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**A**s the Chinese economy continues to flourish, buoyed by 10% annual gross domestic product (GDP) growth, rising incomes, and healthy (if volatile) equity markets, newly-minted millionaires have emerged with a voracious appetite for Gucci shoes, Tiffany jewelry, Armani suits, Prada handbags, Bentley limousines and many other luxury items that broadcast one's wealth and status.

According to a report from Goldman Sachs, China was the world's third-largest consumer of luxury goods in 2006, accounting for 12% of global sales, up from 1% just five years prior. By 2015, China could represent 29% of worldwide luxury product sales, making it the world's top buyer of luxury goods.

As an example of China's craving for luxury, consider one of the world's most iconic luxury products, the Swiss watch. According to the Federation of the Swiss Watch Industry, sales to Chinese buyers leapt by 84.2% in just the past two years, while overall sales ticked up a more modest 26.1%.

Chris Davis, managing director of brand strategy at GfK NOP, a London-based market research organization, explains that affluent Chinese consumers are enamored with foreign luxury brand products and will pay their attendant exorbitant prices. "Despite the Communist culture one associates with China, there is no country in the world that better epitomizes 'conspicuous consumption' than China," he says.

"The luxury brand phenomenon can actually be traced

back to the pre-Mao era of the 20s and 30s — where places like Shanghai were a Mecca of style, fashion, and luxury consumption. This spirit has been rekindled with the government's tacit acceptance of market capitalism, rising disposable incomes, and a

cultural shift toward individualism and indulgence."

"We are seeing a significant number of new points-of-sale opening up in China for luxury goods," says Joshua Byrne, managing director and co-chief investment officer of the international core team at Putnam Management. "As Chinese people accumulate wealth, luxury

goods become aspirational items. And a lot of wealth creation is going on in China."

Global luxury companies appear more than ready to exploit the rising incomes of

China's elite. Many of the world's most prestigious luxury goods companies have established a significant foothold on the Chinese mainland. For instance, French luxury goods maker Hermes International seeks to treble the number of its stores in China over the next five years; Saks [SKS 21 ★★★★★]

plans to open its first store in China in 2008; Richemont, parent company of French watch and jewelry brand Cartier, plans to open 25 new shops in mainland China by March 2008; Italian clothier Gianni Versace plans to open nine stores in China next year; and LVMH Moët Hennessy Louis Vuitton SA, the

A NEW CLASS OF AFFLUENT CONSUMERS IN CHINA HAS CREATED GROWING DEMAND FOR FOREIGN LUXURY PRODUCTS.



# Chinese

300,000 millionaires (in U.S. dollar terms).

According to a recent report by the McKinsey Global

end brands. Indeed, McKinsey predicts that the Chinese upper middle-class will represent the majority of the nation's populace (59.4%) by 2025, from just 9.4% in 2005.

# Basking In

Byrne notes one of the primary problems facing luxury goods sales in

# Luxury

Institute, an economic research firm, the segment of the Chinese population described as "global-affluent"

accounted for just 0.1% of the total

population in 2005. By 2025, they are expected to represent 3.3% of the population. A slightly less well-off group, the "mass-affluent," represented 0.5% of the population in 2005, but will jump to 7.7% by 2025.

Davis indicates that the luxury market in China is in its embryonic stages. Chinese luxury consumers — that is, wealthy and status-conscious individuals — tend to be younger than their counterparts in Western Europe and the United States.

"There is a large number of millionaires and upper middle class Chinese between the ages of 30 and 45," he notes, suggesting tremendous growth potential for luxury goods makers.

But it is not just China's super-rich that seek luxury. The China Product Brand Strategy Association estimates about 13% of China's population — or about 170 million people — now purchase high-

proliferation of sub-standard counterfeit products. "Over time, as the Chinese economy matures and develops its own luxury brands and intellectual property, they'll have more incentive to enforce copyright infringement laws," he says. "But for the moment it remains a significant issue." The U.S. Embassy in Beijing estimates about 20% of all consumer products in China are counterfeit.

"In the long term, we expect the Chinese to grow their home grown luxury brands to compete with the foreign luxury brands," says S&P's Seng.

Davis is not overly concerned by this situation. "Luxury goods consumers are not very price sensitive, even in mainland China," he says. "The demand for these items is so high that many foreign luxury brand companies are opening new retail locations, not just in Beijing and Shanghai, but beyond, into the provinces."

"To protect the brand, a lot of these luxury products have global pricing, so they won't sell an item cheaper in Beijing than they would in Tokyo, New York, or London," says Byrne.

"As a percentage of disposable income, a luxury item will cost more for a Chinese consumer, on average, than for someone overseas." ■

world's largest luxury goods maker, plans to open two to three stores annually in China, where sales are rising 50% each year.

"We expect sustainable economic expansion to increase the appetites for foreign luxury goods synonymous with high quality and status symbols in China," says Alison Seng, an Asia-based equity analyst for Standard & Poor's. "The presence and expansion of major luxury goods retailers in China suggests the optimism over the growth outlook for this segment of the retail market. We believe increased brand marketing and consumer education will be the catalysts to accelerate demand."

While the number of wealthy Chinese remains a tiny proportion of the overall society, their percentages are growing; and given the country's enormous billion-plus population, they already provide a significant market for luxury goods makers. Merrill Lynch estimates that China currently has