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RETAIL

China is becoming the biggest challenge for luxury brands

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As consumer expectations evolve, brands are feeling the heat. The "all eggs in one basket" strategy that fueled growth in 2021 is now looking precarious. Image credit: Shutterstock

By Daniel Langer

Shanghai is not just a city. Its population is comparable to that of Australia and its GDP exceeds that of Belgium. It is the center of luxury consumption in China, where practically all of the world's leading luxury brands have their Chinese flagship stores.

Hence, when Shanghai was in a two-month lockdown alongside other large Chinese cities, the magnitude of the economic fallout can be easily grasped.

Some luxury brands are estimating a negative impact of -10 to -40 percent of revenue this year due to the situation.

Given the first signs of recession in North America and Europe, the reliance on China as the engine for the growth in luxury is much less certain than in 2021.

On top of this, the luxury hospitality sector is suffering quite dramatically in China as most international travel has come to a standstill, while domestic travel decreased significantly.

Fundamentally however, the general positive outlook for China is not changing.

The country is constantly increasing its share of global wealth steadily and more of its population is able to afford luxury purchases and experiences.

However, there are massive challenges: Luxury must cope with rapidly evolving customer expectations, the fastest rise of Gen Z clientele in any country in the world, and an increasingly strong national sentiment where affluent customers change preferences towards domestic premium and luxury brands.

Nike and Adidas had to learn the hard way over the last 18-24 months how fast local rivals such as Anta and Li-Ning were able to outpace them, leading to significant sales and market share losses as reported by many news outlets.

Even in industries that seemed "safe" from local competitors such as luxury cars, the sentiment among Gen Z of late has increasingly shifted towards local names Xpeng or Nio at a similar or even higher level than the traditional

German leaders in the premium and luxury category.

Part of the switch is that the youngest customers do not just see cars as a status symbol, but rather as a personal space, self-expression, "my friend," or "a toy," according to a recent study from China Marketing Insights. And when categories become personal expressions, local labels often can be much more precise in responding to rapidly evolving local trends.

In China, luxury brands evolved over the short span of the last five to 10 years. They went from "manufacturers" to "retailers" especially with the rise of ecommerce and the drive towards own stores and then had to become "publishers" with the need to connect to customers through social media.

Now, they must be "platforms" curating brand communities and be effective "cultural influencers" if they want to be relevant for the digitally native Generation Z.

This is a fundamental shift of the savoir-faire of luxury brands there, all in less than a decade. Most are not yet prepared for this in terms of their capabilities, the quality, structure and governance of local teams and local decision making.

Many brands lack training of their global leadership staff in developing empathy towards the Chinese counterparts, and local teams often are not trained well enough on the fundamentals of luxury. This creates a vicious cycle.

As consumer expectations evolve at an ever-increasing pace and local competition heats up, many international names are already feeling the heat: high operational costs in China, fundamentally different service expectations, challenges to onboard top talents and loss of market share, to name a few of the massive pain points.

A frustrated CEO of a Chinese subsidiary of a global fashion powerhouse told me recently how fed up he is of not being able to generate relevant content in the same fashion as his local competitors. The reason: he must use material prepared in Europe and follow global social media guidelines that to a large extent are irrelevant for Chinese mega platforms such as WeChat.

On top of these challenges, for the first time in decades, geopolitics pose a significant risk to the operations of international brands on the mainland.

Over the last months, the world has seen the sudden exit of luxury brands from Russia with the war in Ukraine and just how fast entire markets can be lost.

In case of an escalation of the already increasing tensions in Southeast Asia and China's ambitions with Hong Kong and Taiwan, the high dependency of luxury brands on China can be troubling.

China is becoming the biggest challenge for luxury brands. It has been already for many years, but the stakes are much higher now.

It will require a new level of strategic excellence and much higher managerial expertise in global portfolio management, global capabilities and global empathy.

The "all eggs in one basket" strategy that helped many luxury brands to clock in significant growth over the last years, especially in 2021, can easily backfire.

Luxury brands will need to recalibrate their global footprint, turn Europe back into a growth market, and expand in North America all of this while these regions may head into recession.

China was never an easy market, and the complexity of successfully connecting with Gen Z is growing exponentially.

On top, a much deeper training on the knowledge of luxury and future consumer expectations is needed, both from a Chinese perspective and from a global viewpoint.

Still, China will remain a key market for luxury brands. However, the higher the stakes get, the more western brands need to radically adapt their structures and capabilities to continuously play to win.

If luxury brands hoped that 2022 will be "a walk in the park," they were overly optimistic. Decisive action is needed. Complacency is no option. It will be winning big or losing big.

This is an op-ed article that reflects the views of the author and does not necessarily represent the views of Jing Daily.

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