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MARKETING

5 risks that could derail China's luxury market

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China might seem like the answer for luxury growth, but there are risks in the medium term that could derail this burgeoning luxury market. Image credit: Li Ning's Fall/Winter 2021 collection, Weibo

By Glyn Atwal

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Investors continue to be bullish on the luxury market. The S&P Global Luxury Index, which comprises 80 of the largest publicly traded luxury companies, generated a 60 percent return over the past 12 months.

A prime reason for new investor confidence has been China's rapid post-pandemic rebound, and strong Chinese spending has been the top driver of luxury sales.

Burberry, for example, reported a 53 percent increase in sales in mainland China for the fiscal year, March 28, 2020, to March 27, 2021.

However, near-record appraisals have caused some analysts to call for a less complacent valuation of luxury stocks and a greater acknowledgment of risks.

Although there are undoubtedly reasons for optimism, the industry should be realistic about imminent challenges facing luxury brands in China.

In other words, luxury executives must conduct a reality check. Below, we have outlined five risks in the medium term that could derail the burgeoning luxury market in China.

Demographics

An aging, slow-growing, or even shrinking population could threaten the fundamentals of China's unprecedented economic growth.

The country's working-age population had already been falling since 2011, but last year's birth rate fell by nearly 20 percent beginning in 2019.

Lessons from Japan's development show that a demographic transition can have a direct impact on economic growth.

China's demographic timebomb is a stark reminder that luxury brands need to factor in the effect of fast-changing socio-demographic patterns within future market projections.

Nationalism

Beyond simple patriotism, the rise of nationalistic sentiment in China has gained significant momentum.

Although survey data is not always reliable, a *Global Times* 2021 survey reported that 41.7 percent of respondents "look down on the West" versus 18.4 percent five years ago. That is an extremely fast and eye-opening change.

Western brands are now facing greater scrutiny and are more likely to be targeted if deemed anti-China.

H&M saw a 23 percent plunge in its sales to China during the second quarter of 2021 following its vocalized concerns over issues regarding cotton production in China's Xinjiang territory.

Local competition

The rise of local premium, lifestyle and luxury brands could be a further consequence of Chinese national pride.

A 2020 post-COVID Fidelity survey found that 85 percent of Chinese respondents compared to only 15 percent in 2011 would buy a local brand over a foreign brand.

Apple may be winning the battle with Huawei, but this greater competitive rivalry will become the norm.

As observed in the sportswear sector, Anta Sports and Li Ning now give Nike and Adidas a run for their money.

Indeed, McKinsey & Co. reported that 18 percent of consumers in Tier-1 and Tier-2 cities are most likely to buy premium skincare products originating in China, compared to 23 percent for French products.

Consumers are still searching for prestige, but improvements in overall product and service performance coupled with consumer nationalism could give local brands a fresh competitive edge.

Geopolitics

Geopolitical tensions over a range of highly sensitive issues often have unforeseen consequences, particularly when it comes to trade relations.

Admittedly, it is difficult to predict how these tensions will impact future business performance.

There is, however, a growing acceptance that geopolitical instability has become more difficult to navigate in an increasingly polarized political environment.

Chinese tariffs of up to 218 percent on Australian wines have made it virtually impossible for that country's winemakers to do business in China. That has resulted in a traumatic development for the Australian wine industry, which was forced to rapidly find buyers in other countries.

Market saturation

China heads the Kearney 2019 Global Retail Development Index, so it is no surprise that it is an attractive developing market retail destination.

However, a closer look at the data reveals that China's retail market is quite saturated, especially compared to India's.

Although the index is not specific to luxury retail, it underscores the extra pressures facing brands that want to enter or expand into China. It also means that other international markets, notably India, although certainly at a very different stage of economic development, could present an alternate retail investment destination.

The risk appetite has rewarded most luxury brands that have invested heavily in China.

However, as investors are all too aware, past performance is no guarantee of future results.

Although some factors are likely to be more pressing or carry more weight than others, it is apparent that the market environment in China is constantly evolving.

As China enters a new era, luxury brands must actively identify and manage risks to leverage future market opportunities. Otherwise, they could lose track of reality and, ultimately, their competitiveness.

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