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RETAIL

Will protests cause more luxury brands to follow Louis Vuitton and reduce exposure to Hong Kong?

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Louis Vuitton is closing its Times Square Mall store in Hong Kong. Image credit: Louis Vuitton

By Pamela N. Danziger

Ever since anti-government protestors took to the streets of Hong Kong in June of last year, luxury brands have taken a wait-and-see approach regarding business there.

A planned Chanel store on Fashion Walk in the Causeway Bay district was put on hold, as was the opening of LVMH's Rimowa luggage store in the same district.

But now Hong Kong retailers are under siege, as protests are increasingly targeting shopping areas and spreading to weekdays after the early days when they were limited to weekends.

The Causeway Bay shopping district has been particularly hard hit, with more than 100 shops out of a reported 1,087 in the district closed by August 2019.

Henry Jong, senior regional sales director of realty agency Centaline Commercial, called Causeway Bay "a battlefield," so it is no surprise that Prada announced in August it would close its Russell Street store in the district when its lease expires in June 2020.

And now Louis Vuitton is pulling out as well, shutting its Times Square Mall store. Both Prada and Louis Vuitton attributed the closings to intractable landlords that refused to make rent concessions in light of rapidly falling sales.

Louis Vuitton's seven other Hong Kong stores will remain open, and it plans a new store opening in the Hong Kong International Airport in 2021, but this closure will still hurt. Some 6 percent of LVMH's 46.8 billion revenues in 2018 were made there.

Hugo Boss, Ralph Lauren, L'Occitane, Cartier owner Richemont, Swatch Group, Tiffany, Moncler, Calvin Klein, Gucci and Salvatore Ferragamo are all on record about the hit their brands have taken there, with sales declines of as much as 45 percent reported.

L'Oreal and Herms both disclosed falling sales in the region, but put a positive spin on the news by saying rising sales in mainland China will carry them over the hump.

LVMH said roughly the same thing, reporting "good progress" in Asia, "despite the difficult context in Hong Kong," during third quarter 2019. Reuters reported that LVMH's Hong Kong sales have declined by about 25 percent in the third quarter 2018.

Hong Kong in recession

The extended protests have plunged Hong Kong into a recession, announced officially in mid-November when GDP fell 3.2 percent in the period from July through September.

Retail sales are feeling the brunt of it, with year-over-year October 2019 sales down 24.4 percent, an official record, followed by a decline in November of 23.6 percent.

Through the first eleven months of the year, total retail sales decreased 10.3 percent, according to the Census and Statistics Department.

Retail sectors that cater to consumers' discretionary spending have been most profoundly impacted, with retail sales in clothing and footwear stores, department stores and jewelry, watches and "valuable" gift stores all down double-digits through the first eleven months of the year.

However, declines in these sectors really picked up steam since August.

In November alone clothing and footwear store sales dropped 31.8 percent, department stores were off 32.9 percent and jewelry, watches and valuable gifts were down 43.5 percent.

Retailers cannot absorb these losses for long.

So far, real estate agency Midland IC&I reports nearly 500 of the 7,400 shops in Hong Kong's four prime shopping districts have closed and it expects another 600 to be shuttered in 2020.

Given the unpredictability of the situation, there is no relief in sight.

"I believe the retail sector will continue to face a difficult time in the first half of the year, as I still can't envisage that the social unrest will be resolved any time soon," said Annie Tse Yau On-yee, chair of the Hong Kong Retail Management Association.

"The outlook for retail sales very much depends on the repercussions of the social turmoil, which has severely dampened consumer sentiment," she said.

Tourists are turning away

While Hong Kong is merely a blip in the global luxury market expected by Statista to reach $6.3 billion in 2020 in a total global market of $331.3 billion it is still a more important market than the whole of Canada, with about $6 billion in luxury sales.

But unlike Canada, Hong Kong has historically benefited from generous spending by the world's wealthy globetrotters. Tourists are said to account for up to 70 percent of luxury sector purchases there.

Overall the Hong Kong Tourist Bureau reports tourism is down 10 percent year-over-year through November 2019, but in November alone it dropped 56 percent.

Declines in tourist visits were sharpest from mainland China, the largest originating tourist market by far and a prime target for luxury brands in the city, as well as other Asian markets off 58 percent and 47 percent, respectively but long-haul visitors from the U.S., U.K., France, Australia and other countries tanked by 36.1 percent in November.

For the wealthy, increasingly concerned about security in an increasingly insecure world, Hong Kong is no longer a premier destination.

Mike O'Rourke, CEO of global security consulting firm Advanced Operational Concepts, told the *Los Angeles Times* that Hong Kong is now a place to avoid for leisure travel, noting the increasing number of protests in prime shopping areas, such as a recent violent protest at the Adidas flagship store.

Just another blip, or long-term trend?

Given the escalating violence and growing uncertainty about when the protests will abate, can we expect more luxury brands to follow Louis Vuitton's lead and retreat from the chaos that Hong Kong has become?

In September, I spoke with Daniel Andr Langer, CEO of management consulting firm quit, professor of luxury strategy at Pepperdine University and a contributor to *Jing Daily*, who predicted the protests would have little lasting impact.

"If you look at the history of Hong Kong, these kinds of crises come around again and again every three-to-five years," Mr. Langer said. "This will likely blow over too.

"Obviously, we are seeing a temporary impact," he said. "This will ultimately be a non-event in terms of their expected long-term business impact."

Even as the situation has worsened since then, Mr. Langer remains confident that Hong Kong will bounce back once the situation normalizes, and most especially the luxury sector.

"Luxury brands are more recession-proof than other categories as the past recessions like the global one of 2008 has shown," Mr. Langer said.

"Also in Hong Kong, those luxury brands that stay loyal and continue to invest in brand equity will come back stronger," he said.

But then the underlying causes of this recession political and social unrest are very different from the last one.

While it has been exacerbated by the U.S.-China trade war, this recession is largely a bottom-up, rather than a top-down one caused by a change in consumer sentiment, which is more intractable.

Further, it is the result of a grassroots movement fueled by a variety of socio-political resentments against the elite establishment, so it is easy to see why luxury brands are a target, representing a most visible symbol of income inequality.

Mr. Langer, however, feels the resiliency of luxury against economic ups-and-down will see Louis Vuitton and its peers through.

"The decision of Louis Vuitton to close one store is in my opinion not a signal of brands abandoning Hong Kong," Mr. Langer said.

"The brand was trying to renegotiate an exorbitant rent and decided after failed negotiations to leave that space," he said. "This is not unusual and happens all the time all over the world.

"I am sure the brand, being the leading luxury brand in the world, will emerge strong once HK is back to growth."

However, others are not so confident.

"For many luxury brands, Hong Kong [historically] has represented over 5 percent of their global sales, which is a significant portion, [and even more for watches and jewelry], so it made sense to have such a large retail footprint in the city," Mario Ortelli, managing partner of the luxury advisory firm Ortelli&Co. told the *South China Morning Post*.

"But if tourist arrivals drop and the Chinese stop coming, that kind of retail footprint becomes excessive and three to four stores for a luxury brand would be enough," he said.

I BELIEVE the dominoes have only started to fall.

Now that the luxury industry's leader has taken a stand, it is likely that other luxury brands on the front lines of the increasingly volatile Hong Kong market will follow its lead, not abandoning the market altogether but seriously contracting their exposure there.

An unnamed top executive at LVMH hinted as much at the recent Paris Fashion Week, when quoted by *South China Morning Post* saying that if the situation does not improve, Hong Kong risks becoming "just like any other second- or third-tier city in China," rather than the first-tier city it long has been.

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