxury group, which

has brands including Cartier, Piaget, Van Cleef & Arpels and Chloé, issued a candidly pessimistic statement about the threat to the global luxury market, admitting the company is facing the toughest market conditions since it was set up 20 years ago.

"We see no cause for optimism. We must assume that there will be no significant recovery in the foreseeable future and plan accordingly to cope with this situation," the company said.

The stern outlook was based on Richemont's dismal third-quarter results in 2008, which included crucial December sales figures. Gross sales in the Americas – the company's biggest market – fell by 28 percent. Overall sales were down 12 percent, with a 2 percent drop in Asia Pacific. The company's pen sector, including top

seller Montblanc, was the worst-hit, with overall sales down 17 percent.

Even De Beers is planning to cut production drastically, with sales indicating that women have temporarily abandoned their "best friends," according to the *Financial Times*. The world's biggest rough diamond producer says it does not expect demand for diamonds to recover until Christmas next year at the earliest. Although the extent of the cutback is not known, the company's January sales of rough diamonds fetched a meagre US\$100 million, compared with US\$600 million in January last year.

Market research firm Bain & Co. predicts a decline of up to 7 percent in global sales of luxury products this year, while J.P. Morgan is slightly more optimistic, putting the fall at 4 percent.



Toughing it out

Around the world, top brands are cutting back. In January, French luxury fashion giant Chanel announced it would cut 200 jobs worldwide, nearly 10 percent of the company's production workforce. LVMH Group – the world's

largest luxury goods company, which owns more than 50 top names – cancelled a planned 10-storey megastore in central Tokyo.

Coach, a U.S. luxury handbag maker, announced a 13 percent drop in North America sales in its second quarter accounting period for 2008, which includes the peak Christmas season, compared to the same period a year earlier. Italian jewellery brand Bvlgari said profits were down 44 percent in the third quarter of last year, reported *The Guardian*.

The one bright spot in Richemont's results, however, was China, where sales were up a whopping 24 percent. While that is still not enough to balance the company's global losses, it contrasts dramatically with losses of 18 percent in Japan, which has long been the region's foremost luxury-brands market.

Even in China, however, many of the high-spending elite – the top clientele of many brands – are tightening their belts after losing millions in the stock market. *Forbes* magazine counted just 24 billionaires in China last year, down almost two-thirds from 66 in 2007.

The average wealth of the richest Chinese who own listed companies shrank 45 percent between early September to early November, after already falling 20 percent earlier in 2008, according to Rupert Hoogewerf, chairman of luxury publishing group Hurun Report.

"I have never seen fortunes [in China] fall so much in so little time – it is unprecedented," Hoogewerf told *China Daily* in January.

Some brands are countering the slowdown in demand by slashing prices. Leading luxury brands including Chanel and Versace have cut prices by up to 10 percent on products selling in the United States, according to *The Wall Street Journal*, and Prada in Milan reportedly slashed prices over Christmas.

While such reductions are clearly meant to sustain a corporation through short-term struggles, many in the industry are warning that such measures are unsustainable in the long run.

"Our strategy is to drive our costs down without compromising on quality," says Jeremy Hobbins, group managing director of LiFung Trinity Ltd., which is part of the fashion retailing arm of Li & Fung Group and owns four luxury brands – Kent & Curwen, Cerruti 1881, Gieves & Hawkes, and D'urban – with the four of them owning more than 250 outlets across the mainland. "We will maintain prices but not put them up. Previously we've been putting prices up but we're not doing that now."

"If you buy luxury, you buy luxury because it has a value," says Francis Gouten, former chief executive of



luxury group Richemont. "If you decrease the price, it's not a luxury."

He expects to see brands reduce marketing and communications budgets, and slow the opening of new outlets. Brands may also introduce cheaper products to sustain sales without damaging the brand, he says.

Top brands have done it before, recalls Gouten: Confronted with a sudden hike in the price of gold in the 1970s, Cartier responded by creating a new version of its popular oval-shaped cigarette lighter that was made with less gold to make it more affordable. Louis Vuitton used this strategy recently, introducing a cheaper handbag – the "Neverfull," made of canvas with a leather trim – which has become a best seller in Japan.

Two-speed market

Gouten predicts a shake-up of the luxury industry in China. "I think China will suffer because first of all, it is the first big crisis in China and many, many brands over-invested in China," says Gouten without naming names.

Analysts predict that tightened competition will change the way brands develop in China. A Darwinian-type split in the market may ensue, with less established brands unable to sustain themselves.

"Recent entrants in the last couple of years are more likely to suffer, as the market in China has become quite crowded," says Nick Debnam, regional chair of consumer markets at KPMG.

Shaun Rein of China Market Research agrees that smaller brands, including Richemont's Dunhill, will

have a very difficult time. "First off, Dunhill was heavily hit by piracy, which hurt their image. Part of the issue is that the style is not that distinct," he says.

The more well-known brands that entered the mainland market earlier, such as Louis Vuitton, Chanel and men's outfitter Ermenegildo Zegna, are expected to fare better, analysts say.

"I don't see a particular problem for the established brands," Debnam says. "They are already making good money in China and even in a downturn will do okay."

"Brands having their own retail network are suffering less. True luxury brands – brands with a good DNA, a good history – will suffer less," says Gouten.

Recession opportunities

With China's GDP still forecast to grow at around 8 percent – an impressive rate compared to abysmal forecasts in most developed countries – some observers say the mainland is still the best place for luxury brands during the economic crisis.

KPMG's Debnam says the recession might even be good for brand building. "Several retailers I have spoken with appear to be committed to continuing with expansion plans, and may even see the softer market as a time to get better value in terms of rentals and store location," he says.

For example, Zegna will open flagship stores in Hong Kong, Tokyo



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and Dubai this year, but will hold off on opening smaller stores elsewhere. "This is also the moment to take advantage," said the company's chief executive, Ermenegildo Zegna.

Luxury jeweller Cartier has similar plans. "Our objective is to do better than the others and to pick up market share," Bernard Fornas, the company's chief executive, told a watch fair in Geneva in January. He added that sales in some markets, including China, were continuing to do well.

Versace says it remains convinced about the mainland outlook, according to *Reuters*. "China is a strategic country for the company," Donatella Versace, creative director of the Versace Group and vice president of the board, said at the brand's first mainland fashion show in November. "We are really focusing on China."

Mid-range brand Chloé is planning to open three new boutiques on the

mainland this year. "We are not experiencing a slowing demand in China and continue to grow well," says Helen Willerton, managing director of Chloé Asia-Pacific.

Steady sales are also reported at the top of the wine market.

Wine company Berry Bros & Rudd says it is "impressed and surprised" at how the luxury end of its wine business performed in Shanghai in December. "There is still plenty of discretionary spending being done," says Nicholas Pegna, the company's managing director.

And for some, the recession is already offering increased business opportunities, including second-hand luxury goods store Milan Stop.

"Business has actually gotten better since the financial crisis," Zhan Yu, owner of Milan Stop, told *China Daily* in Hangzhou in December.

He said the number of products women bring to sell to his shop has increased up to tenfold. "Some women said they get less money from their husbands due to a business downturn," he was quoted as saying.

Analysts say any slowdown by luxury brands in expanding their presence in the mainland is more likely due to the brands' tightening cash flows resulting from weaker sales in the U.S. and Europe, rather than a loss of faith in the China market.

"In the longer term, when China is doing well, the growth rates in China for luxury products, coupled with the sheer volume of emerging consumers, will still outstrip most of the world," says KPMG's Debnam.

"Savvier brands will continue to invest in China because this is where both short- and long-term sales will be," says Rein of China Market Research. **A+**