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All eyes on China for luxury's recovery, but no guarantees of future success

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Power of China's economic empire: Shanghai skyline at night

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Since the 2008-09 recession, China has effectively become the tail that wags the dog of the global luxury market.

That is because China was largely unaffected by the economic downturn that battered the market throughout the rest of the world.

Not only that, Chinese consumers, with their growing economic power, expressed a heady appetite for luxury brands that signaled status in a culture where that really mattered.

Now, after the beating that luxury brands have taken due to the coronavirus pandemic, which Bain & Company predicts will strike off 20 percent to 35 percent of the personal luxury goods market in 2020, and McKinsey is on record for sales to shrink as much as 35 percent to 39 percent, all eyes are on the Chinese to restore luxury brands' fortunes.

In analyzing prospects for the luxury market's recovery, Bain's latest report takes a glass-half-full view of the industry's future. It predicts the industry will recover by end of 2022 or early 2023 to 2019 sales levels of 281 billion ($304 billion).

And to do that, China is the industry's only hope, said Claudia D'Arpizio, Bain partner and leader of its luxury goods practice.

All eyes on China

"The economy in China will be the one that will be least impacted by the long tail of this planetary crisis," Ms. D'Arpizio told me. "For the luxury market, we think the recovery will be stronger and faster in China than in the U.S. and Europe."

Already Bain reports the "best-performing brands" are registering year-over-year sales increases in China for the first four months of 2020. While store traffic remains down, consumers who visit are reportedly more inclined to buy and their level of spending has increased.

Having grown dependent on the Chinese market for growth or more correctly, addicted luxury brands are going to have to keep the pressure on to reach that ambitious 2022-23 recovery schedule.

In 2019, Chinese consumers alone accounted for 90 percent of the growth in the personal luxury goods market, or some 19 billion ($21 billion) in sales. They also generated 35 percent of global luxury spending.

By comparison, U.S. consumers generated only 22 percent of the industry's sales and Europeans 17 percent, and their share of the market has declined from 27 percent and 30 percent, respectively, since 2000, while China's share has grown from 2 percent.

Furthermore, Bain expects that Chinese consumers will make more than half of luxury goods purchases by 2025 when global sales are expected to reach 320 billion to 330 billion ($346 billion to $357 billion). That means they would have to gain some 15 percent more market share in only five years, which is a pretty aggressive expectation.

Ms. D'Arpizio admits predicting the future for luxury coming out of this crisis is particularly problematic since it impacted not just consumers' financial wellbeing, but their health and emotions.

"It's probably going to have more than double the impact that the industry had from 2007 to 2009," she said.

What can get luxury brands off course in the post-coronavirus world, even if China rebounds as strongly as Bain expects?

Plenty.

Travel to and from China will be stalled
First, nobody is going anywhere, as the travel industry will be the very last to recover.

"About 40 percent of overall [global] sales are made when people are traveling, so that is something that will be slow to recover," Ms. D'Arpizio said, as she predicts "repatriazation of purchases" in China will offset losses due to reduced travelling as the government is "pushing" for more local consumption.

On-the-go Chinese consumers have been big luxury shoppers.

Luxury sales in mainland China made up only 11 percent of global sales in 2019, compared to Chinese consumers' 35 percent total market share.

Reduced Chinese consumer spending power
Second, luxury brands are counting on Chinese consumers to have not just the same appetite for their pricey goods, but also the same spending power. That is to be determined.

The Chinese economy contracted 6.8 percent in the first quarter 2020, with industrial production down 1.1 percent and imports/exports off 6.4 percent.

Since China's factories feed the rest of the world's markets and the coronavirus shutdowns and resulting canceled orders did not happen until the second quarter elsewhere, it may be a long shot to achieve the expected 1.3 percent year-over-year growth in the second quarter.

Complicating matters further is rising Chinese unemployment.

CNN Business reports that as many as 80 million Chinese workers are out of a job, while the official figure from government sources are far lower.

Calling "data from Beijing notoriously opaque," CNN quotes economists at Socit Gnrale reporting that nearly 10 percent of people in China are jobless.

Rising unemployment may hit luxury brand performance in China harder than in Western markets.

"A lot of the luxury market depends on the aspirational drives of middle-income Chinese consumers. But if they lose that income, the luxury market will lose those customers," *Luxury Daily* editor in chief Mickey Alam Khan said.

Consider also that the U.S. has four-times more truly wealthy consumers than China, 18.8 million millionaires compared with 4.4 million in China.

Luxury retail post-coronavirus will not give the same emotional kick
Third, what Ms. D'Arpizio calls the "selling ceremony," which is so important to Chinese consumers, will be disrupted by social distancing measures required in the post-coronavirus world.

"There is an element of cautiousness and fear linked to the possibility of contagion which will reduce store traffic," she said. "The sanitary control measures required are not the best setting for luxury shopping which has a huge emotional element."

Ms. D'Arpizio also foresees fewer luxury store openings, which will put more emphasis on ecommerce, as well as the need for greater marketing efforts.

"Luxury brands will have to pull all the marketing levers and make investments in the most efficient way," which will likely result in a hit to brand's profitability down the road, she pointed out.

Rising cultural tensions as localism gains ground

Fourth, and perhaps most importantly, the coronavirus is going to heighten "cultural sensitivities" in the luxury market.

"There is a lot of tension around inequalities, especially among the lower-income tiers of the population," Ms. D'Arpizio said. And it is not just tension between the haves and the have-not's, but also the tension between the East and West.

As Western luxury brands have focused on the Chinese consumers for growth, they have committed any number of mistakes reflecting gross cultural insensitivity, such as the notorious Dolce & Gabbana campaign featuring a model eating pizza with chopsticks.

While Ms. D'Arpizio lauds the luxury industry as the "melting pot of creativity everywhere," she also foresees the "danger of strongly increasing local sensitivities," arising from the coronavirus pandemic, which originated in the central Chinese city of Wuhan and already is a point of sensitivity for the Chinese people.

"Brands really need to pay attention to elements of the monocultural reality and try to be relevant with authenticity around local cultures and local sensitivities," she said.

It is important to note her emphasis on local cultures and sensitivities because both China and Hong Kong are important markets for luxury brands, yet they have cultural differences, challenging a one-size-fits-all-China approach to these markets.

The COVID-19 coronavirus is going to accelerate a trend that Bain defines as cultural relevance and local tribes.

"There has been a social strengthening of localism and nationalism," Ms. D'Arpizio said.

"In particular, the younger Chinese consumers are developing a stronger demand for Chinese products, local brands and local enterprises," she said. "This will probably accelerate and be a threat for European brands."

To meet this shift, Ms. D'Arpizio calls on luxury brands to develop a "global framework that is large enough to accommodate all these differences and all the differing cultural needs.

"Luxury brands will need to make room for more collaborations with local designers, artists and creatives to gain relevance around this trend toward strong localization," she said.

Generational shift

In closing, Ms. D'Arpizio sees hope, and challenges, on the horizon not just in China but around the world coming from the next generational shift in the luxury market, from baby boomers and Gen X consumers to millennials and Gen Z.

"These are both the luxury consumers of today and tomorrow," Ms. D'Arpizio said. "They are a wave shaping and creating luxury brands' evolution in terms of messaging and purpose.

"I see these consumers as a very positive underlying driver for success, as long as brands stay in tune with the next generations," she said.

"As long as" is an important qualifier in that statement and many brands have tripped up staying in tune with consumers' aspirations and drives when generations shift.

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