



## Trends in China's Consumer and Luxury Goods Markets

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grail research  
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# Executive Summary

*Our study of the Chinese consumer and luxury goods markets reveals that both markets are expected to witness a rise in the future as a result of the increasing purchasing power of its middle-income class*

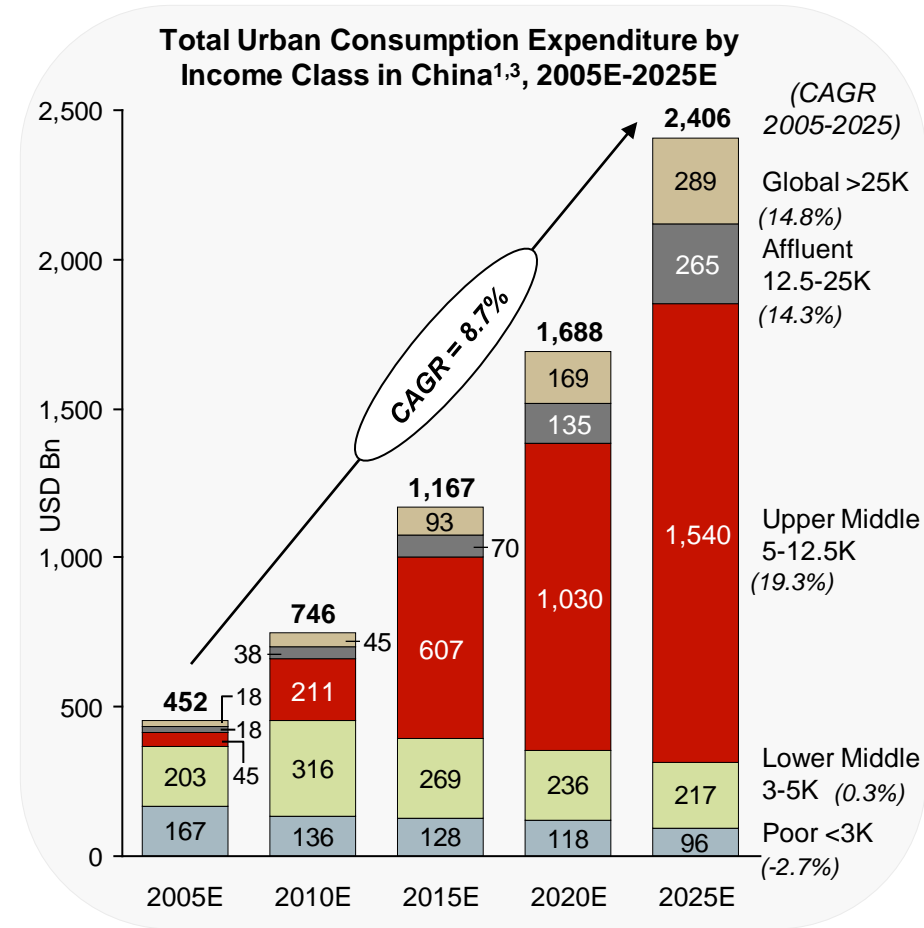
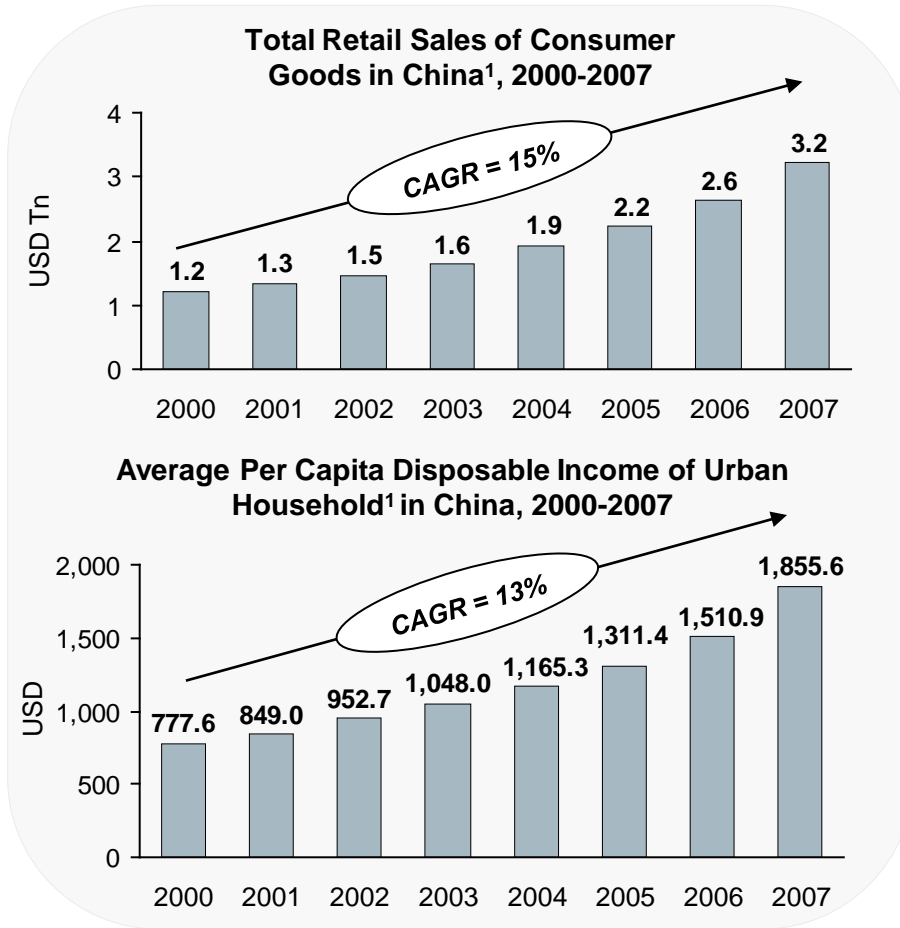


- The total **urban consumption expenditure** of China is projected to reach **USD 2.4 Tn by 2025**
  - The **total retail sales of consumer goods** has grown at a CAGR of 15%, to reach **USD 3.2 Tn**, during 2000-2007
  - The US has invested **~124 Bn, through contract investments**, in China, primarily focused on **mining and manufacturing**. Most global executives believe that this is the opportune **time to invest in China**
  - However, as a result of an increase in labor and production costs, strengthening of the Yuan and a rise in oil and commodity prices, **China's trade surplus in 2008 witnessed a decline**, the first time since 2003. This is likely to **continue until at least 2009**
- China is expected to become the **second-largest market for luxury goods by 2015**
  - The market size is **estimated at USD 11.5 Bn by 2015**, 29% of the global market. The major contributors are likely to be the **automobile sector, and fashion clothing and accessories segments**
  - This trend has led to leading luxury brands establishing their presence in China and setting expectations for strong growth
  - Buyers of luxury goods include the business elite, the middle-income group, independent women and the 'little emperors'
  - A survey of high-income groups revealed that **US luxury goods are less popular, compared to European and Chinese brands**

# China Consumer Market

## China Consumer Market Overview

Retail sales of consumer goods in China have been steadily growing, in tandem with disposable income. The urban consumption expenditure mirrors this trend



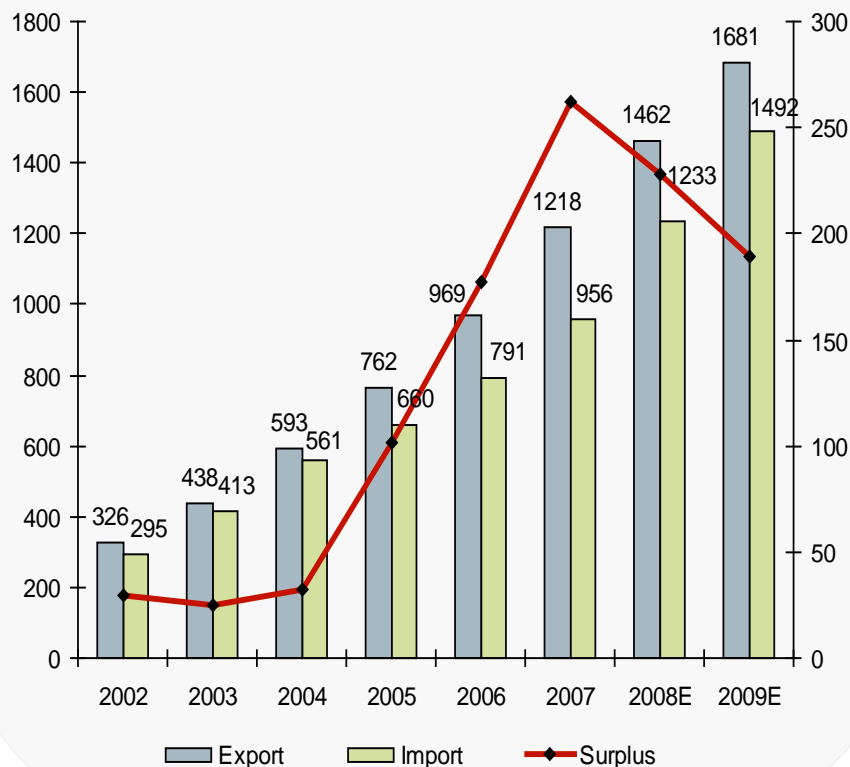
Note: <sup>1</sup>Values are converted from CNY to USD, according to the average annual exchange rates in each year. For the projected data, the exchange rate in 2006 was considered as the base year; <sup>3</sup>Income Class was defined by annual family income per year in USD terms  
 Source: Soshoo; "China Consumer Sector Development and Outlook", Bank of China International, Prudential; "The Rise of China's Urban Middle Class", November 2006, McKinsey Global Institute; Exchange rates from Oanda.com

# China Consumer Market

## China's Trade Deficit

*China's trade deficit is expected to fall through 2009 due to an increase in labor and production costs, the strengthening of the Yuan and a rise in oil and commodity prices*

### China Total Export and Import, 2000–2007



### Trends in China's Trade

- China's trade surplus has risen continuously in recent years to reach USD 262 Bn in 2007.
- China's exports are dominated by machinery, apparel, optical, photographic and medical equipment and furniture
- Electronics, machinery, mineral fuel and oil, chemicals and plastic are the major constituents of China's imports
- Export growth is expected to drop to 20% in 2008 and fall even lower to 15% in 2009
- Import growth is expected to increase to 29% in 2008 and 21% in 2009 due to rise in oil and commodity prices

Note: Exchange rates used are the average annual exchange rates in each year sourced from Oanda.com

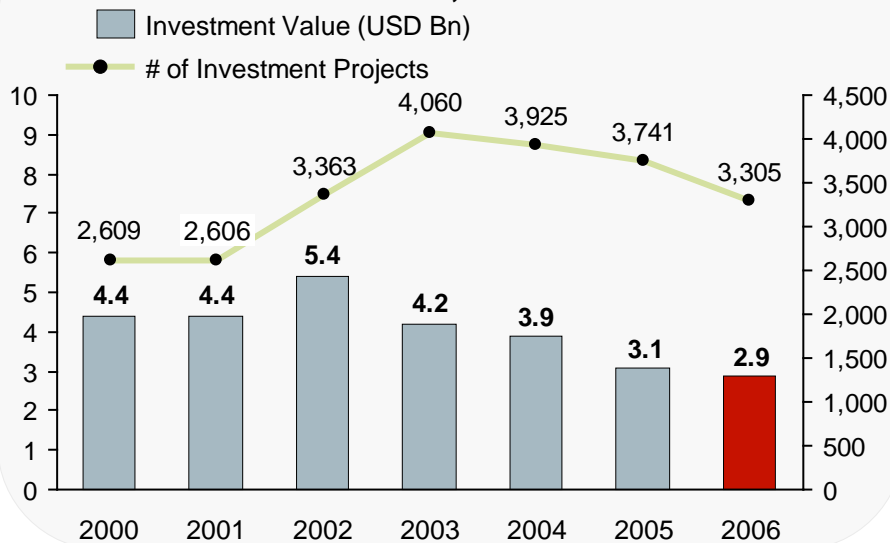
Source: Soshoo; 'China Consumer Sector Development and Outlook', Bank of China International, Prudential; China Customs; Asian Development Bank, Oanda

# China Consumer Market

## Foreign Investment in China (1/2)

As of 2006, more than 50 thousand US-based companies were operating in China with a total investment of USD 54 Bn

### China's Foreign Investment Inflows from US, 2000–2006



### Sector Distribution of US Investments in China, 2006

Sector	%
Mining & manufacturing	69%
Service trade	30%
Agriculture, forestry & fishery	1%

By the end of 2006, 52,211 US-based companies had established operations in China

- Accumulated contracted investments from US to China reached USD 124.2 Bn; 43.5% of the total investments have been realized, accounting for 7.9% of the total foreign investments inflows of China
- Almost 70% of investments were in the mining and manufacturing sectors

# China Consumer Market

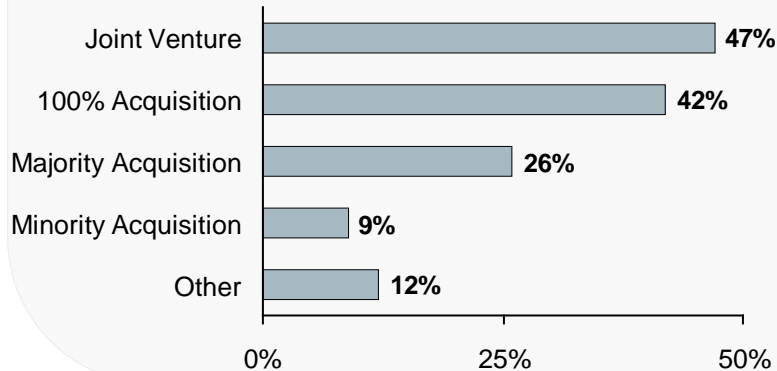
## Foreign Investment in China (2/2)

*In a survey of leading global consumer goods companies, 87% of the interviewed executives said it is time to invest in China. More than 50% of the companies that invested in China have achieved their goals of 'increasing revenues' and 'lowering costs' within 5 years*

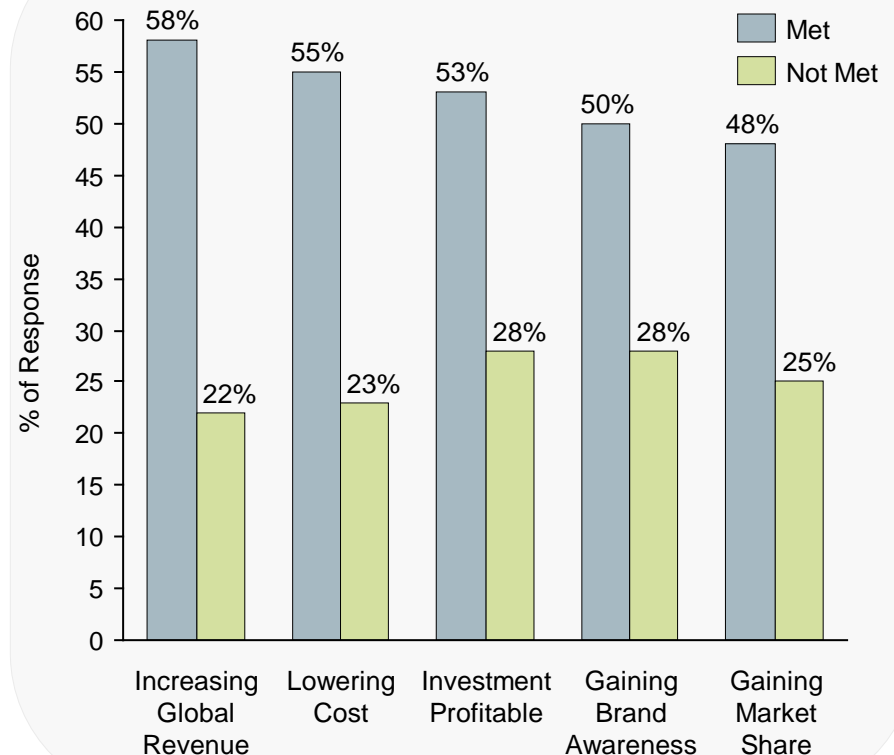
**When to Invest in China<sup>1</sup>**

Timing Preferences	% of Total Respondents
Best time to invest/reinvest	47%
Better to invest than to wait	36%
Makes sense to wait	8%
Not sure	9%

**Entry Modes in Emerging Markets<sup>2</sup>**



**Goals Achieved by Investments in China<sup>3</sup>**



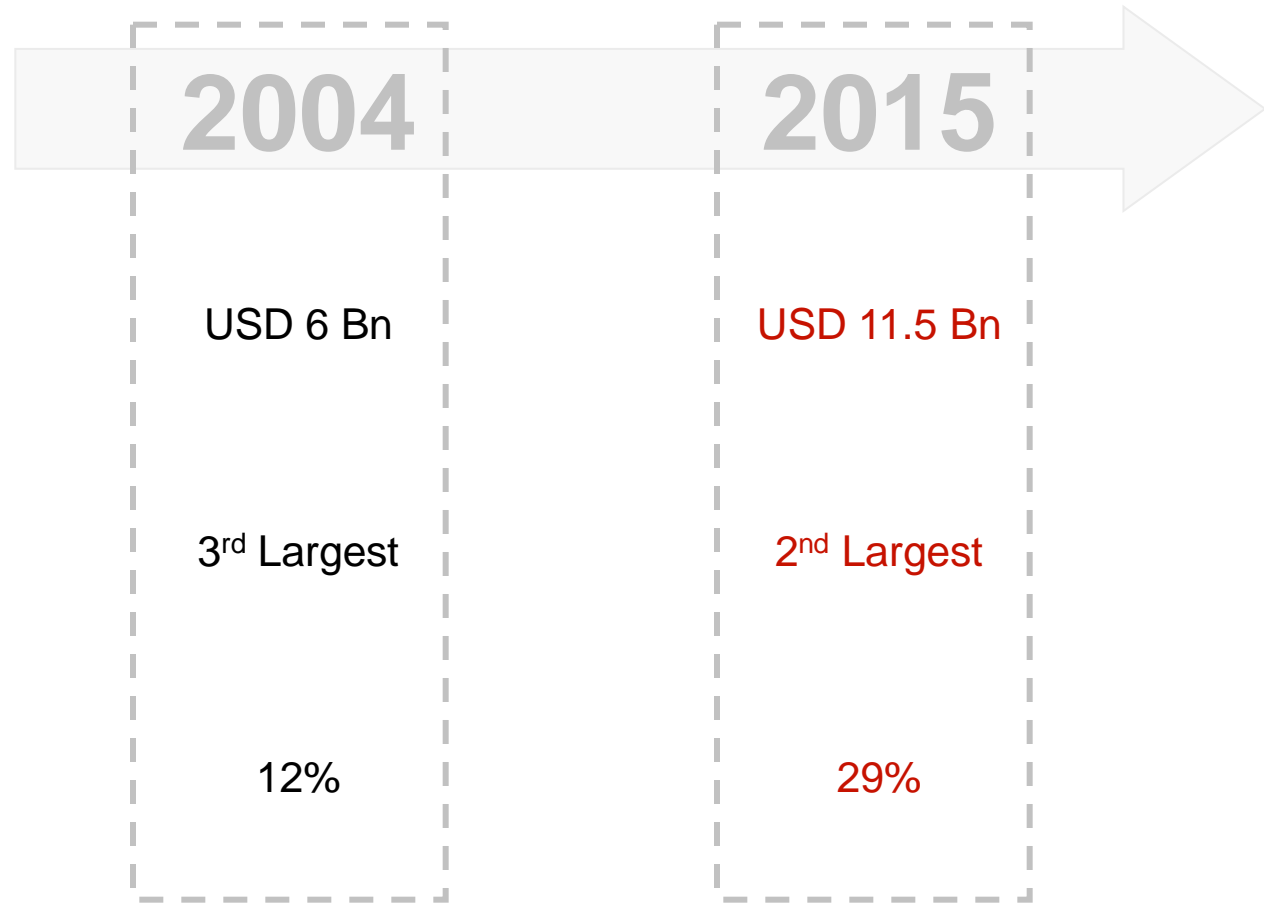
Note: <sup>1</sup>The information is based on 77 telephonic interviews with executives of leading global consumer goods companies (revenues greater than USD 500 MM) conducted between Nov. 2005 and Feb. 2006 by KPMG; <sup>2</sup>The emerging markets in this survey include China, India and Brazil; <sup>3</sup>Based on a survey among the consumer product manufacturers who have invested in China (more than 400 of the global largest 500 companies are present in mainland China)

Source: 'Consumer Markets Companies Investing in Emerging Markets: Focus on China, India and Brazil', KPMG, Fall 2006

# Luxury Goods in China

## Market Evolution

*China is expected to surpass the US and become the second largest luxury goods market accounting for 29% of the total global market by 2015*



Market Value

2004

USD 6 Bn

3<sup>rd</sup> Largest

12%

2015

USD 11.5 Bn

2<sup>nd</sup> Largest

29%

Market Position

Market Share

# Luxury Goods in China

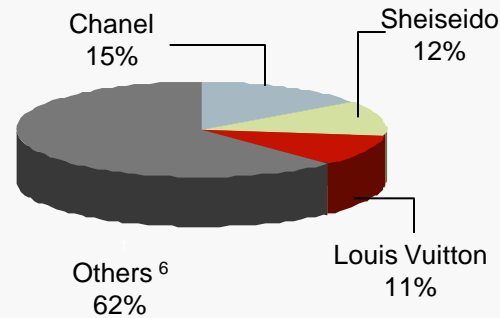
## Top Luxury Brands in China

*A majority of the world's leading luxury brands have already entered major Chinese cities. Most of them are gradually making inroads into two-tier and three-tier Chinese cities*

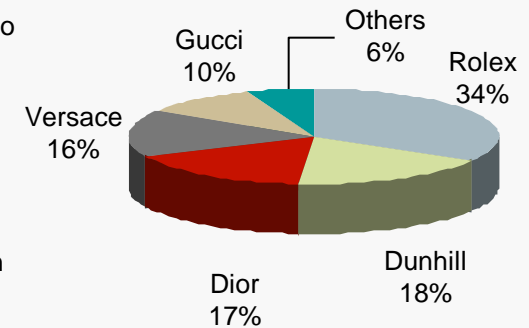
### Preferred Luxury Brands<sup>1</sup> in China – 2008

Rank	Names of Brands	Company Headquarters
1	BMW	Germany
2	Louis Vuitton	France
3	Mercedes-Benz	Germany
4	Cartier	France
5	Chanel	France
6	Rolex	Switzerland
7	Ferrari	Italy
8	Giorgio Armani	Italy
9	Gucci	Italy
10	Vacheron Constantin	Switzerland

China Luxury Clothing and Accessories Market Share – 2007



China Luxury Watches Market Share – 2007



- The world's leading luxury brands are gradually expanding their markets from metropolises such as Beijing, Shanghai and Guangzhou to smaller cities. They plan to expand their stores to tier-2 cities<sup>2</sup> or even tier-3 cities<sup>3</sup> in China
- Leading brands associated with automobiles, fashion clothing and accessories are considered as luxury goods in China
  - **Louis Vuitton** has no presence in Philadelphia or Baltimore, but it opened a store in China's east-coast city of Qingdao in 2006
  - **Cartier** plans to increase its number of stores in China to 30 by 2009 from 12, currently
  - **Bvlgari** opened its biggest store in China in Shenyang<sup>4</sup>, in north-east China's Liaoning province, in 2007
  - **Giorgio Armani** opened 19 stores in China through 2007. Many such stores are located in mid-size Chinese cities such as Shenyang, Jinan, Ningbo<sup>5</sup> and Chengdu

Note: <sup>1</sup>Preferred brands of China's richest individuals, based on a survey conducted amongst 660 Mainland Chinese millionaires (USD), between May and November 2007; <sup>2</sup>Tier-2 cities include capital cities of provinces and cities at provincial levels, except Beijing, Shanghai, Guangzhou, and Shenzhen; <sup>3</sup>Tier-3 cities include cities at the prefecture level; <sup>4</sup>Shenyang, Jinan and Chengdu are tier-2 cities in China; <sup>5</sup> Ningbo is a tier-3 city in China; <sup>6</sup> Others include Lancome, Versace, Dior, Kose, Gucci, Givenchy, Fendi, Ferragamo, Kenzo

Source: Hurun Report 2008, Best of the Best Survey; New York Times

# Luxury Goods in China

## Segmentation of Luxury Consumers

*Apart from successful businessmen, luxury goods shoppers now include economically-independent women, celebrities and “little emperors”<sup>1</sup>*

### “Traditional Business Elites”

- Usually males and over 35-year olds
- Shoppers of advanced and sophisticated luxury goods as a result of periodicity of consumption and experience
- Buyers of niche luxury goods that are less conspicuous, but represent their specific “taste”
- Purchase for family members as well

### “New Luxury Shoppers”

- Entrepreneurs, businessmen, celebrities
- Newly rich, usually the first generation of their family
- Relatively younger than “traditional business elites”
- Less concerned about savings and willing to spend a large proportion of their income on luxury goods

### “Empowered Women”

- Include business women and newly-rich wives, who have achieved economic independence
- Purchase power is expected to continue to rise as they outperform men in education, career and business

### “Little Emperors”

- Most brand conscious amongst all
- Have six sources of income (parents and grand parents<sup>2</sup>), which greatly enhances their ability to purchase luxury goods

Note: <sup>1</sup>“Little emperor” refers to the only child in the family due to the ‘One-Child Policy’ of the Chinese family plan that was launched in 1979; <sup>2</sup>Second generation children after 1979 have two parents and four grand parents, and hence, six sources of income to depend on  
Source: ‘Luxury Brands in China’, KPMG, 2007

# Luxury Goods in China

## Barriers of Luxury Goods Market Development

*Product counterfeits and government taxes are the two key barriers for the expansion in the market for foreign luxury brands in China*

### Counterfeit Products

- Historically, China is known to have weak enforcement of Intellectual Property Rights (IPRs)
  - The US Embassy in Beijing estimated the piracy incidence in China's luxury goods market at 20%
  - This is not only an issue with international luxury brands; it also affects local Chinese luxury brands
    - » According to a study by the Ministry of Information Industry of China, 37% of Chinese companies have encountered IPR violations
- The Chinese government is striving to establish an effective and complete system of laws to protect IPRs and strengthen enforcement and execution
- In 2005, more than **13,000** legal cases regarding IPRs were filed (an increase of 20% from 2004); many were initiated by foreign firms

### Government Consumption Taxes on Luxury Goods

- Custom duty, import VAT and consumption taxes are levied on imported luxury goods
- China has a complex tax structure for foreign luxury brands. There are four different administrative districts in central Shanghai, each of which has its own VAT rate



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